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Research Update:

BRAC Bank Ltd. Assigned 'B+ / B' Ratings; Outlook Stable

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Overview

- We expect BRAC Bank to improve its franchise in Bangladesh, maintain satisfactory asset quality and funding, and have above industry average earnings over the next 12 months.
- The Bangladesh-based bank has lower capitalization than global peers'.
- We are assigning our 'B+' long-term and 'B' short-term issuer credit ratings to BRAC Bank.
- Our stable outlook on BRAC Bank reflects our view that the bank will steadily navigate competitive operating conditions in Bangladesh and maintain its financial profile over the next 12-18 months.

Rating Action

On Feb. 26, 2018, S&P Global Ratings assigned its 'B+' long-term and 'B' short-term issuer credit ratings to Bangladesh-based BRAC Bank Ltd. The outlook on the long-term rating is stable.

Rationale

The rating on BRAC Bank reflects the bank's improving franchise, satisfactory asset quality and funding, with above industry average earnings. BRAC Bank's lower capitalization than global peers' offsets these strengths. We assess the bank's stand-alone credit profile as 'b+'.

Our bank criteria use our Banking Industry Country Risk Assessment economic risk and industry risk scores to determine a bank's anchor, the starting point in assigning an issuer credit rating. The anchor for banks operating only in Bangladesh is 'bb-'.

In our opinion, Bangladesh's low income economy, heavy development needs, and fiscal constraints limit its economic resilience. That said, Bangladesh has healthy growth prospects and moderate economic imbalances with credit growing in line with nominal GDP, as well as a benign inflation and current account position. Bangladesh's credit risk remains substantial, with weak foreclosure laws and underwriting standards, weak governance at some banks, and client concentration leading to sizable stressed assets in the banking industry.

Bangladesh is implementing international regulatory standards. However, in our opinion, supervision has gaps and imposes limited market discipline. In our view, the banking system has overcapacity and market distortions. A supportive

core customer deposit base and low reliance on external funding temper these weaknesses.

We expect BRAC Bank to maintain its satisfactory market position and business stability over the next 12-18 months. The bank has a deposit market share of about 2% and caters to a diversified client base of corporates (41% of the loan book), small and midsize enterprises (SME, 38%), and retail (21%) as of Sept. 30, 2017.

We expect BRAC Bank to continue to grow its franchise in the competitive yet underpenetrated financial services industry in Bangladesh. The bank competes with 56 other banks in the country. The growth of the bank is likely to come from expansion and better utilization of its distribution network, which includes 186 branches, 469 ATMs, and 452 SME unit offices.

BRAC Bank has a higher focus on retail and SME segments than other local banks. It uses mobile banking solutions (through its subsidiary bKash Ltd.) to reach a sizable underbanked and unbanked population in the country. Banks in Bangladesh have traditionally focused on the wholesale segment due to relationship-based lending and higher operating costs associated with SME and retail businesses. BRAC Bank's fee income comes mainly from mobile banking, trade finance, and card products. This income constitutes around 24% of the bank's operating revenues and adds to its business diversity.

We consider BRAC Bank's management to be satisfactory. The management team has identified SME and retail segments as the bank's niche and has since 2015 embarked on strategies to improve operating efficiency. These strategies involve increasing products at branches, reducing unprofitable loans, deposit accounts, and improving customer service levels and technology. BRAC Bank was incorporated in May 1999 and commenced its commercial operations in July 2001.

Our assessment of BRAC bank's capital and earnings reflects our expectation that the bank's pre-diversification risk-adjusted capitalization (RAC) ratio will remain around 4.5% over the next 12-18 months. The bank's ratio of core earnings to average assets averaged about 1% over the past five years and is better than the industry average of 0.7%.

BRAC Bank's profitability is characterized by high net interest margins owing to: (1) higher yields on its SME and retail portfolio; (2) fee income contribution from mobile banking and trade finance; and (3) competitive cost of funds due to sizable low-cost deposits. The bank's strong operating revenues help to offset elevated operating and credit costs.

We expect BRAC Bank's profitability to remain largely stable, considering a cash dividend payout of around 10%. We expect the bank to grow at 17%-20% over next 12-15 months. The bank may have to increase capitalization over the next few years to support its growth and meet Basel III minimum common equity Tier 1 (CET1) and total capital ratios (including capital conservation buffer of 2.5%) of 7% and 12.5%, respectively, by 2019. Its CET1 ratio stood at 10.36% and total capital ratio was 12.06% at the end of 2016.

Our assessment of BRAC Bank's risk position reflects our view that the bank's credit losses will remain within our normalized loss expectations. We expect the bank's growth of unsecured exposures in the SME and retail segments to be balanced by the granularity and high spreads on these exposures. BRAC Bank has some corporate client concentration, with the top 20 loans comprising 16% of its loan book. However, this metric is better than the industry average in Bangladesh. In addition, BRAC Bank has a more balanced overall loan book comprising corporate, SMEs, and retail. Its main corporate exposures include readymade garments and textiles (a key export sector in Bangladesh) and core sectors such as telecommunications, power, and steel.

BRAC Bank's SME business caters to entrepreneurs and small businesses with average ticket sizes of US\$7000-US\$75,000; loans are given for business expansion. The smaller ticket-size loans are unsecured while the larger ticket-size loans are secured by mortgages. The bank's retail loans consist of home loans (around half of the retail exposure, where the loan-to-value ratio has a regulatory cap of 70%), followed by personal loans and credit cards.

We expect BRAC Bank to grow somewhat faster than the industry (given its low base) amid a benign interest rate environment. Still, we expect the bank's credit losses to remain in check over the next 12 months. BRAC Bank had a lower gross nonperforming loan (NPL) ratio of 5.8% on average over the past five years as compared with the industry average of 9.3%. However, given inherently weak borrower profiles and low recovery prospects in Bangladesh, we believe the bank will need to continue to have adequate NPL coverage (over 100% on average over the past three years) in times of cyclically low charge-offs.

BRAC Bank's deposits, particularly its sizable low-cost current and saving accounts (CASA), support its funding profile. Deposits contributed more than 80% to the bank's funding base over the past five years. Household deposits account for around half of deposits, followed by corporates (30%) and SMEs. Its CASA ratio of around 50% is better than the industry average (40%). BRAC Bank's ratio of loans to customer deposits averaged 90% over the past five years, higher than the industry average (78%). This is partly because some state-owned banks in Bangladesh have very low ratios given their capital constraints and due to BRAC Bank's offshore banking unit.

BRAC Bank's assets in the form of cash and short-term funds underpin its liquidity. The bank's ratio of broad liquid assets to short-term wholesale funding is 2.4x as of Dec. 31, 2016, in line with global peers'.

Outlook

The stable outlook on BRAC Bank reflects our view that the bank will steadily navigate competitive operating conditions in Bangladesh and maintain its financial profile over the next 12-18 months.

Downside scenario

We could lower the ratings if the bank's asset quality declines substantially, which could be due to its corporate or unsecured loans.

Upside scenario

We could upgrade the bank if BRAC Bank raises capital to maintain its pre-diversification RAC ratio above 5% on a sustainable basis.

Ratings Score Snapshot

Issuer credit rating: B+/Stable/B

SACP: b+

- Anchor: bb-
- Business Position: Adequate (0)
- Capital and Earnings: Weak (-1)
- Risk Position: Adequate (0)
- Funding and Liquidity: Average and Adequate (0)

Support: 0

- ALAC Support: 0
- GRE Support: 0
- Group Support: 0
- Sovereign Support: 0

Additional Factors: 0

Related Criteria

- Criteria - Financial Institutions - General: Risk-Adjusted Capital Framework Methodology, July 20, 2017
- General Criteria: Methodology For Linking Long-Term And Short-Term Ratings , April 7, 2017
- Criteria - Financial Institutions - Banks: Bank Hybrid Capital And Nondeferrable Subordinated Debt Methodology And Assumptions, Jan. 29, 2015
- General Criteria: Group Rating Methodology, Nov. 19, 2013
- Criteria - Financial Institutions - Banks: Quantitative Metrics For Rating Banks Globally: Methodology And Assumptions, July 17, 2013
- Criteria - Financial Institutions - Banks: Banks: Rating Methodology And Assumptions, Nov. 9, 2011
- Criteria - Financial Institutions - Banks: Banking Industry Country Risk Assessment Methodology And Assumptions, Nov. 9, 2011
- General Criteria: Use Of CreditWatch And Outlooks, Sept. 14, 2009

Ratings List

New Rating

BRAC Bank Ltd.

Issuer Credit Rating

B+/Stable/B

Certain terms used in this report, particularly certain adjectives used to express our view on rating relevant factors, have specific meanings ascribed to them in our criteria, and should therefore be read in conjunction with such criteria. Please see Ratings Criteria at www.standardandpoors.com for further information. Complete ratings information is available to subscribers of RatingsDirect at www.capitaliq.com. All ratings affected by this rating action can be found on the S&P Global Ratings' public website at www.standardandpoors.com. Use the Ratings search box located in the left column.

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