MOODY'S
INVESTORS SERVICE

CREDIT OPINION
28 November 2019

Update

Rate this Research

RATINGS

BRAC Bank Limited

Domicile	Bangladesh
Long Term CRR	Ba3
Type	LT Counterparty Risk Rating - Fgn Curr
Outlook	Not Assigned
Long Term Debt	Not Assigned
Long Term Deposit	B1 / Ba3
Type	LT Bank Deposits - Fgn Curr / Dom Curr
Outlook	Negative / Negative

Please see the ratings section at the end of this report for more information. The ratings and outlook shown reflect information as of the publication date.

Contacts

Tengfu Li +65.6311.2630
Analyst
tengfu.li@moodys.com

Eugene Tarzimanov +65.6398.8329
VP-Sr Credit Officer
eugene.tarzimanov@moodys.com

Jien Hoong Chew +65.6398.8339
Associate Analyst
jienhoong.chew@moodys.com

Graeme Knowd +65.6311.2629
MD-Banking
graeme.knowd@moodys.com

» Contacts continued on last page

BRAC Bank Limited

Update following affirmation at Ba3, outlook changed to negative

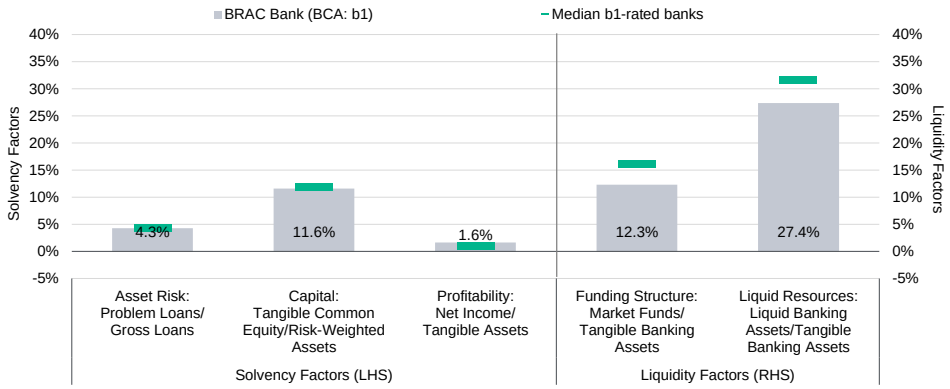
Summary

On 21 November 2019, we affirmed BRAC Bank Limited's (BRAC Bank) long-term local- and foreign-currency deposit ratings at Ba3 and B1 respectively. We also affirmed the bank's Baseline Credit Assessment (BCA) at b1. The rating action follows the downgrade of Bangladesh's Macro Profile to Weak- from Weak to reflect (1) the persistent weakness in underwriting standards; (2) rising regulatory forbearance that will mask asset risks and hamper loan recovery; and (3) high credit concentration in domestic corporates.

BRAC Bank's b1 BCA reflects the bank's (1) strong asset quality compared with those of its industry peers; (2) robust profitability and capitalization, driven by its competitive advantage in the higher-yielding small and medium-sized enterprise (SME) segment; and (3) stable funding profile and liquidity.

BRAC Bank's long-term local-currency deposit rating includes one notch of rating uplift from the bank's b1 BCA. The rating uplift is based on our assumption of a moderate probability of support from the Government of Bangladesh (Ba3 stable), taking into consideration the bank's small market share, as well as the government's propensity and ability to support the banking system. The bank's B1 long-term foreign-currency deposit rating does not benefit from government support due to the country's deposit ceiling.

Exhibit 1
Rating Scorecard - Key financial ratios



Source: Moody's Financial Metrics

Credit strengths

» Strong profitability, which leads to a robust capital position

» Stable funding and liquidity, supported by good reputation and a sizable distribution network

Credit challenges

» Rising risks in the corporate loan segment, in line with the industry trend

Outlook

The outlook on BRAC Bank's ratings is negative, underpinned by our expectation that the deterioration in credit conditions will weigh on the bank's asset quality and profitability over the next 12-18 months.

Factors that could lead to an upgrade

Given the negative outlook, BRAC Bank's BCA and ratings are unlikely to be upgraded over the next 12-18 months. Nevertheless, the outlook could be revised to stable if there is a steady improvement in the bank's asset quality, particularly in its corporate loans. Higher profitability and capitalization, driven by greater operational efficiency or lower funding costs because of an enlarged deposit franchise, will also support a revision to a stable outlook.

Factors that could lead to a downgrade

BRAC Bank's BCA and ratings could be downgraded if there is a material deterioration in asset quality that in turn weakens its profitability.

Key indicators

Exhibit 2
BRAC Bank Limited (Consolidated Financials) [1]

	12-18[2]	12-17[2]	12-16[2]	12-15[2]	12-14[2]	CAGR/Avg.[3]
Total Assets (BDT Million)	349,375.0	299,268.1	260,308.9	223,184.9	202,537.6	14.6[4]
Total Assets (USD Million)	4,164.2	3,598.1	3,311.8	2,844.0	2,599.1	12.5[4]
Tangible Common Equity (BDT Million)	32,373.9	24,606.4	20,023.3	17,887.0	16,894.0	17.7[4]
Tangible Common Equity (USD Million)	385.9	295.8	254.7	227.9	216.8	15.5[4]
Problem Loans / Gross Loans (%)	3.6	4.1	5.1	5.9	5.6	4.9[5]
Tangible Common Equity / Risk Weighted Assets (%)	11.6	10.1	9.3	9.3	10.6	10.2[6]
Problem Loans / (Tangible Common Equity + Loan Loss Reserve) (%)	21.0	25.1	32.1	33.6	29.0	28.1[5]
Net Interest Margin (%)	5.5	5.7	6.1	5.7	6.0	5.8[5]
PPI / Average RWA (%)	3.6	4.1	4.2	4.1	4.1	4.0[6]
Net Income / Tangible Assets (%)	1.6	1.8	1.6	1.1	1.0	1.4[5]
Cost / Income Ratio (%)	64.2	60.1	57.2	59.1	56.6	59.4[5]
Market Funds / Tangible Banking Assets (%)	12.3	13.7	14.4	14.9	5.8	12.2[5]
Liquid Banking Assets / Tangible Banking Assets (%)	27.4	27.1	24.7	25.3	31.3	27.2[5]
Gross Loans / Due to Customers (%)	97.8	98.0	102.6	105.2	84.2	97.6[5]

[1]All figures and ratios are adjusted using Moody's standard adjustments. [2]Basel III - fully-loaded or transitional phase-in; LOCAL GAAP. [3]May include rounding differences due to scale of reported amounts. [4]Compound Annual Growth Rate (%) based on time period presented for the latest accounting regime. [5]Simple average of periods presented for the latest accounting regime. [6]Simple average of Basel III periods presented.
Source: Moody's Investors Service; Company Filings

Profile

BRAC Bank Limited (BRAC Bank) was set up in 2001 as a private commercial bank based in Bangladesh, listed on both the Dhaka Stock Exchange and the Chittagong Stock Exchange in 2007. The lender has developed a competitive advantage in SMEs and has established a strong domestic presence supported by 457 SME offices, 187 branches, more than 200 agent banking outlets and 424 ATMs as of September 2019. Moreover, the bank is a market leader in the mobile financial services industry with its subsidiary bKash Limited (bKash), which provides electronic payment and remittance services.

The bank is sponsored and majority owned by BRAC (44.3%), the world's largest nongovernmental organization (NGO). BRAC is also one of the pioneers of microfinance, and its expertise provides BRAC Bank with a competitive advantage in the SME segment. Given BRAC's good reputation, BRAC Bank will be less susceptible to corporate governance issues that are faced by its industry peers.

Detailed credit considerations

Asset quality continues to improve, driven by its strength in the SME segment

BRAC Bank's asset quality continues to improve. The bank's nonperforming loan (NPL) ratio improved further to 3.4% as of September 2019 from 3.7% a year earlier because of lower NPL ratios at its SME and retail segments. The NPL ratio was also significantly lower than the average of its private-sector peers, which was 7.1% as of June 2019.

BRAC Bank has a competitive advantage in the SME segment, underpinned by (1) its strong physical presence with over 450 dedicated SME offices; and (2) the expertise of its parent, BRAC, a leading microfinance provider.

SME loans constituted 45% of BRAC Bank's loan book as of September 2019. The high proportion of this segment makes the bank less vulnerable to concentration risks compared with its Bangladeshi peers. In addition, the NPL ratio of this segment is relatively low at only 2.5% as of September 2019.

Meanwhile, the NPL ratio for the corporate segment increased to 5.1% as of September 2019 from 3.7% a year earlier, following the default of a few large loans.

BRAC Bank does not have a material amount of rescheduled loans that are still classified as performing. These loans constituted 0.7% of its total loans as of September 2019.

The bank maintains robust loan-loss buffers. Its NPL coverage ratio remained high at 114% as of September 2019, largely unchanged from the 115% reported a year earlier.

The b2 Asset Risk score incorporates rising risks in the corporate loan segment, in line with industry trend.

Robust capitalization, boosted by a conservative dividend policy

BRAC Bank's capitalization is the highest among the Bangladeshi banks that we rate, supported by strong internal capital generation and a conservative dividend policy. The bank's Common Equity Tier 1 (CET1) capital ratio was at 15.4% as of September 2019, up from 13.5% a year earlier.

BRAC Bank did not distribute any cash dividend this year, which in turn boosted its capitalization. The bank adopted a conservative dividend policy, in part because of the higher regulatory requirements; beginning this year, Bangladeshi banks are subject to fully phased-in Basel III requirements, with minimum CET1 and total capital requirements (including the 2.5% capital conservation buffer) at 7.0% and 12.5%, respectively.

Meanwhile, the introduction of new taxes for listed companies[1] will reduce the bank's ability to retain profit. However, we do not expect any material impact on its capitalization, because the recent slowdown in capital consumption will largely offset the reduction in profit retention. The bank's loan growth slowed to 13% as of September 2019 (on a year on year basis), down from 18% a year earlier.

The b2 Capital score reflects our expectation that the bank's capitalization will be fairly stable over the next 12-18 months.

Profitability will moderate, as a result of under-performing capital markets and investment at the mobile service subsidiary

BRAC Bank's annualized consolidated return on assets fell to 1.2% as of 30 September 2019 from 1.6% a year earlier, largely because of the rise in its operating expenses by the growing subsidiary bKash. The weak performance of the capital markets resulted in lower non-interest income which also contributed to the strain on its profitability.

The bank's increasing investment in its subsidiary bKash, may strain its profitability over the next 12-18 months. Specifically, bKash will continue to spend heavily on marketing, promotions and IT infrastructure to expand its market share in the mobile payment space. As of September 2019, the bank's cost-to-income ratio increased to 68.7% from 64.7% a year earlier.

BRAC Bank's interest rate spread has been among the highest in the industry, supported by the high proportion of the higher-yielding SME segment in its loan portfolio. The high interest rate spread underpins the bank's profitability. As of September 2019, the bank's weighted-average lending rate was 12.7%, higher than the 10.4% reported for its private-sector peers. In addition, its weighted-average deposit rate was also lower at 5.6%, compared with the 6.4% industry average.

Meanwhile, the bank's credit cost as a percentage of average gross loans was largely unchanged at 0.4% as of September 2019 compared with the level reported a year earlier. However, we expect the rising asset risks in the bank's corporate loans to exert upward pressure on credit costs.

The Profitability score of b1 reflects our expectation that the bank's profitability will moderate over the next 12-18 months.

Robust funding and liquidity, backed by an established domestic franchise

BRAC Bank is primarily funded by deposits, which constituted 79.5% of the bank's total liabilities as of September 2019. Apart from having a reputable brand name, the bank's domestic franchise is also supported by a sizable network of branches and ATMs, a leading mobile platform, bKash, and a growing agent banking network. As a result, the bank has established strong access to current and savings accounts, which tend to be stickier than term deposits and borrowings. Its current and savings accounts ratio was at 47.9% as of the same date.

BRAC Bank's loan-to-deposit ratio decreased slightly to 92.0% as of September 2019, compared with 94.0% a year earlier, helped by slower loan growth. The bank's Advance to Deposit ratio stood at 82% as of September 2019, below the regulatory limit of 85%.

BRAC Bank obtains concessional funding from the local central bank, which is given to eligible domestic exporters and SMEs. The bank also borrows from multilateral institutions such as the International Finance Corporation (Aaa stable) and the Asian Development

Bank (Aaa stable). This funding is less susceptible to changes in market conditions compared with commercial funding and constituted 59.4% of the bank's total market funds as of 31 December 2018.

The adjusted Funding score of ba3 reflects BRAC Bank's strong deposit franchise, as well as the stable funding provided by the local central bank and multilateral institutions.

BRAC Bank maintains a robust liquidity buffer. The bank's liquid asset ratio, after adjusting for customers' mobile wallets held in trust accounts, was at 20.3% as of September 2019, largely unchanged compared with 20.4% a year earlier. BRAC bank's liquidity coverage ratio stood at 185% as of 30 September 2019, compared with 131% a year earlier. We expect the bank's liquidity to remain stable, reflected by the Liquid Resources score of b2.

BRAC Bank's BCA is supported by Bangladesh's Weak- Macro Profile

BRAC Bank operates mainly in Bangladesh, which has a Weak- Macro Profile.

Bangladesh has a moderately diversified economy, which is largely driven by exports from the ready-made garment sector. The country's track record of steady growth performance is underpinned by large remittance inflow and the role of local microfinance institutions, which have promoted financial inclusion that offsets the low level of per capita income. The government's financial position has also been stable because the government has consistently received concessional financing from the International Monetary Fund to offset its weak revenue to finance its fiscal deficits. The country is moderately susceptible to event risks, driven by its deeply polarized domestic politics.

The country's banking system is characterized by high credit concentration and a high degree of market fragmentation. The state-owned banks together accounted for around 25% of the assets in the system as of the end of December 2018, and there is a fair degree of competition among private commercial banks. In addition, the persistent weakness in underwriting standards and growing trend of regulatory forbearance will lead to a further deterioration in credit conditions.

Environmental, social and governance considerations

In line with our general view for the banking sector, BRAC Bank has a low exposure to environmental risks (see our environmental heat map for further information) and moderate exposure to social risks (see our social heat map for further information).

Governance is highly relevant for BRAC Bank, as it is to all participants in the banking industry. Corporate governance weaknesses can lead to a deterioration in a bank's credit quality, while governance strengths can benefit its credit profile. Governance risks are largely internal rather than externally driven. We do not have any particular concern around BRAC Bank's governance, as the bank has an appropriate risk management framework commensurate with its risk appetite. Nonetheless, corporate governance remains a key credit consideration and requires ongoing monitoring.

Support and structural considerations

Government support considerations

BRAC Bank's Ba3 long-term local-currency deposit rating includes a one-notch uplift from the bank's b1 BCA, based on our assumption of a moderate probability of government support. Our support assumption is based on the bank's small market share, but balanced by the government's willingness and ability to support the bank. The bank's B1 long-term foreign-currency deposit rating does not benefit from government due to the country's deposit ceiling.

Counterparty Risk (CR) Assessment

CR Assessments are opinions of how counterparty obligations are likely to be treated if a bank fails and are distinct from debt and deposit ratings in that they (1) consider only the risk of default rather than both the likelihood of default and the expected financial loss, and (2) apply to counterparty obligations and contractual commitments rather than debt or deposit instruments. The CR Assessment is an opinion of the counterparty risk related to a bank's covered bonds, contractual performance obligations (servicing), derivatives (for example, swaps), letters of credit, guarantees and liquidity facilities.

BRAC Bank's CR Assessment is positioned at Ba3(cr)/NP(cr)

The CR Assessment, before government support, is positioned one notch above BRAC Bank's Adjusted BCA of b1. We then assign government support assumptions, in line with our support assumptions on deposits and senior unsecured debt. Such assignments reflect our view that any support provided by governmental authorities to a bank, which benefits senior unsecured debt or deposits, is very likely to benefit operating activities and obligations reflected by the CR Assessments as well. Such a view is consistent with our belief that governments are likely to maintain the banks' operations as a going concern to reduce contagion and preserve the banks' critical functions.

Counterparty Risk Ratings (CRRs)

CRRs are opinions of the ability of entities to honor the uncollateralized portion of non-debt counterparty financial liabilities (CRR liabilities) and also reflect the expected financial losses in the event that such liabilities are not honored. CRR liabilities typically relate to transactions with unrelated parties. Examples of CRR liabilities include the uncollateralized portion of payables arising from derivatives transactions and the uncollateralized portion of liabilities under sale and repurchase agreements. CRRs are not applicable to funding commitments or other obligations associated with covered bonds, letters of credit, guarantees, servicer and trustee obligations, and other similar obligations that arise from a bank performing its essential operating functions.

BRAC Bank's local-currency and foreign-currency CRRs are positioned at Ba3/NP

We consider Bangladesh a nonoperational resolution regime. For nonoperational resolution regime countries, the starting point for the CRRs is one notch above the bank's Adjusted BCA, to which we then typically add the same notches of government support as applied to the CR Assessment.

Methodology and scorecard

About Moody's Bank Scorecard

Our scorecard is designed to capture, express and explain in summary form our Rating Committee's judgment. When read in conjunction with our research, a fulsome presentation of our judgment is expressed. As a result, the output of our scorecard may materially differ from that suggested by raw data alone (though it has been calibrated to avoid the frequent need for strong divergence). The scorecard output and the individual scores are discussed in rating committees and may be adjusted up or down to reflect conditions specific to each rated entity.

Rating methodology and scorecard factors

Exhibit 3
BRAC Bank Limited

Macro Factors		
Weighted Macro Profile	**Weak -**	**100%**

Factor	**Historic Ratio**	**Initial Score**	**Expected Trend**	**Assigned Score**	**Key driver #1**	**Key driver #2**
Solvency						
Asset Risk						
Problem Loans / Gross Loans	4.3%	b2	←→	b2	Quality of assets	
Capital						
Tangible Common Equity / Risk Weighted Assets (Basel III - transitional phase-in)	11.6%	b2	←→	b2	Expected trend	
Profitability						
Net Income / Tangible Assets	1.6%	ba3	←→	b1	Expected trend	
Combined Solvency Score		b2		b2		
Liquidity						
Funding Structure						
Market Funds / Tangible Banking Assets	12.3%	b1	←→	ba3	Deposit quality	
Liquid Resources						
Liquid Banking Assets / Tangible Banking Assets	27.4%	b2	←→	b2	Stock of liquid assets	
Combined Liquidity Score		b1		b1		
Financial Profile				b2		
Qualitative Adjustments				Adjustment		
Business Diversification				0		
Opacity and Complexity				0		
Corporate Behavior				0		
Total Qualitative Adjustments				0		
Sovereign or Affiliate constraint				Ba3		
BCA Scorecard-indicated Outcome - Range				b1 - b3		
Assigned BCA				b1		
Affiliate Support notching				0		
Adjusted BCA				b1		

Instrument Class	**Loss Given Failure notching**	**Additional notching**	**Preliminary Rating Assessment**	**Government Support notching**	**Local Currency Rating**	**Foreign Currency Rating**
Counterparty Risk Rating	1	0	ba3	0	Ba3	Ba3
Counterparty Risk Assessment	1	0	ba3 (cr)	0	Ba3(cr)	
Deposits	0	0	b1	1	Ba3	B1

[1]Where dashes are shown for a particular factor (or sub-factor), the score is based on non-public information.
Source: Moody's Investors Service

Ratings

Exhibit 4

Category	Moody's Rating
BRAC BANK LIMITED	
Outlook	Negative
Counterparty Risk Rating	Ba3/NP
Bank Deposits -Fgn Curr	B1/NP
Bank Deposits -Dom Curr	Ba3/NP
Baseline Credit Assessment	b1
Adjusted Baseline Credit Assessment	b1
Counterparty Risk Assessment	Ba3(cr)/NP(cr)
Issuer Rating	Ba3
ST Issuer Rating	NP

Source: Moody's Investors Service

Endnotes

1 Listed companies will be subject to a 10% tax on stock dividends if these dividends exceed the amount of any cash dividend in an income year. They will also be subject to an additional 10% tax on the total amount transferred to retained earnings, reserves or surplus if that amount exceeds 70% of net income after tax.

REPORT NUMBER 1203815

Contacts

Tengfu Li +65.6311.2630
Analyst
tengfu.li@moodys.com

Jien Hoong Chew +65.6398.8339
Associate Analyst
jienhoong.chew@moodys.com

Eugene Tarzimanov +65.6398.8329
VP-Sr Credit Officer
eugene.tarzimanov@moodys.com

Graeme Knowd +65.6311.2629
MD-Banking
graeme.knowd@moodys.com

CLIENT SERVICES

Americas	1-212-553-1653
Asia Pacific	852-3551-3077
Japan	81-3-5408-4100
EMEA	44-20-7772-5454

MOODY'S
INVESTORS SERVICE