

Subhechha Bikas Bank Limited

ICRA Nepal assigns [ICRANP] IPO Grade 4 to the proposed Equity Share (Rights Issue) of Subhechha Bikas Bank Limited

Facility/Instrument	Issue Size	Grading Action (December 2015)
Rights Share Issue	NPR 50.09 million	[ICRANP] IPO Grade 4 (Assigned)

ICRA Nepal has assigned an “[ICRANP] IPO Grade 4”, indicating below-average fundamentals to the proposed rights issue amounting to NPR 50.09 million of Subhechha Bikas Bank Limited (hereinafter referred to as SUBBL). ICRA Nepal assigns IPO grading on a scale of IPO Grade 1 through IPO Grade 5, with Grade 1 indicating strong fundamentals and Grade 5 indicating poor fundamentals. For the Grading categories 2, 3 and 4, the sign of + (plus) appended to the Grading symbols indicate their relative position within the Grading categories concerned. Thus, the Grading of 2+, 3+ and 4+ are one notch higher than 2, 3, and 4, respectively. SUBBL is proposing to come out with 3:1 rights issue of 500,852 numbers of equity shares of face value NPR 100/- each to be issued to the existing shareholders at par. The proposed issue is being made to augment the capital base and support the bank’s growth plans.

The grading factors in SUBBL’s experienced management team, adequate track record (operating since 2004) and moderate portfolio growth (CAGR¹ of ~15% over past 5 years on a small base vs. ~24% for industry). Bank’s adequate franchise, moderate capitalization profile (CRAR of 13.15% as on mid Oct-15) and low capital adjusted credit deposit ratio (~62% as on mid Oct-15) is expected to provide SUBBL with adequate growth opportunities, in the near term at least. The grading is however constrained by high geographical concentration risks (>75% of business is concentrated within one district), modest scale of operations (asset base of NPR 2,231 million as on Oct-15), weak competitive positioning (resulting from high cost of funds and stiff competition from established BFIs in the region) and deterioration in earnings profile (financial profile supported by write-back of provisions and non-operating incomes during the last two years). ICRA also takes note of buildup of delinquencies² during the last few months on account of uncertain operating environment created by ongoing political turmoil in the southern plains of the country impacting the overall economy and repayment capacity of the borrowers. Going forward, although this may impact the bank’s asset quality, SUBBL reported fair asset quality as on Oct-15 (gross NPL of 1.16% as on mid Oct-15), benefited by regulatory relaxations. SUBBL’s capital base remains lower relative to revised regulatory capital framework and borrower profile relatively weaker compared to commercial banks, which have also been factored while assigning the grading. Nonetheless, the grading factors in regulatory arbitrage available with ‘Schedule B’ Development Banks compared to ‘Schedule A’ commercial banks in the form of lower absolute capital requirements and lower CRR/SLR³ requirements. Going forward, SUBBL’s ability to scale up its operations, manage delinquencies, improve its cost of funds and the profitability profile would have a bearing on the overall financial profile.

SUBBL’s asset base of NPR 2,231 million (as of Oct-15) remains modest despite adequate track record and lower than similar aged peers. With lower portfolio growth compared to industry (CAGR of ~15% over past 5 years vs. ~24% growth in industry), credit portfolio stood at NPR 1,355 million as of mid Oct-15 representing 0.68% share in the development bank industry credit. The bank however reported higher growth rate of ~24% growth during FY15 (vs. ~20% for industry). Lower credit growth over the years was primarily on account of limited local promoter base (which is a key strength among regional development banks) and higher cost of funds compared to peers, resulting in weak competitive positioning. SUBBL’s portfolio remains highly concentrated towards hire purchase loans (~31%) followed by housing loan (17%),

¹ Compounded annual growth rate

² Delinquent loans (for less than 90 days) on mid-Oct-15 accounted for ~22.61% of total loans vs. 15.45% in mid-Jul-15. Further delinquent loan for more than 90 days but not recognised NPA is 3.79% as on mid-Oct-15.

³ Cash Reserve Ratio/ Statutory Liquidity Ratio



personal overdraft (15%), overdraft/business loans (14%), term loans (6%), deprived sector loans (5%) among others. However, ICRA Nepal takes comfort from the bank's fairly diversified book (12% among top 20 borrowers on Oct-15). High proportion of loans with scheduled repayments (~71% of portfolio as of Oct-15) ensures healthy lending yields among peers at ~15% as of Jul-15 (~13% as of Oct-15).

SUBBL's asset quality indicators have witnessed improvement during the last two years, with gross NPLs of 0.99% as of Jul-15 (compared to 4.14% as of Jul-13, and lower to industry average of 3.58% as of Jul-15). However, post July-15 SUBBL has witnessed weak recoveries on account of elongated strikes in terai region, resulting in an increase in the delinquency levels. Delinquent loans (including NPLs) on mid-Oct-15 accounted for ~28% of total loans vs. ~15% on mid-July-15, with scheduled loans (~71% of the book) facing higher delinquencies (~98% of delinquencies as of Oct-15 are in these segments). This has also impacted the bank's gross NPL's, which have deteriorated during the three month period ending mid Oct-15.. The regulator has provided temporary relaxations in NPL recognition norms factoring in the strike, however the same is expected to defer the actual impact on asset quality towards the end of the year, should the current scenario extend for a longer period of time. Benefitted by this relaxation, bank has reported NPLs of 1.16% as of Oct-15 (gross NPLs of 4.95% had the regulatory relaxations were not available). Further, inferior borrower profile compared to commercial banks and assessed income based lending could lead to pressure on bank's asset quality going forward. Although SUBBL's portfolio was not impacted directly by the earthquake, the exposures in unaffected geographies/segments could witness some stress due to overall moderation in economic activity as well as linkage among businesses/borrowers.

SUBBL has witnessed improvement in its funding profile, with proportion of low cost CASA⁴ deposits at ~50% as on Oct-15 (vs. ~36% as of Jul-11), and marginally lower than industry average of ~54%. However, the bank's cost of funds (7.75% as of Oct-15) is significantly higher to peers and the industry average cost of funds at ~6%. This results in weak competitive positioning and impacts the lending spreads. Additionally, bank's deposit base remains fairly concentrated (18.28% of total deposits on Oct-15 among top 20 depositors). Low capital adjusted CD ratio; of ~62% as of Oct-15 (vs. regulatory ceiling of 80%) on account of high growth in deposits amidst low demand for fresh credit in recent past, provides ample room for future growth. Going forward, bank's ability to improve the cost of funds will have a strong bearing on its overall competitive positioning.

Despite healthy lending yields, the bank has witnessed declining NIMs (5.39% during FY13 compared to 2.53% during Q1FY16) adversely impacting the financial profile. The bank reported a net profit of NPR 36.22 million (corresponding return on net worth of 16.98% and return on assets of 1.97%) during FY15, primarily supported from non-operating profit of NPR 10.25 million. Amidst the challenging backdrop during Q1FY16 (increasing delinquencies and low demand for fresh credit) bank reported PAT of NPR 2.73 million (corresponding to a return on net worth of 4.56% and return on assets of 0.51%). The bank's reported financials were significantly benefitted by relaxations provided by regulator in income booking, credit provisioning and NPL recognition norms. Going forward, the profitability profile of the bank will largely depend on its ability to manage delinquencies; the same however remains a challenge given the expected impact of elongated strikes on the repayment ability of borrowers.

Capitalization profile of SUBBL remains adequate with CRAR⁵ 13.15% on Oct-15 as against minimum regulatory requirement of 11% for class B banks. The proposed issue along with internal accruals would help bank maintain adequate capitalization over the medium term. However, monetary policy of FY 2015-16 requires three district level development banks to increase their paid-up capital to NPR 500 million by FY17. SUBBL has a capital of NPR 177 million as of mid-Oct-15; which is expected to increase to NPR 227 million after proposed issue (assuming full subscription). Bank would either issue further shares along with retention of future profits or undergo merger to meet the revised regulatory capital requirement.

⁴ Current and Saving accounts

⁵ Capital to risk weighted assets ratio



Finding adequate sources to meet the elevated regulatory requirement and maintaining adequate returns (if opted for internal equity enhancement) would remain a key challenge for the bank.

Company Profile

In operation since September 2004, Subhechha Bikas Bank Limited is a three district level regional development bank operating in Chitwan, Nawalparasi and Makawanpur districts of Nepal. Corporate Office of the bank is located at Narayangarh. The bank is primarily promoted by individual promoters with significant representation from medical practitioners and maximum shareholding by one individual at 5% of total capital. Share capital of the company is distributed among promoter & public in the ratio of 51:49, with the shares listed on Nepal Stock Exchange. Mr. Dakshya Prasad Shrestha is the Executive Director of the bank.

SUBBL has presence in three districts of Nepal through its eight branches, one Extension counter and one ATM. The bank has market share of about 0.79% in terms of deposit base and 0.68% in terms of credit portfolio of Development banks as on mid Oct-15. SUBBL reported a net profit of NPR 36 million during 2014-15 over an asset base of NPR 2,020 million as on mid Jul-15 as against net profit of NPR 39 million during 2013-14 over an asset base of NPR 1,651 million as on mid Jul-14. During Q12015-16, bank reported net profit of NPR 3 million over an asset base of NPR 2,231 million. SUBBL's CRAR was 13.15% and gross NPLs were 1.16% as on mid-Oct-2015. In terms of technology platform, SUBBL has implemented MBwin System of Micro-banker across all its branches.

December 2015

For further details please contact:

Analyst Contacts:

Mr. Kishor Prasad Bimali, (Tel No. +977-1-4419910/20)
kishor@icranepal.com

Mr. Rajib Maharjan, (Tel No. +977-1-4419910/20)
rajib@icranepal.com

Relationship Contacts:

Mr. Deepak Raj Kafle, (Tel. No. +977-1-4419910/20)
drkafle@icranepal.com

All Rights Reserved.

Contents may be used freely with due acknowledgement to ICRA Nepal.

ICRA Nepal ratings should not be treated as recommendation to buy, sell or hold the rated debt instruments. The ICRA Nepal ratings are subject to a process of surveillance which may lead to a revision in ratings. Please visit our website (www.icranepal.com) or contact ICRA Nepal office for the latest information on ICRA Nepal ratings outstanding. All information contained herein has been obtained by ICRA Nepal from sources believed by it to be accurate and reliable. Although reasonable care has been taken to ensure that the information herein is true, such information is provided 'as is' without any warranty of any kind, and ICRA Nepal in particular, makes no representation or warranty, express or implied, as to the accuracy, timeliness or completeness of any such information. All information contained herein must be construed solely as statements of opinion and ICRA Nepal shall not be liable for any losses incurred by users from any use of this publication or its contents