ICRA NEPAL

Yeti Development Bank Limited

ICRA Nepal assigns [ICRANP] IPO Grade 4 to the proposed Equity Shares (Rights Issue) of Yeti Development Bank Limited

Facility/Instrument	Issue Size	Grading Action (January 2017)
Rights Share Issue	NPR 693.1167 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 693.12 million of Yeti Development Bank Limited (Yeti). 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. Yeti is proposing to come out with 50% rights issue of 6,931,167 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 to meet the elevated regulatory capital requirements and to support bank's growth plans.

The grading factors in bank's modest track record (operating since 2001) while maintaining moderate portfolio growth (CAGR[1] ~15% over last five years ending FY16 vs. ~21% for industry, aided mainly by swift spike in growth rate in FY16 from ~10% to ~40%). Adequate capitalization profile (CRAR[2] of 13.29% as on mid-Oct-16[3]) and management plans of expansion in franchise are expected to provide Yeti with adequate growth opportunities over the medium term. While assigning the grading, ICRA Nepal also takes note of the bank's ability to recover major part of losses incurred till FY14, primarily supported by increased recovery efforts including upgradation from current management team and the resultant write back of credit provisions.

The grading is however constrained by bank's weak asset quality profile[4] along with high exposure to perceived vulnerable sectors[5] which could lead to volatility in asset quality indicators. The grading also factors in bank's weak CASA[6] profile (~43% as on mid-Oct-16 vs. industry average of ~55%) resulting in higher cost of funds among peers (5.63% as on mid-Oct-16 Vs industry average of 5.01%) and also resulting inmoderate NIMs[7] (3.50% for FY16) compared to peers. Lack of diversity in earnings along with history of major losses sustained under the past management resulting in weak profitability profile (Negative RoNW[8] of ~40% for FY14 improved to ~27% for FY16) are also constraining factors. ICRA Nepal has also factored in Yeti's capital base being much lower to revised regulatory capital requirement of Rs 2,500 million to be complied by mid-Jul-17[9] and the dilution in return indicators over medium term arising from incoming capital. The grading is also constrained by no dividend track record over the 15 years of establishment, lack of Institutional promoters, stiff competition with commercial banks offering products at finer lending rates and uncertain operating and political environment which can affect the asset quality of financial institutions in Nepal. Going forward, Yeti's ability to scale up its operations ensuring efficient utilization of existing as well as additional capital along with ability to improve its deposits and assets quality profile would have key bearing on its overall financial profile.

With moderate credit growth in the past (CAGR of ~15% over past five years ending mid-Jul-16 vs. ~21% growth in industry), Yeti's credit portfolio was NPR 9,124 million as of mid-Oct-16. The growth was partly aided by merger with two Class C Finance Companies (namely Yeti and Valley Finance) with erstwhile

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[1] Compounded Annual Growth rate
[2] Capital to Risk-weighted Assets Ratio
[3] Mid-Jul-16 and Mid-Oct-16 data are unaudited.
[4] Delinquencies (0+ DPD) of ~41% as of mid-Oct-16 including NPLs (Non-Performing Loans) of ~4.3%.
[5] ~34% of portfolio as of mid-Oct-16 in real estate, loan against shares and hire purchase loans vs. ~21% for industry.
[6] Current and Savings Accounts
[7] Net Interest Margins as a % of Average Total Assets
[8] Return on Net-worth
[9] Regulator may impose restrictions in its operations if Yeti fails to comply the capital requirements.

Manakamana Development Bank in Jul-2013. However, Yeti has witnessed high growth rate of ~40% during FY16, supported mainly by competitive rates offered for advances, which has also resulted in yield on advances being slightly lower than some of the peer banks despite having a higher share of loans to vulnerable and riskier segments. The credit portfolio (as of mid-Oct-16) primarily comprises of personal loans (30%), business loans (25%), hire purchase loans (11%), loan against shares (8%), home loans (7%), gold loans (5%), deprived sector loans (5%), among others. Although Yeti's portfolio remains fairly granular with ~14% among top 20 borrowers, high proportion of exposure to vulnerable sectors (including personal loans) and higher portfolio vulnerability due to relatively marginal borrower profile vs. commercial banks remains key area of concern. Over longer term, scalability of business through expansion of franchise in uncovered regions and attaining sustainable growth would be key success factor.

ICRA Nepal takes into account the significant stress on bank's asset quality in the past owing to weak governance leading to inferior collateral and business assessment which is being gradually recovered post new management taking over in FY15. Bank's gross NPLs increased from 3.95% in Jul-12 (pre-merger) to 16.18% in Jul-14 (post-merger) mainly due to identification of problematic loans which was shown as good loan up to the date of merger and inferior quality lending post-merger. Most of the NPLs were originated from the loan disbursed by the lead merger partner "Manakamana Development Bank" (~61% of NPLs on mid-Jul-14) followed by NPLs generated from loan disbursed after merger by Yeti (~21%). Bank's adjusted NPLs including Non-Banking Assets (NBAs) were 20.46% in Jul-14 which has come down to 9.35% by mid-Oct-16. Though the NPLs gradually declined over next two years, fresh NPL generation remained higher till FY15 at ~8.5%. With increased recovery efforts and lower fresh slippage (0.33% during FY16), the NPLs have come down to 4.29% by mid-Oct-16, however still remains higher than industry average and peers. Yeti's delinquency levels also generally remains higher at ~41% of total loans on mid-Oct-16 vs. ~30% on mid-July-16. Owing to impact of earthquake and prolonged strike on repayment capacity of borrowers, Yeti had to reschedule of ~2% of portfolio which could also impact bank's asset quality profile going forward. Overall, Yeti's portfolio vulnerability remains high vs. commercial banks due to inferior borrower profile, limited capability for borrower's credit assessment system and assessed income based lending, which could lead to volatility in asset quality indicators. Management's ability to control on asset quality indicators with targeted portfolio growth would be critical for improvement in its profitability indicators.

As for funding profile, Yeti's proportion of low cost CASA deposits remains inferior to industry average and peers. Despite gradual improvement in CASA from ~36% as on mid-Jul-12 to ~43% as on mid-Oct-16, the same remains low compared to industry average of ~55% and thus results in higher cost of funds among peers (5.50% for FY16). Deposits remain fairly granular with top 20 depositors accounting for ~15% of total deposits as of mid-Oct-16. Going forward, management's focus on achieving granular deposit growth and expansion of depositors' base could improve deposits profile. Bank's ability to manage its deposit cost would have a strong bearing on overall competitive positioning in the future.

Owing to spike in NPLs, the bank incurred significant losses during FY14 eroding ~one-third of its net worth; however with recoveries from NPLs and consequent reversal of provision against loans the profitability has improved in FY15 and FY16 (return on net worth of ~14% and ~27% respectively and return on assets of 1.58% and 3.05% respectively). In absence of reversal of credit provisions, the profitability would have been low at return on networth ~5% on mid-Jul-16. Further, despite moderate NIMs and fee based income (~3.5% of ATA and ~1% of ATA for FY16 respectively), high level of operating expenses (as% of ATA) in relation to peer banks acts as a drag on operating profitability reflected in below average COP/ATA[10] as compared peer banks. Yeti's reported net worth per share of ~NPR 108 as of mid-Oct-16 (against face value of NPR 100) remains benefitted by statutory and other reserves while the bank still carries accumulated loss of NPR 324 million as of mid-Oct-16. However, operating profits have witnessed improvements during FY16 and Q1FY17 (0.10% of ATA for FY15 improved to ~2.2% for FY16 and further to 2.6% for Q1FY17) which along with plans of management to further reduce NPLs is expected to aid in recovery of accumulated losses. Going forward, the profitability profile of the bank will be primarily dependent on its ability to improve asset quality and improving lending

[10] Core Operating Profitability/Average Total Assets

spreads by reducing cost of funds which however remains a challenge given the expected hardening of interest rates in near term

Yeti's CRAR stood at 13.29% as of mid-Oct-16 (12.72% on mid-Jul-16) as against minimum regulatory requirement of 11% for class B banks; with tier I capital of 12.04%. Monetary policy of FY 2015-16 has announced that national level development banks are required to increase their paid-up capital to NPR 2,500 million within Jul-17, failure to comply the same may constrain growth. Yeti has a capital of ~NPR 1,386 million as of mid-Oct-16 and the same is expected to increase to ~NPR 2,079 million after proposed right issue (assuming full subscription). Bank is exploring merger/acquisition options to meet the shortfall capital requirements. Finding adequate sources to meet the elevated regulatory requirement and maintaining adequate returns over increased capital base would also remain key challenges for the bank.

Company Profile

Incorporated in June 2001, Manakamana Development Bank (erstwhile Nepal CSI Development Bank) was renamed as Yeti Development Bank Limited after merger with Yeti Finance and Valley Finance in July 2013. Yeti is a national level development bank whose major promoters include a group of individuals from diverse backgrounds. Its corporate office is located at Durbarmarg, Kathmandu. Share capital of the company is distributed among promoter & public in the ratio of 51:49 with maximum shareholding by one individual at 6.85% of total capital. The shares of the company are listed on the Nepal Stock Exchange. Mr. Sagar Sharma is the chief executive officer of the bank.

Yeti has a network of 25 branches and 20 ATMs (all operating on core banking - Pumori Plus IV System) spread across 19 districts of Nepal. Yeti has market share of 3.68% in terms of deposit base and 3.63% in terms of credit portfolio of Development Banks as on mid-Oct-16. Yeti reported a net profit of NPR 334 million during 2015-16 over an asset base of NPR 12,397 million as on mid Jul-16 as against net profit of NPR 139 million during 2014-15 over an asset base of NPR 9,470 million as on mid Jul-15. For Q1FY17, bank has reported net profit of NPR 66 million over an asset base of NPR 12,435 million. Yeti's CRAR was 13.29% and gross NPLs were 4.29% as on mid-Oct-2016.

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