

Sindhu Bikash Bank Limited

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

Facility/Instrument	Issue Size	Grading Action (April 2016)
Rights Share Issue	NPR 120.9375 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 120.9375 million of Sindhu Bikash Bank Limited (Sindhu). 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. Sindhu is proposing to come out with 1:1 rights issue of 1,209,375 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 in order to reach the revised paid up capital requirement set by Nepal Rastra Bank (NRB), the banking sector regulator in Nepal.

The grading factors in Sindhu’s fair credit portfolio growth (CAGR 43% over past 4 years ending FY15, albeit on a small base vs. 21% for development bank industry) and promoters’ knowledge of its area of operations. Adequate capitalization level (CRAR¹ of 14.63% as on mid-Jan-16²), and expertise of management team in the local market is expected to provide Sindhu with adequate growth opportunities in the near term. The grading also factors in Sindhu’s low cost of deposits (4.10% during H1FY16 vis-à-vis development bank average of 5.46%) aiding competitive positioning. This emanates from healthy CASA³ proportion of the bank (~61% of total deposits on mid-Jan-16 against development bank average of ~53%).

The grading is however constrained by bank’s limited track record (operating since Sep-2010), high geographical concentration risk (entire portfolio concentrated within two districts), small scale of operations (asset base of NPR 1,353 million as of Jan-16), and stiff competition from established BFIs/commercial banks in the region. ICRA Nepal also takes note of increase in delinquencies⁴ for the bank during the last few months on account of earthquake and elongated political turmoil⁵ impacting the overall economy and repayment capacity of the borrowers. This raises concerns about Sindhu’s incremental asset quality; which is currently benefitted⁶ by regulatory relaxations availed by the bank. While assigning the grading, ICRA Nepal has also factored in Sindhu’s capital base (~NPR 120.94 million) being much lower to revised regulatory capital framework to be complied by FY17 (NPR 500 million), lack of Institutional promoters, and relatively weaker borrower profile compared to commercial banks. Moreover, the grading is also constrained by uncertain operating environment that the banks in Nepal which could affect the growth of Sindhu.

Nonetheless, the grading also factors in regulatory arbitrage available with ‘Class B’ Development Banks compared to ‘Class A’ commercial bank in the form of lower absolute capital requirements and lower CRR/SLR⁷ requirements. Going forward, Sindhu’s ability to scale up its operations ensuring efficient utilization of capital, improve its profitability profile and manage delinquencies in its portfolio would have a bearing on the overall financial profile.

¹ Capital to Risk-weighted Assets Ratio

² Mid-Jan-16 data are unaudited

³ Current and Savings Account

⁴ 0+ days delinquency for Sindhu stands at ~19% including 90+days delinquency of 5.4% on Jan-16 .

⁵ Nepalese economy faced ~5 months long custom blockade and strikes in terai region in FY16 that ended recently.

⁶ While 5.40% of total loans on Jan-16 are 90+days delinquent, only 1.4% has been reported as NPA

⁷ Cash Reserve Ratio/ Statutory Liquidity Ratio



Sindhu commenced operations in Sep-2010 and the bank's credit portfolio stands at NPR 803 million as of mid-Jan-2016. The credit portfolio as on mid Jan-16 primarily comprises hire purchase loans (35%), business loans (22%), personal loans (16%), and housing loans (15%). Sindhu's credit concentration remains high (top 20 borrower groups accounting for ~26% of total loans on Jan-16). Going forward, the management plans to grow the business loan segment, leveraging its ability to offer competitive rates owing to low cost of funds. While management plans to expand the franchisee network is also likely to support future credit growth; the same could be a challenge given the promoter's knowledge/ reputation limited to local market.

Sindhu operates in the districts affected by the April 2015 earthquake. Despite the stress in the economy due to earthquake and elongated political turmoil, Sindhu reported Gross NPLs⁸ were relatively low at 1.35% (vs. 2.28% for development bank industry) as on mid Jan-16. This was primarily on account of regulatory relaxation⁹ in NPL recognition norms. Disregarding the forbearance on NPL recognition, gross NPLs would have been 5.40% as of mid Jan-16. However, the pressure on asset quality was evident with delinquencies increasing to ~19% as on mid Jan-16 from ~11% as on mid Jan-15 (both including NPLs), with higher delinquencies in scheduled loan segment. Higher delinquencies, coupled with adverse impact on repayment capacity of borrowers could also impact bank's asset quality profile going forward. Overall, Sindhu's portfolio vulnerability remains high vs. commercial banks due to inferior borrower profile and assessed income based lending, which could lead to volatility in asset quality indicators.

As for funding profile, Sindhu has a healthy proportion of low cost CASA deposits (~61% as on Jan-16); primarily due to healthy retail depositor base in the areas with limited presence of other BFIs. As a result, Sindhu's cost of funds remains lower at 4.10% for H1FY16 compared to peers as well as development bank industry average of 5.46%. This is expected to provide the bank with competitive edge over other players in the region. At the same time, Sindhu's deposit base remains fairly granular vs. peers (top 20 depositors comprise ~17% of total deposits on Jan-16). Going forward, the bank's ability to grow its deposit portfolio while maintaining deposit mix and cost of deposits, will have a strong bearing on overall competitive positioning in the future.

Sindhu reported moderate profit after tax (PAT) of ~NPR 17 million during FY15 (corresponding to return on net worth of 13.28% and return on assets of 1.58%). Sindhu's profitability was primarily supported by healthy NIMs¹⁰ (4.47% in FY15, benefitted by unregulated spread rate¹¹), fair level of fee based income (~1% of ATA) and low credit provisioning expenses so far. Despite the challenging backdrop during H1FY16, bank reported PAT of ~NPR 11 million (corresponding to a return on net worth of 14.60% and return on assets of ~1.64%) primarily supported by improvement in NIMs to 4.70% backed by 125 bps decline in cost of deposits over FY15 levels and low credit provisioning expense of 0.13% of ATA. The financial profile for Sidhu has also been benefitted by regulatory relaxations leading to lower credit provisions (on watch list accounts and non recognition of certain NPLs). Going forward, the profitability profile of the bank will be dependent on its ability to manage recovery profile and hence credit costs; the same however remains a challenge given the impact of elongated strikes on the repayment ability of borrowers.

Sindhu's CRAR stood was comfortable at 14.63% as of mid-Jan-16 (15.10% on mid Jul-15) as against minimum regulatory requirement of 11% for class B banks. Its tier I capital was 13.81% as on mid-Jan-16. The proposed rights issue along with the internal accruals would help bank maintain adequate capitalization over the medium term to support future growth plans. However, monetary policy of FY 2015-16 has raised the minimum paid up capital requirement for 3-district level development banks to NPR 500 million to be met within Jul-17. Sindhu has a capital of ~NPR 121 million as of mid-Jan-16 and the same is expected to increase to ~NPR 242 million after proposed right issues (assuming full subscription). Sindhu's ability to successfully manage merger option or raise capital from internal/external

⁸ Non-Performing Loans

⁹ 4.03% loan overdue more than 3 months are not recognized as NPA utilizing relaxation provided by NRB

¹⁰ Net Interest Margins as a percentage of Average Total Assets (ATA)

¹¹ NRB has imposed a 5% cap on interest spread for Class A banks which has not been made mandatory for class B banks.



investors (in case of merger failure) to meet the elevated regulatory requirement would remain a key challenge for the bank.

Company Profile

Operating since September 2010, Sindhu Bikash Bank Limited (Sindhu) is a three district level regional development bank currently operating in Sindhupalchowk and Kavrepalanchowk districts with plans to expand into Dolakha districts of Nepal in near future. Corporate Office of the bank is located at Banepa, Kavrepalanchowk. The bank is promoted by 184 individual promoters with maximum shareholding by one individual at 3.50% of total capital (as on mid-Jan-16). Share capital of the company is distributed among promoter & public in the ratio of 51:49. Mr. Sanjeeb Pradhan is the Chief Executive Officer of the bank.

Sindhu has presence in two districts of Nepal through its seven branches and two Extension counters. Sindhu has market share of about 0.48% in terms of deposit base and 0.42% in terms of credit portfolio of Development banks as on mid Jan-16. Sindhu reported a net profit of NPR 17 million during 2014-15 over an asset base of NPR 1,214 million as on mid Jul-15 as against net profit of NPR 10 million during 2013-14 over an asset base of NPR 959 million as on mid Jul-14. During H1FY15-16, bank has reported net profit of NPR 10.51 million over an asset base of NPR 1,371 million. Sindhu's CRAR was 14.63% and gross NPLs were 1.35% as on mid-Jan-2016. In terms of technology platform, Sindhu has implemented Pumori banking software throughout all its branches.

April 2016

For further details please contact:

Analyst Contacts:

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

Mr. Sailesh Subedi, (Tel No. +977-1-4419910/20)
salesh@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