

Kalinchowk Development Bank Limited

ICRA Nepal assigns [ICRANP] IPO Grade 4 to the proposed Initial Public offering of Kalinchowk Development Bank Limited

ICRA Nepal has assigned an “[ICRANP] IPO Grade 4”, indicating below-average fundamentals to the proposed initial public offering (IPO) amounting NRs. 49 million of Kalinchowk Development Bank Limited (KDB). 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. KDB is proposing to come out with an initial public offer of 490,000 numbers of equity shares of face value NRs 100/- each.

The grading is constrained by KDB's limited track record, lack of diversity in earnings, unseasoned credit book (less than 3 years of operation), moderate deposit profile (CASA deposit 35% as on mid-Jan-14 against industry average of around 54% on same date) with high deposit concentration (top 10 depositors accounted for around 37% of total deposit as on mid-Jan-14), high credit concentration (top 20 borrowers accounted for 35% of total credit as on mid-Jan-14), competition from commercial banks with wider product suite and uncertain operating environment that banks in Nepal are currently facing. Nonetheless, the grading factors in control on asset quality indicators (Gross NPLs 0.1% as on mid-Jan-14) leading to good solvency profile (0.16% as on mid-Jan-14) and regulatory arbitrage available with 'Schedule B' Development Bank compared to 'Schedule A' Commercial Bank- in the form of lower absolute capital requirement and lower SLR/ CRR requirements. Going forward, KDB's ability to increase its client base/ presence judiciously would have a bearing on the overall financial profile. The proposed IPO would enable the bank augment its capital base in line with its plans to increase scale of operations at a rapid pace over the medium term.

KDB started operations in Nov-2011 and since then it has been able to grow its portfolio at moderate pace; although portfolio size still remains small (credit portfolio was NRs 124 million as on mid-Jan-2014). Being a three-district development bank, KDB is allowed to operate in limited geographical area at the same time it faces competition from commercial banks with wider product suits and finer lending rates. However, KDB's promoters' reputation/knowledge of the local market and it's focussed approach and reach in its geography of operations could help to achieve adequate growth. Over the longer term, scalability of business would remain a challenge given promoters' knowledge/reputation limited to local market.

As on Jul-13, the credit portfolio of KDB stood at NRs. 104 million which increased further to NRs. 124 million as on January 2014. The bank's credit portfolio comprised business overdraft (around 19% of portfolio as of mid-Jan-2014), commercial loans to SMEs (17%), personal loans (16%), home loan (15%), Hire Purchase Loan (14%) and others. KDB reported Gross NPLs 0.1% as of mid-Jan-2014 however its asset quality trend is yet to be established as large proportion of credit is originated over last 12-18 months and remains unseasoned. As for funding profile, the bank faced de-growth of deposit in H1 2013-14 by 1% as compared to deposit of FY 2012-13 due to regulatory restriction to provide interest on Banking & Financial



institution's deposit resultant withdrawal of one large corporate deposit. The deposit profile of KDB remains inferior to industry as its CASA deposit remains 35% as on mid-Jan-14 against development banking industry average low cost deposit of 54% as on mid-Jan-2013. High deposit concentration of KDB (37% to top 10 depositors as on mid-Jan-14) with high reliance on call deposit (43% of total deposit as on mid-Jan-14) is concern on the funding profile of the bank.

Net interest income (NII) of KDB stood at NRs.6.13 million in H1 2013-14 (annualized increase of 41% compared to FY13 levels), driven by increase in scale of operations and improved Net Interest Margins (NIMs). NIMs witnessed an improvement in H1 2013-14 driven by increase in yield on advances. Operating expenses of the bank stood at NRs 10.28 million in H1 2013-14 (annualized increase of 42% compared to FY13 levels). Overall, the bank reported Net Profits at NRs.1.11 million in H1 2013-14, annualised increase of 59%, supported by improvement in NII (compared to NRs. 1.39 million in FY13). Over the near to medium term, as the bank builds scale, the overall financial performance could partly mirror the growth in business.

As on January 2014, capital adequacy ratio (CRAR) of KDB stood at 36.2% as compared to 43.7% as on July 2013. As per ICRA estimates, the proposed IPO (if fully subscribed) is likely to meet the capital requirements to meet KDB's projected medium term (3 year) CAGR growth plans of 35%¹, while maintaining overall capitalization in excess of 30%; with expectations of solvency remaining range bound at 5-10%.

The shareholding of the bank is diversified across over 204 individual promoters with no institutional promoter support. If the IPO² is fully subscribed, the promoter's shareholding in KDB will come down from 100% to 51%. KDB has a 5 member- Board of Directors (all representing promoter group with no independent director at present) having limited experience across Financial Institutions. The top management has moderate experience across Financial Institutions. Overall, the systems and process at KDB are evolving, with moderate to adequate internal control mechanisms.

Company Profile

Kalinchowk Development Bank (KDB) was licensed by NRB in November 2011; to conduct banking transactions in 3 districts of Central Nepal (Dolakha, Ramechhap & Sindhuli Districts).The registered office is in Charikot, Dolakha District which is also the Head Office of the Bank.

KDB has presence in three districts of the country through its 3 branches and a head office in Dolakha District. KDB has market share of about 0.07% in terms of deposit base and 0.09% of total advances of development banks in Nepal as on mid Jan-2014. KDB reported a profit after tax of NRs. 1.11 million during H1 2013-14 over an asset base of NRs. 181.65 million as on Jan-14 against profit after tax of NRs. 1.39 million during 2012-13 over an asset base of NRs. 176.67 million as on Jul-13. In terms of technology platform, KDB has implemented Pumori IV (which is also in use in some of the commercial banks of Nepal) in all of its branches.

¹ The projected CAGR growth rate is on a low base.

²36% of the enhanced capital base as on Jan 2014 (if IPO is fully subscribed)



ICRA Nepal's IPO Grading Scale

ICRA Nepal's five-point IPO Grading scale is as follows:

[ICRANP] IPO Grade 1	: Strong fundamentals
[ICRANP] IPO Grade 2	: Above-average fundamentals
[ICRANP] IPO Grade 3	: Average fundamentals
[ICRANP] IPO Grade 4	: Below-average fundamentals
[ICRANP] IPO Grade 5	: Poor fundamentals

Note:

For the Grading categories 2, 3 and 4, the sign of + (plus) may be appended to the Grading symbols to indicate their relative better position within the Grading categories concerned.

What an [ICRANP] IPO Grade Is Not:

- It is NOT a recommendation to buy, sell or hold the securities Graded
- It is NOT a comment on the valuation or pricing of the IPO Graded
- It is NOT an indication of the likely listing price of the securities Graded
- It is NOT a certificate of statutory compliance

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