Mission Development Bank Limited

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

Facility/Instrument	Issue Size	Rating Action (August 2015)
IPO Grading	NPR 57.5 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 NPR 57.5 million of Mission Development Bank Limited (hereinafter referred to as MDBL). 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. MDBL is proposing to come out with 50% rights issue of 575,000 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 in order to augment the capital base to support the future growth plans of the management.

The grading is constrained by MDBL's limited track record (started operations in June 2010), regional concentration with small scale of operations, limited franchise, unseasoned credit book, lack of diversity in earning, higher portfolio vulnerability due to relatively inferior borrower profile vs commercial banks and high proportion of loans with assessed income based appraisal which could lead to higher volatility in asset quality indicators, and stiff competition from commercial banks and established regional players offering products at more competitive interest rates. The grading is also constrained by small capital base compared to revised regulatory capital framework (NPR 115 mn as on Jul-15 Vs NPR 500 mn to be meet by FY17), lack of Institutional promoters, likely impact of earthquake in the assets quality of the bank due to moderation in the economic activities of the country although direct effect in portfolio is very limited, moderate experience of the management team and uncertain operating environment that financial institutions in Nepal are currently facing. Nonetheless, reputation and knowledge of promoters in its area of operations, high business growth over last three years (albeit on a lower base), good deposit mix (~65% & 70% CASA[1] deposits as on mid Jan-15 & mid-Jul-15[2]) with lower deposit concentration (top 20 depositors accounting for 13% of total deposits on Jul-15), moderate profitability profile, fair assets quality indicators so far (Gross NPL[3] 0.45% on Jan-15 and nil on July-15) and regulatory arbitrage available with 'Schedule B' Development Banks compared to 'Schedule A' commercial bank-in the form of lower absolute capital requirements and lower CRR/SLR[4] requirements. Going forward, MDBL's ability to scale up its operations ensuring efficient utilization of existing as well as additional capital, improve its profitability profile while maintaining its assets quality indicators would have a bearing on the overall financial profile.

The credit portfolio of MDBL has grown at high pace (albeit on a low base) since its establishment in 2010; however, the portfolio size still remains small at NPR 1,099 million on July-15. Slowly growing franchise of MDBL (9 branches across 3 districts in Jul-15) has also supported the credit growth in past 1-2 years; with major business concentration in Rupandehi district (73% of overall portfolio).The credit portfolio of MDBL comprises mainly of Overdraft Loans (35%), Personal Loans (14%), Group based microcredit (14%), Hire purchase loans (11%), Agricultural loans (7%), Housing Loans (6%), Real estate loans (4%). MDBL's

[1] Current and savings account
[2] Data for Jan-15 and Jul-15 are unaudited and based on provided by management of bank.
[3] Non-Performing Loans
[4] Cash Reserve Ratio/ Statutory Liquidity Ratio

credit concentration though moderate (top 20 borrowers groups accounting for ~18% of total loans on Jan-15) remains better than new generation development banks. MDBL's reported NPAs (0.45% on Jan-15 and nil NPA on July-15) are partly benefitted from low seasoning of credit book (~42% of Jul-15 credit portfolio originated in past 2 years). However, portfolio vulnerability remain high vs. commercial banks due to inferior borrower profile and assessed income based product lending in addition to sizeable unsecured microfinance loan portfolio which could lead to volatility in asset quality indicators. At the same time, indirect impact of 2015 earthquake on the assets quality of MDBL remains possible due to interrelations between borrowers/businesses financed by MDBL and those in earthquake affected regions. Although MDBL'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 despite geographical restrictions; competition from several other established regional players in addition to commercial banks with wider product suits and finer lending rates remains a challenge. The competition has further aggravated in recent years since commercial banks are also venturing into retail and SME sector which remains key segment for development banks. Moreover, the scalability of business on the long run also remains a challenge given promoters' knowledge/reputation limited to local market. Going forward, management's ability to scale up the operations and maintain control on asset quality indicators would be critical for improvement in its profitability indicators.

As for funding profile, MDBL's cost of funds remains slightly higher than the industry average and established peers which impact its competitive positioning. The cost of funds is affected by higher rates offered across all deposit accounts during the initial years of operations. However, the rates offered by the bank have gone down in recent years benefitting the overall cost of funds. MDBL has good proportion of low cost CASA deposits (65% as on Jan-15 and 70% on July-15 as compared to development bank's industry average of ~54% as on Apr-15) and relatively lower deposit concentration (~11% of total deposits on Jan-15 among top 20 depositors) which remains a positive from the standpoint of stability of deposit profile. Going forward, the management intends to increase fixed deposit by maintaining CASA around 55-60% with focus on increasing the granularity. However, ability of MDBL to achieve the same by improving retail depositor base and curtail its reliance on large depositors remains to be seen.

Being a relatively new player in the industry with small scale of operations and lower scale efficiencies, the profitability profile remains modest. Profitability in past 2 years remained subdued due to pressure on NIMs from higher decline in yield on advances vs. cost of deposit and lower credit to deposit ratio (66%[5] on Jan-15 and 71% on Jul-15) as compared to regulatory ceiling of 80%). Moreover, profitability profile also remains constrained by higher operating expense ratio (~3% in FY15) despite being supported by lower credit provisioning expense. The profitability profile of the bank will depend on its ability to expand its scale of operations thereby achieving scale economies; the same however remains a challenge given intense competition among the BFIs in the region. MDBL reported after tax profit (PAT) of NPR 28.12 million in FY15 and a NPR 11.75 million in FY14 respectively corresponding to a return on net worth of 16.04% and 9.48% respectively and return on assets of 1.88% and 0.97% respectively. Going forward, the profitability profile is likely to improve backed by improvement in NIMs (~4.7% in FY15 compared to 3.40% in FY14) driven by improvement in cost of funds (declining by ~100 bps each year in past 2 years).

MDBL's capitalization profile remains adequate with CRAR 12.94% on Jan-15 and 13.79% on July-15 as against minimum regulatory requirement of 11% for class B banks; with tier I capital of 12.15% and 12.98% respectively. The proposed rights issue along with the internal accruals generated in the interim is likely to increase the capital levels and support management's plans of 20-30% CAGR growth over next 2-3 years. However, monetary policy of FY 2015-16 has announced that development banks operating up to 3 districts are required to increase their paid-up capital to NPR 500 million within two fiscal yearsFY17. MDBL has a capital of NPR 115 million as of mid-Jul-15 and same is expected to increase to ~NPR 200

[5] Calculated as per NRB directives

mn after capitalization of accrued profit up to FY15 and proceeds from proposed right issues (assuming full subscription), thus the bank likely to issue fresh capital or opt for merger to meet the regulatory minimum capital within FY17. Further, if the bank finds adequate sources to increase the capital to meet the revised regulatory minimum norms, attaining adequate growth to ensure efficient utilization of the same would remain a key challenge for the bank.

Company Profile

Mission Development Bank Limited (MDBL) is a Class B Development Bank licensed by NRB. MDBL started its commercial operations in June, 2010 as a 3-disrict development bank licensed to operate in Rupandehi, Nawalparasi and Kapilvastu Districts of Western Region of Nepal. Its registered office is located in Butwal-8, Rupandehi. The bank is promoted by 148 individual promoters from diverse backgrounds with maximum individual shareholding of 3% and the promoter:public shareholding ratio of 70:30 as on Jan-15. Mr. Hari Prasad Ghimire is the Chief Executive Officer of the bank. The bank's shares are currently listed/ traded at Nepal stock exchange.

At present, MDBL has presence in all of the 3 licensed districts through 9 banking branches including head office. Being a new player, MDBL's has a small share of 0.60% in total deposit base and 0.53% in total credit portfolio of Development bank industry as on mid Apr-15. MDBL reported a net profit of NPR 11.75 million during 2013-14 over an asset base of NPR 1,373 million as on mid Jul-14 as against net profit of NPR 11.85 million during 2012-13 over an asset base of NPR 1,051 million as on mid Jul-13. In 2014-15, the bank has reported a profit after tax of NPR 28.12 million over an asset base of NPR 1,595 million. MDBL's CRAR was 13.79% and gross NPLs were Nil as on mid-July-2015. In terms of technology platform, MDBL has implemented "TrustBank" in all of its branches.

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