

## Rapti Bheri Bikas Bank Limited

### ICRA Nepal assigns [ICRANP] IPO Grade 4 to the proposed Initial Public Offering (IPO) of Rapti Bheri Bikas Bank Limited

	Amount (NPR million)	Rating Action
IPO Grading	50 million	[ICRANP] IPO Grade 4 (Assigned)

ICRA Nepal has assigned an “[ICRANP] IPO Grade 4”, indicating below-average fundamentals to the proposed Initial Public Offering (IPO) amounting NPR 50 million of Rapti Bheri Bikas Bank Limited (hereinafter referred to as RBBL). 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. RBBL is proposing to come out with an IPO of 500,054 numbers of equity shares of face value NRs 100/- each, to be issued to general public at par.

The grading is constrained by RBBL’s limited track record, small scale of operations, limited franchise, weak competitive positioning resulted from high cost of funds (10.89%), low profitability (PAT/ATA<sup>1</sup> & PAT/Net worth of 1.44% and 6.38% respectively in 9M 2013-14), lack of diversity in earnings (fee based income 0.03% of ATA in 9M 2013-14), inadequate internal control mechanism, limited banking experience of top management team, lack of integrated system among the branches and geographical concentration risk. The grading is also constrained by lack of Institutional promoters and uncertain operating environment. However, the grading factors in reputation and knowledge of promoters in its area of operations, fair assets quality indicators (Gross NPL<sup>2</sup> 1.47% as on April-14) and solvency profile, adequate capitalization level (CRAR<sup>3</sup> 27% as on April-14) to enable it to grow, 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<sup>4</sup> requirements.

RBBL has a credit portfolio of NPR 310 million as of mid-Apr-2014 mainly composed of Business and SME loans (52%), Deprived sector loan (13%), Agriculture Loan (10%), Personal Loan (8%), Housing Loan (6%) and Real Estate Loan (5%). The credit expansion of RBBL has been affected by limited franchise (3 branches as on April-14) and competition from commercial banks with wider product suits and finer lending rates. Going forward, RBBL is planning to set up 3 new branches with a view to expand its operations. Over the long term, scalability of business would remain a challenge given promoters’ knowledge/ reputation limited to local market. The gross NPL of RBBL remains under control at at 1.47% as on April-14, though increased from 0.96% as on mid-July-13. RBBL’s reported NPAs are partly benefitted from low seasoning of credit book. However, lack of trained staffs, weak credit underwriting norms and marginal profile of borrowers are the challenges that could prove detrimental to the incremental assets quality of the bank.

<sup>1</sup> Profit after tax/Average total assets

<sup>2</sup> Non-performing loan

<sup>3</sup> Capital to Risk Adjusted Assets Ratio

<sup>4</sup> Cash reserve ratio/Statutory liquidity ratio



As for funding profile, RBBL's cost of funds remains high (around 11% in past 2 years) which affects its competitive positioning in the region. The cost of funds is negatively affected by high interest rates offered in savings deposits and rising proportion of term deposits in past 2 years; which can be attributed to the management's focus on achieving deposit growth through higher interest rates as opposed to the expansion of depositors' base. As a result, unlike the Nepalese banking industry trend, RBBL's cost of funds has increased in past 2 years which raises concern over the bank's ability to expand the deposit base without compromising the cost. Although RBBL plans to expand geographically (post IPO) in order to curtail its reliance on small base of depositors; implementation of the same and its effect on overall deposit profile remains to be seen.

RBBL profitability in recent years has been affected by falling NIMs<sup>5</sup> which has offset the advantage of credit growth in the interim. Gross Interest spread has come down by 150 over basis points in past 2 years (3.42% as on Jul-12 to 1.85% as on Apr-14) as a combined result of declining yield on advances and rising cost of funds, thereby adversely affecting the operational profitability. Moreover, the credit provisioning expense which remained low till 2012-13 has increased during 9M 2013-14 as a result of fresh slippages; which could impact the incremental profitability of the bank. . As a result of falling NIMs and increased credit provisioning, RBBL return on assets declined to 1.44% for 9M2013-14 from 1.51% for 2012-13. The return on net worth has remained low at 5-7% over the past 3 years. Incrementally, RBBL's earnings profile will largely depend on the ability of the bank to control its growing cost of funds thereby improving the NIMs and maintain the quality of incremental credit portfolio.

The shareholding of the bank is diversified across 337 individual promoters with no institutional promoters. Present shareholding structure comprises 100% promoter holding which is expected to come down to 60% post IPO<sup>6</sup>. RBBL has a 6 member- Board of Directors; 5 from promoter group with moderate experience across Financial Institutions and 1 independent director with banking experience. However, the bank lacks established internal control mechanism necessary to mitigate the operational risks associated with banking business. Moreover, RBBL faces shortage of fairly experienced human resources in operational and managerial roles. The board philosophy towards setting up and strengthening the control mechanism and improving the quality of human resource could have a significant impact on the business of the bank, going forward

Over past 3 years, RBBL has been operating with high capital adequacy ratio (past 3 years' average ~30% against regulatory minimum of 11%); on account of low scale of operations and limited business expansion. RBBL's ability to mobilize the proceeds of proposed IPO efficiently will remain critical. As per ICRA estimates, the proposed IPO (if fully subscribed) is likely to meet the capital requirements of RBBL for medium term (2 years) at CAGR of 25% , with capitalization expected to remain high at around 30-35% and solvency indicators remaining range bound at 2-5%, further deterioration in asset quality indicators notwithstanding.

### **Bank Profile**

Rapti Bheri Bikas Bank Limited (RBBL) started its operations in February 2010 as a 3-district-development bank with license to operate in Nepalgunj, Dang and Bardiya Districts of Nepal. The bank is promoted by 337 individual promoters including people from prominent section of the society involved in different professions. The registered office is in Nepalgunj, which is also the Head Office of the Bank.

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<sup>5</sup> Net Interest Margin

<sup>6</sup> Assuming full subscription



At present, RBBL is operating with 3 branches in 3 districts and plans to set up 3 new branches after the proposed IPO. RBBL has market share of about 0.17% in terms of deposit base and 0.20% of total advances of development banks in Nepal as on mid-April-2014. RBBL reported profit after tax of NPR 4.75 million in FY 2012-13 over an asset base of NPR 342 million as on Jul-13 against profit after tax of NPR 4.21 million during 2011-12 over an asset base of NPR 288 million as on Jul-12. In 9M 2013-14, RBBL has reported profit after tax of NPR 4.21 million over an assets base of NPR 437 million as of mid-Apr-14. In terms of technology platform, RBBL has implemented Pumori in all of its branches; however, the integration of the same has not been completed yet.

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