

## Sajha Bikas Bank Limited

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

	Issue Size	Rating Action
IPO Grading	NPR 49 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 49 million of Sajha Bikas Bank Limited (hereinafter referred to as SBBL). 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. SBBL is proposing to come out with an IPO of 490,000 numbers of equity shares of face value NPR 100/- each to be issued to general public at par. The proposed issue is being made in order to maintain comfortable capitalisation profile for further business growth and meet the regulations regarding public shareholding and minimum paid-up capital requirements as well.

The grading is constrained by SBBL’s limited track record (started operations in April 2013), small scale of operations, limited franchise (6 branches and 2 extension counter spread over 3 districts as of now, however adequate for current scale of operations over the medium term), low seasoning of credit book, weak profitability profile, depleted equity base (book value per share was NPR 70.22 as of mid-Oct 2014), high credit concentration (Top 20 borrowers comprised ~43.41% of the credit portfolio as of mid-Oct -14), inferior deposits profile (Low cost CASA<sup>1</sup> deposits were 28.22% of total deposits as of mid-Oct-2014 with top 20 depositors concentration at 61.70%), lack of diversity in earnings, 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 with commercial banks offering products at more competitive interest rates. The grading is also constrained by lack of Institutional promoters and uncertain operating environment that financial institutions in Nepal are currently facing. The grading factors in reputation and knowledge of promoters in its area of operations, moderate experience of management team, adequate control mechanism in place, high business growth achieved over last two years within three district (albeit on a lower base), fair assets quality indicators and solvency profile so far (Gross NPL<sup>2</sup> remain nil as on Mid-Oct 2014, though asset quality trend yet to be established fully), competitive cost of deposits (6.79% as of mid-Oct 2014), moderate capitalization level (CRAR<sup>3</sup> of 12.78% as on Oct-14) to be enhanced post IPO enabling 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. Going forward, SBBL’s ability to scale up its operations, improve its profitability profile whilst maintaining its assets quality indicators would have a bearing on the overall financial profile. The proposed IPO would enable the bank to augment its capital base in line with its plans to increase scale of operations.

SBBL has a credit portfolio of NPR 241 million as of mid-Oct-2014 mainly composed of Business and SME loans (55%), Agriculture Loan (26%), Deprived sector loan (6%), Housing Loan (8%) and miscellaneous sectors (5%). The credit expansion of SBBL has been supported by its growing franchise (6 branches and 2 extension counters as on Jan-15) with major concentration (~86%) in Kailali district from where it started its operations. Moreover, bank’s credit portfolio remains highly concentrated so far with top 20 borrowers accounting for ~43.41% of the credit portfolio as of mid-Oct -14. Bank has already penetrated all 3 of its

<sup>1</sup> Current and Savings Account

<sup>2</sup> Non-Performing Loans

<sup>3</sup> Capital Risk Weighted Adequacy Ratio

<sup>4</sup> Cash Reserve Ratio/ Statutory Liquidity Ratio

working districts and proposes to expand its operations through existing franchise over the medium term. Competition from commercial banks with wider product suits and finer lending rates provide challenge on achieving growth targets going forward. Over the long term, scalability of business would remain a challenge given promoters' knowledge/ reputation limited to local market. SBBL's reported NPAs are partly benefitted from low seasoning of credit book wherein asset quality trend is yet to be established. The gross NPLs of SBBL though went up to 1.07% as on mid-July-14, remains nil as on mid-Oct-14. However, moderate credit underwriting norms, high proportion of loans with assessed income based appraisal which could lead to higher volatility in asset quality indicators and marginal profile of borrowers compared to commercial banks are the challenges that could prove detrimental to the incremental assets quality of the bank. 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, SBBL's cost of funds remains competitive among its peers (6.79% as of mid-Oct 2014) which could become a competitive advantage for the bank, provided it could further improve its low cost CASA deposit proportion from the existing 28.22% as of mid-Oct 2014. CASA deposits, however remain much lower than the development banking industry average of ~54% as on same date. SBBL's cost of funds is however higher vis. a vis. commercial banks which impacts its competitive positioning. Further, deposit profile is also inferior in terms of granularity; top 20 depositors accounting for ~61.70% as of mid-Oct 2014, major proportion of which (~57% of total deposits) is concentrated towards high ticket deposits from BFIs<sup>5</sup>/Insurance companies. Going forward, management's focus on achieving granular deposit growth and expansion of depositors' base could improve deposits profile. However, ability of SBBL to curtail its reliance on large depositors and increase base of small depositors remains to be seen.

SBBL's profitability profile remains subdued as the bank reported negative profitability indicators till last fiscal year, aided by rapid branch expansion entailing higher operating costs, low portfolio base of branches in initial stages and competitive yield being offered by the bank (14.22% as of mid-Oct 2014) despite lower credit provisioning expense till now. SBBL reported net loss of NPR 14.18 million in FY14 & NPR 3.8 million in FY 13, which eroded ~35% of its net worth. However, as of first quarter of FY15, there has been improvement in these ratios; return on networth to ~29% and PAT/ATA<sup>6</sup> 3.19% mainly due to gain on sale of certain investment portfolio. Excluding the gain on sale of such investments, the bank has made nominal profits as indicated by return on net-worth of 1.11% and PAT/ATA 0.12%. As a consequence, net worth per share of the bank has depleted to NPR 70.22 as of mid-Oct 2014. As the bank has no plans for further branch expansion over the medium term and plans to use the capital proceeds from IPO to fuel its business growth, the profitability profile of the bank could improve as indicated by Q1 results wherein bank has started to generate operational profit as well, though nominal. Incrementally, SBBL's earnings profile will largely depend on the ability of the bank to control its cost of funds thereby improving the NIMs and maintain the quality of incremental credit portfolio. Ability of SBBL to swiftly recover the accumulated losses remains to be seen.

Over past 2 years, SBBL's capital adequacy ratio has been squeezing on account of increasing scale of operations and lower initial capital base (started with capital base of NPR 51 million representing the proposed 51% promoter share post IPO), aggravated by losses in initial years of operation. SBBL's CRAR was 12.78% as of mid-Oct 2014 as compared to 62.29% as of mid-Jul 2013. As such, proposed IPO proceeds and recovery of accumulated losses will have a strong bearing in achievability of desired portfolio growth and overall financial profile of the Bank. As per ICRA Nepal estimate, the proposed IPO (if fully subscribed) is likely to meet the capital requirements of SBBL for medium term (2 years) at CAGR of 50%, with capitalization profile expected to remain moderate at around 13-18%, further major deterioration in asset quality indicators notwithstanding.

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<sup>5</sup> Banks and Financial Institutions

<sup>6</sup> Profit after tax/ Average total assets



The shareholding of the bank is diversified across 104 individual promoters with no institutional promoters. Present shareholding structure comprises 100% promoter holding which is expected to come down to 51% post IPO. SBBL has a 5 member- Board of Directors representing promoter groups only so far with moderate experience across financial sector and no independent director. Chairman and General Manager of the Bank has significant exposure in the financial market including core banking while other board and management team members have relatively moderate exposures in financial sector.

### **Company Profile**

Established in August 2012, Sajha Bikas Bank Ltd (SBBL) started its commercial operation as three district level development bank from April 2013 with license to operate in Kailali, Kanchanpur and Doti Districts of Nepal. The registered office of the bank is in Dhangadhi, which is also the Head Office of the Bank. The bank is promoted by 104 individual persons involved in different professions with maximum shareholding by one individual at 24.61% of total capital before IPO. Share capital of the bank is proposed to be distributed among promoter & public in the ratio of 51:49. Mr. Chandra Bahadur Bohara is the General Manager of the bank. The bank's equity share is to be listed in Nepal stock exchange post the IPO.

SBBL has presence in 3 districts of Nepal through its 6 branches and 2 extension counters. SBBL has market share of about 0.15% in terms of deposit base and 0.15% in terms of credit portfolio of Development banks as on mid Oct-14. SBBL reported a net loss of NPR 14.18 million during 2013-14 over an asset base of NPR 327 million as on Jul-14 as against net loss of NPR 3.8 million during 2012-13 over an asset base of NPR 107 million as on Jul-13. As of Q1 FY 2014-15, Bank has reported a profit after tax of NPR 2.62 million over an asset base of NPR 332 million. SBBL's CRAR was 12.78% and gross NPLs were 0.00% as on mid-Oct-2014. In terms of technology platform, SBBL has implemented "Trust Bank" in all of its branches.

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