

Saptakoshi Development Bank Limited

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

Facility/Instrument	Issue Size	Rating Action (March 2015)
IPO Grading	NPR 40 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 40 million of Saptakoshi Development Bank Limited (hereinafter referred to as SKDBL). 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. SKDBL is proposing to come out with an IPO of 400,000 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 meet the regulations regarding public shareholding and minimum paid-up capital requirements as well.

The grading is constrained by SKDBL’s limited track record (started operations in October 2012), small scale of operations with limited franchise, unseasoned credit book, weak profitability profile, lack of diversity in earning, moderate deposit profile (CASA¹ deposit 38.5% as on mid-Jan-15 against industry average of around 55% on same date) with high deposit concentration (top 20 depositors accounted for around 43.42% of total deposit as on mid-Jan-15), high credit concentration (top 20 borrowers accounted for 27.67% of total credit as on mid-Jan-15), 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, high business growth achieved over last two years within three districts (albeit on a lower base), fair assets quality indicators (Gross NPL² were 0.16% as on Mid-Jan 2015, though asset quality trend is yet to be established fully), competitive cost of deposits (6.51% as of mid-Jan 2015), healthy NIMs³ (6.03% as of mid-Jan 2015) 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/SLR⁴ requirements. Going forward, SKDBL’s ability to scale up its operations ensuring efficient utilization of existing as well as additional capital, 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.

SKDBL started operations in Oct-2012 and since then it has been able to grow its portfolio at high pace; although portfolio size still remains small (credit portfolio was NRs 276 million as on mid-Jan-2015). Being a three-district development bank, SKDBL 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,

¹ Current Account & Saving Account

² Non-Performing Loans

³ Net Interest Margins

⁴ Cash Reserve Ratio/ Statutory Liquidity Ratio



SKDBL's promoters' reputation/knowledge of the local market and its 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 mid-Jan-2015, SKDBL has a credit portfolio of NPR 276 million mainly composed of Business loans⁵ (43%), Agriculture Loan (17%), deprived sector loan (9%), Housing Loan (6%), Hire Purchase (5%) and balance being personal & other loans. The credit expansion of SKDBL has been supported by its growing franchise (6 branches as on Jan 2015) with major concentration (~89%) in Morang district from where it started its operations. Moreover, bank's credit portfolio remains highly concentrated so far with top 20 borrowers accounting for ~27.67% of the credit portfolio as of mid-Jan 2015. SKDBL'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 SKDBL were nil as on mid-July-14, however went up to 0.16% as on mid-Jan 2015. However, portfolio vulnerability remain high vs. commercial banks due to inferior borrower profile and assessed income based product lending which could lead to volatility in asset quality indicators. 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, SKDBL's cost of funds remains competitive among its peers (6.51% as of mid-Jan 2015) however higher vis. a vis. commercial banks which impacts its competitive positioning as commercial banks are also venturing into retail and SME sector which remains key segment for development banks. CASA deposits as of now (around 38.5%) remain much lower than the development banking industry average of ~55% as on same date. Further, deposit profile is also inferior in terms of granularity; top 20 depositors accounting for ~43.42% as of mid-Jan 2015, major proportion of which (~35% of total deposits) is concentrated towards high ticket deposits from Microfinance/cooperatives. Going forward, management's focus on achieving granular deposit growth and expansion of depositors' base could improve deposits profile. However, ability of SKDBL to curtail its reliance on large depositors and increase base of small depositors remains to be seen.

SKDBL's profitability profile remains subdued and profitability trend remains to be established. Bank reported low profitability indicators till last fiscal year due to being in initial stages of operation. SKDBL reported net profit of NPR 0.61 million in FY13 and a net profit of NPR 3.09 million in FY14 respectively corresponding to a return on net worth of 1.27% and 4.86% respectively and PAT/ATA of 0.81% and 1.27% respectively.

As of H1 FY15 SKDBL reported net profit of NPR 1.52 million corresponding to a return on net worth of 4.65% and PAT/ATA of 0.88% Net interest income (NII) of SKDBL stood at NRs.10.37 million in H1 2014-15 (annualized increase of around 52% compared to FY14 levels), driven by increase in scale of operations and improved Net Interest Margins (NIMs). NIMs witnessed an improvement in H1 2014-15 driven by decrease in cost of fund. Operating expenses of the bank stood at NRs 9.74 million in H1 2014-15 (annualized increase of around 64% compared to FY14 levels).

Being in initial stages of operations, SKDBL's capital adequacy ratio remains much higher than the regulatory minimum of 11%. SKDBL's CRAR was 25.30% as of mid-July 2014 which has declined to 20.24% as of mid-Jan 2015 owing to portfolio growth by ~30% during the period. As such, proposed IPO proceeds are likely to further maintain capital at higher levels over the medium term. Going forward, utilisation of existing as well as additional capital in an efficient and profitable manner would have strong bearing on bank's ability to generate adequate return for shareholders.

⁵ Loan to registered small & medium business houses.



Company Profile

Established in April 2012, Saptakoshi Development Bank Ltd started its commercial operation as three district level development bank from October 2012 with license to operate in Morang, Panchthar and Ilam Districts of Nepal. The registered and corporate office of the bank is in Morang District. The bank is promoted by 203 individual persons involved in different professions with maximum shareholding by one individual at 13% of total capital before IPO. Share capital of the bank is proposed to be distributed among promoter & public in the ratio of 60:40. Mr. Navin Subedi is the General Manager of the bank. The bank's equity share is to be listed in Nepal stock exchange post the IPO.

SKDBL has presence in 3 districts of Nepal through its 6 branches. SKDBL has market share of about 0.16% in terms of deposit base and 0.16% in terms of credit portfolio of Development banks as on mid Jan 2015. SKDBL reported a net profit of NPR 3.09 million during 2013-14 over an asset base of NPR 297 million as on mid Jul 2014 as against net profit of NPR 0.61 million during 2012-13 over an asset base of NPR 189 million as on mid Jul 2013. As of H1 FY 15, Bank has reported a profit after tax of NPR 1.52 million over an asset base of NPR 390 million. SKDBL's CRAR was 20.24% and gross NPLs were 0.16% as on mid-Jan-2015. In terms of technology platform, SKDBL has implemented "Pumori IV" in all of its branches.

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