

## Srijana Finance Limited

### ICRA Nepal assigns [ICRANP] IPO Grade 4 to the proposed Equity Shares (Rights Issue) of Srijana Finance Limited

Facility/Instrument	Amount (NPR million)	Grading Action (August 2015)
Rights Share Issue	67.2	[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 67.2 million of Srijana Finance Limited (SFL). 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. SFL is proposing to come out with a rights issue of 672,000 numbers of equity shares of face value NPR 100 each, to be issued to its existing shareholders at par.

The grading is constrained by SFL’s small base of operation with limited franchise<sup>1</sup> leading to geographical concentration (though working areas remained unaffected by recent earthquake), low portfolio base so far despite long track record, lack of diversity in earnings, higher exposure to Personal Loan segment (~56% of total credit portfolio) which might be more vulnerable compared to other segments, relatively high credit and deposit concentration among top customers (top-20 borrowers accounted for ~19% of loan book and top-20 depositors accounted for ~27% of deposits as on Apr-15), deposits growth over last three years (although fairly higher) remaining inadequate to support higher credit growth during the same period (Jul-12 to Apr-15) resulting into a tight CCD ratio<sup>2</sup> (~80% as of Apr-15<sup>3</sup> against maximum regulatory ceiling of 80%), moderate management profile and high competition from other BFIs<sup>4</sup> in its working areas with finer interest rate. The grading is also constrained by lack of institutional promoter coupled with uncertain political and operating environment that Nepalese Banks and financial institutions are currently facing. Nonetheless, the grading factors in SFL’s healthy asset quality indicators so far (NPLs<sup>5</sup> were 1.51%<sup>6</sup> as of mid-Apr 15 against 13.74% for the industry, ability to achieve healthy portfolio growth over last few years (CAGR of ~84% in last about three years), strong reported CASA<sup>7</sup> Proportion (~80%) and good profitability (Progressively improving PAT/Net worth over past 5 years and 23% as of Apr-15). Going forward, attaining requisite credit and deposit growth to ensure efficient utilization of capital and also adequately diversifying its portfolio towards various sectors/geographies would remain a key challenge for SFL.

Owing to very low growth in early 10 years of operation, SFL’s credit portfolio was only NPR 1,022 million despite long track record of ~15 years. Following the introduction of new management into SFL in 2012, credit portfolio grew by CAGR 84% since Jul-12 till Apr-15 increasing its market share from 0.01% in Jul-12 to 1.49% as of Apr-15 (however market share seems highly elevated also due

<sup>1</sup> Franchise includes 2 branches & 2 extension counters in two districts out of its working area of 3 districts on Apr-15.

<sup>2</sup> Credit to Core capital and deposits ratio

<sup>3</sup> Apr-15 data are unaudited and all the calculations are based on the data provided by management.

<sup>4</sup> Bank and Financial Institutions

<sup>5</sup> Non-Performing Loans

<sup>6</sup> SFL has not utilised regulatory forbearance in NPL recognition as of Apr-1; Class C companies can classify overdue instalments as NPA as opposed to the entire outstanding term loans for a period of 1 year from the date of instalments overdue.

<sup>7</sup> however institutional deposit of around 25% also includes in Current and Saving (CASA) deposit as reported by company.



to merger of many Finance companies with Class A and B counterparts over this period). Most of the growth was contributed by personal loans (portfolio remains concentrated towards this segment accounting for ~56% of portfolio as of Apr-15) with no tracking of end use in general and thus could be utilized towards vulnerable sectors. Rest of the portfolio comprised of Trading Loans (~24%), Agriculture Loans (~10%), deprived sector lending (~4%) and others, including consumption loans (6%). SFL's credit is moderately concentrated wherein top 20 borrowers accounted for ~20% of portfolio as of Apr-15 which remains lower among peers.

SFL has had comfortable assets quality so far with gross NPLs standing at 1.51% as on Apr-15 as compared to 1.14% as on July-14. Though some slippages have been noted during the interim period, assets quality fares better than finance company industry average of ~14% for Apr-15. Further, the reported NPLs are disregarding the regulatory forbearance towards NPL recognition for term loans accorded to class C finance companies. SFL has not utilized this facility owing to very low proportion of term loans in NPL category as of Apr-15. However, sizeable portion of the credit book of SFL remains unseasoned, considering recent high growth; thereby benefitting the assets quality position. Assets quality of SFL is further benefitted from the fact that significant portion of loans (~71%) are revolving in nature where repayment ability of the borrowers has not been tested fully. Also, portfolio vulnerability remains high due to high share of assessed income based lending (especially Personal Loans) and also due to marginal profile of borrowers compared to higher class BFIs.

As for funding profile, SFL has higher reported CASA proportion (~80% as of Apr-15; however institutional deposit of around 25% also included in CASA as reported by company) compared to industry average of ~46% resulting into modest cost of deposits among peers (7.44% as of Apr-15). Nonetheless, lower proportion of term deposits (~20%) and higher portion of revolving loans may expose the company to liquidity risks. Further, concentration to top 20 depositors remains higher at around 27% as on Apr-15 which poses risk to the stability of deposit and liquidity position. Despite healthy deposit growth (CAGR ~100% from Jul-12 till Apr-15), deposit base remained inadequate to support high credit growth (CAGR ~84% for the same period) whilst maintaining a regulatory CCD ratio of 80%. SFL's CCD ratio was 80.37%<sup>8</sup> as of Apr-15 which was partly supported by its comfortable core capitalization profile as of now. Going forward, the ability of SFL to increase its presence across different geographies thereby increasing the depositor base will remain vital to future portfolio growth and overall financial profile.

As on Apr-15, capital adequacy ratio (CRAR) of SFL stood at ~17% as compared to ~21% as on July-14. Assuming full subscription of proposed rights issue, SFL's capitalization levels are expected to remain high (~18-20%) over next 2-3 years as compared to regulatory minimum of 11%. Monetary policy of FY 2015-16 has announced that finance company operating within 3 districts are required to increase their paid-up capital to NPR 400 million within two fiscal years. SFL has a capital of NPR 134.4 million as of now and thus if the company finds adequate sources to increase the capital to the revised regulatory minimum, attaining adequate growth to ensure efficient utilization of the same would remain a key challenge for the company.

SFL has been reporting progressive profitability indicators over last five years supported by healthy portfolio growth, largely stable NIMs<sup>9</sup> over last few years and lower credit provisioning expenses as of now. SFL reported profits of NPR 30.66 million in FY14 (corresponding to PAT/Net worth of 19.93% and PAT/ATA of 3.74%) and NPR 32.11 million in 9MFY15 (corresponding to PAT/Net worth 23.02% and PAT/ATA 3.84%). SFL's Net Interest Margin (NIMs) at 6.73% as of Apr-15, has

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<sup>8</sup> Reported CCD ratio is lower than 80% in Q3 financial highlight.

<sup>9</sup> Net Interest Margins as a % of Average Total Assets



remained largely stable since Jul-13 supported by healthy interest spread of ~8.5% as of Apr-15. Nepal Rastra Bank has prescribed interest rate spread of BFIs to be within 5% and made mandatory for commercial banks from mid-Jul-14; should this provision be strictly made applicable to B and C Class institutions, SFL's profitability will be significantly deteriorated. Additionally, impact of change in provisioning norms requiring higher provision against watch-list accounts (5% against 1% as of now) could also impact future profitability (~2% loans in watch-list criteria as of Apr-15). SFL's earnings profile going forward will largely depend on the ability of the company to expand its scale of operations and control over assets quality.

### **Company Profile**

Established and started its commercial operation from December 2000, SFL has its corporate office located at Biratnagar, Morang. Working areas of SFL include Morang, Sunsari and Saptari districts. The bank is promoted by 74 individual persons involved in different professions. Share capital of the company is distributed among promoter & public in the ratio of 60:40. The company's equity share is listed in Nepal stock exchange with very low trading so far. Mr. Prabhakar Kumar Devkota is the Managing Director of the company. Though initially established as a national level finance company, its working area was constricted to 3 districts effective from March 2012 with the instruction obtained from Nepal Rastra Bank for such constriction, mainly due to paid up capital not timely being raised to regulatory minimum.

SFL has presence in 2 districts of Nepal (out of its working area of 3 districts) through its two branches and two extension counters. SFL has market share of about 1.47% of deposits and 1.49% in terms of credit portfolio of Nepalese Finance Companies industry as on mid-Apr 2015. SFL has reported a net profit of NPR 30.66 mn during 2013-14 over an asset base of 931 mn as on mid-July 2014 as against net profit of NPR 17.38 mn during 2012-13 over an asset base of NPR 708 mn as on mid-July 2013. During 9MFY15, SFL has reported a net profit of NPR 32.11 mn over an asset base of NPR 1,301 mn. SFL's CRAR was 17.07% and Gross NPLs were 1.51% as on mid- April 2015. In terms of technology platform, SFL uses Pumori III across all its branches.

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