

Shangri-la Development Bank Limited

ICRA Nepal assigns [ICRANP] IPO Grade 4+ to the proposed Equity Share (Rights Issue) of Shangri-la Development Bank Limited

Facility/Instrument	Issue Size	Grading Action (November 2015)
Rights Share Issue	NPR 184 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 to NPR 184 million of Shangri-la Development Bank Limited (hereinafter referred to as SADBL). 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. SADBL is proposing to come out with 25% rights issue of 1,840,000 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 bank.

The grading factors in SADBL’s adequate track record with healthy portfolio growth (CAGR¹ of ~27% over past 5 years) primarily aided by bank’s competitive cost of funds and adequate capitalization.

SADBL has been able to report healthy profitability indicators, supported by adequate NIMs² and fair asset quality.

Although adequate franchise and experienced management team is expected to provide the bank with adequate growth opportunities; uncertain operating environment and pressure on asset quality could impact the bank’s performance going forward.

ICRA Nepal notes the buildup of delinquencies³ in SADBL’s books during the last few months on account of uncertain operating environment created by ongoing political turmoil in the southern plains of the country impacting the overall economy and repayment capacity of the borrowers. This could impact the asset quality indicators going forward.

The grading is also constrained by SADBL’s small capital base compared to revised regulatory capital framework, lack of Institutional promoters, relatively weaker borrower profile compared to commercial banks and stiff competition from commercial banks with finer lending rates.

Nonetheless, the grading also factors in 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. ICRA Nepal also notes the limited impact of April-2015 earthquake on the SADBL’s operations. Going forward, SADBL’s ability to scale up its operations ensuring efficient utilization of additional capital, maintain its profitability profile and manage the delinquency levels would have a bearing on the overall financial profile.

SADBL underwent merger with Bageshwori Development bank in July 2014, resulting in significant increase in the scale of operations (total asset base increased to NPR 7,462 million post-merger as compared to NPR 4,445 million before merger). On a combined basis, the credit portfolio of SADBL has grown at a CAGR¹ of ~27% over past 5 years (vs. 24% growth in industry). The healthy credit growth has

¹ Compounded annual growth rate

² Net Interest Margin

³ Delinquent loans on mid-Oct-15 accounted for 16.81% of total loans vs. 2.84% in mid-July-15.

⁴ Cash Reserve Ratio/ Statutory Liquidity Ratio



been supported by the bank's competitive cost of funds allowing it to offer lending at competitive rates as evident from bank's lower yield on advances among peers at ~13% as of Jul-15 (~12% as of Oct-15). The credit portfolio of NPR 6,605 million as of Oct-15 primarily comprises Overdraft/ Working capital Loans (29%), Term Loans (27%), Hire Purchase Loans (14%), Housing loan (10%), Real estate Loans (2%) among others. SADBL's credit concentration remains low (top 20 borrowers accounting for 9.64% of total loans on Jul-15) and fares better to most of the peers.

The bank reported gross NPLs⁵ of 0.58% on Jul-15 (Vs. 3.58% for industry). However, post July-15 SADBL has witnessed weak recoveries on account of elongated strikes in terai region, resulting in an increase in the delinquency levels. . Delinquent loans on mid-Oct-15 accounted for ~17% of total loans vs. ~3% on mid-July-15, with term loans (~55% of the book) facing higher delinquencies (~75% of delinquencies as of Oct-15 are in this segment). This could impact SADBL's asset quality profile going forward. The regulator has provided temporary relaxations in NPL recognition norms factoring in the strike, however the same is expected to defer the actual impact on asset quality towards the end of the year, should the current scenario extend for a longer period of time. Benefitted by this relaxation, bank has reported NPLs of 0.47% as of Oct-15 (NPLs would have been 0.98% in the absence of the relaxations). Further, 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. Although SADBL's portfolio was not impacted directly by the earthquake, the exposures in unaffected geographies/segments could witness some stress due to overall moderation in economic activity as well as linkage among businesses/borrowers.

As for funding profile, SADBL's cost of funds (5.49% for FY15 vs. industry average of 6.20%) remains competitive among peers; allowing the bank to offer better interest rates while maintaining adequate lending spreads. SADBL has a healthy proportion of low cost CASA⁶ deposits (~56% as on Jul-15 as compared to industry average of ~53%) and a granular deposit base (6.25% of total deposits on Jul-15 among top 20 depositors). Adequate capitalisation level and low CD ratio (~69% as of Oct-15), on account of high growth in deposits amidst low demand for fresh credit in recent past, provide adequate room for credit growth provided the ongoing turmoil resolves soon and economic activity picks up. Going forward, the ability of SADBL to maintain the deposit profile will have a bearing on overall competitive positioning.

SADBL reported profit after tax (PAT) of NPR 191 million in FY15, the first year of merged operations (corresponding to return on net worth of 18.29% and return on assets of 2.29%). SADBL's profit was primarily supported by healthy NIMs (NIMs were 5.01% as of Jul-15) and low provisioning expenses. Amidst the challenging backdrop during Q1FY16 along with low demand for fresh credit and increasing deposit base, bank reported PAT of NPR 32 million (corresponding to a return on net worth of 12.05% and return on assets of 1.34%). The bank's financials were benefitted to an extent by low provisioning allowed by regulator on watch-list accounts (2% instead of 2.5%) along with forbearance in NPL recognition norms. Disregarding these relaxations, bank's reported net profit for the quarter would have been lower by ~25%. Going forward, the profitability profile of the bank will be dependent on its ability to manage delinquencies; the same however remains a challenge given the expected impact of elongated strikes on the repayment ability of borrowers.

Capitalization profile of SADBL remains adequate with CRAR⁷ 13.33% on Jul-15 (13.27% as of Oct-15) as against minimum regulatory requirement of 11% for class B banks; with tier I capital of 12.51%. The proposed rights issue along with the internal accruals would help bank maintain adequate capitalization over the medium term. However, monetary policy of FY 2015-16 has announced that national level development banks are required to increase their paid-up capital to NPR 2,500 million within FY17. SADBL has a capital of NPR 736 million as of mid-Oct-15 and the same is expected to increase to NPR

⁵ Non-performing loans

⁶ Current and Saving accounts

⁷ Capital to risk weighted assets ratio



920 million after proposed right issues (assuming full subscription). Bank would explore mergers with relatively smaller BFIs and/or retention of profits from FY16-17 to meet the revised regulatory capital requirements. Finding adequate sources to meet the elevated regulatory requirement would remain a key challenge for the bank.

Company Profile

Established in December 2006 as a regional development bank, Shangri-la Development Bank Limited (SADBL) underwent merger with another regional development bank viz. "Bageshwori Development Bank" on 13th July 2014 and upgraded itself to a national level development bank. The merged operations continue under the name of Shangri-la Development Bank and the corporate office of the merged entity was relocated to Baluwatar, Kathmandu. The bank is promoted by 410 individual promoters from diverse backgrounds with maximum shareholding by one individual at 2.5% of total capital (as on mid-July 2015). Share capital of the company is distributed among promoter & public in the ratio of 70:30. Mr. Rajendra Prasad Poudel is the Chief Executive Officer of the bank. The bank's equity shares are listed on the Nepal Stock Exchange.

SADBL has presence in 13 districts of Nepal through its 28 branches, 4 Microfinance branches and 10 ATMs. SADBL has market share of about 3.38% in terms of deposit base and 3.38% in terms of credit portfolio of Development banks as on mid Jul-15. SADBL reported a net profit of NPR 191 million during 2014-15 over an asset base of NPR 9,209 million as on mid Jul-15 as against net profit of NPR 74 million during 2013-14 over an asset base of NPR 7,462 million as on mid Jul-14. As of Mid-Oct-15, bank has reported net profit of NPR 32 million over an asset base of NPR 9,856 million. SADBL's CRAR was 13.27% and gross NPLs were 0.47% as on mid-Oct-2015. In terms of technology platform, SADBL has implemented Pumori-IV System throughout all its branches.

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