Gandaki Bikas Bank Limited

ICRA Nepal assigns [ICRANP] IPO Grade 3 to the proposed Rights Issue of Gandaki Bikas Bank Limited

INSTRUMENT/FACILITY	ISSUE SIZE	RATING ACTION (APRIL 2017)
Rights Issue (Equity shares)	NPR 460.9816 million	[ICRANP] IPO Grade 3 (Assigned)

ICRA Nepal has assigned "**[ICRANP] IPO Grade 3**", indicating average fundamentals to the proposed rights issue amounting ~NPR 460.98 million of Gandaki Bikas Bank Limited (GDBL). 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. GDBL has proposed to 25% rights issue of 4,609,816 numbers of equity shares, each with face value of NPR 100, to be issued to existing shareholders at par. The proposed capital injection is targeted towards ensuring regulatory minimum paid up capital of NPR 2,500 million for national level class B Development Bank.

The average fundamental grading factors in synergy in terms of future growth and business prospect, following the merger between two established regional players (erstwhile Fewa Bikas Bank and erstwhile Gandaki Bikas Bank[1]). Integration challenges, though present, remains moderate due to similar business and ownership profile of the merging entities. Strong capitalization, experienced management team and sound reputation of the bank in regional level remain positive for incremental growth prospect of GDBL. The grading also takes into consideration the adequate franchise network (50 branches across 20 districts) and strong retail presence of the bank. This reflects positively on the granularity of GDBL's portfolio resulting in minimal concentration risk (~5% of total credit portfolio and ~8% of total deposits portfolio among top 20 customers). The grading also factors in the bank's healthy assets quality indicator (gross NPLs of 0.4% as on mid-July 2017) maintained over the years and good profitability profile supported by healthy NIMs.

However, the grading remains constrained by relatively weak competitive positioning of GDBL vis-à-vis large class A commercial banks with finer lending rates; especially in the "base rate plus" lending rate regime recently introduced by Nepal Rastra Bank (NRB). Limited avenue for fee based income[2] for class B banks is also likely to affect the income diversity and profitability prospect of GDBL, while operating on a large scale. Scaling up the business will also remain a challenge given the promoter's and management reputation and experience largely limited to the regional arena. The grading is also constrained by marginal borrower profile vis-à-vis commercial banks and relatively high proportion of loans with assessed income based appraisal. The grading also factors in the lack of institutional promoters and uncertain operating environment that the banks in Nepal are currently facing. Although GDBL has maintained healthy track record in terms of growth, profitability and assets quality in the regional arena; its ability to replicate similar performance on large scale of operation spanning over wider geography remains to be seen.

The existing GDBL is formed by the merger between three regional banks and financial institutions (BFIs) within the span of 2 years[3]. The merged entity has registered healthy growth at compounded annual growth rate (CAGR) of 22% in credit and 19% in deposits during FY14-FY17[4]. GDBL's credit portfolio of NPR 16.5 billion as on mid-July 2017 comprised mainly of Personal loans (~37% of total loans), Business loans (~27%), Housing loans (~14%), Hire purchase loans (~11%) and Deprived sector loans (~5%). On assets quality front, GDBL remains comfortable with gross NPLs of 0.40% and solvency ratio (Net NPL/ net worth) of 1.02% as on mid-July 2017. Over past 4-5 years, gross NPLs of GDBL (including merging entities) have remained within 1% level. The ability of the bank to maintain healthy assets quality remains aided by established underwriting practices as well as granularity of the credit portfolio. Going forward,

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[1] Graded IPO 4+ in November 2015 for rights issue.

[2] Class B banks are not permitted to deal in foreign trade financing operations by regulations. Moreover, Class B banks hold small share in guarantee business vis-à-vis class A banks.

[3] Please refer the company profile section.

[4] Considering the combined growth of merging institutions between FY14-FY17.

the management intends to continue the portfolio growth through geographical expansion and gradual decentralization of business (cluster model) for faster service delivery; maintaining focus on retail segments and portfolio granularity.

GDBL's deposit profile remains weaker than development bank industry average in terms of current and savings account (CASA) deposit proportion (~36% as on mid-July 2017 vs development bank average of ~42%). GDBL's CASA proportion has remained below industry average over past 4-5 years. This translates into relatively higher cost of deposits for GDBL vis-à-vis few established development banks and commercial banks operating in the same market. Higher cost of deposits could weaken the competitive positioning of GDBL, especially in the recently introduced "base rate plus" lending rate regime. Nonetheless, granular deposit base of GDBL cushions the bank from liquidity risk as well as offers scope for quicker repricing of the deposits in future.

GDBL's profitability profile has remained healthy over the years, driven by good Net Interest Margin (NIMs) on increasing scale of operations. NIMs remain supported by healthy yield generated on high-yield-retail-advances and healthy rate of credit mobilisation (CCD[5] ratio of ~77% during FY15-FY17), which partly offsets the effect of relatively high cost of funds. Low credit cost and gradual moderation in operating expense ratio also supports the profitability level. However, low proportion of fee based income remains a drag to the profitability. Incremental profitability of the bank will depend on the management's ability to maintain the NIMs and/or increase diversification of the earning profile by strengthening non-interest income sources. Ability of the bank to maintain its assets quality will also have a bearing on the profitability prospect of the bank going forward.

As on mid-July 2017, CRAR of GDBL stood strong at 19.55% (as per Basel II norms[6]) against regulatory minimum of 11% for class B banks. Incremental capital infusion is likely to strengthen the capitalization profile further. Healthy rate of internal capital generation is also likely to support the capital requirement for future growth of the bank. However, over next 1-2 years, achieving business growth and maintaining return on increased capital base will be the focus area for the management. Given the reputation of the management and promoter limited to the regional arena, the ability of the management to growth the business over wider geography remains to be seen.

Company Profile

Gandaki Bikas Bank Limited (GDBL) started combined operation from 5th July 2017, after merger of two class-B Development banks viz. 10-district level Gandaki Bikas Bank and national level Fewa Bikas Bank (FBBL) from 5th July 2017. Erstwhile FBBL was in turn formed after the merger between national level class C Fewa Finance and regional level class B Bishwo Bikas Bank in July 2015. GDBL is promoted by individual businessmen from Gandaki region. Mr. Resham Bahadur Thapa is the Chief Executive Officer of the bank. The bank's equity share is listed in Nepal stock exchange and its market capitalisation stood at ~NPR 6.5 billion as on 15th October 2017.

GDBL has presence across 20 districts of the country through its 50 branches including Head office as on mid-Jul-17. GDBL is one of the largest development bank (third largest in terms of asset base) with market share of about 7.66% in terms of deposit base and 7.88% in terms of credit portfolio in B-class banking industry as on mid-July 2017. GDBL reported profit after tax of NPR 541 million during 2016-17 over an asset base of NPR 21,827 million as on Jul-17 as against profit after tax of NPR 529 million during 2015-16 over an asset base of NPR 19,813 million as on Jul-16. GDBL's CRAR was 19.55% and gross NPLs were 0.40% as on mid-Jul-17.

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[5] Credit to deposit ratio adjusted for networth.

[6] Monetary policy of FY2016-17, announced in August 2016 mandated national level class B bank to report their capital adequacy as per Basel II norms from earlier NRB prescribed method of CRAR calculation. As per old norms, CRAR of GDBL would come to ~15% as on mid-July 2017.

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