Deva Bikas Bank Limited

ICRA Nepal assigns [ICRANP] IPO Grade 4 to the proposed Rights Issue (equity shares) of Deva Bikas Bank Limited

Instrument/Facility	Issue Size	Grading Action (January 2018)
Rights Issue (Equity shares)	NPR 653.31 million	[ICRANP] IPO Grade 4 (Assigned)

ICRA Nepal has assigned "**[ICRANP] IPO Grade 4**", indicating below-average fundamentals to the proposed rights issue amounting NPR 653.31 million of Deva Bikas Bank Limited (DBBL). 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. DBBL proposes to come up with 40% rights issue of 6,533,108.59 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 Banks.

The grading remains constrained by the recent increase in stress over assets quality of DBBL which could be further accentuated by acquisition of entities[1] with weak assets quality profile. Delinquencies for DBBL has spiked from ~10% as of Jul-17 to ~26% as of Oct-17[2] while the NPLs (Gross NPLs 2.91% as on mid-Oct-17) continues to remain inferior vs. peers and the industry average. ICRA Nepal expects incremental strain on asset quality and profitability post the recent hardening of interest rates for DBBL as well as across the banking sector. The grading also takes into account the bank's cost of funds generally remains higher vs. the industry despite better CASA mix. Bank's profitability profile has remained weaker to industry so far; future return prospects to the investors over increased capital base could be affected by accumulated losses brought forward from acquired entities as well as expected stress in asset quality post acquisition of smaller banks with relatively weaker credit assessment. Furthermore, bank's weak competitive positioning vis-à-vis commercial banks with finer lending rates; especially in the "base rate plus" lending regime introduced by Nepal Rastra Bank may impact future growth. The grading is also constrained by marginal borrower profile vis-à-vis commercial banks, relatively high proportion of loans with assessed income based appraisal (particularly personal and real estate loans at ~30%) and the uncertain operating environment that the banks in Nepal are currently facing.

Nonetheless, the grading factors in DBBL's ability to achieve moderate portfolio growth (~18% compounded credit growth over last four years vs. ~19% for banking industry) which was however aided by very high growth of ~50% in FY2017. Comfortable capitalization, experienced management team and diversified franchise remain positive for incremental growth prospect of DBBL. Presence of Employees Provident Fund (Government promoted retirement fund operator) as an institutional promoter (~10% stake as of now) also provides comfort to the assigned grading. While assigning the grading, ICRA Nepal also takes note of the scale advantages that the bank could garner going forward being a prominent national level player and moderate granularity of its portfolio (~15% of total credit and ~13% of total deposits among top 20 customers as of mid-Oct-17). Going forward, DBBL's ability to scale up its operations ensuring efficient utilization of existing and incremental capital, introduce risk management framework commensurate to growth plans, improve its profitability profile and asset quality would have key bearing on the bank's overall financial profile.

Apart from standalone growth, merger with Rising development bank in FY2015 and acquisition of Sajha Bikas Bank and Union Finance in November 2017 have also aided scale enhancement making DBBL one of the prominent development bank operating in Nepal. On a consolidated basis for all pre-merger entities, credit portfolio registered moderate compounded growth of ~18% during last four years ending Jul-17 (vs. 19% for the banking industry). The growth rate was however aided by very high

[1] DBBL acquired Sajha Bikas Bank (ICRANP-IPO grade 5 for its rights issue in Feb-2017) and Union Finance on 9th November 2017 with plans to acquire Sahara Bikas Bank shortly (MOU signed on 9th June 2017).

[2] All the indicators are reported on a consolidated basis, including acquired entities.

growth of ~50% during FY17 which was supported by high CCD[3] margin available with the bank till last year (~71% in Jul-16 which was increased to ~78% as of Jul-17) while the banking industry growth in H2FY17 was largely impacted by lowering CCD margin. Yield on advances at ~13% for FY2017 for DBBL remains moderate among peers indicating comparable borrower profile among peers. However, dilution of borrower profile through recent and planned acquisition of banks with relatively inferior credit assessment norms remains a concern. Nonetheless, the credit portfolio emanating from the entities acquired so far account for ~9% of combined portfolio NPR 11,131 million as of mid-Oct-17. DBBL's credit portfolio as of mid-Oct-17 comprised mainly of Business loans (~31% pf total loans), Personal loans (~25%), Housing loans (~10%), Hire purchase loans (~9%), Loan against shares (~8%), Real estate loans (~5%), Deprived sector loans (~4%), Gold loans (~3%) and Miscellaneous (~5%).

DBBL has reported improvement in asset quality over last few years with gross NPLs coming down from ~9% as of Jul-14 to 2.91% as of mid-Oct-17, however still remaining much higher vs. peers and the industry average of 1.76%. Combined NPLs remain higher on account of ~19% NPLs of Union Finance and ~8% NPLs of Sajha Bikas Bank on mid-Oct-17 while reported NPLs of Deva as on same date stood at 1.79% on a standalone basis. Bank's combined delinquencies after improving to 10% on Jul-17 (vs. 22% on Jul-16) has witnessed major spike to 26% as of Oct-17 (vs. 29% on Oct-16) amidst festive seasons as well as declining repayment capability of borrowers to service loan facilities, given the recent increase in interest rates. Seasoning of the recent high credit growth in FY17 along with the weak underwriting and credit assessment norms of the acquired entities could further impact asset quality of the bank. Adequate provision cover of ~77% as of mid-Oct-17 has reduced the impact on solvency ratio (Net NPL/ net worth) of DBBL to 3.42%. Comfortable capitalisation levels along with incoming capital could help bank maintain moderate solvency profile despite expectation of stress in asset quality over the medium term. High exposure to vulnerable personal and real estate loans at ~30% also remains a concern for incremental asset quality prospects. Going forward, ability of the bank to improve its assets quality would remain a key driver for overall financial profile.

As for funding profile, DBBL's savings products carry higher rates and hence its cost of funds generally remains higher to industry average despite marginally better current and savings account (CASA) mix at ~46% as of mid-Jul-17 (67% in Jul-16) vs. ~42% (50%) for industry. Cost of deposits for DBBL was 5.65% for FY17 compared to 5.05% for industry impacting its competitive positioning. The cost of funds is additionally poised to rise over medium term (8.25% for Q1FY2018) owing to the recent rise in interest rates across banking sector and hence this could increase the stress in asset quality of DBBL and consequently the profitability. Nonetheless, granularity of DBBL's deposit (~13% among top 20 depositors on Oct-17) cushions the bank from liquidity risk as well as offers scope for quicker repricing of the deposits in future if the interest rate goes down.

Owing to high stress in asset quality in the past, DBBL's profitability profile has remained lower to industry average and when compared to peers. Bank's average return on net-worth (RoNW) was ~7% in past five years (vs. ~14% for industry) impacted mainly by spike in NPLs resulting in negative RoNW of ~14% for FY2013-14. Though operating profits have been improving in recent years, DBBL would need to recover accumulated losses of ~NPR 188 million brought forward from the recent acquisition before providing any returns to shareholders. Impacted by moderate yields among peers, Net Interest Margin (NIMs) of DBBL at 5.06% for FY2017 remains on a lower side among peers which has further come under pressure during Q1FY2018 (3.39%) amid spike in delinquencies. This has significantly impacted the return indicators of Q1FY2018; RoNW of ~1% vs. ~17% for FY2017 and return on assets of 0.13% (2.38% for FY2017). High operating expense ratio (2.98% of Average Total Assets-ATA for FY2017) and moderate fee based income (0.91% of ATA for FY2017) also remains a drag to the profitability. Incremental profitability will depend on the management's ability to improve asset quality, achieve healthy portfolio growth ensuring efficient utilisation of existing and incremental capital while improving the NIMs and diversification of the earning profile.

As on mid-Oct-17, CRAR of DBBL stood comfortable at 15.67% against regulatory minimum of 11% for class B banks. Assuming full subscriptions of upcoming rights, DBBL would meet the elevated capital requirements of NPR 2,500 million as applicable to national level development banks after the capitalisation of rights. The proposed capital infusion would further strengthen the capitalization profile

[3] Credit to Core capital and Deposits ratio

and support the targeted credit growth plans of management while maintaining moderate solvency. However, over next 2-3 years, achieving adequate business growth and generating healthy returns over increased capital base would remain key challenges for the management.

DBBL has signed MOU with Sahara Bikas Bank for acquisition of later one on June 9, 2017. Acquisition of Sahara Bikas Bank with NPLs of ~6% on Oct-17 could further impact borrower profile.

Company Profile

Formerly named as NDEP Development Bank, a national level development bank in operation since 2006, the name of the bank was changed to Deva Bikas Bank Limited (DBBL) after merger with Rising Development Bank (a three-district level development bank also in operation from 2006) in July 2015. DBBL acquired two smaller financial institutions viz. Sajha Bikas Bank and Union Finance on 9th November 2017 with plans to acquire Sahara Bikas Bank shortly. The corporate office of the bank is located at Bina Marg, Lal Durbar, Kathmandu. The bank is promoted by wide range of promoters with maximum shareholding by one promoter at 9.61% of total capital (as on mid-Nov 2017). Share capital of the company is distributed among promoter & public in the ratio of 51:49. The bank's equity shares are listed in Nepal stock exchange. Mr. Bijay Bahadur Shrestha is the Chief Executive Officer of the bank.

DBBL has presence in 17 districts of Nepal through its 40 branches and 12 ATMs as of mid-Nov 2017. DBBL has market share of 5.00% in terms of deposit base and 5.10% in terms of credit portfolio of development banks as on mid Oct-17. On a consolidated basis (including all acquired entities), DBBL reported net profit of ~NPR 290 million during FY2017 over an asset base of NPR 13,993 million as of mid-Jul-17 as against net profit of ~NPR 117 million during FY2016 over an asset base of NPR 10,391 million as of mid Jul-16. For Q1FY2018, the bank has reported net profit of NPR 5 million over an asset base of NPR 15,235 million as of mid-Oct-17. The consolidated capitalisation profile (CRAR) of DBBL was at 15.67% and consolidated gross NPLs was at 2.91% as on mid-Oct-2017. In terms of technology platform, DBBL has implemented centralised Banquire DB system throughout all its branches.

January 2018

For further details please contact:

Analyst Contacts:
Mr. Kishor Prasad Bimali (Tel No. +977-1-4419910/20)
kishor@icranepal.com

Mr. Rajib Maharjan, (Tel No. +977-1-4419910/20)
rajib@icranepal.com

Relationship Contacts:
Mr. Tulasi R Gautam, (Tel. No. +977-1-4419910/20)
trgautam@icranepal.com