

Srijana Finance Limited

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

Facility/Instrument	Amount	Grading Action (June 2018)
Rights Share Issue (Equity shares)	NPR 240.41 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 NPR 240.41 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 60% rights offering of 2,404,080 numbers of equity shares of face value NPR 100 each, to be issued to its existing shareholders at par.

The grading factors in SFL’s ability to achieve healthy growth (CAGR of ~56% and ~64% for credit and deposits over last three years ending Jul-17 vs. ~20% and 17% growth in banking industry) albeit over small geography. SFL’s healthy capitalisation, competitive cost of funds among finance companies, experience management team, adequate network¹ along with management plans to expand the geography of operations are expected to provide adequate growth opportunities going forward. SFL’s low customer concentration risks (~7% of loans and ~11% of deposits among top 20 customers as on mid-Apr-18²) and adequate track record in banking operations (since 2000) also provide comfort to the assigned grading.

Nonetheless, the grading is constrained by increase in stress over asset quality indicators of SFL in recent periods (Reported NPLs increased from 0.35% as of Jul-16 to 3.69% as of Apr-18. Delinquencies of SFL also remain generally high in interim periods with some moderation towards year end (~9% as of Jul-17 and ~22% as of Apr-18). Additionally, SFL’s high share of revolving loans (~83% as of Apr-18) and high exposure to assessed income based personal loans (~49% as of Apr-18) could further increase portfolio vulnerability. Though the return indicators for SFL has remained healthy over last few years (RoNW and RoA³ of ~32% and ~4% reported for FY17 over interest spread of 8.54%), recent regulation capping the interest spreads at 5%⁴ would significantly impact the return indicators over medium term and this has also been reflected in the grading. The grading is also constrained by SFL’s geographically concentrated operations (3 districts only), lack of diversity in earnings and high competition from other BFIs with finer interest rates. Going forward, attaining requisite growth to ensure efficient utilization of capital and adequately diversifying its portfolio towards various sectors/geographies would remain key challenges for SFL.

¹ Distribution network includes twenty branches & 3 ATMs in its working area of 3 districts on mid-Apr-18.

² Mid-Apr-18 data are unaudited

³ Return on net worth and Return on assets

⁴ This is to be fully complied from Oct-18 onwards.

SFL's portfolio grew by CAGR 56% in last three years (ending Jul-17) vs. ~20% growth in banking industry. Despite high growth in recent years, SFL's credit portfolio stood low among similar aged peers at NPR 3,722 million as of Apr-18; this was owing to very low growth in early 10 years of operations. The credit portfolio remains concentrated towards personal loans (~49%) with no tracking of end use in general and thus could be utilized towards vulnerable sectors⁵. Rest of the portfolio comprised of agriculture loans (~20%), business loans (~15%), deprived sector lending (~7%), housing loans (~3%), hire purchase loans (~2%) and others (~5%). Lending yields for the company generally remains high among peers at ~16% for 9MFY18 (~18% for FY17). SFL's credit portfolio is granular wherein top 20 borrowers accounted for ~7% of portfolio as of Apr-18.

Despite high growth in portfolio base, SFL's reported NPL levels has increased in recent periods (from 0.35% as of Jul-16 to 3.69% as of Apr-18 vs. ~13% for industry as of Jan-18⁶). The reported NPLs are disregarding the regulatory forbearance towards NPL recognition for term loans accorded to class C finance companies. However, there were some errors in loan classification and hence actual NPLs were slightly higher at ~5% as of Apr-18 remaining inferior compared to well performing peers. Additionally, delinquencies of SFL generally remains higher in the range of ~20% which slightly moderates to an extent towards year end (~9% as of Jul-17 which spiked to ~22% as of Apr-18). Assets quality of SFL is benefitted from the fact that major chunk of loans (~83%) are revolving in nature where repayment ability of the borrowers has not been tested fully. Limited seasoning of credit book, considering recent high growth, could also impact the future assets quality profile. Portfolio vulnerability also remains high due to assessed income-based lending to marginal profile borrowers compared to higher class BFIs.

As for funding profile, SFL has higher CASA proportion vs. industry (~56% as of Apr-18 vs. ~35% for industry as of Jan-18), but high rates offered in savings products result into modest cost of deposits among peers at 9.00% for 9MFY18 (6.65% for FY17). Increase in cost of funds in recent periods has remained in line with shortage of lendable funds across the banking industry. SFL's deposit concentration to top 20 depositors remain lower at ~11% as on Apr-18. Deposit growth has also remained healthy over last few years to support the high credit growth (CAGR ~64% in last three years ending Jul-17). 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.

SFL has been reporting good profitability indicators over last three years supported by healthy portfolio growth, improving Net Interest Margin (NIMs) and low credit provisioning expenses. SFL's return on net worth (RoNW) was ~29% and return on assets (RoA) was ~3.9% on an average over last three years. SFL's NIMs has improved from 7.03% for FY15 to 7.83% for FY17, supported by healthy interest spread of ~8.5% for FY17. However, the recent regulation from Nepal Rastra Bank capping the interest rate spread at 5% (full compliance required after Oct-18) along with sizeable equity injection through proposed issue would be significantly diluting the return indicators over medium term. Amid spike in delinquencies, NIMs has declined to 4.64% for 9MFY18 leading to deteriorated RoNW and RoA at ~15% and 1.65%. Additionally, if the errors in loan classification are to be correctly provided for, these numbers would further deteriorate to ~11% and 1.25% respectively. SFL's earnings profile going forward will largely depend on the ability to expand its scale of operations and control over assets quality.

⁵ Speculative activities, non-income generation/consumption purpose etc.

⁶ Industry data for Apr-18/9MFY18 not available yet.

As on Apr-18, capital adequacy ratio (CRAR) of SFL remains comfortable compared to regulatory minimum (CRAR of ~14% vs. minimum requirement of ~11%) which would be further boosted after proposed issue. High capital cushion could however absorb the losses in the event of stress in asset quality and profitability after fair reporting and provisioning of NPLs. After the proposed issue, SFL's capital would increase to ~NPR 641 million assuming full subscription (vs. minimum capital requirements for three district level finance set by NRB at NPR 400 million).

Company Profile

Established and started its commercial operation from December 2000, Srijana Finance Limited has its corporate office located at Hanuman Das Road, Biratnagar, Morang. Working areas of the company include Morang, Sunsari and Saptari districts. The bank is promoted by diversified range of promoters 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. Mr. Bhawani Shankar Chapagain is the Chief Executive Officer 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 NRB (the regulator) for such constriction, mainly due to paid up capital not timely being raised to regulatory minimum.

SFL has presence in 3 districts of Nepal through it twenty branches and three ATMs as of mid-Apr-18. SFL has market share of about 7.69% of deposits and 6.46% in terms of credit portfolio of Nepalese Finance Companies industry as on mid-Jan 2018. SFL has reported a net profit of ~NPR 133 million for FY17 over an asset base of NPR 3,883 million as on mid-July 2017 as against net profit of ~NPR 86 million for FY16 over an asset base of NPR 2,614 million as on mid-July 2016. During 9MFY18, SFL has reported net profit of NPR 56 million over an asset base of NPR 5,164 million as on mid-April 2018. SFL's CRAR was 13.92% and Gross NPLs were 3.70% as on mid-April 2018. In terms of technology platform, SFL uses Pumori-III across all its branches.

June 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

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