

## World Merchant Banking and Finance Limited

### ICRA Nepal assigns [ICRANP] IPO Grade 5 to the proposed equity shares (rights Issue) of World Merchant Banking and Finance Limited

Facility/Instrument	Issue Size	Grading Action (June 2018)
Rights Share Issue	NPR 363.9606 million	[ICRANP] IPO Grade 5 (Assigned)

ICRA Nepal has assigned “**[ICRANP] IPO Grade 5**”, indicating poor fundamentals to the proposed rights issue amounting NPR 363.9606 million of World Merchant Banking and Finance Limited (WMBF). 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. WMBF has proposed 200% rights issue of 3,639,606 numbers of equity shares of face value NPR 100 each, to be issued to its existing shareholders at par. The proposed issue is being made to augment the capital base and is a step towards revised (higher) paid up capital requirement<sup>1</sup> set by Nepal Rastra Bank (NRB), the banking sector regulator.

The grading is constrained by WMBF’s poor financial profile caused by weak assets quality (gross NPLs<sup>2</sup> of 100% on mid-April 2018). The grading also remains constrained by negative networth of the company (-NPR 305 million on mid-April 2018), a result of prolonged business restriction<sup>3</sup> and accumulated losses. Because of the restrictions, the credit and deposit portfolio has withered over the years. The grading also factors in lack of geographical diversification (2 branches and head office) and dilution of company’s reputation over the years. Moreover, the company is short of minimum paid up capital of NPR 800 million (vs NPR 183 million as of now). Ensuring the same within the stipulated deadline remains a major challenge for the company.

As on mid-April 2018, WMBF is in the list of problematic institution maintained by the central bank (NRB). NRB declared the institution problematic in April 2013 citing poor (negative) capitalization, lack of governance, internal control, weak assets quality and deterioration in financial indicators. WMBF’s downfall was caused by high exposure towards a sector (33% real estate loans in mid-April 2013) and few borrowers. In early 2010, NRB’s capped real estate financing at 10% of total credit and instructed banks to bring the exposure within the ceiling by mid-July 2012. NRB’s decision rendered real estate sector illiquid and the institution with high proportion of real estate loans saw surge in delinquencies and defaults. The following losses rendered WMBF’s capitalization negative and was later categorized as “problematic” by NRB. Since a problematic institution is not allowed to conduct new business until it is recapitalized, WMBF has not done any new business (branch expansion, deposit raising and lending activities, etc) since April 2013.

WMBF has proposed equity raising plans after the introduction of new promoter groups into the company. New promoter group led by Mr. Bhesraj Lohani (real estate developer cum investor) have acquired ~14% stake in WMBF till mid-April 2018. The new group plans to acquire controlling stake in the company by purchasing shares from other promoters as well as rights shares renounced by the existing shareholders. However, the ability of the group to gain control in the company, inject fresh equity and revive the company remains to be seen.

<sup>1</sup> NPR 800 million for national level class C Finance Company (vs. WMBF’s capital current capital of NPR 183 million)

<sup>2</sup> Non-performing loans

<sup>3</sup> Problematic institution cannot renew existing deposits and loans, accept fresh deposits and underwrite fresh loans.



The credit portfolio of WMBF de-grew with compounded annual rate (CAGR) ~22% from mid-July 2012 to mid-April 2017 while the deposit base de-grew with CAGR 30% over the same period. As on mid-Apr-18, WMBF's credit portfolio stood at NPR 220 million on a total deposit base of NPR 77 million. The company cannot undertake incremental business until it is released from problematic status, which is likely after it meets minimum capital adequacy requirement after proposed rights issue. Hence, revival of the company is highly dependent on the ability of promoters to inject fund in the proposed rights issue as well as subsequent issues<sup>4</sup>.

WMBF's profitability profile remains weak because of high NPLs and reduced scale of operations at present. The losses sustained over these years has rendered the net worth negative for the company (Net worth per share is (-) NPR 27 compared to face value of NPR 100). Profitability profile over medium term will be largely determined by the ability of the management to recover from existing NPLs and maintain the quality of incremental credit portfolio.

WMBF breached the minimum regulatory capital requirement in FY12 after additional credit provisioning was required on incremental slippages during the year. Additional credit provisioning resulted in huge loss and rendered company's net worth negative thereby affecting the tier I capital (NPLs rose from 22% in FY11 to 42% in FY12 while CRAR declined from 25% in FY11 to -15% in FY12). Most of the NPLs resulted from aggressive lending in speculative real estate transactions, signifying weak underwriting practices. As on mid-April 2018, top 2 borrowers account for ~50% of the NPA. Proposed rights issue plan is likely to increase the CRAR level above regulatory minimum and release WMBF from problematic status. However, the ability and willingness of the promoters to inject fresh equity into the company remains to be seen.

### **Company Profile**

World Merchant Banking & Finance Limited (WMBF) was incorporated in June 2000 and started commercial operation from August 2001. The company is registered as public limited company and is licensed by NRB as national level class C finance company.

WMBF was declared problematic<sup>5</sup> by NRB on 26th April 2013 citing lack of governance & internal control, poor asset quality and deterioration in financial indicators. The company continues to remain in NRB's list of problematic institutions as on mid-Apr 2018. The company in the list cannot open new branches, raise deposits or extend new loans until it gets released from the problematic status. The company gets released from the problematic status after it maintains regulatory minimum capital adequacy ratio (CRAR) of 11% (which as on mid-April 2018 stands at (-)15.36%). After the proposed equity injection plan, the company is likely to meet the minimum capital adequacy requirement after which NRB is likely to take the company out of the list of problematic institution.

As of mid-April 2018, WMBF has small scale of operation, spread over 3 districts through its 3 branches (including head office). Supported by recoveries from NPLs/NBA<sup>6</sup>, during FY2016-17, WMBF reported

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<sup>4</sup> After this rights issue of NPR 363.96 mn, paidup capital of company will reach to ~NPR 546. To meet the minimum capital requirement of NPR 800 mn, the company is likely to come with subsequent rights.

<sup>5</sup> NRB can declare a BFI a problematic one owing to various reasons including poor management, inadequate financial resources, absence of long-term sustainable business strategy, weak asset quality, poor internal-control system, poor governance and so forth. A problem bank, at its initial stage is, principally, subject to the direct supervision of the NRB. If the deficiencies persist even after taking the necessary corrective steps under various modalities, the bank is subject to insolvency action and finally liquidated in accordance with the applicable laws

<sup>6</sup> Non-Banking Assets



net profit after tax of NPR 17 million over asset base of NPR 51 million as on mid-July 2017 vs. FY2015-16 net profit of NPR 103 million over asset base of NPR 89 million as on mid-July 2016. Till Q3FY2017-18, WMBF reported net profit after tax of NPR 46 million. As on mid-April 2018, the company's accumulated net worth is negative by ~NPR 50 million resulting in negative capital adequacy ratio of 15.36%. Entire loan portfolio of WMBF amounting to ~NPR 220 million have turned problematic (100% gross NPLs).

**June 2018**

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