

## **Bhaktapur Finance Company Limited**

### **ICRA Nepal assigns [ICRANP] IPO Grade 5 to the proposed Initial Public offering of Bhaktapur Finance Company Limited**

ICRA Nepal has assigned an “[ICRANP] IPO Grade 5”, indicating poor fundamentals to the proposed initial public offerings (IPO) amounting NRs. 75 million of Bhaktapur Finance Company Limited (hereinafter referred to as BFCL). 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. BFCL is proposing to come out with an initial public offer of 750,000 numbers of equity shares of face value NRs 100/- each, to be issued to general public at par.

The grading is constrained by BFCL’s limited track record (3 years in operation), lack of diversity in earnings (fee based income of 0.22% of ATA<sup>1</sup> in H1 2013-14 and 0.02% in 2012-13), high proportion of NPLs<sup>2</sup> (6.3% Gross NPL as on January 2014) despite an unseasoned credit book, high credit (top 20 borrowers accounted for 37% of total credit as on July 2013) and deposit concentration( top 20 depositors accounted for 48% of total deposits as on July 2013), low profitability (PAT<sup>3</sup>/ATA of 0.14% in H1 2013-14 & 0.08% in 2012-13), competition from commercial banks and development banks with wider product suite and uncertain operating environment. The grading is also constrained by lack of Institutional promoters’ support that could have a bearing on the long term performance of BFCL.

Although a National Level Finance Company, BFCL at present operates only through its registered office. This localized operation has resulted in constraints in deposit mobilization, created risk of geographical concentration of credit and competition from other financial institutions operating locally. As on January 2014, BFCL’s credit portfolio stood at NPR 274 million with total deposit base of NPR 343 million. The bank’s credit portfolio comprised mainly of Hire purchase loans (around 31% of portfolio), Business Loans to SMEs (22%), Industrial Loans to local industries (11%), housing loans and personal loans (13%), Gold and silver loans (2.5%) and other loans. Stress has been reported across all segments of credit portfolios and credit concentration has been observed as the major reason for fast deteriorating asset quality indicators. As for funding profile, low cost deposits constituted larger proportion of total deposit liability (nearly 60% as on January 2014). Incrementally, ICRA believes that BFCL’s focus is likely to remain on low ticket retail exposures; given the lack of lending opportunities. Overall, the ability of BFCL to meet desired credit growth through retail lending focus model amid competition from financial institutions operating locally remains to be seen.

During FY 2012-13, the credit portfolio of BFCL grew by 65% (albeit on a low base) to NPR 239 million and further to NPR 274 million as on January 2014. During the same period, the Gross NPLs of BFCL increased from 0.1% as on July 2012 to 4.7% as on July 2013 and further to 6.2% as on January 2014. This rapid deterioration in asset quality indicators led to pressure on profitability indicators, with BFCL reporting PAT/ ATA of 0.1% in FY12-13 as compared to PAT/ ATA of 1.6% in FY11-12. At the same time, the solvency indicators deteriorated with Net NPA/Net worth ratio

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<sup>1</sup> Average total assets.

<sup>2</sup> Non-Performing Loans

<sup>3</sup> Profit after tax



increasing from Nil in July-12 to 3.6% in July-13 and further to 6.3% in January 2014. Further, actual stress on asset quality and the solvency profile could be higher than reported; as Class C finance companies are accorded regulatory forbearance<sup>4</sup> in reporting NPAs.

Coupled with high cost of deposits, Gross Interest Spread of BFCL has remained inadequate in the range of 0.75-1.25% over the last 12-18 months. As regards profitability, BFCL witnessed a decline in Net Interest Margin (NIMs) over the past 2 years, primarily driven by low yield on advances, local competition and non realization of income due to increasing NPAs. Falling NIMs combined with increased credit provisioning expense resulted in BFCL reporting modest Net Profits of NPR 0.33 million during H1 2013-14 as against Net Profit of NPR 0.28 million in 2012-13 and NPR 4.01 million in 2011-12. Return on net worth for 2012-13 stood at 0.2% as against 3.0% for 2011-12. BFCL's earnings profile will largely depend on the ability of the company to regularize the existing NPAs, arrest further deterioration in asset quality indicators and increase scale of operations profitably.

BFCL has no immediate branch expansion plans. The scalability of business would remain a challenge given promoter's knowledge/reputation limited to local market. While BFCL has an advantage in terms of access to retail clients and service turnaround, limited scale of operations pose a challenge. Going forward, BFCL's ability to expand geographically thereby lowering concentration risk and increasing the depositors/customers base would be a monitorable.

The shareholding of the bank is diversified across over 106 individual promoters with no institutional promoter support. If the IPO<sup>5</sup> is fully subscribed, the promoter's shareholding in BFCL will come down from 100% to 62.5%; with 37.5% public shareholding. BFCL has a 5 member- Board of Directors (BoD-all representing the promoters) having limited experience across Financial Institutions and no independent/professional director at present. The top management has moderate experience across Financial Institutions. There are four committees under the BoD (composed of Directors as well as Management representatives) for oversight in activities related to human resource management, credit control and audit. Overall, the systems and process at BFCL are evolving, with moderate internal control mechanisms.

As on January 2014, capital adequacy ratio (CRAR) of BFCL stood at 45% as compared to 76% as on July 2013. As per ICRA estimates, the proposed IPO (if fully subscribed) is likely to meet the capital requirements of BFCL for medium term (three years) at CAGR of 45%<sup>6</sup>, with overall capitalization expected to remain comfortable in the range of 25-30%; while the solvency likely to deteriorate in the range of 10-15%. Overall, BFCL's ability to meet the growth plans amid deteriorating assets quality indicators remains to be seen. As regards liquidity profile, BFCL is comfortably placed owing to good savings deposit franchise (~60% as on January 2014), high proportion of term deposits (>50% as on January 2014 with maturity period of over one year) and significant proportion of short term loans (> 50% as on January 2014).

### **Company Profile**

Established in February 2011, Bhaktapur Finance Company Limited (BFCL) is the last Class C finance company of Nepal to be licensed by NRB to operate at national level. At present, the

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<sup>4</sup> In cases of the instalment of the term loan, entire loan amount has to be categorized as loss loan only if the instalment amount has crossed the deadline by a period of more than one year. In case the instalment amount has crossed the deadline by a period of less than one year, only such instalment amount has to be classified in the loss loan with a provision of loan loss.

<sup>5</sup>36% of the enhanced capital base as on Jan 2014 (if IPO is fully subscribed)

<sup>6</sup> The projected CAGR growth rate is on a low base.



company operates only out of its registered office in Bhaktapur, which is also the Head Office of the company.

As regards to market share, BFCL accounts for about 0.03% of deposit base and advances of Nepalese Banking industry and about 0.5% of deposit base and advances of Finance Companies as on mid-Jan-2014. BFCL reported profit after tax of NPR 0.28 million during 2012-13 over an asset base of NPR 428 million as on Jul-13 against profit after tax of NPR 4.01 million during 2011-12 over an asset base of NPR 303 million as on Jul-12.

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