

## Innovative Development Bank Limited

### ICRA Nepal assigns [ICRANP] IPO Grade 4 to the proposed Equity Share (Rights Issue) of Innovative Development Bank Limited

Facility/Instrument	Issue Size	Grading Action (October 2015)
Rights Share Issue	NPR 100 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 100 million of Innovative Development Bank Limited (hereinafter referred to as INDB). 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. INDB is proposing to come out with 66.67% rights issue of 1,000,000 numbers of equity shares of face value NPR 100/- each to be issued to the existing shareholders at par. The proposed issue is being made in order to augment the capital base to support the future growth plans of the management.

The grading is constrained by INDB’s moderate track record (started operations in November 2009), geographical concentration (spread across 3 districts) with small scale of operations (asset size of NPR. 2,151 million as of mid-Jul-15<sup>1</sup>), limited seasoning of a large part of the credit book due to high growth (credit portfolio has grown by around 94% in last two years), limited franchise (7 branches as on mid-Jul-15), lack of diversity in earning, relatively weaker borrower profile which could lead to adverse impact on the asset quality indicators going forward and stiff competition from commercial banks offering products at more competitive interest rates. The grading is also constrained by small capital base compared to revised regulatory capital framework (NPR 150 million as on Apr-15 vs NPR 500 million to be met by FY17), weak recovery profile as on mid-Sep-15 which could be further deteriorated on account of political turmoil causing elongated strike in terai region, lack of Institutional promoters and uncertain operating environment that financial institutions in Nepal are currently facing. Nonetheless the grading factors in INDB’s healthy profitability indicators maintained over last three years (PAT/ATA<sup>2</sup> of 2.36% and PAT/Networth of 18.67% during FY15), healthy mix of low cost deposits (~63% CASA<sup>3</sup> deposits in Jul-15), moderate credit and deposit concentration (~15% on top 20 account), and regulatory arbitrage available with ‘Schedule B’ Development Banks compared to ‘Schedule A’ commercial bank-in the form of lower absolute capital requirements and lower CRR/SLR<sup>4</sup> requirements. ICRA Nepal also notes the limited impact of April-2015 earthquake in the area of operations of INDB. Going forward, INDB’s ability to scale up its operations ensuring efficient utilization of existing as well as additional capital, improve its profitability profile while maintaining its assets quality indicators would have a bearing on the overall financial profile.

The credit portfolio of INDB has grown at a CAGR<sup>5</sup> of 49% during the past 3 years (albeit on a low base) however, the portfolio size still remains small at NPR 1,514 million as of Jul-15. The credit growth has been supported by INDB’s franchise of 7 branches; with major business concentration in Rupendehi

<sup>1</sup> Mid-Jul-15 data are unaudited and all the calculations are done on the basis of provisional data provided by management of INDB.

<sup>2</sup> Profit after tax/Average total assets

<sup>3</sup> Current and Saving Accounts

<sup>4</sup> Cash Reserve Ratio/ Statutory Liquidity Ratio

<sup>5</sup> Compounded annual growth rate



district. The credit portfolio as on Jul-15 was mainly composed of Overdraft/ Working capital Loans (26%), Term Loans (14%), Personal Loans (13%), Housing loan (13%), real estate (9%), Hire purchase loans (7%) and Agricultural loans among others. INDB's credit concentration remains moderate (top 20 borrowers accounting for 16.25% of total loans on Jul-15); comparable to most development banks. INDB's reported gross NPLs<sup>6</sup> (0.01% on Jul-15 and nil on July-14) are partly benefitted from low seasoning of credit book (credit portfolio has been grown by ~94% in past 2 years). However, post FY 14-15, growing loan delinquencies with weak recovery profile on account of elongated strike in terai region where INDB operates might impact its assets quality going forward. Further, portfolio vulnerability remain high vs. commercial banks due to inferior borrower profile and assessed income based product lending could lead to volatility in asset quality indicators. Although INDB's portfolio was not impacted directly by the earthquake, the exposures in unaffected geographies/segments could witness some stress due to overall moderation in economic activity as well as linkage among businesses/borrowers.

As for funding profile, though better than other new generation development banks, INDB's cost of funds (6.54% during FY15 vs industry average of 6.04%) remains comparable with peers operating in the region. INDB has a healthy proportion of low cost CASA deposits (63% as on Jul-15 as compared to industry average of 53%) along with relatively lower deposit concentration (~14% of total deposits on Jul-15 among top 20 depositors). Going forward, the ability of INDB to improve the deposit cost and maintain granularity will have a bearing on the stability of the deposit profile and overall competitive positioning.

INDB reported profit after tax (PAT) of NPR 27.29 million in FY14 (corresponding to return on net worth of 19.32% and return on assets of 1.95%) and NPR 44.95 million during FY15 (corresponding to a return on net worth of 18.67% and return on assets of 2.36%). INDB's profit was primarily supported by healthy NIMs and low provisioning expenses. Going forward, the profitability profile of the bank will depend on its ability to expand its scale of operations thereby achieving scale economies and control over its recovery profile; the same however remains a challenge given intense competition among the BFIs in the region and economic impact of elongated strike in the region.

INDB's capitalization profile remains adequate with CRAR<sup>7</sup> 14.15% on Jul-15 as against minimum regulatory requirement of 11% for class B banks; with tier I capital of 13.28%. The proposed rights issue along with the internal accruals would further increase capitalization. However, monetary policy of FY 2015-16 has announced that development banks operating up to 3 districts are required to increase their paid-up capital to NPR 500 million within FY17. INDB has a capital of NPR 150 million as of mid-Jul-15 and same is expected to increase to NPR 250 million after proposed right issues (assuming full subscription), thus the bank is likely to issue fresh capital or opt for merger to meet the regulatory minimum capital. Further, if the bank finds adequate sources to increase the capital to meet the revised regulatory norms, attaining adequate growth to ensure efficient utilization of the same would remain a key challenge for the bank.

### **Company Profile**

Innovative Development Bank Limited (INDB) is a Class B Development Bank licensed by NRB. INDB started its commercial operations in November, 2009 as a 3-district development bank licensed to operate in Rupandehi, Nawalparasi and Chitwan Districts of Nepal. Its registered office is located in Siddharthanagar, Rupandehi. The bank is promoted by 117 individual promoters from diverse backgrounds with maximum individual shareholding of 2.53% and the promoter: public shareholding ratio stood at 66:34 as on mid-July-15. Mr. Prabin Kumar Dahal is the Chief Executive Officer of the bank. The bank's shares are currently listed with Nepal stock exchange.

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<sup>6</sup> Non-performing loans

<sup>7</sup> Capital to risk adjusted assets ratio



At present, INDB has presence in all of the 3 licensed districts through 7 banking branches including head office. Being a new player, INDB share of ~0.80% in total deposit and loans of Development bank industry as on mid-July-15 remains limited. Similarly, INDB's portfolio accounted for ~0.10% of aggregate banking industry's deposit/credit portfolio. INDB reported a net profit of NPR 45 million during FY 2014-15 over an asset base of NPR 2,150 million as on mid Jul-15 as against net profit of NPR 27 million during 2013-14 over an asset base of NPR 1,655 million as on mid Jul-14. INDB's CRAR was 14.15% and gross NPLs were 0.01% as on mid-July-2015. In terms of technology platform, INDB has implemented "Pumori III" software.

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