Green Development Bank Limited

ICRA Nepal assigns [ICRANP] IPO Grade 4 to the proposed Initial Public Offering (IPO) of Green Development Bank Limited

Facility/Instrument	Issue Size	Grading Action (November 2015)
IPO (equity) Grading	NPR 45 million	[ICRANP] IPO Grade 4 (Assigned)

ICRA Nepal has assigned an "**[ICRANP] IPO Grade 4**", indicating below-average fundamentals to the proposed IPO amounting NPR 45 million of Green Development Bank Limited (GrDBL). 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. GrDBL is proposing to come out with its IPO of 450,000 numbers of equity shares of face value NPR 100/- each to be issued to general public at par. The proposed issue is being made in order to meet the regulatory minimum public shareholding in BFIs[1] and to augment the capitalisation profile for further business growth.

The grading factors in GrDBL's healthy capitallisation profile (CRAR of 17.08% as on Oct-15) and low capital adjusted credit deposit ratio (69%), providing adequate room for the bank's near term growth. However, the bank has limited franchise (two branches in two districts), leading to geographical concentration risks. The grading is also constrained by GrDBL's small scale of operations, limited track record, and weak competitive positioning (resulting from high cost of funds and stiff competition from established BFIs in the region).The grading however factors in experience of the senior management, and established position of the local promoters. ICRA also takes note of the weak financial profile of the bank, with losses reported during FY14 and FY15 (first two years of operation) and buildup of delinquencies[2] during the last few months on account of uncertain operating environment created by ongoing political turmoil in the southern plains of the country impacting the overall economy and repayment capacity of the borrowers. However, GrDBL has reported healthy asset quality; benefited by unseasoned credit book, and regulatory relaxations. The grading also takes into account GrDBL's small capital base compared to revised regulatory capital framework, and lack of Institutional promoters. Nonetheless, ICRA also considers the 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[3] requirements. Going forward, GrDBL's ability to scale up its operations ensuring efficient utilization of capital, improve its deposits and profitability profile, and manage the delinquency levels would have a bearing on the overall financial profile.

GrDBL commenced operations in Aug-2013 with the credit portfolio growing to NPR 219 million as of mid-Oct-2015. GrDBL is allowed to operate in limited geographical area (being a three district level development bank), where it faces stiff competition from commercial banks/established regional players with wider product suits and finer lending rates. The bank's competitive positioning is also advesly impacted due to high cost of funds. Although GrDBL's promoters' reputation/knowledge of the local market and focussed approach is likely to support credit growth over short term; long term credit growth of GrDBL will depend on the ability of the bank to improve its franchise and expand geographically. The credit portfolio as on Oct-15 was mainly composed of personal overdraft (~33%), business overdraft (~27%), hire purchase loans (~18%), personal term loans (~11%), gold loans (~6%) among others.

[1] Banks and financial institutions
[2] Delinquent loans (for less than 90 days) on mid-Oct-15 accounted for ~6% of total loans vs. ~2% in mid-July-15.
[3] Cash Reserve Ratio/ Statutory Liquidity Ratio

GrDBL's reported asset quality remains good so far; benefitted from limited seasoning of the credit book, sizeable revolving loan portfolio (~59% on mid-Oct-15) and recent regulatory relaxation[4]. However high credit concentration among top borrowers (top 20 borrowers accounting for ~43% of total loans) and relatively inferior borrower profile remains a challenge for the incremental asset quality. During FY16, GrDBL has witnessed weak recoveries on account of elongated strikes in Terai region, resulting in build-up of delinquencies. The bank reported delinquencies of ~6% as on mid Oct-15 (~2% as on mid Jul-15), which could impact GrDBL's asset quality profile going forward. The regulator has provided temporary relaxations in NPL recognition norms factoring in the strike; however the same is expected to defer the actual impact on asset quality towards the end of the year, should the current scenario extend for a longer period of time. Benefitted by this relaxation, bank has reported Nil NPLs[5] as on Oct-15 (NPLs would have been 0.69% in the absence of the relaxations). Although GrDBL'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. Going forward, Management's ability to maintain the asset quality indicators along with targeted portfolio growth would be critical for improvement in its profitability indicators.

As for funding profile, GrDBL's deposit mix remains inferior with ~25% CASA[6] deposits on mid-Oct-15 vis-à-vis industry average of ~53%; translating into higher cost of funds (7.15% for FY15 vs. industry average of 6.20%) and hence impacting the bank's competitive positioning. Currently the bank's reliance on corporate deposits is high leading to low granularity (top 20 depositors accounting for ~50% of total deposits on July-15); raising concerns about the stability of deposits profile. Adequate capitalisation level and low CD ratio (~17% & 69% respectively as of Oct-15), provides adequate room for credit growth provided the ongoing turmoil resolves soon and economic activity picks up. Going forward, the ability of GrDBL to improve the deposit mix, deposit cost and granularity will have a bearing on the stability of the deposit profile and overall competitive positioning.

GrDBL's profitability profile remains weak, with the bank reporting losses in first two years of operations ending FY15. Moderate NIMs (3.05% in FY15) and high operating expense ratio (due to limited scale) has impacted the financial profile of GrDBL; despite lower credit provisioning expense so far. GrDBL reported net losses of NPR 6.73 million and NPR 2.69 million during FY15 and FY14 respectively. The bank however reported net profit of NPR 0.07 million during Q1FY16, benefitted by low provisioning allowed by the regulator on watch-list accounts (2% instead of 2.5%) along with forbearance in NPL recognition norms. Incrementally, GrDBL's earnings profile will depend on the ability of the bank to improve its scale of operations and control its cost of funds thereby improving the NIMs and maintain the quality of its credit portfolio. However, it remains a challenge given the intense competition among the BFIs in the region and economic impact of elongated strikes on the repayment ability of borrowers.

GrDBL's capitalization profile remains comfortable with CRAR[7] of 17.08% on mid-Oct-15 vs regulatory minimum of 11% for class B banks; which is likely to improve further post IPO. This is expected to support the bank's growth in the near term at least and has been factored in by ICRA Nepal while assigning the grading. However, the central bank through monetary policy of FY 2015-16, has announced that development banks operating up to three districts are required to increase their paid-up capital to NPR 500 million within FY17 as compared to GrDBL's post IPO capital of NPR 100 million (assuming full subscription). The bank is likely to issue fresh capital or opt for merger to meet the regulatory minimum capital. Going forward, successful execution of merger (if opted) or attaining adequate organic growth to

[4] Nil NPL reported in mid-Oct-15; in absence of regulatory relaxation the NPLs would have been 0.69%
[5] Non-performing loans
[6] Current and savings deposit Account
[7] Capital to Risk weighted Assets Ratio.

ensure efficient utilization of fresh capital (in case of equity injection) thereby preventing dilution of returns; would remainkey challenge for the bank.

Company Profile

Incorporated in November 2012, Green Development Bank Limited (GrDBL) started its commercial operations from August 2013, as a three district level regional development bank. Its head office is located at Baglung. GrDBL is promoted by 57 individual promoters, with maximum individual shareholding of 27% of total capital before IPO (which will be diluted to 15% post IPO). The current 100% promoter holding in GrDBL will be diluted to 55% post IPO; remainder being allotted to general public. Mr. Prakash Kumar Shrestha is the CEO of the bank. The bank's equity share would be listed in Nepal stock exchange post IPO.

GrDBL has presence in two out of three licensed districts of Nepal through its two branches. GrDBL has market share of about 0.11% in terms of deposits and advances of Development bank industry as on Jul-15 and about 0.01% in terms of deposits and advances of Nepalese banking industry on same date. GrDBL reported net loss of NPR 2.69 million during 2014-15 (first full year of operations) over an asset base of NPR 299 million as on mid Jul-15 as against net loss of NPR 6.59 million during 2013-14 over an asset base of NPR 127 million as on mid Jul-14. During Q1FY15-16, GrDBL reported modest net profit of NPR 0.07 million. GrDBL's CRAR was 17.08% and gross NPLs were Nil as on mid-Oct-2015. In terms of technology platform, GrDBL has implemented Pumori IV System.

November 2015

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