Alpine Development Bank Limited

ICRA Nepal assigns [ICRANP] IPO Grade 5 to the proposed Equity Shares (Rights Issue) of Alpine Development Bank Limited

Facility/Instrument	Issue Size	Grading Action (January 2016)
Rights Share Issue	NPR 82 Million	[ICRANP] IPO Grade 5 (Assigned)

ICRA Nepal has assigned an "**[ICRANP] IPO Grade 5**", indicating poor fundamentals to the proposed rights issue amounting to NPR 82 million of Alpine Development Bank Limited (ALDBL). 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. ALDBL is proposing to come out with 3:2.085 rights issue of 820,000 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 to augment the capital base and support the bank's growth plans.

The grading is constrained by ALDBL's inferior asset quality (reported Gross NPLs[1] were 3.53%[2] on mid-Oct-15[3]) which could face further pressures on account of portfolio concentration in earthquake affected areas[4] and low recoveries leading to higher delinquencies[5] across loan products during the last 4-6 months due to uncertain operating environment created by elongated political turmoil and strike. The grading also factors in the weak internal control, systems and processes at the bank leading to limited monitoring of the portfolio. The grading is also constrained by bank's relatively small scale of operations (asset base of NPR 1,433 million as on mid Oct-15) despite moderate track record (operating since October 2007) and adequate franchise[6]. ICRA Nepal takes note of the impact of weakening asset quality on ALDBL's profitability profile with PAT/Net worth deteriorating to 9.70% during Q1FY16 (21.19% during FY15[7]). The profitability profile would report further deterioration, considering higher provisions required on some NPLs which are reported as performing loans by ALDBL, due to system constraints. If the asset quality improves going forward, the bank would benefit from the healthy CASA[8] proportion (~62% as on mid-Oct-15 against industry average of ~54%), and competitive cost of funds (5.70% as of mid-Oct-15). ALDBL's absolute capital base is significantly lower than the revised regulatory capital framework which has also been factored while assigning the grading. Going forward, strengthening of the organization structure, induction of experienced manpower at the senior level, improvement of systems and processes, control fresh slippages while improving recovery profile and generate adequate returns on elevated capital level amidst the challenging scenario currently prevailing, would remain key challenges for ALDBL.

Despite competitive cost of funds and adequate franchise, ALDBL's credit growth remained lower than development banking industry average (CAGR of ~21% for portfolio over past 5 years vs. ~24% growth in industry). Hence, ALDBL's credit portfolio and assets base remains relatively smaller compared to similar aged peers. However, on the back of higher growth rate of ~35% during FY15 (vs. ~20% for industry), the bank reported a credit portfolio of NPR 999 million as of mid Oct-15 representing 0.50% share in the development bank industry credit. ALDBL's portfolio primarily comprises personal term loans (~27%),

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[1] Non-performing loans

[2] The reported NPLs does not include NPL in revolving loan due to interest overdue. Further, reported NPLs are benefited by regulatory relaxation provided by NRB; disregarding the regulatory forbearance on NPL recognition norms, NPLs were 4.43% as of Mid-Oct-15.

[3] Mid-Oct-15 data are unaudited.

[4] ~81% portfolio as of mid-Oct-15 in high quake affected Makawanpur and Kavrepalanchowk districts resulting in loss homes of borrowers representing ~9% of portfolio.

[5] Delinquent accounts (including NPLs) were ~40% of loans as of mid-Oct-15 vs. ~24% in mid-Jul-15.

[6] 14 branches and 2 extension counters

[7] Mid-Jul-15 data are unaudited.

[8] Current and Savings Accounts

business overdraft (~17%), business term loans (~13%), hire purchase loan (~12%), housing loan (~10%), agriculture overdraft (~9%), personal overdraft (~5%), deprived sector loans (~8%) and ~4% among others. ICRA Nepal takes note of the bank's fairly diversified book (~7% among top 20 borrowers on Oct-15) and high proportion of loans with scheduled repayments (~69% portfolio as on Oct-15). Going forward, attaining adequate growth within the limited geographical region would remain a challenge.

In the past, ALDBL has generally reported weaker asset quality compared to peers and industry in general. Amidst weak recoveries and spike in delinquencies on account of elongated strikes in terai region, reported gross NPLs deteriorated from 3.12% as on mid Jul-15 to 3.53% as of mid-Oct-15 (against industry average NPLs of 2.98% on same date). Reported NPLs as on mid Oct-15 were also benefitted by regulatory forbearance on NPL recognition norms, disregarding which NPLs would have been higher at 4.43%. Further, the reported numbers do not include revolving loan where interest is overdue for more than three months as NPLs, due to limited system capabilities. With revolving loans accounting for ~31% of total loan book as on mid Oct-15, the reported NPLs do not capture the true asset quality position of ALDBL. This also results in the bank reporting better profitability due to lower provisioning on such accounts, not currently captured as NPLs. The bank's asset quality could report further stress going forward, as witnessed by increase in delinquent loans (including NPLs) to ~40% of total loans (as on mid-Oct-15) vs. ~24% on mid-July-15. Further, ~9% of ALDBL's portfolio was also impacted on account of damages to borrower's house during the earthquake (Apr-May '15). The temporary relaxations in NPL recognition norms provided by the regulator factoring in the earthquake and strike 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.

ALDBL's funding profile remains healthy with proportion of low cost CASA[9] deposits at ~62% as on mid-Oct-15 better than industry average of ~54%. Benefitted by this, bank's cost of funds (5.70% as of mid-Oct-15) remains better among peers and compared to industry average cost of funds at ~6%, helping bank maintain adequate net interest margins. However, the bank has not been able to deploy its deposits efficiently as reflected by a low CD ratio[10] of 71.39% as on mid Oct-15, affecting the overall competitive position. The bank's deposit base remains fairly concentrated (~16% of total deposits on mid-Oct-15 among top 20 depositors). Going forward, bank's ability to maintain the deposits profile and further improve the depositor base will have a strong bearing on its overall competitive positioning.

Owing to healthy yields and competitive cost of funds, bank has reported largely stable NIMs over last three years (6.17% during FY15 compared to 6.21% during FY13), supporting the profitability profile. Amidst the challenging backdrop during Q1FY16 (increasing delinquencies and low demand for fresh credit), bank reported PAT of NPR 4.30 million (corresponding to a return on net worth of 9.70% and return on assets of 1.23%). The reported financials during Q1FY16 were significantly benefitted by lower provisioning due to large number of accounts not reported as NPLs and relaxations provided by regulator in credit provisioning and NPL recognition norms. Going forward, the profitability profile of the bank will largely depend on its ability to manage delinquencies; the same however remains a challenge given the expected impact of earthquake and elongated strikes on the repayment ability of borrowers.

Capitalization profile of ALDBL remains healthy, with CRAR[11] 16.72% on mid Oct-15 as against minimum regulatory requirement of 11% for class B banks. The proposed issue along with internal accruals would help bank maintain adequate capitalization over the medium term. However, monetary policy of FY 2015-16 requires three district level development banks to increase their paid-up capital to NPR 500 million by FY17. ALDBL has a capital of NPR 118 million as of mid-Oct-15; which is expected to increase to NPR 200 million after proposed issue (assuming full subscription). The management is in initial merger talks with other development banks post the cancellation of merger with Mahalaxmi Finance. Going forward, successful execution of merger (if opted) or attaining adequate organic growth to ensure efficient utilization of fresh capital (in case of equity raising) thereby preventing dilution of returns; would remain key challenge for the bank.

9 Current and Saving accounts
10 Adjusted with net worth
11 Capital to risk weighted assets ratio

Company Profile

Incorporated in July 2007, Alpine Development Bank Ltd (ALDBL) started its commercial operation in October 2007, as a three district level regional development bank. Its Corporate Office is located at Hetauda-4, Makawanpur. ALDBL is promoted by a group of individual promoters from diverse backgrounds, with maximum shareholding by one individual at ~6.5% of total capital (as on mid-Oct 2015). The bank has six member board having limited banking experience and no independent/professional director. Share capital of the company is distributed among promoter & public in the ratio of 67:33, with the shares listed on Nepal Stock Exchange. Mr. Sudarshan Prasad Adhikari is the Chief Executive Officer of the bank.

ALDBL has presence in Makwanpur, Kavrepalanchowk and Chitwan districts, through its 14 branches, two extension counters and one ATM. The bank has market share of about 0.48% in terms of deposit base and 0.50% in terms of credit portfolio of Development Banks as on mid Oct-15. ALDBL reported a net profit of NPR 36 million during 2014-15 over an asset base of NPR 1,369 million as on mid Jul-15 as against net profit of NPR 23 million during 2013-14 over an asset base of NPR 1,041 million as on mid Jul-14. During 3MFY15-16, bank reported net profit of NPR 4 million over an asset base of NPR 1,433 million. Bank's CRAR was 16.72 % and reported gross NPLs were 3.53% as on mid-Oct-2015. In terms of technology platform, ALDBL has implemented Pumori III System with majority of the branches operating on standalone MIS and hence yet to be connected on a real time basis with the head office/ other branches.

January 2016

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