

## Cosmos Development Bank Limited

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

Facility/Instrument	Issue Size	Grading Action (March 2016)
Rights Share Issue	NPR 50.3125 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 to NPR 50.31 million of Cosmos Development Bank Limited (Cosmos). 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. Cosmos is proposing to come out with 1:1 rights issue of 503,125 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 factors in Cosmos’s healthy proportion of CASA<sup>1</sup> deposit (~66% as on mid-Jan-16<sup>2</sup> against Development Bank industry average of ~53% on same date) and healthy portfolio growth (CAGR<sup>3</sup> of ~72% over past 4.5 years ending mid-Jan-16 although on a small base vs. ~19% for development bank industry). ICRA Nepal also takes into account the bank’s healthy financial profile (RoE<sup>4</sup> of 19.6% during H1FY16), despite increase in credit cost. Support from local promoters, adequate capitalization profile (CRAR<sup>5</sup> of 12.61% as on mid-Jan-16<sup>6</sup>) and expertise of management team in the local market is expected to provide Cosmos with adequate growth opportunities in the near term. However, the bank’s limited franchise (four branches and one extension counters in Gorkha district as on mid Jan-16) could limit its growth going forward.

The grading is however constrained by bank’s limited track record (operating since Nov-2010), high geographical concentration risks (operations limited to one district only), small scale of operations (asset base of NPR 577 million as of Jan-16), and weak competitive positioning (resulting from high cost of funds and stiff competition from established BFIs/commercial banks in the region). ICRA Nepal also takes note of spike in delinquencies<sup>7</sup> during the last few months on account of elongated political turmoil/strikes<sup>8</sup> impacting the overall economy and repayment capacity of the borrowers, leading to higher NPLs (gross NPLs of 0.76% as on mid Jan-16 vs. 0.29% as on mid Oct-15). Although the blockade ended recently, the asset quality of Cosmos could be further impacted going forward. While assigning the grading, ICRA Nepal has also factored in Cosmos’s capital base being much lower to revised regulatory capital framework to be complied by FY17, lack of Institutional promoters, and relatively weaker borrower profile compared to commercial banks.

Nonetheless, the grading also factors in 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>9</sup> requirements. Going forward, Cosmos’s ability to scale up its operations ensuring efficient utilization of capital, maintain its profitability profile and manage delinquencies in its portfolio would have a bearing on the overall financial profile.

<sup>1</sup> Current and Savings Accounts

<sup>2</sup> Mid-Jan-16 data are unaudited and all calculations are based on data provided by management.

<sup>3</sup> Compounded Annual Growth Rate

<sup>4</sup> Return on Equity

<sup>5</sup> Capital to Risk-weighted Assets Ratio

<sup>6</sup> Mid-Jan-16 data are unaudited

<sup>7</sup> Delinquent loans on mid-Jan-16 accounted for 12.40% of total loans vs. 6.33% in mid-July-15.

<sup>8</sup> Nepalese economy faced ~5 months long custom blockade and strikes in terai region in FY16 that recently ended.

<sup>9</sup> Cash Reserve Ratio/ Statutory Liquidity Ratio



Cosmos commenced operations in Nov-2010 with the credit portfolio growing to NPR 437 million as of mid Jan-2016. The credit portfolio of Cosmos has grown at a CAGR of ~72% over past 4.5 years ending mid-Jan-16 vs. 19% growth in development bank industry, albeit on a small base. The credit portfolio mix remains healthy with ~75% schedule loan as on Jan-16; primarily comprising business loans (26%), personal loans (26%), hire purchase loans (22%), gold loans (9%), agriculture loans (8%), housing loans (7%), among others. Cosmos's credit concentration remains moderate (top 20 borrower groups accounting for ~13% of total loans on Jan-16) and fares better to most of the peers. Going forward, scalability of business could be a challenge given the promoter's knowledge/ reputation limited to local market.

Benefitted mainly by limited seasoning of credit book, the bank reported gross NPLs of 0.01% on Jul-15 (vs. 3.58% for development bank industry). However, post July-15, Cosmos has witnessed some stress in recoveries on account of elongated strikes, resulting in an increase in the delinquency levels and NPLs (gross NPLs of 0.76% as on mid Jan-16). Delinquent loans on mid Jan-16 accounted for ~12% of total loans vs. ~6% on mid-July-15, with higher delinquencies in the scheduled loan segment (~15% loans are delinquent in this segment accounting for ~85% of overall delinquencies). Higher delinquencies, coupled with adverse impact on repayment capacity of borrowers could also impact bank's asset quality profile going forward. Overall, Cosmos's portfolio vulnerability remain high vs. commercial banks due to inferior borrower profile, limited capability for borrower's credit assessment system and assessed income based lending, which could lead to volatility in asset quality indicators.

As for funding profile, Cosmos has a healthy proportion of low cost CASA deposits (~66% as on Jan-16) as compared 53% for the development bank industry average. However, the cost of funds at 6.71% for H1FY16 remains high among peers (development bank industry average of 5.46%) due to higher rate offered across all products. Additionally, deposits remain moderately concentrated (top 20 depositors comprise ~20% of total deposits on Jan-16). Bank's ability to manage its deposit cost would have a strong bearing on overall competitive positioning in the future.

Cosmos reported moderate profit after tax (PAT) of ~NPR 9 million during FY15 (corresponding to a healthy return on net worth of 17.21% and return on assets of 2.21%). Cosmos's profitability was primarily supported by healthy NIMs<sup>10</sup> (6.15% in FY15, benefitted by unregulated spread rate), healthy fee based income (~2% of ATA) and low provisioning expenses so far. Despite the challenging backdrop during H1FY16, bank reported PAT of ~NPR 6 million (corresponding to a return on net worth of 19.57% and return on assets of ~2.17%) primarily supported by low operating expenses. Interest rate spread remains deregulated so far for development banks and thus any regulatory restrictions on interest rate spread for the sector would have a strong bearing upon future profitability of Cosmos. Cosmos has also witnessed an increase in credit cost (0.59% during H1FY16 vs. 0.30% during FY15), in line with the pressure witnessed in the asset quality. Going forward, the profitability profile of the bank will be dependent on its ability to manage asset quality and hence credit costs; the same however remains a challenge given the expected impact of elongated strikes on the repayment ability of borrowers.

Cosmos's CRAR stood at 12.61% as of mid-Jan-16 (13.20% on mid Jul-15) as against minimum regulatory requirement of 11% for class B banks; with tier I capital of 12.34%. The proposed rights issue along with the internal accruals would help bank maintain adequate capitalization over the medium term. However, monetary policy of FY 2015-16 has announced that 1-district level Development banks are required to increase their paid-up capital to NPR 500 million within FY17. Cosmos has a capital of ~NPR 50.31 million as of mid-Jan-16 and the same is expected to increase to ~NPR 101 million after proposed right issues (assuming full subscription). Bank is planning further rights offering and is also exploring merger options to meet the revised regulatory capital requirements. Finding adequate sources to meet the elevated regulatory requirement would remain a key challenge for the bank.

### **Company Profile**

Cosmos Development Bank Limited started its commercial operation from November 2010, as a one district level development bank. Its Corporate Office is located at Gorkha Municipality-6, Gorkha. Cosmos

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<sup>10</sup> Net Interest Margins as a percentage of Average Total Assets (ATA)



is promoted by group of individual promoters from diverse backgrounds, with maximum shareholding by one individual at 5.03% of total capital (as on mid-Oct 2015). Share capital of the company is distributed among promoter & public in the ratio of 60:40. The bank's equity shares are listed on the Nepal Stock Exchange. Mr. Hridaya Raj Ghimire is the Chief Executive Officer of the bank.

Cosmos has a network of four branches and one extension counter in its working area i.e. Gorkha District. Cosmos has market share of about 0.21% in terms of deposit base and 0.22% in terms of credit portfolio of Development Banks as on mid Jan-16. The bank reported a net profit of NPR 9.40 million during 2014-15 over an asset base of NPR 515 million as on mid Jul-15 as against net profit of NPR 6.73 million during 2013-14 over an asset base of NPR 336 million as on mid Jul-14. As of H1FY16, bank has reported net profit of NPR 5.92 million over an asset base of NPR 577 million. Cosmos's CRAR was 12.61% and gross NPLs were 0.76% as on mid-Jan-2016. In terms of technology platform, Cosmos has implemented Pumori IV System.

**March 2016**

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