Sahara Bikas Bank Limited

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

Facility/Instrument	Issue Size	Grading Action (January 2018)
Rights Share Issue	NPR 182.49 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 182.49 million of Sahara Bikas Bank Limited (SHBL). ICRA Nepal assigns IPO/Rights issue 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. SHBL is proposing to come out with 250% rights issue of 1,824,870 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 towards meeting the elevated regulatory capital requirements.

The grading is mainly constrained by SHBL's weak overall control framework and inferior borrower profile which reflects in high delinquencies ~36% as of mid-Oct-17[1] (including Non-Performing loans-NPLs of ~6%) despite 99% of borrowers having revolving loan. While assigning the grading, ICRA Nepal also takes note of the high portfolio vulnerability due to weak credit appraisal practices and very high proportion of personal loan (~62% as of Oct-17) with assessed income based appraisal. The grading is also constrained by SHBL's limited track record in banking (operating from October 2010) and the small scale of operations (asset base of NPR 581 million as of mid-Oct-17) when compared to similar aged/scaled peers. Further, attaining requisite growth to serve the existing as well as large incremental capital being raised would remain a challenge given the limited geography in which SHBL is licensed to operate. Although SHBL has reported healthy profitability over the years, sustainability of same remains the concern given the fact that regulator has instructed to refund various fees and penalties[2] with significant amount charged by bank to customers against regulations. Despite of healthy deposit profile with CASA[3] mix of ~74% (vs. ~42% for industry as of Jul-17), cost of funds of SHBL remains comparable to industry (5.87% for FY17 vs. 5.91%) mainly due to high rate offered in saving products. The grading is further constrained by lack of diversity in earnings, lack of Institutional promoters, stiff competition with commercial banks and larger development banks offering products at finer lending rates and uncertain operating environment that financial institutions in Nepal are currently facing.

SHBL's pace of credit growth has remained high, but over small base (CAGR of ~34% over last four years ending mid-Jul-17) and hence portfolio size still remains much smaller (NPR 375 million as of mid-Oct-17). SHBL's credit portfolio primarily composed of personal loans (62%), business loans (36%), hire purchase loans (1%) and loan against fixed deposit (1%). Since ~99% of loans are revolving in nature, repayment capabilities of the borrower have not been fully tested so far. Bank's inferior borrower profile has been compensated to an extent by its lending yields at ~18% for FY17 remaining much higher among peers. Bank's credit portfolio concentration however remains moderate with ~13% of portfolio among top 20 borrowers as of mid-Oct-17. Being a one-district level development bank, SHBL is allowed to operate in limited geographical area and at the same time it faces competition from commercial banks and larger development banks with wider product suits and finer lending rates. Over longer term, scalability of business would remain a challenge given promoters' knowledge/reputation limited to local market.

Bank's asset quality witnessed severe stress in Oct-17 with delinquencies increasing from ~16% as of mid-Jul-17 (~17% on Jul-16) to ~36% as of mid-Oct-17 while reported NPLs increased from 1.65% to 5.64% over same period. Provisioning cover for these NPLs remain low at ~25% and hence bank could witness increased credit cost over medium term. Impact on solvency (Net NPA/net-worth) of SHBL also remains weak at ~14% as of mid-Oct-17. Overall, SHBL's portfolio vulnerability remain high vs. commercial banks due to inferior borrower profile, weak capability for borrower's credit assessment system and assessed income based lending, which could lead to volatility in asset quality indicators.

[1] Mid-Oct-17 data are unaudited
[2] Bank has charged high valuation fees, loan application form fees, penal interest higher than regulator celling etc.
[3] Current and Savings Accounts

Management's ability to improve asset quality indicators would be critical for improvement in its profitability indicators.

Despite high delinquencies in interim reporting periods, SHBL has been able to manage the same to an extent towards year end reporting periods. This coupled with high penal interest charged to delinquent borrowers have benefitted bank's profitability profile, the sustainability of which can be a challenge given NRB's action for charging such high penal rates. SHBL's profitability indicators hence remained better to industry with average RoNW[4] of ~24% in last five years vs. ~14% for industry. The same was supported by higher NIMs[5] among peers (5.95% for FY17), high penal interest and other fees base income which has been booked against the regulations. Since, profitability of the bank is heavily reliance on other fees based income (fees based income 2.1% of ATA against profit of 2.7% of ATA for FY 17), there could be large pressure in retained earnings as well as future profitability given the regulator instructed to refund the fees charged against the regulations. Also stress in NIMs (4.23%) in Q1FY18 resulted in the bank reporting significant losses as reflected by negative RoNW of ~13% and negative return on assets of 2.34% compared to positive indicators for FY2017 at ~22% and 2.72% respectively.

SHBL's CRAR[6] was 24.67% (tier I capital of 23.45%) as of mid-Oct-2017, higher than the regulatory minimum of 11%. The proposed issue would significantly enhance the capitalisation levels over the medium term. Against revised capital requirement of NPR 500 million, SHBL's capital would increase to NPR 272 million assuming full subscriptions of upcoming rights. Though the timeline for capital enhancement by one-district level development banks has recently been enhanced by two years to mid-Jan-2020, SHBL has already entered into MOU with Deva Bikas Bank on 9th June 2017 for being acquired by the latter (Due diligence going on; share swap yet to be finalised). Being a much smaller counterpart in the acquisition, return prospects for shareholders of SHBL going forward, would depend upon business appraoch of the acquirer.

Company Profile

Sahara Bikas Bank Limited (SHBL) is a one district level development bank operating since 27th October 2010. The corporate office of the bank is located at Malangawa, Sarlahi. The bank is promoted by wide range of promoters with maximum shareholding by one promoter at 10.50% of total capital (as on mid-Oct 2017). Share capital of the company is distributed among promoter & public in the ratio of 51:49. The shares of the company are listed on the Nepal Stock Exchange. Mr. Ajit Kumar Jha is the Acting Chief Executive Officer of the bank.

SHBL has presence in its sole operating district (Sarlahi) through four branches and one extension counter as of mid-Oct 2017. SHBL has market share of 0.18% in terms of deposit base and 0.17% in terms of credit portfolio of development banks as on mid Oct-17. SHBL reported net profit of ~NPR 16 million during FY2017 over an asset base of NPR 566 million as of mid-Jul-17 as against net profit of ~NPR 7 million during FY2016 over an asset base of NPR 583 million as of mid Jul-16. For Q1FY2018, the bank has reported net loss of ~NPR 3 million over an asset base of NPR 581 million as of mid-Oct-17. The capitalisation profile (CRAR) of SHBL was at 24.67% and gross NPLs was at 5.64% as on mid-Oct-2017. In terms of technology platform, SHBL has implemented Pumori-III system throughout all its branches which however remains to be centralised.

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[4] Return on Net Worth

[5] Net Interest Margins as a percentage of Average Total Assets

[6] Capital to Risk Adjusted Assets Ratio