

Sana Kisan Bikas Bank Limited

ICRA Nepal assigns [ICRANP] IPO Grade 4+ to the proposed Equity Shares (Rights Issue) of Sana Kisan Bikas Bank Limited

Facility/Instrument	Amount (NPR million)	Grading Action (August 2015)
Rights Share Issue	115.34	[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 115.34 million of Sana Kisan Bikas Bank Limited (SKBBL). 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. SKBBL is proposing to come out with rights issue offering of 1,153,412 number of equity shares of face value NPR 100 each to be issued to the existing shareholders at par.

The grading is constrained by lack of post-earthquake recovery trend at Small Farmer’s Cooperative Ltd. (SFCL); entities who avail of micro finance loans from SKBBL, higher portfolio vulnerability for SKBBL due to weak borrower profile and unsecured lending, high credit concentration (top-20 borrowers accounting for 21% of total loans), lack of diversity in earnings, lack of centralized credit bureau in MFI sector, limitation in SKBBL’s ability to control and monitor the exposures in absence of adequate management information system and general lack of transparency and regulatory supervision over Co-operatives forming the franchise network of SKBBL.

Moreover, ICRA Nepal expects moderate level of stress on SKBBL’s asset quality and profitability profile over next 2-3 years due to damage caused by the earthquake in April 2015 and aftershocks; albeit relatively lower impact is expected on future business growth. Although, the exact quantum of the damage is not known at present, the impact is likely to be limited. Nonetheless, the grading factors in SKBBL being a prominent microfinance (MFI) player, long track record in MFI activities in Nepal (operating since 2001), presence of institutional promoters (31% holding by 3 commercial banks¹), good franchise network comprising of partner organisations - Small Farmers Cooperatives Limited (SFCLs), fair profitability (PAT/ATA² ~2% and PAT/Net worth ~14.5% in past 2 years ending FY14), good assets quality so far (Gross NPA of 0.18% on April-15³ and 0.11% on July-14), sound management team and potential for growth for MFIs in Nepal given large below poverty line population. The grading is also constrained by unstable political conditions and uncertain operating environment that the financial institutions in Nepal are currently facing.

As for impact of Earthquake on operations, SKBBL’s branches in the affected geographies accounted for ~14% of credit portfolio. ICRA Nepal has also noted that till FY15, earthquake has not caused significant stress on SKBBL’s assets quality with recovery rate remaining healthy (>99%). At the same time, the liquidity remains supported by the mandatory deprived sector lending provisions. Furthermore, recent activity in the stock market suggests that banks’ ability to raise capital to absorb damages caused by earthquake is not significantly deterred. However, being a wholesale lender, SKBBL’s transactions are limited to SFCLs, whose standalone financial resource⁴ could mask short term impact of earthquake on SKBBL’s assets quality. The banks’ ability to raise planned capital in a timely manner would have critical bearing on its ability to absorb damages arising out of earthquake and maintain comfortable solvency profile.

¹ Agriculture Development Bank Nepal Limited-22%, Nepal Bank Limited-6% and Nabil Bank Limited 3%

² Profit after tax/ Average total assets

³ Mid-Apr-15 data are unaudited and all the calculations on that date are based on data provided by management of SKBBL.

⁴ Equity and reserves, member’s deposits, etc.

SKBBL's credit portfolio has grown at a high rate of CAGR ~45% in past 3-4 years ending April-15, albeit on a low base. The growth was supported mainly by the widening of franchise network through growth in the number of partner organizations (from 316 SFCLs in Jan-13⁵ to 489 on April-15) and expansion in government funded livestock loan program.

In its capacity as a wholesale MFI lender, SKBBL utilizes the network of agriculture cooperatives (SFCLs) - separate legal entities (which SKBBL helps create⁶), in order to reach to the targeted population. SKBBL's credit portfolio stood at NPR 7,346 million on April-15 and comprised of General loans (74%), Livestock loan (25%) and Renewable Energy loans (1%). SKBBL's Livestock loan portfolio, as opposed to the other portfolio, is funded by subsidized loan from Nepal Government. SKBBL's assets quality indicators remains good with Gross NPL of 0.18% on April-15 and 0.11% on July-14; although the portfolio vulnerability remains high due to marginal profile of borrowers and unsecured MFI lending. At the same time, almost all partner organizations are Co-operative societies- an industry that is subjected to limited regulatory control and supervision; thereby posing risk to the incremental assets quality of SKBBL. At the same time, SKBBL's ability to control and monitor its growing portfolio remains a concern given lack of centralized management information system with SKBBL and inherent problems of the its partners in cooperative industry. However, SKBBL's focused approach towards partner cooperatives, long term association with these institutions and gradually lowering of concentration risk among the top borrowers provides some comfort. Going forward, SKBBL's ability to maintain its assets quality profile over enhanced scale of operations will have a bearing on its overall profitability profile.

SKBBL has a healthy resource profile composed of subsidized special purpose government loan in addition to low cost borrowings from Banks and Financial Institutions aided by deprived sector regulations⁷. SKBBL's total external borrowings as on April-15 stood at NPR 7,103 million, with ~37% of it coming from Nepal Government. The average cost of external borrowings for SKBBL remains low at 3.47% for FY14 and is declining in recent period owing to excess liquidity in the financial system. Although the recent regulatory changes have been favouring⁸ deprived sector lending, any untoward change in the regulations is likely to affect the funding profile of SKBBL; however the institutional promoters which include Banks and Financial Institutions provides some comfort regarding the funding profile under adverse conditions.

The profitability profile of SKBBL has remained fair in past 3 years ending FY14 with average PAT/ATA of ~1.95% and PAT/Net worth of 14.5%. The benefit of high credit growth on the profitability was offset by pressure on NIMs from sharp decline in yield on advances (decline of ~250 bps to reach 9.17% in FY14); deflating the lending spreads by ~100 bps to 4.20% in FY14. However, the NIMs were supported by growth in the proportion of loans from 66% of total assets on July-12 to 80% of total assets on July-14. At the same time, lower operating expense ratio (past 3 years average of 1.24% of ATA) and lower credit provisioning expense (past 3 years average of 0.14% of ATA) has aided the profitability profile. Going forward, SKBBL is likely to maintain the profit levels aided by steady NIMs and operational efficiencies brought about by increasing scale of operations. However, SKBBL's ability to maintain the assets quality indicators amid existing portfolio vulnerability and increased business size will remain a key parameter for future profitability.

As on April-15, CRAR of SKBBL stood adequate at 10.15% against the regulatory minimum level of 8%. The gearing level of SKBBL (7.25 times on April-15) remains low despite relaxed capital adequacy norms for MFI institutions. SKBBL is coming out with the rights issue in order to support the future growth plans. Moreover, the rate of internal capital generation remains healthy and is also likely to support the expansion plans. SKBBL's ability to raise planned capital in a timely manner would have

⁵ During the time of IPO of SKBBL

⁶ through a process called "replication"; the process being funded by Nepal Government's grant.

⁷ NRB regulation making it mandatory for BFIs to allocate 4-5% of total loans outstanding towards deprived sector.

⁸ Monetary policy for 2015-16 has provided for 50bps increase in mandatory deprived sector lending.

critical bearing on its ability to absorb damages arising out of earthquake and maintain comfortable solvency profile. Probable deterioration in profit levels over next 2-3 years following the earthquake remains a challenge in internal capital generation. Over the long run, the ability of the bank to raise capital from existing promoters or external investors will have a strong bearing on SKBBL's capitalisation profile. As per ICRA estimates, current level of capital⁹ is likely to support the CAGR 20% growth plans of the management over next 2 years; maintaining overall capitalization in the range of around 9-10% with solvency indicators¹⁰ expected to remain within 6% level.

Company Profile

SKBBL was established in 2001 as an umbrella organization for Small Farmers Cooperatives Ltd. (SFCLs), created as a part of Small Farmer's Development Program initiated under the leadership of Agriculture Development Bank in 1975. SKBBL is involved in wholesale MFI lending to SFCLs or other cooperatives in absence of SFCLs. SKBBL's major promoters include 231 Small Farmers Agricultural Cooperatives (39%), Agriculture Development Bank Nepal (ADB) 22%, Nepal Bank Limited (6%) and Nabil Bank Limited (3%); with remaining 30% share floated to general public through the IPO in 2013¹¹. Mr. Jalan Sharma is the chief executive officer of SKBBL.

SKBBL has monetary and technical support from Nepal Government as well as multilateral donors towards implementation of various MFI related initiatives of the government. During FY14, SKBBL reported a net profit of NPR 114 million on an asset base of NPR 6,607 million on mid-July-14 as against a profit of NPR 86 million on an asset base of NPR 4,894 million on mid-July-13. During 9MFY15, SKBBL has reported a profit of NPR 115 million. As on mid-April-15, SKBBL's gross NPLs stood at 0.18% and CRAR at 10.15%.

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⁹ Including the proposed rights issue

¹⁰ Un-provided NPL (Net NPL)/ Net worth

¹¹ graded by ICRA Nepal at [ICRANP] IPO grade 3