ICRA NEPAL

Deprosc Laghubitta Bikas Bank Limited

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

Facility/Instrument	Issue Size	Grading Action (December 2016)
Rights Share Issue	NPR 257.923845 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 257.9238 million of Deprosc Laghubitta Bikas Bank Limited (DDBL). 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. DDBL is proposing to come out with 1:1 rights issue of 2,579,238.45 numbers of equity shares of face value NPR 100/- each, to be issued to its existing shareholders at par. The proposed issue is being made to augment the capital base to support the future growth plans of the management.

The grading factors in the regulatory uncertainty for MFIs as introduced by Monetary Policy of FY16/17, with cap on interest rate spread at 7% (hitherto unregulated) and requirement for commercial banks to directly lend to deprived sector (2% of the total deprived sector lending requirements of 5%, rest 3% could be through intermediaries). These changes could significantly impact profitability and growth of DDBL and the microfinance sector. The grading also factors in recent increase in NPA levels (gross NPA 0.82% on mid-July 2016 with 0+days delinquencies of 1.03%) caused due to April 2015 earthquake and political turmoil[1] in the following months.

Nonetheless, the grading takes into account DDBL's healthy track record (operating since July 2001) and franchise strength (81 branches across 47 districts as of mid-July 2016,); translating into fair credit portfolio growth (CAGR 39% during FY 2013-16) and adequate scale of operations (asset size of NPR 4,451 million as of Jul-16[2]). The grading also factors in strong promoter profile with ~65% institutional shareholding and diversified funding profile with credit lines from more than 40 BFIs. The grading also considers healthy profitability (Return on networth (RoNW) of ~40% during FY 2015-16) along with adequate capitalization (CRAR ~17% on mid-Jul-16 vs regulatory minimum 8%) and maintaining low gearing level (~6 times on mid-Jul-16) of DDBL. However, incremental profitability is likely to be impacted due to regulations proposing caps on interest spreads, if implemented. Growth opportunities for DDBL remains adequate given the recently acquired national level MFI status (in FY2015-16), comfortable capitalization level (CRAR ~17%[3] in mid-July 2016 vs regulatory minimum of 8%), experienced management team, access to low cost fund benefitted from deprived sector regulations and large below-poverty-line population in Nepal that acts as target group for MFI players. In ICRA's opinion, ability of the company to improve portfolio growth & generate scale economies through geographical expansion and maintain commensurate risk mitigation practices would be critical going forward.

The grading further takes into account DDBL presence in relatively riskier product segment owing to marginal borrower profile and unsecured lending business (~85% of portfolio as of mid-July-2016). Limitation of MIS system of DDBL in generating specific reports on borrower information including asset quality portfolio cuts etc although all the branch has been computerized. Moreover, absence of centralized credit bureau in microfinance segment remains a major concern, limiting MFI's ability to check multiple lending. However, adequate seasoning of credit books of DDBL and low average tickets

[1] 0+days delinquency reached its highest of 7.75% (mid-Oct 2015), 6 months after earthquake and during the period of political turmoil and blockade at Indo-Nepal customs point. The political turmoil was resolved in February 2016.

[2] Mid-Jul-2016 data are unaudited; various ratios for Jul-16 are based on company data

[3] Published CRAR as on mid-Jul-16 was 14.96% (calculation of the same not provided). However, as per the data reported to NRB and to us CRAR comes to 17.37%.

size (~NPR 47K during FY16) provides some comfort. Going forward, DDBL's ability to improve MIS capability and internal controls to maintain its asset quality indicators would have a bearing on the overall financial profile.

DDBL follows group lending model, wherein members related to a group (5 individuals) and a centre (4-5 groups) take mutual responsibility for loan repayment for all the members in the group and centre. In addition, DDBL also extends individual loans (secured loans) up to NPR 700 thousand to finance micro enterprise. DDBL offers credit up to NPR Sixty thousand for the first cycle loans; however the average ticket size remains ~NPR 47,000 as of mid-July 2016, comparable to the peers in the industry. DDBL's credit portfolio of NPR 3,989 million as of mid-July-2016 is dominated by unsecured group guarantee backed loans (~85%), rest being secured loans. DDBL's asset quality indicators remain fair, despite recent deterioration, with 0+days delinquencies of 1.03% as of Jul-16 including NPLs of 0.82%.

As per regulation, Banks and Financial Institutions[4] (BFIs) are required to extend 4-5% of their total loans towards deprived sector[5], either directly or through microfinance companies. However, Monetary Policy of FY 2016/17 has mandated class A commercial banks to maintain direct deprived sector lending of 2%, out of their total deprived sector lending requirements of 5%. This is likely to impact the funds available for growth of microfinance sector to a large extent and thus any further moderation/withdrawal in this regulation could have significant impact on funding profile of microfinance entities. Currently, DDBL is dependent upon bank borrowings (~68% of total funds; diversified across more than 40 lender BFIs[6]). The savings collected from members comprise ~32% of overall funding profile, lower than MFI industry average. DDBL's liquidity position remains comfortable due to availability of revolving lines of credit from lender BFIs, short tenure of loans extended (generally one to two years) and relatively stable nature of deposits from member.

DDBL has reported healthy profit levels over last two years with ROA of ~5% and RoNW of ~39% in FY16 as compared to ~4.80% and ~40% respectively in FY15, primarily aided by high lending spreads of ~12%. Going forward, profitability could be significantly impacted as 7% cap on interest rate spread has been introduced by Monetary Policy of FY17. DDBL's profitability is however supported by healthy non-interest income (~1.50% of ATA[7] in FY16, primarily in the form of loan processing fees), fair operating expense ratio (4.92% of ATA), and low credit costs (0.69% of ATA). The profitability profile going forward will be determined by the ability of DDBL to scale up its business to ensure efficient utilisation of enhanced capital and counter the impact of spread rate cap through scale economies; while at the same time maintaining asset quality.

DDBL's CRAR of 17.37% as on mid-July 2016 remains moderate compared to counterparts, considering the vulnerable asset class. Nonetheless, it remains much higher to regulatory minimum CRAR of 8% for MFIs. Despite high gearing level permitted by regulation (up to 30 times), DDBL has been operating at low gearing levels (~6 times in mid-July 2016).

Company Profile

Incorporated in January 2001, Deprosc Laghubitta Bikas Bank Limited (DDBL) received license regional level Class D microfinance institution in July 2001 from NRB (upgraded as national level microfinance in FY 2015-16). DDBL took over the microfinance business hitherto being conducted by DEPROSC[8] Nepal, an NGO promoter of DDBL, operating since 1995. The current shareholding structure of DDBL hence consists of DEPROSC NGO as promoter (~15%) along with Nabil Bank[9] (~13%), Nepal Bank (~13%), Lumbini Finance and Leasing Co. (13%), ADBL[10] (~10%) and rest being held by individual

[4] Class A, B & C financial institutions.
[5] As defined by the central bank (NRB) covering marginal sections of the society
[6] ~21% of total bank borrowings are accounted for by promoter banks.
[7] Average total assets
[8] Development Project Service Center
[9] Rated AA- under Issuer rating by ICRA Nepal.
[10] Agriculture Development Bank Limited

promoters. Overall shareholding pattern of the bank constitutes of Promoters holding of 70% and public group by 30%[11]. The shares of the Bank are listed in Nepal Stock Exchange. The registered and Corporate Office of the bank is located at Narayangarh, Chitwan, Nepal.

Deprosc has presence across 47 districts of Nepal through its 81 branches. DDBL reported a profit after tax of NPR 193 million during FY16, over an asset base of NPR 4,451 million as on Jul-16 as against as against net profit of NPR 134 million during FY15 over an asset base of NPR 3,169 million as on mid Jul-15. As on mid-Jul-16, DDBL's gross NPLs stood at 0.82% and CRAR at 17.37%. On information technology front, DDBL uses Sysbank software.

December 2016

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[11] Promoter-Public shareholding ratio has been changed to 51:49 post mid-Jul-16.