

## Green Development Bank Limited

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

Facility/Instrument	Issue Size	Grading Action (July 2017)
Rights Share Issue	NPR 400 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 400 million of Green Development Bank Limited (GRDBL). 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. GRDBL is proposing to come out with 400% rights issue of 4,000,000 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 to meet the elevated regulatory capital requirements.

The grading is mainly constrained by significant deterioration seen in asset quality indicators of the bank in recent periods despite limited track record in banking (operating from August 2013) and hence low seasoning of credit portfolio. Delinquencies of the bank spiked from ~3% as of Jul-16 to ~24% as of Apr-17 (including NPLs<sup>1</sup> of 5.55%) without any material changes in operating environment that could have a bearing over credit profile of borrowers. The grading is also constrained by small scale of operations (asset base of NPR 443 million as of mid-Apr-17) and hence the inability to generate any returns for shareholders so far. Attaining requisite growth to serve the existing as well as large incremental capital being raised remains a challenge given the inferior deposits profile (CASA<sup>2</sup> of ~16% vs. ~43% for industry) resulting in high cost of funds among peers (6.53% for 9MFY17 vs. 5.32% for industry) as well as low franchise of the bank so far (three branches). Though business expansion in recently covered district (Kaski) remains a possibility, aggressive growth plans of management could result in inferior credit quality and hence impact asset quality indicators over longer time frame. While assigning the grading, ICRA Nepal also takes note of the high geographical concentration risks (~60% of business is concentrated within one district), higher portfolio vulnerability due to relatively inferior borrower profile vs. commercial banks and high proportion of loans with assessed income based appraisal which could lead to higher volatility in asset quality indicators. The grading is further constrained by bank’s lack of diversity in earnings, lack of Institutional promoters, stiff competition with commercial banks offering products at finer lending rates and uncertain operating environment that financial institutions in Nepal are currently facing.

GRDBL’s pace of credit growth has remained high over small base (CAGR of ~119% achieved from Jul-15 to Apr-17) and hence portfolio size still remains much smaller (credit portfolio of NPR 306 million as of mid-Apr-2017). GRDBL’s credit portfolio primarily composed of personal loans (33%), hire purchase loans (17%), business loans (14%), term loans (9%), gold loans (8%), deprived sector loans (7%), agriculture loans (6%) and balance being other loans. The credit expansion has been impacted by limited franchise (three branches as of mid-Apr-2017, with one being recently opened in Pokhara) with major concentration (~60%) in Baglung district from where it started its operations. Bank’s credit portfolio also remains fairly concentrated among top 20 borrowers at ~30% of portfolio as of mid-Apr 2017. Being a three-district level development bank, GRDBL is allowed to operate in limited geographical area and at the same time it faces competition from commercial 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.

<sup>1</sup> Non-Performing Loans

<sup>2</sup> Current and Savings Accounts



Bank's asset quality witnessed severe stress in Apr-17 despite limited seasoning of the credit portfolio so far. Delinquencies increased from 2.74% as of mid-Jul-16 to 23.62% as of Apr-17 while reported NPLs increased from 0.88% to 5.55% over same period. Provisioning cover for these NPLs remain low at ~33% and hence bank could witness increased credit cost over medium term. Overall, GRDBL'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. Management's ability to improve asset quality indicators with targeted portfolio growth would be critical for improvement in its profitability indicators.

As for funding profile, GRDBL's proportion of low cost CASA deposits has been witnessing gradual decline in recent years. Bank had CASA of ~25% as on mid-Jul-15 which has declined to ~16% as of Apr-17 vs. ~43% for industry resulting in high cost of funds among peers (6.53% for 9MFY17). Cost of funds is expected to further increase owing to increment in term deposits from ~20% to ~40% over last nine months ending Apr-17. Despite some improvement in terms of granularity of deposits profile, top 20 depositors still account for a significantly high proportion of deposits at ~43% as of mid-Apr 2017. Going forward, management's focus on achieving granular deposit growth through expansion of franchise and depositors' base could improve deposits profile. Bank's ability to manage its deposit cost would have a strong bearing on overall competitive positioning in the future.

Bank's profitability profile has remained subdued so far with continuous losses reported till FY16 that has depleted net worth per share to NPR 92 as of Apr-17 (against face value of NPR 100). Nonetheless, the profitability indicators remain gradually progressive with negative RoNW<sup>3</sup> of ~13% for FY14 being improved to ~3% for 9MFY17. Improvement in profitability, though minimal, has been supported by improving NIMs<sup>4</sup> (4.24% for 9MFY17) while lack of diversity in earnings and increasing credit cost act as a drag on profitability. The profitability would be significantly diluted over medium term owing to higher incremental capital. Going forward, bank's ability to maintain healthy NIMs would have a key bearing on profitability profile amidst scenario of upward movement of interest rates as recently seen in banking channel owing to tightening liquidity and regulatory change requiring similar interest rates to call and savings deposits.

GRDBL's CRAR<sup>5</sup> was 25.35% (tier I capital of 24.34%) as of mid-Apr-2017, significantly higher than the regulatory minimum of 11%. The proposed issue is likely to further maintain capital at higher levels over the medium term. Monetary policy of FY 2015-16 had announced that three district level development banks are required to increase their paid-up capital to NPR 500 million within Jul-17 (extended till the time of publication of annual report of FY17). GRDBL has capital of NPR 100 million as of mid-Apr-17 and the same is expected to increase to NPR 500 million after proposed rights issue (assuming full subscription). Hence, maintaining adequate returns over increased capital base would remain key challenge for the bank over the medium term.

### **Company Profile**

Established in November 2012, Green Development Bank Limited (GRDBL) started commercial operation from August 2013 as a three-district level development bank (Kaski, Myagdi and Baglung districts). The bank's head office is located at Harishankar-Road, Baglung. Share capital of the bank is distributed among promoter & public in the ratio of 55:45 with maximum shareholding by one individual at 15% of total capital. The shares of the company are listed on the Nepal Stock Exchange. Mr. Baikuntha Raj Timsina is the Acting Chief Executive Officer of the bank.

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<sup>3</sup> Return on Net Worth

<sup>4</sup> Net Interest Margins as a percentage of Average Total Assets

<sup>5</sup> Capital to Risk Adjusted Assets Ratio



GRDBL's is currently operating from its three branches spread over its three licensed districts with major concentration of business in Baglung. GRDBL's market share in deposits and advances of development bank industry is ~0.13% as on mid-Apr-17. GRDBL reported net loss of NPR 0.6 million in FY16 over an asset base of NPR 435 million as on mid Jul-16 against net loss of NPR 2.76 million in FY15 over an asset base of NPR 298 million as on mid Jul-15. For 9MFY17, GRDBL has reported net profit of NPR 2.14 million over an asset base of NPR 443 million. GRDBL's CRAR was 25.35% and gross NPLs of 5.55% as on mid-Apr-2017. In terms of technology platform, GRDBL has implemented Pumori IV System.

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