NBFI: FIRST QUARTER OUTLOOK

- Non-performing loans of NBFIs is expected to linger further with looming political unrest ahead of the elections. Shaky business confidence because of uncertainties lying ahead has caused business activities to slow down.
- Recent Bangladesh Bank guideline permitting NBFIs to collect deposit for a minimum 3 months period will decrease cost of funds of NBFIs.
- Capital market improvement from current situation hinges on the improvement of current political situation. Given that, the political situation calms down, Profitability of NBFIs from this sector is expected to improve in this quarter.
- Numerous margin accounts, which at present have negative equity, accrue interest on a continuous basis. Interest accrual will continue in the upcoming quarter and thus will show inflated income. However, chances of recovering this amount on these accounts are actually quite low unless the capital market goes on a significant bullish trend.

LR Global Research
research@lrglobalbd.com

OVERVIEW

Number of listed companies	23
Total market cap (USD mn)	1,957
Free float market cap (USD mn)	1,117
Daily average turnover (52 weeks) (USD mn)	2.4
52 week's Sector return	1.5%
52 week's DSE return	11.4%
Asset Size (USD mn)	3,903

Source: Bangladesh bank & Dhaka Stock Exchange

Non-Bank Financial Institution sector (NBFI) represents one of the major parts of the financial system. In Bangladesh, it brings much-needed diversity to the financial system that was otherwise dominated by the banking sector. Currently, 31 NBFIs are operating in the country, among which, 3 are government owned, 18 are privately owned local companies and the remaining 10 are established in joint-venture with foreign participants. There are 11 brokerages and 11 merchant banking licenses among these 31 NBFIs. Out of the total, 23 NBFIs are listed in the stock market, representing around 9% of the total market capitalization in the capital market.

In Bangladesh, NBFIs deal with traditional financial products. However, they cannot issue CASA (Current Account-Savings Account). NBFIs also operate in money market and capital market. NBFI's balance sheet size represents around 4.7% of total asset size of the country's banking sector. ICB, IDLC, DBH, Lanka Bangla Finance and Uttara Finance are the major players of the sector.

Table 01: Industry Income Statement

	2009	2010	2011	2012	2013E
Net Interest Income	**41%**	**28%**	**43%**	**52%**	**53%**
Investment Income	30%	42%	32%	29%	22%
Brokerage & commission	21%	23%	17%	13%	14%
Other	7%	7%	8%	6%	11%
Total Operating Income	**100%**	**100%**	**100%**	**100%**	**100%**
Operating expense	21%	16%	23%	29%	32%
Profit Before Provision	**79%**	**84%**	**77%**	**71%**	**68%**
Provision	12%	9%	5%	7%	13%
Profit Before Tax	**67%**	**75%**	**72%**	**64%**	**54%**
Tax	16%	16%	21%	17%	16%
Profit After Tax	**51%**	**59%**	**51%**	**47%**	**39%**

Source: LR Global Bangladesh

Table 02: Industry Balance Sheet

	2009	2010	2011	2012	2013E
Cash	1%	1%	1%	2%	2%
Balance with FIs	9%	12%	18%	15%	16%
Money at call	0%	0%	0%	0%	0%
Investments	18%	13%	9%	10%	10%
Loans & Leases	**63%**	**61%**	**60%**	**66%**	**65%**
Fixed assets	1%	2%	2%	2%	2%
Other assets	9%	11%	10%	6%	6%
Total Assets	**100%**	**100%**	**100%**	**100%**	**100%**
Borrowings from banks	24%	24%	25%	21%	22%
Deposits	**51%**	**42%**	**42%**	**47%**	**47%**
Other liabilities	14%	17%	13%	12%	12%
Total liabilities	**88%**	**83%**	**80%**	**80%**	**81%**
Shareholders' equity	**12%**	**17%**	**19%**	**20%**	**19%**
Liabilities & equity	**100%**	**100%**	**100%**	**100%**	**100%**

Source: LR Global Bangladesh

SECTOR PERFORMANCE

From 2007 to 2010, most NBFIs achieved exceptional growth, which prompted the central bank to increase paid-up capital to BDT 1bn for better risk management. Consequently, overall equity increased by 59.4% per annum over that period, making the incumbent firms more resilient to shocks, enhancing their capacity to take exposure in capital market and significantly lowering the leverage and finally, creating more scope for business expansion.

Lending activities which were the primary business focus for the sector till 2006-2007, became secondary with capital market's Bull Run, which continued till the end of 2010. As the capital market is going through a correction phase for last couple of years, NBFIs also have started to shift their business focus towards lending.

NBFI sector in general is dependent on banks for funds since it doesn't have adequate deposit base to cover its lending needs. Therefore, credit deposit ratio of the sector is as high as 1.5.

Major portion of NBFI credit portfolio consists of Term Loan (36%), Lease financing (24%), Real-estate financing (20%) and Margin Loan (15%).

In FY 2012, total asset size of the sector was BDT 320 billion, appreciating by 10.9% and total operating income stood at BDT 12 billion, registering a negative growth of 20%. From 2008-2012, loans and advances showed a compound annual growth rate (CAGR) of 22.6%, whereas deposits and bank borrowing grew by 19.9% and 15.4% respectively. In 2009, 14% of the asset was financed with equity, whereas in 2012, it increased to 24%.

Table 03: Financial Performance

	2009	2010	2011	2012	2013E
i) Growth:					
Loans & Advances	30.9%	28.7%	18.0%	21.2%	10.5%
Deposits	35.4%	12.1%	15.2%	21.5%	14.6%
Equity	33.6%	137.9%	15.3%	11.4%	10.1%
Operating Income	30.0%	94.6%	-18.6%	-19.8%	-14.7%
Net Profit	55.6%	123.7%	-29.4%	-16.3%	-10.80%
ii) Weighted Average Interest Rate:					
Lending Rate	12.0%	11.7%	13.3%	13.2%	12.8%
Cost of Funding	7.8%	7.8%	9.0%	10.3%	10.4%
Spread	4.2%	3.9%	4.3%	2.8%	2.4%
NIM	4.4%	4.5%	4.7%	3.3%	3.7%
iii) Financial Indicators:					
Credit/Deposit	1.3	1.5	1.5	1.5	1.4
Asset/Equity	7.3	4.0	3.9	4.1	3.9
NPL	5.9%	6.8%	5.7%	8.0%	8.3%
iv) Valuation:					
PE (x)	15.6	21.3	26.6	17.4	20.7
PB (x)	3.8	4.9	5.1	2.6	1.9
v) Profitability:					
ROE	24.4%	22.9%	19.2%	14.7%	9.1%
ROA	3.4%	5.7%	4.9%	3.6%	2.3%

Source: LR Global Bangladesh

RISKS

DAMPENED BUSINESS ACTIVITIES CAUSED BY POLITICAL TURMOIL WILL INCREASE BAD LOANS

Non-performing loans of NBFIs is expected to linger further with looming political unrest ahead of the elections. Shaky business confidence because of uncertainties lying ahead has caused business activities to slow down. Private sector credit growth bears the evidence as the growth has dropped to around 11% from around 18% at the beginning of the year. Such dull business condition has caused businesses to default, which has put pressure on growing default loans of NBFIs. In a condition where banks get priority over NBFIs in terms of loan disbursement because of their flexibility regarding deposit collection, piling bad loans will seriously hamper sustainability of a few NBFIs.

OUTLOOK

NEW REGULATION IS EXPECTED TO IMPROVE FUND AVAILABILITY

According to a recent Bangladesh Bank directive, NBFIs will be able to collect deposits for 3-month tenure, which was 6-month previously. Such a directive will help NBFIs to mobilize funds easily rather than going for expensive borrowing of funds from money market. This will have a positive impact on cost of funds of NBFIs. However, considering current abundant liquidity situation, such positive impact is not expected to set in within the upcoming quarter.

IMPROVED LIQUIDITY SITUATION IS EXPECTED TO SUSTAIN

Bearish business condition coupled with bleak private sector credit growth has curbed the demand for loans and advances, improving liquidity situation. Call money rate decreased to around 7% from around 9% at the beginning of the year. Furthermore, the upcoming monetary policy is expected to remain unchanged considering current liquidity situation. If situation at the political front does not improve, credit growth will not improve in this quarter. Hence, liquidity situation is expected to show improving trend in this quarter.

SLOW CREDIT GROWTH

Despite improved liquidity scenario, industrial growth of the economy has become stagnant due to deficient infrastructural support and political uncertainty ahead of upcoming national elections. Moreover, new banks, which have already started operation, will compete for the slowly growing pie of industrial credit. Thus, we expect NBFIs' credit growth to be flat in this quarter.

SIGNS OF IMPROVEMENT IN CAPITAL MARKET

Last year, country's primary bourse posted a return of 11.4%, reversing the downward trend continuing for the last 2 years till December 2012 after the market crash on December 2010. Furthermore, market turnover, one of the major sources of earnings for NBFIs, remained encouraging till December last year. Market improvement from current situation hinges on the improvement of current political situation. Given that, the political situation calms down, Profitability of NBFIs from this sector is expected to improve in this quarter.

DETERIORATING ASSET QUALITY

Asset quality of NBFIs deteriorated because of mounting default loans in some sectors such as real estate, commodities and ship breaking business along with increasing negative equity in margin loan accounts due to poor capital market performance. Although capital market started showing signs of improvement, deteriorating credit quality may increase NPL in this quarter. Numerous margin accounts, which at present have negative equity, accrue interest on a continuous basis. Interest accrual will continue in the upcoming quarter and thus will show inflated income. However, chances of recovering this amount on these accounts are actually quite low unless the capital market goes on a significant bullish trend. Such unrecoverable margin loan interests have already inflated the income statement and may further deteriorate asset quality.

EASED PROVISIONING REQUIREMENT MAY HELP IN THE SHORT RUN

Last year, the central bank enacted provisioning and classification guideline, which will ease pressure on NBFIs burdened with NPL as provisioning requirement for general and SMA classified loans are put in the same bracket. This guideline will give some ailing NBFIs respite in the short run. Furthermore, for SME loans provisioning requirement has been reduced to 0.5%, which will positively affect bottom line profitability of the NBFIs. In addition, the central bank relaxed rescheduling rules and terms of repayment for SME and Farm sector affected by turbulent politics.

NO DRAMATIC CHANGE IN REGULATIONS

Like Banks, NBFIs come under constant monitoring of central bank, even though regulations do not frequently change for NBFIs. No new major regulation is expected to come out for NBFIs in this quarter.

Sluggish credit growth along with increase in NPL will have a negative impact on net interest income of NBFIs. However, improving capital market turnover will help NBFIs secure positive income from investment, commission and brokerage income in this quarter. Overall, NBFIs are expected to achieve 8-10% revenue growth in this quarter compared to figure of the same quarter of previous year.