

Nepal SBI Bank Limited

ICRA Nepal assigns [ICRANP-IR] AA rating to Nepal SBI Bank Limited; reaffirms [ICRANP] LAA rating for the subordinated bonds, “rating watch with negative implications” removed

Facility/Instrument	Amount	Rating Action (July 2016)
Issuer Rating	NA	[ICRANP-IR] AA (Assigned)
Subordinated Bond Program	NPR 200 Million	[ICRANP] LAA (Reaffirmed), “rating watch with negative implications” removed

ICRA Nepal has assigned rating of **[ICRANP-IR] AA** (pronounced ICRA NP Issuer Rating Double A) to Nepal SBI Bank Limited (NSBL). [ICRANP-IR] AA rating are considered as high credit quality rating assigned by ICRA Nepal. The rated entity carries low credit risk. The rating is only an opinion on the general creditworthiness of the rated entity and not specific to any particular debt instrument.

ICRA Nepal has also reaffirmed the rating of **[ICRANP] LAA** (pronounced ICRA NP L Double A) to the subordinated bonds of NPR 200 million of Nepal SBI Bank Limited (NSBL). Instruments with this rating are considered to have high degree of safety regarding timely servicing of financial obligations. Such instruments carry very low credit risk. The rating has been removed from “rating watch with negative implications”.

The removal of rating watch with negative implications is on account of NSBL’s ability to manage the asset quality despite general stress in the Nepalese economy during last 12 months due to impact of the earthquake and subsequently the custom blockade. The bank’s overall delinquencies has witnessed improvement with 0+ days past due accounts declining to 1.04% as on mid-Apr-16 from 1.14% in mid-Apr-15 (although increased to 1.83% in mid-Oct-15). This has also helped NSBL to maintain adequate earnings profile. In the near term, although the NPLs¹ could increase to some extent (on account of uncertain political environment coupled with some rescheduled accounts), NSBL’s healthy capitalisation profile is expected to provide support. In ICRA Nepal’s assessment, the bank’s operational and financial profile is expected to remain consistent with the rating level.

The rating assignment/ reaffirmation factors in the bank’s strong promoter profile², existence of Technical Support Service Agreement (TSSA) with State Bank of India, established track record (operating since 1993) and adequate franchise leading to good market positioning in Nepal with ~4% share in industry credit and deposits. The ratings also take into consideration bank’s experienced senior management, improved deposits profile, strong asset quality, adequate capitalisation levels, moderate portfolio growth³ and adequate earnings profile. NSBL’s association with State Bank of India through TSSA provides access to management (MD/CEO, COO and CFO at NSBL are deputed from SBI) and technology support from SBI. Further, SBI has also extended line of credit support to NSBL to meet fund based/ non fund based requirements; which reflect well on the stance of SBI to provide need based liquidity and capital support to NSBL. Moreover, NSBL has been following the systems and policies of SBI compatible in Nepal as per NRB guidelines and is required to comply with the dual reporting procedures of NRB as well as that of RBI, by virtue of being a subsidiary of SBI. The bank has although witnessed some improvement in the deposit concentration with top 20 depositors accounting for ~39%⁴ of total deposits as on mid-Apr-16 (compared to 55% as on mid-Jan-14), the same remains high. Also, NSBL’s loan book primarily comprises corporate loans (accounting for ~69% of the book) with an increase in the credit concentration risks as the top 20 borrowers account for ~28% of credit book as on

¹ Non-Performing Loans

² State Bank of India (SBI) rated at [ICRA]AAA(hyb) (Stable) for Basel III compliant tier II bonds and [ICRA]AAA (Stable) for subordinated bonds programme by ICRA and Employees Provident Fund holding ~55% and ~15% respectively; together accounting for 70.12% shareholding in NSBL.

³ Compounded Annual Growth Rate (CAGR) of ~18% over last five years vs. ~19% for industry.

⁴ LCY deposit concentration to top 20 depositors is ~26% as on mid-Apr-16.

mid-Apr-16 (compared to 17% as on mid-Jan-14). The rating is also constrained by unstable political conditions and uncertain operating environment that banks in Nepal are currently facing.

NSBL reported portfolio growth of ~13% during FY15 and ~16% during 9MFY16 (CAGR of ~18% over past 5 years ending mid Jul-15 vs. industry average growth of ~19%). Credit demand going forward is expected to remain healthy owing to expected pickup in economic activity to support the reconstruction. NSBL's portfolio mix continues to remain concentrated towards large corporate loans (~69%), followed by retail loans (~27%) and SME loans (~4%). However, NSBL's exposure to the relatively vulnerable sectors (margin lending, tourism and hire purchase sector), compare favourably to Nepalese banking industry. Credit portfolio remains moderately concentrated with top 20 borrowers/groups of borrowers accounting for ~28% of portfolio as on mid-Apr-16. Going forward, management intends to continue growing moderately, to ensure efficient utilisation of large capital to be raised by FY17 (as required by changed regulations).

Bank's asset quality remains strong with further improvement over last few years which provides support to the rating (NPLs of 0.14% as of mid-Apr-16 vs. 0.26% as of mid-Jul-14). This was aided by decline in fresh NPL generation rate (0.11% in FY15 compared to 0.16% on an average for FY12 to FY14) and improved recoveries (~61% for FY15). Bank's NPLs continue to compare favourably than peers and the industry average NPLs (which stood at 2.22% on Apr-16). Going forward, although NSBL's asset quality could witness some moderation due to damages caused by earthquake and elongated strikes (more specifically the rescheduled accounts), the overall profile is expected to remain comfortable. The bank also witnessed improvement in delinquencies from 1.14% as of mid-Apr-15 to 1.04% by mid-Apr-16 (including reported NPLs of 0.14%) with ~65% of these remaining within 30 days. The scheduled loans continue to face higher delinquencies (~4.5%) compared to revolving loans (~0.2%). Bank had rescheduled six accounts (~1.6% of portfolio as of Apr-16) under NRB's relaxed norms supporting the reported NPLs. ICRA also takes comfort from the bank's ability to absorb losses (Net NPA/Net worth being nil as on mid-Apr-16 compared to 0.28% on mid-Jul-14). Going forward NSBL's ability to maintain asset quality indicators would be a key monitorable.

As regards capitalisation, bank reported CRAR of 13.75% and tier I capital of 11.17% (both as per Basel III) as of mid-Apr-2016 which remains comfortable compared to minimum regulatory requirement of 11% and 7.25% (both including Capital Conservation buffer) respectively required as on mid-Jul-16. The tier 1 capital requirement is expected to increase to 8.5% by mid-Jul-19 (including capital conservation buffer) although the requirement for total capital would be stable at 11% (incl. CCB). NSBL plans to increase paid-up capital to NPR 8 bn (vs. NPR 3.88 bn as of now) by FY17 (as required by changed regulations) through FPO⁵, rights issue and internal accruals. Accordingly, capitalization levels are expected to remain adequate to support NSBL's growth plans over the medium term. The banks' ability to raise planned capital in a timely manner would have a bearing on its ability to meet the revised guidelines and support growth plans.

NSBL's deposit profile remains comparable to the industry as reflected by CASA, which improved to ~49% as on mid-Apr-16 from 31% as on mid-Jul-13. Despite improvement in CASA profile cost of funds for NSBL at 2.47% as of mid-Apr-16, continues to be marginally higher than its peers, although same is better than the industry average cost of funds at 3.06%. Nonetheless, deposit concentration continues to be high with top 20 depositors accounting for ~39% of the total deposits (~26% on LCY deposit) as of mid-Apr-16.

As for profitability, NSBL reported improvement in earnings profile during last two years supported by healthy NIMs (3.41% during FY15 and 3.45% during 9MFY16) and low credit costs. NIMs were supported by improved cost of fund over the period. Return indicators improved during 9MFY16 with RoNW and RoA⁶ at ~21% and 1.89% respectively compared to ~21% and 1.77% for FY15. Healthy non-interest income (1.28% of ATA during 9MFY16) further supports profitability, however relatively higher operating expense ratio (1.96% of ATA during 9MFY16) has impacted the financial profile to an extent.

⁵ Further Public Offering (to maintain 30% public shareholding ratios)

⁶ Return on Net Worth and Return on Assets



The credit and operating cost for NSBL could witness some increase on account of expected increase in stress over asset quality and plans for aggressive expansion of the branches impacting the profitability profile, however the overall financial profile is expected to remain adequate. Going forward, bank's ability to ensure efficient utilisation of large incremental capital, maintain its NIMs in a competitive landscape and maintain asset quality would have strong bearing on its earnings profile.

Bank Profile

NSBL is the first Indo-Nepal joint venture in the financial sector sponsored by three institutional promoters, namely State Bank of India, Employees Provident Fund and Agricultural Development Bank of Nepal through a Memorandum of Understanding signed in July 1992 and was incorporated in July 1993. NSBL is a subsidiary of State Bank of India which has 55.09% ownership and rest is held by a local partner viz. Employees Provident Fund (15.03%) and general public (29.88%). In terms of the Technical Support Service Agreement (TSSA) between SBI and the NSBL, the former provides management support to the bank through its expatriate officers including MD/CEO, COO and CFO of the Bank. The bank started its commercial operation from July 1993 and is registered as "A" class Commercial Bank with Nepal Rastra Bank (NRB). Its head office is located at Kathmandu. The shares of the Bank are listed in Nepal stock exchange.

NSBL's 62 branches, seven extension counters, four administrative offices and 82 ATMs provides it with presence throughout the country. NSBL has market share of 3.88% in terms of deposit base and 3.66% of loan & advances in commercial banking industry of Nepal as on mid-Apr-16. NSBL reported a profit after tax of NPR 1,065 million during 2014-15 over an asset base of NPR 59,277 million as of mid-Jul-15 against profit after tax of NPR 923 million during 2013-14 over an asset base of NPR 61,083 million as of mid-Jul-14. During 9MFY16, NSBL reported PAT of NPR 950 million over an assets base of NPR 75,062 million. As of mid-Apr-2016, NSBL's CRAR was 13.75% and gross NPLs were 0.14%. In terms of technology platform, NSBL has implemented Finacle across all of its branches.

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For further details please contact:

Analyst Contacts:

Mr. Kishor Prasad Bimali, (Tel No. +977-1-4419910/20)

kishor@icranepal.com

Mr. Rajib Maharjan, (Tel No. +977-1-4419910/20)

rajib@icranepal.com

Relationship Contacts:

Mr. Deepak Raj Kafle, (Tel. No. +977-1-4419910/20)

drkafle@icranepal.com

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