

Himalayan Bank Limited

ICRA Nepal assigns [ICRANP] LA@¹ rating to fresh subordinated bond programme and reaffirms [ICRANP] LA@ rating to existing subordinated bonds of Himalayan Bank Limited

Facility/Instrument	Amount (NPR million)	Rating Action (August 2015)
Subordinated Bond Program	500	[ICRANP] LA/ rating under watch with negative implications (Assigned)
Subordinated Bond Program	750	[ICRANP] LA/ rating under watch with negative implications (Reaffirmed)

@Rating under watch with negative implication

ICRA Nepal has assigned rating of **[ICRANP] LA@** (pronounced ICRA NP L A @) to fresh subordinated bond programme of NPR 500 million of Himalayan Bank Limited (HBL) and reaffirmed the rating of existing subordinated bonds of NPR 750 million at **[ICRANP] LA@** (pronounced ICRA NP L A @). The rating is under watch with negative Implications. Instruments with this rating are considered to have adequate degree of safety regarding timely servicing of financial obligations. Such instruments carry low credit risk. ICRA Nepal assigns long term corporate debt rating on a scale of LAAA to LD, with LAAA indicating lowest credit risk and LD indicating default/ soon expected default. For the rating categories AA through to C, the sign of + (plus)/ - (minus) appended to the rating symbols indicate their relative position within the rating categories concerned. Thus, the Rating of A+ is one notch higher than A, while A- is one notch lower than A.

The rating under watch with developing implication for HBL is on account of deterioration in asset quality indicators during FY15 (gross NPLs² increased from 1.96% as of mid-Jul-14 to 3.22% as of mid-Jul-15³), which could witness further stress in the post-earthquake scenario. The level of delinquent accounts witnessed a significant increase during May and June 2015 (post the earthquake), however ICRA Nepal notes the bank's ability to reduce these delinquent accounts during the month of July 2015. Sustainability of such improvement in the asset quality, going forward would remain a key rating sensitivity and any significant deterioration in the asset quality could lead to a downward pressure on the assigned rating.

The assigned rating factors in HBL's established track record (operating since 1993), adequate franchise⁴ leading to good market positioning with 4.09% share in Nepalese banking sector credit on mid-June-15, adequate capitalization (CRAR⁵ of 11.45% on mid-Jul-15) vs. 10% regulatory minimum requirements. healthy deposit profile with high proportion of CASA⁶ deposit (66% of total deposits on mid-Jul-15 vs 47% industry average as on Apr-15) resulting in lower cost of funds among peers, fair profitability profile (PAT/ATA 1.38% during FY15 as compared to 1.42% during FY14), and experienced management team. HBL's association with Habib Bank Limited⁷ (Habib, being 20% shareholder in HBL) provides access to management and technology support from Habib (1 board representative and Senior General Manager at HBL deputed from Habib). These positives are however offset to an extent by HBL's relatively higher operating expenses which dilutes part of the advantage of good net interest margins (NIMs), small capital base compared to revised regulatory capital framework (NPR 3,333 million as on Jul-15 vs NPR 8,000 million to be met by FY17), unstable political conditions and uncertain operating environment that banks in Nepal are currently facing.

¹ Rating under watch with negative implications

² Non-Performing Loans

³ Mid-Jul-2015 data are unaudited; all calculations are based on management provided data

⁴ Franchise includes 44 branches and 78 ATMs as on mid-Jul-15.

⁵ Capital to Risk (Weighted) Assets Ratio.

⁶ Current & Savings accounts

⁷ Largest Bank of Pakistan which was rated by Moodys at Caa1, baseline credit assessment (BCA) is b3 constrained by sovereign risk of the country itself.

HBL's branches in the earthquake affected areas accounted for ~65% of the credit portfolio and ~85% of the deposits as on April-15. Although several of these businesses (end users of loans) are situated outside the earthquake affected areas the bank witnessed the delinquent accounts increase by around 140% during May-15 (first month post earthquake). However, as on Jul-15 the bank has been able to reduce the delinquent accounts to pre earthquake levels. The bank's ability to sustain the improvement in asset quality in light of its exposure to sectors/segments⁸ impacted by earthquake and the expected stress in exposures in unaffected geographies/segments due to overall moderation in economic activity as well as linkage among businesses/borrowers. However, recent activity in the stock market suggests that banks' ability to raise capital to absorb damages caused by earthquake is not significantly deterred. 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. Going forward, ICRA Nepal will closely monitor the extent of damages on HBL's financial and solvency profile; which could have a bearing on the rating assigned.

HBL's credit portfolio of NPR 55,428 million on mid-Jul-15. HBL has maintained a moderate portfolio growth of CAGR⁹ 14% over past 5 years (ending FY15) which remains lower than commercial banking industry average growth (19%). Moreover, the credit growth over next 1-2 years is likely to get stunted on account of lack of credit demand following recent earthquake and moderation in economic activity. However, reconstruction drive would support credit growth to some extent. As on mid-Jul-15, the credit portfolio of the bank was primarily composed of large Corporate loans (~71%), Retail loans (~20%) and Business/SME loans (~9%). HBL's portfolio remains concentrated towards trading/manufacturing loans in corporate segments accounting for >50% of portfolio, rest being towards various loan categories including real estate, construction, consumption loans, deprived sector lending etc. Due to portfolio concentration towards high ticket corporate loans, credit portfolio remains moderately concentrated with top 20 borrowers accounting for 23% of credit as on mid-Jul-15.

Assets quality of HBL witnessed deteriorations during FY15 with Gross NPLs increasing from 1.96% as of Jul-14 to 3.22% as of Jul-15. Deterioration in asset quality indicators for HBL during FY15 was primarily on account of devolvement of one counter guarantee turning into forced loan, accounting for 1.23% of portfolio as of Jul-15. Owing to increase in NPLs, the solvency position of HBL deteriorated over last one year with Net NPA/Net worth of ~5.61% on Jul-15 compared to 4.0% on July-14. HBL's delinquency levels also remain high at 5.33% on Jul-15. ICRA Nepal expects that asset quality would further come under pressure going forward due to damages caused by earthquake, impacting borrowers' ability to make repayments in a timely manner which is likely to surface in FY16 in the form of incremental slippages. However, moderate concentration among top borrowers and lower exposure to real estate sector mitigates the concern to some extent.

ICRA Nepal has also noted that earthquake has not caused significant stress on HBL's deposits/liquidity profile¹⁰. The bank's funding profile remains better than Nepalese banking industry average; as reflected in high proportion of low cost deposits with CASA of around 66% of total deposits as of mid-Jul-15 as against industry average of around 47%. As a consequence, HBL's cost of deposits at 2.63% as of Jul-15 remains lower among peers which improves its competitive positioning. Furthermore, deposit concentration of top 20 depositors remains moderate at around 22% as of Jul-15.

HBL's capitalisation levels are adequate with CRAR of 11.45% and tier I capital of 9.78% as of mid-Jul-15 against minimum regulatory requirement of 10% and 6% respectively. The bank is looking to augment its capital base to support future growth and meet any deterioration in asset quality by raising subordinated debt of NPR 500 million in FY16. 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. Probable deterioration in profit levels over next 2-3 years following the earthquake remains a challenge in internal capital generation. HBL would also need to increase its paid-up capital to NPR 8 bn (from existing NPR 3.3 bn) by FY17 as required by Monetary Policy of FY16/17. Over the long

⁹ Compounded Annual Growth Rate

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¹⁰ HBL's deposits were NPR 73.52 billion as of mid-July, 2015 vs. NPR 68.31 billion as of mid-April, 2015



term, the ability of the bank to raise capital from existing promoters or external investors will have a strong bearing on HBL's capitalisation profile.

HBL's profitability have remained adequate over the years, though some decline was noted in last 2 years (FY14 and FY15) owing to higher provisions due to deterioration in asset quality. Owing to this, there has been decline in the PAT/Net-worth of HBL to ~15% for these years as against ~18-20% in earlier years while its PAT/ATA¹¹ was ~1.4% for these two years against ~1.6-2% in earlier years, although the same remains healthy. HBL's profitability remains supported by healthy NIMs (3.5-4%) benefitted by low cost of deposits and strong fee based income (1.82% of ATA as of Jul-15), though higher operating expense (~2.7-3% of ATA) and higher credit provisioning expenses (~0.5-0.8% of ATA) act as a drag to profitability. In the aftermath of April-2015 earthquake, ICRA Nepal expects HBL's profitability profile to remain under pressure over next 2-3 years owing to likely decline in credit demand affecting growth and rise in provisioning expenses following incremental slippages.

Bank Profile

Himalayan Bank Limited is one of the oldest and largest private sector banks in Nepal which was incorporated in 1992 by a few individuals of Nepal in partnership with the Employees Provident Fund, Nepal (14% share) and Habib Bank Limited of Pakistan (20% share). The bank started its commercial operation from January 1993 and is registered as "A" class Commercial Bank with Nepal Rastra Bank (NRB). Its head office is located at Kamaladi, Kathmandu. The shares of the Bank are listed in Nepal stock exchange with market capitalization of about NPR 47 billion (based on August 20, 2015 prices).

HBL operates through 44 branches and 78 ATMs spread across the country. HBL has market share of 4.10% in terms of deposit base and 4.09% in terms of credit portfolio in Nepal's banking system as on mid-June-15. HBL reported a profit after tax of NPR 1,096 million during FY15 over an asset base of NPR 84,913 million as on mid-Jul-15 against a profit after tax of NPR 959 million during FY14 over an asset base of NPR 73,590 million as on mid-Jul-14. HBL's CRAR was 11.45% and gross NPLs were 3.22% as on mid-Jul-15. In terms of technology platform, HBL has implemented Temenos Globus (T24) in all of its branches.

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¹¹ Average Total Assets