Standard Chartered Bank Nepal Limited

ICRA Nepal assigns [ICRANP] IPO Grade 2+ to the proposed Further Public Offer (equity shares) of Standard Chartered Bank Nepal Limited

Facility/Instrument	Issue Size	Grading Action (February 2017)
Further Public Offer (Equity)	NPR 3,300 Million	[ICRANP] IPO Grade 2+ (Assigned)

ICRA Nepal has assigned an "[ICRANP] IPO Grade 2+", indicating above-average fundamentals to the proposed Further Public Offer (FPO) amounting to NPR 3,300 million of Standard Chartered Bank Nepal Limited (SCBNL). 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. SCBNL is proposing to come out with FPO of 2,558,140 numbers of equity shares of face value NPR 100/- each to be issued to public at NPR 1,290 each (including premium of NPR 1,190[1] per share). The issue is being made to augment the capital base and meet the revised (higher) paid up capital requirement set by Nepal Rastra Bank (NRB), the banking sector regulator in Nepal

The above average fundamental grading factors in the bank's strong promoter profile (75% subsidiary of Standard Chartered group[2]) along with existence of Technical Services Agreement (TSA) with SCB-UK which ensures strong parental support, group's oversight and deployment of best practices in SCBNL's operations. The grading is further supported by bank's established track record (operating since 1987), strong competitive positioning emanating from lowest cost of funds (~1% for FY16) in the industry backed by healthy CASA[3] profile (~75% as of mid-Oct-16[4] vs. ~50% for industry). ICRA Nepal also takes comfort from the bank's ability to maintain healthy asset quality[5] despite general stress in Nepalese economy during FY15-FY16 due to impact of the Apr-15 earthquake and subsequently the customs blockade. Comfortable capitalisation levels (with further incoming capital), preferred choice for multinational corporations in Nepal and experienced management team is expected to provide SCBNL with adequate growth opportunities over the medium term.

The grading is nonetheless constrained by decline in profitability indicators of the bank in recent years mainly on account of cap on interest spreads at 5% introduced by NRB from FY14[6]; further increasing capital base as per revised regulatory capital norms is expected to moderate the return on networth significantly over the medium term. ICRA Nepal also takes note of the SCBNL's lower credit growth vis a vis industry average (~11% vs. ~21% over last five years ending FY16) resulting in decline in market share over the years and limited presence across the country (12 branches) to support future growth. However, growth has been spiked in line with projected number as of H1FY17; wherein bank achieved ~24% annualised growth mainly due to increased focus on growing retail books by offering competitive lending rates. SCBNL's long standing relationship with large multinational clients and international development agencies having local presence, favourable prospects for banking sector with upcoming foreign investment groups and bank's strong involvement in local and international trade facilitation in the country is expected to provide growth opportunities to the bank going forward. The growth prospects would however remain dependent upon the pace of growth of overall economy.

The grading is also constrained by high concentration risks (~44% of credit and ~36%[7] of deposits as on mid-Oct-16 among top 20 customers); however, ~45% top 20 customer credit exposure is either backed by intra group guarantee or standby LC from rated international bank which provides some comfort. Going forward, SCBNL's ability to scale up its operations for ensuring efficient utilization of fresh capital by maintaining its asset quality, increase deposit base to maintain competitive cost of funds thereby maintaining the interest margins will be critical to improve the profitability. While assigning the grading,

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[1] Subject to approval from regulatory authorities.
[2] The ultimate parent i.e. Standard Chartered PLC has been rated A3 for subordinated debt and A1 for senior unsecured debt with negative outlook by Moodys.
[3] Current and Savings Accounts
[4] Mid-Oct-16 (Q1FY17) data are unaudited, as provided by management
[5] 0+ days past due generally remains below 5% with occasional spikes; 8.34% on Jul-16 declining to 2.93% on Jan-17.
[6] SCBNL has been able to fully comply the same from only FY16.
[7] Concentration of LCY top 20 depositors is ~20% as on mid-Oct-16.

ICRA Nepal also takes note of unstable political conditions and uncertain operating environment that banks in Nepal are currently facing.

SCBNL's association with Standard Chartered Group and TSA with SCB-UK provides access to management and technology support from the group. Many of the SCBNL's multinational clients have been banking with the group globally and hence provided credit facilities in Nepal within their globally sanctioned limits. Further, SCB group company has also extended Intra Group Guarantee on a need basis to SCBNL to support the funding to large corporates in excess of their sole obligor limit[8]. This reflects well on the stance of the group to facilitate future growth and provide requisite support to SCBNL. Moreover, SCBNL has been following the systems and policies of the group that ensures prudent underwriting norms and hence extensive customer screening resulting in low overall portfolio growth. Representation in SCBNL's board from the group (mainly through SCB India) creates a strong board profile for the bank.

The bank has been growing its portfolio cautiously over the years and reported portfolio growth of ~13% during FY16 (CAGR of ~11% over past five years ending mid-Jul-16 vs. industry average growth of ~21%). The growth in recent years has also been impacted by the decline in overall economic growth of the country owing to impact of Apr-15 earthquake and the subsequent elongated blockades. Credit demand going forward is expected to remain healthy owing to expected pickup in economic activity to support reconstruction. SCBNL's portfolio remains dominated by large corporate loans (~44% on Oct-16); however, retail loans also remain sizeable at ~36% compared to peers. Rest of the portfolio is comprised by SME Loans (~15%) and Deprived sector loans (~5%). Owing to risk averse underwriting approaches, SCBNL has not ventured into sectors like tourism, pure real estate lending, hydropower, margin lending etc. which have witnessed swift growth over last few years. Going forward, management intends to spike up the growth rate to an extent to ensure efficient utilisation of large capital to be raised by Jul-17 (as required by changed regulations). Though lower footprints remain a concern in terms of future growth prospects, the branch network capture the major economic hubs of the country which along with bank's digitisation plans acts as offsetting factors. SCBNL's ability to offer low interest rates backed by lowest cost of funds in the industry would aid the targeted growth whilst maintaining better customer profile.

SCBNL's asset quality compares favourably with peers with reported NPLs[9] continuing to remain one of the lowest in the industry over the years (NPLs of 0.31% as of mid-Oct-16 vs. 0.77% as of mid-Jul-13). This was mainly aided by low fresh NPL generation rate (0.19% in FY16 compared to 0.27% on an average for FY13 to FY15). The bank's delinquencies generally remain below 5% with occasional increment in slippages (3.26% as on mid-Jul-15 to 8.34% as on mid-Jul-16 which improved to 2.93% by mid-Jan-17). Majority of the delinquencies are within 30 days and generally ~70% of delinquencies emanate from retail loan book which provides additional comfort over quality of concentrated corporate credit book. ICRA Nepal also takes comfort from the bank's ability to maintain healthy solvency ratio (Net NPA/Net worth of 0.55% as on mid-Jul-16 compared to 0.64% on mid-Jul-14). SCBNL's healthy capitalisation profile is expected to provide requisite support in case of increased stress over asset quality indicators over the medium term.

SCBNL's deposit profile in terms of CASA and cost of funds remains superior among peers and remains a key competitive strength for the bank (CASA of ~75% as of mid-Oct-16 vs. industry average of ~50% resulting in low cost of funds at 0.99% for FY16; 0.91% for Q1FY17). Nonetheless, high share of foreign currency deposits (~34% of deposits as of Oct-16), which are not readily deployable as loans and hence mostly placed in other SCB subsidiaries, yields minimal spreads thereby bringing down the overall NIMs[10] of the bank. Additionally, deposit concentration remains high with top 20 depositors accounted for ~36% of total deposits as of mid-Oct-16, though significantly lower for local currency deposits at ~20%.

As for profitability, SCBNL reported decline in earnings profile over last few years; return on assets came down from 2.73% for FY12 to 1.98% for FY16 and RoNW[11] coming down from ~30% for FY12 to ~19% for FY16. This was mainly due to introduction of interest spread cap at 5% by the regulator from FY14 onwards resulting in decline NIMs (2.86% for FY16 vs. 3.79% on an average for last five years). The

[8] 25%-30% of core capital (depending upon nature of units) as capped by the banking sector regulator (NRB).

[9] Non-Performing Loans

[10] Net Interest Margins as a % of Average Total Assets

[11] Return on Net worth

profitability indicators would further come under stress post significant capital increment by Jul-17 as required by changed regulations and hence mandate higher growth to maintain profitability indicators. This in turn will require mobilisation of additional deposits while keeping cost of deposits under control and maintaining credit quality of loan book while achieving growth. Additionally, low credit costs, healthy non-interest income (1.60% of ATA[12] for FY16) and moderate operating expenses (1.70% of ATA for FY16) supports the profitability. 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.

As regards capitalisation, bank reported CRAR[13] of 16.52% and tier I capital of 14.92% (both as per Basel III) as of mid-Oct-2016 which remains comfortable compared to minimum regulatory requirement of 11% and 7.50% respectively (both including Capital Conservation buffer). 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). Monetary policy of FY 2015-16 requires commercial bank to increase their paid-up capital to NPR 8 billion within mid-Jul-17, failure to comply the same may constrain growth. SCBNL plans to increase paid-up capital to NPR 8 bn (vs. ~NPR 3.75 bn as of now) by Jul-17 (as required by changed regulations) through proposed FPO and internal accruals. Accordingly, capitalization levels are expected to remain adequate to support SCBNL's growth plans over the medium term. The proposed FPO would also be bringing down the promoter holding to ~70% which is the cap on promoter holding as per regulatory norms for banks other than foreign joint venture.

Bank Profile

Incorporated in January 1987 as Nepal Grindlays Bank and subsequently renamed as SCBNL in July 2001 following the acquisition of parent ANZ Grindlays Bank by Standard Chartered Bank, SCBNL is subsidiary of one of the largest international banking brand. The ultimate parent i.e. Standard Chartered PLC (SCPLC), United Kingdom holds 75% stake in the bank while the rest is held by general public. The bank has Technical Services Agreement with SCB-UK, the later thus providing management support to the bank through expatriate CEO along with support in other management functions. The shares of the bank are listed in Nepal Stock Exchange and is one of the largest company in terms of market capitalization. The registered and corporate office of the bank is located at New Baneshwor, Kathmandu.

SCBNL has presence across the country through its 12 branches, 2 extension counters and 24 ATMs. The bank has market share of 3.13% in terms of deposit base and 2.20% of total advances of the industry as on mid-Oct-16. SCBNL reported a profit after tax of NPR 1,292 million during FY16 over an asset base of NPR 65,186 million as of mid-Jul-16 against profit after tax of NPR 1,310 million during 2014-15 over an asset base of NPR 65,059 million as of mid-Jul-15. For Q1FY17, bank has reported net profit of NPR 349 million over an asset base of NPR 66,767 million. SCBNL's CRAR was 16.52% and gross NPLs were 0.31% as on mid-Oct-2016. In terms of technology platform, SCBNL uses global technology platforms of Standard Chartered group across all its branches.

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[12] Average Total Assets
[13] Capital to Risk-weighted Assets Ratio