NIC Asia Bank Limited

ICRA Nepal assigns [ICRANP] LA- rating to subordinated bonds of NIC Asia Bank Limited; reaffirms Issuer Rating of [ICRANP-IR] A- and [ICRANP] LA- rating for existing subordinated bonds

Facility/Instrument	Amount	Rating Action (November 2017)
Subordinated Bond Program "NIC Asia Bond 2081/82"	NPR 3,000 Million	[ICRANP] LA- (Assigned)
Issuer Rating	NA	[ICRANP-IR] A- (Reaffirmed)
Subordinated Bond Program "7.25% NIC Asia Bond 2077"	NPR 500 Million	[ICRANP] LA- (Reaffirmed)

ICRA Nepal has assigned rating of **[ICRANP] LA-** (pronounced ICRA NP L A minus) to the proposed subordinated bonds of NPR 3,000 million of NIC Asia Bank Limited (NICA). ICRA Nepal has also reaffirmed the rating of **[ICRANP] LA-** to the existing subordinated bonds of NPR 500 million of NICA. Instruments with [ICRANP] LA- rating are considered to have adequate degree of safety regarding timely servicing of financial obligations. Such instruments carry low credit risk.

ICRA Nepal has also reaffirmed issuer rating of **[ICRANP-IR] A-** (pronounced ICRA NP Issuer Rating A Minus) to NIC Asia Bank Limited (NICA). [ICRANP-IR] A- rating are considered as adequate credit quality rating assigned by ICRA Nepal. The rated entity carries average credit risk. The rating is only an opinion on the general creditworthiness of the rated entity and not specific to any particular debt instrument. The sign of + (plus) or – (minus) appended to the rating symbols indicate their relative position within the rating categories concerned.

The rating assignment/reaffirmation factors in NICA's established track record (operating since 1998) and diversified franchise[1] leading to good market positioning in Nepal with ~5% and ~4% share in industry deposits and credits respectively. The ratings also factor in the continuous improvement in gross NPL levels of the bank (from 2.07% as on mid-Jul-15 to 0.29% as on mid-Oct-17[2]) despite of seasonal spike in delinquencies witness in Mid-Oct-17 (~5% as of Jul-17, slightly spiked to ~9% as of Oct-17). While assigning the ratings, ICRA Nepal also considers the improvement in profitability profile (RoA and RoNW[3] of 1.64% and ~17% for FY2017 vs. 1.21% and ~13% for FY2015) despite increase in capital base over last two years, required as per regulations. ICRA Nepal also positively takes note of the bank's increasing focus towards retail and SME lending which contributes to ~72% of portfolio as of Oct-17 (vs. ~55% on Jul-15) and has aided the improvement in granularity of credit portfolio (~12% among top 20 borrower groups as of Oct-17 vs. ~18% on Jul-16). Despite the tight liquidity conditions and consequent stress in deposits for the banking industry in recent periods, bank was also able to improve its deposits profile in terms of mix and concentration as well; CASA[4] improved to ~39% as of Oct-17 vs. 32% on Jul-16 and concentration among top 20 customers came down from 37% to 26% over same period.

These positives are however offset to an extent by aggressive credit growth plans of management of ~45% annual advances growth over the medium term, compared to past track record of CAGR[5] ~20% in earlier five years. In line with growth plans, bank has increased authority of the branch managers and achieved ~21% credit growth and ~20% growth in deposit in Q1FY2018.Though the supervisory controls are being tightened commensurate to the growth targets, high growth could create stress over assets quality as the incremental portfolio becomes more seasoned. Additionally, this has resulted in sharp decline in capital cushion as CRAR[6] swiftly came down from 13.83% as on mid-Jul-17 to 12.08% as of mid-Oct-17. While NICA has been largely able to pass the increase in the cost of deposits to borrowers,

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[1] 133 branches, one extension counter and 104 ATMs as of mid-Oct-17.
[2] Mid-Oct-2017 / Q1FY2018 data are unaudited
[3] Return on Assets and Return on Net Worth
[4] Current and Savings Accounts
[5] Compounded Annual Growth Rate
[6] Capital to Risk-adjusted Assets Ratio

increased delinquencies has resulted in contracted NIMs during Q1FY2018[7] (2.17%) which also remains a concern. The ratings also remain constrained by absence of strong institutional promoters and the unstable political conditions and uncertain operating environment that banks in Nepal are currently facing. Going forward, ability to maintain healthy asset quality, profitability and capital cushion, while targeting high growth would remain the key rating sensitivities.

Owing to lower than industry growth in earlier years, NICA's portfolio growth over last five years (ending Jul-17) remained moderate (CAGR ~20% vs. ~23% for industry). However, in line with bank's aggressive growth plans, portfolio growth has been spiked during last two years, whereby the portfolio grew by CAGR ~29% vs. ~25% for industry. The portfolio witnessed even higher growth during Q1FY2018 (~84% annualised growth), The spike in growth was also supported to an extent by rapid network expansion wherein new 66 branches were added post Jul-16 that roughly contributed to ~18% of portfolio growth over this period. Management plans to leverage the newly added branches and further expand the franchise to garner the targeted portfolio growth mostly from retail and SME loans (~72% of portfolio as of Oct-17 including ~41% retail loans, rest being corporate loans[8]). Bank's focus towards these segments has benefitted the granularity of credit portfolio with top 20 borrower groups accounting for ~12% of portfolio as on Oct-17 vs. ~18% on Jul-16. Though the incremental loans were competitively priced among peers, increased cost of funds across the banking sector in recent periods have resulted in higher lending yields of 12.06% for Q1FY2018 vs. 10.07% for FY2017. Bank's ability to mitigate risks while targeting high growth would have a strong bearing over its future financial profile.

Bank's asset quality has witnessed improvement over last few years with the same currently remaining better than industry and most of the peers (NPLs of 0.29% as of mid-Oct-17 vs. 2.07% as of mid-Jul-15). The improvement was aided by decline in fresh NPL generation rate (0.17% in FY2017 compared to ~0.8% on an average for FY2014 to FY2016), healthy recovery (~40-50%) and were also supported by dilution effect of portfolio growth. Delinquencies (0+DPD) of the bank generally remains moderate (5-10% range) with occasional increments; 5.23% as of Jul-17, slightly increasing to 9.05% as of Oct-17 amid festive seasons. However, major chunk of these delinquencies (~91% as of Oct-17) were delinquent within 30 days which provides some comfort. Going forward, seasoning effect because of high portfolio growth on asset quality remains to be seen and stress may inch upward in ICRA Nepal's view. Bank's ability to absorb such losses is however adequate (Net NPA/Net worth of 0.44% on mid-Oct-17 compared to 3.27% on mid-Jul-15).

Banking industry in Nepal witnessed stress in liquidity conditions from Q2FY2017 and hence NICA's cost of funds also increased in line with the industry. Nonetheless, supported by its expanded branch network, the bank was still able to improve deposits profile in terms of mix (CASA improved from 31% on Jul-16 to 39% on Oct-17) as well as concentration (~26% among top 20 depositors on Oct-17 vs. 40% on Jan-17). Despite the improvement, the same however continues to remain weaker than the peers and industry average as reflected by higher cost of funds for NICA at 7.97% for Q1FY2018 (5.49% for FY2017 vs. 4.10% for industry).

NICA's capitalisation levels are moderate with CRAR of 12.08% and tier I capital of 10.69% as of mid-Oct-2017 (both as per Basel III) which remains comfortable compared to minimum regulatory requirement of 11% and 8.00% respectively (both including Capital Conservation buffer - CCB of 2%). The tier I capital requirement is expected to increase to 8.50% by mid-Jul-19 (including CCB of 2.5%) although the requirement for total capital would be stable at 11% (incl. CCB of 2.5%). Considering the bond issuance plans and modest internal accrual targets of management, capitalization levels are expected to remain adequate to support NICA's growth plans over the medium term. However, given the targeted growth, capital cushion over the medium term is expected to remain lower. NICA has already met the capital of NPR 8 billion as required by changed regulations through rights offering and internal accruals. Going forward, maintaining adequate capital buffers through proposed bond issuance as well as internal accruals would be critical to absorb any shocks that may arise in asset quality to maintain comfortable solvency profile.

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

[8] Loan above NPR 100 mn to single borrower group are categorised as corporate loan

As for profitability, NICA's earnings profile has witnessed improvement in recent periods, however still remains lower to industry average. Despite increase in capital base, the improvement in RoNW and RoA was supported by high growth in portfolio and consequent increase in leverage resulting in overall increase in the profits. RoNW and RoA for FY2017 stood at at ~17% and 1.64% respectively (~18% and 1.94% for industry) compared to ~17% and 1.51% for FY2016. Bank's NIMs have declined during last three years (Average 2.82% during FY2015-2017 vs. 3.81% for earlier two years) because of high portfolio growth and consequent increase in leverage. Additionally, high cost of funds than industry also results in lower NIMs among peers for the bank. Despite further decline in NIMs to 2.17% for Q1FY2018, improvement in non-interest income (1.21% of ATA vs. 1.15% of ATA during FY2017) and reduced operating cost (~1.4% of ATA vs. ~2% of ATA during FY2017) supported the profitability to an extent with RoNW and RoA of ~11% and 1.01%. Ability of the bank to control the credit cost on account of concerns on asset quality will be critical for incremental profitability. Going forward, ability to maintain healthy asset quality, profitability and capital cushion, while targeting high growth would remain the key rating sensitivities.

Bank Profile

NICA is one of the large sized private sector commercial banks of Nepal. Incorporated in 1998 by some prominent businessmen/industrialists of the country, the bank was in operation as Nepal Industrial & Commercial Bank Limited until merger with Bank of Asia Nepal Limited in the first ever merger between two commercial Banks in the history of Nepal. Post-merger, the name was changed to NIC Asia Bank Limited and the merged operations commenced from 30th June 2013. Share capital of the company is distributed among promoter & public in the ratio of 51:49. The shares of NICA are listed in Nepal Stock Exchange and being actively traded. Mr. Laxman Risal is the Chief Executive Officer of the bank.

NICA's 133 branches, one extension counter and 104 ATMs provide it with presence throughout the country as of mid-Oct-2017. NICA has market share of 4.82% in terms of deposit base and 4.18% of total advances of commercial banking industry as on mid-Oct-17. NICA reported profit after tax (PAT) of NPR 1,473 million during FY2017 over an asset base of NPR 99,274 million as of mid-Jul-17 against PAT of NPR 1,067 million during FY2016 over an asset base of NPR 80,457 million as of mid-Jul-16. During Q1FY2018, NICA reported PAT of NPR 279 million over an assets base of NPR 120,973 million. As of mid-Oct-2017, NICA's CRAR was 12.08% and gross NPLs were 0.29%. In terms of technology platform, NICA has implemented Finacle across all its branches.

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