NIC Asia Bank Limited

ICRA Nepal assigns [ICRANP] IPO Grade 3 to the proposed Equity Shares (Rights Issue) of NIC Asia Bank Limited

Facility/Instrument	Issue Size	Grading Action (April 2016)
Rights Share Issue	NPR 923.754 Million	[ICRANP] IPO Grade 3 (Assigned)

ICRA Nepal has assigned an "[ICRANP] IPO Grade 3", indicating average fundamentals to the proposed rights issue amounting to NPR 923.754 million of NIC Asia Bank Limited (hereinafter referred to as NICA). 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. NICA is proposing to come out with 4:1 rights issue of 9,237,540 numbers of equity shares of face value NPR 100/- each to be issued to the existing shareholders at par. The proposed issue is to augment the capital base and partly meet the revised (higher) paid up capital requirement set by Nepal Rastra Bank (NRB), the banking sector regulator in Nepal.

The grading takes into account NICA's established track record (operating since 1998), and adequate franchise[1] leading to good market position (market share ~4% of Nepalese commercial banking industry as on mid-Jan-16). Comfortable capitalisation levels (CRAR[2] of ~12.4% as on mid-Jan 16[3]) and experienced management team are expected to provide NICA with adequate growth opportunities going forward. ICRA Nepal also takes note of the management's efforts to strengthen the internal risk management processes and further increase the proportion of retail and SME loan (increased to ~57% as on mid Jan-16 vs. ~46% on mid Jul-13).

The grading is however constrained by the bank's inferior deposits profile (CASA[4] deposits of ~33% vs. ~50% for industry) leading to high cost of funds among peers (4.35% as of mid-Jan-16), and also high depositor concentration risk (top 20 depositors comprised ~40% of deposits as on mid-Jan-16). NICA's profitability profile also remains moderate (PAT/ATA[5] of 1.57% and return on net worth of ~17% for H1FY16; and has been supported by lower credit provisions (due to relaxations provided by NRB) and significant write back of provision and one time income on recovery from NPLs. The bank has reported fair asset quality (Gross NPLs 1.4% as on mid-Jan-16), however same was supported by regulatory forbearance. ICRA Nepal also notes the build-up in bank's delinquencies over last few months (0+ days ~13.3% including NPLs as on mid Jan-16) and stock of restructured loans (0.91%) on account of damage suffered by April 2015 earthquake. Although the event related stress on the borrowers is expected to be limited with the strikes lifted recently, the bank's asset quality could remain under pressure, going forward. The grading further remains constrained by absence of institutional promoters, unstable political conditions and uncertain operating environment that banks in Nepal are currently facing. Going forward, NICA's ability to scale up its operations ensuring efficient utilization of fresh capital, improve its deposit and profitability profile and manage the asset quality would have a bearing on the overall financial profile.

NICA's branches in the earthquake affected areas accounted for ~60% of the credit portfolio as of mid-Jan-16, however several of these businesses (end users of loans) are situated outside the earthquake affected areas. Despite the stress in the economy due to earthquake and elongated political turmoil, NICA reported decline in gross NPLs[6] from 2.14% as on mid Apr-15 to 1.40% as on mid Jan-16. This was on account of large NPL recovery during Q2FY16 and also benefitted by regulatory relaxation[7] in NPL recognition norms. Disregarding the forbearance on NPL recognition, gross NPLs would have been

[1] 66 branches, one extension counter and 68 ATMs
[2] Capital to Risk-weighted Assets Ratio
[3] Mid Jan-16 data are unaudited
[4] Current and Savings Accounts
[5] Profit After Taxes as a % of Average Total Assets
[6] Non-Performing Loans
[7] 0.91% loan were restructured and 0.59% loan overdue more than 3 months are not recognized as NPA utilizing relaxation provided by NRB

2.90% as of mid Jan-16. However, the pressure on asset quality was evident with delinquencies increasing to 11.9% as on mid Jan-16 from 9.3% as on mid Jan-14 (both excluding NPLs). The scheduled loans continue to face higher delinquencies (~17%) compared to revolving loans (~12%), further aggravating asset quality related risks. Further, NICA has sizeable exposure (~27%) towards sectors[8] which could witness higher volatility on projects/earnings due to aftereffects of earthquake and elongated political strike could impact the asset quality indicators going forward and hence the bank's performance.

NICA's portfolio stood at NPR 47,317 million as on mid Jan-16 growing at ~16% during FY15 and ~9% during H1FY16 (CAGR of ~13% over past 5 years ending mid Jul-15 vs. industry average growth of ~19%). Going forward, the credit demand is expected to remain healthy owing to expected pickup in economic activity to support the reconstruction especially after the recent resolution of elongated turmoil and lifting of the economic blockade from major custom points. NICA's portfolio mix primarily comprises large corporate loans (~43%) followed by retail loans (~42%) and SME loans (~15%). Credit portfolio however remains concentrated with top 20 borrower groups accounting for ~21% of portfolio as on mid-Jan-16. Going forward, the management intends to grow at a higher pace (CAGR of~28% during FY16-FY20) in line with their five year strategic plan to ensure efficient utilisation of large capital to be raised by FY17 (as required by revised regulations).The management intends to increase the share of retail and SME loans to 70% by mid July 2020 (57% as on mid Jan-16) to improve portfolio granularity. The bank is also taking steps to improve its risk management systems and limit the exposure to various sectors (eg. LAS), setting up early warning signals for sectors under stress (fresh disbursements have been stopped in certain areas). Bank's ability to successfully implement the strategy while strengthing its controls, systems and processes commensurate with the growth targets would have a strong bearing over its business profile going forward.

NICA's fresh NPL generation witnessed decline in recent periods, primarily benefited by temporary regulatory relaxation (0.82% in FY15 compared to ~1.6% on an average for FY12 to FY14) and moderate recovery (~30%). This coupled with large NPL recovery during Q2FY16, resulted in improvement of reported NPLs (1.40% as of mid-Jan-16 vs. 2.33% as of mid-Jul-14), and better than industry average NPLs of 2.37%. Disregarding the regulatory relaxations, NPLs would have been 2.90% as of mid-Jan-16. Going forward, ICRA Nepal expects NICA's asset quality to remain under pressure in the near term due to damages caused by earthquake and elongated strikes, impacting borrowers' ability to make repayments in a timely manner. However, bank's comfortable solvency position (Net NPA/Net worth of 2.01% on mid-Jan-16 compared to 5.20% on mid-Jul-14), which will be further strengthened after capitalisation of the proposed rights issue (assuming subscription) provides some comfort. The bank's ability to improve its recovery profile in light of its exposure to sectors/segments impacted by earthquake/strikes and moderation in overall economic activity remains to be seen.

NICA's deposit profile remains weak and also inferior to industry as reflected by low portion CASA, which stood at ~33% (industry average of ~50% on Jan-16) as on Jan-16, notwithstanding some improvement from ~28% on mid Jul-13. This has resulted in higher cost of funds for NICA at 4.35% for H1FY16 compared to peers and industry average cost of funds at 3.27%. Furthermore, deposit concentration on top 20 depositors also remains high at ~40% as of mid-Jan-16. Going forward, NICA's ability to improve its deposit profile and hence lower deposit costs and improve NIMs would have strong bearing on its financial profile.

As for profitability, NICA's earnings profile in recent periods have been impacted mainly due to its declining NIMs[9] (3.68% for FY14, 2.83% for FY15 and 2.64% for H1FY16), which remains weaker among peers. Return indicators declined during FY15 with RoNW and RoA[10] at ~12% and 1.21% respectively compared to ~17% and 1.70% for FY14. Although the profitability indicators witnessed some improvement during H1FY16 (RoNW and RoA of ~17% and 1.57% respectively), the same was supported by lower provisioning (forbearance provided by NRB on watch-list and select NPL accounts) along with significant write back of provisions and one time income on NPL recovery (these contributed to ~35% of reported profit for the period). Lower non-interest income (0.87% of ATA during H1FY16)

[8] Tourism, microfinance, real estate, consumption (incl. hire purchase and loan against shares) and hydropower sectors
[9] Net Interest Margins as a % of Average Total Assets
[10] Return on Net Worth and Return on Assets

further acts as a drag to profitability despite moderate operating expense ratio (1.65% of ATA during H1FY16). Going forward, bank's ability to ensure efficient utilisation of large incremental capital, maintain adequate NIMs and manage asset quality would have strong bearing on its profitability profile.

NICA's capitalisation levels are adequate with CRAR of 12.44% and tier I capital of 10.49% as of mid-Jan-2016 (both under Basel III) against minimum regulatory requirement of 10% and 6% respectively (increasing to 11% and 7.25% respectively incl. capital conservation buffer under Basel IIII from md Jul-16). Considering the proposed rights issue and expectations of moderate internal accruals, capitalization levels are expected to remain adequate to meet the regulatory minimum and support NICA's growth plans over the medium term. Post the proposed issue (assuming full subscription), NICA's paid-up capital would increase to NPR 4.62 bn and the bank has plans for further rights and bonus issue to attain the capital of NPR 8 bn by FY17 as required by Monetary Policy of FY15/16. The banks' ability to raise planned capital in a timely manner would also have critical bearing on its ability to absorb damages arising out of earthquake/strikes and maintain comfortable solvency profile.

Bank Profile

NICA is one of the large private sector commercial bank of Nepal. Incorporated in 1998 by some of the prominent businessmen/industrialists of the country, the bank operated as Nepal Industrial & Commercial Bank Limited until the merger with Bank of Asia Nepal Limited in the first ever merger between two commercial Banks in the history of Nepal. Post the merger, the name was changed to NIC Asia Bank Limited and the merged operations commenced from 30th June 2013. Share capital of the bank is distributed among promoter & public in the ratio of 51:49. The bank's equity shares are listed on the Nepal stock exchange. The bank is managed by a team of experienced bankers and professionals. Mr. Laxman Risal is the Acting Chief Executive Officer of the bank.

NICA's 66 branches, one extension counter and 68 ATMs provides it with presence throughout the country. NICA has market share of 3.76% in terms of deposit base and 4.02% of loan & advances in commercial banking industry of Nepal as on mid-Jan-16. NICA reported a profit after tax of NPR 680 million during 2014-15 over an asset base of NPR 60,519 million as of mid-Jul-15 against profit after tax of NPR 832 million during 2013-14 over an asset base of NPR 51,501 million as of mid-Jul-14. During H1FY16, NICA reported PAT of NPR 502 million over an assets base of NPR 67,699 million. As of mid-Jan-2016, NICA's CRAR was 12.44% and gross NPLs were 1.40%. In terms of technology platform, NICA has implemented Finacle across all of its branches.

April 2016

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