

## Bank of Kathmandu Limited

### ICRA Nepal assigns [ICRANP] LBBB rating to subordinated bonds program of Bank of Kathmandu Limited

Facility/Instrument	Amount (NPR million)	Rating Action (July 2015)
Subordinated Bond Program	600	[ICRANP] LBBB (Assigned)

ICRA Nepal has assigned rating of **[ICRANP] LBBB** (pronounced ICRA NP L triple B) to subordinated bond programme of NPR 600 million of Bank of Kathmandu (BOK). Instruments with this rating are considered to have moderate degree of safety regarding timely servicing of financial obligations. Such instruments carry moderate credit risk. ICRA Nepal assigns corporate debt (bond) rating on a scale of LAAA to LD<sup>1</sup>, 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 BBB+ is one notch higher than BBB, while BBB- is one notch lower than BBB.

The rating factors in the BOK's long track record (established in 1995), adequate franchise<sup>2</sup> leading to average market positioning with around 2.5% share in Nepalese banking sector credit and adequate capitalization (CRAR<sup>3</sup> of 11.57% on mid-April-15<sup>4</sup>) vs. 10% regulatory minimum requirements. The rating also considers deposit mix with fair CASA<sup>5</sup> deposit proportion (40% of total deposits on mid-April-15), good assets quality (except for expected loss on one large off balance sheet exposure in FY14) with Gross NPL of 1.06% on April-15 and 1.05% on July-14 and experienced management team. BOK's profitability declined significantly in FY14 (PAT/ATA of 0.71% in FY14 vs. 2.01% in FY13) due to increase in credit provisioning for probable losses in one of its large off balance sheet exposures (counter guarantee exposure). With half of these probable losses provided for in FY14 and remaining half expected to be provided in FY15, the profitability in FY15 is also likely to be affected. BOK's profitability profile is also impacted by its relatively higher operating expenses vs. peers. ICRA Nepal expects moderate level of stress on BOK's asset quality and profitability profile over next 2-3 years due to damage caused by the earthquake in April 2015 and aftershocks. At this stage, exact quantum of damage is not ascertainable. ICRA will closely monitor the extent of damages on BOK's financial and solvency profile which could have bearing on the rating assigned. The rating is also constrained by high deposit concentration (top 20 depositors accounted for 34% of total deposits as on Jan-15), lack of institutional promoter support and by unstable political conditions and uncertain operating environment that banks in Nepal are currently facing.

As for impact on BOK's operations, BOK's branches in the earthquake affected areas accounted for ~64% of the credit portfolio and ~81% of the deposits as on April-15; however several of these businesses (end users of loans) are situated outside the earthquake affected areas due to which extent of damage could be restricted to certain sectors/segments<sup>6</sup> accounting for ~1/6<sup>th</sup> of BOK's loan book. Apart from stress in affected geographies/segments, exposures in unaffected geographies/segments could also witness some stress due to overall moderation in economic activity as well as linkage among businesses/borrowers. ICRA Nepal has also noted that earthquake has not caused significant stress on BOK's deposits/liquidity profile<sup>7</sup>. Furthermore, recent activity in the stock market suggests that banks' ability to raise capital to absorb damages caused by earthquake is not significantly deterred.

<sup>1</sup> For details of rating scale refer Debt Rating Methodology of ICRA Nepal.

<sup>2</sup> 50 branches, 24 branchless banking service, 7 extension counters and 57 ATMs in Nepal

<sup>3</sup> Capital to Risk (Weighted) Assets Ratio.

<sup>4</sup> Jan-2015 and April-2015 data are unaudited; all calculations are based on management provided data

<sup>5</sup> Current & Savings accounts

<sup>6</sup> Tourism, hydropower, real estate/construction, consumer loans, housing loans and loan book of micro finance entities

<sup>7</sup> BOK's deposits were NPR 39.7 billion as on June 10, 2015 vs. NPR 37.8 billion as on April 13, 2015



BOK's credit portfolio of NPR 32,900 million on mid-April-15 accounted for ~2.50% of Nepalese banking industry credit. The portfolio grew by a modest CAGR<sup>8</sup> of 14% over past 4 years (ending FY14) below the industry average growth rate of 18% during the same period and in line with the conservative growth plans adopted by the bank. 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 although reconstruction drive could support credit growth to some extent. As on mid-Jan-15, the credit portfolio of the bank was primarily composed of large corporate loans (45%) and Business/SME loans (37%); the remainder comprising of consumer loans and regulation mandated deprived sector lending. Having started off as a wholesale lender, large ticket corporate loans still accounts for major chunk of BOK's credit portfolio. However, the proportions of corporate loans are coming down in recent years to the advantage of SME loans which have grown from 29% on mid-July-12 to 37% on mid-Jan-15. Management intends to grow in the SME segment, given better security coverage and relatively higher yield in this segment compared to corporate loans.

Apart from the expected losses on one large off balance sheet exposure, asset quality of BOK remains comfortable with Gross NPL<sup>9</sup> of 1.06% as on mid-April-15 and adequate provisioning coverage of ~85%. However, asset quality could come under pressure going forward due to damage caused by earthquake, impacting borrowers' ability to make repayments in a timely manner. ICRA Nepal has noted some build-up of delinquencies with weakened recovery performance in the months following earthquake; with the rate of scheduled loan recovery declining by 500bps over pre earthquake level. The recently introduced regulatory forbearance<sup>10</sup> aimed towards earthquake affected portfolio/borrowers is likely to lower the pressure on banks' reported asset quality profile in FY15; however if economic/business activity remain under pressure due to impact of earthquake damage, banks' reported asset quality could weaken in FY16. However, moderate concentration among top borrowers (22% of credit accounted for by top 20 borrowers on mid-Jan-15); lower exposures to real estate sectors and lower growth in past few years reduces concern to some extent.

BOK's capitalisation levels are adequate with CRAR of 11.57% and tier I capital of 8.97% as of mid-April-15 against minimum regulatory requirement of 10% and 6% respectively. The bank is looking to raise capital through subordinated debt of NPR 600 million in FY15. Furthermore, recent activity in the stock market suggests that banks' ability to raise capital to absorb damages caused by earthquake is not significantly deterred. BOK's relatively healthy profitability and internal capital generation are also a support for its capitalisation profile. However profitability and internal capital generation could also come under stress if asset quality weakens due to earthquake impact. Going forward, the ability of the bank to raise capital from existing promoters or external investors will have a strong bearing on BOK's capitalization profile.

Excluding FY14, BOK has been able to maintain healthy profitability profile as reflected in PAT/ATA of ~2% and return on net worth of ~ 20% over past 3-4 years; driven by healthy NIMs (around 3.5-4%) benefitted from lower cost of deposits and fair non-interest income level (1.24% of ATA in FY14) despite higher operating expense ratio being a drag. BOK's profitability for FY14 was affected (PAT/ATA of 0.71%) by additional provisioning of NPR 408 million, 50% of the amount claimed made by Melamchi River Water Supply Board (MWSB), against BOK's counter guarantee to MWSB. BOK's guarantee was offered on behalf of the contractor China Railway 15 Bureau group and the guarantee was backed by guarantee from China Construction Bank of People's Republic of China. BOK has to provide for balance 50% exposure in FY 15; this provisioning will impact its FY15 profitability indicators as well. In the aftermath of April-2015 earthquake, ICRA Nepal expects BOK's profitability profile to moderate over next 2-3 years owing to likely decline in credit demand affecting growth and rise in provisioning expenses following incremental slippages.

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<sup>8</sup> Compounded annual growth rate

<sup>9</sup> Non performing loans

<sup>10</sup> Allowing banks to defer the due date for payments from July-15 to October-15 without having to classify such loans as NPL till Oct-15; among others relaxations.



### **Bank Profile**

Bank of Kathmandu (BOK) Limited started its commercial operation from March 12, 1995 and is registered as “A” class Commercial Bank with Nepal Rastra Bank (NRB) - Central bank of Nepal. Its head office is located at Kamalpokhari, Kathmandu. The bank is promoted by individual promoters related to business and industrial houses and is managed by a team of experienced bankers and professionals. Mr. Ajay Shrestha is the Chief Executive Officer of the bank. The bank’s equity share is listed in Nepal stock exchange and on Mid-June 2014 was being actively traded with market capitalization of about NPR 10,657 million; before the trading was halted on account of merger talks. The trading is in the process of resumption after the merger talks failed to reach conclusion.

BOK has presence across 32 districts of the country through its 50 branches including Head office and 57 ATMs. BOK is a medium size bank with market share of about 2.22% in terms of deposit base and 2.50% in terms of credit portfolio in Nepalese banking industry as on mid-April-15. BOK reported a profit after tax of NPR 254 million during 2013-14 over an asset base of NPR 39,034 million as on Jul-14 as against profit after tax of NPR 617 million during 2012-13 over an asset base of NPR 32,546 million as on Jul-13. During 9M 2014-15, BOK has reported PAT of NPR 480 million. As on mid-April-15, BOK’s gross NPL stood at 1.06%, net NPL at 0.19%, CRAR at 11.57% and tier I capital at 8.97%.

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