NMB Bank Limited

ICRA Nepal upgrades issuer rating of NMB to [ICRANP-IR] LBBB+ and subordinated bonds rating of NMB bank to [ICRANP] LBBB+; removed from “rating watch with negative implications”

Facility/Instrument	Amount	Rating Action* (August 2016)
Issuer Rating	NA	[ICRANP-IR] BBB+ rating (upgraded)
Subordinated Bond Program	NPR 500 Million	[ICRANP] LBBB+ rating (upgraded)

**“rating watch with negative implications” removed for both the ratings*

ICRA Nepal has upgraded NMB’s Issuer rating from **[ICRANP-IR] BBB** (pronounced ICRA NP Issuer Rating triple B) to **[ICRANP-IR] BBB+** (pronounced ICRA NP Issuer Rating triple B plus). [ICRANP-IR] BBB+ ratings are considered as moderate credit quality rating assigned by ICRA Nepal. The rated entity carries higher than 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 rating has been removed from “rating watch with negative implications”.

ICRA Nepal has also upgraded the rating of subordinated bonds of NPR 500 million of NMB Bank Limited (NMB) from **[ICRANP] LBBB** (pronounced ICRA NP L triple B) to **[ICRANP] LBBB+** (pronounced ICRA NP L triple B plus). Instruments with this rating are considered to have moderate degree of safety regarding timely servicing of financial obligations. Such instruments carry moderate credit risk. The rating has been removed from “rating watch with negative implications”.

The sign of + (plus) or – (minus) may be appended to the rating symbols to 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.

Ratings for NMB were put on watch with negative implications in April 2015, pending assessment of the impact due to the earthquake on credit and financial profile of NMB. While removing the rating from watch with negative implication and upgrading the ratings for NMB, ICRA Nepal takes into consideration scale up of operations on account of merger of four BFIs[1] with NMB during FY2016, improvement in franchisee and reach, NMB’s ability to manage its asset quality (notwithstanding some deterioration during the past 6-9 months) and adequate profitability indicators.

The rating action factors in the improvement in NMB’s market positioning following the recently concluded merger with four class B & C BFIs. By virtue of merger, NMB is now among the large players in the industry with ~4% share in Nepalese commercial bank’s credit base as on mid-April 2016. The merger has also improved NMB’s presence across the country through its 72 branches and extension counters as compared to 32 branches pre-merger. The improved market positioning coupled with NMB’s established track record (operating since 1996[2]) and experienced management team is likely to have positive impact on the future prospects of the bank. The rating up gradation also factors in the inclusion of FMO, Netherland[3] as a promoter of NMB post-merger. Further, as per merger approval conditions NMB is to issue further equity shares to FMO which will increase the latter’s stake in NMB to 20% from

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[1] Four Banks and Financial Institutions viz. **Clean Energy** Development bank (CEDBL-National Level Class B Bank), **Bhrikutee** Development Bank (10-district level Class B Bank-graded IPO 3 by ICRA Nepal in November 2014), **Pathibhara** Development Bank (3-district level Development Bank) and P**rudential** Finance Limited (National Level Class C Finance Company).

[2] As class C finance company before its upgradation to Class A bank in 2008.

[3] The Netherlands Development Finance Company called **Nederlandse Financierings-Maatschappij voor Ontwikkelingslanden (FMO)**, was the promoter of CEDBL, one of the merging partners. FMO is 51% owned by the Dutch Government and also enjoys liquidity and solvency support from the latter.

its current stake of ~3%. In addition to equity stake, FMO would also have board representative[4] in NMB.

The ratings are however constrained by NMB's inferior deposits profile despite improvement post-merger (CASA[5] deposits of ~40% as on mid-April 2016 vs. ~50% for commercial bank industry). This has led to high cost of deposits among peers (4.10% as of mid-April 2016), weakening its competitive positioning to some extent. At the same time, concentration of deposits among top accounts also remains on higher side (top 20 depositors comprised ~34% of deposits as on mid-April 2016). Moreover, successful integration of resources of different class of banks operating in different geographies and with different business methodology remains a challenge. The rating is also constrained by uncertain operating environment that the banks in Nepal are currently facing.

NMB's credit portfolio has grown at a healthy pace of CAGR ~30% over past 5 years ending FY15, albeit on a low base. On account of merger that concluded in mid-October 2015, NMB's portfolio grew by 80% during 9MFY16. Apart from aiding the portfolio growth, the merger has also increased NMB's footprint across the country which is likely to aid the incremental credit growth. As on mid-April 2016, NMB's credit portfolio primarily comprises of Small & Medium Enterprise (SME) Loan (43%), followed by large corporate loans (~32%) and retail loans (20%). On account of strengthening of retail & SME base post-merger, the average yield on advances has improved to 9.59% during 9MFY16 from 9.11% during FY15. Going forward, the management intends to leverage the strength of newly acquired branches (through merger) to achieve future credit growth along retail/SME segment. Moreover, injection of fresh equity through FPO in FY17 will allow the bank to take large ticket exposures to grow its corporate portfolio. However, the bank's ability to achieve the growth targets along with commensurate control measures remains to be seen.

ICRA Nepal takes note of NMB's focus towards portfolio diversification through growth in retail and SME lending; that was further aided by mergers with retail-focussed class B and Class C banks. Healthy proportion of retail/SME lending portfolio has kept the credit concentration among top borrowers at moderate level (top 20 borrowers accounting for ~17% of total loans on mid-April 2016); despite high credit growth in recent years. Similarly, improvement in higher-yielding SME and retail loan portfolio has supported NMB's NIMs (3.43% as on mid-April 2016), aiding the profitability indicators as well. NMB's adequate capitalization level (CRAR 11.35% and CET-I [6]9.63% on mid-April 2016), is likely to be further benefitted from the fresh equity injection through further equity issue (FPO) planned for FY17.

NMB's asset quality has deteriorated in the post-merger era due to inclusion of stressed accounts from merging entities. Gross NPA of NMB increased from 0.42% on mid-July 2015 (pre-merger) to 1.70% on mid-April 2016 (post-merger); yet remains better than industry average of 2.22%. As on mid-April 2016, >70% of total NPA of NMB was accounted for by the credit book taken over from merging class B and class C banks. The bank's overall delinquencies (zero+ days past due) stood at 9.40% as on mid-April 2016 increasing from 4.86% as on mid-July 2015. In addition, bank had restructured four accounts (~1.32% of mid-April 2016 credit portfolio) due to the impact of earthquake/strikes, under NRB's relaxed norms which has supported the reported NPAs. The bank also has sizeable exposure (~26% of mid-April 2016 credit portfolio) towards sectors[7] which could witness higher volatility in earnings due to aftereffects of earthquake/strikes could impact the asset quality indicators going forward and hence the bank's performance. However, NMB has maintained buffer against probable slippages that could arise from the acquired loan books, by maintaining additional provisions towards these loans (additional provision of NPR 381 million as on mid-April 2016 towards standard loans). This is likely to act as buffer against any probable slippages that could arise going forward. Recent increase in delinquency levels, loan accounts restructured in the aftermath of earthquake/strike and impact of uncertain political condition in the business environment could lead to fresh slippages and NPAs over near term. However,

[4] FMO will appoint one nominee in the board of NMB.
[5] Current and Savings Accounts
[6] CRAR: Capital to Risk Adjusted assets ratio and CET-I: Common Equity Tier I Capital
[7] Tourism, microfinance, real estate, consumption (incl. hire purchase and loan against shares) and hydropower sectors

adequate provisions and comfortable solvency profile (net NPA / net worth of ~7% as on mid-April 2016) are likely to support NMB in the event the losses on the NPAs are to be borne by the bank.

NMB's CASA deposit proportion grew from ~30% on mid-July 2015 to ~40% in mid-April 2016, primarily due to merger with regional BFIs with strong retail presence. Nonetheless, the CASA proportion of NMB remains lower to the commercial bank's average. Although the management plans to utilize its newly acquired franchise network in semi-urban & rural area to garner more savings deposit, the same remains to be seen. In line with low CASA proportion, cost of funds for NMB (4.10% during 9mFY16) also remains >100 bps higher than commercial banks' average as on mid-Apr-16. Furthermore, deposit concentration on top 20 depositors also remains high at ~34% as of mid-April-16, despite declining in recent years.

As for profitability, NMB's return indicators were better than commercial bank's average during 9MFY16 with PAT/Net worth of ~21% and PAT/ATA of 1.92% against industry average of 19.85% and 1.74% respectively. During FY15, the indicators stood at 16.40% and 1.40% respectively, well below the commercial bank average of 20.09% and 1.75%. Post-merger improvement in profit levels is contributed by improvement in NIMs, primarily on account of higher yield on advances, optimum utilization of fund (CD ratio ~80%) and decline in cost of deposits. Profitability remains further supported by fair non-interest income (~1% of ATA) and low credit provisioning expense. Going forward, bank's ability to ensure efficient utilisation of incremental capital through promoter FPO, maintain adequate NIMs and manage asset quality would have strong bearing on its profitability profile.

NMB's capitalisation levels are adequate with CRAR of 11.35% and CET-I of 9.63% as of mid-Apr-2016 (both under Basel III norms) against minimum regulatory requirement of 11% and 7.25% (both including capital conservation buffer-CCB) respectively required for mid-July 2016. 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 at 11% (incl. CCB). NMB plans to increase paid-up capital to NPR 8 billion (vs. NPR 4.5 billion as of now) by FY17 (as required by changed regulations) through FPO and internal accruals. Accordingly, capitalization levels are expected to remain adequate to support NMB's growth plans over the medium term. The banks' ability to raise planned capital in a timely manner would have a bearing on its ability to meet the revised guidelines and support growth plans.

Bank Profile

NMB Bank Ltd (previously Nepal Merchant & Banking Finance-Class C Financial Institution) started its operation from 26th December 1996. The bank has been operating as a commercial bank following its up gradation from Class C to Class A in May 2008. It was registered as joint –Venture Company with foreign promoter M/s Young Leon Realty, Malaysia holding 12.67% stake (currently 7.45%).

In the first half of FY 2015-2016, NMB underwent merger with four other banking and financial institutions in a bid to raise the minimum paid up capital as required by NRB. NMB Bank retained the brand name following the merger and joint operations commenced from mid-October 2015. The merger increased the capital fund and assets base of NMB in addition to increasing its footprint across the country.

Through the final approval document of merger, NRB has stipulated that FMO Bank, Netherland will increase its stake in post-merger NMB to 20% of the paid up capital of NMB; from FMO's current stake of 3.18% in NMB. In order to achieve that, NMB will issue further (promoter) equity shares to FMO at premium. As on April 2016, promoter public shareholding of NMB stood at ~52:48; likely to change following further issue of promoter shares to FMO. The current major promoter group of the bank includes the original promoters from NMB bank viz. Employees' provident fund Nepal (9.77% shareholding), Young Leon Realty, Malaysia (7.45%); and other individual shareholders from business houses of Nepal.

NMB has presence throughout the country through its 72 branches (including 3 extension counters) and 48 ATMs. NMB has market share of about 2.92% in terms of deposit base and 3.16% of total advances of Nepalese Banking Industry as on mid-April 2016 (3.52% and 3.88% share among the commercial banks). NMB reported a profit after tax of NPR 501 million during FY 2014-15 over an asset base of NPR 41,337 million as at mid-Jul-15 against profit after tax of NPR 410 million during FY 2013-14 over an asset base of NPR 30,212 million as on mid-Jul-14. Till mid-April-16 (9MFY 2015-16), NMB bank, post-merger, has reported a net profit of NPR 771 million over an asset base of NPR 65,558 million. As of mid-April-16, NMB's CRAR (under Basel III) was 11.35% (CET-I of 9.63%) and gross NPAs were 1.69%.

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