Nepal Investment Bank Limited

ICRA Nepal keeps ratings 'under watch with negative implications'

Facility/Instrument	Amount	Rating Action (July 2019)
Issuer Rating	NA	[ICRANP-IR] A+; under watch with negative implications
Subordinated Debenture Programmes	NPR 2,750 Million	[ICRANP] LA+; under watch with negative implications

ICRA Nepal has placed the ratings assigned to Nepal Investment Bank Limited (NIBL) under watch with negative implications. These ratings include the issuer rating of **[ICRANP-IR] A+@**[1] (pronounced ICRA NP issuer rating A plus) and the rating for subordinated debentures at **[ICRANP] LA+@** (pronounced ICRA NP L A plus). The rated entity carries low credit risk. The issuer rating is only an opinion on the general creditworthiness of the rated entity and not specific to a particular debt instrument. The sign of + (plus) or – (minus) is appended to the rating symbols to indicate their relative position within the rating categories concerned. Thus, the rating of A+ is one notch higher than A, while A- is one notch lower than A.

The ratings for NIBL have been kept under watch with negative implications, given the recent spike in non-performing loans (NPLs) and delinquencies, beyond the levels expected by ICRA Nepal. With two large slippages, the NPLs increased sharply to 3.04% as of mid-April 2019 from 1.26% as of mid-October 2018 (when last rated). Additionally, the 0+ days delinquencies increased to ~18% as of mid-April 2019 from ~14% when last rated, hence increasing the asset quality concerns. In ICRA Nepal's assessment, the bank's financial profile could witness some stress over the near term, given the low provision cover for recent large slippages (~38% for these two NPLs of NPR 2,389 million). NIBL's capitalisation also remained moderate at 11.97% as of mid-April 2019. However, the recently issued debentures (NPR 2,000 million), along with internal accruals, are expected to absorb the expected stress in capitalisation over the near term. ICRA Nepal would be closely monitoring the developments in this regard and any further deterioration in the key indicators may exert pressure on the ratings assigned.

However, the ratings factor in NIBL's strong market positioning, considering it is one of the largest private sector commercial banks with a share of ~5.3% in industry credit and deposits. The bank's established track record (operating since 1986) and its moderate credit growth in recent periods also support the rating. NIBL's diversified network along with its experienced management team are expected to provide it with adequate growth opportunities going forward. The ratings also take into consideration the gradual improvement in the bank's net interest margins (NIMs). This, along with the healthy fee-based income and relatively low operating costs, led to an adequate earnings profile among peers. The ratings remain supported by the presence of institutional promoters, mainly Rastriya Beema Company Limited, a state-owned insurance company, which has a stake of ~12% along with representation on the bank's board.

Nonetheless, the ratings remain constrained by the spike in the bank's NPLs and delinquencies in recent periods. Given the sharp increase in interest rates in the last two years, the asset quality is expected to remain under stress over the medium term. However, consolidation and the moderate growth plans of the management could help lower the delinquency level. ICRA Nepal also notes the high customer concentration risks (~33% of credit and ~30% of deposits among the top 20 customer groups as of mid-April 2019). The ratings are also constrained by NIBL's deposits profile, which is relatively modest among the top-tier banks of Nepal, leading to a slightly higher cost of funds. The ratings also factor in the probable systemic risks emanating from the mismatch in credit and deposit growth in the industry over the last few years. The bank's ability to improve the mix/cost of deposits, reduce the concentration risks and improve the asset quality indicators would remain a key rating driver.

NIBL is one of the largest private sector commercial banks in Nepal with an asset base of ~NPR 175 billion as of mid-April 2019. Its credit portfolio of ~NPR 130 billion, as of mid-April 2019, accounted for 5.33% of the industry credit. Despite some decline in its market share in last 2-3 years on account of aggressive growth by some peers, NIBL's market share remains adequate among its top-tier peers. The bank's credit

[1] *Denotes rating under watch with negative implications*

portfolio increased at a compounded annual growth rate (CAGR) of ~16% during mid-July 2016 to mid-April 2019 (~22% for the industry). The current focus is on the consolidation of the portfolio, which remains a positive from a rating perspective. Yields on advances for the bank remained moderate among peers at 11.55% in 9M FY2019 (9.24% in FY2017). The increased yield in recent periods was largely in line with the industry trend and was partly supported by the booking of interest income on an accrual basis, as per the revised financial reporting framework[2]. NIBL remains a corporate-heavy bank with large corporate loans comprising ~87% of the portfolio as of mid-April 2019, the rest being retail and SME loans. The credit portfolio remains concentrated with the top 20 borrower groups accounting for ~33% of the portfolio and 196% of the Tier-I capital, hence posing asset quality related risks.

The bank's asset quality has witnessed gradual stress in recent periods with the NPLs increasing to 1.26% as of mid-July 2018 from 0.83% as of mid-July 2017. With two large slippages, the NPLs increased sharply to 3.04% as of mid-April 2019. These two accounts carry a total provision of ~38% (for an exposure of NPR 2,389 million). Since the timeline and quantum of recovery from these accounts are unclear, additional provision would be required in subsequent periods, which would pressurise the bank's profitability and capitalisation. The high NPLs together with the high delinquencies among peers, at ~18%, elevate the concerns on the asset quality front. However, ~80% of the delinquencies are within 30 days, providing some comfort. With a low provision cover of ~48% as of mid-April 2019, the net NPA and solvency indicator (net NPA/net worth) deteriorated to 1.60% and 8.16%, respectively. Going forward, the asset quality of the banking sector, including NIBL, is expected to witness some moderation due to a decline in the repayment capability of borrowers over increased interest rates. NIBL's ability to reduce the delinquencies/NPLs would remain a key monitorable.

NIBL's cost of deposits remains better compared to the industry average despite the largely comparable deposits profile, mainly on account of low rates for savings account products. Nonetheless, the share of low-cost CASA deposits is slightly lower in relation to other top-tier banks, which reflects in the relatively higher cost of deposits. During the past two years, the Nepalese banking industry has witnessed a shortage in lendable deposits, leading to price wars for deposits at times. This has caused a major shift to term deposits from CASA deposits for the industry, thereby pushing up the cost of deposits. Accordingly, CASA for NIBL also declined to ~39% as of mid-April 2019 from ~42% as of mid-July 2017 against a decline in the industry average CASA to ~42% from ~44% during the same period. However, the cost of deposits at 6.12% in 9M FY2019 (3.69% in FY2017) remained lower than the industry average of 6.51% (4.10% in FY2017). Compared to credit growth, the deposit growth has remained low (CAGR of ~10% during mid-July 2016 to mid-April 2019 against ~17% for the industry). The lower growth compared to industry standards as well as a mismatch in the credit and deposits growth remain a concern. However, the external capital raising in FY2017 and the healthy internal accruals have provided comfort on the CCD front[3], which stood at ~76% as of mid-April 2019. Despite recent moderation, NIBL's deposit concentration remained high with the top 20 depositors accounting for ~30% of the total deposits as of mid-April 2019 (~35% as of mid-July 2017). Improving the deposits mix, concentration and cost would remain key challenges for the bank over the medium term.

Regarding capitalisation, NIBL's reported capital to risk-weighted assets ratio (CRAR) of 11.97% and tier I capital of 11.07% (both as per Basel III) as of mid-April 2019 remain comfortable against the minimum regulatory requirement of 11% and 8%, respectively (both including capital conservation buffer (CCB) of 2%). The tier I capital requirement is expected to increase to 8.5% by mid-July 2019 (including CCB of 2.5%) although the requirement for total capital would be stable at 11% (including CCB). The capitalisation has declined in the last six months to 11.97% from 13.02% due to the distribution of 22% cash dividend for FY2018. Nevertheless, the recently completed issuance of NPR 2-billion tier II debentures is expected to support the bank's capitalisation over the near term. Given NIBL's healthy internal accruals and profit retention as per business growth needs in the past, the capitalisation levels are expected to remain adequate to support the management's growth plans while maintaining a comfortable solvency profile.

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[2] *Nepal Financial Reporting Standards, adopted from FY2018, requires accrual-based interest income booking on loans; earlier, this used to be on cash basis as per regulations*

[3] *Local currency (LCY) credit to core capital and LCY deposits ratio capped at 80% by regulations*

On the profitability front, NIBL's earnings profile has witnessed stress in recent periods, mainly due to higher credit costs. However, a gradual improvement in NIMs (3.78% in 9M FY2019 from 3.41% in FY2017), healthy fee-based income (1.18% of average total assets; ATA) and a relatively low operating expense ratio (1.41% of ATA) provide support. With high credit costs in 9M FY2019 (0.71% of ATA), the bank reported a decline in the return on assets (RoA) and return on net worth (RoNW) to 1.94% and ~13%, respectively, from 2.27% and ~17%, respectively, in FY2018. Despite the decline, the RoA remained slightly better than the industry average of 1.87% while the RoNW was below the industry average of ~15%. Going forward, the bank's ability to maintain adequate NIMs and manage the asset quality would have a strong bearing on its profitability profile.

Analytical approach: For arriving at the ratings, ICRA Nepal has applied its rating methodology as indicated below.

Links to applicable criteria:
Issuer Rating Methodology
Corporate Credit Rating Methodology
Bank Rating Methodology

Bank Profile
Nepal Investment Bank Limited (NIBL), previously Nepal Indosuez Bank Ltd., was established in 1986 as a joint venture between Nepalese and French partners. In April 2002, the French partner, Credit Agricole Indosuez (holding 50%), sold its stake to a group of companies comprising bankers, professionals, industrialists and businessmen of Nepal. The name of the bank was then changed to Nepal Investment Bank Limited. The bank is promoted by several insurance companies, retirement funds and investment companies, the most prominent being Rastriya Beema Company Limited (12.42%). The bank's shares, which are listed on the Nepal Stock Exchange, are held by the promoters and the public in the ratio of ~69:31. NIBL's registered office is in Durbarmarg, Kathmandu.

NIBL had 80 branches and 115 ATMs spread throughout the country as of mid-April 2019. It had a market share of 5.23% in terms of the deposit base and 5.33% of the total advances of the commercial banking industry as of mid-April 2019. NIBL reported a profit after tax (PAT) of NPR 3,659 million in FY2018 (YoY growth of ~18%) on an asset base of NPR 171,893 million as of mid-July 2018. In 9M FY2019, it reported PAT of NPR 2,522 million on an asset base of NPR 174,747 million. As of mid-April 2019, NIBL's CRAR was 11.97% and gross NPLs were 3.04%. In terms of the technology platform, NIBL has implemented Finacle at all its branches.

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About ICRA Nepal Limited:
ICRA Nepal Limited, the first credit rating agency of Nepal, is a subsidiary of ICRA Limited (ICRA) of India. It was licensed by the Securities Board of Nepal (SEBON) on October 3, 2012. ICRA Nepal is supported by ICRA Limited through a technical support services agreement, which envisages ICRA helping ICRA Nepal

in areas such as the rating process and methodologies, analytical software, research, training, and technical and analytical skill augmentation.

Our parent company, ICRA Limited was set up in 1991 by leading financial/investment institutions, commercial banks and financial services companies as an independent and professional investment information and credit rating agency. Today, ICRA and its subsidiaries together form the ICRA Group of Companies. The international credit rating agency, Moody's Investors Service, is ICRA's largest shareholder.

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