

Bank of Kathmandu Limited

ICRA Nepal assigns issuer rating of [ICRANP-IR] BBB+ to Bank of Kathmandu Limited; reaffirms [ICRANP] LBBB+

Facility/Instrument	Amount	Rating Action (August 2019)
Issuer Rating	NA	[ICRANP-IR] BBB+ (assigned)
Subordinated Debenture Program	NPR 600 million	[ICRANP] LBBB+ (reaffirmed)

ICRA Nepal has assigned **[ICRANP-IR] BBB+** (pronounced ICRA NP Issuer Rating triple B plus) to the Bank of Kathmandu Limited (BOK). Issuers with this rating are considered to have a moderate degree of safety regarding timely servicing of financial obligations. Such issuers carry moderate credit risk. The rating is only an opinion on the general creditworthiness of the rated entity and not specific to any particular debt instrument.

ICRA Nepal has also reaffirmed the rating of **[ICRANP] LBBB+** (pronounced ICRA NP L triple B plus) for BOK's subordinated debentures of NPR 600 million. Instruments with this rating are considered to have a moderate degree of safety regarding timely servicing of financial obligations. Such instruments carry moderate credit risk.

The sign of + (plus) or – (minus) appended to the above ratings symbol indicate their relative position within the rating categories concerned.

The ratings assigned/reaffirmed factor in BOK's established track record in the industry (operating since 1995), adequate market presence (through 84 branches as of mid-April 2019) and established underwriting norms, despite being challenged by a large one-off slippage in FY2015. The assigned rating also considers the healthy capitalisation profile of the bank (CRAR¹ of ~14% as on mid-April 2019) which, coupled with a conservative growth approach is likely to enable the bank to maintain comfortable capitalisation and solvency over the medium term. The rating action also factors in the adequate granularity of the credit portfolio, as reflected in low credit concentration among top borrowers (top 20 borrowers accounted for ~19% of total credit on mid-April 2019). While assigning the rating, ICRA Nepal also takes note of BOK's steady profitability indicators supported by its steady net interest margins (NIMs) of ~3.5% over the last two to three years. Also, the ratings continue to draw comfort from the experienced management team and institutional ownership profile of the bank (~18% stake from Government owned Citizen Investment Trust-CIT & Employees' Provident Fund-EPF).

Nonetheless, the ratings remain constrained by relatively high non-performing loans (NPLs) of BOK vis-à-vis commercial bank industry average. As of mid-July 2019, the bank's reported gross NPLs stood at 1.50%² (~1.82% as of mid-July 2018) marginally higher than the commercial bank average of ~1.4%. Rating concerns also arise from relatively higher deposit concentration among top accounts (~31% of total deposits concentrated among top 20 depositors' group) as on mid-April 2019, which could impact the deposit stability given the interest rate volatility and occasional deposit price war in the industry. The ratings also remain constrained by BOK's moderate deposit profile with low CASA³ proportion of 35% as on mid-April 2019 vs. ~41% for commercial bank industry. This, along with the increased share of term deposits, has kept BOK's cost of deposits relatively higher (~7.5% for 9M FY2019 and ~7.0% during FY2018). This could weaken its competitive positioning and affect the credit profile of the borrowers in the 'base-rate-plus' lending regime.

The BOK's credit growth has remained well below the industry average, following its merger with Lumbini Bank Limited in FY2016. During FY2018 and 9M FY2019, the bank's credit growth stood at ~11% and ~13% (annualised) vis-à-vis commercial bank average annual growth of ~20-22. The BOK's credit portfolio of ~NPR 76 billion as of mid-April 2019 comprised small business loans (~40%),

¹ Capital to Risk-Weighted Assets Ratio

² ~2.60% including the amount recoverable from counterparty Chinese bank in the Melamchi case.

³ Current and Savings Accounts

corporate loans (~40%) & retail and deprived sector loans (~20%). The yield on advances have improved in recent quarters in line with the industry trend and partly supported by the higher proportion of non-corporate lending portfolio. The credit portfolio concentration of the bank remains relatively low with top-20 borrower groups accounting for ~19% of the portfolio and 125% of the Tier-I capital as of mid-April 2019. Going forward, the BOK's ability to improve upon its credit growth rate will have a bearing on its economies of scale.

The BOK's reported gross NPA stood at 1.50% as of mid-July 2019 vs 1.82% as of mid-July 2018. The BOK's gross NPL level remains higher than the commercial bank industry average. 0+ days delinquency level of the bank stood at ~6.5% as of mid-July 2019 as compared to ~5% in mid-July 2018. The recent uptick in delinquency levels (although nominal) remains a concern given the high interest rate regime and tight liquidity scenario in the banking industry. The bank's exposure to a relatively vulnerable sector⁴ as on mid-April 2019 (~16% vs. commercial bank average of ~13%), also raises an assets quality concern, although partly mitigated by its low credit concentration among top accounts. Nonetheless, because of high credit provision maintained on NPL accounts (~78% as of mid-April 2019), the BOK's solvency position remains comfortable with net NPL/ net worth of ~4.1%. Going forward, the asset quality of the banking sector, including the BOK, is expected to witness some moderation due to a decline in the repayment capability of borrowers, following increased interest rates. However, the bank's overall profile is expected to remain comfortable.

The BOK's cost of deposits (~7.5% during 9MFY2019 and ~7% in FY2018) remains above the commercial bank industry average, mainly due to its below industry average CASA deposit proportion. This affects its competitive strength in the base-rate-based lending model being followed in the industry. The bank's CASA proportion has remained stable at ~35% in the last 10-12 months ending mid-April 2019, lower than the industry average CASA of ~41%. The high term deposit proportion (~57% of total deposits on mid-April 2019) has also contributed in the increase of the bank's cost of deposits, which stood at ~85 bps higher than the commercial bank average during 9M FY2019. However, in the current regime of volatile interest rate and deposit shortage, a higher proportion of term deposits could support the stability of the deposit profile. The BOK's deposit concentration remains high and remains a rating concern. As of mid-April 2019, top 20 depositors of the bank accounted for ~31% of its total deposits. On the positive side, ~50% deposits from individual depositors and relatively lower proportion of institutional call deposits remains a comfort to the deposit stability, especially considering the volatility in the banking sector interest rates. Going forward, the BOK's ability to improve its retail deposit base, lower deposit concentration and improve its CASA mix could help the bank improve the stability and quality of the deposit profile.

The BOK's profitability remains supported by steady NIMs of ~3.5% maintained over the last two to three years ending mid-April 2019. The bank has been able to report good yield on advances, partly aided by a strong non-corporate lending portfolio and partly due to its exposure to high yield segments like real estate and hire purchase. Nonetheless, the profitability profile of the BOK remains constrained by low level of non-interest income (~0.9% of average total assets (ATA) for 9M FY2019). The BOK's profitability also remains supported by low credit cost, given the low NPA generation rate in recent years. The bank's return on average assets (RoA) improved from ~1.5% in FY2018 to ~1.7% during 9M FY2019 while the return on average net worth (RoNW) stood at ~12.3% and 12.7% in the corresponding period. Going forward, the bank's ability to maintain adequate NIMs and manage the asset quality would have a strong bearing on its profitability profile.

The BOK's capitalisation level remains comfortable with CRAR of 13.73% and Common Equity Tier I (CET-I) of 12.57% as of mid-April 2019 (~14.88% and ~13.39% resp. as of mid-July 2018) as compared to the minimum regulatory requirement of 11% and 8.5% (both under Basel III norms) respectively. Given its adequate capitalization and moderate growth trend, the bank's capitalization is expected to remain comfortable over the medium term.

Links to applicable criteria:

4 Mainly hire purchase and real estate; where borrower's repayment ability could be affected by higher interest rates.



[Corporate Credit Rating Methodology](#)

[Bank Rating Methodology](#)

Company Profile

Bank of Kathmandu Limited (BOK), is a class A commercial bank, operating since March 1995. The bank is promoted by individual promoters related to business and industrial houses and is managed by a team of experienced bankers and professionals. The bank's equity share is listed in Nepal stock exchange and its market capitalization was ~NPR 21 billion as of mid-June 2019.

BOK merged with Lumbini Bank (LuBL)⁵ with effect from 14th July 2016. LuBL, a class A bank, was operating since July 1998, before merging with BOK. After the merger, the merged entity ran briefly under the brand name of "Bank of Kathmandu-Lumbini (BOKL)", before the name was changed back to Bank of Kathmandu Limited (BOK) by the Annual General Meeting of the merged entity for FY2016.

As on mid-Apr 2019, BOK has presence across the country through its 84 branches across the country. As on mid-April 2019, BOK has market share of 2.69% in credit portfolio and 2.56% in deposit base of Nepalese banking industry (3.12% and 2.97% share respectively in commercial bank industry). BOK reported profit after tax of NPR 1,938 million during FY2019 over an asset base of NPR 100,947 million as compared to the profit after tax of NPR 1,321 million during FY2018 over an asset base of NPR 91,207 million as of mid-July 2018. BOK's CRAR was 14.58% and reported gross NPLs were 1.50% as on mid-July 2019.

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About ICRA Nepal Limited

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For more information, visit www.icranepal.com

⁵ Lumbini Bank Limited, class A bank, was operating since July 1998.



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