

Sunrise Bank Limited

ICRA Nepal assigns [ICRANP] IPO Grade 3 to the proposed equity shares (Rights Issue) of Sunrise Bank Limited

Instrument/Facility	Issue Size	Grading Action (October 2015)
Rights Issue Grading	NPR 369.047 Million	IPO Grade 3 (Assigned)

ICRA Nepal has assigned an “[ICRANP] IPO Grade 3”, indicating average fundamentals to the proposed rights issue amounting NPR 369.047 Million of Sunrise Bank Limited (hereinafter referred to as SrBL). 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. SrBL is proposing to come out with the 15% rights issue of 3,690,473 numbers of equity shares of face value NPR 100/- each to be issued to the existing shareholders at par.

The grading factors in the SrBL’s moderate track record, adequate franchise throughout the country (network of 53 branches), moderate deposit profile (low cost deposit around 38% of total deposits as on mid-Jul-15¹), adequate credit growth over the years leading to average market positioning with ~2% share in Nepalese banking sector credit on mid-Jul-15 and experienced management team. However, the grading is constrained by SrBL’s relatively weak asset quality profile (Gross NPLs were 2.90% as on mid-Jul-15 vs. 4.94% in mid-Jul-14; notwithstanding improvement over last one year partially aided by dilution effect of portfolio growth and by write-offs and NBA² bookings), low seasoning of significant portion of credit book (~23% of portfolio as of Jul-15 was achieved over last one year), moderate earnings vs. peers (return on net worth around 14% in FY15 supported to some extent by improvement in assets quality over last one year), relatively higher operating expenses and lack of institutional promoter support. Although ICRA Nepal takes note of good recovery from accounts post-earthquake as reflected by around 0.69% of the loans being delinquent as of Jul-15 (apart from reported NPLs), the asset quality could witness stress going forward as evident from increased delinquencies during Aug-Sep 2015 which could be further compounded by political turmoil causing elongated strike in terai region. In addition, the grading is constrained by low capital of the bank compared to the minimum capital levels as revised by Monetary Policy of FY 2015/16 (NPR 2.44 bn vs. elevated requirement of NPR 8 bn to be achieved by FY17). The grading is also constrained unstable political conditions and uncertain operating environment that banks in Nepal are currently facing. Going forward, SrBL’s ability to further improve its assets quality and maintaining control on fresh slippages would have critical bearing on its profitability and financial profile. The proposed rights issue would enable the bank to augment its capital base in line with its plans to increase the scale of operations.

As for impact of earthquake on SrBL’s operations, bank’s portfolio in the earthquake affected areas accounted for ~58% of the credit portfolio and ~82% of the deposits. However, several of these businesses (end users of loans) are situated outside the earthquake affected areas due to which exact quantum of affected exposures and extent of damage could be restricted to certain sectors/segments accounting for ~1/4th of SrBL’s loan book, comprising mainly of consumption, tourism and real estate loans which are expected to be relatively more affected by earthquake. 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. Accordingly, ICRA Nepal expects moderate level of stress on SrBL’s asset quality and profitability profile over next 2-3 years due to damage caused by the earthquake in April 2015 and aftershocks, further

¹ Mid-Jul-15 data are provisional and all calculations are based on the data provided by management of SrBL.

² Non-Banking Assets



compounded by general and elongated strike in terai region. The banks' ability to raise planned capital in a timely manner would have critical bearing on its ability to absorb damages arising out of earthquake and maintain comfortable solvency profile.

SrBL started its operations in Oct-2007 and it has been able to grow its portfolio to NPR 27,392 million as of mid-Jul-2015. Portfolio growth over last year has remained higher at ~31%, however the CAGR³ growth of portfolio over last five years remains largely comparable to industry average (~18% for bank vs. ~19% for industry). However, 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 due to political turmoil prevailing in the country as of now; though reconstruction drive is expected to support credit growth to some extent. Credit orientation of the bank has gradually shifted from Corporate to Retail/SME sector (~60% corporate loans in Jul-15 vs. ~80% in Jul-12). The bank's credit portfolio comprised of corporate loan (ticket size > NPR 60 mn for one corporate client: 60%), retail loan (22%) and SME loan (18%). SrBL expects to further improve the portfolio mix in future, favouring Retail/SME sector which could be challenging considering the competition in the segment, though adequate branch network provides some comfort in this regard. Credit concentration so far remains moderate (top 20 borrowers group accounted for ~21% of total credit portfolio as on Jul-15).

Benefitted partly by dilution effect of portfolio growth in FY15, SrBL's Gross NPLs have decreased from 4.94% as of Jul-14 to 2.90% as of Jul-15; however still remaining higher among peers. Reported NPLs were also benefitted by book write-offs and NBA bookings (Totalling NPR 174 mn), excluding which NPAs would have been 3.54% as of Jul-15. Bank has created adequate provisions (~90%) leading to lower Net NPLs of 0.29% and comfortable solvency profile (Net NPA/Net worth of 2.26%) as on Jul-15. However, significant chunk of credit originated in FY15 (~23% of portfolio as of Jul-15) remains unseasoned and significant portion of loans (~65%) are revolving in nature; as such its assets quality remains to be further tested. Asset quality is expected to come under pressure going forward due to the damages caused by earthquake and recent disturbances in businesses as a result of ongoing elongated strikes in terai region, impacting the borrowers' ability to make repayments in a timely manner.

Profitability profile of SrBL remains modest among peers so far. Profitability has improved over last one year due to improvement in asset quality indicators and the according write back of significant provisioning amount (PAT/ATA⁴ improved from 0.88% in FY14 to 1.41% in FY15; RoNW⁵ improved from ~9% to ~14% over the same period). Despite its largely balanced portfolio mix, yield on advances of SrBL (10.18% as of Jul-15) took a larger dip in FY15 (~250 bps) owing to competition from banks with finer lending rates. At the same time, cost of deposits declined by around 100 bps only, thereby impacting operational profitability despite significant business growth. Additionally, higher operating cost around 2-2.5% of average total assets continue to act as a drag to profitability. However, Net Interest Margins remain adequate so far (3.30% as of Jul-15) and thus future scalability of business could contribute to profitability. Going forward, ICRA Nepal expects SrBL's profitability profile to remain under pressure over next 2-3 years due to impact of devastating earthquake and the ongoing political turmoil in the country. Over long term, SrBL's ability to control on assets quality profile, maintain adequate NIMs and control over operating expenses would be critical for its profitability profile.

ICRA Nepal has also noted that earthquake has not caused significant stress on SrBL's deposits/liquidity profile. The bank's funding profile remains fair with CASA⁶ deposit around 38% against the commercial bank industry average of around 49% as on Jul-15. However, high deposit concentration on top 20 depositors (around 41% of total deposit as on Jul-15) offset the strength of CASA deposit to some

³ Compounded annual growth rate

⁴ Profit after tax/Average total assets

⁵ Return on net worth

⁶ Current and Saving account



extent. SrBL's cost of funds (4.30% as on Jul-15) is competitive among peers, however higher vis-a-vis other established commercial banks which could impact its competitive positioning.

As on mid-Jul-15, SrBL's capitalization levels remained moderate at 11.19% (Tier I: 10.19%) against minimum regulatory requirement of 10%. As such, ability to withstand large shocks in assets quality following the earthquake remains moderate. Recent activity in the stock market suggests that banks' ability to raise capital to absorb damages caused by earthquake is not significantly deterred. Also, modest profitability in past and likely pressure in profit levels following the earthquake remains a challenge in internal capital generation. Proposed rights and retention of internal capital generation over next two years is expected to improve capitalisation profile. However, bank would need to raise its capital to NPR 8 bn by FY17 from existing capital of NPR 2.44 bn; accordingly finding adequate sources to fulfil this elevated regulatory requirement would remain a key challenge for the bank.

Company Profile

Established in 2007, Sunrise Bank Limited (SrBL) is a medium sized, relatively new generation commercial bank licenced by Nepal Rastra Bank to conduct banking transactions within Nepal. The bank was incorporated in October 2007 by a group of 52 promoters involved in different professions like Doctors, Industrialist, Businessman and prominent persons of the society. The shares of the Bank are listed on Nepal Stock Exchange and being actively traded in with current market capitalization of about NPR 12,302 million as on Oct 1, 2015. The registered office is in Gairidhara, Kathmandu which is also the Head Office of the Bank.

SrBL has presence through its 53 branches and 64 ATMs spread throughout Nepal. SrBL has market share of about 1.89% in terms of deposit base and 2.01% in terms of total advances in Nepal as on mid-July 2015. SrBL reported a profit after tax of NPR 474 million during 2014-15 over an asset base of NPR 37,392 million as on mid Jul-15 as against profit after tax of NPR 247 million during 2013-14 over an asset base of NPR 29,661 million as on mid Jul-14. As on mid July 2015, its CRAR was 11.19% and Gross NPAs were 2.90%. In terms of technology platform, SrBL has implemented Temenos T24 CBS in all of its branches. A disaster recovery system (DRS) of the Bank has also been established in the Gabahal branch within Kathmandu valley.

October 2015

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