Citizens Bank International Limited

ICRA Nepal assigns [ICRANP] LBBB+ rating to proposed subordinated bond of Citizens Bank International Limited; reaffirms previous ratings

Facility/Instrument	Amount	Rating Action (October 2018)
Subordinated Bond Programme	NPR 2,500 Million	[ICRANP] LBBB+ (Assigned)
Issuer Rating	NA	[ICRANP-IR] BBB+ (Reaffirmed)
Subordinated Bond Programme	NPR 500 Million	[ICRANP] LBBB+ (Reaffirmed)

ICRA Nepal has assigned a rating of **[ICRANP] LBBB+** (pronounced ICRA NP L triple B plus) to the proposed NPR 2,500-million subordinated bond programme of Citizens Bank International Limited (CZBIL). ICRA Nepal has also reaffirmed the rating of **[ICRANP] LBBB+** for the NPR 500-million subordinated bond programme of CZBIL. The sign of + (plus) or – (minus) appended to the rating symbols indicate their relative position within the rating categories concerned. Instruments with this rating are considered to have a moderate degree of safety regarding the timely servicing of financial obligations. Such instruments carry moderate credit risk.

ICRA Nepal has also reaffirmed the rating of **[ICRANP-IR] BBB+** (pronounced ICRA NP issuer rating triple B plus) assigned to CZBIL. **[ICRANP-IR] BBB+** ratings are considered to be of moderate credit quality. The rated entity carries higher-than-average credit risk. The rating is only an opinion on the general creditworthiness of the rated entity and is not specific to any particular debt instrument.

The rating actions factor in the bank's adequate track record (operating since April 2007), its improving market position through franchise expansion[1] and scale up in operations with improving asset quality indicators. ICRA Nepal also notes the moderation in portfolio growth in recent periods compared to the above-industry growth recorded earlier. The bank's comfortable capitalisation with an experienced and stable management team could support its future growth plans of attaining a moderate pace of growth while maintaining comfortable asset quality indicators. CZBIL's focus on the retail/SME[2] segment has resulted in a higher share of these loans at ~54% as of July 2018 along with moderation in credit concentration risks (top 20 borrower groups accounted for ~21%), which also remain rating positives.

The ratings are, however, constrained by the bank's inferior deposit profile with a lower proportion of low-cost CASA[3] deposits (~27% as of mid-July 2018 vs ~43% for the industry), high concentration (top 20 depositors accounted for ~36%) and the high cost of funds (8.26% for FY2018 vs 6.10% for the industry). This could impact its competitive positioning in the base rate-based lending regime where lending rates are linked to cost of funds. Nonetheless, focus is on the high-yielding retail/SME segments, enables the bank to maintain adequate profitability despite higher cost of funds. The rating action also takes note of the continued pressure on the bank's net interest margins (NIMs as a % of ATA[4] declined by 45 bps in the last two years to 2.91% in FY2018 vs 3.57% for the industry), which along with higher capital base has led to moderation in the return on net worth. The high exposure to relatively vulnerable sectors (including real estate, loan against shares and hire purchase loans) at ~25% as of July 2018 (vs ~14% for the industry) also remains a rating constraint. The rating also considers the uncertain operating environment and liquidity constraints that the banks in Nepal are currently facing which can have impact on their asset quality and profitability. Going forward, the bank's ability to maintain comfortable asset quality indicators amid high interest rate environment, while improving its deposit mix/cost and profitability indicators would remain the key rating sensitivities.

[1] 78 branches and 70 ATMs as of July 2018 compared to 58 branches in January 2017 when last rated
[2] Small and medium sized enterprises
[3] Current and savings accounts
[4] Average total assets

CZBIL reported portfolio growth of ~20% in the last two years ending mid-July 2018, lower than the industry growth of ~23%. The pace of growth moderated compared to ~31% growth in the three years ended mid-July 2016, albeit on a small base. Higher growth in the low interest rate regime of FY2014-FY2016 could create stress on the bank's asset quality profile given the upward movement of interest rates thereafter. CZBIL's portfolio mix, as of mid-July 2018, primarily comprised large corporate loans (~46%), followed by retail loans (~43%) and SME loans (~11%). The high exposure to retail/SME loans that carry better rates have supported the bank's lending yields (12.75% for FY2018 vs 12.08% for the industry) while lowering the concentration risks. Going forward, the management intends to leverage the existing franchise while continuing to focus on the retail/SME segments. The bank's ability to achieve the growth targets along with commensurate risk control measures would have a key bearing on its financial profile.

The bank has reported an improvement in its asset quality indicators in the last two years with non-performing loans (NPLs) declining to 1.25% as of July 2018 compared to 1.41% for the industry and 1.38% as of July 2016. However, higher non-banking assets (NBAs, mainly from acquired entities) resulted in slightly higher adjusted gross NPLs at 1.72% as of July 2018 vs 1.57% for the industry. CZBIL's NPLs also benefitted from the dilution effect of portfolio growth. Meanwhile, the overall delinquencies increased slightly from the earlier periods (~7% as of mid-July 2018 compared to ~4% as of mid-July 2016). However, a large chunk of these (~77%) remain overdue within 30 days, which could indicate temporary slippages. The bank's ability to maintain healthy asset quality would remain a key monitorable given the increased interest rate scenario.

CZBIL's deposit profile, despite some improvement, remains inferior with low CASA and high concentration. Deposit growth in the last two years (ending mid-July 2018) also remained low compared to the industry (~14% vs ~18%). A significant increase in the share of term deposits (~67% as of mid-July 2018 compared to ~55% as of mid-July 2016) has further led to an increase in the bank's cost of deposits (increased to 8.26% in FY2018 compared to 6.10% for the industry and 4.23% in FY2016). This remains a major rating concern. The concentration of the top 20 depositors, despite some moderation, remains high at ~36% as of mid-July 2018 (39% in mid-January 2017). However, bank has remained comfortable in terms of liquidity with SLR of ~20% including CRR of ~7% as of mid-Jul-18 vs. minimum requirement of 12% and 6% respectively (this has been brought down by regulator to 10% and 4% for FY19). CCD ratio[5] for the bank remained in the range of ~78% in last three years vs. ~75% earlier and this trend remains largely comparable to industry. Going forward, the bank's ability to improve its deposit mix and cost would remain a key monitorable.

As for profitability, the bank has witnessed a moderation in the return indicators in recent periods owing to an increasing capital base and pressure on NIMs. In the last two years, the cost of funds has witnessed a swift increase, in line with the industry, while the yields reported a relatively lower improvement. Hence, the NIMs declined to 2.91% for FY2018 from 3.36% for FY2016 while the industry reported an improvement in NIMs by 19 bps to 3.57%. The pressure on NIMs would remain a major concern in terms of incremental profitability. The bank's return on net worth reduced to ~15% for FY2018 compared to ~16% for industry and ~24% for FY2016, partly owing to sizeable capital enhancement to ensure compliance with the changed regulations. Similarly, return on assets declined to 1.94% for FY2018 from 2.24% for FY2016. Nonetheless, CZBIL's earnings profile has been supported, to an extent, by sizeable provision write-backs in the last 2-3 years from the recovery of NPLs and NBAs of acquired entities (write-backs of 0.52% and 0.29% of ATA for FY2017 and FY2018, respectively). The profitability in FY2018 was also supported by healthy business growth, modest non-interest income (1.25% of ATA) and a moderate operating expense ratio (~1.7% of ATA). The bank's ability to maintain adequate NIMs amid reducing quantum of provision write-backs, and control credit cost further due to concerns regarding asset quality will be critical for profitability.

[5] LCY credit to core capital and LCY deposits

CZBIL's capitalisation levels are comfortable with CRAR[6] of 15.48% and tier I capital of 14.13% as of mid-July 2018 (both as per Basel III) compared to the minimum regulatory requirement of 11% and 8%, respectively (both including capital conservation buffer; CCB). The tier I capital requirement is expected to increase to 8.5% by mid-July 2019 (including CCB) although the requirement for total capital would be stable at 11% (including CCB). The capitalisation was mainly supported by right issues and stock dividends in FY2017. The current capitalisation levels and similar internal accruals are expected to support moderate growth of ~15% over the medium term. In case of higher growth or high dividend pay-outs, the proposed bond issuance plans could provide requisite support to the capitalisation profile.

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

Links to applicable criteria:

Corporate Credit Rating Methodology

Bank Rating Methodology

Bank Profile

Citizens Bank International Limited (CZBIL) started its commercial operations on April 20, 2007 as a Class A commercial bank. The Narayanhiti, Kathmandu-based bank is largely promoted by individuals from different backgrounds along with some institutions (including Citizen Investment Trust[7] with 3.29% stake). As of mid-July 2018, CZBIL's promoter-public shareholding stood at ~51:49. The bank's equity shares are listed on the Nepal Stock Exchange and are actively traded.

CZBIL's 78 branches and 70 ATMs, as of mid-July 2018, provide it with a diversified presence in the country. The bank's market share was 2.49%, in terms of deposit base, and 2.74% of total advances of the commercial bank industry as of mid-July 2018. CZBIL reported a profit after tax (PAT) of NPR 1,408 million[8] during 2017-18 on an asset base of NPR 78,021 million as of mid-July 2018 against PAT of NPR 1,082 million during 2016-17 on an asset base of NPR 65,405 million as of mid-July 2017. As of mid-July 2018, CZBIL's CRAR was 15.48% and gross NPLs were 1.25%. In terms of technology platforms, CZBIL has implemented Pumori-IV[9] in all its branches.

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[6] Capital to risk weighted assets ratio
[7] One of the largest state-owned retirement fund operators
[8] Profit as per earlier financial reporting norms; Profit as per NFRS-based financials for the year was NPR 1,273 million
[9] This used to be the most widely used system across commercial banks in Nepal. Most of the banks have now migrated to the Finacle system and CZBIL has also started the process of migrating to Finacle

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 incorporated on November 11, 2011 and granted licence 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 such areas as rating processes and methodologies, analytical software, research, training, and technical and analytical skill augmentation.

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