Nepal SBI Bank Limited

ICRA Nepal assigns [ICRANP] IPO Grade 2 to the proposed Further Public Offer (equity shares) of Nepal SBI Bank Limited

Facility/Instrument	Issue Size	Grading Action (November 2016)
Further Public Offer (Equity)	~NPR 65.80 Million	[ICRANP] IPO Grade 2 (Assigned)

ICRA Nepal has assigned an "[ICRANP] IPO Grade 2", indicating above-average fundamentals to the proposed Further Public Offer (FPO) amounting to ~NPR 65.80 million of Nepal SBI Bank Limited (NSBL). 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. NSBL is proposing to come out with FPO of 67,767.87 numbers of equity shares of face value NPR 100/- each to be issued to public at a premium of NPR 871[1] per share (issue price NPR 971 per share). The issue is being made to comply with minimum public shareholding norms (30%) as specified by Nepal Rastra Bank (NRB), the banking sector regulator.

The above average fundamental grading factors in the bank's strong promoter profile[2], existence of Technical Support Service Agreement (TSSA) with SBI, bank's established track record (operating since 1993) and good market positioning in Nepal with ~4% share in commercial banking industry as on mid-Jul-16. ICRA Nepal also takes comfort from the bank's healthy asset quality which further improved[3] despite general stress in Nepalese economy during the last fiscal year due to impact of the Apr-15 earthquake and subsequently the customs blockade. The grading also takes into consideration bank's experienced senior management, and adequate earnings profile. Comfortable capitalisation levels (with further capital increment plans), diversified franchise and management focus on growth is expected to provide NSBL with adequate growth opportunities.

The grading is nonetheless constrained by high deposit concentration (~37% of deposits as on mid-Jul-16[4] among top 20 depositors). ICRA Nepal also notes that although CASA[5] proportion and cost of funds for NSBL improved over last 3-4 years and remain competitive compared to banking industry, the same remains slightly inferior to some of the other larger banks of Nepal. The grading is also constrained by unstable political conditions and uncertain operating environment that banks in Nepal are currently facing. Going forward, NSBL's ability to scale up its operations ensuring efficient utilization of fresh capital, maintain its profitability profile and the delinquency levels would have a bearing on the overall financial profile.

NSBL's association with State Bank of India through TSSA provides access to management (MD/CEO, COO and CFO at NSBL are deputed from SBI) and technology support from SBI. Further, SBI has also extended line of credit support to NSBL to meet fund based/ non-fund based requirements; which reflect well on the stance of SBI to provide need based liquidity and capital support to NSBL. Moreover, NSBL has been following the systems and policies of SBI compatible in Nepal as per NRB guidelines and is required to comply with the dual reporting procedures of NRB as well as that of RBI, by virtue of being a subsidiary of SBI. Representation in NSBL's board from SBI (55.09% holding) and from local institutional promoter viz. Employees Provident Fund (15.03% holding) creates a strong board profile for the bank. The proposed FPO would restrict the promoter holding to 70% as required by regulations.

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[1] Subject to Regulatory approval

[2] State Bank of India (SBI) rated at [ICRA]AAA(hyb) (Stable) for Basel III compliant tier II bonds and [ICRA]AAA (Stable) for subordinated bonds programme by ICRA and Employees Provident Fund holding ~55% and ~15% respectively; together accounting for 70.12% shareholding in NSBL.

[3] 0+ days past due accounts declined to 0.76% as on mid-Jul-16 from 1.49% as on mid-Jul 15.

[4] Mid-Jul-16 (FY16) data are unaudited, as provided by management

[5] Current and Savings Accounts

The bank has been growing its portfolio cautiously over the years and reported portfolio growth of ~17% during FY16 (CAGR of ~17% over past five years ending mid-Jul-16 vs. industry average growth of ~21%). Credit demand going forward is expected to remain healthy owing to expected pickup in economic activity to support reconstruction. NSBL's portfolio mix has remained concentrated towards large corporate loans (~67%), followed by retail loans (~29%) and SME loans (~4%). However, NSBL's exposure to the relatively vulnerable sectors (margin lending, tourism and hire purchase sector), compare favourably to Nepalese banking industry. Credit portfolio remains moderately concentrated with top 20 borrowers/groups of borrowers accounting for ~24% of portfolio as on mid-Jul-16. Going forward, management intends to continue grow moderately, to ensure efficient utilisation of large capital to be raised by FY17 (as required by changed regulations).

NSBL's asset quality compares favourably with peers and has witnessed improvement over last few years (NPLs[6] of 0.14% as of mid-Jul-16 vs. 0.26% as of mid-Jul-14). This was mainly aided by decline in fresh NPL generation rate (0.07% in FY16 compared to 0.16% on an average for FY13 to FY15). The bank also witnessed significant improvement in delinquencies over last few years, from 7.09% as on mid-Jul 14 to 0.76% as on mid-Jul-16, however scheduled loans continue to face higher delinquencies compared to revolving loans. ICRA Nepal also takes comfort from the bank's ability to absorb losses (Net NPA/Net worth being nil as on mid-Jul-16 compared to 0.28% on mid-Jul-14). However, bank had rescheduled six accounts (~1.6% of portfolio as of Jul-16) under NRB's relaxed norms supporting the reported NPLs. Going forward, NSBL's asset quality could witness some moderation due to damages caused by earthquake and elongated strikes (more specifically the rescheduled accounts), however NSBL's healthy capitalisation profile is expected to provide requisite support.

As regards capitalisation, bank reported CRAR[7] of 13.58% and tier I capital of 11.08% (both as per Basel III) as of mid-Jul-2016 which remains comfortable compared to minimum regulatory requirement of 11% and 7.50% respectively (both including Capital Conservation buffer) to be met by mid-Jul-17. 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 stable at 11% (incl. CCB). NSBL plans to increase paid-up capital to NPR 8 bn (vs. NPR 3.88 bn as of now) by FY17 (as required by changed regulations) through FPO, rights issue and internal accruals. Accordingly, capitalization levels are expected to remain adequate to support NSBL's growth plans over the medium term.

NSBL's focus to improve its deposit profile reflected in improved CASA profile from 31% as of mid-Jul-13 to 51% as on mid-Jul-16 remaining comparable to industry average. Nonetheless, despite improvement in CASA profile, cost of funds for NSBL at 2.47% for FY16, continues to be marginally higher than its peers, although better than the industry average cost of funds at 2.87%. Additionally, deposit concentration remains high with top 20 depositors accounting for ~37% of the total deposits as of mid-Jul-16.

As for profitability, NSBL reported improvement in earnings over last few years as reflected by improvement in return on assets from 0.92% for FY12 to 1.90% for FY16. This was supported by healthy NIMs[8] (3.50% for FY16 vs. 2.85% on an average for last five years) and low credit costs. NIMs were supported by declining cost of fund over this period. Despite increasing net worth base through healthy retention of internal accruals, bank has been able to report ~20% return on net worth on an average over last five years. Healthy non-interest income (1.33% of ATA[9] for FY16) further supports profitability, however relatively higher operating expense ratio (2.06% of ATA for FY16) has impacted the financial profile to an extent. The credit and operating cost for NSBL could witness some increase on account of expected increase in stress over asset quality and plans for aggressive expansion of the branches, however the overall financial profile is expected to remain adequate. Going forward, bank's ability to ensure efficient utilisation of large incremental capital, maintain its NIMs in a competitive landscape and maintain asset quality would have strong bearing on its earnings profile.

[6] Non-Performing Loans

[7] Capital to Risk-weighted Assets Ratio

[8] Net Interest Margins as a % of Average Total Assets

[9] Average Total Assets

Bank Profile
Incorporated in July 1993, Nepal SBI Bank Limited (NSBL) is the first Indo-Nepal joint venture in the financial sector. NSBL is a subsidiary of State Bank of India which has 55.09% ownership and rest of promoter shares are held by a local partner viz. Employees Provident Fund (15.03%). The bank has Technical Support Service Agreement (TSSA) with SBI, the later thus provides management support to the bank through its expatriate officers including MD/CEO, COO and CFO of the Bank. The shares of the Bank are listed in Nepal stock exchange.

NSBL's 62 branches, seven extension counters, four administrative offices and 85 ATMs provides it with presence throughout the country. NSBL has market share of 3.70% in terms of deposit base and 3.41% in terms of loan & advances in commercial banking industry of Nepal as on mid-Jul-16. NSBL reported a profit after tax of NPR 1,313 million during 2015-16 over an asset base of NPR 78,956 million as of mid-Jul-16 against profit after tax of NPR 1,065 million during 2014-15 over an asset base of NPR 59,277 million as of mid-Jul-15. As of mid-Jul-2016, NSBL's CRAR was 13.58% and gross NPLs were 0.14%. In terms of technology platform, NSBL has implemented Finacle across all its branches.

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