Standard Chartered Bank Nepal Limited

ICRA Nepal assigns issuer rating of [ICRANP-IR] AAA

Facility/Instrument	Amount	Rating Action (September 2019)
Issuer Rating	NA	[ICRANP-IR] AAA (Assigned)

ICRA Nepal has assigned an issuer rating of **[ICRANP-IR] AAA** (pronounced ICRA NP issuer rating triple A) to Standard Chartered Bank Nepal Limited (SCBNL). The rating is considered to have the highest degree of safety regarding timely servicing of financial obligations. Such issuers carry the lowest 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 rating assignment factors in the bank's strong parentage (70% subsidiary of Standard Chartered Group[1]) along with the existence of a technical services agreement (TSA) with SCB-UK. This ensures strong parental support, the Group's oversight and deployment of best practices in SCBNL's operations. The rating is further supported by the bank's healthy deposit profile with high share of low-cost current and savings accounts (CASA, at ~55% in mid-July 2019 compared to ~43% for industry). This reflects the lowest cost of funds among private sector players (4.17% for FY2019, 6.48% for industry) and hence remains its key competitive strength. ICRA Nepal also takes comfort from the bank's strong risk management practices and underwriting controls, resulting in superior asset quality indicators with low non-performing loans (NPLs) of 0.15% as of mid-July 2019 (0+ dpd of ~1.5%). The bank's established track record (since 1987) and healthy capitalisation profile (Capital to risk weighted assets ratio - CRAR of ~20% as of mid-July 2019) also support the rating action.

The rating also remains comforted by the bank's healthy profitability indicators with the return on assets (RoA) and a return on net worth (RoNW) of 2.83% and ~17% for FY2019. This remains primarily supported by healthy net interest margins (NIMs) and strong fee-based income among its peers, along with low credit costs. Though the recent changes in regulatory interest spread norms could impact profitability to an extent, the bank's incremental growth plans could provide some support. The bank's experienced senior management team, adequate capitalisation and its strong digitisation agendas remain positives for growth over the medium term, despite limited franchise (12 branches). ICRA Nepal notes that the bank's deposit and credit concentration remain high (~35% and ~30% among top 20 customers as on mid-July 2019). However, these concerns are mitigated to an extent, considering its long-standing relationship with these clients and the pioneer position of most of the top borrowers in their respective segments. Additionally, the bank's overall credit portfolio mix remains diversified with ~55% retail/SME loans, whose share has further increased in the recent periods and hence remains a positive. Going forward, the bank's ability to grow its portfolio judiciously, amid current liquidity constraints in the industry, while maintaining its deposits, asset quality and overall financial profile would remain the key rating drivers.

SCBNL's association with the Standard Chartered Group and TSA with SCB-UK provides access to management and technology support from the Group. Many of the SCBNL's multinational clients have been banking with the Group globally and hence provided credit facilities in Nepal within their globally sanctioned limits. Further, the SCB Group company has also extended Intra Group Guarantees on a need basis to SCBNL to support the funding to large corporates that are beyond its risk appetite. This reflects well on the stance of the Group to facilitate future growth and provide requisite support to SCBNL. Moreover, the bank has been following the systems and policies of the Group that ensures prudent underwriting norms and hence extensive customer screening. Representation in SCBNL's board from the Group creates a strong board profile for the bank. Additionally, the management team comprises seasoned bankers whose long banking experience has also been considered while assigning the rating.

The bank has remained a cautious player in terms of credit growth with ~21% growth reported in last three fiscals (~11% growth in earlier three years). Though the recent growth trend remained comparable to the industry (~22%), SCBNL's portfolio of NPR 56,302 million as of mid-July 2019 remains much lower than the

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[1] The ultimate parent i.e. Standard Chartered PLC has been assigned a notional baseline credit assessment (BCA) of baa1; rated A2 for senior unsecured long-term debt with stable outlook by Moody's.

industry average of NPR 89,448 million. Additionally, the increased pace of growth was more along the retail/SME segment, which has increased to ~55% of the portfolio as of mid-July 2019 (~46% in mid-July 2016), the rest being corporate loans (~40%) and deprived sector loans (~5%). SCBNL remains a preferred banking partner for multinational corporations, large domestic corporates as well as the retail/SME segment customers, given its ability to offer low lending rates. This augurs well for its growth prospects while the low cost of funds provides it with flexibility to pursue its selective growth approach. Owing to risk averse underwriting approaches, SCBNL has not ventured into sectors like pure real estate lending, margin lending etc as well as prefers to lend only selectively to under construction projects in hydropower and tourism sectors, backed by strong groups. The bank's yields on advances remain much lower compared to the industry at 11.10% in FY2019 compared to 12.61% for the industry. This has reflected in a relatively better borrower profile compared to most of its peers. Hence, any major moderation in its cost of funds, amid intense competition for deposits in the industry, could have some bearing over the credit profile of its borrowers and would remain a key monitorable. The bank's credit portfolio also remains concentrated among the top 20 borrowers (~30% of its portfolio and 121% of its tier I capital as of mid-July 2019; ~38% and ~152% respectively on top 20 groups). Though the moderation in repayment capacity of large borrowers could impact asset quality to an extent, most of these are market leaders in their segment with relatively better ability to tide over stress, if any. The bank is also comfortable in terms of capitalisation to handle any near-term stress in asset quality, which also has been factored positively into the rating.

On the asset quality front, the bank has been consistently reporting one of the lowest NPLs in the industry, with a further improvement in recent years to 0.15% as of mid-July 2019 (industry average of 1.40%) from 0.32% as of mid-July 2016. The improvement was supported by low fresh generation in the last three years (~0.1%) and modest recoveries (~40%). Moreover, overall 0+ days delinquencies also remain much lower at 1.54% as of mid-July 2019 (4.83% a year ago). With a provision cover of ~66% as on the same date, the bank's impact on solvency (net NPA/net worth) also remains low at 0.19%. Going forward, the asset quality of the banking sector, including SCBNL, is likely to witness some moderation due to a decline in the repayment capability of borrowers, following the increased interest rates. Hence, the bank's ability to maintain a healthy asset quality profile, as the incremental portfolio gets more seasoned, would remain a key rating factor.

The bank fares strong on the deposit front with high share of stable/low-cost CASA deposits (~55% as of mid-July 2019 against ~43% for industry). This leads to the lowest cost of funds among the private sector banks (4.17% in FY2019 against 6.48% for the industry) and hence remains its key competitive strength in the base rate-based lending regime. However, the shortage of lendable funds in the industry in the last few years has led to intense competition for deposits with increased rates on deposits. This has caused a major increase in the proportion of term deposits for the bank to ~32% in mid-July 2019 against ~6% in mid-July 2016. Given the sizeable chunk of term deposits (mostly for the one-year period), the volatile interest rate scenario could have a bearing on its cost of funds. The bank's overall deposits reported a growth of ~11% on the last three fiscals (~18% for industry). However, this was mainly on account of the decline in the share of foreign currency (FCY) deposits to ~19% from ~32% over the same period. Excluding FCY deposits, the growth was ~17% and the cost of funds was still competitive at 5.18% for FY2019 and hence remains a positive. However, deposit concentration on the top 20 accounts remains high at ~35% as of mid-July 2019 (~32% in local currency deposits). Going forward, the bank's ability to maintain its deposit mix and cost would remain a key monitorable.

As for capitalisation, SCBNL reported a CRAR of 19.90% and a tier I capital of 18.52% as of mid-July 2019 (both as per Basel III), much comfortable compared to the regulatory minimum of 11% and 8.5%, respectively (both including capital conservation buffer (CCB) of 2.5%). The bank's capitalisation is also comfortable against the recent increment in tier-I requirement to 10.5% (to be met by mid-July 2020) including the 2% countercyclical buffer requirements for FY2020. Additionally, the bank is also required to issue debentures of at least 25% of equity capital, to comply with the recent regulatory requirements. Hence, bank's capitalisation is likely to remain high over the near term and is expected to remain adequate to absorb any near-term stress in its asset quality profile.

On the profitability front, SCBNL's return indicators, in terms of the RoA, remain strong at 2.83% in FY2019 (1.96% for industry). However, with a sharp increase in the net worth base through external capital infusion in FY2017, the RoNW had diluted to an extent and currently fares with the industry average at ~17% (~16% for industry). The profitability remains supported by healthy NIMs of 3.99% for FY2019 (3.82% for industry), backed by its low cost of funds. Given the bank's sizeable non-fund based business, fee-based income also remains strong at 1.92% of the average total assets (ATA) while the operating costs remain moderate at 1.87% in FY2019. However, SCBNL is to reduce its margins to ensure compliance with the revised interest spread cap of 4.4% (earlier 4.5% which used to include yield on Government securities that is also to be excluded henceforth) and hence its profitability would remain impacted to an extent. Nonetheless, the rising scalability could provide some support. Going forward, SCBNL's ability to maintain healthy NIMs and asset quality would have a key 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]

[Bank Rating Methodology]

Bank Profile

Standard Chartered Bank Nepal Limited (SCBNL) is the second foreign joint venture in the Nepalese financial sector. The bank was incorporated in January 1987 as Nepal Grindlays Bank and was subsequently renamed SCBNL in July 2001, following the acquisition of parent ANZ Grindlays Bank by Standard Chartered Bank. SCBNL is a subsidiary of one of the largest international banking brands which has diversified its presence across the globe. The ultimate parent i.e. Standard Chartered PLC (SCPLC), United Kingdom, holds a 70% stake in the bank while the rest is held by the general public. The bank has a TSA with SCB-UK, the latter thus providing management support to the bank through an expatriate CEO along with support in other management functions. The shares of the bank are listed on the Nepal Stock Exchange. The registered and corporate office of the bank is at New Baneshwor, Kathmandu.

SCBNL has its presence across the country through its 12 branches, three extension counters and 21 ATMs as of mid-July 2019. It has a market share of 2.63% in terms of its deposit base and 2.25% of total advances of commercial banking industry as on mid-July 2019. SCBNL reported a profit after tax of NPR 2,495 million for FY2019 (~14% YoY growth) over an asset base of NPR 93,323 million as of mid-July 2019. As on the same date, SCBNL's CRAR was 19.90% and gross NPLs were 0.15%. In terms of the technology platform, SCBNL uses global technology platforms of the Standard Chartered Group, across all its branches.

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For further details please contact:

Analyst Contacts:

Mr. Kishor Prasad Bimali (Tel No. +977-1-4419910/20)
kishor@icranepal.com

Mr. Rajib Maharjan (Tel No. +977-1-4419910/20)
rajib@icranepal.com

Ms. Kushum Bhattarai (Tel No. +977-1-4419910/20)
kushum@icranepal.com

Relationship Contacts:

Ms. Barsha Shrestha (Tel. No. +977-1-4419910/20)
barsha@icranepal.com

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.

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For more information, visit www.icranepal.com

ICRA Nepal Limited,
Sunrise Bizz Park, 6th Floor, Dillibazar, Kathmandu, Nepal
Phone: +977 1 4419910/20
Email: info@icranepal.com
Web: www.icranepal.com

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