# Nepal SBI Bank Limited

## ICRA Nepal reaffirms issuer rating of [ICRANP-IR] AA and [ICRANP] LAA rating for existing subordinated debenture of Nepal SBI Bank Limited

| Facility/Instrument | Amount | Rating Action (October 2017) |
|---|---|---|
| Issuer Rating | NA | [ICRANP-IR] AA (Reaffirmed) |
| Subordinated Debenture Program | NPR 200 Million | [ICRANP] LAA (Reaffirmed) |

ICRA Nepal has reaffirmed issuer rating of **[ICRANP-IR] AA** (pronounced ICRA NP Issuer Rating Double A) assigned to Nepal SBI Bank Limited (NSBL). [ICRANP-IR] AA rating is considered as high credit quality rating assigned by ICRA Nepal. The rated entity carries low 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] LAA** (pronounced ICRA NP L Double A) to the subordinated debenture of NPR 200 million of NSBL. Instruments with this rating are considered to have high degree of safety regarding timely servicing of financial obligations. Such instruments carry very low credit risk.

The ratings reaffirmation factors in the bank's ability to consistently maintain one of the strongest asset quality in the industry (~1% delinquencies as of mid-Jul-17, comparable to trend across last few years) along with the ability to achieve scale growth while ensuring adequate controls. The ratings also remain supported by established underwriting norms and risk management framework being practiced within the bank. Bank's strong promoter profile (State Bank of India (SBI) rated by ICRA at [ICRA]AAA(hyb) (Stable) for Basel III compliant tier II bonds and Employees Provident Fund hold 55% and 15% stake respectively) along with the existence of Technical Support Service Agreement (TSSA) with SBI continues to provide support to the ratings assigned. NSBL's association with SBI through TSSA provides access to management (MD/CEO, COO and CFO at NSBL are deputed from SBI) and technology support from SBI. 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. The rating action also takes into consideration bank's established track record (operating since 1993), good market positioning in Nepal with ~4% share in industry credit and deposits, fair deposits profile, moderate portfolio growth[1] and adequate earnings profile. Incremental growth prospects for the bank remain supported by strong capitalisation, adequate franchise, comfortable CCD ratio (credit to deposit ratio adjusted for core capital) of ~75% as on mid-Jul-17, strong digitisation agendas and experienced management team.

The ratings are however constrained by bank's relatively lower CASA profile among top tier banks which could create pressure in maintaining competitive cost of funds (though remains better to industry) and healthy interest spreads. Additionally, spiked credit growth in FY17 (~34%) along could increase NPLs[2] to some extent amidst the recent hardening of interest rates across the banking sector. Bank's high deposit concentration (~42% among top 20 depositors as of mid-Jul-17) also remains area of concern. The ratings are also constrained by unstable political conditions and uncertain operating environment that banks in Nepal are currently facing.

NSBL reported portfolio growth of ~34% during FY17 vs. industry average growth of ~25%; growth trend remained contrary to earlier track record of moderate growth. The growth was supported by competitive base rate of the bank (compared to most of the new generation banks) in light of the base rate plus premium based lending mandated by NRB, the regulator. NSBL's portfolio mix continues to remain concentrated towards corporate loans (~65%)[3], followed by retail loans (~31%) and SME loans (~4%). Credit portfolio concentration risks has moderated to an extent in the interim with top 20 borrowers/groups of borrowers accounting for ~20% of portfolio as on mid-Jul-17 (vs. 26% as on mid-

[1] Compounded Annual Growth Rate (CAGR) of ~19% over last five years vs. ~23% for industry.
[2] Non-Performing Loans
[3] Loan to corporate above NPR 10 mn.

Apr-16). Going forward, management intends to grow moderately with more focus on retail and SME, to ensure efficient utilisation of increased capital (as required by changed regulations).

Bank's asset quality remains strong with further improvement over last few years (NPLs of 0.10% as of mid-Jul-17 vs. 0.19% as of mid-Jul-15), aided mainly by decline in fresh NPL generation rate (0.05% for FY17 compared to 0.09% on an average for earlier three years). Bank's NPLs continue to compare favourably than peers and the industry average NPLs (which stood at 1.54% on Jul-17). Going forward, though market could witness some deterioration in repayment capability of borrowers due to increased interest rates, NSBL's overall assets quality profile is expected to remain comfortable. Despite increment in delinquencies in the interim periods (~2% as of Jan-17), the bank was also able to downsize these to ~1% as of mid-Jul-17 (remaining comparable to last few years) with ~80% of these remaining within 30 days. The scheduled loans continue to face slightly higher delinquencies (~1.5%) compared to revolving loans (~0.9%). ICRA Nepal also takes comfort from the bank's ability to absorb losses (Net NPA/Net worth being Nil as on mid-Jul-17 compared to 0.28% on mid-Jul-14). Going forward NSBL's ability to maintain asset quality indicators would be a key monitorable.

As regards capitalisation, bank reported CRAR of 15.76% and tier I capital of 13.61% (both as per Basel III) as of mid-Jul-2017 which remains comfortable compared to minimum regulatory requirement of 11% and 7.50% (both including Capital Conservation buffer) respectively required as on 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). The reported capitalisation was mainly supported by 40% right issuance during FY17 along with FPO and internal accruals in line with regulatory capital increment requirements. Bank had capital of NPR 6.92 billion as of mid-Jul-17 vs. requirement of NPR 8 billion and the shortfall is expected to be met from capitalisation of internal accruals. Accordingly, capitalization levels are expected to remain adequate to support NSBL's growth plans over the medium term.

NSBL's deposit profile remains comparable to the industry as reflected by CASA which witnessed similar decline compared to the industry during FY17 from ~51% as on mid-Jul-16 to ~44% as on mid-Jul-17. CASA remains relatively lower among top tier banks and hence the bank's cost of funds at 3.85% for FY17 continues to be marginally higher than peers, although better than industry average cost of funds at 4.10%. Deposit concentration has further increased and hence continues to remain high with top 20 depositors accounting for ~42% of total deposits (~33% on LCY deposit) as of mid-Jul-17 (vs. 37% and 26% a year ago). To improve utilisation of deposits, NSBL had cautiously degrown the deposits (mainly foreign currency deposits) during FY14 and FY15, leading to improved credit deposit ratio. This along with lower deposit growth in FY17 (~25%) compared to credit growth has led to NSBL's share in deposits declining to 3.90% as on mid-Jul-17 (compared to 5.15% as on mid-Jan-14).

As for profitability, NSBL reported slight decline in earnings profile during FY17, over increased capital and assets base, primarily on account of decline in NIMs (3.27% for FY17 vs. 3.51% for FY16) despite significant business growth and low credit costs. Return indicators witnessed slight moderation during FY17 with RoNW and RoA[4] at ~18% and 1.71% respectively compared to ~21% and 1.93% for FY16. Healthy non-interest income (1.32% of ATA during FY17) supports profitability, however relatively higher operating expense ratio (1.98% of ATA during FY17) 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 impacting the profitability profile, however the overall financial profile is expected to remain adequate. Going forward, bank's ability to ensure efficient utilisation of increased capital, improve its NIMs in a competitive landscape and maintain asset quality would have strong bearing on its earnings profile.

**Bank Profile**

NSBL is the first Indo-Nepal joint venture in the financial sector promoted by three institutional promoters, namely State Bank of India, Employees Provident Fund and Agricultural Development Bank of Nepal through a Memorandum of Understanding signed in July 1992 and was incorporated in July 1993. NSBL is a subsidiary of State Bank of India which has 55% ownership and rest is held by a local

[4] Return on Net Worth and Return on Assets

partner viz. Employees Provident Fund (15%) and general public (30%). In terms of the Technical Support Service Agreement (TSSA) between SBI and the NSBL, the former provides management support to the bank through its expatriate officers including MD/CEO, COO and CFO of the Bank. The bank started its commercial operation from July 1993 and is registered as “A” class Commercial Bank with Nepal Rastra Bank (NRB). Its head office is located at Kathmandu. The shares of the Bank are listed in Nepal stock exchange.

NSBL’s 62 branches, seven extension counters, four administrative offices and 96 ATMs provides it with presence throughout the country. NSBL has market share of 3.90% in terms of deposit base and 3.67% in terms of loan & advances in commercial banking industry of Nepal as on mid-Jul-17. NSBL reported a profit after tax of NPR 1,524 million during 2016-17 over an asset base of NPR 99,829 million as of mid-Jul-17 against profit after tax of NPR 1,332 million during 2015-16 over an asset base of NPR 78,515 million as of mid-Jul-16. As of mid-Jul-2017, NSBL’s CRAR was 15.76% and gross NPLs were 0.10%. In terms of technology platform, NSBL has implemented Finacle across all its branches.

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