Himalayan Bank Limited

ICRA Nepal reaffirms [ICRANP] LA rating to existing subordinated bonds of Himalayan Bank Limited; removed from "rating watch with negative implications". Rating for unissued subordinated bonds withdrawn.

Facility/Instrument	Amount	Rating Action (July 2018)
Subordinated Bond Program "8% HBL Bond 2077"	NPR 600 Million[1]	[ICRANP] LA (Reaffirmed); rating watch with negative implications removed.
Subordinated Bond (Not issued) "HBL Bond 2079"	NPR 500 Million	[ICRANP] LA@ (Rating withdrawn)

@ rating watch with negative implications

ICRA Nepal has reaffirmed the rating of existing subordinated bonds of NPR 600 million at **[ICRANP] LA** (pronounced ICRA NP L A). The rating has been removed from "rating watch with negative Implications". Instruments with this rating are considered to have adequate degree of safety regarding timely servicing of financial obligations. Such instruments carry low credit risk.

ICRA Nepal has withdrawn [ICRANP] LA@ (pronounced ICRA NP L A) rating earlier assigned to the NPR 500 million subordinated bond programme (HBL Bond 2079) of Himalayan Bank Limited as per the request of the bank, as the bank has not raised funds against the rated instrument.

Rating for HBL was put on watch with negative implications after April 2015 earthquake, pending assessment of the impact due to the earthquake on credit and financial profile of HBL. The removal of rating watch is because of HBL's ability to improve financial indicators while maintaining moderate pace of growth and fair asset quality despite general stress in Nepalese economy, especially during FY16, arising from earthquake and subsequent elongated economic blockades. In ICRA Nepal's assessment, the bank's operational and financial profile is expected to remain consistent with the rating level going forward.

The rating action factors in the HBL's established track record (operating since 1993), and the bank's moderate pace of growth over the years leading to good market presence with market share of ~4% in commercial banking industry credit and deposits. Bank's strong CASA profile (~52% as of mid-Apr-18) results in lower cost of fund vs. most of the peers (5.52% for 9MFY18) which remains a key competitive strength for the bank. This along with HBL's comfortable capitalization, diversified network[2] and experienced management team is expected to support bank's growth plans over the medium term. The rating continues to be supported by presence of strong institutional promoters viz. Habib Bank Limited[3] (20% stake) and Employees Provident Fund[4] (14% stake) with representation in board of the bank. HBL's association with Habib provides access to management and technology support (1 board representative and Senior General Manager at HBL deputed from Habib). The rating reaffirmation also considers improving profitability indicators aided by healthy net interest margins (NIMs), strong fee-based income and low credit cost despite relatively higher operating expenses.

The rating however remains constrained due to NPLs of the bank (1.19% as of Apr-18) being slightly higher among peers despite remaining better to industry average (1.66%). Nonetheless, overall delinquencies remain moderate at ~7%[5] as of mid-Apr-18 which provides some comfort. Despite healthy growth in last few years, credit and deposit concentration remain largely similar to earlier levels of ~23% among top 20 customers, which also remains a rating concern. Additionally, low growth in deposits in relation to credit growth in recent years has led to high CCD ratio[6] of ~79% as of Apr-18 (vs. ~74% in Jul-15) which has also

---

[1] Subscribed amount was NPR 600 million vs. initial rated amount NPR 750 million

[2] Includes 47 branches and 100 ATMs as on mid-Apr-18.

3 Largest bank of Pakistan rated by Moody's at Caa1 (baseline credit assessment); downgraded from b3 in Sep-17.

[4] EPF is one of the largest state-owned retirement funds of Nepal

[5] Indicative data based on our calculations as the bank could not provide the same.

[6] LCY Credit to Core capital and LCY Deposits ratio; this is capped at 80% by regulations.

been factored in the rating action. Bank's ability to improve the pace of deposits growth while maintaining its deposits mix/cost and healthy asset quality/profitability indicators would remain key rating drivers.

HBL's credit portfolio has grown at moderate pace of CAGR ~19% in last three years ending Jul-17 vs. ~24% for industry; pace of growth has been moderated in recent periods with growth of ~12-13% in FY17 and 9MFY18 because of slow deposit growth across the industry. HBL's credit growth momentum remains comparable to top tier banks but much lower to new age aggressive banks. Credit demand going forward is expected to remain healthy amid the expected improvement in economic activity as the stable Government is now in place. Yields on advances for the bank remains comparable among peers at 10.81% for 9MFY18 (9.10% for FY17), the increment in recent periods remaining in line with industry trend. HBL continues to remain a corporate heavy bank with large corporate loans comprising ~77% of portfolio as of Apr-18; within this, loans to manufacturing sector remains sizeable at ~35% of portfolio vs. ~19% for industry. The credit portfolio continues to remain fairly concentrated with top 20 borrower groups accounting for ~23% of portfolio, hence posing the asset quality related risks. Going forward, the management intends to grow cautiously with targets to increase exposure towards retail/SME sectors which could moderate the concentration risks.

Bank's NPLs remains relatively higher among peer banks, however better to industry (1.19% as of Apr-18 vs. 1.66% for industry). Nonetheless, the overall delinquencies remain moderate among peers at ~7% as of mid-Apr-18. Going forward, although the portfolio originated during FY15-FY16 could witness some impairment due to decline in repayment ability of borrowers amid recent upward movement of interest rates, the overall profile is expected to remain comfortable. With provision cover of ~72% as of mid-Apr-18, net NPA and solvency indicator (Net NPA/Net-worth) remains moderate at 0.34% and 2.16% respectively. Going forward HBL's ability to improve the NPLs would be a key monitorable.

HBL's deposit profile in terms of CASA remains better to most peers and industry. However, in line with shortage of lendable deposits across the industry during last 12-18 months, HBL's CASA has declined from ~65% as of Jul-16 to ~52% as of Apr-18 vs. ~7% decline in industry CASA to ~44% over the same period. HBL's cost of fund remains competitive among peers at 5.52% for 9MFY18 (3.44% for FY17), remaining lower to industry average of 6.11%. Deposit growth continues to remain lower vs. industry (CAGR ~13% over past three years ending Jul-17 vs. ~20% for industry). The pace of deposits growth was remained significantly lower to industry in recent periods at ~6% for FY17 (~19% for industry) and ~5% for 9MFY18(~11% for industry) and hence this remains a major concern. Deposit concentration on top 20 depositors remains low at ~23% as of Apr-18 (vs. ~22% on Jul-15).

As for profitability, HBL's earnings profile remain healthy supported by strong NIMs (3.66% for FY17 and 3.53% for 9MFY18), healthy fee-based income (1.34% of ATA[7] for 9MFY18) and low credit costs (-0.09% for FY17 and 0.11% for 9MFY18). HBL's operating cost, which generally remained highest in the industry, is also gradually declining with increasing scale of operation (from 2.90% of ATA in FY13 to 2.06% in 9MFY18). These positives are reflected in HBL's improving return on assets (RoA) at 2.10% for FY17 (1.96% for 9MFY18) vs. ~1.4% for FY14-FY15. RoA remained moderate among peers but better to industry average (1.94% for FY17 and 1.82% for 9MFY18). Return on net worth (RoNW) has also improved despite sizeable equity enhancement (~21% for FY17 vs. ~17% for FY15) notwithstanding some moderation to ~17% for 9MFY18. Going forward, bank's ability to maintain adequate NIMs, manage asset quality and operating cost would have strong bearing on its profitability profile.

As regards capitalisation, HBL's reported CRAR[8] of 12.44% and tier I capital of 11.30% (both as per Basel-III) as of mid-Apr-2018, remains comfortable as against the minimum regulatory requirement of 11% and 8% respectively (both including capital conservation buffer-CCB of 2%). The tier-I capital requirement is expected to increase to 8.5% by mid-Jul-19 (including CCB of 2.5%) although the requirement for total capital would be stable at 11% (incl. CCB). The capitalisation profile was supported by retention of internal accruals and injection of external equity via ~14% rights issue in FY17 to ensure minimum capital requirement of NPR 8 billion as required by regulations. Given HBL's healthy internal accruals and

[7] Average Total Assets

[8] Capital to Risk-weighted Assets Ratio

retention of profits as per business growth needs in the past, capitalization levels are expected to remain adequate to support growth plans of management while maintaining comfortable solvency profile.

Bank Profile

Himalayan Bank Limited (HBL) was incorporated in 1992 by few individuals of Nepal in partnership with the Employees Provident Fund, Nepal (14% share) and Habib Bank Limited of Pakistan (20% share). The bank started its commercial operation from January 1993 and has its head office located at Kamaladi, Kathmandu. Shares of the bank are distributed among promoter and public in the ratio of 85:15 and the shares are listed in Nepal stock exchange. Mr. Ashoke SJB Rana is the Chief Executive Officer of the bank.

HBL has presence across 26 districts of the country through its 47 branches and 100 ATMs as of mid-Apr-18. HBL has market share of 4.24% in terms of deposit base and 4.27% of total advances of commercial banking industry as on mid-Apr-2018. HBL reported profit after tax (PAT) of NPR 2,178 million during FY17 over an asset base of NPR 107,255 million as of mid-Jul-17 as against PAT of NPR 1,936 million during FY16 over an asset base of NPR 99,863 million as of mid-Jul-16. For 9MFY18, HBL reported PAT of NPR 1,612 million over an assets base of NPR 112,315 million. As of mid-Apr-2018, HBL's CRAR was 12.44% and gross NPLs were 1.19%. In terms of technology platform, HBL has implemented Temenos Globus (T24) across all its branches.

July 2018

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