NMB Bank Limited

ICRA Nepal assigns [ICRANP] LA- to proposed subordinated debenture programme of NMB Bank; reaffirms [ICRANP-IR] A- and [ICRANP] LA-

Facility/Instrument	Amount	Rating Action (January 2019)
Subordinated Debenture Programme (fresh)	NPR 3,000 million	[ICRANP] LA- (assigned)
Subordinated Debenture Programme (existing)	NPR 500 million	[ICRANP] LA- (reaffirmed)
Issuer Rating	NA	[ICRANP-IR] A- (reaffirmed)

ICRA Nepal has assigned [ICRANP] LA- (pronounced ICRA NP L A minus) to the proposed subordinated debenture programme of NMB Bank Limited. Instruments with this rating are considered to have an adequate degree of safety regarding the timely servicing of financial obligations. Such instruments carry low credit risk.

ICRA Nepal has reaffirmed the issuer rating for NMB at [ICRANP-IR] A- (pronounced ICRA NP issuer rating A minus). This is considered to be an adequate credit quality rating. The rated entity carries average credit risk. The rating is only an opinion on the general creditworthiness of the rated entity and is not specific to any debt instrument. Similarly, ICRA Nepal has reaffirmed the rating of NMB's existing subordinated debentures of NPR 500 million at [ICRANP] LA-.

The sign of + (plus) or – (minus), appended to the rating symbols, indicates their relative position within the rating categories concerned. Thus, the rating of A- is one notch lower than A.

The assigned/reaffirmed ratings factor in the bank's strong capitalisation (capital to risk assets ratio (CRAR) of 15.36% as of mid-October 2018) following fresh equity infusion in FY2017 and FY2018. NMB's strong capitalisation profile along with its extensive track record, experienced management team and good franchise network augurs well for its incremental growth prospects. The ratings also draw comfort from NMB's institutional promoters (~24% stake held by FMO[1] and Employees' Provident Fund Nepal, including board representation from both entities, thereby adding to the governance aspect of the bank). The rating action also takes into consideration the bank's moderate and steady rate of business growth, established underwriting norms and risk management framework along with good asset quality (gross non-performing assets (NPAs) of 0.76% as of mid-October 2018) and solvency indicators. The ratings also factor in the bank's adequate fair profitability (return on assets (RoA) of ~1.9%) supported by adequate net interest margins (NIMs) of ~3% and good non-interest income levels.

Nonetheless, the rating concerns arise from the tight liquidity situation faced by the Nepalese banking industry, including NMB, because of higher growth in banking sector credit vis-à-vis deposits during the last four to five years. As a result, NMB's liquidity ratio has declined with a commensurate increase in the credit-to-deposit ratio. The higher credit-to-deposit ratio has helped the bank offset the impact of the rising cost of funds, thereby stabilising NIMs and supporting profitability. However, the high deposit concentration (~32% of the total deposits are among the top 20 depositors) has lowered the liquidity cushion available to the bank. NMB's credit concentration among the top borrower groups also remains on the higher side (~27% of the total credit was among the top 20 borrower groups as of mid-October 2018), which also remains a concern. The ratings also remain impacted by NMB's moderate funding profile. Despite the recent improvement, the bank's current and savings deposit (CASA) mix is below the industry average (37% as of mid-October 2018 vs. the commercial bank average of ~43%), which reflects in the higher cost of funds for NMB vis-à-vis its established peers. This, coupled with the bank's relatively higher operating expense ratio, has resulted in a relatively higher base rate for NMB, which is a competitive disadvantage in the base rate plus lending model followed by the banking industry. The ratings also remain constrained by the uncertain operating environment faced by banks in Nepal because of high credit growth, rise in interest rates on the deposit and lending side, rising competition despite consolidation, and tight liquidity, which may impact the asset quality in coming periods.

[1] *Nederlandse Financierings-Maatschappij voor Ontwikkelingslanden N.V. (FMO) is a bilateral development bank based in the Netherlands with the Dutch state holding a 51% stake*

NMB's credit portfolio grew at a CAGR of 17% during the two years ending FY2018, below the commercial bank average of a CAGR of 23%. NMB's growth in the interim period was supported by the expansion of the branch network. As of mid-October 2018, the bank's credit portfolio of ~NPR 83 billion comprised corporate[2] loans (36%), SME loans (37%) and retail loans (19%) among others. Increase in the franchise network in the last 12-18 months is expected to support the management's target of boosting NMB's credit portfolio as well as the retail and SME segments, going forward. However, given the tight liquidity scenario, the incremental credit growth is likely to be determined by the bank's ability to raise fresh sources of lendable funds. NMB's credit concentration among the top 20 borrowers increased slightly to 27% in mid-October 2018 from 23% in mid-October 2017 and remains a rating concern. However, due to the sizeable growth in the equity base during the interim period, exposure towards the top 20 borrowers, as a percentage of Tier I capital, has eased since the last rating. In terms of asset quality, NMB's gross NPA level has eased since the last rating on account of the bank's interim credit growth as well as its recovery actions. As of mid-October 2018, NMB's gross NPA was 0.76% vs. 1.67% in mid-October 2017. Similarly, its 0+ days delinquency, as of mid-October 2018, was low at ~4% of total loans outstanding, down from ~6% in mid-October 2017.

NMB registered an improvement in the CASA mix during the last 12-18 months, despite the liquidity challenges and declining CASA proportion across the industry. This can be attributed to management's focussed strategy towards CASA improvement, which remains a positive for the long-term deposit profile. As of mid-October 2018, NMB's CASA deposit proportion stood at 37%, improving from 33% in mid-October 2017. The higher CASA proportion has improved the granularity of the deposits and the concentration among the top depositors (the top 20 depositors accounted for 32% of the total deposits in mid-October 2018 vs. 34% in mid-October 2017). Nonetheless, as of mid-October 2018, NMB's CASA proportion of 37% remained below the commercial bank average of ~43%, translating into a 100 bps higher cost of deposits for NMB vis-à-vis the industry average. This, coupled with the bank's relatively higher operating expense ratio, could be a competitive disadvantage for the bank in the base rate plus lending model following by the industry.

NMB's liquidity position has moderated in the last one to two years because of the ongoing shortage of lendable funds. Its liquid assets, as a percentage of total liabilities, stood at ~22% in mid-October 2018 vs. ~23% in mid-July 2018 and ~27% in mid-July 2017. Although the current liquidity position remains adequate vis-à-vis the regulatory requirement, the liquidity buffer available in case of a large withdrawal has declined over the years. NMB's ability to improve its deposit mix, liquidity buffer and lower the deposit concentration risk will have a bearing on its ability to withstand any incremental liquidity shocks.

NMB's capitalisation profile has strengthened after a series of fresh equity infusion in FY2017 (fresh equity issued to FMO) and FY2018 (fresh equity issued to the general public). NMB raised fresh capital of ~NPR 6 billion through these issuances. This, coupled with moderate growth in the interim period, has led to strong capital levels for NMB. The proposed Tier II bond issuance is expected to further strengthen the capital fund (assuming full subscription). NMB's CRAR stood at 15.36% as of mid-October 2018 (vs. 15.75% in mid-July 2018[3]), comfortable vis-à-vis the regulatory minimum of 11% under the prevailing Basel III norm. NMB's Tier I capital (14.37% as of mid-October 2018) remained well above 8.50%, which is to be maintained by mid-July 2019 under the Basel III norms prescribed by Nepal Rastra Bank (NRB, the Central bank).

NMB's profitability indicators remain sufficient, supported by adequate NIMs (~3.3% during the last 12-18 months). The increase in the bank's credit-to-deposit ratio has helped maintain stable NIMs, offsetting the impact of the rising cost of funds. NMB's good non-interest income levels (~1.3% during the last 12-18 months) and low credit cost have supported its profitability though higher operating expense remains a drag on the same. NMB has reported stable return on assets during the two years ending FY2018 (~1.9% in FY2018 and ~1.8% in FY2017). However, with sizeable equity infusion, the bank's return on net worth diluted to ~14% in FY2018 from ~17% in FY2017.

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[2] *NMB has internally classified loans of up to NPR 200 million as SME while the rest is in the form of corporate loans*

[3] *Before cash dividend for the year*

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

Links to applicable criteria:

Bank Rating Methodology

Bank Profile

NMB Bank Limited commenced operations on December 26, 1996 as a Class C finance company. It has been operating as a commercial bank following its upgradation to Class A in May 2008. NMB is a joint venture company with foreign promoters, FMO (the Netherlands) and Young Leon Realty (Malaysia) holding, holding ~17% and ~5%, respectively. As of mid-October 2018, NMB's promoter-public shareholding stood at ~51:49. The current major promoter group of the bank includes FMO, Employees' Provident Fund, Young Leon Realty and other individual shareholders from business houses of Nepal. Mr Suneel KC is the CEO of the Babarmahal, Kathmandu-based bank.

NMB's market share was about 3.4% in terms of deposit base and 3.7% of total advances of commercial banks as of mid-October 2018 (2.9% and 3.2% share, respectively, in the banking industry). As of mid-October 2018, the bank had a presence throughout the country through 110 branches. It reported a profit after tax of NPR 1,853 million in FY2018 on an asset base of NPR 104,914 million as of mid-July 2018 against a profit after tax of NPR 1,467 million in FY2017 on an asset base of NPR 86,817 million as of mid-July 2017. Till mid-October 2018 (Q1 FY2019), NMB had reported a net profit of NPR 550 million on an asset base of NPR 112,461 million. As of mid-October 2018, the bank's CRAR was 15.36% (Tier I: 14.37%) and gross NPAs were 0.76%.

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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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