Nepal SBI Bank Limited

ICRA Nepal reaffirms issuer rating of [ICRANP-IR] AA and rating of [ICRANP] LAA for existing subordinated debentures

Facility/Instrument	Amount	Rating Action (January 2019)
Issuer Rating	NA	[ICRANP-IR] AA (Reaffirmed)
Subordinated Debenture Programme	NPR 200 Million	[ICRANP] LAA (Reaffirmed)

ICRA Nepal has reaffirmed the issuer rating of **[ICRANP-IR] AA** (pronounced ICRA NP Issuer Rating Double A) assigned to Nepal SBI Bank Limited (NSBL). This is considered to be a high credit quality rating. 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 also reaffirmed the rating of **[ICRANP] LAA** (pronounced ICRA NP L Double A) for NSBL's subordinated debentures of NPR 200 million. Instruments with this rating are considered to have a high degree of safety regarding the timely servicing of financial obligations and carry very low credit risk.

The ratings reaffirmation factors in the bank's consistently strong asset quality (0+ days delinquencies of ~2.4% as of mid-October 2018) while maintaining a cautious growth approach and ensuring adequate controls. NSBL's healthy capitalisation, adequate franchise, comfortable credit-to-deposit ratio adjusted for core capital (CCD of ~75% as of mid-October 2018) and experienced management team augur well for its incremental growth prospects. The ratings also remain supported by the bank's established underwriting norms and risk management framework. NSBL's strong promoter profile (55% stake held by State Bank of India (SBI)[1] and 15% held by Employees Provident Fund), along with the existence of a technical support service agreement (TSSA) with SBI, continues to provide support to the assigned ratings. The bank's association with SBI through the TSSA provides access to management (MD/CEO, COO and CFO and four other departmental heads at NSBL are deputed from SBI) and technology support from SBI. The rating action also takes into consideration the bank's established track record (operating since 1993), adequate earnings profile and good market positioning in Nepal with a share of ~3.7% in industry credit and deposits as of mid-October 2018.

The ratings are, however, constrained by the bank's moderate deposit profile among the top tier banks with a slightly lower share of low-cost current and savings accounts (CASA). This resulted in relatively higher cost of funds. Amid tight liquidity conditions, the bank's cost of funds has increased more compared to the industry in recent periods (3.0% increment in last 15-months ending mid-October 2018, compared to 2.4% increment for the industry). This, along with the high operating costs compared to peers, has pushed up the base rate for the bank, thereby creating pressure in maintaining a competitive position in the current lending regime, which is based on the base rate. The bank's deposit concentration, despite some recent moderation, remains high (~36% among the top 20 depositors as of mid-October 2018) and hence continues to be an area of concern. The rating action also takes note of the spike in credit growth in Q1 FY2019 to ~46% (annualised) compared to ~29% growth for the industry. Additionally, a major chunk of the recent credit growth was in large ticket corporate loans, thereby increasing the credit concentration risk. The ratings also remain constrained by the probable systemic risks emanating from the tight liquidity conditions and the resultant mismatch in credit and deposit growth in the industry over the last few years. This has increased the volatility in interest rates and spiked the cost of funds for the industry. The resultant hardening of interest rates in the loan portfolio might pressurise the asset quality of the banking sector over the medium term.

NSBL reported portfolio growth of ~20% in FY2018 against ~22% growth in the industry. The growth trend witnessed a major spike in Q1 FY2019 (~46% annualised growth compared to ~29% for the industry), contrary to the earlier track record of moderate growth. This was mainly supported by the comfortable CCD levels of banks at ~75% while many banks were close to the regulatory cap of 80%. NSBL's portfolio mix has gradually increased in favour of large corporate loans (~76% in mid-October

[1] *Rated by ICRA at [ICRA]AAA (hyb) (pronounced ICRA triple A hybrid) for the Rs. 15,743-crore Basel III compliant Tier II bonds programme.*

2018 against ~60% in mid-July 2017), followed by retail loans (~16%), deprived sector loans (~6%) and SME loans (~2%). Owing to the low-yielding corporate-heavy loan growth, the bank's yields declined in Q1 FY2019 to 10.89% (11.71% in FY2018) despite a further rise in the cost of deposits during this period. The credit concentration risk also increased to an extent with the top 20 borrower groups accounting for ~164% of the bank's Tier-I capital and ~25% of the portfolio as of mid-October 2018 (128% and 20%, respectively, in mid-July 2017). Management plans to increase focus on the retail and SME segments, which could reduce concentration risks to an extent.

The bank's asset quality, despite minimal stress in recent periods, remains strong among peers. Non-performing loans (NPLs) increased slightly to 0.20% as of mid-October 2018 from 0.10% as of mid-July 2017 with overall delinquencies of 2.36% (1.04% in mid-July 2017). ICRA Nepal also takes comfort from the bank's ability to absorb losses (net NPL/net worth was nil over the last four years). NSBL's asset quality could witness pressure over the medium term due to stress in the repayment capability of borrowers after increased interest rates. However, given the capital position and strong solvency ratio, it is well placed to absorb asset quality shocks. Going forward, NSBL's ability to maintain the asset quality indicators, amid the gradual hardening of interest rates, would remain a key monitorable.

NSBL's deposit profile has witnessed further moderation recently characterised by an increased share of fixed deposits compared to the industry (57% as of mid-October 2018 against 45% for the industry) while the share of CASA was largely comparable at ~41%. This is reflected in the bank's cost of funds, which was higher than the industry average in Q1 FY2019 (6.83% for NSBL against 6.53% for the industry). This contrasts with earlier periods when the bank's cost of funds was competitive compared to the industry average. Additionally, a sizeable chunk of the term deposits, as of mid-October 2018, is for a longer tenure (~16% for more than three years against 1% in mid-July 2017) and would hence impact the cost of funds over the medium term. The deposit concentration has eased slightly but remains high with the top 20 depositors accounting for ~36% of total deposits as of mid-October 2018 (~42% in mid-July 2017). As far as the composition of deposits is concerned, the bank's share of foreign currency deposits (FCY) has declined to ~3% from ~12% over the last 12-15 months. As these deposits are excluded in the CCD calculations, the bank was able to maintain a largely similar CCD ratio at ~75% despite very low overall deposits growth of ~3% in FY2018. Despite the general liquidity stress in the industry, NSBL was able to increase the pace of deposit growth sharply in Q1 FY2019 to ~49% (annualised; ~11% for the industry) to support the high credit growth. This helped NSBL in maintaining similar CCD levels, which reflects well on the bank's stance of maintaining an adequate liquidity cushion. Nonetheless, improving the deposits mix, concentration and cost would remain key challenges for the bank over the medium term.

On the capitalisation front, the bank reported a capital to risk-weighted assets ratio (CRAR) of 14.03% and Tier-I capital of 12.45% (both as per Basel III) as of mid-October 2018, which remain comfortable compared to 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-July 2019 (including CCB of 2.5%) although the requirement for total capital would be stable at 11% (including CCB). The reported capitalisation was mainly supported by a 40% rights issuance in FY2017 along with a follow-on public offer (FPO) and internal accruals in line with the regulatory capital increment requirements. The bank's capitalisation levels are expected to remain adequate to support its growth plans over the medium term.

As for profitability, NSBL's earnings profile was largely stable in FY2017 and FY2018. The net interest margins (NIMs) improved to 4.10% in FY2018 from 3.27% in FY2017, mainly backed by a decline in FCY deposits, which only yielded nominal arbitrage gains. However, a higher operating expense ratio (2.19% of average total assets (ATA) in FY2018) and lower non-interest income (1.32% of ATA) impacted the financial profile to an extent. Hence, return on net worth (RoNW) remained largely similar for last two fiscals at ~17-18% while return on assets (RoA) improved slightly to 2.00% in FY2018. With lowered yields for Q1 FY2019, the NIMs declined to 3.93% and hence RoNW and RoA declined slightly to ~15% and 1.82%, respectively. Given the earnings profile, the bank has sufficient cushion to absorb credit provisioning that may arise in case of any unforeseen stress in asset quality and remain adequate.

Going forward, the bank's ability to improve its NIMs in a competitive landscape and maintain the asset quality would have a strong bearing on its earnings profile.

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

Links to applicable criteria:
Corporate Credit Rating Methodology
Bank Rating Methodology

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 (SBI), which has a 55% stake in the bank, the rest being held by Employees Provident Fund (15%) and the general public (30%). The bank has a technical support services agreement with SBI with the latter providing management support to the bank through its expatriate officers including the MD/CEO and other senior personnel in the management team. The bank's shares are listed on the Nepal Stock Exchange. The registered and corporate office of the bank is in Kesharmahal, Kathmandu.

NSBL has a presence across the country through 76 branches, seven extension counters and 113 ATMs. As of mid-October 2018, the bank's market share was 3.72%, in terms of the deposit base, and 3.75% of total advances of commercial banks. NSBL reported a profit after tax (PAT) of NPR 2,024 million in FY2018 (YoY growth of 33%) on an asset base of NPR 102,539 million as of mid-July 2018. For Q1 FY2019, the bank reported PAT of NPR 490 million on an asset base of NPR 113,193 million. As of mid-October 2018, NSBL's CRAR was 14.03% and gross NPLs were 0.20%. As far as the technology platform is concerned, NSBL has implemented Finacle across all its branches.

January 2019

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About ICRA Nepal Limited:
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