ICRA NEPAL

Citizens Bank International Limited

ICRA Nepal assigns [ICRANP] IPO Grade 3 to the proposed Further Public Offering (FPO) of Citizens Bank International Limited

Facility/Instrument	Amount	Grading Action
Further Public Offer (Equity Shares)	NPR 92.7652 Million	**[ICRANP] IPO Grade 3** (Assigned on April 2018 and revalidated with FPO price update on July 2018)

ICRA Nepal has assigned an "**[ICRANP] IPO Grade 3**", indicating average fundamentals to the proposed Further Public Offering (FPO) of Citizens Bank International Limited (CZBIL). ICRA Nepal assigns IPO grading[1] on a scale of IPO Grade 1 through IPO Grade 5, with Grade 1 indicating strong fundamentals and Grade 5 indicating poor fundamentals. For the grading categories 2, 3 and 4, the sign of + (plus) appended to the grading symbols indicate their relative position within the grading categories concerned. Thus, the grading of 2+, 3+ and 4+ are one notch higher than 2, 3, and 4, respectively. CZBIL is proposing to come out with an FPO of 463,826 numbers of equity shares of face value NPR 100/- each at a premium of NPR 100 per share (issue price of NPR 200 per share).

The average fundamental grading factors in the bank's adequate track record (operating since Apr-2007) with gradually improving market positioning aided by healthy pace of growth (credit grew by CAGR ~27% over last five years ending Jul-17 albeit on small base, vs. ~20% for industry). Although growth has moderated to an extent to ~19-20% in last 12-18 months on account of increase in asset base and shortage of lendable fund in later period; diversified franchise (68 branches), experienced management team and adequate capitalisation (CRAR of 15.55% as of Apr-18[2]) is likely to support incremental growth over the medium term. ICRA Nepal also positively takes note of the ability of the bank to maintain comfortable assets quality indicators despite acquisition of weak financial institutions[3]. CZBIL was able to downsize its adjusted non-performing loans -NPLs (including Non-Banking Assets - NBAs) from 3.75% as of Jul-15 to 2.02% as of Apr-18 (including NBAs of 0.56%) while maintaining moderate delinquencies levels (in the rage of ~4-8%; ~6.2% on Jan-18). The grading also considers the increasing share of retail/SME loans in bank's portfolio (~54% on Jan-18 vs. ~43% on Jul-15) which has gradually reduced credit concentration risks (from ~28% among top 20 borrowers on Jul-14 to ~21% on Apr-18).

The grading is however constrained by the bank's declining net interest margins (NIMs of 2.76% for 9MFY18 vs. 3.36% for FY16) amid shortage of lendable funds leading to swift spike in cost of deposits for the banking sector in last 12-18 months. This along with significant equity raised in last two years could impact the profitability indicators over the medium term (return on net worth - RoNW diluted to ~15% for FY17 vs. ~22% for FY15; ~14% for 9MFY18). Additionally, exposure of the bank to risker segments like real estate sector and loan against shares also remain relatively higher (~17% as on Apr-18 vs. ~7% for industry) which along with portfolio growth in low interest rate regime could witness stress in increasing interest rate scenario. The grading is further constrained by bank's inferior deposits profile with lower proportion of low cost current and savings accounts (CASA ~26% as on mid-Apr-18 vs. ~44% for industry). This has led to high cost of deposits among peers (8.01% for 9MFY18 for CZBIL vs 6.11% for industry), weakening its competitive positioning to some extent in the "base rate plus" lending rate regime. Also, concentration of deposits among top accounts remains on higher side (despite some moderation vs. earlier, top 20 depositors comprise of ~37% of deposits on mid-Apr-18).

CZBIL reported portfolio growth of ~19% during FY17 (~39% in FY16) and ~20% during 9MFY18 (CAGR of ~27% over past 5 years ending mid-Jul-17 vs. industry average growth of ~20%). Higher growth during the low interest rate regime (FY14-FY16) could impair the repayment ability of borrowers in current scenario of upward movement of interest rates. CZBIL's portfolio mix as of Jan-18 primarily

[1] Includes grading of IPO, rights issue and further public issue.
[2] 9MFY18 data are unaudited
[3] 3 problematic finance companies have been acquired so far (two acquired in May 2015 and last one in July 2016) which contribute to ~42% of reported NPLs and ~98% of NBAs of the bank as of mid-Jan-18.

comprises of large corporate loans (~46%) followed by retail loans (~42%) and SME loans (~12%). High exposure to riskier segments and reduction in low yielding corporate loans by ~11% since Jul-15, has been supporting better yields among peers (12.39% for 9MFY18 vs. 9.63% for FY16). Credit concentration risks has also moderated to ~21% of portfolio as on mid-Apr-18 among top 20 borrower groups vs. ~28% in Jul-14. Going forward, the management intends to leverage the existing franchise to achieve future credit growth focusing more along retail/SME segment. The bank's ability to achieve the growth targets along with commensurate risk control measures would have a key bearing over its financial profile.

Asset quality of the bank has remained progressive after witnessing high stress during FY14; NPLs came down from 3.40% as of Jul-14 to 1.94% as of Jan-18 (1.46% on Apr-18) despite acquisition of three problematic financial institution in the interim. ~42% of reported NPLs as of Jan-18 were from the acquired entities thereby reflecting relatively better asset quality originated by CZBIL. With high provision cover of ~86% as of Apr-18, impact on solvency (Net NPA/Net worth) of the bank remains low at 1.07% compared to ~12% on mid-Jul-14. 0+ days delinquencies of the bank also remain moderate at 6.21% as of mid-Jan-18. Fresh NPL generation rate for CZBIL has been in the range of 0.9-1.0% in last three years (0.85% for FY17) while recovery rate has remained ~25% on an average over this period (27% for FY17). Apart from NPLs, bank also has significant stock of NBAs (NPR 344 million as of Jan-18, ~98% of which emanated from acquired entities). Recovery from NBAs of acquired entities has remained good so far with ~60% of NBA addition from acquired entities being disposed till mid-Jan-18 yielding sizeable gains on disposal as well. The bank's ability to sustain its asset quality indicators amid decline in repayment capacity of the borrowers to serve facilities at higher interest rates remains to be seen.

CZBIL witnessed healthy growth in deposits (~25% CAGR over past five years ending Jul-17 compared to ~17% growth for industry). However due to higher growth in advances and consequent reliance on large depositors, bank has not been able to improve share of low cost CASA deposits which remained largely constant at ~25% over last few years (26% on Apr-18). This has resulted in higher cost of funds for CZBIL, compared to peers and industry average, at 8.01% for 9MFY18 (4.23% for FY16) vs. 6.11% for industry. Shortage of lendable funds in the banking sector in the last 12-18 months has resulted in swift increment (~89% increase) in cost of funds for the bank as well. Given the banks' high reliance on term deposits (~67% as of Apr-18), costs of deposits could further increase over near term. Furthermore, deposit concentration on top 20 depositors also remains high at ~37% as of mid-Apr-18 and hence remains a concern.

As for profitability, bank has witnessed moderation in return indicators in recent periods owing to increasing capital base and declining NIMs. Inability to pass on the entire increment in cost of deposits to borrowers have resulted in reduction in NIMs from 3.36% for FY16 to 2.76% for 9MFY18 and hence remains a concern in terms of incremental profitability. Bank's RoNW reduced from ~24% for FY16 to ~15% for FY17 (~14% for 9MFY18) vs. ~18% for industry. Return on assets -RoA has also declined from 2.24% for FY16 to 1.90% for 9MFY18. Nonetheless, CZBIL's earnings profile has been supported to an extent by sizeable provision write backs in last 2-3 years from recovery of NPLs and NBAs of acquired entities. This has resulted in negative credit cost in last two years (0.52% of average total assets -ATA for FY17) despite sizeable portfolio growth. The profitability has also been supported by healthy business growth, modest non-interest income (1.12% of ATA during FY17) and moderate operating expense ratio (~1.8% of ATA during FY17). Ability of the bank to maintain adequate NIMs amid reducing quantum of provision write backs and control further credit cost on account of concerns on asset quality will be critical for profitability.

CZBIL's capitalisation levels are adequate with CRAR of 15.55% and tier-I capital of 14.16% as of mid-Apr-2018 (both as per Basel III) remaining comfortable vs. minimum regulatory requirement of 11% and 8% respectively (both including capital conservation buffer-CCB). The tier-I capital requirement is expected to increase to 8.5% by mid-Jul-19 (including CCB) although the requirement for total capital would be stable at 11% (incl. CCB). CZBIL has increased capital from ~NPR 3 billion as of Jul-15 to ~NPR 8 billion (i.e. increased regulatory minimum) as of Jul-17 largely through series of rights and bonus issues, apart from minimal capital addition from three acquisitions. Capitalization levels are hence expected to remain adequate to support CZBIL's growth plans over the medium term.

Bank Profile

Citizens Bank International Limited (CZBIL) started its commercial operation from April 20, 2007 as a Class "A" Commercial Bank. Citizen Investment Trust, the largest shareholder, holds 4.52% stake in the bank while the other promoters are largely individuals from diverse background. As on mid-Jan 2018, promoter-public shareholding of CZBIL stood at 51.21:48.71; which will be converted to 51:49 through the proposed FPO. The bank's equity share is listed in Nepal stock exchange and being actively traded. Its head office is located at Narayanhiti, Kathmandu. Mr. Rajan Singh Bhandari is the CEO of the bank.

CZBIL has presence throughout the country through its 68 branches and 68 ATMs as of mid-Apr-18. CZBIL has market share of 2.66% in terms of deposit base and 2.79% of total advances of commercial bank industry as on mid-Apr-18. CZBIL reported a profit after tax (PAT) of NPR 1,082 million during 2016-17 over an asset base of NPR 65,405 million as of mid-Jul-17 against PAT of NPR 1,080 million during 2015-16 over an asset base of NPR 55,062 million as of mid-Jul-16. During 9MFY18, CZBIL reported PAT of NPR 1,010 million over an assets base of NPR 76,446 million. As of mid-Apr-2018, CZBIL's CRAR was 15.55% and gross NPLs were 1.46%. In terms of technology platform, CZBIL has implemented Pumori-IV across all of its branches.

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