Nepal Credit and Commerce Bank Limited

ICRA Nepal assigns [ICRANP] IPO Grade 4 to the proposed rights issue (equity shares) of Nepal Credit and Commerce Bank Limited

Facility/Instrument	Issue Size	Grading Action (February 2018)
Rights shares (Equity)	NPR 2,339.5291 million	[ICRANP] IPO Grade 4 (Assigned)

ICRA Nepal has assigned "[ICRANP] IPO Grade 4", indicating below average fundamentals to the proposed rights issue amounting to ~NPR 2,340 million of Nepal Credit & Commerce Bank Limited (NCCB). ICRA Nepal assigns IPO grading 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. NCCB has proposed 50% rights issue of 23,395,291 equity shares of face value NPR 100, each to be issued to existing shareholders at par. The issue is being made to comply with the increased paid up capital requirement[1] set by Nepal Rastra Bank (NRB), the banking sector regulator in Nepal.

The below average fundamental grading factors in NCCB's long track record (since 1996), adequate market share (following merger in FY2017[2]) and improved profitability level maintained in past 1-2 years, notwithstanding moderation during H1FY2018. Adequate capitalization profile (along with proposed capital injection plan) and adequate franchise (with near term expansion plan[3]) is likely to support the incremental growth prospects of the bank. The grading also factors in low credit concentration risk (13% of total loans on mid-Oct 2017 among top 20 borrower groups).

However, the grading remains constrained by inferior assets quality indicator of NCCB, and relatively high delinquency level especially after the merger in FY2017. Gross non-performing loan (NPL) level of NCCB has spiked from <1% (before merger) to 4.29% on mid-Oct 2017 (~4% on mid-Jan 2018) due to inclusion of stressed accounts from merging partners. Over next 1-2 years, recovery from NPA account remains a challenge for the management. Moreover, NCCB also has sizeable non-banking assets (NBA) accounts (~1.45% of total credit as on mid-Oct 2017), leading to total adjusted gross NPA[4] of 5.73% on mid-Oct 2017. Furthermore, the credit books underwritten by NCCB (and its merging partners) during the low interest rate regime could come under stress in the rising interest rate scenario seen since past 12 months.

The grading also remains constrained by moderate funding profile of the bank vis-à-vis the industry. The bank fares moderately in terms of current and savings account (CASA) deposit proportion (32% in mid-Oct 2017 and 35% in mid-Jan 2018 vs. industry average of ~43%) and deposit concentration (top 20 depositors accounting for 33% of total deposits as on mid-Oct 2017). Resulting low granularity exposes NCCB to liquidity and/or pricing risk, as reflected in >100% increase in the average deposit cost of NCCB during past 12-15 months (average cost of deposits increased from ~4% in FY2016 to ~8.50% during H1FY2018). The spike in deposit rates followed the shortage of lendable deposits in the banking system. In the recently introduced "base rate plus" lending rate regime, rising cost of deposits means weak competitive positioning vis-à-vis peers with finer deposit profile/cost.

Post-merger integration issues also remain a concern, especially in the human resource front since >50% of post-merger NCCB staff strength is derived from merging class B banks. NB group along with its affiliates continues to remain the major promoter group in the company with ~16% stake as on mid-Oct 2017, despite considerable dilution in their stake post-merger. This also remains a concern, given the history of weak corporate governance in the institutions under the group. Current board of directors in NCCB is appointed by NRB and is set to change at the upcoming AGM. The constitution of new board will be critical for future corporate governance and performance of the bank. The grading is also constrained by uncertain operating environment that the banks in Nepal are currently facing.

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[1] NPR 8 billion for class A commercial bank.

[2] NCCB acquired 4 class B Banks viz. Apex Development Bank (DB), Supreme DB, Infrastructure DB & International DB and begun combined operation from January 2017.

[3] >30 branches planned to be set up within FY2018.

[4] Includes gross NPLs of 4.29% and NBA account (equal to 1.44% of mid-Oct 2017 credit portfolio).

Pre-merger NCCB's credit portfolio has grown at CAGR of ~18% during past 5 years ending FY16 on consolidated as well as standalone basis, lower than commercial bank average of ~23% over the same period. In FY17, NCCB credit book growth remains of ~94%, heavily supported by the merger in FY17 (merged entities contributed to 78% of the credit growth). Post-merger growth has remained slow due to focus on recovery/ portfolio consolidation as well as due to shortage of lendable deposits in the system. As on mid-October 2017 (Q1FY2018), NCCB's credit portfolio of ~NPR 49 billion (NPR 51 billion on mid-Jan 2018) comprised mainly of corporate loans (40%), followed by retail loans (33%) and SME loans (28%). The proportion of retail and SME loans have increased after the merger (with relatively stronger retail/SME base). Due to low corporate credit proportion, credit concentration of NCCB remains on lower side, which is a positive from incremental assets quality perspective. Over next 12-18 months, incremental credit growth of NCCB is likely to be driven by increased geographical coverage of the bank through branch expansion. On the long run, bank's credit growth will depend on its ability to offer finer lending rates, which in turn will depend on its funding profile.

Assets quality indicators of NCCB remained fair pre-merger (<1% gross NPLs in Jul-2016) which deteriorated sharply post-merger (Gross NPLs of 4.80% on mid-July 2017 and 4.29% on mid-Oct 2017). Sudden spike in NPLs level was caused by inclusion of stressed accounts from merging partners, especially Apex DB (>35% gross NPA reported pre-merger). As on mid-Oct 2017, total gross NPLs of NCCB stood at ~NPR 2 billion spread over ~1,000 borrower accounts. Ability of the management to recover from such high volume of NPLs accounts remains to be seen. However, it is partly comforted by small ticket size of NPL accounts which increases the recovery prospect. As on mid-Oct 2017, 0+ days delinquency stood at ~19% of total credit (~14% on mid-Jan 2018). However, major portion of delinquency are of short term (overdue for <30 days) and are likely to be regularised in later part of financial year. Nonetheless, rising delinquency and high NPA level remains a concern, especially in the rising interest rate environment seen in the banking industry during past 12 months. NPA provision cover of NCCB remains adequate at ~79% on mid-Oct 2017 (declined to ~70% on mid-Jan 2018) corresponding to relatively moderate solvency level (Net NPL/ Net worth) of ~6% (~7.5% on Jan 2018).

In terms of deposit profile, NCCB stands inferior to the industry average. As on mid-Oct 2017, NCCB's deposit base of NPR 61 billion comprised of 32% CASA (lower than industry average of 43%). At the same time, deposit concentration among top accounts remains on higher side. During past 12 months, Nepalese banking industry has witnessed shortage of lendable deposits pushing up the cost of deposits. Low granularity and reliance on price sensitive corporate deposits has resulted in sharp increase in average cost of deposits of NCCB between FY2016 and Q1FY2018. This is likely to adversely affect the bank's competitive positioning (in the "base rate plus" lending rate regime). This is also likely to affect NCCB's profitability (by affecting the net interest margin) as the bank's ability to pass on the increased cost to the borrower is dictated by industry competition. Despite the shortage of lendable deposits in the system, CCD ratio of NCCB stood comfortable at ~76% on mid-Jan 2018 (~70% on mid-Oct 2017); enabling the bank to maintain its CCD ratio even in the event of sudden withdrawal of large deposits. Given the shortage in lendable deposits within the banking system, incremental credit growth of NCCB over next 12-18 months is likely to remain pegged with incremental deposits raised by the bank.

As for profitability, NCCB's return on net worth (RoNW) during FY16 (pre-merger) and FY17 (post-merger) has remained above-industry-average; albeit on a small capital base. Over next 12-18 months, RoNW is likely to remain diluted due to sizeable equity injection plans and moderate growth outlook for the industry. Because of rising cost of deposits, declining CCD ratio and increase in delinquencies NCCB's NIMs moderated from 3.43% in FY2016 (pre-merger) to 2.54% in FY2017 (post-merger) and further to 1.21% in Q1FY2018. However, NIMs has improved marginally to 1.68% during H1FY2018 due to increase in CCD ratio. Triggered by sharp decline in NIMs, return indicators of NCCB has moderated (RoNW of ~9% in H1FY2018 vs ~19% in FY2017 and 21% in FY2016). Moderation in NIMs, despite optimum CCD ratio of ~76% as on mid-Jan 2018, remains a concern to incremental profitability profile of the bank. Concerns also emanated from low non-interest income proportion limiting the diversification of revenue. Nonetheless, profit level remains supported by moderation in operating expense ratio and low incremental credit cost. Management's ability to recover from existing NPL and NBA[5] accounts will have a bearing on short term profitability. Over the long run, NCCB's profitability will be determined by the management ability to boost NIMs, increase non-interest income sources and maintain assets quality on incremental credit growth.

[5] NCCB's NBA account stood at NPR 715 million as on mid-Oct 2017.

NCCB has maintained thin capital cushion over the regulatory minimum (11% for class A banks under prevailing Basel III norms) in the past which continues to remain slim even after merger. As on mid-Oct 2017, NCCB's CRAR stood at 11.68% (11.24% on mid-Jan 2018). NCCB's tier I capital of 10.83% (10.44% on mid-Jan 2018) also remains well above 8% (to be maintained by mid-July 2018 and 8.50% by mid-July 2019). NCCB's capitalisation profile is likely to remain adequate vis-à-vis regulatory minimum over next 2 years, factoring in proposed capital injection and moderate growth outlook. However, given the pressure on NIMs, ability of the bank to maintain return on increased capital remains a challenge.

Bank Profile

Nepal Credit & Commerce Bank Ltd. (NCCB) (originally registered as Nepal-Bank of Ceylon Ltd. (NBOC), commenced its operation on October 14, 1996 as a Joint Venture with Bank of Ceylon, Sri Lanka. The name of the Bank was changed to Nepal Credit & Commerce Bank Ltd. in September 2002; after Bank of Ceylon exited by divesting its stake. The Head Office and Corporate Office is located at Bagbazar, Kathmandu.

NCCB underwent merger with 4 class B Banks to raise its paid-up capital in line with revised regulatory requirement. The merger was concluded under the leadership of NRB[6], with the intent to diversify the ownership profile of pre-merger NCCB. Following the merger, the stake of NB Group (controlling interest in pre-merger NCCB) diluted to 16%. Post-merger joint operation commenced from January 01, 2017. As on mid-Oct 2017, NCCB has 51:49 promoter-public shareholding. Individuals and private companies associated with NB group hold ~16% stake while remaining promoter stake is diversified across >1,000 promoters comprising of small stakes by individuals and institutions.

As of mid-Jan 2018, NCCB has presence across the country through its 79 branches and 62 ATMs. NCCB has market share of 2.84% in terms of deposit base and 2.70% of total advances in Nepal as on mid-Oct-17. NCCB reported profit after tax (PAT) of NPR 1,326 million in FY17 over asset base of NPR 69,478 million on mid-July 2017 vs. PAT of NPR 708 million in FY16 over asset base of NPR 34,349 million as on mid-July 2016. During H1FY2018, NCCB reported PAT of NPR 355 million over an asset base of NPR 70,611 million. As of mid-Jan-2018, NCCB's CRAR was 11.24% (12.11% as at July 2017) and gross NPL was 4.04% (4.80% as at July 2017). In terms of technology platform, NCCB has implemented a centralized platform of Pumori Plus across all its branches.

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For further details please contact:

Analyst Contacts:
Mr. Kishor Prasad Bimali, (Tel No. +977-1-4419910/20)
kishor@icranepal.com

Mr. Sailesh Subedi, (Tel No. +977-1-4419910/20)
sailesh@icranepal.com

Relationship Contacts:
Mr. Tulasi R. Gautam, (Tel. No. +977-1-4419910/20)
trgautam@icranepal.com

[6] A 3-member team from NRB took over the bank's operation by suspending the then Board of Directors in February 2014. NRB action followed a deadlock in pre-merger NCC's board of directors due to dispute between major shareholder groups in the bank. The NRB team exited NCC in January 2017 after the merger of NCC with 4 class B banks was concluded.