Machhapuchchhre Bank Limited

ICRA Nepal assigns [ICRANP] LA- to proposed subordinated debenture

Facility/Instrument	Amount	Rating Action (April 2019)
Subordinated Debenture Program	NPR 3,000 million	[ICRANP] LA- (assigned)

ICRA Nepal has assigned **[ICRANP] LA-** (pronounced ICRA NP L A minus) to the proposed subordinated[1] debenture of NPR 3,000 million of Machhapuchchhre Bank Limited (MBL). Subordinated debenture rating A- is one notch lower than the rating A. Instruments with this rating are considered to have adequate degree of safety regarding timely servicing of financial obligations. Such instruments carry low credit risk.

The assigned rating factors in MBL's adequate track record in the industry (operating since 2000) and adequate market presence (through 94 branches as of mid-January 2019). The rating also factors in MBL's good assets quality and delinquency level, which reflects on the adequate underwriting controls of the bank. Rating also derives comfort from MBL's good capitalization level, backed by sizeable equity injection during FY2015-FY2017; which is likely to be further strengthened after proposed debenture program (assuming full subscription). This is likely to improve the bank's ability to withstand any probable credit shocks. The rating also takes into account MBL's steady and industry-average credit growth maintained in recent years. The rating also factors in MBL's adequate profitability, backed by steady net interest margins (NIMs) of ~3.5% over last two to three years. The rating also takes comfort from the experienced management team and promoters of the bank.

The ratings are however constrained by MBL's relatively inferior deposit profile vis-à-vis commercial bank average (CASA[2] deposits of ~32% as on mid-January 2019 vs. ~41% for commercial bank industry). This was partly aided by recent spike in the proportion of term deposits amid volatility in the banking sector interest rates and high price differential between term and other deposit products. However, despite high term deposits proportion, MBL's deposit portfolio remains fairly granular with ~50% of the total deposits coming from individual depositors. Although, lower CASA/ higher term deposit proportion results in higher cost of deposits for MBL (~7.9% for H1FY2019 and ~7.7% during FY2018) for now; it is likely to moderate going forward given the adequate granularity of the deposit portfolio and accordingly lower deposit repricing risk. Nonetheless, over the short to medium term, higher deposit cost could be a competitive disadvantage in the current regime of "base rate plus" lending model. Rating concerns also arise from relatively higher deposit and credit concentration among top accounts (~24% and ~23% of total deposits/ loans concentrated among top 20 depositors and borrower groups respectively).

Assets quality of MBL will be a key monitorable over next 12-18 months, given the sizeable credit portfolio added by the bank over last four to five years including low-interest rate regime between FY2015-H1FY2017. The quality of credit portfolio added in the recent past could be tested by the high-interest rate prevailing in Nepalese banking industry since H2FY2017. Incremental asset quality concern also arises from volatility in banking sector liquidity and interest rates in recent quarters, which could affect the business and credit profile of the borrowers.

MBL's credit portfolio growth of CAGR 24% during last five years ending FY2018 stood at par with commercial bank average. During FY2018 and FY2017, MBL's credit portfolio registered year-on-year (YOY) growth of 24% & 17% (vis-à-vis commercial bank average of ~22% and ~25% respectively). MBL's addition of 20+ branches in FY2018 and future expansion plans is likely to increase the geographical coverage and customer base, thereby supporting the incremental credit growth plans of the bank. As on mid-January 2019, MBL's credit portfolio of ~NPR 75 billion was distributed evenly

[1] *Subordinated to deposits for principal repayment, in the event of liquidation.*
[2] *Current and Savings Accounts*

among corporate loans (~33%), consumer loans (32%) and SME loans (30%)[3] with ~5% mandatory deprived sector loans. With recent addition to the franchise network of the bank and proposed expansion plans, non-corporate segment of the bank is likely to get a boost going forward, which is likely to soften the relatively high credit concentration level of the bank (~23% of total loans among top 20 borrower groups as on mid-January 2019).

MBL's assets quality remains good with gross NPA of ~0.4% as on mid-January 2019 and mid-July 2018. With adequate provision cover of ~60%, net NPA to net worth of MBL stood comfortable at less than 1.5% on mid-January 2019 (0.87% on mid-July 2018). As on mid-January 2019, MBL's zero plus days delinquency also remains low at ~5%. MBL's assets quality indicator has reported steady improvement over last five years declining from ~4% in mid-July 2011 when MBL's asset quality and solvency was weakened by large one-off default from one of its largest borrower groups. MBL has undergone significant change in management and ownership since then with concomitant improvement in risk management practices. This along with sizeable loan write-offs, interim credit growth and recovery efforts have brought down the NPA levels. Although the current assets quality and delinquency level remains comfortable, incremental assets quality of MBL could remain under pressure given the high interest rate environment prevailing in the industry since H2FY2017. Prevailing high interest rates could have an impact on the credit underwritten during the low-interest rate regime in the past. Also, MBL's exposure to relatively vulnerable sector[4] as on mid-January 2019 remains higher than industry average (~16% vs. commercial bank average of ~13%), creating assets quality concern for future.

MBL's CASA deposit proportion has declined steadily since FY2016, as the shortage of deposits across the industry and resulting interest rate hike in term deposits led to high rate of conversion from savings to term deposits. As a result, CASA deposit declined from ~45% in mid-July 2016 to 32% in mid-Jan 2019 while term deposits grew from 33% to 59% over the same period. Increased term deposit proportion has led to increase in cost of deposits for MBL, which stood ~150 bps higher than commercial bank average in FY2018 and H1FY2019. Higher cost of fund vis-à-vis established peers could weaken MBL's competitive positioning on lending front. MBL's concentration of deposits among top accounts also remains on higher side (top 20 depositors accounted for ~24% of total deposits on mid-January 2019), which could pose liquidity concerns. Although MBL plans to improve its retail deposit base, deposit concentration and savings deposit mix through geographical expansion of branch network, its ability to do so remains to be seen.

MBL's profitability remains supported by steady NIMs of ~3.5%[5] maintained over past three years ending FY2018. The bank has been able to maintain healthy yield on advances, partly aided by strong non-corporate lending portfolio and partly due to its exposure to high yield segments like real estate and hire purchase. High yield has supported MBL's NIMs despite relatively higher cost of deposits. NIMs also remains supported by MBL's healthy rate of credit mobilisation (average CCD[6] ratio of ~79% during past 12-18 months). However, MBL's non-interest income level (less than 1% of ATA in FY2018) remains modest and drags the profitability and limits income diversification. Although non-interest income level in H1FY2019 stands improved (~1.15% of ATA), its sustainability remains to be seen. MBL's profitability in recent years also remain benefitted by low credit cost, resulting from good assets quality. Due to sizeable branch addition in FY2018 and associated costs, MBL's operating expense ratio increased in FY2018 (1.81% of ATA vs. 1.80% of ATA in FY2017); which can be expected to moderate going forward. During FY2018, MBL reported return on assets (RoA) of 1.63% vs. 2.03% in FY2017; moderation caused by pressure on NIMs from rising cost of fund. Accordingly, MBL's return on net worth (RoNW) stood supressed at ~13% in FY2018 vs. ~19% in FY2017. MBL's incremental profitability will be determined by its ability to maintain asset quality, maximize yield and lower its cost of fund.

[3] Loans up to NPR 100 million towards single borrower group is classified as SME and beyond that corporate loans.
[4] Mainly hire purchase and real estate; where borrower's repayment ability could be affected by higher interest rates.
[5] 3.43%, 3.63% and 3.56% respectively in FY2016, FY2017 and FY2018 respectively.
[6] Credit to deposit ratio adjusted for capital (net worth)

As on mid-January 2019, MBL's capital to risk assets ratio (CRAR) stood at 12.83% (~15% in mid-July 2018), comfortable vis-à-vis regulatory minimum of 11% under prevailing Basel III norm. MBL's CRAR has been strengthened by sizeable equity injection made during FY2015-FY2017. MBL's tier I capital stood at 11.91% on mid-January 2019 (14.38% as on mid-July 2018), comfortable against vis-à-vis 8.50% to be maintained by mid-July 2019 under the Basel III norms prescribed by NRB. With proposed debenture program and adequate rate of internal accrual generation, capitalization profile of MBL is expected to remain adequate; to support MBL's growth plans over next 2-3 years.

Links to applicable criteria:

Corporate Credit Rating Methodology

Bank Rating Methodology

Company profile

Machhapuchchhre Bank Limited (MBL), a class A bank licensed by Nepal Rastra Bank (NRB-the central Bank) and based in Lazimpat, Kathmandu, was registered in 1998 as first regional commercial bank and commenced its operations from October 2000.

The major promoters of the bank are Mahato Group (led by Mr. Birendra Mahato, the current chairman) controlling ~28% stake and KC Group (led by Mr. Surya Bahadur KC, the former chairman) controlling ~20% stake. Mr. Suman Sharma is the Chief Executive Officer of the bank. MBL has 51:49 promoter-public shareholding ratio. The bank's equity shares are listed and traded in Nepal stock exchange.

As on mid-January 2019, MBL has presence across the country through its 94 branches including Head office and 115 ATMs. MBL is a medium size bank with market share of about 3.21% in terms of deposit base and 3.15% in terms of credit portfolio in commercial bank industry (2.78% and 2.73% respectively in Nepalese banking industry) as on mid-January 2019. MBL reported a profit after tax of NPR 1,250 million during FY2018 over an asset base of NPR 84,788 million as of mid-July 2018 as against profit after tax of NPR 1,302 million during FY2017 over an asset base of NPR 68,926 million as on Jul-17. During H1FY2019, MBL reported PAT of NPR 777 million. MBL's CRAR was 12.83% and gross NPLs were 0.44% as on mid-January 2019.

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