Nabil Bank Limited

ICRA Nepal assigns [ICRANP] LAA- to proposed subordinated debenture; reaffirms [ICRANP-IR] AA- to Nabil Bank

Facility/Instrument	Amount	Rating Action (April 2019)
Subordinated Debenture Program	NPR 2,000 million	[ICRANP] LAA- (assigned)
Issuer Rating	NA	[ICRANP-IR] AA- (reaffirmed)

ICRA Nepal has assigned **[ICRANP] LAA-** (pronounced ICRA NP L double A minus) to the proposed subordinated[1] debenture programme of NPR 2,000 million of Nabil Bank Limited. The subordinated debenture rating of AA- is one notch lower than the rating of AA. Instruments with AA- rating are considered to have a high degree of safety regarding the timely servicing of financial obligations. Such instruments carry very low credit risk.

ICRA Nepal has also reaffirmed the rating of **[ICRANP-IR] AA-** (pronounced ICRA NP Issuer Rating Double A minus) to Nabil Bank Limited (Nabil). The entities with [ICRANP-IR] AA- rating are considered to have high degree of safety regarding timely servicing of financial obligations. Such issuers carry very 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.

The assigned rating factors in Nabil's established track record (operating since 1984), strong competitive positioning in the industry and healthy performance indicators. The bank's competitive strength arises from its ability to offer better lending rates, which, in turn, stems from one of the lowest cost of funds in the industry. This reflects positively on the bank's incremental growth prospects (in the recently implemented base rate plus lending model) as well as its borrower profile and asset quality. The rating also factors in Nabil's good asset quality, adequate capitalisation and strong solvency profile. The recent expansion of its franchise network and incremental expansion plans are also likely to support the growth-cum-diversification of Nabil's business. The rating also factors in the bank's steady and moderate credit growth over the last three to four years, despite its strong competitive positioning and high industry average growth rate during this period. Nabil's rating also derives comfort from the financial strength of its major promoters, its seasoned management team and established underwriting norms and control processes.

Nonetheless, rating concerns arise from the recent liquidity challenges faced by the Nepalese banking industry, including Nabil, because of higher growth in credit in the sector vis-à-vis deposits during the past four to five years. As a result, Nabil's liquidity ratio has declined with a commensurate increase in the credit-to-deposit ratio. A higher credit-to-deposit ratio has helped Nabil offset the impact of the rising cost of funds, thereby stabilising the net interest margin (NIM) and supporting profitability. However, given its high deposit concentration (the top 20 depositors accounted for 33% of the total deposits as of mid-January 2019), the bank's liquidity cushion has declined.

Rating concerns also arise from the sharp decline in the bank's proportion of current and savings account (CASA) deposits amid price wars between banks in the term deposits segment. So far, Nabil continues to maintain a competitive edge over most of its peers in terms of the low cost of funds (despite the recent increase). Nonetheless, its ability to maintain its position, given the growing competition among players for limited deposit resources in the financial system, will be a key monitorable going forward. Nabil's rating also remains constrained by a relatively higher credit concentration among the top borrowers (~27% of total credit among the top 20 borrower groups). The rating also remains constrained by the uncertain operating environment in Nepal because of high credit growth, rise in interest rates on the deposits and lending side, increasing competition despite consolidation and tight liquidity, which may impact the asset quality in coming periods.

Nabil's average credit growth during the three years ending FY2018 stood at 19%, lower than the industry average of 24% during this period. The credit growth has picked up during the past 12-18 months (23% in FY2018 and ~30% annualised in H1 FY2019). The higher growth in recent quarters has improved Nabil's

[1] Subordinated to deposits for principal repayment, in the event of liquidation

market share in H1 FY2019, following a continuous decline in the past two to three years. Nabil's credit portfolio of ~NPR 131 billion, as of mid-January 2019, accounted for ~4.8% of the Nepalese banking industry's credit, in the fragmented banking sector landscape of Nepal. As of mid-January 2018, its credit portfolio comprised large corporate loans (~55%)[2], retail and SME loans (~40%) and deprived sector loans (5%). With the bank adopting a focused strategy towards network expansion and acquisition of the retail/SME business, the credit mix is likely to get granular over the medium term. Going forward, the low cost of funds and consequent pricing advantage under the base rate plus regime are expected to support Nabil's plans of penetrating into the SME and retail segments. However, its ability to achieve the targeted growth in these segments, given its relatively moderate franchise network across the country, remains to be seen. Nabil's credit concentration among the top borrower groups remains high, in line with the large corporate loan proportion (top 20 borrower groups accounted for 27% as of mid-January 2019). The concentration risk also remains high as the bank has achieved sizeable organic credit growth during the past three to four years with moderate growth in its geographical coverage and customer base.

Nabil's asset quality indicators have improved during the past 12-18 months, aided by interim credit growth, low fresh NPA generation rate and steady NPA recovery rate. As of mid-January 2019, Nabil's gross NPA stood at 0.61% (0.54% in mid-July 2018). The 0+ days delinquency also remained moderate at ~5% as of mid-January 2019 (~3% as of mid-July 2018). The healthy credit provision cover of ~74% in mid-January 2019 (~91% in mid-July 2018) resulted in a comfortable solvency indicator (net NPA/net worth) of 0.92% in mid-January 2019 (0.33% in mid-July 2018).

Nabil's deposit profile has been affected by the liquidity shortage in the banking system since January 2017. The deposit price war among the industry players (especially for term deposits) has led to a decline in Nabil's CASA deposits (~48% in mid-July 2018 and ~45% in mid-January 2019 from ~60% in mid-July 2017) with a corresponding increase in the higher-priced term deposits. As a result, Nabil's cost of deposits increased to ~4% in FY2018 and ~5% in H1 FY2019 from ~2% in FY2017. As of mid-January 2019, Nabil's deposit base of NPR 149 billion comprised CASA deposits of ~45% (vs. the commercial bank average of 41%). Overall, Nabil continues to maintain its cost competitiveness because of a higher-than-industry average CASA proportion and lower-than-industry average cost of deposits (by ~100 bps in H1 FY2019), despite an unfavourable liquidity scenario. However, the bank's ability to maintain its competitive edge over the longer term, given the increasingly competitive deposit landscape, will be a key monitorable.

Nabil's liquidity position has moderated over the past one to two years because of the ongoing shortage of lendable funds. The bank's liquid assets, as a percentage of total liabilities, stood at ~25% in mid-January 2019 vs. ~27% in mid-July 2018 and ~33% in mid-July 2017. Although the current liquidity position remains adequate vis-à-vis the regulatory requirement, the liquidity buffer that would be available in case of a large withdrawal has declined over the years. Nabil's ability to improve its deposit mix and liquidity buffer and lower the deposit concentration risk will have a bearing on its ability to withstand any incremental liquidity shocks.

Nabil's capitalisation level increased till FY2017 due to the higher retention of profit accruals to ensure a paid-up capital of NPR 8 billion and to moderate the pace of credit growth. Higher credit growth since then has led to concomitant moderation in capitalization profile. The bank's capital-to-risk assets ratio (CRAR) stood at 11.95% as of mid-January 2019 (~13% in mid-July 2018), and was adequate vis-à-vis the regulatory minimum of 11% under the prevailing Basel III norms. Nabil's tier I capital of 10.78% as of mid-January 2019 (11.81% as of mid-July 2018) remained well above the level of 8.50% to be maintained by mid-July 2019 under the Basel III norms prescribed by the NRB. This also offers adequate headroom for increasing the capital through tier II instruments. The proposed tier II debenture issuance programme is expected to support Nabil's capitalisation profile and medium-term growth (assuming full subscription). Although the current capital cushion remains slim, Nabil's healthy rate of internal accrual generation can be retained in case of business growth requirement.

[2] Corporate loans: >NPR 100 million; SME loans: <NPR 100 million, towards a single borrower or related group of borrowers

Nabil's profitability indicators remain strong because of the healthy NIMs (~4.2% during the past one to two years). The increase in the bank's credit-to-deposit ratio has helped maintain stable NIMs, offsetting the impact of the rising cost of funds. Nabil's return on assets in FY2018 stood at ~2.6% (similar to FY2017) with a return on net worth of ~23%[3] (~28% in FY2017). Nabil's profitability also remains supported by a healthy non-interest income level (~1.3% of ATA over the last one to two years), a low operating expense ratio and low credit costs.

Links to applicable criteria:

Bank Rating Methodology

Company Profile

Nabil Bank Limited, the first private sector class A commercial bank in Nepal, started commercial operations in July 1984 as Nepal Arab Bank Limited. Nabil started off as a joint venture with Emirates Bank International. The latter divested its stake in Nabil which was ultimately taken over by NB International, an Ireland based special purpose vehicle associated with CG Group[4]. The name was changed to Nabil Bank, following the withdrawal of its joint venture partner -Emirates Bank International, in 1997. Headquartered in Kathmandu, Nabil is the second largest private sector commercial bank, in terms of asset base and net worth as of mid-Jan 2019.

The bank's major promoters are NB International, Ireland (50%) and Rastriya Beema Sansthan (9.67%). Including NB International, the family members of the Chaudhary Group own a majority stake (~53%) in the bank. Mr. Anil Keshary Shah is the bank's Chief Executive Officer. Nabil's equity shares are listed on the Nepal Stock Exchange with the second highest market capitalisation (among banking sector stocks) as of mid-December 2018.

Nabil has a presence throughout the country through 74 branches, two extension counters and 126 ATMs. Its market share was 5.62%, in terms of deposit base, and 5.53% of its total advances was in the Nepalese commercial banking industry, as of mid-January 2019. Nabil reported a profit after tax (PAT) of ~NPR 3,981 million in 2018 on an asset base of NPR 160,978 million as of mid-July-2018. In H1 FY2019, Nabil reported PAT of ~NPR 2,176 million on an asset base of NPR 177,672 million. As of H1 FY2019, Nabil's CRAR was 11.95% with CET 1[5] of 10.78% and gross NPAs of 0.61%. In terms of the technology platform, Nabil has implemented Finacle across all its branches.

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[3] *Moderation caused by the impact of migration from earlier GAAP to NFRS with revaluation reserves added to net worth*

[4] *Business conglomerate led by Mr. Binod Chaudhary (listed in Forbes magazine as Nepal's only billionaire); CG group has stakes in diversified sector mainly manufacturing, trading, hospitality and financial sector.*

[5] *Common equity tier I capital under Basel III norms; currently, banks are reporting capital adequacy norms under Basel III along with existing capital adequacy norms. Banks have been reporting capital adequacy norms under Basel III from mid-July 2016 (FY2016-17 onwards)*

About ICRA Nepal Limited

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