Nepal Bangladesh Bank Limited

ICRA Nepal assigns [ICRANP-IR] BBB+ rating to Nepal Bangladesh Bank Limited; assigns [ICRANP] LBBB+ to proposed subordinated debenture programme of the bank

Facility/Instrument	Amount	Rating Action (April 2019)
Issuer Rating	NA	[ICRANP-IR] BBB+ (Assigned)
Subordinated Debenture Programme	NPR 2,000 Million	[ICRANP] LBBB+ (Assigned)

ICRA Nepal has assigned the issuer rating of **[ICRANP-IR] BBB+** (pronounced ICRA NP issuer rating triple B plus) to Nepal Bangladesh Bank Limited (NBB). **[ICRANP-IR] BBB+** rating is considered to be of moderate credit quality. The rated entity carries moderate credit risk. The issuer rating is only an opinion on the general creditworthiness of the rated entity and not specific to a particular debt instrument. The sign of + (plus) or – (minus) is appended to the rating symbols to indicate their relative position within the rating categories concerned.

ICRA Nepal has also assigned **[ICRANP] LBBB+** (pronounced ICRA NP L triple B plus) to the proposed subordinated debenture programme of NBB. Instruments with this rating are considered to have a moderate degree of safety regarding the timely servicing of financial obligations. Such instruments carry moderate credit risk.

The ratings factor in the presence of institutional promoters in NBB, with ~41% stake of IFIC Bank[1]. NBB's association with IFIC Bank improves its board profile as all the three Promoter Directors in NBB have been deputed from IFIC Bank. These professionals bring in extensive banking experience to the board. The bank's established track record (operating since 1994) and its moderate pace of growth in the recent years (~18% in last three years ending mid-July 2018 against ~24% for the industry) also support the rating action. NBB's diversified network with further expansion plans, along with the experienced/ stable management team and its comfortable capitalisation profile, are expected to provide adequate growth opportunities to the bank, going forward. The ratings also take into consideration the bank's healthy net interest margins (NIMs) and strong fee-based income, which led to adequate earnings profile among peers. The bank's balanced portfolio mix, with ~37% corporate loans followed by an almost equal proportion of retail and SME loans, also remain rating positives. The ratings also considered the bank's relatively moderate credit concentration of ~22% among the top 20 accounts as of mid-January 2019.

The ratings, however, remain constrained by the stress seen in the bank's asset quality in the recent periods with rise in delinquencies to ~11%[2] as of mid-January 2019, including non-performing loans (NPLs) of 1.78% compared to ~4-6% levels earlier. ICRA Nepal also takes note of the bank's increased pace of credit growth in H1 FY2019 (~36% annualised growth), which remains a rating concern. The ageing of the incremental portfolio along with a sharp increase in interest rates in the last two years could keep its asset quality under stress over the near term. The ratings also remain impacted by the bank's relatively smaller asset base in relation to its age and its market positioning as one of the smaller players in the industry with ~2% share in industry credit and deposits. The ratings also consider the risks emanating from a sizeable non-fund based business, which remains almost equal to the bank's fund-based portfolio. The ratings further remain constrained by the bank's relatively inferior deposits profile with declining proportion of stable/ low-cost current and savings accounts (CASA), leading to a higher cost of funds, along with high deposit concentration risks (~38% from top 20 depositors as of mid-January 2019). The rating actions also factor in the probable systemic risks emanating from the mismatch in credit and deposit growth in the industry over the last few years. The bank's ability to grow its portfolio judiciously while maintaining a comfortable liquidity position and healthy asset quality/profitability indicators would remain key rating factors. Further, the bank's ability to improve the mix/cost of deposits, reduce the concentration risks and improve its competitive positioning would remain the key rating drivers.

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[1] IFIC Bank is one of the oldest and established banks of Bangladesh with a long track record of over 36 years in commercial banking. The Government of the People's Republic of Bangladesh holds ~33% stake in IFIC Bank.

[2] Indicative data based on calculations by analysts as the bank could not provide the delinquencies data.

NBB is one of the moderate sized private sector commercial banks in Nepal with an asset base of ~NPR 68 billion as of mid-January 2019. The bank's credit portfolio of ~NPR 50 billion as on the same date accounted for ~2.1% of the industry credit. NBB's credit portfolio witnessed a compounded annual growth rate (CAGR) of ~18% during the last three years, ending mid-July 2018, lower than the industry growth of ~24%. However, the bank has accelerated its pace of credit growth in H1 FY2019 (~36% annualised growth compared to ~25% of the industry), which remains a concern. Nonetheless, this has helped the bank regain some of the lost market share owing to low growth in earlier years. NBB's portfolio remains well diversified among corporate loans (~37% of portfolio as of mid-January 2019), followed by retail loans (~33%) and SME loans (~30%). This augurs well for the bank's yields on advances, which generally remain slightly high compared to the industry, at 12.98% in H1 FY2019 (12.81% for the industry) compared to 10.19% in FY2017. The increment in yields in the recent periods was largely in line with the industry trend and was partly supported by the interest income booking on accrual basis, as per the revised financial reporting framework[3]. The credit portfolio concentration of the bank remains moderate with top-20 borrower groups accounting for ~22% of the portfolio and 102% of the Tier-I capital. However, the bank's sizeable non-funded exposure (~NPR 45 billion) remains concentrated towards a single sector (>80% towards construction entities) as well as among top 20 customers (~35% as of mid-January 2019) and this has also been factored in while assigning the rating.

The bank's asset quality has witnessed increased stress in the recent periods with NPLs rising to 1.78% in mid-January 2019 from 0.71% as of mid-July 2016. Though the overall delinquencies remain moderate at ~11%, revolving loans (~51% of portfolio) have witnessed very high stress (~20% delinquencies) which increases concerns over asset quality. With a low provision cover of ~59% as of mid-January 2019, the net NPA and solvency indicator (net NPA/net worth) have deteriorated to 0.75% and 3.17%, respectively. Going forward, the asset quality of the banking sector, including NBB, is expected to witness some moderation due to a decline in the repayment capability of borrowers following increased interest rates. However, the bank's overall profile is expected to remain comfortable. NBB's ability to reduce the delinquency/NPLs would remain a key rating factor.

NBB's deposits profile have witnessed moderation with the share of stable/low-cost CASA deposits gradually declining over the years, which reflects its relatively high cost of deposits. During the past two years (ending mid-January 2019), the Nepalese banking industry has witnessed shortage of lendable deposits, leading to price wars for deposit at times. This has caused a major shift from CASA deposits to term deposits for the industry, increasing the cost of deposits. CASA for NBB declined to ~32% as of mid-January 2019 from ~37% as of mid-July 2016 while the industry witnessed average CASA declining to ~41% from ~50% over the same period. The bank's cost of deposits at 7.33% in H1 FY2019 (5.06% in FY2017) remained slightly higher than the industry average of 6.50% (4.10% in FY2017). However, this is expected to increase slightly, going forward, given the recent increase in the proportion of term deposits (53% as of mid-January 2019 against 49% in mid-July 2018) and revised interest rates in savings accounts. Deposit growth of the bank remained lower than the industry (CAGR of ~12% over the past three years ending mid-July 2018 against ~19% of the industry). Lower deposit growth compared to the industry as well as a mismatch in credit and deposits growth remain concerns. However, the external capital raising in FY2017 (80% rights) and the adequate internal accruals have provided comfort in the CCD front[4], which stood at ~77% as of mid-January 2019. NBB's deposit concentration remained very high with the top-20 depositors accounting for ~38% of the total deposits as of mid-January 2019. Improving the deposits mix, concentration and cost would remain key challenges for the bank over the medium term.

NBB's reported capital to risk-weighted assets ratio (CRAR) of 12.35% and tier-I capital of 11.61% (both as per Basel-III) as of mid-January 2019 remain comfortable against 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 the total capital would be stable at 11% (including CCB). The capitalisation profile was supported by the rights issue (80% rights amounting to NPR 3.21 billion) floated by the bank in FY2017.

[3] *Nepal Financial Reporting Standards, adopted from FY2018, requires accrual-based interest income booking on loans; this used to be in cash basis as per earlier regulations.*

[4] *Local currency (LCY) credit to core capital and LCY deposits ratio capped at 80% by regulations.*

Given NBB's moderate internal accruals and profit retention as per business growth needs in the past, along with the proposed issue, capitalisation levels are expected to remain adequate to support the management's growth plans while maintaining comfortable solvency profile.

NBB's earnings profile remained adequate owing to its largely stable NIMs at 3.33% in FY2018, which further improved to 4.31% in H1 FY2019. The bank's strong fee-based income (1.87% of the average total assets for FY2018), emanating from its sizeable non-fund based business, also support the profitability. Nonetheless, the fee-based income has witnessed volatility in H1 FY2019 and declined to 1.72% of the average total assets. This was mainly on account of slowdown in construction activities, which impacted its key customer segment (construction contractors). With rapid branch expansion in the last few years, NBB's operating expense ratio has further increased in the recent times (2.12% of the average total assets in H1 FY2019 compared to 1.96% in FY2016) and hence remains a drag on its profitability. Amid the bank's moderate asset base, the return on assets (RoA) remained healthy at ~1.9% in FY2018, largely in line with the industry. This, however, declined from ~2.3% in FY2017 due to a sizeable increase in credit cost (0.51% of the average total assets in FY2018). The return on net worth (RoNW), however, moderated to ~10-14% in FY2018 and H1 FY2019 (~22% in FY2016) after the sizeable external capital raising in FY2017. This remained lower than the industry average of ~16-17%. The NIMs and return indicators reported slight improvement in H1 FY2019, partly because of the effect of adoption of the new financial reporting framework. Excluding the impact of changed accounting policies, the return indicators were slightly lower than FY2018. Going forward, the bank's ability to maintain adequate NIMs and manage the asset quality would have a strong bearing on its profitability profile.

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

Links to applicable criteria:

Issuer Rating Methodology
Bank Rating Methodology

Bank Profile

Nepal Bangladesh Bank Limited (NBB) was incorporated in 1994 as a joint venture with IFIC Bank of Bangladesh. IFIC Bank holds ~41% promoter shares in NBB while the major chunk of the remaining promoter shares (~11%) are held by individuals from the NB Group. The rest of the bank's ~48% shares are held by the general public. All three Promoter Directors of the bank, including the Chairman, are representatives of IFIC Bank. The shares of the bank are listed on the Nepal Stock Exchange. The registered and corporate office of the bank is located at Kamaladi, Kathmandu.

As of mid-January 2019, NBB was present across the country through its 81 branches, seven extension counters, seven branchless banking and 63 ATMs. As on the same date, NBB had a market share of 1.97% in terms of deposit base and 2.11% of the total advances of the commercial banking industry in Nepal. NBB reported a profit after tax (PAT) of NPR 1,144 million in FY2018 (a YoY degrowth of ~5%) over an asset base of NPR 61,377 million as of mid-July 2018. In H1 FY2019, the bank reported a PAT of NPR 793 million over an asset base of NPR 68,217 million. As of mid-January 2019, NBB's CRAR stood at 12.35% and gross NPLs were 1.78%. In terms of the technology platform, NBB has implemented 'Pumori' across all its branches.

NBB was once a problematic bank mainly due to lack of corporate governance among its erstwhile key promoter group i.e. the NB Group. As the loans which were provided in various names to the promoter group went non-performing, the NPLs went to ~40% and capital fund became negative by ~24% in 2006-07. Following the same, management of the bank was taken over by Nepal Rastra Bank (NRB) for corrective actions. In a bid to revive the bank, IFIC Bank agreed to increase its stake in the bank by purchasing shares from the group. The proceeds from this was intended to be utilised for settlement of loans outstanding from promoter groups. Accordingly, IFIC bank purchased shares from NB group as well as from another Bangladeshi partner namely Bank Asia, which had 15% stake in the bank. ultimately, the total stake of IFIC Bank increased to ~41% from 10%. Thereafter, NBB gradually recovered loans from promoter groups. With concomitant improvement in assets quality and capital adequacy, NRB management handed over the bank to the board on January 2010. As of now, NB group holds around <10% stake in the bank with no representation in board.

April 2019

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About ICRA Nepal Limited:

ICRA Nepal Limited, the first credit rating agency of Nepal, is a subsidiary of ICRA Limited (ICRA) of India. It was licensed by the Securities Board of Nepal (SEBON) on October 3, 2012. ICRA Nepal is supported by ICRA Limited through a technical support services agreement, which envisages ICRA helping ICRA Nepal in areas such as the rating process and methodologies, analytical software, research, training, and technical and analytical skill augmentation.

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