Muktinath Bikas Bank Limited

ICRA Nepal assigns [ICRANP] IPO Grade 3 to proposed rights issue (equity shares) of Muktinath Bikas Bank Limited

Facility/Instrument	Amount	Grading Action (May 2019)
Rights Issue (equity shares)	~NPR 613 Million	[ICRANP] IPO Grade 3; Assigned

ICRA Nepal has assigned a grade of **[ICRANP] IPO Grade 3**, indicating average fundamentals, to the proposed rights issue (equity shares) of Muktinath Bikas Bank Limited (MNBBL). ICRA Nepal assigns IPO gradings on a scale of 1 through 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 symbol indicates their relative position within the grading category concerned. Thus, the gradings of 2+, 3+ and 4+ are a notch higher than 2, 3, and 4, respectively. MNBBL proposes to come up with a 20% rights issue of 6,129,520.25 equity shares, with a face value of NPR 100, to be issued at par to the existing shareholders.

The grading factors in the bank's adequate track record (since 2006) and its ability to maintain a healthy pace of growth (franchise as well as portfolio; credit growth of ~54% in the last four years after being upgraded to a national level development bank) while maintaining strong asset quality indicators (gross non-performing loans (NPLs) were below 0.2% in the past four years and 0.05% as of mid-January 2019). This has helped the bank maintain strong return indicators with an average return on equity (RoE) of ~26% and average return on assets (RoA) of ~3% for the last four years, despite the significant capital increment (a nine-fold increase in the net worth during the five years ending mid-July 2018). Further, the grading has also factored in the bank's comfortable capitalisation profile with a capital-to-risk weighted assets ratio (CRAR) of 13.80% as of mid-January 2019 against the regulatory minimum of 11%, and its granular credit portfolio with the top 20 borrowers accounting for ~5% of the total credit portfolio as of mid-January 2019.

Nonetheless, the grading remains constrained by the deterioration in the deposits profile over the years (CASA deposits declined to ~34% as of mid-January 2019 from ~62% as of mid-July 2015) and the increasing dependence on call deposits at ~22% as of mid-January 2019. This, along with the increased share of term deposits, has spiked MNBBL's cost of funds though the same remains competitive so far. The grading also factors in the probable systemic risks emanating from the mismatch in credit and deposit growth in the industry over the last few years. The resultant hardening of interest rates could build up stress on the bank's asset quality over the near term, as the incremental portfolio gets more seasoned.

The grading also factors in the current liquidity constraints faced by the banks in Nepal, which could have a bearing on MNBBL's growth plans. The bank's ability to improve the mix/cost of deposits and its competitive positioning and grow its portfolio judiciously, while maintaining a comfortable liquidity position and healthy asset quality/profitability indicators, would remain critical for its overall financial profile going forward.

MNBBL reported a high CAGR[1] of ~54% for its portfolio during the last four years, which was facilitated by its increasing franchise network (113 branches as of January 2019 compared to 34 as of July 2014). This helped the bank gain market share. MNBBL stands out as the largest development bank, both in terms of credit and deposits, with a market share of approximately 11% in the development bank industry and approximately 1.2% in the overall Nepalese banking industry as of mid-January 2019.

The pace of credit growth accelerated in recent years to ~55% in FY2017 and ~65% in FY2018 compared to the previous range of 40-50%. Growth remained high this year as well with an annualised growth rate of ~61% in H1 FY2019 (~40% for the industry). Despite the high growth rate, the bank has maintained granularity with the top 20 borrowers accounting for ~5% of the total credit portfolio. The average ticket size was low at NPR 0.5 million and the average modern banking ticket size was NPR 2.2 million as of January 2019. This has largely reduced the concentration risk. Credit growth in recent years surpassed the deposit

1 Compounded annual growth rate

growth, resulting in an increased CCD ratio[2] of ~79% as of mid-January 2019 compared to ~71% as of mid-July 2017. As of mid-January 2019, MNBBL's credit portfolio of ~NPR 33 billion comprised term loans (~43%), followed by small and micro-banking loans (~31% of which ~85% were microfinance loans) and revolving loans (~26%). Bank's credit book was mostly towards small and mid-market segment with low ticket size while the largest loan to a single borrower as of mid- January 2019, was NPR 165 million (~0.5% of the total portfolio). Going forward, the management intends to grow more in the small and micro-banking segment. The bank's yield on advances generally remains below class B peers (~14% for the bank vs ~15% for peers) because of cheaper cost of deposits and loans being extended at competitive rates. The applicable cap on lending margin by NRB at 5%[3] are likely to keep yields at similar levels over near term.

On the asset quality front, the bank's gross NPLs remained below 0.2% during the last four years and stood at 0.05% as of mid-January 2019 compared to almost nil (0.004%) in mid-July 2018. Its gross NPL level remains much lower than its peers and the industry (1.12% as of mid-January 2019). However, the overall 0+ days delinquencies remained moderate at ~8% as of mid-January 2019 (~5.6% as of mid-July 2018). Going forward, the asset quality of the banking sector, including MNBBL, is expected to witness some moderation due to a decline in the repayment capability of borrowers, following increased interest rates. The bank's ability to improve the delinquencies and maintain a comfortable asset quality profile would remain a key grading factor.

The deposit profile, in terms of CASA, was weaker due to growth pressure and stress in the overall deposits market amid tightening liquidity in recent years. The bank's CASA reduced to approximately 34% as of mid-January 2019 from 62% in mid-July 2015 while the industry's CASA declined to 37% from 53% during this period. Further, MNBBL's dependence on interest-sensitive call deposits increased to ~22% as of mid-January 2019 from ~16% as of mid-July 2015. The lower CASA share has hence increased the cost of funds by ~300 bps to ~8% during this period. The cost of funds, however, remained better compared to class B peers.

MNBBL's deposits increased at a CAGR of ~53% during the last five years, with the growth rate remaining high at ~81% in FY2018 compared to ~40-50% in earlier years. However, the pace of growth moderated to ~51% (annualised) in H1 FY2019. The concentration of the top 20 depositors remained moderate at ~19% as of mid-January 2019. Going forward, the bank's ability to improve its deposit mix, cost and concentration would remain a key monitorable.

MNBBL's CRAR of 13.80%, as of mid-January 2019, remained comfortable against the regulatory minimum of 11%. The capitalisation profile was supported by the capitalisation of all available internal accruals through a bonus issue along with the injection of external equity via a rights issue (three rights issues in past five years). The current capitalisation is expected to be supported by the proposed rights issue and internal accruals.

MNBBL's profitability profile remained strong with an average RoE of ~27% and RoA of ~3% during the last five years, supported by healthy net interest margins (NIMs) and a strong asset quality profile. The return indicators, however, moderated in FY2018 (RoE of ~20% in FY2018 compared to ~27% in FY2017 and ~31% in FY2016) due to lower NIMs. The increasing cost of funds at a largely similar yield squeezed the NIMs in FY2018 by ~170 bps to 4.7%. The strong fee-based income of ~1.5% of ATA[4] in FY2018 and 1.6% in H1 FY2019 supported the bank's profitability to an extent. Going forward, the regulation capping the interest spreads at 5% would impact the return indicators over medium term and this has also been reflected in the grading. Going forward, the bank's ability to maintain gross interest spreads by maintaining competitive cost of funds along with healthy asset quality would have a key bearing on its profitability profile.

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

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

[3] *Effective from mid-January 2019*

[4] *Average Total Assets*

Links to applicable criteria:
IPO Grading Methodology
Bank Rating Methodology

Bank Profile
Muktinath Bikas Bank Limited (MNBBL), a national level class B bank licensed by Nepal Rastra Bank (NRB - the Central Bank), started its commercial operations from January 7, 2007. The bank upgraded to the national level in July 2015 after the acquisition of the district-level Civic Development Bank. MNBBL is promoted by a wide range of promoters with a single promoter holding a maximum share of 2.55% of the total capital as of mid-July 2018. The bank's share capital is distributed among the promoters and the public in the ratio of 51:49. The corporate office is in Kamaladi, Kathmandu. Mr. Pradyuman Pokharel is the Chief Executive Officer of the bank.

MNBBL had a presence in 38 districts of Nepal through 113 branches, 93 microfinance desks and 21 ATMs as of mid-January 2019. Its market share was ~11%, in terms of deposits as well as the credit base, in the development bank industry as of mid-January 2019. MNBBL reported a net profit of ~NPR 575 million in FY2018 on an asset base of NPR 34,649 million as of mid-July 2018 against a net profit of ~NPR 487 million in FY2017 on an asset base of NPR 19,592 million as of mid-July 2017. The bank reported a net profit of NPR 408 million in H1 FY2019 on an asset base of NPR 44,493 million as of mid-January 2019. Its CRAR was 13.80% and gross NPLs were 0.05% as of mid-January 2019. In terms of the technology platform, MNBBL has implemented the centralised "Pumori IV" system at all its branches for modern banking and "Mfin" for microfinance activities.

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