Machhapuchchhre Bank Limited

ICRA Nepal assigns [ICRANP-IR] A- to Machhapuchchhre Bank Limited; reaffirms [ICRANP] LA- for existing subordinated debentures

Facility/Instrument	Amount	Rating Action (June 2019)
Issuer Rating	NA	[ICRANP-IR] A- (assigned)
Subordinated Debenture Programme	NPR 3,000 million	[ICRANP] LA- (reaffirmed)

ICRA Nepal has assigned **[ICRANP-IR] A-** (pronounced ICRA NP issuer rating A minus) to Machhapuchchhre Bank Limited (MBL). Issuers with this rating are considered to have an adequate degree of safety regarding the timely servicing of financial obligations. Such issuers carry 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.

ICRA Nepal has also reaffirmed the rating of **[ICRANP] LA-** (pronounced ICRA NP L A minus) for MBL's subordinated debentures of NPR 3,000 million. Instruments with this rating are considered to have an adequate degree of safety regarding the timely servicing of financial obligations. Such instruments carry low credit risk.

The sign of + (plus) or – (minus) appended to the above rating symbols indicate their relative position within the rating categories concerned.

The assigned rating factors in MBL's established track record in the industry (operating since 2000), adequate market presence (through 100 branches as of mid-April 2019) and good capitalisation profile. The bank's capitalisation profile is likely to be further strengthened after the proposed debenture programme, assuming full subscription. This is likely to improve the bank's ability to withstand any probable credit shocks. The rating also factors in MBL's good asset quality and delinquency level (notwithstanding the recent deterioration), which reflect the bank's adequate underwriting controls in recent years. The rating also takes into account the steady and industry average credit growth maintained by MBL in recent years with a recent uptick in growth backed by the geographical expansion of the branch network. The rating also factors in MBL's adequate profitability, backed by steady net interest margins (NIMs) of ~3.5% over the last two to three years. The rating also takes comfort from the bank's experienced management team and promoters.

Nonetheless, the ratings remain constrained by MBL's moderate deposit profile with a low CASA[1] proportion of 34% as of mid-April 2019 vs. ~41% for the commercial bank industry. This, along with the increased share of term deposits, has kept MBL's cost of deposits relatively higher (~8.0% in 9M FY2019 and ~7.7% in FY2018), which could weaken its competitive positioning in the 'base rate plus' lending regime. Rating concerns also arise from the relatively higher deposit and credit concentration among the top accounts (~23% and ~22% of total deposits/loans concentrated among the top 20 depositors and borrower groups, respectively) as of mid-April 2019. The ratings are also constrained by the uncertain operating environment currently faced by the banks in Nepal.

MBL's asset quality and liquidity profile will be key monitorable, given the high credit growth registered by the bank in recent years and the prevailing high interest rates as well as the shortage of lendable funds and deposit rate volatility in the market. MBL's relatively higher exposure to sectors that are vulnerable to upticks in interest rates (viz. real estate, hire purchase, etc) also remains a concern. The liquidity profile could also come under pressure, given the high CCD[2] ratio maintained by the bank, relatively high deposit concentration and interest rate volatility in the banking industry.

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[1] *Current and savings accounts*

2 Credit to deposit ratio adjusted for capital

MBL’s credit portfolio increased at a CAGR of 24% during the five years ended FY2018 and was at par with the commercial bank average. The bank’s credit growth stood at ~27% (annualised) in 9M FY2019, vs. 24% in FY2018, vis-à-vis the commercial bank average of ~20% and ~21%, respectively. The recent uptick in MBL’s credit growth comes from the addition of a sizeable number of new branches during the last 12-18 months, including 13 new branches in 9M FY2019. As of mid-April 2019, MBL’s credit portfolio of ~NPR 77 billion was distributed among corporate (~24%) and non-corporate[3] (~76%) loans. With the recent additions to MBL’s franchise network and its proposed expansion plans, the bank’s non-corporate segment is expected to get a further boost. This is likely to ease the credit concentration level (~22% of the total loans among the top 20 borrower groups as of mid-April 2019).

On the asset quality front, MBL’s gross NPLs increased marginally to 0.48% as of mid-April 2019 from 0.44% in mid-January 2019 and mid-July 2018. The bank’s delinquency level has also increased recently with the 0+days delinquency increasing to ~7.5% as of mid-April 2019 from ~5% in mid-January 2019 and ~4% in mid-July 2018. The recent uptick in NPLs and the delinquency level remain a concern, given the high interest rate regime and the tight liquidity scenario in the banking industry. Also, MBL’s exposure to the relatively vulnerable sectors[4], as of mid-April 2019 (~15% vs. commercial bank average of ~13%), raises asset quality concerns for the future. Nonetheless, the bank’s gross NPA level remains well below the commercial bank average and the spike in NPAs and delinquency in 9M FY2019 can be expected to moderate towards the end of FY2019, in line with industry seasonality. MBL’s solvency profile remains strong due to the low NPLs despite a moderate provision cover of ~56% as of mid-April 2019.

MBL’s relatively low CASA deposits led to a higher cost of deposits (7.69% in FY2018 vs. 8.01% in 9M FY2019), thereby impacting its competitive strength in the base rate-based lending regime. Despite the gradual improvement in its CASA (34% as of mid-April 2019 vs. 32% as of mid-January 2019) deposits, the same still remains below the industry average of ~41%. The increased term deposit proportion has led to an increase in the cost of deposits for MBL, which was ~150 bps above the commercial bank average in FY2018 as well as 9M FY2019.

However, in the current regime of volatile interest rates and deposit shortages, the higher proportion of term deposits could support the stability of the deposit profile. MBL’s concentration of deposits among the top accounts also remains on the higher side (the top 20 depositors accounted for ~23% of total deposits in mid-April 2019), which could pose liquidity concerns. On the positive side, MBL’s deposit portfolio comprised ~52% deposits from individual depositors as of mid-April 2019, indicating relatively lower reliance on institutional deposits. Going forward, the bank’s ability to improve its retail deposit base, deposit concentration and savings deposit mix through the geographical expansion of its branch network would remain a key monitorable.

MBL’s profitability remains supported by steady NIMs of ~3.5% over the past 3-4 years ending mid-April 2019. The bank has been able to maintain a healthy yield on advances, partly aided by a strong non-corporate lending portfolio and partly due to its exposure to high-yield segments like real estate and hire purchase. The high yield has supported MBL’s NIMs despite the relatively higher cost of deposits. NIMs also remain supported by the bank’s healthy rate of credit mobilisation (average CCD[5] ratio of ~79% during the past 12-18 months). Additionally, the bank’s non-interest income has improved in recent periods to 1.25% for 9M FY2019 from ~1.15% in H1 FY2019, primarily driven by an increase in fee-based income. MBL’s profitability in recent years also benefitted from low credit costs, resulting from good asset quality. MBL’s return on assets (RoA) improved to 1.75% in 9M FY2019 vs. 1.59% in FY2018 with the improvement supported by good growth in the credit portfolio, steady NIMs and low credit costs. Accordingly, its return on net worth (RoNW) improved to ~16% in 9M FY2019 vs. ~13% in FY2018. MBL’s incremental profitability will be driven by its ability to achieve targeted growth, control the cost of funds and maintain the asset quality.

[3] *Includes retail/SMEs/deprived sectors*
[4] *Mainly hire purchase and real estate, where borrower’s repayment ability could be affected by higher interest rates*
[5] *Credit to deposit ratio adjusted for capital (net worth)*

As of mid-April 2019, MBL's capital to risk assets ratio (CRAR) was comfortable at 12.63% (~15% in mid-July 2018) vis-à-vis the regulatory minimum of 11% under the prevailing Basel III norms. The bank's CRAR was strengthened by sizeable equity infusions during FY2015-2017. MBL's tier I capital was comfortable at 11.72% in mid-April 2019 (14.38% in mid-July 2018) vis-à-vis 8.50% to be maintained by mid-July 2019 under the Basel III norms prescribed by the Nepal Rastra Bank (NRB). MBL's healthy rate of internal accruals generation is also expected to support its incremental capitalisation profile.

Links to applicable criteria:

Corporate Credit Rating Methodology

Bank Rating Methodology

Company Profile

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

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

As of mid-April 2019, MBL had a presence across the country through 100 branches including the Head Office. MBL is a medium-sized bank with a market share[6] of about 3.02% in terms of the deposit base and 3.23% in terms of the credit portfolio in the commercial bank industry (2.61% and 2.79%, respectively, in the Nepalese banking industry) as of mid-April 2019. The bank reported a profit after tax (PAT) of NPR 1,220 million in FY2018 on an asset base of NPR 84,788 million as of July 2018 against PAT of NPR 1,302 million in FY2017 on an asset base of NPR 68,926 million as of July 2017. Till 9M FY2019, MBL had reported PAT of NPR 1,236 million. MBL's CRAR was 12.63% and gross NPLs were 0.48% as of mid-April 2019.

June 2019

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About ICRA Nepal Limited

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[6] *Industry data as of mid-March 2019; latest available*

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