

Everest Bank Limited

ICRA Nepal upgrades the rating assigned to subordinated debenture of Everest Bank Limited to [ICRANP] LA+ from [ICRANP] LA-

Facility/Instrument	Amount	Rating Action (July 2018)
Subordinated Debenture Program ¹	NPR 600 Million	[ICRANP] LA+ (upgraded)*

ICRA Nepal has upgraded the rating assigned to subordinated debentures of Everest Bank Limited (EBL) from [ICRANP] LA- (pronounced ICRA NP L A minus) to [ICRANP] LA+ (pronounced ICRA NP L A plus). Subordinated debenture rating A+ is two notches higher than A-. Instruments with A+ rating is considered to have adequate degree of safety regarding timely servicing of financial obligations. Such instruments carry low credit risk.

Subordinated bond rating of EBL was assigned in the immediate aftermath of April 2015 earthquake; pending detailed impact assessment of the event. While upgrading rating of EBL's bond ICRA Nepal takes in to EBL's ability to maintain healthy financial indicators while managing the asset quality despite general stress in Nepalese economy, especially during FY16 arising from earthquake and subsequent elongated economic blockades. In ICRA Nepal's assessment, the bank's operational and financial profile is expected to remain consistent with the rating level going forward.

The rating action factors in the bank's ability to maintain good assets quality (gross NPLs of 0.23% as on mid-April 2018) on a sizeable asset base. ICRA Nepal notes that the assets quality, solvency and profitability profile did not come under major stress in the aftermath of earthquake and subsequent customs blockade. The rating also factors in EBL's long track record (operating since 1994), commensurately seasoned credit portfolio and adequate market share (~4% share in overall banking industry deposit and credit base). This coupled with established underwriting norms and embedded risk management practice, provides comfort on the incremental assets quality of the bank. The rating also positively factors in good competitive positioning of the bank, aided by one of the lower cost of deposits (4.79% during 9mFY2018) in the industry. This is likely to be a competitive advantage for the bank, especially in the recently implemented "base rate plus lending rate" regime. The rating action looks favourably at the conservative growth approach adopted by the bank over the years and especially during the low interest rate regime between FY2015-H1FY2017. The rating action also factors in the bank's strong capitalization profile (CRAR of 15.70% on mid-April 2018), enabling the bank to absorb credit shocks and support incremental business growth.

The rating also draws comfort from good ownership profile of the bank. EBL has 20% equity participation from Punjab National Bank (PNB)², the second largest public-sector bank in India and a technical support service agreement (TSSA) with PNB. As per the terms of TSSA, three senior officials from PNB are deputed to EBL as senior management team (including CEO). This enhances the management profile of EBL and enables exchange of better banking practices between the joint venture partners.

The rating is however constrained by EBL's relatively higher portfolio concentration among top borrower groups and depositors. As on mid-April 2018, ~26% of total credit and ~33% of total deposits are accounted for by top 20 borrower groups and top 20 depositors respectively. The rating also remains constrained by limited diversification of revenue sources, given modest non-interest income level (<1% of average total assets (ATA) during past 2-3 years). The rating also remains constrained by large proportion of revolving loans (>60% of total credit portfolio) where repayment capacity of the borrowers remains untested. However, this is partly mitigated by strong borrower profile and adequate control measures at the underwriting front. The rating also remains constrained by uncertain operating environment that the banks in Nepal are currently facing.

¹ 6-year debenture maturing in 14th July 2021.

² Rated [ICRA]AA-(hyb)(Negative) for Tier II bonds as on May 2018

EBL's credit portfolio has grown organically at a moderate pace of CAGR ~17% during FY14-9MFY17, vis-à-vis commercial bank average growth of CAGR ~24% over the same period. Bank's credit growth during this period was characterized by slowdown in credit growth in the period surrounding earthquake and blockade (credit portfolio registered degrowth between Q3FY2015 and H1FY2016) as well as cautious growth by the bank during low interest rate regime of FY2016 and H1FY2017. The bank remains retail and SME (36% and 18% share in total credit respectively on mid-April 2018) oriented, with these segments contributing >50% of total credit. However, low base rate and the ability to offer lower lending rates makes the bank attractive for corporate borrowers alike (corporate segment³ stood at ~40% of total credit on mid-April 2018). Incremental credit growth is likely to remain supported by EBL's strong competitive positioning, adequate capitalization with CRAR at 15.70% and comfortable CCD (credit to deposit adjusted for capital) ratio at ~75% as on mid-Apr-18. EBL has reported superior assets quality with gross Non-performing loans (NPLs) of 0.23% as on mid-April 2018 along with low delinquency level (~4% as on mid-April 2018). Gross NPA level of EBL has declined in past 2-3 years indicating that the bank has used the high liquidity environment to shed borrowers with moderate credit quality.

During past 12-18 months, deposit mix of banking industry has shifted in favour of term deposits at the expense of current and savings account (CASA) proportion. This was caused by banks reacting to the deposit crunch that was seen from H1FY2017 onwards, by offering high interest rates on term deposits. EBL's deposit mix has also witnessed similar change. Nonetheless, EBL's CASA deposits as on mid-April 2018 (46%) remain above commercial bank average (44%), on a sizeable deposit base. This coupled with seasoned deposit portfolio of the bank has resulted in one of the lowest cost of deposits for EBL (cost of deposits stood at 4.79% during 9mFY18, ~125 bps lower than commercial bank average), aiding the competitive positioning. During past 3-4 years, rate of deposit growth of EBL has remained low, in line with its low credit growth rate. Growth in deposit base over this period has been supported by commensurate growth in the number of deposit accounts, which augurs well for incremental stability of deposit base and improvement in CASA mix. Concentration among top deposit accounts remains on higher side (33% of total deposits among top 20 depositors); albeit within the range seen during past 2-3 years. Liquidity risk posed by relatively high deposit concentration is partly mitigated by the bank maintaining adequate margin vis-à-vis regulatory CCD ratio ceiling (EBL has maintained CCD ratio at ~75% vis-à-vis regulatory ceiling of 80%).

As for profitability, EBL's return on networth (RoNW) of ~19% and return on assets (RoA) of 1.95% during 9mFY2018 remains above commercial bank average. EBL's profitability indicators came under pressure as net interest margins (NIMs) declined from 3.40% in FY2015 to 3.04% in FY2016 and 3.25% in FY2017. The decline was caused by pressure on interest spread from faster decline in lending yield vis-à-vis cost of deposits amid high liquidity scenario during FY2016 and H1FY2017. Also, slowdown in credit growth in the period surrounding earthquake and blockade and immediate aftermath also resulted in moderation in CCD ratio affecting NIMs to some extent. The credit portfolio declined between Q3FY2015 and H1FY2016 and the growth remained subdued until H1FY2017 affecting NIMs and overall profitability indicators of FY2016 and FY2017. With the growth back in track and improved credit deposit ratio, NIMs of EBL has recovered during 9mFY2018 (~3.51%). Profitability remains supported by fair NIMs which in turn remains supported by low cost of funds. Yield on advances can be expected to remain supported by healthy retail/SME base and current high interest rate regime. Profitability is also likely to remain supported by gradual decline in operating expense ratio and low credit cost of EBL, despite below average non-interest income. Incremental profitability profile will depend on the bank's ability to maintain its superior deposit profile and assets quality and achieve targeted portfolio growth.

EBL has historically operated with slim capital cushion over regulatory minimum requirement, owing to high dividend pay-out (prior to revised capital requirement rolled out by NRB in July 2015). However, the bank has retained most of the profit accruals between FY2015 and FY2017, followed by equity infusion through rights issue in FY2017 to meet revised paid up capital of NPR 8 billion for class A banks. Series of capital retention and fresh equity infusion has bolstered the capitalization profile of the bank. As on

³ As per internal classification at EBL, business loans above NPR 50 million is classified as corporate while lower ticket size loans are classified as SME loans.



mid-April 2018, EBL's CRAR stood at 15.70%, well above 11% required as per prevailing Basel III regulation. EBL's tier I capital (13.83% as on mid-April 2018) remains well above 8% to be maintained by mid-July 2018 and 8.50% to be maintained by mid-July 2019 under the Basel III norms prescribed by NRB. Therefore, capitalization levels are expected to remain adequate to support EBL's moderate growth ambitions over the medium term.

Bank Profile

Everest Bank Limited is one of the older and large private sector banks in Nepal operating since October 1994. The Bank was promoted by Punjab National Bank along with few prominent businessmen in Nepal. EBL is a joint venture with PNB with 20% equity stake. EBL also has a Technical Service Agreement (TSA) with PNB which provides for management support (three top level executives including CEO) from PNB on deputation. Current shareholding pattern of the Bank constitutes of promoters holding 70% of the shares (including PNB's 20%) while remaining 30% is held by the public. As on mid-April-18, EBL is the 4th largest private sector banks in the country in terms of asset base and 3rd largest private sector bank in terms of Nepal Stock Exchange (NEPSE) market capitalization.

As on mid-April 2018, EBL has presence throughout the country through its 80 branches and 7 extension counters. It also has 28 revenue collection centres spread across the country for collection of government dues. As on mid-April 2018, EBL has market share of about 3.87% in credit portfolio and 4.11% in deposit base of Nepalese banking industry (4.46% and 4.71% share respectively in commercial bank industry). EBL reported a profit after tax (PAT) of NPR 1,982 million during FY 2017 over an asset base of NPR 116,511 million as of mid-July 2017 vs. PAT of NPR 1,730 million during FY2016 over an asset base of NPR 113,885 million as on mid July 2016. During 9M FY2018, EBL reported PAT of NPR 1,803 million. As on mid-April 2018, EBL has gross NPL of 0.23% and CRAR of 15.70%. In terms of technology platform, EBL has implemented Finacle across its branches.

July 2018

For further details please contact:

Analyst Contacts:

Mr. Kishor Prasad Bimali, (Tel No. +977-1-4419910/20)

kishor@icranepal.com

Mr. Sailesh Subedi, (Tel No. +977-1-4419910/20)

saillesh@icranepal.com

All Rights Reserved.

Contents may be used freely with due acknowledgement to ICRA Nepal.

ICRA Nepal ratings should not be treated as recommendation to buy, sell or hold the rated debt instruments. The ICRA Nepal ratings are subject to a process of surveillance which may lead to a revision in ratings. Please visit our website (www.icranepal.com) or contact ICRA Nepal office for the latest information on ICRA Nepal ratings outstanding. All information contained herein has been obtained by ICRA Nepal from sources believed by it to be accurate and reliable. Although reasonable care has been taken to ensure that the information herein is true, such information is provided 'as is' without any warranty of any kind, and ICRA Nepal in particular, makes no representation or warranty, express or implied, as to the accuracy, timeliness or completeness of any such information. All information contained herein must be construed solely as statements of opinion and ICRA Nepal shall not be liable for any losses incurred by users from any use of this publication or its contents