

## Citizens Bank International Limited

### ICRA Nepal reaffirms [ICRANP] LBBB rating for subordinated bonds of Citizens Bank International Limited, “rating watch with negative implications” removed

Facility/Instrument	Amount	Rating Action (March 2016)
Subordinated Bond Program	NPR 500 Million	[ICRANP] LBBB (Reaffirmed), “rating watch with negative implications” removed

ICRA Nepal has reaffirmed rating of [ICRANP] LBBB (pronounced ICRA NP L triple B) to subordinated bonds of NPR 500 million of Citizens Bank International Limited (CZBIL). Instruments with [ICRANP] LBBB Rating are considered to have moderate degree of safety regarding timely servicing of financial obligations. Such instruments carry moderate credit risk. The rating has been removed from “rating watch with negative implications”.

The removal of rating watch with negative implications is on account of ending of the four-five month old blockade at various import trade points resulting in economic activity gradually returning to normalcy across Nepal. This is expected to improve the cash flow for borrowers and hence reduce the event related stress on the accounts, supporting CZBIL’s asset quality. In the near term, although the NPLs<sup>1</sup> could increase (considering the high delinquencies), the bank’s operational and financial profile is expected to remain consistent with the rating level in ICRA Nepal’s assessment.

The rating reaffirmation of CZBIL factors in the bank’s adequate franchise<sup>2</sup>, adequate capitalization levels (CRAR<sup>3</sup> of 12.39% as of mid-Jan-16), healthy profitability profile (PAT/ATA<sup>4</sup> of 1.92% and return on net worth of ~20% for H1FY16<sup>5</sup> although supported to an extent by non–operating profits related to sale of NBA<sup>6</sup>) and the experienced management team. The rating also takes into account the bank’s gradual increase in market share (~2.6-2.8%% share in commercial banking industry deposit and credit as of mid-Jan-16), supported by healthy business growth (CAGR<sup>7</sup> of ~22% over last five years vs. ~19% for industry).

The rating is however constrained by the bank’s moderate track record (operating since Apr-2007), inferior deposits profile with relatively lower proportion of low cost deposits (CASA<sup>8</sup> deposit around 24% as on mid-Jan-16), high customer concentration risks (top 20 customers comprised ~27% of credit book and ~43% of deposits as on mid-Jan-16), and relatively higher exposure to real estate sector (around 12% as on Jan-16) though remains within limit prescribed by Nepal Rastra Bank (NRB). ICRA Nepal also notes the build-up in bank’s delinquencies over the last few months<sup>9</sup> especially with 1.64% of loans overdue for more than 60 days but less than 90 days as of mid-Jan-16. Stress in the economy was also reflected in the increase in gross NPLs from 1.79% as on mid Apr-15 to 2.43% as on mid Jan-16. Bank’s sizeable exposure (~30%) towards sectors<sup>10</sup> which could witness higher volatility on projects/earnings due to aftereffects of earthquake and elongated political strike could impact the asset quality indicators going forward and hence the bank’s performance. However, with the custom blockade lifted recently, event related stress on the accounts is expected to be limited. The rating however continues to factor in the unstable political conditions and uncertain operating environment that banks in Nepal are currently facing.

CZBIL’s branches in the earthquake affected areas accounted for >75% of the credit portfolio as of mid-Jan-16, however several of these businesses (end users of loans) are situated outside the earthquake

<sup>1</sup> Non-Performing Loans

<sup>2</sup> 56 branches and 46 ATMs spread across Nepal

<sup>3</sup> Capital to Risk-weighted Assets Ratio

<sup>4</sup> Profit After Taxes as a % of Average Total Assets

<sup>5</sup> Mid-Jan-16 data are unaudited and all calculations are based on data provided by management.

<sup>6</sup> Non-Banking Assets

<sup>7</sup> Compounded Annual Growth Rate

<sup>8</sup> Current and Savings Accounts

<sup>9</sup> Delinquent accounts (up to 90 days) of 5.62% as on mid Jan-16 vs. 4.41% as on mid April 15

<sup>10</sup> Tourism, microfinance, real estate, consumption and hydropower sectors

affected areas. Till mid-Jan-16, bank had restructured 10 accounts (~2.2% of portfolio) due to the impact of earthquake/strikes under the NRB's relaxed norms supporting the NPL levels. CZBIL reported gross NPLs of 2.43% as on mid Jan-16. Additionally, large borrowers of CZBIL are hydropower, real estate and industrial units which were impacted by the elongated political turmoil and unrest strikes. Amidst this backdrop, the bank witnessed increase in delinquencies from ~4% as of mid-Apr-15 to ~6% as of mid-Jul-15 and further to ~9% as of mid-Oct-15. Though this has declined to ~6% by mid-Jan-16, a large chunk of these (~30%) remain overdue by >60 days. The scheduled loans are still facing higher delinquencies (~10%) compared to revolving loans (~3%) which also remains a key area of concern.

CZBIL reported portfolio growth of ~26% during FY15 and ~15% during H1FY16 (CAGR of ~22% over past 5 years ending mid Jul-15 vs. industry average growth of ~19%). Credit demand going forward is expected to remain healthy owing to expected pickup in economic activity to support the reconstruction, especially after the recent resolution of elongated turmoil and lifting of the economic blockade from major custom points. However, higher growth in low interest rate regime could impair the repayment ability of borrowers in scenario of upward movement of interest rates. CZBIL's portfolio mix primarily comprises large corporate loans (~54%) followed by retail loans (~33%) and SME loans (~13%). The exposure to low yielding corporate loans have reduced by ~10% over past three years, thus supporting the yields (10.04% for H1FY16). However, credit portfolio remains fairly concentrated with top 20 borrower groups accounting for ~27% of portfolio as on mid-Jan-16, hence aggravating the asset quality related risks. Going forward, the management intends to grow at a moderate pace amidst increased competitiveness among banks for efficient utilisation of large capital to be raised by FY17 (as required by changed regulations).

Owing to high fresh NPL generation (2.13% on an average for last three years) and low recovery rate (~20% on an average for last three years), reported NPLs of the bank have been gradually increased over the years (2.43% as of mid-Jan-16 vs. 2.01% as of mid-Jul-12) despite the dilution effect of portfolio growth. The reported NPLs are also supported by regulatory forbearance on NPL recognition extended by NRB on restructured advances. Bank witnessed much higher slippages in FY14 (3.75%), however significant NBA bookings in FY15 (~52% of FY14 NPLs) supported the reduction in NPLs. Additionally, the bank's stock of NBAs increased by ~674 mn during FY15 due to acquisition of two weaker finance companies. Recovery from NBAs has remained satisfactory so far with ~50% of NBA addition in FY15 being disposed over FY15 and H1FY16. Going forward, ICRA Nepal expects CZBIL's asset quality to witness deterioration in the near term due to damages caused by earthquake and elongated strikes, impacting borrowers' ability to make repayments in a timely manner. However, the bank's ability to absorb such losses is adequate (Net NPA/Net worth of 6.79% on mid-Jan-16 compared to 6.51% on mid-Jul-12) and is expected to be supported by the planned capital enhancement through series of rights issue (coming up with 55% rights shortly) and capitalisation of profits. The bank's ability to improve its asset quality in light of its exposure to sectors/segments impacted by earthquake/strikes and moderation in overall economic activity remains to be seen and would remain a key rating driver.

CZBIL witnessed healthy growth in deposits (~20% CAGR over past five years compared to ~19% for industry). However, bank has witnessed marginal decline in share of low cost CASA deposits to ~24% as on mid Jan-16 from ~25% as on mid Jul-15. This has resulted in higher cost of funds for CZBIL at 4.58% as of mid-Jan-16 compared to peers and industry average cost of funds at 3.27%. Furthermore, deposit concentration on top 20 depositors also remains high at ~43% as of mid-Jan-16 and remains a rating concern.

As for profitability, CZBIL's earnings profile has improved owing to its adequate NIMs (3.44% during FY15 and 3.28% during H1FY16) with healthy business growth, adequate non-interest income (1.46% of ATA<sup>11</sup> during H1FY16), moderate operating expense ratio (1.68% of ATA during H1FY16) and write back of provision on account of sale of NBAs in recent periods. Return indicators have also improved during the past few years with RoNW and RoA for H1FY16 at ~20% and 1.92% respectively. The credit cost for CZBIL is expected to increase on account of concerns on asset quality impacting the profitability profile, however the same is expected to remain adequate. Going forward, bank's ability maintain adequate NIMs and manage asset quality would have strong bearing on its profitability profile.

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<sup>11</sup> Average Total Assets

CZBIL's capitalisation levels are adequate with CRAR of 12.39% and tier I capital of 10.27% as of mid-Jan-2016 against minimum regulatory requirement of 10% and 6% respectively. The tier 1 capital and total capital requirement is expected to increase by 1.25% and 1% respectively by mid Jul-16 on account of capital conservation buffer required under Basel III. Given the expectation of CZBIL's adequate internal accruals and the proposed rights issue, capitalization levels are expected to remain adequate to support CZBIL's growth plans over the medium term. Post the proposed issue (assuming full subscription), CZBIL's paid-up capital would increase to NPR 4.78 bn and the bank would plan for further rights issue to attain the capital of NPR 8 bn by FY17 as required by Monetary Policy of FY16/17.

### **Bank Profile**

Citizens Bank International Limited started its commercial operation from April 20, 2007 and is registered as "A" class Commercial Bank with Nepal Rastra Bank (NRB). Its head office is located at Kathmandu. The bank is promoted by individual/ business and industrial houses and is managed by a team of experienced bankers and professionals. Share capital of the company is distributed among promoter & public in the ratio of 51:49. The bank's equity shares are listed on the Nepal stock exchange. Mr. Rajan Singh Bhandari is the Chief Executive Officer of the bank.

CZBIL's 56 branches and 46 ATMs provides it with presence throughout the country. CZBIL has market share of 2.58% in terms of deposit base and 2.85% of loan & advances in commercial banking industry of Nepal as on mid-Jan-16. CZBIL reported a profit after tax of NPR 721 million during 2014-15 over an asset base of NPR 41,493 million as of mid-Jul-15 against profit after tax of NPR 498 million during 2013-14 over an asset base of NPR 32,222 million as of mid-Jul-14. During H1FY16, CZBIL reported PAT of NPR 418 million over an assets base of NPR 45,905 million. As of mid-Jan-2016, CZBIL's CRAR was 12.39% and gross NPLs were 2.43%. In terms of technology platform, CZBIL has implemented Pumori-IV across all of its branches.

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