

NIC Asia Bank Limited

ICRA Nepal assigns [ICRANP-IR] A- rating to NIC Asia Bank Limited; reaffirms [ICRANP] LA- rating for the subordinated bonds, “rating watch with negative implications” removed

Facility/Instrument	Amount	Rating Action (May 2017)
Issuer Rating	NA	[ICRANP-IR] A- (Assigned)
Subordinated Bond Program	NPR 500 Million	[ICRANP] LA- (Reaffirmed), “rating watch with negative implications” removed

ICRA Nepal has assigned rating of **[ICRANP-IR] A-** (pronounced ICRA NP Issuer Rating A Minus) to NIC Asia Bank Limited (NICA). [ICRANP-IR] A- rating are considered as adequate credit quality rating assigned by ICRA Nepal. The rated entity carries average credit risk. The rating is only an opinion on the general creditworthiness of the rated entity and not specific to any particular debt instrument. The sign of + (plus) or – (minus) appended to the rating symbols indicate their relative position within the rating categories concerned.

ICRA Nepal has also reaffirmed the rating of **[ICRANP] LA-** (pronounced ICRA NP L A minus) to the subordinated bonds of NPR 500 million of NICA. Instruments with [ICRANP] LA- rating are considered to have adequate degree of safety regarding timely servicing of financial obligations. Such instruments carry low 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 improvement in asset quality with delinquencies¹ returning to normal levels compared to last year when spike in delinquencies were seen on account of impact of earthquakes and elongated customs blockade. Bank has been able to report improvement across most of the operational and financial indicators post these events because of decline in fresh NPL generation, improved recovery and high portfolio growth. However, despite improvement, sustainability of recent improvement in asset quality over longer periods would remain a key rating sensitivity.

The rating assignment/reaffirmation factors in NICA’s established track record (operating since 1998) and diversified franchise² leading to good market positioning in Nepal with ~4% share in industry credit and deposits. The ratings also factor adequate capitalisation levels (CRAR³ of 13.69% as on mid-Apr-17⁴), decline in gross NPLs of the bank (from 2.07% as on mid-Jul-15 to 0.46% as on mid-Apr-17) and the ability to improve profitability profile (PAT/ATA⁵ of 1.78% and return on net worth of ~18% for 9MFY17 vs. 1.51% and ~17% for FY16) despite increment in capital base to meet elevated regulatory requirements. ICRA Nepal also positively takes note of bank’s shifting focus towards retail and SME lending resulting in increment in their portfolio share (~72% as of Jan-17 vs. ~57% on Jan-16) and aiding improvement in granularity of credit portfolio (~15% among top 20 borrower groups as of Jan-17 vs. ~21% on Jan-16).

These positives are however offset to an extent by significant spike in portfolio growth trend in recent years (~37% credit growth achieved in FY16 compared to ~26% growth in industry and bank’s own past track record of CAGR⁶ ~13% in earlier four years ending FY15), with plans of pursuing higher growth over the medium term. Though the controls commensurate to the growth targets have been kept in place, high growth in low interest rate regime could create stress over incremental assets quality when the interest rate cycle reverses. The ratings also remain constrained by continuous pressure in NIMs⁷ (decreased to 2.88% for 9MFY17 from 3.93% for FY13 due to higher decline in yields compared to cost

¹ Delinquent accounts (0+ days) of 7.38% as on mid Jan-17 vs. 9.40% as on mid-Jan-16 (7.26% on mid-Jan-15).

² 103 branches, one extension counter and 75 ATMs as of mid-Apr-17.

³ Capital to Risk-adjusted Assets Ratio

⁴ 9MFY17 as well as H1FY17 data are unaudited

⁵ Profit After Taxes as a % of Average Total Assets

⁶ Compounded Annual Growth Rate

⁷ Net Interest Margins as a % of Average Total Assets



of deposits), inferior deposits profile (CASA⁸ deposits of ~30% vs. ~48% for industry as of Jan-17) resulting in high cost of funds among peers (5.07% for 9MFY17). The bank continues to face challenges because of high deposit concentration risks (top 20 depositors comprised ~40% of deposits as on mid-Jan-17) and the unstable political conditions and uncertain operating environment that banks in Nepal are currently facing.

NICA spiked its portfolio growth trend since FY16 and reported growth of ~37% during FY16 and ~20% during 9MFY17 (CAGR of ~17% over past 5 years ending mid-Jul-16 vs. industry average growth of ~23%). Going forward also, the management intends to achieve higher growth in line with their five-year strategic plan to ensure efficient utilisation of large capital to be raised by Jul-17 (as required by changed regulations). However, higher growth in low interest rate regime in last few years could impair the repayment ability of borrowers in scenario of upward movement of interest rates. NICA's portfolio mix have moved in favour of retail and SME loans with these comprising ~72% of portfolio as of Jan-17 (46% retail loans), followed by large corporate loans (~28% in Jan-17 vs. ~44% in Jul-15). This has benefitted the granularity of credit portfolio with top 20 borrower groups accounting for ~15% of portfolio as on Jan-17 vs. ~21% on Jan-16. Though the incremental loans were competitively priced among peers, increased cost of funds across the banking sector in recent months have resulted in higher lending yields of 9.90% for 9MFY17 vs. 8.29% for FY16. Bank's ability to mitigate risks while targeting high growth would have a strong bearing over its future financial profile.

Bank's asset quality witnessed improvement in recent periods and continues to remain better than industry (NPLs of 0.46% as of mid-Apr-17 vs. 2.07% as of mid-Jul-15). The improvement was aided by decline in fresh NPL generation rate (0.10% in FY16 compared to ~1.4% on an average for FY13 to FY15), improved recovery (~46%) and were also supported by dilution effect of portfolio growth. Delinquencies (0+DPD) of the bank have also improved to 4.34% as of Jul-16 compared to 7.11% as of Jul-15. As of Jan-17, given the seasonality in delinquency profile, delinquencies were at 7.38% of portfolio, of which 6.04% loans were delinquent within 30 days which provides some comfort (9.40% as of Jan-16 with 5.52% loans overdue within 30 days). Going forward, ICRA Nepal expects NICA's asset quality to witness increment in stress over medium term due to decline in repayment capacity of the borrowers to serve facilities at higher interest rates. However, bank's ability to absorb such losses is adequate (Net NPA/Net worth of 1.34% on mid-Jan-17 compared to 3.27% on mid-Jul-15) and is expected to be further supported by the planned capital enhancement through rights and capitalisation of internal accruals to meet elevated capital requirements of NPR 8 bn by Jul-17.

NICA's deposit profile however continue to remain weaker than the industry as reflected by ~30% CASA deposits as of Jan-17 vs. ~48% for industry. This has resulted in higher cost of funds for NICA at 5.07% for 9MFY17 (3.91% for FY16 vs. 2.87% for industry) compared to peers and industry average cost of funds. Tightening liquidity in banking sector in recent months has resulted in increased cost of funds for the bank as well. Also, with changed regulations⁹, interest rates in savings deposits may witness upward trend and as banks' reliance on call and term deposits remain high, costs of deposits is expected to increase over medium term. Deposit concentration for NICA also continues to remain high at ~40% on top 20 depositors as of mid-Jan-17.

NICA's capitalisation levels are adequate with CRAR of 13.69% and tier I capital of 12.20% as of mid-Apr-2017 (both as per Basel III) which remains comfortable compared to minimum regulatory requirement of 11% and 7.50% respectively (both including Capital Conservation buffer). The tier 1 capital requirement is expected to increase to 8.5% by mid-Jul-19 (including capital conservation buffer) although the requirement for total capital would be stable at 11% (incl. CCB). Considering the 15% rights issue that is to be capitalised shortly and expectations of modest internal accruals, capitalization levels are expected to remain adequate to support NICA's growth plans over the medium term. NICA plans to provide bonus shares to meet the shortfall in attaining the capital of NPR 8 bn by Jul-17 as required by Monetary Policy of FY15/16. The incremental capital would also have critical bearing on its ability to absorb damages arising out of possible stress in asset quality and maintain comfortable solvency profile.

⁸ Current and Savings Accounts

⁹ Call deposits (mostly from institutions) which used to enjoy preferential rates can now be provided interest rates up to minimum interest rates offered on savings deposits.

As for profitability, NICA's earnings profile has witnessed improvement in recent periods, however still remaining lower to industry average. Return indicators improved during FY16 with RoNW and RoA¹⁰ at ~17% and 1.51% respectively (~21% and 1.97% for industry) compared to ~13% and 1.21% for FY15. Bank's NIMs have been declining in recent years (2.80% during FY16 vs. 3.68% for FY14) and hence remains weaker among peers mainly due to weak deposit profile along with competitive lending rates. This along with lower non-interest income (0.94% of ATA during FY16) and high operating cost (~1.8% of ATA during FY16 primarily on account of rapid branch expansion targeting retail/SME customers) acts as a drag to profitability. Nonetheless, these indicators have improved to an extent for 9MFY17 (NIMs of 2.88% and non-interest income of 1.11% of ATA resulting in RoNW and RoA of ~18% and 1.78% respectively) but ability to control the credit cost on account of concerns on asset quality will be critical for profitability. Going forward, bank's ability to ensure efficient utilisation of large incremental capital, maintain adequate NIMs and manage asset quality would have strong bearing on its profitability profile.

Bank Profile

NICA is one of the large sized private sector commercial banks of Nepal. Incorporated in 1998 by some of the prominent businessmen/industrialists of the country, the bank was in operation as Nepal Industrial & Commercial Bank Limited until the merger with Bank of Asia Nepal Limited in the first ever merger between two commercial Banks in the history of Nepal. Post the merger, the name was changed to NIC Asia Bank Limited and the merged operations commenced from 30th June 2013. Share capital of the company is distributed among promoter & public in the ratio of 51:49. The shares of the NICA are listed in Nepal Stock Exchange and being actively traded. Mr. Laxman Risal is the Chief Executive Officer of the bank.

NICA's 103 branches, one extension counter and 75 ATMs provides it with presence throughout the country. NICA has market share of 4.13% in terms of deposit base and 4.24% of total advances of commercial banking industry as on mid-Jan-17. NICA reported profit after tax (PAT) of NPR 1,067 million during FY16 over an asset base of NPR 80,457 million as of mid-Jul-16 against PAT of NPR 680 million during FY15 over an asset base of NPR 60,519 million as of mid-Jul-15. During 9MFY17, NICA reported PAT of NPR 1,139 million over an assets base of NPR 90,423 million. As of mid-Apr-2017, NICA's CRAR was 13.69% and gross NPLs were 0.46%. In terms of technology platform, NICA has implemented Finacle across all its branches.

May 2017

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¹⁰ Return on Net Worth and Return on Assets