

Citizens Bank International Limited

ICRA Nepal assigns [ICRANP-IR] BBB+ rating to Citizens Bank International Limited; upgrades subordinated bond rating to [ICRANP] LBBB+

Facility/Instrument	Amount	Rating Action (May 2017)
Issuer Rating	NA	[ICRANP-IR] BBB+ (Assigned)
Subordinated Bond Program	NPR 500 Million	[ICRANP] LBBB+ (Upgraded)

ICRA Nepal has assigned rating of **[ICRANP-IR] BBB+** (pronounced ICRA NP Issuer Rating Triple B Plus) to Citizens Bank International Limited (CZBIL). The sign of + (plus) or – (minus) appended to the rating symbols indicate their relative position within the rating categories concerned. [ICRANP-IR] BBB+ ratings are considered as moderate credit quality rating assigned by ICRA Nepal. The rated entity carries higher than 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.

ICRA Nepal has also upgraded the rating of subordinated bonds of NPR 500 million of CZBIL from **[ICRANP] LBBB** (pronounced ICRA NP L Triple B) to **[ICRANP] LBBB+** (pronounced ICRA NP L Triple B Plus). Subordinated bond rating BBB+ is one notch higher than BBB. Instruments with this rating are considered to have moderate degree of safety regarding timely servicing of financial obligations. Such instruments carry moderate credit risk.

The rating assignment/upgradation of CZBIL factors in the bank's adequate track record (operating since Apr-2007), improving market positioning through franchise expansion¹ and scale up in operations while maintaining adequate profitability and progressively improving its assets quality indicators despite acquisition of weak financial institutions². CZBIL was able to downsize its adjusted NPLs (including NBAs³) from 3.75% as of Jul-15 to 2.50% as of Jan-17⁴ (including NBAs of 1.18%) while maintaining moderate delinquencies levels (generally ~4-7%; ~5.4% on Jan-17). Bank's adequate capitalization levels (CRAR⁵ of 13.85% as of mid-Apr-17) and experienced management team is expected to support future growth plans of the bank. ICRA Nepal also positively takes note of increasing share of retail/SME loans in bank's portfolio (~57% on Jan-17 vs. ~40% on Jul-14) which has gradually reduced credit concentration risks (~28% among top 20 borrowers on Jul-14 to ~22% on Jan-17).

The ratings are however constrained by the bank's high growth strategy as reflected in CAGR⁶ of ~31% over last three years vs. ~23% for industry which though has benefitted bank's market share (54 bps increment in market share over this period to 2.91% as of mid-Jul-16) which could create incremental stress in asset quality in increasing interest rate scenario. The ratings also take into account the bank's inferior deposits profile with lower proportion of low cost CASA⁷ deposits (~25% as on mid-Jan-17 vs. ~48% for industry). This has led to high cost of deposits among peers (4.54% for H1FY17 for CZBIL vs 3.14% for industry), weakening its competitive positioning to some extent. At the same time, concentration of deposits among top accounts also remains on higher side (~39% among top 20 customers as on mid-Jan-17, although same has been reduced compared to earlier period) and exposure to riskier segments like real estate sector and loan against shares (~18% as on Jan-17) also remain relatively higher. The ratings also continue to factor in the unstable political conditions and uncertain operating environment that banks in Nepal are currently facing.

CZBIL reported portfolio growth of ~39% during FY16 and ~24% during 9MFY17 (CAGR of ~27% over past 5 years ending mid-Jul-16 albeit on a small base vs. industry average growth of ~21%). Higher

¹ 58 branches and 53 ATMs spread across Nepal as of Jan-17 compared to 42 branches in Jul-14.

² 3 problematic finance companies have been acquired so far which contribute to ~36% of reported NPAs and ~95% of NBAs of the bank as of Jan-17.

³ Non-Banking Assets

⁴ H1FY17 and 9MFY17 data are unaudited

⁵ Capital to Risk-weighted Assets Ratio

⁶ Compounded Annual Growth Rate

⁷ Current and Savings Accounts

growth in low interest rate regime especially in recent years could impair the repayment ability of borrowers in scenario of upward movement of interest rates. CZBIL's portfolio mix primarily comprises of retail loans (~43%) followed by large corporate loans (~43%) and SME loans (~14%). The high exposure to riskier segments and reduction in low yielding corporate loans by ~16% since Jul-14, has been supporting better yields among peers (10.24% for 9MFY17). This has also reduced credit concentration risks to ~22% of portfolio as on mid-Jan-17 among top 20 borrower groups. Going forward, the management intends to leverage the existing franchise to achieve future credit growth focusing more along retail/SME segment. The bank's ability to achieve the growth targets along with commensurate risk control measures would have a key bearing over its financial profile.

Despite increased fresh NPL generation during FY16 (1.02% vs. 0.88% for FY15), improved recovery rate (~36% vs. ~17% for FY15) prevented spike in NPLs and hence the bank reported improvement in NPLs from 1.53% in Jul-15 to 1.38% in Jul-16 (notwithstanding some deterioration during the past 6-9 months; NPLs reached to 1.55% as of Apr-17). Reported NPLs of the bank were also benefitted by dilution effect of portfolio growth. 0+ days delinquencies of the bank have also moderated compared to earlier periods and was 5.39% as of mid-Jan-17 with a large chunk of these (~65%) remaining overdue up to 30 days. The bank's ability to sustain improvement in its asset quality remains to be seen and would remain a key rating driver.

Apart from NPLs, bank also has significant stock of NBAs (0.93% as of Jul-16; increased to 1.18% as of Jan-17 through acquisition of Premier Finance). Recovery from NBAs has remained satisfactory so far with ~36% of NBA addition from acquired entities being disposed till mid-Jan-17 yielding good gains on disposal as well. Out of bank's NBA stock of NPR 559 million as of mid-Jan-17, ~95% were contributed by acquired entities. In addition, ~36% of NPLs as of Jan-17 were from these acquired entities thereby reflecting relatively better asset quality originated by CZBIL. Going forward, with increasing interest rates, ICRA Nepal expects the asset quality of banks, including CZBIL's 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, the bank's ability to absorb such losses is adequate (Net NPA/Net worth of 2.47% on mid-Jan-17 compared to 12.11% on mid-Jul-14) and is expected to be further supported by planned capital enhancement through rights issue and capitalisation of internal accruals to meet the elevated capital requirements of 8 bn by Jul-17.

CZBIL witnessed healthy growth in deposits (~29% CAGR over past five years compared to ~21% for industry). However due to high growth in advances and consequent reliance on large depositors, bank was not able to improve share of low cost CASA deposits which remained largely constant at ~25% over last few years. This has resulted in higher cost of funds for CZBIL, compared to peers and industry average, at 5.44% for 9MFY17 (4.23% for FY16 vs. 2.87% for industry). Tightening liquidity in banking sector in recent months has resulted in increased cost of funds for the bank as well. Also, with changed regulations⁸, interest rates in savings deposits may witness upward trend and given the banks' high reliance on term deposits, costs of deposits is expected to increase over medium term. Furthermore, deposit concentration on top 20 depositors also remains high at ~39% as of mid-Jan-17 and remains a rating concern.

As for profitability, despite higher cost of deposits, CZBIL's earnings profile has improved owing to its adequate NIMs (3.36% for FY16) supported by higher yield on advances and improved asset quality. The net profitability has also been supported by healthy business growth, adequate non-interest income (1.31% of ATA⁹ during FY16), moderate operating expense ratio (1.70% of ATA during FY16) and healthy write back of provision on account of sale of NBAs in recent periods. Return indicators have improved during the past few years with RoNW and RoA¹⁰ for FY16 at ~24% and 2.24% and hence continues to remain better to industry average at ~21% and 1.97% respectively. Nonetheless, these indicators have declined to an extent for 9MFY17 owing to increased capital base and delayed pricing of

⁸ 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.

⁹ Average Total Assets

¹⁰ Return on Net Worth and Return on Assets

advances vis. a vis. increased cost of funds (NIMs of 2.74% and fee based income of 1.22% of ATA reflecting into RoNW of ~18%) and hence the ability to maintain adequate NIMs and control the credit cost on account of concerns on asset quality will be critical for profitability.

CZBIL's capitalisation levels are adequate with CRAR of 13.85% and tier I capital of 12.24% 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). Given the expectation of CZBIL's adequate internal accruals and proposed rights and bonus issue to attain the revised regulatory capital of NPR 8 bn by Jul-17 (NPR 5.88 bn as of Apr-17), capitalization levels are expected to remain adequate to support CZBIL's growth plans over the medium term.

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 Narayanhiti, Kathmandu. Citizen Investment Trust, the largest shareholder holds 4.43% stake in the bank while the other promoters are largely individuals from diverse backgrounds. Share capital of the company is distributed among promoter & public in the ratio of ~51:49. The bank's equity shares are listed and being actively traded on the Nepal stock exchange. Mr. Rajan Singh Bhandari is the CEO of the bank.

CZBIL's 58 branches and 53 ATMs provides it with presence throughout the country. CZBIL has market share of 2.76% in terms of deposit base and 2.94% of loan & advances in commercial banking industry of Nepal as on mid-Jan-17. CZBIL reported a profit after tax of NPR 1,080 million during FY16 over an asset base of NPR 55,062 million as of mid-Jul-16 against profit after tax of NPR 720 million during FY15 over an asset base of NPR 41,493 million as of mid-Jul-15. For 9MFY17, CZBIL reported PAT of NPR 883 million over an assets base of NPR 66,948 million. As of mid-Apr-2017, CZBIL's CRAR was 13.85% and gross NPLs were 1.55%. In terms of technology platform, CZBIL has implemented Pumoriv across all of its branches.

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