ICRA NEPAL

NMB Bank Limited

ICRA Nepal upgrades issuer rating of NMB Bank at [ICRANP-IR] A- from [ICRANP-IR] BBB+ and subordinated bond/debenture rating at [ICRANP] LA- from [ICRANP] LBBB+.

Facility/Instrument	Amount	Rating Action (January 2018)
Issuer Rating	NA	[ICRANP-IR] A- (upgraded)
Subordinated Bond Program	NPR 500 Million	[ICRANP] LA- (upgraded)

ICRA Nepal has upgraded the issuer rating of NMB Bank Limited (NMB) at **[ICRANP-IR] A-** (pronounced ICRA NP Issuer Rating A minus) from [ICRANP-IR] BBB+ (pronounced ICRA NP Issuer Rating Triple B Plus). Entities with [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.

ICRA Nepal has also upgraded the rating of subordinated bond/debentures of NPR 500 million of NMB at **[ICRANP] LA-** (pronounced ICRA NP L A minus) from **[ICRANP] LBBB+** (pronounced ICRA NP L Triple B Plus). Instruments with this rating are considered to have adequate degree of safety regarding timely servicing of financial obligations. Such instruments carry low credit risk.

The sign of + (plus) or – (minus) appended to the rating symbols indicate their relative position within the rating categories concerned. Thus, the rating of A- is one notch lower than A.

The rating upgrade factors in the bank's ability to maintain its assets quality (gross NPL[1]s of 1.20% on mid-Jan 2018) and return indicators in the post-merger era, despite sizeable credit book acquired from regional BFIs and their relatively weaker underwriting norms. NMB's ability to successfully manage the post-merger integration issues is reflected in steady assets quality and profitability indicators. The rating action also factors in NMB's healthy capitalization profile aided by fresh equity injection by FMO[2] in late 2016, which could strengthen further after proposed equity raising plans (FPO)[3] of the bank (assuming full subscription). With induction of FMO as joint venture partner (with 20% stake) through fresh equity injection[4], the institutional shareholding in NMB has increased to ~35% aiding the governance aspect of the bank. The rating action also factors in NMB's good market positioning in the industry as reflected in adequate market share (~3.5% share in the commercial bank industry credit and deposits) and franchise network (93 branches as on mid-Jan 2018). Good market positioning coupled with NMB's established track record (operating since 1996[5]), support and business synergies from FMO and experienced management team is likely to have positive impact on the prospects of the bank.

The ratings are however constrained by moderate funding profile of the bank; characterised by inferior CASA mix (33% as on mid-Jan 2018 vs. commercial bank average of ~43%) and relatively higher deposit concentration (34% of deposits among top 20 accounts as on mid-Oct 2017). Due to higher reliance on price sensitive high-ticket deposits, NMB fares inferior to the industry leaders in terms of cost of fund and base rate. This could be a competitive disadvantage in the "base rate plus" lending model recently implemented in the industry. Rating concern also emanates from the rising interest rates across the banking industry which could result in the stress in the credit portfolio underwritten during the lower interest rate regime. The rating is also constrained by uncertain operating environment that the banks in Nepal are currently facing.

NMB's credit portfolio has grown at a healthy pace of CAGR ~38% over past 5 years ending FY17, albeit on a low base. The credit growth was aided by merger with 4 regional BFIs in October 2015. The growth in the post-merger era has remained low (~15% growth in FY17) due to focus on the portfolio

[1] Non-performing loans
[2] FMO is a bilateral Development Bank based in Netherland with 51% stake by the Dutch State.
[3] The bank has proposed to issue ~11.41 million units of equity shares to public at a premium.
[4] ~9.4 million new shares of NMB was issued to FMO at NPR 250 per share (total equity injection of ~NPR 2.35 billion)
[5] As class C finance company before its upgradation to Class A bank in 2008.

consolidation and shortage of lendable funds in the banking industry that developed towards second half of FY17. Given the deposit crunch, incremental credit growth of the bank is likely to remain pegged with the incremental deposit growth. Management's ability to mobilize the adequate franchise network of the bank to generate fresh deposits remains to be seen. As on mid-Oct 2017, NMB's credit portfolio stood at NPR 64 billion; broadly comprised of loan towards Small and Medium Enterprise (SMEs) (40%), towards large corporates (35%) and retail consumer loans (19%). NMB's credit concentration has grown marginally during past 12-18 months yet remains comfortable (23% of total credit among top 20 borrower groups). Assets quality of NMB remains good with gross NPLs of 1.20% on mid-Jan 2018 (1.68% on mid-July 2017) and 0+ days delinquency of ~6% on mid-Oct 2017.

In terms of deposit profile, NMB continues to fare weaker to the industry average. As on mid-Jan 2018, NMB's deposit base of NPR 80 billion comprised of 33% CASA (lower than industry average of ~43%), at par with mid-July 2017 level and lower to mid-July 2016 level of ~36%. At the same time, deposit concentration among top accounts remains on higher side. During past 12-18 months, Nepalese banking industry has witnessed shortage of lendable deposits pushing up the cost of deposits. This is likely to adversely affect the bank's competitive positioning (in the "base rate plus" lending rate regime). This is also likely to affect NMB's profitability (by affecting the net interest margin) as the bank's ability to pass on the increased cost to the borrower is dictated by industry competition. CCD ratio of NMB remains comfortable despite moderation in deposit growth vis-à-vis credit growth in recent years (~76% on mid-Jan 2018 vs. regulatory ceiling of 80%).

As for profitability, NMB's average return on net worth (~19% over past 2-3 years) remains above commercial bank average; albeit partly aided by reversal of credit provisions maintained at the time of merger. Profitability also remains supported by fair Net Interest Margin (NIMs) (~3% of average total assets (ATA)) on growing asset base. NIMs in turn remains supported by healthy yield on advances on retail/SME dominated lending portfolio and healthy rate of credit mobilisation (CCD ratio of 75-78% during past 1-2 years). Non-interest income of NMB has improved in the post-merger era (~1.5% of ATA) diversifying the earnings profile. Profitability also remains supported by low credit provision expenses. However, due to slow growth post-merger, operating expense ratio continues to remain high (~1.9% of ATA) which remains a drag to profitability. Going forward, bank's profitability will depend on its ability to achieve targeted growth by managing required funds and maintain assets quality on current and incremental credit portfolio.

NMB's capitalization profile improved in FY17 after fresh equity injection from FMO, pushing up the capital adequacy ratio (CRAR[6]) from ~11% to ~13%. As on mid-Jan 2018, NMB's CRAR stood at 13.06%, comfortable vis-à-vis regulatory minimum of 11% under prevailing Basel III norm. NMB's tier I capital (11.87% as on mid-Jan 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. Capitalisation of proceeds from proposed FPO is likely to give further boost to the capitalization profile of the bank (assuming full subscription) and improve the risk bearing capacity of the bank. However, NMB's capital would still remain lower by ~NPR 0.4 billion compared to minimum regulatory requirement of NPR 8 billion even after the proposed FPO (assuming full subscription), hence bank would need to be capitalise retained earnings to meet regulatory minimum capital.

Bank Profile

NMB Bank Ltd started its operation from 26th December 1996 as a Class C Finance Company. The bank has been operating as a commercial bank following its up gradation from Class C to Class A in May 2008. It was registered as joint –Venture Company with foreign promoter M/s Young Leon Realty, Malaysia. In the first half of FY 2015-2016, NMB underwent merger with 4 regional banking and financial institutions[7] to raise the minimum paid up capital, commencing joint operation from mid-October 2015.

[6] Capital to risk-weighted-assets adjusted ratio

[7] **Clean Energy** Development bank (CEDBL-National Level Class B Bank), **Bhrikutee** Development Bank (10-district level Class B Bank-graded IPO 3 by ICRA Nepal in November 2014), **Pathibhara** Development Bank (3-district level Development Bank) and P**rudential** Finance Limited (National Level Class C Finance Company)

The merger increased the capital fund and assets base of NMB in addition to increasing its footprint across the country.

Post-merger NMB issued further promoter equity shares to FMO Netherland. This increased FMO's stake in NMB to 20% from 3.18% immediately following the merger[8]. As on mid-Jan 2018, promoter public shareholding of NMB stood at ~60:40. The current major promoter group of the bank includes FMO (20% shareholding), Employee's Provident fund (~8%) and Young Leon Realty (~6%) with remaining promoter stake held mostly by individual businessmen and private investment companies.

As on mid-Jan 2018, NMB has presence throughout the country through its 93 branches. NMB has market share of about 3.1% in terms of deposit base and 3.2% of total advances of Nepalese Banking Industry as on mid-Jul 2017 (3.5% and 3.6% share among the commercial banks). NMB reported a profit after tax of NPR 1,511 million during FY 2016-17 over an asset base of NPR 86,867 million as at mid-Jul-17 against profit after tax of NPR 1,115 million during FY 2015-16 over an asset base of NPR 74,613 million as on mid-Jul-16. Till mid-Jan-18 (Q2FY 2017-18), NMB has reported a net profit of NPR 1,007 million over an asset base of NPR 95,042 million. As of mid-Jan-18, NMB's CRAR[9] was 13.06% (tier I CRAR 11.87%) and gross NPLs10 were 1.20%.

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[8] FMO was the major promoter in one of the merging entities (Clean Energy Development Bank).
[9] Capital to risk-weighted-assets adjusted ratio
[10] Non-performing loans