Siddhartha Bank Limited

ICRA Nepal assigns [ICRANP] LBBB+ rating to proposed subordinated debenture of Siddhartha Bank; reaffirms [ICRANP-IR] BBB+ rating to Siddhartha Bank and [ICRANP] LBBB+ rating to existing subordinated debenture

Facility/Instrument	Amount	Rating Action (August 2018)
Subordinated Debenture Program	NPR 2,250 million	[ICRANP] LBBB+ (assigned)
Issuer Rating	NA	[ICRANP-IR] BBB+ (reaffirmed)
Subordinated Debenture Program	NPR 500 Million	[ICRANP] LBBB+ (reaffirmed)

ICRA Nepal has assigned **[ICRANP] LBBB+** (pronounced ICRA NP Long Term Debt Rating Triple B Plus) to the proposed subordinated[1] bonds of NPR 2,250 million of Siddhartha Bank Limited (SBL). ICRA Nepal also reaffirms the rating of **[ICRANP] LBBB+** to subordinated debenture of NPR 500 million of SBL. Subordinated debenture 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.

ICRA Nepal also reaffirms the rating of **[ICRANP-IR] BBB+** (pronounced ICRA NP Issuer Rating Triple B Plus) assigned to SBL. Issuer rating BBB+ is one notch higher than BBB. [ICRANP-IR] BBB+ rating is considered 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.

The rating assigned/ reaffirmed factors in SBL's ability to maintain its market share along with recent improvement in assets quality indicators. The rating action also factors in strong geographical presence of the bank (through 118 branches as of mid-July 2018), especially after recent branch expansion. This is likely to support balanced and geographically diversified growth going forward. The rating continues to draw support from adequate track record of the bank (operating since December 2002), promoters with adequate experience in financial sector and experienced and stable management team of the bank. The rating also factors in good profitability profile of the bank, supported by fair Net Interest Margins (NIMs). Improvement of overall financial profile and assets quality of the bank also indicates at successful integration of resources post-merger in FY16, which has been factored into the rating.

The ratings are however constrained by SBL's relatively inferior deposit profile vis-à-vis commercial bank average (CASA[2] deposits of ~37% as on mid-July 2018 vs. ~44% for commercial bank industry); because of relatively higher reliance on institutional deposits over the years to fund high credit growth rate of the bank. Lower CASA proportion has led to relatively higher cost of deposits for SBL among peers (7.22% for FY18 vs commercial bank average of ~6.11%). In the current regime of "base rate plus" lending model, this could be a competitive disadvantage. With sizeable addition to branch network and concomitant increase in penetration to wider customer base, CASA proportion of SBL is likely to improve going forward. SBL has registered good growth in CASA proportion in FY18 (from ~29% in mid -July 2017 to ~37% in mid-July 2018) owing to greater focus by management towards CASA improvement; also aided by increased penetration of the bank among retail customer base. However, its sustainability remains to be seen. SBL's concentration of deposits among top depositors also remains on relatively higher side (top 20 depositors comprised ~25% of deposits as on mid-July 2018), despite improvement in past 12-15 month (~31% when last rated[3]). Rating is also constrained by moderate capitalization profile of the bank vis-à-vis peers (CRAR of 12.10% on mid-July 2018 vs. regulatory minimum of 11% and Tier 1 of 10.84% vs 8% regulatory requirement).

[1] Subordinated to deposits for principal repayment, in the event of liquidation. Further, this debenture is proposed to include in tier II capital while calculation Capital Risk Adjusted Assets Ratio (CRAR) and Credit to Core capital and Deposit (CCD) ratio
[2] Current and Savings Accounts
[3] In mid-July 2017, based on mid-April 2017 data.

Assets quality of SBL will be a key monitorable over next 6-12 months, given high credit growth registered by SBL in recent years and prevailing high interest rates. Sizeable portion of recent credit growth has come during low interest rate regime prior to H2FY17. Moreover, SBL's exposure to the sector that are vulnerable to uptick in interest rates (viz. real estate, hire purchase, etc) also remains higher than industry average. SBL's gross non-performing asset (NPA) level have declined in FY18 (from 1.30% in mid-July 2017 to 1.05% in mid-July 2018), which is partly aided by limited seasoning of credit books underwritten in past 12-18 months and good recovery efforts of the bank. However, sustainability of the same remains to be seen.

During FY18 and FY17, SBL's credit portfolio registered year-on-year (YOY) growth of 28% & 19% (vis-à-vis commercial bank average of ~20% and ~25% respectively). SBL's growth in credit portfolio is partly aided by increase in branch network of the bank (from 70 in mid-July 2017 to 118 as on mid-July 2018). As on mid-July 2018, SBL's credit portfolio primarily comprised of Corporate loans (~62%), Retail Loans (29%) and SME loans (9%)[4]. SBL's corporate portfolio has moderated in recent years to the benefit of SME and retail segment. With increased penetration and access to larger customer base (due to expansion of branch network), SBL's SME/retail segment is likely to get further boost in future. SBL's concentration of credit among top borrower groups remains on lower side which remains a comfort. As on mid-July 2018, SBL's top 20 borrower groups accounted for ~13% of total loans (as compared to 12% when last rated). As on mid-July 2018, SBL's exposure to relatively vulnerable sector[5] also remained higher (~22% vs. commercial bank average of ~14%). In terms of assets quality, SBL has reported improvement in Gross NPA levels during past 12-18 months. Gross NPA of SBL declined from 1.30% in mid-July 2017 to 1.05% in mid-July 2018, partly aided by credit growth in the interim. With the uptick in interest rate, slippage rate has remained high for SBL (average of ~0.75% during FY17 & FY18) which has been partly offset by good recovery performance. However, the ability of SBL to check the fresh slippage rate and maintain overall NPA level remains to be seen. Due to low NPA levels, SBL has been able to maintain good solvency profile (net NPA/ Net worth of ~3%), despite low NPA provision cover (~56% as on mid-July 2018).

SBL's CASA deposit proportion grew from ~29% as on mid-July 2017 to ~37% as on mid-July 2018 owing to increased focus by management towards CASA improvement. This has largely offset the decline in CASA proportion in FY17, amid deposit crunch faced by the banking industry. Improvement in CASA proportion has also resulted in the granularity of deposit profile, bringing down the concentration among top 20 depositors to ~26% as on mid-July 2018 (from ~31% when last rated). However, despite improvement, SBL's CASA proportion remains lower to commercial bank average of ~44%, which translates into 100-120 bps higher cost of deposits for SBL vis-à-vis commercial bank average; affecting the competitive positioning of the bank to some extent. With sizeable growth in branch network, SBL's prospect of building strong retail deposit base has improved. However, the ability of the bank to improve it further remains to be seen.

SBL's profitability remains supported by steady NIMs of ~3.3% maintained over past 2 years. The bank has been able to maintain healthy yield on advances, partly aided by portfolio granularity and exposure to high yield segments like real estate and hire purchase. Higher yield has supported the NIMs of the bank despite relatively higher cost of deposits. NIMs also remains supported by SBL's healthy rate of credit mobilisation (CCD ratio of ~75% on mid-July 2018). SBL has registered an increased in non-interest income level during FY18 (~1.06% of average total assets (ATA)), after a dip in FY17 (0.87% of ATA), which remains a positive from income diversification perspective. Profitability remains benefitted by low credit cost, which is partly due to low NPA provision cover. However, operating expense of the bank has remained elevated in FY18 (1.73% of ATA vs. 1.69% of ATA in FY17) due to sizeable branches added in those periods and associated costs. This can be expected to moderate going forward. During FY18, SBL reported return on assets (RoA) of 1.79% vs. 1.69% in FY17 while its return on net worth (RoNW) for those periods stood at ~16.5% and ~17% respectively. Going forward, bank's profitability will depend on the bank's ability to maintain its assets quality and bring down the cost of deposits by improving the deposit mix.

[4] Loans up to NPR 40 million towards single borrower group is classified as SME and beyond that corporate loans.

[5] Includes real estate, hire purchase, mining and margin loans.

As on mid-July 2018, SBL's capital to risk assets ratio (CRAR) stood at 12.10%, adequate vis-à-vis regulatory minimum of 11% under prevailing Basel III norm; yet moderate vis-à-vis peers. SBL's CRAR position has improved in past 2-3 years as opposed to earlier practice of maintaining thin capital cushion over regulatory minimum which limited the bank's ability to withstand credit shocks. SBL's tier I capital (10.84% as on mid-July 2018) though moderate among the peers, remains adequate vis-à-vis 8.50% to be maintained by mid-July 2019 under the Basel III norms prescribed by NRB. SBL's current capitalisation ratio is likely to be further strengthened after the capitalization of proposed tier II bond, assuming full subscription. Accordingly, capitalization levels are expected to remain adequate to support SBL's growth plans over next 1-2 years. Adequate profitability level of the bank is also expected to support the capital requirement for future growth.

Analytical approach: For arriving at the ratings, ICRA Nepal has applied its rating methodology as indicated below**:**

Links to applicable criteria:

Corporate Credit Rating Methodology

Bank Rating Methodology

Bank Profile

Siddhartha Bank Limited (SBL), 18th Class A Commercial Bank to be licensed by NRB, started its operation in December 2002. As on mid-April 2018, SBL has market share of about 3.5% in terms of deposit base and total advances in Nepalese banking industry (~4% in the commercial bank industry deposit and advances). As on mid-July 2018, SBL has presence throughout the country through its 118 branches, 3 extension counters and 113 ATMs.

As of mid-July 2018, SBL's shareholding is divided among promoter and public shareholders in the ratio of 51:49. The bank is promoted by individuals and private institutions related to different business house of Nepal, mainly Kedia Group.

SBL reported a profit after tax of NPR 1,858 million[6] in FY18 over an asset base of NPR 118,225 million vis-à-vis profit after tax of NPR 1,386 million in FY17 over an asset base of NPR 89,902 million as of mid-July 2017. As on mid-July 2018, SBL's CRAR was 12.10% (tier I capital of 10.84%) and gross NPA was 1.05%. In technology frontier, SBL is using Flex-Cube banking software for the day to day operations which is linked to a Management Information System. A disaster recovery system (DRS) of the Bank has also been established in Bhairahawa, Rupandehi.

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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)
sailesh@icranepal.com

Relationship Contacts:

Ms. Barsha Shrestha, (Tel No. +977-1-4419910/20)
barsha@icranepal.com

[6] Unaudited as per old provision. As per NFRS compliant financials for mid-July 2018, profit after tax stands at NPR 2,459 million. The difference of NPR 604 million is mainly due to changes in credit provisioning norms and interest recognition norms between the two accounting regimes. As per NRB, the differential amount must be maintained under "Regulatory Reserve" which cannot be distributed or considered for CRAR calculation.

About ICRA Nepal Limited:

ICRA Nepal Limited, the first Credit Rating Agency of Nepal, is a subsidiary of ICRA Limited (ICRA) of India. It was incorporated on November 11, 2011 and granted license by the Securities Board of Nepal (SEBON) on October 3, 2012. ICRA Nepal is supported by ICRA Limited through a Technical Support Services Agreement, which envisages ICRA helping ICRA Nepal in such areas as rating process & methodologies, analytical software, research, training, and technical & analytical skill augmentation.

Our parent company, ICRA Limited was set up in 1991 by leading financial/investment institutions, commercial banks and financial services companies as an independent and professional investment Information and Credit Rating Agency. Today, ICRA and its subsidiaries together form the ICRA Group of Companies. The international Credit Rating Agency Moody's Investors Service is ICRA's largest shareholder with majority stake.

For more information, visit www.icranepal.com

ICRA Nepal Limited,
Sunrise Bizz Park, 6th Floor, Dillibazar, Kathmandu, Nepal.
Phone:+977 1 4419910/20