Siddhartha Bank Limited

ICRA Nepal assigns [ICRANP] IPO Grade 3 to the proposed rights issue (equity shares) of Siddhartha Bank Limited

Facility/Instrument	Issue Size	Grading Action (November 2017)
Rights issue (Equity)	NPR 682.611719 million	[ICRANP] IPO Grade 3 (Assigned)

ICRA Nepal has assigned "[ICRANP] IPO Grade 3", indicating average fundamentals to the proposed rights issue amounting to ~NPR 683 million of Siddhartha Bank Limited (SBL). ICRA Nepal assigns IPO grading on a scale of IPO Grade 1 through IPO Grade 5, with Grade 1 indicating strong fundamentals and Grade 5 indicating poor fundamentals. For the grading categories 2, 3 and 4, the sign of + (plus) appended to the grading symbols indicate their relative position within the grading categories concerned. Thus, the grading of 2+, 3+ and 4+ are one notch higher than 2, 3, and 4, respectively.

SBL is proposing to come out with 10% rights issue of 6,826,117.19 equity shares of face value NPR 100, each to be issued to existing shareholders at par. The issue is being made to comply with the increased paid up capital requirement[1] set by Nepal Rastra Bank (NRB), the banking sector regulator in Nepal.

The average fundamental grading factors in SBL's established track record (since 2002), healthy rate of business growth (aided by merger[2] in FY2016) and healthy profitability level maintained over the years, notwithstanding the seasonal moderation during Q1FY2018. Comfortable capitalization profile, adequate franchise and experienced management team are likely to support the incremental growth prospects of the bank. The grading also factors in low credit concentration risk (12% of total loans on mid-Oct 2017[3] among top 20 borrower groups) which partly comforts the asset quality profile of the bank, notwithstanding the seasonal spike in delinquencies during Q1FY2018. The grading is also comforted by fair non-interest income level, aiding the diversity of earning profile.

However, the grading remains constrained by moderate funding profile of the bank vis-à-vis the industry. The bank fares moderately in terms of current and savings account (CASA) deposit proportion (33% in mid-Oct 2017 vs. industry average of ~43%) and deposit concentration (top 20 depositors accounting for 27% of total deposits as on mid-Oct 2017). Resulting low granularity exposes SBL to liquidity and/or pricing risk, as reflected in >100% increase in the average deposit cost of SBL during past 12-15 months (average cost of deposits increased from ~3.4% in FY2016 to ~7.4% in Q1FY2018). The spike in deposit rates followed the shortage of lendable deposits in the banking system. In the recently introduced "base rate plus" lending rate regime, rising cost of deposits means weak competitive positioning vis-à-vis peers with finer deposit profile/cost. The grading also remains constrained by rise in seasonal delinquency and NPA level during Q1FY2018. SBL has underwritten sizeable credit portfolio during low interest rate regime of FY2013-FY2016. The unseasoned credit books could come under stress in the rising interest rate scenario. The grading is also constrained by uncertain operating environment that the banks in Nepal are currently facing.

SBL has registered healthy credit growth of CAGR 27% during past 5 years ending FY2017 (vs. commercial bank average of 23%), aided by merger with BUDBL in late FY2016 (credit growth of 52% during FY2016). As on mid-October 2017 (Q1FY2018), SBL's credit portfolio of NPR 70 billion comprised mainly of corporate loans[4] (60%), followed by retail loans (30%) and SME loans (10%). The proportion of retail and SME loans have increased after the merger with BUDBL (with relatively stronger retail/SME base). Despite corporate heavy credit portfolio, credit concentration of SBL remains on lower side, which is a positive from assets quality perspective. Over next 12-18 months, incremental credit growth of SBL is likely to be driven by increased geographic coverage and penetration plans of the management through aggressive branch expansion[5]. On the long run, bank's credit growth will depend on its ability to offer finer lending rates, which in turn will depend on its funding profile.

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[1] NPR 8 billion for class A commercial bank.

[2] With Business Universal Development Bank Limited (BUDBL), a national level class B development bank.

[3] Mid-Oct-17 data are unaudited

[4] Loan >30 mn to the corporate group of borrowers

[5] >40 additional branches planned to be set up within FY2018 vs 70 as on July 2017.

Assets quality indicators of SBL has remained fair over the year, with gross NPA level staying below industry average over past 5 years ending FY2017, despite 0+ days delinquency remaining on higher side (gross NPA of 1.15% and 0+ days delinquency of ~9% at FY2017 end). NPA level has witnessed deterioration during Q1FY2018 (gross NPA of 2.01%) along with the delinquency level (13% as on mid-Oct 2017). Major portion of the delinquencies as on mid-Oct 2017 are short term (overdue for <30 days) and are likely to be regularised in later part of the financial year. Nonetheless, rising delinquency and NPA level remains a concern, especially considering the unseasoned credit books of SBL (credit portfolio grew by >80% between FY2015 and FY2017) and hardening interest rates in the banking industry. Due to large proportion of fresh slippages, credit provisioning cover has fallen to ~40% during Q1FY2018 (from ~58% in FY2017), weakening the solvency indicator (net NPA/ net worth) to ~8% in mid-Oct 2017 (~3% in mid-July 2017[6]). Low credit provision on NPA also remains a concern to incremental profitability profile of the bank.

In terms of deposit profile, SBL continues to fare weaker to the industry average. As on mid-Oct 2017, SBL's deposit base of NPR 77 billion comprised of 33% CASA (lower than industry average of 43%), increasing from 29% in mid-July 2017. At the same time, deposit concentration among top accounts remains on higher side. During past 6-12 months, Nepalese banking industry has witnessed shortage of lendable deposits pushing up the cost of deposits. Low granularity and reliance on price sensitive corporate deposits has resulted in >100% increase average cost of deposits of SBL between FY2016 and Q1FY2018. 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 SBL'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. During past 3 years ending FY2017, the rate of credit growth has outpaced the rate of deposit growth pushing up the CCD ratio (~79% as on mid-Oct 2017 vis-à-vis regulatory ceiling of 80%).

As for profitability, SBL's return on net worth (RoNW) has remained above-industry-average in past 4-5 years; partly aided by relatively small equity capital base and higher leverage vis-à-vis industry peers. Over next 12-18 months, RoNW is likely to remain diluted due to sizeable equity injection made into the company. Because of rising cost of deposits and increase in delinquency levels during Q1FY2018, SBL's NIMs moderated from 3.43% in FY2016 to 3.17% in FY2017 and further to 2.30% in Q1FY2018. Triggered by sharp decline in NIMs, return indicators of SBL has moderated (RoNW of ~8% in Q1FY2018 vs ~18% in FY2017 and 25% in FY2016). Moderation in NIMs, despite optimum CCD ratio of ~79% as on mid-Oct 2017, remains a concern to incremental profitability profile of the bank. Nonetheless, the profitability indicators remain supported by fair non-interest income level, declining operating expense ratio and relatively low credit cost. The incremental profitability is likely to be determined by the bank's ability to boost the net interest margins (NIMs), explore non-interest sources of income and maintain good assets quality.

SBL has maintained thin capital cushion over the regulatory minimum (11% for class A banks under prevailing Basel III norms) in the past. SBL's capitalisation level improved after the capitalisation of 30% rights issue in FY2017. It is likely to be further strengthened after the proposed rights issue. As on mid-Oct 2017, SBL's CRAR stood at ~13%, comfortable vis-à-vis regulatory minimum of 11% (under Basel III norms). SBL's tier I capital of ~11% also remains well above 8% (to be maintained by mid-July 2018 and 8.50% by mid-July 2019). Comfortable capitalisation profile of SBL is likely to support the incremental growth plans of the management. However, given the pressure on NIMs, ability of the bank to maintain return on increased capital remains a challenge. With the bank resorting to capital retention as well as sizeable injection of fresh equity in recent years, gearing level of SBL has declined from ~11 times on mid-July 2016 to ~7 times on mid-Oct 2017.

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-Oct 2017, SBL has market share of about 3.2% in terms of deposit base and 3.4% of total advances in Nepalese banking industry (3.7% and 3.9% in the commercial bank industry respectively). SBL has presence throughout the country through its 70 branches, 2 Extension Counters, 70 branchless banking counters and 84 ATMs.

[6] Mid-Jul-17 data are unaudited

Shareholding pattern of the Bank constitutes of the promoters holding 51% of the shares while 49% is floated for the public. Out of the total shareholding, 6% stake is held by institutional promoters and 45% by individual promoters. SBL reported a profit after tax of NPR 1,418 million in FY17 over an asset base of NPR 92,808 million as on mid-July 2017 as compared to a net profit of NPR 1,254 million over asset base of NPR 74,402 million during FY16. During Q1FY18, SBL has reported PAT of 216 million over asset base of NPR 95,885 million as on mid-Oct 2017. As on mid-Oct 2017, SBL's CRAR was 12.69% (tier I capital of 10.99%) and gross NPLs was 2.01%. 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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