

## NIC Asia Bank Limited

### ICRA Nepal reaffirms [ICRANP] LA-@<sup>1</sup> rating to the existing subordinated bonds of NIC Asia Bank Limited

Facility/Instrument	Amount	Rating Action (April 2016)
Subordinated Bond Program	NPR 500 Million	[ICRANP] LA-/ rating under watch with negative implications (Reaffirmed)

ICRA Nepal has reaffirmed the rating of **[ICRANP] LA-@** (pronounced ICRA NP L A minus @) to the subordinated bonds of NPR 500 million of NIC Asia Bank Limited (NICA). The rating continues to be under watch with negative Implications. 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 under watch with developing implication for NICA takes into account pressure on bank's asset quality as demonstrated by build-up in delinquencies (0+ days ~13.3% incl. NPLs, as on mid Jan-16) and stock of restructured loans (0.91%) on account of damage suffered by April 2015 earthquake/elongated political turmoil impacting the overall economy and repayment capacity of the borrowers. Although the bank reported fair asset quality (gross NPL of 1.4% as on mid Jan-16), the same was supported by regulatory forbearance. Higher delinquencies could impact NICA's asset quality indicators going forward, and also impact the bank's financial profile. Bank's ability to manage its asset quality and recover from delinquent/ restructured accounts would remain a key rating sensitivity and any significant deterioration in the asset quality could lead to a downward pressure on the assigned rating.

The rating reaffirmation factors in NICA's established track record (operating since 1998) and adequate franchise<sup>2</sup> leading to good market positioning (market share ~4% of Nepalese commercial banking industry as on mid-Jan-16). The rating also takes into consideration bank's experienced management team, comfortable capitalisation levels (CRAR of ~12.4% as on mid-Jan 16<sup>3</sup>) and moderate growth over the years (CAGR<sup>4</sup> of ~13% over last five years vs. ~19% for industry), though scaled up in FY15 (~16%) with plans of pursuing higher growth over the medium term. ICRA Nepal also takes note of the management's efforts to strengthen the internal risk management processes and further increase the proportion of retail and SME loan (increased to ~57% as of mid-Jan-16 vs. ~46% on mid-Jul-13).

The rating is however constrained by bank's inferior deposits profile (CASA<sup>5</sup> deposits of ~33% vs. ~50% for industry) leading to high cost of funds among peers (4.35% as of mid-Jan-16), high concentration risks (top 20 depositors comprised ~40% of deposits as on mid-Jan-16) and absence of institutional promoters. NICA's profitability profile also remains moderate (PAT/ATA<sup>6</sup> of 1.57% and return on net worth of ~17% for H1FY16; and has been supported by lower credit provisions (due to relaxations provided by NRB) and significant write back provision and one time income on recovery from NPLs. Although the event related stress on the borrowers is expected to be limited with the strikes lifted recently, the bank's asset quality could remain under pressure, going forward. Further, the rating continues to factor in the unstable political conditions and uncertain operating environment that banks in Nepal are currently facing.

NICA's branches in the earthquake affected areas accounted for ~60% of the credit portfolio as of mid-Jan-16, however several of these businesses (end users of loans) are situated outside the earthquake affected areas. Despite the stress in the economy due to earthquake and elongated political turmoil, NICA reported decline in gross NPLs<sup>7</sup> from 2.14% as on mid Apr-15 to 1.40% as on mid Jan-16. This was on account of large NPL recovery during Q2FY16 and also benefitted by regulatory relaxation<sup>8</sup> in NPL

@Rating under watch with negative implications

<sup>1</sup> Rating under watch with negative implications

<sup>2</sup> 66 branches, one extension counter and 68 ATMs

<sup>3</sup> Mid Jan-16 data are unaudited

<sup>4</sup> Compounded Annual Growth Rate

<sup>5</sup> Current and Savings Accounts

<sup>6</sup> Profit After Taxes as a % of Average Total Assets

<sup>7</sup> Non-Performing Loans

<sup>8</sup> 0.91% loan were restructured and 0.59% loan overdue more than 3 months are not recognized as NPA utilizing relaxation provided by NRB

recognition norms. Disregarding the forbearance on NPL recognition, gross NPLs would have been 2.90% as of mid-Jan-16. However, the pressure on asset quality was evident with delinquencies increasing to 11.9% as on mid Jan-16 from 9.3% as on mid Jan-14 (both excluding NPLs). The scheduled loans continue to face higher delinquencies (~17%) compared to revolving loans (~12%), further aggravating asset quality related risks. Further, NICA has sizeable exposure (~27%) towards sectors<sup>9</sup> which could witness higher volatility on projects/earnings due to aftereffects of earthquake and elongated political strike could impact the asset quality indicators going forward and hence the bank's performance.

NICA's portfolio stood at NPR 47,317 million as on mid Jan-16 growing at ~16% during FY15 and ~9% during H1FY16 (CAGR of ~13% over past 5 years ending mid Jul-15 vs. industry average growth of ~19%). Going forward, the credit demand is expected to remain healthy owing to expected pickup in economic activity to support the reconstruction especially after the recent resolution of elongated turmoil and lifting of the economic blockade from major custom points. NICA's portfolio mix primarily comprises large corporate loans (~43%) followed by retail loans (~42%) and SME loans (~15%). Credit portfolio however remains concentrated with top 20 borrower groups accounting for ~21% of portfolio as on mid-Jan-16. Going forward, the management intends to grow at a higher pace (CAGR of ~28% during FY16-FY20) in line with their five year strategic plan to ensure efficient utilisation of large capital to be raised by FY17 (as required by revised regulations). The management intends to increase the share of retail and SME loans to 70% by mid July 2020 (57% as on mid Jan-16) to improve portfolio granularity. The bank is also taking steps to improve its risk management systems and limit the exposure to various sectors (eg. LAS), setting up early warning signals for sectors under stress (fresh disbursements have been stopped in certain areas like commercial vehicle financing). Bank's ability to successfully implement the strategy while strengthening its controls, systems and processes commensurate with the growth targets would have a strong bearing over its business profile going forward.

NICA's fresh NPL generation witnessed decline in recent periods, primarily benefited by temporary regulatory relaxation (0.82% in FY15 compared to ~1.6% on an average for FY12 to FY14) and moderate recovery (~30%). This coupled with large NPL recovery during Q2FY16, resulted in improvement of reported NPLs (1.40% as of mid-Jan-16 vs. 2.33% as of mid-Jul-14), and better than industry average NPLs of 2.37%. Disregarding the regulatory relaxations, NPLs would have been 2.90% as of mid-Jan-16. Going forward, ICRA Nepal expects NICA's asset quality to remain under pressure in the near term due to damages caused by earthquake and elongated strikes, impacting borrowers' ability to make repayments in a timely manner. However, bank's comfortable solvency position (Net NPA/Net worth of 2.01% on mid-Jan-16 compared to 5.20% on mid-Jul-14), which will be further strengthened after capitalisation of the proposed rights issue (assuming subscription) provides some comfort. The bank's ability to improve its recovery profile in light of its exposure to sectors/segments impacted by earthquake/strikes and moderation in overall economic activity remains to be seen.

NICA's deposit profile remains weak and also inferior to industry as reflected by low portion CASA, which stood at ~33% (industry average of ~50% on Jan-16) as on Jan-16, notwithstanding some improvement from ~28% on mid Jul-13.. This has resulted in higher cost of funds for the bank at 4.35% for H1FY16 compared to peers and industry average cost of funds at 3.27%. Furthermore, deposit concentration on top 20 depositors also remains high at ~40% as of mid-Jan-16. Going forward, NICA's ability to improve its deposit profile and hence lower deposit costs and improve NIMs would have strong bearing on its financial profile.

As for profitability, NICA's earnings profile in recent periods have been impacted mainly due to declining NIMs<sup>10</sup> (3.68% for FY14, 2.83% for FY15 and 2.64% for H1FY16), which remains weaker among peers. Return indicators declined during FY15 with RoNW and RoA<sup>11</sup> at ~12% and 1.21% respectively compared to ~17% and 1.70% for FY14. Although the profitability indicators witnessed some improvement during H1FY16 (RoNW and RoA of ~17% and 1.57% respectively), the same was supported by lower provisioning (relaxations provided by NRB on watch-list and select NPL accounts) along with significant write back of provisions and one time income on NPL recovery (these contributed to

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<sup>9</sup> Tourism, microfinance, real estate, consumption (incl. hire purchase and loan against shares) and hydropower sectors

<sup>10</sup> Net Interest Margins as a % of Average Total Assets

<sup>11</sup> Return on Net Worth and Return on Assets

~35% of reported profit for the period). Lower non-interest income (0.87% of ATA during H1FY16) further acts as a drag on profitability despite moderate operating expense ratio (1.65% of ATA during H1FY16). 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.

NICA's capitalisation levels are adequate with CRAR of 12.44% and tier I capital of 10.49% as of mid-Jan-2016 (both under Basel III) against minimum regulatory requirement of 10% and 6% respectively (increasing to 11% and 7.25% respectively incl. capital conservation buffer under Basel III from mid Jul-16). Considering the proposed rights issue and expectations of moderate internal accruals, capitalization levels are expected to remain adequate to meet the regulatory minimum and support NICA's growth plans over the medium term. Post the proposed issue (assuming full subscription), NICA's paid-up capital would increase to NPR 4.62 bn and the bank has plans for further rights and bonus issue to attain the capital of NPR 8 bn by FY17 as required by Monetary Policy of FY15/16. The banks' ability to raise planned capital in a timely manner would also have critical bearing on its ability to absorb damages arising out of earthquake/strikes and maintain comfortable solvency profile.

### **Bank Profile**

NICA is one of the large private sector commercial bank of Nepal. Incorporated in 1998 by some of the prominent businessmen/industrialists of the country, the bank operated 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 30<sup>th</sup> June 2013. Share capital of the bank is distributed among promoter & public in the ratio of 51:49. The bank's equity shares are listed on the Nepal stock exchange. The bank is managed by a team of experienced bankers and professionals. Mr. Laxman Risal is the Acting Chief Executive Officer of the bank.

NICA's 66 branches, one extension counter and 68 ATMs provides it with presence throughout the country. NICA has market share of 3.76% in terms of deposit base and 4.02% of loan & advances in commercial banking industry of Nepal as on mid-Jan-16. NICA reported a profit after tax of NPR 680 million during 2014-15 over an asset base of NPR 60,519 million as of mid-Jul-15 against profit after tax of NPR 832 million during 2013-14 over an asset base of NPR 51,501 million as of mid-Jul-14. During H1FY16, NICA reported PAT of NPR 502 million over an assets base of NPR 67,699 million. As of mid-Jan-2016, NICA's CRAR was 12.44% and gross NPLs were 1.40%. In terms of technology platform, NICA has implemented Finacle across all of its branches.

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