Siddhartha Bank Limited

ICRA Nepal upgrades issuer rating of Siddhartha Bank Limited to [ICRANP-IR] BBB+ and subordinated debenture rating of the bank to [ICRANP] LBBB+; removed from "rating watch with negative implications"

Facility/Instrument	Amount	Rating Action* (July 2017)
Issuer Rating	NA	[ICRANP] IR BBB+ rating (upgraded)
Subordinated Debenture Program	NPR 500 Million	[ICRANP] LBBB+ rating (upgraded)

ICRA Nepal has upgraded Siddhartha Bank Limited's (SBL) Issuer rating from **[ICRANP-IR] BBB** (pronounced ICRA NP Issuer Rating Triple B) to **[ICRANP-IR] BBB+** (pronounced ICRA NP Issuer Rating triple B plus). Issuer rating BBB+ is one notch higher than BBB. [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. The rating has been removed from "rating watch with negative implications".

ICRA Nepal has also upgraded the rating of subordinated Debenture of NPR 500 million of SBL from **[ICRANP] LBBB** (pronounced ICRA NP L Triple B) to **[ICRANP] LBBB+** (pronounced ICRA NP L Triple B plus). 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. The rating has been removed from "rating watch with negative implications".

Ratings for SBL were put on watch with negative implications in April 2015, pending assessment of the impact due to the earthquake in Nepal on bank's credit and financial profile. The rating was continued under watch amid assets quality concerns emanating from custom blockade in subsequent months. While removing the rating from watch with negative implication and upgrading the ratings for SBL, ICRA Nepal takes into consideration improvement in core capital, scale up of operations because of organic and inorganic growth[1] in recent years supported by improvement in franchise and reach, SBL's ability to manage its assets quality (notwithstanding some deterioration during past 6-9 months) and good profitability indicators in recent years.

The rating action factors in the improvement in SBL's market positioning because of recent growth in scale of operations. Following past 2-3 years of organic and inorganic growth, SBL is now among the large players in the industry with ~4% share in Nepalese commercial bank's credit base as on mid-April 2017. SBL's footprint across the country has also increased because of new branches set up by the bank as well as branches added through merger. Growth in customer base has eased the credit concentration among top borrowers (top 20 borrower groups accounted for ~12% of total loans of SBL as on mid-April 2017). Improved market positioning coupled with SBL's established track record (operating since 2002) and experienced management team is likely to have positive impact on the prospects of the bank.

The ratings are however constrained by SBL's inferior deposits profile (CASA[2] deposits of ~28% as on mid-April 2017 vs. ~43% for commercial bank industry). This has led to high cost of deposits among peers (4.98% as of mid-April 2017), weakening its competitive positioning to some extent. At the same time, concentration of deposits among top accounts also remains on higher side (top 20 depositors comprised ~31% of deposits as on mid-April 2017). SBL has underwritten sizeable credit portfolio during low interest rate regime of FY13-FY16. The unseasoned credit books could come under stress given recent rise in banking interest rates. Risks also emanate from the merger with class B development bank with relatively moderate underwriting norms vis-à-vis commercial banks. SBL also faces integration

[1] SBL acquired Business Universal Development Bank (BUDBL), a national level class B bank in FY16.
[2] Current and Savings Accounts

challenges post-merger before business synergy can be achieved. The rating is also constrained by uncertain operating environment that the banks in Nepal are currently facing.

SBL's credit portfolio has grown at a healthy pace of CAGR ~38% during FY14-9MFY17, albeit on a low base. SBL reported healthy organic credit growth during this period which was further accentuated by inorganic growth through merger with Business Universal Development Bank Limited (BUDBL). Merger concluded in late FY16 helped SBL register a credit growth of 52% during FY16. Apart from aiding in business growth, merger with BUDBL also increased SBL's footprint across the country which is likely to support incremental credit growth. As on mid-Jan 2017, SBL's credit portfolio primarily comprised of Corporate loans (59%), Retail Loans (31%) and SME loans (10%)[3]. SBL's corporate portfolio has moderated in recent years to the benefit of SME and retail segment. Going forward, the management intends to leverage the strength of increased footprints to achieve future credit growth along retail/SME segment. Incremental credit growth is likely to remain supported by SBL's equity injection plan to meet revised paid up capital. However, the bank's ability to achieve the growth targets along with commensurate control measures remains to be seen.

SBL's percentage of gross Non-performing Loan (NPL) has moderated during FY14-16, on account of sharp rise in credit portfolio. There has been marginal deterioration in NPL level during 9MFY17 (amid adverse interest rate scenario and post-merger with class B development bank) which remains a concern. As on mid-April 2017, SBL's gross NPL stood at 1.70%, marginally higher than commercial bank average of 1.67%. The bank also has sizeable exposure (~25% of mid-April 2017 credit portfolio) towards relatively vulnerable sectors[4]. Recent increase in delinquency levels, adverse interest rate scenario and impact of uncertain political condition in the business environment could lead to fresh slippages and NPLs over near term. Provision cover of SBL remains moderate (~55% as on mid-April 2017) which exposes the incremental profitability of SBL to further stress on assets quality.

SBL's CASA deposit proportion grew from ~34% to ~37% during FY14-16. Improvement in CASA mix was supported by merger with class B development bank with better savings deposit proportion. However, SBL's CASA proportion has softened during 9MFY17 like most of the industry peers as the banks are focussing on term deposits to counter the deposit crunch situation and stabilize the funding profile. Slower growth of deposits (CAGR 31% during FY14-9MFY17) vis-à-vis credit growth has pushed the CD ratio of SBL very close to regulatory ceiling. Incremental credit growth is likely to remain driven by the bank's ability to raise incremental deposits. At the same time, preventing deposit flight amid tight liquidity scenario and relatively higher deposit concentration among top deposit account remains a challenge for liquidity of SBL. Moreover, due to inferior CASA proportion, SBL's cost of deposits remains higher than commercial banks' average, affecting the competitive positioning of the bank to some extent.

As for profitability, SBL's return on net worth (22-25%) has remained better than commercial bank average during FY14-16, primarily because of small capital base. Healthy profitability during the period was supported by fair Net Interest Margin (NIMs) (~3.50% of average total assets (ATA)) and growth in scale of operation. NIMs was supported by improvement in rate of credit mobilisation (CCD[5] ratio improving from ~73% to ~79%). Profitability during the period was also supported by fair non-interest income (~1.22%), moderation in operating expense ratio with growth in scale and low credit provision expense ratio (~0.23%). SBL's return on net worth is likely to remain diluted considering the equity raising plans of the bank[6] and challenges in credit growth arising from current deposit crunch. 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.

SBL has operated with thin capital cushion over regulatory minimum over past years which limits the bank's ability to withstand probable credit shocks. As on mid-April 2017, SBL's capital to risk assets ratio (CRAR) stood at 11.60%, adequate vis-à-vis regulatory minimum of 11% under prevailing Basel III norm;

[3] As per bank's internal classification; loans up to NPR 30 million towards single borrower group is classified as SME and beyond that corporate loans.

[4] Includes real estate loans, Hire purchase loans (mostly commercial) and margin lending.

[5] Credit to deposit ratio adjusted for capital (networth)

[6] 30% rights under progress and SBL has proposed another 10% rights after that. ~NPR 2.25 billion equity will be raised.

yet moderate vis-à-vis peers. SBL's tier I capital (9.54% as on mid-April 2017) though moderate among the peers, remains adequate vis-à-vis 7.50% to be maintained by mid-July 2017 and 8.50% (both including capital conservation buffer) to be maintained by mid-July 2019 under the Basel III norms prescribed by NRB. SBL's current capitalisation ratio will be further strengthened after the equity injection to increase paid-up capital to NPR 8 billion (vs. NPR 5.25 billion as of mid-April 2017). Accordingly, capitalization levels are expected to remain adequate to support SBL's growth plans over the medium term. The banks' ability to raise planned capital in a timely manner would have a bearing on its ability to meet the revised guidelines and support growth plans.

Bank Profile

Siddhartha Bank Limited (SBL), 18th Class A Commercial Bank to be licensed by NRB, started its operation in December 2002. Shareholding pattern of the Bank constitutes of the promoters holding 51% of the shares while 49% is floated for the public.

SBL acquired Business Universal Development Bank Limited (BUDBL) in FY16 and started combined operation from 5th July 2016. The merger was a step towards raising paid up capital of SBL to the required minimum threshold of NPR 8 billion. BUDBL was a national level class B bank in operation since May 2005 and was operating with 14 branches at the time of merger with SBL. At the end of Q3FY16 (immediately preceding quarter end before merger), BUDBL accounted for ~30% of SBL's networth and ~14% of SBL's assets base.

SBL has presence throughout the country through its 70 branches, 2 Extension Counters, 70 branchless banking counters and 84 ATMs as on mid-April 2017. SBL has market share of about ~3.3% in terms of deposit base and ~3.5% of total advances in Nepal Banking Industry as on Mid-Apr-17. SBL reported a profit after tax of ~NPR 1,255 million during 2015-16 over an asset base of ~NPR 74,403 million as on Mid-Jul-16 against profit after tax of ~NPR 767 million during 2014-15 over an asset base of NPR 50,647 million as on Mid-Jul-15. During 9M 2016-17, SBL reported profit after tax of ~NPR 957 million over an asset base of ~NPR 87,494 million as on Mid-Apr-17. As of mid-Apr-2017, SBL's CRAR was 11.60% and gross NPLs were 1.71%. In the 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 Bhairawa, Rupendhai.

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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:
Mr. Deepak Raj Kafle, (Tel. No. +977-1-4419910/20)
drkafle@icranepal.com