Prime Commercial Bank Limited

ICRA Nepal assigns [ICRANP] IPO Grade 3 to the proposed Equity Shares (Rights Issue) of Prime Commercial Bank Limited

Facility/Instrument	Issue Size	Grading Action (July 2016)
Rights Share Issue	NPR 1,235.0874 Million	[ICRANP] IPO Grade 3 (Assigned)

ICRA Nepal has assigned an "[ICRANP] IPO Grade 3", indicating average fundamentals to the proposed rights issue amounting to NPR 1,235.0874 million of Prime Commercial Bank Limited (hereinafter referred to as PCBL). 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. PCBL is proposing to come out with 3:1 rights issue of 12,350,874 numbers of equity shares of face value NPR 100/- each to be issued to the existing shareholders at par. The proposed issue is to augment the capital base and partly meet the revised (higher) paid up capital requirement set by Nepal Rastra Bank (NRB), the banking sector regulator.

The grading takes into account PCBL's healthy business growth (CAGR[1] of ~19% over last five years, comparable to industry growth) with focus on project financing and collateral backed lending. Adequate capitalisation levels (CRAR[2] of ~12.2% as on mid-Apr-16[3]), diversified franchise[4] and experienced management team are expected to provide PCBL with adequate growth opportunities going forward. The grading also factors in PCBL's healthy profitability profile (RoNW and RoA[5] of ~20% and 1.93% for 9MFY16) supported by healthy NIMs[6] (3.04% as of mid-Apr-16), and low operating expenses (1.08% of ATA as of mid-Apr-16).

The grading is however constrained by the bank's moderate track record (operating since 2007), inferior deposits profile with low proportion of stable and low cost deposits (CASA[7] deposits of ~19% vs. ~50% for industry) resulting in high cost of funds among peers (4.40% as of mid-Apr-16), high customer concentration risks (top 20 customers comprised ~27% of credit book and ~34% of deposits as on mid-Apr-16), limitation of MIS to generate adequate data for top level management and weaker borrower profile for the bank. Although the bank has reported fair asset quality (Gross NPLs ~1.6% as on mid-Apr-16), ICRA Nepal notes the build-up in bank's delinquencies[8] over the last few months especially with 2.19% of loans overdue for more than 30 days but less than 90 days as of mid-Apr-16. Bank's sizeable exposure (~31%[9]) towards sectors 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. Stress in the borrower profile was also reflected through rescheduling some borrower accounts with ~7[10]% loan exposure as on mid-Apr-16. However, with the end of custom blockade, event related stress on the accounts going forward is expected to be limited. The grading also remains constrained by absence of institutional promoters, unstable political conditions and uncertain operating environment that banks in Nepal are currently facing. Going forward, PCBL's ability to scale up its operations ensuring efficient utilization of fresh capital, improve its deposit profile, maintain its profitability profile and manage the asset quality would have a bearing on the overall financial profile.

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[1] Compounded Annual Growth Rate
[2] Capital to Risk-weighted Assets Ratio
[3] Mid-Apr-16 data are unaudited
[4] 30 branches, two extension counters and 25 ATMs spread across the country
[5] Return on Net Worth and Return on Assets
[6] Net Interest Margins as a % of Average Total Assets
[7] Current and Savings Accounts
[8] Delinquent accounts (0+ days) of 15.29% as on mid-Jul-15 vs. 17.55% as on mid-Jan-16 and 22.03% as on mid-Apr-16
[9] Real estate, tourism, microfinance, consumption (incl. hire purchase and loan against shares) and hydropower sectors
[10] Total exposure of the borrower availing rescheduling facility

PCBL's portfolio stood at NPR 37,902 million as on mid-Apr-16 growing at ~20% during FY15 and ~17%(annualised) during 9MFY16 (CAGR of ~19% 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 resolution of elongated turmoil and lifting of the economic blockade from major custom points. PCBL's portfolio mix primarily comprises large corporate loans (~61%) followed by retail loans (~36%) and SME loans[11] (~3%). Credit portfolio however remains concentrated with top 20 borrower groups accounting for ~27% of portfolio as on mid-Apr-16 with high proportion of real estate loans at ~12%. Going forward also, the management intends to maintain similar pace of growth (CAGR of ~20% during FY16-FY18) to ensure efficient utilisation of large capital to be raised by FY17 (as required by revised regulations). Bank's ability to achieve the targeted growth while strengthening its controls, systems and processes commensurate to the growth targets would have a strong bearing over its future financial profile.

Bank's reported NPLs have improved over last few periods (2.43% as on mid-Jul-14 to 1.59% as of mid-Apr-16) on account of lower NPL generation (1.18% in FY15 compared to ~2.2% on an average for FY13 to FY15) and moderate recovery (~40%). Though the reported NPLs remain better than industry average NPLs of 2.22%, the pressure on asset quality was evident with 0+ delinquencies increasing to 22.03% as on mid-Apr-16 from 15.29% as on mid-Jul-15 (both including NPLs). For PCBL the revolving loans face higher delinquencies (~24%) compared to scheduled loans (~17%), further aggravating asset quality related risks. Bank had also rescheduled 14 accounts (total exposure of these accounts was ~7% of portfolio as of mid-Apr-16) under NRB's relaxed norms supporting the asset quality. Further, PCBL has sizeable exposure (~31%) towards sectors[12] which could witness higher volatility on projects/earnings due to aftereffects of earthquake and elongated political strike. ICRA Nepal expects PCBL's asset quality to remain under stress 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 3.01% on mid-Apr-16 compared to 5.94% 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.

PCBL's deposit profile remains weak and also inferior to industry as reflected by low portion of CASA, which stood at ~19% on mid-Apr-16 (vs. industry average of ~50%). This has resulted in higher cost of funds for PCBL at 4.40% for 9MFY16 compared to peers and industry average cost of funds at 3.06%. Furthermore, deposit concentration amongst top 20 depositors also remains high at ~34% as of mid-Apr-16. Going forward, PCBL's ability to improve its deposit profile, lower deposit costs and hence improve NIMs would have strong bearing in its financial profile.

PCBL reported CRAR of 12.19% and tier I capital of 11.33% as of mid-Apr-2016 which remains comfortable compared to minimum regulatory requirement of 10% and 6% respectively (increasing to 11% and 7.25% respectively incl. capital conservation buffer under Basel IIII from mid-Jul-16). Considering the proposed rights issue and expectations of adequate internal accruals, capitalization levels are expected to remain comfortable and comply with regulatory minimum as well as support PCBL's growth plans over the medium term. Post the proposed issue (assuming full subscription), PCBL's paid-up capital would increase to NPR 4.94 bn compared to NPR 8 bn to be met by FY17 as required by Monetary Policy of FY15/16. PCBL has also signed MOU for acquisition with Biratlaxmi Development Bank and Country Development Bank, both regional Class B development banks to raise its capital base to minimum regulatory requirement. Though the proposed acquisitions would support PCBL in terms of capital and franchise, integration of the financials could result in some stress on the asset quality front and hence profitability profile as well. However, scale of these banks being much smaller which provides some comfort.

PCBL reported healthy NIMs (3.0%-3.5% for FY14-9MFY16), despite higher cost of funds on the back of higher yields on advances generated through lending to riskier asset classes (real estate and loan against

[11] As per NRB norms for classifying as SME Loans

[12] Tourism, microfinance, real estate, consumption (incl. hire purchase and loan against shares) and hydropower sectors

share around 18%,), and weaker borrower profile as compared to large commercial banks. Return indicators improved during FY15 with RoNW and RoA at ~19% and 1.78% respectively compared to ~17% and 1.57% for FY14. These indicators witnessed further improvement during 9MFY16 (RoNW and RoA of ~20% and 1.93% respectively), supported to an extent by improvement in NPL levels. The resultant decline in credit costs (0.91% of ATA for FY13 to 0.41% for FY15; further declined to 0.09% for 9MFY16) and lower operating expense ratio (1.08% of ATA during 9MFY16) further support the profitability while lower non-interest income (0.89% of ATA during 9MFY16) acts as a drag on profitability. PCBL also plans to acquire weaker development banks over the next two years to meet the higher capital requirements under the revised NRB norms, and hence the bank's asset quality and profitability profile could be impacted. 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.

Bank Profile

Incorporated in 2007 by a group of businessmen/industrialists, Prime Commercial Bank Limited (PCBL) is one of the mid-sized private sector commercial bank of Nepal. Current shareholding pattern of the bank constitutes of promoters holding 51% while 49% shares are held by the general public. 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. Narayan Das Manandhar is the Chief Executive Officer of the bank.

PCBL's 30 branches, two extension counters and 25 ATMs provides it with presence throughout the country. PCBL has market share of 2.83% in terms of deposit base and 2.97% of total advances of commercial bank industry of Nepal as on mid-Apr-16. PCBL reported a profit after tax of NPR 746 million during 2014-15 over an asset base of NPR 45,801 million as on mid-Jul-15 against profit after tax of NPR 554 million during 2013-14 over an asset base of NPR 38,031 million as on mid-Jul-14. During 9MFY16, PCBL reported PAT of NPR 710 million over an assets base of NPR 52,031 million. As of mid-Apr-2016, PCBL's CRAR was 12.19% and gross NPLs were 1.59%. In terms of technology platform, PCBL has implemented Pumori across all of its branches.

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