Nepal Investment Bank Limited: [ICRANP] LA assigned to proposed subordinated debentures; [ICRANP-IR] A and [ICRANP] LA reaffirmed

July 13, 2020

Summary of rated facilities/instruments

Facility/Instrument	Rated Amount	Rating Action
Issuer Rating	NA	[ICRANP-IR] A; reaffirmed
Existing Subordinated Debentures*	NPR 2,750 million	[ICRANP] LA; reaffirmed
Proposed Subordinated Debentures*	NPR 4,000 million	[ICRANP] LA; assigned

** Instrument details are attached as Annexure-1.*

Rating action

ICRA Nepal has assigned the rating of **[ICRANP] LA** (pronounced ICRA NP L A) to the proposed subordinated debentures of Nepal Investment Bank Limited (NIBL) and also reaffirmed the rating of **[ICRANP] LA** to NIBL's existing subordinated debentures. Instruments with this rating are considered to have an adequate degree of safety regarding the timely servicing of financial obligations. Such instruments carry low credit risk.

ICRA Nepal has also reaffirmed the issuer rating of **[ICRANP-IR] A** (pronounced ICRA NP issuer rating A) to NIBL, indicating adequate credit quality. The rated entity carries low credit risk. The rating is only an opinion on the general creditworthiness of the rated entity and not specific to any particular debt instrument.

Rationale

The rating actions factor in NIBL's strong market position as one of the largest private sector commercial banks with a share of ~5% in industry credit and deposits. The bank's established track record (operating since 1986) and its controlled/cautious credit growth strategy in the last few years also support the rating. NIBL's diversified network along with its experienced directors/management team and adequate capitalisation remain positives for controlled growth, going forward. The ratings also take into consideration the bank's healthy fee-based income and lean operating cost structure, which support its adequate earnings profile among peers. ICRA Nepal also takes note of the bank's competitive cost of funds among the top-tier banks. This has aided it in maintaining adequate margins, while keeping lending yields at relatively lower levels, thus enabling the bank to operate in the less risky borrower segments. Further, the ratings remain supported by the presence of institutional promoters, mainly Rastriya Beema Company Limited, a state-owned insurance company, which has a stake of ~12% along with representation on the bank's board.

However, the ratings remain constrained by the increased pressure on the bank's asset quality in the recent periods with non-performing loans (NPLs) sharply increasing to 2.67% as of mid-April 2020 against 1.35% as of mid-July 2018. The short-to-medium term asset quality outlook for the banking sector is expected to remain under stress amid the potential economic impact of the Covid-19 pandemic. This is also evident from the spike in NIBL's delinquencies (30+ days) to ~7.0% as of mid-April 2020 from ~4.4% as of mid-July 2019. Rating concerns along the asset quality are further accentuated by the bank's high reliance on the top borrowers (~35% among the top 20 group as of mid-April 2020). The Central Bank's stance in supporting the pandemic-impacted borrower segments would have a major bearing over the banking sector's asset quality profile. Hence, the upcoming policy announcements remain a key monitorable in this regard. The bank's ability to maintain comfortable asset quality indicators, reduce concentration risks, and further improve the mix/cost of deposits would remain a key rating driver. Also, the bank's stance in attaining sustainable portfolio growth while maintaining adequate profitability amid the regulatory changes would remain a key monitorable.

Key rating drivers

Strengths

Long track record and experienced board/management support growth outlook – NIBL is one of the oldest private sector commercial banks of Nepal that has been in operation since 1986. Over these years, the bank has established itself as one of the largest players in the industry. As of mid-April 2020, NIBL had 82 branches spread across the country. The bank's diverse franchise, long track record and experienced board/management profile remain positives for controlled growth going forward.

Adequate capitalisation – The bank's capitalisation remains adequate with a tier-I CRAR (Capital to risk-weighted assets ratio) of 10.85% as of mid-April 2020 (industry average of 11.23%), albeit lower than 11.58% as of mid-July 2018. However, aided by the tier-II debentures issuance in the last fiscal, the bank's overall CRAR remained largely similar at ~12.6% against the minimum regulatory requirement of 11% as per the prevailing Basel III norms implemented by the Nepal Rastra Bank (NRB; the regulator). This, along with the proposed tier-II debenture issue plans, would strengthen the bank's ability to withstand the shocks arising from the credit risk to an extent, and would also provide the requisite support for its credit growth plans. Despite the increase in NPLs, the bank's solvency profile (net NPA/net worth) remains moderate at ~2.7% as of mid-April 2020.

Controlled growth approach in recent years – Over the last two fiscals, the bank has grown its portfolio at a CAGR of ~11% against ~20% growth in the industry. The controlled pace of growth continued in 9M FY2020 with ~14% growth compared to ~19% growth in the industry. While NIBL's credit portfolio remains concentrated to corporate borrowers at present (~83%), the bank's plans to grow more along the retail/SME segment augurs well for incremental portfolio diversification.

Fair funding profile among top-tier banks – NIBL's deposit mix is moderate among top-tier peers with low-cost current and savings (CASA) deposits of ~39% against ~41% for the industry as of mid-April 2020. However, the cost of deposits remains competitive (~5.9% for 9M FY2020 against the industry average of ~6.3%) on account of relatively lower interest rates offered. In the current regime of the base rate plus lending model, the bank can offer competitive rates to its borrowers and hence, maintain a comfortable credit profile among the low risk segments. On deposit concentration, the top 20 depositors accounted for a sizeable chunk at ~26% of the total deposits as of mid-April 2020, which remains a key characteristic among top-tier banks. However, increasing reliance of the banking sector in tier-II debentures, which in spite of providing a stable source of funding, could prove challenging in maintaining the competitive cost of funds. The bank's ability to maintain the requisite credit and deposit growth while controlling the cost structure could remain crucial.

Diverse income sources and low operating cost – NIBL's corporate-heavy portfolio and focus on the trade finance business results in a healthy share of fee-based income at 1.24% of average total assets (ATA) in 9M FY2020 against 1.07% for the industry. Additionally, the bank's operating expense ratio remains among the lowest in the industry at 1.38% of the ATA (1.89% for industry) because of the presence in the wholesale segment. These dynamics are likely to provide some support to the bank's incremental profitability outlook amid rising credit costs.

Challenges

Stress in asset quality; pandemic likely to further stretch indicators – The bank has witnessed increasing stress in asset quality in the recent periods with gross NPLs increasing to 2.67% as of mid-April 2020, much higher against the industry average of 1.72%. The spike in NPLs was mainly because of two large slippages, recovery from which is less likely over the near term. However, the bank has recently received a contested counter-guarantee claim amounting ~NPR 2.1 billion (related to one of the large slippages), which is a positive. The bank's delinquencies generally remain higher with 30+

days' delinquencies of ~7.0% as of mid-April 2020 (~2.2% as of mid-July 2018). Additionally, a large chunk of borrowers has availed the timeline extensions provided by the NRB for loans falling due on mid-April 2020, leading to sizeable accrued interest receivables. The bank's ability to recover from the same and control fresh slippages, amid the expected economic slowdown due to the pandemic, would remain a key monitorable. ICRA Nepal expects the stress in the asset quality and solvency profile (net NPL to net worth) to continue over the near to medium term, albeit remaining consistent within the rating level. Any slippages leading to depletion in capitalisation levels could have a bearing over the ratings assigned.

High credit concentration – As of mid-April 2020, NIBL's reliance on the top-20 borrower groups was very high at ~35% of the total credit portfolio and ~226% of tier-I capital (~208% last rating). High concentration among large borrowers has impacted the bank's credit profile with slippages of just two borrowers around the same time. The concentration basically stemmed from the bank's key focus on large corporate borrowers, which accounted for >80% of the portfolio. Any major build-up/elongation of stress in key borrower segments (viz. steel, cement, tourism, hydro etc.) could impact its operational profile.

Decline in profitability profile in recent years, albeit adequate – NIBL usually has a lower yield on advances compared to the industry, given its corporate segment-dominated lending portfolio. Additionally, the regulatory constriction in lending spreads to 4.4% (to be met by mid-July 2020) is likely to pressurise the bank's net interest margins (NIMs), which stood at ~3.5% for FY2019, corresponding to a lending spread of 5.3%. The NIMs have corrected to ~3.2% for 9M FY2020, which corresponded to ~4.8% of the lending spreads. Further, the bank's credit costs have increased in the recent periods leading to return on assets (RoA) and return on net worth (RoNW) of 1.75% and ~13% for 9M FY2020 against 2.27% and ~17% for FY2018. The profitability profile for FY2020 is likely to remain muted amid the challenges imposed by the pandemic on asset quality as well as interest rate rebates to be allowed to borrowers as per current regulatory instruction (2% interest rate reductions to be provided for Q4 FY2020, among others). The bank's ability to control fresh slippages and recover from the current NPLs while maintaining sustainable growth would have a bearing over its medium-term profitability.

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

Links to applicable criteria:
Bank Rating Methodology

Bank Profile

Nepal Investment Bank Limited (NIBL)[1], previously Nepal Indosuez Bank Ltd., was established in 1986 as a joint venture between Nepalese and French partners. In April 2002, the French partner, Credit Agricole Indosuez (holding 50%), sold its stake to a group of companies comprising bankers, professionals, industrialists, and businessmen in Nepal. The name of the bank was then changed to Nepal Investment Bank Limited. The bank is promoted by several insurance companies, retirement funds and investment companies, the most prominent being Rastriya Beema Company Limited (12.15%). Its shares, which are listed on the Nepal Stock Exchange, are held by the promoters and the public in the ratio of ~69:31. NIBL's registered office is in Durbarmarg, Kathmandu.

NIBL had 82 branches spread throughout the country as of mid-April 2020. It had a market share of 4.96% in terms of the deposit base and 5.19% of the total advances of the commercial banking industry as on the same date. NIBL reported a profit after tax (PAT) of NPR 3,324 million in FY2019 (YoY de-growth of ~9%) on an asset base of NPR 185,670 million as

[1] Mr. Surya Prakash Shrestha is an independent director at ICRA Nepal Limited, who is also a director at NIBL, representing promoter shareholders.

of mid-July 2019. In 9M FY2020, it reported a PAT of NPR 2,496 million on an asset base of NPR 1,95,518 million. As of mid-April 2020, NIBL's CRAR was 12.59% and gross NPLs were 2.67%. In terms of the technology platform, NIBL has implemented Finacle at all its branches.

Key financial indicators

Year Ended	Mid July 2017 (Audited)	Mid July 2018 (Audited)	Mid July 2019 (Audited)	Mid-April 2020 (Provisional)
Operating ratios				
Yield on average advances	9.24%	11.23%	11.24%	12.64%
Cost of deposits	3.69%	5.66%	5.95%	5.89%
Net interest margin/ATA	3.41%	3.63%	3.45%	3.17%
Non-interest income/ATA	1.37%	1.29%	1.41%	1.24%
Operating expenses/ATA	1.29%	1.43%	1.46%	1.38%
Credit provisions/ATA	0.30%	0.42%	0.89%	0.54%
PAT/ATA	2.22%	2.27%	1.86%	1.75%
PAT/net worth	17.80%	16.79%	13.18%	12.64%
Gross NPAs	0.83%	1.35%	2.77%	2.67%
30+ days delinquencies	2.26%	2.22%	4.44%	7.02%
Capitalisation ratios				
Capital adequacy ratio	13.02%	12.66%	13.26%	12.59%
Tier-I Capital	11.58%	11.58%	11.39%	10.85%
Net NPAs/net worth	0.80%	2.92%	4.17%	2.65%
Liquidity ratios				
Total liquid assets/total liability	29%	26%	27%	23%
Total advances/total deposits	83%	87%	85%	91%

For further details please contact:

Annexure-1: Instrument details

Instrument	Amount in NPR Million	Expiry	Rating Action
8% NIBL Debenture 2078	750	July 26, 2021	[ICRANP] LA; Reaffirmed
10.5% NIBL Debenture 2083	2,000	June 17, 2026	[ICRANP] LA; Reaffirmed
8.5% NIBL Debenture 2084 (proposed)	4,000	Proposed issue	[ICRANP] LA; Assigned
Total	**6,750**		

Analyst Contacts

Mr. Kishor Prasad Bimali (Tel No. +977-1-4419910/20)
kishor@icranepal.com

Mr. Rajib Maharjan (Tel No. +977-1-4419910/20)
rajib@icranepal.com

Mr. Sajjan Tamrakar (Tel No. +977-1-4419910/20)
sajjan@icranepal.com

Relationship Contacts

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

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 licensed 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 areas such as rating process and methodologies, analytical software, research, training, and technical and 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.

For more information, visit www.icranepal.com

ICRA Nepal Limited
Sunrise Bizz Park, 6th Floor, Dillibazar, Kathmandu, Nepal.
Phone:+977 1 4419910/20
Email: info@icranepal.com
Web: www.icranepal.com