

NIC Asia Bank Limited: Ratings downgraded to [ICRANP-IR] BBB+ and [ICRANP] LBBB+

July 13, 2020

Summary of rated instruments

INSTRUMENT/FACILITY	RATED AMOUNT	RATING ACTION (JULY 2020)
Issuer Rating	NA	[ICRANP-IR] BBB+; downgraded from [ICRANP-IR] A-
Subordinated Debenture	NPR 3,000 million	[ICRANP] LBBB+; downgraded from [ICRANP] LA-
Subordinated Debenture	NPR 500 million	[ICRANP] LBBB+; downgraded from [ICRANP] LA-

Rating Action

ICRA Nepal has downgraded the issuer rating of NIC Asia Bank Limited (NICA) to **[ICRANP-IR] BBB+** (pronounced ICRA NP issuer rating triple B plus) from **[ICRANP-IR] A-** (pronounced ICRA NP issuer rating A minus), indicating a moderate degree of safety regarding timely servicing of financial obligations. Such issuers carry moderate credit risk. The sign of + (plus) or – (minus) appended to the rating symbol indicates the entities relative position within the rating categories concerned. The rating is only an opinion on the general creditworthiness of the rated entity and is not specific to any debt instrument.

ICRA Nepal has also downgraded the bank's subordinated debentures rating to **[ICRANP] LBBB+** (pronounced ICRA NP L Triple B Plus) from **[ICRANP] LA-** (pronounced ICRA NP L A minus). 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 sign of + (plus) or – (minus) appended to the rating symbol indicates the entities relative position within the rating categories concerned.

Rationale

The rating downgrade of NICA factors in the steady decline in the bank's capital cushion at tier I level, following consistently high growth in risk assets during the last three-four years. The capital cushion declined further in FY2020 because of the dividend withdrawal out of the FY2019 profits and the impact on the FY2020 interest income realisation caused by the rise in Covid-induced delinquencies till 9MFY2020. The bank remains among the thinly capitalised banks at tier I level among the industry peers, which coupled with the unseasoned credit books and uncertain externalities created by the Covid-19 pandemic, raises concern on NICA's resilience to probable credit shocks. The concerns are further exacerbated by the rise in NPA and non-Covid delinquencies reported in 9MFY2020 vis-à-vis earlier years. Major portion of the bank's credit growth in the last few years has come from the retail and the SME segments, which are likely to come under pressure in the post-pandemic era given the low resilience and financial flexibility of the borrowers in those segments. This remains a challenge to the future assets' quality of the bank, despite the loss-given-default being partly cushioned by the strong collateral backing in those loans. The bank's cost of fund and hence the base rate are higher than other old and established industry players, which could be a competitive disadvantage in attracting good quality borrowers in the "base-rate-plus" lending model being practiced in the industry.

Nonetheless, the rating continues to derive comfort from the bank's long track record and its experienced and financially strong promoters. Following a rapid growth in the last three-four years, NICA has developed a strong market share and market positioning. The strong branch network of the bank (321 as of mid-April 2020) supports its ability to grow and diversify its portfolio in future. The rating action also factors in the bank's high credit portfolio granularity, which cushions the assets quality and the capitalisation concerns to some extent. Backed by high-scale growth in the recent years, NICA's profitability level has remained good despite its high operating expense ratios. This remains a positive from the standpoint of its ability to generate internal capital in the future.

Going forward, NICA's ability to improve its capitalisation profile at tier I level as well as overall CRAR level commensurate with its scale of operation and magnitude of its risk assets, thereby enabling the bank to better withstand the probable credit and operational shocks in future, will remain a key rating sensitivity.

Key rating drivers

Credit strengths

Long track record and strong promoters – NICA (erstwhile Nepal Industrial and Commercial Bank) has been in operation since 2000 and has an adequate track record in the industry, which is a rating positive. The bank is promoted by individuals from the Vishal Group and the Sanghai group, the two large and financially strong family-owned business houses in Nepal, with diversified presence across multiple sectors such as manufacturing, trading, and financial services.

Good asset quality despite recent moderation– NICA has maintained a good assets quality, with gross NPA of 0.74% as of mid-April 2020 and 0.46% as of mid-July 2019. Although the regulatory forbearance through payment deferral for mid-April 2020 has led to a build-up of 0+ days delinquency to ~16% as of mid-April 2020, the bank has maintained an otherwise moderate delinquency level of ~4.4% as of mid-April 2020. Low NPL and adequate provision cover maintained by the bank have led to good solvency profile with Net NPA/Net worth at ~1.6% as of mid-April 2020.

Wide branch network and customer base contribute to portfolio granularity – With 321 branches as of mid-April 2020, NICA has the widest branch network in the industry. The bank has been aggressively branching out in the last few years in line with its strategy to grow along non-corporate segments. As a result of rapid network expansion, NICA has been able to register high growth while maintaining portfolio granularity and a low portfolio concentration in terms of both credit and deposits. Top-20 borrowers accounted for ~6% of the total credit and top-20 depositors accounted for ~15% of the total deposits as of mid-April 2020 and the concentration levels are lower than many other peer-rated banks in the industry.

Good profitability profile– Rapid credit growth, optimum utilisation of available fund (as reflected in tight CCD ratio) in the recent years and a good non-interest income level have helped NICA maintain good return indicators despite the bank's high operating expenses. Reported profitability is also supported by its low credit cost. NICA reported a return on assets (ROA) of ~1.5% for 9MFY2020 (slightly below industry average of ~1.6%) and RoNW of ~21% (well above industry average of ~13%) for the same period. Return on net worth remains supported NICA's leveraged capital structure on a large-scale operation.

Credit challenges

High credit growth, unseasoned credit portfolio and Covid-induced externalities pose asset quality concerns – During FY2015 to FY2019, NICA registered a high credit growth of CAGR 32% versus the commercial bank industry average of 23%. Annualised credit growth till Q3FY20 was ~24% versus the industry average of ~19%. The growth was a part of the bank's internal growth strategy, which encompassed high growth along non-corporate segments through aggressive market penetration, branch expansion and product pricing. As a result of the growth, a major portion of NICA's current day credit portfolio remains unseasoned and borrowers untested. This coupled with the Covid-created externalities remains a concern for the bank's incremental assets' quality. Interest rate volatility also remains a concern to the assets quality of the freshly underwritten credit, despite being comforted by the moderation in banking sector interest rates in the last 6-12 months. Amid the expectations of a higher impact of the Covid-induced stress on the retail and SME borrowers, the ability of the bank to maintain good assets quality and delinquency level over the next 12-18 months remains to be seen.

Thin capital cushion over regulatory minimum, with stretched tier I capital ratio– NICA's CRAR stood at 12.1% as of mid-April 2020 with a moderate cushion over the regulatory minimum of 11%. The bank's tier I capital remains even stretched at 7.42% for mid-April 2020, below the NRB recommended level of 8.5% (including capital conservation buffer). Despite being one of the largest banks in the industry, NICA has among the lowest tier I capital cushion, which makes the capitalisation profile vulnerable to credit and operational shocks. The concerns are further exacerbated by the bank's rapid growth in recent years, its unseasoned credit portfolio and the recent rise in NPA and delinquency level.

Relatively high base rate affects competitive positioning and ability to attract quality borrowers– NICA's cost of deposits has remained marginally above the industry average in the recent years amid high interest rates offered by the bank across its deposit products to support the rapid growth in its credit portfolio. During 9MFY2020, NICA's cost of average

deposits stood at ~6.7% (~27 bps higher than the industry average), despite good CASA proportion (42% on mid-April 2020 vs. commercial bank average of ~40%). NICA's base rate also remains comparable to the new generation banks but is higher than the established players, which remains a competitive disadvantage in the "base rate plus" lending regime currently in practice within the Nepalese banking industry. This could be an impediment in attracting good quality of borrowers which could pose assets quality concern going forward.

Company profile

Incorporated in 1998 as Nepal Industrial & Commercial Bank (NIC), NIC Asia bank got its current name after its merger with another class 'A' bank (Bank of Asia Limited) in June 2013, in a first ever merger between two class A banks in Nepal. Controlling interest in NICA is held by the promoters from two family-owned business houses of Nepal viz. the Vishal Group and the Shanghai Group. Major shareholders of NICA include Ashok Kumar Agrawal (~6.5%), Mr. Trilok Chand Agrawal (~5%), Mr. Ram Chandra Sanghai (~4%), and Mr. Subhash Chandra Shanghai (~4%), with the remaining stake held mostly by the members of the Agrawal (Vishal) and Shanghai family. The shares of NICA are listed in Nepal Stock Exchange and are actively traded. Mr. Roshan K. Neupane is the Chief Executive Officer of the bank.

As of mid-April 2020, NICA is one of the largest private sector commercial banks of Nepal. The bank underwent a spell of high credit growth in the years after FY2017, sharply increasing its market share in the following years. As of mid-April 2020, NICA is the strongest bank in terms of branch network (321 branches as of mid-April 2020). NICA is among the top-three banks in the Nepalese banking industry in terms of size, with a share of ~5.9% in commercial bank deposit and ~6.3% of commercial bank loans.

NICA reported a profit after tax (PAT) of NPR 3,023 million in FY2019 over an asset base of NPR 217,697 million as of mid-Jul-19 against a PAT of NPR 1,335 million in FY2018 over an asset base of NPR 170,943. In Q3FY2020, NICA reported a PAT of NPR 2,503 million over an assets base of NPR 232,842 million. As of mid-Apr-2020, NICA's CRAR was 12.11% and gross NPLs were 0.74%.

Key financial indicators

KEY FINANCIAL RATIOS YEAR ENDED	Jul-17 (Audited)	Jul-18 (Audited)	Jul-19 (Audited)	Q3 FY2020 ¹ (Provisional)
OPERATING RATIOS				
Net Interest Margin/Avg. Total Assets	2.83%	3.12%	3.58%	3.27%
Non-interest Income/Avg. Total Assets	0.38%	0.73%	1.27%	1.33%
Operating Expenses/Avg. Total Assets	2.00%	2.47%	2.31%	2.08%
Credit Provisions / Avg. Total Assets	-0.34%	0.23%	0.31%	0.59%
PAT / Avg. Total Assets	1.64%	0.99%	1.56%	1.48%
PAT / Net Worth	16.84%	12.25%	22.73%	21.26%
Gross NPAs	0.36%	0.06%	0.46%	0.75%
CAPITALISATION RATIOS				
Capital Adequacy Ratio	13.83%	12.24%	13.32%	12.11%
Tier I capital	12.38%	8.66%	8.24%	7.42%
Net NPAs/Net Worth	0.25%	0.10%	2.34%	1.61%
COVERAGE & LIQUIDITY RATIOS				
Total Liquid Assets/Total Liability	24.62%	22.53%	25.32%	19.11%
Total Advances/Total Deposits	82.57%	86.30%	84.55%	93.91%

¹ Annualized



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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 the rating process and methodologies, analytical software, research, training, and technical and analytical skill augmentation.

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