Machhapuchchhre Bank Limited: Ratings reaffirmed at [ICRANP-IR] A- and [ICRANP] LA-, placed on watch with negative implications

July 13, 2020

Summary of rated instruments

INSTRUMENT/FACILITY	RATED AMOUNT	RATING ACTION (JULY 2020)
Issuer Rating	NA	[ICRANP-IR] A- @; reaffirmed and placed on watch with negative implications
Subordinated Debenture	NPR 3,000 million	[ICRANP] LA- @; reaffirmed and placed on watch with negative implications

Rating Action

ICRA Nepal has reaffirmed the issuer rating of **[ICRANP-IR] A-@** (pronounced ICRA NP issuer rating A minus) to Machhapuchchhre Bank Limited (MBL), indicating an adequate degree of safety regarding timely servicing of financial obligations. Such issuers carry low 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 reaffirmed the rating of **[ICRANP] LA-@** (pronounced ICRA NP L A Minus) assigned to the bank's subordinated debentures. Instruments with this rating are considered to have adequate degree of safety regarding timely servicing of financial obligations. Such instruments carry low credit risk. The sign of + (plus) or – (minus) appended to the rating symbol indicates the entities relative position within the rating categories concerned.

The ratings have been placed on watch with negative implications in the light of weakening Tier I capitalisation profile and the expected impact of the Covid-19 pandemic on the general credit profile of the bank.

Rationale

The rating watch factors in the rapid erosion in the capital cushion of MBL in the last two to three years caused by high growth in risk assets. The capitalisation ratio of MBL as of mid-April 2020 stood at CRAR 12.80%, with a tier I capital of 9.18%, only marginally above the Nepal Rastra Bank (NRB) recommended minimum tier I level of 8.50%. This coupled with the rise in NPA level in recent quarters and build-up of delinquencies, largely resulting from the impact of the Covid-19 pandemic has exacerbated the concerns regarding the bank's resilience to the credit shocks. High growth in risk assets in the recent years, resulting in a sizeable proportion of credit among untested borrowers and a relatively high borrower concentration for MBL, also increases the credit concerns. Credit concerns also arise from the expected increase in the Covid-19 induced stress in repayment capacity of SME and retail segment borrowers, which have been the focus area of MBL in the last two to three years. The ability of the bank to come out of the situation while maintaining its capital cushion and a buffer capital to withstand such pressure going forward will be a key monitorable. Rating concerns also arise from the relatively moderate competitive positioning of MBL vis-à-vis large and established banking sector players, given its relatively high cost of deposits and base rate, which remains a competitive disadvantage in the "base rate plus" lending regime currently practiced in the industry. This also challenges its ability to attract good quality borrowers, who could address assets quality concerns during stressed times. Relatively high cost of deposits stems from the bank's lower CASA proportion vis-à-vis the industry average and a higher proportion of term deposits raised during the deposit-price war in the industry during FY2017 to FY2018, which is gradually moderating across the industry in the recent period.

Nonetheless, the rating continues to take comfort from MBL's long track record in the industry (operating since 2000) and its experienced promoters and management team. The bank has increased its presence across the country by setting up a sizeable number of new branches (159 branches as of mid-April 2020) in the last 2-3 years, which augurs well for the incremental growth as well as the diversification of the portfolios. The portfolio concentration, albeit high, has remained at similar levels to that of a year ago, despite a sizeable growth in portfolio in the interim, indicating an improving diversification of incremental portfolio. The bank continues to report a low gross NPA level, pointing to adequate assets quality, notwithstanding the recent Covid-19-induced deterioration. The bank's profitability profile also remains adequate, supported by good NIMs and a good portion of non-interest income levels, despite being challenged by the increase in operating expense ratio and more recently by an increase in credit cost amid rising delinquency levels.

Going forward, MBL's ability to maintain an adequate capital cushion thereby enabling the bank to mitigate the probable shocks arising from its unseasoned and relatively concentrated credit portfolio and protect its assets quality from deteriorating in the aftermath of the Covid-created challenges will remain a key rating sensitivity.

Key rating drivers

Credit strengths

Long track record, wide network, and seasoned management team– Operating since 2000, MBL has an adequate track record of operations along with an extensive branch network (159 branches across country as of mid-April 2020). Expansion of network in recent period has enabled the bank to increase its portfolio base in terms of deposit as well as credit. MBL's board of directors and management team are seasoned professionals in the Nepalese banking sector with long history, good knowledge and adequate experience.

Good reported assets quality– MBL's reported assets quality has remained good, with low gross NPA levels, despite the recent moderation (gross NPA of 0.45% as of mid-April 2020 vs. 0.37% as of mid-July 2019), partly aided by the high growth in credit portfolio in the last 2-3 years. Although the regulatory forbearance through payment deferral for mid-April 2020 has led to a build-up of 0+ days delinquency to ~17% as of mid-April 2020, the bank has maintained an otherwise moderate delinquency level of 2.5% 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 ~1.5% as of mid-April 2020.

Comfortable profitability profile–MBL has maintained an adequate profitability profile and return indicators in recent period supported by optimal utilisation of fund (as evidenced in a tight CCD ratio) and adequate NIMs, despite being challenged by an increased operating expense ratio following rapid branch expansion. Profitability also remains supported by a good portion of non-interest income, which indicates adequate revenue diversification.

Credit challenges

Thin capitalisation cushion over regulatory minimum– The capitalisation level of MBL, though adequate at CRAR level, remains low at tier I level (CRAR of ~12.8% as of mid-April 2020 and tier I capital of 9.18% vs. regulatory minimum CRAR of 11% and NRB recommended minimum tier I of 8.5%). In the light of recent rise in NPA level and delinquencies, the capital cushion remains thin especially at tier I level to withstand the credit shocks, which remains a challenge.

Relatively high credit concentration and expected impact of Covid-19 pandemic- Despite the incremental credit growth of the bank in the last 1-2 years coming largely from non-corporate segments, MBL continues to maintain a relatively high credit concentration (top-20 borrower groups accounted for ~22% of the credit portfolio as of mid-April 2020). This remains a concern amid the disruption in business environment created by Covid-created externalities and its likely impact on the asset's quality.

Furthermore, MBL has significant exposure to retail/SME segment (~61% of total portfolio as of mid-April 2020), where the bank has made sizeable portfolio addition in the recent years. The borrowers from these segments are likely to remain under pressure over the near term given their low resilience and financial flexibility to withstand cashflow volatility amid stress induced by the Covid-19 pandemic. This too remains a concern to the incremental asset's quality.

Relatively high base rate affects competitive positioning and ability to attract quality borrowers– MBL's cost of deposits has remained marginally above the industry average in the recent years, partly aided by its lower-than industry-average CASA proportion and a high proportion of costlier term deposits. During 9MFY2020, NICA's cost of average deposits stood at 7.7% (~125 bps higher than the industry average). MBL's base rate, while being comparable to new-age players remains higher than established players, is 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 borrowers, posing assets quality concern going forward.

Company profile

Machhapuchchhre Bank Limited (MBL), a class A bank licensed by Nepal Rastra Bank, was registered in 1998 as the first regional commercial bank and commenced its operations from October 2000. Its head office/ registered office is in Lazimpat, K.M.C.-2, Kathmandu.

The major promoters of the bank are the Mahato Group (led by Mr. Birendra Mahato, the current chairman), which controls ~25% stake and the KC Group (led by Mr. Surya Bahadur KC, the former chairman), which controls ~20% stake. Mr. Santosh Koirala is the Chief Executive Officer of the bank. The bank's equity shares are listed and traded in Nepal stock exchange.

As of mid-April 2020, MBL had presence across the country through its 159 branches and 196 ATMs. MBL is a medium size bank, with a market share of about 3.13% in terms of deposit base and 3.36% in terms of credit portfolio in the commercial bank industry (2.72% and 2.94% respectively in Nepalese banking industry) as on mid-April 2020. MBL reported a profit after tax of NPR 1,697 million in FY2019 over an asset base of NPR 105,246 million as on Jul-19 as against profit after tax of NPR 1,250 million in FY2018 over an asset base of NPR 84,788 million as on Jul-18. Till 9MFY2020, MBL had reported PAT of NPR 1,167 million. MBL's CRAR was 12.8% (including tier I capital of 9.18%) and gross NPLs were 0.44% as on mid-April 2020.

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	3.63%	3.56%	3.74%	3.52%
Non-interest Income/Avg. Total Assets	0.40%	0.79%	1.15%	1.19%
Operating Expenses/Avg. Total Assets	1.80%	1.81%	2.37%	2.42%
Credit Provisions / Avg. Total Assets	0.01%	0.20%	0.12%	0.29%
PAT / Avg. Total Assets	2.03%	1.63%	1.79%	1.37%
PAT / Net Worth	18.60%	13.14%	15.72%	13.68%
Gross NPAs	0.38%	0.44%	0.37%	0.45%
CAPITALISATION RATIOS				
Capital Adequacy Ratio	16.82%	15.36%	12.79%	12.80%
Tier I capital	15.78%	14.38%	11.88%	9.18%
Net NPAs/Net Worth	0.53%	0.87%	1.03%	1.48%
COVERAGE & LIQUIDITY RATIOS				
Total Liquid Assets/Total Liability	22.65%	22.25%	23.70%	19.66%
Total Advances/Total Deposits	87.27%	90.26%	91.01%	94.88%

[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.

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.

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