Siddhartha Bank: Ratings reaffirmed; placed on Watch with Negative Implications

August 17, 2020

Summary of rated instruments

INSTRUMENT/FACILITY	RATED AMOUNT	RATING ACTION
Issuer Rating	NA	[ICRANP-IR] A- @; reaffirmed and placed on watch with negative implications
Subordinated Debenture	NPR 2,500 million	[ICRANP] LA- @; reaffirmed and placed on watch with negative implications
Subordinated Debenture	NPR 2,163 million	[ICRANP] LA- @; reaffirmed and placed on watch with negative implications
Subordinated Debenture	NPR 500 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 Siddhartha Bank Limited (SBL), 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 an 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 the weakening capitalisation at the tier I level, which has lowered the bank's resilience towards probable credit shocks that could arise in the aftermath of the Covid-19 pandemic.

Rationale

The rating watch factors in the capital erosion of SBL at the tier I level, following high credit growth and concomitant rise in risk assets. Tier I capital of SBL stood at ~9% as on mid-July 2020, marginally above the regulatory minimum of 8.5% despite the CRAR remaining comfortable at ~13% vis-à-vis minimum regulatory requirement of 11%. Moderate tier I capital has lowered the bank's ability to withstand the probable credit shocks while maintaining the capital as per regulatory requirements. The risks stand exacerbated, given the bank's higher exposure (~16% vs. industry average of ~11% as of mid-April 2020) towards the sectors deemed vulnerable[1] as well as the recent moderation in assets quality (rise in NPA and non-NPA delinquencies post-Covid and deterioration in solvency level). At the same time, recent high growth in the credit portfolio has added a significant portion of unseasoned credit to the bank's portfolio, which could get tested in these challenging economic conditions. The ratings also remain constrained from weak competitive positioning of the bank due to the high base rate, a result of low CASA proportion and higher cost of funds. Weak competitive positioning constrains the bank's ability to attract good quality borrowers, which could lead to longer-term asset quality concerns. Deposit concentration of SBL also remains on the higher side, raising liquidity and repricing risks for the bank.

However, ratings continue to derive comfort from SBL's long track record (operating since December 2002), strong presence across the country (185 branches as of mid-July 2020) and experienced and stable senior management team

1 Includes hire purchase, real estate, margin loans and loan towards mining sector and experienced board of directors. The credit portfolio granularity of the bank continues to remain good despite the rapid growth, partly aided by adequate geographical diversification of the bank. Relatively stable credit concentration despite rapid credit growth indicates diversification in incremental portfolio, which has been factored as a positive. Stable NIMs coupled with scale growth in the recent years has helped the bank maintain a good profitability profile, notwithstanding the recent deterioration amid Covid-induced increase in credit cost and a rise in operating expenses to support the branch expansion.

Going forward, SBL's ability to improve asset quality, prevent further slippages and build a capital cushion to withstand future shocks will remain a key rating sensitivity. Sustained deterioration of capitalisation at both tier I and CRAR level and/or continued stress on the asset quality could warrant a rating downgrade.

Key rating drivers

Credit strengths

Adequate track record, wide network, stable and experienced management team – Operating since 2002, SBL has an adequate track record of operations and a wide branch network (185 branches across country as of mid-July 2020). Expansion of network in the recent period has enabled the bank to achieve rapid growth in terms of credit as well as deposit. SBL's board of directors and the management team are seasoned professionals in the Nepalese banking sector with extensive experience and good knowledge.

Steady increase in scale of operations along with portfolio diversification- SBL's credit portfolio grew at a CAGR of ~29% in the five years ending FY2020. Similarly, SBL reported a deposit growth of CAGR ~26% between FY2015-20. Rapid portfolio growth remains supported by an equally fast network expansion in the recent years. Credit concentration has remained largely stable amid rapid credit growth, indicating diversification in incremental portfolio. Concentration among top borrowers stood relatively low at ~13% as of mid-April 2020, which remains a comfort. However, deposit concentration of the bank continues to remain on the higher side (~25% among top 20 depositors on mid-April 2020) despite recent moderation.

Fair profitability profile – The bank's profitability has remained supported in the last two to three years by the stable NIMs of 3.3-3.5% and fair non-interest income level of 1% of average total assets (ATA), on an increasing scale of operations. However, a steady rise in operating expense in the last two years (~2% of ATA in FY2019 and FY2020) and the recent rise in credit costs has led to a moderation in profitability indicators. SBL reported a return on assets (ROA) of ~1.3% and a return on net worth (RoNW) of ~13.5% for FY2020 vs. ~1.7% and ~15.7% for FY2019.

Credit challenges

Weakening of capitalisation at tier I level - SBL reported a CRAR of ~12.9% and Tier I of ~9.1% as of mid-July 2020 (against ~11.9% and ~8.0% as of mid-April 2020), indicating adequate cushion over a regulatory minimum of 11%. Capitalisation levels have improved in Q4 FY2020 following improved recovery/upgradation of delinquent loans as compared to Q3 FY2020. However, despite the recovery, the capitalisation at the Tier I level continues to remain marginally higher than the regulatory minimum of 8.5%. Thin capital cushion over a regulatory minimum at the Tier I level, especially amid the Covid-induced stress expected in the general credit profile of the bank, raises concerns over the bank's ability to withstand the probable credit shocks without breaching the regulatory capital guidelines.

Deterioration in asset quality amid Covid-19 impact - SBL gross NPA level increased to ~1.6% as of mid-July 2020 as compared to ~1.4% when last rated (April 2019). Higher NPA levels come on the heels of the Covid-19 impact on the borrowers' repayment capacity. In addition to the asset quality impact on the general borrower profile, concerns also arise due to sizeable addition of unseasoned credit portfolio in the books of SBL in the last two to three years. Increase in the NPA levels and relatively low provision cover of ~54% as of mid-July 2020 has led to a weak solvency profile with NPA/Net worth of ~6% as of mid-July 2020, which is among the weakest in the industry. SBL's delinquency level increased due to the impact of Covid-19 in the borrower's repayment capacity. For mid-July 2020, the delinquency based on accrued interest receivables stood at ~9% (a significant improvement from ~17% as of mid-April 2020).

Weak competitive positioning due to higher base rate - Moderate CASA and higher proportion of term deposits has led to higher cost of funds of SBL vis-à-vis the industry average (~110 bps higher than the industry average as of mid-April 2020). SBL's base rate remains higher among 'A' rated players in the industry; weakening its competitive positioning in the current base rate-plus regime practiced in the industry. Weak competitive positioning may create an impediment in the attraction of borrowers with good credit quality, leading to asset quality concerns in the medium term.

High deposit concentration amid rapidly increasing portfolio - SBL has a relatively high concentration of deposits among the top depositors (~25% of the total deposits among top 20 depositors as on mid-April 2020 vs. 27% in mid-April 2019, when last rated). This remains a challenge for the bank in terms of stability of deposits and incremental cost of funds.

Company profile

Siddhartha Bank Limited (SBL), 18th Class 'A' Commercial Bank to be licensed by NRB, started its operation in December 2002. As of mid-July 2020, SBL's presence throughout the country is through its 185 branches. As of mid-April 2020, SBL has a market share of about 3.6% in terms of deposit base and ~3.9% in terms of total advances in the Nepalese banking industry (~4% share in commercial bank industry deposits and ~4.5% share in commercial bank industry advances).

As of mid-April 2020, SBL's shareholding is divided among the promoter and the public shareholders in the ratio of 51:49. The bank is promoted by individuals and private institutions related to different business house of Nepal, mainly the Kedia Group.

SBL reported a profit after tax of NPR 2,093 million as of mid-July 2020 over an asset base of NPR 170,807 million vis-à-vis profit after tax of NPR 2,258 million in FY2019 over an asset base of NPR 144,406 million. As of mid-July 2020, SBL's CRAR was ~13% (tier I capital of ~9%) and gross NPLs level was 1.6%. On the technology frontier, SBL is using the 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 Bhairahawa, Rupandehi.

Key financial indicators

KEY FINANCIAL RATIOS YEAR ENDED	Jul-17 (Audited)	Jul-18 (Audited)	Jul-19 (Audited)	Jul-20 (Provisional)
OPERATING RATIOS				
Net Interest Margin/Avg. Total Assets	3.33%	3.28%	3.53%	3.55%
Non-interest Income/Avg. Total Assets	0.87%	1.08%	1.08%	0.99%
Operating Expenses/Avg. Total Assets	1.78%	1.63%	1.98%	2.15%
Credit Provisions / Avg. Total Assets	0.17%	0.22%	0.14%	0.46%
PAT / Avg. Total Assets	1.69%	1.82%	1.71%	1.33%
PAT / Net Worth	17.19%	16.15%	15.71%	13.50%
Gross NPAs	1.30%	1.09%	0.75%	1.56%
CAPITALISATION RATIOS				
Capital Adequacy Ratio	12.74%	12.12%	12.77%	12.97%
Tier I Capital	11.02%	10.99%	10.19%	9.06%
Net NPAs/Net Worth	3.63%	2.58%	1.90%	5.72%
COVERAGE & LIQUIDITY RATIOS				
Total Liquid Assets/Total Liability	24.28%	26.02%	22.76%	22.77%
Total Advances/Total Deposits	85.34%	91.01%	94.11%	91.29%

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

Ms. Swastika Khanal (Tel No. +977-1-4419910/20)
swastika@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 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.

For more information, visit www.icranepal.com

ICRA Nepal Limited,
Sunrise Bizz Park, 6th Floor, Dillibazar, Kathmandu-33, Nepal.
Phone: +977 1 4419910/20
Email: info@icranepal.com
Web: www.icranepal.com