ICRA NEPAL

Nabil Bank Limited: Ratings reaffirmed

September 7, 2020

Summary of rated instruments

INSTRUMENT/FACILITY	RATED AMOUNT	RATING ACTION
Subordinated Debenture Program	NPR 2,000 million	[ICRANP] LAA- (reaffirmed)
Issuer Rating	NA	[ICRANP-IR] AA- (reaffirmed)

Rating action

ICRA Nepal has reaffirmed the issuer rating of [ICRANP-IR] AA- (pronounced ICRA NP issuer rating Double A minus) to Nabil Bank Limited (Nabil), indicating a high degree of safety regarding the timely servicing of financial obligations. Such issuers carry very low credit risk. The sign of + (plus) or – (minus) appended to the rating symbol indicates the entity's 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] LAA- (pronounced ICRA NP L Double A Minus) assigned to the bank's subordinated debentures. Instruments with this rating are considered to have a high degree of safety regarding timely servicing of financial obligations. Such instruments carry very low 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 ratings reaffirmation continues to draw comfort from Nabil's strong competitive positioning in the industry which stems from its long track record and established brand reputation. Nabil's competitive positioning is further strengthened by its ability to offer better lending rates vis-à-vis peer banks (given its low cost of fund); thereby allowing Nabil to pick from good quality borrowers through pricing advantage. This, coupled with Nabil's tested underwriting norms and experienced management team, has helped it maintain a comfortable asset quality and solvency levels over the years, notwithstanding the recent moderation caused by Covid-19 and its impact on the credit profile. Nabil's current capitalisation level, though lower compared to the industry average and considering Nabil's high portfolio concentration level, remains adequate vis-à-vis regulatory minimum at both the CRAR and the tier I level, which, coupled with Nabil's good credit quality and healthy rate of internal capital generation remains a comfort. Liquidity position of Nabil remains strong with liquid assets accounting for ~28% of the total assets as of mid-July 2020. Nabil is among the larger banks in the industry in terms of market share with growing branch network which remains a positive for future portfolio growth and diversification. Nabil continues to maintain a strong profitability profile, which remains supported by good NIMs (notwithstanding the moderation in FY2020 caused by interest rebate offered to borrowers in Q3 and Q4 FY2020) and the non-interest income level and supported by low operating cost and credit cost. The ratings also continue to take comfort from the bank's seasoned management team and strong promoter profile.

However, the ratings are constrained from the high portfolio concentration levels of the bank, despite its long track record and sizeable asset base, which remains a concern. As of mid-July 2020, top 20 borrowers' groups of Nabil accounted for ~27% of its total credit and 202% of Tier I capital, while top 20 depositors accounted for ~35% of the total deposits. High borrower concentration could pose the risk of capital erosion in the event of slippages of the large loans, especially in the light of the difficult economic condition created by the Covid-19 pandemic. The concerns stand exacerbated by recent rise in the delinquency level in mid-July 2020 (~13%[1]). High deposit concentration coupled with higher-than-industry average call deposit proportion (~18% as of mid-July 2020) also remains a risk from liquidity standpoint, although partly

1 Based on the ratio of accrued interest receivable to total interest income.

mitigated by the comfortable liquidity scenario across the industry in recent quarters and adequate buffer in the capital-adjusted credit to deposit ratio (CCD ratio) of Nabil as of mid-July 2020. Although Nabil continues to maintain industry average CASA deposit proportion and maintains better-than-industry-average deposit rates, a steady decline in CASA and increase in the term deposit proportion in the last one to two years has led to a rise in the cost of deposits in the recent period. This may lead to erosion of the bank's strong competitive positioning, which could prove detrimental for banks like Nabil with a relatively moderate branch network and a concentrated portfolio.

Going forward, Nabil's ability to maintain its asset quality amid the economic uncertainty and the adequacy of its capital cushion to withstand potential credit shocks will remain a key monitorable. The bank's ability to maintain its competitive positioning in the increasingly competitive banking sector will also remain a key rating sensitivity.

Key rating drivers

Credit strengths

Long track record, strong promoter profile and experienced management team – Operating since 1984, Nabil Bank is the first private sector bank of Nepal with a long track record of operations. The bank's track record in terms of growth, profitability and asset quality has remained strong over the years. The Chaudhary Group, one of the leading family-owned business houses in Nepal, along with its associated companies (including NB International Ltd) has ~53% equity stake in the bank. Nabil's board of directors and management team are seasoned professionals in the Nepalese banking sector with long history and adequate experience.

Strong competitive position, long-established relationship with customers and adequate market share – Nabil's competitive position in the industry remains strong, which arises largely from its long track record, established brand and traction with the customers and Nabil's ability to offer better lending rates to the borrowers (courtesy of its lowest cost of fund). This translates into a healthy market share for the bank, despite its relatively moderate branch network and a good borrower profile, which leads to a healthy asset quality.

Good reported assets quality and solvency profile, notwithstanding recent moderation – Nabil's asset quality remains strong despite the recent moderation caused by Covid-induced slippage in the recent period. The gross NPA level stood at ~0.97% in mid-July 2020, well below the industry average ~1.8%. Further, the solvency profile of the bank also remains strong, supported by low NPA levels and adequate credit provisioning. Good competitive positioning, conservative growth strategy and tested underwriting norms of the bank also remains a comfort on the asset quality front, despite the high 0+ days delinquency in mid-July 2020 remaining a concern.

Capitalisation profile remains adequate, albeit with thin cushion over regulatory minimum – Nabil has maintained an adequate capitalisation level (CRAR of 12.81% and Tier I capital of 10.69% as of mid-July 2020, albeit lower than industry average of ~14% and ~11.8% respectively), supported by healthy internal capital generation rate and profit retention (through bonus share issue) in recent years. The Central bank's restriction on cash dividend out of FY2020 profits is likely to support the capital conservation for Nabil. Future capitalisation is also expected to remain comfortable, given Nabil's good rate of internal capital generation and past track record of profit retention.

Healthy profitability profile supported by adequate NIMs, moderate operating expenses and low credit cost – Nabil has outperformed its industry peers in terms of profitability profile and return indicators over the years with strong NIMs, low credit cost and moderate operating expenses. The bank reported an average ROA of ~2.25% and RONW of ~19% in the last three years ending FY2020, supported by adequate NIMs (average NIMs of ~3.9% in last three years), moderate operating expenses and low credit cost. The NIMs have moderated in FY2020 due to the interest rate rebate allowed to regular customers for payments made in Q3 and Q4 FY2020 as per the NRB's relief measures for affected borrowers. However, profitability remains better than the industry with a reported ROA of ~1.7% in FY2020 and RONW of ~14.6% as of mid-July 2020, above the industry average of ~1.4% and ~12% respectively. The profitability indicators are expected to improve in FY2021 with the provision of rebate no longer applicable.

Comfortable liquidity position – Nabil has a comfortable liquidity position as of mid-July 2020, with low CCD ratio of ~68% as of mid-July 2020. Further, the liquid assets/total asset ratio stood at ~28% as of mid-July 2020, indicating the availability of adequate liquid assets. The bank has ample space for incremental growth and is expected to remain comfortable on liquidity going forward.

Credit challenges

High portfolio concentration among top accounts – Nabil remains a corporate heavy bank with corporate lending accounting for ~44% of total portfolio as of mid-July 2020. Credit and deposit concentrations remain high at ~25% and ~35% among the top 20 borrower groups & depositors, respectively. High credit concentration on a large credit portfolio base poses credit repricing risks and asset quality concerns for the bank to some extent, although comforted by the bank's good borrower profile. At the same time, a high deposit concentration increases repricing risks and raises concerns over the liquidity position of the bank during times of interest rate volatility, although comforted by the recent easing of liquidity across the banking industry and the comfortable CCD ratio maintained by the bank as of mid-July 2020

High delinquency level in recent period could be an indication of increasing slippages over the near term – Amid the Covid-induced stress on the borrowers, Nabil's 0+ days delinquency rose to ~13% as of mid-July 2020 vs. ~6.8% as of mid-July 2019. Although the bank's good borrower profile remains a comfort, the difficult economic condition created by Covid-19 pandemic and recent rise in delinquency could be an indication of asset quality stress over the near future.

Steady decline in CASA proportion could be detrimental to profitability and competitive positioning going forward – Nabil has witnessed a steady decline in CASA in the recent years. The CASA declined from ~60% in FY2017 to ~41% in FY2020. On the other hand, term deposit proportion increased from ~20% in FY2017 to ~41% in FY2020. Decline in CASA has led to a rise in cost of deposits in the recent period; cost of deposits increased from ~2.3% in FY2017 to ~5.3% in FY2020, albeit lower than the industry average of ~6.1%. for FY2020. Rise in the cost of deposit could erode the competitive advantage of Nabil, which could challenge the bank's growth prospect, profitability, and asset quality over the longer term.

Company profile

Nabil Bank Limited (Nabil), the first private sector class A commercial bank in Nepal, started its commercial operations from July 1984 as Nepal Arab Bank Limited. Nabil started off as joint venture bank with Emirates Bank International. The latter divested its stake in Nabil, which was ultimately taken over by NB International, an Ireland-based special purpose vehicle associated with CG Group[2]. The name was changed to Nabil Bank, following the withdrawal of the joint venture partner Emirates Bank International in 1997. Headquartered in Kathmandu, Nabil is among the top three commercial banks in terms of asset base, net worth, and market capitalisation as of mid-July 2020.

The major promoters of the bank are NB International, Ireland (50%) and Rastriya Beema Sansthan (9.67%). Including NB International, the family members of the Chaudhary Group own a majority (~53%) stake in the bank. Mr. Anil Keshary Shah is the Chief Executive Officer of the bank and its equity share is listed in the Nepal Stock Exchange.

Nabil's presence throughout the country is seen through its 118 branches and 184 ATMs. It is among the top three banks in terms of asset base in the Nepalese banking industry with a market share of 5.5% in terms of deposit base and 5.3% of total advances in Nepalese commercial banking industry as on mid-July 2020. Nabil reported a Profit After Tax (PAT) of ~NPR 3,567 million during FY2020 over an asset base of NPR 226,957 million as of mid-July 2020, against a PAT of ~NPR 4,239 million over an asset base of NPR 192,804 million as of mid-July 2019. As of mid-July 2020, Nabil's CRAR was 12.8% with a Tier I capital of 10.7% and gross NPLs stood at 0.97%. In terms of technology platform, the bank has implemented Finacle across all its branches.

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2 *Business conglomerate led by Mr. Binod Chaudhary (listed in Forbes magazine as Nepal's only billionaire); CG group has stakes in diversified sector mainly manufacturing, trading, hospitality, and financial sector.*

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	4.08%	4.16%	4.05%	3.34%
Non-interest Income/Avg. Total Assets	1.28%	1.32%	1.23%	1.02%
Operating Expenses/Avg. Total Assets	1.57%	1.60%	1.64%	1.58%
Credit Provisions / Avg. Total Assets	(0.01%)	0.12%	0.23%	0.35%
PAT / Avg. Total Assets	2.70%	2.64%	2.40%	1.70%
PAT / Net Worth	28.13%	22.96%	19.37%	14.56%
Gross NPAs	0.80%	0.54%	0.74%	0.97%
CAPITALISATION RATIOS				
Capital Adequacy Ratio	12.42%	13.00%	12.50%	12.81%
Tier I capital	11.21%	11.81%	11.40%	10.69%
Net NPAs/Net Worth	0.46%	0.29%	1.03%	1.95%
COVERAGE & LIQUIDITY RATIOS				
Total Liquid Assets/Total Liability	32.56%	27.26%	28.56%	28.10%
Total Advances/Total Deposits	75.59%	84.29%	81.96%	80.75%

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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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