

Grading Rationale
Nepal Bank Limited

Grading

Facility	Amount (Rs. In Million)	Grading	Grading Action
Further Public Offer (FPO)	4951.76024	CARE-NP IPO Grade 3+ [IPO Grade Three Plus]	Assigned on June 07, 2018 and reaffirmed on June 18, 2018

The explanatory notes regarding the Grading symbols of CARE Ratings Nepal Limited (CRNL) are attached as Annexure I

CRNL has assigned grading of ‘CARE-NP IPO Grade 3 +’ to the proposed Further Public Offer (FPO) of Nepal Bank Limited (NBL). ‘CARE-NP IPO Grade 3+’ indicates average fundamentals. CRNL assigns IPO grades on a scale of Grade 1 to Grade 5, with Grade 1 indicating strong fundamentals and Grade 5 indicating poor fundamentals. CRNL use modifier {"+" (plus)} with the grading symbols 2, 3 and 4 and the same reflect the comparative standing within the category. CRNL’s IPO grading is an opinion on the fundamentals of the issuer. The grade assigned to any individual issue represents a relative assessment of the ‘fundamentals’ of the issuer. NBL has proposed a FPO of 17,684,858 equity shares of face value of Rs.100 each at issue price of Rs.280 per share (including Rs.180 premium per share) aggregating Rs.4951.76024 million.

Detailed Rationale & Key Grading Drivers

The grading assigned to NBL derives strength from long track record of operations, majority ownership by Government of Nepal (GoN) and experienced management team, adequate capitalization level, diversified and high geographical coverage through branches, considerable growth in total income and net profit over the period, consistent growth in loan & advances and deposits, strong Return on Total Assets (RoTA) and Current Account Saving Account (CASA) ratio, diversified loan portfolio over various industries and comfortable liquidity profile. The grading, however, is constrained by moderate asset quality and high GNPL ratio, decreasing investment portfolio, intense competition and exposure to regulatory risk related to industry.

Ability of the bank to continue its growth momentum without compromising on asset quality and maintaining capital adequacy and ability to manage the impact of any regulatory changes by Nepal Rastra Bank (NRB) would be the key grading sensitivities.

Detailed Description of the Key Grading Drivers

Key Grading Strength

Long track record, ownership by GoN and experienced management team

Established in the year 1937, NBL has a strong presence in Nepal with 135 branches and 60 ATMs (as on April 13, 2018) covering all the Provinces in Nepal. The bank's profile also derives strength from the fact that the 62% of the total shares are held by Government of Nepal. NBL is professionally managed bank under the overall guidance of the bank's Board of Directors (BoD) which includes officers of Government of Nepal (Joint Secretary - Ministry of Finance), retired Secretary of Government of Nepal and Lecturer of Tribhuvan University. Mr. Janardan Sharma Acharya is the Chairman of the bank, who has more than 25 years of experience in Agricultural Development Bank (GoN owned bank) and also served as CEO of Rastriya Banijya Bank (GoN owned bank). The bank is led by a professional CEO, Mr. Devendra Pratap Shah who has more than 3 decades of banking sector experience. He is assisted by senior management team members with vast experience in their respective fields.

Adequate capitalisation

Tier I capital adequacy of the bank stood at 16.78% as on April 13, 2018 (As on July 15, 2017: 13.37%) and overall capital adequacy stood at 18.02% (As on July 15, 2017: 14.47%) as against the minimum regulatory requirement of 8% and 11% respectively as per Basel III norms of NRB. The CAR of the bank would be further strengthened after the proposed FPO. During FY17 (refers to period ended July 15, 2017), the bank has raised the paid-up capital by Rs.1543 Mn through rights share issue.

Diversified and high geographical coverage through branches

NBL has presence all over the country through its 135 branches and 60 ATM terminals as on April 13, 2018. The branches are spreaded over all 7 provinces and cover 52 districts (out of total 77 districts) of Nepal.

Consistent growth in loans & advances and deposits

Over the last 3 years, the bank has shown robust growth in the Loans & Advances and Deposits. The total Loans & Advances grew by about 17% to Rs.72 Bn during FY17 as compared to FY16 against the industry growth rate of around 24.5%. The same further grew by 11% to Rs.80 Bn as on April 13, 2018 vis-à-vis FY17. NBL's share in overall industry advances stood at 4.33% as on July 15, 2017.

On the back of additions of 3 new branches during FY17 and with adaptation of various services & facilities on existing deposit accounts, the deposits registered a growth of 5.1% to Rs.94 Bn during FY17 as compared to FY16 (overall industry growth rate of 18.63%). However, during 9MFY18 (refers to period ended mid-April 2018), the deposits declined by 3% over FY17 to Rs.90 Bn on back of high competition between the commercial banks and the liquidity crunch existing in the industry. However, the deposits shown growth of 8.17% during 9MFY18 over 9MFY17.

Considerable growth in total income and net profit over the period; Strong RoTA

During FY17, NBL's total income increased by nearly 13% to Rs.9,838 Mn (FY16: Rs.8,727 Mn) majorly due to rise in interest income by 20% on back of growth in advances and higher yield on advances. The growth in total income was despite decrease in non-interest income by 6% on back of decrease in profit on sale of assets (declined by 21%). Excluding the impact of profit on sale of assets, the non-interest income grew by 28% y-o-y. Further, to strengthen the capital adequacy of the bank, NBL sold non-core assets and profit from sale of those investments and assets was Rs.1,734 Mn, Rs.1,376 Mn and Rs.492 Mn during FY16, FY17 and 9MFY18 respectively. On account of this, the Net Profit increased by 8% y-o-y to Rs.3,188 Mn in FY17 with strong Return on Total Assets (RoTA) of 2.90% for FY17 (FY16: 3.01%).

NBL also witnessed substantial growth in the net interest income of 26% y-o-y to Rs.5,798 Mn during FY17 mainly because of growth in interest income on the back of increase in loans and advances. The yield on advances increased by 7bps to 10.88% on the back of increasing proportion of retail loans in the loan portfolio as well as increasing interest rate in the market. However, the cost of deposits decreased by 11bps to 1.87% on back of high CASA ratio of 72.45%. Increase in the Net Interest Income compared to lower increase in cost of deposits resulted into substantial improvement in the Net Interest Margin (NIM) to 5.38% in FY17 as compared to NIM of 4.81% in FY16.

During 9MFY18, bank's total income increased by 12.39% to Rs.8,516 Mn in comparison to Rs.7,577 Mn during 9MFY17. Also PAT of the bank has marginally increased by 2.06% to Rs.2,569 Mn during 9MFY18 (Rs.2,516 Mn during 9MFY17) due to substantial increase in interest income of the bank by 25% to Rs.6,606 Mn.

Diversified loan portfolio over various industries

NBL has a diversified loan portfolio which consists of various types of loans disbursed over the period for various Industry/Sector with highest lending of 26.40% towards wholesale & retail trading sector followed by 15.51% towards consumption loans (hire purchase, gold/ silver, fixed deposit receipt etc.) and lower lending of 0.05% on fishery related sectors as on April 13, 2018. Bank has its major portion contributed towards retail and corporate sector. As on July 15, 2017, the corporate segment comprised of 27.67% (26.21% as on July 15, 2016) of the advances, retail banking comprised 41.31% (27.37% as on July 15, 2016) and small & medium enterprises (SME) comprised 20.97% (40.58% as on July 15, 2016).

Strong CASA ratio

CASA deposits proportion decreased from 80.64% as on July 15, 2016 to 72.45% as on July 15, 2017, and subsequently improved to 76.28% as on April 13, 2018 (Industry avg. CASA for July 15, 2016 and July 15, 2017 was 49.70% & 43.11% respectively). The Term deposit/Total deposits increased from 13.12% as on July 15, 2016 to 22.66% as on July 15, 2017, however decreased to 19.40% as on April 13, 2018 (Industry avg. term deposit/total deposit for July 15, 2016 and July 15, 2017 was 29.72% & 42.00% respectively), which resulted in lower cost of deposit (i.e. 1.98% and 1.87% during FY16 and FY17 respectively) in comparison to industry and provides the competitive advantage to NBL over the other Banks.

Comfortable liquidity profile

NBL has maintained SLR of 22% as on July 15, 2017 (against industry average of 23.34%) & 19% as on April 13, 2018; average CRR of 9.51% and 6.27% at the last reporting week as of FY17 and 9MFY18 respectively; Net Liquidity of 29.89% as on July 15, 2017 (against industry average of 29.65%) & 20.10% as on April 13, 2018. Maintained SLR, CRR and Net Liquidity are within the norms of NRB.

Moderate deposits concentration and Moderate advances concentration

Deposit concentration of top 20 depositors has increased substantially from 5.51% of total bank deposits as on July 15, 2017 to 15.89% of total bank deposits as on April 13, 2018. NBL has moderate concentration on advances as top 20 individual borrowers account for 11.02% of total loan portfolio as on April 13, 2018.

Key Grading Weaknesses

Moderate Assets quality and high GNPL ratio

There was significant increase in absolute amount of Gross NPLs from Rs.1,978 Mn at the end of FY16 to Rs.2,310 Mn as on July 15, 2017. Gross NPL ratio was 3.32% as on July 15, 2017 (Industry average for commercial bank 1.54 % as on July 15, 2017). Gross NPL to Net-worth ratio was 21.74% as on July 15, 2017 (29.46% as on July 15, 2016). At the end of 9MFY18, the asset quality has improved to 2.91% on back of decline in GNPL and increase in overall loans and advances.

Decreasing investment portfolio with less diversification

NBL has gross investments of Rs.11,307 Mn as on April 13, 2018 which decreased by 7.74% from Rs.12,181 Mn (P.Y: Rs. 12843 Mn) as of July 15 2017, out of which Rs.8,927 Mn (79% of total investments) has been invested in Treasury & Bonds issued by Nepal Government and Nepal Rastra Bank. During FY17, NBL made Rs.1,376 Mn profit on sale of investments and assets, Rs.224 Mn received as interest income from Nepal Government, Rs.43.39 Mn received as Interest on Interbank Placements and Rs.11.10 Mn received as dividend income from shares of corporate sectors.

Intense Competition

Currently there are 28 Commercial Banks operating with total 2,535 branches all over Nepal (based on Monthly statistics published by NRB for Mid-Feb 2018). NBL has 135 branches as on Mid-April, 2018. Industry (Class ‘A’ Commercial Banks) has achieved total interest income of Rs.109,407 Mn during 9MFY18 with Rs.43,118 Mn net interest income; NBL’s share of interest income was 3.88% and 6.82% share of net interest income for the same period. Due to emergent competition it is challenge to recruit and retain skilled manpower. High competition in interest rates is the prominent challenge. New technology based services and its growing demand among customers is fresh challenges for Nepalese banking sector.

Exposure to regulatory risk related to industry

The banking sector is under capital increment pressure. Nepal Rastra Bank has extensively increased capital requirement for banking sector, i.e. from Rs.2 Bn to Rs.8 Bn for Class “A” Commercial Banks. It is a new challenge to the banking sector for financial performance as compared to capital increment in terms of Deposit, Credit, Profitability growth and payout to shareholders. As weighted average interest rate spread shouldn’t be more than 5% since FY15

stated by NRB and together with growing competition it has been decreasing continuously over the period thereby impacting profitability. Further the banking industry in Nepal is exposed to changes in the various regulatory measures issued by NRB from time to time.

About the Company

Nepal Bank Limited (NBL) is “A” Class Licensed Institutions from Nepal Rastra Bank (NRB). It was incorporated on November 15, 1937 and was the first bank of Nepal, which started formal banking in Nepal. The 62.21% of the total shareholding of the Bank is held by Government of Nepal, 5% by corporate entities (other than GoN and Licensed Institutions) and rest by Individual General Public as on July 15, 2017. The market share of NBL in terms of deposit base is 4.48% as on Mid-July 2017 and 4% as on Mid-April 2018; for the loan portfolio the market share is 4.33% as on Mid-July 2017 and 4% as on Mid-April 2018 of industry (Class ‘A’ Commercial Banks).

The bank has achieved PAT of Rs.2883 million on an asset size of Rs. 112 billion as on July 15, 2017 (A) as against PAT of Rs. 3118 million on an asset size of Rs.103 billion as on July 15, 2016. Further, NBL earned PAT of Rs.2568 million during 9MFY18.

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Annexure 1

CARE Ratings Nepal – IPO Grading Scale

CARE IPO grade	Definition
CARE-NP IPO Grade 1	Strong fundamentals
CARE-NP IPO Grade 2	Above average fundamentals
CARE-NP IPO Grade 3	Average fundamentals
CARE-NP IPO Grade 4	Below average fundamentals
CARE-NP IPO Grade 5	Poor fundamentals

Note:

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