

Rating Rationale

NIC Asia Bank Limited

Rating

Facility/Instrument	Amount (Rs. In Million)	Rating	Rating Action
Issuer Rating	-	CARE-NP A (Is) [Single A (Issuer)]	Assigned

The explanatory notes regarding the Rating symbols of CARE Ratings Nepal Limited (CRNL) are attached as Annexure 1

CRNL has assigned Issuer Rating of ‘CARE-NP A (Is)’ to NIC Asia Bank Limited (NIC Asia). ‘CARE-NP A (Is)’ indicates ‘Issuers with this rating are considered to offer adequate degree of safety regarding timely servicing of financial obligations, in Nepal. Such issuers carry low credit risk’. CRNL assigns Issuer Rating on a scale of CARE-NP AAA (Is) to CARE-NP D (Is). The rating is only an opinion on the general creditworthiness of the company and not specific to any particular debt instrument.

Detailed Rationale & Key Rating Drivers

The rating assigned to NIC Asia derives strength from the long track of operations, experienced promoters and management team, adequate capitalization level & capital adequacy, geographical diversification through branches, consistent growth in loans & advances and deposits, considerable growth in total income and net profit over the period, good assets quality with declining Gross Non Performing Loans (GNPL) ratio, diversified loan portfolio with focus on retail and SME segments, improving CASA ratio, comfortable liquidity profile and declining deposits concentration & moderate advances concentration. The rating, however, is constrained by declining return on total assets (RoTA), increasing operating expenses, intense competition and exposure to regulatory risk related to industry.

Ability of the company 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 rating sensitivities.

Detailed Description of the Key Rating Drivers

Key Rating Strength

Long track record, experienced promoters and management team

NIC Asia Bank was established in the year 1998 and has two decades of market presence. The bank’s profile derives strength from its strong promoters who are well experienced in the Banking, Insurance, Manufacturing, Import and Export, Trade sectors etc. NIC Asia is professionally managed bank under the overall guidance of the bank’s Board of Directors (BoD) which includes eminent Businessmen/ Industrialists with wide experience in the financial services. Mr. Tulsi Ram Agrawal is the Chairman of the bank, who has been engaged in industry, import export, banking and business sector for more than 3 decades.

The top and senior management team is highly experienced in their respective field of operations. The bank is led by its present Acting CEO, Mr. Roshan Neupane along with

Assistant CEO Mr. Sudhir Nath Pandey who are assisted by senior management team members with vast experience in their respective fields. All the management members have minimum 3 years to 24 years of banking experience.

Adequate capitalisation & capital adequacy

Tier I capital adequacy of the bank stood at 9.48% as on January 14, 2018 (As on July 15, 2017: 12.38%) and overall capital adequacy stood at 13.59% (As on July 15, 2017: 13.83%) as against the regulatory requirement of 8% and 11% respectively as per Basel III norms of NRB. The bank has an adequate capital adequacy ratio inspite of the strong growth over the years due to regular capital infusion. During FY17 (refers to 12 month period ending mid July 2017), the bank has raised the paid-up capital by Rs.1,339 Mn through bonus shares issue and Rs.873 Mn through right share issue. Further, to strengthen the CAR, Bank has raised Rs.3 Bn by issuing “9% NIC Asia Debenture 2081/82” during H1FY18 having 7 years’ maturity period.

Geographical diversification through branches

The bank has been aggressive on branch expansion over the period. During FY17, the bank has added 53 branches and has also planned to add 80 new branches during FY18. NIC Asia Bank has good geographical spread in Nepal with all over the country through its 179 branches, 4 extension counters and 172 ATM Terminals as per latest available data (i.e. as on February 18, 2018). The branches are spreaded over all 7 Provinces and covers 56 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. Total deposits grew by 25% to Rs.87 Bn during FY17 as compared to FY16 against industry growth of 18.63% and further increased by 39% to Rs.120 Bn as on January 14, 2018, on back of 53 new branch additions during FY17 and further new branches added during H1FY18. High addition of branches over the last 2 years coupled with aggressive lending by the bank, led to total advances growth of 22% during FY17 to Rs.72 Bn. The same further grew substantially by 41% during H1FY18 to Rs.102 Bn over July 15, 2017. NIC Asia had a share of 4.18% & 5.31% of the industry advances as on July 15, 2017 and January 14, 2018 respectively. Due to this rapid pace of growth, the loan book is relatively unseasoned and has to see the test of time. Further, the ability of the bank to maintain the asset quality is the key rating sensitivity.

Considerable growth in total income and net profit over the period

During FY17, the bank’s total income grew by 57% to Rs.7,986 Mn on the back of rise in both interest income by 57% on back of growth in advances & yield on advances and increase in the non-interest income by 58% on back of increase in investment income. However, the net interest income reported a lower growth of 30% to Rs.2,542 Mn in comparison to the increase in the total income mainly due to higher cost of deposits leading to increase in interest expenses.

The yield on advances increased by 178 bps to 10.07% and the cost of deposits increased by 159 bps to 5.49%. Increase in the yield on advances compared to lower increase in cost of deposits resulted into marginal improvement in the Net Interest Margin (NIM) to 2.83% in FY17 as compared to NIM of 2.78% in FY16. Significant decline in NPLs during FY17 led to decline in provision for loan loss expenses by 19.25% as compared to previous year. As a result of this, the

net profit increased by 38% Y-o-Y to Rs.1,473 Mn in FY17 with Return on Total Assets (RoTA) of 1.64% for FY17 (FY16 1.51%).

During H1FY18, bank's total income grew by 94.30% to Rs.6,113 Mn compared to Rs.3,146 Mn during H1FY17. However, PAT of the Bank declined by 20.74% to Rs.572 Mn during H1FY18, due to increase in interest expenses (i.e. 160%) on back of higher cost of funds and also due to substantial increase on Provision for Possible Losses on back of substantial increase in the level of advances during H1FY18. Tightening liquidity in banking sector during the end of FY17 resulted in increased cost of funds for banking sector in Nepal.

Good asset quality and declining GNPLs

The asset quality of the bank remained good reflected by GNPL% of 0.36% & 0.26% as on July 15, 2017 & January 14, 2018 respectively. This is in comparison to the average GNPL% of 1.54% & 1.71% for commercial banks (A class) as on July 15, 2017 & January 14, 2018 respectively. Further, the provision coverage was 372.37% as on July 15, 2017. The bank has strengthened the recovery department with improvement in the tracking mechanism for NPLs. Out of total advances of Rs.72,562 Mn as of July 15, 2017, Rs.709 Mn delinquencies of more than 30 days have been observed, which accounts for 0.98% of total advances; the same has decreased to Rs.645 Mn out of total advances of Rs.102,201 Mn as of January 14, 2018; decrease of 35bps to 0.63% compared to July 15, 2017.

Diversified loan portfolio, concentration towards retail and SME portfolio

NIC Asia has a diversified loan portfolio which consists of various types of loan disbursed over the period for various Industries/Sectors with maximum lending of 26.38% towards wholesale & retail sector as on January 14, 2018. Bank has shifted its concentration towards retail and SME portfolio over the period with a view of risk diversification. As on July 15, 2017, the corporate segment comprised 18.62% (29.47% as on July 15, 2016), Retail banking comprised 44.43% (42.83% as on July 15, 2016) and Small & medium enterprises (SME) comprised 31.12% (23.68% as on July 15, 2016) of the total advances. Retail portion further improved to 45.69% (Retail plus SME 77.53%) as on January 14, 2018. Bank has been able to decrease corporate portion on its portfolio and focused on retail and SME lending as targeted.

Improving CASA ratio

CASA deposits proportion increased marginally from 31% as on July 15, 2016 to 32% as on July 15, 2017. The same further improved to 41% during H1FY18 (Industry avg. CASA for Oct 17, 2017 was 43.45%). Also the Term deposit/Total deposits increased from 39.52% as on July 15, 2016 to 45.85% as on July 15, 2017 (Industry avg. term deposit/total deposit for July 15, 2017 was 42.00%), which resulted in higher cost of funds.

Comfortable liquidity profile

Bank has comfortable liquidity profile with positive cumulative mismatches upto 270 days, as on January 14, 2018, due to well matched tenure of assets and liabilities. However, the assets and liabilities show mismatches during 91 to 180 days (but has positive cumulative mismatches). NIC Asia has maintained SLR of 21.69% as on July 15, 2017 & 20.10% as on January 14, 2018 against industry average of 23.34% & 23.38% respectively; average CRR of 11.37% and 6.38% at the last reporting week as of FY17 and H1FY18 respectively; Net Liquidity of 25.80% as on 15 July 2017 & 20.35% as on January 14, 2018. The bank has maintained SLR, CRR and Net

Liquidity as per the norms of NRB along with the rollover of the deposits and additional deposits are expected to provide some cushion to the liquidity profile.

Declining deposits concentration and moderate advances concentration

Deposit concentration to top 20 depositors has declined from 28% of total bank deposits as on July 15, 2017 to 25% of total bank deposits as on January 14, 2018. Moderate concentration on advances as top 20 individual borrowers accounts for 6.95% of the total loan portfolio (i.e.Rs. 102 Bn) as on January 14, 2018.

Key Rating Weaknesses

Decreasing return on total assets (RoTA)

The ROTA of the bank declined to 0.82% during H1FY18 which was 1.64% for FY17 and 1.69% at H1FY17; due to substantial increase in assets base and on the other hand, the PAT declined by 21% as stated above. However, the Net interest income of the Bank increased by 34% to Rs.1,545 Mn during H1FY18 vis-a-vis H1FY17.

Increasing operating expenses

On the operational efficiency front, during FY17, the operating expenses have shown a y-o-y growth of 50.44% on account of branch expansion (53 branches added during FY17), increase in the number of employees to 1,755 against 1,101 employees at the end of FY16 and high expenses towards business promotion activities. The operating expenses/ average total assets increased to 1.76% in FY17 as compared to 1.49% in FY16. With further expansion in the branches, the operating cost may take some time to stabilize.

Intense Competition

Currently there are 28 Commercial Banks operating with total 2341 branches all over Nepal (based on Monthly statistics published by NRB for Mid-Dec 2017). NIC Asia has 179 branch along with head office and four extension counters as on February 18, 2018. Industry (Class ‘A’ Commercial Banks) has achieved total interest income of Rs.109,407 Mn during H1FY18 with Rs.43,118 Mn net interest income; NIC Asia’s share on interest income is 5.08% (Rs.5,555 Mn) and 3.58% share on net interest income (Rs.1,545 Mn) for the same period. Currently bigger banks are providing advances at the fine interest rates of 10%-14% p.a. to its customers, however Base Rate of NIC Asia is 10.71% as of January 14, 2018. Due to emergent competition it is challenges to recruit and retain skilled manpower. Unhealthy competition on 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 reeling 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, due to which banks are facing investable amount deficit to grant new loans and advances. It’s the new challenges to 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

NIC Asia Bank Limited (NIC Asia) is “A” Class Licensed Financial Institutions from Nepal Rastra Bank (NRB) and is one of the top 5 “A” Class (Commercial) banks of Nepal in terms of Deposits and loans and advances as on Jan 14, 2018. It was incorporated on July 21, 1998 as Nepal Industrial & Commercial Bank Ltd., later it was merged with Bank of Asia Nepal Ltd. as on June 30, 2013 and named NIC Asia Bank Limited. The 93.48% of the total shareholding of the Bank is held by individual general public and 6.52% by corporate entities as on July 15, 2017; among which 51% belongs to promoter group shares and 49% belongs to general public. NIC Asia has certified by ISO 9001:2000 for implementing Quality Management System Standard; which has been upgraded to *ISO 9001:2008* Certificate for *Quality System on Commercial Banking Activities*. Bank has been awarded as Bank of the Year 2007 and Bank of the Year 2013 by The Financial Times, U.K.-The Banker. The market share of NIC Asia Bank in terms of deposit base is 4.14% as on Mid-July 2017 and 5.44% as on Mid-January 2018; for the loan portfolio the market share is 4.18% as on Mid-July 2017 and 5.31% as on Mid-January 2017 of industry (Class ‘A’ Commercial Banks). The Bank has two wholly owned subsidiary companies operating in Nepal namely NIC Asia Capital Limited (undertake Merchant Banking activities) and NIC Asia Laghubitta Bittiya Sanstha Limited (microfinance business).

Monetary Policy 2015-16 issued by NRB advocates commercial banks would have to increase minimum paid-up capital from existing Rs. 2 Bn to Rs. 8 Bn. NIC Asia Bank has achieved the minimum paid up capital with paid up capital of Rs. 8.03 Bn as on January 14, 2018.

The bank has achieved PAT of Rs.1,473 Mn on an asset size of Rs.99,232 Mn as on July 15, 2017 (A) as against PAT of Rs.1,067 Mn on an asset size of Rs.80,425 Mn as on July 15, 2016. Further, NIC Asia earned PAT of Rs.572 Mn during H1FY18(UA).

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Annexure 1

CARE Ratings Nepal – Symbols for Issuer Rating in Nepal

Symbols	Rating Definition
CARE-NP AAA (Is)	Issuers with this rating are considered to offer the highest degree of safety regarding timely servicing of financial obligations, in Nepal. Such issuers carry lowest credit risk.
CARE-NP AA (Is)	Issuers with this rating are considered to offer high degree of safety regarding timely servicing of financial obligations, in Nepal. Such issuers carry very low credit risk.
CARE-NP A (Is)	Issuers with this rating are considered to offer adequate degree of safety regarding timely servicing of financial obligations, in Nepal. Such issuers carry low credit risk.
CARE-NP BBB (Is)	Issuers with this rating are considered to offer moderate degree of safety regarding timely servicing of financial obligations, in Nepal. Such issuers carry moderate credit risk.
CARE-NP BB (Is)	Issuers with this rating are considered to offer moderate risk of default regarding timely servicing of financial obligations, in Nepal.
CARE-NP B (Is)	Issuers with this rating are considered to offer high risk of default regarding timely servicing of financial obligations, in Nepal.
CARE-NP C (Is)	Issuers with this rating are considered to offer very high risk of default regarding timely servicing of financial obligations, in Nepal.
CARE-NP D (Is)	Issuers with this rating are in default or are expected to be in default soon.

Note:

- i. Modifiers {"+" (plus) / "-"(minus)} can be used with the rating symbols for the categories CARE-NP AA (Is) to CARE-NP C (Is). The modifiers reflect the comparative standing within the category.
- ii. '(Is)' suffix will be added to indicates 'Issuer Rating'.