THE ANALYST

NMB CAPITAL LIMITED

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MARKET UPDATE

- The NEPSE index has remained bearish during the review period of Mid-May to Mid-August. The index slid to 1,210.32 from 1,338.17; a decline of 9.55% i.e.127.85 points. Apart from the Trading index which rose by 4.81%, all other sub-indices ended in the red zone with Life Insurance Index witnessing the steepest fall of 16.42%. Significant drop in investors' participation has been observed as the average daily turnover for the review period dropped to NPR 296,532,243 from the average daily turnover of NPR 632,495,316 during the previous review period (Mid-April to Mid-May).
- The unaudited financial statements of commercial banks published for FY 17/18 during the review period exhibited growth in net profit by 19.9% y-o-y in accordance with Nepal Accounting Standard as compared to growth of 24.5% in FY 16/17. In accordance with the newly followed Nepal Financial Reporting Standard, net profit in FY 17/18 revealed growth of 21.44%. The average base rate of commercial banks grew to 10.58% during the FY 17/18 from 10.00% in the previous year, while interest spread rate stood at 4.47% compared to 3.9% at the end of FY 16/17. [1]
- On the macroeconomic front, Current Account deficit has widened to NPR 245.22 billion from NPR 10.13 billion a year ago. The report also shows that Balance of Payment (BOP) had registered a minimal surplus of NPR 0.96 billion compared to surplus of NPR 82.11 billion a year ago.[2]
- The budget for FY 18/19 announced on 30th May 2018, has increased capital gain of securities in the capital market to 7.5% for individuals, 15% for institutions and 25% for others. Also, it was announced that VAT shall not be applied on brokers' commission.
- Monetary policy for the FY 18/19 was unveiled on 11st July 2018. Some of the major highlights are as follows:
  - Margin calls to be triggered only when the decline in share prices exceeds 20%, which was previously 10%.
  - Cash Reserve Ratio has been reduced to 4% for all classes of Banks and Financial Institutions. Statutory Liquidity Reserve (SLR) for Class A, B and C companies has been reduced to 10%, 8% and 7% respectively.
  - Interest rate spread has been revised to 4.5% which was previously fixed at 5% for commercial banks.
  - The spread rate of 6% is allowed for MFIs, the upper cap for lending rates has been withdrawn.

Table 1: Changes in major indices during the quarter

Sub-Index	14th May 2018	16th August 2018	Change
Banking	1,147.92	1,041.32	-9.29%
Dev. Bank	1,544.19	1,469.33	-4.85%
Finance	652.13	618.8	-5.11%
Microfinance	1,720.34	1,529.47	-11.09%
Life Insurance	6,941.80	5,801.84	-16.42%
Non-Life Insurance	6,941.80	5,960.5	-14.14%
Hydro Power	1,650.96	1,413.46	-14.39%
Hotels	1,965.92	1,849.77	-5.91%
Trading	195.00	204.38	4.81%
Manu. & Pro.	2,313.80	2,222.47	-3.95%
Others	749.85	723.63	-3.50%

NMBCL UPDATES

- Issuance of Right Shares of **Siddhartha Insurance Ltd.** *Issue Open date: July 1, 2018 – August 5, 2018.*
- Issuance of Right Shares of **NagBeli LaghuBitta Bikas Bank Ltd.** *Issue Open date: July 20, 2018 – August 23, 2018.*
- Issuance of Right Shares of **Swarojgar LaghuBitta Bikas Bank Ltd.** *Issue Open date: July 29, 2018 – September 2, 2018.*
- Issuance of Right Shares of **Naya Nepal Laghubitta Bikas Bank Ltd.** *Issue Open date: August 12, 2018 – September 16, 2018.*

[1] *(Figures for FY 17/18 are based on unaudited Q4 financials while figures for FY 15/16 and FY 16/17 are based on audited figures where available)*
[2] (Nepal Rastra Bank, Current Macroeconomic and Financial Situation of Nepal, 2018)

INTEREST RATES

During the review period the average interbank rate has decreased from 4.88% to 3.02%. Nepal Rastra Bank (NRB) has been implementing Interest Rate Corridor (IRC) since the FY 16/17 with the objective to stabilize fluctuations in short term interest rates. In the present interest corridor system, standing lending facility rate acts as a ceiling of the corridor while two-week deposit auction rate acts as the floor. Both rates are fixed by the central bank. The repo rate is set as the central bank's policy rate and is currently fixed at 5%. If the interbank rate in the money market goes beyond 5%, NRB injects liquidity to bring the interest rate down through issuance of repo and if the interbank rate goes below 3.5%[3], NRB mops up liquidity from the system. As depicted in *Figure 1*, the inter-bank declined below 3%[4] during the months of July and August. In response, NRB mopped up NPR 42.8 billion through deposit collection under this interest rate corridor mechanism during the quarter. Also, NRB has mopped up NPR 84.65 billion through regular deposit collection on average rate of 3.4774%.

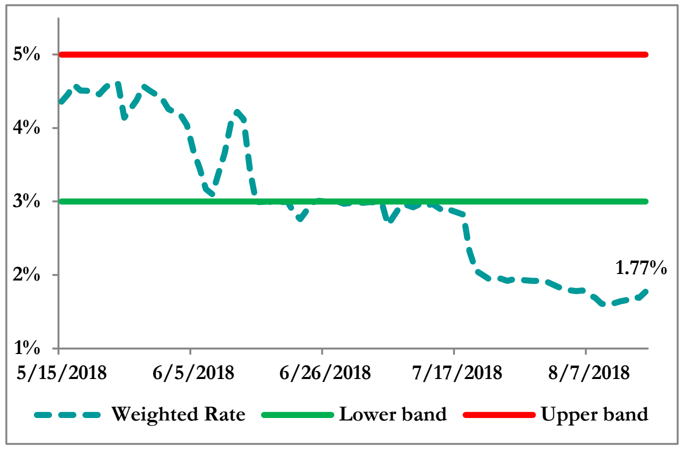


Figure 1: Weighted average interbank rate

NRB also issues treasury bills of varying maturity each week to help Government of Nepal manage its treasury. At the end of the review period, the discount rate on the treasury bills maturing in 28 days, 91 days, 182 days and 365 days stood at 2.449%, 3.2852%, 4.3911% and 4.0240% respectively *(See: Figure 2)*. Discount rates of the government treasuries fell significantly during the quarter.

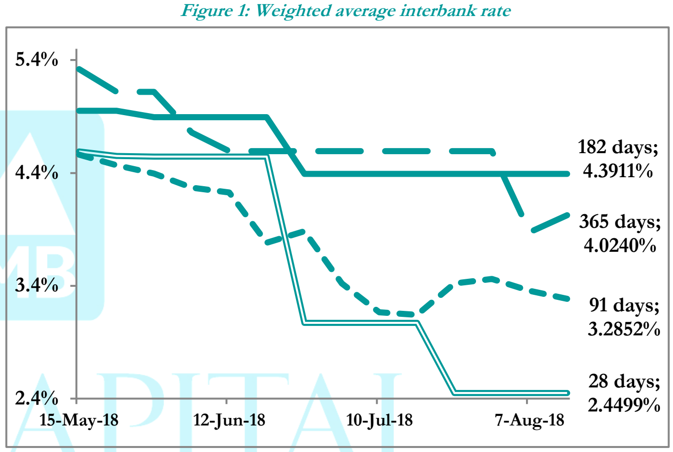


Figure 2: Discount rates of treasury bills of different maturity over the review period

Figure 3 below shows average interest rates offered by commercial banks on fixed deposits of different tenure ranging from 3 months to 10 years. The average rates offered for fixed deposit of 3 months was 8.9% while the rate was 8.6% for tenure of 10 years. On an average, commercial banks were offering 10.4% interest on fixed deposit of 1 year tenure. The dotted line shows average fixed deposit rates for respective tenure during mid-May 2018.

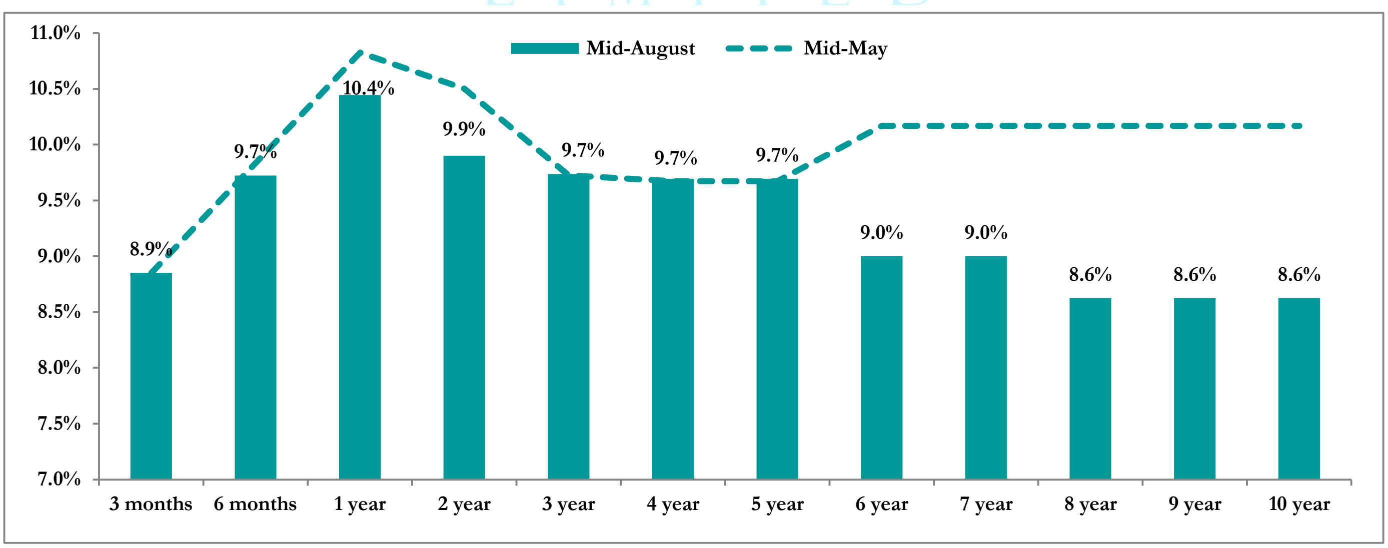


Figure 3: Average interest rates offered by commercial banks in fixed deposits of different tenure

[3] (Nepal Rastra Bank, Monetary Policy 2018-19, 2018)

[4] *Revised floor rate of 3.5% came to effect only after Mid-July. However NRB hasn't yet implemented IRC with this revised floor rate.*

NEPSE – TECHNICAL ANALYSIS

Figure 4: Daily chart of NEPSE

During the review period, NEPSE index registered a loss of 127.85 points, i.e. 9.6% to close at 1,210.32. The index that started to tumble from late April continued its fall during the months of May and June as well, although during the end of the quarter the movement turned sideways. In early August, the benchmark index dropped to its lowest close - 1,163 points, since January 2016 breaking its previous low of 1,168 of early April 2018. After making its record high of 1,881 points, the index has made three consecutive lower lows (on close basis) accompanied by lower highs which represents the basic characteristics of a downtrend. Transaction volume has dried up during the period which can be distinctly seen in the chart above.

During the month of July and August, NEPSE turned sideways which is exhibited by the narrowing Bollinger bands (20 days). The Moving averages and MACD don't provide any conclusive direction of the market as of now due to the sideways movement of the index. A notable price structure has started to form during the end of the review period - divergences between RSI and the index - as shown in *Figure 5*. Divergence supported by increase in volume and other technical indicators have the ability to initiate reversal from a prevailing trend.

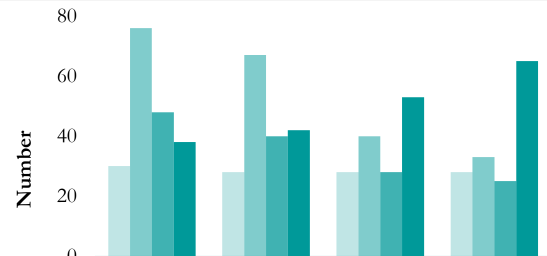
Figure 5: Daily chart of NEPSE with indicators

The overall market is still in a bearish trend as characterized by the lower lows and lower highs and the newly formed lower low has reinforced it. The formation of divergences will have to be keenly monitored during the coming days. Such divergence has also appeared in the banking sub-index which constitutes more than half of the total market capitalization of the NEPSE index.

BANKING INDUSTRY OUTLOOK

Nepalese banking industry has seen significant changes over the past decades as a result of liberalization, deregulation, advances in information technology and globalization. The financial sector liberalization resulted in entry of more players in the market; deregulation widened the scope of banking business; and globalization added more pressure on competitiveness of local banks.

The recent regulatory requirement for minimum paid up capital has resulted in amalgamation of financial institutions in the country. The Nepalese banking industry is currently going through a consolidation phase of with mergers and acquisitions. According to the central Bank, Nepal Rastra Bank (NRB), the merger and acquisition of banks and financial institutions (BFIs) has helped strengthen financial sector stability.[5] The mergers between Bank of Asia and the then NIC Bank and later Bank of Kathmandu and Lumbini Bank have resulted in the decline in number of commercial banks. However, the provision[6] of upgrading small financial intermediaries and non-governmental organizations (FINGO) to microfinance institutions by mid-December 2018 has led to the increase in the number of microfinances despite the reluctance of NRB[7] to issue new license.



	2015	2016	2017	2018
Commercial Banks	30	28	28	28
Development Banks	76	67	40	33
Finance	48	40	28	25
Microfinance	38	42	53	65

Figure 6: Number of Banks and Financial Institution

The robust growth in the major indicators of the banking industry as depicted in *Table 2* indicates the expansion of the industry over the last few years. The given table highlights the steady growth in broad money supply. Deposits at banks and financial institutions have been growing in tandem with the increase in broad money supply. In the last FY the deposits at Banks and Financial Institutions (BFIs) increased by 19.2 percent from a decreased growth of 14.0 percent in the previous year.[8] The rate of growth in credit disbursements has been higher as compared to deposit growth in recent years. This can result in higher ALM mismatches in future than the past due to the growth in the size of banks' balance sheet. It can further result in a heated tussle for acquiring funds thus leading to higher interest rates. The banks are expected to be prudent in their growth plans and show a holistic approach on their overall business strategies.

Table 2: Key Indicators during past 5 years

Key Indicators	FY 13/14	FY 14/15	FY 15/16	FY 16/17	FY 17/18
Broad Money (M2) Growth	19.1%	19.9%	19.5%	15.5%	19.4%
Deposit Growth	18.4%	20.1	19.4%	14.0%	19.2%
Credit Growth	14.4%	19.8%	23.7%	18.2%	22.5%
Net Profit (in millions)	19,448	28,120	35,590	44,310	53,128
Return on Equity	16.44%	19.06%	18.05%	15.25%	14.51%

The net profit of the commercial banks has been increasing in absolute terms every year; however the industry's return on the equity (ROE) seems to indicate a different picture. The ROE peaked at 19.06% in FY 14/15 after which the ROE of the industry had started to decline and currently stands at the 14.51%, the lowest in the last 5 years. On further introspection, the recently met minimum paid up capital requirement through issuance of further public offerings (FPO), rights share and bonus may have contributed to the fall in ROE. As paid up capital rose during the past couple of years, ROE has declined accordingly. As the capital increments have taken place in the most recent years, the additional resources have yet to be fully utilized to their optimum capacity. The industry capital adequacy ratio stands at 14.61 %[9]. The industry has 3.61% of free capital to leverage more to achieve the optimum efficiency and positive growth in ROE may be expected upon utilization.

Report published by National Planning Commission has highlighted that the country requires NPR 1,770 billion worth of investments (gross capital formation) each year to attain its sustainable development goal target by the year 2030[10]. In the last two fiscal years, when country had witnessed one of the highest levels of economic growth in past two decades, the average investment stood at NPR 1,382

[5] (Bank Supervision Report, 2017)
[6] (https://nrb.org.np/ofg/other_policy/Policies--Provision_related_to_FINGO_Conversion.pdf, n.d.)
[7] (Bank and Financial Institution Act 2074, 2074)
[8] (Nepal Rastra Bank, Current Macroeconomic and Financial Situation of Nepal, 2018)
[9] (Nepal Rastra Bank, https://nrb.org.np/bsd/bsdindex.php?vw=4, 2018)
[10] (National Planning Commission, 2017)

billion[11]. Similarly, the Government of Nepal has set a target of economic growth at 8 percent for FY 18/19[12], for which the majority of investment shall be contributed by the private sector; hence the demand for credit shall be insistent.

Simultaneously, the banking system's demand for deposits shall also increase to facilitate the fulfillment of credit requirement. However, growth rate of remittance which is the major source of deposit for the banking system is declining in recent years. If this trend continues in the years to come, it is likely to put upward pressure on interest rates. Rise in interest rates can become an obstacle for capital formation that is required for economic growth targeted by the Government. However, banks can utilize the provision made by the Monetary Policy for FY 18/19 to source additional funds to meet the credit demand. BFIs have been allowed to utilize external borrowing in convertible foreign currencies, including borrowing in Indian currency up to 25 percent of their core capital[13]. As of Mid-July 2018, commercial banks can draw funds worth of approx. NPR 87.9 billion though foreign borrowing[14]. This may not be an easy process though as - Nepal is yet to have a sovereign ratings, peg risk due to NPR being anchored with INR, acceptable level of bank risk of individual banks for foreign lenders and above all the costs associated with hedging the foreign currency will be higher than the cost of borrowing. On the political front, after a lengthy transitional period Nepal has finally witnessed the conclusion of the peace process with the formation of the new constitution. Establishment of a stable government has resulted in emphasis on economic growth, infrastructural development and capital formation. The devastating earthquake of 2015 had resulted in loss of lives and physical infrastructure, which require rebuilding. Reconstruction activities which have not been completed yet also increase the demand for credit both at household and state level.

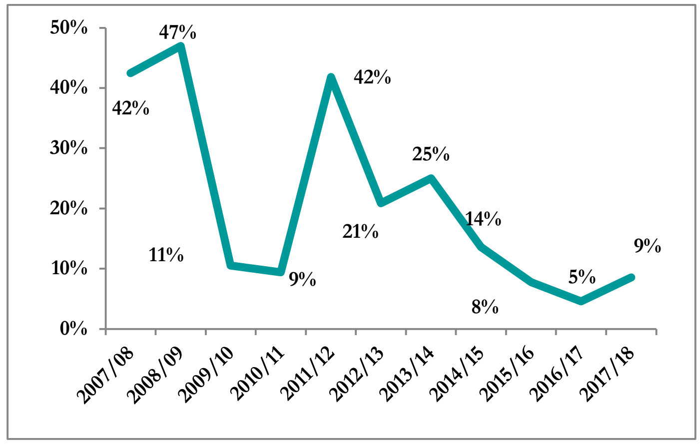


Figure 7: Growth rate of Remittance over the years

Meanwhile, the earnings of the banking industry may shrink as the Monetary Policy for FY 18/19 has revised the interest rate spread to 4.5 percent from the existing 5 percent. The average interest spread rate of commercial banks at the end of FY 17/18 stood at 4.49% and 15 out of 28 commercial banks' spread is above this newly revised spread rate[15]. The decrease in spread rate is likely to put pressure on already shrinking return on equity. BFIs may opt for issuance of debenture to fund the credit demands which can help improve their ROE and balance out the regulatory changes. The provision[16] of Monetary Policy encourages issuing debenture as it also helps them to reduce their dependencies on core-capital and deposit to facilitate the credit.

The growth in the economy is likely to fuel demand for credit, however meeting this demand might turn out to be a challenge for the overall banking sector. Declining growth rate in remittance as a result of fewer outbound migrants plus an ever increasing trade deficit might have adverse impact in the meeting this increased demand.

Although the use of digital wallets, internet banking, mobile banking and ATM's[17] has risen significantly in recent years; Nepalese Banking system has yet to benefit from major technological advances. In coming days, we can expect innovative products and services using internet technology and robotics being offered by local banks which are likely to be the disruptors in the context of the local banking landscape. Although the use of advanced technology to offer new innovative products and solutions to existing processes will lead to efficient systems, at the same time this will pose unforeseen threats and risks which have to be carefully assessed. The advancements in technology also bring with it new threats to the security and stability of the banking system. All in all, banking is expected to keep growing with growth in the economy and post reasonable return for next few years.

[11] (Center Bureau of Statistics, 2017)
[12] (Fiscal Policy 2018/19, 2018)
[13] (Nepal Rastra Bank, Monetary Policy 2018-19, 2018)
[14] (Nepal Rastra Bank, https://nrb.org.np/bsd/bsdindex.php?vw=4, 2018)
[15] (Unadited Annual Financial Statement, 2017/18)
[16] (Nepal Rastra Bank, Monetary Policy 2018-19, 2018)
[17] (Bank Supervision Report, 2017)

CHART OF THE QUARTER

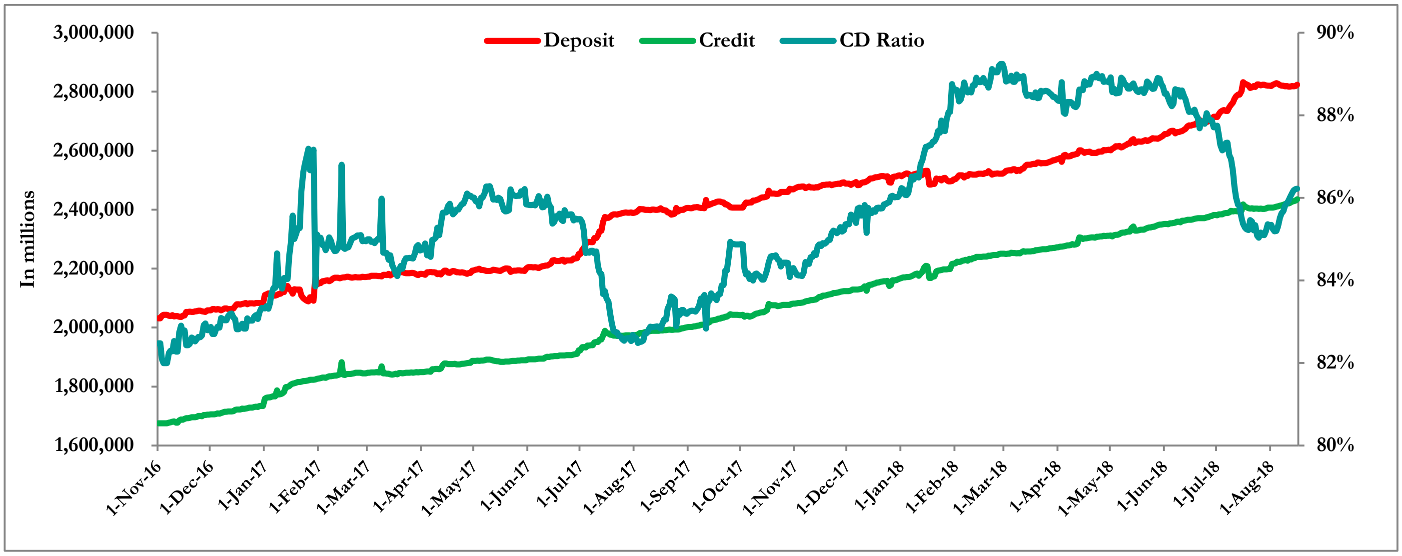


Figure 8: Deposits, Credits and CD ratio of BFIs over the time

CD ratio is a simple ratio of credit (Loans and advances) to deposit. At the end of the review period, CD ratio stands at 86% which signifies that for every NPR 100 worth of deposit BFIs have deployed NPR 86 as loans and advances. Increasing CD ratio depicts higher growth rate of credit as compared to deposit and vice versa. Since CCD restricts BFIs from lending more than 80% of their deposit plus core capital and debenture, increasing CD ratio also signifies decreasing abundance of the deposit and loanable amount in BFIs which can impact on interest rates offered. During acute crisis of deposits earlier this year was, CD ratio stood at 90%. This ratio later fell to 85% as the fiscal year came to an end. Such ratio fell to 82.5% last year during end of the fiscal year. This indicates that BFIs have lesser deposit in proportion of loans and advances as compared to the same period last year.

NMB Capital Limited

RTS List

S. No	Symbol	Company	Sector
1	BHBL	Bhargav Bikash Bank Limited	Development Banks
2	BPCL	Butwal Power Company Limited	Hydropower
3	CFCL	Central Finance Limited	Finance
4	CBBL	Chhimek Laghubitta Bittiya Sanstha Limited	Microfinance
5	EIC	Everest Insurance Company Limited	Non-Life Insurance
6	GLICL	Guras Life Insurance Company Limited	Life Insurance
7	HGI	Himalayan General Insurance Company Limited	Non-Life Insurance
8	KMCDB	Kalika Microcredit Development Bank Limited	Microfinance
9	KSBBL	Kamana Sewa Bikas Bank Limited	Development Banks
10	NHDL	Nepal Hydro Developer Limited	Hydropower
11	NBBL	Nagbeli Laghubitta Bikash Bank Limited	Microfinance
12	NNLB	Naya Nepal Laghubitta Bikas Bank Limited	Microfinance
13	NMB	NMB Bank Limited	Commercial Bank
14	NMBHF1	NMB Hybrid Fund L- 1	Mutual Fund
15	NMBMF	NMB Microfinance Bittiya Sanstha Limited	Microfinance
16	NMBSF1	NMB Sulav Investment Fund-1	Mutual Fund
17	PICL	Prudential Insurance Company Limited	Non-Life Insurance
18	SKDBL	Saptakoshi Development Bank Limited	Development Banks
19	SIL	Siddhartha Insurance Limited	Non-Life Insurance
20	SLBBL	Swarojgar Laghubitta Bittiya Sanstha Limited	Microfinance

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