

Rating Rationale

Kamana Sewa Bikas Bank Limited

Rating

Facility/Instrument	Amount (Rs. In Million)	Rating ¹	Rating Action
Issuer Rating	NA	CARE-NP BB+ (Is) [Double B Plus (Issuer)]	Assigned

**The issuer rating is subject to company maintaining Capital adequacy ratio of minimum 12% throughout the period and may be subject to review, if CAR is below that point.*

CARE Ratings Nepal Limited (CRNL) has assigned the issuer rating of “CARE-NP BB+ (Is) to Kamana Sewa Bikas Bank Limited (KSBBL). Issuers with this rating are considered to offer moderate risk of default regarding timely servicing of financial obligations, in Nepal.

Detailed Rationale & Key Rating Drivers

The ratings assigned to KSBBL is constrained on account of moderate asset quality with significant deterioration during FY20 (Unaudited, refers to the 12 months period ended Mid-July 2020), low proportion of Current Account Savings Account (CASA) deposits, moderate portfolio concentration among top depositors, intense competition and exposure to regulatory risk related to Banking industry. The rating, however, derives strength from the long track record of operation with experienced board and management team, considerable growth in loans & advances and deposits over the period with decent market share, adequate capitalization level, diversified sector wise credit portfolio distribution, diversified and geographical coverage through branches, low concentration over top borrowers and significant increase in investment portfolio. The ratings also derives strength from moderate financial performance with substantial decline in PAT during FY20 and moderate liquidity profile. The ability of the bank to continue its growth momentum while maintaining asset quality and capital adequacy and ability to manage the impact of COVID-19 and any regulatory changes by Nepal Rastra Bank (NRB) would be the key rating sensitivities.

Impact of COVID-19

The current situation of COVID-19 pandemic which has led to disruption on overall industry is likely to impact the quality of bank’s advances portfolio as well. Ability of bank to manage its asset quality would be key rating sensitivity. Considering, current situation, NRB in March reduced Cash Reserve Ratio (CRR) from 4% to 3% providing additional liquidity to the Banks and also has reduced Bank Rate from 6% to 5%.

Further, it has relaxed its asset classification guidelines till Mid-July 2020 whereby delays in payment of due amount since quarter ending Mid-April 2020 doesn’t entail downgrade of such assets. Additionally, monetary policy published for the FY21, has provided additional moratorium ranging from 6 months to 2 years for different businesses according to the level of impact. As on Mid July 2020, bank has ~3.87% of its total loan

¹Complete definitions of the ratings assigned are available at www.careratingsnepal.com

portfolio in tourism sector with majority of it in Hotel industry which is one of the majorly impacted industry. As a result, in CRNL's view the credit risk profile of the bank is expected to deteriorate over the medium term. Liquidity profile, resource raising ability and exposure to vulnerable asset classes and operating profiles in terms of geographies and borrower types would be critical monitorable factors in the banking sector. CRNL will continue to assess on the impact on the key business and financial parameters of banking and finance sector and shall take appropriate rating actions if, needed.

Detailed Description of the Key Rating Drivers

Key Rating Weaknesses

Moderate Asset Quality with significant deterioration during FY20

KSBBL's Gross Non-performing Loan (GNPL) was moderate at 2.13% at the end of FY20 which increased from 0.96% at the end of FY19 (industry average (development bank) GNPL was 1.52% at the end of FY20 and 0.92% at the end of FY19). The delinquencies of more than 30 days increased significantly to 22.31% of total advances at the end of FY20 from 2.31% of total advance at the end of FY19. As per the monetary policy for FY21 by NRB, advances which were categorized as pass loan as on Mid Jan 2020 and has overdue balance as on Mid July 2020 can be classified as pass loan. However, 5% provision is required for such advances instead of 1% for pass loan leading high increment in the watch list category.

Low CASA deposit ratio

KSBBL maintained low CASA proportion of 29.51% during FY20, which is lower than its peers and industry average of 34.41% during the same period, which has been decreased from 34.88% of FY19. However, CASA deposits in absolute amount has increased over the period. CASA deposits have increased by 29.51% during FY20 over FY19.

Moderate concentration over top 20 depositors

Deposit concentration of top 20 depositor was moderate at 19.04% of the total bank's deposits as on July 15, 2020, which is deteriorated from 17.54% of total deposit in FY19.

Competition from other banks and financial institution

Currently, there are 20 development banks operating with total 1,029 branches all over Nepal (based on monthly statistics published by NRB for Mid-July, 2020) out of that KSBBL has 124 branches. Industry (Class 'B' Banks-Development banks) has achieved total interest income of Rs. 39,332 Mn in FY20 with Rs. 13,724 Mn net interest incomes; KSBBL's share on interest income and net interest income is ~8.95% (Rs. 3,519 Mn) and 8.33% (Rs 1,143 Mn) respectively for the same period. Despite being one of the established national development bank in the industry, it is challenging for KSBBL to maintain current market share and expand its business, due to high competition among bank and finance companies, existence of large number of Development bank along with Commercial and finance companies conducting similar kind of businesses and they lend at lower interest rate as well as they offer wider banking services than development banks.

Exposure to regulatory risk related to industry

The Banking and Finance industry in Nepal is exposed to changes in the various regulatory measures issued by NRB from time to time. In past, development bank faced pressure from NRB for capital increment to Rs. 2,500 Mn. NRB via its Monetary Policy has reduced the Statutory Liquidity Ratio (SLR) to 8% from earlier 9%; reduced the overdraft including personal loan of revolving nature to Rs 5 Mn from Rs.7.5 Mn; increment of CCD ratio to 85% from 80%; increment of margin lending to 70% from 65%; reduction of bank rate to 5% from 6%. Also, to relax the liquidity crisis, Cash Reserve Ratio (CRR) has been reduced to 4% (further reduced to 3% amid COVID-19) from 6%. Further, NRB through its notice dated April 28, 2020 has directed BFIs to provide rebate of 200bps in interest rate for quarter ending Mid July 2020 which made significant impact on bank's profit.

Key Rating Strength***Long track record of operation with experienced board and management team***

KSBBL is a national level class "B" Development bank formed after merger of Kamana Bikas Bank and Sewa Bikas Bank on 4th August 2017 (Pre-merger, both entities operating since 2007). KSBBL is professionally managed bank under the overall guidance of Board of Directors (BoD) led by Chairman Mr. Sudeep Acharya. The top and senior management team is highly experienced in their respective field of operations. The bank is led by CEO, Mr. Prabin Basnet who has more than 15 years of banking experience. All the management members have wide banking experience.

Adequate capital adequacy level

KSBBL's overall Capital Adequacy Ratio (CAR) stood at 12.84% as on Mid July, 2020 (16.81% as on Mid July, 2019) as against regulatory requirement of 11%. Overall CAR declined during FY20 due to increase in risk weighted assets due to increase in loans and advances during the year. KSBBL reported CET-I of 11.57% as on Mid July 2020 as against regulatory requirement of 6%.

Diversified sector wise credit portfolio distribution

At the end of FY20, portfolio distribution proportion stood at 19.08% for wholesaler & retail sector followed by 8.49% towards finance, insurance and real estate, 8.34% towards construction and 7.21% towards transport, communication and public utilities. KSBBL lent 15.35% in FY20 and 23.00% in FY19 towards productive sector (which includes agriculture sector, energy sector, tourism sector and cottage and small industries); of gross loans and advances outstanding prior to 6 months. All the lending (i.e. priority sector, agriculture, energy & tourism sector (combined) are within the NRB regulatory norms.

Diversified and geographical coverage through branches

Currently, KSBBL is operating in 7 provinces and 38 districts of Nepal (out of 7 provinces and 77 districts of Nepal) through its 124 branches and 66 ATM terminal. As per monthly statistics published by NRB, 20 development banks have total 1,029 branches, 296 ATM terminals as on Mid July, 2020.

Moderate financial performance with decline in PAT during FY20

During FY20, KSBBL's total income increased by 40.17% to Rs. 3,749 Mn due to increase in both interest income and non-interest income. Interest income increased by 42.42% to Rs. 3,519 Mn during FY20 due to increase in advances and investment in securities. Net interest income increased by 32.18% to Rs.1,143 Mn during FY20 and operating expenses increased by 47.20% during FY20. Its yield on advances increased to 13.39% during FY20 from 13.10% during FY19. Similarly, cost of deposit increased marginally to 8.92% during FY20 from 8.87% during FY19 due to increase in proportion of fixed deposits. Its Net Interest Margin (NIM) deteriorated to 3.62% during FY20 from 3.75% of FY19 because of lower increase in the net interest income and slight increment in cost of deposit. On the operational efficiency front, its operating expenses/ average total assets increased to 2.72% in FY20 as compared to 2.53% in FY19 due to increase in operating expenses mainly employee expenses. Impairment charge for loans and other losses increased substantially to Rs. 435 Mn during FY20 as against Rs. 61 Mn during FY19. Due to huge increment in provisions and impairment charges and high increase in employee expenses as compared to previous year, KSSBL reported decline in PAT by 80.76% to Rs.55 Mn during FY20 from Rs 285 Mn during FY19. Accordingly, the Return on Total Assets (ROTA) has declined substantially to 0.17% in FY20 (1.24% in FY19).

Considerable growth in loans & advances and deposits over the period with decent market share

KSBBL has demonstrated high growth in the loan portfolio and deposits over the period. Total loan portfolio grew by compounded annual growth rate (CAGR) of 64.11% over last 3 years ending Mid July, 2020 on back of increase in number of branches (36 new branches in FY18, 36 in FY19 and 29 in FY20). It grew by Y-o-Y growth rate of 31.34% to Rs 27,017 Mn in FY20 from Rs. 20,570 Mn in FY19 (whereas development bank loan portfolio grew by CAGR of 11.12 % over last 3 years ending Mid July, 2020). However, high growth in advance in past few years leads to high unseasoned advances and the quality of the assets is yet to be tested in the light of impact of COVID 19. Similarly, KSBBL's deposit grew by CAGR of 65.93% over last 3 years ending Mid July, 2020 on back of increased in branches and effective marketing strategy. It grew by Y-o-Y growth rate of 49.24% to Rs 31,902 Mn in FY20 from Rs 21,376 Mn in FY19 (whereas development bank industry deposit grew by CAGR of 14.01% over last 3 years ending Mid July, 2020). KSBBL is one of the national level development bank in Nepal with 9.02% and 9.33% market share in terms of deposit base and loan portfolio respectively of development banks at the end of FY20 based on monthly data published by NRB.

Moderate liquidity profile

Further, KSBBL has maintained CRR of 3.26%, SLR of 11.34% and Liquidity of 24.04% as on Mid July, 2020 (4.70%, 8.33% and 22.74% respectively as on July 16, 2019) which is in compliance with NRB norms of 3%, 8% and 20% respectively. Maintained SLR, CRR and Net Liquidity are within the norms of NRB.

Low concentration over top 20 borrowers

KSBBL’s lending to top 20 group borrower was 5.40% of total loans and advances in FY20. Similarly, lending to top 20 individual borrower was 5.74% of total loans and advances in FY20.

Significant increment in investment portfolio

KSBBL’s total investment in FY20 increased to Rs. 5,746 Mn. from Rs. 769 Mn. of FY19. During FY20, KSBBL has earned interest income from investment in Securities/Bonds of Rs 78 Mn (Rs.7 Mn during FY19); dividend income of Rs 13 Mn (Rs 6 Mn during FY19).

About the Company

Kamana Sewa Bikas Bank Limited (KSBBL) is a national level class “B” Development bank formed after merger of Kamana Bikas Bank Limited (established on FY07) (National level development bank) and Sewa Bikas Bank Limited (established on FY07) (10 district level development bank) on August 4, 2017. Major promoter of KSBBL is Mrs. Tulasha Pandey with shareholding of 2.09% as on Mid July 2020. The bank reported PAT of Rs. 55 Mn on an asset size of Rs. 36,476 Mn. as on July 15, 2020, it has Rs 2540 Mn paid up capital which is distributed among promoter and public shareholders in the ratio of 51:49.

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