

Rating Rationale

Prime Commercial Bank Limited

Rating

Facility/Instrument	Amount (Rs. In Million)	Rating ¹	Rating Action
Issuer Rating	NA	[CARE-NP] A- (Is) [Single A Minus (Issuer)]	Reaffirmed
Subordinated Debenture	3,500.00	CARE-NP A- [Single A Minus]	Reaffirmed

CARE Ratings Nepal Limited (CRNL) has reaffirmed the issuer rating of ‘CARE-NP A- (Is)’ assigned to Prime Commercial Bank Limited (PCBL). 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 has also reaffirmed rating of ‘CARE-NP A-’ assigned to the new proposed Subordinated Debenture issue of PCBL. The instruments with this rating are considered to have adequate degree of safety regarding timely servicing of financial obligations, in Nepal. Such instruments carry low credit risk.

Detailed Rationale & Key Rating Drivers

The rating assigned to PCBL derives strength from the long track record of the operations with experienced promoters and management team, adequate capitalization, diversified and geographical coverage through branches in Nepal, consistent growth in advances and deposits and consistent growth in total income and net profit. The rating also factors in moderate liquidity profile, diversified sector-wise loan portfolio with regulatory compliance and diversified investment portfolio. The rating, however, is constrained on account of low Current Account Savings Account (CASA) deposits with volatile trend over the period and moderate asset quality however better than industry average. The rating is also constrained by high concentration in borrowers and depositors, intense competition and exposure to regulatory risk related to industry. Ability of the bank to continue its growth momentum without compromising on asset quality, 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

Established in the year 2007; PCBL has over a decade of operational history and an established market presence in Nepal. PCBL is professionally managed bank under the overall guidance of the bank's Board of Directors (BoD) which includes eminent businessmen and professionals with wide experience in the industry and financial services. Mr. Rajendra Das Shrestha is the Chairman of the bank, who has been engaged in manufacturing and trading industry from last 26 years. The bank is led by Chief Executive Officer (CEO),

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

Mr. Narayan Das Manandhar, who has 5 decade long experience in various financial institutions. He is supported by an experienced management team.

Adequate capitalization level

PCBL had paid up capital of Rs.13,985 Mn at the end of FY20 (refers to 12 months period ended mid-July, 2020). As per Basel norms of NRB, every "A" class licensed institutions shall maintain 11% overall Capital Adequacy Ratio (CAR). Tier I (CET I) capital adequacy ratio (CAR) of the bank stood at 12.83% against minimum requirement of 7% as on July 15, 2020 and overall capital adequacy stood at 13.84% as against the regulatory requirement of overall CAR of 11%. Accretion of the profit to the reserves and addition to the capital after the acquisition of Kailash Bikas Bank Limited (KBBL) are the main reason for improved CAR during FY20. PCBL maintained 13.20% Tier I CAR and 14.24% overall CAR during H1FY21.

Diversified and geographical coverage through branches

PCBL has diversified presence in Nepal with 188 branches and 103 ATMs terminals as on mid-Oct 2020 across the Country. The branches are spread over all 7 Provinces and cover 53 districts (out of total 77 districts) of Nepal.

Consistent growth in Loans & Advances and Deposits

Over the last 3 to 4 years the bank has shown robust growth in the loans & advances and deposits. Total deposits of PCBL have reached to Rs.129.80 Bn in FY20 recording a three-year CAGR of 25.38% and reported growth of 50.56% over FY19. Further deposits of PCBL increased to Rs.136.56 Bn during H1FY21 reporting a growth of 52.38% over H1FY20. PCBL's share of total industry deposits is at 3.72% as on July 15, 2020 in comparison to the 3.00% share of total industry deposits as on July 16, 2019. PCBL also reported consistent growth in total advances. Total loans and advances stood at Rs. 115.47 Bn in FY20 recording a three year CAGR of 25.31% and reported growth of 51.34% over FY19. Further, total loans and advances of PCBL increased by 9.48% to Rs.125.41 Bn during H1FY21 over H1FY20. PCBL holds 3.97% of the industry advances as on July 15, 2020. This increase in loans & advances and deposits was on back of leveraging the 9 & 127 new branch additions during FY19 & FY20 respectively on account of acquisition of Kankai Bikas Bank Limited and KBBL. Credit to Core Capital cum Deposit (CCD) ratio of PCBL was at 81.37% at the end of H1FY21 as against maximum allowable CCD ratio 85%.

Consistent growth in total income and net profit over the period

During FY20, the bank's total income increased by 23.60% to Rs.13,465 Mn majorly due to rise in both interest income by 24.54% on back of growth in advances on account of merger of KBBL during the year and increase in the non-interest income by 14.97%. On back of these, net interest income had increased by 29.46% to Rs.4,641 Mn during FY20. The yield on advances decreased by 71 bps to 12.01% on back of discounts provided to the borrowers as per the NRB guidelines, also there was decrease in cost of deposits by 38 bps to 7.02% mainly due to decreased market interest rate on all type of deposits on back of excess liquidity in the market. Net Interest Margin (NIM) of the bank increased marginally from 3.64% in FY19 to

3.65% in FY20 due to increase in the absolute amount of interest income being more than increase in interest expenses.

On the operational efficiency front, operating expenses have been increasing y-o-y. In FY20, the operating expenses increased by 34.02% to Rs.1,838 Mn as compared to Rs.1,371 Mn in FY19. This is mainly due to increase in employee related expenses which grew by 23.13% from FY19 on back of acquisition of financial institutions leading to increase in the number of employees. Growth in operating expenses led to increase in operating expenses/ average total assets to 1.45% in FY20 as compared to 1.39% in FY19. PCBL's impairment charge for loans and other losses in FY20 was Rs.766 Mn as against Rs.135 Mn during previous year due to the increment of provision for loss on account of impact of COVID-19 as per the NRB regulations. PCBL reported marginal increase in the PAT of Rs.2,251 Mn in FY20 as compared to PAT of Rs.2,199 Mn reported in FY19. Return on Total Assets (RoTA) of the bank has deteriorated to 1.77% during FY20 from 2.23% of FY19.

During H1FY21, bank's total income has increased by 26.74% to Rs.7,911 Mn in comparison to Rs.6,242 Mn during H1FY20 on back of increase in interest income by 25% and increase in non-interest income by 39.44% over the same period. Net interest income of the bank increased by 34.18% to Rs.2,905 Mn during H1FY21 vis-a-vis H1FY20. PAT of the bank has increased by 39.35% to Rs.1,813 Mn during H1FY21 and ROTA improved by 2.23% during H1FY21.

Moderate liquidity profile

Bank has moderate liquidity profile with positive cumulative mismatches as on October 16, 2020 due to well matched tenure of assets and liabilities. However, the assets and liabilities show mismatches in 91-180 days and over 1 year buckets (but has positive cumulative mismatches). PCBL has maintained SLR of 18.50% as on July 15, 2020 and 19.37% as on October 16, 2020; average CRR of 7.25% and 6.27% at the last reporting week as of FY20 and Q1FY21; Net Liquidity of 23.95% as on October 16, 2020. Maintained SLR (10%), CRR (3%) and Net Liquidity (20%) are within the norms of NRB.

Diversified loan portfolio with regulatory compliance

PCBL has diversified portfolio distribution across sectors with higher lending of 12.08% in FY20 towards construction sector. Next major lending of 11.67% during FY20 is towards finance, insurance and fixed asset sector which comprises major lending towards real estate sector and lending to microfinance institutions. During Q1FY21, PCBL had higher lending of 12.10% towards finance, insurance and fixed asset sector followed by lending of 11.86% towards construction sector.

Diversified investment portfolio

PCBL has made investments of Rs.13,684 Mn as on July 15, 2020, out of which 86.08% has been invested in treasury bills and bond instruments issued by Government of Nepal (GoN) and NRB (combined), 5.79% has been invested in equity securities of domestic corporate entities and 8.17% Mn has been invested in foreign securities. The investment portfolio of the bank has increased by 34.92% in FY20 over FY19 mainly due to

additional investments made in GoN and NRB securities and foreign securities which increased by 31.70% and 65.09% respectively during FY20.

Key Rating Weaknesses

Moderate asset quality, although better than industry average

There was significant increase in Gross Non Performing Loans (GNPL) of the bank in absolute amount and %age terms. GNPL was at Rs.761 Mn during FY19 which increased substantially to Rs. 1,708 Mn during FY20. Increase in GNPL in absolute amount resulted into increased GNPLs ratio to 1.48% as on July 15, 2020 as compared to 1.00% that of July 16, 2019 due to the impact of COVID-19, however GNPL ratio of PCBL is better than industry average GNPL. Also, GNPL ratio improved to 1.08% during H1FY21. Out of total advances, the delinquencies of more than 30 days were 9.59% of total advances at the end of FY20; the same has increased by 314 bps to 12.73% at the end of H1FY21 as compared to July 15, 2020. The management of the more than 30 days delinquencies and lower slippage to GNPL category will be critical for the financial risk profile of the company.

Low CASA deposits maintained with declining trend

PCBL has maintained low CASA deposits as compared to industry and the CASA proportion of PCBL is in volatile trend. PCBL maintained 27.47% CASA deposits in FY19 which has increased to 30.78% in FY20 but again declined to 28.66% in H1FY21 (industry avg. CASA for FY19, FY20 was 40.90% and 41.32% respectively). Lower and volatile CASA proportion resulted higher cost of funds of PCBL against its peers imposing competitive disadvantage for the bank. Term deposit/ total deposits increased from 48.32% during FY19 to 53.56% during FY20 and further to 60.78% during H1FY21. In absolute amount CASA deposits increased by 68.59% during FY20 over FY19, however decreased by 2.03% during H1FY21 over FY20.

High portfolio concentration among top depositors and borrower groups

Deposit concentration by top 20 institutional depositors was high at 30.83% of the total bank deposits as on July 15, 2020. However, the same marginally decreased to 30.79% of the total bank deposits as on October 16, 2020. The bank has moderately high concentration on loan portfolio as top 20 single borrower accounts for 13.82% of total advances during FY20 and slightly increased to 15.08% of total advances during Q1FY21. Likewise, top 20 group borrowers accounted 27.38% of total advances during FY20 which was slightly decreased to 26.86% of total advances during Q1FY21.

Intense competition

Currently there are 27 Commercial Banks, including three major state owned banks, operating with total 4,514 branches all over Nepal (based on Monthly statistics published by NRB for Mid-Oct 2020). PCBL had 188 branch along with head office as on same date. Industry (Class 'A' Commercial Banks) has achieved total interest income of Rs.328,666 Mn during FY20 with Rs.128,669 Mn net interest income; PCBL share on interest income is 3.72% and 3.59% share on net interest income for the same period. The market share of

PCBL has increased to 4.30% and 4.69% in terms of interest income and net interest income during H1FY21 respectively. Competition in the interest rates is the prominent challenge in the Nepalese banking sector.

Exposure to regulatory risk related to industry

The banking industry in Nepal is exposed to changes in the various regulatory measures issued by NRB from time to time. To relax the liquidity crisis in the banking sector, 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 profit of the banks in Nepal.

About the Bank

PCBL is an “A” Class Licensed Institution from Nepal Rastra Bank (NRB), listed in Nepal Stock Exchange is one of the mid-sized private sector bank in Nepal. It was incorporated on July 17, 2007 as 21st commercial bank in Nepal and started commercial operation from September, 2007. The bank reported PAT of Rs.2,251 Mn on an asset size of Rs.152 Bn as on July 15, 2020. Further, PCBL reported PAT of Rs.1,813 Mn during H1FY21.

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