

**Rating Rationale  
Prabhu Bank Limited**

**Rating**

Facility/Instrument	Amount (Rs. In Million)	Rating <sup>1</sup>	Rating Action
Subordinated Debenture (Prabhu Bank Debenture 2084)	2,000.00	CARE-NP BBB [Triple B]	Reaffirmed

CARE Ratings Nepal Limited (CRNL) has reaffirmed rating of ‘CARE-NP BBB’ assigned to the Subordinated Debenture “Prabhu Bank Debenture 2084” issue of Prabhu Bank Limited (PBL). The instruments with this rating are considered to have moderate degree of safety regarding timely servicing of financial obligations, in Nepal. Such instruments carry moderate credit risk.

**Detailed Rationale & Key Rating Drivers**

The rating of PBL continues to derives strength from its experienced promoters and management team, diversified and geographical coverage through branches in Nepal, consistent growth in advances and deposits and growth in total income over the period ended mid-July 2020. The rating also factors in comfortable Current Account Savings Account (CASA) ratio, lower cost of funds as compared to the industry, moderate liquidity profile, diversified sector-wise loan portfolio with regulatory compliance and diversified investment portfolio.

The rating is constrained on account of weak asset quality parameters; however, being improving over the period at the end of H1FY21 (Unaudited, refers to 6 months period ended mid-January 2021), moderate capitalization as per existing requirement and increasing operating expenses. The rating also taken into consideration substantial decline in profitability of the bank during FY20 (Audited, refers to 12 months period ended mid-July 2020), however, the profits recovered during H1FY21, high concentration in group 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**

*Experienced promoters and management team*

Established in the year 2001; PBL has around two decades of operational history and an established market presence in Nepal. PBL 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. Ramesh Singh Khadka is the senior director in the bank’s board who have more

<sup>1</sup>Complete definitions of the ratings assigned are available at [www.careratingsnepal.com](http://www.careratingsnepal.com)

than 3 decades of banking experience and had served in Agricultural Development Bank. The bank is led by Chief Executive Officer (CEO), Mr. Ashok Sherchan, who has 24 years of banking experience in various financial institutions. He is supported by an experienced management team.

***Low cost of fund in the industry and comfortable CASA ratio***

PBL continues to have one of the lower cost of funds of 6.06% in FY20 (ranked 6th among the industry) and 5.01% during H1FY21. This is likely to be a competitive advantage for the bank, especially in the recently implemented “base rate plus lending rate” regime. PBL’s deposit mix changed in favour of term deposits at the expense of CASA proportion by offering high interest rates on deposit. Fixed deposit comprised 42.90% of PBL’s total deposit mix in FY20 as compared to 41.14% in FY19. CASA deposit in absolute amount increased by 28.39% to Rs. 62,141 Mn during FY20 as compared to Rs. 48,401 Mn during FY19 and further increased by 2.26% to Rs. 63,546 Mn during Q1FY20 over FY20.

***Diversified and geographical coverage through branches***

PBL has diversified presence in Nepal with 214 branches, 51 extension counters and 153 ATMs terminals as on October 16, 2020 across the country. The branches are spread over all 7 Provinces and cover 59 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 consistent growth in the loans & advances and deposits. Total deposits of PBL have reached to Rs.128,741 Mn in FY20 recording a three-year CAGR of 16.53% and reported growth of 14.54% over FY19. Further deposits of PBL increased to Rs.162,025 Mn during H1FY21 reporting a growth of 25.85% over FY20. PBL’s share of total industry deposits is at 3.81% as on July 15, 2020 in comparison to the 3.91% share of total industry deposits as on July 16, 2019. PBL also reported consistent growth in total advances. Total loans and advances stood at Rs.103,134 Mn in FY20 recording a three-year CAGR of 18.50% and reported growth of 14.24% over FY19. Further, total loans and advances of PBL increased by 25.62% to Rs.129,764 Mn during H1FY21 over FY20. PBL holds 3.59% of the industry advances as on July 15, 2020. Credit to Core Capital cum Deposit (CCD) ratio of PBL remains 76.62% at the end of FY19 which has decreased to 66.96% at the end of FY20 as against maximum allowable CCD ratio of 85%.

***Marginal growth in total income; however net profit over the period (FY20) had been impacted due to COVID -19***

During FY20, the bank’s total income increased by 9.20% to Rs.13,216 Mn due to rise in both interest income by 9.59% on back of growth in advances and increase in the non-interest income by 6.03%. On strength of these, net interest income increased marginally by 2.79% to Rs.4,521 Mn during FY20. However, yield on advances decreased by 89 bps to 10.81% and cost of deposits decreased minimally by 28 bps to 5.74%. Net Interest Margin (NIM) of the bank decreased to 2.97% in FY20 where during FY19 the growth margin was

3.47% as the interest expenses grew substantially by 14.29% in compare to interest income. Overall growth in financial performance remained passive as compared with previous years because of COVID-19 impact.

In spite of adverse impact of COVID -19 in overall economic situation of the country PBL was able to reported PAT of Rs.1,194 Mn in FY20 as compared to PAT of Rs.1,784 Mn reported in FY19. Return on Total Assets (RoTA) of the bank declined to 0.78% during FY20 (FY19: 1.41%) with impact on PAT which is decreased by 33.05% during FY20 over FY19.

During Q1FY21, bank's total income has increased by 13.94% to Rs.4,070 Mn in comparison to Rs.3,572 Mn during Q1FY20 on back of increase in interest income by 8.21% due to increased advances portfolio of the bank and increase in non-interest income by 55.47% over the same period. Net interest income of the bank increased by 20.41% to Rs.1,694 Mn during Q1FY21 vis-a-vis Q1FY20 due to increase in interest income. PAT of the bank has increased by 35.25% to Rs.850 Mn during Q1FY21 (Rs. 628 Mn during Q1FY20).

#### ***Moderate liquidity profile***

PBL has maintained SLR of 21.71% as on October 16, 2020 vis-à-vis regulatory requirement of 10%; CRR of 6.26% as on October 16, 2020 vis-à-vis regulatory requirement of 3%; Net Liquidity of 26.22% as on October16, 2020 vis-à-vis regulatory requirement of 20%. Maintained SLR, CRR and Net Liquidity are within the norms of NRB.

#### ***Moderately diversified sector wise loan portfolio with regulatory compliance***

PBL has moderately diversified portfolio distribution which consists of various types of loan disbursed over the period for various Industry/ Sector with higher lending of 16.10% in FY20 and 17.11% in Q1FY21 towards wholesalers & retailers sector (wholesale trade of durables, non-durables, automotive dealer/franchise, other retail trade, import-export trade etc.). Next major lending of 14.05% in FY20 and 12.18% in Q1FY21 is towards construction sector which comprises majorly towards housing sector. More than 50% of fund disbursed consist of only four sectors (i.e. Wholesaler & Retailer: 17.11%, Non-food Production: 13.81%, Construction: 12.19% and Service: 11.84%)

#### ***Diversified investment portfolio***

PBL has made investments of Rs.20,842 Mn (P.Y: Rs.14,565 Mn) as on July 15, 2020, out of which Rs.14,917 Mn (P.Y: Rs. 8,657 Mn) has been invested in Government of Nepal (GoN) bonds, Rs.2,335 Mn (P.Y: Rs. 3,558 Mn) has been invested in GoN treasury bills and Rs.2,875 Mn (P.Y: Rs. 2,233 Mn) has been invested in equity securities of domestic corporate entities.

The investment portfolio of the bank has increased by 43.09% in FY20 over FY19 mainly due to additional investments made in GoN bonds and treasury bills which increased by 42.80% to Rs.17,443 Mn in total and 44.61% more investments in equity securities of domestic corporate entities during FY20 to reach Rs.3,399 Mn. PBL earned Rs.760 Mn as interest income from bonds/ treasury bills (P.Y: Rs. 482 Mn) and Rs.26 Mn (P.Y: Rs. 23 Mn) received as dividend income from shares of corporate sectors during FY20.

**Key Rating Weaknesses*****Moderate capitalization as per existing requirement, however needs improvement to meet new regulatory requirements***

PBL had paid up capital of Rs.10,316 Mn at the end of FY20. To reach the regulatory paid-up capital requirements of Rs.8,000 Mn for 'A' Class Commercial Bank. Core Equity Tier I Ratio (CET I Ratio) of the bank stood low at 9.37% (against minimum requirement of 7%) as on July 15, 2020 which decreased from 10.22% as on July 16, 2019 following the decreasing trend, further it has decreased to 8.62% as on Mid-October, 2020. However, overall capital adequacy stood at 11.18% (against minimum requirement of 11%) as on July 15, 2019 which was marginally increased from 11.16% as on July 16, 2019, also as on mid-October 2020 it has been further increased to 11.63%. The reason for increasing CAR over the period is due to issuance of 10.25% Debenture of Rs. 1,000 Mn during May 2019 and another subordinated debenture of Rs. 2,000 Mn during February 2020.

***Moderate asset quality, however being corrected over a period***

PBL's asset quality is marked by high Gross Non-Performing Loans (GNPL) with one of the highest NPA in the industry. However, the same has been in declining trend, PBL reported Gross Non-Performing Loan (GNPL) ratio of 3.76% during FY19 which decreased to 3.15% during FY20 which further declined during Q1FY21 to 2.67%.

GNPL in absolute numbers also was at Rs. 3,252 Mn at the end of FY20 reporting which was declined from Rs. 3,396 Mn at the end of FY19. Also, GNPL further decreased to Rs 3,160 Mn at the end of Q1FY21. However, PBL's GNPL ratio is above Industry GNPL ratio of 1.81% at the end of FY20 and 1.63% at the end of Q1FY21.

PBL had COVID-19 induced delays amounting to Rs. 473 Mn which accounted for 0.46% of total advances as on July 15, 2020 which further increased to 607 Mn as on October 16, 2020 which accounted for 0.51%. Currently, Bank has provisioned for these loans at 5% and has classified as performing loan based on relaxation provided by NRB. Going forward, reduction in COVID-19 induced delays and blanket relaxation by NRB to COVID-19 impacted borrowers and the ability of the bank to maintain its asset quality especially in view of COVID-19 impact would be critical for the bank's earning profile and profitability and would-be key rating sensitivity.

***High portfolio concentration among top depositors and borrower groups***

Deposit concentration by top 20 institutional depositors has been moderately high at 23.46% of the total bank deposits as on July 16, 2019, which increased to 25.36% of the total bank deposits as on July 15, 2020 and marginally increased to 25.76% of the total bank deposits as on October 16, 2020. The bank has low concentration on single borrowers as top 20 single borrower accounts for 7.36% of total advances during FY20 which was increased to 8.58% of total advances during Q1FY21. However, the bank has moderately

high concentration on group borrowers as top 20 group borrowers accounted for 18.70% of total advances during FY20 which further increased to 20.16% 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). PBL have 214 branches 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.108,480 Mn net interest income; PBL’s share on interest income is 3.58% (Rs.11,797 Mn) and 3.06% share on net interest income (Rs.4,521 Mn) for the same period. The market share of PBL has increased to 4.11% and 5.27% in terms of interest income and net interest income during Q1FY21 respectively. Due to emergent competition, it is challenging to recruit and retain skilled manpower. Unhealthy competition in the 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 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 profitability of the banks in Nepal.

**About the Bank**

Prabhu Bank Limited (PBL) is “A” Class Licensed Institutions from Nepal Rastra Bank (NRB), listed on Nepal Stock Exchange. It was incorporated on July 21, 1998 as Kist Merchant Banking and Finance Ltd. and renamed as Kist Bank Ltd. dt. June 19, 2001. Later it was merged with three other bank and financial institutions (BFIs) namely Prabhu Bikash Bank Ltd., Zenith Finance Ltd. and Gaurishankar Development Bank Ltd. as on September 15, 2014 and the name of the bank was changed to Prabhu Bank Ltd. Following the aforesaid merger PBL acquired another BFI Grand Bank Nepal Ltd. dt. February 04, 2016. As on July 15, 2020; 51% of shares belongs to promoter group and 49% belongs to general public. The bank reported PAT of Rs. 1,194 Mn on an asset size of Rs. 167 Bn as on July 16, 2020. Further, PBL reported PAT of Rs. 1,519 Mn during H1FY20.

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