

Prime Commercial Bank Limited

Ratings

Facility/Instrument	Amount (Rs. in Million)	Ratings ¹	Rating Action
Issuer Rating	NA	[CARE-NP] A- (Is) [Single A Minus (Issuer)]	Reaffirmed
Subordinated Debenture (8.75% Prime Debenture 2085)*	2,447.96	[CARE-NP] A- [Single A Minus]	Reaffirmed

* Issued debenture amounting to Rs.3,500.00 million, subscribed for Rs.2,447.96 million

CARE Ratings Nepal Limited (CRNL) has reaffirmed the issuer rating of "CARE-NP A- (Is) [Single A Minus (Issuer)]" 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- [Single A Minus]" assigned to the Subordinated Debenture (8.75% Prime Debenture 2085) issued by 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 bank's long track record of the operations with experienced promoters and management team, adequate capitalization, diversified and geographical coverage through branches in Nepal, sustained growth in deposits and total income, healthy profitability levels vis-à-vis peers, improving asset quality, diversified sector-wise loan portfolio with regulatory compliance, and diversified investment portfolio. The rating also factors in the moderation in financial performance during H1FY22 (refers to the six-month period ended mid-January 2022) resulting in slightly lower profitability and capital adequacy ratios as on January 14, 2022.

The rating is, however, constrained by the volatile trend in and lower levels of Current Account Savings Account (CASA) deposits vis-a-vis the industry (Class 'A' Commercial Banks), moderate liquidity profile, continued high concentration in borrowers and depositors, intense competition and exposure to regulatory risk related to the banking industry in Nepal.

Going forward, the ability of the bank to sustain its growth in business while maintaining the profitability levels and without compromising on asset quality, maintaining capital adequacy with adequate cushion to the minimum regulatory requirement levels 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 Strengths

Long track record, experienced promoters and management team

Established in the year 2007; PCBL has almost 15 years of operational history and an established market presence in Nepal. PCBL is a 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 financial services and other industries. Mr. Rajendra Das Shrestha is the Chairman of the bank, who has been engaged in manufacturing and trading industry for the last 27 years. The bank is led by Chief Executive Officer (CEO), Mr. Narayan Das Manandhar, who has 5-decade long experience in various financial institutions. He is aptly supported by an experienced management team.

¹Complete definitions of the ratings assigned are available at www.careratingsnepal.com and in other CRNL publications

Adequate capitalization levels, albeit declining trend in H1FY22 due to higher risk weighted exposure

PCBL's capitalization levels continue to remain adequate, although marginal moderation was observed during H1FY22 as compared to previous periods. As on July 15, 2021 PCBL's Common Equity Tier 1 (CET-I) capital stood at 12.28% of its risk weighted exposure against minimum regulatory requirement of 7% stipulated by Nepal Rastra Bank (NRB) in compliance with Basel III norms. PCBL's overall capital adequacy ratio (CAR) stood at 14.82% as on July 15, 2021 as against the minimum regulatory requirement of 11%. However, the bank's CET-I ratio moderated to 11.78% and overall CAR to 12.97% as on January 14, 2022 on account of greater increase in risk weighted exposure owing to the 14% growth in loans & advances during H1FY22 over FY21 (refers to the twelve-month period ended mid-July 2021). Lower capitalization levels could limit a bank's ability to absorb losses, should they materialize, esp. given the uncertainty surrounding credit recovery amid the lingering impact of the covid19 pandemic. However, despite some moderation during H1FY22, PCBL's capitalization levels remain at adequate levels with moderate cushion above the minimum regulatory requirements.

Increasing scale of operations backed by consistent growth in deposits and loans & advances

Over FY17-FY21, PCBL has shown robust growth in its loans & advances and deposits. The bank's deposits and loans & advances have grown at a compounded annual growth rate (CAGR) of 24.89% and 24.92%, respectively, over FY17 to FY21 compared to around 19.05% and 20.99% growth in deposits and loans & advances recorded by the industry's (commercial banks) during the same period. PCBL has followed both organic and inorganic routes to increase its scale over the last 3 to 4 years. Acquisitions of Kankai Bikas Bank Ltd. and Kailash Bikas Bank Ltd. coupled with expansion of own branches have helped PCBL more than double its deposits and loans & advances between FY17 and FY21.

PCBL's deposits stood at Rs. Rs.160,182 Mn and loans & advances at Rs. 142,931 Mn at the end of FY21. However, the growth trend has been arrested so far in FY22 on a sequential basis. The bank's deposits grew 2.79% quarter-on-quarter (q-o-q) in Q1FY22 (refers to the three-month period ended mid-October 2021) but declined 1.24% q-o-q in Q2FY22 (refers to the three-month period ended mid-January 2022). Bank deposits in H1FY22 are being impacted by the liquidity crunch currently faced by the country's economy amid increased imports coupled with lower inward remittance during the period. Similarly, loans and advances growth trend of PCBL continued in H1FY22, albeit at a slower rate. On a quarterly basis loans & advances had increased 5.51% and 7.65% q-o-q during Q1FY22 and Q2FY22, respectively.

Sustained growth in total income and net profit in FY21, slight moderation during H1FY22 amid lower spreads

Continued growth in advances have resulted in sustained growth in interest income for the bank in FY21. PCBL's total income grew 18.89% y-o-y to Rs.16,009 Mn during FY21 backed by 14.52% y-o-y increase in interest income and 62.23% y-o-y increase in non-interest income, majorly due to higher fees and commission income. Similarly, PCBL's net interest income had increased by 28.19% y-o-y to Rs.5,949 Mn during FY21 (FY20: Rs.4,641 Mn). PCBL reported PAT of Rs.3,268 Mn in FY21 (FY20: Rs.2,251 Mn). During H1FY22, bank's total income increased by 14.87% y-o-y to Rs.9,087 Mn. Interest income grew 18.67% y-o-y to Rs.8,141 Mn in H1FY22 on account of 29.45% y-o-y increase in gross advances; however, non-operating income of the bank declined 9.92% y-o-y to Rs.946 Mn during H1FY22 mainly due to lower commission earned during the period. Interest expenses increased even more, by 26.28% y-o-y, during H1FY22 on the back of increase in deposit rate resulting in a higher cost of funds of 7.29% during H1FY22 (FY21: 5.74%). Amid tighter liquidity PCBL's interest rate spread declined to 3.46% as on January 14, 2022 from 4.09% as on July 15, 2021. Due to relatively higher increase in interest expenses vis-à-vis increase in interest income, net interest income of the bank declined by 6.43% y-o-y to Rs.3,710 Mn during H1FY22. Consequently, PAT of the Bank decreased by 7.43% y-o-y to Rs.1,679 Mn during H1FY22.

Diversified and geographical coverage through branches

PCBL has diversified presence in Nepal with 187 branches and 107 ATMs terminals as on mid-January 2022 across the country. The branches are spread over all 7 Provinces and cover 53 districts (out of total 77 districts) of Nepal.

Improvement in asset quality

PCBL's Gross Non-Performing Loan (GNPL) ratio improved to 0.99% during FY21 from 1.48% during FY20 and improved further to 0.78% at the end of H1FY22. GNPL in absolute numbers at the end of FY21 was Rs.1,413 Mn (FY20: Rs.1,708 Mn). GNPL declined to Rs.1,266 Mn at the end of H1FY22 resulting in a substantial improvement in GNPL ratio. The improvement in GNPL levels during FY21-H1FY22 is aided by the relaxations provided by NRB amid the covid pandemic coupled with the higher base effect – due to the increased loans & advances during this period. Bank's covid19 related restructured/rescheduled portfolio was around 2.65% of total loans & advances as on January 14, 2022, declining from 3.89% of total loans & advances as on July 15, 2021. Furthermore, PCBL's GNPL ratio was well below the industry GNPL ratio of 1.41% at the end of FY21 and 1.18% at the end of H1FY22. Going forward, the ability of the bank to maintain its asset quality especially in view of the lingering impact of the pandemic would be critical for the bank's earning profile and profitability and would be a key rating sensitivity.

Diversified loan portfolio with regulatory compliance

PCBL has diversified portfolio distribution across sectors with higher lending of 14.42% (of total loans & advances) in FY21 (FY20:12.08%) towards finance, insurance and real estate sector which comprises major lending towards real estate sector (8.91%) and lending to microfinance institutions. Next major lending of 11.66% in FY21 (FY20:9.50%) was towards wholesale & retailer sector (majorly towards wholesale trade – durables and retail trade). During H1FY22, PCBL had higher lending of 13.63% towards finance, insurance and real estate sector followed by lending of 13.17% % towards wholesale & retailer sector. As on July 15, 2021 PCBL's priority sector lending was 27.00% of gross loans and advances outstanding prior to 6 months and 27.7% as on January 14, 2022.

Diversified Investment Portfolio

The investment portfolio of the bank has increased by 71.20% y-o-y in FY21 to Rs.23,427 Mn (FY20: Rs.13,684 Mn) mainly due to additional investments made in Government of Nepal (GoN) and NRB securities which increased by 76.85% y-o-y during FY21. 89.37% of the investments in FY21 (FY20: 86.08%) had been invested in treasury bills and bond instruments issued by GoN and NRB and 2.68% (5.79%) had been invested in equity securities of domestic corporate entities and 2.63% (8.12%) Mn has been invested in foreign securities. PCBL earned Rs.745 Mn, up 53.24% y-o-y, as interest income from Securities/ Bonds in FY21 (FY20: Rs.338 Mn), Rs.67 Mn (Rs.115 Mn) received as interest on interbank placements and Rs.19 Mn (Rs.15 Mn) received as dividend income from shares of corporate sectors during FY21.

Key Rating Weaknesses**Moderate liquidity profile**

Bank has moderate liquidity profile with positive cumulative mismatches as of January 14, 2022 due to well matched tenure of assets and liabilities. Although the assets and liabilities show mismatches in the 91-180 days and over 1 year bucket, cumulative mismatch remains positive. PCBL has maintained SLR of 19.50% as on July 15, 2021 and 17.15% as on January 14, 2022 against minimum requirement of 10%. Net liquidity was comfortable at 25.12% as on July 15, 2021 but declined to 18.62% as on January 14, 2022 against minimum requirement of 20%. The bank is in the process of issuing new debentures of around Rs.2,500 Mn, which will help improve its liquidity in 2HFY22.

Low CASA deposits maintained with volatile trend

PCBL continues to maintain relatively volatile and lower levels of CASA deposits as compared to the industry average. PCBL maintained 27.47% CASA deposits in FY19 which increased to 30.78% in FY20 but moderated slightly to 30.37% in FY21. It dipped even further to 24.46% during H1FY22 (industry avg. CASA for FY21 and H1FY22 were 45.23% and 40.01%, respectively). Lower and volatile CASA proportion results in higher cost of funds for the bank vis-à-vis peers, imposing competitive disadvantage for the bank. CASA deposits were lower during H1FY22 industry-wide with lower proportion of current deposits as compared to previous quarters.

High portfolio concentration among top depositors and borrower groups

Deposit concentration by top 20 institutional depositors was high at 30.34% of the total bank deposits (Rs.160,190 Mn) as on July 15, 2021. This has increased to 35.03% of the total bank deposits (Rs.162,630 Mn) as on January 14, 2022. The bank has moderately high concentration on loan portfolio as top 20 group borrowers accounted 21.96% of total loans & advances (Rs.142,931 Mn) as on July 15, 2021 which has slightly increased to 24.64% of total loans & advances (Rs.162,343) as on January 14, 2022. Similarly, top 20 corporate borrowers accounted for 20.68% of the total loans & advances as on July 15, 2021. This has decreased to 18.81% as on January 14, 2022.

Intense competition

Currently there are 27 Commercial Banks, including three major state-owned banks, operating with total 4,856 branches all over Nepal (based on monthly statistics published by NRB for mid-January 2022). PCBL had 187 branches along with head office as on same date. Industry (Class 'A' Commercial Banks) had achieved total interest income of Rs.326,157 during FY21, down 0.76% y-o-y (FY20: Rs.328,666 Mn) with Rs.131,748 Mn (FY20: Rs.128,669 Mn) net interest income. PCBL's market share on interest income during FY21 was 4.28% (FY20: 3.72%) and on net interest income was 4.49% (3.61%). PCBL's market share on interest income and net interest income was 4.34% and 3.99% during H1FY22, respectively. Intense competition in the banking industry results in a highly dynamic market with volatile market shares. Competition in the interest rates remains a prominent challenge.

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. After the extensive capital increment pressure from Rs. 2 Bn to Rs. 8 Bn for Class "A" Commercial Banks, NRB has now decreased weighted average interest rate spread to 4.4% from earlier 5% via Monetary Policy issued by NRB, for the FY20. Due to increased capital, banks are facing investable amount deficit to grant new loans and advances. And decreased weighted average interest rate spread together with growing competition will be responsible for decreasing net interest margin thereby impacting profitability.

About the Bank

PCBL, an "A" Class Licensed Institution from Nepal Rastra Bank (NRB) listed in Nepal Stock Exchange, is one of the mid-sized private sector banks in Nepal. It was incorporated on July 17, 2007 as the 21st commercial bank in Nepal and started commercial operation from September, 2007. The bank reported PAT of Rs. 3.27 Bn on an asset size of Rs. 190.50 Bn as on July 15, 2021. Further, PCBL reported PAT of Rs. 1.68 Bn on an asset size of Rs. 201.87 Bn during H1FY22.

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About CARE Ratings Nepal Limited:

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