

Kamana Sewa Bikas Bank Limited

Rating

Facilities	Amount (Rs. in Million)	Ratings ¹	Rating Action
Issuer Rating	NA	CARE-NP BB+ (Is) [Double B Plus (Issuer)]	Reaffirmed

CARE Ratings Nepal Limited (CRNL) has reaffirmed issuer rating of 'CARE-NP BB+ (Is)' [Double B Plus (Issuer)] to Kamana Sewa Bikas Bank Limited (KSB). Issuers with this rating are considered to offer moderate risk of default regarding timely servicing of financial obligations.

Detailed Rationale & Key Rating Drivers

The rating assigned to KSB continues to be constrained by its below average asset quality, modest liquidity profile and moderate concentration over top 20 depositors. The rating is also constrained by intense competition and exposure to regulatory risk related to Banking industry.

The rating, however, derives strength from the long track record of operations with experienced board and management team, moderate capitalization levels albeit declining trend over FY22 (Unaudited, refers to the twelve-month period ended mid-July 2022), growing and diversified advances portfolio, increase in investment portfolio and geographical coverage. The rating also derive strength from moderate Current Account Saving Account (CASA) deposits and moderate financial performance during FY22.

Going forward, the ability of the company to continue its growth momentum while improving asset quality and capital adequacy ratio and its ability to manage the impact of any regulatory changes will be the key rating sensitivities.

Detailed Description of the Key Rating Drivers

Key Rating Weaknesses

Below average assets quality

KSB's asset quality stood weaker than industry average in FY22. KSB had Gross Non-Performing Loans (GNPL) of 2.45% in FY22 which deteriorated from 1.60% in FY21 and is higher than industry average of 1.36% in FY22 (PY: 1.30%). The bank's gross NPLs in absolute amount increased to Rs. 1,095 Mn as on mid-July 2022 from Rs. 647 Mn as on mid-July 2021. The increase was on account of the lingering impact of COVID, which has been further impacted by the ongoing liquidity stress in the economy, impacting borrowers' repayment ability. Out of total loans of Rs. 42,511 Mn as on mid-July 2022, delinquencies (including restructured loan) of more than 30 days amounted to Rs. 1,932 Mn (4.54% of total advances) which deteriorated from Rs. 1,754 Mn (4.34% of total advances) at the end of FY21. Given the lingering impact of the pandemic, exacerbated by the ongoing liquidity crisis, deterioration in asset quality in a short span remains a risk and hence tight monitoring of the asset quality will remain critical for the company's financial health going forward and would be crucial from analytical prospective.

Modest liquidity profile

KSB has modest liquidity profile with negative cumulative balances as of mid-July 2022. KSB has maintained SLR of 16.13% as on July 16, 2022 and 15.88% as on July 15, 2021 vis-à-vis regulatory requirement of 10%; CRR of 3.13% and 3.26% at the last reporting week as of FY22 and FY21 vis-à-vis regulatory requirement of 3%. KSB has maintained Net Liquidity Ratio of 23.20% as on July 16, 2022 and 22.10% as on July 15, 2021 vis-à-vis regulatory requirement of 20%.

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

Moderate concentration over top 20 depositors

KSB's deposits from top 20 depositors remain moderate at 19.74% of total deposits on the balance sheet date of FY22 which increased from 17.30% of total deposits over previous balance sheet date. Top 20 depositors mainly consist of institutional depositors. Lower concentration towards deposits normally reduces re-pricing risks at times of interest rate volatility.

Competition from other Finance Companies and Bank

Currently, there are 17 development banks operating with total 1,118 branches all over Nepal (based on monthly statistics published by NRB for Mid-July, 2022) out of that KSB has 135 branches. Industry (Class 'B' Banks- Development banks) has achieved total interest income of Rs. 55,444 Mn in FY22 with Rs. 18,254 Mn net interest incomes; KSB's share on interest income and net interest income is ~10.46% (Rs. 5,797 Mn) and 10.71% (Rs 1,954 Mn) respectively for the same period. Despite being one of the established national development bank in the industry, it is challenging for KSB 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. From FY22 end, NRB has changed to Credit to Deposit (CD) ratio mechanism from existing Credit to Core Capital plus Deposit (CCD) ratio measures. CD ratio needs to be maintained below 90% from mid-July 2022 from earlier provision of 85% for CCD. Furthermore, risk weights of certain loans including personal overdrafts, TR loans, hire purchase loans for personal purpose, margin lending, etc. has been increased to 150% from existing 100% via the mid-term review of monetary policy issued by NRB for FY22. These changes are likely to put downward pressure on capital adequacy ratios of the banks and limit their ability for significant credit expansion, at least over the near term. Furthermore, bank rate has been increased to 8.5% from 7% and repo rate increased to 7% from 5.5% in the monetary policy issued by NRB for FY23. Increased bank rates will likely put upward pressure on both lending and deposit interest rates of the bank over the near term.

Key Rating Strengths**Experienced board members and management team supported by moderate geographical coverage**

KSB is a national level class "B" Development bank formed after merger of Kamana Bikas Bank and Sewa Bikas Bank on August 4, 2017 (Pre-merger, both entities operating since 2007). KSB has a reasonable geographic presence in Nepal with 134 branches, one extension counter and 77 ATMs covering all 7 provinces and 38 districts of Nepal (out of 7 provinces and 77 districts of Nepal) as on mid-July 2022. KSB is a 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 18 years of banking experience. All the management members have wide banking experience.

Moderate capitalization level, albeit on a declining trend

KSB's overall capital adequacy stood at 13.28% as on July 16, 2022 which decreased from 13.93% as on July 15, 2021 as against minimum regulatory requirement of 10%. KSB has seen aggressive growth in its advances book over the last

five years resulting in sequential moderation in its core capitalization levels. Tier I CAR has been declining from 20.52% as on mid- July, 2018 to 9.72% as on mid-July, 2022, however has sufficient cushion over the regulatory requirement of 6%. Lower capitalization levels could limit the bank's ability to absorb losses, should they materialize, especially given the uncertainty surrounding credit recovery amid the lingering impact of the covid-19 pandemic. The bank's ability to maintain adequate cushion in the capital adequacy ratios is critical for its solvency and will remain crucial for its growth perspective.

Moderate growth in loans & advances and deposits with decent market share and diversified credit portfolio

Loan portfolio of KSB recorded growth of 12.46% year-on-year in FY22 to Rs. 45,493 Mn aided by increase in business through addition of 5 new branches in FY22. Amid the lingering impact of the pandemic, KSB has taken a more conservative approach vis-à-vis the industry. The overall Class-B finance industry' loan portfolio grew by 16.03% year-on-year in FY22. Similarly, KSB's deposit grew by 4.65% to Rs. 46,256 Mn in FY22. The overall Class-B finance industry' deposit portfolio grew by 14.28% year-on-year in FY22. KSB has 9.92% and 10.22% market share in terms of deposit base and loan portfolio respectively of Class-B financial industry at the end of FY22 (9.91% and 10.45% respectively in FY21), based on monthly data published by NRB. KSB has a diversified loans portfolio across various Industry/ sector with higher lending of 20.68% at the end of FY22 for wholesale & retail sector (PY: 22.25%) followed by 7.13% towards finance, insurance and real estate (PY: 4.51%). Diversification helps bank to maintain the bank's assets quality and mitigate volatility risk in case of experienced swings in the economy.

Moderate financial performance in FY22

During FY22, KSB's total income increased by 30.57% year on year to Rs. 6,132 Mn supported by rise in interest income by 41.73% owing to sustained growth in loans and advances during the last few years, coupled with increase in yield on advances to 12.60% in FY22 compared to 11.14% in FY21. Similarly, cost of deposits increased to 8.04% during FY22 from 6.61% during FY21 due to increased interest rates in the overall industry. Higher cost of funds was also in part on account of increase in proportion of fixed deposits as compared to the previous year. Despite higher cost of funds, improved spread led to KSB's Net Interest Margin (NIM) slightly improving to 3.54% during FY22 from 3.48% during FY21. The total operating expenses increased by 8.29% in FY22 to Rs. 1,088 Mn compared to Rs. 1,004 Mn during FY21 on account of increase in branches coupled by increase in other operating expenses. KSB's PAT slightly increased by 5.48% to Rs. 631 Mn during FY22 from Rs 598 Mn during FY21. This was mainly on account of lower non-interest income during FY22. KSB's non-interest income declined to Rs. 335 Mn in FY22 from Rs. 606 Mn in FY21. The higher non-interest income in FY21 was on account of KSB reporting profits on sale of investments of Rs. 249 Mn during FY21 (FY22: Rs. 1 Mn) amid a more favorable market dynamics during FY21. KSB's Return on Total Assets (ROTA) decreased to 1.14% in FY22 (1.36% in FY21), due to higher growth in total assets by 15.68% in FY22 against 5.48% increase in PAT in FY22.

Increase in investment portfolio

KSB's total investment increased by 25.89% to Rs. 6,260 Mn in FY22. Total investments include investment in equity share of Rs. 251 Mn. in FY22 as compared to Rs 303 Mn. in FY21. Furthermore, out of KSB's total investment, investment in government bond and treasury bills has been increased to Rs 6,009 Mn in FY22 from Rs. 4,670 Mn in FY21. During FY22, KSB earned interest income of Rs. 269 Mn (Rs. 258 Mn during FY21) from investment in Securities/Bonds.

Moderate CASA deposit ratio and low portfolio concentration among top borrowers

KSB's CASA mix continues to remain largely in line with the industry average. KSB's CASA proportion declined to 24.09% at the end of FY22 (slightly lower than finance industry average of 25.62%) from 31.33% at the end of FY21 (finance industry average of 34.50%). Due to decrease in CASA proportion, cost of deposit has increased to 8.04% at the end of

FY22 compared to 6.61% at the end of FY21. Increasing cost of the funds could impact the company's profitability in the long term, resulting in a competitive disadvantage. The ability of the company to maintain lower cost of funds will be critical as it would continue to provide a competitive advantage in the "base rate plus" lending rate regime.

KSB's lending to top 20 group borrower was 0.92% of total loans and advances at the end of FY22. Similarly, lending to top 20 individual borrower was 6.28% of total loans and advances in FY22. Due to low concentration over top borrowers there will not be significant impact on its assets quality, if any big borrower defaults on loan.

About the Company

Kamana Sewa Bikas Bank Limited (KSB) 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. At the end of FY22, KSB has Rs. 3,143 Mn paid up capital which is distributed among promoters and public shareholders in the ratio of 51:49.

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