

**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]	Assigned

CARE Ratings Nepal Limited (CRNL) has assigned ‘CARE-NP BBB’ rating to the new proposed 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 assigned to PBL derives strength from its experienced promoters and management team, diversified and geographical coverage through branches in Nepal, consistent growth in advances and deposits and considerable growth in total income and net profit over the period ended mid-July 2019. 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 as compared to the industry average, moderate capitalization as per existing requirement and increasing operating expenses. The rating is also constrained by 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. Devi Prakash Bhattachan is the Chairman of the bank, who has been engaged in various sectors like tourism, remittance, insurance and bank & financial institution. 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.

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

***Comfortable CASA ratio with lower cost of deposits as compared to industry***

PBL maintained comfortable CASA proportion of 43.06% (FY18 44.41%) during FY19 (refers to 12 months period ended mid-july 2019), which is better than its peers and industry average of 41.77% (FY18 42.93%) during same period. CASA proportion of PBL has slightly improved to 43.18% during Q1FY20, against industry average of 40.48%. CASA deposits in absolute amount has also been increasing over the period. CASA deposits have increased by 12.06% during FY19 over FY18, which further increased by 1.77% during Q1FY20 over FY19. PBL have one of the lower cost of funds at 6.26% in FY19 and 6.15% during Q1FY20. This is likely to be a competitive advantage for the bank, especially in the “base rate plus lending rate” regime.

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

PCBL has diversified presence in Nepal with 202 branches, 12 extension counters, 27 revenue counters and 152 ATMs terminals as on January 02, 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.112,393 Mn in FY19, recording a three-year CAGR of 22.63% and reported growth of 15.56% over FY18. Further, deposits of PBL increased to Rs.114,078 Mn during Q1FY20 reporting a growth of 10.85% over Q1FY19. PBL’s share of total industry deposits is 3.91% as on July 16, 2019 in comparison to the 3.94% share of total industry deposits as on July 16, 2018. PBL also reported consistent growth in total advances. Total loans and advances stood at Rs.90,280 Mn in FY19 recording a three year CAGR of 23.26% and reported growth of 18.77% over FY18. Further, total loans and advances of PBL increased by 6.10% to Rs.95,787 Mn during Q1FY20 over FY19. PBL had 3.61% of the industry advances as on July 16, 2019. This increase in loans & advances and deposits was on back of leveraging the 30 new branch additions FY19. Credit to Core Capital cum Deposit (CCD) ratio of PBL remains 68.91% at the end of FY18 which has increased to 76.62% at the end of FY19 as against maximum allowable CCD ratio of 80%.

***Considerable growth in total income and net profit over the period***

During FY19, the total income of the bank increased by 30.69% to Rs.12,103 Mn majorly due to rise in both interest income by 30.57% and increase in the non-interest income by 31.65%. On back of these, net interest income increased by 56.07% to Rs.4,398 Mn during FY19. The yield on advances increased by 81 bps to 11.70% and cost of deposits decreased marginally by 1 bps to 6.02%. Net Interest Margin (NIM) of the bank increased from 2.70% in FY18 to 3.47% in FY19 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 FY19, the operating expenses increased by 37.75% to Rs.3,084 Mn over FY18. This is mainly due to increase in employee related expenses which increased by 29.59% on back of supporting the branch expansion leading to increase in the

number of employees. Increase in operating expenses led to increase in operating expenses/ average total assets to 2.43% in FY19 as compared to 2.15% in FY18 due to huge growth in operating expenses in contrast growth in assets of the bank. PBL's impairment charge for loans and other losses in FY19 was Rs.370 Mn as against Rs.155 Mn reversal during previous year. PBL reported PAT of Rs.1,784 Mn in FY19 as compared to PAT of Rs.967 Mn reported in FY18. Return on Total Assets (RoTA) of the bank has adequately improved to 1.41% during FY19 (FY18: 0.93%).

During Q1FY20, bank's total income has increased by 19.03% to Rs.3,572 Mn in comparison to Rs.3,001 Mn during Q1FY19 on back of increase in interest income by 17.51% and non-interest income by 31.34% over the same period. Net interest income of the bank increased by 24.10% to Rs.1,407 Mn during Q1FY20 vis-a-vis Q1FY19. PAT of the bank has increased by 5.02% to Rs.628 Mn (Rs.598 Mn during Q1FY19) and ROTA improved to 1.90% during Q1FY20.

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

PCBL has maintained SLR of 19.76% as on July 16, 2019 and 17.36% as on October 17, 2019 vis-à-vis regulatory requirement of 10%; average CRR of 4.39% and 4.40% at the last reporting week as of FY19 and Q1FY20 vis-à-vis regulatory requirement of 4%; Net Liquidity of 28.08% as on July 16, 2019 and 25.38% as on October 17, 2019 vis-à-vis regulatory requirement of 20%. Maintained SLR, CRR and Net Liquidity are within the norms of NRB. Bank has moderate liquidity profile with positive cumulative mismatches as of October 17, 2019. However, the assets and liabilities show mismatches for 1 to 180 days, on account of advances given of longer tenure in contrast with short term fixed deposits.

#### ***Diversified sector wise loan portfolio with regulatory compliance***

PBL has diversified loan portfolio distribution across sectors with major loans towards wholesalers & retailers sector and construction sector which comprise majorly housing loans. PBL lent 37.01% as on October 17, 2019 towards priority sector; of gross loans and advances outstanding prior to 6 months. Out of priority sector advances PBL lent 11.09% as on October 17, 2019 towards Agriculture sector and 25.91% as on October 17, 2019 towards energy & tourism sector (combined). Bank adequately lends to deprived sector; 5.47% as on July 16, 2019 and 5.45% as on October 17, 2019. All these lending (i.e. priority sector, agriculture, energy & tourism sector (combined) and deprived sector) are within the NRB requirements.

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

PBL has made investments of Rs.14,565 Mn as on July 16, 2019, out of which Rs.8,657 Mn has been invested in Government of Nepal (GoN) bonds, Rs.3,558 Mn has been invested in GoN treasury bills and Rs.2,233 Mn has been invested in equity securities of domestic corporate entities. The investment portfolio of the bank has increased by 40.48% in FY19 over FY18 mainly due to additional investments made in GoN and NRB securities. PCBL reported 5.22% yield on investments during FY19.

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

The paid up capital of the was Rs.8,893 Mn at the end of FY19. To reach the regulatory paid up capital requirements of Rs.8,000 Mn for 'A' Class Commercial Bank, PBL issued 23.53 Mn units right shares in FY18 amounting to Rs.2,353 Mn. Further the bank has issued 8% bonus share amounting to Rs.659 Mn during FY19. The capital adequacy ratio (CAR) of the bank is maintained at low level and is in the declining trend. Core Equity Tier I Ratio (CET I Ratio) of the bank stood at 10.22% as on July 16, 2019 and overall CAR stood at 11.16% as against the regulatory requirement of overall CAR of 11% as per norms of NRB for FY19. PBL maintained 10.00% CET I and 11.03% overall CAR during Q1FY19. However, PBL needs to improve CAR to overall 13% with the provision to maintain additional counter cyclical buffer of 2%, introduced by Monetary Policy issued by NRB for the FY20 which requires "A" class licensed institutions to maintain overall capital adequacy of 13% from Mid-July 2020.

***Weak asset quality parameters as compared to industry***

PBL's asset quality is marked by high Gross Non-Performing Loans (GNPL) with one of the highest NPL in the industry. GNPL of the bank is high at 3.76% during FY19 although the same declined to 3.32% during Q1FY20 vis-à-vis industry average of 1.61%. Bank had weak NPL after merger and acquisition with other BFIs having poor asset quality. However, GNPL has been in declining trend from 24.29% during FY14 during which mergers took place to 3.32x by Q1FY20. Out of total advances of Rs 90,280 Mn as on July 16 2019, the delinquencies of more than 30 days amounted to Rs. 6,149 Mn, that accounts for 6.81% of total advances; the same has increased to Rs. 8.750 Mn out of total advances of Rs. 95,787 Mn as on October 17, 2019; increased by 232 bps to 9.13% compared to July 16, 2019.

***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 and slightly decreased to 23.41% of the total bank deposits as on October 17, 2019. The bank has moderate concentration on single borrowers as top 20 single borrower accounts for 14.15% of total advances during FY19 which was slightly increased to 14.61% of total advances during Q1FY20. However, the bank has high concentration on group borrowers as top 20 group borrowers accounted for 19.81% of total advances during FY19 which was slightly increased to 20.22% of total advances during Q1FY20

***Intense competition***

Currently there are 27 Commercial Banks, including three major state owned banks, operating with total 3884 branches all over Nepal (based on Monthly statistics published by NRB for Mid-October 2019). PBL had 196 branch along with head office as on same date. Industry (Class 'A' Commercial Banks) has achieved total interest income of Rs.304,264 Mn during FY19 with Rs.127,266 Mn net interest income; PBL's share on interest income is 3.54% (Rs.10,765 Mn) and 3.46% share on net interest income (Rs.4,398 Mn) for the same

period. The market share of PBL has increased to 3.77% and 4.08% in terms of interest income and net interest income during Q1FY20 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. After the extensive capital increment pressure from Rs.2 Bn to Rs.8 Bn for Class “A” Commercial Banks, NRB decreased weighted average interest rate spread to 4.5% from earlier 5% for the FY19 and again decreased to 4.4% for the FY20 and has also changed the calculation method of interest rate spread via Monetary Policy, thereby impacting the absolute profitability of the banks. Also, to relax the liquidity crisis, Cash Reserve Ratio (CRR) and Statutory Liquidity Ratio (SLR) has been reduced to 4% & 10% respectively from existing 6% & 12% respectively. Further, NRB has introduced additional counter cyclical buffer of 2% which requires "A" class licensed institutions to maintain overall capital adequacy of 13% from Mid-July 2020.

**About the Bank**

Prabhu Bank Limited (PBL) 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 June 19, 2001 as Kist Bank Ltd. 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. on February 04, 2016. Current shareholding pattern of the Bank constitutes of promoters holding 55% of the shares while remaining 45% is held by the general public. The major promoters of the bank are Mrs. Tara Kumari Thakali Bhattachan (5.08%), M/s Prabhu Group Private Limited (4.93%). The bank reported PAT of Rs. 1,784 Mn on an asset size of Rs. 138 Bn as on July 16, 2019. Further, PBL reported PAT of Rs. 628 Mn during Q1FY20.

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