

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)]	Assigned
Subordinated Debenture	3,500.00	CARE-NP A- [Single A Minus]	Assigned

CARE Ratings Nepal Limited (CRNL) has assigned ‘CARE-NP A- (Is)’ rating 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 assigned ‘CARE-NP A-’ rating 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 with experienced promoters and management team, adequate capitalization as per existing requirement, 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 declining trend over the period ended mid-October 2019 (Q1FY20), moderate asset quality however better than industry average and concentration towards corporate advances portfolio. 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.

PCBL has proposed to acquire Kailash Bikash Bank Limited (KBBL, a ‘B’ Class Financial Institution) in swap ratio of 100:94 and Lalitpur Finance Limited (LFL, a ‘C’ Class Financial Institution). The proposed merger plan is currently in progress and CRNL will monitor the impact of the merger with the KBBL and LFL on the rating assigned to PCBL.

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

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 25 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 supported by an experienced management team.

Adequate capitalization as per existing requirement, however needs improvement to meet new regulatory requirements

PCBL had paid up capital of Rs.9,319 Mn at the end of FY19 (refers to 12 months period ended mid-july 2019). To reach the regulatory paid up capital requirements of Rs.8,000 Mn, PCBL issued 17.08 Mn units bonus shares during FY18. Further the bank has issued 16% bonus share amounting to Rs.1,285 Mn during FY19. Core Equity Tier I Ratio (CET I Ratio) of the bank stood at 11.97% as on July 16, 2019 (July 16, 2018: 11.43%) and overall capital adequacy ratio (CAR) stood at 12.76% (July 15, 2018: 12.24%) as against the regulatory requirement of overall CAR of 11% for FY19. PCBL maintained 11.95% CET I and 12.75% overall CAR during Q1FY19. However, PCBL needs to improve CAR to overall 13% by Mid-July 2020 with the provision to maintain additional counter cyclical buffer of 2%, introduced by Monetary Policy issued by NRB for the FY20.

Diversified and geographical coverage through branches

PCBL has diversified presence in Nepal with 99 branches and 54 ATMs terminals as on mid-Oct 2019 across the Country. The branches are spread over all 7 Provinces and cover 34 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 PCBL have reached to Rs.86,266 Mn in FY19 recording a three-year CAGR of 21.29% and reported growth of 6.09% over FY18. Further, deposits of PCBL increased to Rs.88,094 Mn during Q1FY20 reporting a growth of 15.40% over Q1FY19. PCBL's share of total industry deposits is at 3.00% as on July 16, 2019. PCBL also reported consistent growth in total advances. Total loans and advances stood at Rs.76,298 Mn in FY19 recording a three year CAGR of 22.91% and reported growth of 7.84% over FY18. Further, total loans and advances of PCBL increased by 8.63% to Rs.72,808 Mn during Q1FY20 over FY19. PCBL had 3.06% of the industry advances as on July 16, 2019. This increase in loans & advances and deposits was on back of leveraging the new branch additions along with acquisition of Kankai Bikas Bank

Ltd. Credit to Core Capital cum Deposit (CCD) ratio of PCBL was at 75.82% at the end of FY19 as against maximum allowable CCD ratio 80%.

Considerable growth in total income and net profit over the period

During FY19, the bank's total income increased by 13.63% to Rs.10,894 Mn majorly due to rise in both interest income by 14.75% on back of growth in advances, increased interest rates leading to improvement in yield on advances and increase in the non-interest income by 4.32%. On back of these, net interest income increased by 34.46% to Rs.3,585 Mn during FY19. The yield on advances increased by 7 bps to 12.72%. However, cost of deposits decreased by 55 bps to 7.40% mainly due to decreased market interest rate on fixed deposits as PCBL maintained huge term deposits in its total deposits which in turn was beneficial in favour of PCBL. Net Interest Margin (NIM) of the bank increased from 3.09% in FY18 to 3.64% in FY19 due to increase in the absolute amount of interest income being more than increase in interest expenses. Interest income grew by 14.75% whereas interest expense grew by only 5.84%.

On the operational efficiency front, the operating expenses have been increasing y-o-y. In FY19, the operating expenses increased by 34.22% to Rs.1,371 Mn over FY18. This is mainly due to increase in employee related expenses 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 1.39% in FY19 as compared to 1.18% in FY18. PCBL's impairment charge for loans and other losses in FY19 was Rs.135 Mn as against Rs.224 Mn during previous year. PCBL reported PAT of Rs.2,199 Mn in FY19 as compared to PAT of Rs.1,726 Mn reported in FY18. Return on Total Assets (RoTA) of the bank has adequately improved to 2.23% during FY19.

During Q1FY20, bank's total income increased by 12.86% to Rs.3,241 Mn over Q1FY19 on back of increase in interest income by 9.65% and increase in non-interest income by 33.23% over the same period. Net interest income of the bank increased by 9.30% to Rs.1,061 Mn during Q1FY20 vis-a-vis Q1FY19. PAT of the bank has increased by 13.38% to Rs.660 Mn during Q1FY20 and ROTA improved to 2.66% during Q1FY20.

Moderate liquidity profile

PCBL has maintained SLR of 20.52% as on July 16, 2019 and 17.52% as on October 17, 2019 vis-à-vis regulatory requirement of 10%; average CRR of 8.71% and 5.08% at the last reporting week as of FY19 and Q1FY20 vis-à-vis regulatory requirement of 4%; Net Liquidity of 24.54% as on July 16, 2019 and 20.48% as on October 17, 2019 vis-à-vis regulatory requirement of 20%. Bank has moderate liquidity profile with positive cumulative mismatches as of October 17, 2019 due to well matched tenure of assets and liabilities. However, the assets and liabilities show mismatches over 1 year (but has positive cumulative mismatches).

Diversified sector wise loan portfolio with regulatory compliance

PCBL has diversified portfolio distribution across sectors with 13.83% in FY19 towards construction sector. Next major lending of 13.60% during FY19 is towards finance, insurance and real estate sector which comprises major lending towards real estate sector and lending to microfinance institutions. During Q1FY20, PCBL had higher lending of 13.22% towards non-food production sector followed by lending of 13.19%

towards construction sector. PCBL lent 33.06% as on July 16, 2019 and 39.11% as on October 17, 2019 towards priority sector; of gross loans and advances outstanding prior to 6 months. Out of priority sector advances PCBL lent 11.11% as on July 16, 2019 & 14.61% as on October 17, 2019 towards Agriculture sector and 21.94% as on July 16, 2019 and 24.51% as on October 17, 2019 towards energy & tourism sector (combined). Bank adequately lends to deprived sector; 5.17% as on July 16, 2019 and 5.43% 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

PCBL has made investments of Rs.10,142 Mn as on July 16, 2019, out of which Rs.8,945 Mn has been invested in treasury bills and bond instruments issued by Government of Nepal (GoN) and NRB, Rs.524 Mn has been invested in equity securities of domestic corporate entities and Rs.673 Mn has been invested in foreign securities. The investment portfolio of the bank has increased by 19.94% in FY19 over FY18 mainly due to additional investments made in GoN and NRB securities. PCBL reported 4.89% yield on investments during FY19.

Key Rating Weaknesses

Moderate asset quality, although better than industry average

There was increase in Gross Non Performing Loans (GNPL) of the bank in absolute amount and in %age terms. GNPL was at Rs.603 Mn during FY18 which increased to Rs.761 Mn during FY19. Increase in GNPL in absolute amount resulted increased GNPLs ratio to 1.00% as on July 16, 2019 as compared to 0.85% as on July 15, 2018 however GNPL ratio of PCBL is better than industry average GNPL. Further, GNPL ratio deteriorated to 1.14% during Q1FY20. Out of total advances, the delinquencies of more than 30 days was 4.07% of total advances at the end of FY19; the same has increased by 38 bps to 4.45% at the end of Q1FY20 as compared to July 16, 2019.

Concentration towards corporate portfolio

Over the period, PCBL has continuously increased its lending proportion towards corporate sectors. As on July 16, 2018, the corporate segment constituted 52.88% of the total advances which further increased to 57.24% and 60.05% of the total advances as on July 16, 2019 and October 17, 2019 respectively. Retail portfolio (including Small & medium enterprises (SME)) proportion decreased from 37.77% as on July 16, 2019 to 35.19% as on October 17, 2019 of the total advances.

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 declining trend. PCBL maintained CASA deposits of 27.47% in FY19 and which declined to 24.13% in Q1FY20 (industry avg. CASA for FY19 and Q1FY20 was 41.77% and 40.48% respectively). Lower and declining CASA proportion resulted higher cost of funds (7.90% at the end of FY19 and ranked 24 out of 28 in the industry) of PCBL against its peers imposing competitive disadvantage for the bank. Term deposit/total deposits increased from 38.98% during FY18 to 48.32% during FY19 and further to 50.31% during

Q1FY20. In absolute amount CASA deposits increased by 1.40% during FY19 over FY18, however decreased by 10.29% during Q1FY20 over FY19.

High portfolio concentration among top depositors and borrower groups

Deposit concentration by top 20 institutional depositors was high at 40.60% of the total bank deposits as on July 16, 2019. However, the same has slightly decreased to 38.67% of the total bank deposits as on October 17, 2019. The bank has high concentration on loan portfolio as top 20 single borrower accounts for 18.06% of total advances during FY19 though slightly decreased to 17.99% of total advances during Q1FY20. Likewise, top 20 group borrowers accounted 24.09% of total advances during FY19 which was slightly decreased to 23.62% 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). PCBL had 99 branch along with head office as on same date. Banking Industry (Class 'A' Commercial Banks) has achieved total interest income of Rs.304,384 Mn during FY19 with Rs.127,386 Mn net interest income; PCBL's share on interest income is 3.23% and 2.81% share on net interest income for the same period. The market share of PCBL has increased marginally to 3.26% and 3.08% 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

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.2,199 Mn on an asset size of Rs.102 Bn as on July 16, 2019. Further, PCBL reported PAT of Rs.660 Mn during Q1FY20. PCBL has undergone multiple acquisition in the past and is in process of acquiring Kailash Bikas Bank Limited and Lalitpur Finance Limited. In past, PCBL acquired Biratlaxmi Bikas Bank Ltd and Country Development Bank Limited during FY17 and recently acquired Kankai Bikas Bank Limited during Q1FY20.

Analyst Contact Mr. Bidhan Ojha bidhan.ojha@careratingsnepal.com Tel No.: +977-01-4445473	Relationship Contact Mr. Sajan Goyal sajan.goyal@careratingsnepal.com Tel No.: 9818832909/+977-01-4445472/3/4
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