

Rating Rationale

Sunrise Bank Limited

Ratings

| Instrument | Amount (Rs. In Mn) | Rating ¹ | Rating Action |
|---|--------------------|--|---------------|
| Subordinate Debenture (10.25% Debenture 2083) | 3,000.00 | CARE-NP A- [Single A Minus] | Reaffirmed |
| Subordinate Debenture (10% Debenture 2080) | 1,000.00 | CARE-NP A- [Single A Minus] | Reaffirmed |
| Issuer Rating | NA | CARE-NP A- (Is) [Single A Minus (Issuer Rating)] | Reaffirmed |

CARE Ratings Nepal Limited (CRNL) has reaffirmed the issuer rating of “CARE-NP A- (Is)” assigned to Sunrise Bank Limited (SBL). 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-’ assigned to the various Subordinated Debentures program of SBL. 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 ratings assigned to SBL derive strength from the long track record of operations with experienced promoters and management team, comfortable capitalization; diversified and good geographical coverage through branches. The ratings also factor in consistent growth in loans & advances and deposits; moderate proportion of Current Accounts Savings Account (CASA) ratio; diversified loan portfolio with increasing concentration towards SME portfolio & moderate deposit concentration with increasing advances concentration although moderate along with comfortable liquidity profile. The rating however, is constrained by subdued growth in total income and decline in profitability during FY20 owing to COVID-19, deterioration in asset quality with increase in COVID-19 induced delinquencies, however improvement in H1FY21, intense competition and exposure to regulatory risk related to industry. Ability of the bank to continue its growth momentum without compromising on asset quality and 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

Long track record of operation, geographical coverage with experienced promoters and management team

Established in the year 2007; SBL has a strong presence in Nepal with 139 branches, 10 extension counters and 160 ATMs (as on January 13, 2021) covering all the Provinces in Nepal. The bank’s profile derives strength from its promoters who have diversified experience in sectors like banking, insurance,

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

manufacturing, import and export, trading etc. SBL is a professionally managed bank under the overall guidance of the bank's Board of Directors (BoD) which includes eminent businessmen and industrialists with wide experience in the financial services. Mr. Moti Lal Dugar is the Chairman of the bank, who has been engaged in service and manufacturing industry, import export, insurance, hydro power, banking and business sector for more than 5 decades. The senior management team is highly experienced in their respective field of operations and is headed by Mr. Suman Sharma (Chief Executive Officer; CEO) who has more than 20 years of banking experience.

Comfortable capitalisation

The bank reported Capital Adequacy Ratio (CAR) of 14.62% as on July 15, 2020 with Tier I (CET I) CAR of 10.26% as compared to CAR of 13.24% and Tier I CAR of 11.28% as on July 16, 2019. The bank has maintained adequate capital adequacy levels as against minimum regulatory requirement of overall CAR of 11% as stipulated by NRB in compliance with Basel III norms. SBL maintained 10.36% Tier I CAR and 14.53% overall CAR during H1FY21.

Consistent growth in loans & advances and deposits

Over the last 3 to 4 years the bank has shown healthy growth in the advances and deposits. Total loans and advances stood at Rs. 83,830 Mn in FY20 recording a three year CAGR of 17.45% and reported growth of 19.12% over FY19. Further, total loans and advances of SBL increased by 15.47% to Rs. 89,472 Mn during H1FY21 over H1FY20. Total deposits of SBL have reached to Rs. 80,301 Mn in FY20 recording a three-year CAGR of 15.69% and reported growth of 20.29% over FY19. Further deposits of SBL increased to Rs. 98,431 Mn during H1FY21 reporting a growth of 16.09% over H1FY20. Bank's share of total industry deposits stood at 2.71% as on July 15, 2020, which slightly reduced to 2.65% as on January 13, 2021.

Diversified loan portfolio, with increasing concentration towards SME portfolio

The bank's advances are diversified across segments. As on July 16, 2020, Retail banking comprised 34.63% (35.45% as on July 16, 2019), corporate segment comprised of 33.67% (37.25% as on July 16, 2019) of the advances, Small & medium enterprises (SME) comprised 25.55% (18.05% as on July 16, 2019) and Agricultural and deprived sector comprise of remaining 6.15% (9.26% as on July 16, 2019). As of January 13, 2021, retail banking exposure continued at 30.50%, SME increased to 28.56% with corporate segment at 32.72%.

Moderate CASA ratio

CASA deposits mix has been increasing marginally in the past with increase in overall deposit size. CASA mix increased from 35.84% at the end of FY19 to 38.08% during FY20 and further increased to 41.19% at the end of Mid- January 2021. Industry avg. CASA for FY20 & Q1FY21 was 41.32% & 40.77% respectively. CASA deposits in absolute amount increased by 27.81% to Rs. 36,071 Mn during FY20 over FY19 and further increased by 12.40% during H1FY21 over FY20.

Moderate liquidity profile

Bank has moderate liquidity profile with positive cumulative mismatches as on January 13, 2021 due to well matched tenure of assets and liabilities. However, the assets and liabilities show mismatches for 1-90 days, however, assets and liabilities show positive cumulative mismatches during the period. Further, SBL has maintained Statutory Liquidity Ratio (SLR) of 21.27% as on January 13, 2021 vis-à-vis regulatory requirement of 10%; Cash Reserve Ratio(CRR) of 4.36% as on January 13, 2021 vis-à-vis regulatory requirement of 3%; Net Liquidity of 23.45% as on January 13, 2021 vis-à-vis regulatory requirement of 20%. Maintained SLR, CRR and Net Liquidity are within the norms of NRB.

Moderate deposits concentration and increasing advances concentration

Deposit concentration by top 20 institutional depositor accounts has been moderate and on declining trend with 28.95%, 24.78% and 23.88% of total bank deposits as on July 16, 2019, July 15, 2020 and October 16, 2020 respectively. Similarly, concentration on advances as top 20 individual borrowers as % of total loan portfolio accounted for 18.70% as on July 16, 2019 which increased to 24.30% as on July 15, 2020. However, the same marginally reduced to 23.72% as on October 16, 2020. Top 20 group borrowers accounted for 22.20% as on July 16, 2019 which increased to 26.85% as on July 15, 2020 and stood at 26.07% as on October 16, 2020.

Key Rating Weaknesses***Subdued growth in total income and decline in profitability during FY20 owing to COVID-19***

During FY20, bank's total income increased by 9.59% to Rs. 11,307 Mn due to rise in both interest income by 8.85% on back of growth in advances and increase in the non-interest income by 15.74%. However, growth in interest income and total income remained subdued as compared with previous years owing to COVID-19. The yield on advances declined by 209 bps to 11.18% and the cost of deposits decreased by 78 bps to 6.71% mainly due to interest discounts provided, based on NRB guidelines and reduction in interest rates during last quarter of FY20. Net interest income increased by 7.65% to Rs. 3,859 Mn during FY20. However, Net Interest Margin (NIM) of the bank declined from 4.05% in FY19 to 3.66% in FY20 due to lower growth in Net Interest Income as compared to Average Total Assets.

On the operational efficiency front, operating expenses have been increasing y-o-y. In FY20, the operating expenses increased by 15.67% over FY19 on back of increase in employee related expenses. However, despite growth in operating expenses, operating expenses/ average total assets corrected to 2.11% in FY20 as compared to 2.17% in FY19 on account of growth in average total assets being more than the growth in operating expenses. SBL's impairment charge for loans and other losses in FY20 increased substantially to Rs. 850 Mn as against Rs. 104 Mn during previous year due to deteriorated assets quality during FY20 and provisions made for COVID-19 induced delays as per the NRB Guidelines. Accordingly, SBL's PAT declined by 20.32% in FY20 to Rs. 1,359 Mn as against Rs. 1,706

Mn earned in FY19. Return on Total Assets (RoTA) of the bank remained at 1.29% during FY20 reporting a decline from 1.93% during FY19.

During H1FY21, bank's total income declined by 6.76% to Rs. 5,289 Mn in comparison to Rs. 5,673 Mn during H1FY20 on back of decline in interest income by 8.12% to Rs. 4,562 Mn in H1FY21. This was partially offset by increase in non-interest income. Further, interest expenses also declined by 5.87% during H1FY21 on the back of decline in interest rates offered in deposits. Due to substantial decline in interest income as compared to decline in interest expenses net interest income of the bank declined by 11.31% to Rs. 1,816 Mn during H1FY21 vis-à-vis Rs. 2,047 Mn in H1FY20. However, with reduced impairment charges made during H1FY21, PAT of the Bank declined marginally by 0.53% to Rs. 949 Mn during H1FY21.

Deterioration in asset quality with increase in COVID-19 induced delinquencies, however improvement in H1FY21

SBL reported Gross Non Performing Loan (GNPL) ratio of 1.03% during FY19 which increased substantially to 1.86% during FY20 which however declined during H1FY21 to 1.06%. GNPL in absolute numbers was at Rs. 1,558 Mn at the end of FY20 reporting an increase from Rs. 722 Mn at the end of FY19. However, GNPL declined substantially to Rs 949 Mn at the end of H1FY21. SBL's GNPL ratio was marginally above the Industry GNPL ratio of 1.81% at the end of FY20. However, the same was below the Industry GNPL ratio of 1.68% at the end of H1FY21. GNPL increased at the end of FY20 on account of impact of Covid-19, however the same has declined substantially in H1FY21 due to subsequent recoveries made by the Bank.

Intense Competition

Currently there are 27 Commercial Banks, including three major state owned banks, operating with total 4,585 branches all over Nepal (based on Monthly statistics published by NRB for Mid-Dec 2020). Sunrise Bank has 139 branch along with head office as on mid-Jan 2021. Industry (Class 'A' Commercial Banks) has achieved total interest income of Rs.328,649 Mn during FY20 with Rs.110,888 Mn net interest income; SBL's share on interest income is 3.05% and 3.48% share on net interest income for the same period. The market share of SBL has slightly reduced to 2.88% and 2.85% in terms of interest income and net interest income during H1FY21 respectively. Due to emergent competition it is challenging to recruit and retain skilled manpower. 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 profit of the banks in Nepal.

About the Bank

Sunrise Bank Limited (SBL) is “A” Class Licensed Institutions from Nepal Rastra Bank (NRB). It was incorporated on October 12, 2007 as 23rd Commercial Bank of Nepal. The bank is promoted by reputed entrepreneurs who are industrialist, businessman, engineers, and prominent person of Nepal. As on July 15, 2020, 51% of the total shares of SBL were held by the promoter whereas remaining 49% is held by the general public. The bank had acquired two “C” Class Financial Institution (Finance Company), Narayani National Finance Limited and NIDC Capital Markets Limited. NCM Merchant Banking Limited (a Merchant Banker), a subsidiary of the erstwhile NIDC Capital Markets Ltd., has become a subsidiary of SBL after the acquisition, which is now operating under a new name Sunrise Capital Limited. The bank has an asset size of Rs. 1,16,250 Mn as on July 15, 2020, which witnessed ~22.97% growth over July 16, 2019.

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