

**Rating Rationale
Civil Bank Limited**

Rating

Particulars	Amount (Rs. In Million)	Rating ¹	Rating Action
Issuer Rating	NA	CARE-NP BBB- (Is) [Triple B Minus (Issuer Rating)]	Assigned

CARE Ratings Nepal Limited (CRNL) has assigned the issuer rating of ‘CARE-NP BBB- (Is)’ to Civil Bank Limited (CBL). Issuers with this rating are considered to offer moderate degree of safety regarding timely servicing of financial obligations, in Nepal. Such issuers carry moderate credit risk.

Detailed Rationale & Key Rating Drivers

The rating assigned to CBL derives strength from the established track record of the bank along with experienced promoters and management team, moderate capitalization level, diversified and moderate geographical coverage and improvement in asset quality. The ratings also factor in consistent growth in loans & advances and deposits, moderately diversified sector-wise loan portfolio with regulatory compliance, moderate liquidity profile and healthy investment portfolio.

The rating, however, is constrained on account of moderate scale of operations in the Banking sector of Nepal leading to low profitability in comparison to the peers, financial performance marked by subdued growth during FY20 (refers to the 12 months’ period ended Mid-July 2020) owing to COVID-19, however improved financial performance in Q3FY21 (refers to the 9 months’ period ended Mid-April 2021). The ratings also factor in lower proportion of Current Account Savings Account (CASA) deposits (below industry average) leading to high cost of funds as compared to the other industry players, loan portfolio concentration towards corporate portfolio, moderate deposits and advances concentration on the clients, intense competition and exposure to regulatory risk related to industry.

Ability of the bank to grow its assets without compromising on asset quality especially in view of COVID-19 impact and maintaining capital adequacy would be critical for the bank’s earning profile and profitability. Also, ability to manage the impact of any regulatory changes by Nepal Rastra Bank would be the key rating sensitivity.

Detailed Description of the Key Rating Drivers

Key Rating Strength

Established track record of the bank along with experienced promoters and management team

Established in the year 2010; CBL has over a decade of operational history and an established market presence in Nepal. CBL is a professionally managed bank under the overall guidance of bank's Board of Directors (BoD) which includes eminent businessmen and professionals with wide experience in the industry and financial services. Er. Ichhya Raj Tamang is the Chairman of the bank, who has been engaged

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

in hospitality, banking, real estate and housing business sector for more than 16 years. The bank is led by acting Chief Executive Officer (CEO), Mr. Sunil Kumar Pokharel, who has over 29 years long experience in various financial institutions. He is supported by an experienced management team.

Moderate capitalization level

CBL had paid up capital of Rs. 8,003 Mn at the end of FY20. Tier I (CET I) capital adequacy ratio (CAR) of the bank stood at 13.83% against minimum requirement of 7% as on July 15, 2020 and overall capital adequacy stood at 15.00% as against the regulatory requirement of overall CAR of 11%. CET-I and overall CAR declined to 10.47% and 11.43% respectively during Q3FY21 due to higher increase in loans and advances than increase in capital during the period.

Diversified and moderate geographical coverage through branches

CBL has diversified presence in Nepal with 114 branches and 88 ATMs terminals as on mid-April 2021 across the Country. The branches are spread over all 7 Provinces and cover 42 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 growth in the loans & advances and deposits. Total deposits of CBL have reached to Rs. 60,413 Mn in FY20 recording a three-year CAGR of 18.88% and reported growth of 27.8% over FY19. Further deposits of CBL increased to Rs. 87,897 Mn during Q3FY21 reporting a growth of 49.47% over Q3FY20. CBL's share of total industry deposits is at 1.73% as on July 15, 2020 and 2.20% as on April 13, 2021.

CBL also reported consistent growth in total advances. Total loans and advances stood at Rs. 53,974 Mn in FY20 recording a three year CAGR of 20.46% and reported growth of 20.55% over FY19. Further, total loans and advances of CBL increased by 54.37% to Rs.81,446 Mn during Q3FY21 over Q3FY20. CBL's share of the industry advances is at 1.85% as on July 15, 2020 and 2.29% as on April 13, 2021.

Moderate asset quality

CBL reported declining Gross Non Performing Loan (GNPL) ratio in the past years which improved from high levels of 3.96% during FY17 to 2.37% during FY20 and further improved to 1.13% during Q3FY21. GNPL in absolute numbers was at Rs. 1,281 Mn at the end of FY20 reporting. However, GNPL declined to Rs. 921 Mn at the end of Q3FY21. CBL'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 1.41% at the end of Q3FY21. GNPL increased at the end of FY20 on account of impact of Covid-19, however the same has declined substantially in Q3FY21 due to subsequent recoveries made by the Bank.

Moderately diversified sector wise loan portfolio with regulatory compliance

CBL has moderately diversified portfolio distribution which consists of various types of loan disbursed over the period for various Industry/ Sector with higher lending of 19.05% in FY20 and 18.49% in Q3FY21 towards wholesalers & retailers sector (wholesale trade of durables, non-durables, automotive

dealer/franchise, other retail trade, import-export trade etc.). Next major lending of 19.01% in FY20 and 14.73% in Q3FY21 is towards non-food production sector which comprises majorly lending towards metals-basic iron & steel plant and lending to cement industries.

Moderate liquidity profile

Bank has moderate liquidity profile with negative cumulative mismatches as on April 13, 2021 due to mismatched tenure of assets and liabilities. However, liquidity of the Bank is moderate in terms of Statutory Liquidity Ratio (SLR) and Net Liquidity maintained. CBL has maintained SLR of 18.39% as on April 13, 2021 and; average Cash Reserve Ratio (CRR) of 3.24% as on April 10, 2021; Net Liquidity of 22.93% as on April 13, 2021. Maintained SLR, CRR and Net Liquidity are within the norms of NRB i.e. 10%, 3% and 20% respectively.

Healthy investment portfolio

CBL has made investments of Rs. 8,107 Mn as on July 15, 2020, out of which 95.84% has been invested in treasury bills and bond instruments issued by Government of Nepal (GoN) and NRB (combined) and 4.16% has been invested in equity securities of domestic corporate entities. The investment portfolio of the bank has increased by 45.88% in FY20 over FY19 mainly due to additional investments made in GoN and NRB securities which increased by 21.02% during FY20.

Key Rating Weaknesses

Financial performance marked by subdued growth during FY20 owing to COVID-19, however improved financial performance in Q3FY21.

During FY20, the bank's total income increased by 9.83% to Rs.6,827 Mn majorly due to rise in both interest income by 8.23% on back of growth in advances and increase in the non-interest income by 28.60%. On back of these, net interest income had increased by meager 1.59% to Rs.2,237 Mn during FY20. 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 197 bps to 11.49% mainly on account of interest discounts provided to the borrowers as per the NRB guidelines. Cost of deposits also declined by 42 bps to 7.46% in FY20 mainly due to decreased market interest rate on all type of deposits on the back of excess liquidity in the market. Net Interest Margin (NIM) of the bank declined from 4.14% in FY19 to 2.85% 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 20.47% to Rs.1,705 Mn over FY19. This is mainly due to increase in employee related expenses which grew by 31.26% from FY19 on back of new branch additions. However, despite growth in operating expenses, operating expenses/ average total assets corrected to 2.44% in FY20 as compared to 2.45% in FY19 on account of growth in average total assets being more than the growth in operating expenses. CBL's impairment charge for loans and other losses in FY20 increased substantially to Rs. 224 Mn as against Rs. 59 Mn during previous year due to the increment of provision for loss on account

of impact of COVID-19 as per the NRB regulations. CBL reported decline in the PAT to Rs.555 Mn in FY20 as compared to PAT of Rs.707 Mn reported in FY19. Return on Total Assets (RoTA) of the bank has deteriorated to 1.13% during FY20 from 0.72% of FY19.

During Q3FY21, bank's total income increased by 11.18% to Rs.5,583 Mn in comparison to Rs.5,022 Mn during Q3FY20 on the back of increase in non-interest income by 47.32% due to improvement of fee based income followed by increase in interest income by 8.01%. With increase in interest expenses by 18.52% during Q3FY21, net interest income of the bank declined by 9.87% to Rs.1,540 Mn during Q3FY21 vis-a-vis Q3FY20. However, PAT of the bank improved by 39.39% to Rs.503 Mn during Q3FY21 and ROTA declined to 0.65% during Q3FY21.

Lower portion of CASA deposits (below Industry Average) and high cost of funds

CBL has low CASA deposits as compared to industry. CBL maintained 27.64% CASA deposits in FY19 which has increased to 30.07% in FY20 but again declined to 25.45% in Q3FY21 (industry avg. CASA for FY19, FY20, Q3FY21 was 40.90%, 41.32% and 43.74% respectively). Lower CASA proportion resulted higher cost of funds of CBL against its peers imposing competitive disadvantage for the bank. In absolute amount CASA deposits increased by 39.01% during FY20 over FY19, which further increased by 32.12% during Q3FY21 over FY20.

Loan portfolio concentration towards corporate portfolio

CBL's advances portfolio is concentrated towards corporate sectors which constitutes 46.98% of the advances as on July 15, 2020 (48.55% as on July 16, 2019) which has remained at 46.83% of the advances as on April 13, 2021. As on July 15, 2020; the Retail portfolio, including Small & medium enterprises (SME), sector lending proportion constitutes 47.65% (45.56% as on July 16, 2019) of the advances which has decreased to 45.25% of the advances as on April 13, 2021.

Moderate deposits concentration and moderate advances concentration

Deposit concentration to top 20 depositors has been moderate at 36.55% of total bank deposits as on April 13, 2021. The concentration on advances to top 20 individual borrowers was low at 19.69% as on Q3FY21 and top 20 group borrowers accounts for 23.47% during same period of total loan portfolio.

Intense competition

Currently there are 27 Commercial Banks, including three major state owned banks, operating with total 4,702 branches all over Nepal (based on Monthly statistics published by NRB for Mid-April 2021). CBL had 114 branch along with head office as on same date. Industry (Class 'A' Commercial Banks) has achieved total interest income of Rs.328,666 Mn during FY20 with Rs.128,669 Mn net interest income; CBL share on interest income is 1.89% and 1.74% share on net interest income for the same period. The market share of CBL has increased to 2.08% in terms of interest income, however, reduced to 1.61% in terms of net interest income during Q3FY21. 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. 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

CBL is an “A” Class Licensed Institution from Nepal Rastra Bank (NRB), listed in Nepal Stock Exchange. It was incorporated on August 04, 2010. CBL merged with International Leasing and Finance Company Limited, Unique Finance Limited & Hama Merchant & Finance Limited (HAMA) during FY17. Out of the total shareholding of the Bank, 75.05% is held by individuals, 23.77% by domestic institutions and 1.08% by foreign institutions as on April 13, 2021.

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