

Prabhu Bank Limited

Ratings

Facilities	Amount (Rs. Million)	Rating ¹	Rating Action
Subordinate Debenture (Prabhu Bank Debenture 2084)	2,000.00	CARE-NP BBB [Triple B]	Reaffirmed

Details of instruments/facilities in Annexure-1

CRNL has reaffirmed 'CARE-NP BBB' to the Subordinate Debenture "Prabhu Bank Debenture 2084" of Prabhu Bank Limited. The instrument 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 continues to derive strength from the long track record of operations, experienced promoters and management team, diversified and good geographical coverage through branches, comfortable proportion of low-cost deposits (Current Accounts Savings Account (CASA)) and diversified investment portfolio. The ratings also factor in improvement in asset quality with moderate liquidity profile. The rating also factors in the moderation in financial performance during H1FY22 (refers to 6 months' period ended mid –January 2022)

The rating is constrained by moderation in Tier-I capital with thin cushion over regulatory requirement, concentration of advances and depositors, intense competition and exposure to regulatory risk related to industry.

Ability of the bank to continue its growth momentum while maintaining its asset quality and improving its 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, experienced promoters and management team

Established in the year 2001, PBL has over two decades of operational history and an established market presence in Nepal. PBL is a professionally managed bank under the overall guidance of the bank's Board of Directors (BoD) which includes professionals with wide experience in the banking industry. Mr. Lila Prakash Sitaula is the Chairman of the bank, who have more than 30 years of experience in banking industry.

The senior management team is highly experienced in their respective field of operations and is headed by Mr. Ashok Sherchan (Chief Executive Officer; CEO) who has more than 25 years of experience in banking industry.

Diversified and good geographical coverage through branches

PBL has diversified presence in Nepal through its 215 branches, 61 extension counters, 189 ATM Terminals and 2 branchless banking units as on Mid- January 2022. The branches are spread over all the 7 Provinces of Nepal.

Low cost of deposits

PBL continues to have one of the lower cost of funds of 4.70% in FY21 (ranked 9th among the industry) and 6.16% during H1FY22. This is likely to be a competitive advantage for the bank, especially in the recently implemented "base rate plus lending rate" regime. CASA deposits mix has been increasing in the past with increase in overall deposit size. CASA mix increased from 48.61% at the end of FY20 to 50.76% during FY21 as against the industry average of 45.23% for FY21. CASA deposits in absolute amount increased by 34.65% and stood at Rs. 83,673 Mn during FY21

Consistent growth in Loans & Advances and Deposits

Over the last 3 to 4 years the bank has shown healthy growth in the Loans & advances and Deposits. Total loans and advances stood at Rs. 142,257 Mn in FY21 recording a four-year CAGR of 24.52% and reported growth of 37.93% over FY20. Further, total loans and advances of PBL increased by 14.36% to Rs. 148,403 Mn during H1FY22 over H1FY21 (4.32% over FY21). Bank's share

¹Complete definition of the ratings assigned are available at www.careratingsnepal.com and other CARE publications

of total industry loans and advances stood at 3.83% as on Mid July, 2021 (FY20: 3.59%). The increase in loan and advances was on the back of revival of the economic activities which was affected due to the COVID-19.

Total deposits of PBL have reached to Rs. 164,851 Mn in FY21 recording a four-year CAGR of 19.30% and reported growth of 28.05% over FY20. Bank's share of total industry deposits stood at 3.92% as on Mid July, 2021 (FY20:3.81). The credit to Deposit (CD) ratio stood at 81.90% as on mid-January 2022.

Marginal growth in total income in FY21 with improved profitability

During FY21, bank's total income increased by 11.66% to Rs. 14,757 Mn due to rise in interest income by ~9.34% on back of growth in advances and increase in non-interest income. On strength of these, net interest income increased by 11.11% to Rs. 5,023 Mn during FY21 from Rs. 4,521 in FY20. During FY21, the borrowing and lending rates declined in the financial market. The same led to decline in yield on advances by 284 bps to 7.97% and the average cost of deposits by 82 bps to 5.08%. Though the average cost of borrowings has declined, the interest expenses of the bank increased by 8.24% to Rs. 7,876 Mn on the back of increase in overall deposits during FY21. Net Interest Margin (NIM) of the bank declined from 2.97% in FY20 to 2.63% in FY21. Accordingly, PBL's PAT increased by 44.10% in FY21 to Rs. 1,721 Mn as against Rs. 1,194 Mn earned in FY20. Return on Total Assets (RoTA) of the bank remained at 0.90% during FY21 reporting an improvement from 0.78% during FY20.

Improvement in asset quality

PBL reported Gross Non-Performing Loan (GNPL) ratio of 3.15% during FY20 which improved to 1.68% during FY21 and further improved during H1FY22 to 1.23%. GNPL stood at Rs. 2,386 Mn at the end of FY21 reporting a decrease from Rs. 3,252 Mn at the end of FY20. GNPL further declined to Rs 1,820 Mn at the end of H1FY22. GNPL ratio decreased at the end of FY21 and H1FY22 on account of increase in the level of advances of bank during FY21 and H1FY22. Ability of bank to manage its asset quality would be crucial from analytical prospective.

Moderate liquidity profile

PBL has maintained SLR of 19.32% as on January 14, 2022 vis-à-vis regulatory requirement of 10%; CRR of 3.47% as on January 14, 2022 vis-à-vis regulatory requirement of 3%; Net Liquidity of 23.88% as on January 14, 2022 vis-à-vis regulatory requirement of 20%. Maintained SLR, CRR and Net Liquidity are within the norms of NRB.

Diversified Investment Portfolio

PBL has investments of Rs. 33,881 Mn (P.Y: Rs. 20,842 Mn) at the end of FY21. The investment portfolio of the bank has increased by 62.56% in FY21 over FY20 mainly due to additional investments made in treasury bills/ bonds of Nepal Government. PBL earned Rs. 1,205 Mn as interest income from bonds/ treasury bills (P.Y: Rs. 760 Mn), Rs. 29 Mn (P.Y: Rs. 26 Mn) received as received as dividend income from shares of corporate sectors during FY21.

Key Rating Weaknesses

Moderation in financial performance during H1FY22

During H1FY22, the bank financial performance has moderated due to lower deposits and advances as compared to previous year. During H1FY22, bank's total income increased by 12.23% to Rs. 8,648 Mn in comparison to Rs. 7,705 Mn during H1FY21 on back of increase in interest income by 18.36% which increased from Rs. 6,473 Mn in H1FY21 to Rs. 7,661 Mn in H1FY22. Further, interest expenses also increased by 28.05% during H1FY22 on the back of increase in deposit rate. Due to increase in interest expenses as compared to interest income, net interest income of the bank improved marginally by 4.78% to Rs. 2,825 Mn during H1FY22 vis-à-vis Rs. 2,696 Mn in H1FY21. However, with decrease in non-operating income and increase in interest expense during H1FY22, PAT of the Bank decreased by 18.9% to Rs. 1,262 Mn during H1FY22 (Rs. 1,519 Mn during H1FY21). Non-operating income decreased to Rs. 987 Mn during H1FY22 as compared to Rs. 1,232 Mn in H1FY21 on account of decrease in gain on sale of investment properties.

Declining Tier –I capital with thin cushion over regulatory requirement

CET-I of the bank has been continuously declining and is below the industry average of 10.41% in FY21. Core Equity Tier I (CET-I) of the bank stood at 8.66% against minimum requirement of 7% as on July 15, 2021 which declined from 9.37% as on July 15, 2020 and further declined to 8.55% in H1FY22 providing thin cushion over the regulatory requirement of 7%.

However, overall capital adequacy stood moderate and increased to 13.07% as on mid-July 2021 from 11.18% as on July 15, 2020 as against the regulatory requirement of overall CAR of 11%. The overall CAR of the company improved in FY21 on account of issuance of debentures improving Tier II capital. During H1FY22, overall CAR slightly declined to 12.89% on account of increase in risk weighted loans and advances.

High advances concentration towards corporate sector and top group borrowers and depositors

The bank has its major portion of advances concentrated towards corporate sector. As on July 15, 2021, Retail banking comprised 18.34% (22.96% as on July 15, 2020), corporate segment comprised of 65.06% (51.86% as on July 15, 2020) of the advances, Small & medium enterprises (SME) comprised 5.72% (20.35% as on July 15, 2020) and Agricultural and deprived sector comprise of remaining 7.52% (4.83% as on July 15, 2020). Going forward, the bank is planning to increase its exposure towards SME sector lowering its concentration towards corporate sector.

Deposit concentration by top 20 institutional depositor accounts has been moderately high though in declined on y-o-y basis from 25.36% as on July 15, 2020 to 24.61% as on January 14, 2022 of total bank deposits. Similarly, top 20 group borrowers accounted for 18.70% as on July 15, 2020 which increased to 21.33% as on July 15, 2021 and stood at 21.40% as on January 14, 2022. High concentration towards advances and deposits normally increases re-pricing risks at times of interest rate volatility. Furthermore, the asset quality is more vulnerable to single default due to high concentration towards advances.

Intense Competition

Currently there are 27 Commercial Banks, including three major state-owned banks, operating with total 4,822 branches all over Nepal (based on Monthly statistics published by NRB for Mid-October 2021). Prabhu Bank has 214 branches along with head office as on Mid-Oct 2021.

Industry (Class 'A' Commercial Banks) has achieved total interest income of Rs. 326,110 Mn during FY21 with Rs. 131,700 Mn net interest income; PBL's share on interest income is 3.96% (Rs. 12,899 Mn) and 3.81% share on net interest income (Rs. 5,023 Mn) for the same period. The market share of PBL in terms of net interest income has slightly improved to 3.93% in Q1FY22. However, the interest income has slightly reduced to 3.95% of the market share during Q1FY22. Due to emergent competition, it is challenging to recruit and retain skilled manpower. Unhealthy competition in the interest rates is the prominent challenge. 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. After the extensive capital increment pressure from Rs. 2 Bn to Rs. 8 Bn for Class "A" Commercial Banks, NRB has now decreased weighted average interest rate spread to 4.4% from earlier 5% via Monetary Policy issued by NRB, for the FY21. Due to increased capital, banks are facing investable amount deficit to grant new loans and advances. And decreased weighted average interest rate spread together with growing competition will be responsible for decreasing net interest margin thereby impacting profitability.

About the Company

Prabhu Bank Limited (PBL) is "A" Class Licensed Institutions from Nepal Rastra Bank (NRB). It was incorporated on July 21, 1998 as Kist Merchant Banking and Finance Ltd. and renamed as Kist Bank Ltd. dt. June 19, 2001. 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. As on July 15, 2021, 51% of the total shares of PBL were held by the promoter whereas remaining 49% is held by the general public.

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