Civil Bank Limited

Rating

Facility/Instrument	Amount (Rs. in Million)	Ratings[1]	Rating Action
Issuer Rating	**NA**	**CARE-NP BBB- (Is) [Triple B Minus (Issuer)]**	**Reaffirmed and rating placed on credit watch with developing implications**

CARE Ratings Nepal Limited (CRNL) has reaffirmed the issuer rating of 'CARE-NP BBB- (Is)' assigned to Civil Bank Limited (CBL) and has placed the rating on credit watch with developing implications. 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 has been placed on credit watch with developing implications factoring in the ongoing litigation faced by one of the bank's current Directors/Promoters. CRNL will resolve the rating watch once clarity emerges on the case. CRNL will take a view on the rating once the exact implications of the above on the credit risk profile of the bank becomes clear.

The rating continues to derive strength from CBL's established track record of operations along with experienced promoters and management team, moderate capitalization level, diversified and moderate geographical coverage, and improved asset quality. The rating also factors in CBL's growth in deposits and loans & advances during FY21 (Audited, refers to the twelve-month period ended mid-July 2021), moderately diversified sector-wise loan portfolio with regulatory compliance, moderate liquidity profile and healthy investment portfolio.

The rating, however, remains constrained by CBL's moderate scale of operations and below average low cost CASA mix compared to the other industry players leading to low profitability. The rating also considers subdued financial performance of the bank in FY21 although improving trend during 9MFY22 (Unaudited, refers to the nine-month period ended Mid-April 2022). The rating further factors in CBL's loan portfolio concentration towards corporate portfolio, moderate deposits and advances concentration, intense competition, and exposure to regulatory risk related to industry.

Ability of the bank to manage growth without compromising on asset quality and maintaining capital adequacy would be critical for the bank's earning profile and profitability. 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 Strengths

Established track record with diversified presence and experienced promoters

Established in the year 2010, CBL has over a decade of operational history in Nepal. The bank is professionally managed under the overall guidance of its Board of Directors (BoD) which includes eminent bankers, administrators, businessmen etc. Mr. Pratap Jung Pandey, Chairman, has experience in cement industry, tourism, banking and insurance, information technology and trade for more than 16 years. The bank's management team is led by Mr. Sunil Kumar Pokharel, Chief Executive Officer (CEO), who has more than three decades of work experience at different leading national and international financial institutions. Furthermore, CBL has an increasingly diversified presence in the country through its 115 branches, 11 extension counters, 5 branchless banking and 88 ATM Terminals as on Mid-April, 2022 spread over all 7 Provinces of Nepal covering 42 districts.

[1]Complete definitions of the ratings assigned are available at www.careratingsnepal.com and in other CRNL publications.

Moderate capitalization level

As on mid-July 2021, CBL's overall Capital Adequacy Ratio (CAR) had declined to 11.93% and Core Equity Tier I (CET-I) had declined to 10.75% from 15.00% and 13.83% respectively, as on mid-July 2020, due to substantially high pace of credit growth (over 50%) during FY21. However, boosted by debenture issuance of Rs. 3,000 Mn, the bank's CAR and CET-I have improved to 15.81% and 11.39%, respectively, as on mid-April 2022. Apart from the debentures, the improvement in capitalization levels during 9MFY22 was also aided by the improving financial performance of the bank during the period. Adequate capitalization levels support a bank's ability to absorb losses, should they materialize, especially given the uncertainty surrounding credit recovery amid the lingering impact of the covid19 pandemic exacerbated by the current liquidity stress in the economy. Post-pandemic recovery, particularly after the NRB relaxations are over, remains a concern and the bank's ability to maintain adequate cushion in the capital adequacy ratios will remain critical for its solvency and growth prospects.

Consistent growth in deposits, offset to some extent by similarly high growth in loans & advances amid the pandemic

CBL's scale of operations grew significantly during FY21 aided by the geographical expansion through addition of 18 new branches during FY20. Total deposits of the bank increased by 57.09% year on year (yoy) at the end of FY21 to Rs. 90,345 Mn (industry growth: 21.18% yoy). CBL also reported a significant growth in total advances during FY21. Total loans and advances stood at Rs. 83,038 Mn at the end of FY21 registering a growth of 53.85% yoy (industry growth: 27.81% yoy).
During 9MFY22, however, deposit growth was muted with total deposits recording a below industry average growth of 1.77% over FY21 (industry growth: 4.40%). Similarly, growth in total loans and advances of CBL was also muted, with growth of 8.02% over FY21 (industry growth: 13.00%) as the bank is focusing more on consolidation of its portfolio. The bank's share in terms of total industry deposits as well as in terms of loans & advances was 2.09% as on mid-April, 2022. CBL's ability to manage growth while maintaining its asset quality will remain a key monitorable, as post-pandemic recovery still remains largely unpredictable in the long term.

Improving asset quality

CBL reported Gross Non Performing Loan (GNPL) ratio of 1.05% as on mid-July 2021 (industry average: 1.40%), which improved from 2.37% at the end of mid-July 2020. GNPL amounted to Rs. 873 Mn at the end of FY21, compared to Rs. 1,281 Mn at the end of FY20 aided by an improving risk management practice leading to improved recovery. GNPL ratio of the bank further improved to 0.99% at the end of 9MFY22 (industry average: 1.32%). Furthermore, COVID19 related restructured /rescheduled loan accounted for 1.92% of total advances at the end of FY21, which further declined to 1.31% of total advances at the end of 9MFY22.

Moderately diversified sector wise loan portfolio with regulatory compliance

CBL had moderately diversified portfolio with higher lending of 22.87% at the end of 9MFY22 towards wholesalers & retailers sector (wholesale trade of durables, non-durables, automotive dealer/franchise, other retail trade, import-export trade etc.). Next major lending of 21.30% at the end of 9MFY22 was towards non-food production sector which comprises majorly lending towards metals-basic iron & steel plant and lending to cement industries. Corporate, Retail and SME loans were 29%, 21% and 41% of total loans & advances at the end of 9MFY22.

Key Rating Weaknesses

Low proportion of CASA deposits leading to high cost of funds and affecting competitive positioning

CBL continues to have a low CASA mix in its total deposit with 25.40% CASA deposits at the end of FY21, which decreased from 29.88% at the end of FY20. CASA proportion further decreased to 20.93% of the total deposits at the end of 9MFY22 as the bank raised rates of fixed deposits. CASA ratio of the bank has been well below industry average (industry avg. CASA ratio for FY21 and 9MFY22 were 43.94% and 38.62% respectively), which leads to higher cost of funds for CBL vis-à-vis peers and provides a competitive disadvantage to CBL in the "base rate plus" lending rate regime.

Subdued financial performance during FY21, however, improving trend in 9MFY22

During FY21, the bank's performance had remained subdued as net interest income had decreased by 0.91% yoy to Rs. 2,216 Mn despite increase in bank's total income by 15.71% yoy. The bank's yield on advances had declined by 224 bps to 9.29% while the cost of deposits had decreased by 97 bps to 6.49%, due to comparatively lower interest rates during FY21 amid high liquidity in the system. Consequently, CBL had reported decline in PAT to Rs. 528 Mn in FY21 from Rs. 555 Mn in FY20. However, financial performance have rebounded during 9MFY22, as CBL's total income increased by 43.05% yoy to Rs. 7,987 Mn aided by interest income by 49.83% yoy to Rs. 7,472 Mn. Furthermore, with better absorption of operating expenses coupled with significantly reduced impairment charges, the bank reported an increase in PAT by 79.91% yoy to Rs. 904 Mn during 9MFY22.

Loan portfolio concentration towards corporate portfolio, however increase in SME portfolio during 9MFY22

CBL's advances portfolio as on July 15, 2021 was concentrated more towards corporate sector with 45.99% of the total advances (46.98% as on July 15, 2020). The advances on SME portfolio constituted 25.10% of total advances. However, the proportion of advances towards corporate sector has declined to 29.41% as on April 13, 2022. Instead, the concentration has shifted towards SME sector with 40.92% of total advances.

Moderate deposits and advances concentration

Deposit concentration from top 20 depositors remained moderate at 33.93% of total bank deposits as on April 13, 2021. The concentration on advances to top 20 single borrowers, however, was low at 14.30% while the top 20 group borrowers accounted for 17.03% of total loan portfolio. Lower concentration towards advances and deposits normally decreases re-pricing risks at times of interest rate volatility.

Intense competition

Currently there are 27 Commercial Banks, including three major state owned banks, operating with total 4,949 branches all over Nepal (based on Monthly statistics published by NRB for mid-April 2022). CBL had 115 branch along with head office as on same date. Industry (Class 'A' Commercial Banks) had achieved total interest income of Rs. 309,982 Mn during 9MFY22 with Rs. 109,123 Mn net interest income, where CBL's share on interest income was 2.41% (FY21: 2.16%) and on net interest income was 2.24% (FY21: 1.68%). Intense competition in the banking industry results in a highly dynamic market with volatile market shares. Competition in the interest rates remains a prominent challenge.

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. NRB has changed to CD ratio mechanism from existing Credit to Core Capital plus Deposit (CCD) ratio measures. CD ratio needs to be maintained below 90% by mid-July 2022 from earlier provision of 85% for CCD. Furthermore, risk weights of certain loans including personal overdrafts, TR loans, hire purchase loans for personal purpose, margin lending, etc. has been increased to 150% from existing 100% via the mid-term review of monetary policy issued by NRB for FY22. These changes are likely to put downward pressure on capital adequacy ratios of the banks and limit their ability for significant credit expansion, at least over the near term. Furthermore, bank rate has been increased to 7% from 5% and repo rate increased to 5.5% from 3.5% in the midterm review of monetary policy issued by NRB for FY22. Increased bank rates will likely put upward pressure on both lending and deposit interest rates of the bank over the near term.

About the Bank

Civil Bank Limited is an 'A' Class Licensed Institution from Nepal Rastra Bank (NRB), incorporated on August 04, 2010. The bank has one subsidiary company operating within the territory of Nepal, namely Civil Capital Market Limited. Out of the total shareholding of the bank, 75.19% is held by individuals, 23.73% by domestic institutions and 1.08% by foreign institutions as on April 13, 2022.

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About CARE Ratings:

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