Everest Bank limited

Ratings

Facilities	Amount (Rs. Million)	Rating[1]	Rating Action
Issuer Rating	**NA**	**CARE-NP AA- (Is) [Double A Minus (Issuer)]**	**Rating reaffirmed and placed on credit watch with negative implications**

CARE Ratings Nepal Limited (CRNL) has reaffirmed the issuer rating of 'CARE-NP AA- (Is)' assigned to Everest Bank Limited (EBL) and placed it on credit watch with negative implications. Issuers with this rating are considered to have high degree of safety regarding timely servicing of financial obligations, in Nepal. Such issuers carry very low credit risk.

Detailed Rationale & Key Rating Drivers

The rating assigned to EBL has been placed on credit watch with negative implications factoring in the continuous moderation in the bank's capitalization profile over FY21-9MFY22 (FY refers to the twelve-months period ending mid-July; 9MFY refer to the nine months period ending mid-April), resulting in thin cushion above regulatory requirements following a growth phase where credit expansion outpaced capital accretion. Declining capitalization levels is particularly concerning as the high credit expansion during the pandemic era has led to an increased proportion of unseasoned credit, increasing risk of additional stress in asset quality going forward, particularly after the relaxations by Nepal Rastra Bank are over. Maintaining adequate cushion in capitalization levels remains critical, particularly in the event of any severe further waves of the pandemic or continuation of the liquidity crunch in the system for a sustained period.

The rating continues to derive strength from EBL's long track record of operations, strong promoter group backed by institutional promoters along with experienced directors and management team, diversified and wide geographical coverage through branch network, and strong asset quality. The rating also factors in consistent growth in scale of operations, above industry average Current account saving account (CASA) mix leading to lower cost of funds vis-à-vis peers, diversified loan portfolio, and moderate liquidity profile.

The rating, however, is constrained on account of high portfolio concentration in borrowers and depositors, intense competition and exposure to regulatory risk related to industry. The rating also takes cognizance of the subdued financial performance of the bank in FY21 with declining earnings and profitability, although reported improvement during 9MFY22 leads to expected year on year improvement for FY22.

Going forward, the ability of the bank to improve capital adequacy indicators, with adequate cushion to the minimum regulatory requirement levels, within the envisaged timelines, manage growth sustained improvement in its earning profile and profitability without compromising on asset quality will be the key rating sensitivities. Also, the bank's ability to manage the impact of any regulatory changes by Nepal Rastra Bank would remain critical from credit prospective.

Detailed Description of the Key Rating Drivers

Key Rating Strengths

Long track record, strong promoter group backed by institutional promoter and experienced management team supported by diversified and geographical coverage

Operating since October 1994, EBL has strong presence in Nepal with 115 branches spread over 7 Province Offices, 149 ATMs, 3 extension counters, 31 revenue collection counters and more than 9000 payout agents as on April 13, 2022. EBL is promoted by Punjab National Bank (PNB) with 20.03% equity stake as on April 13, 2022. PNB is one of the largest nationalised bank in India with Global Business at Rs. 18,51,097 crores as on September 30, 2021. Further, PNB has been providing top management support to EBL under Technical Service Agreement (TSA). Mr. Bishnu Krishna Shrestha, is the Chairman of EBL since last two

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

decades and has more than 40 years of experience in various sectors including trading, manufacturing, banking, finance and insurance sectors. The bank is led by Sudesh Khaling, Chief Executive Officer (CEO), who has an experience of more than 34 years in banking sector. He is supported by an experienced management team.

Strong asset quality

EBL has historically maintained strong asset quality marked by well below industry average (Gross Non-Performing Loans) GNPL ratio. The bank's GNPL ratio of 0.12% as on mid-July 2021 was substantially lower than the industry average of 1.41%. Strong asset quality emanates from a robust risk management practice leading to good borrower profile and also reflects EBL's strong underwriting norms. Although GNPL ratio increased to 0.26% as on mid-April 2022, it remained comfortably above the industry average of 1.32%. Borrower's' repayment capacity could be impacted by the ongoing liquidity crunch in the economy. Furthermore, various counter measures taken by the Government of Nepal and NRB, in the recent months, to curb imports could have adverse impact in the trading industry. Credit quality is also masked to some extent by the various relaxations by NRB to the covid-19 impacted sectors. The bank's ability to maintain asset quality at current level will remain critical for its financial health.

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

Deposits of EBL grew at a three-year Compounded Annual Growth Rate (CAGR) of 11.52% and stood at Rs. 160,220 Mn as on mid-July 2021. Similarly, loans and advances (Gross) recorded a three-year CAGR of 12.29% and stood at Rs. 134,954 Mn as on mid-July 2021. Deposit growth trend was subdued in 9MFY22 with EBL reporting 1.36% growth in deposits as on mid-April 2022, impacted by the liquidity stress in the overall economy. However, advances increased by 13.00% over FY21. Owing to the higher growth in advances compared to deposits, Credit to Deposit (CD) ratio of the bank stood at 91.78% as on mid-April 2022 against regulatory requirement of below 90% by mid-July 2022. Higher than permissible CD ratio is likely to limit the bank's ability to extend credit, unless offset by a higher growth in deposits, which seems a bit challenging given the current liquidity situation in the country.

Comfortable CASA mix and Moderate liquidity profile

Bank continues to maintain a comfortable CASA mix, which was 44.73% of total deposits as on mid-July 2021. Although CASA level has declined to 39.82% as on mid-April 2022 as the bank raised rates on fixed deposits due to tightening liquidity environment, it was still better than the industry average of 38.62%. The bank's ability to maintain lower cost of funds will be critical for its profitability profile as it would continue to provide a competitive advantage to EBL in the "base rate plus" lending rate regime. The bank continues to maintain a moderate liquidity profile with positive cumulative mismatches as on mid-April 2022. Similarly, EBL maintained SLR, CRR and Net liquidity ratio of 25.35%, 3.54% and 29.44%, respectively, against minimum regulatory requirement of 10%, 3% and 20%, respectively as on Mid-April 2022

Diversified loan portfolio

EBL continues to maintain a diversified loan portfolio distribution with 26.75% of total loans and advances towards wholesale and retail sector (includes wholesale trade of durables, non-durables, automotive dealer/franchise, other retail trade, etc.), followed by 21.02% in consumption loans (includes home loans up to Rs. 15 Mn, personal overdraft, hire purchase loan, education loan, professional loan, margin lending etc) as on mid-April 2022. EBL also lent 22.34% toward priority sector and 6.31% towards deprived sector as on mid-April 2022. Diversified loan portfolio towards various sectors supports in maintaining better quality of advances during the time of stress in the sector or slowdown in the economy by mitigating volatility risk.

Key Rating Weakness

Moderate capitalization profile with declining cushion over regulatory requirements is a key concern as post-pandemic recovery remains largely unpredictable

Over FY21-9MFY22, EBL has witnessed a sustained decline in its capitalization level due to relatively higher pace of credit growth vis-à-vis capital accretion. Core Equity Tier I (CET-I) of the bank stood at ~11.24% against the minimum requirement of 7% as on mid-July 2021, declining from 11.92% as on mid-July 2020. Furthermore, overall capital adequacy ratio had declined to 12.48% from 13.38% over the same period. Amid continued higher credit growth coupled with NRB increasing risk weights for certain loans, overall CAR had further declined to 12.25% as on mid-April 2022, resulting in thinning cushion over regulatory requirement of 11%. Lower capitalization levels could limit a bank's ability to withstand the probable credit shocks post-pandemic, should they materialize, especially given 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 prospect.

Subdued financial performance during FY21 with declining earnings and profitability, although some improvement during 9MFY22

During FY21, total income of the bank decreased by 15.55% to Rs. 13,077 Mn primarily due to lower interest income collected by bank attributable to decreased yield on advances. Also, NRB had reduced the interest spread to 4.4% from the earlier 5%, impacting banks' interest income. Consequently, the bank's net interest income had declined substantially to Rs. 3,957 Mn in FY21 from Rs. 5,309 Mn in FY20, squeezing the bank's Net Interest Margin (NIM) from 2.99% in FY20 to 1.99% in FY21. Accordingly, EBL's PAT decreased by 29.62% to Rs. 1,770 Mn in FY21. However, the bank's financial performance has rebounded to some extent in 9MFY22 as its total income increased to Rs. 11,878 Mn from Rs. 9,686 Mn in 9MFY21 backed by 22.01% increase in interest income and 25.74% increase in other income owing to higher growth in loans and advances. However, despite healthy growth in income, PAT only increased marginally by ~0.59% to Rs. 1,516 Mn in 9MFY22 impacted by higher provisions amid increased risk assets and NPL levels.

Concentration in institutional depositors and group loans & advances

Deposit concentration by top 20 institutional depositors remained moderately high at 24.89% of total deposits as on mid-April 2022. High deposit concentration raises the risk of high interest sensitivity and volatility in deposits profile. Similarly, the bank has high concentration in its loan portfolio, as top 20 single borrower accounted for 22.41% and top 20 group borrowers accounted for 28.99% of total loans & advances as on mid-April 2022. High concentration in loans and advances could increase portfolio vulnerability and stress in assets quality, particularly during economic downturn.

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). EBL had 115 branches along with head office as on same date. Industry (Class 'A' Commercial Banks) had achieved total interest income of Rs. 10,502 Mn during 9MFY22 with Rs. 3,506 Mn net interest income, where EBL's share on interest income was 3.38% (FY21: 3.69%) and market share on net interest income was 3.21% (FY21: 3.66%) for the same period. 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 maintain 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

EBL is an "A" Class Licensed Institution from Nepal Rastra Bank (NRB) and listed on Nepal Stock Exchange. It was incorporated on October 16, 1994. EBL has a TSA with PNB which provides management support from PNB on deputation. As on July-15, 2021, 31.24% of the shares (including PNB's 20.03%) is held by the promoters and remaining 68.76% is held by the public.

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About CARE Ratings:

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