Himalayan Bank limited

Ratings

Facilities	Amount (Rs. Million)	Rating[1]	Rating Action
Issuer Rating	NA	CARE-NP A- (Is) [Single A Minus (Issuer)]	**Revised from CARE-NP A (Is) and removed from credit watch with developing implications**
Subordinated Bond "10% Himalayan Bank Limited Bond 2083"	2569.10	CARE-NP A- [Single A Minus]	**Revised from CARE-NP A and removed from credit watch with developing implications**

CARE Ratings Nepal Limited (CRNL) has revised the issuer rating of Himalayan Bank Limited (HBL) to 'CARE-NP A- (Is)' from to 'CARE-NP A (Is)'. 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 revised the rating assigned to the Subordinated Bond issued by HBL to "CARE-NP A-" from "CARE-NP A". 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.

The above rating has also been removed from 'credit watch with developing implications', as the bank did not go through with the earlier proposed merger.

Detailed Rationale & Key Rating Drivers

The revision in the ratings assigned to Himalayan Bank Limited takes into account the moderation in the capitalization levels of the bank following a growth phase where credit expansion outpaced capital accretion resulting in decreased cushion in its capital adequacy ratios at the end of 9MFY22 (Unaudited, refers to the nine-month period ended mid-April 2022) and declining portion of CASA mix at the end of 9MFY22, leading to high cost of funds and affecting profitability of the bank. The rating continues to derive strength from HBL's established long track record of operations, experienced promoters and management team supported by moderate geographical coverage, moderate assets quality, consistent growth in loans and advances, diversified loan portfolio across industries and moderate liquidity profile. The rating, however, remains constrained on account of higher concentration in corporate loan portfolio, moderate deposits, and borrower concentration. The rating also factors in the subdued financial performance of the Bank during FY21 (Audited, refers to the twelve-month period ended mid-July 2021) albeit marginal improvement during 9MFY22, intense competition, and HBL's exposure to regulatory risk related to the banking industry.

Going forward, the ability of the bank to manage growth in business without compromising on asset quality, maintain CD ratio and improve capital adequacy indicators with adequate cushion to the minimum regulatory requirement levels and its 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 Strengths

Long track record backed by institutional promoters, experienced directors and management team supported by moderate geographical coverage

Operating since February 1992, HBL is providing banking services to its customers for more than 30 years. HBL has a reasonable geographic presence in Nepal with 74 branches, 5 extension counters and 149 ATMs (as on January 14, 2022) covering all seven Provinces in Nepal. HBL is promoted by Employees Provident Fund and other investment companies as a joint venture with Habib Bank Limited of Pakistan. HBL is a professionally managed bank under the overall guidance of its Board of Directors (BoD) which includes eminent bankers, administrators, businessmen etc. with wide experience in the financial and other sectors. Mr. Prachandra B. Shrestha is the chairman of the bank and has almost two decades of experience as director of the bank and various

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

other sectors. The management team is led Mr. Ashok SJB Rana who has been associated with the bank for over two decades at various capacities.

Moderate asset quality

The Gross Non Performing Loans (GNPL) ratio of the bank stood at 0.48% as on mid-July 2021 (industry average was 1.48%), showing significant improvement from 1.01% as on mid-July 2020. HBL has historically had better than industry average asset quality backed by its strong risk management practices and underwriting norms. In absolute amount, GNPL of HBL had reduced to Rs. 636 Mn at the end of FY21 from Rs. 1,101 Mn at the end of FY20 aided by recovery in NPA Category loans. However, GNPL increased to Rs. 1,583 Mn as on mid-April 2022, resulting in GNPL ratio deteriorating to 1.00% (industry average was 1.32%). The slippages can be attributable to the lingering impact of COVID, which has been further impacted by the ongoing liquidity stress in the economy, impacting borrowers' repayment ability. Deteriorating asset quality could be a concern as the high credit expansion during the pandemic era has led to an increased proportion of unseasoned credit, increasing risk of further stress in asset quality going forward, 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.

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

Over the last 2-3years, the bank has shown consistent growth in its deposits and loans & advances. Deposits of HBL grew at a three-year Compounded Annual Growth Rate (CAGR) of 12.23% and reached Rs. 141,021 Mn at the end of FY21.Similarly, loans and advances (Gross) recording a three year CAGR of 15.22% and reached Rs. 132,858 Mn at the end of FY21. The growth trend continued in 9MFY22, as loans and advances increased by 19.53% to Rs. 158,809 Mn over FY21 and deposits increased by 19.18% over FY21 to Rs. 168,065 Mn. Owing to marginally higher growth in advances compared to deposits, Credit to Deposit (CD) ratio of the bank stood at 91.81% as on mid-April 2022 against regulatory requirement of below 90% by mid-July 2022. An already high CD ratio will limit the bank's ability to extend credit, unless offset by a higher growth in deposits, which is a bit more challenging given the current liquidity stress in the economy.

Moderate liquidity profile

The bank continues to maintain a moderate liquidity profile. HBL reported SLR, CRR and Net Liquidity ratio of 26.87%, 3.07%, and 20.09%, respectively, against regulatory requirement of 10%, 3% and 20%, respectively as on Mid-April 2022. Also, bank has moderate liquidity profile with zero cumulative mismatches as of April 13, 2022.

Diversified loan portfolio with regulatory compliance

HBL has a diversified loan portfolio distribution with higher lending of 22.26% of total advances towards non-food production related sectors (includes handicraft, textile, paper manufacturing, etc.) followed by 21.39% towards wholesaler & retailers (includes wholesale trade of durables, non-durables, automotive dealer/franchise, other retail trade, etc.) as on mid-April 2022. Furthermore, the bank has advanced 28.77% towards priority sector (NRB minimum requirement of 28%) and 5.70% towards deprived sector (NRB minimum requirement of 5%) as on mid-April 2022. Diversification helps bank to maintain the bank's assets quality and mitigate volatility risk in case of experienced swings in the economy.

Key Rating Weakness

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

Over FY21-9MFY22, the bank's capitalization levels have declined sharply to below industry average due to relatively higher pace of credit growth vis-à-vis capital accretion. Core Equity Tier I (CET I) of the bank stood at 11.16% against the minimum requirement of 7% as on July 15, 2021 (July 15, 2020: 11.76%) and the overall capital adequacy ratio (CAR) stood at 13.85%

(July 15, 2020: 14.89%) as against the minimum regulatory requirement of 11% stipulated by Nepal Rastra Bank (NRB). Furthermore, during 9MFY22, CET I and overall CAR have declined further to 10.07% and 12.40%, respectively owing to continued increment in the Risk Weighted Exposure as the growth in credit expansion continued to outpace capital accretion. Lower capitalization levels could limit 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 prospect.

Muted financial performance during FY21, although improving trend during 9MFY22

During FY21, the bank's total income declined to Rs. 14,051 Mn from Rs. 14,236 Mn during FY20 primarily due to low-interest revenue collected by banks attributable to reduced 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. 3,789 Mn in FY21 from Rs. 4,822 Mn in FY20, and the bank's Net Interest Margin (NIM) squeezed from 3.34% in FY20 to 2.27% in FY21. Despite squeezed margins and subdued income growth, PAT of the bank had, however, increased by 15.92% yoy to Rs. 2,999 Mn in FY21. The profits include substantial one-time income of Rs. 1,998 Mn earned from profit on sales of investment securities. However, during 9MFY22, the bank's financial performance has picked up as total income increased to Rs. 12,430 Mn from Rs. 8,745 Mn during 9MFY21 backed by growth in interest income (46.29% yoy) and other fees-based income (13.19% yoy) owing to the high growth in loans and advances during the period. PAT increased by 8.11% to Rs. 1,392 Mn in 9MFY22.

Declining portion of CASA mix resulting increasing cost of funds and affecting the competitive positioning

HBL has historically maintained a CASA mix in the range of 40%-50% over FY18 to FY21, which was generally better than the industry average for these years. However, the CASA mix decreased to 34.37% at the end of 9MFY22, lower than the industry average of 38.62%, as the bank raised rates on fixed deposits. This affected the cost of the funds of the bank to rise, which will impact the profitability of the bank in the long term unless passed through on to borrowers with high lending rate, which is a competitive disadvantage. The bank's ability to maintain lower cost of funds will be critical as it would continue to provide a competitive advantage to the bank in the "base rate plus" lending rate regime.

Concentration in institutional depositors and group borrowers

Deposit concentration of the top 20 institutional depositors remains moderate and on an increasing trend from 25.20% of total bank deposits in FY20 to 27.33% in FY21 and to 30.77% as in H1FY22. Likewise, concentration of the top 20 group borrowers also remains moderate but on a marginal decreasing trend. Top 20 borrowers accounted for 28.86% of total advances during FY20 which decreased to 27.77% during FY21 and further decreased to 26.51% during H1FY22. Higher concentration towards advances and deposits normally increases 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). HBL had 74 branches along with head office as on same date. Industry (Class 'A' Commercial Banks) had achieved total interest income of Rs. 11,189 Mn during 9MFY22 with Rs. 3,361 Mn net interest income, where HBL's share on interest income was 3.61% (FY21: 3.17%) and market share on net interest income was 3.08% (FY21: 2.87%) 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

Himalayan Bank Limited (HBL) is an "A" class licensed institutions from Nepal Rastra Bank (NRB) listed in the Nepal Stock Exchange. It was incorporated as a joint venture with Habib Bank Limited of Pakistan and obtained license to operate as a commercial bank from NRB on February 18, 1992. HBL has wholly owned subsidiary company namely HBL Capital Limited. Total shareholding of the bank is divided between promoter group and general public in the ratio of 85:15.

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