Sunrise Bank Limited

Ratings

Facilities	Amount (Rs. Million)	Rating[1]	Rating Action
Subordinate Debenture (10.25% Debenture 2083)	**3,000.00**	**CARE-NP BBB+ [Triple B Plus] (Credit watch with developing implications)**	**Revised from CARE-NP A- and placed on credit watch with developing implications**
Subordinate Debenture (10% Debenture 2080)	**1,000.00**	**CARE-NP BBB+ [Triple B Plus] (Credit watch with developing implications)**	**Revised from CARE-NP A- and placed on credit watch with developing implications**
Issuer Rating	**NA**	**CARE-NP BBB+ (Is) [Triple B Plus (Issuer)] (Credit watch with developing implications)**	**Revised from CARE-NP A- (Is) and placed on credit watch with developing implications**

Details of instruments/facilities in Annexure-1

CARE Ratings Nepal Limited (CRNL) has revised the issuer rating assigned to Sunrise Bank Limited (SBL) to 'CARE-NP BBB+ (Is)' from 'CARE-NP A- (Is)' 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.

CRNL has also revised the rating assigned to Subordinate Debenture "10.25% Sunrise Debenture 2083" and "10% Sunrise Debenture 2080" of SBL to 'CARE-NP BBB+' from 'CARE-NP A-' and has placed the ratings on credit watch with developing implications. Instruments 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.

Furthermore, the above ratings have been placed on 'credit watch with developing implications', factoring in the on-going merger process with Laxmi Bank Limited. CRNL will resolve the rating watch once clarity emerges on the merged entity's business and financial profile post-merger. CRNL will take a view on the ratings once the exact implications of the above on the credit risk profile of the bank is clear.

Detailed Rationale & Key Rating Drivers

The revision in ratings assigned to SBL factors in the increased stress in the asset quality of the bank resulting from a sharp increase in its Gross Non-Performing Loans (GNPL) as on mid-January 2023. Additionally, the bank's total delinquent loans have also surged substantially, increasing probability of further slippages over the near-term, adding further stress on the bank's credit risk profile. Return indicators of the bank have accordingly declined substantially amid higher provision requirements. Although majority of the banking industry in Nepal has seen a sudden rise in GNPL ratio as on mid-January 2023, higher than industry average decline in asset quality indicators of the bank remain a key concern. More slippages in asset quality over the near term remains a high possibility for the Nepalese banking sector, particularly in light of the restrictive Working Capital Loan Guideline introduced by Nepal Rastra Bank (NRB) in September 2023 with more stringent NPL recognition norms coupled with slower than expected pace of economic growth impacting repayment abilities of borrowers across the spectrum. Hence, amid near-term headwinds, stress on SBL's asset quality is likely to sustain, leading to added pressure on the bank's earnings and distributable profits, which remains a key constraint from credit perspective.

The ratings, however, continue to derive strengths from the bank's long track record of operations along with experienced directors and management team, widespread geographical coverage through branches, diversified loan portfolio with the regulatory compliance and diversified investment portfolio. The rating also factors in the moderate financial profile of the bank and capitalization levels. The above rating strengths are however tempered by declining low cost Current Account Savings Account

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

(CASA) deposits of the bank leading to relatively higher cost of funds which could impact its pricing power and profitability amid intense competition in the industry.

Going forward, the ability of the bank to improve its asset quality while managing growth in operations, maintain adequate cushion in capital adequacy indicators from the minimum regulatory requirement levels, and manage the impact of any other regulatory changes by Nepal Rastra Bank would be the key rating sensitivities.

Detailed Description of the Key Rating Drivers

Key Rating Strength

Long track record of operation, geographical coverage with experienced promoters and management Team

Established in the year 2007, SBL has over 15 years of operational history. The bank's profile derives strength from its experienced promoters who have diversified experience in sectors like banking, insurance, manufacturing, import and export, trading etc. SBL is a professionally managed bank under the overall guidance of its Board of Directors (BoD), which includes eminent businessmen and industrialists with wide experience in the financial services. Mr. Moti Lal Dugar, Chairman, has been engaged in manufacturing, import export, insurance, hydro power, and banking sectors among others for more than five decades. The senior management team is highly experienced in their respective field of operations and is headed by Mr. Suman Sharma (Chief Executive Officer) who has more than two decades of experience in banking industry.

SBL has established market presence in Nepal through its 139 branches, 13 extension counters, 161 ATM Terminals and 100 branchless banking units as on mid-January 2023. The branches are spread over all the 7 Provinces of Nepal.

Moderate financial profile, although declining trend in H1FY23

During FY22, bank's total income increased by 46.50% year-on-year (y-o-y) to Rs. 15,510 Mn boosted by increase in interest income by ~54% y-o-y. Interest income increased on account of increase in overall loans and advances coupled with higher yields on advances. The yield on advances increased by 234 bps to 11.06%. However, interest expenses of the bank increased even more, by 74% y-o-y to Rs. 9,459 Mn, on account of increase in deposits majorly fixed deposits and increase in overall cost of deposits. The cost of deposits increased by 225 bps to 7.03% during FY22. Consequently, Net interest income increased by 23.18% to Rs. 4,341 Mn during FY22 (FY21: Rs. 3,524 Mn). Further, Net Interest Margin (NIM) of the bank also increased from 2.77% in FY21 to 2.82% in FY22. Accordingly, SBL's PAT increased to Rs. 1,961 Mn in FY22 (FY21: Rs. 1,447 Mn). Return on Total Assets (RoTA) of the bank remained moderate at 1.27% during FY22 reporting an increase from 1.14% during FY21.

During H1FY23, bank's total income increased by 41.64% to Rs. 9,746 Mn on account of higher yield on advances despite reporting 2.28% y-o-y degrowth of loans and advances to Rs. 122,513 Mn in H1FY23 (H1FY22: Rs. 125,375 Mn). The net interest income of the bank increased by 59.30% y-o-y to Rs. 2,916 Mn during H1FY23. However, on account of substantial impairment charge of Rs. 1,062 Mn during H1FY23 owing to increase in GNPLs, net profit of the bank decreased by 12.28% y-o-y to Rs. 654 Mn during H1FY23. Similarly, annualized Return on Total Assets (RoTA) of the bank stood at 0.78% during H1FY23, which was below the industry average of 1.11% during H1FY23.

Moderate capitalization levels, albeit with thin cushion in Tier-I capital

As on mid-January 2023, SBL's overall Capital Adequacy Ratio (CAR) stood moderate at 12.67% (industry average: 13.01%), with Core Equity Tier-1 (CET-1) of 9.30% against industry average of 10.13% (mid-July 2022: 12.35% and 9.06%, respectively). The bank currently has thin cushion, particularly in Tier-I capital, over the regulatory requirement with a cushion of 0.80%. Furthermore, downward pressure on capitalization levels persists over the near term, given the likelihood of increased provisioning requirements amid higher delinquent loans. Lower capitalization levels could limit a bank's ability to absorb losses, should they materialize, especially given the increasing uncertainty surrounding credit recovery in the country. Post-pandemic recovery remains a concern amid the ongoing liquidity/credit crunch in the banking sector and macroeconomic headwinds leading to increased upward pressure on interest rates. The bank's ability to maintain adequate cushion in the capital adequacy ratios will remain critical for its solvency and growth prospect, particularly following a period of high credit expansion during the pandemic.

Diversified loans and advances portfolio

The bank's advances are diversified across segments. As on January 13, 2023, Retail banking comprised 28.94% (30.52% as on July 16, 2022), corporate segment comprised of 36.17% (34.80% as on July 16, 2022) of the advances, Small & medium enterprises (SME) comprised 25.69% (25.35% as on July 16, 2022) and deprived sector comprise of 9.20% (9.33% as on July 16, 2022), against the minimum regulatory requirement of 5%. Diversification in the loan portfolio decreases the risk of concentration of banks' exposure in particular industry. Although beneficial over the longer term, having a higher concentration towards retail and SME portfolio, however, could mean a more risk-prone borrower base given that the credit history/debt repaying ability of a lot of these borrowers tend to decline sharply amid a stressful macroeconomic scenario, resulting in increased possibility of bulk slippages.

As on July 16, 2022 SBL's prescribed sector lending was 30.94% of gross loans and advances outstanding. In the prescribed sectors, 12.28% was towards agriculture, 7.63% towards hydropower/energy, and 11.03% towards SME (includes micro, cottage, small and medium industries) against the regulatory requirement of 12%, 6% and 11% respectively. As on January 14, 2023 SBL's prescribed sector lending was 32.44% of gross loans and advances outstanding including, 13.07% towards agriculture,8.10% towards hydropower/energy, and 11.27% towards SME against the regulatory requirement of 11%, 6% and 11% respectively.

Moderate deposits concentration

Deposit concentration by top 20 institutional depositor accounts has been moderate with 17.62% of total bank deposits as on July 16, 2022 (FY21:18.42%), which slightly increased to 18.41% of total deposits as on January 14, 2023. Similarly, concentration on advances as top 20 individual borrowers as % of total loan portfolio accounted for 14.09% as on July 15, 2021 which stood at 13.79% as on July 16,2022 and 14.92% as on January 14, 2023. Top 20 group borrowers accounted for 16.28% as on July 15, 2021 which however increased to 27.27% as on July 16, 2022 and 28.06% as on January 14, 2023. Moderate concentration towards advances and deposits normally reduces re-pricing risks at times of interest rate volatility.

Diversified Investment Portfolio

SBL has investments including local and foreign bank placements of Rs. 28,329 Mn (FY21: Rs. 25,507 Mn) at the end of FY22, out of which Rs. 26,011 Mn (FY21: Rs. 18,724 Mn) has been invested in treasury bills/ bonds of Nepal Government. The investment portfolio of the bank has increased by 11.07% in FY22 over FY21 mainly due to additional investments made in treasury bills/ bonds of Nepal Government. During FY22, SBL earned Rs. 1,058 Mn as interest income from bonds/ treasury bills (FY21: Rs. 604 Mn), and Rs. 246 Mn (FY21: Rs. 57 Mn) received as dividend income from shares of corporate sectors during FY22.

Key Rating Weaknesses

Declining trend in asset quality following high growth in portfolio during the pandemic

As on mid-January 2023, SBL's GNPL ratio stood at 3.36%, deteriorating from 1.30% at the end of FY22 (FY21: 1.86%). Similarly, total delinquent loans (0+ days past due) had surged substantially to 26.81% as on mid-January 2023 from around 17.12% as on mid-July 2022 (mid-July 2021:10.72%). These slippages can be attributed to the substantial growth in unseasoned credit of the bank over FY20-FY22, facilitated to some extent by the various relaxations/concessions provided by NRB amid the covid19 pandemic.

SBL's total loans and advances grew at a three-year CAGR of 20.71% over FY19-FY22 (industry average: 18.71%) although this was also accompanied by a similar level of growth in its deposits, which grew at a three-year CAGR of 19.62% (industry average: 16.43%). However, a substantial increase in loans & advances in a relatively short span resulted in higher proportion of unseasoned credit in the bank's portfolio. When the relaxations ended in mid-July 2022 and following introduction of the more stringent NPL recognition norms, the NPL levels of majority of banks, including SBL, sharply increased as on mid-January 2023. SBL's ability to improve its asset quality via efficient recovery mechanisms will be a key monitorable aspect.

Decline in CASA ratio leading to high cost of funds

SBL's CASA deposit mix has declined to 34.54% of its total deposits at the end of FY22 (Industry average: 37.74%), which decreased from 43.97% at the end of FY21 (Industry average: 43.94%). CASA deposit mix further declined to 31.75% as on mid-January 2023 (Industry average: 34.80%). CASA ratio have declined over FY22-H1FY23 industry-wide with relatively lower pace of deposit generation coupled with higher proportion of fixed deposits amid tight liquidity. This led to higher cost of funds at 9.07% in H1FY23 resulting in higher base rate of 11.62%, which was amongst the highest compared to peers. Higher cost of funds imposes competitive disadvantage for the bank, especially in the "base rate plus lending rate" regime.

Intense competition in the industry

Currently there are 22 commercial banks, including three major state-owned banks, operating with total 5,029 branches all over Nepal (based on monthly statistics published by NRB for mid-January 2023). SBL had 139 branches along with head office as on same date. Industry (Class A Commercial Banks) had achieved net interest income of Rs. 87.72 Bn during H1FY23, where SBL's share on net interest income was 3.32% (FY22: 2.75%). Intense competition in the banking industry results in a highly dynamic market with volatile market shares, especially considering the wave of mergers and acquisition in the industry. Also, certain relaxations are provided to the commercial banks who have undergone merger and acquisitions and started joint operations till mid-January 2023 for a period of one year form the date of integrated transactions including relaxations up to 0.5% in SLR ratio, 1% in CRR ratio, additional 1% in interest rate spread and additional 1-year period extension to maintain the CD ratio. Competition in the interest rates also remains a prominent challenge, especially amid liquidity challenges in the banking system.

Exposure to regulatory risk related to industry

The banking industry of Nepal is exposed to changes in the various regulatory measures issued by NRB from time to time. NRB introduced CD ratio mechanism from previous Credit to Core Capital plus Deposit (CCD) ratio measures from FY22 onwards, where CD ratio needs to be maintained below 90% from earlier provision of 85% for CCD. This has limited banks' lendable funds. Via the monetary policy for FY23, NRB increased the minimum requirement of liquid assets that the BFIs must hold, where Cash Reserve Ratio (CRR) was increased to 4%, while Statutory Liquidity Ratio (SLR) was kept at 12% of the total deposit base. Such increase in mandatory liquidity reserve to be maintained by BFIs is likely to increase cost for BFIs, and is likely to reduce the amount of loanable funds, thereby limiting liquidity in the economy. Bank rate and policy rate (repo rate) were increased to 8.5% and 7% (previously 7% and 5.5%). Furthermore, via the first quarter review of the Monetary Policy for FY23, NRB reduced the maximum interest rate spread to be maintained at the end of FY23 by commercial banks to 4% from 4.4%. Increased bank rates will likely put upward pressure on both lending and deposit interest rates of the bank over the near term, while decreased interest rate spread will likely put downward pressure on the bank's profitability. Ability of the bank to manage the impact of any other regulatory changes by Nepal Rastra Bank would be the key rating sensitivities.

Industry Outlook

Credit expansion in Nepal took off substantially during the pandemic era with loans & advances portfolio of BFIs growing by a compounded annual growth rate of 19.91% over FY20-FY22. Subsequently, NRB introduced a slew of contractionary policies to help check the surging pace of credit expansion by BFIs. Furthermore, with the country's economy yet to completely recover from the lingering impact of the pandemic, disruptions from global macroeconomic headwinds spilling into Nepal has led to a difficult road to recovery for domestic corporates. In the last twelve months, supply disruptions amid various geopolitical events have led to cost-push inflation globally, which Nepal imports given its excessively import heavy trade balance, resulting in elevated input prices. However, pass-through of the higher input cost is being checked amid sluggish demand scenario across sectors, particularly so for sectors like steel, cement, construction, and even consumer goods to some extent. Consequently, revenue momentum across various sectors has continually faded over FY22-H1FY23. In contrast, working capital needs remain elevated, as net operating cycle is getting elongated. With rising base rates and widening premiums of BFIs resulting in highly elevated corporate funding costs, cash flows have come under sustained pressure adding to the slippages observed in H1FY23. While a revival in the tourism industry, pick up in remittances and replenishing of forex reserves bodes well for the economy, there are several headwinds that could offset the positive impact. Stubborn inflation, declining exports, and discouraging foreign direct investment flows pose as a threat to the economic outlook leading to the possibility of a sharp credit deterioration and further slippages in asset profile of the BFIs over the next few quarters, which could add to the woes of the banking sector including SBL, given the ongoing trend of sharp rise in NPL levels.

About the Company

Sunrise Bank Limited (SBL) is "A" Class Licensed Institutions from Nepal Rastra Bank (NRB). It was incorporated on October 12, 2007 as 23rd Commercial Bank of Nepal. The bank is promoted by reputed entrepreneurs who are industrialist, businessman, engineers, and prominent person of Nepal. As on July 16, 2022, 51% of the total shares of SBL were held by the promoter whereas remaining 49% is held by the general public.

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