

## Himalayan Bank limited

### Ratings

Facilities	Amount (Rs. Million)	Rating <sup>1</sup>	Rating Action
<b>Issuer Rating</b>	<b>NA</b>	<b>CARE-NP A- (Is) [Single A Minus (Issuer)] (Credit Watch with Negative Implications)</b>	<b>Removed from Credit Watch with Developing Implications and Placed on Credit Watch with Negative Implications</b>
<b>Subordinated Bond "10% Himalayan Bank Limited Bond 2083"</b>	<b>2,569.10</b>	<b>CARE-NP A- [Single A Minus] (Credit Watch with Negative Implications)</b>	<b>Removed from Credit Watch with Developing Implications and placed on Credit Watch with Negative Implications</b>

CARE Ratings Nepal Limited (CRNL) has placed the issuer rating of 'CARE-NP A- (Is)' assigned to Himalayan Bank Limited (HBL) on credit watch with negative implications. 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 placed the rating of 'CARE-NP A-' assigned to the Subordinated Bond issued by HBL on credit watch with negative implications. 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 earlier credit watch with developing implications has been removed after completion of the acquisition of Civil Bank Limited (CBL) by HBL with commencement of joint operations from February 24, 2023.

### Detailed Rationale & Key Rating Drivers

The ratings assigned to HBL have been placed on credit watch with negative implications factoring in the possibility of continued stress in the bank's asset quality, reflective in the sharp increase in total delinquent loans in recent quarters, continuation of which could adversely impact its overall credit risk profile further going forward. The banking industry in Nepal has seen a sharp rise in Gross Non-Performing Loans (GNPL) ratio as on mid-April 2023. High growth in loans & advances amid challenging market scenario during waves of Covid19, facilitated to some extent by various relaxations by the Nepal Rastra Bank (NRB), had led to an increased proportion of unseasoned credit of banks over FY20 and FY21 (FY refers to the twelve-month period ending mid-July). Following a contractionary monetary policy leading to the credit crunch in the banking sector, most BFIs have seen increasing stress in their asset quality over FY22-9MFY23 (9M refers to the nine-months period ending mid-April) owing to declining repayment ability of the borrowers who, in turn, have been impacted by the tight liquidity, rising funding cost and slower than expected pace of economic growth in the country over the last twelve months or so. More slippages in asset quality over the near term remains a key concern for the banking sector.. Hence, amid near-term headwinds for the banking sector, stress on HBL'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 continue to derive strength from HBL's established track record of operations, experienced promoters and management team supported by moderate geographical coverage, consistent growth in loans and advances, diversified loan portfolio across industries and moderate liquidity profile. The ratings also take cognizance of improved overall capitalization level post-acquisition of CBL. The ratings, however, remain constrained by moderate financial performance of the bank during FY22 albeit improving trend in 9MFY23, declining portion of CASA mix leading to increased cost of funds, higher concentration in corporate loan portfolio with moderate deposits and borrower concentration, intense competition, and HBL's exposure to regulatory risk related to the banking industry.

<sup>1</sup>Complete definition of the ratings assigned are available at [www.careratingsnepal.com](http://www.careratingsnepal.com) and other CARE publications

*Going forward, the ability of the bank to improve its asset quality indicators while maintaining growth and profitability, maintain adequate cushion in capital adequacy indicators above the minimum regulatory requirement levels, and manage the impact of any regulatory changes by Nepal Rastra Bank (NRB) would also 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 189 branches, 20 extension counters and 264 ATMs (as on April 13, 2023) 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 and businesspersons with wide experience in the financial and other sectors. Mr. Prachanda B. Shrestha is the chairman of the bank and has almost two decades of experience as director of the bank and various 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.

#### **Improved overall capitalization level post-acquisition of CBL**

After acquisition of Civil Bank Limited (CBL), HBL's capitalization levels improved as on mid-April, 2023 aided by much better overall CAR ratio of CBL (over 15%). Over FY21-FY22, the bank's capitalization level had fallen sharply to below industry average due to relatively higher pace of credit growth vis-à-vis capital accretion. Primarily owing to better Tier II capitalization of CBL, overall CAR improved to 12.93% at the end of 9MFY23 (11.63% at the end of FY22), albeit still below the industry average of 13.01%. Core Equity Tier I (CET I) of the bank stood at 9.58% at the end of mid-April 2023 (mid-July 2022: 10.45%), providing adequate buffer over the regulatory requirement with a cushion of 2.58%. The bank's CET-I ratio at the end of 9MFY23 was lower than that at the end of FY22, which was mainly on account of increased transfer to regulatory reserve amid surging GNPLs. Lower capitalization levels could limit a bank's ability to absorb losses, should they materialize, especially given the uncertainty surrounding credit recovery. However, recent improvement in overall capitalization remains a positive.

#### **Consistent growth in deposits, offset to some extent by higher growth in loans & advances**

Over FY19-FY22, HBL has shown consistent growth in its deposits as well as loans & advances with a three-year Compounded Annual Growth Rate (CAGR) of around 16%. In FY22, however, growth in deposits outpaced the growth in loans and advances. While loans and advances grew 17.75% y-o-y to Rs. 156 Bn at the end of FY22, deposits grew by 21.60% y-o-y to Rs. 171 Bn. Post-acquisition, the total deposits and advances of HBL at the end of 9MFY23 stood at Rs. 269 Bn and Rs. 251 Bn respectively, with Credit to Deposit (CD) ratio at 90.50% as on mid-April 2023 against the regulatory requirement of below 90%. The bank is likely to receive six additional months after the joint operation date in order to bring the CD ratio below the regulatory requirement, as central bank recently announced several relaxations for the BFIs who underwent merger/acquisition and started the joint operations in the current financial year. Besides, an already high CD ratio will limit the bank's ability to extend further credit, unless offset by a higher growth in deposits.

#### **Moderate liquidity profile**

The bank continues to maintain a moderate liquidity profile. HBL reported SLR, CRR and Net Liquidity ratio of 17.98%, 4.08% and 20.13% respectively, against regulatory requirement of 12%, 4% and 20%, respectively as on Mid-April 2023. Also, bank has moderate liquidity profile with zero cumulative mismatches as of April 13, 2023.

**Diversified loan portfolio**

HBL has a diversified loan portfolio distribution with higher lending of 20.88% of total advances towards wholesaler & retailers (includes wholesale trade of durables, non-durables, automotive dealer/franchise, other retail trade, etc.) followed by 19.50% towards non-food production related sectors (includes handicraft, textile, paper manufacturing, etc.) as on mid-April 2023. Furthermore, the bank has advanced 29.93% towards priority sector and 5.93% towards deprived sector as on mid-April 2023. Diversification helps bank to maintain the bank's assets quality and mitigate volatility risk in case of experienced swings in the economy.

**Key Rating Weaknesses****Sharp deterioration in asset quality**

The Gross Non-Performing Loans (GNPL) ratio of the bank deteriorated sharply to 4.56% as on mid-April 2023 (industry average 3.23%). The deterioration in GNPL ratio was a stark jump from the 1.59% as on mid-July 2022 reported in the audited financials for FY22. While HBL has historically had better than industry average asset quality backed by its strong risk management practices and underwriting norms, the GNPL ratio has declined substantially over the last year or so. In absolute amount, GNPL of HBL rose to Rs. 11,460 Mn at the end of 9MFY23 from Rs. 2,495 Mn at the end of FY22. The slippages can be attributed to the recovery challenges seen across various industries amid rising interest rates and ongoing liquidity stress in the economy, impacting borrowers' repayment ability. In HBL's advances portfolio more stress is seen particularly in the hospitality (albeit majorly due to a single but substantial NPL account), agriculture and construction materials manufacturing sector (cement, steel etc.).

Increasing stress in asset quality remains a major concern from the bank's overall credit profile. Although the central bank has recently come up with provisions of certain relaxations such as rescheduling/restructuring of loans for companies in certain sectors such as hospitality and construction related industries by FY23 end, which could provide some temporary relief to the bank's elevated GNPL ratio, further slippages in asset profile is a distinct possibility in the Nepalese banking sector over the near term as the macro-economic indicators remain muted, particularly amid lower government spending emanating mainly from lesser revenue collection.

**Moderate financial performance**

During FY22, the bank's total income increased by 36.42% to Rs. 19,167 Mn primarily due to increase in interest income by 59.73% to Rs. 16,566 Mn attributable to increased interest rates. The bank's average quarterly base rate at the end of FY22 was 9.88% (PY: 6.74%). Consequently, the bank's net interest income also increased by 30.47% to Rs. 4,943 Mn in FY22, with Net Interest Margin (NIM) also improving slightly to 2.50% during FY22 from 2.27% during FY21. Despite improved margins and income growth, PAT of the bank, however, declined by 21.05% yoy to Rs. 2,368 Mn in FY22. Earlier in FY21, the bank had earned substantial one-time income of Rs. 1,998 Mn earned from profit on sales of investment securities, which had contributed to the bank's net profit. Further during 9MFY23, the bank's total income increased to Rs. 20,422 Mn (includes around two months of joint income) from Rs. 12,430 Mn during 9MFY22 also backed by growth in interest income (72.65% yoy) owing to the higher interest rates. The bank's PAT also increased by 24.96% yoy to Rs. 1,739 Mn in 9MFY23, partly owing to around two months of joint operations. Although financial performance of the bank show year on year improvement in the near term, sustained positive impact of the acquisition over the medium term remains to be seen.

**Declining portion of CASA mix resulting increased cost of funds and affecting competitive positioning**

HBL has historically maintained a CASA mix in the range of 40-50% over FY18 to FY21, which used to be generally better than the industry average for those years. However, CASA mix has decreased sharply from FY22 onwards. As on mid-July 2022, the bank's CASA mix stood at 32.78% (Industry average: 37.74%) and further declined to 29.78% as on mid-April 2023 (Industry average: 34.98). The decline in CASA mix was due to the bank's high reliance on high cost fixed deposits to fuel its deposit growth and maintain CD ratio below the regulatory requirement. In the long term, this could also cause the cost of the funds of the bank

to rise, which will impact the profitability of the bank unless passed through on to borrowers with higher lending rate, which could be 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 remains on the higher side with top twenty institutional depositors contributing to 32.33% of total deposits at the end of FY22 (PY: 27.33%) and 30.19% at the end of 9MFY23. Concentration of the top 20 group borrowers is also high, although moderated to 24.40% of the total advances at the end of FY22 (PY: 27.77%), which has further moderated to 18.97% at the end of 9MFY23. Higher concentration towards advances and deposits normally increases re-pricing risks at times of interest rate volatility.

### **Intense competition**

Currently there are 21 Commercial Banks, including three major state-owned banks, operating with total 5,066 branches all over Nepal (based on monthly statistics published by NRB for mid-April 2022). HBL had 189 branches along with head office as on same date. Industry (Class 'A' Commercial Banks) had achieved total interest income of Rs. 409 Bn during 9MFY23 with Rs. 138 Bn in net interest income, where HBL's share on interest income was 4.73% (FY22: 3.92%) and market share on net interest income was 4.71% (FY21: 3.25%) 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 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 FY22-9MFY23. 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 9MFY23. 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 HBL, given the ongoing trend of sharp rise in NPL levels.

### **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. Recently, HBL acquired Civil Bank Limited, a Class "A" commercial bank and started joint operations in February 24, 2023. Total shareholding of the bank is divided between promoter group and general public in the ratio of 72.99:27.01.

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#### **About CARE Ratings:**

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