Rastriya Banijya Bank Limited

Ratings

Facility/Instrument*	Amount (Rs. in Million)	Ratings[1]	Rating Action
Issuer Rating	**NA**	**CARE-NP A+ (Is) [A Plus (Issuer)]**	**Reaffirmed**
Subordinated Debenture	**2,500.00**	**CARE-NP A+ [A Plus]**	**Reaffirmed**

CARE Ratings Nepal Limited (CRNL) has reaffirmed the rating of 'CARE-NP A+ (Is)' assigned to Rastriya Banijya Bank Limited (RBB). 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 reaffirmed the rating of 'CARE-NP A+' assigned to the Subordinated Debentures of RBB. 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.

Detailed Rationale & Key Rating Drivers

The reaffirmation of ratings assigned to RBB continues to derive strength from its long track record of operations, ownership by Government of Nepal (GoN) along with experienced management team supported by diversified geographical coverage, adequate capitalization level, sustained growth in loans & advances and deposits, comfortable liquidity profile and diversified loan portfolio with regulatory compliance. The ratings also factor in strong deposit profile with higher proportion of low-cost deposits leading to a relatively cost of funds for the bank which remains a key competitive advantage for RBB, and moderate deposits and advances concentration. The ratings also take cognizance of the satisfactory financial performance of the company in FY22 (Audited, FY refers to the twelve-month period ending mid-July), which has continued in 9MFY23 (refers to the nine-month period ended mid-April 2023) despite industry headwinds. The ratings, however, remain constrained by comparatively weak asset quality with relatively high Gross Non-Performing Loans (GNPL) ratio vis-à-vis industry average, which has deteriorated further in 9MFY23. Sustained high GNPL levels owing to more slippages in asset quality over the near term remains a key concern for the Nepalese banking sector. Hence, amid near-term headwinds further stress on RBB's asset quality could lead to added pressure on the bank's earnings and distributable profits, which remains a key constraint from credit perspective. The ratings also factor in intense competition, and exposure to regulatory risk related to industry.

The bank's ability to improve its asset quality will be critical for the bank's earning profile and profitability and will continue to be a key rating sensitivity. Maintaining adequate cushion towards the capital adequacy requirements, and ability of the bank to manage the impact of any regulatory changes by Nepal Rastra Bank (NRB) will also remain key rating sensitivities.

Detailed Description of the Key Rating Drivers

Key Rating Strengths

Long track record, ownership by Government of Nepal and experienced management team supported by diversified geographical coverage

Established in the year 1966 as the second commercial bank of Nepal, RBB has a well-diversified geographical reach in Nepal through its 270 branches, 41 extension counters, 95 branchless banking and 247 ATM Terminals (as on mid-April 2023) covering all seven provinces and all 77 districts. RBB is promoted by Government of Nepal (GoN) with 99.97% of its shares held by different Ministries of GoN. Furthermore, the bank is managed under the overall guidance of its Board of Directors

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

who are appointed by GoN. Dr. Balram Pathak, Chairman, had earlier served as a BoD of Rastriya Beema Company and is currently a faculty of Economics at Tribhuvan University. The management team is led by Chief Executive Officer (CEO), Mr. Kiran Kumar Shrestha, who has over three decades of experience in various financial institutions. He is supported by an experienced management team.

Adequate capitalization level

RBB's capitalization levels continue to remain adequate with reasonable cushion over the minimum regulatory requirements. The overall capital adequacy ratio (CAR) of the bank improved to 13.97% (minimum regulatory requirement of 11%) as on July 16, 2022 (July 15, 2021: 13.46%) boosted by increase in supplementary capital through issuance of debentures worth Rs. 2.5 Bn, equity infusion of Rs. 2 Bn by Government of Nepal against right shares and accretion of profits. Core Equity Tier I (CET-I) of the bank also improved to 11.63% (minimum regulatory requirement of 7%) at the end of FY22 from 11.09% at the end of FY21 primarily due to core capital accretion coupled with relatively conservative growth of loans and advances. As on mid-April 2023, capitalization levels have moderated slightly with overall CAR of 13.86% and CET-I of 11.57%. Nonetheless, these still remain well above industry average levels of 13.01% and 10.16%, respectively, with adequate cushion from the regulatory requirement levels. Ample cushion in the capitalization levels would put the bank in a better position to absorb losses, should they materialize, especially given the uncertainty surrounding credit recovery amid ongoing economic slowdown in the country.

Satisfactory financial performance in FY22-9MFY23

During FY22, bank's interest income grew by 27.49% y-o-y supported by higher yields on advances amid higher interest rates. Yield on advances increased by 79 bps y-o-y to 8.55%. During FY22, interest rate was on an increasing trend amid tight liquidity in the market coupled with decline in loanable funds of banks amid stricter regulatory/monetary policy by NRB. Although RBB's cost of deposits also increased by 85 bps y-o-y in FY22, Net Interest Margin improved by 5 bps to 2.90%. However, the bank's PAT increased substantially by 25.39% y-o-y to Rs. 4,293 Mn, supported by increased income levels. The growth trend continued in 9MFY23 with RBB's total income increasing by 56.85% y-o-y leading to increase in PAT by 36.69% y-o-y to Rs. 3,577 Mn. Return on Total Assets (RoTA) of the bank improved to 1.34% in FY22 (FY21: 1.19%), which improved further to 1.47% during 9MFY23 aided by improved profitability. The ability of the bank to manage sustained growth in business despite industry headwinds which has resulted in moderation in financial performance of some of the larger peers in the industry during 9MFY23 is reflective of its resiliency and an established market presence.

Sustained growth in deposit base and advances in 9MFY23

RBB reported strong growth in its deposits base with 23.83% year-on-year increase to Rs. 304 Bn at the end of 9MFY23 (industry deposits grew by only 10.43% during this period). The higher growth in RBB's deposits in 9MFY23 was partly on account of addition of new salary accounts of some marquee government institutions. Similarly, RBB's total loans and advances of Rs. 243 Bn at the end of 9MFY23 had grown by 7.82% y-oy (industry growth was 2.71%). The overall banking industry along with RBB had recorded higher growth in their loans & advances portfolio over FY21-FY22 and a sharp decline in pace in 9MFY23. In RBB's case, the growth in credit has been generally well supported by its growth in deposits as indicated by its comfortable Credit to Deposit (CD) ratio of 79.83% (regulatory requirement of less than 90% by mid-July 2023) compared to the industry average of 85.75% as on mid-April 2023.

Comfortable liquidity profile

RBB continues to maintain a comfortable liquidity profile with SLR of 21.78% (regulatory requirement:10%) and average CRR of 3.50% (regulatory requirement: 3%) as on July 16, 2022. As on April 13, 2023, the ratios have improved further with the bank's SLR increased to 25.25% and CRR to 4.21%, remaining comfortably above the updated minimum regulatory requirement of 12% and 4% respectively. Furthermore, net liquidity of the bank was 26.93% as on April 13, 2023 against the minimum regulatory requirement of 22%.

Diversified loan portfolio

RBB's advances concentration, albeit moderate, has been towards corporate sector, followed by retail sector and SME sector. RBB continues to have a diversified loan portfolio with higher lending of 27.07% of total advances towards consumable loans (includes personal loans, credit card, fixed deposit receipt, gold/silver, etc.) followed by 22.34% towards wholesaler and retailer sector (includes wholesale trade of durables, non-durables, automotive dealer/franchise, other retail trade, etc) as on mid-April 2023. The bank has relatively less exposure towards construction sector (1.53% of total advances at the end of 9MFY23), which has been one of the most stressed sectors in terms of recovery so far this year. Furthermore, RBB lent 38.71% (minimum regulatory requirement of 32%) towards priority/prescribed sectors which include Agriculture, Energy and Small/Medium Enterprises as on April 13, 2023. 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.

Strong deposit profile with low-cost deposits

RBB continues to have a comparatively higher proportion of low-cost Current Account Saving Account (CASA) deposits in the industry. Although there has been some moderation in CASA ratio over the past year or so on account of increased proportion of fixed deposits amid tight liquidity, RBB's CASA ratio still remains above 60%, which is well above the industry average of around 35% as on mid-April 2023. This leads to lower cost of funds for RBB vis-à-vis peers and provides competitive advantage to RBB in the "base rate plus" lending rate regime. The bank's average base rate for the last month of 9MFY23 was 8.47%, which was lowest in the industry.

Key Rating Weaknesses

Weak asset quality

RBB continues to have a relatively weak asset quality marked by a high GNPL ratio. Barring the sudden jump during 9MFY23, there had been marked improvement in RBB's GNPL ratio over the past several years aided by improved recovery efficiency. The bank reported GNPL ratio of 2.09% at the end of FY22 (industry average: 1.2%), which had improved from 3.07% at the end of FY21. However, the ratio deteriorated to 3.88% at the end of 9MFY23 (Industry average: 3.23%). The slippages can be attributed to the recovery challenges seen across various sectors (mainly in agriculture, manufacturing, hospitality, construction) amid rising interest rates and slowdown in economic growth in the country, impacting borrowers' repayment ability. Deteriorating asset quality remains a major concern from the bank's overall credit profile. However, the central bank has again come up with provisions of certain relaxations (need to be availed by FY23 end) such as rescheduling/restructuring of loans for companies in certain sectors such as hospitality and construction related industries, which could provide some temporary relief to the bank's elevated GNPL ratio at FY23 end.

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 2023). RBB had 270 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 RBB's share on interest income was 5.61% (FY22: 4.75%) and market share on net interest income was 6.90% (FY22: 6.13%) 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. While the liquidity requirements have remained unchanged, NRB has lowered policy rate from 7% to 6.5% and Bank rate remains steady at 7.5%. Furthermore, NRB has allowed maximum interest rate spread to be maintained at the end of FY23 by commercial banks to 4% from 4.4%, which is likely add further stress on banks' 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 sustained 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 RBB, given the ongoing trend of sharp rise in NPL levels, notwithstanding the transient impact of relaxations by NRB.

About the Bank

RBB is an "A" Class Licensed Institution from Nepal Rastra Bank (NRB). It was incorporated on January 23, 1966. The bank has one subsidiary company operating within the territory of Nepal, namely RBB Merchant Banking Limited. As on Mid-January 2022, 99.97% of its shares are held by different Ministries of GoN, among which 93.33% is held by Ministry of Finance.

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About CARE Ratings:

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Our parent company, CARE Ratings Limited commenced operations in April 1993 and over two decades, it has established itself as one of the leading credit rating agencies in India. CARE is registered with the Securities and Exchange Board of India (SEBI) and also recognized as an External Credit Assessment Institution (ECAI) by the Reserve Bank of India (RBI).