Prabhu Bank Limited: [ICRANP-IR] BBB and [ICRANP] LBBB reaffirmed

July 6, 2020

Summary of rated facilities/instruments

Facility/Instrument	Rated Amount (NPR Million)	Rating Action
Issuer Rating	NA	[ICRANP-IR] BBB; reaffirmed
Subordinated Debenture Programme	NPR 1,000 Million	[ICRANP] LBBB; reaffirmed

Rating action

ICRA Nepal has reaffirmed an issuer rating of **[ICRANP-IR] BBB** (pronounced ICRA NP issuer rating triple B) to Prabhu Bank Limited (PRVU). This rating is considered to be of moderate credit quality. The rated entity carries moderate credit risk. The issuer rating is only an opinion on the general creditworthiness of the rated entity and not specific to a particular debt instrument. ICRA Nepal has also reaffirmed the rating of **[ICRANP] LBBB** (pronounced ICRA NP L triple B) assigned to the existing subordinated debenture programme of PRVU. Instruments with this rating are considered to have a moderate degree of safety regarding the timely servicing of financial obligations. Such instruments carry moderate credit risk.

Rationale

The ratings reaffirmation factor in the bank's ability to further improve its overall financial profile in the last 12-15 months. The bank's operating profitability has witnessed gradual improvements over this period, even as the provision write- backs remained limited. This enabled it in reporting fair annualised RoNW and RoA[1] of ~13% and ~1.4% respectively in 9M FY2020, which remains a positive. The ratings also consider PRVU's balanced portfolio mix and hence relatively low customer concentration risks. ICRA Nepal also takes note of PRVU's healthy deposits profile with a higher share of low-cost current and savings accounts (CASA) compared to the industry (~45% against 40% for the industry as of mid-April 2020). PRVU's diversified franchise (208 branches as of mid-April 2020) has led to good market positioning in Nepal with a share of ~3.7% and ~3.6% in commercial banking industry deposits and credits respectively. This, along with a controlled credit growth approach in recent periods, affiliation to the established Prabhu Group and the bank's experienced board of directors and senior management team, continue to remain supporting factors for the rating.

Nonetheless, the ratings remain constrained by the bank's weaker asset quality mix with gross non-performing loans (NPLs) of 2.95% (1.72% for the industry) and 30+ days delinquencies of ~7.5% as of mid-April 2020. While the NPLs have been gradually declining (from ~11% in mid-July 2016), fresh NPL generation continued to remain high till FY2019 (2.59%), a major rating concern. The impact on the bank's solvency also remains high at ~7% as of mid-April 2020, despite recent moderations. The bank's ability to maintain comfortable asset quality indicators amid the expected economic impact of Covid-19, would remain a key monitorable. The ratings are also impacted by PRVU's high operating expenses compared to its peers and moderate capitalisation (Tier-I CRAR[2] of 9.78% as of mid-April 2020 against 11.23% for the industry). At the current capital levels, its ability to absorb unexpected asset quality shocks remain minimal. Additionally, the recent regulatory directive to provide interest rebates to Covid-19-impacted customers would keep internal capital generation in FY2020 under pressure. Nonetheless, the proposed debentures could provide support to capital ratios (assuming full subscription). Going forward, the bank's ability to maintain/improve its funding profile while attaining sustainable portfolio growth and adequate profitability, amid the regulatory changes would remain crucial. The slowing economic growth due to the ongoing pandemic (Covid-19) also remains a rating concern.

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[1] *Return on net worth and return on assets*
[2] *Capital Adequacy Ratio*

Key rating drivers

Strengths

Improving operational profitability – PRVU's profitability in earlier years (FY2015 to FY2017) was largely supported by credit provision write-backs while the operational profitability remained weaker among its peers. With the lowering of the NPL levels, the quantum of reversals was much lower in FY2018. However, despite the same, improving operating profitability has provided support in recent years. The bank reported an operating profit of 2.06% of average total assets (ATA) in 9M FY2020 as against 1.17% for FY2017. This was mainly aided by improving net interest margins (improved to 3.33% of ATA from 2.77% over the same period) and adequate fee-based income (~1% of ATA for 9M FY2020). Additionally, the increased scale of operations resulted in a reduction in the operating costs front, which, however, still remains on the higher side among peers. The bank's reported annualised RoNW of ~13% in 9M FY2020 remains comparable to the industry average while the annualised RoA at 1.35% remains slightly lower compared to 1.57% for the industry.

Diversified branch network sees portfolio granularity; affiliation to Prabhu Group provides further support – The bank had 208 branches spread across the country as of mid-April 2020, providing adequate growth opportunities. The bank's affiliation with the Prabhu Group (Prabhu Money Transfer, the remittance wing of the Group, is one of the main players in the Nepalese remittance industry) and shared brand name also remain positives from the viewpoint of incremental growth and diversification. This, coupled with the bank's adequate track record (since 2002) and focus on the retail/SME segment, results in a diversified credit portfolio with ~54% share of such loans. As of mid-April 2020, PRVU's reliance on the top-20 borrowers was relatively low at ~20% of the total credit portfolio (~157% of tier-I capital).

Fair funding profile with better CASA and concentration compared to most peers – PRVU's low-cost CASA deposits at ~45% as on mid-April 2020, were higher than the industry average of ~40%. However, unlike in the past, the cost of fund at 6.39% for 9M FY2020 is slightly higher than the industry average of 6.32%. This was mainly on account of the sharp reduction in the share of call deposits (to ~11% as of mid-April 2020 against ~17% as of mid-July 2018). These were mostly replaced by the high cost-bearing term deposits. The reduction in the share of call deposits was in line with the regulatory requirement of bringing down the portion to 10% by mid-July 2020. The recent revision in interest rates is likely to benefit the cost of funds over the near term. The deposit concentration among the top 20 accounts stood high at ~23% as of mid-April 2020, though lower than many other banks.

Controlled and cautious credit growth in recent periods – Over the last three fiscals, PRVU registered a credit growth of CAGR ~23% in line with the commercial bank average growth of ~22%. The bank has reported a ~15% credit growth in 9M FY2020 as against the industry average growth of ~19%. As of mid-April 2020, PRVU's reliance on the top-20 borrowers stood high at ~20% but relatively low among peers. As a result, top 20 borrowers accounted for ~157% of tier-I capital, which is also on a higher side.

Challenges

Weaker asset quality – The bank has relatively weaker asset quality with gross NPLs of 2.95% as of mid-April 2020, which remain much higher against the industry average of 1.72%. The 30+ days delinquencies were also high at ~7.5% as on same date. Though the asset quality has gradually improved over the years (NPLs of 10.87% as on mid-July 2016), this was also aided by the diluting effect of the portfolio growth as well as the sizeable write-offs, apart from recoveries/upgradations. The impact on solvency (net NPL to net worth) still remains high at 7% as of mid-April 2020, despite moderation over the years. The bank's ability to control fresh slippages would remain critical for profitability and capital position.

Externalities brought on by Covid-19 could affect key operating parameters – The ongoing global pandemic is expected to have a significant impact on the country's economic growth. This could in turn, impact the repayment capacity of the bank's borrowers and result in increased credit costs. Additionally, deposit growth is likely to be significantly impacted in a remittance-dependent economy, with sizeable remittance inflows so far from the Gulf countries. Hence, incremental growth plans, asset quality and profitability are likely to remain under stress. The regulator's further stance on supporting the impacted sectors and additionally, the bank's ability to manage these externalities remains to be seen.

Thin capitalisation buffer – PRVU has a thin buffer in capitalisation profile with CRAR of 11.56% as on mid-April 2020 (slightly above the minimum regulatory requirement of 11%). This remains lower compared to most peers and the industry average of 13.38%. The last Tier-II capital issuance has helped maintain the capitalisation, despite a decline in Tier I (9.78% on mid-April 2020 against 10.82% in mid-July 2018) capital. The bank proposes to issue a further NPR 2,000 million of subordinated debentures, which are expected to support the capitalisation profile for future growth (assuming there is full subscription).

Changing regulatory landscape could affect growth – In a recent regulatory change to support the GoN's measures to strengthen the tax administration, the NRB has requested the banks to closely monitor the loans where the borrower's repayment capacity is not supported by the income (as reflected in their tax filings) and has mandated banks to maintain additional provisions for non-compliance with the norms. Misutilisation of loans and instances of dual financials (separate set of financials for bank loan and tax filing purposes) are also being classified as non-performing, even if the debt-servicing is regular. These issues are largely related to retail and SME portfolios which form the major target credit segment for PRVU (~54% exposure as of mid-April 2020). This could impede the credit growth over the short-to-medium term and could also increase the credit costs.

Analytical approach: For arriving at the ratings, ICRA Nepal has applied its rating methodology as indicated below.

Links to applicable criteria:

Issuer Rating Methodology

Bank Rating Methodology

Bank Profile

Prabhu Bank Limited (PRVU), formerly known as Kist Bank, was incorporated in 2002 as a finance company and was upgraded to a Class A commercial bank in May 2009. Kist Bank came under stress as a large chunk of its credit portfolio turned into NPLs from 2013 (NPLs were ~24% in July 2014). The bank opted for a merger to improve its financial profile and was renamed after the merger of four financial institutions on September 15, 2014. These institutions were Kist Bank Limited (Class A), Prabhu Bikas Bank Limited (Class B), Gaurishankar Development Bank Limited (Class B) and Zenith Finance Limited (Class C). In February 2016, PRVU acquired another distressed bank i.e. Grand Bank Nepal Limited, which had a very high level of NPLs at the time of the merger (~35%).

PRVU is mainly promoted by the individuals and entities belonging to the Prabhu Group, which is an established business group, especially in the remittance and financial sector. The bank's shares are listed on the Nepal Stock Exchange with ~51% held by the promoters and the rest being public holding. PRVU's registered and corporate office is in Babarmahal, Kathmandu.

As of mid-April 2020, PRVU's presence throughout the country is visible with 208 branches, 46 branchless banking counters and 157 ATMs. Its market share was around 3.70% in terms of the deposit base and 3.61% of the total advances of the commercial banking industry as of mid-April 2020. PRVU reported a profit after tax (PAT) of NPR 1,784 million in FY2019 (YoY growth of ~84%) on an asset base of NPR 137,886 million as of mid-July 2019. For 9M FY2020, the bank reported a profit of NPR 1,464 million on an asset base of NPR 150,586 million as of mid-April 2020. PRVU reported a CRAR of 11.56% and gross NPLs of 2.95% as on same date. In terms of the technology platform, PRVU has recently started using Finacle as its core banking software across all its branches.

Key financial indicators

Year Ended	Mid July 2017 (Audited)	Mid July 2018 (Audited)	Mid July 2019 (Audited)	Mid-April 2020 (Provisional)
Operating ratios				
Yield on average advances	9.89%	11.14%	11.24%	11.09%
Cost of deposits	4.15%	6.03%	6.18%	6.39%
Net interest margin/ATA	3.18%	2.77%	3.51%	3.33%
Non-interest income/ATA	1.03%	0.93%	0.97%	1.00%
Operating expenses/ATA	2.76%	2.52%	2.50%	2.26%
Credit provisions/ATA	-1.38%	-0.15%	0.30%	0.16%
PAT/ATA	2.01%	0.95%	1.42%	1.35%
PAT/net-worth	21.71%	9.27%	13.27%	13.03%
Gross NPAs	4.55%	3.97%	3.76%	2.95%
30+ days delinquencies				
Capitalisation ratios				
Capital adequacy ratio	11.18%	11.86%	11.16%	11.56%
Net NPAs/net worth	9.70%	10.13%	9.58%	6.67%
Liquidity ratios				
Total liquid assets/total liability	29%	27%	27%	23%
Total advances/total deposits	73%	78%	85%	87%

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About ICRA Nepal Limited:

ICRA Nepal Limited, the first credit rating agency of Nepal, is a subsidiary of ICRA Limited (ICRA) of India. It was licensed by the Securities Board of Nepal (SEBON) on October 3, 2012. ICRA Nepal is supported by ICRA Limited through a technical support services agreement, which envisages ICRA helping ICRA Nepal in areas such as the rating process and methodologies, analytical software, research, training, and technical and analytical skill augmentation.

Our parent company, ICRA Limited was set up in 1991 by leading financial/investment institutions, commercial banks and financial services companies as an independent and professional investment information and credit rating agency. Today, ICRA and its subsidiaries together form the ICRA Group of Companies.

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