Kumari Bank Limited: Ratings reaffirmed

February 08, 2021

Summary of rated facilities/instruments

Facility/Instrument	Rated Amount (NPR Million)	Rating Action
Issuer rating	NA	[ICRANP-IR] BBB+; reaffirmed
Subordinated Debenture Programme	NPR 3,000 million	[ICRANP] LBBB+; reaffirmed

Rating Action

ICRA Nepal has reaffirmed the issuer rating of **[ICRANP-IR] BBB+** (pronounced ICRA NP issuer rating Triple B Plus) to Kumari Bank Limited (KBL), indicating a moderate degree of safety, regarding the timely servicing of financial obligations with the moderate credit risk. The sign of + (plus) or – (minus) appended to the rating symbols indicates their relative position within the rating categories concerned. The rating is only an opinion on the general creditworthiness of the rated entity and not specific to any particular debt instrument. ICRA Nepal has also reaffirmed the rating of **[ICRANP] LBBB+** (pronounced ICRA NP L Triple B Plus) to KBL's subordinated debentures. 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 rating actions factor in the bank's comfortable capitalisation profile (capital to risk weighted assets ratio - CRAR of 14.93% as on mid-October 2020 against the minimum regulatory requirement of 11%), which is expected to help it absorb any near-term asset quality shocks. The ratings also take note of the bank's adequate track record (operating since 2001), experienced board/senior management and decent market share after the recent acquisition of one of the largest development banks viz. Deva Bikas Bank limited (Deva) in FY2020. The rating also considers the bank's improved portfolio granularity after the acquisition of Deva with the top-20 borrowers, now accounting for ~16% of the total credit as on mid-October 2020 as against ~20% in mid-October 2019 (when last rated). Moreover, the credit portfolio remains fairly diversified with ~45% SME/retail loans, the rest being mid to large corporate loans. The bank's franchise has also sharply increased with currently 193 branches, which is expected to help it maintain a similar/better portfolio mix and granularity. Further, the bank has been able to report improved profitability in recent periods, which also remains a rating positive.

Nonetheless, the ratings are constrained by the deterioration in the asset quality with an increase in the non-performing assets (NPA) at 1.43% as on mid-October 2020 (1.05% as of mid-October 2019), which could be attributed to the impact of Covid-19 pandemic and also the relatively inferior assets quality of Deva, the acquired bank. Though the overall delinquencies remain under control at ~10% as of mid-October 2020, the bank's ability to maintain a similar asset quality profile amid the evolving economic impact of the pandemic remains to be seen. This, along with the seasoning effect of the acquired credit portfolio and the portfolio emanating from recent high growth trend, could impact its asset quality outlook. Further, the operating environment remains uncertain with the recent political turmoil which could impact the credit profile of entities operating in Nepal. The ratings are also impacted by the bank's deposit profile, which continues to remain inferior to most peers and the industry average, despite the recent improvement. The bank's mix of low-cost current and savings accounts (CASA) remains low at ~33% against ~42% for industry, resulting in a high cost of fund at 6.62% for Q1 FY2021 against the industry average of 5.49%. The deposit concentration also remains moderate among the peers at ~25%. Similarly, the bank faces stiff competition from other larger commercial banks with finer lending rates. Going forward, the bank's ability to maintain its comfortable asset quality in the post-Covid-19 scenario, obtain synergies from the recent acquisition, while improving its deposits profile, would remain a key rating driver.

Key rating drivers

Credit Strengths

Comfortable capitalisation – The bank's capitalisation ratio remains comfortable with a tier-I of 11.63% and overall CRAR of 14.93% as of mid-October 2020 as against the minimum regulatory requirement of 8.5% tier-I and 11% CRAR as per the prevailing Basel-III norms implemented by the Nepal Rastra Bank (NRB, the regulator). This is expected to help the bank comfortably absorb any near-term asset quality shocks.

Adequate track record and decent market share supported by the recent acquisition – KBL has been in operation since 2001 and with the standalone growth as well as recent acquisition, the bank now commands a decent market share of ~3.2% in terms of deposits and ~3.8% in terms of credit portfolio of commercial banks as of mid-October 2020. This is likely to help the bank generate adequate profitability amid the regulatory constriction in interest spreads as well as non-interest income avenues.

Experienced management team and diversified branch network could further aid the balanced credit mix – Aided to an extent by the recent acquisition, the bank has been able to report its relatively granular credit portfolio base amongst the peers with the top-20 borrowers accounting for ~16% of the total portfolio as on mid-October 2020 (~20% a year ago). This somewhat reduces the risks of capital erosion amid the concerns along the asset quality outlook. Moreover, the credit portfolio mix is also fairly diversified with ~45% SME/retail loans, rest being towards mid to large corporates. Post the acquisition, the bank currently has a diversified branch network of 193 branches across the country, which, along with its experienced management team, is likely to further support in maintaining granular portfolio.

Improved profitability in recent periods – With higher improvements in the cost of funds in recent periods as compared to the lending yields, KBL has reported a marked improvement in gross interest spreads in the recent periods (2.87% for Q1 FY2021 against 2.18% for FY2019). This, along with control over operating costs and credit provisions, (mainly through write back of provisions for NPAs from earlier acquisitions) have aided improvement in profitability indicators. The bank reported a return on assets of 1.53% and return on net worth of ~14% for Q1 FY2021 against 1.31% and ~11% for FY2019. While the reversal of provisions is likely to be short-lived, the bank's ability to maintain adequate lending spreads could remain crucial.

Credit Challenges

High growth trend in recent years – The bank has been following a high growth strategy in recent years, both through organic and inorganic means. Including the acquisition in FY2020, the bank reported a high credit and deposit growth of ~52% and ~59%, compared to the commercial bank's industry average growth of ~16-17%. Excluding the acquisition of Deva, the standalone growth still remained high at ~24%. Increased seasoning of the credit portfolio arising from recent high growth and through the acquisition could have a bearing over its future asset quality profile.

Uncertain operating environment – The economic impact of the pandemic is still evolving and its impact on the asset quality of the banking system remains to be seen. With the major chunk of the borrowers availing moratoriums till mid-January 2021 and the impacted sectors still under moratorium till mid-July 2021 (depending upon the level of the impact), the effect on the asset quality is not yet clearly evident. This, along with rescheduling opportunities for borrowers, has deferred the asset quality impact. Additionally, the operating environment has further weakened for the borrowers due to the increased political uncertainty in the recent periods. KBL's ability to tide over the uncertain environment whilst maintaining comfortable financial profile would remain critical.

Slight decline in asset quality amidst the pandemic – KBL's asset quality has declined with the increase in the NPA level at 1.43% as on mid-October 2020 (1.01% as of July 2019). The fresh slippages in recent periods can mainly be attributed to the impact of Covid-19. Besides, the asset quality of the acquired bank i.e., Deva was relatively inferior, which also contributed to an increasing NPA. Nevertheless, the NPA levels remain lower vis-à-vis the industry average, which stood at 1.63% as on mid-October 2020. The 0+ delinquency also remains moderate amongst rated peers at ~9% as on mid-October 2020, which provides comfort.

Relatively inferior deposit profile with lower CASA and high deposit concentration – KBL's deposits profile continues to remain inferior with relatively high cost of deposits (6.62% for Q1 FY2021 against the industry average of 5.49%). Due to this, the bank's ability to offer competitive rates to its borrowers is limited in the base rate plus lending model, thereby affecting its credit profile. The high-cost structure mainly stems from the low CASA share (~33% for KBL against ~42% for industry) and the concomitant high share of the term deposits. The deposit concentration also continues to remain high despite some improvement, post acquisition, with the top-20 depositors accounting for ~25% of total deposits as of mid-October 2020 (~29% at time of last rating). This raises concern along the interest rate sensitivity and the volatility of deposits. Nevertheless, the bank's adequate cushion in terms of credit to core capital deposits (CCD) ratio, which stood at ~75% as on mid-October 2020 against the current regulatory limit of 85%, provides comfort.

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

Links to applicable criteria:
Bank Rating Methodology

Bank Profile

Incorporated in 2001, Kumari Bank Limited (KBL) has since undergone multiple acquisitions, including various B class banks. In FY2020, the bank again acquired another large sized B class bank viz. Deva. With the support of this acquisition, the bank has become a decent-sized commercial bank of Nepal in terms of asset base and market share (deposit and credit). KBL now has presence across the country through its 193 branches, 14 extension and revenue collection counters and 156 ATMs. The bank currently has a market share of ~3.2% in terms of deposit base and ~3.8% in terms of the credit portfolio of commercial banks as of mid-October 2020.

KBL reported a standalone profit after tax of NPR 1,159 million (NPR 1,393 million including Deva's profit till 9M FY2020) during FY2020 (13% YoY growth including Deva's profit) over an asset base of NPR 153,342 million as of mid-July 2020. As of mid-October 2020, KBL's CRAR was 14.93% (tier I CRAR 11.63%) and gross NPLs were 1.43%. In terms of the technology platform, KBL has implemented Finacle across all its branches. The shares of the bank are listed on the Nepal Stock Exchange.

Key financial indicators

Year Ended	Mid July 2018 (Audited)	Mid July 2019 (Audited)	Mid July 2020* (Audited)	Mid October 2020[1] (Provisional)
Operating ratios				
Yield on average advances	12.02%	12.15%	12.68%	10.87%
Cost of deposits	7.81%	8.72%	8.97%	6.62%
Net interest margin/ATA	2.83%	3.05%	3.40%	3.34%
Non-interest income/ATA	0.84%	0.87%	0.83%	0.74%
Operating expenses/ATA	1.76%	1.79%	2.18%	1.86%
Credit provisions/ATA	0.04%	0.24%	0.47%	0.03%

[1] *annualized*

Year Ended	Mid July 2018 (Audited)	Mid July 2019 (Audited)	Mid July 2020* (Audited)	Mid October 2020[1] (Provisional)
PAT/ATA	1.45%	1.31%	1.08%	1.53%
PAT/net-worth	11.19%	11.05%	9.61%	13.75%
Gross NPAs	1.05%	1.01%	1.39%	1.43%
Capitalisation ratios				
Capital adequacy ratio	13.36%	11.75%	15.35%	14.93%
Net NPAs/net worth	1.57%	1.73%	1.44%	2.06%
Liquidity ratios				
Total advances/total deposits	22.99%	20.89%	18.68%	22.34%

** Profitability ratios include Deva's numbers till 9MFY2020.*

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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 rating process and methodologies, analytical software, research, training, and technical and analytical skill augmentation.

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