Prabhu Bank Limited: Ratings removed from Watch with Developing Implications and placed on Watch with Negative Implications

October 16, 2023

Summary of rating action

Facility/Instrument	Rated Amount	Rating Action
Issuer Rating	NA	**[ICRANP-IR] BBB@**[1]; removed from 'Watch with Developing Implications' and placed on 'Watch with Negative Implications'
Subordinated Debentures	NPR 1,000 million	**[ICRANP] LBBB@**; removed from 'Watch with Developing Implications' and placed on 'Watch with Negative Implications'

Rating action

ICRA Nepal has removed the issuer rating assigned to Prabhu Bank Limited (PRVU) from 'Watch with Developing Implications' and placed on 'Watch with Negative Implications'. The revised rating is [ICRANP-IR] BBB@ (pronounced ICRA NP issuer rating triple B) indicating moderate degree of safety regarding the timely servicing of financial obligations. Such issuers carry moderate credit risk. The rating is only an opinion on the general creditworthiness of the rated entity and is not specific to any debt instrument.

ICRA Nepal has also removed the rating assigned to the bank's subordinated debentures from 'Watch with Developing Implications' and placed on 'Watch with Negative Implications'. The revised rating is [ICRANP] LBBB@ (pronounced ICRA NP L triple B) indicating a moderate degree of safety regarding the timely servicing of financial obligations. Such instruments carry a moderate credit risk.

Rationale

The rating watch with negative implications is mainly on account of the recent deterioration in the PRVU's assets quality profile with higher than industry average non-performing asset (NPA) levels (4.16% as of mid-July 2023 against 2.98% for the industry), along with spike in 0+ days delinquencies (~23% as of mid-July 2023 Vs. ~9% as of mid-July 2022). The recent slippages have impacted the bank's solvency profile (net NPA/ net worth) which has slipped to ~14%, on a higher side among the industry peers as of mid-July 2023. While the spike in delinquencies can be partly attributed to acquisition of stressed accounts from erstwhile Century Commercial Bank Limited, the uptick in delinquencies coinciding with recent economic slowdown and high interest rate environment remains a concern for PRVU's incremental asset quality outlook. The resultant increase in the credit costs has led to slight moderation in PRVU's profitability indicators for FY2023. The ratings also remain constrained by the bank's thin capital cushion over the regulatory minimum, especially at the tier-I level, which stood at 8.91% as of mid-July 2023 against the regulatory minimum of 8.50%. Further, the recent change in regulation requiring the counter-cyclical buffer of 0.5%, to be maintained by mid-July 2024, is expected to exert pressure on the capitalisation and growth for PRVU. Rating concerns also emanate from the moderation in the deposit portfolio of the bank as reflected in a decline in CASA deposits leading to uptick in cost of deposits.

Nonetheless, the ratings continue to derive comfort from PRVU's experienced directors/management team and the bank's affiliation to the established Prabhu Group having diverse presence in financial and other sectors. The ratings also positively factor the growth in PRVU's market share (aided by the acquisition) in the fragmented banking industry (~5.13% in deposits and ~4.87% in credit respectively as of mid-July 2023). Further, the increasing granularity of credit

[1] *The symbol '@' denotes rating on "Watch with Negative Implications".*

portfolio (concentration among top-20 borrowers/groups declined to ~19% as of mid-July 2023 from ~22% as of mid-July 2022, when last rated) remains a positive. The growth prospects and market share are likely to remain supported by the consolidated entity's diversified network (301 branches post-acquisition). Going forward, PRVU's ability to improve its asset quality profile, contain its delinquencies and maintain adequate capital cushion to withstand probable credit shocks will remain key rating sensitivities. Moreover, improvement in its profitability and deposits profile will also remain among other key rating drivers.

Key rating drivers

Credit strengths

Affiliation to Prabhu Group with experienced directors/management team - Operating since 2002, PRVU has an adequate track record of operations in the Nepalese banking industry. The bank has an experienced board and is led by a seasoned management team which remains a positive. Further, the bank's affiliation with the Prabhu Group (having diverse presence in financial and other sectors) and shared brand name provides comfort. Post-acquisition of Century Commercial Bank, PRVU's network coverage has improved with 301 branches across the country as of mid-July 2023 and its market share has improved to ~5.13% share in total deposits and ~4.87% share in total credits as of mid-July 2023 (from ~3.53% and 3.18% respectively as of mid-July 2022).

Improved portfolio granularity – The portfolio concentration has declined since the last rating exercise aided by the higher credit growth (due to acquisition) and granularity of the acquired loan book. The concentration among top-20 borrowers has decreased to ~19% of total loan (167% of tier-I capital) as of mid-July 2023 from ~22% (~195%) as of mid-July 2022. The deposit concentration has also improved, with top-20 depositors contributing ~21% of total portfolio as of mid-July 2023 (~24% of total portfolio as of mid-July 2022).

Credit challenges

Increased delinquency and NPLs amid unfavourable economic environment – PRVU reported major deterioration in its asset quality since last rating, wherein NPLs have spiked to 4.16% as of mid-July 2023 (industry average of 2.98%) from 1.20% as of mid-July 2022. Moreover, 0+ days delinquency levels increased to ~23% as of mid-July 2023 (mainly in the 61-90 days bucket) from ~9% as of mid-July 2022. This has also impacted the bank's solvency indicators (net NPL to net worth) to 13.54% as of mid-July 2023 compared to 4.23% as of mid-July 2022. Although the rising delinquency can be partly attributed to the integration of credit book acquired from Century, it nonetheless creates risk of a sustained impact on asset quality, given the unfavourable economic environment created by high interest rate and regulatory changes like introduction of stringent working capital guidelines etc. Sustained high NPLs could further increase the provisioning expenses and could impact the incremental profitability and capitalisation for the bank and could have rating implications.

Thin cushion in core capital – PRVU's cushion in tier I capital, which stood at 8.91% as on mid-July 2023 (similar in mid-July 2022) remains very thin vis-à-vis the minimum regulatory requirement of 8.5%. This was impacted mainly by the high credit growth in previous years and increased delinquencies in recent years. Acquisition of CCBL, with low Tier-I as of the merger date (8.28%) has also pressurised the Tier-I for PRVU. Further, the recent change in regulation requiring counter cyclical buffer of 0.5% to be maintained by mid-July 2024, is likely to exert pressure on the capitalisation and growth going forward.

Stressed profitability – Despite the improvement in net interest margins, PRVU's profitability indicators in FY2023 were impacted by the deteriorated asset quality leading to high credit cost. The bank reported a return on average total assets (ATA) and return on net worth of ~0.85% and ~9.3%, respectively, for FY2023 (~0.85% and ~10.5% respectively for FY2022). Since the NIMs remain supported by the relaxations on interest spread cap until mid-Jan 2024 (i.e., one year from the commencement of combined operations), removal of such relaxation is likely to further exert pressure on the profitability in future. The bank's ability to maintain its profitability amid interest margin and asset quality pressure will remain crucial for its incremental profitability profile.

Moderation in funding profile – PRVU's current and saving accounts (CASA) have depleted in the last 12 months to ~36% as of mid-July 2023 (vs. industry average of ~36%) from ~46% as of mid-July 2022. Declining low-cost deposits have increased the bank's cost of deposits in the recent periods. This has largely impaired the PRVU's competitive position amid the base rate plus lending regime.

Regulatory risk and difficult operating environment – The banking industry as well as banking sector borrowers have been facing stress from H1FY2022, following the roll-back of Covid-relaxations and introduction of stringent regulations affecting the fresh credit creation. The incremental regulatory changes have also remained stringent such as higher provisioning for group units in case of stress developed in any unit. The borrowing rates has remained sticky at higher level which has reduced the repayment ability of borrowers which coupled with the ineligibility of many borrowers for fresh loans after the implementation of working capital guidelines, could create asset quality stress and remains a rating concern across the industry.

Analytical approach: For arriving at the ratings, ICRA Nepal has applied its rating methodology as indicated below.
Links to applicable criteria:
Bank Rating Methodology
Issuer Rating Methodology

Links to last rating rationale:
Rationale PRVU Ratings Surveillance September 2022

Bank profile

PRVU is a class A commercial bank licensed by NRB that has grown into a sizeable industry player through a series of mergers and acquisitions. PRVU was formed after the merger of erstwhile Kist Bank Limited[2] with three other financial institutions including the then Prabhu Development Bank in September 2014. PRVU later acquired two more problematic institutions viz. Nepal Bikas Bank Limited (a problematic class B development bank) in 2015 and Grand Bank Limited in 2016. Recently, PRVU has acquired another class-A commercial bank, Century Commercial Bank Limited (CCBL) and started the consolidated operations from January 10, 2023.

PRVU is a part of the Prabhu Group, which has a long presence in remittance and financial sector in Nepal. As of mid-July 2023, the bank had a nationwide presence through 301 branches, 71 extension counters and 276 ATMs. PRVU's shareholding pattern among promoters and public is ~51:49 and its shares are listed in Nepal Stock Exchange. The registered and corporate office of the bank is in Babarmahal, Kathmandu. PRVU had a market share of 5.13% in terms of deposit base and 4.87% of total advances of Nepalese banking industry as of mid-July 2023 (5.82% and 5.51% share among the commercial banks).

[2] Kist was originally incorporated as class C finance company in 2002 and was upgraded to class A in 2009.

PRVU reported a profit after tax (PAT) of NPR 3,002 million in FY2023 (including the profit of CCBL for FY2023, till the date of acquisition) i.e., YoY increase of ~58% over an asset base of NPR 351,676 million as of mid-July 2023. As on the same date, PRVU's reported CRAR was 12.95% (tier I capital of 8.91%) and gross NPAs were 4.16%.

Key financial indicators

Year ending on	Mid July 2020 (Audited)	Mid July 2021 (Audited)	Mid July 2022 (Audited)	Mid-July 2023 (Unaudited)
	Standalone for PRVU			Consolidated*
Net Interest Income - NPR million	4,521	5,023	5,743	12,252
Profit before tax – NPR million	1,762	2,456	2,747	4,369
Profit after tax – NPR million	1,194	1,721	1,903	3,002
Loan and advances – NPR million	103,295	138,596	149,730	237,451
Total assets – NPR million	167,517	215,514	232,753	351,676
Operating ratios				
Yield on average advances	10.95%	9.37%	10.09%	13.58%
Cost of deposits	5.71%	4.87%	5.65%	7.67%
Net interest margin/ATA	2.96%	2.62%	2.56%	3.47%
Operating expenses/ATA	2.28%	2.19%	1.95%	1.97%
Credit provisions/ATA	0.35%	0.06%	0.19%	0.92%
PAT/ATA	0.78%	0.90%	0.85%	0.85%
PAT/net-worth	8.04%	10.59%	10.50%	9.28%
Gross NPAs	3.15%	1.68%	1.20%	4.16%
0+ days delinquencies	29.15%	9.69%	9.38%	22.77%
Capitalisation ratios				
Capital adequacy ratio	11.18%	13.07%	13.16%	12.95%
Tier-I Capital	9.37%	8.55%	8.90%	8.91%
Net NPAs/net worth	7.87%	5.36%	4.23%	13.54%
Liquidity ratios				
Total liquid assets/total liability	29.43%	27.31%	30.46%	25.49%
Total advances/total deposits	75.66%	81.66%	82.21%	80.24%

** P/L items are after consolidating the line items for the first ~6 months figure of CCBL before acquisition. Other financial ratios are also on the consolidated basis (taking the average of B/S items on consolidated basis of CCBL and PRVU for both FY2022 and FY2023).*

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About ICRA Nepal Limited

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