Kumari Bank Limited: Ratings downgraded and placed on Watch with Negative Implications

January 03, 2024

Summary of rating action

Facility/Instrument*	Rated Amount	Rating Action
Issuer rating	NA	[ICRANP-IR] BBB-@**; downgraded from [ICRANP-IR] BBB&
Subordinated Debenture	NPR 3,000 million	[ICRANP] LBBB-@; downgraded from [ICRANP] LBBB&

** Instrument details are presented in Annexure-1*

*** The symbol '@' indicates Rating Watch with Negative Implications, while the symbol '&' indicates Rating Watch with Developing Implications. Please refer here for further details on rating watch and its implications.*

Rating Action

ICRA Nepal has downgraded the issuer rating of Kumari Bank Limited (KBL) to **[ICRANP-IR] BBB-@** (pronounced ICRA NP Issuer Rating Triple B Minus) from **[ICRANP-IR] BBB&** (pronounced ICRA NP Issuer Rating Triple B), indicating moderate degree of safety regarding the timely servicing of financial obligations, with moderate credit risk. The rating has also been placed on 'Watch with Negative Implications'. The rating is only an opinion on the general creditworthiness of the rated entity and not specific to any particular debt instrument. The sign of + (plus) or – (minus) appended to the rating symbols indicates their relative position within the rating categories concerned.

ICRA Nepal has also downgraded the bank's subordinated debenture rating to **[ICRANP] LBBB-@** (pronounced ICRA NP L Triple B Minus) from **[ICRANP] LBBB&** (pronounced ICRA NP L Triple B) and placed the rating on 'Watch with Negative. 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 downgrade mainly factors in the sharp deterioration in the bank's tier-I capital (8.21% as of mid-October-2023 as against the regulatory minimum of 8.50%) amid the rising credit costs owing to major deterioration in asset quality profile (high gross non-performing asset (NPA) of 4.89% as of mid-October-2023). These concerns are further exacerbated by the bank's significantly elevated 0+ days delinquencies at ~29% as of mid-October 2023 (including ~13% in the 61-90 days bucket). The rating concerns also emanate from the bank's relatively low proportion of stable/low-cost deposits[1], resulting in the highest cost of funds in the industry. Despite a relatively lower operating expense ratio, higher cost of funds, recent expiry of interest spread cap relaxations (related to merger) and the asset quality concerns remain the major challenges in internal capital generation. The recent change in regulation requiring the counter-cyclical buffer of 0.5%, to be maintained by mid-July 2024, could further exacerbate the stress in capitalisation. Further, the bank's high deposit concentration (on the largest depositor as well as among the top-20 depositors) also remains a major rating concern, from the stability perspective of its funding profile.

Nonetheless, the ratings derive comfort from the banks' long operational track record and its improved market positioning, after the recent merger (~6% as of mid-October 2023). The bank's diversified network and improved credit portfolio granularity also remain the rating positives. Going forward, KBL's ability to improve its asset quality and capitalisation profile on a sustained basis, will remain the key rating sensitivity. A sustained inability to maintain capitalisation at tier-I level above regulatory levels along with any major increase in asset quality stress, could warrant a further rating action.

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[1] Low-cost deposits include current, saving and call deposits.

Key rating drivers

Credit Strengths

Long track record and diverse branch network – KBL has a long track record of operations (since 2001) in the Nepalese banking industry. Post-merger with Nepal Credit and Commerce Bank in January 2023, KBL's network coverage has improved with 308 branches across the country as of mid-October 2023 and its market share has improved to 6.38% in terms of total deposits and 6.68% in terms of total credit portfolio of the commercial banking industry as of mid-October 2023 (from 4.03% and 3.81% respectively as of mid-July 2022, when last rated, prior to the merger).

Improved credit portfolio granularity – The bank's portfolio concentration has improved, aided by the higher portfolio granularity of the acquired loan book. The concentration among top-20 borrowers has decreased to ~12% of total loan (109% of tier-I capital) as of mid-October 2023 from ~16% as of mid-January-2022 (151% of tier-I capital). Further, the credit mix also continues to remain fairly diversified (~44% SME/retail loans, ~5% towards DSL, rest being towards mid to large corporates).

Credit Challenges

Decline in tier-I capitalisation to below the regulatory minimum; overall CRAR cushion also remains low – KBL reported CRAR of 12.08% and tier-I capital of 8.21% as of mid-October 2023 (against 12.63% and 9.83% respectively as of mid-July 2022) as against the regulatory minimum CRAR of 11% and common equity tier-I capital of 8.5% (including capital conservation buffer). The bank witnessed a major decline in tier-I capitalisation following the rapid rise in NPAs, amid the backdrop of sizeable cash dividend distribution by both banks prior to the merger. Further, the recent change in regulation requiring counter cyclical buffer of 0.5% to be maintained by mid-July 2024, is likely to exert additional pressure on capitalisation. Any further stress over asset quality will result in muted internal accruals, thus impacting the ability to recoup the tier-I capitalisation and maintain adequate buffer over regulatory minimum, on a sustained basis.

Major deterioration in asset quality indicators – The bank has reported a major deterioration in its asset quality, wherein the NPAs have spiked to 4.89% as of mid-October 2023 (industry average of 3.61%) from 1.11% as of mid-July 2022. This was mainly on account of the pressure on large borrowers as well as retail/SME segment, amid the economic slowdown. Moreover, the 0+ days delinquency levels have also increased to ~29% in mid-October 2023 from ~13% as of mid-July 2022. Further, ~13% of the portfolio were in the 61-90 days' delinquency bracket (i.e. borderline to NPA category), which elevates the concerns regarding potential slippages. Ongoing economic slowdown and regulatory constrictions in the recent years could continue to further impact the operating environment and credit profile of the borrowers. The bank's ability to control incremental slippages and recover from the existing NPAs will remain crucial for its incremental profitability and capitalisation indicators and therefore remains a key rating sensitivity.

Moderation in return indicators owing to increased credit cost – KBL's profitability indicators in FY2023 were mainly impacted by the deterioration in asset quality and the resultant rise in credit cost. Since the net interest margins in last 12 months were supported by the relaxations on interest spread cap until December 2023 (i.e., one year from the commencement of combined operations after the merger), the expiry of such relaxation is likely to exert further pressure on the bank's profitability. Furthermore, the recently paid out prior-period taxes (~NPR 580 million) related to the bargain purchase gains during the earlier mergers/acquisitions, would be impacting the near-term profitability and capitalisation profile. The bank's ability to maintain adequate profitability amid the pressure on interest margins and asset quality remains to be seen.

Relatively inferior deposit profile with high deposit cost and high concentration – The bank's cost of deposits has continued to remain among the highest in the industry owing to its inferior mix of low-cost deposits at ~32% as of mid-October 2023 against ~42% for the industry. For Q1FY2024, the bank's cost of deposits stood at 8.73% (highest in the industry and ~100 bps higher than the industry average). Hence, KBL's base rate remains at the highest end, which is a competitive disadvantage in the "base rate plus" lending regime. The bank's deposit concentration also continues to remain high with ~5% coming from the largest depositor and the top-20 depositors accounting for ~29% of the total deposits as of mid-October 2023 (albeit sharply moderating from ~32% as of mid-January 2022). Rating concerns along the deposit concentration are heightened, amid the likely pressures in funding profile in the event of any further increase in NPAs.

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

Links to the applicable criteria:
Bank Rating Methodology
Issuer Rating Methodology

Links to the last rating rationales:
Rationale_KBL_Update-for-merger_November-2022
Rationale_NCC_Update-for-merger_November-2022

Bank Profile

Incorporated in 2001, Kumari Bank Limited (KBL) has undertaken multiple merger and acquisitions with various financial institutions in recent years. With these mergers and acquisitions (recent one being the merger in January 2023 with Nepal Credit and Commerce Bank Limited), the bank has become a decent-sized commercial bank of Nepal in terms of asset base and market share. KBL now has presence across the country through its 308 branches as of mid-October 2023. The bank currently has a market share of 6.38% in terms of deposit base and 6.68% in terms of the credit portfolio of commercial banks as of mid-October 2023.

KBL reported profit after tax (PAT) of NPR 518 million during FY2023 over an asset base of NPR 380,525 million as of mid-July 2023. For Q1FY2024, the PAT stood at NPR 264 million. As of mid-October 2023, KBL's CRAR was 12.08% (tier-I CRAR of 8.21%) and gross NPAs were 4.89%. 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 ending on	Mid-July 2020 (Audited)	Mid-July 2021 (Audited)	Mid-July 2022 (Audited)	Mid-July 2023 (Provisional)*	Mid-Oct 2023 (Provisional)
Net interest income - NPR million	3,573	5,078	6,217	11,066	3,042
Profit before tax - NPR million	1,709	3,039	3,594	1,002	438
Profit after tax - NPR million	1,159	1,971	2,580	518	264
Gross loan and advances - NPR million	117,045	143,503	159,444	289,388	295,352
Total assets - NPR million	145,972	189,783	212,108	380,525	390,792
Operating ratios					
Yield on average advances	10.07%	8.77%	10.98%	14.37%	13.11%
Cost of deposits	6.87%	5.24%	6.35%	8.35%	8.73%
Net interest margin/ATA	2.84%	3.02%	3.09%	3.73%	3.16%
Non-interest income/ATA	0.71%	0.97%	0.87%	0.69%	0.97%
Operating expenses/ATA	1.82%	1.90%	1.77%	1.34%	1.41%
Credit provisions/ATA	0.37%	0.28%	0.40%	2.74%	2.26%
PAT/ATA	0.92%	1.17%	1.28%	0.17%	0.27%
PAT/net worth	7.99%	10.90%	12.93%	1.84%	2.92%
Gross NPAs	1.39%	0.96%	1.11%	4.96%	4.89%
0+ days delinquencies	14.70%	6.04%	13.45%	20.13%	28.53%

Year ending on	Mid-July 2020 (Audited)	Mid-July 2021 (Audited)	Mid-July 2022 (Audited)	Mid-July 2023 (Provisional)*	Mid-Oct 2023 (Provisional)
Capitalisation ratios					
Capital adequacy ratio	15.35%	13.71%	12.63%	12.11%	12.08%
Tier-I Capital	12.01%	10.64%	9.83%	8.13%#	8.21%
Net NPAs/net worth	1.44%	1.99%	2.10%	11.12%	9.74%
Liquidity ratios					
Total liquid assets/total liability	19.62%	23.04%	22.63%	22.37%	23.13%
Total advances/total deposits	98.26%	90.99%	86.58%	86.03%	85.85%

** For FY2023, the pre-merger performance of the erstwhile Nepal Credit and Commerce Bank Limited were directly adjusted in the retained earnings of the merged entity, which also resulted in moderation of profitability ratios.*
 # Decreased from initially published 8.83%, upon addition of credit provisions by regulator/statutory auditors.

Annexure-1: Instrument details

Instrument	Amount (NPR million)	Expiry	Rating Action
10.25% KBL Debenture 2086	3,000	February 1, 2030	[ICRANP] LBBB-@; downgraded from [ICRANP] LBBB& and placed on watch with negative implications
Total	**3,000**		

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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.

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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