

Prabhu Bank Limited: Ratings downgraded to [ICRANP-IR] BBB-@ and [ICRANP] LBBB-@

February 20, 2024

Summary of rating action

Facility/Instrument	Rated Amount	Rating Action
Issuer Rating	NA	[ICRANP-IR] BBB-@ ¹ ; downgraded from [ICRANP-IR] BBB@ with continuation of 'Watch with Negative Implications'
Subordinated Debentures	NPR 1,000 million	[ICRANP] LBBB-@; downgraded from [ICRANP] LBBB@ with continuation of 'Watch with Negative Implications'

Rating action

ICRA Nepal has downgraded the issuer rating assigned to Prabhu Bank Limited (PRVU) to [ICRANP-IR] BBB-@ (pronounced ICRA NP issuer rating triple B minus) from [ICRANP-IR] BBB@ (pronounced ICRA NP issuer rating triple B) with continuation of 'Watch with Negative Implications'. Issuers with this rating are considered to have 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 downgraded the rating assigned to the bank's subordinated debentures to [ICRANP] LBBB-@ (pronounced ICRA NP L triple B minus) from [ICRANP] LBBB@ (pronounced ICRA NP L triple B) with continuation of 'Watch with Negative Implications'. Instruments with this rating are considered to have a moderate degree of safety regarding the timely servicing of financial obligations. Such instruments carry a moderate credit risk.

Rationale

The ratings downgrade is mainly on account of the sharp deterioration in the bank's tier-I capital (8.12% as of mid-January 2024 as against 8.91% as of mid-July 2023, during last rating; regulatory minimum of 8.5%) amid the rising asset quality stress. The bank's non-performing asset (NPAs) have increased to 4.90% and the 0+ days delinquencies (DPDs) increased to 32.25% (4.16% and 22.77% respectively as of mid-July 2023). This has weakened the bank's solvency profile (net NPA to net worth) to ~14%, remaining on a higher side in the industry peers as of mid-January 2024. The increasing credit costs along with the decline in net interest margins (NIMs) have led to moderation in PRVU's profitability indicators for H1FY2024. 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 bank's capitalisation profile.

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. Going forward, PRVU's ability to improve its asset quality and capitalization profile on a sustained basis, will remain the key rating sensitivity. A sustained inability to maintain capitalization at tier-I level above regulatory levels along with any major increase in asset quality stress, could warrant a further rating action.

Key rating drivers

Credit strengths

Affiliation to the Prabhu Group with experienced directors/management team – Operating since 2002, PRVU has an adequate track record 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

¹ The symbol '@' denotes rating on "Watch with Negative Implications". Please refer [here](#) for further details on rating watch and its implications.

presence in financial and other sectors) and shared brand name provides comfort. Post-acquisition of Century Commercial Bank Limited (CCBL), PRVU's network coverage has also improved, which could aid in diversified growth.

Credit challenges

Weakened capitalisation with tier-I recently reported below the regulatory minimum – PRVU reported capital to risk weighted assets ratio (CRAR) of 11.82% and tier-I capital of 8.12% as of mid-January 2024 (12.95% and 8.91% respectively as of mid-July 2023) as against the regulatory minimum of 11% and 8.5% respectively (including capital conservation buffer). The capitalisation was mainly impacted by the steady rise in NPAs. Further, the recent regulation requiring counter cyclical buffer of 0.5% to be maintained by mid-July 2024, is likely to exert additional pressure on the bank's capitalisation. Any further stress over asset quality will result in muted internal accruals, thus impacting the ability to recoup the tier-I capitalisation.

Increasing asset quality stress – The bank reported sustained deterioration in its asset quality since the last rating, wherein NPAs have spiked to 4.90% as of mid-January 2024 (industry average of 3.63%) from 4.16% as of mid-July 2023. Moreover, the 0+ DPDs have increased to ~32% as of mid-January 2024 from ~23% as of mid-July 2023. Amid the recent slippages in lower provisioning category, the bank's solvency profile also remains weak at 13.79% as of mid-January 2024. Although the rising delinquency can be partly attributed to the integration of credit book acquired from CCBL, sustained asset quality pressures are likely, given the unfavourable economic environment created by regulatory changes like introduction of stringent working capital guidelines along with the inflationary impact on demand for major borrowers etc. 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.

Stressed profitability – Despite the 1% relaxation on interest spread cap (of 4%) being available until mid-January 2024 (i.e., one year from the commencement of combined operations after acquisition of CCBL), the bank's NIMs declined to 2.74% in H1FY2024 from 3.51% in FY2023. This, along with the high credit costs amid deteriorated asset quality has impacted PRVU's profitability indicators. Accordingly, the bank reported a return on average total assets (ATA) and return on net worth of 0.41% and 4.40%, respectively, for H1FY2024 (0.97% and 10.69% respectively for FY2023). The bank's ability to improve its profitability amid interest margin and asset quality pressures will remain crucial.

Regulatory risk and difficult operating environment – The banking industry as well as borrowers have been facing stress from H1FY2022, following the roll-back of Covid-relaxations and introduction of stringent regulations affecting fresh credit creation. The incremental regulatory changes have also remained stringent such as introducing the requirement of borrower-wise provisioning (against facility-wise provisioning also in practice across major banks) and higher provisioning requirement for group units in case of stress reported in any group unit. The borrowing rates have remained elevated until recent months, which coupled with the high debt burden, has reduced the repayment capability of the borrowers. This coupled with the ineligibility of many borrowers for fresh loans after the implementation of working capital guidelines, has exacerbated liquidity pressure across the spectrum, which is partly reflected in increased asset quality stress for banks and hence remains a rating concern across the industry. Further, the regulation to maintain interest rate differential at 2% among the same-category loans is likely to impact on the interest margins and profitability going forward.

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](#)

Link to the last rating rationale:

[Rationale Prabhu Bank Ratings Surveillance October 2023](#)

Bank profile

Prabhu Bank Limited (PRVU) is a class A commercial bank, which has grown into a sizeable industry player through a series of mergers and acquisitions, with the recent one being the acquisition of Century Commercial Bank Limited (CCBL) in January 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 presence through 301 branches, 71 extension counters and 276 ATMs across the country. PRVU's shareholding pattern among promoters and public is ~51:49 and its shares are listed in the Nepal Stock Exchange. The registered and corporate office of the bank is in Babarmahal, Kathmandu. PRVU had a market share of 4.68% in terms of deposit base and 4.52% of total advances of Nepalese banking industry as of mid-January 2024 (5.28% and 5.11% share among the commercial banks). PRVU reported a profit after tax (PAT) of NPR 720 million in H1FY2024, over an asset base of NPR 344,660 million as of mid-January 2024. As on the same date, PRVU's reported CRAR was 11.82% (tier I capital of 8.12%) and gross NPAs were 4.90%.

Key financial indicators

Year ending on	Mid July 2020 (Audited)	Mid July 2021 (Audited)	Mid July 2022 (Audited)	Mid July 2023 (Unaudited)*	Mid January 2024 (Unaudited)
	Standalone for PRVU				
Net Interest Income - NPR million	4,521	5,023	5,743	10,258	4,767
Profit before tax – NPR million	1,762	2,456	2,747	4,074	1,447
Profit after tax – NPR million	1,194	1,721	1,903	2,825	720
Loan and advances – NPR million	103,295	138,596	149,730	237,451	229,579
Total assets – NPR million	167,517	215,514	232,753	351,676	344,660
Operating ratios					
Yield on average advances	10.95%	9.37%	10.09%	13.70%	11.95%
Cost of deposits	5.71%	4.87%	5.65%	7.56%	7.37%
Net interest margin/ATA	2.96%	2.62%	2.56%	3.51%	2.74%
Operating expenses/ATA	2.28%	2.19%	1.95%	1.99%	1.89%
Credit provisions/ATA	0.35%	0.06%	0.19%	0.83%	0.72%
PAT/ATA	0.78%	0.90%	0.85%	0.97%	0.41%
PAT/net-worth	8.04%	10.59%	10.50%	10.69%	4.40%
Gross NPAs	3.15%	1.68%	1.20%	4.16%	4.90%
0+ days delinquencies	29.15%	9.69%	9.38%	22.77%	32.25%
Capitalisation ratios					
Capital adequacy ratio	11.18%	13.07%	13.16%	12.95%	11.82%
Tier-I Capital	9.37%	8.55%	8.90%	8.91%	8.12%
Net NPAs/net worth	7.87%	5.36%	4.23%	13.54%	13.79%
Liquidity ratios					
Total liquid assets/total liability	29.43%	27.31%	30.46%	25.49%	24.55%
Total advances/total deposits	75.66%	81.66%	82.21%	80.24%	80.03%

* Due to merger with CCBL from mid-January 2023, some financial ratios for FY2023 remain distorted.

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About ICRA Nepal Limited

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