Sanima Bank Limited: Ratings placed on watch with negative implications

February 26, 2024

Summary of rating action

INSTRUMENT/FACILITY	RATED AMOUNT	RATING ACTION
Issuer Rating	NA	[ICRANP-IR] A-@*; placed on watch with negative implications
Subordinated Debenture	~NPR 1,355[1] million	[ICRANP] LA-@; placed on watch with negative implications
Subordinated Debenture	~NPR 3,052[2] million	[ICRANP] LA-@; placed on watch with negative implications

**@ indicates rating Watch with Negative Implications*

Rating Action

ICRA Nepal has placed the issuer rating assigned to Sanima Bank Limited (Sanima) on 'Watch with Negative Implications' (denoted by @); revised rating is [ICRANP-IR] A-@ (pronounced ICRA NP issuer rating A minus @). Issuers with this rating are considered to have adequate degree of safety regarding the timely servicing of financial obligations. Such issuers carry low credit risk. The sign of + (plus) or – (minus) appended to the rating symbol indicates the entity's relative position within the rating categories concerned. The issuer 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 placed the ratings assigned to the bank's subordinated debentures on 'Watch with Negative Implications' (denoted by @); revised rating is [ICRANP] LA-@ (pronounced ICRA NP L A minus @). Instruments with this rating are considered to have adequate degree of safety regarding the timely servicing of financial obligations. Such instruments carry low credit risk. The sign of + (plus) or – (minus) appended to the rating symbol indicates the instrument's relative position within the rating categories concerned.

Rationale

The rating watch with negative implications mainly factors the stress on asset quality developing across the banking industry, which is also reflected in the rising delinquency level of Sanima's credit portfolio. Moreover, the incremental outlook for banking industry asset quality remains moderate to weak, given high leverage across the spectrum of borrowers, ongoing moderation in demand and reduced liquidity at borrower's level following the implementation of working capital guidelines by the central bank on lender banks; which remains the major reason behind the rating watch. Although Sanima continues to fare relatively better than industry average and peers in terms of gross non-performing loans (NPLs), it has nonetheless reported an uptick in NPLs to 1.72% as of mid-January 2024 from 1.31% as of mid-July 2023 (~0.77% as of mid-January 2023, when last rated). Sanima's 0+ days delinquencies continues to remain elevated at ~26% as of mid-January 2024 (~15% as of mid-July 2023 and ~19% on mid-January 2023, when last rated), which raises concerns. As of mid-January 2024, the reported NPLs for the banking industry (including Sanima) remains benefitted by rescheduling/restructuring provisions introduced by central bank and therefore its continuation/similar regulatory forbearance will have an impact on incremental financial profile of banks. While Sanima continues to report better profitability indicators (RoA and RoE) among the industry peers, the moderation in net interest margins (NIMs) amid the regulatory reduction in interest spread cap (reduced from 4.4% to 4% with effect from FY2024) and rising credit cost (provisioning expenses) is likely to dampen the bank's ability to generate internal capital.

Nonetheless, the ratings derive comfort from the improvement in capitalization profile reported by the bank in recent quarters despite the asset quality pressure. The bank's tier-I capital stood at 9.96% with overall CRAR of 13.64% as of mid-January 2024 vis-à-vis 9.42% and 13.39% respectively as of mid-January 2023, when last rated. This partly stems from the slowdown in growth of risk assets and relatively better profitability/internal accruals than industry players. Improved capital position is expected to improve the bank's ability to better withstand near-term credit shocks. Sanima's liquidity and funding profile remains comfortable with fairly granular deposit base (top-20 deposits accounting for ~16% of total deposits), strong proportion of individual deposits and comfortable net liquid assets (NLA) proportion of ~28%

1 10% Sanima Debenture 2085
2 8.5% Sanima Debenture 2087

as of mid-January 2024. Sanima's adequate track record (operating since 2004[3]) and adequate branch network (105 branches and 28 extension counters) along with its experienced management team continue to remain a positive from long-term growth, diversification and sustainability perspective.

Going forward, the bank's ability to control its asset quality will remain a major monitorable and rating sensitivity over the near to medium term. Moreover, the bank's ability to maintain adequate capital position on an ongoing basis amid the asset quality pressure will also remain among key monitorable.

Key rating drivers

Credit strengths

Adequate track record and branch network – Operating since 2004 (since 2012 as a commercial bank), Sanima has an adequate track record of operations in the Nepalese banking arena. Despite being the youngest commercial bank in the industry, Sanima has established a good track record of growth, profitability, asset quality and management of funding profile over the years. The bank also has an adequate presence across the country through its 133 branches (including 28 extension counters) as of mid-January 2024, which has supported a diversified and granular portfolio growth (especially on the funding side).

Adequate capitalisation profile – Sanima's capitalisation profile has improved since last rating with the bank reporting tier-I capital of 9.96% and overall CRAR of 13.64% as of mid-January 2024 (9.42% and 13.39% as of mid-January 2023, when last rated). This was partly aided by the interim profit accruals and slow growth in risk assets, despite being challenged by the dividend payout from FY2023 profits and rising pressure on asset quality. The current capitalization level is adequate vis-à-vis the regulatory minimum tier-I of 8.5% and CRAR of 11.0% as well as additional countercyclical buffer of 0.5% to be maintained by mid-July 2024. As the asset quality pressure in the industry is likely to persist over near to medium term, the ability of the bank to maintain the capital cushion on an ongoing basis will have a bearing on the bank's ability to better withstand any credit shocks.

Comfortable liquidity position and granular deposit portfolio – Sanima's liquidity position remained comfortable with net liquid assets (NLA) to deposit ratio of ~28% and credit to deposit ratio (CD ratio) of ~78% as of mid-January 2024 against the regulatory floor of 20% and ceiling of 90% respectively. Further, the bank's deposit profile remains fairly granular with top-20 depositors accounting for ~16% of total deposits as of mid-January 2024. Although Sanima's overall CASA deposits remain marginally lower than commercial bank average as of mid-January 2024, it fares comparable to the industry average in terms of savings deposit proportion which coupled with the bank's strong base of individual depositors offers comfort to the long-term stability of its funding profile.

Credit challenges

Deterioration in asset quality, albeit with better-than-industry NPL level – In line with the industry trend, Sanima reported deterioration in asset quality with gross NPLs of 1.72% as of mid-January 2024 vis-à-vis 1.31% as of mid-July 2023 (0.77% as of mid-January 2023, when last rated). Despite moderation, Sanima's asset quality and solvency profile (net NPL to net worth of ~6%) fares better than the industry average (commercial banking industry NPLs ~3.63% as of mid-January 2024). Nonetheless, elevated credit portfolio delinquency (0+ days overdue loans accounting for ~26% of total loans), rising delinquency in higher maturity buckets (~5.6% of loan portfolio in 60-90 days overdue bucket) and generally weak asset quality outlook for the industry raises concern on the incremental NPL and solvency level of the bank. As of mid-January 2024, the reported NPLs of banking industry in general (including Sanima bank) remains partly benefitted by the relaxation from the central bank in rescheduling/restructuring of stressed account. The near-term NPL level of the industry is likely to remain dependent on the continuation of similar regulatory forbearance. While the recent stress in asset quality has been more pronounced in SME segment across the industry, Sanima's high credit portfolio concentration (~23% of total credit portfolio among top 20 borrowers/group), nonetheless, exposes the bank to the risk emanating from slippage of higher-ticket loans.

3 Operated as class B bank before its upgradation into class A commercial bank in 2012

Moderation in profitability indicators – Sanima reported adequate profitability in FY2023 with return on assets (RoA) of 1.28% and return on net worth (RoNW) of 14.36% aided by the healthy net interest margins. However, downward revision in interest spread ceiling by the regulator (earlier 4.4% to 4.0%), falling CD ratio amid subdued credit demand and increased credit provisioning cost have dampened the profitability indicators in H1FY2024, despite being supported by controlled operating expense ratio and increase in non-interest income. Nonetheless, the bank continues to report better return on assets (RoA) and return on net worth (RoNW) than many of the peers that have reported a material deterioration in asset quality. Over the near to medium term, Sanima's profitability is likely to remain largely driven by its ability to maintain asset quality and control the provisioning expense.

Regulatory risk and moderation in operating environment – The banking industry as well as banking sector borrowers have been reporting steady deterioration in credit profile following the roll-back of Covid-relaxations announced by central bank in H1FY2022, followed by import restrictions by the government for most part of 2022 in order to shore up foreign reserves and subsequent introduction of stringent regulations from the central bank (such as introduction of working capital guidelines, tighter norms on classification of loans and NPL recognition, etc). The recent regulations, especially the working capital guidelines, has reduced the eligibility of many borrowers for fresh credit and affected the pace of fresh credit creation by lender banks creating liquidity shortage across the businesses' supply chain which in turn has reduced the demand. As such, the credit profile of the borrowers is likely to weaken over the near to medium term which is likely to commensurately affect the asset quality of lender banks.

Link to previous rating rationale:
Issuer and Debenture rating surveillance – February 2023

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

Company profile

Sanima Bank Limited (Sanima) started operations in 2004 as a national level class-B development bank and was upgraded into a class A commercial bank in February 2012. The bank's major promoters comprise of individuals from Non-Resident Nepalese (NRN) community. The bank's equity share is listed in Nepal Stock Exchange (NEPSE) with a market capitalization of ~NPR 35 billion as of mid-January 2024.

Sanima's head office is located at Naxal, Kathmandu and the bank has a pan-Nepal presence through its 105 branches and 28 extension counters as of mid-January 2024. The bank has a market share of ~3% in terms of total advances as well as total deposit base of Nepalese Banking Industry as on mid-January 2024 (~3.5% share among the commercial banks). Sanima reported a profit after tax of NPR 2,606 million in FY2023 over an asset base of NPR 215,643 million as of mid-July 2023. During H1FY2024, Sanima reported profit after tax of NPR 1,139 million over an asset base of NPR 223,368 million. As of mid-January 2024, Sanima's CRAR stood at 13.64% (tier I capital of 9.96%) while its gross NPL stood at 1.72%.

Key financial indicators

YEAR ENDED	Mid July 2021 (Audited)	Mid July 2022 (Audited)	Mid July 2023 (Audited)	Mid-January 2024 (Provisional)
Net Interest Income – NPR million	4,525	4,652	6,479	3,017
Profit before tax – NPR million	3,309	2,949	3,730	1,574
Profit after tax – NPR million	2,318	2,093	2,606	1,139
Loan and advances – NPR million	123,165	140,829	150,049	157,028
Total assets – NPR million	160,751	192,511	215,643	223,368
OPERATING RATIOS				
Yield on average advances	8.75%	9.73%	12.72%	12.04%

YEAR ENDED	Mid July 2021 (Audited)	Mid July 2022 (Audited)	Mid July 2023 (Audited)	Mid-January 2024 (Provisional)
Cost of deposits	4.95%	6.49%	8.09%	7.88%
Net Interest Margin/ATA	3.15%	2.63%	3.17%	2.75%
Non-interest Income/ATA	0.85%	0.77%	0.58%	0.88%
Operating Expenses/ATA	1.58%	1.43%	1.41%	1.43%
Credit Provisions / ATA	0.17%	0.31%	0.52%	0.77%
PAT / ATA	1.61%	1.19%	1.28%	1.04%
PAT / Net Worth	16.71%	13.15%	14.36%	11.66%
Gross NPAs	0.12%	0.33%	1.31%	1.72%
0+ days delinquencies	5.59%	4.29%	15.00%	25.72%
CAPITALISATION RATIOS				
Capital Adequacy Ratio	13.57%	13.66%	14.42%	13.64%
Tier I capital	9.29%	9.52%	10.37%	9.96%
Net NPAs/Net Worth	0.15%	1.49%	4.88%	5.98%
COVERAGE & LIQUIDITY RATIOS				
Total Liquid Assets/Total Liability	20.97%	23.97%	27.41%	27.00%
Total Advances/Total Deposits	94.10%	89.18%	83.80%	85.00%

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About ICRA Nepal Limited

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