Kumari Bank Limited

ICRA Nepal assigns issuer rating of [ICRANP-IR] BBB+ and [ICRANP] LBBB+ to proposed subordinated debenture programme

Facility/Instrument	Amount	Rating Action (September 2019)
Issuer Rating	NA	[ICRANP-IR] BBB+ (Assigned)
Subordinated Debenture Programme	NPR 3,000 Million	[ICRANP] LBBB+ (Assigned)

ICRA Nepal has assigned an issuer rating of **[ICRANP-IR] BBB+** (pronounced ICRA NP issuer rating triple B plus) to Kumari Bank Limited (KBL). The rating is considered to have a moderate degree of safety, regarding the timely servicing of financial obligations with the rated entity carrying moderate credit risk. The issuer rating is only an opinion on the general creditworthiness of the rated entity and not specific to a particular debt instrument. The sign of + (plus) or – (minus) is appended to the rating symbol to indicate their relative position within the rating category concerned.

ICRA Nepal has also assigned **[ICRANP] LBBB+** (pronounced ICRA NP L triple B plus) to the proposed subordinated debenture programme of KBL. 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.

The rating actions factor in the bank's adequate track record (since 2001) and its improving risk management practices in last few years. This is reflected in its asset quality indicators with non-performing loans (NPLs) declining to 0.97% as of mid-July 2019 (0+ dpd of ~7%) compared to 1.86% as of mid-July 2017. The rating also takes comfort from the ability of the bank to manage the risks arising out of acquisition of various classes of banks (in June 2017), which had relatively inferior underwriting norms and borrower quality. The ratings also factor in the bank's fairly diversified credit portfolio with ~51% retail/SME loans resulting in moderate credit concentration risks (~19% among top 20 borrowers as on mid-July 2019). The bank's experienced senior management team, along with its improving market position through rapid franchise expansion remain positives for sustainable growth over the medium term. The franchise expansion plans augur well for the growth of the retail/SME segments which could further lower portfolio concentration risks and help improve yields. This in turn is likely to support its profitability profile going forward.

Nonetheless, the ratings remain constrained by KBL's weak deposits profile with low chunk of current and savings accounts (CASA) at ~28% as on mid-July 2019 (~43% for industry). This has kept the cost of funds relatively higher and hence weakened its competitive positioning in the current base rate-based lending regime. Additionally, the concentration among top 20 depositors remains on the higher side (~30% as on mid-July 2019), which could pressurise its liquidity profile in case of increased volatility in interest rates. Though the bank's credit growth remained low at ~15% in the low interest rate regime of FY2015-2017, a spike in the credit growth trend in the last two years (~30% against ~20% growth in industry) with similar plans over the near term, also remain rating concerns. The bank's declining capitalisation (CRAR of 12.07% as of mid-July 2019) is also a concern, although it is comfortable against the regulatory minimum of 11%. However, this is expected to be supplemented by the proposed debenture issue plans. ICRA Nepal also takes note of bank's lower profitability profile with return on net worth (RoNW) and return on assets (RoA) of ~12% and 1.46% respectively in FY2019 (~16% and 1.96% for industry), primarily on account of lower net interest margins (NIMs) of 3.30% for FY2019 (3.82% for the industry). However, KBL's margins are already compliant with the recently revised interest spread calculation norms while many players in the industry would need to lower their spreads. The rating is also constrained by the lack of strong institutional promoters and the uncertain operating environment/liquidity constraints that the banks in Nepal are currently facing, which could have a bearing over the bank's growth plans. Its ability to grow its portfolio judiciously, improve its mix/cost of deposits and sustain the improvement in its asset quality and overall financial profile would remain the key rating drivers.

KBL's credit growth remained much higher compared to the industry at ~30% for the last two years ending on mid-July 2019 (~20% for the industry). Though the high growth plans would compensate for the lost market share in the earlier years, seasoning of incremental growth could increase the stress over future asset quality. Additionally, the incremental growth had been achieved following penetration along the corporate loan segment, which rose to ~49% of the portfolio as of mid-April 2019 (~32% on mid-July 2017), the rest being retail/SME loans. Nevertheless, the bank's credit portfolio remains fairly diversified so far with moderate credit concentration among top 20 borrowers (~19% of portfolio and 133% of tier I capital as of mid-July 2019). The bank's yields on advances generally remain slightly higher compared to the industry, which has further increased in the recent years to 12.74% in FY2019 (10.72% in FY2017), in line with the industry trend. This was also partly supported by the booking of interest income on an accrual basis from FY2018, as per the revised financial reporting framework[1]. Going forward, the management intends to grow more along the retail and the SME segments and hence downsize the share of corporate loans. The bank's ability to achieve the growth targets along with commensurate risk control measures would have a key bearing on its financial profile.

On the asset quality front, the bank's NPLs have improved in the recent years to 0.97% as of mid-July 2019 from 1.86% as of mid-July 2017. With low fresh generation in the last two years (~0.5%) and modest recoveries (~40%), the NPL levels now remain lower among the peers and the industry average of 1.40% as on mid-July 2019. Moreover, overall 0+ days delinquencies also remain comfortable at ~7% as of mid-July 2019. With a provision cover of ~76% as on same date, the bank's impact on solvency (net NPA/net worth) also remains low at 1.87%. Going forward, the asset quality of the banking sector, including KBL, is expected to witness some moderation due to a decline in the repayment capability of borrowers, following the increased interest rates. Hence, the bank's ability to maintain a comfortable asset quality profile, as the incremental portfolio gets more seasoned, would remain a key rating factor.

KBL fares weaker on the deposit front with lower share of stable/low-cost CASA deposits (~28% as of mid-July 2019 against ~43% for industry). This leads to higher cost of funds (8.00% in FY2019 against 6.48% for the industry) and hence impacts its competitive strength in the base rate-based lending regime, a major rating concern. Given the bank's sizeable chunk of term deposits (mostly for the one-year period) at ~55% as of mid-July 2019 (~47% as ofmid-July 2018), the volatile interest rate scenario could have a bearing on its cost of funds. In line with the credit growth, deposit growth was also higher compared to the industry at ~28% in the last two fiscals (~17% for the industry) despite volatile liquidity in the market and hence remains a positive. However, deposit concentration on the top 20 accounts remains high at ~30% as of mid-July 2019. Going forward, the bank's ability to improve its deposit mix and cost would remain a key monitorable.

As for capitalisation, KBL reported a CRAR of 12.07% and tier I capital of 11.20% as of mid-July 2019 (both as per Basel III), slightly above the regulatory minimum of 11% and 8.5%, respectively (both including capital conservation buffer (CCB) of 2.5%). The tier-I requirement has been recently increased to 10.5% (to be met by mid-July 2020) including the 2% countercyclical buffer requirements for FY2020. In addition to providing capital support for its growth targets, the bank's debenture issue plans would also aid compliance with the recent regulatory requirement of issuing 25% of paid up capital as debentures. The bank's ability to maintain the requisite capital levels while maintaining an appropriate dividend policy would remain crucial.

On the profitability front, KBL's return indicators remain lower compared to the industry with an RoNW of 11.91% in FY2019 (15.95% for industry) and an RoA of 1.46% in FY2019 (1.96% for industry). This was primarily due to lower NIMs of 3.30% for FY2019 (3.82% for industry), a result of its high cost of funds along with high exposure in the corporate segment with comparatively lower yields. The bank's non-operating income remained low at 0.86% of average total assets (ATA) while the operating costs increased to 1.81% in FY2019 (1.76% in FY2018) due to branch expansion. These factors along with expected stress in asset quality could exert pressure on its future profitability profile. However, the increasing scalability could provide some support. Additionally, KBL's latest margins are largely compliant to the revised interest spread cap of 4.4% (earlier 4.5% which used to include yield on government securities that is also to be excluded henceforth) and hence its profitability would not be impacted to comply with revised norms. Going

[1] *Nepal Financial Reporting Standards (NFRS), adopted from FY2018, requires accrual-based interest income booking on loans; this used to be on a cash basis, as per earlier regulations.*

forward, KBL's ability to maintain healthy NIMs and manage the asset quality would have a key bearing on its profitability profile.

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

Links to applicable criteria:
Issuer Rating Methodology
Bank Rating Methodology

Bank Profile
Kumari Bank Limited is the 15th Class 'A' commercial bank of Nepal, which has been in operation from April 2001. In June 2017, KBL acquired four various classes of banking and financial institutions in a bid to raise the minimum paid up capital as required by the regulator. The acquisition increased the capital fund and assets base of KBL in addition to increasing its footprints across the country. The corporate office of the bank is located at Tangal, Kathmandu. The share capital of the bank is distributed among the promoter and the public in the ratio of 51:49. The shares of KBL are registered and traded at the Nepal Stock Exchange (NEPSE). Mr. Surender Bhandari is the Chief Executive Officer of the bank.

KBL has made its presence felt throughout the country through its 105 branches, three branchless banking and 84 ATMs as of mid-July 2019. The bank has a market share of 2.54% in terms of deposit base and 2.63% of total advances of Nepalese banking industry as on mid-July 2019 (2.96% and 3.06% share among the commercial banks). KBL reported a profit after tax of NPR 1,334 million during FY2018-19 (28% YoY growth) over an asset base of NPR 100,257 million as of mid-July 2019. As on same date, KBL's CRAR was 12.07% (tier I CRAR 11.20%) and gross NPLs were 0.97%. In terms of technology platform, KBL has implemented Finacle across all its branches

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About ICRA Nepal Limited:
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