Prabhu Bank Limited

ICRA Nepal assigns [ICRANP-IR] BBB to Prabhu Bank Limited and [ICRANP] LBBB to proposed subordinated debenture programme

Facility/Instrument	Amount	Rating Action (May 2019)
Issuer Rating	NA	[ICRANP-IR] BBB (Assigned)
Subordinated Debenture Programme	NPR 1,000 Million	[ICRANP] LBBB (Assigned)

ICRA Nepal has assigned an issuer rating of **[ICRANP-IR] BBB** (pronounced ICRA NP issuer rating triple B) to Prabhu Bank Limited (PRVU). This rating is considered to be of moderate credit quality. The rated entity carries 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) to the proposed subordinated debenture programme of PRVU. 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 assigned ratings factor in PRVU's healthy deposits profile with a higher share of low-cost current and savings accounts (CASA) compared to the industry (~44% against 41% as of mid-January 2019). As a result, the bank has a relatively lower cost of deposits compared to its peers (6.04% for the bank compared to 6.50% for the industry in H1 FY2019) and hence remains a key competitive strength. PRVU's diversified franchise (169 branches as of mid-January 2019) has led to good market positioning in Nepal with a share of ~4% in industry deposits and credits. This, along with further franchise expansion plans, the experienced board of directors and senior management team, augurs well for PRVU's growth prospects, going forward. The ratings also factor in the bank's ability to improve its overall financial profile during the last 3-4 years despite having merged with/acquired much weaker financial institutions with high non-performing loans (NPLs). This was aided by gradual improvements in the bank's operational profitability during this period. Though the profitability was not supported by sizeable provision write-backs, as in earlier years, the bank was able to report RoNW and RoA[1] of ~16% and ~1.8%, respectively, in H1 FY2019, which remains a rating positive. The ratings also take into consideration PRVU's balanced portfolio mix and hence relatively low customer concentration risks.

Nonetheless, the ratings remain constrained by the bank's inferior asset quality with gross NPLs of 2.47% as of mid-January 2019 (1.48% for the industry) and 0+ days delinquencies of ~10%. While ICRA Nepal notes the gradual decline in NPLs (from ~15% in mid-July 2014), fresh NPL generation remained high till FY2018 (2.4%), thereby remaining an area of concern. Additionally, the downsizing of NPLs was aided by the diluting effect of portfolio growth as well as the sizeable write-offs apart from recoveries/upgradations. Despite the moderation over the years, the impact on solvency remained high at ~4.5% as of mid-January 2019. The ratings assignment also takes note of the risks emanating from the bank's high credit portfolio growth (compounded annual growth rate (CAGR) of ~37% for the three fiscal years ended mid-July 2018 compared to ~24% for the industry). The ratings also consider the probable systemic risks emanating from the mismatch in credit and deposit growth in the industry over the last few years. The resultant hardening of interest rates could build up further stress on the bank's asset quality over the near term as the incremental portfolio gets more seasoned. PRVU's high operating expenses compared to its peers and its moderate capitalisation profile (CRAR of 11.92% as of mid-January 2019 compared to 14.24% for the industry) also remain rating concerns. The bank's ability to raise the requisite capital in a timely manner for targeted growth would remain critical. The ratings also factor in the uncertain operating environment and liquidity constraints that the banks in Nepal are currently facing, which could have a bearing on PRVU's growth plans. The bank's ability to grow its portfolio judiciously, improve its asset quality while maintaining a competitive mix/cost of deposits, and sustain the improvement in its overall financial profile would remain a key rating driver.

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[1] *Return on net worth and return on assets*

PRVU's credit growth was higher compared to the industry at a CAGR of ~37% for the three years ended mid-July 2018 (~24% for the industry). Nonetheless, a part of the growth was aided by the acquisition of Grand Bank in FY2016. Excluding this, the growth rate would have been slightly moderate at ~31%. The pace of growth remained high at ~31% in H1 FY2019 compared to ~25% for the industry. Credit growth in recent years surpassed deposit growth, resulting in an increased CCD ratio[2] of ~77% as of mid-January 2019 compared to ~66% as of mid-July 2015. However, the growth was partly supported by franchise expansion with a focus on maintaining low granularity of the portfolio, which provides some comfort. Hence, the bank's credit portfolio remains well balanced with large corporate/project loans accounting for ~44% of the total loans as of mid-January 2019, followed by SME loans (~32%) and retail loans (~24%). This also augurs well for the bank's credit concentration risks with relatively moderate concentration among the top 20 borrower groups (~21% of the portfolio and 149% of the tier I capital as of mid-January 2019). The bank's ability to offer lower lending rates among peers reflects in its relatively lower yield on advances of 11.72% for H1 FY2019 (9.89% for FY2017) compared to 12.81% for the industry. Hence, this remains a key strength. The increase in yields in recent years was largely in line with the industry trend and was partly supported by the booking of interest income on an accrual basis from FY2018, as per the revised financial reporting framework[3].

On the asset quality front, PRVU's reported NPLs declined to 2.47% as of mid-January 2019 from ~15% as of mid-July 2014. Despite the improvement, NPLs still remained higher compared to peers and the industry average of 1.48%. The NPL reduction was also supported by sizeable book write-offs and non-banking asset bookings of NPR 2,045 million (~57% of NPLs as of mid-July 2014). The recovery/upgradation rate has also remained healthy at ~45% on an average during this period. However, the fresh NPL generation was also high during the last two years (2.40% in FY2018 and 4.09% in FY2017), which remains a key rating concern. Although this declined to 0.76% in H1 FY2019, the sustainability of the same remains to be seen. Further, the impact on solvency (net NPA/net worth) remained high at 4.53% as of mid-January 2019, despite the improvement, compared to ~25% in mid-July 2014. PRVU's overall 0+ days delinquencies remained moderate at ~10% as of mid-January 2019 (~15% in mid-July 2018). Going forward, the asset quality of the banking sector, including PRVU, is expected to witness some moderation due to a decline in the repayment ability of borrowers following the increased interest rates. The bank's ability to improve the delinquencies and report a sustainable improvement in its asset quality profile would remain a key rating factor.

PRVU fares relatively better among its peers on the deposit front with a higher share of stable and low-cost CASA deposits. This leads to a lower cost of funds (6.04% in H1 FY2019 against 6.50% for the industry) and remains a competitive strength in the base rate-based lending regime. Despite a decline over the years (~44% as of mid-January 2019 from ~61% as of mid-July 2015), the bank's CASA still remains above the industry average (41% as of mid-January 2019). In line with the industry trend, the growth in deposits has remained lower than credit growth during the three years ended mid-July 2018, at a CAGR of ~32%. This, however, was better than the industry average growth of ~19% during this period. Due to the volatile market liquidity scenario, the deposit growth in H1 FY2019 declined to ~16%, largely comparable to the growth of ~15% in the industry. As a major chunk of the incremental growth in recent years was from term deposits, this could impact the cost of funds over the near to medium term. The concentration of the bank's top 20 depositors remained moderate at ~23% as of mid-January 2019. Going forward, the bank's ability to maintain its deposit mix and cost would remain a key monitorable.

As for capitalisation, PRVU reported CRAR of 11.92% and tier I capital of 10.66% as of mid-January 2019 (both as per Basel III), slightly above the regulatory minimum of 11% and 8%, respectively (both including capital conservation buffer (CCB) of 2%). The tier I capital requirement is expected to increase to 8.5% by mid-July 2019 (including CCB of 2.5%) although the requirement for total capital would be stable at 11% (including CCB). PRVU's capitalisation profile was supported by a 40% rights issue in FY2017 (~NPR 2.3 billion) and internal accruals retained over the last few years. The proposed debenture issue and internal

[2] Local currency (LCY) credit to core capital and LCY deposits ratio, capped at 80% by regulations

[3] 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

accruals are likely to remain adequate for the bank's moderate growth plans over the medium term. The bank's ability to maintain the requisite capital levels while maintaining an appropriate dividend policy would remain crucial.

PRVU's profitability during the last few years was supported to an extent by sizeable provision write-backs from the recovery of erstwhile NPLs. However, the amount of net reversals has been witnessing a declining trend (NPR 155 million in FY2018 i.e. ~11% of profit before tax (PBT) compared to NPR 1,132 million in FY2015 i.e. ~82% of PBT). At the same time, the operating profitability has generally shown an improving trend (2.32% of average total assets (ATA) in H1 FY2019 against 0.62% in FY2015), except for a dip in FY2018 (1.17%). The stress in FY2018 was mainly on account of a decline in NIMs to 2.77% (3.18% in FY2017) owing to sizeable rebates provided on interest accruals for the recovery of NPLs. The NIMs improved thereafter to 3.64% in H1 FY2019, aided by higher yields of 11.72% (11.14% for FY2018) along with an increment in the CCD ratio to ~77% from ~69% during this period. As a result, PRVU's RoA and RoNW improved to 1.76% and ~16%, respectively, (1.96% and ~16%, respectively, for the industry) from 0.95% and ~9%, respectively, in FY2018 (1.92% and ~16%, respectively, for the industry). The operating expense ratio also remained high for the bank at 2.32% of ATA in H1 FY2019, which could affect profitability. Considering this and the stressed asset quality profile, the bank's ability to report sustainable profits from its core operations over a longer time frame remains to be seen. Going forward, PRVU'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
Prabhu Bank Limited (PRVU), formerly known as Kist Bank, was incorporated in 2002 as a finance company and was upgraded to a Class A commercial bank in May 2009. Kist Bank came under stress as a large chunk of its credit portfolio turned into NPLs from 2013 (NPLs were ~24% in July 2014). The bank opted for a merger to improve its financial profile and was renamed after the merger of four financial institutions on September 15, 2014. These institutions were Kist Bank Limited (Class A), Prabhu Bikas Bank Limited (Class B), Gaurishankar Development Bank Limited (Class B) and Zenith Finance Limited (Class C). In February 2016, PRVU acquired another distressed bank i.e. Grand Bank Nepal Limited, which had a very high level of NPLs at the time of merger (~35%).

PRVU is mainly promoted by the individuals and entities belonging to the Prabhu Group, which is an established business group, especially in the remittance and financial sector in Nepal. The bank's shares are listed on the Nepal Stock Exchange with 55% held by the promoters and the rest (45%) by the public. The bank's registered and corporate office is in Babarmahal, Kathmandu.

As of mid-January 2019, PRVU had a presence throughout the country in the form of 169 branches, 19 branchless banking counters and 139 ATMs. Its market share was around 3.95% in terms of the deposit base and 3.71% of the total advances of the commercial banking industry as of mid-January 2019. PRVU reported a profit after tax (PAT) of NPR 967 million in FY2018 (YoY decline of ~39%) on an asset base of NPR 112,587 million as of mid-July 2018. For 9M FY2019, the bank reported a profit of NPR 1,441 million on an asset base of NPR 126,633 million as of mid-April 2019. PRVU reported CRAR of 11.44% and gross NPLs of 2.42% as of mid-April 2019. In terms of the technology platform, PRVU uses Pumori as its core banking software across all its branches.

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About ICRA Nepal Limited:

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