Muktinath Bikas Bank Limited

Rating

Facilities	Amount (Rs. in Million)	Ratings[1]	Rating Action
Issuer Rating	**NA**	**CARE-NP BBB (Is) [Triple B (Issuer Rating)]**	**Reaffirmed**

CARE Ratings Nepal Limited (CRNL) has reaffirmed issuer rating of 'CARE-NP BBB (Is)' [Triple B (Issuer Rating)] assigned to Muktinath Bikas Bank Limited (MNBBL). Issuers with this rating are considered to offer moderate degree of safety regarding timely servicing of financial obligations, in Nepal. Such issuers carry moderate credit risk.

Detailed Rationale & Key Rating Drivers

The reaffirmation of rating assigned to MNBBL continues to derive strength from its established track record of operations, experienced board and management team supported by diversified geographical coverage, satisfactory asset quality, and adequate capitalization level, albeit some moderation at the end of FY22 (Audited, FY refers to twelve-month period ending mid-July) and H1FY23 (Unaudited, H1 refers to the six-month period ending mid-January). The rating also factors in sustained growth in loans & advances and deposits leading to improving financial performance trend during FY22 and H1FY23, increasing investment portfolio, and moderate liquidity profile.

The rating, however, is constrained by MNBBL's lower levels of Current Account Savings Account (CASA) deposits leading to relatively higher cost of funds which could impact its pricing power and profitability amid intense competition in the industry. The rating also factors in the bank's exposure to the regulatory risk. Decrease in regulatory cap in interest spread, and subdued scope for credit growth over the near-term coupled with increasing cost structure and elevated provisioning requirements in the current market dynamics are likely to add to the margin pressure of the bank over the near term. Although current capitalization levels remain adequate, further slippages in asset quality leading to GNPL levels significantly higher than envisaged will remain a key rating concern.

Going forward, the ability of the bank to manage growth while maintaining profitability levels and without compromising on asset quality would be critical for the bank's earning profile. The bank's ability to improve capital adequacy indicators with comfortable cushion from the minimum regulatory requirement levels, and manage the impact of any other regulatory changes by Nepal Rastra Bank (NRB) would be the key rating sensitivities.

Detailed Description of the Key Rating Drivers

Key Rating Strengths

Established track record, experienced board and management team and diversified geographical coverage

Operating since 2007, MNBBL has more than 16 years of operational history and an established market presence in Nepal. MNBBL is a professionally managed bank under the overall guidance of the Board of Directors (BoD) which includes eminent bankers, retired government officials and professionals with wide experience in the financial and economic sector. Mr. Bharat Raj Dhakal, Chairman, has over two decades of experience in banking sector. He was also CEO of the bank for 12 years. The management team is led by Mr. Pradyuman Pokheral, Chief Executive Officer, who has around three decades of experience in banking sector and is aptly supported by an experienced management team.

[1]Complete definitions of the ratings assigned are available at www.careratingsnepal.com and in other CRNL publications

MNBBL has diversified geographical presence in Nepal with 178 branches and 22 ATMs as on mid-January 2023 across the country. The branches are spread over all seven provinces of Nepal.

Satisfactory asset quality profile

MNBBL has historically maintained a relatively better asset quality profile vis-à-vis the industry reflective of the bank's more efficient risk management setup. MNBBL had Gross Non-Performing Loans (GNPL) ratio of 0.98% as on mid-January 2023, compared to the industry average of ~2.82% for class B financial institutions. Although the GNPL level has deteriorated from 0.21% as on mid-July 2022, it still remained well below the industry average. The decline in asset quality of MNBBL and the overall banking industry in H1FY23 can be attributed to the industrywide slippages and recovery challenges amid lingering impact of COVID. Increasingly stressed asset profile currently observed in the banking industry has exacerbated amid the liquidity crunch, high inflation and increasing interest rates impacting entire demand-supply dynamics for various sectors, resulting in higher delinquencies. Amid the stressed environment, however, some comfort is taken in MNBBL displaying a more resilient asset quality relative to peers. MNBBL's ability to maintain the asset quality indicators going forward would remain a key rating monitorable.

Adequate capitalization levels; albeit some moderation at the end of FY22 and H1FY23

As on mid-January 2023, MNBBL's overall Capital Adequacy Ratio (CAR) stood moderate at 11.55%, with Tier-I CAR of 8.44% (mid-July 2022: 11.80% and 8.83%, respectively). Although the capitalization levels have deteriorated in H1FY23, the bank currently has adequate buffer over the regulatory requirements of 10% and 6% for CAR and Tier-I CAR respectively for Class B banks and financial institutions. Moderation in capitalization levels of the bank in FY22 and H1FY23 was mainly on account of greater pace of credit growth leading to increased risk weighted exposures, outpacing capital accretion during the period. Lower capitalization levels could limit the bank's ability to absorb losses, should they materialize, especially given the increasing uncertainty surrounding credit recovery. Post-pandemic recovery remains a concern amid the ongoing liquidity stress in the economy and macro headwinds leading to increased upward pressure on interest rates. The bank's ability to maintain adequate cushion in the capital adequacy ratios will remain critical for its solvency and growth prospect, particularly following a period of around 3-4 years of high credit expansion in the industry.

Increasing scale of operations backed by considerable growth in deposits and advances

MNBBL's loans and advances portfolio grew 16.92% year-on-year to Rs. 89,654 at the end of FY22 (industry average: 16.03%), leveraging on the increased branch network during the period. At the end of H1FY23, MNBBL's total loans & advances increased to Rs. 95,246 Mn, with growth of 6.24% over FY22. MNBBL's deposits stood at Rs. 104,675 Mn at the end of FY22, growing 20.45% over FY21. At the end of H1FY23, deposits further grew 6.22% to Rs. 111,190 Mn over FY22. Significant increase in loans & advances in a short span can put added stress to the asset quality, particularly amid the uncertainty regarding the residual impact of the pandemic on borrowers. However, in MNBBL's case, the growth in credit has been generally well supported by its growth in deposits as also indicated by a comfortable Credit to Deposit ratio of 85.65% (industry average: 87.33%) and 85.66% (industry average: 86.54) at the end of FY22 and H1FY23 against the regulatory requirement of below 90%.

Improving financial performance trend during FY22 and H1FY23

During FY22, MNBBL's total income grew 40.37% year-on-year to Rs. 12,116 Mn on account of 52.48% year-on-year increase in interest income. Growth in interest income was supported by increase in yield on advances by 165 bps. Amid increasing cost of funds, the bank's net interest income increased by around 19% year-on-year to Rs. 3,330 Mn during FY22 (FY21: Rs. 2,789 Mn) resulting in Net Interest Margin (NIM) of 3.00% in FY22 (FY21: 3.33%). Despite moderation in NIM mainly due to increased cost of funds, the bank's PAT increased by 16.03% to Rs. 1,342 Mn in FY22. The bank's PAT grew 3.96% year to Rs. 626 Mn mainly on account of increase in total income by 42.60% year-on-year to Rs. 7,825 Mn. Return on Total Assets (RoTA) of the bank deteriorated to 1.21% in FY22 from 1.38% in FY21. The bank's annualized Return on Total Assets (RoTA) for H1FY23 stood at 1.05%.

Moderate liquidity profile

MNBBL has a moderate liquidity profile marked by Cash Reserve Ratio (CRR) of 4.13%, Statutory Liquidity Ratio (SLR) of 20.50% and Net Liquidity Ratio of 22.54% as on mid-January 2023 (CRR: 3.08%, SLR: 21.20% and Net Liquidity Ratio: 26.32% as on Mid-July, 2022) against regulatory requirement of 4%, 10% and 22% respectively which remain satisfactorily above the regulatory norms. Furthermore, the bank's liquidity profile remains moderate from the asset-liability mismatch perspective with positive cumulative mismatches as of mid-January 2023.

Key Rating Weakness

Depleting CASA mix resulting in increased cost of funds

MNBBL continues to maintain relatively lower levels of CASA deposits as compared to the industry average. MNBBL had low CASA mix of 23.24% in its total deposits at the end of H1FY23 (Industry average: 23.71%), which decreased from 23.80% at the end of FY22 (Industry average: 25.62%). Lower CASA proportion resulted in higher cost of funds for MNBBL of 10.53% during H1FY23 thus imposing competitive disadvantage for the bank against its peers in the "base rate plus" lending rate regime. However, base rate of the bank remains competitive, to some extent, owing to the lower operational expense of the bank. CASA ratio was lower in the industry in FY22 and H1FY23 amid industrywide liquidity stress and upward pressure in CD ratio. The bank's ability to support overall profitability through managing low-cost funds could be a challenge amid a declining CASA mix.

Competition from other banks and financial institutions

Currently there are 17 Development Banks, operating with total 1,128 branches all over Nepal (based on monthly statistics published by NRB for mid-January 2023). MNBBL has 178 branches along with head office as on same date. Industry (Class B Development Banks) had achieved total interest income of Rs. 36,504 Mn during H1FY23 with Rs. 10,584 Mn net interest income. MNBBL's market share on interest income was 20.68% (Rs. 7,550 Mn) and on net interest income was 19.32% (Rs. 2,044 Mn) for the same period. MNBBL's share on interest income decreased from 20.85% however, share on Net interest income increased from 18.50% in FY22. Despite being established national development bank in the industry, it is challenging for MNBBL to maintain current market share and expand its business, particularly due to existence of large number of Commercial banks which have wider presence and generally offer similar services at lower price than development banks.

Exposure to regulatory risk related to industry

The banking industry of Nepal is exposed to changes in the various regulatory measures issued by NRB from time to time. NRB has changed to CD ratio mechanism from previous Credit to Core Capital plus Deposit (CCD) ratio measures, where CD ratio needs to be maintained below 90% by mid-July 2022 from earlier provision of 85% for CCD. Via the monetary policy for FY23, NRB increased the minimum requirement of liquid assets that the BFIs must hold, where Cash Reserve

Ratio (CRR) was increased to 4%. Such increase in mandatory liquidity reserve to be maintained by BFIs is likely to increase cost for BFIs, and is likely to reduce the amount of loanable funds, thereby limiting liquidity in the economy. Bank rate and policy rate (repo rate) were increased to 8.5% and 7% (previously 7% and 5.5%). Furthermore, via the first quarter review of the Monetary Policy for FY23, NRB reduced the maximum interest rate spread to be maintained at the end of FY23 by development banks to 4.6% from 5%. Increased bank rates will likely put upward pressure on both lending and deposit interest rates of the bank over the near term, while decreased interest rate spread will likely put downward pressure on the bank's profitability. Ability of the bank to manage the impact of any other regulatory changes by NRB would be the key rating sensitivities.

About the Company

Muktinath Bikas Bank Limited (MNBBL) is a national level class "B" Development bank and started its commercial operations from January 07, 2007. MNBBL was upgraded into a national level development bank in July 2015 after acquisition of Civic Development Bank. The bank is listed on Nepal stock exchange and promoter and public shareholding was in the ratio of 51:49 as on Mid-July, 2022.

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