Muktinath Bikas Bank Limited

Ratings

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

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

Detailed Rationale & Key Rating Drivers

The reaffirmation of rating assigned to MNBBL continues to derive strength from its established long track record of operations, experienced promoters and management team supported by diversified geographical coverage, good assets quality, and adequate capitalization level, albeit some moderation at the end of FY21 (Audited, refers to the twelve-month period ended mid-July 2021) and 9MFY22 (Unaudited, refers to the nine-month period ended mid-April 2022). The rating also factors in considerable growth in loans & advances and deposits, improved financial performance during 9MFY22, sustained increment in investment portfolio, and moderate liquidity profile.

The rating is, however, constrained on account of declining proportion of low-cost Current Account Savings Account (CASA) deposits leading to increased cost of funds which could adversely impact the profitability particularly at the time of liquidity stress, intense competition and exposure to regulatory risk related to banking industry.

Going forward, the ability of the bank to sustain its growth in business while maintaining the profitability levels, asset quality and capital adequacy would be the key rating sensitivities. Also, the bank's ability to manage the impact of any regulatory changes by Nepal Rastra Bank (NRB) would also remain a key rating sensitivity.

Detailed Description of the Key Rating Drivers

Key Rating Strengths

Well established track record of operation with experienced board and management team supported by wide geographical network

Operating since 2007, MBBL has around 15 years of track record of operations in Nepal. The bank has a diversified geographical presence in the country with 168 branches as on April 13, 2022 covering all seven Provinces of Nepal. MBBL 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 20 years of banking experience. He was also CEO of the bank for around last 12 years. The senior management team is led by Mr. Pradyuman Pokheral, Chief Executive Officer, who has more than 29 years of banking experience and is supported by an experienced team.

Good asset quality marked by consistently low GNPL levels

MNBBL continues to maintain good asset quality owing to a prudent risk management policy. MNBBL's Gross Non Performing Loan (GNPL) ratio stood low at 0.23% of its outstanding loans & advances at the end of FY21, comfortably better than the industry average of 1.30% for B Class Financial Institutions. GNPLs decreased to Rs. 175 Mn at the end of FY21 from Rs. 225 Mn at the end of FY20. GNPL ratio further improved to 0.17% at the end of 9MFY22 on account of efficient recovery of NPLs coupled with

[1]Complete definition of the ratings assigned are available at www.careratingsnepal.com and other CARE publications

increased loans and advances portfolio. The ability of the bank to maintain its asset quality, especially in view of the lingering impact of the pandemic, remains critical for its earning profile and profitability.

Moderate Capital Adequacy level

As on mid-July 2021, overall Capital Adequacy Ratio (CAR) of the bank declined to 11.19% and Common Equity Tier I (CET I) ratio to 9.94% from 13.23% and 11.97%, respectively, as on mid-July 2020 against the minimum requirement of 10% and 6%, respectively, for B Class Banks and Financial Institutions. The moderation in the bank's capitalization profile in FY21 was on account of relatively higher credit expansion vis-à-vis capital accretion. Further in 9MFY22, CET I of the bank decreased to 9.22% owing to continued increment in the risk weighted exposure as the growth in credit portfolio continued to outpace capital growth coupled with NRB increasing risk weights for certain loans. However, overall CAR increased to 12.48% on account of issuance of debentures worth of Rs. 1,250 Mn during the period. Despite the moderation in the capitalization levels during FY21 and 9MFY21, the bank continues to have moderate cushion against regulatory requirements. Having adequate capitalization levels would enhance a bank's ability to absorb losses, should they materialize, especially given the uncertainty surrounding credit recovery amid the lingering impact of the covid-19 pandemic. The bank's ability to maintain adequate cushion in the capital adequacy ratios is critical for its solvency and will remain crucial for its growth perspective.

Increasing scale of operations marked by considerable growth in deposits and loans & advances with adequately maintained Credit to Deposit ratio

The bank's loans and advances portfolio grew with a Compounded Annual Growth Rate (CAGR) of 44.84% over FY19-FY21, leveraging on the increased branch network during the period. At the end of 9MFY22, MNBBL's total loans & advances had increased to Rs. 90,820 Mn, with growth of 18.44% over FY21. The growth in loans and advances has been generally well matched by a similar growth in deposits during the last three years, which grew at a CAGR of 47.48% over FY19-FY21. MNBBL's Deposits stood at Rs. 102,232 Mn, growing 17.75% over FY21. 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 86.51% against the regulatory requirement of below 90% required to be maintained by mid-July 2022.

Improving financial performance trend during FY21 and 9MFY22

During FY21, the bank's total income increased by 20.82% yoy to Rs. 8,631 Mn backed by 15.04% yoy growth of interest income and by 89.93% yoy growth of non-interest income. The increase in non-interest income was primarily on account of realization of profit of Rs. 405 Mn on sale of securities. Net interest income had increased by 23.43% yoy to Rs. 2,789 Mn owing to higher credit expansion despite decreased yield on advances by 233 bps to 13.71%. Consequently, PAT of the bank grew 63.48% yoy to Rs. 1,156 Mn during FY21. Return on Total Assets (RoTA) of the bank improved to 1.38% in FY21 from 1.20% in FY20. The improving trend in the financial performance of the bank continued into FY22 with the bank's total income growing 38.10% yoy to Rs. 8,576 owing to increase in interest income amid credit expansion, although offset to some extent by decline in non-interest income in the period by 48.55%. Net interest income of the bank increased by 26.78% yoy during 9MFY22. The bank reported PAT of Rs. 1,021 Mn during 9MFY22.

Moderate liquidity profile

MNBBL has a moderate liquidity profile marked by Cash Reserve Ratio (CRR) of 3.12%, Statutory Liquidity Ratio (SLR) of 20.63% and Net Liquidity Ratio of 24.07% as on mid-July 2021 against regulatory requirement of 3%, 8%, and 20%, respectively. The bank's SLR and net liquidity ratio have moderated somewhat to 19.94% and 20.87%, respectively, as on Mid-April 2022. However, these continue to remain satisfactorily above the regulatory norms. Furthermore, the bank's liquidity profile remains adequate from the asset-liability mismatch perspective with positive cumulative mismatches as of April 13, 2022.

Key Rating Weakness

Depleting CASA mix resulting in increased cost of funds that could impact competitive positioning

MNBBL maintained CASA mix of 25.63% of total deposits as on mid-April 2022 (Industry Average: 33.01%) which has decreased from 31.61% as on mid-July 2021 (Industry average: 34.50%). The substantial decline in CASA mix during 9MFY22 was mainly on account of switching to fixed deposits as banks had increased interest rates amid the ongoing liquidity stress in the country. Lower remittance, increasing balance of payment deficit, and reduced government expenditure so far during FY22 has impacted the overall banking industry. Due to lower CASA level cost of the funds of the bank has risen to 8.54% in 9MFY22 from 6.26% in FY21. Lower CASA levels leads to a relatively higher base rate which can be a competitive disadvantage for the bank especially in the "base rate plus" lending rate regime and can also impact the bank's earnings and profitability profile going forward.

Competition from other banks and financial institutions

Currently there are 17 Development Banks, operating with total 1,093 branches all over Nepal (based on monthly statistics published by NRB for mid-April 2022). MNBBL has 168 branches along with head office as on same date. Industry (Class B Development Banks) had achieved total interest income of Rs. 38,756 Mn during 9MFY22 with Rs. 13,063 Mn net interest income. MNBBL's market share on interest income was 20.93% (Rs. 8,114 Mn) and on net interest income was 18.38% (Rs. 2,402 Mn) for the same period, which had increased from 19.50% and 18.13%, respectively for FY21. 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

The banking industry in 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 existing Credit to Core Capital plus Deposit (CCD) ratio measures. CD ratio needs to maintain below 90% by mid-July 2022 from earlier provision of 85% for CCD. Furthermore, risk weights of certain loans including personal overdrafts, TR loans, hire purchase loans for personal purpose, margin lending, etc has been increased to 150% from existing 100% via the mid-term review of monetary policy issued by NRB for FY22. These changes are likely to put downward pressure on capital adequacy ratios of the banks and limit their ability for significant credit expansion, at least over the near term. Furthermore, bank rate has been increased to 7% from 5% and repo rate increased to 5.5% from 3.5% in the midterm review of monetary policy issued by NRB for FY22. Increased bank rates will likely put upward pressure on both lending and deposit interest rates of the bank over the near term.

About the bank

Muktinath Bikas Bank Limited (MNBBL) is a leading national level class "B" Development bank and started its commercial operation form 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, 2021.

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