

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 the rating assigned to MNBBL derives strength from its established track record of operations, experienced board and management team supported by diversified geographical coverage, satisfactory asset quality albeit on declining trend in recent quarters, and adequate capitalization level. The rating also factors in sustained growth in loans & advances and deposits leading to improving financial performance trend during FY23 (Audited, FY refers to the twelve-month period ending mid-July) and 9MFY24 (refers to the nine-month period ended mid-April 2024), 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 monitorable.

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.

MNBBL has diversified geographical presence in Nepal with 178 branches and 22 ATMs as on mid-January 2024 across the country. The branches are spread over all seven provinces of Nepal.

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

Satisfactory asset quality profile despite moderation over FY23-9MFY24

MNBBL continues to exhibit better asset quality profile vis-à-vis industry peers. However, its Gross Non-Performing Loans (GNPL) levels have spiked to around 2% as on mid-April 2024 from earlier levels of less than 1%. 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 GNPL ratio of 2.02% as on mid-April 2024, compared to the industry average of ~3.63% for class B financial institutions. Although the GNPL level has deteriorated from 0.98% as on mid-July 2023 and 0.22% as on mid-July 2022, it continues to remain well below the industry average. The decline in asset quality of MNBBL and the overall banking industry over FY23 and so far in FY24 can be attributed to the slowdown in the country's economy (estimated GDP growth for FY23 of 1.9% and around 3% so far in FY24) amid monetary tightening and effects of import restrictions in FY23. 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. Although increasing trend in the delinquent loans (up to 30 days past due and 30-90 DPD category as on mid-April 2024) could result in further deterioration of the bank's GNPL ratio at FY24 end.

Adequate capitalization levels

Tier I Capital Adequacy ratio of the bank improved to 9.28% as on mid-April 2024 from 8.84% as on mid-July 2023 (minimum requirement of 7% for Class-B Banks and Financial Institutions from mid-July 2024) and Overall Capital Adequacy improved to 12.15% from 11.77% during the same period (minimum requirement of 11%). The central bank of Nepal has increased regulatory capital to 7% and 11% (Tier I and total CAR, respectively) from mid-July 2024 from 6% and 10% earlier. Improvement in capitalization levels of the bank in 9MFY24 was mainly on account of decline in its loans and advances portfolio by 2.64%. Risk weighted exposure for credit risk actually declined by ~6% owing to decreased exposure on higher risk weighted assets. Consequently, this led to improved capital adequacy indicators as on mid-April 2024. The bank is likely to maintain Tier I above 9% going forward. The bank's ability to manage asset quality and growth in business while maintaining enough cushion in its capitalization levels will remain critical from credit perspective.

Moderate financial performance during FY23-9MFY24

During FY23, the MNBBL's total income increased significantly by 32.81% year-on-year to Rs. 16,091 Mn. The increment is mainly due to higher interest revenue collected by banks attributable to increase in advances portfolio and also supported by improved yield on advances to 15.23% in FY23 (FY22: 13.03%). The increase is backed by an increase in overall interest income by 33.83%, other income increased by 11.39% to Rs. 616 Mn and operating expenses increased by 17.79% in FY23 to Rs 2,211 Mn. However, PAT had decreased by 6.97% to Rs. 1,248 Mn in FY23 (FY21: 1,342 Mn) on account of higher impairment charges amid increasing GNPL levels. Consequently, ROTA declined to 0.99% in FY23 from 1.21% in FY22. The bank's Net Interest Margin (NIM), however, had improved to 3.25% in FY23 from 3.00% in FY22. The profitability improved during 9MFY24. Although the bank's total income has decreased by 6.77% year-on-year to Rs. 11,061 in 9MFY24 mainly due to subdued interest income by 7.33% to Rs. 10,612 Mn. However, amid even lower interest expense owing to lower cost of funds aided by improved CASA mix (resulting in improved NIM) and slightly lower impairment charges compared to previous year, the bank's PAT increased 8.13% year-on-year to Rs. 872 Mn during 9MFY24.

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 2024 (CRR: 4.12%, SLR: 20.36% and Net Liquidity Ratio:

23.06% as on Mid-July, 2023) 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 2024.

Key Rating Weakness

Low CASA mix over FY22-FY23 resulting in increased cost of funds

MNBBL's CASA deposits were on declining trend in FY22 which continued in FY23. MNBBL maintained 24.64% CASA deposits in FY23, marginal improvement from 24.57% in FY22 compared to industry average of 25.17% and 25.62%, respectively. The lower CASA ratio led to increased cost of funds at 9.79% in FY23 resulting into base rate of over 10% in FY23. Higher cost of funds against its peers and commercial banks imposes competition risk for the bank, especially in the "base rate plus lending rate" regime. CASA deposits were lower in FY22-FY23 industry-wide with lower proportion of current deposits and higher proportion of fixed deposits as compared to previous quarters. MNBBL's CASA proportion improved in 9MFY24 to 30.16%, better than industry average of 27.97%. The bank's ability to maintain the improving trend in CASA mix leading to favourable cost of funds vis-à-vis peers for a sustained period remains to be seen.

Competition from other banks and financial institutions

Currently there are 17 Development Banks, operating with total 1,134 branches all over Nepal (based on monthly statistics published by NRB for mid-January 2024). MNBBL has 178 branches along with head office as on same date. Industry (Class B Development Banks) had achieved total interest income of Rs. 53,518 Mn during 9MFY24 with Rs. 15,745 Mn net interest income; MNBBL's share on interest income is 19.83% (Rs. 10,610 Mn) and 19.87% share on net interest income (Rs. 3,128 Mn) for the same period. MNBBL's share on interest income decreased from 20.85% to 20.66% in FY23 however, share on Net interest income remained stable at 18.50% in FY23. Despite being established national development bank in the industry, it is challenging for MNBBL to maintain current market share and expand its business, due to high competition among bank and finance companies, existence of large number of Development bank along with Commercial banks and finance companies conducting similar kind of businesses and they lend at lower interest rate as well as they offer wider banking services than development banks.

Exposure to regulatory risk related to industry

The Banking and Finance industry in Nepal is exposed to changes in the various regulatory measures issued by NRB from time to time. In past, finance companies faced pressure from NRB for capital increment to Rs. 800 Mn from Rs. 200 Mn. Furthermore, NRB had changed to CD ratio mechanism from existing Credit to Core Capital plus Deposit (CCD) ratio measures. CD ratio needs to maintain below 90% from mid-July 2022 from earlier provision of 85% for CCD. Risk weights of certain loans including personal overdrafts, TR loans, hire purchase loans for personal purpose, margin lending, etc. have been fluctuating between 100% to 150% via interim changes in monetary policies by the NRB. Unfavourable changes depending on the bank's exposures are likely to put downward pressure on capital adequacy ratios of the MFIs and limit their ability for significant credit expansion, at least over the near term. Furthermore, increased interest rates will likely put upward pressure on both lending and deposit interest rates of the MFIs over the near term.

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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