

## Nepal SBI Bank Limited

### Ratings

Facility/Instrument	Amount (Rs. in Million)	Ratings <sup>1</sup>	Rating Action
Issuer Rating	NA	CARE-NP AAA (Is) [Triple A (Issuer Rating)]	Assigned

CARE Ratings Nepal Limited (CRNL) has assigned the issuer rating of 'CARE-NP AAA (Is)' to Nepal SBI Bank Limited (NSBL). Issuers with this rating are considered to offer the highest degree of safety regarding timely servicing of financial obligations, in Nepal. Such issuers carry lowest credit risk.

### Detailed Rationale & Key Rating Drivers

The issuer rating assigned to NSBL factors in the bank's strong parentage with State Bank of India (SBI, rated CARE AAA; Stable<sup>2</sup>) holding majority stake (55%), strategic importance of the bank to SBI coupled with high operational linkages and the parent's demonstrated track record of providing technical and financial support to the subsidiary company. The parent's oversight over the practices, controls, performance and compliance aspects of subsidiary company can be seen by the way of representation of parent in board of NSBL (three out of six board of directors) and deputation of senior management personnel from SBI to NSBL.

The ratings also derive strength from NSBL's adequate capitalization levels and healthy internal capital generation through accruals of profit to meet the regulatory requirements and support its credit growth. The ratings further factor in NSBL's relatively stable asset quality parameters over the last two years with lower slippages vis-à-vis substantial surge seen in the industry over this period. NSBL's better asset quality vis-à-vis industry peers is also reflective of its strong risk management practices in lines with SBI's group policy.

The rating additionally factors satisfactory financial performance of the bank over the past two-three years marked by growing income levels and profitability despite industry headwinds reflective in the industry-wide sharp increase in provisioning for Gross Non-Performing Loans (GNPLs) resulting in muted profitability. The rating takes note of consistent growth in deposit and advances base of NSBL, with more prudent growth in advances during the pandemic period, diversified advances portfolio with adherence to regulatory compliance regarding the exposure towards prescribed sector lending and comfortable liquidity profile of the bank.

The above rating strengths are, tempered by NSBL's moderate low-cost deposit ratio, although comfort is taken from strong institutional depositors of the bank and proven track record to expand its loan portfolio without compromising interest rate spreads. The rating also factors in intense competition and exposure to regulatory risk related to industry.

*Going forward, the ability of the bank to maintain its asset quality while managing growth in operations, maintain adequate cushion in capital adequacy indicators 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. Additionally, any substantial changes in shareholding pattern leading to material changes in linkages with major shareholder (SBI) will also remain key rating sensitivity.*

<sup>1</sup>Complete definitions of the ratings assigned are available at <https://www.careratingsnepal.com/> and in other CRNL publications.

<sup>2</sup>State Bank of India is rated AAA (for Tier II bonds) by Care Ratings Limited (CARE Ratings)

## Detailed Description of the Key Rating Drivers

### Key Rating Strengths

#### **Strong parentage and established track record of operations along with experienced management**

NSBL's credit profile is backed by strong institutional promoters with SBI holding 55% and the Employee Provident Fund holding 15% stake in the bank. SBI, with more than 200 years of history, is the largest bank in India in terms of total business size (advances and deposits) as on March end, 2023. SBI is designated as one of the domestic systemically important banks (D-SIB) in India. SBI's major shareholder is Government of India (GoI), which held 56.92% stake in the bank as on March 31, 2023. As on March 31, 2023, SBI had sizeable domestic and overseas presence with network of over 22,405 domestic branches, 65,627 ATMs, and an international network of 235 offices across 29 countries.

SBI has strong representation in board of NSBL as three of its six board members are nominated by SBI. The board of director of NSBL is chaired by Ms. Jayati Bansal, Deputy Managing Director of International Banking Group of State Bank of India (SBI) with over three decades of experience in SBI. Mr. Dipak Kumar De, MD and CEO of NSBL, also has almost three decades experience in SBI. Furthermore, other various top management personnel of NSBL including the Chief Finance Officer and Chief Operating Officer are deputed by SBI as per the terms of Technical Service Agreement (TSA) entered between SBI and NSBL. NSBL has entered into TSA with SBI (renewed every five years) for providing technical and management skill support. The operational linkages between SBI and its subsidiary NSBL are clearly demonstrated by the full support provided by SBI to NSBL in terms of IT infrastructure. Additionally, parent's demonstrated track record of support to its subsidiary is evident through line of credit and financial support in the form of External Commercial Borrowings (ECB) provided by SBI to NSBL in the past. Strategic importance of subsidiary to parent is reflective from close oversight by SBI's management over the performance, risk management and compliance aspect of NSBL. As a subsidiary and part of SBI group, SBI extends its best practices to NSBL. NSBL's financials get consolidated in that of SBI and it also shares SBI's name, brand equity and logo, underpinning its strategic importance to the parent. Considering the majority shareholding and the strategic importance of the bank to SBI, CRNL expects continued support from parent company going forward as well.

#### **Adequate capitalization level**

The bank has been maintaining adequate levels of capitalization to meet the minimum regulatory requirement and support its credit growth. Tier-I capitalization stood at 10.00% as on mid-April 2024 with adequate cushion over the regulatory requirement of 8.5%. Similarly, overall Capital Adequacy Ratio (CAR) stood at 13.22% as on mid-April 2024 with buffer of 2.22% over the minimum regulatory requirement of 11% stipulated by NRB in compliance with Basel-III norms. The bank has been funding its credit growth through internal capital generation through accruals, which has been consistent for the last three years. Additionally, NSBL has also been providing cash dividend to its shareholders on a consistent basis. The bank has been raising supplementary capital and has raised subordinated debentures of Rs. 1,418 Mn during 9MFY24 to support its overall CAR. The capitalization levels of the bank have remained resilient over the years and are likely to be supported by steady internal accruals over the medium term.

#### **Sustained better asset quality vis-à-vis industry**

Robust credit sanctioning and risk management practices of NSBL is reflective in its better asset quality profile historically as indicated by a distinctly lower GNPL ratio compared to the industry average. GNPL ratio of A class commercial banks in Nepal have increased from 1.20% as on mid-July 2022 to 3.89% as on mid-April 2024. The sustained slippages over this period can be attributed to the slowdown in the country's economy (estimated GDP growth for FY23 of 1.9%) amid monetary tightening and effects of import restrictions, which led to surge in GNPL levels of NSBL as well. NSBL's GNPL ratio, despite sequential deterioration over this period, remained at 1.98% as on mid-April, one of the lowest in the

industry. Furthermore, NSBL's net NPL (NNPL) ratio was below unity at 0.23% and solvency profile of the bank remains strong with low NNPL/ Networth ratio of 1.59% as on mid-April 2024. In addition, 30+ days overdue advances also stood relatively low at ~4% as on mid-April 2024. Comfort is taken from the controlled historical asset quality profile maintained by the bank with improvement seen during the recent quarter. Going forward, the ability of the bank to limit slippages and maintain its asset quality at envisaged levels will be a key rating monitorable.

### **Steady financial performance, albeit with some moderation in recent quarters**

The financial performance of the bank remains steady marked by growing income levels and profitability over last two years. During FY20-FY23, NSBL experienced robust growth in total income, achieving a compounded annual growth rate (CAGR) of ~16%, barring FY21 which saw a decline in income levels due to the impact of the pandemic. During FY23, NSBL's total income (TOI) increased by ~41% y-o-y to Rs. 19,527 Mn supported by growth in advances as well as higher yield on advances, though mostly due to increase in overall cost of deposits. Supported by credit growth, improved Net Interest Margins (NIM) (2.95% and 3.40% during FY22 and FY23, respectively) and controlled operating expenses, the bank was able to report ~45% y-o-y growth in its pre-provisioning operating profit (PPOP) in FY23. The credit cost increased on account of rise in NPL levels and more stringent provisioning requirements by regulator during FY23. Nonetheless, the net profit of the bank increased by ~20% y-o-y to Rs. 1,967 Mn during FY23, resulting into improved profitability indicators indicative from its Return on Total Assets (ROTA) of 1.16% in FY23 (FY22: 1.13%).

During 9MFY24, TOI grew by 2.79% y-o-y to Rs. 14,412 Mn. Slight moderation in growth of loans and advances during 9MFY24 over FY23 levels coupled with cap in interest rate spread (interest rate spread to be maintained at 4% from FY23 end onwards, down from 4.4% earlier) led to moderation in Net Interest Margin (NIM), which stood at 2.41% in 9MFY24. Consequently, ROTA was subdued at 0.78% in 9MFY24. With the industry's growth in loans and advances moderating in FY23-9MFY24, more stringent regulatory requirements regarding the credit disbursements, cap on the interest spreads and deteriorating asset quality in overall banking sector along with elevated provisioning requirements by the regulator, industry's profitability indicators remained subdued during 9MFY24. The ability of the bank to manage sustained growth in business while improving its asset quality will remain critical from credit perspective.

### **Consistent growth in deposit base and advances**

Amid rising remittance inflows, overall industry deposits have grown by ~12% in FY23 and ~7% in 9MFY24 over FY23 level. The deposits base of the bank itself grew by ~26% y-o-y in FY23 and ~16% in 9MFY24 over FY23 levels, which were much higher than the industry average. Remittance inflows recorded healthy growth, up 21% from the previous year in FY23 attributable to 40% rise in the number of Nepalese going for foreign employment. Remittance inflows have surged by ~12% since mid-July, reaching Rs 121.4 billion in mid-April, 2024. Similarly, growth in total loans and advances remained consistent at ~8%, ~9% and ~11% (while the industry advances grew by ~3% during FY23) during FY21, FY22 and FY23 respectively. During 9MFY24, NSBL's total advances grew by ~5% over FY23 level, similar to industry average. The growth in credit has been well supported by its growth in deposits. Credit to Deposit (CD) ratio stood at 72.49% (below the regulatory requirement of less than 90%) compared to the industry average of 80.75% as on mid-April 2024.

### **Diversified loan portfolio**

NSBL has fairly diversified portfolio distribution which consists of various types of loan disbursed over the period for various Industry. NSBL had higher lending of 21.71% towards wholesale & retail sector (includes wholesale trade -durables, wholesale non-durables, automotive dealers, other retail trade, import trade) followed by lending of 17.27% towards non-food production related sector (includes metals- basic iron and steel plant, cement, paper products etc.). The next major

lending is towards Agriculture, Forestry & Beverage Production, with 13.15% exposure in total advances as on 9MFY24 end. The bank has adequately lent towards the prescribed sectors, which was 32.29% of total advances at the end of 9MFY24 over the regulatory requirement of 28.50%. Bank's exposure towards agriculture sector was 18.22% (regulatory requirement: 11%). The deprived sector lending was above the norms of regulatory requirement as on mid-April, 2024. Diversified loan portfolio towards various sectors support in maintaining better quality of advances during the time of stress in the sector or slowdown in the economy.

### **Key Rating Weaknesses**

#### **Moderate low-cost deposit ratio**

NSBL's low-cost deposit ratio remain below the industry average. NSBL's low-cost deposit ratio was ~38% at the end of FY23 and 9MFY24 (Industry average: ~42%). Low-cost deposits were lower in FY23 industry-wide with bank preference to lock in fixed deposits amid tight liquidity. This leads to higher cost of funds and base rates for NSBL vis-à-vis peers. However, the comfort is taken from strong institutional depositors of the bank which include government enterprises and prominent businesses. Despite having higher cost of funds, the bank is able to consistently grow its loan portfolio and maintain its interest spread (which remains under regulatory threshold of 4% applicable to all commercial banks).

#### **Intense competition**

Currently there are 20 Commercial Banks (as on mid- April 2024), including three major state-owned banks, operating with total 5,042 branches all over Nepal (based on monthly statistics published by NRB for mid- April, 2024). NSBL had 97 branches along with head office as on same date. Industry (Class A Commercial Banks) had achieved net interest income of Rs. 143.624 Bn during 9MFY24, where NSBL's share on net interest income was 2.51%. NSBL is a mid-sized Class A bank. Compared to its peers, it is relatively smaller in scale, with a growth strategy focused on organic and consistent expansion of its deposit base and loans and advances, rather than aggressive growth. Intense competition in the banking industry results in a highly dynamic market with volatile market shares. Unhealthy competition in the interest rates remains a prominent challenge.

#### **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. In recent times, NRB had changed to CD ratio mechanism from previous Credit to Core Capital plus Deposit (CCD) ratio measures, increased the minimum requirement of liquid assets that the BFIs must hold, and implemented working capital guidelines. Cumulatively these led to muted credit growth and tightened liquidity in the market in FY23. NRB capped interest rate spread of commercial banks at 4% from 4.4%, which has also added to the lower profitability of banks in FY23 and 9MFY24 apart from increased impairment. Going forward, NRB has required Class A banks to maintain countercyclical buffer of 0.5% from FY24 end. Increase in regulatory requirement in capitalization levels in an industry with increasingly stressed asset profile is likely to subdue the growth prospects in loans and advances in near term. Subdued growth in loans and advances, reduced interest rate spread and increase in credit cost due to rising NPL levels and tightening of provisioning requirements by NRB will likely put downward pressure on the bank's profitability indicators.

### **Industry Outlook**

The major challenges currently faced by the banking sector in Nepal is centered around declining asset quality. High and rising GNPLs are leading to stressed profitability and adding downward pressure on banks' capitalization. The regulator's directive to implement countercyclical buffer from FY24 end only adds to their near-term woes. CARs of Class A banks declined from 13.53% as on mid-July 2022 to 12.50% as on mid-April 2024 against the backdrop of deterioration in GNPL

ratio from 1.20% to 3.89% over the same period. Credit expansion in Nepal took off substantially and in more aggressive manner during the pandemic era with loans & advances portfolio of Class A banks growing by a compounded annual growth rate of 19.91% over FY20-FY22, leading to a higher proportion of unseasoned credit in their books. Introduction of contractionary policies helped check credit growth in FY23. However, muted GDP growth in the country and lower than expected government expenditures (12% y-o-y decline in capital expenditure during 11MFY24 on a low base) has prolonged the difficult road to recovery for various sectors including construction, steel, cement, automobiles, retail and SME sectors. Although the central bank has come up with prescriptions to provide reliefs to some stressed sectors, doing so would increase the provisioning requirements of banks, which could add further stress to their capitalization levels. As cash flows of corporates have come under sustained pressure, BFIs have been reporting higher slippages in asset quality over FY23 and 9MFY24. While a revival in the tourism industry, sustained growth in remittances, augmenting forex reserves and controlled inflation so far in FY24 remain some positives, there are several headwinds that could offset the positive impact. Declining exports and moderation in government capital expenditure etc pose slowdown to the economic outlook leading to the possibility of sustained credit deterioration and further slippages in asset profile of the BFIs over the near term.

### About the Bank

Nepal SBI Bank Limited (NSBL), an "A" Class Licensed Financial Institution from Nepal Rastra Bank (NRB; central bank of Nepal) listed on Nepal Stock Exchange, is a subsidiary of State Bank of India (SBI) having 55 percent of ownership. It was incorporated on April 28, 1993 and is the only listed subsidiary of SBI. NSBL has entered into Technical Service Agreement (TSA) with SBI on May 25, 1993 for providing technical and management skills, knowledge and experience in banking activities and modern banking developments from SBI. SBI provides management support to NSBL through its expatriate officers. Central Management Committee (CENMAC) consisting of the Managing Director & CEO, Dy. CEO & Chief Financial Officer, Chief Operating Officer and two Vertical Heads as decided by Managing Director of the Bank, exercises overall control functions with the help of controlling offices, and oversees the overall operations of the Bank.

(Rs. Mn)

Brief Financials	FY21 (A)	FY22 (A)	FY23 (A)
Total Income	10,454	13,897	19,527
PAT	964	1,638	1,967
Total Assets	137,809	153,103	185,958
GNPL (%)	0.23	0.15	2.43
NNPL (%)	-	-	0.90
ROTA (%)	0.71	1.13	1.16

A: Audited

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**About CARE Ratings Nepal Limited:**

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Our parent company, CARE Ratings Limited commenced operations in April 1993 and over three decades, it has established itself as one of the leading credit rating agencies in India. CARE is registered with the Securities and Exchange Board of India (SEBI) and also recognized as an External Credit Assessment Institution (ECAI) by the Reserve Bank of India (RBI).

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