Laxmi Bank Limited: Ratings reaffirmed

August 10, 2020

Summary of rated facilities/instruments

Facility/Instrument	Amount	Rating Action (August 2020)
Issuer Rating	NA	[ICRANP-IR] BBB+; reaffirmed
Subordinated Debenture Programme	NPR 2,000 Million	[ICRANP] LBBB+; reaffirmed

Rating action

ICRA Nepal has reaffirmed the issuer rating of **[ICRANP-IR] BBB+** (pronounced ICRA NP issuer rating triple B plus) assigned to Laxmi Bank Limited (LBL). The rating is considered to be of moderate credit quality. The rated entity carries a 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 symbols to indicate their relative position within the rating categories concerned.

ICRA Nepal has also reaffirmed the rating of **[ICRANP] LBBB+** (pronounced ICRA NP L triple B plus) assigned to the subordinated debenture programme of LBL. 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.

Rationale

The rating action continues to factor in LBL's adequate track record (since 2002) in the industry with sound indicators. The Rating also takes comfort from the presence of institutional promoters in the bank; Citizen Investment Trust, one of the state-owned retirement funds with ~9% stake and representation on the bank's board. This, along with the bank's experienced board of directors and senior management team remain positives for controlled growth going forward. LBL's increasing geographical presence is likely to help it improve the exposure along granular loan segments. The ratings also take into consideration the bank's adequate capitalisation profile at 12.69% as of mid-April 2020 and decent profitability indicators with return on assets of 1.31% for 9M FY2020.

Nonetheless, the ratings remain constrained by the evolving impact of the Covid-19 pandemic on the economy and hence upon the credit profile of the banking system. Accordingly, LBL has also witnessed increased stress in the asset quality front in the recent periods with rise in the 30+ days delinquencies (DPD) to ~5.3% as of mid-April 2020, including non-performing loans (NPLs) of 1.78% (30+ DPD was ~3.4% as of mid-Jan 2019 i.e. last rating). The economic impact of the pandemic could impair the repayment capability of a lot of borrowers and hence impact the asset quality. However, the recent Monetary Policy announcement is likely to provide some support. ICRA Nepal also takes note of the bank's increased pace of credit growth in FY2019 (~25%, remaining higher to ~18% industry growth). The higher pace of growth was also maintained in 9M FY2020 along large borrowers, resulting in increased dependence upon top-20 borrower groups (~31% of portfolio and ~232% of tier-I Capital as of mid-April 2020). This, along with the risks emanating from the relatively high share of non-fund based portfolio, remain the major rating concerns. LBL's weaker deposits profile with low proportion of stable/ low-cost current and savings accounts (CASA), leads to a relatively higher cost of funds. The ratings also remain impacted by the bank's relatively moderate asset base in relation to its age with ~3% share in industry credit and deposits, albeit the recent growth trend, which has aided market positioning to an extent. Going forward, the bank's ability to control fresh slippages and effort to improve the portfolio granularity while maintaining a comfortable capitalisation profile would remain crucial. Also, its stance in attaining sustainable portfolio growth, while maintaining adequate profitability amid the regulatory changes would remain a key monitorable.

Key rating drivers

Strengths

Adequate track record and increasing franchise; experienced board/management – LBL has had an adequate track record in the industry with its operations having started from 2002. The bank has gradually increased its presence in the country with 121 branches as of mid-April 2020. LBL is mainly promoted by the Khetan Group and the Shanghai Group, both business houses in Nepal. The bank has an experienced board of directors and a knowledgeable/stable senior management team, which remains a positive for balanced growth going forward.

Satisfactory profitability profile – LBL's earnings profile remained adequate with return on assets (RoA) of 1.74% and the return on net worth (RoNW) of ~13% for FY2019, albeit slightly lower than the industry average (1.96% and ~16% respectively). These are supported by its healthy net interest margins (NIMs as a percentage of the average total assets-ATA) at 3.47% and good fee-based income at 1.25% of ATA. The profitability indicators have reported some decline in 9M FY2020 on account of the bank not utilising the regulatory forbearance in NPL recognition and credit provisioning norms, amid the pandemic. Additionally, LBL's operating expense ratio has been on the rise with increasing franchise and stood at 1.86% of ATA in 9M FY2020, albeit reporting some moderations compared to the FY2019 levels. With the rising portfolio contribution from new branches and a halt on further major expansions, operating costs are likely to moderate. This will aid the profitability to an extent amid the reduced regulatory cap on interest rate spreads. Going forward, the bank's ability to maintain adequate NIMs and manage the asset quality would have a strong bearing on its profitability profile.

Adequate capitalisation profile – LBL's reported capital to risk-weighted assets ratio (CRAR) of 12.69% and tier-I capital of 10.09% as of mid-April 2020 remain adequate against the minimum regulatory requirement of 11% and 8.5% respectively, as per the prevailing BASEL-III norms implemented by the Nepal Rastra Bank (NRB, the regulator). With the recent increase in NPLs, the bank's solvency profile (net NPA/net worth) remains moderate at ~7% as of mid-April 2020. Given LBL's moderate internal accruals and profit retention, capitalisation levels are expected to remain adequate to support the management's growth plans while maintaining a comfortable solvency profile.

Challenges

Rising stress over assets quality – The bank's asset quality has witnessed increased stress in the recent periods with the NPLs rising to 1.78% in mid-April 2020 from 1.11% as of mid-January 2019 (last rating). However, the recent reported NPLs were disregarding the available regulatory forbearance and with the extended timeline for recoveries in Q4 FY2020, NPL levels are likely to report some moderation. Nonetheless, the 30+ days' delinquencies have also increased to ~5% (from ~2-3% levels earlier) which increases the concerns over its asset quality. LBL's ability to reduce the delinquency/NPLs and avoid a further flow of delinquencies would remain a key rating factor. Any major slippages leading to depletion in capitalisation levels could have a bearing on the ratings assigned.

Going forward, the asset quality of the banking sector, including LBL, is expected to witness some moderation due to a decline in the repayment capability of borrowers amid the ongoing pandemic. The pickup in economic activities in the post-lockdown era remains to be seen and the same would have a bearing on the asset quality outlook. Additionally, banks would have to carefully analyse the impact on the borrower's cash flow streams and provide the rescheduling/moratorium, accordingly, as announced by the recent Monetary Policy. In lack of prudent deferrals of loans and arbitrary addition of loans, the asset quality impact is likely to surface after some lag.

Increased credit concentration risks and high non-fund-based business – As of mid-April 2020, LBL still had a corporate heavy portfolio at ~58%, followed by retail loans at ~21% and SME loans of ~16%, the rest being deprived sector loans. The recent credit growth has partly been along the corporate loan segment, as reflected in the largely stagnant share of such loans in the portfolio. Within this segment, dependence upon large borrower groups has further increased in recent periods with the top-20 Groups accounting for ~31% of the portfolio as on mid-April 2020. As a % of tier-I capital, this remains sizeable at ~232% (~199% last rating) and hence is a major rating concern. As on the same date, LBL also had a relatively high share of non-fund business at ~52% of the fund-based portfolio. This could increase the portfolio vulnerability amid the expected economic slowdown.

Spiked credit growth in recent periods – LBL's credit grew by ~25% in FY2019 against ~18% for the industry, as opposed to the largely comparable or lower growth earlier. The growth momentum continued in 9M FY2020 wherein ~23% annualised growth was reported (industry growth at ~19%). The resilience of the recently added credit portfolio amid the challenges created by the pandemic remains to be seen. However, the increased pace of growth has gradually increased bank's market share which stood at ~3% as of mid-April 2020.

Lower CASA and relatively high cost of deposit – The bank's CASA deposits portion continues to remain slightly low at ~34% compared to ~41% for industry as of mid-April 2020. Hence, its cost of deposits at 7.23% for 9M FY2020 remained higher than the industry average of 6.32% for the same period. This has impacted the bank's profitability as the lending yields mostly remain lower than the industry average. The bank's reliance upon top-20 depositors remain high at ~24% as of mid-April 2020, however, it is lower in relation to its peers. Improving the deposits mix and cost would remain the key challenges for the bank over the medium term, amid the recent discontinuation of similar deposit rate practice among banks.

Analytical approach: For arriving at the ratings, ICRA Nepal has applied its rating methodology as indicated below.

Links to applicable criteria:

Bank Rating Methodology

Bank Profile

In operation since April 2002, LBL is mainly promoted by the Khetan Group and the Shanghai Group, both business houses in Nepal. The bank's shares are listed on the Nepal Stock Exchange and the shareholding pattern constitutes the promoters holding ~51% and a public shareholding of ~49%. Mr. Ajaya Bikram Shah is the Chief Executive Officer of the Hattisar, Kathmandu-based bank.

LBL has presence across the country through its 121 branches, 49 branchless banking counters and 148 ATMs as of mid-April 2020. As on the same date, LBL has a market share of about 2.65% in terms of deposit base and 2.79% of total advances of Nepalese banking industry (3.05% and 3.20% share among the commercial banks). LBL reported a profit after tax (PAT) of NPR 1,590 million in FY2019 (YoY growth of 35%) over an asset base of NPR 101,950 million as of mid-July 2019. For 9M FY2020, bank has reported a profit of NPR 1,090 million over an asset base of NPR 119,695 million as of mid-April 2020. As on the same date, LBL's reported CRAR was 12.69% and gross NPLs were 1.78%. In terms of the technology platform, LBL is using Finacle as the core banking software across all its branches.

Key financial indicators

Year Ended	Mid-July 2017 (Audited)	Mid-July 2018 (Audited)	Mid-July 2019 (Audited)	Mid-April 2020 (Provisional)
Operating ratios				
Yield on average advances	9.76%	11.82%	12.10%	11.38%
Cost of deposits	5.57%	7.46%	7.74%	7.23%
Net interest margin/ATA	2.77%	3.08%	3.47%	3.14%
Non-interest income/ATA	1.13%	1.20%	1.25%	1.04%
Operating expenses/ATA	1.66%	1.72%	2.13%	1.86%
Credit provisions/ATA	0.08%	0.42%	0.14%	0.49%
PAT/ATA	1.61%	1.56%	1.74%	1.31%
PAT/net-worth	13.21%	11.38%	13.36%	11.15%
Gross NPAs	0.93%	1.29%	1.09%	1.78%
30+ days delinquencies	1.57%	2.83%	1.62%	5.30%
Capitalisation ratios				
Capital adequacy ratio	13.58%	12.43%	11.83%	12.69%
Net NPAs/net worth	1.94%	3.22%	2.97%	7.24%
Liquidity ratios				
Total liquid assets/total liability	22.30%	21.31%	21.87%	20.54%
Total advances/total deposits	87.47%	93.79%	95.30%	95.45%

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About ICRA Nepal Limited

ICRA Nepal Limited, the first credit rating agency of Nepal, is a subsidiary of ICRA Limited (ICRA) of India. It was licensed by the Securities Board of Nepal (SEBON) on October 3, 2012. ICRA Nepal is supported by ICRA Limited through a technical support services agreement, which envisages ICRA helping ICRA Nepal in areas such as rating process and methodologies, analytical software, research, training, and technical and analytical skill augmentation.

Our parent company, ICRA Limited, was set up in 1991 by leading financial/investment institutions, commercial banks and financial services companies as an independent and professional investment information and credit rating agency. Today, ICRA and its subsidiaries together form the ICRA Group of Companies.

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