Excel Development Bank Limited: [ICRANP-IR] BBB- assigned

June 07, 2021

Summary of rated facilities

Facility	Rated Amount	Rating Action
Issuer Rating	NA	[ICRANP-IR] BBB-; assigned

Rating action

ICRA Nepal has assigned the issuer rating of [ICRANP-IR] BBB- (pronounced ICRA NP issuer rating triple B minus) to Excel Development Bank Limited (EDBL). The rating is considered to have a moderate degree of safety, regarding timely servicing of financial obligations with moderate credit risk. The sign of + (plus) or – (minus) appended to the rating symbol indicates their relative position within the rating categories concerned. The issuer rating is only an opinion on the general creditworthiness of the rated entity and not specific to a particular debt instrument.

Rationale

The rating assignment factors in the bank's strong deposit profile with high proportion of low-cost current and savings account (CASA) at ~47% as of mid-April 2021 against ~30% for the development bank's industry average. This resulted in low cost of fund of 4.52% for 9M FY2021 against the industry average of 6.10% and hence provided competitive advantage to the bank. The deposit concentration remains granular with the top 20 depositors accounting for ~12% of total deposits as of mid-April 2021. The rating considers the bank's strong foothold in the eastern region of the country with diverse network presence (41 branches), established track record (operating since 2005) and experienced directors/management team. The bank has expanded its organisational structure and improved its risk management framework over the years, which also remains a rating positive. Moreover, its capitalisation profile (capital to risk weighted assets ratio - CRAR) remained adequate at 12.25% as of mid-April 2021 (against the minimum regulatory requirement of 11%), which would be supported by the proposed rights issue.

However, the rating is mainly constrained by the bank's high credit growth trend in the recent periods, along with the build-up in asset quality stress after the outbreak of the Covid-19 pandemic. EDBL's gross non-performing assets (NPA) increased to 2.62% as on mid-April 2021 from 0.62% as on mid-July 2019, while the 0+ days delinquency increased to ~13% from ~4% over the same period. This has deteriorated the bank's profitability indicators with return on assets (RoA) of 1.02% and return on net worth (RoNW) of ~13% in 9M FY2021, against 2.25% and ~18%, respectively, in FY2019. The decline in profitability was attributable to the competition-induced pressure on its net interest margins (NIMs as a percentage of average total assets-ATA) and introduction of regulatory cap on lending spreads at 5%. The rating factors in EDBL's high dependence on top 20 borrowers at ~17% as of mid-April 2021, along with the geographical concentration risks associated with being a regional player. The rating notes the increasing competition from large and established commercial banks offering a wider range of services. Additionally, the regulatory restrictions for class-B banks in areas such as loans against hypothecation of stocks and receivables and foreign currency-based transactions (such as import letter of credit) erodes their competitive positioning and earning potential vis-à-vis class-A banks, which remains a long-term credit negative. The recently developed volatile political environment in Nepal could also impact the operating environment and credit profile of the borrowers. Going forward, the bank's ability to grow its portfolio judiciously in the post-Covid-19 scenario, while maintaining its deposits profile, improving the asset quality and profitability, would remain a key rating driver.

Key rating drivers

Credit Strengths

Strong deposits profile with high CASA, lower cost of deposit and fair granularity – EDBL's deposit mix remains strong with CASA deposits of ~47% against ~30% for the development bank's industry average as of mid-April 2021. Consequently, the bank has much lower cost of deposits at 4.52% for 9M FY2021 against the industry average of 6.10%.

This also remains lower to the commercial banks' industry average of 4.96% for the same period. The bank has generally been able to maintain a lower cost of funds on account of its diverse presence and focus on customer service. In the current regime of the base rate plus loan pricing model, EDBL has a good competitive position and can offer lower rates to its borrowers. Moreover, the deposit remains granular with the top 20 depositors accounting for ~12% of the total deposits as of mid-April 2021. Going forward, the bank's ability to maintain its deposit mix and cost would remain the key monitoring factors.

Established track record; diversified presence and experienced management team – EDBL is a seasoned regional level player with an established track record in the Nepalese development banking industry (from 2005). The bank has diversified branch network (41 branches as of mid-April 2021) in five districts (Jhapa, Illam, Morang, Sunsari, Panchthar) of eastern Nepal. The franchises added in new geographies, over the recent years, supported the bank's credit growth trajectory. EDBL has also added several levels in its organisational structure over the years and hence its current senior management team comprises experienced individuals, mostly from class-A Banks. The risk management practices have also been enhanced accordingly. This remains a positive in terms of controlled business performance going forward.

Adequate capitalisation profile – The bank's capitalisation remains adequate with a CRAR of 12.25% as of mid-April 2021 against the minimum regulatory requirement of 11%. EDBL has mostly met its capital requirements through retention of profits over the last few years. Though the current capitalisation is lower than the industry average of 13.48% as of mid-April 2021, the proposed 30% rights issue is expected to support its growth plans, as well as absorb any near-term asset quality shocks.

Credit Challenges

High credit growth, followed by stress in assets quality – EDBL has maintained a high credit growth trend in the recent years, albeit over a small base, with CAGR of ~33% from mid-July 18 to mid-April 2021 (against 20% growth in the overall banking industry credit). Despite the high growth, the company reported sizeable credit concentration among the top 20 borrower group at ~17% as of mid-April 2021. While the bank was able to maintain comfortable asset quality in pre-Covid years, its NPA sharply increased after the pandemic, which remained at 2.62% as on mid-April 2021 (against 0.62% as on mid-July 2019). Despite the recent moderations, the NPA remains much higher compared to the industry average of 1.35% on the same date. With a modest provision cover of ~70%, the impact on solvency (net NPA to net worth) remained high at ~6% as of mid-April 2021. The bank's 0+ days delinquencies, however, remains was among peers at ~13% as on the same date (increased compared to ~4% as on mid-July 2019). The bank's ability to improve the asset quality, while controlling fresh slippages amid the pandemic, as well as the central bank's further stance in supporting the impacted units would remain crucial.

Moderation in profitability profile – In line with the rising industry competition, EDBL reported decline in NIMs over the years, which was further accentuated by the introduction of regulatory cap on lending spreads at 5% from FY2021 onwards. Hence, the bank's NIMs decreased to 3.55% for 9M FY2021 against 5.31% for FY2019. Additionally, the increased asset quality stress led to deterioration in the profitability indicators with RoA of 1.02% and RoNW of ~13% in 9M FY2021 against 2.25% and ~18% for FY2019, respectively. Nevertheless, the operating expense ratio has also been moderating and stood at 2.07% for 9M FY2021 against 2.63% in FY2019, hence providing some support. Going forward, the bank's ability to maintain adequate NIMs and manage the asset quality would have a strong bearing on its profitability profile.

Intense competition from commercial banks with wider range of services – As per the regulatory provisions, class-B banks are restricted to undertake certain activities that are allowed only for class-A commercial banks, viz. credit secured against hypothecation of stock and receivables, opening of foreign currency denominated letter of credit/guarantees, etc. These provisions erode the competitive positioning of the development banks (such as EDBL) vis-à-vis commercial banks with higher capital, stronger brand and nationwide branch network, larger customer base, wider range of services. This remains a long-term negative for the development bank industry. Further, EDBL is exposed to geographical concentration risks being a regional level bank, currently present only in five districts of eastern Nepal.

A**nalytical approach:** For arriving at the rating, ICRA Nepal has applied its rating methodology as indicated below.

Links to applicable criteria:
[Bank Rating Methodology]
[Issuer Rating Methodology]

Bank Profile

Excel Development Bank Limited (EDBL), a regional level class-B bank, started its commercial operation from July 2005 as 1-3 district level development bank. The corporate office of the bank is located at Birtamode, Jhapa. The bank is promoted by a wide range of promoters with maximum shareholding by one promoter at ~9% of the total capital (as of mid-July 2020). The share capital of the bank is distributed among promoter and public in the ratio of ~51:49. Mr. Dinesh Kumar Pokhrel is the Chief Executive Officer of the bank.

EDBL has presence in five districts viz. Illam, Jhapa, Morang, Sunsari and Panchthar of Nepal through its 41 branches as of mid-April 2021. It has a market share of ~2.6% in the development bank industry and ~0.3% in the overall banking industry, both in terms of deposit and credit base as on mid-April 2021. The company reported a net profit of ~NPR 104 million in FY2020 (~38% YoY decline) over an asset base of NPR 11,434 million as of mid-July 2020. For 9M FY2021, the bank reported a net profit of NPR 118 million over an asset base of NPR 12,924 million as of mid-April 2021. The capitalisation profile (CRAR) of EDBL was at 12.25% and gross NPLs stood at 2.62% as on the same date.

Key financial indicators

Year Ended	Mid-July 2018	Mid-July 2019	Mid-July 2020	Mid-Apr 2021
	(Audited)	(Audited)	(Audited)	(Unaudited)
Operating ratios				
Yield on average advances	13.71%	13.97%	13.55%	10.52%
Cost of deposits	5.21%	6.46%	6.76%	4.52%
Net interest margin/ATA	5.83%	5.31%	4.63%	3.55%
Non-interest income/ATA	0.74%	0.92%	0.91%	0.99%
Operating expenses/ATA	2.23%	2.63%	2.58%	2.07%
Credit provisions/ATA	0.51%	0.36%	1.48%	0.64%
PAT/ATA	2.68%	2.25%	1.02%	1.28%
PAT/net worth	21.09%	17.87%	9.53%	12.94%
Gross NPAs	0.62%	0.62%	2.76%	2.62%
0+ days delinquencies		4.28%	22.69%	12.57%
Capitalisation ratios				
Capital adequacy ratio	19.23%	12.89%	13.67%	12.25%
Tier I capital	18.43%	12.10%	12.29%	11.00%
Net NPAs/net worth	0.61%	1.24%	9.51%	5.87%
Liquidity ratios				
Total liquid assets/total liability	27.84%	21.66%	27.85%	21.80%
Total advances/total deposits	82.09%	86.08%	77.98%	84.86%

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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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