Narayani Development Bank Limited: Rating reaffirmed

December 19, 2022

Summary of rating action

Facility/Instrument	Rated Amount (NPR million)	Rating Action
Issuer rating	NA	[ICRANP-IR] C+; reaffirmed

Rating action

ICRA Nepal has reaffirmed the issuer rating of [ICRANP-IR] C+ (pronounced ICRA NP issuer rating C plus) to Narayani Development Bank Limited (NDBL). The rating indicates a very high risk of default regarding the timely servicing of financial obligations. The issuer rating is only an opinion on the general creditworthiness of the rated entity and not specific to a debt instrument. The sign of + (plus) or – (minus) appended to the rating symbol indicates their relative position within the rating category concerned.

Rationale

The rating continues to remain constrained by the weak financial profile of the bank despite scale growth since last rating. The bank continues to carry significant accumulated losses and operates with a moderate scale of operation, leading to a modest operating cashflows vis-à-vis operating expenses resulting in a weak operating profitability. The bank's ability to grow and generate operating profitability on a sustained basis remains untested, and therefore remains a key rating monitorable/sensitivity. The bank's efforts to scale up remains impeded by the challenges in raising funds amid the eroded brand image of the bank as well as current unfavourable economic outlook. The impact of recent deterioration in economic environment is also evident in the uptick in NPLs during Q1FY2023, leading to increased credit cost and further contributing to the losses reported during Q1FY2023. The way forward is challenging given the highly fragmented and competitive banking sector universe, impact of the liquidity crunch on the overall economy, and NDBL's weak competitive position in the banking industry.

However, the rating reaffirmation continues to derive comfort from the bank's improved capitalisation profile through two consecutive tranches of rights share issue (100% each in FY2021 and FY2022) that increased the paid-up capital to ~NPR 262 million. This, along with the further 100% rights issue plan, is expected to help the bank achieve the minimum regulatory capital requirement of NPR 500 million, for the regional level class-B banks. The gradual increase in credit and deposit portfolio, following the removal of NDBL from the NRB's list of problematic institutions and removal of deposit raising ceiling with effect from October 2021 (earlier capped at 100% of paid-up capital) also remain rating positives.

Going forward, NDBL's ability to timely raise the last tranche of equity capital and comply with regulatory minimum requirement levels and scale up its business while maintaining asset quality will remain key rating monitorable. Also, the bank's ability to generate operating profitability on a sustained basis will also remain a major rating sensitivity.

Key strengths and challenges

Credit strengths

Improved capitalisation profile – The successful issue of the two tranches of 100% rights issue each, has improved the capitalisation profile with a capital to risk weighted assets (CRAR) of 17.24% as of mid-October 2022. Further, the proposed 100% rights issue is expected to provide an increased capital cushion to support near to medium term scale growth. Since the original timeline for meeting the minimum licensing capital has expired in August 2022, the bank's ability to comply with the regulations at the earliest will remain necessary to avoid the consequences of non-compliance. To that end, the ability of the promoters to raise the equity remains to be seen.

Improvement in outlook after gradual removal of business restriction – The business operations have gradually improved after the bank was released from the NRB's list of problematic institutions in August 2020. Following the removal, the bank has registered an increase in deposit and credit portfolio. The increased credit portfolio has also diluted the NPA level to 4.67% as of mid-October 2022, which is expected to remain under the threshold of 5% (generally considered acceptable by institutional depositors) assuming future business growth and no major slippages. The removal of the restriction on deposit collection (w.e.f. October 2021, earlier capped at 100% of paid-up capital) has also supported the business expansion to some extent.

Credit challenges

Lack of operational self-sufficiency – The bank is yet to report operating profit on a sustainable basis given its small scale, relatively high operating expense ratio and unfavourable economic environment increasing the probability of increased credit cost going forward (operating loss of NPR 23 million and NPR 24 million in FY2021 and FY2022 respectively). With sizeable accumulated losses, NDBL's net worth was ~NPR 137 million as of mid-October 2022 (vs. paid-up capital of ~NPR 262 million on the same date).

Weak asset quality profile – The bank continues to report sub-optimal assets quality with recent slippages despite recovery of major chunk of dated NPLs. The NPLs continue to remain high at ~4.67% as of mid-October 2022 (2.94% in mid-July 2022). Improving assets quality while achieving scalability will have bearing on the bank's future performance and remains a key rating monitorable.

Scalability challenges – NDBL has a nominal market share as of mid-October 2022, following the erosion in asset base, credit and deposit portfolio and customer base during the years of its existence as a problematic institution. The weak competitive positioning coupled with limited footprint (five branches), fragmented banking industry, weak financial indicators and weak brand recall of NDBL remains a challenge in raising funds, growing the business and achieving operational self-sufficiency. The challenges are further accentuated by the ongoing unfavourable economic conditions.

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

Links to applicable criteria:
Issuer Rating Methodology
Bank Rating Methodology

Link to previous detailed rating rationale:
Issuer Rating Rationale – November 2021

About the company

Narayani Development Bank Limited (NDBL) started its commercial operation in October 2001. The bank is registered as a public limited company and is licensed by the NRB as a 3-district level class-B bank.

The bank was granted a conditional release from the problematic status on August 6, 2020, which now allows it to conduct its business such as accepting deposits, extending loans and opening new branches. NDBL is in the process of raising its paid-up capital to NPR 500 million, which is the minimum licensing requirement for regional class-B banks.

As of mid-October 2022, NDBL has a small scale of operation in the Chitwan district through its five branches. In FY2022, the bank reported a net loss of ~NPR 16 million over an asset base of ~NPR 519 million as of mid-July 2022 compared to a net loss of ~NPR 12 million in FY2021 over an asset base of ~NPR 217 million as of mid-July 2021. The bank reported net loss of ~NPR 17 million in Q1FY2023 over an asset base of ~NPR 686 million. As of mid-October 2022, the bank's capital adequacy ratio was 17.24%, supported by series of rights issues in last two years. The reported gross NPLs was ~4.67% as of mid-October 2022.

Key financial indicators

YEAR ENDED	Jul 2019 (Audited)	Jul 2020 (Audited)	Jul 2021 (Audited)	Jul 2022 (Provisional)	Oct 2022 (Provisional)
Net Interest Income – NPR million	2	2	(1)	8	2
Profit before tax – NPR million	(1)	(3)	(14)	(16)	(17)
Profit after tax – NPR million	1	(1)	(12)	(16)	(17)
Loan and advances – NPR million	12	10	94	353	490
Total assets – NPR million	91	134	217	519	686
OPERATING RATIOS					
Yield on average advances	80.64%	76.87%	2.84%	9.47%	11.67%
Cost of deposits	1.13%	1.92%	5.16%	5.75%	9.34%
Net Interest Margin/Avg. Total Assets	1.41%	1.67%	-0.54%	2.29%	1.05%
Non-interest Income/Avg. Total Assets	1.20%	0.57%	1.21%	1.23%	1.09%
Operating Expenses/Avg. Total Assets	8.91%	6.08%	13.96%	10.16%	7.10%
Credit Provisions / Avg. Total Assets	-5.21%	-1.54%	-5.24%	-2.36%	6.12%
PAT / Avg. Total Assets	0.80%	-1.01%	-6.81%	-4.29%	-11.09%
PAT / Net Worth	-100.37%	-7.86%	-19.45%	-13.51%	-46.38%
Gross NPAs	77.36%	73.26%	9.74%	2.94%	4.67%
CAPITALISATION RATIOS					
Capital Adequacy Ratio	-22.71%	34.85%	58.47%	26.76%	17.24%
Tier I capital	-22.74%	34.82%	57.85%	25.90%	16.40%
Net NPAs/Net Worth	13.28%	-3.07%	0.64%	3.30%	8.13%
COVERAGE & LIQUIDITY RATIOS					
Total Liquid Assets/Total Liability	78.17%	87.01%	47.59%	26.86%	25.35%
Total Advances/Total Deposits	46.66%	39.38%	95.90%	104.70%	94.71%

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About ICRA Nepal Limited

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