Excel Development Bank Limited: Rating downgraded to [ICRANP-IR] BB

September 25, 2023

Summary of rating action:

Facility	Rated Amount	Rating Action
Issuer Rating	NA	**[ICRANP-IR] BB**; downgraded from [ICRANP-IR] BB+

Rating action

ICRA Nepal has downgraded the issuer rating of Excel Development Bank Limited (EDBL) to **[ICRANP-IR] BB** (pronounced ICRA NP issuer rating double B) from [ICRANP-IR] BB+ (pronounced ICRA NP issuer rating double B plus). Issuers with this rating are considered to have a moderate risk of default with regard to the timely servicing of financial obligations. The rating is only an opinion on the general creditworthiness of the rated entity and not specific to any particular debt instrument.

Rationale

The rating downgrade mainly factors in a further deterioration in the bank's asset quality, with the non-performing loans (NPLs) increasing to 4.88% and the 0+ days delinquency (DPD) increasing to ~24% as of mid-July 2023 (2.85% and ~15% respectively as of mid-July 2022). This has led to a weak solvency profile (net NPL to net worth) of ~13% and modest return indicators, despite improved net interest margins. Rating concerns along the asset quality are accentuated by the ongoing economic slowdown and high interest rate environment, both of which have impacted EDBL's top borrowers. Additionally, the recent regulatory changes requiring continued credit provision for recovered NPLs for a curing period of six months, along with other provisions are likely to keep credit costs higher over the near term. Further, the bank's capitalisation profile has moderated with CRAR of 11.72% as of mid-July 2023 (12.19% respectively as of mid-July 2022) mainly owing to sectoral credit concentration induced deductions from tier-I. The rating also remains impacted by the intense competition from "Class-A" commercial banks with a wide range of banking services, along with EDBL's high geographical concentration risks.

Nonetheless, the rating continues to derive comfort from the bank's relatively high share of granular and low-cost current and savings account (CASA) deposits which has helped it in maintaining the lowest cost of funds among development banks. The rating action also derives comfort from the bank's strong foothold in the eastern region of the country with diverse network presence, established track record (since 2005) and experienced directors/management team. Going forward, the bank's ability to recover existing NPLs and avoid large slippages amid the difficult operating environment, while maintaining its competitive cost of funds and generating adequate profitability would remain the key rating sensitivities.

Key rating drivers

Rating Strengths

Fair deposit profile with relatively better CASA mix and granular deposits – Despite recent decline in line with the industry trends, the CASA deposits for EDBL continue to remain above the industry average, contributing to its relatively lower cost of deposits vis-à-vis its peers and the industry average. The bank's CASA deposit mix of ~35% as of mid-July 2023, remains better compared to the development banking industry average of ~25%. This has aided the bank to report relatively lower cost of deposits at 8.56% for FY2023 (development banking industry average of 9.85%) and thus maintain good net interest margins (NIMs) of 3.96% for FY2023. Moreover, the deposit remains fairly granular with the top-20 depositors accounting for ~11% of the total deposits as of mid-July 2023, which comforts the stability of the funding profile to an extent, amid the volatile interest rate environment.

Established track record; diversified presence and experienced management team – The bank is a seasoned player in the eastern region of the country, with an established track record since 2005. It has diversified branch networks (45 branches as of mid-September 2023) in six districts of eastern Nepal. EDBL's senior management team comprises of experienced individuals, mostly from "Class-A" Banks, which remains a positive.

Rating Challenges

Weak asset quality indicators – With major spike reported during FY2023, EDBL's gross NPLs of 4.88% as of mid-July 2023, remains much higher than the development bank industry average of 2.49%, despite booking a chunk of NPLs into non-banking assets (NBAs, including which the adjusted NPLs were 6.29% as of mid-July 2023). This was mainly on account of the pressure on few large borrower groups amid the economic slowdown, which sharply increased its NPL levels. The asset quality concerns are further exacerbated by the bank's high delinquency level, with 0+ days DPD of ~24% (including NPLs) as of mid-July 2023, which could potentially further weaken the solvency indicators, given the current economic slowdown along with the continuation of high interest rate scenario. Further, the company has relatively high credit concentration among the top-20 borrower groups at ~14% as of mid-July 2023 (~15% during last rating exercise), which remains ~85% of net worth. The bank's ability to control incremental slippage and recover from existing NPLs will remain crucial for its future profitability and solvency.

Modest capitalisation profile – The bank's tier-I capital moderated to 10.37% and CRAR to 11.72% as of mid-July 2023 (10.98% and 12.19% respectively as of mid-July 2022). The decline in capitalisation was mainly due to the deduction in tier-I capital, related to loan disbursement above the ceiling of 40% in a specific sector (consumption sector). The CRAR remains marginally above the regulatory minimum requirement of 10%, while the solvency has also stretched to ~13% as of mid-July 2023. The declining capital cushion along with asset quality pressures will remain the key rating monitorable.

Modest profitability profile – EDBL reported moderate profitability in FY2023 (despite slight improvement), which was mainly on account of the increased credit provisions. The bank reported a return on assets (RoA) of 0.83% and a return on net worth (RoNW) of 7.44% for FY2023 (0.70% and 6.55% respectively for FY2022), as against the industry average RoNW of ~10%. The minimal improvements were aided by refinement in NIMs which stood at 3.96% for FY2023 (3.27% for FY2022) and the bank's ability to sustain the same also remains to be seen. 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 solely 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 the commercial banks with higher capital, stronger brand and nationwide branch network, larger customer base, wider range of services and finer lending rates. Further, EDBL is exposed to geographical concentration risks being a province level bank, currently present only in six districts of eastern Nepal.

Link to the previous rating rationale
Rationale_EDBL_Issuer Rating Surveillance_July-2022

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

Links to the applicable criteria:
Bank Rating Methodology
Issuer Rating Methodology

Bank Profile

Excel Development Bank Limited (EDBL), a province level class-B bank, started its commercial operation from July 2005 as 3-district level development bank and was last upgraded to province level status on October 19, 2022. 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-April 2023. The share capital of the bank is distributed among promoter and public in the ratio of ~51:49. Dr. Indra Kumar Kattel is the Chief Executive Officer of the bank.

EDBL has presence in six districts viz. Ilam, Jhapa, Morang, Sunsari, Panchthar and Udayapur of Nepal through its 45 branches as of mid-September 2023. It had a market share of 2.48% and 2.30% in terms of deposit and credit base of the development bank industry (0.25% and 0.23% respectively in the overall banking industry) as on mid-July 2023. The company reported a net profit of ~NPR 127 million in FY2023 (~31% YoY growth) over an asset base of NPR 16,195 million as of mid-July 2023. As on the same date, the capitalisation profile (CRAR) of EDBL was at 11.72% and gross NPLs stood at 4.88%.

Key financial indicators

Year ending on	Mid-July 2020 (Audited)	Mid-July 2021 (Audited)	Mid-July 2022 (Audited)	Mid-July 2023 (Unaudited)
Net interest income - NPR million	471	457	452	605
Profit before tax - NPR million	149	186	145	181
Profit after tax - NPR million	104	134	96	127
Gross loan and advances - NPR million	7,908	9,558	10,671	10,979
Total assets - NPR million	11,677	13,359	14,318	16,195
Operating ratios				
Yield on average advances	13.55%	10.16%	11.45%	13.58%
Cost of deposits	6.76%	4.36%	6.36%	8.56%
Net interest margin/ATA	4.63%	3.65%	3.27%	3.96%
Non-interest income/ATA	0.91%	0.88%	0.54%	0.56%
Operating expenses/ATA	2.58%	2.26%	2.64%	2.49%
Credit provisions/ATA	1.48%	0.78%	0.11%	0.85%
PAT/ATA	1.02%	1.07%	0.70%	0.83%
PAT/net worth	9.53%	10.88%	6.55%	7.44%
Gross NPLs	2.76%	3.77%	2.85%	4.88%
0+ days delinquencies	23%	15%	15%	24%
Capitalisation ratios				
Capital adequacy ratio	13.67%	12.26%	12.19%	11.72%
Tier I capital	12.29%	11.15%	10.98%	10.37%
Net NPLs/net worth	9.51%	13.89%	5.26%	12.56%
Liquidity ratios		`		
Total liquid assets/total liability	28%	27%	23%	29%
Total advances/total deposits	78%	84%	88%	77%

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