Lumbini Bikas Bank Limited: Rating downgraded and placed on Watch with Negative Implications

December 18, 2023

Summary of rating action

Facility/Instrument	Rated Amount (NPR Million)	Rating Action
Issuer Rating	NA	[ICRANP-IR] BB@*; downgraded from [ICRANP-IR] BB+ and placed on watch with negative implications

*@ denotes rating on '*Watch with Negative Implications*'

Rating Action

ICRA Nepal has downgraded and revised the issuer rating of Lumbini Bikas Bank Limited (LBBL) to [ICRANP-IR] BB@ (pronounced ICRA NP issuer rating double B) from [ICRANP-IR] BB+ (pronounced ICRA NP issuer rating double B plus). The rating has been placed on watch with negative implications (denoted by @). Issuers with this rating are considered to have moderate risk of default regarding timely servicing of financial obligations. The rating is only an opinion on the general creditworthiness of the rated entity and not specific to any debt instrument. The sign of + (plus) or – (minus) appended to the rating symbol indicates their relative position within the rating categories concerned.

Rationale

The rating action factors the deterioration in LBBL's asset quality as reflected in rising proportion of gross non-performing loans (NPLs) as well as overall portfolio delinquencies (~3.48% and 35% respectively as of mid-October 2023). Although the spike in delinquency during Q1FY2024 can also be partly attributed to industry seasonality, the steady decline in the banking sector asset quality in the last 12-18 months, stress among the banking sector borrowers and generally moderate borrower profile of development bank sector remains a concern on the LBBL's ability to report a turnaround in asset quality over the near term. Moreover, sustained decline in tier-I capital in recent years has depleted the capital cushion impairing bank's ability to absorb credit shocks. Rising slippages has lowered the provision cover, increased the net NPLs (~1.38% as of mid-October 2023) and stretched the solvency profile (net NPL/net worth ~10% as of mid-October 2023); which could weaken incremental profitability/solvency in case the bank is unable to recover from/upgrade the NPLs. Additionally, relatively high deposit cost (amid low CASA proportion) and rising credit cost is likely to subdue the incremental profitability for the company over the near to medium term. ICRA Nepal notes the regulatory restriction on the class-B development banks in areas such as hypothecation loans, foreign currency-based transactions (such as import letter of credits), etc., which coupled with relatively small scale of operations compared to the class-A commercial banks offering wider range of services, remains a long-term credit negative for development bank industry.

Nonetheless, the rating continues to derive comfort from the bank's adequate track record of operation as well as adequate branch network for its current scale of operation (90 branches as of mid-October 2023). LBBL's increasing scale of operation and market share in the development banking industry and resulting economies of scale has brought down the operating expenses ratio which remains a positive for operating profitability. Further, the improving portfolio granularity (~16% of total loans among top-20 borrowers/group and ~16% of total deposits among top 20 depositors) has been factored in the rating positives.

Going forward, the bank's ability to control incremental slippage and improve the asset quality will have a bearing on the profitability and capitalisation and remains a key rating sensitivity. Further, LBBL's ability to maintain adequate capital cushion, liquidity position and improve the deposit profile remain among the key monitorable.

Key rating drivers

Credit strengths

Adequate track record and branch network for its scale of operation – LBBL has adequate track record of operation via the constituent class B and class C banks that merged into the present day bank. The bank also has adequate track record of post-merger operations, given that the most recent merger/acquisition took place in 2017. Through organic/inorganic measures, LBBL has scaled up and gained market share in the class B industry. Further, the bank's network of 90 branches contributes to the portfolio growth, operational efficiency and portfolio granularity.

Adequate overall capitalization; albeit with moderating tier I capital – LBBL issued tier-II debentures of NPR 1,000 million in FY2023 that improved the company's overall CRAR to 13.38% as of mid-July 2023 from 11.72% as of mid-July 2022. Nonetheless, the tier-I capital continues to moderate (9.33% as of mid-October 2023 from 9.83% as of mid-July 2023; 10.26% as of mid-July 2022) and is likely to moderate further following the proposed dividend out of FY2023 profits. Although the tier I capital remains adequate vis-à-vis regulatory minimum of 8.5%, the decline in cushion amid the asset quality stress remains a concern.

Credit challenges

Deterioration in asset quality – LBBL reported deterioration in asset quality with rise in reported gross NPLs to 3.48% as of mid-October 2023 (3.01% as of mid-July 2023; 1.70% as of mid-July 2022). The asset quality concerns are further exacerbated by the bank's high delinquency, with 0+ days delinquent portfolio of ~35% (including NPLs) as of mid-October 2023 vis-a-vis ~18% as of mid-July 2023 (~11% as of mid-July 2022). The rising slippage has diluted the provision cover and stretched the solvency profile for the bank. The slowdown in the economic activities amid high leverage prevailing across almost entire spectrum of bank's borrowers, raises concerns on the incremental debt recovery despite the moderating interest rate outlook. Sustained stress on borrowers might impact the bank's asset quality thereby impacting its incremental profitability and capitalisation which remains a major rating concern.

Moderation in return indicators – The bank reported moderation in its profitability indicators due to the deterioration in asset quality and rise in credit cost (provision expenses of 0.70% in FY2023 compared to 0.07% in FY2022) despite the improved net interest margins (3.25% in FY2023 compared to 3.04% in FY2022). LBBL's return on assets (RoA) and return on net worth (RoNW) moderated to 1.06% and 10.30% in FY2023 (1.26% and 11.56% respectively in FY2022). The decline in NIMs in 3MFY2024 along with the expected impact of tax liabilities relating to gain on bargain purchases related to merger/acquisition (~NPR 110 million) is expected to impact the profitability and/or capitalisation for FY2024 and remains a credit negative.

Low CASA deposits and higher cost – The CASA deposits for the bank have remained below the industry average over the years (~19% vis-à-vis industry average of ~25% as of mid-October 2023), which has resulted in higher cost of fund for the bank and led to relatively higher base among the similar rated peers. High cost stems from high proportion of term deposits, which remains a competitive disadvantage, despite its support to the stability of funding profile. Despite low CASA, the bank's deposit concentration has improved (~16% among top-20 depositors as of mid-October 2023 compared to ~23% as of mid-April 2022; last rating exercise) which remains positive.

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 LBBL) vis-à-vis the commercial banks with higher capital, stronger brand, larger customer base, wider range of services and finer lending rates.

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

Links to applicable criteria:
Bank Rating Methodology
Issuer Rating Methodology

Link to previous detailed rating rationale:
Issuer Rating Rationale – June 27, 2022

Bank profile

Lumbini Bikas Bank Limited (LBBL) is a national-level development bank, formed after the merger of multiple class B and class C financial institutions, the last merger concluded in July 2017. Its corporate office is in Dillibazar, Kathmandu. The share capital of the company is distributed among promoter and the public in the ratio of 51:49. Mr. Naresh Singh Bohra is the CEO of the bank. The bank's equity share is listed on the Nepal Stock Exchange (NEPSE).

LBBL is operating through its network of 90 branches as of mid-October 2023. The bank has a market share of ~9.1% in terms of deposit base and ~9.6% in terms of advances in the development banking industry (comprising 17 players) as of mid-October 2023. LBBL reported a profit after tax (PAT) of NPR 612 million in FY2023 (4% YoY degrowth) over an asset base of NPR 58,751 million as of mid-July 2023. In 3MFY2024, the bank reported a PAT of NPR 173 million over an asset base of NPR 61,101 million as of mid-October 2023. LBBL's CRAR was 12.61% (with tier-I capital of 9.33%) and gross NPLs stood at 3.48% as of mid-October 2023.

Key financial indicators

Year ended	Mid-July 2021 (Audited)	Mid-July 2022 (Audited)	Mid-July 2023 (Provisional)	Mid-October 2023[1] (Provisional)
Net Interest Income – NPR Million	1,211	1,532	1,874	432
Profit before tax – NPR Million	625	938	855	248
Profit after tax – NPR Million	434	637	612	173
Loans and advances – NPR Million	33,000	41,133	44,570	46,189
Total assets – NPR Million	44,125	56,689	58,751	61,101
OPERATING RATIOS				
Yield on average advances	11.46%	12.38%	14.80%	14.44%
Cost of average deposits	6.67%	7.72%	9.97%	10.00%
Net Interest Margin/Avg. Total Assets	3.08%	3.04%	3.25%	2.88%
Non-interest Income/Avg. Total Assets	0.57%	0.41%	0.35%	0.40%
Operating Expenses/Avg. Total Assets	1.59%	1.52%	1.42%	1.47%
Credit Provisions / Avg. Total Assets	0.75%	0.07%	0.70%	0.16%
PAT / Avg. Total Assets	1.10%	1.26%	1.06%	1.16%
PAT / Net Worth	8.91%	11.56%	10.30%	11.28%
Gross NPLs	2.17%	1.70%	3.01%	3.48%
0+ days delinquencies	15.86%	11.26%	17.90%	34.59%
CAPITALISATION RATIOS				
Capital Adequacy Ratio	13.26%	11.72%	13.38%	12.61%
Tier-I Capital	11.89%	10.26%	9.83%	9.33%
Net NPLs/Net Worth	4.60%	4.23%	8.70%	10.03%
COVERAGE & LIQUIDITY RATIOS				
Total Liquid Assets/Total Liability	24.08%	25.53%	22.70%	22.96%
Total Advances/Total Deposits*	88.80%	92.70%	88.97%	87.96%

Credit to deposit ratio calculated as per NBR directives ~85% as of mid-October 2023
Source: Company Data

For further details please contact:

[1] *Annualised*

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About ICRA Nepal Limited

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