

## Shangri-la Development Bank Limited: Rating downgraded with continuation of watch with negative implications

February 26, 2024

### Summary of rating action

INSTRUMENT/FACILITY	ISSUE SIZE	RATING ACTION
Issuer Rating	NA	[ICRANP-IR] BB@*; downgraded from [ICRANP-IR] BB+@ with continuation of watch with negative implications.

\*@ indicates [Rating Watch with Negative Implications](#)

### Rating Action

ICRA Nepal has downgraded and revised the issuer rating of Shangri-la Development Bank Limited (SADBL) to [ICRANP-IR] BB@ (pronounced ICRA NP issuer rating double B @) from [ICRANP-IR] BB+@ (pronounced ICRA NP issuer rating double B plus @) with continuation of the rating 'Watch with Negative Implications' (denoted by '@').

Issuers with this rating are considered to have a 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 is 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 in the material deterioration in SADBL's asset quality since last rating, as reflected in rising proportion of gross non-performing loans (NPLs) as well as overall portfolio delinquencies (~4.89% and ~45% respectively as of mid-January 2024). Higher proportion of delinquencies in 30+ days ageing bucket raises concern on the bank's ability to control its incremental NPL level. 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 could challenge SADBL's ability to report a turnaround in asset quality over the near to medium 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 of the bank has also lowered the provision cover and impacted its solvency profile (net NPL/ net-worth of ~24% as of mid-January 2024); which could weaken the bank's incremental profitability/solvency in the event of non-recovery/non-upgradation of delinquent accounts. 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.

On the other hand, the rating continues to derive comfort from the bank's adequate track record (operating since 2006) along with an adequate presence across the country (112 branches as of mid-July 2023). The bank's growing branch network and experienced management team remains a positive for the long-term sustainability of business growth.

Going forward, SADBL's ability to improve its asset quality profile, contain its delinquencies and maintain adequate capital and liquidity cushion to withstand probable shocks will remain key rating sensitivities. Moreover, maintaining its competitive positioning in the industry by improving its deposits profile and profitability profile will remain among other key rating drivers.

## Key rating drivers

### Rating strengths

**Adequate track record with diversified presence across the country** – Operating since 2006, SADBL has an adequate track record of operations in the Nepalese banking arena. The bank also has an adequate presence across the country through its 112 branches as of mid-January 2024, supporting the bank's portfolio growth along the retail and SME segments. The diversified branch network has supported good growth - deposit and credit growth at CAGR of ~31% each in the last four years ending mid-July 2022 (higher than banking industry<sup>1</sup> growth of ~16% and ~18% respectively); notwithstanding marginal degrowth in FY2023. SADBL reported annualised credit growth of ~14% and deposit growth of ~3% during H1FY2024 leading to increased credit to deposit (CD) ratio of ~85% as of mid-January 2024 from ~80% as of mid-July 2023.

**Granular credit portfolio, improved deposit granularity** – SADBL maintained good portfolio granularity wherein the top-20 borrower groups accounted for ~13% of the total credit portfolio as of mid-July 2023 (13% as of mid-January 2022). This provides some comfort amid deterioration in its asset quality profile. Further, the deposit concentration also decreased to ~15% among top-20 depositors as of mid-July 2023 from ~19% as of mid-January 2022, which remains a comfort against the concerns on stability of the funding profile amid the volatile banking sector interest rates.

### Rating challenges

**Deterioration in asset quality** – SADBL's gross NPLs spiked to 4.89% as of mid-January 2024 from 3.16% as of mid-July 2023. The asset quality concerns are further exacerbated by the bank's high delinquency, with 0+ days delinquent portfolio of ~45% (including NPLs) as of mid-January 2024 vis-a-vis 32% as of mid-July 2023. Moreover, the bank has ~12% delinquencies in near-to-NPL category (i.e. 61-90 day's bucket) which could potentially lead to further spike in NPL level, weakening the bank's solvency position, given the current economic slowdown. Sustained stress on borrowers might impact the bank's asset quality thereby impacting its incremental profitability, solvency and capitalisation which remains a major rating concern.

**Depleting capitalisation profile** – SADBL reported a modest capital to risk-weighted assets ratio (CRAR) of 11.52% as of mid-January 2024, which declined from 12.41% as of mid-July 2023, amid piling NPLs/ delinquencies and interim credit portfolio growth (annualised growth of ~14% in H1 FY2024). Over the same period, tier I capital also declined by ~66 bps to 8.74% as of mid-January 2024. A thin capital cushion amid asset quality pressure remains a concern to the bank's ability to maintain regulatory capitalization level in the event of future slippage.

**Moderating profitability** – Increased credit costs amidst asset quality deterioration has weakened SADBL's return indicators, despite healthy net interest margins (NIMs) and controlled operating expenses. The bank reported reduced return on net worth of ~4% in H1 FY2024 from ~6% in FY2023 and reduced return on assets of ~0.3% from 0.5% during the same period. Going forward, the bank's ability to maintain adequate NIMs and manage the assets quality would have a strong bearing on its profitability profile.

**Intense competition from larger commercial banks with a wider range of services** – As per the regulatory provisions, class-B banks are restricted to undertake certain activities viz. credit secured only 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 Shangri-la vis-à-vis the commercial banks with higher capital, stronger brand and branch network, larger customer base, a wider range of services and finer lending rates.

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<sup>1</sup> Industry data of development banks remain distorted by mergers of many peers with class A commercial banks and hence overall banking industry data taken for comparison.

**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 the last rating rationale:**

[Rationale- Shangri-la Development Bank Limited-Rating Surveillance October 2023](#)

## Bank profile

Established in December 2006 as a regional development bank, Shangri-la Development Bank Limited (SADBL) became a national level development bank following a merger with another regional development bank (Bageshwori Development Bank) on July 13, 2014. Later, SADBL acquired Cosmos Development Bank, a one district level development bank on July 14, 2017. SADBL's corporate office is located at Baluwatar-4, Kathmandu. The share capital of the company is held by the promoter and public shareholders in the ratio of 51:49.

SADBL has a presence throughout the country through its 112 branches as of mid-January 2024. The bank has a market share of ~9.1% each in terms of deposit and advances of the development banks' industry as of mid-January 2024. SADBL reported a profit after tax (PAT) of NPR 270 million during FY2023 (49% YoY decline) over an asset base of NPR 58,650 million as of mid-July 2023. SADBL reported PAT of NPR 100 million in H1 FY2024 over an asset base of NPR 59,387 million; CRAR was 11.5% (with tier-I capital of 8.7%) and gross NPLs stood at 4.89% as of mid-January 2024.

## Key financial indicators

YEAR ENDED	Mid-July 2020 (Audited)	Mid-July 2021 (Audited)	Mid-July 2022 (Audited)	Mid-July 2023 (Audited)	Mid-January 2024 (Provisional)
Net Interest Income – NPR Million	1,050	1,207	1,691	1,792	946
Profit before tax – NPR Million	268	589	741	395	143
Profit after tax – NPR Million	191	410	527	270	100
Loans and advances – NPR Million	23,926	36,294	43,240	42,093	45,045
Total assets – NPR Million	32,898	47,837	59,822	58,650	59,387
<b>OPERATING RATIOS</b>					
Net Interest Margin/Avg. Total Assets	3.55%	2.99%	3.14%	3.02%	3.21%
Non-interest Income/Avg. Total Assets	0.58%	0.58%	0.40%	0.26%	0.37%
Operating Expenses/Avg. Total Assets	2.35%	2.12%	1.87%	1.71%	1.76%
Credit Provisions / Avg. Total Assets	0.88%	0.58%	0.30%	0.90%	1.33%
PAT / Avg. Total Assets	0.65%	1.02%	0.98%	0.46%	0.34%
PAT / Net Worth	5.75%	11.69%	13.34%	6.24%	4.44%
Gross NPLs	1.13%	1.40%	1.39%	3.16%	4.89%
0+ days delinquencies	30.24%	15.76%	22.95%	32.02%	44.73%
<b>CAPITALISATION RATIOS</b>					
Capital Adequacy Ratio	13.62%	11.77%	11.59%	12.41%	11.52%
Tier-I Capital	12.35%	10.52%	8.61%	9.40%	8.74%
Net NPLs/Net Worth	4.36%	7.20%	6.74%	10.02%	24.18%
<b>COVERAGE &amp; LIQUIDITY RATIOS</b>					
Total Liquid Assets/Total Liability	25.65%	23.16%	25.29%	26.01%	22.47%
Total Advances/Total Deposits	81.79%	84.70%	82.83%	80.16%	84.58%

**Source:** Company Data

*For further details please contact:*

### **Analyst contacts**

**Mr. Sailesh Subedi** (Tel No. +977-1-4519910/20)

[sailesh@icranepal.com](mailto:sailesh@icranepal.com)

**Ms. Kushum Bhattarai** (Tel No. +977-1-4519910/20)

[kushum@icranepal.com](mailto:kushum@icranepal.com)

### **Relationship contacts**

**Ms. Barsha Shrestha** (Tel. No. +977-1-4519910/20)

[barsha@icranepal.com](mailto:barsha@icranepal.com)

### **About ICRA Nepal Limited**

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ICRA Nepal Limited,  
Sunrise Bizz Park, 6th Floor, Dillibazar, Kathmandu, Nepal.  
Phone: +977 1 4519910/20  
Email: [info@icranepal.com](mailto:info@icranepal.com)  
Web: [www.icranepal.com](http://www.icranepal.com)

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