Laxmi Sunrise Bank Limited[1]: Ratings downgraded; continue to remain on Watch with Negative Implications

June 10, 2024

Summary of rating action

Facility/Instrument	Rated Amount (NPR million)	Rating Action
Issuer Rating	NA	**[ICRANP-IR] BBB@***; downgraded from [ICRANP-IR] BBB+@
Subordinated Debenture[2]	2,000	**[ICRANP] LBBB@**; downgraded from [ICRANP] LBBB+@

** The symbol '@' indicates Rating Watch with Negative Implications*

Rating action

ICRA Nepal has downgraded the issuer rating of Laxmi Sunrise Bank Limited (LSL) to [ICRANP-IR] BBB@ (pronounced ICRA NP Issuer Rating triple B) from [ICRANP-IR] BBB+@ (pronounced ICRA NP Issuer Rating triple B plus), with continuation of the rating "Watch with Negative Implications" (indicated by "@"). The rating is considered to be of moderate credit quality. The rated entity carries a moderate credit risk. The issuer rating is only an opinion on the general creditworthiness of the rated entity and not specific to a particular debt instrument.

ICRA Nepal has also downgraded the bank's subordinated debenture rating to [ICRANP] LBBB@ (pronounced ICRA NP L triple B) from [ICRANP] LBBB+@ (pronounced ICRA NP L triple B plus), with continuation of the rating "Watch with Negative Implications". Instruments with this rating are considered to have a moderate degree of safety regarding the timely servicing of financial obligations. Such instruments carry moderate credit risk.

Rationale

The ratings downgrade mainly factors in the sharp deterioration in the bank's assets quality with non-performing asset (NPAs) of 5.49% as of mid-April 2024 (industry average of 3.89%) along with high chunk of loans in borderline NPA category (i.e. 61-90 days overdue) at 4.15%, while 0+ days delinquencies (DPD) was also high at ~31% as on the same date. The recent spike in NPAs has resulted in relatively weak solvency profile (net NPA to net worth) at ~15% (~5% as of mid-January 2023, when last rated). While the uptick in delinquencies can be attributed to the ongoing economic slowdown, high interest rate environment during FY2023 (gradually declining thereafter), the merger with the erstwhile Sunrise Bank Limited (SrBL) in July 2023, also added to the impact. Amid the backdrop of high credit costs and muted internal accruals, the bank reported moderation in capitalization profile with capital to risk weighted assets ratio (CRAR) and tier-I at 12.47% and 9.48% respectively as of mid-April 2024 (13.21% and 10.04% as of mid-July 2023), thus elevating the concerns on the ability to absorb incremental credit shocks. The rating concerns also emanate from the bank's moderate proportion of stable/low-cost deposits[3], leading to relatively higher cost of funds than the industry average. The resultant pressure in net interest margins (NIMs) and increasing credit costs have also moderated the bank's profitability indicators for 9MFY2024, which remains a concern.

Nonetheless, the ratings continue to derive comfort from LSL's long track record (since 2002), decent market share and its experienced directors/senior management team. Furthermore, the presence of a strong institutional promoter in LSL, viz. Citizen Investment Trust (CIT, one of the state-owned retirement funds with ~5% stake, after the dilution post-merger) also remains a rating positive. The ratings also take into account the bank's improved credit portfolio granularity (~18% portfolio among top-20 borrower groups as of mid-April 2024; ~149% of tier-I capital). Going forward, LSL's ability to improve its asset quality and profitability profile while enhancing its capital cushion will remain the key rating sensitivities.

1 Erstwhile Laxmi Bank Limited, till last rating. Name changed after merger with Sunrise Bank Limited in July 2023.
2 10% Laxmi Bank Debenture 2086.
3 Low-cost deposit includes current, saving and call deposits.

Key rating drivers

Rating strengths

Long track record and experienced board/management – LSL has a long track record in Nepalese banking industry (since 2002) and is mainly promoted by the Khetan Group and the Shanghai Group, while the Dugar Group has been added as a major promoter group after the merger with SrBL, all of which are prominent business houses in Nepal. There is also an institutional promoter, viz. CIT with ~5% stake. LSL's board of directors and management team are seasoned professionals in the industry with long history, good knowledge, and adequate experience, which remains a rating positive.

Improved portfolio granularity – The bank has reported decline in credit portfolio concentration since the last rating exercise, aided mainly by the dilution effect of merger. The concentration among top-20 borrower groups has decreased to ~18% of total credit book (~149% of tier-I capital) as of mid-April 2024 from ~26% (~223% of tier-I capital) as of mid-January 2023. The deposit concentration has also slightly improved, with the top-20 depositors contributing ~17% of total portfolio as of mid-April 2024 (~20% of total portfolio as of mid-January 2023). The bank's liquidity also remains satisfactory with a credit to deposit ratio of ~79% and liquidity ratio of ~31% in recent quarters, which provides comfort.

Rating challenges

Build-up in asset quality stress – LSL reported major deterioration in its asset quality since the last rating, wherein NPAs have spiked to 5.49% as of mid-April 2024 (industry average of 3.89%), from 1.56% as of mid-January 2023. Moreover, the 0+ DPD levels also increased to ~31% as of mid-April 2024 from ~23% as of mid-January 2023, which accentuates the concerns. The fresh incremental slippage has stretched the solvency indicator to ~15% as of mid-April 2024 (remaining among the highest in the industry), compared to 4.6% as of mid-January 2023. Rating concerns are further exacerbated by the high chunk of loans in borderline NPA category (i.e. 61-90 days overdue) at 4.15%. Additionally, ~5% of the credit book have taken the rescheduling/restructuring facilities provided by the central bank (this window being open till mid-April 2024), wherein repayment capacity remains to be tested, once the regular as well as deferred repayment obligations fall due. Although the rising delinquency can be partly attributed to the integration challenges for the credit book acquired from SrBL, the unfavourable economic environment created by the economic slowdown, high interest rate (during FY2023) and regulatory changes like introduction of stringent working capital guidelines etc, accentuated the impact. Sustained high NPAs could further increase the provisioning expenses and impact the incremental profitability and capitalisation for the bank and hence would have a bearing over the rating levels.

Declining capital cushion – The bank's tier-I capital at 9.48% as of mid-April 2024 (industry average of 9.68% and regulatory minimum of 8.5%), continues to remain moderate. LSL's overall capital to risk-weighted assets ratio (CRAR) also remained moderate at 12.47% as of mid-April 2024 (12.94% when last rated) compared to the regulatory minimum of 11%. Moderation in CRAR was on account of nearing maturity[4] of "Sunrise Debenture 2083". Further, the additional requirement of counter-cyclical buffer of 0.5% to be maintained by mid-July 2024 and the increasing stress in asset quality, elevates the concerns amid the moderate capital cushion of the bank. The bank's ability to improve its capital cushion, while absorbing any near-term asset quality shocks, would remain a key rating monitorable.

Muted return indicators – With the slight decline in NIMs, coupled with high credit cost, LSL's profitability indicators have moderated in 9MFY2024, with return on average total assets (ATA) and return on net worth of 0.58% and 5.52%, respectively (1.22% and 12.29% respectively for H1FY2023, during last rating). Since the bank is currently benefitted by the relaxation on the interest rate spread until mid-July 2024[5], end of such relaxation period is likely to exert further pressure on the bank's profitability. Despite a sizeable non-fund-based portfolio base, the bank's non-funded income remains moderate among peers. The bank's ability to report adequate profitability amid asset quality pressures will remain crucial for its incremental financial

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[4] *As per the NRB directives "a cumulative discount (amortization) factor of 20% per annum shall be applied for capital adequacy computations, during the last 5 years to maturity of the subordinated term debt".*

[5] *As per the NRB directives, if any commercial bank starts combined operations before mid-July 2023 after merger, they will be given one year time to bring the interest spread within the regulatory requirement. LSL had interest rate spread of 4.42% as on the date of merger.*

profile.

Moderate funding profile – LSL's low-cost current and saving accounts (CASA) and call deposits mix remains moderate at ~39% as of mid-April 2024 despite a slight improvement from ~37% as of mid-January 2023. Since the deposit mix remains slightly weaker to the industry average, the bank's cost of deposits also continues to remain slightly higher than the industry (7.54% for 9MFY2024 as against 7.24% for the industry). This impacts LSL's competitive position amid the base rate plus lending regime.

Regulatory risk and difficult operating environment – The banking industry as well as borrowers have been facing stress from H1FY2022, following the roll-back of Covid-relaxations and introduction of stringent regulations affecting fresh credit creation. The incremental regulatory changes have also remained stringent such as introducing the requirement of borrower-wise provisioning (against facility-wise provisioning also in practice across major banks) and higher provisioning requirement for group units in case of stress reported in any group unit. The borrowing rates have remained elevated till the recent past (in gradually declining trend as of now) which coupled with the high debt burden, has reduced the repayment capability of the borrowers. This coupled with the ineligibility of many borrowers for fresh loans after the implementation of working capital guidelines, has exacerbated liquidity pressure across the spectrum, which is partly reflected in increased asset quality stress for banks and hence remains a rating concern across the industry. Further, the regulation to maintain interest rate differential at 2% among the same-category loans is likely to impact on the interest margins and profitability going forward.

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

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

Link to the last rating rationale:
Rationale - Surveillance of Laxmi Bank - March 2023

Bank Profile
In operation since April 2002, LSL is mainly promoted by the Khetan Group, the Shanghai Group and the Dugar Group, prominent business houses in Nepal. The bank's shares are listed on the Nepal Stock Exchange. The promoters have ~51% stake, along with a public shareholding of ~49%. Mr. Ajaya Bikram Shah is the Chief Executive Officer of the Hattisar, Kathmandu-based bank.

LSL has presence across the country through its 264 branches, 28 extension counters and 328 ATMs as of mid-January 2024. Further, it had a market share of 5.80% in terms of deposit base and 5.03% of total advances of Nepalese commercial banking industry as of mid-April 2024. LSL reported a profit after tax (PAT) of NPR 2,285 million (standalone for Laxmi Bank till merger date and consolidated for both banks for 3 days) in FY2023 (Y-o-Y growth of ~51%) over an asset base of NPR 361,666 million (post-merger) as of mid-July 2023. For 9MFY2024, the bank has reported a PAT of NPR 1,616 million over the asset base of NPR 384,996 million. As of mid-April 2024, LSL's CRAR was at 12.47%, with gross NPAs at 5.49%. In terms of technology platform, LSL is using Finacle as core banking software across all its branches.

Key financial indicators

Year Ended	Mid-July 2021 (Audited)	Mid-July 2022 (Audited)	Mid-July 2023* (Audited)	Mid-April 2024 (Provisional)
Net interest income - NPR million	3,457	3,760	5,687	8,533
Profit before tax - NPR million	2,229	2,128	3,044	2,242
Profit after tax - NPR million	1,576	1,513	2,285	1,616
Loan and advances - NPR million	108,655	132,569	255,858	257,747
Total assets - NPR million	152,240	173,384	361,666	384,996

Year Ended	Mid-July 2021 (Audited)	Mid-July 2022 (Audited)	Mid-July 2023* (Audited)	Mid-April 2024 (Provisional)
Operating ratios				
Yield on average advances	8.62%	10.09%	8.97%	12.17%
Cost of average deposits	5.17%	6.71%	5.59%	7.54%
Net interest margin/ATA	2.46%	2.31%	2.13%	3.05%
Non-interest income/ATA	1.22%	1.04%	0.52%	0.67%
Operating expenses/ATA	1.75%	1.63%	1.23%	1.49%
Credit provisions/ATA	0.35%	0.34%	0.40%	1.43%
PAT/ATA	1.12%	0.93%	0.85%	0.58%
PAT/net-worth	10.21%	8.95%	8.28%	5.52%
Gross NPAs	0.75%	0.89%	2.91%	5.49%
0+ days delinquencies	9.28%	9.32%	26.40%	31.32%
Capitalisation ratios				
Capital adequacy ratio	12.15%	12.75%	13.21%	12.47%
Tier I Capital	9.49%	9.05%	10.04%	9.48%
Net NPAs/net worth	3.78%	3.06%	7.73%	14.52%
Liquidity ratios				
Net Liquidity (NLA to total deposits)	22.40%	21.88%	27.91%	30.86%
CD ratio (as per NRB Directive)	79.63%*	86.72%	86.27%	79.48%

**CCD ratio till FY2021, calculated based on earlier NRB directive.*

 # Standalone Profit and Loss account of Laxmi Bank till merger date and consolidated for both banks for 3 days and consolidated Balance Sheet (after merger in July 2023 with Sunrise Bank Limited).

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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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