Laxmi Bank Limited

ICRA Nepal assigns [ICRANP] LBBB+ rating to proposed subordinated debenture programme; reaffirms [ICRANP-IR] BBB+ rating for Laxmi Bank Limited

Facility/Instrument	Amount	Rating Action (May 2019)
Subordinated Debenture Programme	NPR 2,000 Million	[ICRANP] LBBB+ (Assigned)
Issuer Rating	NA	[ICRANP-IR] BBB+ (Reaffirmed)

ICRA Nepal has assigned **[ICRANP] LBBB+** (pronounced ICRA NP L triple B plus) to the proposed subordinated debenture programme of Laxmi Bank Limited (LBL). 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. The sign of + (plus) or – (minus) is appended to the rating symbols to indicate their relative position within the rating categories concerned.

ICRA Nepal has also reaffirmed the issuer rating of **[ICRANP-IR] BBB+** (pronounced ICRA NP issuer rating triple B plus) to LBL. The entities with [ICRANP-IR] BBB+ ratings are considered to have a moderate degree of safety regarding the timely servicing of financial obligations. 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 any particular debt instrument.

The ratings factor in the bank's adequate track record (since 2002) and the ability to maintain a healthy pace of growth in the last three years (~25% vs. 24% for industry). This has supported the bank in maintaining the return indicators, despite the significant capital increment in the last few years, in line with the regulatory requirement. The bank's experienced senior management and established underwriting practices remain positives for controlled growth over the near term. The ratings also take into consideration the management plans to grow the portfolio more along the retail and the SME segments by expanding its geographical presence. This remains positive, both from the perspective of improvement in yields as well as diversification of portfolio risks and hence is likely to support the bank's profitability profile going forward. The bank's comfortable asset quality indicators, with non-performing loans (NPLs) of 1.11% as of mid-January 2019, has also been factored in the rating action. The ratings also factor in the presence of the institutional promoter in LBL, Citizen Investment Trust (one of the state-owned retirement funds) with ~9% stake and representation in the board.

Nonetheless, the ratings remain constrained by LBL's weak deposits profile with low chunk of current and savings deposits (CASA) at ~34% as on mid-January 2019 vs. ~41% for industry. This, along with the increased share of term deposits, has kept LBL's cost of funds relatively higher and hence weakening its competitive positioning. The rating also remains constrained by the increase in the share of corporate loans in the interim (59% of total loans as of mid-January 2019) leading to increased credit concentration risks (~30% among top-20 groups amounting to ~200% of bank's tier-I capital as on mid-January 2019 as compared to 146% as on mid-April 2018). The bank's declining capital cushion (CRAR of 11.66% as of mid-January 2019 as compared to 12.43% as on mid-July 2018, against the regulatory minimum of 11%) also remains a concern. However, this is expected to be supplemented by the proposed debenture issue plans. The rating actions also factor in the probable systemic risks emanating from the mismatch in credit and deposit growth in the industry over the last few years. The resultant hardening of interest rates could build up stress on the bank's asset quality over the near term, as the incremental portfolio gets more seasoned. This is evident to an extent from the increased delinquencies of LBL to ~13% as of mid-January 2019 as against 5-8% earlier. ICRA Nepal also takes note of the risks emanating from the bank's increasing non-fund based portfolio which remains sizeable at ~two-thirds of funded portfolio with high concentration among top-20 customers (~50%) as on mid-January 2019. The rating also takes into account the uncertain operating environment and liquidity constraints that the banks in Nepal are currently facing, which could have a bearing over the bank's growth plans. The bank's ability to grow its portfolio judiciously while maintaining a comfortable liquidity position and healthy asset quality/profitability indicators and its ability to improve the mix/cost of deposits, reduce the concentration risks and improve its competitive positioning would remain the key rating drivers.

LBL's YoY credit growth was low for FY2018 at ~18% as against ~29% in the earlier two years. However, the portfolio growth remains comparable to the industry average over a longer tenure with compounded annual growth rate (CAGR) of ~25% during the past three years, ending mid-July 2018 (~24% for industry). The pace of growth has increased to ~28% in H1 FY2019 compared to ~25% growth in industry, with similar plans over medium term. The bank has added 18 branches since its last rating (reaching a total of 96 branches as of mid-January 2019) with further franchise addition plans, focusing on retail & SME segment to support the growth targets. Credit growth in recent years surpassed the deposit growth, resulting in increased CCD ratio[1] to ~78% as of mid-January 2019 from ~74% as of mid-July 2015. As on mid-January 2019, LBL's credit portfolio of ~NPR 71 billion comprised corporate/project loans (~59% of total loans), followed by retail loans (22%), SME/mid-market loans (~14%) and deprived sector loans (~6%). Contrary to the targets, the proportion of corporate loans has increased in the recent periods (~53% in mid-July 2017) which has heightened the credit concentration risks. The bank's yield on advances generally remains lower to the industry average at 12.14% for H1 FY2019 (12.81% for industry) compared to 9.76% for FY2017. This was mainly on account of the high share of corporate loans that demand competitive lending rates. The increment in yields was largely in line with the industry trend and was partly supported by the interest income booking on an accrual basis, as per the revised financial reporting framework[2]. Going forward, the management intends to grow more along the retail and the SME segments and hence downsize the share of the corporate loans.

On the asset quality front, the bank's reported NPLs have reported a marginal increment from 0.93% as of mid-July 2016 to 1.11% as of mid-January 2019. Despite the increment, NPL levels remain lower among peers and comfortable when compared to the industry average NPLs of 1.48%. However, overall 0+ days delinquencies have spiked to ~12.5% as of mid-January 2019 which is much higher than the earlier levels of 5-8%, and hence remains a rating concern. Nonetheless, the bank's solvency profile (net NPA/net worth) remains comfortable at 2.1% on mid-January 2019. Going forward, the asset quality of the banking sector, including LBL, is expected to witness some moderation due to a decline in the repayment capability of borrowers, following increased interest rates. The bank's ability to improve the delinquencies and maintain a comfortable asset quality profile would remain a key rating factor.

LBL fares weaker on the deposit front with lower share of stable/low-cost CASA deposits. This leads to higher cost of funds (7.69% for H1 FY2019 against 6.50% for the industry) and hence impacts its competitive strength in the base rate-based lending regime. Despite gradual improvements over the years, the bank's CASA (~34% as of mid-January 2019 from ~28% as of mid-July 2016) still remains lower to industry average (41% as of mid-January 2019). Deposits growth has remained lower to credit growth over last three years ending mid-July 2018, with CAGR ~18% (~19% for the industry). Despite volatile market liquidity scenario, the deposit growth in H1 FY2019, however, surpassed the industry growth by a wide margin (~32% compared to 15% for industry) and hence remains a positive. However, a major chunk of the incremental growth was from term deposits whose share remains higher than the industry (53% for bank and 47% for industry as of mid-January 2019) and hence this could impact the cost of funds over the near term. Deposit concentration on the top-20 depositors has, however, moderated to ~25% as of mid-January 2019 (30% in mid-July 2017). Going forward, the bank's ability to improve its deposit mix and cost would remain a key monitorable.

As regards capitalisation, LBL's reported capitalisation (CRAR) of 11.66% and tier-I capital of 10.67% as of mid-January 2019 (both as per Basel-III) remains slightly higher as against the regulatory minimum of 11% and 8% respectively (both including capital conservation buffer-CCB of 2%). The tier-I capital requirement is expected to increase to 8.5% by mid-July 2019 (including CCB of 2.5%) although the requirement for the total capital would be stable at 11% (including CCB). The capitalisation profile was supported by a 100% rights issue in FY2017 (~NPR 3.2 billion) and capitalisation of internal accruals through bonus issues in the last three years. The current capitalisation is expected to be supported by the proposed debenture issue and internal accruals. However, the capitalisation is expected to require a further injection, considering the

[1] Local currency (LCY) credit to core capital and LCY deposits ratio, capped at 80% by regulations.

[2] Nepal Financial Reporting Standards (NFRS), adopted from FY2018, requires accrual-based interest income booking on loans; this used to be in cash basis as per earlier regulations.

high growth plans over the medium term. Hence, the banks' ability to maintain the requisite capital levels for the targeted growth plans would remain crucial.

As for profitability, LBL's return on assets (RoA) improved over last two years to 1.56% in FY2018 from 1.35% in FY2016, however, it remained lower than the industry average (1.92% for FY2018). The improvement in profitability was supported by an increase in the net interest margins (NIMs of 3.08% for FY2018 compared to 2.43% for FY2015). NIMs were benefitted by increased utilization of fund (CCD increased to ~78% as of mid-January 2019 from ~74% as of mid-July 2015). Additionally, bank's non-interest income has also improved in recent years (1.27% of ATA[3] for H1 FY2019 compared to 1.09% for FY2016), primarily benefitted by increasing its non-fund based business. However, the profitability remains constrained by increased credit costs (0.31% of ATA for H1 FY2019) due to recent slippages and spikes in operating expenses (1.92% of ATA for H1 FY2019) due to rapid branch expansion. The bank's return on net worth (RoNW) has slightly diluted to ~11% for FY2018 (~14% for FY2016) due to a sizeable increase in the net worth base (~36%) in FY2018 as required under the revised financial reporting. For H1 FY2019, RoNW and RoA has further improved and stood at ~12% and 1.66% respectively (industry average of ~15% and 1.96%). Going forward, the bank's ability to improve NIMs by reducing the cost of funds and manage asset quality would have key bearing on its profitability profile.

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

Links to applicable criteria:
[Issuer Rating Methodology](#)
[Bank Rating Methodology](#)

Bank Profile
In operation since April 2002, LBL is mainly promoted by the Khetan Group and the Shanghai Group, both business houses in Nepal. The shares are listed on the Nepal Stock Exchange and the shareholding pattern constitutes the promoters holding ~64% (including Citizen Investment Trust's 8.68%) and a public shareholding of ~36%. Mr. Ajaya Bikram Shah is the Chief Executive Officer of the Hattisar, Kathmandu-based bank.

LBL has 96 branches, 51 branchless banking counters and 108 ATMs as of mid-January 2019. Its market share is around 2.86% in terms of the deposit base and 2.98% of the total advances of the commercial banking industry as on mid-Jan 2019. LBL reported a profit after tax (PAT) of NPR 1,181 million in FY2018 (YoY growth of ~22%) over an asset base of NPR 80,960 million as of mid-July 2018. For H1 FY2019, bank reported a profit of NPR 724 million over an asset base of NPR 93,915 million as of mid-January 2019. LBL's reported CRAR was at 11.66% and gross NPLs were around 1.11% as of mid-January 2019. In terms of the technology platform, LBL is using Finacle as the core banking software across all its branches.

May 2019

For further details please contact:

Analyst Contacts:
Mr. Kishor Prasad Bimali (Tel No. +977-1-4419910/20)
kishor@icranepal.com

Mr. Rajib Maharjan (Tel No. +977-1-4419910/20)
rajib@icranepal.com

Relationship Contacts:
Ms. Barsha Shrestha (Tel. No. +977-1-4419910/20)
barsha@icranepal.com

[3] *Average Total Assets*

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 the 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. The international credit rating agency, Moody's Investors Service, is ICRA's largest shareholder.

For more information, visit www.icranepal.com

ICRA Nepal Limited,
Sunrise Bizz Park, 6th Floor, Dillibazar, Kathmandu-33, Nepal
Phone: +977 1 4419910/20
Email: info@icranepal.com
Web: www.icranepal.com