ICRA NEPAL

Laxmi Bank Limited

ICRA Nepal upgrades the issuer rating of Laxmi Bank Limited from [ICRANP-IR] BBB to [ICRANP-IR] BBB+

Facility/Instrument	Amount	Rating Action (August 2018)
Issuer Rating	NA	[ICRANP] IR BBB+ (upgraded)

ICRA Nepal has upgraded the issuer rating of Laxmi Bank Limited (LBL) from **[ICRANP-IR] BBB** (pronounced ICRA NP Issuer Rating Triple B) to **[ICRANP-IR] BBB+** (pronounced ICRA NP Issuer Rating Triple B Plus). Issuer rating BBB+ is one notch higher than BBB. ICRANP-IR] BBB+ ratings are considered as moderate credit quality rating assigned by ICRA Nepal. The rated entity carries higher than average credit risk. The rating is only an opinion on the general creditworthiness of the rated entity and not specific to any debt instrument.

The rating upgradation of LBL factors in the bank's fair asset quality indicators, comfortable capitalization level and the ability to improve the return indicators to an extent in last few years. Bank's adequate track record (since 2002), experienced senior management and established underwriting practices remains positive for controlled growth over near term. In addition, presence of institutional promoter support from Citizen Investment Trust (CIT)[1] also provides comfort to the rating action. The rating also takes into consideration, management plans to increase the portfolio share of retail & SME segments which along with increasing geographical presence could lower the credit and deposit concentration (~27% and ~29% respectively among top 20 customers as of Apr-18) over medium term.

Nonetheless, the rating remains constrained by LBL's weak deposits profile (CASA[2] deposits of ~33% as on mid-Apr-18 vs. ~44% for industry) resulting in higher cost of fund and hence weaker competitive positioning. The rating also remains constrained by the bank's increased pace of credit growth, mostly during the period of comfortable liquidity, with CAGR[3] of ~32% in last three years ending Jul-17 vs. ~24% for industry. Though the up-stick in growth has slightly benefitted the market positioning of the bank, seasoning of the incremental portfolio could increase stress on asset quality over near term, especially given the increased interest rate scenario. The rating also takes into account the uncertain operating environment and liquidity constraints that the banks in Nepal are currently facing.

LBL accelerated its pace of credit growth accelerated in recent years with CAGR of ~32% during past three years ending Jul-17 vs. ~15% CAGR in earlier three years. This increased the bank's market share in banking industry by ~60 bps and hence compensated for lost market share due to lower than industry growth in earlier years. Growth in 9MFY18 has moderated to ~15% vs. ~21% for banking industry. Bank also acquired small regional level development bank, Professional Diyalo Bikas Bank starting joint operation from Jan-2017. The acquisition helped expand its network base with additional 8 branches and contributed to ~4% growth in FY17 (~31% growth in FY17 vs. ~25% for industry). Growth in credit in recent years surpassed the deposit growth resulting in increased CCD[4] ratio (from ~74% as of Jul-15 to ~78% as of Apr-18). Increased franchise (from 50 branches as of Jul-16 to 78 as on Apr-18) and focus on retail & SME segment has also supported the growth. As on mid-Apr-18, LBL's credit portfolio comprised of corporate Loan (~54% of total loans), followed by retail loans (24%), SME/mid-market loans (~16%), and deprived sector loans (~6%). The proportion of corporate loans has declined over the years (~60% in Jul-15) to the benefit of retail/SME segment. Bank's yield on advances generally remains lower to industry average (11.49% for 9MFY18 vs. 11.66% for industry) due to high share of corporate loans that demand competitive lending rates. Going forward, management intends to grow more along the retail and SME segments and hence further downsize the share of corporate loans.

[1] With ~9% shareholding; CIT has one representative on the board of LBL from among its staffs
[2] Current and Savings Accounts
[3] Compounded Annual Growth Rate
[4] LCY Credit to Core capital and LCY Deposits

In the asset quality front, despite some slippages in 9MFY18, bank's reported NPLs[5] remains lower among peers. However, increase in NPLs (from 0.80% as of Jul-16 to 1.16% as of Apr-18 vs. 1.66% for industry) despite healthy credit growth remains an area of concern. Nonetheless, overall 0+ days delinquency level remains comfortable at ~5.5% as of Apr-18 which is largely consistent to earlier trends in delinquencies and hence this provides some comfort. Additionally, solvency profile (net NPA/net worth) remains moderate at 2.73% on Apr-18. The bank's ability to maintain comfortable asset quality profile would remain a key rating driver.

LBL fares weaker on the deposit front with lower CASA proportion leading to higher cost of funds (7.28% for 9MFY18 vs. 6.11% for the industry) and hence impacting bank's competitive strength. Bank's CASA however is gradually improving over the years (~25% as of Jul-13 to ~33% as of Apr-18). Deposits growth has remained healthy with CAGR ~25% over last three years ending Jul-17 vs. ~20% for the industry. Growth for 9MFY18 however remained sluggish (~9% vs.11% for industry) amid volatile market liquidity scenario with rising cost of funds (5.57% for FY17). Deposit concentration on top 20 depositors has however moderated to ~29% as of Apr-18 (36% in Jul-16). Going forward, bank's ability to improve its deposit mix and cost would remain a key monitorable.

As for profitability, LBL's RoNW and RoA[6] improved over last two years (from ~11% and 1.04% respectively for FY15 to ~13% and 1.61% for FY17), however still remaining lower to industry average (~18% and 1.94% for FY17). The Improvement in profitability was supported by increase in net interest margins (NIMs of 2.43% for FY15 to 2.77% for FY17). NIMs reported increment despite lower growth in lending yields vs. rise in deposit cost due to increased utilization of fund (CCD increased from ~74% as of Jul-15 to ~78% as of Apr-18). Additionally, healthy non-interest income (1.13% of ATA[7] for FY17) and lower credit provisioning expenses (0.08% of ATA for FY17) provided support. During 9MFY18, RoNW and RoA moderated slightly and stood at ~11% and 1.46% respectively vs. industry average of ~15% and 1.82% because of Increased operating expenses and credit costs. Going forward, bank's ability to improve NIMs by reducing cost of funds and manage asset quality would have key bearing on its profitability profile.

As regards capitalisation, LBL's reported CRAR[8] of 12.97% and tier-I capital of 11.96% as of Apr-18 (both as per Basel-III) remains comfortable as against 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-Jul-19 (including CCB of 2.5%) although the requirement for total capital would be stable at 11% (incl. CCB). The capitalisation profile was supported by 1:1 rights issue in FY17 (~NPR 3.2 billion) and capitalization of internal accruals via bonus issues in last three years. Current capitalisation levels and internal accruals are expected to support moderate of ~15% over medium term. In the event that bank chooses to grow further or maintain high dividend pay-out, capitalisation would need to be supplemented. Hence, the banks' ability to maintain the requisite capital levels for the targeted growth plans would remain crucial.

Bank Profile

In operation since April 2002, LBL was mainly promoted by Khetan group and Shanghai group, both business houses in Nepal. Shareholding pattern of the bank constitutes of promoters holding ~64% (including Citizen Investment Trust's 8.68%) and public shareholding of ~36%. The shares of the bank are listed in Nepal Stock Exchange and being actively traded. The registered and corporate office of the bank is located at Hattisar, Kathmandu.

LBL has presence across the country through its 78 Branches, 51 branchless banking counters and 98 ATMs as of mid-Apr-18. LBL has market share of about 2.43% in terms of deposit base and 2.54% of total advances of Nepalese banking industry as on mid-Apr 2018 (2.79% and 2.93% share among the

[5] Non-Performing Loans
[6] Return on Net worth and Return on Assets
[7] Average Total Assets
[8] Capital to Risk weighted Assets Ratio

commercial banks). LBL reported a profit after tax (PAT) of NPR 1,007 million during FY17 over an asset base of NPR 70,389 million as of mid-Jul-17, as against PAT of NPR 677 million during FY16 over an asset base of NPR 54,663 million as of mid-Jul-16. For 9MFY18, bank has reported profit of NPR 803 million over an asset base of NPR 75,968 million as of mid-Apr-18. LBL's reported CRAR was 12.97% and gross NPLs were 1.16% as of mid-Apr-18. In terms of technology platform, LBL is using Finacle as core banking software across all its branches.

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