ICRA NEPAL

Laxmi Bank Limited

ICRA Nepal reaffirms issuer rating of Laxmi Bank Limited at [ICRANP-IR] BBB; removed from "rating watch with negative implications"

Facility/Instrument	Amount	Rating Action* (November 2016)
Issuer Rating	NA	[ICRANP] IR BBB rating (reaffirmed)

"rating watch with negative implications" removed

ICRA Nepal has reaffirmed the issuer rating of Laxmi Bank Limited (LBL) at **[ICRANP-IR] BBB** (pronounced ICRA NP Issuer Rating Triple B). 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 has been removed from "rating watch with negative implications".

Rating of LBL was kept on watch with negative implications in April 2015, pending assessment of the impact due to the earthquake on credit and financial profile of LBL. While removing the rating from watch with negative implication, ICRA Nepal takes into consideration LBL's ability to manage its assets quality amid the earthquake and political turmoil in following months as well as bank's healthy business growth during past 1-2 years supported by improvement in franchisee and reach.

The reaffirmation of assigned rating factors in the bank's adequate track record, institutional promoter support from Citizen Investment Trust (CIT)[1], experienced senior management, established underwriting practices, control on assets quality and steady growth supported by geographical expansion of business. The rating also takes into consideration, management efforts to diversify the portfolio along retail & SME segments, easing the concentration of credit among top borrower accounts (Top 20 borrower groups accounting for 29% of credit portfolio vs. 36% in mid-April-14[2]). Geographical diversification of business along with experienced management team is likely to aid balanced portfolio growth going forward, minimizing the concentration risk.

The rating is however constrained by LBL's weak deposits profile (CASA[3] deposits of ~29% vs. ~50% for commercial bank industry as on mid-July 2016) with high reliance on institutional bulk deposits. The deposit concentration towards top accounts remains on higher side (top 20 depositors comprised ~36% of deposits as of mid-July 2016, a marginal improvement over 38% in mid-April 2014). Due to comfortable liquidity position in the banking sector, the cost of deposits has witnessed a decline. Cost of deposits for LBL declined from 5.68% for FY14 to 3.91% for FY16; however, it remains higher than commercial bank industry average of 2.87% for FY16.. Capitalization level of LBL remains moderate (CRAR 11.15% on mid-July 2016 vs. regulatory minimum of 10%); however, it is likely to benefit from proposed capital augmentation plan to meet the regulatory requirements by way of 1:1 rights issue of equity shares before mid-July 2017 (assuming full subscription). The rating is also constrained by uncertain operating environment that the banks in Nepal are currently facing due to political uncertainties, regulatory changes requiring higher capitalisation, high credit growth amid declining interest rates and slow/partial economic recovery post the massive earthquake in April 2015 and political turmoil in the following months.

LBL's credit growth has improved in recent years, growing by CAGR 26% during past 3 years ending FY16, outpacing the average growth rate of commercial bank industry of 23% during the period. LBL's share in the commercial bank industry credit has also improved from 2.65% to 2.90% during last three years. The growth was partly aided by expansion along retail & SME segment which in turn was supported by geographical expansion of business (number of branches grew from 36 when last rated to 50 as on mid-July 2016). As on mid-July 2016, LBL's credit portfolio primarily comprises of corporate Loan (~59% of total loans), followed by SME/mid-market loans (~20%), retail loans (17%) and deprived sector loans (~5%). The proportion of corporate loans has declined over the years (~64% in mid-April 2014) to the

[1] With ~9% shareholding; CIT has one representative on the board of LBL from among its staffs

[2] Considered at the time of last rating

[3] Current and Savings Accounts

benefit of retail/SME segment. Nonetheless, yield on advances remains lower to industry average due to higher concentration towards competitive corporate loan segment. Going forward, the management intends to continue along the plans to expand its business network and customer base and boost retail business to improve both the credit and deposit profile. Moreover, injection of fresh equity through proposed rights in near future will allow the bank to take large ticket exposures to grow its corporate portfolio to ensure adequate utilisation of incremental capital. However, the bank's ability to achieve the growth targets along with commensurate control measures remains to be seen.

LBL's asset quality remains good with gross NPL of 0.80% as on mid-July 2016 (declining from 1.30% in mid-July 2015 owing to recovery efforts of the bank) and 0+ days delinquency level of 4.74% of total loans outstanding. In addition, bank had restructured few accounts (~0.51% of mid-July 2016 credit portfolio) due to the impact of earthquake/strikes, under NRB's relaxed norms which has supported the reported NPAs. After the earthquake and during the political turmoil in following months, 0+ days delinquency level reached its peak level of 7.70% in mid-Jan 2016, before moderating in later months. However, adequate provisions against existing NPA (provision cover of ~87% in mid-July 2016) has been maintained leading to comfortable solvency profile (net NPA / net worth) of ~0.77%. Since credit growth of banking sector remains healthy in low interest regime, uptick in the interest rate environment could have adverse impact asset quality of the sector. However, LBL's established underwriting practices also provides some comfort towards the incremental assets quality.

LBL's deposit profile remains weak compared with its age and presents scope for improvement. Low CASA deposit proportion of the bank leads to low granularity and higher concentration among top deposit accounts. Short term liquidity profile of the bank remains comfortable due to sizeable proportion of short term loans and term deposits. However, large proportion of price sensitive institutional deposits could mean swift uptick in the deposit cost during the period of liquidity shortage in the system.

High cost of deposits and concentration towards competitive corporate loan segment results in below average profitability and return indicators as compared to commercial bank industry average (PAT/Net worth of ~14% and PAT/ATA of 1.32% against industry average of 21.32% and 1.97% respectively in FY 16). During FY15, the indicators stood at 11.37% and 1.04% respectively, well below the commercial bank industry average of 20.09% and 1.75%. The Improvement in profitability during FY16 is supported by improvement in NIMs (2.56% Vs 2.43% in FY15), optimum utilization of fund (CD ratio ~75% Vs regulatory maximum limit of 80%) and lower operating expense ratio (1.55% of ATA). Profitability remains further supported by fair non-interest income (~1.10% of ATA) and low credit provisioning expense (0.17% of ATA). Going forward, bank's ability to ensure efficient utilisation of incremental capital through proposed rights, maintain adequate NIMs and manage asset quality would have strong bearing on its profitability profile.

LBL's capitalisation levels are adequate with CRAR of 11.15% and CET-I of 9.78% as of mid-July-2016 (both under Basel III norms) against minimum regulatory requirement of 11% and 7.25% (both including capital conservation buffer-CCB) respectively required for mid-July 2016. LBL plans to increase paid-up capital to NPR 8 billion (vs. NPR 3.65 billion[4] as of now) by FY17 (as required by changed regulations) through rights issue of equity shares and internal accruals. Accordingly, capitalization levels are expected to remain adequate to support LBL's growth plans over the medium term. The banks' ability to raise planned capital in a timely manner would have a bearing on its ability to meet the revised guidelines and support growth plans.

LBL has signed a memorandum of understanding to acquire Professional Diyalo Development Bank (PRDBL) (a 10-district level class B Bank) towards the end of June 2016. The due diligence audit for determination of share swap ratio is under progress. Acquisition of PRDBL, with relatively small scale of operation[5] is expected to aid the retail presence of LBL to some extent.

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[4] Including NPR 605.75 million calls in advance towards proposed rights issue

[5] Networth and assets base of PRDBL as on mid-July 2016 stood at 301 million and 2,368 million respectively vis-à-vis LBL's networth and assets base of 5,646 million and 56,803 million.

Bank Profile

LBL commenced its operation as an “A” Class Commercial Bank from April 2002. LBL is promoted by Khetan group and Shanghai group, both business houses in Nepal. LBL also has 9.02% shareholding from Citizen Investment Trust (semi-government retirement fund of Nepal). Overall shareholding pattern of the bank constitutes ~65% shareholding by promoters group and rest by general public. The shares of the Bank are listed in Nepal Stock Exchange. The registered and Corporate Office of the bank is located at Hattisar, Kathmandu.

LBL has presence across the country through its 50 Branches, 3 dedicated Service Counters and 69 ATMs. LBL has market share of 2.73% in terms of deposit base and 2.90% of total advances in Nepal as on mid-Jul-16. LBL reported a profit after tax of NPR 674 million during 2015-16 over an asset base of NPR 56,803 million as of mid-Jul-16 against profit after tax of NPR 416 million during 2014-15 over an asset base of NPR 45,340 million as of mid-Jul-15. As of mid-Jul-2016, LBL’s CRAR was 11.15% and gross NPLs were 0.80%. In terms of technology platform, LBL has implemented Finacle across all its branches.

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