Laxmi Sunrise Bank Limited

Ratings

Facilities	Amount (Rs. Million)	Rating[1]	Rating Action
Issuer Rating	**NA**	**CARE-NP BBB+ (Is) [Triple B Plus (Issuer)] (Credit watch with negative implications)**	**Assigned and placed on credit watch with negative implications**
Subordinate Debenture (10.25% Debenture 2083)*	**3,000.00**	**CARE-NP BBB+ [Triple B Plus] (Credit watch with negative implications)**	**Removed from credit watch with developing implications and placed on credit watch with negative implications**
Subordinate Debenture (10% Debenture 2080)*	**1,000.00**	**CARE-NP BBB+ [Triple B Plus] (Credit watch with negative implications)**	**Removed from credit watch with developing implications and placed on credit watch with negative implications**

**Rating coverage for the debenture issued by erstwhile Sunrise Bank Limited (SBL) is being provided under Laxmi Sunrise Bank Limited (LSBL) following the merger of SBL and Laxmi Bank Limited (LBL) in July 2023.*

CARE Ratings Nepal Limited (CRNL) has placed on credit watch with negative implications the rating of 'CARE-NP BBB+' assigned to Subordinate Debenture "10.25% Sunrise Debenture 2083" and "10% Sunrise Debenture 2080" of Laxmi Sunrise Bank Limited (LSBL). The earlier credit watch with developing implications has been removed after completion of the merger of LBL and SBL. Instruments with this rating are considered to have moderate degree of safety regarding timely servicing of financial obligations, in Nepal. Such instruments carry moderate credit risk.
CRNL has assigned the issuer rating of 'CARE-NP BBB+ (Is)' to LSBL and has placed the rating on credit watch with negative implications. Issuers with this rating are considered to offer moderate degree of safety regarding timely servicing of financial obligations, in Nepal. Such issuers carry moderate credit risk.

Detailed Rationale & Key Rating Drivers

The ratings assigned to LSBL have been placed on credit watch with negative implications factoring in further stress in the asset quality of the bank amid substantial uptick in its total delinquent loans as on mid-January, 2024 with its already high Gross Non-Performing Loans (GNPL) above the industry average. Although, ~20% of these delinquent loans fall under pass category (0-30 days due), the delinquent loan on 30-90 days bucket also stood high at ~11% as on mid- January, 2024 (up from 6% as on mid-July, 2023) with increased probability of further slippages over the near-term, adding further stress on the bank's credit risk profile. The solvency profile of the bank deteriorated as indicated by its sharp increase in net NPL to net worth ratio which stood at ~12% as on mid-January, 2024 (~8% as on mid-July, 2023) and lower provision cover of ~95% at the end of H1FY24. Hence, amid near-term headwinds, stress on LSBL's asset quality is likely to sustain, leading to added pressure on the bank's earnings and distributable profits, which remains a key constraint from credit perspective.
The ratings, however, continue to derive strengths from the bank's long track record of operations along with experienced directors and management team, widespread geographical coverage through branches, substantial increase in scale of operations and market reach post-merger. The rating also factors in the moderate capitalization levels with decent cushion in Tier I capital adequacy ratio (CAR) as on mid-January, 2024 and moderate concentration on top depositors and borrowers. Further, the rating takes note of added advantage of relaxations on interest rate spread to LSBL as compared to its peers i.e. waiver of regulatory cap of 4% on interest rate spread till July 14, 2024 (one year from the date of completion of merger) which augurs well for its incremental earning profile for FY24 (FY refers to the twelve-month period ending mid-July). The above rating strengths are

[1]Complete definition of the ratings assigned are available at www.careratingsnepal.com and other CARE publications

however tempered by low-cost Current Account Savings Accounts (CASA) mix of the bank leading to relatively higher cost of funds which could impact its pricing power and profitability amid intense competition in the industry.

Going forward, the ability of the bank to improve its asset quality while managing growth in operations, maintain adequate cushion in capital adequacy indicators from the minimum regulatory requirement levels, and manage the impact of any other regulatory changes by Nepal Rastra Bank would be the key rating sensitivities.

Detailed Description of the Key Rating Drivers

Key Rating Strength

Long track record of operations and experienced promoters and management Team

Laxmi Bank Limited was incorporated in 2002 with more than two decades of track record of operations and the bank merged with Sunrise Bank Limited (SBL) which was incorporated in 2007. The bank's profile derives strength from its experienced and diverse promoters who are well known in the Banking and insurance sectors. There are five members in board, chaired by Mr. Raman Nepal, who has over three decades of experience with Nepal Rastra Bank and as executive Director of Citizen Investment Trust (2018-2023). Mr. Ajaya Bikram Shah, Chief Executive Officer, was involved with Lami Bank Limited for more than a decade under different capacities. Previously he was involved with Standard Chartered Bank Limited for over a decade and even held position of Deputy Chief Officer in Standard Chartered Bank Limited. The board is supported by other experienced team members.

Moderate capitalization levels

LSBL's capitalization levels remain moderate with decent cushion in Tier I capital adequacy ratio (CAR) over minimum regulatory requirement levels in H1FY24. As on mid-January 2024, LSBL's overall Capital Adequacy Ratio (CAR) stood at 12.67% (regulatory minimum requirement of 11%), with Tier-1 CAR of 9.66% (regulatory minimum requirement of 8.5%) which declined from 13.21% and 10.04%, respectively, as on mid-July 2023. Moderation in CARs in H1FY24 was mainly owing to transfer of Rs. 970 Mn to Regulatory Reserve from retained earnings (adjustment for interest booked but not yet received, which is excluded from the bank's capital fund). Reduced borrower's repayment ability due to subdued economic indicators led to increase in interest receivables and overall NPL levels in FY23 and the impact has prolonged in H1FY24. Nonetheless, the bank has decent buffer of 1.16% in Tier I ratio over the minimum regulatory requirement of 8.50% as on mid-January, 2024. Declining asset quality trend, particularly with its already high GNPL levels and delinquent loans could add to the downward pressure on capitalization levels over the near term. Rising concerns for further increase in credit cost may subdue the profitability over near term, however LSBL has added advantage in terms of earnings due to relaxations in interest rate spread provided by NRB for the banks who have undergone mergers and acquisition before mid-July, 2023 (Regulatory limitation for interest spread cap of 4% to be waived for a period of 1 year from the date of merger i.e. till July 14, 2024).

Nepal Rastra Bank's (NRB) implementation of adding 0.5% countercyclical buffer to the regulatory capital from mid-July 2024 for Class A commercial banks (minimum Tier 1 CAR to be maintained at 9% from FY24 end) will limit the near-term growth prospect of LSBL. Adequate capitalization levels, particularly in core capital, helps a bank's ability to absorb losses, should they materialize, especially given the increasing uncertainty surrounding credit recovery. The bank's ability to maintain adequate cushion in the capital adequacy ratios will remain critical for its solvency and growth prospect, particularly following a period of around 3-4 years of high credit expansion in the industry.

Substantial increase in scale of operations post-merger between SBL and LBL

Following merger between SBL and LBL, overall scale of the combined bank has grown substantially as indicated by advances and loans portfolio. LSBL's market share stood at 5.81% and 5.66%, respectively, in terms of loans and deposits as on mid-January, 2024 (ranked 6th and 7th highest advances and deposits respectively out of 20 commercial banks as on mid-January, 2024). The overall capital base and tangible net worth of LSBL stood one of the highest as on FY23 and H1FY24 end. Similarly, market penetration and reach of the bank also substantially increased and the bank now has 264 branches spread across all seven provinces of the country (as on Q1FY24) (139 branches of SBL prior to the merger). A larger scale with increased network could provide the bank with better business opportunities by increasing its reach as well as competitiveness. The bank's ability to drive in synergy post-acquisition remains to be seen for now, marred mainly by the decline in its asset quality, and will be a key monitorable.

Moderate concentration on top borrowers and depositors

Following merger between LBL and SBL, concentration of top 20 single borrowers on total advances portfolio of LSBL stood low at ~12% as on FY23 and H1FY24. Similarly, concentration of top 20 group borrowers on total loan portfolio stood moderate at ~13% and ~19% as on July 16, 2022 and January 14, 2024 respectively. Deposit concentration by top 20 institutional depositor accounts has been moderate with ~18% and ~19% of total bank deposits as on July 16, 2023 and January 14, 2024 respectively. Moderate concentration towards advances and deposits normally reduces re-pricing risks at times of interest rate volatility.

Key Rating Weaknesses

Weak asset quality; likely to remain under stress in FY24

LSBL's asset quality has deteriorated in H1FY24 reflected by its rising proportion of gross non-performing loans as well as overall portfolio delinquencies. As on mid-January 2024, LSBL's GNPL ratio had increased to 4.67% (above industry average of ~3.5%) from 2.91% as on mid-July 2023 (industry average of 2.98%). The slippages can be attributed to the slowdown in the country's economy (estimated GDP growth for FY23 of 1.9%) amid monetary tightening and effects of import restrictions. LSBL's total delinquent loans (0+ days past due) of ~36% of total loans and advances as on mid-January 2024 (up from ~26% as on mid-July 2023) also remains comparatively higher vis-à-vis peers, which along with the bank's substantially higher GNPL ratio, heightens risk of further deterioration in asset quality over the near-term. Furthermore, 30 to 90 days past due loans of ~11% as on mid-January 2024 (mid-July 2023: ~6%) increases possibility of more slippages over the near-term. More concerningly, the bank's net NPL to net worth stood high at ~12% at the end of H1FY24. Also, provision cover for loan loss also declined to 95.46% as on mid-January 2024 from over 100% in previous period. Any major slippages going forward could impact the bank's earnings and its overall credit risk profile. LSBL's ability to improve its asset quality via efficient recovery mechanisms will be a key monitorable aspect.

Low CASA ratio leading to high cost of funds

LSBL has a low Current account Saving Account (CASA) mix in its total deposit with 31.35%. CASA deposits at the end of FY23 (Industry average: 35.55%). CASA ratio has been declining in the industry during FY23 amid industry wide liquidity crunch resulting in higher interest rates leading to higher demand for high-cost fixed term deposits. CASA deposits in absolute amount have however increased by 6.26% (over FY23 level) to Rs. 100,056 Mn at the end of H1FY24, however it still remained low at 31.79% as on mid-January, 2024. Higher cost of funds vis-à-vis peers pose advantage to a bank in the "base rate plus" lending rate regime. Despite improvement in CASA mix, the base rate of the company was one of highest in the industry during Q1FY24 with base rate of 10.80% above industry average: 9.98%

Intense competition in the industry

Currently there are 20 Commercial Banks (as on mid-January 2024), including three major state-owned banks, operating with total 5,019 branches all over Nepal (based on monthly statistics published by NRB for mid-January 2024). LSBL had 264 branches along with head office as on same date. Industry (Class A Commercial Banks) achieved net interest income of Rs. 49.45 Bn during Q1FY24, where LSBL's share on net interest income was 5.80%. Competition in the interest rates also remains a prominent challenge, especially amid volatile liquidity in the banking system.

Exposure to regulatory risk related to industry

The banking industry of Nepal is exposed to changes in the various regulatory measures issued by NRB from time to time. In recent times, NRB had changed to CD ratio mechanism from previous Credit to Core Capital plus Deposit (CCD) ratio measures, increased the minimum requirement of liquid assets that the BFIs must hold, and implemented working capital guidelines. Cumulatively these led to muted credit growth and tightened liquidity in the market in FY23. NRB capped interest rate spread of commercial banks at 4% from 4.4%, which has also added to the lower profitability of banks in FY23 and H1FY24 apart from increased impairment. However, regulatory cap for interest rate spread has been waived till July 14, 2025 (one year from the date of merger) for LSBL. Going forward, NRB has required Class A banks to maintain countercyclical buffer of 0.5% from FY24 end. Increase in regulatory requirement in capitalization levels in an industry with increasingly stressed asset profile is likely to subdue the growth prospects in loans and advances in near term. Subdued growth in loans and advances and increase in credit cost due to rising NPL levels and tightening of provisioning requirements by NRB will likely put downward pressure on the bank's profitability indicators.

Industry Outlook

The major challenges currently faced by the banking sector in Nepal is centered around declining asset quality. High and rising GNPLs are leading to stressed profitability and adding downward pressure on banks' capitalization. The regulator's directive to implement countercyclical buffer from FY24 end only adds to their near-term woes. CARs of Class A banks declined from 13.53% as on mid-July 2022 to 12.48% as on mid-January 2024 against the backdrop of deterioration in GNPL ratio from 1.20% to 3.63% over the same period. Credit expansion in Nepal took off substantially and in more aggressive manner during the pandemic era with loans & advances portfolio of Class A banks growing by a compounded annual growth rate of 19.91% over FY20-FY22, leading to a higher proportion of unseasoned credit in their books. Introduction of contractionary policies helped check credit growth in FY23. However, muted GDP growth in the country and lower than expected government expenditures (4% y-o-y decline in 7MFY24 on a low base) has prolonged the difficult road to recovery for various sectors including construction, steel, cement, automobiles, retail and SME sectors. Although the central bank has come up with prescriptions to provide reliefs to some stressed sectors, doing so would increase the provisioning requirements of banks, which could add further stress to their capitalization levels. As cash flows of corporates have come under sustained pressure, BFIs have been reporting higher slippages in asset quality over FY23 and H1FY24. While a revival in the tourism industry, sustained growth in remittances, augmenting forex reserves and controlled inflation so far in FY24 remain some positives, there are several headwinds that could offset the positive impact. Declining exports and moderation in government capital expenditure, etc. pose slowdown to the economic outlook leading to the possibility of sustained credit deterioration and further slippages in asset profile of the BFIs over the near term.

About the Company

With completion of merger between Sunrise Bank Limited (SBL) and Laxmi Bank Limited (LBL), joint operations started under the name of Laxmi Sunrise Bank Limited (LSBL) from July 14, 2023 onwards. LSBL had 264 branches, 28 extension counters, 328 ATMs terminals and 143 branchless banking and 7 revenue counters as on October 17, 2023. As on July 16, 2023, 51% of the total shares of LSBL were held by the promoter whereas remaining 49% is held by the general public.

Contact us

Analyst
Ms. Monika Rawal
Contact No.: 977-01-4012629
monika.rawal@careratingsnepal.com

Mr. Santosh Pudasaini
Contact No.: +977-9802312855
pudasaini.santosh@careratingsnepal.com

Relationship Contact
Name: Achin Nirwani
Contact No.: +977 9818832909
Email: achin.nirwani@careratingsnepal.com

About CARE Ratings:

CARE Ratings Nepal Limited (CRNL) is licensed by the Securities Board of Nepal w.e.f. November 16, 2017. CRNL is supported by CARE Ratings Limited through a technical services agreement to provide technical support in the areas such as rating systems and procedures, methodologies, etc. from CARE Ratings on an ongoing basis. The technical support shall ensure that CRNL has adequate resources to provide high quality credit opinions in Nepal.

Our parent company, CARE Ratings Limited commenced operations in April 1993 and over two decades, it has established itself as one of the leading credit rating agencies in India. CARE is registered with the Securities and Exchange Board of India (SEBI) and also recognized as an External Credit Assessment Institution (ECAI) by the Reserve Bank of India (RBI).

Disclaimer