Dhanlaxmi Bank Limited

January 03, 2020

Ratings

Facilities	Amount (Rs. crore)	Ratings[1]	Remarks
Tier II Bonds (BASEL III Compliant)	150.00	**CARE BB+; Stable (Double B Plus; Outlook: Stable)**	**Reaffirmed**
Upper Tier II Bonds	27.50	**CARE BB; Stable (Double B; Outlook: Stable)**	**Reaffirmed**
Lower Tier II Bonds	-	**-**	**Withdrawn**
Total	**177.50 (Rupees One Hundred Seventy Seven crore and Fifty lakh only)**		

Details of instruments/facilities in Annexure-1

Tier II Bonds under Basel III are characterized by a 'Point of Non-Viability' (PONV) trigger due to which the investor may suffer a loss of principal. PONV will be determined by the Reserve Bank of India (RBI) and is a point at which the bank may no longer remain a going concern on its own unless appropriate measures are taken to revive its operations and thus, enable it to continue as a going concern. In addition, the difficulties faced by a bank should be such that these are likely to result in financial losses and raising the Common Equity Tier I capital of the bank should be considered as the most appropriate way to prevent the bank from turning non-viable. In CARE's opinion, the parameters considered to assess whether a bank will reach the PONV are similar to the parameters considered to assess rating of Tier II instruments even under Basel II. CARE has rated the Tier II bonds under Basel III after factoring in the additional feature of PONV.

Detailed Rationale & Key Rating Drivers

The ratings assigned to various debt instruments of Dhanlaxmi Bank Limited (DBL) continue to factor in the relatively small size of operations, weak asset quality and regional concentration of its operations.

The ratings, however, favorably factor in the long track record of operations and a well-established presence of the bank in Kerala, adequate capitalization levels and liquidity profile. The ratings also take note of improvement in profitability during FY19 and H1FY20.

The ability of DBL to improve its scale of operations while maintain its capitalization levels above regulatory requirement, improve asset quality and profitability are the key rating sensitivities.

CARE has withdrawn the rating assigned to the Lower Tier II bonds of Dhanlaxmi Bank Limited with immediate effect, as the bank has repaid the aforementioned bonds in full and there is no amount outstanding under the issue as on date.

Rating Sensitivities

Positive factors

- Improvement in the scale of operations along with improvement in Asset quality and profitability

Negative factors

- Further moderation in asset quality parameters
- Weakening of profitability and capital adequacy levels

Credit Risk Assessment

Key Rating Weaknesses

Regional concentration and small size of operations

The business of the bank is largely concentrated in the state of Kerala, which accounted for 145 branches of the branch network of 250 branches as on March 31, 2019. With total advances of Rs. 6,368 crore and total assets of Rs. 11,920 crore as on September 30, 2019, DBL is one of the small-sized banks in India.

Weak Asset quality

GNPA slightly moderated to 7.48% as on March 31, 2019 from 7.35% as on March 31, 2018. However, because of the higher provisions, NNPA reduced to 2.41% as on March 31, 2019 from 3.19% as on March 31, 2018. On absolute terms, GNPA has increased from Rs.469 crore as on March 31, 2018 to Rs.496 crore as on March 31, 2019.

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

Standard restructured assets increased to Rs.44 crore as on March 31, 2019 as against Rs.29 crore as on March 31, 2018 due to restructuring post Kerala floods. Gross Stressed Assets (Standard restructured asset + Security receipts outstanding + GNPA) to Advances stood at 9.72% (PY: 9.52%) and Net stressed Assets (Standard restructured asset + Security receipts outstanding + NNPA) to Networth stood at 41.54% as on March 31, 2019 (PY: 46.75%).

GNPA and NNPA as on September 30, 2019 improved to 7.06% and 1.65%. Though there was moderation in asset quality during FY19, the bank was able to control slippages during H1FY20. On absolute terms, GNPA stood at Rs.476 crore as on September 30, 2019. Provision coverage ratio remained at 89.16% as on September 30, 2019. DBL has already started focusing on recoveries and the bank has a separate recovery team for one time settlement for technically written off accounts.

However, any further slippage will have an impact on the profitability and capitalization levels of the bank.

Decline in overall business during FY19; however slight improvement during H1FY20.

During FY19, overall business (advances + deposits) declined from Rs. 17,030 crore as on March 31, 2018 to Rs. 16,893 crore as on March 31, 2019. As on September 30, 2019, overall business remained at Rs.17,053 crore.

During FY19, the bank registered 3% increase in advances and 3% decline in deposits. Net advances increased from Rs. 6,110 crore as on March 31, 2018 to Rs.6,289 crore as on March 31, 2019. The trend continued in H1FY20 with advances increasing to Rs.6,368 crore as on September 30, 2019.

Deposits declined from Rs.10,920 crore as on March 31, 2018 to Rs. 10,603 crore as on March 31, 2019. CASA (%) improved to 32.01% as on March 31, 2019 from 30.80% as on March 31, 2019 despite the absolute value of CASA deposits remained at Rs.3,394 crore as on March 31, 2019 as against Rs.3,363 crore as on March 31, 2018. Deposits marginally grew to Rs.10,685 crore as on September 30, 2019.

Key Rating Strengths

Long standing track record

DBL has a long standing track record of around 90 years. Over the years, the bank has established in the State of Kerala with extensive presence in the rural and urban markets. As on March 31, 2019, total branches stood at 250 with majority of the branches in Kerala and total ATMs stood at 346.

Adequate Capitalization

CAR and Tier 1 CAR as March 31, 2019 stood at 13.75% and 10.57% as against 13.87% and 10.60% as on March 31, 2018 with slight increase in advances during FY19. Overall Gearing has improved to 15.00x as on March 31, 2019 as against 15.97x as on March 31, 2018.

During H1FY20, CAR stood at 13.77% as on September 30, 2019. The capital adequacy looks adequate for current level of operations and for limited growth envisaged by the bank. However, once the bank starts focusing on growing advances, infusion of capital remains a critical factor.

Improvement in profitability during FY19 and H1FY20

During FY19, NIM remained at 2.89% in FY19 as against 2.82% in FY18. Cost of deposits decreased from 5.77% during FY19 to 5.53% during FY18 with improvement in CASA proportion. Non-Interest income moderated to Rs.53 crore in FY19 from Rs.102 crore in FY18 with decline in profit on sale of investments from Rs.11 crore in FY18 to a loss of Rs.34 crore in FY19. Opex to average assets stood at 2.54% during FY19 as against 2.46% in FY18.

With decline in non-interest income and stable operating expenses, operating profit decreased to Rs.95 crore in FY19 from Rs.146 crore in FY18. However, with decrease in provisions towards NPAs, the bank reported a profit of Rs.12 crore during FY19 as against a net loss of Rs.25 crore during FY18.

During H1FY20, the bank reported profit of Rs.42 crore with a total income of Rs.534 crore mainly due to improvement in non-interest income to Rs.40 crore in H1FY20. ROTA improved to 0.71% during H1FY20.

Industry outlook and prospects

Over the last three years, RBI which is the regulator for the sector has been focusing on cleaning of the balance sheets of banks and emphasised on adequate provisioning for stressed assets. The regulator has time and again provided banks with several schemes like Joint Lending Forum (JLF), 5/25 scheme, Strategic Debt Structuring (SDR), Scheme for Sustainable Structuring of Stressed Assets (S4A), and has also directed banks to file for Insolvency proceedings with National Company Law Tribunal (NCLT) against the large borrowers to resolve the issue of Non-Performing Assets (NPA) and manage the risk on the banks' books. RBI also revised the Prompt Correcting Action (PCA) framework for banks. In terms of Credit growth, the banking sector witnessed declining trend over the last three years due to decline in economic activity leading to moderation in industrial output, leveraged

corporate balance sheets and low capital expenditure (capex) plans resulting in decline in credit demand and asset quality overhang making banks cautious in lending. However during FY18, the banking sector has witnessed marginal improvement in advance growth of around 7% as against 4.7% during FY17 due to increase in bond yield resulted in shift in borrowings through banks from bond markets. Also the growth during FY18 witnessed towards services and retail segment while industry growth was muted. In terms of Asset quality, the asset quality of the banks continued to show deterioration in general and public sector banks (PSB) in particular during FY18. During FY19, the stress on the asset quality of banks is expected to continue with the absolute amount of NPA is expected to increase, however, the pace of incremental NPA would be lower. Due to deterioration in asset quality, banks especially public sector banks, saw sharp decline in profitability over the last three years due to interest income reversal and higher provisioning requirements and has impacted the capital adequacy levels of the banks. Currently, the overall sector remains moderately capitalized, Public sector banks would continue to require further capital infusion to maintain regulatory capital requirement and fuel the credit growth in future.
The ability of DBL to improve its scale of operations while maintain its capitalization levels above regulatory requirement, improve asset quality and profitability are the key rating sensitivities.

Liquidity: Adequate
ALM profile of the bank as on September 30, 2019 was adequate with no negative cumulative mismatches in any of the time bucket and with a liquidity coverage ratio 325% as on September 30, 2019. Also, DBL has liquidity backup in the form of excess SLR investments of Rs.439 crore as on September 30, 2019 to meet contingencies. Term Deposit rollover rate of 80% also provides comfort.

Analytical approach: Standalone.

Applicable Criteria
Criteria on assigning Outlook and Credit watch to Credit Ratings
CARE's Policy on Default Recognition
Financial ratios – Financial sector
Bank - CARE's Rating Methodology for Banks
Bank - Rating framework for Basel III instruments (Tier I & Tier II)
Policy on withdrawal of ratings

About the Bank
Established in 1927, Dhanlaxmi Bank Ltd. (DBL) is a Kerala-based small-sized private sector bank headquartered at Thrissur. As on March 31, 2019, the bank had a presence across 250 branches and 346 ATMs. The bank's shares are listed in BSE and NSE and are widely held. DBL has no identifiable promoter and the share holding pattern is well diversified with major holding by resident individuals at 53.09% as on September 30, 2019.

Brief Financials (Rs. crore)	FY18 (A)	FY19 (A)
Total income	1,116	1,024
PAT	-25	12
Total Assets	12,249	11,762
Net NPA (%)	3.19	2.41
ROTA (%)	NM	0.10

Note: a). A – Audited; NM – Not Meaningful
b). Ratios have been computed based on average of annual opening and closing balances
c). NIM has been calculated as net interest income/ average annual total assets

Status of non-cooperation with previous CRA: Not Applicable

Any other information: Not Applicable

Rating History for last three years: Please refer Annexure-2

Annexure-1: Details of Facility

Name of the Instrument	ISIN No.	Date of Issuance	Coupon Rate	Maturity Date	Size of the Issue (Rs. crore)	Rating assigned along with Rating Outlook
Bonds-Upper Tier II	INE680A09022	July 28, 2018	10%	July 30, 2025	27.50	CARE BB; Stable
Bonds-Lower Tier II	-	-	-	-	-	Withdrawn
Bonds-Tier II Bonds	INE680A08081	March 29, 2018	11%	March 28, 2025	150.00	CARE BB+; Stable

Annexure-2: Rating History of last three years

Sr. No.	Name of the Instrument/Bank Facilities	Current Ratings			Rating history			
		Type	Amount Outstanding (Rs. crore)	Rating	Date(s) & Rating(s) assigned in 2019-2020	Date(s) & Rating(s) assigned in 2018-2019	Date(s) & Rating(s) assigned in 2017-2018	Date(s) & Rating(s) assigned in 2016-2017
1.	Bonds-Upper Tier II	LT	27.50	CARE BB; Stable	-	1)CARE BB; Stable (04-Jan-19)	1)CARE BB; Stable (05-Oct-17)	1)CARE D (04-Aug-16)
2.	Bonds-Lower Tier II	LT	-	-	-	1)CARE BB+; Stable (04-Jan-19)	1)CARE BB+; Stable (05-Oct-17)	1)CARE BB+ (13-Oct-16)
3.	Bonds-Lower Tier II	LT	-	-	-	1)Withdrawn (04-Jan-19)	1)CARE BB+; Stable (05-Oct-17)	1)CARE BB+ (13-Oct-16)
4.	Bonds-Tier II Bonds	LT	150.00	CARE BB+; Stable	-	1)CARE BB+; Stable (04-Jan-19)	1)CARE BB+; Stable (16-Mar-18)	-

Note on complexity levels of the rated instrument: *CARE has classified instruments rated by it on the basis of complexity. This classification is available at www.careratings.com. Investors/market intermediaries/regulators or others are welcome to write to care@careratings.com for any clarifications.*

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About CARE Ratings:

CARE Ratings 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). CARE Ratings is proud of its rightful place in the Indian capital market built around investor confidence. CARE Ratings provides the entire spectrum of credit rating that helps the corporates to raise capital for their various requirements and assists the investors to form an informed investment decision based on the credit risk and their own risk-return expectations. Our rating and grading service offerings leverage our domain and analytical expertise backed by the methodologies congruent with the international best practices.

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