The Lakshmi Vilas Bank Limited

April 12, 2019

Ratings

Facilities	Amount (Rs. crore)	Rating[1]	Rating Action
Lower Tier II Bonds	50.50	**CARE BBB (Triple B) (Credit Watch with developing implications)**	**Revised from CARE BBB (Triple B) (Credit Watch with negative implications)**
Tier II Bonds (Basel III Compliant) –I @	78.10	**CARE BBB (Triple B) (Credit Watch with developing implications)**	**Revised from CARE BBB (Triple B) (Credit Watch with negative implications)**
Tier II Bonds (Basel III Compliant) –II @	140.10	**CARE BBB (Triple B) (Credit Watch with developing implications)**	**Revised from CARE BBB (Triple B) (Credit Watch with negative implications)**
Tier II Bonds (Basel III Compliant) –III @	100.00	**CARE BBB (Triple B) (Credit Watch with developing implications)**	**Revised from CARE BBB (Triple B) (Credit Watch with negative implications)**
Proposed Basel III Compliant Additional Tier I Perpetual Bond issue #	250.00	**CARE BB (Double B) (Credit Watch with developing implications)**	**Assigned**
Total	**618.70 (Rupees Six Hundred Eighteen crore and Seventy lakh only)**		

Details of instruments/facilities in Annexure-1

Detailed Rationale & Key Rating Drivers

@ 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.

CARE has rated the aforesaid Basel III Compliant Tier-I Perpetual Bonds [Additional Tier I Bonds (Basel III)] after taking into consideration its key features as mentioned below:

• The bank has full discretion at all times to cancel coupon payments.

• The coupon is to be paid out of current year profits. However, if the current year's profits are not sufficient, i.e., payment of such coupon is likely to result in losses during the current year, the balance of coupon payment may be made out of reserves representing appropriation of net profits, including statutory reserves and excluding share premium, revaluation reserve, foreign currency translation reserve, investment reserve and reserves created on amalgamation provided the bank meets the minimum regulatory requirements for Common Equity Tier I [CET I], Tier I and Total Capital Ratios and capital buffer frameworks as prescribed by the Reserve Bank of India [RBI].

• The instrument may be written-down upon CET I breaching the pre-specified trigger of 5.5% before March 31, 2020, and 6.125% on and after March 31, 2020, or written-off / converted into common equity shares on occurrence of the trigger event called point of non-viability (PONV). The PONV trigger shall be determined by RBI. Any delay in payment of interest/principal (as the case may be) due to invocation of any of the features mentioned above would constitute as an event of default as per CARE's definition of default and as such these instruments may exhibit a some-what sharper migration of the rating compared with other subordinated debt instruments.

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

Detailed description of the key rating drivers

The ratings assigned to the various debt instruments of The Lakshmi Vilas Bank Ltd are placed on rating watch or credit watch with developing implications following the announcement by the Board of Directors of LVB approving the scheme of amalgamation between lndiabulls Housing Finance Limited (IBH) and LVB. The scheme is subjected to regulatory and shareholders' approval. As per the scheme of amalgamation, every shareholder of LVB shall receive 14 shares of IBH for 100 shares held in LVB. The proposed scheme is expected to improve the capitalisation levels and other financial parameters of the amalgamated entity and will result in significant change in shareholding. CARE will closely follow the developments in this regard and will consider taking appropriate rating action in due course. Indiabulls Housing Finance is a Housing Finance Company with total asset size and net worth of Rs.1,31,903 crore and Rs.17,792 crore as December 31, 2018 respectively.

Earlier, the ratings were placed on 'credit watch with negative implications' with LVB reporting CAR adequacy below regulatory requirement and the bank was in the process of mobilizing fresh equity capital. With proposed amalgamation with IBH, the ratings are moved to 'credit watch with developing implications'.

CARE has also assigned rating to the proposed AT1 bonds issue of LVB. The ratings continue to derive strength from the long-standing operational track record of Lakshmi Vilas Bank Ltd (LVB) and its established presence in Southern India. The rating takes into account the losses reported in 9mFY19 (refers to the period March to December) mainly on account of higher provisions on NPAs during the period. The rating is constrained by moderate size of the bank, its regional nature of operations, weak asset quality parameters, weak capitalisation levels and relatively low proportion of current account & savings account (CASA) deposits. The ratings also take also note of the equity mobilization of Rs.460 crore through QIP during March 2019.

LVB's ability to raise capital, improve its asset quality and profitability would be the key rating sensitivities. In view of current capital adequacy levels and phased increase in minimum capital adequacy ratio (CAR) as per regulatory requirement, timely mobilisation of capital to augment its CAR is critical in the near term.

Key Rating Strengths

Long standing operational track record

Established in 1926, LVB is one of the old private sector banks based out of TN with a track record of more than 90 years. LVB now has a wide spread shareholder base with promoters' holding of 8.88% as on December 31, 2018. As on December 31, 2018, the bank had a network of 569 branches and 1046 ATMs.

Improvement in CASA proportion; however continues to be relatively low

The proportion of low-cost current account and savings account (CASA) is relatively low but has improved in FY18 and Q3FY19. CASA improved to 21.06% as on March 31, 2018 from 19.11% as on March 31, 2017 thereby lowering the overall cost of deposits in FY18. As on December 31, 2018, CASA stood at 22.85%. Saving deposits grew by 15% from Rs.4,573 crore as on December 31, 2017 to Rs.5,265 crore as on December 31, 2018 whereas current accounts deposits declined by 7% from Rs.1909 crore as on December 31, 2017 to Rs.1771 crore as on December 31, 2018. The bank was able to decrease the bulk deposits (deposits greater than Rs.1 crore) from 43.27% of total term deposits as on March 31, 2017 to 41.10% as on March 31, 2018.

Liquidity profile

LVB had no cumulative mismatches up to 5 year bucket. LVB had an excess SLR investments of Rs.711 crore as on December 31, 2018 which would support the liquidity position of the bank. Liquidity coverage ratio stood at 180% as on December 31, 2018.

Key Rating Weaknesses

During FY18, the asset quality parameters have witnessed deterioration with the bank reporting GNPA and NNPA of 9.98% and 5.66% as on March 31, 2018 as against 5.66% and 4.27% as on December 31, 2017 (GNPA and NNPA of 2.67% and 1.76% as on March 31, 2017). GNPA in absolute terms increased from Rs.640 crore as on March 31, 2017 to Rs. 1,427 crore as on December 31, 2017 and subsequently to Rs.2,694 crore as on March 31, 2018. The increase in NPA levels is on account of slippages of standard restructured assets (including SDR, S4A, 5/25), NCLT accounts, accounts classified based on RBI circular on resolution plan dated February 12, 2018 and also from other standard accounts.

Standard restructured assets declined from Rs.965 crore as on March 31, 2017 to Rs.76 crore as on March 31, 2018 as majority of them slipped into NPA due to RBI circular on resolution plan dated February 12, 2018. LVB had outstanding security receipts of Rs.339 crore on March 31, 2018. Stressed Assets (Standard restructured asset + Security receipts outstanding + GNPA) stood at Rs. 3,109 crore as on March 31, 2018 as against Rs. 1,954 crore as on March 31, 2017. Provisions coverage ratio stood at 55.07% as on March 31, 2018.

Asset quality has deteriorated further in 91FY19 with bank reporting GNPA and NNPA of 13.95% and 7.64% as on December 31, 2018. Considering the high quantum of NPAs, LVB needs to scale up the recovery efforts in order to improve the asset quality parameters.

Decline in business during 9mFY19 due to capital constraint

During FY18, advances grew by 9% from Rs. 23,729 crore as on March 31, 2017 to Rs. 25,768 crore as on March 31, 2018, whereas deposits grew by 9% from Rs. 30,553 crore as on March 31, 2017 to Rs. 33,309 crore as in March 31, 2018.
Advances declined to Rs. 22,475 crore as on December 31, 2018 from Rs. 25,768 crore as on March 31, 2018. During the same period deposits also declined to Rs. 30,787 crore as on December 31, 2018 from Rs. 33,309 crore as on March 31, 2018.

Continuation of losses in 9mFY19

Interest income grew by 7% from Rs. 2,847 crore in FY17 to Rs. 3,042 crore in FY18. Non-Interest Income has declined from Rs.503 crore in FY17 to Rs.347 crore in FY18 mainly on the account decrease in profit from sale of investments from Rs.260 crore in FY17 to Rs.64 crore in FY18 with unfavourable movement in bond yields. During FY18, the bank reported an operating profit (Profit before provisions and tax) of Rs.355 crore (PY: Rs.634 crore) mainly on account of stagnant NII, decline in non-interest income and increase in operating expenses during the year. LVB has reported a loss of Rs.584 crore in FY18 as against profit of Rs.256 crore in FY17 mainly on account of higher provisions towards NPAs (Rs.1302 crore in FY18 as against Rs.235 crore in FY17).
The interest income has decreased from Rs. 2,339 crore in 9mFY18 to Rs. 2,158 crore in 9mFY19 mainly due to high quantum of NPAs. Non-Interest income declined to Rs.192 crore in 9mFY19 from Rs.309 crore in 9mFY18. The bank made provisions on depreciation of investments (MTM) of Rs.162 crore and provisions towards NPAs of Rs.575 Crore during 9mFY19 resulting in the bank reporting loss of Rs.630 crore during the period.
The incremental provisions on existing NPA accounts along with fresh slippages during the year is expected to have an impact on profitability in the near term.

Weak capitalization levels

LVB reported a capital adequacy ratio (CAR) of 10.38% as on March 31, 2017 and subsequently the bank raised capital to the tune of Rs.787 crore through rights issue during January 2018. With the bank reporting higher than expected loss during FY18, LVB reported a capital adequacy of 9.81% as on March 31, 2018 as against the regulatory requirement of 10.875%. With the bank reporting losses in 9MFY19, capital adequacy further declined to 7.57% as on December 31, 2018. LVB has raised capital to a tune of Rs.460 crore via QIP during March 2019, However the CAR levels are expected to remain below regulatory requirement.
Considering the weak financial performance in 9MFY19, ageing provisions and fresh slippages, LVB need to raise significant equity capital to maintain the CAR at regulator prescribed levels.

Industry 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. In terms of Credit growth, the banking sector witnessed declining trend over the three years ended FY17 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 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, 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, banks would continue to require further capital infusion to maintain regulatory capital requirement and fuel the credit growth in future.
LVB's ability to raise capital, improve its asset quality and profitability would be the key rating sensitivities. In view of current capital adequacy levels and phased increase in minimum capital adequacy ratio (CAR) as per regulatory requirement, timely mobilisation of capital to augment its CAR is critical in the near term

Analytical approach: Standalone

Applicable Criteria

Criteria on assigning Outlook 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)](#)

About the company
Established in 1926, LVB is one of the old private sector banks based out of Tamil Nadu. As on March 31, 2018, the bank had a network of 548 branches and 1020 ATMs. LVB has a wide spread shareholder base with the promoters' holding of 8.99% as on March 31, 2018. As on March 31, 2018, the total advances stood at Rs. 25,768 crore and deposits stood at Rs.33,309 crore.
During FY18, LVB reported loss of Rs.585 crore on total income of Rs. 3,388 crore. During H1FY19, the bank reported loss of Rs.256 crore on total income of Rs.788 crore.

For Y.E./ As on March 31,	FY17 (A)	FY18 (A)
Total Income	3,349	3,388
PAT	256	(585)
Net Advances	23,729	25,768
Net NPA (%)	1.76	5.66
ROTA (%)	0.81	NM
Capital Adequacy Ratio	10.38	9.81

***Note**:* A-Audited

Status of non-cooperation with previous CRA: Not Applicable

Any other information: Not Applicable

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

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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****For detailed Rationale Report and subscription information, please contact us at www.careratings.com**

About CARE Ratings:
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Annexure-1: Details of Instruments/Facilities

Name of the Instrument	Date of Issuance	Coupon Rate	Maturity Date	Size of the Issue (Rs. crore)	Rating assigned along with Rating Outlook
Bonds-Lower Tier II	February 10, 2012	11.40	10-02-2022	50.50	CARE BBB (Under Credit watch with Developing Implications)
Bonds-Tier II Bonds	March 24, 2014	11.80	24-03-2024	78.10	CARE BBB (Under Credit watch with Developing Implications)
Bonds-Tier II Bonds	September 30, 2015	11.50	30-09-2025	140.10	CARE BBB (Under Credit watch with Developing Implications)
Bonds-Tier II Bonds	June 09, 2017	10.70	09-06-2024	100.00	CARE BBB (Under Credit watch with Developing Implications)
Bonds-Tier I Bonds (Proposed)	-	-	-	250.00	CARE BB (Under Credit watch with Developing Implications)

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-Lower Tier II	LT	-	-	-	-	-	1)Withdrawn (30-Aug-16)
2.	Bonds-Lower Tier II	LT	50.50	CARE BBB (Under Credit watch with Developing Implications)	-	1)CARE BBB (Under Credit watch with Negative Implications) (02-Nov-18) 2)CARE BBB; Negative (04-Oct-18) 3)CARE BBB+; Negative (04-Jun-18)	1)CARE A-; Stable (07-Jul-17)	1)CARE A- (30-Aug-16)
3.	Bonds-Tier II Bonds	LT	78.10	CARE BBB (Under Credit watch with Developing Implications)	-	1)CARE BBB (Under Credit watch with Negative Implications) (02-Nov-18) 2)CARE BBB; Negative (04-Oct-18) 3)CARE BBB+; Negative (04-Jun-18)	1)CARE A-; Stable (07-Jul-17)	1)CARE A- (30-Aug-16)
4.	Bonds-Tier II Bonds	LT	140.10	CARE BBB (Under Credit watch with Developing	-	1)CARE BBB (Under Credit watch with Negative	1)CARE A-; Stable (07-Jul-17)	1)CARE A- (30-Aug-16)

				Implications)		Implications) (02-Nov-18) 2)CARE BBB; Negative (04-Oct-18) 3)CARE BBB+; Negative (04-Jun-18)		
5.	Bonds-Tier II Bonds	LT	100.00	CARE BBB (Under Credit watch with Developing Implications)	-	1)CARE BBB (Under Credit watch with Negative Implications) (02-Nov-18) 2)CARE BBB; Negative (04-Oct-18) 3)CARE BBB+; Negative (04-Jun-18)	1)CARE A-; Stable (07-Jul-17) 2)CARE A-; Stable (09-Jun-17)	-

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