

ICRA Lanka revises the ratings of Regional Development Bank

December 20, 2021

Instrument*	Rated Amount (LKR Mn)	Rating Action
Issuer rating	N/A	Revised to [SL]BBB+ (Negative) from [SL]A- (Negative)
Subordinated Unsecured Redeemable Debenture Programme	2,000	Revised to [SL]BBB (Negative) from [SL]BBB+ (Negative)

Rating action

ICRA Lanka Limited has revised the issuer rating of Regional Development Bank (“RDB” / “the Bank”) to [SL]BBB+ (Pronounced as S L triple B plus) with Negative Outlook from [SL]A- (Pronounced as S L A minus) with Negative Outlook. ICRA Lanka Limited has also revised the issue rating of the LKR 2,000 Mn Subordinated Unsecured Redeemable Debenture programme to [SL]BBB (Pronounced as S L triple B) with Negative outlook from [SL]BBB+ (Pronounced as S L triple B plus) with Negative outlook.

Rationale

The rating revisions factor in the continuous deterioration of the asset quality indicators of the Bank, where the gross non-performing assets ratio increased to 12.69% as on September 2021 as compared to 10.11% as on December 2020 and 9.63% as on December 2019. ICRA Lanka notes that, higher NPAs are attributable to the challenging macro environment affecting the vulnerable segments of the economy, where the bank is largely exposed to.

The rating revisions also factor in the moderating capital profile amidst the weakening earnings profile and faster portfolio growth. The Tier 1 capital ratio stood at 8.60% as on September 2021 against the regulatory requirement of 8.00%. In addition, the weak earnings profile of the bank (net loss of LKR 537 Mn during H1CY2021) has also contributed to the downward revision of the ratings.

However, the ratings continue to factor the Government of Sri Lanka’s (GoSL) ownership of 91% of the Bank together with the strong and established franchise of the Bank with over 275 branches island-wide.

Outlook: Negative

The Negative Outlook reflects the continued weakness in RDB’s asset quality, moderate capitalisation indicators and the weakening earnings profile. The outlook may be revised to ‘Stable’ in case of a steady improvement in the asset quality indicators while maintaining a comfortable earnings profile. The ratings may be downgraded in case of a further weakening in capitalization and asset quality profiles, and the overall financial risk profile.

Key rating drivers

Credit strengths

Majority GoSL ownership and strategic importance for rural development: RDB is a state-owned Licensed Specialised Bank; with GoSL holding about 91% and Bank of Ceylon, People’s Bank and National Savings Bank holding about 3% each. The GoSL has demonstrated a good track record of providing both capital and managerial support to the Bank. In December 2017, the GoSL infused about LKR 2.5 Bn to RDB by issuing treasury bonds. In December 2018, the GoSL helped the Bank to further improve its capital base

by facilitating the acquisition of Lankaputhra Development Bank (LDB); the acquisition added about LKR 4.2Bn to the capital base of RDB, while adding about LKR 6 Bn in liquid investments. The GoSL also offered a sovereign guarantee for the USD 25 Mn development loan from the Asian Development Bank (ADB) which was granted in CY2019. Being a Bank, which primarily caters to the low-income segments of the country, RDB continues to remain of strategic importance to the Government and therefore ICRA Lanka envisages continued state support for the Bank.

Established franchise with island wide retail footprint: RDB has a strong geographic presence in rural Sri Lanka, with a network of 276 branches island-wide (National Savings Bank: 260, People's Bank: 741, BOC: 646 branches). The Bank primarily caters to the low-tier income earners of the economy such as Micro-SMEs, Agri farmers and self-employed and its portfolio is spread across the country with Colombo centric western province only contributing to 17% of the gross portfolio, while the balance coming from non-urban areas such as Southern (19%), North Western (17%), Sabaragamuwa (13%) as on June 2021. The Bank's gross portfolio stood at LKR 172 Bn as on June 2021 (19% YoY Growth) vis-à-vis LKR 165 Bn (+16% YoY growth) in December 2020 and LKR 142 Bn (+5% YoY Growth) as on December 2019. The Island-wide presence aids the Bank to maintain a healthy deposit base with 38% of the total deposits being in low-cost savings deposits as on June 2021. RDB is also a beneficiary of several refinancing schemes aimed at promoting rural economic development. ICRA Lanka notes that the bank continues to focus on lending towards income generating activities.

Credit Challenges:

Moderate Capitalisation Profile: Following the capital infusions of LKR 2.5 Bn by the GoSL in 2017 and the LDB acquisition (RDB issued shares worth LKR 4.2 Bn to Government Treasury during the acquisition of LDB), the Bank maintained adequate capital profile and reported a core capital of LKR 13.7 Bn in June 2021 against the regulatory minimum requirement of LKR 7.5 Bn to be met at the end of CY2022. However, the same has somewhat moderated in H1CY2021 compared to LKR 14 Bn in Dec-20 due to the recent losses. Owing to the weak earnings and the significant growth in the Bank's lending portfolio, the risk weighted capital adequacy ratios of the Bank have moderated sharply in June 2021. RDB reported a Tier 1 capital ratio of 8.60% (Regulatory requirement of 8.00%) and a total capital adequacy ratio of 12.56% (Regulatory requirement of 12.00%) as on September 2021. ICRA Lanka notes that the bank has the option to convert some of the loans given by the GoSL into equity and the remaining tranches of the ADB loan (tier-2) will also provide some comfort from a capital point of view. However, ICRA Lanka does not envisage fresh capital infusions from the GoSL in the immediate to short term.

Sharp weakening of asset quality indicators: Being a Bank which primarily caters to the low-income segment of the economy, RDB's asset quality indicators have remained continuously under pressure since CY2019. ICRA Lanka notes the Gross Non-Performing Assets Ratio (GNPA %) of the Bank increasing to 12.69% in September 2021 from 10.11% in December 2020 and 9.63% in December 2019. ICRA Lanka notes a sharp accumulation of non-performing loans in the portfolio, over the last 18 months, as some of the core customer segments of the bank got affected by the consecutive macro-challenges. ICRA Lanka envisages the asset quality indicators of RDB to remain stretched in the short to medium term until the economy rebounds. The Bank's solvency ratio (Net NPA/ Networth) also remains high at above 60%. Also, ICRA Lanka notes that a sizable portion of the bank's portfolio still remains under the debt moratorium. The Bank's ability to control incremental slippages and improve the overall asset quality will be a key rating monitorable, going forward.

Weak Earnings profile: RDB's core margins improved in H1CY2021 with a Net Interest Margin (NIM) of 5.37% in H1CY2021 as compared to 4.55% in H1CY2020. This was mainly due to part of the Bank's deposit portfolio being repriced at the lower interest rates during the H1CY2021. ICRA Lanka also notes some

improvement in fee income and other income although the significant increase in the credit cost (Provisioning/ATA) to 1.60% in H1CY2021 as compared to 0.91% in H1CY2020 has kept the Bank's earnings profile under pressure. RDB reported a net loss of LKR 537 Mn for H1CY2021 (LKR 254 Mn Net loss in H1CY2020). The Bank reported a profit after tax of LKR 404 Mn in CY2020 (LKR 499 Mn Profit after tax in CY2019).

Analytical approach: For arriving at the ratings, ICRA has applied its rating methodologies as indicated below. **Links to applicable criteria:** [ICRA Lanka's Credit Rating Methodology for Banks](#)

About the Bank:

Regional Development Bank (RDB) was established in May 2010 by merging six provincial banks, to form a national level rural development bank. RDB was established under the Pradeshiya Sanwardhana Bank Act No.41 of 2008 as a fully state-owned national level Bank with the long-term objective of improving the living standards of the rural masses by providing them accessible and affordable financial services. The Bank is 91% owned by the GoSL, and the balance 9% is equally owned by the three state owned banks, namely, Bank of Ceylon, People's Bank, and National Savings Bank.

For the H1CY2021, the Bank reported a net loss of LKR 537 Mn on a total asset base of LKR 231 Bn against the H1CY2020 where the Bank reported a net loss of LKR 338 Mn on a total asset base of LKR 204 Bn. For the CY2020, RDB reported a profit after tax (PAT) of LKR 404 Mn on a total asset base of LKR 221 Bn as compared to a PAT of LKR 499 Mn in CY2019 against a total asset base of LKR 200 Bn.

Key financial indicators

	CY2019	CY2020	H1CY2020*	H1CY2021*
Net Interest Income	12,453	10,888	4,604	6,068
Profit after Tax/ (Loss)	499	404	(338)	(537)
Net worth	14,965	15,114	14,624	14,577
Loans and Advances (Net)	136,206	156,694	138,818	161,830
Total Assets	199,979	221,109	204,456	231,052
Return on Equity	3.36%	2.69%	-4.56%	-7.24%
Return on Assets (On PAT)	0.26%	0.19%	-0.33%	-0.48%
Gross NPA	9.63%	10.11%	11.54%	19.08%
Net NPA	4.25%	3.86%	5.67%	12.39%
Capital Adequacy Ratio (Tier 1)	10.90%	10.34%	10.82%	8.62%
Gearing (times) (Adjusted for revaluation)	12.1	13.6	12.0	14.7

*Unaudited financials

Rating history for last three years:

Instrument	Current Rating (CY2021)			Chronology of Rating History for the past 3 years		
	Amount Rated (LKR Mn)	Amount Outstanding (LKR Mn)	Date & Rating in CY2021	Date & Rating in CY2020	Date & Rating in CY2019	Date & Rating in CY2018
			Dec-21	Sep-20	Oct-19	Aug-18
Issuer rating	N/A	N/A	[SL]BBB+ (Negative)	[SL]A- (Negative)	[SL]A (Negative)	[SL]A (Negative)
Subordinated Unsecured Redeemable Debenture programme	2,000	2,000	[SL]BBB (Negative)	[SL]BBB+ (Negative)	[SL]A- (Negative)	[SL]A- (Negative)



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