Mero Microfinance Bittiya Sanstha Limited

ICRA Nepal assigns [ICRANP] IPO Grade 4 to the proposed Initial Public Offering (IPO) of Mero Microfinance Bittiya Sanstha Limited

Facility/Instrument	Amount (NPR million)	Grading Action (August 2015)
IPO Grading	61.20	[ICRANP] IPO Grade 4 (Assigned)

ICRA Nepal has assigned an "**[ICRANP] IPO Grade 4**", indicating below-average fundamentals to the proposed IPO amounting to NPR 61.20 million of Mero Microfinance Bittiya Sanstha Limited (MMF). ICRA Nepal assigns IPO grading on a scale of IPO Grade 1 through IPO Grade 5, with Grade 1 indicating strong fundamentals and Grade 5 indicating poor fundamentals. For the Grading categories 2, 3 and 4, the sign of + (plus) appended to the Grading symbols indicate their relative position within the Grading categories concerned. Thus, the Grading of 2+, 3+ and 4+ are one notch higher than 2, 3, and 4, respectively. MMF is proposing to come out with its IPO of 612,000 numbers of equity shares of face value NPR 100 each, to be issued to general public at par. The proposed issue is being made to meet the regulations regarding minimum public shareholding.

The grading is constrained by MMF's limited track record (started operations in July 2013), small scale of operations (asset size of NPR 1,529 million as of Jul-15[1]), with operations concentrated towards the recent earthquake affected districts (~35% credit portfolio and 53% of deposits in 9 of the earthquake affected districts as of Jul-15), which poses significant risk to its asset quality and hence the financial profile. The grading is also constrained by low seasoning of MMF's credit book, comparably larger ticket size offered to borrowers in the first cycle (up to NPR 100 thousand), higher portfolio vulnerability arising from unsecured loan book, lack of diversity in earnings, competition from other BFIs[2] undertaking microcredit activities through larger franchise, absence of centralized credit bureau in microfinance segment and uncertain operating environment that financial institutions in Nepal are currently facing. Nonetheless, the grading factors in favorable regulation for microfinance entities wherein loans to microfinance entities by banks/other financial institutions classify for mandatory deprived sector lending norms helping these entities to raise funds from banking channel at very low interest rates. Deprived sector norms remain a key regulatory risk for microfinance entities, withdrawal/moderation in this regulation could have significant impact on microfinance entities business profile. The grading also factors in the institutional promoters[3] of MMF, improved profitability profile in second year of operation (return on net worth ~31% as on Jul-15) benefitted by de-regulation of interest rate spread, fair asset quality so far although delinquencies have witnessed an increase in the earthquake impacted branches, experienced management team in microfinance sector and regulatory advantage available with 'Class D' Microfinance Companies compared to its counterparts in banking industries-in the form of lower SLR/ CRR[4] & capital adequacy requirements. MMF also remains exposed to the challenges associated with high business growth across diverse geographic locations (albeit on a lower base). Going forward, MMF's ability to further scale up its operations through geographical diversification, maintain adequate profitability profile and maintain its asset quality indicators in a challenging post-earthquake scenario would have a bearing on the overall financial profile.

[1] Mid-Jul-2015 data are unaudited; all calculations are based on management provided data
[2] Banks and Financial Institutions, Class A, B, C & D engaged in microcredit activity
[3] Eight commercial banks and two development banks holding 100% of share capital as of now, with representation in board either by CEO or by senior officials of promoter BFIs
[4] Statutory Liquidity Ratio/ Cash Reserve Ratio

MMF follows Grameen model, wherein 5 individuals come together for the purpose of availing loans through group mechanism against mutual guarantee for its microcredit activities. Members upon introduction to the groups can avail loan up to NPR 100 thousand at the beginning (comparatively higher amount offered in 1st cycle; however average ticket size remains ~NPR 36,000 as of Jul-15) and the same can be renewed/ enhanced upon completion of each loan cycle. MMF's portfolio growth of 190% during FY15 (the first year of full operations) remains high, albeit on a small base. MMF's credit portfolio of NPR 1,184 million as of July-15 is composed almost entirely (99.81%) of unsecured group guarantee backed loans and can be further classified into regular General Loan (92.04%), seasonal loans (7.77%) and remaining 0.19% secured loans. As of Jul-15, majority of the loans were provided to agriculture sector (~46%), followed by service sector (~34%) and small and cottage industries (~2%). Asset quality indicators of MMF remain fair, with no reported NPLs[5] so far, benefitted mainly by low seasoning of its credit book. However, controlling the slippages of earthquake affected borrowers into NPLs would remain a key challenge for MMF going forward.

MMF is a national level microfinance institution and as on Jul-15 operated across 24 districts of Nepal through its 30 branches. As a result of lower penetration of other financial institutions in the rural areas (primary areas of MMF's operations), MMF faces moderate competition from other MFIs and cooperatives. Further, being a national level institution, MMF has scope for geographical expansion in coming years and it plans to continue its higher network expansion and portfolio growth pattern even in years to come. The institutional promoter's expertise is expected to help MMF mitigate the risks associated with high targeted growth.

As per the Central Bank's regulation, Banks and Financial Institutions[6] (BFIs) are required to channel 3.5-4.5% percentage of their total loans towards deprived sector[7], either directly or through microfinance companies. Most of the BFIs use the network of microfinance companies to meet the deprived sector lending target which provides steady source of cheap funding for these institutions which augur well for the incremental business growth. Accordingly, microcredit activities of MMF are funded mainly through the bank borrowings; major portion of which is sourced from its promoter BFIs (line of credit utilised from all 10 of its Promoter BFIs accounted for ~79% of total borrowings as on Jul-15). As of now, the savings collected from members (mostly non-withdraw able deposits) comprise of a lower proportion of overall funding profile vis. a vis. the industry due to limited track record (Member's deposits were ~8% of total external funds raised as on Jul-15). Owing to high debt funded growth since its inception, MMF's gearing at 7.19 as on Jul-15 (compared to 6.24 as on July-14) remains higher compared to peers. MMF's capital would increase to NPR 200 million after the IPO (against a regulatory minimum of NPR 100 million) and is likely to support the growth plans of MMF. MMF's liquidity position remains comfortable due to availability of revolving lines of credit from funders, lending recoverable within a year and higher proportion of non-withdraw able deposits among member deposits.

MMF has reported healthy improvement in profitability profile over last one year with PAT/ATA[8] of 0.53% and PAT/Net-worth of 3.89% in FY14 improving to 3.83% and 31.15% respectively in FY15, aided mainly by lending spreads of 11.84% during FY15. However, going forward MMF profitability profile would depend on the ability of the company to maintain its assets quality owing to stress expected on the portfolio due to the earthquake and also achieve sustainable growth in business in order to ensure efficient utilisation of the enhanced capital. Interest rate spread remains deregulated so far for microfinance sector and thus any regulatory restrictions on interest rate spread for the microfinance sector would have a strong bearing upon future profitability of MMF.

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[5] Non-Performing Loans
[6] Class A, B & C financial institutions.
[7] As defined by the central bank (NRB) covering marginal sections of the society
[8] Profit after Taxes as a percentage of Average Total Assets

MMF's CRAR[9] of 14.92% as on Jul-15 remains comfortable and higher to regulatory minimum of 8%. The proposed IPO would increase its capital levels further. However, given MMF's aggressive growth plans in future, capital adequacy position is expected to remain moderate over medium term. Going forward, MMF's capital adequacy position will largely depend on its ability to control delinquencies owing to earthquake effect in its portfolio.

Company Profile

Mero Microfinance Bittiya Sanstha Limited (MMF) was registered as a public limited company in November 2012 and received its banking license as a National Level Class D microfinance institution in July 2013 from NRB (the central bank). It is 29th class D institution licensed by NRB to carry out microcredit activities out of 36 such institutions so far. MMF is promoted by 8 commercial banks and 2 development banks. As on July-15, MMF operations were spread across 24 districts of Nepal through its 30 branches. The registered office of MMF is in Bidur Municipality, Battar, Nuwakot.

MMF reported a profit after tax of NPR 2.81 million during FY14, the first year of operations, over an asset base of NPR 525 million as on Jul-14. For FY15, MMF has reported a profit after tax of NPR 39.45 million over an asset base of NPR 1,529 million as of mid-Jul-15. Its net worth as on mid-Jul 2015 was NPR 181.06 million and total loan portfolio was NPR 1,184 million. Its CRAR was 14.92% and NPLs were Nil as of mid Jul-15. In terms of technology platform, MMF has implemented "Empower" in all of its branches.

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[9] Capital to Risk (Weighted) Assets Ratio