

ILFCO Microfinance Bittiya Sanstha Limited

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

	Amount (NRs million)	Rating Action
IPO Grading	40 mn	[ICRANP] IPO Grade 4 (Assigned)

ICRA Nepal has assigned an “[ICRANP] IPO Grade 4”, indicating below-average fundamentals to the proposed Initial Public Offering (IPO) amounting NPR 40 million of ILFCO Microfinance Bittiya Sanstha Limited (hereinafter referred to as ILFCOM). 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. ILFCOM is proposing to come out with an IPO of 400,000 numbers of equity shares of face value NRs 100/- each to be issued to general public at par. The proposed issue is being made in order to meet the regulations regarding public shareholding and minimum paid-up capital requirement.

The grading is constrained by ILFCOM's limited track record, small scale of operations (concentrated mostly within 3 districts of Kathmandu Valley), low seasoning of credit book, low profitability, lack of diversity in earnings, higher portfolio vulnerability arising from unsecured loan book, absence of centralized credit bureau in microfinance segment, competition from other BFIs¹ undertaking microcredit activities through larger franchise and uncertain operating environment that financial institutions in Nepal are currently facing. Nonetheless, the grading factors in the institutional promoter base (International Leasing & Finance Company, a class C institution holds 85% equity share capital of ILFCOM as on april-2014; the holding is expected to dilute to 51% post proposed IPO), comfortable solvency profile (although portfolio seasoning is limited) and regulatory advantage available with 'Class D' Microfinance Companies compared to its counterparts in banking industries- in the form of lower SLR/ CRR² & capital adequacy requirements and easy access to cheaper funds from banks. As per the Central Bank's regulation, Banks and Financial Institutions³(BFIs) are required to channel 3.5-4.5% percentage of their total loans towards deprived sector⁴, 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 for the funding requirement of these companies.

Going forward, ILFCOM's ability to scale up its operations through geographical diversification and increase in member base, improvement in profitability profile and maintain its assets quality indicators would have a bearing on the overall financial profile.

ILFCOM started its operations in April-2012, and has a credit portfolio of NPR 51.4 million as of April-14. At present, ILFCOM has 2 branches overlooking 4 districts with most of the operations concentrated in 3 districts of Kathmandu valley. As a result of over penetration of financial institutions in the Kathmandu valley, it faces stiff competition from other MFIs operating in the region as well as Class A, B & C banks undertaking microcredit operations through larger franchise. However, being a national level institution, ILFCOM has scope for geographical expansion in coming

¹ Banks and Financial Institutions, Class A, B & C

² Statutory Liquidity Ratio/ Cash Reserve Ratio

³ Class A, B & C financial institutions.

⁴ As defined by the central bank (NRB) covering marginal sections of the society



years. Going forward, ILFCOM is planning to gradually expand into new districts to achieve increase in scale of operations. The promoter's franchise and expertise is likely to support ILFCOM in achieving the adequate growth.

ILFCOM is running microcredit activities following JLG (Joint Liability Group) model, wherein 5 individual come together for the purpose of availing bank loans either singly or through group mechanism against mutual guarantee. ILFCOM's credit portfolio as of April-14 is composed entirely of unsecured group guarantee backed loans. Members upon introduction to the groups can avail loan up to NPR 50 thousand at the beginning and the amount is increased upon completion of each loan cycle i.e. repayment of each loan (usually 8-12 months). The credit portfolio of ILFCOM is broadly classified into regular Micro Loan (~80%) and seasonal/top-up loans (~20%) with maximum ticket size remaining within NPR 1 lakh per individual (against NPR 1.5 lakh permitted by regulations). As of April-14, majority of the loans were provided to service sector (~80%), followed by agriculture (~11%) and small and cottage industries (~8%). The assets quality indicator of ILFCOM remains comfortable. The Gross NPL of ILFCOM stood at 0.72% and net NPL at 0.43% as on April-14 with NPR 3.7 lakhs in non-performing loans spread across ~30 accounts. The assets quality indicators of the company remains benefitted, partly due to low seasoning of credit books.

The microcredit activities of ILFCOM are funded mainly through the bank borrowings; mostly sourced from its Class C parent company (line of credit utilised from parent company accounted for more than 85% of total borrowings as on April-14). Additionally, the savings collected from members (mostly fixed deposits) also add to the overall funding profile (~23% of total credit portfolio as on April-14). Moreover, owing to the regulatory provisions, Microfinance institutions are likely to get steady flow of cheap loans from banks and financial institutions which augur well for the incremental business growth. Owing to the start-up nature of the business and low credit expansion, the gearing ratio of ILFCOM remains low at 0.78 as on April-14 compared to 0.63 as on July-13. ILFCOM remains comfortable on liquidity front since the line of credit available from the parent company is of revolving nature while the deposits collected from the members are of fixed nature warranting repayment only upon termination of membership.

ILFCOM has been maintaining healthy NIMs⁵ (around ~11%) albeit on a low base, supported by high lending spreads of ~14%. However, the profitability profile remains dismal due to low mobilisation of funds (Credit portfolio as a percentage of total available funds⁶ stood at ~46% as on April-14) and low yield on investments. ILFCOM's profit after tax (PAT) for 9M 2013-14 stood at NPR 2 million translating into return on net worth of ~4.5% and return on assets of ~2.5%, compared to negligible profit in the first year of operations i.e. 2012-13. Going forward, the profitability prospect of ILFCOM will depend on the ability of the company to achieve growth in business size.

ILFCOM remains comfortable in capital adequacy front with CRAR of 94% as on April-14 compared to regulatory minimum of 8%. Given the current scale of operation, growth plans and impending IPO, ILFCOM capital adequacy position can be expected to remain comfortable over medium term. As per ICRA Nepal estimate, current level of capital (including proposed IPO and internal capital generation @10% of net worth per annum) will support the CAGR 40% growth plans over next 2 years; with capitalization level expected to remain high in the range of around 65-80% with solvency indicators range bound at 1-3%⁷. In the long run, the ability of ILFCOM to raise additional capital from its existing/ external investors will have a strong bearing on its growth prospects and overall capitalization profile.

⁵ Net interest margin

⁶ Networth plus deposits plus bank borrowings

⁷ Assuming NPL level remains within 5% level



Company Profile

ILFCO Microfinance (ILFCOM) was established in April 2012 as a public limited company and commenced its operations from July 2012. ILFCOM is the 24th microfinance institution to receive Class D status from Central Bank of Nepal. ILFCOM is a subsidiary company of International Leasing and Finance Company (ILFCO), a class C Finance Company licensed by NRB. The registered office of ILFCOM is in Chabahil, Kathmandu metropolitan city. ILFCOM currently has 2 branches (including head office). While the head office looks after its operations in 3 districts within Kathmandu valley (viz. Kathmandu, Lalitpur and Bhaktapur), the recently opened first branch looks after the operations in Kavre District. The company is in the process of setting up its 3rd branch for which approval has been obtained from NRB.

ILFCOM reported a profit after tax of NPR 2 million during 9M 2013-14 over an asset base of NPR 116 million as of April-14 compared to profit after tax of 1,534 during 2012-13 over an asset base of NPR 100 million as on Jul-13. Its net worth as on July 2013 was NPR 60.94 million and total loan portfolio at 41.84 million. In terms of technology platform, ILFCOM has implemented 'Micro Banker' in all of its branches.

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