

NMB Microfinance Bittiya Sanstha Limited

ICRA Nepal assigns [ICRANP] IPO Grade 4 to the proposed Equity Shares (Rights Issue) of NMB Microfinance Bittiya Sanstha Limited

Facility/Instrument	Issue Size	Grading Action (August 2016)
Rights Share Issue	NPR 55.20 Million	[ICRANP] IPO Grade 4 (Assigned)

ICRA Nepal has assigned an “[ICRANP] IPO Grade 4”, indicating below-average fundamentals to the proposed rights issue amounting to NPR 55.20 million of NMB Microfinance Bittiya Sanstha Limited (NMBMF). 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. NMBMF is proposing to come out with 1:1.2 rights issue of 552,000 numbers of equity shares of face value NPR 100/- each, to be issued to its existing shareholders at par. The proposed issue is being made to augment the capital base to support the future growth plans of the management.

The grading factors in the regulatory uncertainty for MFIs as introduced by Monetary Policy of FY16/17, with cap on interest rate spread at 7% (hitherto unregulated) and requirement for commercial banks to directly lend to deprived sector (2% of the total deprived sector lending requirements of 5%, rest 3% could be through intermediaries). These changes could significantly impact profitability and growth of NMBMF and the microfinance sector. The grading is also constrained by NMBMF’s limited track record (operating since March 2013), small scale of operations (asset size of NPR 1,211 million as of Jul-16¹) with significant exposure to earthquake affected districts (~50% portfolio as of mid-July 2016), high gearing levels (9.77 times on mid-July 2016) and competition from established peers undertaking microcredit activities through larger franchise. The grading is further constrained by high delinquencies (0+ day’s delinquency as on mid-Apr 2016 at 2.58% before declining to 1.30% on mid-July 2016). Coupled with high proportion of loan outstanding in earthquake affected districts, it raises concerns about the incremental assets quality.

The grading however factors in NMBMF’s promoter profile², diversified funding profile with credit lines from more than 15 BFIs³, ability to achieve high credit portfolio growth (CAGR⁴ ~128% over past two years ending FY16, albeit on a small base) largely through expansion in borrower base (105% CAGR) while the average annual growth in credit per borrower has been around 11%. Although NMBMF’s profitability profile remains healthy (RoNW and RoA⁵ of ~40% and 2.62% respectively for FY16 vs. ~28% and 2.58% respectively for FY15); it could be severely impacted by the regulations proposing cap on interest spreads, if implemented. Growth opportunities for NMBMF remain adequate given NMBMF’s plans to upgrade into a national level player following the proposed rights issue, experienced management team, access to low cost funds benefited from deprived sector regulation, adequate capitalization profile (CRAR⁶ 11.50% as on Jul-16 vs. regulatory minimum 8%) and large below poverty line population in Nepal that act as target group for MFIs⁷. In ICRA’s opinion, ability of the company to manage growth and asset quality while expanding into newer districts as well as increasing share of high ticket collateralised loans and maintaining prudent leveraging levels would be critical.

As for NMBMF’s monitoring mechanisms, the branches (33 branches and head office as on mid-July 2016) are audited twice a year. However, the MIS has limitations in generating specific reports on asset quality cuts, portfolio cuts, and hence has a scope of improvement. In ICRA Nepal’s opinion, the company’s internal audit processes (frequency and scope) could be further strengthened, in line with the

¹ Mid-Jul-2016 data are unaudited; various ratios for Jul-16 are based on company data

² Promoted by NMB Bank Limited (rated at BBB+ by ICRA Nepal) which holds 51% equity stake in NMBMF

³ Banks and financial institutions

⁴ Compounded Annual Growth Rate

⁵ Return on Net Worth and Return on Assets

⁶ Capital to Risk (Weighted) Assets Ratio; including calls in advance. Regulations permit the inclusion of calls in advance in tier I capital for MFI.

⁷ Micro-Finance Institutions

management's growth/expansion plans. ICRA Nepal also takes note of the high growth rate of NMBMF and probable increase in ticket sizes following the regulatory enhancement⁸ of MFI lending limits; both of which could impact borrower discipline and hence asset quality. MFIs would have to develop strong credit appraisal systems and carefully assess the cash flows and debt repayment capacity of the borrowers for sustainable growth.

The grading further takes into account the vulnerable asset class of NMBMF primarily due to marginal borrower profile and unsecured lending business (~93% of portfolio as of mid-July 2016); further accentuated by low seasoning of NMBMF's credit book. Overleveraging concerns also exist for NMBMF considering the company's policy to offer large ticket size loans to borrowers in the first cycle (up to NPR 100 thousand), and absence of centralized credit bureau in microfinance segment. Going forward, NMBMF's ability to maintain adequate profitability profile and improve internal controls to maintain its asset quality indicators would have a bearing on the overall financial profile.

NMBMF follows group lending model, wherein members related to a group (4-5 individuals) and a centre (4-5 groups) take mutual responsibility for loan repayment for all the members in the group and centre. In addition, NMBMF also extends individual loans (secured loans) up to NPR 700 thousand to finance micro enterprise. NMBMF offers credit up to NPR one lakh for the first cycle loans; however the average ticket size remains ~NPR 44,000 as of mid-July 2016, comparable to the peers in the industry. NMBMF's credit portfolio of NPR 942 million as of mid-July 2016 is dominated by unsecured group guarantee backed loans (~93%, comprising mainly of general loan ~75% and Disaster relief loans ~16%⁹), rest being secured loans. As of Jul-16, majority of the loans were provided to agriculture sector (~52%), followed by service sector (~42%) and others (~6%). NMBMF's asset quality indicators remain fair, despite recent deterioration, with 0+days delinquencies of 1.30% as of Jul-16 including NPLs of 1.15%.

As per regulation, Banks and Financial Institutions¹⁰ (BFIs) are required to extend 4-5% of their total loans towards deprived sector¹¹, either directly or through microfinance companies. However, Monetary Policy of FY 2016/17 has mandated class A commercial banks to maintain direct deprived sector lending of 2%, out of their total deprived sector lending requirements of 5%. This is likely to impact the funds available for growth of microfinance sector to a large extent and thus any further moderation/withdrawal in this regulation could have significant impact on funding profile of microfinance entities. Currently, NMBMF is dependent upon bank borrowings (~82% of total funds; diversified across more than 15 lender BFIs¹²). The savings collected from members comprise ~18% of overall funding profile, lower than MFI industry average. NMBMF's liquidity position remains comfortable due to availability of revolving lines of credit from lender BFIs, short tenure of loans extended (generally one year) and relatively stable nature of deposits from member.

NMBMF has reported healthy improvement in profitability profile over last two years with ROA of 2.58% and RoNW of 28.26% in FY15 improving to 2.62% and 39.61%¹³ respectively in FY16, primarily aided by high lending spreads of ~11%. Going forward, profitability could be significantly impacted as 7% cap on interest rate spread has been introduced by Monetary Policy of FY17. NMBMF's profitability is however supported by healthy non-interest income (~2% of ATA¹⁴ for FY16, primarily in the form of loan processing fees), fair operating expense ratio (4.92% of ATA), and low credit costs (0.84% of ATA). The profitability profile going forward will be determined by the ability of NMBMF to scale up its business to ensure efficient utilisation of enhanced capital and counter the impact of spread rate cap through scale economies; while at the same time maintaining asset quality.

⁸ With effect from FY17, MFI's can now lend unsecured loans upto NPR 5 lakhs and secured loans upto NPR 10 lakhs within initial (first cycle loan) ticket size of upto NPR 3 lakhs and NPR 5 lakhs respectively.

⁹ Disaster relief loans were rolled out for the borrowers in the districts that were highly affected by earthquake. The loans were sanctioned starting November 2015 with 6 months moratorium. Total loans sanctioned till Mid-July 2016 was NPR 167 million and loans outstanding on mid-July 2016 (after repayment) stood at NPR 148 million.

¹⁰ Class A, B & C financial institutions.

¹¹ As defined by the central bank (NRB) covering marginal sections of the society

¹² NMB Bank, the promoter of NMBMF, accounts for ~24% of total bank borrowings raised by NMBMF as on mid-July 2016

¹³ Return indicators without considering calls in advance (NPR 28.15 million) received towards the end of FY16

¹⁴ Average total assets

NMBMF's CRAR of 11.50% as on mid-July 2016 remains moderate compared to counterparts, considering the vulnerable asset class. Nonetheless, it remains higher to regulatory minimum CRAR of 8% for MFIs. Owing to high debt funded growth since its inception, NMBMF's gearing remains high at 9.77 times as on Jul-16¹⁵ (compared to 10.76 times as on Jul-15). Assuming full subscription of the proposed rights issue, NMBMF's paid up capital will increase to NPR 101 million¹⁶ (against regulatory minimum of NPR 100 million for national level MFI as of now) and is likely to support the company's growth plans.

Company Profile

NMB Microfinance Bittiya Sanstha Limited (formerly known as Clean Village Bittiya Sanstha Limited) was registered as a public limited company in May, 2012 and obtained the certificate of commencement of business from NRB to carry on financial transactions as a 10 district microfinance institution in March, 2013. NMBMF was initially promoted by Clean Energy Development Bank (Class B Development Bank). NMB Bank Limited¹⁷ acquired majority stake (51%) in NMBMF, after the merger of Clean Energy Development Bank with NMB Bank in October 2015. NMBMF has 70:30 promoter-public shareholding ratio as on mid-July 2016. NMBMF's operation as of mid-Jul- 016 is spread across 19 districts with 33 branches. The registered office of NMBMF is in Pokhara, Kaski. Post-rights, NMBMF will meet the regulatory minimum capital¹⁸ required for National level retail microfinance under prevailing norms.

NMBMF reported a profit after tax of NPR ~30 million over an asset base of NPR 1,211 million as on mid-July 2016 as against profit after tax of ~NPR 11 million over an asset base of NPR 591 million as on mid Jul-15. Its net worth as on mid-July 2016 stood at ~NPR 108 million¹⁹ with a total loan portfolio of NPR 942 million. As on mid-July 2016, NMBMF reported gross NPLs of 1.15% and CRAR of 11.50%. In terms of technology platform, NMBMF has implemented "Uranus Tech" software, with all its branches being interconnected.

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For further details please contact:

Analyst Contacts:

Mr. Kishor Prasad Bimali, (Tel No. +977-1-4419910/20)
kishor@icranepal.com

Mr. Sailesh Subedi (Tel No. +977-1-4419910/20)
sailesh@icranepal.com

Relationship Contacts:

Mr. Deepak Raj Kafle, (Tel. No. +977-1-4419910/20)
drkafle@icranepal.com

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¹⁵ Decline caused by calls in advance received from NMBMF's promoters towards the end of FY16.

¹⁶ The proceeds of right issue (calls in advance) has been included in net worth as on mid-July 2016

¹⁷ Rated BBB+ for issuer rating by ICRA Nepal in August 2016

¹⁸ Minimum capital requirement of NPR 100 million under prevailing regulations for national level retail microfinance companies

¹⁹ Including calls in advance of NPR 28.15 million