Mirmire Microfinance Development Bank Limited

ICRA Nepal assigns [ICRANP] IPO Grade 4 to the proposed Equity Shares (Rights Issue) of Mirmire Microfinance Development Bank Limited

Facility/Instrument	Issue Size	Grading Action (February 2018)
Rights Share Issue	NPR 45 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 45 million of Mirmire Microfinance Development Bank Limited (MMFDB). 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. MMFDB is proposing to come out with 100% rights issue of 450,000 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 MMFDB's ability to scale up operations (credit portfolio CAGR[1] ~103% during FY13-17, albeit over small base) partly through expansion in client base (~57% CAGR) whilst maintaining moderate portfolio per member (average ~NPR 60,000 as of mid-Jan-18[2]). Growth opportunities for MMFDB remain adequate given the plans for upgradation into national level MFI (Micro Finance Institution), rapid expansion targets over new geographies and large below poverty line population in Nepal that act as target group for MFIs. The growth plans are expected to be supported by incoming capital from proposed issue and internal generations as the current capitalization (9.01% as on Jan-18) remains moderate vs. regulatory minimum of 8%. Despite having witnessed high stress in initial years of operation, MMFDB's asset quality and profitability remain comfortable as of now; NPLs declined from ~47% in Jul-12 (over small base) to 1.18% as of mid-Jan-18 with delinquencies of ~6% which remains higher among peers. While MMFDB's profitability indicators were good with RoNW and RoA[3] of ~36% and ~2.5% respectively for FY17 (36% and ~3.2% for FY16) there could be some decline in the same owing to squeezing NIMs (Net Interest Margins of ~7% for H1FY18 vs. ~10-12% earlier). Going forward, ability of the company to maintain sustainable growth through geographical expansion while strengthening commensurate risk mitigation practices would be important from a risk perspective.

Nonetheless, the grading is constrained by regulatory cap on lending rates for MFIs at 18% and hence the inability to pass on the increased cost of funds to borrowers resulting in pressure over NIMs. This is expected to impact profitability of the sector going forward as the borrowing cost for MFIs have increased sharply in recent periods owing to tightening liquidity across banking sector. Moreover, the recently implemented "base rate plus" lending regime would keep cost of borrowings higher compared to earlier when MFIs could borrow at subsidized rates from banks who were largely dependent upon wholesale/retail MFIs for meeting their deprived sector lending targets. Any further changes in regulations and banking sector's preference to route deprived sector lending through MFIs could significantly impact funding support for the sector and accordingly the growth and profitability prospects of MMFDB. The grading is also constrained by MMFDB's moderate track record (operating since October 2010), small scale of operations (asset size of NPR 1,227 million as of Jan-18) with relatively higher operating cost (~6% of Average Total Assets - ATA). The grading also takes into account MMFDB's promoter base being concentrated across limited promoters (26), high cost of funds (~10.5% for H1FY18) and competition from larger/established peers. The grading also factors in MMFDB's sizeable exposure in high ticket collateralized loans (~11% as of Jan-18) to marginal borrower profile. Moreover, presence of large number of players in the industry (including cooperatives), increased ticket size by regulations and absence of centralized credit information for MFI raises concerns of overleveraging.

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[1] Compounded Annual Growth Rate

[2] Mid-Jan-2018 data are unaudited; all calculations are based on management provided data

[3] Return on Net Worth and Return on Assets

As for MMFDB's monitoring mechanisms, field monitoring of branches is done by assigned monitoring officers quarterly/semi-annually in addition to annual audit by outsourced internal auditors. In ICRA Nepal's opinion, company's monitoring and supervision could be strengthened; frequency and coverage of monitoring would remain critical given the high growth being targeted. ICRA Nepal also takes note of the increased regulatory maximum permissible ticket sizes (from NPR 1 lakh to NPR 3 lakhs for 1st cycle loans and maximum from NPR 3 lakhs to NPR 5 lakhs from FY17 onwards), both of which could impact discipline and hence asset quality. MFIs would have to develop strong credit appraisal systems and carefully assess cash flows and debt repayment capacity of the borrowers for sustainable growth.

MMFDB follows group lending model, wherein 5 individuals take mutual responsibility for loan repayment for all members. In addition, MMFDB also extends secured loans up to NPR 10 lakhs to finance micro enterprise in line with regulatory limit. MMFDB offers NPR 70,000 for first cycle of general loans; maximum limit allowed in successive cycles is NPR 2 lakhs vs. 5 lakhs allowed by regulations. Owing to this, the average ticket size remains relatively moderate at ~NPR 60,000 as of Jan-18. MMFDB's credit portfolio of NPR 1,115 million as of Jan-18 is dominated by unsecured group guarantee backed loans (~89%), rest being secured loans. As of Jan-18, majority of the loans were provided to agriculture sector (~60%), followed by service sector (~34%), rest towards other sectors (~6%).

The grading is further constrained by risker asset mix of MMFDB due to marginal borrower profile and unsecured lending business further accentuated by low seasoning of major portion of MMFDB's credit book. Additionally, MMFDB has sizeable share of collateral-based loans (~11%) where collateral quality remains inferior compared to other banking counterparts while the ticket size remains high. Though ticket sizes offered are lower compared to regulatory permissible limit, overleveraging concerns exist for MMFDB considering the absence of centralized credit information in microfinance segment so far limiting MFI's ability to check multiple lending. However, centralized credit information for MFI sector is also expected to be available soon which provides some comfort. MMFDB's asset quality indicators remain healthy as of now with 0+days delinquencies of ~6% as of Jan-18 including NPLs of 1.18% (1% as of Jul-17). Going forward, MMFDB'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.

As per regulation, Banks and Financial Institutions[4] (BFIs) are required to extend 4-5% of their total loans towards deprived sector[5], either directly or through microfinance companies. Though the 2% direct deprived sector lending requirement for commercial banks has now been made voluntary, these banks could gradually shift towards direct lending given the increased ticket size that qualify as deprived sector lending as well as expanding franchise at local/rural levels. 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, MMFDB is highly dependent upon bank borrowings (~73% of total funds availed across diverse BFIs including 13 commercial banks) which has witnessed spike in cost in recent periods (~11% vs. H1FY18 vs. ~7% for FY17). Despite limited track record, savings collected from members also comprise ~27% of overall funding profile and this currently carries lower cost than bank borrowings (~9% for H1FY18) lowering overall cost of funds at 10.44% for H1FY18 (7.33% for FY17). MMFDB's liquidity position remains comfortable due to availability of revolving lines of credit, short tenure of loans extended (generally one year) and higher proportion of stable, non-withdrawable deposits from members. Lack of diversity in funding sources would also remain major challenge for the MFI sector going forward

MMFDB has reported healthy profitability indicators over recent years with ROA of ~2.5% and RoNW of ~36% in FY17, aided mainly by lending spreads of 12.47%. Though the regulations regarding 7% spread rate has been favorably amended to include up to 4% operating costs (overall spreads hence can be up to 11%), 18% cap on lending rates could impact future profitability given the increasing cost of funds. This has been witnessed to an extent in H1FY18 where NIMs moderated to 6.85% (vs. 9.28% for FY17). However, the interim profitability (RoNW ~36% and RoA ~2.6%) remained supported by increased fee-based income (3.71% of ATA vs. 2.01% for FY17) while the operating expenses have moderated to 5.96% (6.99% for FY17). Increased fee base is supported by allowing borrowers to prepay the facilities

[4] Class A, B & C financial institutions.

[5] As defined by the central bank (NRB) covering marginal sections of the society

after 8 months and considering them eligible for higher loan amount in next cycle, hence adding up to fees income though the processing fees charged are within 2% as allowed by regulations. Profitability, going forward, is expected to be supported by existing branches achieving higher efficiency, incremental portfolio from new branches that are planned to be set up and low credit costs (~1% of ATA). Thus, ability of MMFDB to achieve sustainable growth in business ensuring efficient utilisation of enhanced capital whilst maintaining asset quality would have key bearing over its future profitability profile.

MMFDB's capitalisation (CRAR) of 9.01% as on Jan-18, was moderate compared to other banking counterparts, given the marginal borrower profile, remains slightly higher to regulatory minimum of 8%. Owing to high debt funded growth since its inception, MMFDB's gearing remains higher among peers at 11.25 as on Jan-18 (compared to 14.23 as on Jul-17). MMFDB's promoter base is largely diversified across individuals which is in contrast to most of the retail MFI players whereby BFI promoters hold major stake. MMFDB's capital would increase to NPR 90 million after proposed issue and after capitalisation of proposed bonus for FY17, the capital would cross the regulatory minimum of NPR 100 million for national level MFI. Hence, MMFDB has plans to upgrade into national level status in order to support the company's growth plans.

Company Profile

Mirmire Microfinance Development Bank (MMFDB) started its operation as 10 district level Class D retail microfinance institution in October 2010. Through series of geographical expansions, MMFDB currently has approval from the regulator to operate in 25 districts. Shareholding pattern of the company constitutes of promoter holding of 70% and public group 30%. MMFDB's shares are listed in Nepal Stock Exchange and being actively traded in with current market capitalization of ~NPR 1,287 million as on 14th Jan 2018. The registered and corporate office of MMFDB is located at Banepa, Kavrepalanchowk. Mr. Laxmishwor Devkota is the Chief Executive Officer of the company.

MMFDB has presence across 17 districts of Nepal through its 38 branches as of mid-Jan-18. MMFDB reported a profit after tax (PAT) of ~NPR 19 million during FY17, over an asset base of NPR 1,063 million as on Jul-17 as against as against PAT of ~NPR 12 million during FY16 over an asset base of NPR 472 million as of mid-Jul-16. For H1FY18, MMFDB has reported PAT of ~NPR 15 million over an asset base of 1,227 million as of mid-Jan-18. MMFDB's gross NPLs stood at 1.18% and CRAR at 9.01% as of mid-Jan-18. On technology front, MMFDB uses Empower software which remains to be centralized across all branches (34 out of 38 branches centralized so far).

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