Womi Laghubitta Bittiya Sanstha Limited

ICRA Nepal assigns [ICRANP] IPO Grade 4+ to the proposed rights issue of Womi Laghubitta Bittiya Sanstha Limited

Facility/Instrument	Issue Size	Grading Action (April 2019)
Rights Share Issue (equity) Grading	NPR 101.088 Million	[ICRANP] IPO Grade 4+ (Assigned)

ICRA Nepal has assigned **[ICRANP] IPO Grade 4+**, indicating below-average fundamentals to the proposed rights issue of Womi Laghubitta Bittiya Sanstha Limited (Womi). 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+ is one notch higher than the grading of 2, 3, and 4, respectively. Womi has proposed a 100% rights issue of 1,010,880 equity shares of face value NPR 100 each, which will be issued to its existing shareholders at par.

The assigned grading factors in Womi's healthy credit growth, albeit on a low base (CAGR growth of ~59% over last three years ending FY2018), established underwriting norms and good asset quality maintained over the years. The grading also factors in Womi's good profitability indicators which in turn remains supported by strong net interest margin (NIMs ~10% over last three years). Womi's past track record of growth and profitability, coupled with its recent upgradation into a national level MFI (from erstwhile regional status) augurs well for its incremental growth and profitability prospect. The grading also factors in Womi's adequate branch network, which is expected to grow going forward, with the upgradation into a national level MFI. This, coupled with a large below-poverty population, still is outside the reach of mainstream banking, remain positive from a growth perspective. The grading also factors in the institution's good management team and adequate capitalisation profile (capital to risk assets ratio (CRAR), of 12.39% as of mid-January 2019 against regulatory minimum of 8%). The proposed equity injection is likely to further strengthen the capitalisation profile (assuming full subscription) and support incremental growth.

Nonetheless, the grading is constrained by Womi's limited track record (operating since 2012) leading to a small scale of operations. Geographical concentration of credit portfolio also remains a concern, although likely to moderate going forward with Womi's upgradation from regional level status. However, the MFI's ability to grow and expand geographically could be a challenge, given the intense competition from established national level MFI players. Womi's funding profile is highly reliant on bank borrowings (~61% of total external fund as on mid-January 2019), which exposes it to interest rate volatility in the banking industry. Grading concerns also emanate from the absence of a centralised credit information for the MFI, which could result in overleveraging of the borrowers. The grading also takes note of the frequent changes in regulation, impacting the spreads and funding sources for the MFI sector.

Going forward, Womi's ability to maintain growth, generate scale economies, achieve geographical diversification while maintaining commensurate risk mitigation practices and asset quality will have a bearing on its overall financial profile.

Womi's credit portfolio of ~NPR 1,470 million as of mid-January 2019 is dominated by unsecured group guarantee-backed loans (~70%), with the rest being secured loans. Unsecured loans of Womi are based on a group guarantee, wherein a group of borrowers (at least nine individuals) take mutual responsibility for loan repayment for all the members. Womi's initial ticket size for unsecured loan is NPR 50,000 (vs. regulatory ceiling of NPR 0.3 million) with the ticket size increasing in subsequent cycles. As on mid-Jan 2019, the average ticket size for unsecured loans stood low at ~NPR 57,000. Similarly, Womi also extends secured loans, mostly up to NPR 0.5 million (against regulatory ceiling of NPR 1 million). As on mid-Jan 2019, the average ticket size of secured loans of Womi stood at ~NPR 280,000. Overall, Womi's average loan ticket size as on mid-Jan 2019- stood at NPR ~75,000. As of mid-January 2019, most loans were extended towards the agriculture sector (~40%), followed by the services sector (~33%). The company's asset quality indicators remain healthy so far with 0+ days delinquencies of 0.89%, including NPLs of 0.73% as of mid-January 2019 and remains comforted by the 100% provisioning norms on 0+days delinquencies, irrespective of their classifications.

As for monitoring mechanisms, compliance and monitoring activities are performed by the area managers, deputed across five different regions of the country, aided by the real time data from its branches, which are connected with a centralised software system across all its branches. In ICRA Nepal's opinion, the company's monitoring and supervision remains adequate for the current scale of operations. However, its ability to maintain a similar control framework amid targeted portfolio growth would remain important for sustainable growth. Womi's incremental growth plans, highly competitive industry, high regulatory permissible ticket sizes (NPR 0.30 million for 1st cycle of general loans and maximum NPR 0.50 million in successive cycles) and lack of centralised credit information bureau for the MFIs could impact incremental borrowers' profile, their discipline and hence the asset quality. The MFIs would have to strengthen their credit appraisal systems from time to time and carefully assess cash flows and debt repayment capacity of the borrowers for sustainable growth.

Womi's asset class remains relatively vulnerable, mainly due to the marginal borrower profile and unsecured lending business, further accentuated by low seasoning of a major portion of its credit book. Additionally, Womi has a substantial share of collateral-based loans (~30% vs. a maximum permissible limit of 1/3rd of the overall portfolio) wherein the collateral quality remains inferior, compared to other banking counterparts, while the ticket size remains high. Though ticket sizes offered are lower compared to the regulatory permissible limit, overleveraging concerns exist for Womi, considering the absence of a centralised credit bureau in the microfinance segment. Going forward, Womi's ability to maintain and improve internal controls to maintain its asset quality indicators would have a bearing on the overall financial profile.

As per regulations, banks and financial institutions[1] (BFIs) are required to extend 5% of their total loans towards the deprived sector[2], either directly or through microfinance companies. Nonetheless, the BFIs could gradually shift towards direct lending, given the increased ticket size that qualify as deprived sector lending as well as expanding franchise at the local/rural levels. This could impact the funds available for growth of the microfinance sector to a large extent and thus any further moderation/withdrawal in this regulation could have a significant impact on the funding profile of the microfinance entities. Currently, Womi relies strongly on bank borrowings (~61% of total external funds) which are being availed across diverse BFIs (including 14 commercial banks). The remaining 39% is being funded through member's deposits (marginally lower than MFI industry average of over 40%). Womi's liquidity position remains comfortable due to the availability of revolving lines of credit from the lender (~77% as of mid-January 2019), short tenure of loans (generally one year) and an established and further growing proportion of stable, non-withdrawable deposits from the members. The cost of funds for this source is currently lower (~9% for H1 FY2019) than bank borrowings (~11%), hence it lowers the overall cost of funds at ~10%. Womi's continuation of its ability to diversify funding sources at competitive rates will have a bearing on the stability and cost of funds for the company.

The company has been able to report good profitability indicators with last three years average RoNW and ROA[3] of ~31% and ~4% respectively; albeit on a low base. The interim profitability was mainly aided by healthy net interest margins of ~10% of average total assets (ATA - *three years average ending mid-July 2018)* and remains supported by a healthy non-interest income (~3% of ATA over the last three years ending mid-July 2018). The recent removal of the lending rate cap (18%) has improved the MFI's ability to pass on the increased cost to the borrowers. However, the regulatory reduction of interest

[1] *Class A, B & C financial institutions.*

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

[3] *Return on Net Worth and Return on Assets*

spread to 9% (from earlier 11[4]%) could limit the NIMs for the MFIs. Womi's ability to scale up the operations and achieve scale economies will be necessary to protect the current NIMs and profitability levels.

The capitalisation (CRAR) of the company at 12.39% as of mid-January 2019 remains comfortable against the regulatory minimum of 8%. This is likely to be further strengthened after the proposed equity injection plans (assuming full subscription). Womi's gearing remains moderate among peers at 7.36x as on mid-January 2019 and offers adequate room for incremental growth. The company's healthy rate of internal capital generation also remains a comfort. However, its ability to maintain the return to the equity holders on an increased capital base could be a challenge.

Analytical approach: For arriving at the ratings, ICRA Nepal has applied its rating methodology as indicated below:

Links to applicable criteria:
IPO Grading Methodology
Bank Rating Methodology
NBFC Rating Methodology

Company profile
Incorporated in June 9, 2011, Womi is a new generation player in the retail MFI sector. It started commercial operations from March 8, 2012 and was upgraded to the national level retail class-D MFI in H1 FY2019. As of mid-January 2019, it has been operating across 32 districts (out of 77) through its 40 branches. The company's registered office is in Bharatpur, Chitwan. Mr. Pramesh Acharya is the chief executive officer of the company.

Womi has entered a memorandum of understanding (MoU) on March 8, 2019 to merge a 10-district level retail MFI, Nagarik Laghubitta Bittiya Sanstha Limited[5]. A joint merger committee has been formed to further the process along with fixation of the swap ratio. The overall process has been scheduled to be completed by mid-July 2019.

Womi reported a profit after tax (PAT) of ~NPR 40 million over an asset base of NPR 1,393 million as of mid-July 2018. For H1 FY2019, the PAT stood at ~NPR 26 million over an asset base of NPR 1,576 million as of mid-January 2019. Womi's gross NPLs stood at 0.73% with an overall 0+days delinquencies of 0.89% as of mid-January 2019. The capitalisation ratio stood at 12.39% as of mid-January 2019. On the technology front, Womi uses MFIN software - centralised across all its branches.

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[4] *Includes 6% towards interest spread and 3% towards operating expense (vs. 7% and 4% respectively earlier)*
[5] *with asset size less than 10% of Womi's*

About ICRA Nepal Limited:

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