Global IME Laghubitta Bittiya Sanstha Limited

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

Facility/Instrument	Issue Size	Grading Action (May 2019)
Rights Share Issue (equity) Grading	NPR 110.4575 Million	[ICRANP] IPO Grade 4+ (Assigned)

ICRA Nepal has assigned **[ICRANP] IPO Grade 4+**, indicating below-average fundamentals to the proposed rights issue of Global IME Laghubitta Bittiya Sanstha Limited (GILB). 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 gradings of 2+, 3+ and 4+ are one notch higher than the gradings of 2, 3, and 4, respectively. GILB has proposed a 100% rights issue of 1,104,575 equity shares of face value of NPR 100 each, which will be issued to its existing shareholders at par.

The assigned grading factors in the presence of strong institutional promoter in GILB, with entire promoter holding of 70% held by Global IME Bank Limited (rated at [ICRANP-IR] A- by ICRA Nepal). The bank has deputed four senior personnel to the company's board which strengthens its board profile. This is expected to provide GILB with requisite oversight and managerial support, apart from financial flexibility as per the requirement. The grading also factors in the healthy credit growth of the micro finance institution (MFI) at a CAGR[1] of ~130% from mid-July 2016 to mid-April 2019. Though the growth was exceptionally high, this was supported mainly through franchise expansion, following the series of geographical expansion, which provides some comfort. GILB's recent upgradation into a national level MFI augurs well for incremental growth and profitability prospects. Additionally, a large below-poverty population, outside the reach of mainstream banking, also remains a positive from the growth perspective. The grading also factors in the lower average ticket size (~NPR 63,000 as of mid-April 2019) indicating a cautious growth move of the MFI, emanating from its established underwriting norms. This, along with regular monitoring and supervision functions has aided in maintaining good asset quality indicators (non-performing loans-NPLs of 0.47% as of mid-April 2019).

Nonetheless, the grading is constrained by the relatively lower net interest margins (NIMs) of the MFI, which impacts its overall profitability profile. The grading is also impacted by the marginal capital buffer of GILB (~1% above the regulatory minimum of 8% as of mid-April 2019) despite already having received entire promoter equity contribution under proposed issue. The capitalisation would hence improve only slightly after the proposed issue and considering the company's high growth plans, the dependence on external capital raising might remain high. However, the strong institutional backup remains a comfort in this front with a proven track record of equity infusion as per growth requirements of the MFI. The grading is also constrained by the intense competition from established national level MFI players along with the presence of a large number of unregulated cooperatives performing similar functions. Grading concerns also arise from the absence of a centralised credit information for the MFI sector, which could result in overleveraging of the borrowers. The grading also takes note of the frequent regulatory changes impacting the spreads and funding sources for the sector. Going forward, GILB's ability to maintain sustainable 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.

GILB's credit portfolio of NPR 2,875 million as of mid-April 2019 was dominated by unsecured loans (~80%), with the rest being secured loans. The unsecured loans of GILB are based on group guarantee, wherein a group of borrowers (at least five individuals) take mutual responsibility for loan repayment for all the members. As on mid-April 2019, the average ticket size for unsecured loans stood low at ~NPR 52,000 per borrower. Similarly, GILB also extends secured loans of up to NPR 0.5 million (against regulatory ceiling of NPR 1 million). As on mid-April 2019, the average ticket size of secured loans of

[1] Compounded annual growth rate

GILB stood at ~NPR 363,000 per borrower. This averages GILB's average loan ticket size to ~NPR 63,000 per borrower. Most loans were extended towards the agriculture sector (~61%), followed by the services sector (~22%) as of mid-April 2019. The company's yield on average advances remain low at ~16% for FY2018 and 9M FY2019, primarily on account of the heavy credit growth towards later ends of these periods. While the company has room to increase its lending rates after the removal of the cap on lending rates at 18%, the company's strategy to maintain similar lending rates remains positive in terms of incremental growth. Its recent upgradation to the national level status has also opened a greater avenue to expand its operations over all 77 districts of Nepal from its existing coverage of 45 districts through 63 branches as of mid-April 2019.

As for the monitoring mechanisms, compliance and monitoring activities are performed by the area managers, deputed across five different clusters of the current operational areas. In addition to this, the internal audit of branches is also conducted at least twice a year by the in-house internal audit department. The centralised software system ensures real time availability of data from all its branches and hence supports regular off-site monitoring as well. 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 going forward, would remain important for sustainable growth.

GILB'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. Aided by the dilution effect of high portfolio growth, GILB's NPLs declined to 0.47% as of mid-April 2019 as against 2.44% in mid-July 2017. However, the 0+ days delinquencies of the company at 4.34%[2] remains an area of concern. GILB's high growth plans, intense competition in the 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 the lack of a centralised credit information bureau for the MFIs could impact incremental borrower profile, their discipline and hence the asset quality of MFI sector. The MFIs would have to strengthen their credit appraisal systems and carefully assess the cash flows and debt repayment capacity of the borrowers for sustainable growth.

As per regulations, banks and financial institutions[3] (BFIs) are required to extend 5% of their total loans towards the deprived sector[4], 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 their 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 microfinance entities. GILB's funding profile is highly reliant on bank borrowings (~76% of funding profile as on mid-April 2019) which exposes it to interest rate volatility in the banking industry. However, the major borrowing (~25%) is from its promoter bank at relatively competitive rates, which provides some comfort. The savings collected from members also comprise ~24% of its overall funding profile. GILB's liquidity position remains comfortable due to the availability of revolving lines of credit from the lender, short tenure of loans (generally one year) and a growing proportion of stable, non-withdrawable deposits from members. The cost of funds for this source is currently lower (~8% for 9M FY2019) than the bank borrowings (~11%), lowering the overall cost of funds at ~10% (~9% for FY2018). GILB's ability to further diversify funding sources at competitive rates would remain a major challenge, going forward.

On the profitability front, the company's return on net worth remains healthy at ~30% for 9M FY2019 (14% for FY2018) despite having already received 70% of the proposed issue as calls in advances from the promoter. The company's return on assets also remains adequate at ~1.9% for 9M FY2019, improved compared to 1.4% for FY2018. Despite relatively lower NIMs (5% for 9M FY2019), profitability remains supported mainly by strong non-interest income (~3.5% of average total assets-ATA for 9M FY2019) and low operating expense ratio (4.55% of ATA for 9M FY2019). Recent removal of a lending rate cap of 18% provides the MFI with flexibility to pass on the increased cost of funds to the borrowers.

2 Extracted from borrower-wise loan report by the analysts, as the company was unable to provide exact data

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

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

However, regulatory interest spread has been reduced to 9% (including operating costs up to 3%) from an earlier 11% (including operating costs of up to 4%). Contrary to earlier unregulated spreads, this could restrain the MFIs from reporting better profitability indicators even if the current high interest rate regime moderates. GILB's ability to achieve sustainable growth and scale economies whilst maintaining the asset quality would have a key bearing over the future profitability profile.

Capitalisation (CRAR) of the company at 9.03% as of mid-April 2019 remains marginally higher than the regulatory minimum of 8%. As 70% of the proposed issue has already been infused by the promoter bank, the capitalisation profile is expected to strengthen minimally after the completion of the proposed issue. Hence, GILB's dependence on external capital might remain considering its growth plans. GILB's gearing remains relatively high among peers at 12.24x as on mid-April 2019.

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

Company Profile
Incorporated in March 2013, GILB started commercial operations from May 2013 as a 10-district level retail MFI. The company was later upgraded to 45-district level retail MFI in October 2017 and subsequently as a national level MFI in January 2019. As of mid-April 2019, it is operating across 45 districts (out of 77) through its 63 branches. The company's registered office is in Besisahar, Lamjung. Mr. Kiran Kunwor is the chief executive officer of the company.

GILB reported a profit after tax (PAT) of ~NPR 16 million in FY2018 over an asset base of NPR 1,517 million as of mid-July 2018. For 9M FY2019, the PAT stood at ~NPR 41 million over an asset base of NPR 3,323 million as of mid-April 2019. GILB's gross NPLs stood at 0.47% and CRAR stood at 9.03% as of mid-April 2019. On the technology front, GILB uses the Micro Finance Banking Software that is centralised across all its branches.

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