

## Naya Nepal Laghubitta Bittiya Sanstha Limited

### ICRA Nepal assigns [ICRANP] IPO Grade 5 to the proposed Equity Shares (Rights Issue) of Naya Nepal Laghubitta Bittiya Sanstha Limited

Facility/Instrument	Issue Size	Grading Action (June 2018)
Rights Share Issue	NPR 60 Million	[ICRANP] IPO Grade 5 (Assigned)

ICRA Nepal has assigned an “[ICRANP] IPO Grade 5”, indicating poor fundamentals to the proposed rights issue amounting to NPR 60 million of Naya Nepal Laghubitta Bittiya Sanstha Limited (NNLB). 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. NNLB is proposing to come out with 250% rights issue of 600,000 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 is constrained by NNLB’s weak track record so far (High NPAs generations, low credit growth<sup>1</sup> and weak profitability) leading to small scale of operations and weak profitability even when compared to newer players<sup>2</sup>. NNLB hence lacks scale advantages which could have supported it in current turbulent scenario. As of now, the regulatory cap on lending rates for MFIs at 18% has resulted in inability to pass on the increased cost of funds (~10% for 9MFY18) to borrowers. The resultant pressure over NIMs<sup>3</sup> (~6% for 9MFY18 vs. ~10-11% in FY16-FY17) along with relatively higher operating costs have resulted in subdued return indicators for 9MFY18 (RoNW and RoA<sup>4</sup> of ~1% and 0.11% for 9MFY18 vs. ~19% and ~3.3% for FY17). The grading also considers NNLB’s weak MIS<sup>5</sup>, inadequate internal control system, concentration of bank borrowings across few BFIs, lack of strong promoter base and competition from larger/established peers. Additionally, track record of high NPLs in the early years of operations (~14% in Jul-14) also constrains the grading; NPLs though downsized to 2.32% on Apr-18<sup>6</sup>, still remains high among peers. Asset quality concerns also emanates given the low monitoring/follow-ups of delinquent accounts by NNLB in absence of proper MIS. Moreover, increased ticket size by regulations, presence of large number of players in the industry (including cooperatives), and absence of centralized credit information for MFI raises concerns of overleveraging. However, moderate ticket size of NNLB at ~43k provides some comfort. Going forward, ability of the company to maintain sustainable growth while strengthening commensurate risk mitigation practices would be important from a risk perspective.

NNLB follows group lending model, wherein 5 individuals take mutual responsibility for loan repayment for all members. In addition, NNLB also extends secured loans up to NPR 7 lakhs to finance micro enterprise in line with regulatory limit. NNLB offers NPR 50,000 for first cycle of general loans vs. 3 lakhs allowed by regulations; limit allowed is gradually increased in successive cycles. Owing to this, the average ticket size remains relatively low at ~NPR 43,000 as of mid-Jan-18 and the company plans to maintain lower ticket sizes in first cycle going forward as well, which provides some comfort. NNLB’s credit portfolio of NPR 304 million as of Apr-18 is dominated by unsecured group guarantee backed

<sup>1</sup> Credit growth CAGR of ~26% from Jul-13 to Jul-17 vs. ~49% for industry

<sup>2</sup> Asset size of NPR 333 million as of mid-Apr-18

<sup>3</sup> Net Interest Margins

<sup>4</sup> Return on Net Worth and Return on Assets

<sup>5</sup> Management information system

<sup>6</sup> Data of Apr-18 are unaudited



loans (~91%), rest being secured loans. Going forward, growth opportunities for NNLB remain adequate given the rapid branch expansion in recent periods and large below poverty line population in Nepal that act as target group for MFIs. This is also evident through increased growth rate during 9MFY18 wherein credit portfolio has grown at 82% (albeit over small base) vs. ~26% growth in earlier four years.

Lack of centralized MIS and strong internal control measures also remains a major concern for NNLB. Out of 16 branches as of mid-Apr-18, only 12 branches are connected in central database, 3 branches operate in manual records while one branch uses the software but is not connected with central database. These four branches carry sizeable portfolio of ~44% as of mid-Apr-18. Further, even the centrally connected 12 branches are in different phase of updating data in the system and hence these branches have not updated its records timely (delays up to 8 months) as on mid-Apr-18.

As for NNLB's monitoring mechanisms, field monitoring of branches is done by assigned monitoring officers on a monthly basis in addition to quarterly/annual audit by inhouse 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 1<sup>st</sup> 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.

The grading is further constrained by riskier asset mix due to marginal borrower profile and unsecured lending business, further accentuated by low seasoning of major portion of NNLB's credit book. Additionally, though ticket sizes offered by NNLB are lower compared to regulatory permissible limit, overleveraging concerns exist for NNLB 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. NNLB's asset quality indicators had witnessed major stress in initial years of operation with NPLs increasing to ~14% in Jul-14. Though the same has gradually moderated to 2.32% as of Apr-18, it still remains high among peers. 0+days delinquencies also could be high, but the management couldn't provide this data due to lack of centralization of MIS (~20% delinquencies as of Apr-18 for Banepa branch based on due-diligence). Going forward, NNLB's ability to improve internal controls and asset quality indicators would have a bearing on the overall financial profile.

As for funding profile, NNLB is highly dependent upon bank borrowings (~76% of total funds availed across just 6 BFIs including 4 commercial banks) which has witnessed spike in cost in recent periods (~11.4% vs. 9MFY18 vs. ~5.6% for FY17). Borrowing cost for MFIs have increased sharply in recent periods owing to tightening liquidity across banking sector. The "base rate plus" lending regime would be keeping cost of borrowings higher. Savings collected from members comprise ~24% of overall funding profile and this currently carries lower cost (7.5-9% on different products) than bank borrowings lowering overall cost of funds at ~10% for 9MFY18 (~6% for FY17). Lack of diversity in funding sources would also remain major challenge for NNLB going forward. As per regulation, Banks and Financial Institutions (BFIs) are required to extend 4-5% of their total loans towards deprived sector, either directly or through microfinance companies. Any moderation or withdrawal to this regulation could have significant impact on funding profile of MFIs.

NNLB's profitability indicators have witnessed high fluctuations over the years, primarily impacted by the movement of NPLs. RoNW and ROA remained ~3% and ~0.4% for FY13-FY15 when NPLs were high (12-14%); the same improved to ~27% and ~4.4% for FY16-FY17 respectively as NPLs gradually came down to 3.63% as of Jul-17. Declining yields and increasing cost of funds has led to moderations in NIMs (5.68% for 9MFY18 vs. 10.08% for FY17). Fees-based income remains fair at ~2.5%, but high



operating expenses (~7.5% of ATA for 9MFY18) has resulted in low RoNW of ~1% and RoA ~0.11%. Profitability, going forward could be supported to an extent as the recently added branches achieve higher efficiency. Thus, ability of NNLB to achieve sustainable growth in business ensuring efficient utilisation of enhanced capital whilst improving asset quality would have key bearing over its future profitability profile.

NNLB's capitalisation (CRAR) of 12.77% as on Apr-18 remains comfortable vs. regulatory minimum of 8%. NNLB's gearing generally remains lower among peers at 7.11 as on Apr-18 (4.71 as on Jul-17) and the same is expected to remain low over medium term given the proposed sizeable capital enhancement. NNLB's promoter base comprises of diverse range of individuals, hence depriving NNLB of funding/technical support that could be expected from promoters in case of distress.

### **Company Profile**

Incorporated in 2009, Naya Nepal Laghubitta Bittiya Sanstha Limited (NNLB) started its commercial operation as 10 districts level Class D retail microfinance institution. Shareholding pattern of the company constitutes of promoter holding of 51% and public group 49% (earlier 70:30). NNLB's shares are listed in Nepal Stock Exchange. Mr. Saroj Ghimire is the Executive Director of the company. The registered and corporate office of NNLB is located at Dhulikhel, Kavrepalanchowk, Nepal.

NNLB has presence over its 10 licensed districts through 16 branches as of mid-Apr-18. NNLB reported a profit after tax (PAT) of ~NPR 7 million during FY17, over an asset base of ~NPR 233 million as of mid-Jul-17 as against PAT of ~NPR 10 million during FY16 over an asset base of NPR 178 million as of mid-Jul-16. During 9MFY18, NNLB has reported PAT of NPR 0.24 million over an asset base of NPR 333 million as of mid-Apr-18. NNLB's gross NPLs stood at 2.32% and CRAR at 12.77% as of mid-Apr-18. On technology front, NNLB uses Empower software for 13 branches which remains to be centralized across all.

**June 2018**

*For further details please contact:*

*Analyst Contacts:*

**Mr. Kishor Prasad Bimali**, (Tel No. +977-1-4419910/20)

[kishor@icranepal.com](mailto:kishor@icranepal.com)

**Mr. Rajib Maharjan**, (Tel No. +977-1-4419910/20)

[rajib@icranepal.com](mailto:rajib@icranepal.com)

All Rights Reserved.

Contents may be used freely with due acknowledgement to ICRA Nepal.

ICRA Nepal ratings should not be treated as recommendation to buy, sell or hold the rated debt instruments. The ICRA Nepal ratings are subject to a process of surveillance which may lead to a revision in ratings. Please visit our website ([www.icranepal.com](http://www.icranepal.com)) or contact ICRA Nepal office for the latest information on ICRA Nepal ratings outstanding. All information contained herein has been obtained by ICRA Nepal from sources believed by it to be accurate and reliable. Although reasonable care has been taken to ensure that the information herein is true, such information is provided 'as is' without any warranty of any kind, and ICRA Nepal in particular, makes no representation or warranty, express or implied, as to the accuracy, timeliness or completeness of any such information. All information contained herein must be construed solely as statements of opinion and ICRA Nepal shall not be liable for any losses incurred by users from any use of this publication or its contents