Vijay Laghubitta Bittiya Sanstha Limited

ICRA Nepal assigns [ICRANP] IPO Grade 4 to the proposed Initial Public Offering of Vijay Laghubitta Bittiya Sanstha Limited

	Issue Size	Rating Action
IPO Grading	NPR 42 million	[ICRANP] IPO Grade 4 (Assigned)

ICRA Nepal has assigned an "**[ICRANP] IPO Grade 4**", indicating below-average fundamentals to the proposed Initial Public Offering (IPO) amounting NPR 42 million of Vijay Laghubitta Bittiya Sanstha Limited (hereinafter referred to as VLBS). 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. VLBS is proposing to come out with an IPO of 420,000 numbers of equity shares of face value NRs 100/- each to be issued to general public at par. The proposed issue is being made in order to meet the regulations regarding public shareholding and minimum paid-up capital requirement.

The grading is constrained by VLBS's limited track record (started operations in Jan 2013), small scale of operations, low seasoning of credit book, low profitability, lack of diversity in earnings, higher portfolio vulnerability arising from unsecured nature of loan book, inferior borrower profile, absence of centralized credit bureau in microfinance segment, limited experience of management team in microfinance sector, competition from other microfinance institutions & BFIs[1] undertaking microcredit activities through larger franchise and uncertain operating environment that financial institutions in Nepal are currently facing. The grading factors in favorable regulation for microfinance entities wherein loans to microfinance entities by banks/other financial institutions classify for 'mandatory deprived sector lending norms' thus help these entities to raise funds from banking channel at very low interest rates. 'Deprived sector norms' remain a key regulatory risk for microfinance entities, withdrawal/moderation in this regulation could have significant impact on microfinance's entities business profile. The grading also factors in in the institutional promoter base (Goodwill Finance Limited, a class C banking institution, held 21% equity stake in the company), good assets quality so far & comfortable solvency profile (although portfolio seasoning is limited), healthy rate of business expansion across different geographical area and regulatory advantage available with 'Class D' Microfinance Companies compared to its counterparts in banking industries-in the form of lower SLR/ CRR[2] & capital adequacy requirements. As per the Central Bank's regulation, BFIs are required to channel 3.5-4.5% percentage of their total loans towards deprived sector[3], either directly or through microfinance companies. Going forward, VLBS's ability to scale up its operations through geographical diversification and increase in member base for efficient use of capital base, improve profitability profile and maintain its assets quality indicators would have a bearing on the overall financial profile.

VLBS is running microcredit activities following JLG (Joint Liability Group) model, wherein 15-25 individual come together for the purpose of availing loans through group mechanism against mutual guarantee. VLBS's credit portfolio as of Oct-14 is composed largely of unsecured group guarantee backed loans (>99% of total portfolio). Members upon introduction to the groups can avail loan up to NPR 100 thousand at the beginning (average ticket size ~40,000) and the amount is increased upon completion of each loan cycle[4] i.e. repayment of each loan. The credit portfolio of VLBS is broadly

[1] Banks and Financial Institutions, Class A, B & C
[2] Statutory Liquidity Ratio/ Cash Reserve Ratio
[3] As defined by the central bank (NRB) encompasses the poorer section of society.
[4] Subject to a minimum period of 6 months

classified into General/micro Loan (~95%) and seasonal/top-up loans (~5%) with maximum ticket size up to NPR 1 lakh (against NPR 2 lakh permitted by regulations). Although, VLBS has recently ventured into microenterprise loan (secured loan product upto NPR 3 lakhs), the proportion of same remains negligible at present (less than 1%). As of Oct-14, the loans outstanding are divided between agriculture sector (54%) & service sector (41%). The assets quality indicator of VLBS remains comfortable, although partly benefitted by low seasoning of credit books and regulatory arbitrage provided to Microfinance Institutions in NPA recognition norms. The Gross NPL of VLBS stood at 0.20% and net NPL at 0.15% as on Oct-14 with NPR 3.6 lakhs in non-performing loans spread across ~10 accounts.

In funding profile front, favorable regulation for microfinance entities wherein loans to microfinance entities by banks & financial institutions classify for mandatory deprived sector lending norms thus help these entities to raise funds from banking channel at very low interest rates. Deprived sector norms remain a key regulatory risk for microfinance entities, withdrawal/moderation in this regulation could have significant impact on microfinance's entities business profile. The microcredit activities of VLBS are funded mainly through the bank borrowings; sourced from multiple BFIs including the promoter Goodwill Finance (line of credit utilised from Goodwill accounted for ~23% of total borrowings as on Oct-14). Due to limited track record and low member base, member's savings with VLBS remains negligible. Member's deposit as a percentage of loans outstanding remains on the lower side for VLBS (4% on Oct-14) as compared to industry average of 31% as on Jul-14. However, owing to the regulatory provisions, Microfinance institutions are likely to get steady flow of loans at subsidized interest rates from BFIs which augur well for the incremental business growth and liquidity support. Due to startup nature of business, small size of external borrowings and relatively fair level of capital fund, the gearing ratio[5] for VLBS remains low (1.33 times on Oct-14). VLBS remains comfortable on liquidity front due to short term lending, availability of line of credit from BFIs and generally non-withdrawable nature of members' deposits.

VLBS has been maintaining healthy NIMs[6] (around ~10%) supported by high lending spreads of ~13%. Moreover, the rate of credit growth remains healthy supported by readily available funds from BFIs. However, the profitability profile remains modest due to small scale of operations, lower leverage and resultant high operating cost ratio despite low credit provisioning expense at present. VLBS's profit after tax (PAT) for FY 2013-14 stood at NPR 3.8 million, corresponding to return on assets of 2.36% and return on net worth of 3.82%. The indicators remain progressive coming into Q1FY14-15 (PAT/ATA[7] of 2.95% and PAT/Networth of 6.80% in Q1FY15), aided by continuous growth in business volume. VLBS management's ability to forge strategic partnership for financial literacy & business expansion with other national and international development agencies working in Nepal in cost sharing basis could also help to improve future profitability by reducing operating cost to some extent. Going forward, the profitability profile is likely to improve as the company grows in size and achieves economies of scale; sharp deterioration in assets quality notwithstanding.

VLBS CRAR at 50% remains much higher than regulatory minimum requirement of 8%. The proposed IPO would increase its capital levels further. While these levels of capital provide adequate headroom for growth, the company's ability to efficiently use the same would have bearing on profitability indicators.

[5] Total external debt/Networth
[6] Net interest margin
[7] Average total assets

Company Profile

Established in February 2012, Vijay Laghubitta Bittiya Sanstha (VLBS) is a public limited company and commenced its operations from January 2013. VLBS is the 26th microfinance institution to receive Class D status from Central Bank of Nepal. VLBS has 100% promoter holding at present which is expected to dilute to 70% post proposed IPO (assuming full subscription). Major promoters of VLBS include Goodwill Finance Limited (21% holding at present) and Vijay Development Resource Centre-VDRC (2% holding at present) along with other individual promoters with loose affiliation to VDRC or its members. The registered office of VLBS is in Rajahar VDC of Nawalparasi district in Nepal. VLBS currently has 10 branches apart from its head office (registered office) spread across 9 districts. As on Oct-14, VLBS had staff strength of 40 overlooking member base of 5,687 including 4,714 borrowers. At present, VLBS caters to the people living in semi-urban and rural areas. VLBS is progressively diversifying its area of operations and has till now expanded its operations in 3 major geographical areas (Nawalparasi & vicinity, Baglung & Vicinity and Dang & Vicinity).

VLBS reported a profit after tax of NPR 3.84 million during FY 14 over an asset base of NPR 225.4 million and net worth of NPR 102.5 million as on Jul-14. Similarly, the PAT for Q1 FY15 stood at NPR 1.75 million over the asset base of NPR249.6 million and net worth of NPR 103.5 million as on Oct-14. The credit portfolio of VLBS as on Oct-14 stood at NPR 183.43 million, Member's deposit at NPR 7.67 million and borrowings from BFIs at NPR 129.98 million. In terms of technology platform, VLBS has implemented 'Empower' in all of its branches.

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