

**Grading Rationale**

**Infinity Laghubitta Bittiya Sanstha Limited**

**Grading**

<b>Facility/Instrument</b>	<b>Amount (Rs. In Million)</b>	<b>Grading</b>	<b>Grading Action</b>
Initial Public Offer	60.00	CARE-NP IPO Grade 4 [IPO Grade Four]	Assigned

*The explanatory notes regarding the Rating/Grading symbols of CARE Ratings Nepal Limited (CRNL) are attached as Annexure I*

CRNL has assigned grading of ‘CARE-NP IPO Grade 4’ to the proposed Initial Public Offer (IPO) of Infinity Laghubitta Bittiya Sanstha Ltd. (ILBSL). ‘CARE-NP IPO Grade 4’ indicates below average fundamentals. CRNL assigns IPO grades on a scale of Grade 1 to Grade 5, with Grade 1 indicating strong fundamentals and Grade 5 indicating poor fundamentals. CRNL’s IPO grading is an opinion on the fundamentals of the issuer. The grade assigned to any individual issue represents a relative assessment of the ‘fundamentals’ of the issuer. ILBSL proposes IPO issue of 0.6 Mn equity shares of face value of Rs.100 each at par aggregating Rs.60 Mn.

**Detailed Rationale & Key Rating/Grading Drivers**

The grading is constrained by short track of operations; concentrated resource profile with high dependence on Banks & Financial Institutions; concentrated product portfolio distribution; exposure to the regulatory risks related to the microfinance industry and inherent risk involved in the microfinance business including socio political interventions. However, the grading draws strength from ability of the company to increase its scale of operations along with improving its profitability; Comfortable Capital Adequacy ratio; adequate geographical diversified reach in its area of operation; controlled and low Non Performing loans (NPLs) and comfortable liquidity profile.

Ability of the company to scale up the operations while maintaining the capital adequacy levels and asset quality and ability of the company to manage the impact of any regulatory changes by NRB would be the key rating sensitivities.

## Detailed Description of the Key Grading Drivers

### Key Grading Weakness

#### *Short track record of operations, however, adequate geographical reach in its area of operation*

ILBSL has short track record of operations as it is operating since January 20, 2017. However, within short span of operations, ILBSL is covering 23 districts operating in 6 states of Nepal through its 39 branches as on July 16, 2018. Further, the company also has plans for gradual expansion over new geographies, access to funds benefited from deprived sector regulation of NRB and large target group of below poverty line population in Nepal for MFIs leading to growth in the loan portfolio over the period.

#### *Concentrated resource profile with high dependence on Banks and Financial institution borrowings*

Major source of external funding for ILBSL has been loans from banks and financial institutions and deposits. As on July 16, 2018, ILBSL has funding tie up with 18 banks and financial institution, where interest rate ranges from 9% to 12% depending upon the financial institution. The ratio of Bank borrowing to total resource profile was around 54.02% in FY17 which is increased to 61.57% in FY18. During FY18, the cost of funds increased to 11.03% from 9.75% during FY17, which indicates ILBSL has obtained the costly debt due to high interest rates prevailing in the market on back of shortage of liquidity in the Banking & Finance Industry.

#### *Concentrated product portfolio distribution, however being diversified over the year*

ILBSL has portfolio distribution consists of various types of loan disbursed over the period for the small businesses related to agricultural sector (crops, vegetable, poultry, bee keeping etc), small & cottage industry, service industry (wholesale & retail, hotel industry etc.) and others. During FY17, ILBSL has highest lending of 38.72% to service industry (52.82% on mid-July 2017) followed by 33.46% to agriculture related (44.75% on mid-July 2017) and least lending in bee keeping of 0.04% (0.11% on mid-April 2017).

#### *Exposure to regulatory risks related to microfinance industry*

The microfinance industry in Nepal is exposed to changes in the various regulatory measures issued by NRB from time to time. As per the earlier regulations, A, B & C class financial institutions were required to extend 5%, 4.5% and 4% respectively of their total loans towards

deprived sector. However, Monetary Policy of 2018-19 changed the guidelines and instructed all A, B & C class financial institutions to lend 5% of their total loan to deprived sector. This regulation change is expected to impact the incremental fund availability to MFIs, cost of fund, credit growth and profitability of the MFIs.

Earlier MFIs were allowed to determine interest rate on their lending by adding upto 4% administrative expenses above cost of fund plus maximum of 7% spread with the interest rate ceiling of 18%. However, monetary policy of 2018-19 changed this provision where MFIs are now allowed to determine interest rate on loan by adding upto 3% administrative expenses above cost of fund plus maximum of 6% spread and the interest rate ceiling (i.e.18% earlier) is eliminated. As a result of changed NRB provision, MFIs can now pass increased cost of fund to the borrower which will improve their interest earning capacity.

***Inherent risk involved in the microfinance business including socio political interventions***

MFIs are prone to credit risk which is directly related to the portfolio of the organization and is one of the most significant risks from an MFI perspective. Credit risk assumed by a MFI is typically higher compared to banks and other types of lenders given the weak borrower profile. Further, MFI provides unsecured loans, i.e. loans without any collateral, which makes the credit even riskier. Similarly, as per NRB norms also MFIs are allowed to give loan against collateral only 33.33% of total loan. However, ILBSL secured loan portfolio is low at 4.15% in FY18 (UA).

**Key Grading Strengths**

***Ability of the company to increase its scale of operations and improve its profitability***

Over the period ILBSL has demonstrated robust growth in the loan & advances (albeit low base) due to increase in geographical reach through branch expansion leading to substantial increase in its client base. The total loan portfolio of the company has grown to Rs. 816 Mn at the end of FY18 from Rs. 151 Mn at the end of FY17. The number of the JLG borrowers also increased over the period from 2439 in FY17 to 11982 in FY18.

During FY18, the total income of ILBSL increased to Rs.117 Mn from Rs.10 Mn in FY17. The growth in income was primarily due to increase in interest income with portfolio growth and the growth in income was also aided by non-interest income of Rs.27 Mn which included loan processing fees, membership fees, account closing fees and pre-payment charge etc. However,

ILBSL witnessed substantial increase in interest expenses to Rs. 56 Mn in FY18 from Rs. 2 Mn in FY17 because of increase in operation and high dependence in borrowed fund because of which cost of fund has increased from 9.75% in FY17 to 11.03% in FY18, tightening liquidity in banking sector during the end of FY17 resulted in increased cost of funds for banking sector in Nepal during FY18. In spite of increase in expenses ILBSL has achieved profit after tax of Rs. 11 Mn in FY18 against loss of Rs. 6 Mn in FY17.

#### ***Comfortable Capital Adequacy ratio (CAR)***

Tier I Capital of microfinance stood at 16.51% as on July 16, 2018 and overall capital adequacy ratio stood at 17.44% which is at comfortable level in comparison to the minimum regulatory requirement of 8% and 4% respectively for micro finance institution. Increase in paid up capital by Rs. 70 Mn and accretion of profit to networth during FY18 led to high CAR. CAR is expected to increase further after the proposed Initial public issue and such increase in capital level is expected to help in expansion of business.

#### ***Comfortable Liquidity Profile***

ILBSL has comfortable liquidity profile with positive cumulative mismatch over one year, as of July 16, 2018, due to well mismatch tenure of assets and liabilities. CRR of 0.51% is maintained by ILBSL as on July 16, 2018 whereas the regulation has stated to maintain CRR at 0.5% of the fund received from its member so CRR maintained is within the norms of NRB.

#### ***Controlled and low Non Performing Loans (NPLs) and absence of centralized credit bureau***

ILBSL's NPL% to the total loans was low at 0.09% at the end of FY18. Lack of cooperation from local financial institution leading to over funding to the borrowers and absence of proper credit report from Credit Information Bureau (CIB) are some of the reasons for loan duplication. However, monetary policy of 2018-19 required MFIs to send credit information to CIB continuously and 2% additional LLP have to be maintained on such loan if MFIs fail to send credit information to CIB. ILBSL has also started convincing the group to recover and also started educating, motivating and conducting various awareness program.

#### **About the Company**

Infinity Laghubitta Bittiya Sanstha Ltd. (ILBSL) is a small-sized category "D" (National Level Microfinance Institution) licensed by Nepal Rastra Bank on January 20, 2017. ILBSL was established on July 14, 2016 and commenced its operation under Bank and Financial Institution Act 2006. ILBSL is engaged in providing microfinance loans based on the Joint Liability Group

(JLG) model. As on June 16, 2018, ILBSL was operating in 23 Districts (out of total 77 Districts) of Nepal with 39 number of Branches (including head office) and loan & advances of Rs.816 Million covering 1416 active JLG borrowers. ILBSL is providing loan to its member ranging from minimum Rs. 10000 to Maximum Rs. 300000 without collateral and Rs. 500000 with collateral. ILBSL have four experienced members on board led by Mr. Khemraj Nepal who has 29 years of experience and was retired as Secretary of Nepal Government is the chairman of the company. The company is promoted by 88 individual promoters who belong from diverse background. The day to day operations of the company are headed by Mr. Prabin Kumar Lama who is the chief executive officer of the company.

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**Annexure I**

**CARE Ratings Nepal – IPO Grading Scale**

<b>CARE IPO grade</b>	<b>Definition</b>
CARE-NP IPO Grade 1	Strong fundamentals
CARE-NP IPO Grade 2	Above average fundamentals
CARE-NP IPO Grade 3	Average fundamentals
CARE-NP IPO Grade 4	Below average fundamentals
CARE-NP IPO Grade 5	Poor fundamentals

Note:

Modifiers {"+" (plus)} can be used with the grading symbols. The modifiers reflect the comparative standing within the category.