

**Brief Rating Rationale**

**Infinity Laghubitta Bittiya Sanstha Limited**

**Grading**

Particulars	Amount (Rs. In Million)	Grading	Grading Action
Initial Public Offer	67.40	CARE-NP IPO Grade 4 [IPO Grade Four]	Reaffirmed (enhanced from Rs.60.00 Mn)

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

CRNL has reaffirmed 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 674,000 equity shares of face value of Rs.100 each at par aggregating Rs.67.40 Mn.

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

The grading assigned to Initial Public issue of ILBSL is constrained by short track of operations and concentrated resource profile with high dependence on Banks & Financial Institutions borrowings. The grading is also constrained by increasing percentage of Non-Performing loan (NPLs) to total loan ratio and concentrated product portfolio distribution. Further, grading also factors in 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 derives 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 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 grading 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 43 branches as on January 14, 2019. 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.

#### ***Concentrated resource profile with high dependence on Banks and Financial Institution (BFIs) borrowings***

Major source of external funding for ILBSL has been loans from BFIs and deposits. As on July 16, 2018, ILBSL has funding tie up with 18 banks and financial institution with interest rate ranging from 9% to 12%. The ratio of BFIs borrowings to total resource profile was around 54.02% in FY17 which 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.

#### ***Increasing percentage of Non-Performing loan (NPLs) to total loan ratio***

ILBSL's NPL level are on increasing trend, it increased to 1.33% in H1FY19 (refer to period from Mid-July, 2018 to Mid-January, 2019) from 0.09% in FY18 (refers to period ending July 16, 2018). NPL level increased mainly due to higher indebtedness as well as lack of financial discipline in borrowers due to existence of large number of MFIs and higher competition within MFIs. Monetary policy of 2018-19 required MFIs to send credit information to Credit Information Bureau (CIB) continuously and 2% additional loan loss provision (LLP) have to be maintained on such loan if MFIs fail to send credit information to CIB. These provisions may control loan duplication problem to some extent. ILBSL has started to convincing the group to recover loan and also started educating, motivating and conducting various awareness program.

***Concentrated product portfolio distribution, however made some efforts to diversify from last 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 FY18, 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.

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.

Further, NRB required MFIs to classify overdue loan for more than one month to three months as watch list loan and required to make 5% loan loss provision thereon, which will impact MFIs profitability.

***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***

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. Its total loan portfolio grew substantially to Rs 1,203.82 Mn in H1FY19 from Rs 824.88 Mn in FY18 (Rs. 151 Mn in FY17). The number of the JLG borrowers also increased over the period to 16,311 in H1FY19 from 11,982 in FY18 (2,439 in FY17). Similarly, its deposit grew over the period to Rs 394.08 Mn in H1FY19 from Rs 250.74 Mn in FY18 (Rs 27.48 Mn in FY17).

#### **Improved financial performance during H1FY19 (UA)**

ILBSL total income increased by 235.01% to Rs 119.24 Mn during H1FY19 from Rs 35.59 Mn during H1FY18 on back of increase in interest income (due to growth in credit portfolio) and increase in non- interest income. Similarly, the interest expenses increased by 242.93% to Rs 56.15 Mn during H1FY19 from Rs 16.37 Mn during H1FY18 due to increase in amount of deposit and borrowing as well as increase in interest rate on borrowings. ILBSL's net profit substantially increased to Rs 12.97 Mn during H1FY19 from Rs 1.24 Mn during H1FY18 on back of sharp increase in net interest income and non-interest income as compared to increase in non-interest expenses.

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

Tier I CAR of ILBSL stood at 12.44% in H1FY19 (16.55% in FY18) and overall capital adequacy ratio stood at 13.31% in H1FY19 (17.49% in FY18) which is at comfortable level in comparison to the minimum regulatory requirement of 4% and 8% respectively for MFIs. Increase in risk weight assets mainly from increase in credit portfolio is higher than increase in capital fund led to decrease in CAR in H1FY19. CAR is expected to increase 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. Cash Reserve Ratio (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.

**About the Company**

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.

ILBSL is providing loan to its member ranging from minimum Rs. 10000 to Maximum Rs. 300000 without collateral and Rs. 500000 with collateral. It has five 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 II****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.