

**Grading Rationale**

**Samata Laghubitta Bittiya Sanstha Limited**

**Grading**

Particulars	Amount (Rs. In Million)	Grading	Rating Action
Right Share issue	121.344	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 1*

CRNL has assigned grading of ‘CARE-NP IPO Grade 4’ to the proposed Right Share Issue of Samata Laghubitta Bittiya Sanstha Limited (SLBSL). ‘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. SLBSL propose 200% right share issue of 12.1344 lakh number of equity shares of face value of Rs.100 each at par aggregating Rs. 121.344 million.

**Detailed Rationale & Key Grading Drivers**

The grading assigned to the right share issue of SLBSL is constrained by low market share in terms of credit portfolio and deposit and concentrated credit portfolio. The grading also constrained by its significant increase in Non-Performing Loan (NPLs) to total loan in H1FY19, high dependence of resource profile on Banks & Financial Institutions (BFIs) borrowing and deteriorated financial performance in FY18 over FY17, however improved during H1FY19. Competition from other Micro Finance Institutions (MFIs) and Co-operatives, inherent risk involved in the microfinance industry including competition and unsecured lending and exposure to regulatory risks related to microfinance industry also remain a concern.

The grading, however, derives strength from experienced board members and management team, ability to geographically diversify business over moderate period of operation and moderate Capital Adequacy ratio (CAR). The grading is further supported by considerable growth in business over the period and comfortable liquidity profile.

## Detailed Description of the Key Grading Drivers

### Key Grading Weakness

#### ***Deteriorated financial performance in FY18 over FY17, however improved during H1FY19***

SLBSL financial performance deteriorated significantly during FY18 over FY17. Its net profit declined by 47.75% to Rs 7.23 Mn during FY18 from Rs 13.83 Mn during FY17. Net interest income of the company increased by 7.33% to Rs. 39.60 Mn during FY18 over FY17, despite 51.64% increase in interest income, mainly due to high interest expenses. The profitability of the company impacted by significant increase in Non-interest expenses during FY18 mainly due to increase in number of branches and increase in loan loss provision expenses due to increase in credit portfolio. Interest spread declined to 7.31% in FY18 from 11.94% in FY17 due to substantial increase in interest rate on borrowing as a result of liquidity crunch in Nepalese banking sector. Net Interest margin (NIM) decreased to 6.68% in FY18 from 10.96% in FY17. ROTA and RONW declined substantially to 1.22% and 12.21% respectively in FY18 from 4.11% and 33.40% in FY17.

However, its financial performance improved substantially during H1FY19 over H1FY18. Its net profit increased substantially to Rs 7.22 Mn during H1FY19 from Rs 2.58 Mn during H1FY18, despite substantial increase in non-interest expenses (by 107.76%), mainly due to increase in fee based income on account of increase in service charge to 2% since Mid-July FY18 (1% earlier) and increase in credit portfolio. Apart from this, increase in net interest income also lead to increase in net profit.

#### ***Low market share in terms of credit portfolio and deposit and concentrated credit portfolio***

SLBSL market shares in terms of loan portfolio and deposit is low as compared to peers. In H1FY19, it has 0.58% and 0.60% market share in terms of loan portfolio and deposit of microfinance industry respectively which was 0.47% and 0.52% in FY18. Further, SLBSL's credit portfolio mainly concentrated to agricultural crops and vegetables cultivation. In H1FY19, its lending consists of 89.88% to agriculture crop (90.78% in FY18), 3.82% to vegetable cultivation (4.20% in FY18).

#### ***Significant increase in Non-Performing Loan (NPLs) to total loan in H1FY19***

SLBSL's NPL level increased significantly to 1.16% in H1FY19 from 0.44% in FY18 due to loan duplication in absence of credit report from Credit Information Bureau (CIB); frequent changes in the staff as well as members not able to generate expected income from their businesses. To mitigate increase in NPAs, SLBSL started educating, motivating and conducting various awareness program for recovery of loan.

***High dependence of resource profile on Banks & Financial Institutions (BFIs) borrowings***

SLBSL major source of external funding consist of borrowing from BFIs. The ratio of borrowing from BFIs to total resource was high and decreased slightly to 55.59% in H1FY19 from 56.58% in FY18. As on January 14, 2019, its funding tie-up is with 9 BFI, where interest rate ranges from 10.5% to 13.5% depending upon the financial institution. Its cost of borrowing (i.e. 12.24% in H1FY19 and 11.19% in FY18) is substantially higher than cost of deposit (i.e. 7.95% in H1FY19 and 7.87% in FY18) which indicates it has obtained costly debt. Cost of borrowing increases in last one and half year due to shortage of liquidity in the Banking Industry.

***Competition from other MFIs and Co-operatives***

As on Mid-Jan 2019, there are 72 MFIs in operation with total 3,000 branches all over Nepal. SLBSL has 24 branch as on Mid Jan, 2019. Micro Finance Industry earned Rs. 14,063 Mn interest income, Rs 6,506 Mn net interest income and Rs 2,596 Mn Net profit during H1FY19 however, SLBSL has 0.51% (Rs. 71.90 Mn) share on interest income, 0.44% (Rs. 28.37 Mn) share on net interest income and 0.28% (Rs. 7.22 Mn) share on net profit for the same period in the industry. Further, large number of cooperatives are operating all over Nepal providing loan and other financial services to their members with or without collateral. Due to presence of large number of micro finance and co-operatives, SLBSL is competing to tap the new customer and to retain the existing good customer.

***Inherent risk involved in the microfinance industry***

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.

SLBSL percentage of collateral loan to total loan is decreasing in trend. It is decreased to 7.27% in H1FY19 from 12.49% in FY18 and 23.02% in FY17. Decrease in % of collateral loan to total loan lead to increase credit risk of SLBSL.

***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.

### **Key Grading Strengths**

#### ***Experienced board members and management team***

SLBSL has 7 members on its board including one independent director. Its board is chaired by Mr. Damber Mani Thebe Limbu since last 4 years. Mr. Limbu is chairperson of Community Active Participation Nepal and board member of Makawanpur Udhyog Association. He has 2 decades of overall industrial experience. Dr. Madan Ghimire, CEO of the company since last 5 years, has more than 2.5 decades of experience in INGO and NGO in various position. He has been supported by other experienced management team members.

#### ***Ability to geographically diversify business over moderate period of operation.***

SLBSL obtain licence from NRB on August 18, 2013 as one district microfinance institution. Later on February 1, 2018, SLBSL got approval from NRB as 10 district microfinance institution. It is operating in 10 districts and 3 provinces through 24 branches as on January 14, 2019. As on January 14, 2019, its loan portfolio diversified over 10 districts through 24 branches and loan concentration in any one branch is not more than 12.9 % of total loan portfolio.

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

SLBSL overall CAR and Tier I CAR stood at 9.6% and 8.65% as on July 16, 2018 which is moderate in comparison to the minimum regulatory requirement of 8% and 4% respectively for microfinance institutions (MFIs). During FY18, its CAR decreased to 9.6% from 13.04% in FY17 due to high growth in loans and advances as compared to increase in capital fund. However, its overall CAR and Tier I CAR improved to 9.94% and 8.96% respectively in H1FY19. CAR is expected to improve further after proposed right issue.

***Considerable growth in business and market share over the period.***

SLBSL has demonstrated considerable growth in the credit portfolio over the period. Its credit portfolio grew by compounded annual growth rate (CAGR) of 81.25% over last 2.5 years ending H1FY19 (whereas industry CAGR is (38.93) %) due to increase in amount of credit utilized by existing borrowers and substantial increase in client base (30513 in H1FY19 from 7084 in FY16) by increase in geographical reach through branch expansion (i.e. 24 branches at the end of H1FY19 from 5 branches at the end of FY16). The credit portfolio of the company grew by 84.13% to Rs. 698 Mn at the end of FY18 from Rs. 379 Mn at the end of FY17. The credit portfolio further grew by 46.80% to Rs. 1025 Mn in H1FY19. Similarly, its deposit grew substantially over the period. Its deposit grew by Y-o-Y growth rate of 90.91% (albeit low base) in FY18 to Rs 259 Mn from Rs.136 Mn in FY17 due to increase in client base. Further deposit increased by 41.72% to Rs 367 Mn in H1FY19.

***Comfortable Liquidity Profile***

SLBSL has comfortable liquidity profile with positive cumulative mismatch over one year as on January 14, 2019. Further, it has maintained CRR 0.54% in H1FY18 and 0.53% in FY18 which is in compliance with NRB norms of 0.5%. Similarly, it has maintained liquid assets of 19.38% in H1FY19 and 15.94% in FY18 (5.93% in FY17) which is high against the minimum regulatory requirement of 2.5%.

**About the Company**

Samata Laghubitta Bittiya Sanstha Ltd. (SLBSL, formerly known as Samata Microfinance Bittiya Sanstha Ltd.) is a “D” class ten district microfinance institution incorporated on April 15, 2013. SLBSL is licensed by Nepal Rastra Bank on August 18, 2013 as one district microfinance institution and commenced its operation from August 25, 2013. It is primarily engaged in providing microfinance loan based on the Joint Liability Group (JLG) model with each group consisting of minimum five members. It has 30,513 members and 21,341 borrowers as on January 14, 2019.

It has loan portfolio of Rs 1,025 Mn and deposits of Rs 367 Mn as on January 14, 2019. It has earned net profit of Rs 7.23 Mn during FY18 (Rs 13.83 Mn during FY17). As on January 14, 2019, the company have share capital of Rs 60.67 Mn, held by promoter and public in 70:30 ratio respectively.

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**Annexure 1**

**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 2, 3 and 4. The modifiers reflect the comparative standing within the category.