

**Grading Rationale**  
**Civil Laghubitta Bittiya Sanstha Limited**

**Grading**

Facility	Amount (Rs. In Million)	Grading	Rating Action
Right Share Issue	114.114	CARE-NP IPO Grade 4 [IPO Grade Four]	Assigned

*The explanatory notes regarding the Grading symbols of CARE Ratings Nepal Limited (CRNL) are attached as Annexure 1*

CARE Ratings Nepal Ltd. (CRNL) has assigned grading of ‘CARE-NP IPO Grade 4’ to the proposed Right Share Issue of Civil Laghubitta Bittiya Sanstha Ltd. (CLBSL). ‘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. CLBSL proposes to issue 1.14114 Million shares of face value of Rs.100 each at par aggregating Rs. 114.114 Million.

**Detailed Rationale & Key Grading Drivers**

The grading assigned to CLBSL is constrained by deteriorating asset quality over the period, low market shares in term of credit portfolio and deposit, concentrated credit portfolio distribution towards animal husbandry and wholesale and retail sector, and concentrated resource profile with high dependence on Banks & Financial Institutions (BFIs) borrowings. The grading is also constrained by competition from other Micro Finance Institutions (MFIs) and Co-operatives, and the inherent risk involved in the microfinance industry. The grading, however, derives strength from strong institutional promoter, experienced board members and management team, and moderate track record of operation coupled with geographical diversification of business. The grading also considered adequate capitalization level, considerable growth in business over the period, moderate liquidity profile, and growth in total income and net profit over the period.

**Detailed Description of the Key Grading Drivers**

**Key Grading Weaknesses**

*Deteriorating assets quality over the period*

CLBSL’s Gross Non-Performing Loans (GNPL) level is in increasing trend. In absolute amount, GNPL has increased to Rs 24 Mn in Q1FY20 (refers to 3 months’ period ended on October 17, 2019) from Rs. 14 Mn in FY19 (refers to 12 months’ period ended on July 16, 2019). Further, GNPL ratio increased to 2.16% in Q1FY20 from 1.34% in FY19 (0.78% in FY18) mainly due to loan duplication problem in absence of credit report from Credit Information Bureau (CIB), lack of financial literacy and borrower’s repayment intension, inability to perform loan recovery work effectively due to staff turnover problem. To ensure repayment and control NPL,

CLBSL is planning to educate, motivate and conduct various awareness program, publishing defaulter's name in newspaper, staff quality improvement, regular follow-up and pressurizing the borrower through the group for repayment of loan. In Q1FY20, out of total loans of Rs. 1,128 Mn, the delinquencies of more than 30 days amounted to Rs. 53 Mn (4.71% of total advances) which increased from Rs. 33 Mn (3.21% of total advance) in FY19.

***Low market shares in terms of credit portfolio and deposit***

CLBSL has low market share in terms of credit portfolio and deposit base of microfinance industry despite being in operation since 2012. It has 0.46% and 0.34% market share in terms of credit portfolio and deposit base respectively of microfinance industry in Q1FY20 (based on monthly data published by NRB) which is slightly increased from 0.43% and 0.31% respectively in FY19.

***Concentrated credit portfolio distribution towards animal husbandry and wholesale & retail sector***

Out of total credit portfolio of CLBSL's in Q1FY20, lending towards wholesale & retail business consist of 33.9% (62.09% in FY19) followed by 29.71% towards animal husbandry (20.71% in FY19).

***Concentrated resource profile with high dependence on Banks & Financial Institutions (BFIs) borrowings***

CLBSL's major source of funding consists of borrowing from BFIs. Borrowing from BFIs in Q1FY20 consist of 55.78% of total resource (58% in FY19). In Q1FY20, its funding was tied up with 10 BFIs where interest rate ranged from 11% to 13.31% depending upon the financial institution. Its average cost of borrowing increased to 12.75% in Q1FY20 from 10.23% in FY19 due to increase in proportion of high interest rate borrowing. Average cost of borrowing was substantially higher than average cost of deposit of 6.43% in Q1FY20 (7.58% in FY19). Use of large portion of debt resulted in high cost of fund (i.e. 10.79% in Q1FY20) which put pressure on profitability. Out of total borrowing in Q1FY20, 30.78% is contributed by its promoter shareholder CBL. Further, it's overall gearing ratio increased to 6.79% in Q1FY20 from 6.42% in FY19.

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

As on Mid-October 2019, there were 91 MFIs in operation with total 3,753 branches all over Nepal. CLBSL has 47 branches as on Mid October, 2019. Micro Finance Industry earned Rs. 10,277 Mn interest income, Rs 4,994 Mn net interest income and Rs 1,991 Mn Net profit during Q1FY20. CLBSL has 0.46% (Rs. 47 Mn) share on interest income, 1.10% (Rs. 22 Mn) share on net interest income and 0.25% (Rs. 5 Mn) share on net profit for the same period in the industry. Further, large number of cooperatives are operating all over Nepal which provides loans and other financial services to their members with or without collateral. Due to presence of large number of micro finance and co-operatives, CLBSL is facing competition to tap the new customer and to retain the existing good consumer.

***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 MFI's perspective. Credit risk assumed by a MFI is typically higher compared to other BFIs given the weak borrower profile. Further, MFIs provide unsecured loan i.e. loan without any collateral. In case

any borrower defaults, the MFI does not have any assets backed as collateral to meet its loss, which makes the credit even riskier. As borrowing from MFIs do not require collateral and in absence of credit report from CIB, clients tend to borrow from multiple MFIs resulting to a problem of loan duplication. However, monetary policy of 2018-19 required MFIs to send credit information to CIB continuously and failing to comply the same will result in 2% additional Loan Loss Provision (LLP). Further, as per NRB norms, MFIs are allowed to lend against collateral upto 33.33% of total lending. CLBSL's percentage of collateral loan to total loan is low at 1.60% in Q1FY20 which is decreased from 2.69% in FY19.

#### ***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. A, B & C class financial institutions are required to lend 5% of their total loan to deprived sector (earlier 5%, 4.5% and 4% respectively). This regulation change is expected to impact the incremental fund availability, cost of fund, and credit growth of the MFIs.

Earlier MFIs were allowed to determine interest rate on their lending by adding up to 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. However, reduction in spread rate by 1% and maximum allowable administrative expenses by 1% in determining interest rate might restrict 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**

##### ***Strong institutional promoter***

CLBSL is subsidiary company of Civil Bank Ltd. (CBL) with 51% stake in share capital of CLBSL. CBL is "A" Class (Commercial) Bank of Nepal operating since November 2010. To support CLBSL's business, CBL has injected Rs 58 Mn capital and has provided Rs 208 Mn loan at the end of Q1FY20.

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

CLBSL has 6 members on its board which includes three directors from promoter group (all are senior management level staff of CBL), two directors from public group and one independent director. The board is chaired by Mr. Sachin Jung Rayamajhi, Chief Credit officer of CBL, who has more than 2 decades of overall banking experience. Other directors of the company have decades of experience in banking sector. Company's management team is led by CEO, Mr. Balaram Paudel who has more than 3 decades of experience in banking and microfinance sector. He has experience of ~2 decades in Agricultural Development Bank Ltd. and ~1 decade in Sanakishan Bikash Bank Ltd. CEO has been supported by other experienced management team.

***Moderate track record of operation coupled with geographical diversification of business***

CLBSL is operating since July 5, 2012. It is operating in 27 districts and 5 provinces through 47 branches as on October 17, 2019. It has opened 20 new branches during FY19 and 2 new branches during Q1FY20. It has plans to open additional 8 branches during FY20. Further expansion of branches and area of operation will lead to growth of business, diversification of operation in new geographical areas including economies of scale.

***Adequate capitalization level***

CLBSL's overall Capital Adequacy Ratio (CAR) stood at 13.05% in Q1FY20 (13.38% in FY19) which is comfortable in comparison to the minimum regulatory requirement of 8% for MFIs. Its CAR decreased significantly to 13.38% in FY19 from 20.30% in FY18 due to substantial increase in risk weighted assets (RWA) mainly by increase in loan and advances as compared to increases in capital fund by increase in reserve and surplus. Further, CAR decreased slightly to 13.05% in Q1FY20 from 13.38% in FY19 due to proportionate increase in RWA was higher than increase in capital fund. Proposed right share issue will help in further expansion of business including improvement in CAR.

***Growth in total income and net profit over the period***

CLBSL reported net profit of Rs. 16 Mn during FY19 which increased by 42.46% from Rs 11 Mn during FY18 on back of substantial increase in total income as compared to increase in interest expenses and other non-interest expenses. Total income increased by 68.97% to Rs. 162 Mn during FY19 due to increase in both interest incomes and non-interest income (mainly service charge) on the back of increase in loan and advances. Net interest income increased by 39.35% to Rs 65 Mn during FY19 due to increase in interest income was higher than interest expenses. Yield on advances decreased to 16.39% in FY19 from 17.95% in FY18.

Further, its net profit increased substantially by 84.46% to Rs 5 Mn during Q1FY20 from Rs 2 Mn during Q1FY19 on back of substantial increase in net interest income and non-interest income as compared to increase in operating expenses and provision and written off expenses. Return on Total Assets (ROTA) decreased to 1.61% in Q1FY20 from 1.87% in FY19. Interest spread rate decreased to 6.39% in Q1FY20 from 6.68% in FY19 (7.66% in FY18) due to increase in interest expense to average interest bearing liability (10.79% in Q1FY20 from 9.42% in FY19 and 8.82% in FY18).

***Considerable growth in business over the period***

CLBSL's credit portfolio grew by compounded annual growth rate (CAGR) of 81.08% (albeit low base) to Rs 1,022 Mn over last 3 years ending Mid July, 2019 (microfinance industry credit portfolio grew by CAGR of 44.93% over the same period) on the back of substantial increase in member base by increase in geographical reach through branch expansion and increase in proportion of members utilizing loan. The credit portfolio of the company has grown by 74.99% to Rs. 1,022 Mn in FY19 from Rs. 584 Mn in FY18.

Similarly, its deposit grew substantially by CAGR of 71.71% (albeit low base) to Rs. 271 Mn over last 3 years ending Mid July, 2019 (microfinance industry deposit grew by CAGR 54.40% over the same period) on back of

substantial increase in member base by increase in geographical reach through branch expansion. Its deposit grew by 62.46% to Rs 271 Mn in FY19 from Rs.167 Mn in FY18.

Further, its credit portfolio and deposit grew by 10.41% to Rs. 1,128 Mn and 14.39% to Rs 310 Mn respectively over the period of 3 months ending Q1FY20 which is higher than microfinance industry growth rate of 3.99 % and 3.18% respectively over the same period.

**Moderate Liquidity Profile**

CLBSL has moderate liquidity profile with positive cumulative mismatch over one year as on October 17, 2019. However, assets and liability show negative mismatch over 1 to 90 days and 91 to 180 days. Further, during Q1FY20, CLBSL has maintained CRR of 0.54% (0.56 % in FY19), SLR of 10.30% (11.14 % in FY19) and liquidity assets 8.66% (9.45% in FY19).

**About the Company**

CLBSL is a “D” class National Level microfinance institution incorporated on March 15, 2011 as ILFCO Micro Finance Bittiya Sanstha Ltd. (ILFCO), licensed by Nepal Rastra Bank on April 19, 2012, and started its operation from July 5, 2012. Later on April 19, 2017, its name was changed to CLBSL after Civil Bank Ltd. (CBL) acquired International Leasing and Finance Company (parent company of ILFCO) and ILFCO became subsidiary company of CBL. Currently, CBL has 51% stake in share capital of CLBSL. CLBSL is primarily engaged in providing microfinance loan based on the Joint Liability Group (JLG) model with each group consisting of minimum five members. As on October 17, 2019, it has total 29,640 members and 19,027 borrowers. It has total assets size of Rs 1,876 Mn at the end of Q1FY20 which grew by 76.98% from Rs 659 Mn at the end of FY19. Total paid up share capital of the company is Rs 114 Mn (excluding bonus share of Rs 6 Mn) as on October 17, 2019 held by promoter and public shareholders in the ratio of 60:40.

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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.