

Rating Rationale
Manjushree Finance Limited

Rating

| Facility/Instrument | Amount (Rs. In Million) | Rating ¹ | Rating Action |
|---------------------|----------------------------|--|---------------|
| Issuer Rating | NA | [CARE-NP] BB (Is) [Double B (Issuer)] | Assigned |

CARE Ratings Nepal Limited (CRNL) has assigned the issuer rating of “CARE-NP BB (Is) [Double B (Issuer)]” to Manjushree Finance Limited (MFL). Issuers with this rating are considered to offer moderate risk of default regarding timely servicing of financial obligations, in Nepal.

Detailed Rationale & Key Rating Drivers

The ratings assigned to MFL is constrained on account of weak asset quality with marginal improvement in FY20, low proportion of Current Account Savings Account (CASA) deposits, moderate portfolio concentration among top borrower groups and high concentration on top depositors, intense competition and exposure to regulatory risk related to Banking industry. The rating, however, derives strength from the track record of operation, experienced board and management team, considerable growth in loans & advances and deposits over the period, adequate capitalization level, diversified and geographical coverage through branch network in Nepal and significant increase in investment income. The ratings also derives strength from considerable growth in total income, with significant increase in non-interest income during FY20, (Unaudited, refers to the 12 months period ended Mid-July 2020) and moderate liquidity profile. The ability of the company to continue its growth momentum while maintaining asset quality and capital adequacy and ability to manage the impact of COVID-19 and any regulatory changes by Nepal Rastra Bank (NRB) would be the key rating sensitivities.

Impact of COVID-19

The global outbreak of Coronavirus disease 2019 (Covid-19) has affected Nepal as well. Government of Nepal (GoN) imposed countrywide lockdown since March 24, 2020 halting operations of most of the organizations and slowing down of the economic activities, which is likely to impact quality of company’s advances portfolio as well. Ability of the company to manage its asset quality would be key rating sensitivity. Considering, current situation, NRB in March 2020, reduced Cash Reserve Ratio (CRR) from 4% to 3% providing additional liquidity to the Banks and also has reduced Bank Rate from 6% to 5%.

Further, it has relaxed its asset classification guidelines till Mid-July 2020 whereby delays in payment of due amount or renewal of short term limits since quarter ending Mid-April 2020 doesn’t entail downgrade of such assets. Additionally, monetary policy published for the FY21 has provided additional moratorium ranging from 6 months to 2 years for different businesses according to the level of impact of the pandemic. As on Mid July 2020, the company has ~3% of its total loan portfolio in tourism sector with majority of it in Hotel

¹Complete definitions of the ratings assigned are available at www.careratingsnepal.com

industry which is one of the majorly impacted industry. As a result, in CRNL's view the credit risk profile of the company is expected to deteriorate over the medium term. Liquidity profile, resource raising ability and exposure to vulnerable asset classes and operating profiles in terms of geographies and borrower types would be critical monitorable factors in the banking sector. CRNL will continue to assess on the impact on the key business and financial parameters of banking and finance sector and shall take appropriate rating actions, if needed.

Detailed Description of the Key Rating Drivers

Key Rating Weaknesses

Weak Asset Quality, however, marginal improvement in FY20

Gross Non-performing Loan % (GNPL) was high at 3.36% at the end of FY20 though marginally improved from 3.41% in FY19 (industry average (finance companies) GNPL for FY19 was 8.8%). GNPL however increased in absolute amount to Rs. 232 Mn in FY20 from Rs 229 Mn in FY19. GNPL increased substantially during FY19 to 3.41% from 2.15% in FY18. However, MFL has healthy provision coverage ratio of 125.52% as on year end FY20. The delinquencies of more than 30 days amounted to Rs.251 Mn (3.64% of total advances) which decreased from Rs. 261 Mn (3.89% of total advance) in FY19.

Low CASA deposit ratio

MFL maintained low CASA proportion of 14.44% during FY20, which is lower than its peers and industry average of 29.90% during the same period, however, it has increased marginally from 13.57% of FY19. However, CASA deposits in absolute amount has increased over the period. CASA deposits have increased by 13.91% during FY20 over FY19.

Moderate concentration over top 20 borrowers and high concentration on top 20 depositors

Deposit concentration of top 20 institutional depositor was high at 27.60% of the total company's deposits as on July 15, 2020, which is improved from 35.36% of total deposit in FY19. Further, company has moderate concentration on top 20 single borrowers at 16.75% of total advances during FY20 which increased from 13.48% in FY19.

Competition from other Finance Companies and Bank

Currently, there are 22 finance companies operating with total 243 branches all over Nepal (based on monthly statistics published by NRB for Mid-July, 2020) out of that MFL has 11 branches. Industry (Class 'C' Banks-Finance Companies) has achieved total interest income of Rs. 10,138 Mn in FY20 with Rs. 2,793 Mn net interest incomes; MFL's share on interest income and net interest income is ~10.85% (Rs. 1100 Mn) and 13.64% (Rs 381 Mn) respectively for the same period. Despite being one of the leading finance company in the industry, it is challenging for MFL to maintain current market share and expand its business, due to high competition among bank and finance companies, existence of large number of finance companies along with

Commercial and Development bank. Competition in the interest rates is the prominent challenge in the Nepalese banking sector.

Exposure to regulatory risk related to industry

The Banking and Finance industry in Nepal is exposed to changes in the various regulatory measures issued by NRB from time to time. In past, finance companies faced pressure from NRB for capital increment to Rs. 800 Mn. NRB via its Monetary Policy has reduced the Statutory Liquidity Ratio (SLR) to 7% from earlier 8%; reduced the overdraft including personal loan of revolving nature to Rs 5 Mn from Rs.7.5 Mn; increment of CCD ratio to 85% from 80%; increment of margin lending to 70% from 65%; reduction of bank rate to 5% from 6%. Also, to relax the liquidity crisis, Cash Reserve Ratio (CRR) has been reduced to 4% (further reduced to 3% amid COVID-19) from 6%. Further, NRB through its notice dated April 28, 2020 has directed BFIs to provide rebate of 200bps in interest rate for quarter ending Mid July 2020 which made significant impact on company's profit.

Key Rating Strength

Track record of operation with experienced board and management team

Established in the year 2007; MFL has more than a decade of operational history. MFL is professionally managed company under the overall guidance of Board of Directors (BoD) led by chairman Mr. Damodar Prasad Gautam. The top and senior management team is highly experienced in their respective field of operations. The company is led by CEO, Mr. Santosh Niraula, M.A (Economics)/Chartered Accountant, who has been CEO of MFL from last 6 years. He has more than 17 years of banking experience. All the management members have wide banking experience.

Adequate capital adequacy level

MFL's overall Capital Adequacy Ratio (CAR) stood at 14.89% as on Mid July, 2020 (16.51% as on Mid July, 2019) as against regulatory requirement of 11%. Overall CAR declined during FY20 due to increase in risk weighted assets due to increase in loans and advances during the year. MFL reported CET-I of 13.99% as on Mid July 2020 as against regulatory requirement of 6%.

Geographical concentration of business

Currently, MFL is operating in 6 provinces and 8 districts of Nepal (out of 7 provinces and 77 districts of Nepal) through its 11 branches, 1 ATM terminal. As per monthly statistics published by NRB, 22 finance companies have total 243 branches, 51 ATM terminals as on Mid July, 2020.

Diversified sector wise credit portfolio distribution however higher concentration towards Construction

In FY20, portfolio distribution proportion stood at 27.84% for construction followed by 18.84% towards finance, insurance & real estate, 10.67% towards consumption loan and 9.44% towards wholesaler & retailer. MFL lent 12.05% in FY20 and 11.02% in FY19 towards productive sector (which includes agriculture sector, energy sector, tourism sector and cottage and small industries); of gross loans and advances outstanding prior

to 6 months. All these lending (i.e. priority sector, agriculture, energy & tourism sector (combined)) are within the NRB regulatory norms.

Growth in total income over the period with significant increase in non-interest income during FY20

During FY20, MFL's total income increased by 24.76% from Rs. 1,072 Mn to Rs. 1,338 Mn majorly due to increase in non-interest income. Interest income increased by 6.70% to Rs. 1,100 Mn during FY20 due to increase in advances. Net interest income increased by 6.07% to Rs.381 Mn during FY20. Further, Non-interest income increased by 478% during FY20 from Rs. 41 Mn to Rs. 238 Mn, mainly due to gain on sale of treasury bills and government bonds.

Operating expenses increased by 28.30% during FY20 mainly due to increase in employee related and office administration expenses. Its operating expenses/ average total assets increased to 2.17% in FY20 as compared to 1.90% in FY19. Impairment charge for loans and other losses decreased to Rs. 10 Mn during FY20 as against Rs. 135 Mn during FY19. As a result of significant increase in non-interest income as compared to increase in interest expenses and other non-interest expenses, MFL has reported huge increase in PAT by 284.21% to Rs.281 Mn during FY20 from Rs 73 Mn during FY19. Yield on advances decreased to 13.79% during FY20 from 15.36% during FY19 due to decline in interest rates during the year. Similarly, cost of deposit decreased to 9.29% during FY20 from 9.75% during FY19. Net Interest Margin (NIM) deteriorated to 4.00% during FY20 from 4.23% during FY19 because of lower increase in the interest income as compared to interest expenses. It's Return on Total Assets (ROTA) has been increased to 2.95% in FY20 (0.86% in FY19), due to increase in PAT.

Considerable growth in loans & advances and deposits over the period

MFL has demonstrated high growth in the loan portfolio and deposits over the period. Total loan portfolio grew by compounded annual growth rate (CAGR) of 33.66% over last 4 years ending Mid July, 2020. It grew by Y-o-Y growth rate of minimal 2.97% to Rs 6,902 Mn. in FY20 over FY19. The aggressive advances growth helped the company to increase its market share in the industry and resulting in higher interest income, however, seasoning of the incremental advances and the impact on the asset quality is yet to be tested. Similarly, MFL's deposit grew by CAGR of 33.20% over last 4 years ending Mid July, 2020. It grew by Y-o-Y growth rate of 7.07% to Rs 7,824 Mn in FY20 over FY19. MFL is one of the leading finance company in Nepal with 8.81% and 9.17% market share in terms of deposit base and loan portfolio respectively of finance industry at the end of FY20 based on monthly data published by NRB.

Moderate liquidity profile

MFL has maintained CRR of 4.13% and SLR of 9.99% as on Mid July, 2020 (4.10% and 7.55% respectively as on July 16, 2019) which is in compliance with NRB norms of 3% (4% before March 2020) and 7% respectively. Maintained SLR, CRR and Net Liquidity are within the norms of NRB.

Significant increase in investment income

During FY20, MFL has earned interest income from investment in Securities/Bonds of Rs 59 Mn (Rs.14 Mn during FY19). Further, it has significantly gained on sales of treasury bills and government bonds of Rs 201 Mn during FY20.

About the Company

Manjushree Finance Limited (MFL) is a national level class “C” finance company incorporated on June 20, 2007 in the name of Manjushree Financial Institution Ltd. which was changed to Manjushree Finance Ltd. on September 2, 2016. Major promoter of MFL is Mr. Suman Prasad Adhikari with shareholding of 9.63% as on Mid July 2020. The company reported PAT of Rs. 281 Mn on an asset size of Rs. 9,174 Mn as on July 15, 2020, it has Rs 818 Mn paid up capital which is distributed among promoter and public shareholders in the ratio of 51:49.

| | | |
|--|--|---|
| <p>Analyst Contact Mr. Rishi Ram Poudel rishi.poudel@careratingsnepal.com Tel No.: +977-01-4012628/29/30</p> | <p>Group Head Mr. Bidhan Ojha bidhan.ojha@careratingsnepal.com Tel No.: +977-01-4012628/29/30</p> | <p>Relationship Contact Mr. Sajan Goyal sajan.goyal@careratingsnepal.com Tel No.: 9818832909/+977-01-4012628/29/30</p> |
|--|--|---|

Disclaimer

CRNL’s ratings are opinions on credit quality and are not recommendations to sanction, renew, disburse or recall the concerned bank facilities or to buy, sell or hold any security. CRNL has based its ratings on information obtained from sources believed by it to be accurate and reliable. CRNL does not, however, guarantee the accuracy, adequacy or completeness of any information and is not responsible for any errors or omissions or for the results obtained from the use of such information. Most entities whose bank facilities/instruments are rated by CRNL have paid a credit rating fee, based on the amount and type of bank facilities/instruments.