

CYC Nepal Laghubitta Bittiya Sanstha Limited

Ratings

Facilities	Amount (Rs. in Million)	Ratings ¹	Rating Action
Issuer Rating	NA	CARE-NP BB- (Is) [Double B Minus Issuer]	Assigned

CARE Ratings Nepal Limited (CRNL) has assigned rating of 'CARE-NP BB- (Is)' [Double B Minus (Issuer)] to CYC Nepal Laghubitta Bittiya Sanstha Limited (CYCN). Issuers with this rating are considered to have moderate risk of default regarding timely servicing of financial obligations.

Detailed Rationale & Key Rating Drivers

The ratings assigned to CYCN is constrained by weak asset quality leading to high Gross Non-Performing Loans (GNPL) ratio, low market share in the industry, high concentration of advances towards agriculture sector and its presence in highly competitive market. The rating is also constrained by inherent risk involved in the microfinance industry and exposure to regulatory risks related to microfinance industry.

The rating, however, derives strength from experienced board members and management team, adequate level of capitalization. The ratings also factor in its improved financial risk profile in FY21 low dependence of resource mobilization on Banks & Financial Institutions (BFIs) and geographical diversification of business.

Ability of the company to continue its growth momentum while improving its asset quality and improving the Capital Adequacy Ratio and ability to manage the impact of any regulatory changes by central bank of Nepal are the key rating sensitivities.

Detailed Description of the Key Rating Drivers

Key Rating Weaknesses

Weak assets quality leading to high GNPL on back of Covid-19 pandemic impact

CYCN's asset quality stood weak reflected from high GNPL which stood at 8.23% for FY20 (FY refers to 12 months' period ended on July 15, 2020). Though GNPL of the company, improved to 4.84% in FY21 (unaudited); however, continues to remain on the higher side. Furthermore, advances under loss category has increased significantly from Rs. 35 Mn in FY20 to Rs. 56 Mn. in FY21, the same was on account of slow recovery which was impacted by pandemic induced lockdown, etc.

Significantly low market share in the industry, albeit moderate growth in business over the period

CYCN's credit portfolio increased by 57% to Rs 1,750 Mn in FY21 over FY20 and as on mid-July 2021, deposit portfolio stood at Rs. 882 Mn representing growth of around 23% over previous balance sheet date. Despite significant growth in the deposits and advances, market share of CYCN stood low as reflected from market share microfinance industry of 0.69% and 0.45% respectively. With the very low market share in the highly competitive industry, the business

¹Complete definitions of the ratings assigned are available at www.careratingsnepal.com and in other CRNL publications
*Issuer did not cooperate; Based on best available information

operations are highly susceptible to any change in business dynamics / shocks, thereby limiting its ability to absorb financial exigencies.

High concentration of advances towards agriculture sector

The credit portfolio of the company is highly concentrated towards agricultural sector. Furthermore, comparing FY20 and FY21, the advances concentration towards agricultural sector has increased from 54.79 % in FY20 to 59.21 % in FY21. The recovery in the sector is highly depends on various factors viz. climatic conditions like monsoons, drought and floods, availability of prices etc and any increase in advances under loss category is critical from analytical perspective.

Presence in highly competitive industry

As on Mid-April 2021, there were 74 MFIs in operation having 4,568 branches all over Nepal. CYCN has 29 branches as on Mid-April, 2021. CYCN has 0.45% share on interest income, 0.45% share on net interest income and 0.54% share on net profit for FY21 in the industry. Further, large number of cooperatives are operating having significant presence and same target customer base. Due to presence of large number of micro finance and co-operatives, CYCN is facing competition to tap the new customers 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 MFI is typically higher compared to banks and other types of lenders given the weak borrower profile. Furthermore, MFIs provide unsecured loan thereby recovery in case of default is low in the absence of collateral. As borrowing from MFIs do not require collateral, customers tend to borrow from multiple MFIs resulting to loan duplication without proper repayment capability assessment. As per NRB norms, MFIs are allowed to lend against collateral upto 33.33% of total lending. CYCN's percentage of collateral loan to total loan is 3.46% in FY21 which is decreased from 4.31% in FY20.

Exposure to regulatory risks related to microfinance industry

The microfinance industry 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. As per the regulations, Class A, B & C financial institutions is required to lend 5% of their total advances to deprived sector. This change in this regulation in FY2019 impacted the incremental fund availability, cost of fund, credit growth and profitability of the MFIs. As per regularity norms, 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; thereby restricting the margins of micro financial institutions. Furthermore, central bank has also capped fees at 1.5%. As a result of this, MFI cannot charge interest rate more than 15% which will restrict interest earning capacity.

Key Rating Strengths

Experienced board members and management team

CYCN is managed by 5 board members and the board is chaired by Mr Padhmanath Sharma. He has more than 17 years of experience in diversified fields. The company's management team is led by CEO, Mr. Dolindra Prasad Sharma, M.A,

has a experience of more than a decade including banking and financial sector. He has been associated with CYC in the capacity of Managing Director for last 2 years. He is supported by other experienced management team.

Adequate level of capitalization however minimum regulatory capital requirement not met

CYCN's overall Capital Adequacy Ratio (CAR) stood at 10.12% in FY20 (FY19: 9.11%) as against the minimum regulatory requirement of 8% for MFIs. Furthermore, CAR improved to 10.18% in mid-July 2021 on account of significant increment in core capital by 67%. CYCN is planning to increase the capital base (Initial Public Offering (IPO) issue of NPR 39.5 Mn) which is expected to improve the CAR and also support the expansion of business operations.

CYCN has maintained CRR 0.59% in FY20 and FY21. Further, CYCN has maintained liquid assets of 13.46% in FY21 and 13.69% in FY20 which are in align with regulatory norms.

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

CYCN's major source of funding consists of deposits from its members. The ratio of borrowing from BFIs to total resource was low 14.99% in FY21 with nil borrowings from BFI's in the preceding to previous financial year (FY20). Due to low reliance on BFI's for funding, the cost of funding is on lower side as it largely consists of source of fund from deposits. The average cost of borrowing and deposit was moderate at 8.39% and 6.93% in FY21 respectively.

Geographical diversification of business

CYCN has started its business operations in March 2019 by taking over the operations of Chartare Youva Club (FI-NGO). CYC started MFI activities from June 05, 2000 as a financial intermediary. the company is operating in 16 districts (and presence in 3 provinces through 38 branches as on August 1, 2021. Geographical diversified network base enables bank to have varied customer base and diversified portfolio and thereby reduces the risk of volatility of a single economic region.

Financial performance over the period ended FY20 and FY21

CYCN's financial performance improved during FY21 over FY20. It has reported net profit of Rs. 52 Mn during FY21 against net profit of Rs 33 Mn in FY20 mainly due to increase in interest income supported by increase in advances along with decrease in interest expense. Total income increased to Rs 229 Mn during FY21 (FY20: Rs. 183 Mn) on account of increase in interest income supported by growth in loans and advances.

The company's operating expenses / average total assets stood at 4.32% in FY21 showing improvement from 6.16% in FY20 mainly on account of economies of scale. Net interest margin (NIM) decreased to 7.20% in FY21 from 8.54% in FY20 on account of increase in expenses. Decline in NIM also led to deterioration in Return on Total Assets (ROTA) to 2.66% in FY21 from 2.74% in FY20.

About the Company

CYC Nepal Laghubitta Bittiya Sanstha Limited (CYCN) is a "D" class National Level microfinance institution. It was incorporated on July 01, 2018, and commenced operations in March 2019. It is promoted by individuals from different background and is primarily engaged in providing microfinance loan based on the Joint Liability Group (JLG) model with

each group consisting of minimum five members. In FY 21, the company acquired Shaligram Laghubitta Bittiya Sanstha Limited in share swapping ratio of 1:0.72.

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