

## Adarsha Laghubitta Bittiya Sanstha Limited

### Ratings

Facilities	Amount (Rs. in Million)	Rating <sup>1</sup>	Rating Action
Issuer Rating	NA	<b>CARE-NP B+ (Is)</b> <b>[Single B Plus Issuer]</b>	Assigned

CARE Ratings Nepal Limited (CRNL) has assigned rating of 'CARE-NP B+ (Is)' to Adarsha Laghubitta Bittiya Sanstha Limited (ALBS). Issuers with this rating are considered to have high risk of default regarding timely servicing of financial obligations.

### Detailed Rationale & Key Rating Drivers

The ratings assigned to ALBS is constrained by small scale of operations, business operations geographically concentrated to single province, high concentration of advances towards service sector and its presence in highly competitive market with very low market share of the industry. The rating is also constrained by thin capital cushion, declining deposit ratio, 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, moderate growth in business and moderate assets quality.

*Ability of the company to continue its growth momentum while maintaining its asset quality & 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

#### ***Small scale of operations although growing and low profitability margins***

The scale of operations has remained low marked by a total operating income and net profit of Rs. 32 Mn and Rs. 1 Mn respectively during FY21 (Unaudited, FY refers to 12 months' period ending mid-July). Furthermore, the company's net-worth base was relatively small at Rs. 20 Mn as on July 15, 2021. The small scale limits the company's financial flexibility in times of stress and deprives it from scale benefits. Net profit remained at low level mainly due to increase in operating expenses on account of increase in branches. However, the risk is partially mitigated by the fact that the scale of operations has been growing continuously. For the period FY19-FY21, ALBS's total operating income grew from Rs. 18 Mn to Rs. 32 Mn reflecting a compounded annual growth rate (CAGR) of 23%. The growth in TOI was supported by increase in interest income due to growth in loans and advances portfolio along with growth in non-interest income. Loan and advances increased due to increase in percentage of members utilizing loan to 61% in FY21 from 56% in FY20 and increase in number of borrowers by 28%.

The company's operating expenses / average total assets remained at higher side ~9% in last two years ending FY21 due to small scale of operations and the company suffers on account of lack of economies of scales. Return on Total

<sup>1</sup>Complete definitions of the ratings assigned are available at [www.careratingsnepal.com](http://www.careratingsnepal.com) and in other CRNL publications

Assets (ROTA) also stood low at 0.51% in FY21 and showing deterioration from 0.71% in FY20 mainly due to increase in branches with high initial operating cost. Also, interest spread rate decreased to 8.44% in FY21 from 11.89% in FY20 due to restriction imposed by central bank towards interest ceiling of 15% on lending from FY21 onwards. Further, Net Interest Margin (NIM) ratio decreased to 7.77% in FY21 from 9.18% in FY20.

#### ***Geographically concentrated operations***

ALBS has short track of operations and commenced operations in May 2018 by taking over the operations of Mahila Adarsha Sewa Kendra (Mahila). Mahila started financial activities from March 16, 1989 as a financial intermediary. ALBS is operating in 5 districts (out of approved 13 districts) through 7 branches as on July 15, 2021. Being a province level microfinance, the expansion is limited to approved 13 districts compare to national level microfinance. Due to geographically concentrated business the customer base and portfolio of the bank is not diversified which increases the risk of volatility of a single economic region.

#### ***High concentration of advances towards service sector***

The credit portfolio of the company is highly concentrated towards service sector which includes retail business (0.90%), restaurants (0.86%) and other services (58.75%) being financing to different business like saloon, taxi service, rice & flour mill, tractor funding and other small business. However, the advances concentration towards service sector has decreased from 68.65% in FY20 to 60.52% in FY21. This remains a concern amid the disruption in business environment created by Covid-19 induced externalities and its likely impact on the asset's quality.

#### ***Declining deposit ratio with increase in dependence on Banks & Financial Institutions (BFIs) borrowings***

ALBS's major source of funding consists of deposits from its members. The ratio of deposits to total resource decreased to 49.40% in FY21 from 70.97% in FY20. Also, the ratio of borrowing from BFIs to total resource has increased to 41.02% in FY21 which was 14.72% in FY20. Due to decrease in interest rate on deposits and borrowings in FY21, cost of funding also decreased from 8.57% in FY20 to 6.30% in FY21. Its average cost of borrowings was 6.97% in FY21 which is higher than its cost of deposit of 5.95%.

#### ***Thin capital cushion with minimum regulatory requirement not being met***

ALBS's overall Capital Adequacy Ratio (CAR) stood at 8.57% in FY21 (FY20: 12.91%) which is just above the minimum regulatory requirement of 8% for microfinance institutions (MFIs). CAR decreased significantly in FY21 due to substantial increase in risk weighted assets as compared to increase in total capital. It is expected that the capital base of the company would increase as the company is planning an IPO issue of Rs. 6 Mn to increase its capital base to Rs 20 Mn. With the low base of own funds, its operations are highly susceptible to any business shock, thereby limiting its ability to absorb losses or financial exigencies.

#### ***Low market share in highly competitive industry***

ALBS's credit portfolio increased by 84% to Rs 231 Mn. in FY21 over FY20. Also, its deposit grew by 9.43% to Rs 119 Mn in FY21 over FY20 due to increase in members. Despite significant growth in the deposits and advances, market share of ALBS stood low as reflected from market share microfinance industry of 0.09% and 0.06% respectively as on July 15, 2021. As on Mid-July 2021, there were 70 MFIs in operation having 4,685 branches all over Nepal. 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, ALBS 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 MFIs 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, clients 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. ALBS's percentage of collateral loan to total loan is 10.01% in FY21 which is increased from 2.63% 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 regulations, Class A, B & C financial institutions is required to lend 5% of their total advances to deprived sector. Also, monetary policy has capped interest rate upto 15% on lending and fees at 1.5%, which will restrict interest earning capacity. Also, NRB has fixed loan ceiling for new borrowers of Rs. 3 lakh to unsecured loans and Rs. 7 lakh to secured loans. And, Rs. 15 lakh to old borrowers whose loan category is in pass during last two years.

#### **Key Rating Strengths**

##### ***Experienced board members and management team with backup from strong institutional promoter***

ALBS is managed by 5 board members and the board is chaired by Ms. Surya Kumari Shrestha. She has more than 2.5 decades of experience in diversified fields. The company's management team is led by CEO, Mr. Rajesh Sharma, MBA, has more than 4 decades of experience in bank and finance sector. He has associated with the banking and finance sector in different capacities which includes senior level positions also. He is supported by other experienced management team and institutional promoter Garima Bikash Bank Limited holding 17% of total capital as on July 15, 2021.

##### ***Moderate assets quality and liquidity profile***

ALBS's asset quality stood moderate reflected from Gross Non-Performing Loans (GNPL) which stood at 1.64% for FY20. Also GNPL of the company, improved to 1.33% in FY21 (Unaudited) due to subsequent recovery.

ALBS has maintained CRR 0.53% in FY20 and 0.54% in FY21. Further, ALBS has maintained liquid assets of 12.75% in FY21 and 26.81% in FY20 which are in align with regulatory norms which mitigate risk of company's ability to face financial hardships and additional regulator penal charges.

#### **About the Company**

Adarsha Laghubitta Bittiya Sanstha Limited (ALBS) is a "D" class Province Level microfinance institution with approval of operation in only Bagmati Province through 13 districts. It was incorporated on May 23, 2018, and commenced operations from January 2019. It is promoted by institution and 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.

## Contact Us

### Analyst

Mr. Nibesh Manandhar  
+977-01-4012629  
Nibesh.manandhar@careratingsnepal.com

### Senior Analyst

Ms. Shalini Sanghai  
+977-01-4012629  
shalini.sanghai@careratingsnepal.com

### Relationship Contact

Achin Nirwani  
+977-9818832909  
achin.nirwani@careratingsnepal.com

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