

Shrijanshil Laghubitta Bittiya Sanstha Limited

Ratings

Facilities	Amount (Rs. Million)	Rating 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 Shrijanshil Laghubitta Bittiya Sanstha Limited (SLBL). 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 SLBL is constrained by limited experience of board members in the finance sector, declining deposit ratio with dependence on Banks and Financial Institutions (BFIs) borrowings, competition from other Micro Finance Institutions (MFIs) and Co-operatives and inherent risk involved in the microfinance industry. The rating is also constrained by exposure to regulatory risks related to microfinance industry and concentrated credit portfolio.

The rating, however, derives strength from backup of strong institutional promoter and long track record of operations. The rating also factors in moderate capitalization level, asset quality and liquidity profile and improved financial performance leading to increased capital cushion over minimum regulatory requirements during FY21 (audited; refers to the twelve-month period ended mid-July 2021) and H1FY22 (unaudited; refers to the six-month period ended mid-January 2022).

Going forward, the ability of the company to continue its growth momentum with improving asset quality and capital adequacy ratio and its ability to manage the impact of any regulatory changes will be the key rating sensitivities.

Detailed Description of the Key Rating Drivers

Key Rating Weaknesses

Board members with limited relevant experience albeit support from the strong institutional investors

SLBL has five members on its board and is chaired by Mr. Shyam Kumar Shrestha, with experience of over a decade in diversified sectors. The company's management team is led by Chief Executive Officer Mr. Batuk Shamsher Shrestha, who has experience of more than a decade and was associated with non-government organizations. The board is supported by other experienced management team members, with over a decade of experience in microfinance sector, to look after various functions in the company.

At the end of FY21, 81% of current paid up capital of SLBL is held by institutional promoters namely Srijana Samudayik Bikas Kendra and NIC Asia Bank Limited [CARE-NP A-(Is)]. NIC Asia Bank is "A Class" Commercial Bank of Nepal operating for last more than 2 decades. NIC Asia Bank having its established presence in banking industry gives advantage to SLBL in respect of any management and operational assistance.

Declining deposit ratio with increased dependence on Banks and Financial Institutions (BFIs) borrowings

SLBL's major source of funding consists of deposits from its members and borrowings from banks and financial institutions. The ratio of deposits to total resource decreased to 31.64% in FY21 from 41.91% in FY20. Also, the ratio of borrowing from BFIs to total resource has increased to 50.48% in FY21 from 36.88% in FY20. Higher dependence on BFI borrowings increases the cost of funds for the MFI, putting additional pressure on its profitability. Cost of funding decreased to 6.10% in FY21 from 9.75% in FY20. Its average cost of borrowings was 7.74% in FY21 which is higher than its cost of deposit of 5.05%. Furthermore, the ratio

¹Complete definition of the ratings assigned are available at www.careratingsnepal.com and other CARE publications

of deposits to total resource decreased to 30.88% in 9MFY22 from 31.64% in FY21. However, the ratio of borrowings from BFIs to total resource has decreased to 46.65% in 9MFY22 from 50.48% in FY21.

Competition from other MFIs and Co-operatives

As on mid-January 2022, there were 67 MFIs in operations with total of 5,046 branches in Nepal. SLBL had 33 branches as on mid-January, 2022. Micro Finance Industry earned Rs. 41,688 Mn interest income, Rs 10,759 Mn net interest income and Rs 10,669 Mn Net profit during FY21. SLBL had 0.59% (Rs. 245 Mn) share on interest income for the same period in the industry. Furthermore, large number of cooperatives are operating all over Nepal which provide loans and other financial services to their members with or without collateral. Due to presence of large number of microfinance institutions and co-operatives, SLBL faces competition to tap in a new customer base and to retain the existing customer.

Inherent risk involved in the microfinance industry

Micro Finance Institutions 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, majority of MFI's loan portfolio is unsecured in nature means advances not secured by adequate collateral. In case any borrower defaults, the MFI does not have any asset backed as collateral to meet its loss, which makes the credit even riskier. As borrowing from MFIs do not usually require collateral, clients tend to borrow from multiple MFIs resulting to problem of loan duplication. As per NRB norms, MFIs are allowed to lend against collateral up to 33.33% of total lending. SLBL's percentage of collateral loan is 16.29% of total lending in FY21 and 20.38% in H1FY22 which has increased from 9.01% in FY20.

Sector wise credit portfolio distribution, however high concentration towards service and agriculture sector

The credit portfolio of SLBL is highly concentrated towards service and agricultural sector. In FY21 the advances were concentrated towards service sector with 50.10% exposure, however, decreased to 46.22% in H1FY22. Advances towards agriculture sector stood at 49.77% in FY21 which increased to 53.72% in H1FY22. The recovery in the agriculture sector highly depends on various factors such as climatic conditions like monsoons, drought and floods, availability of prices etc. Any adverse climatic conditions or other unfavorable factors which might have an impact on crop production or sales would adversely affect repayment capacity of the borrowers and put added stress on the MFI's asset quality.

Key Rating Strengths

Moderate capitalization levels with modest, albeit increasing, cushion over minimum regulatory requirement

SLBL's Tier I and overall Capital Adequacy Ratio (CAR) stood at 7.76% and 9.01% respectively at the end of FY21 over the minimum regulatory requirement of 4% and 8%, respectively, for microfinance institutions (MFIs). Overall CAR improved to 9.89% at the end of H1FY22, which is expected to improve after completion of the proposed public issuance of around Rs. 39.30 Mn.

Improved financial performance marked by sustained growth in advances and income in FY21 and H1FY22

SLBL's credit portfolio grew by 42.71% year on year (y-o-y) to Rs. 1,897 Mn in FY21. During H1FY22, credit portfolio grew by 21.19% over FY21 to Rs. 2,299 Mn. SLBL has 0.52% market share each in terms of deposit base and loan portfolio, of the microfinance industry in H1FY22. During FY21, SLBL's total income increased to Rs. 280 Mn from Rs. 221 Mn during FY20. Interest income improved by 16.93% y-o-y to Rs. 245 Mn in FY21 due to the growth in advances by 42.71% to Rs. 1,897 Mn in FY21. Consequently, net interest income increased to Rs. 150 Mn during FY21 from Rs. 89 Mn during FY20. Overall financial performance has improved backed by increasing scale of operations. Addition of new branches is likely to help continue this growth trend for SLBL over the medium term.

Moderate asset quality and liquidity profile

SLBL has a moderate asset quality profile marked by Gross Non-Performing Loans (GNPL) ratio of 2.16% of total loans and advances as on mid-July 2021. GNPL ratio improved to 2.08% as on mid-January 2022 aided by accelerated recoveries. Furthermore, more than 30-day delinquency of SLBL was also moderate at 2.67% of total advances as on July 15, 2021. This has increased slightly to 2.72% as on January 14, 2022 on account of slow recovery during H1FY22, majorly amid the third wave of the covid-19 pandemic. Furthermore, given the lingering impact of the pandemic, deterioration in asset quality in a short span remains a risk and hence tight monitoring of the asset quality will remain critical for the company's financial health going forward. As on mid-January 2022, SLBL has moderate liquidity profile with positive cumulative mismatch in its asset and liabilities. The CRR of SLBL has been maintained at 0.84% in FY21 and 0.53% in H1FY22 against minimum requirement of 0.5%. Further, SLBL has maintained net liquid asset ratio of 16.10% in FY21 and 16.77% in H1FY22 against the minimum regulatory requirement 2.5% for MFIs not taking public deposits.

Geographical diversification of business

The MFI is operational in 10 districts of Nepal spanning 3 provinces through 33 branches as on mid-Jan 2022. Geographical diversified network base enables SLBL to have varied customer base and diversified portfolio and thereby reduces the risk of volatility of a single economic region.

About the Company

SLBL is a "D" class National Level microfinance institution. It was incorporated on October 14, 2018, licensed by Nepal Rastra Bank on February 15, 2019 and commenced operations on March 15, 2019. Thereafter, SLBL took over the microfinance business of Srijana Samudayik Bikas Kendra, an NGO established in 2003 and operating as a financial intermediary in Nepal. SLBL is primarily engaged in providing microfinance loan based on the Joint Liability Group (JLG) model with each group consisting of minimum five members.

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