CareEdge RATINGS

Dhaulagiri Laghubitta Bittiya Sanstha Limited

Rating

Facilities	Amount (Rs. in Million)	Rating[1]	Rating Action
Issuer Rating	**NA**	**CARE-NP B+ (Is) [Single B Plus (Issuer)]**	**Reaffirmed**

CARE Ratings Nepal Limited (CRNL) has reaffirmed the issuer rating of 'CARE B+ (Is)' assigned to Dhaulagiri Laghubitta Bittiya Sanstha Limited (DLBS). Issuers with this rating are considered to offer high risk of default regarding timely servicing of financial obligations, in Nepal.

Detailed Rationale & Key Rating Drivers

The rating assigned to DLBS is constrained by subdued financial performance resulting in net losses in FY23 (Unaudited; refers to the twelve-month period ending mid-July) and Q1FY24 (Unaudited; refers to the three-month period ending mid-October) along with weak asset quality and increased dependence on borrowing from BFIs. The rating also factors in high concentration of advances towards agriculture sector, competition from other MFIs and co-operatives, inherent risk involved in the microfinance industry and exposure to regulatory risks related to microfinance industry. The rating, however, continues to derive strength from experienced directors and management team and support from the institutional investor as well as moderate capitalization and liquidity profile. The rating also factors in growing geographic diversification of DLBS post-merger with Khaptad Laghubitta Bittiya Sanstha Limited (KLBS).

Going forward, the ability of the company to manage growth along with improvement in profitability while maintaining asset quality and capitalization levels will remain the key rating sensitivities.

Detailed Description of the Key Rating Drivers

Key Rating Weaknesses

Declining financial performance trend in FY23, likely to sustain over near-term

During FY23, DLBS's total income increased by 26.27% year-on-year to Rs. 305 Mn supported by growth in loans and advances and increased non-interest income. Interest income increased by 24.20% year-on-year to Rs. 243 Mn. However, it was set off by even higher increase in interest expense by 70.68% to Rs. 160 Mn. Interest spread rate decreased to 4.14% in FY23 from 7.25% in FY22 due to substantial increase in cost of borrowings amid tight liquidity in the banking sector. Consequently, DLBS's net interest income declined to Rs. 83 Mn in FY23 from Rs. 102 Mn in FY22. Decline in net interest income along with increase in operating expenses following the merger with KLBS led to net losses of Rs. 11 Mn in FY23 compared to net profit of Rs. 15 Mn in FY22. Although income has sustained in Q1FY24, profitability has declined further, with the company reporting quarterly net loss of Rs. 21 Mn amid squeezed net interest margin.

Weak asset quality

DLBS's asset quality is marked by Gross Non-Performing Loan (GNPL) of 4.99% of total loans and advances as on mid-October 2023, compared to 4.07% as on mid-July 2023. Despite being better than the industry average of 4.85% at the end of FY23, the GNPL is still on a higher side. Also, more than 30-days overdue advances increased to 6.59% at the end of Q1FY24 from 4.56% at the end of FY23. Amid a difficult operating environment and industrywide recovery challenges, the ability of DLBS to improve collection leading to better asset quality would remain critical from analytical perspective.

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

Increasing dependence on borrowings from Bank and Financial Institutions (BFIs)

DLBS's major sources of funding consist of deposits from members and borrowings from BFIs. The ratio of its deposits to total resources declined to 36.33% as on mid-July 2023 from 42.30% as on mid-July 2022. Consequently, the ratio of borrowings from BFIs to total resources stood high at 43.38% as on mid-July 2023, increasing from 39.47% as on mid-July 2022. This ratio further increased to 48.43% at the end of Q1FY24. Increased dependence on BFI borrowings leads to higher cost of funding for the MFI, which could result in squeezed margins.

Higher lending concentration towards agriculture sector

DLBS's credit portfolio is highly concentrated towards agricultural sector with 52.99% of total lending towards the agriculture sector at the end of FY23 (PY: 56.67%), followed by 38.01% towards service industry (PY: 41.52%), and 4.86% towards small and cottage industry (PY: 0.68%). The recovery in the agriculture sector highly depends on factors like climatic conditions, droughts 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.

Competition from other MFIs and co-operatives leading to low market share in the industry

As on mid-July 2023, there were 57 MFIs in operation with 5,073 branches all over Nepal, among which DLBS had 55 branches. During FY23, the microfinance industry earned Rs. 61,707 Mn interest income and Rs. 24,741 Mn net interest income. Out of this, DLBS had 0.39% share (Rs. 243 Mn) on interest income and 0.34% share (Rs. 83 Mn) on net interest income (PY: 0.32% and 0.34%, respectively). Likewise, the MFI had 0.42% (Rs. 708 Mn) and 0.40% (Rs. 1,734 Mn) market share in terms of deposit base and loan portfolio, respectively, of the microfinance industry at the end of FY23 (PY: 0.41% and 0.31%). With a low market share in the highly competitive industry, DLBS's business operations are highly susceptible to any change in business dynamics/ shock, thereby limiting its ability to absorb financial exigencies. Furthermore, cooperatives are operating all over Nepal which provide loans and other financial services to their members with or without collateral. So, presence of large number of microfinance institutions and co-operatives creates competition for DLBS to tap new customers and to retain the existing good ones.

Inherent risk involved in the microfinance industry

MFIs are prone to credit risk which is directly related to the portfolio of the institution and is one of the most significant risks from a MFI's perspective. Credit risk assumed by an MFI is typically higher compared to other banks and lenders given its weak borrower profile. Furthermore, MFIs majorly provide unsecured loans i.e. loans without any collateral. In case any borrower defaults, the MFIs do not have any assets backed as collateral to meet its losses, which makes the credit even riskier. As borrowing from MFIs do not require collateral, clients tend to borrow from multiple MFIs resulting in the problem of loan duplication. As per NRB norms, MFIs are allowed to lend up to 33.33% of total lending against collateral. DLBS's percentage of non-collateral loan to total loan was 89.98% at the end of FY23 (PY: 90.33%), which is on the higher side due to the company's focus on providing loan to deprived group of borrowers.

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, A, B & C class financial institutions have to lend 5%, 4.5% and 4%, respectively, of their total loans to the deprived sector, a major part of which is generally routed through microfinance institutions. Furthermore, NRB has capped the interest rates of MFIs at 15% and fees at 1.5% while scrapping the interest rate spread cap of 9%, which has tightened their profitability due to restriction in interest earning capacity, particularly during periods of high interest rates. Also, NRB has fixed loan ceiling for new borrowers at Rs. 3 lakhs for unsecured loans, Rs. 7 lakhs for secured loans, and Rs. 15 lakhs for old borrowers whose loan is in pass category during last two years.

Key Rating Strengths

Experienced board members and management team along with support from the institutional investor

DLBS has five board members with the board chaired by Mr. Ishworlal Rajbhandari, who has more than 23 years of experience in diverse fields, including the chairmanship of Dhaulagiri Community Resource Development Center (DCRDC). Director Suman Prasad Shrestha was the chairman of KLBS for four years and has been the founder of Harvest Tours and Travels for 18 years. Other directors of the company also have long track record of experience in DCRDC and other organizations. The company's management team is led by CEO Mr. Suresh Bahadur Bam.

As on July 16, 2023, Prabhu Bank Limited (PRVU) [CARE-NP BBB (Credit Watch with Negative Implications)] held 11.27% of the total shares of the company. PRVU, being an established "A" class commercial bank of Nepal, provides advantage to DLBS with regard to managerial and operational assistances.

Moderate capitalization and liquidity profile

DLBS's Tier I and overall Capital Adequacy Ratio (CAR) stood at 8.97% and 9.70%, respectively, as on mid-July 2023, up from 8.37% and 8.97% as on mid-July 2022, against the minimum regulatory requirement of 4% and 8% for MFIs. However, DLBS's Tier I and overall CAR declined to 8.05% and 8.74%, respectively, at the end of Q1FY24. Adequate cushion in the capitalization levels would put the MFI in a better position to absorb any losses, should they materialize, especially given the uncertainty surrounding credit recovery. So, DLBS's ability to maintain adequate cushion in the capital adequacy ratios remains critical for its solvency and growth prospect. Besides, its liquidity profile at the end of FY23 remained moderate with CRR of 0.52% against minimum regulatory requirement of 0.50% and net liquid asset ratio of 11.58% against the requirement 2.50% for MFIs not taking public deposits.

Growing geographical diversification of business with long track record of operation

DLBS started its operations on February 13, 2019 by taking over the microcredit operations of DCRDC, which started MFI activities as a financial intermediary in 2001. DLBS is operating in 24 districts and five provinces through 55 branches as on July 16, 2023. Following the merger with KLBS, the MFI added 11 new branches and now also serves the Sudurpaschim Province. Along with increase in its geographical reach, its member base grew to 38,629 in FY23 from 35,585 members in FY22. Further expansion of branches as well as area of operation could lead to growth of business, diversification of operations, and economies of scale.

About the Company

Dhaulagiri Laghubitta Bittiya Sanstha Limited (DLBS) is a "D" class national level microfinance institution. It was incorporated on July 2018 and commenced operations in February 2019. DLBS entered into merger with Khaptad Laghubitta Bittiya Sanstha Limited (KLBS) in the swap ratio of 1:0.75, starting joint operations in July 2023. The company is primarily engaged in providing microfinance loans based on the Joint Liability Group (JLG) model with each group consisting of minimum five members.

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