

Wean Nepal Laghubitta Bittiya Sanstha Limited

Rating

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

CARE Ratings Nepal Limited (CRNL) has assigned the issuer rating of CARE-NP B (Is) to Wean Nepal Laghubitta Bittiya Sanstha (WNLB). 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 WNLB is constrained by minimum buffer in overall Capital Adequacy Ratio (CAR) of the MFI over the regulatory requirement in FY23 (Audited; FY refers to the twelve-month period ending mid-July). Overall CAR has further declined in H1FY24 (Unaudited; H1 refers to the six-month period ending mid-January) amid economic slowdown. The rating factors in its weak financial performance marked by net losses in FY23, presence in a highly competitive market with low market share of the industry. The rating also takes into account declining deposit ratio, high dependence on bank borrowings, concentration of borrowings towards agricultural sector, geographical concentration of business, inherent risk involved in the microfinance industry and exposure to regulatory risks related to microfinance industry (MFI).

The rating, however, derives strength from experienced board members and management team, better than industry average asset quality in H1FY24 and moderate liquidity profile of the company.

Going forward, the ability of the company to manage growth along with improvement in financial profile and capital adequacy while maintaining asset quality will remain the key rating sensitivities.

Detailed Description of the Key Rating Drivers

Key Rating Weaknesses

Thin capitalization levels

WNLB's overall Capital Adequacy Ratio (CAR) stood at 8.21% (FY23: 8.66%) as on mid- January 2024 with very thin cushion over the minimum regulatory requirement of 8% for MFIs (microfinance institutions), declining from 10.52% as on mid-July 2022. CAR remains substantially lower than the industry average of ~13% as on mid-July 2023. Tier I ratio stood at 7.7% as on mid-January, 2024 against the regulatory requirement of 4% (FY23: 8.1%). Lower capitalization levels could limit the MFI's ability to absorb losses, should they materialize, especially given the increasing uncertainty surrounding credit recovery. The company's ability to maintain adequate cushion in the capital adequacy ratios will remain critical for its solvency and growth prospect going forward.

Weak financial performance marked by net losses in FY23 with geographical concentration

During FY23, WNLB's total income decreased by ~14% to Rs. 117 Mn, with decrease in interest income by ~15% year-on-year to Rs. 110 Mn in FY23. WNLB's credit portfolio contracted by ~13% year-on-year to Rs. 753 Mn in FY23. Consequently, net interest income decreased by 66.67% to Rs. 16 Mn during FY23 due to increased interest expenses amid increased cost of borrowings coupled with decline in total income. The company incurred net losses of Rs. 4 Mn in FY23 (PAT: 0). WNLB has 0.11% and 0.17% market share in terms of deposit base and loan portfolio respectively of microfinance industry at FY23 end. Its near-term financial performance is likely to remain impacted by the increasing stress to maintain its asset quality observed in overall industry amid economic slowdown. The MFI is operational in 13 districts of Nepal spanning Bagmati Province through 21 branches

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

as on mid-January 2024. Geographically concentrated network base weakens the company's ability to diversify its credit portfolio and thereby increases the risk of volatility of a single economic region.

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

WNLB'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 declined to 18.07% as on mid-January 2024 from 21.30% as on mid-July 2023 (FY22: 18.29%). Also, the ratio of borrowing from BFIs to total resource has decreased to 65.20% in FY23 from 69.07% in FY22 which has further decreased to 50.86% in H1FY24. Although borrowings from bank remained on declining trend in H1FY24, it is still high. High dependence of BFI borrowings will lead to higher cost of funding for the MFI which could lead to squeezed margins for MFIs, which have to abide by regulatory ceiling of 15% for their advances. WNLB's average overall cost of funding increased to 8.07% during FY23 compared to 8.04% in previous year.

Competition from other MFIs and Co-operatives

As on mid-July 2023, there were 57 MFIs in operation with total of more than 5,073 branches in Nepal. WNLB had 21 branches as on mid-July 2023. Micro Finance Industry earned Rs. 61,707 Mn interest income, Rs. 24,741 Mn net interest income and Rs. 4,130 Mn net profit as on mid-July 2023 WNLB has 0.20% (Rs. 110 Mn) share on interest income, 0.07% (Rs. 16 Mn) share on net interest income and 0.35% (Rs. 15 Mn) share on net profit for the same period in the industry. Furthermore, large number of cooperatives (National and Provincial level) 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 micro finance institutions and co-operatives, WNLB is facing competition to tap the new customer 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 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. WNLB's percentage of non-collateral loan to total loan was 86.85% at the end of FY23 (PY: 86.55%), 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 with backup from strong institutional promoter**

WNLB has been managed by seven experienced board members under the chairmanship of Dr. Madan Gopal Shrestha who is the President and Founder of 'Friends of Sankhu'. He is also the Associate Professor at Padma Kanya Campus. Likewise, the company's management team is led by Chief Executive Officer (CEO), Mr. Jeevan Khanal, who has more than 15 years of experience in microfinance sector. He has worked at Managerial position at different Microfinance in Nepal and he has been CEO at WNLB since last 3 months. He is supported by other experienced management team to look after various functions in the company.

Better than industry average asset quality in H1FY24

WNLB has a moderate asset quality marked by Gross Non-Performing Loans (GNPL) ratio of 2.61% as on H1FY24, which improved from 5.93% at FY23 end. GNPL stood better than the industry average of 7.49% in H1FY24. More than 30-day delinquency of WNLB stood at 14.62% of total advances as on mid-July 2023 compared to 11.24% as on mid-July 2022, with slight improvement in H1FY24 at 11.37%. However, any slippages in asset quality could materially impact its overall credit risk profile and its requirement for increased provisioning, which is likely to subdue its profitability and capitalization indicators in FY24. The company's ability to improve its asset quality amid stressed environment scenario will remain a key monitorable aspect.

Moderate liquidity profile

The Cash Reserve Ratio of WNLB has been maintained at 0.76% each at the end of FY23 and H1FY24 against minimum requirement of 0.50%. WNLB has maintained net liquid asset ratio of 31.26% and 37.72% respectively in FY23 and H1FY24 against the minimum regulatory requirement 2.50% for MFIs not taking public deposits, which is in line with NRB norms.

About the Company

Wean Nepal Laghubitta Bittiya Sanstha Limited (WNLB) is a "D" class microfinance institution incorporated on December 01, 2013, licensed by Nepal Rastra Bank on August 06, 2014 and commenced operations on November 24, 2014. WNLB 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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