

Rating Rationale

Swadeshi Laghubitta Bittiya Sanstha Limited

Rating/Grading

Facility/Instrument	Amount (Rs. In Million)	Rating/Grading	Rating Action
Rights Share Issue	115	CARE-NP IPO Grade 4 [IPO Grade Four]	Assigned

The explanatory notes regarding the Rating/Grading symbols of CARE Ratings Nepal Limited (CRNL) are attached as Annexure I

CRNL has assigned grading of ‘CARE-NP IPO Grade 4’ to the proposed Rights Share Issue of Swadeshi Laghubitta Bittiya Sanstha Limited (SLBSL). ‘CARE-NP IPO Grade 4’ indicates below average fundamentals. CRNL assigns IPO grades on a scale of Grade 1 to Grade 5, with Grade 1 indicating strong fundamentals and Grade 5 indicating poor fundamentals. CRNL’s IPO grading is an opinion on the fundamentals of the issuer. The grade assigned to any individual issue represents a relative assessment of the ‘fundamentals’ of the issuer. SLBSL proposes a 100% rights share issue of 1.15 million equity shares of face value of Rs.100 each at par aggregating Rs.115 million.

Detailed Rationale & Key Rating/Grading Drivers

The grading is constrained by limited track record & small scale of operations of SLBSL, resource profile highly dependent on banks and financial institutions borrowings, exposure to the regulatory risks related to the microfinance industry, the inherent risk involved in the microfinance business including unsecured lending and increasing trend in Non-Performing Loans (NPLs). The grading is also constrained by subdued performance during Q1FY18 (UA). However, the grading draws strength from the experience of the directors and management team, considerable growth in Assets Under Management (AUM), total income and net profit over the period, healthy Capital Adequacy Ratio (CAR) and adequate geographical reach.

Ability of the company to scale up the operations while maintaining the capital adequacy levels, asset quality and geographical diversification would be the key rating sensitivities.

Detailed Description of the Key Rating/Grading Drivers

Key Rating Weakness

Resource profile dependent on banks and financial institutions borrowings

The major source of external funding for SLBSL has been borrowings from banks and financial institutions. The ratio of bank borrowing to total resources was around 69% as on July 15, 2017 (FY17) and 70% as on Oct 17, 2017 (UA, Q1FY18) which is on a high side although it has improved from FY16 level of 78%. As on July 15, 2017, SLBSL borrowed money from various banks and financial institutions at the interest rate ranges from 9% to 12% whereas on the deposits the interest rate ranges from 6% to 10%. During FY17, SLBSL’s interest expenses

increased by 189% which is due to increase in the borrowings & deposits and also due to increase in cost of funds which was 7.15% and 4.73% during FY17 and FY16 respectively. Despite substantial increase in total income by 87%, the profits are half in absolute terms in QIFY18 in comparison with profits during QIFY17 mainly due to increase in the cost of funds and provision for possible losses. Tightening liquidity in banking sector during the end of FY17 resulted in increased cost of funds for banking sector in Nepal.

Increase in Non-Performing Loans (NPLs)

The NPL ratio of SLBSL was at 1.24% as on mid July 2017, which increased to 1.80% on mid October 2017 on back of aggressive lending in the past and absence of credit report from Credit Information Bureau.

Exposure to regulatory risk related to microfinance industry

The microfinance industry in Nepal is exposed to changes in the various regulatory measures issued by NRB from time to time. As per the earlier regulations, the Banks and Financial Institutions (BFIs) were required to extend 5% of their total loans towards deprived sector, either directly or through microfinance companies. However, Monetary Policy of 2016-17, has changed the guidelines and instructed the commercial banks to directly lend 2% out of their total deprived sector lending requirements of 5%. This regulation change is expected to impact the incremental fund availability to MFIs, cost of fund, credit growth and profitability of the MFIs. Further, as per the NRB directions, the MFIs to maintain maximum of 7% spread in excess to their cost of fund while charging interest on loans to the borrowers limiting the interest earning capacity of the MFIs.

Key Rating Strengths

Experienced board and management team

The board of SLBSL consists of four directors including one independent director, led by Mr. Lal Mani Joshi who is the chairman of the company and has more than 36 years of experience in board with various commercial banks, Ministry of Finance, Ministry of Housing and Urban Poverty Alleviation, in Government of Nepal. Similarly, company has been managed by experienced management team with diverse experience. Mr. Punya Prasad Khaniya (CEO of SLBSL) has more than 14 years of experience with various financial institutions.

Considerable growth in total income, assets under management and net profit over the period

During FY17, the total income of SLBSL increased considerably by 123% y-o-y to Rs.251 Million from Rs.113 Million in FY16. The growth in income was primarily due to increase in interest income with portfolio growth. The growth in income was also aided by fee based income of Rs.33 Million. On back of the increase in the income the net profit of the company increased by 55% during FY17 over FY16 to Rs.24 Million from Rs.15.5 Million. SLBSL has demonstrated high growth in the AUM due to increase in the geographical reach leading to increase in its client base. The total loan portfolio of the company has grown by 89% (albeit on a small base) to Rs.1393 Million at the end of FY17. As per the unaudited results of Q1FY18, the loan portfolio of the company further grew by 18% in to Rs. 1650 Million. The number of the

JLG borrowers also increased over the period from 5,405 in FY16 to 9,648 in FY17 the same further increased to 11,262 during Q1FY18.

Healthy Capital Adequacy ratio (CAR)

SLBSL has maintained CAR of 10.96% and core capital of 7.57% at the end of Q1FY18 (unaudited) which is comfortable in comparison to the minimum regulatory requirement of 8% and 4% respectively for micro finance institutions. The CAR decreased from 10.28% as on July 15, 2016 to 9.83% as on July 15, 2017 mainly due to increase in risk weighted assets with portfolio growth. However, the CAR improved to 10.96% as on October 17, 2017 mainly on back of loan insurance fund which amounts to Rs. 41.12 Million taken as a part of supplementary capital as per the NRB guidelines. CAR is expected to further improve on back of proposed right shares issue.

Background

SLBSL is a small-sized category “D” National Level financial institution-Microfinance Institution licensed by Nepal Rastra Bank (NRB). SLBSL commenced its operation on December 24, 2014 (2071 BS) under Bank and Financial Institution Act 2006. SLBSL is primarily engaged in providing microfinance loans based on Joint Liability Group (JLG) model where each group consist of five members. SLBSL is operating in 42 Districts of Nepal with 65 number of Branches. The company is listed in Nepal Stock Exchange w.e.f. July 16, 2017 by issuing 300000 shares of Rs.100 each at par.

As on mid-July, 2017, SLBSL has earned PAT of Rs.24 million (as against Rs. 15.50 million in mid-July 2016) with total outstanding loan portfolio of Rs.1393 Million (as against Rs.735 Million in mid-July 2016). Further, during Q1FY18 (UA), SLBSL earned profit of Rs.2.62 Million (as against Rs.5.37 Million during Q1FY17).

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Annexure 1

CARE Ratings Nepal – IPO Grading Scale

CARE IPO grade	Definition
CARE-NP IPO Grade 1	Strong fundamentals
CARE-NP IPO Grade 2	Above average fundamentals
CARE-NP IPO Grade 3	Average fundamentals
CARE-NP IPO Grade 4	Below average fundamentals
CARE-NP IPO Grade 5	Poor fundamentals

Note:

Modifiers {"+" (plus)} can be used with the grading symbols 2, 3 and 4. The modifiers reflect the comparative standing within the category.