

Brief Rationale

Mahuli Samudayik Laghubitta Bittiya Sanstha Limited

Grading

Facility	Amount (Rs. In Million)	Grading	Grading Action
Rights Share Issue	30.00	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 Mahuli Samudayik Laghubitta Bittiya Sanstha Limited (MSLB). ‘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. MSLB proposes a 50% rights share issue of 0.3 Mn equity shares of face value of Rs.100 each at par aggregating Rs.30 Mn.

Detailed Rationale & Key Grading Drivers

The grading is constrained by limited track record of operations, volatile net profit over the period, increasing non-performing loans (NPLs), portfolio concentration towards wholesale and trade business, moderate dependence of resource profile on banks and financial institution borrowings, exposure to the regulatory risks related to the microfinance industry and the inherent risk involved in microfinance lending. However, the grading draws strength from the considerable growth in loan & advance and total income & profit over the period, healthy capital adequacy ratio (CAR), adequate geographic diversification and comfortable liquidity profile.

Ability of the company to scale up the operations while maintaining the capital adequacy levels, asset quality, geographical diversification and ability of the company to manage the impact of any regulatory changes by NRB would be the key rating sensitivities.

Detailed Description of the Key Grading Drivers

Key Rating Weakness

Limited track record of operation; however, adequate geographical diversification

MSLB has limited track record of operations as it is operating since May 16, 2013. However, within track period of 5 years with coverage permit of 15 districts, microfinance institution is covering 10 districts operating in 3 states of Nepal through its 29 branches as on April 13, 2018. Further, the company also has plans for gradual expansion over new geographies, access to funds benefited from deprived sector regulation of NRB and large target group of below poverty line population in Nepal for MFIs leading to growth in the loan portfolio over the period.

Increasing Non Performing Loans (NPLs)

MSLB's NPL% to the total loans is 1.79% as on July 15, 2017 which gradually increased from 0.52% as the end of FY16 and has reached to 1.82% as on April 13, 2018. The main reason for increase in NPL was due to the impact on the business activities of the borrowers during border blockage in FY16 and the effect of the same lead to increase in NPLs during FY17. Further, absence of credit report from Credit Information Bureau is also one of the reasons for NPLs.

Moderate dependence of resource profile on Banks and Financial institution borrowings

Major source of external funding for MSLB has been term loans from banks and financial institutions and deposits. As on April 13, 2018, MSLB had funding tie-up with 10 banks and financial institutions, where interest rates range from 9% to 12%. The ratio of bank borrowing to total resource profile is around 40% in FY17 which further increased to around 45% in 9MFY18. During FY17, MSLB's interest expenses increased by 58% due to increasing cost of funds which was 8.24% and 6.62% during FY17 and FY16 respectively indicating MSLB has availed costly debt due to tightness of liquidity in the Banking & Finance Industry.

Exposure to regulatory risks 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 and also the interest rate cannot be more than 18% while charging interest on loans to the borrowers limiting the interest earning capacity of the MFIs.

Inherent risk involved in the microfinance industry including unsecured lending

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 an MFI perspective. Credit risk assumed by a MFI is typically higher compared to banks and other types of lenders given the weak borrower profile. Further, MFI provides unsecured loans, i.e. loans without any collateral. In case a borrower default, the MFI does not have any asset to meet its loss, which makes the credit even riskier. Similarly, as per NRB norms also MFIs are allowed to give loan against collateral only 33.33% of total loan. However, MSLB secured loan portfolio is low which is 2.37% and 3.9% in FY17 and 9MFY18 respectively.

Key Rating Strengths

Considerable growth in loan & advances and total income, however volatile net profit over the period

Over the period MSLB has demonstrated growth in the loan & advances due to increase in the geographical reach leading to substantial increase in its client base. The total loan portfolio of the company has grown by 31.34% to Rs. 1210 Mn at the end of FY17 from Rs. 921 Mn at the end of FY16. As on April 13, 2018, the loan portfolio of the company further grew by 23% to Rs. 1489 Mn. Joint Liability Group (JLG) borrowers also increased over the period from 48,157 in FY16 to 50,619 in FY17.

During FY17, the total income of MSLB increased by 37.52% (albeit on low base) y-o-y to Rs.235 Mn from Rs.171 Mn in FY16. The growth in income was primarily due to increase in interest income with portfolio growth by 37.44% to Rs.233 Mn. However, because of substantial increase in interest expenses by 58.05% in FY17 over FY16, the net profit of the company declined by 11.59% during FY17 over FY16 to Rs.39 Mn from Rs.44 Mn. Also, the interest spread of the company narrowed during FY17 with high increase in Interest expenses/ Average interest bearing liability (FY17 8.24% from FY16 6.62%). The NIM of the company also

dropped to 12.27% in FY17 from 12.48% in FY16, costly debt and around 45% of total resources are obtained from bank and financial institution termed as main reasons.

Further during 9MFY18, despite increase in total income by 18%, the net profit declined by 5% in comparison to profit during 9MFY17, mainly due to increase in the interest expenses which has been increased substantially by 49.61%. Tightening liquidity in banking sector during the end of FY17 resulted in increased cost of funds for banking sector in Nepal.

Healthy Capital Adequacy ratio (CAR)

Tier I Capital of microfinance stood at 11.36% as on July 15, 2017 (As on July 15, 2016: 11.99%) and overall capital adequacy ratio stood at 12.36% (As on July 15, 2016: 12.95%) which is comfortable in comparison to the minimum regulatory requirement of 8% and 4% respectively for micro finance institution. As on April 13, 2018, CAR has further improved to 14.72%. MSLB has raised the capital by Rs. 20 Mn through bonus share issued in FY17.

Comfortable Liquidity Profile

MSLB has comfortable liquidity profile with positive cumulative mismatch over one year, as of April 13, 2018, due to well mismatch tenure of assets and liabilities. Cash Reserve Ratio of 0.58% and 0.55% is maintained in FY17 and 9MFY18 respectively against the minimum regulatory requirement of 0.5% of total deposit for non-deposit taking from general public institution.

About the Company

Mahuli Samudayik Laghubitta Bittiya Sanstha Limited (MSLB) is a small-sized category “D” 15 district financial institution (Microfinance Institution) licensed by Nepal Rastra Bank. MSLB was established on September 2, 2012 and commenced its operation on May 16, 2013 under Bank and Financial Institution Act 2006. MSLB is engaged in providing microfinance loans based on the Joint Liability Group (JLG) model with each group consisting of five members. As on April 13, 2018, MSLB was operated in 10 Districts (out of total 77 Districts) of Nepal with 29 number of Branches and loan & advances of Rs.1531 Million covering 11410 active JLG borrowers. MSLB is providing loan to its member ranging from minimum Rs. 45000 to Maximum Rs. 0.3 Mn without collateral and Rs. 0.7 Mn with collateral.

MSLB have five experienced members on board led by Mr. Prabhu Narayan Chaudhary who has 20 years of experience is the chairman of the company, Mr. Chaudhary is founder member,

micro finance head and executive secretary of Mahuli Community Development Center (MCDC) which holds 25% of the total share of MSLB. The day to day operations of the company are headed by Mr. Roshan Kumar Mandar who is the managing director of the company.

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Annexure I

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. The modifiers reflect the comparative standing within the category.