

**Rating Rationale**

**Asha Laghubitta Bittiya Sanstha Limited**

**Grading**

<b>Facility/Instrument</b>	<b>Amount (Rs. In Million)</b>	<b>Rating/Grading</b>	<b>Rating Action</b>
Initial Public issue	60.00	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 1*

CRNL has assigned grading of ‘CARE-NP IPO Grade 4’ to the proposed Initial Public Issue of Asha Laghubitta Bittiya Sanstha Limited (ALBSL). ‘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. ALBSL proposes to issue 600,000 number of equity shares of face value of Rs.100 each at par aggregating Rs. 60.00 million.

**Detailed Rationale & Key Grading Drivers**

The grading assigned to the Initial Public issue of ALBSL is constrained by short track record and small scale of operation, increasing percentage of Non-Performing loan (NPLs) to total loan ratio, limited resource profile with high dependence on Banks & Financial Institutions (BFIs) borrowings, exposure to regulatory risks related to microfinance industry, inherent risk involved in the microfinance industry including socio political risks and competition from other Micro Finance Institutions (MFIs) and Co-operatives. The grading, however, derives strength from strong promoter group, experienced board and management team, increasing scale of operations, comfortable Capital Adequacy ratio (CAR), comfortable liquidity profile, and moderate geographical diversification in its area of operation.

Ability of the company to continue its growth momentum without compromising on asset quality and maintaining the CAR and ability to manage the impact of any regulatory changes by NRB are key grading sensitivities.

## **Detailed Description of the Key Grading Drivers**

### **Key Grading Weakness**

#### ***Short track record of operations, however, moderate geographical reach in its area of operation***

ALBSL has short track record of operations as it is operating since August 31, 2016. However, within track period of ~ 2 years, it is operating in 23 districts (out of 77 districts) and 6 provinces (out of 7 provinces) through 36 branches as on July 16, 2018 leading to diversification and less concentration on any single branch. Further, the company has plans for gradual expansion over new geographies which may lead to growth of business, achieve diversification of operation in new geographical areas and economies of scale. As on July 16, 2018, the loan concentration in any one branch is not more than 6.52% of total loan portfolio.

#### ***Increasing percentage of Non-Performing Loans (NPLs) to total loan***

ALBSL's NPL level is increasing in trend, which increased to 0.78% in FY18 (refers to period ending July 16, 2018) from 0.05% in FY17 mainly due to loan duplication on back of absence of credit report from Credit Information Bureau. However, ALBSL is taking steps for the recovery of GNPL through education, motivation and various awareness program for timely repayment of loans.

#### ***Limited resource profile with high dependence on Banks and Financial institution borrowings***

Major source of external funding for ALBSL is borrowing from BFIs. The ratio of Bank borrowing to total resource of ALBSL was high at 69.32% in FY18. As on July 16, 2018, ALBSL has funding tie up with 25 banks and financial institution, where interest rate ranges from 10.5% to 14% depending upon the financial institution. ALBSL cost of borrowing at 12.31% in FY18 is higher than its cost of deposit at 7.97% in FY18 which indicates ALBSL's dependence upon costly debt due to shortage of liquidity in the Banking Industry.

#### ***Exposure of 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, A, B & C class financial institutions were required to extend 5%, 4.5% and 4% respectively of their total loans towards

deprived sector. However, Monetary Policy of 2018-19 changed the guidelines and instructed all A, B & C class financial institutions to lend 5% of their total loan to deprived sector.

Earlier MFIs were allowed to determine interest rate on their lending by adding upto 4% administrative expenses above cost of fund plus maximum of 7% spread with the interest rate ceiling of 18%. However, monetary policy of 2018-19 changed this provision where MFIs are now allowed to determine interest rate on loan by adding upto 3% administrative expenses above cost of fund plus maximum of 6% spread and the interest rate ceiling (i.e.18% earlier) is eliminated. As a result of changed NRB provision, MFIs can now pass increased cost of fund to the borrower which will improve their interest earning capacity.

#### ***Inherent risk involved in the microfinance industry***

MFIs are prone to credit risk given the borrower profile and higher proportion of unsecured lending portfolio. MFIs provides unsecured loan i.e. loan without any collateral, which makes the credit riskier. As borrowing from MFIs do not require collateral, clients tends to borrow from multiple MFIs resulting to problem of loan duplication. Absence of credit report from Credit Information Bureau (CIB) is also one of the reasons for loan duplication which increases credit risk. However, monetary policy of 2018-19 required MFIs to send credit information to CIB continuously and 2% additional loan loss provision have to be maintained on such loan if MFIs fail to send credit information to CIB. Apart from these risks, the sector is also prone to socio political risks. And as per NRB norms, MFIs are allowed to lend against collateral upto 33.33% of total lending. ALBSL percentage of collateral loan to total loan was at 28.73% in FY18.

#### ***Competition from other MFIs and Co-operatives***

As on Mid-April 2018, there are 62 MFIs in operation with total 2,275 branches all over Nepal. ALBSL has 36 branch. Micro Finance Industry earned Rs. 15,629 Mn total interest income, Rs 7,271Mn net interest income and Rs 2718Mn Net profit on April 13, 2018; however, ALBSL has 0.60% share in interest income, 0.5% share in net interest income and 0% share in net profit for the same period in the Microfinance industry. Further, large number of cooperatives are operating all over Nepal which provides loan and other financial services to their members with or without collateral. Due to presence of large number of micro finance and co-operatives, ALBSL is facing competition to tap the new customer and to retain the existing good consumer.

## **Key Grading Strengths**

### ***Strong promoter group and experienced board & management team***

ALBSL is promoted by individuals and corporates related with Prabhu Group of companies. Prabhu Group is one of the leading group in finance sector in Nepal having investment in various entities in Banking, Merchant Banking, Money transfer business, Insurance and other industries. ALBSL has four directors on the Board of the company. Mr. Nirgun Prasad Bhattachan, Chairperson of the company, has ~ 31 years of experiences in BFIs. Mr. Badri Prasad Dulal (CEO), has ~ 9.5 years of experience in BFIs and microfinance. The top management is assisted by experienced management team.

### ***Increasing scale of operations***

ALBSL commenced its operation from August 31, 2016 and FY18 was the first full year of operation. Its loan portfolio grew substantially in FY18 to Rs 1292 Mn from Rs 391 Mn in FY17 on back of increase in the client base (32618 members in FY18 from 11314 in FY17) by increase in geographical reach through branch expansion. The number of the borrowers increased to 21,224 in FY18 from 6,855 in FY17. Similarly, ALBSL deposit grew substantially over the period to Rs 257Mn in FY18 from Rs.37 Mn in FY17. ALBSL is lending upto Rs 0.06 Mn for the first time for 1-year tenure and loan limit is increase thereafter upto Rs 0.08 Mn for second time. It is providing maximum of Rs 0.16 Mn group loan to its members and Rs 0.5 Mn collateral loan to the members as well as general public.

During FY18, its total income increased substantially to Rs.187Mn from Rs.26 Mn in FY17 primarily due to increase in interest income on back of growth in loan portfolio. The growth in total income was also aided by growth in non-interest income (Rs 30 Mn) which included loan processing fees, membership fees and account closing fees etc. However, the interest expenses increased to Rs 89Mn in FY18 from Rs 10 Mn in FY17 due to increased amount of deposit and borrowing as well as increased cost of fund. Despite increase in expenses ALBSL achieved net profit of Rs. 11Mn in FY18 against net loss of Rs 10 Mn in FY17.

### ***Comfortable Capital Adequacy ratio (CAR)***

ALBSL overall CAR and Tier I CAR stood at 11.55% and 10.58% as on July 16, 2018 which is comfortable in comparison to the minimum regulatory requirement of 8% and 4% respectively

for MFIs. ALBSL has Rs 140 Mn share capital which is higher as compared to minimum capital requirement by NRB for national level MFIs of Rs. 100 Mn. Its share capital will increase further after proposed initial public issue of Rs 60 Mn.

### ***Comfortable Liquidity Profile***

ALBSL has comfortable liquidity profile with positive cumulative mismatch over one year as of July 16, 2018. Further, it has maintained CRR 0.53% and liquid assets of 16.56% in FY18 which is in compliance with minimum regulatory requirement of 0.5% and 2.5% respectively for MFIs not collecting deposit from general public.

### ***Diversified credit portfolio***

ALBSL credit portfolio distribution consists of various types of loan disbursed over the period for the small businesses related to agricultural sector (crops, vegetable, fruits & flowers, animal husbandry, poultry farming, bee keeping, fishery related etc.), small & cottage industry, service industry (wholesale & retail business) and others. In FY18, ALBSL has highest lending of 27.36% to wholesale and retail business followed by 18.3% to animal husbandry, 10.9% to vegetable cultivation and balance to other sectors namely agricultural crops, hotel & restaurants and poultry farming.

### **About the Company**

ALBSL is a “D” class National Level Microfinance Institution licensed by Nepal Rastra Bank with its registered office in Kakani 6, Nuwakot. ALBSL is incorporated on April 17, 2016, and commenced its operation from August 31, 2016 as per Bank and Financial Institution Act 2006. It is primarily engaged in providing microfinance loan based on the Joint Liability Group (JLG) model with each group consisting of minimum five members.

ALBSL earned Rs 11 Mn net profit during FY18 on Rs 1292 Mn loan portfolio and Rs 257 Mn deposit as on July 16, 2018. As on April 13, 2018 it has 0.81% and 0.45% market share in terms of loan portfolio and deposit of microfinance industry respectively. 100% share capital of the company is held by promoter shareholders.

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**Annexure 1**

**CARE Ratings Nepal – IPO Grading Scale**

<b>CARE IPO grade</b>	<b>Definition</b>
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.