

Grading Rationale

Ganapati Microfinance Bittiya Sanstha Limited

Grading

Facility/Instrument	Amount (Rs. In Million)	Rating/Grading	Grading Action
Initial Public issue	33.50	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 Ganapati Microfinance Bittiya Sanstha Limited (GMBSL). ‘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. GMBSL proposes to issue 3.35 lakh numbers of equity shares of face value of Rs.100 each at par aggregating Rs. 33.50 million.

Detailed Rationale & Key Grading Drivers

The grading assigned to the Initial Public issue of GMBSL is constrained by short track record and small scale of operation, weak financial performance due to initial year of operation, however improving over the period, increasing Non-Performing Loan (NPLs) to total loan and high dependence of resource profile on Banks & Financial Institutions (BFIs) borrowings. The grading also factor in exposure to regulatory risks related to microfinance industry, inherent risk involved in the microfinance industry including competition and unsecured lending and competition from other Micro Finance Institutions (MFIs) and Co-operatives. The grading, however, derives strength from institutional promoter as well as experience board and management team, ability of the company to grow business over the short track of operations, adequate Capital Adequacy Ratio (CAR), comfortable liquidity profile, diversified credit portfolio and adequate geographical diversified reach 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 Nepal Rastra Bank (NRB) are key grading sensitivities.

Detailed Description of the Key Grading Drivers

Key Grading Weakness

Short track record of operations and small scale of operation

GMBSL has short track record of operations as it is operating since Dec 9, 2016. It has low market share in terms of loan portfolio and deposit. Its market share in the microfinance industry in terms of loan portfolio was 0.37% and in terms of deposit was 0.25% in FY18 (based on data published by NRB). Similarly, it has 0.3% and 0.23% market share in terms of interest income and net interest income during FY18.

Weak financial performance due to initial year of operation, however improving over the period

GMBSL has incurred net loss of Rs. 2.58 Mn during FY18 (refers to 12 months period ended mid-July 2018) and Rs 12.11 Mn during FY17. However, it has earned net profit of Rs 4.94 Mn during Q1FY19 (refers to 3 months period ended mid-October 2018) on back of sharp increase in net interest income and other income. Net interest income increased by 241.12% to Rs 11.66 Mn during Q1FY19 due to growth in interest income on back of growth in loan portfolio and increase in yield on advance. Net Interest margin (NIM) increased to 5.56% in FY18 from 4.17% in FY17 on back of increase in yield on advance higher than increase in cost of deposit and borrowing. Non-interest expenses increased by 40.66% to Rs 14.52 Mn during Q1FY19 over Q1FY18 respectively. It has accumulated losses of Rs 9.82 Mn and networth of Rs 60.18 Mn at the end of Q1FY19.

Increasing Non-Performing Loans (NPLs) to total loan

GMBSL's NPL level is increasing in trend, which increased to 1.37% in Q1FY19 from 1.19% in FY18, mainly due to loan duplication on back of absence of credit report from Credit Information Bureau (CIB) as well as weak performance of client business.

High Dependence of resource profile on Banks and Financial institution borrowings

GMBSL major source of external funding is borrowing from BFIs. The ratio of bank borrowing to total resource was high and increased to 70.19% in FY18 from 67.88% in FY17. As on November 16, 2018, GMBSL has funding tie up with 16 BFIs, where interest rate ranges from 11% to 13%. Its cost of borrowing (i.e. 12.75% in FY18) is substantially higher than its cost of deposit (7.58% in FY18) which indicates dependence upon costly debt due to shortage of liquidity in the Banking Industry.

Exposure of regulatory risks related to microfinance industry

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. This regulation change is expected to impact the incremental fund availability to MFIs, cost of fund, credit growth and profitability of the MFIs.

Earlier MFIs were allowed to determine interest rate on 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 lending 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 this changed, 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 weak borrowers 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 CIB is also one of the reasons for loan duplication which increases credit risk. However, 2018-19 monetary policy 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. As per NRB norms, MFIs are allowed to lend against collateral upto 33.33% of total lending. GMBSL percentage of collateral loan to total loan was at 8.09% in Q1FY19 and 7.67% in FY18.

Competition from other MFIs and Co-operatives

As on Mid-Nov 2018, there are 69 MFIs in operation with total 2,741 branches all over Nepal. GMBSL has 24 branch as on Mid Nov 2018. Micro Finance Industry earned Rs. 6,597 Mn total interest income, Rs 2,975 Mn net interest income and Rs 1,073 Mn Net profit on Q1FY19 however, GMBSL has 0.43% share in interest income, 0.39% share in net interest income and 0.46% share in net profit for the same period in the 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, GMBSL is facing competition to tap the new customer and to retain the existing good consumer.

Key Grading Strengths

Institutional promoter as well as experienced board and management team

GMBSL is promoted by institutional as well as individual promoters with 32.14% of the company's share held by Guheswori Merchant Banking and Finance Ltd (GMFIL). GMFIL is 'C' class finance company license by NRB operating since last 17 years. As on Nov 16, 2018, GMFIL extended loans amounting to 35.74% of the total borrowing of GMBSL.

GMBSL has 5 directors. Mr. Yubaraj Bhandari, chairperson of this company, who is lawyer, has ~25 years of experience in Advocacy. He is Legal Advisor & Company Secretary at Guheswori Merchant Banking & Finance Ltd. since past 10 years. Mr. Dinesh Lal Shrestha, Director of company, is CEO of GMFIL since Jan 2002, has more than 15 years of experience in banking sector and has 10 years of experience as a director of Asian Life Insurance Company Ltd. Mr. Achut Raj Sapkota, CEO of this company since august 2016, is former CEO of ILFCO Microfinance Bittiya Sanstha Ltd. for 3 years & has more than 15 years of experience in Nepal Aawas Finance Ltd. He is supported by other experienced management team.

Ability of the company to grow business over the short track of operations:

Over the short period of operation (~2 years) GMBSL loan and advance and deposit grew substantially. Loan and advance grew by Y-o-Y growth rate of 246.73% to Rs 542.79Mn from Rs 156.54Mn in FY17 on back of increase in the amount of loan utilized by existing borrowers and substantial increase in client base (10231 in FY18 from 3946 in FY17) by increase in geographical reach through branch expansion. Loan and advance further increased to Rs 630.52Mn at the end of Q1FY19. Similarly, its deposit grew by Y-o-Y growth rate of 625.70% (albeit low base) in FY18 to Rs 124.98Mn from Rs 17.22 Mn in FY17 mainly due to increase in client base and geographical expansion. Deposit further increased to Rs 153.75 Mn at the end of Q1FY19.

Adequate Capital Adequacy ratio (CAR)

GMBSL overall CAR and Tier I CAR stood at 10.66% and 9.71% respectively as on July 16, 2018 which is comfortable in comparison to the minimum regulatory requirement of 8% and 4% respectively for

MFIs. Its CAR decreased to 10.66% in FY18 from 33.95% in FY17 due to sharp increase in Risk weighted assets on back of increase in loans and advances, and decline in core capital as a result of net losses incurred during FY18. CAR declined slightly to 10% at the end of Q1FY19 from 10.66% in FY18 due to further increase in risk weighted assets was higher than proportionate increase in capital fund.

GMBSL has Rs 70 Mn paid-up share capital which is lower as compared to minimum capital (i.e. Rs 100 Mn) as required by NRB for national level MFIs. It will be able to maintain the required minimum capital after proposed initial public issue.

Comfortable Liquidity Profile

GMBSL has comfortable liquidity profile with positive cumulative mismatch over one year, as on Oct 17, 2018. GMBSL has maintained 2.12% and 2.30% cash reserve ratio (CRR) respectively in Q1FY19 and FY18 respectively. Further, GMBSL maintained liquid assets 56.83% of deposit in Q1FY19 and 70.66% of deposit in FY18.

Diversified credit portfolio

GMBSL credit portfolio diversified to various sector. It has been disbursing loan to 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 and retail business, hotel and restaurants, and other services) and others sector (mainly include agricultural loan). In Q1FY19, its lending consist of 31.64% to other sector (11.01% in FY18) followed by 23.75% to wholesale and retail business (23.12% in FY18) and 17.17% to animal husbandry (17.20% in FY18).

Adequate geographical diversified reach in its area of operation

Within short track period of operation (~ 2 years), it is operating in 14 districts (out of 77 districts) and 4 provinces (out of 7 provinces) through 24 branches as on November 16, 2018. Further, the company has plans for gradual expansion over new geographies. It is planning to open 4 new branches during FY19, 8 new branches during FY20 by opening 2 new branches in each quarter. Further expansion of branches may lead in growth of business, achieve diversification of operation in new geographical areas and economies of scale.

About the Company

Ganapati Microfinance Bittiya Sanstha Ltd. is a “D” class National Level Microfinance Institution incorporated on June 27, 2016, licensed by Nepal Rastra Bank (NRB) on November 15, 2016 and commenced its operation from Dec 9, 2016 under 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. It has its registered office in Suklagandaki Municipality, Tanahun, Nepal. As on October 17, 2018 it has loan portfolio of Rs 620.08 Mn and deposit base of Rs 153.75 Mn; and have 11,402 members and 8338 borrowers. Guheswori Merchant Banking and Finance Ltd (32.14%) and Mr. Yubraj Bhandari (14.29%) are the major shareholders of the company.

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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.