Rating Rationale

Manushi Laghubitta Bittiya Sanstha Limited

Rating

Facility/Instrument	Amount (Rs. In Million)	Rating[1]	Rating Action
Issuer Rating	NA	CARE-NP B+ (Is) [Single B Plus (Issuer)]	Assigned

CARE Ratings Nepal Limited (CRNL) has assigned the issuer rating of "CARE-NP B+ (Is) [Single B Plus (Issuer)]" to Manushi Laghubitta Bittiya Sanstha Limited (MLBSL). 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 MLBSL is constrained by subdued financial performance over the period marked by net loss during FY20 (Audited, refers to the 12 months period ended Mid-July 2020) and H1FY21 (Provisional, refers to the 6 months period ended Mid-January 2021), deteriorated asset quality on back of Covid-19 pandemic impact, competition from other Micro Finance Institutions (MFIs) and Co-operatives, inherent risk involved in the microfinance industry and exposure to regulatory risks related to microfinance industry.The rating, however, derives strength from backup of institutional promoter, experienced board members and management team and adequate capitalization, which is expected to improve after the proposed capital injection. The rating also factors in moderate growth in business over the period, moderate dependence of resource profile on Banks & Financial Institutions (BFIs) borrowings, moderate liquidity profile and sector wise credit portfolio distribution with higher concentration towards animal husbandry and lack of geographical diversification of business, however, long track record of operation. Ability of the company to continue its growth momentum with improving asset quality and improving the Capital Adequacy Ratio and ability to manage the impact of any regulatory changes by NRB are the key rating sensitivities.

Detailed Description of the Key Rating Drivers

Key Rating Weaknesses

Deteriorated assets quality on back of Covid-19 pandemic impact

MLBSL's asset quality is marked by high Gross Non-Performing Loans (GNPL) in the industry. GNPL of the company was moderate at 2.48% during FY20 as compared to 1.63% during FY19, which deteriorated substantially to the high level of 13.04% during H1FY21. Primary reason for high GNPL was due to impact of COVID 19. Furthermore, more than 30 days delinquency of MLBSL was 2.48% of total advances as on July 15, 2020 and the same has increased to higher side of 21.63% as on January 13, 2021.

[1] *Complete definitions of the ratings assigned are available at www.careratingsnepal.com*

Subdued financial performance over the period marked with net loss during FY20 and H1FY21

MLBSL's financial performance has deteriorated during FY20 over FY19 in terms of profitability. Total income increased by 43.17% in FY20 to Rs. 139 Mn due to increase in interest income on account of growth in loans and advances and recovery of interest income on due course. Despite increase in total income in FY20, MLBSL reported net loss of Rs.2 Mn during the year against net profit of Rs 18 Mn during FY19 due to higher level of loan loss provision of Rs.25 Mn. during the year. Further, MLBSL incurred loss of Rs 5 Mn during H1FY21 from profit of Rs 5 Mn during H1FY20 mainly due to substantial increase in loan loss provision (by 251% to Rs 21 Mn during H1FY21 from Rs 6 Mn during H1FY20). Similarly, return on Total Assets (ROTA) deteriorated to negative 0.90% in H1FY21 from negative 0.30% in FY20. However, Net Interest Margin (NIM) ratio improved to 7.39% in H1FY21 from 7.19% in FY20.

Competition from other MFIs and Co-operatives

As on Mid-January 2021, there were 76 MFIs in operation with total 4,272 branches all over Nepal. MLBSL has 26 branches as on Mid-January, 2021. Micro Finance Industry earned Rs. 20,875 Mn interest income, Rs 12,195 Mn net interest income and Rs5178 Mn Net profit during H1FY21. MLBSL has 0.34% (Rs. 70 Mn) share on interest income, 0.31% (Rs. 38 Mn) share on net interest income and negative 0.09% (Rs. -5 Mn) share on net profit for the same period in the industry. Further, large number of cooperatives are operating all over Nepal which provides loans and other financial services to their members with or without collateral. Due to presence of large number of micro finance and co-operatives, MLBSL 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 organization and is one of the most significant risks from MFI's perspective. Credit risk assumed by a MFI is typically higher compared to banks and other types of lenders given the weak borrower profile. Further, MFIs provide unsecured loan i.e. loan without any collateral. In case any borrower defaults, the MFI do not have any asset backed as collateral to meet its loss, which makes the credit even 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 one of the reasons for loan duplication. However, monetary policy of 2018-19 required MFIs to send credit information to CIB continuously and failing to comply the same will result in 2% additional Loan Loss Provision (LLP). As per NRB norms, MFIs are allowed to lend against collateral up to 33.33% of total lending. MLBSL's percentage of collateral loan to total loan is 2.57% in H1FY21 which is increased from 0.36% in FY20.

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, 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 A, B & C class financial institutions to lend 5% of their total loan to deprived sector. This regulation change impact the incremental fund availability to MFIs, cost of fund, credit growth and profitability of the MFIs. Monetary policy of 2018-19 explained the provision, where MFIs are now allowed to determine interest rate on loan by adding up to 3% administrative expenses above cost of fund plus maximum of 6% spread and the interest rate ceiling (i.e.18% earlier). However, as per latest introduction of monetary policy 2019/20, MFIs are not allowed to take interest more than 15% w.e.f. July 28, 2020. Further, regulator has capped fees at 1.5%, scrapping the interest rate spread cap of 9%.As a result of this provision, MFI cannot charge interest rate more than 15% which will restrict interest earning capacity and yield from FY21 onwards.

Key Rating Strengths

Backup from institutional promoter

At the end of FY20, 63.29% of the current paid up capital of MLBSL is held by institutional promoters namely Manusi and Manushi Private Limited. Manushi is the NGO established in 1991 to enhance social security, women's empowerment, child education, health and sanitation. Manushi has injected Rs. 38 Mn capital into the company till the end of FY20. Similarly, Manushi Private Limited is a company engaged primarily in the export of handicraft materials.

Experienced board members and management team duri

MLBSL has 6 members on its board and is chaired by Mrs. Padmasana Shakya, who has more than 25 years of experience. She has been Chairperson of MANUSHI since last 21 years. The company's management team is led by CEO, Mrs. Shova Bajracharya, who has more than 25 years of experience in microfinance sector. She has worked in various position at Manushi for 23 years and she has been CEO at MLBSL since last 2 years. She is supported by other experienced management team to look after various functions in the company.

Adequate capitalization which is expected to improve after the proposed capital injection

MLBSL's Tier I capital and minimum Capital overall Capital Adequacy Ratio (CAR) stood at 8.81% and 10.06% respectively in FY20 which complies to minimum regulatory requirement of 4% and 8% respectively for microfinance institutions (MFIs). Further, CAR deteriorated to 8.44% at the end of H1FY21 due to transfer of net loss in reserve & surplus during H1FY21. CAR is expected to improve after issue of proposed IPO. Further, it has paid up capital of Rs 70 Mn. As per new Unified directives 2020 issued by NRB, the company operating as national level MFI shall have minimum paid up capital of Rs. 100 Mn within 3 years from the commencement of commercial operation. Accordingly, after issuance of proposed IPO during FY21 of Rs. 39.3 Mn, the equity share capital is proposed to be Rs 109.3 Mn.

Moderate dependence of resource profile on Banks & Financial Institutions (BFIs) borrowings

The ratio of borrowing from BFIs to total resource was moderate at 27.60% in FY20 which was at 27.18% in FY19. Due to moderate reliance on BFI's for funding, the cost of fund is on lower side as it largely consist of source of fund from deposits. As on July 15, 2020, its funding is tied up with 7 BFIs where interest rate ranges from 5 % to 14 % depending upon the financial institution. Its average cost of borrowing was 13.39% in FY20 which is substantially higher than its cost of deposit of 7.24%. Due to use borrowings from BFI's at higher interest rate, its cost of fund was high (i.e. 9.31% in FY20) which has put pressure on profitability.

Moderate growth in business over the period

MLBSL's credit portfolio grew by 1.78% to Rs 833 Mn in FY20 from Rs 819 Mn in FY19. Further, credit portfolio increased by 12.68% to Rs 939 Mn in H1FY21.Similarly, its deposit grew by 19.12% to Rs 552 Mn in FY20 over FY19, which further grown by 17.38% during H1FY21. MLBSL has 0.50% and 0.29% market share in terms of deposit base and loan portfolio respectively of microfinance industry in H1FY21 based on monthly data published by NRB.

Moderate Liquidity Profile

MLBSL has maintained CRR 0.57% in H1FY21 and 0.65% in FY20.Further, MLBSL has maintained liquid assets of 15.40% in H1FY21 and 11.66% in FY20, which are in compliance with NRB norms.

Sector wise credit portfolio distribution with concentration towards animal husbandry

In H1FY21, MLBSL has lent 43.54% towards service industry (which includes 10.10% to wholesale and retail business, 0.09% to hotel and restaurants and 33.35% to other services) followed by 43.28% towards agriculture sector (which includes 26.55% to animal husbandry, 4.65% to Vegetables, 3.53% to poultry farming) and 2.98% towards small and cottage industry.

Lack of Geographical diversification of business, however long track record of operation

MLBSL started operations from October 2018 by taking over the existing microcredit operation of MANUSHI. MANUSHI started Microfinance Institution (MFI) activities from April, 2002 as a financial intermediary. Currently, MLBSL operating in 8 districts (out of 77 districts) and 1 province (out of 7 provinces) through 26 branches as on January 13, 2021.

About the Company

Manushi Laghubitta Bittiya Sanstha Ltd. (MLBSL) is a "D" class national level microfinance incorporated on June 24, 2018, licensed by Nepal Rastra Bank on October 11, 2018 and commenced operation on October 29, 2018. Thereafter, MLBSL took over the microfinance business conducted by the Manushi, an NGO established in 1991 and operating as a financial intermediary since April, 2002 in Nepal. MLBSL is primarily engaged in providing microfinance loan based on the Joint Liability Group (JLG) model with each group consisting of minimum five members. At the end of FY20, paid up share capital of the company was Rs. 70 Mn. The company proposes to issue IPO of Rs. 39.3 Mn. in FY21. The shares of the company is proposed to be held by promoter and public shareholders in 64:36 ratio.

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