Dhaulagiri Laghubitta Bittiya Sanstha Limited

Ratings

Facilities	Amount (Rs. Million)	Rating[1]	Rating Action
Issuer Rating	NA	CARE-NP BB-(Is) [Double B Minus Issuer]	Assigned

CARE Ratings Nepal Limited (CRNL) has assigned rating of 'CARE-NP BB- (Is)' [Double B Minus (Issuer)] to Dhaulagiri Laghubitta Bittiya Sanstha Limited (DLBS). Issuers with this rating are considered to have moderate risk of default regarding timely servicing of financial obligations.

Detailed Rationale & Key Rating Drivers

The ratings assigned to DLBS is constrained by small scale of operations with moderate asset quality, low market share in the industry, high concentration of advances towards agriculture sector and its presence in highly competitive market and below average financial performance. The rating is also constrained by inherent risk involved in the microfinance industry and exposure to regulatory risks related to microfinance industry.

The rating, however, derives strength from institutional promoter, experienced board members and management team, adequate level of capitalization. The rating also factors in, moderate liquidity profile, diversified resource profile and geographical diversification of business.

Ability of the company to continue its growth momentum while improving its asset quality, improving the Capital Adequacy Ratio and ability to manage the impact of any regulatory changes by central bank of Nepal are the key rating sensitivities.

Detailed Description of the Key Rating Drivers

Key Rating Weaknesses

Small scale of operations with moderate assets quality

DLBS's asset quality stood moderate reflected from moderate GNPL which stood at 2.22% for FY20 (FY refers to 12 months' period ended on July 15, 2020). GNPL of the company, has shown improvement in FY21 (unaudited); however, again deteriorated to 2.87% in Q1FY22 on account of slowdown in recoveries due to flood in Terai region which is main customer base of DLBS. Furthermore, advances under watchlist category have increased significantly to Rs. 128 Mn. in FY21 (FY20: Nil), the same was on account of slow recovery, which was impacted by pandemic induced lockdown, etc.

Significantly low market share in the industry, albeit moderate growth in business over the period

DLBS's credit portfolio increased by 30% to Rs 1,027 Mn in FY21 over FY20 and deposit portfolio grew by 12% to Rs. 515 Mn during FY21. Despite significant growth in the deposits and advances, market share of DLBS deposit base and advances portfolio stood low as reflected from market share microfinance industry of 0.39% and 0.28% respectively. With the very low market share in the highly competitive industry, the business operations are highly susceptible to any change in business dynamics / shock, thereby limiting its ability to absorb financial exigencies.

Below average financial performance

Despite the growth in interest income by 5.05% in FY21 over previous year and decline in interest expenses from Rs. 45 Mn in FY20 to Rs. 42 Mn in FY21; DLBS's Net Interest Margin (NIM) showed moderation during FY21 by 107 bps and stood at 7.83% against 8.90% in FY20. The total operating income stood at Rs. 131 Mn in FY21 showing growth on back of growth in advances during the said year by 29.79%. With a view to garner the increased market share, company settled for little margin of profit and disbursed loans at lower rate of interest. Also the company faces stiff competition and hence the company's strategize to increase the market share. All this led to moderation in NIM during FY21.

[1]Complete definition of the ratings assigned are available at www.careratingsnepal.com and other CARE publications

Its operating expenses/ average total assets improved to 7.53% in FY21 as compared to 9.42% in FY20. Impairment charge for loans and other losses decreased during FY21 on account of reversal of impairment charges. Accordingly, DLBS reported increase in PAT to Rs.35 Mn during FY21 from Rs 0.2 Mn during FY20 which led to increment in Return on Total Assets (ROTA) by 3.08% in FY21 (0.02% in FY20). In Q1FY22, interest income increased by 42.19% to Rs 40 Mn as compared to Rs 28 Mn in Q1FY21.Interest expense increased to Rs 16 Mn in Q1FY22 from Rs 10 Mn .PAT improved to Rs 10 Mn as compared to 1 Mn.

High Concentration of advances towards agriculture sector

The credit portfolio of the company is highly concentrated towards agricultural sector. In FY20 the advances are concentrated towards agricultural sector which stood at 56.06% and further shown an increase in FY21 to 56.86 %. The recovery in the sector is highly depends on various factors viz. climatic conditions like monsoons, drought and floods, availability of prices etc. Any adverse climatic conditions or other unfavourable factors which might have an impact on crop would adversely affect repayment capacity of the borrowers.

Presence in highly competitive industry

As on Mid-July 2021, there were 70 MFIs in operations having 4,685 branches all over Nepal. DLBS has 19 branches as on Mid-July, 2021. DLBS has 0.29% share on interest income, 0.33% share on net interest income and 0.30% share on net profit for FY21 in the industry. Furthermore, large number of cooperatives are operating having significant presence and same target customer base. Due to presence of large number of micro finance and co-operatives, DLBS is facing competition to tap the new customers 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 MFI is typically higher compared to banks and other types of lenders given the weak borrower profile. Furthermore, MFIs provide unsecured loan thereby recovery in case of default is low in the absence of collateral. As borrowing from MFIs do not require collateral, clients tend to borrow from multiple MFIs resulting to loan duplication without proper repayment capability assessment. As per NRB norms, MFIs are allowed to lend against collateral upto 33.33% of total lending. DLBS's percentage of collateral loan to total loan is 11.77% in FY21 which is increased from 11.35% in FY20.

Exposure to regulatory risks related to microfinance industry

The microfinance industry 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. As per the regulations, Class A, B & C financial institutions are also required to lend 5% of their total advances to deprived sector. This change in this regulations in FY2019 impacted the incremental fund availability, cost of fund, credit growth and profitability of the MFIs. Monetary policy 2019/20 has capped interest rate upto 15%. 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.

Key Rating Strengths

Experienced board members, management team and support from the institutional investor

DLBS is managed by 5 board members and the board is chaired by Mr Ishworlal Rajbhandari. He has more than 22 years of experience in diversified fields. The company's management team is led by CEO, Mr. Min Bahadur Bohara who has more than 26 years of experience in bank and finance sector. He has worked as Branch Manager of Grameen Bikas Bank Limited for more ~13 years and as Acting CEO of Nepal Community Development Limited for ~2 years. He has also worked as CEO and Acting CEO of Kalika Laghubitta Bittiya Sanstha Limited and Nepal Agro Laghubitta Bittiya Sanstha Limited respectively. He is supported by other experienced management team.

At the end of July 15, 2021, Prabhu Bank Limited(PRVU) [CARE-NP BBB] holds 21.43% of the total share capital in the company. PRVU is "A Class" Commercial Bank of Nepal operating since 2002. Prabhu Bank having its established presence in banking industry gives advantage to DLBS in respect of any management and operational assistance.

Adequate level of capitalization however minimum regulatory capital requirement not met and moderate liquidity

DLBS's overall Capital Adequacy Ratio (CAR) stood at 10.40% in FY21 (FY20: 11.15%) as against the minimum regulatory requirement of 8% for MFIs. CAR decreased in FY21 on account of significant increment in risk weighted assets by 29%. DLBS is planning to increase the capital base (Initial Public Offering (IPO) issue of NPR 30 Mn which is expected to improve the CAR and support the expansion of business operations.

DLBS has maintained CRR 0.62% in FY21 as compared to 1.16% in FY20. Further, DLBS has maintained liquid assets of 8.77% in FY21 and 9.49% in FY20 which are in align with regulatory norms.

Diversified Resource Profile

DLBS's major source of funding consist of deposits from members and borrowing from BFIs and stood at 45.19% and 30.77% respectively at the end of FY21. The borrowing from BFIs increased to Rs. 350 Mn. in FY21 by 98.86% from Rs 176 Mn in FY20. Also, DLBS was able to increase funding source from deposits to Rs. 515 Mn. in FY21 by 11.71% from Rs. 461 Mn. in FY20. Due to decrease in interest rate on deposits and borrowings in FY21, cost of fund decreased from 8.49% in FY20 to 6.23% in FY21. As on July 15, 2021, its funding is tied up with 7 Banks where borrowing cost ranges from 6% to 8%.

Geographical diversification of business

DLBS has started its business operations in February 2019 by taking over the operations of Dhaulagiri Community Resource Development Center (DCRDC)(FI-NGO). DCRDC started MFI activities from 2001 as a financial intermediary. The company is operating in 19 districts (and presence in 4 provinces through 43 branches as on July 15, 2021. Geographical diversified network base enables bank to have varied customer base and diversified portfolio and thereby reduces the risk of volatility of a single economic region.

About the Company

Dhaulagiri Laghubitta Bittiya Sanstha Limited (DLBS) is a "D" class National Level microfinance institution. It was incorporated on July 03, 2018, and commenced operations in February 2019. It is primarily engaged in providing microfinance loan based on the Joint Liability Group (JLG) model with each group consisting of minimum five members.

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