

## Manushi Laghubitta Bittiya Sanstha Limited

### Ratings

Facilities	Amount (Rs. Million)	Rating <sup>1</sup>	Rating Action
<b>Issuer Rating</b>	<b>NA</b>	<b>CARE-NP B+(Is) [Single B Plus (Issuer)]</b>	<b>Reaffirmed</b>

CARE Ratings Nepal Limited (CRNL) has reaffirmed the issuer rating of "CARE-NP B+ (Is) [Single B Plus (Issuer)]" assigned 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 ratings assigned to MLBSL continues to be constrained by its weak asset quality profile, declining deposit ratio with higher dependence on Banks and Financial Institutions (BFIs) borrowings, competition from other Micro Finance Institutions (MFIs) and Co-operatives and inherent risk involved in the microfinance industry. The rating also factors in exposure to regulatory risks related to microfinance industry and concentrated credit portfolio.

The rating, however, derives strength from support from institutional promoter, experienced board members and management team and long track record of operations. The rating also factors in moderate capitalization level and liquidity profile and improved financial performance leading to increased capital cushion over minimum regulatory requirements during FY21 (audited; refers to the twelve-month period ended mid-July 2021) and H1FY22 (unaudited; refers to the six-month period ended mid-January 2022).

*Going forward, the ability of the company to continue its growth momentum with improving asset quality and capital adequacy ratio and its ability to manage the impact of any regulatory changes will be the key rating sensitivities.*

### Detailed Description of the Key Rating Drivers

#### Key Rating Weaknesses

##### Weak asset quality

MLBSL's asset quality remains weak marked by high Gross Non-Performing Loans (GNPL) ratio, which stood at 5.81% as on mid-July 2021. Although GNPL ratio had improved to 3.69% as on mid-Jan 2022, it still remains higher than the industry average. GNPL ratio has been on an improving trend as the borrowers' financial health steadily improved after the initial shock of the covid-19 pandemic, also indicated by 30-day plus delinquency of 5.15% of total loans and advances as on mid-January 2022 compared to 12.72% as on mid-July 2021. However, given the lingering impact of the pandemic, deterioration in asset health in a short span remains a risk and hence tight monitoring of the asset quality will remain critical for the company's financial health going forward.

##### Declining deposit ratio with increased dependence on Banks and Financial Institutions (BFIs) borrowings

MLBSL's major source of funding consists of deposits from its members and borrowings from banks and financial institutions. The ratio of deposits to total resource decreased to 55.04% as on mid July 2021 from 59.38% as on previous balance sheet date. Also, the ratio of borrowing from BFIs to total resource has increased to 32.49% in FY21 from 27.60% in FY20. Increased dependence of BFI borrowings will lead to higher cost of funding for the MFI, resulting in lower margins. MLBSL's average cost of borrowings and average cost of deposits was 7.70% and 6.60% respectively during FY21. Furthermore, the ratio of deposits to total resource decreased to 42.51% in H1FY22 from 55.04% in FY21 and the ratio of borrowings from BFIs to total resource has increased to 34.96% in H1FY22 from 32.49% in FY21, which is likely to put additional pressure on the MFI's interest spread.

<sup>1</sup>Complete definition of the ratings assigned are available at [www.careratingsnepal.com](http://www.careratingsnepal.com) and other CARE publications

**Sector wise credit portfolio distribution, however high concentration towards service and agriculture sector**

The credit portfolio of MLBSL is highly concentrated towards service and agricultural sector. In FY21 the advances were concentrated towards agriculture sector with 46.99% exposure which increased to 49.14% in H1FY22. Advances towards service sector stood at 41.86% in FY21 which increased to 48.03% in H1FY22. The recovery in the agriculture sector highly depends on various factors such as climatic conditions like monsoons, drought and floods, availability of prices etc. Any adverse climatic conditions or other unfavorable factors which might have an impact on crop production or sales would adversely affect repayment capacity of the borrowers and put added stress on the MFI's asset quality.

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

As on mid-January 2022, there were 67 MFIs in operations with total of 5,046 branches in Nepal. MLBSL had 32 branches as on mid-January 2022. Micro Finance Industry earned Rs. 41,688 Mn interest income, Rs 10,759 Mn net interest income and Rs 10,669 Mn Net profit during FY21. MLBSL had 0.34% (Rs. 141 Mn) share on interest income for the same period in the industry. Furthermore, large number of cooperatives are operating all over Nepal which provide loans and other financial services to their members with or without collateral. Due to presence of large number of microfinance institutions and co-operatives, MLBSL faces competition to tap in a new customer base and to retain the existing customer.

**Inherent risk involved in the microfinance industry**

Micro Finance Institutions are prone to credit risk which is directly related to the portfolio of the organization and is one of the more 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, majority of MFI's loan portfolio is unsecured in nature means advances not secured by adequate collateral. In case any borrower defaults, the MFI does not have any asset backed as collateral to meet its loss, which makes the credit even riskier. As borrowing from MFIs do not usually require collateral, clients tend to borrow from multiple MFIs resulting to problem of loan duplication. As per NRB norms, MFIs are allowed to lend against collateral up to 33.33% of total lending. MLBSL's percentage of collateral loan is 3.49% of total lending in FY21 and 3.26% in H1FY22 which has increased from 0.26% in FY20.

**Key Rating Strengths****Experienced board members and management team with support from institutional promoter**

At the end of FY21, 40.50% of current paid up capital of MLBSL is held by institutional promoters namely Manushi 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. 38.30 Mn capital into the company till the end of FY21. Similarly, Manushi Private Limited is a company engaged primarily in the export of handicraft materials. MLBSL has four members on its board and is chaired by Ms. Padmasana Shakya, with more than 25 years of experience in various sectors. The company's management team is led by Mrs. Shova Bajracharya, who has more than 25 years of experience in microfinance sector.

**Moderate capitalization levels with modest, albeit increasing, cushion over minimum regulatory requirement**

MLBSL's Tier I and overall Capital Adequacy Ratio (CAR) stood at 7.92% and 8.92% respectively at the end of FY21 over the minimum regulatory requirement of 4% and 8%, respectively, for microfinance institutions (MFIs). Overall CAR improved to 9.89% at the end of H1FY22. Improved cushion in the capitalization levels would put the MFI in a better position to absorb any losses, should they materialize, especially given the uncertainty surrounding credit recovery amid the lingering impact of the covid-19 pandemic. The MFI's ability to maintain adequate cushion in the capital adequacy ratios will remain critical for its solvency and growth prospect.

**Improved financial performance marked by sustained growth in advances and income in FY21 and H1FY22**

MLBSL's credit portfolio grew 28.13% year on year (y-o-y) to Rs. 1,067 Mn in FY21, which further increased to Rs. 1,380 Mn by H1FY22, aided mainly by an increasing member base. MLBSL has 0.49% and 0.32% market share in terms of deposit base and loan portfolio respectively, of the microfinance industry in H1FY22. During FY21, MSBSL's total income increased to Rs. 163 Mn from Rs. 158 Mn during FY20. Interest income improved by 1.76% y-o-y to Rs. 141 Mn in FY21 supported by increased advances. Consequently, net interest income increased to Rs. 77 Mn during FY21 from Rs. 68 Mn during FY20. Overall financial performance has improved backed by increasing scale of operations aided also by addition of new branches and the growth trend is likely continue over the medium term. The MFI is operational in 12 districts of Nepal spanning 3 provinces through 32 branches as on mid-Jan 2022. Geographical diversified network base enables MLBSL to have varied customer base and diversified portfolio and thereby reduces the risk of volatility of a single economic region.

**Moderate liquidity profile**

MLBSL has moderate liquidity profile with positive cumulative mismatch in its asset and liabilities as on mid-January 2022. MLBSL has maintained Capital Adequacy Ratio at 0.51% in FY21 and 0.53% in H1FY22 against minimum requirement of 0.50%. Further, MLBSL has maintained net liquid asset ratio of 16.67% in FY21 and 16.77% in H1FY22 against the minimum regulatory requirement 2.5% for MFIs not taking public deposits.

**About the Company**

MLBSL is a "D" class National level microfinance institution 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 loans based on the Joint Liability Group (JLG) model with each group consisting of minimum five members.

**Contact us****Analyst Contact**

Mr. Girish Bhatta  
+977-01-4012630  
[girish.bhatta@careratingsnepal.com](mailto:girish.bhatta@careratingsnepal.com)

**Senior Analyst Contact**

Mr. Santosh Pudasaini  
+977-01-4012629  
[pudasaini.santosh@careratingsnepal.com](mailto:pudasaini.santosh@careratingsnepal.com)

**Relationship Contact**

Mr. Achin Nirwani  
+977-9818832909  
[achin.nirwani@careratingsnepal.com](mailto:achin.nirwani@careratingsnepal.com)

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