Aatmanirbhar Laghubitta Bittiya Sanstha Limited

Rating

Facilities	Amount (Rs. in Million)	Rating[1]	Rating Action
Issuer Rating	**NA**	**CARE-NP B+ (Is) [Single B Plus (Issuer)]**	**Reaffirmed**

CARE Ratings Nepal Limited (CRNL) has reaffirmed the issuer rating of 'CARE-NP B+ (Is)' [Single B Plus (Issuer)] assigned to Aatmanirbhar Laghubitta Bittiya Sanstha Limited (ALBSL). Issuers with this rating are considered to have high risk of default regarding timely servicing of financial obligations.

Detailed Rationale & Key Rating Drivers

The rating assigned to ALBSL continues to be constrained by its weak asset quality, small scale of operation with low market share in the industry, and deteriorating financial performance with suppressed return indicators. The rating also factors in the inherent risk involved in the microfinance industry, exposure to regulatory risks related to microfinance industry and competition from other Micro Finance Institutions (MFIs) and Co-operatives.

The rating, however, derives strength from ALBSL's experienced board members and management team, adequate capitalization levels and moderate liquidity profile at the end of 9MFY23 (Unaudited, refers to the nine-month period ended mid-April 2023) and moderate dependence of resource profile on Banks & Financial Institutions (BFIs) borrowings.

Going forward, the ability of the company to grow its scale of operations along with improvement in asset quality and maintaining adequate cushion in capital adequacy indicators will remain the key rating sensitivities.

Detailed Description of the Key Rating Drivers

Key Rating Weaknesses

Weak assets quality

ALBSL has a weak asset quality profile marked by high Gross Non-Performing Loans (GNPL) of 8.73% as on mid-January 2023, which continues to be substantially higher compared to other peers in the industry (industry average of 4.68% as on mid-January 2023). Collections are being impacted by the ongoing slowdown in the economy, exacerbated by the ongoing liquidity stress in the industry which has severely impacted the repayment capabilities of the borrowers. Furthermore, more than 30-days overdue advances of ALBSL were also relatively high at 10.41% of total loans and advances as on mid-April 2023. Muted pace of economic growth in the country could result in further slippages in ALBSL's asset quality in coming quarters. The company's ability to improve collection leading to better asset quality will remain a key monitorable aspect.

Small scale of operations with low market share in the industry

ALBSL has been operational since April 15, 2019 and has 21 branches covering four districts (out of 77 districts) as on mid-April 2023. Being a province level microfinance company, ALBSL's scope for growth are, at least for now, limited to a single province. The company's credit portfolio grew by ~20% year on year (y-o-y) to Rs 1,419 Mn at the end of FY22 (Audited; FY refers to the twelve-month period ending mid-July), which however declined to Rs. 1,280 Mn as on mid- April 2023. Despite increasing trend in the deposits and advances over FY20-FY22, market share of ALBSL's deposit base and advances portfolio stood low at 0.53% and 0.32% of microfinance industry, respectively, at the end of FY22. Due to geographically concentrated business, the customer base and portfolio of the bank is relatively less diversified which increases the risk of volatility of a single economic region.

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

Deteriorating financial performance with suppressed return indicators

During FY22, despite ALBSL's total income increasing by 16.36% year-on-year to Rs. 225 Mn supported by increased interest income amid increasing advances, profitability and other return indicators are on a declining trend. Net Interest Margin (NIM) ratio deteriorated to 8.71% in FY22 from 9.86% in FY21 on account of increase in interest expense. The company reported net profit of Rs. 59 Mn. in FY22 compared to Rs. 63 Mn in FY21 mainly due to increased loan loss provisioning. Consequently, Return on Total Assets (ROTA) decreased to 4.07% in FY22 from 5.20% in FY21. Also, interest spread rate decreased to 6.93% in FY22 from 8.94% in FY21 due to sudden increase in interest expenses leading to increase in cost of borrowings. During Q3FY23, ALBSL's income further declined to Rs. 138 Mn amid declined advances to Rs. 1,280 Mn.

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 borrowings 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. ALBSL's percentage of collateral loan to total loan is 20.63% in FY22 which decreased from 21.95% in FY21, however increased to 24.70% at the end of Mid-April 2023.

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 regulations, A, B & C class financial institutions have to lend 5%, 4.5% and 4% respectively of their total loans towards deprived sector, a major part of which is generally routed through microfinance institutions. Furthermore, NRB has capped the interest rates of MFI's at 15% and fees at 1.5% while scrapping the interest rate spread cap of 9%, which has tightened the profitability of the MFI's due to restriction in interest earning capacity, particularly during periods of high interest rates. Also, NRB has fixed loan ceiling for new borrowers of Rs. 3 lakhs to unsecured loans and Rs. 7 lakhs to secured loans. And, Rs. 15 lakhs to old borrowers whose loan category is in pass during last two years.

Competition from other MFIs and Co-operatives

As on Mid- March, 2023, there were 63 MFIs in operation with total 5,168 branches all over Nepal. ALBSL has 21 branches as on Mid-April, 2023. Micro Finance Industry earned Rs. 32,157 Mn interest income, Rs. 13,181 Mn net interest income and Rs. 3,208 Mn Net profit as on Mid-January, 2023. ALBSL has 0.29% (Rs. 138 Mn) share on interest income, 0.48% (Rs. 92 Mn) share on net interest income and 0.39% (Rs. 45 Mn) share on net profit for the same period in the industry. Furthermore, large numbers 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, ALBSL is facing competition to tap the new customer and to retain the existing good consumer.

Key Rating Strengths

Adequate capitalization levels and moderate liquidity profile

ALBSL's Tier I and overall Capital Adequacy Ratio (CAR) stood at 13.64% and 14.88%, respectively, as on mid- July, 2022 improving from 11.43% and 12.67% as on mid- July, 2021 compared to the minimum regulatory requirement of 4% and 8% for microfinance institutions (MFIs). ALBSL's CAR further improved to 19.11% at the end of mid-April, 2023 aided by IPO issuance of Rs. 20.34 Mn. Post IPO, the total paid up capital of the company is Rs 62.34 Mn which is in accordance of minimum requirement levels as per regulation. Adequate 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. The MFI's ability to maintain adequate cushion in the capital adequacy ratios will remain critical for its solvency and growth prospect. Furthermore, liquidity profile of ALBSL remains moderate with Cash Reserve Ratio of 0.56% at the end of FY22 against minimum requirement of 0.50%. Additionally, ALBSL had maintained net liquid asset ratio of 7.85% in FY22 against the minimum regulatory requirement 2.50% for MFIs not taking public deposits.

Backup from experienced institutional promoter

At the end of FY22, 64.29% of paid up capital of ALBSL was held by institutional promoter namely Gramin Mahila Utthan Kendra (GMUK**)**. GMUK is a registered NGO, established in the year 1993 to promote the indigenous society and unite to combat for gender equality, justice and dignity. GMUK has been conducting microfinance program to uplift the poor and deprived families in Dang. The institution has serviced more than 20,000 families with microfinance services. ALBSL can tap on the established reach of its promoter GMUK to help expand its customer base.

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

ALBSL's major source of funding consist of deposits from members. Borrowing from BFIs stood moderate at 12.33% of total resource at the end of FY22. The ratio of borrowing from BFIs to total resource further decreased to 5.56% as on mid-April 2023. Consequently, cost of fund is on lower side as it largely consists of source of fund from deposits. ALBSL's cost of deposits stood at around 6.14% in FY22.

About the Company

ALBSL is a "D" class Province Level microfinance institution. It was incorporated on November 20, 2018, licensed by Nepal Rastra Bank on February 12, 2019 and commenced operations on April 15, 2019. Initially, ALBSL commenced its business as Gramin Mahila Utthan Kendra (Rural Women Development Center-RWDC), a financial intermediary. However, of lately, ALBSL initiated its operation as a separate financial entity. ALBSL 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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