

## Dhaulagiri Laghubitta Bittiya Sanstha Limited

### Rating

Facilities	Amount (Rs. in Million)	Rating <sup>1</sup>	Rating Action
Issuer Rating	NA	CARE-NP B+ (Is) [Single B Plus (Issuer)]	Reaffirmed and removed from Issuer not Cooperating Category

CARE Ratings Nepal Limited (CRNL) has reaffirmed the issuer rating of 'CARE B+ (Is)' assigned to Dhaulagiri Laghubitta Bittiya Sanstha Limited (DLBSL) and removed it from Issuer Not Cooperating category as the company has submitted the requisite information to CRNL. 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 DLBSL is constrained by substantial deterioration in its assets quality in FY22 (Audited; FY refers to the twelve-month period ending mid-July) and H1FY23 (Unaudited; H1 refers to the six-month period ending mid-January), company's below average financial performance and low market share in the industry, albeit moderate growth in business over the period. The rating is also constrained by high concentration of advances towards agriculture sector, competition from other 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 experienced board members, management team and support from the institutional investor, moderate level of capitalization levels and liquidity profile and diversified resource profile.

*Going forward, the ability of the company to manage growth along with improvement in asset quality while maintaining adequate cushion in capital adequacy indicators will remain the key rating sensitivities.*

### Detailed Description of the Key Rating Drivers

#### Key Rating Weaknesses

##### Substantial deterioration in assets quality

DLBSL has a weak asset quality profile marked by high Gross Non-Performing Loans (GNPL) of 5.87% of total loans and advances as on mid-July 2022 which deteriorated from 1.27% as on mid-July 2021. GNPL ratio further deteriorated to 7.69% 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 DLBSL were also relatively high at 10.42% and 15.37% of total advances at the end of FY22 and H1FY23, respectively. Muted pace of economic growth in the country is likely to result in further slippages in coming quarters. The company's ability to improve collection leading to better asset quality will remain a key monitorable aspect.

##### Below average financial performance with suppressed return indicators

During FY22, despite DLBSL's interest income increasing by 49.44% year-on-year to Rs. 196 Mn supported by increased advances, profitability and other return indicators have declined compared to previous periods. Net Interest Margin (NIM) ratio deteriorated to 6.54% in FY22 on account of increase in interest expense. The company reported net profit of Rs. 15 Mn. in FY22, sharp decline from Rs. 32 Mn in FY21 mainly due to increased loan loss provisioning. Consequently, Return on Total Assets (ROTA) decreased significantly to 0.97% in FY22 from 2.87% in FY21. Also, interest spread rate decreased to 6.44% in FY22 from 7.70% in FY21 due to sudden increase in interest expenses leading to increase in cost of borrowings. Although income has sustained in

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

H1FY23 amid higher yields on advances, profitability has declined further amid sharp increase in impairment losses related to growing NPLs. DLBSL reported interest income of Rs. 101 Mn in H1FY23 with NIM ratio of 2.81% and PAT of Rs. 3 Mn during H1FY23.

#### **Low market share in the industry, albeit moderate growth in business over the period**

DLBSL's loans and advances portfolio increased by ~40% year-on-year (y-o-y) to Rs 1,438 Mn in FY22 and deposit base grew by ~31% y-o-y to Rs. 676 Mn during FY22. Despite significant growth in the deposits and advances, market share of DLBSL' deposit base and advances portfolio stood low at 0.41% and 0.31% of microfinance industry at the end of mid-January, 2023. With a 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.

#### **High concentration of advances towards agriculture sector**

DLBSL's credit portfolio is highly concentrated towards agricultural sector with 56.67% and 57.02% of total portfolio at the end of FY22 and H1FY23, respectively. 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- March, 2023, there were 64 MFIs in operation with total 5,168 branches all over Nepal. DLBSL has 44 branches as on Mid-January 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. DLBSL has 0.32% (Rs. 102 Mn) share on interest income, 0.34% (Rs. 45 Mn) share on net interest income and 0.11% (Rs. 3 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, DLBSL is facing competition to tap the new customer and to retain the existing good consumer.

#### **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. DLBS's percentage of collateral loan is 10.61% of total lending as on mid-January 2023 compared to 9.67% at the end of FY22.

#### **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.

### **Key Rating Strengths**

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

DLBSL is managed by 5 board members and the board is chaired by Mr Ishworlal Rajbhandari. He has more than two decades of experience in diversified fields. The company's management team is led by CEO, Mr. Min Bahadur Bohara who has almost three decades 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 16, 2022, Prabhu Bank Limited (PRVU) [CARE-NP BBB (Credit watch with negative implications)] holds 14.55% 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 DLBSL in respect of any management and operational assistance.

#### **Moderate capitalization and liquidity profile**

DLBSL's Tier I and overall Capital Adequacy Ratio (CAR) stood at 8.37% and 8.97%, respectively, as on mid-July 2022, slightly declining from 9.74% and 10.40% as on mid-July 2021 against the minimum regulatory requirement of 4% and 8% for microfinance institutions (MFIs). However, DLBSL's CAR improved to 11.65% at the end of H1FY23 as compared to 8.97% at the end of FY22, aided by IPO issuance of Rs. 33.10 Mn. Post IPO, the total paid up capital of the company has surpassed the minimum requirement level of Rs. 100 Mn 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 DLBSL remains moderate with Cash Reserve Ratio of 0.56% at the end of FY22 against minimum requirement of 0.50%. Additionally, DLBSL had maintained net liquid asset ratio of 7.85% in FY22 against the minimum regulatory requirement 2.50% for MFIs not taking public deposits.

#### **Diversified Resource Profile**

DLBSL's major source of funding consist of deposits from members and borrowings from banks and financial institutions. The ratio of deposits to total resource stood at 43.30% as on mid-July 2022 from 46.42% and declined slightly to 42.68% as on mid-January 2023. Also, the ratio of borrowing from BFIs to total resource stood high at 40.40% as on mid-July 2022 and decreased to 34.18% as on mid-January 2023. Increased dependence on BFI borrowings will lead to higher cost of funding for the MFI which could lead to squeezed margins for MFIs, which have to abide by regulatory ceiling of 15% for their advances.

#### **About the Company**

Dhaulagiri Laghubitta Bittiya Sanstha Limited (DLBSL) is a "D" class National Level microfinance institution. It was incorporated on July 03, 2018, and commenced operations from 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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