

CYC Nepal Laghubitta Bittiya Sanstha Limited

Rating

Facilities	Amount (Rs. in Million)	Rating ¹	Rating Action
Issuer Rating	NA	CARE-NP BB- (Is) [Double B Minus (Issuer Rating)]	Reaffirmed and Removed from Credit Watch with Developing Implications

CARE Ratings Nepal Limited (CRNL) has reaffirmed the rating of 'CARE-NP BB- (Is)' assigned to CYC Nepal Laghubitta Bittiya Sanstha Limited (CYCN). Issuers with this rating are considered to offer moderate risk of default regarding timely servicing of financial obligations, in Nepal.

CRNL has also removed the rating from credit watch with developing implications following completion of CYCN's merger with Adhi Khola Laghubitta Bittiya Sanstha Limited (AKBSL) with commencement of joint operations from March 14, 2023.

Detailed Rationale & Key Rating Drivers

The rating assigned to CYCN remains constrained by its moderate capitalization levels with thin cushion from minimum regulatory requirement, higher cost of funds resulting in squeezed margins and sharp decline in net profits and modest return indicators in FY23 (Unaudited, FY refers to the twelve-month period ending mid-July), and higher concentration towards agricultural sector. The rating also factors in CYCN's moderate asset quality with declining trend in FY23 and its presence in a highly competitive market with inherent risks related to the industry. The rating, however, continues to derive strength from the company's experienced board members and management team, moderate liquidity profile, and growing scale of operations in FY23 following merger with AKBSL. Despite evident increase in scale, other credit profile parameters including asset quality and capitalization levels remain at similar levels prior to the merger.

Going forward, the ability of the company to manage growth without compromising on asset quality and maintaining capital adequacy while improving profitability will remain a key rating sensitivity. The company's ability to manage the impact of any regulatory changes by Nepal Rastra Bank would also be a key monitorable aspect.

Detailed Description of the Key Rating Drivers

Key Rating Weaknesses

Thin cushion in capitalization levels exposes risks to absorb additional credit shocks

CYCN's Tier I and overall Capital Adequacy Ratio (CAR) stood modest at 8.14% and 9.79%, respectively, as on mid-July 2023 with relatively thin cushion from the minimum regulatory requirement of 4% and 8% for MFIs (microfinance institutions). Although the capitalization ratios increased from 6.84% and 8.49% as on mid-July 2022 following merger with AKBSL, it continues to remain substantially lower than the industry average of around 11.99% and 13.33% as on mid-July 2023. Lower capitalization levels could limit the MFI's ability to absorb losses, should they materialize, especially given the increasing uncertainty surrounding credit recovery. Post-pandemic recovery continues to remain a concern amid high inflation and interest rates impacting entire demand-supply dynamics for various sectors, leading to reduced debt repayment capabilities of borrowers. The company's ability to maintain adequate cushion in the capital adequacy ratios will remain critical for its solvency and growth prospect going forward.

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

Sharp decline in profitability amid increased cost of funds

CYCN's major source of funding consist of deposits from its members and borrowings from BFIs. The ratio of borrowing from BFIs to total resources increased to 59.49% at the end of FY23 from 45.69% at the end of FY22. Due to increasing reliance on BFIs for funding, the average overall cost of funding also increased to 8.56% in FY23 from 6.03% in FY22. Consequently, CYCN reported 91.58% year-on-year decline in its net profit in FY23 to Rs. 6 Mn from Rs. 67 Mn in FY22. Return on total asset in FY23 plummeted to around 0.1% from over 1.5% in earlier years.

Moderate asset quality with declining trend in FY23

CYCN has a moderate asset quality marked by Gross Non-Performing Loans (GNPL) ratio of 2.97% as on mid-July 2023, a deterioration from 2.57% as on mid-July 2022. Although GNPL continues to remain better than the industry average of 4.85%, declining trend in FY23 remains a concern with possibilities of further slippages going forward. More than 30-day delinquency of CYCN stood at 6.38% of total advances as on mid-July 2023 compared to 7.63% as on mid-July 2022. The company's ability to improve collection leading to better asset quality will remain a key monitorable aspect.

Concentrated credit portfolio towards agricultural sector

CYCN has been disbursing loans to various sectors with its credit portfolio highly concentrated on agricultural and service sectors. In FY23, it lent 63.63% (FY22: 55.71%) towards Agricultural Industry (which includes 37.47% to animal husbandry, 9.06% to crop and crop services, 6.25% to poultry, and 4.62% to vegetables), followed by 14.02% (FY22: 13.49%) towards Service Industry (which includes 4.92% to wholesale and retail business, 4.27% to hotel & restaurants, and 4.83% to other services). The recovery in the agriculture sector highly depends on factors like climatic conditions such as monsoons, droughts 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-July 2023, there are 57 MFIs in operations with 5,073 branches all over Nepal. Among them, CYCN had 124 branches. In FY23, microfinance industry earned the total of Rs. 61,707 Mn interest income, Rs. 24,741 Mn net interest income and Rs. 4,783 Mn net profit, among which CYCN has 0.99% (Rs. 613 Mn) share on interest income, 0.94% (Rs. 232 Mn) share on net interest income and 0.12% (Rs. 6 Mn) share on net profit for the same period. Likewise, CYCN had 1.29% and 1.23% market share in terms of deposit base and loan portfolio respectively of microfinance industry at the end of FY23. 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 the presence of large number of microfinance banks and co-operatives, CYCN faces competition to tap in new customer base and to retain the existing ones.

Inherent risk involved in the microfinance industry

MFIs are prone to credit risk which is directly related to the portfolio of the institution and is one of the most significant risks from a MFI's perspective. Credit risk assumed by an MFI is typically higher compared to other banks and lenders given its weak borrower profile. Furthermore, MFIs majorly provide unsecured loans i.e. loans without any collateral. In case any borrower defaults, the MFIs does not have any assets backed as collateral to meet its loss, which makes the credit even riskier. As borrowing from MFIs do not require collateral, clients tend to borrow from multiple MFIs resulting in the problem of loan duplication. As per NRB norms, MFIs are allowed to lend against collateral up to 33.33% of total lending. CYCN's percentage of collateral loan to total loan is 8.63% at the end of FY23, which is increased from 3.82% 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 MFIs at 15% and fees at 1.5% while scrapping the interest rate spread cap of 9%, which has tightened the profitability of the MFIs 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, Rs. 7 lakhs to secured loans and Rs. 15 lakhs to old borrowers whose loan is in category pass during last two years.

Key Rating Strengths

Experienced board members and management team

CYCN has seven board members and the board is chaired by Mr. Padhmanath Sharma, Graduate, with more than 17 years of experience in Chartare Youva Club Nepal (FI-NGO) as a patron. He also has vast experience as a lawyer and social worker. The company's management team is led by Managing Director, Mr. Dolindra Prasad Sharma, M.A, who has served as the chairperson and general manager of Sajha Prakashan, one of the renowned publishing houses of the country funded by Government of Nepal. He has also served as Contact Officer in Kathmandu for Chartare Youva Club. The board is supported by other experienced management team members to look after various functions in the company.

Moderate liquidity profile

The CRR of CYCN at the end of FY23 slightly increased to 0.59% from 0.56% at the end of FY22, but its SLR reduced significantly to 8.13% at the end of FY23 from 55.90% at the end of FY22. Nevertheless, both figures were in line with the minimum regulatory requirement of 0.50% for CRR and 2.50% for SLR for MFIs not taking public deposits. Also, CYCN's liquidity profile as on mid-July 2023 shows positive cumulative balances.

Growing scale of operations post completion of merger in FY23

Total income of the company increased by 28.53% to Rs. 684 Mn in FY23 from Rs. 533 Mn in FY22. This increase in total income was majorly due to significant increase in interest income by 51.62% to Rs. 613 Mn in FY23 from Rs. 405 Mn in FY22 aided by growth in loans and advances by 48.48%. Likewise, its net interest income increased by 8.13% to Rs. 232 Mn during FY23. Deposits also grew by 55.51% to Rs. 2,156 Mn at the end of FY23 from Rs. 1,386 Mn at the end of FY22 majorly due to the merger with AKBSL. However, CYCN reported a net profit of Rs. 6 Mn, down from Rs. 67 Mn during FY22 on the back of decline in non-interest income and increase in operating expenses.

Long track record of operations with growing geographical reach

CYCN has been operating as a financial intermediary since June 2000. As on mid-July 2023, the MFI was operating in all 77 districts of Nepal spanning all seven provinces through 124 branches as compared to 60 districts and seven provinces through 89 branches as on mid-July 2022. The growth in geographical reach in FY23 was mainly on account of addition of branches after merger with AKBSL. Geographical diversified network base enables CYCN to have varied customer base and diversified portfolio and thereby reduce the risk of volatility of a single economic region.

About the Company

CYC Nepal Laghubitta Bittiya Sanstha Limited (CYCN) is a "D" class national level microfinance institution. It was incorporated on July 01, 2018, and commenced operations in March 2019. After the merger with Adhi Khola Laghubitta Bittiya Sanstha Limited (AKBSL) with the swap ratio of 100:70 (CYCN: AKBSL), joint operations started on March 14, 2023. CYCN is promoted by institutions and individuals from different background and is primarily engaged in providing microfinance loans based on the Joint Liability Group (JLG) model with each group consisting of minimum five members. At the end of FY23, it had Rs. 266 Mn paid up capital, distributed among promoters and public shareholders in the ratio of 64.45:34.55.

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