

Rastra Utthan Laghubitta Bittiya Sanstha Limited: [ICRANP-IR] BB assigned

June 21, 2021

Summary of rated facilities

Facility	Rated Amount	Rating Action
Issuer Rating	NA	[ICRANP-IR] BB; assigned

Rating action

ICRA Nepal has assigned the issuer rating of [ICRANP-IR] BB (pronounced ICRA NP issuer rating double B) to Rastra Utthan Laghubitta Bittiya Sanstha Limited (RULBSL). Issuers with this rating are considered to have moderate risk of default regarding timely servicing of financial obligations. The rating is only an opinion on the general creditworthiness of the rated entity and not specific to any particular debt instrument.

Rationale

The assigned rating factors in RULBSL's experienced management team and good promoter profile comprising strong institutional promoters (~48% combined stake held by Rastriya Banijya Bank Limited [state-owned class A bank] and Prabhu Bank Limited, rated IR-BBB by ICRA Nepal), which augur well for its governance and management aspects. The rating also factors in the long track record (since 1997) and experience of Nepal Rural Development Organization (NeRuDo) (RULBSL's forerunner NGO and its major promoter) in the microfinance activities. The rating also considers the company's low cost of fund (4.66% in 9M FY2021) amid lower borrowing rates on account of excess banking liquidity, which remains a positive in the current regime of lending rate cap for microfinance institutions (MFIs). ICRA Nepal also notes the adequate network base (82 branches in 34 districts as of mid-April 2021), which remains positive from a geographically balanced growth perspective.

However, the rating is mainly constrained by the asset quality concerns of the MFI given the ongoing Covid-19 pandemic and its impact on the repayment capacity of the marginal borrower profile. This risk is further accentuated by the company's aggressive credit growth trend in the recent periods (~126% annualised growth in 9M FY2021 supported by a sharp increase in the average ticket size). While the reported asset quality indicators as of mid-April 2021 remain comfortable, stress could build up as a sizeable portion of current credit book remains unseasoned, along with the likely impact of the pandemic. The rating is also constrained by the company's relatively moderate profitability indicators with return on assets (RoA) of 1.97% and return on net worth (RoNW) of 16.53% in 9M FY2021, dragged by the small size of business and limited economies of scale. The rating also notes the company's thin capital cushion with capital to risk weighted assets ratio (CRAR) of 9.29% against the regulatory requirement of 8%, though likely to be comforted by the proposed IPO. Rating concerns also arise owing to the fragmented microfinance industry (coupled with comparatively weak regulated cooperatives), intense competition, high ticket sizes permitted by regulations, and lack of fully functional credit information bureau, which raise concerns on the overleveraging of borrowers and long-term asset quality for the industry. Going forward, RULBSL's ability to maintain comfortable asset quality indicators, while increasing its scale of operations and generating stable and adequate profitability over an increasing capital base will have a bearing on its overall financial profile.

Key rating drivers

Rating strengths

Good promoter profile and experienced management; adequate track record – RULBSL's largest promoter is the erstwhile financial intermediary NGO (FINGO) named Nepal Rural Development Organization (NeRuDo) holding a ~43% stake. The company also has other two strong institutional promoters viz. Rastriya Banijya Bank Limited (state owned class A bank) holding a ~31% stake and Prabhu Bank Limited (private sector class A bank) holding a ~17% stake. The

company has an experienced board of directors with one senior official from each of these institutions in the board. Although RULBSL started operations from February 2019, it took over NeRuDo's existing microcredit operation, which started from 1997 (credit portfolio was NPR 906 million as on the date of business takeover). The company has an adequate track record in the microfinance business along with an experienced management team, which remain positives for controlled growth.

Competitive cost of fund and diversified borrowings – RULBSL has been able to maintain a relatively lower cost of fund among peers over the years, which stood at 4.66% in 9M FY2021 (7.97% in FY2020). This can be mainly attributed to the funding support from promoter banks at a relatively lower rate of interest. Further, the company has a relatively low share of member deposits (~27% as of mid-April 2021), which generally carries higher cost, while the borrowing cost from banks remains low amid excess liquidity at present. The company has met ~72% of its total funding requirement through bank borrowings from 16 banks and financial institutions, indicating access to diverse institutions for incremental funding requirements. Going forward, the company's ability to maintain competitive cost of funds would remain the key monitoring factor.

Adequate network base – The company has a diverse presence in 34 districts of Nepal through its 82 branches, and has a member base of approximately 40,000 as of mid-April 2021. Although the company still has a relatively small scale of operation, its adequate network base and further expansion plans along new geographies, are expected to provide room for geographically balanced growth, going forward.

Rating challenges

Aggressive credit growth and rising ticket size raise asset quality concerns – RULBSL has maintained a high credit growth in the recent period, albeit over a small base, with an annualised growth of ~126% in 9M FY2021. The growth was mainly aided by focusing on higher ticket size collateral-based loans, which increased the average ticket size to ~NPR 94,000 as of mid-April 2021 from ~NPR 64,000 as of mid-July 2020. Accordingly, the collateral-based loan has also increased sharply to ~28% as of mid-April 2021 (~4% as of mid-July 2020) against the regulatory cap of one third of the total portfolio. Although reported asset quality remains comfortable with non-performing loans (NPLs) of 1.32% and 0+ delinquency of ~7% as of mid-April 2021, the company's ability to maintain the asset quality with portfolio seasoning, while controlling fresh slippages due to the pandemic would remain crucial. Near-term asset quality for the MFI sector would depend on the stance of the regulator in extending support to the pandemic impacted borrowers. Although the loan portfolio, insured with Deposit and Credit Guarantee Corporation (DCGC), provides comfort, the company's traction of recovery from insurance remains to be seen.

Modest profitability profile amid small scale of operations – The company's profitability profile remains relatively weaker among its peers, despite an improvement in the recent period with RoA of 1.97% and RoNW of 16.53% in 9M FY2021 (1.16% and 6.90%, respectively in FY2020), which affects its ability to generate internal capital to support business growth and absorb credit shocks. The low profitability is mainly on account of the company's high operating cost (operation expense to average total assets [ATA] of 6.55% in 9M FY2021) due to its relatively lower scale of operation. The company has aggressively added branches in the recent years but they are yet to contribute significantly to its profitability. Going forward, the company's ability to attain adequate scalability while controlling the asset quality would remain crucial.

Moderate capitalisation – The company's capitalisation remains modest with a CRAR of 9.29% as of mid-April 2021, maintaining a thin cushion against the minimum regulatory requirement of 8%. The capitalisation has moderated in the recent periods due to the company's high credit growth. As of now, its ability to absorb any near-term asset quality shocks remains weak. However, the proposed Initial Public Offer (IPO) of NPR 85 million is expected to support its capitalisation and help it attain its future growth plans.

Low penetration of credit bureau in Nepalese MFI sector; risk of overleveraged borrowers remains high – Many MFI players and micro lending by some class-A and class-B banks as well as cooperatives in the same geography as RULBSL led to a stiff competition and the risk of multiple financing to MFI sector borrowers. This risk is accentuated by the lack of fully operational and functional centralised credit information bureau for the MFI sector and a relatively weak credit

profile of the borrowers in general. Besides a high regulatory lending ceiling, this raises concerns of overleveraging, which could increase long-term asset quality concerns.

High regulatory risks – Regulatory risks are high for the sector as any changes in the regulations may impact funding sources and interest spreads. The regulatory changes capping the MFI’s lending rate at 15% and fees at 1.5% are expected to strain the profitability of the entire microfinance industry, especially if the current low interest rate scenario reverses. Also, a high loan ceiling for MFI lending by NRB (unsecured loan of NPR 300,000 and secured loans of NPR 700,000 for new borrowers) might lead to an aggressive growth and affect the industry’s asset quality. Low regulatory capital requirements (8%) and higher permissible gearing levels (30 times), despite lending to risky segments, remain concerns from the perspective of the company’s ability to absorb credit shocks.

Analytical approach: For arriving at the rating, ICRA Nepal has applied its rating methodology as indicated below.

Links to applicable criteria:

[Issuer Rating Methodology](#)

[Credit Rating Methodology for Non-Banking Finance Companies](#)

Company Profile

Rastra Utthan Laghubitta Bittiya Sanstha Limited (RULBSL) started its operation in February 2019 as a national level class D microfinance institution, licenced by the Nepal Rastra Bank (the central bank). After its licensing, RULBSL took over the microfinance business of Nepal Rural Development Organization (NeRuDO), a financial intermediary NGO, established in 1997. NeRuDO started the MFI activities with seed loan fund of US\$ 20,000 received from Grameen Trust, Bangladesh (established by Professor Muhammad Yunus) on December, 1998.

As of mid-April 2021, RULBSL operated through 82 branches in 34 districts. As on the same date, its shareholders comprised NeRuDO (a ~43% stake) along with Rastriya Baniya Bank (~31%), Prabhu Bank Limited (~17%) and individual promoters (~9%). The registered and corporate office of RULBSL is located at Banepa-13, Kavrepalanchowk, Nepal. RULBSL reported a net profit of ~NPR 17 million in FY2020 (YoY decline of ~11%), over an asset base of ~NPR 1,601 million as of mid-July 2020. Further, it reported a net profit of ~NPR 33 million in 9M FY2021 over an asset base of ~NPR 2,807 million as of mid-April 2021. As on the same date, RULBSL’s gross NPLs stood at 1.32% and CRAR at 9.29%.

Key financial indicators

Year ended	Mid-July 2019 (Audited)	Mid-July 2020 (Audited)	Mid-April 2021 (Provisional)
Number of members	21,325	29,314	39,558
Credit portfolio (NPR million)	1,002	1,307	2,516
Number of borrowers	15,968	20,411	26,828
Average ticket size (NPR)	62,769	64,053	93,800
Number of branches	42	67	82
Deposits (NPR million)	495	619	676
Deposit to loan ratio	49%	47%	27%
Gross NPLs	0.85%	1.17%	1.32%
Operating ratios			
Yield on average loans	18.96%	16.90%	12.74%
Cost of average interest-bearing funds	9.47%	7.97%	4.66%
Net interest margin/ATA	8.14%	7.79%	7.32%
Non-interest income/ATA	1.86%	2.19%	2.77%
Operating expenses /ATA	7.78%	8.48%	6.55%
Credit provision and write-offs /ATA	0.18%	-0.10%	0.71%

Year ended	Mid-July 2019 (Audited)	Mid-July 2020 (Audited)	Mid-April 2021 (Provisional)
Return on ATA	1.79%	1.16%	1.97%
Return on average net worth	11.92%	6.90%	16.53%
Capitalization ratios			
Capital adequacy ratio	18.40%	14.43%	9.29%
Gearing [(deposits+ borrowing)/ net-worth] times	4.21	5.20	8.57
Borrowing/ net worth (times)	2.08	2.70	6.14

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About ICRA Nepal Limited

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