

## RSDC Laghubitta Bittiya Sanstha Limited

### ICRA Nepal assigns [ICRANP] IPO Grade 4 to the proposed Initial Public Offer (IPO) of RSDC Laghubitta Bittiya Sanstha Limited

Facility/Instrument	Issue Size	Grading Action (January 2016)
IPO (Equity)	NPR 40 million	[ICRANP] IPO Grade 4 (Assigned)

ICRA Nepal has assigned an “[ICRANP] IPO Grade 4”, indicating below-average fundamentals to the proposed Initial public offer (IPO) amounting NPR 40 million of RSDC Laghubitta Bittiya Sanstha Limited (RSDC). ICRA Nepal assigns IPO grading on a scale of IPO Grade 1 through IPO Grade 5, with Grade 1 indicating strong fundamentals and Grade 5 indicating poor fundamentals. For the grading categories 2, 3 and 4, the sign of + (plus) appended to the grading symbols indicate their relative position within the grading categories concerned. RSDC is proposing to come out with an IPO of 400,000 number of equity shares of face value NPR 100 each to be issued to the general public at par.

The grading factors in RSDC’s experienced promoters (RSDC-NGO, with experience in social mobilisation and financial access programmes and Lumbini Bank Limited a Class A commercial Bank) and RSDC’s demonstrated ability to grow (portfolio grew by CAGR 49% during FY14 – Q1FY16; albeit on a small base) driven by increase in number of partner co-operatives (from 62 in Jul-14 to 136 on Oct-15). Growth opportunities remain adequate in the medium term, given access to low cost funds for RSDC benefited from deprived sector regulation, adequate capitalisation profile (CRAR 13.73% as on mid-Oct-15 vs regulatory minimum 8%), and potential for growth for MFIs in Nepal given large below poverty line population; which have been factored in while assigning the grading. The grading also takes into consideration RSDC’s fair profitability in initial stage of operations (return on net worth of ~13% in FY15 and ~18% in Q1FY16).

The grading is however constrained by RSDC’s limited track record (operating since Sept-13), , high credit and geographical concentration (top-20 borrowers accounted for 38% and top five districts accounted for 59% of the total loans, both as on mid Oct-15), and increased delinquencies (overdue accounts comprised 8% of RSDC’s total loans as on mid Dec-15 as compared to 1% as on mid Jul-15) on account of unfavourable operating environment arising from continuing political turmoil in the southern plains. The grading also takes into account higher portfolio vulnerability for RSDC due to unsecured lending and marginal profile of the ultimate borrower accentuated by lack of centralized credit bureau in microfinance (MFI) sector raising concerns of overleveraging. ICRA Nepal also takes note of weak regulatory supervision over co-operative players’ (as a wholesale lender to MFIs, RSDC lends to co-operatives) and evolving systems and processes at RSDC, leading to limited ability to monitor the exposures.

As a wholesale lender to MFIs, RSDC uses the network of existing co-operatives (separate legal entities), in order to reach the targeted population. As on mid-Oct-15, RSDC’s credit portfolio was primarily lent towards savings and credit co-operatives (34%), self-reliance co-operatives<sup>1</sup> (32%), and multipurpose co-operative (11%), and agriculture co-operatives (9%) among others. RSDC’s credit portfolio remains relatively small at NPR 531 million on Oct-15, despite 49% CAGR growth during FY14 – Q1FY16 (albeit on a small base). The credit growth is primarily driven by the increasing number of partner organizations (from 62 partner co-operatives in Jul-14 to 136 as on Oct-15).

RSDC has reported good asset quality with Nil Gross NPL as on mid-Oct-15 and mid-Jul-15 (partly benefited by low seasoning of credit book). However, ongoing political turmoil in the southern plains of the country has impacted the overall economy and repayment capacity of the borrowers resulting in the buildup of delinquencies<sup>2</sup> during the last few months, which could impact RSDC’s asset quality indicators going forward. Although RSDC lends to co-operatives, the portfolio vulnerability remains high due to

<sup>1</sup> Co-operatives set up by RSDC-NGO (promoter of RSDC) through multilateral donor-funded programs.

<sup>2</sup> Delinquent loans (for less than 90 days) on mid-Dec-15 accounted for ~8% of total loans vs. ~1% in mid-July-15.

unsecured lending and marginal profile of ultimate borrowers. Lack of centralized credit bureau in MFI sector raises overleveraging concerns, which could impact RSDC's asset quality. In addition, all partner organizations of RSDC are co-operative societies - an industry that is subjected to limited regulatory control and supervision with generally weak systems. Additionally, RSDC's systems and processes are also evolving, thereby limiting its ability to monitor the exposures. In ICRA Nepal's opinion, establishing adequate systems, strengthening of organization structure and close supervision of co-operatives would be necessary to support the planned growth and maintain asset quality going forward.

RSDC's funding profile comprises low cost borrowings from banks and financial institutions, aided by deprived sector regulations<sup>3</sup>. RSDC's total borrowings as on Oct-15 stood at NPR 578 million, with ~20% from Lumbini Bank Limited (Class A commercial bank and promoter of RSDC). The average cost of borrowings for RSDC remains low at 4.15% for FY15 and has declined in the recent past owing to excess liquidity in the financial system. Although the recent regulatory changes have been favouring<sup>4</sup> deprived sector lending, any adverse change in the regulations is likely to affect the funding profile of RSDC. However, class A bank as institutional promoter of RSDC provide some comfort regarding the funding profile under adverse conditions.

The profitability profile of RSDC remains fair (return on net worth of ~13% in FY15 and ~18% in Q1FY16) and is supported by healthy NIMs (4% - 4.5%) and adequate proportion of loans as a % of total assets (80% as on mid-Oct-15). At the same time, low operating expense ratio (1.53% of ATA during Q1FY16) and low credit provision expense (0.14% of ATA during Q1FY16) has aided the profitability profile. However, the earnings stream for RSDC lacks diversity at present, and has been considered by ICRA Nepal while assigning the grading.. Going forward, RSDC is likely to maintain the profitability profile on the back of steady NIMs and operational efficiencies brought about by increasing scale of operations, provided the company is able to maintain its asset quality indicators. However, RSDC's ability to maintain asset quality indicators amid uncertain operating environment and increased scale of operations remains to be seen.

As on Oct-15, CRAR of RSDC was comfortable at 13.73% against the regulatory minimum level of 8%, and provides adequate room for near term growth. Proposed IPO is expected to further support RSDC's growth plans. Although the recovery profile of loan book of RSDC and resultant profitability has witnessed limited impact so far, prolongation of the current turmoil could affect the rate of internal capital generation. Over the long run, the ability of the bank to raise capital from existing promoters or external investors will have a strong bearing on capitalisation profile. As per ICRA estimates, current level of capital<sup>5</sup> is likely to support the 40% CAGR growth plans of the management over the next 3 years; maintaining overall capitalization in the range of around 12-14% with solvency indicators<sup>6</sup> expected to remain within 7% level.

### **Company Profile**

RSDC Laghubitta Bittiya Sanstha Limited (RSDC), a class D microfinance institution licensed by NRB, commenced operations from September 11, 2013. RSDC is a wholesale microfinance lender, relying on the network of its partner cooperatives, to carry out the microfinance operations. RSDC's major promoters include Rural Self-reliance Development Centre (NGO; 40.90% shareholding) and Lumbini Bank Limited (a class A commercial bank; 20%). Head office of RSDC is located in Butwal, Rupandehi District. Mr. Damodar Joshi is the Chief Executive Officer of RSDC.

RSDC was set up to provide funding and technical support to the cooperatives set up by parent NGO<sup>7</sup> and other MFI entities with similar nature; with an aim to strengthening them. During FY14-15 (first year of full operation), RSDC reported a net profit of NPR 8.63 million on an asset base of NPR 555 million on mid-July-15 (corresponding to return on assets of ~2% and return on net worth of ~13%). During Q1FY15-

<sup>3</sup> NRB regulation making it mandatory for BFIs to allocate 4-5% of total loans outstanding towards deprived sector.

<sup>4</sup> Monetary policy for 2015-16 has provided for 50bps increase in mandatory deprived sector lending.

<sup>5</sup> Including the proposed IPO

<sup>6</sup> Un-provided NPL (Net NPL)/ Net worth

<sup>7</sup> More than 150 co-operatives were helped establish by RSDC-NGO through donor-funded Self-reliance (Swabalamban) projects carried out in 13 districts of Nepal. As of mid-Jul-15, 43 of these co-operatives are borrowing from RSDC.



16, RSDC has reported a profit of NPR 3.28 million over an asset base of NPR 660 million as of mid-Oct-15 (corresponding to return on assets of ~2% and return on net worth of ~18%). As on mid-Oct-15, RSDC's gross NPLs stood at Nil and CRAR at 13.73%. On information technology front, RSDC uses Pumori IV software.

**January 2016**

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