Swarojgar Laghubitta Bikas Bank Limited

ICRA Nepal assigns [ICRANP] IPO Grade 4+ to the proposed Equity Shares (Rights Issue) of Swarojgar Laghubitta Bikas Bank Limited

Facility/Instrument	Issue Size	Grading Action (March 2017)
Rights Share Issue	NPR 34.99 Million	[ICRANP] IPO Grade 4+ (Assigned)

ICRA Nepal has assigned an "**[ICRANP] IPO Grade 4+**", indicating below-average fundamentals to the proposed rights issue amounting to NPR 34.99 million of Swarojgar Laghubitta Bikas Bank Limited (SLBBL). 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. Thus, the grading of 2+, 3+ and 4+ are one notch higher than 2, 3, and 4, respectively. SLBBL is proposing to come out with 50% rights issue of 349,994 numbers of equity shares of face value NPR 100/- each, to be issued to its existing shareholders at par. The proposed issue is being made to augment the capital base to support the future growth plans of the management.

The grading factors in SLBBL's ability to achieve high portfolio growth (CAGR[1] ~44% during FY14-16, albeit on a small base) largely through expansion in client base (~23% CAGR) whilst maintaining low average portfolio per member (~NPR 47,000 as of mid-Jan-17[2]). SLBBL's asset quality remains comfortable (0+ day past due of 0.47% as on mid-Jan-17, improving from 0.72% as on mid-Jul-16) and profitability profile remains healthy (RoNW and RoA[3] of ~35% and ~4% respectively for FY16 vs. ~23% and ~2% respectively for FY13). Growth opportunities for SLBBL remain adequate given the bank's experienced management team, adequate geographical reach in its area of operations[4] with plans of rapid expansion over new geographies, access to low cost funds benefited from deprived sector regulation, adequate capitalization profile (CRAR[5] 11.76% as on Jan-17 vs. regulatory minimum 8%) and large below poverty line population in Nepal that act as target group for MFIs[6]. The grading also positively takes note of the recent regulatory relaxation of allowing addition of up to 4% operating costs to cost of funds in maintaining the 7% lending spreads as introduced by Monetary Policy of FY17. Going forward, ability of the company to maintain sustainable growth & generate scale economies through geographical expansion while maintaining commensurate risk mitigation practices would be critical.

Nonetheless, the grading is constrained by the recent regulatory constriction for MFIs capping lending rates at 18% which is expected to impact profitability of the sector going forward. Additionally, Monetary Policy of FY17 also required commercial banks to directly lend 2% to deprived sector (rest 3% of deprived sector lending requirements could be through intermediaries). Any further changes in regulations and banking sector's preference to route deprived sector lending through MFIs could significantly impact funding support for the sector and hence its growth and profitability prospects of SLBBL. The grading is also constrained by SLBBL's limited track record (operating since December 2009), small scale of operations (asset size of NPR 1,020 million as of Jan-17) with relatively higher operating cost (~6.5% of AMA[7]). The grading also takes into account SLBBL's promoter base being diversified across limited individuals, high cost of funds (~7% for H1FY17), tightening liquidity scenario and competition from established peers undertaking microcredit activities through larger franchise. The grading further takes into account SLBBL's significant exposure in high ticket collateralized loans (~19% as of Jan-17) to marginal borrower profile. Moreover, absence of centralized credit bureau in microfinance segment remains a major concern, limiting MFI's ability to check multiple lending, hence raising concerns of overleveraging.

[1] Compounded Annual Growth Rate
[2] Mid-Jan-2017 data are unaudited; all calculations are based on management provided data
[3] Return on Net Worth and Return on Assets
[4] 29 branches spread across 10 districts working area as of mid-Jan-17
[5] Capital to Risk (Weighted) Assets Ratio
[6] Micro-Finance Institutions
[7] Average managed advances

As for SLBBL's monitoring mechanisms, field monitoring of branches is done by head office assigned monitoring officers on a monthly basis in addition of the branches are audited once a quarter by outsourced internal auditors so far. In ICRA Nepal's opinion, the company's monitoring and supervision remains moderate and ability of the company to maintain similar frequency and coverage would remain critical given the high growth being targeted. ICRA Nepal also takes note of the high growth targets of SLBBL and regulatory increase in maximum permissible ticket sizes (from NPR 1 lakh to NPR 3 lakhs for 1st cycle loans and maximum from NPR 3 lakhs to NPR 5 lakhs by Monetary policy of FY17), both of which could impact discipline and hence asset quality. MFIs would have to develop strong credit appraisal systems and carefully assess cash flows and debt repayment capacity of the borrowers for sustainable growth.

SLBBL follows group lending model, wherein 5 individuals take mutual responsibility for loan repayment for all the members. In addition, SLBBL also extends secured loans up to NPR 700 thousand to finance micro enterprise against regulatory limit of NPR 10 lakhs. SLBBL offers NPR 50,000 for the first cycle loans (maximum limit allowed in successive cycles is NPR 2 lakhs vs. 5 lakhs allowed by regulations) owing to this, the average ticket size remains relatively lower at ~NPR 47,000 as of Jan-17. SLBBL's credit portfolio of NPR 888 million as of Jan-17 is dominated by unsecured group guarantee backed loans (~81%, comprising of General and Business growth loans), rest being secured loans. As of Jan-17, majority of the loans were provided to agriculture sector (~68%), followed by service sector (~32%). SLBBL's asset quality indicators remain healthy so far with 0+days delinquencies of 0.47% as of Jan-17 including NPLs of 0.32%.

The grading is further constrained by risker asset mix of SLBBL mainly due to unsecured lending business to marginal borrower profile further accentuated by low seasoning of major portion of SLBBL's credit book and plans to spike growth rate[8]. Although, SLBBL has substantial share of collateral based loans (~19%), the collateral quality remains inferior compared to other banking counterparts while the ticket size remains high. Also, recovery of loan from these borrowers in default will be difficult given SLBBL is following both secured and unsecured lending module in same community. Though ticket sizes offered are lower compared to regulatory permissible limit, overleveraging concerns exist for SLBBL considering the absence of centralized credit bureau in microfinance segment. Going forward, SLBBL's ability to maintain adequate profitability profile and improve internal controls to maintain its asset quality indicators would have a bearing on the overall financial profile.

As per regulation, Banks and Financial Institutions[9] (BFIs) are required to extend 4-5% of their total loans towards deprived sector[10], either directly or through microfinance companies. However, Monetary Policy of FY16/17 has mandated commercial banks to directly lend 2%, out of their total deprived sector lending requirements of 5% (this is to be fully complied from Jul-18 onwards). This is likely to impact the funds available for growth of microfinance sector to a large extent and thus any further moderation/withdrawal in this regulation could have significant impact on funding profile of microfinance entities. Currently, SLBBL is dependent upon bank borrowings (~58% of total funds availed across diverse BFIs including 9 commercial banks). Despite limited track record of SLBBL, savings collected from members also comprise ~42% of overall funding profile which remains higher to industry average of ~32%. SLBBL's liquidity position remains comfortable due to availability of revolving lines of credit from funder, short tenure of loans extended (generally one year) and higher proportion of stable, non-withdrawable deposits from member though these generally carry higher costs.

SLBBL has reported healthy profitability indicators over last two years with ROA of ~4% and RoNW of ~35% in FY16, aided mainly by lending spreads of 12.40% during FY16. The change in the spread rate as per regulations going forward (spreads are to be maintained maximum at 11% including maximum 4% operating costs) is expected to impact profitability to an extent. Additionally, 18% cap on lending rates could impact on profitability incase cost of funds were to go up in a tight liquidity scenario. With addition of 12 new branches in H1FY17, operating expenses have increased by ~60 bps to 6.48% which

[8] ~108% annualized growth achieved in H1FY17; plans to grow by CAGR 54% over the medium term
[9] Class A, B & C financial institutions.
[10] As defined by the central bank (NRB) covering marginal sections of the society

has impacted the interim profitability (RoA of ~3.3% and RoNW of ~30%). Profitability, going forward, is expected to be supported by these branches achieving higher efficiency along with healthy non-interest income (~2.6% of ATA for H1FY17, primarily on account of loan processing fees) and low credit costs (~1% of ATA). Thus, ability of SLBBL to achieve sustainable growth in business in order to ensure efficient utilisation of enhanced capital whilst maintaining asset quality would have key bearing over future profitability of SLBBL.

SLBBL's CRAR of 11.76% as on Jan-17, though remains moderate compared to other banking counterparts and considering the vulnerable asset class, remains comfortable and higher to regulatory minimum of 8%. Owing to high debt funded growth since its inception, SLBBL's gearing remains higher among peers at 8.55 as on Jan-17 (compared to 6.43 as on Jul-16). Bank's promoter base is diversified across individuals only which is in contrast to most of the retail MFI players whereby BFI promoters hold major stake in most of the peers. SLBBL's capital would increase to ~NPR 105 million after proposed issue (against regulatory minimum of NPR 100 million for national level MFI) and hence SLBBL has plans to upgrade into national level status in order to support the company's growth plans.

Company Profile

Incorporated in July 2009, Swarojgar Laghubitta Bikas Bank Limited (SLBBL) started its commercial operation as a 3-district level Class D microfinance institution from December 2009. SLBBL was subsequently upgraded to 10 district level status from FY15 onwards. Shareholding pattern of the bank constitutes of 70% promoters holding and rest being held by public; the same is to be converted to 51:49 shortly. The shares of the bank are listed in Nepal Stock Exchange. The registered and corporate office of the bank is located at Banepa, Kavrepalanchowk, Nepal. Mr. Udaya Raj Khatiwada is the Chief Executive Officer of the company.

SLBBL has presence across 10 districts of Nepal through its 29 branches. SLBBL reported a profit after tax of ~NPR 25 million during FY16, over an asset base of NPR 702 million as on Jul-16 as against net profit of ~NPR 18 million during FY15 over an asset base of NPR 523 million as on mid-Jul-15. Bank reported profit after tax of ~NPR 14 million in H1FY17 over an asset base of 1,020 million as of mid-Jan-17. Its net worth as on mid-Jan 2017 was NPR 102 million and total loan portfolio was NPR 888 million. As on mid-Jan-17, SLBBL's gross NPLs stood at 0.32% and CRAR at 11.76%. On technology front, SLBBL uses "MFIN" software which is across all branches.

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