Janasewi Laghubitta Bittiya Sanstha Limited

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

Facility/Instrument	Issue Size	Grading Action (August 2018)
IPO (equity) Grading	NPR 42 Million	[ICRANP] IPO Grade 4 (Assigned)

ICRA Nepal has assigned an "**[ICRANP] IPO Grade 4**", indicating below-average fundamentals to the proposed Initial Public Offering (IPO) amounting to NPR 42 million of Janasewi Laghubitta Bittiya Sanstha Limited (JLB). 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. JLB is proposing to come out with an IPO of 420,000 numbers of equity shares of face value NPR 100 each at par. The proposed issue is being made to fulfill the regulatory provision requiring BFIs to float IPO within 3 years of coming into operation.

The assigned grading factors in JLB's ability to maintain high credit growth so far, aided by rapid branch expansion and growth in client base, whilst maintaining moderate average ticket size (~NPR 59,000 as of mid-Jul-18[1]). Growth opportunities for JLB remain adequate given branch expansion plans over new geographies (expansion in additional five districts planned shortly which is subject to regulatory approval) and large below poverty line population in Nepal that act as target group for MFIs. Current capitalization of JLB (~25 % as of Jul-18) remains high vs. regulatory minimum of 8%, which along with capital from proposed issue could support growth plans of the management. The grading also takes comfort from the recent regulatory change removing 18% interest rate cap for MFIs which could provide some comfort in profitability front of MFI sector going forward.

Nonetheless, the grading is constrained by recent deterioration in asset quality of JLB (NPLs increasing from 0.29% as of Jul-17 to 1.43% as of Jul-18 and 0+ days delinquencies increasing from 3% to ~6%) despite low seasoning of portfolio. The grading further remains constrained by subdued return indicators of JLB so far despite some improvement in FY18 (RoNW and RoA[2] of ~5% and 0.98% for FY18 vs. ~3% and 0.59% respectively for FY17). JLB's profitability indicators would further be impacted by capitalization of proposed IPO and hence company's ability to improve profitability over longer time frame remains to be seen. The grading also takes into account the frequent changes in regulation impacting the spreads and funding sources for MFI sector. After recently removing the interest rate cap of 18%, spread for MFIs has been reduced to 6% (earlier 7%) which is considered over cost of fund plus operating costs up to 3% (earlier 4%); this could impact the profitability of MFIs in low interest rate regime. The grading is also constrained by JLB's limited track record (operating since September 2015), small scale of operations (assets base of NPR 485 million as of Jul-18) with relatively higher operating expenses (~8% of Average Total Assets - ATA) and competition from larger/established peers. Moreover, increased ticket size by regulations, presence of large number of players in the industry (including cooperatives), and absence of centralized credit information for MFI raises concerns of overleveraging for the sector as a whole. Going forward, JLB's ability to increase its scale of operations while maintaining healthy asset quality indicators, by enhancing its credit appraisal capabilities and improving internal controls, would have a bearing on its overall financial profile.

JLB follows group lending model, wherein 5 individuals take mutual responsibility for loan repayment for all members. JLB offers up to NPR 60,000 for first cycle of general loans; maximum limit allowed in successive cycles is NPR 0.3 million vs. 0.5 million allowed by regulations. Owing to this, the average ticket size remains relatively moderate at ~NPR 59,000 as of Jul-18. In addition, JLB also extends secured loans up to NPR 0.7 million to finance micro enterprise as allowed by regulations. JLB's credit portfolio of NPR 418 million as of Jul-18 is dominated by unsecured group guarantee backed loans

[1] Mid-Jul-2018 data are unaudited; all calculations are based on management provided data
[2] Return on net worth and Return on assets

(~92%), rest being secured loans. Credit portfolio has reported high growth at CAGR[3] of ~164% in two years ending Jul-18, albeit on a very small base of ~NPR 60 million as of Jul-16. Over medium term, management plans to maintain high credit growth with increment in share of collateral-based loans up to regulatory ceiling (1/3rd of portfolio). However, planned increase in high ticket collateral loans to marginal borrower profile (which could impair their repayment capability) with relatively inferior collateral remains an area of concern in terms of incremental asset quality profile.

As for JLB's monitoring mechanisms, field monitoring of branches is done by respective branch manager along with sample-based review by internal auditor. Internal audit department however, is handled by single individual so far, hence limiting the scope. In addition, JLB is yet to establish separate monitoring department. In ICRA Nepal's opinion, company's monitoring and supervision could be strengthened; frequency and coverage of monitoring would remain critical given the high growth being targeted. ICRA Nepal also takes note of the increased regulatory maximum permissible ticket sizes (from NPR 0.1 million to NPR 0.3 million for 1st cycle loans and maximum from NPR 0.3 million to NPR 0.5 million from FY17 onwards), both of which could impact discipline and hence asset quality. JLB would have to develop strong credit appraisal systems and carefully assess cash flows and debt repayment capacity of the borrowers for sustainable growth.

As per regulation, Banks and Financial Institutions[4] (BFIs) are required to extend 5%[5] of their total loans towards deprived sector[6], either directly or through microfinance companies. Nonetheless, BFIs could gradually shift towards direct lending given the increased ticket size that qualify as deprived sector lending as well as expanding franchise at local/rural levels. This could 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, JLB is primarily dependent upon bank borrowings (~67% of total funds availed across 11 BFIs) which has witnessed increased cost in recent periods (~14% for FY18 vs. ~7% for FY17). Moreover, the "base rate plus" lending regime would keep cost of borrowings higher compared to earlier when MFIs could borrow at subsidized rates from banks. Despite limited track record, the company has been able to raise sizeable savings from members which comprised ~33% of overall funding profile and the cost of funds for this source is lower than bank borrowings (~7% for FY18), hence lowering overall cost of funds at ~12% for FY18 (~7% for FY17). Ability of JLB to diversify funding sources at competitive rates would remain major challenge going forward.

In the profitability front, JLB's indicators have remain subdued so far despite gradual improvements. Amid rising cost of funds and the then cap on lending rates at 18%, the profitability was supported mainly by strong fee-based income (4.16% of ATA for FY18 vs. 3.15% for FY17) while NIMs remained low at 7.14% for FY18. High operating expenses among peers at 8.34% for FY18 and increased credit cost (from 1.14% of ATA for FY17 to 1.47% for FY18) remained a drag to profitability. Nonetheless, JLB's overall profitability indicators improved in FY18 with RoNW and ROA increasing from ~3% and ~0.6% for FY17 to ~5% and ~1% for FY18 respectively. Profitability, going forward, is expected to be supported by existing branches achieving higher efficiency, incremental portfolio from new branches that are planned to be set up and control over asset quality. Thus, ability of JLB to achieve sustainable growth in business ensuring efficient utilisation of enhanced capital whilst maintaining healthy asset quality would have key bearing over its future profitability profile.

Capitalisation (CRAR) of the company at 24.81% as of Jul-18, was much higher compared to regulatory minimum of 8%. JLB's gearing remains lowest among peers at 3.67 as on Jul-18. JLB's capital would increase to NPR 140 million after proposed IPO vs. regulatory minimum of NPR 100 million for national level MFI. Hence, JLB has plans to upgrade into national level status over medium term in order to support the company's growth plans.

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[3] Compounded Annual Growth Rate

[4] Class A, B & C financial institutions.

[5] This was 5%, 4.5% and 4% respectively for class-A, B and C respectively till Jul-18.

[6] As defined by the central bank (NRB) covering marginal sections of the society

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

Links to applicable criteria:

IPO Grading Methodology

Bank Rating Methodology

Company Profile

Janasewi Laghubitta Bittiya Sanstha Limited (JLB) started its commercial operation from 29th of September 2015 upon receiving licence to operate as 10 districts level class D microfinance institution. As of mid-Jul-18, JLB operates through 21 branches over its 10 licensed districts. JLB is promoted by 120 individual promoters engaged in different professions. The registered and corporate office of JLB is located at Kushma, Parbat, Nepal.

JLB reported a profit after tax of ~NPR 4 million during FY18, over an asset base of ~NPR 485 million as of mid-Jul-18 as against a net profit of ~NPR 1 million during FY17 over an asset base of NPR 252 million as of mid-Jul-17. JLB's gross NPLs stood at 1.43% and CRAR at 24.81% as of mid-Jul-18. On technology front, JLB uses MFin software which is centralized across all of its branches.

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About ICRA Nepal Limited:

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