Chhimek Laghubitta Bikas Bank Limited

ICRA Nepal assigns [ICRANP] IPO Grade 3+ to the proposed Rights Offering of Chhimek Laghubitta Bikas Bank Limited

	Issue Size	Rating Action
IPO Grading	NPR 105.05 million	[ICRANP] IPO Grade 3+ (Assigned)

ICRA Nepal has assigned an "**[ICRANP] IPO Grade 3+**", indicating average fundamentals to the proposed rights offering amounting NPR 105.05 million of Chhimek Laghubitta Bikas Bank Limited (hereinafter referred to as CLBL). 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. CLBL is proposing to come out with rights issue of 1,050,482 numbers of equity shares of face value NRs 100/- each to be issued to general public at par. The proposed issue is being made in order to augment the capital base in order to support future business growth.

The average fundamental grading factors in CLBL's established track record in MFI[1] sector (established in 2001), strong franchise (network of over 78 branches spread across 40 districts as on mid-Oct-14), healthy growth potential in MFI sector given Nepal's large below poverty line population, healthy assets quality (gross NPLs 0.03% as on mid-Oct-14), healthy profitability indicators (PAT/ATA of ~2.50% and return on net worth around 28-30%), strong deposit base (67% of total lending portfolio as on Oct-14) with >90% share of member's deposit, strong institutional promoters and management team and regulatory advantage available with 'Class D' Microfinance Companies compared to its counterparts in banking industries-in the form of lower SLR/ CRR[2] & regulatory minimum capital adequacy requirements. The grading also takes into consideration, the established loan underwriting and monitoring process offset to some extent by the lack of complete integration of software and member's database across business places, favorable regulation for microfinance entities wherein loans to microfinance entities by banks/other financial institutions classify for 'mandatory deprived sector lending norms[3]; thereby helping these entities to raise funds from banking channel at very low interest rates. However, the grading remains constrained by high portfolio vulnerability due to inferior borrower profile and sizeable share of unsecured loans, competition from other microfinance institutions & BFIs[4] undertaking microcredit activities through larger franchise and uncertain operating environment that financial institutions in Nepal are currently facing. Moreover, deprived sector norms' remain a key regulatory risk for microfinance entities, withdrawal/moderation in this regulation could have significant impact on microfinance's entities business profile.

CLBL is running microcredit activities following JLG (Joint Liability Group) model, wherein individuals come together for the purpose of availing loans through group mechanism against mutual guarantee. These members are allotted a center and are further divided in groups of at least 5 members. Members upon introduction to the groups can avail basic unsecured loan product upto NPR 40 thousand at the beginning and the amount is increased in steps, upon completion of each loan cycle[5] i.e. completion of each loan repayment. . The members become eligible for higher amount of loans on subsequent cycles depending upon the age of membership and evaluation of member by the management along different parameters, as per the procedures laid down in the credit policy. CLBL's policy allows its members in the highest graded category to borrow a maximum unsecured loan amount of NPR 150,000 as compared to the regulatory maximum of NPR 200,000 and the average ticket size per member stood at ~NPR 65,000. CLBL's credit

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[1] Microfinance
[2] Statutory Liquidity Ratio/ Cash Reserve Ratio
[3] As per the Central Bank's regulation, BFIs are required to channel 3.5-4.5% percentage of their total loans towards deprived sector, either directly or through microfinance companies
[4] Banks and Financial Institutions, Class A, B & C
[5] Subject to a minimum period of 6 months

portfolio as of Oct-14 is broadly comprised of unsecured group guarantee backed loans (~73% of total loan outstanding) and collateral backed loans (~27% of total loan outstanding).

Although MFI portfolio is susceptible to higher vulnerability arising from unsecured nature of loan book and inferior borrower profile, the same is mitigated to some extent by healthy deposit base (67% of outstanding loans on Oct-14) that can be used as recovery backup in the event of credit default as well as slowly growing proportion of collateral based lending (27% of outstanding loans on Oct-14).Product wise, the unsecured portfolio of CLBL is mainly composed of Normal loan (36%), Discipline Loan (31%), Special Discipline (3%) while the collateral backed portfolio mainly comprises of Microenterprise loan (26%). As of Oct-14, the loans from CLBL are mostly lent out for agricultural activities (52%) and service based activities (44%). The assets quality indicator of CLBL remains superior with Gross NPL 0.03% as on Oct-14 (keeping NPR recognition norms at par with that of Class A & B banks); encompassing 97 accounts at risk with total loan outstanding of NPR 1.5 million.

In funding profile front, favorable regulation for MFI entities remains a positive; wherein loans to these entities by banks & financial institutions classify for mandatory deprived sector lending norms thereby help these entities to raise funds from banking channel at very low interest rates. Deprived sector norms remain a key regulatory risk for microfinance entities, withdrawal/moderation in this regulation could have significant impact on microfinance's entities business profile. However, CLBL's dependence on bank borrowings for operations has been on steady decline over recent years. As of Oct-14, 63% (NPR 3,747 million) of total external funds raised by CLBL were accounted for by members' deposit while bank borrowings accounted for remaining 37% (NPR 2,163 million). Since ~70% of deposits are subjected to full or partial withdrawal restrictions, stability of CLBL's funding profile has grown in recent years. The deposit profile remains highly granular, spread across over 200,000 depositors. The borrowing profile, though relatively concentrated, fares better compared to industry peers. CLBL's borrowings as on Oct-14 was spread across 23 BFIs[6], with the largest lender bank accounting for ~13% of total borrowings of CLBL. At the same time promoter banks accounted for ~24% of these borrowings, providing comfort regarding the funding profile under adverse conditions. CLBL remains comfortable on liquidity front due to large proportion of short term loans, sizeable proportion of deposit base subjected to withdrawal restrictions and availability of line of credit from BFIs in case of need.

CLBL's profitability profile has remained good and steady over past 5 years which has been supported by fair NIMs[7] (around ~7-8% of ATA[8] over past 3 years) which in turn is supported by good yield on assets (16-17%). Moreover, the profitability also remains supported by low level of credit provisioning warranted due to good assets quality and amenable operating expense ratio (5.5% of ATA) benefitted by economy of scale. However, some of these advantages are offset by the cost of funds, which remains high on account of higher interest rate offered by CLBL on members' deposits in general (8% p.a.) and pension saving deposit scheme in particular wherein interest provisioning upto 16% p.a. has been done to provide for contingency. While the actual outlay for CLBL on the pension scheme remains lower than the provisioned amount, the provisioning has affected the profitability profile to some extent. Higher servicing cost of deposits coupled with CLBL's growing leverage over deposits vis-à-vis low cost bank borrowings might affect the profitability profile going forward. While strong deposit base is likely to allow CLBL lower its dependence on borrowed funds in addition to providing security against probable credit default, the resultant increase in cost of fund is likely to impact the current profitability profile. Maintaining the trend of healthy profitability exhibited over past 5 years, CLBL reported profit after tax (PAT) of NPR 129 million in FY 13-14, corresponding to return on assets of 2.40% and return on net worth of 28% as compared to 2.69% and 31% in FY 2012-13. The profitability indicators remain consistent coming into Q1 FY14-15. Going forward, profitability indicators of CLBL will depend on its ability to maintain the assets quality, check the rising cost of fund and maintain the market share amid competition from existing big MFI players and new entrants.

[6] Including NRB (central bank) and 17 Class A commercial banks
[7] Net interest margin
[8] Average total assets

On capitalization front, CLBL's CRAR remains adequate (9.70% on Oct-14) against the minimum regulatory requirement of 8%. Because of low CRAR requirement for MFIs and sizeable business volume of CLBL, the gearing ratio remains on higher side (11.04 times on Oct-14 & 12.23 times on July-14).The proposed rights issue is expected to further ease the current position and support business growth over next 2-3 years. As per ICRA Nepal estimate, the current capitalization level (including proposed equity infusion) is likely to support CAGR 30% credit growth plans of management over next 2-3 years, maintaining overall capitalization level in the range of 9-10.5% while the solvency indicators (Net NPA/Networth) are expected to remain within 2% level. However, the adequacy of capitalization in the interim is likely to be determined by the retention of profit accruals by CLBL. In the long run, the ability of CLBL to raise additional capital from its existing/ external investors will have a strong bearing on the growth prospects and overall capitalization profile.

Company Profile

Chhimek Laghubitta Bikas Bank Ltd. (CLBL) was registered as a public limited company in December 2001 and received license as a national level Class D microfinance institution in January 2002 from NRB (the central bank). It is the 5th class D institution licensed by NRB to carry out microcredit activities. The head office of CLBL is in Mid-Baneshwor, Kathmandu Submetropolitan city. CLBL has its roots in an NGO named NSSC (The Neighbourhood Society Service Center) which carried out microfinance activities in Chitwan and Mahottari Districts of the country as a forerunner to CLBL. The current shareholding is divided among promoters and general public in the ratio of 70:30. In addition to NSSC (19% shareholding), the major promoters of CLBL include 3 class A commercial banks (Nabil Bank, Himalayan Bank & Bank of Kathmandu) each with promoter shareholding of 12%; the remainder being held mostly in small stakes by individuals and few institutions.

CLBL's operation as on Oct-14 was spread across 40 districts of Nepal through 78 branch offices. CLBL has market share of about 18% of advances & 32% of deposit in MFI industry as on mid-Jul-14. CLBL reported a profit after tax of NPR 129 million during FY 14 over an asset base of NPR 6,211 million as on Jul-14 against profit after tax of NPR 108 million during FY13 over an asset base of NPR 4,554 million as on Jul-13. In terms of technology platform, CLBL has implemented 'M-Fin' in all of its branches with process of software integration underway for consolidation of accounting database and member's record.

February, 2015

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