RSDC Laghubitta Bittiya Sanstha Limited

ICRA Nepal assigns [ICRANP] IPO Grade 4 to the proposed rights issue (equity shares) of RSDC Laghubitta Bittiya Sanstha Limited

Facility/Instrument	Issue Size	Grading Action (July 2017)
Rights Issue (Equity)	NPR 230 million	[ICRANP] IPO Grade 4 (Assigned)

ICRA Nepal has assigned "**[ICRANP] IPO Grade 4**", indicating below-average fundamentals to the proposed rights issue of equity shares amounting NPR 230 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. Thus, the grading of 2+, 3+ and 4+ are one notch higher than 2, 3 and 4 respectively. RSDC has proposed to come out with 2:1 rights issue of 2,300,000 number of equity shares of face value NPR 100 each to be issued to the existing shareholders at par. The issue is being made to augment capital base and is a step[1] towards meeting the revised (higher) paid up capital requirement[2] set by Nepal Rastra Bank (NRB), the banking sector regulator in Nepal.

The grading factors in RSDC's institutional promoter strength (RSDC-NGO, with experience in social mobilisation and financial access programmes and Bank of Kathmandu Limited[3]- a class A Commercial Bank with long track record. The grading also factors in RSDC's demonstrated ability to grow (credit portfolio grew by CAGR 64% during FY14–9MFY17; albeit on a small base) driven by increase in number of partner co-operatives (from 62 in mid-Jul-14 to 154 on mid-April 2017). Incremental credit growth prospect remains supported by adequate capitalisation profile (CRAR 16.40% as on mid-April-17 vs regulatory minimum 8%), proposed equity injection plans and potential for growth for MFIs in Nepal given large below poverty line population; which has been factored in while assigning the grading. The grading also takes into consideration RSDC's improvement in profitability profile during past 12-18 months, backed by growth in scale of operations.

The grading is however constrained by change in regulatory environment which could affect the incremental funding profile and profitability of RSDC. Through Monetary Policy of FY17, NRB has directed class A commercial banks to maintain 2% (out of total 5%) deprived sector lending (DSL) target in the form of direct loans (rest 3% could be through intermediaries). This would result in diversion of 40% of the funds hitherto available from class A banks to Microfinance institutions (MFIs). As on mid-April 2017, 92% of the borrowings of RSDC was from class A commercial banks. Therefore, the regulation change is likely to affect the incremental fund availability, cost of fund, credit growth and therefore, profitability of RSDC. The grading is also constrained by the probable dilution in return indicators following equity injection over next 12 months. Moreover, the grading is also constrained by limited track record of RSDC and limited seasoning of its credit books. High portfolio vulnerability due to unsecured lending and marginal profile of the ultimate borrower accentuated by lack of centralized credit bureau in MFI sector creates the risk of overleveraging. At the same time, RSDC's ability to monitor its credit exposures also remains limited which coupled with weak regulatory supervision over co-operative players raises long term assets quality concern.

As a wholesale lender to MFIs, RSDC uses the network of existing co-operatives (separate legal entities), to reach the targeted population. As on mid-April 2017, RSDC's credit portfolio of NPR 885 million was distributed among 154 borrower co-operatives- mainly comprising of Self-reliance co-operatives[4] (32% of credit portfolio), savings and credit co-operatives (24%), multipurpose co-operative (12%) and agriculture co-operatives (12%) among others. The credit growth was aided by growth in number of partner organizations as well as increase in individual ticket size of loans. RSDC has reported good asset quality with Nil Gross NPL as on mid-April 2017 (partly benefited by low seasoning of credit book). Delinquency level has moderated (~1.56% as on mid-April 2017) as the event related stress emanating from earthquake and strikes has subsided.

[1] RSDC plans to raise another round of fresh equity after the completion of proposed 2:1 rights issue.
[2] Minimum paid up capital of NPR 600 million for wholesale MFI, to be maintained by mid-July 2018.
[3] Rated BBB+ by ICRA Nepal for subordinated tier II bond
[4] Co-operatives set up by RSDC-NGO (promoter of RSDC)-forerunner to RSDC, as a part of donor-funded programs.

Being a wholesale MFI, RSDC's funding profile is entirely dependent on external borrowings. So far, the funding profile has been benefitted from low cost borrowings from banks and financial institutions, aided by deprived sector regulations[5]. RSDC's total borrowings as on mid-April 2017 stood at NPR 794 million, 92% of which was accounted for by Class A banks. ~25% of the total external borrowings was from BOK- the promoter bank, indicating promoter support. Average cost of borrowings for RSDC has increased during past 6-12 months due to shortage of lendable funds in the banking industry. Additionally, change in DSL regulations has also raised concerns about the incremental fund availability and its cost. However, sizeable equity raising plans of RSDC is likely to mitigate the shortage of fund and support credit growth over next 6-12 months. Presence of class A bank as institutional promoter also adds to the funding strength of RSDC.

The profitability profile of RSDC remains fair (return on net worth of ~19 during FY16 and 9MFY17) and remains supported by healthy NIMs (4-4.5%) which emanated from healthy rate of credit mobilisation (credit to total assets ratio of 92% as on mid-April 2017). Moderation in operating expense ratio and low credit provision expense has aided the profitability profile in recent years. Going forward, profitability profile is likely to remain under pressure due to regulatory changes and sizeable equity injection plans of the company.

As on mid-April 2017, capital to risk assets ratio (CRAR) of RSDC was comfortable at 16.40% (against regulatory minimum of 8%) benefitted by equity injection through IPO in early FY17. With the company planning to raise sizeable equity over next 12 months, RSDC is likely to maintain excess capital over next 2-3 years. This is likely to enhance the risk bearing capacity of the company although maintaining return on the incremental capital will remain a challenge, more so after the regulatory change regarding DSL norms. Due to adequate capitalization on a small scale of operations, gearing ratio of RSDC remains comfortable (~6 times as on mid-April 2017 much lower to regulatory maximum of 30 times). With proposed capital injection plan, gearing level is also expected to come down considerably.

Company Profile

RSDC Laghubitta Bittiya Sanstha Limited (RSDC) is a class D wholesale microfinance institution licensed by NRB, operating since September 11, 2013. RSDC is involved in microfinance operation through its network of partner cooperatives. RSDC has a 60:40 promoter-public shareholding. Major promoters of RSDC include Rural Self-reliance Development Centre (NGO) ~25% and Bank of Kathmandu[6] (a class A commercial bank) ~12%. As on mid-April 2017, the company is in operation through its head office at Butwal in Rupandehi District and 13 staffs. Mr. Damodar Joshi is the chief executive officer of RSDC. Shares of the company are listed with Nepal Stock Exchange.

RSDC was set up to provide funding and technical support to the cooperatives set up by promoter NGO as well as other cooperatives with similar scope of activities. During FY15-16, RSDC reported a net profit of NPR 15.07 million on an asset base of NPR ~765 million on mid-July-16 as against a profit of NPR 8.48 million on an asset base of NPR 546 million on mid-July-15. During Q3FY16-17, it has reported a profit of NPR 15.66 million over an asset base of NPR 954 million. RSDC's gross NPLs stood at nil and CRAR at 16.40% as on mid-April 2017. In information technology front, RSDC uses Pumori IV software.

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[5] NRB regulation making it mandatory for BFIs to allocate 4-5% of total loans outstanding towards deprived sector.
[6] RSDC was promoted by Lumbini Bank which merged with Bank of Kathmandu with effect from mid-July 2016.