Jalpa Samudayik Laghubitta Bittiya Sanstha Limited: [ICRANP-IR] BB assigned

July 12, 2021

Summary of rated instruments

Facility/Instrument	Rated Amount (NPR Million)	Rating Action (July 2021)
Issuer Rating	NA	[ICRANP-IR] BB; assigned

Rating action

ICRA Nepal has assigned the issuer rating of [ICRANP-IR] BB (pronounced ICRA NP Issuer Rating Double B) to Jalpa Samudayik Laghubitta Bittiya Sanstha Limited (JSLBSL). Issuers with this rating are considered to have a moderate risk of default regarding timely servicing of financial obligations. The rating is only an opinion on the general creditworthiness of the rated entity and not specific to any debt instrument.

Rationale

The assigned rating factors in the adequate track record of JSLBSL in the microfinance activities (between 2003 and 2018 as financial intermediary NGO (FINGO) and since 2019, as a Nepal Rastra Bank (NRB)-licensed class-D microfinance institution). The rating notes the increased operational scale and network base (76 branches across 19 districts as of mid-April 2021) with the recent merger of Jalpa Laghubitta Bittiya Sanstha Limited (JLBSL) and Mahila Samudayik Laghubitta Bittiya Santha Limited (MSLBSL). This coupled with the company's plan to upgrade to national level MFI (from the current status as 20-district MFI) remains positive for its future growth and diversification. The rating factors in JSLBSL's moderate capitalisation profile (10.20% as of mid-April 2021 against the minimum regulatory requirement of 8%), which is expected to improve after the proposed Initial Public Offering (IPO, assuming full subscription), thereby offering a cushion to absorb any near-term credit shocks amid the ongoing Covid-19 pandemic. Further, the large below-poverty-line population in Nepal, the target group for microfinance institutions (MFIs), and experienced management team remain rating positives.

However, the rating is mainly constrained by the asset quality concerns of the MFI sector, given the likely impact of the pandemic on the repayment capacity of the marginal borrower profile. This risk is further accentuated by the company's increasing ticket size and higher concentration of unsecured loans (~95% as of mid-April 2021) in its credit portfolio. The company reported increased NPLs of 3.00% as of mid-April 2021 from 2.45% as of mid-July 2021. Given the elevated delinquency level (0+ days delinquency level of ~7% as of mid-April 2021), the incremental NPL level remains a concern. The rating is constrained by the moderate profitability profile with return on assets (RoA) of ~1.05% and return on net worth (RoNW) of ~9.57% in FY2020, mainly because of higher credit provisioning expenses. JSLBSL is also exposed to geographical concentration risk with ~57% of the credit and ~64% of deposits concentrated in top three districts as of mid-April 2021. The rating remains restrained by the fragmented microfinance industry (coupled with comparatively weak regulated cooperatives), intense competition, high ticket sizes permitted by regulations, and lack of fully functional credit information bureau, which raise concerns on the overleveraging of borrowers and the long-term asset quality for the industry.

Going forward, JSLBSL's ability to maintain comfortable asset quality indicators, while increasing its scale of operations with post-merger synergy and generating stable and adequate profitability over an increasing capital base will have a bearing on its overall financial profile and will remain the key rating monitorables.

Key rating drivers

Credit strengths

Adequate track record of operations and experienced management team – JSLBSL has a long history of operations as a FINGO. Both the MFIs (JLBSL and MSLBSL) that merged to become present day JSLBSL had their origins in FINGO, both operating since 2003, before their microcredit operations were spun off to form new entities registered as class-D institutions. Microfinance business operated by Srijana Development Centre (SDC), an NGO involved in MFI activities since 2003 was spun off under JLBSL. Similarly, Microfinance business operated by Nepal Women Community Service Centre (NWCSC), another NGO involved in MFI activities since 2003; was spun off under MSLBSL. JSLBSL's board and senior management team comprise experienced officials with an established track record in microfinance activities, which remains a rating positive.

Increased operational scale and geographical diversification through merger – JLSBL and MSLBSL - the two entities that merged to form JSLBSL, were both a 10-district player with no overlapping in terms of the area of operation. As a result, the merged entity has a much wider geographical presence and member base, which remains a positive from the diversification aspect. The company has met the capital requirement criteria of ~NPR 10 crore and is in the process for up-gradation to national level MFI that will aid to the balanced geographical growth. Nonetheless, the concentration of ~57% of the credit portfolio in the top three districts as of mid-April 2021 remains a concern.

Moderate capitalisation profile – JSBSL's capitalisation ratio (capital to risk-weighted assets ratio; CRAR) of ~10.20% as of mid-April 2021 remained adequate against the regulatory minimum requirement of 8%. Proceeds from the proposed IPO is expected to further improve the capitalisation profile (assuming full subscription), thereby offering a cushion against the near-term credit shocks amid the ongoing pandemic. The company's gearing remained moderate at ~7.4 times as of mid-April 2021, much lower than the regulatory maximum of 30 times, and is expected to further improve with the capitalisation of the proposed IPO.

Credit challenges

Incremental asset quality concerns – JSLBSL, on a combined basis, reported NPLs at 2.46% as of mid-July 2020 that increased from 1.38% as of mid-July 2019. The asset quality further deteriorated after the global pandemic stretched the credit profile of the marginal borrowers with NPLs reaching 3.00% as of mid-April 2021. Zero plus (0+) delinquency increased to ~61% as of mid-July 2020, which moderated to ~6.6% as of mid-April 2021. However, its sustainability remains to be seen. The credit risk is further accentuated by the increasing average ticket size (~NPR 99,800 in mid-April 2021 against ~NPR 77,979 in mid-July 2020) and a higher portion of non-collateral-based lending (~95% as of mid-April 2021). The company's ability to improve the asset quality, while controlling the fresh slippage, will remain essential to its incremental financial profile.

Subdued profitability due to increased credit cost and higher cost to income ratio – JSLBSL's profitability for FY2020 remained subdued on account of higher credit cost and deterioration in asset quality. Although the same has improved in 9M FY2021 because of a sharp decline in borrowing cost, the higher credit cost continues to remain a drag to profitability. The company reported RoNW of ~9.57% and RoA of ~1.05%, which increased to ~20.44% and ~2.27%, respectively, in 9M FY2021. JSLBSL's yield on advances reduced in 9M FY2021 to conform with the new regulatory lending cap of 15%. Although the interest margins at present continue to benefit from low borrowing cost, it could moderate in the event of a higher interest rate regime in the banking industry. The cost to income ratio of ~58% in 9M FY2021 (~63% for FY2020) is higher compared to peers.

Low penetration of credit bureau in Nepalese MFI sector; risk of overleveraged borrowers remains high – Many MFI players and micro-lending by some class-A and class-B banks, as well as cooperatives, in the same geography as JSLBSL has led to stiff competition and risk of multiple financing to MFI borrowers. This risk has been accentuated by the lack of a fully operational and functional Centralised Credit Information Bureau for the MFI sector and the relatively weak credit profile of the borrowers in general. Coupled with a high regulatory lending ceiling, this raises concerns of overleveraging, which could give rise to long-term asset quality concerns. However, the credit information bureau is working towards the creation of a fully functional centralised credit information system for MFI institutions, which remains a positive.

Regulatory risk – Regulatory risks remain high for the MFI sector as any changes in the regulations may impact funding sources and interest spreads. The regulatory changes capping the MFI's lending rate at 15% and fees at 1.5% are expected to strain the profitability of the entire microfinance industry. Also, a high loan ceiling for MFI lending by NRB (unsecured loan of NPR 3 lakh and secured loans of NPR 7 lakh for new borrowers) could lead to aggressive growth and affect the industry's asset quality. Low regulatory capital requirements (8%) and higher permissible gearing levels (30 times), despite lending to risky segments, remain concerns from the standpoint of the company's ability to absorb credit shocks.

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

Links to applicable criteria:
Issuer Rating Methodology
Credit Rating Methodologies for Non-banking Finance Companies

Company Profile

Jalpa Samudayik Laghubitta Bittiya Sanstha Limited (JSLBSL) started joint operation in December 2020 following the merger of two regional level MFIs (viz. Jalpa Laghubitta Bittiya Sanstha Limited (JLBSL), 10-district MFI operating since March 2019 and Mahila Samudayik Laghubitta Bittiya Sanstha Limited (MSLBSL), another 10-district MFI operating since February 2019). JSLBSL has an NGO background with the takeover of microfinance business operated by FINGOs.

JLBSL took over the microfinance business being conducted by Srijana Development Centre (SDC), an NGO, operating as a financial intermediary from 2003. Similarly, MSLBSL took over the microfinance business conducted by Nepal Women Community Service Centre (NWCSC), another NGO, operating as a financial intermediary from 2003.

JSLBSL's shareholding as of mid-April 2021 consisted of SDC (~32%), NWCSC (~24%), Prime Commercial Bank Limited (~6%), Jyoti Bikas Bank Limited (~5%), Pokhara Finance Limited (~5%), and rest individual and institutional promoters (~28%) and is operating through a network of 76 branches across 19 districts. The registered and corporate office of the company is located at Pokhara-8, Kaski, Nepal.

JSLBSL reported[1] a net profit of ~NPR 33 million in FY2020 over an asset base of ~NPR 3,391 million as of mid-July 2020 as against the net profit of ~NPR 76 million in FY2019 over an asset base of ~NPR 2,916 million as of mid-July 2019. Further, it reported a profit after tax of ~NPR 64 million in 9M FY2021 over an asset base of ~NPR 4,143 million as of mid-April 2021. JSLBSL's gross NPLs stood at 3.00% and CRAR at 10.20% on the same date. On the technology front, JSLBSL uses web-based MFin Plus software, which is centralised across all its branches.

[1] *Combined figures of merged MFIs/NGOs taken for the periods/dates prior to merger/conversion*

Key financial indicators

Year Ended	Mid-July 2019[2] (Audited)	Mid-July 2020[2] (Audited)	Mid-April 2021[2] (Provisional)
Number of members	76,510	78,631	84,804
Credit portfolio (NPR million)	2,716	2,972	3,873
Number of borrowers	38,406	38,118	38,806
Average ticket size (NPR)	70,730	77,979	99,800
No of branches	51	55	76
Deposits (NPR million)	1,587	1,898	2,107
Deposit to loan ratio	58%	64%	54%
Gross NPLs	1.37%	2.45%	3.00%
Operating ratios			
Yield on Average Loans		17.37%	15.60%
Cost of Avg. Int. Bearing Funds		9.81%	7.12%
Net Interest Margin / Average Total Assets		7.76%	7.96%
Non- interest income/ Average Total Assets		2.19%	2.49%
Operating expenses / Average Total Assets		6.24%	6.01%
Credit Prov. & Write-offs / Average Total Assets		2.18%	1.15%
Profit After Tax / Average Total Assets		1.05%	2.27%
Profit After Tax / Average Net worth		9.57%	20.44%
Capitalisation ratios			
Capital adequacy ratio	10.72%	10.71%	10.20%
Gearing [(deposits+ borrowing)/ net-worth] times	7.45	7.08	7.41
Borrowing/ net worth (times)	2.19	2.19	2.71

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About ICRA Nepal Limited

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[2] *Combined figures of merged MFIs taken for the periods/dates prior to the merger*

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