INITIAL PUBLIC OFFERING | Report Date: 2074/06/09

SUPPORT MICROFINANCE BITTIYA SANSTHA LTD.

Recommendation – Apply

SECTOR: RETAIL MICRO CREDIT | Listing Range: Rs. 107-321

Overview of the Company

Support Microfinance Bittiya Sanstha Limited was registered under the 'Company Act 2063' as a Microfinance Institution ("D" Class) on 27/07/2071. It received Operating License under Banking and Financial Institution Act, 2073 on 15/03/2072 and started its formal operation from 27/03/2072.

The registered office of the company is situated at Hasposha-1, Itahari-26, Sunsari district.

Area of Operation

The company has license to operate in 10 districts that includes Panchthar, Terhathum, Udayapur, Dhankuta, Bhojpur, Sunsari, Sindhuli, Khotang, Ramechhap and Makwanpur. As on Chaitra end 2073, it is operating its services in 7 districts with 11 branches already established. Upcoming branches are in Harinagra, Sunsari and Mahendranagar, Sunsari.

Members Details

There are memberships of 5,055 females in the company from 7 districts as of Chaitra 2073.

Future Plan and Strategy

- Prioritize the extension of branch offices
- Increase deposits and loan amounts
- Increase the number of its members
- Offer services and facilities as required by its members

Utilization of IPO Proceeds

The IPO proceed is projected to be utilized under following headings:

- Agriculture & animal husbandry loan – Rs. 75 lakh
- Retail business & services loan – Rs. 75 lakh
- Small & domestic Industries Loan – Rs. 30 lakh

Issue Details	
Issue Size	180,000
Price per Share	100
Issue Open Date	18/06/2074
Issue Close Date	23/06/2074
Issue to Staff	3,600
Issue to Mutual Funds (5%)	9,000
Issue to General Public (2%)	1,67,400
Issue Manager	NMB Capital Ltd.
Collection Centres	ASBA Approved BFIs
Min. Application (Kitta)	50
Max. Application (Kitta)	900
ICRA Rating	Not Applicable

***Note:** As per regulation 3 (ka) of Credit Rating Regulation, 2068 the credit rating of this issue is not required since the issue is less than NPR Three Crores.*

Capital Structure (%)

	Existing	Post issue
Authorized	15,00,00,000	15,00,00,000
Issued	6,00,00,000	6,00,00,000
Paid Up	42,000,000	6,00,00,000
Shareholding Structure (%)		
Pubic	-	180,000 (30%)
Promoter	420,000 (100%)	420,000 (70%)

Operational Coverage	
Numbers of Authorized Districts	10
Number of District Covered (As of 2073)	7
Number of Branches	11

Board of Directors

1) ***Mr. Pradip Adhikari**, Chairman*

2) ***Mr. Ashok Kumar Pradhan**, Director*

3) ***Mr. Mahesh Kumar Pokharel,** Director*

4) ***Mr. Punit Kumar Sarda**, Director*

5) ***Mr. Sumit Adhikari**, Director*

Management Team

1) ***Mr. Chandra Lal Dhakal**, Chief Executive Officer*
   - Experience of involvement in many Microfinance companies, Savings and Credit Cooperatives and Teaching Profession.

2) ***Mr. BhojraJ Luitel,** HR Head*
   - More than 11 years of services in Nerude Laghubitta Bittiya Sanstha Ltd.

3) ***Mr. Pradip Kumar Yadav,** Account Head*
   - Managerial level exposure in Savings and Credit Cooperatives.

4) ***Mr. Cheaban Mani Bhattrai,** Internal Audit Head*
   - Exposure to Account and Finance, Credit Department

5) ***Mr. Mahesh Kumar Chaudhary,** Credit Head*
   - Engaged with Forward Community Microfinance Ltd. for more than 5 years.

Composition of Board of Directors

As per Article 27(2) of the Company, the Board shall constitute 8 members as follows:

Representing Promoters	5 members
Representing Ordinary Shareholders	2 members
Independent Director	1

The tenure of directors shall be 4 years.

 # Article 28 requires the directors representing the ordinary shareholders to hold at least 100 ordinary shares of the company.

 # Meeting fee of Rs.1,500 will be paid to directors for attending Board Meetings.

Key Shareholder	
Name	**Shareholdings**
Mr. Punit Kumar Sarda	79,000

Market Average (Microfinance)	
Sector	**Development Banks**
Indexes	**1924.69** (2nd Ashoj 74)
Listed Microfinance	**33**
Market Cap (NPR)	**117,620,116,884**
EPS	**46.27**
BVPS	**205.50**
P/E	**53.65**
P/B	**9.45**
ROE	**22.24%**
ROA	**2.82%**
Net Profit Margin	**21.62%**
CAR	**15.48%**
Cost Of Funds	**7.88%**
NPL	**1.12%**
Credit Deposit Ratio	**162.58%**
Financial Leverage	**7.72 x**

The above fundamentals are as per Fourth quarter 2073/74. Market Cap is as of 2nd Ashoj 2074.

Key Fundamentals (4th Quarter 2074)	
Paid up Capital	**42,000,000**
Reserve and Surplus	**3,119,290**
Book Value Per Share	**107.43**
Earnings Per Share	**11.44**
ROE	**10.65%**
ROA	**1.50%**
CD Ratio	**354.93%**
Net Profit Margin	**12.76%**
NPL	**0.82%**
Cost of Funds	**10.57%**

General Introduction to Balance Sheet Figures

Paid up capital will increase to Rs.60 million after the public issue. Company **projects Rs.120 million** paid up capital implying the possibility of 100% **right/bonus shares**. Reserve and Surplus are projected to increase at **CAGR 151.21%.** However, **reserve as of 4th Quarter 2074 has surpassed the projection of 2073/74**. **Deposits** as per provisional is 29.74 million and it is projected to increase at **CAGR 110.88%,** while **loan and advances at CAGR 73.30**%, till FY 2076/77. Similarly, the company projects the borrowing amounts to increase at 63% CAGR. Loan and advance is Rs.265.7 million, beating the projection of Rs.262.71 million. **Total asset** of the company is projected to rise at **CAGR 71.24%**. The company has made Rs.1 million of investment in FY 2073/74 and is projected to remain same in the projected periods. Company project no dividends in the projected periods.

Comparison with Industry Figures

- BVPS of the company as of 4th Quarter 2073/74 is significantly lower than the industry average of Rs.205.50. However, the company projects the gradual growth of net worth in the projected periods.
- Financial leverage of company correspond the industry average which signifies the use of borrowed money by company similar to that of industry, giving similar risk attributes.
- CAR is nearly 17% as on 4th quarter which is higher than the current industry average of 15.48%. Higher CAR signifies less risky weighted assets and is considered safer.
- Deposit has increased by 358.82% as on last quarter of FY 2073/74. Industry average deposit growth is 78%. 3 year CAGR of deposit of company is 111%.
- Loan and advance has surged by 143% and is projected to grow at CAGR 73%. Industry growth of loan and advance is 57% in 4th quarter of 2073/74 compared to previous corresponding quarter.
- NPL is below the industry average which is a positive factor.

Excerpts from Balance Sheet (NRs. In Millions)

	Audited	Provsional		Projected	
Particular	**72/73**	**73/74**	**74/75**	**75/76**	**76/77**
Paid-Up capital	42	42	120	120	120
Reserve/ Surplus	(2.673)	2.131	8.059	19.827	33.765
Net Worth	39.33	44.131	128.059	139.827	153.765
Borrowing	83.719	235.203	566.65	799.74	1020.14
Deposits	6.482	29.741	126.211	191.45	278.92
Loans/ Advances	108.28	262.711	699.67	1057.87	1367.34
Total Assets	130.702	315.146	837.838	1176.35	1582.46

Ratios

	Audited	Provisional		Projected	
Particular	**72/73**	**73/74**	**74/75**	**75/76**	**76/77**
BVPS	93.19	104.76	106.65	116.51	128.14
Return on Net worth	(5.08)	10.92	4.63	8.42	9.06
Credit/ Deposit	1670.47 %	883.33 %	554.37 %	552.56 %	490.23 %
Borrowing Growth	-	181%	141%	41%	28%
Advance Growth	-	142.62 %	166%	51%	29%
Deposit Growth	-	358.82 %	324%	52%	46%
SLR	-	-	18.42%	10.62%	15.25%
CAR	25.74%	-	18.85%	14.29%	11.06%
Financial Leverage	3.32	7.14	6.54	8.41	10.29

Note: Provisional here refers to the unaudited projected report of the company for the FY 73/74.

General Introduction to Income Statement

Company has made a profit of Rs.4.8 million coming to the 4th Quarter. **Net profit is projected to increase at 42.64% CAGR**. Net interest income and operating profits are projected to increase at CAGR 67% and 56% respectively. Employee expense constitutes the significant portion of the operating expenses and is projected to grow at 93% CAGR. **NPL has increased to 0.82% in 4th Qtr** from 0.10% of 3rd Qtr, while industry NPL is 1.12%. NPL of the company can be expected to be higher in future and company projects to increase its provision for losses at 40% CAGR. Company has no non-operating/extraordinary income/expenses. Fees, commission, discount and other operating income also contribute to the income of the company and it is projected to increase at 102% CAGR. Company's income is taxable at 30%.

Compare with Industry Figures

- EPS is positive which is commendable for a newly operating company. However, the average EPS of Microfinance sector is comparatively higher. Lower EPS of the company shows the earnings and paid up capital of the company does not increase in the same ratio.

- Similarly, the ROE of the company is significantly lower than industry average. This indicate company is earning less than other microfinance with the shareholders money.

- Net profit margin is falling over the period as shown by projected figures. This is again weaker as compared to 21.62% of industry. Major profits of the company is found to be absorbed by operating expenses.

- Average operating expenses of the industry is nearly 60% to the net interest income. Such expenses of the company is very high, which requires to be controlled for lifting the profit. In operating expenses, employee expenses is huge.

- IRS is Interest rate spread that shows the profit margin of the company, high IRS high profits. IRS of company is projected to be 9%.

Excerpts from Income Statement (in Millions)

	Audited	Provisional		Projected5	
Particulars	**72/73**	**73/74**	**74/75**	**75/76**	**76/77**
Net Int. Income	3.65	22.61	40.26	75.42	105.78
Employee Expenses	2.993	9.86	29.273	49.44	71.16
Provision for losses	1.169	1.82	8.55	5.66	5.034
Operating Profit	(3.055)	5.79	9.32	18.49	21.902
Net Profit	(1.99)	4.804	5.93	11.767	13.94

Ratios

	Audited	Provsional		Projected	
Particulars	**72/73**	**73/74**	**74/75**	**75/76**	**76/77**
Net Int. Margin	2.90%	7.37%	3.46%	6.49%	6.77%
Op. Profit Margin	-	15.38%	10.24%	11.27%	9.70%
Opt. Exp/NII	152.38%	74.90%	108.42%	91.35%	89.55%
Op. Profit Growth	-	-	60.86%	98.47%	18.46%
Op. Exp. Growth	-	204.42%	157.80%	57.82%	37.50%
Net Profit Margin	-	12.75%	6.52%	7.17%	6.17%
IRS	-	-	9%	9%	9%
ROE %	-	10.88%	4.24%	8.42%	9.06%
ROA %	-	2.15%	1.03%	1.17%	1.01%
EPS	(4.74)	11.44	4.94	9.81	11.61

Du-Pont Analysis – Breaking ROE

DuPont analysis is an approach to decompose the ROE, thereby analysing the factors causing the changes in ROE.

Here, we try to see the factor of ROE of the company based solely on the information as presented in the financial statements of the company. We check this on both variant of the DuPont system: the original three part approach and the extended five part system.

Original three part approach: ROE = (Net Profit / Revenue) * (Revenue / Assets) * (Assets / Equity)

i.e. ROE = (Net profit margin)*(Asset turnover)*(leverage ratio)

The original three part approach states that ROE is affected primarily by three factors: operating efficiency as measured by profit margin, efficient use of assets measured by asset turnover and financial leverage measured by leverage ratio.

Year	Net profit margin	Asset turnover	Leverage Ratio	ROE
4th Quarter 73/74	12.76%	11.74%	7.11	**10.65%**
74/75	6.52%	10.86%	6.54	**4.63%**
75/76	7.17%	13.95%	8.41	**8.42%**
76/77	6.17%	14.27%	10.29	**9.06%**

The low ROE indicates the possibility of any of the three reasons – i) Poor profitability ii) Inefficient use of assets iii) Too little leverage. Drastic fall of ROE in FY 74/75 from 10.65% to 4.63% is due to the drastic fall in profit margin of the company supported more by the fall of asset turnover and leverage ratio. ROE is projected to improve in subsequent periods with the betterment of asset efficiency and financial leverage that offset the poor profitability. Net profit has not increased in proportion to increase in capital of the company. Operating expenses are increasing at the cost of profits. Increased leverage indicates increased debt financing indicating the increased risks of the company. Leverage ratio is also known as equity multiplier that shows the level of debt and equity financing on the assets of the company.

Extended five way approach: This is an extension of the net profit margin.

ROE = (Net Profit/EBT)*(EBT/EBIT)*(EBIT/Revenue)*(Revenue/Total assets)*(Total assets/Total equity)

i.e. ROE = (Tax burden)*(Interest burden)*(EBIT margin)*(Asset turnover)*(Financial leverage)

Year	4th Qtr 73/74	2074/75	2075/76	2076/77
Tax burden	85.70%	70%	70%	70%
Interest burden	96.78%	90.91%	90.91%	90.90%
EBIT margin	15.38%	10.24%	11.27%	9.70%
Asset turnover	11.74%	10.86%	13.95%	14.27%
Financial leverage	7.11	6.54	8.41	10.29
ROE	**10.65%**	**4.63%**	**8.42%**	**9.06%**

It can be seen that the tax burden and interest burden are consistently same over the periods having negligible effects on the ROE. Increase in these burden ratios tends to decrease ROE. Increase in leverage increases interest burden. This analysis again shows the greater effects of EBIT margin/Operating profit margin on the lower ROE.

Strengths-Weaknesses-Opportunities-Threats (SWOT) Analysis

SWOT

Strength

1) In its short span, it has been able to enlist good number of members. There seems to be greater and easy access to more local members in the period ahead.

2) It has been able to reach the areas where the other BFIs isn't able to go. It has already 11 branches and few other areas has been identified.

3) Board members and management teams has previous experience of serving in banking and microfinance companies. The company on its second full year operation is in profits.

Weakness

1) Comparatively weak financial indicators in the projected periods also likely to fall behind in competition ahead with weaker fundamentals.

2) Due to the low capital base of the company, it may not be able to grab most of the business opportunities which could affect the profitability of the company.

Opportunities

1) MFI holds a better prospects in the future and for a long periods as well as its main purpose is linked with the poverty allevation. Such MFI is pivotal to uplift the economic status of poor and quarter of Nepalese population are under poverty zone.

2) Government seems to be encouraging the MFI and its role greatly in economic relief of poor through budget speech, monetary policy and other occations etc. Specially, MFI with coverage of 10 districts that lacks financial services are encouraged.

3) National economic indicators is very good and is promising in future. This could uplift the people living standard, increase per capita income, disposable income and saving amounts. This is likely to enhance the saving and enhancement of the company too.

Threats

1) Likely an intense competition due to high numbers of MFIs in the same districts and operational areas, giving possibility of dual membership and loans.

2) As the paid up capital is comparatively lower than the industry average, in case there is a regulatory requirement of increment of paid up capital, the company may be forced to be a part of merger/acquisition with an established industy player trading below its own Trading Price (*As generally perceived, microfinances with recent IPO and lower paid up capital trades at a higher end than already establihed industry players*) and at a unfoavourable swap ratio .

Porter's *five* forces – Industry Scrutiny

While every industry operate differently, but the underlying drivers of profitability are normally the same. Porter's five forces tries to scrutinize the competitive position of the industry, determining the industry's structure, its attractiveness, profitability and challenges. The concept was developed by Michael E. Porter back in 1979. The long term profitability of the industry is determined by the interaction of these five forces as below:

1. Threat of new entrant – ***Medium to high,*** *though controls are made on issuance of license to new MFIs at present, but MFIs with operating license are not operating at full capacity.*

2. Threat of Substitute products/services – **High,** MFIs are coming with different services and ideas to attract customers.

3. Bargaining power of Buyers/Customers – **High,** due to no regulatory restrictions customers/members could access the dual membership facilities availing loans from more than one MFIs, they have more bargaining power for cheap credit.

4. Bargaining power of Industry suppliers – **High,** business of microfinance highly depends on loan and advances from other BFIs at low rate. It normally is difficult for new MFIs to get credit facility since the existing MFIs could hold strong business relation with BFIs due to which the new MFIs are forced to avail credit at high rates costing the profitability.

5. Rivalry among existing competitors – **High,** high numbers of MFIs in the country and same operational areas.

Both long and short term outlook of microfinance sectors is favourable, though are more competitive.

Valuation of Company

Relative Valuation Model - The idea underlying relative valuation is that similar assets should sell at similar prices. The application of relative valuation is called the method of comparable. It estimates an asset's value relative to that of another asset (benchmark). The model helps to check whether a particular stocks is overvalued, undervalued or fairly valued in terms of measures like earnings, book value, cash flow, sales per shares by comparing the industry multiples. Here, we value the company based on P/E and P/B based multiples.

P/E ratio shows the amount investors are willing to pay for each rupee earnings of the company.

P/B ratio shows the amount investors are willing to pay for each rupee of company *tangible* assets.

Both the methods of valuation have provided different values of the company and it should be intuitive. Both methods are supported by different principles and assumptions.

It is also imperative to understand that these are the fair/theoretical values based on defined assumptions. The market value of the company after listing of the shares can be different completely, affected by factors other than fundamentals of the company.

Note: We assume P/E and P/B ratio to be same in the projected periods.

P/E Based Valuation

Projected Year	Industry P/E (As of 4th Qtr)	EPS of Company	Value of Shares
2074/75	53.65	4.94	265
2075/76	53.65	9.81	526
2076/77	53.65	11.61	623

P/B Based Valuation

Projected Year	Industry P/B (As of 4th Qtr)	BVPS of Company	Value of Shares
2074/75	9.45	106.65	1008
2075/76	9.45	116.51	1101
2076/77	9.45	128.14	1211

Tentative allotment Module

Chapter 5, Article 30 of Securities Issue and Allotment Guidelines 2074 provides the new process of allotment of securities under which every valid applicant shall be allotted 10 kitta shares on the very first round of allotment and the round following then, provided the kittas available are sufficient for allotment to each eligible applicant. Otherwise, the lottery system will be followed.

On top right is the issue and applicants details of Nepal Hydro Developer Limited as per new process. The FPO of Nepal Grameen Bikas Bank is subscribed by more than 250,000 applicants as per Prabhu Capital, the Issue Manager. The scrip was trading around Rs.700 and the issue price of FPO was only Rs.100, that attracted the high number of applicants The applied units was 27.69 % higher than the issued units.

We estimate the IPO of Support Microfinance will be subscribed by nearly 160,000 applicants. This is because the Microfinance sector has the most charm among all sectors. The trading price of almost all microfinance is very attractive. After the new allotment modules people are encouraged to apply for the IPO with the hope of minimum 10 kitta shares. Though the number of applicants could be high but the application amounts could fall short.

The IPO of the company is most likely to be allotted on lottery basis. The issue size is very small. Past application of public on the IPO is found to be high. For our forecast of 160,000 applicants, the number of kittas required to satisfy all with minimum 10 kittas is 16,00,000. However, the company can only satisfy 16,740 applicants with 10 kitta shares.

Nepal Hydro Developer Limited (NHDL)	
Issue Units	390,000
Staff (2%)	7,800
Mutual Fund (5%)	19,500
Public	362,700
Allotment Date	30/05/2074
Total Applicants	173,501
Valid Applicants	171,592
Invalid Applicants	1,909
Total Kitta Applied	15,214,790
Number of Allottees	36,270
Kittas Allotted	10
Allotment Basis	Lottery

Support Microfinance Bittiya Sanstha Limited	
Issue Units to Public	167,400
Estimated Applicants	160,000
Est. Applied Kittas	80,00,000
Oversubscription	47.8 x
Allotment	
Required Kittas	16,00,000
Available Kittas	167,400
Allotment Basis	Lottery
Number of Allottees	16,740
% Allotment	10.46%
Allotment Date	
Estimated Allotment Date	30 days
Estimated Listing Date	30 days of allotment
Estimated Trading Date	7 days of listing

As per Chapter 5, Article 29 of Securities Issue and Allotment Guidelines, 2074, the allotment of securities should be made within 30 days of issue if the number of applicants is upto 2 lakhs. For applicants from 2 lakhs to 3 lakhs, allotment period is 40 days and for applicants above 3 lakhs, allotment should be made within 50 days.

Excerpts from NEWS - NRB governor cautions microfinance institutions against unhealthy competition

***myRepublica** (7th Sept 17)*

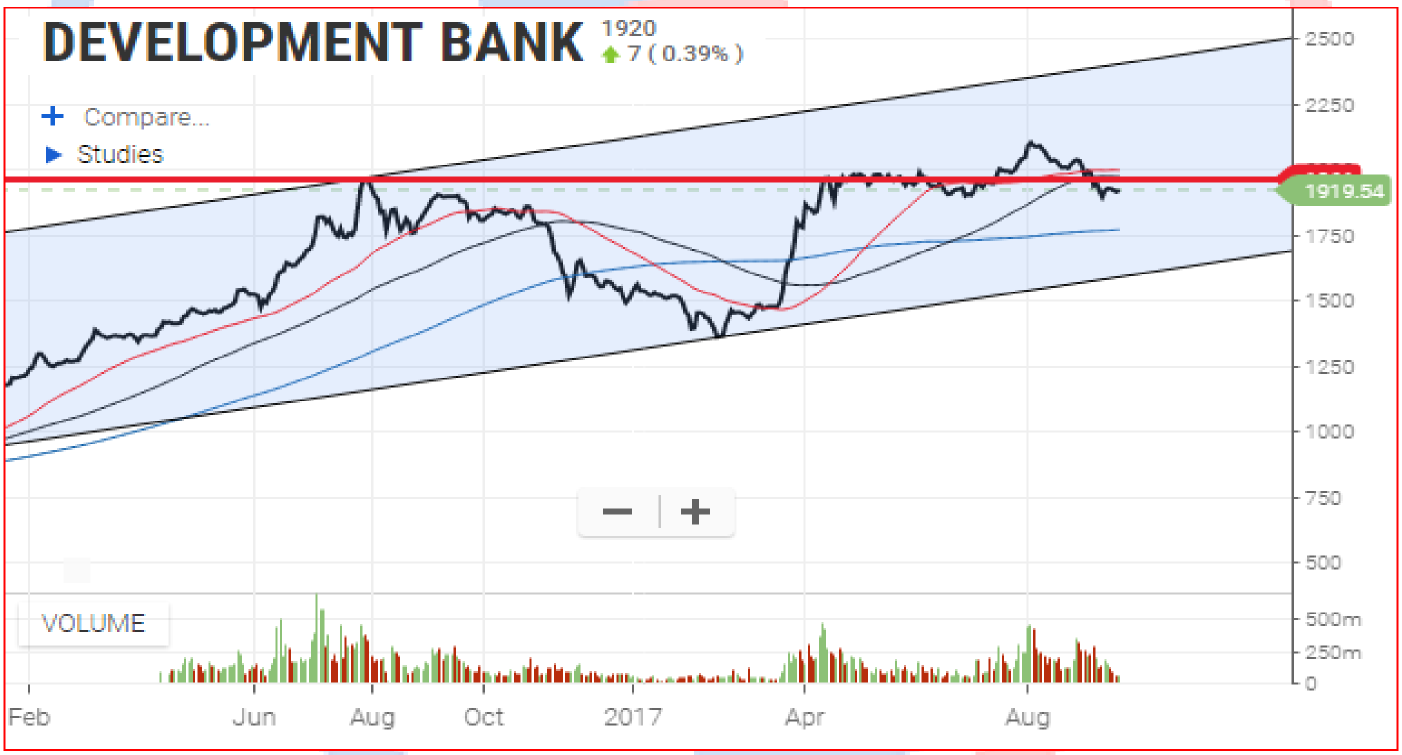
"Instead of uplifting people from poverty, many microfinance institutions are perpetuating multiple banking practices. One person is getting loans from 4 to 5 microfinance institutions," said NRB Governor Chiranjibi Nepal: "Due to lending from more than one microfinance institutions, the financial burden to the borrower increases. This practice (of multiple banking) increases poverty."

***"If this concentration of many microfinance institutions in the same areas continues to grow, they would be taken to the merger process**,"* he said.

"We have been providing interest-free loans of up to 4 million to microfinance institutions to open their branches in rural areas. However, they are still reluctant to go to the unbanked areas." Governor Nepal added.

Technical Analysis

Fading Buoyancy, No signs of Resilience Yet



Along with the overall market, Microfinance stocks saw diminishing returns since last year. A year before from today, the benchmark index Nepse had hit all time high around 1888 at which time microfinance sectors found its peak too. During this 1-year period microfinance stocks were ahead of the benchmark Nepal stock exchange index (Nepse) as it conquered new height in August this year. Last year's peak of microfinance index was around 1950 levels whereas renewed peak this year is around 2100. However, the new height could not sustain for long resulting in a sharp fall back.

For now, 1950 is a significant level from technical analysis point of view but this level was broken recently which suggests that a quick recovery would be difficult. A near support lines up at 1900 from which development bank index has bounced recently. A break below the psychological level of 1900 would indicate even worse scenario but stability above 1950 will be a green signal.

50-day and 100-day simple moving averages are above the current index which indicates down trend. But 200-day simple moving average insists that the market is in up trend. Trading volume has decreased dramatically since last two months. Sentiment of the investors after Dashain will be a key point in deciding the direction of the market. Remember the key level 1950.

RECOMMENDATION: APPLY

We recommend to apply the IPO. The possibility for allotment of the minimum kittas is very low depending upon the subscriptions level from the general public. However, the stock in the microfinance sectors is trading at a very lucrative price with the average market prices of above Rs.1800. So, the allotment of the stock through the IPO could earn a good amount of profits. The company is likely to issue bonus/rights shares to increase its paid up capital from Rs.60 million to Rs.120 million. However, analysing the financial statements and its projected reports, the fundamental indicators are poor as compared to industry average. Company is in profits already and that is commendable. While we did not have any sort of communication or the premises visits for the verification and this is only our opinion based on data as publicly available, profitability of the company depends majorly upon the revenue collection ability from the saving and credit businesses. Commission from insurance and remittance services could add to the profits as well. Sustainable earnings capacity of the company is essential for long term competitiveness. Board and management teams have years of experience and knowledge necessary for the microfinance company. Microfinance sector is exposed to different kinds of risks, both systematic and unsystematic. For unsystematic risks it will be pertinent to understand the internal control policies of the company along with the better corporate governance practices. Still, the microfinance industry has favourable long and short term outlook. Beside, the development bank index has less daily volatility of 1.30% in 2017 as compared to other sectors.