

Rating Rationale

Unique Nepal Laghubitta Bittiya Sanstha Limited

Rating

Facility/Instrument	Amount (Rs. In Million)	Rating ¹	Rating Action
Issuer Rating	NA	[CARE-NP] BB- (Is) [Double B Minus (Issuer)]	Assigned

CARE Ratings Nepal Limited (CRNL) has assigned the issuer rating of “CARE-NP BB- (Is) [Double B Minus (Issuer)]” to Unique Nepal Laghubitta Bittiya Sanstha Limited (UNLBSL). Issuers with this rating are considered to offer moderate risk of default regarding timely servicing of financial obligations in Nepal.

Detailed Rationale & Key Rating Drivers

The rating assigned to UNLBSL is constrained by weak asset quality on back of Covid-19 pandemic impact, thin capital cushion over minimum regulatory requirement, competition from other Micro Finance Institutions (MFIs) and Co-operatives and inherent risk involved in the microfinance industry. The rating is also constrained by exposure to regulatory risks related to microfinance industry. The rating, however, derives strength from backup of strong institutional promoter, experienced board members and management team and geographical diversification of business along with long track record of operation. The rating also factors in considerable growth in business over the period, moderate dependence of resource profile on Banks & Financial Institutions (BFIs) borrowings, moderate liquidity profile and comfortable financial performance over the period marked with healthy profitability till FY20 (Audited, refers to the 12 months period ended Mid-July 2020), however declined during Q1FY21 (Provisional) and sector wise credit portfolio distribution with higher concentration towards agriculture. Ability of the company to continue its growth momentum with improving asset quality and improving the Capital Adequacy Ratio and ability to manage the impact of any regulatory changes by NRB are the key rating sensitivities.

Detailed Description of the Key Rating Drivers

Key Rating Weaknesses

Weak asset quality on back of Covid-19 pandemic impact

UNLBSL's asset quality is marked by high Gross Non-Performing Loans (GNPL) in the industry. GNPL of the company was high at 2.55% during FY20 which deteriorated substantially to 5.61% during Q1FY21. Primary reason for high GNPL was due to impact of COVID 19. Furthermore, more than 30 days delinquency of UNLBSL is also on higher side which was 28.91% of total advances as on July 15, 2020 and the same has increased to 42.30% as on October 16, 2020.

¹Complete definitions of the ratings assigned are available at www.careratingsnepal.com

Thin capital cushion over minimum regulatory requirement, which is expected to improve after the proposed capital injection

UNLBSL's Tier I capital and Overall Capital Adequacy Ratio (CAR) stood at 7.27% and 8.52% respectively in FY20 which is in moderate cushion over the minimum regulatory requirement of 4% and 8% respectively for microfinance institutions (MFIs). Further, CAR marginally improved to 8.55% at the end of Q1FY21. The improvement in CAR is majorly due to higher accretion of profit to reserve and surplus. CAR is expected to improve further after issue of proposed IPO. Further, it has paid up capital of Rs 63 Mn (Previously NRB required to maintain minimum paid up capital of Rs 20 Mn for MFI operating in 4 to 10 districts) in Q1FY20. But, as per new Unified directives 2020 issued by NRB, the company operating in more than one state shall be converted into national level MFI with minimum paid up capital of Rs. 100 Mn within Mid-July, 2022. Accordingly, after conversion of calls in advance of Rs. 33.82 Mn outstanding at the end of FY20 and issuance of proposed IPO, the company will be converted to national level microfinance.

Competition from other MFIs and Co-operatives

As on Mid-October 2020, there were 70 MFIs in operation with total of 4,117 branches all over Nepal. UNLBSL has 38 branches as on Mid October, 2020. Micro Finance Industry earned Rs. 9,853 Mn interest income, Rs 5,336 Mn net interest income and Rs 1,712 Mn Net profit during Q1FY21. UNLBSL has 1.12% (Rs. 110 Mn) share on interest income, 1.14% (Rs. 61 Mn) share on net interest income and 0.47% (Rs. 8 Mn) share on net profit for the same period in the industry. Further, large number of cooperatives are operating all over Nepal which provides loans and other financial services to their members with or without collateral. Due to presence of large number of micro finance and co-operatives, UNLBSL is facing competition to tap the new customer and to retain the existing good consumer.

Inherent risk involved in the microfinance industry

MFIs are prone to credit risk which is directly related to the portfolio of the organization and is one of the most significant risks from MFI's perspective. Credit risk assumed by a MFI is typically higher compared to banks and other types of lenders given the weak borrower profile. Further, MFIs provide unsecured loan i.e. loan without any collateral. In case any borrower defaults, the MFI do not have any asset backed as collateral to meet its loss, which makes the credit even riskier. As borrowing from MFIs do not require collateral, clients tends to borrow from multiple MFIs resulting to problem of loan duplication. Absence of credit report from Credit Information Bureau (CIB) is one of the reasons for loan duplication. However, monetary policy of 2018-19 required MFIs to send credit information to CIB continuously and failing to comply the same will result in 2% additional Loan Loss Provision (LLP). As per NRB norms, MFIs are allowed to lend against collateral up to 33.33% of total lending. UNLBSL's percentage of collateral loan to total loan is 3.29% in Q1FY21 which is decreased from 3.56% in FY20.

Exposure to regulatory risks related to microfinance industry

The microfinance industry in Nepal is exposed to changes in the various regulatory measures issued by NRB from time to time. As per the earlier regulations, A, B & C class financial institutions were required to extend 5%, 4.5% and 4% respectively of their total loans towards deprived sector. However, Monetary Policy of 2018-19 changed the guidelines and instructed A, B & C class financial institutions to lend 5% of their total loan to deprived sector. This regulation change impact the incremental fund availability to MFIs, cost of fund, credit growth and profitability of the MFIs. Monetary policy of 2018-19 explained the provision, where MFIs are now allowed to determine interest rate on loan by adding up to 3% administrative expenses above cost of fund plus maximum of 6% spread and the interest rate ceiling (i.e.18% earlier). However, as per latest introduction of monetary policy 2019/20, MFIs are not allowed to take interest more than 15% w.e.f. July 28, 2020. As a result of these provisions, MFI cannot charge interest rate more than 15% which will restrict interest earning capacity and yield from FY21 onwards.

Key Rating Strengths***Backup from strong institutional promoter***

At the end of FY20, 65.24% of current paid up capital of UNLBSL is held by institutional promoters namely United Youth Community (UNYC Nepal), Prabhu Bank Limited (PBL, CARE-NP BBB) and Nepal Credit and Commerce Bank Limited.

Experienced board members and management team

UNLBSL has 5 members on its board and is chaired by Mr. Kali Prasad Chaudhary, who was Chief Executive Officer of Nepal hydro and Electric Limited and has more than 32 years of overall working experience. Other directors of the company have experience in various industry. The company's management team is led by Executive Director (ED), Dr. Gopal Dahit, who has more than 21 years of experience in microfinance sector. He has worked as ED at UNYC Nepal for four years and he has been ED at UNLBSL since last 2 years. He is supported by other experienced management team to look after various functions in the company.

Geographical diversification of business with long track record of operation

UNLBSL started operations from December 2018 by taking over the existing microcredit operation of UNYC. UNYC started MFI activities from 2000 as a financial intermediary. Currently, it is operating in 6 districts (out of 77 districts) and 2 provinces (out of 7 provinces) through 38 branches as on October 16, 2020. Also it has plans to open additional 4 branches during FY21 mainly in western part of Nepal (i.e. in province 5 and 6).

Moderate dependence of resource profile on Banks & Financial Institutions (BFIs) borrowings

The ratio of borrowing from BFIs to total resource was moderate and decreased to 18.95% in FY20 from 24.42% in FY19. As a result of which cost of fund is on lower side. As on July 15, 2020, UNLBSL is tied up with 10 BFIs for the credit line where interest rate ranges from 4.5 % to 12.70 % depending upon the financial institution.

Considerable growth in business over the period

UNLBSL's credit portfolio grew by 9.36% to Rs 2,504 Mn in FY20 from Rs 2,290 Mn in FY19. Further, credit portfolio increased marginally by 4.46% to Rs 2,626 Mn in Q1FY21. Similarly, its deposit grew by 17.43% to Rs 1,790 Mn in FY20 over FY19. Further, the deposit grew by 3.30% during Q1FY21. UNLBSL has 1.61% and 0.92% market share in terms of deposit base and loan portfolio respectively of microfinance industry in Q1FY21 based on monthly data published for Mid-October 2020 by NRB.

Moderate Liquidity Profile

UNLBSL has moderate liquidity profile with positive cumulative mismatch over one year as on October 16, 2020. However, the assets and liabilities show mismatches in all the buckets ranging from 1 to 90 days to 271 to 356 days, on account of advances given of longer tenure in contrast with low tenure saving deposits. It has maintained compulsory reserve ratio (CRR) and liquid assets of 0.55% and 5.77% in Q1FY21 as against minimum regulatory requirement of 0.5% and 2.5% respectively for microfinance institutions (MFIs) not collecting deposit from general public.

Comfortable financial performance over the period marked with healthy profitability, however declined during Q1FY21

UNLBSL's financial performance is stagnant during FY20 over FY19 in terms of profitability. It has reported net profit of Rs.41 Mn during FY20 against net profit of Rs 40 Mn during FY19 despite increase in total income by 83.5% due to higher level of loan loss provision during the year. Total income increased to Rs. 408 Mn during FY20 due to increase in interest income on account of growth in loans and advances. Accordingly, Net interest income increased to Rs 193 Mn during FY20.

UNLBSL's net profit declined substantially by 68% to Rs 8 Mn during Q1FY21 from Rs 25 Mn during Q1FY20 mainly due to substantial increase in loan loss provision (by 289% to Rs 35 Mn during Q1FY21). Similarly, return on Total Assets (ROTA) decreased to 1.17% in Q1FY21 from 1.63% in FY20. However, Net Interest Margin (NIM) ratio improved to 8.84% in Q1FY21 from 7.68% in FY20.

Sector wise credit portfolio distribution, however high concentration towards Agriculture sector

In Q1FY21, UNLBSL has lent 56.90% towards agriculture sector (which includes 19.42% to animal husbandry, 15.13% to Vegetables, 3.23% to poultry farming) followed by 36.45% towards service industry and 5.14% towards small and cottage industry.

About the Company

UNLBSL is a "D" class 10 district microfinance institution (MFI's operating in 4 to 10 districts) incorporated on August 03, 2018, licensed by Nepal Rastra Bank on November 11, 2018 and commenced operation on December 16, 2018. Thereafter, UNLBSL took over the microfinance business of UNYC, an NGO established in 1995 and operating as a financial intermediary since 2000 in Nepal. UNLBSL is primarily

engaged in providing microfinance loan based on the Joint Liability Group (JLG) model with each group consisting of minimum five members.

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