

Kisan Laghubitta Bittiya Sanstha Limited (Former NRN Laghubitta Bittiya Sanstha Limited)

Ratings

Facilities	Amount (Rs. in Million)	Rating ¹	Rating Action
Issuer Rating	NA	CARE-NP BB- (Is) [Double B Minus (Issuer)]	Reaffirmed

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

Detailed Rationale & Key Rating Drivers

The ratings assigned to KLBSL continues to be constrained by its weak asset quality profile, high dependence of resource profile on Banks & Financial Institutions (BFIs) borrowings, and competition from other Micro Finance Institutions (MFIs) and Co-operatives. The rating also factors in the inherent risk involved in the microfinance industry and exposure to regulatory risks related to microfinance industry.

The rating, however, derives strength from backup from strong institutional promoter, experienced board members and management team, improved financial performance marked by increased revenue and profitability in FY21 (Audited, refers to the twelve-month period ended mid-July 2021) and H1FY22 (Unaudited, refers to the six-month period ended mid-January 2022). The rating also factors in moderate capitalization level and liquidity profile, considerable growth in business over short period of time and sector wise credit portfolio distribution.

Going forward, the ability of the company to continue its growth momentum with improving asset quality and capital adequacy ratio and its ability to manage the impact of any regulatory changes will be the key rating sensitivities.

Detailed Description of the Key Rating Drivers

Key Rating Weaknesses

Short track record of operations and weak asset quality

KLBSL commenced its operation since January 21, 2019. Having short track record of operations of only three years, the company's seasoning of loan portfolio remains unproven. Furthermore, KLBSL's asset quality remains weak marked by high Gross Non-Performing Loans (GNPL) ratio of 4.60% of total loans and advances as on mid-July 2021 compared to 1.53% in FY20, which further increased to 4.73% as on mid-Jan 2022. The main reason for high GNPL was due to impact of COVID 19 leading to non-recovery of loan amount in due course. More than 30-day delinquency of KLBSL, however, remained manageable at 5.93% of total advances as on July 15, 2021 and decreased to 5.09% as on mid-January 2022. Given the lingering impact of the pandemic, exacerbated by the ongoing liquidity crisis, deterioration in asset quality in a short span remains a risk and hence tight monitoring of the asset quality will remain critical for the company's financial health going forward.

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

KLBSL's major source of funding consists of deposits from its members and borrowing from banks and financial institutions (BFIs). The ratio of borrowing from BFIs to total resource was high at 75.24% in FY21 compared to 71.12% in FY20, which further increased to 75.37% in H1FY22. Due to high reliance on BFI's for funding the cost of fund is on higher side. The average cost of borrowing was 5.75% in FY21 (FY20: 5.65%) which is higher than its cost of deposit of 5.53% (FY20:2.45%). Higher reliance on BFIs increases the MFI's cost of fund and is likely to squeeze spread leading to lower profitability.

¹Complete definition of the ratings assigned are available at www.careratingsnepal.com and other CARE publications

Competition from other MFIs and Co-operatives

As on mid-January 2022, there were 67 MFIs in operations with total of more than 5,000 branches in Nepal. KLBSL had 128 branches as on mid-January 2022. Micro Finance Industry earned Rs. 41,688 Mn interest income, Rs 10,759 Mn net interest income and Rs 10,669 Mn Net profit during FY21. KLBSL had 1.74% (Rs. 729 Mn) share on interest income for the same period in the industry. Furthermore, large number of cooperatives is 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 microfinance institutions and co-operatives, KLBSL faces competition to tap in a new customer base and to retain the existing customer.

Inherent risk involved in the microfinance industry

Micro Finance Institutions are prone to credit risk which is directly related to the portfolio of the organization and is one of the more significant risks from MFI's perspective. Credit risk assumed by MFI is typically higher compared to banks and other types of lenders given the weak borrower profile. Furthermore, majority of MFI's loan portfolio is unsecured in nature means advances not secured by adequate collateral. In case any borrower defaults, the MFI does not have any asset backed as collateral to meet its loss, which makes the credit even riskier. As borrowings from MFIs do not usually require collateral, clients tend to borrow from multiple MFIs resulting to problem of loan duplication. As per NRB norms, MFIs are allowed to lend against collateral up to 33.33% of total lending. KLBSL's percentage of collateral loan is 19.38% of total lending in FY21 which has improved from 5.10% in FY20.

Exposure to regulatory risks related to microfinance industry

The microfinance industry is exposed to changes in the various regulatory measures issued by NRB from time to time. As per the regulations, A, B & C class financial institutions have to lend at least 5% of their total loans towards deprived sector. Furthermore, NRB has capped the interest rates of MFI's at 15% and fees at 1.5% while scrapping the interest rate spread cap of 9%, which has tightened the profitability of the MFI's due to restriction in interest earning capacity, particularly during periods of high interest rates.

Key Rating Strengths**Backup from strong institutional promoter and experienced management team**

At the end of H1FY22, 10% of the paid up capital of KLBSL is held by institutional promoters namely Century Commercial bank [CARE-NP BBB (Is)] holding 7% of the total share capital and Prime Commercial Bank [CARE-NP A-] holding 3% of the total capital in the company. Both institutions are established "A Class" Commercial Banks of Nepal giving advantage to KLBSL in respect of management and operational assistance.

KLBSL has 7 board members and the board is chaired by Mr. Lokraj Sharma, with a decade long experience in international business. The company's management team is led by CEO, Mr. Debendra Bahadur Shah and is supported by other experienced management team.

Improved financial performance marked by increased revenue and profitability in FY21 and H1FY22

During FY21, KLBSL's total income increased to Rs. 831 Mn from Rs. 337 Mn during FY20. Interest income increased to Rs. 729 Mn in FY21 from Rs. 297 Mn in FY20 supported by growth in advances. Consequently, net interest income increased to Rs. 400 Mn during FY21 from Rs. 97 Mn during FY20, offset to some extent by increase in interest expense to Rs. 329 Mn in FY21 from Rs. 200 Mn in FY20. Although operating expenses also increased to Rs 252 Mn during FY21 from Rs 110 Mn in FY2, boosted by increased scale of operations, the MFI reported net profit of Rs. 135 Mn compared to Rs. 8 Mn during FY20. In H1FY22, the MFI reported improvement in net profit, which increased to Rs. 44 Mn compared to Rs. 37 Mn in H1FY21 on account of increase in income coupled with decrease in provisions.

Furthermore, KLBSL's credit portfolio had increased substantially by 40.53% to Rs 5,811 Mn in FY21 from Rs 4,135 Mn in FY20, which further increased by 15.88% to Rs 6,734 Mn in H1FY22 over FY21. Similarly, KLBSL's deposit grew by 27.61% to Rs 1,130 Mn in FY21 from Rs.886 Mn in FY20 due to accumulation of compulsory deposit amount into the account of members during FY21. KLBSL has 0.88% and 1.56% market share in terms of deposit base and loan portfolio respectively of microfinance industry as on mid-January 2022, based on data published by NRB.

Moderate level of capitalization and liquidity profile

KLBSL's Tier I and overall Capital Adequacy Ratio (CAR) stood at 8.84% and 9.21%, respectively, at the end of FY21 compared to the minimum regulatory requirement of 4% and 8% for microfinance institutions (MFIs). Furthermore, overall CAR improved to 9.99% at the end of H1FY22. Higher cushion in the capitalization levels would put the MFI in a better position to absorb any losses to be materialized, especially given the uncertainty surrounding credit recovery amid the lingering impact of the covid-19 pandemic. The MFI's ability to maintain adequate cushion in the capital adequacy ratios will remain critical for its solvency and growth prospect.

KLBSL has proposed for FPO issue of Rs. 129.83 Mn in FY23, which is expected to improve the CAR and support the expansion of business. The total paid up capital of the company was Rs 393 Mn as on mid-January 2022 compared to the regulatory requirement minimum paid-up capital of Rs 100 Mn for national level microfinance.

As on July 15, 2021, the Cash Reserve Ratio (CRR) of KLBSL has been maintained at 0.56% in FY21 and 0.53% in H1FY22. Furthermore, KLBSL has maintained net liquid asset ratio of 20.61% in H1FY22 which are in align with NRB norms.

Geographical diversification of business and sector wise credit portfolio distribution, however high concentration towards service sector

KLBSL is operating through 128 branches covering 43 districts (out of 77 districts) as on mid-January 2022. Being a national level microfinance company, KLBSL's scope for growth is not confined to a single region, providing opportunities to cater geographically diversified business, customer base and portfolio of the bank which reduces the risk of volatility.

However, the credit portfolio of KLBSL is highly concentrated towards service and agricultural sector. In FY21 the advances were concentrated towards service sector with 54.80% exposure, which further increased to 56.78% in H1FY22. Advances towards agriculture sector stood at 40.03% in FY21, however decreased to 38.60% in H1FY22. The recovery in the agriculture sector highly depends on various factors such as climatic conditions like monsoons, drought and floods, availability of prices etc.

About the Company

Kisan Laghubitta Bittiya Sanstha Limited (KLBSL) (Former NRN Laghubitta Bittiya Sanstha Limited) is a "D" class National Level microfinance institution. It was incorporated on January 21, 2019 as NRN Laghubittiya Sanstha Limited and later as on January 6, 2021 the name was changed to KLBSL. It is promoted by individuals from different background and is primarily engaged in providing microfinance loan based on the Joint Liability Group (JLG) model with each group consisting of minimum six members. The company was merged with 4 microfinance entities named Creative Laghubitta Bittiya Sanstha Limited, Ramaroshan Laghubitta Bittiya Sanstha Limited, Kisan Microfinance Bittiya Sanstha Limited and Divya Laghubitta Bittiya Sanstha Limited.

Contact us**Analyst Contact**

Ms. Sarina Khakurel

977-01-4012628

sarina.khakurel@careratingsnepal.com

Mr. Santosh Pudasaini

+977-01-4012629

pudasaini.santosh@careratingsnepal.com

Relationship Contact

Mr. Achin Nirwani

+977 9818832909

achin.nirwani@careratingsnepal.com

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