

## Unique Nepal Laghubitta Bittiya Sanstha Limited

### Rating

Facilities	Amount (Rs. in Million)	Rating <sup>1</sup>	Rating Action
<b>Issuer Rating</b>	<b>NA</b>	<b>CARE-NP B+ (Is) [Single B Plus (Issuer Rating)]</b>	<b>Revised from CARE-NP BB- (Is)</b>

CARE Ratings Nepal Limited (CRNL) has revised the rating assigned to Unique Nepal Laghubitta Bittiya Sanstha Limited's (UNLBSL) issuer rating to CARE-NP B+ (Is) from CARE-NP BB- (Is). Issuers with this rating are considered to offer high risk of default regarding timely servicing of financial obligations, in Nepal.

### Detailed Rationale & Key Rating Drivers

The revision in issuer rating of UNLBSL takes into account sustained deterioration in the asset quality of the company in FY22 (Audited; FY refers to the twelve-month period ending mid-July) and H1FY23 (Unaudited; H1 refers to the six-month period ending mid-January). The rating assigned to UNLBSL remains constrained by its weak financial performance marked by declining profitability in FY22 and H1FY23, presence in a highly competitive market with low market share of the industry. The rating also factors in declining deposit ratio, concentration towards agricultural sector, geographical concentration of business, inherent risk involved in the microfinance industry and exposure to regulatory risks related to microfinance industry.

The rating, however, derives strength from experienced board members and management team, moderate capitalization levels and moderate liquidity profile of the company.

*Going forward, the ability of the company to manage growth along with improvement in asset quality and maintaining capital adequacy will remain a key rating sensitivity.*

### Detailed Description of the Key Rating Drivers

#### Key Rating Weaknesses

##### Substantial deterioration in assets quality

UNLBSL has a weak asset quality profile marked by higher Gross Non-Performing Loans (GNPL) ratio of 9.76% of total loans and advances as on mid-July 2022 which deteriorated from 7.45% as on previous balance sheet date. Furthermore, more than 30-day delinquency of UNLBSL was also relatively high at 12.42% and 11.36% of total advances at the end of FY22 and as on mid-January 2023 respectively. GNPL ratio further deteriorated to 14.68% as on mid-January 2023, which is on higher side compared to other peers in the industry as collections are being impacted by the ongoing liquidity stress in the industry which has severely impacted the repayment capabilities of the borrowers. The company's ability to improve collection leading to better asset quality will remain a key monitorable aspect.

##### Weak financial performance marked by decline in profitability in FY22 and H1FY23 with geographical concentration

UNLBSL's credit portfolio grew 32.88% year-on-year to Rs. 3,959 Mn in FY22, which show a nominal increase of ~1% to Rs. 3,998 Mn in H1FY23 aided mainly by an increasing member base. UNLBSL has 1.51% and 0.88% market share in terms of deposit base and loan portfolio respectively, of the microfinance industry at the end of FY22. During FY22, UNLBSL's total income increased by 18.32% to Rs. 585 Mn. Interest income increased by 24.38% year-on-year to Rs. 531 Mn in FY22 supported by increased advances. Consequently, net interest income increased by 15.20% to Rs. 279 Mn during FY22. Total Operating Income has improved backed by increasing number of members post-merger with Ghodighoda Laghubitta Bittiya

<sup>1</sup>Complete definition of the ratings assigned are available at [www.careratingsnepal.com](http://www.careratingsnepal.com) and other CARE publications

Sanstha Limited. PAT of the company declined year-on-year by 12.21% to Rs. 67 Mn in FY22 mainly due to increased loan loss provisioning. Company reported net profit of Rs. Rs. 7 Mn in H1FY23. The MFI is operational in 6 districts of Nepal spanning 2 provinces through 41 branches as on mid-January 2023. Geographically concentrated network base weakens the company's ability to diversify its credit portfolio and thereby increases the risk of volatility of a single economic region.

#### **Declining deposit ratio with increased dependence on Banks and Financial Institutions (BFIs) borrowings**

UNLBSL's major source of funding consists of deposits from its members and borrowings from banks and financial institutions. The ratio of deposits to total resource decreased to 62.28% as on mid-July 2022 from 68.24% as on previous balance sheet date which has further declined to 55.30% as on mid-January 2023. Also, the ratio of borrowing from BFIs to total resource has increased to 22.14% in FY22 from 16.15% in FY21 which has decreased to 19.10% in H1FY23. Increased dependence of BFI borrowings will lead to higher cost of funding for the MFI which could lead to squeezed margins for MFIs, which have to abide by regulatory ceiling of 15% for their advances. UNLBSL's average overall cost of funding increased to 8.77% during FY22 compared to 7.94% in previous year.

#### **Sector wise credit portfolio distribution, however high concentration towards agricultural sector**

UNLBSL's credit portfolio is concentrated towards agricultural sector with 54.96% and 51.28% of total portfolio at the end of FY22 and H1FY23 respectively, albeit in a declining trend as compared to 78.52% at the end of FY21. The recovery in the agriculture sector highly depends on various factors such as climatic conditions like monsoons, drought and floods, availability of prices etc. Any adverse climatic conditions or other unfavorable factors which might have an impact on crop production or sales would adversely affect repayment capacity of the borrowers and put added stress on the MFI's asset quality.

#### **Competition from other MFIs and Co-operatives**

As on mid-July 2022, there were 65 MFIs in operation with total of more than 5,000 branches in Nepal. UNLBSL had 38 branches as on mid-July 2022. Micro Finance Industry earned Rs. 59,985 Mn interest income, Rs. 29,463 Mn net interest income and Rs. 12,218 Mn Net profit as on Mid-July 2022. UNLBSL had 0.89% (Rs. 531 Mn) share on interest income, 0.95% (Rs. 279 Mn) share on net interest income and 0.55% (Rs. 67 Mn) share on net profit for the same period in the industry. Furthermore, large number of cooperatives (National and Provincial level) are operating all over Nepal which provide loans and other financial services to their members with or without collateral. Due to presence of large number of micro finance institutions and co-operatives, CYCN is facing competition to tap the new customer and to retain the existing good consumer.

#### **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. UNLBSL's percentage of collateral loan is 4.73% of total lending as on mid-January 2023 compared to 3.09% at the end of FY22.

#### **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 5%, 4.5% and 4% respectively of their total loans towards deprived sector, a major part of which is generally routed through microfinance institutions. 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. Also, NRB has fixed loan ceiling for new borrowers of Rs. 3 lakhs to unsecured loans and Rs. 7 lakhs to secured loans. And, Rs. 15 lakhs to old borrowers whose loan category is in pass during last two years.

### **Key Rating Strengths**

#### **Experienced board members and management team with backup from strong institutional promote**

At the end of FY22, 59.75% of paid up capital of UNLBSL is held by institutional promoters namely United Youth Community (UNYC Nepal), Prabhu Bank Limited (CARE-NP BBB, Credit watch with negative implications) and Kumari Bank Limited (erstwhile Nepal Credit and Commerce Bank Limited). UNLBSL is managed under overall guidance of its board having five members and is chaired by Mr. Kali Prasad Chaudhary, with more than 35 years of experience in various sectors. The company's management team is led by Executive Director, Dr. Gopal Dahit, having more than two decades of experience in various sectors. He is further supported by experienced management team to look after various functions in the company.

#### **Moderate level of capitalization and moderate liquidity profile**

UNLBSL's Tier I and overall Capital Adequacy Ratio (CAR) stood at 8.17% and 9.82%, respectively, as on mid-July 2022 declining from 8.64% and 9.89% as on mid-July 2021 compared to the minimum regulatory requirement of 4% and 8% for microfinance institutions (MFIs). Overall CAR further declined to 9.44% as on mid-January 2023. Adequate cushion in the capitalization levels would put the MFI in a better position to absorb any losses, should they materialize, especially given the uncertainty surrounding credit recovery amid the lingering impact of the covid-19 pandemic and the ongoing liquidity stress/ credit crunch in the banking industry. The MFI's ability to maintain adequate cushion in the capital adequacy ratios will remain critical for its solvency and growth prospect. The total paid up capital of the company increased to Rs. 110.63 Mn at the end of FY22 which is more than the minimum requirement of Rs. 100 Mn as per regulation.

The Cash Reserve Ratio of UNLBSL has been maintained at 0.55% and 0.54% at the end of FY22 and H1FY23 respectively against minimum requirement of 0.50%. Furthermore, UNLBSL has maintained net liquid asset ratio of 5.46% and 10.44% respectively in FY22 and H1FY23 against the minimum regulatory requirement 2.50% for MFIs not taking public deposits, which is in line with NRB norms.

### **About the Company**

Unique Nepal Laghubitta Bittiya Sanstha Limited (UNLBSL) is a "D" class microfinance institution incorporated on August 03, 2018, licensed by Nepal Rastra Bank on November 11, 2018 and commenced operations 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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