

## Unique Nepal Laghubitta Bittiya Sanstha Limited

### Rating

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

CARE Ratings Nepal Limited (CRNL) has revised the rating assigned to Unique Nepal Laghubitta Bittiya Sanstha Limited (UNLBSL) to CARE-NP B (Is) from CARE-NP B+ (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 decline in the asset quality of the company in FY23 (Audited; FY refers to the twelve-month period ending mid-July), which has declined even further in H1FY24 (Unaudited; H1 refers to the six-month period ending mid-January) amid economic slowdown. The rating assigned to UNLBSL is also constrained by its weak financial performance marked by declining profitability in FY23 and H1FY24, 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 (MFI). 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 while maintaining capital adequacy will remain the key rating sensitivities.*

### Detailed Description of the Key Rating Drivers

#### Key Rating Weaknesses

##### Substantial deterioration in assets quality over FY23-H1FY24, stress likely to continue over near-term

UNLBSL has a weak asset quality profile marked by higher Gross Non-Performing Loans (GNPL) ratio of 12.41% of total loans and advances as on mid-July 2023 which deteriorated from 8.23% as on previous balance sheet date. GNPL ratio further deteriorated to 16.48% as on mid-January 2023, which was markedly higher compared to other peers in the industry (industry average of 7.49% for retail MFIs) as collections are being impacted by the slowdown in the country's economy, which has impacted the repayment capabilities of the borrowers. Furthermore, more than 30-day delinquency of UNLBSL was also relatively high at 26.51% of total advances as on mid-January 2024, up from 22.72% as on mid-July 2023. This heightens possibility of sustained slippages in the MFI's asset quality over the near-term, continuing in the trend seen in H1FY24. The company's ability to improve collection leading to better asset quality will be critical from analytical perspective.

##### Weak financial performance marked by decline in profitability in FY23 with geographical concentration

During FY23, UNLBSL's total income decreased by 3.04% to Rs. 629 Mn. Interest income decreased by 1.38% year-on-year to Rs. 570 Mn in FY23 as a result of declining advances. UNLBSL's credit portfolio contracted by 5.98% year-on-year to Rs. 3,492 Mn in FY23. Consequently, net interest income decreased by 17.79% to Rs. 268 Mn during FY23. PAT of the company declined year-on-year by 59.37% to Rs. 39 Mn in FY23 mainly due to increased loan loss provisioning amid surging GNPLs. UNLBSL has 1.52% and 0.87% market share in terms of deposit base and loan portfolio respectively of microfinance industry at FY23 end. Its

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

near-term financial performance is likely to remain impacted by the increasing stress its asset quality observed over FY23-H1FY24. 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 increased to 64.63% as on mid-July 2022 from 62.28% as on previous balance sheet date which has increased to 66.87% as on mid-January 2024. Also, the ratio of borrowing from BFIs to total resource has decreased to 15.92% in FY23 from 22.14% in FY22 which has decreased to 12.25% in H1FY24. 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 7.82% during FY23 compared to 7.61% in previous year.

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

As on mid-July 2023, there were 57 MFIs in operation with total of more than 5,073 branches in Nepal. UNLBSL had 41 branches as on mid-July 2023. Micro Finance Industry earned Rs. 61,707 Mn interest income, Rs. 24,741 Mn net interest income and Rs. 4,130 Mn net profit as on mid-July 2023. UNLBSL has 1.01% (Rs. 569 Mn) share on interest income, 1.19% (Rs. 267 Mn) share on net interest income and 0.94% (Rs. 39 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**

MFIs are prone to credit risk which is directly related to the portfolio of the institution and is one of the most significant risks from a MFI's perspective. Credit risk assumed by an MFI is typically higher compared to other banks and lenders given its weak borrower profile. Furthermore, MFIs majorly provide unsecured loans i.e. loans without any collateral. In case any borrower defaults, the MFIs do not have any assets backed as collateral to meet its losses, which makes the credit even riskier. As borrowing from MFIs do not require collateral, clients tend to borrow from multiple MFIs resulting in the problem of loan duplication. As per NRB norms, MFIs are allowed to lend up to 33.33% of total lending against collateral. UNLBSL's percentage of non-collateral loan to total loan was 93.23% at the end of FY23 (PY: 96.91%), which is on the higher side due to the company's focus on providing loan to deprived group of borrowers.

#### **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 to the deprived sector, a major part of which is generally routed through microfinance institutions. Furthermore, NRB has capped the interest rates of MFIs at 15% and fees at 1.5% while scrapping the interest rate spread cap of 9%, which has tightened their profitability due to restriction in interest earning capacity, particularly during periods of high interest rates. Also, NRB has fixed loan ceiling for new borrowers at Rs. 3 lakhs for unsecured loans, Rs. 7 lakhs for secured loans, and Rs. 15 lakhs for old borrowers whose loan is in pass category during last two years.

**Key Rating Strengths****Experienced board members and management team with backup from strong institutional promoter**

At the end of FY23, 44.49% of paid-up capital of UNLBSL is held by institutional promoters namely United Youth Community (UNYC Nepal), Prabhu Bank Limited (CARE-NP BB+, Credit watch with developing 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. Shiva Bahadur Chaudhary, with 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 capitalization and liquidity profile**

UNLBSL's Tier I and overall Capital Adequacy Ratio (CAR) stood at 9.19% and 10.84% (minimum regulatory requirement of 4% and 8%), respectively, as on mid-July 2023, improving from 8.37% and 10.02% as on mid-July 2022 amid decline in loans and advances. 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. The MFI's ability to maintain adequate cushion in the capital adequacy ratios will remain critical for its solvency and growth prospect.

The Cash Reserve Ratio of UNLBSL has been maintained at 0.57% and 0.58% at the end of FY23 and H1FY24 respectively against minimum requirement of 0.50%. Furthermore, UNLBSL has maintained net liquid asset ratio of 11.02% and 11.92% respectively in FY23 and H1FY24 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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