

**Kisan Laghubitta Bittiya Sanstha Limited**  
(Erstwhile NRN Laghubitta Bittiya Sanstha Limited)

**Ratings**

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 (Issuer Rating)]</b>	<b>Revised from CARE-NP B+ (Is)</b>

CARE Ratings Nepal Limited (CRNL) has revised the rating assigned to Kisan Laghubitta Bittiya Sanstha Limited (KLBSL) 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 rating assigned to KLBSL factors in deterioration in its asset quality as reflected by uptick in non-performing loans (NPL) with substantial increase in delinquent loans (30+days) i.e. ~28% of total advances as on mid- January, 2024, up from ~5% of total advances as on mid-July, 2022. Delinquencies in 31-90 days bucket (including restructured loan) were ~21% of total advances with the possibility of further slippages, which could adversely impact its overall credit risk profile over the near term. Consequently, increased provisioning requirements in addition to squeezed Net Interest Margins (NIM) led to net losses resulting in the decline in KLBSL's capitalization levels in H1FY24 (Unaudited; refers to the six-month period ending mid-January, 2024). The rating, also factor in high dependence of resource profile on Banks & Financial Institutions (BFIs) borrowings and deteriorating financial performance amid increased cost of funds and impairment losses. Declining asset quality trend, particularly with its already high GNPL levels and delinquent loans could add to the downward pressure on MFI' earnings and capitalization levels over the near term. The rating takes note of inherent risk involved in the microfinance industry, competition from other Micro Finance Institutions (MFIs) and Co-operatives and exposure to regulatory risks related to microfinance industry.

The rating, however, derives strength from backup from strong institutional promoters and experienced board members and management team. 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 improve its asset quality while managing growth in its scale of operations, maintain adequate cushion in capital adequacy indicators from the minimum regulatory requirement levels, and manage the impact of any other regulatory changed by Nepal Rastra Bank (NRB) will remain 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 five years, the company's seasoning of loan portfolio and creditors' portfolio remains unproven. Furthermore, KLBSL's asset quality remains weak marked by high Gross Non-Performing Loans (GNPL) ratio of 5.95% of total loans and advances as on mid-July 2023 compared to 4.96% in FY22, which further deteriorated to 7.44% as on mid- January 2024 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 (including restructured loans) of KLBSL remains high at ~28% of total advances as on mid-January 2024. 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.

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

### **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 66.43% in FY23 (FY22: 67.89%), which stood at 69.47% in H1FY24. Due to high reliance on BFI's for funding the cost of fund is on higher side. The average cost of borrowing was 14.48% in FY23 (FY22: 10.55%) which is higher than its cost of deposit of 7.44% in FY23. Higher reliance on BFIs increases the MFI's cost of fund and is likely to squeeze spread leading to lower profitability.

### **Deteriorating financial performance amid increased cost of funds and impairment losses**

During FY23, KLBSL's total income increased by 2.5% y-o-y to Rs. 1,020 Mn (FY22: Rs. 995 Mn) attributable to increase in interest income on account of growth in loans and advances. However, the cost of average interest-bearing funds increased to 11.86% in FY23 from 9.67% in FY22, given its high dependence on BFI borrowings coupled with high interest rates in banking sector during FY23. Increased cost of funds coupled with ceiling of lending rate at 15% has squeezed the Net Interest Margins (NIM) to 3.59% in FY23 (FY22: 5.33%). Consequently, Pre-provisioning operating profit (PPOP) substantially declined by ~76% y-o-y to Rs.32 Mn during FY23 (FY22: Rs.136 Mn). Although impairment losses on loans and advances declined to Rs. 29 Mn in FY23 from 122 Mn during FY22 resulting in slight improvement in net profitability of the MFI in FY23, Return on Total Assets (ROTA) stood low at 0.17% in FY23 (FY22: 0.02%).

Financial performance trend remained subdued in H1FY24. Total income declined by ~8% y-o-y to Rs. 437 Mn in H1FY24 amid decline in its loan portfolio resulting into further decline in NIM-annualized to 2.85% in H1FY24. Amid squeezed margins and increase in impairment losses (increased to Rs. 44 Mn in H1FY24 from Rs. 16 Mn in H1FY23), the MFI reported net losses of Rs. 56 Mn in H1FY24.

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

As on Mid- January, 2024, there were 57 MFIs in operation with total 5,076 branches all over Nepal. KLBSL has 137 branches as on Mid-January, 2024. 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. KLBSL has 1.55% (Rs. 955 Mn) share on interest income, ~1.00% (Rs. 246 Mn) share on net interest income and 0.29% (Rs. 12 Mn) share on net profit for the same period in the industry. KLBSL has 0.82% and 1.49% market share in terms of deposit base and loan portfolio respectively of microfinance industry as on Mid- July, 2023. Furthermore, large numbers 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, 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 4.75% of total lending in FY23 which has slightly improved from 4.35% in 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 MFIs 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**

#### **Backup from strong institutional promoter and experienced management team**

As on Mid-July FY23, 10% of the paid-up capital of KLBSL is held by institutional promoters Prabhu Bank Limited (PBL) [CARE-NP BB+] (post-acquisition of Century Commercial Bank Limited (CCBL)) holding 7% of the total share capital and Prime Commercial Bank Limited (PCBL) [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 six 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. Prabhat Kumar Karki, and is supported by experienced management team.

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

KLBSL's overall Tier I and overall Capital Adequacy Ratio (CAR) stood at 8.82% and 10.38%, respectively, as on mid- July 2023, up from 8.20% and 9.69% respectively as on mid-July 2022 mainly due to decline in loans and advances portfolio at FY23 end leading to lower risk weighted assets for credit risk. However, KLBSL'S Tier I and overall CAR declined to 7.68% and 9.37% as on mid-January 2024 owing to net losses resulting into decline in qualified capital coupled with growth in loans and advances with increment in risk weighted assets. Lower capital cushion is likely to restrict KLBSL's ability to undertake additional business over the near-term. This could also limit the MFI's ability to adequately absorb further losses, given the increasing trend in its GNPL levels over FY23-H1FY24 in the subdued economic scenario which remains a key concern for KLBSL.

Cash Reserve Ratio (CRR) of KLBSL has been maintained at 0.64% in FY23 and 0.58% in H1FY24 against the regulatory requirement of 0.50%. Furthermore, KLBSL has maintained net liquid asset ratio of 28.92% in H1FY24 against the minimum regulatory requirement 2.50% for MFIs not taking public deposits 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 137 branches covering 48 districts (out of 77 districts) as on mid- January 2024. 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 FY23 the advances were concentrated towards service sector with 51.35% exposure, which stood at 55.54% in FY22. Advances towards agriculture sector stood at 44.60% in FY23, increased from 40.19% in FY22. 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.

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