

Rating Rationale

Kisan Laghubitta Bittiya Sanstha Limited

(Former NRN Laghubitta Bittiya Sanstha Limited)

Rating

Particulars	Amount (Rs. In Million)	Rating ¹	Rating Action
Issuer Rating	NA	CARE-NP BB- (Is) [Double B Minus (Issuer)]	Assigned
Total Facilities	924.00		

CARE Ratings Nepal Limited (CRNL) has assigned rating of ‘CARE-NP BB- (Is)’ [Double B Minus (Issuer)] 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.

Detailed Rationale & Key Rating Drivers

The ratings assigned to KLBSL is constrained by poor asset quality leading to high Gross Non-Performing Loans (GNPL) ratio on back of Covid-19 pandemic, high dependence of resource profile on Banks & Financial Institutions (BFIs) borrowings, and competition from other MFIs and Co-operatives. The rating is also constrained by 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, moderate financial performance over the period ended FY20 (Unaudited; refers to 12 months’ period ended on July 15, 2020) and H1FY21 (Unaudited; refers to 6 months period ended on January 13, 2021) , and moderate level of capitalization. The ratings also factor in considerable growth in business over short period of time, moderate liquidity profile, sector wise credit portfolio distribution, however high concentration towards Agriculture sector and geographical diversification of business however, short track record of operation. 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

Poor assets quality leading to high GNPL on back of Covid-19 pandemic impact

GNPL of the company has deteriorated substantially to 7.50% during H1FY21 as compared to 1.53% during FY20. Primary reason for high GNPL during H1FY21 was due to impact of COVID -19 on the borrowers of the entity.

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

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

KLBSL's major source of funding consists of borrowing from BFIs. The ratio of borrowing from BFIs to total resource was high, which increased to 70.12% in H1FY21 from 68.81% in FY20 (FY19: 54.78%). The average cost of borrowing was 5.65% in FY20 (FY19: 2.03%) which is substantially higher than its cost of deposit of 2.45% (FY19:1.50%).

Competition from other MFIs and Co-operatives

As on Mid-January 2021, there were 76 MFIs in operation with total 4,272 branches all over Nepal. KLBSL has 128 branches as on Mid-January, 2021. KLBSL has 1.57% share on interest income, 1.40% share on net interest income and 0.72% share on net profit for H1FY21 in the industry. KLBSL has 0.87% and 1.55% market share in terms of deposit base and loan portfolio respectively of microfinance industry in H1FY21. 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, KLBSL 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. As borrowing from MFIs do not require collateral, clients tend to borrow from multiple MFIs resulting to loan duplication without proper repayment capability assessment. As per NRB norms, MFIs are allowed to lend against collateral upto 33.33% of total lending. KLBSL's percentage of collateral loan to total loan is 16.09% in Q1FY21 which is increased 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 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 impacted the incremental fund availability, cost of fund, credit growth and profitability of the MFIs. As per monetary policy of 2019/20, MFIs are not allowed to take interest more than 15% w.e.f. July 28, 2020. Further, regulator has capped fees at 1.5%, scrapping the interest rate spread cap of 9%. As a result of this provision, MFI cannot charge interest rate more than 15% which will restrict interest earning capacity.

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

At the end of January 31, 2021, Century Commercial Bank Limited [CARE-NP BBB] hold 7% of the total share capital and Prime Commercial Bank Limited [CARE-NP A-] hold 3% of the total capital in the company. Both institutions are established “A Class” Commercial Banks of Nepal.

Experienced board members and management team

KLBSL has 6 board members and the board is chaired by Ms. Sarita Upreti, who has more than 30 years of experience. The company’s management team is led by CEO, Mr. Indra Kumar Shah, who has more than 27 years of experience in Co-operatives and microfinance sector. He has worked as CEO of Kisan Microfinance for ~6 years and Kisan Co-operatives for ~10 years. He is supported by other experienced management team.

Moderate financial performance over the period ended FY20 and H1FY21

KLBSL’s financial performance improved substantially during FY20 over FY19. It has reported net profit of Rs. 8 Mn during FY20 against net loss of Rs 4 Mn in FY19 on the back of increase in total income. Total income increased to Rs. 337 Mn during FY20 (FY19: Rs. 17 Mn) on account of increase in interest income by growth in loans and advances due to impact of synergy created from merger. Operating expenses increased during FY20 over FY19 mainly due to increase in business size and number of branches. Provisions and written off expenses increased to Rs. 11 Mn during FY20 mainly due to increase in loan loss provision on back of increase in loan and advances.

Further, its net profit increased substantially to Rs 37 Mn during H1FY21 as compared to profit of Rs 4 Mn in H1FY20 mainly due to substantial increase in net interest income as compared to increase in operating expenses. It’s operating expenses/ average total assets improved to 2.01% in H1FY21 from 2.40% in FY20. Similarly, Return on Total Assets (ROTA) increased although low at 0.65% in H1FY21 from 0.17% in FY20. The interest spread rate increased to 3.45% in H1FY21 from 2.22% in FY20. Further, Net Interest Margin (NIM) ratio improved to 3.01% in H1FY21 from 2.12% in FY20.

Moderate level of capitalization

KLBSL’s overall Capital Adequacy Ratio (CAR) stood at 10.26% in FY20 which is moderate in comparison to the minimum regulatory requirement of 8% for MFIs. CAR declined to 9.44% in H1FY21 due to substantial increases in risk weighted assets as compared to increase in capital. KLBSL has proposed for Further Public Offering (FPO) issue which is expected to improve the CAR. The total paid up capital of the company is Rs 393 Mn in H1FY21 against minimum paid-up capital requirement of Rs 100 Mn for national level microfinance.

Considerable growth in business over short period of time

KLBSL’s credit portfolio grew substantially to Rs 4,135 Mn in FY20 from Rs 400 Mn in FY19 due to synergy impact created through merger with two microfinance entites during FY20 which also lead to

increase in member base. Also, credit portfolio increased by 20.66% to Rs 4,990 Mn in H1FY21 over FY20. Similarly, its deposit grew substantially to Rs 886 Mn in FY20 from Rs.63 Mn in FY19 due to the synergy created from the merger. Further, the deposit grew by 7.40% during H1FY21.

Moderate Liquidity Profile

KLBSL has maintained CRR 0.59% in FY20 and 0.54% in Q1FY21. Further, KLBSL has maintained liquid assets of 28.17% in H1FY21 and 32.14% in FY20 which are in align with NRB norms.

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

In H1FY21, it has lent 54.52% (FY20:53.53%) towards service industry (which includes 42.60% to wholesale and retail business, 5.81% to hotel and restaurants and 6.11% to other services) followed by 38.57% (FY20: 36.43%) towards agriculture sector (which includes 20.46% to animal husbandry, 6.41% to vegetables, 4.48% to poultry farming) and 2.31% (FY20: 1.86%) towards small and cottage industry.

Geographical diversification of business however, short track record of operation

KLBSL has short track of operation as it is operating since January 21, 2019. During the very short period of operation (i.e. ~2 years) it is operating in 43 districts (out of 77 districts) and 7 provinces (out of 7 provinces) through 128 branches as on January 13, 2021, on back of addition of branches due to acquisitions in the past.

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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