

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

Ratings

Facilities	Amount (Rs. in Million)	Rating ¹	Rating Action
Issuer Rating	NA	CARE-NP B+ (Is) [B Plus (Issuer)] (Credit watch with Developing Implications)	Removed from Issuer Not Cooperating category and placed on Credit watch with Developing Implications

CARE Ratings Nepal Limited (CRNL) has removed the issuer rating of 'CARE-NP B+ (Is)' assigned to Kisan Laghubitta Bittiya Sanstha Limited (KLBSL) from 'Issuer Not Cooperating' category as the company has submitted the requisite information to CRNL. Issuers with this rating are considered to have high risk of default regarding timely servicing of financial obligations in Nepal.

Also, CRNL has placed the rating on credit watch with developing implications factoring in KLBSL's on-going merger process with Jalpa Samudayik Laghubitta Bittiya Sanstha Limited (JALPA). CRNL will resolve the rating watch once clarity emerges on the merged entity's business and financial profile post-merger. CRNL will take a view on the ratings once the exact implications of the above on the credit risk profile of the microfinance is clear.

Detailed Rationale & Key Rating Drivers

The rating assigned to KLBSL continues to be constrained by its relatively short track record of operations, weak asset quality profile, high dependence of resource profile on Banks & Financial Institutions (BFIs) borrowings and deteriorating financial performance amid increased cost of funds and impairment losses. The rating also factors in the 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 grow its scale of operations along with improvement in asset quality and maintaining adequate cushion in capital adequacy indicators 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 four 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 4.88% of total loans and advances as on mid-July 2022 compared to 4.60% in FY21, which further deteriorated to 5.96% as on mid- April 2023. The reason for high GNPL is pandemic induced impact coupled with liquidity crunch in the economy impacting debt repayment capabilities of borrowers. Increasingly stressed asset profile currently observed in the banking industry has exacerbated amid the liquidity crunch, high inflation and increasing interest rates impacting entire demand-supply dynamics for various sectors, resulting in higher delinquencies. Muted pace of economic growth in the country could result in further slippages in KLBSL's asset quality in coming quarters. The company's ability to improve collection leading to better asset quality will remain a key monitorable aspect.

¹Complete definition of the ratings assigned are available at 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 68.82% in FY22 (FY21: 70.91%), which stood at 63.64% in 9MFY23. Due to high reliance on BFI's for funding the cost of fund is on higher side. The average cost of borrowing was 10.55% in FY22 (FY21: 6.84%) which is higher than its cost of deposit of 5.95% in FY22. 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 FY22, KLBSL's total income increased by 19% y-o-y to Rs. 987 Mn (FY21: Rs. 831 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 9.58% in FY22 from 6.71% in FY21, given its high dependence on BFI borrowings coupled with high interest rates in banking sector during FY22 amid tight liquidity in the market and decline in loanable funds due to stricter regulatory/monetary policy by NRB. Increased cost of funds coupled with ceiling of lending rate at 15% has squeezed the net interest margins to 5.35% in FY22 (FY21: 7.20%). Impairment losses on loans and advances has also increased substantially to Rs. 122 Mn during FY22 (FY21: Rs. 41 Mn). The decline in interest margins alongside substantial increase in impairment losses has resulted in decrease in PAT to Rs. 1 Mn during FY22 (FY21: Rs. 135 Mn). Return on Total Assets (ROTA) decreased to 0.02% in FY22 (FY21: 2.43%). In 9MFY23, interest income increased by 11% y-o-y to Rs. 710 Mn (9MFY22: Rs. 640 Mn). However, the cost of average interest-bearing liabilities further increased to 8.72% in 9MFY23, thus further squeezing interest margin to 2.55%. Consequently, PAT declined to Rs. 4 Mn during 9MFY23 (9MFY22: Rs. 52 Mn).

Competition from other MFIs and Co-operatives

As on Mid- March, 2023, there were 63 MFIs in operation with total 5,168 branches all over Nepal. KLBSL has 137 branches as on Mid-April, 2023. Micro Finance Industry earned Rs. 46,902 Mn interest income, Rs. 18,289 Mn net interest income and Rs. 2,991 Mn Net profit as on Mid- April, 2023. KLBSL has 1.51% (Rs. 710 Mn) share on interest income, 1.00% (Rs. 183 Mn) share on net interest income and 0.15% (Rs. 4 Mn) share on net profit for the same period in the industry. KLBSL has 0.82% and 1.47% market share in terms of deposit base and loan portfolio respectively of microfinance industry at the end of Mid- April, 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 4.35% of total lending in FY22 which has improved from 19.38% in FY21.

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

Backup from strong institutional promoter and experienced management team

At the end of 9MFY23, 10% of the paid-up capital of KLBSL is held by institutional promoters Prabhu Bank Limited (PBL) [CARE-NP BBB] (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 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. 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 7.76% and 9.45%, respectively, as on mid- July, 2022 compared to the minimum regulatory requirement of 4% and 8% for microfinance institutions (MFIs). KLBSL'S CAR slightly moderated to 9.37% in mid-January 2023, with increment in risk weighted assets outpacing the increase in total capital. 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 is Rs 504 Mn as on Mid-April, 2023 compared to the regulatory requirement minimum paid-up capital of Rs 100 Mn for national level microfinance.

Cash Reserve Ratio (CRR) of KLBSL has been maintained at 0.57% in FY22 and 0.59% in 9MFY23. Furthermore, KLBSL has maintained net liquid asset ratio of 11.45% in 9MFY23 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- April 2023. 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 FY22 the advances were concentrated towards service sector with 55.54% exposure, which stood at 53.24% in 9MFY23. Advances towards agriculture sector stood at 40.19% in FY22, however increased to 42.81% in 9MFY23. 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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