

Rating Rationale
ICFC Finance Limited

Rating

| Facility/Instrument | Amount (Rs. In Million) | Rating ¹ | Rating Action |
|---|-------------------------|---|---------------|
| Issuer Rating | NA | CARE-NP BBB- (Is) (Triple B Minus [Issuer Rating]) | Assigned |
| Subordinated Debenture “12% ICFC Finance Ltd. Debenture 2083” | 200.00 | CARE-NP BBB- [Triple B Minus] | Reaffirmed |

CRNL has assigned Issuer Rating of ‘CARE-NP BBB- (Is)’ to ICFC Finance Limited (ICFC). CRNL has also reaffirmed rating of ‘CARE- NP BBB-’ assigned to Subordinated Debenture “12% ICFC Finance Ltd. Debenture 2083”. Issuers with this rating are considered to offer moderate degree of safety regarding timely servicing of financial obligations, in Nepal. Such issuers carry moderate credit risk.

Detailed Rationale & Key Rating Drivers

The issuer rating assigned to ICFC derives strength from long track record of operation with experienced board and management team, considerable growth in loans & advances and deposits over the period with large market share in the Finance Companies Industry, moderate capital adequacy level, and good assets quality however, slightly deteriorated in Q1FY20 (refers to 3 months’ period ending October 17, 2019). The ratings also factor in diversified sector wise credit portfolio distribution, moderate concentration over top 20 depositors, healthy financial performance however, volatile over the period, and comfortable liquidity profile. The rating, however, is constrained by low level of current account and saving account (CASA) however, slightly increases in Q1FY20, geographical concentration of business, and high concentration over top 20 borrowers. Further the rating is constrained by significant decrease in fair value of investment over cost price despite diversified investment portfolio, exposure to regulatory risks related to finance industry, and competition from other finance companies and banks. Ability of the company to continue its growth momentum without impacting the asset quality and maintaining capital adequacy and ability to manage the impact of any regulatory changes by Nepal Rastra Bank (NRB) would be the key rating sensitivities.

Detailed Description of the Key Rating Drivers

Key Rating Strength

Long track record of operation with experienced board and management team

ICFC is operating since July 17, 2004 and guided by experienced Board of Directors (BoD) which includes eminent bankers, retired Nepal Rastra Bank (NRB) officials, and professionals with wide experience in the financial and economic sector. The BoD is chaired by Mr. Ram Babu Pant, who is a retired Deputy Governor of

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

Nepal Rastra Bank (NRB) and former CEO of ICFC with work experience of ~3 decades, which includes ~2 decades in NRB and ~1 decades in ICFC. The top and senior management team is composed of experienced banker having long track record of banking experience. Management team is led by Mr. Sunil Pant, CEO, who has more than 2.5 decades of banking experience and has been working in ICFC since 2004 in various managerial positions. He has been supported by other experienced management team.

Considerable growth in loans & advances and deposits over the period

ICFC's loan portfolio and deposit grew by compounded annual growth rate (CAGR) of 22.03% and 22.35% respectively over last 3 years ending July 16, 2019 on back of increase in number of branches and effective marketing strategy (finance industry loan portfolio and deposit grew by CAGR of 6.83% and 5.74% respectively over the same period). In FY19 (refers to 12 months' period ending July 16, 2019). ICFC's loan portfolio grew by 24.71% to Rs 8,713 Mn and deposit grew by 23.14% to Rs 10,933 Mn (higher than finance industry loan portfolio and deposit growth rate of 19.87% and 19.57% respectively in FY19). Further, company loan and advances and deposit grew slightly by 2.24% and 1.15% respectively in Q1FY20 from FY19 (which is lower than industry growth rate of loan and advance and deposit of 3.18% and 3.56% respectively for the same period). ICFC has 14.04% and 12.65% market share in terms of deposit base and loan portfolio respectively of finance industry at the end of Q1FY20 (14.39% and 12.68% respectively in FY19), based on monthly data published by NRB.

Moderate capital adequacy level

ICFC's overall Capital Adequacy Ratio (CAR) stood at 13.24% as on Mid October, 2019 (12.29% as on July 16, 2019) as against regulatory requirement of 11% (Finance Industry has 18.70% CAR, based on monthly report of Mid October, 2019 published by NRB). After issue of proposed subordinated bond (if fully subscribed) its supplementary capital will strengthen further.

Good asset quality however, slightly deteriorated in Q1FY20

ICFC's Gross Non performing Loan % (GNPL) is low at 0.28% in Q1FY20 although slightly increased from 0.08% in FY19 (0.02% in FY18) despite increase in size of loan portfolio (industry average GNPL was 8.87% in Q1FY20 and 8.8% in FY19). GNPL also increased in absolute amount to Rs 25 Mn in Q1FY20 from Rs 7 Mn in FY19. Further, in Q1FY20, out of total loans of Rs. 8,909 Mn, the delinquencies of more than 30 days amounted to Rs.207 Mn (2.38% of total advances) which increased from Rs. 144 Mn (1.65% of total advance) in FY19.

Diversified sector wise credit portfolio distribution

ICFC has been disbursing loan to various sector with 24.71% of total advances towards finance, insurance and real estate followed by 15.40% towards wholesaler & retail sector, 8.27% towards hotel and restaurant and 4.06% towards consumption loan in Q1FY20. In Q1FY20, ICFC lent 16.65% of gross loans and advances outstanding prior to 6 months (17.01% in FY19) towards productive sector which consist of 9.17% towards tourism sector, 3.67% towards cottage and small industries and 3.80% towards agricultural sector.

Moderate concentration over top 20 depositors

ICFC's deposit from top 20 depositors consists 11.02% of total deposit in Q1FY20 which is decreased from 15.58% in FY19. Top 20 depositors mainly consist of institutional depositors.

Healthy financial performance however, volatile over the period

During FY19, ICFC's total income increased by 34.12% to Rs. 1,371 Mn due to increase in both interest income and non-interest income. During FY19, interest income increased by 31.42% to Rs. 1,272 Mn FY19 mainly due to increase in advances, and non-interest income increased by 82.32% to Rs 99 Mn mainly due to increase in fees and commission income on back of increase in loan administration fees and prepayment charge; increase in net trading income and gain on sales of trading assets. Net interest income increased by 39.30% to Rs.361 Mn during FY19.

On back of sharp increase in total income as compared to increase in interest expenses and other non-interest expenses, it has reported increase in PAT by 75.89% to Rs.140 Mn during FY19 from Rs 80 Mn during FY18. Yield on advances increased to 13.97% during FY19 from 13.36% during FY18. Similarly, cost of deposit decreased marginally to 8.77% in FY19 from 8.79% in FY18. Net Interest Margin (NIM) improved to 2.92% during FY19 from 2.66% during FY18 because of proportionate increase in net interest income was higher than increase in total assets. Return on Total Assets (ROTA) has increased to 1.14% in FY19 (0.82% in FY18), due to higher increase in PAT as compared to total assets.

ICFC's total income increased by 17.89% during Q1FY20 over Q1FY19, mainly due increase in advances and bank balance. Non-interest income decreased by 79.86% during Q1FY20 over Q1FY19 mainly due to net trading loss of Rs 18 Mn during Q1FY20 because of provision for decrease in fair value of investments against net trading income of Rs 12 Mn during Q1FY19. Further, net interest income increased by 18.16% to Rs 378 Mn, and operating expenses increased by 10.26% to Rs 62 Mn during Q1FY20 against Q1FY19. Company reported decline in PAT by 30.40% to Rs.31 Mn during Q1FY20 from Rs 44 Mn during Q1FY19 due to decrease in non-interest income and increase in operating expenses was higher than increase in net interest income. ROTA has decreased to 0.87% in Q1FY20 from 1.14% in FY19 due to decrease in PAT and increase in total assets size. Further, yield on advance was 13.60% and cost of deposit increased to 9.39% in Q1FY20.

Comfortable liquidity profile

ICFC's liquidity profile as on Mid October, 2019 shows positive cumulative mismatches due to well matched tenure of assets and liability. Further, ICFC has maintained CRR of 4.27% and SLR of 13.63% as on Mid October, 2019 (4.12% and 11.76% respectively as on July 16, 2019).

Key Rating Weaknesses***Low level of CASA declining over the period***

ICFC maintained CASA proportion of 28.88% in Q1FY20 (slightly higher than finance industry average of 28.16%) which is slightly increased from 28.66% in FY19 (lower than finance industry average of 32%). Low level of CASA leads to high cost of fund. Further ICFC's CASA witnessed declining trend over the period,

although it has slightly improved in Q1FY20 and FY19. CASA declined to 28.09% in FY18 from 52.50% in FY17. CASA proportion was declined due to growth rate in fixed deposit was higher than growth rate in saving deposit as a result of competition over Bank and Financial Institutions (BFIs).

Geographical concentration of business

At the end of Q1FY20, ICFC is operating in 3 provinces (i.e. Province 3, 4 and 5) and 8 districts of Nepal with 18 branches, 1 extension counter and 17 ATM terminals (as per data published by NRB, 22 finance companies have total 215 branches, 50 ATM terminals on that date). Despite having large number of branches as compared to peers in finance industries, 14 branches are located in province 3 and ~80% of business, in terms of loan portfolio is concentrated over province 3. During FY20, it has opened one branch in province 3 and has plans for opening maximum of three new branches in eastern part of Nepal.

High concentration over top 20 borrowers however, decreased in Q1FY20

ICFC's lending to top 20 borrower was 21.48% of total loans and advances in Q1FY20 which decreased from 24.75% in FY19. Due to concentration over top borrowers there may be significant impact on assets quality, if any big borrower default on loan.

Significant decrease in fair value of investment over cost price despite diversified investment portfolio

ICFC's fair value of investment is Rs 1,044 Mn (Rs 1,093 Mn cost price) at the end of Q1FY20 and Rs 1,060 Mn (Rs 1,101 Mn cost price) at the end of FY19. Provision for decrease in fair value of investment due to decrease in market price as a result of decline in overall stock market of Nepal was Rs 18 Mn during Q1FY20 and Rs 19 Mn during FY19. However, during Q1FY20, it has earned interest income from investment in Securities/Bonds of Rs 1 Mn and dividend income of Rs 4 Mn.

Exposure to regulatory risks related to Finance industry

The Banking and Finance industry in Nepal is exposed to changes in the various regulatory measures issued by NRB from time to time. In past, finance companies faced pressure from NRB for capital increment to Rs. 800 Mn from Rs. 200 Mn. NRB via its Monetary Policy has reduced the Statutory Liquidity Ratio (SLR) to 7% from earlier 8%; increased the priority sector lending requirement to 5% from earlier 4%; reduced the overdraft including personal loan of revolving nature to Rs 5 Mn from 7.5 Mn. Also, margin lending nature loan limit increased to 40% of primary capital from earlier 25%, percentage of deposit allowed to be received from any one institutional depositor reduced to 15% (earlier 20%), and allowed to provide term loan, having repayment period of more than one year, at fixed interest rate which will not change over the tenor of loan. Hence, the banking and finance industry in Nepal is exposed to changes in the various regulatory measures issued by NRB from time to time.

Competition from other Finance Companies and Banks

Currently, there are 22 finance companies operating with total 215 branches all over Nepal (based on monthly statistics published by NRB for Mid-October, 2019) out of that ICFC has 18 branches. Industry (Class 'C' Banks-Finance Companies) has achieved total interest income of Rs. 2,466 Mn in Q1FY20 with Rs. 635 Mn net interest

incomes; ICFC’s share on interest income and net interest income is ~15% (Rs. 378 Mn) and 17% (Rs 108 Mn) respectively for the same period. Despite being a leading finance company in the industry, it is challenging for ICFC to maintain current market share and expand its business, due to high competition among bank and finance companies, existence of large number of finance companies along with Commercial and Development bank conducting similar kind of businesses and they lend at lower interest rate as well as they offer wider banking services than finance companies.

About the Company

ICFC is a national level class “C” finance company incorporated on September 22, 2003 as Investment and Credit Finance Company Limited which was changed to ICFC Finance Ltd. on March 1, 2010. It is licensed by NRB on July 14, 2004 and commenced operation on July 17, 2004. It is one of the leading finance company in Nepal. In terms of technology, it is using PUMORI PLUS IV software which enables to provide real time services to consumer across all branches. It has total assets size of Rs 14,439 Mn at the end of Q1FY20 which grew by 31.59% over FY19. At the end of Q1FY20 it has Rs 882 Mn paid up capital which is distributed among promoter and public shareholders in the ratio of 51:49 and the shares are listed in Nepal Stock Exchange Ltd. (Rs 1,367 Mn market capitalization as on November 27, 2019). Mr. Purshottam Poudyal (6.35%), United Distributor Nepal P. Ltd. (3.79%), and Mr. Sushil Kumar Pant (3.62%) are major promoter shareholders of the company.

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