

ICFC Finance Limited

Ratings

Facilities	Amount (Rs. in Million)	Ratings ¹	Rating Action
Issuer Rating	NA	[CARE-NP] BBB- (Is) [Triple B Minus (Issuer)]	Reaffirmed
Subordinated Bond (12% Debenture 2083)	200.00	CARE NP BBB- [Triple B Minus]	Reaffirmed

CARE Ratings Nepal Limited (CRNL) has reaffirmed the issuer rating of "CARE-NP BBB- (Is) [Triple B Minus (Issuer)]" assigned to ICFC Finance Limited (ICFC). 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.

CRNL has also reaffirmed rating of 'CARE-NP BBB- [Triple B Minus]' assigned to the Subordinated Debentures of ICFC. The instruments with this rating are considered to have moderate degree of safety regarding timely servicing of financial obligations, in Nepal. Such instruments carry moderate credit risk.

Detailed Rationale & Key Rating Drivers

The reaffirmation of ratings assigned to ICFC continues to factor in strength from its long track record of operations; experienced management team; moderate capitalization level; good asset quality and liquidity profile, and increasing trend in investment portfolio. The rating also factors in consistent growth in loan & advances and deposits over the period, moderate deposit concentration, moderate proportion of Current Account Savings Account (CASA) deposits and healthy financial performance amid improved core operations in FY22 (Unaudited, refers to the twelve-month period ended mid-July 2022).

The rating, however, remains constrained by geographical concentration of business, high portfolio concentration among borrower, intense competition and exposure to regulatory risk related to the industry.

Going forward, the ability of the company to continue its growth momentum while improving asset quality and capital adequacy ratio and its ability to manage the impact of any regulatory changes will be the key rating sensitivities.

Detailed Description of the Key Rating Drivers

Key Rating Strength

Experienced management team

Established in the year 2004, ICFC has around two decades of operational history in Nepal. ICFC is a professionally managed company under the overall guidance of its Board of Directors (BoD) led by Chairman Mr. Ram Babu Pant who is a retired Deputy Governor of Nepal Rastra Bank (NRB) with work experience of more than 19 years. The company's management team is led by Mr. Sunil Pant, Chief Executive Officer (CEO), who has more than 25 years of banking experience. Furthermore, ICFC is operating in 4 provinces out of 7 (i.e. Province No. 1, Bagmati, Lumbini and Gandaki) through its 21 branches, 1 extension counter and 20 ATM terminals as on mid- August, 2022.

Moderate capitalization level, albeit declining trend over FY21-FY22

ICFC has seen sustained growth in its advances book over the last five years resulting in sequential decline in core capitalization levels over the period. ICFC's Tier I Capital Adequacy Ratio (CAR) stood at 9.31% as on mid-July, 2022, declining from 10.00% as on mid-July 2021. However, ICFC continues to have moderate cushion over the minimum regulatory requirement of 6%. ICFC's overall CAR stood at 11.61% as on Mid July, 2022 declining from 12.29% as on July 15, 2021 as against minimum regulatory requirement of 10%. The decline in CAR at the end of FY22 was also, in part, on account of NRB increasing risk weights of some loan categories such as certain personal loans, real estate loans, hire-purchase loans etc. to 150% from 100%.

¹Complete definition of the ratings assigned are available at www.careratingsnepal.com and other CARE publications

This had added to the increase in Risk Weighted Exposure (RWE) of the company at the end of FY22 by 11.88% over PY. However, the overall CAR remains lower than the other Class- C finance companies in the industry (average industry CAR was 15.64% based on monthly report of Mid July, 2022 published by NRB).

Lower capitalization levels could limit the company's ability to absorb losses, should they materialize, especially given the uncertainty surrounding credit recovery amid the lingering impact of the covid-19 pandemic. The bank's ability to maintain adequate cushion in the capital adequacy ratios is critical for its solvency and will remain crucial for its growth perspective.

Good asset quality and diversified credit portfolio

ICFC reported Gross Non Performing Loan (GNPL) ratio of 0.54% as on mid-July 2022 (industry average: 1.40%), which improved from 1.65% at the end of mid-July 2021. GNPL improved to Rs. 80 Mn at the end of FY22 from Rs.191 Mn PY supported by recoveries of some large accounts during the year. Out of total loans of Rs. 14,728 Mn as on mid-July 2022, delinquencies (including restructured loan) of more than 30 days amounted to Rs. 493 Mn (3.35% of total advances) which improved from Rs. 595 Mn (5.13% of total advance) at the end of FY21.

Furthermore, ICFC has a diversified portfolio distribution which consists of various types of loans disbursed over the period for various industry/ sector with higher lending of 39.58% of total advances towards consumption loans followed by 17.57% towards wholesaler and retailers (wholesale trade of durables, non-durables, automotive dealer/franchise, other retail trade, import-export trade etc.). As on mid-July 2022, ICFC lent 26.46% of gross loans and advances outstanding prior to 6 months towards productive sector (which includes agriculture sector, energy sector, tourism sector and cottage and small industries). Diversification helps bank to maintain the bank's assets quality and mitigate volatility risk in case of experienced swings in the economy.

Increasing scale of operations backed by considerable growth in loans & advances and deposits over the period with largest market share in the industry

Focusing on improving its market penetration in already present locations, ICFC's has reported a consistent growth in the Loans & advances over the last 4-5 years, which is well supported by a similar growth in its deposit base. This has led to the company growing at a much faster pace than the industry. The total loans and advances recorded compounded annual growth rate (CAGR) of 20.23% over last 4 years ending Mid-July 2022. At the end of FY22, total loan portfolio stood at Rs. 14,728 Mn increasing 28.45% from Rs. 11,283 Mn at the end of FY21. The overall banking industry's loan portfolio grew by a CAGR of 10.76% over last 4 years ending Mid July, 2022 with year on year growth of 20.64% at the end of FY22.

Similarly, total deposits of ICFC grew by a CAGR of 19.47% over last 4 years ending Mid July, 2022 supported by increasing network, improving product offerings and effective marketing strategy. Deposits grew by 26.10% to Rs 18,807 Mn in FY22 from Rs 14,343 Mn in FY21 (Class C finance industry deposit grew by CAGR of 13.24% over last 4 years ending Mid July 2022 with year on year growth of 17.02% in FY22).

Improved performance in core operations albeit lower net profit in FY22 amid lesser non-operational income

During FY22, ICFC's total income increased by 19.03% year on year to Rs. 2,028 Mn (FY21: 1,704 Mn) supported by rise in interest income by 40.06% owing to sustained growth in loans and advances during the last few years, coupled by increase in yield on advances to 12.55% in FY22 compared to 11.53% in FY21. Similarly, cost of deposits increased to 7.92% during FY22 from 7.39% during FY21 due to increased interest rates in the overall industry. Higher cost of funds was also in part on account of increase in proportion of fixed deposits as compared to the previous year. Despite higher cost of funds, improved spread led to ICFC's Net Interest Margin (NIM) improving to 2.23% during FY22 from 1.91% during FY21.

The total operating expenses increased by 11.69% in FY22 to Rs. 322 Mn compared to Rs. 288 Mn during FY21 on account of increase in branches coupled by increase in other operating expenses. Although core operations improved on a year on year basis, ICFC's PAT declined by 20.21% to Rs. 201 Mn during FY22 from Rs 251 Mn during FY21. This was mainly on account of

lower non-interest income during FY22. ICFC's non-interest income declined to Rs.143 Mn in FY22 from Rs. 358 Mn in FY21. The higher non-interest income in FY21 was on account of ICFC reporting profits on sale of investments of Rs. 256 Mn during FY21 (FY22: Rs. 28 Mn) amid a more favourable market dynamics during FY21. ICFC's Return on Total Assets (ROTA) decreased to 0.95% in FY22 (1.52% in FY21), due to decrease in PAT as compared to previous year. Similarly, return on net worth (RONW) also decreased to 11.54% in FY22 from 15.46% in FY21.

Comfortable liquidity profile

ICFC has maintained moderate liquidity profile characterized by Statutory Liquidity Ratio (SLR) of 25.76% and average Cash Reserve Ratio (CRR) of 3.86% as on Mid- July, 2022 (25.67% and 4.45% respectively as on July 15, 2021) which is in compliance with NRB norms of 10% and 4% respectively. Furthermore, ICFC has comfortable liquidity profile with positive cumulative mismatches as of mid-July 2022 due to well matched tenure of assets and liabilities. However, the assets and liabilities show negative mismatches on quarterly basis in the coming year. This is primarily because rollover of fixed deposits has not been accounted for.

Moderate CASA deposit ratio and moderate concentration in top 20 depositors

ICFC's CASA mix continues to remain largely in line with the industry average. ICFC's CASA proportion declined to 20.82% at the end of FY22 (slightly higher than finance industry average of 20.79%) from 30.78% at the end of FY21 (finance industry average of 30.47%). Due to decrease in CASA proportion, cost of deposit has increased to 7.92% at the end of FY22 compared to 7.39% at the end of FY21. Increasing cost of the funds could impact the company's profitability in the long term, resulting in a competitive disadvantage. The ability of the company to maintain lower cost of funds will be critical as it would continue to provide a competitive advantage in the "base rate plus" lending rate regime.

Furthermore, ICFC's deposits from top 20 depositors remain moderate at 12.61% of total deposit in FY22 which decreased from 19.61% of total deposit in FY21. Top 20 depositors mainly consist of institutional depositors. Lower concentration towards deposits normally reduces re-pricing risks at times of interest rate volatility.

Significant increase in investment portfolio

ICFC's fair value of investments stood at Rs 6,840 Mn at the end of FY22 which increased from Rs. 3,491 Mn at the end of FY21 on account of significant increase in bonds and treasury bills by 115.98% from Rs 3,011 Mn at the end of FY21 to Rs 6,503 Mn at the end of FY22. During FY22, ICFC earned interest income from investment in Securities/Bonds of Rs. 220 Mn (Rs.94 Mn during FY21).

Key Rating Weakness

Limited reach of business

ICFC is operating in 4 provinces out of 7 (i.e. Province No. 1, Bagmati, Lumbini and Gandaki) through its 21 branches, 1 extension counter and 20 ATM terminals as on mid-August, 2022. This remains largely limited in comparison to the Class A and Class B Financial Institutions. On account of limited geographical presence, the business remains concentrated towards limited customer base which increases the risk of volatility of a single economic region. Major growth in the company's operations over the last 4-5 years has been on account of improving market penetration in already present locations. Although reach and marketing efforts have been improving in these locations, the company's prospect of increasing its geographical diversification remains limited by its relatively small capital base.

High portfolio concentration among top borrowers

ICFC has high concentration on lending as top 20 borrowers accounted for 28.49% of total loans and advances at the end of FY22 which has decreased slightly from 29.29% at the end of FY21. Due to concentration over top borrowers, there may be risk on its assets quality due to increase in impact of any big borrowers default on loan.

Competition from other Finance Companies and Bank

Currently, there are 17 finance companies operating with total 267 branches all over Nepal (based on monthly statistics published by NRB for Mid-July, 2022) out of that ICFC has 21 branches. Industry (Class 'C' Banks-Finance Companies) has achieved total interest income of Rs. 11,517 Mn in FY22 with Rs. 3,450 Mn net interest incomes; ICFC's share on interest income and net interest income is ~16.36% (Rs. 1,885 Mn) and 13.64% (Rs 471 Mn) respectively for the same period. Despite being one of the 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

Exposure to regulatory risk related to the industry

The Banking and Finance industry in Nepal is exposed to changes in the various regulatory measures issued by NRB from time to time. From FY22 end, NRB has changed to Credit to Deposit (CD) ratio mechanism from existing Credit to Core Capital plus Deposit (CCD) ratio measures. CD ratio needs to be maintained below 90% from mid-July 2022 from earlier provision of 85% for CCD. Furthermore, risk weights of certain loans including personal overdrafts, TR loans, hire purchase loans for personal purpose, margin lending, etc. has been increased to 150% from existing 100% via the mid-term review of monetary policy issued by NRB for FY22. These changes are likely to put downward pressure on capital adequacy ratios of the banks and limit their ability for significant credit expansion, at least over the near term. Furthermore, bank rate has been increased to 8.5% from 7% and repo rate increased to 7% from 5.5% in the monetary policy issued by NRB for FY23. Increased bank rates will likely put upward pressure on both lending and deposit interest rates of the bank over the near term.

About the Company

ICFC Finance Limited (ICFC) is a national level class "C" finance company incorporated September 22, 2003 as Investment and Credit Finance Company Limited which was changed to ICFC Finance Ltd. on March 1, 2010. It was Licensed by Nepal Rastra Bank (NRB) on July 14, 2004 and commenced operation on July 17, 2004. At the end of FY22, ICFC has Rs. 1,127 Mn paid up capital which is distributed among promoters and public shareholders in the ratio of 51:49.

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