Grading Rationale

Hathway Finance Company Limited

Grading

Facility	Amount (Rs. In Million)	Grading	Grading Action
Rights Share Issue	540.00	CARE-NP IPO Grade 5 [IPO Grade Five]	Assigned

The explanatory notes regarding the Rating/Grading symbols of CARE Ratings Nepal Limited (CRNL) are attached as Annexure I

CRNL has assigned grading of 'CARE-NP IPO Grade 5' to the proposed Rights Share Issue of Hathway Finance Company Limited (HFCL). 'CARE-NP IPO Grade 5' indicates Poor Fundamentals. CRNL assigns IPO grades on a scale of Grade 1 to Grade 5, with Grade 1 indicating strong fundamentals and Grade 5 indicating poor fundamentals. CRNL's IPO grading is an opinion on the fundamentals of the issuer. The grade assigned to any individual issue represents a relative assessment of the 'fundamentals' of the issuer. HFCL proposes 180% rights share issue of 5.4 Million number of equity shares of face value of Rs.100 each at par aggregating Rs.540.00 million.

Detailed Rationale & Key Grading Drivers

The grading assigned to HFCL is constrained by its high Gross Non-performing loans (GNPL) ratio with slow recovery from GNPLs & Non-Banking Assets (NBA), low level of deposits and high depositor concentration, low level of credit portfolio, although the same is growing post HFCL coming out of the 'Problematic Institution' status. The grading is also constrained by HFCL's negative net worth till July 15, 2015 (albeit improved as on April 13, 2018), volatile operating performance over the period, high borrower & geographical concentration and lack of good corporate governance practices in past (however, expected to be improved by entry of new promoters and management team). The grading further takes into account HFCL's diversified product portfolio catering to different sectors with some concentration in home loan and personal loan segment in 9MFY18. HFCL's exposure to inherent regulatory risks and competition from other big finance companies and banks in Nepal also constrains the grading. The grading, however, derives support from reputed & experienced new promoter group and management team, high Capital Adequacy Ratio (CAR) post infusion of capital and high level of CASA.

Ability of the company to improve asset quality by recovery of NPLs and realization from NBA, ability to raise the share capital as proposed and grow business without compromising on asset quality, and ability to manage the impact of any regulatory changes by NRB would be the key sensitivities.

Detailed Description of the Key Grading Drivers

Key Grading Weakness

Poor asset quality and low recovery from GNPL and Non-Banking Assets (NBA)

HFCL's GNPL ratio was 97.91% in July 15, 2016, which decreased to 71.54% as on July 15, 2017 (Industry GNPL% was 13.37% as on July 15, 2017) on back of recoveries as well as disbursement of new loans. Further, GNPL declined sharply to 8.39% during 9MFY18 mainly due to transfer of majority of GNPLs to Non-Banking Assets (NBA), loans written off and further disbursement of new loans. GNPL in absolute terms decreased to Rs.19.15 Mn during 9MFY18 from Rs.47.19 Mn as on July 15, 2017 on back of transfer of Rs.22.76 Mn GNPL to NBA and write off of Rs.17.6 Mn GNPL. Even though GNPL% decreased significantly over the period, recovery of GNPL and NBA was low in absolute terms. As on July 16, 2015, HFCL has total Rs.163.48 Mn of GNPL and NBA which decreased to Rs.92.84 Mn as on April 13, 2018 on the back of write off of Rs.17.60 Mn and rest through recovery of GNPLs.

Low level of deposit which is increasing over the period and high depositor's concentration

Deposit was decreased by 59.17% to Rs.34.22 Mn in FY17 (refers to period ended Mid July 2017) from Rs.83.82 Mn at the end of FY16, due to maturity of deposits, withdrawal of saving deposit by customers and the company was unable to accept further deposit because it has been declared as problematic financial institution by Nepal Rastra Bank (NRB) from January 2015 to February 2017 and NRB imposed restrictions on doing financial transaction (except recovery of loan and repayment of deposit). However, during 9MFY18, the deposits of the company show a rise of 300% (albeit on small base) over FY17 to Rs.137.10 Mn. HFCL's market share in terms of deposits was low at 0.07% as on July 15, 2017. Further, deposit concentration of top 20 depositors was high at 57% of total deposits as on July 15, 2017 and 57% of total deposits as of April 13, 2018. High deposits concentration may impact its liquidity position if few large depositors choose to withdraw their deposits.

Low level of credit portfolio, although the same is growing post HFCL coming out of the 'Problematic Institution' status

The total loan portfolio of the HFCL declined by about 45% y-o-y to Rs.55.12 Mn in FY16 as it was declared as 'Problematic Institution' by the NRB and there was restriction on disbursement of new loans. However, the credit portfolio increased by nearly 20% to Rs.65.97 Mn at the end of FY17 on the back of removal of 'Problematic Institution' status by NRB during February 2017. During 9MFY18 (UA), the total loan portfolio of the company further grew by about 246% (albeit on a low base) to Rs.228.17 Mn due to focus of the new management towards the new loan disbursements. HFCL's market share in terms of credit portfolio of the finance companies was low at 0.13% as on July 15, 2017. As on April 13, 2018, HFCL's exposure to top 20 borrowers was close to 40% of total loan portfolio (91% as on July 15, 2017) leading to high borrower concentration.

Negative net worth till July 15, 2015; however, improved as on April 13, 2018

HFCL had a negative net worth of Rs.(78.74) Mn at the end of FY15 because of net losses incurred by the company mainly due to high provisions made for bad loans. It's net worth has improved to Rs.159.51 Mn at the end of 9MFY18 due to the net profit of Rs.31.63 Mn, Rs12.21 Mn and Rs.17.75 Mn made during FY16, FY17 and 9MFY18 respectively (on back of write back of provisions for possible losses and gain on sales of NBA) and infusion of additional capital of Rs.15 Mn through rights issue.

Operating performance was volatile over the period.

HFCL operating performance was volatile over the period. HFCL achieved Rs.11.90 Mn operating profit in FY16 as against Rs (82.21) Mn operating loss in FY15 which was mainly due to increase in interest income on back of recovery of interest on GNPL and decrease in interest expenses by 43% due to decline in deposits. However, the company has incurred operating losses of Rs.3.58 Mn in FY17 due to decline in interest income and increase in operating expenses as the company started operations after removal of 'Problematic Institution' tag during FY17. Further, HFCL incurred operating loss of Rs.17.76 Mn in 9MFY18 due to increase in employee expenses by over 350% due to recruitment of additional staff, increase in other operating expenses and also due to write off of loans and provision for NBAs.

Lack of good corporate governance practices in past (however, expected to be improved by entry of new promoters and management team)

In the past, HFCL was declared as 'Problematic Institution' because it did not follow the directives given by NRB, credit concentration risk was very high, CAR was negative, high GNPL% etc., which shows, below average corporate governance practices. However, the corporate governance is expected to improve in future due to entry of new promoters, directors and management team as well as NRB releasing it from problematic institution status with the condition of reducing non-performing loans gradually, making internal control and risk management system effective, formulating a sound credit policy and implementing the same, making good corporate governance system and adhering to NRB guidelines.

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. As per the regulations, the Financial Institutions were required to extend 4% of their total loans towards deprived sector, either directly or through microfinance companies which impact its earning capacity because interest rate on deprive sector loan is normally lower than other loans. Further, as per the NRB directions, the interest spread rate for (BFIs) should not exceed 5% which is limiting the interest earning capacity of the finance companies. The changes in the Monetary policy of 2017-18 will have direct impact on the earning profile of the Finance Companies. According to the policy the amount of personal home loan that can be provided by (BFIs) increased to Rs. 15 Mn (previously Rs. 10 Mn), further NRB made provision that BFIs can provide margin lending (against the collateral of shares) only up to 40% of the primary capital of the BFIs, reduce the limit of real estate loan which is disburse on Kathmandu valley to 40% of collateral value (Previously 50% of collateral value) and increase the limit of hire purchase loan to 65% of value of vehicles (Previously 50% of vehicles value) which impact the credit exposure as well income of finance companies.

Competition from other big finance companies and banks

As on October 17, 2107, there are 27 finance companies operating with total 136 branches all over Nepal. HFCL has only 3 branches (including head office). Industry (Class 'C' Banks-Finance Companies) has gained total interest income of Rs. 1602 Mn during Q1FY18 with Rs. 368 Mn net interest income; however, HFCL share on interest income is 1.9% (i.e. Rs. 30.48 Mn) and 7.5% share on net interest income (i.e. Rs. 27.61 Mn) for the same period in the industry. Due to large number of finance companies, presence of bigger finance companies in the industry along with Commercial and Development bank conducting similar kind of businesses and they lend at lower interest rate than finance companies; HFCL is facing competition to tap the new customer and to retain the existing good consumer.

Key Grading Strengths

Reputed & experienced new promoter group and management team

HFCL is operating since August 1997 as Arun Finance & Saving Cooperative Ltd. however, its performance was not satisfactory and was declared as problematic institution by NRB in FY15 and released from Problematic institution in FY17 and started its operation with new name (i.e. Hathway Finance Company Ltd.) with new directors and management team. The promoter group includes individual promoters, who are associated with Hathway Investment Nepal Ltd. (HINL). HINL is an investment company in Nepal headed by Mr. Hemraj Dhakal, Chairman, which belongs to IME Group of companies. IME group have long track record in Banking and Insurance. Mr. Ambika Prasad Poudel, MBA, MPA, is Chairman of the company, had served as a treasury comptroller of financial Comptroller General of Nepal, finance officer of department of education, and account officer of ministry of finance from 1998 to 2009 and he is managing director of HINL since 2009. HFCL has been managed by experienced management team. Mr. Bishnu Pandey, (CEO of HFCL), MBS, has more than a decade of experience in NIC Asia Bank at various managerial level positions and is working as CEO of HFCL since June 2017. Mr. Pralhad Nidhi Tiwari, has 2 years of work experience in Everest Bank Ltd and has more than 16 years of work experiences in NIC Asia Bank at various managerial level positions.

High capital adequacy ratio (CAR)

HFCL CAR was 26.62% at the end of FY17 as against the minimum regulatory requirement of 11% and 5.5% respectively for 'C' class financial institution. CAR increased from 20.84% in FY16 due to increase in risk weighted assets is lower as compared to increase in capital fund by receipt of additional calls in advance and net profit made during FY17. The industry average CAR as on July 15, 2017 was 20.21%. Further, the CAR has increased to 34.56% as on April 13, 2018 due to lower increase in quantum of loan portfolio as compared to increase in capital fund. HFCL has made 100% right issue (i.e. Rs 150 Mn) during FY18. CAR is expected to increase further after the proposed right share issue and such increase in capital level is expected to help in expansion of business. HFCL's paid up capital is expected to reach at Rs 840 Mn after the issue of proposed right share against the Rs.800 Mn minimum paid up capital requirement as per the regulatory requirements.

High level of CASA which is declining in trend

HFCL's CASA deposit proportion is high at 61.93% at the end of 9MFY18. However, it is decrease from 75.55% at the end of FY17 due to increase in fixed deposit is higher than increase in saving deposit.

About the Company

Hathway Finance Company Limited (formerly known as Arun Finance Limited) is a National Level class "C" Finance Company which was incorporated on February 24, 1995 as Arun Finance and Saving Ltd and commenced operation from August 17, 1997; later on obtained the license for banking operation from NRB on April 26, 2006 with not accepting current and call deposit. Further, its name was changed to Arun Finance Ltd as on Jan 26, 2010 and thereafter HFCL on March 14, 2018. It has been declared as problematic institution by NRB as on Jan 26, 2015 and released from problematic institution on Feb 1, 2017. It is operating in 3 District (out of total 77 Districts) of Nepal with 3 branches (including head office which is located at Dharan, Nepal) as on April 13, 2018. The share capital of the company is distributed among promoters and public in the ratio of 60:40.

During FY17 (A), HFCL earned PAT of Rs.12 million with total operating income of Rs. 11 million. Further, during 9MFY18 (UA), HFCL earned profit of Rs.18 Million with total operating income of Rs. 52 million.

Analyst Contact
Ms. Apsara Upreti

apsara.upreti@careratingsnepal.com
Tel No.: +977-1-4232610

Relationship Contact
Mr. Sajan Goyal
sajan.goyal@careratingsnepal.com
Tel No.: 9818832909/+977-1-4233436

Annexure I

CARE Ratings Nepal – IPO Grading Scale

CARE IPO grade	**Definition**
CARE-NP IPO Grade 1	Strong fundamentals
CARE-NP IPO Grade 2	Above average fundamentals
CARE-NP IPO Grade 3	Average fundamentals
CARE-NP IPO Grade 4	Below average fundamentals
CARE-NP IPO Grade 5	Poor fundamentals

Note:

Modifier {"+" (plus)} can be used with the grading symbols 2, 3 and 4. The modifier reflect the comparative standing within the category.