ICFC Finance Limited

Ratings

Facilities	Amount (Rs. Million)	Ratings[1]	Rating Action
Issuer Rating	**NA**	**CARE-NP BBB- (Is) [Triple B Minus (Issuer Rating)] (Credit Watch with Negative Implications)**	**Reaffirmed and placed on credit watch with Negative implications**
Subordinated Bond (12% Debenture 2083)	**200.00**	**CARE NP BBB- [Triple B Minus] (Credit Watch with Negative Implications)**	**Reaffirmed and placed on credit watch with Negative implications**

CARE Ratings Nepal Limited (CRNL) has reaffirmed and placed on credit watch with negative implications the rating of 'CARE-NP BBB- (Is)' 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 and placed on credit watch with negative implications the rating of 'CARE-NP BBB-' 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 ratings assigned to ICFC and its subordinated debentures have been placed on credit watch with negative implications factoring in the increased stress in the asset quality of the company, indicative in the sharp increase in its Gross Non-Performing Loans (GNPL) as on mid-July 2023 (Unaudited; FY refers to the twelve-month period ending mid-July). Additionally, the company's total delinquent loans have also surged, increasing probability of further slippages over the near-term, adding further stress on the company's credit risk profile. The banking and finance industry in Nepal has seen a sharp rise in Gross Non-Performing Loans (GNPL) ratio as on mid-July 2023. High growth in loans & advances amid challenging market scenario during waves of Covid19, facilitated to some extent by various relaxations/concessions by the Nepal Rastra Bank (NRB), had led to an increased proportion of unseasoned credit of banks and financial institutions over FY20 and FY21. Sustained high GNPL levels owing to more slippages in asset quality over the near term remains a key concern for the Nepalese banking and finance sector. Hence, amid near-term headwinds, further stress on ICFC's asset quality could lead to added pressure on the company's earnings and distributable profits, which remains a key constraint from credit perspective.

The ratings continue to derive strength from ICFC's long track record of operations, experienced management team, moderate capitalization level, moderate liquidity profile and Current Account Savings Account (CASA) deposits. The ratings also factor in the moderate financial performance albeit lower net profit and increasing deposits with moderate concentration among top depositors. The ratings, however, remain constrained by geographical concentration of business, declining investment portfolio, high portfolio concentration among top borrowers, intense competition and exposure to regulatory risk related to the industry.

Going forward, the ability of the company to improve its asset quality while managing growth in operations, maintain adequate cushion in capital adequacy indicators from the minimum regulatory requirement levels, and manage the impact of any other regulatory changes by Nepal Rastra Bank would be the key rating sensitivities.

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

Detailed Description of the Key Rating Drivers

Key Rating Strengths

Experienced Board of Directors and 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 around 2 decades. The company's management team is led by Mr. Sunil Pant, Chief Executive Officer (CEO), who has more than 25 years of banking experience.

Moderate capitalization level

As on mid-July 2023, ICFC's overall Capital Adequacy Ratio (CAR) of 12.96% with Tier I Capital Adequacy Ratio of 10.54% (11.61% and 9.31% respectively as on mid-July 2022) has adequate buffer over the regulatory requirements with a cushion of 3.31% in Tier I CAR and 2.96% in overall CAR. Lower capitalization levels could limit the company's ability to absorb losses, should they materialize, especially given the increasing uncertainty surrounding credit recovery. Post-pandemic recovery continues to remain a concern amid high inflation and interest rates impacting entire demand-supply dynamics for various sectors, leading to reduced debt repayment capabilities of borrowers. The company's ability to maintain adequate cushion in the capital adequacy ratios will remain critical for its solvency and growth prospect, particularly following a period of around 3-4 years of high credit expansion in the industry.

Moderate financial performance albeit lower net profit in FY23

During FY23, ICFC's total income increased by 33.83% y-o-y to Rs. 2,728 Mn supported by rise in interest income by 39.20% owing to increase in yield on advances to 15.82% in FY23 compared to 12.65% in FY22 despite reporting ~3% y-o-y degrowth of loans and advances to Rs. 14,248 Mn at the end of FY23. However, interest expenses of the company increased even more, by ~45% y-o-y to Rs. 2,085 Mn, on account of increase in deposits majorly fixed deposits and increase in overall cost of deposits. Cost of deposit increased to 10.65% during FY23 from 7.92% during FY22. Despite higher cost of funds, ICFC's Net Interest Margin (NIM) improved to 2.37% during FY23 from 2.18% during FY22. Although the interest income improved on y-o-y basis, ICFC's PAT declined by 17.22% to Rs. 165 Mn during FY23 mainly on account of higher interest expenses coupled with lower non-interest income during FY23 compared to FY22. ICFC's non-interest income declined by 35.80% to Rs. 94 Mn in FY23. Also, Impairment charge increased to Rs. 59 Mn during FY23 as against Rs. 13 Mn during FY22 amid surge in delinquent loans. The total operating expenses increased 9.89% y-o-y to Rs. 348 Mn in FY23 mainly on account of increase in employment costs and other operating expenses during FY23. ICFC's Return on Total Assets (ROTA) decreased to 0.71% in FY23 (0.95% in FY22) amid y-o-y decline in PAT. Similarly, return on net worth (RONW) also decreased to 8.87% in FY23 from 11.17% in FY22.

Moderate CASA deposit ratio and liquidity ratio

ICFC's CASA mix continues to remain largely in line with the industry average. ICFC's CASA proportion declined to 18.99% at the end of FY23 (slightly higher than finance industry average of 18.66%) from 20.82% at the end of FY22 (finance industry average of 20.79%). The decline in CASA mix was due to the company's high reliance on high cost fixed deposits to fuel its deposit growth. 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. ICFC has maintained moderate liquidity profile characterized by Statutory Liquidity Ratio (SLR) of 32.10% and Net Liquidity Ratio of 32.40% as on mid-April 2023 which is in compliance with NRB norms of 10% and 20% respectively.

Increasing deposits with moderate concentration among top 20 depositors

Total deposits of ICFC grew at a compounded annual growth rate (CAGR) of 14.81% over last 4 years ending mid-July 2023 supported by increasing network, improving product offerings and effective marketing strategy. Deposits grew 5.75% y-o-y to Rs.

19,127 Mn at the end of FY23 (whereas Class C finance industry deposit grew by CAGR of 8.48% over last 4 years ending mid-July 2023 and y-o-y growth of 8.51% at the end of FY23). ICFC continues to remain a leading finance company in Nepal with 16.86% market share in terms of deposit base of the overall finance industry as on mid-July 2023 (17.30% as on mid-July 2022), based on monthly data published by NRB.

Furthermore, ICFC's deposits from top 20 depositors remain moderate at 9.22% of total deposits at the end of FY23 which decreased from 13.10% of total deposits at the end of FY22. Top 20 depositors mainly consist of institutional depositors. Lower concentration towards deposits normally reduces re-pricing risks at times of interest rate volatility.

Key Rating Weakness

Declining asset quality trend in FY23, likely to sustain over near-term

As on mid-July 2023, ICFC's GNPL ratio stood at 1.99%, deteriorating from 0.54% as on mid-July 2022 (FY21: 1.18%). Similarly, total delinquent loans (0+ days past due) had surged substantially to 15.50% as on mid-July 2023 from 9.87% as on mid-July 2022 (FY21: 11.60%). The decline in asset quality of ICFC and the overall banking and finance industry, in general, in FY23 can be attributed to industrywide slippages and recovery challenges amid lingering impact of COVID, with more slippages occurring after the relaxations/concessions provided by NRB ended after mid-July 2022. Increasingly stressed asset profile currently observed in the banking and finance industry has exacerbated amid the liquidity crunch, high inflation and elevated interest rates impacting entire demand-supply dynamics for various sectors, resulting in higher delinquencies. Amid a difficult operating environment, however, some comfort is taken in ICFC displaying a more resilient asset quality relative to peers. ICFC's ability to improve its asset quality indicators going forward would remain a key rating monitorable.

Limited reach of business

ICFC is operating in four provinces out of seven (i.e. Koshi, Bagmati, Lumbini and Gandaki) through its 21 branches, 1 extension counter and 21 ATM terminals as on mid-July 2023. 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 few 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 26.16% of total loans and advances at the end of FY23 which increased from 22.59% at the end of FY22. High concentration in loans and advances could increase portfolio vulnerability and stress in assets quality, particularly during economic downturn.

Competition from other Finance Companies and Bank

Currently, there are 17 finance companies operating with total 284 branches all over Nepal (based on monthly statistics published by NRB for mid-July 2023) out of that ICFC has 21 branches. Industry (Class-C Finance Companies) has achieved total interest income of Rs. 15,666 Mn in FY23 with Rs. 4,048 Mn net interest income; ICFC's share on interest income and net interest income is ~16.82% (Rs. 2,635 Mn) and 13.57% (Rs. 549 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 of Nepal is exposed to changes in the various regulatory measures issued by NRB from time to time. NRB introduced CD ratio mechanism from previous Credit to Core Capital plus Deposit (CCD) ratio measures from FY22 onwards, where CD ratio needs to be maintained below 90% from earlier provision of 85% for CCD. This has limited banks' lendable funds. Via the monetary policy for FY23, NRB increased the minimum requirement of liquid assets that the BFIs must hold, where Cash Reserve Ratio (CRR) was increased to 4%, while Statutory Liquidity Ratio (SLR) was kept at 10%. Such increase in mandatory liquidity reserve to be maintained by BFIs is likely to increase cost for BFIs, and is likely to reduce the amount of loanable funds, thereby limiting liquidity in the economy. Bank rate and policy rate (repo rate) were increased to 8.5% and 7% (previously 7% and 5.5%). Furthermore, NRB reduced the maximum interest rate spread to be maintained by class-C finance companies to 4.6% from 5%. Increased bank rates will likely put upward pressure on both lending and deposit interest rates of the bank over the near term, while decreased interest rate spread will likely put downward pressure on the bank's profitability. Ability of the bank to manage the impact of any other regulatory changes by Nepal Rastra Bank would be the key rating sensitivities.

About the Company

ICFC Finance Limited (ICFC) is a national level class "C" finance company incorporated on September 22, 2003 as Investment and Credit Finance Company Limited which was later changed to ICFC Finance Limited on March 01, 2010. It was Licensed by Nepal Rastra Bank (NRB) on July 14, 2004 and commenced operations on July 17, 2004. At the end of FY23, ICFC has Rs. 1,183 Mn paid up capital which is distributed among promoters and public shareholders in the ratio of 51:49.

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About CARE Ratings Nepal Limited:

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