

## ICFC Finance Limited

### ICRA Nepal assigns [ICRANP] IPO Grade 4 to the proposed Equity Shares (Rights Issue) of ICFC Finance Limited

| Facility/Instrument | Amount (NPR million) | Grading Action (August 2015)    |
|---------------------|----------------------|---------------------------------|
| Rights Share Issue  | 213.4845             | [ICRANP] IPO Grade 4 (Assigned) |

ICRA Nepal has assigned an “[ICRANP] IPO Grade 4”, indicating below-average fundamentals to the proposed rights issue amounting NPR 213.4845 million of ICFC Finance Limited (ICFC). ICRA Nepal assigns IPO grading on a scale of IPO Grade 1 through IPO Grade 5, with Grade 1 indicating strong fundamentals and Grade 5 indicating poor fundamentals. For the Grading categories 2, 3 and 4, the sign of + (plus) appended to the Grading symbols indicate their relative position within the Grading categories concerned. Thus, the Grading of 2+, 3+ and 4+ are one notch higher than 2, 3, and 4, respectively. ICFC is proposing to come out with a rights issue of 2,134,845 numbers of equity shares of face value NPR 100 each, to be issued to its existing shareholders at par.

The grading is constrained by ICFC’s moderate assets quality (Gross NPLs<sup>1</sup> were 3.10% as of Apr-15) along with possible degradations in future asset quality and financial profile due to business concentrated towards earthquake affected geographies, inferior borrower profile compared to commercial and development banks, high portfolio concentration towards Personal Loan segment (~24% of portfolio as of Apr-15), lack of diversity in earnings, declining profitability indicators on account of lowering NIMs<sup>2</sup> (Return on net worth which was ~18% as of Jul-13 has come down to ~7% as of Apr-15), high credit concentration (top-20 borrowers accounted for ~24% of loan book as on Apr-15) and high competition from other BFIs<sup>3</sup> in the market. The grading is also constrained by ICFC’s lower capitalization profile (CRAR<sup>4</sup> of 11.32% as on mid-Apr 15 against regulatory minimum of 11%) and uncertain political and operating environment that Nepalese Banks and financial institutions are currently facing. Nonetheless, the grading factors in ICFC’s strong management team<sup>5</sup> in relation to peers, adequate track record (in operation since 2003), sizeable base of operation among peers with moderate franchise<sup>6</sup> leading to healthy market share<sup>7</sup>, healthy CASA<sup>8</sup> proportion (~65% as of Apr-15 Vs. ~46% for Finance company industry aiding competitive cost of deposits Vs. peers; 6.23% on Apr-15) and lower deposit concentration among peers (top-20 depositors accounted for ~15% of deposits as of Apr-15). Going forward, attaining sustainable growth, maintaining fair assets quality and generating adequate returns to the shareholders in a post the earthquake scenario would remain a key challenge for ICFC.

As for impact on ICFC’s operations, ICFC’s branches in the earthquake affected areas accounted for ~84% of credit and ~93% of deposits as on April-15. However, quantum of affected exposures and extent of damage could be restricted to certain sectors/segments<sup>9</sup> accounting for ~1/3<sup>rd</sup> of ICFC’s loan book. Out of above, exposure to sectors perceived to be highly affected by earthquake (especially tourism sector) puts its more slippage prone portfolio at ~5%. Accordingly, ICRA Nepal

<sup>1</sup> Non-Performing Loans

<sup>2</sup> Net Interest Margins as a % of Average Total Assets

<sup>3</sup> Bank and Financial Institutions

<sup>4</sup> Capital to risk assets adjusted ratio

<sup>5</sup> Led by former Deputy Governor of Nepal Rastra Bank

<sup>6</sup> Franchise includes 11 branches & 1 extension counter in 8 districts of Nepal as on Apr-15.

<sup>7</sup> 5.70% in terms of deposit base and 5.09% in terms of credit portfolio of Finance companies as on Apr-15.

<sup>8</sup> Current & Savings accounts

<sup>9</sup> Tourism, hydropower, real estate/construction, consumer loans, housing loans, deprived sector lending and share based loans.



expects moderate level of stress on ICFC's asset quality and profitability profile over next 2-3 years due to damage caused by the earthquake in April 2015 and aftershocks.

ICFC's credit portfolio has grown moderately at a CAGR<sup>10</sup> ~10% over last five years and stood at NPR 3,628 million as of Apr-15. Credit portfolio remains concentrated towards trading loans (~39%), followed by personal loans (~24%), home loan (~11%), share based loans (~11%) and other miscellaneous loan segments (~15%). Out of these, personal loans, with no tracking of end use in general, could be utilized towards vulnerable sectors compared to other loan segments. ICFC's credit is concentrated wherein top 20 borrowers accounted for ~24% of portfolio as of Apr-15 which remains high considering the capacity to absorb risk, although it is moderate among peers.

Assets quality of ICFC though remains better than industry; was benefitted from regulatory forbearance<sup>11</sup> accorded to class C finance companies regarding NPL recognition criteria; therefore the actual NPL level remains higher than reported. ICFC's reported gross NPLs were 3.10% as on Apr-15 (Vs. ~14% for industry) as compared to 1.85% as on July-14. Assets quality of ICFC is further benefitted from the fact that significant portion of loans (~75%) are renewal in nature where repayment ability of the borrowers has not been tested fully. Also, portfolio vulnerability remains high due to high share of assessed income based lending (especially Personal Loans) and also due to marginal profile of borrowers compared to higher class BFIs.

ICRA Nepal has also noted that earthquake has not caused significant stress on ICFC's deposits/liquidity profile. As for funding profile, ICFC has healthy CASA proportion (~65% as of Apr-15 compared to industry average of ~46%) with moderate deposits growth (CAGR ~9% for last four years) resulting into competitive cost of deposits among peers (6.23% as of Apr-15). Further, concentration to top 20 depositors remains lower among peers at ~15% as on Apr-15. Going forward, the ability of ICFC to increase its presence across diverse geographies thereby increasing the depositor base will remain vital to future portfolio growth and overall financial profile.

Despite having competitive cost of funds, ICFC's falling yield on advances (11.67% as of Apr-15 compared to 13.05% as of Jul-14 which remains lower among peers) and NIMs (3.06% for Apr-15 Vs. 3.30% for Jul-14) have resulted in declining profitability indicators as of now. ICFC's profitability was further affected by decline in assets quality profile in recent periods in addition to lower fee based income (0.6% of ATA<sup>12</sup> as of Apr-15) despite moderate operating expenses (1.93% of ATA as of Apr-15). ICFC reported profits of NPR 74.03 million in FY14 (corresponding to PAT/Net worth of 14.08% and PAT/ATA of 1.45%) and NPR 27.25 million in 9MFY15 (corresponding to PAT/Net worth 6.57% and PAT/ATA 0.64%). However, profitability profile of FY14 was largely supported by trading gain on sale of investments; excluding such gains in FY14, profit would have been NPR 15.29 mn reflecting into PAT/ATA of 0.30% and PAT/Net-worth of 2.91%. ICFC's interest spread was ~6.03% as of Apr-15. Nepal Rastra Bank has prescribed interest rate spread of BFIs to be within 5% and made mandatory for commercial banks from mid-Jul-14; should this provision be strictly made applicable to B and C Class institutions, ICFC's profitability will be impacted to some extent. Additionally, impact of change in provisioning norms requiring higher provision against watch-list accounts (5% against 1% as of now) could also impact future profitability (~0.5% loans in watch-list criteria as of Apr-15). ICFC's earnings profile going forward will largely depend on the ability of the company to maintain NIMs with increase in its scale of operations and control over assets quality.

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<sup>10</sup> Compounded Annual Growth Rate

<sup>11</sup> Class C companies can classify overdue instalments as NPA as opposed to the entire outstanding term loans for a period of 1 year from the date of instalments overdue.

<sup>12</sup> Average Total Assets



Capitalization profile of ICFC was largely supported by internal capital generation over last five years. As on Apr-15, capital adequacy ratio (CRAR) of ICFC stood at ~11.32% (was 12.39% as on Jul-14) as compared to regulatory minimum of 11%. Proposed issue is likely to support capitalization in profile over the medium term (assuming full subscription). Monetary policy of FY 2015-16 has announced that national level finance company are required to increase their paid-up capital to NPR 800 million within two fiscal years. ICFC is likely to fulfill the elevated capital requirements in organic way after proposed issue and retention of future profits. However, attaining adequate growth to ensure adequate return to shareholders would remain a key challenge for the company.

### **Company Profile**

Registered in 2003, ICFC Finance started its commercial operation from 17th July, 2004. ICFC is a National Level Finance Company with its corporate office located at Bhatbhateni, Kathmandu. ICFC is promoted by 89 individual persons involved in different professions with support from some private institutions. Mr. Ram Babu Pant (former Deputy Governor) is the Chief Executive Officer of the company. Share capital of the company is distributed among promoter & public in the ratio of 51:49. The company's equity share is listed and actively traded in Nepal stock exchange.

ICFC Finance has presence in 8 districts of Nepal (Kathmandu, Bhaktapur, Lalitpur, Kavre, Nuwakot, Rasuwa, Kapilvastu and Rupandehi) through its 11 branches and 1 extension counter. ICFC has market share of about 5.70% in terms of deposit base and 5.09% in terms of credit portfolio of Finance companies as of mid-April, 2015. ICFC reported a net profit of NPR 74.03 million during 2013-14 over an asset base of NPR 5,097 million as of mid Jul-14 as against net profit of NPR 81.40 million during 2012-13 over an asset base of NPR 5,145 million as of mid Jul-13. As of Q3FY15, ICFC has reported after tax profit of NPR 27.25 million over an asset base of NPR 6,232 million. ICFC's CRAR was 11.32% and gross NPLs were 3.10% as on mid-Apr-2015. In terms of technology platform, ICFC has implemented "Pumori Plus III" in all of its branches.

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