

## Nepal Finance Limited: [ICRANP] IPO Grade 5 assigned to proposed rights issue

March 2, 2020

### Summary of graded instruments

INSTRUMENT/FACILITY	ISSUE SIZE	GRADING ACTION (MARCH 2020)
Rights issue (equity shares)	NPR 169.751 million	[ICRANP] IPO Grade 5; assigned

### Rationale

ICRA Nepal has assigned [ICRANP] IPO Grade 5 to Nepal Finance Limited's (NFS) proposed rights issue amounting to ~NPR 169.75 million, indicating poor fundamentals. ICRA Nepal assigns IPO gradings on a scale of 1 through 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 symbol indicates their relative position within the grading categories concerned. Thus, the gradings of 2+, 3+ and 4+ are one notch higher than 2, 3, and 4, respectively. NFS has proposed a 125% rights issue of 1,697,506.25 equity shares of face value NPR 100 each, to be issued to its existing shareholders at par. The proposed issue is being made to augment the capital base and is a step towards achieving the revised paid-up capital requirement<sup>1</sup> set by the Nepal Rastra Bank (NRB), the banking sector regulator.

The grading is constrained by NFS' weak financial profile, characterised by significant accumulated losses, weak asset quality (100% NPAs in addition to sizeable non-banking assets (NBAs) as of mid-July 2019) and a small scale of operations following years of erosion in the asset base and net worth. Even though the company has now resumed regular operations after release from the NRB's problematic status, the way forward remains challenging given the highly fragmented and competitive banking sector universe and NFS' weak competitive position. Raising fresh funds to support its business growth will remain a challenge, given the small branch network (two as of mid-January 2020) and high NPA level (~95%), which will affect its ability to attract new depositors. At the same time, NFS' ability to improve its financial profile will depend on its ability to grow its credit portfolio and recover from the existing NPAs/NBAs. Furthermore, increasing the paid-up capital base to the regulatory minimum of NPR 800 million from the current level of ~NPR 136 million (~NPR 221 million including calls in advance of ~NPR 85 million) within the stipulated timeline will remain a challenge.

### Key strengths and challenges

#### Strengths

**Released from problematic status and introduction of new promoter group with resumption of normal operations –** NFS' classification as a problematic institution by the NRB in December 2014 stopped it from engaging in regular business such as accepting fresh deposits and extending fresh credit and only allowed the repayment of its then existing depositors. As a result, the asset base eroded over the years and accumulated losses wiped out its capital fund. In December 2019, NFS was released from the problematic status after it met the regulatory minimum capital adequacy. The new promoter group has infused fresh equity (~NPR 85 million) in the form of an advance against the share capital to meet the minimum capital adequacy framework. Following its removal from the problematic list, the company has extended loans of ~NPR 11 million and has garnered deposits of ~NPR 30 million so far. Further, it has formulated new policies for credit, deposit and operations as a strengthening measure. However, NFS' removal from the problematic list is subject to the NRB's conditions such as the timely raising of revised paid-up capital by its new promoter group, reduction of the NPA level, etc, among others. Meeting these conditions remains a major challenge for the company.

<sup>1</sup> NPR 800 million for national level class C finance company (vs. NFS's capital current capital of NPR 136 million)

NFS now has a new promoter group (led by Ms. Pramila Shakya and Mr. Hirendra Man Pradhan) with a stake of ~31% as of mid-January 2020. The new promoters are planning to increase their stake by acquiring the shares of existing promoters as well as the unsubscribed proposed rights shares, if any. Given its history of weak governance and management, the introduction of new promoters and management team could be a positive for the company.

## Challenges

**Weak asset quality** – The company reported 100% gross NPA levels in the four years ending mid-July 2019 (~95% NPLs as of January 2020 with fresh loan disbursement of NPR 5 million). Over these years, NFS has been recovering from its NPAs and using the proceeds to partially pay off its depositors. While its major NPA accounts are concentrated among its top few accounts, the recovery from these accounts remains a challenge amid the legal proceedings involved. The NPL and NBA levels are expected to remain high over the near term, given the limited prospect of recovery from existing NPLs/NBAs (NBAs of ~NPR 93 million as of mid-January 2020) and the limited prospect of incremental credit growth amid funding constraints.

**Maintaining regulatory minimum capital within stipulated timeline** – One of the conditions attached to the release of the company from the problematic status is the raising of regulatory minimum paid-up capital (i.e. NPR 800 million) within two years of the release. The ability of the new promoters to infuse sizeable fresh equity within the regulatory timeframe will remain a challenge. NFS' paid-up capital, as of mid-January 2020, stood at ~NPR 221 million (including calls in advance of ~NPR 85 million) while it had an accumulated loss of NPR 150 million as on the same date.

**Challenges in scaling up amid resource constraints will limit profitability prospects** – As of mid-January 2020, NFS had a small asset base following the erosion during the years of its existence as a problematic financial institution. Achieving growth in its scale over the medium term will remain a key challenge for the company because of the funding constraints. NFS' ability to raise retail deposits is constrained by its weak branch network while its ability to source institutional deposits is limited by its weak financial numbers. This is likely to lead to limitations for the management's strategy of improving the company's financial indicators including the profitability indicators.

**Analytical approach:** For arriving at the ratings, ICRA Nepal has applied its rating methodology as indicated below.

**Links to applicable criteria:**

[IPO Grading Methodology](#)

[Bank Rating Methodology](#)

## About the company

Nepal Finance Limited (NFS) was incorporated and started its commercial operations from July 1992. It is the first finance company in Nepal's private sector. NFS is registered as a public limited company and is licensed by the NRB as a national level class C finance company.

NFS was declared problematic<sup>2</sup> by the NRB on December 3, 2014 citing lack of governance and internal control, poor asset quality, negative capitalisation profile, low share capital compared to the regulatory requirement and breach of regulatory directions. The company was granted a conditional release from the problematic status on December 6, 2019, which now allows it to conduct its business such as accepting deposits, extending loans and opening new branches. As

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<sup>2</sup> NRB can declare a BFI a problematic one owing to various reasons including poor management, inadequate financial resources, absence of long-term sustainable business strategy, weak asset quality, poor internal control system, poor governance and so forth. A problem bank/BFI, at the initial stage, is principally subject to the direct supervision of the NRB. If the deficiencies persist even after taking the necessary corrective steps under various modalities, the bank/BFI is subject to insolvency action and finally liquidated in accordance with the applicable laws

per the NRB's provision, NFS has to increase its paid-up capital to NPR 800 million within two years from the date of release from the problematic status. The proposed equity raising plan is a step towards the same.

As of mid-January 2020, NFS had a small scale of operations in Kathmandu district through two branches (including the head office). In FY2019, the company reported a net profit after tax of ~NPR 8 million on an asset base of NPR 185 million as of mid-July 2019 vs. a net profit of NPR 17 million in FY2018 on an asset base of NPR 195 million as of mid-July 2018. In H1 FY2020, NFS reported a PBT of ~NPR 23 million. As of mid-January 2020, the company's capital adequacy ratio was 34.07%, supported largely by the advance equity infused by the new promoters and a decline in the risk assets, offsetting the impact of the accumulated losses of ~NPR 150 million as of mid-January 2020. NFS' entire loan portfolio, amounting to ~NPR 103 million (as of mid-July 2019), had turned problematic. With the disbursement of fresh loans, post the resumption of the normal course of operations, the company reported NPLs of ~95% as of mid-January 2020.

### Key financial indicators

KEY FINANCIAL NUMBERS (Amount in NPR million) YEAR ENDED	Jul 2017 (Audited)	Jul 2018 (Audited)	Jul 2019 (Provisional)	Jan 2020 <sup>3</sup> (Provisional)
Gross loans and advances	163	148	103	93
Deposits	84	65	45	42
Paid-up capital	136	221*	221*	221*
Net worth	2	99	106	171
Total asset base	117	195	185	241
<b>OPERATING RATIOS</b>				
Gross NPAs	100.00%	100.00%	100.00%	94.61%
<b>CAPITALISATION RATIOS</b>				
Capital adequacy ratio	-19.73%	6.60%	13.17%	34.07%
<b>COVERAGE &amp; LIQUIDITY RATIOS</b>				
Total liquid assets/Total liability	20.63%	74.40%	92.43%	74.76%
Total advances/Total deposits	194.46%	228.02%	229.42%	219.63%

\*Including calls in advance of ~NPR 85 million.

### Analyst contacts

**Mr. Kishor Prasad Bimali** (Tel No. +977-1-4419910/20)

[kishor@icranepal.com](mailto:kishor@icranepal.com)

**Ms. Kushum Bhattarai** (Tel No. +977-1-4419910/20)

[kushum@icranepal.com](mailto:kushum@icranepal.com)

### Relationship contacts

**Ms. Barsha Shrestha** (Tel. No. +977-1-4419910/20)

[barsha@icranepal.com](mailto:barsha@icranepal.com)



## About ICRA Nepal Limited

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ICRA Nepal Limited,  
Sunrise Bizz Park, 6th Floor, Dillibazar, Kathmandu, Nepal.  
Phone: +977 1 4419910/20  
Email: [info@icranepal.com](mailto:info@icranepal.com)  
Web: [www.icranepal.com](http://www.icranepal.com)

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