Goodwill Finance Limited

ICRA Nepal reaffirms issuer rating of [ICRANP-IR] BB and [ICRANP] LBB to subordinated debentures programme

April 26, 2021

Summary of rated instruments

Facility/Instrument	Amount	Rating Action (April 2021)
Issuer Rating	NA	[ICRANP-IR] BB; reaffirmed
Subordinated debentures (12% Goodwill Finance Limited Debenture- 2083)	NPR 250 million	[ICRANP] LBB; reaffirmed

Rating action

ICRA Nepal has reaffirmed the rating of [ICRANP-IR] BB (pronounced ICRA NP issuer rating double B) to Goodwill Finance Limited (GFCL), indicating moderate risk of default regarding timely servicing of financial obligation. This rating is only an opinion on the general creditworthiness of the rated entity and is not specific to any debt instrument.

ICRA Nepal has also reaffirmed the rating of [ICRANP] LBB (pronounced ICRA NP long-term debt rating double B) to GFCL's existing subordinated[1] debenture programme worth ~NPR 250 million. Instruments with this rating are considered to have a moderate risk of default regarding the timely servicing of the financial obligations.

Rationale

The ratings reaffirmation continues to derive comfort from GFCL's strong capitalisation level (CRAR of 16.31% as of mid-January 2021), which supports the company's ability to withstand near-term credit shocks, amid the uncertain operating conditions created by the ongoing Covid-19 pandemic. The rating continues to factor in GFCL's long track record of operation (since 1995), adequate branch network (relative to its asset base) and its experienced senior management. GFCL's reported healthy asset quality, with gross non-performing loans (NPLs) of 1.38% as of mid-January 2021 (1.14% as of mid-July 2020) that resulted in a strong solvency position, has also been factored into the rating action. ICRA Nepal also positively takes note of a high proportion of scheduled loans (over 74% as of mid-January 2021) of GFCL, which allows a better assessment of the repayment capacity of the borrowers.

However, the ratings remain constrained by the recent build-up of delinquencies on account of the ad-hoc moratorium granted by the central bank to Covid-19 affected borrowers. As of mid-January 2021, the 0+ days delinquencies of GFCL stood at ~16%, which coupled with company's relatively marginal borrower profile, indicates a possible near-term stress in the asset quality. The ratings also remain constrained by the low current and saving (CASA) proportion and consequently the higher cost of deposits that have impacted the company's competitive position in the "base rate plus" lending regime currently practiced in the industry. High cost of deposits coupled with lower lending yield (due to competitive pressure) has supressed GFCL's NIMs and the overall profitability, which remains a concern to the long-term financial profile of the company. Rating concerns also arise from GFCL's concentrated borrower profile (~30% of loans among top 20 customers as on mid-January 2021), lack of strong institutional promoters and its modest scale of operations. Rating concerns also arise from the relatively weak competitive positioning of GFCL vis-à-vis large and established commercial banks that offer wider range of services with finer lending rates. The regulatory restrictions for class C financial institutions in areas, such as loans against hypothecation of stocks and receivables and foreign currency-based transactions (such as import LCs) erode their competitive positioning and earning potential vis-à-vis class A banks and remains a long-term credit negative.

[1] *Subordinated to deposits for principal repayment in the event of liquidation; subordinated debentures are eligible for inclusion in the calculation of tier II capital*

Going forward, GFCL's ability to scale up its operations while maintaining the credit quality and checking the near term NPA slippages arising from the impact of Covid-19 impact are likely to remain the key rating sensitivities.

Key rating drivers

Credit strengths

Long track record, adequate presence and experienced senior management team

GFCL started its operations in 1995 as a class C finance company. The long track record of the company has been factored as a positive in the rating exercise. The company's footprints through 16 branches as of mid-January 2021 across the country remain adequate for its scale of operation. GFCL has a relatively stable team of experienced senior management, which also remains a positive.

Comfortable capitalisation profile

GFCL has maintained a CRAR of 16.31% as of mid-January 2021, (tier I capital of ~12.40%)—well above the minimum regulatory requirement of 11% (tier-I capital of 6%). The strong capitalisation profile serves as a cushion against the near-term credit shocks and provides a support for future business growth.

Good assets quality and strong solvency level; notwithstanding the recent build-up in delinquencies

Despite the impact of pandemic and the rise in delinquencies (mainly on account of the ad-hoc moratorium granted by the central bank to borrowers in Covid-affected sectors), the company has been able to maintain its gross NPA at low level. Reported asset quality numbers have improved with the decline in gross NPLs from 1.65% in mid-July 2019 to 1.14% as of mid-July 2020, partly because of the fresh credit growth in the interim. However, the NPA level registered an uptick in H1FY2021 (~1.38% as of mid-January 2021), which coupled with elevated 0+ days delinquency level (~16% as of mid-January 2021), remains a concern. As a result of low NPAs and healthy capitalisation profile, GFCL continues to report strong solvency levels. However, the NPA levels as of mid-January 2021 benefit from the regulatory relaxation in NPA recognition during the period of central bank-granted moratorium and the actual NPAs could spike in the case of fresh slippages arising from the existing delinquencies. However, adequate capital cushion of GFCL offers some comfort to this end.

Credit challenges

Deteriorating profitability profile due to decline in NIMs; small-scale of operations

GFCL's profitability indicators moderated in the recent period with return on average assets (RoA) of 0.96% and return on average net-worth (RoNW) of ~9% in H1FY2021 (1.91% and ~14% in FY2019). This was mainly on account of reduction in NIMs, from 3.61% in FY2019 to 1.41% in H1FY2021, triggered by proportionately higher decline in yields on advances (by 487 bps from FY2020 to H1FY2021) compared to the cost of deposits (~195 bps). GFCL's cost of fund remains high because of its high proportion of term deposits, while the company faces competitive pressure from larger commercial banks with finer lending rates, forcing it to operate at low NIMs. This, coupled with the lack of economies of scale that subdues the profitability of GFCL, remains a negative to its long-term financial profile.

Concentrated borrower profile

GFCL's portfolio remains concentrated, wherein the top 20-customers accounted for ~30% of the total credit portfolio as of mid-January 2021. This could impair the company's asset quality profile in the event of distress among top borrowers.

Moderate funding profile with low CASA

GFCL's deposits profile remains slightly inferior with relatively low CASA of ~26% as on mid-January 2021, as against the industry average of 30%, which translates into a higher cost of deposits (8.38% for H1 FY2021 vs. 7.36% for the class C finance industry). This impairs the company's competitive strength of GFCL in the "base rate plus" lending regime practiced in the Nepalese banking industry. However, GFCL has a low deposit concentration among top accounts (~11% of the overall deposit among top 20 depositors as of mid-January 2021), which remains a positive from the deposit stability standpoint.

Intense competition from larger commercial banks with wider range of services

As per the regulatory provisions, class-C financial institutions are restricted to undertake certain activities that are allowed for class A commercial banks, viz. credit secured only against hypothecation of stock and receivables, opening of foreign currency denominated letter of credit/guarantees, etc. These provisions erode the competitive positioning of the finance companies (such as Goodwill) vis-à-vis commercial banks with higher capital, stronger brand and branch network, larger customer base, wider range of services and finer lending rates. This remains a long-term negative for the finance company industry.

Links to applicable criteria:

Bank Rating Methodology
Issuer Rating Methodology

Company profile

Incorporated in September 1994, Goodwill Finance Limited (GFCL) started its commercial operation from May 1995. The company is now operating as national-level finance company. The company is promoted by a diversified range of promoters involved in different professions. Share capital of the company is distributed among promoter & public in the ratio of 51:49. The company's equity share is listed in the Nepal stock exchange. Its corporate office is located at Hattisar, Kathmandu, Nepal. Mr. Saroj Kaji Tuladhar is the Chief Executive Officer of the company.

Goodwill Finance has presence in 13 districts of Nepal through its 16 branches and two ATMs as of mid-January 2021. GFCL has market share of about 9.31% of deposits and 9.39% in terms of credit portfolio of Nepalese Finance Companies industry as on mid-January 2021. GFCL has reported a net profit of ~NPR 114 million in FY2020 (~23% YoY decline) over an asset base of NPR 10,768 million as of mid-July 2020. For H1 FY2021, the company reported a net profit of ~NPR 55 million over an assets base of ~NPR 12,451 million as of mid-January 2021. GFCL's CRAR was 16.31% and Gross NPLs were 1.38% as on mid-January 2021.

Key financial indicators

KEY FINANCIAL RATIOS YEAR ENDED	Mid-Jul-17 (Audited)	Mid-Jul-18 (Audited)	Mid-Jul-19 (Audited)	Mid-Jul-20 (Audited)	Mid-Jan 2021[2] (Provisional)
OPERATING RATIOS					
Net Interest Margin/Avg. Tot Assets	2.92%	2.54%	3.61%	2.77%	1.41%
Non-Interest Income/Avg. Tot Assets	2.17%	1.79%	1.43%	1.23%	1.91%
Operating Expenses/Avg. Total Assets	2.28%	2.07%	2.38%	2.05%	1.38%
Credit Provisions/Avg. Total Assets	0.19%	0.77%	0.06%	0.12%	0.58%
PAT/Average Total Assets	1.83%	1.02%	1.91%	1.17%	0.96%
PAT/Net Worth	14.61%	7.57%	14.38%	10.10%	9.29%
Gross NPAs	2.63%	2.67%	1.65%	1.14%	1.38%
CAPITALISATION RATIOS					
Capital Adequacy Ratio	16.39%	16.72%	12.27%	15.74%	16.31%

[2] *Annualised*

Net NPAs/Net Worth	2.69%	3.53%	3.79%	0.29%	0.40%
COVERAGE & LIQUIDITY RATIOS					
Total Liquid Assets/Total Liability	30.66%	30.31%	27.55%	33.02%	36.38%
Total Advances/Total Deposits	79.97%	86.12%	85.98%	80.53%	80.65%

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About ICRA Nepal Limited:

ICRA Nepal Limited, the first Credit Rating Agency of Nepal, is a subsidiary of ICRA Limited (ICRA) of India. It was licensed by the Securities Board of Nepal (SEBON) on October 3, 2012. ICRA Nepal is supported by ICRA Limited through a technical support services agreement, which envisages ICRA helping ICRA Nepal in areas such as rating process and methodologies, analytical software, research, training, technical and analytical skill augmentation.

Our parent company, ICRA Limited, was set up in 1991 by leading financial/investment institutions, commercial banks and financial services companies as an independent and professional investment Information and Credit Rating Agency. Today, ICRA and its subsidiaries together form the ICRA Group of Companies.

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