

United Finance Limited

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

Facility/Instrument	Issue Size	Grading Action (April 2016)
Rights Share Issue	NPR 115.9837 Million	[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 115.9837 million of United Finance Limited (UFL). 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. UFL is proposing to come out with a rights issue of 1,159,837 numbers of equity shares of face value NPR 100/- each, to be issued to existing shareholders at par. The proposed issue is being made to augment the capital base to support the bank’s growth plans as well as to augment the capital base in order to reach the revised paid up capital requirement set by Nepal Rastra Bank (NRB).

The grading factors in UFL’s established track record (operating since 1996), and sizeable base of operations among peers with adequate market share (~5.5% market share among Nepalese finance companies industry as on mid-Jan-16¹). Experienced management team, moderate franchise² and adequate capitalization (15.24% as on mid Jan-16) are expected to provide UFL with moderate growth opportunities going forward. ICRA Nepal also takes into account UFL’s granular credit portfolio (~11% among top 20 borrowers) profile.

The grading is however constrained by UFL’s weak deposit profile with low CASA³ proportion (~21% vs. ~48% for industry on Jan-16), high cost of funds (6.35% for H1FY16) leading to weaker competitive positioning. ICRA Nepal also takes note of high deposit concentration (~31% among top 20 depositors on Jan-16), high product concentration (hire purchase loans were ~35% of portfolio on Jan-16) and lack of diversity in earnings for UFL. UFL’s gross NPLs⁴ increased to 1.23% as on mid Jan-16 (vs. 0.59% as on mid Jul-15), although the same compares favorably to the industry (NPLs 12.94% for the finance industry as on mid-Jan-16). ICRA Nepal however takes note of regulatory forbearance accorded to finance companies in recognizing only the overdue instalment as NPL upto a period of one year (against entire facility as NPL for class A and B bank). ICRA Nepal also notes the increase in delinquencies (0+ days overdue ~30%⁵ including NPLs as on mid Jan-16) for UFL during the last few months on account of earthquake and elongated political turmoil impacting the overall economy and repayment capacity of the borrowers. Hence the bank’s asset quality could remain under pressure going forward, although the event related stress on the borrowers is expected to reduce with the strike ending recently. As a result of deterioration in asset quality, UFL’s profitability also declined (RoE⁶ of 10.6% during H1FY16 vs. 15.4% during FY15) on account of higher credit costs. While assigning the grading, ICRA Nepal has also factored in UFL’s capital base being much lower to revised regulatory capital framework to be complied by FY17 and relatively weaker borrower profile compared to commercial and development banks. Moreover, the grading is also constrained by high competition from other BFIs⁷ in the market and uncertain political and operating environment that Nepalese Banks and financial institutions are currently facing. Going forward, attaining sustainable growth, improving deposit profile, managing delinquency levels and generating adequate returns for the shareholders over increased capital base would remain key challenges for UFL.

¹ Data of mid-Jan-16 are unaudited.

² Franchise includes 11 branches in nine districts of Nepal as on Jan-16.

³ Current and saving accounts

⁴ Non-Performing Loans

⁵ 0+ days delinquencies decreased to ~22% as on mid-Apr-16 as per unaudited data, provided by management.

⁶ Return on equity

⁷ Bank & financial institutions



UFL's credit portfolio has grown moderately at a CAGR ~10% over last four years and stood at NPR 3,663 million as of Jan-16. Credit portfolio remains concentrated towards hire purchase loans (~35%), followed by housing loans (~24%), personal loan (~13%), business loans (~11%), and share based loans (~7%). Compared to peers, UFL's credit portfolio is granular wherein top 20 borrowers accounted for ~11% of portfolio as on mid Jan-16.

UFL's exposure towards the sectors/segments⁸ with relatively high effect of earthquake accounted for ~1/3rd of UFL's loan book (as on mid Jan'16). The portfolio performance was also impacted due to political turmoil as evident by increase in delinquencies, which increased from ~20% as of mid-Apr-15 to ~44% as of mid-Oct-15. However, this has declined to ~30% by Jan-16 and further to ~22% by mid-Apr-16 (including reported NPLs of 0.99% on Apr-16; actual NPLs disregarding regulatory forbearance⁹ attributable to finance companies was 12.23%). The scheduled loans, accounting for ~57% of portfolio on Apr-16, continue to face much higher delinquencies (~37%) compared to revolving loans (~2%) which remains a key area of concern. Hence, the asset quality of UFL is benefitted from the fact that significant portion of loans (~40%, revolving loans) 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 marginal profile of borrowers compared to higher class BFIs. ICRA Nepal expects UFL's asset quality to remain under stress in the near term due to damages caused by earthquake and elongated strikes, impacting borrowers' ability to make repayments in a timely manner.

As for funding profile, UFL has weaker deposit profile compared to peers with CASA proportion of ~21% as on mid Jan-16 (compared to industry average of ~48%) resulting in high cost of deposits (6.35% for H1FY16). Further, UFL also faces deposit concentration risks with top 20 depositors accounting for ~31% of total deposits as on mid Jan-16. Going forward, ability of UFL to increase its presence across larger geography, improve the deposit mix and diversify the depositor base will remain vital to overall competitive positioning in the future.

Although UFL's NIMs (~4.1%-4.2% during the last four years) have remained largely stable, profitability has been impacted during H1FY16 due to increase in credit cost (0.99% of ATA¹⁰ for H1FY16 vs. 0.13% for FY15). The profitability indicators declined during H1FY16 (RoE and RoA¹¹ of ~11% and 1.31% for H1FY16 vs. ~15% and 1.92% for FY15). UFL's profitability was also impacted by decrease in non-interest income (0.8% of ATA as of Jan-16 vs. 1.2% of ATA as on mid-Jul-15) and high operating costs (operating expenses 2.09% of ATA as on mid Jan-16).

UFL's interest spread was ~5.87% as of Jan-16. Nepal Rastra Bank has prescribed interest rate spread of BFIs to be within 5% and made the provision mandatory for commercial banks from mid-Jul-14; should this provision be strictly made applicable to B and C Class institutions, UFL's profitability will be impacted to some extent. UFL's earnings profile going forward will largely depend on the ability of the company to maintain NIMs, improve its scale of operations and control its assets quality.

As on Jan-16, capital adequacy ratio of UFL was comfortable at 15.24% (14.78% as Jul-15) as compared to regulatory minimum of 11%. Monetary policy of FY 2015-16 requires national level finance company to increase their paid-up capital to NPR 800 million within FY17. UFL has a capital of NPR 464 million as of mid-Jan-16 and the same is expected to reach to ~NPR 580 million after proposed right issues (assuming full subscription). UFL plans to fulfill the elevated capital requirements through series of rights and retention of future profits. The banks' ability to raise planned capital in a timely manner would also have critical bearing on its ability to absorb deterioration in asset quality and maintain comfortable solvency profile. However, attaining adequate growth to ensure adequate returns to shareholders would remain a key challenge for the company.

⁸ Real estate/construction, housing loans, deprived sector lending and share based loans.

⁹ 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.

¹⁰ Average Total Assets

¹¹ Return on Assets



Company Profile

In operation since January 1996, UFL is a national level “Class C Finance Company”. UFL is promoted by members of the Chaudhary family (from the reputed Chaudhary Group) among others, with maximum shareholding by one shareholder at ~15% of total capital. Its Corporate Office is located at Durbarmarg, Kathmandu. Share capital of the company is distributed among promoter & public in the ratio of ~60:40. The shares of the company are listed on the Nepal Stock Exchange. Mr. Sunanda Bahadur Shrestha is the Chief Executive Officer of the company.

UFL has presence in nine districts of Nepal through its 11 branches and has a market share of 5.66% in terms of deposit base and 5.47% in terms of credit portfolio of finance companies industry as on mid Jan-16. UFL reported a net profit of NPR 91 million during 2014-15 over an asset base of NPR 5,084 million as on mid Jul-15 as against net profit of NPR 84 million during 2013-14 over an asset base of NPR 4,372 million as on mid Jul-14. During H1FY16, company has reported net profit of NPR 33 million over an asset base of NPR 4,959 million. UFL’s CRAR was 15.24% and reported gross NPLs were 1.23% as on mid-Jan-2016. In terms of technology platform, UFL has implemented Pumori-IV System which is centralized throughout its branches.

April 2016

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