Reliance Lotus Finance Limited

ICRA Nepal assigns [ICRANP] IPO Grade 5 to the proposed Equity Shares (Further Public offering) of Reliance Lotus Finance Limited

Facility/Instrument	Amount (NPR million)	Rating Action (August 2015)
Further Public Offering (FPO)	51.4286	[ICRANP] IPO 5 (Assigned)

ICRA Nepal has assigned an “**[ICRANP] IPO Grade 5**”, indicating poor fundamentals to the proposed FPO amounting NPR 51.4286 million of Reliance Lotus Finance Limited (RLFL). 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. RLFL proposes to come out with an FPO of 514,286 numbers of equity shares of face value NPR 100 each, to be issued to general public at par. The issue is being made in order to achieve a minimum 30% public shareholding in RLFL, as required by Nepalese Banking regulations.

The grading is constrained by RLFL’s moderate track record of operations, poor asset quality (Gross NPLs[1] of 8.21% on April-15[2] and 4.18% in July-14) despite regulatory forbearance, small scale of operation with lack of franchise network leading to geographical concentration, and weak profitability indicators impacted by high credit costs (PAT/Net worth declined to 1.9% during 9MFY15 as compared to 11.5% during FY14). ICRA Nepal also notes the lack of diversity in earnings for RLFL, relatively high credit and deposit concentration (top-20 borrowers accounted for 23% of loan book as on April-15, top 20 depositors accounted for ~25% of total deposits on April-15) and apparent lack of synergy post-merger in FY14[3]. Although RLFL has a healthy CASA[4] deposit (65% as on Apr-15) the cost of deposits remain high (~8.93% in FY14 and 8.23% in 9MFY15) impacting RLFL’s competitive positioning vis-à-vis other players in the industry. Given RLFL’s geographical concentration of advances to earthquake affected region coupled with significant exposure to industries impacted severely by earthquake and relatively weaker borrower profile, ICRA Nepal expects deterioration in the financial profile of the company going forward. RLFL’s ability to achieve sustainable growth and generate adequate returns in the current scenario remains weak; considering high capitalization level (~25% on April-15) and proposed equity injection. The grading is also constrained by small capital base compared to revised regulatory capital framework (NPR 320 million as on Apr-15 vs NPR 800 million to be met by FY17), uncertain operating and regulatory environment that Nepalese Banks and financial institutions are currently facing. Nonetheless, the grading factors in RLFL’s healthy CASA proportion (CASA deposit remains at ~65% as on mid-Apr-15 against industry average of 46%), and relatively experienced management team in relation to the peers, Going forward, attaining sustainable growth, maintaining fair asset quality and generating adequate returns to the shareholders in the post-earthquake scenario would remain key challenges for RLFL.

RLFL came into existence during FY14, following merger between erstwhile Reliance Finance and Lotus Investment Finance; with combined operations commencing from 8th May 2014.The credit portfolio of RLFL grew by CAGR 24% (albeit on a low base) over past 3 years ending FY14, primarily due to merger .However RLFL has witnessed deterioration in performance indicators including marginal growth of 0.96% during 9MFY15, hinting at the lack of synergy post-merger. The gross NPLs over the same period has increased from 4.18% as on July-14 to 8.21% on April-15; which along with the weak underwriting norms of RLFL raises concerns regarding the quality of incremental portfolio.

[1] Non-performing loans
[2] Gross NPL declined to 3.80% as per July-15 unaudited report; sustainability of which remains to be seen
[3] Between erstwhile Reliance Finance Limited and Lotus Investment Finance Limited; combined operations commenced since 8th May 2014 (FY14).
[4] Current and Saving accounts

Assets quality of RLFL is further benefitted from regulatory forbearance accorded to class C finance companies in NPL recognition norms; therefore the actual NPL level remains higher than reported.

Although a National Level Finance Company, RLFL's business is concentrated primarily in Kathmandu valley. This localized operation has imposed constraints in deposit mobilization, created risk of geographical concentration of credit and competition from other larger scale financial institutions with lower interest rate. As on April-15, RLFL's credit portfolio stood at NPR 1,372 million with total deposit base of NPR 1,554 million. RLFL's credit portfolio comprised mainly of Personal Loans (22%), Hire purchase Loans (19%), Business Loan (19%), Housing Loan (17%) and Share loans (11%) among others. Higher stress has been reported in Vehicle loans (segmental NPA 24%), Business Loan (22%) and housing loans (14%) which remains a cause of concern. Exposure towards share loans also remains vulnerable to any untoward movement in the stock market; considering the marginal profile of borrowers and general lack of secondary collateral or income source.

As for funding profile, the cost of deposits for RLFL remains high due to higher interest rate offered for the deposit product resulting from limited franchise, although CASA deposit remains healthy at 65%. However, RLFL has recently opened 3 branches outside Kathmandu valley and is likely to aid the deposit profile to some extent. At the same time, concentration of deposits among the top depositors (~25% of total deposits among top 20 depositors) also poses risk to the stability of deposit and liquidity position. Going forward, the ability of RLFL to increase its presence across different geographies thereby increasing the depositor base will remain vital to funding profile as well as competitive positioning vis-à-vis other players.

CD[5] ratio (adjusted for net worth) of RLFL remains on the lower side (past 3 years average of 70% vs. regulatory ceiling of 80%); which in combination with falling yield on advances, large proportion of idle funds yielding nominal return on investments and high cost of deposits has resulted in low gross interest spread and NIMs (~3-3.5% over past 3 years) thereby adversely impacting overall profitability. Increasing provisioning expenses due to deteriorating asset quality and higher operating expense, led to marginal operating profits in FY14 and operating losses during 9MFY15. The net profits during FY14 and 9MFY15 were on account of gains from sale of its share investment portfolio. RLFL reported profit after tax of NPR 39.58 million (corresponding to PAT/Net worth of 11.46% and PAT/ATA of 2.35%) and NPR 5.61 million during 9MFY15 (corresponding to PAT/Net worth 1.90% and PAT/ATA 0.36%). RLFL's earnings profile going forward will largely depend on the ability of the company to expand its scale of operations with improved franchise, control over and maintaining the quality of the credit portfolio.

As on Apr-15, capital adequacy ratio (CRAR) of RLFL stood at ~25% as compared to ~21% as on July-14. Assuming full subscription of proposed FPO and probability of low credit growth over short term, RLFL' capitalization levels are expected to remain adequate against the minimum regulatory requirement. However, monetary policy announced by the central bank for FY 2015-16 has stipulated an increase in the minimum paid up capital requirement for national level class C finance companies to NPR 800 million by the end of FY2016-17. RLFL has a capital of NPR 320 million as of mid-April-15, and same is expected to increase to NPR 400 million after capitalization of accrued profit till Apr-15 and proceeds from proposed FPO (assuming full subscription), thus the company likely to issue fresh capital or opt for merger to meet the regulatory minimum capital within FY17. Further, if the company finds adequate sources to increase the capital to meet the revised regulatory norms, attaining adequate growth to ensure efficient utilization of the same would remain a key challenge for the company.

The shareholding of the company is diversified across over 249 individual promoters[6] with no institutional promoter support. Present shareholding structure comprises ~82% promoter holding with ~18% holding by general public. The shortfall in minimum shareholding requirement of 30% was on

[5] Credit to deposit

[6] Post merger

account of the failure of erstwhile Lotus Finance's IPO in FY12[7], before merger with the then Reliance Finance. RLFL is likely to meet the capital requirements of 70:30 promoter/public ratio post proposed FPO (assuming full subscription). RLFL has 8 members- Board of Directors having limited experience and no independent/professional director. The top management has moderate experience across banking and financial Institutions.

Company Profile

Reliance Lotus Finance Limited (RLFL), erstwhile Reliance Finance Limited started its commercial operation on July 2009. The name was changed following merger with Lotus Investment Finance in FY14, with merged entity commencing operations from 8th May 2014. Although the then Reliance Finance had met the minimum regulatory public shareholding ratio, erstwhile Lotus finance had not met the same following cancellation of its IPO process due to under subscription in FY12. As a result, the public shareholding in RLFL stands at 18.25% as compared to minimum regulatory requirement of 30%. The proposed FPO is expected to meet the requirement, assuming full subscription. The head office of RLFL is in Putalisadak, Kathmandu. RLFL has 249 individual promoters and the equity share is listed in Nepal stock exchange. Mr. Anil Shrestha is the Chief Executive Officer of the company.

RLFL is a National Level finance company and currently has presence in 4 districts viz: Kathmandu, Kaski, Chitwan, and Lamjung via 5 branches (including Head Office). RLFL has market share of about 2.10% of deposits and 2% in terms of credit portfolio of Nepalese Finance Companies industry as on mid-Apr 2015. RLFL has reported a net profit of NPR 39.58 million during 2013-14 over an asset base of NPR 2,112 million as of mid-July 2014 as against net profit of NPR 12.58 million during 2012-13 over an asset base of NPR 1,254 million as of mid-July 2013[8]. During 9MFY15, RLFL has reported a net profit of NPR 5.61 million over an asset base of NPR 2,097 million. As on mid-April 2015, RLFL's CRAR was 25.14% and gross NPLs at 8.21%[9]. In terms of technology platform, RLFL uses banking software "Inorins Banquier" across all its branches.

August 2015

For further details please contact:

Analyst Contacts:
Mr. Sailesh Subedi (+977-1-4419910/20), **for immediate contact 01-5551616**
sailesh@icranepal.com

Relationship Contacts:
Mr. Deepak Raj Kafle, (+977-1-4419910/20), **for immediate contact 01-5551616**
drkafle@icranepal.com

[7] Out of shares worth NPR 80 million floated to public, only NPR 11 million was subscribed resulting in cancellation of IPO and refund of money to the investors.
[8] Profits are not comparable due to merger in FY14.
[9] Gross NPL declined to 3.80% as per July-15 unaudited report; sustainability of which remains to be seen