Multipurpose Finance Company Limited

ICRA Nepal assigns [ICRANP] IPO Grade 5 to proposed rights issue of Multipurpose Finance Company Limited

Facility/Instrument	Amount	Grading Action (October 2018)
Rights Share Issue (Equity Shares)	NPR 358.5264 Million	[ICRANP] IPO Grade 5 (Assigned)

ICRA Nepal has assigned a grading of "**[ICRANP] IPO Grade 5**", indicating poor fundamentals to the proposed rights issue amounting to NPR 358.5264 million of Multipurpose Finance Company Limited (MPFL). ICRA Nepal assigns IPO gradings on a scale of IPO Grade 1 to 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 category concerned. Thus, the grading of 2+, 3+ and 4+ are one notch higher than 2, 3, and 4, respectively. MPFL has proposed rights offering of ~864% of 3,585,264 numbers of equity shares of face value NPR 100 each, to be issued to the existing shareholders at par. The proposed issue is being made to comply with the capital requirement set by the Nepal Rastra Bank (NRB) - the Central Bank.

The lowest grade assigned to the proposed rights issue reflects MPFL's limited scale of operations arising out of being a one-district player with one-branch set up. This has resulted in high geographical as well as client concentration in its business. Smaller regional players like MPFL are losing their niche market/ business potential due to aggressive geographical expansion by larger Banks and Financial Institutions (BFIs) with wider product range and better pricing capability. MPFL's Lower price competitiveness (resulting from high cost of funds of ~11%), in a highly competitive industry results in moderate borrower profile for the company. This raises long term asset quality concerns. Given the limited operating scale, control and monitoring mechanisms of MPFL has scope for significant improvement; which is reflected in its moderate underwriting quality. All these are likely to weaken the prospect of sustainable future growth for MPFL. This coupled with the large size of the proposed equity injection program (vis-à-vis the current scale of operation); is likely to result in weak returns to MPFL's equity holders over medium term. Going forward, MPFL's ability to expand and grow with an adequate internal control mechanism and achieve efficient utilisation of capital will be a key factor for determining its incremental financial profile.

As of mid-July 2018, MPFL's credit portfolio stood at ~NPR 193 million. The company has not been able to grow despite being in business for ~20 years. This is partly due to its limited geographical coverage and competition from other BFIs. Going forward, MPFL has plans for management overhaul, geographical expansion and portfolio growth, after the proposed equity injection. However, its ability to achieve growth in a highly competitive landscape remains to be seen. Moreover, the prospect of successful geographical expansion and business also remains modest as the experience of the promoters/ key management personnel is limited to the local arena. In terms of assets quality, MPFL's gross NPA stood at 4.63%[1] as of mid-July 2018 (deteriorating marginally from 4.29% in mid-July 2017). MPFL's current NPA level remains lower than the industry average of ~11% (mid-July 2018) for finance companies. However, this could come under stress given the current high interest rate environment, assessed income/ collateral based (rather than cash flow based) lending practices coupled with the company's moderate underwriting norms and control measures. Future asset quality concerns also arise due to the liberal stances taken by the company towards non-NPA delinquencies as reflected by the high 0+ day's delinquency level[2].

MPFL's current one-branch set up has led to low penetration and hence a small depositor base for the company. This has resulted in high reliance on a small set of depositors with corresponding cost

[1] Without availing regulatory forbearance given by NRB to class C finance companies in NPA recognition.
[2] MPFL's MIS does not keep track of non-NPA delinquencies. On due diligence, ~45% of the accounts sampled were found to be 0+ days delinquent.

implications. During FY2018, MPFL's deposit portfolio stood at NPR 190 million with average cost of deposits of ~11%, much higher than its larger and more established banking sector counterparts. In the current "base rate plus" lending regime in the banking sector, this is likely to result in higher lending rates, thereby deterring borrowers with good profiles. Going forward, MPFL's ability to expand its depositor base/ deposit portfolio and manage the cost of deposits will remain vital for achieving the management's credit growth plan and profitability levels.

Due to the limited scale of operations/ low economies of scale, MPFL's profitability ratios have remained subdued so far. During FY2018, MPFL reported return on assets of ~3% and return on net worth of ~11% (vis-à-vis ~4% and ~15% respectively, in FY2017). The return indicators are likely to remain subdued going forward, as the NRB has capped the average interest spread for class C finance companies at 5% (to be maintained from mid-October 2018; the spread was unregulated in the past). Coupled with the sizeable equity injection planned by the company, returns to equity holders over medium term are likely to remain low. MPFL's earnings profile, going forward, will largely depend upon its ability to scale up and maintain control over the asset quality.

As of mid-July 2018, MPFL's capital adequacy ratio (CRAR) stood at ~28%, well above the regulatory minimum of 11%, albeit on a low base. Given the high capitalization level, the proposed equity injection and modest growth prospects, the company is likely to remain overcapitalised over the next 1-2 years. Although this will have an impact on returns to equity holders, it will nonetheless enable the company to withstand probable credit shocks over the near term.

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

Links to applicable criteria:

IPO Grading Methodology

Company Profile

Established in March 1998, Multipurpose Finance Company Limited (MPFL) is a one-district level class C finance company operating in Saptari district of Eastern Nepal. The Rajbiraj-based company is promoted by local individual promoters from different professions. MPFL's share capital is distributed among the promoters and the public shareholders in the ratio of 60:40. Its equity shares are listed in the Nepal Stock Exchange. Mr. Ajit Kumar Mishra is the Chief Executive Officer of the company.

As of mid-July 2018, MPFL had a market share of about 0.30% of deposits and 0.34% in terms of credit portfolio of the Nepalese Finance Companies industry. For FY2018, MPFL reported a net profit of NPR 6 million over an asset base of NPR 276 million as of mid-July 2018 vis-à-vis a net profit of ~NPR 7 million during FY2017 over an asset base of NPR 223 million as of mid-July 2017. MPFL's CRAR was 27.54% and gross NPLs were 4.63% as of mid-July 2018. In terms of technology platforms, MPFL uses Micro Banker software.

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About ICRA Nepal Limited:

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