Progressive Finance Limited

ICRA Nepal assigns [ICRANP] IPO Grade 5 to the proposed Rights Issue of Progressive Finance Limited

ICRA Nepal has assigned an "**[ICRANP] IPO Grade 5**", indicating poor fundamentals to the proposed rights issue amounting NRs. 90 million of Progressive Finance Limited (hereinafter referred to as PFL). 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. PFL is proposing to come out with a rights issue of 900,000 numbers of equity shares of face value NRs 100/- each, to be issued to its existing shareholders.

The grading is constrained by PFL's moderate track record, poor assets quality indicators (Gross NPL[1] 20.3% as on April 2014), very low profitability (PAT/ATA & PAT/Net worth of 0.22% and 0.74% respectively in 9M 2013-14), lack of diversity in earnings (fee based income 0.16% of ATA in 9M 2013-14), high credit concentration (top-20 borrowers accounted for 47% of loan book as on April 2014) and geographical concentration risk. In addition, PFL's inferior deposits profile (as reflected in higher concentration of deposits as well as low proportion of CASA deposits) is negative from liquidity perspective as well as leading to higher cost of funds which impacts PFL's competitive positioning, uncertain operating environment. The grading is also constrained by absence of independent directors on the board and lack of Institutional promoters that could have a bearing on the long term performance of PFL and uncertain operating environment. As on April 2014, capital adequacy ratio (CRAR) of PFL stood at 33% as compared to 39% as on July 2013.

The credit portfolio of PFL grew by 14% over 9M 2013-14 and stood at NPR 175 million as on April 2014. The portfolio suffered de-growth in 2012-13 (by 6%) and 2011-12 (by 40%) on account of regulatory restriction[2] on credit expansion. The gross NPL as on April 2014 stood at 20.3% compared to 25.6% as on July 2013, contributed largely by the cases later identified by the regulator as insider lending. Most of these problematic loans have emanated during 2010-11 when high credit growth was reported (80%). The misappropriation cases (5 loan accounts in total) account for over 80% of total NPL of PFL as on April 2014. Poor assets quality over a prolonged duration has led to pressure on profitability indicators, with PFL reporting negative return on assets in 2 out of past 5 years. Although the large NPAs are under recovery process, no major accounts have been recovered yet. Going forward, PFL ability to recover the NPAs will have a bearing on future profitability and assets quality.

Although a National Level Finance Company, PFL at present operates only through its registered office. This localized operation has imposed constraints in deposit mobilization, created risk of geographical concentration of credit and competition from other financial institutions with larger scale of operations. As on April 2014, PFL's credit portfolio stood at NPR 175 million with total deposit base of NPR 259 million. PFL's credit portfolio comprised mainly of Personal Loans (or mortgage loans) (~29% of total portfolio), Trading Loan (~13%), Margin (Share) loan (~12%), Hire purchase

---

[1] Non-performing loans

2 The central bank imposed ban on credit expansion from September 2011 to April 2013 after the issue of poor governance was uncovered

loans (~12%), Housing loan (~11%), Real estate loan (~10%), Business loan (~6%), Deprived sector loan (~4%) and others. Stress has been reported mainly in loan against shares and Real estate loan and incrementally, PFL will look to curtail its exposure in those sectors.

As for funding profile, proportion of low cost deposits remains low at 36% (as on April 2014), below industry average, resulting in high deposit cost (~10% for 2012-13 and 9M2013-14). Incrementally, ICRA estimates PFL's focus to remain on low ticket retail exposures; given the high credit concentration among top borrowers and its impact on assets quality. However, attaining desired credit growth through retail lending might be difficult due to PFL's limited scale of operations and competition from other financial institutions.

PFL has no immediate branch expansion plans. The scalability of business would remain a challenge given promoter's knowledge/reputation limited to local market. While PFL has an advantage in terms of access to retail clients and service turnaround, limited scale of operations pose a challenge.

PFL has not been able to adequately deploy its funds as evidenced by low CD ratio (last 5 years' average of 62% compared to 80% permitted by the regulations). Falling yield on advances, large proportion of idle funds yielding nominal return on investments coupled with high cost of deposits has resulted in lower gross interest spread affecting overall profitability. PFL witnessed a decline in Net Interest Margin (NIMs) in past 2 years, driven by low yield on advances on account of increased liquidity in the system and non realization of income due to increasing NPAs. Falling NIMs combined with increased credit provisioning expense led to PFL reporting Net loss of NPR 28.85 million in 2012-13 and modest profit of NPR 0.57 million in 9M 2013-14. Return on net worth for 2012-13 stood at (-) 28.23% and 0.74% for 9M 2013-14. PFL's earnings profile going forward will largely depend on the ability of the company to regularize the existing NPAs and maintain the quality of incremental credit portfolio.

The shareholding of the company is diversified across over 20 individual promoters with no institutional promoter support. Present shareholding structure comprises 60% promoter holding with 40% holding by general public. PFL has a 5 member- Board of Directors (3 from promoter group & 2 from general public) having moderate experience across Financial Institutions and no independent/professional director at present. The top management has moderate experience across Financial Institutions. There are four committees under the BoD (composed of Directors as well as Management representatives) for oversight in activities related to human resource management, credit control and audit. Overall, the systems and process at PFL are evolving, with moderate internal control mechanisms. As on April 2014, capital adequacy ratio (CRAR) of PFL stood at 33% as compared to 39% as on July 2013.

As per ICRA estimates, the proposed rights issue (if fully subscribed) is likely to meet the capital requirements of PFL for medium term (2 years) at CAGR[3] of 25%[4], with expected capitalization remaining range bound at 35-45%, further deterioration in asset quality indicators notwithstanding. As regards medium term liquidity profile, stress could emanate from low level of savings deposit (~36% on April 2014) compared to industry average and significant proportion (~45%) of term deposits as on April 2014 maturing within 1 year.

3 Compounded Annual Growth Rate
4 Albeit on a low base. Past trend shows higher growth rate which is less meaningful for future growth estimates.

Company Profile
Progressive Finance Limited (earlier known as Merchant Finance Company Limited) is registered as a public company. It was licensed as a class C finance company by the Central bank of Nepal in October 1994 and began its operation from 1995. The registered office of PFL Limited is in Kathmandu.

PFL Limited has market share of about 0.018% in terms of deposit base and 0.016% of total advances in the banking sector in Nepal, as on April 2014. PFL Limited reported a loss of NPR 28.85 million during 2012-13 over an asset base of NPR 339 million as on Jul-13 compared to profit after tax of NPR 8.06 million during 2011-12 over an asset base of NPR 201 million as on Jul-12. During 9M 2013-14, PFL has reported profit after tax of NPR 0.57 million over an asset base of NPR 368 million on April-14.

July 2014

For further details please contact:

Analyst Contacts:
Mr. Sailesh Subedi (Tel No. +977-1-4419910/20)
sailesh@icranepal.com

Relationship Contacts:
Mr. Deepak Raj Kafle (Tel. No. +977-1-4419910/20)
drkafle@icranepal.com