

Rating Rationale
City Express Finance Company Limited

Rating/Grading

Particulars	Amount (Rs. In Million)	Rating/Grading	Rating Action
Rights Share Issue	400.00	CARE-NP IPO Grade 5 [IPO Grade Five]	Assigned

The explanatory notes regarding the Rating/Grading symbols of CARE Ratings Nepal Limited (CRNL) are attached as Annexure 1

CRNL has assigned grading of ‘CARE-NP IPO Grade 5’ to the proposed Rights Share Issue of City Express Finance Company Limited (CEFL). ‘CARE-NP IPO Grade 5’ indicates Poor Fundamentals. CRNL assigns IPO grades on a scale of Grade 1 to Grade 5, with Grade 1 indicating strong fundamentals and Grade 5 indicating poor fundamentals. CRNL’s IPO grading is an opinion on the fundamentals of the issuer. The grade assigned to any individual issue represents a relative assessment of the ‘fundamentals’ of the issuer. CEFL proposes 100% rights share issue of 4 Million number of equity shares of face value of Rs.100 each at par aggregating Rs. 400 Million.

Detailed Rationale & Key Rating/Grading Drivers

The grading assigned to the rights share issue of CEFL is constrained by low market share in the industry, operating losses, substantial decline in PAT during 9MFY19, decline in CASA proportion, and negative reserve and surplus. The grading also factors in high Gross Non-Performing loan (GNPL) although improved as on June 15, 2019 (as per provisional results). The grading is also constrained by geographical concentration, exposure to regulatory risks related to finance industry and competition from other finance companies and banks. The grading, however, derives strength from experienced director and management team, adequate capital adequacy ratio and satisfactory status of the recovery of Non-Performing Loan (NPL) and Non-Banking Assets (NBA). The grading also derives support from strengthened loan & advance and deposit profile during 9MFY19 (refers to 9 months period ended mid April 2019) and comfortable liquidity profile of the company.

Detailed Description of the Key Rating/Grading Drivers

Key Rating/Grading Weakness

Operating losses, substantial decline in PAT during 9MFY19 (UA) and negative reserve and surplus

During FY18, CEFL has earned net profit of Rs.54.96 Mn, despite negative net interest income of Rs 1.85 Mn and operating losses of Rs.31.20 Mn, mainly on the back of write-back of provision for possible losses.

CEFL's net interest income increased to Rs.9.70 Mn during 9MFY19 from Rs (4.55) Mn during 9MFY18 due to increase in interest income (by 202% to Rs.12.42 Mn) on the back of increase in loan & advances, recovery of overdue interest in past and increase in interest income on deposits and decline in interest expenses (by 68.53% to Rs.2.73 Mn). Further, the operating loss increased to Rs.26.22 Mn during 9MFY19 from Rs.19.95 Mn during 9MFY18 due to increase in operating expenses. The PAT of the company declined by 70.78% to Rs.9.49 Mn during 9MFY19 from Rs.32.49 Mn during 9MFY18.

The company had a Networth of Rs (55.68) Mn at the end of FY17 which improved to Rs.214.98 Mn at the end of 9MFY19 due to net profit earned during the period and infusion of additional capital.

High Gross Non-Performing Loans (GNPL) although improved as on June 15, 2019

CEFL's GNPL to total loans was 100% at the end of FY18 (i.e. from July 16, 2017 to July 16, 2018) which substantially improved to 9.58% as on April 13, 2019 (industry, Class „C“ Banks-Finance Companies, GNPL is 9.99% as on April 13, 2019). Further, it is improved to 4.11% as on June 15, 2019. This improvement was due to disbursement of additional loans during the year and recovery as well as write-off of non-performing loans. GNPL in absolute term has been decreasing over the period. It decreased to Rs.15.26 Mn in 9MFY19 from Rs.40.48 Mn at the end of FY18.

Low market shares and inadequate geographical diversification

CEFL market share in terms of loan portfolios and deposit is very low as compared to peers. Its market share in terms of loan portfolio was 0.24% as on April 13, 2019 which improved from 0.07% in FY18. Similarly, its market share in terms of deposit was 0.15% as on April 13, 2019 which too improved from 0.04% in FY18. The company operates in 2 states and 3 districts (out of 7 states and 77 districts of Nepal) through 3 branches (including head office) as on April 13, 2019. It has plans for expansion of new branches during FY20 which may lead in growth of loan portfolio and diversification of operation in new geographical areas.

Exposure to regulatory risks related to Finance industry

The Banking and Finance industry in Nepal is exposed to changes in the various regulatory measures issued by NRB from time to time. In past, finance companies face pressure from NRB capital increment requirement to Rs. 800 Mn from Rs. 200 Mn. NRB has reduced the Statutory Liquidity Ratio (SLR) to 7% from earlier 8%; increased the priority sector lending requirement to 5% from earlier 4%; reduced the overdraft including personal loan of revolving nature to Rs 5 Mn from 7.5 Mn via Monetary Policy issued

by NRB. Also, margin lending nature loan limit decrease to 25% of primary capital from earlier 40% and percentage of deposit allowed to be received from any one institutional depositors reduced to 15% (earlier 20%). Further, the banking industry in Nepal is exposed to changes in the various regulatory measures issued by NRB from time to time.

Competition from other Finance Companies and Banks

As on April 13, 2019 there were 24 finance companies operating with total 203 branches all over Nepal. CEFL has only 3 branches including head office. Industry (Class C Banks-Finance Companies) reported total interest income of Rs. 7,040 Mn in 9MFY19 with Rs. 2,277 Mn net interest income; however, CEFL's share on interest income and net interest income is only 0.18% (Rs. 12.42 Mn) and 0.43% (Rs 9.69 Mn) for the same period. It is challenging for CEFL to expand its business, due to high competition among banks and finance companies, existence of large number of finance companies along with Commercial and Development banks conducting similar kind of businesses with ability to lend at lower interest rate than finance companies.

Key Rating/Grading Strengths

Experienced director and management team

CEFL is operating since March 2006 as Kuber Merchant Finance Ltd. however, it was declared as problematic institution by NRB in FY13. It started its operation with new name and new directors and management team after being released from its 'Problematic institution' status by NRB. The promoter group includes individual promoters, who are associated with City Express Money Transfer Pvt Ltd. (CEMT). It has 6 board of directors and the board is chaired by Mr. Chandra Tandon, Chairman, who is Managing Director of CEMT since 2007, worked in past as Director of Nepal Electricity Authority, Citizen International Bank Ltd., Reliable Finance Ltd, IME Finance Ltd and chairman of City Express Saving and Credit Co-operative Ltd. Other directors have experience in different sector.

The management team is led by Mr. Bhisraj Chalise, since January, 2018. He has been working in many organizations since last 25 years. He had worked as CEO of Kathmandu Capital Markets, Civil Capital Markets; Chief Operating Officer at Kasthamandap Development Bank Ltd., and Assistance General Manager of Ace Development Bank Ltd. He has been assisted by experienced management team.

Adequate capital adequacy Ratio

The Capital Adequacy Ratio (CAR) of CEFL stood at (26.44) % at the end of FY17 as against regulatory requirement of 11% which was improved at the end of FY18 on back of increase in capital fund through accretion of profits and infusion of additional capital. Further, CAR increased to 51.95% as on April 13,

2019 on back of increase in capital fund (by issue of right shares of Rs 250 Mn during FY19, accretion of reserve and surplus by net profit made during 9MFY19).

NRB requires finance companies to maintain minimum paid-up capital of Rs. 800 Mn by mid-July 2017. However, being a problematic institution CEFL is allowed to meet the minimum paid up capital requirement within 2 years from the date of release from the problematic institution status (i.e. Dec 10, 2017). Currently, it has Rs 400 Mn paid up capital which is expected to reach Rs 800 Mn after issue of proposed right shares.

Satisfactory status of recovery of Non-Performing Loan (NPL) and Non-Banking Assets (NBA)

CEFL's NPL decreased to Rs 15 Mn at the end of 11MFY19 from Rs 360 Mn at the beginning of FY16 on account of recovery of NPL (Rs 236 Mn), transfer of NPL to NBA (Rs 142 Mn) and written off NPL (Rs 5 Mn). Further, from FY16 to 11MFY19, the company has realized Rs 70 Mn from NBA.

Strengthened loan & advance and deposit profile during 9MFY19; however, decline CASA proportion

CEFL has Rs 628.39 Mn loan & advances and Rs 496.00 Mn deposit during FY13 (before being declared as problematic). Loans & advances decreased to Rs 40.48 Mn and deposit decreased to Rs 27.75 Mn at the end of FY18. During FY19, the company focused on loans and deposits. Accordingly, the company's loans & advances increased to Rs 159.29 Mn and deposit increased to Rs 106.60 Mn during 9MFY19. However, CASA deposit proportion has been substantially decreased to 59.73% in 9MFY19 from 82.01% in FY18; mainly due to increase in proportion of fixed deposit.

Comfortable liquidity profile

CEFL has comfortable liquidity profile with positive cumulative mismatches as on April 13, 2019 due to well matched tenure of assets and liabilities. Further, it has maintained SLR of 19.37% as on April 13, 2019 against 7% as per NRB norms.

About the Company

CEFL is National Level "C" Class Financial institution incorporated as on August 5, 2005 as a Public Limited Company under the name of Kuber Merchant Finance Limited (KMFL), obtained the license for banking operation from Nepal Rastra Bank and commenced its operation from March 16, 2006. It was declared as problematic institution by Nepal Rastra Bank (NRB) as on January 10, 2013; there by the company is purchased by another promoter group and its name was changed to CEFL on February 27, 2018. CEFL released from problematic institution on December 10, 2017; however, the business expansion program is started from mid July 2018. It is mainly engaged in taking deposits and providing loans and advances as Finance company. The share capital of the company is distributed among promoters and public in the ratio of 55:45.

Analyst Contact

Ms. Apsara Upreti

apsara.upreti@careratingsnepal.com

Tel No.: +977-01-4445473

Relationship Contact

Mr. Sajan Goyal

sajan.goyal@careratingsnepal.com

Tel No.: 9818832909/+977-01-4445472/3/4

DISCLAIMER

CRNL's IPO grading is a onetime assessment and the analysis draws heavily from the information provided by the issuer as well as information obtained from sources believed by CRNL to be accurate and reliable. However, CRNL does not guarantee the accuracy, adequacy or completeness of any information and is not responsible for any errors or omissions or for the results obtained from the use of such information. CRNL's IPO grading does not take cognizance of the price of the security and it is not a recommendation to buy, sell or hold shares/securities. It is also not a comment on the offer price or the listed price of the scrip. It does not imply that CRNL performs an audit function or forensic exercise to detect fraud. It is also not a forecast of the future market performance and the earnings prospects of the issuer; also it does not indicate compliance/violation of various statutory requirements. CRNL shall not be liable for any losses incurred by users from any use of the IPO grading.

Annexure 1

CARE Ratings Nepal – IPO Grading Scale

CARE IPO grade	Definition
CARE-NP IPO Grade 1	Strong fundamentals
CARE-NP IPO Grade 2	Above average fundamentals
CARE-NP IPO Grade 3	Average fundamentals
CARE-NP IPO Grade 4	Below average fundamentals
CARE-NP IPO Grade 5	Poor fundamentals

Note:

Modifiers {"+" (plus)} can be used with the grading symbols 2, 3 and 4. The modifiers reflect the comparative standing within the category.