

**Grading Rationale
Progressive Finance Limited**

Rating/Grading

Facility/Instrument	Amount (Rs. In Million)	Rating/Grading	Rating Action
Rights Share Issue	590.1	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 Progressive Finance Limited (PFL). ‘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. PFL proposes 1:2.81 rights share issue of 5.901 million equity shares of face value of Rs.100 each at par aggregating Rs.590.01 million.

Detailed Rationale & Key Rating/Grading Drivers

The grading assigned to the rights share issue of PFL is constrained by frequent changes in the promoter group and moderately experienced management team albeit long track record leading to small scale of operations, geographical concentration risk, volatile financial and business performances over the period & losses during Q1FY18, competition from other bigger finance companies and banks, high borrower & deposit concentration, declining CASA proportion over the period and exposure to regulatory risk related to finance industry. The grading, however, derives strength from high capital adequacy, good asset quality, albeit increasing trend in Non-performing loans (NPLs), and diversified product portfolio.

Ability of the company to continue its growth momentum without compromising on asset quality and maintaining capital adequacy and ability to manage the impact of any regulatory changes by Nepal Rastra Bank (NRB) would be the key rating sensitivities.

Detailed Description of the Key Rating/Grading Drivers

Key Rating/Grading Weaknesses

Frequent changes in the promoter group and moderate experienced management team albeit long track record leading to small scale of operations

PFL is managed under the overall guidance of the company’s Board of Directors who possesses moderate experience in financial services. Mr. Mukunda Prasad Dahal is the Chairman of the company. Mr. Dahal has served as Director of cooperatives, cooperatives association and is a retired Government of Nepal (GoN) employee. PFL had frequent changes in the promoter group over the period where the promoter group changed four times in the last nine years. Frequently changing promoter group over the period impacted the long term performance and positioning of PFL and created volatile operating environment leading to small scale of operations despite long

track record of operations. However, the financial performance improved in the last 2 years over the previous years. PFL is led by its CEO since May 21, 2015, Mr. Bishal Humagain; having 9 years of experience in financial sector; who is assisted by senior management team members. All the management members have moderate banking and finance experience.

Geographical concentration risk

Despite of long track record of operations (operating since February 1996), PFL has limited geographical coverage; operating only through two branches (including head office). High concentration of loan portfolio has observed on one district only as out of total outstanding loan portfolio of Rs.578.78 Mn as of October 17 2017; 90.43% of total advances has been disbursed from Head Office (Kathmandu District).

Volatile financial and business performances over the period and losses during Q1FY18

Total income of PFL remained volatile over the last 3 years, where the total income declined by 18.55% during FY16 (refers to 12-month period ending mid July 2016) over FY15 and the same increased by 5.31% to Rs. 82.93 million during FY17 over FY16. During FY17, the increase in the total income was majorly due to substantial rise in interest income by 66% on back of growth in advances despite decline in other non-interest income as compared to FY16. Due to high increase in interest income; the net interest income has also increased by 56% during FY17 to Rs.30.46 million. Total Income/Average Total Assets of PFL was 10.99% during FY17 (P.Y: 13.93%) which is comparable to industry's Total Income/Average Total Assets of 9.17%.

The yield on advances and Net Interest Margin (NIM) also been volatile in the last 3 years, where both declined substantially during FY16 and improved to certain extent during FY17. During FY17, the yield on advances increased by 126bps to 12.79% and the cost of deposits increased by 209bps to 8.09% mainly due to increasing term deposits and declining CASA deposits. Despite high increase in cost of deposits as compared to increase on yield on advances; Net Interest Margin (NIM) increased to 4.04% during FY17 as compared to NIM of 3.45% during FY16; due to low growth of total deposits (2.49%) as compared to high growth in advances (36.16%). The net profit of PFL declined by 20.86% Y-o-Y to Rs.16.58 million in FY17 on the back of increase in the provision for loan loss, decline in other income and higher income tax provision.

In Q1FY18, PFL's total income has increased by 55% to Rs.26.54 million in comparison to Rs.17.18 million during Q1FY17. However, PFL incurred loss of Rs.8.95 million during Q1FY18 (profit of Rs.2.03 million during Q1FY17) due to higher increase in interest expenses and provision for possible losses as compared to Q1FY17. The GNPL% increased to 2.44% as on October 17, 2017 from 1.67% as on July 15, 2017.

High concentration on top 20 borrowers and depositors

PFL have high deposit concentration as top 20 depositors constitutes 45% and top 10 depositors account for 34% of total PFL's deposits and 45.51% of loan portfolio comprises top 20 loan accounts as on July 15, 2017.

Declining CASA ratio

CASA deposits proportion has substantially decreased from 73% as on July 15, 2016 to 45% as on July 15, 2017. However, PFL maintained adequate & better CASA ratio as compared to industry average of 36% as on July 15, 2017. Term deposit/Total deposits substantially increased from 24% as on July 15, 2016 to 55% as on July 15, 2017 (Industry avg. term deposit/total deposit for July 15, 2016 and July 15, 2017 is 38.80% & 47.66% respectively), which resulted in higher cost of funds.

Key Rating/Grading Strength

High Capital Adequacy

Tier I Capital Adequacy Ratio (CAR) of the PFL stood at 31.48% as on July 15, 2017 (P.Y.: 34.84%) and overall CAR stood at 32.46% (P.Y.: 35.72%) as against the regulatory requirement of 5.5% and 11% respectively as per NRB directives (Industry Average Tier I and Overall Capital adequacy is 20.21% and 21.19% for FY17). PFL maintained high CAR over the period. As per NRB, finance companies can accept deposits upto fifteen times of their core capital fund and can lend 80% of core capital and deposits. As of July 15, 2017, PFL has accepted deposits only 2.58 times of their core capital and lend 78.15% of core capital and deposits. Due to low business (deposits & advances) as compared to core capital the CAR seems high. As of October 17, 2017, total CAR declined marginally to 32.14% and Tier I CAR to 31.22%. CAR is expected to improve on back of proposed right shares issue.

Good Asset quality; however, increasing trend in NPLs

PFL's Gross NPL% to the total loans was 0.98% as on October 17, 2016 which gradually increased to 1.67% on July 15, 2017 (industry average for Mid-July FY17 is 13.37%) and has further increased substantially to 2.44% on October 17, 2017 (industry average for Mid Oct, FY18 is 13.23%). There was increase in absolute amount of Gross NPLs from Rs. 7.12 million as on July 15, 2016 to Rs. 10.10 million as on July 15, 2017. Despite NPLs seems increased during current period, the management of the company is able to reduce the NPLs vividly over the period (Gross NPL was 25.41% as on mid July 2013, 16.31% as on mid July 2014, 2.90% as on mid July 2015).

Diversified Product Portfolio Distribution

The gross loan portfolio of the company has grown by 35% (albeit small base) to Rs. 605 million at the end of FY17 from Rs. 447 million at the end of FY16. However, as per UA results of Q1FY18, the loan portfolio of the company has declined by 4.36% in 3 months to Rs. 579 million. PFL has diversified portfolio distribution which consists of various types of loan disbursed over the period for various Industry/Sector such as agriculture, forestry & beverage production related; construction; metal products, machinery, transport, communication and public utilities; wholesaler & retailer trade; financial institutions, hotel or restaurant, hospital, and educational services.

About the Company

Progressive Finance Limited (PFL) is National Level “C” Class Licensed Institutions (Finance Company) from Nepal Rastra Bank (NRB) with not accepting Call & Current deposits. It was incorporated on September 30, 1994 as Merchant Finance Limited; later its name was changed to PFL in 2010. PFL commenced its operation on February 26, 1996 under Bank and Financial Institution Act 2006. The company is listed in Nepal Stock Exchange w.e.f. March 01, 2009. Promoter of PFL holds 51% of total shares and 49% is held by general public. The market share of PFL in terms of deposit base is 1.05% as of Mid-July 2017 and 1.18% as of Mid Oct 2017; for loan portfolio it is 1.23% as of Mid-July 2017 and 1.16% as of Mid Oct 2017 of industry (Class “C” Banks-Finance Companies).

Monetary Policy 2015-16 issued by NRB provisioned Finance Companies would have to increase minimum paid-up capital from existing Rs. 200 million to Rs. 800 million by mid-July 2017. The paid-up capital of the company was Rs. 210 million as on July 15, 2017. After the proposed right share issue of Rs. 590.1 million; the total paid-up capital of the company is expected to reach at Rs. 800.1 million.

The bank has achieved PAT of Rs.16.58 million on an asset size of Rs. 779 million as on July 15, 2017 (UA) as against PAT of Rs. 20.95 million on an asset size of Rs.735 million as on July 15, 2016. Further, PFL incurred loss of Rs. 8.95 million during Q1FY18

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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.