Central Finance Limited

ICRA Nepal assigns [ICRANP] IPO Grade 5 to the proposed Equity Shares (Rights Issue) of Central Finance Limited

Facility/Instrument	Issue Size	Grading Action (December 2017)
Rights Share Issue	NPR 260.33	[ICRANP] IPO Grade 5 (Assigned)

ICRA Nepal has assigned "**[ICRANP] IPO Grade 5**", indicating poor fundamentals to the proposed rights issue amounting NPR 260.3314 million of Central Finance Limited (CFCL). 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. CFCL is proposing to come out with 50% rights issue of 2,603,314.08 numbers of equity shares of face value NPR 100/- each, to be issued to its existing shareholders at par. The proposed issue is being made to augment the capital base and is a step towards ensuring revised (higher) paid up capital requirement set by Nepal Rastra Bank (NRB), the banking sector regulator.

The lowest IPO grade reflects CFCL's weak assets quality (delinquencies were ~42% as of Jul-17 which spiked to ~65% as of mid-Oct-17[1] while reported gross NPLs remained low at ~2%[2]) and moderate growth trend in advances so far (CAGR ~10% over last five years vs. ~20% for banking industry) resulting in much smaller asset base despite track record of more than 20 years in banking industry. Despite CRAR being strong at ~27% as of mid-Oct-17, which will further get augmented post the right issue, alignment of asset classification with NRB norms may jeopardize the capital ratios and profitability hence ability to purse future growth. Low franchise (seven branches as on mid-Oct-17) despite being a national level player also weakens the competitive positioning of the company and creates challenges in incremental growth prospects. If the asset quality improves going forward, CFCL would benefit from moderate cost of funds among peers emanating from fair CASA profile (~54% as on mid-Jul-17 against ~36% for industry). The grading also takes into consideration the uncertain operating environment that the banks in Nepal are currently facing and also the relatively weak competitive positioning of CFCL, vis-à-vis commercial and development banks with finer lending rates, leading to relatively inferior borrower profile of CFCL.

The credit portfolio of CFCL grew with compounded annual growth rate (CAGR) ~10% over last five years (ending Jul-17) while the deposit base grew by CAGR ~8% over the same period vs. ~17% growth for the banking industry. As for funding profile, CFCL had CASA of 54% as of mid-Jul-17 vs. industry average of ~36%; however, this remains to be reflected in cost of funds which remain higher than industry average (6.83% vs. 6.11% for FY2017). Credit concentration however remain moderate at ~13% while deposit concentration remains higher at ~26% among top 20 customers. As on mid-Oct-17, CFCL's credit portfolio stood at NPR 2,351 million on a total deposit base of NPR 2,871 million, resulting in low credit to core capital and deposit (CCD) ratio of ~65%. Though the CCD currently remains lower vs. regulatory cap of 80%, ability to achieve adequate deposit growth to support targeted high portfolio growth (~27% over medium term) remains to be seen. Additionally, achieving business growth in the competitive banking industry with fair borrower profile will remain major challenges for the company going forward given its relatively higher cost of deposits.

In the past, CFCL has reported high slippages (~3% for last four years) while recoveries remained moderate; delinquencies however remained much higher (42% for Jul-17 increased to 65% for Oct-17). Reported NPLs of 1.87% as of mid-Oct-17 do not include revolving loan where interest is overdue for more than three months as NPLs. With revolving loans accounting for ~60% of total loan book, the reported NPLs do not capture the true asset quality position of CFCL. This also results in the company reporting better profitability due to lower provisioning on such overdue accounts, not currently captured as NPLs. Given CFCL's geographical concentration of advances coupled with significant delinquencies,

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[1] Mid-Jul-17 and Mid-Oct-17 both data are unaudited.

[2] Reported Gross NPLs (Non-Performing Loans) however, does not include NPL in revolving loan due to interest overdue, factoring which actual Gross NPLs are ~7.5% on mid-Oct-17 as per ICRA Nepal estimates. Further, reported NPLs are benefited by regulatory forbearance provided by NRB on NPL recognition (only installment can be recognized as NPLs until overdues exceed by more than one year), disregarding which Gross NPLs were ~17% on same date.

relatively weaker borrower profile and assessed income based lending, asset quality is expected to remain under stress going forward.

Profitability indicators of CFCL, despite improvement in recent years, remains weaker among peers and the industry average. Return on net worth of CFCL was ~10% in last four years vs. ~23% for industry while average return on assets was ~1.9%. Despite low CCD ratio in last few years (~60-65%), reported profitability remains supported by moderate NIMs among peers (4.46% for FY2017) which however has witnessed much stress in Q1FY2018 (1.31%) amid increased delinquencies. Profitability profile over medium term will be largely determined by the ability of the management to downsize the delinquencies and maintain the quality of incremental credit portfolio.

CFCL's reported capitalization remains much higher compared to regulatory minimum (CRAR of ~27% vs. minimum requirement of ~11%) which would be further boosted after proposed issue. High capital cushion could however absorb the losses in the event of stress in asset quality and profitability after fair reporting and provisioning of NPLs. After the proposed issue, CFCL would remain slightly short of the revised minimum capital requirements set by NRB (NPR 800 million vs. ~NPR 781 million capital of CFCL after rights issue, assuming full subscription).

Company Profile

Incorporated in April 1996, Central Finance Limited (CFCL) is a national level "C" class financial institution. The company merged with another finance company viz. Bhaktapur Finance Company Limited in March 2017. CFCL's current promoter base consists of 117 individual promoters involved in different professions with maximum shareholding by an individual at 8.27% as of mid-July-2017. The promoter: public shareholding ratio of the company stands at ~53:47. Its head office is located at Kupondole, Lalitpur. CFCL's equity shares are listed in Nepal stock exchange. Mr. Rajoj Man Shrestha is the CEO of the company.

CFCL has operations spread over seven districts of Nepal through its seven branches as of mid-Oct-17. CFCL has market share of 4.91% in terms of credit portfolio and 5.24% in terms of deposits of finance companies' industry as of mid-Jul-17. CFCL has reported a net profit of ~NPR 91 million during 2016-17 over asset base of NPR 3,553 million as of mid-Jul-17 as against net profit of NPR 84 million during 2015-16 (on combined basis for both pre-merger entities) over asset base of NPR 3,084 million as of mid-Jul-16. For Q1FY2018, the company reported net profit of NPR 2 million over asset base of NPR 3,745 million as of mid-Oct-17. CFCL's reported capitalization (CRAR) was 27.17% and reported Gross NPA was 1.87% as of mid-Oct-17. In technology front, CFCL uses Pumori IV across all its branches.

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