ICRA Lanka reaffirms the ratings of Alliance Finance Company PLC

December 02, 2019

Instrument	Rated Amount (LKR Mn)	Rating Action
Issuer rating	N/A	[SL]BBB- (Negative); Reaffirmed
Senior Unsecured Redeemable Debenture Programme	800	[SL]BBB- (Negative); Reaffirmed
Senior Unsecured Redeemable Debenture Programme	200	[SL]BBB- (Negative); Withdrawn

Rating action

ICRA Lanka Limited, subsidiary of ICRA Limited, a group company of Moody's Investors Service, has reaffirmed the issuer rating of Alliance Finance Company PLC (AFCP or the Company) at [SL]BBB- (Pronounced SL triple B minus) with Negative outlook. ICRA Lanka has also reaffirmed the rating for LKR 800 Mn Senior Unsecured Redeemable Debentures at [SL]BBB- (Pronounced SL triple B minus) with Negative outlook.

ICRA Lanka has withdrawn the issue ratings of [SL]BBB- (Pronounced SL triple B minus) with Negative outlook for the LKR 200 Mn Senior Unsecured Redeemable Debentures, at the request of the company, as the same have been fully redeemed.

Rationale

The continued Negative outlook factors in the sustained weakening in asset quality with gross NPAs increasing to 10.03% in Sep-19 from 7.69% in Mar-19 (4.34% in Mar-18). Correspondingly, the solvency ratio weakened to 28.12% in Sep-19 as compared to 22.78% in Mar-19 and 12.27% in Mar-18. ICRA Lanka notes that the 90+ days past due (dpd) increased steeply to 21.42% in Sep-19 as compared to 17.17% in Mar-19 (8.28% in Mar-18), indicating further possible stress. The Company has taken initiatives to improve its loan appraisal, collection and monitoring processes, the impact of the same on the asset quality however remains to seen. The Tier-1 capital adequacy ratio decreased to 9.77% in Sep-19 as compared to 9.86% in Mar-19 (9.35% in Mar-18) while the Total Capital Adequacy Ratio increased to 13.20% as in Sep-19 as compared to 11.93% as in Mar-19 (12.37% in Mar-18) as CBSL granted approval to recognize the revaluation reserves of LKR 506 Mn under tier II capital. The earnings profile was impacted by the increasing credit cost; RoA declined to 0.90% for 6MFY2020 from 0.96% in FY2019 (2.36% in FY2018). AFCP's portfolio growth slowed down during FY2019 (6%) and 6MFY2020 (4%, annualized) as compared to FY2018 (10%), as the Company tightened lending norms and shifted focus towards asset backed lending (90% of the portfolio was secured as in Jun-19). The gearing (adjusted for revaluation reserves) increased to 7.7 times as in Jun-19 from 7.2 times in Mar-19 (7.9 times in Mar-18).

The ratings however factor AFCP's established track record, a fairly diversified lending and borrowing profiles and its adequate liquidity profile.

Outlook: Negative

The Negative outlook reflects the modest asset quality and earnings profile in view of the build-up in the softer bucket delinquencies. The outlook may be revised to 'Stable' in case of steady improvement in AFCP's delinquencies and profitability over the medium term. The ratings may be downgraded in case of further deterioration in asset quality by way of forward movement of delinquencies into harder buckets and in case of weakening in solvency, liquidity or earnings profile.

Key rating drivers

Credit strengths

Established track record; experienced Board and senior management team; AFP is one of the oldest finance companies in Sri Lanka with an established track record of more than 60 years. The promoter group is Mr. R.K.E.P De Silva and family which holds close to 53% stake. AFP operates in 71 locations staffed with 1,200 employees. The board of the Company comprises of eight directors including four non-executive directors. The board includes a mix of experienced and professionally qualified executive directors overlooking operations, finance, marketing and sustainability aspects. The executive directors provide direction to the management which comprises of experienced and qualified team. The Company is presently undergoing a restructuring programme with the assistance of IFC, which is expected to improve the credit origination, credit appraisal, portfolio management, collections and recovery functions of the Company.

Fairly diversified portfolio shifting to asset backed lending: The Company's key products are leasing, which accounts for 74% of the total portfolio as on June 30, 2019, followed by other loans (17%), gold loans (5%) and micro finance (3%). In terms of asset classes, 3-wheeler (29%), car financing (20%), lorry (10%), and van financing (7%) were the key constituents of AFP's portfolio as in Jun-19. The portfolio is shifting towards vehicle financing, with close to 78% of the portfolio backed by vehicles as in Jun-19 as compared to 77% in Mar-19 and 72% in Mar-18. ICRA Lanka notes that the portfolio growth is expected to remain at about 15% over the near to medium term with focus on 3-wheeler, 4wheeler, 2wheeler and gold loans.

Adequate capitalisation profile: AFP reported a core capital ratio of 9.86% as in Mar-19 as compared to 9.35% as in Mar-18, the same was 9.77% in Jun-19. The ratio moderated with the implementation of CBSL's new capital computation with effect from July 2018. The total capital adequacy ratio, improved to 13.20% as in Sep-19 as compared to 11.93% as in Mar-19 (12.37% in Mar-18) with the recognition of revaluation reserves of LKR 506 Mn under tier II capital. Presently, the Company is maintaining adequate margin above the core and total CAR ratios as compared to the regulatory requirements of 6% and 10%. AFP's core capital stood at about LKR 3,279 Mn as in Sep-19 as compared to the regulatory minimum capital requirement of LKR 1,500 Mn. The Company's present core capital meets the future regulatory requirement till Jan-21. ICRA Lanka does not envisage any external capital requirements for the Company for the next two years. However, the Company may need fresh capital infusion in 2022, in a case of continuous slippages in its lending portfolio or if the loan book grows at about 15% as envisaged by the management. The Company reported a gearing of 6.0 times in Sep-19. The Company's adjusted gearing for revaluation reserves stood high at 7.7 times during the same period.

Diversified funding base and comfortable liquidity profile; AFP has a fairly diversified funding profile comprising of retail fixed deposits, debentures and term loans from banks. As in Jun-19, around 46% of the Company's funding was from deposits, while the balance was from foreign funding agencies, bank loans and debentures. The Company reported foreign borrowing of LKR 5.5 Bn which accounts for 43% of the total borrowings (excluding fixed deposits) in Jun-19. The management has taken measures to hedge the foreign exchange risk of the Company. Going forward, the Company's funding composition would maintain at 50:50 share between deposits and other borrowings. ICRA Lanka notes that Top 10 depositors accounted for 13% of the Company's total deposits as on June 30, 2019 indicating concentration in its deposits profile. However, access to diversified funding lines and healthy deposit renewal rate of 85% provides comfort from a liquidity perspective. The short term (less than 1 year) ALM mismatch moderated to 1.12% as in Jun-19 as compared to 3.95% as in Jun-18. As compared to peers, the Company maintains a healthy liquidity profile. ICRA Lanka noted that significant debt-repayments of around LKR 3.0 Bn are due in November and December 2019. The Company's LKR 2.8 Bn unutilised funding lines provide comfort on the same.

Credit challenges

Deterioration in asset quality and solvency ratio; The Company's gross NPA ratio increased to 7.69%as in Mar-19 from 4.34% in Mar-18, and it further increased to 10.03% in Sep-19. Gross NPA of the Company was slightly higher than the system average of 9.23% as in Jun-19. Reason for high NPAs was due to high slippages reported on the micro finance and the business loan (Working Capital and Mortgage loans) portfolios. The micro finance portfolio slippages increased post the government's announcement on loan write off as a relief for the flood affected borrowers in Jun-18. The Business loan portfolio was affected due to shortcomings identified in credit operations of the Company; ICRA Lanka takes note of the steps taken by the management to strengthen the credit evaluation and operations processes. The net NPA ratio stood at 3.79% as in Jun-19 as compared to 2.99% in Mar-19 (1.57% in Mar-18). AFP's Net NPA ratio was higher than the systematic average of 2.93% as in Jun-19. However, the provision coverage ratio of the Company was 59% as in Jun-19 as compared to the systematic average of 58% during the same period. Portfolio delinquencies in the softer buckets (30+,60+ and 90+ dpd) have been under stress since FY2018. Going forward, ICRA Lanka expects improvement in the same in the medium term due to initiatives such as the establishment of Tele-Collection center and the Delinquency Management system. The solvency ratio [1]of the Company increased sharply over the last two years to 28.12% in Sep-19 as compared to 22.78% in Mar-19 and 12.27% in Mar-18. ICRA Lanka notes that the ability of the Company to control the slippages of mortgage and working capital loans and its ability to control the delinquencies of the softer buckets will be key monitorable.

Moderating profitability; AFCP's yield has been maintained at 26.07% in FY2019 as compared to 25.52% in FY2018. Cost of funds moderated to 12.48% in FY2019 as compared to 12.74% in FY2018 with the diversification of funding into foreign funding sources that offer more competitive terms. As a result, NIM improved to 11.23%in FY2019 from 10.59% in FY2018. The operating cost/ATA increased to 7.39% in FY2019 from 7.08% in FY2018 as a result of increased direct government levies imposed on the financial sector. ICRA Lanka noted that the credit cost/ ATA increased to 2.55% in FY2019 as compared to 1.66% in FY2018 and same has further increased to 3.54% during H1FY2020. AFCP's profitability (return on average assets) reduced to 0.96% inFY2019 as compared to 2.36% in FY2018 and it remained at 0.90% in Q1FY2020. Profitability of the Company moderated largely because of the increased credit costs. Ability of the Company to improve its profitability going forward would be crucial.

Analytical approach: For arriving at the ratings, ICRA Lanka has applied its rating methodologies as indicated below**.**

Links to applicable criteria: [ICRA Lanka's Credit Rating Methodology for Non-Banking Financial Institutions]

About the Company:

Alliance Finance Company PLC is one of the oldest finance companies in Sri Lanka with a history of over 60 years. The key shareholders of the Company include Mr. R.K.E.P De Silva (26.51%), Motor Service station (Pvt) Ltd (13.48%), Ms. D.M.E.P Perera (7.42%) and Mr. J.E.P.A De Silva (6.24%). The Company extends leasing, hire purchase, micro finance, gold loans and other loans. The Company has close to 40,000 customers through a network of 71 customer locations and, has over 1,200 employees. Alliance Finance Company PLC has investments in subsidiary Alfinco Insurance Brokers (Pvt) Ltd (63.94%) and an associate entity, Macbertan (Pvt) Ltd (11.80%).

During FY2019, AFCP reported a PAT of LKR 306 Mn on a total asset base of LKR 31.8 Bn as compared with a PAT of LKR 728 Mn on a total asset base of LKR 31.8 Bn in the previous financial year. During 6MFY2019, AFCP reported a PAT of LKR 148 Mn on a total asset base of LKR 33.3 Bn

---

[1] Solvency ratio = Net NPA/ Networth adjusted to revaluation reserves

During FY2018, AFCP Group reported a PAT of LKR 333 Mn on a total asset base of LKR 32.2 Bn as compared with a PAT of LKR 707 Mn on a total asset base of LKR 31.9 Bn in the previous financial year. During 6MFY2020, AFCP reported a PAT of LKR 167 Mn on a total asset base of LKR 33.4 Bn.

Key financial indicators

	FY2018	FY2019	6MFY2020	6MFY2019
Net Interest Income	3,272	3,589	1,967	1,802
Profit after Tax	728	306	148	192
Net worth	4,299	4,510	4,624	4,347
Loans and Advances, net	25,494	25,366	26,015	24,579
Total Assets	31,781	32,132	33,348	31,577
Return on Equity	17.42%	6.95%	6.48%	8.96%
Return on Assets	2.36%	0.96%	0.90%	1.21%
Gross NPA	4.34%	7.69%	10.03%	6.68%
Net NPA	1.57%	2.99%	n/a	3.84%
Capital Adequacy Ratio	12.37%	11.93%	13.20%	11.92%*
*Gearing (times)	6.03	5.58	6.01	5.87
Gearing (adjusted for revaluation reserves)	7.91	7.21	7.71	7.51
Solvency Ratio (Net NPA/Net worth adjusted for revaluation reserves)	12.27%	22.78%	28.12%	28.96%

Rating history for last three years:

Instrument	Chronology of Rating History for the past 3 years					
	Type	Amount Rated (LKR Mn)	Date & Rating FY2020 Dec 2019	Date & Rating FY2019 Oct 2018	Date & Rating in FY2018 Sep 2017	Date & Rating in FY2016 -
Issuer rating	N/A	N/A	**[SL]BBB- (Negative)**	**[SL]BBB- (Negative)**	**[SL]BBB- (Stable)**	**N/A**
Senior Unsecured Redeemable Debentures	Long Term	800	**[SL]BBB- (Negative)**	**[SL]BBB- (Negative)**	**[SL]BBB- (Stable)**	**N/A**
Senior Unsecured Redeemable Debentures	Long Term	200	**[SL]BBB- (Negative) Withdrawn**	**[SL]BBB- (Negative)**	**[SL]BBB- (Stable)**	**N/A**

ANALYST CONTACTS

Mr. Dasith Fernando
+94 11 4339907
dasith@icralanka.com

Mr. Sahil Udani
+91 22 61143429
sahil.udani@icraindia.com

RELATIONSHIP CONTACT

Mr. W. Don Barnabas
+94 11 4339907
wdbarnabas@icralanka.com

Subsidiary of

ICRA Limited

A Group Company of Moody's Investors Service

CORPORATE OFFICE
Level 10, East Tower, World Trade Center, Colombo 01, Sri Lanka
Tel: +94 11 4339907; Fax: +94 11 2333307
Email: info@icralanka.com; Website: www.icralanka.com

ICRA Lanka ratings should not be treated as recommendation to buy, sell or hold the rated debt instruments. ICRA Lanka ratings are subject to a process of surveillance, which may lead to revision in ratings. An ICRA Lanka rating is a symbolic indicator of ICRA Lanka's current opinion on the relative capability of the issuer concerned to timely service debts and obligations, with reference to the instrument rated. Please visit our website www.icralanka.com or contact ICRA Lanka's office for the latest information on ICRA Lanka ratings outstanding. All information contained herein has been obtained by ICRA Lanka from sources believed by it to be accurate and reliable, including the rated issuer. ICRA Lanka however has not conducted any audit of the rated issuer or of the information provided by it. While reasonable care has been taken to ensure that the information herein is true, such information is provided 'as is' without any warranty of any kind, and ICRA Lanka in particular, makes no representation or warranty, express or implied, as to the accuracy, timeliness or completeness of any such information. Also, ICRA Lanka or any of its group companies may have provided services other than rating to the issuer rated. All information contained herein must be construed solely as statements of opinion, and ICRA Lanka shall not be liable for any losses incurred by users from any use of this publication or its contents