

## ICRA Lanka reaffirms the issuer rating of Alliance Finance Company PLC

December 09, 2021

Instrument	Rated Amount (LKR Mn)	Rating Action
Issuer Rating	N/A	[SL]BBB- (Negative); Reaffirmed

### Rating action

ICRA Lanka Limited has reaffirmed the Issuer Rating of Alliance Finance Company PLC (AFC or the Company) at [SL]BBB- (Pronounced SL triple B minus) with Negative outlook.

### Rationale

The rating reaffirmation factors in AFC's established track record, diversified funding base and increased asset backed lending exposure, as well as its adequate capital and liquidity profiles. During the period under review, ICRA Lanka notes that AFC was able to achieve marginal growth of 1.62% in its portfolio in FY2021 and 2.45% in the 3MFY2022 despite the challenging macro environment, while continuing to focus on asset backed lending (98% of the portfolio was secured as of Jun-21).

The Negative outlook factors in the continued pressure on asset quality due to the non-conducive macro environment. The gross NPA of the company improved to about 8.43% in Mar-21 from about 11.10% in Mar-20, however, increased to 10.57% by Jun-21 with the impact of the 3rd and 4th waves of the pandemic. ICRA Lanka notes that the management was able to reduce the same to 8.87% by Jul-21. 90+ days past due (dpd) also improved to 22.38% in Mar-21 as compared to 30.49% in Dec-20 (27.46% in Mar-20) but increased to 30.69% in Jun-21. The same improved to 24.43% by Jul-21. AFC was somewhat successful in controlling the slippages into the 180+ days past due. ICRA Lanka also notes that the NPA increase during Jun-21 is inline par with the asset quality trend in the NBFIs sector. The rating also takes cognizance of the initiatives taken by the company to improve its loan appraisal, collection and monitoring processes with the technical assistance programme of International Finance Corporation (IFC) and the impact of the above on asset quality is seen in Mar-21. The earnings profile improved in FY2021 as a result; ROA increased to 1.65% in FY2021 from 0.63% in FY2020 (0.96% in FY2019), however, moderated to 0.33% in the 3MFY2022.

### 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 AFC's delinquencies and profitability over the medium term. The rating 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:** AFC is the oldest finance company 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, who holds close to 34% of the stake. AFC operates with 42 fully fledged branches, 11 gold centers and 38 collection centers staffed with over 1,300 employees as of Mar-2021. 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 an experienced and qualified team. The company underwent a restructuring programme with technical assistance from IFC and has largely improved the credit origination, credit appraisal, portfolio management, collections and recoveries of the company. The company has a good track record of obtaining funding from reputed DFIs such as IFC, DWM and FMO.

**Higher exposure to asset backed lending:** As in July 2021, AFC's portfolio almost entirely consisted of asset-backed lending consisting of leasing, gold and other loans; leasing accounted for around 69% of the total portfolio, gold loans accounted for 12% and the remaining was accounted for by other loans. The key asset classes within the leasing portfolio continue to be 3Ws, cars and lorries which accounted for over 67% of the total portfolio as at Jul-21. High risk unsecured products such as micro finance loans have been phased off by the management and growth is expected mainly from 3Ws, gold loans and certain 4W asset classes.

**Comfortable capitalisation profile:** As on Jun-21, AFC reported a total net worth of LKR 5,832 Mn against a regulatory requirement of LKR 2,000 Mn. In terms of risk-weighted capital adequacy ratios, the core capital and the total capital ratio stood at 11.38% and 14.00% as on Mar-21 (9.94% and 12.63% respectively as on Dec-20) as compared with the regulatory requirement of 6.50% and 10.50%. Going forward, it will be important for AFC to maintain a healthy capitalization profile as it intends to grow its portfolio aggressively.

**Diversified funding base:** AFC has a fairly diversified funding profile comprising of retail fixed deposits, debentures and term loans from banks. As of Mar-21, around 50% of the company's funding was from deposits, while the balance was through foreign funding agencies, bank loans and debentures; around 73% of the NBFIs sector funding base is from public deposits. As in Mar-21, AFC had a relatively smaller short term ALM mismatch of -5.35%, due to its long-term funding profile. ICRA Lanka notes that the company has a sizable exposure (13% of the funding base) to foreign borrowings; however, these forex liabilities are hedged through back-to-back arrangements and currency swaps. Going forward, management indicates that in the short to medium term, deposit funding would be reduced, as the company is increasingly reliant on long term funding sources.

## Credit challenges

**Moderate profitability:** The core margins of AFC improved from 10.59% in Dec-20 (10.82% in Sep-20) to 12.52% in Mar-21 and 12.47% in Jun-21 as a result of a sharper fall in cost of funds as opposed to asset yields in FY21. Cost of funds fell as a result of reduced interest rates and reduction in overall total borrowings. The operating cost/ATA reduced to 6.79% as at Jun-21 from 7.55% as at Mar-21 and 7.67% as at Mar-20 due to cost efficiencies created by work from home initiatives and economies of scale. Therefore, AFC's PBT/ATA improved to 3.81% in FY21 (from 1.61% in Mar-20) however moderated to 0.64% in the 3MFY2022 on account of increased credit costs, as the company has revised its provisioning policy as a step towards adopting the upcoming regulatory changes on NPA recognition. ICRA Lanka notes that this policy change has contributed close to LKR 300 Mn in additional provisioning during the period. AFC reported a PAT of LKR 561 Mn in FY21, vis-à-vis LKR 209 Mn in FY20; for the Q1FY22, the PAT was 28 Mn. ICRA Lanka notes that the overall profitability indicators of the company is likely to remain moderate as the room for margin expansion is quite limited in the competitive vehicle leasing market.

**Improved asset quality indicators, but remains under pressure:** AFC's gross NPA ratio improved to about 8.43% in Mar-21 from about 11.10% in Mar-20. However, the same increased to 10.57% by Jun-21 due to

lockdowns and the impact of the third and fourth waves of the pandemic. However, ICRA Lanka notes that the management was able to bring-down the NPAs to 8.86% by Jul-21. The improved GNPA ratio during FY21 was due to the focused efforts in collection and recoveries together with better credit quality being achieved following the IFC restructuring programme. Further, ICRA Lanka notes that higher GNPA ratios are present in product classes that are currently being phased out by the company. The growing asset classes such as gold loans and 3Ws reported a GNPA of 0.23% as in Jul-21, vis-à-vis 0.30% in Jun-21 (0.23% as at Mar-21) and 5.56% as in Jul-21, vis-à-vis 7.28% as in Jun-21 (4.17% as at Mar-21) respectively. The collection levels remained healthy with significant collections noted as soon as lockdowns were removed. Improvements in delinquency levels noted in Jul-21 with recovery efforts after 90+ days being somewhat successful in controlling the slippages into the 180+ days bucket. ICRA Lanka notes that the ability of the company to control the slippages of phasing out products and its ability to control the delinquencies of the softer buckets will be key monitorable given the current challenging macro outlook.

**Analytical approach:** For arriving at the ratings, ICRA 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 the oldest finance company in Sri Lanka with a history of over 60 years. The key shareholders of the Company include Mr. R.K.E.P De Silva (33.64%), Motor Service station (Pvt) Ltd (13.48%), Ms. D.M.E.P Perera (7.42%) and Mr.D.F.W.S.K. Perera (4.10%) as of Sep-20. The Company grants leasing, hire purchase, micro finance, gold loans and other loans. The Company has close to 103,000 customers through a network of 91 customer locations and has over 1,300 employees as of Mar-21. Alliance Finance Company PLC has investments in subsidiary Alfinco Insurance Brokers (Pvt) Ltd (63.94%) and an associate entity, Macbertan (Pvt) Ltd (22.45%) as of Mar-21.

During FY2021, AFC reported a PAT of LKR 561 Mn on a total asset base of LKR 34.12 Bn as compared with a PAT of LKR 209 Mn on a total asset base of LKR 33.95 Bn in the previous financial year. During 3MFY2022, AFC reported a PAT of LKR 28 Mn on a total asset base of LKR 33.78 Bn.

During FY2021, AFC Group reported a PAT of LKR 596 Mn on a total asset base of LKR 34.28 Bn as compared with a PAT of LKR 240 Mn on a total asset base of LKR 34.09 Bn in the previous financial year. During 3MFY2022, AFC Group reported a PAT of LKR 37 Mn on a total asset base of LKR 33.99 Bn.

## Key audited financial indicators

	FY2018	FY2019	FY2020	FY2021	3MFY2022*
Net Interest Income	3,272	3,589	3,891	4,260	1,058
Profit after Tax	728	306	209	561	28
Reported net worth	4,299	4,510	4,613	5,816	5,832
Loans and Advances	25,494	25,366	26,244	26,614	26,763
Total Assets	31,781	32,132	33,945	34,122	33,777
Return on Equity	17.42%	6.95%	4.59%	10.76%	1.91%
Return on Assets <sup>1</sup>	2.36%	0.96%	0.63%	1.65%	0.33%
Gross NPA ratio	4.34%	7.69%	11.10%	8.43%	10.57%
Net NPA ratio (based on IFRS provisioning)	1.57%	3.14%	4.50%	1.44%	1.76%
Core CAR	11.60%	9.86%	9.76%	11.38%	11.52%
Adjusted Gearing (times) <sup>2</sup>	6.04	5.77	6.03	4.50	4.47

\*Unaudited

## Rating history for the last three years:

Instrument	Current Rating			Chronology of Rating History for the past 3 years		
	Type	Amount Rated (LKR Mn)	Date & Rating FY2022	Date & Rating FY2021	Date & Rating FY2020	Date & Rating in FY2019
			Oct 2021	Dec 2020	Dec 2019	Oct 2018
Issuer Rating	N/A	N/A	[SL]BBB- (Negative)	[SL]BBB- (Negative)	[SL]BBB- (Negative)	[SL]BBB- (Negative)

<sup>1</sup> Return on Assets: PAT/ Average Total Assets

<sup>2</sup> Gearing adjusted for revaluation reserves and deferred tax assets



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