ICRA Lanka assigns issuer rating of [SL]BBB- with stable outlook to Alliance Finance Company PLC

September 19, 2017

Instrument	Amount	Rating Action
Issuer Rating	N/A	[SL]BBB- with Stable Outlook assigned
Listed Senior Unsecured Redeemable Debentures Programme	LKR 1,000 Mn	[SL]BBB- with Stable Outlook assigned
Listed Subordinated Unsecured Redeemable Debentures Programme	LKR 480.17 Mn	[SL]BB+ with Stable Outlook assigned
Listed Subordinated Unsecured Redeemable Debentures Programme	LKR 613.14 Mn	[SL]BB+ with Stable Outlook assigned

ICRA Lanka Limited, subsidiary of ICRA Limited, group company of Moody's Investors Service has assigned the issuer rating of [SL]BBB- (pronounced SL triple B minus) with a stable outlook to Alliance Finance Company PLC ("AFCP" or "the Company"). ICRA Lanka has also assigned the issue rating of [SL]BBB- (pronounced SL triple B minus) with a stable outlook to the LKR 1,000 Mn Senior Unsecured Redeemable debentures programme of the Company, currently listed on the Colombo Stock Exchange. ICRA Lanka has also assigned issue ratings of [SL]BB+ (pronounced SL double B plus) with stable outlook to the LKR 480.17 Mn Subordinated Unsecured Redeemable Debentures programme and the LKR 613.14 Mn Subordinated Unsecured Redeemable Debentures programme of the Company currently listed on the Colombo Stock Exchange.

The ratings factor in the established track record of the company in the financing business, a fairly diversified lending portfolio, comfortable asset quality and a fairly diversified funding profile. The ratings are however constrained by its high gearing and moderate profitability indicators. The ratings take note of the strict Loan to Value ("LTV") ratio for vehicle financing, which is expected to increase competitive pressure and impact business growth and margin expansion for the players including AFCP. ICRA Lanka takes note of the company's initiative to diversify its portfolio, which could reduce the share of vehicle financing going forward from current levels; however, ability to grow at an optimal pace in the new target segments namely mortgage loans and business loans etc without impacting its asset quality and generating good risk adjusted returns would be critical.

AFCP is one of the older finance company in Sri Lanka with a track record of more than 60 years. The company has presence in 89 locations (39 branches, 21 microfinance service locations, 12 gold loan centers and 17 collection centers) covering all 25 districts of the country. The company's key products are leasing, which accounts for 67% of the total portfolio as on June 30, 2017, followed by loans (23%), micro finance (7%,) gold loans/pawning (2%) and hire purchase (1%). In terms of asset classes, 3-wheeler financing (21%), car financing (18%), lorry financing (12%), mortgage loans (9%) and van financing (8%) were the key constituents of AFCP's portfolio. The other key asset classes include micro finance (group lending), equipment financing, 2-wheeler financing, which account for 13% of the portfolio. ICRA Lanka notes that the portfolio growth is expected to remain at about 20-25% over the near to medium term with focus on 4-wheeler financing.

The company's gross NPA ratio increased to 17.4% on March 31, 2014 from 2.2% on March 31, 2013 because of the stress on its pawning exposures. The same however improved over FY2015 and FY2016, largely on account of the large write-offs and recoveries made during the period. As on March 31, 2017, the company reported a gross NPA of 2.1% and a net NPA of 0.8%when compared to gross NPA of 2.5% and net NPA of 0.7% in March 2016. The gross and net NPA stood at 2.6% and 1.3% as on June 30, 2017. ICRA Lanka notes that while the asset quality indicators are comfortable presently, ability to control incremental slippages, especially in the target business segments for growth, would be a key monitorable. The ratings nevertheless take note of the strengthening in the company's management team and internal control process and systems, which provide some comfort.

AFCP has a fairly diversified funding profile comprising of retail fixed deposits, debentures and term loans from banks. As on June 30, 2017, around 42% of the company's funding was from deposits, while the balance was through debentures and bank loans. Going forward, the company is expecting to maintain a 45:55 share between deposits and other borrowings. ICRA Lanka notes that Top 10 depositors accounting for 15% of the company's total deposits as on June 30, 2017 indicates concentration in its deposits profile. However, funding lines from 12 banks and good deposit renewal rate of 80% provides comfort from a liquidity perspective. The company reported a positive short term (less than 1 year) ALM mismatch of 1% as of June 30, 2017; which is quite comfortable as compared to most peers.

The company's gearing[1] moderated to 8.7 times on March 31, 2017 from 9.7 times as on March 31, 2016 as the portfolio growth moderated to 21% (28% in FY2016), while the internal generation improved to 17.9% in FY2017 (16.5% in FY2016); the company also raised capital of LKR 71 million via a rights issue in January 2017. ICRA Lanka notes that notwithstanding the moderation, the capital structure is stretched on account of the high leverage. The company's core Tier-I and total capital adequacy ratios stood at 10.0% and 13.8% respectively, as on June 30, 2017. The company's capital adequacy was supported by the issuance of LKR 606 Mn subordinate debenture in March 2017.

AFCP's business yield moderated from about 24-25% in FY2014-FY2015 to about 22-23% currently because of its shift to lower yielding 4-wheeler financing from 3-wheeler financing. Going forward, AFCP' yields are expected to be under pressure in view of the increased focus on 4-wheeler financing. The NIMs have consequently moderated from 9.9% in FY2016 to about 9.3% in FY2017. ICRA Lanka notes that the credit cost increased to 1.8% in Q1FY2018 (0.3% in FY 2017 and 1.5%in FY2015) because of the accelerated provision made by the company on account the portfolio impacted by the recent floods and because of the additional provision made post CBSL's review. The operating efficiency improved with the portfolio expansion; operating cost /ATA reduced to 7.1% for Q1FY2018 from 7.3% in FY2017 and 7.8% in FY2016. AFCP's profitability (return on average assets) reduced to 1.6% in Q1FY2018 (2.4% in FY2017 and 1.9% in FY2016) largely because of the increased credit costs and remains moderate in relation to peers. Ability of the company to improve its profitability going forward would be crucial.

Company Profile

Alliance Finance Company PLC is one of the older 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 (26.50%), 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 89 customer locations (39 fully fledge branches, 21 micro finance service locations, 12 gold loan centers and 17 collection centers) and over 1,200 employees. Alliance Finance Company PLC has investments in subsidiary Alfinco Insurance Brokers

[1] Gearing calculated after excluding revaluation reserves

(Pvt) Ltd (64%) and in two associates namely Macbertan (Pvt) Ltd (24%) and Alliance Tech Trading (Pvt) Ltd (40%).

During FY2017, AFCP reported a PAT of LKR 649 Mn on a total asset base of LKR 28.7 Bn as compared with a PAT of LKR 419 Mn on a total asset base of LKR 25.4 Bn in the previous financial year. During Q1FY2018, AFCP reported a PAT of LKR 114 Mn on a total asset base of LKR 30.1 Bn.

During FY2017, AFCP Group reported a PAT of LKR 660 Mn on a total asset base of LKR 30.1 Bn as compared with a PAT of LKR 436 Mn on a total asset base of LKR 25.9 Bn in the previous financial year. During Q1FY2018, AFCP reported a PAT of LKR 118 Mn on a total asset base of LKR 31.5 Bn.

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