

## ICRA Lanka assigns [SL]B rating to Nations Lanka Finance PLC

October 09, 2018

Instrument	Previous Rated Amount (LKR Mn)	Current Rated Amount (LKR Mn)	Rating Action
Issuer rating	N/A	N/A	[SL]B (Stable); assigned

### Rating action

ICRA Lanka Limited, subsidiary of ICRA Limited, a group company of Moody's Investors Service, has assigned the issuer rating of [SL]B (Pronounced SL B) with a stable outlook to Nations Lanka Finance PLC (NLF or the company).

### Rationale

The rating considers NLF's moderate scale, modest asset quality, constrained funding profile and weak profitability indicators. NLF's core capital as in June 2018 stood at LKR 705 Mn, below the regulatory requirement of LKR 1 Bn<sup>1</sup> for Licenced Finance Companies (LFCs). ICRA Lanka takes note of the rights issue of LKR 600 Mn in September 2018, which uplifted the company's capitalisation to an extent, however the capital profile is expected to remain subdued considering the new CBSL norms for capital adequacy computation. Further, NLF would require sizeable external capital infusion (about LKR 1.4-1.5 Bn over the period FY2019-FY2021, with adequate buffer), in relation to its net worth, as internal generation is expected to remain modest. ICRA Lanka takes note of the participation of some key shareholders (constituting about 60% of the shareholding in Jun-18) in the recent rights issues and subordinated debenture issuance of the company. However, support from them going forward, considering NLF' future capital requirements, remains to be seen. Ability to meet regulatory capital and, improvement in asset quality and financial indicators would be crucial, going forward, from a rating perspective.

### Outlook: Stable

The outlook may be revised to "Positive" in case of significant improvement in NLF's capital position, improvement in its asset quality and overall financial risk profile. The outlook may be revised to "Negative" in case NLF falls short to meeting the regulatory capital requirement in a timely manner going forward or further deterioration in its financial and asset quality indicators.

<sup>1</sup> LKR 1.5 Bn by Jan-19, LKR 2.0 by Jan-20 and LKR 2.5 Bn by Jan-21

## Key rating drivers

### Credit strengths

**Support from some key shareholders:** Main shareholders of NLF are Mr. V Ramanan (29.99%), Mr. U.H Dharmadasa (24.67%) and Mr. H.K.J Dharmadasa (4.98%) as in Jun-18. Since FY2016, these shareholders have invested close to LKR 1.1 Bn (LKR 502 Mn in Mar-16 and LKR 600 Mn in Sep-18) through right issues and LKR 250 Mn in the form of privately placed subordinated debentures. NLF's board consists of seven directors including two independent directors. Presently, all three main shareholders are present on the board. Considering the large capital requirement going forward, timely support from these shareholders would be crucial and a monitorable going forward.

### Credit challenges

**Moderate loan portfolio:** NLF reported a portfolio of LKR 6.5 Bn in Jun-18; the company's key products include micro finance (33%), business loans backed by guarantors (31%), leasing (12%), gold loans (9%), fixed deposit loans (6%), vehicle backed loans (6%) and property mortgage (2%). Currently, NLF is present in 36 locations including its head office. Going forward, NLF is expected to focus on vehicle leasing and loans and, is expected to reduce the share of microfinance and unsecured business loans because of the increase in NPAs in these segments. The company reported 8% y-o-y growth in portfolio during FY2018 and 32% annualized growth in Q1FY2019, however going forward ability to grow the portfolio considering the operational restrictions (LKR 7.8 Bn cap on deposits) imposed by CBSL and constraints in its capitalisation profile will have to be seen.

**Weak asset quality:** The company reported gross NPA of 13.62% in Jun-18 as compared to 12.69% in Mar-18 (11.47% in Mar-17). NPAs in the microfinance and business loans segment stood at 11.91% and 17.34% respectively in Jun-18 and accounted for 67% of the total NPAs as in Jun-18. The company is expected to reduce the share of microfinance and is currently being selective in extending business loans. The company has initiated recovery process including legal actions on NPAs in the business loan segment. Gross NPA ratio, excluding microfinance and business loans stood high at 10.64% because of personal loans and property loans. NLF's ability to recover from the microfinance and business loan portfolio and controlling incremental slippages as business expands would be crucial going forward.

**To meet minimum regulatory capital requirements:** NLF's tier-I capital stood at 3.38% and total capital adequacy ratio was 5.97% in Aug-18 (as per the revised CBSL directions on capital computation with effect from July 2018), which is below the regulatory requirement. Further, according to the CBSL direction to LFCs, NLF's core capital is required to be increased to 1.5 Bn by Jan-19, this would have to be thereafter increased by LKR 500 Mn each year to reach LKR 2.5 Bn by Jan-21; NLF's core capital stood at about LKR 705 Mn in Jun-18, below the threshold of LKR 1 Bn as of Jan-18. ICRA Lanka takes note of the recently concluded LKR 600 Mn right issue which would help it meet the current minimum core capital requirement of LKR 1.0 Bn by Sep-18. NLF however would need regular external capital infusion to meet future regulatory requirements, as internal generation is expected to be lower and also as the company has to provide for the IFRS 9 transition. Therefore, ability to raise timely capital would be crucial going forward.

**Poor profitability indicators:** NLF's business yields moderated over the last two years with the shift of the portfolio towards asset backed lending, while cost of funds increased resulting in the contraction of NIMs (12.4 % provisional in Q1FY2019 from 14.6% in FY2018 and 18.5% in FY 2017). The company's operating

expense however continued to remain high at about 11-12% during the above-mentioned period, thus exerting pressure on the overall profitability. The credit costs have come down in Q1FY2019 (1.38%) vis a vis FY2018 (6.22%). NLF reported RoA of 0.82% (provisional) in Q1FY2019 as compared to loss of 0.59% in FY2018. Improvement in operating efficiencies and keeping credit costs under control would be crucial going forward.

**Constrained financial flexibility:** NLF's main funding source is fixed deposits, which accounted for 89% of the total debt in Jun-18. The company's funding ability from public deposits is limited by a cap of LKR 7.8 Bn placed by CBSL. Removal of deposit caps and ability tap alternative and longer-term funding sources would be crucial from a liquidity and funding perspective going forward.

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

**Links to applicable criteria:** [ICRA Lanka Credit Rating Methodology for Non-Banking Finance Companies](#)

### **About the company:**

Nation Lanka Finance PLC (NLF) formally known as Ceylinco Finance PLC is a public limited company incorporated in Sri Lanka on 15th July 1987. The company operates as a licenced finance company registered under finance business act for the past 30 years. The main shareholders of the company are Mr. V Ramanan (29.99%), Mr. U.H Dharmadasa (24.67%) and Mr. H.K.J Dharmadasa (4.98%).

During the year ended March 31, 2018, NLF reported a net loss of LKR 51 Mn on a total asset base of LKR 9.1 Bn as compared to PAT of LKR 174 Mn on a total asset base of LKR 8.4 Bn in the previous fiscal year.

For the three months ended June 2018, the company reported a PAT of LKR 19 Mn on a total asset base of LKR 9.7 Bn

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