

ICRA Lanka assigns [SL]BBB- rating for Prime Finance PLC

September 28, 2018

Instrument*	Previous Rated Amount (LKR Mn)	Current Rated Amount (LKR Mn)	Rating Action
Issuer rating	N/A	N/A	[SL]BBB- (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]BBB- (Pronounced SL triple B minus) with a stable outlook to Prime Finance PLC (PRIME or the company).

Rationale

The rating factors in the financial, operational and management support from the Prime group; Prime Lands Private Limited (PLPL) holds about 95% stake in PRIME. The rating also takes into consideration, PRIME's modest scale (portfolio at LKR 3.4 Bn), its less seasoned portfolio, moderate resource profile and subdued profitability indicators. ICRA Lanka notes that the company's capital profile characterised by core capital of LKR 1.45 Bn in July 2018 (gearing at 4.80 times in Jun-18) is adequate currently, however it would require external capital for meeting future regulatory capital requirements (core capital of LKR 2.5 Bn by Jan-21) as internal generation is expected to be relatively modest. ICRA Lanka however factors in the commitment from PLPL to extend capital and liquidity support to PRIME when required. Going forward, ability to improve earnings profile, as business expands, while keeping the asset quality under control and meeting the regulatory capital requirements would be crucial from a rating perspective

Outlook: Stable

The stable outlook factors in the timely overall support from the Prime group. The outlook may be revised to "Positive" based on PRIME's ability to grow its portfolio and improve its earnings profile and asset quality indicators while maintaining a healthy capital profile. The outlook may be revised to "Negative" in case PRIME is unable to meet the regulatory capital requirement in a timely manner or in case of a significant deterioration in its financial risk profile or lower than expected support from the Prime group.

Key rating drivers

Credit strengths:

Support from Prime group: The current promoter of the company, Prime Lands (Pvt) Ltd., is a leading real estate developer. The promoter has demonstrated his ability to infuse needed capital and its committed support in case of future capital needs. Given PRIME's product focus of being primarily undertaking mortgage backed lending, there is significant group synergy, which it can leverage upon.

Credit challenges

Small scale of operations and modest competitive position: PRIME is a relatively small player in the NBFII industry with a portfolio of about LKR 3.4 Bn as of June 2018. The company operates with 6 branches, including its head office. PRIME's portfolio consisted of loans and leasing & HP, which accounted for about 79% and 21% respectively as of Jun-18. The loan segment largely consists of property mortgage loans for residential and commercial lands (about 43% of total portfolio) and business loans backed by vehicles and property (about 26% of total portfolio). The leasing portfolio mainly consists of lending for small cars and small lorries, which accounted for about 17% of the total portfolio in Jun-18. PRIME expects to achieve a total portfolio of LKR 12 Bn by FY2021, with an exposure 70% to mortgaged backed loans segment and 25% to leases. PRIME is expected to benefit from the Prime group's expertise and access to the real estate business, as it increases its focus on mortgage backed loans.

Sizeable external capital required; timely support from the Parent envisaged- PRIME has a comfortable core capital adequacy ratio of 31% as of Jul-18 (post the rights issue) and gearing of 4.8 times as on Jun-18. However, according to the CBSL direction for LFCs, PRIME's core capital is required to be increased up to 1.5 Bn by January 2019 and each year thereafter by LKR 500 Mn until it reaches LKR 2.5 Bn by Jan-21; PRIME's core capital stood at about LKR 1.45 Bn in Jul-18. ICRA Lanka estimates that the company would require external capital support of about LKR 800-900 Mn over the period FY2019-FY2021 to meet the same (with adequate buffer). ICRA Lanka notes the commitment provided by the parent company, Prime Lands (Pvt) Ltd., to infuse capital to meet the regulatory requirement. This was demonstrated by under writing of the rights issue programmes in Sep-17 and Jul-18. Further, ICRA Lanka notes the company's initiative to secure equity capital in FY2019 to meet the upcoming core capital requirements. PRIME's ability to raise capital on a timely basis would be a key rating monitorable going forward.

Limited seasoning of the new portfolio: PRIME recorded a gross NPA ratio of 6.14% in Jun-18 largely on account of the legacy portfolio. When acquired, in Jan-17, the portfolio amounted to LKR 1.3 Bn and had NPAs of LKR 161 Mn. During FY2018, PRIME wrote off about LKR 100 Mn of NPAs from the legacy portfolio. As of June 2018, the legacy portfolio stood at about LKR 298 Mn with NPAs being high at LKR 201 Mn as credit assessment of the legacy loans were found to be inadequate and collection process was not fully ramped-up. The gross NPA ratio of the newly originated portfolio (92% of the total portfolio as in Jun-18), which mainly consisted of asset backed (property, vehicles, etc.) loans and leasing, was negligible as of Jun-18. The active portfolio however is relatively new and is therefore less seasoned.

To diversify funding profile: Total borrowings of PRIME stood at about LKR 3.3 Bn and about 80% of it comprised of customer deposits in Jun-18 (fixed deposits 64% and savings deposits 16%). The bank and securitised borrowings represented the balance 20%. The savings deposit base as of Jun-18, included the savings of about LKR 459 Mn (including accumulated interest) placed by the parent company which was later utilised to subscribe for the rights issue in Jul-18. The fixed deposits are quite concentrated with top 10 accounting for about 30% of the total fixed deposits in Jun-18. Further, PRIME's ALM profile is characterised by sizable mismatches in the <1-year bucket (-23% of total assets in Aug-18) as majority of deposits (about 68%) mature in less than 12-months. Expected timely financial support from the prime group provides some comfort from a liquidity perspective.

Ability to achieve a healthy earnings profile: PRIME's profit after tax for FY2018 and Q1FY2019 were LKR 13 Mn (RoA¹ at 0.5%) and LKR 30 Mn (provisional RoA at 3.0%) respectively on an asset base of LKR 3.7 Bn and LKR 4.1 Bn. The lending yields in FY2018 was about 20% with a NIM of 9.25%. The earnings profile is characterized by high operating expenses ratio (operating expense to average total assets) of 7.0% in Mar-18 and 7.8% in Jun-18. PRIME's credit cost increased in FY2018 to 3.93% because of write offs of about LKR 100 Mn from the legacy portfolio. The same moderated to 1.72% as of Jun-18, which supported net profitability to an extent, however the sustainability of the same remains to be seen. Going forward, it is crucial to keep credit costs and operating costs under control as business expands.

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:

Prime Finance PLC (PRIME), a registered finance company, is largely focusing on mortgage backed loans and leasing. PRIME was established in 2004 as Asia Commerce Limited and was registered as a finance leasing establishment in 2005. In 2011, the company was registered under the Finance Companies Act and was rebranded as Divasa Finance Limited. The company went through a name change in 2012 as George Steuart Finance Limited and listed on the Colombo Stock Exchange by way of an Introduction. Under the financial sector consolidation programme of the Central Bank of Sri Lanka, the Company was acquired by Sarvodaya Development Finance Limited (formerly known as Deshodaya Development Finance Company Ltd) in 2014 and changed the name of the company to Summit Finance PLC in 2016. The current shareholders, Prime Lands (Pvt) Ltd. acquired the company in January 2017 and later changed the name to Prime Finance PLC. Prime Lands (Pvt) Ltd. presently holds 95% of PRIME.

During the year ended March 31, 2018, PRIME reported a net profit of LKR 13 Mn on a total asset base of LKR 3.7 Bn as compared to net profit of LKR 3 Mn on a total asset base of LKR 1.7 Bn in the previous fiscal year. For the three months ended June 30, 2018, PRIM reported a net profit of LKR 30 Mn (unaudited) on a total asset base of LKR 4.1 Bn.

Key financial indicators (Audited)

	FY2017	FY2018	3MFY2019*
Net Interest Income	158	236	101
Profit after Tax	3	13	30
Net worth	316	613	643
Loans and Advances	1,166	2,681	3,402
Total Assets	1,702	3,671	4,146
Return on Equity	0.8%	2.8%	18.9%
Return on Assets	0.2%	0.5%	3.0%
Gross NPA	11.3%	7.3%	6.1%
Net NPA	3.2%	2.9%	2.2%
Capital Adequacy Ratio	26.2%	21.0%	17.2%
Gearing (times)	4.3	4.6	4.8

*Unaudited

¹ Profit after tax /average total assets

Rating history for last three years:

Instrument	Type	Current Rating (FY2019)			Chronology of Rating History for the past 3 years		
		Amount Rated (LKR Mn)	Date & Rating	Date & Rating	Date & Rating in FY2018	Date & Rating in FY2017	Date & Rating in FY2016
1	Issuer rating	N/A	N/A	Sep 2018 [SL]BBB-(Stable)	-	-	-
					N/A	N/A	N/A

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