

ICRA Lanka revises the issuer rating of Softlogic Finance PLC to [BB] with Negative outlook

May 07, 2019

Instrument	Rated Amount (LKR Mn)	Rating Action
Issuer rating	N/A	Revised to [SL]BB (Negative) from [SL]BB+ (Negative)
Guaranteed redeemable debenture programme	1,400	[SL] AAA (SO) with stable outlook; outstanding

Rating action

ICRA Lanka Limited, subsidiary of ICRA Limited, a group company of Moody's Investors Service has revised the issuer rating of Softlogic Finance PLC (SFP or the Company) to [SL]BB (pronounced SL double B) with Negative outlook from [SL]BB+ (pronounced SL double B plus) with Negative outlook. ICRA Lanka has also the issue rating of [SL]AAA (SO) (pronounced SL triple A Structured Obligation) with Stable outlook outstanding for the LKR 1,400 Mn Guaranteed Redeemable Debenture programme of SFP. The letters SO in parenthesis suffixed to a rating symbol stand for Structured Obligation. An SO rating is specific to the rated issue, its terms, and its structure. The SO rating does not represent ICRA Lanka's opinion on the general credit quality of the issuer concerned.

The issue rating is based on the strength of an unconditional and irrevocable guarantee from Guarant Co Limited, Mauritius (GLM/ the Guarantor; rated A1/stable by Moody's) covering the principal amount due on the rated instrument. The rating also takes into account two interest instalments (quarterly) and principal amounting in total to LKR 100 Mn deposited by the company with the debenture trustee in the form of Debt Service Reserve Account (DSRA), as well as the payment mechanism designed to ensure payment on the rated instrument when and if the issuer does not pay and the guarantee has to be invoked by the debenture trustee. The rating assumes that the guarantee and DSRA will be duly invoked/ utilised by the debenture trustee, as per the terms of the transaction, in case there is a default in payment by SFP (Issuer).

Rationale

The revision in the issuer rating factors in the higher than expected deterioration in SFP's capital indicators and further weakening in its asset quality. SFP's (provisional) core and total capital adequacy ratios (as per the new CBSL guidelines) stood at 4.04% and 3.61%, respectively in Feb-19, below regulatory requirement, as the one-time IFRS 9 transition impact on its capital was higher than the earlier anticipated levels. Softlogic group (Softlogic Holdings PLC (SHL); rated [SL]BBB+(Stable)), over the current financial year, is expected to infuse fresh equity and support SFP in securing tier-II capital totaling to about LKR 1.1 Bn; ICRA Lanka however notes that SFP's capital profile would remain weak and below regulatory requirement as in March 2020, unless it scales down its business volumes from current levels or is able to secure a larger capital infusion. SFP's gross NPAs increased further to 13.77% in Dec-18 from 12.52% in Mar-18 (8.96% in Mar-17)

The rating also takes note of the fall in the profitability indicators during 9MFY2019, amidst a competitive business and weak operating environment. The rating continues to factor in the financial, managerial and operational support from the Softlogic group.

Outlook: Negative

The outlook may be revised to 'Stable' in case the company is able to considerably augment its capital profile to reach a level above the regulatory requirement along with improvement in its asset quality and earnings profile. The rating may be revised downwards, if the capital profile continues to remain stretched and below regulatory requirement or in case of further weakening in its asset quality. Significant weakening in the credit profile of the Soflogic group, dilution in the ownership or lower than expected support from group would also adversely impact the rating.

Credit strengths

Access to financial, managerial and operational support from Softlogic group; Softlogic Finance is a 67% (in Dec-18) owned subsidiary of Softlogic Capital PLC, which in turn is a 75% owned subsidiary of Softlogic Holdings PLC (rated BBB+, Stable outlook). The Softlogic group is a leading conglomerate in Sri Lanka with exposure to the healthcare, financial services (Softlogic Life Insurance and Softlogic Finance), leisure and retail sectors. ICRA Lanka expects financial, managerial and operational support from the group, as demonstrated in the past, by capital infusions to SFP. ICRA Lanka takes note of the expected capital support from the group to SFP for improving the company's capital profile, going forward.

Credit challenges

Steep deterioration in capital profile - In terms of the new capital adequacy framework effective since Jul-18 along with the one time impact on account of the IFRS 9 transition, SFP's Tier-I CAR declined steeply to 4.04% in Feb-19 (12.66% in terms of the prior framework as on Feb-19), while the total CAR stood at 3.61% (11.45% in terms of the prior framework as on Feb-19), which was below the regulatory capital adequacy requirements. ICRA Lanka envisages support from the Softlogic group which includes LKR 600Mn equity infusion by the group entities. The group is also expected to support SFP in securing tier II capital totaling to about LKR 500 Mn; ICRA Lanka however notes that SFP's capital profile would remain weak and below regulatory requirement as on March 2020, unless it scales down its business volumes from current levels or is able to secure a larger capital infusion.

Further weakening in asset quality; The gross non-performing assets (NPA) ratio of the company weakened to 13.77% in Dec-18 from 12.52% and 8.96% in Mar-18 and Mar-17, respectively. The increase in NPA levels is mainly due to higher slippages in the core SME and business loans segments (accounting for 64% of the total portfolio in Dec 2018). SME and business loans segment NPAs collectively stood at 13.07% in Dec-18 as compared to 8.78% in Mar-18. The rating takes note of management efforts to strengthen credit, recovery and collection processes, as well as changes in portfolio mix leading to the reduction of unsecured products. SFP's ability to improve asset quality going forward, would be a key monitorable from a rating perspective.

Subdued profitability; SFP's RoA declined further to 0.67% in 9M FY2019 from 1.01% in FY2018 (RoA stood at 1.16% in FY2017). Going forward, ability to improve business margins and keep credit costs under control would be crucial as the company is expected to focus on the more competitive vehicle finance segment in view of the stress in the SME and business loans segment.

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

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

Company Profile:

SFP was incorporated in 1999 as Capital Reach Leasing PLC (Capital Reach), a Specialised Leasing Company and, in 2007 the company got registered as a Licensed Finance Company. In 2010, the Softlogic Group acquired the controlling stake of Capital Reach through its subsidiary Softlogic Capital PLC and renamed it as Softlogic Finance PLC. As of December 2018, Softlogic Capital PLC (SCAP) holds about 67% of the company; SHP holds about 75% in SCAP as in December 2018. Currently, as one of the mid-sized LFCs in Sri Lanka, SFP offers working capital and term loans to the SME segment, personal loans, gold loans and vehicle financing. During FY2018, SFP reported a PAT of LKR 219 Mn on a total asset base of LKR 21,680 Mn via-a-vis LKR 244 Mn PAT in FY2017 on a total asset base of LKR 21,706 Mn.

Guarantor Profile – Gurant Co Limited, Mauritius

Gurant Co Limited is a Mauritius based Company which provides credit guarantees for financing Infrastructure projects and financial markets. Private Infrastructure Development Group holds 88% stake in the company and Nederlandse Financierings (FMO) holds 12% in the company. Private infrastructure development group is a development agency owned by the international development arms of United Kingdom, Netherlands, Switzerland and Sweden governments.

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