

ICRA Lanka assigns [SL]B- rating for TKS Finance Ltd

October 30, 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 minus) with a stable outlook to TKS Finance Ltd. (TKS or the company).

Rationale

The rating considers TKS's modest scale and franchise, weak asset quality indicators, poor earnings and constrained resource profile. ICRA Lanka takes note that the company is under CBSL's restriction on borrowings (deposit and other borrowings caps at LKR 4.9 Bn and LKR 123 Mn respectively) since Jan-18 and lending since Jun-18, due to non-compliance of the minimum core capital requirement. TKS's core capital as in June 2018 stood at about LKR 0.7 Bn, below the regulatory requirement of LKR 1 Bn¹ for Licenced Finance Companies (LFCs). Further, TKS's total capital adequacy ratio at 6.2% as of Jul-18 was below the regulatory requirement of 10% and the gearing stood high at 8.8 times as of Jun-18. ICRA Lanka notes that, sizeable further external capital infusion (about LKR 2.0-2.5 Bn over the period FY2019-FY2021) would be required as internal generation is likely to remain modest. Going forward, timely capital infusion would be crucial to meet regulatory capital requirement.

Outlook: Stable

TKS's ability to raise capital to meet the regulatory requirement on a timely basis would be a key rating sensitivity. The outlook may be revised to "Positive" based on TKS'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 of TKS continuing to fail in meeting regulatory capital requirement going forward or in case of further deterioration in its overall financial risk profile.

Key rating drivers

Credit challenges

Small scale of operations and modest competitive position: TKS is a relatively small player in the NBFi industry with a portfolio of about LKR 4.9 Bn as of June 2018. Presently, the company is operating with restrictions on lending (since Jun-18) and borrowings (since Jan-18), imposed by CBSL, because of non-compliance of the minimum core capital requirement of LKR 1 Bn, currently. As of Jun-18, the portfolio

¹ LKR 1.5 Bn by Jan-19, LKR 2.0 by Jan-20 and LKR 2.5 Bn by Jan-21

consisted of loans, leasing and HP, and microfinance lending which accounted for about 85%, 12% and 3% respectively. The loan segment largely consists of property loans (37% of total portfolio), working capital finance loans (about 16%), personal loans (about 16%) and loan (about 10%) granted to a group company, AFL Asset Management Ltd. The leasing portfolio mainly consists of lending for passenger vehicles (cars, vans, jeeps) which accounted for about 8% of total portfolio and lorries which accounted for about 2% of the total portfolio in Jun-18.

Weak asset quality indicators: TKS recorded a high gross NPA ratio of 22.0% in Jun-18 (19.2% in Mar-18) largely on account of working capital financing backed by post-dated cheques and property backed loans to SME clients. The working capital financing portfolio (about 16% of the total portfolio in Jun-18) recorded a gross NPA ratio of 63.7% and property loans (about 37%) recorded a gross NPA ratio of 21.6%. The high slippages were primarily because of stress faced by the SME segment due to macro-economic challenges, and inadequate credit evaluation and monitoring. The top 20 NPA accounts constituted about 17% of the total NPAs as of Jun-18. TKS's ability to curtail further slippages and recover loans extended to AFL and from current NPAs would be a key rating monitorable going forward.

Sizeable external capital required: TKS's core and total capital adequacy ratios stood at 6.2% as of Jul-18. While TKS is complying with the minimum core CAR requirement of 6.00%, its total CAR is below the regulatory threshold of 10.00%. Further, according to the CBSL direction for LFCs, TKS's core capital was required to be increased up to 1.0 Bn by January 2018 and each year thereafter by LKR 500 Mn until it reaches LKR 2.5 Bn by Jan-21; the company's core capital stood at about LKR 0.7 Bn in Jun-18, below the threshold. ICRA Lanka estimates that the company would require further external capital support of about LKR 2.0-2.5 Bn over the period FY2019-FY2021 to meet the subsequent requirements (with adequate buffer). Further, TKS's solvency ratio² stood high at about 119% as of Jun-18 because of the asset quality weakness and high gearing (8.8 times in Jun-18). TKS's ability to raise capital on a timely basis would be a key rating monitorable going forward.

Limited funding diversity: Since Jan-18, TKS has a cap imposed by CBSL on public deposits at LKR 4.9 Bn and other borrowings at LKR 123 Mn. Total borrowings of TKS stood at about LKR 4.5 Bn and about 98% of it as public deposits, consisting of fixed deposits (about 94%) and savings deposits (about 4%) in Jun-18. The borrowings from banks accounted for the remaining 2%.

Poor profitability indicators: TKS has been reporting net losses since FY2017 and the net loss for Q1FY2019 was LKR 78 Mn (net loss of LKR 124 Mn for FY2018). The earnings profile is characterized by high credit costs of 6.0% in Jun-18 (4.5% in Mar-18) because of higher provisioning for slippages in the SME portfolio. Going forward, it is crucial for TKS to improve its asset quality and keep credit cost 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](#)

² Net NPAs divided by adjusted net worth for goodwill

About the company:

TKS Finance Limited (TKS) is a licensed finance company providing an array of products in terms of leasing, hire purchase, property loans, working capital loans and personal loans etc. The Company was incorporated in 2010 by the current promoters; Mr. D. S. T. K. Sing, Mr. L. C. Zhen and Ms. T. Y. Shin. The company started active operations in 2011 after being registered under Finance Act. Pursuant to the direction issued by the CBSL on the financial sector consolidation, in June 2014, TKS has acquired the assets and liabilities of Asian Finance Ltd. (now AFL Asset Management Ltd.) which was a fully owned subsidiary of the promoters.

During the year ended March 31, 2018, TKS reported a net loss of LKR 124 Mn on a total asset base of LKR 5.7 Bn as compared to net loss of LKR 6 Mn on a total asset base of LKR 6.2 Bn in the previous fiscal year.

For the three months ended June 30, 2018, TKS reported a net loss of LKR 78 Mn (unaudited) on a total asset base of LKR 5.4 Bn.

ANALYST CONTACTS

Mr. Vidura Welathanthri
+94 11 4339907
vidura@icralanka.com

Mr. Dasith Fernando
+94 11 4339907
dasith@icralanka.com

Mr. A.M Karthik
+91 44 45964308
a.karthik@icraindia.com

RELATIONSHIP CONTACT

Mr. W. Don Barnabas
+94 11 4339907
wdbarnabas@icralanka.com



Subsidiary of

ICRA Limited

A Group Company of Moody's Investors Service

CORPORATE OFFICE

Level 10, East Tower, World Trade Center, Colombo 01, Sri Lanka

Tel: +94 11 4339907; Fax: +94 11 2333307

Email: info@icralanka.com; Website: www.icralanka.com

© Copyright, 2018 ICRA Lanka Limited. All Rights Reserved.
Contents may be used freely with due acknowledgement to ICRA Lanka.

ICRA Lanka ratings should not be treated as recommendation to buy, sell or hold the rated debt instruments. ICRA Lanka ratings are subject to a process of surveillance, which may lead to revision in ratings. An ICRA Lanka rating is a symbolic indicator of ICRA Lanka's current opinion on the relative capability of the issuer concerned to timely service debts and obligations, with reference to the instrument rated. Please visit our website www.icralanka.com or contact ICRA Lanka's office for the latest information on ICRA Lanka ratings outstanding. All information contained herein has been obtained by ICRA Lanka from sources believed by it to be accurate and reliable, including the rated issuer. ICRA Lanka however has not conducted any audit of the rated issuer or of the information provided by it. While reasonable care has been taken to ensure that the information herein is true, such information is provided 'as is' without any warranty of any kind, and ICRA Lanka in particular, makes no representation or warranty, express or implied, as to the accuracy, timeliness or completeness of any such information. Also, ICRA Lanka or any of its group companies may have provided services other than rating to the issuer rated. All information contained herein must be construed solely as statements of opinion, and ICRA Lanka shall not be liable for any losses incurred by users from any use of this publication or its contents.