ICRA Lanka revises the outlook of Trade Finance & Investments PLC to negative

July 30, 2018

Instrument	Rated Amount (LKR Mn)	Rating Action
Issuer rating	N/A	Reaffirmed the issuer rating of [SL]BBB-; Outlook revised to Negative from Stable

Rating action

ICRA Lanka Limited, subsidiary of ICRA Limited, a group company of Moody's Investors Service, has reaffirmed the issuer rating of Trade Finance & Investments PLC (TFIP or the Company) at [SL]BBB- (Pronounced SL triple B minus) while revising the outlook to negative from stable.

Rationale

The revision in the outlook factors in the weakening of TFIP's parent company, Commercial Credit and Finance PLC's (CCFL/ rated [SL]BBB with negative outlook) financial profile. TFIP is a 99.7% owned subsidiary and benefits from managerial and operational support from the parent. The rating takes note of the moderation of TFIP's asset quality over the period largely because of macro-economic challenges. However, ICRA Lanka notes that the asset quality indicators are better than the industry average, notwithstanding the modest credit profile of its customer segments. The rating further takes cognizance of TFIP's modest scale, and exposure to riskier product segments and competitive business environment. ICRA Lanka takes note that there is scope for improvement in internal controls and processes, as the company is expected to grow at a robust pace over the next 3 years.

The rating, however takes note of the company's established track record and experienced management team, good profitability indicators and granular nature of the loan portfolio. The company plans to grow its portfolio at a CAGR of 50% over the next 3-years, with focus on 2-wheeler and 3-wheelers, which together contributing to about 85-90% of the portfolio, while microfinance, pawning/gold loans etc contributing to the balance of the portfolio. ICRA Lanka notes that TFIP's core capital is expected to remain adequate to support the medium term envisaged portfolio growth. ICRA Lanka however expects timely support from the parent, in raising funding, for meeting the capital or liquidity requirements of TFIP, if required.

Outlook: Negative

The negative outlook reflects the deterioration of the credit profile of the parent company, CCFL. The outlook may be revised to 'stable' in case of steady improvement in CCFL's credit profile while TFIP maintains comfortable capital, asset quality and earnings profiles. The rating may be downgraded in case of downward rating revision of the parent or significant moderation in the financial risk profile of TFIP.

Key rating drivers

Credit strengths

Operational and managerial support from CCFL: TFIP is a 99.7% owned subsidiary of CCFL (rated [SL]BBB/stable) and has strong business linkages with the parent. Out of the 5 directors of the board, 2 are CCFL representatives. CCFL's support in terms of shared services and knowledge sharing in all key aspects of the operations has helped TFIP to diversify into new product lines such as pawning/gold loans, microfinance and daily business loans. Further, CCFL has provided the IT support, which has strengthened TFIP's internal controls. The internal audit of the pawning/gold loans operations is also carried out by CCFL's internal audit team. ICRA Lanka expects CCFL to continue its operational and managerial support to TFIP as and when required, to support its medium-term growth plans. While there is no immediate funding requirement for TFIP, ICRA Lanka expects timely support from the parent, in securing funding, for meeting the capital or liquidity requirements, if required.

Established track record and experienced management team- TFIP has an established track record of 40-years operations as a finance company in Sri Lanka. TFIP operates with 7 branches (including head office), and it has presence covering 11 districts of the country through its virtual business model (branchless operations). The company's management is well experienced in its traditional business of leasing 2-wheelers and 3-wheelers. The company is expected to leverage on CCFL's experience in diversifying to new asset segments.

Comfortable capitalization profile: Capitalization profile of the company is comfortable with core and total capital adequacy ratios (CAR) at 14.0% (19.3% including PAT for FY2018) and gearing at 3.5 times as of Mar-18. ICRA Lanka estimates the gearing to increase to about 6-6.5 times going forward along with envisaged portfolio growth at about CAGR of 50% over the next 3-years. Based on the revised CBSL direction for capital adequacy computation, TFIP's adjusted core and total CAR stood at 16.2% as of Mar-18. TFIP is expected to have a comfortable core capital position over the next 2-3 years. However, the company may need to raise external capital or curtail dividend payout to maintain an adequate total capital ratio, in view of the envisaged growth plans.

Granular loan portfolio, share of unsecured loans however has increased – TFIP's portfolio grew by 107% to LKR 7.3 Bn as of Mar-18. The exposure to leasing decreased to 93% as of Mar-18 vis a vis 96% as of Mar-17, largely because of the increase in exposure to unsecured microfinance to 6% from 3% in the respective periods. The top 10 exposures only accounted for 0.5% of the total portfolio (1.1% as of Mar-17) indicating portfolio granularity and low credit concentration risk. As of Mar-18, TFIP's portfolio consisted of 78% 2-wheelers, 14% 3-wheelers, 6% microfinance and 1% each of cars and pawning/gold loans. Going forward, the company envisages focusing 85-90% of its portfolio on 2-wheelers and 3-wheelers with the balance on microfinance, pawning/gold loans etc. While the portfolio is expected to remain granular, ability keep credit quality under control in view of the steep envisaged growth and the increased share of unsecured loans would be a key monitorable.

Adequate profitability indicators: NIM and RoA (on PAT) stood at 20.8% and 7.5% respectively as of Mar-18 (22.9% and 10.2% as of Mar-17) supported by healthy business yields and low leverage. During FY2018, TFIP witnessed increase in cost of funds by about 250bps to 13.1% (annual weighted average) because of increased securitized borrowing to fund the aggressive portfolio growth. The provisioning cost of the company increased to 1.6% from 1.3% largely because of subdued macroeconomic and adverse weather conditions that prevailed in the country. Going forward, TFIP's ability to improve its operating efficiency and keep credit cost under control would be crucial for incremental profitability.

Credit challenges

Moderation in asset quality indicators; however, remains better than the industry: TFIP's gross NPA ratio, on 6-months lagged basis, increased to 3.6% as of Mar-18 from 2.6% as of Mar-17. The weak economic condition and adverse weather conditions have largely contributed to the increased NPAs during FY2018. However, the GNPA% remains better than systemic levels; TFIP's asset quality is supported by strong focus on collections and recoveries. ICRA Lanka notes that historically TFIP had high delinquency in softer buckets. The 90+dpd stood at 13% as of Mar-18 vis a vis 10% as of Mar-17 (17% as of Mar-16). Going forward, TFIP's ability to maintain good asset quality levels, considering the envisaged high portfolio growth and diversification into other riskier asset classes, would be a key rating sensitivity going forward.

Small scale of operations and exposure to riskier asset classes: TFIP is a relatively smaller player in the NBFI industry with a portfolio of about LKR 7.3 Bn as of Mar-18. About 92% of TFIP's portfolio is in the riskier segments; namely, 2-wheelers and 3-wheelers accounting for 78% and 14% respectively as of Mar-18. TFIP targets largely the self-employed borrowers having a moderate credit profile. In addition, the company's plan to grow its microfinance business is likely to increase portfolio vulnerability.

Competitive business environment susceptible to unfavorable regulatory changes: The operating environment for 2W and 3W financing is quite competitive with established NBFIs and banks competing for market share. Further, the leasing business is susceptible to adverse regulatory changes as observed in the recent past.

Scope for improvement in internal controls; certain initiatives have been taken- ICRA Lanka notes that given certain operational lapses, there is need to improve procedures and internal controls to make it commensurate with the business risk. Given the expected increase in the scale and diversification into new asset classes, it would be crucial to strength its internal controls further,

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

Links to applicable criteria: ICRA Lanka's Credit Rating Methodology for Non-Banking Financial Institutions

About the company:

TFIP was incorporated in the year 1978 as a Private Limited company and was part of the J. L. Morrison Son & Jones group. It was converted to a Public Limited company (unquoted) in 1990. The company was taken over by Mr. N G H Cooray, former Chairman of the Jetwing Group of companies, in 1990 by acquiring 93% stake; the Cooray family took management control of TFIP in 1995. As part of the consolidation of the finance and leasing companies in Sri Lanka, Commercial Credit and Finance PLC (CCFL) acquired majority shares of TFIP in the year 2014. CCFL holds close to 99.7% of the Company as of March 31, 2018. TFIP is a registered Finance Company, operating with 6 branches namely, Negombo, Kilinochchi, Jaffna, Batticaloa, Marawila and Maligawatta. The company extends loans largely for 2-wheeler and 3-wheeler financing, which accounted for about 92% of the total portfolio as on March 31, 2018. TFIP also extends loans for financing cars, vans, tractors, commercial vehicles etc. In August 2016, the company diversified its portfolio by offering microfinance and small business loans.

During FY2018, TFIP reported a net profit of LKR 418 Mn on a total asset base of LKR 7,471 Mn as compared to net profit of LKR 325 Mn on a total asset base of LKR 3,725 Mn in the previous fiscal.

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