ICRA Lanka assigns [SL]BBB- rating for Unisons Capital Leasing Limited

February 21, 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 Unisons Capital Leasing Limited (UCL or the company).

Rationale

The rating factors UCL's status as a 90% subsidiary of Citizens Development Business Finance PLC (CDB; rated [SL]BBB+ by ICRA Lanka); ICRA Lanka expects UCL to benefit from the managerial, operational and financial support from CDB. CDB acquired UCL in October 2014, however its active involvement commenced only from January 2016. The rating takes note of the company's comfortable capitalisation profile characterised by core capital of about 58% as of September 2017, which is likely to support the envisioned portfolio growth over FY2019-FY2021 while keeping the gearing capped below 5 times. The rating, however, takes note of the company's modest scale (portfolio at LKR 856 Mn), its exposure to riskier asset classes with close to 92% of the portfolio represented by 2-wheelers and 3-wheelers, and limited funding diversity. Further, ICRA Lanka takes cognizance of the competitive operating environment in the 2-wheeler financing space and UCL's business susceptibility to unfavourable regulatory changes. Going forward, the company's ability to maintain a healthy asset quality and adequate profitability profile would be crucial from a rating perspective.

Outlook: Stable

ICRA Lanka believes that UCL would continue to get CDB's support in a timely manner, when required. The outlook may be revised to "Positive" based on UCL's ability to maintain healthy asset quality as business expands and with improvement in its earnings profile. The outlook may be revised to "Negative" in case of change in ownership and support from CDB or in case of a significant deterioration in its financial risk profile.

Key rating drivers

Credit strengths:

Operational, managerial and financial support from CDB: UCL is a 90% owned subsidiary of Citizen's Development Business PLC (CDB; rated [SL]BBB+/stable) and has strong business linkages with the parent. Majority (4 out of 6) of the board of directors are represented by CDB while the key senior management positions, including the CEO, are former CDB personnel. CDB's support in terms of shared services and knowledge sharing in all key aspects of the operations has helped UCL to strengthen its systems and internal controls. CDB's operational support to UCL includes access to CDB's branch network, core-banking system, and credit evaluation process. The internal audit of the operations is also carried out by CDB's internal audit team. ICRA Lanka expects CDB to provide liquidity or capital to UCL, as and when required, to support its medium-term growth plans. UCL, however is expected to be listed in the Colombo Stock Exchange in the medium to long term with CDB holding controlling stake in the company.

Comfortable capitalisation profile: Capitalization profile of the company is comfortable with core CAR at 57.9% and gearing at 1.5 times as of September 2017. The current capitalisation level is sufficient to support the targeted asset base of LKR 3.0 Bn by March 2020, while maintaining the gearing capped below 5 times.

Credit challenges

Small scale of operations and modest competitive position: UCL is a relatively smaller player in the NBFI industry with a portfolio of about LKR 856 Mn as of September 2017. The company's portfolio largely consists of leasing (about 96%) with a 46% exposure each towards 2-wheelers and 3-wheelers as of September 2017. At the start of the operations in January 2016, the main product category of UCL was 3-wheelers (32% in March 2016 and 70% in March 2017), however, subsequently the focus shifted to 2-wheelers with the challenging Loan to Value (LTV) rule for 3-wheeler financing. Over the H1FY2018, the 2-wheeler portfolio has grown quite sharply to LKR 397 Mn from about LKR 96 Mn in March 2017. UCL expects to achieve an exposure mix of 40% in 2-wheelers, 30% in 3-wheelers, 25% in 4-wheelers and 5% towards other loan products in the next 1-2 years. The operating environment for 2-wheeler financing is quite competitive and the support from the parent in terms of access to CDB branch network, core banking system and credit evaluation process are expected to assist UCL to grow the portfolio.

Exposure to riskier asset classes and borrower segments; limited portfolio seasoning: ICRA Lanka notes that close to 92% of UCL's portfolio is in the riskier segments; namely, 2-wheelers and 3-wheelers accounting for 46% each as of September 2017. UCL targets largely the salaried or self-employed borrowers having a moderate credit profile. The current composition is 40% salaried and 60% self-employed, which includes small entrepreneurs and businessmen. Further the 2-wheeler portfolio, a key asset class in focus of the company, is relatively new as it has grown quite sharply during H1FY2018. UCL's gross NPAs are comfortable at about 2.1% as on September 2017. Going forward, UCL's ability to maintain a healthy credit quality considering the risky target asset classes would be a key rating sensitivity.

Susceptibility to unfavourable regulatory changes: Target asset classes, especially 3-wheeler, exposes the company to adverse regulatory changes. 3-wheeler was the key target segment for the company when stricter LTV rule was imposed in January 2017. The company, however, was able to grow the portfolio by leasing used 3-wheelers and diversifying into 2-wheeler leasing.

Improving operating efficiency while keeping credit cost and borrowing cost under control is crucial for incremental profitability: UCL's NIM of 17.0% for FY2017 has dropped to 15.9% for H1FY2018 owing to the increased cost of borrowing during the period. UCL has been able to marginally improve its operating efficiency in H1FY2018 as operating expenses/average assets reduced to 11.4% from 12.0% in FY2017. However, expected increase in shared services fee charged by CDB and additions to field staff are likely to exert some pressure on the operating efficiency if commensurate business generation does not take place. Credit costs increased to 2.0% during the H1FY2018 (0.9%, if adjusted for repossessed stock) vis a vis 1.1% in FY2017 UCL's ability to improve operating efficiency and keep credit costs and borrowing cost under control would be critical.

Improving funding diversity is crucial to support growth: Total borrowings of UCL stood at LKR 527 Mn and comprised of securitized borrowing (57%) mainly from CDB, long term bank funding (23%) and promissory notes (20%) as of September 2017. ICRA Lanka expects timely support from the parent to continue as and when needed. The cost of incremental borrowing during H1FY2018 was at a higher rate of AWPLR+4%, which had increased the overall cost of funds of UCL. UCL being a specialized leasing company, cannot access public deposits. Going forward, UCL would have to diversify its funding sources to secure funds at competitive rates for supporting its growth.

Analytical approach: UCL credit risk profile is strengthened by the operational, managerial and financial support from CDB. 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:

Unisons Capital Leasing Limited (UCL) is a Specialized Leasing Company largely focusing on 2-wheeler and 3-wheeler financing presently. It envisages offering loans for products including consumer durable, solar panel etc going forward. The company was initially set up by Vanik Incorporation PLC. The ownership was then transferred to the Softlogic Group. Laugfs Gas PLC acquired it from Softlogic group and subsequently CDB acquired it from Laugfs Gas PLC in October 2014 as part of the consolidation of the finance and leasing companies in Sri Lanka. CDB currently holds 90.4% of the equity capital of UCL as at September 30, 2017.

During the year ended March 31, 2017 UCL reported a net profit of LKR 20.1 Mn on a total asset base of LKR 693 Mn as compared to net profit of LKR 15.7 Mn on a total asset base of LKR 370 Mn in the previous fiscal year.

For the six months ended September 30, 2017 UCL reported a net profit of LKR 18.6 Mn on a total asset base of LKR 1,078 Mn.

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