ICRA Lanka reaffirms the ratings of Unisons Capital Leasing Limited

February 22, 2019

Instrument*	Previous Rated Amount (LKR Mn)	Current Rated Amount (LKR Mn)	Rating Action
Issuer rating	N/A	N/A	[SL]BBB- (Negative); Reaffirmed
Proposed Senior, Unsecured, Unlisted, Redeemable debenture Programme	N/A	500	[SL]BBB- (Negative); Reaffirmed

Rating action

ICRA Lanka Limited, subsidiary of ICRA Limited, a group company of Moody's Investors Service, has reaffirmed the issuer rating of [SL]BBB- (pronounced SL triple B minus) with Negative outlook for Unisons Capital Leasing Limited (UCL or "the Company"). ICRA Lanka also has reaffirmed the issue rating of [SL]BBB- with Negative outlook assigned to the proposed LKR 500 Mn Senior, Unsecured, Unlisted, Redeemable debenture programme[1] of the Company.

Rationale

The negative outlook continues to factor in the weakening of Citizens Development Business Finance PLC's (CDB has an issuer rating [SL]BBB+, outlook was revised from Stable to Negative in October 2018) credit profile. UCL is a 90% subsidiary of CDB and benefits from managerial, operational and financial support from the parent.

The ratings take note of the Company's currently adequate capitalisation profile characterised by core capital ratio of about 12% as of Dec-18 (based on new CBSL guidelines and factoring in the SLFRS- 9 adjustments) and the Company's initiative to secure equity capital in H1CY2019 to support the envisioned portfolio growth of CAGR of 40% over the period FY2019-FY2021. The ratings, however, take note of the Company's modest scale (gross portfolio at LKR 2.5 Mn in Dec-18), its exposure to riskier asset classes with close to 94% of the portfolio consisting of 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. Going forward, the Company's ability to maintain a healthy asset quality and adequate profitability and capitalisation profile would be crucial from a rating perspective.

Outlook: Negative

The Negative outlook reflects the deterioration of the credit profile of the parent company, CDB. The outlook may be revised to "Stable" in case of steady improvement in CDB's financial profile while UCL maintains comfortable capital, asset quality and earnings profiles. The ratings may be downgraded in case of downward rating revision of the parent or significant moderation in the financial risk profile of UCL. The ratings may also be downgraded in case of lower than envisioned financial support from CDB, when required by UCL.

[1] With a put option to redeem after 13-months

Key rating drivers

Credit strengths:

Operational, managerial and financial support from CDB: UCL is a 90% subsidiary of Citizen's Development Business PLC (CDB; rated [SL]BBB+/Negative) and has strong business linkages with the parent. Three out of six of the board of directors are from CDB; while key senior management positions, including the CEO, are held by former CDB personnel. Support from the parent 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 over the recent past. 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 envisions the parent to provide liquidity or capital support, when required, for meeting its medium-term growth plans.

Adequate capitalisation profile: Capitalization profile of the Company is adequate with core and total CAR both at 12.07% as of Dec-18 (based on new CBSL guidelines and factoring in the SLFRS 9 adjustments) and gearing at 4.91 times as of Dec-18. ICRA Lanka estimates that the Company may need to raise additional equity capital over the next 3-years to grow at CAGR of 40% per annum while maintaining a comfortable buffer (2%) to minimum CAR. ICRA Lanka notes the Company's initiative to secure equity capital in H1CY2019.

Credit challenges

Small scale of operations and modest competitive position: UCL is a small player in the NBFI industry with a portfolio of about LKR 2.5 Bn as of Dec-18. The Company's portfolio largely consists of leasing (about 99%) with 60% and 34% of the exposures being towards 2-wheelers and 3-wheelers respectively as of Dec-18. The 3-wheelers were the product category of UCL, which accounted for 70% of the portfolio in March 2017, however, subsequently the focus shifted to 2-wheelers as Loan to Value (LTV) rule for 3-wheeler financing was tightened. Over the period, the 2-wheeler portfolio has grown quite sharply to about LKR 1.5 Bn as of Dec-18 from about LKR 96 Mn in Mar-17, largely with the support from the parent in terms of access to CDB's branch network, core banking system and credit evaluation process.

Exposure to riskier asset classes and borrower segments; limited portfolio seasoning: ICRA Lanka notes that close to 95% of UCL's portfolio is in the riskier segments; namely, 2-wheelers and 3-wheelers as of Dec-18. Currently, salaried customers account for 40% and self-employed borrowers accounted for 60% of the portfolio. The 2-wheeler portfolio, a key asset class focused by the Company, is relatively new as it has grown quite sharply during last 24-months. UCL's gross NPA ratio has increased to about 3.94 % as of Dec-18 (1.76% as of Mar-18), however, the same adjusted for repossessed stock stood at 1.52% (0.93% as of Mar-18). Going forward, UCL's ability to maintain healthy credit quality considering the riskier target asset classes would be a key rating sensitivity.

Moderation in earnings: UCL's RoA of 4.5% and NIM of 18.0% in FY2018 moderated to 3.8% and 16.3% in 9MFY2019 respectively, owing to the increased cost of borrowings and credit costs during the period. Cost of funds increased to 16.8% as of Dec-18 vis a vis 12.1% as of Mar-18 largely due to the increase in expensive securitised borrowings at a rate of about 16-17%. UCL's credit costs (provisioning/average assets) increased to 2.8% during the 9MFY2019 vis a vis 2.2% in FY2018 because of the increase in slippages in the portfolio. The Company has been able to improve its operating efficiency (operating expenses/average assets) in 9MFY2019 to 8.4% from 9.8% in FY2018 (12.3% in FY2017). However, expected increase in additions to field staff are likely to exert some pressure on the operating efficiency if commensurate business generation does not take place going forward. Going forward, UCL's ability to keep credit costs and borrowing costs under control would be critical.

Improving funding diversity is crucial to support growth: Total borrowings of UCL stood at LKR 2.1 Bn and comprised of securitized borrowing (84%) mainly from CDB, promissory notes (9%) and long-term bank funding (7%) as of Dec-18. ICRA Lanka expects timely support from the parent to continue as and when needed. The cost of incremental borrowing during 9MFY2019 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. 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 December 31, 2018.

During the year ended March 31, 2018, UCL reported a net profit of LKR 55 Mn on a total asset base of LKR 1,749 Mn, as compared to net profit of LKR 20 Mn on a total asset base of LKR 693 Mn in the previous fiscal year. For the nine months ended December 31, 2018 UCL reported a net profit of LKR 68 Mn on a total asset base of LKR 3,053 Mn.

Key financial indicators (Audited)

LKR Mn	FY2017	FY2018	9MFY2019 (Unaudited)
Net Interest Income	90	161	233
Profit after Tax	20	55	68
Net worth	337	371	433
Loans and Advances	518	1,533	2,451
Total Assets	693	1,749	3,053
Return on Equity	6.2%	15.5%	22.4%
Return on Assets	3.8%	4.5%	3.8%
Gross NPA	2.0%	1.8%	3.9%
Net NPA	-0.2%	0.0%	0.7%
Capital Adequacy Ratio	85.7%	32.4%	12.1%
Gearing (times)	0.8	3.1	4.9

Rating history for last three years:

Instrument	Amount Rated (LKR Mn)	Current Rating		Chronology of Rating History for the past 3 years		
		FY2019		FY2018	FY2017	FY2016
		Feb-19	Oct-18	Jan-18	-	-
Issuer rating	N/A	[SL]BBB- (Negative)	[SL]BBB- (Negative)	[SL]BBB- (Stable)	N/A	N/A
Proposed senior, unsecured, unlisted, redeemable debenture Programme	500	[SL]BBB- (Negative)	[SL]BBB- (Negative)	N/A	N/A	N/A

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