

ICRA Lanka reaffirms [SL]BBB+ rating of Asia Asset Finance PLC: outlook revised Negative

November 12, 2018

Instrument*	Rated Amount (LKR Mn)	Rating Action
Issuer rating	N/A	[SL]BBB+ reaffirmed; 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 Asia Asset Finance PLC (AAF or the Company) at [SL]BBB+ (Pronounced SL triple B plus) while revising the outlook to negative from stable.

Rationale

The revision in the outlook factors in the weakening in AAF's asset quality and earnings profile in FY2018 and Q1FY2019. AAF's gross NPA ratio increased to 9.4% in Jun-18 as compared to 7.8% in Mar-18 (6.5% in Mar-17) largely because of macro-economic challenges and adverse weather conditions. AAF's ROA moderated to 0.5% in Q1FY2019 from 1.6% in FY2018 (3.1% in FY2017) on increased funding and credit costs.

The rating continues to factor in AAF's status as a 60% subsidiary of Muthoot Finance Limited (MFL or the Parent; rated by ICRA Limited at [ICRA]AA(Stable)/[ICRA]A1+) and, the operational, financial and managerial support that it derives from MFL. The rating takes note of the adequate capitalisation profile characterized by a gearing of 5.2 times in Jun-18; ICRA Lanka envisages timely support from MFL to support portfolio growth of 25-30% over the next 2-3 years and meeting regulatory capital requirements, as internal generation is likely to remain moderate.

The rating also takes note of the company's currently moderate scale of operations and its exposure to customers with a modest credit profile. ICRA Lanka takes note of the company's target product segments going forward would be gold loans, 2-wheeler/3-wheeler leasing and mortgage loans (including SME loans). Considering the target segments, AAF's ability to maintain asset quality segments within reasonable limits and generate adequate earnings would be critical from a rating perspective.

Outlook: Negative

The negative outlook reflects the deterioration in AAF's asset quality and earnings profile. The outlook may be revised to "Stable" in case of steady improvement in AAF's asset quality indicators. ICRA Lanka believes that Asia Asset Finance PLC would continue to get MFL's support in a timely manner. The rating may be revised in case of a further weakening in the asset quality and profitability and, in case of lower than expected support from MFL.

Key rating drivers

Credit strengths

Operational, managerial and financial support from the parent: AAF is a 60% subsidiary of Muthoot Finance Limited (MFL; rated [ICRA]AA/stable/[ICRA]A1+). MFL is a gold loan non-banking finance

company, based in India, with a total asset base of LKR 777 Bn (INR 342 Bn) in Mar-18. MFL is represented by three board members on the nine-member board of AAF. Operationally, MFL supports AAF in staff training, internal controls, and internal audit functions. MFL infused LKR 400 Mn through a right issue in Oct-14 and going forward ICRA Lanka expects timely capital support from MFL for the envisaged business expansion and for meeting regulatory requirements, if required.

Adequate capital structure, timely capital infusion required for growth: AAF's gearing increased to 5.2 times in Jun-18 from 4.0 times in Mar-18 (3.8 times in Mar-17) as business expanded at a robust pace in relation to the internal generation. The company reported a Tier 1 of 13.1% (regulatory requirement 6%) and total capital ratio of 14.4% in Jul-18 (provisional), based on CBSL's new capital adequacy requirement. AAF would require close to LKR 600 Mn to LKR 650 Mn to support a 25- 30% growth per annum while keeping the tier-I capital at 9.5%¹, as internal generation is expected to remain modest; further the impact on account of the IFRS 9 transition on the company's capital profile also remains to be seen. However, ICRA Lanka believes MFL would provide timely capital support to the company if any need arises.

Diversification in resource profile: The Company's exposure to deposits has gradually reduced from 91% in Mar-15 to 64% in Jun-18. The funding profile has been diversified through securitisation and term loans which accounted for 24% and 12% on its total debt in Jun-18. ICRA Lanka noted that the securitisation facilities were obtained at higher rates, which impacted the margins of the company. The company continued to maintain a positive ALM mismatch of 8% in Jun-18 vis-à-vis 8% in Jun-17 with the support of long tenured securitised and term borrowings from banks and FIs.

Credit challenges

Moderate scale of operations and franchise: AAF is a medium scale NBFI, operating with 18 branches and more than 440 employees. The company reported LKR 10.7 Bn portfolio in Jun-18 and it comprised of leasing (25.8%), personal/working capital loans (20.5%), gold loan (18.9%) micro finance (14.8%), group personal loans (9.8%), property loans (5.2%) and other loans (5%). The portfolio reported a 29% annualised growth in 3MFY2019, compared to 15% and 31% growth reported in FY2018 and FY2017 respectively. AAF slowed down the growth in the micro finance and personal loan/working capital loan portfolios in view of the increase in delinquencies, which impacted growth in FY2018. Going forward, AAF is expected to focus on gold loans, leasing (2-wheeler, car and van) and mortgage loans, with an expected portfolio share of 40%, 30% and 20% over the medium term.

Modest profile of the target customer segment: AAF's target customers are lower and middle level salaried government and private sector employees, self-employees and SMEs. Modest credit profile of the target customer segments exposes it to adverse swings in economic cycles, which has currently impacted the asset quality of the company. Further, strengthening of the credit process is required to improve the quality of the loan portfolio, going forward.

Weakened asset quality indicators: AAF's portfolio quality deteriorated in FY2018. As a result, NPA increased from 6.5% in Mar-17 to 7.7% in Mar-18 and it stood 9.4% in Jun-18. Micro finance and personal/working capital loan portfolios were the main contributors for the increase in the delinquencies. Micro portfolio was affected because of adverse weather conditions experienced in CY2017 and CY2018. Personal/working capital portfolio was affected by tighter liquidity conditions that impacted the SME sector. AAF slowed down incremental exposure in the microfinance and personal/working capital loan

¹ 1 % above the regulatory requirement (8.50%) for NBFs with asset base of < LKR 100 Bn by July 2021

segments and strengthened its recovery activities. In the long term the company expects to move into asset backed products and its key focus would be gold loans, 2-wheelers, car, van and mortgage backed personal /SME loans. AAF's ability to control its delinquencies will be a key monitorable.

Weakening earnings profile: The increase in the cost of funds during FY2018 and 3MFY2019 impacted the company net interest margins, which moderated to 10.5% (provisional) in 3MFY2019 from 12.1% in FY2017 (11.1% in FY2018). Further, higher credit costs of 2.9% (provisional) in 3MFY2019 as compared to 2.5% in FY2017 (3.1% in FY2018) impacted the ROA which moderated to 0.5 % for 3MFY2019 as compared to 3.1% in FY2017 (1.6% in FY2018). Going forward, ability to control credit costs and improve operating efficiencies, would crucial for incremental profitability, as the company is expected to witness moderation in business yields on account of its focus on secured asset classes .

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:

Asia Asset Finance PLC is a registered finance company setup in 1970 as "Finance and Land Sales Company". In 2004, Asia Capital PLC (ACP) acquired AAF. In Aug-14, MFL acquired about 30% of the company and in Dec-14 MFL increased its stake up to 51%. During FY2016, MFL has further increased its stake to 60%. AAF offers gold loans, SME loans, vehicle finance (2wheelers, 3 wheelers, cars& vans etc.), loan against property, microfinance, fixed deposits and other personal credit facilities.

During FY2018, AAF reported a PAT of LKR 178 Mn on a total asset base of LKR 11.7 Bn as compared with a PAT of LKR 278 Mn on a total asset base of LKR 10.0 Bn in the previous financial year.

During Q1FY2019, AAF reported a PAT of LKR 16 Mn on a total asset base LKR 12.0 Bn.

Key financial indicators (audited)

	FY2017	FY2018	Q1FY2019 (Unaudited)
Net Interest Income	1,101	1,210	313
Profit after Tax	278	178	16
Net worth	1,737	1,859	1,875
Loans and Advances (Gross)	8,662	9,949	10,680
Total Assets	10,027	11,728	12,026
Return on Equity	17.39%	9.91%	3.44%
Return on Assets	3.07%	1.64%	0.54%
Gross NPA	6.45%	7.76%	9.43%
Net NPA	1.81%	1.05%	1.43%
Capital Adequacy Ratio	21.80%	21.95%	21.86%
Gearing (times)	3.79	4.01	5.20

Rating history for last three years:

Instrument	Current Rating (FY2018)			Chronology of Rating History for the past 3 years			
	Type	Amount Rated (LKR Mn)	Amount Outstanding (LKR Mn)	Date & Rating Oct 2018	Date & Rating Feb 2018	Date & Rating in FY2017 Dec 2016	Date & Rating in FY2016 -
Issuer rating	N/A	N/A		[SL]BBB+ (Negative)	[SL]BBB+ (Stable)	[SL]BBB+ (Stable)	N/A

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