

## ICRA Lanka Assigns Issuer rating of [SL]BBB+ to Asia Asset Finance PLC

December 09, 2016

Instrument	Amount	Rating Action
Issuer Rating	N/A	[SL]BBB+ with stable outlook; Assigned

ICRA Lanka Limited, Subsidiary of ICRA Limited, group company of Moody's Investors Service has assigned the issuer rating of **[SL]BBB+ (pronounced SL triple B plus)** with a stable outlook to Asia Asset Finance PLC (AAF or the Company). The rating factors in AAF's status as 59.7% subsidiary of Muthoot Finance Limited (MFL or the Parent; rated [ICRA]AA(Stable)/[ICRA]A1+ by ICRA Limited) and, the operational, financial and managerial support that it derives from the parent company. The company presently has a moderate capitalization with gearing at 4.8 times as in Jun-2016; while it would require capital over the medium term to support the high portfolio CAGR of 30-40% in the medium term, strong parent provides comfort on timely availability of capital support. The rating takes cognizance of the reduction in the share of fixed deposits to 71% in Jun-16 from about 96% in Mar-14 and its comfortable liquidity profile due to availability of unutilized funding lines and expected availability of funding lines from the parent entity.

The rating also takes note of the company's currently small scale of operations, exposure to customers with a modest credit profile and its weak asset quality (Gross NPA at 6.8% in Jun-16). ICRA Lanka takes note of the improvement in the profitability indicators in the recent past (RoA at 2.18% in FY2015, 2.60% in FY2016 and 2.63% in Q1FY2017); however considering the company's target product segment namely, microfinance, gold loans, personal loans and 2/3 wheeler loans, ability to control asset quality in these segments within reasonable limits and maintain good profitability indicators would be critical from a rating perspective.

As of Jun-16, total portfolio of the company was LKR 7,457 Mn. Product wise, 50% of the lending portfolio comprised of loans followed by Leases (18%) and Hire purchases (5%). SME loans is the largest asset class in the lending portfolio with 26% of the portfolio, followed by group personal loans (12%) and Gold loans (11%) as in Jun-16. During the last 4 years ended Mar-16, AAF has recorded a portfolio CAGR of 33%; AAF has 15 branches and it is planning to expand it to 50 branches by 2020.

AAF has weak asset quality characterized by gross NPA at 6.8% as in Jun-16 and net NPA/network of 14.2%. The company's asset quality moderated over the recent past with the expansion of its lending portfolio; largely contributed by growth in the micro finance portfolio, however the share of the unseasoned portfolio has also increased. Ability of the company to control incremental slippages would be crucial, considering the modest credit profile of the target customer segment.

The capital infusion in FY2015 supported the capitalization profile, while the portfolio grew at 51% (Y-o-Y) during FY2016 (50% Y-o-Y in Q1FY2017). The company would require regular capital infusion to support the envisaged portfolio CAGR of 30%-40% over the next 2 years. ICRA Lanka takes cognizance of the strong parent, which is expected to provide timely capital support.

Deposits account for about 71% of the total borrowing profile of the company as on June 30, 2016; with 81% having tenure of 1 year and above. It has increased share of bank funding which provides some comfort on the liquidity. In addition to the bank funding, the company is expecting a credit facility close to LKR 500-600 Mn from Muthoot Finance at favourable rates. Going forward, ability of the

company to diversify its funding profile further would be critical to secure timely funding, at competitive rates, as the portfolio expands.

AAF's profitability indicators improved during FY2016 and in Q1FY2017 as it increased the share of high yielding assets, i.e. microfinance in its portfolio. RoA improved to 2.6% in FY2016 and in Q1FY2017 as compared with 2.2% in FY2015 as the NIM expanded. During the above mentioned periods, the operating expenses was largely range bound at about 7.3-7.4% but credit costs increased to 1.6% in Q1FY2017 as compared with 0.5% in FY2015 (1.2% in FY2016). Going forward, therefore ability to keep the operating costs and credit costs under control, considering the target customer segment, would be crucial for incremental profitability.

### **Company Profile**

AAF 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 59.7%. Currently, as one of the small scale Licensed Finance Companies (LFCs) in the Sri Lanka, AAF offers SME loans, vehicle finance ( 2/3 wheelers, cars& vans, buses etc.), loan against property, microfinance, gold loans, fixed deposits and other personal credit facilities.

During FY2016, AAF reported a PAT of LKR 175 Mn on a total asset base of LKR 8.1 Bn as compared with a PAT of LKR 101 Mn on a total asset base of LKR 6.2 Bn in the previous financial year.

During Q1FY2017, AAF reported a PAT of LKR 56 Mn on a total asset base LKR 8.9 Bn.

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