

ICRA Lanka reaffirms the issuer rating of Asia Asset Finance PLC

February 09, 2018

Instrument*	Rated Amount (LKR Mn)	Rating Action
Issuer rating	N/A	[SL]BBB+ (Stable); 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 plus) with a stable outlook assigned to Asia Asset Finance PLC (AAF or the Company).

Rationale

The reaffirmation of the rating takes note of AAF's status as a 60% subsidiary of Muthoot Finance Limited (MFL or the Parent; rated [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 5.1 times in Sep-17 as ICRA Lanka envisages timely support from the parent to support portfolio growth of 20-25% over the next 2-3 years, while internal generation is likely to be relatively moderate. The rating also takes note of the steady reduction in the share of deposits, however the funding costs have increased thereby impacting its profitability indicators.

The rating also takes note of the company's currently moderate scale of operations, exposure to customers with a modest credit profile and its subdued asset quality (Gross NPA at 6.97% in Sep-17). ICRA Lanka takes note of the company's target product segment namely gold loans, personal loans, SME loans and 2-wheeler/3-wheeler loans. Considering the target segments, AAF's ability to maintain asset quality within reasonable limits and generate good profitability indicators would be critical from a rating perspective.

Outlook: Stable

ICRA Lanka believes that Asia Asset Finance PLC would continue to get MFL's support in a timely manner. The outlook may be revised to 'Positive' in case of steady improvement in the asset quality and earnings of the company. The outlook may be revised to 'Negative' in case of a further weakening in the asset quality or a significant deterioration in the profitability and capitalisation profile.

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 non-banking finance company with focus on gold loan having a total asset base of LKR 791 Bn (INR 324.4 Bn) as in Sep-17. MFL has three board members on the nine-member board of AAF. Operationally, MFL supports AAF in staff training, internal controls and in process audits. At the board level, MFL's representatives provide strategic direction to the senior management. MFL infused LKR 443.8 Mn through a right issue in Oct-14 and going forward ICRA Lanka expects timely capital support from MFL for the envisaged business expansion.

Adequate capital structure; timely capital infusion required for growth - The company reported a risk weighted capital adequacy ratio of 20.4% in Sep-17, which was above the systematic average of 11.6%. AAF reported a PAT of LKR 96 Mn with a RoE of 10.9% in H1FY2018 as compared to LKR 278 Mn with a RoE of 17.4% in FY2017. The gearing of the company was 5.1 times in Sep-17 and 4.5 times in Mar-17. In Sep-17, gearing increased to 5.1 times as internal generation moderated with the increase in the cost of funds during H1FY2018. The company reported a RoE of about 11.0% for the H1FY2018. Based on ICRA Lanka's estimates, AAF requires close to LKR 600 Mn over the period FY2018-FY2020 to support annual portfolio CAGR 25% during this period, while maintaining the leverage at about 5 times. ICRA Lanka believes that MFL would provide timely capital support to the company for growth, when required.

Steady reduction in dependence on deposits - The company's exposure to deposits reduced from 91% in Mar-15 to 67% in Sep-17. The funding profile was diversified through securitisation and term loans from banks and cooperative societies. Securitisation and term loans contributed to 24% and 9% respectively of the total borrowings in Sep-17. ICRA Lanka however notes that the higher cost of funds has impacted AAF's margins in H1FY2018.

Credit challenges

Moderate scale of operations and franchise - AAF is a moderate sized NBFI, operating with 18 branches and about 440 employees. The company reported a LKR 9.4 Bn portfolio in Sep-17 and it comprised of business loans/SME loans (28%), micro finance (19%), leasing (16%), gold loans (15%) and other personal loans (10%). The portfolio reported a 19% annualised growth in H1FY2018, compared to 31% and 51% growth reported in FY2017 and FY2016 respectively. AAF slowed down its microfinance loan growth in view of the increase in delinquencies. As a result, overall portfolio growth moderated in H1FY2018. Going forward AAF is expected to focus on gold loans, business/SME loans, personal loans and leasing (2wheeler, car and van). The company envisages to achieve a LKR 20 Bn portfolio by FY2020 with 30% exposure towards gold loans and business/SME (backed by mortgage) loans and leasing accounting for 30% and 25% respectively.

Modest profile of the target customer segment - AAF's target customers are lower and middle level salaried government and private sector employees, and self-employed segment. Modest credit profile of the target customer segments exposes them to adverse swings in economic cycles.

Asset quality indicators continue to remain subdued - Gross NPA increased from 6.08% in Mar-16 to 6.45% in Mar-17 and was 6.97% in Sep-17. Microfinance was the main contributor for the increase. Microfinance portfolio was affected because of the adverse weather conditions experienced in 2017. AAF controlled the delinquencies by slowing down the micro finance disbursements and strengthening the recovery activities. Going forward, AAF envisages reducing the microfinance portfolio share to less than 10% by Mar-20. AAF's ability to control incremental delinquencies and undertake effective recoveries would be key monitorable.

Profitability impacted by the increase in cost of funds - AAF's yield on earning assets improved during FY2017 and in H1FY2018 to about 23% as compared with 20% in FY2016 with the increase in the share of high yielding microfinance and gold loan portfolio. However, the increase in cost of funds, especially during H1FY2018, impacted the margin which declined to about 11% as compared with about 12% in FY2017 (10% in FY2016). While the operating costs and credit costs remained range bound at about 7.2-7.3% and 2.4-2.5% respectively during FY2017 and H1FY2018 moderation in NIMs impacted the RoA. RoA declined from 3.1% in FY 2017 to 1.8% in H1FY2018. Going forward, ability to keep funding costs and credit costs under control would be critical from an incremental profitability perspective.

Analytical approach: For arriving at the ratings, ICRA Lanka 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%. Currently, as one of the medium scale Licensed Finance Companies (LFCs) in the Sri Lanka, AAF offers gold loans, SME loans, vehicle finance (2wheelers, 3 wheelers, cars & vans etc.), loans against property, microfinance, fixed deposits and other personal credit facilities.

During FY2017, AAF reported a PAT of LKR 278 Mn on a total asset base of LKR 10.0 Bn as compared with a PAT of LKR 175 Mn on a total asset base of LKR 8.1 Bn in the previous financial year.

During H1FY2018, AAF reported a PAT of LKR 96 Mn on a total asset base LKR 11.1 Bn.

Key financial indicators (audited)

	FY2016	FY2017	H1FY2018 (Unaudited)
Net Interest Income	672	1,101	600
Profit after Tax	175	278	96
Net worth	1,462	1,737	1,775
Loans and Advances (Gross)	6,629	8,662	9,494
Total Assets	8,115	10,027	11,170
Return on Equity	12.76%	17.39%	10.98%
Return on Assets	2.60%	3.07%	1.82%
Gross NPA	9.07%	6.45%	6.97%
Net NPA	3.69%	1.81%	1.59%
Capital Adequacy Ratio	22.27%	21.80%	20.47%
Gearing (times)	4.50	3.79	5.11

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 Jan 2018	Date & Rating in FY2017 Oct 2016	Date & Rating in FY2016 -	Date & Rating in FY2015 -
Issuer rating	N/A	N/A		[SL]BBB+	[SL]BBB+	N/A	N/A

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