

ICRA Lanka reaffirms the issuer rating of [SL]BB+ for Orient Finance PLC; Revises outlook to Negative

October 19, 2018

Instrument	Rated Amount (LKR Mn)	Rating Action
Issuer rating	N/A	[SL]BB+; outlook negative; watch with developing implications removed
Guaranteed redeemable debenture programme	1,000	[SL]A-(SO); rating continues under watch with developing implications

Rating action

ICRA Lanka Limited, subsidiary of ICRA Limited, a group company of Moody's Investors Service has reaffirmed the issuer rating at [SL]BB+ (pronounced SL double B plus) for Orient Finance PLC (OFP or the company). The watch with developing implications on the issuer rating has been removed, outlook on the rating is revised to Negative.

ICRA Lanka continues to keep the rating of [SL]A-(SO) (pronounced SL A minus Structured Obligation) on the LKR 1,000 Mn Guaranteed Redeemable Debenture programme under watch with developing implications. The letters SO in parenthesis suffixed to a rating symbol stand for Structured Obligation. An SO rating is specific to the rated issue, its terms, and its structure. The SO rating does not represent ICRA Lanka's opinion on the general credit quality of the issuer concerned.

Rationale

The issuer rating factors in the operational, financial and managerial support from the Janashakthi group; Janashakthi PLC (JPLC), the holding company of the group is rated [SL]BBB; on watch with developing implications. The issuer rating however considers the weakening in OFP's asset quality, subdued financial performance and its moderate capitalization profile. The company's portfolio declined to LKR 15.7 Bn in March 2018 from LKR 17.1 Bn in March 2017, as incremental growth was controlled in view of the deterioration in the asset quality and financial risk profile. ICRA Lanka also notes OFP would require regular capital infusion going forward to meet the enhanced regulatory capital requirements over the next 3 years, as internal generation may not be adequate. ICRA Lanka expects timely support from the Janashakthi group in meeting the regulatory capital and growth capital requirements of the company, going forward.

The rating for the LKR 1,000 Mn Guaranteed Redeemable Debentures programme is based on the strength of an unconditional and irrevocable guarantee from Janashakthi General Insurance Limited (JGIL/the Guarantor), a subsidiary of Allianz SE from February 2018, to the extent of the entire principal and two interest instalments, and the payment mechanism designed to ensure repayment of the rated instrument even if OFP does not pay and, the guarantee being invoked by the debenture trustee. The rating also assumes that the guarantee will be duly invoked by the debenture trustee, as per the terms of the underlying transaction, in case there is a default in payment by OFP. ICRA Lanka has an insurance financial strength rating of [SL]A (pronounced SL A) on JGIL, which is currently under watch with developing implications.

Outlook: Negative

The negative outlook reflects the weakening in the asset quality and overall financial risk profile of OFP. The outlook may be revised to 'Stable' in case of steady improvement in the asset quality, earnings, and capitalization profile of OFP. The rating may be revised downwards, in case of a lower than expected support from the Janashakthi group or in the event of further weakening in OFP's asset quality and financial indicators.

Key rating drivers

Credit strengths

Part of the Janashakthi group; ICRA Lanka is cognizant of the commitment of the Janashakthi group towards OFP; OFP is 90% owned by JPLC. ICRA Lanka envisages that future capital requirements of OFP would be met by the group in a timely manner. Moreover, Mr. Prakash Schaffter (promoter), will be acting in an executive capacity along with the management team of OFP going forward in overlooking overall administrative functions, while the current CEO would be overlooking primarily the core operations. ICRA Lanka envisages the greater management bandwidth and focus resulting from this move to support company's future performance.

Credit challenges

Deterioration in asset quality indicators - OFP's gross NPAs increased by 52% during FY2018 to LKR 1,399Mn as of March 2018; gross NPA ratio stood at 8.9% as in March 2018 from 5.98% in March 2017. The increase in the NPAs was observed in all key asset classes namely buses/lorries, car/van, 3-wheelers and equipment finance. The rating takes note of the efforts by the management to strengthen the credit and recovery processes. OFP's ability to improve overall asset quality and control incremental slippages will be a key monitorable from a rating perspective.

Moderate capitalization profile - OFP's total capital adequacy ratio (CAR) stood at 12.14% as of June 2018 (12.18% in March 2018), whereas core CAR stood at 9.54% (compared to 9.65% in March 2018). The company expects to convert the preference shares of LKR 400 Mn, subscribed by JPLC, to equity in the current financial year to augment its capital profile. ICRA Lanka however notes that capital adjustments because of the IFRS 9 transition and, the increased regulatory capital requirements over the next three years, would warrant further external capital infusion as OFP's internal generation would not be adequate. The company's core capital stood at LKR 1.4 Bn as in Jun-18, which would have to be enhanced to LKR 2.0 Bn by Jan-20 and LKR 2.5 Bn by Jan-21 as per the regulatory requirement for Licensed Finance Companies (LFCs). ICRA Lanka expects timely support from the group for meeting the capital requirements.

Subdued profitability indicators - The core product of OFP is vehicle leasing, which accounted for around 74% of the total portfolio in March 2018 (77% in March 2017). The vehicle leasing industry is characterised by a high level of competition as well as regulatory restrictions. Competitive business environment and increase in the cost of funds has resulted in contraction of OFP's business margins. OFP's NIMs reduced to 6.4% in FY2018 as compared to 7.1% in FY2017 and 7.3% in FY2016. Further, deteriorating asset quality has pushed the credit cost upwards, with the total impairment cost at LKR 546 Mn in FY2018 vis-à-vis LKR 322 Mn in FY2017 and LKR 329 Mn in FY2016. Consequently, OFP reported a net loss of LKR 110 Mn in FY2018, compared to a net profit of LKR 258 Mn reported in FY2017. For the three months ended June 2018, OFP reported a net loss of LKR 21 Mn.

Analytical approach: For arriving at the ratings, ICRA has applied its ratings methodologies as indicated below.

Links to applicable criteria: [ICRA Lanka's Credit Rating Methodology for Non-Banking Finance Companies](#)

Company Profiles:

Janashakthi PLC (Parent company)

Janashakthi PLC is an investment holding company incorporated in the year 1990. The company is owned and managed by the Schaffter family (Mr. Prakash Schaffter 50%, Mr. Ramesh Schaffter 50%). The main subsidiaries include Janashakthi Insurance PLC and Orient Finance PLC. In September 2018, JPLC also acquired a 41.1% stake in Dunamis Capital PLC, a listed financial services and real estate development company.

During the financial year ended March 31, 2018 Janashakthi PLC reported a standalone net profit of LKR 4,926 Mn (inclusive of capital gains) on a total operating income of LKR 179 Mn, compared to a net loss of LKR 510 Mn, on a total operating income of LKR 496 Mn in the corresponding period of the previous fiscal. On a consolidated basis, Janashakthi group reported a net profit of LKR 8,567 Mn on a total income of LKR 7,690 Mn in FY2018, compared to a net profit of LKR 885Mn on a total income of LKR 17,819 Mn for the previous fiscal.

Janashakthi Insurance PLC

Janashakthi Insurance Company PLC was initially incorporated in Sri Lanka as Janashakthi Life Insurance Co. Ltd, a public company with limited liability, in 1992. JIP began its operations in September 1994, as Sri Lanka's first specialized life insurer and ventured into Non-Life Insurance through Janashakthi General Insurance Co Ltd (Janashakthi General), which was established in 1995. JIP and Janashakthi General were merged in 2000 to form JIP, a composite insurance player. JIP acquired National Insurance Corporation Ltd in 2001, and later diversified into other areas of financial services. Janashakthi General Insurance Limited (JGIL) was incorporated as a wholly owned subsidiary of JIP during 2014 and, JIP transferred the non-life business to JGIL from January 01, 2015, thus complying with the regulatory requirement. JIP fully acquired AIA General Insurance Lanka Limited during 2015 and merged it with JGIL during January 2016. JIP was the 3rd largest general insurer and 7th largest life insurer in Sri Lanka in Dec-17.

On February 2018, the Board of Directors of Janashakthi PLC announced the proposed sale of JGIL to Allianz SE. Having completed the divestment by February 2018, JIP now operates as standalone life insurance company. During the year ended December 2017, JIP reported a stand-alone net profit of LKR 1,692 Mn on a gross written premium of LKR 2,903 Mn, compared to a net profit of LKR 953 Mn on a gross written premium of LKR 2,944 Mn in the 12 month period ended December 2016.

Orient Finance PLC

Orient Finance PLC (formerly known as Bartleet Finance PLC, BFP, prior to the acquisition and merger process) was incorporated in 1981. The Company is a registered finance company and is licensed by the Monetary Board of Sri Lanka to accept Fixed Deposits from the public. The Company was listed on the Main Board of the Colombo Stock Exchange in June 2011.

In July 2015, BFP acquired erstwhile-Orient Finance Plc after paying close to LKR 1.70 Bn in cash and 1,213 Bartleet shares to the erstwhile-Orient Finance Plc shareholders. After the merger, the company was renamed as Orient Finance PLC and Janashakthi PLC became the main shareholder of the company with a

99.9% shareholding. In January 2015, OFP made an initial public offer (IPO) of about LKR 1.0 Bn. Objective of the IPO was to improve the capital structure of the company and settle the short term loan obtained from Orient Capital Limited (a fully owned sub-subsidiary of Janashakthi PLC) for acquisition. As of June 2018 Janashakthi PLC holds 89.8% in OFP.

Recent Results

During the year ended March 2018, OFP reported a net loss of LKR 110 Mn on a total asset base of LKR 18,115 Mn, compared to a PAT of LKR 258 Mn on a total asset base of LKR 19,450 Mn in the previous financial year. For the three months ended June 2018, OFP reported a net loss of LKR 21 Mn on a total asset base of LKR 17,790 Mn.

Orient Finance PLC - Audited

LKR Mn	FY2017	FY2018	Q1 FY2019
Total income	3,310	3,496	828
Operating Profit/Loss	700	497	129
Profit After Tax	258	(110)	(21)
Reported Net Worth	2,500	2,348	2,328
Borrowings	16,372	15,252	14,795
RPAT/ATA	1.41%	-0.59%	-0.47%
Gross NPA	5.98%	8.90%	NA
Total CAR	11.70%	12.18%	NA
Gearing – reported	6.6	6.5	6.4
Gearing – adjusted*	9.0	9.1	9.0
Total Assets	19,450	18,115	17,790

Note: Figures as on 30.06.2018 are based on un-audited financials. * Gearing adjusted for re-valuation reserve and goodwill.

Rating history for last three years:

Chronology of Rating History for the past 3 years						
Instrument	Amount Rated (LKR Mn)	Amount Outstanding (LKR Mn)	Date & Rating in FY2019	Date & Rating in FY2018	Date & Rating in FY 2018	Date & Rating in FY 2017
			Oct 2018	Mar 2018	Aug 2017	Sep 2016
Issuer Rating	N/A	N/A	[SL] BB+; Negative	[SL]BB+ rating put on watch with developing implications	[SL]BB+ (Stable)	[SL]BB+ (Stable)
Guaranteed redeemable debenture program	LKR 1,000 Mn	LKR 1,000 Mn	[SL]A- (SO); rating on watch with developing implications	[SL]BB+ rating on watch with developing implications	[SL]A- (SO) (Stable)	[SL] A- (SO) (Stable)

ANALYST CONTACTS

Ms. Apsara Thurairetnam
+94 11 4339907
apsara@icralanka.com

Mr. A.M Karthik
+91 44 45964308
a.karthik@icraindia.com

RELATIONSHIP CONTACT

Mr. W. Don Barnabas
+94 11 4339907
wdbarnabas@icralanka.com



Subsidiary of

ICRA Limited

A Group Company of Moody's Investors Service

CORPORATE OFFICE

Level 10, East Tower, World Trade Center, Colombo 01, Sri Lanka

Tel: +94 11 4339907; Fax: +94 11 2333307

Email: info@icralanka.com; Website: www.icralanka.com

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