

## ICRA Lanka reaffirms the rating of Asia Asset Finance PLC

December 09, 2019

Instrument*	Rated Amount (LKR Mn)	Rating Action
Issuer rating	N/A	[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 Asia Asset Finance PLC (AAF or the Company) at [SL]BBB+ (Pronounced SL triple B plus) with Negative outlook.

### Rationale

The continued Negative outlook factors in the sustained deterioration of AAF's asset quality indicators, where gross NPA has increased from 9.4% in June 2018 to about 12.9% as in June 2019, mainly on account of higher slippages in company's micro and SME related lending; ICRA Lanka is cognizant of challenging macro-economic and political conditions that prevailed during the period, particularly affecting SMEs and other weaker segments of the economy. The rating, however, factors the efforts made by the Company to shift its portfolio from unsecured lending to safer asset backed products such as gold loans and leasing; exposure to unsecured lending has moderated to about 35% as in June 2019 from about 60% as in March 2017 (about 52% as in March 2018). ICRA Lanka also notes that, while the risk weighted capital adequacy ratios remain adequate; however, buffer over minimum core capital requirement (set by the CBSL) is expected to be modest. AAF's reported net worth stood at LKR 2.1 Bn as in June 2019 (tangible net worth adjusted for deferred tax remained at about LKR 1.9Bn) as compared to the minimum regulatory core capital requirement of LKR 2 Bn by January 2020 (LKR 2.5 Bn by January 2021). The rating continues to factor in AAF's status as a 73% owned 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. ICRA Lanka expects timely capital support from MFL, if required.

The rating also takes cognizance of moderation in overall profitability, mainly on the account of lending margin compression. The company's liquidity however is supported by funding diversification to relatively longer tenor bank funding, however the same also contributed to the margin compression.

### 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 over the medium term. The rating may be downgraded in case of further weakening in the asset quality and profitability and also, in case of lower than expected support from MFL or a significant reduction in the shareholding by MFL.

## Key rating drivers

### Credit strengths

**Operational, managerial and financial support from the parent:** AAF is a 73% owned subsidiary of Muthoot Finance Limited (MFL; rated [ICRA]AA/stable/[ICRA]A1+). MFL has demonstrated a track record

of providing both financial and operational support to AAF over the last few years. During FY2019, MFL infused about LKR 403 Mn via rights issue; the rights issue has increased MF's stake in AAF from about 60% to 73%. 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. ICRA Lanka expects continuous financial, managerial and operational support from MFL, particularly in meeting growth and regulatory capital requirements, going forward.

**Adequate capitalisation ratios; buffer over core minimum capital may remain modest:** As in June 2019, AAF had a total reported net worth of LKR 2.1Bn (LKR 1.9Bn adjusted for deferred tax). ICRA Lanka notes that internal generation remains modest in relation to additional core capital requirements going forward. Timely capital support, if required from MFL, is however expected to provide support in meeting regulatory requirements and for growth. From a risk weighted capital adequacy point of view, AAF remained adequate, where the core CAR stood at 15.6% as in June 2019 against the regulatory minimum of 6.5% and total CAR also remained at 15.6% against the regulatory minimum of 10.5%.

**Funding diversification with steady reduction in dependence on deposits supports liquidity profile:**

The Company's exposure to deposits has gradually reduced from about 91% in March 2015 to 52% in June 2019. The funding profile has been diversified through securitisation and term loans. ICRA Lanka noted that these securitisation facilities were obtained at higher rates, which impacted the core margins of the company. The company continued to maintain a positive ALM mismatch of 10.1% in June 2019 vis-à-vis positive 7.6% in June 2018, with the support of long tenured securitised and term borrowings from banks and FIs.

### Credit challenges

**Deterioration in asset quality indicators, however shifting the portfolio towards more secure asset backed lending provides some comfort:** AAF's gross NPA has increased to 12.9% as in June 2019, from 9.4% in June 2018 and 7.8% in March 2018, mainly on the account of higher slippages in company's micro and SME related lending. However, the rating factors the shift in lending portfolio towards secured asset classes such as gold loans and leasing, that demonstrate better asset quality indicators. As in June 2019 gross NPA ratio of secured portfolio stood at about 2.6% as compared to the overall gross NPA ratio of 12.9%, while the NPA ratio of unsecured portfolio stood at about 30.6% during the same period.

**Compression of core lending margins, affecting overall profitability:** AAF's lending yields are moderating as the portfolio is shifting from high yielding unsecured lending to more secured asset backed lending. Also, overall cost of funds has increased due to higher contribution of securitized funding facilities. This has resulted in moderation of NIM from 12.1% in March 2017 to 10.1% in March 2019 and 9.5% in June 2019. ROA (PAT/ ATA) has moderated over the last 2 years, from 1.6% in March 2018 to 0.7% in June 2019 (0.8% in March 2019). Going forward, it is crucial for the Company to manage its operating and credit costs, as room for lending margin expansion is expected to be limited.

**Analytical approach:** For arriving at the ratings, ICRA has applied its rating methodologies as indicated below. The rating factors in the support from the parent, Muthoot Finance Limited.

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 August 2014, MFL acquired about 30% of the company and in December 14 MFL increased its stake up to 51%. During FY2020, MFL has further increased its stake to about 73% via a rights issue. AAF offers gold loans, SME loans, vehicle finance (2wheelers, 3 wheelers, cars& vans etc.), loans against property, fixed deposits and other personal credit facilities.

During FY2019, AAF reported a PAT of LKR 101 Mn on a total asset base of LKR 13.9 Bn as compared with a PAT of LKR 178 Mn on a total asset base of LKR 11.7 Bn in the previous financial year. During Q1FY2019, AAF reported a PAT of LKR 25 Mn on a total asset base LKR 14.4 Bn.

### Key financial indicators (audited)

	FY2018	FY2019	Q1FY2020 (Unaudited)
Net Interest Income	1,210	1,289	334
Profit after Tax	178	101	25
Net worth (adjusted for deferred tax)	1,746	1,703	1,878
Loans and Advances (Gross)	9,949	12,586	12,904
Total Assets	11,728	13,899	14,366
Return on Equity	9.9%	5.3%	4.9%
Return on Assets	1.6%	0.8%	0.7%
Gross NPA	7.8%	9.2%	12.9%
Net NPA	1.1%	0.9%	2.0%
Capital Adequacy Ratio	21.9%	15.6%	15.6%
Gearing (times)	4.3	6.8	6.4

Note: Capital adequacy ratio from FY2019 onwards is based on the new CAR computation framework

### Rating history for last three years:

Instrument	Chronology of Rating History for the past 3 years						
	Type	Amount Rated (LKR Mn)	Amount Outstanding (LKR Mn)	Date & Rating in FY2020	Date & Rating in FY2019	Date & Rating in FY2018	Date & Rating in FY2017
				Nov-19	Nov-18	Feb-18	Dec-16
Issuer rating	N/A	N/A	N/A	[SL]BBB+ (Negative)	[SL]BBB+ (Negative)	[SL]BBB+ (Stable)	[SL]BBB+ (Stable)

### ANALYST CONTACTS

**Mr. Rasanga Abhishek**  
+94 11 4339907  
rasanga@icralanka.com

**Mr. Dasith Fernando**  
+94 11 4339907  
dasith@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](mailto:info@icralanka.com); Website: [www.icralanka.com](http://www.icralanka.com)

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