

## ICRA Lanka reaffirms the issuer rating of UB Finance Company Limited

May 02, 2020

Instrument	Rated Amount (LKR Mn)	Rating Action
Issuer rating	N/A	[SL]BB (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 UB Finance Company Limited ("UBF" or the Company) at [SL]BB (Pronounced SL double B). The outlook on the rating is Negative.

### Rationale

The rating reaffirmation factors in UBF's weak capital profile and asset quality indicators as compared to the system average. UBF's capital profile deteriorated significantly since 2018 because of poor profitability and adjustments required as per the revised regulatory capital computation norms and very specifically due to the one-time adjustment of LKR 430 Mn on account of the IFRS-9 transition in Mar-19. Consequently, in Jan-19 Central Bank of Sri Lanka ("CBSL") placed a lending cap of LKR 9.8 Bn (LKR 8.6 Bn <sup>1</sup>as in Dec-19) and deposit cap of LKR 7.2 Bn (LKR 6.3 Bn as in Dec-19) on the Company. ICRA Lanka had factored in timely capital and liquidity support from Union Bank of Colombo PLC (UBC or the parent; rated [SL]BBB/stable). However, UBC did not infuse fresh capital in the last fiscal year as UBF is in the process of raising a sizeable capital (in relation to its current net worth) from an external investor. The capital-raising process is still underway. ICRA Lanka takes into consideration the commitment from UBC via an undertaking letter, to provide capital support, if capital infusion from external investor does not materialise. In view of the commitment from UBC and the ongoing capital raising from an external investor, CBSL has granted an extension to UBF to meet various statutory thresholds till March 31, 2020. ICRA Lanka noted that the company has failed to meet the extended deadline to infuse capital. If the Company fails to meet the regulatory capital requirement by Jun-20, it could lead to a correction in the rating.

ICRA Lanka notes UBF's weak asset quality with its gross NPA ratio (GNPA) at 17.00% in Dec-19, higher than the Licensed Finance Company sector's average of 10.78%. The GNPA marginally improved in Dec-19 from 18.1% in Mar-19, as a result of the write off of LKR 664 Mn during 9MFY2020. Further, ICRA Lanka notes the potential impact of the COVID-19 pandemic and the proposed debt moratorium announced by the CBSL. ICRA Lanka foresees a substantial reduction in the collections in the short term and significant liquidity requirement to bridge the short-term liquidity gap. The Company has unutilized funding lines of LKR 900 Mn from UBC and expects further liquidity support from UBC, if required, till the stability of the present developments. ICRA Lanka would closely monitor the UBF's extent of timely capital infusion, liquidity position, changes in ownership structure and asset quality performance, over the near term. The rating continues to factor in UBF' modest scale and subdued earnings profile.

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<sup>1</sup> Gross lending portfolio

## Outlook: Negative

The Negative outlook reflects the weakened capital profile, which has resulted in the lending and borrowing restrictions and, its weak asset quality profile. The outlook may be revised to 'Stable' in case the Company is able to secure adequate capital in a timely manner and improve its asset quality and liquidity profiles. There could be a correction in the rating in case the capital infusion does not materialise by June 2020.

## Key rating drivers

### Credit challenges

**Significant external capital requirement;** UBF is a 73% subsidiary (81% by voting rights) of Union Bank of Colombo PLC ("UBC", rated by ICRA at [SL]BBB/Stable). UBC has infused close to LKR 1.4 Bn to UBF ("UB Finance Company Limited"/ "the Company") since 2011. UBF continues to non-comply with the regulatory Core Capital requirement since Mar-18 and capital adequacy requirements since Jan-19. The Company reported a core capital of LKR 435 Mn in Dec-19 as compared to regulatory requirement of LKR 1,500 Mn in Dec-19. The one-time IFRS 9 transition adjustment of LKR 400 Mn, adjusted for FY2019 had a significant impact on UBF's overall capital position. The regulatory Core Capital Ratio and the Capital Adequacy Ratio was 1.50% and 3.05% in Dec-19 as compared to the regulatory requirement of 6.50% and 10.50% in Dec-19 (3.90% and 5.74% in Mar-19). As a result, CBSL has placed a lending cap of LKR 9,800 Mn and deposit cap of LKR 7,200 Mn on the Company since Jan-19.

ICRA Lanka notes that UBF requires immediate minimum capital support of around LKR 2,200 Mn to meet the regulatory core capital requirement of LKR 2,000 Mn by January 01, 2020 and LKR 2,500 Mn by January 01, 2021. UBC did not infuse fresh capital in 2018, as UBF was in the process of raising a sizeable capital from an external investor. ICRA Lanka takes into consideration the commitment from UBC via an undertaking letter that in case UBF is unable to secure capital from an external investor, then UBC would infuse capital, to meet the statutory capital requirements of UBF in 2020. In view of the on-going capital raising process with an external investor, Central Bank of Sri Lanka ("CBSL") granted extension to UBF till March 31, 2020 to meet various statutory thresholds.

**Weak asset quality;** UBF reported Gross NPA ratio of 17.00% as in Dec-19 as compared to 18.07% in Mar-19 (13.83% in Mar-18). UBF's asset quality was weak as compared to the Licensed Finance Company ("LFC") sector's gross NPA of 10.78% in Dec-19. This was partly due to depletion of its portfolio and weaker collection and recovery process. The legacy portfolio contributed for 1% of the total lending portfolio and 6% of the NPA portfolio in Dec-19 as compared to 6% and 33% in Mar-19. The decline in the share of legacy portfolio to total portfolio was due to LKR 499 Mn write-off from the legacy portfolio in 9MFY2020. Delinquency of the 90 days past due ("dpd") bucket remained high at 27.78% in Dec-19 as compared to 24.95% in Mar-19. The provision coverage ratio of the Company was low at 45.29% in Dec-19 (65.86% in Mar-19) as compared to 56.41% of the LFC sector. The reason for the reduction in provision coverage ratio and Gross NPA ratio in Dec-19 was due to LKR 640 Mn (36% of opening Gross NPA) write-off during 9MFY2020.

**Modest scale of operations;** UBF operates with a modest portfolio of LKR 8.6 Bn as in Dec-19 (LKR 9.9 Bn as in Mar-19 and LKR 10.1 Bn as in Mar-18). The Company offers lease and vehicle backed loans (62% as in Dec-19), factoring & working capital financing (14%), Fixed Deposits backed loans (7%), Gold loans (3%) and others (14%). Key asset classes in the lease and vehicle backed loan category includes cars, light

commercial vehicles, lorry, bus and van which accounted for 33%, 14% 8%, 3% and 2% of the total portfolio as in Dec-19. Going forward, UBF is expected to focus on leasing, mortgage loans and gold loans. Presently, the portfolio growth is constrained by the LKR 9.8 Bn lending cap placed by CBSL since Jan-19.

**Subdued profitability:** UBF's profitability indicators weakened in 9MFY2020 due to moderation in yields and operational inefficiencies driven by portfolio reduction as a result of the lending cap. The Return on Asset and Return on Equity of the company moderated to 0.05% and 0.74% in 9MFY2020 as compared to 0.14% and 1.33% in 9MFY2019 (0.18% and 2.07% in CY2019). The Net Interest Margin ("NIM") of UBF moderated to 5.98% in 9MFY2020 as compared to 6.48% in FY2019 (5.77% in FY2018). The reason for moderation was due to reduction in yield on investments and marginal reduction in yield on advances. The operating expenses to total asset ratio of the company increased to 4.98% in 9MFY2020 as compared to 4.72% in FY2019 (4.38% in FY2018). UBF's credit cost declined by 30% to LKR 130 Mn in 9MFY2020 as compared to LKR 186 Mn in 9MFY2019, resulting in a decline in the credit cost to average advances to 1.66% in 9MFY2020 as compared to 1.92% in FY2019 (1.24% in FY2018). Going forward, UBF needs to improve its operational efficiencies and control the credit cost in-order to improve its profitability.

**Concentrated deposit and weak liquidity profile:** The deposit taking ability of the Company is restricted to LKR 7.2 Bn following the cap placed by CBSL; deposits stood at LKR 6.3 bn as in Dec-19 (7.2 Bn in Mar-19). UBF has a concentrated deposit profile with top 10 depositors accounting for 33% of the total deposits as in Dec-19, however renewal rates have been at about 70% in the past. In Dec-19, the Company reported a negative cumulative Asset and Liability maturity mismatch of 19% (as a proportion of total assets) in the less than one year bucket as compared to negative mismatch of 8.73% in Mar-19. However, the Company has unutilized funding lines of LKR 900 Mn (includes LKR 700 Mn from UBC).

**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:

UB Finance Company Limited (UBF) was formerly known as The Finance & Guarantee Co. Ltd. It was incorporated in 1961 and, operated as a Finance and Real estate development company. In 2011, Union Bank of Colombo (UBC) acquired majority stake in the Company with a capital infusion of LKR 600 Mn. The Company received a capital infusion of LKR 500 Mn from a private equity investor- ShoreCap II Ltd. As in April 2018, UBC and ShoreCap II Ltd hold about 73% (81% voting rights) and 12% (13% voting rights) respectively in UBF. Initially, UBF was involved in real-estate development and financing. The Company still has some of its old loan portfolio, which is completely in the NPA category. Presently, the Company focuses on retail asset classes (vehicles loans/ leases/ hire purchase) and working capital finance.

During the 9MFY2020, UBF reported a PAT of LKR 4 Mn (unaudited) on a total asset base of LKR 9.7 Bn (unaudited) as compared to a PAT of LKR 6 Mn on a total asset base of LKR 11.5 Bn in FY2019.

## Key financial indicators

LKR Mn	FY2018 (Audited)	FY2019 (Audited)	9MFY2019 (Unaudited)	9MFY2020 (Unaudited)
Net Interest Income	613	721	540	468
Profit after Tax	72	20	12	4
Net worth	1,152	770	1,164**	774
Loans and Advances (Net)	9,453	8,785	9,619	7,965
Total Assets	11,151	11,127	11,384	9,743
Return on Equity	7.2%	2.1%	1.3%	0.7%
Return on Assets	0.7%	0.2%	0.1%	0.1%
Gross NPA	13.8%	18.1%	18.6%	17.0%
Net NPA	8.4%	6.2%	12.3%	9.3%
Capital Adequacy Ratio	14.6%*	5.7%	5.5%	3.1%
Gearing (times)	7.8	13.1	8.3	11.0

\*Based on old CAR regulations\*\*Before adjusting the IFRS 9 transition net adjustment of LKR 430 Mn

## Rating history for last three years:

Chronology of Rating History for the past 3 years						
Instrument	Type	Amount Rated (LKR Mn)	Date & Rating FY2020	Date & Rating FY2019	Date & Rating FY2018	Date & Rating in FY2017
			May 2020	May 2019	May 2018	May 2017
Issuer rating	N/A	N/A	[SL]BB (Negative)	[SL]BB (Negative)	[SL]BB (Stable)	[SL]BB (Stable)

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