

ICRA Lanka revises the issuer rating of Orient Finance PLC; retains Negative outlook

July 30, 2020

Instrument	Rated Amount (LKR Mn)	Rating Action
Issuer rating	N/A	Revised to [SL]BB (Negative) from [SL]BB+ (Negative)

Rating action

ICRA Lanka Limited has revised the issuer rating of Orient Finance PLC (OFP or the Company) to [SL]BB (pronounced SL double B) from [SL]BB+ (pronounced SL double B plus). The outlook on the rating continues to be Negative.

Rationale

The rating downgrade factors the sharp deterioration in OFP's asset quality indicators, weak profitability, and moderate liquidity profile. OFP's gross NPA ratio increased from 10.9% in March 2019 to 18.8% in March 2020. However, ICRA Lanka takes a note of the decline in lending portfolio that has also contributed to the increase in the NPA ratio. The rating is also affected by the weak profitability of the Company, mainly on account of higher credit cost (provisioning cost). Credit provisioning cost/ATA increased to 5.8% during the first 9M of FY2020 vis-à-vis 3.2% in FY2019; provisions and loan losses were LKR 726 Mn for the 9M ended December 2019 vis-à-vis LKR 569 Mn in FY2019. The rating also factors the impact the CBSL debt moratorium is likely to have on loan collections and the overall liquidity profile of the Company over the next 6M. The rating continues to take comfort from the support from the parent company, Janashakthi PLC (JPLC), which is rated BBB- (Negative) by ICRA Lanka. Over the last 9M, JPLC has provided additional capital support totaling close to LKR 1Bn, in the way of a right's issue and conversion of preference shares.

Going forward, it is imperative the OFP controls incremental loan slippages and improve the overall asset quality of the Company. Also, the Company's ability to meet the on-going regulatory capital requirements will be crucial from a rating point of view.

Outlook: Negative

The Negative outlook reflects weak asset quality, subdued profitability, and modest overall financial risk profile of the entity. The outlook may be revised to Stable in case of substantial improvement in the capital structure, asset quality, and earnings profile of OFP. The rating may be revised further downwards, in case the asset quality continues to deteriorate and in case of less than expected capital support from the parent entity.

Key rating drivers

Credit strengths

Part of the Janashakthi group: OFP is over 90% owned by JPLC, the holding Company of the Janashakthi group. Janashakthi Group has significant interests in the financial services sector through its controlling interests in Janashakthi Insurance PLC (life insurance), First Capital PLC (primary dealership and investment banking), and Orient Finance PLC (non-banking financial services). JPLC has demonstrated a track-record

of providing capital and managerial support for OFP, especially in terms of meeting the regulatory capital requirements. Over the last nine months, JPLC has provided capital support to the NBF1 subsidiary through a rights issue of LKR 507 Mn and conversion of LKR 476 Mn preference shares (which was classified as part of debt capital) to ordinary shares. Going forward, it will be crucial for the parent company to provide capital support on a timely basis, if required.

Credit challenges

Sharp deterioration of asset quality levels: Since March 2018, asset quality levels of the Company had significantly deteriorated, as witnessed by the higher NPAs across all major asset classes. Asset quality levels deteriorated further in March 2020 with closing gross NPAs standing at LKR 2,779 Mn vis a vis LKR 1,698 Mn in March 2019; the gross NPA ratio increased to 18.78% in March 2020 (higher than the systemic average) from 10.96% in March 2019. Moderation of the overall portfolio as well as incremental slippages, especially in the passenger vehicle, commercial vehicle and, business lending portfolios have contributed to the increase in the gross NPA ratio. Going forward, the management's ability to control new slippages and improve overall asset quality levels will be crucial, from a rating point of view.

Weak profitability indicators: Profitability in FY2020 was significantly affected by higher credit cost, due to the deterioration of asset quality levels. Credit provisioning cost/ATA increased to 5.8% during the first 9M of FY2020 vis-à-vis 3.2% in FY2019; provisions and loan losses were LKR 726 Mn for the 9M ended December 2019 vis-à-vis LKR 569 Mn in FY2019. For the 9M ended December 2019, OFP reported a net loss of LKR 350 Mn compared to the marginal profit of LKR 32 Mn in FY2019 and a net loss of LKR 110 Mn in FY2018. ICRA Lanka expects OFP to benefit from the current low-interest rate regime, as the relatively short-tenured deposit base will be repriced at much lower rates. Also, going forward, the impact of incremental credit cost on overall profitability could be moderate, as the loan loss provisioning has increased to about 71% (as a % gross NPA) in FY2020 from about 56% in FY2019.

Moderate capitalization profile: OFP's capitalization profile has improved with successive capital enhancement initiatives over the last nine months that added close to LKR 1 Bn to the core capital of the Company. Core capital adjusted for revaluation reserves, and deferred tax assets stood at about LKR 2.2 Bn vis-à-vis the regulatory minimum of LKR 2 Bn. However, ICRA Lanka takes cognizance of the sizable intangible assets (goodwill and brand value of about LKR 800 Mn) on the Company's balance sheet. The rating also factors the additional capital requirement of about LKR 300 Mn, in order to comply with the LKR 2.5 Bn regulatory capital requirement by December 2021. OFP will have to resort to external capital infusions to comply with the same as the internal generation is likely to be modest over the next 12M. Therefore, going forward, the parent company's ability to provide capital support in a timely manner will be crucial from a rating point of view. The risk-weighted Tier-1 capital adequacy ratio of the Company has improved to 10.2% in March 2020, from 5.47% in March 2019, following the recent capital infusions; regulatory CAR is 6.5% for Tier 1. OFP's ability to maintain the capital adequacy ratios at comfortable levels will be a rating key monitorable.

Stretched liquidity profile: ICRA Lanka expects the liquidity position to weaken during the next 6M, as a result of lower loan recoveries due to Covid-19 impact and debt moratoriums introduced by the CBSL. As per the management estimates, about 20% of OFP's loan portfolio is affected by the proposed debt moratorium, and overall recoveries could be slower over the next 6M. The availability of undrawn sanction limits and the reduction of the statutory liquidity requirement by the CBSL provide some comfort from a liquidity point of view. However, ICRA Lanka will continue to monitor actual loan recovery levels continuously, as it is a key rating driver.

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:

Orient Finance PLC (formerly known as Bartleet Finance PLC, BFP, prior to the acquisition of erstwhile – Orient Finance PLC and its subsequent 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 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 the acquisition. As of December 2019, Janashakthi PLC held 91.4% shareholding in OFP.

Recent Results

For the 9M ended December 2019, OFP reported a net loss of LKR 350 Mn on a total asset base of LKR 15.9 Bn, as compared to the net profit of LKR 29 Mn reported in FY2019, on a total asset base of LKR 17.4 Bn.

Janashakthi PLC (Parent Company)

Janashakthi PLC is an investment holding company incorporated in the year 1994. The company is owned and managed by the Schaffter family (Mr. Prakash Schaffter 50%, Mr. Ramesh Schaffter 50%). Subsidiaries include Janashakthi Insurance PLC, which is an established insurance company in Sri Lanka operating for over two decades and Orient Finance PLC, which is a listed finance company in Sri Lanka. In September 2018, JPLC also acquired a 41.1% stake in Dunamis Capital PLC (DCP), an investment holding company with exposure to the real estate and finance sectors, and subsequently concluded a voluntary offer in December 2018 to obtain the remaining 58.9% shareholding. On October 29, 2019 shareholder approval was obtained for the amalgamation of DCP and JPLC. Full amalgamation was completed in December 2019, resulting in DCP ceasing to exist and its subsidiaries (namely, First Capital Holdings and Kelsey Development PLC) becoming the step-down subsidiaries of JPLC.

During the financial year ended March 31, 2019 Janashakthi PLC reported a standalone net loss of LKR 672 Mn, on a total operating income of LKR 364 Mn, compared to the net profit of LKR 8 Mn on a total operating income of LKR 1,314 Mn in the corresponding period of the previous fiscal.

On a consolidated basis, Janashakthi group reported a net profit of 1,689 Mn on a total operating income of LKR 10,497 Mn in FY2019, compared to a net profit of LKR 8,563 Mn on a total operating income of LKR 7,807 Mn in the previous fiscal.

For the 9M ended December 2019, JPLC reported a standalone net loss of LKR 517 Mn on an operating income of LKR 673 Mn and a consolidated loss of LKR 65 Mn on an operating income of LKR 9,148 Mn.

Recent results of Orient Finance PLC

LKR Mn	FY2018	FY2019	9MFY2020
Total income	3,496	3,493	2,485
Operating Profit/Loss	497	664	376
Profit After Tax	(110)	29	(350)
Reported Net Worth	2,348	2,166	2,716
Borrowings	15,252	14,706	12,231
RPAT/ATA	-0.59%	0.16%	-2.80%
Gross NPA	8.90%	10.96%	18.78%
Total CAR	12.18%	8.04%	11.65%
Gearing - reported	6.5	6.8	4.5
Gearing - adjusted*	9.1	10.1	5.6
Total Assets	18,115	17,360	15,958

Note: From July 2018 onwards, CAR is reported in terms of the new capital adequacy framework set under Basel 3 requirements * Gearing is adjusted for revaluation reserves and goodwill.

Rating history for the last three years:

Instrument	Current Rating (CY2020)			Chronology of Rating History for the past 3 years		
	Amount Rated (LKR Mn)	Amount Outstanding (LKR Mn)	Date & Rating in FY2021	Date & Rating in FY2020	Date & Rating in FY2020	Date & Rating in FY2019
			Jul 2020	Jan 2020	Aug 2019	Oct 2018
Issuer rating	N/A	N/A	[SL] BB; Negative	[SL] BB+; Negative	[SL] BB+; Negative	[SL] BB+; Negative
Guaranteed redeemable debenture program	1,000	N/A	N/A	[SL] A-(SO); withdrawn	[SL] A-(SO); rating on watch with developing implications	[SL] A-(SO); rating on watch with developing implications

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