

ICRA Lanka reaffirms the ratings of Vallibel Finance PLC

August 31, 2020

Instrument	Rated Amount	Rating Action
Issuer rating	N/A	[SL]BBB (Stable); Reaffirmed
Guaranteed subordinated redeemable debenture programme	LKR 1,000 Mn	[SL]AA-(SO) (Stable); Withdrawn

Rating action

ICRA Lanka Limited has reaffirmed the issuer rating of Vallibel Finance PLC (VFP or the Company) at [SL]BBB (Pronounced SL triple B) with Stable outlook. ICRA Lanka has withdrawn the outstanding issue rating of [SL]AA-(SO) with Stable outlook for the LKR 1,000 Mn guaranteed, subordinated, redeemable debenture programme of the Company, as the instrument was repaid fully on maturity in Apr-20.

Rationale

The issuer rating factors in the expected financial and managerial support from the Vallibel group of companies, VFP's experienced senior management team and, its adequate internal controls. The rating also factors in the comfortable capital profile, with the Tier I and Total capital ratios at 11.93% and 13.04%, respectively in Mar-20, above the regulatory thresholds of 6.50% and 10.50%. Further, the rating takes note that the gearing has improved to 6.58 times in Mar-20, compared to 7.41 times in Mar-19 (10.17 times in Mar-18). VFP's healthy capital ratios and improvement in gearing was driven by an equity infusion of LKR 1.0 Bn via a rights issue in Jun-18 coupled with healthy internal capital generation. ICRA Lanka takes note of the moderation in the net profitability with RoE at 20.98% in Mar-20, compared to 25.73% in Mar-19 (34.78% in Mar-18), largely due to the increasing credit costs and slower portfolio growth.

The rating reaffirmation takes into account VFP's healthy operating profits and capital position, which is expected to provide a cushion against the expected losses which may arise due to likely stress on the asset quality on account of the Covid-19 pandemic. Despite a rise in collection efficiency¹ in May-20 and June-20 to 92% and 113%, respectively, compared to 40% in March-20, the asset quality remains uncertain with loan book under moratorium at 27% currently against 9% in March-20. This is expected to increase the credit cost in FY2021 and negatively impact the profitability and capital ratios. ICRA Lanka estimates that in a worst case scenario with the fresh slippages ratio rising to 15%² and a gearing of 7 to 8 times, the company is expected to report Tier I capital ratio of about 11% - 12 % in FY2021. VFP's asset quality deteriorated, with the gross NPA ratio increasing to 5.01% in Mar-20 vis-à-vis 3.02% in Mar-19 (2.72% in Mar-18); nonetheless, same remains below the systemic average of 11.56% in Mar-20. Also, the company's delinquencies in the 60+ days past due (dpd) bucket increased to 34.9% in Mar-20, compared to 15.9% in Mar-19, due to the pandemic-related lockdown. However, the availability of funding lines of about LKR 1.1 Bn in Jun-20 provides comfort from a liquidity perspective. Going forward, VFP's ability to improve its asset quality indicators considering its exposure to borrowers with a modest credit profile and the subdued

¹ Collections efficiency is calculated as total collections (including overdue amounts) divided by collections due

² Fresh slippages ratio is calculated as New NPL's divided by closing Net Advances of the prior fiscal

business environment prevailing in the country, along with maintaining a healthy capital and earnings profile, would be crucial from a rating perspective.

Outlook: Stable

ICRA Lanka believes that VFP would continue to benefit from the financial support provided by the Vallibel group. The outlook may be revised to 'Positive' in case of steady improvement in the capitalization, asset quality and profitability indicators of VFP. The outlook may be revised to 'Negative' if the loan book under moratorium does not reduce substantially in the ensuing months, thereby increasing the risk for asset quality and capitalization.

Key rating drivers

Credit strengths

Expected financial and managerial support from the Vallibel group: Vallibel Investments (Pvt) Ltd (VIPL) is the main shareholder of VFP, holding 51.4% shares as of Mar-20, which in turn is fully owned by Mr. Dammika Perera. The second largest shareholder is Mr. Dammika Perera who increased his direct shareholding in VFP to 21.4% by subscribing to a rights issue (LKR 1,039 Mn) of the company in Jun-18. VFP is part of the Vallibel group promoted by Mr. Dammika Perera; Vallibel One PLC (VOP) acts as the holding company of the group. The Vallibel group has diversified interests in financial services, trading, manufacturing and leisure businesses. VFP has access to the managerial support from the Vallibel group in strategic decision making. In addition to equity support, Vallibel group's entities have placed long term deposits with VFP, when required; group companies accounted for about 4% of the deposits of the Company as of Mar-20 (4% in Dec-18).

Experienced senior management team and adequate risk management systems: As in Mar-20, VFP's board consisted of 9 members including 3 independent members. The Company has an experienced senior management team, with the CEO/ Managing director having over 30 years of experience in the NBFi industry. The Company has an elaborate organization structure covering all key business functions, including, business development, credit, collections, recoveries, finance and administration. Each business function is headed by an experienced senior manager. VFP has a prudent loan origination system and an effective loan monitoring and collection mechanism, as reflected by its relatively better asset quality indicators compared to peers. The mechanism provides it with early warning signals and helps in adjusting the loan policies in line with the evolving credit trends. The credit and recovery functions are centralized at the Head Office which supports in optimizing its collection and recovery activities. The Company has implemented adequate internal controls and risk management processes. Further, the internal controls and risk management processes are reviewed by an external team and are updated on a regular basis. The Company also has an in-house internal audit team that undertakes timely review of the operations.

Healthy profitability indicators, notwithstanding some level of moderation in RoE and RoA: In FY2020 the company reported a healthy Net Interest Margin (NIM) of 8.19% (7.82% in FY2019), driven by a reduction in the cost of funds by about 54 bps YoY to 11.67% as of Mar-20 on account of the low interest rate environment, which supported its earnings profile. Operating expenses as percentage of total assets have remained range -bound at the level of 4.00% - 4.30% over the past few fiscals; the cost- to -income ratio reduced further to 40.0% in FY2020 vis-à-vis 40.94% in FY2019 (41.76% in FY2018), led by operational improvements. However, company's credit costs (provisions/average total assets - ATA) have increased (to 0.98% in FY2020 vis-à-vis 0.45% in FY2019 and 0.30% in FY2018), due to a deterioration in asset quality indicators. VFP reported a RoA and RoE of 2.53% and 20.98%, respectively in FY2020, compared with a RoA and RoE of 2.62% and 25.73% in FY2019, largely due to moderation in portfolio growth and rising

credit costs. Going forward, VFP's ability to control its credit costs whilst continuously improving operating efficiency as the business expands would be crucial from a profitability perspective.

Adequate capital profile: The Company's Tier I and Total capital adequacy ratios stood at 11.93% and 13.04% in Mar-20, as compared to the regulatory requirement of 6.50% and 10.50% (from Jul-19). Due to the pandemic, the Sri Lankan government extended the regulatory capital threshold by one year to Jul-21, which provided relief to companies in the sector. Further, the company's present core capital funds amount to LKR 6.34 Bn in Mar-20, which comfortably exceeds the minimum core capital requirement of LKR 2.0 Bn set by the CBSL. In the event of a worst case scenario, with the fresh slippages ratio rising to 15% in FY21, the company is likely to maintain a Tier 1 capital ratio of 11%-12 and the gearing in the range of 7-8 times, as per ICRA estimates.

Improvement in leverage: VFP's gearing improved to 6.58 times in Mar-20, compared with 7.41 times in Mar-19 (10.17 times in Mar-18). VFP's total borrowings stood at LKR 42.6 Bn in Mar-20 (LKR 40.5 Bn in Mar-19) with 69% being contributed by deposits and 21% in the form of bank borrowings. Given a high share of deposits maturing in a year while average loan book tenure stood at 30-36 months, the Company reported a negative cumulative ALM mismatch of 12.13% in Mar-20 (13.50% in Dec-19) in the less than 12 month bucket. Nonetheless, the Company's deposit renewal rate of 75-80% and unutilized funding lines of LKR 1.1 Bn in Jun-20, provide comfort from a liquidity perspective.

Credit challenges

Asset quality uncertain driven by high share of loan book under moratorium: The pandemic related lockdown resulted in a significant decline in VFP's collection efficiency to 40% in Mar-20 and 24% in Apr-20 compared to more than 90% in the previous six months. As the government relaxed the lockdown conditions in May-20 and Jun-20, the collection efficiency improved to 92% and 113%, respectively. However, the loan book under moratorium increased to 27% currently against 9% in Mar-20. ICRA Lanka notes that the moratorium is available till September 2020, hence a sustained improvement in the collections remains to be seen, thereby reflecting asset quality uncertainty. As of Mar-20, VFP's gross NPA and net NPA stood at 5.01% and 1.51% (3.02% and 0.60% as in Mar-19), respectively compared to the systemic average of 11.56% and 3.82%, respectively. Asset class -wise, cars (46.04% of total portfolio) vans (14.75%) and lorries (11.18%), reported gross NPA ratios of 3.38%, 4.70% and 8.91%, respectively, in Mar-20. The rise in the gross NPA ratio was mainly on account of higher slippages of LKR 2.5 Bn or fresh NPA generation ratio of 6.29% in Mar-20 compared to 4.35% in Mar-19. The increased slippages were largely due to the lagging effects of macro-economic challenges, which have affected the disposal income of company's borrowers. However, the Company's comprehensive credit operations and effective recoveries have supported its portfolio quality. VFP's provision coverage ratio (based on CBSL guidelines) reduced to 56.50% in Mar-20 (66.83% in Mar-19); however based on IFRS, the provisioning stood at around 80.62% in the same period (97.28% in Mar-19). The company expects to maintain a similar level of provisioning in the near term.

Exposure to customers with modest credit profile: VFP is serving SME's (6% of total portfolio) and individuals (94%) who have a moderate risk profile and are susceptible to adverse economic cycles. ICRA Lanka however takes note of the adequate internal controls put in place, which provides comfort from a credit perspective.

Analytical approach: For arriving at the ratings, ICRA 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 - Vallibel Finance PLC

VFP was incorporated in 1974 as Rupee Finance Limited. In 2005, Vallibel Investment (Pvt) Ltd acquired the Company and renamed it as Vallibel Finance PLC. Mr. Dammika Perera has the controlling stake of the Company through direct holding of 21.4% and 51.4% holding through his fully owned investment arm, Vallibel Investment (Pvt) Ltd as in Mar-20. The Company is listed on the main board of the Colombo stock exchange. VFP currently operates through 41 branches. The principal activities of the Company include extending finance leases, granting of mortgage loans, gold loans and mobilization of deposits. VFP also extends vehicle backed overdraft facilities and business loans.

During the year ended March 2020, VFP reported a Profit After Tax (PAT) of LKR 1,253 Mn on a total asset base of LKR 51.4 Bn as compared to a PAT of LKR 1,129 Mn on a total asset base of LKR 47.7 Bn in the previous financial year.

Key financial indicators (Audited)

	FY2018	FY2019	FY2020
Net Interest Income	2,757	3,363	4,058
Profit after Tax	1,019	1,129	1,253
Net worth	3,301	5,471	6,478
Loans and Advances	30,845	38,973	41,136
Total Assets	38,406	47,660	51,424
Return on Equity	34.78%	25.73%	20.98%
Return on Assets	2.95%	2.62%	2.53%
Gross NPA	2.72%	3.02%	5.01%
Net NPA	0.41%	0.60%	1.51%
Tier I CAR	10.60%	11.13%	11.93%
Total CAR	12.21%	12.61%	13.04%
Gearing (times)	10.17	7.41	6.58

Rating history for last three years

Instrument	Current Rating (FY2020)			Chronology of Rating History for the past 3 years		
	Type	Amount Rated (LKR Mn)	Date & Rating Aug-2020	Date & Rating in FY2019 Mar-2019	Date & Rating in FY2018 Mar-2018	Date & Rating in FY2017 Mar-2017
Issuer rating	N/A	N/A	[SL]BBB (Stable)	[SL]BBB (Stable)	[SL]BBB (Stable)	[SL]BBB (Stable)
Guaranteed subordinated redeemable debenture programme	Long term	1,000	[SL]AA-(SO) (Stable); Withdrawn	[SL]AA-(SO) (Stable)	[SL]AA-(SO) (Stable)	[SL]AA-(SO) (Stable)
Unsecured subordinated redeemable debenture programme	Long term	500	NA	[SL]BBB-(Stable); Withdrawn	[SL]BBB-(Stable)	[SL]BB+(Stable)

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