ICRA Lanka reaffirms the rating of Trade Finance & Investments PLC

October 06, 2020

Instrument	Rated Amount (LKR Mn)	Rating Action
Issuer rating	N/A	[SL]BBB- with Negative outlook reaffirmed

Rating action

ICRA Lanka Limited has reaffirmed the issuer rating of Trade Finance & Investments PLC (TFIP or the Company) at [SL]BBB- (Pronounced SL triple B minus) with Negative outlook.

Rationale

The rating factors in the subdued financial profile of TFIP's parent company, Commercial Credit and Finance PLC (CCFL or the Parent/rated [SL]BBB with Negative outlook). TFIP is a 99.7% owned subsidiary and benefits from managerial and operational support from the Parent. The rating also takes cognizance of TFIP's established track record and experienced management team, granular loan portfolio and healthy earnings profile. TFIP's portfolio recorded a growth of 7% in FY2020 to LKR 10.3 Bn, in comparison to the higher growth rates of 33% and 107% in FY2019 and FY2018, respectively, due to macro shocks including the April-19 Easter attacks which impacted the business environment. It is expected that the effects of the Covid-19 pandemic would moderate portfolio growth in FY2021 as well. The rating factors in the adequate capital profile with the Tier 1 and Total capital adequacy ratios standing at 14.83% (against the regulatory minimums of 6.50% and 10.50%, respectively) and gearing at 3.9 times in Jun-20. Moreover, company's core capital base of LKR 2.1 Bn in Jun-20 meets the regulatory minimum capital threshold of LKR 2.0 Bn effective from Dec-20. In view of the pending amalgamation with CCFL, the company's capital profile is envisaged to be adequate going forward to maintain the expected portfolio growth (less than 10%).

The liquidity profile remains moderate with the <12 months cumulative ALM mismatch standing at negative 0.35% in Jun-20, compared with a positive 4.24% mismatch in Mar-19. Nonetheless, the healthy deposit renewals and the availability of unutilized funding of about LKR 61 Mn in Jun-20 mitigates the liquidity risk. The rating notes the moderation in the company's gross NPA ratio to 9.57% in Jun-20 (8.51% in Mar-20) due to the macro-economic challenges and the moderate credit profiles of its customer segments. The rating further takes cognizance of TFIP's small scale and the competitive business environment.

Outlook: Negative

The Negative outlook reflects the deterioration in asset quality and the weakened credit profile of the parent company, CCFL. As TFIP is expected to be amalgamated with its parent entity in the near term, the ratings are expected to continue to reflect CCFL's credit profile. The outlook may be revised to 'Stable' in case of steady improvement in CCFL's credit profile while TFIP maintains comfortable capital, asset quality and earnings profiles. The rating may be downgraded in case of downward rating revision of the parent entity, lower than expected support from the Parent or significant moderation in the financial risk profile of TFIP.

Key rating drivers

Credit strengths

Operational and managerial support from CCFL: TFIP is a 99.7% owned subsidiary of CCFL (rated [SL]BBB/Negative) and has strong business linkages with the Parent. CCFL's support in terms of shared services and knowledge sharing in all key aspects of the operations has helped TFIP to strengthen its systems and procedures. ICRA Lanka expects CCFL to continue its operational and managerial support to TFIP in the near term. CCFL acquired TFIP under the financial sector consolidation programme of the Central Bank of Sri Lanka (CBSL) in 2014, and an amalgamation of the two entities is expected to take place with board approvals obtained for same on 23rd September 2020; ICRA Lanka will continue to monitor the developments. Out of the 6 directors of the board, CCFL has one representative. TFIP has an established track record of over 40 years of operation as a finance company in Sri Lanka and the company's management is also well experienced in its traditional business of leasing 2-wheelers and 3-wheelers.

Adequate capitalization profile: Capitalization profile of the Company is adequate with core and total capital adequacy ratios (CAR) at 14.83% and gearing at 3.9 times as of Jun-20 (in Mar-20 the core and total CAR ratios stood at 14.65% and gearing at 4.0 times). TFIP's core capital stood at about LKR 2.1 Bn as of Jun-20 (LKR 2.0 Bn in Mar-20) which meets the minimum threshold of LKR 2.0 Bn effective from Dec-20. Given the expected amalgamation with the Parent (CCFL's core capital stood at LKR 13.3 Bn in Mar-20), it is expected that there would be no requirement for TFIP to meet further regulatory capital requirements post Mar-21, on a standalone basis. Company expects to generate a profit after tax (PAT) of about LKR 200 Mn in FY21, which may further improve its capital profile.

Granular loan portfolio– TFIP's portfolio recorded a subdued growth of 7% to LKR 10.3 Bn in FY20, in comparison to the 33% and 107% growth rates in FY19 and FY18, respectively. The slow-down in portfolio growth is primarily due to the challenging operating environment and weaker macro conditions. The exposure to leasing increased to 98% of the portfolio as of Jun-20 vis a vis 96% as of Mar-19 (93% as of Mar-18), largely because of the curtailment in lending to the microfinance and business loans segments during the period. Going forward, the company envisages focusing 95-98% of its portfolio on 2-wheelers and 3-wheelers with the balance on pawning and other loans. The top 10 exposures only accounted for 0.3% of the total portfolio in Jun-20 (0.4% as of Mar-19) indicating portfolio granularity and low credit concentration risk. As of Jun-20, TFIP's portfolio exposures comprised of 76% towards 2-wheelers, 22% towards 3-wheelers, and 1% each of pawning and other loans. While the portfolio is expected to remain granular, ability keep credit quality under control in view of the vulnerability of its target borrower segment in the current environment would be a key monitorable.

Credit challenges

Moderation in asset quality indicators; however, same remains better than the industry average: TFIP's gross NPA ratio increased to 8.51% as of Mar-20 from 3.44% in Mar-19 (2.49% as of Mar-18), compared to an industry level GNPA of 11.56% and 7.82%, respectively, in the same periods. The higher NPAs during FY20 are largely due to the weaker economic conditions, which has deteriorated the financial strength of the company's susceptible customer segment. ICRA Lanka is cognizant that TFIP targets largely the self-employed borrowers, who tend to have a moderate credit profile. The GNPA further increased to 9.57% as of Jun-20 (industry average GNPA stood at 14.31% in Jun-20). As of Aug-20, an amount of LKR 789 Mn stood under debt moratorium (about 8% of the portfolio). These comprise of 3 - wheeler leasing customers who are eligible for the moratorium upto Sep-20. ICRA Lanka also notes that the company has written off about LKR 278 Mn in FY20 (LKR 279 Mn in FY19) from disposal losses in the leasing portfolio. Future improvement in asset quality would depend on sustained improvement in its collections and recoveries;

The Company remains focused in this area. The 90+ days past due (dpd) increased to 23% as of Mar-20 vis a vis 16% as of Mar-19 (13% as of Mar-18), with the lockdown contributing to higher delinquency during this period.

Moderation in earnings: Company's NIM stood 15.15% in Mar-20 and 9.46% in Jun-20, compared to the NIM of 18.59% in Mar-19 (20.78% in Mar-18). Despite compression in its NIMs in recent fiscals, same remains one of the highest in the industry (industry average NIM stood at 6.0% in Jun-20) and has supported the earnings profile of the company. The RoA (on PBT) and RoE stood at 3.84% and 19.05% as in FY20 vis a vis 8.74% and 38.91% in FY19, respectively. The RoA (on PBT) and RoE further reduced to 3.56% and 7.87% in the 3 months ended Jun-20, due to the business disruptions during the quarter. During FY20, TFIP witnessed an increase in provision costs (as percentage of average total assets) to 6.58% from 2.15% in FY19 (1.61% in FY18) which has eroded its profitability. However, company's operating expenses (as percentage of average total assets) has reduced to 6.53% in FY20 vis a vis 8.33% in FY19 (9.22% in FY18) due to increasing business scale and operational improvements. Going forward, TFIP's ability to further improve its operating efficiency and keep credit costs under control would be crucial for incremental profitability.

Small scale of operations, competitive business environment and susceptibility to unfavourable regulatory changes: TFIP is a relatively smaller player in the NBFI industry with an asset base of about LKR 10.6 Bn as of Jun-20 (about 1% of the industry asset base). The Company operates with 7 branches (including its head office), and it has a presence in 11 districts of the country through its virtual business model (branchless operations). Currently, the operating environment for 2W and 3W financing is quite competitive with established NBFIs and banks competing for market share. The leasing business is also susceptible to adverse regulatory changes as observed in the past.

Analytical approach: TFIP credit risk profile is strengthened by the support from CCFL (rated BBB/ Negative). 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:

TFIP is a registered finance company which offers leasing, hire purchase, gold loans and other loan products apart from accepting deposits (fixed and savings). The Company is specialised in leasing 2-wheelers and 3-wheelers, which accounted for about 98% of the total portfolio as on March 31, 2020. TFIP operates with 7 branches namely, Negombo, Kilinochchi, Jaffna, Batticaloa, Marawila, Maligawatta, and its head office in Colombo. TFIP was incorporated in the year 1978 as a private limited company and was part of the J. L. Morrison Son & Jones group. It was converted to a public limited company (unquoted) in 1990. The Company was taken over by Mr. N G H Cooray, former Chairman of the Jetwing Group of companies, in 1990 by acquiring a 93% stake; the Cooray family took management control of TFIP in 1995. As part of the consolidation of the finance and leasing companies in Sri Lanka, Commercial Credit and Finance PLC (CCFL) acquired majority shares of TFIP in the year 2014. CCFL holds close to 99.7% of the Company as of June 30, 2020.

During FY2020, TFIP reported a net profit of LKR 358 Mn on a total asset base of LKR 10,635 Mn as compared to net profit of LKR 624 Mn on a total asset base of LKR 10,364 Mn in the previous fiscal. In the three months ended June 30,2020, TFIP reported a net profit of LKR 41 Mn on a total asset base of LKR 10,627 Mn.

Key financial indicators

	FY18	FY19	FY20	Q1 FY21
Net Interest Income	1,117	1,619	1,539	251
Profit after Tax	418	624	358	41
Net worth	1,498	1,707	2,056	2,096
Loans and Advances (Gross)	7,125	9,228	9,451	9,324
Total Assets	7,471	10,364	10,635	10,627
Return on Equity	29.8%	38.9%	19.1%	7.9%
Return on Assets	7.5%	7.0%	3.4%	1.5%
Gross NPA	2.5%	3.4%	8.5%	9.6%
Net NPA	0.8%	1.4%	3.8%	4.9%
Capital Adequacy Ratio	20.6%	13.1%	14.6%	14.8%
Gearing (times)	3.5	4.6	4.0	3.9

Rating history for last three years:

Instrument	Chronology of Rating History for the past 3 years					
	Type	Amount Rated (LKR Mn)	Date & Rating FY2021	Date & Rating FY2020	Date & Rating in FY2019	Date & Rating in FY2018
			Oct-20	Jul-19	Jul-18	Jul-17
Issuer rating	N/A	N/A	**[SL]BBB- (Negative)**	[SL]BBB- (Negative)	[SL]BBB- (Negative)	[SL]BBB- (Stable)

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