

Softlogic Finance PLC: Rating reaffirmed

February 18, 2021

Instrument	Rated Amount (LKR Mn)	Rating Action
Issuer rating	N/A	[SL]BB-; Rating watch with developing implications; reaffirmed

Rating action

ICRA Lanka Limited has reaffirmed the Issuer rating of Softlogic Finance PLC (hereafter referred to as SFP or “the Company”) at [SL] BB- (pronounced as S L double B minus). The rating remains on watch with developing implications.

Rationale

The rating takes note of the capital support provided by parent entity Softlogic Capital PLC (SCAP, rated BBB+/ Rating watch with developing implications) via the rights issues in Dec-19 and Nov-20, amounting to LKR 602 Mn and LKR 1,902 Mn, respectively. The overall managerial and operational support of the Softlogic group is also factored into the rating. SFP’s Tier 1 and Total capital adequacy ratios (CAR) stood at -11.69% and -11.94%, respectively, in Sep-20, below the regulatory threshold, mainly due to a provisioning gap between IFRS 9 provisioning and CBSL provisioning requirements. Subsequent to the recent rights issue, both the Tier 1 and Total CAR are estimated to stand at around 0% in Dec-20. The rating also takes into account the proposed acquisition of Abans Finance PLC (AFP) by SCAP and its subsequent amalgamation with SFP; the combined entity is expected to witness improvement in capital position. The Gross NPA ratio of the company deteriorated further to 28.8% in Sep-20 from 27.5% in Mar-20 (13.1% in Mar-19), while around 18% of the lending portfolio stood under moratorium as of Jan-21. The ongoing repositioning of the portfolio away from unsecured SME loans and towards vehicle leasing, gold loans and factoring is expected to improve portfolio quality going forward, and has been factored into the rating.

Outlook: Rating watch with developing implications

The outlook on the company would be revised post-amalgamation with AFP. The outlook may be revised to ‘Stable’ in case the company is able to considerably augment its capital profile to reach a level above the regulatory requirement, along with improvement in its asset quality indicators. The outlook may be revised to negative, if the capital profile continues to remain stretched and below regulatory requirements or in case of further weakening in its asset quality. Significant weakening in the credit profile of the Softlogic group, dilution in the ownership or lower than expected support from the group would also adversely impact the rating.

Key rating drivers

Credit strengths

Access to financial, managerial and operational support from the Softlogic Group: SFP is an 85% owned subsidiary of Softlogic Capital PLC, which in turn is a 77% owned subsidiary of the diversified conglomerate Softlogic Holdings PLC (rated [SL] BBB+ /Negative). The Softlogic group is a leading conglomerate in Sri Lanka with exposure to the healthcare, financial services (Softlogic Life Insurance and Softlogic Finance), leisure and retail sectors. The group has in the past demonstrated its ability and willingness to support SFP, both financially and operationally. SCAP had infused capital of LKR 502 Mn in

a rights issue of SFP held in Dec-19 and a further LKR 1.7 Bn via rights issue held in Nov-20. ICRA Lanka envisages the financial, managerial and operational support from the group to continue to support SFP's performance. Moreover, a new management team has been put in place post Mar-20; the induction of experienced industry professionals into key roles is considered a positive.

Credit challenges

Weak capitalization; however recent rights issue and proposed AFP amalgamation is expected to improve the capital profile: As in Sep-20, SFP's risk weighted capital adequacy ratios were significantly below the regulatory minimum with the Tier 1 CAR and Total CAR standing at -11.69% and -11.94%, respectively (Tier 1 CAR and Total CAR stood at -5.55% and -5.76%, respectively, in Mar-20). The Negative CAR ratios are mainly due to a provisioning gap between IFRS 9 provisioning and CBSL provisioning requirements of LKR 2.7 Bn. However, the recent LKR 1.9 Bn rights issue is expected to bring the Tier 1 and Total CAR to about 0% in Dec-20 (against regulatory limits of 6.5% and 10.5%, respectively), as per ICRA Lanka's estimates. ICRA Lanka notes the proposed acquisition of Abans Finance PLC by SCAP in the near term, and plans to subsequently amalgamate both SFP and AFP. The combined entity's Tier 1 CAR is expected to improve and reach the regulatory threshold of 7.0% by Mar-22 as per ICRA Lanka's estimates. Hence, the timely completion of the AFP acquisition is crucial for SFP's capital adequacy requirements and would be a key monitorable in the near term. SFP's gearing stood at 9.6 times in Sep-20 vis-à-vis 9.4 times in Mar-20 (11.6 times in Mar-19), and is expected to moderate to around 6.0 times by Mar-21, due to the rights issue which has improved its net worth.

Asset quality remains under stress; unlikely to improve in near term: Asset quality indicators remain weak with the Gross NPA and Net NPA ratios at 28.8% and 22.2%, respectively, in Sep-20 (27.5% and 22.1% in Mar-20), compared with the industry averages of 12.9% and 3.9% in the same period. The weak asset quality was largely due to SFP's high exposure to unsecured SME loans and business loans. Further, the Covid-19 pandemic and resulting economic stress have worsened the asset quality indicators with 18% of the lending portfolio under moratorium as of Jan-21. However, ICRA Lanka takes note of the management decision to curtail all business-related lending in FY2021. As of Sep-20, business related loans (consisting of SME loans, Atha Hitha and Term and Mortgage loans) accounted for about 38% of the total portfolio, having moderated from 40% in Mar-20 and 55% in Mar-19. Moreover, the management is in the process of re-positioning the portfolio towards secured lending, consisting mostly of vehicle leasing, gold loans and factoring. Going forward, the company's ability to improve asset quality indicators through lower slippages and good recovery measures is crucial from a rating point of view.

Weak earnings profile: Due to declining revenue and rising credit costs, company reported a net loss of LKR 334 Mn in FY2020 vis-à-vis a net profit of LKR 204 Mn in FY2019; in the 6M ended Sep-20 the company witnessed a further net loss of LKR 649 Mn. Going forward, the company's ability to improve business margins and keep credit costs under control would be critical as SFP is expected to remain focused on the more competitive vehicle financing segment, in view of the on-going stress in the SME lending segment.

Moderate liquidity profile: As in Sep-20, the cumulative ALM mismatch in the less than one year maturity bucket stood at negative 18.1%, compared to negative 1.9% in Jun-19 (positive 3.4% in Mar-18) as company has shifted its focus towards long term asset backed lending products, and away from short term SME lending. Given the subdued macro outlook, ICRA Lanka expects SFP to experience further slippages in the SME/business lending portfolio over the immediate to short term, which could exert some pressure on its liquidity profile. However, ICRA Lanka is cognizant that SFP has liquidity support from the Softlogic group. As of Nov-20, the company had unutilized funding of LKR 206 Mn from different banking entities.

Further, its funding profile is dominated by fixed deposits (close to 87% of funding in Sep-20) with a healthy renewal rate of ~85%, which provides comfort from a liquidity perspective.

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 Profile:

SFP was incorporated in 1999 as Capital Reach Leasing PLC (Capital Reach), a Specialised Leasing Company and, in 2007 the Company got registered as a Licensed Finance Company. In 2010, the Softlogic Group acquired the controlling stake of Capital Reach through its subsidiary Softlogic Capital PLC and renamed it as Softlogic Finance PLC. As of December 2020, Softlogic Capital PLC holds about 85% ownership of the Company; SHP holds about 77% ownership in SCAP as in December 2020. Currently, as one of the smaller-sized LFCs in Sri Lanka, SFP offers term and mortgage loans, personal loans, gold loans and vehicle financing.

During FY2020, SFP reported a net loss of LKR 334 Mn on a total asset base of LKR 21,747 Mn vis-à-vis a LKR 204 Mn PAT in FY2019 on a total asset base of LKR 22,405 Mn. In the six months ended September 2020, SFP reported a net loss of LKR 649 Mn on a total asset base of LKR 21,466 Mn vis-à-vis a net profit of LKR 41 Mn on a total asset base of LKR 22,195 Mn in the six months ended September 2019

Key financial indicators of SFP - Audited

LKR Mn	FY2019	FY2020	6M FY2020*	6M FY2021*
Operating Income	1,528	1,300	773	191
Operating Profit/Loss	254	(95)	136	(426)
Profit Before Tax	64	(485)	104	(764)
Profit After Tax	204	(334)	41	(649)
Reported Net Worth	1,757	2,041	1,804	1,981
Adjusted Net Worth**	1,641	1,914	1,688	1,855
PAT/ATA	0.9%	-1.5%	0.4%	-6.0%
Gross NPA	13.1%	27.5%	22.5%	28.8%
Core CAR	2.2%	-5.6%	-0.8%	-11.7%
Gearing- adjusted***	12.46	10.05	11.80	10.26

* Unaudited. ** Net worth adjusted for revaluation reserves *** Gearing adjusted for revaluation reserves

Rating history for last three years:

Instrument	Type	Amount Rated (LKR Mn)	Current Rating (FY2021)		Chronology of Rating History for the past 3 years			
			Date & Rating FY2021		Date & Rating FY2020		Date & Rating FY2019	Date & Rating FY2018
			Jan-21	Oct-20	Nov-19	Apr-19	Oct-18	Jul-17
Issuer rating	N/A	N/A	[SL]BB-; Rating watch developing implications	[SL]BB-; Rating watch developing implications	[SL]BB-; Negative	[SL]BB; Negative	[SL]BB+; Negative	[SL]BB+; Stable



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