

## ICRA Lanka reaffirms [SL]BBB- ratings of Alliance Finance Company PLC; outlook revised Negative

October 30, 2018

Instrument	Rated Amount (LKR Mn)	Rating Action
Issuer rating	N/A	Reaffirmed the rating [SL]BBB-; Outlook revised to Negative from Stable
Senior Unsecured Redeemable Debenture Programme	LKR 1,000 Mn	Reaffirmed the rating [SL]BBB-; Outlook revised to Negative from Stable
Subordinated Unsecured Redeemable Debenture Programme	LKR 480.17 Mn	[SL]BB+ (Stable); withdrawn
Subordinated Unsecured Redeemable Debenture Programme	LKR 613.14 Mn	[SL]BB+ (Stable); withdrawn

### Rating action

ICRA Lanka Limited, subsidiary of ICRA Limited, a group company of Moody's Investors Service, has reaffirmed the issuer rating of Alliance Finance Company PLC (AFCP or the Company) at [SL]BBB- (Pronounced SL triple B minus). ICRA Lanka has reaffirmed the rating for LKR 1,000 Mn Senior Unsecured Redeemable Debentures at [SL]BBB- (Pronounced SL triple B minus). The outlook on the ratings have been revised to negative from stable.

ICRA Lanka has withdrawn the issue ratings of [SL]BB+ (pronounced SL double B plus) for the LKR 480.17 Mn subordinated unsecured redeemable debentures and LKR 613.14 Mn subordinated unsecured redeemable debentures, at the request of the company, as the same have been fully redeemed.

### Rationale

The revisions in the outlook factor in the weakening in AFCP's asset quality profile as gross NPAs increased sharply to 6.68 % in Sep-18 from 4.34% in Mar-18 (3.11% in Dec-17); 90+ days past due (dpd) also increased steeply to 17.27% in Sep-18 as compared to 8.28% in Mar-18 (6.54% in Sep-17) indicating further stress. Consequently, the earnings profile was impacted with RoA declining to 1.6% for 3MFY2019 from 2.3% in FY2018, as credit costs increased. AFCP registered a decline in the portfolio during Q1FY2019, which to an extent supported the capital profile as gearing (Adjusted for revaluation reserves) moderated to 7.4 times from 7.9 times in Mar-18. The ratings however factor the established track record, a fairly diversified lending and borrowing profiles and AFCP's adequate liquidity profile.

### Outlook: Negative

The negative outlook reflects the expected moderation in AFCP's asset quality profile and earnings profile in view of the build-up in the delinquencies in the softer buckets. The outlook may be revised to 'stable' in case of steady improvement in AFCP's delinquencies and profitability. The ratings may be downgraded in case of further deterioration in asset quality by way of forward movement of delinquencies into harder buckets and in case of weakening in capitalization, liquidity or earnings profile.

## Key rating drivers

### Credit strengths

**Established track record; experienced Board and senior management team:** AFCP is one of the old finance companies in Sri Lanka with an established track record of more than 60 years. The promoter group - Mr. R.K.E.P De Silva and family- holds close to 53% stake. AFCP operates in 93 locations (39 fully fledged branches, 25 micro finance service locations, 12 gold loan centers and 17 collection centers) with an employee base of 1,200. The board of the company comprises of eight directors including two independent non-executive directors and two non-executive directors. The executive directors include a mix of experienced and professionally qualified personnel overlooking functions including operations, finance and marketing.

**Fairly diversified portfolio, with focus on asset backed lending:** The Company's key products are leasing, which accounts for 69% of the total portfolio as on June 30, 2018, followed by loans (19%), micro finance (8%) and gold loans (5%). In terms of asset classes, 3-wheeler financing (23%), car financing (17%), lorry financing (12%), mortgage loans (7%) and van financing (7%) were the key components of AFCP's portfolio. The other key asset classes include 2-wheeler, tractor, bus and equipment financing, which together accounted for 13% of the portfolio. ICRA Lanka notes that the portfolio growth is expected to remain at about 10-15% over the near to medium term with focus on 3-wheeler financing, used personal vehicle (cars and vans) financing, micro leasing (lite weighted lorries and tractors) and gold loans.

**Adequate capitalisation profile:** AFCP reported tier-I core capital ratio of 9.87% and total capital adequacy ratio of 12.04% in Aug-18 (as per the CBSL directions on capital computation with effect from July 2018). AFCP's core capital stood at about LKR 3,251 Mn in Jun-18 and was above the minimum capital requirement<sup>1</sup> for LFCs. The company may need to raise external capital of LKR 400-500 Mn, in view of the envisaged growth plans over the next 3 years. The company reported a gearing (Adjusted for revaluation) of 7.4 times in Jun-18.

**Diversified resource profile and comfortable liquidity profile:** AFCP has a diversified funding profile comprising of retail fixed deposits, debentures and term loans from banks. As on June 30, 2018, around 50% of the company's funding was from deposits, while the balance was through bank loans and debentures. The company secured foreign borrowing of LKR 3.6 Bn, which accounts for 37% of the total borrowings (excluding fixed deposits) in Jun-18. The management has taken measures to hedge the foreign exchange risk of the company. Going forward, the company is expecting to maintain a 50:50 share between deposits and other borrowings. ICRA Lanka however notes that top 10 depositors account for 13% of the total deposits as on June 30, 2018 indicating concentration in its deposits profile. However, healthy funding pipeline and good deposit renewal rate of 80% provides comfort from a liquidity perspective. The company reported a positive short term (less than 1 year) ALM mismatch as of June 30, 2018.

### Credit challenges

**Weakening asset quality profile:** The Company's gross NPA ratio increased to 4.34% on March 31, 2018 from 2.12% in March 31, 2017 as a result of poor performance of the mortgage and working capital loan portfolios. The gross and net NPA stood at 5.68% and 2.05% as on June 30, 2018. AFCP reported relatively

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<sup>1</sup> LKR 1.5 Bn by Jan-19, LKR 2.0 by Jan-20 and LKR 2.5 Bn by Jan-21

comfortable gross NPA ratio of 2.02%, 2.45% and 0.16% in 3-wheelers, cars and gold loan segments respectively as in Jun-18. ICRA Lanka expects asset quality pressures to remain in view of the increase in the delinquencies in the softer buckets and expected subdued recoveries considering the prevailing macroeconomic conditions. Going forward, ability to control incremental slippages and forward flow of delinquencies into harder buckets (180+ dpd) would be crucial.

**Moderating profitability:** ICRA Lanka notes that credit costs increased to 3.37% in Q1FY2019 (1.66% in FY 2018 and 0.26% in FY2017) because of the weakening in the asset quality. The operating efficiency improved with the consolidation of microfinance operations; operating cost/ATA reduced to 6.1% for Q1FY2019 from 7.1% in FY2018 (7.1% in FY2017). AFCP's profitability (return on average assets) reduced to 1.64% in Q1FY2019 (2.30% in FY2018 and 2.33% in FY2017) largely because of the increased credit costs. Going forward, therefore it is crucial to keep asset quality under control and further improve operating efficiencies.

**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:

Alliance Finance Company PLC is one of the old finance companies in Sri Lanka with a history of over 60 years. The key shareholders of the company include Mr. R.K.E.P De Silva (26.51%), Motor Service Station (Pvt) Ltd (13.48%), Ms. D.M.E.P Perera (7.42%) and Mr. J.E.P.A De Silva (6.24%). The company extends leasing, hire purchase, micro finance, gold loans and other loans. The company has close to 40,000 customers through a network of 93 customer locations (39 fully fledged branches, 25 micro finance service locations, 12 gold loan centers and 17 collection centers) and, has over 1,200 employees. Alliance Finance Company PLC has investments in subsidiary Alfinco Insurance Brokers (Pvt) Ltd (64.00%) and an associate entity, Macbertan (Pvt) Ltd (19.51%).

During FY2018, AFCP reported a PAT of LKR 709 Mn on a total asset base of LKR 31.8 Bn as compared with a PAT of LKR 649 Mn on a total asset base of LKR 30.0 Bn in the previous financial year. During Q1FY2019, AFCP reported a PAT of LKR 129 Mn on a total asset base of LKR 31.1 Bn. During FY2018, AFCP Group reported a PAT of LKR 688 Mn on a total asset base of LKR 31.8 Bn as compared with a PAT of LKR 660 Mn on a total asset base of LKR 30.2 Bn in the previous financial year. During Q1FY2019, AFCP reported a PAT of LKR 138 Mn on a total asset base of LKR 31.2 Bn.

### Key financial indicators

	FY2017	FY2018	Q1FY2019
Net Interest Income	2,521	3,272	890
Profit after Tax	649	709	129
Net worth	4,065	4,230	4,364
Loans and Advances	23,806	26,232	25,921
Total Assets	30,022	31,779	31,110
Return on Equity	19.14%	17.10%	12.03%
Return on Assets	2.33%	2.30%	1.64%
Gross NPA	2.12%	4.34%	5.68%
Net NPA	0.78%	1.57%	2.05%
Capital Adequacy Ratio	12.32%	14.09%	14.37%
Gearing (times)	7.44	6.15	5.58
Gearing (adjusted for revaluation reserves)	8.74	7.92	7.37

## Rating history for last three years:

Chronology of Rating History for the past 3 years						
Instrument	Type	Amount Rated (LKR Mn)	Date & Rating FY2019 Oct 2018	Date & Rating in FY2018 Sep 2017	Date & Rating in FY2017	Date & Rating in FY2016 -
Issuer rating	N/A	N/A	[SL]BBB-(Negative)	[SL]BBB-(Stable)	N/A	N/A
Senior Unsecured Redeemable Debentures	Long Term	1,000	[SL]BBB-(Negative)	[SL]BBB-(Stable)	N/A	N/A
Subordinated Unsecured Redeemable Debentures	Long Term	480.17	[SL]BB+(Stable) Withdrawn	[SL]BB+(Stable)	N/A	N/A
Subordinated Unsecured Redeemable Debentures	Long Term	613.14	[SL]BB+(Stable) Withdrawn	[SL]BB+(Stable)	N/A	N/A

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