

ICRA Lanka Assigns [SL]BB rating with Stable outlook to Arpico Finance Company PLC

March 17, 2016

Instrument	Amount	Rating Action
Issuer Rating	N/A	[SL]BB with stable outlook; Assigned
Unsecured Subordinated Redeemable Debentures	LKR 355.98 Million	[SL]BB- with stable outlook; Assigned

ICRA Lanka Limited, subsidiary of ICRA Limited, a group company of Moody's Investors Service has assigned the issuer rating of [SL]BB (Pronounced SL double B) with a stable outlook to Arpico Finance Company PLC (AFCP or the Company) and [SL]BB- (Pronounced SL double B minus) rating with stable outlook to the LKR 355.98 Million Unsecured Subordinated Redeemable Debentures programme of AFCP. The rating takes note of the company's modest scale and limited business franchise, its high portfolio vulnerability due to its concentration in 2-wheeler segment and limited funding diversity. AFCP is one of the older financing companies in the country incorporated in the year 1951. AFCP's capital profile is moderate with gearing at 5.3 times as in Sep-15. ICRA Lanka takes note of the initiatives taken by the company to diversify to newer asset classes and, also envisages high portfolio growth (portfolio CAGR of 45-55%) over the near to medium term; it would therefore be critical for the company to put in place commensurate systems for the same. Also, given the limited financial flexibility of the parent company (Associated Motors Finance Company PLC) to infuse capital, securing timely equity capital to maintain a comfortable capital structure in relation to the envisaged portfolio growth would be crucial. ICRA Lanka takes note of the improvement in the company's profitability profile in the current financial year (PBT/ATA¹ for H1FY2016 at 5.5% vis a vis 4.8% in FY2015), however the ability to maintain good profitability indicators going forward by keeping a check on the credit costs, especially in the newer asset classes, and improving operating efficiencies would be a key rating sensitivity.

AFCP had a portfolio of LKR 5.8 Bn as in Sep-15 (LKR 4.8 Bn in Mar-15) and operated out of 9 branches (including Head office). The portfolio registered a portfolio growth of about 44% in H1FY2016 (35% in FY2015) after a decline of about 6% in FY2014. The company was acquired by AMF during FY2015, which presently holds about 94% stake in AFCP. As in Sep-15, 2-wheelers accounted for about 42% of the total portfolio, the same has steadily increased from about 13% in Mar-13. The company is expected to leverage on the expertise of AMF in the 2-wheeler business to support business growth and maintain reasonable credit quality. Apart from 2-wheelers, the company has exposure on 3-wheelers, cars, vans and lorry segments which accounted for 15%, 16%, 13% and 8% of the portfolio as in Sep-15. Going forward, the company is expected to diversify its portfolio by extending short term gold loans, micro loans to SMEs and undertake real estate financing activities. The rating notes that the company and the parent entity have limited experience in the new product segments, which AFCP is expected to venture into, thus it would be crucial for the company to develop prudent credit appraisal norms, ensure adequate monitoring and internal controls for the same. Going forward, AFCP envisages overall portfolio growth of about 45-50% over to reach a portfolio of about LKR 10-12 Bn by Mar-17.

The company's gross NPAs moderated to about 4.0% in Sep 2015 as compared to over 6.8% in Mar-15 (8.8% in Mar-14) as the company wrote off NPAs/repossessed and undertook effective recoveries during FY2015 and in H1FY2016. The company's NPA generation rate, notwithstanding the moderation to about 4.6% for H1FY2016 from about 6.0% in FY2015 (7.1% in FY2014) remains high compared to peers indicating the inherent risk in the company's exposure. The rating however takes note of the company's good coverage ratio of about 75% (Sep-15) and adequate solvency profile 5.4% (Sep-15). Ability to control incremental slippages and keeping a check on the asset quality of the new products envisaged by the company would be critical going forward.

¹ Profit before tax/ average total assets (Excluding onetime gains and extraordinary income)

AFCP's gearing stood at 5.3 times as in Sep-15. The rights issue of LKR 148 Mn during FY2014 supported the capitalisation profile to an extent, as the company expanded its portfolio at a rate of 35% during FY2015. Capital requirement going forward, assuming the portfolio to expand by 45-55% over the next 4 year period ending Mar-19 with internal generation being at 16-18% and core capital at 10%, the estimated capital requirement is about LKR 1-1.5 Bn; this is about 1-1.5x of the company's net worth as at Mar-15. The holding company has limited ability to infuse capital as required, so there would have to be some dilution by the holding company for raising timely capital infusion to support the high business growth.

The company's funding profile is characterised by deposits which constituted about 90% of the total borrowings as in Sep 2015, while funding via debentures and from banks accounted for 6% and 4% respectively. The company's less than 1 year mismatch was about 22% as in Sep-15 due to the short term nature of its deposit profile. As of Sep-15, 63% of the deposits base had a maturity of one year or less. ICRA Lanka takes note of the good renewal rates of about 85% over the last 2-3 years, and availability of unutilised bank lines, which provides comfort from a liquidity perspective.

AFCP enjoys a good yield on its exposure due to the target customer segment; notwithstanding some moderation in the recent past, in line with the systemic trends. The company's NIMs have remained largely stable at about 9-10 % over the last 3 years (FY13-FY15). However, high operating costs at about 7%-8% and a steady increase in the credit costs over the above mentioned period resulted in moderate net profitability (before tax) of about 1.5-2.0%. The company's net profitability in FY2015 was supported by onetime gains of about LKR 169 Million. During H1FY2016, AFPC reported an improvement in the earning profile as the spread improved following the increase in the share of high yielding 2- wheeler book, moderation in the GNPA's and reduction in the cost of funds.

Company Profile

Arpico Finance Company PLC (AFCP) is one of the older finance company in Sri Lanka, with a track record of over six decades. The company is listed on the Main Board of the Colombo Stock Exchange. The controlling interest of AFCP was acquired by Alliance Finance Group in 1967 from the original shareholders. With the consolidation drive initiated by the Central bank, Alliance Finance Group divested its controlling interest to Associated Motor Finance PLC. The company's major shareholder presently is Associated Motor Finance Company PLC with a stake of 94%.

AFCP's primary customer segments are Retail and Small and Medium Enterprises (SME) sector. The company's key areas of operations are Deposits, Leasing & Hire Purchase, Loans and Islamic Finance. The company presently has a total asset base of approximately LKR 7 Bn as in Sep-15 and operates through 9 branches and has staff strength of 245 employees.

During the year ended March 2015, AFCP reported a PAT of LKR 269 Mn on a total asset base of LKR 6.2 Bn as compared to a PAT of LKR 88 Mn on a total asset base of LKR 5.0 Bn in the previous financial year. For H1FY16, AFCP reported a PAT of LKR 179 Mn on a total asset base of LKR 7.0 Bn.

Associated Motor Finance PLC profile

Associated Motor Finance PLC (AMF) is one of the older Finance company in Sri Lanka. AMF focuses on 2-wheelers as its key asset class. Imperial Imports and Exports (Pvt) Ltd (IIEP) which is a family owned company of Mr. Nalantha Dayamansa, holds 43.1% of the company. Mr. Nalantha Dayawansa directly holds another 42.8% of the company, while other Dayawansa family members hold 6.5% of the shares. Effectively Dayawansa family controls close to 92.0% of the company. Imperial Imports and Exports (Pvt) Ltd is into motor trading business and it imports luxury vehicles and prime movers from UK.

During the year ended March 2015, AMF reported a PAT of LKR 139 Mn on a total asset base of LKR 4.6 Bn as compared to a PAT of LKR 237 Mn on a total asset base of LKR 2.6 Bn in the previous financial year. For H1FY16, AMF reported a PAT of LKR 78 Mn on a total asset base LKR 5.3 Bn.

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