

ICRA Lanka Reaffirms the issuer rating of [SL]BB for UB Finance Company Limited

May 26, 2017

Instrument	Amount	Rating Action
Issuer Rating	N/A	[SL]BB with stable outlook; reaffirmed
Guaranteed Subordinated Redeemable Debentures	LKR 300 Million	Provisional [SL]A-(SO) with stable outlook; withdrawn

ICRA Lanka Limited, Subsidiary of ICRA Limited, Group company of Moody's Investors Service has reaffirmed the issuer rating of **[SL]BB (Pronounced SL double B)** with a stable outlook assigned to UB Finance Company Limited (UBF or the Company). As the company is not expected to issue the LKR 300 Million guaranteed subordinated redeemable debentures, ICRA Lanka has withdrawn the **Provisional [SL]A-(SO) (Pronounced Provisional SL A minus Structured Obligation)** rating with stable outlook, at the request of the company.

The issuer rating factors in the UBF's status as 66.5% (75.6% voting shares) subsidiary of Union Bank of Colombo (UBC or the Parent with issuer rating of [SL]BBB/stable) and the operational, financial and managerial support that it derives from the parent company. The rating however takes note of the company's current modest scale (portfolio at LKR 8.5 Bn as on December 31, 2016), modest asset quality resulting from the legacy portfolio (gross NPA at 13.8% as on December 31, 2016), modest profitability (RoA at 0.8% for 9MFY2017) and its quite moderate capitalization profile (gearing at 10.8 times as on December 31, 2016). ICRA Lanka notes that the company's net worth stood at LKR 775 Mn as on December 31, 2016 and, it would need to at least secure LKR 150-200 Mn external equity over the next few months to meet the LKR 1.0 Bn minimum core capital requirement by January 01, 2018, considering its modest internal generation. ICRA Lanka expects timely support from UBC for meeting the regulatory capital requirements.

UBF's funding is largely in the form of public deposits (69% of the total borrowings as in December 31, 2016) and the deposit profile is quite concentrated. ICRA Lanka however takes comfort from the funding lines provided by the parent and from a few other entities and, expects timely support from UBC, which provides comfort from a liquidity perspective. ICRA Lanka notes that UBF's ability to maintain an adequate capital profile, undertake recoveries from the legacy portfolio, keep the asset quality of the new portfolio within reasonable levels and its ability to improve its profitability profile would be critical from a rating perspective.

UBF is a modest sized licensed finance company with a portfolio of LKR 8.5 Bn with 16 branches as on December 31, 2016. Vehicle finance accounted for 67% of the total portfolio, with working capital facilities being at 18% and, the legacy property loans at 9% and others 6% as on December 31, 2016. The legacy property-backed loans are NPAs in which the company is undertaking recoveries. In the vehicle finance category, the UBF's portfolio includes exposure to cars, lorries, vans, 3-wheelers, bus and other which accounted for 26%,25%,8%,5%,3%,33% respectively of the total portfolio as in December 31, 2016. Going forward, the company is expected to focus on vehicles financing and on extending working capital facilities. UBF's portfolio grew at a CAGR of 30.4% over the period FY2013-9MFY2017. In the first nine months of FY2017, the portfolio grew by about 31.0%. UBF is expected to grow its portfolio at an annualized growth rate of 25-30% going forward.

UBF' asset quality is characterized by gross NPA at 13.8% (gross NPA stood at 23% in Sep 2015) as in December 31, 2016 and net NPA/net worth of 88% as on December 31, 2016. The company's asset

quality is impacted by legacy property portfolio, which accounted close to 63% of the total gross NPA of the company as on December 31, 2016. ICRA Lanka notes that high standalone gross NPA of 21.0% on 3-wheeler (22.7% as on March 31, 2016) and lorry 6.9% on December 31, 2016; as a precautionary measure, UBF has discontinued 3-wheeler financing from FY2017. Presently, 3-wheelers accounted for 5% of the total portfolio. ICRA Lanka notes that the gross NPA of UBF's new portfolio stood at 5.57% on December 31, 2016, which is on par with the systematic average of 5.6% on September 30, 2016. ICRA Lanka takes cognizance of the recovery initiatives on the legacy property loans. However, its ability to control incremental slippages in the new portfolio and improving new portfolio quality would be crucial.

The company's capital profile is characterised by a sharp decrease in reported capital adequacy ratio (CAR) to 9.4% as on March 31, 2016 from 14.5% on March 31, 2015, as the portfolio grew at CAGR of 38%, while the internal generation was quite modest. UBC infused LKR 300 Mn of subordinated debt to augment the CAR, which improved to 12.1% on December 31, 2016. UBF's gearing increased to 10.0 times as on March 31, 2016 from 6.4 times as on March 31, 2015, gearing further increased to 10.8 on December 31, 2016. Based on the recent minimum core capital direction issued by CBSL, non-banking financial institutions have to have a minimum core capital of LKR 1.0 Bn by January 01, 2018. UBF would require close to LKR 150-200 Mn as equity to meet the regulatory requirement after factoring the internal capital generation of the company. Timely capital support from UBC, which is expected to retain the majority share-holding and voting rights in the company, would be critical to meet the regulatory capital requirements.

UBF's funding profile is characterised by deposits and funding from banks/institution, which constituted about 69% and 31% respectively of the total borrowings as on December 31, 2016. The deposit profile of the company is quite concentrated with top 10 depositors accounting for about 34% of the total deposits as on December 31, 2016. While the above exposes the company to liquidity related pressures in the event of chunky withdrawals; existing sanctioned facilities and UBF being a subsidiary of a bank provides some comfort on the liquidity front.

The company's profitability was quite modest with RoA at 0.8% for 9MFY2017. The NIMs are moderate at 5.8% in 9MFY2017 (5.7% in FY2016) because of the high leverage and modest asset quality. Operating expense ratio however improved from 6.9% in FY2015 to 5.1% in FY2016 and further to 4.9% in 9MFY2017, as expenses were rationalised over a larger asset base. Moderate provision cover of about 35-40% over the period FY2016 and in 9MFY2017 resulted in credit cost of about 1-1.1% during the above mentioned period. Going forward, it would be critical for UBF to increase its scale of business and strengthen its NIMs, while keeping the operating efficiency and credit costs at reasonable levels, to improve its overall profitability profile.

Company Profile

UB Finance Company Limited (UBF) was formerly known as The Finance & Guarantee Co. Ltd. It was incorporated in 1961 and, operated as a Finance and Real estate development company. In 2011, Union Bank of Colombo (UBC) acquired majority stake in the company with a capital infusion of LKR 600 Mn. The company also received a capital infusion of LKR 550 Mn from a Private Equity investor-ShoreCap II Ltd. As in February 2017, UBC and ShoreCap II Ltd held about 66.5% (75.6% voting rights) and 16.3% (18.5% voting rights) respectively in UBF. Initially, UBF was involved in real-estate development and financing. The company still has remnants of the old portfolio, which is completely in the NPA category. Presently, the company focuses on retail asset classes (vehicles loans/ leases/ hire purchase) and working capital finance.

During the year ended March 31, 2016, UBF reported a PAT of LKR 78 Mn on a total asset base of LKR 8.2 Bn as compared to a PAT of LKR 12 Mn on a total asset base of LKR 4.9 Bn in the previous financial year. For 9MFY2017, UBF reported a PAT of LKR 50 Mn on a total asset base LKR 9.6 Bn.

May 2017

For further details please contact:

Analyst Contacts:

Mr. Karthik Srinivasan, (Tel No. +91-22-6114 3444)
karthiks@icraindia.com

Relationship Contacts:

Mr. W. Don Barnabas, (Tel. No. +94-11-4339907)
wdbarnabas@icralanka.com



Subsidiary of

ICRA Limited

A Group Company of Moody's Investors Service

CORPORATE OFFICE

Level 10, East Tower, World Trade Center, Colombo 01, Sri Lanka

Tel: +94 11 4339907; Fax: +94 11 2333307

Email: info@icralanka.com; Website: www.icralanka.com

Contents may be used freely with due acknowledgement to ICRA Lanka.

All information contained herein has been obtained by ICRA from sources believed by it to be accurate and reliable. Although reasonable care has been taken to ensure that the information herein is true, such information is provided 'as is' without any warranty of any kind, and ICRA in particular, makes no representation or warranty, express or implied, as to the accuracy, timeliness or completeness of any such information. All information contained herein must be construed solely as statements of opinion, and ICRA shall not be liable for any losses incurred by users from any use of this publication or its contents.