

UB FINANCE COMPANY LIMITED

February 11, 2016

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

ICRA Lanka Limited, subsidiary of ICRA Limited, A Moody's Investors Service Company has assigned the issuer rating of **[SL]BB (Pronounced SL double B)** with a stable outlook to UB Finance Company Limited (UBF or the Company) and **Provisional [SL]A-(SO) (Pronounced Provisional SL A minus Structured Obligation)** rating with stable outlook to the proposed LKR 300 Million Guaranteed Subordinated Redeemable Debentures programme of UBF. The letters SO in parenthesis suffixed to a rating symbol stand for Structured Obligation. An SO rating is specific to the rated issue, its terms, and its structure. The SO ratings do not represent ICRA Lanka's opinion on the general credit quality of the issuer(s) concerned.

The rating for the Guaranteed Subordinated Redeemable Debentures is based on the strength of the unconditional and irrevocable guarantee from Seylan Bank PLC (Seylan/"the Guarantor") covering the principal and two interest instalments (Semi-Annual) of the proposed issue. The Guarantor undertakes the obligation to pay, on demand from the Trustee, the total principal sum of LKR 300 Mn and, two half-yearly interest instalments of the proposed Guaranteed Subordinated Redeemable Debentures. The rating also assumes that the guarantees will be duly invoked by the Trustee, as per the terms of the underlying Trust deed and guarantee agreements, in case there is a default in payment by UBF.

The Provisional rating is subject to the fulfilment of all conditions under the structure and review of all the final documentation pertaining to this transaction by ICRA Lanka.

The Issuer rating factors in UBF's status as 66.5% (75.6% voting shares) subsidiary of Union Bank of Colombo (UBC or the Parent) and the operational, financial and managerial support that it derives from the parent company. The scale of operations is modest notwithstanding the compounded annual growth rate of 33.6% over the 3-year period ended Mar-15. UBF's asset quality is weak on account of the legacy portfolio (Gross NPA 23% in Sep-15); the above along with higher establishment costs resulted in muted profitability indicators (RoA at 0.2% and RoNW at 1.4% for H1FY2016). ICRA Lanka takes note of UBF's moderate capitalization profile characterized by gearing of about 8.0 times as in Sep-15. The Company would need sizeable capital infusion (Approx. 2 to 3 times of its net-worth as at Mar-15 over the 3 year period ending Mar-18) to maintain a conservative capital profile and, support the envisaged business expansion plan (portfolio CAGR of 65% over the next 3 years) considering the modest internal generation; ICRA Lanka expects timely support from UBC for meeting the capital requirements. UBF's funding is largely in the form of public deposits (75% of the total borrowings as in Sep-15); the deposit profile however is also quite concentrated (top 10 deposits amounts to 38% of the total deposits in Sep-15). ICRA Lanka takes comfort from the funding lines provided by the parent and a few other entities and, expected timely support from UBC provides comfort on the liquidity profile. ICRA notes that UBF's ability to undertake prompt and early recoveries from the legacy portfolio, manage asset quality of the new portfolio within reasonable levels, maintain a risk adjusted capital and a comfortable liquidity profile as business expands and, its ability to improve its profitability profile, which are critical from a rating perspective.

UBF is a modest sized licensed finance company with a portfolio of LKR 5.8 Bn and 13 branches as in Sep 2015. As in Sep 2015, vehicle finance accounted for 63% of the total portfolio, with loan to working capital facilities accounting for 18% and legacy property loans accounting for about 18%. The legacy property

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 and buses which contributed to 24%, 19%, 8%, 8% and 3% respectively of the total portfolio as in Sep 2015. Going forward, the company is expected to focus on financing personal and commercial vehicles and in extending working capital facilities. UBF's portfolio grew at a CAGR of 34% over the period FY13-FY15. In the first six months of the current financial year, the portfolio grew by about 31%. UBF is expected to grow its portfolio at a CAGR of 65-70% over the next 3-4 years.

UBF has a weak asset quality characterized by gross NPA at 23% as in Sep-15 and net NPA/network of 90% as in Sep-15. The company's asset quality is characterized by legacy property portfolio which accounts close to 62% of the total gross NPA of the company as in Sep-15. ICRA Lanka notes that standalone gross NPA of 3-wheeler which is 8% of the total portfolio (23.5% as in Sep-15) and Cars (11.7%) is much higher than peers. While ICRA Lanka takes cognizance of the recovery initiatives on the legacy property loans, which could improve the asset quality profile going forward; 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 steady moderation of Core Capital to 11.7% in Sep -15 from about 32.9% in Mar-12, as the portfolio grew at CAGR of 34%, while the internal generation was quite modest at about 3% (Average of the period FY13-FY15). UBF's gearing stood at about 8.0 times as in Sep-15. As UBF envisages growing its portfolio at a CAGR of 65-70% over the next 3 years; assuming an internal generation of 6-8%, it would require capital of LKR 1.5-2.0 Bn over the three year period for maintaining the core capital at 10%. The incremental capital requirement is about 2.0-3.0 times the network as in Mar-15. Timely capital support from UBC, which is expected to retain the majority share holding and voting rights in the company, would be critical for the envisaged business expansion as internal generation is expected to remain modest.

UBF's funding profile is characterised by deposits and funding from banks/institution, which constituted about 75% and 25% respectively of the total borrowings as in Sep 2015. The deposit profile of the company is quite concentrated with top 10 depositors accounting for about 38% of the total deposits as in Sep-15. While the above exposes the company to liquidity related pressures in the events of the withdrawal of deposits by the large depositors. UBF being a subsidiary of a bank is expected to receive timely support from the bank in such events. This apart the company has funding support from 3 other banks and 2 financial institutions.

The company's profitability was quite modest with RoA at 0.2% for H1FY16. UBF's overall profitability is impacted as close to 23% of the total portfolio is NPA as in September 2015, resulting in a moderate NIM of about 4.5-5.5% over the last 3 years. The company's operating expenses were higher at about 6-7% over the last 3 years due to branch and staff expansion cost relating to its on-going restructuring process. The modest net profits in the last 2-3 years were supported by provision reversals or extraordinary gains. Going forward, it would be critical for UBF to increase its scale of business without adversely affecting the operating efficiency and keeping credit costs at reasonable levels, to improve its 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 500 Mn from a Private Equity investor ShoreCap II Ltd. As in Sep-15, UBC and ShoreCap II Ltd held about 66.5% (75.6% voting rights) and 16.3% (18.5% voting rights) of the shareholding respectively in UBF. Initially, UBF was involved in real-estate development and financing. The company still has remnants of the old portfolio, which is totally in NPA category. Presently, the company focuses on retail asset classes (vehicles loans/ leases/ hire purchase) and working capital finance.

During the year ended March 2015, UBF reported a PAT of LKR 12 Mn on a total asset base of LKR 4.9 Bn as compared to a PAT of LKR 92 Mn on a total asset base of LKR 2.9 Bn in the previous financial year. For H1FY16, UBF reported a PAT of LKR 4 Mn on a total asset base LKR 6.2 Bn.

Guarantor Profile:

Seylan Bank PLC

Seylan Bank PLC (Seylan) with total asset base of LKR 249.3 Billion as in Dec 2014 accounted for about 4.2% of sector assets; it also accounted for 4.5% of sector loans and advances and 4.7% of the sector deposits as in Dec 2014. The bank was incorporated in the year 1987. Sri Lanka Insurance Corporation Ltd (15.0%), Browns and Company PLC (13.9%), Employee Provident Fund (9.9%), LOLC Investments Limited (9.6%), NDB Bank (8.7%) and Bank of Ceylon (7.5%) are the major voting shareholders of the bank. The bank recorded net profits of LKR 3,079 Million on a total asset base of LKR 249.3 Billion for the FYE Dec 2014 and LKR 2,730 Million on a total asset base of LKR 277.2 Billion for the period ended Sep 2015, which resulted in ROA (post tax) of 1.33% and 1.38% for the respective periods. The bank had gross NPA ratios (Net of interest in suspense) of 7.69% and 6.12% as at FYE Dec 2014 and period ending Sep 2015 respectively and net NPA ratios of 5.31% and 4.13% respectively for the said periods. The bank had a net worth (excluding revaluation reserve) of LKR 23.3 Billion as at Dec 2014 with core capital adequacy ratio of 13.8% and total capital adequacy ratio of 14.7%.

The Seylan Bank Group recorded consolidated net profits of LKR 3,252 Million on a total asset base of LKR 251 Billion for the FYE Dec 2014 and LKR 2,731 Million on a total asset base of LKR 279.4 Billion for the period ended Sep 2015.

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