ICRA Lanka assigns [SL]BBB- rating for the proposed LKR 500 Mn Redeemable Debenture programme of Unisons Capital Leasing Limited

October 26, 2018

Instrument*	Previous Rated Amount (LKR Mn)	Current Rated Amount (LKR Mn)	Rating Action
Issuer rating	N/A	N/A	[SL]BBB- reaffirmed; outlook revised to Negative from Stable
Proposed senior, unsecured, unlisted, redeemable debenture Programme	N/A	500	[SL]BBB- (Negative); Assigned

Rating action

ICRA Lanka Limited, subsidiary of ICRA Limited, a group company of Moody's Investors Service, has reaffirmed the issuer rating of [SL]BBB- (pronounced SL triple B minus) assigned to Unisons Capital Leasing Limited (UCL or the company), while revising the outlook to negative from stable. ICRA Lanka also has assigned the issue rating of [SL]BBB- with negative outlook to the proposed LKR 500 Mn senior, unsecured, unlisted, redeemable debenture programme[1] of the company.

Rationale

The revision in the outlook factors in the weakening of Citizens Development Business Finance PLC's (CDB has an issuer rating [SL]BBB+, outlook was revised from stable to negative in October 2018) credit profile. UCL is a 90% subsidiary of CDB and benefits from managerial, operational and financial support from the parent.

The ratings take note of the company's currently adequate capitalisation profile characterised by core capital ratio of about 15% as of August 2018 (based on new CBSL guidelines and factoring in the SLFRS 9 adjustments) and the company's initiative to secure equity capital in the early part of CY2019 to support the envisioned portfolio growth at a CAGR of 50% over FY2019-FY2021. The ratings, however, take note of the company's modest scale (portfolio at LKR 1.8 Mn in Jun-18), its exposure to riskier asset classes with close to 93% of the portfolio constituted by 2-wheelers and 3-wheelers, and limited funding diversity. Further, ICRA Lanka takes cognizance of the competitive operating environment in the 2-wheeler financing space. Going forward, the company's ability to maintain a healthy asset quality and adequate profitability and capitalisation profile would be crucial from a rating perspective.

Outlook: Negative

The negative outlook reflects the deterioration of the credit profile of the parent company, CDB. The outlook may be revised to "Stable" in case of steady improvement in CDB's financial profile while UCL maintains comfortable capital, asset quality and earnings profiles. The ratings may be downgraded in case of downward rating revision of the parent or significant moderation in the financial risk profile of UCL.

[1] With a put option to redeem after 13-months

Key rating drivers

Credit strengths:

Operational, managerial and financial support from CDB: UCL is a 90% subsidiary of Citizen's Development Business PLC (CDB; rated [SL]BBB+/negative) and has strong business linkages with the parent. Majority (4 out of 6) of the board of directors are from CDB; while the key senior management positions, including the CEO, are held by former CDB personnel. Support from the parent in terms of shared services and, knowledge sharing in all key aspects of the operations has helped UCL to strengthen its systems and internal controls over the recent past. CDB's operational support to UCL includes access to CDB's branch network, core-banking system, and credit evaluation process. The internal audit of the operations is also carried out by CDB's internal audit team. ICRA Lanka expects the parent to provide liquidity or capital support, when required, for meeting its medium-term growth plans. UCL, however is expected to be listed on the Colombo Stock Exchange in the medium to long term with CDB holding controlling stake in the company.

Adequate capitalisation profile: Capitalization profile of the company is adequate with core and total CAR both at 14.72% as of Aug-18 (based on new CBSL guidelines and factoring in the SLFRS 9 adjustments) and gearing at 4.89 times as of Jun-18. ICRA Lanka estimates that the company may need to raise additional equity capital of about LKR 60 Mn over the next 3-years to grow at CAGR 50% per annum while maintaining a comfortable buffer (2%) to minimum CAR. ICRA Lanka notes the company's initiative to secure equity capital in early part of CY2019.

Credit challenges

Small scale of operations and modest competitive position: UCL is a small player in the NBFI industry with a portfolio of about LKR 1.8 Bn as of June 2018. The company's portfolio largely consists of leasing (about 98%) with 61% and 32% of the exposures being towards 2-wheelers and 3-wheelers respectively as of June 2018. The key product category of UCL was 3-wheelers, which accounted for 70% of the portfolio in March 2017, however, subsequently the focus shifted to 2-wheelers as Loan to Value (LTV) rule for 3-wheeler financing was tightened. Over the period, the 2-wheeler portfolio has grown quite sharply to about LKR 1.1 Bn as of Jun-18 from about LKR 96 Mn in Mar-17, largely with the support from the parent in terms of access to CDB's branch network, core banking system and credit evaluation process.

Exposure to riskier asset classes and borrower segments; limited portfolio seasoning: ICRA Lanka notes that close to 93% of UCL's portfolio is in the riskier segments; namely, 2-wheelers and 3-wheelers as of June 2018. Currently salaried customers account for 40% and self-employed borrowers accounted for 60% of the portfolio. The 2-wheeler portfolio, a key asset class focused by the company, is relatively new as it has grown quite sharply during last 18-months. UCL's gross NPA ratio has slightly increased to about 2.67% as of Jun-18 (1.76% as of Mar-18), however, the same adjusted for repossessed stock stood at 1.23% (0.93% as of Mar-18). Going forward, UCL's ability to maintain healthy credit quality considering the riskier target asset classes would be a key rating sensitivity.

Ability to maintain healthy profitability indicators: UCL's RoA and NIM of 4.5% and 18.0% in FY2018 moderated to 3.4% and 14.6% in Q1FY2019 respectively, owing to the increased cost of borrowings during the period. UCL has been able to improve its operating efficiency (operating expenses/average assets) in Q1FY2019 to 7.5% from 9.8% in FY2018 (12.3% in FY2017). However, expected increase in shared services fee charged by CDB and additions to field staff are likely to exert some pressure on the operating efficiency if commensurate business generation does not take place going forward. Credit costs decreased to 1.7% during the Q1FY2019 vis a vis 2.2% in FY2018, however, going forward, UCL's ability to keep credit costs and borrowing costs under control would be critical.

Improving funding diversity is crucial to support growth: Total borrowings of UCL stood at LKR 1.9 Bn and comprised of securitized borrowing (79%) mainly from CDB, long term bank funding (9%), promissory notes (9%) and bank overdraft of 2% as of June 2018. ICRA Lanka expects timely support from the parent to continue as and when needed. The cost of incremental borrowing during Q1FY2019 was at a higher rate of AWPLR+4%, which had increased the overall cost of funds of UCL. UCL being a specialized leasing company, cannot access public deposits. Going forward, UCL would have to diversify its funding sources to secure funds at competitive rates for supporting its growth.

Analytical approach: UCL credit risk profile is strengthened by the operational, managerial and financial support from CDB. For arriving at the ratings, ICRA Lanka has applied its rating methodologies as indicated below.
Links to applicable criteria: ICRA Lanka Credit Rating Methodology for Non-Banking Finance Companies

About the company:

Unisons Capital Leasing Limited (UCL) is a Specialized Leasing Company largely focusing on 2-wheeler and 3-wheeler financing presently. The company was initially set up by Vanik Incorporation PLC. The ownership was then transferred to the Softlogic Group. Laugfs Gas PLC acquired it from Softlogic group and subsequently CDB acquired it from Laugfs Gas PLC in October 2014, as part of the consolidation of the finance and leasing companies in Sri Lanka. CDB currently holds 90.4% of the equity capital of UCL as at June 30, 2018.

During the year ended March 31, 2018, UCL reported a net profit of LKR 55 Mn on a total asset base of LKR 1,749 Mn, as compared to net profit of LKR 20 Mn on a total asset base of LKR 693 Mn in the previous fiscal year. For the three months ended June 30, 2018 UCL reported a net profit of LKR 18 Mn on a total asset base of LKR 2,594 Mn.

Key financial indicators (Audited)

LKR Mn	FY2017	FY2018	3MFY2019 (Unaudited)
Net Interest Income	90	161	63
Profit after Tax	20	55	18
Net worth	337	371	389
Loans and Advances	518	1,533	1,725
Total Assets	693	1,749	2,594
Return on Equity	6.2%	15.5%	19.4%
Return on Assets	3.8%	4.5%	3.4%
Gross NPA	2.0%	1.8%	2.7%
Net NPA	-0.2%	0.0%	-0.9%
Capital Adequacy Ratio	85.7%	32.4%	27.0%
Gearing (times)	0.8	3.1	4.8

Rating history for last three years:

Instrument	Amount Rated (LKR Mn)	Current Rating	Chronology of Rating History for the past 3 years		
		FY2019 Oct-18	FY2018 Jan-18	FY2017 -	FY2016 -
Issuer rating	N/A	**[SL]BBB- (Negative)**	**[SL]BBB- (Stable)**	**N/A**	**N/A**
Proposed senior, unsecured, unlisted, redeemable debenture Programme	500	**[SL]BBB- (Negative)**	**N/A**	**N/A**	**N/A**

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