

FOR IMMEDIATE RELEASE

March 10, 2017

## ICRA Lanka reaffirms the long term ratings of Vallibel Finance PLC

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) with stable outlook for Vallibel Finance PLC (VFP or the company). ICRA Lanka also has reaffirmed the [SL]BB+ (pronounced SL double B plus) rating with stable outlook for the LKR 500 Million unsecured subordinated redeemable debentures programme and the [SL]AA-(SO) (pronounced SL double A minus Structured Obligation) rating with stable outlook for the LKR 1,000 Million guaranteed subordinated redeemable debentures programme of the company. 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 issuers concerned.

The rating for the guaranteed subordinated redeemable debentures is based on the strength of the unconditional and irrevocable guarantee from Hatton National Bank PLC (HNB) covering the principal and two interest instalments (semi-annual) and, the undertaking from the Trustee to declare the entire guaranteed amount as payable in the event the issuer does not meet the scheduled interest payment on any due date or in the event the issuer does not redeem the debenture in full on any redemption date. The guarantor undertakes the obligation to pay, on demand from the Trustee, LKR 1,102.5 Million, being the total principal sum and two half-yearly interest instalments of the proposed Guaranteed Subordinated Redeemable Debentures. The rating also assumes that the guarantee will be duly invoked by the Trustee, as per the terms of the underlying Trust deed, Trustee' undertaking and guarantee agreements, in case there is a default in payment by VFP (Issuer).

The issuer rating takes note of the expected financial and managerial support from the Vallibel group of companies, its experienced senior management team, adequate internal controls and systems, comfortable asset quality profile (gross NPA at 3.15% as in Dec-16) and good profitability indicators (RoA<sup>1</sup> at 2.58% and RoNW<sup>2</sup> at 31.66% in 9MFY2016). The rating however takes note of the expected increase in competitive pressures in VFP's target product segment (used motor vehicles), exposure to customers with a moderate credit profile and its high gearing level (11.4 times in Dec-16). Going forward, VFP's ability to manage the envisaged growth of about 25-30% over the medium term and diversify its product profile by keeping asset quality under control and while maintaining a comfortable and risk-adjusted capital structure would be crucial from a rating perspective.

VFP's portfolio stood at LKR 24,508 Mn as of Dec-16, with exposures largely towards cars (39%), vans (17%), Lorries (15%) and 3-wheelers (7%). The company has steadily reduced its exposures on the risky segments like lorries, which stood high at about 23% in Mar-14. VFP's gold loan exposure was quite modest at about 3% as in Dec-16. Going forward, the company is expected to focus on short term loan product backed by motor vehicles, business loans and gold loans.

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<sup>1</sup>RoA- Return on average assets (Annualised)

<sup>2</sup>RoNW-Return on average networth (Annualised)

The company has been able to maintain gross and net NPA ratios below the systematic averages. As of Dec-16, VFP's gross & net NPA was 3.15% and 0.46%. In the first 9 months of FY2017, VFP was able to curtail its slippages to LKR 322 Mn when compared with LKR 558 Mn in FY2016 and LKR 1,973 Mn in FY2015. The ratings however note that the NPAs in the lorry segment was higher at about 7.2% as on December 31, 2016. VFP's ability to control incremental slippages would be crucial going forward, it has a comfortable provision coverage of 85.8% as on December 31, 2016 (86.2% in Mar-16).

The company's overall earnings profile is characterised by a decline in the NIMs to about 7.3% for 9MFY2017 (FY201 - 8.5%, FY2015 - 9.9%) as VFP's yields moderated due to competition and some increase in the cost of funds. VFP's operating costs in relation to the total assets have remained range-bound at about 5-5.5% over the last few years. The company's credit costs however moderated to about 0.15% in 9MFY2017 (0.35% in FY2016, 1.62% in FY2015) as incremental slippages reduced and as it was able to undertake effective recoveries. VFP's reported RoA was stable at about 2.5-2.6% during 9MFY2017, FY2016 and FY2015. VFP's ability to control credit costs and further improve operating efficiency as the business expands and, as it ventures to newer asset classes would be critical from a profitability perspective. The business yields could witness some moderation due to the increase in competitive pressures.

VFP's funding is steered through fixed deposits, which accounted for 66% of the total borrowings as of Dec-16, followed by bank funds (24%) and debenture (6%). The ALM mismatches in the shorter term bracket (less than 1 year mismatch at 10.7% of total assets as of Dec-16) moderated with the increase in the share of long term funding from banks, which has increased from 4% in Mar-15 to 24% in Dec-16. ICRA Lanka takes note of the management's plans to mobilize further longer tenure funding to reduce the cost of funds, diversify its funding profile and improve liquidity.

VFP's capital profile is characterised by high gearing of 11.4 times as in Dec-16; while ICRA Lanka takes note of the good internal generation<sup>3</sup> of about 20-25%, the company would require regular external capital support for its envisaged business expansion for maintaining a comfortable risk adjusted capital structure.

## **Company Profile**

VFP was incorporated in 1974 as Rupee Finance Limited. In 2005, Vallibel Investment (Pvt) Ltd acquired the company and renamed it as Vallible Finance PLC. Vallibel Investment (Pvt) Ltd holds 72.9% shareholding as in Dec-16. The company is listed on the main board of the Colombo stock exchange; VFP currently operates through its 24 branches and 8 service centers. The principal activities of the company include extending finance leases, hire purchase assets financing, granting of mortgage loans, gold loans and mobilization of deposits. VFP also extends vehicle backed overdraft facilities and business loans.

During the year ended March 2016, VFP reported a PAT of LKR 513 Mn on a total asset base of LKR 22.7 Bn as compared to a net profit of LKR 373 Mn on a total asset base of LKR 16.8 Bn in the previous financial year. For 9MFY2017, VFP reported a PAT of LKR 506 Mn on a total asset base LKR 29.6 Bn.

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<sup>3</sup> Profit after tax net of dividend as a proportion of networth

**Guarantor Profile:****Hatton National Bank PLC**

Hatton National Bank PLC (HNB) is one of the large private sector commercial banks in the country with total assets amounting to LKR 858 Bn as at Dec-16. It accounted for 9.4% of sector assets, 10.9% of sector loans and advances and 11.8% of sector deposits as at Dec-16. The bank was incorporated in the present form in the year 1970. Stassen's group with 17.9%, Sri Lanka Insurance Corporation Ltd with 14.6% and Employee Provident Fund with a 9.7% are the major shareholders of the bank. The bank recorded a total income of LKR 84.3 Bn for the FY2016 and LKR 61.1 Bn for the FY2015. The net profits of the bank amounted to LKR 14.1 Bn for the FY2016 and LKR 10.4 Bn for the FY2015, which resulted in ROAA of 1.8% and 1.6% for the respective periods. The bank had gross NPA ratios of 1.80% and 2.43% as at FY2016 and FY2015 and net NPA ratios of 0.46% and 0.84% respectively for the said periods. The bank had a net worth of LKR 77.0 Bn for the FY2016 with tier 1 capital adequacy ratio of 11.22% and total capital adequacy ratio of 15.27%.

*March 2017*

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