

## ICRA Lanka reaffirms the ratings of Vallibel Finance PLC

April 05, 2019

| Instrument*  | Rated Amount | Rating Action                    |
|--|--------------|----------------------------------|
| Issuer rating  | N/A          | [SL]BBB (Stable); Reaffirmed     |
| Guaranteed subordinated redeemable debenture programme | LKR 1,000 Mn | [SL]AA-(SO) (Stable); Reaffirmed |
| Unsecured subordinated redeemable debenture programme  | LKR 500 Mn   | [SL]BBB- (Stable); Withdrawn     |

### Rating action

ICRA Lanka Limited, subsidiary of ICRA Limited, a group company of Moody's Investors Service, has reaffirmed the issuer rating of Vallibel Finance PLC (VFP or the Company) at [SL]BBB (Pronounced SL triple B) with Stable outlook. ICRA Lanka has also reaffirmed the issue rating of [SL]AA-(SO) with Stable outlook for the LKR 1,000 Mn guaranteed, subordinated, redeemable debenture programme of the Company. ICRA Lanka has withdrawn the issue rating of [SL]BBB- (Pronounced SL triple B minus) with a stable outlook, for the LKR 500 Mn unsecured, subordinated, redeemable debenture programme, at the request of the Company, as the instrument was repaid fully on maturity in Feb-19.

### Rationale

The issuer rating takes note of the expected financial and managerial support from the Vallibel group of companies, VFP's experienced senior management team and, its adequate internal controls leading to a comfortable asset quality profile (gross NPA ratio at 3.16% as in Dec-18). The capital profile was supported following the equity infusion via the rights issue concluded in Jun-18; however, considering its growth plans, the gearing is expected to increase and remain high at about 8 to 9 times going forward. ICRA Lanka takes note of the moderation in the net profitability (profit after tax/average total assets) as systematic interest rates went up and credit cost witnessed some increase, nevertheless net profitability was adequate at 2.4% (unaudited) for 9MFY2019. Going forward, VFP's ability to maintain good asset quality profile considering its exposure to borrowers with modest credit profile and the subdued business environment, which is prevailing in the country, would be crucial from a rating perspective.

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 installments (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 payments on any due date or in the event the issuer does not redeem the debenture in full on any redemption date, to redeem the instrument in full. 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 installments of the 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's undertaking and guarantee agreements, in case there is a default in payment by VFP.

## Outlook: Stable

ICRA Lanka believes that VFP would continue to benefit from the support from the Vallibel group and maintain a healthy asset quality and earnings profile. The outlook may be revised to 'Positive' in case of steady improvement in VFP' capital profile. The outlook may be revised to 'Negative' in case of weakening in the asset quality or a significant deterioration in the profitability, liquidity and capitalisation profile from current levels.

## Key rating drivers

### Credit strengths

**Expected financial and managerial support from the Vallibel group:** Vallibel Investments (Pvt) Ltd (VIPL) is the main shareholder of VFP, holding 51.4% shares as of December-2018, which in turn is fully owned By Mr. Dammika Perera. VFP is part of the Vallibel group promoted by Mr. Dammika Perera. Vallibel One PLC (VOP) acts as the holding company of Vallibel group. The Vallibel group has diversified interests in financial services, trading, manufacturing and leisure businesses. VFP has access to the managerial support from the Vallibel group in strategic decision making. In Jun-18, VFP secured LKR 1,034 Mn via a rights issue which was largely subscribed by Mr. Perera resulting in his shareholding going up to 21.4% in Dec-18 from less than 1% in Mar-18. In addition to equity support, Vallibel group's entities have placed long term deposits with VFP, when required; group companies accounted for about 4% of the deposits of the Company as of Dec-18 (8% in Dec-17).

**Experienced senior management team and adequate risk management systems:** VFP's board consisted of 8 members including 3 independent members. The Company has an experienced senior management team, with CEO/ Managing director having over 30 years of experience in the NBFi industry. The Company has an elaborate organization structure covering all key business functions, including, business development, credit, collections, recoveries, finance and administration. Each business function is headed by an experienced senior manager. VFP has a prudent loan origination system and an effective loan monitoring and collection mechanism, as reflected by its healthy asset quality. The mechanism provides it with early warning signals and helps in adjusting the loan policies in line with the evolving credit trends. The credit and recovery functions are centralized at the Head Office. The centralized approach supports VFP in optimizing its collection and recovery activities. The Company has implemented adequate internal control and risk management processes. The internal controls and risk management processes are reviewed by an external team and are updated on a regular basis. The Company also has an in-house internal audit team that undertakes timely review of the operations.

**Healthy asset quality compared to systematic averages;** The Company has been able to maintain gross and net NPA ratios below the systematic averages. As of Dec-18, VFP's gross and net NPA ratios were 3.16% and 0.82% as compared to the systemic average of 7.80% and 2.47% as in Dec-18. The Company's comprehensive credit operations and effective recoveries has supported its portfolio quality. VFP's provision coverage ratio (based on CBSL guidelines) reduced to 61% in Dec-18 from 72% in Mar-18, however the same is expected to increase once the IFRS 9 related additional provisions (about 20-25% of the current outstanding provisions) are made

**Adequate profitability indicators, notwithstanding the moderation:** The Company's overall earnings profile is characterized by a healthy NIM of 7.73% (unaudited) for 9MFY2019 (FY2018 - 7.98%, FY2017 - 7.52%); during 9MFY2019 NIM was affected largely because of the increase in the cost of borrowings. VFP's operating costs in relation to the total assets have remained range-bound at about 5.2-5.3% over the last few years. The Company's credit costs however increased to about 0.56% in 9MFY2019 (0.30% in FY2018, 0.12%

in FY2017) due to incremental slippages during the period. VFP's net profitability therefore moderated to 2.43% in 9MFY2019 from 2.95% in FY2018 (2.72% in FY2017). Ability to control credit costs while improving operating efficiency, as the business expands, would be critical from a profitability perspective.

## Credit challenges

**Moderate Capital profile-** VFP's gearing reduced to 7.8 times in Dec-18 (10.2 times in Mar-18) following the rights issue of LKR 1,038 Mn in Jun-18. Going forward, however, the Company's gearing is expected to increase and remain high at about 8-9 times in view of its growth plans and as it envisages to cap the same at those level. The Company's tier-I and total capital adequacy ratios (CAR; based on new direction) stood at 9.57% and 10.67% in Dec-18 as compared to regulatory requirement of 6.5% and 10.5% (by Jul-19). ICRA Lanka envisages further incremental capital requirement for VFP to support portfolio growth of 25-30% per annum over the next 2-3 years, while maintaining a comfortable buffer to the minimum CAR requirement. VFP's total borrowings stood at LKR 39.7 Bn in Dec-18 (LKR 33.6 Bn in Mar-18) with 63% being contributed by deposits and 33% in the form of bank borrowings. VFP's short term (less than 12 months) ALM mismatch stood at -11.5% in Dec-18 (-13.5% in Mar-18). The Company's deposit renewal rate of 75-80% and unutilized funding lines of LKR 3.3 Bn provide comfort on the liquidity.

**Exposure to customers with modest credit profile:** VFP is serving SME's and individuals who have a modest risk profile and are susceptible to adverse economic cycles. ICRA Lanka however takes note of the adequate internal controls put in place by the Company, which provides comfort from a credit perspective.

**Analytical approach:** For arriving at the ratings, ICRA has applied its rating methodologies as indicated below. **Links to applicable criteria:** [ICRA Lanka's Credit Rating Methodology for Non-Banking Financial Institutions](#)

## About the Company - Vallibel Finance PLC

VFP was incorporated in 1974 as Rupee Finance Limited. In 2005, Vallibel Investment (Pvt) Ltd acquired the Company and renamed it as Vallibel Finance PLC. Mr. Dammika Perera has the controlling stake of the Company through direct holding of 21.4% and 51.4% holding through his fully owned investment arm, Vallibel Investment (Pvt) Ltd as in Dec-18. The Company is listed on the main board of the Colombo stock exchange. VFP currently operates through 38 branches. 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 2018, VFP reported a PAT of LKR 1,019 Mn on a total asset base of LKR 38.4 Bn as compared to a net profit of LKR 726 Mn on a total asset base of LKR 30.6 Bn in the previous financial year. For 9MFY2019, VFP reported a PAT of LKR 772 Mn on a total asset base LKR 46.3 Bn.

## About the guarantor - 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 1,086 Bn as at Dec-18. It accounted for 10.5% of sector assets, 13.3% of sector loans and advances and 9.4% of sector deposits as in Dec-18. The bank was incorporated in the present form in the year 1970. The major shareholders of the bank are Stassen's group 17.9%, Employees Provident Fund (9.7%), and Sri Lanka Insurance Corporation Ltd (8.2%).

The bank recorded a net interest income of LKR 47.6 Bn for the CY2018 as compared to LKR 39.6 Bn for the CY2017. The net profits of the bank amounted to LKR 15.5 Bn for the CY2018 and LKR 16.5 Bn for the CY2017, which resulted in RoA of 1.52% and 1.82% for the respective periods. The bank had gross NPA ratios of 2.78% and 2.28% as at Dec-18 and Dec-17 and net NPA ratios of 1.11% and 0.77% respectively for the said periods. The bank had a net worth of LKR 115.7 Bn as of Dec-18 with tier 1 capital adequacy ratio of 12.80% and total capital adequacy ratio of 15.22%.

### Key financial indicators (VFP)

|                        | FY2017 | FY2018 | 9MFY2019 (Unaudited) |
|------------------------|--------|--------|----------------------|
| Net Interest Income    | 2,200  | 3,422  | 2,456                |
| Profit after Tax       | 726    | 1,019  | 772                  |
| Net worth              | 2,558  | 3,301  | 5,110                |
| Loans and Advances     | 26,101 | 30,845 | 37,552               |
| Total Assets           | 30,685 | 38,406 | 46,365               |
| Return on Equity       | 32.37% | 34.77% | 24.55%               |
| Return on Assets       | 2.72%  | 2.95%  | 2.43%                |
| Gross NPA              | 2.93%  | 2.72%  | 3.16%                |
| Net NPA                | 0.37%  | 0.41%  | 0.82%                |
| Capital Adequacy Ratio | 13.72% | 12.21% | 10.67%*              |
| Gearing (times)        | 10.59  | 10.18  | 7.77                 |

\*Based on the new direction issued by CBSL

### Rating history for last three years:

| Instrument   | Current Rating (FY2019) |                       |                      | Chronology of Rating History for the past 3 years |                         |                         |
|--|-------------------------|-----------------------|----------------------|---|-------------------------|-------------------------|
|  | Type                    | Amount Rated (LKR Mn) | Date & Rating        | Date & Rating                                     | Date & Rating in FY2017 | Date & Rating in FY2016 |
|  |                         |                       | Mar-2019             | Mar-2018  | Mar-2017                | Mar-2016                |
| Issuer rating  | N/A                     | N/A                   | [SL]BBB (Stable)     | [SL]BBB (Stable)                                  | [SL]BBB- (Stable)       | [SL]BBB- (Stable)       |
| Guaranteed subordinated redeemable debenture programme | Long term               | 1,000                 | [SL]AA-(SO) (Stable) | [SL]AA-(SO) (Stable)                              | [SL]AA-(SO) (Stable)    | [SL]AA-(SO) (Stable)    |
| Unsecured subordinated redeemable debenture programme  | Long term               | 500                   | Withdrawn            | [SL]BBB- (Stable)                                 | [SL]BB+ (Stable)        | [SL]BB+ (Stable)        |

### ANALYST CONTACTS

**Mr. Dasith Fernando**

+94 11 4339907  
dasith@icralanka.com

**Mr. Vidura Welathanthri**

+94 11 4339907  
vidura@icralanka.com

**Mr. A.M Karthik**

+91 44 45964308  
a.karthik@icraindia.com

### RELATIONSHIP CONTACT

**Mr. W. Don Barnabas**

+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](mailto:info@icralanka.com); Website: [www.icralanka.com](http://www.icralanka.com)

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