

## ICRA Lanka revises the issuer rating of Softlogic Finance PLC to [BB-] with Negative outlook

November 07, 2019

Instrument	Rated Amount (LKR Mn)	Rating Action
Issuer rating	N/A	Revised to [SL]BB- (Negative) from [SL]BB (Negative)
Guaranteed redeemable debenture programme 1,400	1,400	[SL] AAA (SO) with stable outlook; Withdrawn

### Rating action

ICRA Lanka Limited, subsidiary of ICRA Limited, a group company of Moody's Investors Service has revised the issuer rating of Softlogic Finance PLC (SFP or the Company) to [SL]BB- (pronounced SL double B minus) with Negative outlook from [SL]BB (pronounced SL double B) with Negative outlook. ICRA Lanka also has withdrawn the issue rating of [SL]AAA (SO) (pronounced SL triple A Structured Obligation) with Stable outlook outstanding for the LKR 1,400 Mn Guaranteed Redeemable Debenture programme of SFP, as the same is matured and fully repaid by the Company.

### Rationale

The rating revision factors in the sharp deterioration in SFP's capital indicators and further weakening in its asset quality. SFP's core and total capital adequacy ratios (as per the new CBSL guidelines) stood at -0.47% and -0.68%, respectively in June 2019, below regulatory requirement, as higher than expected loan provisioning has affected its core capital. Capital enhancement plans, including on-going rights issue of LKR 600Mn will provide some comfort; ICRA Lanka however notes that SFP's capital profile would remain weak and below regulatory requirement until about March 2020, until the NBF is able to secure a larger capital infusion. SFP's gross NPAs increased further to 17.4% June 2019 from 13.1% in March (12.5% in March 2018). The rating continues to factor in the financial, managerial and operational support from the Softlogic group.

### Outlook: Negative

The outlook may be revised to 'Stable' in case the company is able to considerably augment its capital profile to reach a level above the regulatory requirement along with improvement in its asset quality indicators. The rating may be revised downwards, if the capital profile continues to remain stretched and below regulatory requirement or in case of further weakening in its asset quality. Significant weakening in the credit profile of the Soflogic group, dilution in the ownership or lower than expected support from group would also adversely impact the rating.

### Credit strengths

**Access to financial, managerial and operational support from Softlogic group;** Softlogic Finance is a 67% (as in March 2019) owned subsidiary of Softlogic Capital PLC (rated BBB+, Stable outlook), which in turn is a 75% owned subsidiary of Softlogic Holdings PLC (rated BBB+, Stable outlook). Softlogic group is a leading conglomerate in Sri Lanka with exposure to the healthcare, financial services (Softlogic Life

Insurance and Softlogic Finance), leisure and retail sectors. ICRA Lanka expects financial, managerial and operational support from the group, as demonstrated in the past, by capital infusions to SFP. The rating takes cognizance of on-going capital enhancements plans, with the support of the Softlogic Group.

## Credit challenges

**Sharp deterioration in capital profile;** As in June 2019, tangible net worth of SFP stood at about LKR 1.8Bn (adjusted for deferred tax), against the regulatory minimum capital level of LKR 1.5Bn. With the on-going rights issue, ICRA Lanka expects the company to meet LKR 2.0 Bn minimum capital hurdle in January 2020, set by the CBSL. However, risk weighted capital adequacy ratio stood significantly below regulatory minimum with core CAR at -0.47% and total CAR at -0.68% as in June 2019 (Core CAR 3.87% and total CAR 3.47% as in March 2019). ICRA takes note that capital infusion plans are in the pipe-line to enhance the capitalization profile to meet regulatory requirements. Timely completion of these capital raising exercises would be a key monitorable, going forward.

**Further weakening in asset quality;** Previous rating actions taken by ICRA Lanka has factored in the deterioration of asset quality indicators of SFP where, gross non-performing assets (NPA) ratio of the company weakened to 13.8% in December 2018 from 12.5% and 8.9% in March 2018 and March 2017, respectively. The latest rating action factors the further increase in NPA levels, mainly on the account of higher slippages in the SME and business loans segments (accounting for over 50% of the total portfolio in June 2019). Overall gross NPA stood at 13.1% as in March 2019 and 17.4% as in June 2019. ICRA Lanka takes note of the management decision to curtail its exposure to unsecured SME lending and focus more on asset backed products such as gold loans and vehicle leasing. However, company's ability to arrest incremental slippages and improve overall credit quality of the portfolio is crucial from a rating point of view.

**Subdued profitability;** SFP's RoA declined further to 0.49% in 3M FY2020 from 0.92% in FY2019 (RoA stood at 1.01% in FY2018). Moderation of overall profitability is largely due to higher credit costs. Going forward, ability to improve business margins and keep credit costs under control would be crucial as the Company is expected to focus on the more competitive vehicle finance segment, in view of the stress in the SME lending segment.

**Moderate liquidity profile;** As in June 2019, cumulative ALM mismatch of SFP in less than one year maturity bucket stood at about negative 1.9% compared to positive 3.4% recorded in March 2018, as the Company has shifted its focus toward long term asset backed lending products, from short term SME lending. As in June 2019, Close to 87% of total funding of SFP was represented by fixed deposits, that are largely of short term nature (13 months or less). However, relatively good renewal rate of over 80% on these deposits provides some comfort, from a liquidity point of view.

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

## Company Profile:

SFP was incorporated in 1999 as Capital Reach Leasing PLC (Capital Reach), a Specialised Leasing Company and, in 2007 the Company got registered as a Licensed Finance Company. In 2010, the Softlogic Group acquired the controlling stake of Capital Reach through its subsidiary Softlogic Capital PLC and

renamed it as Softlogic Finance PLC. As of December 2018, Softlogic Capital PLC (SCAP) holds about 67% of the Company; SHP holds about 75% in SCAP as in March 2019. Currently, as one of the mid-sized LFCs in Sri Lanka, SFP offers working capital and term loans to the SME segment, personal loans, gold loans and vehicle financing.

During FY2019, SFP reported a PAT of LKR 204 Mn (PBT LKR 63Mn) on a total asset base of LKR 22,555 Mn via-a-vis LKR 220 Mn PAT in FY2018 on a total asset base of LKR 21,680 Mn.

## Softlogic Finance PLC

LKR Mn	FY2018	FY2019	Q1FY2020
Operating Income	1,585	1,528	376
Operating Profit/Loss	401	254	67
Profit Before Tax	292	64	57
Profit After Tax	220	204	27
Reported Net Worth	2,280	1,906	1,931
Adjusted Net Worth*	2,280	1,771	1,795
RPAT/ATA	1.01%	0.92%	0.49%
Gross NPA	12.5%	13.1%	17.4%
Core CAR	14.5%	3.9%	-0.47%
Gearing - adjusted**	8.30	11.55	11.02
Total Assets	21,680	22,555	22,197

Note: Figures as on June 2019 are based on un-audited financials. \* Net worth adjusted for revaluation reserves. \*\* Gearing adjusted for re-valuation reserves.

## Rating history for last three years:

Instrument	Current Rating (CY2019)			Chronology of Rating History for the past 3 years			
	Amount Rated (LKR Mn)	Amount Outstanding (LKR Mn)	Date & Rating in	Date & Rating in	Date & Rating in	Date & Rating in	Date & Rating in
			FY2020	FY2020	FY2019	FY2018	FY2017
			Nov 2019	Apr 2019	Oct 2018	Jul 2017	Jul 2016
Issuer rating	N/A	N/A	[SL] BB-; Negative	[SL] BB; Negative	[SL] BB+; Negative	[SL] BB+ Stable	[SL] BB+ Stable
Guaranteed Redeemable Debenture programme	1,400	-	[SL]AAA (SO); Withdrawn	[SL]AAA (SO); Stable	[SL]AAA (SO); Stable	[SL]AAA (SO); Stable	[SL]AAA (SO) Stable

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