

## ICRA Lanka reaffirms the issuer rating of [SL]BB+ of Softlogic Finance PLC; Revises outlook to Negative

October 15, 2018

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

### Rating action

ICRA Lanka Limited, subsidiary of ICRA Limited, a group company of Moody's Investors Service has reaffirmed the issuer rating of [SL] BB+ (pronounced SL double B plus) for Softlogic Finance PLC (SFP or the company); outlook has been revised to negative from stable. ICRA Lanka has also re-affirmed the [SL]AAA (SO) (pronounced SL triple A Structured Obligation) rating with stable outlook to the LKR 1,400 Mn Guaranteed Redeemable Debenture programme of SFP. 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 rating does not represent ICRA Lanka's opinion on the general credit quality of the issuer concerned.

The issue rating is reaffirmed based on the strength of an unconditional and irrevocable guarantee from Guarant Co Limited, Mauritius (GLM/the Guarantor; rated A1/stable by Moody's) covering the principal amount due on the rated instrument. The rating also takes into account two interest instalments (quarterly) and principal amounting in total to LKR 400 Mn deposited by the company with the debenture trustee in the form of Debt Service Reserve Account (DSRA), as well as the payment mechanism designed to ensure payment on the rated instrument when and if the issuer does not pay and the guarantee has to be invoked by the debenture trustee. The rating assumes that the guarantee and DSRA will be duly invoked/utilised by the debenture trustee, as per the terms of the transaction, in case there is a default in payment by SFP (Issuer).

### Rationale

The revision in the outlook factors in the significant weakening in the asset quality indicators of SFP, stemming from company's exposure to small and medium enterprises (SME) and business loans (together at 75% of the total portfolio) and expected pressure on the capitalization profile going forward. The gross NPAs increased to 12.37% in Mar-18 from 8.95% in Mar-17; SME and business loans segment NPAs stood at 7.74% and 11.00% respectively in Mar-18 as compared to 1.34% and 12.10% in Mar-17. SFP's gearing levels (adjusted for re-valuation reserves) have reduced to 8.87x in Mar-18 compared to 11.24x in Mar-17, following the conversion of LKR 310 Mn of debt into equity and moderation in the portfolio during FY2018. However, core and total capital adequacy ratios (as per the new CBSL guidelines) as of Mar-18, stood moderate at 10.00% and 9.53% respectively. The company would require external capital to support growth and to meet future regulatory requirements as internal generation may not be adequate. The rating however factors in the financial, managerial and operational support from Softlogic group, Softlogic Holdings (SHL); rated [SL]BBB+ with a stable outlook. The rating also takes note of the subdued profitability indicators because of the contraction in the margins. Going forward, company's ability to grow its portfolio while

controlling asset quality and maintain comfortable levels of capitalization and earnings profile, would be crucial from a ratings perspective.

## Outlook: Negative

ICRA Lanka takes the view that OFP's increased focus towards asset based lending would contribute towards improving asset quality. The outlook may be revised to 'Stable' in case of steady improvement in the asset quality indicators, earnings, and capitalization profile of the company.

## Key rating drivers

### Credit strengths

**Access to financial, managerial and operational support from Softlogic group** - Softlogic Finance is a 73% (in Jun-18) owned subsidiary of Softlogic Capital PLC, which in turn is a subsidiary of Softlogic Holdings PLC (SHL). ICRA Lanka expects SFP to receive financial and operational support from the group, going forward. Moreover, one board member of SHL also acts in an executive capacity at SFP, as the deputy chairman, and provides strategic guidance to the company.

**Comfortable asset-liability profile** - The relatively short-term (<1 year) nature of SME exposures (51% of the portfolio in Mar-18), healthy renewal rate of deposits and access to funding lines from banks & financial institutions provide comfort on the overall liquidity profile of the company. As on Mar-2018, SFP had a positive asset-liability maturity (ALM) mismatch (3.39% of total assets) in the less than 1 year age bracket. However, ICRA Lanka notes that company would be faced with mismatches as it ventures into long tenure products going forward. Thus, it would be crucial to diversify its funding profile and secure tenure matching borrowing going forward.

### Credit challenges

**Significant weakening in asset quality** - During FY2018, gross non performing assets (NPA) increased to 12.37% from 8.95% in Mar-17. The increase in NPA levels was mainly due to higher slippages in the core SME and business loans segments (accounting for 75% of the total portfolio). SME and business loans segment NPAs stood at 7.74% and 11.00% respectively in Mar-18 as compared to 1.34% and 12.10% in Mar-17. Gross NPAs in the non SME/business loans segments were also high and stood at 23.81% in Mar-18 (22.23% in Mar-17); company currently has about 25% portfolio exposure to these segments and higher NPAs were observed mainly in vehicle leasing and personal loans segments. The rating takes note of management efforts to strengthen credit recovery and collection processes, as well as the envisaged reduction of unsecured products going forward. SFP's ability to improve asset quality going forward would be a key monitorable from a rating perspective.

**Moderate capitalization profile** - Tier-I CAR of SFP stood at 12.67% in Mar-2018 (11.83% in Mar-2017), whereas the total CAR stood at 11.42% in Mar-2018 (11.26% in Mar-2017), above regulatory minimum capital requirements. Following IFRS 9 adjustments and new capital adequacy requirements with the minimum capital levels increasing sharply over the next few years, ICRA Lanka envisages internal generation to be insufficient in maintaining capitalization indicators. However, ICRA expects support from the Softlogic group would enable SFP to maintain comfortable level of capital adequacy going forward; adjusted tier-I CAR (as per the new capital adequacy framework) stood at 10.00% in Mar-2018.

**Subdued profitability** – SFP’s net interest margin contracted from 5.43% in FY2017 to 4.44% in FY2018, impacted by the decline in the portfolio and increase in the cost of funds. The above has impacted the net profitability of the company, with RoA declining to 1.01% and RoE to 10.61% in FY2018 (from 1.16% and 12.77%, respectively in FY2017); RoA and RoE stood lower at 0.56% and 5.25%, respectively in Q1FY2019. 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 and business loans segment.

**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 June 2018, Softlogic Capital PLC (SCAP) holds about 73% of the company; SHP holds about 75% in SCAP as in June 2018. 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 FY2018, SFP reported a PAT of LKR 219 Mn on a total asset base of LKR 21,680 Mn via-a-vis LKR 244 Mn PAT in FY2017 on a total asset base of LKR 21,706 Mn.

### Guarantor Profile – Gurant Co Limited, Mauritius

Gurant Co Limited is a Mauritius Company which provides credit guarantees for financing Infrastructure projects and financial markets. Private Infrastructure Development Group holds 88% stake in the company and Nederlandse Financierings (FMO) holds 12% in the company. Private infrastructure development group is a development agency owned by the international development arms of United Kingdom, Netherlands, Switzerland and Sweden governments.

### Softlogic Finance PLC - Audited

LKR Mn	FY2017	FY2018	Q1FY2019
Total income	4,179	4,146	949
Operating Profit/Loss	765	401	41
Profit After Tax	244	219	30
Reported Net Worth	1,842	2,280	2,296
Adjusted Net Worth*	1,754	2,177	2,193
Borrowings	19,720	19,309	19,277
RPAT/ATA	1.16%	1.01%	0.56%
Gross NPA	8.95%	12.37%	NA
Total CAR	11.26%	11.42%	NA
Gearing – reported	10.71	8.47	8.39
Gearing – adjusted**	11.24	8.87	8.79
Total Assets	21,706	21,680	21,574

Note: Figures as on 30.06.2018 are based on un-audited financials. \* Net worth adjusted for revaluation reserves. \*\* Gearing adjusted for re-valuation reserves.

## Rating history for last three years:

Company	Instrument	Current Rating (CY2018)			Chronology of Rating History for the past 3 years			
		Type	Amount Rated (LKR Mn)	Amount Outstanding (LKR Mn)	Date & Rating in FY2019 Oct 2018	Date & Rating in FY2018 Jul 2017	Date & Rating in FY2017 Jul 2016	Date & Rating in FY2016
Softlogic Finance PLC (SFP)	Issuer rating	N/A	N/A	N/A	[SL] BB+; Negative	[SL] BB+ Stable	[SL] BB+ Stable	N/A
Guaranteed redeemable debenture program	Issue rating	N/A	LKR 1,400 Mn	N/A	[SL] AAA (SO); Stable	[SL] AAA (SO); Stable	[SL] AAA (SO) Stable	N/A

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