ICRA Lanka Reaffirms the long term ratings of Softlogic Finance PLC

July 20, 2017

Instrument	Amount	Rating Action
Issuer rating	NA	[SL]BB+ with stable outlook; reaffirmed
Issue rating	LKR 1,400 Mn	[SL]AAA(SO) with stable outlook; reaffirmed

ICRA Lanka Limited, subsidiary of ICRA Limited, group company of Moody's Investors Service, has reaffirmed the issuer rating of [SL]BB+ (Pronounced SL double B plus) with a stable outlook for Softlogic Finance PLC (SFP or the Company). ICRA Lanka also reaffirmed the [SL]AAA(SO) (pronounced SL triple A Structured Obligation) rating with stable outlook for the LKR 1,400 Million Guaranteed Redeemable Debentures programme of Softlogic Finance PLC (SFP/the Company/the Issuer). 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 GuarantCo 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 deposited by the company with the debenture trustee in the form of Debt Service Reserve Account (DSRA) and 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).

The issuer rating continues to factor the company's status as a Softlogic group entity; Softlogic Holdings PLC (SHP), the holding company of the Softlogic Group having an issuer rating of [SL]BBB (stable). ICRA Lanka expects SFP to receive financial, managerial and operational support from the Group. The rating continues to factor in the weak asset quality, modest capitalization profile, characterized with high gearing and moderate profitability indicators of the company. Going forward, it would be critical to maintain a comfortable risk adjusted capital structure in relation to the target business segment and to support the envisaged business growth. ICRA Lanka also takes cognizance of a highly competitive business environment in the SME and the business loan segments, the key focus segments of the company; this is expected to exert some pressure on the margin and business expansion going forward.

The issuer rating also factors the recent restatement of SFP's financial accounts for FY2015 and FY2016, and the corresponding impact on the key financial indicators including profitability and the capital structure. During the financial year ended March 31, 2017 Company has restated the financial accounts for FY2016 and FY2015 to reflect the changes post updating its loan impairment model. The PAT for FY2016 was revised down to from LKR 369Mn to LKR 73Mn due to the revised loan impairment expenses. In terms of capitalization, the previously reported gearing of 8.9x and 6.8x for FY2015 and FY2016 was revised upwards to 10.6x and 9.1x respectively, after the restatement. The company would have to improve its overall capital adequacy, from the current levels of 11.3% in the near term. The Tier-I however is comfortable at 11.8%.

SFP is a Licensed Finance company with a moderate sized portfolio of about LKR 19 Bn as on March 31, 2017. The company changed its exposure profile over the recent past, post the takeover by the new shareholder in

CY2010; SFP shifted its focus from vehicle finance in the past to extending SME loans (largely for working capital) and business loans (long term loans). As in March 2017, SME loans accounted for about 55% of the total portfolio, followed by business loans (18%) and personal loans (11%); share of vehicle finance has declined to about 8%; the share of vehicle finance in the overall portfolio was about 61% in March 2012. The share of gold loans has remained moderate at about 3-4% over the last few years. The portfolio grew at a CAGR of about 26% over the period FY2013-FY2017; growth was largely driven by the robust disbursements of SME loans. Going forward, the portfolio CAGR is expected to be about 20% over the next 2-3 years, with share SME loans expected to increase to about 70% over the above mentioned period.

The company's asset quality indicators remain weak, with gross NPA at 8.9% as in March 2017 via-a-via 9.7% in March 2016. However, the core SME and business loan segment, which accounts to about 75% of the total portfolio, has relatively better asset quality indicators (segment gross NPA 3.9% as in March 2017) than the overall portfolio. Nevertheless, ICRA Lanka is cognizant of the limited seasoning of the SME exposures considering the high portfolio growth in the recent past. Ability to keep the asset quality indicators under control considering the average profile of the target segments and undertake active recoveries from the existing NPAs would be critical from a rating perspective.

ICRA Lanka also takes note of the relatively subdued capitalization profile, which is characterized by gearing higher than systemic levels. As on March 31, 2017 gearing level of SFP stood at 8.7x vis-à-vis 9.1x (restated) as on March 31, 2016. Risk adjusted capital adequacy ratios remained moderately above the regulatory minimum level with core capital at 11.8% and total CAR 11.3% as on.

SFP's funding profile is characterised by public deposits, that account for about 83% of the total debt as on March 31, 2017. The rest is funded by a mix of short term and long term debt, including LKR 1.4 Bn long-term debentures. The relatively short-term nature of the SME exposures, healthy renewal rate on deposits and access to funding lines from banks & financing institutions provide comfort on the overall liquidity profile of the company. As on March 31, 2017 SFP had a positive maturity mismatch of 3.7% (cumulative mismatch as percentage of total assets) in the less than 1 year bracket.

The lending margins of the company came under pressure (NIM of 6.4% in FY 2017 vis-à-vis 7.8% in FY2016) in the recent past, because of the increase in the systemic rates since November 2015; and higher competition in the SME – business loan segment. Notwithstanding the moderation of NIM, SFP' overall profitability was supported by the improvement in its operating efficiencies and, the moderation in credit costs. The operating expense/ATA reduced to 5.6% in FY2017 as compared with 6.4% in FY2016 while credit costs declined to 1.7% in FY2017 from 3.6% (restated, previously 1.9%) in FY2016. The above resulted in an improvement in RoA of 1.8% in FY2017 via-a-vis 0.4% (restated, previously 1.8%) in FY2016.

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 March 2017, Softlogic Capital PLC (SCAP) holds about 68% of the company; SHP holds about 59% in SCAP as in March 2017. Currently, as one of the mid-sized LFCs in Sri Lanka, SFB offers working capital and term loans to the SME segment, personal loans, gold loans and undertakes vehicle financing.

During FY2017, SFP reported a PAT of LKR 365 Mn on a total asset base of LKR 22.2 Bn via-a-vis LKR 73 Mn PAT (restated, previously LKR 369 Mn) in FY2016 on a total asset base of LKR 20.3 Bn.

Guarantor Profile – GuarantCo Limited, Mauritius

GurantCo 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 international development arms of United Kingdom, Netherland, Switzerland and Sweden governments.

July, 2017

For further details please contact:

Analyst Contacts:
Mr. Karthik Srinivasan, (Tel No. +91-22-61143444)
karthiks@icraindia.com

Relationship Contacts:
Mr.W. Don Barnabas, (Tel. No. +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; Website: www.icralanka.com