

ICRA Lanka assigns [SL]BB+ rating to Softlogic Finance PLC

July 5, 2016

Instrument	Amount	Rating Action
Issuer Rating	N/A	[SL]BB+ with stable outlook; Assigned

ICRA Lanka Limited, Subsidiary of ICRA Limited, Group company of Moody's Investors Service, has assigned the issuer rating of **[SL]BB+ (Pronounced SL double B plus)** with a stable outlook to Softlogic Finance PLC (SFP or the Company).

The rating takes note of 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 takes note of the currently weak asset quality with gross NPA at 9.7% (in Mar-16), high dependence on deposits (78% of the total debt as in Mar-16) and moderate profitability (PAT/ATA¹ for 9MFY2016 at 1.5% vis a vis 1.1% in FY2015). The rating takes cognizance of a highly competitive business environment in the SME and the Business loan segment, the key focus segments of the company; this is expected to exert pressure on the margin and business expansion going forward. ICRA Lanka takes note of the improvement in the capital structure with the gearing reducing to about 7.0 times as in March 2016 as compared to 9.1 times in March 2015; however the company is expected to operate at a high leverage of about 9-9.5 times going forward. The company has a steep portfolio and branch expansion plan, thus it would be critical for SFP to keep the operating expenses and credit costs under control and, maintain a comfortable risk-adjusted capital profile in relation to the target business segment.

SFP is a Licensed Finance Company with a moderate sized portfolio of about LKR 17 Bn as in Dec-15. The company changed its exposure profile over the recent past, post the takeover by the new shareholder in 2010; SFP shifted its focus from vehicle finance in the past to extending SME loans (largely working capital), business loans (long term loans) and personal loans. The personal loans are extended to the salaried class in government and private sector. As in Dec-15, SME loans accounted for about 40% of the total portfolio, with business loans (19%) and personal loans (18%); share of vehicle finance stood at about 14%. The share of vehicle finance was about 61% in Mar-12. The share of pawning has remained moderate at about 3% over the last 4-5 years. SME loans are secured either by immovable properties or personal guarantees and postdated cheques. The personal loan (loan size of LKR 0.1-0.5 Mn) product is on the back of two guarantors and, an employer salary remittance undertaking. The business loans (loan size LKR 4-5 Mn) are backed by immovable collateral. Further, exposure to customers with a moderate credit profile accentuates the overall portfolio vulnerability. The portfolio grew at a CAGR of about 33% over the period FY2011-FY2015; during the first nine months of the current financial year, the portfolio grew by about 13% (annualised). Going forward, the portfolio is expected to expand at about 30% CAGR over the 2-3 year period, with focus on the SME segment; share of SME loans is likely to increase to about 55% by March 2018. The company is expected to increase the share of vehicle finance to about 20-25% as it is expected to re-launch its leasing product (cars/vans/3/2 wheelers) and pawning to about 5-6%, while personal loans are expected to be range bound about 17-18%. Presently, the company operates with 30 branches including its Head Office. Going forward, SFP envisages setting up 25 branches per year and, increasing its branch network to about 100 in 3 years.

The company has a weak asset quality with GNPA's at 9.7% in Mar-16 (8.7% in Mar-15 and 5.52% in Mar-14). The NPA coverage ratio² is moderate at about 40% and solvency³ is weak at about 43% in Mar-16. SFP shifted its portfolio from lease products to loan products due to poor quality identified in the leasing

¹ Profit before tax/ average total assets (Excluding onetime gains and extraordinary income)

² (Gross NPA-Net NPA)/Gross NPA

³ Net NPA/Networth

portfolio (GNPA at 23.6% in Mar-16). With the shift in the product mix, 40% of the portfolio was concentrated on SME loans (Gross NPA in SME was about 1.9%) as in Mar-16. Business loan (19%-20% of the portfolio) has a high NPA ratio (10% in Dec-15) due to poor performance of some large exposures. Ability to recover from the large accounts and control incremental slippages would be crucial from the asset quality perspective, considering the steep business expansion plan of the company.

The company's capital profile is moderate with gearing at about 7.0 times (provisional) in Mar-16. The capitalisation profile was supported by the right issue in FY2015 and the conversion of the \$2 Mn FMO loan to equity shares in Jan-16. The equity shares post conversion of the FMO loan were purchased by Softlogic Capital PLC and thereby increasing its stake to 68.4% as in Jan-16. The conversion of the remaining \$2Mn FMO loan is also expected to happen in the next 6-12 months, which could support the overall capital profile, however the company is expected to operate with a high gearing of about 9 times.

Public deposits accounted for 78% of the total funding profile of the company in Mar-16. As of Dec-15, the company had a concentrated deposit profile with the top 10 depositors accounting for 25% of the total deposits. SFP has been able to reduce the deposit concentration of the top 10 depositors to 16% in Mar-16 by steadily moving to retail deposits. SFP also has a short term deposit base with 62% of the deposits having a maturity of 1 year or lesser period. The company's good deposit renewal rate of 70%, its access to bank facilities and a comfortable Asset Liability profile provides a favourable view on the overall liquidity profile.

SFP has been able to maintain its NIMs at about 7.5-8.5% over the last 3-4 years, however higher credit costs(2.0-2.5%), notwithstanding a largely stable operating costs (5.5-6.3%) has resulted in a moderate RoA of about 1.3-1.5%.The company reported an RoE of about 15.1% during 9MFY2016 and 13.3% in FY2015. Going forward, SFP has a steep portfolio and branch expansion plan, thus it would be critical for SFP to keep the operating expenses and credit costs under control to improve its profitability profile.

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 Jan-16, Softlogic Capital PLC (SCP) holds 68.4% of the company; SHP holds 58.97% in SCP as in Dec-15. 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.

In 9MFY2016, SFP reported a PAT of LKR 227 Mn on a total asset base of LKR 21.6 Bn. During FY2015, the company reported a PAT of LKR 216 Mn on a total asset base of LKR 20.0 Bn.

Parent company profile – Softlogic Holdings PLC

Softlogic Holdings PLC (SHL) was founded in 1991 and was listed on the Colombo Stock Exchange in June 2011. The company had commenced operations in 1991 as a software company with just 12 employees. Today, the Company acts as the primary holding company for the Softlogic Group of entities with businesses across healthcare, retail, financial services, Information and Communication Technology (ICT) distribution, leisure / hotels and automobile dealerships. The Group now provides employment to over 8,000 individuals generating an annual turnover of more than LKR 50 Billion (annualized for 2015-16) and has market leading positions in segments such as healthcare, retail and ICT distribution. The group is led by Mr. Ashok Pathirage.

During FY2015, SHL reported a PAT of LKR 1,819 Mn on a total asset base of LKR 87.5 Bn as compared to a PAT of LKR 1,008 Mn on a total asset base of LKR 65.8 Bn in the previous financial year. For 9MFY2016, SHL reported a PAT of LKR 1,731 Mn on a total asset base LKR 92.1 Bn.

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