

ICRA Lanka reaffirms the issuer rating of Softlogic Finance PLC; revises outlook to Stable

November 04, 2021

Instrument	Rated Amount (LKR Mn)	Rating Action
Issuer rating	N/A	[SL]BB-; reaffirmed; Outlook revised to Stable from 'rating watch with Developing implications'

Rating action

ICRA Lanka Limited has reaffirmed the Issuer rating of [SL] BB- (pronounced as S L double B minus) assigned to Softlogic Finance PLC (referred to as SFP or “the Company”). The outlook on the rating has been revised to Stable from rating watch with developing implications.

Rationale

As per the announcement of August 6, 2021, the proposed acquisition of Abans Finance PLC (AFP) by parent entity, Softlogic Capital PLC is no longer being pursued. It had been expected that AFP and SFP would be merged post the acquisition. In the absence of the merger, SFP has resorted to capital support from its immediate parent, SCAP.

The rating factors in the capital support provided by parent entity Softlogic Capital PLC (SCAP, rated BBB+/Stable) via the rights issues in Dec-19, Dec-20 and Aug-21, amounting to LKR 600 Mn, LKR 1.9 Bn, and LKR 2.2 Bn respectively. The overall managerial and operational support of the Softlogic group is also factored into the rating. SFP's Tier 1 and Total capital adequacy ratios (CAR) both stood at 7.86% in Aug-21 (both the Tier 1 and Total CAR stood at -3.93% in Mar-21), against the regulatory thresholds of 7.0% and 11.0%, respectively. Following the recent LKR 900 Mn sub-debt issue privately placed with SCAP, ICRA Lanka envisages the Total CAR to be above the regulatory limit in Oct-21. The rating also takes note of the improved gearing levels, with reported gearing at 5.97x in Jun-21 vis-à-vis 9.43x in Mar-20 (11.65x in Mar-19). The gearing has moderated further to about 3.19x as of end Aug-21, due to the recent rights issue.

However, the rating continues to factor in the weak asset quality indicators of the company. The Gross NPA ratio deteriorated to 37.14% in Jun-21 from 34.57% in Mar-21 (32.79% in Mar-20), whilst around 22% of lending portfolio stood under moratorium as of Aug-21. ICRA Lanka notes that the higher NPAs are largely attributable to unsecured SME lending done by the company in the past, and these segments of the portfolio are currently discontinued. Nonetheless, the ongoing re-positioning of the lending portfolio towards asset backed lending and strengthening of the collection systems and processes is envisaged to improve asset quality, going forward.

The rating also takes note of the sizable asset liability maturity (ALM) mismatch in the short term, due to the movement towards longer term leasing products and dependence on short term deposits. However, a healthy renewal rate on the deposits (around 80%) and support from the Softlogic group provides comfort from a liquidity perspective. Going forward, the ability to maintain adequate capitalization to support portfolio growth, and further improvement in the asset quality and earnings of the Company would be crucial from a rating's perspective.

Outlook: Stable

The outlook may be revised to 'Positive' in case of further substantial improvement in the capital structure, asset quality, and earnings. The outlook may be revised to Negative, if the capitalization falls below regulatory requirements and/or in case of further weakening in the asset quality and earnings profiles of SFP. Significant weakening in the credit profile of the Softlogic group, dilution in the ownership or lower than expected support from the group would also adversely impact the rating.

Key rating drivers

Credit strengths

Access to financial, managerial and operational support from the Softlogic Group: Softlogic Finance PLC is a 91% owned subsidiary of Softlogic Capital PLC (SCAP, rated BBB+/Stable by ICRA Lanka), which in turn is a 77% owned subsidiary of the diversified conglomerate Softlogic Holdings PLC (rated BBB/Negative by ICRA Lanka). The 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. The group has in the past demonstrated its ability and willingness to support SFP, both financially and operationally. SCAP had infused equity capital into SFP amounting to LKR 4.5 Bn over the period Dec-19 to Aug-21. The group remains committed to the NBFi and envisages turning around its recent performance.

Improvement in the capital profile: SFP raised fresh equity capital of LKR 1.9 Bn and LKR 2.2 Bn through rights issues held in Dec-20 and Aug-21, respectively. Consequently, the Company's Tier 1 and Total CAR both improved to 7.86% as in Aug-21 (both the Tier 1 and Total CAR stood at -3.93% in Mar-21). To bring its Total CAR above the regulatory minimum, SFP issued sub-debt of LKR 900 Mn in October 2021; same was privately placed with SCAP. The Tier 1 and Total CAR are expected to stand at around 8.0% and 13.5%, respectively, in Mar-22 as per ICRA estimates (against the regulatory thresholds of 7.00% and 11.00%). The CBSL had imposed a lending cap of LKR 18.5 Bn on the Company due to it being below minimum CAR limits. However, the same was removed in October 2021. SFP's reported gearing stood at 5.97x in Jun-21 vis-à-vis 5.69x in Mar-21 and 9.43x in Mar-20; adjusted gearing stood at 5.97x in Mar-21 and 10.05x in Mar-20. Going forward, the ability to maintain an adequate capital profile will be a key monitorable.

Credit challenges

Weak asset quality, largely due to legacy unsecured lending portfolio: Due to the effects of Covid-19, the asset quality indicators remain weak with the Gross NPA and Net NPA ratios standing at 37.1% and 29.2%, respectively, in Jun-21 (34.6% and 26.5% in Mar-21), compared with the industry averages of 13.0% and 3.6% in the same period. The loan book under moratorium stood at around LKR 4.0 Bn in Aug-21 (22% of the total portfolio). The Company had taken a decision to curtail all business/SME related lending in FY2021. Hence, the business lending portfolio (consisting of unsecured working capital loans and mortgage loans) has moderated to around 35% of the total portfolio in Jun-21 vis-à-vis 40% in Mar-20 (55% in Mar-19). Further, the portfolio is being re-positioned towards secured lending, consisting mostly of vehicle leasing, gold loans and factoring. The collection systems have been revamped to improve recoveries from the legacy portfolio and prevent future slippages. ICRA Lanka expects the above initiatives to improve the asset quality indicators, going forward.

Modest earnings profile: The provisions/ATA stood at 2.24% in Q1 FY2022 compared with 2.31% in FY2021 (1.77% in FY2020). Due to the declining revenue from its legacy portfolio and high credit costs, Company recorded net losses of LKR 334 Mn in FY2020 and LKR 903 Mn in FY2021; in the 3M ended Jun-21, the Company recorded a further net loss of LKR 145 Mn. On account of the current challenges, ICRA

Lanka expects the earnings profile to remain modest in the near term; same may improve over the longer term due to better portfolio quality.

Deterioration in liquidity profile: As in Jun-21, the cumulative ALM mismatch in the less than one year maturity bucket had increased to negative 25.7%, compared to the negative 18.1% in Sep-20 (negative 1.9% in Jun-19) as Company has shifted its focus towards long term asset backed lending, and away from short term SME lending. However, ICRA Lanka is cognizant that SFP has liquidity support from the Softlogic group. As of Jun-21, the Company had unutilized funding of LKR 263 Mn from different banking entities. Further, its funding profile is dominated by fixed deposits (close to 84% of funding in Jun-21), with a healthy renewal rate of ~80%, which provides comfort from a liquidity perspective.

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 August 2021, Softlogic Capital PLC held about 91% ownership of the Company; SHP held about 77% ownership in SCAP as in June 2021. Currently, as one of the smaller-sized LFCs in Sri Lanka, SFP offers factoring, term and mortgage loans, gold loans and vehicle financing.

During FY2021, SFP reported a net loss of LKR 903 Mn on a total asset base of LKR 20,870 Mn vis-à-vis a LKR 334 Mn net loss in FY2020 on a total asset base of LKR 21,747 Mn. In the three months ended June 2021, SFP reported a net loss of LKR 145 Mn on a total asset base of LKR 20,863 Mn vis-à-vis a net loss of LKR 375 Mn on a total asset base of LKR 21,005 Mn in the three months ended June 2020.

Key financial indicators of SFP - Audited

LKR Mn	FY2020	FY2021	3M FY2021*	3M FY2022*
Operating Income	1,300	693	43	281
Operating Profit/Loss	(95)	(520)	(261)	(28)
Profit Before Tax	(485)	(1,012)	(468)	(145)
Profit After Tax	(334)	(903)	(375)	(145)
Reported Net Worth	2,041	3,028	1,640	2,888
Adjusted Net Worth**	1,914	2,889	1,513	2,749
PAT/ATA	-1.5%	-4.2%	-7.0%	-2.8%
Gross NPA	32.8%	34.6%	33.2%	37.1%
Core CAR	-5.6%	-3.9%	-9.8%	-5.5%
Gearing- adjusted***	10.05	5.97	12.38	6.27

* Unaudited. ** Net worth adjusted for revaluation reserves *** Gearing adjusted for revaluation reserves

Rating history for last three years:

Instrument	Current Rating (FY2022)			Chronology of Rating History for the past 3 years				
	Type	Amount Rated (LKR Mn)	Date & Rating FY2022 Oct-21	Date & Rating FY2021		Date & Rating FY2020		Date & Rating FY2019 Oct-18
				Jan-21	Oct-20	Nov-19	Apr-19	
Issuer rating	N/A	N/A	[SL]BB-; Stable	[SL]BB-; Rating watch with developing implications	[SL]BB-; Rating watch with developing implications	[SL]BB-; Negative	[SL]BB; Negative	[SL]BB+; Negative



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