

ICRA Lanka upgrades the Issuer Rating of Softlogic Finance PLC

April 18, 2022

Instrument	Rated Amount (LKR Mn)	Rating Action
Issuer Rating	N/A	[SL]BB (Stable); upgraded from [SL]BB- (Stable)

Rating action

ICRA Lanka Limited has upgraded the Issuer Rating of Softlogic Finance PLC (referred to as SFP or “the Company”) to [SL] BB from [SL] BB-. The outlook on the rating remains Stable.

Rationale

The rating upgrade factors in the continuous capital support provided by parent entity Softlogic Capital PLC (SCAP, rated BBB+/Stable) via various rights issues totaling to LKR 4,743 Mn during Dec-19 to Aug-21. Following the last round of capital infusion of LKR 2,240 Mn in Aug-21, SFP’s core capital adequacy ratio stood at 7.54%, while the total capital adequacy ratio of 12.14% in Dec-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. The rating also notes the removal of lending and deposit caps placed on the entity by the regulator, as the company is fully compliant in terms of regulatory capital requirement. The rating also considers the improved gearing levels, with reported gearing at 3.6x as of the end Dec-21 compared to 5.7x as of Mar-21. In addition to capital support, ICRA Lanka also factors in the operational and managerial support extended by the parent group to SFP.

However, the rating continues to factor in the company’s weak asset quality indicators. The Gross NPA ratio stood at 30.19% in Dec-21, vis-a-vis 34.57% in Mar-21 (32.79% in Mar-20). 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 and strategies have been put in place to recover this portfolio as well. The latest rating action factors low slippages in the new portfolio. Further, the company’s strategy to re-position the lending portfolio towards asset backed lending and strengthening of the collection systems and processes is envisaged to improve asset quality, going forward. 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 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 demonstrated its ability and willingness to support SFP, both financially and operationally. The last equity capital infusion from the parent was LKR 2,240 Mn via a rights issue in Aug-21. With that SCAP had infused equity capital into SFP totaling to LKR 4.7 Bn over the period Dec-19 to Aug-21. Going forward, ICRA Lanka expects the capital support from the parent group to be forthcoming, to meet the growth capital requirements of the company.

Improvement in the capital profile: The company's Tier 1 CAR improved to 7.54% and Total CAR improved to 12.14% as in Dec-21 (both the Tier 1 and Total CAR stood at -3.93% in Mar-21). Further, SFP issued sub-debt of LKR 900 Mn in October 2021 which was privately placed with SCAP to augment its total CAR above the regulatory minimum. 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, following the company meeting all the regulatory capital requirements. SFP's reported gearing stood at 3.6x in Dec-21 vis-à-vis 5.73x in Mar-21 and 9.51x in Mar-20. Going forward, the ability to maintain an adequate capital profile will be a key monitorable.

Credit challenges

Weak asset quality, while the slippages in the new portfolio remains low: The Gross NPA ratio stood at 30.19% in Dec-21, vis-a-vis 34.57% in Mar-21 (32.79% in Mar-20). However, ICRA Lanka notes that about 95% of the total NPAs are attributable to the discontinued portfolio, which largely consists of SME-related exposures. The new portfolio (recognized after March 2020) which is in the form of asset-backed lending, demonstrated healthy asset quality levels, with GNPA of about 2.44% as in Dec-21 (0.12% Mar-21). However, the rating is constrained by the low provisioning coverage on the legacy portfolio, given the exposures are largely in the form of unsecured lending. Solvency of the company remain weak with Net NPA/ Net worth at 90.74% as in Dec-21, while the same has improved from 147.42% in Mar-21 and 218.71% in Mar-20. Going forward, it will be crucial for the company to expedite the collections from the legacy portfolio while maintaining healthy asset quality levels of the incremental new portfolio.

Modest earnings profile, while the key profitability indicators are improving: ICRA Lanka notes that, the overall profitability of the company has been improving in 9M FY2022, and the removal of the lending and deposit caps has also assisted. SFP's net interest margins ("NIM") improved in 9M FY2022 due to the reductions in cost of funds with the incremental deposits accruing at a relatively lower cost and the substantial growth of the portfolio. NIM improved to 5.4% in 9M FY2022 as compared to 2.6% in FY2021 (4.9% in FY2020). Cost rationalization initiatives by the new management have resulted in better expense ratios for the company, wherein Opex/ ATA improved to 5.4% by Dec-21, compared to 5.7% in FY21 and 6.3% in FY20. Loan provisioning cost has also moderated during 9M FY2022, as the company has made sizable provisioning during the last two fiscals. SFP reported net loss of LKR 27 Mn for the 9M FY2022, compared to the sizable losses of LKR 903 Mn in FY2021 and LKR 334 Mn in FY2020. ICRA Lanka expects the profitability to improve over the short to medium term, as the new portfolio shows healthy growth

while, demonstrating better asset quality levels. Also, the increased funding flexibility would also support the earnings profile of the company. Liquid Assets Ratio of the company remained at 10.92% in Dec-21 which was above the statutory minimum requirement of 10%.

Analytical approach: For arriving at the ratings, ICRA has applied its rating 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 2021, Softlogic Capital PLC held about 91% ownership of the Company; SHP held about 77% ownership in SCAP as in Dec 2021. Currently, as one of the smaller sized LFCs in Sri Lanka, SFP offers factoring, 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. During the nine months ended December 2021, SFP reported a net loss of LKR 27 Mn on a total asset base of LKR 24,833 Mn.

Key financial indicators of SFP

LKR Mn	FY2020	FY2021	9M FY2021*	9M FY2022*
Operating Income	1,300	693	374	1,109
Operating Profit/Loss	(95)	(520)	(541)	182
Profit Before Tax	(485)	(1,012)	(955)	28
Profit After Tax	(334)	(903)	(846)	(27)
Reported Net Worth	2,041	3,028	3,090	5,244
Adjusted Net Worth**	1,914	2,889	2,963	5,105
PAT/ATA	-1.5%	-4.2%	-5.3%	-0.2%
Gross NPA	32.8%	34.6%	38.0%	30.2%
Core CAR	-5.6%	-3.9%	-3.9%	7.5%
Gearing- adjusted***	10.05	5.97	5.81	3.67

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

Rating history for last three years:

Instrument	Amount	Current Rating	Chronology of Rating History for the past 3 years				
		Date & Rating FY2022 Mar-22	Date & Rating FY2022 Oct-21	Date & Rating FY2021		Date & Rating FY2020	
				Jan-21	Oct-20	Nov-19	Apr-19
Issuer	N/A	[SL] BB (Stable)	[SL] BB- (Stable)	[SL] BB-; Rating watch with developing implications	[SL] BB-; Rating watch with developing implications	[SL] BB-; Negative	[SL] BB; Negative



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