

ICRA Lanka reaffirms the issuer rating of UB Finance Limited

May 23, 2018

Instrument	Rated Amount (LKR Mn)	Rating Action
Issuer rating	N/A	[SL]BB (Stable); Reaffirmed

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) assigned to UB Finance Limited (UBF or the Company). The outlook on the rating is stable.

Rationale

The reaffirmation of the rating takes note of UBF's status as a 73% subsidiary of Union Bank of Colombo PLC (UBC or the parent; rated [SL]BBB with a stable outlook) and, the operational, financial and managerial support that it derives from UBC. The rating also takes note of the company's currently modest scale of operations, modest asset quality, subdued profitability and its stretched capitalization profile. ICRA Lanka expects timely support from UBC for supporting UBF's portfolio expansion plan (40-45% CAGR over the next 3 years) and for meeting the regulatory minimum core capital requirement over the next 2-3 years, as UBF's internal generation is likely to remain subdued. ICRA Lanka notes that, UBF, subject to CBSL's approval, is likely to leverage on UBC's branch network for its business sourcing; this is expected to improve synergies and support UBF' business growth going forward.

Outlook: Stable

ICRA Lanka believes that UBF will continue to benefit from the operational, managerial and financial support from UBC. The outlook may be revised to 'Positive' in case of steady improvement in the asset quality and earnings of the company. The outlook may be revised to 'Negative' in case of a further weakening in the asset quality, profitability and capitalisation.

Key rating drivers

Credit strengths

Demonstrated financial, managerial and operational support from the parent: UBF is a 73% subsidiary (81% by voting rights) of Union Bank of Colombo PLC. In 2011, UBC acquired the company with a capital infusion of Rs 600 Mn. It invested LKR 300 Mn as subordinated debenture in Sep-16 and subscribed to the LKR 300 Mn right issue in Dec-17. ICRA Lanka notes that UBF requires LKR 1.5-1.7 Bn capital infusion to support the 40-45% CAGR over the next 3 years (FY2019-FY2021) and, expects timely support from UBC as its own internal generation is expected be relatively modest. UBF has an eight member board, of which, three are UBC representatives. UBF's risk management systems are supported and guided by UBC and going forward, UBF is expected to leverage on IT & MIS, HR and other business functions of UBC for its own operations. Further, UBF has also applied for CBSL's approval to use UBC branches for loan sourcing. UBC has about 67 branches as in Mar-18 and UBF's own branch count stood at 17.

Credit challenges

Modest scale of operations: UBF operates with a modest portfolio of LKR 9.8 Bn in Dec-17 (LKR 9.0 Bn in Mar-17 and LKR 6.9 Bn in Mar-16). The company mainly offers lease (56% in Dec-17), factoring & working capital financing (18%), loans (16%) and legacy advances (7%). Key asset classes, under the leasing and loan categories, include cars, light commercial vehicles, lorries, buses, 3-wheelers and mortgages which accounted for 28%, 20%, 9%, 3%, 2% and 2% respectively of the total portfolio in Dec-17. Going forward, UBF is expected to focus on the vehicle leasing business; however the share of gold loans and SME credit together is expected to increase and account for 20% of its total portfolio by Mar-21, which currently is negligible. The company is expecting to expand its portfolio at a CAGR of 40-45%, over the next 3 years, with the likely access to UBC's branch network.

Modest overall asset quality profile; The company reported a GNPA of 12.7% as in Dec-17 compared to 13.2% in Mar-17 and 16.3% in Mar-16. High NPAs are due to its legacy loan portfolio where the entire portfolio is non-performing and, it accounted for 59% of the total NPAs in Dec-17. NPA in the newly originated portfolio has been in the range of 5.3-5.7% over the last 4 quarters. ICRA Lanka takes note of the increase in the 90+ day past due (dpd) in the leasing segment, which was 15% in Dec-17 as compared with 12% in Mar-17. The company's ability to control new NPAs is crucial going forward considering the weak solvency profile with net NPA to net worth at 63% in Dec-17.

Subdued net profitability: UBF's profitability indicators weakened in FY2017 and 9MFY2018 due to declining NIM and high credit cost. The company reported a ROA of 0.4% in 9MFY2018 as compared to 0.7% in FY2017 and 1.2% in FY2016. The company's weighted average cost of funds increased from 11.5% in Mar-17 (9.4% in Mar-16) to 13.8% in Dec-17. The credit cost increased during 9MFY2018 on account of the write-offs during the period. The company reported improvement in operational efficiency with the moderation of operational expenses over average total asset to 4.5% in Dec-17 from 4.8% in Mar-17 (5.9% in Mar-16). UBF's ability to control its cost of funds and credit cost is crucial for incremental profitability.

Stretched capitalisation profile: With the LKR 300 Mn capital infusion by UBC in Dec-17, UBF's gearing improved to 8.5 times in Dec-17 from 10.9 times in Mar-17. Core capital of the company improved to 11.7% in Dec-17 from 8.0% in Mar-17. ICRA Lanka expects the internal generation to remain modest due to subdued profitability. The company requires regular capital support till 2021 to meet the regulatory core capital requirements and for the envisaged 40-45% portfolio CAGR.

Concentrated deposit profile: UBF has a concentrated deposit profile with top 10 depositors accounting for 27% of the total deposits in Dec-17. ICRA Lanka however takes note of the 70% renewal rate and availability of the unutilized bank facilities (625 Mn in Dec-17), which provides comfort from a liquidity perspective. UBF's funding profile is characterized by deposits and bank borrowings, which accounted for 72% and 24% respectively of the total borrowings in Dec-17.

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 Financial Institutions](#)

About the company:

UB Finance Company Limited (UBF) was formerly known as The Finance & Guarantee Co. Ltd. It was incorporated in 1961 and, operated as a Finance and Real estate development company. In 2011, Union Bank of Colombo (UBC) acquired majority stake in the company with a capital infusion of LKR 600Mn. The

company received a capital infusion of LKR 500 Mn from a private equity investor- ShoreCap II Ltd. As in April 2018, UBC and ShoreCap II Ltd hold about 73% (81% voting rights) and 12%(13% voting rights) respectively in UBF. Initially, UBF was involved in real-estate development and financing. The company still has some of its old loan portfolio, which is completely in the NPA category. Presently, the company focuses on retail asset classes (vehicles loans/ leases/ hire purchase) and working capital finance.

During the year ended March 31, 2017, UBF reported a PAT of LKR 68 Mn on a total asset base of LKR 10.1 Bn as compared to a PAT of LKR 78 Mn on a total asset base of LKR 8.2 Bn in the previous financial year. For 9MFY2018, UBF reported a PAT of LKR 33 Mn on a total asset base LKR 11.3 Bn.

Key financial indicators

	FY2016	FY2017	9MFY2018
Net Interest Income	377	478	427
Profit after Tax	78	68	33
Net worth	725	816	1,148
Loans and Advances (Gross)	6,896	9,028	9,777
Total Assets	8,223	10,096	11,277
Return on Equity	11.6%	8.8%	4.5%
ROE (adjusted for equity infusion)			5.2%
Return on Assets	1.2%	0.7%	0.4%
Gross NPA	16.3%	13.2%	12.7%
Net NPA	10.3%	7.3%	7.5%
Capital Adequacy Ratio	9.5%	11.5%	14.4%
Gearing (times)	9.9	10.9	8.5

Rating history for last three years:

Chronology of Rating History for the past 3 years						
Instrument	Type	Amount Rated (LKR Mn)	Date & Rating FY2018	Date & Rating in FY2017	Date & Rating in FY2016	Date & Rating in FY2015
Issuer rating	N/A	N/A	May 2018 [SL]BB (Stable)	May 2017 [SL]BB (Stable)	Feb 2016 [SL]BB (Stable)	- N/A

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