

ICRA Lanka revises UB Finance Limited's outlook to Negative

May 27, 2019

Instrument	Rated Amount (LKR Mn)	Rating Action
Issuer rating	N/A	[SL]BB reaffirmed; outlook revised to Negative from Stable

Rating action

ICRA Lanka Limited, subsidiary of ICRA Limited, a group company of Moody's Investors Service, has reaffirmed the issuer rating of UB Finance Limited (UBF or the Company) at [SL]BB (Pronounced SL double B) while revising the outlook to Negative from Stable.

Rationale

Revision in the outlook factors in the significant deterioration in UBF's capital profile during 9MFY2019 and further weakening in its asset quality indicators. Its gross NPA ratio (GNPA) increased to 18.6% in Dec-18 as compared to 13.8% in Mar-18 (13.2% in Mar-17). UBF's capital profile was impacted because of the one-time adjustment on account of the IFRS-9 transition and adjustments required as per the revised capital computation norms; UBF's core capital was lower at about LKR 1,159 Mn ¹as compared to regulatory requirement of LKR 1,500 Mn and the total capital adequacy ratio (CAR) was 5.49% in Dec-18 as compared to regulatory requirement of 10%. Consequently, CBSL has placed a lending cap of LKR 9.8 Bn and deposit cap of LKR 7.2 Bn on the Company. ICRA Lanka had factored in timely capital and liquidity support from Union Bank of Colombo PLC (UBC or the parent; rated [SL]BBB with a stable outlook), however UBC did not infuse fresh capital as UBF is in the process of raising a sizeable capital (in relation to its current net worth) from an external investor. The capital raising process however is somewhat delayed and is likely to be completed by June 2019. In case, UBF is unable to raise the envisaged capital, in the near term, UBC would infuse the required capital for meeting regulatory requirement. ICRA Lanka notes that the Company has unutilized funding lines of LKR 600 Mn (includes LKR 400 Mn from UBC) and expects further liquidity support from UBC, if required, in view of the deposit taking restrictions and, till the same is removed. ICRA Lanka would closely monitor the UBF's liquidity position, extent of capital infusion, changes in ownership structure and asset quality performance, over the near term, before taking further rating action. The rating continues to factor in UBF' modest scale and subdued earnings profile.

Outlook: Negative

The Negative outlook reflects the weakened capital profile, which has resulted in the lending and borrowing restrictions and, its declining asset quality profile. The outlook may be revised to 'Stable' in case the Company is able to secure adequate capital and improve its asset quality and liquidity profile. The rating may be downgraded, in case the capital profile continues to remain below regulatory requirement or if the liquidity and asset quality indicators continue to remain under pressure. Early removal of the lending and deposit taking restrictions would be crucial from a rating perspective.

¹ Capital adjusted for IFRS 9 first day adjustment (LKR 400 Mn) is estimated to be LKR 759 Mn

Key rating drivers

Credit challenges

Significant external capital requirement: UBF reported a core capital of LKR 1,159 Mn² as of Dec-18 as compared to regulatory minimum capital requirement of LKR 1,500 Mn. The one-time IFRS 9 transition adjustment was LKR 400 Mn, which had a significant impact on UBF's overall capital position. As a result, CBSL has placed a lending cap of LKR 9,800 Mn and deposit cap of LKR 7,200 Mn on the Company. ICRA Lanka notes that UBF would require immediate capital support of LKR 1,000 Mn to LKR 1,500 Mn to meet the regulatory core capital requirement of LKR 2,500 Mn by January 01, 2021, given the modest internal generation. While UBC infused equity capital of LKR 1.1 Bn in 2011, invested LKR 300 Mn as subordinated debenture in Sep-16 and infused further equity of LKR 300 Mn in Dec-17, it did not infuse fresh capital in 2018, as UBF is in the process of raising a sizeable capital from an external investor. The capital raising process however is somewhat delayed and is likely to be completed by June 2019. In case, UBF is unable to raise the envisaged capital in the near term, UBC would infuse the required capital for meeting regulatory requirements. ICRA Lanka would closely monitor the progress on the capital raising programme of the Company and the extent of support from UBC.

Weak overall asset quality profile: UBF's asset quality deteriorated sharply in 2018. The Company reported a GNPA% of 18.6% as in Dec-18 compared to 13.8% as in Mar-18 and 13.2% as in Mar-17. High NPAs are partly due to its legacy loan portfolio where the entire portfolio is non-performing and accounted for 31% of the total NPAs as in Dec-18. GNPA% in the newly originated portfolio has also increased to 13.6% as in Dec-18 as compared to 7.2% as in Mar-18. UBF's GNPA in the new portfolio increased as a result of adverse macro conditions and modest collection and recovery activities. ICRA Lanka takes note of the high build-up in the 90+ days past due (dpd) bucket in the leasing (17.0% as in Mar-18 to 23.5% as in Dec-18) and factoring (8.1% as in Mar-18 to 21.1% as in Dec-18) portfolios, which together account for 74% of the total portfolio. UBF's modest collection and recovery activities also contributed to the increase in the 90+dpd over the recent past. Ability to control new NPA's is crucial going forward considering the weak solvency profile with net NPA to net worth at 99% as in Dec-18.

Modest scale of operations: UBF operates with a modest portfolio of LKR 10.4 Bn as in Dec-18 (LKR 10.1 Bn as in Mar-18 and LKR 9.0 Mn as in Mar-17). The Company mainly offers lease (58% as in Dec-18), factoring & working capital financing (18%), mortgage/property loans (9%), Personal loans (5%) and others (10%). Key asset classes in the leasing category includes cars, light commercial vehicles, lorry, bus and van which accounted for 33%, 15% 10%, 3% and 2% of the total portfolio as in Dec-18. Going forward, UBF is expected to focus on the leasing, mortgage loans and gold loans. Presently, the portfolio growth is constrained by the LKR 9.8 Bn lending cap placed by CBSL since Jan-19.

Subdued profitability: UBF's profitability indicators weakened in FY2019 due to high credit cost. The Company reported a ROA of 0.14% in FY2019 as compared to 0.68% in FY2018 and 0.74% in FY2017. The Company's credit cost increased from 1.24% in FY2018 (0.99% in FY2017) to 2.20% in FY2019. The credit cost increased in line with the higher slippages reported in the portfolio. UBF has to control its credit cost (2.25% in FY2019 and 1.24% in FY2018) and operational expenses (4.21% in FY2019 and 4.38% in FY2018) in-order to improve its profitability.

² Capital adjusted for IFRS 9 first day adjustment (LKR 400 Mn) is estimated to be LKR 759 Mn

Weak liquidity profile: The deposit taking ability of the Company is restricted to LKR 7.2 Bn following the cap placed by CBSL; deposits stood at 7.0 bn as on December 31, 2018. UBF has a concentrated deposit profile with top 10 depositors accounting for 30% of the total deposits as in Dec-18, however renewal rates have been at about 70% in the past. The Company has a negative ALM mismatch of 15% (as a proportion of total assets) in the less than one year bucket; it however has unutilized funding lines of LKR 600 Mn (includes LKR 400 Mn from UBC) and ICRA Lanka expects further liquidity support from UBC, if required, in view of the deposit taking restrictions and, till same is removed.

Analytical approach: For arriving at the ratings, ICRA Lanka 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, 2019, UBF reported a PAT of LKR 6 Mn (unaudited) on a total asset base of LKR 11.5 Bn (unaudited) as compared to a PAT of LKR 72 Mn on a total asset base of LKR 11.2 Bn in the previous financial year.

Key financial indicators

	FY2017	FY2018	FY2019 (Unaudited)
Net Interest Income	478	613	730
Profit after Tax	68	72	6
Net worth	816	1,152	1,159 [^]
Net worth (adjusted for IFRS 9) - Estimated			787
Loans and Advances (Gross)	8,502	9,453	9,335
Total Assets	10,096	11,151	11,525
Return on Equity	8.8%	7.2%	0.5%
Return on Assets	0.7%	0.7%	0.1%
Gross NPA	13.2%	13.8%	18.6%*
Net NPA	7.4%	8.4%	11.4%*
Capital Adequacy Ratio	11.5%**	14.6%**	5.5%*
Gearing (times)	11.0	7.8	8.4 [^]
Gearing (times, adjusted for IFRS 9)			12.8

*Dec-18 **Based on old CAR regulations [^]Before factoring the expected LKR 400 Mn impact from IFRS 9 transition

Rating history for last three years:

Chronology of Rating History for the past 3 years						
Instrument	Type	Amount Rated (LKR Mn)	Date & Rating FY2019 May 2019	Date & Rating FY2018 May 2018	Date & Rating in FY2017 May 2017	Date & Rating in FY2016 Feb 2016
Issuer rating	N/A	N/A	[SL]BB (Negative)	[SL]BB (Stable)	[SL]BB (Stable)	[SL]BB (Stable)

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