

ICRA Lanka revises the rating outlook of UB Finance Company Limited

April 5, 2022

Instrument	Rated Amount (LKR Mn)	Rating Action
Issuer Rating	N/A	[SL]BB; Reaffirmed, Outlook revised to Positive from Stable

Rating action

ICRA Lanka Limited has reaffirmed the Issuer Rating of UB Finance Company Limited (“UBF” or the Company) at [SL]BB (Pronounced SL double B). The outlook on the rating is revised to Positive from Stable.

Rationale

The revision in the outlook factors in the improved capitalization profile following the rights issue of around LKR 2 Bn from Union Bank of Colombo PLC (UBC or the parent; rated [SL]BBB/stable). As a result, UBF reported an unimpaired core capital of LKR 2,680 Mn in Feb-22 as compared to the regulatory minimum requirement of LKR 2,500 Mn. As at Dec-21, regulatory Core Capital Ratio and the Capital Adequacy Ratio was 28.53% and 28.67%, well above the regulatory minimum requirements of 7.00% and 11.00% respectively.

ICRA Lanka also factors in the improvement in asset quality indicators despite remaining below the industry average. The gross NPA (GNPA) improved to 12.08% in Feb-22 in comparison to 15.87% in Sep-21 and 16.18% in Jun-21, due to the sharp portfolio growth, following the removal of the lending caps by the regulator and the absolute level of GNPA declining to LKR 1,100 Mn as of Feb-22 from LKR 1,207 Mn as of Jun-21. The rating also takes note of the improving return ratios with portfolio growth resuming and increased funding flexibility with access to public deposits.

Outlook: Positive

The outlook revision to “Positive” from “Stable” reflects the improvement of the capital profile with the support extended from the parent and the improvement of the asset quality and earnings profiles. The rating may be upgraded in case of continued improvement in the asset quality indicators and earnings profile of the Company. The outlook may be revised to “Stable” in case of moderations in asset quality indicators and earnings profile of the Company.

Key rating drivers

Credit strengths

Operational, managerial and financial support from the parent: UBF is a 92% owned subsidiary of Union Bank of Colombo PLC (“UBC rated [SL] BBB/stable). The Bank along with the strategic partner Shorecap II Limited has infused close to LKR 1.45 Bn to UBF since 2011 and recently infused around LKR 2 Bn. UBF is further strengthened by the appointment of board members representing TPG, a global private investment firm and the parent company. ICRA Lanka expects the capital and operational support from UBC to continue, going forward.

Improved capital profile following the completion of the rights issue: UBF reported an unimpaired core capital of LKR 2,680 Mn as compared to the regulatory minimum requirement of LKR 2,500 Mn as at Feb-22, following the rights issue of around LKR 2 Bn by the parent company in Oct-21. As at Dec-21, regulatory Core Capital Ratio and the Capital Adequacy Ratio was 28.53% and 28.67% respectively, as compared to the regulatory requirement of 7.00% and 11.00%. ICRA Lanka notes that the capitalisation profile would be further strengthened by the impending IPO (subject to CSE approval) of about LKR 200 Mn (around 2% of risk weighted assets as on Dec-21), that is expected to complete by Mid-2022. UBF was non-compliant with the regulatory minimum Core Capital requirement from Mar-18 and capital adequacy requirements from Jan-19 mainly due to the one-time IFRS 9 transition adjustment of LKR 430 Mn (4% of risk weighted assets as on Mar-18), adjusted for FY2019 having a significant impact on UBF's overall capital position.

Credit challenges

Asset quality witnessing signs of improvement but remains below industry average: The absolute level of GNPA declined to LKR 1,100 Mn as of Feb-22 from LKR 1,207 Mn as of Jun-21. The GNPA ratio improved to 12.08% as of Feb-22 compared to 16.18% as of Jun-21 due to high portfolio growth post removal of lending caps by the CBSL and the reduction in absolute GNPA levels. Further, ICRA Lanka notes that the asset quality holds up well for portfolio disbursed under the new credit criteria from Oct-20 to Feb-22 with GNPA ratio of 1.0% as of Feb-22 despite the weak macro-economic environment. ICRA Lanka also takes comfort in the improved recovery efforts within the 90+ days buckets after Dec-21 which was successful in controlling the slippages into the NPA category bucket. UBF plans to increase focus on lending in secured products such as vehicle leasing and gold loans to support its asset quality, as these asset classes are seeing sharp increase in market value.

Improving profitability indicators but return ratios remain weak: ICRA Lanka notes that, the overall profitability of the company has been improving following the LKR 2 Bn capital infusion and subsequent removal of the lending and deposit caps that were in place during the past 2 years. UBF's net interest margins ("NIM") improved in 11MFY2022 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. The NIM of UBF rose to 9.03% in 11MFY2022 as compared to 6.76% in FY2021 (5.79% in FY2020). Further, UBF witnessed improvement in the ROA and ROE of the company to 1.20% and 5.98% respectively in 11MFY2022 as compared to -0.47% and -5.46%, respectively in FY2021 (0.05% and 0.70% in FY2020). However, the company's return ratios remain below industry average. The operating expenses of the company increased to 5.19% in the 11MFY2022 as compared to 4.30% in FY2021 (4.21% in FY2020). However, the company's credit cost reduced to 2.25% as compared to 2.43% in FY2021, with the improvement of delinquency levels. Going forward, the company's ability to improve overall profitability by managing operating expenses and credit cost will be crucial.

Modest scale of operations and limited franchise: UBF's limited franchise with a branch network of 17, operates a modest portfolio of LKR 9.1 Bn as in Feb-22 (LKR 7.5 Bn as in Mar-21 and LKR 8.5 Bn as in Mar-20). The Company offers lease and vehicle backed loans (69% as in Feb-22), property backed loans (12%), Fixed Deposits backed loans (9%), Gold backed loans (8%) and others (2%). Key asset classes in the lease and vehicle backed loan category includes cars, lorry, light commercial vehicles, van and bus which accounted for 24%, 12% 11%, 6% and 2% of the total portfolio as in Feb-22.

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 600 Mn. The Company also received a capital infusion of LKR 550 Mn from a private equity investor- ShoreCap II Ltd. As in February 2022, UBC and ShoreCap II Ltd held about 95% 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) and gold loans.

During FY2021, UBF reported a Loss After Tax of LKR 41 Mn (which includes a one off deferred tax asset and ESC write off adjustment of LKR 83 Mn) on a total asset base of LKR 8,187 Mn as compared to a PAT of LKR 5 Mn on a total asset base of LKR 9,350 Mn in FY2020. During the 11MFY2022, UBF reported a PAT of LKR 98 Mn on a total asset base of LKR 9,572 Mn.

Key financial indicators

LKR Mn	FY2019 (Audited)	FY2020 (Audited)	FY2021 (Audited)	11MFY2022 (Unaudited)
Net Interest Income	721	593	592	735
Profit after Tax	20	5	(41)	98
Net worth	770	768	738	2,824
Loans and Advances (Net)	8,785	7,739	6,901	8,385
Total Assets	11,127	9,350	8,187	9,572
Return on Equity	2.1%	0.7%	-5.5%	6.0%
Return on Assets	0.2%	0.1%	-0.5%	1.2%
Gross NPA	18.1%	18.6%	15.8%	12.1%
Net NPA	6.2%	10.2%	8.0%	4.2%
Capital Adequacy Ratio	5.7%	2.6%	4.6%	28.7% ¹
Gearing (times) ²	13.1	10.8	9.8	2.3

Rating history for last three years:

Instrument	Current Rating Exercise			Chronology of Rating History for the past 3 years			
	Type	Amount Rated (LKR Mn)	Date & Rating FY2022 Mar 2022	Date & Rating FY2022 Jan 2022	Date & Rating FY2021 July 2021	Date & Rating FY2020 May 2020	Date & Rating FY2019 May 2019
Issuer rating	N/A	N/A	[SL]BB (Positive)	[SL]BB (Stable)	[SL]BB (Negative)	[SL]BB (Negative)	[SL]BB (Negative)

¹ As at December-21

² Gearing adjusted for revaluation reserves



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