

ICRA Lanka reaffirms the issuer rating of Associated Motor Finance Company PLC; revises the outlook to Stable

October 08, 2021

Instrument	Rated Amount	Rating Action
Issuer rating	N/A	[SL]B+; Outlook revised to Stable from Negative

Rating action

ICRA Lanka Limited has reaffirmed the issuer rating of Associated Motor Finance Company PLC (AMF or the Company) at [SL]B+ (Pronounced SL B plus). The outlook on the rating has been revised to Stable from Negative.

Rationale

ICRA Lanka has taken a consolidated view of Associated Motor Finance PLC (AMF) and its 94% owned subsidiary Arpico Finance Company PLC (AFCP), for arriving at the rating as the companies merged in April 2021. The combined entity henceforth is referred to as AMF.

The revision in the outlook factors in the improvement in AMF's capitalisation profile, with the recently completed capital infusion. AMF's capital position improved as a result of the capital infusion completed in Aug-21 which allowed the Company to meet the minimum capital requirement of LKR 2.0 Bn. However, the company would require further external capital infusion to meet the upcoming minimum capital requirement of LKR 2.5 Bn by January 2022. The core/Tier 1 capital adequacy ratio (CAR) and total CAR of AMF remains comfortably above the regulatory requirement (12.85% as compared to 7.00% and 12.75% as compared to 11.00% respectively as at Aug-21). ICRA Lanka also notes that the improvement of the risk weighted capital adequacy levels are largely on account of portfolio moderation during the last several years. ICRA Lanka also takes cognizance of the improvement in the overall liquidity profile of AMF where the cumulative asset liability mismatches (ALM) in <12-months' bucket improved to about 1.9% in Mar-21, vis-à-vis negative 4.9% in Mar-20 due to the decline in the portfolio and increase in longer term deposits.

However, ICRA Lanka continues to note the weak asset quality indicators and moderate earning profile of the company. The gross NPA ratio (GNPA %) increased to about 18.3% as of Mar-21 compared to about 14.0% as of Dec-20 (12.8% as of Mar-20), largely because of the decline of the overall portfolio and the challenging macro environment. ICRA Lanka notes that the overall portfolio of AMF has declined due to management's decision to focus on credit quality of the portfolio and the non-conducive business environment in the country.

Outlook: Stable

The Stable outlook reflects the improvement in the capital profile with the capital infusion. The outlook may be revised to 'Positive' in case the Company is able to improve its asset quality and earnings profile, and improve the capitalization further. The outlook may be revised to 'Negative' if the asset quality and earnings profile of AMF shows deterioration, and/or if there is less than expected capital support from the promoter group.

Key rating drivers

Credit strengths

Established track record and experience in the vehicle leasing sector: AMF and AFCP are the fourth oldest and second oldest NBFIs in the country respectively and have an established track record of over 50-years in operation as finance companies in Sri Lanka. Post-merger, AMF operates with 12 branches and its island wide network of over 100 dealers. AMF's promoters are experienced professionals in financing business and are actively involved in the day to day business operations and decision making. AMF's core expertise lies in 2W leasing, where close to 42% of the overall portfolio was contributed by 2W leasing. Going forward also, the management intends to focus on its core 2W leasing segment, while some degree of diversification via small vehicle leasing and gold loans.

Credit challenges

Weak asset quality indicators: AMF's gross NPA ratio increased to 24.50% as of Jun-21 vis a vis 18.28% as of Mar-21 and 14.01% as of Dec-20 (12.77% in Mar-20) because of the weak macro environment and the sharp contraction in the overall portfolio. AMF's main product, 2Ws, are mainly used by borrowers with modest financial profiles thus are adversely affected by the current events. This asset class recorded a GNPA ratio of 7% in Mar-21 vis-a-vis 6% in Dec-20 and 4% in Mar-20. However, ICRA Lanka notes that the absolute NPA quantum of the total portfolio has remained largely stable over the last 3 years. NPA provision coverage has moderated from 75.79% in Mar-20 to 71.57% in Mar-21, due to the improvement of the LGD ratios following the sharp increase in vehicle prices. AMF's ability to control further slippages from its portfolio and improve overall asset quality would be crucial going forward.

Moderate capital profile, despite some improvement following the capital infusion: As in Jun-21, the total net worth of the company stood at LKR 1.72 Bn, which is below the regulatory minimum of LKR 2 Bn. The company has recently completed a rights issue of LKR 500 Mn, which would allow AMF to meet the immediate capital requirement. However, the company would require further capital support to meet the upcoming capital hurdle of LKR 2.5 Bn by Jan-22. Timely infusion of capital to meet this hurdle subject to required regulatory approvals would be important going forward. Core capital ratios of AMF are comfortably above the regulatory requirements (12.85% as at Aug-21 as opposed to the regulatory requirement of 7.00%) and total CAR are above the threshold (12.75% as at Aug-21 as opposed to the regulatory requirement of 11.00%). However, ICRA Lanka notes that, the improvement of the risk weighted capital adequacy levels are largely on account of portfolio moderation during the last several years.

Modest scale of operations and competitive business environment- AMF's franchise is limited with 12 branches (AMF-2 branches and AFCP-10 branches) and operates within a limited geography. The total portfolio has considerably moderated over the last 4 years, mainly due to the challenging macro environment and management's decision to focus on credit quality as opposed to portfolio growth. As of Mar-21, about 99% of the portfolio is asset backed with the leasing portfolio largely comprising of 2-wheelers, and cars & vans which accounted for about 42% and 24% as of Mar-21. The operating environment for vehicle financing is quite competitive with established NBFIs and banks competing for market share. And the leasing sector (unregistered segment) growth is adversely affected by the prevailing vehicle import restrictions.

Declining overall profitability - AMF's core lending margins moderated (NIM 3.20% in Q1FY22, 5.60% in FY2021 and 6.88% in FY20), largely due to the sharp contraction of the lending portfolio. While the credit cost (provision/ATA) reduced to 0.85% in FY21 from 3.21% FY2020, the same has increased to 2.78% in Q1FY22 due to higher slippages during the period. Overall profitability in FY21 was further affected by

LKR 78 Mn one-off tax charge during the period. AMF reported a PAT of LKR 6 Mn in FY21, vis-à-vis loss after tax of LKR 111 Mn in FY20, and for the Q1FY22, the loss after tax was LKR 170 Mn. ICRA Lanka expects the overall profitability to be moderate over the short term due to modest portfolio growth and potential higher credit costs.

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:

Associated Motor Finance PLC (AMF) is one of the older Finance companies in Sri Lanka. AMF focuses on leasing as its key product class. Imperial Imports and Exports (Pvt) Ltd (IIEP) which is a family owned company of Mr. Nalatha Dayawansa, holds 25.6% of the Company. Mr. Nalatha Dayawansa directly holds another 39.9% of the Company, while other Dayawansa family members hold 7.2% of the shares. Effectively Dayawansa family controls close to 72.8% of the Company. Imperial Imports and Exports (Pvt) Ltd is in the motor trading business and it imports luxury vehicles and prime movers from UK.

During FY2021, AMF reported a PAT of LKR 6 Mn on a total asset base of LKR 17,156 Mn as compared to a loss of LKR 111 Mn on a total asset base of LKR 20,152 Mn in FY2020.

Key financial indicators

	FY18	FY19	FY20*	FY21
Net Interest Income	1,854	2,255	1,471	1,050
Profit after Tax	39	252	(111)	6
Net worth (adjusted) ¹	1,119	1,356	1,492	1,504
Total Assets	24,495	22,223	20,152	17,156
Return on Equity	2.51%	15.53%	-6.13%	0.33%
Return on Assets	0.19%	1.08%	-0.52%	0.03%
Gross NPA	4.35%	12.88%	12.77%	18.28%
Net NPA	0.65%	3.28%	3.09%	5.20%
Gearing	14.39	11.49	9.20	7.88

*Restated financials

Rating history for last three years:

Instrument	Current Rating (FY22)			Chronology of Rating History for the past 3 years		
	Type	Amount Rated (LKR Mn)	Date & Rating	Date & Rating in FY21	Date & Rating in FY20	Date & Rating in FY19
			Sep-21	Sep-20	May-19	May-18
Issuer rating	N/A	N/A	[SL]B+ (Stable)	[SL]B+ (Negative)	[SL]B+ (Negative)	[SL]BB- (Negative)

¹ Networth = Total Equity-Revaluation - Goodwill



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