

ICRA Lanka upgrades the Issuer Rating of Vallibel Finance PLC

August 10, 2021

Instrument	Rated Amount (LKR Mn)	Rating Action
Issuer Rating	N/A	Upgraded to [SL]BBB+ from [SL]BBB; Stable Outlook

Rating action

ICRA Lanka Limited has upgraded the Issuer Rating of Vallibel Finance PLC (VFP or the Company) to [SL]BBB+ (pronounced SL triple B plus) with Stable outlook from [SL]BBB (pronounced SL triple B) with Stable outlook.

Rationale

The rating upgrade considers the improvement in the Company's capital profile with the Tier 1 and Total CAR at 12.98% and 14.09% in Mar-21 vis-à-vis 11.93% and 13.04% in Mar-20; same is above the regulatory limits of 6.50% and 10.50%. Also, the Company's gearing improved to 5.52 times as of Jun-21, compared with 6.58 times in Mar-20, aided by its healthy internal generation. The rating factors in the financial and managerial support expected from the Vallibel group of companies, VFP's experienced senior management team and its adequate internal controls. The rating also takes note of VFP's healthy profitability indicators with RoE and RoA of 23.57% and 3.24%, respectively, in FY2021 which further improved to 27.41% and 4.04% in Q1 FY2022. The rating also factors in VFP's favourable asset quality indicators with its Gross NPA and Net NPA ratios at 4.48% and 1.23%, respectively, in Mar-21, which remain below sector average of 11.32% and 2.81%, respectively. In Q1 FY2022, the GNPA and Net NPA ratios rose to 5.47% and 1.89%, respectively, due to the effects of the third Covid wave in the country and the lockdown restrictions. Further, the delinquencies in the 60+ days past due (dpd) improved to 18.7% in Mar-21 vis-à-vis 34.9% in Mar-20 due to healthy recoveries and collections.

ICRA Lanka is cognizant of the increase in the short-term ALM mismatch to negative 23.49% in Mar-21 (negative 12.13% in Mar-20), due to a reduction in long term bank borrowings and dependence on short term deposits. However, the availability of funding lines of LKR 10.6 Bn and healthy deposit renewal mitigates the liquidity risk. Going forward, the ability to maintain healthy asset quality, comfortable capitalization and steady earnings whilst meeting portfolio growth targets, is crucial from a rating's perspective.

Outlook: Stable

ICRA Lanka believes that VFP would continue to benefit from the financial support provided by the Vallibel group. The outlook may be revised to 'Positive' in case of steady improvement in the asset quality, profitability and capitalization indicators of VFP. The outlook may be revised to 'Negative' if the asset quality and financial risk profile of VFP shows deterioration amidst the subdued macroeconomic outlook.

Key rating drivers

Credit strengths

Financial and managerial support expected from the Vallibel group: Vallibel Investments (Pvt) Ltd (VIPL) is the majority shareholder of VFP, holding 51.4% shares as of Mar-21, which in turn is fully owned by Mr. Dammika Perera. He also has a direct shareholding in VFP of 21.4% as of Mar-21. VFP is part of the Vallibel group promoted by Mr. Perera; he holds the position of Chairman/Managing Director of Vallibel One PLC (VOP) which acts as the holding company of the group. The Vallibel group has diversified interests in financial services, trading, manufacturing and leisure businesses. VFP has access to managerial and financial support from the group. In addition to equity support, Vallibel group entities have placed long term deposits with VFP; group companies accounted for 7.5% of the deposits of the Company as of Mar-21 (5.0% in Mar-20).

Experienced senior management team and adequate risk management systems: As in Mar-21, VFP's board consisted of 9 members including 3 independent directors. The Company has an experienced senior management team, with the CEO/ Managing director (Mr. S.B. Rangamuwa) having over 30 years of experience in the NBFi industry. VFP also has a prudent loan origination system and an effective loan monitoring and collection mechanism, as reflected by its relatively better asset quality indicators compared to peers. The mechanism provides it with early warning signals and helps in adjusting the loan policies in line with the evolving credit trends. The credit and recovery functions are centralized at the Head Office which supports VFP in optimizing its collection and recovery activities. Further, the internal controls and risk management processes are reviewed by an external team and are updated on a regular basis. The Company also has an in-house internal audit team that undertakes timely review of the operations. ICRA Lanka notes, that the Company has implemented adequate internal control and risk management processes.

Healthy profitability indicators, despite the Covid-19 pandemic: VFP's portfolio grew by 17% to LKR 50 Bn in the year ended Mar-21 compared with the industry de-growth of 3% which supported its earnings profile. The Company's Net Interest Margin (NIM) reduced marginally to 7.99% in FY2021 vis-à-vis 8.19% in FY2020, mainly due to a reduction in loan yields (18.15% in FY2021 versus 21.69% in FY2020) which outpaced the reduced cost of funds (9.28% in FY2021 versus 11.67% in FY2020). The cost to income ratio improved to 36.70% in FY2021 vis-à-vis 40.00% in FY2020, led by operational efficiencies. The provisions/ATA rose marginally to 1.08% in FY2021 vis-à-vis 0.98% in FY2020; however, in Q1 FY2022 the same reduced to 0.85%. Overall, VFP reported a net profit of LKR 1,728 Mn in FY2021 vis-à-vis LKR 1,253 Mn in the prior fiscal. The Company's RoA and RoE improved to 3.24% and 23.57%, respectively, in FY2021, compared with the RoA and RoE of 2.53% and 20.98% in FY2020. In the 3M ended Jun-21, the RoA and RoE improved further to 4.04% and 27.41%.

Comfortable capital profile supported by healthy internal accruals: The Company's Tier 1 and Total CAR stood at 12.98% and 14.09% in Mar-21, as compared to the regulatory requirement of 6.50% and 10.50% (upto Jul-21). Further the Company's core capital stood at LKR 8.2 Bn in Mar-21, which comfortably exceeds the future regulatory requirement of LKR 2.5 Bn in Dec-21. ICRA Lanka estimates the capital profile to remain comfortable in the medium term to support the envisaged portfolio growth (around 20% in FY2022). Moreover, VFP's gearing improved to 5.52 times in Jun-21, compared with 6.58 times in Mar-20 aided by its healthy internal generation.

Asset quality indicators deteriorated marginally but remained better compared to the industry: As of Mar-21, VFP's gross and net NPA stood at 4.48% and 1.23%, compared to the systemic average of 11.32% and 2.81%, respectively. Due to the lockdown that took place in Q1 FY2022, VFP's GNPA and Net NPA ratios deteriorated to 5.47% and 1.89%, respectively, in Jun-21. However, ICRA Lanka notes that VFP has

been consistent in maintaining better asset quality than peers. The slippages ratio rose to 12.46% in FY2021, as compared with 6.29% in FY2020 (4.35% in FY2019) due to the effects of the pandemic; slippages as of Jun-21 stood at 1.55%. VFP's core asset classes namely, cars (46% of total portfolio), vans (14%) and lorries (11%) and gold loans (11%), reported GNPA ratios of 2.69%, 3.24%, 6.08% and 4.92%, respectively, in Mar-21. ICRA Lanka notes that VFP's relatively better asset quality indicators are also due to higher loan growth coupled with higher recovery and upgrades of LKR 4,516 Mn in FY2021 (LKR 1,315 Mn in FY2020). The Company's comprehensive credit operations and effective recoveries have supported its portfolio quality. ICRA Lanka also notes that almost 100% of the portfolio is asset-backed, which provides comfort on the recoverability of the facilities. VFP's provision coverage ratio (based on CBSL guidelines) stood at 58.2% in Mar-21 (56.5% in Mar-20); however based on IFRS, the provisioning stood at around 106.4% in the same period (81.4% in Mar-20).

Credit challenges

Moderate liquidity profile supported by funding lines: VFP's total borrowings stood at LKR 45.0 Bn in Mar-21 (LKR 42.6 Bn in Mar-20) with 72% being contributed by deposits and 19% in the form of bank borrowings. VFP witnessed a modest liquidity profile with its short term (less than 12 months) ALM mismatch deteriorating to negative 23.5% in Mar-21 (negative 12.1% in Mar-20) due to a reduction in long term bank borrowings and increased dependence on short-term deposits. Nevertheless, the Company's healthy deposit renewal rate (around 75-85%) and unutilized funding lines of LKR 10.6 Bn as of Jun-21, provide comfort from a liquidity perspective.

Exposure to customers with modest credit profile: VFP is catering to SME's (6% of total portfolio) and individuals (94%) who have a moderate risk profile and are susceptible to adverse economic cycles. ICRA Lanka however takes note of the adequate internal controls put in place, which provides comfort from a credit perspective.

Analytical approach: For arriving at the ratings, ICRA has applied its ratings methodologies as indicated below:

Links to applicable criteria: [ICRA Lanka's Credit Rating Methodology for Non-Banking Finance Companies](#)

Company Profile:

VFP was incorporated in 1974 as Rupee Finance Limited. In 2005, Vallibel Investment (Pvt) Ltd acquired the Company and renamed it as Vallibel Finance PLC. Mr. Dammika Perera has the controlling stake of the Company through a direct holding of 21.4% and 51.4% holding through his fully owned investment arm, Vallibel Investment (Pvt) Ltd as in Mar-21. The Company is listed on the main board of the Colombo stock exchange. VFP currently operates through 46 branches. The principal activities of the Company include extending finance leases, granting of mortgage loans, gold loans and mobilization of deposits. VFP also extends vehicle backed overdraft facilities and business loans.

During the year ended March 2021, VFP reported a Profit After Tax (PAT) of LKR 1,728 Mn on a total asset base of LKR 55.2 Bn as compared to a PAT of LKR 1,253 Mn on a total asset base of LKR 51.4 Bn in the previous financial year. For the three months ended June 2021, the Company reported a PAT of LKR 570 Mn on a total asset base of LKR 57.4 Bn vis-à-vis a PAT of LKR 173 Mn on a total asset base of LKR 52.8 Bn in the three months ended June 2020.

Key financial indicators of VFP - Audited

	FY2019	FY2020	FY2021	Q1 FY2022*
Net Interest Income	3,363	4,058	4,264	1,282
Profit after Tax	1,129	1,253	1,728	569
Net worth	5,471	6,478	8,188	8,404
Loans and Advances	38,973	41,136	47,761	49,741
Total Assets	47,660	51,424	55,241	57,392
Return on Equity	25.73%	20.98%	23.57%	27.41%
Return on Assets	2.62%	2.53%	3.24%	4.04%
Gross NPA	3.02%	5.01%	4.48%	5.47%
Net NPA	0.60%	1.51%	1.23%	1.89%
Tier I CAR	11.13%	11.93%	12.98%	11.77%
Total CAR	12.61%	13.04%	14.09%	12.89%
Gearing (times)	7.41	6.58	5.50	5.52

*Unaudited

Rating history for last three years:

Instrument	Current Rating (FY2022)			Chronology of Rating History for the past 3 years		
	Amount Rated (LKR Mn)	Outstanding Amount (LKR Mn)	Date & Rating	Date & Rating in FY2020	Date & Rating in FY2019	Date & Rating in FY2018
			Aug-2021	Aug-2020	Mar-2019	Mar-2018
Issuer rating	N/A	N/A	SL]BBB+ (Stable)	SL]BBB (Stable)	[SL]BBB (Stable)	[SL]BBB (Stable)
Guaranteed subordinated redeemable debenture programme	1,000	-	NA	[SL]AA-(SO) (Stable); Withdrawn	[SL]AA-(SO) (Stable)	[SL]AA-(SO) (Stable)
Unsecured subordinated redeemable debenture programme	500	-	NA	NA	[SL]BBB-(Stable); Withdrawn	[SL]BBB-(Stable)



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