FitchRatings

Fitch Affirms Ratings of 10 Sri Lankan Finance Companies

Fitch Ratings-Singapore/Colombo-21 July 2017: Fitch Ratings has affirmed the ratings of the following finance companies:
- People's Leasing & Finance PLC (PLC)
- Central Finance Company PLC (CF)
- Melsta Regal Finance Ltd (MRF)
- HNB Grameen Finance Limited (HGL)
- LB Finance PLC (LB)
- Siyapatha Finance PLC (Siyapatha)
- Senkadagala Finance PLC (Senka)
- AMW Capital Leasing And Finance PLC (AMWCL)
- Singer Finance (Lanka) PLC (SFL)
- Mercantile Investments and Finance PLC (MIF)

In addition, Fitch assigned Siyapatha's proposed subordinated debentures an expected rating of 'BBB+(lka)(EXP)'.

A full list of rating actions is at the end of this rating action commentary.

KEY RATING DRIVERS
IDRS, NATIONAL RATINGS AND SENIOR DEBT
The rating actions follow Fitch's periodic review of the large and mid-sized finance companies in Sri Lanka.

Fitch expects capitalisation in the sector to come under pressure as a result of asset quality pressures stemming from a challenging operating environment and unfavourable weather conditions and declining profitability due to higher funding and credit costs. Fitch sees that the shift in the business mix of the entities considered in this peer review has become more apparent given the slowdown in the vehicle financing segment following the increase in import tariffs, imposition of lower allowable loan-to-value ratios coupled with a high interest rate environment. Licensed finance companies have increasingly engaged in term/working capital financing - a segment that we believe is more risky due to larger transaction amounts and poor collateral such as third-party guarantees or post-dated cheques.

Fitch's ratings on the finance companies in the peer group are primarily driven by their business model, franchise and risk appetite, which is reflected in their exposure to more vulnerable customer segments.

Finance Companies with Institutional Support-Driven Long-Term Ratings
PLC's Issuer Default Rating and National Long-Term Rating reflect Fitch's view that PLC's parent, the state-owned and systemically important People's Bank (Sri Lanka) (PB: AA+(lka)/Stable) would provide PLC with extraordinary support, if required. PB's propensity to support PLC stems from its role in the group as a strategically important subsidiary and the high reputational risk to PB should PLC default as PB owns 75% of PLC and they share a common brand. PB's ability to provide support to PLC is limited, and stems from Sri Lanka's rating of 'B+'/Stable.

PLC accounted for 10.1% of PB's assets and contributed 25.5% to PB's post-tax profit for the quarter ended March 2017. In addition to its own branches, PLC has 101 window offices within PB's branches and has board representation from PB.

MRF's rating reflects Fitch's expectation of support from its group through MRF's parent Melstacorp PLC (MC). The Rating Watch Negative (RWN) reflects Fitch's assessment that MC's ability to provide support to MRF is dependent on the resolution of the RWN on Distilleries Company of Sri Lanka PLC (DIST: AAA(lka)/RWN), a significant subsidiary within the group. Fitch expects capital support from MC for MRF to meet the enhanced regulatory minimum capital requirement imposed by the regulator.

MRF is of limited strategic importance to the group and the level of its operational integration within the consolidated group's core business is low. MRF accounted for just 1.3% of group pre-tax profit and 5.1% of group assets at financial year end-March 2017. We believe that the disposal of MRF would not significantly alter the group's operations or earnings, although that is not currently in MC's plans.

HGL's rating reflects Fitch's expectation of support from its parent, Hatton National Bank PLC (HNB; AA-(lka)/Stable), Sri Lanka's fourth-largest domestic commercial bank. This view is based on HNB's majority shareholding (51%), its involvement in the strategic direction of HGL through board representation and the common HNB brand.

The two-notch differential reflects HGL's limited role in the group. HGL is mainly engaged in microfinance, which is not a significant product for HNB. Furthermore, there is limited operational integration between the entities.

AMWCL's rating reflects Fitch's view that support would be forthcoming from Associated Motorways Private Limited (AMW), which owns 90% of AMWCL, given the finance company's strategic importance to the parent. This is based on AMWCL's role in the group, the common AMW brand and the existence of common creditors, which mean high reputational risk for AMW if AMWCL were to default. About 75% of its advances comprised vehicle finance facilities provided to its parents' clients at end-March 2017 (end-2015: 74% and 2014: 46%). AMWCL also benefits from business referrals from AMW's branch network and has 11 branches within AMW's branches.

Siyapatha's rating reflects Fitch's view that support would be forthcoming from its parent, Sampath Bank PLC (A+(lka)/Negative), which owns 100% of Siyapatha and is involved in the strategic direction of Siyapatha through board representation. Siyapatha is rated two notches below its parent because of Siyapatha's limited contribution to the group's core businesses; group leasing book accounted for just 7% of group advances at end-2016, of which Siyapatha provided 42%. In addition Siyapatha's contribution to group profit remains low and Siyapatha is branded independently from its parent.

Finance Companies with Long-Term Ratings Driven by Intrinsic Strength
CF's rating reflects its strong capitalisation supported by its above-industry profitability and retention rates. CF's regulatory Tier-1 ratio improved to 32.3% at the end of the financial year to March 2017 (29.9% as at end-FY16), maintaining its position as the highest capitalised non-bank financial institution among our rated peers. However, these strengths are counterbalanced to an extent by its still-weak asset quality relative to similar rated peers, high risk appetite stemming from its loan book concentration to registered three-wheelers and potential pressure on profitability from a weakening market share. Even though CF's asset quality and provisioning have been improving, they still remain weaker compared with similar rated peers.

LB's rating reflects its established franchise and satisfactory capital levels supported by sound profitability from its higher-yielding products. These are counterbalanced by its higher risk appetite given high exposure to gold-backed lending. Fitch believes this exposure has so far been managed through active monitoring and risk-control measures. However, an unexpected sharp decline in gold prices could pressure its asset quality. The ratings also reflect its increasing liquidity risk given its high loan growth relative to its assets (gross loans to total assets: 89% at end-March 2017), which could potentially reduce its liquidity buffer.

Senka's rating reflects the satisfactory credit profile that it has maintained through economic cycles, its relatively strong franchise among finance companies in Sri Lanka and better matched maturity gaps. These positive factors are counterbalanced by its deposit base and capitalisation, which are weaker compared with higher rated peers. Senka's asset quality has been satisfactory with key ratios such as the regulatory gross NPL ratio improving to 1.64% at end-FY17 (end-FY16: 2.02%). However, Fitch sees that there are still downside risks to asset quality given Senka's high gross loan growth of 40% in FY17 (FY16: 24%). A rights issue of LKR580 million in April 2017 helped improve the regulatory Tier-1 capital adequacy ratio to 16.44% after falling to 14.19% at end-FY17 (end-FY16: 15.98%) as a result of high loan growth.

SFL's rating reflects its relatively measured risk appetite, weaker-than-peers franchise and overall stable financial indicators. SFL's capitalisation is higher than that of its similar rated peers amid modest loan growth, and its asset-quality metrics have improved. The rating is underpinned by Fitch's view that the rating on SFL's parent, retailing company Singer (Sri Lanka) PLC (Singer; A-(lka)/Stable), provides a floor for SFL's rating that is two notches below. This reflects Singer's majority ownership in SFL, the common Singer brand and Singer's influence on SFL's strategic direction through representation on the finance company's board.

MIF's rating reflects its high risk appetite, stemming from weaker underwriting standards, declining profitability relative to peers and greater reliance on concentrated and short-term funding. MIF's rating also captures its long operating history, satisfactory capitalisation and loan book exposure to less risky customer segments relative to peers. We estimate the six-month regulatory gross NPL ratio to have increased sharply to nearly 7% by end-March 2017 from 3.4% in FY16 after two new large defaults which are backed by collateral. The company's capitalisation metrics remain supportive to its current rating levels. However, any NPLs without provisions could weaken capital buffers.

The ratings on the senior debentures of PLC, CF, Senka, SFL, MIF and Siyapatha are in line with their National Long-Term Ratings according to Fitch criteria. Fitch has not provided any rating uplift for the collateralisation of CF's and SFL's secured notes as their recovery prospects are considered to be average and comparable with those of unsecured notes in a developing legal system.

SUBORDINATED DEBT

Subordinated debentures of CF, LB, Senka and Siyapatha and the proposed subordinated debentures of Siyapatha are rated one notch below their National Long-Term Ratings to reflect the subordination to senior unsecured creditors. The final rating on Siyapatha's debentures is subject to the receipt of final documentation conforming to information already received.

RATING SENSITIVITIES

IDRS, NATIONAL RATINGS AND SENIOR DEBT

Finance Companies with Institutional Support Driven Long-Term Ratings

A downgrade of PLC's IDR and National Ratings would occur if PB's ability to support PLC were to weaken or PB were to cede its majority ownership in PLC, or if PLC's strategic importance to its parent were to diminish over time, which would reflect a reduced propensity to support PLC, but Fitch does not anticipate this in the foreseeable future. PLC's ratings are also sensitive to changes in the sovereign rating, as this would affect PB's ability to provide support to PLC.

The ratings on AMWCL, Siyapatha, and HGL are similarly sensitive to changes in Fitch's assessment of their respective parents' ability and propensity to provide support, none of which is expected by Fitch to change materially in the short to medium term.

The resolution of MRF's RWN will depend on the resolution of the RWN on DIST and the ability of Fitch to form an opinion of the restructuring's full impact on MC's credit profile.

Finance Companies with Long-Term Ratings Driven by Intrinsic Strength

The rating of CF could be upgraded if its risk appetite moderates, which Fitch does not expect in the medium term. However, CF's rating could be downgraded if it is not able to provide a buffer against further loan quality deterioration through provisioning and further continuous decline in its market share which could pressure future profitability.

Downgrade triggers for LB include capital pressures stemming from weaker profitability, increase in liquidity risk or a further increase in risk appetite. This could be indicated through aggressive loan growth or deterioration in asset quality. An upgrade of LB's rating is contingent on the company achieving stronger capitalisation levels, lower exposure to risky assets and a more comfortable liquidity position.

An upgrade of Senka's rating is contingent upon the company sustaining stronger capital levels and a more robust deposit franchise that would allow the company to expand in a controlled manner. Rating could be downgraded if its asset quality weakens, leading to a significant decline in capitalisation or excessive asset encumbrance.

An upgrade of SFL's ratings from an improvement in its standalone strength is unlikely as we expect its franchise to remain materially weaker compared with that of its more established, higher-rated peers. The more likely driver of an upgrade of SFL's rating would be its relationship with its parent, in particular its strategic importance to Singer. A sustained deterioration in SFL's standalone credit profile in terms of its capitalisation and asset quality relative to similarly rated peers would not result in a downgrade of SFL's rating unless our assessment of parental support were to also change.

MIF's ratings could be downgraded if its large maturity mismatches were to increase or if MIF were to experience an increase in capital impairment risks due to sustained deterioration in profitability and asset quality relative to better rated peers. An upgrade of MIF's ratings is contingent upon a moderation of its risk appetite as seen through better underwriting standards and risk controls alongside improvements in asset quality and profitability.

The ratings on the senior debt of PLC, CF, Senka, SFL, MIF and Siyapatha will move in tandem with their National Long-Term Ratings.

SUBORDINATED DEBT AND OTHER HYBRID SECURITIES
The assigned subordinated debt ratings will move in tandem with their National Long-Term Ratings.

FULL LIST OF RATING ACTIONS

The following ratings were affirmed as follows:

People's Leasing & Finance PLC:
Long-Term Foreign-Currency Issuer Default Rating at 'B'; Outlook Stable
Long-Term Local-Currency Issuer Default Rating at 'B'; Outlook Stable
National Long-Term Rating at 'AA-(lka)'; Outlook Stable
National Long-Term Rating for senior unsecured debt at 'AA-(lka)'

Central Finance Company PLC:
National Long-Term Rating at 'A+(lka)'; Outlook Stable
National Long-Term Rating for senior secured debt at 'A+(lka)'
National Long-Term Rating for senior unsecured debt at 'A+(lka)'
National Long-Term Rating for subordinated debt at 'A(lka)'

Senkadagala Finance PLC
National Long-Term Rating at 'BBB+(lka)'; Outlook Stable
National Long-Term Rating for senior unsecured debt at 'BBB+(lka)'
National Long-Term Rating for subordinated debt at 'BBB(lka)'

Singer Finance (Lanka) PLC
National Long-Term Rating at 'BBB(lka)'; Outlook Stable
National Long-Term Rating for senior secured debt at 'BBB(lka)'
National Long-Term Rating for senior unsecured debt at 'BBB(lka)'

AMW Capital Leasing And Finance PLC
National Long-Term Rating at 'BBB+(lka)'; Outlook Stable

Siyapatha Finance PLC

National Long-Term Rating at 'A-(lka)'; Outlook Negative
National Long-Term Rating for senior unsecured debt at 'A-(lka)'
National Long-Term Rating for subordinated debt at 'BBB+(lka)'
National Long-Term Rating for proposed subordinated debt at 'BBB+(lka)(EXP)'

Melsta Regal Finance Ltd:
National Long-Term Rating at 'A+(lka)'; Rating Watch Negative

HNB Grameen Finance Ltd.:
National Long-Term Rating at 'A(lka)'; Outlook Stable

LB Finance PLC:
National Long-Term Rating at 'A-(lka)'; Outlook Stable
National Long-Term Rating for subordinated debt at 'BBB+(lka)'

Mercantile Investments and Finance PLC
National Long-Term Rating at 'BBB-(lka)'; Outlook Stable
National Long-Term Rating for senior unsecured debt at 'BBB-(lka)'

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People's Bank, Central Finance Company PLC, Sampath Bank PLC and Hatton National Bank PLC each have a 1.78% equity stake in Fitch Ratings Lanka Ltd. No shareholder other than Fitch, Inc. is involved in the day-to-day rating operations of, or credit reviews undertaken by, Fitch Ratings Lanka Ltd.

Note to editors: Fitch's National ratings provide a relative measure of creditworthiness for rated entities in countries with relatively low international sovereign ratings and where there is demand for such ratings. The best risk within a country is rated 'AAA' and other credits are rated only relative to this risk. National ratings are designed for use mainly by local investors in local markets and are signified by the addition of an identifier for the country concerned, such as 'AAA(lka)' for National ratings in Sri Lanka. Specific letter grades are not therefore internationally comparable.

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Additional information is available on www.fitchratings.com

Applicable Criteria
Global Bank Rating Criteria (pub. 25 Nov 2016)
Global Non-Bank Financial Institutions Rating Criteria (pub. 10 Mar 2017)
National Scale Ratings Criteria (pub. 07 Mar 2017)

Additional Disclosures
Dodd-Frank Rating Information Disclosure Form
Solicitation Status
Endorsement Policy