

ICRA Lanka upgrades the Long-term rating of Asia Asset Finance PLC

January 03, 2022

Instrument	Rated Amount (LKR Mn)	Rating Action
Issuer Rating	N/A	Upgraded to [SL]A- (Stable) from [SL]BBB+ (Stable)
Asset backed secured debenture programme	1,000	Upgraded to [SL]A (SO) (Stable) from [SL]A- (SO) (Stable)
Asset backed secured debenture programme	1,000	Upgraded to [SL]A (SO) (Stable) from [SL]A- (SO) (Stable)
Asset backed secured trust certificates	600	Upgraded to [SL]A (SO) (Stable) from [SL]A- (SO) (Stable)

Rating action

ICRA Lanka Limited upgraded the Issuer Rating of Asia Asset Finance PLC (AAF or the Company) to [SL]A- (pronounced SL A minus) from [SL]BBB+ (pronounced SL triple B plus). ICRA Lanka has also upgraded the issue ratings to [SL]A(SO) (pronounced SL A Structured Obligation) for the two LKR 1,000 Mn asset backed secured debenture programmes of AAF. Further, ICRA Lanka has also upgraded the issue rating to [SL]A(SO) (pronounced SL A Structured Obligation) for the LKR 600 Mn asset backed secured trust certificates programme of AAF. The letters SO in parenthesis suffixed to a rating symbol stand for Structured Obligations. The SO rating is specific to the rated issue, its terms, and its structure. The SO ratings do not represent ICRA Lanka's opinion on the general credit quality of the issuer concerned. The outlook on the long term ratings remain Stable.

Rationale

The rating upgrades factor in the operational, financial and managerial support which AAF derives from being a 73% owned subsidiary company of Muthoot Finance Limited (MFL or the parent) rated by ICRA Limited at [ICRA]AA+ (Stable). The parent has demonstrated a good track record of providing both financial and operational support to AAF over the past few years and has completed a rights issue of LKR 414 Mn in Aug-21. This resulted in an improvement in AAF's tangible net worth to LKR 2.67 Bn as of Sep-21 which was higher than the minimum regulatory requirement of LKR 2.5 Bn to be met by Jan-22. The rating also takes into account both the ability and willingness of the parent entity, MFL to provide capital support on a timely basis, going forward. The upgrades also consider the improvement in the overall portfolio quality of AAF, with its shift away from unsecured lending to secured products such as gold loans.

ICRA Lanka is cognizant of the Company's weak asset quality indicators mainly on the account of discontinued products such as SME and micro-lending. The ratings also take note of the Company's moderate earnings profile with compression in net interest margin given its shift to relatively lower yielding secured lending. Going forward, AAF's ability to control incremental slippages and improve overall profitability will be crucial, from a rating point of view.

Outlook: Stable

The Stable outlook factors in ICRA Lanka's expectation that AAF will continue to benefit from the strong parentage of MFL and the Company will continue to increase its exposure to relatively safer products such as gold loans. The outlook may be revised to "Positive" in case of improvement in asset quality indicators

and overall profitability, while maintaining adequate capital buffers. The outlook may be revised to “Negative” in case of deterioration in AAF’s asset quality indicators, weakening profitability or lower than expected support from MFL.

Key rating drivers

Credit strengths

Operational, managerial and financial support from the parent: AAF is a 73% owned subsidiary of MFL, which is the largest gold loan finance company in India. MFL has demonstrated a track record of providing both financial and operational support to AAF over the past few years. In FY2019, MF infused about LKR 402 Mn via rights issue; which increased its stake to 73%. Furthermore, a rights issue of around LKR 414 Mn was completed in August 2021 in the form of preference shares. MFL is represented by three board members on the eight-member board. Operationally, MFL supports in staff training, internal controls and risk management. ICRA Lanka notes that the parent company has the ability to extend further capital support as and when required.

Increasing exposure to asset backed lending is expected to support asset quality: As in Sep-21, AAF’s gross portfolio stood at LKR 14,564 Mn vis-à-vis LKR 14,026 Mn in Mar-21. The Company shifted its exposure towards asset backed lending gradually over the past three years, with gold loans being the key asset class. Clean lending products such as micro-finance and working capital financing have been discontinued and account to around 20% as at Sep-21 in comparison to around 60% as at Mar-17. As in Sep-21, gold loans accounted for about 57% of the total portfolio, while the management intends to further increase its gold loan exposure over the medium term. ICRA Lanka takes cognizance of the relatively low credit risk and higher liquidity of these gold loans, while taking note of the vulnerability to market risk stemming from gold price fluctuations.

Comfortable capitalisation profile: AAF reported a net worth of LKR 2,671 Mn as on Sep-21 as against a regulatory requirement of LKR 2,000 Mn (LKR 2,500 Mn by Jan-22) following the rights issue of preference shares completed in Aug-21 of around LKR 414 Mn. In terms of risk-weighted capital adequacy ratios, the core capital and the total capital ratios remain comfortably above regulatory requirements; stood at 18.95% as on Sep-21 (16.75% as on Mar-21) as compared with the regulatory requirement of 7.00% and 11.00%, respectively. ICRA Lanka expects the capitalization profile of the Company to remain comfortable over the short to medium term, given its increasing exposure to low risk weighted gold lending.

Diversified funding profile with less dependence on public deposits: AAF has a fairly diversified funding profile comprising of retail fixed deposits, debentures, term loans from banks and securitised borrowings. The funds from fixed deposits have moderated over the years with 57% of the funding base as in Sep-21 in comparison to 55% in Mar-21 and 52% in Mar-20. Going forward, AAF expects to further improve the long-term funding sources such as securitisation. The gearing of the Company improved to 7.29 times as in Sep-21 from 8.51 times as at Jun-21 due to the recent completed rights issue of preference shares of around LKR 414 Mn in Aug-21.

Credit challenges

Asset quality remains under pressure, despite some improvement in the recent quarters: AAF noted an improvement in AAF’s asset quality indicators in Q2 FY2022 in line with the industry trend. The Gross NPA ratio improved to 13.86% as at Sep-21 in comparison to 21.06% in Jun-21 and 19.18% in Mar-21. However, a larger part of the NPA reduction is attributable to the high write-offs of about LKR 600 Mn from its discontinued products. Despite the relatively high Gross NPA ratio in the overall portfolio, AAF’s

core gold loan portfolio demonstrated better asset quality indicators with GNPA of 1.4% as in Sep-21, compared to 2.4% in Mar-21. The Net NPA ratios moderated and stood at 3.78% as at Sep-21 in comparison to 6.47% as at Jun-21 and 4.66% as at Mar-21. Provision coverage reduced as a result of the increased exposure to gold loans which require low provisioning. Going forward, ICRA Lanka envisages the GNPA ratios to improve mainly due to the portfolio shift towards the secured asset quality segment of Gold loans and the discontinuation of the unsecured lending.

Moderate earnings profile due to margin compression and elevated cost to income ratio: With the somewhat moderate growth of the portfolio and its shifting away from unsecured lending that are typically high yielding products and focusing more on asset-backed low yielding products such as gold loans, the lending margins have moderated over the years. As a result, the net interest margins moderated further to 6.15% in 6MFY2022 from 7.69% in Mar-21. Although Cost to Income ratio marginally declined to 68.3% in 6MFY2022 compared to 68.9% in Mar-21, it remains elevated, thereby adversely impacting profitability. Credit costs (Loan provisioning/ATA) of AAF fell to 2.18% in the 6MFY2022 from 2.51% in FY2021 as a result of the Company focusing on safer asset classes such as gold loans as opposed to unsecured lending such as micro and SME finance. AAF reported an ROA of 0.42% in 1HFY22 vis-à-vis 0.30% in FY2021 and 0.48% in FY2020. ICRA Lanka notes that AAF will have to maintain its overall profitability by controlling operating expenses and credit costs as core margins are likely to remain moderated.

Analytical approach: For arriving at the ratings, ICRA 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:

Asia Asset Finance PLC is a registered finance company setup in 1970 as "Finance and Land Sales Company". In 2004, Asia Capital PLC (ACP) acquired AAF. MFL acquired about 30% of the Company in August 2014, and increased its stake up to 51% in December 2014,. During FY2020, MFL has further increased its stake to about 73% via a rights issue. AAF offers gold loans, SME loans, vehicle finance (2 wheelers, 3 wheelers, cars & vans etc.), loan against property, fixed deposits and other personal credit facilities.

During FY2021, AAF reported a PAT of LKR 45 Mn on an asset base of LKR 15,350 Mn, as compared with a PAT of LKR 70 Mn on a total asset base of LKR 15,155 Mn in the previous financial year.

During 6M ended September 2021, AAF reported a profit after tax of LKR 35 Mn on an asset base of LKR 17,709 Mn, as compared with a PAT of LKR 1.3 Mn on an asset base of LKR 14,649 Mn.

Key financial indicators (audited)

	FY2019	FY2020	FY2021	6MFY2022*
Net Interest Income	1,289	1,339	1,164	508
Profit after Tax	101	70	45	35
Reported net worth	1,953	2,171	2,222	2,671
Loans and Advances (Net)	11,556	12,640	12,411	13,360
Total Assets	13,899	15,155	15,350	17,709
Return on Equity	5.3%	3.4%	2.1%	2.8%
Return on Assets	0.8%	0.5%	0.3%	0.4%
Gross NPA	9.2%	16.2%	19.8%	13.9%
Net NPA	0.9%	5.9%	4.7%	3.8%
Core Capital Adequacy Ratio	15.6%	16.2%	16.8%	18.9%
Adjusted Gearing ¹	6.8	6.5	6.4	5.9

*Unaudited

Rating history for last three years:

Instrument	Current Rating			Chronology of Rating History for the past 3 years			
	Amount Rated (LKR Mn)	Outstanding Amount (LKR Mn)	Date & Rating in FY2022	Date & Rating in FY2022	Date & Rating in FY2022	Date & Rating in FY2021	Date & Rating in FY2020
			Dec-21	Oct-21	Apr-21	Jul-20	Dec-19
Issuer rating	N/A	N/A	[SL]A-(Stable)	[SL]BBB+(Stable)	[SL]BBB+(Stable)	[SL]BBB+(Negative)	[SL]BBB+(Negative)
Asset Backed Secured Debenture	1,000	1,000	[SL]A (SO) (Stable)	[SL]A-(SO) (Stable)	[SL]A-(SO) (Stable)	[SL]A-(SO) (Negative)	N/A
Asset Backed Secured Debenture	1,000	1,000	[SL]A (SO) (Stable)	[SL]A-(SO) (Stable)	[SL]A-(SO) (Stable)	N/A	N/A
Asset Backed Secured Trust Certificates	600	600	[SL]A (SO) (Stable)	[SL]A-(SO) (Stable)	N/A	N/A	N/A

¹ Gearing adjusted for deferred tax and revaluation reserves



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