

ICRA Lanka assigns [SL]B rating for Multi Finance PLC

September 28, 2018

Instrument*	Previous Rated Amount (LKR Mn)	Current Rated Amount (LKR Mn)	Rating Action
Issuer rating	N/A	N/A	[SL]B (Stable); assigned

Rating action

ICRA Lanka Limited, subsidiary of ICRA Limited, a group company of Moody's Investors Service, has assigned the issuer rating of [SL]B (Pronounced SL B) with a stable outlook to Multi Finance PLC (MFP or the company).

Rationale

The rating considers MFP's modest scale and franchise, weak asset quality indicators and poor earnings profile. ICRA Lanka notes that the company's resource profile largely consists of fixed deposits, which are highly concentrated to a few depositors (Top 10 accounting for about 30% of total deposits in March 2018). MFP's core capital as in June 2018 stood at LKR 0.8 Bn, below the regulatory requirement of LKR 1 Bn¹ for Licenced Finance Companies (LFCs), however the company's gearing was low at 1.0 time. ICRA Lanka takes note of the initiatives taken by the company to augment its core capital by LKR 200 Mn in the near term with support from Fairway Holdings (Pvt) Ltd (Fairway), which currently holds about 65% equity stake. ICRA Lanka notes that, sizeable further external capital infusion (about LKR 1.5-1.6 Bn over the period FY2019-FY2021) would be required as internal generation is likely to remain modest. Timely capital infusion would be crucial, going forward, to meet regulatory capital requirement.

Outlook: Stable

MFP's ability to raise capital to meet the regulatory requirement on a timely basis would be a key rating sensitivity. The outlook may be revised to "Positive" based on MFP's ability to grow its portfolio and improve its earnings profile and asset quality indicators while maintaining a healthy capital profile. The outlook may be revised to "Negative" in case of MFP failing to meet the regulatory capital requirement in a timely manner going forward or in case of a significant deterioration in its overall financial risk profile.

Key rating drivers

Credit strengths:

Support from Fairway group- In Feb-17, the current promoter, Fairway Holdings (Pvt) Ltd. acquired the controlling stake in MFP by subscribing to its private placement. Fairway group, established in 2003, has

¹ LKR 1.5 Bn by Jan-19, LKR 2.0 by Jan-20 and LKR 2.5 Bn by Jan-21

business interests in real estate and property development, renewable energy projects, manufacturing and trading operations, financial services, pharmaceuticals and travel and leisure industry. ICRA Lanka takes note of the currently subdued financial risk profile of the fairway group, however takes note of the initiatives taken by the group to bring in new investors to augment MFP capital profile.

Credit challenges

Small scale of operations and modest competitive position: MFP is a relatively small player in the NBFI sector with a portfolio of about LKR 1.5 Bn as of June 2018. The company has a concentrated portfolio with exposures to top 10 borrowers at about 18% of the total portfolio as of Jun-18. The portfolio consisted of loans, leasing and HP, pawning and microfinance which accounted for about 58%, 30% 11% and 1% respectively as of Jun-18. The loan segment largely consists of working capital financing for SME segment backed by stocks (about 22% of total portfolio), backed by property (about 17%) and backed by vehicles (about 11%). The leasing portfolio mainly consists of lending for passenger vehicles (cars, vans, jeeps) which accounted for about 25% of total portfolio and medium size lorries which accounted for about 5% of the total portfolio in Jun-18. MFP expects to achieve a total portfolio of LKR 7.7 Bn by FY2021, with 60% exposure towards leasing followed by loans and pawning at 30% and 10% respectively.

Sizeable external capital required to meet regulatory core capital requirement; MFP's core capital adequacy ratio stood at 45% as of Jul-18 and gearing was 1.0 times as in Jun-18. MFP's core capital, however, stood at about LKR 0.8 Bn in Jun-18, below the threshold of LKR 1 Bn. The company's core capital is expected to be increased up to 1.0 Bn by January 2018 and each year thereafter by LKR 500 Mn until it reaches LKR 2.5 Bn by Jan-21. ICRA Lanka takes note of the company's proposed fund-raising program of LKR 200 Mn and commitment provided by the parent company, Fairway Holding (Pvt) Ltd., to subscribe to the same. However, ICRA Lanka estimates that the company would require further external capital support of about LKR 1.5-1.6 Bn over the period FY2019-FY2021 to meet the subsequent requirements (with adequate buffer). MFP's ability to raise capital on a timely basis would be a key rating monitorable going forward.

Weak asset quality indicators: MFP recorded a high gross NPA ratio of 10.5% in Jun-18 (9.8% in Mar-18) largely on account of business loans granted for working capital financing backed by stocks, fixed and movable assets to SME clients. The business loans portfolio (about 20% of the total portfolio in Jun-18) recorded a gross NPA ratio of 42.1%. The high slippages were primarily because of difficulties faced by the SME segment due to macro-economic challenges and inadequate follow-up by MFP for collections. The top 20 NPA accounts constituted about 70% of the total NPAs as of Jun-18. The company envisages to bring down gross NPA ratio to below 5% in the near term via recovery of its top NPAs. MFP's ability to curtail further slippages while recovering the current NPAs would be key rating monitorable.

Limited funding diversity: Total borrowings of MFP stood at about LKR 800 Mn and about 90% of it as fixed deposits in Jun-18, while borrowings from banks accounted for the rest. Top 10 deposits accounted for about 30% of total deposits in March 2018, indicating a concentrated deposit profile. Ability to diversify resource profile going forward would be crucial for business growth.

Poor profitability indicators: MFP has been reporting net losses since FY2016. However, the losses in FY2018 moderated to about LKR 17 Mn vis a vis loss of LKR 40 Mn in FY2017. The net loss for Q1FY2019 stood at LKR 1.2 Mn. The lending yields in FY2018 was about 17% with a NIM of 11.0%, which was supported by the low leverage. The earnings profile is characterized by high operating expenses ratio (operating expense to average total assets) of 10.8% in Mar-18 and 12.1% in Jun-18. MFP's credit cost

increased in FY2018 to 3.15% because of high provisioning for increased slippages. The same moderated to 0.87% as of Jun-18. Going forward, it is crucial for MFP to improve its operating efficiency and keep credit cost under control as business expands.

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

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

About the company:

Multi Finance PLC (MFP) is a licensed Finance Company providing an array of products in terms of Leasing, Hire Purchase, Business loans, Multi draft, SME financing, Pawning, Micro Finance, Factoring and Trader financing etc. The Company was incorporated on the 14th of October 1974 as a limited liability company in Kandy. The ordinary shares of the company were listed on the Colombo Stock Exchange in 2011. In February 2017, Fairway Holdings, a diversifying conglomerate acquired 65% of MFP.

During the year ended March 31, 2018, MFP reported a net loss of LKR 17.0 Mn on a total asset base of LKR 1.6 Bn as compared to net loss of LKR 40.2 Mn on a total asset base of LKR 1.3 Bn in the previous fiscal year.

For the three months ended June 30, 2018, MFP reported a net loss of LKR 1.2 Mn (unaudited) on a total asset base of LKR 1.7 Bn.

Key financial indicators (Audited)

Amount in LKR Mn	FY2017	FY2018	3MFY2019*
Net Interest Income	77	139	47
Profit after Tax	-40	-17	-1
Net worth	824	806	805
Loans and Advances	595	1,197	1,428
Total Assets	1,302	1,634	1,715
Return on Equity	-7.1%	-2.1%	-0.6%
Return on Assets	-3.4%	-1.2%	-0.3%
Gross NPA	7.7%	9.8%	10.5%
Net NPA	1.9%	5.7%	4.9%
Capital Adequacy Ratio	148.9%	66.4%	56.6%
Gearing (times)	0.5	0.9	1.0

*Unaudited

Rating history for last three years:

Current Rating (FY2019)					Chronology of Rating History for the past 3 years		
Instrument	Type	Amount Rated (LKR Mn)	Date & Rating Sep 2018 [SL]B (Stable)		Date & Rating in FY2018	Date & Rating in FY2017	Date & Rating in FY2016
1	Issuer rating	N/A	N/A		N/A	N/A	N/A

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