Fitch Affirms 10 Sri Lankan Finance Companies

Fitch Ratings-Colombo/Singapore-01 August 2016: Fitch Ratings has affirmed the ratings of 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 (AMCL), Singer Finance PLC (SFL), and Mercantile Investment & Finance PLC (MIF).

A full list of rating actions is included 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.

The companies in the peer group remain predominantly exposed to vehicle financing. Fitch expects growth potential in the vehicle financing segment to be limited due to the increase in import tariffs for cars and the central bank's imposition of a 70% cap on loan-to-value ratio for loans extended for the purpose of acquiring or using motor vehicles. Fitch expects asset quality and capitalisation to deteriorate in the sector following aggressive loan book growth in recent years and challenging operating conditions, which were signalled in Fitch's downgrade of Sri Lanka's sovereign rating to 'B+' from 'BB-' in February 2016.

Fitch's ratings on the finance companies in the peer group are driven by their business model and franchise, and their 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 (IDR) and National Long-Term Rating continue to reflect Fitch's view that PLC's parent, the state-owned and systemically important People's Bank (AA+(lka)/Stable), would provide extraordinary support to PLC, if required. People's Bank's propensity to support PLC stems from its 75% shareholding in PLC, common brand and PLC's position as a "strategic subsidiary" of the bank. The finance company accounted for 29.6% of the bank's consolidated post-tax profits and 9.9% of total assets at end-March 2016. In addition to its own branches, PLC has 110 window offices within branches of People's Bank. The parent's ability to provide support to PLC stems from the limited ability of the sovereign (B+/Negative) to provide such backing.

The negative Outlook on the IDR mirrors that on the sovereign's. Fitch maintains a Stable Outlook on the National Long-Term Rating, in line with that of People's Bank, as this is a measure of relative strength between issuers within Sri Lanka.

AMCL's rating reflects Fitch's view that support would be forthcoming from Associated Motorways Private Limited (AMW), which owns 90% of AMCL, given the finance company's strategic importance to the parent. This is based on AMCL's role in the group, the common AMW brand and the existence of common creditors, which contribute to high reputational risk for AMW if AMCL were to default. In addition AMW remains a key source of funding for AMCL; 53% of AMCL's total funding at end-2015 was either directly borrowed from or guaranteed by AMW.

AMW is involved in the strategic direction of AMCL, having four out of 10 seats on AMCL's board. AMCL also benefits from business referrals from AMW's branch network, and has 11 branches within AMW's branches. About 74% of its advances comprised vehicle finance facilities provided to its parents' clients at end-2015 (end 2014: 46% and 2013:49%).

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 and Siyapatha's different branding from its parent. Siyapatha's relative size to Sampath Bank and its contribution to group profit remains low, averaging 6% of group profit in 2013 to 2015. Sampath Bank's leasing book accounted for just 7% of group advances at end-2015, of which Siyapatha provided 33%.

HGL's rating reflects Fitch's expectation of support from its parent, Hatton National Bank PLC (HNB; AA-(lka)/Stable). We apply a two-notch differential to reflect that HGL is mainly engaged in the provision of micro finance, which is not a significant product for HNB as it accounted for only about 3% of the bank's loan book at end-2015. Furthermore, there is limited operational and management integration of the entities. We also consider HNB's majority shareholding (51%), its involvement in the strategic direction of HGL through board representation, and the common HNB brand.

The rating of MRF reflects Fitch's expectation of support from its ultimate parent, Distilleries Company of Sri Lanka (DIST; AAA(lka)/Stable), a leading domestic alcoholic-beverage manufacturer that wholly owns MRF. The four-notch differential between DIST and MRF reflects the latter's negligible role in the parent company. MRF has limited synergies and low operational integration with the group's core business, and a different brand from the parent. MRF accounted for just 1.9% of group revenue, 1.1% of consolidated net profit and 5.4% of group assets at end-March 2016. Fitch believes that the disposal of MRF would not significantly alter the group's operations or earnings, although that is not currently planned, according to DIST.

Finance Companies with Long-Term Ratings Driven by Intrinsic Strength

CF's rating continues to be supported by its strong capitalisation, which is driven by above-industry profitability and the company's practice of high profit retention. The rating also reflects its better funding profile compared with peers; a higher proportion of CF's deposits are sourced from its established franchise. However, these strengths are partly offset by CF's weak asset quality stemming from its high risk appetite and low provisioning compared with peers, despite the recent improvements.

The rating of LB captures its established franchise as the third-largest non-bank financial institution in Sri Lanka in terms of assets, and its satisfactory levels of capital, which are supported by healthy revenue generation and sound profitability through its higher-yielding products. These are counterbalanced by its relatively higher risk appetite as seen from its exposure to gold-backed lending (end-March 2016: 17.7% of gross loan book), which is unique in the licensed finance company peer group, and increasing liquidity risk given its high loan growth relative to its assets (gross loans to total assets: 88% at end-March 2016). Mitigating factors include its 10.9% deposit market share among LFCs, which remains moderately concentrated and the availability of unused credit lines.

Senka's rating reflects its satisfactory credit profile that has been maintained through economic cycles, its relatively strong franchise among finance companies in Sri Lanka and access to longer-term institutional funding. These positive factors are counterbalanced by its deposit franchise and capitalisation, which are weaker compared with higher-rated peers.

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 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 at two notches below its rating level for SFL's rating. 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 long operating history, satisfactory capitalisation and loan book exposure to less risky customer segments relative to peers. However, its ratings also capture its high risk appetite, which is evident in its substantial exposure to equity investments, low profitability metrics relative to peers and greater reliance on concentrated and short-term funding.

The ratings on the senior debentures of PLC, CF, Senka, SFL and MIF and the proposed senior debentures of Siyapatha and Senka 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 as their secured notes' 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 are rated one notch below their National Long-Term Ratings to reflect the subordination to senior unsecured creditors.

RATING SENSITIVITIES
IDRS, NATIONAL RATINGS AND SENIOR DEBT

Finance Companies with Institutional Support Driven Long-Term Ratings

PLC's ratings may be downgraded if People's Bank ceases to be a majority shareholder, if People's Bank's ability to provide support weakens, or if PLC's strategic importance to its parent diminishes over time. Fitch does not expect PLC's ratings to be upgraded, unless People's Bank's ratings are upgraded, which would be most likely driven by an upgrade of the sovereign.

The ratings on AMCL, Siyapatha, MRF 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 in the short to medium term.

Finance Companies with Long-Term Ratings Driven by Intrinsic Strength

Fitch deems the ratings upside for the entities whose ratings are driven by their own intrinsic strength as limited, taking into account our view of the operating environment, which is likely to be challenging over the short to medium term. All these ratings are on Stable Outlooks as we expect the entities' to maintain their risk profiles and, where necessary, adjust their risk appetites to preserve capital. Outperformance against this backdrop and relative to peers, while not expected, could make us consider positive rating action.

CF's rating could be downgraded if it is not able to provide adequate buffers against further loan quality deterioration through provisioning, which would lead to an increase in net NPLs relative to equity. An upgrade is only likely if CF is able to improve its asset quality and provisioning cover on sustained basis alongside a reduction in its high risk appetite.

Weakening profitability or a further increase in LB's risk appetite, indicated through aggressive loan growth or deterioration in asset quality, all of which increase capital impairment risk, could lead to a downgrade of the company's ratings. An increase in liquidity risk can also lead to a downgrade. 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.

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

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, 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.

Fitch would consider downgrading MIF's ratings if its large maturity mismatches were to increase or if MIF were to experience a sustained deterioration in capitalisation and asset quality relative to its higher-rated peers. An upgrade of MIF's rating is contingent on the company significantly reducing its equity investment exposure, structural maturity mismatches and deposit concentrations, as well as improving core profitability and maintaining its capitalisation.

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

SUBORDINATED DEBT
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 Negative
Long-Term Local-Currency Issuer Default Rating at 'B'; Outlook Negative
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)'
National Long-Term Rating for proposed senior unsecured debt at 'BBB+(lka)(EXP)'

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

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

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

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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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.

Additional information is available on www.fitchratings.com

Applicable Criteria
Global Bank Rating Criteria (pub. 15 Jul 2016)
(https://www.fitchratings.com/creditdesk/reports/report_frame.cfm?rpt_id=884135)
Global Non-Bank Financial Institutions Rating Criteria (pub. 15 Jul 2016)
(https://www.fitchratings.com/creditdesk/reports/report_frame.cfm?rpt_id=884128)
National Scale Ratings Criteria (pub. 30 Oct 2013)
(https://www.fitchratings.com/creditdesk/reports/report_frame.cfm?rpt_id=720082)

Additional Disclosures
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