Lanka Rating Agency

Rating Report

Vallibel Finance PLC

Report Contents

Rating History

Dissemination Date	Long Term Rating	Outlook	Action	Rating Watch
13-May-2024	BBB+	Stable	Maintain	-
28-Feb-2023	BBB+	Negative	Initial	-

Rating Rationale and Key Rating Drivers

Vallibel Finance PLC (“VFIN” or “the Company”) is a licensed finance company primarily focusing on leases, vehicle loans, auto drafts, and gold loans in Sri Lanka. It is a mid-sized player in the LFC industry with assets comprising ~5.2% of the total industry. The rating reflects the Company's extensive outreach, superior asset quality (VFIN NPLs are well below the industry average) and improving profitability. Although VFIN's profitability has improved on YoY basis, it still remains below its profitability in FY22. The profitability is expected to remain stable given reduced interest rates and potential repricing of assets/liabilities leading to better interest margin. On the product mix side, auto drafts, vehicle loans and leases make up ~73% of the total lending portfolio as at 9MFY24. The Company intends to build its vehicle loan and gold loan portfolio further as a strategic move. The gross NPL remains lower than the industry, but the NPL of the leasing portfolio remains relatively high due to stagnation of the product. Majority of the loan portfolio is short-term in nature and would be repriced accordingly. Rating incorporates adequate capitalization and Tier I Capital Adequacy ratio (~15.2%) and total Capital Adequacy ratio (~19.8%) during 9MFY24, which is above the regulatory requirement but is on the lower end when compared to industry average. The gearing ratio remains high (9MFY24: ~6.1; FY23: ~6.2x). The asset liability mismatch is positive in the short where ~35% of advances and ~78% of the investment in government securities are maturing, while it is negative in the long-term reflecting short-term nature of the advances portfolio.
The rating outlook has improved to "Stable" considering better profitability, sustained asset quality and other indicators including ROE and ROA. The lending portfolio was stagnant in FY23 while it has grown by ~4% in 9MFY24. The Company continues to maintain its deposits base with high retention rate.

The rating is dependent on sustaining the asset quality and improving the profitability of the Company. Strengthening capitalization and adhering to prudent lending will be critical while VFIN expands its branch network and advances portfolio. Any significant decline in profitability or adverse interest rate or market price movement leading to revaluation losses would impact the rating negatively.

Disclosure

Name of Rated Entity	Vallibel Finance PLC
Type of Relationship	Solicited
Purpose of the Rating	Entity Rating
Applicable Criteria	Methodology | Non-Banking Finance Companies Rating(Jun-22)
Related Research	Sector Study | Leasing & Finance Companies(Aug-23)
Rating Analysts	Savindri Hansamala Kuruppu | savindri@lra.com.lk | +94 114 500099

Profile

Structure Vallibel Finance PLC (the "Company" or "VFIN") is a public limited liability company incorporated in Sri Lanka, regulated under the Finance Business Act No. 42 of 2011. It has been listed on the Colombo Stock Exchange since 2010.

Background Prior to the acquisition by Vallibel Investment (Pvt) Limited (the parent company) in 2005, it was known as Rupee Finance Company Limited. VFIN has a wholly owned subsidiary, Vallibel Properties Limited, formed to manage the construction and maintenance of the new corporate office building.

Operations VFIN is engaged in providing financial solutions and offering products and services, such as leasing, vehicle loans, auto drafts, gold loan and fixed deposits.

Ownership

Ownership Structure VFIN is a listed company. Vallibel Investments (Pvt.) Limited is the major shareholder with ~51.44% followed by Mr. Dhammika Perera (~21.4%) and Mr. Anuradha Perera (~3.62%), who is the current Chairman. Altogether the Perera family owns ~78% of the stake as at 9MFY24.

Stability Vallibel Investments (the parent company) with equal proportions is owned by Ms. K. A. D. B. Perera and Ms. K. A. D. K. Perera, daughters of Mr. Dammika. The succession has taken place as the next generation of Mr. Dammika is about to reign over the business affairs, hence considered stable.

Business Acumen The primary objective of Vallibel Investments is to offer financial services and activities. Vallibel Group is also well renowned in the financial sector.

Financial Strength Vallibel Group is well established and positioned in the market. The Group has supported VFIN during the crisis period in order to strengthen the Tier II capital by way of subordinated debt.

Governance

Board Structure Vallibel Finance PLC board consists of six members. Out of which three are Independent, Non-Executive directors. Mr. K. D. A. Perera is the Chairman. The Board has appointed Mr. J. Kumarasinghe as a Senior Independent Director since the Chairman is Non-Independent. During the year two Directors completed their tenor and resigned while one director joined the Board.

Members' Profile The Board consists of personnel with extensive knowledge, expertise and experience in different business fields giving the Company a competitive edge within the industry. The Chairman holds directorships under several private sector companies that fall under the Vallibel group.

Board Effectiveness VFIN operates with four board committees. Twelve meetings were held during FY23 and the attendance was satisfactory.

Financial Transparency The external audit was carried out by KMPG Chartered Accountants, and they have issued an unqualified audit opinion with regard to the Company's annual financial statements for FY23.

Management

Organizational Structure The Company has a well-defined organizational structure with 8 divisions. The final authority lies with the Managing Director.

Management Team The Management team is well experienced and knowledgeable, steered by Mr. S. B. Rangamuwa, who is the Managing Director.

Effectiveness VFIN effectively manages the Company operations through 3 management committees.

MIS The Company uses "eFinancials" as the core system. Additionally, it uses a MIS system to generate MIS reports and run its everyday operations. In addition, KTMS is used to monitor transactions for anti-money laundering purposes.

Risk Management Framework VFIN has a formal and comprehensive risk management policy in place and adherence is ensured by the IRMC and Audit Committee.

Business Risk

Industry Dynamics At present, there are ~34 LFCs in Sri Lanka, out of which, ~27 are listed. The net interest income has declined in FY23 by ~10% to LKR~115bn and during 9MFY24 it has improved by ~20% to LKR~102bn compared to 9MFY23. Similarly profit after tax saw a decline of ~47% to LKR~31.5bn in FY23 and it was LKR~34.8bn in 9MFY24. The total asset base of the LFC sector stood at LKR~1.6tn and LKR~1.7tn as at FY23 and 9MFY24 respectively. The gross and net NPLs deteriorated to ~17.8% and ~12% by 9MFY24 mainly due to change in NPL classification to ~90 days past due (DPD) from ~120 DPD.

Relative Position VFIN represents ~3% of equity in the LFC industry for 9MFY24. The Company asset base contributes to ~5.2% of the industry assets in 9MFY24 which is an improvement from ~4.7% in FY23. VFIN loan and advance in FY23 was ~5.3% and this increased to ~5.5% in 9MFY24. The deposit base also increased to ~6% in 9MFY24 compared to ~5.5% in FY23.

Revenues Net Interest Income (NII) of the Company indicates a decline of (~18.15%) to LKR~4,662mn in FY23. But in 9MFY24 the NII has improved by ~62% to LKR~5,276mn compared to 9MFY23. The Net Interest Margin (NIM) has declined in FY23 to ~5.94% from ~7.75% in FY22. But it has picked up again slightly in 9MFY24 to ~6.51%. Interest spread has gone down in FY23 to ~4.7% from ~8.4% in FY22 but it has picked up during 9MFY24 to ~6.1%. The average advance yield is ~22.3% for 9MFY24 and it was ~24.6% in FY23. The average cost of deposits was ~17.6% for 9MFY24 and ~16.3% for FY23. The average cost of borrowings was ~13.8% for 9MFY24 and ~16.7% for FY23.

Performance VFIN profitability has contracted by (~54%) which is the movement from FY22: LKR~2.9bn to FY23: LKR~1.3bn, but this reversed in 9MFY24 with PAT of LKR~1.4bn, an improvement of ~79%. Rising income tax levels held back potential growth in profitability. The ROA recorded as ~2.2% during 9MFY23 (FY23: ~1.7%). Moreover, the ROE increased to 9MFY24: ~16.3% (9MFY23: ~10.1%) and it was ~12.3% for FY23. The loan portfolio has grown in 9MFY24 by ~4% contributed mainly by auto draft (~11%) and vehicle loans (~16%) while the gold loans and leases have contracted by (~7%).

Sustainability According to the four-year strategic plan the NII is expected to grow by ~36% and ~34% for the next two financial years while the PAT is expected to grow by ~60% and ~45%. The lending portfolio is expected to grow by ~20% and ~12% and the lending rates to be kept at ~19% and ~18%. The gross NPLs are expected to be kept at ~6% and ~6.5%. VFIN has plans to open eight new branches each year and to introduce savings products to general public and digital services by FY25. In terms of lending portfolio, the priority is given to vehicle loans, auto drafts and gold loans (gold loans are expected to be kept below ~30% of the lending portfolio).

Financial Risk

Credit Risk VFIN's NPL levels are maintained below the industry average during the past three years and gross and net NPLs stood at ~8.8% and ~3.6% respectively. Auto drafts, and vehicle loans show low NPL levels while leases and property mortgage loans NPL has gone up during 9MFY24. The gold loan NPL has increased to ~5.6% due to planned auctions not being held and went down subsequent to auctions held in the last quarter. The top 20 advances amounted to ~3.3%.

Market Risk Assets subject to market risk ~97% of the total assets as at FY23 and the rate sensitive liabilities stood at ~97.12% of the total liabilities. As far as the Company Investments are concerned in 9MFY24 VFIN has invested ~11.7% in T-bills (FY23: ~2.6%) as a proportion of total assets. Moreover ~5.4% of total assets were placed with Banks and Other Finance companies. In addition to the interest rate risk the Company is exposed to gold price fluctuations as well.

Liquidity And Funding VFIN's majority funds are from customer deposits, in 9MFY24 it represents ~77% of total funding (FY23: ~72%) but the growth of deposit base has slowed down. The top 20 depositors in 9MFY24 accounted for ~23%. VFIN decreased its borrowing position by (~31%) from LKR~20bn to LKR~14bn in FY23. It has further been repaid to reach LKR~11bn in 9MFY24. The mix of floating and fixed interest rate borrowings stood at ~47% and ~53% as at FY23. It has LKR~4bn of contingent funding lines, in case of excessive working capital requirements. As at FY23 the trend for the positive maturity mismatch has been skewed towards short term. The advances to funding ratio was ~92.6% in 9MFY24 and ~93.2% in FY23 and it goes in line with the industry average (~97%). VFIN has given a corporate guarantee amounting to LKR~2.15bn as at 9MFY24 for Commercial Bank Ceylon PLC for borrowings obtained by Vallibel Properties Limited.

Capitalization The Tier I capital was ~15.2% and the total Capital was ~19.8% respectively in 9MFY24. This was recorded as ~14.3% and ~20% respectively in 9MFY23. The total debt to equity ratio shows 6.1x as at 9MFY24 and 6.2x as at FY23. The Company expects to maintain a 1/3 dividend payout policy in line with the related companies.

LRA

Lanka Rating Agency

LKR mln

Vallibel Finance PLC Listed Public Limited	Dec-23 9M	Mar-23 12M	Mar-22 12M	Mar-21 12M
A BALANCE SHEET				
1 Total Finance-net	61,463	60,537	66,726	47,838
2 Investments	15,428	6,848	3,332	2,289
3 Other Earning Assets	4,738	9,861	5,938	2,063
4 Non-Earning Assets	3,989	4,215	2,756	3,128
5 Non-Performing Finances-net	2,398	863	(1,061)	(92)
Total Assets	88,016	82,324	77,690	55,225
6 Funding	72,738	69,185	64,989	45,037
7 Other Liabilities	2,996	2,052	2,046	2,000
Total Liabilities	75,734	71,237	67,035	47,037
Equity	12,283	11,087	10,655	8,188
B INCOME STATEMENT				
1 Mark Up Earned	14,106	15,676	9,930	8,331
2 Mark Up Expensed	(8,830)	(11,014)	(4,235)	(4,068)
3 Non Mark Up Income	1,086	1,029	2,136	1,139
Total Income	6,361	5,690	7,832	5,402
4 Non-Mark Up Expenses	(2,664)	(2,830)	(2,461)	(1,969)
5 Provisions/Write offs/Reversals	(379)	(98)	(592)	(575)
Pre-Tax Profit	3,318	2,763	4,778	2,859
6 Taxes on Financial Services	(808)	(697)	(784)	(469)
Profit Before Income Taxes	2,510	2,065	3,994	2,390
7 Income Taxes	(1,079)	(726)	(1,082)	(662)
Profit After Tax	1,431	1,340	2,912	1,728
C RATIO ANALYSIS				
1 PERFORMANCE				
a Non-Mark Up Expenses / Total Income	41.9%	49.7%	31.4%	36.4%
b ROE	16.3%	12.3%	30.9%	21.1%
2 CREDIT RISK				
a Gross Finances (Total Finance-net + Non-Performing Advances + Non-Performing Debt Instruments) / Funding	92.6%	93.2%	105.6%	111.2%
b Accumulated Provisions / Non-Performing Advances	59.3%	78.3%	156.6%	104.1%
3 FUNDING & LIQUIDITY				
a Liquid Assets / Funding	25.7%	23.7%	13.3%	8.3%
b Borrowings from Banks and Other Financial Institutes / Funding	21.7%	26.8%	35.5%	27.2%
4 MARKET RISK				
a Investments / Equity	125.6%	61.8%	31.3%	28.0%
b (Equity Investments + Related Party) / Equity	0.0%	0.0%	0.0%	0.0%
5 CAPITALIZATION				
a Equity / Total Assets (D+E+F)	14.0%	13.5%	13.7%	14.8%
b Capital formation rate (Profit After Tax - Cash Dividend) / Equity	14.4%	8.2%	31.2%	21.1%

Credit Rating

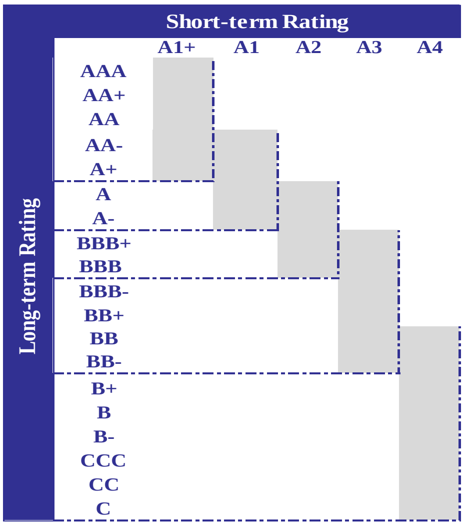
Credit rating reflects forward-looking opinion on credit worthiness of underlying entity or instrument; more specifically it covers relative ability to honor financial obligations. The primary factor being captured on the rating scale is relative likelihood of default.

Long-term Rating

Scale	Definition
AAA	**Highest credit quality.** Lowest expectation of credit risk. Indicate exceptionally strong capacity for timely payment of financial commitments
AA+ AA AA-	**Very high credit quality.** Very low expectation of credit risk. Indicate very strong capacity for timely payment of financial commitments. This capacity is not significantly vulnerable to foreseeable events.
A+ A A-	**High credit quality.** Low expectation of credit risk. The capacity for timely payment of financial commitments is considered strong. This capacity may, nevertheless, be vulnerable to changes in circumstances or in economic conditions.
BBB+ BBB BBB-	**Good credit quality.** Currently a low expectation of credit risk. The capacity for timely payment of financial commitments is considered adequate, but adverse changes in circumstances and in economic conditions are more likely to impair this capacity.
BB+ BB BB-	**Moderate risk.** Possibility of credit risk developing. There is a possibility of credit risk developing, particularly as a result of adverse economic or business changes over time; however, business or financial alternatives may be available to allow financial commitments to be met.
B+ B B-	**High credit risk.** A limited margin of safety remains against credit risk. Financial commitments are currently being met; however, capacity for continued payment is contingent upon a sustained, favorable business and economic environment.
CCC CC C	**Very high credit risk.** Substantial credit risk "CCC" Default is a real possibility. Capacity for meeting financial commitments is solely reliant upon sustained, favorable business or economic developments. "CC" Rating indicates that default of some kind appears probable. "C" Ratings signal imminent default.
D	Obligations are currently in default.

Short-term Rating

Scale	Definition
A1+	The highest capacity for timely repayment.
A1	A strong capacity for timely repayment.
A2	A satisfactory capacity for timely repayment. This may be susceptible to adverse changes in business, economic, or financial conditions.
A3	An adequate capacity for timely repayment. Such capacity is susceptible to adverse changes in business, economic, or financial conditions.
A4	The capacity for timely repayment is more susceptible to adverse changes in business, economic, or financial conditions. Liquidity may not be sufficient.



**The correlation shown is indicative and, in certain cases, may not hold.*

Outlook (Stable, Positive, Negative, Developing) Indicates the potential and direction of a rating over the intermediate term in response to trends in economic and/or fundamental business/financial conditions. It is not necessarily a precursor to a rating change. 'Stable' outlook means a rating is not likely to change. 'Positive' means it may be raised. 'Negative' means it may be lowered. Where the trends have conflicting elements, the outlook may be described as 'Developing'.

Rating Watch Alerts to the possibility of a rating change subsequent to, or, in anticipation of some material identifiable event with indeterminable rating implications. But it does not mean that a rating change is inevitable. A watch should be resolved within foreseeable future, but may continue if underlying circumstances are not settled. Rating watch may accompany rating outlook of the respective opinion.

Suspension It is not possible to update an opinion due to lack of requisite information. Opinion should be resumed in foreseeable future. However, if this does not happen within six (6) months, the rating should be considered withdrawn.

Withdrawn A rating is withdrawn on a) termination of rating mandate, b) the debt instrument is redeemed, c) the rating remains suspended for six months, d) the entity/issuer defaults., or/and e) PACRA finds it impractical to surveill the opinion due to lack of requisite information.

Harmonization A change in rating due to revision in applicable methodology or underlying scale.

Surveillance. Surveillance on a publicly disseminated rating opinion is carried out on an ongoing basis till it is formally suspended or withdrawn. A comprehensive surveillance of rating opinion is carried out at least once every six months. However, a rating opinion may be reviewed in the intervening period if it is necessitated by any material happening.

Note. This scale is applicable to the following methodology(s):

a) Broker Entity Rating
b) Corporate Rating
c) Debt Instrument Rating
d) Financial Institution Rating
e) Holding Company Rating
f) Independent Power Producer Rating
g) Microfinance Institution Rating
h) Non-Banking Finance Companies Rating

Regulatory and Supplementary Disclosure

(Rules applicable to Credit Rating Agencies, No. 19 of 2021 - issued on 15th March 2022)

Rating Team Statements

(1) Credit Rating Agency means a body corporate engaged in the business of assessing and evaluating the credit- worthiness of any issuer or a specific issue of securities. https://www.sec.gov.lk/credit-rating-agency/

Conflict of Interest

(2) i. LRA will disclose to the Commission all other business activities it is engaged in at the time of applying for its licence and inform the Commission in writing prior to engaging in any other business activity after obtaining a licence from the Commission. (Section 34 – Rules applicable to Credit Rating Agencies)

(2) ii.LRA will not engage in any other business which in the view of the Commission creates a conflict of interest unless prior written approval of the Commission is obtained. (Section 35 – Rules applicable to Credit Rating Agencies)

(2) iii.In the conduct of any such other business activity, the LRA will ensure that proper processes are in place to have a clear demarcation of the different functions pertaining to such businesses. (Section 36 – Rules applicable to Credit Rating Agencies)

Restrictions

(3) (i) LRA will not be outsource any part of its work, which has a direct bearing on the function of rating. (Section 24 – Rules applicable to Credit Rating Agencies)

(3) (ii) LRA will enter into a written agreement with the party to whom any work is outsourced. Such agreement contains an undertaking from the party to whom any work is outsourced that they shall comply with the laws, rules, and directives that the LRA is bound to follow. (Section 25 – Rules applicable to Credit Rating Agencies)

(4) The LRA will not appoint any individual as a member of the rating committee who:

(a) has a business development function of the Credit Rating Agency; or

(b) who initiates or participates in discussions regarding fees or payments with any Client of the LRA. (Section 28 – Rules applicable to Credit Rating Agencies)

Conduct of Business

(5) Prior to the commencement of a rating or during such process the LRA will not promise, assure or guarantee to a Client that a particular rating will be assigned. (Section 39 – Rules applicable to Credit Rating Agencies)

(6) LRA performs a rigorous and formal periodic review of all its methodologies. Such methodologies will be made available to the Commission for perusal, upon request. (Section 41 – Rules applicable to Credit Rating Agencies)

Independence & Conflict of interest

(7) LRA receives compensation from the entity being rated or any third party for the rating services it offers. The receipt of this compensation has no influence on LRA´s opinions or other analytical processes. In all instances, LRA is committed to preserving the objectivity, integrity, and independence of its ratings.

(8) LRA will not engage in any other business which in the view of the Commission creates a conflict of interest unless prior written approval of the Commission is obtained. (Section 35 – Rules applicable to Credit Rating Agencies)

(9) LRA will structure its rating teams and processes to promote continuity, consistency and avoid bias in the rating process. (Section 47 – Rules applicable to Credit Rating Agencies)

Monitoring and review

(10) For purposes of transparency the LRA will publish sufficient information about an entity/security rated, frequency of default and whether a rating grade assigned has changed over time. The definitions and computation methods for the default rates stated in the default studies shall also be disclosed. (Section 44 – Rules applicable to Credit Rating Agencies)

LRA maintain the following records pertaining to Clients:

(a) all internal records to support its credit rating opinions;

(b) all particulars relating to Clients at its office which shall include the name and registered address and contact numbers of such Client, names and addresses of their directors as at the date of rating, its issued share capital and the nature of business; and

(c) a written record of all complaints received from Clients and action taken thereon by the LRA. (Section 48 – Rules applicable to Credit Rating Agencies)

(11) LRA maintains confidentiality of all non-public information entrusted to it by Clients at all times including such Client's identity and transactions carried out for such Client unless and to the extent such disclosure is required by law, or unless authorised by the Client to disclose such information. (Section 50 – Rules applicable to Credit Rating Agencies)

(12) LRA does not destroy, conceal or alter any records, property or books relating to the business of the Credit Rating Agency which are in its possession or under its control with the intention of defeating, preventing, delaying or obstructing the carrying out of any examination (Section 53 – Rules applicable to Credit Rating Agencies)

Probability of Default

(13) LRA's Rating Scale reflects the expectation of credit risk. The highest rating has the lowest relative likelihood of default (i.e., probability).

Proprietary Information