Lanka Rating Agency

Rating Report

Vallibel Finance PLC

Report Contents

Rating History

Dissemination Date	Long Term Rating	Outlook	Action	Rating Watch
28-Feb-2023	BBB+	Negative	Initial	-

Rating Rationale and Key Rating Drivers

Vallibel Finance PLC (the Company or VFIN) is a licensed finance company primarily focusing on leases, vehicle loans, auto drafts, and gold loans in Sri Lanka. The ratings reflect their strong presence in the market, their perseverance in the face of turbulent economic conditions in the country. The sponsoring family is a well-established business family in Sri Lanka owning majority stake in the Company, providing them with a much-needed stability. The ownership is exhibited through the major shareholder, Vallibel Investments (Pvt) Ltd, which is owned by the Perera family. VFIN holds ~5% of the industry in terms of assets and ~3% in terms of net assets. The profitability also goes in line as VFIN holds ~5% in the industry profits. On the product mix side, auto drafts, vehicle loans and leases makes up ~70% of the total lending portfolio as at 9MFY23. Whereas ~24% of the portfolio consists of gold loans, which is becoming a preferable domain in the recent times as VFIN is focusing to enhance their credit quality. They have managed to keep their NPL below the industry average reflecting their high efficiencies in recovery. However, this has increased considerably over the last few quarters owing to unfavorable economic situation and regulatory changes. In terms of the loan book, the majority of the book is in short term and helped the Company to roll over once the interest rate has hiked suddenly. Ratings reflect strong capitalization highlighted by the Tier I Capital Adequacy Ratio which was 14.34% and Total Capital Adequacy which stood at 20.04% during 9MFY23 which is well above the requirement. This was supplemented by the LKR 1Bn subordinated term loan given by the Vallibel Group. The ALM mismatch has narrowed in the 1HFY23 to when compared to the FY22 reflecting an impact due to the volatile interest rates.
The outlook reflects deterioration in the major indicators: profitability has shrunken considerably, ROE dropped to 10.1% in 9MFY23 compared to the 27.4% in FY22, ROA has also slumped to 1.38% from 4.04% in FY22, The total debt to equity ratio is showing a thumping figure of 6.2 times. The Company has recorded gross and net NPLs of 8.5% and 4.5% respectively in 120 day NPL as at 9MFY23, though it has increased over the quarters. The lending portfolio has been stagnant in the last few quarters. The Company also has given a corporate guarantee on behalf of Vallibel Properties which is their wholly owned subsidiary.

The rating is dependent on the management's ability to navigate its way through unpredictable macroeconomic conditions while maintaining regulatory requirements and preserving asset quality. The ratings take comfort from the stability coming from its shareholding as a support from the Vallibel Group and the sponsoring family, which remains imperative for the ratings.

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(Dec-22)
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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 is listed on the Colombo Stock Exchange since 2010.

Background Prior to the acquisition by Vallibel Investment (Pvt) Ltd (the parent company) in 2005, it was known as Rupee Finance Company Ltd. 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) Ltd is the major shareholder with 51.44% followed by Mr. Dhammika Perera (21.4%) and Mr. Anuradha Perera, who is the current Chairman. Altogether the Perera family owns 78% of the stake as at 9MFY23.

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 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 seven members. Out of which five of the members are Non-Executive directors. The Board has further determined three Non-Executive directors are independent. Mr. K.D.A. Perera is the Chairman.

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, Mr. K.D.A. Perera holds directorships under several private sector companies that fall under the Vallibel group.

Board Effectiveness VFIN operates with four board committees: Audit Committee ("AC"), Remuneration Committee ("RC"), Integrated Risk Management Committee ("IRMC") and Related Party Transactions Review Committee ("RPTRC"). Twelve meetings(12) were held during FY22 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 FY22.

Management

Organizational Structure The Company has a well-defined organizational structure with 07 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. He has over 30 years with relevant experience with professional and educational background.

Effectiveness VFIN has formed 03 management committees, namely, i) Assets and Liability Management Committee ("ALCO"), ii) Credit Committee, and iii) IT Steering Committee ("ITSC").

MIS The Company uses "eFinancials" as the core system which is provided by Scienter Pvt Ltd. They also use a CRM system, "hSenid HRM", "Doxpro" and an MIS system for their daily operations and for generating MIS reports.

Risk Management Framework VFIN has a formal Risk Management Policy in place and the IRMC identifies key risk areas and manages them accordingly. The Board Audit Committee ensure adequate controls and procedure are in place to provide a reasonable assurance and external audit mitigates financial risk.

Business Risk

Industry Dynamics At present, there are 36 LFCs in Sri Lanka, out of which, 29 are listed in the CSE. The profit after tax for the six months ending September 2022 saw a decline of 11%. The loan loss provisions declined by ~LKR 6Bn in the 1HFY23 compared to the previous financial year, which aided the sector earn profits. The total asset base of the LFC sector stood at LKR 1.6Tn as at 1HFY23, which represents 5.6% of Sri Lanka's financial system. The gross and net NPLs deteriorated to ~16.81% and ~11.74% by September 2022.

Relative Position VFIN represents 3.2% of equity in the LFC and SLC industry for the FY22 however the contribution has lessened in 1HFY23, to 2.9%. The Company asset base contributes to 4.9% of the industry assets in FY22 though it has declined to 4.7% in 1HFY23. VFIN loan and advance in FY22 was 5.4% and this declined to 5.3% in 1HFY23. The deposit base declined to 5% in 1HFY23 compared to 5.1% in FY22.

Revenues YoY Net interest income of the Company indicated a growth of 33.6% in the FY22 from LKR 4.3Bn to 5.7Bn (9MFY23: LKR 3.2Bn). The Fee and Commission income has indicated a YoY 80% growth. However, investment income from Trading and Fair Value through Profit or Loss showed a significant YoY drop of 98% and 7.4% respectively in FY22. It has further done down exponentially in 9MFY23. The NIM has declined in 9MFY23 to 6.1% from 7.8% in FY22.

Performance VFIN profitability YoY growth was recorded as 68.5% which is the movement from FY21: LKR 1.7Bn to FY22: LKR 2.9Bn (9MFY23: LKR 801.1Mn). Rising income tax levels held back potential growth in profitability. Moreover, personnel expenses also surged by 68.5%. The ROA recorded as 1.4% during 9MFY23 (FY22: 4.3%, FY21: 3.2%). Moreover, the ROE increased from FY21: 23.6% to FY22: 30.9% and it was 10.1% for 9MFY23. Interest spread has gone down over the years but it has picked up during the 9MFY23 to 5.7% (1HFY23: 4.1%, FY22: 8.4%, FY21: 10.4%).

Sustainability As of now they have a strategic plan but with the current economic conditions they are forming only quarterly budgets. They are making adjustments for the existing plan in accordance with the developing market conditions. VFIN has put more focus on the Gold Loan product as a strategic decision. In the short to medium term the Company plans on maintaining the same product mix.

Financial Risk

Credit Risk VFIN's NPL levels are maintained below the industry average during the past three years. Gold Loans, Auto Drafts, Vehicle Loans and Leases show low NPL levels in FY20 to FY22 time span. But these NPLs have increased in the 9MFY23. It is evident that in FY22 Vallibel Finance PLC was focusing more on high yielding avenues gradually overtime under the prevailing economic circumstances.

Market Risk YoY growth of assets subject to market risk was recorded as 41.66% in FY22 which is 96.1% of the total assets. As far as the Company Investments are concerned in FY22 VFIN has invested 2.2% in T-Bonds (FY21: 0.0004%) in T-Bill 0.1% (FY21: nil) proportion of total assets. Since the rising inflation rate causes market rates to go up and this could dampen the risk in the short run. FVTPL investment depicts 0.40% in FY22 (FY21: 2.2%) from total assets, which consists of investment in quoted shares. Moreover 5.4% of total assets were placed with Banks and Other Finance companies (FY21: 0.5%) and 1.5% was invested in Property in the FY22 (FY21: 2%).

Liquidity And Funding VFIN's majority funds are from customer deposits, in FY22 it represents 62.9% (1HFY23: 65%). However, the Company increased its borrowing position and the YoY growth indicates as 5.8% (FY22: 30.7%, FY21: 24.9%). The total unutilized funding lines as at 31st Jan 2023 is ~LKR 3.3Bn. The weighted average cost of deposits was 20.8% and the cost of borrowings is 20.5%. As at FY22 the maturity mismatch, for the first 03 months and the 3-12 months shows a negative gap of LKR -4.2Bn and -8.5Bn respectively. In the 1-3 years bucket there is a positive gap of LKR 19.5Bn. As at 1HFY23 the trend for the maturity mismatch has continued, but the gaps have decreased. This short-term mismatch is because ~74% of the deposits are short term. Their fixed deposits renewal ratio was 81% for the FY22 which is comparatively high. The advances to funding ratio is 103% in 9MFY23 and 106% in FY22 which goes in line with the industry average.

Capitalization The Tier I capital was 10.9% and the Total Capital was 14.8% respectively in FY22. This was recorded as 14.3% and 20% respectively in 9MFY23. The total debt to equity ratio shows 6.2x in 9MFY23 (FY22: 6.1x, FY21: 5.5x).

Lanka Rating Agency *LKR mln*

Vallibel Finance PLC Listed Public Limited	Dec-22 9M	Sep-22 6M	Jun-22 3M	Mar-22 12M	Mar-21 12M	Mar-20 12M
A BALANCE SHEET						
1 Total Finance-net	61,499	61,911	62,295	66,726	47,838	40,701
2 Investments	6,356	4,771	4,420	3,332	2,289	1,183
3 Other Earning Assets	3,469	3,711	5,171	5,938	2,063	4,649
4 Non-Earning Assets	3,272	2,970	3,081	2,756	3,128	4,473
5 Non-Performing Finances-net	2,366	2,109	1,533	(1,061)	(92)	418
Total Assets	76,961	75,472	76,499	77,690	55,225	51,424
6 Funding	65,012	63,912	64,689	64,989	45,037	42,649
7 Other Liabilities	1,402	1,191	2,181	2,046	2,000	2,297
Total Liabilities	66,415	65,103	66,870	67,035	47,037	44,946
Equity	10,546	10,369	9,629	10,655	8,188	6,478
B INCOME STATEMENT						
1 Mark Up Earned	11,078	6,870	3,174	9,930	8,331	8,912
2 Mark Up Expensed	(7,830)	(4,737)	(1,839)	(4,235)	(4,068)	(4,855)
3 Non Mark Up Income	776	537	297	2,136	1,139	783
Total Income	4,024	2,670	1,632	7,832	5,402	4,841
4 Non-Mark Up Expenses	(2,103)	(1,404)	(696)	(2,461)	(1,969)	(1,911)
5 Provisions/Write offs/Reversals	(320)	(211)	(127)	(592)	(575)	(488)
Pre-Tax Profit	1,601	1,055	809	4,778	2,859	2,442
6 Taxes	(800)	(431)	(343)	(1,866)	(1,130)	(1,188)
Profit After Tax	801	623	465	2,912	1,728	1,253
C RATIO ANALYSIS						
1 PERFORMANCE						
a Non-Mark Up Expenses / Total Income	52.3%	52.6%	42.7%	31.4%	36.4%	39.5%
b ROE	10.1%	11.9%	18.3%	30.9%	23.6%	19.3%
2 CREDIT RISK						
a Gross Finances (Total Finance-net + Non-Performing Advances + Non-Performing Debt Instruments) / Funding	103.3%	105.2%	103.5%	105.6%	111.2%	100.5%
b Accumulated Provisions / Non-Performing Advances	58.4%	60.3%	66.9%	156.6%	104.1%	80.5%
3 FUNDING & LIQUIDITY						
a Liquid Assets / Funding	15.5%	13.1%	14.8%	13.8%	11.0%	18.5%
b Borrowings from Banks and Other Financial Institutes / Funding	30.5%	33.4%	34.4%	35.5%	27.2%	30.4%
4 MARKET RISK						
a Investments / Equity	60.3%	46.0%	45.9%	31.3%	28.0%	18.3%
b (Equity Investments + Related Party) / Equity	11.5%	1.5%	2.8%	2.9%	14.5%	16.7%
5 CAPITALIZATION						
a Equity / Total Assets (D+E+F)	13.7%	13.7%	12.6%	13.7%	14.8%	12.6%
b Capital formation rate (Profit After Tax - Cash Dividend) / Equity	4.1%	2.9%	-0.2%	31.2%	26.7%	15.7%

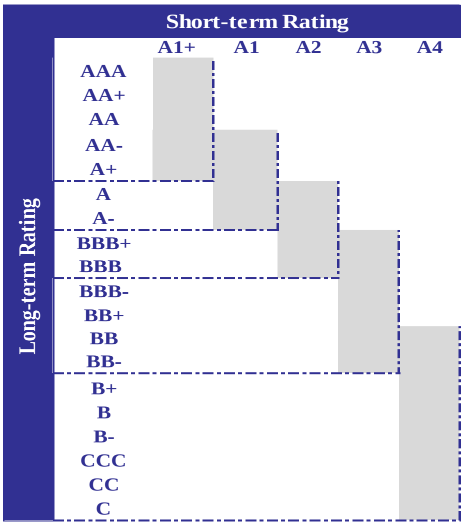
Credit Rating
Credit rating reflects forward-looking opinion on credit worthiness of underlying entity or instrument; more specifically it covers relative ability to honor financial obligations. The primary factor being captured on the rating scale is relative likelihood of default.

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

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/index.php/credit-rating-agency/)

2) **Conflict of Interest**
i. LRA shall 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 33- Draft Rules Credit Rating Agency - 2021)

Restrictions
(3) LRA is not entitled to outsource any part of its work, which has a direct bearing on the act of rating. However, if any other function other than the core function of rating is to be outsourced, such fact shall be brought to the attention of the Client and be included in the Credit Rating Agreement entered into with the Client. (Section 22- Draft Rules Credit Rating Agency - 2021)
(4) LRA cannot appoint any individual as a member of the Rating Committee who has a business development function of the Credit Rating Agency, or who initiates or participates in discussions regarding fees or payments with any Client of Credit Rating Agency. (Section 26- Draft Rules Credit Rating Agency -2021)

Conduct of Business
(5) Prior to the commencement of a rating, LRA does not promise, assure or guarantee to a client that a particular rating will be assigned.
(6) LRA performs a rigorous and formal periodic review of all its methodologies. Such methodologies shall be made available to the Commission for perusal, upon request. (Section 39- Draft Rules Credit Rating Agency -2021)

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 does not engage in any other business activity which in the view of the Commission creates a conflict of interest unless prior written approval of the Commission is obtained (Section 33- Draft Rules Credit Rating Agency -2021)
(9) LRA structures its rating teams and processes to promote continuity, consistency and avoid bias in the rating process. (Section 45 - Draft Rules Credit Rating Agency -2021)

Monitoring and review
(10) For purposes of transparency, LRA publishes 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 are also be disclosed. (Section 42- Draft Rules Credit Rating Agency -2021) LRA monitors below factors specifically, (a) all internal records to support our credit rating opinions; (b) all particulars relating to Clients at our office which shall include the name and registered address and contact numbers of such Client's, names and addresses of their Directors as at the date of rating, its issued share capital and the nature of business; and (c) a comprehensive written record of all complaints received from Clients and action taken thereon by LRA.
(11) LRA ensures confidentiality of all information at all times relating to Clients including such Client's identity and transactions carried out for such Client unless and to the extent such disclosure is required by law. (Section 48 - Draft Rules Credit Rating Agency -2021)
(12) LRA does not destroy, conceal or alter any records, property or books relating to the business of the LRA 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 51 - Draft Rules Credit Rating Agency - 2021).
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
(14) All information contained herein is considered proprietary by LRA. Hence, none of the information in this document can be copied or, otherwise reproduced, stored or disseminated in whole or in part in any form or by any means whatsoever by any person without LRA's prior written consent