

ICRA Lanka reaffirms the issuer rating of Orient Finance PLC; revises the outlook to Stable

July 12, 2021

| Instrument | Rated Amount (LKR Mn) | Rating Action |
|---------------|-----------------------|---|
| Issuer rating | N/A | [SL]BB; Outlook revised to Stable from Negative |

Rating action

ICRA Lanka Limited has reaffirmed the Issuer rating of Orient Finance PLC (OFF or the Company) at [SL]BB (pronounced SL double B). The outlook on the rating was revised to Stable from Negative.

Rationale

The revision in the outlook factors in the improvement in OFF's asset quality and profitability indicators in FY2021. OFF's gross NPA ratio reduced to 10.18% in March 2021 vis-à-vis 18.78% in March 2020, mainly due to a NPA write-off of LKR 1,422 Mn. ICRA Lanka also takes note of the improved slippages ratio which stood at 1.79% in March 2021, compared to 9.43% in March 2020, which also contributed to the reduction in the GNPA ratio. The rating factors in the net profit of LKR 193 Mn in FY2021 vis-à-vis the net loss of LKR 437 Mn in FY2020, mainly on account of lower credit costs; credit provisioning/ATA had reduced to 1.29% during FY2021 vis-à-vis 6.15% in FY2020. The rating continues to take comfort from the support derived from the parent Company, Janashakthi PLC (JPLC, rated [SL]BBB-/Negative by ICRA Lanka). JPLC had infused over LKR 1 Bn to OFF by way of a rights issue and conversion of preference shares in FY2020. With the capital support from JPLC and incremental internal generation, OFF's Tier 1 and Total capital ratios stood at 9.71% and 11.13%, respectively in March 2021; same is above the regulatory limits of 6.50% and 10.50%.

The rating also takes note of the impact of the CBSL debt moratorium and the likely effect on loan collections and the overall liquidity profile of the Company over the next 6M. Going forward, it is crucial that OFF keeps control on incremental loan slippages and continues to maintain asset quality at a comfortable level. Further, the Company's ability to meet the on-going regulatory capital requirements is also crucial from a rating point of view and will be monitored by ICRA Lanka.

Outlook: Stable

The Stable outlook reflects the improvement in the asset quality and profitability indicators of the entity. The outlook may be revised to Positive in case of further substantial improvement in the capital structure, asset quality, and earnings profile. The outlook may be revised to Negative if the asset quality and financial risk profile of OFF shows deterioration, and/or if there is less than expected capital support from the parent entity.

Key rating drivers

Credit strengths

Part of the Janashakthi Group: OFF is 93% owned by Janashakthi PLC (JPLC, rated [SL]BBB-/Negative by ICRA Lanka), the holding company of the Janashakthi group. Janashakthi Group has significant interests in the financial services sector through its controlling interests in Janashakthi Insurance PLC (life insurance), First Capital PLC (primary dealership and investment banking), and Orient Finance PLC (non-

banking financial services). JPLC has demonstrated a track record of providing capital support for OFP, in order to meet regulatory capital requirements. During FY2020, the Janashakthi group infused over 1 LKR Bn to OFP through a rights issue and a conversion of preference shares. Further, the Janashakthi group provides strategic managerial support for the NBFI, especially in terms of talent acquisition.

Improved capital profile and leverage: In March 2021, OFP's Tier 1 and Total CAR stood at 9.71% and 11.13%, respectively; same is above the regulatory limit of 6.50% and 10.50%. The Company's core capital base had improved due to the conversion of preference shares into common equity during August 2019 (LKR 547 Mn) and rights issue in January 2020 (LKR 507 Mn). The Company's net worth stood at LKR 2,886 Mn in March 2021, above the minimum capital threshold of LKR 2.0 Bn. In the near term, assuming a moderate portfolio growth (5-10%), ICRA Lanka estimates that no further equity infusions would be needed, as internal generation would be sufficient to maintain capital adequacy. The Company's reported gearing improved to 4.0 times in March 2021 vis-à-vis 4.59 times in March 2020 (6.79 times in March 2019). The gearing adjusted for revaluation and goodwill stood at 5.29 times in March 2021, compared with 6.21 times in March 2020 (10.07 times in March 2019).

Credit challenges

Asset quality indicators moderated due to a write-off, but remain in line with the systemic average: As of March 2021, the Company's Gross NPA ratio (GNPA) stood at 10.18%, compared to the systemic average of 11.32%. The GNPA had reduced from 18.78% in March 2020 largely due to a write-off of LKR 1,422 Mn. The slippages ratio improved to 1.79% in FY2021, compared to 9.43% in F2020 (8.08% in FY2019), which supported the asset quality. Further, ICRA Lanka is cognizant that OFP's portfolio is at present 98% asset-backed which provides comfort on the recoverability of facilities. The delinquencies in the 90+ dpd reduced to 20.84% in March 2021 vis-à-vis 35.01% in March 2020 (23.75% in March 2019); the provisions coverage (based on IFRS) stood at 71.7% and 70.7% in the same periods, respectively.

Negative ALM mismatch in the short-term maturity buckets; however, availability of funding and good deposit renewal rates provide comfort: As of March 2021, OFP had a negative ALM mismatch of 14.6% in the <1 year maturity bucket (11% in March 2020). Moreover, a CBSL mandated debt moratorium in effect for the period May-August 2021, is expected to keep the liquidity profile stretched. However, OFP's funding profile is dominated by fixed deposits (around 75% in March 2021); a good renewal rate (over 75%) on the FD's and availability of funding lines amounting to LKR 1.8 Bn mitigates the liquidity risk. ICRA Lanka will continue to monitor the liquidity profile, as it is a key rating driver.

Modest profitability: The Company was able to revert to profitability with a net profit of LKR 193 Mn in FY2021, compared to the net loss of LKR 437 Mn in the prior fiscal. The Company's NIM improved to 7.68% in FY2021 vis-à-vis 7.59% in FY2020, due to reduction in the average cost of funds (10.95% in FY2021 versus 13.26% in FY2020). The provisions/ATA reduced to 1.29% in FY2020 vis-à-vis 6.15% in FY2020 (3.21% in FY2019) and supported the Company's overall profitability. Driven by its NIM and lower credit costs, OFP was able to report a RoE and RoA of 6.88% and 1.26%, respectively, in FY2021. However, the ability to maintain adequate profitability in the future is dependent on keeping control on credit costs and maintaining operational efficiency; the same will be a key monitorable.

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

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

Company Profiles:

Orient Finance PLC (formerly known as Bartleet Finance PLC, BFP, prior to the acquisition of erstwhile – Orient Finance PLC and its subsequent merger process) was incorporated in 1981. The Company is a registered finance company and is licensed by the Monetary Board of Sri Lanka to accept Fixed Deposits from the public. The Company was listed on the Main Board of the Colombo Stock Exchange in June 2011.

In July 2015, BFP acquired erstwhile-Orient Finance PLC after paying close to LKR 1.70 Bn in cash and 1,213 Bartleet shares to the erstwhile-Orient Finance PLC shareholders. After the merger, the Company was renamed as Orient Finance PLC and Janashakthi PLC became the main shareholder of the Company with 99.9% shareholding. In January 2015, OFP made an initial public offer (IPO) of about LKR 1.0 Bn. Objective of the IPO was to improve the capital structure of the Company and settle the short term loan obtained from Orient Capital Limited (a fully owned sub-subsidiary of Janashakthi PLC) for the acquisition. As of March 2021, Janashakthi PLC held a 92.85% shareholding in OFP.

Recent Results

For the financial year ended March 2021, OFP reported a net profit of LKR 193 Mn on a total asset base of LKR 14.9 Bn, as compared to the net loss of LKR 437 Mn reported in FY2020, on a total asset base of LKR 15.6 Bn.

Janashakthi PLC (Parent Company)

Janashakthi PLC is an investment holding company incorporated in the year 1994. The company is owned and managed by the Schaffter family (Mr. Prakash Schaffter 50%, Mr. Ramesh Schaffter 50%). Subsidiaries include Janashakthi Insurance PLC, which is an established insurance company in Sri Lanka operating for over two decades and Orient Finance PLC, which is a listed finance company in Sri Lanka. In September 2018, JPLC also acquired a 41.1% stake in Dunamis Capital PLC (DCP), an investment holding company with exposure to the real estate and financial services sectors, and subsequently concluded a voluntary offer in December 2018 to obtain the remaining 58.9% shareholding. On October 29, 2019 shareholder approval was obtained for the amalgamation of DCP and JPLC. Full amalgamation was completed in December 2019, resulting in DCP ceasing to exist and its subsidiaries (namely, First Capital Holdings and Kelsey Development PLC) becoming the step-down subsidiaries of JPLC.

Key financial indicators of OFP - Audited

| LKR Mn | FY2019 | FY2020 | FY2021* |
|-----------------------|--------|--------|---------|
| Total Income | 3,493 | 3,285 | 2,679 |
| Operating Profit/Loss | 95 | (426) | 259 |
| Profit After Tax | 29 | (437) | 193 |
| Reported Net Worth | 2,166 | 2,710 | 2,886 |
| Borrowings | 14,706 | 12,442 | 11,535 |
| PAT/ATA | 0.16% | -2.65% | 1.26% |
| Gross NPA | 10.96% | 18.78% | 10.18% |
| Total CAR | 8.54% | 11.66% | 11.13% |
| Gearing- reported | 6.8 | 4.6 | 4.0 |
| Gearing- adjusted | 10.1 | 6.2 | 5.3 |

*Unaudited

Rating history for last three years:

| Instrument | Current Rating (CY2021) | | | Chronology of Rating History for the past 3 years | | |
|---------------|-------------------------|-----------------------------|-------------------------|---|-------------------------|-------------------------|
| | Amount Rated (LKR Mn) | Amount Outstanding (LKR Mn) | Date & Rating in FY2022 | Date & Rating in FY2021 | Date & Rating in FY2020 | Date & Rating in FY2019 |
| | | | Jun 2021 | Jul 2020 | Aug 2019 | Oct 2018 |
| Issuer rating | N/A | N/A | [SL] BB; Stable | [SL] BB; Negative | [SL] BB+; Negative | [SL] BB+; Negative |



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