Lanka Rating Agency

Rating Report

Alliance Finance Company PLC

Report Contents

Rating History

Dissemination Date	Long Term Rating	Outlook	Action	Rating Watch
02-Apr-2024	BBB-	Stable	Maintain	-
10-Feb-2023	BBB-	Stable	Initial	-

Rating Rationale and Key Rating Drivers

Alliance Finance Company PLC ("AFC" or "the Company") is a Licensed Finance Company (LFC) listed on the Colombo Stock Exchange since 1959. It is relatively a mid sized player in the LFC industry with assets comprising ~3.4% of total industry. AFC being the oldest finance company in the country has adopted the Triple Bottom Line (TBL) philosophy in 2012 and plans to develop its products in line with these values driven to a sustainable business mandate. The rating reflects the Company's known brand and sustained performance over the years. AFC's profitability remains constrained due to relatively small ticket size as three-wheeler segment has the highest contribution (~28%) in advances portfolio. The Company currently records Capital Adequacy Ratio (CAR) of ~13.66% as of 9MFY24 (FY23: ~16.55%), moderately above the ~12.5% Central Bank of Sri Lanka (CBSL) statutory requirement, but it remains on the lower side as compared to its peer companies. The NPLs ratio is below industry average but increased to ~15.29% in 9MFY24 (FY22: ~3.64%; FY23: ~13.12%) due to change in classification of Days Past Due from 180 to 90 days and pressure on certain segments. AFC's Net Interest Income (NIM) increased to LKR~4bn in 9MFY24 compared to LKR~3.6bn in 9MFY23, a growth of ~12.5% YoY. Similarly, AFC's net profit stood at LKR~505mn in FY23 and LKR~493mn in 9MFY24. With declining interest rates, AFC is expected to reprice its liabilities to strengthen its NIM. The Company intends to expand its operations on the 4-wheeler segment, going forward. Stiff competition is expected in the segments as other LFCs also target growth. AFC will face fierce competition. AFC intends to build on its triple bottom line initiatives and introduce more products to enhance its presence.

The rating is dependent on successful completion of envisioned growth plans on asset and liabilities side. Similarly, sustaining profitability trends and improving asset quality indicators remain critical. Diversification in advances portfolio with high margins and better profitability and improvement in CAR will impact the rating positively.

Disclosure

Name of Rated Entity	Alliance Finance Company 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	Gayani Randima Ariyawansa | gayani@lra.com.lk | +92-42-35869504

Profile

Structure Alliance Finance Company PLC (AFC or the Company) was incorporated as a public company in 1956 under the provisions of the Companies Ordinance No. 51 of 1938 and re-registered under the Companies Act No. 07 of 2007. It was listed on the Colombo Stock Exchange (CSE) in 1959.

Background AFC is one of the oldest Finance Companies in Sri Lanka, with 66 years in the industry. It formally adopted the Triple Bottom Line ("TBL") philosophy in 2012.

Operations The principal business activities include acceptance of fixed and savings deposits and granting term loans, gold loans, and other credit facilities, leasing, vehicle trading and hiring services.

Ownership

Ownership Structure The largest shareholder of the Company is Mr. R K E P De Silva, with an ownership of 35.22%. He is also the Deputy Chairman (DC) and the Managing Director (MD) of the Company.

Stability Mr. R K E P De Silva was appointed to the Board in 1990 and serves as a non-executive director in AFC's associates and subsidiaries.

Business Acumen Mr. De Silva is a Fellow of the Institute of Credit Management. He also holds directorships in many companies and is also a member of multiple professional bodies.

Financial Strength AFC currently does not have a need for capital infusion. However, the sponsors are willing and able to provide financial support if AFC needs it.

Governance

Board Structure The Board has seven directors, out of which four are independent non-executive directors and three are executive directors. Mrs. Dharmakirti-Herath leads the Board members since 2020.

Members' Profile The Executive directors, has experience in Non-Banking Financial institutions (NBFI), micro financing, investment banking and marketing, both locally and internationally. The non-executive directors possess a wealth of experience in sectors such as healthcare, financial services, brand building, strategic planning and law.

Board Effectiveness The Company has formed four board sub-committees, namely, Board Audit Committee (BAC), Board Integrated Risk Management Committee (BIRMC), Related Party Transactions Review Committee (RPTRC) Board Remuneration Committee (BRC).

Financial Transparency The external auditors of the company, Baker Tilly Edirisinghe & Co, issued an unqualified audit opinion pertaining to the annual financial statements for FY23.

Management

Organizational Structure The head of the organization remains on the Board of Directors. Four divisions in the Company report directly to Mr. De Silva. Other departments report to Mr. De Silva through the relevant Executive Directors.

Management Team The management team is headed by Mr. De Silva. The Managing Director is supported by a team of executive directors, Chief Experience officers (CXOs), assistant general managers, and a team of managers for different functions and areas. The Company has a large corporate and middle management. They have acquired decades of experience in their respective careers.

Effectiveness AFC has formed seven management committees to run the operations smoothly in the Company.

MIS The Company is planning to move into a new core banking system. It is planning to move into the Finacle core banking solution, Lime front-end workflow engine and the Microsoft Dynamics system for the general ledger by July/August 2024.

Risk Management Framework The internal audit department follows a comprehensive audit plan where all branches are audited at least once a year, while the gold loan divisions are audited twice a year. The risk management division focuses mainly on credit risk, market risk, and liquidity risk.

Business Risk

Industry Dynamics There are 36 Licensed Finance Companies (LFCs) in Sri Lanka, out of which 27 are listed on the CSE. The Profit After Tax (PAT) of LFC and Specialized Leasing Companies sector for 9MFY24 stood at LKR 34.8bn. The interest income and interest expense stood at LKR 306.7bn and LKR 191.8bn in 9MFY24, respectively. The total asset base of the LFC sector stood at LKR 1.6tn as in FY23 and 9MFY24 as well. Subsequent to FY18, the asset quality of the sector deteriorated to a gross Non-Performing Loan (NPL) ratio of 16.01%, in FY23 from 5.9% in FY18. As a result of the current macroeconomic challenges in the country, the gross and net NPL ratio have further deteriorated to 17.79% and 12.01%, respectively, during 9MFY24.

Relative Position AFC is considered as a medium sized Licensed Finance Company and accounts for 3.4% of the assets and 2.5% of the deposits in the sector, as at 9MFY24. AFC's net loans and advances account for 3.7% of the loans and advances in the sector in 9MFY24.

Revenues AFC earned a net interest income of LKR ~4.0 bn (FY23: LKR ~4.5 bn), in 9MFY24, which is a ~12.5% increase since the same quarter of previous financial year. Interest income improved by ~10.3% to LKR ~9.7 bn (FY23: LKR ~11.9 bn) in 9MFY24 compared to 9MFY23. Interest expense increased by ~8.8% to LKR ~5.7 bn (FY23: LKR ~7.4 bn) in 9MFY24 compared to 9MFY23. The growth in interest income was as a result of the loans and advances portfolio increasing by ~11.3% to LKR ~43.4 bn, in 9MFY24 from LKR ~39.0 bn in 9MFY23, which resulted in the improvement in interest income from loans and advances. The core spread was maintained at ~9.4% in 9MFY24 and ~4.2% in FY23 however it was at ~11.1% in FY22.

Performance The Company's PAT increased by ~95.3% to LKR ~492.6 mln in 9MFY24 from LKR ~252.2 mln in 9MFY23. This increase is due to growth in interest income and net fee and commission income. However, the PAT in FY23 declined by ~65.5% to LKR ~504.9 mln from LKR ~1.5 bn in FY22. The decline was due to the considerable increase in interest expenses outpacing the growth in interest income driven by margin compression due to increase in cost of funds in line with market rates. ROE and ROA as at 9MFY24 stood at ~9.2% and ~1.2%.

Sustainability The Company plans to develop a diversified portfolio, increasing portfolio value from LKR ~42 bn to LKR ~73 bn while reducing the over reliance of mobility solutions from ~80% to ~65% by FY25/26. The Company plans to support the financial value creation by increasing profit after tax to LKR ~1.8 bn while improving ROE to ~19% by FY25/26.

Financial Risk

Credit Risk The Company has maintained a gross and net NPL of ~15.29% (FY23: ~13.12%) and ~10.77% (FY23: ~8.84) respectively in 9MFY24. It has maintained gross and net NPL below industry levels over the periods. The significant increase from FY22 to FY23 is due to the Company moving to a 90-day classification since 01st April 22.

Market Risk The Company increased its investments by ~86.3% in FY23 by increasing the investments in government securities. It increased its investment in government securities in FY23 by ~108% to LKR ~3.1 bn compared to LKR 1.5 bn in FY22.

Liquidity And Funding The Company is dependent on both deposits and borrowings as it constitutes each ~50% of funding in 9MFY24. The Company's total borrowings include both local and foreign borrowings which consist of securitized borrowings and other facilities and bank overdrafts. Local borrowings accounted for ~72.6% of total borrowings while foreign borrowings accounts for ~27.4%.

Capitalization The Capital Adequacy Ratio (CAR) of the Company stood at ~13.66% as of 9MFY24 (FY23: ~16.55%) which is above the requirement of the Central Bank of Sri Lanka (CBSL).

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Alliance Finance and Company PLC	Dec-23	Sep-23	Jun-23	Mar-23	Mar-22	Mar-21
#	9M	6M	3M	12M	12M	12M
A BALANCE SHEET						
1 Total Finance-net	38,568	35,249	33,430	35,400	40,472	26,382
2 Investments	3,458	4,310	2,357	3,564	1,913	2,020
3 Other Earning Assets	5,723	5,261	4,982	5,572	1,201	1,691
4 Non-Earning Assets	4,418	4,200	4,179	4,109	4,724	3,800
5 Non-Performing Finances-net	4,849	5,244	5,608	3,603	(171)	228
Total Assets	57,017	54,264	50,556	52,248	48,140	34,122
6 Funding	47,089	44,811	41,215	43,047	38,107	26,133
7 Other Liabilities	2,626	2,436	2,305	2,243	3,352	2,173
Total Liabilities	49,715	47,247	43,521	45,290	41,459	28,306
Equity	7,302	7,017	7,035	6,958	6,681	5,816
B INCOME STATEMENT						
1 Mark Up Earned	9,679	6,291	3,065	11,947	7,852	7,172
2 Mark Up Expensed	(5,670)	(3,919)	(2,040)	(7,411)	(2,651)	(2,913)
3 Non Mark Up Income	257	163	58	175	518	309
Total Income	4,266	2,535	1,083	4,710	5,719	4,569
4 Non-Mark Up Expenses	(2,580)	(1,687)	(775)	(3,139)	(2,776)	(2,261)
5 Provisions/Write offs/Reversals	(322)	(246)	(128)	(202)	(24)	(705)
Pre-Tax Profit	1,364	602	180	1,370	2,918	1,604
6 Taxes on Financial Services	(376)	(216)	(63)	(419)	(555)	(308)
Profit Before Income Taxes	988	386	117	951	2,364	1,296
7 Income Taxes	(496)	(178)	(52)	(446)	(901)	(735)
Profit After Tax	493	209	65	505	1,463	561
C RATIO ANALYSIS						
1 PERFORMANCE						
a Non-Mark Up Expenses / Total Income	60.5%	66.5%	71.5%	66.6%	48.5%	49.5%
b ROE	9.2%	6.0%	3.7%	7.4%	23.4%	9.6%
2 CREDIT RISK						
a Gross Finances (Total Finance-net + Non-Performing Advances + Non-Performing Debt Instruments) / Funding	96.7%	95.0%	99.3%	94.7%	110.2%	109.6%
b Accumulated Provisions / Non-Performing Advances	30.4%	28.2%	25.3%	32.6%	111.2%	89.9%
3 FUNDING & LIQUIDITY						
a Liquid Assets / Funding	19.5%	21.4%	17.7%	21.0%	7.9%	12.1%
b Borrowings from Banks and Other Financial Institutes / Funding	50.2%	50.2%	47.2%	52.4%	59.2%	50.6%
4 MARKET RISK						
a Investments / Equity	47.4%	61.4%	33.5%	51.2%	28.6%	34.7%
b (Equity Investments + Related Party) / Equity	4.8%	4.2%	4.4%	3.9%	3.8%	4.6%
5 CAPITALIZATION						
a Equity / Total Assets (D+E+F)	12.8%	12.9%	13.9%	13.3%	13.9%	17.0%
b Capital formation rate (Profit After Tax - Cash Dividend) / Equity	6.2%	1.2%	3.7%	3.5%	18.2%	9.6%

Credit Rating

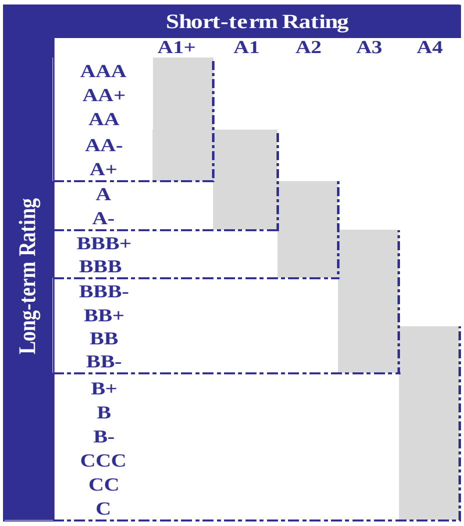
Credit rating reflects forward-looking opinion on credit worthiness of underlying entity or instrument; more specifically it covers relative ability to honor financial obligations. The primary factor being captured on the rating scale is relative likelihood of default.

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