



Lanka Rating Agency

Rating Report

Asia Asset Finance LKR 600mn Asset Backed Secured Trust Certificates

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Rating History

Dissemination Date	Long Term Rating	Outlook	Action	Rating Watch
27-Jan-2023	A	Stable	Initial	-

Rating Rationale and Key Rating Drivers

Rating of trust certificate highlights asset-backed secured structure. The certificates are secured by 130% of gold loan receivables with a lien in name of the trustee. Ratings take comfort from the fact that most of the loans which are used as security behind have an LTV of ~70% and the Company has the ability to auction gold as soon as LTV reaches 90% or payments are delayed. Consequently, debentures are rated one notch above the entity. As an entity, Asia Asset Finance PLC (the Company or AAF) is a licensed finance company primarily focusing on Gold Loans in Sri Lanka. The ratings reflect strong sponsor support from Muthoot Finance. Muthoot Finance is a leading Gold loan provider in India with over 80 years of experience and has continued to provide both technical and financial support to the Company. Strong technical support in terms of audits and operations from Muthoot finance, lowers operational risk and improves performance. Despite better operational efficiencies in recent years, overall profitability remains low a factor of lower net interest margins due to lower margin yielding gold loans. The Company has lower credit risk owing to a higher concentration of asset-backed gold loans although the legacy book of unsecured leasing keeps the gross NPL number higher at ~10%. On the other hand, 67% of the book consists of gold loan which has an NPL of only ~0.02% and LTV of ~77%. The Company plans to increase its share in gold loans to up to 90% which is expected to further improve credit quality. 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 been hiked suddenly. Ratings reflect strong capitalization highlighted by equity which remains above the required LKR 2.5Bn and the Capital Adequacy Ratio which was 25.44% as at 1HFY23 and 27.77% in FY22 which is well above the requirement.

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. Stability in the shareholding and support from Muthoot finance will remain critical for the ratings.

Disclosure

Name of Rated Entity	Asia Asset Finance LKR 600mn Asset Backed Secured Trust Certificates
Type of Relationship	Solicited
Purpose of the Rating	Debt Instrument Rating
Applicable Criteria	Methodology Structured Finance Rating(Jun-22)
Related Research	Sector Study Leasing & Finance Companies(Jun-22)
Rating Analysts	Savindri Hansamala Kuruppu savindri@lra.com.lk +94 114 500099

Profile Asia Asset Finance PLC ("the Company" or "AAF") is a public limited liability company incorporated and domiciled in Sri Lanka and listed on the Colombo Stock Exchange. The principal activities of AAF are accepting deposits and giving loans and advances. The Company branch network consists of 59 branches as of FY22.

Ownership MFL holds the largest shareholding of Asia Asset Finance PLC with 72.9% of the total stake. The second largest shareholder is Senthilvel Holdings (Pvt) Ltd (Seylan Bank – Margin Trading) with 6.2% and 3.6% is owned by J.B. Cocoshell (Pvt) Ltd. MFL provides the mainstay for Asia Asset PLC operations. MFL has been increasing its shareholding since 2014 and it plans to hold it for long term which brings stability for the Company's shareholding. MFL is the largest Gold Loan company in India and they have been operating the Gold Loan product for over 80 years successfully. The Company does not have any guarantees or commitments from the parent company. MFL has injected cash through a rights issue to AAF. Although there is no written commitment, the previous track record shows that MFL is willing to inject cash if and when needed.

Governance The Board consists of eight members where three are Non-Independent and Non-Executives Directors and four are Independent and Non-Executive Directors as of the end of FY22. The remaining is the CEO. The Board members in possess experience and knowledge in many fields. The Company Chairman Mr. V. A. Prasanth also holds an Independent, Non-Executive Directorship. AAF consists of six board committees. To ensure financial transparency the Company has an independent internal audit function and an external audit function in place. The external audit was carried out by BDO Chartered Accountants and they issued an unqualified audit opinion with regarding the Company's annual financial statements for FY22.

Management The Company has a functional organizational structure. The CEO of the Company steers some key functions while the COO and GM handle the other functions both of whom report directly to the CEO. The management team of the Company is steered by the CEO, Mr. Rajiv Gunawardena. He possesses overall 16 years of experience and qualifications. He has held the current position for about 12 years. AAF has formed Assets & Liability Management Committee to manage various risks. The senior management and department heads meet bi-monthly. The Company uses a comprehensive core system, a mobile wallet and a ERP system. AAF has a formal risk management policy in place.

Business Risk At present, there are 36 LFCs in Sri Lanka, out of which, 29 are listed in the CSE. The PAT for the six months ending September 2022 saw a decline of 11%. The loan loss provisions declined by ~LKR 6Bn in the six months to September 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 1H FY23, 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. AAF represents 1.2% of asset base with comparison to the industry in FY22. The loans and advances portfolio of the Company demonstrates a slight increase to 1.3% in FY22. The equity base only accounts for 0.8% in the industry. The Company funding from deposits and borrowings represents 1.1% and 2.1% respectively in FY22. Net interest income has recorded a decline of 0.9% in FY22. However, in 1H FY23 the net interest income illustrated an increase of 101.5% in comparison to 1H FY22. The NIM was 5.1% for 1H FY23. The core spread of the Company went up in 1H FY23 to 10% from 8.1% in FY22. The interest income received from Gold Loans was 59.4% in FY22. The Gold Loan portfolio concentration has increased over time to 67.4% in FY22. In FY22 the YoY rise in profit of 162.33% (PAT for FY22: LKR 119Mn and FY21: LKR 45Mn) and has shown a major increase in 1H FY23 of 333.55% (1H FY23: LKR 150Mn, 1H FY22: LKR 35Mn). Over the year of FY22 major expenses such as personnel and general administration expenses have increased by 20.7% and 9.1% respectively. The growth in fees and commission income in FY22 which recorded an increase of 177.1%. The Company ROE was at 4% for the FY22 and EPS has improved to 0.95 in FY22. With the synergies gained from the parent company AAF is planning on moving towards a product portfolio where 90% is Gold Loans which requires lower provisioning resulting in higher profits. In the event gold prices goes down NPLs are expected to increase. The Company has decided to expand the branch network up to 100 branches by 2024.

Financial Risk The gross NPL of AAF improved to 12.5% in FY22 which is moderately higher than the industry. Nevertheless, it has gone down to 10.2% in 1H FY23 which is lower than the industry. The top 10 advances concentration is minimum at 3.6% as at 1H FY23. The exposure to leasing and loans has reduced over the years, while the exposure to pawning has increased. AAF continued to bring down the overall exposure to unsecured portfolio. Currently, AAF has a weighted average LTV of 77.9% during 1H FY23. The Company is exposed to interest rate risk via short term investments and the savings accounts with banks have increased FY22. AAF's investment on Re-Repo agreements increased in FY22 by 51.1% savings accounts with banks in foreign currency has increased by 48.4% in FY22. The highest funding is from customer deposits and in FY22 it increased by 23.9%. The advances over funding ratio stood at 101.3% in 1H FY23. Moreover, bank borrowings and debentures have also increased. The total liquid assets increased by 44.1% in FY22 mainly. Further its deposit renewal ratio in FY22 was stated as 98%. The majority of the loans are short term and deposits in the medium to long term which creates a positive maturity gap. The Capital Adequacy Ratio was 25.4% as of 1H FY23 and 27.8% in FY22 which is well above the requirement. It was also noted the Company was able to infuse capital of LKR 414Mn via an issue of preference shares in FY22 and LKR 151Mn via a rights issue of ordinary shares in FY20. The Company has made two debenture issues during the past two years; LKR 1Bn in Oct FY21, and LKR 1Bn in Aug FY22.

Instrument Rating Considerations

About The Instrument AAF has raised LKR 600Mn by securitizing Gold Loan receivables. The tenure of the securitization is for a period of 3 years. The trust certificate was issued in three tranches. The coupon rates are fixed at 10.15% and 10% for tranche 1, 10% for tranche 2 and 12.50% for tranche 3 and will be paid annually. The issue date is 07th October 2021 and they were issued to several entities. The objective of the issue is for the purpose of supporting the expansion of Gold Loan portfolio.

Relative Seniority/Subordination Of Instrument In the event of winding up the claims of the certificate holders, shall rank above any subordinated debt, the ordinary voting and non-voting shareholders and preference shareholders of the Company.

Credit Enhancement This is secured by Gold loan receivables up to of 130% of the face value of the trust certificates and interest. The cash collection will be handled by AAF and in the case of default the Trustee will collect the receivables. The first coupon payment started in October 2022 and the last payment will go out in October 2024. The capital repayment will be done at the end of the tenor.



Lanka Rating Agency

Asia Asset Finance PLC
Listed Public Limited

LKR mln

Sep-22
6M

Mar-22
12M

Mar-21
12M

Mar-20
12M

A BALANCE SHEET

1 Total Finance-net	14,479	12,186	9,924	9,575
2 Investments	324	360	377	400
3 Other Earning Assets	3,142	2,265	1,525	1,285
4 Non-Earning Assets	870	904	1,038	830
5 Non-Performing Finances-net	3,385	3,627	2,486	3,064
Total Assets	22,200	19,342	15,350	15,155
6 Funding	19,054	16,473	13,058	12,857
7 Other Liabilities	270	113	70	127
Total Liabilities	19,324	16,586	13,128	12,983
Equity	2,877	2,756	2,222	2,171

B INCOME STATEMENT

1 Mark Up Earned	2,311	2,576	2,725	3,044
2 Mark Up Expensed	(1,398)	(1,324)	(1,462)	(1,704)
3 Non Mark Up Income	321	607	230	289
Total Income	1,234	1,858	1,492	1,628
4 Non-Mark Up Expenses	(718)	(1,127)	(978)	(1,100)
5 Provisions/Write offs/Reversals	(270)	(493)	(383)	(382)
Pre-Tax Profit	245	239	132	147
6 Taxes	(95)	(120)	(87)	(77)
Profit After Tax	150	119	45	70

C RATIO ANALYSIS

1 PERFORMANCE

a Non-Mark Up Expenses / Total Income	58.2%	60.6%	65.5%	67.6%
b ROE	10.7%	4.8%	2.1%	3.2%

2 CREDIT RISK

a Gross Finances (Total Finance-net + Non-Performing Advances + Non-Performing Debt Instruments) / Funding	101.3%	105.3%	107.5%	107.6%
b Accumulated Provisions / Non-Performing Advances	29.8%	29.7%	39.5%	28.1%

3 FUNDING & LIQUIDITY

a Liquid Assets / Funding	17.1%	14.5%	12.7%	10.7%
b Borrowings from Banks and Other Financial Institutions / Funding	35.2%	33.4%	36.8%	47.8%

4 MARKET RISK

a Investments / Equity	11.3%	13.0%	17.0%	18.4%
b (Equity Investments + Related Party) / Equity	0.0%	0.0%	0.0%	0.0%

5 CAPITALIZATION

a Equity / Total Assets (D+E+F)	13.0%	14.2%	14.5%	14.3%
b Capital formation rate (Profit After Tax - Cash Dividend) / Equity	10.9%	5.3%	2.1%	3.2%

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.

Scale	Long-term Rating Definition
AAA	Highest credit quality. Lowest expectation of credit risk. Indicate exceptionally strong capacity for timely payment of financial commitments
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.
AA-	
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.
A-	
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.
BBB-	
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.
BB	
BB-	
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.
B-	
CCC	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.
CC	
C	
D	Obligations are currently in default.

Scale	Short-term Rating 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 surveil 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

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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

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Regulatory and Supplementary Disclosure

Nature of Instrument	Size of Issue (LKR)	Tenor	Security	Quantum of Security	Nature of Assets	Trustee	Book Value of Assets as at FY22 (Gold Loan) (LKR mn)
Asset backed secured Trust Certificates	600Mn	3 Years (2021/2024)	Gold Loan Receivables	130% of the face value of the trust certificate	Gold	Hatton National Bank PLC	LKR 11.6Bn

Name of Issuer	Asia Asset Finance PLC
Issue Date	October 7, 2021
Maturity	3 Years
Coupon Basis	10.15% payable annually 10.00% payable annually 12.50% payable annually
Repayment	Bullet repayment at maturity with annual coupon payment
Option	NA

Asia Asset Finance PLC

Due Date Principal	Opening Principal	Principal Repayment	Coupons Due Date	Fixed Rate	Coupon	Principal Outstanding		
	LKR				Oct-21	LKR		
Tranche 1					Fixed			
07-Oct-21	450,000,000	-						450,000,000
07-Oct-22		-	07-Oct-22	10.15%	10.15%			
07-Oct-22		-	07-Oct-22	10.00%	10.00%			
07-Oct-23		-	07-Oct-23	10.15%	10.15%			
07-Oct-23		-	07-Oct-23	10.00%	10.00%			
07-Oct-24		-	07-Oct-24	10.15%	10.15%			
07-Oct-24		450,000,000	07-Oct-24	10.00%	10.00%			
Tranche 2					Fixed			
25-Oct-21	100,000,000	-						100,000,000
25-Oct-22		-	07-Oct-22	10.00%	10.00%			
25-Oct-23		-	07-Oct-23	10.00%	10.00%			
25-Oct-24		100,000,000	07-Oct-24	10.00%	10.00%			
Tranche 3					Fixed			
07-Dec-21	50,000,000	-						50,000,000
07-Dec-22		-	07-Dec-22	12.50%	12.50%			
07-Dec-23		-	07-Nov-23	12.50%	12.50%			
07-Dec-24		50,000,000	07-Nov-24	12.50%	12.50%			