Lanka Rating Agency

Rating Report

Multi Finance PLC

Report Contents

Rating History

Dissemination Date	Long Term Rating	Short Term Rating	Outlook	Action	Rating Watch
02-Jun-2023	B-	A4	Negative	Initial	-

Rating Rationale and Key Rating Drivers

The rating of Multi Finance PLC (MFC or the Company) takes into consideration its small size, accounting for approximately 0.1% of the equity in the industry. The negative outlook on the rating reflects pending litigation regarding the transfer of shares to LB Finance PLC. The overall entity rating reflects the potential ability of the sponsor, LB Finance PLC, to support MFC. LB Finance PLC holds a prominent position in the Non-Banking Financial sector, providing strategic direction to the Company. However, due to the pending transfer of shareholding, it remains uncertain whether LB Finance PLC will provide the necessary capital infusion to meet regulatory requirements. The economic turmoil in the country has further deteriorated the Company's performance, with a Net Interest Income of LKR 68mn (FY22: LKR 86mn) as of FY23. The Company's asset quality remains poor, with high levels of Non-Performing Loans (NPLs), indicated by Gross and Net NPLs of approximately 56% (FY22: approximately 53%) and 7% (FY22: approximately 12%) respectively, as of FY23. MFC has followed the impairment guidelines of LB Finance PLC and has prudently provided for its NPLs. Going forward, MFC will focus on Gold Loans, Leasing, and Auto Financing as its primary business segments under the guidance of LB Finance PLC. However, it is important to note that MFC has not adhered to the regulatory requirement of core capital, with a core capital of LKR 295mn as of FY23, while the regulatory requirement stands at LKR 2.5bn. MFC has submitted a four-year plan to the Central Bank of Sri Lanka (CBSL) to meet the core capital requirement by FY27 and is currently awaiting approval.

Ratings of the Company remains dependent upon adhering to the minimum capital requirements. Any future rating movement will rely on the improvement in the size of the Company while enhancing the asset quality of the book.

Disclosure

Name of Rated Entity	Multi 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)
Rating Analysts	Amreetha Mahindapala | amreetha@lra.com.lk | +92-42-35869504

Profile

Structure Multi Finance PLC ("MFC" or "the Company") is a Licensed Finance Company incorporated in 1974. It was registered under the Companies Act No 07 of 2007 in 2009. The Company was listed on the Colombo Stock Exchange ("CSE") in 2011.

Background The Company was owned by Fairway Holdings (Pvt) Ltd. As at FY22. However, it was acquired by LB Finance PLC ("LB") in March 2022.

Operations The main operations of the Company include acceptance of deposits and granting loans and leases. It has a branch network of eight branches.

Ownership

Ownership Structure The Company was acquired by LB in March 2022, with ownership of ~64.63%. Entrust Holdings Limited and Mr. Palitha Peiris remain the second and third largest shareholders with ownership of ~29.9% and ~0.5% respectively. However, LB has yet to complete the acquisition of shares from Entrust Holdings which is pending due to litigation.

Stability The guidance provided by Mr. Dammika Perera and the strong structure of LB Finance PLC provides stability to the Company. The acquisition by LB further stabilizes the Company as it provides strategic guidance to the MFC.

Business Acumen L B Finance PLC has been in operations since 1971 and is one of the largest LFCs in Sri Lanka. The ultimate owner Mr. Dammika Perera is a prominent businessman in Sri Lanka who has invested in multiple and diversified business segments such as, hospitality, manufacturing, power, entertainment and banks.

Financial Strength Mr. Dammika Perera has ownership of over 20 companies, both directly and indirectly in Sri Lanka and is one of the wealthiest individuals in Sri Lanka.

Governance

Board Structure The Company has seven Non-Executive members on the board. There are no Independent Directors in the Company and it doesn't comply with the CSE regulations to have two Independent Directors. All directors are directors of LB as well. The Company is in the process to appoint independent directors.

Members' Profile Mr. G A R D Prasanna, the Chairman of the Company, is also the Chairman of LB. He holds directorships and other positions in related and unrelated companies. The Chairman is not Independent as required by the listing rules of CSE. It has not appointed a Senior Director to comply with the requirement. The other members of the Board possess years of experience which helps them guide MFC strategically.

Board Effectiveness The Company has formed four board sub-committees, namely, i) Board Audit Committee ("BAC"), ii) Board Remuneration Committee ("BRC"), iii) Integrated Risk Management Committee ("IRMC"), iv) Related Party Transactions Review Committee ("RPTRC"). The Company does not comply with the CSE listing regulations for the composition of Board sub-committees.

Financial Transparency The external auditors of the Company, KPMG issued an unqualified audit opinion pertaining to the annual financial statements for FY22.

Management

Organizational Structure The Company is divided into 12 divisions which are headed by the senior management of LB. The head of the organization remains on the Board of Directors.

Management Team The Company does not have senior management and is managed by LB Finance PLC management. The Chief Executive Officer ("CEO") Mr. Jayasundara resigned in November 2022 and has not yet appointed a replacement. Currently, the three Non-Executive Directors oversee the operations, namely, Mr. Yatawara, Mr. Udage, and Mr. Perera.

Effectiveness MFC does not have any management committees of its own in place. Therefore, the management committees in place at LB will discuss matters related to MFC. It has five management committees in place.

MIS MFC uses eFinancials as the core financial system. It has been developed by Scienter Technologies (Pte) Ltd. Subsequent to the acquisition by L B Finance PLC, the Company is transitioning to the Eclipse core system platform. MFC has implemented the Eclipse Gold Loan Management system as the initial step.

Risk Management Framework The internal audit department performs cash and gold loan audits quarterly for each branch. Once issues are identified in branches, they will be documented and circulated among process owners. The Company follows the three lines of defense. The Board of Directors is ultimately responsible for the management of risks and the overall risk appetite of the Company. It has currently identified the non-compliance with the minimum capital requirement as a major risk to the Company. The credit risk is also identified as the Company has high Non-Performing loan ("NPL") levels.

Business Risk

Industry Dynamics At present, there are 36 Licensed Finance Companies ("LFC") in Sri Lanka, out of which 28 are listed. The profitability of the sector grew by ~102% in FY22 to LKR 59,820mn. The sector profitability as of 9MFY23 is recorded at LKR 18,542mn. In comparison to 9MFY22, the interest income has increased by ~38% to LKR 222,762mn, while the net interest income shows a marginal decline of ~13% as of 9MFY23. The total asset base of the LFC sector stood at LKR 1.6tn as of 9MFY23. As a result of the current macroeconomic challenges in the country, the gross and net NPL ratios deteriorated to ~17.45% and ~12.28% respectively as of 9MFY23.

Relative Position The Company remains a small player in the industry with equity of ~0.1% (FY22: ~0.1%; FY21: ~0.2%) as of 9MFY23, compared to the total sector. The advances, asset, and equity position in the Company, compared to the sector, have reduced since FY20.

Revenues MFC has seen a reduction in its interest income since FY19 and the Company saw a ~25% decline in net interest income in FY21. The Company has not surpassed its performance of FY22 in FY23 as the Net Interest Income has reduced by ~22% to LKR 68mn.

Performance The Company has been making losses from FY13 to FY23, except for FY15. The loss in FY22 increased by ~142% to LKR 200mn as a result of the high impairment of LKR 156mn. Similarly, the core spread suffered due to the deposit cost increasing by a higher percentage in comparison to the advances yield. The Company improved its performance by reducing its loss in FY23 to LKR 5mn as a result of the large reduction in impairment.

Sustainability Along with the strategic collaboration with LB, the Company will focus on Gold Loans and Vehicle Financing.

Financial Risk

Credit Risk The Company records extremely high NPL levels and it has been increasing since FY20. The Company recorded a Gross and Net NPL of ~56% and ~7% respectively. Apart from FD loans, most loans are categorized as NPL but MFC has provided adequately for them.

Market Risk The Company has increased its investment in government securities in FY22 to LKR 10mn. The government securities make up ~12.3% as of FY22 out of its total investments. Though in line with the overall size of the company, its investments are very low.

Liquidity And Funding The advances to funding ratio increased extensively as of 9MFY23. The Top 20 depositors' concentration is quite high at ~55% as of 9MFY23. However, the concentration was recorded at ~60% in FY21, which has reduced gradually over the years.

Capitalization MFC has maintained high capital adequacy ratios of ~94% (9mFY23: ~87%) as of FY23. It has not adhered to the core capital requirement of the regulator and records a core capital of LKR 295mn as of FY23. It has provided a four-year plan to increase the capital base to LKR 2.5bn by FY26. However, it has not received the approval for the plan as of now. LB Finance will also inject capital only when it will have shares transferred from Entrust Holdings after the litigation issue is resolved. The Company is expected to remain non-compliant with capital requirements till then and will continue to have lending and deposit caps from the central bank.

Lanka Rating Agency

Multi Finance PLC	Dec-22	Mar-22	Mar-21	Mar-20
Listed Public Limited	9M	12M	12M	12M
A BALANCE SHEET				
1 Total Finance-net	303	322	542	821
2 Investments	12	81	69	69
3 Other Earning Assets	113	131	135	116
4 Non-Earning Assets	70	69	97	148
5 Non-Performing Finances-net	26	15	27	40
Total Assets	524	618	870	1,195
6 Funding	192	272	328	562
7 Other Liabilities	45	47	49	55
Total Liabilities	237	319	376	618
Equity	287	299	494	577
B INCOME STATEMENT				
1 Mark Up Earned	81	111	111	195
2 Mark Up Expensed	(28)	(25)	(43)	(83)
3 Non Mark Up Income	13	9	23	24
Total Income	67	95	91	136
4 Non-Mark Up Expenses	(76)	(139)	(147)	(213)
5 Provisions/Write offs/Reversals	1	(156)	(4)	(27)
Pre-Tax Profit	(8)	(199)	(60)	(103)
6 Taxes	(4)	(0)	(23)	(38)
Profit After Tax	(12)	(200)	(83)	(142)
C RATIO ANALYSIS				
1 PERFORMANCE				
a Non-Mark Up Expenses / Total Income	114.2%	146.1%	161.5%	156.5%
b ROE	-5.6%	-50.3%	-15.4%	-24.6%
2 CREDIT RISK				
a Gross Finances (Total Finance-net + Non-Performing Advances + Non-Performing Debt Instruments) / Funding	317.6%	227.7%	315.6%	279.2%
b Accumulated Provisions / Non-Performing Advances	91.4%	95.0%	94.4%	94.6%
3 FUNDING & LIQUIDITY				
a Liquid Assets / Funding	75.2%	54.9%	43.6%	21.5%
b Borrowings from Banks and Other Financial Institutes / Funding	1.9%	1.2%	1.0%	3.1%
4 MARKET RISK				
a Investments / Equity	4.2%	27.1%	13.9%	11.9%
b (Equity Investments + Related Party) / Equity	0.0%	0.0%	0.0%	0.0%
5 CAPITALIZATION				
a Equity / Total Assets (D+E+F)	54.7%	48.4%	56.8%	48.3%
b Capital formation rate (Profit After Tax - Cash Dividend) / Equity	-5.5%	-40.4%	-14.3%	-24.6%

Credit Rating

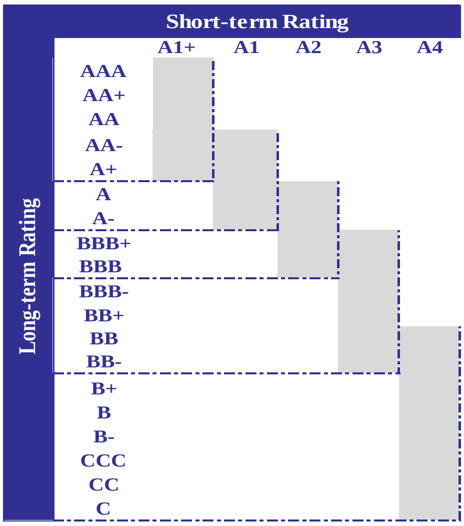
Credit rating reflects forward-looking opinion on credit worthiness of underlying entity or instrument; more specifically it covers relative ability to honor financial obligations. The primary factor being captured on the rating scale is relative likelihood of default.

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

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