Lanka Rating Agency

Rating Report

Associated Motor Finance Company PLC

Report Contents

Rating History					
Dissemination Date	Long Term Rating	Short Term Rating	Outlook	Action	Rating Watch
17-Jul-2023	BB-	-	Stable	Initial	-

Rating Rationale and Key Rating Drivers

The rating reflects the small relative position of Associated Motor Finance Company PLC (AMF or the Company) in the leasing and finance sector. The Company is primarily engaged in leasing vehicles; primarily in the 2-wheeler segment. Despite challenging economic conditions, the Company has managed to increase its leasing portfolio, a factor of the shift of people from 4-wheeler to 2-wheeler due to lower purchasing power. The net Interest Income of the Company improved due to higher lending and higher interest rates. However, prudent provisioning and change in the categorization of NPL from 180 days to 120 days lead to higher NPL impacting overall profitability. The Company booked a net profit of LKR 200mn lowering by 33% as compared to FY22. The lending book of the Company is largely categorized by asset-backed leasing products which lower credit risk. The rating reflects the Company’s adequate capital position as it meets both equity and CAR requirements with equity of ~2.9bn and CAR of ~17%. Going forward, the Company's ability to expand its portfolio, whilst maintaining its credit risk would be critical for the Company.

The rating is dependent on the Company’s ability to improve its performance while maintaining asset quality. Any significant increase in credit risk leading to higher provisioning expenses can impact the ratings.

Disclosure	
Name of Rated Entity	Associated Motor Finance Company PLC
Type of Relationship	Solicited
Purpose of the Rating	Entity Rating
Applicable Criteria	Criteria | Rating Modifiers(Jun-22),Methodology | Non-Banking Finance Companies Rating(Jun-22)
Related Research	Sector Study | Leasing & Finance Companies(Jun-22)
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Profile

Structure Associated Motor Finance PLC (“AMF ” or “the Company”) was incorporated as a limited liability company in 1962 under the Companies Act No. 51 of 1938 and reregistered under the Companies Act No. 07 of 2007. AMF was listed on the Colombo Stock Exchange in 2011. The principal place of business is located at No 89, Hyde Park Corner, Colombo 02. The Company is registered under the Finance Business Act No. 42 of 2011

Background Founded by the Late Mr. J.P.I. Piyadasa in 1962, has a history of over 6 decades. AMF acquired Arpico Finance Company PLC in 2014 and subsequently amalgamated in 2021 as part of CBSL's amalgamation plan.

Operations The principal business activities range from financial services that support personal and business needs ranging from leasing, loans, fixed deposits, and savings including Islamic finance solutions.

Ownership

Ownership Structure Dayawansa family controls close to 72.8% of the Company and hence has management control. They owns directly 47.12% and 25.65% through its wholly owned company Imperial Imports and Exports (Pvt) Ltd.

Stability Mr. J.P.I. Nalatha Dayawansa has three children. At present Mrs. A.S. Dayawansa (wife) and Mr.Shanil Dayawansa (son) are executive directors at AMF. Mr. Shanil is qualified in Management & Finance and is the executive director of lending, deposits, and marketing for AMF. The involvement of the next generation in the business provides stability and shows the long-term ownership plan of the sponsors.

Business Acumen Mr. Nalatha Dayawansa was appointed to the AMF Board in 1982 and has over 38 years of extensive experience in many industries such as Finance, Hospitality and Leisure, Garments, Exports, and Imports. Overall Dayawansa Family has decades of experience in leasing and motor finance shows the healthy business acumen of the sponsors.

Financial Strength There have been many instances where the sponsors have provided financial assistance. The sponsors contributed LKR 500mn via the rights issue held in 2021. This provides comfort that the sponsors have the ability and willingness to inject cash into the business if needed.

Governance

Board Structure The Board has nine directors, out of which, four are Independent Non-Executive directors and four are Executive directors, and one Non-Independent Non-Executive director.

Members’ Profile The Chairman, Mr. K.D.U.S. Nanayakkara, was appointed to the Board in 2015. He has over 24 years of experience in the corporate sector. The Executive directors have experience in Non-Banking Financial institutions, microfinancing, investment banking, and marketing, both locally and internationally.

Board Effectiveness The Company has formed four board sub-committees, namely, Board Audit Committee, Board Integrated Risk Management Committee, Related Party Transactions Review Committee and Remuneration Committee.

Financial Transparency The external auditors of the Company, SJMS Associates, issued an unmodified audit opinion for the annual financial statements for FY23.

Management

Organizational Structure The Company has a well-defined organization. The final authority lies with the CEO who reports to the Board of Directors.

Management Team The management team is headed by the DCEO, Mr. Chandrin Fernando. The CEO, Mr. T M A Sallay, is supported by 3 executive directors, from HR & Administration, Operation & Recoveries and Lending, Deposits and Marketing, and also Deputy CEO. The Management team is able and has decades of experience.

Effectiveness AMF has formed four management committees, namely, Assets and Liability Management Committee, Credit Committee, IT Steering Committee, and Management Committee

MIS The main core system in use is “eFinancials”. It is the leading banking and finance software solution in Sri Lanka with an impressive portfolio of clientele including some of Sri Lanka’s most successful banks and financial institutions. Its web-based, cloud-enabled platform automates all business processes specific to financial institutions and helps scale business operations. Apart from the main core system AMF uses hSenid HRIS. AMF also uses internally developed applications for certain functions

Risk Management Framework The risk management division, focuses mainly on credit risk, market risk and the liquidity risk. The divisions and branches have the responsibility to identify risks and submit risk reports to the risk management division. The risk management will then identify the most important risks to the company and develop an action plan to mitigate it. The risk reports generated by the risk management division will be shared with management and the IRMC

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 dropped by 47% in FY23 to LKR 31Bn from LKR 60Bn in FY22 In comparison to FY22, the interest income has increased by ~46% to LKR 307Bn (FY22: LKR 210Bn) mainly due to interest rate hikes. The loan loss provisions increased by ~118% to LKR 14Bn (FY22: 6Bn) in FY23.The total asset base of the LFC sector stood at LKR 1.6Tn as of FY23. Subsequent to FY21, the asset quality improved to a gross NPL ratio of ~9.11% as of FY22. The gross and net NPL ratios deteriorated to ~16% and ~11% respectively as of FY23 because of the changing the time-based classification of NPLs

Relative Position AMF accounts for ~0.98% FY23 (FY22: ~0.95%) of the assets and ~1.37% FY23 (FY22: ~1.39%) of the deposits. Apart from the above mentioned, it has been able to witness a decrease in its position with regard to loans and advances as well. In the 2-wheeler market now AMF is second in the market with 15% of the market share.

Revenues AMF earned a net interest income of LKR 1.7 bn FY23 (FY22: LKR 949 mn), which is a ~79% increase since the previous financial year. The interest income increased by 57.3% and interest expense increased by ~ 44% during FY23 to LKR 3.88 bn and LKR 2.19bn, respectively. This is due to the increase in interest rates and higher lending.

Performance AMF profitability depicts a deterioration and was recorded as LKR 200Mn in FY23 while it was LKR 299Mn in FY22 due to a significant rise in the impairment charges for lease.

Sustainability AMF’s strategic direction is focusing on increasing profitability by leveraging on high-yielding products, reducing operational costs through cost savings, optimizing synergies of the merged entity, and other strategies. As a long-term goal, AMF will actively pursue expansion by utilizing branches as regional administrative units and employing technology to expand its network and serve clients across the island.

Financial Risk

Credit Risk AMF’s gross NPL levels have remained above the industry average during the past three years and with the introduction of the new direction changing the NPL classification, the NPLs have gone up. however, as 90% of the lending book is asset-backed, it lowers credit risk.

Market Risk Largely AMF was invested in Repos however in FY23 the AMF significantly invested in TB in FY23 to LKR 2,508mn. Overall AMF has decreased its investment by 3% in FY23 compared to FY22.

Liquidity And Funding AMF’s majority of funds are from customer deposits, in FY23 it represents 99% of total funding (FY22: 94%, FY21: 79%). When considering AMF’s regulatory liquid assets to funding position it was able to perform above the industry levels in FY23 and it was at 26% while in the industry it was 19.08% in FY23.

Capitalization The Company as a LFC adheres to CBSL capital adequacy requirements that need to be fulfilled. The regulatory requirement is 8.5% for core capital and 12.5% for total capital adequacy as per the CBSL. In FY23, the Minimum core capital is LKR 2.7bn, and the AMF's T1 and T2 ratios are 16.26% and 17.24% respectively.

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ASSOCIATED MOTOR FINANCE PLC PLC	Mar-23 12M	Mar-22 12M	Mar-21 12M	Mar-20 12M
A BALANCE SHEET				
1 Total Finance-net	9,809	8,847	2,454	4,407
2 Investments	3,132	3,667	2,550	1,940
3 Other Earning Assets	-	-	-	-
4 Non-Earning Assets	1,851	2,228	882	880
5 Non-Performing Finances-net	1,231	419	605	487
Total Assets	16,023	15,161	6,492	7,714
6 Funding	12,470	11,939	5,114	6,028
7 Other Liabilities	619	523	149	453
Total Liabilities	13,088	12,461	5,263	6,482
Equity	2,935	2,699	1,229	1,232
B INCOME STATEMENT				
1 Mark Up Earned	3,881	2,468	1,107	1,339
2 Mark Up Expensed	(2,188)	(1,519)	(696)	(872)
3 Non Mark Up Income	106	113	52	121
Total Income	1,799	1,062	463	588
4 Non-Mark Up Expenses	(878)	(894)	(390)	(392)
5 Provisions/Write offs/Reversals	(414)	423	(45)	(143)
Pre-Tax Profit	507	590	27	53
6 Taxes	(306)	(290)	(33)	(30)
Profit After Tax	200	299	(6)	23
C RATIO ANALYSIS				
1 PERFORMANCE				
a Non-Mark Up Expenses / Total Income	48.8%	84.2%	84.4%	66.6%
b ROE	7.1%	15.2%	-0.5%	1.9%
2 CREDIT RISK				
a Gross Finances (Total Finance-net + Non-Performing Advances + Non-Performing Debt Instruments) / Funding	99.2%	85.3%	89.6%	106.5%
b Accumulated Provisions / Non-Performing Advances	51.9%	68.7%	71.6%	75.8%
3 FUNDING & LIQUIDITY				
a Liquid Assets / Funding	25.9%	35.9%	34.4%	14.9%
b Borrowings from Banks and Other Financial Institutes / Funding	0.2%	6.4%	20.6%	23.3%
4 MARKET RISK				
a Investments / Equity	106.7%	135.8%	207.5%	157.4%
b (Equity Investments + Related Party) / Equity	1.9%	2.0%	94.5%	106.9%
5 CAPITALIZATION				
a Equity / Total Assets (D+E+F)	18.3%	17.8%	18.9%	16.0%
b Capital formation rate (Profit After Tax - Cash Dividend) / Equity	7.4%	24.4%	-0.5%	1.9%

Credit Rating

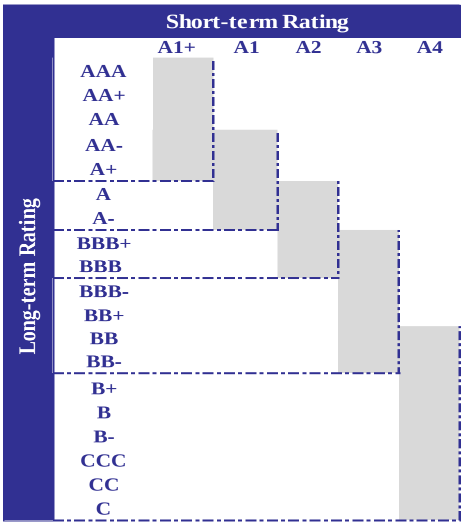
Credit rating reflects forward-looking opinion on credit worthiness of underlying entity or instrument; more specifically it covers relative ability to honor financial obligations. The primary factor being captured on the rating scale is relative likelihood of default.

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
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