Peer Review: Tunisian Leasing Companies

Weak Economy Weighing on Performance

Special Report

Ratings

Sovereign Risk

Long-Term Foreign-Currency IDR	BB−
Long-Term Local-Currency IDR	BB
Country Ceiling	BB

Outlooks

Sovereign Long-Term Foreign-Currency IDR	Negative
Sovereign Long-Term Local-Currency IDR	Negative

Tunisian Leasing Companies' Ratings (As of 7 February 2014)

Bank	NLT[a]/Outlook	Support driven	Support provider
AIL	AA+(tun)/Stable	Yes	GBPCE[b] (A/Stable/a)
TL	BBB+(tun)/ Stable	No	n.a.
ATL	BBB(tun)/ Negative	Yes	AB[c] (BBB−/ Negative/ bbb−)
ML	BBB(tun)/ Stable	Yes	BH[d] (not rated)
CIL	BBB−(tun)/ Negative	No	n.a.
EWL	BBB−(tun)/ Stable	No	n.a.
AL	BB+(tun)/Stable	Yes	AWB[e] (BB+/ Stable/bb−)
HL	BB−(tun)/Stable	No	n.a.

[a] National Long-Term Rating
[b] Groupe BPCE
[c] Arab Bank Plc
[d] Banque de l'Habitat
[e] Attijariwafa Bank
Source: Fitch

Rating Drivers: The National Ratings of Arab International Lease (AIL), Attijari Leasing (AL), Arab Tunisian Lease (ATL) and Modern Leasing (ML) are underpinned by Fitch Ratings' expectations of these leasing companies being supported by their majority shareholders if need be. Compagnie Internationale de Leasing (CIL), El Wifack Leasing (EWL), Hannibal Lease SA (HL) and Tunisie Leasing's (TL) National Ratings are based on Fitch's assessment of their standalone creditworthiness relative to the best credit in the country.

Credit Quality Remains a Weakness: Tunisian leasing companies' impaired loans ratios remain under pressure, reflecting the country's ongoing economic difficulties. TL and EWL are outperforming the Tunisian leasing sector with lower impaired loan ratios, underlining their prudent credit risk policies. Residual credit risk compared to equity still represents a major risk, particularly for AL, AIL and ML.

Tight Liquidity; Shareholder Support: All the leasing companies are wholesale-funded and, with the exception of EWL, maintain small liquidity buffers. Undrawn committed bank credit lines are fairly limited relative to annual funding needs for most companies. Access to funding through a bank shareholder is therefore a strong advantage. AIL, AL, ATL and EWL have benefited from such support since 2011 due to continued pressure on the Tunisian financial market, allowing them to better withstand liquidity shortages and supporting their loan growth.

Profitability Affected by Economy: Tunisian leasing companies' profitability declined in 2013, mirroring the country's difficult economic environment, but remains broadly acceptable. The leasing companies' performance remains undermined by declining revenue due to muted lending business, rising funding costs and still material loan impairment charges (LICs).

Only Acceptable Capital Ratios: Following capital increases at some leasing companies, Tier 1 capital ratios have improved. However, capital ratios remain only acceptable for most of the sector when considering the weak credit risk profile, substantial debtor concentration and level of unreserved impaired loans. At end-1H13, AL's capital ratios were the weakest in the sector, while those of EWL, ATL and ML were substantially higher than the sector average.

Rating Sensitivities

Parent's Support: Fitch considers that the respective shareholders' propensity to support AIL, AL, ATL and ML is unlikely to change in the foreseeable future. AIL, AL and ATL's National Ratings would be downgraded if their respective parents' Viability Rating were to be downgraded. ML's Long-Term National Rating would not necessarily be affected by a one-notch downgrade of Tunisia's Long-Term Local-Currency IDR.

Financial Strength Deterioration: The ratings of EWL, HL and TL are sensitive to a material deterioration in asset quality, leading to an erosion of their capital position. Their ratings would also be downgraded if their access to liquidity were constrained, either for bond issuance or for bank credit lines. A downgrade of CIL's ratings could result from continuous pressure on asset quality, solvency and profitability ratios.

Potential for rating upgrades at EWL, HL and TL is limited as the Tunisian fragile economic environment still weighs on these companies' asset quality and liquidity. However, significant increases in capital ratios and sustained improvements in asset quality could lead to an upgrade.

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Key Issues

Still Uncertain Economic Environment

Tunisia is still coping with the repercussions of the 2011 Arab Spring, and its economy is still being dragged down by a long political transition, which is generating ongoing uncertainty and undermining investment. Fitch has revised down its projections for Tunisia's real GDP growth to 2.8% for 2013 and 3.0% for 2014 (from 3.5% and 4.2% respectively), compared with 3.6% in 2012 and 3.0% yoy in 1H13.

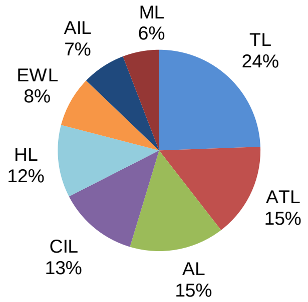
Liquidity pressures arose in the Tunisian financial sector from the economic disruption, deposit flights and growing overdue loans in 2011. Therefore, local interest rates have been on an upward trend since 1Q12.

The leasing sector, which encompasses nine companies, remains overcrowded. Competition is therefore a key driver for Tunisian leasing companies' strategies, with leaders (such as TL and ATL) fighting to maintain their market shares and smaller (or outsider) companies (AIL, EWL and HL) aiming to gain market share (see Figure 1). The vast majority of the clients of these companies are SMEs and professionals, which are more vulnerable to economic downturns than large corporates.

Figure 1

Market Shares

(Estimates at end-2013)

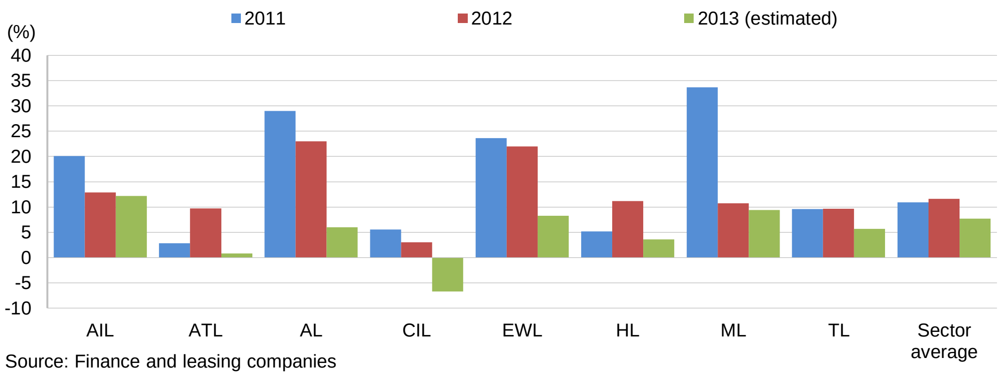


Source: Fitch and leasing companies

Since 2012, loan growth in the leasing sector has been decelerating. At end-1H13, it was a modest 6% yoy (after a high 19% per year on average between end-2007 and end-2011; see Figure 2). Discrepancies among leasing companies have been obvious since 2011, largely owing to uneven access to funding and different risk appetites. As such, TL, ATL, CIL and HL have had to reduce new lending significantly since 2011. At the other end of the spectrum, AL, EWL, AIL and, to a lesser extent, ML took advantage of the 2011 liquidity crisis to gain market shares in 2011 and 2012 despite the fragile operating environment. These entities faced lower liquidity constraints than peers and have been able to expand their franchise thanks to their funding base being largely supported by their parents.

Figure 2

Loan Growth



Source: Finance and leasing companies

In 2013, all the leasing companies experienced a slowdown in lending activity, a trend Fitch expects to persist in 2014 due to Tunisia's poor economic prospects. Delays in government payments to the private corporate sector negatively affected asset quality in some leasing companies in 1H13. The bulk of them have reinforced lending criteria and restricted lending given a continuing broad liquidity shortage in the financial markets and funding cost increases.

Small Leasing Sector; Unlikely to Receive State Support

The Tunisian leasing sector accounts for less than 10% of financial sector financing. Given their limited importance in the financing of the local economy, Fitch believes that the government would be highly unlikely to provide support to any of the leasing companies if they were to face financial stress. Fitch believes that support for AIL, AL, ATL and ML would very likely be forthcoming from their majority shareholders.

Related Criteria

Global Financial Institutions Rating Criteria (January 2014)

Finance and Leasing Companies Criteria (December 2012)

National Scale Rating Criteria (October 2013)

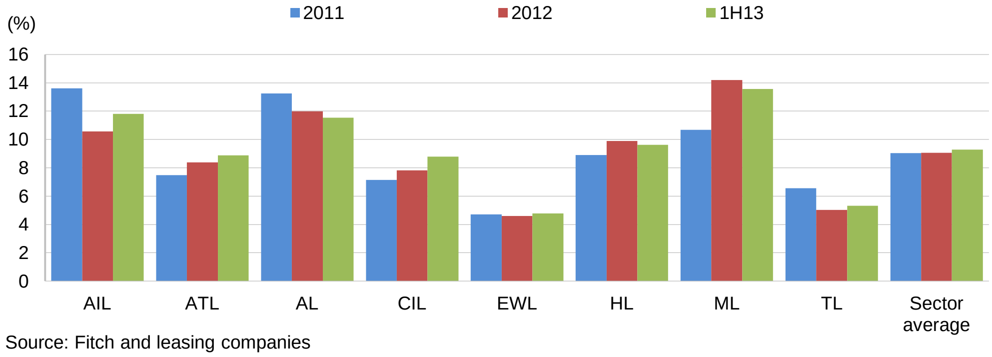
Asset Quality Remains a Weakness; Strongly Correlated With the Country's Economic Performance and Quality of Risk Management

With the exception of TL, Tunisian leasing companies' product diversification is weak (exclusively operating leases, related to vehicles, standard and specific equipment, and, to a lesser extent, real estate) and their leasing services are basic. All of the companies (with the exception of TL) operate exclusively in Tunisia. The leasing market remains dominated by small-ticket and more liquid vehicle leases (both light and heavy vehicles, approximately 74% of total leases at end-1H13), and TL remains a clear leader in this market, with significant pricing power. Specific equipment and real estate leases accounted for 17% and 9% respectively of total leases at end-1H13.

Lease asset quality, which has closely mirrored the fortunes of the Tunisian economy, sharply deteriorated in 2011 and has not recovered since. Although end-2013 figures are not yet available, Fitch expects asset quality to have deteriorated slightly compared to end-1H13, given continuous economic weaknesses. No major improvement is foreseen until the Tunisian economy starts its economic recovery. At end-1H13, the average impaired loan ratio remained at a stable 9.3% compared to end-2011 (see Figure 3), while delinquent leases were up 18% yoy at the same date.

Figure 3

Impaired Loans/Gross Loans

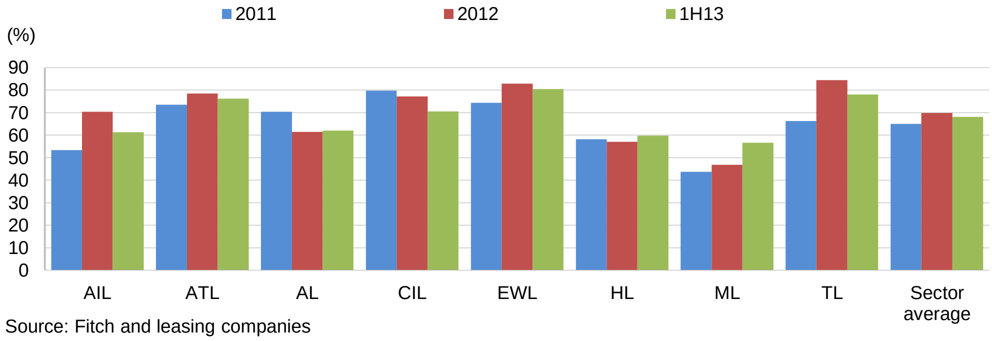


Source: Fitch and leasing companies

Tunisian leasing companies' risk management is basic and poorly automated by international standards, although leasing in Tunisia is not a complex business. TL has the most sophisticated systems and tools among peers. Credit risk approaches at both TL and EWL have historically been cautious, which explains their lower through-the-cycle impaired loan ratios. ML, AIL and AL, whose impaired loan ratios are at the higher end of the range, are lagging behind peers in terms of the sophistication of their IT systems and credit risk monitoring tools. However, major efforts are under way to upgrade them at AL and, to a lesser extent, AIL. AL's very high impaired loan ratio partly relates to an old stock of impaired exposures (originated before 2006), which are fully reserved but not written off.

Figure 4

Coverage Ratios

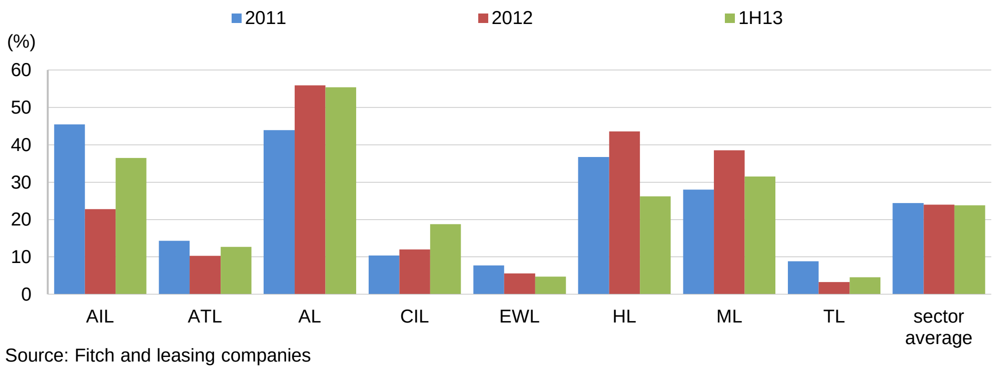


Source: Fitch and leasing companies

Coverage of impaired loans has plummeted since January 2011 following the rise in impaired loans and the loosening of provisioning criteria for some of the leasing companies (to 68% on average at end-1H13 from 77% at end-2010). TL, EWL, CIL and ATL maintained acceptable coverage ratios at end-1H13 (in absolute terms and relative to their equity), and Fitch does not expect material deterioration at these entities in the coming quarters. ML, HL, AIL and AL are at the other end of the spectrum, with fairly low coverage ratios (see Figure 4), highlighting the lower efforts for provisioning in an environment of soaring impaired loans. High residual credit risk relative to equity is a concern at AL (see Figure 5).

Figure 5

Net Impaired Loans/Equity



Source: Fitch and leasing companies

The Tunisian financial services regulator sets relatively loose impairment and provisioning criteria. However, most of the Tunisian leasing companies have individually adopted stricter guidelines, and there are today large discrepancies, mainly related to residual value (RV) calculations. RV risk, early recognition of overdue loans, efficiency of repossession and resale processes, and access to second-hand vehicle markets are key measures for gauging the health of leasing companies.

In this regard, impairment/provisioning criteria are particularly weak at AL and ML. Tighter policies are in place at TL, EWL, CIL and, to a lesser extent, HL, notably as regards asset depreciation rates and collateral haircuts. TL has the most advanced RV monitoring process and uses statistical models to benchmark its asset depreciation model. As such, TL's provisioning policies are more stringent than those of any of the other Tunisian leasing companies. In addition, TL is the only leasing company to systematically monitor data losses on repossession and resale of assets. This lack of data monitoring at other leasing companies is somewhat mitigated by their focus on vehicle leases, which have shown historical price resilience in the second-hand vehicle market (given continuing increasing demand and constraints on new vehicle imports).

Obligor Concentration Exposes Some Leasing Companies to Further Deterioration Risk

High obligor concentration in some leasing companies' lease portfolios exposes these companies to additional credit risk in an economic downturn. Single-debtor concentration is high for ML (the 20 largest leases accounted for 95% of its equity at end-1H13), AL and HL (75% each), while a few large exposures represented more than 10% of equity for ML and ATL at end-1H13. With the exception of CIL and EWL, all of the leasing companies' impaired loan portfolios encompassed large exposures at end-1H13.

TL, EWL and AIL's portfolios are the most fragmented (their 20 largest leases accounted for 51%, 60% and 62% of equity respectively at end-1H13), reflecting their more prudent credit policies. CIL, whose asset quality was hit in 1H13 by a deterioration of some large exposures, is looking at reducing its client concentration in 2014. Its 20 largest leases accounted for 72% of equity at end-1H13.

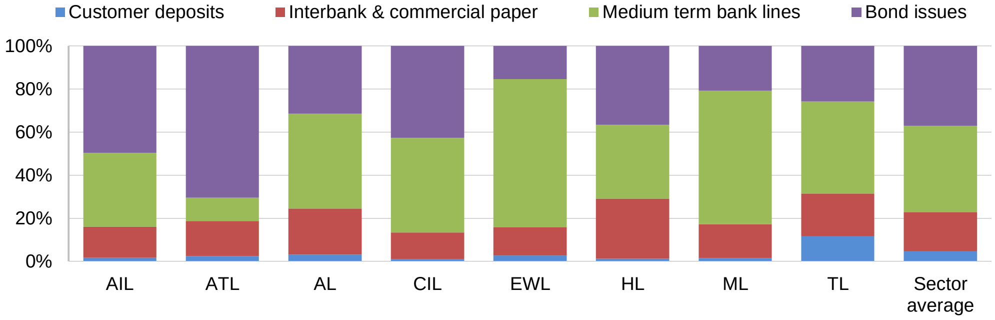
Vulnerable Funding Structure; Support From Bank Shareholders a Strength

All the Tunisian leasing companies are reliant on access to wholesale funding sources (see Figure 6), which Fitch considers a weakness, although the companies have taken steps to diversify their funding profile over the past few years and to utilise the full array of authorised wholesale funding sources (interbank deposits, commercial papers, short- to medium-term bank lines, senior unsecured debt and subordinated debt).

Figure 6

Funding Breakdown

(At end-1H13)



Source: Fitch and leasing companies

Apart from ML – which had never tapped the bond market before 4Q12 and continued in 2013 to rely strongly on its bank shareholder for its borrowing – and EWL, the Tunisian bond market remains one of the major sources of funding for the rated leasing companies (ranging from around 20% to 70% of total funding at end-1H13).

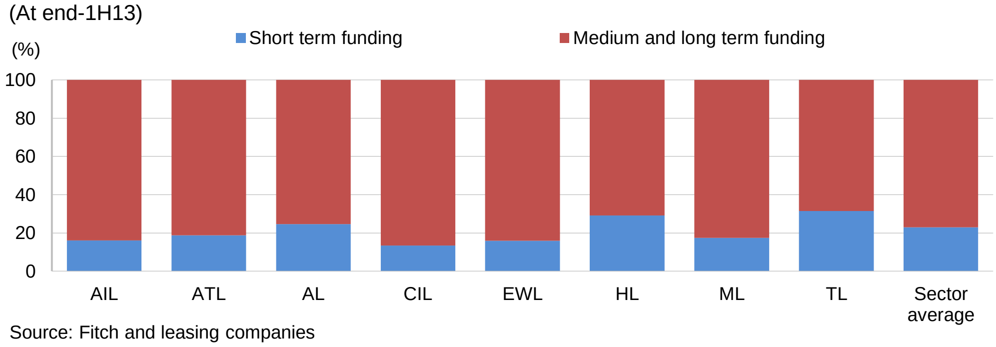
This reliance on bond issues put the leasing companies' liquidity under pressure in 2011 as investors in the Tunisian bond market turned risk-averse to leasing sector exposures. Liquidity pressures have somewhat eased since 2012 as the bond market has progressively reopened, albeit at higher costs. Bond issuances continued in 2013 despite the tightening of liquidity in the financial market. Overall, Fitch does not expect Tunisian financial market liquidity to ease in 2014. The Tunisian economy is far from recovering and investor confidence is highly sensitive to the political climate, which remains fragile, though improving, in early 2014.

Medium-term credit lines from local banks are the leasing companies' second main source of funding (11%-69% of total funding at end-1H13). Overall, there are no specific interbank exposures or concentration. Following the liquidity crunch in 2011 and the subsequent increase in funding costs (both in the bond markets and for interbank credit lines), some leasing companies (AL, AIL, HL, TL and CIL) are considering tapping medium-term multilateral/ supranational credit lines (ADB, EIB and ERDB), which have been in place since 2013.

Figure 7

Short-Term vs. Long-term Funding

(At end-1H13)



Source: Fitch and leasing companies

Significant short-term funding at some leasing companies (TL – 31% of total funding at end-1H13, HL – 29%, AL – 25%; see Figure 7), is a further refinancing risk factor. However, TL's reliance on short-term funding, which may appear high, is mitigated by the support of its managed funds, which take around 85% of commercial paper issued by the company. Short-term funding represents a reasonable share of funding at CIL (12% at end-1H13), EWL (13%) and AIL (14%).

Liquidity remains a key rating driver at Tunisian leasing companies. In its analysis, Fitch focuses on balance sheet liquidity and committed sources of liquidity as they could prove key in determining which companies might default in the absence of external support.

Liquidity is tight and Fitch believes that liquidity risk management remains poor at all leasing companies. Liquidity is managed using simple monthly cash flow forecasts, which do not include stress scenarios. Maintaining a liquidity buffer is not a priority, as evidenced by the lack of contingency plans in place. At end-1H13, only a few leasing companies (CIL, ATL, EWL) had a material stock of committed undrawn credit lines, which covered from 32% (CIL) to 62% (EWL) of their total annual funding needs (which generally include significant bond issues).

With the exception of ML and AL, all leasing companies monitor their maturity gaps and focus on matching their funding profiles with their asset maturity. Therefore, liquidity risk is mitigated by average lease maturities being shorter than average funding maturities. EWL and CIL are managing their liquidity particularly well (at end-1H13: average lease maturities largely below average funding maturities). In contrast, ML and AL are showing significant weaknesses in their liquidity management.

According to the stress tests conducted by Fitch, only EWL, CIL and AIL could withstand one year's liquidity needs in the case of a major shortage of liquidity, although AIL's resilience factors in ordinary support from its bank shareholder, Banque Tuniso Koweitienne (through treasury credit lines).

If TL, ATL, AL, AIL, ML and EWL were to require immediate liquidity, it is likely that they could attempt to access funds from their respective bank shareholders, although capacity might be questionable at Amen Bank (TL's parent), Attijari Bank (AL's parent), Banque de l'Habitat (BH, ML's parent) and Société Tunisienne de Banque (STB, EWL's parent). At end-1H13, funding from the parent was not material for either TL or EWL, highlighting their ability to tap external funding sources, while it was material at AL and ML.

Ultimate support from the Tunisian state would be likely for ML (through BH) and possible albeit less likely for EWL (through STB), as their respective bank shareholders are state-owned. Fitch does not believe the local central bank would act as lender of last resort for the other leasing companies.

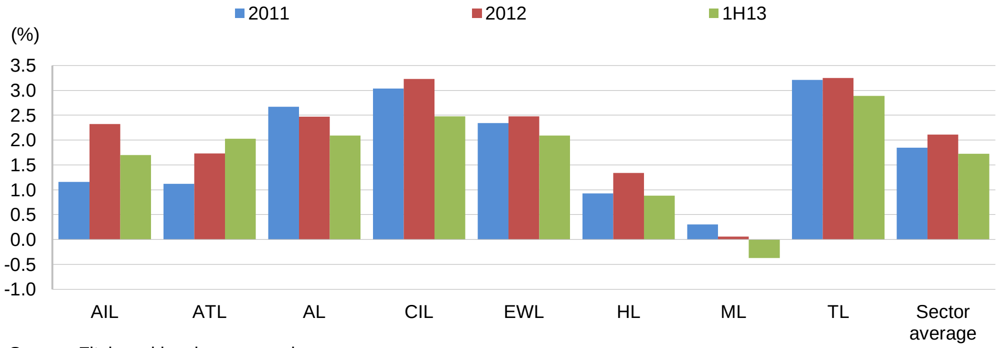
Profitability Under Pressure but Still Adequate

Overall, profitability indicators of the leasing companies deteriorated in 1H13, due to lower lending activity (except at CIL, which drastically reduced its lending activity in 2012 due to liquidity constraints), declining net interest margins (partly due to increasing funding costs) and substantial LICs.

Fitch expects pressure on net interest margins to have continued in 2H13 as liquidity strains and therefore pressure on funding costs persisted, while not all leasing companies would have had sufficient pricing power to pass on increases in funding costs to their clients. At the same time, Fitch does not anticipate either leasing companies to report a rebound in lending activity or an improvement in credit risk in 2H13, given Tunisia's current difficult economic environment and negative outlook. However, Fitch believes that all the leasing companies except ML will continue to generate sufficient revenue to absorb LICs and limit declines in their profitability.

Apart from ML and HL, profitability for the leasing companies remains satisfactory (see Figure 8) despite the unfavourable economic conditions. In 1H13, operating profit/total assets ratios ranged from an acceptable 1.7% (AIL) to a satisfactory 2.9% (TL). Over the past few years, all the companies' profitability has proved vulnerable to the economic downturn, although TL, ATL, AL and EWL have been able to record less volatile and adequate through-the-cycle profitability.

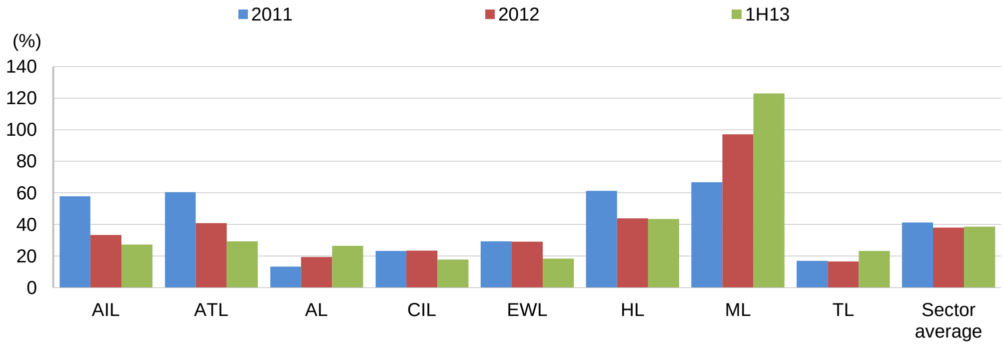
Figure 8
Operating ROAA



Source: Fitch and leasing companies

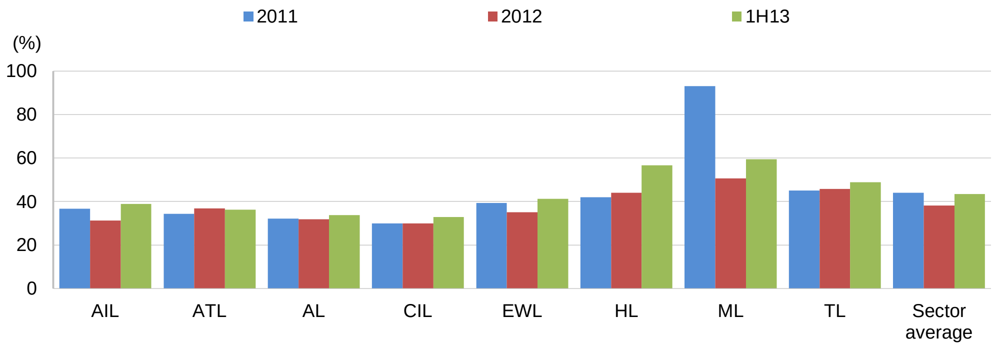
Of the eight leasing companies, ML is by far the weakest-performing, reporting losses in 1H13 due to weaker revenue generation capacity, high operating costs and LICs exceeding pre-impairment profit (see Figure 9). HL's profitability also lagged behind peers' in 1H13, reflecting the combination of a slowdown in lending activity (3.3% loan growth yoy versus a 6.2% sector average), increasing funding and operating costs and heavy LICs (absorbing 43% of pre-impairment profit versus a 38% sector average).

Figure 9
Loan Impairment Charges/Pre-Impairment Operating Profit



Source: Fitch and leasing companies

Figure 10
Cost-to-Income Ratios



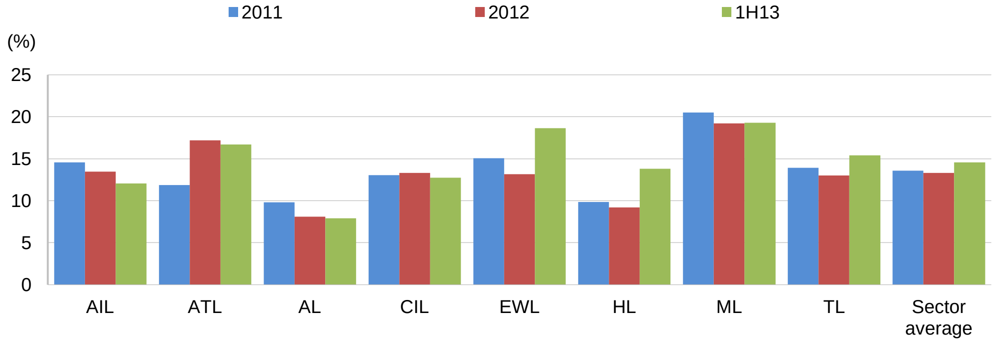
Source: Fitch and leasing companies

Apart from ML, cost efficiency remains acceptable at all the leasing companies (see Figure 10). TL and HL's fairly high cost/income ratios (49% and 56% respectively in 1H13) reflect their recent IT investments. Fitch expects TL's cost/income ratio to decrease slightly based on cost efficiencies from its recent technology upgrade.

Capital Buffer Remains Modest Relative to Potential Losses

Fitch views the leasing companies' capitalisation, as measured by regulatory Tier 1 ratios (Basel 1; see Figure 11), as only acceptable if not modest for some companies (Tier 1 ratio ranging from a weak 7.9% at AL to 19% at EWL at end-1H13; sector average: 14.3% at end-1H13), given the companies' significant exposures to credit risk, and the notable obligor concentration in some companies and considering unreserved impaired loans.

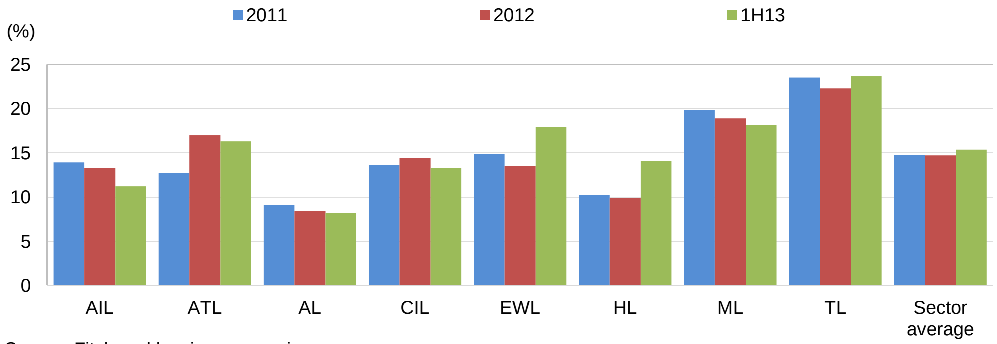
Figure 11
Tier 1 Ratios



Source: Fitch and leasing companies

With the exception of AL, Fitch views the Tunisian leasing companies' leverage ratios as adequate: at end-1H13, the equity/assets ratio for the seven other companies ranged from 11.2% (AIL) to 23.7% (TL), and Fitch does not expect any material decline in leverage ratios given leasing companies' modest loan growth forecasts. AL's leverage ratio was a weak 8.2% at end-1H13, with no capital increase planned in the short term. ATL, HL, EWL and, to a lesser extent, TL's leverage and Tier 1 ratios were boosted by capital increases achieved in late 2012 (ATL) or 1H13 (again ATL, TL, EWL, HL) and muted risk-weighted asset growth. The significant difference between TL's Tier 1 and leverage ratios mainly relate to large minority interests not accounted for as Tier 1 capital.

Figure 12
Equity/Total Assets



Source: Fitch and leasing companies

Annex

Figure 13

Financial Summary for Tunisian Leasing Companies

(TNDm unless stated)[a]	AIL (AA+(tun)/ Stable/F1+(tun)) Jun 13	AIL Dec 12	ATL (BBB(tun)/ Negative/F3(tun)) Jun 13	ATL Dec 12	AL (BB+(tun)/ Stable/B(tun)) Jun 13	AL Dec 12	CIL (BBB−(tun)/ Negative/F3(tun)) Jun 13	CIL Dec 12	EWL (BBB−(tun)/ Stable/F3(tun)) Jun 13	EWL Dec 12
Total assets	205	175	415	401	384	368	377	354	223	200
Total equity	23	23	68	68	31	31	50	51	40	27
Net income	1	3	3	5	3	6	3.7	9	2	4
Gross loan growth (%)	8.50	12.93	4.77	9.73	5.25	22.99	5.0	3.0	5.89	22.00
Net interest margin (%)	3.63	5.04	4.05	4.35	3.94	4.25	4.67	5.20	4.28	5.42
Operating profit/average total equity (%)	13.91	17.27	12.18	12.34	25.13	28.72	17.93	23.48	13.20	18.11
Operating profit/average total assets (%)	1.70	2.32	2.03	1.73	2.09	2.47	2.48	3.23	2.09	2.48
Net income/average total equity (%)	9.56	12.73	8.32	8.35	18.68	20.42	14.75	19.08	9.60	15.35
Net income/average total assets (%)	1.17	1.71	1.38	1.17	1.56	1.75	2.04	2.63	1.52	2.11
Loans and securities impairment charges/pre-impairment op. profit	27.27	33.33	29.31	40.87	26.42	19.42	23.73	12.50	18.52	29.23
Cost/income (%)	38.89	31.33	36.26	36.81	33.75	31.79	32.95	30.05	41.30	35.00
Fitch core capital ratio (%)	12.84	14.63	17.25	18.05	8.44	8.85	13.42	14.53	18.36	13.63
Tier 1 capital ratio (%)	12.06	13.46	16.70	17.20	7.90	8.13	12.75	13.32	18.63	13.15
Equity/assets (%)	13.14	11.22	16.30	17.00	8.19	8.45	13.32	14.39	17.95	13.54

n.a.: Not available
[a] 1 USD = 1.65480TND at end-1H13
Source: Fitch and banks

Figure 14

Financial Summary for Tunisian Leasing Companies

(TNDm unless stated)[a]	HL (BB−(tun)/ Stable/B(tun)) Jun 13	HL Dec 12	ML (BBB(tun)/ Stable/F3(tun)) Jun 13	ML Dec 12	TL (BBB+(tun)/ Stable/F2(tun)) Jun 13	TL Dec 12
Total assets	314	285	166	162	930	873
Total equity	44	28	30	31	220	195
Net income	1	3	-0.5	0.4	11	21
Gross loan growth (%)	3.31	11.19	3.13	10.76	6.84	9.67
Net interest margin (%)	3.71	4.33	3.96	5.06	6.02	6.98
Operating profit/average total equity (%)	7.22	13.60	-1.99	0.33	12.54	14.47
Operating/average total assets (%)	0.88	1.34	-0.37	0.06	2.89	3.25
Net income/average total equity (%)	5.56	10.29	-3.32	1.31	10.59	11.06
Net income/average total assets (%)	0.67	1.02	-0.62	0.25	2.44	2.48
Loans and securities impairment charges/ pre-impairment op. profit	43.48	43.94	123.08	97.44	23.21	16.56
Cost/income (%)	56.60	44.07	59.38	50.63	48.94	45.85
Fitch core capital ratio (%)	14.36	9.87	20.70	20.40	24.28	22.36
Tier 1 capital ratio %	13.80	9.20	19.3	19.2	15.39	12.99
Equity/assets (%)	14.11	9.91	18.17	18.92	23.69	22.31

n.a.: Not available
[a] 1 USD = 1.65480TND at end-1H13
Source: Fitch and leasing companies