

## ICRA Lanka Reaffirms the ratings of Commercial Leasing

December 14, 2020

Instrument	Rated Amount (LKR Mn)	Outstanding Amount (LKR)	Rating Action
Issuer rating	N/A	N/A	[SL]A (Stable); reaffirmed
Listed Senior Unsecured Redeemable Debenture Programme	5,000	5,000	[SL]A (Stable); reaffirmed
Listed Senior Unsecured Redeemable Debenture Programme	5,000	N/A	[SL]A (Stable); withdrawn

### Rating action

ICRA Lanka Limited has reaffirmed the issuer rating of [SL]A (pronounced as S L A) with Stable outlook for Commercial Leasing and Finance PLC ("CLC" /"the Company). ICRA Lanka has also reaffirmed the issue rating of [SL]A (pronounced as S L A) with Stable outlook for the LKR 5,000 Mn Listed Senior Unsecured Redeemable Debenture Programme.

Further, ICRA Lanka has withdrawn the issue rating of of [SL]A (pronounced as S L A) with Stable outlook for the LKR 5,000 Mn Listed Senior Unsecured Redeemable Debenture Programme, as the said debenture are fully redeemed by the Company.

### Rationale

ICRA Lanka has taken a consolidated view of the performance of the LOLC group, which has interests in various segments including financial services, insurance, manufacturing, trading, plantations, renewable energy and leisure for arriving at the ratings. However, the group performance is primarily driven by the finance sector of the group and hence the ratings reflect the same.

The ratings factor in the group's long track record and leadership position in the Sri Lankan NBFI sector, its experienced management team, commensurate risk management systems and its adequate funding profile. The ratings also take comfort from the improved capitalization and liquidity profile of the group, post PRASAC divestment. Group gearing<sup>1</sup> has reduced to about 2.6 times as in September 2020, from 5.3 times in March 2020. LOLC has access to funding, through its diversified funding profile, which includes local and foreign funding partners. However, ICRA Lanka takes note of the weakening in the asset quality profile of its Sri Lanka based non-bank finance companies (NBFCs) and the deterioration in the overall earnings profile during 6MFY2020, as NIM moderated and credit cost increased. Group's ability to control incremental slippages and improve the overall asset quality over the next 6M will be a key monitorable, going forward.

While ICRA Lanka takes cognisance of the diversification to newer geographies (Cambodia, Myanmar, Indonesia and Pakistan) over the recent past by the LOLC group, ability to manage country specific risks across businesses and regulatory cycles would be crucial from a rating perspective. Further, ICRA Lanka

<sup>1</sup> Gearing adjusted for revaluation gains and deferred tax assets

would continue to monitor the performances of the non-financial service entities and their contribution to the overall group going forward.

## Outlook: Stable

ICRA Lanka believes that the LOLC group, on the back of its established presence, business experience and fund raising ability would be able to grow its business and provide timely and adequate capital support to the various group entities. The outlook may be revised to 'Negative' in case of further weakening in the profitability and asset quality indicators of the group. The outlook may be revised to 'Positive' in case of a significant improvement in overall financial profile of the group and if the portfolio profile and asset quality improve.

## Key rating drivers

### Credit strengths

**One of the largest financial services group, with experienced, strong management team and risk management systems:** LOLC group is one of the largest financial conglomerates in Sri Lanka with a consolidated asset base of LKR 778 Bn as in September 2020 (reduced from LKR 1,336 Bn in March 2020, which included PRASAC that was divested in April 2020) and an aggregate branch network of over 220, island-wide. The group's operations can be broadly identified under financial and non-financial sectors, with the finance sector (including insurance) contributing to about 89% of the group assets and 82% of the group revenue in September 2020. The LOLC group has an experienced senior management team, with knowledge in retail lending, micro-lending, and SME financing. The group has centralised the key business functions like IT & MIS, human resources, finance & accounts, and risk management. The centralised model gives a competitive advantage to LOLC group entities by optimising the overall operating costs. LOLC has been able to leverage its expertise to expand into regional markets in Asia and Africa. LOLC is the only Sri Lankan financial institution to significantly expand its reach in the international markets.

**Fairly diversified group level exposures:** The LOLC group commenced its operations 40 years back in Sri Lanka. With time LOLC has diversified its finance sector operations to Cambodia, Myanmar, Indonesia, and Pakistan. As in March 2020, the group portfolio stood at about LKR 897 Bn, and the same has moderated to about LKR 399 Bn with the divestment of its flagship entity PRASAC in Cambodia. The group has a geographically diversified portfolio with Sri Lanka accounting for about 57% of the total exposures as in June 2020, followed by Cambodia (39% of the portfolio) and Myanmar (4% of the portfolio). The group also has smaller NBFIs in Pakistan, Indonesia, and the Philippines. Going forward, the company is expecting to further diversify its global presence to East Asia and Africa using the proceeds from the divestment of PRASAC. ICRA Lanka would monitor the country risks of the new investments, as the future growth for the group is likely to come from these international markets. In addition to the finance sector, the group has significant investments in the manufacturing, trading, leisure, and plantations sectors. However, the group's performance over the medium term is likely to be driven by the core finance sector. Within the finance sector also, the group has a fairly diversified exposure profile that includes vehicle financing, SME lending, and micro-lending. Going forward, LOLC's Sri Lankan NBFIs will focus on asset-backed lending, while overseas operations will mostly focus on micro-related lending.

**Healthy funding profile of the group with access to funding:** The Group has a diversified funding base that consists of public deposits, bank funding, debt instruments, and funding lines from multilateral institutions. LOLC group has the advantage of having long-standing relationships with DFIs such as IFC, FMO, DEG, and DWM, that provide long term funding at favourable terms. ICRA Lanka notes that the two

key local NBFIs, LOLC Finance (LOFC) and Commercial Leasing & Finance (CLC) have strong deposit franchises due to their extensive reach and brand recognition, while the smaller entity LOLC Development Finance (LDFF) is dependent on bank loans and funding from the parent company. The ratings also take comfort from the healthy liquidity profile of the group, with excess funding at both holding company and operating entity levels. As in September 2020, LOLC holdings (stand-alone) had liquid assets/investments and unutilized funding lines of about LKR 10.4 Bn, with several funding lines, in the pipe-line, pending approval.

**Adequate capitalisation of key operating companies and the significant improvements in the holding company's capitalization profile with PRASAC divestment:** The capitalisation of the LOLC group's local financial subsidiaries improved as a result of the slowdown in portfolio growth and capital infusions made over the last three years. LOFC reports a risk-weighted core capital adequacy ratio of 13.5% (total CAR 14.9%) in June 2020, as compared to 13.3% (total CAR 14.7%) in March 2020; gearing has improved to 4.5<sup>2</sup> times in June 2020, from about 5.8 times in September 2019 and 8.0 times in March 2019. ICRA Lanka notes that the overall capitalization of LOFC has improved with the LKR 4.8 Bn right's issue in August 2019. CLC's capitalization levels remained comfortable with risk-weighted core CAR reported at 21.6% in June 2020, compared to 21.8% in March 2020. CLC's gearing stood at 2.7 times in June 2020, compared to 2.6 times in March 2020 and 3.0 times in March 2019. LDFF reported a risk-weighted core capital adequacy ratio of 11.1% in June 2020, compared to 11.2% in March 2020. LDFF's gearing was 5.7 times in June 2020, compared to 5.7 times in March 2020 and 4.3 times in March 2019. ICRA Lanka expects the capitalization of the local NBFIs to remain comfortable over the short to medium term due to the muted growth outlook in the sector. ICRA Lanka notes that the holding company's capitalization profile and that of the overall group have significantly improved with the divestment of PRASAC in April 2020. Group gearing has moderated to about 2.6 times in September 2020, from about 5.3 times in March 2020 and 5.9 times in March 2019. The gearing of the holding company at the stand alone has also moderated to about 1.2<sup>3</sup> times in September 2020, from about 2.1 times in March 2020 and 1.6 times in March 2019, as the group has utilized the bulk of the divestment proceeds repatriated to Sri Lanka to repay the debt at the holding company level.

## Credit challenges

**Sharp deterioration of asset quality of the local entities, largely due to the challenging macro environment that prevailed during the period.** The LOLC group's asset quality of the local operations weakened as a result of adverse macroeconomic conditions, including the Easter events in April 2019, and the recent COVID-19 outbreak. ICRA Lanka notes that LOFC has contributed to the bulk of the NPA increase over the last 12M; LOFC's GNPA ratio increased to 15.2% in September 2020, from 11.0% in March 2020 and 8.3% in September 2019. However, the NPA increase of CLC and LDFF is relatively moderate where CLC reported a GNPA ratio of 7.29% in September 2020, compared to 7.1% in March 2020 and 5.7% in September 2019, while LDFF reported a GNPA ratio of 8.8% in June 2020, compared to 8.0% in March 2020 and 7.7% in September 2019. Relatively higher slippages of LOFC are mainly attributable to the company's SME-business lending exposures. ICRA Lanka notes that the local NBFIs of LOLC group have written-off a sizable portion of its NPAs over the last three years. During FY2020, LOFC has written-off about LKR 6.1 Bn non-performing loans, accounting for about 63% of the LKR 9.6 Bn group write-offs during the period. Despite the NPA increase in local NBFIs, the group NPA level remains relatively lower due to healthy asset

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<sup>2</sup> Gearing based on net worth adjusted for deferred tax and revaluation gains

<sup>3</sup> Gearing is calculated based on net debt adjusted for back-to-back borrowings

quality indicators of overseas exposures; NPA of the overseas portfolio was 0.6% in June 2020, vis-à-vis 0.3% in March 2020 and 0.8% in September 2019.

**Weakened group earnings profile:** LOLC's group NIM moderated in FY2020 (NIM 5.2% in FY2020, vis-à-vis 5.8% in FY2019), mainly due to the muted loan growth in local NBFIs during the period. Group NIM further moderated to about 3.3% during the 6M ended September 2020, with the divestment PRASAC in April 2020. PRASAC was the largest NBFI of the group, accounting for about 47% of the group assets in March 2020, and the entity reported attractive NIMs on its lending portfolio. Also, LOLC Group saw a sharp increase in loan impairment costs in FY2020 and the 6M ended September 2020, due to the higher delinquency levels, especially in the local NBFI segment (mainly at LOFC). Group credit cost (loan impairment/ATA) increased to 3.1% during the 6M ended September 2020, compared to 1.6% in FY2020 and 1.5% in FY2019. ICRA Lanka also notes that sustained losses of the group's leisure sector (non-finance) have affected the overall group earnings. The leisure sector reported a loss before tax of LKR 1.9 Bn during the 6M ended September 2020, vis-à-vis a loss of 2.9 Bn in FY2020 and a loss of LKR 2.2 Bn in FY2019, due to the challenging outlook in the tourism sector. The Group witnessed a moderation of overall profitability during FY2020, where the Group reported an operating profit of LKR 21.1Bn in FY2020, down from LKR 26.8 Bn in FY2019. For the 6M ended September 2020, the Group reported an operating loss (after credit cost) of LKR 20 Mn. However, the group reported a net profit of LKR 41.3 Bn for the 6M ended June 2020, due to the LKR 42.9 Bn gain on PRASAC divestment.

**Analytical approach:** For arriving at the ratings, ICRA has applied its rating methodologies as indicated below.

**Links to applicable criteria:** [ICRA Lanka's Credit Rating Methodology for Non-Banking Financial Institutions](#)

## About CLC:

CLC was incorporated in the year 1988 as a Specialised Leasing Company. The LOLC Group acquired controlling stake and then 100% of the Company in 2008. The main product lines of CLC include leasing and loans for vehicles & equipment, and factoring. CLC obtained the license to operate as a LFC in December 2011. Subsequently, CLC has also started offering savings and deposit products. CLC primarily operates with borrowers in the retail and MSME<sup>4</sup> segments. CLC was relisted on the Colombo Stock Exchange (CSE) on June 05, 2012 to comply with the requirements of the Central Bank of Sri Lanka (CBSL) and LOLC group currently has an effective equity stake of 99%. In November 2015, CLC acquired 94.35% stake in LOLC Development Finance PLC and the same was reduced to 44% after LDFFP's rights issue program in May 2017.

During the year ended March 31, 2020, CLC reported a net profit of LKR 1,547 Mn on a total asset base of LKR 69.6 Bn as compared to a net profit of LKR 1,198 Mn on a total asset base of LKR 70.8 Bn in the previous financial year. The Company reported a net profit of LKR 189 Mn on a total asset base of LKR 72.9 Bn in H1FY2021.

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<sup>4</sup> MSME- micro, small and medium enterprises

## Key financial indicators-CLC

In LKR Mn	FY2019	FY2020	H1FY2020 (Unaudited)
Net Interest Income	7429	6,632	3,569
Profit after Tax	1,198	1547	189
Net worth (adjusted for revaluation reserves)	17459	18,925	19,199
Loans and Advances	53,493	54,139	54,861
Total Assets	70,856	69,631	72,944
Return on Equity	7.05%	8.50%	1.99%
Return on Assets	2.83%	2.84%	0.70%
Gross NPA	4.90%	7.05%	7.29%
Capital Adequacy Ratio (Tier 1)	20.51%	21.79%	21.65%
Gearing (times, adjusted for revaluation reserves)	2.99	2.61	2.60

## Rating history for last three years:

Current Rating (FY2021)				Chronology of Rating History for the past 3 years		
Type	Amount Rated (LKR Mn)	Amount Outstanding (LKR Mn)	Date & Rating	Date & Rating in FY2021	Date & Rating in FY2020	Date & Rating in FY2019
			Dec 2020	May 2020	Jan 2020	Feb 2019
Issuer rating	N/A	N/A	[SL]A (Stable)	[SL]A (Stable)	[SL]A (under rating watch with developing implications)	[SL]A (Stable)
Listed senior unsecured redeemable debenture	5,000	N/A	[SL]A (Stable); withdrawn	[SL]A (Stable)	[SL]A (under rating watch with developing implications)	[SL]A (Stable)
Listed senior unsecured redeemable debenture	5,000	5,000	[SL]A (Stable)	N/A	N/A	N/A



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