

ICRA Lanka reaffirms the ratings of Citizens Development Business Finance PLC

January 3, 2017

Instrument	Amount	Rating Action
Issuer rating	N/A	[SL]BBB (stable); reaffirmed
Subordinated unsecured redeemable debentures	LKR 1,000 Mn	[SL]BBB- (stable); reaffirmed
Guaranteed unsecured redeemable debentures; guaranteed by Seylan Bank PLC	LKR 1,000 Mn	[SL]A-(SO) (stable); reaffirmed

ICRA Lanka Limited, subsidiary of ICRA Limited, a group company of Moody's Investors Service, has reaffirmed the issuer rating of [SL]BBB (pronounced SL triple B) with stable outlook for Citizens Development Business Finance PLC (CDB or the company). ICRA Lanka has also reaffirmed the [SL]BBB- (pronounced SL triple B minus) with stable outlook to the subordinated redeemable debentures of CDB amounting to LKR 1,000 Mn.

ICRA Lanka has also reaffirmed the [SL]A-(SO) (pronounced SL A minus structured obligation) rating with stable outlook to the redeemable debentures of CDB amounting to LKR 1,000 Mn, which are guaranteed by Seylan Bank PLC (Seylan). The letters SO in parenthesis suffixed to a rating symbol stand for structured obligation. An SO rating is specific to the rated issue, its terms, and its structure. The SO rating does not represent ICRA Lanka's opinion on the general credit quality of the issuer concerned.

The rating for the guaranteed redeemable debentures programme is based on the strength of the unconditional and irrevocable guarantee from Seylan Bank PLC (Seylan) covering the principal and two interest instalments (semi-annual) of the proposed issue. The guarantor undertakes the obligation to pay, on demand from the trustee, the total principal sum of LKR 1,000 Mn and, two half-yearly interest instalments of the proposed redeemable debentures. The rating also assumes that the guarantee will be duly invoked by the trustee, as per the terms of the underlying trust deed and guarantee agreement, in case there is a default in payment by CDB (issuer).

The ratings continue to factor in CDB's established franchise (asset base of about LKR 50.6 Bn as on March 31, 2016 with over 69 branches), good competitive position in Sri Lanka, professional and experienced management team and its adequate appraisal and monitoring systems. The ratings take note of the gradual shift in the asset class mix towards safer assets such as motor cars and vans from 3-wheelers and the consequent improvement in asset quality (gross NPA 3.7% as on September 30, 2016 vis-à-vis 5.2% on March 31, 2014) of the company. The ratings however, take cognizance of the competitive operating environment in traditional vehicle financing space, affecting growth (portfolio growth of 8% in H1FY2017 vis-à-vis 31% in FY2016) and asset yields of CDB. Also, the ratings take note of relatively high gearing and sizable asset liability mismatches in the short term as the company is primarily dependent on public deposits for its funding. Going forward, envisioned regulatory changes in the vehicle financing space and the consequent impact of the same on the NBFIs sector would be crucial from a rating perspective.

CDB operates a conventional asset backed lending portfolio focusing mainly on auto finance (about 90% of the total lending portfolio as on September 30, 2016), while other loans including gold loans, property loans, loans against deposits and personal loans accounted for the remaining. Over the last 2-3 years, CDB has gradually shifted the asset class mix, wherein it has reduced the exposure to 3-wheelers (from 43% as on March 31, 2014 to 23% as on September 30, 2016) and focus more on safer

asset classes such as motor cars and vans (60% of the loan portfolio as on September 30, 2016 vis-à-vis 32% as on March 31, 2014). In view of the competitive vehicle financing business, the company is expected to mitigate the same by diversifying to gold loans and property loans; non-vehicle portfolio represented about 10% of the total loan portfolio as on September 30, 2016 and is expected to be about 20% of the overall portfolio in the medium to long term. As on March 31, 2016 CDB had a total loan portfolio of LKR 39.4 Bn, recording a 31% growth from LKR 30.2 Bn as on March 31, 2015. However, it recorded a moderate portfolio growth of about 8% (annualised growth) for the H1FY2017.

The shift in the asset class mix is reflected on the overall asset quality; gross NPA of CDB has improved during the corresponding period (gross NPA 3.7% as on September 30, 2016 vis-à-vis 5.8% as on March 31, 2015 and 5.2% on March 31, 2014). Historically, 3-wheelers accounted for the bulk of NPAs (over 50% of the total NPAs) for CDB; reduced exposure to the asset class has positively contributed to the overall NPA levels of the company. As on September 30, 2016 motor cars (48% of the total loan portfolio) recorded a gross NPA of below 1%, while vans (11% of the total portfolio) recorded a gross NPA of about 1.9%. However, 3-wheelers (23% of the total loan portfolio) recorded a fairly high NPA of about 8.9%. The other loan products of CDB recorded moderate NPA levels, however, the portfolios are not seasoned. Going forward, ICRA Lanka will continue to monitor the asset quality indicators of CDB, especially in newer asset classes, namely gold loans and property loans.

CDB's funding profile is largely characterized by fixed deposits, which account for about 66% of the total debt as on September 30, 2016 (82% as on March 31, 2014); proportion of savings has remained range bound at about 3-4%, while debt instruments and bank borrowings represented the balance. CDB's ALM profile is characterized by sizeable mismatches in the <1 year bucket (18% cumulative mismatch) due to the short term nature of the deposits. However, good deposit renewal rate of about 75% and the long standing relationships with banks & other financial institutions provide comfort on CDB's overall liquidity profile.

CDB reported a total capital adequacy ratio (CAR) of 13.6% as on September 30, 2016 (March 2016 - 11.6%, March 2015 - 14.1%). The gearing however is high at 8.1 times; going forward, ability to maintain a comfortable risk adjusted capital profile would be crucial.

The company's overall earnings profile is characterised by a moderation in the NIMs to about 5.8% in H1FY2017 (FY2016 - 6.9%, FY2015 - 8.0%), as CDB shifted its focus to lower yielding asset classes and due to increase in systemic rates, which affected the cost of funding. CDB's credit cost reduced over the last few years (Credit provisions/ATA 0.5% for H1FY2017 vis-à-vis 1.3% in FY2015 and 1.4% in FY2014), as the company has shifted the asset class mix to focus on safer asset classes. Going forward, CDB's ability manage the operating and credit expenses will be key drivers of profitability, as the core asset yields are expected to remain moderate.

Company Profile

Citizens Development Business Finance PLC (CDB), set up in 1995 was initially named as Ceylinco Development Bank Limited. In 2009 CDB obtained RFC license and re branded itself as Citizens Development Business Finance PLC. CDB's largest shareholder is Ceylinco insurance with an effective 37.5% stake as of September 30, 2016. The company's ESOP owned about 27% of the shareholding, before the ESOP was distributed among the employees in March 2016. Currently, as one of the relatively large NBFIs in the Sri Lankan non-banking financial institutions sector, CDB offers leasing, hire purchase, deposits (fixed and savings) and other personal credit facilities. CDB was initially listed in the secondary board of the Colombo Stock Exchange and was transferred to the main board in December 2010. CDB operates 69 outlets and over 600 ATMs across the island as of September 2016.

The company acquired controlling stake in Unison Capital Leasing (previously known as Laughs Capital Limited) in October 2014 and currently holds over 90% shares of the company.

During the year ended March 31, 2016, CDB reported a net profit of LKR 1,005 Mn on a total asset base of LKR 50.6 Bn as compared to net profit of LKR 702 Mn on a total asset base of LKR 37.8 Bn in the previous fiscal.

For the six months ended September 30, 2016, CDB reported a net profit of LKR 444 Mn on a total asset base of LKR 49.4 Bn.

Guarantor Profile

Seylan Bank PLC

Seylan Bank PLC (Seylan) with total asset base of LKR 296.3 Bn as in December 31, 2015 (LKR 249.3 Bn in December 31, 2014) accounted for about 4.2% of sector assets; it also accounted for 4.6% of sector loans and advances and 4.2% of the sector deposits as in December 31, 2015. The bank was incorporated in the year 1987. Sri Lanka Insurance Corporation Ltd (15.0%), Browns and Company PLC (13.9%), Employee Provident Fund (9.9%), LOLC Investments Limited (9.6%), NDB Bank (8.7%) and Bank of Ceylon (7.5%) are the major voting shareholders of the bank.

The bank recorded net profits of LKR 3.8 Bn on a total asset base of LKR 296.3 Bn for the CY2015 and LKR 3.08 Bn on a total asset base of LKR 249.3 Bn for the CY2014, which resulted in ROA (post tax) of 1.40% and 1.33% for the respective periods. The bank had gross NPA ratios of 4.68% and 7.69% as at CY2015 and CY2014 respectively and net NPA ratios of 3.06% and 5.31% respectively for the said periods. The bank had a net worth (excluding revaluation reserve) of LKR 24.4 Bn as on December 31, 2015 with core capital adequacy ratio of 12.2% and total capital adequacy ratio of 12.9%.

The Seylan Bank Group recorded consolidated net profits of LKR 3.25 Bn on a total asset base of LKR 251 Bn for the CY2014 and LKR 3.89 Bn on a total asset base of LKR 298 Bn for the CY2015. The Seylan Bank Group recorded consolidated net profits of LKR 1,749.0 Mn on a total asset base of LKR 328.4 Bn for the 6 months ended June 30, 2016. Bank's gross NPA ratio stood at 4.63% as on June 30, 2016.

Note 01: CY - Calendar Year from January 01 to December 31

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