

## ICRA Lanka Assigns [SL] BBB- for Citizens Development Business Finance PLC's Subordinated Debenture Programme

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Instrument	Amount	Rating Action
Subordinated Unsecured Redeemable Debenture programme	LKR 1,000 Million	[SL]BBB-; assigned with stable Outlook

ICRA Lanka Limited, subsidiary of ICRA Limited, a group company of Moody's Investors Service, has assigned the [SL]BBB- (pronounced SL triple B minus) rating with a stable outlook to the LKR 1,000 Mn Subordinated Unsecured Redeemable Debenture programme with a tenure of five years currently listed on the Colombo Stock Exchange. ICRA Lanka has the issuer rating outstanding of [SL]BBB (pronounced SL triple B) with stable outlook on CDB.

The rating factors CDB's established franchise, good competitive position in Sri Lanka, professional and experienced management team and its strong appraisal and monitoring systems. The credit rating however takes note of the deterioration in the CDB's asset quality during Financial Year (FY) 2014 and in FY2015 resulting in moderation in the profitability indicators, the company's relatively high gearing level and high dependence on deposits. Arresting incremental slippages along with recovery from the existing NPAs/repossessed assets and diversification of its funding profile going forward would be key sensitivities.

CDB operates a conventional asset backed lending portfolio focusing mainly on Auto Finance (94.5%), while other loans including loans against deposits, personal loans, pawning accounted for the remaining as in September 2015. The company's portfolio growth moderated to about 14% in FY 2015 from 33% in FY2014 and the growth during H1FY2016 was 18% over the March 2015 levels. The company's main focus over the past had been 3-wheeler financing; however it is expected to reduce the share of 3-wheeler segment going forward with incremental focus on other 4-wheeler asset classes (cars, vans, commercial vehicles) in line with its strategy to improve the overall portfolio asset quality. The recent pressure witnessed in the asset quality was largely on account of the 3-wheeler segment (gross NPA in 3-wheeler segment stood at 9.0% as compared to the CDB's overall NPA of 5.2% in September 2015). The share of 3-wheelers in the overall portfolio moderated to 33% as of September 2015 (36% in March 2015) as compared to 42% in March 2014 with a corresponding increase in the Cars & Vans to 53% in September 2015 (48% in March 2015) as compared to 32% in March 2014. CDB's pawning portfolio recorded a significant growth (84%) during FY2013 and accounted for 5% of CDB's total portfolio as of March 2013, however following the deterioration observed in the asset quality of the pawning portfolio, the company has brought down its pawning exposure to less than 1% as of September 2015.

CDB reported a Gross NPA Ratio of 5.8% as of March 2015 down from 5.2% reported as of March 2014. The asset quality improved to an extent in the current financial year with Gross NPAs moderating to 5.2% in September 2015. The company's 3-wheeler portfolio was the highest contributor for NPAs accounting for over 58% of total NPAs (3-wheeler account for 33% of the total portfolio) as of September 2015. ICRA Lanka notes that CDB also holds repossessed stock accounting for about 45% of the company's total NPAs as of March 2015. ICRA Lanka expects the company to reduce the repossessed stock in the current financial year, which should contribute to the improvement in overall NPA ratios. CDB reported a Net NPA ratio of 2.7% as of September 2015, resulting in moderate provision coverage of about 49.4%. ICRA Lanka notes that CDB's ability to arrest incremental slippages and, realizing income from the sale of repossessed stock with minimal overall losses in the due process would be crucial from a credit perspective.

CDB's funding is steered through fixed and savings deposits (total 79% of the overall borrowings) as of September 2015. The ALM mismatches in the shorter term time brackets (less than 1 year) mismatches 18% of total assets as of September 2015. About 60% of the CDB's total deposits had a contractual maturity of more than 1 year as of September 2015 and deposit renewal rates in the past were good at about 70-75%; this provides comfort from a liquidity perspective. ICRA Lanka also takes note of the management's plan to mobilize longer tenure funding; and initiatives to reduce the cost of funds, diversify its funding profile and improve overall liquidity.

CDB reported a total Capital Adequacy Ratio (CAR) of 11.3% as of September 2015 (March 2015 – 12.9%, March 2014 – 16.0%). ICRA Lanka notes that improvements in CDB's capitalization would be vital going forward considering the high gearing reported by the company; 8.4 times as of September 2015.

The company's overall earnings profile is characterised by a moderation in the NIMs to about 7.4% for the six months ended September 2015 (FY2015 - 8.0%, FY2014 – 8.1%) notwithstanding the moderation in the cost of funds, as CDB shifted its focus to lower yielding asset classes. The company's operational efficiency moderated during H1FY2016 with Operating cost to Operating income ratio increasing to 63% as compared to 57% for FY2015 and 55% for FY2014. The increase in the operating expenses could be attributed to their relocation to the state of art head office and corresponding manpower additions during FY2015. CDB's new head office premises has resulted in some increase in the depreciation expenses; this along with higher marketing related expenses also contributed to the increase in the operating expenses. The company's credit costs which remained high in FY2014(1.8%) due to the losses on account of the pawning portfolio and in FY2015(1.3%) due to the losses on account of the sale of repossessed stock, witnessed some moderation during the six months ended September 2015 (0.5%) . As of March 2015, the company has repossessed stock of about LKR 800 Million, ability to recover from these assets would be critical for the overall profitability in the next 1-2 years. CDB's reported return on average assets (ROAA) has remained largely stable over the last two years at about 1.9-1.95% levels, improved moderately during the six months ended September 2015 at 2.0%. Going forward, ICRA Lanka expects CDB's yields on the portfolio to moderate due to diversification to lower yielding asset classes; however rationalisation in the operating costs by the way of optimal business expansion and, its ability to control credit cost would be critical for the improvement in the profitability indicators.

### **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 35.6% stake as of March 2015, while the company's ESOP Trust owns 27%. Currently, as one of the mid-sized LFCs 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 59 outlets across the island employing over 1100 personnel as of March 2015. The company acquired controlling stake in Laughs Capital Limited and currently holds about 86% shares of the company.

During the year ended March 2015, CDB reported a net profit of LKR. 701 Million on a total asset base of LKR 38.0 Billion as compared to net profit of LKR. 561 Million on a total asset base of LKR 33.8 Billion in the previous fiscal. The consolidated net profit for the year ended March 2015 stood at LKR 710 Million on a total asset base of 38.1 Billion. For the half year ended Sep 2015, CDB reported a net profit of LKR 413 Million on a total asset base of LKR 43.4Billion. On a consolidated basis, the company reported a net profit of LKR 424 Million on a total asset base of LKR 43.5 Billion for the period.

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