ICRA Lanka reaffirms the Issuer and Issue Ratings of Commercial Leasing and Finance PLC

November 23, 2017

Instrument	Amount	Rating Action
Issuer rating	N/A	[SL]A(Stable); reaffirmed
Listed senior unsecured redeemable debentures	LKR 5,000 Mn	[SL]A(Stable); reaffirmed

ICRA Lanka Limited, subsidiary of ICRA Limited, group company of Moody's Investors Service has reaffirmed the issuer rating of [SL]A (pronounced SL A) with stable outlook for Commercial Leasing and Finance PLC (CLC or the company). ICRA Lanka has also reaffirmed the issue rating of [SL]A (pronounced SL A) with stable outlook for the LKR 5,000 Mn listed senior unsecured redeemable debentures of the company. Lanka Orix Leasing Company PLC ("LOLC"/ "HoldCo") has 99% effective holding in CLC. The ratings reflect the significant operational and financial linkages with LOLC and other peer subsidiaries and associates, especially in financial services business in the LOLC group. LOLC's financial services subsidiaries and other investments in financial services entities was about 85% of the total PAT in 3MFY2018 and 84% total group assets as on June 30, 2017.

At group level, the ratings factor in LOLC Group's long track record, and leadership position in the Sri Lankan retail finance market, its experienced management team, commensurate risk management systems, its comfortable asset quality and adequate profitability indicators. The ratings also take note of the committed support and oversight from its investor–ORIX Corporation of Japan (rated Baa1 with positive outlook by Moody's) which has a 30% stake in the entity.

ICRA Lanka notes that the group level gearing increased to 6.1 times[1] as on March 31, 2017 from 4.7 times as on March 31, 2016; it stood at 6.2 times as on June 30, 2017. The increase was mainly because of the leveraged acquisition of the controlling stake in PRASAC Micro Finance Institution Ltd (PRASAC) in Cambodia and the consolidation of the same into the group. The standalone gearing of PRASAC stood at 6.5 times as on June 30, 2017. In addition, the sizeable long-term foreign currency funding secured by the group's financial services entities (namely LOFC, CLC, LOMC and BRAC[2]) during the period, which is invested in deposits and government securities for hedging against exchange rate movements and the local currency borrowings secured against these deposits resulting in higher balance-sheet liabilities. The gearing adjusted for the above stood at 5.8 times as on March 31, 2017 (4.7 times as on March 31, 2016). ICRA Lanka takes note of the increase in the share of microfinance loans in the overall lending portfolio post acquisition of PRASAC and the growth witnessed in LOMC and LOLC Cambodia PLC, thereby increasing the overall portfolio vulnerability considering the modest credit profile of the target borrowers. While ICRA Lanka takes cognisance of the diversification to newer geographies (Cambodia, Myanmar and Pakistan) over the recent past, the ability to manage country specific risks across business and regulatory cycles would be crucial from a rating perspective. Further, ICRA Lanka would continue to monitor the performances of the non-financial services entities and their contribution to the overall group going forward.

At the company level, ICRA Lanka factors in CLC's demonstrated track record in the retail finance segment, its well-established franchise combined with a professional and experienced management

[1] Adjusted for revaluation and goodwill

[2] LOFC- LOLC Finance PLC, CLC- Commercial Leasing & Finance PLC, LOMC-LOLC Micro Credit, BRAC- Brac Lanka Finance PLC

team, healthy profitability indicators, comfortable liquidity profile and its adequate capitalization levels. The company has a good asset quality profile as compared to most peers; ability of the company to improve margins, restrict incremental slippages and maintain good profitability indicators would be crucial going forward.

CLC's lending portfolio comprised of loans (57%), leases (26%), factoring (12%) and microfinance (5%) as on March 31, 2017. CLC recorded 16% growth in its overall portfolio in FY2017 as compared with the 43% growth reported in FY2016. CLC is expected to grow its portfolio at a CAGR of 10-15% over the next 3-years. CLC's reported gross NPA ratio as on March 31, 2017 was 1.9% up from 1.1% as on March 31, 2016; it stood at 2.0% as on June 30, 2017. The main reasons for the increase were the deterioration of the factoring portfolio (12% of the total lending book as on March 31, 2017) and the adverse weather conditions that prevailed in the country, which impacted the credit quality of its customers.

CLC's capitalization levels remained comfortable with gearing at about 4.4 times as on March 31, 2017 vis a vis 5.9 times as on March 31, 2016 because of the moderate growth in the portfolio. The company has raised long term foreign currency funding and placed the same in a foreign currency deposit, which it used as security for domestic borrowings thus leading to higher level of debt on the company's balance sheet. The gearing adjusted for the foreign currency funding was about 4.0 times as on March 31, 2017.

CLC's liquidity profile has improved during the period, as the company was able to secure longer tenure funds of about USD 153 Mn in FY2017. CLC's exposure to fixed deposits increased, from 17% as on March 31, 2016 to 25% as on March 31, 2017 and 31% as on June 30, 2017 because of aggressive promotion of the same by the company. The company has a positive short-term ALM (less than 1 year) mismatch of 3% as on June 30, 2017 because of the short-term nature of its investment profile and maturing of 37% of its lending profile during the period.

CLC's overall profitability level moderated during FY2017 with the increase in cost of funding. The RoA stood at 2.1% as on March 31, 2017 vis a vis 2.5% as on March 31, 2016. The same improved to 3.5% (annualized) as on June 30, 2017 augmented by the one-off gain from deemed disposal of BRAC Lanka Finance PLC (BRAC). The moderate operating expenses and credit cost supported the overall profitability. The company's ability to maintain healthy interest margins and keep asset quality under control would be crucial for generating good risk adjusted returns.

Company Profile

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 and equipment and factoring. During FY2016, the company started microfinance operations. 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[3] segments. CLC was relisted in 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 BRAC Lanka Finance PLC and the same was reduced to 44% after BRAC's rights issue program in May 2017.

[3] MSME- micro, small and medium enterprises

During the year ended March 31, 2017, CLC reported a net profit of LKR 1.7 Bn on a total asset base of LKR 78 Bn as compared to a net profit of LKR 1.6 Bn on a total asset base of LKR 84 Bn in the previous financial year. The company reported a net profit of LKR 686 Mn on a total asset base of 79 Bn in 3MFY2018.

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