ICRA Lanka Assigns [SL]BBB rating to the proposed Senior Debentures, [SL]BBB- rating to the existing Subordinated Debentures and [SL]AA-(SO) rating to the Guaranteed Debentures of Commercial Credit and Finance PLC

March 29, 2016

Instrument	Amount	Rating Action
Proposed Senior Secured Redeemable Debentures Programme	LKR 2,000Million (with option to increase up to LKR 3,000 Million)	[SL]BBB; assigned with stable outlook
Listed Unsecured Subordinated Redeemable Debentures Programme	LKR 500 Million	[SL]BBB-; assigned with stable outlook
Listed Guaranteed Subordinated Redeemable Debentures Programme	LKR 1,000 Million	[SL]AA- (SO); assigned with stable Outlook

ICRA Lanka Limited, a wholly owned subsidiary of ICRA Ltd., a group company of Moody's Investors Service, has assigned issue rating of [SL]BBB (pronounced SL Triple B) with stable outlook to the proposed LKR 2,000 Million (with option to increase up to LKR 3,000 Miliion) Senior Secured Redeemable Debentures Programme of Commercial Credit and Finance PLC (CCFL or the Company), which is proposed to be listed on the Colombo Stock Exchange. ICRA Lanka has assigned the [SL]BBB- (pronounced SL Triple B Minus) with stable outlook to the LKR 500 Mn Unsecured Subordinated Redeemable Debentures Programme of the company, which is currently listed on the Colombo Stock Exchange. ICRA Lanka has also assigned the [SL]AA-(SO) (pronounced SL Double A Minus Structured Obligation) rating with stable outlook to the LKR 1,000 Million Guaranteed Subordinated Redeemable Debenture Programme of the Company, which is currently listed on the Colombo Stock Exchange. 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 ratings do not represent ICRA Lanka's opinion on the general credit quality of the issuer(s) concerned. ICRA Lanka has an issuer rating of [SL]BBB with stable outlook and an issue rating of [SL]A+(SO) with stable outlook for the LKR 2,000 Million Guaranteed Subordinated Redeemable Debentures Programme of the company.

The rating for the Guaranteed Subordinated Redeemable Debentures is based on the strength of the unconditional and irrevocable guarantee from Hatton National Bank PLC (HNB) for the principal amount (Rs 1,000 Million) and the two quarterly interest instalments (Rs. 52.5 Million) maintained as a security deposit with the Trustee. The guarantor undertakes the obligation to pay, on demand from the Trustee, Rs.1,000 Million of the principal amount of the Subordinated Redeemable Debentures. ICRA Lanka also factors in the undertaking from the Trustee to utilize the Security Deposit to pay the interest amount due to the NCD investors and declare the entire guaranteed amount as payable in the event the issuer does not meet the scheduled interest payment on any due date or, in the event the issuer does not redeem the Debenture in full on any redemption date to redeem the instrument in full. The rating also assume that the guarantee will be duly invoked by the Trustee, as per the terms of the underlying Trust deed, Trustee's undertaking and guarantee agreements, in case there is a default in payment by CCFL (Issuer).

The ratings factor in CCF's established business presence in Sri Lanka, its experienced senior management team along with the presence of a private equity investor who holds about 28% stake in the company and, its good profitability indicators, notwithstanding some moderation in the recent past. ICRA Lanka however takes note of CCF's high gearing level, high dependence on deposits and exposure to a customer segment with a modest credit profile that is highly vulnerable to the economic cycles. The ratings also takes note of the increase in the NPA during FY2016 (about 6.7% in December 2015) and would closely monitor the trends in the same post the initiatives taken by the company to keep the same under control. ICRA Lanka notes that the company's asset quality is subdued as compared to in the past and also notes the limited seasoning of the Microfinance (MF) and MF-related SME, however the strong provision coverage (about 88% as in December 2015) and good profitability indicators is expected to support the overall financial profile of the company. Further, the initiatives taken by the company to improve its MIS, internal controls and monitoring systems to make it commensurate with the risks inherent in the business provides some comfort. Going forward, the company is expected to grow its portfolio at about 30-35% CAGR over the medium term. Therefore, ability of the company to achieve a conservative capital structure in relation to the risks inherent in the business, maintain prudent appraisal/sourcing norms for improving its asset quality and, its ability to maintain good profitability indicators by improving its operating efficiencies and reducing credit related losses would the key rating sensitivities.

CCF's gross lending portfolio increased to about Rs. 53.9 Billion as of December 2015, recording a 16% Y-o-Y growth. The company reported a decline in its MF, MF-related SME loans due to asset quality concerns and a moderate growth in leasing/Hire Purchase (HP). MF and MF-related SME loans together accounted for 27% of the gross portfolio in December 2015 while HP/leasing accounted for about 46%. Within the HP/leasing segment, the company takes exposures for financing cars/vans (17% of the total portfolio in December 2015), commercial vehicles (9%), 3-wheelers (8%), 2-wheelers (11%).The company has steadily reduced its pawning portfolio which accounted for about 3% in December 2015 as compared to 10% in March 2014. Going forward, the company is expected to reduce its focus on MF/MF-related products segments to 25% of the total portfolio and increase the share of less risky product segments namely personal vehicles and 3wheeler.

ICRA Lanka takes note of the weakening in the asset quality indicators during FY2016 specifically due to the increase in the delinquencies witnessed in the MF, MF-related SME loans segment. The company's gross NPAs increased from about 4.1% in March 2015 to about 6.7% in December 2015. CCF's provision coverage however is strong at about 88% in December 2015. The rating takes note of the increasing standalone NPAs in the MF/ MF-related SME loans to 6.2% in December 2015, which stood at about 1.1% as in March 2015. Notwithstanding the healthy provision coverage, ability of the company to contain NPAs in the MF/MF-related SME loans at reasonable levels and reduce losses on sale of reprocessed stocks, as the business expands and portfolio seasons would be a key monitorable from a credit perspective.

CCF's gearing reduced to 8.35 times as in December 2015, when compared to 8.70 times, reported in March 2015 due to a moderation in the portfolio growth. ICRA Lanka notes that the company is expected to grow at a relatively moderate pace of 30-35% as compared to the past (71% CAGR over the period FY12-FY15); and while its reported capital adequacy ratio (CAR) was comfortable at 13.1% with core capital at 10.7% as in December 2015; it would be critical for CCF to moderate its gearing from the current levels to have capitalisation profile commensurate with the risk inherent in its business, due to its exposures to customers with modest credit profile.

The company is largely dependent on deposits, which accounted for about 91% (86% being fixed deposits) of the total funding base as in December 2015. CCF generally has rollover rate of about 70-75% on the fixed deposits; while CCF has been able to grow its deposit base on the back of the sharp increase in its service locations over the past 3-4 years, it would be crucial for the company to secure longer term funding to offset the liquidity related risks for meeting the envisaged business growth.

CCF's RoA for the 9MFY16 moderated to 3.4% as compared to 4.0% in FY15 as the credit cost increased to 3.7% from about 3.1% and NIMs moderated to 14.8% from about 15.7% during the above mentioned period. The increase in the delinquencies impacted the company's credit costs while moderation in the share of the high yielding advances (MF-/MF-related SME loans) resulted in some reduction in the NIMs. Going forward, CCF's ability to control delinquencies in the MF/MF-related book and losses on the repossessed stock would be crucial from a rating perspective.

Company Profile:

CCF, a Registered Finance Company, offers microfinance, leasing, hire purchase, accepts deposits (Fixed and Savings) and extends other personal credit facilities. The company was established in 1982 as specialized leasing company in Kandy. In October 2009, the company's ownership changed, with controlling interest being acquired by BG investments (Pvt) Ltd, an investment holding company controlled by Mr. Roshan Egodage, Executive Director and Chief Executive Officer- CCF. In 2010, the company moved its Head Office to Colombo. Since change of ownership, the company has rapidly expanded its service locations to about 118 from about 22 in FY2012. The company has an employee base of about 3,300 and caters to about 940,000 customers. CCF's shares were listed in the Dirisavi Board (secondary board) of the CSE in June, 2011. BG Investment (Pvt) Ltd holds 58% of the shares, while Creation Investments Sri Lanka LLC owns about 28%, following the equity infusions during FY2014 and in FY2015. During FY2015, the company acquired majority stake in Trade Finance and Investments PLC, which presently is a wholly owned subsidiary.

During the year ended March 2015, CCFL reported a net profit of LKR 2.1 Billion on a total asset base of LKR. 57.7 Billion as compared to net profit of LKR 1.0 Billion on a total asset base of LKR 31.6 Billion in the previous fiscal. The consolidated net profit for the year ended March 2015 stood at LKR 2.2 Billion on a total asset base of LKR 59.0 Billion.

For the nine months ended Dec 2015, CCFL reported a net profit of LKR 1.6 Billion on a total asset base of LKR 67.9 Billion. On a consolidated basis, the company reported a net profit of LKR 1.7 Billion on a total asset base of LKR 69.9 Billion for the period.

Guarantor Profile:

Hatton National Bank PLC

Hatton National Bank PLC (HNB) is one of the largest private sector commercial banks in the country with total assets amounting to LKR 725 Billion as at Dec 2015. It accounted for 8.9% of sector assets, 11.0% of sector loans and advances and 9.7% of sector deposits as at Dec 2015. The bank was incorporated in the present form in the year 1970. Stassen's group with 17.95%, Sri Lanka Insurance Corporation Ltd with14.68% and Employee Provident Fund with a 9.81% are the major shareholders of the bank. The bank recorded a total income of LKR Rs.61.1 Billion for the FYE Dec 2015 and LKR 59.5 Billion for the FYE Dec 2014. The net profits of the bank amounted to LKR 10.4 Billion for the FYE Dec 2015 and LKR 9.0 Billion for the FYE Dec 2014, which resulted in ROAA of 1.6% and 1.7% for the respective periods. The bank had gross NPA ratios of 2.43% and 3.16% as at FYE Dec 2015 and FYE Dec 2014 and net NPA ratios of 0.84% and 1.43% respectively for the said periods. The bank had a net worth of LKR 65.0 Billion for the FYE 2015 with tier 1 capital adequacy ratio of 10.53% and total capital adequacy ratio of 12.70%.

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