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ICRA Lanka assigns [SL]BBB+ rating with a stable outlook for Lanka ORIX Finance PLC's proposed subordinated unsecured redeemable debenture programme

ICRA Lanka Limited, a wholly owned subsidiary of ICRA Ltd, a group company of Moody's Investors Service, has assigned the [SL]BBB+(pronounced S L Triple B plus) rating with a stable outlook for the proposed LKR 5 Bn subordinated unsecured redeemable debenture Programme of Lanka ORIX Finance PLC (LOFC or the Company). ICRA Lanka also maintains an outstanding issuer rating of [SL]A- for LOFC. Given the significant operational and financial linkages with the Holding company (Holdco; Lanka Orix Leasing Company PLC), ICRA Lanka continues to take a consolidated rating view of the HoldCo and the key asset financing subsidiaries.

At Group level the rating factors in LOLC Group's long track record in the retail finance sector, its leadership position in the Sri Lankan retail finance market, professional and experienced management team and adequate risk management systems with a strong retail franchise. The rating also derives support from the committed support and oversight from its Key investor of the Holdco–ORIX Corporation of Japan (rated Baa2 with stable outlook by Moody's), which has a 30% stake in the entity. The Group's performance is largely dependent on its key financial service subsidiaries due to the low contribution from the non-financial service subsidiaries; increase in NPAs of the financial services subsidiaries in the recent past, although in line with the increase witnessed in the industry and the consequent pressure in the profitability levels are the key rating constraints. At group level it would be important to improve overall asset quality of the key financial services subsidiaries, through effective management of incremental slippages and focused recovery initiatives going forward.

At the company's level, the rating factors LOFC's robust franchise, healthy competitive position given its superior market share (8% approx) among its peer LFCs and a professional and experienced management team. ICRA Lanka has also taken note of the improvements in LOFC's Asset-Liability Maturity (ALM) profile in terms of moderation in shorter term ALM gaps and improvement in the overall profitability levels. The ratings take note of LOFC's increase in NPAs and the lower capitalization levels. Going forward, improving asset quality, by effective recoveries and controlling incremental slippages, along with LOFC's ability to generate adequate internal generation for maintaining a prudent capitalization profile in relation to the envisaged business growth would be critical from the credit perspective.

LOFC's portfolio recorded a growth of 7% for FY2014 (8.6% annualized growth for Q1FY2015) compared to 12% growth for FY2013 – excluding the factoring portfolio. LOFC's growth was lower compared to peers and the industry, due to the prevailing subdued credit demand and the group adopting a more cautious lending strategy. LOFC's standalone asset quality indicators registered improvement with GNPA improving from the peak levels of 6.9% in Jun-13 (5.3% in Mar-13) to 5.1% reported as in Mar-14 mainly due to accelerated recoveries, decline in overall incremental slippages and write-offs. ICRA Lanka takes note of the increase in Gross NPA Ratio to 5.93% as of Jun-14; the same however is expected to moderate going forward. The company has managed to improve its overall provisioning level resulting in a better Net NPA ratio of 1.37% as of Mar-14 compared to 1.70% as of Mar-13.

LOFC's financial leverage improved during FY2014 mainly due to the moderate growth in the portfolio, while accretion of reserves continued to remain healthy. ICRA Lanka notes the improvement in LOFC's ALM profile during FY2014, as the company was able to secure longer tenure funds. The negative mismatch for >1 year moderated from about 23% in Mar-13 to 12% in Mar-14. LOFC's funding mix continues to be steered mainly through fixed deposits (95% as of Jun-14) however the overall duration of these deposits has been shifting into longer tenures (Approximately 60% accounting for deposits with tenure of 1-3 years) adding further comfort to LOFC's liquidity profile.

LOFC's Capital Adequacy Ratio (CAR) stood at 13.1% as on Mar-14 (12.8% - Jun-14) compared to 12.1% as on Mar-13, recording an improvement mainly due to healthy accretion to reserves combined with low credit growth. Further improvements in the regulatory capital adequacy would be important for LOFC in order to withstand any unexpected pressure and to support business growth, as the company's capitalization levels, although within the regulatory requirements, remain below the industry average and peers.

LOFC's overall earnings profile recovered during FY2014 with some improvement in the NIMs and other income including income from government securities resulting in an overall 45% growth in PAT levels for the FY2014. The operating expenses as a proportion of average assets increased in FY2014, while the credit costs remained at stable levels supported by the healthy recoveries, although write-offs witnessed a sharp increase; overall provision coverage increased from 37% in Mar-13 to about 74% in Mar-14. The company reported a Return on Average Assets of 1.98% for FY2014 compared to 1.6% for FY2013. LOFC's Return on Net Worth also improved to 16.7% for the FY2014 compared to 13.5% for the FY2013.LOFC's earnings profile moderated in Q1FY2015, with Return on Average Assets at 1.7%, mainly due to the increase witnessed in the credit costs and some moderation in the margins as business growth remained subdued at about 8% (annualized) during the period.

Company Profile

Lanka ORIX Finance PLC (LOFC), (set up in 2001) established initially as a wholly owned subsidiary of LOLC (Lanka Orix Leasing Company PLC, has a strong Retail Franchise among Licensed Finance Companies (LFCs) in Sri Lanka. The LOLC Group is one of the Largest Financial Services conglomerate in the country, with the parent (LOLC) being the first leasing company to be established in Sri Lanka. LOFC was the largest operational financial services subsidiary (31% of Group Assets as at Jun-14) of LOLC, which offers Savings and Deposits in Local and Foreign Currency, Leasing and Hire Purchase Loans mainly for financing Auto Vehicles for commercial use and Islamic finance. In July 2011, as per the Central Bank of Sri Lanka (CBSL) directions, LOLC divested 10% of its stake in LOFC and obtained a listing on the Colombo Stock Exchange (CSE).

During the quarter ended June 2014, LOFC reported a net profit of Rs. 241 Mn (unaudited) on a total income of Rs. 2,651 Mn compared to net profit of Rs. 1,000 Mn on a total income of Rs. 11.4 Bn in the previous fiscal.

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