

ICRA Lanka reaffirms the Issuer and Issue Ratings of LOLC Finance PLC

January 31, 2017

Instrument	Amount	Rating Action
Issuer Rating	n/a	[SL]A(Stable); reaffirmed
Subordinated 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 LOLC Finance PLC (LOFC or the Company). ICRA Lanka has also reaffirmed the issue rating of [SL]A- (pronounced SL A minus) with stable outlook for the LKR 5,000 Mn listed subordinated unsecured redeemable debentures of the Company. Given the significant operational and financial linkages with the Holding company (Holdco; Lanka Orix Leasing Company PLC), ICRA Lanka continues to take a consolidated view of the HoldCo and the key subsidiaries in the financial sector.

At group level the ratings factor in LOLC Group's ("the group") long track record in the retail finance sector, its established franchise and leadership position in the Sri Lankan retail finance market, experienced management team, commensurate risk management systems, comfortable asset quality and adequate profitability. The ratings also take note of the committed support and oversight from its largest investor-ORIX Corporation of Japan (rated Baa1 with stable outlook by Moody's) which has a 30% stake in the entity. ICRA Lanka notes that the group level gearing increased to 4.3 times in March 31, 2016 from 3.1 times in March 31, 2015; it remained at 4.3 times as on June 30, 2016. The increase was partly due to the sizeable long-term foreign currency funding secured by the group for its financial services entities (namely LOFC, CLC and LOMC) during FY2016, which is held as deposit, for hedging against exchange rate movements and the local currency borrowing made against these deposits resulting in double count of liabilities. ICRA Lanka would continue to monitor the performances of other entities, including the non-financial services entities, in the group and improvements in the performances of the same would be key rating sensitivities going forward. Going forward, envisioned regulatory changes in the vehicle financing space and the consequent impact of the same on the NBFIs sector would also be a key monitorable.

The ratings continue to factor LOFC's robust franchise, good competitive position and its professional and experienced management team. ICRA Lanka expects LOFC's liquidity profile to improve with the USD 69 Mn long term funding from Asia Development Bank (ADB). However, the company's gearing is relatively high at 10.4 times as on September 30, 2016. The asset quality improved during FY2016; it would have to undertake recoveries and close monitoring of slippages to keep NPAs within reasonable levels. ICRA Lanka also takes note of the moderation in the earnings profile as the business spreads reduced.

Going forward, LOFC's ability to achieve envisaged business growth while maintaining a comfortable risk adjusted capital profile would be crucial. LOFC's portfolio recorded a growth of 50% (Y-o-Y) for FYE2016 (30% for FYE2015), growth however moderated to 14% for H1FYE2017 because of regulatory changes. LOFC's standalone asset quality indicators registered improvements as Gross NPA reduced from 4.94% reported as in March 31, 2015 to 4.33% as on March 31, 2016, because of effective recoveries and decline in overall incremental slippages. The Gross NPA has further declined to 4.25% as on September 30, 2016.

LOFC's gearing increased to 10.6 times as on March 31, 2016 as compared with 7.1 times as on March 31, 2015, given the growth in portfolio recorded for the period and because of the long term foreign currency funding was deposited in the banks to hedge against currency movement and used it as collateral 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 9.7 times as on June 30, 2016. LOFC' core capital moderated to 10.07% as on March 31, 2016 (9.39% as on September 30, 2016); regulatory minimum core capital requirement is 5.0%. The capital adequacy ratio of the company was 13.47% as at 31st March 2016 (12.41% as at September 30, 2016).

ICRA Lanka expects LOFC's liquidity profile to improve, as the company was able to secure longer tenure funds. LOFC's dependency on fixed deposits reduced, from 73% as of March 31, 2015, to 57% as at March 31, 2016.

LOFC's overall earnings profile in FYE2016 and H1FY2017 moderated as business yields declined and the cost of funds increased. The company has been able to keep its operating costs and credit costs within reasonable levels. Nevertheless, RoA moderated to 1.6% for FY2016 as compared to 2.4% in FYE2015 further to 1.2% in H1FYE2017. The company's ability to maintain good interest margins and keep asset quality under control would be crucial for generating good risk adjusted returns.

Company Profile

LOLC 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. 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). 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 is the largest financial services subsidiary (29% of Group Assets as in March 31, 2016) of LOLC, which offers Savings and Deposits in Local and Foreign Currency, extends Loans mainly for Auto finance and Islamic Finance.

During the year ended March 31, 2016, LOFC reported a net profit of LKR 1.4 Bn on a total asset base of LKR 110.3 Bn as compared to a net profit of LKR 1.5 Bn on a total asset base of LKR 67.9 Bn in the previous financial year. The company reported a net profit of LKR 714 Mn for the H1FYE2017 on a total asset base of LKR 121.8 Bn.

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