

Update on acquisition and merger of LOLC Micro Credit Limited with LOLC Finance PLC

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Update

ICRA Lanka Limited, subsidiary of ICRA Ltd, a group company of Moody's Investors Service, takes note of the acquisition of LOLC Micro Credit Limited (LOMC), by LOLC Finance PLC (LOFC) on January 29, 2018. LOFC acquired LOMC by purchasing Lanka Orix Leasing Company PLC's (LOLC) 80% stake and FMO's (The Netherlands Development Finance Company) 20% stake for a consideration of LKR 12.2 Bn. The purchase consideration was settled using its internal resources.

Between, January 29, 2018 to March 31, 2018, LOMC will be a subsidiary of LOFC. As a result, LOFC's regulatory capital adequacy would be significantly stretched on account of the Rs.12 Bn investment in LOMC; the total capital base of LOFC was LKR 13.1 Bn in Jun-17 (Tier I: LKR 10.8 Bn and Tier II: LKR 2.3 Bn).

LOMC is expected to merge with LOFC on or before March 31, 2018. LOFC's and LOMC's provisional gearing (adjusted for revaluation reserve) stood at 9.8 times and 6.2 times respective as on June 30, 2017. LOFC is expected to raise LKR 5.9 Bn via a proposed rights issue; LOLC is expected to invest part of the proceeds received from sale of LOMC in the proposed right issue of LOFC. The company also intends to issue a LKR 3.5 Bn subordinated debenture in the near term to augment its regulatory capital adequacy position. ICRA Lanka expects the above to adequately support the overall capitalisation profile of the merged consolidated entity in the near term.

ICRA Lanka does not expect any significant operational changes as LOFC and LOMC have been sharing the branch network. However, operational level synergies and leverage are expected to improve post the merger. ICRA Lanka expects the asset quality of the merged entity to improve with the merger, as the reported asset quality of LOMC (G NPAs at 1.27% in Jun-17) was better than LOFC (G NPAs at 5.18% in Jun-17). However, the customer profile and target asset classes of LOMC are relatively moderate as compared with LOFC, which could expose the company to higher portfolio vulnerability during adverse business and economic cycle. The profitability of the merged entity is expected to improve, as LOMC reported better profitability (RoA at 2.98% in 8MFY2018 vis a vis LOFC's 0.93%) indicators on account of its higher business yields.

ICRA Lanka would continue to monitor the developments with regards to the proposed merger.

About the company:

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 was listed on the Colombo Stock Exchange (CSE). The LOLC Group is one of the largest business groups in the country, with the parent (LOLC) being among the first leasing company to be established in Sri Lanka. The LOLC group has interests in trading, plantation, leisure and energy. LOFC offers savings and deposits in local and foreign currency, extends loans mainly for auto finance and Islamic finance.

During the year ended March 31, 2017, LOFC reported a net profit of LKR 1.6 Bn on a total asset base of LKR 123 Bn as compared to a net profit of LKR 1.4 Bn on a total asset base of LKR 110 Bn in the previous financial year. The company reported a net profit of LKR 620 Mn for the 6MFY2018 on a total asset base of LKR 134 Bn.

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