

**ICRA Lanka assigns “[SL] A-” rating with a stable outlook to the proposed Senior Unsecured debenture programme of Lanka ORIX Leasing Company**

August 22, 2014

<b>Instrument</b>	<b>Amount</b>	<b>Rating Action</b>
Long Term Unsecured Redeemable Debenture Programme	LKR 7 Bn (with provision for the amount to be increased to LKR 12 Bn)	[SL]A- (Stable);assigned

ICRA Lanka has assigned the [SL] A- (pronounced SL A minus) rating with a stable outlook to the proposed LKR 7 Bn (with provision for the amount to be increased to LKR 12 Bn) Long Term Senior Unsecured, to be Listed, Redeemable Debenture Programme of Lanka ORIX Leasing Company PLC (LOLC or the HoldCo). ICRA Lanka already has an outstanding Issuer rating of [SL] A- for LOLC. The company’s existing senior unsecured debentures of LKR 1.25 Bn is also rated at [SL] A-; the ratings carry a stable outlook. Given the significant operational and financial linkages with the subsidiaries (especially pertaining to financial services), ICRA Lanka continues to take a consolidated rating view of the HoldCo and the key asset financing subsidiaries.

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–ORIX Corporation of Japan (rated Baa2 with stable outlook by Moody’s), which has a 30% stake in the entity. ICRA Lanka notes that the said debentures would be used to re-finance existing short term debt at the Holdco level, which would improve the overall liquidity and cost of funds. The Holdco’s moderate earnings profile and the contribution from non-financial service businesses to the group level profitability are limiting factors to the rating.

LOLC Group mainly operates in the area of leasing and hire purchase of automobiles (with over 80% share in total portfolio) and its largest customer segment comprises of small and medium business enterprises for working capital finance. As part of the organisational restructuring, fresh retail business is originated by LOLC’s operational financial services subsidiaries, whereas the remaining portfolio in LOLC is expected to run-down over the next 2 years. Over the past 2 years, the Group has diversified its presence across leisure and energy ventures, but the financial services are likely to remain the group’s mainstay over the medium term.

LOLC’s group level asset quality has improved marginally from the Jun-13 levels when the reported Gross NPA ratio stood at 4.94% (3.36% - Mar-13) to 4.85% as of Mar-14. Lanka Orix Finance PLC (LOFC) and Commercial Leasing and Finance PLC (CLC), the two key financial entities in the group, witnessed moderation in the incremental slippages and carried out substantial recoveries during FY2014 resulting in improvements in the overall Gross NPA and Net NPA Ratios. The said Companies also carried out write offs during the same period (20% of the opening NPAs and slippages for FY2014 for LOFC and 61% of the opening NPAs and slippages for FY2014 for CLC) in order to clear out longstanding NPAs. ICRA Lanka takes note of the decline in overall slippages recorded by the two LFCS over the past FY and



expects the overall asset quality profile to improve further in FY2015 with the stability observed in the operating environment. Further improvements in the overall group's asset quality profile, through effective management of incremental slippages and focused recovery initiatives would be key rating sensitivities.

LOLC group's earning profile has strengthened during FY2014 with improved profitability indicators of the financial services subsidiaries and contributions to underlying profitability from non-financial services businesses as well. Overall decline in funding costs due to the prevailing low interest rate scenario and the resultant increase in NIM has contributed to the financial services profitability. Although group level operating costs remained constant, credit costs remained significantly higher at 2.06% of Average Total Assets as of end Mar-14 (1.36% - Mar-13). Improved financial services profitability indicators provide comfort to the Holdco as the financial services subsidiaries has the highest contribution to the Group profitability. RONW for the group improved to 7.05% (Mar-14) compared as 5.9% (Mar-13). The Holdco's standalone earnings comprise mainly of shared services fees and interest income charged from on-lending to subsidiaries. The Holdco profitability levels improved during in FY 2014 owing mainly to profit from sale of investments accounting for Rs 945 Mn. Consequently the Holdco ROAA improved to 1.35% for FYE Mar-14 compared to 0.06% reported for FYE Mar-13.

LOLC Group's insurance business reported steady growth in its overall business and profitability levels during the FYE Mar-14, but accounts for a small portion of the group's profits. LOLC's non-financial services businesses also registered recovery during the same period with the leisure business cutting the losses by 63% (Rs 904Mn – Mar-13 to Rs 335 Mn – Mar-14) during FYE Mar-14. The trading segment of the group also reported improvement in overall profitability at PBT levels (Rs 148 Mn – Mar-13 to Rs 542 Mn – Mar-14) supported by gain from sale of investments ( 12 % of the profits in FYE Mar-14). LOLC's power segment reported losses while the plantation segment reported marginal profits for the FYE Mar-14.

The Holdco's trading investment portfolio has been scaled down over the FYE Mar-14. The trading and investments securities portfolio declined to around Rs. 900 Mn as at end Mar-14 from Rs 1,200 Mn reported as at end Mar-13. During the FYE Mar-14 the Holdco increased its stake in its key financial services subsidiary CLC from 90% (Mar-13) to 99% (Mar-14). At Group level, the incremental investments have been mostly in government securities, which accounted for 31% of the total investments in Mar-14 as compared to 22% in Mar-13 and, the composition of equity investments have declined during the FYE Mar-14.

ICRA Lanka notes that the group has been able to secure longer tenure borrowings at favourable rates, which is expected to support the overall liquidity profile and profitability going forward. Group level earnings recovered during the FYE Mar-14 with the ROAA improving to 1.84% from 1.66% in FYE Mar-13 largely on account of improved margins in the financial services subsidiaries and improved financial performances of the non-financial services businesses.



ICRA Lanka takes note of the consistent progress made by the management to de-leverage the Holdco from the reported gearing levels of 0.6 times as on end Mar-13 to 0.4 times by end Mar-14 through the transfer of the residual lending portfolio to its financial services subsidiary and further reducing intra-group exposures. ICRA Lanka notes that the overall group level gearing indicators have increased over the past 2 FYs from 2.16 times as of end Mar-12 to 2.65 times as on end Mar-14. ICRA Lanka would be monitoring the ability of the LOLC group to improve on their operating margins while reducing the standalone leverage which would be a key rating sensitivity.

### **Company Profile**

Setup in 1980, Lanka ORIX Leasing Company PLC (LOLC) is a leading player in leasing and other lending activities with ORIX Corporation holding 30% of LOLC since its inception. With the group diversifying into other interests including leisure and energy in the past few years, LOLC surrendered its Specialized Leasing Company (SLC) license from CBSL and has transformed itself into a holding company by transferring all operations to its subsidiaries. At the end of March 2014, financial services contributed 91% of PBT of the group while interests in leisure and power reported losses.

During the year ended March 2014, LOLC group reported net profit of Rs. 3.1 Bn on a total income of Rs. 35 Bn compared to net profit of Rs. 2.5 Bn on a total income of Rs. 32 Bn in the corresponding period of the previous fiscal.

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