

ICRA Lanka reaffirms the Issuer and Issue Ratings of Lanka Orix Leasing Company PLC

November 23, 2017

Instrument	Amount	Rating Action
Issuer Rating	N/A	[SL]A with Stable outlook reaffirmed
Listed Senior Unsecured Redeemable Debenture Programme	LKR 5,000 Mn	[SL]A with Stable outlook reaffirmed
Unlisted Senior Unsecured Redeemable, Debenture Programme	LKR 2,750 Mn	[SL]A with Stable outlook reaffirmed

ICRA Lanka Limited, subsidiary of ICRA Limited, a group company of Moody's Investors Service, has reaffirmed the issuer rating of [SL]A (pronounced SL A) with Stable outlook for Lanka Orix Leasing Company PLC (LOLC or the HoldCo). ICRA Lanka has also reaffirmed the issue ratings of [SL]A (pronounced SL A) with Stable outlook for the LKR 5,000 Mn listed senior unsecured redeemable debenture programme and the LKR 2,750 Mn unlisted senior unsecured redeemable debenture programme of the company. ICRA Lanka has taken a consolidated rating view of the LOLC group, which has interest in financial services, insurance, manufacturing and trading, plantation and renewable energy, and leisure. The contribution of all financial services subsidiaries and other investments in financial services entities of the group was about 85% of the total PAT in 3MFY2018 and 84% total group assets as on June 30, 2017.

The rating reaffirmations factor in LOLC Group's long track record, and leadership position in the Sri Lankan retail finance market, its experienced management team, commensurate risk management systems, its comfortable asset quality and adequate profitability indicators. The ratings also take note of the committed support and oversight from its investor-ORIX Corporation of Japan (rated Baa1 with positive outlook by Moody's) which has a 30% stake in the entity.

ICRA Lanka notes that the group level gearing increased to 6.1 times¹ as on March 31, 2017 from 4.7 times as on March 31, 2016; it stood at 6.2 times as on June 30, 2017. The increase was mainly because of the leveraged acquisition of the controlling stake in PRASAC Micro Finance Institution Ltd (PRASAC) in Cambodia and the consolidation of the same into the group. The standalone gearing of PRASAC stood at 6.5 times as on June 30, 2017. In addition, the sizeable long-term foreign currency funding secured by the group's financial services entities (namely LOFC, CLC, LOMC and BRAC²) during the period, which is invested in deposits and government securities for hedging against exchange rate movements and the local currency borrowings secured against these deposits resulting in higher balance-sheet liabilities. The gearing adjusted for the above stood at 5.8 times as on March 31, 2017 (4.7 times as on March 31, 2016). ICRA Lanka takes note of the increase in the share of microfinance loans in the overall lending portfolio post acquisition of PRASAC and the growth witnessed in LOMC and LOLC Cambodia PLC, thereby increasing the overall portfolio vulnerability considering the modest credit profile of the target borrowers. While ICRA Lanka takes cognisance of the diversification to newer geographies (Cambodia, Myanmar and Pakistan) over the recent past, the ability to manage country specific risks across business and regulatory cycles would be crucial from a

¹ Adjusted for revaluation and goodwill

² LOFC- LOLC Finance PLC, CLC- Commercial Leasing & Finance PLC, LOMC-LOLC Micro Credit, BRAC- Brac Lanka Finance PLC

rating perspective. Further, ICRA Lanka would continue to monitor the performances of the non-financial services entities and their contribution to the overall group going forward.

LOLC-SL NBFIs³ asset quality has improved from 2.9% as on March 31, 2016 to 2.7% on at March 31, 2017. The same increased to 3.2% as on June 30, 2017 primarily because of the increase in LOFC's gross NPAs to 5.2% as on June 30, 2017 from 4.4% as on March 31, 2017 (4.2% as on March 31, 2016). LOFC witnessed a deterioration in its factoring portfolio and overall credit quality of its customers due to challenging weather conditions that prevailed in the country. The gross NPA (on 180 days overdue basis) ratio of CLC, LOMC and BRAC stood largely stable at 2.0%, 1.3% and 1.8% as on June 30, 2017 vis a vis 1.9%, 1.5% and 0.6% as on March 31, 2017 respectively (1.1%, 1.4% and 0.8% as on March 31, 2016). PRASAC reported an NPA (on 30 days overdue basis) of 1.2% as on December 31, 2016.

LOLC group's NIMs reduced to 6.1%⁴ in FY2017 from 6.5% in FY2016 largely because of the higher cost of funds. However, stable credit costs (0.84% in FY2017 from 0.95% in FY2016) and improvement in the operating efficiencies, supported overall profitability to an extent. Consolidated RoA which stood at 3.0% in FY2016, improved to 4.1% in FY2017 on account of the one-time extraordinary gains. LOLC group recorded a one-off gain of about LKR 11 Bn from divestment of group investments and fair value gain of PRASAC holdings during FY2017; adjusted RoA stood at 2.6% for FY2017. LOLC's standalone earnings comprised mainly of fee income from shared services and interest income charged from lending to subsidiaries. The standalone RoA was 0.8% (adjusted for one-time gain) in FY2017 vis a vis 1.0% in FY2016.

LOLC group's exposure to foreign operations increased significantly with the acquisition of the controlling stake in PRASAC in March 2017. The contribution from overseas financial services entities to the group's PAT and total assets stood high at 51% and 42% respectively in 3MFY2018. The asset base of PRASAC stood at about LKR 232 Bn as of June 30, 2017, while the same for LOLC Cambodia PLC, LOLC Myanmar Microfinance Company Ltd. and Pak Oman Microfinance Bank Ltd. stood at about LKR 38 Bn, LKR 2 Bn and LKR 1.8 Bn respectively.

LOLC group's general and life insurance business recovered from its losses in FY2017 to report a PBT of LKR 632 Mn vis a vis losses of LKR 76 Mn in FY2016, however, the contribution to group assets and profits stood insignificant at 1% and 3% respectively for FY2017. The manufacturing and trading segment reported an improved PBT of LKR 2,189 Mn in FY2017 vis a vis LKR 1,124 Mn in FY2016 with a contribution of 5% to group's assets as of March 31, 2017. LOLC's power and plantation segments also reported improved PBT; about LKR 4,824 Mn in FY2017 (including one-time gain of about LKR 3 Bn) vis a vis losses of LKR 669 Mn in FY2016. However, the leisure business continued to incur losses of LKR 903 Mn in FY2017 (LKR 618 Mn loss in FY2016).

LOLC's total investments grew by about 30% during FY2017 mainly because of the investment in PRASAC during the period. LOLC acquired the controlling stake of PRASAC by increasing its stake from 22% to 70% for a consideration of USD 186 Mn (about LKR 28 Bn) in March 2017. The group acquired 50.1% of Pak Oman for a consideration of USD 11.6 Mn (LKR 1.7 Bn). Further, LOLC subscribed for the rights issue program of BRAC by investing LKR 1.3 Bn. Going forward, ICRA Lanka expects no other significant investments by the group over the near to medium term.

³ LOLC-SL NBFIs include LOLC Finance PLC, Commercial Leasing & Finance PLC, LOLC Micro Credit, Brac Lanka Finance PLC

⁴ Adjusted for the consolidation of PRASAC

Company Profile

Setup in 1980, Lanka Orix Leasing Company PLC (LOLC) has evolved itself from a financial services provider to a holding company which has interests in trading, plantation, leisure and energy. The Orix Corporation holding has 30% of LOLC since its inception. The group has diversified geographically into Cambodia, Myanmar and Pakistan. As of June 30, 2017, financial services contributed to about 85% of PAT of the group and 84% of total assets of the group.

During the FY2017, LOLC group reported net profit of LKR 21 Bn on a total Asset base of LKR 641 Bn compared to net profit of LKR 9 Bn on a total Asset base of 380 Bn in the previous fiscal. The Group reported a net profit of LKR 5 Bn on a total asset base of LKR 690 Bn in 3MFY2018.

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