

ICRA Lanka revises the long term ratings of LOLC Finance PLC

November 10, 2015

Instrument	Amount	Rating Action
Issuer Rating	n/a	Revised to [SL]A with stable outlook from [SL]A- with stable outlook
Subordinated Unsecured Redeemable Debentures	LKR 5,000 Mn	Revised to [SL]A- with stable outlook from [SL]BBB+ with stable outlook

ICRA Lanka has revised the issuer rating of LOLC Finance PLC (LOFC or the Company) to [SL]A (pronounced SL A) with stable outlook from [SL]A- (pronounced SL A minus) with stable outlook. ICRA Lanka has also revised the LKR 5,000 Mn Listed Subordinated Unsecured Redeemable Debentures to [SL]A- (pronounced SL A minus) with stable outlook from [SL]BBB+ (pronounced SL triple B plus) with stable outlook. Given the significant operational and financial linkages with the Holding company (Holdco; Lanka ORIX Leasing Company PLC), ICRA Lanka continues to take a consolidated financial analysis of the HoldCo and the key financing subsidiaries namely, LOFC, LOMC (LOLC Micro Credit Limited) and CLC (Commercial Leasing and Finance PLC).

At Group level the rating factors in LOLC Group's ("the group") long track record in the retail finance sector, its leadership position in the Sri Lankan retail finance market along with a strong retail franchise, professional and experienced management team and adequate risk management systems. The rating also derives support from the committed support and oversight from its key investor in the Holdco-ORIX Corporation of Japan (rated Baa1 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 as contribution from the non-financial services subsidiaries is quite modest. ICRA Lanka notes that the LOLC group's consolidated NPA has moderated to about 2.8% as in March 2015 as compared to 4.9% in March 2014 and the consolidated profitability improved with RoA at 3.1% for FY2015 as compared to 1.9% in FY2014, largely on account of the improvement in the performance of the financial services entities. The financial services entities contributed to about 87% of the group PBT¹ in FY2015. Going forward, ability of the group to contain incremental slippages while achieving good recoveries in the financial services business, maintain good profitability indicators and, improved performance of the non-financial subsidiaries would be crucial from a rating perspective.

At Company level, LOFC witnessed moderation in the incremental slippages and carried out substantial recoveries during FYE Mar-14 and Mar-15 resulting in improvements in Gross NPA and Net NPA Ratios. ICRA Lanka takes note of the decline in overall slippages recorded by LOFC over the past two FYs and expects the trend to improve further in FY2016.

¹ PBT-Profit Before Tax

The rating continues to factor LOFC's robust franchise, healthy competitive position given its superior market share and its professional and experienced management team. ICRA Lanka has 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. Going forward improving asset quality, in terms of effecting recoveries and closer monitoring of slippages, combined with LOFC's ability to generate adequate accretion to reserves for maintaining a prudent capitalization profile, while achieving the envisaged business growth, would be key rating sensitivities.

LOFC's portfolio recorded a growth of 30% for FYE Mar-15 (7% for FYE Mar-14). LOFC's growth was higher compared to peers and the industry. LOFC's standalone asset quality indicators registered improvements with Gross NPA improving from 5.1% reported as in Mar-14 to 4.8% in Mar-15, mainly due to accelerated recoveries, decline in overall incremental slippages and write-offs. The Gross NPA has further declined to 4.5% as in Sep-15.

LOFC's gearing marginally increased during FYE Mar-15 to 7.2 times as compared to 6.9 times in Mar-14, given significant growth in portfolio recorded for the period, which however was supported by improved accretion of reserves. LOFC's Capital Adequacy Ratios improved for the FYE Mar-15. Core Capital which stood at 13.08% as in Mar-14 has improved to 13.11% as in Mar-15, recording an improvement mainly due to healthy accretion to reserves and total Capital which stood at 13.08% as on Mar-14 has increased to 18.12%, following the subordinated debentures issued by the company during the period.

ICRA Lanka notes the improvement in LOFC's ALM profile during FYE Mar-15, as the company was able to secure longer tenure funds. The negative mismatch for <1year which moderated from about 23% in Mar-13 to 12% in Mar-14 further declined to 7% in Mar-15. LOFC's funding mix has shifted significantly from its dependency on fixed deposits which stood at 94% as of Mar-14 declining to 73% as at Mar-15 with the longer term sources contributing towards the shift which adds further comfort to LOFC's liquidity profile.

LOFC's overall earnings profile in FY2015 was supported by the moderation in the cost of funds as the company diversified to lower cost funds and reduced dependence on deposits, which resulted in the expansion of NIM to about 10.9% for FY2015 as compared to 9.9% in FY2014. The above along with the moderation in the credit costs/provisions (from about 2.7% to 2.2%) supported the overall profitability indicators, although the operating expenses increased by about 60bps due to the business expansion. The company's RoA improved to 2.4% for FY2015 as compared to 2.0% in FY2014. LOFC's Return on Net Worth also improved to 20.4% for FY2015 compared to 16.7% for FY2014. The company would have to control its incremental slippages, secure effective recoveries, achieve optimal operating efficiencies as the business expands and improves its provision coverage going forward.

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. 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 (28% of Group Assets as in March 2015) 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 2015, LOFC reported a net profit of LKR 1.5 Billion on a total asset base of LKR 67.9 Billion as compared to a net profit of LKR 1.0 Billion on a total asset base of LKR 53.4 Billion in the previous financial year.

November 2015

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