

## **ICRA Lanka assigns [SL]A- rating with stable outlook to LOLC Micro Credit Limited**

November 10, 2015

Instrument	Amount	Rating Action
Proposed Senior Unsecured Redeemable Debentures	LKR 3,000 Mn (with option to increase up to LKR 5,000 Mn)	[SL]A- Assigned (Outlook-Stable)

ICRA Lanka has assigned an issue rating [SL]A- (pronounced SL A Minus) with stable outlook to the proposed LKR 3,000Mn (with an option to increase up to LKR 5,000 Mn) Senior Unsecured Redeemable Debentures to be listed on the Colombo Stock Exchange. 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, LOMC, LOFC (LOLC Finance PLC) and CLC (Commercial Leasing and Finance PLC). The rating of the issue is notched down from the ratings of other financing entities in the LOLC group to reflect the relatively riskier target customer segment, which could increase the portfolio vulnerability vis a vis the other key financing entities in the group.

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 services 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 financing entities. The financial services entities contributed to about 87% of the group PBT<sup>1</sup> 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 key rating sensitivities.

At the company level, the instrument rating factors in the good profitability indicators (RoA of 4.0% in FY2015), adequate capitalization (gearing of 3.7 times as in March 2015) and LOMC's access to stable and competitive funding from multilateral foreign funding agencies. The company being part of the LOLC group has access to the established franchise along with other operational, managerial and financial support from the group. LOMC is also expected to benefit from the robust risk management system, which resides with the LOLC group. The above is likely to partly offset the vulnerability arising from the target customer segment of the company (asset backed and non-asset backed microfinance, which are perceived to be riskier). Nevertheless, ICRA Lanka notes that LOMC's portfolio vulnerability is expected to be higher than the peer LOLC group financing entities. . LOMC has been able to moderate its NPAs to 2.4% in March 2015 despite gross NPAs of 4.4% in March 2014; largely due to delinquencies arising from its pawning portfolio. LOMC was able to maintain good profitability (RoA 4.0% in FY2015 as compared to 3.0% in FY2014) during the year despite sizable NPA write offs during FY 2015, supported by prudent provisioning policy and NIM expansion; as the cost of funds moderated. ICRA Lanka notes that the company presently has a good provision cover on its NPAs; about 97% in June 2015. Going forward, ability of the company to keep incremental slippages at reasonable levels as the business expands and portfolio seasons further would be a key monitorable.

LOMC's portfolio consists of the conventional microfinance group lending and small ticket asset backed lending. The non-asset backed micro finance segment has seen rapid growth over the last five years increasing from LKR 1.0 Bn in March 2011 to LKR 9.9 Bn for the period ending June 2015, presently

<sup>1</sup> PBT-Profit Before Tax

accounting for 35% of the total portfolio. Micro leases accounted for the largest segment of the portfolio amounting to 62% of the portfolio as of June 2015. LOMC's exposure in the leasing is largely to the 3-wheelers, agricultural equipment (2 wheel and 4 wheel tractors), and light truck segment. Pawning accounted for 3% of the portfolio as of June 2015 vis a vis 16% of the portfolio as of March 2013. In terms of asset classes financed, 3-wheelers, accounted for 36%, followed by microfinance loans (35%), tractors (10%), light trucks (10%) and 2-wheelers (5%).

LOMC reported a PAT of LKR 1,134 Mn for FY2015 in comparison to LKR 730 Mn reported in FY 2014. LOMC's advances increased from LKR 18.9 Bn in March 2014 to LKR 25.5 Bn in March 2015 (LKR 28.6 Bn in September 2015) registering an increase of 35%, as the company expanded the non-asset backed microfinance and 3-wheeler exposures. The Profits for FY2015 was supported mainly by the expansion of lending portfolio. Interest income increased from Rs.5.5 Bn to Rs.6.5 Bn compared to last year. The company has been able to maintain attractive yield at about 27-29% during the last three financial years, while the company was able to attract funds at competitive rates from foreign developmental agencies.

LOMC has comfortable capital position with gearing at 3.2 times as in September 2015 (3.7 times in March 2015). ICRA expects the internal generation to remain good at about 20-22%, which is likely to support the envisaged portfolio expansion of about 30-35% in the medium term. However, the company may have to secure equity capital in the medium term to maintain conservative risk adjusted capital structure with gearing of less than 5 times. The company being part of the LOLC group is expected to secure the same in a timely manner.

## **Company Profile**

LOMC was established in 2009 with FMO (The Netherlands Development Finance Company) holding a 20% stake in LOMC. LOMC mainly focuses on the low income groups and provides Micro finance group loans, vehicle financing and personal loans. Currently, LOMC operates in more than 124 locations and it includes "Isuru Diriya" service centers in deep rural parts of the country, which operates in collaboration with Sri Lanka Postal Service.

During FY2015 LOMC reported PAT of LKR 1,134 Mn on a total Asset base of LKR 30.3 Bn as against a PAT of LKR 730 Mn on a total Asset base of LKR 26.6 Bn during FY2014.

**November 2015**

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