

## ICRA Lanka reaffirms the long term ratings of Sanasa Development Bank

December 14, 2016

Instrument	Amount	Rating Action
Issuer Rating	N/A	[SL]BBB-; with Positive Outlook Reaffirmed
Guaranteed Redeemable Debentures, type A and type B, guaranteed by Sampath Bank PLC	LKR 2,000Mn	[SL]A+(SO); with Stable Outlook Reaffirmed
Guaranteed Redeemable Debentures, type C and type D, guaranteed by Seylan Bank PLC	LKR 2,000Mn	[SL]A-(SO); 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]BBB- (pronounced SL triple B minus) with positive outlook for Sanasa Development Bank (SDB or the bank).

ICRA Lanka has reaffirmed the [SL]A+(SO) (pronounced SL A plus Structured Obligation) rating with stable outlook to the type A and type B Redeemable Debentures of SDB amounting to LKR 2,000 Million, which are guaranteed by Sampath Bank PLC (Sampath). ICRA Lanka has also reaffirmed the [SL]A-(SO) (pronounced SL A minus Structured Obligation) rating with stable outlook to the type C and type D Redeemable Debentures of SDB amounting to LKR 2,000 Million, which are guaranteed by Seylan Bank PLC (Seylan). The letters SO in parenthesis suffixed to a rating symbol stand for Structured Obligation. An SO rating is specific to the rated issue, its terms, and its structure. The SO rating does not represent ICRA Lanka's opinion on the general credit quality of the issuer concerned.

The rating for the Redeemable Debentures is based on the strength of the unconditional and irrevocable guarantees from Sampath Bank PLC (Sampath) for the type A and type B Redeemable Debentures and from Seylan Bank PLC (Seylan) for the type C and type D Redeemable Debentures covering the principal and two interest instalments (Semi Annual). As the guarantor, Sampath Bank undertakes the obligation to pay on demand from the trustee, the total principal amounting to LKR 2,000 Million, and two semi-annual interest instalments of type A and type B Redeemable Debentures. Seylan Bank also undertakes the obligation to pay on demand from the Trustee, the total principal amounting to LKR 2,000 Million, and two semi-annual interest instalments of type C and type D Redeemable Debentures. The rating also assumes that the guarantees will be duly invoked by the Trustee, as per the terms of the terms of the underlying Trust Deed and guarantee agreements

The issuer rating continues to factor in SDB's established position, especially in the rural and the semi-urban segments, on the back of the SANASA movement; the bank has about 87 branches, out of which about 55 are in the semi urban and rural areas. The positive outlook takes note of the steady improvement in the asset quality and the expected capital infusion in the near to medium term. The gross NPAs reduced to 2.4% as on June 30, 2016 (2.4% as on December 31, 2015) compared with 3.8% on December 31, 2014. The rating takes note of the initiatives taken to improve its internal systems and processes including setting up integrated loan origination system, market risk management system and digital banking systems. The rating however, takes cognizance of the aggressive loan growth of the bank in the recent years and exposure to customer segments with modest credit profile. Further, the rating is affected by the impact of the aggressive loan growth on the capitalization profile of the bank; total capital adequacy ratio has declined to 11.7% as on June 30, 2016 compared to 13.1% on June 30, 2015. Also, the rating takes cognizance of the limited funding diversification (deposits accounted for about 78% of the total debt as on June 30, 2016) and subdued liquidity profile

characterised by relatively high asset liability mismatches (<1year mismatch at 17% of the total assets as on June 30, 2016). Going forward, SDB's ability to manage credit growth while maintaining the asset quality and the ability to maintain a risk adjusted capital profile would be crucial from a rating perspective.

For the financial year ended December 31, 2015, SDB recorded a robust asset growth of 49% and a loan growth of 43%. For the 6 months ended June 30, 2016 the bank recorded 11% credit growth from December 31, 2015 to reach a total loan portfolio value of LKR 50.9 Bn. Banks's lending portfolio broadly consist of five market segments: co-operatives, MSME (micro & small enterprise), retail, leasing & HP and agriculture. The retail segment, which consists of consumer lending products such as pensioner loans, housing loans, personal loans to salaried employees and pawning, is the largest segment, representing about 61% of the portfolio as on June 30, 2016. MSME segment is the second largest segment (23% of the loan portfolio), followed by the co-operative segment and the leasing segment, each representing about 7% of the loan portfolio. Going forward, SBD expects a moderation of the loan growth in the near-medium term.

SDB recorded a steady improvement in asset quality, where the gross NPA ratio reduced to 2.4% as on December 31, 2015, compared with 3.8% recorded in December 31, 2014; the gross NPA ratio as on June 30, 2016 was 2.4%. However, the portfolio is not seasoned due to high portfolio growth witnessed in 2014 and in 2015. Good overall NPAs are largely driven by the low NPAs of the retail lending segment (retail segment gross NPA 1.3% as on June 20, 2016), which accounted for about 61% of the total lending portfolio as in June 30, 2016. The SME segment, which accounted for about 23% of the total portfolio had a relatively high gross NPA of about 4.1%. Co-operative lending segment has a gross NPA of about 0.9%, while SDB's leasing & HP segment had a gross NPA of about 4.9% as in June 30, 2016.

Bank's funding profile is largely characterized by fixed deposits, which account for about 63% as on September 30, 2016; proportion of savings has remained range bound at about 15-20%, while debt instruments and other borrowings represented the balance. SDB's ALM profile is characterized by sizeable mismatches in the <1 year bucket due to the short term nature of the deposits (about 90% of the deposits mature in 1 year or less), while the assets have an average tenure of about 5-7 years. However, good deposit renewal rate of 75-80%, granular nature of the deposit base and the long standing relationships with banks & other financial institutions provide comfort on SDB's overall liquidity profile.

SDB's core margins have moderated in the recent past (NIM 5.25% in 6M CY2016 vis a vis 6.97% in CY2014), due to recent increase in systemic interest rates; over 70% of the loan exposures (which are long term) of the bank are fixed rate, while the deposit base of the company, which is largely 1 year or less, was repriced at higher levels. Further, average loan yields of the bank have reduced during the same period, largely due to the moderation of retail lending yields. The bank's core fee based income has remained moderate at about 0.4-0.5%, thus there is scope for improving the same as the bank ventures into newer products and services, such as online banking. SDB's cost to income ratio has increased (75.5% as on June 30, 2016 vis a vis 67.6% as on December 31, 2014), as the bank is expanding its operations (increased headcount and salary revisions) and implementing new marketing and operations initiatives. Credit cost has recorded a marginal improvement with provisions/ATA of 0.3% as on June 30, 2016 vis a vis 0.6% as on December 31, 2014. Return on average assets was 0.3% for 6MCY2016 vis a vis 1.4% in CY2015 and CY2014. Going forward, SDB's ability to improve the fee income base and manage the operating and credit expenses will be key drivers of profitability, as the room for improving loan yields will be limited.

## **Bank Profile**

Established in the year 1997, as the key credit institution for the SANASA movement, SANASA Development Bank Plc (SDB/the bank) is a Licensed Specialised Bank. The bank has a primary listing on the Colombo Stock Exchange. Close to about 46% of the total shareholding is with the SANASA affiliate entities, which includes, Co-operative Societies, Trusts and other institutions. SDB had a network of 87 branches and over 1,000 employees.

In the financial year ended December 31, 2015, SDB reported a net profit of LKR 720 Mn on a total asset base of LKR 60.3 Bn.

For the 6 months ended June 30, 2016, the bank reported a net profit of LKR 180 Mn on a total asset base of LKR 61.9 Bn.

## **Guarantors Profiles**

### **Sampath Bank PLC**

Sampath Bank Plc is one of the larger private sector commercial bank in the country with total assets of LKR 525 Bn as at December 31, 2015. Sampath accounted for 6.49% of the industry assets, 8.09% of the sector loans and advances and 7.52% of sector deposits as on December 31, 2015. The bank commenced operations as a licensed commercial bank in 1987 and was noted for introducing technology to the banking sector. Major institutional shareholders include Vallibal 1 PLC with a 14.95% and Employees Provident Fund with a 9.97% stake. The Sampath group companies include Sampath Centre Ltd (97.14%), SC Securities (Pvt) Ltd (100%), Siyapatha Finance PLC (100%) and Sampath Information Technology Ltd (100%).

The bank recorded a total income of LKR 29.3 Bn for the 6MCY2016 and LKR 47.0 Bn during CY2015 (LKR 44.5 Bn for the CY2014). The net profits of the bank amounted to LKR 4.2 Bn during 6MCY2016 and LKR 6.1 Bn for the CY2015 (LKR 4.9 Bn for the CY2014), which resulted in ROA of 1.5% and 1.2% (1.6% in CY2014) for the respective periods. The bank had gross NPA ratios of 1.80% and 1.64% as at 6MCY2016 and CY2015 (1.93% in CY2014) and net NPA ratios of 0.69% and 0.46% respectively for the said periods (0.53% in CY2014). The bank had a net worth of LKR 38.1 Bn as of June 30, 2016, with tier 1 capital adequacy ratio of 7.97% and total capital adequacy ratio of 12.35%.

### **Seylan Bank PLC**

Seylan Bank PLC (Seylan) with total asset base of LKR 296.3 Billion as in December 31, 2015 (LKR 249.3 Billion in December 31, 2014) accounted for about 4.2% of sector assets; it also accounted for 4.6% of sector loans and advances and 4.2% of the sector deposits as in December 31, 2015. The bank was incorporated in the year 1987. Sri Lanka Insurance Corporation Ltd (15.0%), Browns and Company PLC (13.9%), Employee Provident Fund (9.9%), LOLC Investments Limited (9.6%), NDB Bank (8.7%) and Bank of Ceylon (7.5%) are the major voting shareholders of the bank.

The bank recorded net profits of LKR 3.8 Billion on a total asset base of LKR 296.3 Billion for the CY2015 and LKR 3.08 Billion on a total asset base of LKR 249.3 Billion for the CY2014, which resulted in ROA (post tax) of 1.40% and 1.33% for the respective periods. The bank had gross NPA ratios of 4.68% and 7.69% as at CY2015 and CY2014 respectively and net NPA ratios of 3.06% and 5.31% respectively for the said periods. The bank had a net worth (excluding revaluation reserve) of LKR

24.4 Billion as on December 31, 2015 with core capital adequacy ratio of 12.2% and total capital adequacy ratio of 12.9%.

The Seylan Bank Group recorded consolidated net profits of LKR 3.25 Billion on a total asset base of LKR 251 Billion for the CY2014 and LKR 3.89 Billion on a total asset base of LKR 298 Billion for the CY2015. The Seylan Bank Group recorded consolidated net profits of LKR 1,749.0 Million on a total asset base of LKR 328.4 Billion for the 6 months ended June 30, 2016. Bank's gross NPA ratio stood at 4.63% as on June 30, 2016.

Note 01: CY - Calendar Year from January 01 to December 31

*December 2016*

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