

## ICRA Lanka reaffirms the issuer rating of State Mortgage and Investment Bank

January 12, 2018

Instrument*	Rated Amount (LKR Mn)	Rating Action
Issuer rating	N/A	[SL]A (Stable); Reaffirmed

### Rating action

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 a stable outlook assigned to State Mortgage & Investment Bank (SMIB or the Bank).

### Rationale

The reaffirmation of the rating takes note of the 100% Government of Sri Lanka (GoSL) ownership in SMIB, which provides a strong likelihood of sovereign support to the Bank, when needed. The bank has a comfortable capital profile characterised by core capital of about 25% in Sep-17. The rating however notes that the bank would have to enhance its core capital to LKR 7.5 Bn by Dec-20 from LKR 4.9 Bn in Sep-17 to meet the minimum core capital requirement for Licensed Specialised Banks (LSBs). ICRA Lanka expects external capital infusion to meet the regulatory requirements, to be quite sizeable in relation to the current networth, as internal generation is likely to remain quite modest during the period CY2017-2020. ICRA Lanka envisages timely capital support from GoSL to meet the regulatory requirement of SMIB. The rating takes note of the weak asset quality of SMIB with gross NPA at 24.9% (in Sep-17), high dependence on deposits (91% of the total debt as in Sep-17) and deteriorating profitability (ROA for 9MCY2017 at 0.45% vis a vis 1.25% in CY2016). The net profitability is expected to moderate further going forward from the levels witnessed in CY2016, as the bank narrows its lending spread, based on CBSL's recommendations. ICRA Lanka notes that close to 57% of the portfolio as in Sep-17 is backed by mortgage properties or EPF<sup>1</sup> fund of the borrowers; while asset quality is impacted because of the high overdues in the EPF backed loans, NPAs in the mortgage loan segment and personal loan segment are also higher than the peers at 6.4% and 3.6% respectively. SMIB has higher short term (less than 1 year) asset-liability mismatch of 49% (in Sep-17) due to shorter tenured liabilities vis-a-vis the loan profile; 90% deposit renewal rate however provides comfort from a liquidity perspective.

### Outlook: Stable

ICRA believes that State Mortgage and Investment Bank would continue to get GoSL support and meet regulatory capital requirement in a timely manner. The outlook may be revised to 'Positive' in case of steady improvement in the asset quality and earnings of the bank. The outlook may be revised to 'Negative' in case of a weakening in the capital profile or a significant deterioration in the profitability and overdue profile of the bank

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<sup>1</sup> EPF-Employee Provident Fund

## Key rating drivers

### Credit strengths

**100% government ownership provides visibility on timely support** - SMIB is a 100% GoSL owned LSB, with focus on mortgage, EPF backed lending and personal loans. The bank has received financial and managerial support from GoSL in the past and, ICRA Lanka envisages timely support in the future also. The GoSL has appointed three government administrative officers to SMIB' Board representing the ministry of finance, housing and agriculture. In 2001, GoSL has granted a LKR 250 Mn loan and in 2017 it has agreed to convert the same into capital. ICRA Lanka therefore expects timely support from GoSL to SMIB for meeting its core capital requirement of Rs 7.5 Bn in December 2020.

**Established franchise and healthy deposit renewal rate** - 100% state ownership and long standing presence of the bank has helped it to secure an established depositor base. As of Jun-17 the bank had a deposit base of LKR 31.6 Bn; of which, close to 63% are retail deposits. The bank's deposit renewal rate is healthy at about 90%.

**Granular loan portfolio, share of unsecured loans however has increased** - The bank offers personal loans, EPF loans and mortgage loans which accounted for 37%, 29% and 28% respectively of its portfolio in Sep-17. Top 50 loans accounted for about 2% of the total portfolio as in Sep-17 indicating portfolio granularity and low credit concentration risk. ICRA Lanka takes note of the increase in the share of unsecured loans in the overall portfolio, as personal loans share has increased to 37% in Sep-17 from 26% in Dec-16 and 17% in Dec-15. Personal loans are backed by two guarantors without any other underlying security. As the bank expands its personal loans book further going forward and diversifies to newer products namely SME credit and microfinance, the share of unsecured loans are expected to increase further from current levels. While the portfolio is expected to remain granular, ability keep credit quality under control in view of the increased share of unsecured loans would be a key monitorable.

### Credit challenges

**Moderate scale of operations** - SMIB is a moderate sized LSB with a total asset base of LKR 38 Bn. The bank has 24 branches spread across the country. The bank is expected to expand its portfolio at a growth rate of about 15% over the next 3 years, with the portfolio reaching LKR 48 Bn by Dec-20. Going forward, the bank is expected to focus on personal loans and mortgage loans, and the share of these products is expected to increase to 45% and 35% respectively by Dec-20.

**Sizeable capital required for meeting minimum regulatory core capital** - SMIB has a comfortable capital adequacy ratio since its exposures to EPF loans and mortgage loans (29% and 28% in Sep-17) has lower risk weights of 0% and 50% respectively. The bank reported a healthy capital adequacy ratio of 25.3% in Sep-17 and 29.8% in Dec-16. The bank's gearing stood at 6.4 times as on September 30, 2017. However, CBSL has directed that all LSBs should maintain a minimum core capital of LKR 5 Bn from Jan-16. SMIB has obtained an extension from CBSL till Dec 2018 to comply with the above regulatory requirement. Further, CBSL has issued new directions in Oct-17, further increasing the minimum capital for LSBs to LKR 7.5 Bn from Dec-20. Based on ICRA Lanka's estimates, the bank would require external capital support of about 1.5-2.0 Bn to meet the same, as internal generation is limited and inadequate. However, timely support from GoSL is envisaged to meet the above minimum regulatory requirement.

**Weak asset quality indicators** - The bank reported high Gross NPA ratio of 24.9% in Sep-17. EPF backed loans contribute significantly for the above high NPA's. The NPA ratio in the EPF loan segment was high

at 59.9% as in Jun-17 as most borrowers expect the bank to recover the loan liabilities out of Employees' Provident Fund balances. In the mortgage loan category, the NPA remained at about 6.5% in Jun-17 notwithstanding the moderation from Dec-14 level of 11.2% as incremental slippages decreased. ICRA Lanka notes that Top 30 NPAs accounted for 0.2% of the total NPAs, indicating the granular nature of the portfolio; the NPAs largely comprised of mortgage loans that have adequate collateral coverage and the EPF backed loans, which provide comfort on recoverability of these loans.

**Modest profitability indicators** - SMIB's lending spread declined to 3.0% in 9MFY2017 from 4.7% in CY2016, as SMIB was compelled to reduce yields, based on the recommendations of CBSL and, upward re-pricing of its deposits, which are largely of shorter term tenures. Consequently, in 9MCY2017, the bank's ROA reduced to 0.45%. The bank reported a ROA of 1.25% and 1.27% in CY2016 and CY2015. Operational inefficiencies were the main reason for low ROA in CY2015 and CY2016. The bank targets ROA and ROE of 1.0% and 7.5% for CY2018 on the back of expected improvements in operating efficiency.

**Analytical approach:** For arriving at the ratings, ICRA has applied its rating methodologies as indicated below.

**Links to applicable criteria:** [ICRA Lanka's Credit Rating Methodology for Banks](#)

### About the company:

The State Mortgage & Investment Bank (SMIB) is one of the older banks in Sri Lanka; it commenced operations as the Ceylon State Mortgage Bank (CSMB) in December 1931. SMIB was formed by the State Mortgage & Investment Bank Act No. 13 of 1975, amalgamating CSMB and the Agricultural and Industrial Credit Corporation and commenced its operations from January 1979. The Bank was recognized as a licensed specialized bank and the license was issued by the CBSL in April 1998. SMIB is a 100% GoSL owned, Licensed Specialized Bank operating with 24 branches. SMIB is one of the five entities in Sri Lanka to offer EPF backed loans. Apart from the above, the bank also offers mortgage backed housing loans, personal loans and leasing facilities to its customers.

In 2016, SMIB reported a PAT of LKR 436 Mn (audited) on a total asset base of LKR 36.9 Bn. During 2015, the bank reported a PAT of LKR 410 Mn on a total asset base of LKR 35.6 Bn. The Bank's net worth as in Dec-16 stood at LKR 4.9 Bn.

For the nine months ended Sep-17, the bank reported a PAT of LKR 165 Mn (un-audited) on a total asset base of LKR 38.1 Bn.

### Key financial indicators (audited)

	CY2015	CY2016	9MCY2017 (Unaudited)
Net Interest Income	1,822	1,815	1,188
Profit after Tax	410	436	165
Net worth	4,263	4,918	4,979
Loans and Advances	26,523	28,164	31,499
Total Assets	35,663	36,955	38,156
Return on Equity	9.61%	8.87%	3.31%
Return on Assets	1.27%	1.25%	0.45%
Gross NPA	29.40%	25.17%	24.92%
Net NPA	28.52%	23.87%	23.82%
Capital Adequacy Ratio	29.24%	29.78%	25.33%
Gearing (times)	6.73	5.94	6.41

## Rating history for last three years:

		Current Rating (CY2017)			Chronology of Rating History for the past 3 years		
Instrument	Type	Amount Rated (LKR Mn)	Amount Outstanding (LKR Mn)	Date & Rating	Date & Rating in CY2016	Date & Rating in CY2015	Date & Rating in CY2014
Issuer rating	N/A	N/A		Dec 2017 [SL]A	Jun 2016 [SL]A	- N/A	- N/A

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