

ICRA Lanka reaffirms the ratings of Sanasa Development Bank

November 15, 2017

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 also reaffirmed the [SL]A+(SO) (pronounced SL A Plus Structured Obligation) rating with stable outlook for the type A and type B redeemable guaranteed 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 for the type C and type D redeemable guaranteed 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 ratings for the redeemable guaranteed 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 guaranteed debentures and from Seylan Bank PLC (Seylan) for the type C and type D redeemable guaranteed 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 guaranteed 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 guaranteed debentures. The ratings also assume that the guarantees will be duly invoked by the Trustee, as per 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 91 branches, out of which about 55 are in the semi urban and rural areas. The positive outlook takes note of the healthy asset quality and adequate capitalisation position post the equity infusion in May 2017 from multilateral investors. The gross NPA ratio was at about 2.2% as on June 2017. During May-July of 2017, the bank raised about LKR 1.5 Bn as equity and LKR 1 Bn as tier II- debt from the multilateral investors. This improved the bank's core and total CAR to 13% and 15% respectively in June 2017. SDB is expected to meet CBSL' minimum core capital requirement of LKR 7.5 Bn by December 31, 2020 and the Basel-III Tier-I requirement of 8.50% by January 01, 2019 through its own internal generation and supported by the envisaged capital raising of about LKR 1.3 Bn in the near term. The rating takes note of the initiatives taken to improve its internal systems and processes including setting up of centralized credit appraisal system, integrated loan origination system, market risk management system and digital banking systems.

The rating, however, takes cognizance of the moderation in SDB's profitability. The ROA has moderated to 0.6% in CY2016 (0.3%, annualised for H1CY2017) vis a vis 1.4% in CY2015. The NIM of the bank has contracted during CY2016 to 5.3% from 6.7% in CY2015 primarily because of the combined effect of moderation in business growth, decline in the business yields and increase in the cost of borrowings. The rating also takes cognizance of the limited funding diversification (deposits accounted for about 81% of the total debt as on June 30, 2017) and subdued liquidity profile characterised by relatively high asset liability mismatches (<1year mismatch at 17% of the total assets as on June 30, 2017). Going forward, SDB's ability to improve profitability, 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, 2016, SDB recorded moderate asset growth of 10% and a loan growth of 17%. For the 6 months ended June 30, 2017 the bank recorded 26% (annualised) loan growth to reach a total loan portfolio value of LKR 61.2 Bn. SDB's lending portfolio broadly consists of three target segments namely retail segment, SME segment and co-operative segment. 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 70% of the portfolio as on June 30, 2017. SME segment is the second largest segment (23% of the loan portfolio), followed by loans to co-operatives which was about 7% of the loan portfolio. Going forward, SDB expects to maintain a portfolio growth of 20% per annum over next 2-3 years and increase the share of SME loans and loans to cooperatives to about 20-30% in each segment.

SDB recorded an improvement in asset quality as the gross NPA ratio reduced to 2.1% as on December 31, 2016, compared with 2.4% recorded in December 31, 2015; the gross NPA ratio as on June 30, 2017 was 2.2%. Good overall NPAs are largely driven by the low NPAs in the retail lending segment (retail segment gross NPA was 1.8% as on June 30, 2017), which accounted for about 70% of the total lending portfolio as on June 30, 2017. The SME segment, which accounted for about 23% of the total portfolio had a relatively high gross NPA of about 4.4%. Co-operative lending segment has a gross NPA of about 0.5%, as in June 30, 2017. Ability to increase the share of SME loans and loans to cooperatives in the overall portfolio, while keeping asset quality under control would be crucial going forward.

SDB's funding profile is largely characterized by fixed deposits, which accounted for about 67% of the total borrowings as on June 30, 2017; proportion of savings has remained range bound at about 14-15%, 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 47% 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 5.3% in CY2016 vis a vis 6.7% in CY2015). The average loan yields of the bank have reduced during the same period, largely because of the bank's portfolio realignment strategy under which the focus has shifted from high yielding microfinance business to SME finance. The bank's core fee based income has remained moderate at about 0.3%-0.5%, thus there is scope for improving the same as the bank ventures into newer products and services, such as online banking etc. SDB's cost to income ratio has increased (79.7% as on December 31, 2016 vis a vis 68.2% as on December 31, 2015), as the bank is expanding its operations, revised its salary structure and is implementing new marketing and operational initiatives. The credit

cost has remained modest because of stable and healthy asset quality. Return on average assets nevertheless declined to 0.3% for 6MCY2017 vis a vis 0.6% in CY2016 and 1.4% in CY2015.

Bank Profile

Established in the year 1997, 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 29% of the total shareholding is with SANASA affiliated entities as in June 2017, which includes, co-operative societies, trusts and other institutions. SDB had a network of 91 branches and over 1,000 employees.

In the financial year ended December 31, 2016, SDB reported a net profit of LKR 404 Mn on a total asset base of LKR 66.0 Bn. For the 6 months ended June 30, 2017, the bank reported a net profit of LKR 199 Mn on a total asset base of LKR 74.0 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 659 Bn as at December 31, 2016. Sampath accounted for 8.4% of the industry assets, 9.3% of the sector loans and advances and 9.4% of sector deposits as on December 31, 2016. 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 One PLC with 14.95% and Employees Provident Fund with 9.97% stakes. 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 43.3 Bn for the H1CY2017 and LKR 66.1 Bn during CY2016 (LKR 47.0 Bn for the CY2015). The net profits of the bank amounted to LKR 5.7 Bn during H1CY2017 and LKR 9.1 Bn for the CY2016 (LKR 6.1 Bn for the CY2015), which resulted in ROA of 1.7% (annualised) for H1CY2017 and 1.5% for CY2016 (1.3% in CY2015) respectively. The bank had gross NPA ratios of 1.77% and 1.61% as at H1CY2017 and CY2016 (1.64% in CY2015) and net NPA ratios of 0.88% and 0.62% respectively for the said periods (0.46% in CY2015). The bank had a net worth of LKR 50.5 Bn as of June 30, 2017, with tier 1 capital adequacy ratio of 8.21% and total capital adequacy ratio of 12.17%.

Seylan Bank PLC

Seylan Bank PLC (Seylan) with total asset base of LKR 356 Bn as in December 31, 2016 (LKR 296 Bn in December 31, 2015) accounted for about 4.5% of sector assets; it also accounted for 4.8% of sector loans and advances and 5.0% of the sector deposits as in December 31, 2016. 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 a total income of LKR 21.6 Bn for the H1CY2017 and LKR 38.0 Bn during CY2016 (LKR 28.5 Bn for the CY2015). The net profits of the bank amounted to LKR 1.8 Bn during H1CY2017 and LKR 4.0 Bn for the CY2016 (LKR 3.8 Bn for the CY2015), which resulted in ROA of 1.0%

(annualised) for H1CY2017 and 1.2% for CY2016 (1.4% in CY2015) respectively. The bank had gross NPA ratios of 5.16% and 4.47% as at H1CY2017 and CY2016 (4.68% in CY2015) and net NPA ratios of 3.62% and 3.07% respectively for the said periods (3.06% in CY2015). The bank had a net worth of LKR 30.3 Bn as of June 30, 2017, with tier 1 capital adequacy ratio of 10.42% and total capital adequacy ratio of 12.67%.

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