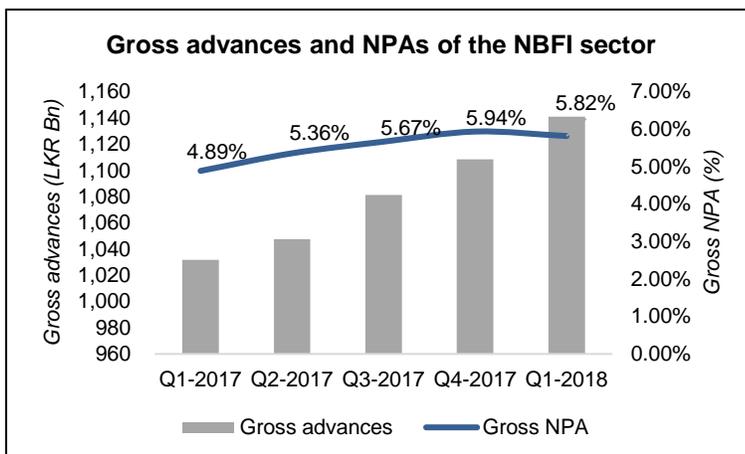


Noteworthy asset quality deterioration in Sri Lankan finance companies

ICRA Lanka, a group company of Moody's Investors Service is cognisant of the asset quality deterioration in licensed finance companies in Sri Lanka, during the financial year ended March 31, 2018. As per our analysis about 100bps increase (5.82% in March 2018 vis-s-vis 4.89% in March 2017) in gross NPA levels during the period is attributable to a number of factors:

1. Overall slow-down in economic growth, particularly affecting lower tiers of the economy
2. Adverse weather conditions that prevailed from the last quarter of 2016 to end 2017.



Particularly high NPAs in SME related lending: In the last couple of years, NBFIs were extensively growing their SME related lending portfolios, due to relatively better yields in SME lending and due challenging market dynamics in the traditional vehicle leasing segment. SME related loans are granted in the form of factoring, post-dated cheque discounting and short-term loans. However, we observe increasing slippages in these product segments of the SME portfolios as the facilities mature.

ICRA Lanka also observes a significant moderation in portfolio growth, in NBFIs that are involved in SME lending, as the focus has shifted towards recovery efforts of the same facilities. Thus, we expect incremental slippages to moderate during the year and overall NPA levels to stabilize at current levels.

Asset quality in Micro-lending is also affected: As per ICRA Lanka's observations, micro lending (Grameen model group lending and other micro related lending) of the NBF1 sector has grown by about 28% CAGR between the period FY2015 to FY2017. As per our estimates, aggregate micro lending by licensed finance companies stood at about LKR 90-100Bn as in March 2017.

Number of factors including the recent weather conditions affecting rural areas, as well as multiple lending done by unregulated micro finance lenders has affected the credit quality dynamics of the segment, However, as per our observation, the NPAs of this segment (NBF1 micro lending) remains better than that of the SME segment of NBFIs.

Going forward, ICRA Lanka will continue to monitor the NPA movement of the rated NBFIs and specific rating actions will be announced accordingly.

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