

ICRA Lanka reaffirms the Issuer and Issue Ratings of Commercial Leasing and Finance PLC

January 31, 2017

| Instrument | Amount | Rating Action |
|---|--------------|---------------------------|
| Issuer rating | N/A | [SL]A(Stable); reaffirmed |
| Listed senior unsecured redeemable debentures | LKR 5,000 Mn | [SL]A(Stable); reaffirmed |

ICRA Lanka Limited, subsidiary of ICRA Limited, group company of Moody's Investors Service has reaffirmed the issuer rating of [SL]A (pronounced SL A) with stable outlook for Commercial Leasing and Finance PLC (CLC or the company). ICRA Lanka has also reaffirmed the issue rating of [SL]A (pronounced SL A) rating with stable outlook for the LKR 5,000 Mn Listed senior unsecured redeemable debentures of the company. Given the significant operational and financial linkages with the Holding company (Holdco; Lanka Orix Leasing Company PLC), ICRA Lanka continues to take a consolidated view of the HoldCo and the key subsidiaries in the financial sector.

At group level, the ratings factor in LOLC Group's ("the group") long track record in the retail finance sector, its established franchise and leadership position in the Sri Lankan retail finance market, experienced management team, commensurate risk management systems, comfortable asset quality and adequate profitability. The ratings also take note of the committed support and oversight from its largest institutional investor-ORIX Corporation of Japan (rated Baa1 with stable outlook by Moody's) which has a 30% stake in the entity. ICRA Lanka notes that the group level gearing increased to 4.3 times in March 31, 2016 from 3.1 times in March 31, 2015; it remained at 4.3 times as on June 30, 2016. The increase was partly due to the sizeable long-term foreign currency funding secured by the group for its financial services entities (namely LOFC, CLC and LOMC) during FY2016, which is held as deposit, for hedging against exchange rate movements and the local currency borrowing made against these deposits resulting in double count of liabilities. ICRA Lanka would continue to monitor the performances of other entities, including the non-financial services entities, in the group and improvements in the performances of the same would be key rating sensitivities going forward. Going forward, envisioned regulatory changes in the vehicle financing space and the consequent impact of the same on the NBFI sector would also be a key monitorable.

At company level, ICRA Lanka factors in CLC's demonstrated track record in the retail finance segment, its well established franchise combined with a professional and experienced management team, good profitability indicators, comfortable liquidity profile and its adequate capitalization levels. The company has a good asset quality profile as compared to most peers; ability of the company to improve margins, restrict incremental slippages and maintain good profitability indicators would be crucial.

CLC's lending portfolio mainly comprises of Loans (58%), Leases (31%) and Factoring (11%) as of March 31, 2016. CLC recorded 42% growth in its overall portfolio for the FYE2016 as compared with the 20% growth reported in FYE2015. The portfolio's asset quality improved during the FYE2016 driven mainly by moderation in overall slippages. CLC's reported gross NPA ratio as on March 31, 2016 was 1.1% down from 2.7% as on March 31, 2015; it stood at 1.3% as on September 30, 2016. During FYE2015, CLC acquired 94% of BRAC Lanka Finance PLC (BRAC). The acquisition has not impacted the financial risk profile of the company. CLC's capitalization levels remained comfortable with consolidated gearing at about 6.4 times as at March 31, 2016. The standalone gearing for the company was 5.9 times as on March 31, 2016, which was an increase over the 2.3 times recorded as on March

31, 2015, given the growth in portfolio recorded and because of the long term foreign currency funding and the corresponding foreign currency deposit placed by the company towards hedging its foreign currency exposure, which it used as security for domestic borrowings thus leading to higher level of debt on the company's balance sheet. The gearing adjusted for the foreign currency funding was about 4.0 times as on March 31, 2016.

ICRA Lanka expects CLC's liquidity profile to improve further, as the company was able to secure longer tenure funds of about USD 153 Mn. CLC's dependency on fixed deposits reduced, from 32% as of March 31, 2015, to 17% as at March 31, 2016. The company has a positive short-term ALM (less than 1 year) mismatch of 4% as of September 30, 2016.

CLC's overall profitability level moderated during FYE2016 with the decline in yields. However, moderate operating expenses and credit cost supported the overall profitability. CLC's return on average assets (RoAA) moderated to 2.5% for FYE2016 as compared to 3.8% in FYE2015 and stood at 1.8% in H1FY2017. The company's ability to maintain good interest margins and keep asset quality under control would be crucial for generating good risk adjusted returns.

Company Profile

CLC was incorporated in the year 1988 as a Specialised Leasing Company. LOLC Group acquired controlling stake and then 100% of the company in 2008. The main product lines of CLC include leasing, hire purchase and loans for vehicles and equipment and, factoring. CLC obtained the license to operate as a LFC in December 2011. Subsequently, CLC has also started offering savings and deposit products. CLC operates primarily in the SME and Micro Sectors. Business is mostly sourced by third-party Agents/brokers, but the company has managed to maintain a strict control over origination standards. CLC was relisted in the Colombo Stock Exchange (CSE) on June 05, 2012 to comply with the requirements of the Central Bank of Sri Lanka (CBSL). In Nov-15 CLC acquired 94.35% stake in BRAC Lanka Finance PLC for LKR 968 Mn.

During the year ended March 31, 2016, CLC reported a net profit of LKR 1.5 Bn on a total asset base of LKR 84.3 Bn as compared to a net profit of LKR 1.4 Bn on a total asset base of LKR 42.3 Bn in the previous financial year. The company reported a net profit of LKR 760 Mn on a total asset base of 84.5 Bn in H1FYE2017.

January 2017

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