

## ICRA Lanka assigns issuer rating of [SL]B to LCB Finance Limited

March 22, 2019

Instrument	Previous Rated Amount (LKR Mn)	Current Rated Amount (LKR Mn)	Rating Action
Issuer rating	N/A	N/A	[SL]B (Stable); assigned

### Rating action

ICRA Lanka Limited, subsidiary of ICRA Limited, a group company of Moody's Investors Service, has assigned the issuer rating of [SL]B (Pronounced SL B) with a stable outlook to LCB Finance Limited (LCF or "the Company").

### Rationale

The rating considers LCF's limited track record, small scale and modest competitive position. In April 2018, LCB Limited (LCB) acquired non-operational City Finance Limited (CITY), under the guidance of Central Bank of Sri Lanka (CBSL) and renamed it as LCF. Post-acquisition, LCB transferred its assets and liabilities to LCF and became its holding company. The rating also takes into consideration LCF's subdued asset quality indicators, limited funding diversity and modest profits. ICRA Lanka notes that the Company's funding profile largely consists of legacy fixed deposits, which needs to be settled in two equal tranches in April 2019 and April 2020; this is expected to exert pressure on its near-term liquidity and growth. LCF's core capital as of Dec-18 stood at about LKR 1.0 Bn, below the regulatory requirement of LKR 1.5 Bn<sup>1</sup> for Licenced Finance Companies (LFCs), however the Company's gearing was low at 1.0 time. ICRA Lanka takes note of the initiatives taken by the Company to secure capital in the near-term. ICRA Lanka notes that, sizeable further external capital infusion (about LKR 1.4 Bn over the period FY2019-FY2021) would be required as internal generation is likely to remain modest. Going forward, the timely settlement of legacy deposit liabilities and infusion of capital would be crucial.

### Outlook: Stable

The outlook may be revised to "Positive" if the Company demonstrates a track record of profitable and good quality portfolio growth over the medium term, while maintaining an adequate capital and liquidity profile. The outlook may be revised to "Negative" in case LCF continues to remain in breach of the regulatory capital, or if its liquidity, asset quality or earnings profiles weaken further.

### Key rating drivers

#### Credit challenges

**Limited track record, small scale of operations and modest competitive position:** LCF has a limited track record under the new management as it was taken over by Lanka Credit and Business Limited (LCB) in

<sup>1</sup> LKR 1.5 Bn by Jan-19, LKR 2.0 by Jan-20 and LKR 2.5 Bn by Jan-21

Apr-18. LCF's gross portfolio was at about LKR 1.5 Bn as of Nov-18. The legacy portfolio stood at LKR 244 Mn (about 16% of the total portfolio) as of Nov-18 and was fully provided for. As of Nov-18, the active or the new portfolio consisted of loans, leasing & HP, factoring, microfinance lending and pawning/gold loans which accounted for about 71%, 10%, 8%, 7% and 4% respectively of the total active portfolio. The loan segment largely consists of business purpose loans (42% of total active portfolio), housing loans (about 16%), and revolving loans (about 4%). The leasing & HP portfolio mainly consists of lending for passenger vehicles (cars, vans, jeeps). LCF has started gold loans in Oct-18 and going forward plans to promote the same as opposed to pawning because of the flexibility in recovery.

**Limited seasoning and subdued asset quality indicators:** LCF recorded a high gross NPA ratio of 21.0% as of Nov-18 largely on account of the non-performing legacy portfolio. The GNPA% of the active portfolio stood at 5.4% as of Nov-18. The loans portfolio (about 71% of the total active portfolio as of Nov-18) recorded a gross NPA ratio of 6.3% and microfinance recorded a gross NPA ratio of 11.9%. The top 15 NPA accounts constituted about 5% of the total NPAs as of Nov-18. Given the limited seasoning of the portfolio, LCF's ability to curtail further slippages as the business expands would be a key rating monitorable going forward.

**Sizeable external capital required:** LCF's core capital adequacy ratio stood comfortable at 35.2% as of Dec-18 and gearing was at about 1.0 times as of Nov-18. According to the CBSL direction for LFCs, LCF's core capital requirement currently is 1.5 Bn and, this would increase each year by LKR 500 Mn until it reaches LKR 2.5 Bn by Jan-21; the Company's core capital stood at about LKR 1,041 Mn in Nov-18, below the minimum core capital requirement. ICRA Lanka estimates that the Company would require further external capital support of about LKR 1.4 Bn over the period FY2019-FY2021 to meet the subsequent requirements (with adequate buffer of 2% to the minimum CAR). Further, ICRA Lanka notes the Company's initiatives to secure capital and the ability to raise the same on a timely basis would be a key rating monitorable going forward.

**Limited funding diversity:** Total borrowings of LCF stood at about LKR 1,062 Mn as of Dec-18, and about 50% of it comprised of legacy borrowings. The new management has given a commitment to settle the legacy borrowings of former City Finance Limited, including deposits of about LKR 500 Mn as of Dec-18. The other main borrowing exposures were bank funding (19% of total borrowings), fixed deposits (19%) and savings (11%). Ability to diversify resource profile going forward would be crucial for business growth.

**Modest profitability:** LCF's profitability in 8MFY2019 was supported by tax credit and reversal in provisions on the back of the recoveries from the legacy portfolio. The Company's PAT stood at LKR 283 Mn (post tax credit of LKR 193 Mn) for 8MFY2019 on an asset base of LKR 2.2 Bn as of Nov-18. Going forward, it is crucial for LCF to maintain healthy lending margins to absorb possible escalation in operating expenses and credit costs as business expands

**Analytical approach:** For arriving at the ratings, ICRA Lanka has applied its rating methodologies as indicated below. **Links to applicable criteria:** [ICRA Lanka Credit Rating Methodology for Non-Banking Finance Companies](#)

## About the Company:

LCB Finance Limited (LCF) is a licensed Finance Company providing an array of products including Leasing, Hire Purchase, Business loans, Pawning/gold loans, Micro Finance, and Factoring. The Company was incorporated in 1962 as Industrial Finance Limited. In 2008, the ownership of the Company was

transferred to ASPIC group and subsequently to Millennium group in 2009. The Company went through a name change in 2012 as City Finance Limited after it was acquired by Investment Lanka Investments (Pvt) Limited. In April 2018, under the guidance of Central Bank of Sri Lanka, LCB Limited, took over the Company and renamed it as LCB Finance Limited. LCB transferred its assets and liabilities to LCF during May 2018 and became its holding company. As of Dec-18, LCB Limited held 86% of LCF.

For the eight months ended November 30, 2018, LCF reported a net profit of LKR 283 Mn (post a tax credit of LKR 193 Mn) on a total asset base of LKR 2.2 Bn.

### Key financial indicators (Audited)

Amount in LKR Mn	8MFY2019 (audited)
Net Interest Income	109
Profit after Tax	283
Net worth	1,041
Loans and Advances	1,213
Total Assets	2,190
Return on Equity	N/A
Return on Assets	N/A
Gross NPA	20.9%
Net NPA	1.6%
Capital Adequacy Ratio	35.2%
Gearing (times)	1.0

### Rating history for last three years:

Instrument	Current Rating (FY2019)			Chronology of Rating History for the past 3 years		
	Type	Amount Rated (LKR Mn)	Date & Rating	Date & Rating in FY2018	Date & Rating in FY2017	Date & Rating in FY2016
Issuer rating	N/A	N/A	Mar 2018 [SL]B (Stable)	- N/A	- N/A	- N/A

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