ICRA Lanka reaffirms the issuer rating of LOLC Development Finance PLC

March 18, 2019

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

Rating action:

ICRA Lanka Limited, subsidiary of ICRA Limited, group company of Moody's Investors Service, has reaffirmed the issuer rating of [SL]A- with stable outlook for LOLC Development Finance PLC ("LDFP" /"the Company", formerly known as BRAC Lanka Finance PLC).

Rationale:

LOLC Holdings PLC (LOLC group) held about 99% stake in the Company as in December 2018. The rating reflects the significant operational, managerial and financial support from the LOLC group. The rating however takes note of the modest credit profile of LDFP's borrowers and, its weakened asset quality and earnings profile. ICRA Lanka takes note of the currently adequate capital structure and asset liability maturity profile of the Company. LDFP's ability to manage new slippages and control credit costs would be crucial from a rating perspective.

Outlook: Stable

ICRA Lanka believes that LOLC group will continue to provide timely and adequate capital support to LDFP. The outlook may be revised to 'Negative' in case of further weakening in the asset quality indicators and profitability of the Company. The outlook maybe revised to 'Positive' in case of significant improvement in asset quality, profitability and capitalisation of the Company.

Key rating drivers:

Credit Strength

Financial, operational and managerial support from LOLC group: LOLC Holdings PLC (LOLC) and Commercial Leasing and Finance PLC (CLC; 99% subsidiary of LOLC) held 55% and 44% stake in LDFP as in Dec-18. LOLC participated in LDFP's rights issue programme of May 2017 for raising equity capital of LKR 1.3 Bn. The LOLC group is also expected to extend funding lines to LDFP, if needed, for meeting its liquidity or growth requirements. LOLC group provides operational and managerial support to the Company through its shared service framework. Under this mechanism, LDFP receives managerial and operational support on finance, treasury, HR, IT and credit administration.

Adequate capital and liquidity profile: LDFP reported a regulatory capital adequacy ratio (based on the new regulatory requirements) of 17.53% in Dec-18. Gearing improved to 4.2 times in Dec-18 from 4.7 times in Mar-18 as portfolio reduced by 20% during the above period. In FY2018, LDFP's gearing moderated to 4.7 times from 8.4 times in Mar-17 as a result of LKR 1.3 Bn rights issue. Going forward, the Company envisages a 30-40% portfolio growth per annum over the period FY2019-FY2022; ICRA Lanka notes that the Company would get regular capital support from LOLC group for growth and to maintain a comfortable capital profile, as internal generation is expected to remain moderate. The asset liability maturity (ALM) profile remained positive due to short term nature of the advances; currently LDFP gets funding support largely from banks and from the LOLC group. Going forward, the Company's ability to improve its deposit profile and diversify its funding mix would be crucial in view of the envisaged portfolio growth.

Credit Challenges

Modest credit profile of the target customer segment and weakened asset quality: LDFP is a licensed finance Company with presence in 76 locations and having 16 branches. Group micro lending is the key product accounting for 78% of the portfolio as on September 30, 2018. The Company reported a portfolio of LKR 13.9 Bn in Mar-18 with an YoY growth of 23%; portfolio declined by 20% during 9 months ended Dec-18 to LKR 11.8 Bn. LDFP curtailed the micro finance operations during 9MFY2019 in view of the higher slippages post the government's announcement to write-off microfinance loans of 12 flood affected districts. These districts accounted for 46% of the total LDFP portfolio as in Sep-18. LDFP's NPAs increased sharply to 7.55% in Dec-18 as compared to 1.64% in Mar-18 as a result of government's announcement on loan write-off in Jul-18 with collection ratio reducing to 75% from 95% prior to the announcement. The Company has directed all its staff to recover the portfolio while curtailing incremental micro finance disbursements. Going forward, the Company expects to diversify its geographical presence and product offering; LDFP plans to extend micro enterprise development loans, micro housing loans and leasing facilities for 2-wheelers, 3-wheelers and small commercial vehicles in addition to group micro lending. Keeping incremental slippages under control and undertaking recoveries would be crucial for improving asset quality going forward.

Weakened earnings profile: LDFP enjoyed good business yields from the group microloans (34-35%) during last two financial years, which supported a healthy net interest margin of about 18-21%. Going forward, the Company expects a moderation of yields to 32-33% with the diversification into other micro loans and micro leasing. The operating expenses are however relatively high at 13.8% in six months ended FY2019 as compared to 13.3% in FY2018 and 12.7% in FY2017. The credit cost increased to 6.9% in 6MFY2019 from 3.45% in FY2018 (3.0% in FY2017) and, is expected to remain high in the near term. LDFP's RoA consequently moderated as it incurred losses for 9MFY2019 (-0.4) compared with net profitability of 2.5% in FY2018 (1.9% in FY2017). Ability to control credit costs and improving operating efficiencies would be crucial for incremental profitability.

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 Non-Banking Financial Institutions

About LOLC Group:

Setup in 1980, Lanka Orix Leasing Company PLC (LOLC) has evolved itself from a financial services provider to a holding company which has interests in financial services, insurance, manufacturing, trading, plantations, leisure and energy. The ORIX Corporation of Japan which had 30% of LOLC since its inception, has presently divested the same. The group has diversified geographically into Cambodia, Myanmar, Indonesia and Pakistan.

During the FY2018, LOLC group reported net profit of LKR 19 Bn on a total Asset base of LKR 822 Bn compared to net profit of LKR 21 Bn on a total Asset base of 641 Bn in the previous fiscal. The Group reported a net profit of LKR 11 Bn on a total asset base of LKR 1,008 Bn for 9MFY2019.

About LDFP:

BRAC International established its Sri Lankan operations as a NGO in 2004 to serve the tsunami affected community in southern and eastern provinces. Subsequently, along with LOLC as a joint venture, it acquired Nanda Finance PLC (incorporated in 1961) to extend micro finance. In 2014, the Company became a wholly owned subsidiary of Commercial Leasing & Finance PLC (CLC, 99% owned subsidiary of LOLC), when BRAC international divested its holding. In May 2017, LDFP raised additional capital amounting to LKR 1.3 Bn by way of a rights issue which was fully subscribed by LOLC. Post the rights issue, LOLC became the largest shareholder with a 55.6% holding, while CLC held 44.3% share. LDFP is a licensed finance company and it is in the business of providing group micro finance, micro lease and individual loans to its customers.

During the FY2018, LDFP reported net profit of LKR 362 Mn on a total asset base of LKR 16.5 Bn compared to net profit of LKR 220 Mn on a total asset base of LKR 12.9 Bn in the corresponding period of the previous fiscal. The Company reported a loss of LKR 302 Mn during 9MFY2018 on a total asset base of LKR 13.4 Bn in Dec-18.

ANALYST CONTACTS

Mr. Dasith Fernando
+94 11 4339907
dasith@icralanka.com

Mr. Vidura Welathanthri
+94 11 4339907
vidura@icralanka.com

Mr. A.M Karthik
+91 44 45964308
a.karthik@icraindia.com

RELATIONSHIP CONTACT

Mr. W. Don Barnabas
+94 11 4339907
wdbarnabas@icralanka.com

Subsidiary of

ICRA Limited

A Group Company of Moody's Investors Service

CORPORATE OFFICE
Level 10, East Tower, World Trade Center, Colombo 01, Sri Lanka
Tel: +94 11 4339907; Fax: +94 11 2333307
Email: info@icralanka.com; Website: www.icralanka.com

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