

FOR IMMEDIATE RELEASE

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ICRA Lanka reaffirms the Issuer and Issue Ratings of LOLC Finance PLC

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 LOLC Finance PLC (LOFC or the Company). ICRA Lanka has also reaffirmed the issue rating of [SL]A- (pronounced SL A minus) with stable outlook for the LKR 5,000 Mn listed subordinated unsecured redeemable debentures of the Company. Lanka Orix Leasing Company PLC ("LOLC"/ "HoldCo") has 90% effective holding in LOFC. The ratings reflect the significant operational and financial linkages with LOLC and other peer subsidiaries and associates, especially in financial services business in the LOLC group. The contribution of all financial services subsidiaries and other investments in financial services entities of the group was about 85% of the total PAT in 3MFY2018 and 84% total group assets as on June 30, 2017.

At group level, the ratings factor in LOLC Group's long track record, and leadership position in the Sri Lankan retail finance market, its experienced management team, commensurate risk management systems, its comfortable asset quality and adequate profitability indicators. The ratings also take note of the committed support and oversight from its investor-ORIX Corporation of Japan (rated Baa1 with positive outlook by Moody's) which has a 30% stake in the entity.

ICRA Lanka notes that the group level gearing increased to 6.1 times¹ as on March 31, 2017 from 4.7 times as on March 31, 2016; it stood at 6.2 times as on June 30, 2017. The increase was mainly because of the leveraged acquisition of the controlling stake in PRASAC Micro Finance Institution Ltd (PRASAC) in Cambodia and the consolidation of the same into the group. The standalone gearing of PRASAC stood at 6.5 times as on June 30, 2017. In addition, the sizeable long-term foreign currency funding secured by the group's financial services entities (namely LOFC, CLC, LOMC and BRAC²) during the period, which is invested in deposits and government securities for hedging against exchange rate movements and the local currency borrowings secured against these deposits resulting in higher balance-sheet liabilities. The gearing adjusted for the above stood at 5.8 times as on March 31, 2017 (4.7 times as on March 31, 2016). ICRA Lanka takes note of the increase in the share of microfinance loans in the overall lending portfolio post acquisition of PRASAC and the growth witnessed in LOMC and LOLC Cambodia PLC, thereby increasing the overall portfolio vulnerability considering the modest credit profile of the target borrowers. While ICRA Lanka takes cognisance of the diversification to newer geographies (Cambodia, Myanmar and Pakistan) over the recent past, the ability to manage country specific risks across business and regulatory cycles would be crucial from a rating perspective. Further, ICRA Lanka would continue to monitor the performances of the non-financial services entities and their contribution to the overall group going forward.

The ratings continue to factor LOFC's robust franchise, good competitive position and its professional and experienced management team. However, the company's gearing is relatively high at 9.8 times as on June 30, 2017. The asset quality declined during the period with GNPA's increasing from 4.2% as on March 31, 2016 to 4.4% as on March 31, 2017 and 5.2% as on June 30, 2017; it would therefore be

¹ Adjusted for revaluation and goodwill

² LOFC- LOLC Finance PLC, CLC- Commercial Leasing & Finance PLC, LOMC-LOLC Micro Credit, BRAC- Brac Lanka Finance PLC

crucial for it to undertake recoveries and control incremental slippages to keep NPAs within reasonable levels. ICRA Lanka also takes note of the moderation in the earnings profile as the lending spreads reduced because of increase in cost of funds. Going forward, LOFC's ability to achieve healthy portfolio growth with adequate business returns while keeping the capital structure and asset quality under control would be crucial.

LOFC's portfolio recorded a moderate growth of 7.4% in FY2017 (49.7% in FY2016), which further moderated to 0.1% (annualized) for 3MFY2018 mainly because of the tighter LTV ratio on vehicle financing. LOFC envisages consumer financing, including issuance of credit cards, to steer the portfolio growth of 10-15% per annum over the next 3-years. LOFC's standalone asset quality indicators deteriorated as gross NPA increased from 4.2% reported as on March 31, 2016 to 4.4% as on March 31, 2017 and 5.2% as on June 30, 2017, primarily because of the deterioration of the factoring portfolio (18% of the total lending book as on March 31, 2017) and the adverse weather conditions that prevailed in the country, which impacted the credit quality of its customers.

LOFC's gearing decreased to 10.0 times as on March 31, 2017 as compared with 10.6 times as on March 31, 2016, given the moderation of growth in portfolio recorded for the period. LOFC's long term foreign currency funding received during FY2016 was deposited in the banks to hedge against currency movement and used it as collateral for domestic borrowings thus leading to higher level of debt on the company's balance sheet. The gearing adjusted for the foreign currency funding nevertheless was still high at about 8.9 times as on June 30, 2017. LOFC's core capital improved to 10.91% as on March 31, 2017 (10.98% as on June 30, 2017); regulatory minimum core capital requirement is 5.0%. The total capital adequacy ratio of the company was 13.31% as on March 31, 2017 (13.39% as on June 30, 2017).

The ratings also take cognizance of the increased dependence on fixed deposits funding. LOFC's exposure to fixed deposits increased from 57% as of March 2016 to 73% as of March 2017 and 78% as of June 2017 because of attractive rates it offered. The liquidity profile of the company deteriorated recording relatively high asset liability mismatches (<1year mismatch at 10.3% of the total assets as on March 31, 2017 vis a vis 9.3% as on March 31, 2016) because of the short-term nature of its deposits profile and the medium to long-term nature of the lending products.

LOFC's overall profitability in FY2016 and FY2017 moderated as lending yields declined because of competitive pressure and with increase in the cost of funds. The ROA stood at 1.4% in FY2017 vis a vis 1.6% in FY2016. The company however has been able to keep its operating costs and credit costs within reasonable levels. LOFC's RoA moderated further to 1.3% in 3MFY2018. The company's ability to maintain healthy interest margins and keep its asset quality under control would be crucial for generating good risk adjusted returns.

Company Profile

LOLC Finance PLC (LOFC), (set up in 2001) established initially as a wholly owned subsidiary of LOLC (Lanka Orix Leasing Company PLC), has a strong retail franchise among Licensed Finance Companies (LFCs) in Sri Lanka. In July 2011, as per directions of the Central Bank of Sri Lanka (CBSL), LOLC divested 10% of its stake in LOFC and was listed on the Colombo Stock Exchange (CSE). The LOLC Group is one of the largest business groups in the country, with the parent (LOLC) being among the first leasing company to be established in Sri Lanka. The LOLC group has interests in trading, plantation, leisure and energy. LOFC offers savings and deposits in local and foreign currency, extends loans mainly for auto finance and Islamic finance.

During the year ended March 31, 2017, LOFC reported a net profit of LKR 1.6 Bn on a total asset base of LKR 123 Bn as compared to a net profit of LKR 1.4 Bn on a total asset base of LKR 110 Bn in the

previous financial year. The company reported a net profit of LKR 399 Mn for the 3MFY2018 on a total asset base of LKR 126 Bn.

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