

## ICRA Lanka assigns [SL]A with a stable outlook to the proposed listed, senior, unsecured, redeemable debenture programme of LOLC Holdings PLC

July 10, 2019

### LOLC Holdings PLC

Instrument	Rated Amount (LKR Mn)	Rating Action
Proposed Senior Unsecured Redeemable Debenture Programme (Initial issue of LKR 3,000 Mn with the option to raise a maximum of LKR 5,000) to be listed	5,000	[SL]A (Stable); assigned
Issuer rating	N/A	[SL]A (Stable); outstanding
Commercial Paper Programme	1,000	[SL]A1; outstanding
Listed Senior Unsecured Redeemable Debenture Programme	5,000	[SL]A (Stable); outstanding
Listed Senior Unsecured Redeemable, Debenture Programme	2,750	[SL]A (Stable); outstanding

### Rating action:

ICRA Lanka Limited, subsidiary of ICRA Limited, group company of Moody's Investors Service, has assigned the issue rating of [SL]A with stable outlook for the LKR 5,000 Mn (an initial issue of LKR 3,000 with the option to raise a maximum of LKR 5,000 Mn) Senior Unsecured Redeemable Debenture Programme to be listed on the Colombo Stock Exchange.

ICRA Lanka has issuer rating outstanding of [SL]A with stable outlook for LOLC Holdings PLC ("LOLC"/"the Company"). ICRA Lanka also has issue rating outstanding of [SL]A with stable outlook for the LKR 5,000 Mn Listed Senior Unsecured Redeemable Debenture Programme, the issue rating outstanding of [SL]A with stable outlook for the LKR 2,750 Mn Listed Senior Unsecured Redeemable Debenture Programme and issue rating of [SL]A1 for the LKR 1,000 Mn Commercial Paper Programme.

### Rationale:

ICRA Lanka has taken the consolidated performance of the LOLC group, which has interest in various segments including financial services, insurance, manufacturing, trading, plantation, renewable energy and leisure for arriving at the ratings.

The ratings factor in the group's long track record and leadership position in the Sri Lankan retail finance market, its experienced management team, commensurate risk management systems and its adequate funding profile. ICRA Lanka also takes note of the weak asset quality profile of the Sri Lanka based non-bank finance companies (NBFCs) of the group and the deterioration in the overall earnings profile during FY2019, as interest spreads narrowed and credit cost increased. ICRA Lanka takes cognisance of the increase in the overdues in the softer buckets (<180 days past due) for the Sri Lanka based NBFCs and, the increase in the share of unsecured credit in the overall group's lending business, which is expected to keep portfolio vulnerability at higher levels in the near to medium term. The ratings also take note of the increase in the group leverage over the last few years as result of growth in the foreign portfolio; although, the portfolio growth of the local entities in the financial services was relatively muted. The group was expected

to divest its holdings in one of the overseas subsidiaries by Q1FY2020 and use part of the proceeds to reduce the group level leverage, which however is delayed pending various regulatory approvals. ICRA Lanka would closely monitor the asset quality performance and the extent of deleveraging in the current quarter, as the same remains critical from a rating perspective.

While ICRA Lanka takes cognisance of the diversification to newer geographies (Cambodia, Myanmar, Indonesia and Pakistan) over the recent past by the LOLC group, ability to manage country specific risks across businesses 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.

## Outlook: Stable

ICRA Lanka believes that the LOLC group, on the back of its established presence, business experience and fund raising ability would be able to grow its business and provide timely and adequate capital support to the various group entities. The outlook may be revised to 'Negative' in case the consolidated gearing continues to remain high, or in case of further weakening in the earnings and asset quality indicators. The outlook may be revised to 'Positive' in case of a significant improvement in overall financial profile of the group and if the portfolio profile and asset quality improves.

## Key rating drivers:

### Credit strengths

**Experienced management team and good risk management systems:** LOLC group is one of the largest financial conglomerates in Sri Lanka with a history spanning more than 30 years. The group's operations can be broadly identified under financial and non-financial sectors. The LOLC group has an experienced senior management team, with knowledge in retail lending and banking, for managing its group operations including the foreign entities. The group has centralised the key business functions like Treasury, IT & MIS, human resources, finance & accounts and risk management. The centralised model gives competitive advantage to LOLC group entities by optimising the overall operating cost. The group has a prudent loan origination policy and effective loan monitoring process, which provides them with early warning signals and helps them in adjusting the loan policies in line with the evolving credit trends.

**Fairly diversified group level exposures; increase in the share of micro-credit however is monitorable:** LOLC group has diversified its finance sector operations to Cambodia, Myanmar, Indonesia and Pakistan over the recent past. LOLC group reported a consolidated loan portfolio of LKR 707 Bn in Mar-19. LOLC's largest lending portfolio exposure is in Cambodia (69%) followed by Sri Lanka (28%) with Myanmar, Pakistan and Indonesia accounting for the rest as in Mar-19. Going forward, the Company is expecting to further diversify its global presence to East Asia and Africa. LOLC group's, local financial sector subsidiaries have diversified their operations into all districts and offer diverse loans products. However, in Cambodia, the group largely extends micro-credit. As of Mar-19, close to 75% of the loan portfolio was contributed by the micro-credit segment, the borrower profile of which is modest and vulnerable to adverse economic cycles. The LOLC group's non-financial sector consists of manufacturing and trading, leisure, entertainment, plantation and hydropower. The non-financial sector performance was impacted by the weak performance in the leisure sector segment, while the contribution from the other segments continued to remain very modest.

**Adequate funding profile:** LOLC group has a diverse funding profile, with funding from various sources including, foreign funding agencies, local banks and public deposits. As of Mar-19, 54% of the group's funds were sourced through fixed deposits and 46% was through short and long-term borrowings. LOLC group's local NBFC subsidiaries maintain a lower short-term (< 1 year) mismatch that are below the industry averages. Deposits accounted for 68% of the PRASAC's funding in Mar-19, while LOLC Cambodia and LOLC Myanmar are largely funded by borrowings from banks and other funding institutes.

## Credit challenges

**Weakened asset quality of Sri Lankan NBFCs:** Consolidated gross NPA of the Sri Lankan NBFCs stood at 6.08% as in Mar-19 (3.41% in Mar-18) while foreign operations reported gross NPAs of 0.74% (0.54% in Dec-17) as in Sep-18. The performance of the Sri Lankan operations was impacted by the subdued macroeconomic conditions which will be further accentuated by the adverse impact on tourism sector as a result of drop in tourist arrivals since April-19. Build-up in the 90+days past due (dpd) for the Sri Lankan based NBFCs of the group has been quite significant, the same improved slightly in the quarter ended Mar-19 as a result of tightening recovery operations; 90+dpd for the Sri Lankan based NBFCs improved to 13.9% in Mar-19 from 19.6% in Dec-18. The group has slowed down the growth of the portfolio in Sri Lanka to consolidate the portfolio and concentrate on collections. ICRA Lanka also notes the increase in the share of unsecured credit and microfinance in the overall group's NBFC exposure because of its foreign expansion, unsecured credit stood at 75% in Mar-19 as compared to 63% in Mar-18 (58% in Mar-17). High exposure to these segments increases the group portfolio vulnerability to any adverse regulatory or business development.

**Deterioration in group earnings:** Consolidated RoA declined to 2.1% for FY2019 from 2.6% in FY2018 (2.6% in FY2017; adjusted for one-time gains). The moderation was largely because of the contraction in interest margins as yields on advances moderated and the high credit cost in its Sri Lankan NBFCs. LOLC's standalone earnings comprised mainly of fee income from shared services and interest income from lending to subsidiaries. LOLC's non-financial sector's Manufacturing & Trading and Plantation & Hydropower sectors reported weak earnings performance during FY2019; its leisure and entertainment sector continued to report losses as operations are yet to commence in some of its new investments.

**Increase in group leverage:** LOLC group's consolidated gearing<sup>1</sup> was 6.2 in Mar-19 (6.7 times in Mar-18) as compared to 6.1 times reported in Mar-17. LOLC's standalone gearing increased to 1.6 times in Mar-19 (1.1 times in Mar-18) from 1.2 times in Mar-17; the Holdco raised funds to invest mainly on its non-financial subsidiaries. LOFC, the largest Sri Lanka based NBFC of the group, reported a stretched capital adequacy ratio of 10.45% in Mar-19 (11.94% in Dec-18) as compared to the regulatory requirement of 10.00% and would require regular capital infusion, over the next 2-3 years, to support growth and for maintaining a comfortable capitalisation profile. LOFC has announced a LKR 4.8 Bn rights issue in Jun-19 to meet the near term capital requirement. Similarly, LDFP would require capital support, notwithstanding its currently adequate capitalisation (CAR at 17.03% in Mar-19), if the portfolio grows at the higher pace (30% CAGR over FY2019-FY2022), as envisaged. CLC reported a healthy capital adequacy ratio of 19.52% in Mar-19 (18.35% in Dec-18). Considering CLC's current capital profile and projected growth (10-15% CAGR over FY2019-FY2022), it may not require any significant capital. The group expects close to USD 20 Mn capital investments in its overseas businesses, including financial subsidiaries, the funding would be sourced through foreign entities, however the same would further exert pressure on group level leverage. The

---

<sup>1</sup> Net worth adjusted for Revaluation Reserves

group was expected to realise sizable inflows by divesting its holdings in one of the overseas subsidiaries by Q1FY2020 and use part of the proceeds to reduce the group level leverage, however it is delayed pending various regulatory approvals. The extent of group level deleveraging in the current quarter would be crucial from a rating perspective.

**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:**

Setup in 1980, LOLC Holdings PLC ("LOLC", formerly known as Lanka Orix Leasing Company PLC) has evolved itself from a financial services provider to a holding company which has interests in trading, plantation, leisure and energy. The ORIX Corporation of Japan which had 30% of LOLC since its inception, has divested the same in 2018. The group has diversified geographically into Cambodia, Myanmar, Indonesia, Pakistan and Maldives.

During the FY2019, LOLC group reported net profit of LKR 19.6 Bn on a total Asset base of LKR 1,044 Bn compared to net profit of LKR 19.2 Bn on a total Asset base of 822 Bn in the previous fiscal.

### **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](mailto:info@icralanka.com); Website: [www.icralanka.com](http://www.icralanka.com)

© Copyright, 2019 ICRA Lanka Limited. All Rights Reserved.

Contents may be used freely with due acknowledgement to ICRA Lanka.

ICRA Lanka ratings should not be treated as recommendation to buy, sell or hold the rated debt instruments. ICRA Lanka ratings are subject to a process of surveillance, which may lead to revision in ratings. An ICRA Lanka rating is a symbolic indicator of ICRA Lanka's current opinion on the relative capability of the issuer concerned to timely service debts and obligations, with reference to the instrument rated. Please visit our website [www.icralanka.com](http://www.icralanka.com) or contact ICRA Lanka's office for the latest information on ICRA Lanka ratings outstanding. All information contained herein has been obtained by ICRA Lanka from sources believed by it to be accurate and reliable, including the rated issuer. ICRA Lanka however has not conducted any audit of the rated issuer or of the information provided by it. While reasonable care has been taken to ensure that the information herein is true, such information is provided 'as is' without any warranty of any kind, and ICRA Lanka in particular, makes no representation or warranty, express or implied, as to the accuracy, timeliness or completeness of any such information. Also, ICRA Lanka or any of its group companies may have provided services other than rating to the issuer rated. All information contained herein must be construed solely as statements of opinion, and ICRA Lanka shall not be liable for any losses incurred by users from any use of this publication or its contents