ICRA Lanka reaffirms the long term ratings of Commercial Credit Finance PLC

September 20, 2016

Instrument	Amount	Rating Action
Issuer Rating	N/A	[SL]BBB with Stable Outlook; reaffirmed
Proposed Senior Secured Redeemable Debentures Programme	LKR 2,000 Mn (with option to increase up to LKR 3,000 Mn)	[SL]BBB with Stable Outlook; reaffirmed
Listed Unsecured Subordinated Redeemable Debentures Programme	LKR 500 Mn	[SL]BBB- with Stable Outlook; reaffirmed
Listed Guaranteed Subordinated Redeemable Debentures Programme	LKR 1,000 Mn	[SL]AA- (SO) with Stable Outlook; reaffirmed
Listed Guaranteed Subordinated Redeemable Debentures Programme	LKR 2,000 Mn	[SL]A+(SO) with Stable Outlook; reaffirmed

ICRA Lanka Limited, subsidiary of ICRA Limited, a group company of Moody's Investors Service, has reaffirmed the issuer rating of [SL]BBB (pronounced SL Triple B) with stable outlook for Commercial Credit and Finance PLC (CCFL or the company) and issue rating of [SL]BBB (pronounced SL Triple B) with stable outlook for the proposed LKR 2,000 Mn (with option to increase up to LKR 3,000 Mn) Senior Secured Redeemable Debentures Programme of CCFL, which is proposed to be listed on the Colombo Stock Exchange.

ICRA Lanka has also reaffirmed the [SL]BBB- (pronounced SL Triple B Minus) with stable outlook for the LKR 500 Mn Unsecured Subordinated Redeemable Debentures Programme of the company, which is currently listed on the Colombo Stock Exchange.

ICRA Lanka has also reaffirmed the [SL]AA-(SO)[1] (pronounced SL Double A Minus Structured Obligation) rating with stable outlook for the LKR 1,000 Million Guaranteed Subordinated Redeemable Debenture Programme of the company, which is currently listed on the Colombo Stock Exchange. This rating is based on the strength of the unconditional and irrevocable guarantee from Hatton National Bank PLC (HNB) for the principal amount (LKR 1,000 Mn) and the two quarterly interest instalments (LKR 52.5 Mn) maintained as a security deposit with the Trustee. The guarantor undertakes the obligation to pay, on demand from the Trustee, LKR 1,000 Mn, the principal amount of the Subordinated Redeemable Debentures. ICRA Lanka also factors in the undertaking from the Trustee to utilize the Security Deposit to pay the interest amount due to the investors and declare the entire guaranteed amount as payable in the event the issuer does not meet the scheduled interest payment on any due date or, in the event the issuer does not redeem the Debenture in full on any redemption date to redeem the instrument in full. The rating also assumes that the guarantee will be duly invoked by the Trustee, as per the terms of the underlying Trust deed, Trustee's undertaking and guarantee agreements, in case there is a default in payment by CCFL.

[1] The letters SO in parenthesis suffixed to a rating symbol stand for Structured Obligation. An SO rating is specific to the rated issue, its terms, and its structure. The SO ratings do not represent ICRA Lanka's opinion on the general credit quality of the issuer(s) concerned

ICRA Lanka has also reaffirmed the [SL]A+(SO)[1] (pronounced SL A plus Structured Obligation) rating with stable outlook for the LKR 2,000 Mn Guaranteed Subordinated Redeemable Debentures Programme which is currently listed on the Colombo Stock Exchange. This rating is based on the strength of the unconditional and irrevocable guarantees from Sampath Bank PLC (Sampath) and HNB covering the principal and two interest instalments (Semi-Annual) of the proposed issue. Each guarantor undertakes the obligation to pay, on demand from the Trustee, LKR 1,000 Mn, being 50% of the total principal sum of LKR 2,000 Mn and, one half-yearly interest instalment of the proposed Subordinated Redeemable Debentures. The rating also assumes that the guarantees will be duly invoked by the Trustee, as per the terms of the underlying Trust deed and guarantee agreements, in case there is a default in payment by CCFL.

The issuer and other issue ratings continue to factor in CCFL's established business presence in Sri Lanka, its experienced senior management team, adequate capital adequacy ratio, and, its good profitability indicators, notwithstanding some moderation in the recent past. ICRA Lanka however takes note of CCFL's high dependence on fixed deposits and exposure to a customer segment with a modest credit profile that is highly vulnerable to the economic cycles. The ratings take cognisance of the increase in the NPA during FYE Mar 2016 and Q1FYE Mar 2017 (about 4.2% as on March 31, 2016 and 5.90% as on June 30, 2016); the company witnessed weakening in the asset quality of the Microfinance (MF) and MF-related SME segment. The strong overall provision coverage (about 88.9% as on June 30, 2016 and 101.1% as on March 31, 2016) and initiatives taken to further augment its MIS, internal controls to make it commensurate with the risks inherent in this business segment, provides some comfort. ICRA Lanka takes note of the moderation in gearing levels as the portfolio growth slowed during FYE Mar 2016, while internal generation continued to remain healthy. Going forward, the company is expected to grow its portfolio at about 20% over the medium term, which is expected to be supported by its good profitability. However, ability to maintain prudent appraisal/sourcing norms in view of the asset quality related pressures and, its ability to maintain good profitability indicators by improving its operating efficiencies and reducing credit related losses would be key rating sensitivities.

CCFL's gross lending portfolio increased to about LKR 62.6 Bn as on June 30, 2016, recording a 2% Y-o-Y growth (27% Y-o-Y during FYE Mar 2016). The company reported a decline in its MF, MF-related SME loans due to asset quality concerns and a higher growth in leasing/Hire Purchase (HP). MF and MF-related SME loans together accounted for 25% of the gross portfolio as on June 30, 2016, while HP/leasing accounted for about 43%. Within the HP/leasing segment, the company takes exposures for financing cars/vans (15.4% of the total portfolio as on June 30, 2016), commercial vehicles (8.8%), 3-wheelers (7.3%), 2-wheelers (11.1%). The company has steadily reduced its pawning portfolio which accounted for about 2.4% as on June 30, 2016 as compared to 10% as on March 31, 2014. Going forward, the company is expected to reduce the share of MF/MF-related products segments to 20% of the total portfolio and increase the share of personal loans, business loans, and vehicle financing.

ICRA Lanka takes note of the weakening in the asset quality indicators during FYE Mar 2016 specifically due to the increase in the delinquencies witnessed in the MF, MF-related SME loans segment. The company's gross NPAs increased from about 4.2% as on March 31, 2016 to about 5.9% as on June 30, 2016 (4.0% as on March 31, 2015). CCFL's provision coverage however is strong at about 88% as on June 30, 2016 and 101% as on March 31, 2016. The ratings take note of the increasing standalone NPAs in the MF and MF-related SME loans to 8.2% as on June 30, 2016 as compared with about 3.2% as on March 31, 2016 (1.1% as on March 31, 2015). Notwithstanding the healthy provision coverage, ability of the company to contain NPAs in the MF/MF-related SME loans at reasonable levels and to maintain the quality of the loans and leasing segments, as the business expands and portfolio seasons would be a crucial.

CCFL's gearing reduced to 7.3 times as on June 30, 2016, when compared to 7.7 times reported on March 31, 2016 (8.4 times as on March 31, 2016) due to a moderation in portfolio growth. ICRA Lanka notes that the company is expected to grow at a relatively moderate pace of 20% as compared to the past (71% CAGR over the period FYE Mar 2012-FYE Mar 2015); and while its reported capital adequacy ratio (CAR) was comfortable at 13.4% with core capital at 11.2% as on June 30, 2016; it would be critical for CCFL to further moderate its gearing, from the current levels, to have a capitalisation profile commensurate with the risks inherent in its business.

The company is largely dependent on deposits, which accounted for about 81% (77% being fixed deposits) of the total funding base as on June 30, 2016. CCFL has a good renewal rate of about 75-80% for its fixed deposits; while CCFL has been able to grow its deposit base on the back of the sharp increase in its service locations over the past few years. Going forward, it would be critical for the company to secure longer tenure funding to offset liquidity related risks as it increases focus on longer tenure loans.

CCFL's return on average assets moderated to 3.35% in FYE Mar 2016 (3.37% in Q1FYE Mar 2017) as compared to 4.71% in FYE Mar 2015 because of increase in credit costs to 4.48% in FYE Mar 2016 from 3.13% in FYE Mar 2015 and moderation in NIMs to 15.06% from 15.67% in FYE Mar 2015. The increase in credit cost was due to the increase in the NPAs, while reduction in the share of high yielding MF/MF-related loans and increase in systemic rates impacted the NIMs. Operating efficiency improved moderately with cost to income ratio improving to 49.53% in FYE Mar 2016 from 53.31% in FYE Mar 2015. Notwithstanding the moderation, overall profitability continues to remain healthy; going forward however, company's ability to control credit costs and further improvement in the operating efficiencies would be key for profitability, as the company increases the share of lower yielding advances (personal loans, business loans, and vehicle loans).

Company Profile:

CCFL, a registered finance Company, offers microfinance, leasing, hire purchase, term loan, factoring and other personal and business credit facilities apart from accepting deposits (Fixed and Savings). The company was established in 1982 as specialized leasing company in Kandy. In October 2009, the company's ownership changed, with controlling interest being acquired by BG investments (Pvt) Ltd, an investment holding company controlled by Mr. Roshan Egodage, Executive Director and Chief Executive Officer- CCFL. In 2010, the company moved its Head Office to Colombo. Since change of ownership, the company has rapidly expanded its service locations to about 122 from about 22 in FYE Mar 2012. The company has an employee base of about 3,400 and caters to about 1,000,000 customers. CCFL's shares were listed in the Dirisavi Board (secondary board) of the CSE in Jun 2011. BG Investment (Pvt) Ltd holds 57.0% of the shareholding, while Creation Investments Sri Lanka LLC owns about 28.6%, following the equity infusions of LKR 1,680 Mn during FYE Mar 2014 and in FYE Mar 2015. During FYE Mar 2015, the company acquired majority stake in Trade Finance and Investments PLC, which presently is a wholly owned subsidiary.

During the year ended March 31, 2016, CCFL reported a net profit of LKR 2.1 Bn on a total asset base of LKR 70.7 Bn as compared to net profit of LKR 2.1 Bn on a total asset base of LKR 57.7 Bn in the previous fiscal. The consolidated net profit for the year ended March 31, 2016 stood at LKR 2.3 Bn on a total asset base of LKR 72.4 Bn.

For the three months ended June 30, 2015, CCFL reported a net profit of LKR 607 Mn on a total asset base of LKR 73.2 Bn. On a consolidated basis, the company reported a net profit of LKR 675 Mn on a total asset base of LKR 75.1 Bn for the period.

Guarantor Profile:

Hatton National Bank PLC

Hatton National Bank PLC (HNB) is one of the largest private sector commercial banks in the country with total assets amounting to LKR 725 Bn as at December 31, 2015. It accounted for 8.9% of sector assets, 11.0% of sector loans and advances and 9.7% of sector deposits as at December 31, 2015. The bank was incorporated in the present form in the year 1970. Stassen's group with 17.95%, Sri Lanka Insurance Corporation Ltd with 14.68% and Employee Provident Fund with a 9.81% are the major shareholders of the bank. The bank recorded a total income of LKR 37.6 Bn for the 6MFYE Dec 2016 and LKR 61.1 Bn for the FYE Dec 2015 (LKR 59.5 Bn for the FYE Dec 2014). The net profits of the bank amounted to LKR 6.4 Bn during 6MFYE Dec 2016 and LKR 10.4 Bn for the FYE Dec 2015 (LKR 9.0 Bn for the FYE Dec 2014), which resulted in ROAA of 1.6% and 1.6% for the respective periods. The bank had gross NPA ratios of 2.25% and 2.43% as at Jun 30, 2016 and FYE Dec 2015 (3.16% in FYE Dec 2014) and net NPA ratios of 0.80% and 0.84% respectively for the said periods (1.43% in FYE Dec 2014). The bank had a net worth of LKR 67.2 Bn as on Jun 30, 2016 with tier 1 capital adequacy ratio of 9.77% and total capital adequacy ratio of 12.97%.

Sampath Bank PLC

Sampath Bank Plc is one of the larger private sector commercial bank in the country with total assets of LKR 525 Bn as at December 31, 2015. Sampath accounted for 6.49% of the industry assets, 8.09% of the sector loans and advances and 7.52% of sector deposits as on December 31, 2015. The bank commenced operations as a licensed commercial bank in 1987 and was noted for introducing technology to the banking sector. Major institutional shareholders include Vallibal 1 PLC with a 14.95% and Employees Provident Fund with a 9.97% stake. The Sampath group companies include Sampath Centre Ltd (97.14%), SC Securities (Pvt) Ltd (100%), Siyapatha Finance PLC (100%) and Sampath Information Technology Ltd (100%). The bank recorded a total income of LKR 29.3 Bn for the 6MFYE Dec 2016 and LKR 47.0 Bn for the FYE Dec 2015 (LKR 44.5 Bn for the FYE Dec 2014). The net profits of the bank amounted to LKR 4.2 Bn during 6MFYE Dec 2016 and LKR 6.1 Bn for the FYE Dec 2015 (LKR 4.9 Bn for the FYE Dec 2014), which resulted in ROAA of 1.5% and 1.2% (1.6% in FYE Dec 2014) for the respective periods. The bank had gross NPA ratios of 1.80% and 1.64% as at 6MFYE Dec 2016 and FYE Dec 2015 (1.93% in FYE Dec 2014) and net NPA ratios of 0.69% and 0.46% respectively for the said periods (0.53% in FYE Dec 2014). The bank had a net worth of LKR 38.1 Bn as of June 30, 2016 with tier 1 capital adequacy ratio of 7.97% and total capital adequacy ratio of 12.35%.

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