Rating of LOLC Holdings PLC is placed on watch with developing implications

February 07, 2020

LOLC Holdings PLC

Instrument	Rated Amount (LKR Mn)	Rating Action
Issuer rating	N/A	[SL]A; rating put on watch with developing implications
Commercial Paper Programme	1,000	[SL]A1; rating put on watch with developing implications
Listed Senior Unsecured Redeemable Debenture Programme	5,000	[SL]A; rating put on watch with developing implications
Listed Senior Unsecured Redeemable, Debenture Programme (outstanding balance of the LKR 2,750 Mn debenture)	2,000	[SL]A; rating put on watch with developing implications
Listed Senior Unsecured Redeemable, Debenture Programme (matured amount of the LKR 2,750 Mn debenture)	750	[SL]A; rating put on watch with developing implications and withdrawn
Listed Senior Unsecured Redeemable Debenture Programme	5,000	[SL]A; rating put on watch with developing implications and withdrawn

Rating action:

ICRA Lanka Limited, subsidiary of ICRA Limited, a group company of Moody's Investors Service, has placed the issuer rating of [SL]A for LOLC Holdings PLC ("LOLC"/"the Company") on watch with developing implications. ICRA Lanka also has placed the issue rating of [SL]A for the LKR 5,000 Mn Listed Senior Unsecured Redeemable Debenture Programme, the issue rating of [SL]A for the LKR 2,000 Mn (remaining balance of 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 on watch with developing implications.

ICRA Lanka also has placed the issue rating of [SL]A for the LKR 5,000 Mn Listed Senior Unsecured Redeemable Debenture Programme and the issue rating of [SL]A for the LKR 750 Mn (matured balance of the LKR 2,750 Mn) Listed Senior Unsecured Redeemable Debenture Programme on watch with developing implications and has withdrawn the ratings at the request of the Company, as the same have been fully redeemed.

Rationale:

ICRA Lanka has taken the consolidated view of the LOLC group, which has interests in various segments including financial services, insurance, manufacturing, trading, plantations, renewable energy, and leisure when arriving at the ratings.

The ratings have been placed on watch with developing implications in view of the expected divestment in PRASAC Microfinance Institution Limited ("PRASAC"), envisaged reduction in the group level leverage (stood at 5.5 times in Sep-19 vis a vis 6.9 times in Sep-18). The rating action also factors in the weakened asset quality (consolidated NPAs of the local NBFIs increased to 7.25% in Sep-19 from 5.29% in Sep-18) and earnings profiles (consolidated RoA moderated to 1.34% [1]in H1FY2020 vis a vis 1.61% in H1FY2019) of the Sri Lanka based NBFCs (LOLC Finance PLC, Commercial Leasing & Finance PLC and LOLC Development Finance PLC) of the group over the recent past, which would account for the 60% of the group's assets post PRASAC divestment and, drive the group level performance over the near to medium. Post the divestment of PPRASAC, ICRA Lanka expects the consolidated profitability to moderate further as PRASAC was the most profitable (RoA[2] of 3.69% and 3.81% respectively of the 11MCY2019 and CY2018) subsidiary of the Group. ICRA Lanka would closely monitor the extent of reduction in the group level leverage, near to medium term investment plans of the group and, the performance of the financial sector entities in the group, especially the Sri Lanka based NBFCs, post the PRASAC divestment.

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. While ICRA Lanka takes cognisance of diversified presence of the LOLC group and near term investment plans in newer geographies, 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.

Key rating drivers:
Credit strengths

Experienced and strong management team and risk management system; The LOLC Group is one of the largest conglomerates in Sri Lanka with a history spanning more than 40 years. The group's operations can be broadly identified under financial and non-financial sectors. Finance sector (including insurance) contributes closer to 97% of the asset base and 90% of the revenue for the period H1FY2020. The LOLC Group has an experienced senior management team, with knowledge in retail lending and banking, for managing the operations of the group entities, including the foreign entities. The group has centralised the key business support functions and the centralised model gives a competitive advantage to LOLC group's entities by optimising the overall operating costs. LOLC had expanded its operations in the South and East Asia regions and Africa and manages these entities using the knowledge and insight of its local management team.

Fairly diversified group level exposure: The LOLC group commenced its operations 40 years back in Sri Lanka. With time LOLC has diversified its finance sector operations to Cambodia, Myanmar, Indonesia and Pakistan. LOLC group reported a consolidated loan portfolio of LKR 804 Bn in Sep-19 as compared to LKR 620 Bn in Sep-18. The Group's financial sector exposure stood at 97% of the assets in Sep-19. Presently, LOLC's largest lending portfolio exposure is from Cambodia with 72% followed by Sri Lanka 26%, Myanmar 1% and Pakistan and Indonesia less than 1%. The group's overall exposure to the foreign entities (largely financial sector entities) stood at 66% based on total assets as of Mar-19 and contributes 41% of the revenue. Cambodia has a 56% exposure based on asset base and 40% contribution from revenue. However, the divestment of PRASAC would significantly reduce the Cambodian share of the lending portfolio to 36% of total exposure, while the share of the Sri Lankan exposure could go up to 60%. Going forward, the

[1] RoA computed excluding the LKR 5.2 Bn acquisition gain on Sunbird Bioenergy (SL) Ltd

[2] RoA computed based on US Dollar terms. When converted in to Sri Lankan Rupees, RoA stood at 3.69% and 5.26% respectively for the 11MCY2019 and CY2018

company is expecting to diversify its global presence to East Asia and Africa using the proceeds of the divestment. ICRA Lanka would monitor the country specific risks of these new investments and the impact on the group' overall risk profile.

LOLC group's local financial sector subsidiaries have diversified their operations into all districts. LOLC Finance PLC (LOFC), the flagship company in the group, has 104 branches and 32 service centers covering the entire country. It largely extends loans and leases to SME and micro segments. Commercial Leasing & Finance PLC (CLC) has a long track record of 20 years, with an established franchise of 65 branches. It has a seasoned Leasing portfolio and envisages to grow an asset backed SME portfolio. LOLC Development Finance PLC (LDFP) has its presence in 66 locations focusing on micro loans and micro leases and envisages to diversify its portfolio by extending Individual Loans, Micro Enterprise Development Loans, Micro Housing Loans and Leasing facilities to its customers. Consolidated portfolio of the Sri Lanka NBFCs has remained range bound over the past quarters on account of the weak operating environment and asset quality issues faced by the group. The LOLC group's non-financial sector consists of manufacturing and trading, leisure and entertainment, plantations and hydropower. However, currently the contribution from the non-finance sector to group performance remains quite modest (contributed for 14.3% and 22.1% of the Group's Gross Income and PBT).

Healthy funding profile of the group: LOLC group sources funds through local banks, international funding agencies and via debentures. The group has developed long-term relationship with the foreign funding agencies, which gives access to the group to source funds at competitive rates. LOFC and CLC reported healthy deposit bases of LKR 112 Bn and LKR 25 Bn in Sep-19 (68% and 50% of their interest bearing liabilities respectively) with the support of its established franchise and long track record. LDFP is presently relying on bank funding lines and it envisages to enhance its deposit profile going forward.

Adequate capitalisation of key operating companies and the expected improvement in gearing of the holding company post-PRASAC divestment; The capitalisation of the LOLC group's local financial subsidiaries improved as a result of the slowdown in portfolio growths and capital infusions made over the recent past. LOFC reported a risk-weighted capital adequacy ratio of 15.0% (Tier I of 13.1%) in Sep-19 as compared to 12.3% (Tier I of 10.2%) in Mar-19. LOFC's capital profile improved with the LKR 4.9 Bn rights issue concluded in Jun-19. CLC's capitalization levels remained comfortable with risk-weighted capital adequacy reported at 19.4% in Sep-19, as compared to 19.5% in Mar-19. LDFP reported a risk-weighted capital adequacy ratio of 13.5% in Sep-19 as compared to 15.2% in Mar-19. The capital moderated somewhat because of the sharp growth witnessed in HIFY2020, which was funded by short term bank borrowings. Standalone gearing of the holding company (LOLC) increased to 1.7 times in Sep-19 as compared to 1.6 times in Mar-19 and 1.3 times in Mar-18, while the consolidated gearing stood at 5.5 times in Sep-19 (6.9 times in Sep-18). Consolidated gearing adjusting the networth for the repossessed assets (assets taken over as part of recovery process of the NPAs and moved to investment properties) stood at 5.8 times as in Sep-19. ICRA Lanka expects stand-alone and the consolidated gearing levels of LOLC to improve based on the proposed debt repayment plan from the proceeds of the divestment of PRASAC.

Credit challenges

Weakened asset quality of the Sri Lankan entities, largely due to the challenging macro-political environment that prevailed during the period: Asset quality of the group's Sri Lankan NBFCs weakened as a result of adverse macroeconomic conditions in FY2019 and HIFY2020. The consolidated Gross NPA ratio of the Group's Sri Lankan NBFCs stood at 7.25% in Sep-19 as compared to 5.29% in Sep-18 (6.08% in Mar-19). LOFC reported a Gross NPA of 8.3% in Sep-19. Additionally, LOFC's repossessed assets stood at 2.5% of the total advances in Sep-19. CLC's gross NPA increased to 5.72% in Sep-19 as compared 3.27% in Sep-18 (4.90% in Mar-19), while LDFP's gross NPA increased to 7.71% in Sep-19 as compared to 5.18% in

Sep-18 (7.44% in Mar-19). ICRA Lank notes that while LOFC's slippages continue to remain elevated, CLC's and LDFP's slippages have moderated in Q2FY2020.

The group's overseas NBFCs, PRASAC, LOLC Myanmar Micro Finance Company Limited ("LMYN"), LOLC Cambodia PLC ("LCAM"), Pak Oman Microfinance Bank Limited ("PAKOMAN") and PT Sarana Sumut Ventura ("PTSSV"), however, have reported stable asset quality with a consolidated gross NPA of 0.81% in Sep-19 as compared to 0.74% in Sep-18. The LOLC group's overall asset quality including the foreign operations stands at 2.61% in Sep-19. ICRA Lanka expects a moderation in the share of unsecured credit and microfinance in the overall group NBFC exposure because of the divestment of PRASAC. Going forward, local entities will largely focus on asset-backed lending.

Moderation in earnings profile The LOLC group's consolidated RoA was 2.3% in H1FY2020 vis a vis 2.1% in FY2019 and 2.6% in FY2018. The RoA decreased because of moderation in interest margins due to the slowdown in growth, especially of the Sri Lankan NBFCs and, increased credit costs of the same. Overall profitability was supported by the overseas financial sector entities. The non-financial sector entities of the group (in manufacturing, trading and plantation & hydropower sectors) continued to report moderate performance, while its exposure to leisure and entertainment sector continued to report losses.

LOLC's standalone earnings consited mainly of fee income from shared services and interest income charged from lending to subsidiaries. LOLC at a standalone level reported a loss of LKR 5.1 Bn in HIFY2020 as compared to LKR 3.2 Bn in FY2019, due to increased interest costs as a result of increased borrowings during FY2019 and H1FY2020 to fund its investments. LOLC is expecting to settle part of the debt using the proceeds from the PRASAC divestment.

LOFC's ROA moderated to 0.9% in H1FY2020 vis a vis 2.8% in FY2019 as the NIM contracted to 8.6% in HIFY2020 from 10.3% in FY2019 on account of moderate growth and weakening asset quality. CLC and LDFP also reported moderate ROA of 2.0% and 0.7% during HIFY2020 because of weak asset quality.

Analytical approach: ICRA Lanka has taken the consolidated view of the LOLC group, which has interests in various segments including financial services, insurance, manufacturing, trading, plantation, renewable energy, and leisure when arriving at the ratings. 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 also has interests in manufacturing, trading, plantations, 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, Maldives and in the African region.

During the FY2019, LOLC group reported a net profit of LKR 19.6 Bn on a total Asset base of LKR 1,044 Bn compared to the net profit of LKR 19.2 Bn on a total Asset base of 822 Bn in the previous fiscal. During the HIFY2020, LOLC group reported a net profit of LKR 12.8 Bn on a total Asset base of LKR 1,221 Bn

LOLC (Consolidated)

In LKR Mn	FY2018	FY2019	HIFY2019	HIFY2020
Net Interest Income	46,254	53,904	25,943	**28,896**
Profit after Tax	19,190	19,635	7,040	**12,818**
Net worth (adjusted for revaluation reserves)	109,949	143,307	122,173	188,772
Loans and Advances	549,976	707,278	619,597	803,918
Total Assets	822,239	1,043,747	926,763	1,221,164
Return on Equity	18.6%	15.5%	12.1%	15.4%
Return on Assets	2.6%	2.1%	1.6%	1.3%*
Gross NPA	1.70%	2.31%	2.59%	2.61%
Net NPA	N/A	N/A	N/A	N/A
Capital Adequacy Ratio	N/A	N/A	N/A	N/A
Gearing (times)	5.5	5.5	5.8	4.8
Gearing adjusted for revaluation reserves and goodwill on acquisition (times)	6.7	6.5	6.9	5.5

*RoA after adjusting the LKR 5.2 Bn gain on acquisition of Sunbird Bioenergy (SL) Ltd

Current Rating (FY2020)			Chronology of Rating History for the past 3 years		
Type	**Amount Rated (LKR Mn)**	**Date & Rating Jan-20**	**Date & Rating FY2020 Jul-19**	**Date & Rating FY2019 Mar-19**	**Date & Rating in FY2018 Nov-17**
N/A	N/A	[SL]A (under rating watch with developing implications)	[SL]A (Stable)	[SL]A (Stable)	[SL]A (Stable)
Commercial Paper	1,000	[SL]A1(under rating watch with developing implications)	[SL]A1	[SL]A1	N/A
Listed Senior Unsecured Redeemable, Debenture Programme (outstanding balance of the LKR 2,750 Mn Debenture)	2,000	[SL]A (under rating watch with developing implications)	[SL]A (Stable)	[SL]A (Stable)	[SL]A (Stable)
Proposed Senior Unsecured Redeemable Debenture Programme to be listed	5,000	[SL]A (under rating watch with developing implications)	[SL]A (Stable)	N/A	N/A
Listed Senior Unsecured Redeemable Debenture Programme	5,000	[SL]A (under rating watch with developing implications) Withdrawn	[SL]A (Stable)	[SL]A (Stable)	[SL]A (Stable)
Listed Senior Unsecured Redeemable, Debenture Programme (matured amount of the LKR 2,750 Mn Debenture)	750	[SL]A (under rating watch with developing implications) Withdrawn	[SL]A (Stable)	[SL]A (Stable)	[SL]A (Stable)

ANALYST CONTACTS

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

Mr. Rasanga Weliwatte
+94 11 4339907
rasanga@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

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 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