

ICRA Lanka assigns [SL]BB- rating for Lakderana Investments Limited

November 18, 2020

| Instrument | Rated Amount (LKR Mn) | Outstanding Amount (LKR Mn) | Rating Action |
|---------------|--------------------------|--------------------------------|----------------------------|
| Issuer Rating | N/A | N/A | [SL]BB- (Stable); assigned |

Rating action

ICRA Lanka Limited has assigned the issuer rating of [SL]BB- (Pronounced SL double B minus) with a Stable outlook to Lakderana Investments Limited (LIL or the company).

Rationale

The rating factors the company's modest scale and franchise, deterioration in asset quality and limited funding diversity. ICRA Lanka notes that LIL is not a Licensed Finance Company, which limits its financial flexibility and growth. The company's exposure is mainly to the three-wheeler segment, which is a somewhat risky asset class, with modest customer credit profiles. Out of the total gross portfolio (gross portfolio of LKR 2.9 Bn as in September 2020), three wheelers accounted for 93%. LIL's asset quality has deteriorated with an increasing GNPA % (90 days past due) of 10.0% in September, 2020. (5.2% in September 2019 and 7.1% in March 2020). This is largely attributable to the non-conducive macro-economic environment and the muted portfolio growth during the period. The company has a comfortable earnings profile, characterised by return on assets of 3.8% in FY2020 (3.9% FY2019 and 3.9% in FY2018). However the ability of the Company to maintain the same, considering the competitive business environment, would be crucial going forward.

Outlook: Stable

The outlook may be revised to "Positive" based on LIL's ability to maintain healthy asset quality as the business expands and improve its capitalization profile. The outlook may be revised to "Negative" in case of significant deterioration in asset quality and earnings profile.

Key rating drivers

Credit strengths:

Adequate earnings profile: Earnings profile of the company is supported by healthy lending margins, where the company reported a NIM of 13.5 % in FY2020 as compared to 13.6% in FY2019 (13.5% in FY2018). The NIM remained constant despite the portfolio de-growth due to the shift towards relatively high yielding registered 3-wheeler segment, because of attractive second-hand (registered) 3W prices. The company's spreads are also supported by its significant other income derived from the insurance commission income. The company reported a ROA of 3.8% in FY2020 as compared to 3.9% in FY2019 and 3.9% in FY2018. PAT for FY2020 was LKR 178 Mn, vis-à-vis LKR 182 Mn in FY2019. Going forward, it will be crucial for the company to maintain the overall profitability by better managing operating expenses and credit cost, as the room for further increase in lending yields will be limited.

Credit challenges

Small scale of operations in a relatively risky Market segment; LIL is a smaller player in the vehicle financing industry with a portfolio of about LKR 3.4 Bn and an asset base of LKR 4.4 Bn respectively, as of March 2020. The company has 31 branches and 2 touch points. The company offers hire purchase facilities for 3-wheelers and 4-wheelers. Out of the total portfolio, registered 3Ws contributed to 45.3%, while unregistered 3Ws contributed to about 43.5% as in September 2020. The target customer base of the company has a modest credit profile and are vulnerable to adverse economic cycles. Going forward, LIL's ability to maintain sustainable growth, with its franchise, could be crucial, in the increasingly competitive 3W financing sector.

Deterioration in asset quality; The company reported GNPA (90 days due) of 10.0% in September 2020 as compared to 5.2% reported in September 2019 and 4.2% in December 2018. ICRA Lanka notes that, the sharp increase in GNPA ratio is mainly a result of the non-conducive macro-economic environment which prevailed in the country, since March 2019. GNPA ratio is also affected by the muted portfolio growth during the period. The increase in absolute NPA (90 days due) during the period was about 42%, from LKR 218 Mn in September 2019 to LKR 310 Mn in September 2020. Disruption of branch activities and collections during the COVID-19 lockdown has primarily contributed to the slippages during the period. Going forward, ICRA Lanka will continue to monitor the asset quality movement of the company, as the core 3W segment served by the company is susceptible to adverse Market conditions.

Limited funding diversity, which hinders growth; Total borrowings of LIL stood at LKR 2,524 Mn and comprised of long term bank borrowings (66% of the total funding), securitised borrowings (20%) and subordinated loans (12%) as of June 2020. LIL's legal status prohibits it from canvassing funds from deposits. As a result, the company has to resort to high cost securitization facilities. The company reported a relatively low gearing ratio of 1.9 times in June 2020 and 2.1 times in March 2020 compared to 3.2 times in March 2019.

Analytical approach: For arriving at the ratings, ICRA Lanka has applied its rating methodologies as indicated below.

Links to applicable criteria: [ICRA Lanka Credit Rating Methodology for Non-Banking Finance Companies](#)

About the company:

Lakderana Investments Ltd is a limited liability company incorporated in Sri Lanka, in March 2006. The company is not a licensed financial institution; it carries out hire-purchase operations under the Consumer Credit Act no. 29 of 1982. High Peak Holdings (Pvt) Ltd. is the main shareholder of the company holding 54%. Mr. Virath Esela De Alwis has a holding of 25%. The company offers Hire Purchase facilities to three wheelers, two wheelers and other vehicles. The company employs 211 staff members and has 31 branches and 2 touch points.

During the year ended March 31, 2020 LIL reported a net profit (unaudited) of LKR 178 Mn on a total asset base of LKR 4,407 Mn as compared to net profit of LKR 182 Mn on a total asset base of LKR 5,069 Mn in the previous fiscal year. For the six months ended September, 2020 LIL reported a net profit (unaudited) of LKR 61 Mn.

Key financial indicators

| LKR Mn | FY2017 | FY2018 | FY2019 | FY2020* |
|----------------------|--------|--------|--------|---------|
| Net Interest Income | 404 | 472 | 641 | 640 |
| Profit after Tax | 84 | 135 | 182 | 178 |
| Net worth | 969 | 1,039 | 1,127 | 1,296 |
| Total Assets | 2,587 | 4,378 | 5,069 | 4,407 |
| Return on Equity | 12.58% | 13.49% | 16.83% | 14.73% |
| Return on Assets | 4.02% | 3.89% | 3.86% | 3.76% |
| Gross NPA (90 days) | 4.21% | 3.72% | 4.17% | 7.06% |
| Gross NPA (180 days) | NA | NA | 1.85% | 2.68% |
| Gearing (times) | 1.54 | 2.95 | 3.15 | 2.09 |

*Unaudited Financials

Rating history for last three years:

| Instrument | Current Rating (FY2021) | | | Chronology of Rating History for the past 3 years | | |
|---------------|-------------------------|-----------------------|-----------------------------|---|-------------------------|-------------------------|
| | Type | Amount Rated (LKR Mn) | Date & Rating | Date & Rating in FY2019 | Date & Rating in FY2018 | Date & Rating in FY2017 |
| Issuer rating | N/A | N/A | Nov 2020 [SL]BB-(Stable) | - N/A | - [SL]BB-(Stable) | - N/A |



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