

Sri Lanka Savings Bank: Ratings reaffirmed; Stable outlook assigned

March 09, 2021

Instrument	Rated Amount (LKR Mn)	Rating Action
Issuer Rating	N/A	[SL]BBB-; reaffirmed; 'outlook revised to Stable from rating watch with developing implications'

Rating action:

ICRA Lanka Limited has reaffirmed the Issuer Rating of [SL]BBB- (Pronounced as S L Triple B Minus) for Sri Lanka Savings Bank ("SLSB" / "the Bank"), while revising the outlook to Stable from rating watch with developing implications.

Rationale:

The rating action factors the 100% government ownership of SLSB, where the Bank is now a subsidiary of state-owned National Savings Bank (NSB; rated [SL]AAA; Stable by ICRA Lanka). The rating takes note of the comfortable risk-weighted capital adequacy ratios (CAR) characterised by a Tier 1 and total CAR of 70.73% each as of Sep-20. However, SLSB would have to enhance its core capital to LKR 7.5 Bn by Dec-22 from LKR 4.6 Bn as of Sep-20 in order to meet the minimum core capital requirement for Licensed Specialised Banks (LSBs), as stipulated by the CBSL. The timely capital support from the parent entity will be a key monitorable, going forward.

The rating, however takes cognizance of SLSB's modest scale of operations (total assets of LKR 8.8 Bn as of Sep-20) and the limited franchise (4 branches as of Sep-20). The rating also considers the Bank's risky exposure profile, where micro-lending accounts for bulk of the lending portfolio (27% of total gross advances as of Sep-20). Further, the rating is constrained by the weak asset quality indicators with Gross NPA ratio of 22.96% in the active portfolio (i.e., excluding the legacy Pramukha Savings and Development Bank- PSDB portfolio) as of Sep-20. ICRA Lanka expects the asset quality to remain under pressure in the near term as the Bank's core segments are yet to recover from the recent challenges posed by Covid-19 pandemic and slowdown in the macro-economic situation.

Outlook: Stable

ICRA Lanka believes that SLSB will benefit from the support of the new parent, NSB. The outlook may be revised to 'Positive' in case of a significant improvement in the resource and earnings profile of the Bank with the portfolio expansion, while keeping the asset quality under control. The outlook may be revised to 'Negative' in case of a sharp deterioration in asset quality and profitability indicators or lower than expected support from the parent entity.

Key rating drivers:

Credit strengths

Subsidiary of the state-owned National Savings Bank: In October 2019, SLSB was acquired by the state-owned National Savings Bank (NSB). SLSB is expected to benefit from NSB ownership in terms of capital, operational and managerial support. ICRA Lanka envisages, NSB to support SLSB with additional capital

in order to meet regulatory capital requirements. Currently, the SLSB board has 2 Board members representing NSB. However, from a rating point of view, benefit that can be derived by the parentage is constrained as the operational linkage between the two entities are moderate.

Healthy risk-weighted capital adequacy ratios; however remains largely dependent on parent to meet absolute core capital requirements : SLSB maintains a healthy capitalisation profile with a Core capital ratio and Total capital ratio of 70.73% each as of Sep-20 (Regulatory requirement of 8.00% and 12.00%) as compared to 82.81% and 83.78% as of Dec-19. ICRA Lanka notes that the high capital adequacy ratios are largely attributable to the modest loan book of the Bank, where over 68% of the asset base is deployed in investments. However, the Bank's core capital of LKR 4.6 Bn as of Sep-20 remains below the minimum core capital requirement of LKR 7.5 Bn as stipulated by CBSL to be complied by Dec-22. ICRA Lanka envisages that NSB would provide timely capital support to SLSB in meeting this capital requirement, as the Bank's internal generation is expected to be modest.

Credit challenges

Modest scale of operations and limited franchise: SLSB is a modest sized specialized bank with a total asset base and a gross lending portfolio (including the legacy portfolio) of LKR 8.8 Bn and LKR 3.6 Bn, respectively as of Sep-20. The asset base is dominated by its investment portfolio accounting for over 68% as of Sep-20 (67% as of Dec-19 and 65% as of Dec-18), as the Bank has maintained a high proportion of investments, historically, in order to facilitate the repayment of the deposit holders of the failed Pramukha Savings & Development Bank (PSDB). Since vesting of PSDB's liabilities, SLSB has paid out about LKR 2.9 Bn (including interest on PSDB debentures) and an unclaimed balance of LKR 526 Mn remains as of Sep-20. The lending portfolio of the Bank consists of Micro-finance bulk lending, Micro-SME loans, Leasing & Hire purchase and Consumer loans which accounted for 27%, 16%, 15% and 14%, respectively as of Sep-20. The legacy portfolio (PSDB) accounted for 28% of the total portfolio as of Sep-20. SLSB currently has only 4 branches including its head office; hence has limited franchise to grow its portfolio. However, ICRA Lanka expects that the Bank will benefit from the NSB branch network to increase the geographic footprint and reach a wider market.

Weak Asset Quality indicators due to high exposures in risky asset classes: SLSB's portfolio is largely exposed to vulnerable customer segments including microfinance and micro-scale enterprises. The rating also factors SLSB's microfinance portfolio which is concentrated, with the top 10 microfinance borrowers representing 22% of the total active portfolio as of Sep-20. The reported gross NPA ratio and net NPA ratio of the Bank stood at 44.70% and 4.77% as of Sep-20, as compared to 40.69% and 3.76% as of Dec-19. The asset quality is further affected by the legacy portfolio vested from PSDB which is 100% NPA and there have been no tangible recovery from the legacy portfolio. The asset quality of the active portfolio too deteriorated over the period largely due to the challenging macro environment which prevailed during the period. The Bank's active portfolio reported GNPA ratio of 22.96% as of Sep-20 in comparison to 18.80% as of Dec-19 and 14.67% as of Dec-18. ICRA Lanka notes that, overall moderation of the portfolio has also contributed to the increase in the GNPA ratio. Going forward, the Bank's ability to control incremental slippages in the active portfolio and improve overall asset quality will be crucial, from a rating point of view.

Profitability remains under pressure driven by high operating expenses and credit cost: Historically, SLSB has maintained healthy margins, with Net Interest Margin ("NIM") of 10.33% for CY2019 and 9.89% for CY2018. This has somewhat moderated to 7.93% in the 9MCY2020, as the interest income of the Bank is largely derived from the investment portfolio (~68% of the total assets as of Sep-20), and the interest rates sharply declined during the period. The cost to income ratio increased to 46.21% for 9MCY2020 as compared to 40.46% in CY2019 as a result of the reduced operating income reported in 9MCY2020 in

comparison to CY2019. The credit cost (loan provisioning/ATA) also increased to 0.36% in 9MCY2020 as compared to -0.14% in CY2019 and -0.27% in CY2018, due to increased slippages in the active portfolio and moderate recovery in the legacy portfolio. SLSB reported a PAT of LKR 184 Mn during 9MCY2020, vis-à-vis LKR 448 Mn in CY2019 and LKR 351 Mn in CY2018. As a result, the Bank reported a Return on Equity of 4.88% for 9MCY2020 (8.68% in CY2019 and 6.52% in CY2018) as compared to LSB Sector average of 8.56% for 9MCY2020 (5.85% for CY2019 and 10.26% for CY2018).

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 Banks](#)

About the Bank:

The Sri Lanka Savings Bank was established in July 2006 as a state owned licensed specialized bank, with the primary objective of taking over the assets and liabilities of Pramukha Savings and Development Bank (PSDB). In 2010, with state intervention, National Development Trust Fund (NDTF) was merged with SLSB to meet the capital deficiency of the Bank. Until 2011, SLSB was only authorised to recover the PSDB portfolio and pay-off its deposit holders. Subsequently, in 2011, the articles of the Bank was amended to enable SLSB to commence its own lending operations. Following a government budget proposal in 2016, SLSB was acquired by NSB in October 2019.

During the year ended December 31, 2019, SLSB reported a profit after tax (PAT) of LKR 448 Mn on a total asset base of LKR 8.7 Bn as compared to a PAT of LKR 351 Mn on a total asset base of LKR 9.2 Bn for the year ended December 31, 2018. For the 9MCY2020, SLSB reported a PAT of LKR 184 Mn on a total asset base of LKR 8.8 Bn.

Key financial indicators

LKR Mn	CY2017	CY2018	CY2019	9MCY2020*
Net Interest Income	896	926	924	520
Profit after Tax	604	351	448	184
Net worth	5,390	5,387	4,931	5,125
Loans and Advances	2,874	2,408	2,222	2,024
Total Assets	9,539	9,176	8,717	8,767
Return on Equity	11.90%	6.52%	8.68%	4.88%
Return on Assets (on PAT)	6.29%	3.75%	5.01%	2.80%
Gross NPA	32.99%	36.66%	40.69%	44.70%
Net NPA	6.42%	3.36%	3.76%	4.77%
Capital Adequacy Ratio	72.62%	89.94%	83.78%	70.73%
Gearing (times)	0.7	0.6	0.4	0.4

*Unaudited

Rating history for the last three years:

Instrument	Amount Rated (LKR Mn)	Current Rating	Chronology of Rating History for the past 3 years		
		CY2020 Mar-21	CY2019 Oct-19	CY2018 Dec-18	CY2016 Dec-16
Issuer rating	N/A	[SL]BBB- (Stable)	[SL]BBB-; on watch with developing implications	[SL]BBB- (Stable)	[SL]BBB- (Stable)



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