

Sanasa Development Bank PLC: Ratings reaffirmed

May 28, 2021

Instrument	Previous Rated Amount (LKR Mn)	Current Rated Amount (LKR Mn)	Rating Action
Issuer Rating	N/A	N/A	[SL]BBB- (Stable); reaffirmed
Guaranteed Redeemable Debentures, type B, guaranteed by Sampath Bank PLC	403	-	[SL]A+ (SO) (Stable); withdrawn
Guaranteed Redeemable Debentures, type D, guaranteed by Seylan Bank PLC	562	-	[SL]A- (SO) (Stable); withdrawn

Rating action

ICRA Lanka Limited has reaffirmed the Issuer Rating of Sanasa Development Bank (“SDB” / “the Bank”) at [SL]BBB- (pronounced as S L Triple B Minus) with Stable outlook. ICRA Lanka has also withdrawn the issue rating of [SL]A+(SO) (pronounced S L A Plus Structured Obligation) with Stable outlook on the type B, guaranteed redeemable debentures amounting to LKR 403 Mn and the issue rating of [SL]A-(SO) (pronounced S L A Minus Structured Obligation) with Stable outlook on the type D, guaranteed redeemable debentures amounting to LKR 562 Mn of the Bank. as the rated debentures were redeemed on maturity. The ratings have been withdrawn at the request of the Bank as the rated debentures have been redeemed on maturity.

Rationale

The reaffirmation of the Issuer Rating factors in SDB’s established franchise and healthy asset quality indicators. ICRA Lanka notes the diversification of SDB’s shareholder base with the presence of multilateral investors; Nederlandse Financierings-Maatschappij voor Ontwikkelingslanden N.V. (“FMO”), International Finance Corporation (IFC) and SBI Emerging Asia Financial Sector Fund PTE. LTD (SBI) holding 10.00%, 5.91% and 3.15%, respectively as on Dec-20. The asset quality indicators of the Bank have historically remained better than that of similar peers, mainly as a result of its low exposure towards micro-lending and presence of better systems and controls in place. The reported gross NPA ratio as on Dec-20 was 4.54%, improved from a high of 4.93% as on Mar-20, 4.72% as on June-20 and 4.53% as on Sep-20. However, ICRA Lanka notes the expected increase in the risk profile of the portfolio, following the shift towards the SME segment. Going forward, SDB’s ability to maintain healthy asset quality indicators given its target customer segment would remain a key monitorable.

ICRA Lanka takes note of the adequate capital structure following the LKR 1.5 Bn rights issue in Dec-20 and envisages the same to further improve, following the recently announced Secondary Public Offer (SPO). However, it will be crucial for the Bank to maintain an adequate capitalization profile, that commensurate with its growth plans.

Outlook: Stable

The stable outlook reflects SDB’s established franchise and the improved asset quality indicators despite the macro-challenges. The outlook may be revised to “Positive” in case of a steady improvement in the capital structure while maintaining comfortable asset quality indicators. The outlook may be revised to “Negative” in case of deterioration of the Bank’s capital structure or a significant weakening in the asset quality indicators and profitability.

Key rating drivers:

Credit strengths

Established franchise and strong promoter profile: The Bank has an established position on the back of the SANASA movement, especially in the rural and semi urban segments due to the various credit plus activities. This link to SANASA provides a competitive edge to the Bank in the rural and semi urban regions in sourcing, lending and deposit businesses. As in Dec-20, the Bank operated with 94 branches and 1,486 employees. Further, the Bank has a strong and diversified promoter profile with investment from multilateral investors such as FMO (10.0% stake), IFC (5.91%) and SBI (3.15%) as of Dec-20. The assistance from the multilateral investors has helped SDB to strengthen its systems and procedures to drive its business growth using new technology.

Healthy asset quality levels despite the challenging macro-outlook: SDB maintained relatively healthy asset quality indicators over the years due to its low exposure towards micro-credit lending as compared to peer banks. Despite the gross NPA ratio deteriorating to 4.93% as on Mar-20 post the pandemic, Bank was able to reduce it to 4.72% as on June-20 and 4.54% as on Dec-20 subsequently. SDB's gross NPA ratio was below the Licensed Specialized Bank (LSB) sector average of 6.88% as on Dec-20. However, ICRA Lanka notes that Bank's significant growth in the gross loans and advances of 20.7% YoY in Dec-20 (LSB growth of 5.5% YoY) has also contributed to the lower GNPA ratio. SDB has sizable exposure towards the loans to pensioners and salaried employees which helps to maintain healthier asset quality indicators. Also, with the assistance of multilateral investors (FMO, IFC and SBI), the Bank has implemented better systems and management practices in contrast to peer LSBs. ICRA Lanka will continue to monitor the asset quality of the Bank, with its increasing shift towards SME lending which typically has high gross NPA ratio of 6.33% compared to retail (3.69%) and co-operative segment (1.15%), respectively as on Sep-20.

Adequate capital structure with further capital raising plans to cushion the capital ratios: As on Dec-20, SDB raised capital via a rights issue amounting to LKR 1,500 Mn. Post the rights issue, SDBs core capital for regulatory purpose stood at LKR 9,262 Mn against a regulatory minimum requirement of LKR 7,500 Mn which is to be met by end-2022. In terms of risk-weighted capital adequacy ratios, the core capital ratio and total capital ratio stood at 9.84% and 13.38%, respectively as on Dec-20 against the regulatory requirement of 8.00% and 12.00%, respectively. The core capital and total capital adequacy ratios as on Dec-19 stood at 9.47% and 14.83%, respectively. ICRA Lanka notes that the capital buffers of the Bank (compared to the regulatory minimum) have somewhat moderated due to the sharp portfolio growth. Bank has announced a Secondary Public Offer (SPO) and plans to raise about LKR 4,000 Mn (4.2% of risk weighted assets as of Dec-20) in July-21. Going forward, it will be crucial for the Bank to maintain adequate capital buffers over the regulatory requirements, in-line with its growth expectations. ICRA Lanka expects a buffer of ~2% over the regulatory requirement in the short to medium term given the Bank's growth rates and capital infusion.

Adequate profitability and is expected to remain stable in the medium term: SDB reported an operating profit¹ of LKR 1,984 Mn in CY2020 (LKR 1,250 Mn in CY2019 and LKR 1,113 Mn in CY2018). The operating profit/ATA improved to 1.68% in CY2020 compared to 1.22% in CY2019 and 1.24% in CY2018. Despite the macro-outlook and the reduction in the systemic interest rates, Bank's Net Interest Margin ("NIM") improved by few basis points to 5.89% in CY2020 in comparison to 5.88% in CY2019 and 5.50% in CY2018 as a result of the significant growth witnessed in the lending portfolio. The cost to income ratio has improved in CY2020 to 73.22 % from 75.50 % in CY2019 and 81.97% in CY2018. This is on account of the

¹ Operating Profit before Value added tax (VAT) on financial services

improved systems and efficiency levels. The credit cost (loan provisioning/ATA) improved to 0.35% in CY2020 from 0.90% in CY2019 (0.59% in CY2018). This is largely due to 4 large facilities being fully provided in the CY2019. In absolute terms, the provisioning for CY2020 amounted to LKR 417 Mn vis-à-vis LKR 917 for CY2019. The profitability in terms of Return on Assets (ROA) (on PAT) was higher than the industry average in CY2020 with SDB reporting 0.71% in CY2020 as compared to 0.58% for the LSB Sector. SDB reported a ROA on PAT of 0.25% and 0.40% in CY2019 and CY2018 respectively as compared to LSB's 0.36% and 0.57% in the respective periods. Overall, SDB reported a profit after tax (PAT) of LKR 836 Mn on an asset base of LKR 129,060 Mn for CY2020. For CY2019, SDB reported a PAT of LKR 253 Mn on an asset base of LKR 107,784 Mn.

Credit challenges

Moderate liquidity profile: SDB's asset liability mismatch (ALM) profile is characterized by sizeable negative cumulative mismatches in the <1-year bucket of 16.9% as on Sep-20. The mismatch is largely due to the short-term nature of the borrowings (that are largely in the form of short-term deposits) against the long-term nature of the lending products which have an average tenure of about 5-7 years. The Bank has 4 funding lines amounting to LKR 2 Bn which provides comfort on SDB's overall liquidity position. The liquid coverage ratios of the Bank stood comfortable at 125.21% as on Dec-20 (123.77% on an Dec-19), which is above the regulatory requirement of 90.00%. Furthermore, the liquid asset ratio stood at 21.57% as on Dec-20 (21.74% as on Dec-19), marginally above the regulatory requirement of 20.00% as on Dec-20. Management decided to maintain the liquid asset ratio closer to the regulatory requirement in order to optimize its utilization of funds.

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](#)
[ICRA Lanka's Suspension And Withdrawal Policy](#)

About the Bank:

Established in the year 1997, SANASA Development Bank PLC (SDB) is a Licensed Specialised Bank. SDB provides financial solutions to retail, SME, Business Banking and co-operative customers through its 94-branch network across the island. In 2012, SDB was listed on the Colombo Stock Exchange (CSE). As on Dec-20, 27% of the total shareholding is with SANASA affiliated entities which includes, cooperative societies, trusts and other institutions. As on Dec-20, the other top shareholders include Dr. Thirugnanasambandar Senthilverl (14.7%), Ayenka Holdings (Pvt) Ltd (13.9%), FMO (10.0%), IFC (5.9%) and SBI (3.2%). SDB reported a profit after tax of LKR 836 Mn on an asset base of LKR 129,060 Mn for CY2020. For the CY2019, the SDB reported a PAT of LKR 253 Mn on an asset base of LKR 107,784 Mn.

Key financial indicators (Audited)

LKR Mn	CY2017	CY2018	CY2019	CY2020
Net Interest Income	3,887	4,693	5,697	6,127
Profit after Tax	508	357	253	836
Networth	7,331	7,449	7,669	9,916
Loans and Advances	66,687	77,507	85,823	102,662
Total Assets	82,375	96,818	107,784	129,060
Return on Equity	7.90%	4.83%	3.35%	9.51%
Return on Assets (on PAT)	0.68%	0.40%	0.25%	0.71%
Gross NPA	2.07%	2.57%	4.44%	4.54%
Capital Adequacy Ratio	13.88%	12.54%	14.83%	13.38%
Adjusted Gearing (times)	10.1	11.9	12.8	11.7

Rating history for the last three years:

Instrument	Amount Rated (LKR Mn)	Amount Outstanding (LKR Mn)	Current Rating	Chronology of Rating History for the past 3 years		
			CY2020 April-21	CY2019 Aug-19	CY2018 Sep-18	CY2017 Nov-17
Issuer Rating	N/A	N/A	[SL] BBB- (Stable)	[SL] BBB- (Stable)	[SL] BBB- (Stable)	[SL] BBB- (Positive)
Guaranteed Redeemable Debentures, type A guaranteed by Sampath Bank PLC	1,597	-	NA	[SL]A+(SO) (Stable); Withdrawn	[SL]A+ (SO) (Stable)	[SL]A+ (SO) (Stable)
Guaranteed Redeemable Debentures, type B, guaranteed by Sampath Bank PLC	403	-	[SL]A+ (SO) (Stable); Withdrawn	[SL]A+ (SO) (Stable)	[SL]A+ (SO) (Stable)	[SL]A+ (SO) (Stable)
Guaranteed Redeemable Debentures, type C, guaranteed by Seylan Bank PLC	1,438	-	NA	[SL]A-(SO) (Stable); Withdrawn	[SL]A- (SO) (Stable)	[SL]A- (SO) (Stable)
Guaranteed Redeemable Debentures, type D, guaranteed by Seylan Bank PLC	562	-	[SL]A-(SO) (Stable); Withdrawn	[SL]A-(SO) (Stable)	[SL]A- (SO) (Stable)	[SL]A- (SO) (Stable)



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