

ICRA Lanka revises the issuer rating of LCB Finance Limited

July 12, 2021

| Instrument | Rated Amount (LKR Mn) | Rating Action |
|---------------|-----------------------|--|
| Issuer rating | N/A | Revised to [SL]B+ (Stable) from [SL]B (Stable) |

Rating action

ICRA Lanka Limited has revised the issuer rating of LCB Finance Limited (“LCB” or the Company) to [SL]B+ from [SL]B. The outlook on the rating remains Stable.

Rationale

The rating considers LCB’s limited track record, small scale of operations and modest competitive position in the non-banking finance sector. As in March 2021, the gross portfolio of the Company stood at about LKR 2.5 Bn. The rating also takes into consideration LCB’s moderate asset quality indicators especially in its core SME segment, improvement in its capitalisation profile and its comfortable liquidity position. LCB’s gross NPA reduced to 9.30% as in Mar-21 (9.01% in the active portfolio), from about 28.73% in Mar-20 (14.97% in the active portfolio) and 23.0% (3.68% in the active portfolio) in Mar-19. ICRA Lanka notes that the NPA reduction is largely attributable to the significant write-off of the legacy portfolio. LCB’s core capital as of March 2021 stood at about LKR 2.1 Bn, above the regulatory minimum capital requirement of LKR 2 Bn by December 2020, for Licenced Finance Companies (LFCs); and the Company’s gearing was low at 0.64 times due to its modest asset size. ICRA Lanka takes note of the initiatives taken by the Company to secure capital in the near-term to meet the regulatory minimum capital requirement of LKR 2.5 Bn by December 2021 for LFCs. Going forward, LCB’s ability to improve asset quality, particularly that of its core SME segments will be crucial from a rating point of view, as the third wave of the COVID outbreak has a sizable impact on smaller businesses.

Outlook: Stable

The outlook may be revised to “Positive” if the Company demonstrates a steady improvement of asset quality and an adequate capital profile over the medium term, while maintaining a track record of profitable portfolio growth. The outlook may be revised to “Negative” in case LCB breaches the regulatory minimum capital requirements, or if its asset quality or earnings profiles weaken.

Key rating drivers

Credit strengths

Improvement in the capitalization profile, backed by successive capital infusions: As in March 2021, LCB’s TNW stood at about LKR 2.1 Bn (LKR 1.5 Bn in Mar-20), compared to the regulatory minimum of LKR 2 Bn by Dec-20. The company has to comply with the LKR 2.5 Bn minimum capital requirement by Dec-21. However, ICRA Lanka notes that the IPO of LCB which is expected to be completed by Aug-Sep 2021, will raise about LKR 500 Mn, which will fulfil the future capital requirement. In addition, the planned merger with a potential smaller NBFIs is also expected to further increase the capital base. The rating also

takes comfort from the good track record of the promoters in infusing capital to the NBFI. LCB's core capital adequacy ratio stood comfortable at 58% as of Mar-21 and gearing was low at about 0.64 times as of Mar-21, as the portfolio size is quite small at the moment. The rating also takes comfort in CBSL's recognition of LCB as a Category A NBFI, despite its smaller size and the modest franchise.

Comfortable liquidity profile: As in March 2021, LCB had a positive ALM position of 30% in Mar-21 vis-à-vis 31% in Mar-21. The liquidity profile of the company is comfortable as the entity is largely equity funded at the moment (gearing only 0.64x), and the deposit exposure is only 40% of the total funding base. Further, management notes that their deposit base is increasing with the improvement of the deposit franchise. Management expects to further diversify the funding base with more long-term funding facilities from banks and other financial institutions in the long run. Also, ICRA Lanka takes note of the currently concentrated deposit base of the company with the top 10 deposits accounting for about 45% of the total deposit base as in Mar-21.

Credit challenges

Limited track record, small scale of operations and modest competitive position: LCB has a limited track record under the new management, as the company was taken over by Lanka Credit and Business Limited (LCB) in Apr-18; the entity was dysfunctional at that time. LCB's gross portfolio is at about LKR 2.5 Bn as of Mar-21. The legacy portfolio stood at LKR 8.1 Mn after a significant write-off of about LKR 306 Mn (about 12% of the total portfolio), which was fully provided for. As of Mar-21, the active portfolio consisted of loans, leasing & HP, factoring, microfinance lending and pawning/gold loans which accounted for about 80%, 14%, 1%, 1% and 3% respectively of the total active portfolio. The loan segment largely consists of business purpose loans (46% of total active portfolio), revolving loans (about 14%) and housing loans (about 1%). The leasing and HP portfolio mainly consists of lending for commercial vehicles and delivery trucks. ICRA Lanka notes that the management intends to diversify the portfolio by increasing its exposure to vehicle leasing and gold loans, in the short to medium term.

Moderate asset quality indicators, especially in its core SME segment: LCB's GNPA reduced to 9.30% as in Mar-21 (9.01% in the active portfolio), from about 28.73% in Mar-20 (14.97% in the active portfolio) and 23.0% (3.68% in the active portfolio) in Mar-19. ICRA Lanka notes that the NPA reduction is largely attributable to the write-off of the legacy portfolio (LKR 328 Mn as in Mar-20), which was entirely non-performing for a long period. NBFI sector GNPA ratio was 11.32% in Mar-21, vis-à-vis 11.56% in Mar-20, and 7.82% in Mar-19. ICRA Lanka takes cognizance of the relatively higher NPA ratio of its core product segments such as business loans (13.29% GNPA as in Mar-21) and housing loans (16.94% GNPA as in Mar-21), which collectively accounted for about 56% of the total portfolio during the same period. However, asset quality levels of the leasing portfolio (0.42% GNPA) and Gold loan portfolio (GNPA 0%) remain healthy. LCB's NPA coverage ratio remains healthy with over 100% NPA coverage and -2.14% Solvency as in Mar-21; stage 3 provisioning coverage was 28.5%. ICRA Lanka will continue to monitor the asset quality movement of LCB's core SME segments, as the third wave of the COVID outbreak has a sizable impact on smaller businesses.

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:

LCB Finance Limited (LCB) is a licensed Finance Company providing an array of products including Leasing, Hire Purchase, Business loans, Gold loans, Micro Finance, and Factoring. The Company was incorporated in 1962 as Industrial Finance Limited. In 2008, the ownership of the Company was transferred to ASPIC group and subsequently to Millennium group in 2009. The Company went through a name change in 2012 as City Finance Limited. In April 2018, under the guidance of Central Bank of Sri Lanka, LCB Limited, took over the Company and renamed it as LCB Finance Limited. LCB transferred its assets and liabilities to LCB during May 2018 and became its holding company. As of Mar-21, LCB Limited held 84% of LCB. For the FY2021, LCB reported a net profit of LKR 25 Mn on a total asset base of LKR 3.7 Bn.

Key financial indicators

| LKR Mn | FY2019 (Audited) | FY2020 (Audited) | FY2021 (Unaudited) |
|--------------------------|---------------------|---------------------|-----------------------|
| Net Interest Income | 221 | 292 | 348 |
| Profit after Tax | 514 | 11 | 25 |
| Net worth | 1,332 | 1,483 | 2,107 |
| Loans and Advances (Net) | 1,526 | 1,812 | 2,306 |
| Total Assets | 2,684 | 3,105 | 3,673 |
| Return on Equity | 59.31% | 0.81% | 1.39% |
| Return on Assets | 23.69% | 0.39% | 0.74% |
| Gross NPA | 23.00% | 23.06% | 9.30% |
| Net NPA | 2.83% | 2.93% | -1.79% |
| Capital Adequacy Ratio | 30.41% | 29.17% | 58.00% |
| Gearing (times) | 0.98 | 1.00 | 0.64 |

Rating history:

| Instrument | Current Rating Exercise | | | Chronology of Rating History | | |
|---------------|-------------------------|-----------------------------|----------------------------|------------------------------|----------------------------|----------------------------|
| | Type | Amount Rated (LKR Mn) | Date & Rating FY2021 | Date & Rating FY2021 | Date & Rating FY2020 | Date & Rating FY2019 |
| | | | June 2021 | September 2020 | March 2020 | March 2019 |
| Issuer rating | N/A | N/A | [SL]B+ (Stable) | [SL]B (Stable) | Suspended | [SL]B (Stable) |



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