

ICRA Lanka reaffirms the ratings of LOLC Holdings PLC

June 21, 2022

Instrument	Rated Amount (LKR Mn)	Outstanding Amount (LKR Mn)	Rating Action
Issuer Rating	N/A	N/A	[SL]A (Stable); Reaffirmed
Listed Senior Unsecured Redeemable Debenture Programme	2,000	2,000	[SL]A (Stable); Reaffirmed
Commercial Paper Programme	3,000	3,000	[SL]A1; Reaffirmed
Listed Senior Unsecured Redeemable Debenture Programme	5,000	5,000	[SL]A (Stable); Reaffirmed
Listed Senior Redeemable Debenture Programme	10,000	10,000	[SL]A (Stable); Reaffirmed
Senior Unsecured Unlisted Rated Redeemable Debenture Programme	2,000	2,000	[SL]A (Stable); Reaffirmed

Rating action

ICRA Lanka Limited has reaffirmed the issuer rating of [SL]A with stable outlook for LOLC Holdings PLC (“LOLC” / “the Company”). ICRA Lanka has also reaffirmed the issue rating of [SL]A with stable outlook for the LKR 2,000 Mn Senior Unsecured Redeemable Debenture Programme, the issue rating of [SL]A1 for the LKR 3,000 Mn Commercial Paper Programme, the issue rating of [SL]A with stable outlook for the LKR 5,000 Mn Senior Unsecured Redeemable Debenture Programme, the issue rating of [SL]A with stable outlook for the LKR 10,000 Mn Senior Redeemable Debenture Programme and the issue rating of [SL]A with stable outlook LKR 2,000 Mn Senior Unsecured Redeemable Debenture Programme.

Rationale

ICRA Lanka has taken a consolidated view of the performance of the LOLC group, which is a diversified group with interests in various segments including financial services, insurance, manufacturing, trading, plantation, renewable energy and leisure. Group’s performance is primarily driven by the financial services cluster which accounts to over 80% of the group’s assets and therefore, the ratings reflect the performance of the same.

ICRA Lanka’s rating on LOLC group takes into account the long track record and the leading market position within the Sri Lankan Non-Banking Financial Institutions (NBFI) sector, the experienced management team and the possession of strong risk management systems. ICRA Lanka also takes comfort of the advantage LOLC experiences with its vastly diversified geographic presence. Its foreign operations account for the major portion of its portfolio and this is highly beneficial for the group given the devaluation of the local currency. LOLC Group also reported its highest-ever profit in FY2022 amounting to LKR 77 Bn.

ICRA Lanka also take note of the amalgamation of the 2 key local operating NBFIs; LOLC Finance PLC (“LOFC”) and Commercial Leasing & Finance PLC (“CLC”) with effect from March 31, 2022, where LOFC continued to be the surviving entity. The amalgamation will achieve significant cost synergies for the

Group. ICRA Lanka also takes comfort from the healthy funding profile of the group where Group gearing¹ has significantly reduced post the PRASAC divestment. Group gearing as at March 31, 2022 stood at 2.21 times vis-à-vis 2.63 times as at March 31, 2021 and 5.19 times (Prior to PRASAC divestment) in March 31, 2020. Group also possess adequate liquidity both in terms of local currency and foreign-currency.

ICRA Lanka expects the asset quality indicators of the local NBFIs of the group to be under pressure during H2CY2022, due to the challenging operating environment faced by their clientele, including the SMEs. However, the rating take some comfort from the sharp increase in asset backed lending of the group, over the last 2 - 3 years, where unsecured SME and micro exposures have been largely curtailed. In addition, the sharp increase in systemic interest rates will also affect the core margins of the local NBFIs, while portfolio growth would be moderate.

ICRA Lanka takes cognisance of the diversification into newer geographies by the group over the recent past, ability to manage country specific risks across businesses and regulatory cycles would be crucial from a rating perspective. ICRA Lanka would also continue to monitor the performances of the non-financial service cluster and their contribution to the overall group performance.

Outlook: Stable

ICRA Lanka believes that the LOLC group, on the back of its established presence, business experience and fund-raising ability would be able grow its business and provide timely and adequate capital support to the various group entities. The outlook may be revised to 'Negative' in case of weakening in the profitability and asset quality indicators of the group. The outlook maybe revised to 'Positive' in case of a significant improvement in overall financial profile of group and if the portfolio profile and asset quality improve.

Key rating drivers

Credit strengths

Large & established financial services group with a track record of strong & experienced management team and risk management systems: Spanning for over 40 years, LOLC group is one of the largest and established conglomerates in the country reporting a consolidated asset base of LKR 1,354 Bn as on March 31, 2022 vis-à-vis LKR 875 Bn as on March 31, 2021. Group's operations are mainly categorised under two clusters; financial services sector and non-financial services sector. Financial services cluster (including insurance) leads the group accounting for the 81% of group's assets as at March 31, 2022 and 69% of the group's revenue for the year ended March 31, 2022. The key local operating entities within the financial services cluster includes; LOLC Finance PLC (LOFC rated [SL]A/Stable by ICRA Lanka)² and LOLC Development Finance PLC (LDFP rated [SL]A-/Stable by ICRA Lanka). The non-financial segment is led by Brown & Company PLC; a diversified conglomerate (rated [SL]BBB+/Stable by ICRA Lanka). LOLC is also the only Sri Lankan financial institution to significantly expand its presence in the international

¹ Gearing adjusted for revaluation gains and deferred tax assets

² Commercial Leasing & Finance PLC (CLC) has been amalgamated with LOLC Finance PLC (LOFC) with effect from 31st March 2022, with LOFC being the surviving entity.

markets. The group currently has presence in Cambodia, Myanmar, Indonesia, Pakistan, Philippines Tajikistan, Zambia, Nigeria, Malawi, Tanzania, Egypt, Zimbabwe and Kenya. The group's centralised key business functions, IT & MIS, human resources, finance & accounts and risk management provides a competitive advantage by being able to optimise the overall operating costs. LOLC also has a strong & experienced management team with knowledge in retail lending, micro-lending and SME- financing.

Fairly diversified group level exposures: LOLC group's diversified exposure profile provides some comfort from a rating point of view, especially given the challenging dynamics in the Sri Lankan NBFIs sector. Due to the group's aggressive expansion into new markets in East Asia and Africa, the local NBFIs now account only for about 38% of the group lending portfolio. With the merger of CLC and LOFC, the combined entity is now the largest NBFi in Sri Lanka with a total portfolio of LKR 207 Bn, and LOFC now accounts for about 32% of the group portfolio. ICRA Lanka also notes that the recent sharp LKR devaluation has also contributed to the moderation of the group exposure to Sri Lanka. ICRA Lanka would continue to monitor the country risks of the new investments, as the future growth for the group is likely to come from these international markets. The financial cluster has a fairly diversified exposure profile including vehicle financing, SME lending and micro-lending. The non-financial services cluster of the group includes investments in manufacturing, trading, leisure, and plantations sector.

Gearing and liquidity levels remains healthy; LOLC Group's borrowing profile consists of a diversified mix of public deposits, bank funding, debt instruments and funding from multi-laterals including DFIs such as OPIC, Proparco, and DEG, that provide long term funding at competitive terms. Being highly concentrated on the financial services sector, the group has a sizable deposit base, which accounts to 45% of the total debt of the group as on March 31, 2022. Amongst the local operating NBFIs, LOFC has a strong deposit franchise given its extensive reach and brand recognition while LDFP is largely dependent on bank loans. The gearing levels of the group has significantly reduced over the past 2 years mainly due to the PRASAC divestment. As on March 31, 2022, group gearing stood at 2.21 times as compared to 2.63 times as on March 31, 2021 and 5.19 times as on March 31, 2020 (Prior to PRASAC divestment). However, ICRA Lanka takes note of some increase in the group debt over the recent past which is mainly due to the rising debt levels at Brown and Company PLC.

The overall liquidity has somewhat moderated in comparison to CY2020 levels. In CY2020, the low credit growth resulted in excess liquidity at NBFIs; however, with the credit growth bouncing back from H2CY2021, the liquidity levels at NBFIs have somewhat diminished. However, LOLC Group still has a healthy liquidity profile and ICRA Lanka also takes comfort of the excess liquidity held at various group entities. Amongst the local NBFIs, LOFC reported LKR 16 Bn excess liquidity above the regulatory requirement as on March 31, 2022 (LKR 21 Bn as on March 31, 2021) while maintaining 21.95% liquid assets to deposits ratio as on March 31, 2022 (25.90% as on March 31, 2021). LDFP reported LKR 392 Mn excess liquidity above the regulatory requirement as on March 31, 2022 (LKR 461 Mn as on March 31, 2021) while maintaining 19% liquid assets to deposit ratio as on March 31, 2022 (18% as on March 31, 2021).

Capitalization profiles of the Group entities remain comfortable and the Parent company has the capacity to extend capital support if required: In terms of the capital adequacy ratios (CAR), the 2 key local operating entities; LOFC & LDFP operates with healthy buffers over the regulatory CAR. As on March 31, 2022, LOFC reported core capital ratio of 18.16% against 8.00% regulatory requirement while LDFP

reported 10.80% against 7.00% regulatory requirement. These entities are also well-above the absolute minimum core capital requirement of LKR 2.5 Bn where LOFC reported a Networth of LKR 85 Bn while LDFP reported 3 Bn as on March 31, 2022. ICRA Lanka notes that if any need arises, the parent company is in a healthy position to extend capital support to LDFP. The other foreign entity operations; LOLC Cambodia and LOLC Myanmar is also in compliance with the relevant regulatory requirements in the specific geographies.

Credit Challenges:

Improved asset quality levels post-pandemic; however, ICRA Lanka envisages some stress on the same amidst the current adverse market conditions: ICRA Lanka notes that the group's overall asset quality indicators demonstrated a healthy recovery, post pandemic. LOFC (pre-merger) reported a GNPA % of 10.08% as on December 31, 2021 (15.30% as on June 30, 2020 and 11.10% as on March 31, 2020). CLC; an entity with relatively safer asset classes reported the best GNPA % amongst the local entities with 5.12% as on December 31, 2021 as compared to 8.40% in June 30, 2020 and 7.00% as on March 31, 2020). However, ICRA Lanka expects the overall asset quality levels of the group to come under pressure during FY2023, as the operating environment is quite challenging for some of the core segments served by the group, including the SMEs. However, ICRA Lanka takes comfort from the increase in asset backed exposures among the local NBFIs over the last 3 years. Aggregate unsecured exposure of the local NBFIs has now reduced to less than 10%, compared to about 30% about 3 years ago.

Out of the foreign operations, LOLC Cambodia reported a GNPA % of 1.45% in December 31, 2021 (0.50% in June 30, 2020 and March 31, 2020). The heightened uncertainty at Myanmar arising from the political instability resulted in increased GNPA % to 8.13% in December 31, 2021 from 0.40% in June 30, 2020. Overall group GNPA % remained at 5.49% in December 31, 2021 from 7.60% in June 30, 2020 and 2.60% in March 31, 2020.

Group profitability significantly improved in FY2022; however, compression in NIM is expected to affect profitability in FY2023; The Group achieved its highest-ever profit where it reported a PAT of LKR 77.8 Bn in FY2022 in comparison to LKR 53.2 Bn in FY2021 and LKR 19.8 Bn in FY2020. Other income/Average Total Assets stood at 7.74% in FY2022 (4.35% in FY2021). The group witnessed significantly high provisioning cost in FY2021 with credit cost (provisioning/Average Total Assets) reported at 2.69%. This was mainly due to high provisioning cost at LOFC level to combat high delinquency levels arising due to the pandemic. However, the excess provisioning has been reversed in FY2022 and the credit cost improved to 1.06% in FY2022. In terms of the core margins, the group's core margins moderated in FY2021 post the divestment of PRASAC and also due to modest loan growth in the NBFi sector. By catering to the microfinance market, PRASAC reported attractive yields. For FY2022, the Group reported 3.82% NIM (3.62% in FY2021); however, ICRA Lanka envisages compression of the same in FY2023 due to the impact of the sharp increase in systemic interest rates. Overall, the group profitability measured at Return on Assets (RoA on PAT) stood at 6.98% in FY2022 vis-à-vis 4.81% in FY2021.

ICRA Lanka also notes the bounce-back of the leisure sector, which reported LKR 8.9 Bn profit in FY2022 (LKR 3.7 Bn loss in FY2021) after many loss-making years.

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 Non-Banking Financial Institutions](#)

About LOLC:

Setup in 1980, with ORIX Corporation of Japan and the International Finance Corporation (IFC) among the initial shareholders, today LOLC Holdings PLC has evolved itself from a financial services provider to a holding company which also has interests in manufacturing, trading, plantations, leisure construction and energy. The group has diversified geographically into Cambodia, Myanmar, Indonesia, Pakistan, Philippines Tajikistan, Zambia, Nigeria, Malawi, Tanzania, Egypt Zimbabwe and Kenya.

On April 10, 2020, LOLC Group has divested 70% of its stake in PRASAC for a total consideration of about USD 603 Mn and the balance stake was divested in June 2021 for USD 225 Mn. The investment was held by LOLC International Private Limited (LOLCIPL), a fully owned subsidiary of LOLC holdings, incorporated in Singapore. Furthermore, on March 31, 2022, 2 of the key local operating NBFIs; LOLC Finance PLC ("LOFC") and Commercial Leasing & Finance PLC ("CLC") was amalgamated, where LOFC continued to be the surviving entity.

For FY2022, the LOLC group reported a consolidated PAT of LKR 77.78 Bn on a total asset base of LKR 1,354.16 Bn as compared to a PAT of LKR 53.19 Bn on a total asset base of LKR 874.94 Bn during the previous financial year.

Key financial indicators of LOLC Holdings PLC (Consolidated)

LKR Mn	FY2019	FY2020	FY2021	FY2022*
Net Interest Income ³	53,904	61,621	40,011	42,592
Profit after tax ⁴	19,636	19,792	53,196	77,777
Reported Networth	152,220	212,577	235,268	402,757
Loans and Advances (Net)	707,278	897,447	423,787	619,866
Total Assets	1,043,747	1,335,919	874,944	1,354,157
Return on Equity	15.43%	10.85%	23.76%	24.38%
Return on Assets (On PAT)	2.10%	1.66%	4.81%	6.98%
Gearing (times) - adjusted	5.73	5.19	2.63	2.21

*Unaudited financials

Rating history for last three years:

³ FY2020 includes discontinued operations

⁴ PAT for FY2021 includes the capital gain of LKR 42.9Bn from the disposal of PRASAC Microfinance Institution Limited

Current Rating (FY202)		Chronology of Rating History for the past 3 years			
Type	Amount Rated	Date & Rating	Date & Rating	Date & Rating	Date & Rating
	(LKR Mn)	FY2022 Jun-22	FY2021 Jun-21	FY2021 May-20	FY2020 Jan-20
Issuer Rating	N/A	[SL]A (Stable)	[SL]A (Stable)	[SL]A (Stable)	[SL]A (under rating watch)
Commercial Paper	3,000	[SL]A1	[SL]A1	[SL]A1	[SL]A1(under rating watch)
Listed Senior Unsecured Redeemable, Debenture Programme	2,000	[SL]A (Stable)	[SL]A (Stable)	[SL]A (Stable)	[SL]A (under rating watch)
Listed Senior Unsecured Redeemable Debenture Programme to	5,000	[SL]A (Stable)	[SL]A (Stable)	[SL]A (Stable)	[SL]A (under rating watch)
Senior Unsecured Redeemable Debenture Programme	10,000	[SL]A (Stable)	[SL]A (Stable)	NA	NA
Senior Unsecured Redeemable Debenture Programme	2,000	[SL]A (Stable)	[SL]A (Stable)	NA	NA



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