

ICRA Lanka reaffirms the ratings of LOLC Finance PLC

June 23, 2022

Instrument	Rated Amount (LKR Mn)	Outstanding Amount (LKR Mn)	Rating Action
Issuer Rating	N/A	N/A	[SL]A (Stable); Reaffirmed
Listed Subordinated Unsecured Redeemable Debenture Programme	3,500	2,500	[SL]A- (Stable); Reaffirmed
Listed Senior Unsecured Redeemable Debenture Programme	5,000	5,000	[SL]A (Stable); Assigned
Asset Backed Trust Certificates Programme	3,000	3,000	[SL]A+ (SO) (Stable); Assigned
Asset Backed Trust Certificates Programme	3,000	3,000	[SL]A+ (SO) (Stable); Assigned

Rating action

ICRA Lanka Limited has reaffirmed the issuer rating of [SL]A (Pronounced as S L A) with stable outlook for LOLC Finance PLC (“LOFC” / “the Company”). ICRA Lanka has also reaffirmed the issue rating of [SL]A- (Pronounced as S L A minus) with stable outlook for the LKR 3,500 Mn Listed Subordinated Unsecured Redeemable Debenture Programme.

Furthermore, ICRA Lanka has assigned the issue rating of [SL]A (Pronounced as S L A) with Stable outlook for the LKR 5,000 Mn Listed Senior Unsecured Redeemable Debenture Programme, the issue rating of [SL]A+ (SO) (Pronounced as S L A plus Structured Obligation) with Stable outlook for the LKR 3,000 Mn Asset Backed Trust Certificates Programme and the issue rating of [SL]A+ (SO) (Pronounced as S L A plus Structured Obligation) with Stable outlook for the LKR 3,000 Mn Asset Backed Trust Certificates Programme. These issue ratings assigned to LOFC are now transferred to LOFC from Commercial Leasing & Finance PLC (“CLC”) as the two entities have been amalgamated with effect from March 31, 2022.

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. 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.

In terms of LOFC, the company has a strong deposit franchise given its extensive reach and brand recognition. The public deposits accounted for 75% of the total debt as on March 31, 2022, while the company's gearing stood at 2.50 times as on March 31, 2022 as compared to 3.51 times as on March 31, 2021. (4.86 times as on March 31, 2020).

The overall liquidity has somewhat deteriorated 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.

In terms of LOFC, the company 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 a 21.95% liquid assets to deposits ratio as on March 31, 2022 (25.90% as on March 31, 2021). ICRA Lanka is cognisant of the LKR 11.8 Bn worth investments on International Sovereign Bonds (ISBs) as the restructuring of the foreign debts by the CBSL will affect the dollar Assets-Liability Mismatch of the Company.

Capitalization profile of LOFC remains comfortable: In terms of the capital adequacy ratios (CAR), LOFC operates with healthy buffers over the regulatory CAR. As on March 31, 2022, LOFC reported core capital ratio of 20.49% against 8.00% regulatory requirement. The entity is also well-above the absolute minimum core capital requirement of LKR 2.5 Bn where LOFC reported a Networth of LKR 84 Bn. ICRA Lanka notes that if any need arises, the parent company is in a healthy position to extend capital support to its subsidiaries.

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 (15.3% as on June 30, 2020 and 11.1% 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.

Group profitability significantly improved in FY2022, however LOFC's core margins will come under pressure 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.

LOFC reported a Profit After Tax (PAT) of LKR 16,951 Mn for FY2022 on a total asset base of LKR 311,569 Mn while it reported a PAT of LKR 4,366 Mn on a total asset base of LKR 170,109 Mn for FY2021. The company profitability measured at Return on Assets (RoA on PAT) stood at 9.24% in FY2022 vis-à-vis 2.41% in FY2021. However, ICRA Lanka expects the profitability of LOFC to come under pressure during FY2023, as the sharp increase in systemic interest rates would affect NIMs, while potentially high delinquency levels in H2CY2022 would affect the credit cost. Sizable synergies and tax savings from the merger with CLC will, however, provide some comfort from an overall earnings point of view.

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 LOFC:

LOLC Finance PLC (LOFC), (set up in 2001) established initially as a wholly owned subsidiary of LOLC Holdings, has a strong Retail Franchise among Licensed Finance Companies (LFCs) in Sri Lanka. In July 2011, as per the Central Bank of Sri Lanka (CBSL) directions, LOLC divested 10% of its stake in LOFC and was listed on the Colombo Stock Exchange (CSE). The LOLC Group is one of the largest business groups in the country, with the parent (LOLC) being among the first leasing company to be established in Sri Lanka. The LOLC group has interests in trading, plantation, leisure and energy. LOFC offers savings and deposits in local and foreign currency, extends loans mainly for auto finance and Islamic finance. On March 31, 2022, LOFC was amalgamated with Commercial Leasing & Finance PLC (CLC), where LOFC remains the surviving entity.

LOFC reported a Profit After Tax (PAT) of LKR 16,951 Mn for FY2022 on a total asset base of LKR 311,569 Mn while it reported a PAT of LKR 4,366 Mn on a total asset base of LKR 170,109 Mn for FY2021.

Key financial indicators of LOLC Finance PLC

In LKR Mn	FY2019	FY2020	FY2021	FY2022*
Net Interest Income	21,772	18,910	21,474	21,590
Profit after Tax	5,963	3,780	4,366	16,951
Reported Networth	22,767	31,290	35,889	83,554
Loans and Advances	136,191	133,954	104,649	206,810
Total Assets	211,035	191,888	170,109	311,569
Return on Equity	29.91%	13.98%	13.00%	33.62%
Return on Assets	2.83%	1.88%	2.41%	9.24%
Capital Adequacy Ratio (Tier 1)	10.22%	13.25%	15.88%	20.49%
Gearing (times)- Adjusted	7.97	4.86	3.51	2.50

*Unaudited financials

Rating history for last three years:

Current Rating (FY2021)				Chronology of Rating History for the past 3 years		
Type	Amount Rated (LKR Mn)	Amount Outstanding (LKR Mn)	Date & Rating	Date & Rating	Date & Rating	Date & Rating
			June 2022	Dec 2020	May 2020	Jan 2020
Issuer Rating	N/A	N/A	[SL]A (Stable)	[SL]A (Stable)	[SL]A (Stable)	[SL]A (under rating watch with developing implications)
Subordinated unsecured redeemable debenture	3,500	2,500	[SL]A- (Stable)	[SL]A- (Stable)	[SL]A- (Stable)	[SL]A- (under rating watch with developing implications)
Listed senior unsecured redeemable debenture	5,000	5,000	[SL]A (Stable)	NA	NA	NA
Asset Backed Trust Certificates	3,000	3,000	[SL]A+ (SO) (Stable)	NA	NA	NA

Current Rating (FY2021)				Chronology of Rating History for the past 3 years		
Type	Amount Rated (LKR Mn)	Amount Outstanding (LKR Mn)	Date & Rating	Date & Rating	Date & Rating FY2021	Date & Rating FY2020
			June 2022	Dec 2020	May 2020	Jan 2020
Asset Backed Trust Certificates	3,000	3,000	[SL]A+ (SO) (Stable)	NA	NA	NA

About LOLC Holdings PLC (Parent)

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

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



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