Lanka Rating Agency

Rating Report

Commercial Credit and Finance PLC

Report Contents

Rating History				
Dissemination Date	Long Term Rating	Outlook	Action	Rating Watch
26-Feb-2024	BBB	Positive	Maintain	-
07-Feb-2023	BBB	Stable	Initial	-

Rating Rationale and Key Rating Drivers

Commercial Credit and Finance PLC (CCFP or the Company) is a Licensed Leasing and Finance company in Sri Lanka that specializes in hire purchase, finance leases and gold loans. The Company's ratings reflect its medium-sized position in the leasing industry, sound profitability and asset-backed loan portfolio. The rising Non-Performing Loans (NPL) remain a concern but are below industry average. The total assets of the Company exceeded LKR 100Bn mark, resulting in a market share of around 7% of deposits. The net interest income of the Company reduced in FY23 to LKR 11.1Bn from LKR 11.9Bn in FY22, however, net interest income of 9MFY24 increased to LKR 8.3Bn compared to the same quarter of the previous year of LKR 7.4Bn. The profitability of CCFP declined by 42.5% in FY23 compared to FY22 due to considerable increase in interest expenses outpacing the growth in interest income as the deposit base was repriced to higher rates. The profitability for 9MFY24 shows a growth of 34.4% to LKR 2Bn from LKR 1.5Bn in 9MFY23. Although CCFP has maintained gross NPL ratio below industry levels, NPLs increased from around 4.67% based on loans 180 Days Past Due (DPD) in FY22 to 11.07% (on 120 DPD) in FY23 and 16.15% (on 90 DPD) in 9MFY24. The Company expects to maintain its profitability trends and intends to focus on microfinance loans and asset-backed loans. Given the current economic situation, growth prospects are considered modest for the sector. The Company has strong capitalization and CAR ratio, well above the regulatory requirement. The granular nature of its deposit base bodes well for the funding of the Company.

The rating depends on the management's ability to improve asset quality and stem rising NPL trend. Any further increase in NPLs that dampen profitability will have a negative impact on the rating. Meanwhile, growth in loan portfolio with improving profitability and a strong capital structure will impact the rating positively.

Disclosure	
Name of Rated Entity	Commercial Credit and Finance PLC
Type of Relationship	Solicited
Purpose of the Rating	Entity Rating
Applicable Criteria	Methodology | Non-Banking Finance Companies Rating(Jun-22)
Related Research	Sector Study | Leasing & Finance Companies(Aug-23)
Rating Analysts	Gayani Randima Ariyawansa | gayani@lra.com.lk | +92-42-35869504

Profile

Structure Commercial Credit and Finance PLC ("CCFP" or "the Company") was incorporated as a limited liability company in 1982 under the provisions of the Companies Ordinance No. 17 of 1982 and re-registered under the Companies Act No. 07 of 2007. CCFP was listed on the Colombo Stock Exchange (CSE) in 2011.

Background During the initial stages of operation, the Company was mainly focused on lending to the agricultural sector with this sector accounting for over 50% of the lending portfolio. The Company operated in 16 locations throughout the island including the traditional agricultural regions such as Anuradhapura and Dehiattakandiya.

Operations The principal business activities include acceptance of deposits, granting lease facilities, hire purchase, term loans, personal loans, microloans, pawning, other credit facilities, real estate development, and related services.

Ownership

Ownership Structure The largest shareholding of the Company is with BG Investments (Pvt) Limited, with an ownership of 50.25%. The ultimate ownership of BG investments lies with Mr. R. S. Egodage & Mrs. G. R. Egodage holding 50% each. Other major shareholder is Group Lease Holdings Pte Ltd with a shareholding of 29.99%.

Stability The ownership structure is likely to remain the same in the foreseeable future which provides stability to the Company.

Business Acumen Mr. R. S. Egodage has been involved in the financial services sector for over fifteen years. Mr. R. S. Egodage, who is also the Chief Executive Officer (CEO) and an Executive Director (ED), earned a BSc. Eng. degree from the University of Peradeniya. His business acumen and vision for the Company bodes well for providing strategic direction.

Financial Strength CCFP draws stability from BG Investments Pvt. Ltd., holding the majority of shares.

Governance

Board Structure The Board has ten directors, out of which, five are Independent Non-Executive directors and three are Executive directors. The Chairman of the Company, Mr. G. B. Egodage, was appointed to the Board on 17th November 2022.

Members' Profile The Board members have decades of experience in their respective fields. The Executive Director, who is also the Chief Operating Officer (COO) Mr. Rajiv Casie Chitty, has experience in Non-Banking Financial institutions (NBFI), investment banking, and in various private sectors. Other directors have experience in the fields of finance, entrepreneurship, education and IT.

Board Effectiveness The Company has formed five board sub-committees, namely, i) Board Audit Committee, ii) Board Integrated Risk Management Committee, iii) Board Related Party Transactions Committee, iv) Board Remuneration Committee, and v) Board Nomination Committee.

Financial Transparency The external auditors of the Company, Ernst & Young, issued an unqualified audit opinion pertaining to the annual financial statements for FY23.

Management

Organizational Structure The highest level of authority of the organization remains with the Board of Directors. The Company has a well defined management hierarchy with clear roles and responsibilities.

Management Team The management team is headed by the Chief Executive Officer (CEO) of the Company, Mr. R. S. Egodage. The CEO is supported by the Executive Director, Chief Operating Officer (COO), and Deputy CEO. A lot of emphasis is given on providing trainings to various management tiers to build strong succession in-house.

Effectiveness CCFP has formed three management committees, namely, i) Assets and Liability Management Committee, ii) Executive Credit Committee, and iii) IT Security Committee.

MIS CCFP currently uses an inbuilt ERP system. The Company intends to replace and strengthen its ERP system as the operations scale. The functional updates to the ERP are applied based on approved change requests by business teams. The disaster recovery system is managed by the internal team and it is located at Dialog iDC Malabe.

Risk Management Framework The Company has an independent risk management department, Board-approved risk appetite, and risk tolerance levels along with well-defined procedures to support risk management. CCFP needs to further strengthen this function and revisit guidelines to further improve asset quality.

Business Risk

Industry Dynamics There are 36 Licensed Finance Companies (LFC) in Sri Lanka, out of which, 29 are listed on the CSE. The Profit After Tax (PAT) of LFC and Specialized Leasing Companies sector for 6MFY24 stood at LKR 16.4Bn. The interest income and interest expense stood at LKR 168.8Bn and LKR 105.4Bn in 6MFY24, respectively. The total asset base of the LFC sector stood at LKR 1.6Tn as at FY23 and 6MFY24 as well. Subsequent to FY18, the asset quality deteriorated to a gross Non-Performing Loan (NPL) ratio of 16.01%, in FY23 from 5.9% in FY18. However, as a result of the current macroeconomic challenges in the country, the gross and net NPL ratio deteriorated to 19.99% and 14.06%, respectively, during 6MFY24.

Relative Position CCFP is considered a mid-size LFC. CCFP accounts for 6.2% (FY23: 6.2%) of the assets, 7% (FY23: 6.6%) of the deposits as at 6MFY24 and net loans and advances account for 2% in FY23 in LFC and Specialized Leasing Companies sector. The Company is focusing more on asset-backed and micro loans for growth.

Revenues The gross income of the Company stood at LKR 28.9Bn in FY23, a 32.7% increase compared to FY22, and stood at LKR 22.1Bn in 9MFY24 (9MFY23: LKR 19.8Bn), showing 11.6% growth. CCFP earned net interest income of LKR 11.1Bn in FY23, which is 7% lower compared to FY22. This decline was due to considerable increase in interest expenses outpacing the growth in interest income as the deposit base was repriced to higher rates. The net interest income in 9MFY24 stood at LKR 8.3Bn which increased from LKR 7.4Bn in 9MFY23. The core spread was maintained at 10.2% in 9MFY24. Although it is still adequate, the spread was lower compared to FY22 (FY23: 9.6%, FY22: 14.1%). It is expected to improve with re-pricing of deposit base in next 2 quarters.

Performance The PAT of the Company decreased by 42.5% in FY23 to LKR 2.6Bn, compared to LKR 4.5Bn in FY22. CCFP earned a PAT of LKR 2.0Bn in 9MFY24 (9MFY23: LKR1.5Bn), an increase of 33%. The ROE and ROA recorded at 12.7% and 2.6% in 9MFY24 which is an increase compared to of 10.4% and 1.9% respectively in 9MFY23.

Sustainability CCFP has formed a 3-year strategic plan starting from FY23. Major emphasis remains on employee development and leadership within the Company. CCFP intends to maintain its profitability trends and improve its asset-backed portfolio, going forward.

Financial Risk

Credit Risk The Company's gross NPLs increased over the periods from FY21 to 9MFY24 and stood at 16.15% (on 90 DPD) in 9MFY24 (FY22: 4.67% on 180 DPD, FY23: 11.07% on 120 DPD). The deterioration in asset quality is mainly due to challenges faced amidst unfavourable economic situation in the country. However, CCFP's NPL ratios are still below the industry averages.

Market Risk The Company increased its investment in government securities to LKR 8.4Bn in FY23 (9MFY24: LKR 7.9Bn) from LKR 5.1Bn in FY22 to capitalize on rising interest rates. Further, the Company has successfully managed the interest rate risk via short-term investments and savings accounts with banks.

Liquidity And Funding CCFP is more dependent on deposits as it constitutes 77% (9MFY24: 78%) of funding in FY23 compared to 70% in FY22. The Company's deposit base increased by 23.22% to LKR 59.2Bn in FY23 (9MFY24: LKR 60.4Bn) compared to LKR 48.1Bn in FY22. The concentration of the top 20 depositors remains low at 7%, indicating granular deposit base.

Capitalization The Capital Adequacy Ratio ("CAR") of the Company stood at 18.66% as at FY23 (FY22: 19.22%) against regulatory requirement of 14.0%. It stood at 17.42% as at 9MFY24. The Company has strong capitalization and room for growth.

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	#REF!				
COMMERCIAL CREDIT AND FINANCE PLC	**Dec-23**	**Sep-23**	**Mar-23**	**Mar-22**	**Mar-21**
#	**9M**	**6M**	**12M**	**12M**	**12M**
A BALANCE SHEET					
1 Total Finance-net	73,716	69,317	75,286	76,988	70,932
2 Investments	9,696	10,775	10,017	6,885	7,570
3 Other Earning Assets	3,948	3,659	3,527	2,166	5,965
4 Non-Earning Assets	12,676	12,068	12,439	10,586	9,028
5 Non-Performing Finances-net	5,331	6,683	885	(2,995)	(2,365)
Total Assets	105,367	102,502	102,154	93,630	91,130
6 Funding	77,349	76,557	76,799	68,603	71,879
7 Other Liabilities	5,957	4,855	4,996	5,834	3,855
Total Liabilities	83,306	81,412	81,795	74,437	75,734
Equity	22,061	21,091	20,359	19,193	15,396
B INCOME STATEMENT					
1 Mark Up Earned	19,619	12,551	25,055	18,365	16,087
2 Mark Up Expensed	(11,273)	(7,916)	(13,948)	(6,416)	(7,052)
3 Non Mark Up Income	1,834	1,201	3,136	2,466	1,437
Total Income	10,180	5,836	14,242	14,415	10,472
4 Non-Mark Up Expenses	(5,240)	(3,312)	(6,549)	(5,858)	(5,463)
5 Provisions/Write offs/Reversals	(537)	(172)	(2,612)	(764)	(1,004)
Pre-Tax Profit	4,404	2,353	5,081	7,792	4,005
6 Taxes on Financial Services	-	-	-	-	-
Profit Before Income Taxes	4,404	2,353	5,081	7,792	4,005
7 Income Taxes	(2,384)	(1,303)	(2,481)	(3,272)	(1,670)
Profit After Tax	2,020	1,050	2,600	4,520	2,335
C RATIO ANALYSIS					
1 PERFORMANCE					
a Non-Mark Up Expenses / Total Income	51.5%	56.8%	46.0%	40.6%	52.2%
b ROE	12.7%	10.1%	13.1%	26.1%	16.3%
2 CREDIT RISK					
a Gross Finances (Total Finance-net + Non-Performing Advances + Non-Performing Debt Instruments) / Funding	113.7%	110.5%	110.2%	117.7%	104.3%
b Accumulated Provisions / Non-Performing Advances	62.5%	56.3%	90.5%	179.5%	158.5%
3 FUNDING & LIQUIDITY					
a Liquid Assets / Funding	18.4%	19.2%	18.8%	14.4%	16.8%
b Borrowings from Banks and Other Financial Institutes / Funding	20.1%	18.4%	21.2%	28.0%	31.4%
4 MARKET RISK					
a Investments / Equity	43.9%	51.1%	49.2%	35.9%	49.2%
b (Equity Investments + Related Party) / Equity	1.8%	1.7%	1.8%	1.7%	2.5%
5 CAPITALIZATION					
a Equity / Total Assets (D+E+F)	20.9%	20.6%	19.9%	20.5%	16.9%
b Capital formation rate (Profit After Tax - Cash Dividend) / Equity	11.1%	10.3%	10.2%	24.2%	17.5%

Credit Rating

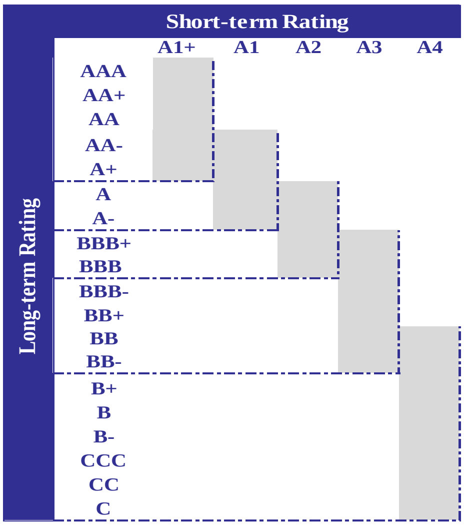
Credit rating reflects forward-looking opinion on credit worthiness of underlying entity or instrument; more specifically it covers relative ability to honor financial obligations. The primary factor being captured on the rating scale is relative likelihood of default.

Long-term Rating

Scale	Definition
AAA	**Highest credit quality.** Lowest expectation of credit risk. Indicate exceptionally strong capacity for timely payment of financial commitments
AA+ AA AA-	**Very high credit quality.** Very low expectation of credit risk. Indicate very strong capacity for timely payment of financial commitments. This capacity is not significantly vulnerable to foreseeable events.
A+ A A-	**High credit quality.** Low expectation of credit risk. The capacity for timely payment of financial commitments is considered strong. This capacity may, nevertheless, be vulnerable to changes in circumstances or in economic conditions.
BBB+ BBB BBB-	**Good credit quality.** Currently a low expectation of credit risk. The capacity for timely payment of financial commitments is considered adequate, but adverse changes in circumstances and in economic conditions are more likely to impair this capacity.
BB+ BB BB-	**Moderate risk.** Possibility of credit risk developing. There is a possibility of credit risk developing, particularly as a result of adverse economic or business changes over time; however, business or financial alternatives may be available to allow financial commitments to be met.
B+ B B-	**High credit risk.** A limited margin of safety remains against credit risk. Financial commitments are currently being met; however, capacity for continued payment is contingent upon a sustained, favorable business and economic environment.
CCC CC C	**Very high credit risk.** Substantial credit risk “CCC” Default is a real possibility. Capacity for meeting financial commitments is solely reliant upon sustained, favorable business or economic developments. “CC” Rating indicates that default of some kind appears probable. “C” Ratings signal imminent default.
D	Obligations are currently in default.

Short-term Rating

Scale	Definition
A1+	The highest capacity for timely repayment.
A1	A strong capacity for timely repayment.
A2	A satisfactory capacity for timely repayment. This may be susceptible to adverse changes in business, economic, or financial conditions.
A3	An adequate capacity for timely repayment. Such capacity is susceptible to adverse changes in business, economic, or financial conditions.
A4	The capacity for timely repayment is more susceptible to adverse changes in business, economic, or financial conditions. Liquidity may not be sufficient.



**The correlation shown is indicative and, in certain cases, may not hold.*

Outlook (Stable, Positive, Negative, Developing) Indicates the potential and direction of a rating over the intermediate term in response to trends in economic and/or fundamental business/financial conditions. It is not necessarily a precursor to a rating change. ‘Stable’ outlook means a rating is not likely to change. ‘Positive’ means it may be raised. ‘Negative’ means it may be lowered. Where the trends have conflicting elements, the outlook may be described as ‘Developing’.

Rating Watch Alerts to the possibility of a rating change subsequent to, or, in anticipation of some material identifiable event with indeterminable rating implications. But it does not mean that a rating change is inevitable. A watch should be resolved within foreseeable future, but may continue if underlying circumstances are not settled. Rating watch may accompany rating outlook of the respective opinion.

Suspension It is not possible to update an opinion due to lack of requisite information. Opinion should be resumed in foreseeable future. However, if this does not happen within six (6) months, the rating should be considered withdrawn.

Withdrawn A rating is withdrawn on a) termination of rating mandate, b) the debt instrument is redeemed, c) the rating remains suspended for six months, d) the entity/issuer defaults., or/and e) PACRA finds it impractical to surveill the opinion due to lack of requisite information.

Harmonization A change in rating due to revision in applicable methodology or underlying scale.

Surveillance. Surveillance on a publicly disseminated rating opinion is carried out on an ongoing basis till it is formally suspended or withdrawn. A comprehensive surveillance of rating opinion is carried out at least once every six months. However, a rating opinion may be reviewed in the intervening period if it is necessitated by any material happening.

Note. This scale is applicable to the following methodology(s):

a) Broker Entity Rating
b) Corporate Rating
c) Debt Instrument Rating
d) Financial Institution Rating
e) Holding Company Rating
f) Independent Power Producer Rating
g) Microfinance Institution Rating
h) Non-Banking Finance Companies Rating

Rating Team Statements
(1) Credit Rating Agency means a body corporate engaged in the business of assessing and evaluating the credit- worthiness of any issuer or a specific issue of securities. https://www.sec.gov.lk/credit-rating-agency/

Conflict of Interest
(2) i. LRA will disclose to the Commission all other business activities it is engaged in at the time of applying for its licence and inform the Commission in writing prior to engaging in any other business activity after obtaining a licence from the Commission. (Section 34 – Rules applicable to Credit Rating Agencies)
(2) ii.LRA will not engage in any other business which in the view of the Commission creates a conflict of interest unless prior written approval of the Commission is obtained. (Section 35 – Rules applicable to Credit Rating Agencies)
(2) iii.In the conduct of any such other business activity, the LRA will ensure that proper processes are in place to have a clear demarcation of the different functions pertaining to such businesses. (Section 36 – Rules applicable to Credit Rating Agencies)

Restrictions
(3) (i) LRA will not be outsource any part of its work, which has a direct bearing on the function of rating. (Section 24 – Rules applicable to Credit Rating Agencies)
(3) (ii) LRA will enter into a written agreement with the party to whom any work is outsourced. Such agreement contains an undertaking from the party to whom any work is outsourced that they shall comply with the laws, rules, and directives that the LRA is bound to follow. (Section 25 – Rules applicable to Credit Rating Agencies)

(4) The LRA will not appoint any individual as a member of the rating committee who:
(a) has a business development function of the Credit Rating Agency; or
(b) who initiates or participates in discussions regarding fees or payments with any Client of the LRA. (Section 28 – Rules applicable to Credit Rating Agencies)

Conduct of Business
(5) Prior to the commencement of a rating or during such process the LRA will not promise, assure or guarantee to a Client that a particular rating will be assigned. (Section 39 – Rules applicable to Credit Rating Agencies)

(6) LRA performs a rigorous and formal periodic review of all its methodologies. Such methodologies will be made available to the Commission for perusal, upon request. (Section 41 – Rules applicable to Credit Rating Agencies)

Independence & Conflict of interest
(7) LRA receives compensation from the entity being rated or any third party for the rating services it offers. The receipt of this compensation has no influence on LRA´s opinions or other analytical processes. In all instances, LRA is committed to preserving the objectivity, integrity, and independence of its ratings.

(8) LRA will not engage in any other business which in the view of the Commission creates a conflict of interest unless prior written approval of the Commission is obtained. (Section 35 – Rules applicable to Credit Rating Agencies)

(9) LRA will structure its rating teams and processes to promote continuity, consistency and avoid bias in the rating process. (Section 47 – Rules applicable to Credit Rating Agencies)

Monitoring and review
(10) For purposes of transparency the LRA will publish sufficient information about an entity/security rated, frequency of default and whether a rating grade assigned has changed over time. The definitions and computation methods for the default rates stated in the default studies shall also be disclosed. (Section 44 – Rules applicable to Credit Rating Agencies)

LRA maintain the following records pertaining to Clients:
(a) all internal records to support its credit rating opinions;
(b) all particulars relating to Clients at its office which shall include the name and registered address and contact numbers of such Client, names and addresses of their directors as at the date of rating, its issued share capital and the nature of business; and
(c) a written record of all complaints received from Clients and action taken thereon by the LRA. (Section 48 – Rules applicable to Credit Rating Agencies)

(11) LRA maintains confidentiality of all non-public information entrusted to it by Clients at all times including such Client's identity and transactions carried out for such Client unless and to the extent such disclosure is required by law, or unless authorised by the Client to disclose such information. (Section 50 – Rules applicable to Credit Rating Agencies)

(12) LRA does not destroy, conceal or alter any records, property or books relating to the business of the Credit Rating Agency which are in its possession or under its control with the intention of defeating, preventing, delaying or obstructing the carrying out of any examination (Section 53 – Rules applicable to Credit Rating Agencies)

Probability of Default
(13) LRA's Rating Scale reflects the expectation of credit risk. The highest rating has the lowest relative likelihood of default (i.e., probability).

Proprietary Information