Lanka Rating Agency

Rating Report

Commercial Credit and Finance PLC

Report Contents

Rating History

Dissemination Date	Long Term Rating	Outlook	Action	Rating Watch
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 and Finance Leases. The company's ratings reflect its medium-sized position in the leasing industry, with total assets exceeding 90 billion and a market share of around 5.6%. Since 2009, the company has experienced exceptional growth, which has stabilized in recent years as it focuses on improving book quality and changing its asset mix. Although the company saw growth in Net Interest Income in FY22, this declined in 1HFY23 due to a sudden increase in interest rates. Despite this, the company posted a net profit of LKR 1.1bn in 1HFY23, albeit lower than 1HFY22 (LKR 1.3bn). CCFP has successfully maintained a gross Non-Performing Asset (NPA) ratio below industry levels, but the current economic conditions in the country have impacted its gross NPA levels, which increased from around 4.67% as of FY22 to 9.9% as of 1HFY23. Asset quality is considered strong, with over 95% of loans backed by assets. However, the current economic scenario, with increased NPLs and decreased overall profitability, has limited the company's growth. The ratings also take into account the company's strong capitalization and CAR, which remain comfortably above regulatory requirements.

The ratings are contingent on maintaining asset quality in a volatile and uncertain economic environment. Maintaining growth in the asset book while reducing NPLs will be crucial for any potential upward movement in the ratings.

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(Jun-22)
Rating Analysts	Rabiya tul Athaviya Naushard | rabiya@lra.com.lk | +94 114 500099

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. The principal place of business is located at No. 106, Yatinuwara Veediya, Kandy.

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. While operating in 16 locations throughout the island, 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 50.06% shares. The Ultimate Ownership of BG investments lies with Mr. R.S.Egodage & Mrs. G.R.Egodage holding 50% of each shareholding. Other shareholders mainly include Group Lease Holdings Pte Ltd with a shareholding of 29.99%, Creation Investments Sri Lanka Llc owning 6.40%, and Creation Investments Sl1 Llc accounting 2.27%.

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

Business Acumen Mr.R.S.Egodage & Mrs.G.R.Egodage, have been involved in the financial services sector from the year 2009. The largest shareholder Mr. R.S. Egodage, who is also the Chief Executive Officer ("CEO") and the Executive Director ("ED") is having earned a BSc. Eng. degree from the University of Peradeniya.

Financial Strength The sponsors have not provided any written financial guarantees since the Company currently does not have a need for capital infusion, nor there have been any previous instances where capital infusion was required. CCFP draws stability from B G Investments Pvt Ltd, holding the majority of Shares.

Governance

Board Structure The Board has eleven directors, out of which, five are Independent Non-Executive directors and three are Executive directors. The Chairman of the Company, Mr. G. Bandula 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 (ED) 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.

Board Effectiveness The Company has formed five board sub-committees, namely, i) Board Audit Committee ("BAC"), ii) Board Integrated Risk Management Committee, iii) Board Related Party Transactions Committee ("RPTC") iv) Board Remuneration Committee ("RC") 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 FY22.

Management

Organizational Structure The highest level of authority of the Organisation remains with the Chairman, followed by the Board of Directors. The Board Integrated Risk Management Committee and the Board Audit Committee report directly to the Chairman.

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 Operational Executive (OE), COO, and Deputy CEO.

Effectiveness CCFP has formed three management committees, namely, i) Assets and Liability Management Committee ("ALCO"), ii) Executive Credit Committee ("ECC"), and iii) IT Risk Committee ("ITRC").

MIS The Company maintains adequate IT infrastructures and related control. CCFP currently uses an inbuilt financial system, which has a business module and a supporting module.

Risk Management Framework The architecture of the risk management of the Company includes an independent Risk Management Department, Board-approved risk appetite, and risk tolerance levels along with well-defined procedures to support the effective management of risk.

Business Risk

Industry Dynamics At present, there are 36 LFCs in Sri Lanka, out of which, 29 are listed in the CSE. The profit after tax for the six months ending September 2022 saw a decline of 11%. The loan loss provisions declined by ~LKR 6bn in the six months to September compared to the previous financial year, which aided the sector earn profits. The total asset base of the LFC sector stood at LKR 1.5tn as of 4QFY21, which represents 5.6% of Sri Lanka's financial system.

Relative Position CCFP accounts for 6.0% (FY22: ~5.8%) of the assets and ~6.1% (FY22: ~5.9%) of the deposits in the sector, as at 1HFY23. It is considered a mid-size LFC. Apart from the above-mentioned, CCFP has been able to increase its position in loans and advances as well.

Revenues CCFP earned a net interest income of LKR 5.4bn (FY22: LKR 11.9bn), in 1HFY23, which is a ~5.0% increase compared to 1HFY23. The product portfolio of CCFP consists of various segments and Hire Purchase (HP) segment contributes the highest level of income. The increase in interest income received from HP is 41% in 1HFY23 compared to the ~30% contribution in FY22. Due to a significant increase in interest rates, the core spread decreased to ~12.1% in 1HFY23 (FY22: ~15.7%)

Performance The Company increased its profit after tax by ~93.6% and ~40.2% in FY22 and FY21 to LKR 4.52bn and LKR 2.33bn, respectively, compared to the previous financial year. The biggest contributor to it was the improvement in fee and commission income and bad debt recovery respectively. However, CCFP earned a profit after tax of LKR 1.14bn in 1HFY23(2QFY22: LKR 1.32bn). Decrease in profit is largely a function of lower net interest margins, high operating cost and higher impairment cost given high interest rate scenario.

Sustainability The Company is planning to increase its net loan books to LKR 83.7bn by FY25, which is a net loan book growth of 5.6% compared to FY22. Further, the Company is planning to maintain its NIM at 15.6% by FY25. However, under current economic conditions maintaining asset quality of the book will remain important.

Financial Risk

Credit Risk In FY22, the Company kept its gross and net NPL at 4.67% and (4.09)%, respectively. Additionally, CCFP was able to lower both its gross and net NPL levels, owing to prudent collection methods adopted. As of 1HFY23, it continued to keep its gross NPL below industry averages though increased. Its portfolio concentration risk is minimum since the top 20 customer concentration is ~10.03% as of 1HFY23 (FY22: 16.94%). The Company has a higher concentration for a finance lease, hire purchase, and gold loans, which are ~43.45%, ~30.66%, and ~14.25% respectively as at 1HFY23. The Company has a large exposure to leasing, and hire purchases. High NPLs are recorded for factoring, Reschedule Loans, Cash Loans, and RBL Loans.

Market Risk CCFP increased its investment in government securities in 1HFY23 by ~3.92% to LKR 5.26bn, (FY22: 5.06bn) compared to FY22. Further, the Company has successfully managed the interest rate risk via short-term investments and savings accounts with banks. As a result, the placement values with banks have reduced to LKR 1.8bn in FY22 from LKR 4.5bn in FY21 which is a reduction of ~59.6%.

Liquidity And Funding The highest funding for the organization is considered to be the finances that flow through customer deposits. In 1HFY23 finances, Customer Deposits increased by 6.9% from LKR 48,078mn in FY22 (1HFY23: LKR 51,394mn). Borrowing largely comprises Securitized borrowing, syndicated loans, and other bank facilities representing 28% of the funding facilities obtained in 1HFY23.

Capitalization The Capital Adequacy Ratio ("CAR") of the Company stood at ~19.2% as of FY22 (FY21: ~14.5%), while the required rate for FY22 and FY21 were 12.5% and 11% respectively. The ratio is currently at ~16.3% as of 1HFY23. The Company also maintained its core capital above the required minimum. CCFP's core capital as of FY22 was LKR 17.1bn (FY21: LKR 13bn), while the required minimum was LKR 2.5bn since 01st January 2021.

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Commercial Credit and Finance Listed Public Limited	Sep-22	Mar-22	Mar-21	Mar-20
	6M	12M	12M	12M
A BALANCE SHEET				
1 Total Finance-net	77,495	77,014	70,975	59,982
2 Investments	6,984	6,859	7,528	5,837
3 Other Earning Assets	3,406	4,324	7,749	7,519
4 Non-Earning Assets	9,605	8,428	7,244	5,346
5 Non-Performing Finances-net	345	(2,995)	(2,365)	1,675
Total Assets	97,836	93,630	91,130	80,360
6 Funding	73,590	68,603	71,879	63,406
7 Other Liabilities	5,353	5,834	3,855	3,638
Total Liabilities	78,943	74,437	75,734	67,044
Equity	18,893	19,193	15,396	13,317
B INCOME STATEMENT				
1 Mark Up Earned	10,894	18,365	16,087	17,966
2 Mark Up Expensed	(5,455)	(6,416)	(7,052)	(8,593)
3 Non Mark Up Income	1,374	2,466	1,437	1,460
Total Income	6,813	14,415	10,472	10,833
4 Non-Mark Up Expenses	(3,361)	(5,858)	(5,463)	(5,918)
5 Provisions/Write offs/Reversals	(1,055)	(764)	(1,004)	(2,255)
Pre-Tax Profit	2,397	7,792	4,005	2,661
6 Taxes	(1,248)	(3,272)	(1,670)	(997)
Profit After Tax	1,149	4,520	2,335	1,664
C RATIO ANALYSIS				
1 PERFORMANCE				
a Non-Mark Up Expenses / Total Income	49.3%	40.6%	52.2%	54.6%
b ROE	12.1%	26.1%	16.3%	12.5%
2 CREDIT RISK				
a Gross Finances (Total Finance-net + Non-Performing Advances + Non-Performing Debt Instruments) / Funding	116.9%	117.8%	104.4%	104.9%
b Accumulated Provisions / Non-Performing Advances	96.0%	179.5%	158.5%	74.4%
3 FUNDING & LIQUIDITY				
a Liquid Assets / Funding	12.3%	14.4%	16.8%	15.4%
b Borrowings from Banks and Other Financial Instituties / Funding	28.3%	28.0%	31.4%	25.3%
4 MARKET RISK				
a Investments / Equity	37.0%	35.7%	48.9%	43.8%
b (Equity Investments + Related Party) / Equity	1.7%	1.6%	2.2%	14.9%
5 CAPITALIZATION				
a Equity / Total Assets (D+E+F)	19.3%	20.5%	16.9%	16.6%
b Capital formation rate (Profit After Tax - Cash Dividend) / Equity	5.3%	24.2%	17.5%	10.1%

Credit Rating

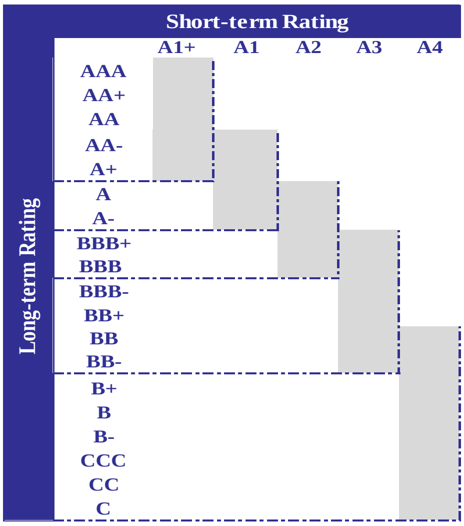
Credit rating reflects forward-looking opinion on credit worthiness of underlying entity or instrument; more specifically it covers relative ability to honor financial obligations. The primary factor being captured on the rating scale is relative likelihood of default.

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/index.php/credit-rating-agency/)

2) **Conflict of Interest**
i. LRA shall 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 33- Draft Rules Credit Rating Agency - 2021)

Restrictions
(3) LRA is not entitled to outsource any part of its work, which has a direct bearing on the act of rating. However, if any other function other than the core function of rating is to be outsourced, such fact shall be brought to the attention of the Client and be included in the Credit Rating Agreement entered into with the Client. (Section 22- Draft Rules Credit Rating Agency - 2021)
(4) LRA cannot appoint any individual as a member of the Rating Committee who has a business development function of the Credit Rating Agency, or who initiates or participates in discussions regarding fees or payments with any Client of Credit Rating Agency. (Section 26- Draft Rules Credit Rating Agency -2021)

Conduct of Business
(5) Prior to the commencement of a rating, LRA does not promise, assure or guarantee to a client that a particular rating will be assigned.
(6) LRA performs a rigorous and formal periodic review of all its methodologies. Such methodologies shall be made available to the Commission for perusal, upon request. (Section 39- Draft Rules Credit Rating Agency -2021)

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 does not engage in any other business activity which in the view of the Commission creates a conflict of interest unless prior written approval of the Commission is obtained (Section 33- Draft Rules Credit Rating Agency -2021)
(9) LRA structures its rating teams and processes to promote continuity, consistency and avoid bias in the rating process. (Section 45 - Draft Rules Credit Rating Agency -2021)

Monitoring and review
(10) For purposes of transparency, LRA publishes 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 are also be disclosed. (Section 42- Draft Rules Credit Rating Agency -2021) LRA monitors below factors specifically, (a) all internal records to support our credit rating opinions; (b) all particulars relating to Clients at our office which shall include the name and registered address and contact numbers of such Client's, names and addresses of their Directors as at the date of rating, its issued share capital and the nature of business; and (c) a comprehensive written record of all complaints received from Clients and action taken thereon by LRA.
(11) LRA ensures confidentiality of all information at all times relating to Clients including such Client's identity and transactions carried out for such Client unless and to the extent such disclosure is required by law. (Section 48 - Draft Rules Credit Rating Agency -2021)
(12) LRA does not destroy, conceal or alter any records, property or books relating to the business of the LRA 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 51 - Draft Rules Credit Rating Agency - 2021).
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
(14) All information contained herein is considered proprietary by LRA. Hence, none of the information in this document can be copied or, otherwise reproduced, stored or disseminated in whole or in part in any form or by any means whatsoever by any person without LRA's prior written consent