Lanka Rating Agency

Rating Report

LOLC Finance PLC

Report Contents

Rating History				
Dissemination Date	Long Term Rating	Outlook	Action	Rating Watch
08-Aug-2024	A	Positive	Maintain	-
16-Mar-2023	A	Stable	Initial	-

Rating Rationale and Key Rating Drivers

LOLC Finance PLC ("LOFC" or "the Company") maintains its very strong position as the largest Licensed Finance Company (LFC) in the sector, strengthened by a series of strategic amalgamations. In March'22, LOFC merged with Commercial Leasing and Finance PLC (CLF) following CLF's merger with Sinhaputhra Finance PLC (SFPLC). Subsequently, LOFC consolidated further by merging with LOLC Development Finance PLC (LODF) in January'23. As at FY24, LOFC's asset base stood at LKR~378bn representing ~22% of the LFC industry asset base. The Company's dominant position is underpinned by its association with LOLC Group that has diversified investments in several sectors. During FY24, LOFC's net interest income surged to LKR~38bn, ~15.4% increase from FY23. Additionally, the Company's core spread improved ~11% in FY24 (FY23: ~10%), in line with decreasing interest rates in Sri Lanka as liabilities were re-priced at lower rates. In terms of profitability, LOFC's Profit After Tax (PAT) rose significantly by ~40%, reaching to LKR~21.6bn in FY24 (FY:23 LKR~15.4bn). This was on account of improved net interest income and substantial supplementary income. However, the Company's operational and non-markup expenses remain high in relevance to its total interest income. LOFC's core income constitutes ~73.8% of its total income, while its non-core income, including fair value gains from investment properties and government securities, and write-backs of provisions, makes up a significant share of ~26.2%. In terms of credit risk, the Company's Non-Performing Loans (NPLs) ratio remains below the industry average, with a 90-day gross NPL of ~13.86% and a net NPL of ~10.49% in FY24 but is higher than comparable peers. The rating incorporates the Company's solid capitalization with its Capital Adequacy Ratio (CAR), clocking in at ~23% in FY24 (FY23: ~21.71%), well above the regulatory requirement set by the Central Bank of Sri Lanka (CBSL).

The assigned "Positive Outlook" reflects the Company's improved performance indicators. Continuation of the growth momentum and sustenance of strong key performance and financial indicators are essential for an upgrade consideration. In addition, improvement in core income and rationalization of administrative expenses are imperative as the Company consolidates its position after series of mergers. The Company continues to be a vital profit-generating entity for the Group, therefore, the flow of funds to the Holding level is largely influenced by the Company's profitability. Significant slowdown in growth, rise in NPLs and reduction in total capital through dividends to lower capita augmentation will be negative for rating.

Disclosure	
Name of Rated Entity	LOLC 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)
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Profile

Structure LOLC Finance PLC ("LOFC" or "the Company") is a quoted public company with limited liability. The Company is registered as a Finance Company under the provisions of the Finance Business Act No. 42 of 2011. The Company was incorporated in 2001 and listed on the Colombo Stock Exchange ("CSE") in 2011. LOFC is registered under the Securities and Exchange Commission as a Market Intermediary to perform the functions of a Margin Provider. Currently, the Company is listed in Diri Savi Board of CSE.

Background LOFC amalgamated with Commercial Leasing and Finance PLC ("CLF") in March 2022. CLF merged with Sinhaputhra Finance PLC ("SFPLC") prior to this merger. LOFC further merged with LOLC Development Finance PLC ("LODF") effective 31st January 2023.

Operations The principal activities of LOFC include leasing, loans, margin trading, mobilization of public deposits, and alternative financing. It has introduced digital inhouse developed products such as iPay, OYES and Oasys.

Ownership

Ownership Structure The largest shareholder of LOFC is LOLC Ceylon Holdings PLC ("LOCH"). It owns ~90.96% of the Company as at FY24. LOLC Asia Private Limited (LOAL) owns ~5.72%. LOCH and LOAL is ultimately owned by LOLC Holdings PLC with the effective shareholding of ~82% of the LOFC.

Stability The ultimate beneficial owner, Mr. Ishara Nanayakkara, is a prominent businessman in Sri Lanka and the largest shareholder of LOLC Holdings PLC ("LOLC"). He joined the board of LOLC in 2002. The diversity and the structure of the holding company brings stability to LOFC.

Business Acumen LOLC is a highly diversified group in Sri Lanka. It has investments in Licensed Finance Companies, Insurance, Banks, Plantations, Leisure, Information Technologies, Construction, and Real Estate.

Financial Strength LOLC Holdings PLC Group has earned a profit after tax of LKR~21.7bn in FY24 (FY23: LKR~21.6bn). It has an asset base amounting to LKR~1.7tn (FY23: LKR~1.56tn) and equity amounting to LKR~489bn (FY23: LKR~434bn).

Governance

Board Structure The Board consists of seven directors, out of which six are Non-Executive Directors including four Independent Directors. The Company has appointed Mr. P A Wijeratne as a Senior Independent Director since the Chairman of the Board is not an Independent Director.

Members' Profile The Chairman of the Board, Mr. F K C P N Dias, was appointed in 2020 and possesses an experience close to 30 years. The Board of Directors possess a wealth of knowledge to run the affairs of the Company.

Board Effectiveness The Board of Directors have formed five Board sub-committees, namely, Board Audit Committee ("BAC"), Integrated Risk Management Committee ("IRMC"), HR & Remuneration Committee, Related Party Transaction Review Committee and Nomination Committee.

Financial Transparency The External Auditors of the Company, Ernst & Young, Ford Rhodes, issued an unqualified audit opinion pertaining to the financial statements of FY23.

Management

Organizational Structure The Company has in place a robust organizational structure to efficiently support and optimize the functions of LOFC, ensuring seamless coordination and effective utilization of resources.

Management Team The management team is headed by the CEO, Mr. Thilakaratne, who was also the Director/CEO of CLF previously. He has over 25 years of experience in the financial sector and is supported by a large management team with relevant experience and qualifications.

Effectiveness The Company has formed four management committees, namely, Credit Committee, Asset & Liability Committee, Legal Settlement Committee and Management Committee. These committees assist the Company in executing and monitoring its operations smoothly.

MIS The IT department uses "Fusion" as its information system It is an in-house developed core banking system. It also has an online banking platform, a mobile banking application, call center modules, LOFC trading system and Oracle as its main systems and software.

Risk Management Framework The departments report risk to the CEO and afterward Enterprise Risk Management communicates risk to the Board. IRMC/BAC advises Board regarding risks. The internal audit does spot audit per branch annually for concentrated branches. Issues require the branch/division to submit a recovery plan.

Business Risk

Industry Dynamics At present, there are 33 Licensed Finance Companies ("LFC") in Sri Lanka, out of which 28 are listed. In FY23, the sector profitability contracted by ~47% to LKR~31,460mn. The sector's profitability for 9MFY24 was recorded at LKR~34,799mn. Interest income of the sector for 9MFY24 amounted to LKR~253,072mn (9MFY23: LKR~222,762mn), which represents significant increase of ~14% in the interest income. Net interest income also showed a significant increase of ~20% as during 9MFY24. As at 9MFY24, LFC sector asset base stood at LKR~1,693bn and equity stood at LKR~409bn.

Relative Position LOFC is the largest player in the LFC sector in Sri Lanka as per the asset base, equity and profits in 9MFY24. It occupies ~22% of assets, ~28.5% of equity and 45% of profits from the industry.

Revenues The Company's interest income has rapidly increased by ~9% amounting to LKR~75,006mn in FY24 from LKR~69,040mn in FY23. Net Interest Income also improved by ~15.4% to LKR~38bn in FY24 compared to LKR~32.9bn in FY23. LOFC's core income constitutes ~73.8% of its total income, while its non-core income, including fair value gains from investment properties and government securities, and write-backs of provisions, makes up a significant share of ~26.2%. In FY24, interest expense increased only by 2% compared to FY23 due to reduction in interest expenses on overdrafts and savings deposits.

Performance The Company earned a profit after tax (PAT) of LKR~21.6bn during FY24, compared to an LKR~15.4bn profit after tax in FY23, which is a ~40% YoY increase. In FY23, PAT decreased by ~9% YoY owed to an increase in the personnel expenses by ~70%, and overall General and Administration Expenses by ~91% YoY basis.

Sustainability The Company now operates as the largest LFC in the country, as per the asset base following the amalgamation with CLF and SFPLC. The Company plans on focusing on gold loans and credit cards in the short term. Capitalizing on its large size, the Company also plans to acquire more foreign funding as well.

Financial Risk

Credit Risk LOFC offers leases, loans, hire purchase, pawning, factoring, credit cards and margin trading facilities for customers. In FY24, the Company recorded gross NPLs of ~13.86% and net NPLs of ~10.49%. It has maintained its gross NPLs level below industry levels. In terms of its segments, the lowest NPLs were recorded for pawning loans and margin trading, which remained minimal despite the economic conditions in the country. On the other hand, highest NPLs were recorded for products including hire purchase and factoring during FY24.

Market Risk The Company has invested in Government Securities worth LKR~28bn in FY24. LOFC has invested heavily in investment properties and has investments amounting to LKR~48.3bn in FY24, which is a ~17% growth compared to FY23. LOFC is exposed to foreign currency risk and manages it by entering in to forward rate contracts with the banks and placing deposits and maintaining financial assets in the same currency to negate the risk. LOFC has invested LKR~15bn in foreign currency designated assets.

Liquidity And Funding The Company has increased its dependency on customer deposits over the years. As at FY24, customer deposits constituted ~89% (FY23: ~83%; FY22: ~76%) of the funding base. LOFC recorded customer deposits amounting to LKR~206.4bn in FY24. Composition of the Interest-bearing borrowings and overdrafts from total funding reduced to ~11% (FY23: ~17%) as at FY24.

Capitalization The Capital Adequacy Ratio ("CAR") of the Company was recorded at ~23% and ~21.71% as at FY24 and FY23 respectively (FY22: ~20.7%), well above the regulatory requirement of ~14%.

Lanka Rating Agency

LOLC Finance PLC
Public Limited Company

	LKR mln	LKR mln	LKR mln	LKR mln
	Mar-24	Mar-23	Mar-22	Mar-21
	12M	12M	12M	12M
A BALANCE SHEET				
1 Total Finance-net	222,658	220,937	201,660	102,994
2 Investments	96,366	78,066	73,702	42,750
3 Other Earning Assets	4,060	2,494	8,886	7,203
4 Non-Earning Assets	27,292	33,662	22,122	15,473
5 Non-Performing Finances-net	27,095	25,688	5,198	1,688
Total Assets	377,472	360,848	311,567	170,109
6 Funding	232,631	242,553	212,957	126,710
7 Other Liabilities	22,496	17,486	15,057	7,510
Total Liabilities	255,127	260,040	228,014	134,220
Equity	122,345	100,808	83,553	35,889
B INCOME STATEMENT				
1 Mark Up Earned	75,006	69,040	30,570	33,762
2 Mark Up Expensed	(37,019)	(36,125)	(8,980)	(12,447)
3 Non Mark Up Income	13,495	9,087	8,603	5,262
Total Income	51,482	42,002	30,193	26,577
4 Non-Mark Up Expenses	(21,812)	(18,961)	(10,540)	(10,219)
5 Provisions/Write offs/Reversals	(4,657)	(3,624)	(72)	(11,305)
Pre-Tax Profit	25,013	19,417	19,580	5,053
6 Taxes	(3,466)	(4,024)	(2,630)	(687)
Profit After Tax	21,547	15,393	16,951	4,366
C RATIO ANALYSIS				
1 PERFORMANCE				
a Non-Mark Up Expenses / Total Income	42.4%	45.1%	34.9%	38.4%
b ROE	19.3%	16.7%	28.4%	13.0%
2 CREDIT RISK				
a Gross Finances (Total Finance-net + Non-Performing Advances + Non-Performing Debt Instruments) / Funding	111.1%	106.6%	101.5%	93.0%
b Accumulated Provisions / Non-Performing Advances	24.4%	31.6%	64.1%	88.6%
3 FUNDING & LIQUIDITY				
a Liquid Assets / Funding	19.5%	20.1%	22.0%	29.6%
b Borrowings from Banks and Other Financial Institutes / Funding	8.3%	12.3%	18.8%	11.9%
4 MARKET RISK				
a Investments / Equity	78.8%	77.4%	88.2%	119.1%
b (Equity Investments + Related Party) / Equity	2.2%	2.7%	4.7%	3.3%
5 CAPITALIZATION				
a Equity / Total Assets (D+E+F)	32.4%	27.9%	26.8%	21.1%
b Capital formation rate (Profit After Tax - Cash Dividend) / Equity	21.4%	18.4%	47.2%	14.0%

Credit Rating

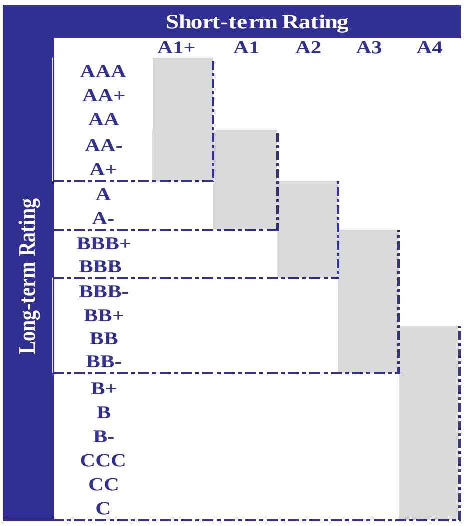
Credit rating reflects forward-looking opinion on credit worthiness of underlying entity or instrument; more specifically it covers relative ability to honor financial obligations. The primary factor being captured on the rating scale is relative likelihood of default.

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

Regulatory and Supplementary Disclosure

(Rules applicable to Credit Rating Agencies, No. 19 of 2021 - issued on 15th March 2022)

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)

(10) LRA's Revenue from the LOLC Group is more than 5% of its total earned in the preceding year.

Monitoring and review
(11) 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)

(12) 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)

(13) 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
(14) 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