Lanka Rating Agency

# Rating Report

## LOLC Finance - LKR 05bn Listed Debentures (Maturity 2025)

Report Contents



| Rating History | | | | | |
|---|---|---|---|---|---|
| Dissemination Date | Long Term Rating | Short Term Rating | Outlook | Action | Rating Watch |
| 16-Mar-2023 | A | A1 | Stable | Initial | - |

### Rating Rationale and Key Rating Drivers

The rating of the debenture highlights the unsecured senior structure, where the debenture will rank after all the claims of the secured creditors and preferential claims under any statutes governing the Company, but in pari passu to the claims of unsecured creditors of the Company. Consequently, the debt instrument is rated equivalent to the entity rating. On the entity level, the rating emanates from the leading position LOLC Finance PLC (LOFC or the Company) holds in the sector as the largest Licensed Finance Company (LFC). LOFC amalgamated with Commercial Leasing and Finance PLC (CLF) in March 2022 following the merger of CLF with Singhaputhra Finance PLC (SFPLC). LOFC further merged with LOLC Development Finance PLC (LODF) in January 2023 consolidating its position as the largest player in LFCs. The Company draws strength from the diversified investments and financial strength of LOLC Group. During 9MFY23, the Company's net interest income increased to LKR 23bln due to mergers, even though the Company's core spread decreased. Despite higher provisions due to a higher interest rate scenario, the Company's profits improved at an absolute level. Going forward, stability in the country and the impact of the mergers are expected to improve the performance of the company. Its Non-Performing Loans (NPL) remain below industry averages with a 120-day gross and net NPL of 12.6% and 8.3% respectively. Ratings reflect its solid capitalization position with the Capital Adequacy Ratio (CAR) maintained at ~20.2% (FY22: ~20.7%) as at 9MFY23, which is well above the regulatory requirement of the Central Bank of Sri Lanka (CBSL). The merger in March 2022, further improved its equity base to LKR ~94bn as at 9MFY22

The ratings remain dependent upon maintaining its leading position in the sector and navigating through challenging economic times while maintain and improving asset quality. Any future rating action will be dependent upon sustainable synergies developed through merger resulting into operational efficiencies and better performance.

| Disclosure | |
|---|---|
| **Name of Rated Entity** | LOLC Finance - LKR 05bn Listed Debentures (Maturity 2025) |
| **Type of Relationship** | Solicited |
| **Purpose of the Rating** | Debt Instrument Rating |
| **Applicable Criteria** | Methodology \| Debt Instrument Rating(Jun-22),Methodology \| Non-Banking Finance Companies Rating(Jun-22) |
| **Related Research** | Sector Study \| Leasing & Finance Companies(Dec-22) |
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## Issuer Profile

**Profile** 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 in 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. LOFC amalgamated with Commercial Leasing and Finance PLC ("CLF") in March 2022. CLF merged with Singhaputhra Finance PLC ("SFPLC") prior to this merger. LOFC further merged with LOLC Development Finance PLC ("LODF") effective 31st January 2023. The principal activities of LOFC include, leasing, loans, margin trading, mobilisation of public deposits and alternative financing. It has digital products introduced such as iPay, OYES and Oasys which are built in-house.

**Ownership** The largest shareholder of LOFC is LOLC Ceylon Holdings PLC ("LOCH") with an ownership of ~81.04% of the Company as at 1HFY23. The Company does not adhere to the minimum public holding requirements of CSE. As at 9MFY23, the Company has a public holding of 5.37%, which needs to be increased to 7.5%. The Company will rectify it by disposing the shares held by LOCH. LOLC Asia Private Limited and Phantom Investments (Private) Limited owns ~13.58% and ~0.4% respectively. 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. 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. LOCH earned a profit after tax of LKR 10.6bn as at 9MFY23, with an asset base of LKR 385bn. LOLC earned a profit after tax LKR 26.1bn as at 9MFY23, with an asset base of LKR 1.73tn.

**Governance** The Board consists of eight directors, out of which six are Non-Executive directors. Two Non-Executive directors, which includes the Chairman are Non-Independent directors. The Company has appointed Mr. P A Wijeratne as a Senior Director since the Chairman is not an Independent Director. The Chairman Mr. F K C P N Dias was appointed to the board in 2020 and possesses experience close to 30 years. The Board of Directors possess a wealth of knowledge to run the affairs of the Company. The Board of Directors have formed five board sub-committees, namely, i) Board Audit Committee ("BAC"), ii) Integrated Risk Management Committee ("IRMC"), iii) HR & Remuneration Committee, iv) Related Party Transaction Review Committee, v) Nomination Committee. The external auditors of the Company, Ernst & Young issued an unqualified audit opinion pertaining to the financial statements as at FY22.

**Management** The Company is headed by the Board of Directors and it has a comprehensive organisational structure to support the functions of LOFC. The management team is headed by the CEO, Mr. Thilakaratne and he was the Director/ CEO of CLF previously. He has over 25 years of experience in the finance sector and is supported by a large management with relevant experience and qualifications. The Company has formed four management committees, namely, i) Credit Committee, ii) Asset & Liability Committee, iii) Legal Settlement Committee, iv) Management Committee. These committees assist the Company to run its operations smoothly. The IT department uses "Fusion", an in-house built core banking system. It also has an online banking platform, a mobile banking application, call centre modules, LOFC trading system and Oracle as its main systems/ software it uses. CLF, LODF and LOFC uses Fusion as its core banking system. Therefore, the information systems were amalgamated using the core banking system. The departments will report to the CEO regarding risk related matters and through the Enterprise Risk Management department, the risks will be communicated to the Board of Directors. The IRMC and BAC will communicate and advise the Board of Directors on risk related matters. The internal audit department performs one spot audit per branch each year. It has also appointed audit officers to certain branches based on branch concentration. Any issues identified during audits will require the branch or division to submit a recovery plan.

**Business Risk** At present there are 36 Licensed Finance Companies ("LFC") in Sri Lanka, out of which 28 are listed. The sector profitability as at 1HFY23 is recorded at LKR 12,981mn. In comparison to 1HFY22, the interest income has increased by ~35%, while the net interest income shows a marginal decline of ~7% as at 1HFY23. The loan loss provisions declined by ~41% to LKR 9,693mn in 1HFY23 due to the Covid-19 relief measures which were in place at the time. The total asset base of the LFC sector stood at LKR 1.6tn as at 1HFY23. Subsequent to FY21, the asset quality improved to a gross Non-Performing loan ("NPL") ratio of ~9.11% as at FY22. However, as a result of the current macroeconomic challenges in the country, the gross and net NPL ratio deteriorated to ~16.81% and ~11.74% respectively as at 1HFY23. LOFC is the largest player in the LFC sector in Sri Lanka as per the asset base as at FY22. It occupies one fifth of the assets, equity and deposits of the industry as at 1HFY23. LOFC was not capable of increasing its interest income since FY19. It however improved its Net Interest Income ("NII") marginally in FY22. It earned an interest income of LKR 48.7bn by 9MFY23, which is an improvement by ~112%, compared to 9MFY22. Its interest expense increased by ~282% to LKR 25.3bn in 9MFY23. The Company recorded a core spread of ~9.6% (FY22: ~11%) as at 9MFY23 and it has been reducing since FY21. The profit after tax of the Company increased by ~288% in FY22 to LKR 16.95bn. It was possible as a result of the large decrease of allowance for impairment and write-offs by ~82% to LKR 3bn in FY22 as a result of the collections. The Company earned a profit after tax of LKR 10.9bn as at 9MFY23. However, it was a drop of ~10% compared to 9MFY22. Despite the considerable increase at the top level, the significant growth in interest expense, impairment and operating expenses prevented LOFC from earning a superior profit after tax. The Company now operates as the largest LFCs in the country, as per the asset base, following the amalgamation with CLF and SFPLC. While the SME sector will remain the largest component of the portfolio, LOFC will explore gold loans and credit cards as well. Using its large size as leverage it also plans to acquire more foreign funding as well.

**Financial Risk** The Company recorded a 120 day gross and net NPL of ~12.6% and ~8.3% respectively as at 9MFY23. Lowest NPLs are recorded for gold loans and margin trading and it has remained minimal despite the economic condition in the country as of 9MFY23. Highest NPLs are recorded for hire purchase, leases and factoring as of 9MFY23. The Company has invested in government securities worth LKR 23.8bn as at FY22. LOFC has increased its investment by ~82% in FY22, compared to FY21 and currently has investment properties amounting to LKR 38.3bn. The Company has chosen to extend the maturity of the SLDBs by one year. LOFC has also maintained a provision of 23% for its ISBs as at 9MFY23 and plans to increase it up to 30% by FY23. LOFC is exposed to foreign currency risk and manages it by entering in to forward rate contracts with the banks and by maintaining foreign currency denominated assets. The Company has increased its dependency on customer deposits over the years. As at 9MFY23, customer deposits constitute ~84% of the funding. The top 20 depositors concentration has improved to ~11.8% as at 9MFY23 as a result of the merger. The Capital Adequacy Ratio ("CAR") of the Company has been maintained at ~20.7% as at FY22. The CAR is recorded at ~20.2% as at 9MFY23.

## Instrument Rating Considerations

**About The Instrument** CLF raised an unsecured senior redeemable five (05) year debenture of LKR 100 each up to the value of LKR 3bn, with an option to raise a further LKR 1bn. At the event of an oversubscription, it had an additional option to issue up to a further LKR 1bn. It was transferred to LOFC at the merger and it has two types of debentures, namely i) Type A, ii) Type B.

**Relative Seniority/Subordination Of Instrument** The claims of the debenture holders shall in the event of winding up of the Company rank after all the claims of secured creditors and preferential claims under any statutes governing the Company but pari passu to the claims of unsecured creditors of the Company and shall rank in priority to and over any subordinated debt of the Company and the ordinary and preference shareholder/s of the Company.

**Credit Enhancement** It is an unsecured debt instrument and the debenture is not underwritten. The capital repayment will be done at the end of the tenor. The principal and the interest of the debenture is not secured by a specific asset of the Company.

**Lanka Rating Agency**

| LOLC Finance PLC<br>Public Limited Company | Dec-22<br>9M | Mar-22<br>12M | Mar-21<br>12M | Mar-20<br>12M |
|---|---|---|---|---|
| **A BALANCE SHEET** | | | | |
| 1 Total Finance-net | 214,889 | 201,660 | 102,994 | 126,022 |
| 2 Investments | 79,649 | 73,702 | 42,750 | 29,986 |
| 3 Other Earning Assets | 2,767 | 8,886 | 7,203 | 17,282 |
| 4 Non-Earning Assets | 22,589 | 22,122 | 15,473 | 10,603 |
| 5 Non-Performing Finances-net | 20,276 | 5,198 | 1,688 | 7,995 |
| **Total Assets** | 340,170 | 311,567 | 170,109 | 191,888 |
| 6 Funding | 232,490 | 212,957 | 126,710 | 152,957 |
| 7 Other Liabilities | 13,463 | 15,057 | 7,510 | 7,642 |
| **Total Liabilities** | 245,953 | 228,014 | 134,220 | 160,599 |
| **Equity** | 94,216 | 83,553 | 35,889 | 31,290 |
| **B INCOME STATEMENT** | | | | |
| 1 Mark Up Earned | 48,686 | 30,570 | 33,762 | 38,082 |
| 2 Mark Up Expensed | (25,338) | (8,980) | (12,447) | (19,271) |
| 3 Non Mark Up Income | 9,038 | 11,522 | 10,298 | 4,920 |
| **Total Income** | 32,386 | 33,112 | 31,613 | 23,730 |
| 4 Non-Mark Up Expenses | (12,907) | (10,540) | (10,219) | (11,115) |
| 5 Provisions/Write offs/Reversals | (6,270) | (2,992) | (16,341) | (7,844) |
| **Pre-Tax Profit** | 13,209 | 19,580 | 5,053 | 4,772 |
| 6 Taxes | (2,325) | (2,630) | (687) | (992) |
| **Profit After Tax** | 10,883 | 16,951 | 4,366 | 3,780 |
| **C RATIO ANALYSIS** | | | | |
| **1 PERFORMANCE** | | | | |
| a Non-Mark Up Expenses / Total Income | 39.9% | 31.8% | 32.3% | 46.8% |
| b ROE | 16.3% | 28.4% | 13.0% | 12.1% |
| **2 CREDIT RISK** | | | | |
| a Gross Finances (Total Finance-net + Non-Performing Advances + Non-Performing Debt Instruments) / Funding | 105.7% | 101.5% | 93.0% | 92.6% |
| b Accumulated Provisions / Non-Performing Advances | 34.4% | 64.1% | 88.6% | 49.0% |
| **3 FUNDING & LIQUIDITY** | | | | |
| a Liquid Assets / Funding | 15.6% | 22.0% | 29.6% | 24.4% |
| b Borrowings from Banks and Other Financial Institutes / Funding | 15.5% | 18.8% | 11.9% | 32.3% |
| **4 MARKET RISK** | | | | |
| a Investments / Equity | 84.5% | 88.2% | 119.1% | 95.8% |
| b (Equity Investments + Related Party) / Equity | 4.3% | 4.7% | 3.3% | 3.7% |
| **5 CAPITALIZATION** | | | | |
| a Equity / Total Assets (D+E+F) | 27.7% | 26.8% | 21.1% | 16.3% |
| b Capital formation rate (Profit After Tax - Cash Dividend ) / Equity | 17.4% | 47.2% | 14.0% | 12.1% |

## Credit Rating

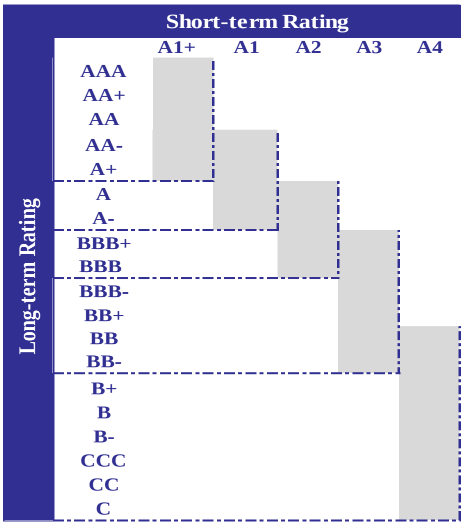
Credit rating reflects forward-looking opinion on credit worthiness of underlying entity or instrument; more specifically it covers relative ability to honor financial obligations. The primary factor being captured on the rating scale is relative likelihood of default.

### 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+<br>AA<br>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+<br>A<br>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+<br>BBB<br>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+<br>BB<br>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+<br>B<br>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<br>CC<br>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

## Regulatory and Supplementary Disclosure

| Nature of Instrument | Size of Issue (LKR) | Tenor | Security | Quantum of Security | Nature of Assets | Trustee | Book Value of Assets (LKR mln) |
|---|---|---|---|---|---|---|---|
| Listed, Rated, Senior, Unsecured, Redeemable Debenture | 5 bn | 5 Years | Unsecured | N/A | N/A | Bank of Ceylon | N/A |

| | |
|---|---|
| **Name of Issuer** | LOLC Finance PLC |
| **Issue Date** | 24.09.2020 |
| **Maturity** | 25.09.2025 |
| **Option** | Redeemable |

| Due Date Principal* | Opening Principal | Interest (%) | | Interest Payment (LKR Mn) | | Principal Payment (LKR Mn) | | Principal Outstanding (LKR Mn) | Total Interest Payment (LKR Mn) |
|---|---|---|---|---|---|---|---|---|---|
| | | Type A | Type B* | Type A | Type B | Type A | Type B | | |
| | 5,000 | | | | | | | 5,000 | |
| 23-Mar-23 | | 10.50% | 34.88% | 176 | 284 | - | - | 5,000 | 1,532 |
| 23-Sep-23 | | 10.50% | 34.88% | 180 | 284 | - | - | 5,000 | 1,997 |
| 23-Mar-24 | | 10.50% | 34.88% | 177 | 284 | - | - | 5,000 | 2,457 |
| 23-Sep-24 | | 10.50% | 34.88% | 177 | 284 | - | - | 5,000 | 2,918 |
| 23-Mar-25 | | 10.50% | 34.88% | 177 | 284 | - | - | 5,000 | 3,379 |
| 23-Sep-25 | | 10.50% | 34.88% | 177 | 284 | 3,371 | 1,629 | - | 3,840 |

**** 6 Month Treasury Bill Rate + 425 basis points. The 6 Month Treasury Bill rate as at 23.09.2022 is 30.63%***