



Lanka Rating Agency

Rating Report

Lanka Credit and Business Finance PLC

Report Contents

1. Rating Analysis
2. Financial Information
3. Rating Scale
4. Regulatory and Supplementary Disclosure

Rating History

Dissemination Date	Long Term Rating	Short Term Rating	Outlook	Action	Rating Watch
06-Jun-2023	B+	A4	Positive	Initial	Yes

Rating Rationale and Key Rating Drivers

Lanka Credit & Business Finance PLC ('LCBF' or 'the Company') is a licensed finance company. It offers over various financial services, while primary focus is on term loans, leases and gold loans in Sri Lanka. The Company is in the process of merger with Lanka Cooperative Leasing Company (LCLC) with LCBF as the surviving entity. The merger is expected to be completed in the ongoing year (CY23) once the procedural matters are settled. The "Rating Watch" will be removed once it is completed. The impact of this merger on the Company's overall position is expected to be positive with improvement in the capital position and the Company's transition into cooperative sector as a niche player. However, any fallout (additional provisions etc.), if materializes, is considered critical and will be incorporated in the rating opinion. The Company intends to increase its agriculture sector penetration where they mainly serve the consumption needs of the customers for business purposes. In a very competitive industry dynamics, LCBF holds a minor share and remain a small player among non-banking financial institutions. The ownership structure holds a prevalent role in Company's stability. The parent company and major sponsors, Lanka Credit and Business Limited (LCBL), provides support in terms of capital infusion and management expertise. The Company has maintained profitability and adequate liquidity despite tough operating environment. However, the Gross NPLs have been fluctuating just above the industry average for the last three years despite having a small lending portfolio. During 9MFY23, they have managed to keep the NPL below the industry average. LCBF has managed to maintain their capital adequacy ratio at 44.85%, which is well above the regulatory requirement due to limited lending.

The Rating Watch is assigned due to the ongoing merger as the process has yet to be completed with final net asset value and swap ratio to be decided. Moreover, the synergies from merger and positive impact on business and financial profile of the Company has yet to materialize.

The rating is dependent on the management's ability to navigate its way through unpredictable macroeconomic conditions where the interest rates are on the downward trend while maintaining regulatory requirements and preserving asset quality. The ability of the Company to leverage the synergies from the merger is imperative for the rating and will be taken into account accordingly when the merger is finalized.

Disclosure

Name of Rated Entity	Lanka Credit and Business 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(Dec-22)
Rating Analysts	Savindri Hansamala Kuruppu savindri@lra.com.lk +92-42-35869504



Leasing & Finance Companies

Lanka Rating Agency

Profile

Structure Lanka Credit & Business Finance PLC (LCBF or the Company) was incorporated in 2016 under the Finance Business Act No. 42 of 2011. It was domiciled in Sri Lanka under the provisions of the Companies Act No. 7 of 2007 and was listed in 2021.

Background In 2018, LCBF (formally known as City Finance Corporation Limited) was restructured as a result of an investment made by Lanka Credit and Business Limited (LCBL) under the guidance of the Central Bank of Sri Lanka (CBSL). Recently, the Company has entered the phase of a merger, post merger the company shall be renamed as "Lanka Co-operative Business Finance PLC"

Operations The Company provides a comprehensive range of financial services encompassing accepting deposits and providing credit facilities such as term loans, leases, gold loans, and other credit facilities. At present they are focusing on the cooperative sector.

Ownership

Ownership Structure The major shareholding vests with LCBL owning 72.08% of the shares as at 9MFY23. The second highest is owned by Helios Ventures (Pvt) Ltd followed by Nation Lanka Finance PLC.

Stability The Nanayakkara family owns ~30% of LCBL (the parent company). The sponsors provide support in the form of equity injection in the business through LCBL.

Business Acumen LCBL does not have any operations other than management of the investment in LCBF. The shareholders of LCBL are well reputed businessmen with other profitable investments.

Financial Strength The financial strength of the company is derived from its shareholders, who are well known for their business investments.

Governance

Board Structure LCBF board consists of twelve (12) members, out of which eleven (11) members are Non-Executive Directors while four (4) among them are Independent.

Members' Profile The Board consists of personnel with extensive knowledge, expertise and experience in different business fields. Emeritus Professor Abeyratne Bandara functions as the Chairman of the Company's Board since 2018.

Board Effectiveness LCBF operates with five (5) board sub-committees, namely Board Audit Committee, Board Human Resource and Remuneration Committee, Board Integrated Risk Management Committee, Credit Committee and Board Related Party Transactions Review Committee.

Financial Transparency E&Y Chartered Accountants of Sri Lanka, has provided an unqualified audit opinion on the financial statements for FY22.

Management

Organizational Structure The Company has a well-defined organizational structure with 10 divisions. The final authority lies with the Chief Executive Officer (CEO) who reports to the Board of Directors.

Management Team The management team is steered by Mr. Leelananda who functions as the CEO/ Executive Director who has the relevant qualifications and experience.

Effectiveness The Company has formed seven (7) management committees and these committees assist the Company to effectively carry out its operations.

MIS The Company uses "eFinancials" as the core financial system. LCBF is planning on introducing an online app, ATM, SLIPS and CEFTS by the next year.

Risk Management Framework LCBF has a comprehensive risk management policy in place. Risk management is embedded within the organization's strategic planning process, performance measurement system and day-to-day operations.

Business Risk

Industry Dynamics At present, there are 36 LFCs in Sri Lanka, out of which, 28 are listed in the CSE. The profit after tax for the 9MFY23 is recorded at LKR 19Bn. In comparison to 9MFY22, the interest income has increased by ~38% to LKR 223 Bn. The loan loss provisions increased by ~6% to LKR 14 Bn (9MFY22: 13Bn) in 9MFY23. The total asset base of the LFC sector stood at LKR 1.6 Tn as at 9MFY23. The gross and net NPL ratio deteriorated to ~17.45% and ~12.28% respectively as at 9MFY23.

Relative Position LCBF represents 0.75% of equity in the LFC industry as at 9MFY23. Moreover, the Company asset base contributes to 0.33% of the industry assets during 9MFY23. The impact of the merger on the Company's overall position is expected to be positive with Company's transition in cooperative sector as a niche player.

Revenues The revenue has increased to LKR 773 Mn in 9MFY23 compared to LKR 552 Mn in FY22. Net interest income for 9MFY23 was LKR 467 Mn which is a growth of 54% from 9MFY22. This improvement was mainly due to the interest rate increase and the expansion of their lending portfolio. The Net Interest Margin (NIM) has picked up slightly in 9MFY23 to 15.25% since the borrowing cost has also increased in line with lending rates from 10.15% in FY22. The Company product portfolio is predominantly focused on term loans, lease, gold loans, and housing loans which collectively amounts to ~94% of the total lending portfolio in 9MFY23. During 9MFY23, interest income from term loans contributes to 36%, followed by interest from fixed deposits and commercial papers which accounts for around 22.6% combined. The trend in increase in revenue is expected to continue due to increase in the portfolio with the expansion of their branch network and penetration in to the cooperative sector. But the impact of the falling interest rates are yet to materialize and will affect the revenues.

Performance LCBF profitability depicts an improvement and the YoY growth was recorded as ~17% from FY21 to FY22 while it was a 97% growth from 9MFY22 to 9MFY23. The massive jump in the profits in 9MFY23 is attributable to the gain in share investment. Core Interest spread has increased over the years up to ~7% in 9MFY23. The asset base has also increased by 23.73% when compared to 9MFY22. The total advances increased by 31.27% from FY21 to FY22, and it has gone up by another 33.22% by the end of 9MFY23, in comparison to FY22. The Company's Return on Assets (ROA) and Return on Equity (ROE) is recorded as 3.2% and in 5.7% as at 9MFY23 respectively.

Sustainability LCBF strategic direction is focusing on repositioning the Company to align with major customer segments of the Leasing, Small and Medium sized Enterprises (SME) and Micro Finance. The management is also looking into improving its agriculture sector products and green products in order to differentiate itself from the rest. LCBF is in the process of merging with Lanka Cooperative Leasing Company (LCLC) which is at present 95% completed and it is expected to be merged before Sept'23. The surviving entity after the merger will be LCBF.

Financial Risk

Credit Risk LCBF's gross Non Performing Loan (NPL) levels have remained above the industry average during the past three years, which has been rectified in the last three quarters. The gross and net NPLs were recorded at ~15.84% and ~11.52% in 9MFY23 respectively. Accumulated provisioning for the NPL is ~48% in 9MFY23. However, any fallout (additional provisioning etc), if materialize is considered Critical.

Market Risk Growth of assets subject to market risk was recorded as ~22% in 9MFY23 which is ~89% of the total assets compared to FY22. The fixed deposits and commercial papers which stood at 19.41% have a short-term maturity. Moreover 2.67% of total assets were placed with repurchase agreements of treasury bills as at FY22.

Liquidity And Funding LCB's majority funds are from customer deposits and in 9MFY23 it represents 74% of total funding. The deposits have significantly risen in 9MFY23 compared to FY22 due to the implementation of a cooperative deposits mobilization unit. The Company's top 20 depositors have ~48% of the total deposits as at FY22 which is very high. The Company records an overall cost of funds is ~21%. As at 9MFY23 the maturity mismatch, shows a positive gap which shows that the lending portfolio is long term while the deposits are in the short end of the curve.

Capitalization The Company adheres to the capital adequacy requirements (CAR) of CBSL and maintains Tier I and total CAR of 44.85% as at 9MFY23. On another angle this exceptionally high CAR reflects unutilized potential of the capital invested. Company's capital position is anticipated to improve post merger.



Lanka Rating Agency

LCB Finance PLC
Listed Public Limited

A BALANCE SHEET

	Dec-22 9M	Mar-22 12M	Mar-21 12M	Mar-20 12M
1 Total Finance-net	4,459	3,500	2,880	2,742
2 Investments	13	136	164	88
3 Other Earning Assets	-	-	-	-
4 Non-Earning Assets	538	447	541	511
5 Non-Performing Finances-net	381	274	88	(235)
Total Assets	5,390	4,357	3,673	3,106
6 Funding	2,615	1,630	1,525	1,610
7 Other Liabilities	27	46	41	12
Total Liabilities	2,642	1,676	1,566	1,622
Equity	2,749	2,681	2,107	1,483

B INCOME STATEMENT

1 Mark Up Earned	741	504	456	424
2 Mark Up Expensed	(274)	(97)	(108)	(131)
3 Non Mark Up Income	32	37	5	32
Total Income	499	445	353	325
4 Non-Mark Up Expenses	(238)	(227)	(208)	(184)
5 Provisions/Write offs/Reversals	(115)	62	(23)	(101)
Pre-Tax Profit	146	280	122	40
6 Taxes	(30)	(182)	(97)	(29)
Profit After Tax	115	98	25	11

C RATIO ANALYSIS

1 PERFORMANCE				
a Non-Mark Up Expenses / Total Income	47.8%	51.0%	58.9%	56.6%
b ROE	5.7%	4.1%	1.4%	0.8%
2 CREDIT RISK				
a Gross Finances (Total Finance-net + Non-Performing Advances + Non-Performing Debt Instruments) / Funding	197.9%	246.1%	213.3%	192.2%
b Accumulated Provisions / Non-Performing Advances	46.8%	46.5%	76.4%	166.7%
3 FUNDING & LIQUIDITY				
a Liquid Assets / Funding	36.5%	59.9%	57.8%	51.7%
b Borrowings from Banks and Other Financial Institutes / Funding	15.6%	36.0%	34.0%	29.3%
4 MARKET RISK				
a Investments / Equity	0.5%	5.1%	7.8%	5.9%
b (Equity Investments + Related Party) / Equity	0.5%	0.7%	4.8%	0.0%
5 CAPITALIZATION				
a Equity / Total Assets (D+E+F)	51.0%	61.5%	57.4%	47.8%
b Capital formation rate (Profit After Tax - Cash Dividend) / Equity	3.4%	4.6%	1.7%	0.8%

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.

Scale	Long-term Rating Definition
AAA	Highest credit quality. Lowest expectation of credit risk. Indicate exceptionally strong capacity for timely payment of financial commitments
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.
AA-	
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.
A-	
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.
BBB-	
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.
BB	
BB-	
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.
B-	
CCC	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.
CC	
C	
D	Obligations are currently in default.

Scale	Short-term Rating 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 surveil 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

Disclaimer: LRA has used due care in preparation of this document. Our information has been obtained from sources we consider to be reliable but its accuracy or completeness is not guaranteed. LRA shall owe no liability whatsoever to any loss or damage caused by or resulting from any error in such information. Contents of LRA documents may be used, with due care and in the right context, with credit to LRA. Our reports and ratings constitute opinions, not recommendations to buy or to sell.

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