Lanka Rating Agency

Rating Report

Lakderana Investments LTD

Report Contents

Rating History

Dissemination Date	Long Term Rating	Outlook	Action	Rating Watch
19-Jul-2024	BB	Stable	Initial	-

Rating Rationale and Key Rating Drivers

Lakderana Investments Limited ("LIL" or "the Company") is a limited liability company dedicated to providing financing solutions to those that traditionally lack access to such services. The Company operates under Consumer Credit Act and Mortgage Act. LIL does not take deposits. The rating takes into account the Company's solid earning profile, relatively higher spread, established track record and strong asset quality indicators. The Company has recorded gross and net NPLs of ~10.13% and ~(2.92%), respectively, as of end-FY24. The NII has improved by ~4% to LKR~662mln in FY24 as compared to LKR~635mln in FY23 as core spread improved to ~14.42% in FY24 after decreasing to ~8.81% in FY23. Core income is supplemented by other income, mainly insurance premiums and processing fees. LIL's business model is concentrated towards Hire-Purchase (Three-Wheeler) segment of registered and non-registered vehicles, representing ~96% of the lending portfolio. The target customers of the Company remain vulnerable to economic shocks but higher prices of underlying assets provide cushion against defaults. The rating is constrained by limited funding profile, high cost of borrowings and relatively leveraged capital structure of the Company, impeding growth. As of FY24, loans and borrowings constituted approximately ~92% of the company's funding, up from ~82% in FY23. The debt-to-equity ratio increased to approximately ~1.3x in FY24 from ~1.1x in FY23, primarily due to a significant rise in borrowings. Going forward, LIL aims to increase both its interest and non-interest income through new initiatives such as top-up loans, life insurance, consumer product financing and green financing. These strategies are expected to diversify loan portfolio.

The rating is dependent on Lakderana Investments Limited's ability to sustain its margins and robust asset quality while achieving its growth targets. Meanwhile, effectively reducing cost of borrowings, especially high cost funding lines, establishing new product lines and strengthening governance practices will be important. Any significant reduction in margin and/or profitability or deterioration in asset quality will have have negative rating implications.

Disclosure

Name of Rated Entity	Lakderana Investments LTD
Type of Relationship	Solicited
Purpose of the Rating	Entity Rating
Applicable Criteria	Methodology | Non-Banking Finance Companies Rating(Jun-22)
Related Research	Sector Study | Leasing & Finance Companies(Aug-23)
Rating Analysts	Nilum Liyana Arachchi | nilum@lra.com.lk | +94 114 500099

Profile

Structure Lakderana Investments Limited ("LIL" or "the Company") is a limited liability company. The Company commenced its operations on 6th March 2006, under the Companies Act No. 17 of 1982, and re-registered on 1st July 2018 under the Companies Act No. 07 of 2007.

Background The Company is providing finance solutions to an identified segment of society to whom such solutions are not available otherwise. Initially, LIL has started operations with a staff of 7 has grown to 27 branches with nearly 200 employees.

Operations The main business activity of the Company is to provide Hire Purchase facilities for both registered and unregistered vehicles. The Company has also entered into the Gold & Mortgage loans. The Company also offers sub-loans to its existing customers to meet their urgent financial needs.

Ownership

Ownership Structure The largest shareholder of LIL vests with High Peak Holdings (Pvt.) Ltd. It owns ~54% of the Company as of FY24. The majority shareholding of High Peak Holdings (Pvt.) Ltd is owned by Mr. Virath De Alwis, who directly holds ~25% of the shares of the Company.

Stability The ownership structure does not reflect any major changes in the recent past and the same trend is expected to continue in the future.

Business Acumen Mr. Virath De Alwis has ample knowledge in the banking, real estate, and legal sectors in Colombo. He is the son of Mr. Hemaka De Alwis, the Chairman of the Board, a successful businessman from Sri Lanka who has a track record of successfully guiding creative teams to success. After 18 years of operation, the company has served about 60,000 consumers under his direction.

Financial Strength The financial strength of the business vest with Mr. Virath, & Mr. Hemaka. Mr. Hemaka is a prominent businessman in Sri Lanka and the largest shareholder and founder of the Fairway Group of Companies.

Governance

Board Structure The Board consists of eight directors, of whom three are non-executive directors. There are no independent directors on the Board. Mr. Hemaka De Alwis is the Chairman of the Board.

Members' Profile The Chairman, Mr. Hemaka De Alwis, was appointed to the Board of Directors in 2006 and he possesses an experience of over 30 years. Mr. Hemaka De Alwis is a veteran individual in the corporate world.

Board Effectiveness The Board of Directors have formed four sub-committees, and on behalf of the Board of Directors, the sub-committees fulfill regulatory requirements on monitoring and evaluation.

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

Management

Organizational Structure The Company's organization is headed by the Executive Chairman and the Board of Directors. Executive Directors heads the Sales, Credit Operations, Administration, Finance and HR functions of the Company. The COO oversees the Internal Audit, IT, Insurance, Admin and Legal Departments. The Treasury Operations, Gold Loan, Pawning, Recovery, and Quality Assurance Departments are headed by the Deputy CEO. All the Executive Directors, COO, and Deputy CEOs report to the Executive Chairman.

Management Team The management team is headed by the Executive Chairman, Mr. Naresh Adikaram. He possesses over 28 years of experience in Banking and Finance, with 17 years at HSBC and 11 years at Standard Chartered Bank, along with 6 years of experience in the Property Development, Hotel and Leisure Sectors.

Effectiveness The Company has formed eight management committees which assist the departments in running their operations smoothly. These committees separately address different business functions and operate individually to support the Company in managing its day-to-day operations effectively and efficiently.

MIS The Company has incorporated the latest information and communication technologies and application software systems, forming the backbone of all processes and spanning the entire range of operations. This is a key element in their unique selling point, i.e., 'a same day facility, within a few hours'.

Risk Management Framework The Company has introduced Corporate Risk Matrix in its risk management framework. Risk areas in the matrix are continuously monitored by the Audit Committee. The Integrated Risk Management Committee and Audit Committee will communicate and advise the Board of Directors on risk related matters.

Business Risk

Industry Dynamics The total asset base of the LFC sector stood at LKR~1.7tn as of 9MFY24. Subsequent to FY22, the asset quality deteriorated to a gross non-performing loan ("NPL") ratio of ~16.01% in FY23 (FY22: ~9.11%) and further deteriorated to ~17.79% in 9MFY24. As a result of the current macroeconomic challenges in the country, net NPL ratio also deteriorated to ~10.67% in FY23 (FY22: ~1.90%) and further deteriorated to ~12.01% as of 9MFY24.

Relative Position In comparison to the peers, Lakderana Investments Ltd. operates with a unique different business model, hence, no direct competition exists for the Company within its sector. However, the Company holds ~2 to ~3% of the market share in terms of Hire-Purchase.

Revenues In FY22, the Company's portfolio comprised of hire purchase facilities only. In FY23 and FY24, this composition decreased to ~98% and ~96% respectively, with the introduction of gold loans facility. During FY24, the Interest income of the Company increased by ~17%, amounting to LKR~1,202mln and ~13%, amounting to LKR~1,023mln in FY23 (FY22: LKR~905mln). In FY24, the share of the interest income from Hire Purchase as a percentage of total interest income reduced to ~85% from ~90% in FY23, reflecting growth coming in from the gold loans portfolio.

Performance The Company's Profit After Tax (PAT) decreased by ~12% in FY24 to LKR~145mln (FY23: LKR~166mln, FY22: LKR~230mln). The main reasons for the decline were an increase in personnel costs by ~10% and other operating expenses by ~34% in FY24. LIL's customer concentration risk remains low as the top 20 customers hold only ~1% of the total portfolio of the Company.

Sustainability The Company is planning to increase its hire purchase portfolio and gold loans portfolio in the coming years. In FY24, the Company entered into mortgage loan provision as well, and is planning to expand its portfolio in this business segment too. Additionally, the Company is planning to introduce life insurance products and green financing products to diversify and sustain its business operations.

Financial Risk

Credit Risk The Company recorded a gross and net NPL of ~10.13% and ~(2.92)% respectively during FY24, a reduction from FY23's gross NPLs. In FY23, the Company recorded a gross NPL of ~11.49% and net NPL of ~(3.00)%. Up to FY22, the Company's NPLs presented a declining trend. However, during FY23, the gross NPLs increased significantly from ~6.32% in FY22 to ~11.49%.

Market Risk During FY24, the Company's investments included deposits with banks and other financial institutions worth LKR~46mln (FY23: LKR~29mln, FY22: LKR~76mln). The Company has also made investments in unquoted shares of Fairway City Hotel (Pvt.) Ltd., amounting to LKR~228mln in FY24 and FY23. Furthermore, the Company has significantly expanded its share in investment properties by ~25% to LKR~106mln in FY23 and further by ~176% to LKR~292mln in FY24.

Liquidity And Funding As of FY24, the Company's Loans and Borrowings constituted ~92% (FY23: ~82%) of its funding base. Total Loans and Borrowings have increased by ~35% in FY24 to LKR~2,389mln from LKR~1,774mln in FY23. Out of the total funding, the Company has borrowed LKR~605mln from the banks and other financial institutions, LKR~1,251mln from the securitizations and LKR~534mln from subordinated and other loans.

Capitalization The Company's debt-to equity ratio has increased to ~1.3x in FY24 from ~1.1x in FY23 (FY22: ~1.3x) due to a significant increase in the borrowings. In FY24, LIL maintained its Capital Formation Ratio at ~8.5%, which is a slight increase from ~8.3% in FY23.

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LKR mln

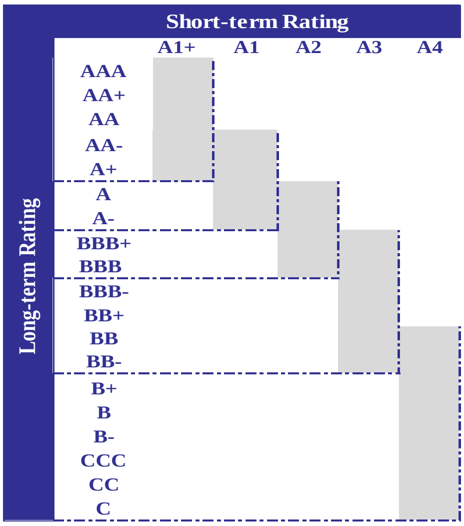
Lakderana Investments Limited Private Limited	Mar-24 12M	Mar-23 12M	Mar-22 12M	Mar-21 12M
A BALANCE SHEET				
1 Total Finance-net	3,307	2,858	3,205	2,816
2 Investments	520	334	84	1
3 Other Earning Assets	46	29	76	218
4 Non-Earning Assets	824	855	944	987
5 Non-Performing Finances-net	(125)	(115)	(222)	(92)
Total Assets	4,572	3,961	4,088	3,929
6 Funding	2,393	1,822	2,173	2,199
7 Other Liabilities	324	430	266	300
Total Liabilities	2,717	2,252	2,439	2,499
Equity	1,855	1,710	1,648	1,430
B INCOME STATEMENT				
1 Mark Up Earned	1,202	1,023	905	984
2 Mark Up Expensed	(540)	(388)	(276)	(373)
3 Non Mark Up Income	284	194	237	181
Total Income	946	829	866	792
4 Non-Mark Up Expenses	(651)	(555)	(475)	(414)
5 Provisions/Write offs/Reversals	(8)	(19)	(34)	(37)
Pre-Tax Profit	286	255	358	341
6 Taxes on Financial Services	(71)	(78)	(66)	(66)
Profit Before Income Taxes	216	178	292	275
7 Income Taxes	(70)	(12)	(62)	(87)
Profit After Tax	145	166	230	188
C RATIO ANALYSIS				
1 PERFORMANCE				
a Non-Mark Up Expenses / Total Income	68.9%	67.0%	54.8%	52.3%
b ROE	8.2%	9.9%	15.0%	13.2%
2 CREDIT RISK				
a Gross Finances (Total Finance-net + Non-Performing Advances + Non-Performing Debt Instruments) / Funding	152.5%	175.8%	156.4%	138.2%
b Accumulated Provisions / Non-Performing Advances	136.3%	133.4%	215.3%	141.3%
3 FUNDING & LIQUIDITY				
a Liquid Assets / Funding	11.7%	16.6%	7.9%	15.2%
b Borrowings from Banks and Other Financial Institutes / Funding	77.6%	81.8%	84.5%	85.6%
4 MARKET RISK				
a Investments / Equity	28.0%	19.5%	5.1%	0.0%
b (Equity Investments + Related Party) / Equity	12.3%	13.3%	0.0%	0.0%
5 CAPITALIZATION				
a Equity / Total Assets (D+E+F)	40.6%	43.2%	40.3%	36.4%
b Capital formation rate (Profit After Tax - Cash Dividend) / Equity	8.5%	8.2%	14.8%	11.8%

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.

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)

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

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

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

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

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