

ICRA Lanka reinstates the issuer rating of LCB Finance Limited

September 19, 2020

Instrument	Previous Rated Amount (LKR Mn)	Current Rated Amount (LKR Mn)	Rating Action
Issuer rating	N/A	N/A	[SL]B (Stable); reinstated

Rating action

ICRA Lanka Limited has reinstated the issuer rating of [SL]B (Pronounced SL B) with a Stable outlook for LCB Finance PLC (LCF or “the Company”).

Rationale

The rating considers LCF’s limited track record, small scale, and modest competitive position in the non-banking finance sector. As in March 2020, the gross portfolio of the Company stood at about LKR 2.3 Bn. LCF was formed after the acquisition defunct CITY Finance Limited by LCB Limited (LCB) in April 2018, under the guidance of Central Bank of Sri Lanka (CBSL). Post-acquisition, LCB transferred its assets and liabilities to LCF and became its holding company. The rating also takes into consideration LCF’s subdued asset quality indicators and moderate capital profile. LCF’s core capital as of March 2020 stood at about LKR 1.2 Bn, below the regulatory requirement of LKR 2 Bn by December 2020, for Licenced Finance Companies (LFCs); however, the Company’s gearing was low at 1.0 time due to its modest asset size. ICRA Lanka takes note of the initiatives taken by the Company to secure capital in the near-term. The rating also factors the sharp deterioration of asset quality indicators, where the gross NPA ratio (including legacy portfolio from City Finance Ltd.) increased to about 23.1% in March 2020, from about 23.0% in March 2019 and 20.8% in November 2018. Going forward, LCF’s ability to meet the regulatory capital requirements in a timely manner and its ability to improve overall asset quality will be crucial from a rating point of view.

Outlook: Stable

The outlook may be revised to “Positive” if the Company demonstrates a steady improvement of asset quality and an adequate capital profile over the medium term, while maintaining a track record of profitable portfolio growth. The outlook may be revised to “Negative” in case LCF continues to remain in breach of the regulatory capital, or if its asset quality or earnings profiles weaken further.

Key rating drivers

Credit strengths

Comfortable liquidity profile: As in March 2020, LCF had a positive ALM position of 153%, vis-à-vis 18% in December 2018. The liquidity profile of the Company is comfortable as the entity is largely equity funded at the moment (gearing only 1x), and the deposit exposure is only about 36% of the total funding base. In addition, as per the management, the Company has experienced healthy deposit renewals even during the COVID-19 outbreak in March-May 2020. However, in the future, as the portfolio grows, it will be crucial for the Company to maintain a well-diversified funding base with a healthy mix of deposits and long term debt funding.

Credit Challenges

Limited track record, small scale of operations, and modest competitive position: LCF has a limited track record under the new management as the company was taken over by Lanka Credit and Business Limited (LCB) in Apr-18; the entity was dysfunctional at that time. LCF's gross portfolio is at about LKR 2.3 Bn as of Mar-20. The legacy portfolio stood at LKR 240 Mn (about 10.5% of the total portfolio) and was fully provided for. As of Mar-20, the active portfolio consisted of loans, leasing & HP, factoring, microfinance lending, and pawning/gold loans, which accounted for about 73%, 9%, 3%, 2% and 3%, respectively of the total active portfolio. The loan segment primarily consists of business purpose loans (37% of the total active portfolio), housing loans (about 9%), and revolving loans (about 9%). The leasing & HP portfolio mainly consists of lending for passenger vehicles (cars, vans, jeeps). LCB has started gold loans in Oct-18 and going forward, plans to promote the same as opposed to pawning because of the flexibility in recovery.

Subdued asset quality indicators: LCF recorded a high gross NPA ratio (including the legacy portfolio of City Finance Ltd.) of 23.1% as of Mar-20 vis-à-vis 23% in Mar-19. However, the GNPA% of the active portfolio stood at 11% as of Mar-20 vis-à-vis 3.7% in Mar-19. The increase in overall NPA is largely attributable to the adverse macro outlook that prevailed since the Easter events in April 2019. LCF's portfolio was affected by these events as the Company is primarily focusing on the SME sector, with significant exposures to the tourism sector. The legacy portfolio stood at about LKR 240 Mn as of Mar-20 and was fully provided for, as the portfolio is in non-performing status. ICRA Lanka notes that several larger ticket facilities have contributed to the overall NPA as the top 15 NPA accounts constituted to about 44% of the total NPAs of the active portfolio as of Mar-20. LCF's ability to curtail further slippages as the business expands and the portfolio seasons, would be a key rating monitorable going forward.

Sizeable external capital required, however the promoters have the ability and the willingness to provide the capital support: LCF's core capital adequacy ratio stood comfortable at 29.2% as of Mar-20 and gearing was at about 1.0 times as of Mar-20, as the balance sheet is largely equity funded, at the moment. However, as per the revised minimum core capital requirements stipulated by the CBSL, all the NBFIs will have to have a minimum core capital base of LKR 2 Bn by December 31, 2020. As in March 2020, LCF's core capital stood at about LKR 1.2 Bn, where an additional capital infusion of about LKR 800 Mn is required by December 2020. However, ICRA Lanka notes that the promoters have enhanced the capitalization profile of the Company through successive capital infusions. ICRA Lanka also notes that the Company is currently working on a CBSL approved IPO process, where the balance capital requirement will be fulfilled by a public offering by the end of this year.

Analytical approach: For arriving at the ratings, ICRA Lanka has applied its rating methodologies as indicated below. **Links to applicable criteria:** [ICRA Lanka Credit Rating Methodology for Non-Banking Finance Companies](#)

About the Company:

LCB Finance Limited (LCF) is a licensed Finance Company providing an array of products including Leasing, Hire Purchase, Business loans, Pawning/ gold loans, Micro Finance, and Factoring. The Company was incorporated in 1962 as Industrial Finance Limited. In 2008, the ownership of the Company was transferred to ASPIC group and subsequently to Millennium group in 2009. The Company went through a name change in 2012 as City Finance Limited. In April 2018, under the guidance of Central Bank of Sri Lanka, LCB Limited, took over the Company and renamed it as LCB Finance Limited. LCB transferred its assets and liabilities to LCF during May 2018 and became its holding company. As of Mar-20, LCB Limited held 86% of LCF. For the FY2020, LCF reported a net profit of LKR 11 Mn on a total asset base of LKR 3.1 Bn.

Key financial indicators (Audited)

Amount in LKR Mn	FY18	FY19	FY20
Net Interest Income	98	222	292
Profit after Tax	3	515	11
Net worth	403	1,332	1,483
Total Assets	1,659	2,684	3,105
Return on Equity	N/A	N/A	N/A
Return on Assets	0.2%	21.1%	0.4%
Gross NPA	30.9%	23.0%	23.1%
Net NPA	0.0%	2.8%	2.9%
Capital Adequacy Ratio	35.2%	30.4%	29.2%
Gearing (times)	1.0	1.0	1.0

Rating history for the last three years:

Instrument	Type	Current Rating (FY2019)		Chronology of Rating History for the past 3 years		
		Amount Rated (LKR Mn)	Date & Rating	Date & Rating in FY2019	Date & Rating in FY2018	Date & Rating in FY2017
Issuer rating	N/A	N/A	Sept 2020 [SL]B (Stable)	[SL]B (Stable)	N/A	N/A

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