ICRA Lanka reaffirms the ratings of Commercial Credit and Finance PLC

October 27, 2021

Instrument	Rated Amount (LKR Mn)	Outstanding Amount (LKR Mn)	Rating Action
Issuer rating	N/A	N/A	[SL]BBB (Stable); Reaffirmed
Guaranteed Redeemable Debentures Programme	2,000	1,288	[SL]AA(CE) with Stable outlook; Reaffirmed
Commercial Paper Programme	1,000	1,000	[SL]A3; Reaffirmed

Rating action

ICRA Lanka has reaffirmed the issuer rating of Commercial Credit and Finance PLC ("CCFL"/ "The Company") at [SL]BBB (pronounced as S L Triple B) with Stable outlook. ICRA Lanka has also reaffirmed the short-term rating of [SL]A3 for the LKR 1,000 million Commercial Paper Programme of the Company.

ICRA Lanka also has reaffirmed the issue rating of [SL]AA (CE) (pronounced as S L double A credit enhancement) with a Stable outlook for the LKR 2,000 Mn (LKR 1,288 Mn outstanding) Guaranteed Senior Redeemable Debenture programme of the Company. The letters CE in parenthesis suffixed to a rating symbol stand for Credit Enhancement. A CE rating is specific to the rated issue, its terms, and its structure. The CE ratings do not represent ICRA Lanka's opinion on the general credit quality of the issuers concerned.

Rationale

The reaffirmation of the ratings with a Stable outlook factors in the improved asset quality indicators and the increase in the asset-backed exposure of the portfolio. CCFL's gross NPA ratio improved to 5.42% as on Mar-21 from the post Covid gross NPA ratios of 9.14% as on Dec-20 and 9.92% as on Mar-20. ICRA Lanka notes that, the GNPA ratio has increased to 6.39% in Jun-21 due to the increase in the NPA levels within the pawning portfolio, however improved to 6.28% by Jul-21. The rating also takes comfort from the increase in asset backed portfolio over the last 3 years; about 95% of the portfolio was asset-backed as on Jun-21, compared to 68% asset-backed exposure as on Mar-18. Furthermore, the ratings continue to factor in CCFL's established business presence in Sri Lanka, the experienced Senior Management team and the adequate capital structure.

ICRA Lanka takes cognisance of the risk profile of the company as it is exposed to customer segments with modest credit profiles who are highly vulnerable to economic cycles. Going forward, CCFL expects to focus on 3W and 2W leasing together with gold loans while curtailing other unsecured lending. CCFL's ability to maintain healthy asset quality indicators would be a key monitorable.

The rating for the Guaranteed Senior Redeemable Debentures is based on the strength of the unconditional and irrevocable guarantee from Hatton National Bank PLC (HNB) covering the principal and two interest instalments (annual) of the issue. The guarantor undertakes the obligation to pay, on demand from the Trustee, LKR 1,288 Million (of LKR 2,000 Mn rated), being the total principal sum, and two yearly interest instalments of the Senior Redeemable Debentures. The rating also assumes that the guarantee will be duly invoked by the Trustee, as per the terms of the underlying Trust deed and guarantee agreement, in case there is a default in payment by CCFL (Issuer).

Outlook: Stable

The "Stable" outlook reflects the continued improvement of the asset quality indicators of the Company and factors in the increase in exposure to asset-backed lending. The outlook may be revised to "Negative in case of deterioration in the Company's asset quality levels or weakening profitability. The outlook may be revised to "Positive" in case of an improvement in the earnings profile and asset quality indicators of the Company.

Key rating drivers

Credit Strengths

Established franchise and experienced senior management team: CCFL has 120 branches across the island. It is one of the larger non-banking financial institutions in Sri Lanka with an asset base of LKR 91 Bn as on Mar-21. CCFL's net lending portfolio stood at LKR 75 Bn as in Mar-21 (LKR 66 Bn in Dec-20) with a composition of 73% in leasing, 10% in loans, 14% in gold loans and 4% in microfinance. CCFL's current focus is on 2W, 3W leasing and gold loans which collectively accounted for 77% of the portfolio as on Mar-21. Furthermore, the promoter/CEO and the senior management team are experienced professionals in the financing business.

Improved asset quality indicators compared to the sector outlook: CCFL's gross NPA ratio improved to about 6.28% as on Jul-21 from 6.39% as on Jun-21 and 9.14% as on Dec-20. The improved GNPA ratio is on account of the management's focused effort in collection and recoveries, together with sizable write offs. CCFL wrote off about LKR 1.6 Bn in FY2021 mainly from the discontinued portfolio and Trade Finance's leasing & HP portfolio. Further, higher GNPA ratios are present in asset classes related to SME/ business lending, which the company has currently curtailed. The core leasing portfolio reported a GNPA of 5.14% as in Mar-21, vis-à-vis 7.57% in Mar-20, while the gold loan portfolio reported a GNPA of 0.18% as in Mar-21. The collection levels remained healthy at around 80% with high collections levels noted in Jul-21. Improvements in delinquency levels were noted in Jul-21, with 90+ days recovery efforts being somewhat successful in controlling the slippages into the 180+ days bucket.

Increasing exposure to asset-backed lending: CCFL's portfolio has shifted over the past years, where asset backed lending accounted for about 94% of the total portfolio as in Mar-21, compared to about 68% as on Mar-18. CCFL had a ~18% exposure to Micro-Finance as in Mar-18 which has been reduced to just LKR 2.69 Bn (4% of the total portfolio) as in Mar-21. The company has curtailed its SME and business lending amidst the adverse impacts faced by the segment following the continuous macro-challenges since FY2018. Going forward, CCFL will focus on 3W, 2W leasing and gold loans and these 3 products collectively accounted for 77% of the portfolio as on Mar-21. Notwithstanding the increase in asset backed exposures (resulting in improvements in the portfolio risk profile), ICRA Lanka notes that the company is exposed to relatively vulnerable client segments.

Healthy Capitalization Profile: As on Mar-21, CCFL reported a core capital of LKR 13,016 Mn against a regulatory minimum requirement of LKR 2,000 Mn. In terms of risk-weighted capital adequacy ratios, the core capital and the total capital ratio stood at 13.46% and 14.55% as on Mar-21 (13.14% and 13.31% respectively as on Dec-20) as compared with the regulatory requirement of 6.50% and 10.50%. Going forward, it will be important for the company to maintain a healthy capitalization profile as it intends to grow its 3W, 2W and gold loan portfolios.

Credit challenges

Profitability and margins likely to remain moderate: The Net Interest Margin ("NIM") has moderated over the period as a result of the portfolio's shift away from the high yielding unsecured products such as microfinance and SME lending, towards more secured lending product categories including leasing and gold loans. Combined with the sharp decline in the systemic interest rates and the debt moratorium, CCFL's NIM rose to 10.47% in Jun-21 vis-à-vis 9.98% in Mar-21 and 12.93% in Mar-20. The credit cost (Provisioning/ATA) slightly increased to 2.86% in Jun-21 from 1.87% in FY21 (2.75% in FY20). On account of the reduction in other operating expenses due to cost efficiencies, the operating expenses/ATA moderated to 6.41% in Jun-21 vis-à-vis 6.93% in FY21 and 8.45% in FY20. Overall, the profitability in terms of ROA (on PBT) moderated to 3.11% in Jun-21 vis-à-vis 3.53% in FY21. Going forward, it will be crucial for the company to manage its credit costs and operating expenses, as the room for core lending margin expansion will be limited in the short term.

Analytical approach: For arriving at the ratings, ICRA has applied its rating methodologies as indicated below.
Links to applicable criteria: [ICRA Lanka's Credit Rating Methodology for Non-Banking Financial Institutions]

About the Company:

CCFL, a registered finance company, offers leasing, hire purchase, business credit facilities, microfinance, factoring, term loans and other personal loans apart from accepting deposits (fixed and savings). The Company was established in 1982 as a specialized leasing company in Kandy. In October 2009, BG Investments (Pvt) Ltd. acquired the controlling stake of the Company. Since the change of ownership, the Company has rapidly expanded its service locations to 120 from about 22 in FY2012. The Company has an employee base of about 2,800. CCFL's shares were listed on the Dirisavi Board (secondary board) of the CSE in June 2011. The Company witnessed investments from the impact investor, Creation Investment Sri Lanka LLC in March 2014 and regional NBFI, Group Lease Holdings Pte Ltd in December 2016. As of March 2021, BG Investment (Pvt) Ltd held 50.25% of the shares, while Group Lease Holdings Pte Ltd. held 29.99%, Creation Investments owned about 8.67%. During FY2015, the Company acquired the majority stake in Trade Finance and Investments PLC, and subsequently on 31st December 2020, Trade Finance and Investments PLC was amalgamated with CCFL.

During the financial year ended March 31, 2021, CCFL reported a net profit of LKR 2,335 Mn on a total asset base of LKR 91,130 Mn, compared to the net profit of LKR 1,664 Mn on a total asset base of LKR 80,360 Mn during the financial year ended March 31, 2020. For the 3M ended June 30, 2021, CCFL reported a net profit of LKR 517 Mn on a total asset base of LKR 88,838 Mn.

Guarantor Profile:

Hatton National Bank PLC

Hatton National Bank PLC (HNB) is one of the larger private sector commercial banks in the country with total assets amounting to LKR 1,337 Bn as at June 30, 2021. The Bank was incorporated in the present form in the year 1970. Stassen's group with 14.8%, Browns Investments PLC with 10.0%, Employees Provident Fund, with 9.8% and Sri Lanka Insurance Corporation Ltd with 8.8% stake, are the major shareholders of the Bank. During 6MCY2021, HNB reported a PAT of LKR 9 Bn on a total asset base of LKR 1,337 Bn, compared to a PAT of LKR 11 Bn on a total asset base of LKR 1,292 Bn in CY2020. The Bank witnessed a moderation of NIM during 6MCY2021, to about 3.52% from about 3.70% in CY2020 and 4.45% in CY2019. Overall profitability has improved during the period with ROA (PAT/ATA) increasing from about 0.95%

in CY2020 to 1.38% in 6MCY2021. HNB reported a gross NPA of 4.25% as on Jun-21 in comparison to 4.31% as on Dec-20 and 5.91% as on Dec-19.

Key financial indicators of CCFL

	FY2019	FY2020	FY2021	3MFY2022*
Net Interest Income	10,856	9,373	9,035	2,355
Profit after Tax	2,079	1,664	2,335	517
Reported net worth	11,987	13,317	15,396	15,913
Loans and Advances	60,855	61,615	68,567	68,131
Total Assets	80,111	80,360	91,130	88,838
Return on Equity	17.14%	13.15%	15.62%	13.20%
Return on Assets[1]	2.54%	2.07%	2.58%	2.30%
Gross NPA ratio	6.51%	9.92%	5.42%	6.39%
Net NPA ratio (based on IFRS provisioning)	-0.41%	2.54%	-2.71%	-2.45%
Core CAR	13.02%	14.14%	13.46%	
Adjusted Gearing (times)[2]	5.44	4.84	4.89	4.47

*Unaudited

Rating history for the last three years:

Instrument	Current Rating			Chronology of Rating History for the past 3 years		
	Amount Rated (LKR Mn)	Outstanding Amount (LKR Mn)	Date & Rating FY2022	Date & Rating FY2021	Date & Rating FY2021	Date & Rating FY2021
			Sep-21	Apr-21	Feb-21	Aug-20
Issuer rating	N/A	N/A	[SL]BBB (Stable)	[SL]BBB (Stable)	[SL]BBB (Negative)	[SL]BBB (Negative)
Commercial Paper Programme	1,000	1,000	[SL]A3	[SL]A3	[SL]A3	[SL]A3
Guaranteed Redeemable Debentures Programme	2,000	1,288	[SL]AA (CE) (Stable)	[SL]AA (CE) (Stable)	[SL]AA (CE) Stable	-

[1] Return on Assets: PAT/ Average Total Assets

[2] Gearing adjusted for revaluation reserves and deferred tax assets

ICRA LANKA

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