

## ICRA Lanka revises the outlook of Citizens Development Business Finance PLC to Stable from Negative

January 18, 2022

Instrument*	Rated Amount (LKR Mn)	Outstanding Amount (LKR Mn)	Rating Action
Issuer Rating	N/A	N/A	[SL]BBB+; Outlook revised to Stable from Negative
Subordinated, Unsecured, Listed Redeemable Debentures Programme	1,075	1,075	[SL]BBB; Outlook revised to Stable from Negative
Subordinated, Unsecured, Listed Redeemable Debentures Programme	928	928	[SL]BBB; Outlook revised to Stable from Negative
Subordinated, Unsecured, Listed Redeemable Debentures Programme	2,000	2,000	[SL]BBB; Outlook revised to Stable from Negative
Subordinated Guaranteed Listed Redeemable Debentures Programme	1,000	-	[SL]A-(SO) (Stable); Withdrawn
Trust Certificates Programme of Citizens Development Business Finance PLC Trust-03	628	-	[SL]A-(SO); Negative Outlook; Withdrawn
<b>Total</b>	<b>5,631</b>	<b>4,003</b>	

### Rating action

ICRA Lanka Limited has reaffirmed the issuer rating of Citizens Development Business Finance PLC (CDB or the Company) at [SL]BBB+ (pronounced SL triple B plus). ICRA Lanka has also reaffirmed the issue ratings of [SL]BBB (pronounced SL triple B) for the LKR 2,000 Mn, LKR 1,075 Mn and LKR 928 Mn subordinated, unsecured, listed, redeemable debentures programmes of the Company. The outlook on all the ratings have been revised to Stable from Negative.

The issue rating of [SL]A-(SO) (pronounced SL A minus structured obligation) with Stable outlook for the LKR 1,000 Mn subordinated guaranteed listed redeemable debentures of the Company, guaranteed by Seylan Bank PLC (Seylan) has been withdrawn as the said debentures have matured and there is no amount outstanding against the rated instrument. The issue rating of [SL]A-(SO) (pronounced SL A minus structured obligation) with Negative outlook for the LKR 628 Mn Trust Certificates Programme of Citizens Development Business Finance PLC – Securitization 03 was withdrawn, as the same had matured and there is no amount outstanding against the rated instrument.

### Rationale

The outlook revision factors in the improvements in the capital profile of CDB. The Tier 1 and Total capital adequacy ratios (CAR) stood at 12.88% and 15.90%, respectively, in Sep-21 vis-à-vis 12.10% and 15.34%, respectively, in Mar-21; same is above the regulatory limits of 7.0% and 11.0%. CDB's gearing (adjusted for re-valuation reserves) improved to 5.17 times in Sep-21, compared with 5.71 times in Mar-21 and 7.03 times in Mar-20 mainly due to robust internal generation and an equity infusion of LKR 1.0 Bn in Jun-19 via a rights issue. The outlook revision also factors in the healthy profitability indicators with the RoE and RoA (on PBT) standing at 19.08% and 4.12%, respectively, in 6M FY2022 vis-à-vis 19.97% and 3.01% in FY2021 (18.17% and 2.99% in FY2020). However, the ratings take cognizance of the deterioration in delinquency in the 90+ days past due (dpd) to 29.2% in Sep-21 (23.7% in Sep-20), whilst the Gross NPA ratio (GNPA%) stood at 7.47% in the same period (the GNPA% stood at 7.0% in Mar-21 and 7.54% in Mar-20). Excluding

re-possessed assets the NPA stood at 6.92% in Sep-21, compared with 6.43% in Mar-21 (5.64% in Mar-20). ICRA Lanka however notes that the Company has not written off any facilities in the past few years, indicating a strong recovery mechanism. The ratings also continue to factor in CDB's established track record, experienced senior management team, and exposures to less risky asset classes.

Despite having a negative ALM mismatch of 4.78% as of Sep-21 (8.22% in Sep-20), the ratings take note of the availability of unutilised bank funding lines of about LKR 12 Bn in Sep-21 and CDB's deposit renewal rates (over 70%); the same provide comfort from a liquidity perspective. Going forward, the ability to maintain healthy earnings, moderate asset quality and leverage indicators, and an adequate capital profile to support portfolio growth, would be crucial from a rating's perspective.

## Outlook: Stable

The Stable outlook reflects the healthy earnings, capital profile and leverage indicators of the Company. The outlook may be revised to "Positive" based on significant improvement in the asset quality indicators, profitability and capitalization. The outlook may be revised to "Negative" in case of further deterioration in the asset quality indicators, weakening in the financial risk profile and/or in the event, the capitalization is insufficient to support portfolio growth.

## Key rating drivers

### Credit strengths

**Established track record and experienced senior management team:** CDB was established in 1995; it has a robust franchise and an experienced management team. CDB has about 71 outlets (including service centres) and about 600+ ATM machines (in alliance with Commercial Bank) across the island as on September 30, 2021. The senior management team holds about 13% stake in the Company and have a proven track record in transforming CDB into one of the larger non-banking financial institutions in the country with an asset base of LKR 93 Bn as of September 2021. The management team has been associated with the Company for over a decade and there has not been any significant attrition in the senior management team over the last 10 years.

**Exposure to relatively safer asset classes moderates the portfolio risk:** About 97% of CDB's portfolio is backed by assets (vehicles/property), with 82% being as lending for vehicles. Cars and vans are the core asset classes and have accounted for about 55-63% of the total portfolio in the recent fiscals. The exposure to 3-wheelers stood at 21% as of Sep-21 vis-à-vis 20% as of Mar-21 (19% as of Mar-20). The Company's loan segment which accounted for about 18% of the total portfolio in Sep-21 (17% in Mar-21), comprised mainly of property backed lending to SME and retail segments (about 2% of total portfolio), gold backed loans (10%), personal loans (2%) and loans against fixed deposits (2%). Going forward, the Company expects to grow its gold loan portfolio to about 15% of the total portfolio, given the relatively safe nature of the asset class and higher yields. The Company will also continue to focus mainly on leasing with exposure to safer asset classes and maintain its portfolio quality.

**Adequate internal controls and risk management systems:** CDB has a comprehensive core-banking system, which seamlessly integrates the key business functions including loan origination, appraisal, monitoring and accounting & finance; thus, enabling timely management information. CDB's branches and its dealer network operate as the primary business generation units and the online channel also provides business leads. In addition, the Company has implemented rigorous processes to evaluate loan eligibility and manage collections. ICRA Lanka also notes that CDB's accounting policies are in line with industry practices combined with adequate provisioning. The internal controls and risk management systems are expected to reduce market and operational risks, going forward.

**Adequate capital profile:** CDB's Tier 1 and Total capital adequacy ratios (CAR) stood at 12.88% and 15.90%, respectively, in Sep-21 (12.10% and 15.34% in Mar-21); same is above the regulatory thresholds of 7.0% and 11.0%. The Company's core capital base had improved due to a rights issue of LKR 1.0 Bn in Jun-19. ICRA Lanka expects that no further equity infusions would be needed in the near to medium term, as internal generation is sufficient to support the envisaged portfolio growth (5-15% in the next 3 years), whilst maintaining an adequate buffer (2%) to the Tier-1 minimum requirement. As of Sep-21, CDB's gearing had improved to 4.96 times, compared with 5.47 times in Mar-21 and 6.68 times in Mar-20. Gearing adjusted for revaluation, stood at 5.17 times in Sep-21, compared with 5.71 times in Mar-21 (7.03 times in Mar-20).

**Healthy profitability indicators:** The company's NIM improved to 8.28% in the 6M ended Sep-21, compared with 8.10% in FY2021 and 7.17% in FY2020, mainly due to a reduction in the cost of funds (7.98% in 6M FY2022 vis-à-vis 9.46% and 11.73% in FY2021 and FY2020, respectively). CDB's fee and non-interest income (as a % of ATA) stood at 2.67% in 6M FY2022 (compared with 1.82% in FY2021 and 1.89% in FY2020). The cost to income ratio stood at 41.54% in 6M FY2022 (41.19% in FY2021 and 48.81% in FY2020) due to cost savings in operating expenses and higher operating income. Further, credit costs (provisions/ATA) stayed stable at 1.52% in 6M FY2022 (1.52% in FY2021 and 1.70% in FY2020) benefitting the earnings profile. Hence, CDB was able report a RoE and RoA (on PBT) of 19.08% and 4.88%, respectively in the 6M FY2022, compared with a RoE and RoA (on PBT) of 19.97% and 4.36% in FY2021 (in FY2020, the same stood at 18.17% and 2.99%, respectively). Going forward, CDB's ability to manage its credit costs and operating expenses, would be the key drivers of profitability.

## Credit challenges

**Asset quality indicators remain elevated; higher provisioning helps to offset the credit risk:** As of Sep-21, the Company's gross NPA ratio (GNPA) stood at 7.47%, compared with 7.0% in Mar-21 and 7.54% in Mar-20; the same is below the sector average which stood at 12.66%, 11.31% and 11.56%, in the same periods respectively. The NBFIs sector has witnessed a deterioration in asset quality over the past two years due to subdued economic conditions due to the Covid-19 pandemic. ICRA Lanka expects CDB's GNPA ratio to remain in the range of 7.0-8.0% in the near term, similar to the recent past. Asset class-wise cars and vans (55% of the portfolio), 3-wheelers (21%) and commercial vehicles (4%) recorded GNPA ratios of 4.4%, 9.2% and 19.5%, respectively, in Sep-21. For the loans category (18% of the portfolio) same was around 19.5%, stemming from the poorer asset quality in the business loans segment. ICRA Lanka notes that the delinquencies in the 90+ dpd had increased to 29.2% as of Sep -21 vis-à-vis 23.7% in Sep-20 (19.1% in Dec-19). However, CDB has not written off any facilities in the past few years and have instead relied on good collections and recovery efforts; the higher used vehicles prices recently have also been supportive of recoveries. Moreover, a rise in provision coverage to 77.3% as in Sep-21 from 69.1% in Mar-21 (45.7% in Mar-20), provides comfort in terms of credit losses, going forward.

**Mismatches in the short-term maturity buckets remain, however good deposit renewal rates provide comfort:** CDB's funding profile stood at about LKR 75 Bn with 61% exposure to fixed deposits in Sep-21 (60% in Mar-21). The other exposures include long term bank loans (25% of total funding), debentures (7%), and savings deposits (4%). CDB's ALM profile is characterized by cumulative negative mismatches in the < 1-year bucket of 4.78% as in Sep-21 (8.22% as of Sep-20) because of the near-term maturity profile of its deposits, against the longer tenure portfolio. However, a good deposit renewal rate (over 70%) and the availability of unutilized funding lines of about LKR 12 Bn in Sep-21, provide comfort on the overall liquidity profile.

**Analytical approach:** For arriving at the ratings, ICRA has applied its ratings methodologies as indicated below:

**Links to applicable criteria:** [ICRA Lanka's Credit Rating Methodology for Non-Banking Finance Companies](#)

### Company Profile:

Citizens Development Business Finance PLC, a registered finance company, offers leasing, hire purchase, mortgage loans, gold loans and other personal loans apart from accepting deposits (fixed and savings). The Company was established in 1995 as Ceylinco Development Bank Limited. In 2009 CDB was registered under the Finance Companies Act and re-branded as Citizens Development Business Finance PLC. It was listed on the Colombo Stock Exchange in September 2010. As of Sep-21 CDB's largest shareholders were Ceylinco Insurance PLC (with an effective holding of 40%), Janashakthi group (about 10%) and CDB's corporate management (about 13%). The Company acquired controlling stake in Unison Capital Leasing (UCL, previously known as Laughs Capital Limited) in October 2014. Under the financial sector consolidation programme of the Central Bank of Sri Lanka (CBSL), the subsidiary UCL was merged with the Company on May 18, 2020.

During the year ended March 31, 2021, CDB reported a net profit of LKR 2,557 Mn on a total asset base of LKR 94.3 Bn, compared to a net profit of LKR 1,837 Mn on a total asset base of LKR 93.2 Bn in the previous fiscal year.

For the six months ended September 30, 2021, CDB reported a net profit of LKR 1,389 Mn on a total asset base of LKR 92.7 Bn.

### CDB - Key financial indicators (Audited)

LKR Mn	FY2020	FY2021	6M FY2022*
Net Interest Income	6,639	7,595	3,872
Profit after Tax	1,837	2,557	1,389
Net worth	11,556	14,052	15,067
Loans and Advances	72,423	75,058	74,081
Total Assets	93,195	94,331	92,684
Return on Equity	18.17%	19.97%	19.08%
Return on Assets	2.01%	2.73%	2.97%
Gross NPA	7.54%	7.00%	7.47%
Net NPA	4.24%	2.23%	1.76%
Total CAR	13.29%	15.34%	15.90%
Gearing (times)	6.68	5.47	4.96
Adjusted Gearing (times)	7.03	5.71	5.17

\*Unaudited

## Rating history for last three years: Citizens Development Business Finance PLC

Instrument	Amount Rated (LKR Mn)	Outstanding Amount (LKR Mn)	Current Rating	Chronology of Rating History for the past 3 years			
			FY2022	FY2021	FY2020	FY2019	
			Jan-22	Apr-20	Oct-19	Oct-18	
Issuer rating	N/A	N/A	[SL]BBB+ (Stable)	[SL]BBB+ (Negative)	[SL]BBB+ (Negative)	[SL]BBB+ (Negative)	
Subordinated unsecured redeemable debentures	928	928	[SL]BBB (Stable)	[SL]BBB (Negative)	[SL]BBB (Negative)	[SL]BBB (Negative)	
Subordinated unsecured redeemable debentures	2,000	2,000	[SL]BBB (Stable)	[SL]BBB (Negative)	[SL]BBB (Negative)	[SL]BBB (Negative)	
Subordinated unsecured redeemable debentures	1,250	1,075	[SL]BBB (Stable)	[SL]BBB (Negative)	[SL]BBB (Negative)	N/A	
Subordinated guaranteed redeemable debentures	1,000	-	[SL]A- (SO) (Stable); Withdrawn	[SL]A- (SO) (Stable)	[SL]A- (SO) (Stable)	[SL]A- (SO) (Stable)	
Trust Certificates Programme	628	-	[SL]A- (SO) (Stable); Withdrawn	[SL]A- (SO) (Negative)	[SL]A- (SO) (Negative)	[SL]A- (SO) (Negative)	





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