ICRA Lanka reaffirms the ratings of Citizens Development Business Finance PLC

April 28, 2020

Instrument*	Previous Rated Amount (LKR Mn)	Current Rated Amount (LKR Mn)	Rating Action
Issuer Rating	N/A	N/A	[SL]BBB+ (Negative); reaffirmed
Subordinated, Unsecured, Listed Redeemable Debentures Programme	1,075	1,075	[SL]BBB (Negative); reaffirmed
Subordinated, Unsecured, Listed Redeemable Debentures Programme	928	928	[SL]BBB (Negative); reaffirmed
Subordinated, Unsecured, Listed Redeemable Debentures Programme	2,000	2,000	[SL]BBB (Negative); reaffirmed
Subordinated Guaranteed Listed Redeemable Debentures Programme	1,000	1,000	[SL]A-(SO) (Stable); reaffirmed
Total	**5,003**	**5,003**	

Rating action

ICRA Lanka Limited, subsidiary of ICRA Limited, a group company of Moody's Investors Service, has reaffirmed the issuer rating of Citizens Development Business Finance PLC (CDB or the Company) at [SL]BBB+ (pronounced SL triple B plus). The outlook on the rating continues to be Negative. ICRA Lanka has also reaffirmed the issue ratings of [SL]BBB (pronounced SL triple B) with Negative outlook for the LKR 2,000 Mn, LKR 1,075 Mn and LKR 928 Mn subordinated, unsecured, and listed redeemable debentures programmes of the Company.

Further, ICRA Lanka has reaffirmed the [SL]A-(SO) (pronounced SL A minus structured obligation) rating with Stable outlook for the LKR 1,000 Mn subordinated guaranteed listed redeemable debentures of the Company, guaranteed by Seylan Bank PLC (Seylan). The rating for the subordinated guaranteed redeemable debentures programme is based on the strength of the unconditional and irrevocable guarantee from Seylan Bank PLC (Seylan) covering the principal and two interest instalments (semi-annual) of the rated issue. The guarantor undertakes the obligation to pay, on demand from the trustee, the total principal sum of LKR 1,000 Mn and, two half yearly interest instalments of the proposed 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 CDB.

Rationale

The ratings factor in CDB's established track record, experienced senior management team, and exposure to relatively less risky asset classes. The ratings factor in the improvement in the capital profile, with the Tier 1 and Total capital adequacy ratios (CAR) standing at 9.46% and 13.41% in Dec-19 vis-à-vis 8.09% and 11.07%, respectively, in Mar-19; same is above the regulatory thresholds of 6.50% and 10.50%. CDB's gearing (adjusted for revaluation reserve) improved to 7.6 times in Dec-19, compared with 9.5 times in Mar -19, largely due to the equity infusion of about LKR 1.0 Bn in Jun-19 via a rights issue programme. Further, the Company was able to secure Tier 2 capital in 9M FY2020, via debenture issues amounting to LKR 928 Mn and LKR 1,075 Mn. However, the ratings note the moderation in profitability, largely due to increasing credit costs; RoE and RoA stood at 13.8% and 1.5% in 9M FY2020, compared with 21.6% and 2.1%, respectively, in FY2019 (20.9% and 2.2% in FY2018). CDB's gross NPA ratio (GNPA%) increased to 7.5% as of Dec-19 vis-à-vis 6.7% in Mar-19 (3.1% as of Mar-18), while delinquencies in the 90 + day past due (dpd) increased to 19.7% vis-à-vis 15.3% (11.2% as of Mar-18), due to on-going macro challenges. Excluding repossessed assets, the NPA stood at 5.4% as of Dec-19, compared with 4.1% in Mar-19 (2.0% in Mar-18).

ICRA Lanka further takes cognizance of the Company's sizable asset liability mismatches in the short-term because of the dependence on short-term public deposits. Nonetheless, the availability of unutilized funding of about LKR 14 Bn provide comfort from a liquidity perspective. Going forward, the Company's ability to maintain a comfortable risk adjusted capital profile to support portfolio growth, and ability to improve its asset quality and earnings profile would be crucial from a ratings perspective.

Outlook: Negative

The outlook may be revised to "Stable" based on CDB's ability to improve its asset quality profile while achieving healthy profitability indicators and capitalization. The ratings may be downgraded in case of further deterioration in the asset quality indicators leading to weakening in the earnings profile from current levels, or in case the Company is unable maintain sufficient capital to support the envisaged 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 December 31, 2019. The Company is one of the relatively larger non-banking financial institutions in the country with an asset base of LKR 90 Bn as of December 2019. The senior management team holds about 13% stake in the Company and are experienced professionals in the retail financing business. 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 6-7 years.

Exposure to relatively less risky asset classes: About 97% of CDB's portfolio is backed by assets (vehicles/property), with 83% being as lending for vehicles. Cars and vans have accounted for about 58% of the total portfolio in Dec-19, compared with about 62% in Mar-19. CDB's exposure to 3-wheelers stood at 19% as of Dec-19 vis-à-vis 16% as of Mar-19 (16% as of Mar-18). Cars and vans are the core asset classes of CDB, while relatively risky 3-wheelers are expected to account for around 15-20% of the total portfolio going forward. The Company's loan segment, which accounted for 16% of the total portfolio as of Dec-19 (14% as of Mar-19), largely comprised of property backed lending to SME and retail segments (about 3% of total portfolio), gold backed loans (6%), personal loans (3%) and loans against fixed deposits (2%). Going forward, the Company expects to grow its gold loan portfolio to 10% of the total portfolio, given the relatively safe nature of the asset class and higher yields. The envisaged portfolio mix is expected to be about 80% motor and 20% non-motor going forward.

Efficient 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. The efficient internal controls and risk management systems are expected to reduce market and operational risks.

Credit challenges

Improved capital profile; nonetheless, capital ratios may remain moderate: CDB's Tier 1 and Total capital adequacy ratios (CAR) stood at 9.46% and 13.41%, respectively in Dec-19 vis-à-vis 8.09% and 11.07% in Mar-2019; same is above the regulatory thresholds of 6.50% and 10.50%. Company's core capital base has improved due to a rights issue of LKR 1.0 Bn in Jun-19. CDB has also taken initiatives to secure Tier 2 capital via debenture issues of LKR 928 Mn and LKR 1,075 Mn in Jan-19 and Nov-19, respectively. Going forward, it is estimated by ICRA Lanka that no further equity infusions would be needed, as internal generation is sufficient to support the envisaged portfolio growth of about 10% or less, whilst maintaining an adequate buffer (2%) to the Tier 1 minimum requirement. As of Dec-19, CDB's gearing improved to 7.2 times compared with 8.8 times in Mar-19 and 8.9 times in Mar-18 (sector average is about 6-7 times). Gearing adjusted for revaluation, stood at 7.6 times in Dec-19, compared with 9.5 times in Mar-19 (9.5 times in Mar-18). Whilst the current capital ratios are above regulatory thresholds, the Company's ability to maintain a comfortable risk-adjusted capital profile as it reaches an asset size of LKR 100 Bn, would be a key monitorable going forward.

Deteriorated asset quality: CDB's delinquencies in the 90+dpd increased to 19.1% as of Dec-19, from 15.3% as of Mar-19 and 11.2% as of Mar-18. The Company's gross NPA ratio (GNPA) stood at 7.5% as of Dec-19, lower than the Non-Bank Financial Sector average of about 11%. However, the same has increased from 6.7% as of Mar-19 and 3.1% as of Mar-18. The GNPA% when adjusted for repossessed stock stood at 5.4%, 4.1% and 2.0% in the same periods, respectively. The increased slippages that were witnessed are largely due to the lagging effects of macro-economic challenges, which have affected the disposal income of its borrowers. Asset class wise, cars and vans (58% of total net portfolio), 3-wheelers (19%), lorries (4%), and tractors (1%), recorded gross NPAs of 3.7%, 6.0%, 15.4% and 25.6% respectively, as in Dec-19; the other loans portfolio recorded about 12.1% gross NPA in the same period. CDB's collateralized nature of lending (about 97% of portfolio is asset backed as of Dec-19) provides comfort with regard to the recoverability of NPA facilities. Going forward, the Company's ability to curtail future slippages, while recovering from the current NPA portfolio would be crucial

Moderation in profitability indicators: Company's RoA moderated to 2.1% in FY2019 vis-à-vis 2.2% in FY2018; same decreased further to 1.5% in 9M FY2020. The moderation in profitability is largely on account of the sharp increases in credit costs (provisions/ATA stood at 1.7% in 9M FY2020 vis-à-vis 1.3% in FY2019 and 0.6% in FY2018), due to the deterioration in the asset quality of the portfolio. Company's NIM improved to 6.8% as of Dec-19 vis-à-vis 6.3% as of Mar-19 (5.3% in Mar-18), due to an increase in lending yields to about 21.6% in 9M FY2020 (20.9% in FY2019) and moderation in the cost of funds (11.8% in 9M FY2020 vis-à-vis 12.8% in FY2019). However, CDB's fee and non –interest income (as % of ATA) moderated to 1.7% in the 9M FY2020 (compared with 2.5% in FY2019 and 2.6% in FY2018). The operating expenses/ATA increased to about 5.0% in FY2019 vis-à-vis 4.7% in FY2018; although same has reduced to 4.5% in 9M FY2020 due the reduction of expenditures related to promotions and recruitment. Going forward, CDB's ability to manage credit costs and operating expenses would be the key drivers of profitability.

Mismatches in the short- term maturity buckets remain, however good deposit renewal rates and availability of funding lines provide comfort: CDB's total debt stood at about LKR 76 Bn with 58% exposure to fixed deposits in Sep-19 (59% in Mar-19). The exposure to FDs has moderated from about 66% as of Mar-18, largely because of an increase in long term bank funding (28% as of Sep-19 vis-à-vis 20% as of

Mar-18). The other exposures included debentures (5% of total funding), securitised borrowings (4%) and savings deposits (3%). CDB's ALM profile is characterized by cumulative negative mismatches in the < 1-year bucket of 14.3% as of Sep-19 (9.9% as of Mar-19 and 14.9% as of Mar-18) due to the near-term maturity profile of its deposits, against the relatively medium-long term lending portfolio. However, a good deposit renewal rate (over 70%) and the availability of unutilized funding lines and excess liquid funds of about LKR 14 Bn in Feb-20, provide comfort on the overall liquidity profile.

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:

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 Dec-19, CDB's largest shareholders were Ceylinco Insurance PLC (with an effective holding of 40%), Janashakthi group (about 17%) and CDB's corporate management (about 13%). The Company operates 71 outlets (including service centres) and has access to over 600 ATMs (in alliance with Commercial Bank) across the island as of December 2019. The Company acquired controlling stake in Unison Capital Leasing (UCL, previously known as Laughs Capital Limited) in October 2014 and currently holds about 90.4% shares of the Company. Under the financial sector consolidation programme of the Central Bank of Sri Lanka, Company is currently in the process of merging with its subsidiary UCL; process is expected to complete by March FY2020.

During the year ended March 31, 2019, CDB (stand-alone) reported a net profit of LKR 1,710 Mn on a total asset base of LKR 89.4 Bn as compared to net profit of LKR 1,401 Mn on a total asset base of LKR 75.5 Bn in the previous fiscal year.

For the nine months ended December 31, 2019, CDB reported a net profit of LKR 989 Mn on a total asset base of LKR 90.3 Bn.

Guarantor Profile:

Seylan Bank PLC (Seylan) is a commercial bank in Sri Lanka with total assets of LKR 516 Bn as of Dec-19. Seylan accounted for 4.1% of the banking industry assets, 4.8% of the sector loans and advances and 4.4% of sector deposits as of December 31, 2019. Seylan commenced operations as a licensed commercial bank in 1987. Major institutional shareholders (voting shares) include, Sri Lanka Insurance Corporation (15%), Brown & Company PLC (13.87%), and Employee Provident Fund (about 10%) .

Seylan recorded a total income of LKR 61,370 Mn for the CY2019 and LKR 54,872 Mn for CY2018 (LKR 49,174 Mn for CY2017). The net profits of Seylan amounted to LKR 3,680 Mn during CY2019 and LKR 3,189 Mn for CY2018 (LKR 4,430 Mn for CY2017), which resulted in RoA (PAT as a proportion of average assets) of 0.75% and 0.73% (1.16% in CY2017) for the respective periods. Seylan had gross NPA ratios of 6.49% as of Dec-19 and 6.55% as of Dec-18 and net NPA ratios of 5.76% and 5.98%, respectively for the said periods. Seylan had a net worth of LKR 44,627 Mn as of December 31, 2019 with a Tier 1 capital adequacy ratio of 11.27% and Total capital adequacy ratio of 14.84%.

CDB - Key financial indicators (Audited)

LKR Mn	FY2018	FY2019	9M FY2020*
Net Interest Income	3,454	5,226	4,561
Profit after Tax	1,401	1,710	989
Net worth	7,152	8,665	10,462
Loans and Advances	59,438	69,133	70,024
Total Assets	75,502	89,432	90,295
Return on Equity	20.9%	21.6%	13.8%
Return on Assets	2.2%	2.1%	1.5%
Gross NPA	3.1%	6.7%	7.5%
Net NPA	0.9%	3.8%	4.2%
Capital Adequacy Ratio	13.9%	11.1%	13.4%
Gearing (times)	8.9	8.8	7.2
Adjusted Gearing (times)	9.5	9.5	7.6

*Unaudited

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

Instrument	Amount Rated (LKR Mn)	Current Amount rated (LKR Mn)	Current Rating			Chronology of Rating History for the past 3 years		
			FY2020			FY2019	FY2018	FY2017
			Mar-20	Sep-19	May-19	Oct-18	Nov-17	Jan-17
Issuer rating	N/A	N/A	[SL]BBB+ (Negative)	[SL]BBB+ (Negative)	[SL]BBB+ (Negative)	[SL]BBB+ (Negative)	[SL]BBB+ (Stable)	[SL]BBB (Stable)
Subordinated unsecured redeemable debentures	1,250	1,075	[SL]BBB (Negative)	[SL]BBB (Negative)	N/A	N/A	N/A	N/A
Subordinated unsecured redeemable debentures	928	928	[SL]BBB (Negative)	[SL]BBB (Negative)	[SL]BBB (Negative)	[SL]BBB (Negative)	N/A	N/A
Subordinated unsecured redeemable debentures	2,000	2,000	[SL]BBB (Negative)	[SL]BBB (Negative)	[SL]BBB (Negative)	[SL]BBB (Negative)	N/A	N/A
Subordinated unsecured redeemable debentures	1,000	1,000	N/A	N/A	N/A	[SL]BBB (Negative)	[SL]BBB (Stable)	[SL]BBB (Stable)
Subordinated guaranteed redeemable debentures	1,000	1,000	[SL]A- (SO) (Stable)	[SL]A- (SO) (Stable)	[SL]A- (SO) (Stable)	[SL]A- (SO) (Stable)	[SL]A- (SO) (Stable)	[SL]A- (SO) (Stable)

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