People's Leasing & Finance PLC

Key Rating Drivers

Intrinsic Profile Drives Rating: People's Leasing & Finance PLC's (PLC) National Long-Term Rating is driven by its standalone profile and reflects its established position as one of Sri Lanka's largest finance and leasing companies (FLC) and benefits to its credit profile from its links with its 75% parent, People's Bank (Sri Lanka) (PB; AA+(lka)/Negative); Sri Lanka's second-largest and fully state-held commercial bank. These strengths are counterbalanced by higher-risk exposures that render PLC's asset quality more susceptible to operating conditions.

Extraordinary Support Limited: Fitch Ratings does not give credit to potential extraordinary support from the parent. The deterioration in the sovereign's credit profile, as reflected in its 'B-'/Negative rating, has diminished the likelihood of extraordinary sovereign support to PLC.

An uplift to PLC's ratings is also not merited by factors that underpin institutional support, which are based on PB's intrinsic credit strength, because of its large size relative to the bank's equity. An improvement in PB's intrinsic credit strength could lead to a reassessment of institutional support considerations.

Declining Loan Quality: We expect asset-quality risk for PLC to remain high in light of the deteriorating operating environment. PLC's reported regulatory gross non-performing loan ratio based on six-month arrears rose to 9.1% in the financial year ended March 2020 (FY20), from 4.6% in FY19, and its impaired loans (based on stage 3 loans that are 90 days past due) soared to 20.4%, from 9.5% in FY19, amid a sluggish economy that was exacerbated by the April 2019 terrorist attacks.

Downside Risk to Leverage: We see the risk of capital impairment should operating conditions worsen relative to our expectations, with the deterioration in asset quality in FY20 already reducing capital buffers. An improvement in PLC's leverage – indicated by debt/tangible equity falling to 4.0x in FY20, from 4.3x in FY19 – provides some buffer for loss absorption.

Rating Sensitivities

Limited Upside: An upgrade of PLC's National Long-Term Rating is not probable in the near term due to the pressure on the sovereign rating and operating environment. In the medium-to-longer term, an upgrade would hinge on a meaningful strengthening of the operating environment leading to a significant improvement in PLC's financial profile, assuming its existing rating strengths are sustained.

Stronger Sovereign Rating: A higher sovereign rating, indicating an improved ability of the sovereign to provide extraordinary support, may result in a higher support-driven rating for PLC, assuming that Fitch believes the parent remains motivated to provide such support. However, such an outcome is not probable in the near term because of the pressure on the sovereign rating.

Weaker Operating Conditions: PLC's ratings are most sensitive to deterioration in the operating environment beyond our base-case expectation, which could further weaken its key credit metrics, particularly those related to profitability, capitalisation and leverage. This could arise through a structural deterioration in asset quality that leads to sustained losses and capital impairment, or if funding access is significantly limited.

Ratings

National

National Long-Term Rating	A+(lka)

Sovereign Risk

Long-Term Foreign-Currency IDR	B-
Long-Term Local-Currency IDR	B-
Country Ceiling	B-

Outlooks

National Long-Term Rating	Stable
Sovereign Long-Term Foreign-Currency IDR	Negative
Sovereign Long-Term Local-Currency IDR	Negative

Applicable Criteria

Non-Bank Financial Institutions Rating Criteria (February 2020)

Bank Rating Criteria (February 2020)

National Scale Rating Criteria (June 2020)

Related Research

Fitch Affirms People's Leasing & Finance at 'A+(lka)'; Outlook Stable (September 2020)

Fitch Revises Outlook on 5 Banks, 1 NBFI in Sri Lanka to Negative; Downgrades PLC; Affirms HNB (January 2020)

Global Economic Outlook - September 2020 (September 2020)

Coronavirus Rating Impact: Global NBFIs (July 2020)

Financial Data

People's Leasing & Finance PLC

	31 Mar 20	31 Mar 19
Total assets (USDbn)	1.0	1.1
Total assets (LKRbn)	186.0	185.9
Total equity (LKRbn)	35.3	33.0

Source: Fitch Ratings

Analysts

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Key Developments

Challenging Operating Environment

Our assessment of the operating environment for Sri Lankan FLCs incorporates the significant economic impact from the pandemic and its negative implications for FLCs' largely sub-prime clientele as well as any extension of motor-vehicle import restrictions. We expect GDP to contract by 1.3% in 2020, then recover in 2021, although growth prospects partly depend on how the pandemic develops in Sri Lanka and globally.

Strong Domestic Franchise

PLC was the market-leading FLC in Sri Lanka until FY18, and still accounted for 12% of sector assets, 13% of loans and 15% of deposits in FY20. With total assets in excess of LKR100 billion, PLC falls under the definition of a 'domestic systemically important licensed finance company' (D-SFLC) and, as such, is required to maintain higher capital buffers. PLC's franchise also benefits from linkages with PB in terms of the common brand and window offices within 90 of PB's branches across the island as at FYE20. It carries out the vehicle-financing business for PB group through its core product offering, with auto leasing and motor loans accounting for 53% and 21% of total gross loans, respectively, in FY20.

Weak Operating Environment Challenges Underwriting

We expect loan growth to remain extremely subdued due to the economic slowdown and PLC's limited appetite for growth in the current operating environment. PLC's FY20 loan growth was just above 0.45%, against 0.66% for the sector, reflecting the impact of the April 2019 terrorist attack and weak economic growth. However, we believe PLC's underwriting standards could come under pressure, since the company would have to assume higher risk if it is to continue to lend, given the weak operating environment and the sub-prime credit profile of its customers.

Non-Performing and Impaired loans on the Rise

PLC remains more exposed to weaker asset quality than some peers due to its high share of commercial-vehicle financing, where repayments are more dependent on economic activity. Its asset-quality position had already weakened in FY20, which did not reflect the full impact of the pandemic. We believe underlying stress will continue to build, despite regulatory relief in the form of a moratorium on loan repayments for affected customers, which, to a large extent, halted the recognition of credit impairments.

Earnings Depressed by Weaker Income and Credit Costs

We expect earnings and profitability to weaken substantially due to depressed income generation and potentially higher credit costs. PLC's pre-tax net income/average assets ratio has decreased due to the sharp rise in loan-impairment charges.

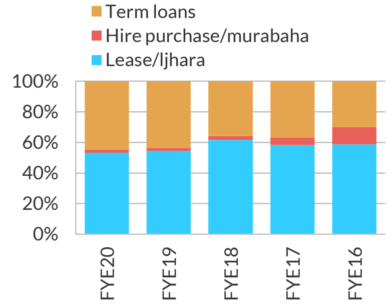
Capital Buffers Eroded by Rising Delinquencies

PLC's capital position in relation to unprovided non-performing and impaired loans has deteriorated significantly, despite a substantial increase in loan loss allowances. Most of its loan book is backed by collateral that could mitigate losses to an extent. Tier I and total capital adequacy ratios stood at 15.1% and 15.9%, respectively, at FYE20, which was above minimum requirements . Being a D-SFLC, PLC is required to maintain higher capital ratios and meet Tier 1 and total capital ratios of 10% and 14%, respectively, by July 2021.

Healthy Funding and Liquidity Among FLCs

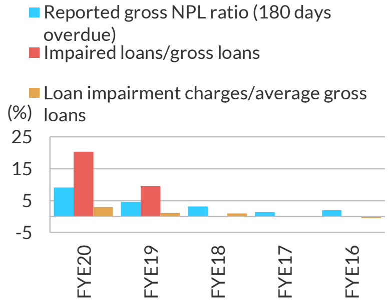
PLC's financial flexibility, as reflected in a larger share of unsecured debt/total debt than peers, is supported by its high and increasing share of deposits. Its funding and liquidity profile benefits from its recognised relationship with PB, which supports the stability of its deposit base and wholesale funding access. PLC's liquidity position could weaken along with that of FLCs in general under the current challenging circumstances.

Loan Book Composition



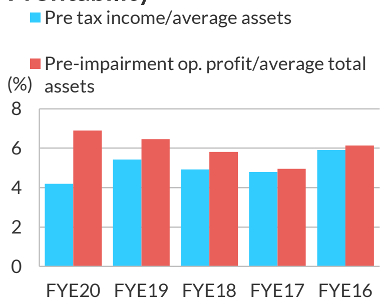
Source: Fitch Ratings, Fitch Solutions, PLC

Asset Quality



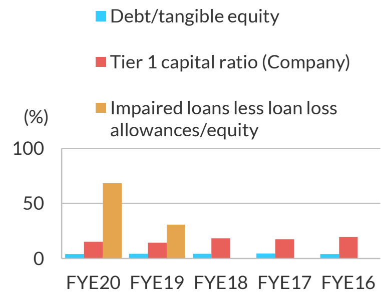
Source: Fitch Ratings, Fitch Solutions, PLC

Profitability



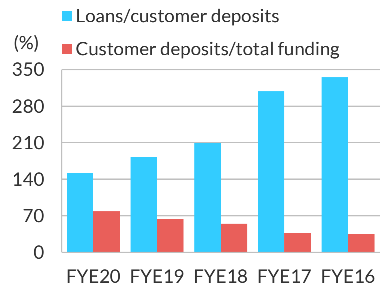
Source: Fitch Ratings, Fitch Solutions, PLC

Capitalisation and Leverage



Source: Fitch Ratings, Fitch Solutions, PLC

Funding and Liquidity



Source: Fitch Ratings, Fitch Solutions, PLC

Summary Financials and Key Ratios

	31 Mar 20		31 Mar 19	31 Mar 18	31 Mar 17	31 Mar 16
	Year end	Year end	Year end	Year end	Year end	Year end
	(USDm)	(LKRm)	(LKRm)	(LKRm)	(LKRm)	(LKRm)
	Audited - unqualified	Audited - unqualified	Audited - unqualified	Audited - unqualified	Audited - unqualified	Audited - unqualified
Summary income statement						
Net interest and dividend income	91	17,189.2	16,359.6	12,982.0	11,016.1	10,344.1
Net fees and commissions	6	1,165.6	1,004.3	819.7	621.7	528.3
Other operating income	11	2,140.9	1,712.5	1,866.7	1,572.4	1,247.3
Total operating income	109	20,495.7	19,076.4	15,668.4	13,210.2	12,119.7
Operating costs	41	7,762.1	7,532.8	6,232.9	5,943.9	4,619.9
Pre-impairment operating profit	68	12,733.6	11,543.6	9,435.5	7,266.3	7,499.8
Loan and other impairment charges	26	4,904.6	1,692.8	1,466.5	282.8	130.4
Operating profit	42	7,829.0	9,850.8	7,969.0	6,983.5	7,369.4
Other non-operating items (net)	-1	-96.2	-145.6	20.2	45.1	7.6
Tax	22	4,141.1	4,693.9	2,971.5	2,587.0	2,635.5
Net income	19	3,591.7	5,011.3	5,017.7	4,441.6	4,741.5
Other comprehensive income	0	79.0	152.0	9.2	-107.3	-18.6
Fitch comprehensive income	19	3,670.7	5,163.3	5,026.9	4,334.3	4,722.9
Summary balance sheet						
Assets						
Gross loans	866	163,304.8	162,232.9	145,148.3	137,260.6	112,814.2
- Of which impaired	176	33,283.9	15,436.0	0.0	0.0	0.0
Loan loss allowances	49	9,169.9	5,277.0	3,233.3	1,790.9	1,657.7
Net loans	817	154,134.9	156,955.9	141,915.0	135,469.7	111,156.5
Interbank	45	8,551.2	10,196.4	12,670.5	6,643.2	0.0
Derivatives	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.
Other securities and earning assets	79	14,928.3	12,138.6	8,802.2	8,308.4	12,184.7
Total earning assets	942	177,614.4	179,290.9	163,387.7	150,421.3	123,341.2
Cash and due from banks	4	669.3	895.6	696.3	553.2	1,868.1
Other assets	41	7,713.6	5,746.2	6,071.9	6,388.9	5,891.5
Total assets	986	185,997.3	185,932.7	170,155.9	157,363.4	131,100.8
Liabilities						
Customer deposits	571	107,685.6	88,923.2	69,377.8	44,465.6	33,677.3
Interbank and other short-term funding	6	1,212.2	12,976.9	11,872.0	206.3	2,037.8
Other long-term funding	149	28,103.9	38,632.5	45,745.9	75,448.3	60,202.1
Trading liabilities and derivatives	n.a.	n.a.	n.a.	0.0	8.4	0.0
Total funding	726	137,001.7	140,532.6	126,995.7	120,128.6	95,917.2
Other liabilities	73	13,685.4	12,418.1	12,306.1	10,310.0	10,409.9
Preference shares and hybrid capital	n.a.	n.a.	n.a.	n.a.	n.a.	103.4
Total equity	187	35,310.2	32,982.0	30,854.1	26,924.8	24,670.3
Total liabilities and equity	986	185,997.3	185,932.7	170,155.9	157,363.4	131,100.8
Exchange rate		USD1 = LKR188.6236	USD1 = LKR176.13	USD1 = LKR155.9	USD1 = LKR151.735	USD1 = LKR143.9

Source: Fitch Ratings, Fitch Solutions

Summary Financials and Key Ratios

	31 Mar 20	31 Mar 19	31 Mar 18	31 Mar 17	31 Mar 16
Ratios (annualised as appropriate)					
Profitability					
Net interest income/average earning assets	9.8	9.6	8.5	8.1	9.0
Non-interest expense/gross revenue	37.9	39.4	39.7	44.7	38.4
Net income/average equity	10.4	15.6	17.7	17.3	20.4
Asset quality					
Impaired loans ratio	20.4	9.5	n.a.	n.a.	n.a.
Growth in gross loans	0.7	11.8	5.8	21.7	13.2
Loan loss allowances/impaired loans	27.6	34.2	n.a.	n.a.	n.a.
Loan impairment charges/average gross loans	3.0	1.1	1.0	0.1	-0.5
Capitalisation					
Tier 1 Capital ratio	15.1	14.4	18.4	17.6	19.6
Tangible common equity/tangible assets	18.8	17.6	17.9	16.9	18.6
Net impaired loans/equity	68.3	30.8	n.a.	n.a.	n.a.
Funding and liquidity					
Loans/customer deposits	151.7	182.4	209.2	308.7	335.0
Customer deposits/funding	78.6	63.3	54.6	37.0	35.1

Source: Fitch Ratings, Fitch Solutions

The ratings above were solicited and assigned or maintained at the request of the rated entity/issuer or a related third party. Any exceptions follow below.