SRI LANKAN BANKING AND NBFI SECTOR

July 15, 2021

ALPEN CAPITAL

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Alpen Capital took views from the top executives of leading Banks and NBFIs of Sri Lanka on their outlook for the Banking / NBFI sector along with the impact of COVID-19 on the sector.

Mr. Lakshman Silva, Director / Chief Executive Officer, DFCC Bank PLC

In view of the recent rating downgrades and concerns regarding the banking sector, what factors will aid the future growth of the sector?

The Sri Lankan economy is mainly driven by sectors such as agriculture, service related businesses, retail and the Micro, Small and Medium Scale Enterprises (MSME) sectors. Creating a conducive environment through stable interest rates and exchange rates are a cornerstone of growth achieved. The banks, as financial intermediaries, support these growth sectors in achieving their objectives in a stable macroeconomic environment. Therefore, it can be said that the banking sector growth can be attributable to the overall economic trajectory of the country. It is noteworthy to mention that the MSME sector will be a key driver of the next phase of the sector growth.

What major challenges is the sector facing?

A continuous subdued economic environment due to macroeconomic aberrations and the resultant asset quality deterioration are the main challenges faced by the banking sector at the moment. The geopolitical events and the sovereign rating downgrades of Sri Lanka also exacerbated the situation. In light of this, it was observed that shareholder capital has been partially utilized to absorb impairment losses and used to support increased capital costs of the portfolios instead of full utilization in business growth. The depressed ROE in the sector has made raising fresh capital challenging.

What impact has COVID-19 had on your bank and the overall sector?

The COVID-19 pandemic has made the already stagnant economy face unprecedented challenges by way of a drop in traditional streams of revenue, mainly from tourism and worker remittances, which resulted in undue pressure on the exchange rate. Continuous lockdowns and restricted business activities also contributed to the worst ever recession in the country in the year 2020 (with GDP growth of -3.6%). To support the government response to the COVID-19 pandemic, the banking industry actively provided moratoriums to the affected sectors, provided interest concessions, and had to manage increased NPLs. Nonetheless, the sector is now poised to take up the growth opportunities that may arise once the pandemic is over, thanks to prudential management of the situation.

Mr. Dimantha Seneviratne, Director / Group Chief Executive Officer, National Development Bank

In view of the recent rating downgrades and concerns regarding the banking sector, what factors will aid future growth of the sector?

It should be noted that no commercial bank in the country has tapped the international bond market for raising funds in recent times and are less reliant on international markets for funding than the sovereign. However, the rating downgrades are expected to have an indirect impact and create some disruption in the short term, especially in relation to trade financing. As trade is inherently about credit facilities, international banks, due to their internal risk matrices are unable to extend the credit they used to. However, as the clients and banks find alternate avenues to bridge the gap in extending credit, activities will normalize. The government's stated goal is to raise financing within the country to fund long term projects; this will be a growth area for the banks, especially in the renewable energy sector.

We see appetite from external parties to finance these projects through banks to ensure better oversight on the financing. The other growth area is the MSME sector which is now supported by programs to enable them to build capacity and relevant understanding to increase their contribution to economic growth. Further, private sector banks are adequately capitalized and any concerns regarding the banking sector is unfounded. The implementation of tax policies will further improve the ability to generate capital internally.

Hence, continued political stability and sustained implementation of current policies especially around increasing manufacturing capabilities, import substitution and establishment of export-oriented industries will give banks the necessary clarity to pursue long term growth.

What major challenges is the sector facing?

In the short term, the challenge that the sector will face is to support its clients to ease out of moratoriums and rebuild a sustainable business. Without this support, banks run the risk of the client slipping into non performing status which can have a far-reaching impact on the sector. Hence, helping the customers deleverage or restructure their debt and adapt their businesses to the new normal will be a new advisory role the banks will have to play. With interest rates at historically low levels, balance sheet management will play a crucial role as banks inherently run a maturity mismatch. Managing net interest margins whilst supporting economic expansion will occupy the time of asset-liability committees (ALCOs) in the banking sector.

What impact has COVID-19 had on your bank and the overall sector?

The main impact on the industry is the slowdown in growth as economic activity came to a standstill in most sectors. However, with the impact of the moratoriums and steps taken to review the economy, assets in the sector grew by 17%, including growth in loans book by 12%. The slowdown in the economy elevated the non-performing loan ratios and consequently led to an increase in provisions. The sector had to absorb the cost of the moratoriums which resulted in negative net interest income growth for the sector as a whole. This saw most banks record a negative bottom-line growth in 2020.

However, at National Development Bank (NDB), we used this slowdown to our advantage to improve on office operations through the introduction of more robotic process automations. We also used the momentum created by the lockdown to increase digital penetration among our customers and promote the national QR based payment platform. The operational effectiveness and efficiency project we ran led to us recording one of the best cost to income ratios in the industry, being the only bank with assets over LKR 500bn to record growth in the bottom-line. We did this whilst ensuring we support the economic recovery of the country and managing the quality of the asset portfolio.

Mr. Nimal R Tillekeratne, Director / Chief Executive Officer, Pan Asia Bank

In view of the recent credit rating downgrades and concerns regarding the banking sector, what factors will aid future growth of the sector?

The COVID-19 pandemic caused and continues to have a multi-faceted impact on the Sri Lankan Banking Sector. The sector's recovery is strongly correlated with the speed of recovery of the Sri Lankan economy. Swift measures enacted by the government helped contain the impact to a certain extent. However, sectors like leisure and transport were hit hard, while collapsing global demand impacted the export-oriented apparel industry. Jobs and earning losses disrupted private consumption and uncertainty impeded investments.

However, enhanced foreign exchange earnings and increased investment inflows are expected to assist the country in reducing its dependence on external debt and improve macroeconomic resilience. These, along with supportive economic policies and necessary reforms towards improving the business environment, will help the country return to a high growth path in 2021 and beyond. As the vaccination program progresses, the economy will be back to normal gradually. Foreign currency inflows will be largely connected with the success of large strategic project investments such as Port City, rebound in demand for exports and revival of the tourism industry.

What major challenges is the sector facing?

The operating environment for banks in Sri Lanka remains challenging and banks' financial profiles are expected to come under stress. Sri Lankan banks could also face increased challenges in the access to and the pricing of foreign-currency funding stemming from the deteriorating sovereign credit profile due to dampening foreign currency reserve positions. Although, foreign borrowings would mitigate these to an extent in the short run.

A rise in Non-Performing Credit is expected after the expiry of payment holidays specially in lagging sectors, while adequate provisioning buffers would be required to absorb such shocks. Most banks have started building-up provision buffers in the form of higher Expected Credit Losses (ECL) provisions.

The exchange rate has recorded intermittent volatility, and the CBSL has taken steps to reduce excessive speculation causing such volatility in the foreign exchange market. Foreign currency funding is demanding higher pricing in the backdrop of a dearth of the USD in financial markets. Meanwhile, the CBSL's intervention to curb exchange rates by introducing a cap on USD/LKR exchange rates could result in foreign exchange losses to the financial system, unless regulatory authorities intervene to stabilize undue exchange rate volatility and ensure foreign currency liquidity in the banking system.

What impact has COVID-19 had on your bank and the overall sector?

The prolonged impact of COVID-19 has caused waves in the domestic economy, leaving a substantial responsibility on the banking sector to provide support. This has caused pressure on banks' asset quality and profitability to some extent. As a result, most Banks reported declines in operating profits during FY 2020. However, supported by its unique business model, PABC managed to grow all of its profitability matrices despite challenging economic conditions.

The key industry credit quality indicators such as stage 2 and stage 3 loan ratios witnessed an increase since emergence of COVID-19, signalling the possible emergence of Non-Performing Loans once payment holidays expire. Furthermore, some sectors such as travel and leisure are yet to recover due to the evolving nature of the COVID-19 pandemic. Most banks have already built additional provision buffers in view of the elevated credit risks.

Mr. Nanda Fernando, Managing Director, Sampath Bank

In view of the recent credit rating downgrades and concerns regarding the banking sector, what factors will aid future growth of the sector?

Credit rating downgrades were done mostly due to burgeoning external debt payments with diminished rollover opportunity and the pandemic impacting economic growth and earnings.

Most of the concerns have been managed thus far with fresh borrowings from China Development Bank (US$ 500m), a SWAP facility of US$ 1.5bn, IMF's new Special Drawing Rights (SDR) allocation, and other bilateral debt under negotiation. The pandemic is being managed without severe lockdowns thus far, and the vaccine rollout plan indicates that approximately 40% of the population will be vaccinated by August 2021 (revised down from 60% as previously planned).

Effective management of these two key areas will be critical for future growth as most other conducive factors including stable government policies, low interest rates, predictable taxation, and stimulus spending are already in place. With these steps having already been undertaken and planned for the next few months, we are positive on seeing strong growth both in the economy and the banking sector.

What major challenges is the sector facing?

Currently the biggest challenge is the lack of sufficient momentum in private credit growth. Despite the conducive business environment created on the policy front, both private consumption and investment have been slow to react due to the pandemic. We observed a pick-up in private credit growth from January to March this year with the easing of the pandemic. However, with the increasing number of infections we expect the growth to dip again. Thus, finding growth, particularly for the private banks has been a major challenge for the sector.

What impact has COVID-19 had on your bank and the overall sector?

For Sampath Bank as well as the industry, the most direct impact has been on growth and profits. However, the crisis has had a positive impact on long term sustainability and stability of the sector. The sector, Sampath Bank included, had to function during an unprecedented crisis, under severely stressed conditions. Managing during this period without facing any major banking crisis is a testament to regulatory prudence and banking sector stability in the country.

In addition to this, reducing costs and investing in digital infrastructure have been major requirements in future-proofing the banking industry. COVID-19 became a catalyst in this process as banks were pushed to reduce costs and invest and operationalize digital infrastructure. Customers were also pushed to adapt to digital and automated channels at a faster pace across age groups. Thus, when economic growth returns, the industry will be well placed to benefit from these changes that took place during the pandemic.

Mr. Nilantha Jayanetti, Chief Executive Officer, Sarvodaya Development Finance

In view of the recent credit rating downgrades and concerns regarding the banking sector, what factors will aid future growth of the sector?

Most of the value-added factors are not considered in statistics where ratings agencies are concerned. Ratings are highly dependent on published quantitative factors. Unique business propositions such as shared economic activities that have reduced many hindrances addressing inequalities of income distribution that are emerging, are not being addressed by them. However, we need to focus on the following factors for the growth of finance companies – Digitization, Cost reduction, Virtualization of the workforce/Virtual Branches, Safety and surveillance, The sharing economy, Corporate responsibility and the Global movement of people and goods.

What major challenges is the sector facing?

The Non Bank and Financial Institutions (NBFI) sector in Sri Lanka will continue to face further challenges, both financially and operationally due to COVID-19. These issues include the government's directive to continue moratoriums for the fourth time. Hence moratoriums have become a "rent-seeking" instrument.

Although several competing finance companies are suffering increased defaults resulting from curtailed economic activities, lower recoveries and higher credit exposures, SDF's unique model has helped us avoid these challenges as we are accommodating domestic product-oriented facilities. Our ticket size is comparatively lower where more than 2400 societies' networks have engaged in disbursement of loans and collections.

The combined effect of low business activities, higher impairment and possible operational and fair value losses may result in reduced profit levels and capital depletion in the industry. Fortunately, 80% of Sarvodaya Development Finance's (SDF) portfolio is outside the western province, whereby agro-based economic activities are being financially powered by us. As a result, SDF has recorded its highest ever profit during FY20/21.

Increased cash withdrawals by depositors to meet their own funding needs and customers moving their funds from finance companies to banks that are offering lower rates have had a double effect on finance companies' operations. Bigger ticket size facilities are moving away from our industry to banks and a reduced interest rate regime has helped us reduce our cost of funds. Therefore, many business benefits are unfolding for finance companies to bounce back.

What impact has COVID-19 had on your bank and the overall sector?

Although COVID-19 has generated mid and long-term opportunities in the Banking and Finance Sector in Sri Lanka, SDF has been able to create opportunities and ensure top performance for this period. All our financial performance indicators are better than the previous year. More importantly, the core capital requirement of LKR 2bn was also met while improving capital adequacy ratios and growth of asset portfolios.

The significant impact of COVD-19 along with the low interest rate environment, is improving profitability of the finance sector. But this will also challenge companies that have a bigger market share due to low business activities, higher impairment and possible operational and fair value losses. This may result in a reduction in profit levels and capital depletion. However, SDF has recorded approximately LKR 130m profit in the last financial year.

Due to the pandemic, most of the finance companies that were predominantly granting leases are suffering from increased defaults resulting from curtailed economic activities, such as lower recoveries from tourism and higher credit exposures. The expected reduction in the value of the loan portfolio from impairment may impact their ability to meet certain ratios such as Capital Adequacy Ratio (CAR), Loan to Deposit Ratio (LDR), Non Performing Loan (NPL) ratios. However, SDF was able to achieve these ratios with a considerable premium.

1. Executive Summary

The COVID 19 pandemic has disrupted global financial markets at an unprecedented scale and dramatically reshaped the world in which we live. Sri Lanka is not agnostic to the world's situation and like most other economies has had to cope with a host of economic challenges. The Banking and Non-Banking Financial Institutions (NBFI) sector remains one of the largest and most prominent sectors in Sri Lanka. While banks and finance companies have faced challenging times, both the banking and the NBFI sector remain competitive with new and emerging opportunities to capitalize on.

1.1. Scope of the report

This report dated July 15th, 2021 presents a detailed overview of the Sri Lankan Economy and the Banking and NBFI sectors. It aims to provide an overall understanding of these sectors to investors, investment funds and companies looking for lucrative and viable investment opportunities in Sri Lanka. It also looks at opportunities and challenges faced by the sectors and profiles some of the key firms within the two sectors.

1.2. Macroeconomic Overview

The Sri Lankan economy encountered a complex set of challenges in 2020 with the COVID-19 pandemic being foremost amongst them. The economic impacts of the pandemic led to a sharp contraction of 3.6% in the GDP, which marked the sharpest contraction since independence[1]. In spite of the same, the country recorded the smallest trade deficit since 2010. The fall in fuel prices and regulations put in place to control imports of non-essential goods resulted in a fall in import expenditure which largely cancelled out the effects of a corresponding fall in the export earnings. Combined with the fall in trade deficit, the country's current account has recorded a smaller deficit, at 1.3% of GDP in 2020, primarily due to a fall in tourism income by 73.5% as a result of pandemic related travel restrictions imposed. However, this fall was largely offset by an increase in remittance inflows by 5.8%, the first time a positive growth was recorded since 2016.

Debt repayment obligations remain one of the key challenges for the economy with a debt to GDP ratio of 101.0% at the end of 2020. This caused multiple credit rating agencies to downgrade the country's long term foreign currency ratings to CCC in 2020[2]. With foreign exchange reserves of US$ 5.7bn as of end December 2020, the country has a total of approximately US$29bin in foreign-currency debt obligations due between now and 2026. The reserves have been boosted in the current year by securing project financing through various multilateral and bilateral channels, as well as swap facilities under the South Asian Association for Regional Cooperation (SAARC) currency framework and the People's Bank of China and the planned IMF SDR allocation[3]. In June 2021, Fitch Ratings has reaffirmed Sri Lanka's Long-Term Foreign-Currency Issuer Default Rating (IDR) at 'CCC' and believes that these resources should enable Sri Lanka to meet its remaining debt maturities through the rest of this year[4] .

[1] Primary source for macroeconomic indicators is the CBSL Annual Report 2020
[2] Source: "S&P downgrades Sri Lanka sovereign rating to 'CCC+', over budget, excess liquidity", Economynext, December 11, 2020
[3] Source: "Lanka goes to IMF for US$ 800m", Sunday Times, July 11, 2021
[4] Source: "Fitch affirms Sri Lanka at CCC', Fitch June 14, 2021

1.3. Banking Sector Overview and Outlook

Total asset base of the Sector stood at USD 78.7bn , a growth of 14.2% over the previous year[5]. Total deposit base of the sector increased by 18.7% in 2020 primarily due to the movement of deposits from the NBFI sector to the commercial banks, given that the banks were perceived to be 'safer' institutions. Banking sector loans increased by 9%. CBSL's reduction of Average Weighted Prime Lending Rate and the Statutory Reserve Ratio progressively in 2020 led to enhanced liquidity in the system. Its impact however did not translate into the growth in private sector credit at the same rate given low demand for loans and selective lending undertaken by banks.

The banking sector remains vulnerable to Sri Lankan sovereign weakness due to the banks' significant direct exposure to the sovereign and their domestically focused operations. The profitability of banks was adversely impacted by lower interest margins and deterioration of asset quality which led to higher impairment costs. The government responded with several measures to ease pressure on banks and the economy amidst COVID-19 including monetary policy easing, debt moratoriums and easing of capital and liquidity measures for banks.

1.4. NBFI Sector Overview and Outlook

Total asset base of the sector stood at US$ 7 bn as at 31st March 2021, a growth of 7.9% over the corresponding period in the previous year[6]. Total deposit base of the sector contracted by 5% in US$ terms primarily due to the movement of funds by depositors to commercial banks as they were perceived to be safer institutions. Loan growth too contracted by 10% due to macro prudential measures adopted by the government restricting the import of motor vehicles, which has directly affected the business of the leasing and hire purchase sector and selective lending undertaken by banks due to the deteriorating performance of the SME and MSME sector and macro prudential measures adopted by the government restricting the import of motor vehicles, which has directly affected the business of the leasing and hire purchase sector

The ongoing challenges posed by the pandemic and the weakened macroeconomic environment have affected the asset quality and profitability of the sector. In spite of these challenges, most LFCs remained well capitalized due to the enhanced regulatory capital thresholds that were to be achieved at the start of 2020. In addition, consolidation of the NBFI sector is a policy priority[7]. This is expected to bring about greater stability to the sector going forward.

[5] Source: Computed based on CBSL Annual Statistics
[6] Source: Computed based on CBSL Annual Statistics
[7] Source: "CBSL pushes forward with NBFI Sector Consolidation", Ceylon Today, July 15, 2021

Performance Highlights - Macroeconomic Indicators

	2019	2020	
GDP Growth	2.3%	-3.6%	↓
Trade Deficit (US$ mn)	-7,997	-5,978	↓ -25.2%
FDI (US$ mn)	1,189	670	↓ -43.7%
Current Account Deficit (% of GDP)	-2.2%	-1.3%	↓
Workers' Remittances (US$ mn)	6,717	7,104	↑ 5.8%

Key:
2019
2020

Indicator	2019	2020	Change
Central Government Debt (% of GDP)	86.8%	101.0%	↑
Budget Deficit (% of GDP)	-9.6%	-11.1%	↑ 5.8%
Average Annual Inflation Rate (CCPI)	4.3%	4.6%	↑
End Year Exchange Rate (LKR/USD)	181.6	186.4	↑ 2.6%
Tourism Earnings (US$ mn)	3,607	957	↓ -73.5%

Key:

2019

2020

2. Macroeconomic and Capital Market Overview

Sri Lanka's economic growth is driven by an increasingly important services sector, which has helped the country achieve relatively high levels of GDP per capita. However, Gross Domestic Product (GDP) growth has slowed during recent years while the complex challenges the country had to face during the COVID-19 pandemic in 2020 which pushed the country to record its sharpest contraction in GDP since independence. The country's trade balance, however, fared well during the pandemic due to a faster than expected recovery in exports. The export recovery was facilitated by the quick adaptation of domestic export manufacturers to the needs of international markets. At the same time, stringent import restrictions implemented in the wake of the pandemic curtailed expenditure on imports significantly. These twin effects contributed to the country recording its lowest trade deficit since 2010[8]. This positive development in the trade account, was offset by a hit to the tourism sector for the second consecutive year, following the Easter Sunday tragedy in 2019. While a weak trade account has meant that the country often faces Balance of Payments (BOP) pressures, a high debt burden along with persistent fiscal deficits have added additional pressure on the country. Despite this, underlying confidence in Sri Lanka continues to remain high due to strong fundamentals of growth, with the country being able to successfully finance its requirements each year without ever facing default.

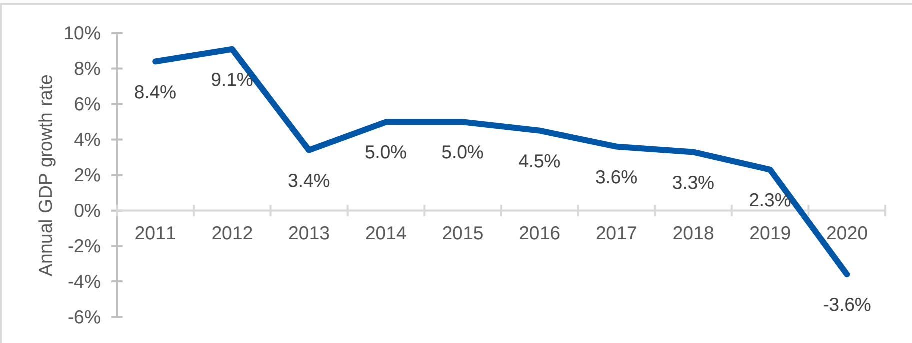
2.1. Economic Growth

GDP growth and GDP per capita

Despite recording its deepest recession since independence, Sri Lanka's GDP per capita remains one of the highest in the South Asian region

Alongside the global economic downturn induced by the COVID-19 pandemic, the Sri Lankan economy too had to encounter a complex set of challenges which brought the economy under pressure in 2020. The country was seeing a declining trend in its real GDP during the past few years as a result of political uncertainty and the economic impacts of the Easter Sunday tragedy in 2019 and was in the process of implementing new policy reforms aimed at stimulating economic growth within the country, when it was hit by the effects of the COVID-19 pandemic. The economic impacts of the pandemic led to a decline in GDP numbers, as the economy recorded a contraction of 3.6%, which marked the sharpest contraction in GDP for the country since independence (Exhibit 1) [9].

Exhibit 1: GDP Growth Rate (Annual Growth)



Source: CBSL Annual Reports

[8] Source: CBSL Annual Report 2020
[9] Source: CBSL Annual Report 2020

While the GDP growth rate for Sri Lanka remained comparatively lower in 2020 compared to the regional peers, mainly driven by a comparatively large drop in the agricultural sector which remained in negative territory compared to countries like Pakistan where the contraction was capped by an unscathed agricultural sector[10]. However, on a per capita basis, Sri Lanka's GDP per capita (PPP), remains one of the highest in the South Asian region and compares favourably against its peers, standing at International US$ 13,656.8 (Exhibit 2)[11].

Exhibit 2: Key Economic Indicators of Sri Lanka and South Asian Markets

Country	Rating (Fitch Long Term Foreign Currency)	GDP Growth Rate 2020	GDP (PPP) per capita (Int.$) - 2019
Pakistan	B-	-0.4%	4,898.1
Sri Lanka	CCC	-3.6%	13,656.8
Bangladesh	BB-	5.2%	4,964.1
India	BBB-	-8.0%	6,996.6

Source: World Bank, IMF, Annual reports of respective CBSLs

Sectoral breakup of GDP

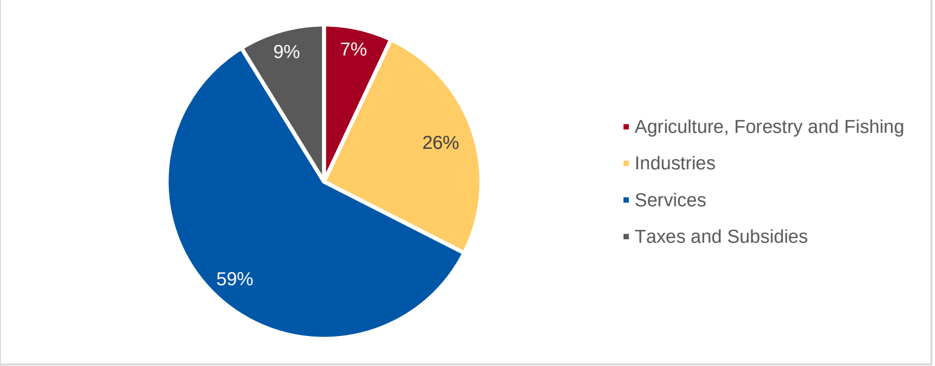
Sri Lanka's economy is driven by a strong services sector which accounts for the lion share of GDP which is ably supported by the country's industrial sector and the agriculture sector (Exhibit 3)[12]. In recent years, the growth of the country's services sector has been driven by growth in financial service activities & auxiliary financial services as well as IT programming consultancy and related service - growing at an average rate of 10.9% and 10.0%, respectively from 2015 to 2020. The COVID-19 pandemic had a positive impact on some of the service sector activities, especially related to the IT and telecommunications sector, as most organizations resorted to remote working due to pandemic related restrictions. However, the pandemic also caused severe disruption in mobility and tourism related services, which led to an overall contraction of the services sector by 1.5% in 2020.

The growth of the industrial sector is driven by strong performance in apparel manufacturing, which also comprises a significant proportion of the country's export revenues (43.9% in 2020)[13]. The adverse impact of the pandemic on major export markets spilled over to Sri Lanka, weakening the demand in the textile and apparel industry causing a contraction in the industrial sector in 2020. However, quick adaptation to the conditions with most major textile manufacturers moving into manufacturing PPE contained the contraction of the industrial sector to 6.9% in 2020.

The agriculture sector has been a core part of Sri Lanka's economy and, while it only contributed 7.0% to the country's GDP in 2020, it accounted for 23.3% of the country's export revenues, driven by the plantation-based tea sector. The sector contracted by 2.4% in 2020 due to the COVID-19 pandemic. Tea production and fishing activities were hit especially hard by both the onset of the first wave of the pandemic in March as well as the second wave in October.

[10] Source: CBSL Annual Report 2020
[11] Source: State Bank of Pakistan Annual Report
[12] Source; CBSL, National Accounts data
[13] Source: CBSL External Sector Data

Exhibit 3: Sectoral Breakdown of GDP (2020)



Source: CBSL Annual Reports, Department of Census and Statistics

2.2. External Sector Performance

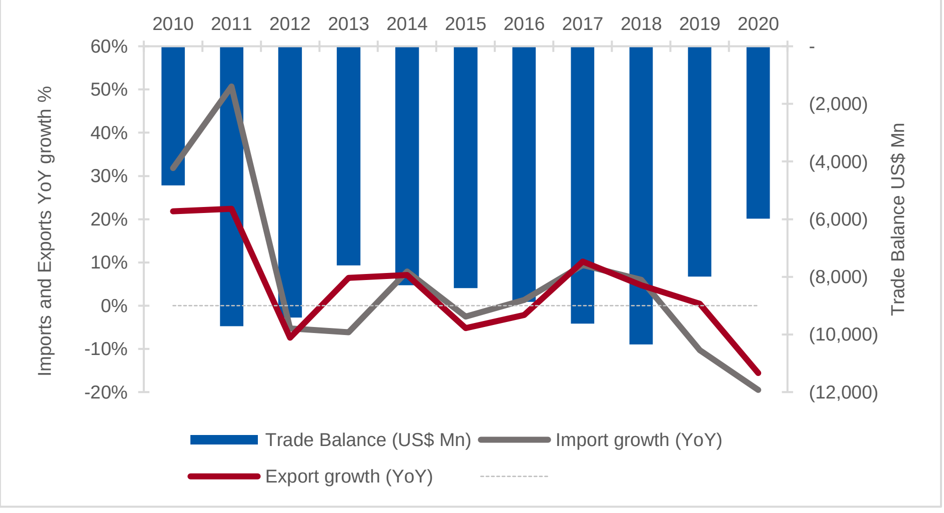
Sri Lanka records the smallest trade deficit since 2010 amidst tough import controls while the export sector recovers faster than expected.

Trade

Sri Lanka's exports in goods is driven primarily by apparel and tea, which constituted a combined 56.4% of the country's export basket in 2020, while the country's imports are driven primarily by fuel, food and beverages and vehicles. Earnings from exports were severely impacted by the COVID-19 pandemic as lockdowns and other public health restrictions negatively affected the exportable goods in 2020, while subdued external demand, disruptions to supply chains and issues in importing necessary inputs exacerbated the negative impacts on the export industry.

The fall in fuel prices and regulations put in place to control importation of non-essential goods in an attempt to support the economy resulted in a fall in import expenditure in 2020, thus creating a relatively favourable balance of trade (Exhibit 4). The trade deficit saw a considerable fall of 25.2% in 2020 from a year earlier to record a deficit of US$ 6bn by the end of year 2020 which is the smallest trade deficit since 2010.

Exhibit 4: Trade Breakdown

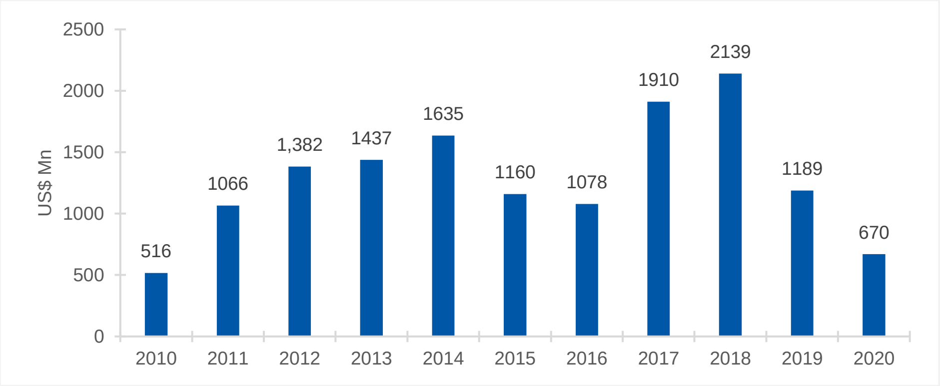


Source: CBSL Annual Reports, External Sector Data

Foreign Direct Investment

Sri Lanka has generally managed to maintain inflows between US$ 1-2bn over the years (Exhibit 5). These FDI inflows have been centred around investment into export industries and investment into large scale infrastructure projects, such as the establishment of ports and highways[14]. However, the low FDI environment globally and high uncertainty, as a result of the pandemic, meant that Sri Lanka's FDI inflows were limited to a meagre US$ 670m in 2020 which were mainly on account of ongoing projects[15].

Exhibit 5: Foreign Direct Investment into Sri Lanka (US$ Mn)



Source: CBSL Annual Reports

Current Account

Remittance inflows saw an increase in 2020 as the pandemic led to remittances being made through official channels, with the encouragement of the authorities

In addition to the trade balance, the current account in Sri Lanka has two main contributors: tourism and remittances. The tourism sector earned US$ 3.6bn in 2019 despite the hit on the sector due to the Easter tragedy. However, the earnings fell significantly by 81.1% to US$ 682m in 2020, as a result of the pandemic related travel restrictions from the 18th of March 2020[16]. During the year, total number of tourist arrivals were limited to 507,704, out of which 99.9% was recorded during the first three months of the year. This led to the country's current account deficit being recorded higher than most of its regional peers (Exhibit 8). Sri Lanka was able to open up the country for tourists in January 2021[17]. While concerns have been raised with the propagation of new virus strains which saw the re closure of airports in May 2021[18], tourists have continued to trickle into the country.

Remittance inflows which have been declining since 2017, saw an increase in 2020 as the pandemic led to remittances being made through official channels, which are now being encouraged by the authorities (Exhibit 7). Other factors cited as reasons for the sudden rise in remittances during the year are longer stay periods of migrant workers due to the closure of most international borders as well as a possible increase in the amounts remitted by migrant workers to families in Sri Lanka to manage the pandemic-driven hardships. Before rising by 5.8% in 2020, remittances recorded a 4.3% decline in 2019[19]. Combined with the fall in the trade deficit, the country's current account balance has recorded a smaller deficit, at 1.3% of GDP in 2020, compared to the 2.2% of GDP recorded in 2019 (Exhibit 6)[20].

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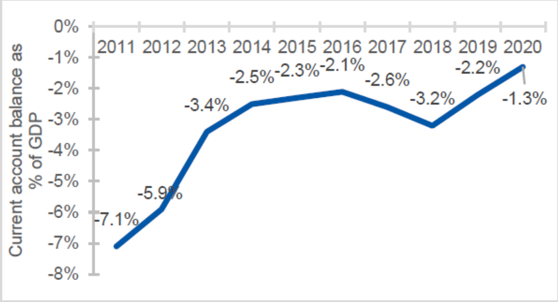
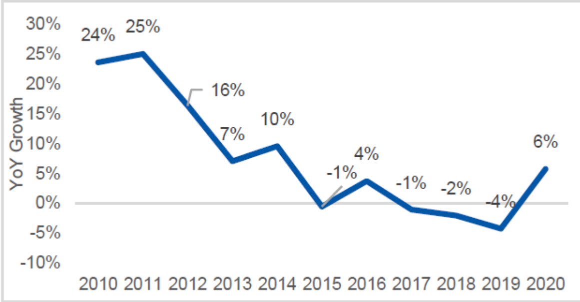
[14] Source: CBSL Annual Report 2020
[15] Source: CBSL External Sector Data and Annual Report 2020
[16] Source: CBSL Annual report 2020
[17] Source: "Govt. issues new health guidelines to fully reopen borders for tourism", Daily FT, January 09, 2021
[18] Source: "Sri Lanka will reopen to foreign tourists from June 1", TTG Asia, May 27, 2021
[19] Source: CBSL External Sector Data
[20] Source: CBSL Annual report 2020

Exhibit 6: Current Account Balance (% of GDP)



Source: CBSL Annual Reports, External Sector Data

Exhibit 7: Worker Remittances (YoY Growth)



Source: CBSL External Sector Data

Exhibit 8: Current Account Deficit of Sri Lanka and South Asian Peers

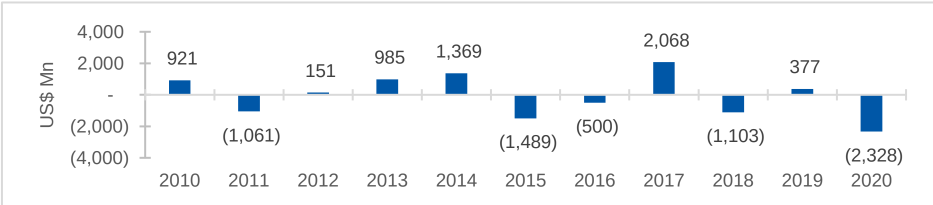
Country	Current account (% of GDP) - 2019
Pakistan	-2.6
Sri Lanka	-2.2
Bangladesh	-0.9
India	-1.0

Source: World Bank, IMF, Annual reports of respective CBSLs

Balance of Payments

Along with the current account deficit, debt outflows of around US$ 4bn in 2020 means that the country's Balance of Payments (BOP) has witnessed greater pressure in 2020 (Exhibit 9)[21]. This has led to a persistent need to bridge the country's overall BOP deficit using external funding sources and in 2020, the deficit stood at a historical high of US$ 2.3bn[22].

Exhibit 9: Balance of Payments (BPM6 Format*) – Overall Balance



Source: CBSL Annual Reports, External Sector Data

**Note: BPM6 format - IMF's Balance of Payments and International Investment Position Manual (BPM6)*

Official Reserves

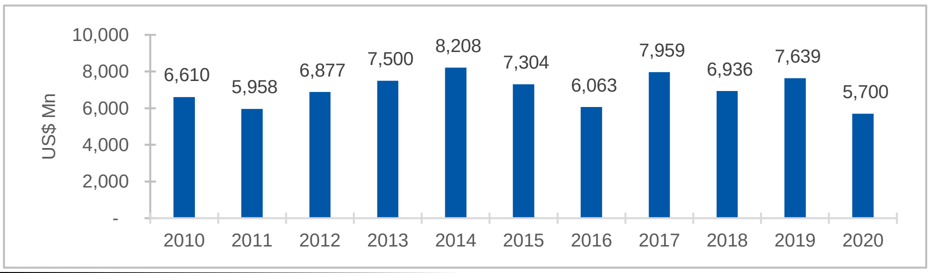
Sri Lanka's gross official reserves fell by US$ 1.94bn since 2019, recording the largest fall in reserves the country has witnessed over the last decade, standing at US$ 5.7bn at end 2020

In 2020, Sri Lanka ended the year with gross official reserves of US$ 5.7bn after having experienced a US$ 1.94bn dip which is the largest fall in reserves the country has recorded in a single year over the last decade. This was equivalent to 4.2 months of imports as at end December 2020 (Exhibit 10). The situation continued to remain daunting in 2021 with reserves falling to US$ 4.1bn in March 2021 which is the lowest levels recorded since 2009[23]. In the face of these pressures,, but continuous debt repayments and a current account deficit have negatively impacted the level of reserves. In this context, a focus for

[21] Source: CBSL Press Releases
[22] Source: CBSL Annual Report 2020
[23] Source: "Reserves fall to lowest since 2009, rupee strengthening to be short-lived: report", Island, April 21, 2021

the CBSL and government has been in securing lines of credit through varied bilateral and multilateral sources (Exhibit 11) as well a variety of other funding sources to meet its foreign obligations (Exhibit 12).

Exhibit 10: Gross Official Reserves (US$ Mn) – End year



Source: CBSL Annual Reports, External Sector Data

Exhibit 11: Committed Foreign Loans and Grants

Partner	Total Disbursement (US$ m)	Undisbursed funds (To be used in the next 3-5 years)
Bilateral		
China	514.9	1,561.1
Japan	42.1	1,407.7
Other	33.9	1,035.7
Multilateral		
ADB	113.6	1,883.8
World Bank	135.0	975.3
Other	16.9	1,140.3

Source: CBSL, Fitch Ratings

Exhibit 12: Other foreign funding available or being negotiated

Partner	Amount (USD Mn)	Type of Funding
People's Bank of China	1,500.0	SWAP
Bangladesh Bank	250.0	SWAP
India Reserve Bank	400.0	SWAP
India	1,000.0	Special SWAP
IMF	780.0	SDR Allocation
China	700.0	Syndicate Loan
ADB	300.0	
Federal Reserve Bank of New York	1,000.0	Repo Facility
IMF	800.0	Rapid Financing Facility

Source: CBSL, Fitch Rating

2.3. Government Finances

Debt Burden

The rise in debt burden led to multiple credit rating downgrades in 2020

Sri Lanka has been facing a steep upward trend in its debt burden accounting for a Central Government debt to GDP ratio of 101.0% at the end of 2020 showing an increase from 2019 which ended with a ratio of 86.8% (Exhibit 14). This was a result of the COVID-19 pandemic and tax concessions introduced at end-2019 which had further compelled the need for the government to borrow to meet budgetary expenses. The poor economic growth and low tax collection witnessed in 2020 worsened the government's debt burden over the period.[24] The country's external debt burden remained one of the largest among its peers (Exhibit 13). The rising debt burden also caused multiple credit rating agencies to downgrade the country's long term foreign currency ratings in 2020.

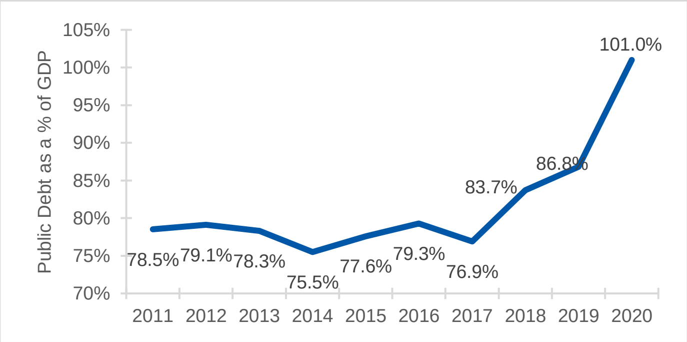
[24] Source: CBSL Fiscal Sector Data

Exhibit 13: External debt burden of Sri Lanka and South Asian Peers

Country	External Debt (% of GNI) - 2019
Pakistan	36.9
Sri Lanka	68.8
Bangladesh	18.0
India	19.7

Source: World Bank, IMF, Annual reports of respective CBSLs

Exhibit 14: Central Government Debt-to-GDP (Central Government Debt as a % of GDP)

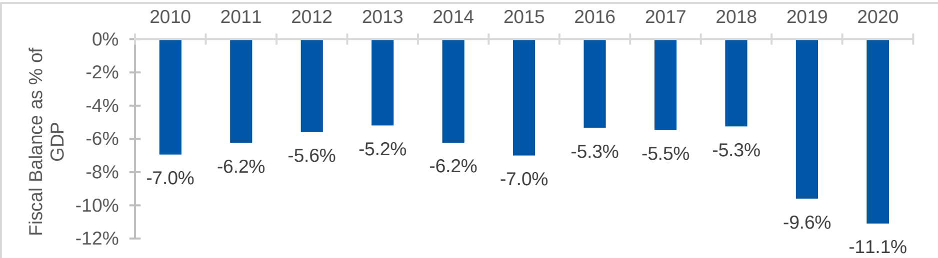


Source: CBSL Annual Reports, External Sector Data

Fiscal Position

The country's external debt pressures have been worsened by the increasing fiscal deficits incurred by the government. The overall budget deficit as a percentage of GDP increased to 11.1% in 2020 from 9.6% in the previous year, due to a notable decline in government revenue resulting mainly from the impact of tax concessions such as the removal of PAYE, prolonged moderation of economic activity exacerbated by the Easter Sunday tragedy in 2019 and the uncertainty caused at the onset of COVID-19 pandemic during 2020 (Exhibit 15)[25]. The country also maintains one of the highest fiscal deficits compared to its regional peers.

Exhibit 15: Fiscal Balance (% of GDP)



Source: CBSL Annual Reports, IMF

2.4. Monetary Policy

Interest rates

Sri Lanka was able to maintain stable inflation, with prices being contained at mid-single digit growth

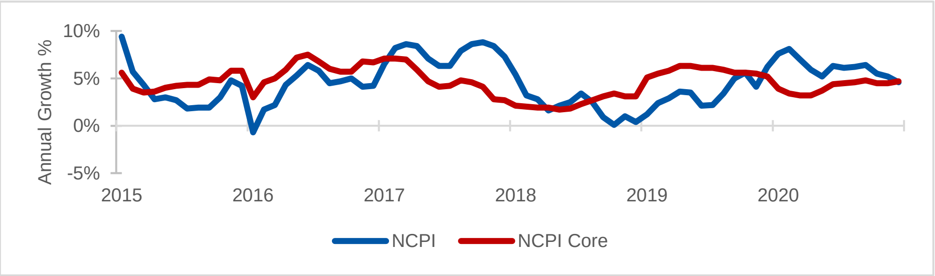
The CBSL followed an accommodative monetary policy stance throughout 2020, focusing on growth, recovery and stability, supported by muted inflation and well-anchored inflation expectations. The COVID-19 pandemic and the subsequent containment measures contracted economic activity, requiring the CBSL to sustain the accommodative monetary stance adopted during mid-2019. As such, the CBSL continued the significant reduction of policy interest rates with the Standing Deposit Facility Rate (SDFR) and Standing Lending Facility Rate (SLFR) being cut by 250 bps each while the Statutory Reserve Ratio (SRR) was cut by 300 bps during the year.

[25] Source: CBSL Annual Report 2020

Inflation

Inflation has remained within the expected mid-single digit range of 4%-6% during the past few years[26]. In 2020, inflation on an annual average basis, as indicated by both the Colombo Consumer Price Index (CCPI) and the National Consumer Price Index (NCPI) remained at desirable levels, being recorded at 4.6% and 6.2% respectively. The NCPI which reflects the consumption expenditure of all households in Sri Lanka showed a declining trend in 2020 ending the year with a 4.6% annual growth (Exhibit 16). This was mainly due to the subdued demand for non-essential goods and services as a result of the lockdowns and other containment measures put in place to mitigate the impacts of the COVID-19 pandemic. This was supported by the absence of periodical price revisions of Airfare, Health and Education.

Exhibit 16: National Inflation (NCPI 2013=100) – Annual Growth



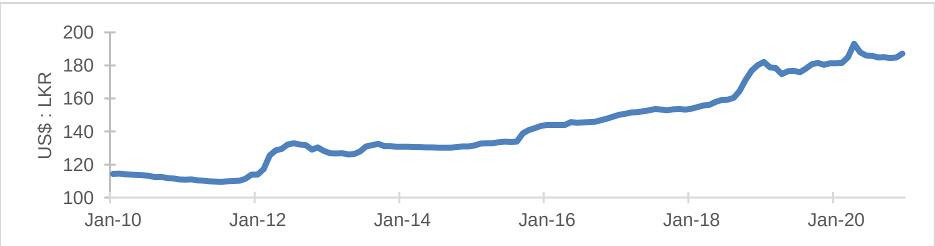
Source: CBSL Real Sector Data

Currency Performance

The LKR briefly exceeded the psychological LKR 200 against the US$ threshold in April 2020 as a result of the pandemic

The Sri Lankan Rupee (LKR), subsequent to the high depreciation following political uncertainty in 2018, remained relatively stable during 2019, however this shifted in 2020 with the LKR coming under significant pressure during the year and continues to remain under pressure in 2021 (Exhibit 17). The currency weakened significantly against the US$ during March and April of 2020 exceeding the psychological boundary of LKR 200 against the US$ during the period as the country faced the first wave of the COVID-19 pandemic. The depreciatory pressure which prevailed during this period necessitated the active intervention of the CBSL in the domestic foreign exchange market through supply of foreign exchange and entering in to sell-buy swap agreements with LCBs in view of enhancing foreign exchange liquidity in the market. This along with the import controls imposed on non-essential goods resulted in the containment of the depreciation of the currency against the USD to 2.6% during 2020[27] ending the year at LKR 186.4 against the US$.

Exhibit 17: Average Monthly Exchange Rate (US$: LKR)



Source: CBSL External Sector Data

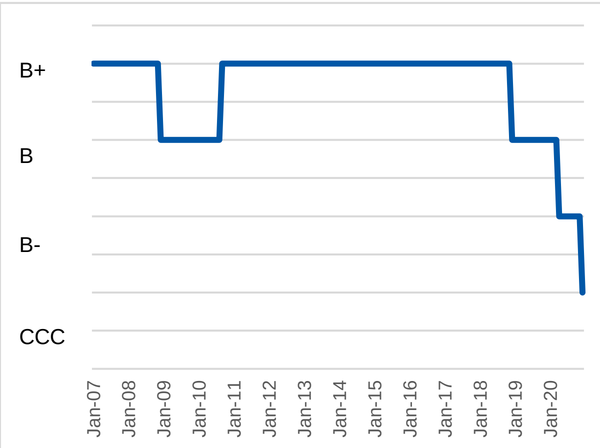
[26] Source: CBSL Annual Report 2020
[27] Source: CBSL Annual Report 2020

2.5. Sovereign Ratings

Despite Sri Lanka's rating downgrades, the country has been able to maintain its untarnished repayment record.

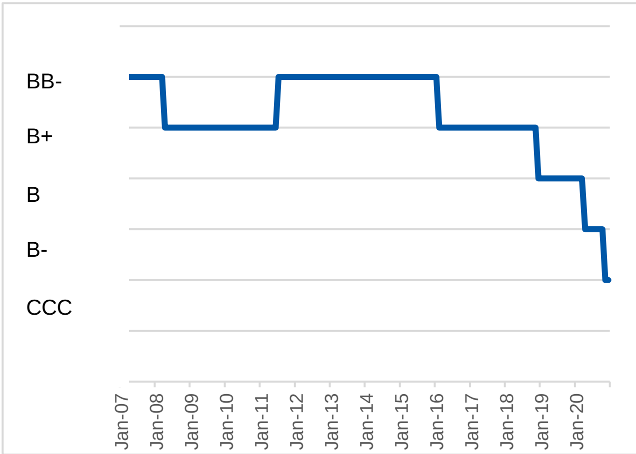
Sri Lanka's credit rating by Fitch for long term foreign currency currently stands at CCC since its last review as at June 2021[28], following four downgrades since 2015, out of which two downgrades happened in 2020 (Exhibit 18a). The S&P Long Term rating also stands at CCC+ after three downgrades since 2015, out of which two were done during 2020 (Exhibit 18b). Moody's Investors Service, which placed Sri Lanka's ratings of 'B2' under review in April 2020, downgraded Sri Lanka's sovereign ratings by two notches to 'Caa1' and changed the outlook to stable from negative. The most recent downgrade by S&P Ratings in December 2020 was driven by expectations of the country's fiscal position deteriorating over the next few years due to unfavourable economic conditions. Fitch ratings recent downgrade in November 2020 and the subsequent affirming of the rating in June 2021 points to Sri Lanka's increasingly challenging external-debt repayment position over the medium term. In particular, a sharp rise in the sovereign debt to GDP ratio associated with the COVID-19 shock and narrowing financing options have heightened debt sustainability risks.

Exhibit 18a: Sri Lanka Fitch Ratings (Long Term Foreign Currency Rating)



Source: Fitch Ratings

Exhibit 18b: Sri Lanka S&P Ratings (Long Term Foreign Currency Rating)

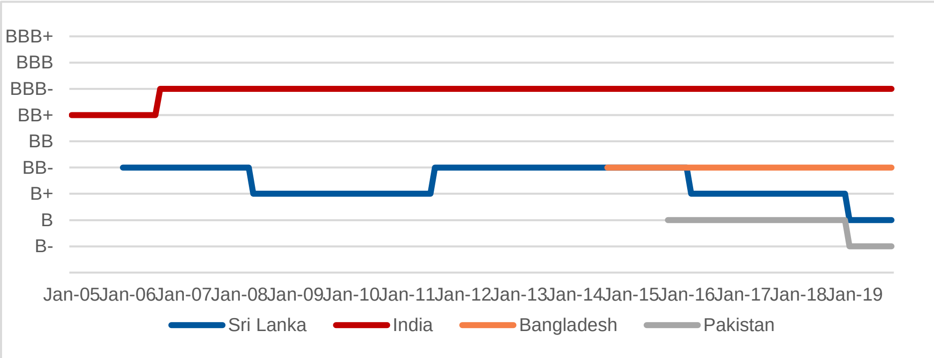


Source: S&P Ratings

A look at some peer countries show that Sri Lanka experienced greater volatility in its rating (Fitch Long Term) and has trended down over the period (Exhibit 19). India has been upgraded to Investment Grade, having maintained lower Debt-to-GDP figures and current account deficits (Exhibit 13).

[28] Source: "Fitch Affirms Sri Lanka at 'CCC', Fitch Ratings, June 14, 2021

Exhibit 19: Rating Comparison with Peers (Fitch Long Term Foreign Currency)



Source: Fitch

**Pakistan was first rated in 2015. Bangladesh was first rated in 2014. Sri Lanka was first rated in 2006.*

Despite Sri Lanka's rating downgrades, the country has been able to fulfil its debt servicing obligations in 2020, including the ISB repayment of US$ 1bn which matured in October 2020, maintaining its untarnished repayment record. While the country's access to international markets were limited during the year, it was able to obtain adequate bilateral support, including a US$ 140m loan from China Development Bank in July 2020, US$ 400m swap from the Reserve Bank of India which was successfully settled in February 2021 and a US$ 90m grant from China in October 2020. In May 2021, Sri Lanka secured a US$ 200m currency swap arrangement with the Bangladesh CBSL which was the first time the bank had entered such an arrangement[29].In addition, the country is also in discussions with bilateral and multilateral partners to ensure its ability to maintain its repayment record.

[29] Source: "Bangladesh becomes a lender for first time thanks to SL", Daily FT, May 28,202

Performance Highlights - Financial and Capital Markets

	2019	2020	Change
ASPI Index Value	6,129	6,774	↑ 11%
Market Capitalisation (US$ bn)	15.7	15.9	↑ 1%
Daily Average Turnover (US$ mn)	3.9	10.2	↑ 161%
Number of Companies Listed	289	283	↓ -2.1%
Price to Earnings multiple (x)	10.8	11.3	↑ 4%

Key:
2019
2020

2.6. Financial and Capital Markets

In January 2021, the CSE became the world's 2nd best performing stock exchange

In December 2020, the CSE reached a significant milestone where it completed 35 years of operations. The year was one of the most eventful years for the CSE which began on an optimistic note with the expectation of new market friendly reforms being introduced by the new government administration. However, the optimism soon soured with the onset of the COVID-19 pandemic which saw the first wave cases being reported in March 2020, resulting in the closure of the CSE for nearly 2 months on account of the lockdowns that were implemented to curb the community spread of the virus. Notwithstanding the criticism from stakeholders on the prolonged closure of the market, the CSE together with the Securities and Exchange Commission (SEC) succeeded in driving forward its digitization initiative with the necessary amendments being introduced to allow fully digital onboarding experience for new customers and post trade transaction settlement[30]. These developments placed the CSE in a better position during the second outbreak of community spread of COVID-19 in October 2020 where it was able to return to normalcy within a shorter timeframe[31]. Further, the digitization drive simplified the process of opening and managing investment accounts which propelled greater participation by domestic retail investors resulting in a significant uptick in market turnover levels. Alongside these reforms, the low interest rate environment and the improved corporate earnings for the December 2020 quarter galvanized interest in the CSE which saw a strong revival in terms of market performance culminating in the CSE becoming the world's 2nd best performing stock market on the 13th of January 2021 (Exhibit 21)[32].

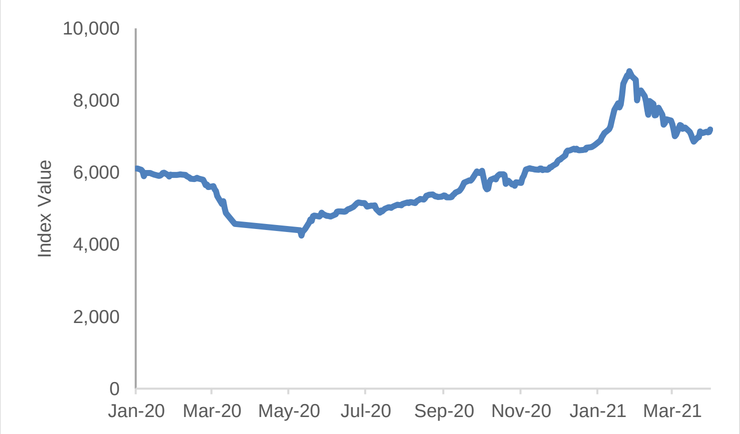
The following exhibits provide key facts and recent performance of the main index.

Exhibit 20: Key Facts

Year of initiation	1985
Bloomberg Ticker	CSEALL
Number of Companies	283
Number of Sectors (GICS Classification)	20
Market Capitalization (US$ m)	15,884
Total Market Turnover - 2020 (US$ m)	1,988
Year to Date (YTD) return -2020 (%)	11%

Source: CSE, CSE Annual Report 2020

Exhibit 21: Recent movement-CSEALL



Source: CSE

The Digitization drive of the CSE enabled the CSE to weather the impacts of the second wave of COVID-19

With the onset of the COVID-19 outbreak, the regulators were cognizant of the challenges facing investors and firms and announced a number of relief measures including a three month moratorium on interest payment on credit granted by licensed stockbrokers and margin traders, guidance on the conduct of Company Annual General Meetings virtually, grace periods for the release of audited financial statements as well as providing information to investors by requiring firms to disclose the impact of COVID-19 on their operations.

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[30] Source: "CSE marks paradigm change today with digitisation", Daily FT, September 17,2020
[31] Source: "CSE and intermediaries successfully operate stock market remotely", Daily FT, October 27,2020
[32] Source: "CSE ranked world's second best performing market", Daily Mirror, January 14,2021

Encouraging new listings and diversifying its product offerings were key priorities for the CSE

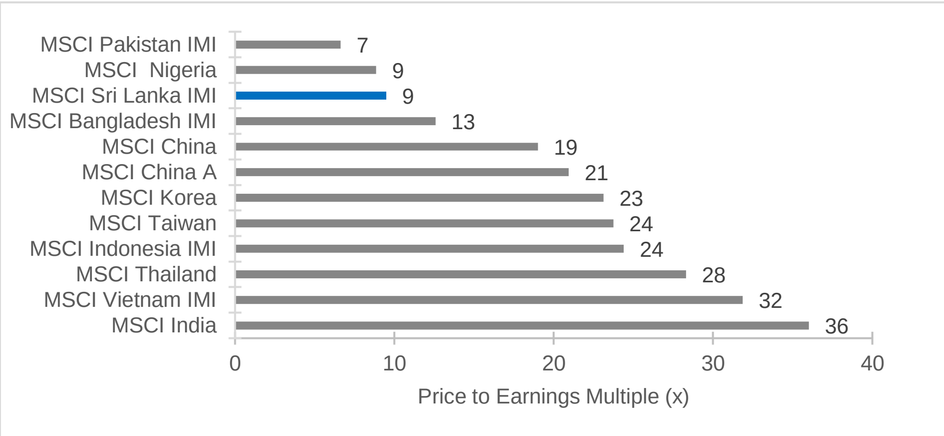
Further development of the Capital Markets has been a key agenda of the new government administration and was underscored by the appointment of a state minister for finance, capital markets & state enterprise reforms in August 2020[33]. This agenda includes encouraging new listings on the CSE, listing of the State-Owned Enterprises (SOEs) and attracting foreign investments to new developments such as the Colombo Port City development. The specific measures taken in line with the above agenda include simplifying the approval process for new listings and providing regulatory flexibility in terms of new listing requirements for technology stocks to list on the exchange. The government budget for 2021 was also in favour of new listings, with companies being provided a 50% tax concession for two years and a reduced tax rate for a further three years. In 2021 these activities have begun to bear fruit with the listing of a number of firms including Windforce; a renewable energy company which was the biggest Initial Public Offering in the CSE in nearly 10 years[34] as well as the listing of Chrissworld; a warehouse management services firm which was the first to list under the Small & Medium Scale Enterprise (SME) category of the CSE[35].

Widening the product offerings of the CSE was another area of focus where the much-anticipated framework for Real Estate Investment Trusts (REITs) was introduced in August 2020[36]. In conjunction with the incentives offered for REITs in the government budget for 2021 where investments in housing markets via REITs would be exempted from capital gains tax, as well as the ongoing developments taking place at the Colombo Port City project is expected to drive interest in this popular asset class.

At the same time, steps were taken by the SEC to improve the corporate governance of stakeholders in the Capital Markets with the publication of a new set of guidelines on good practices for stockbrokers[37]. In addition, the final draft of the new SEC Act which has been pending for a number of years was approved by the Cabinet in October 2020 and is in the process of being brought before parliament for approval[38]. The new Act provides for a more robust regulatory regime while also paving the way for the demutualization of the CSE.

Despite these favourable developments, the market has continued to trade at low multiples and, according to MSCI indices, trades at a significant discount compared to other emerging market indices (Exhibit 22).

Exhibit 22: Price to Earnings Multiple of Emerging & Frontier Markets – April 2021



Source: MSCI

[33] Source: "Cabraal sworn in as State Minister for Finance, Capital Market et al", Ada Derana, August 12, 2020
[34] Source: "Windforce IPO twice oversubscribed at retail level itself", Daily FT, April 1, 2021
[35] Source: "Chrissworld, first SME to list at CSE", Daily News, April 6, 2021
[36] Source: "SE introduces framework for Real Estate Investment Trusts", Daily News, August 4, 2020
[37] Source: "SEC approves guidelines for stockbroker firms on good practices", Daily FT, January 25, 2021
[38] Source: "New SEC bill to be presented to Parliament for approval", Daily FT, June 9, 2021

Broad policy measures taken to provide relief amidst COVID-19

Tourist arrivals dipped by nearly 100% with the closure of the airport in 2020 for an extended period

Severe restrictions on Mobility

The government imposed an Island wide lockdown in March 2020 in order to mitigate the spread of COVID-19. Individuals were prohibited from leaving their homes during that time except for special needs. During this period, the govt. issued an interest free advance of LKR 10,000 to all low income households (Samurdhi beneficiaries and Samurdhi card holders) and vulnerable families, registered senior citizens, disabled people etc. during the initial lockdown in March 2020 while also allocating Rs. 400mn to distribute LKR 5,000 each to ~4mn individuals who have lost their incomes in particular districts due to the COVID-19 pandemic during the second wave in October 2020[39].

On March 17, 2020, the government announced that all international airports in Sri Lanka would be closed to arriving international commercial passenger flights for tourist arrivals because of the COVID-19 pandemic[40]. In December 2020 it was noted that the government had lost US$ 2,790m by way of levies and other revenue due to the closure of the airport as there was an almost 100% drop in tourist arrivals[41].

Sri Lanka experienced a current account surplus after many decades in July 2020 due to macroprudential measures to curb imports

Banning of Imports of Motor Vehicles and Non-essential products

Sri Lanka first imposed a ban on motor vehicles in early 2020 in order to curb its foreign exchange outflows due to its dwindling reserves. It further introduced import restrictions on non-essential items and agricultural goods such as turmeric, ginger, pepper etc. in order to promote domestic production, resulting in soaring prices for these goods. However, Sri Lanka did see a positive effect on its trade balance as a result of the import restrictions resulting in a current account surplus being experienced after decades in July 2020, this was also in line with increased levels of worker remittance seen in mid-2020[42].

Maintaining accommodative Monetary Policy

The CBSL continued to maintain an accommodative monetary policy environment and has pledged to keep interest rates low in order to give way for economic recovery. The CBSL first began monetary easing in 2019 by reducing its policy rates, most notably the Standing Deposit Facility Rate (SDFR) and the Standing Lending Facility Rate (SLFR). It reduced its policy rates further in January 2020 being the first CBSL to reduce policy interest rates following the outbreak of COVID-19 globally[43].

Debt moratoriums & credit support schemes

The CBSL utilized the Commercial banks and LFCs as the main vehicle through which to provide relief measures to affected individuals and businesses. The main measures instituted were debt moratoriums which were extended periodically and applied to industries such as tourism which were badly affected by the pandemic, and a concessional loan scheme (Saubagya Renaissance Facility) to assist Micro, Small and Medium Sector Enterprises (MSMEs) including individuals, self-employed workers and small scale farmers who were also adversely affected by the COVID-19 outbreak[44].

Maintaining consistent tax policy

Despite the fiscal challenges exacerbated by the onset of the COVID-19 pandemic, the government did not backtrack on its major tax reductions imposed at the end of 2019 and

[39] Source: "Rs. 5,000 each for over 4 m Lankans to cope with COVID-19", Daily FT, April 3, 2020
[40] Source: "Airports closed for inbound passengers till further notice", Daily News, April 5, 2020
[41] Source: "Country lost US$ 2,790 mn due to airport closure - Prasanna", Daily News, December 12, 2020
[42] Source: "SL achieves first trade surplus in decades", Daily FT, July 10, 2020
[43] Source: CBSL Press Release, March 2020
[44] Source: CBSL Press Release, April 2020

the beginning of 2020 such as the removal of PAYE and ESC. This consistency in policy was reflected in the Government Budget for 2021 which was to act as a stimulus package in order to help the economy recover.

2.7. Strengths of the Sri Lankan Economy

In a bid to improve economic activity in the country, the government set forth a proposal to grant tax exemptions to the agriculture, fisheries and livestock farming sectors, applicable over the next five years.

The inaugural budget of the new government has ushered in a framework designed to signal consistency in economic policies formulated and bring about a favourable environment for domestic corporates to operate in. These policies are also set to capitalize on Sri Lanka's strategic placement in the Indian Ocean with a focus on bringing foreign direct investments into the country.

Focus on domestic growth and investment into the economy

To focus on domestic growth, the government in its 2021 budget sought to rationalize revenue collection. One of the main methods proposed to do so was to simplify taxation by combining multiple taxes to form a special Goods and Services Tax (GST). In a bid to improve economic activity and ensure food security in the country, the government set forth a proposal to grant tax exemptions to the agriculture, fisheries and livestock farming sectors, applicable over the next five years[45].

The policy stance on food security was reinforced with import restrictions being imposed on agricultural products including turmeric, pepper, ginger and other field crops, which led to a notable increase in domestic production, with local farmers being able to receive premium prices for their produce[46]. These favourable developments resulted in 115,138 individuals moving into the agriculture sector with a view of enhancing the domestic production-based economy[47].

The pandemic has also brought about export opportunities to Sri Lanka in terms of the manufacture of personal protective equipment (PPE), with a number of companies stepping up to cater to PPE demand globally, providing a valuable source of export revenue for the country and opening up new opportunities for growth and investment[48].

To further aid growth in the domestic economy, a proposal to provide a 50% tax concession for the financial year 2021/2022 for companies that are listed on the CSE before the 31st December 2021 and the maintenance of a concessionary corporate tax rate of 14% for subsequent three years were put forth[49]. In conjunction to this, the government also showcased other policies aimed at uplifting the domestic economy. In addition, to promote self-sufficiency and import substitution, the government introduced import restrictions on motor vehicles and a number of other items[50].

These efforts have borne fruit where the industry conditions for the services and manufacturing sector, as reflected by the CBSLs Purchasing Managers' Index (PMI) for manufacturing, has shown a rebound to pre-pandemic levels at end 2020, showcasing the potential of the domestic economy to bounce back from implementations of prior lockdowns (Exhibit 23)[51].

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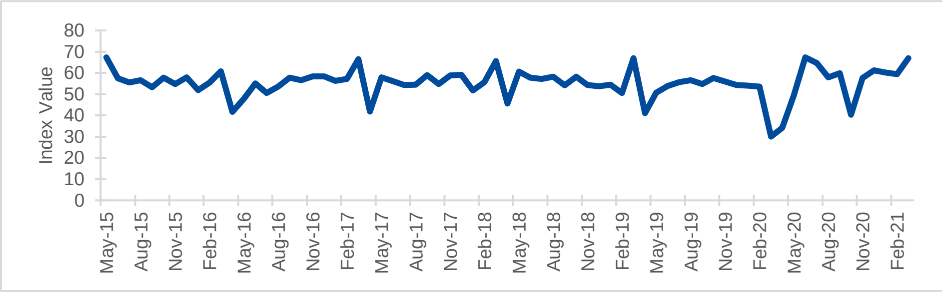
[45] Source: Budget Speech 2021, Government of Sri Lanka
[46] Source: CBSL Annual Report 2020
[47] Source: "More people took to agriculture in 2020 as services strangled due to pandemic", Daily FT, May 2021
[48] Source: "Export earnings in May increase due to PPE exports", News First, June 11, 2020
[49] Source: Budget Speech 2021, Government of Sri Lanka
[50] Source: CBSL Annual Report 2020
[51] Source: CBSL Press Release, April 2021

Exhibit 23: Manufacturing Purchasing Managers' Index



Source: CBSL Purchasing Managers' Index

Higher FDI inflows expected in the future

The construction of Port City is estimated to attract US$ 5.6bn worth of FDI whilst estimated job opportunities created from its commercial operations, once mature, are expected to be 209,000.

FDI inflows which have in the past been maintained within a narrow range of around US$ 1-2bn, are expected to improve in the medium to long term with the launch of a number of key development initiatives such as the following;

The Colombo Port City

Port City; consisting of 5.7m sqm of gross floor area for residential, commercial, retail and hospitality is currently being developed by the China Harbour Engineering Company with an initial investment of US$ 1.4bn. The reclamation of land within this area was completed in 2019 and development of common infrastructure is currently in progress, with targeted completion of the Port City Project expected to be by 2041[52]. The area is classified as a Special Economic Zone (SEZ), which is expected to be governed by a separate regulatory environment with an emphasis on being more investment friendly is expected to come into effect in the near term. Transactions within the zone are set to be dollarized, shielding the area from adverse currency movements[53].

In line with the government's objective of bringing non-debt creating inflows into the country, the construction of Port City is estimated to attract US$ 5.6bn worth of FDI whilst estimated job opportunities created from its commercial operations, once fully operational, are expected to be 209,000. The significant employment opportunities generated are expected to reduce brain drain from the country, strengthen its BOP position and bolster economic growth. The value addition to GDP once the project is fully complete is expected to be US$ 29.3bn[54]. The construction stage of the project however, is expected to generate sizeable outflows arising from the import of raw materials, construction material and equipment to build the project. However, these high outflows are subsequently expected to be mitigated once the project is fully operational, with the export of services and tourism revenue creating a net positive for the country.

The Hambantota Pharma Zone & Eravur Garment Town

In November 2020, the government decided to establish a pharmaceutical manufacturing zone in Hambantota located within the country's southern province. This area will span 400 acres and will involve foreign investor participation with global pharmaceutical companies being expected to set up companies within the zone. The project is expected to be implemented in two stages of 200 acres each, with the Sri Lanka Board of Investment (BOI) expected to support all infrastructure facilities within this zone[55].

[52] Source: Economic Impact Assessment of the Port City Colombo, PricewaterhouseCoopers, February 11, 2020
[53] Source: "Sri Lanka Port City Special Economic Zone to be dollarized", Economynext, March 29, 2020
[54] Source: Economic Impact Assessment of the Port City Colombo, PricewaterhouseCoopers, February 11, 2020
[55] Source: Investment Policy Hub, UNCTAD, November 2020

The Pharma Zone is expected to meet 40% of domestic pharmaceutical requirements through the local manufacturing of drugs whilst creating a pathway to US$ 1bn export earnings as import substitution by 2025[56], helping the government achieve its objective of self-sufficiency and mitigate currency depreciation.

The BOI is also expected to set up a garment park in Eravur, Batticaloa, located in the country's Eastern Province[57]. This would be a significant step in increasing locally-sourced raw materials, including artificial and natural textiles for the apparel industry. This would enable the country to reduce its high dependency on imports. In 2020, Sri Lanka imported US$ 234.8m worth of textile and textile articles, comprising 15% of the country's total imports[58].

Key factors to ensure that these projects are expedited with sufficient foreign investor participation would be through upgrades made to the country's sovereign credit rating and improvements in factors dictating the country's Ease of Doing Business ranking.

2.8. Challenges of the Sri Lankan economy

Worsening Debt and Fiscal Position

Growing Debt Burden

Supporting the economy amidst the COVID-19 pandemic and ensuring fiscal and debt sustainability remains a key challenge for Sri Lankan

One of the main challenges faced by the Sri Lankan economy currently is its growing debt burden. The country's debt burden ballooned to a massive 101.0% in 2020 from the 86.8% recorded just one year prior. In such a condition, with the repayment obligations amounting to an average of around US$ 4bn for the next 5 years, the means of funding these repayments have become of utmost importance for the economic future of the country.

Adding to the financing concerns was the downgrade of the country's long term foreign currency credit ratings by all major credit rating companies, which was affirmed by Fitch Ratings in June 2021[59]. Such downgrades hinder the ability of the country to access foreign funding sources which had been a primary source of funding for the country.

At the same time, the government had been hesitant to enter into an agreement to obtain funding from the International Monetary Fund (IMF). This would also mean that any structural reforms expected to improve the debt sustainability of the country is likely to be delayed.

In this backdrop, the government had decided to increase its portion of domestic borrowings, as such the domestic debt as a percentage of GDP ballooned to 60.6% in 2020 compared to the 45.5% recorded in 2019[60].

Growing fiscal deficits

Alongside the increasing debt burden, the financing needs of the country have been exacerbated by the rising fiscal deficit. The overall fiscal deficit deteriorated to 11.1% of GDP in 2020 in comparison to the 9.6% of GDP recorded in 2019. This decline reflects the effects of declining government revenue as a result of the tax concessions introduced in the latter part of 2019. The effects were exacerbated by the decline in economic activity due to

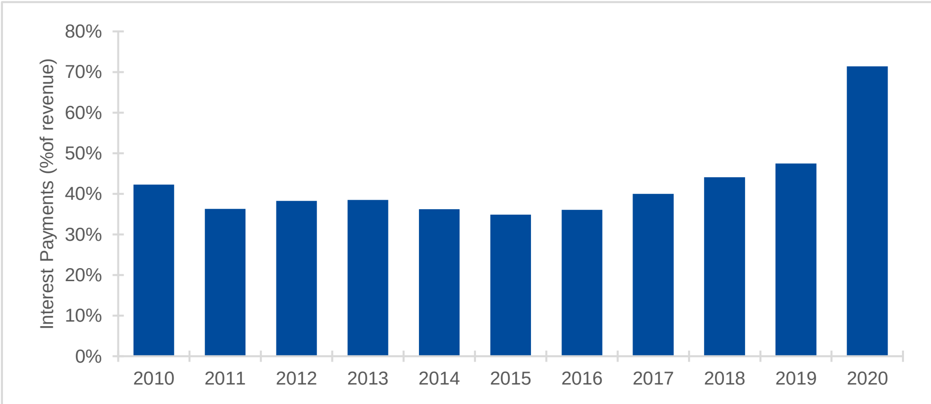
[56] Source: Board of Investment Sri Lanka, December 2020
[57] Source: "BOI to set up Garment Park in Eravur", Daily News, May 22, 2020
[58] Source: CBSL External Sector Press Release, December 2020
[59] Source: "Fitch Affirms Sri Lanka at 'CCC'",Fitch Ratings, June 14, 2021
[60] Source: CBSL Annual Report 2020

the COVID-19 pandemic as well as an increase in recurrent expenditure due to various measures put in place to support the economy and to strengthen the healthcare sector during the pandemic[61].

During the year 2020, the government also took an unconventional step to change the mechanism of calculating the fiscal deficit to an accrual basis instead of the more conventional cash basis [62]. This increased the overall fiscal deficit of 2019 to 9.6% of GDP from the previously published 6.8% of GDP.

The World Bank in a recent report had also commented that striking a balance between supporting the economy amidst the COVID-19 pandemic and ensuring fiscal and debt sustainability remains a key challenge for the Sri Lankan economy[63].

Exhibit 24: Interest Payments as a percentage of revenue (2010-2020)



Source: CBSL Fiscal Sector Data

Weak External Sector

Weak currency performance

One of Sri Lanka's biggest challenges lies in the persistent trade deficit which needs to be addressed as exports remain uncompetitive even with currency depreciation.

One of the main challenges faced by Sri Lanka is the weakening currency. While the Rupee only saw a 2.7% depreciation against the US Dollar for the whole year in 2020, the currency weakened by a staggering 10.1% during the period upto April 2020. The April 2020 peak was a result of the outflows from Government Securities and Stocks [64].

In light of a weakening currency, the CBSL had intervened on several occasions in an attempt to keep the LKR at desirable levels. These measures included, entering into sell-buy agreements with Licensed Commercial Banks (LCBs), implementing import controls, putting in place requirements to convert a portion of export proceeds and opening of Special Deposit Accounts to encourage foreign currency deposits within the formal banking sector.

To address this issue, the government has focused on attracting FDI as a source of non-debt creating inflows.

[61] Source: CBSL Annual Report 2020
[62] Source: "Sri Lanka 2020 budget deficit projected at 7.9-pct of GDP, 2019 gap re-stated up", Economynext, November 16, 2020
[63] Source: "World Bank Reassures Support for Sri Lanka to Build Back Better from COVID-19", World Bank, April 25, 2021
[64] Source: CBSL Annual Report 2020

However, along with continued reoccurrences of the pandemic which hampers economic activity, and the possible inability to continue some of the measures put in place to counter the weakening of the currency, the Rupee is expected to weaken in the medium term.

Weak Balance of Payments position

While the trade deficit saw a considerable fall of 25.2% in 2020 – the lowest it had reached since 2010, as a result of the import controls put in place, the lockdowns imposed in the US and the EU – the two largest importers from Sri Lanka [65], led to a drastic fall in exports (Exhibit 25).

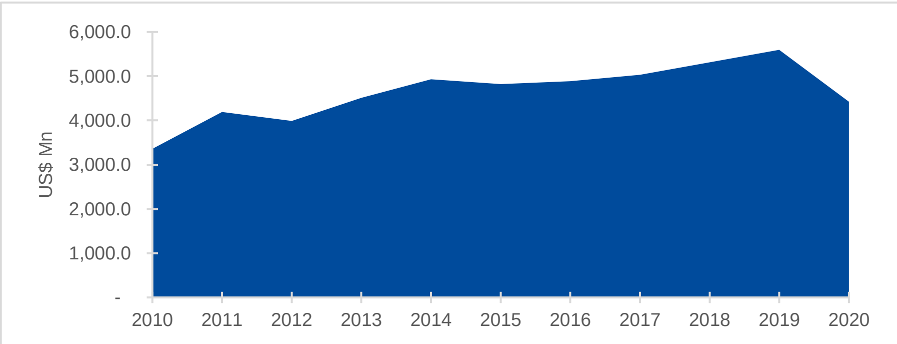
These import control measures are often not sustainable over an extended period of time. This is a concern for countries like Sri Lanka, where the finished export goods heavily depend on imported raw materials. This is especially true with pressure exerted by international bodies including the EU to remove such import controls[66]. The failure to do so may result in the country losing some of the privileges such as the GSP+ scheme.

The recent adaptation of a resolution by the EU parliament, calling for the EU Commission to consider the temporary suspension of Sri Lanka's GSP+ status due to concerns over human rights conventions exacerbates the possible negative impacts on Sri Lankan exports to the EU which is its second largest export destination[67].

As such, although future FDI inflows and the recovery of the US and EU economies would bridge the gap to some extent, a persistent trade deficit needs to be addressed as exports remain uncompetitive even with currency depreciation. This is important given that the tourism sector which brings in a considerable portion of foreign income to the country may also take longer than expected to recover given the resurgence of the pandemic.

Short term inflation expectations remain high due to measures taken to combat the spread of the COVID-19 pandemic and its economic impacts.

Exhibit 25: Export Earnings from the Textiles and Garments sector (2010-2020)



Source: CBSL External Sector Data

High Inflation Expectations

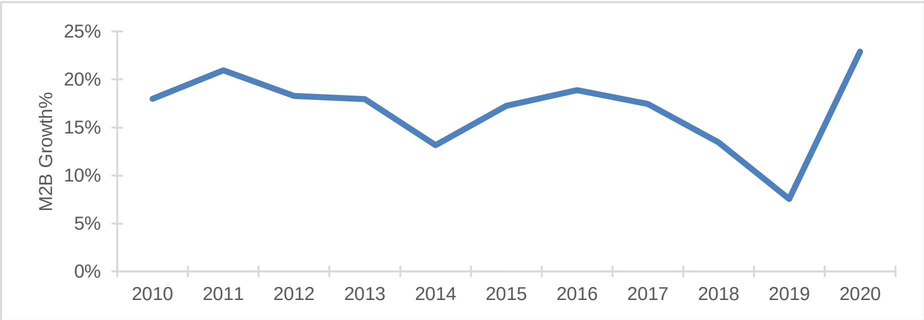
The general price levels increased at a slower pace in 2020 mainly supported by the subdued demand as a result of containment measures put in place in order to stop the spread of the COVID-19 pandemic and the various control measures put in place to control non-essential imports[68].

[65] Source: CBSL Annual Report 2020
[66] Source: "EU unimpressed with Sri Lanka's import ban", Daily Mirror, November 05, 2020
[67] Source: "EU parliament adopts resolution on Sri Lanka; wants PTA repealed, GSP+ withdrawn", Economynext, June 11, 2021
[68] Source: CBSL Annual Report 2020

However, with the restarting of economic activity in the country and the expected recovery of the economy, the demand for goods and services are expected to increase resulting in demand-pull inflation. This is further exacerbated by the increase in money supply due to the various measures taken by the government in the form of money printing and interest rate caps to support the economy during the pandemic. Private sector credit which had risen throughout 2020 is also likely to remain at elevated levels adding to the inflationary pressure[69].

The import restrictions put in place and the resulting black-market activity as well as a weakening currency amidst an expected recovery of global oil prices would also mean that the cost of imported goods and raw materials would rise resulting in a further upward pressure in the general price levels[70].

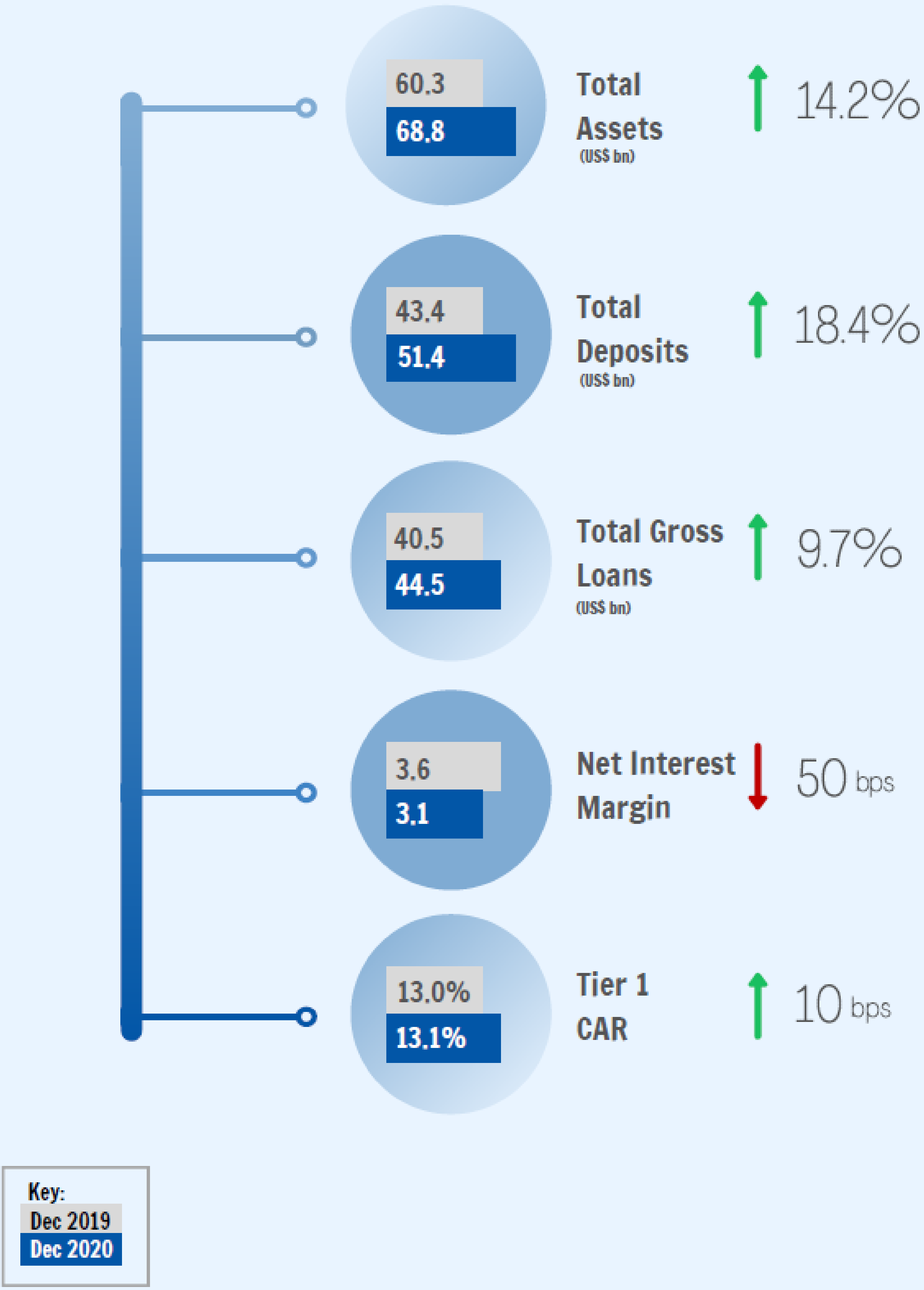
Exhibit 26: Growth in Broad Money (M2b) (2010-2020)

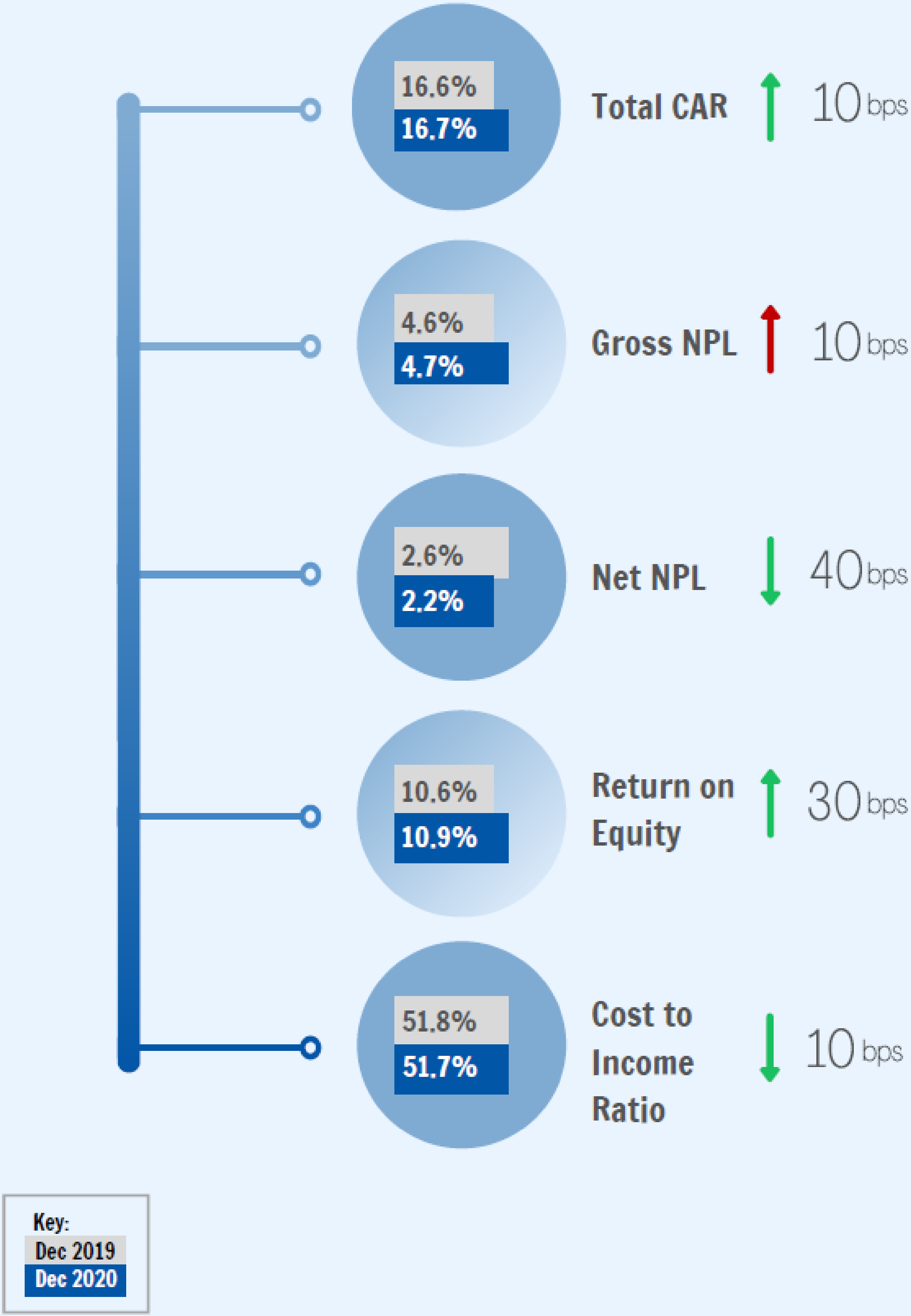


Source: CBSL Weekly Statistics

[69] Source: "CB eyes 14% private credit growth; hints at remaining dovish throughout 2021", Daily FT, January 05, 2021
[70] Source: CBSL Recent Economic Developments Report, October 2020

Performance Highlights - Licensed Commercial Banking Sector




16.6%
16.7%
Total CAR
10 bps
4.6%
4.7%
Gross NPL
10 bps
2.6%
2.2%
Net NPL
40 bps
10.6%
10.9%
Return on Equity
30 bps
51.8%
51.7%
Cost to Income Ratio
10 bps
Key:
Dec 2019
Dec 2020

2. Banking Sector Overview

Sri Lanka's banking sector has grown from humble beginnings since the 1800s to a well-developed industry with 30 banks including commercial and specialized banks

Sri Lanka's banking sector has grown from humble beginnings since the 1800s to a well-developed industry with 30 banks including commercial and specialized banks. The CBSL serves as the sector's regulator and supervisor. The Basel III framework and the Sri Lanka Accounting Standard (SLFRS) 9 were the two key standards adopted by Banks in the recent past under the supervision of the CBSL. The onset of the COVID-19 pandemic led the CBSL to take a variety of measures including the offering of debt relief through moratoriums, a 300 basis points (bps) reduction of the Statutory Reserve Ratio (SRR) over the year and the allowance for LCB's to draw down on capital buffers, among other measures, to help maintain stability in the banking system. The CBSL is also encouraging consolidation of the banking sector to enable the merger of weaker banks with banks with stronger financial footing to enhance the resiliency of the banking sector[71].

2.1. Brief History

The preliminary entry of foreign banks in Sri Lanka took place in the mid-nineteenth century, focusing primarily on trade operations for British plantations. The first state-owned commercial bank however, wasn't established in Sri Lanka up until 1939. In the absence of competition, the banking system in Sri Lanka remained largely static between 1950 and 1976. In 1977, measures implemented in terms of economic liberalization led to the gradual deregulation of the banking sector, ushering in new banks to the sector over time.

Exhibit 27: Evolution of the Banking sector

Year	Key Milestones
1939	The Bank of Ceylon (BOC), the first state-owned commercial bank, was established under the Bank of Ceylon Ordinance (No. 53 of 1938).
1950	The CBSL of Sri Lanka (CBSL) was founded by the Sri Lankan government as the primary regulatory agency for the financial services sector.
1956	The Development Finance Corporation of Ceylon (now known as DFCC Bank) was founded as the country's first development bank.
1961	The People's Bank was founded as a public sector bank under the People's Bank Act No. 29 of 1961.
1969	Commercial Bank of Ceylon was established as the country's first private bank.
1971	The National Savings Bank (NSB) was formed by the merger of four financial service providers.
1977	Interest rate reform, market-oriented credit distribution, and the allowance of market entry for domestic and international banks take place.
1979	The National Development Bank of Sri Lanka (now known as NDB) was established as a specialist financial institution concentrating their activities in lending to small and medium-sized businesses.
1986	Introduction of the first Automated Teller Machine (ATM) by HSBC.
1988	The CBSL was given greater authority over banking supervision and control in Sri Lanka, with The Banking Act 1988 being passed.
1990	The Credit Information Bureau (CRIB) was founded by the CBSL to serve as a platform for banks in screening borrowers in order to minimize loan defaults.

[71] Source: CBSL Road Map 2021, Monetary and Financial Sector Policies for 2021 and Beyond

2002	The operator of the country's interbank payment scheme, Lanka Clear, began operations under the CBSL's oversight.
2008	BASEL II framework for capital adequacy was adopted.
2010	Introduction of the Sri Lanka Deposit Insurance Scheme.
2012	Issuance of SLFRS resulted in the adoption of IFRS.
2019	Capital requirements under the BASEL III framework capital regulations become fully effective.

Source: Economic Review April/May 2019, CBSL 40th Anniversary Commemorative Volume, Banks and Banks System Journal, CBSL Annual Report 2014 & 2018, CBSL Directions, Determinations, and Circulars issued to Licensed Commercial Banks

Exhibit 28 shows how the number of banks in Sri Lanka increased over the years.

Exhibit 28: Number of banks over the years

	1977	1990	2000	2010	2020
Local commercial banks	4	6	10	11	13
Foreign commercial banks	7	18	16	11	11
Licensed specialized banks	N/A	N/A	12	9	6

**Note: N/A: Not Available*
Source: Financial reforms in Sri Lanka and their influence on the banking industry, Banks and Bank Systems, Volume 4, Issue 4, 2009; CBSL Annual Report 2010 & 2020

2.2. Overview

Licensed Commercial Banks (LCBs) held a share of 87.5% of total assets of the banking sector as at end 2020[72]. Out of the LCBs, 4 Banks are categorized as Domestic Systemically Important Banks (D-SIBs) in Sri Lanka; the two state commercial banks and the 2 largest private commercial banks (Exhibit 29). Under a revised framework introduced by the CBSL in December 2019, D-SIBs are determined based on four factors: size, interconnectedness, substitutability, and complexity. Under this framework, D-SIBs were required to maintain revised loss absorbency requirements to be maintained above the Common Equity Tier 1 (CETI) capital. In March 2020, with the onset of the spread of COVID-19 in Sri Lanka, the CBSL allowed D-SIBs to draw down on their capital conservation buffers by 100 bps[73].

Out of the LCBs, 4 Banks are categorized as Domestic Systemically Important Banks (D-SIBs) in Sri Lanka; the two state commercial banks and the 2 largest private commercial banks.

Exhibit 29: Domestic Systemically Important Banks

As at end 2020	Total Assets (US$ Bn)
Bank of Ceylon	16.23
People's Bank	12.77
Commercial Bank of Ceylon PLC	9.43
Hatton National Bank PLC	7.30

Source: Annual Reports

The contribution of Licensed Specialized Banks (LSBs) toward the asset base of the banking industry, standing at just 12.5%, showcases the fact that the sector's systemic importance to the banking sector is minimal. However, National Savings Bank (NSB), which

[72] Source: CBSL Annual Statistics
[73] Source: CBSL

functions as an LSB, accounts for 9% of total assets within the banking sector. LSBs can be of two types, savings banks and regional development banks[74]. During 2020, the CBSL issued directives for LCBs and LSBs instructing them of several relief measures to be provided to customers adversely affected by the COVID-19 outbreak including debt moratoriums and concessional loan schemes.

2.3. Banking Density

The Northern Province recorded the highest banking density overall in comparison to other provinces in the country, followed by the Western Province which is the most densely populated province in the country and is also home to the country's commercial and administrative capitals (Exhibit 30).

The Northern Province recorded the highest banking density overall in comparison to other provinces in the country, followed by the Western Province which is the most densely populated province in the country and is also home to the country's capital.

Exhibit 30: Banking Density

Province	Banking Density (No. of bank branches per 100,000 persons) as at end 2019*
North	21.1
Western	18.6
Southern	16.4
Eastern	16.3
North Central	16.1
Uva	14.8
North Western	13.8
Central	13.8
Sabaragamuwa	13.3
Overall	**16.5**

Source: Economic and Social statistics of Sri Lanka 2020, CBSL
**Latest available figures*

The bank and branch network for LCB's and LSB's in Sri Lanka exceed 3,600, with the LCB branch network having grown consistently over the past decade (Exhibit 31).

Exhibit 31: Distribution of Banks

	2020
No of LCB branches	**2,916**
Local	2,854
Foreign	47
No of LCB ATMs	**5,744**
No of LSB branches	**703**
National Level Savings Banks	265
Housing Finance Institutions	64
Other LSBs	374
No of LSB ATMs	**432**

Source: Annual Report 2020, CBSL

[74] Source: NSB Annual Report 2020; CBSL Annual Report 2020

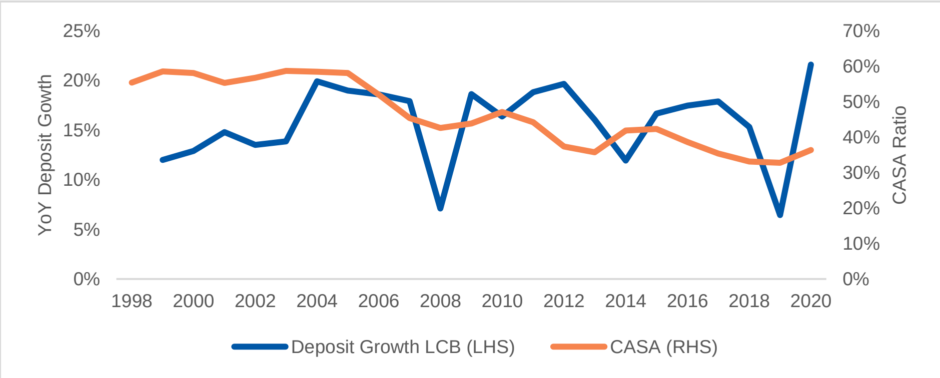
2.4. Resource Mobilization

Deposit growth, which was fluctuating over the past several years spiked to 22% in 2020, possibly due to conservative use of funds by the public amidst the pandemic

LSBs cannot provide customers with demand deposit facilities and have limited foreign exchange transaction capacities, while LCBs are able to engage in these transactions[75]. Deposit growth, which was fluctuating over the past several years spiked to 22% in LKR terms in 2020, possibly due to conservative use of funds by the public amidst the pandemic, among other factors (Exhibit 32). The low-cost fund base of the sector, as measured by the CASA ratio stood at 37% in 2020, improving from 33% recorded in 2019[76].

Exhibit 33 is a snapshot of the total deposit, borrowings and lending portfolios of the Banking industry.

Exhibit 32: Deposit growth and CASA ratio of LCBs (LKR terms)



Source: CBSL statistics

The CBSL reduced lending caps of selected lending products and put in place lending targets for the SME sector in order to direct lending towards specific sectors of the economy

Exhibit 33: Total Deposits, Borrowings and Lending of the Banking Industry

US$ Bn	2017	2018	2019	2020
Total Assets	**67.3**	**64.5**	**68.9**	**78.7**
LCB	58.4	56.8	60.3	68.8
LSB	8.9	7.8	8.7	9.9
% share LCB	87%	88%	87%	87%
% share LSB	13%	12%	13%	13%
Total Deposits	**40.7**	**46.8**	**50.4**	**59.8**
LCB	35.4	40.8	43.4	51.4
LSB	5.4	6.0	7.0	8.3
% share LCB	87%	87%	86%	86%
% share LSB	13%	13%	14%	14%
Total Borrowings	**8.85**	**9.7**	**9.3**	**9.1**
LCB	7.4	8.7	8.5	8.5
LSB	1.5	1.1	0.8	0.6
% share LCB	84%	89%	92%	94%
% share LSB	16%	11%	8%	6%
Total Gross Loans	**35.4**	**42.4**	**44.7**	**48.8**
LCB	31.9	38.4	40.5	44.5
LSB	3.5	3.9	4.2	4.3
% share LCB	90%	91%	91%	91%
% share LSB	10%	9%	9%	9%

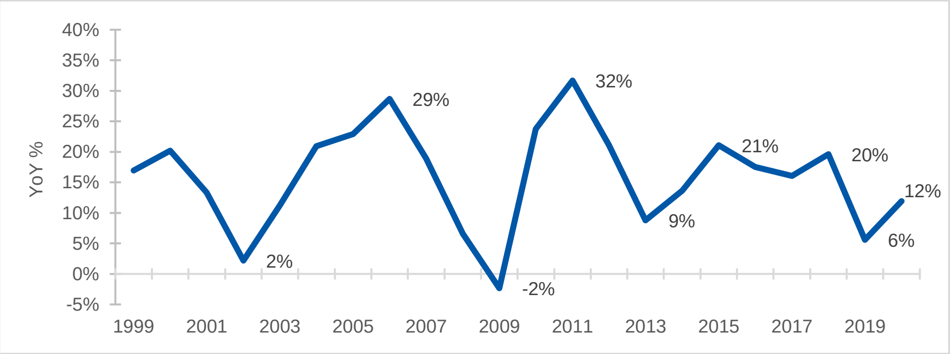
Source: CBSL Annual Statistics

Note: The percentage growth shown in charts and tables may not correspond to the figures shown in the table due to currency translation impacts as well as the figures shown may not matchup due to rounding errors

[75] Source: Guidelines on opening new banks in Sri Lanka, CBSL, April 2018
[76] Source: CBSL quarterly statistics

The CBSL implemented an accommodative monetary policy stance, bringing down key lending rates over the year in a step-wise manner, with the AWPR (Average Weighted Prime Lending Rate) falling by 393 bps in 2020. Increased liquidity was also provided with the SRR being cut progressively over the year to a tune of 300 bps, alongside other policy rate reductions. Although YoY banking sector loan growth picked up (Exhibit 34), its impact has not translated to the growth in private sector credit, with private credit growing by only 6.5% (From 2015 – 2019 on average, private sector credit growth was 16%) given low demand for loans and selective lending by banks[77]. In conjunction with this, the CBSL reduced lending caps of selected lending products and put in place lending targets for the SME sector in order to direct lending towards specific sectors of the economy.

Exhibit 34: Banking sector YoY Loan Growth

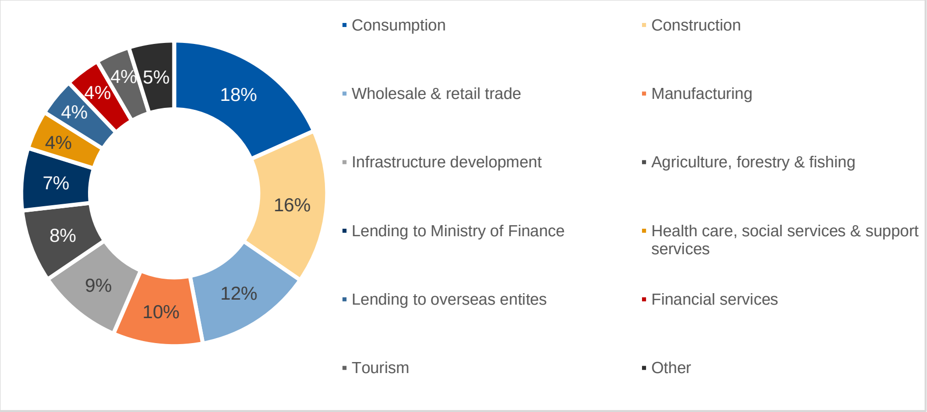


Source: CBSL statistics

The manufacturing, consumption, agriculture, trade, tourism and construction sectors collectively accounted for 77% of total loans and advances in the banking sector as at end 2020[78]. In terms of Non-performing Loans (NPLs), an increase in NPLs for the manufacturing and trade sectors in 2020 stemmed mainly from adverse business conditions prevailing due to COVID-19 in conjunction to import restrictions imposed[79]. The banking sector exposure to various economic sectors as at end 2020 is shown in Exhibit 35

The manufacturing, consumption, agriculture, trade, tourism and construction sectors collectively accounted for 77% of total loans and advances in the banking sector as at end 2020

Exhibit 35: Sectoral credit exposure of the Banking sector as at December 2020



Source: CBSL Annual Report 2020

[77] Source: CBSL Annual Report 2020
[78] Source: CBSL Annual Report 2020,
[79] Source: CBSL Financial System Stability Review 2020

2.5. Financial Inclusion

The Financial Inclusion Survey carried out showcases that account ownership stands at 90%, comparatively a higher number than the South Asian average reported by the Global Findex

The CBSL launched the first ever National Financial Inclusion Strategy (NFIS) of Sri Lanka in March 2021[80]. With the launch of the NFIS, Sri Lanka joins more than 60 countries who have taken efforts to bolster financial inclusion and reach sustainable financial solutions. Results from the survey show that Sri Lanka currently faces gaps in financial inclusion as a result of low levels of financial literacy, limited access to credit for individuals and MSMEs, low acceptance and usage of electronic payment instruments and low availability and use of insurance products[81].

The Financial Inclusion Survey carried out showcases that account ownership stands at 90%, comparatively a higher number than the South Asian average as reported by the Global Findex. The survey also found Sri Lanka's density of banking network to be almost double the regional average in South Asia. The percentage of adults owning a mobile money account in Sri Lanka stands at 2% in comparison to the regional average 4% in South Asia[82].

The NFIS seeks to address the lack of financial inclusion in the country under 4 pillars consisting of Digital Finance and Payments, Micro, Small, and Medium sized Enterprises (MSME) Finance, Consumer Protection and Financial Literacy & Capacity Building[83]. Each of these pillars contain specific objectives for the achievement of financial inclusion within the country alongside an action plan tracker to ensure that accountability and progress for the objectives are met.

2.6. Regulatory Authorities

A new Banking Act, which is currently in the process of being formulated, includes provisions for deposit insurance and resolution procedures for banks

The CBSL is the key regulatory agency for the financial system. The CBSL ensures financial market stability and limits systemic risk by regulating and supervising the entire banking system. In addition, the Sri Lankan Securities and Exchange Commission (SEC) regulates publicly listed corporations on the stock exchange.

2.7. Key laws governing the Banking Sector and recent amendments

The Banking Act No. 30 of 1988 (as amended in 2006), the Monetary Law Act No. 58 of 1949, and the Companies Act No. 7 of 2007 are the main laws that regulate the industry. The listing rules of the Colombo Stock Exchange and The Securities and Exchange Commission (SEC) of Sri Lanka Act No. 36 of 1987, must be followed by all publicly traded firms. A new Banking Act, which is currently in the process of being formulated, includes provisions for deposit insurance and resolution procedures for banks[84]. While measures were implemented to strengthen the banking sector this year, relaxation of several other measures were also observed given the adverse effects arising from the pandemic.

The total value of working capital loans approved by the CBSL under the Saubagya Loan Scheme stood at LKR 179.3bn (~US$ 962m) for 62,573 beneficiaries at the end December 2020

Measures taken to provide relief amidst COVID-19

'Saubagya' COVID-19 credit support facility and debt moratoriums

The CBSL issued directions to LCBs and NSB to offer a new refinance facility for businesses adversely affected by COVID-19 under the Saubagya Loan Scheme. This facility provided

[80] Source: CBSL National Financial Inclusion Strategy of Sri Lanka (2021 – 2024)
[81] Source: CBSL National Financial Inclusion Strategy of Sri Lanka (2021 – 2024)
[82] Source: CBSL National Financial Inclusion Strategy of Sri Lanka (2021 – 2024)
[83] Source: CBSL National Financial Inclusion Strategy of Sri Lanka (2021 – 2024)
[84] Source: CBSL Annual Report 2020

concessional working capital loans at low interest rates to COVID-19 affected MSMEs, and self-employed individuals. This scheme was deployed under three phases across the year[85]. The total value of working capital loans approved by the CBSL under the Saubagya Loan Scheme stood at LKR 179.3bn (~US$ 962m[86]) for 62,573 beneficiaries at the end December 2020[87].

In conjunction with this, debt moratoriums were also granted in March 2020 towards customers in several sectors adversely affected by the pandemic where loans under these moratoriums would have their classification frozen. The moratoriums which were initially granted for a period of 6 months till end September 2020 under phase 1 of the scheme, were further extended till 31st March 2021 under phase 2[88]. Given the impact of the 3rd COVID-19 wave, the CBSL issued another circular for the restructuring of existing credit facilities in May 2021 on request of customers, to be effective till 31st August 2021[89]. Given the prolonged impact of the pandemic on the tourism sector, the moratoriums provided to the tourism sector were further extended till September 2021[90].

Changes to Capital requirements

Banks were allowed to draw down their capital conservation buffers by 100 bps for D-SIBs and 50 bps for non D-SIBS given the impact of COVID-19 on the banking sector

In 2020, in order to allow smooth credit flow to the economy amidst the pandemic, banks were allowed to draw down their capital conservation buffers by 100 bps for D-SIBs and by 50 bps for non D-SIBs given the impact of COVID-19 on the banking sector[91]. (Refer exhibit 45 on page 52 for the minimum capital requirements applicable to each bank, as given in their annual reports). The banking sector was largely in compliance with required capital adequacy ratios without drawing down on capital conservation buffers[92].

In 2017, the CBSL introduced regulations to enhance the minimum capital of LCBs to LKR 20bn by end-2020, while stipulating requirements for foreign banks and LSBs as well. However, in light of COVID-19, the timeline to meet this requirement was rescheduled to December 2022[93].

Suspension of purchase of Sri Lanka International Sovereign Bonds by banks

In 2020, the CBSL issued a Banking Act Direction which suspended LCBs and National Savings Bank from purchasing Sri Lanka International Sovereign Bonds (ISBs), in order to ease pressure on the exchange rate[94]. In June 2021, CBSL allowed banks to purchase ISBs subject to certain conditions including the funds being sourced by foreign borrowings[95].

Support for SMEs and marginal borrowers

In order to direct lending towards priority sectors, the CBSL introduced lending targets to the Micro, Small and Medium Enterprise (MSME) sector in April 2021. Accordingly, licensed banks are ordered to ensure a growth in lending to MSMEs of at least 20% YoY for FY 2021[96].

In August 2020, the CBSL also lowered maximum interest rates applicable on lending products including credit cards and pawning [97] to offer support to marginal borrowers[98].

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[85] Source: Banking Circular No.5 of 2020: "Rupees 50 Billion, Six-Month Re-Financing Facility to Support COVID-19 Hit Businesses including Self Employment and Individuals "
[86] Note: Converted using LKR/US$ = 186.4, December 2020, CBSL data
[87] Source: CBSL Annual Report 2020
[88] Source: CBSL Banking Circular No.10 of 2020
[89] Source: CBSL Banking Circular No.05 of 2021
[90] Source: CBSL Banking Circular No.4 of 2021
[91] Source: CBSL Annual Report 2020,
[92] Source: CBSL Annual Report 2020
[93] Source: CBSL Annual Report 2020
[94] Source: CBSL Banking Act Direction No. 11 of 2020
[95] Source: CBSL Banking Act Direction No. 6 of 2021
[96] Source: CBSL Monetary Law Act Order No. 1 of 2021
[97] Source: CBSL Monetary Law Act Order No.2 of 2020
[98] Source: CBSL Monetary Law Act Order No.1 of 2020

Exhibit 36: Other Regulatory Changes implemented due to COVID-19

	Information on Other Regulatory Changes implemented due to COVID-19
Measures to provide enhanced liquidity	Regulations were issued to licensed banks which allowed certain additional assets to be considered as liquid assets, subject to conditions, for the purpose of computation of Statutory Liquid Assets Ratio (SLAR), and reduced the minimum requirement for Liquidity Coverage Ratio (LCR) and Net Stable Funding Ratio (NSFR) subject to enhanced supervision and frequent reporting up to 30 June 2021.
Suspension of discretionary payments	Banking Act Directions were issued suspending discretionary payments of licensed banks including cash dividends, profit repatriation, share buy-back and increasing management allowances and payments to the Board of Directors.
NPL classification relaxation	Regulations were issued permitting banks to provide additional 60 days to settle loans and advances which became past due during March 2020. The CBSL also withdrew the requirement to classify all credit facilities of a borrower as NPL when the aggregate NPLs of that borrower exceeded 30% of their total credit facilities.

Source: CBSL, CBSL Financial System and Stability Report 2020, Banking Act Direction No.5,6 of 2020

Other regulatory measures implemented in 2020

Group-wise Consolidated Risk-based Supervision Framework

The CBSL formulated a framework for Group-wise Consolidated Risk-based Supervision Framework (GCRS) to address contagion risks arising from group entities

The CBSL formulated a Group-wise Consolidated Risk-based Supervision Framework (GCRS) with necessary amendments being made in the new Banking Act to address contagion risks arising from group entities[99].

Concept Paper to establish a dedicated Asset Management Company prepared

The CBSL has drafted a concept paper for a dedicated Asset Management Company (AMC) to purchase and manage non-performing assets of the banking sector and non-banking financial institutions. This will also allow such intermediaries to restructure their balance sheet through a reduction of NPLs[100].

Drafting of a company resolution framework for banks and finance companies

The CBSL is in the process of drafting a company resolution to provide resolution techniques and exit strategies for failing bank and financial institutions[101].

2.8. Key Performance Indicators

Exhibit 37 gives a summary of the KPIs of the LCB sector overtime and the subsequent charts show the performance of selected banks against sector KPIs.

This report covers all publicly Listed LCBs in Sri Lanka as well as select Public Sector and unlisted private sector banking Institutions. Note that for comparison purposes, the KPI charts shown in the subsequent pages only include the performance of LCBs. For details of the individual bank performances, see the Bank Profiles section of the report.

[99] Source: CBSL Annual Report 2020
[100] Source: CBSL Annual Report 2020
[101] Source: "CB to draft company resolution framework, The Sunday Times, October 04, 2020

ABL : *Amana Bank*

BOC : *Bank of Ceylon*

CBL : *Cargills Bank*

COMB : *Commercial Bank*

DFCC : *DFCC Bank*

PB : *People's Bank*

HNB : *Hatton National Bank*

NDB : *National Development Bank*

NSB : *National Savings Bank*

NTB : *Nations Trust Bank*

PABC : *Pan Asia Banking Corporation*

PB : *People's Bank*

SAMP : *Sampath Bank*

SDB : *SANASA Development Bank*

SEYB : *Seylan Bank*

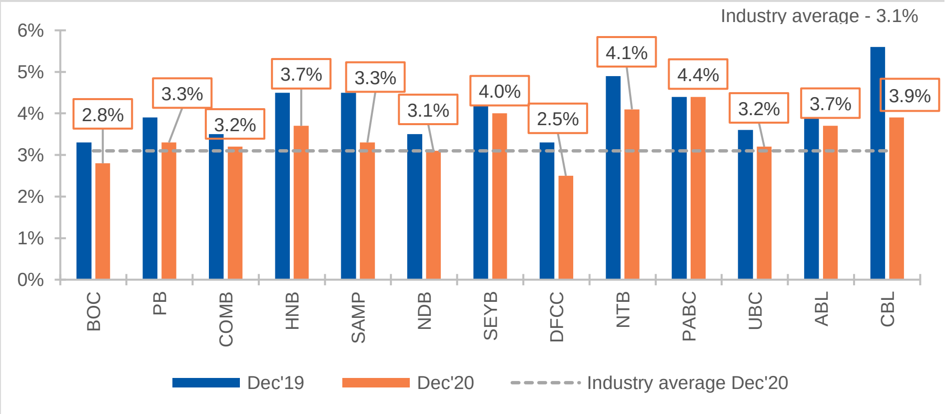
UBC : *Union Bank*

Exhibit 37: Key Performance Indicators of the LCB sector (FY End December)

%	2015	2016	2017	2018	2019	2020
Net Interest Margin	3.5	3.6	3.5	3.7	3.6	3.1
Cost to Income Ratio	51.1	48.9	45.2	48.5	51.8	51.7
ROA before tax	1.9	2.0	2.1	1.9	1.5	1.4
ROA after tax	1.3	1.4	1.5	1.2	1.0	1.0
ROE after tax	15.7	17.2	17.4	13.7	10.6	10.9
Gross NPL	2.9	2.4	2.3	3.3	4.6	4.7
Net NPL	1.3	1.0	1.0	1.8	2.6	2.2
Gross Loans/Deposits	91.8	91.9	90.1	94.2	93.4	87.5
Tier 1 CAR	12.8	12.5	13.4	13.0	13.0	13.1
Total CAR	15.3	15.6	16.4	16.2	16.6	16.7

Source: CBSL, Annual Statistics

Exhibit 38: Net Interest Margins (NIM) – FY December '20



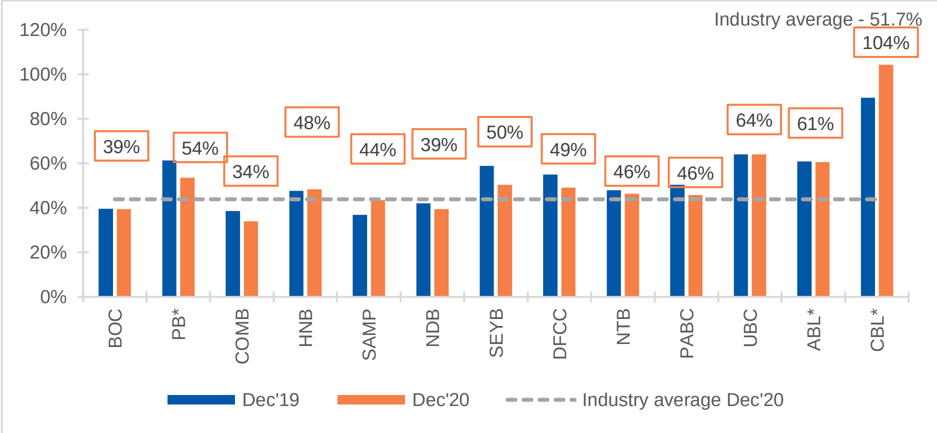
Source: CBSL, Annual reports, Quarterly reports
Note: The Net Financing Margin was used for ABL for comparison purposes

The industry operated in an environment with all-time low interest rates (as measured by the Average Weighted Prime Lending Rate) in 2020, resulting in industry wide NIMs dropping from 3.6% to 3.1%. CBL, SAMP and HNB saw the largest drops in NIMs during the year (Exhibit 38). Another factor that weighed down on NIMs at certain banks was the modification losses (or day 1 losses) recorded on account of debt moratoriums and other relief measures extended to pandemic-hit customers. SAMP recorded a modification loss of LKR 3.1bn (~US$ 16.7m[102]) on account of debt moratoriums, with Net Interest Income (NII) dropping by LKR 7.8bn (~US$ 41.7m[103]) during the year. BOC, PB which recorded relatively smaller drops in NIMs and PABC which maintained stable NIMs, were among the banks that recorded the highest loan growth during the year[104].

[102] Note: Converted using LKR/US$ = 185.9, average for 2020, CBSL data
[103] Note: Converted using LKR/US$ = 185.9, average for 2020, CBSL data
[104] Source: Sampath Bank Annual Report, 2020

Banks such as DFCC and COMB saw considerable reduction in cost to income due to growth in non-fund based income

Exhibit 39: Cost to Income Ratio (Efficiency Ratio) – FY December '20



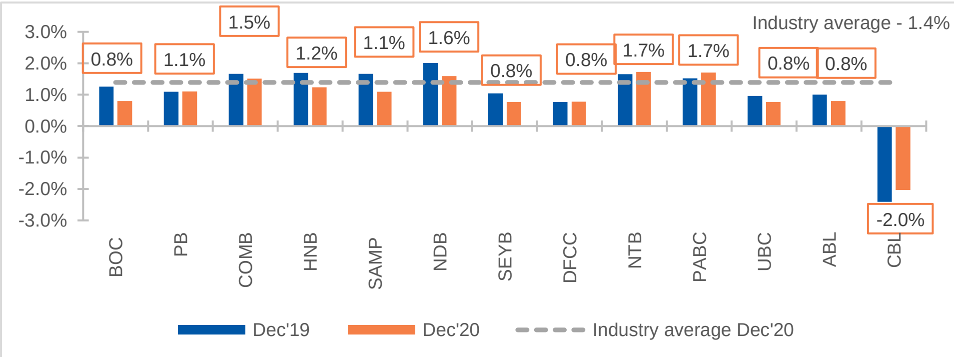
Source: CBSL, Annual reports

Note: The ratios of PB, ABL and CBL have been calculated as these banks do not report the cost to income ratio.

Cost reduction measures adopted by banks in the face of COVID-19 and work from home arrangements led to a marginal improvement in the cost to income ratio of the industry which fell from 51.8% to 51.7% (Exhibit 39)[105]. This fall was capped by the drop in Net Interest Income for the year. Banks such as DFCC and COMB saw considerable reduction in cost to income due to growth in non-fund based income (including foreign exchange gains, trading gains and capital gains on government securities). While SAMP and CBL saw operating costs reduce to some extent, drop in both interest and non-interest income led to cost to income ratio increasing.

Reflecting the impact of the pandemic, most banks recorded lower Profit Before Tax (PBT) in 2020 resulting in pre-tax ROA reducing for

Exhibit 40: Pre-tax Return on Assets (ROA) – FY December '20

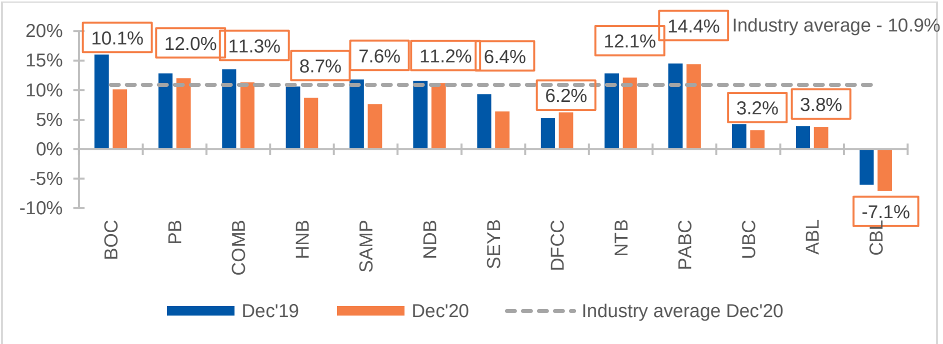


Source: CBSL, Annual reports, Quarterly reports

Reflecting the impact of the pandemic, most banks recorded lower Profit Before Tax (PBT) in 2020 resulting in pre-tax ROA reducing for the year (Exhibit 40). A major cause of this was higher impairments as banks made provisions for losses against loans including loans under moratoriums as well as provisions against government securities amidst the sovereign ratings downgrades by credit rating agencies. Low interest income was also another major contributor amidst monetary easing policies undertaken by the CBSL. Relatively lower loan growth during the year also meant banks had to direct most of their excess liquidity into investments in government securities. PABC and NTB were the only banks to record an increase in PBT, on account of lower interest expenses, with both recording the highest pre-tax ROA.

[105] Note: Cost to income ratio of the LCB sector calculated as operating expenses excluding impairment charges as a percentage of total operating income (i.e: total of Net Interest Income and Non-interest income)

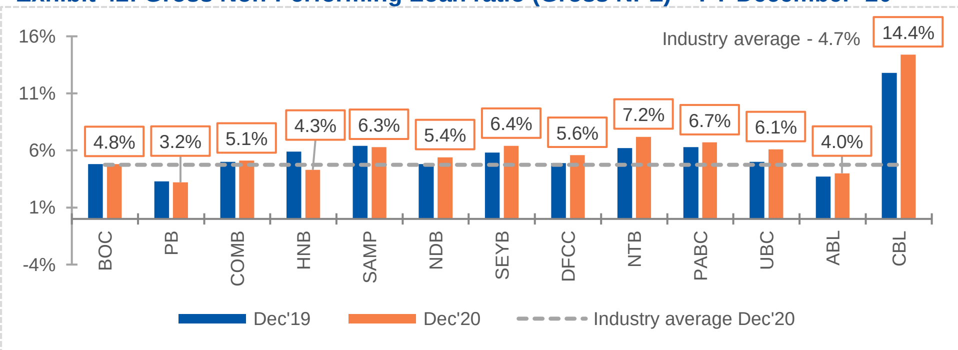
Exhibit 41: Return on Equity (ROE) – FY December '20



Source: CBSL, Annual reports, Quarterly reports

Effective tax of the banking sector dropped from 34% to 28% during the year as a result of the removal of the Debt Repayment Levy (DRL), which was a direct tax charged from banks from 2018, and Nation Building Tax (NBT) in November 2019 . Despite this, profit after tax contracted relative to 2019 at several banks including the larger banks (SAMP, BOC, HNB, SEYB and COMB), which recorded the largest drops in ROE (Exhibit 41). DFCC was the only bank to record an improvement in ROE during the period.

Exhibit 42: Gross Non-Performing Loan ratio (Gross NPL) – FY December '20[106]



Source: CBSL, Annual reports, Quarterly reports

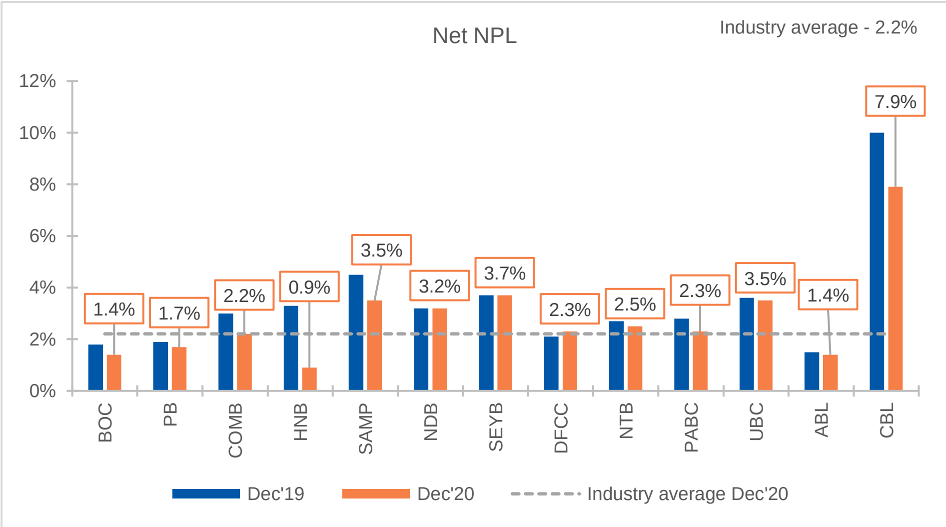
While overall NPLs and NPLs of several pandemic-hit sectors including tourism and trade related sectors are likely to have increased during the year, this is not fully reflected in the reported numbers due to the debt moratoriums

Gross NPL ratio of the industry increased marginally from 4.6% to 4.7% during the year (Exhibit 42). While overall NPLs and NPLs of pandemic-hit sectors including tourism and trade related sectors are likely to have increased during the year, this is not fully reflected in the reported numbers due to the debt moratoriums that were in effect from 2Q 2020 till March 2021 and which have subsequently been extended till August 2021. The share of loans under moratorium at most banks, which was reported to be around 30-40% of total loans during the first phase of moratoriums (ending in September 2020) was reported to have reduced by December 2020. In April 2021, the CBSL reported that only about 10-20% of customers would need further assistance . However, most banks recorded increases in gross NPLs, with only PB, BOC, HNB and ABL recording ratios below 5%.

Net NPL ratio however, reduced at several banks, possibly due to banks making additional provisions for loan losses in the form of management overlays to account for losses arising due to COVID-19 that may not be captured by their impairment models (Exhibit 43).

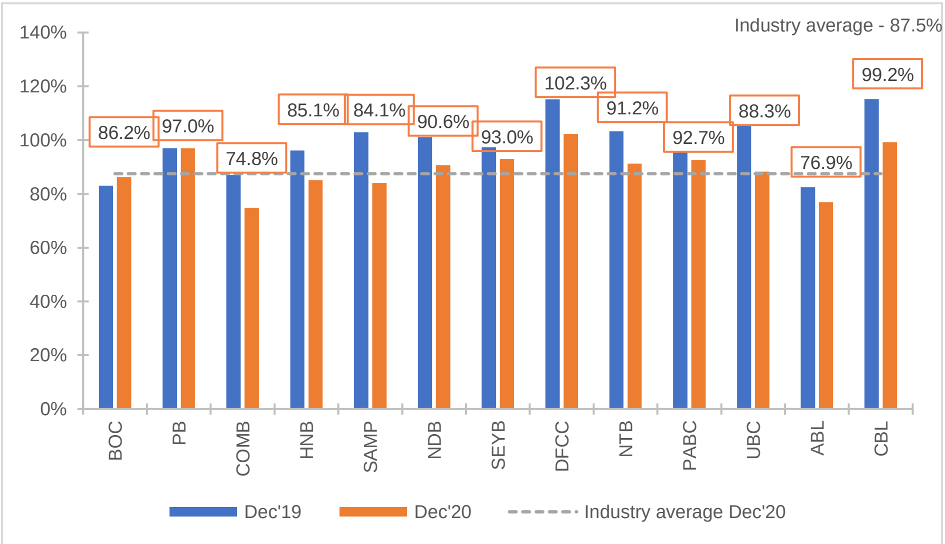
[106] Note: The difference between the Gross and Net NPL ratios is a result of removing the specific provisions made by banks on identified customers (as opposed to the general provisions made on the total loan portfolio) from the non-performing loans base when calculating the Net NPL ratio. Please refer Annexure 2 for the formula.

Exhibit 43: Net Non-Performing Loan ratio (Net NPL) – FY December '20



Source: CBSL, Annual reports, Quarterly reports

Exhibit 44: Gross Loans to Deposits – FY December '20



Source: CBSL, Annual reports, Quarterly reports.

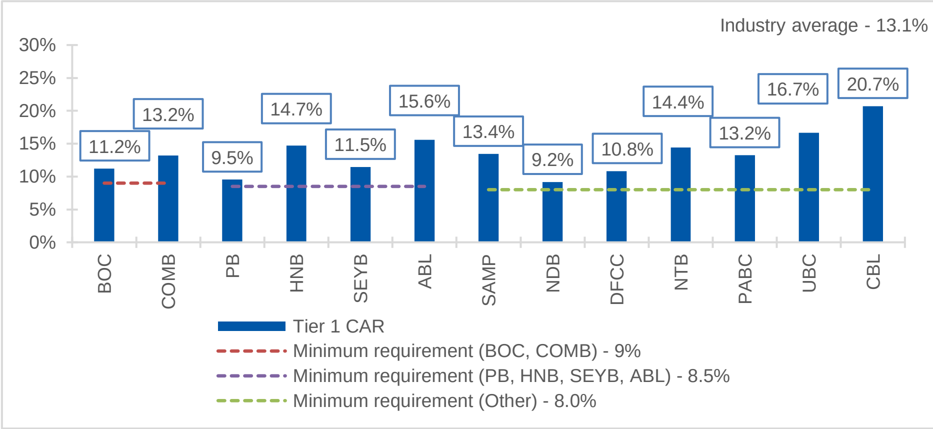
Gross loans to deposits ratio of the sector saw a significant decline during the year

Gross loans to deposits ratio of the sector saw a significant decline during the year, from 93.4% to 87.5%[107] (Exhibit 44). Various factors including lower discretionary spending of customers amidst the uncertainty of the pandemic as well as movement of money away from finance companies to banks which are considered the 'safer' institutions, led to the deposit base increasing by much more than the growth in credit in 2020. Only BOC recorded an increase in the ratio, following a 28% YoY expansion in loans during the year.

[107] Source: CBSL quarterly statistics

Exhibit 45: Tier 1 Capital Adequacy Ratio – FY December '20[108]

As at the end of 2020, all banks met the minimum stipulated Tier 1 CAR with several of the smaller banks having relatively larger buffers.

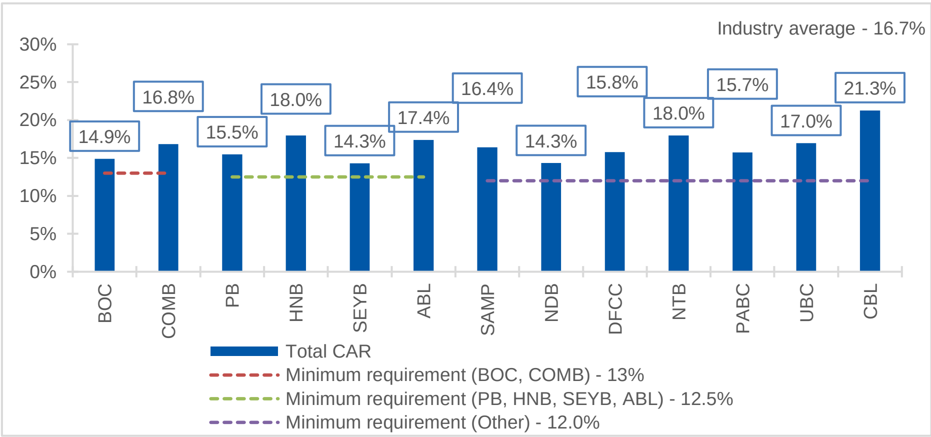


Source: CBSL, Annual reports, Quarterly reports
Note: Charts display Bank figures

Sector Tier 1 Capital Adequacy Ratio (CAR) remained largely stable in 2020 compared to the previous year (Exhibit 45). While there was capital raising activities carried out to a certain extent in mid-2020, this slowed down towards the end of the year as some banks saw difficulty raising funds due to unfavourable market conditions. As at the end of 2020, all banks met the minimum stipulated Tier 1 CAR with several of the smaller banks having relatively larger buffers.

Exhibit 46: Total Capital Adequacy Ratio – FY December '20

Total CAR of the sector too remained stable in 2020



Source: CBSL, Annual reports, Quarterly reports
Note: Charts display Bank figures

Total Capital Adequacy Ratio (CAR) of the sector too remained stable in 2020 (Exhibit 46)[109]. As at the end of 2020, BOC, SEYB and NDB had the lowest buffers while NTB and CBL recorded the highest buffers (Exhibit 46). However, CBLs capital fell below the CBSL's minimum capital requirement of LKR 10bn (~US$ 53.6m) in 2020, which the Bank states it has taken measures to rectify in 2021. NDB raised LKR 6.5bn (~US$ 34.5m[110]) in September 2020 while SEYB announced a LKR 10bn debenture issue in July 2020 which

[108] Note: The difference between Tier 1 capital and total capital is a result of the exclusion of Tier 2 capital in the former case. Tier 1 capital is the 'core capital' of the bank including shareholders' equity and retained earnings. Tier 2 capital, which is usually less secure than Tier 1 capital, consists of any supplementary capital the bank has, such as loan-loss and revaluation reserves and undisclosed reserves.
[109] Source: CBSL quarterly statistics
[110] Note: Converted using LKR/US$ = 188.1, September 2020, CBSL data

was later postponed and revised down, raising LKR 6bn (~US$ 30.1m[111]) from the issue which took place in March 2021. DFCC announced a debenture issue in October 2020, which was undersubscribed and raised LKR 4.5bn (~US$ 24.4m[112]). So far HNB and SAMP have announced plans to raise Tier 2 capital via debenture issues in 2021.

Summary – FY December'20

The following tables includes the key indicators of all Bank profiles covered in this report as well as other Banks listed on the CSE and select private banks.

Bank	Details (US$ Mn)							Key Ratios					
	Gross Income	Net Profit Before Taxes	Net Profit After Taxes	Net Loans and Advances	Asset Base	Deposit Base	Total Equity	Cost to Net Income Ratio	Tier 1 CAR	Total CAR	Gross NPL Ratio	Post-tax Return on Assets	Return on Equity
Bank of Ceylon	1,360	156	88	10,828	16,227	13,375	900	39.4%	11.2%	14.9%	4.8%	N/A	10.1%
People's Bank	1,192	158	86	9,452	12,775	10,298	678	53.5%	9.5%	15.5%	3.2%	N/A	12.0%
Commercial Bank	813	132	91	4,865	9,425	6,880	861	34.0%	13.2%	16.8%	5.1%	1.1%	11.3%
National Savings Bank	697	105	58	2,774	7,411	6,631	308	39.1%	13.6%	16.5%	2.8%	N/A	20.3%
Hatton National Bank	715	114	73	4,261	7,297	5,294	821	48.3%	14.7%	18.0%	4.3%	1.1%	8.7%
Sampath Bank	588	82	45	4,037	6,168	4,842	614	43.5%	13.4%	16.4%	6.3%	N/A	7.6%
National Development Bank	332	50	28	2,284	3,391	2,627	257	39.4%	9.2%	14.3%	5.4%	1.6%	11.2%
Seylan Bank	314	31	17	2,112	2,994	2,362	272	50.3%	11.5%	14.3%	6.4%	0.6%	6.4%
DFCC Bank	235	24	15	1,620	2,507	1,661	276	49.0%	10.8%	15.8%	5.6%	0.9%	6.2%
Nations Trust Bank	219	41	22	1,128	1,813	1,291	188	46.3%	14.4%	18.0%	7.2%	1.2%	12.1%
HSBC Sri Lanka		25	13	1,176	2,278	1,273	377	N/A	20.6%	21.4%	0.9%	0.9%*	3.5%
Pan Asia Banking Corporation	112	19	11	661	949	757	83	45.7%	13.2%	15.7%	6.7%	1.2%	14.4%
Union Bank	81	8	3	396	695	467	96	64.0%	16.7%	17.0%	6.1%	0.5%	3.2%
SANASA Development Bank	87	11	5	551	692	500	53	64.9%	9.8%	13.4%	4.5%	1.2%	9.5%
Amana Bank	43	6	3	336	537	448	67	60.6%	15.6%	17.4%	4.0%	0.5%	3.8%
HDFC Bank of Sri Lanka	42	6	4	221	327	257	31	N/A	20.2%	20.7%	33.0%	1.2%	13.0%
Cargills Bank	26	-5	-4	156	250	172	52	104.2%	20.7%	21.3%	14.4%	N/A	-7.1%

Source: Annual Reports

Note: For comparison purposes, all figures are as at FY 2020 (Financial year ending December 2020)

**HSBC Sri Lanka only reports pre tax return on assets*

[111] Note: Converted using LKR/US$ = 199.4, April 2021, CBSL data
[112] Note: Converted using LKR/US$ = 184.2, October 2020, CBSL data

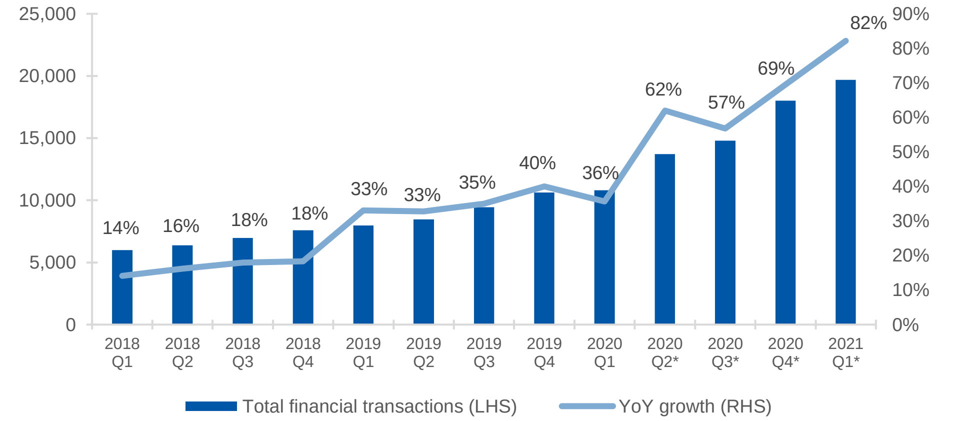
2.9. Opportunities

Acceleration of digitalization drive amidst COVID-19 to provide benefits

With island wide curfew measures being implemented in 2020, banks were forced to focus on their digital channels in order to serve people remotely. While there was already a move to incorporate technology and provide digital financial services prior to COVID-19, the pandemic accelerated both the pace of improvements made by banks to digital channels as well as the pace of adoption of non-traditional channels by customers (Exhibit 47). The wider reach of these online services, with more and more people getting accustomed with using these services has presented banks with opportunities to reduce costs in the long term and has significant potential for growth.

The pandemic accelerated both the pace of improvements made by banks to digital channels as well as the pace of adoption of non-traditional channels by customers

Exhibit 47: Total transaction volumes and YoY growth of transactions made through internet-based payment systems



Source: CBSL
*Note: *Provisional*

In 2020 the CBSL also took several steps to create awareness and encourage the adoption of digital services. The CBSL initiated the National Quick Response (QR), 'LankaQR' code standard for local currency payments. This would allow banks to allow their customers to make safe and low cost digital payments to merchants and service providers through digital platforms. The awareness created through these programs is likely to increase adoption of these digital platforms among the larger community. In addition, banks could also benefit through collaboration with fintech players such as telecommunication companies in the growth of their digital platforms.

Cost minimization strategies implemented during the pandemic are likely to continue

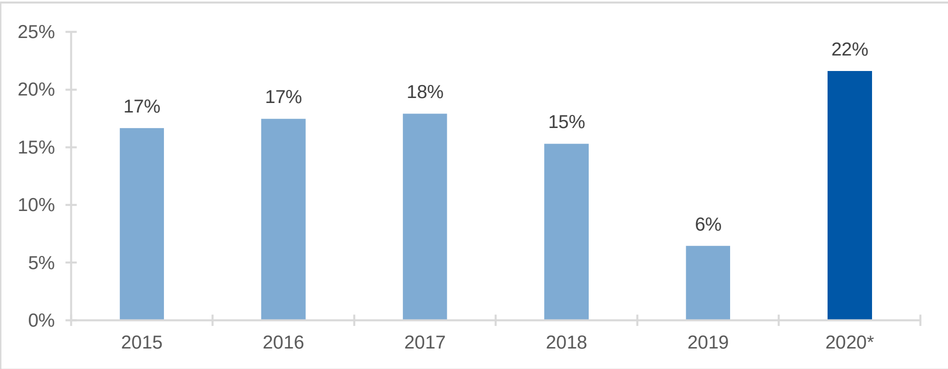
Operating expenses of LCB sector dropped by 5% in 2020 as a result of various cost minimization strategies implemented during the pandemic. Certain strategies implemented recently, such as work from home arrangements and the gradual reduction of bank branches, could become the norm, providing banks with opportunities to improve productivity and reduce operating costs further, in the longer term.

Deposits directed to banks due to flight to quality away from risky institutions

With the onset of the pandemic and subsequent lower discretionary spending of consumers, banks have seen strong growth in their deposit base in 2020. Another reason for the strong growth has been the loss of confidence in certain finance companies resulting in customers moving funds to banks which are perceived to be safer. Deposits of the Licensed Commercial Banking sector recorded a YoY growth of 22% in 2020 (Exhibit 48), the highest growth recorded in recent history. The banks' robust regulatory framework has resulted in increased confidence in the banking sector amidst the risky operating environment. This gives banks opportunities to grow their deposit base while lowering their cost of funds as the CASA base (i.e.: banks' low cost fund base) has also grown.

With the onset of the pandemic and subsequent lower discretionary spending of consumers, banks have seen strong growth in their deposit base in 2020.

Exhibit 48: YoY growth of deposits of the LCB sector



Source: CBSL
*Note: *Provisional*

Opportunities for strategic acquisitions of finance companies and smaller banks

The CBSL is currently encouraging market driven consolidation between small and larger banks while the government also brought forward a proposal in its 2021 budget for finance companies which are under financial and regulatory stress to merge with the parent commercial banks where applicable. The budget proposal stipulated that the expenses incurred during such acquisitions are to be tax deductible. In addition, the pandemic induced economic slowdown could put smaller banks with weaker capital and profitability under pressure. Overall, these factors are likely to provide banks which have relatively stronger capital positions with opportunities to make strategic investments which are beneficial to them.

2.10. Challenges

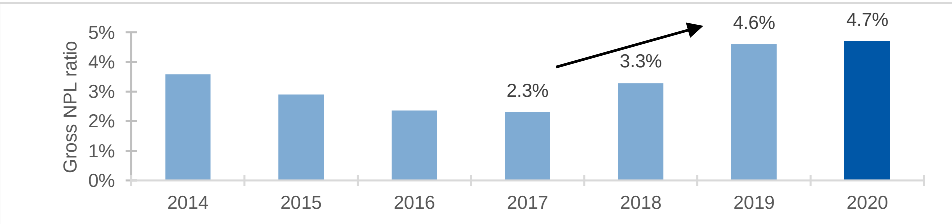
Risk of industry NPLs rising with expectations of an increase after the expiration of debt moratoriums

The industry has experienced increasing NPLs since 2017 due to various reasons including adverse weather conditions, the April 2019 East Sunday attacks and COVID-19 in 2020 (Exhibit 49). Reported NPLs of the LCB sector only saw a marginal increase in 2020 due to the debt moratoriums[113] implemented. A major portion of the moratoriums implemnted in 2020 expired on March 31st 2021, with a small portion of the same to expire in September 2021. However, given the impact of the COVID-19 outbreak in April 2021, the CBSL issued guidelines for a new moratoriumscheme to be implemented in May 2021 as well, which is set to expire in August 2021. NPL ratios are expected to continue on its upward trajectory from 3Q21 when the moratoriums end, reflecting the true impact of the pandemic on customers.

Among the sectors with a relatively higher share of loans (above 5% of total loans), the 'manufacturing' and 'wholesale and retail trade' sectors saw the largest deterioration in asset quality in 2020 due to the restrictions on movement due to the panedmic and import restrictions imposed (see exhibit 50 for Sector-wise NPL ratios of the Banking sector as at end 2020). The tourism sector which has been significantly impacted by the pandemic only recorded a marginal increase in NPL ratios (6.4% to 6.8%) in 2020 amidst moratoriums granted to the sector but remained above the average NPL ratio of the banking sector (4.9%)[114]. NPLs of this tourism sector are likely to increase after the expiration of moratoirums extended to the sector on 30th September 2021. However, loans granted to this sector account for less than 4% of total loans of the banking sector in Sri Lanka. Nevertheless, if the pandemic worsens, the sector will find it challenging to keep its rising NPL ratios contained. This could in turn restrict credit growth, impacting the profitablity of banks.

While reported NPLs of the LCB sector only saw a marginal increase in 2020 due to the debt moratoriums implemented, a major portion of the moratoriums are set to expire on August 31st 2021

Exhibit 49: Trend in NPL ratio of LCBs



Source: CBSL

*Note: *Provisional*

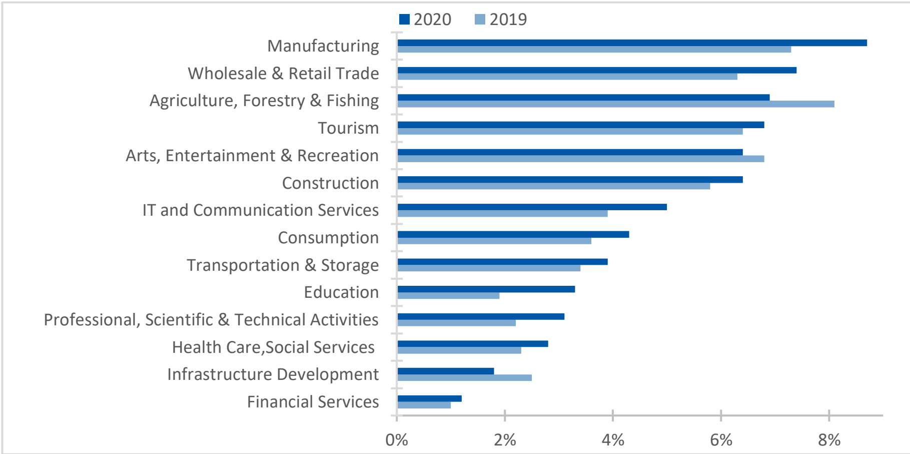
Another factor that could impact NPL growth is the CBSL's intiatives to direct lending to SMEs and marginal borrowers in 2020 in order to revive the economy. The CBSL has set a lending target of 20% YoY growth for 2021 for the MSME sector for LCBs and LSBs[115]. The regulator also reduced maximum interest rates applicable on credit cards, pawning and pre-arranged temporary overdrafts.The resulting increase in lending to these sectors is likely to put upward pressure on NPL ratios of the banking sector.

[113] Note: Please refer page 38 for details of the debt moratoriums granted in 2020 & 2021
[114] Source: CBSL Annual Report 2020
[115] Source: CBSL Monetary Law Act Order No.01 of 2021

Exposure to foreign currency government securities could increase risks of the banking sector

As at December 2020, the larger commercial banks hold government foreign currency securities accounting for 7-15% of total assets

Exhibit 50: Sector-wise NPL ratios of the Banking sector as at end 2020



Source: CBSL

With the downgrade to Sri Lanka's sovereign credit rating in late 2020 and concerns around high foreign currency debt repayments of the government, banks' holdings of government foreign currency securities, namely Sri Lanka Development Bonds (SLDBs) and Sri Lanka's International Sovereign Bonds (ISBs), has increased the risks faced by banks. As at December 2020, the larger commercial banks' holdings of government foreign currency securities accounted for 7-15% of total assets[116]. While the government has reiterated its commitment to meeting all debt repayments on time, unforeseen adverse events which could impact the government's repayment capacity could pose risks to foreign currency liquidity of the banks with high exposure to these assets.

Accelerated digitalization drive exposes the sector to cyber security risks

The sector's accelerated digitalization drive is likely to open up systems to vulnerabilities related to cyber security. The CBSL has also emphasized that work from home arrangements and wider adoption of digital channels by consumers have increased banks' risks related to data security, internal and external fraud and cyber-attacks[117]. The uncertainty of how long the pandemic would last underscores the need for robust cyber security and data protection systems to be implemented at banks and for processes to be put in place to take swift action in situations where the security of systems are breached.

The CBSL, in its annual report for 2020, has placed strong emphasis on the importance of having adequate measures in place to secure banks' systems against cyber-attacks and continues to carry out awareness programs on cybersecurity. The regulator has also stressed on the importance of the financial sector having robust Business Continuity Plans (BCPs) in order to prepare their information systems to function effectively during adverse situations. The CBSL has also directed firms to work with Sri Lanka Computer Emergency. Readiness Team (Sri Lanka CERT), Sri Lanka's national computer incident response team, pertaining to matters related to cybersecurity in order to mitigate this challenge[118].

[116] Source: Bank Annual reports
[117] Source: CBSL Annual Report 2020
[118] Source: CBSL Annual Report 2020

Performance Highlights - Licensed Finance Companies Sector

Indicator	Mar 20	Mar 21	Change
Total Assets (US$ bn)	7.4	6.8	↓ 8.1%
Total Deposits (US$ bn)	4.0	3.8	↓ 5.0%
Total Net Loans (US$ bn)	5.7	5.2	↓ 8.8%
Net Interest Margin	7.4%	7.4%	
Tier 1 CAR	10.6%	13.6%	↑ 300 bps

Key:
Mar 20
Mar 21

	Mar 20	Mar 21	Change
Total CAR	12.0%	14.8%	↑ 280 bps
Gross NPL	11.6%	11.3%	↓ 30 bps
Net NPL	3.8%	2.8%	↓ 100 bps
Return on Equity	6.2%	12.8%	↑ 660 bps
Cost to Income Ratio	77.7%	62.4%	↓ 1530 bps

Key:
Mar 20
Mar 21

3. NBFI Sector Overview

The NBFI sector primarily consists of 40 Licensed Finance Companies and 3 Specialized Leasing Companies

The NBFI sector in Sri Lanka traces its origins back to the 1970's with the opening up of the Sri Lankan economy to global trade where firms specialized in providing vehicle leasing & hire purchase facilities. Since then, the sector, which as at end 2020 includes 40 Licensed Finance Companies (LFCs) and 3 Specialized Leasing Companies (SLCs), has grown in its sophistication and product offerings, providing a well-diversified portfolio of Financial Services including Gold Pawning, lending to SMEs and Microfinance and catering to segments that are underserved by the formal banking sector.

The CBSL is the regulator for the sector where a key focus has been on enhancing the resilience and financial soundness of the sector in the face of internal and external challenges. This has been exemplified with their proposed Master Plan which includes plans for the consolidation of the LFC and SLC sector in the medium term. The Government is in agreement with this policy framework and introduced a number of incentives and directives in the Government budget 2021 to facilitate this. Another significant development was the drafting of a replacement to the existing Microfinance Act of 2016 with the Credit regulatory act in order to broad base and further strengthen the regulation pertaining to the sector in order to reduce the propensity for systemic risks due to adverse conditions affecting the sector in the future.

3.1. Brief History

The formal NBFI segment of the financial markets began its operations with the opening of the Sri Lankan economy in 1977, which fundamentally changed the dynamics of the economy and opened up new avenues for funding such as vehicle leasing and emerging customer segments seeking financial services. The NBFI sector consists of LFCs, which accept customer deposits and provide leasing, loans and other financial services as well as SLCs, which have a narrower range of activities and are not permitted to accept public deposits. As a result of stringent regulations introduced in the late 1980's, the popularity of SLCs declined as the CBSL encouraged more SLCs to convert to LFCs amidst the growing capital adequacy requirements. Furthermore, due to the challenges posed by the implementation of the new SLFRS 9 accounting rules, a further wave of mergers is expected.

Exhibit 51: Evolution of the NBFI Sector

Year	Key Events/Milestones
1979	Finance Companies Act No.27 is introduced, providing the regulatory framework for LFCs to operate
1986-1988	A string of failures of LFCs occurs. This was primarily due to inadequacies in the regulatory framework
1988	Finance Companies Act No. 78 repeals and replaces the previous Act
1991	Finance Companies (Amendment) Act No. 23 introduced
2009-2013	LFCs begin investing heavily in gold-backed lending (pawning). The subsequent gold price crash of 2013 has serious consequences on several overexposed LFCs

2011	Finance Business Act No. 42 repeals and replaces all previous Acts. It is the current Act under which LFCs operate
2012	Most SLCs are requested to convert to LFCs
2015	Amalgamation of smaller LFCs occurs following the introduction of higher minimum capital requirements
2015	Macroprudential measures such as LTV ratio first introduced in October 2015
2019	Debt relief programme where borrowers in drought affected regions with loans less than LKR 100,000 and outstanding for more than three months, were written off
2020	A variety of relief measures directed by the CBSL including provision of debt moratoriums for COVID-19 affected businesses and individuals, special credit support schemes, interest rate caps on lending products and other relief measures
2021	Extension of debt moratorium for COVID-19 affected businesses and individuals in the tourism industry

Source: CBSL, Varied news articles

The number of LFCs operating in the market is expected to reduce given the Government and CBSL's consolidation plan for the sector

Exhibit 52 shows how the number of LFCs and SLCs increased over the years. It is clear from the decline in the number of SLCs, that there has been a shift in preference for LFCs that offer more diversified services. There has also been a decline in number of LFCs due to the cancellation of the licenses of a few distressed LFCs and this trend of having fewer LFCs is expected to continue in the medium term given the Government and CBSL's consolidation plan for the NBFIs.

Exhibit 52: Number of LFCs and SLCs over the years

	1977	1989	2010	2019	2020
LFCs	56	72	34	43	40
SLCs	N/A*	N/A*	21	5	3

Source: CBSL
**N/A – Not available.*

3.2. Overview

Exhibit 53: Top 5 LFCs

As at year end March '21	Total Assets (US$ m)
People's Leasing & Finance	911
LOLC Finance	855
LB Finance	708
Central Finance Company	575
Citizens Development Business Finance	474

Source: Company Annual reports

4 LFCs are recognized as Domestic Systematically important LFCs (D-SILFC) with assets over LKR 100bn

While the NBFI sector is overshadowed by LCBs in terms of asset size, the CBSL has recognized the top 4 LFCs with assets over LKR 100bn (~US$ 536m[119]) as Domestic Systematically Important LFCs (D-SILFC) accounting for around 44% of sector assets as at end March 2021, which in itself is an acknowledgement of the importance of the industry and the role it plays in financial services (Exhibit 53)[120]. In particular, LFCs play a key role in providing formal sources of funding for riskier investments. As a result, the sector has been an important channel through which the CBSL's economic relief measures are being directed towards SMEs and entrepreneurs in sectors such as tourism which have been hard hit by the effects of the COVID-19 pandemic. The NBFI sector asset base of US$ 7bn at end March 2021. According to the CBSL, the NBFI sector accounted for 5.9% of Sri Lanka's financial system as at end December 2021[121].

3.3. Branch Distribution

The sector as at end March 2021 had 1,530 branches of LFCs and SLCs covering all nine provinces of the island. 66% of LFC and SLC branches are concentrated outside of the Western province (Exhibit 54).

66% of LFC and SLC branches were concentrated outside of the Western province as at end December 2020.

Exhibit 54: Number of LFC & SLC branches as at End March 2021

Province	Number of branches
North	98
North Central	106
North Western	166
Central	164
Eastern	120
Uva	71
Sabaragamuwa	116
Southern	163
Western	526
Total	**1,530**

Source: CBSL

LFCs and SLCs typically operate a number of customer touchpoints spread throughout the island which include pawning centres, loan collection centres and service centres that specialize in specific activities. However, more recently a number of LFCs have opted to consolidate their activities into a single branch in order to rationalize operating costs as well as in response to customer preference for branches which offer a full range of services. Our focus in the report is on LFCs.

3.4. Key Activities of LFCs

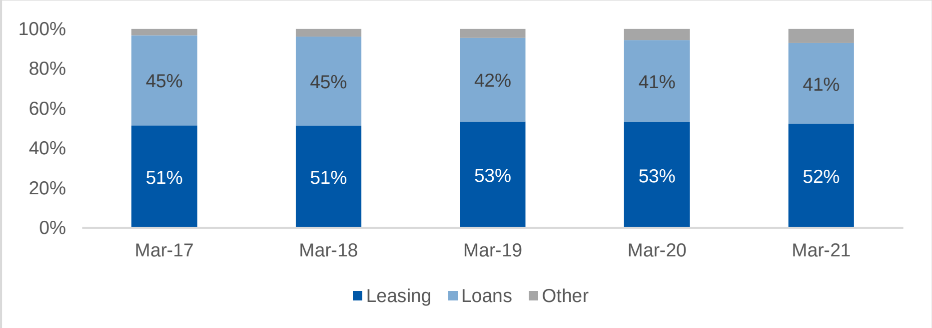
Key activities of the LFCs are Leasing, Pawning, Microfinance and lending to SMEs

LFCs broadly concentrate on serving the underserved segments of the economy with a greater focus on retail financial services and product offerings which cater to SME

[119] Note: Converted using LKR/US$ rate = 186.4,December 2020, CBSL data
[120] Source: CBSL, Recent Economic Developments, 2020
[121] Source: CBSL Annual Report 2020

businesses, while having a greater presence in rural areas. Their lending portfolio is primarily focused on leasing activities as shown in Exhibit 55.

Exhibit 55: Loan composition of LFCs



Source: CBSL

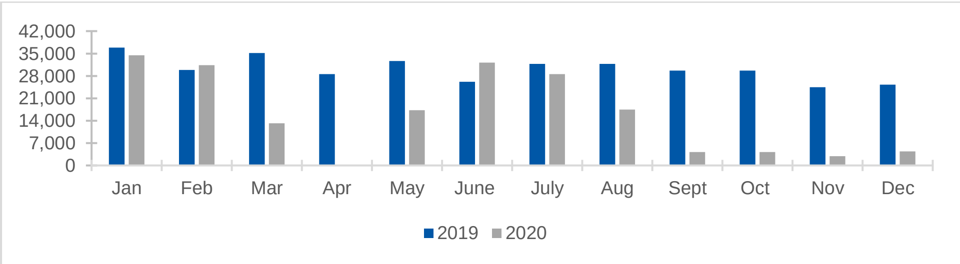
Leasing accounts for over half of the total loan portfolio of LFCs

Leasing

For a typical LFC, motor vehicles generally account for more than 50% of the total loan portfolio with most LFCs specializing in granting vehicle leasing for the purchase of certain categories of motor vehicles such as motorbikes and motor tricycles (three-wheelers) for both consumer and commercial use and which collectively accounted for 72% of the total vehicle population of the country in 2019.

2020 proved to be one of the most challenging years for the motor vehicle segment where at the onset of the COVID-19 pandemic in March 2020, the CBSL undertook macroprudential measures to restrict the import of non-essential goods including motor vehicles and related spare parts. As a result, there was no motor vehicle imports in April 2020 with demand collapsing further with the 2nd wave of the COVID-19 pandemic in the 3rd quarter of 2020 which resulted in an overall drop of 47% in vehicle imports for 2020 compared to the previous year (Exhibit 56)[122].

Exhibit 56: Monthly new vehicle registrations



Source: Department of Motor Traffic

Gold backed lending activity experienced a pickup in 2020 as a source of short-term liquidity for households

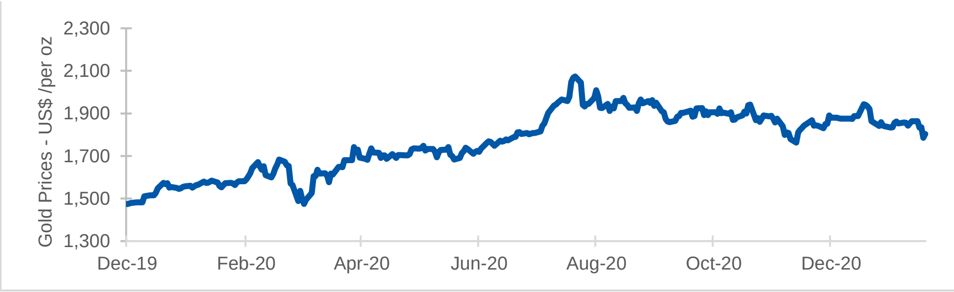
Gold backed Loans/Pawning

Gold backed lending or pawning is another category of lending LFCs specialize in, wherein gold acts as the collateral for the loan granted. Traditionally, pawning has been a ready source of emergency funding for households due to unexpected events. This was evidenced in 2020 with increased pawning activities as households resorted to this as a source of short-term liquidity at a time where household incomes were adversely affected.

[122] Source: Sri Lanka Customs, News articles

As a result, pawning portfolios for the NBFI sector collectively amounted to approx. US$ 383m as of December 2020 which represents a 20% growth compared to the previous year. At the same time, the CBSL imposed a maximum interest rate on pawning activities in order to provide relief to households[123].

Exhibit 57: Gold Price movements in US$/oz



Source: Goldprice.org

The growth in Pawning has been aided by the growth in global gold prices with gold prices in Sri Lanka reaching a record high in July 2020 (Exhibit 57)[124] in the face of global uncertainties and stimulus measures undertaken by CBSLs around the world. While gold prices had cooled somewhat towards the latter half of 2020 with the strengthening of the US Dollar, most global analysts expect the rally in gold prices to continue in 2021[125].

Microfinance

The Microfinance sector primarily provides funding to low-income households, particularly concentrated in the Northern and Eastern provinces and encompasses lending activities by government institutions, Non-Governmental Organizations (NGOs), individuals and recently by LCBs and LFCs.

Over the past 3 years, interest in the sector by LFCs and private ventures have waned given the escalating costs and risks associated with lending to the sector where bad weather and unregulated lending practices which has led to underprivileged households to be victims of a cash crunch. In response, the government is keen on overhauling the segment and is seeking to strengthen the regulations governing the sector and is in the draft stage of introducing a new credit regulatory act to replace the existing Microfinance act of 2016 to further strengthen the regulation of the sector[126].

The CBSL granted a number of relief measures to SMEs in key sectors such as tourism via LCBs and LFCs in the form of Debt Moratoriums and concessionary working capital loans

Small & Medium Scale Enterprises (SMEs)

The NBFI sector has an outsized presence in the SME sector where it provides funding to individual entrepreneurs and SMEs given their higher risk appetites. While alternative means of start-up funding has emerged in recent years catering to particular sectors, NBFIs often serve as the main funding source for SMEs, which lays the groundwork for them to access more traditional sources of funding as the firms progress through different stages of development.

This lending activity by NBFIs was particularly important in 2020 with the outbreak of COVID-19 pandemic where NBFIs along with banking institutions became the main conduit

[123] Source: “Central Bank sets maximum limit on pawning interest rates”, News First, April 27, 2020
[124] Source: “Sri Lanka reports a record hike in Gold prices”, News First, July 9, 2020
[125] Source: “Gold will soar 22% next year as investors protect against rising inflation Goldman Sachs says”, Market Insider, November 17, 2020
[126] Source: “Micro finance sector undergoes reforms despite present cash crunch”, Sunday Times, April 18, 2021

through which relief measures were provided to this segment which was particularly vulnerable to the negative impacts wrought by the disruptions caused by the pandemic. Some of the measures include a six-month debt moratorium that was granted in March 2020 alongside concessionary working capital loans which targeted affected sectors including SMEs, tourism, apparel, plantations and IT services[127]. Sectors where the informal sector accounts for a significant share of the activity such as the tourism sector were amongst the hardest hit and continue to be impacted due to the pandemic. In response, moratoriums given to the sector were granted multiple extensions, with the latest extension pushing moratoriums till October 2021[128].

Governments in their budgets over the years have also proposed targeted lending schemes for SMEs via financial institutions. This trend was continued in the government budget for 2021 where targeted lending schemes for SMEs were introduced for sectors such as agriculture, dairy, renewable energy and exports. In addition, the government's policy objective of import substitution in identified sectors such as the banning of textile fabric imports[129] is expected to be a boon for domestic entrepreneurs.

3.5. Resource Mobilization

NBFIs rely on a mix of deposits from the public and borrowings, primarily from commercial banks, for their funding requirements. As LFCs improve their product offerings to consumers which are increasingly becoming comparable with Banking Institutions' offerings, the sector has over time been successful in reducing its reliance on borrowings (Exhibit 58). In addition, the weakened lending environment has resulted in a reduced need for LFCs to mobilize deposits or borrowings.

Exhibit 58: Deposits, Borrowings, Net Loans of NBFI Sector

US$ bn	Mar-18	Mar-19	Mar-20	Mar-21
Total Assets	**8.8**	**8.3**	**7.6**	**7.0**
LFC	8.6	8.0	7.4	6.8
SLC	0.3	0.3	0.2	0.2
% share LFC	97%	97%	97%	98%
% share SLC	3%	3%	3%	2%
Total Deposits	**4.4**	**4.3**	**4.0**	**3.8**
LFC	4.4	4.3	4.0	3.8
Total Borrowings	**2.7**	**2.5**	**2.1**	**1.5**
LFC	2.5	2.3	2.0	1.4
SLC	0.2	0.2	0.1	0.1
% share LFC	93%	93%	94%	95%
% share SLC	7%	7%	6%	5%
Total Net Loans	**7.0**	**6.4**	**5.9**	**5.3**
LFC	6.7	6.2	5.7	5.2
SLC	0.3	0.2	0.2	0.1
% share LFC	96%	96%	97%	97%
% share SLC	4%	4%	3%	3%

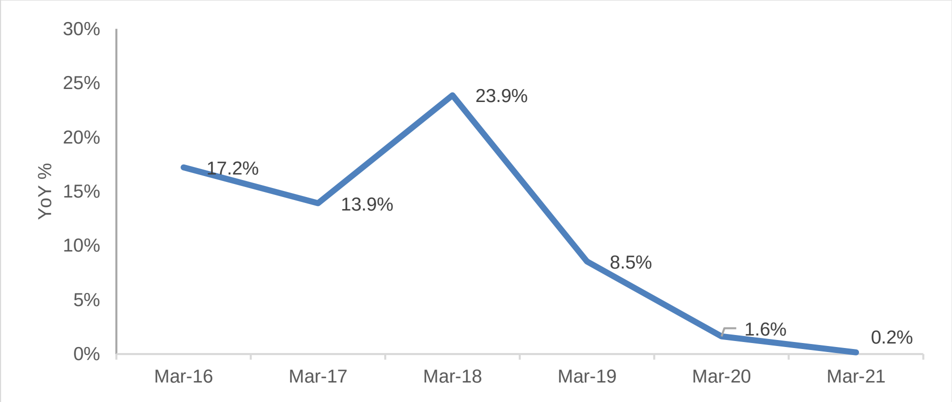
Source: CBSL
Note: The Percentage growth shown in charts and tables may not correspond to the figures shown in the table in USD terms due to currency translation impacts as well as the figures shown may not matchup due to rounding errors

[127] Source: "Relief Measures to Assist COVID-19 affected businesses and individuals", CBSL Bulletin, March 24, 2020
[128] Source: "Extension of Debt Moratorium for COVID-19 affected businesses and individuals in the tourism industry", CBSL Bulletin, March 19, 2021
[129] Source: "Steps already taken to ban import of textile fabrics: State Minister", The Morning, April 8, 2021

Deposits at LFCs which had been trending downwards in recent years due to the imposition of measures such as deposit caps, contracted as at end March 2021 (Exhibit 59). Negative consumer sentiment due to a number of failed finance companies[130] as well as the low interest rate environment may have sparked a 'flight to quality' which may have contributed to this contraction.

The deposit base of LFCs collectively contracted in December 2020 which may partly reflect a 'flight to quality' taking place in the financial services industry

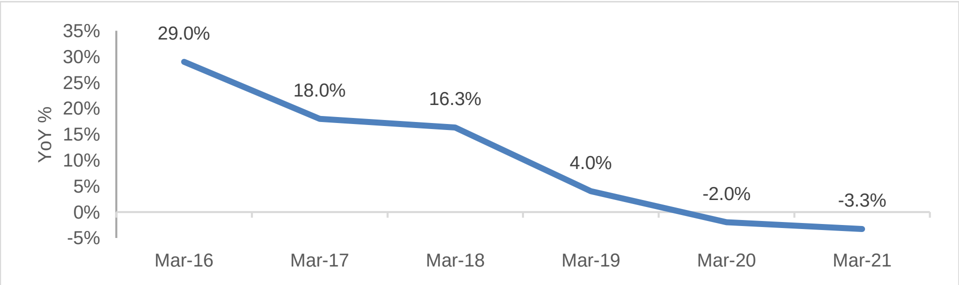
Exhibit 59: LFC Deposit Growth



Source: CBSL

Mirroring the trend in deposit growth, loan growth too had been trending downwards due to adverse macroeconomic conditions affecting lending segments such as vehicle leasing and microfinance (Exhibit 60). These conditions were exacerbated in 2020 with the disruption to business activity and households as well as macroprudential measures implemented such as the banning of motor vehicle imports, which adversely affected the loans and advances and leasing & hire purchase portfolios of many LFCs exposed to the segment. This contributed to a shrinking of the loan portfolio as at end December 2020 compared to the corresponding period in the previous year.

Exhibit 60: LFC YoY Net Loan Growth



Source: CBSL

3.6. Regulatory Authorities

The regulation and supervision of LFCs is governed by the Supervision of Non-Bank Financial Institutions (SNBFI) Department of the CBSL, under the Finance Business Act (FBA) No. 42 of 2011[131]. In addition, publicly listed companies are regulated by the SEC.

[130] Source: "Sri Lanka failed finance company depositors to Rs9.8bn extra after insurance increased", Economynext, March 19, 2021
[131] Source: Non-Bank Finance and Leasing Sector, CBSL website, April 2021

3.7. Key laws governing the LFC Sector and recent amendments

The Finance Companies Act no. 27 of 1979 provided the regulatory framework for the establishment of Finance companies. Since then, the two key laws governing the LFCs are the Finance Business Act No. 42 of 2011 and the Companies Act No. 7 of 2007. The CBSL is also in the early stages of introducing amendments to the Finance Business Act No. 42 of 2011 in order to further strengthen and address shortcomings in the existing regulatory framework[132]. Publicly listed companies are also required to adhere to SEC of Sri Lanka Act No. 36 of 1987 and the listing rules of the CSE[133]. Furthermore, LFCs involved in microfinance related activities must adhere to the Microfinance Act No.6 of 2016.

Microfinance

At present, microfinance related activities also fall under the purview of the CBSL and is governed by the Microfinance Act No. 06 of 2016. The Act encourages firms engaged in microfinance activities to register with the CBSL which would enable them to be termed as Licensed Microfinance Firms (LMFCs)[134]. However, given the slow uptake by firms to become licensed operators as well as the structural challenges facing the sector, the government has been looking to amend the Microfinance act in order to strengthen and broaden the regulations governing the sector. Given some of the challenges facing the microfinance sector, directives were issued under the previous government which included partial debt waivers as well as an interest rate caps were granted on microfinance loans for distressed households[135]. The present government has noted this is not a sustainable situation and hence, the government has introduced a draft for the Credit Regulatory Authority Act which would replace the existing Microfinance Act with the objective of overhauling the Microfinance market[136] .

Deposit Rate Caps

As a measure to enhance credit transmission, the CBSL in 2016 introduced maximum interest rates on savings, term deposits and debt instruments issued by LFCs. The maximum interest rates are computed with respect to 1-year treasury bill rate as well as a term premium depending on the maturity of the instrument. The CBSL has periodically made use of this measure, most recently in April 2020 where the term premium was revised downward marginally taking into account the downward trend in market interest rates[137]

Loan to Value (LTV) ratios and temporary bans on motor vehicle imports are some of the common macroprudential measures the CBSL has resorted to which directly impacts the activities of LFCs

Loan to Value (LTV) Ratios

Since 2015, the CBSL has put in place Loan-to-Value (LTV) ratios which limits the credit facilities which can be granted to certain categories of Motor Vehicles. This tool is used as a macroprudential measure during periods where the exchange rate faces pressure as motor vehicle imports alongside the fuel imports which goes with it represents a significant category of expenditure. It is also used as a tool for government policy to promote or discourage the importation of certain vehicle categories. A case in point is the low LTV ratio of 25% that is placed on non-electric three wheelers which has a bearing on many LFCs that cater to this market segment[138]. More recently, the CBSL has also shown a willingness to implement bans on Vehicle imports in the face of foreign exchange pressures. This was

[132] Source: "Finance Business Act to be amended", Daily Mirror, April 22, 2021
[133] Source: Rules and Regulations, SEC
[134] Source: Microfinance Sector, CBSL website, April 2021
[135] Source: "Micro finance sector undergoes reforms despite present cash crunch", Sunday Times, April 18, 2021
[136] Source: Financial System Stability Review, CBSL, 2020
[137] Source: Directions, Circulars and Guidelines for Non-Banks, CBSL, December 2019
[138] Source: Directions, Circulars and Guidelines for Non-Banks, CBSL, October 2018

in effect for a prolonged period in 2020 in response to the COVID-19 outbreak. At the same time in line with the government's policy of promoting domestic industries, the LTV ratio were revised in April 2020 to promote locally assembled motor vehicles.[139]

Ownership Limits

Given the lack of diversified ownership of LFCs, the CBSL in December 2020 introduced ownership limits to LFCs which would come into effect from 2022 onwards. Under this direction, the number of shares which can be held by a single individual or a group of shareholders acting in concert is to be brought down on a staggered basis. In the first phase the limit is to be 75% which needs to be complied with by end 2029 and a 50% limit to be achieved by 2033. The directive however exempts LFCs which are owned by LCBs or any others which have obtained special approval from the Monetary Board[140].

Consolidation of NBFI Sector

In parallel to the CBSL directive on diversifying ownership of LFCs, the Government proposed in its Budget for 2021 that LFCs which are subsidiaries of a group of companies should merge with its parent. The same directive is expected to be applied to LFCs that function under LCBs. The government has proposed financial incentives for firms which follow through with its merger proposal in the form of tax deductibles for investment expenditure associated with the mergers.

The CBSL has also expressed its willingness to move ahead with the consolidation process which it has outlined in its medium-term master plan for the NBFI sector as a method for addressing capital issues and bringing about a more stable and resilient NBFI sector. The CBSL is expected to take a decision with regard to this plan during the 2nd half of 2020[141].

Capital Adequacy

In 2018, the CBSL set the minimum capital adequacy requirements for LFCs with the regulatory capital limits being revised periodically (Exhibit 61). LFCs which are identified as D-SLFCs have enhanced regulatory capital thresholds to meet. Given the increased stress facing the financial system in 2020, the CBSL issued directives for a temporary reduction in the minimum liquidity assets requirements[142] as well as amended the definition of liquid assets of LFCs to include Treasury Bonds and SLDBs and ISBs in order to provide adequate liquidity for NBFIs[143]. The CBSL also issued directives to delay the core capital levels to be achieved by 12 months. Hence LFCs need to meet a core capital target of LKR 2.5 Bn by 1st January 2022[144].

Exhibit 61: Capital Adequacy Requirements for LFCs

%		2018	2019	2020	2021
Non D-SILFC	Tier I Capital	6.0	6.5	7.0	8.5
	Total Capital	10.0	10.5	11.0	12.5
D-SILFC	Tier I Capital	6.0	7.0	8.0	10.0
	Total Capital	10.0	11.0	12.0	14.0

Source: CBSL

[139] Source: Directions, Circulars and Guidelines for Non-Banks, CBSL, April 2020
[140] Source: Directions, Circulars and Guidelines for Non-Banks, CBSL, November 2020
[141] Source: "Under CBSL, NBFI sector consolidation process: 13 Finance Companies Looking for Partners", Ceylon Today, April 22, 2021
[142] Source: Directions, Circulars and Guidelines for Non-Banks, CBSL, March 2020
[143] Source: Directions, Circulars and Guidelines for Non-Banks, CBSL, September 2020
[144] Source: CBSL Annual Report 2020

3.8. Key Performance Indicators

The following exhibit provides a summary of the KPIs of the LFC sector overtime and the subsequent charts show the performance of 6 LFCs which includes the top 5 publicly listed LFCs in terms of asset size as well as a large private LFC against sector KPIs. Due to the limited data available on the individual firm performance at the time of writing the report, for comparison purposes the performance comparison in the subsequent charts has been presented for the financial year ended as at March 2020 (FY 2020). For details of the individual firm performances, see the NBFI Sector Profiles section of the report.

LOFC : LOLC Finance

PLC : People's Leasing & Finance

CFIN : Central Finance Company

LFIN : LB Finance

CDB : Citizens Development Business Finance

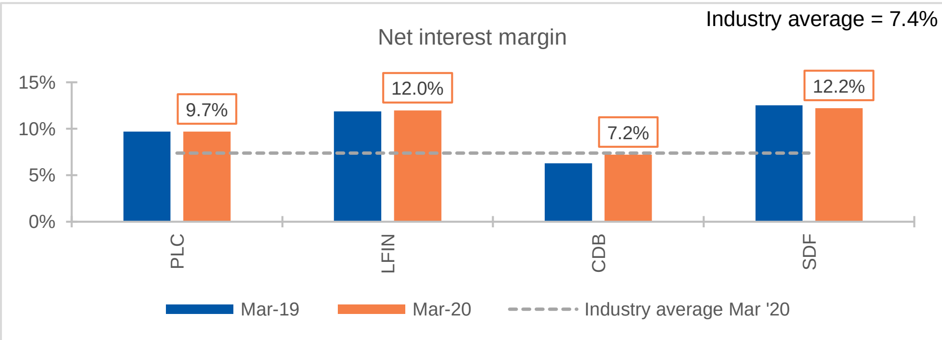
SDF : Sarvodaya Development Finance

Exhibit 62: Key Performance Indicators of the LFC Sector

%	Mar-17	Mar-18	Mar-19	Mar-20	Mar-21
Net Interest Margin	7.3	7.2	7.8	7.4	7.4
Cost to Income Ratio	62.8	66.1	70.0	77.7	62.4
ROA before tax	3.4	2.9	2.6	1.7	3.1
ROE	20.4	15.6	12.0	6.2	12.8
Gross NPL	5.2	5.9	7.8	11.6	11.3
Net NPL	1.2	1.5	2.3	3.8	2.8
Gross Loans/ Deposits	169	159	155	153	150
Tier 1 CAR	10.0	10.4	8.8	10.6	13.6
Total CAR	10.3	11.0	10.1	12.0	14.8

Source: CBSL

Exhibit 63: Net Interest Margins (NIMs) – FY March '20



Source: CBSL, Annual reports

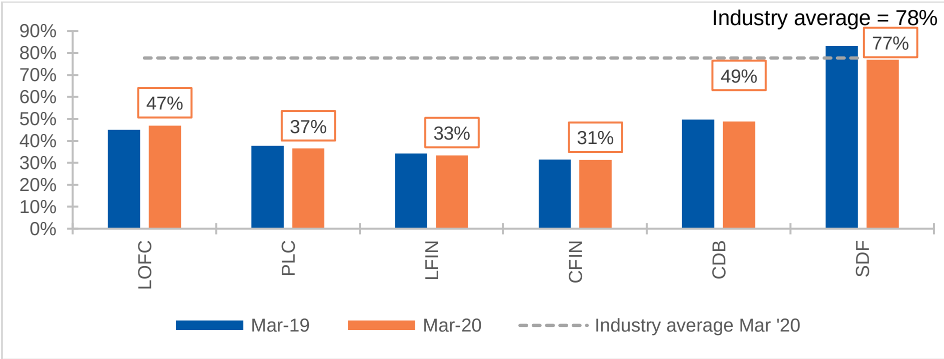
Note: NIMs are not reported by CFIN and LOFC

Industry-wide NIMs dipped alongside a downturn in market interest rates while Cost to Net Income ratio rose due higher impairment provisions during FY20

Overall sector NIMs weakened during the year ending March 2020 on account of a decrease in interest income by 1.9%, while the interest expenses also recorded a dip of 1.6%. NIM's continued to remain subdued for the remainder of 2020 and its March 2021 as the economic stimulus measures undertaken by the CBSL placed downward pressure on market interest rates which contributed to the repricing of lending facilities and yields of deposits (Exhibit 63).

Of the reported interest margins, all firms except CDB had recorded ratios above industry average during the year ending March 2020, while LFIN and CDB recorded an increase over the previous year. In the case of CDB this was due to steps taken to reduce its cost of funds while rebalancing the makeup of its loan book. In contrast SDF witnessed a weakened NIM due to higher costs of funds coming from higher bank borrowings.

Exhibit 64: Cost to Net Income Ratio - FY March '20



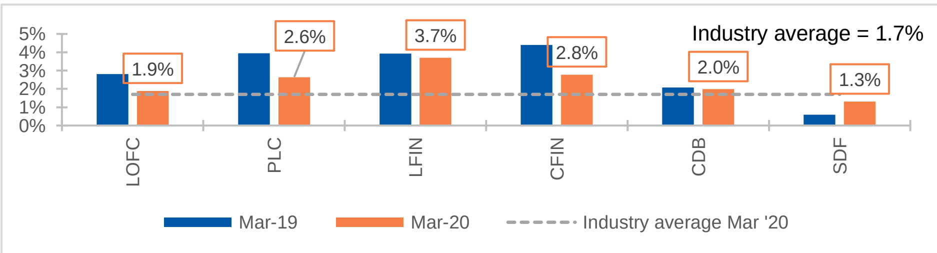
Source: CBSL, Annual reports

Sector cost to net income ratio rose significantly in March 2020 compared to the previous year on account of a decrease in interest income as well as higher impairment provisions (Exhibit 64). The ratio rose steeply to above 200% in June 2020 which maybe reflective of the cumulative effects of the first wave of the COVID-19 pandemic due to a steep growth in impairment provisions. Of the LFCs covered in this report, only SDF recorded cost to income ratios above the industry average of 78% for the year ending March 2020.

Except for LOFC and CDB, the remaining LFCs saw an improvement in their cost management in FY 2020 reflected in improved cost to income ratios. Many LFCs undertook a reassessment of their cost centres in order to rationalize their operating expenses with many recording a reduction in their non-interest expenses during the second half of 2020 and by March 2021 a noteworthy improvement in the cost to net income ratio was recorded.

Except for SDF, all other LFCs covered in this report recorded a drop in ROA and ROE in FY20

Exhibit 65: Return on Assets (ROA) – FY March '20



Source: CBSL, Annual reports

Note: LFIN, CFIN, CDB and SDF returns are post-tax, PLC returns are pre-tax. LOFC does not give specifics.

Sector profits before tax fell by 33% over the year ending March 2020, while the asset base shrunk by 1.1% over the same period which led to a reduction in ROA (Exhibit 65). The

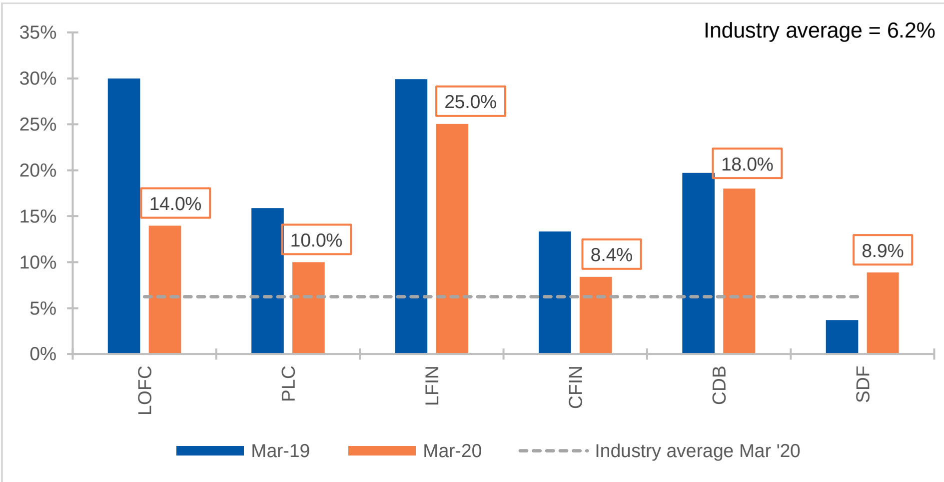
Sector ROA turned negative in June 2020 with the LFCs collectively recording an approx. US$ 46.8m[145] loss before tax for the 3-month period ending in June 2020.

All LFCs covered in this report except for SDF recorded a dip in their ROAs during FY 2020, mainly driven by a reduction in profit owing to lower income and higher impairment charges. LFIN displaced CFIN to record the highest ROA (post-tax) amongst its peers which was primarily on account of its relatively better management of non-performing loans.

SDF recorded a noteworthy improvement in its ROA with an over 100% increase in its profit after tax as at year ending March 2020 as a result of its prudent loan management while keeping overhead costs in check which led to the firm being recognized as one of the fastest growing LFCs in the industry.[146]

Subsequently, with the reduction in impairments and cost rationalisation measures undertaken by LFCs, ROAs improved in FY 2021 with LFCs collectively recording a noteworthy improvement as at end March 2021.

Exhibit 66: Return on Equity (ROE) – FY March '20



Source: CBSL, Annual reports

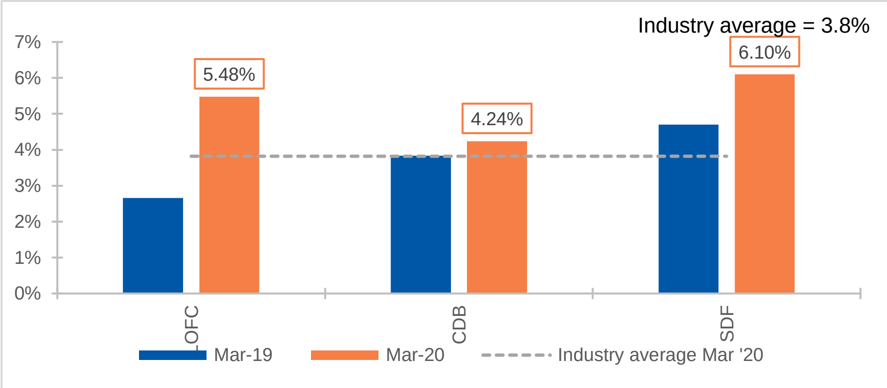
A similar trend was witnessed with ROE, where except for SDF, all other firms recorded a dip in ROE in FY 2020 due to a slowdown in annual profits (Exhibit 66).

LFIN continued to maintain a relatively high ROE among its peers while LOFC recorded one of the steepest dips in its ratio mainly on account of base effects caused by a one-off fair value investment gain in the previous year. However, all firms recorded an ROE above the industry average.

In FY 2021, a similar trend to ROA was witnessed where ROE collectively improved significantly as at end March 2021.

[145] , Note: Converted using LKR/US$ rate =188, June 2020, CBSL data
[146] Source: "Sarvodaya Development Finance recognised as fastest growing development finance company", Daily FT, April 16, 2021

Exhibit 67: Net Non-Performing Loan ratio (Net NPL) – FY March '20



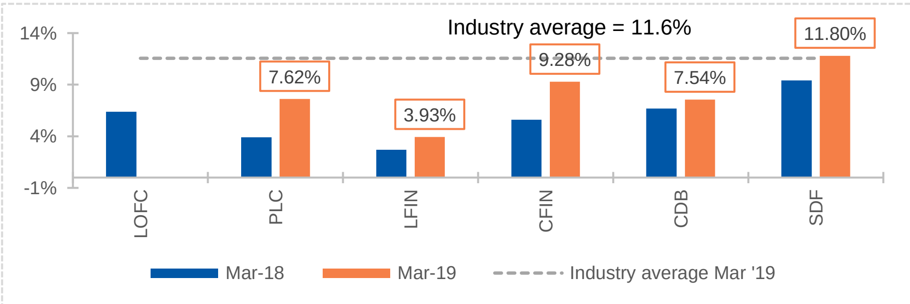
Source: CBSL, Annual reports

Note: Net NPLs were not reported by PLC, LFIN and CFIN.

Gross and Net NPL ratios continued to trend upwards and rose significantly during the year ending March 2020 with the Gross NPL ratio remaining above double-digit levels for the remainder of 2020 (Exhibit 68).This was mainly on account of the economic slowdown in the wake of the Easter Sunday attacks of April 2019 and the onset of COVID-19 outbreak which disrupted economic activity. In FY 2021, an improvement was noted in both Gross NPL and Net NPL while it remained at an elevated level compared to previous years.

Industry wide Gross NPLs were above double-digit levels during FY20 and remained at an elevated level for the remainder of 2020

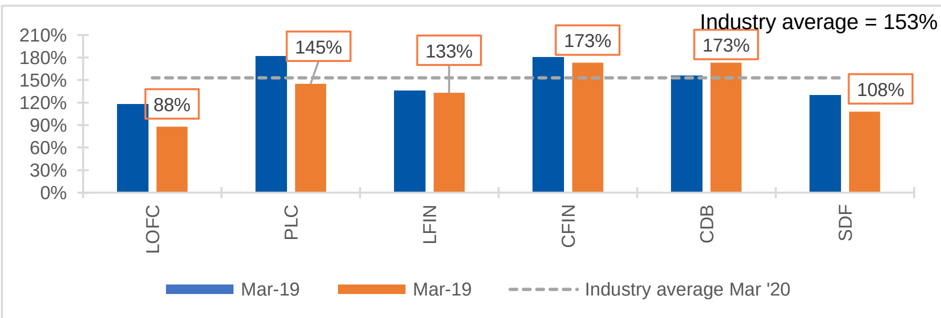
Exhibit 68: Gross Non-Performing Loan ratio (Gross NPL) – FY March '20



Source: CBSL, Annual reports

Considering the reported Net NPLs, all firms recorded ratios above the industry average (Exhibit 67). In contrast, apart from SDF all other LFCs recorded Gross NPL ratios below the industry average.

Exhibit 69: Gross Loans to Deposits – FY March '20



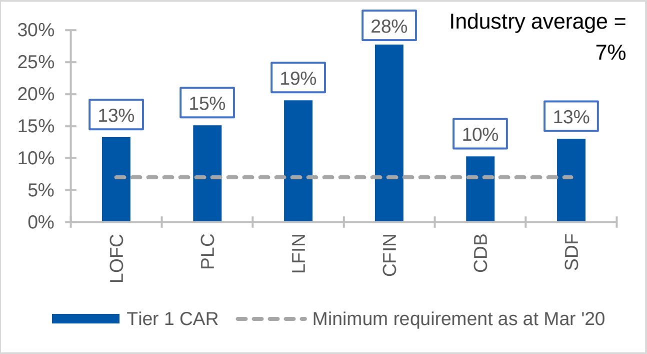
Source: CBSL, Annual reports Note: The ratio for CFIN and LOFC has been calculated based on reported net loans.

Gross loans to deposits ratio of the sector continued to decline during the year ending March 2020 (Exhibit 69). This trend continued for the remainder of the year and by end March 2021 the ratio had declined further. This was a result of the contraction in loan growth while deposits grew minimally over the same period.

Gross Loans to deposit ratio contracted among most firms as loan portfolios contracted while deposit growth was negative or minimal during FY20

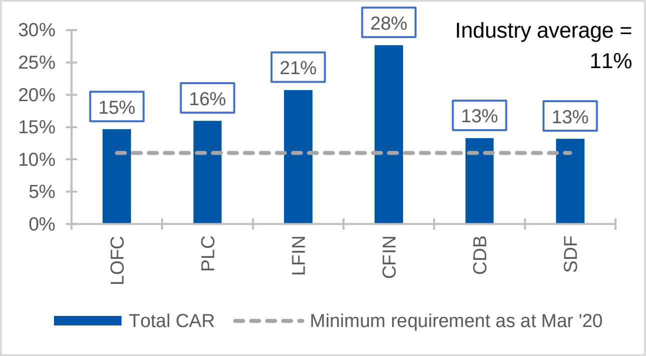
CFIN and CDB were the only firms to record ratios above industry average ratios over the period among those covered in this report. CDB was also the only firm to record a growth in the Gross loans to deposits ratio due to sharp contraction in its deposit base during the year ending March 2020.

Exhibit 70: Tier 1 Capital Adequacy Ratio – FY March '20



Source: CBSL, Annual reports, CSE announcements

Exhibit 71: Total Capital Adequacy Ratio – FY March '20



Source: CBSL Annual reports, CSE announcements

Tier I and Total CAR improved during FY20 with all LFCs covered in this report meeting the minimum capital adequacy requirements

Both Tier 1 CAR and Total CAR of the sector improved during the year ending March 2020 which was in line with the enhanced regulatory capital thresholds that were to be achieved at the start of 2020 (Exhibit 70 & 71). As at 31st March 2020 all firms covered in this report met the statutory minimum Total CAR of 11% (12% for D-SILFCs) and 7% for Tier 1 CAR (8% for D-SILFCs) stipulated by the CBSL, with CFIN maintaining significantly higher Tier 1 and Total CAR buffers.

During 2020, the regulatory capital requirements for 2021 and 2022 was deferred by 1 year due to the impact of the COVID-19 outbreak. Overall capital levels of the sector continued to improve throughout 2020 due to firms engaging in capital raising activities to meet the initial set capital requirements, the decrease in risk weighted assets for the segment in line with the reduced lending activities as well as due to the cancellation of the licenses of a few distressed LFCs which had negative capital. These contributed to a further improvement in both Tier I and Total CAR which improved to 13.6% and 14.8% respectively by end March 2021.

CDB raised EUR 5m via a subordinated debt issue from Netherlands based Tridos Investment Management in March 2021 while LFIN raised US$ 15m from FMO; the Dutch Entrepreneurial Development Bank in May 2021. PLC announced that they plan to raise LKR 8bn (~US$ 40m) via a listed debenture issue.

At the same time, the CBSL reported that a few LFCs had not met the minimum capital adequacy requirements and hence has proposed a Financial Sector Consolidation Master Plan (FSCMP) to prompt consolidation in the LFC sector in order to address this issue.

Summary - FY March ’20

The following tables includes the key indicators of all NBFI profiles covered in this report as well as all the NBFIs listed on the main board of the CSE.

LFC	Details (US$ Mn)							Key Ratios					
	Gross Income	Net Profit Before Taxes	Net Profit After Taxes	Net Loans and Advances	Asset Base	Deposit Base	Total Equity	Cost to Net Income Ratio	Tier 1 CAR	Total CAR	Gross NPL Ratio	Post-tax Return on Assets	Return on Equity
LOLC Finance	205	26	20	719	1029	533	168	47%	13.25%	14.66%	N/A	1.88%*	13.98%
People’s Leasing & Finance	215	32	19	827	998	637	189	36.53%	15.12%	15.99%	7.62%	2.64%	10.00%
LB Finance	165	55	27	628	760	470	122	33.44%	19. 04%	20.75%	3.93%	3.7%	25.04%
Central Finance Company	139	39	22	496	636	286	246	31.3%	27.73%	27.68%	9.28%	2.78%	8.40%
Citizens Development Business Finance	87.8	15	9.2	396	471	217	58	48.79%	10.25%	13.29%	7.54%	1.98%	17.99%
Commercial Credit & Finance	0.6	0.1	0.1	92	451	246	73	N/A	N/A	N/A	N/A	N/A	N/A
Commercial Leasing & Finance	0.4	0.1	0.0	222	350	125	95	N/A	21.79%	20.97%	7.05%	N/A	N/A
Vallibel Finance	51	13	7	207	258	147	33	39.48%	11.93%	13.04%	5.01%	2.53%	20.98%
Mercantile Investments & Finance	0.2	0.02	0.01	87	217	115	-2	69%	21.79%	20.97%	11.69%	0.88%	N/A
Siyapatha Finance	40	4	2	194	209	87	26	39.28%	9.77%	14.18%	18.07%	0.96%	9.54%
Commercial Credit & Finance	0.6	0.1	0.1	92	451	246	73	N/A	N/A	N/A	N/A	N/A	N/A
HNB Finance	49	6	2	89	191	138	25	58.16%	9.93%	14.00%	12.25	1.19%	8.69%
Alliance Finance	41	3	1	31	171	62	24	53.50%	9.86%	12.97%	11.10%	0.60%	4.60%
Senkadagala Finance	16	3	1	137	171	56	27	60.30%	15.48%	21.54%	7.03%	0.64%	4.26%
Singer Finance	24	3	2	101	113	36	20	52.10%	13.87%	13.87%	5.01%	1.85%	10.44%
Softlogic Finance	7	-3	2	73	109	86	10	N/A	-5.60%	-5.80%	N/A	N/A	N/A
Associated Motor Finance Company	23	-0.3	-0.8	1	102	67	10	N/A	13.72%	14.80%	6.55%	0.16%	0.97%
Asia Asset Finance	18	0.5	0.4	45	76	33	11	N/A	16.15%	N/A	16.21%	0.46%	3.23%
Sarvodaya Development Finance	9.7	1	0.5	28	44	36	6.4	76.90%	13.0%	13.2%	11.8%	1.3%	8.87%
Prime Finance	7	1.0	0.4	20	31	14	9	40.00%	23.76%	24.87%	N/A	1.21%	4.31%
S M B Leasing	1	-0.3	-0.3	0.3	9	1	5	N/A	50.87%	48.15%	13.90%	N/A	-7.00%
Merchant Bank of Sri Lanka & Finance Company	29	-5	-5	0.1	0.17	0.11	0.01	119.72%	4.41%	5.59%	7.42%	-3.20%	-54.39%

Source: Annual Reports

Note: For comparison purposes, all figures are as at FY 2020 (Financial year ended March 2020) except for Merchant Bank of Sri Lanka and Siyapatha Finance which have their Financial year end in December 2020

**LOFC annual reports do not specify whether ROA is pre or post tax*

3.9. Opportunities

Digitalization of services helps improve customer service and reduce operational costs in the long term

Regulators have demonstrated their support for creating a more digitally inclusive financial services sector

Even prior to the onset of the COVID-19 outbreak which has accelerated the digital drive, the CBSL signalled its support for deepening of the digital transformation of the financial services sector with the launch of its promotional campaigns where 2020 was declared as the 'Year of digital transactions'[147]. This initiative included the promotion of digital payment methods as well as the island wide launch of the National QR code initiative branded as 'LANKAQR'. A number of LCBs and LFCs have already been onboarded to this initiative[148].

With lockdown restrictions being put in place to combat the spread of the COVID-19 virus, the regulators introduced directives which allowed for the acceptance of digital submissions of documents such Know Your Customer (KYC) and other customer onboarding initiatives allowing for financial services to provide their services and fulfil customer needs in a digital space. The CBSL is exploring this space further and is supportive of the development of a proof of concept for a blockchain based shared KYC solution[149].

Two areas of focus for LFCs are on the use of technology in order to streamline costs and automate process in order to free up personnel to be deployed to more value-added activities as well as the introduction of new digital products and services to place themselves on a more competitive footing with LCBs.

LFCs maybe better positioned to leapfrog in terms of technological developments allowing them to gain an edge over competitors

Hence the above developments are a boon for LFCs given their greater presence outside of the Western Province where a key challenge has been the costs associated with having a more geographically dispersed customer base. A number of LFCs which have already started on their digital journey, have deepened their investments into the digital space which has been on an accelerated path since the onset of the COVID-19 pandemic. Further, unlike LCBs which may have to contend with legacy systems and existing IT infrastructure, LFCs are in a better position to leapfrog in terms of technological developments and hence gain an edge over competitors.

The above is expected to help maintain the sector's competitiveness at a time when lending activities are under stress.

Favourable gold prices present growth opportunities in the short to medium term for gold backed lending activities

Pawning and other Gold backed lending was a bright spot in lending activity for 2020

With the growing global uncertainty stemming from the outbreak of the COVID-19 pandemic, assets such as gold which is regarded as a potential safe haven asset has seen increased interest which has resulted in gold prices trending upwards in 2020 with most analysts expecting prices to remain at an elevated level in 2021.

In this backdrop, while most loan categories of LFCs have seen a slowdown or contraction in activity, pawning and other gold backed lending facilities has seen a surge in demand as cash strapped households have resorted to this as a ready form of cash flow. As at end December 2020, the Pawning advances portfolio for LFCs stood at LKR 71bn (~US$ 382m) which represents a 20% growth compared to the corresponding period in the previous year (Exhibit 72). A number of LFCs have also in recent years been increasing their exposure to

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[147] Source: Launching of '2020-Year of digital transactions' promotional campaign, CBSL, March 2020
[148] Source: Launch of the National LANKAQR initiative, CBSL, October 2020
[149] Source: CBSL Commences the Process of Developing a Blockchain Technology based Know-Your-Customer Proof of Concept, CBSL, July 2020

A number of LFCs have announced plans to expand and introduce new products in this segment

this segment given the slowdown in the leasing segment and disruptions in the microfinance segment. Large NBFIs such as People's Leasing and Finance (PLC) launched a new gold loans product in 2020 which has witnessed strong interest and has opened separate pawning and gold centres dedicated to this product. At the same time, firms such as LB Finance (LFIN) which is the largest player in this segment amongst NBFI peers has also been increasing its exposure to this segment and introduced new product loans.

Exhibit 72: Key LFC exposure to Gold loan activities as at 31st March 2020*

LFC	Gold loan portfolio US$ m	Gold loans % of loan Portfolio	No of dedicated gold loan service centres
LB Finance	164.4	26%	36
LOLC Finance	32.4	7%	75**
Siyapatha Finance	25.3	13%	N/A
Citizens Development Business Finance	24.9	6%	N/A
Asia Asset Finance	22.6	31%	30**
Softlogic Finance	15.6	18%	1
People's Leasing & Finance	4.8	1%	14
Sarvodaya Development Finance	0.2	0%	N/A

Source: Company Annual reports, Company websites

**Note: Above is not an exhaustive list of LFCs providing Gold Loan facilities*

***Note: LOLC Finance and Asia Asset Finance do not have dedicated Gold Loan Centres. Instead, the figures shown are the number of branches offering Gold Loan facilities*

****Note: Central Finance Company (CFIN) covered in this report does not have Gold loan facilities*

With the impact of the COVID-19 pandemic continuing to dominate and affect the global and domestic outlook, gold loans and related products may continue to show sustained growth in the short to medium term. While LCBs dominate this segment in terms of portfolio size, with its more dispersed branch network outside of the Western province and given the challenges facing other lending products such as microfinance, LFCs may be well positioned to capitalize on this growth opportunity.

A leaner, better regulated Microfinance sector offers growth opportunities in the long run

LFCs took a step back from Microfinance activities due to numerous challenges facing the sector

The microfinance sector has faced numerous challenges over the past couple of years including adverse weather conditions, regulatory intervention such as lending rate ceilings and depressed macroeconomic conditions. This has led to a shrinkage in the micro loan and related loan segments of LFCs as well as a reduction in the number of branches dedicated to microfinance activities. A case in point is Alliance Finance which has taken a strategic decision to step back from Microfinance operations where in FY 2019 it had a micro finance portfolio of over LKR 1bn and 21 branches dedicated to microfinance activities (Exhibit 73). In addition, large operators in the segment such as Commercial Credit & Finance have seen a steep drop in their portfolios and has led to significant NPL provisions.

Exhibit 73: Key LFCs engaged in Microfinance (MF) activities as at 31st March 2020*

LFC	Start of MF operations	Size of MF portfolio (US$) – March 2019	Size of MF portfolio (US$) – March 2020	No of branches providing MF lending
Alliance Finance	2013	6.7m	2.5m	35**
LOLC Finance**	2008	~164.7m	~148.4m	34
Commercial Credit & Finance	2010	34.1m	16.4m	-
People's Leasing Company***	2011	13.6m	14.8m****	33
LB Finance*****	2017	2.2m	2.9m	7

Source: Company Annual reports, Company websites

**Note: Above is not an exhaustive list of LFCs providing MF facilities*

***Note: In FY 2020, Alliance Finance no longer has dedicated branches providing Microfinance lending. Hence the figure shown is the branches classified as collection centres and others*

****Note: Through People's Micro Commerce Ltd and Lankan Alliance Microfinance Company, Bangladesh respectively*

*****Note: The figure stated is the total assets for Micro Commerce Ltd and hence is not comparable with March '2019 reported figure*

******Note: Through LB Microfinance Myanmar*

Apart from the economic challenges, another factor which has thwarted the efforts of LFCs to gain a foothold in this sector has been the weak regulatory environment where the existing regulations in the form of the Microfinance Act no. 06 of 2016 has had limited success in curbing the excess of unregulated and informal lenders in the sector. Hence the newly drafted Credit Regulatory Authority Act is expected to address some of these concerns and bring about a more level playing field which would be beneficial to the sector.

Another development which stands to benefit formal entities operating in this segment is the use of technology and automation to streamline the costs associated with catering to this segment. A case in point is LOLC Finance which is one of the largest NBFIs in the sector has reiterated its commitment to the segment and plans to deploy technologies such as Ipay; LOLC's mobile payment platform, to enable customers to pay their micro finance loans via the system[150].

While the prospects for the sector in the immediate term remains challenging, with new legislation coming in to play and the debt relief schemes introduced by the previous government expected to wind-down[151], the microfinance segment offers growth opportunities for NBFIs who possess expertise in the segment and who can effectively make use of technological solutions to cater to this untapped market.

High food prices, import bans and tax concessions present opportunities for investments in the agriculture sector

Concerns over food security may drive opportunities in agriculture, fisheries & livestock sector

The agricultural sector in Sri Lanka has a tendency to display volatile performance given weather disruptions and other sector specific factors. However, in the context of the COVID-19 pandemic which caused disruptions to global value chains, concerns over food security had become a top priority. Global as well as domestic disruptions to supply chains creating post-harvest losses due to lockdowns and other disruptions to food distribution, led to food inflation in Sri Lanka to remain at elevated levels in 2020[152].

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[150] Source: Company Annual Report 2019/20
[151] Source: "Micro finance sector undergoes reforms despite present cash crunch", Sunday Times, April 18, 2021
[152] Source: CBSL Annual Report 2020

At the same time, the favourable prices as well as the government's policy of promoting greater levels of food security which was encouraged with the tax concessions granted to the agriculture and SME sector in the 2021 government budget resulted in a noteworthy increase in activity in the agricultural sector in 2020[153].

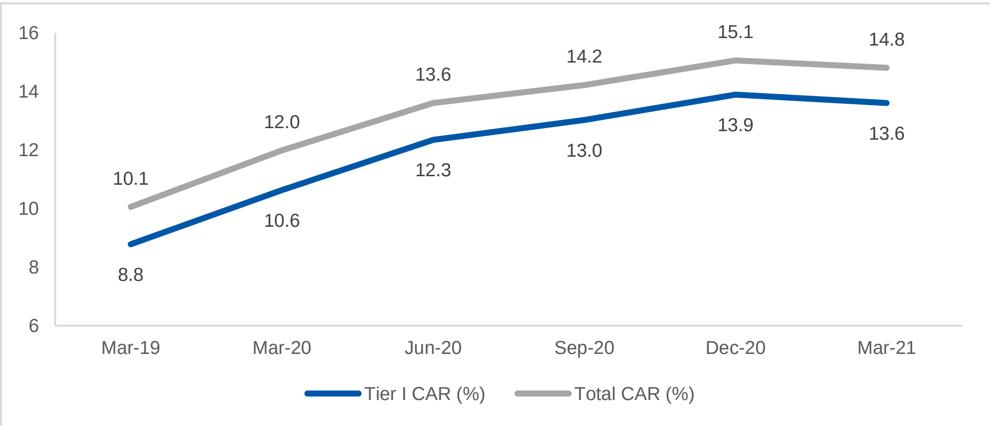
While many challenges remain for the sector including debt moratoriums and issues over excessive microfinance lending to the sector, given the government's policy to drive domestic industry and ensure food security, the segment presents the potential to draw new investments into the sector which presents lending opportunities for LFCs.

Adequate capital and liquidity buffers create a more stable NBFI sector

Capital and liquidity levels of LFCs improved significantly in 2020

The CBSL being cognizant of the extraordinary challenges facing the sector in 2020 made allowances for NBFIs in meeting their statutory minimum capital and liquidity requirements where amendments were issued to existing directives with respect to liquid assets and meeting capital adequacy thresholds[154]. It is noteworthy that in such a context aggregate capital adequacy and liquidity levels of the NBFI sector has improved noticeably in 2020 due to the capital raising activities of LFCs to meet regulatory requirements as well as the elimination of LFCs which had negative capital due to the cancellation of their licenses (Exhibit 74). Despite these improvements for the sector overall, several LFCs had failed to meet the minimum capital requirements and hence strengthening the core capital and liquidity buffers remains a key focus for the CBSL [155].

Exhibit 74: Tier I and Total Capital Adequacy ratios of LFC sector in recent quarters



Source: CBSL
Note: Dec-20 value is provisional

3.10. Challenges

Increase in Non-Performing Loans exerts pressure on bottom line performance of LFCs

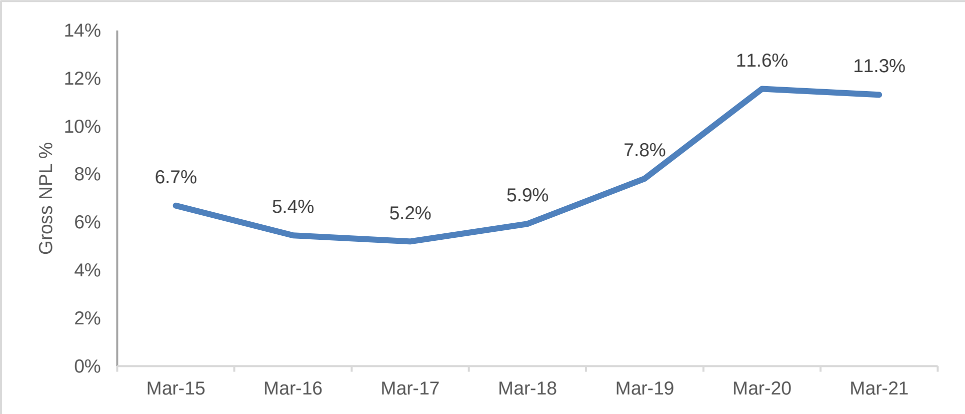
Gross NPLs have remained above double digit levels throughout 2020

Gross NPLs of the sector remained above double-digit levels throughout 2020 and remains one of the single biggest concerns for the sector (Exhibit 75). Analysts have warned that NBFIs potentially face one of the weakest performances in a decade on account of high

[153] Source: "More people took to agriculture in 2020 as services strangled due to pandemic", Daily Mirror, May 01, 2021
[154] Source: CBSL Financial System Stability Review 2020
[155] Source: CBSL Annual report 2020

NPLs which may continue to impact the sector[156]. The following are some of the reasons as to why NPLs are likely to remain a concern in the coming years.

Exhibit 75: Gross NPL ratio of LFC sector over time



Source: CBSL
Note: Dec-20 value is provisional

Extended debt moratoriums, adverse impacts on SMEs, and tighter loan rules in future contribute to NPLs remaining an ongoing concern for NBFIs

Debt Moratoriums remaining in place for extended periods

The debt moratoriums which were first introduced in May 2019 for stakeholders in the tourism sector in the wake of the Easter Sunday attacks, have since been extended to a much wider group of sectors with the onset of the COVID-19 pandemic. In March 2020, the CBSL issued circulars for LFCs and SLCs to grant a six-month debt moratorium to individuals and firms affected by the pandemic. These have since been extended and in the case of the tourism sector it has been extended through to September 2021[157]. This raises the possibility that the impact of the ongoing debt moratoriums on the NPLs is underestimated. Hence a further increase in NPLs is likely to take place as the full impact is felt by LFCs in the coming years.

SMEs acutely impacted by the adverse economic environment

At the onset of the pandemic, key sectors such as consumer durables, retail, tourism and construction were some of the most severely affected segments with many of them seeing a complete halt to their activities. Self-employed workers and SMEs operating in these segments have particularly been hard hit[158]. This is significant given that many LFCs are exposed towards the SME segment. The CBSL too has paid particular attention to this vulnerable segment where relief measures such as the 'Saubagya COVID-19 renaissance facility' providing refinance facilities which were channelled through the Banking and NBFI sectors[159]. While some sectors such as retail and construction have since adapted their business activities to the 'new normal', some such as the tourism sector face severe challenges. It is likely that with the outbreak of the 'third wave' of the COVID-19 pandemic gripping Sri Lanka beginning in April 2021 with the arrival of new strains of the virus, tighter restrictions on travel[160] are being considered which would further hamper the sector's recovery and thus impact loan collection activity for the LFCs exposed to the segment.

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[156] Source: "NBFI sector to record weakest performance in current decade with substantial loss: FCR", LBO, October 17, 2020
[157] Source: Directions, Circulars and Guidelines for Non-Banks, CBSL, April 2021
[158] Source: "Most Sri Lanka workers without formal protection amid Covid-19 shock: IPS study", Economynext, November 28, 2020
[159] Source: Directions, Circulars and Guidelines for Non-Banks, CBSL, April 2020
[160] Source: "Sri Lanka mulls curbing repatriation, tighter quarantine as Covid-19 cases spike", Economynext, May 02, 2021

Tighter loan loss rules coming into effect

With the adoption of the new IFRS 9 accounting rules for LFCs key provisions such as the accelerated recognition of NPLs which would shorten the time period within which a credit facility that is in arrears would be recognized as an NPL would pose further challenges to the sector[161].

Prospects for the motor sector remain weak while LFCs exposure to the sector remains high

Macro prudential measures aimed at import of motor vehicles likely to remain in place for an extended period of time

Despite the slowdown in the activity in the motor vehicles segment in recent years due to adverse economic conditions which saw new motor vehicle registrations falling to a 7 year low in June 2019, the importation of motor vehicles remained the single largest import category within the "non-food consumer goods" group in 2019 and accounted for 4.1% of the total import value of the country[162] [163]. Hence, in the face of exchange rate pressures the government has been quick to implement macroprudential measures aimed at curbing the importation of motor vehicles. This was the case in 2020 as well where with the onset of the COVID-19 pandemic, vehicle imports were halted in March which resulted in zero new vehicle imports in the month of April. Despite calls for leniency by the motor sector to relax the suspension on vehicle imports which is reported to have driven several vehicle importers out of business[164], the government has stood firm with its policies and plans to extend the ban till the end of 2021[165]. The cumulative impact of these measures resulted in vehicle imports accounting for only 1.8% of import value of the country in 2020.

At the same time, in line with the government's import substitution policy the government has been keen to encourage the local assembly of vehicles and spare parts and hence the LTV ratios for vehicles were revised in March 2020 to encourage this. Current LTV ratios are as below.

Exhibit 76: LTV ratios – March 2020

Vehicle category	Electric vehicles	Other
Commercial vehicles	90%	90%
Motor cars, SUVs, Vans	90%	50%
Locally assembled motor cars, SUVs and Vans	90%	70%
Three-wheelers	90%	25%
Light trucks	90%	90%
Any other vehicle	90%	70%
Hybrid Motor cars, SUVs, Vans	50%	

Source: Finance Business Act Directions no. 3 of 2020, CBSL

Note: The above rates are applicable for registered and unregistered vehicles which have been used for less than 1 year

Activity in second hand vehicle markets has shown an uptick in the context of import restrictions

Despite the slowdown in activity, vehicle leasing remains the largest lending category of the majority of LFCs in Sri Lanka. As a result, many LFCs have turned their attention to providing credit facilities for second-hand vehicles which have seen an uptick in demand as the supply shortages have led to an increase in vehicle prices[166]. The pandemic has also created new opportunities with increased use of e-commerce and online deliveries, which

[161] Source: "Fitch warns Sri Lanka on finance companies, ahead of tighter bad loan rule", Economynext, March 13, 2020
[162] Source: "Sri Lanka car registrations down to 7 – year low in June after 'Nixon' shock", Economynext, July 23, 2020
[163] Source: CBSL Statistics, External Sector
[164] Source: "Sri Lanka import ban pushes motor traders out of business", Sunday Times, March 07, 2021
[165] Source: "Vehicle import ban to continue until end of 2021", News 1st, February 23, 2021
[166] Source: "Vehicle prices skyrocket", The Morning, May 3, 2021

has created demand for vehicle categories that fulfil the logistics aspect of these new ventures such as Motorcycles & Three Wheelers, which LFCs specialize in. The CBSL recently issued directives to facilitate this with LTV ratios for registered vehicles which are more than a year old being set at 80%[167].

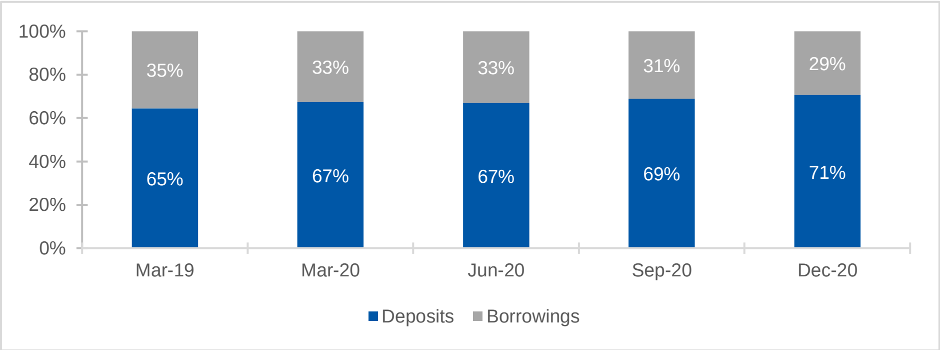
While new opportunities such as the above have emerged in the vehicle leasing space, overall the prolonged restrictions on the motor vehicles sector would continue to hamper loan growth potential for NBFIs.

Lack of diversity in funding sources heightens the impact of a 'flight to quality' in the event of market distress

LFCs funding sources becoming increasingly concentrated in customer deposits

Given the adverse economic conditions over the past few years which have adversely impacted the performance of the NBFI sector, LFCs have increasingly found it difficult to diversify away its funding sources beyond customer deposits. Borrowings from LCBs which is the key alternative source of funding for LFCs has been trending down since December 2018 as banks turned cautious with respect to their lending activities (Exhibit 77). This has led LFCs to rely more on customer deposits, which as at end December 2020, accounted for over 70% of its funding mix.

Exhibit 77: Funding Mix for LFCs in recent years



Source: CBSL
Note: Dec-20 value is provisional

Relaxed restrictions provide certain LFCs with the opportunity to raise funds from abroad

While the recent directive by the CBSL to raise the foreign borrowing limit by LFCs from 10% of total assets to 20%[168] provides greater flexibility for LFCs to seek alternative sources of funding, this avenue for funding may only be feasible for large scale LFCs.

Hence, in the face of depressed market conditions affecting the profitability of LFCs as well as the negative sentiment arising from news of distressed firms, a sudden market shock could trigger a 'flight to quality' of deposits away from LFCs which could cause a liquidity crunch.

Distressed firms contributing to the negative sentiment surrounding LFCs

While the capital and liquidity levels of LFCs saw a noteworthy improvement in 2020, a number of firms have failed to meet the minimum capital requirements with few recording negative levels of capital[169]. At the same time, risky lending practices, internal mismanagement which was compounded by adverse operating conditions have led to a

[167] Source: Directions, Circulars and Guidelines for Non-Banks, CBSL, February 2021
[168] Source: Directions, Circulars and Guidelines for Non-Banks, CBSL, September 2021
[169] Source: "Nine Licensed Finance Companies face regulatory pressure", Ada Derana, October 15, 2020

number of failed finance companies in recent years[170]. In 2020, the CBSL took action against three such failed companies where licenses were revoked[171]. The above developments add to the negative sentiment surrounding LFCs and may compound the current challenges faced by the sector surrounding deposit mobilization.

New directives issued with the intent of creating a more stable, transparent and professional NBFI sector

In lieu of such developments as well as the CBSL coming under criticism for the failed finance companies, a number of directives were issued with the intent of strengthening the corporate governance of LFCs, encouraging prudent risk management and providing greater visibility for its financial performance. The directives include an approval process for opening new branches, the responsibilities of board of directors, a minimum risk management standard as well as new disclosure requirements for financial information and key performance indicators[172]. While such directives are prudent and reasonable and help to further professionalize the sector, they also add to the underlying costs of LFCs, further hampering its bottom-line performance.

Industry consolidation may dampen performance in the medium term and come at the cost of underserved market segments

The government budget 2021 encouraged banks and group companies to amalgamate with its subsidiary LFCs

Similar to the consolidation drive which took place in 2015 which saw the amalgamation of smaller LFCs, the CBSL and the government has expressed their intent to drive forward another wave of consolidation in the NBFI sector. In its proposed Financial Sector Consolidation Master Plan (FSCMP), the CBSL has set out the need for LFCs to comply with its minimum prudential requirements as well as the need to have a diversified business model which may prompt a merger of smaller LFCs with larger players who are better capitalized, with more diverse lending activities[173]. At the same time, the government's 2021 budget requirements may prompt several LCBs and group firms to announce their intent to merge with the LFCs which are part of their group. In line with the above directives, Trade Finance and Investments and Commercial Credit and Finance amalgamated their operations[174] while National Lanka Finance and Sinhaputhra Finance have announced their intention to amalgamate as well[175].

Amalgamation may result in a change in the strategic focus of LFCs and thus deny credit facilities to certain risky lending segments

While the government has proposed financial incentives for firms which follow through with its merger proposal in the form of tax deductibles for investment expenditure associated with the mergers, not all firms maybe keen on this given the lack of synergies as well as the potential impact on the credit rating of the parent company.

According to Fitch Ratings, LCBs in particular would be reluctant to merge with their respective LFCs given the differences in their operating profiles and the respective market segments they cater to that can affect the credit ratings of the LCBs[176].

At the same time there is a concern that given the disparity in the relative asset sizes of LFC and LCBs this may result in certain high risk lending segments being denied access to credit as the activities of the merged LFC may not be an area of focus[177]. Hence there is a potential concern that excessive consolidation may constrain the unique role that NBFIs play in the financial services industry.

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[170] Source: "Six failed finance companies held Rs. 62 b in deposits", Economynext, January 21, 2021
[171] Source: "Sri Lanka suspends licenses of ETI Finance and Swarnamahal Financial Services", Economynext, July 13, 2020
[172] Source: Directions, Circulars and Guidelines for Non-Banks, CBSL, August & September 2020
[173] Source: CBSL Financial System Stability Review 2020
[174] Source: "National Lanka Finance, Sinhaputhra Finance to amalgamate", Daily FT, November 2, 2020
[175] Source: "Trade Finance and Investments PLC amalgamates into Commercial Credit and Finance PLC", Sunday Times, February 28, 2021
[176] Source: "Sri Lankan Bank ratings unaffected by proposed FLC Mergers", Fitch Ratings, November 23, 2020
[177] Source: "Sri Lanka bank – finance company mergers could deny credit to some borrowers: Fitch", Economynext, November 24, 2020

Profiles of Banks

Amana Bank PLC (ABL) — Fitch Ratings: BB+(lka)

Company Description

ABL Sri Lanka's leading Islamic Banking service provider since its inception in 2009. ABL is listed with the CSE and its principal shareholder is a Jeddah based IDB Group, with a 29.7% stake in the company. The IDB Group is a 'AAA' rated multilateral development financial institution with a capital base of over US$ 150 bn which has a membership of 57 countries. Ranking the 12th largest LCB in Sri Lanka based on its asset base in 2020, ABL crossed the threshold of holding total assets worth LKR 100bn (~US$ 540m) in 2020. ABL operates over a network of 32 branches island wide.

Key Business Segments

- **Retail/Consumer Banking** – Retail banking comprises of deposit facilities, personal financing, leasing, housing financing and Islamic Banking products extended to the general public.
- **Business Banking** – ABL finances SMEs and emerging corporates, focusing on Corporate Banking, SME Banking, commercial leasing, trade financing and project financing – contributing to 51% of ABLs total income. Plans for 2020 included increased focus on strategic sectors based on the country's economic and policy outlook to build sector specific capacity and risk resilience.

Strengths

- ABL recorded an increasing CASA ratio from 39% (2019) to 45% (2020), fueling profit growth.
- Overall Gross NPA ratios stood at 4%, below the industry average of 4.9%, among the lowest in LCBs in Sri Lanka. ABL recorded improved NPL ratios in the first quarter of 2021.
- Capital buffers were maintained above the current regulatory requirements, though additional equity infusion is required to meet the minimum capital requirement of LKR 20bn by end of 2022.

Challenges

- Financing income reduced to LKR 7.2bn (~US$ 38m) in 2020 as the bank's charges and fees income and foreign exchange transactions income declined.
- Asset quality will likely diminish as the full impact of CBSL's regulations for loan restructuring and debt moratoriums is realized, especially as the bank has high exposure to the riskier SME and retail segments.

Recent Developments/ Future Plans

- ABLs credit ratings was revised upwards by Fitch Ratings from BB (lka) Positive outlook in 2019 to BB+(lka) Stable Outlook in June 2020. This was reaffirmed in the last review in October 2020.
- Scrip dividends of LKR 200m (~US$ 1.1m) were paid to shareholders in the final quarter of 2020.
- Accelerated digital transformation leveraging on electronic payment networks such as JustPay and LankaQR.

Source: Amãna Bank Annual Report 2020, CSE, Fitch Ratings, Corporate website

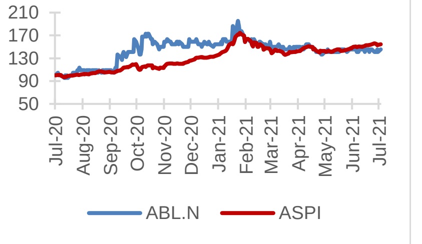
Current Price (US$)	0.02

Price as at July 5th, 2021 (LKR/US$ = 200)

Stock Details	
Market Cap (US$ m)	42
Market Cap (%)	0.002%

Source: CSE

Share Price Chart (Indexed)



Source: CSE

Valuation Multiples	2018	2019	2020
Year End Price (US$)	0.02	0.01	0.02
P/E(x)	14.09	12.78	18.89
P/B(x)	0.67	0.49	0.71

Source: Ratios calculated using data from Annual Reports, CSE

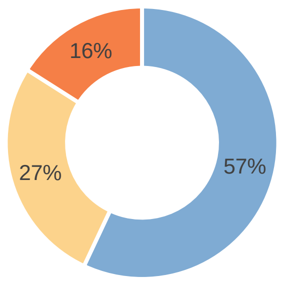
Shareholder Structure	
IB Growth Fund (Labuan) LLP	23.7%
Mr. Hossain Ahmed Ismail	10.0%
Mr. Mohamed Haji Omar	8.4%
Bank Islam Malaysia Berhad	7.2%
AB Bank Limited	7.2%
Other	43.5%
Total	**100.0%**

Source: Interim Financial Statement 31.03.2021

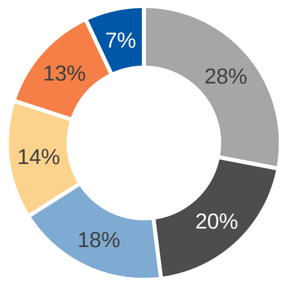
Note: See the Annexure for further details on the US$ conversion rates, Key formulae used and sources used.

Note: Graphs and Tables may not sum to 100% due to rounding errors

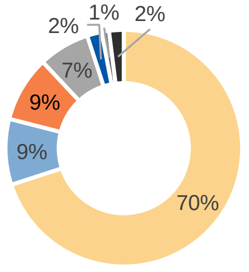
Total Income by Segment (FY20)



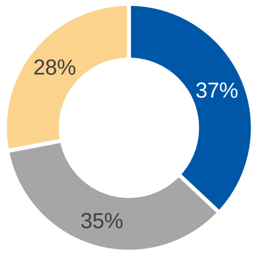
Sectoral Classification of Loans (FY20)



Segmental Classification of Loans (FY20)



Exposure by Key Business Segments (FY20)



Source: Annual Report 2020

Key Performance Indicators			
	2019 YE Dec	**2020 YE DEC**	**2021 Q1 (Mar)**
Gross Income (US$ m)	49.2	43.0	8.6
Net Profit (US$ m)	2.6	2.5	0.7
Net Financing Margin (%)	3.9	3.7	3.7
Operating Cost/Net Income Ratio (%)	60.9	60.6	N/A
Asset Base (US$ m)	476.7	537.4	534.8
Deposit Base (US$ m)	394.3	448.2	440.8
Shareholder Funds (US$ m)	65.3	66.9	62.8
Net Loan Portfolio (US$ m)	317.8	335.6	345.2
ROE (%)	3.9	3.8	4.2
ROA (% after tax)	0.6	0.5	0.9 (Pre-Tax)
Gross loans / Deposits (%) (calculated)	82.4	76.9	80.3
Gross NPL (%)	3.7	4.0	3.3
Net NPL (%)	1.5	1.4	0.7
Tier 1 CAR (%)	15.4	15.6	13.6
Total CAR (%)	16.9	17.4	15.2

Source: Annual Report 2020, Interim Financial Statements for the quarter ended March 2021

Bank Of Ceylon (BOC)

Fitch Ratings: AA-(lka)
Moody's: Caa1 (International)

Company Description

BOC has been in operation for more than eight decades since its inception in 1939 as Sri Lanka's first state-owned commercial bank. Owned solely by the Sri Lankan Government, BOC is the country's largest bank and is graded a D-SIB. The bank operates over a network of 646 branches and has 10 subsidiaries and 4 associate companies within its group structure, including Property Development PLC and Merchant Bank of Sri Lanka and Finance PLC. Overseas operations mainly extend across India, Maldives, Seychelles through its branches and in the UK via BOCs fully owned subsidiary. BOC Debentures are listed on the CSE.

Key Business Segments

- **Retail Banking** –This cluster provides a range of investment, lending and transactional banking solutions to individuals. It provides development banking solutions to start-up ventures and SMEs. The credit portfolio mainly comprises of personal loans, housing loans, commercial/development loans, leasing, overdrafts and pawning. The retail cluster is also the main deposit mobiliser for BOC.
- **Corporate and Offshore Banking** – This segment provides finance solutions to corporate clients, the Government, state-owned enterprises and large-scale projects. Expanding the private sector corporate client portfolio is also a key focus under this segment.
- **International, Treasury, Investment and Overseas operations** – The International division engages in foreign currency related transactions, facilitating remittances, issuing foreign currency travel cards and offering foreign currency deposit products. The Investment division provides portfolio management services, trustee and custodian services and is involved in the structuring of investments such as debentures and securitized papers.

Strengths

- BOCs asset base crossed the threshold of LKR 3.0tn (~US$ 15bn) in the first quarter of 2021. Loans and Advances crossed the LKR 2tn (~US$ 10bn) mark, supported by both Government and Private sector lending. BOC occupies the largest market share in the sector, accounting for over 20% of sector assets.
- BOCs extensive reach in the country creates significant competitive advantages over the other banks in terms of customers, exposure and reliability.
- Amidst interest rate cuts, debt moratoriums, new repayment schemes and increases in the interest expenses due to an expanding deposit base, the Net Interest Income recorded a drop of only 0.5% YoY.

Challenges

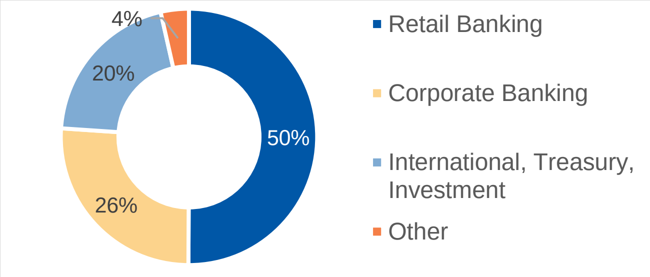
- BOC is heavily dependent on the sovereign's fiscal profile. Exposure to the sovereign in terms of lending and investment is high. It is likely to put pressure on asset quality, should the serviceability of the sovereign's debt obligations be tested.
- Total impairment charges increased by 68% but the NPA ratio was maintained at 4.8%, however as the impact of extended moratoriums have not yet set in, asset quality is likely to be lower in actuality.
- BOCs Tier I Capital and Total Capital ratio stood at 11.2% and 14.9% respectively by end 2020, which were above regulatory norms but weighed more towards the lower end of the ratios reported by LCBs.

Recent Developments/Future Plans

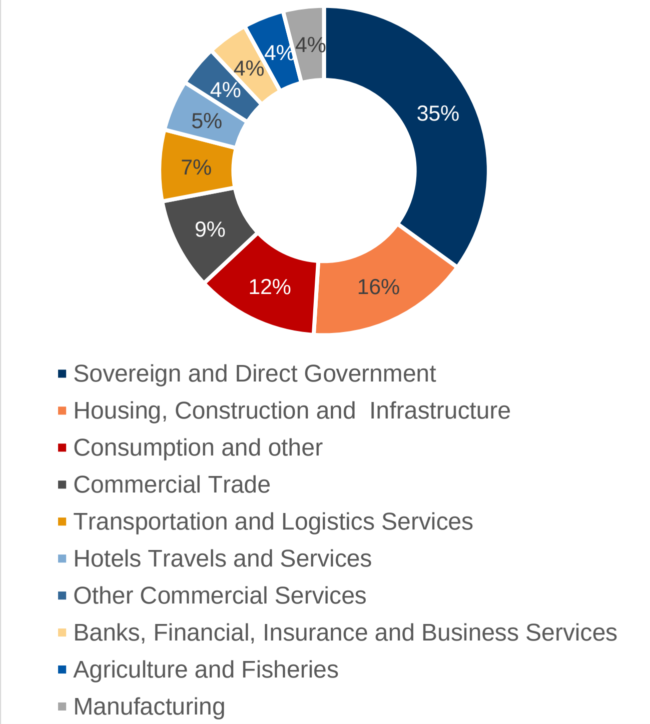
- According to news reports, BOC is expected to receive US$ 115m in overseas funding in July 2021 from China Development Bank (CDB) and the Asia Infrastructure Investment Bank (AIIB)
- In 2020, BOC executed issuance of an Additional Tier 1 (AT1) bond, generating LKR 15bn (~US$ 80m) ATI capital. This was the first of its kind to be issued by a LCB in the country.
- Fitch downgraded the national rating from AA+(lka) to AA-(lka) in January 2021, following the recalibration of their Sri Lankan national rating scale. However, it remains the highest rating level assigned to a domestic LCB.
- In delivering the Government mandate for reviving the economy, LKR 39.1bn (~US$ 210m) was disbursed by BOC under the "Saubagya COVID-19 Renaissance Facility". BOC also introduced the "Divi Udana" loan scheme in 2020 to revitalize the ailing economy, by ensuring that the funding needs of SMEs were met.

Source: BOC Interim Financial Statements & Annual Report 2020, Fitch Ratings, Moody's Investor Service, Corporate website, Media reports

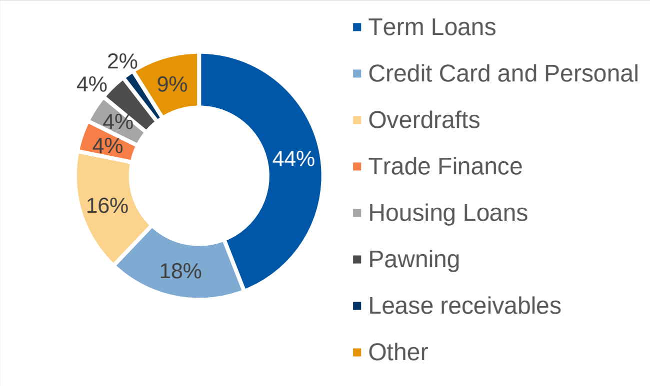
Total Group Operating Income by Segment (FY20)



Sectoral Classification of Loans (FY20)



Segmental Classification of Loans (FY20)



Source: Annual Report 2020

Key Performance Indicators (Figures refer to Group values unless stated otherwise)			
	2019 YE Dec	**2020 YE Dec**	**2021 Q1 (Mar)**
Gross Income (US$ m)	1,389.3	1,359.9	358.6
Net Profit (US$ m)	132.7	87.7	69.1
Net Interest Margin (%)	3.3	2.8	3.2
Operating Cost/Net Income Ratio (%)	39.6	39.4	N/A
Asset Base (US$ m)	13,557.4	16,226.6	16,035.1
Deposit Base (US$ m)	11,149.9	13,374.5	12,875.1
Shareholder Funds (US$ m)	843.5	899.6	916.3
Net Loan Portfolio (US$ m)	8,704.0	10,827.8	11,041.0
ROE (%)	16.0	10.1	30.4
Pre-tax ROA (%)	1.3	0.8	2.0
Gross loans / Deposits (%) (calculated)	83.1	86.2	91.0
Gross NPL (%) *(Bank)*	4.8	4.8	4.4
Net NPL (%) *(Bank)*	1.8	1.4	1.2
Tier 1 CAR (%) *(Bank)*	11.2	11.2	11.1
Total CAR (%) *(Bank)*	15.6	14.9	14.6

Source: Annual Report 2020, Interim Financial Statements for the quarter ended March 2021

Note: US$ based financial statements are provided in annual report

Cargills Bank (CBL) — Fitch Ratings : AA-(lka)

Company Description

Since its inception in 2014, CBL is a privately held licensed commercial bank in Sri Lanka that adopts a unique agency banking model. CBL carries out a proportion of its operations through the 'Cargills Food City' chain of supermarkets, serving more than 150,000 customers and employing 632 people in 20 branches. It is the smallest among LCBs in Sri Lanka with a total asset base of LKR 46.5bn (~US$ 249m).

Key Business Segments

- **Retail Banking** – Retail banking constitutes of savings and deposit facilities, personal loans, housing loans, vehicle loans, and electronic cards. CBL leverages on the agency banking model implemented through the Cargills Group's supermarket chain to be their key growth driver.
- **Corporate Banking** – CBL offers business banking services and trade services to corporate clients. Services include working capital finance, term loan financing, project financing etc.
- **SME and Business Banking** – The bank offers financial services to SMEs with a focus on the agricultural sector emphasizing on agricultural modernization and dairy development. This segment actively engages with CBSL development initiatives.

Strengths

- Leveraging on the Cargills ecosystem, the bank has an expansive reach to a large customer base across the island, as they have enabled certain transactions to be carried out at the Cargills supermarket outlets.
- Net fee and commission income rose by 19% in 2020, as the bank's credit card business was supported by a 40% growth in cardholders.
- CASA ratio improved from 16% to 28% in 2020 due to deposit augmentation; an achievement considering that the bank recorded the lowest CASA among LCBs in 2019.

Challenges

- Operating losses of LKR 886m (~US$ 4.76m) led to a decline in the bank's capital to fall below the CBSL's requirement of LKR 10bn, requiring an additional capital infusion in 2021, although Tier 1 CAR was maintained at 20.7%, above the required minimum of 8%. CBL is also required to raise their minimum capital to LKR 20bn by end-2022.
- Deterioration in loan portfolio quality, as gross NPLs further increased from 12.8% to 14.4% in FY20, with added vulnerabilities that may arise due to business cycle fluctuations and adverse weather given the bank's exposure to the SME/agricultural segment.
- Net interest income declined by 23% in the context of a reducing interest rate environment and high fixed deposit base in FY20.

Recent Developments/Future Plans

- Improvements were made in the payments space through digital platforms like POS, JustPay and LankaQR to enable growth in non-cash payments.
- Fitch Ratings for the bank were revised to AA-(lka) with a stable outlook, following the recalibration of Fitch's Sri Lankan national rating scale.
- CBL prepares to be listed on the CSE by 31st June, 2021.

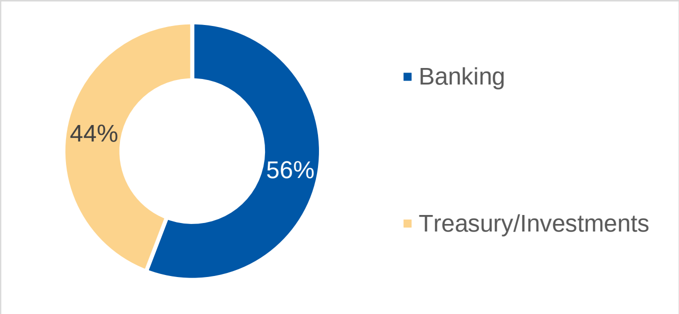
Source: CARG Annual Report 2020, Fitch Ratings

Shareholder Structure	
Cargills (Ceylon) PLC*	39.7%
CT Holdings PLC*	25.3%
Monetary Board of Sri Lanka - On Behalf of EPF	5.0%
Mulitex Investment Limited	3.5%
MJF Foundation Investments (Pvt) Ltd	3.2%
Other	23.3%
Total	**100.0%**

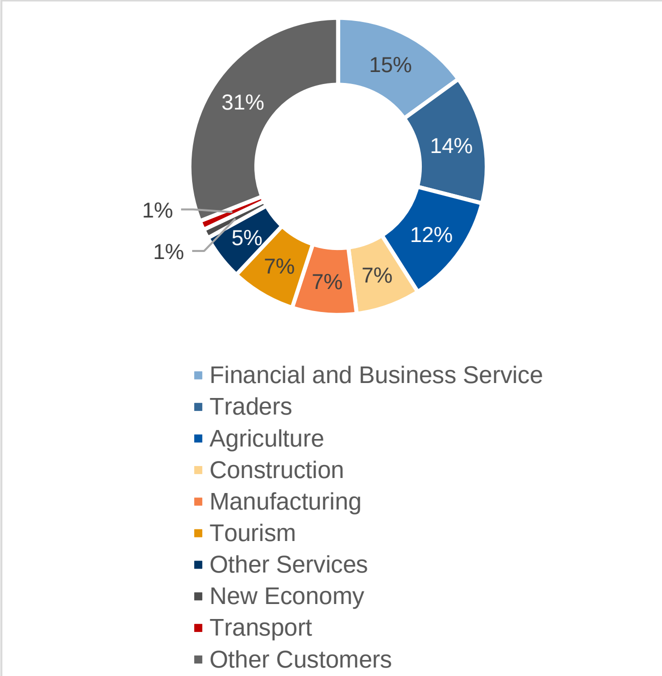
**No voting rights will be exercised by Cargills (Ceylon) PLC and CT Holdings PLC on any shares held in excess of 30% of the issued capital of the bank carrying voting rights.*

Source: Interim Financial Statement 31.03.2021

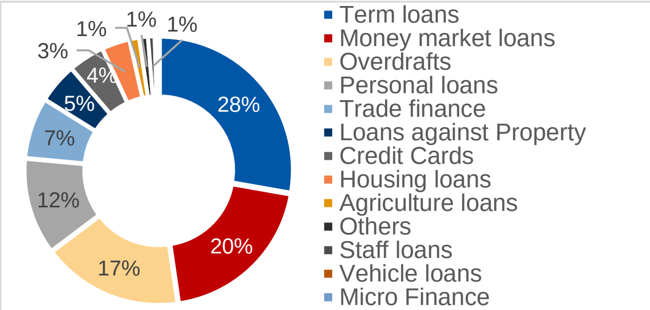
Total Operating Income by Segment (FY20)



Sectoral Classification of Loans (FY20)



Segmental Classification of Loans (FY20)



Source: Annual Report 2020

Key Performance Indicators

	2019 YE Dec	2020 YE Dec	2021 Q1 (Mar)
Gross Income (US$ m)	27.7	25.7	6.4
Net Profit (US$ m)	-3.7	-4.0	-0.9
Net Interest Margin (%)	5.6	3.9	4.0
Operating Cost/Net Income Ratio (%)	89.4%	104.2%	N/A
Asset Base (US$ m)	215.5	249.6	236.2
Deposit Base (US$ m)	137.9	171.7	167.4
Shareholder's Funds (US$ m)	57.4	52.2	47.9
Net Loan Portfolio (US$ m)	148.7	156.0	159.7
ROE (%)	-6.0	-7.1	-7.1
Pre-Tax ROA (%)	-2.4	-2.0	-0.8
Gross loans / Deposits (%) (calculated)	115.3	99.2	104.0
Gross NPL (%)	12.8	14.4	12.5
Net NPL (%)	10.0	7.9	6.0
Tier 1 CAR (%)	26.4	20.7	20.6
Total CAR (%)	26.9	21.3	21.2

Source: Annual Report 2020, Interim Financial Statements for the quarter ended March 2021

ALPEN CAPITAL

Commercial Bank (COMB)

Fitch Ratings : AA-(lka)

Company Description

COMB was established in 1969 as the first private commercial bank in Sri Lanka. Since then, COMB has had steady progress to become the third largest domestic commercial bank in Sri Lanka, accounting for a total asset share of over 13% within the LCB sector. COMB has been graded a D-SIB by CBSL and is listed on the CSE. The branch serves over 3.5m customers across an extensive branch network. COMB is the first Sri Lankan bank to establish a global presence by extending their operations primarily in Asia.

Key Business Segments

- **Personal Banking** – Catering to the mass market, this segment provides loans to government pensioners, leasing, housing loans, emergency loans for remittance beneficiaries and more.
- **Corporate Banking** – Under this cluster, COMB focuses on pledge loans, credit card securitization, corporate cards, trade financing, investment banking, Islamic banking and its offshore banking unit.
- **International Operations** - COMB maintains steady operations in Italy, Bangladesh, Maldives and Myanmar.

Strengths

- Deposits grew by 20.2% in 2020, recording a historic high in deposit growth. CASA ratio increased significantly to 42.7%, above the industry average of 34.7% in 2020.
- Both Tier 1 and Total Capital ratios improved to 13.2% and 16.8% respectively, remaining in excess of the higher capital adequacy requirements imposed on banks graded as a D-SIB under Basel III requirements.
- COMB has managed to contain the keep their NPL ratios stable in 2020 and during first quarter of 2021.
- Received a significant equity capital growth by way of an equity infusion by IFC amounting to US$ 50m.
- Existence of strong overseas banking operations, with Bangladesh and Maldivian operations accounted for 20% of the pre-tax profit of the Group.

Challenges

- Growth in total operating income of 13.5% in 2020 was insufficient to cover the increasing impairment provisions, causing the operating profit before taxes to decrease by 5.1%. Total impairment charges amounted to LKR 21bn (~US$ 114m), the highest provision the bank has made in a single year in its history.
- As at end-2020, COMB had significant exposure to Sri Lanka Development Bonds and International Sovereign Bonds. With worries over the debt repayment capacity of the government, this poses a risk to the bank.

Recent Developments/ Future Plans

- In May 2021, COMB proposed to raise LKR 10bn (~US$ 50m, May'21 LKR/US$ = 199.5) via a Basel IIII compliant debenture issue with a credit rating of 'A(EXP)(lka)' by Fitch ratings.
- COMB launched the omni-channel digital platform 'ComBank Digital' and formulated the 'Digital Roadmap' up to 2023.
- COMB became the first bank in the country to achieve carbon neutral status.
- COMB was ranked among the 'Top 1000 World Banks' by 'The Banker' magazine in 2021 for the 11th consecutive year. In the same year it was also awarded the 'Best Bank in Sri Lanka' by Finance Asia.

Source: COMB Annual Report 2020, CSE, Fitch Ratings, Corporate website, Media reports

Current Price (US$)
Voting : 0.44
Non-voting : 0.39

Price as on July 5th, 2021 (LKR/US$ = 200)

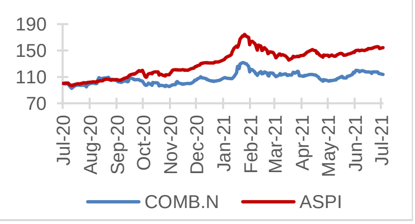
Stock Details (Voting)	
Market Cap (US$ m)	489
Market Cap (%)	2.83%

Source: CSE

Group Snapshot (Key companies)	Profits FY20 (US$ m)
Commercial Bank	88.13
Commercial Development Company	0.66
CBC Tech	0.51
CBC Finance Limited	0.31
Commercial Bank of Maldives	1.47
CBC Myanmar Microfinance Company	0.07
Commex Sri Lanka	(0.56)
Bangladesh Operations	20.12

Source: Annual Report 2020

Share Price Chart (Indexed)



Source: CSE

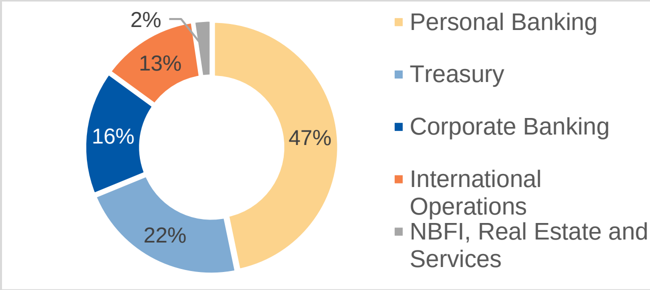
Valuation Multiples (Group)	2018	2019	2020
Year End Price (US$)	0.63	0.54	0.43
P/E(x)	6.73	5.87	5.33
P/B(x)	0.98	0.73	0.60

Source: Ratios calculated using data from Annual Reports, CSE

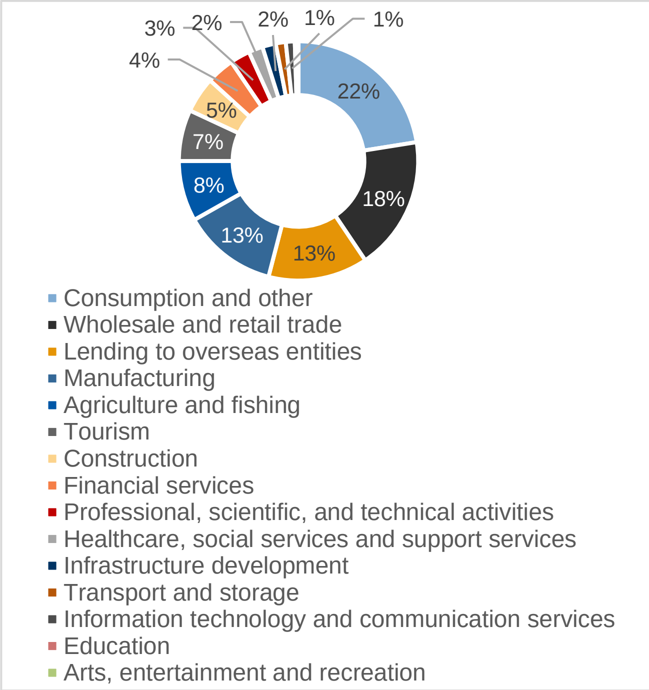
Shareholder Structure (Voting)	
DFCC Bank A/C No. 1	12.0%
Mr. Y. S. H. I. Silva	9.9%
Employees Provident Fund	8.6%
CitiBank NY S/A IFC	7.1%
Sri Lanka Insurance Corp. Ltd	5.6%
Other	56.8%
Total	100.0%

Source: Interim Financial Statement 31.03.2021

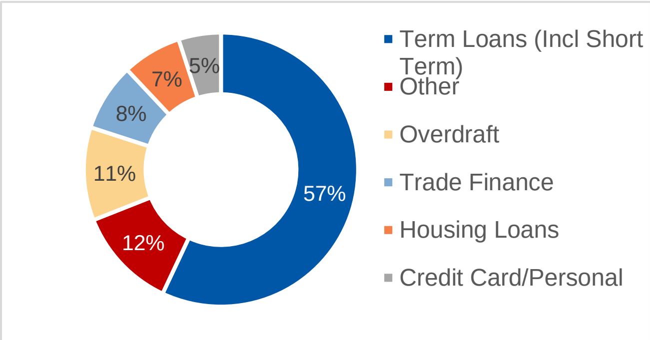
Contribution to Profit before Tax by Segment (FY20)



Sectoral Classification of Loans (FY20)



Segmental Classification of Loans - Bank (FY20)



Source: Annual Report 2020

Key Performance Indicators (Figures refer to Group values unless stated otherwise)			
	2019 YE Dec	**2020 YE Dec**	**2021 Q1 (Mar)**
Gross Income (US$ m)	806.1	812.6	211.0
Net Profit (US$ m)	93.1	91.3	34.3
Net Interest Margin (%) *(Bank)*	3.5	3.2	3.5
Operating Cost/Net Income Ratio (%) *(Bank)*	38.5	34.0	N/A
Asset Base (US$ m)	7,534.4	9,425.1	9,165.6
Deposit Base (US$ m)	5,716.5	6,880.3	6,765.3
Shareholder Funds (US$ m)	727.3	860.7	822.4
Net Loan Portfolio (US$ m)	4,780.3	4,865.4	4,670.6
ROE (%)	13.5	11.3	17.1
ROA (after tax %)	1.3	1.1	1.9 (Pre-Tax)
Gross loans / Deposits (%) (calculated)	87.1	74.8	73.3
Gross NPL (%) *(Bank)*	5.0	5.1	4.9
Net NPL (%) *(Bank)*	3.0	2.2	1.9
Tier 1 CAR (%) *(Bank)*	12.3	13.2	12.9
Total CAR (%) *(Bank)*	16.2	16.8	16.5

Source: Annual Report 2020, Interim Financial Statements for the quarter ended March 2021

Note: US$ based financial statements are provided in annual reports

DFCC Bank PLC (DFCC) — ICRA Lanka : [SL] AA-

Company Description

Established in 1955 as the first development bank in Sri Lanka and one of the oldest in the region, DFCC has been the lender of choice for trailblazing Sri Lankan entrepreneurs. Having honed its expertise in project lending for over six decades, DFCC turned to commercial banking in 2015 with its amalgamation with DFCC Vardana Bank. By the end of 2020, DFCC had 139 branches including postal units and over 4500 ATMs island wide, with over 2000 staff. In December 2020, DFCC was ranked the number one Cash Management Service Provider in Sri Lanka by Euromoney Magazine.

Key Business Segments

- **Corporate Banking** – This unit serves the larger corporations, both within the country and offshore.
- **Business Banking** – This unit serves a mix of lower-end corporate customers, high-end SME customers and retail customers through a range of development banking, commercial banking and retail banking products.
- **Consumer Banking** – This unit provides a range of financial solutions to consumers such as personal loans, overdrafts, housing loans, vehicle loans, leasing, education loans, card operations, Bancassurance and more. This unit also covers the banking section dedicated to growing its variety of customer segments such as retail, SME and MSME.

Strengths

- DFCC continued its focus on aiding the development of Sri Lankan SMEs and MSMEs amidst the COVID-19 pandemic by implementing a number of relief measures, while identifying growth opportunities in select industries such as the Cinnamon trade as well as the long-term potential for the tourism industry.
- Launched a ‘Vision 2025’ strategy with the aim of achieving two major goals which are getting customers onboard through their digital platform and implementing credit hubs as a process improvement.
- Cost management procedures implemented during the pandemic helped bring down DFCCs operating expenses by 2% in 2020 and thus strengthening their cost-to-income ratio to 48.97%.

Challenges

- Net interest income declined by 13% in 2020 due to a slowdown in loans and advances and other key loan categories which resulted in a decline in the Net interest margin to 2.5%, below industry average.
- Impairment charges grew steeply by 97% during 2020 where the Gross NPL ratio continued to climb during the year reaching 5.6% by end 2020 which was above the industry average.

Recent Developments/Future Plans

- With the discontinuation of International credit rating provided by Fitch ratings, ICRA Lanka provided a rating of [SL] AA- with a stable outlook in December 2020
- The banks digital drive in 2020 saw the launch of ‘DFCC ‘Chatz’; an interactive multi-channel digital assistant as well as ‘DFCC Pay’ app which supports QR code enabled payments.

Source: DFCC Annual Report 2020, CSE, ICRA Reports, Corporate website, Media reports

Current Price (US$)	0.30

Price as on July 5th, 2021 (LKR/US$ = 200)

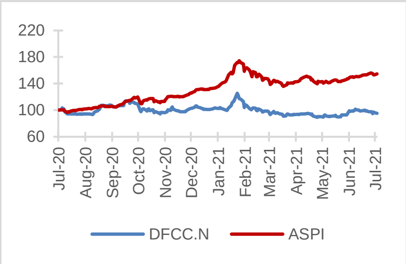
Stock Details	
Market Cap (US$ m)	97
Market Cap (%)	0.60%

Source: CSE

Group Snapshot (Key companies)	Profits FY20 (US$ m)
DFCC Bank	12.85
Acuity Partners (Pvt) Limited	2.19
DFCC Consulting (Pvt) Limited	0.06
Synapsys Limited	0.04
Lanka Industrial Estates Limited	1.12
National Asset Management Limited*	0.00

Source: Annual Report 2020
**Note: Associate Company*

Share Price Chart (Indexed)



Source: CSE

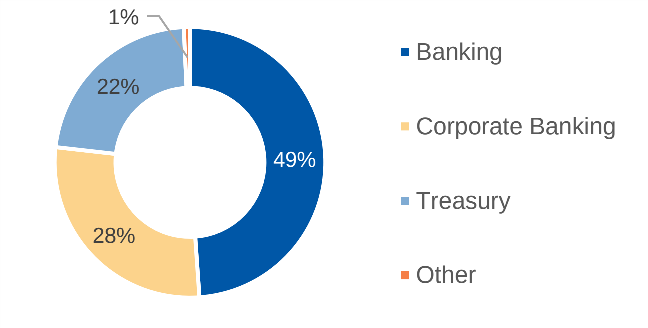
Valuation Multiples (Group)	2018	2019	2020
Year End Price (US$)	0.51	0.51	0.35
P/E(x)	8.19	12.06	7.26
P/B(x)	0.54	0.57	0.39

Source: Ratios calculated using data from Annual Reports, CSE

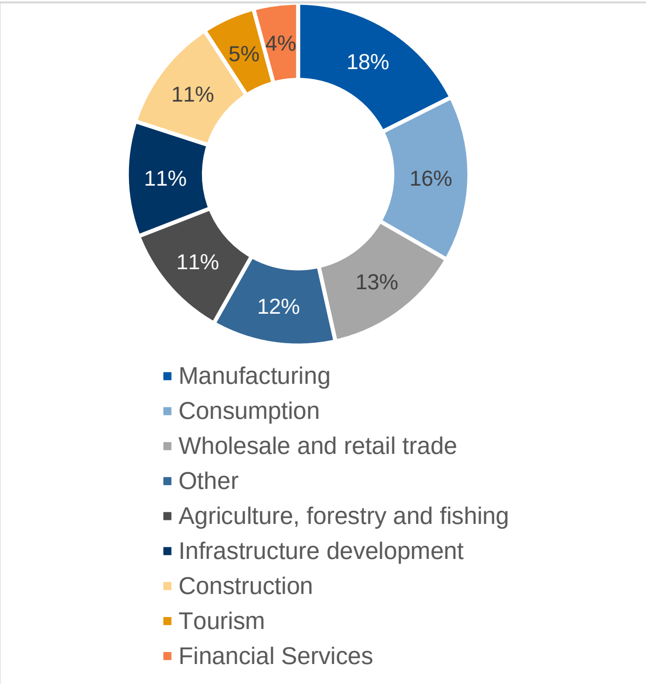
Shareholder Structure	
Hatton National Bank PLC	14.91%
Bank of Ceylon	12.51%
Mr. M A Yaseen	10.00%
Sri Lanka Insurance Corporation Ltd-Life Fund	9.07%
Employees’ Provident Fund	8.01%
Other	45.50%
Total	**100.0%**

Source: Interim Financial Statement 31.03.2021

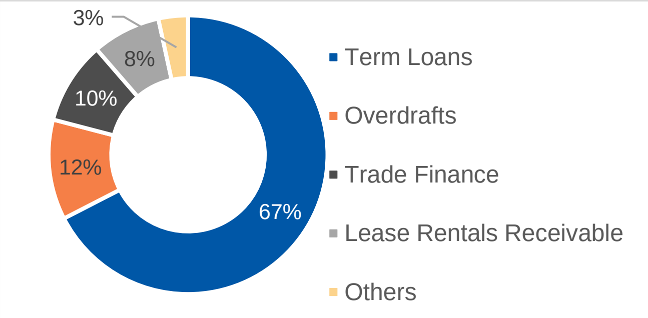
Total Operating Income by Segment (FY20)



Sectoral Classification of Loans (FY20)



Segmental Classification of Loans (FY20)



Source: Annual Report 2020

Key Performance Indicators (Figures refer to Group values unless stated otherwise)			
	2019 YE Dec	**2020 YE Dec**	**2021 Q1 (Mar)**
Gross Income (US$ m)	243.8	234.6	58.0
Net Profit (US$ m)	12.9	15.3	8.2
Net Interest Margin (%) *(Bank)*	3.3	2.5	2.4
Operating Cost/Net Income Ratio (%) *(Bank)*	55.0	49.0	N/A
Asset Base (US$ m)	2,240.3	2,507.2	2,325.6
Deposit Base (US$ m)	1,362.4	1,660.7	1,565.0
Shareholder Funds (US$ m)	270.7	275.9	266.1
Net Loan Portfolio (US$ m)	1,502.0	1,619.6	1,580.4
ROE (%)	5.3*	6.2*	6.0 (Bank)
ROA (after tax %)	0.6*	0.9*	0.91 (Bank - Pre-tax)
Gross loans / Deposits (%) (calculated)	115.1	102.3	106.1
Gross NPL (%) *(Bank)*	4.9	5.6	5.5
Net NPL (%) *(Bank)*	2.1	2.3	2.1
Tier 1 CAR (%) *(Bank)*	11.3	10.8	10.2
Total CAR (%) *(Bank)*	15.8	15.8	14.5

**After eliminating fair value reserve*
Source: Annual Report 2020, Interim Financial Statements for the quarter ended March 2021

Hatton National Bank PLC (HNB)

Fitch Ratings: AA- (lka)
Moody's: Caa1 (International)

Company Description

HNB is Sri Lanka's fourth largest domestic commercial bank, which was incorporated as a public limited company in 1970. HNB is categorized as a D-SIB and is listed on the CSE. HNB has 252 branches, 4,836 employees, 787 self-service machines and serves over 2.6m customers.

Key Business Segments

- **Retail Banking –** Retail banking includes deposit facilities, personal loans, housing loans, leasing, and Islamic banking products.
- **SME Banking –** HNB facilitates wealth creation for SME customers through a range of savings, investments, lending, remittance and transactional products.
- **Corporate Banking –** HNB lends to larger corporate enterprises and has the largest corporate banking portfolio among private commercial banks.

Strengths

- NPL ratios declined notably during 2020, following the regularization of a loan due from an SOE, thus recording one of the lowest ratios among the sector.
- HNB holds a healthy share of low-cost funding in its funding deposit base, where the CASA ratio improved from 35% to 40% during the year. This growth in deposits also led to the improvement of the gross loans to deposits ratio, which was earlier considered to be at the higher end compared to its peers.
- Both the liquidity and capital adequacy ratios remain well above statutory requirements, strengthening HNBs ability to absorb the effects of negative developments in the economy and sector.

Challenges

- HNB had a high share of assets invested in foreign-currency instruments of the sovereign relative to peers, amounting to approximately 15% as at end 2020. Given the concerns of the debt repayment ability of the sovereign, this poses a risk to HNB as well.

Recent Developments/Future Plans

- HNB was recognized as the "Best Retail Bank in Sri Lanka" by the Asian Banker Magazine for the 11th time in 2020.
- An e-commerce platform, AppiGo, was launched in May 2020, which has enabled over 70 businesses to establish e-commerce sites.
- HNB has plans to raise up to LKR 7bn via a debenture issue (~US$ 35m, Mar'21 LKR/US$ = 199.0) for the purpose of refinancing the debentures maturing in 2021 and to further strengthen its Tier 2 capital base.

Source: HNB Annual Report 2020, CSE, Fitch Ratings, Moody's Investor Service, Corporate website

Current Price (US$)
Voting : 0.66
Non-voting : 0.54

Price as on July 5th, 2021 (LKR/US$ = 200)

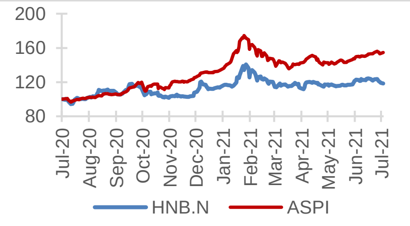
Stock Details (Voting)	
Market Cap (US$ m)	276
Market Cap (%)	1.60%

Source: CSE

Group Snapshot (Key companies)	Profits FY20 (US$ m)
HNB Assurance	6.26
HNB Finance	(1.47)
Acuity Partners	6.38
Sithma Development	2.20

Source: Annual Report 2020

Share Price Chart (Indexed)



Source: CSE

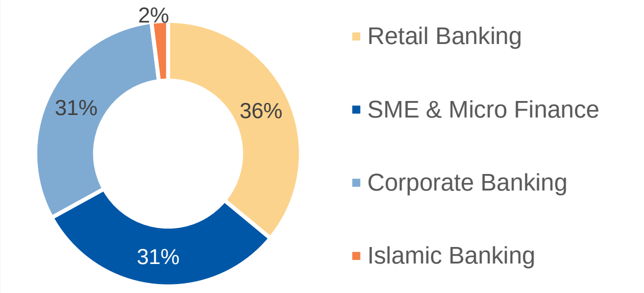
Valuation Multiples (Group)	2018	2019	2020
Year End Price (US$)	1.17	0.95	0.68
P/E(x)	6.07	5.87	4.95
P/B(x)	0.81	0.59	0.42

Source: Ratios calculated using data from Annual Reports, CSE

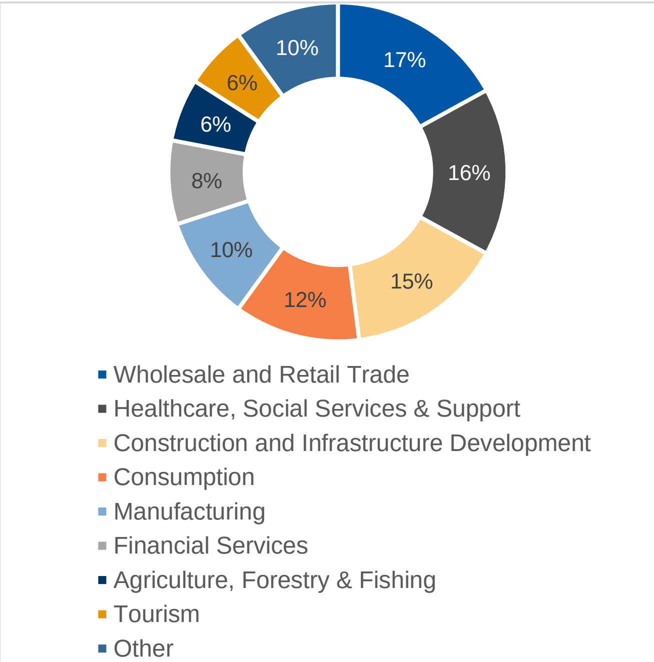
Shareholder Structure (Voting)	
Employees Provident Fund	9.8%
Sri Lanka Insurance Corporation - Life Fund	8.8%
Milford Exports (Ceylon) Limited	7.9%
Stassen Exports Ltd	6.9%
Mr.Sohli Edelji Captain	6.5%
Other	60.1%
Total	**100.0%**

Source: Interim Financial Statement 31.03.2021

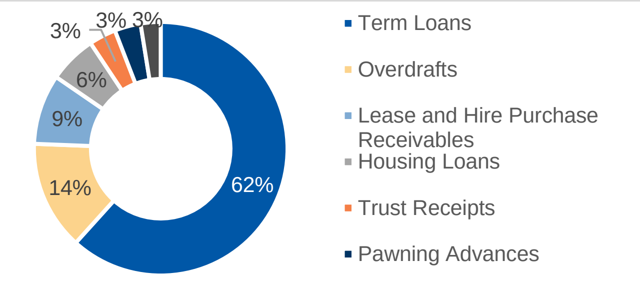
Total Bank Operating Income by Segment (FY20)



Sectoral Classification of Loans (FY20)



Segmental Classification of Loans (FY20)



Source: Annual Report 2020

Key Performance Indicators	2019 YE Dec	2020 YE DEC	2021 Q1 (Mar)
Gross Income (US$ m)	801.8	715.3	171.7
Net Profit (US$ m)	82.9	72.7	24.8
Net Interest Margin (%) (*Bank*)	4.5	3.7	3.3
Operating Cost/Net Income Ratio (%)	47.6	48.3	N/A
Asset Base (US$ m)	6,604.0	7,297.1	6,971.6
Deposit Base (US$ m)	4,604.7	5,293.7	5,130.4
Shareholder Funds (US$ m)	802.4	820.7	791.1
Net Loan Portfolio (US$ m)	4,242.6	4,260.8	3,979.1
ROE (%)	10.6	8.7	13.9 (Bank)
ROA (% after tax)	1.3	1.1	1.7 (Pre-Tax)
Gross loans / Deposits (%) (calculated)	96.1	85.1	82.4
Gross NPL (%) (*Bank*)	5.9	4.3	4.3
Net NPL (%) (*Bank*)	3.3	0.9	0.8
Tier 1 CAR (%) (*Bank*)	14.6	14.7	14.8
Total CAR (%) (*Bank*)	18.3	18.0	17.9

Source: Annual Report 2020, Interim Financial Statements for the quarter ended March 2021

Note: US$ based financial statements are provided in annual reports

National Development Bank (NDB)

Fitch Ratings : A+ (lka)

Company Description

In 1979, NDB began operations as a state-owned development finance institution. NDB was privatized and listed on the CSE after a change of ownership structure in 1993. NDB converted from a Licensed Specialized Bank to a Licensed Commercial Bank in August 2005. NDB currently operates 113 branches with 2,924 employees.

Key Business Segments

- **Retail and SME banking –** NDB offers a range of investment, lending and transactional products to individuals and SMEs with the objective of creating enterprise and wealth.
- **Wholesale Banking –** This unit specializes in the provision of Corporate Banking solutions including Commercial Banking, Transactional Banking, Supply Chain Financing and Cash Management.
- **Project and Infrastructure Finance Banking –** This unit is focused on development banking and overseas lending. The main aim in recent years has been to strengthen NDBs position in the renewable energy sector.

Strengths

- Despite the difficulties faced by most corporations during the pandemic, with the help of their targeted penetration strategy and focus on pursuing cross-sell opportunities, NDBs retail banking sector delivered considerable growth with loans and receivables increasing by 8% and deposits growing by 21% in 2020.
- Sustainable cost reduction and efficiency improvement programs implemented in 2020 helped the banks record the lowest cost to income ratio (37%) in 2020 after COMB.
- NDB emerged as the fourth largest lender of the Saubhagya COVID-19 Renaissance Facility of CBSL (Relief loan scheme for COVID-19 affected customers) after approving loans amounting to LKR 18bn under the facility in 2020.

Challenges.

- NDB had a very low Tier 1 Capital ratio (9.0%) and Total Capital adequacy (13.7%) in 2020. In addition, the bank raised funds via a rights issue in May 2021 to further shore up its capital base.
- Due to COVID-19, NDB reports that there were difficulties in the micro finance sector with regards to disbursements, pursuing collections and engaging with clients.

Recent Developments/ Future Plans

- NDB conducted a rights issue to raise LKR 8.0bn (~USD $ 40.1m, May'21 LKRUS$ = 199.58). In addition to this, LKR 1.46bn (~USD $ 7.3m, May'21 LKRUS$ = 199.58) worth of shares is to be issued to Norwegian Development Finance Institution Norfund, via a private placement.
- Following the recalibration of Fitch Ratings' 'Sri Lankan National Ratings Scale', NDB's rating was affirmed at A+ (lka) while the outlook was revised to Stable from Negative in June 2020. The revision of the outlook was due to the expectation of reduced pressure on NDB's capitalization relative to its risk appetite.
- NDB introduced NEOS PAY (a QR payment method) alongside LankaQR in September 2020.

Current Price (US$)	0.40

Price as on July 5th, 2021 (LKR/US$ = 200)

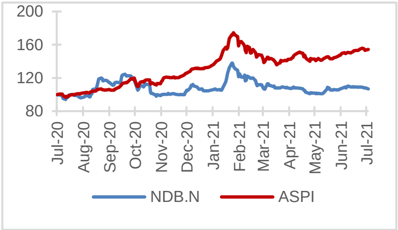
Stock Details	
Market Cap (US$ m)	142
Market Cap (%)	0.82%

Source: CSE

Group Snapshot (Key companies)	
	Profits FY20 (US$ m)
NDB Bank	29.5 (after tax)
NDB Capital Holdings	1.5 (before tax)
Development Holdings (Pvt) Ltd	1.28 (after tax)

Source: Annual Report 2020

Share Price Chart (Indexed)



Source: CSE

Valuation Multiples (Group)	2018	2019	2020
Year End Price (US$)	0.58	0.55	0.42
P/E(x)	4.06	4.87	3.55
P/B(x)	0.58	0.51	0.38

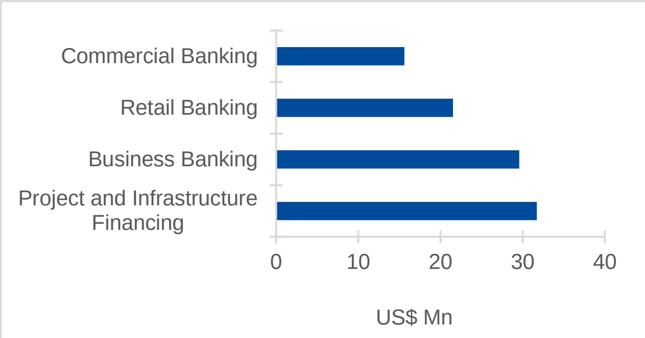
Source: Ratios calculated using data from Annual Reports, CSE

Shareholder Structure	
Employees Provident Fund	10.0%
Bank of Ceylon	8.4%
Sri Lanka Insurance Corporation Ltd-General fund	6.4%
Sri Lanka Insurance Corporation Ltd-Life fund	5.3%
Dr. S. Yaddehige	4.4%
Other	65.5%
Total	**100.0%**

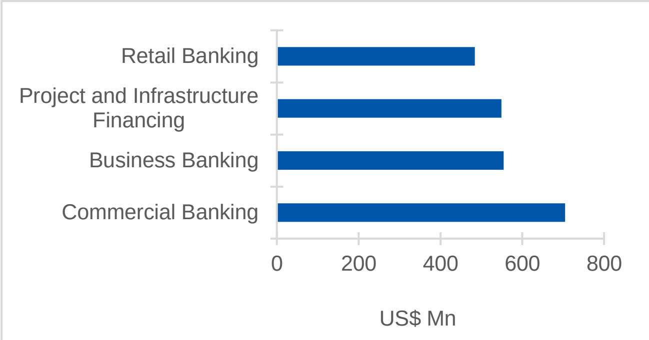
Source: Interim Financial Statement 31.03.2021

Source: NDB Annual Report 2020, CSE, Fitch Ratings, Corporate website

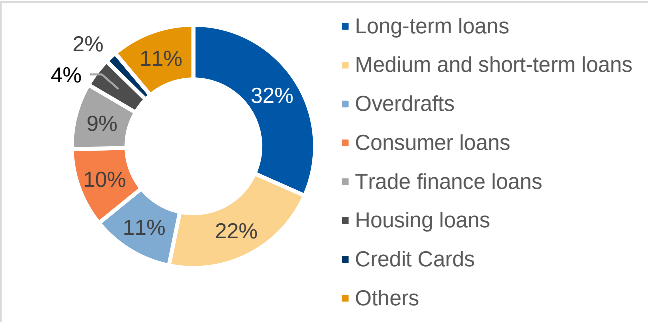
Total Operating Income (Bank) - Key Segments (FY20)



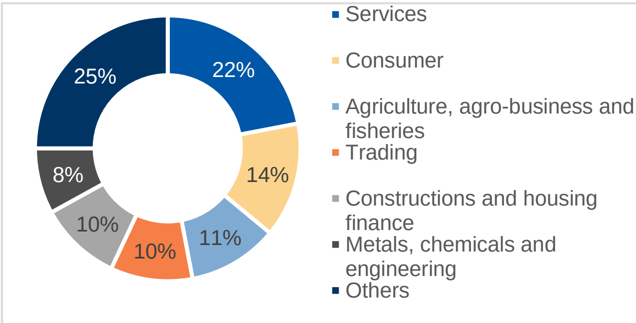
Loans & Receivables - Key Business Segments (FY20)



Segmental Classification of Loans (FY20)



Sectoral Classification of Loans (FY20)



Source: Annual Report 2020

Key Performance Indicators			
	2019 YE Dec	2020 YE Dec	2021 Q1 (Mar)
Gross Income (US$ m)	336.5	331.6	82.8
Net Profit (US$ m)	27.3	28.1	12.5
Net Interest Margin (%)	3.5	3.1	3.3
Operating Cost/Net Income Ratio (%)	42.0	39.4	N/A
Asset Base (US$ m)	2,948.8	3,391.1	3,224.0
Deposit Base (US$ m)	2,227.9	2,626.8	2,506.4
Shareholder Funds (US$ m)	238.9	257.4	249.8
Net Loan Portfolio (US$ m)	2,183.9	2,283.6	2,221.9
ROE (%)	11.6	11.2	16.0
ROA (% after tax)	2.0	1.6	1.8
Gross loans / Deposits (%) (calculated)	101.1	90.6	92.6
Gross NPL (%)	4.8	5.4	5.4
Net NPL (%)	3.2	3.2	3.0
Tier 1 CAR (%) *(Bank)*	9.2	9.2	9.0
Total CAR (%) *(Bank)*	13.4	14.3	13.7

Source: Annual Report 2020, Interim Financial Statements for the quarter ended March 2021

National Savings Bank (NSB) ICRA Ratings: [SL] AAA (Stable)

Company Description

Known to be a wholly state-owned bank, NSB was established in 1972 and was formed by amalgamating 4 traditional savings institutions, including the Ceylon Savings Bank. The Banking Act of 1988 recognized NSB as an LSB. In 2017, NSB was branded the first LSB to reach an asset base of LKR 1 tn. The principal activities of the bank include retail banking, corporate banking, trade financing, treasury dealing and investments, correspondence banking and money remittance facilities and international banking. NSB's staff strength as of December 2019 was 4,715 employees with 256 branches and 334 ATMs. NSB has two subsidiaries in the form of NSB Fund Management Company Ltd. that is engaged in dealing Government Securities and Sri Lanka Savings Bank Limited that offers a wide range of financial services such as mobilizing savings and time deposits, leasing and loan facilities.

Key Business Segments

- **Retail Banking** – Retail banking includes a full range of services such as deposit taking, retail lending solutions, card solutions, and transactional banking. The credit portfolio mainly comprises of personal loans, housing loans, leasing, overdrafts and pawning.
- **International Banking** – NSB has the following products in this segment: foreign currency products (savings and FD in US$, GBP, AUD, JPY), remittances, forex, issuance of import letter of credit, handling of import bills, issuance of shipping and air freight guarantees.
- **Corporate Banking** – The bank lends to medium sized and larger private corporates, state-owned enterprises, and financial institutions.

Strengths

- 100% explicit guarantee is provided by the government for funds deposited with the bank, which has established its reputation as a safe bank for depositors.
- According to a report by ICRA in July 2020, since the bank's inception, NSB has been able to self-fund its capital requirements and has not required any capital support from the government.
- While there has been a deterioration in the NPL ratios of the bank in 2020 (Gross NPL of 2.79%), they remained notably below the sector average of LSBs, which reported a Gross NPL of 6.9% as at December 2020.
- Adequate capital profile is maintained with the Tier 1 and Total CAR being above the regulatory minimum.
- The bank recorded their highest ever profit before tax and profit after tax in 2020, aided by the government's stimulus initiatives.
- After implementing a variety of cost savings strategies, the bank was able to improve its cost to income ratio to 39.1% in 2020, a healthy development after recording ratios of 54% and 49% over the previous two years.

Challenges

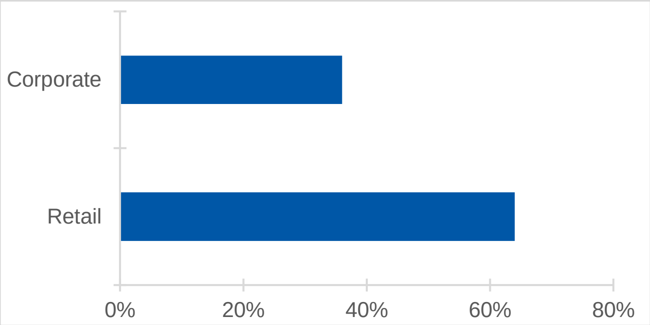
- Limited opportunities to invest in high yielding assets as the bank is bound by the NSB Act, which imposes limitations on expansion of business lines such as into the microfinance and SME sectors. Further, the bank is required to invest 60% of customer deposits in government securities, which limits other investment opportunities.

Recent Developments/Future Plans

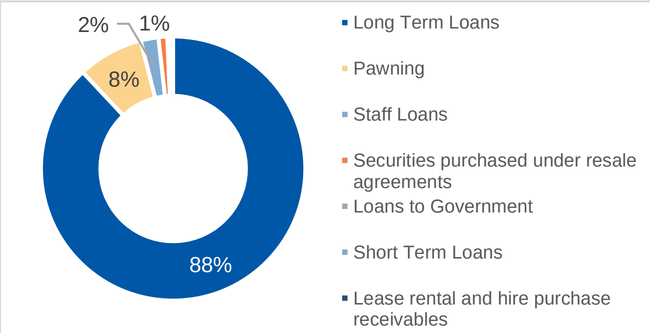
- NSB became the first bank in Sri Lanka to be awarded the 'Tier III' Design Certification for its data centre in May 2021, with it being expected to significantly enhance NSB's digital banking services.

Source: NSB Annual Report 2019, CBSL, ICRA Ratings, Corporate website, Media reports

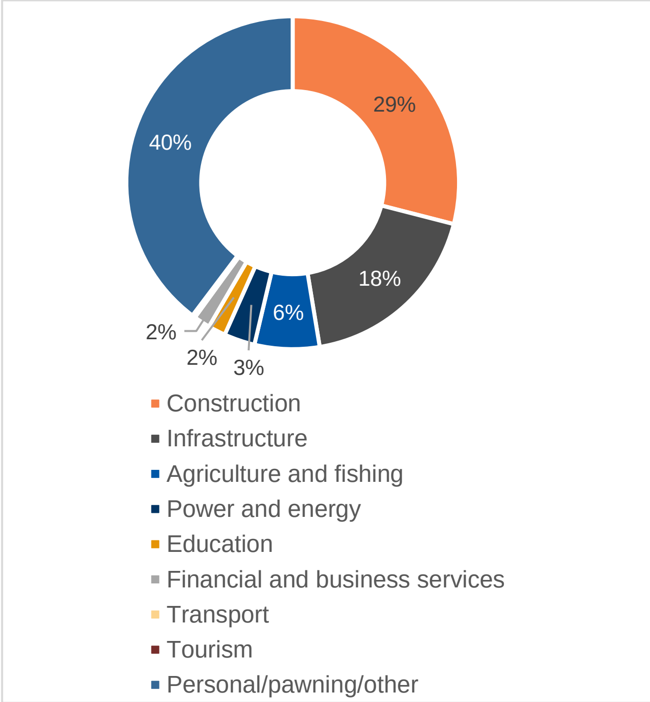
Loans & Advances by Segment (FY20)



Segmental Classification of Loans (FY20)



Sectoral Classification of Loans (FY20)



Source: Annual Report 2020

Key Performance Indicators (Figures refer to Group values unless stated otherwise)			
	2019 YE Dec	**2020 YE Dec**	**2021 Q1 (Mar)**
Gross Income (US$ m)	693.2	696.7	172.7
Net Profit (US$ m)	48.0	58.0	35.8
Net Interest Margin (%) *(Group)*	2.7	2.8	3.9
Operating Cost/Net Income Ratio (%) *(Bank)*	49.4	39.1	N/A
Asset Base (US$ m)	6,477.0	7,410.8	7,355.2
Deposit Base (US$ m)	5,595.8	6,631.0	6,539.7
Shareholder Funds (US$ m)	272.1	307.8	322.1
Net Loan Portfolio (US$ m)	2,515.9	2,774.4	2,492.0
ROE (%)	18.5	20.3	46.3
Pre-Tax ROA (%)	1.2	1.3	2.4
Gross loans / Deposits (%) (calculated)	44.7	42.7	38.9
Gross NPL (%) *(Bank)*	1.6	2.8	2.6
Net NPL (%) *(Bank)*	1.2	2.1	1.8
Tier 1 CAR (%) *(Bank)*	13.5	13.6	13.2
Total CAR (%) *(Bank)*	15.8	16.5	15.9

Source: Annual Report 2020, Interim Financial Statements for the quarter ended March 2021

Note: US$ based financial statements are provided in annual reports

Nations Trust Bank PLC (NTB)

Fitch Ratings: A (lka)

Company Description

The company's inception as an LCB took place in July 1999, where NTB was listed on the stock exchange over the same year. NTB offers a wide array of services to Corporate, Consumer and SME customers, in line with its vision of helping people and businesses through the provision of financial services. The branch network consists of 92 branches and 111 ATM's nationwide serving over 800,000 customers with 2,832 employees. The asset base of the bank stood at US$ 1.8bn as at end 2020, ranking ninth highest among the domestic LCBs.

Key Business Segments

- **Consumer Banking –** This unit offers current account services, a range of loan and leasing services to retail customers. NTB faced a 25% contraction in revenue in this segment in 2020.
- **Commercial Banking –** This segment offers a wide range of banking products to small and medium scale enterprises including working capital financing, trade financing among other services. Loans and advances under this segment constitute 29% of the bank's overall loans and advances.
- **Corporate Banking –** The Corporate Banking unit offers structured finance & syndications, trade finance, and working capital financing among other services. This unit contributed 13% to the net interest income of the Group in 2020.

Strengths

- NTB maintained their position as the largest issuer of credit cards in 2020, featuring contactless credit card transactions amidst the pandemic.
- The bank cemented itself as one of the most well capitalized banks in the industry, with Tier I and Total Capital Adequacy Ratio's being 14.4% and 18.0% respectively as at end 2020, well above minimum regulatory levels.

Challenges

- The Gross NPL ratio recorded was the highest among all listed LCBs at 7.2% as at end 2020, standing well above the industry average. While in Q1 2021 the NPL ratio came down to 6.1%, it remains amongst the highest ratios recorded by LCBs. Furthermore, NTB recorded Gross NPL's higher than the industry average over the past 3 years.
- The cost to asset ratio is higher in comparison to most peer banks, putting pressure on NTB's profitability.

Recent Developments/Future Plans

- 'Nations Diriya', a dedicated financing scheme was launched to support key sectors in the economy through the provision of working capital facilities.
- Launched "Nations On-Site Leasing", an online leasing platform digitizing the entire leasing procedure in an effort to improve efficiency and transactional banking products.
- NTB's efforts in enhancing 'FriMi', their digital bank platform continued to expand in 2020, with digital transactions accounting for 82% of transactions in comparison to 72% in 2019. The digitalization efforts by the bank brought in US$ 2.3m in terms of digital investments during the year. 'FriMi' was repositioned as a digital bank offering digital onboarding and account creation, from an e-wallet based system.

Source: NTB Annual Report 2020, CSE, Fitch Ratings, Corporate website, Media reports

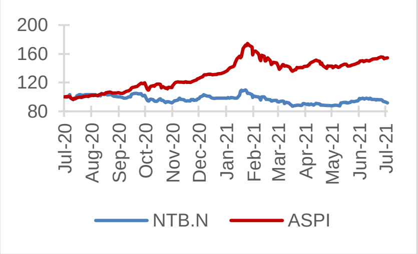
Current Price (US$)
Voting : 0.28
Non-voting : 0.37

Price as on July 5th, 2021 (LKR/US$ = 200)

Stock Details (Voting)	
Market Cap (US$ m)	68
Market Cap (%)	0.40%

Source: CSE

Share Price Chart (Indexed)



Source: CSE

Valuation Multiples (Group)

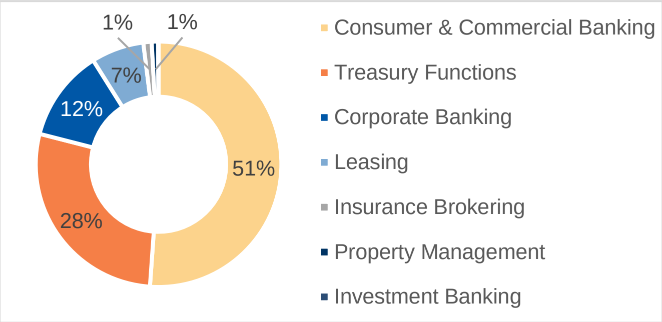
	2018	2019	2020
Year End Price (US$)	0.49	0.45	0.32
P/E(x)	6.81	6.12	4.20
P/B(x)	0.92	0.72	0.48

Source: Ratios calculated using data from Annual Reports, CSE

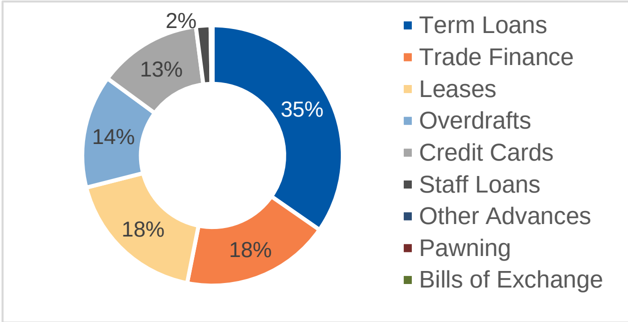
Shareholder Structure (Voting)	
John Keells Holdings PLC	19.7%
HWIC Asia Fund	15.0%
Central Finance Company PLC A/C No 03	9.8%
Mackinnons Keells Limited	9.8%
Janashakthi Insurance PLC - Shareholders	8.0%
Other	37.7%
Total	**100.0%**

Source: Interim Financial Statement 31.03.2021

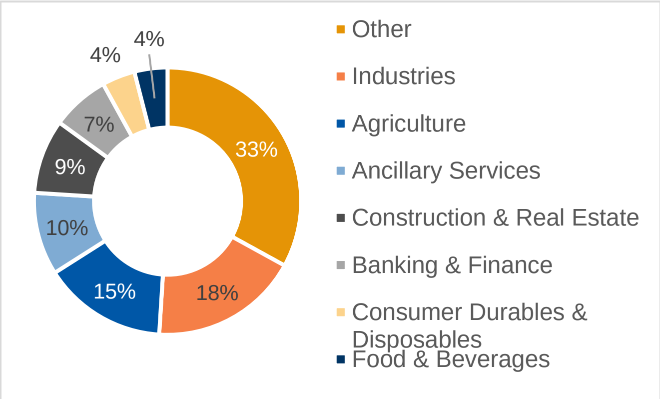
Operating Income by Segment (Group, FY20)



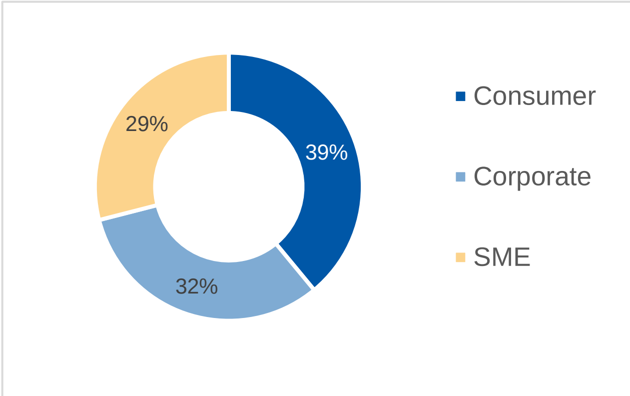
Sectoral Classification of Loans (FY20)



Segmental Classification of Loans (FY20)



Credit Exposure – Business Segments (FY2020)



Source: Annual Report 2020

Key Performance Indicators (Figures refer to Group values unless stated otherwise)	2019 YE Dec	2020 YE Dec	2021 Q1 (Mar)
Gross Income (US$ m)	258.7	218.8	47.1
Net Profit (US$ m)	20.7	21.8	9.3
Net Interest Margin (%)	4.9	4.1	3.8
Operating Cost/Net Income Ratio (%)	47.9	46.3	N/A
Asset Base (US$ m)	1,791.3	1,813.2	1,819.0
Deposit Base (US$ m)	1,249.1	1,290.6	1,247.1
Shareholder Funds (US$ m)	172.9	188.4	180.1
Net Loan Portfolio (US$ m)	1,248.6	1,127.6	1,157.4
ROE (%)	12.8	12.1	21.2
ROA (%) (after tax)	1.1	1.2	2.4 (Pre-Tax)
Gross loans / Deposits (%)	103.3	91.2	96.7
Gross NPL (%) *(Bank)*	6.2	7.2	6.1
Net NPL (%) *(Bank)*	2.7	2.5	1.9
Tier 1 CAR (%) *(Bank)*	13.0	14.4	13.3
Total CAR (%) *(Bank)*	17.6	18.0	16.4

Source: Annual Report 2020, Interim Financial Statements for the quarter ended March 2021

Pan Asia Banking Corporation PLC (PABC)

Fitch Ratings : BBB- (lka)

Company Description

PABC was established on March 6th, 1995 and marked its 25th anniversary in 2020. The bank was incorporated as a public limited company on the CSE in 2005 and has its branch network established nationwide, with 85 branches being placed across the country having a workforce of over 1,400 employees. The bank currently remains a mid-sized bank with an asset base of US$ 949m as at end 2020, ranking 10th among the domestic commercial banks.

Key Business Segments

- **Retail and MSME Banking –** These segments provide retail and MSME customers a range of facilities, including personal loans, housing loans, deposit facilities and other services. Efforts were concentrated in growing this segment with the 'Together We Rise' initiative, which allowed for successful deposit mobilization by the bank. The bank also granted moratoriums to a wide array of SME's affected by COVID-19 under the 'Saubagya Renaissance' facility.
- **Corporate Banking –** This segment provides deposit facilities, loan and overdraft facilities among others to larger businesses. Given the uncertainty brought about by the pandemic, the bank focused on recovery efforts. To stimulate activity under this pillar, a new institutional deposit mobilization team was appointed in 2020 to drive deposit growth.

Strengths

- ROE stood at 14.36%, marking one of the highest in the industry, given that operating profit for the bank grew 17% in 2020.
- The total CAR stood at 15.74% at end 2020, well above the minimum of 12% required by the CBSL, showcasing the bank's ability to tap into internal and external funding sources over the years.
- Net Interest Margins recorded by PABC were one of the highest in the industry, despite the significant lowering of rates over 2020, deteriorations in credit quality and loan moratoriums granted.

Challenges

- Despite granting moratoriums in light of the pandemic, the Gross NPL ratio continued to remain above the banking sector average, given a significant concentration of the loan portfolio in riskier segments of retail customers and SMEs.
- Although a significant growth of the CASA base took place over 2020, the ratio stood below the industry average, showcasing difficulties in obtaining cost efficient sources of funding for the bank.
- The high exposure to foreign-currency denominated sovereign instruments (8% of asset as at December 2020) poses additional risk given Sri Lanka's weak credit profile.

Recent Developments/Future Plans

- PABC secured a US$ 25m senior debt line from European based Foreign Financial Institutions in June 2021. The bank expects to secure a further US$ 35m funding lines in the comings months.
- Won the 'Best Green Bank in Sri Lanka' award and was ranked as one of the top 30 business entities in the country for 2020.

Source: PABC Annual Report 2020, CSE, Fitch Ratings, Corporate website

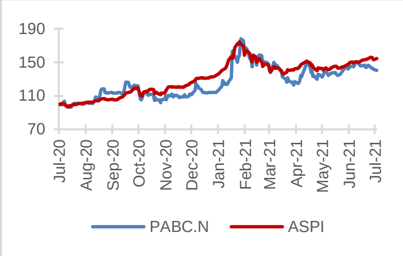
Current Price (US$)	**0.08**

Price as on July 5th, 2021 (LKR/US$ = 200)

Stock Details	
Market Cap (US$ m)	35
Market Cap (%)	0.21%

Source: CSE

Share Price Chart (Indexed)



Source: CSE

Valuation Multiples

	2018	2019	2020
Year End Price (US$)	0.08	0.07	0.07
P/E(x)	4.25	3.23	2.81
P/B(x)	0.58	0.42	0.37

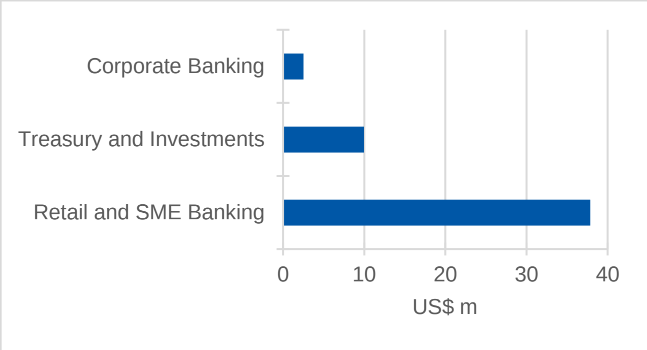
Source: Ratios calculated using data from Annual Reports, CSE

Shareholder Structure	
K.D.D Perera	30.0%
Bansei Securities Co, Ltd.	15.0%
Seylan Bank PLC/Ambeon Holdings PLC (Collateral)	9.9%
W.K.H Wegapitiya	6.2%
K.D.H Perera	5.3%
Other	33.6%
Total	**100.0%**

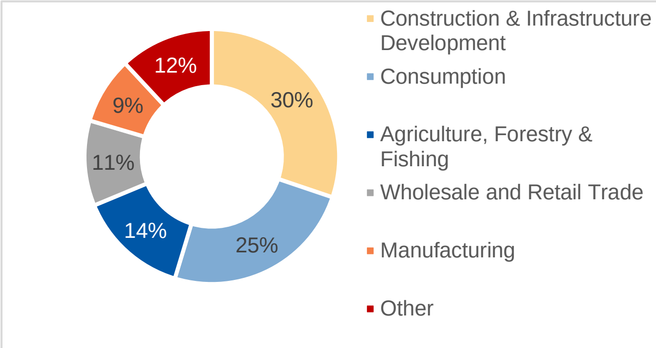
Source: Interim Financial Statement 31.03.2021

ALPEN CAPITAL

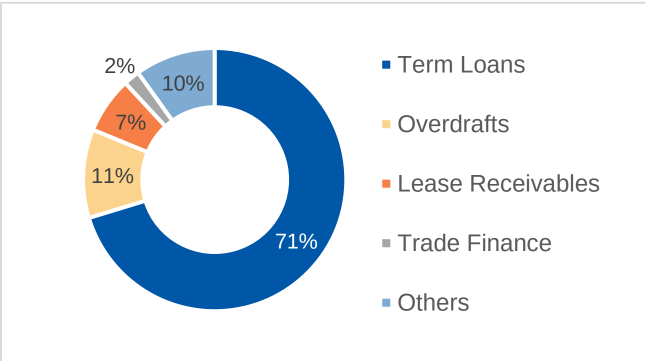
Total Operating Income - Key Segments (FY20)



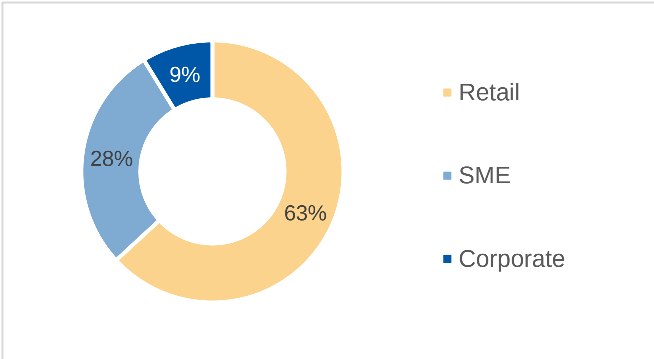
Sectoral Classification of Loans (FY20)



Segmental Classification of Loans (FY20)



Loans & Advances - Key Business Segments (FY20)



Source: Annual Report 2020

Key Performance Indicators			
	2019 YE Dec	**2020 YE Dec**	**2021 Q1 (Mar)**
Gross Income (US$ m)	122.4	112.3	27.6
Net Profit (US$ m)	9.8	11.0	3.9
Net Interest Margin (%)	4.4	4.4	5.1
Operating Cost/Net Income Ratio (%)	50.3	45.7	N/A
Asset Base (US$ m)	866.5	949.2	908.1
Deposit Base (US$ m)	694.1	756.8	715.4
Shareholder Funds (US$ m)	75.5	82.6	81.3
Net Loan Portfolio (US$ m)	629.8	660.7	635.5
ROE (%)	14.5	14.4	19.3
ROA (% after tax)	1.2	1.2	2.2 (Pre-Tax)
Gross loans / Deposits (%) (calculated)	95.9	92.7	94.6
Gross NPL (%)	6.3	6.7	6.8
Net NPL (%)	2.8	2.3	2.2
Tier 1 CAR (%)	12.9	13.2	12.8
Total CAR (%)	14.3	15.7	15.3

Source: Annual Report 2020, Interim Financial Statements for the quarter ended March 2021

ALPEN CAPITAL

People's Bank (PB) — Fitch Ratings: AA-(lka)

Company Description

PB was established in 1961 and is a majority state-owned commercial bank. The PB Group consists of People's Bank and its subsidiaries, People's Leasing & Finance (PLC) and People's Travels Pvt (Ltd), owning a 75% and 99% stake in them respectively. The bank is classified as a Domestically Systematically Important Bank (D-SIB) by the Central Bank, given its large asset base of US$ 12.8 bn accounting for nearly 16% of assets in the domestic banking system. PB has the most extensive branch network in the country, with 739 branches and 7,685 employees.

Key Business Segments

- **Retail Banking** – This segment offers depository, pawning, personal loans and credit card services. The large scale of PB in this unit is showcased with its deposit base, which is 2nd highest in the banking industry within Sri Lanka. During the year, the bank witnessed a 29% YoY increase in their personal loan portfolio. Given the adverse impact of the pandemic, PB offered close to 400,000 debt moratoriums to its customers, totaling ~US$ 23.4m.
- **Enterprise (Development) Banking** – This unit lends out to the SME segment in the economy. Apart from offering conventional lending products, the bank offers products including refinance loans, credit guarantee schemes and interest subsidy loans. Given the hard-hitting impact of COVID-19 on the SME segment, PB granted working capital facilities worth US$ 73m to 8,600 customers.
- **Corporate Banking** – This segment offers services to large scale corporations, including local and foreign companies. To drive foreign currency inflows over the year and help mitigate currency depreciation, PB introduced a Special Deposit Account (SDA). PB also continued its digitalization drive by enabling QR payments and cashless transactions to enable seamless operations of transactions virtually.

Strengths

- Despite record high impairment costs during 2020, PB has one of the highest ROEs in the industry at 14.4%, showcasing an efficient use of shareholder funds.
- The Gross NPL ratio for PB stood below the LCB average since 2014 and stood at 3.2% for 2020, showcasing resiliency of the bank to economic shocks.
- In July 2020, PB issued the largest ever BASEL III, subordinated debenture in Sri Lanka signifying the bank's ability to raise debt as a D-SIB under tumultuous economic conditions.

Challenges

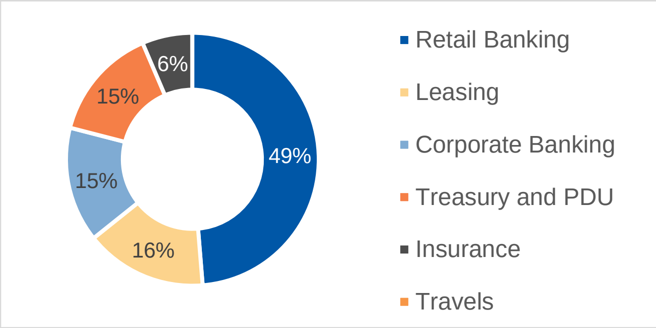
- The low interest rate environment has led to declining net interest margins over the past 3 years which have weakened profit growth of the bank. The impact of the pandemic could result in the low interest rate environment to prevail in the short term, putting further pressure on the bank's NIMs.
- The percentage of gross loans and advances given out to Government and State-Owned Enterprises remained high. This high exposure of the loan portfolio to the government can translate into elevated levels of concentration risk.
- PB built up a portfolio of International Sovereign Bonds (ISBs) over the year, although its total exposure remained small compared to peer banks. Given the multiple sovereign downgrading faced by Sri Lanka over the year, PB may suffer from increased levels of market risk and impairment charges.

Recent Developments/Future Plans

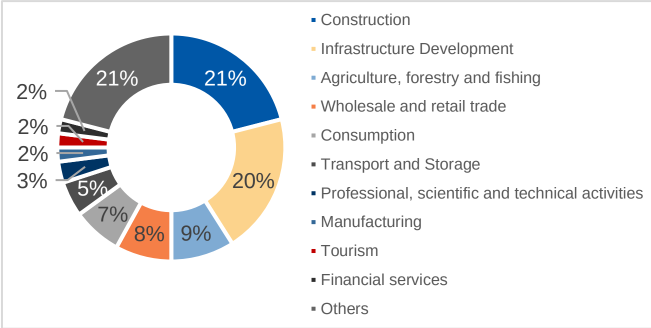
- PB was recognized amongst the top 1000 Banks in the world and within the 400 largest banks in Asia.- when?
- It developed 'Helaviru', an electronic trading platform to structure the country's agri-value chain.
- It won the award for Sri Lanka's 'Best Consumer Digital Bank' in 2020 and the 'Best Mobile Banking App' for People's Wave, its mobile app for digitized banking solutions.
- PB is the first state owned bank in Asia to achieve the 'Carbon Conscious' certification for its efforts in implementing sound practices in the financial services industry.

Source: PB Annual Report 2020, Fitch Ratings, Corporate website

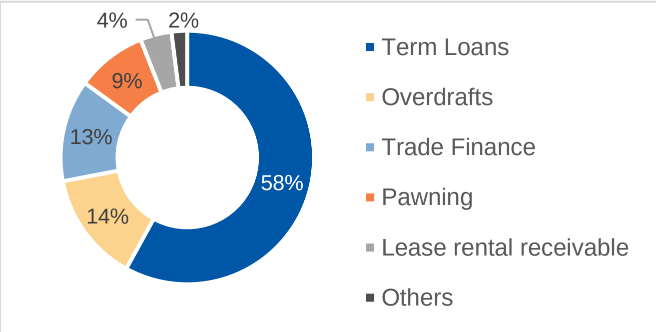
Total Group Operating Income by Segment (FY20)



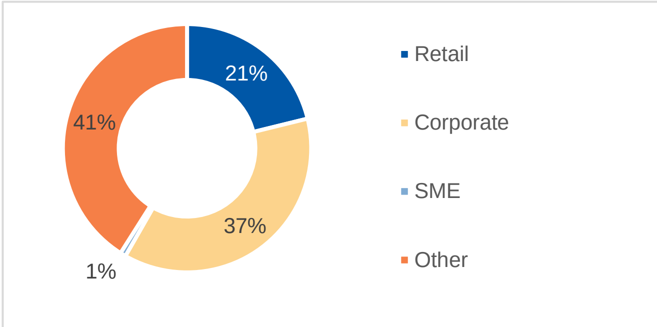
Sectoral Classification of Loans (FY20)



Segmental Classification of Loans (FY20)



Loans & Advances - Key Business Segments (FY20)



Source: Annual Report 2020

Key Performance Indicators			
	2019 YE Dec	2020 YE Dec	2021 Q1 (Mar)
Gross Income (US$ m)	1,313.3	1,191.5	299.5
Net Profit (US$ m)	89.2	85.6	44.0
Net Interest Margin (%)	3.9	3.3	3.8
Operating Cost/Net Income Ratio (%)	61.3	53.5	N/A
Asset Base (US$ m)	11,300.8	12,774.6	12,854.6
Deposit Base (US$ m)	8,759.9	10,298.1	10,517.8
Shareholder Funds (US$ m)	656.9	678.1	740.2
Net Loan Portfolio (US$ m)	8,052.0	9,452.2	9,861.1
ROE (%)	12.8	12.0	23.8
Pre-Tax ROA (%)	1.3	1.1	1.6
Gross loans / Deposits (%) (calculated)	97.0	97.0	98.6
Gross NPL (%) *(Bank)*	3.3	3.2	3.0
Net NPL (%) *(Bank)*	1.9	1.7	1.5
Tier 1 CAR (%) *(Bank)*	10.7	9.5	10.1
Total CAR (%) *(Bank)*	14.7	15.5	15.6

Source: Annual Report 2020, Interim Financial Statements for the quarter ended March 2021

Note: US$ based financial statements are provided in annual reports

Sampath Bank PLC (SAMP) — Fitch Ratings : AA- (lka)

Company Description

Incorporated as a licensed bank in 1986, SAMP is Sri Lanka's third largest domestic private sector commercial bank. In 2020, SAMP achieved an asset base of ~US$ 6.2 bn, which in LKR terms, surpassed 1tn milestone and becoming Sri Lanka's youngest bank to do so. Primary activities of SAMP include consumer, SME and corporate banking. With over 4,000 employees, 229 branches and 445 ATMs island wide, the bank serves nearly 3m customers.

Key Business Segments

- **Consumer/Retail Banking –** Retail banking includes deposit facilities (including foreign currency deposits), leasing, pawning and housing loans, personal loans and card solutions.
- **SME Banking –** SAMP engages in and promotes development financing, SME lending and supports Government-led SME development programs.
- **Corporate Banking –** SAMP offers financing, international trade and electronic banking solutions for corporate clients.

Strengths

- Despite the low-interest rate environment, the deposit base expanded to reach LKR 902bn (US$ 4.8bn) with CASA ratio improving to 39.3%. SAMPs term deposits also expanded by 15.8% at end 2020.
- SAMP remained well capitalized in 2020 as well as in Q1 2021, with Tier I and Total Capital ratios at 12.9% and 15.8% respectively. This is notably above the regulatory minimums.

Challenges

- Gross NPL ratio stood at 6.3% as at Q4 2020 (above the industry average of 4.7%), with a significant proportion of the bank's SME lending concentrated in Manufacturing and Tourism in 2020 which were affected negatively by COVID-19 and subsequent lockdowns.
- In 2020, PAT decreased by 28% to LKR 8.4bn (~US$ 45.4m, 2020 average LKR/US$ = 185.87) as NII decreased due to debt moratoriums and the low interest rate regime. While PAT has seen a significant growth in Q1 2021 helped by lower impairment charges and high non-interest income, the bank's NII continues to remain under pressure amidst low interest rates.

Recent Developments/Future Plans

- In April 2021, SAMP raised LKR 6.0bn (~US$ 30m, Apr'21 LKR/US$ = 199.75) through a debenture issue which was oversubscribed.
- 'Cash-in-a-Flash', a cash delivery service in partnership with PickMe, Mobile ATM services, and 'Doorstep Banking' were launched to enable customers to carry out transactions without having to visit a branch.
- SAMP withdrew from Moody's Ratings with effect from December 2020, being the only private commercial bank to have had a Moody's rating apart from HNB.

Current Price (US$)	0.26

Price as at July 5th, 2021 (LKR/US$ = 200)

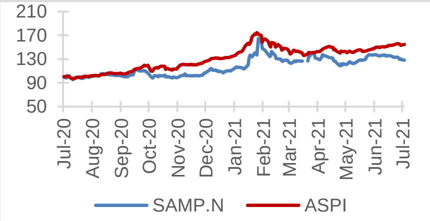
Stock Details	
Market Cap (US$ m)	299
Market Cap (%)	1.73%

Source: CSE

Group Snapshot (Key companies)	Profits FY20 (US$ m)
Siyapatha Finance PLC	2.20
SC Securities (Private) Limited	0.59
Sampath Centre Limited	1.14
Sampath Information Technology Solutions Limited	0.40

Source: Annual Report 2020

Share Price Chart (Indexed)



Source: CSE

Valuation Multiples (Group)	2018	2019	2020
Year End Price (US$)	1.29	0.89	0.73
P/E	5.44	4.73	6.13
P/B	0.78	0.56	0.45

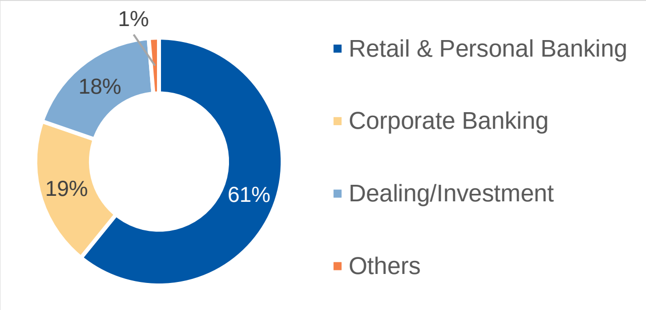
Source: Ratios calculated using data from Annual Reports, CSE

Shareholder Structure	
Vallibel One PLC	15.0%
Employees' Provident Fund	10.0%
Ayenka Holdings Private Limited	9.7%
Mr. Y S H I Silva	8.2%
Rosewood (Pvt) Limited	4.5%
Other	52.6%
Total	**100.0%**

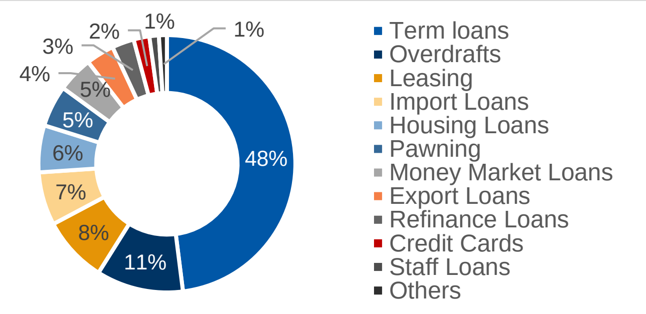
Source: Interim Financial Statement 31.03.2021

Source: SAMP Annual Report 2020, CSE, Fitch Ratings, Moody's Investor Service, Corporate website

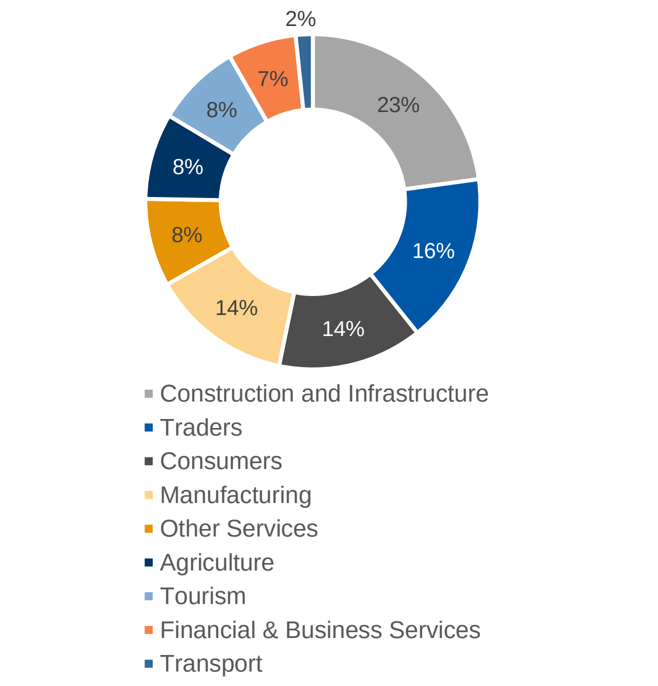
Total Bank Operating Income by Segment (FY20)



Segmental Classification of Loans (FY20)



Sectoral Classification of Loans (FY20)



Source: Annual Report 2020

Key Performance Indicators			
	2019 YE Dec	**2020 YE DEC**	**2021 Q1 (Mar)**
Gross Income (US$ m)	703.5	587.6	146.0
Net Profit (US$ m)	65.2	45.4	26.3
Net Interest Margin (%) (*Bank*)	4.5	3.3	3.4
Operating Cost/Net Income Ratio (%) (*Bank*)	36.9	43.5	N/A
Asset Base (US$ m)	5,501.8	6,167.6	5,991.1
Deposit Base (US$ m)	4,020.1	4,841.5	4,675.0
Shareholder Funds (US$ m)	613.6	613.8	585.1
Net Loan Portfolio (US$ m)	3,958.8	4,036.5	3,882.1
ROE (%) (*Bank*)	11.8	7.6	17.0
Pre-tax ROA (%) (*Bank*)	1.7	1.1	2.2
Gross loans / Deposits (%) (calculated)	102.9	84.1	87.6
Gross NPL (%) (*Bank*)	6.4	6.3	5.9
Net NPL (%) (*Bank*)	4.5	3.5	2.9
Tier 1 CAR (%) (*Bank*)	14.2	13.4	12.9
Total CAR (%) (*Bank*)	18.1	16.4	15.8

Source: Annual Report 2020, Interim Financial Statements for the quarter ended March 2021

SANASA Development Bank PLC (SDB)

Fitch Ratings : BB+(lka)
ICRA Lanka : [SL] BBB-

Company Description

Established in the year 1997, SDB which rebranded itself as SDB Bank in 2019, is a Licensed Specialized Bank. SDB provides financial solutions through its 94 branches and 12 ATMs spread across the country with a workforce of 1,490 individuals as of December 2020.

Key Business Segments

- **Retail Banking** – Retail banking includes deposit facilities, personal loans, housing loans, leasing, and pawning products. The segment accounts for the majority of SDBs business volumes.
- **SME Banking** – The bank serves SME customers through a range of savings, investments and loan products.
- **Co-operative Banking** – The bank provides financial services to an extensive network of co-operative societies and government organizations.

Strengths

- SDBs asset base which crossed the LKR 100bn mark in 2019, expanded further by 20% to LKR 129bn (US$ 692m) in 2020. This was fueled by a growth in loans and advances, which amounted to LKR 103.7bn (~US$ 556m).
- Profit after tax improved by 230%, from LKR 253m in 2019 to LKR 835m in 2020 due to declining impairment charges and additional tax cuts during the year. ROA and ROE improved to 1.19% and 9.51%, respectively.
- Expertise in the SME sector has enabled SAMP to form strategic partnerships and to secure funding for the sector. In 2021, SDB secured a US$ 40m commitment from the United States International Development Finance Corporation (DFC) and FMO has extended a US$ 15m credit facility to support SME development through loans and mentorship.

Challenges

- High cost-to-income ratio of 64.9% at end 2020 as personnel expenses and depreciation and amortization costs increased due to salary increments, increases in staff allowances and new capital expenditure.
- SDBs SME segment, which accounts for 41% of the loan book and 18% of deposits recorded at end 2020, can pose a challenge to the bank's profitability given the segment's vulnerability to market losses and disruptions in value chains caused by pandemic-containment measures.
- The bank's CARs are among the lowest in Fitch-rated banks, only marginally above the prescribed minimums. Given this, asset quality will likely diminish further under the protracted economic fallout.

Recent Developments/Future Plans

- SDB upgraded its banking platform with Fiserv; a leading global provider of payment and financial services technologies as part of its digital transformation effort.
- SDB introduced Sri Lanka's first digital rights issue in November 2020 accumulated a capital infusion of LKR 1.5bn (~ US$ 8m).
- It has plans to raise LKR 4bn (~ US$ 21m) through a secondary public offering (SPO) in June 2021 to strengthen the capital base.

Source: SDB Annual Report 2020, CSE, Fitch Ratings, Corporate website

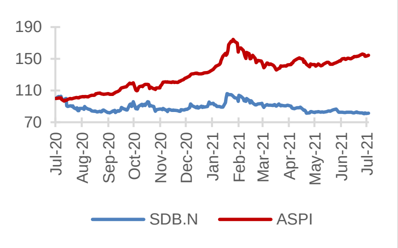
Current Price (US$)	0.25

Price as on July 5th, 2021 (LKR/US$ = 200)

Stock Details	
Market Cap (US$ m)	23
Market Cap (%)	0.13%

Source: CSE

Share Price Chart (Indexed)



Source: CSE

Valuation Multiples (Group)	2018	2019	2020
Year End Price (US$)	0.41	0.35	0.31
P/E(x)	11.83	14.20	5.26
P/B(x)	0.57	0.47	0.54

Source: Ratios calculated using data from Annual Reports, CSE

Shareholder Structure	
Ayenka Holdings Private Limited	12.5%
Seylan Bank PLC /Senthilverl Holdings (Pvt) Ltd	11.6%
Nederlandse Financierings-Maatschappij Voor Ontwikkelingslanden N.V.	10.0%
CB NY S/A International Finance Corporation	5.9%
SBI Emerging Asia Financial Sector Fund PTE. LTD	3.2%
Other	56.8%
Total	**100.0%**

Source: Interim Financial Statement 31.03.2021

Exhibit 1: Total Operating Income by Segment (FY20)

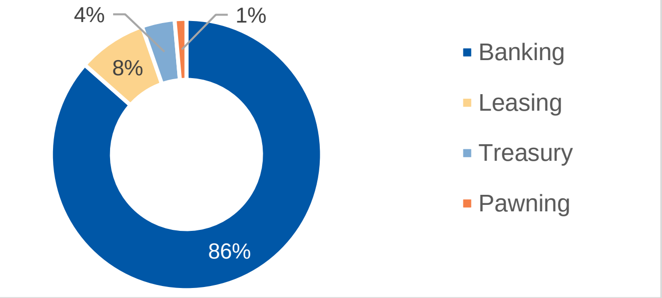


Exhibit 2: Sectoral Classification of Loans (FY20)

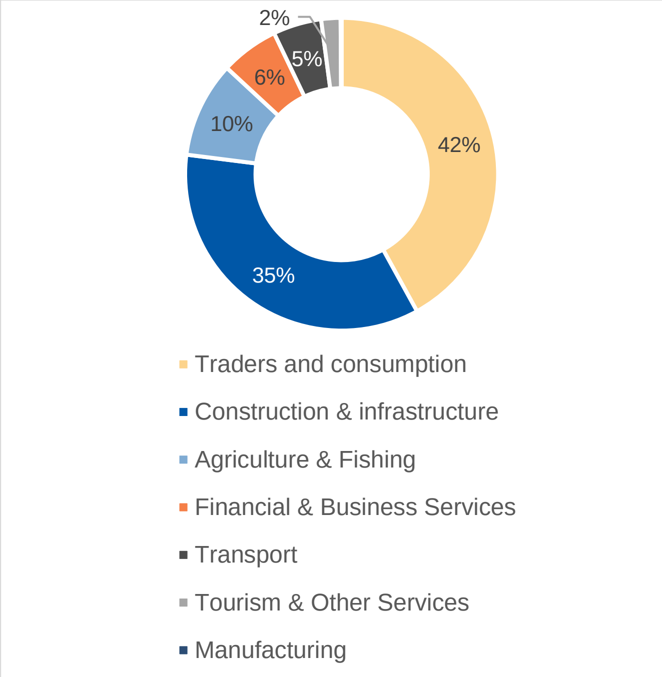
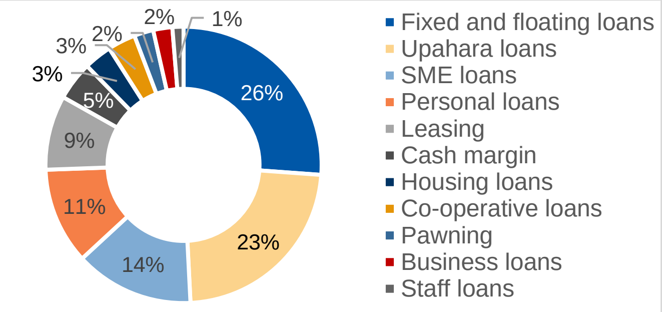


Exhibit 3: Segmental Classification of Loans (FY20)



Source: Annual Report 2020

Key Performance Indicators			
	2019 YE Dec	**2020 YE DEC**	**2021 Q1 (Mar)**
Gross Income (US$ m)	86.7	86.9	20.1
Net Profit (US$ m)	1.4	4.5	1.6
Net Interest Margin (%)	5.9	5.9	5.7
Operating Cost/Net Income Ratio (%)	64.7	64.9	N/A
Asset Base (US$ m)	593.4	692.4	682.8
Deposit Base (US$ m)	398.8	500.4	488.6
Shareholder Funds (US$ m)	42.2	53.2	51.3
Net Loan Portfolio (US$ m)	472.5	550.7	542.7
ROE (%)	3.4	9.5	12.0
ROA (% after tax)	0.6	1.2	1.0
Gross loans / Deposits (%) (calculated)	122.5	113.6	114.6
Gross NPL (%)	4.4	4.5	4.5
Net NPL (%)	1.9	1.8	1.7
Tier 1 CAR (%)	9.4	9.8	9.4
Total CAR (%)	14.8	13.4	12.7

Source: Annual Report 2020, Interim Financial Statements for the quarter ended March 2021

Seylan Bank PLC (SEYB) — Fitch Ratings: A (lka)

Company Description

Established in 1987, SEYB is a public limited liability company incorporated in Sri Lanka and listed on the Colombo Stock Exchange. It is the seventh largest domestic commercial bank with a total asset base of LKR 577.7bn (~US$ 2.9bn). SEYB operates through a well-dispersed network of 172 banking centers including 3 specialized SME hubs and 215 ATMs throughout the country. It has a staff strength of over 3,215 employees as at the end of December 2020.

Key Business Segments

- **Retail Banking –** The bank offers a variety of services including credit cards, pawning, leasing, personal loans, margin trading and factoring.
- **International and Trade Finance –** This division undertakes all operational processes of import and export related transactions and remittance services.
- **Corporate and Offshore Banking –** This division consists of the Domestic Banking Unit (DBU), Foreign Currency Banking Unit (FCBU) and the Islamic Banking Unit.

Strengths

- SEYB has been recognized for its customer service excellence which is reflected in its deposit base which grew to LKR 440.3bn (~US$ 2.3bn) in 2020, a growth of 9.87% compared to 2019, driven by the internal campaign 'Heroes of the Heart'. CASA base recorded a notable growth of 27.83% to LKR 145.42bn (approx. US$ 780m), with the CASA ratio standing at 33.03% in 2020.
- Its gross loans grew to LKR 409.3bn (approx. US$2.1bn), recording a growth of 4.95% as at December 2020 supported by growth in term and refinance loans and pawning activity. SEYB's interest income amounted to LKR 52.32bn (~US$ 281m) while NII recorded a growth of 4.64% in 2020.
- It maintains sound CAR ratios; Total Tier 1 Capital ratio of 11.46% and Total Capital Ratio of 14.30%, which are well above the regulatory minimums.

Challenges

- SEYB recorded an impairment charge of LKR 6.99bn (approx. US$ 37.5m) in 2020 with the net NPL ratio standing at 3.7%, highest among peers, above the industry average of 2.2%. Asset quality will likely weaken further due to the exposure in the SME sector.
- Profitability decreased by 18.18% as impairment charges absorbed the bulk of profits. Post-tax profit (PAT) decreased to LKR 3.01bn (approx. US$ 16.1m) in 2020. ROE decreased from 9.29% in 2019, to 6.43% in 2020, below the industry average of 10.9%.

Recent Developments/ Future Plans

- SEYB disbursed over LKR 10bn (approx. US$ 53.6m) under the 'Saubhagya Covid-19 Renaissance Loan facility' in 2020, with 86% of the lending extended to the SME sector and 14% to corporates.
- It issued a debenture of LKR 6bn (~US$ 30.4m Apr'21 LKR/US$ = 197.4) in April 2021 to fund loan growth and strengthen Tier 2 capital base.
- Fitch Ratings affirmed SEYB rating at 'A(lka)'; with a Stable Outlook.

Source: SEYB Annual Report 2020, CSE, Fitch Ratings, Corporate website

Current Price (US$)
Voting : 0.25
Non-voting : 0.19

Price as on July 5th, 2021 (LKR/US$ = 200)

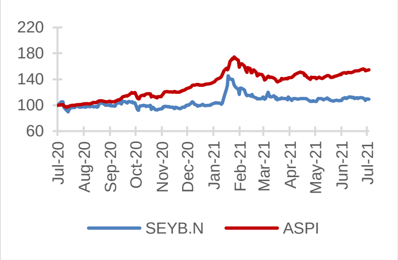
Stock Details (Voting)	
Market Cap (US$ m)	65
Market Cap (%)	0.38%

Source: CSE

Group Snapshot (Key companies)	Profits FY20 (US$ m)
Seylan Bank	5.2
Seylan Development Plc	1.4

Source: Annual Report 2020

Share Price Chart (Indexed)



Source: CSE

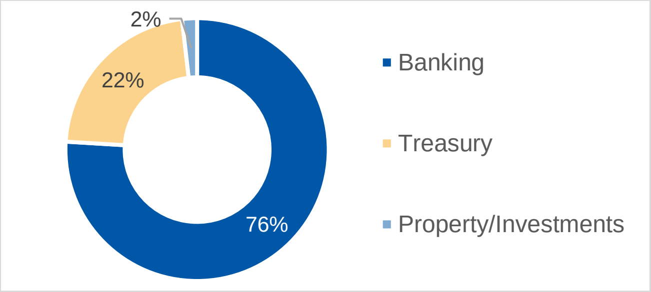
Valuation Multiples (Group)	2018	2019	2020
Year End Price (US$)	0.43	0.29	0.25
P/E(x)	9.95	5.95	7.82
P/B(x)	0.79	0.57	0.47

Source: Ratios calculated using data from Annual Reports, CSE

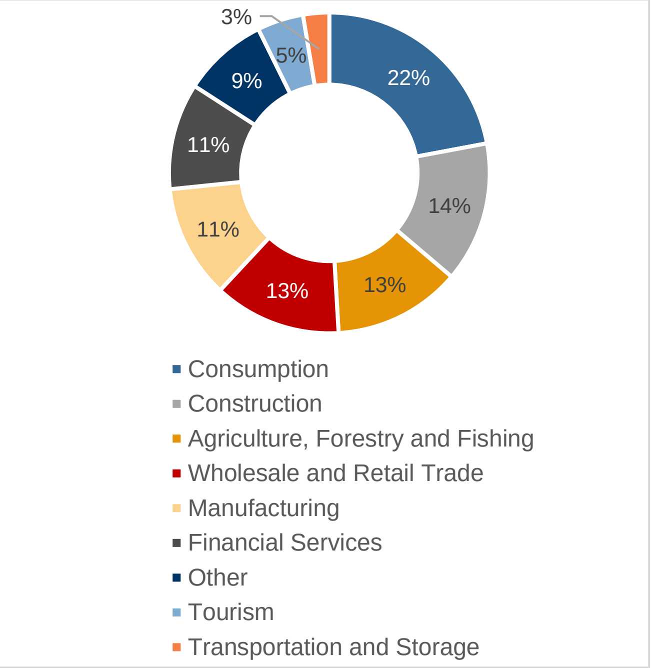
Shareholder Structure (Voting)	
Sri Lanka Insurance Corporation Ltd [includes General Fund and Life Fund]	15.0%
Brown and Company PLC	10.5%
Employees Provident Fund	9.9%
Sampath Bank PLC/LOLC Investments Ltd	9.4%
Mr. K D D Perera	9.0%
Other	46.2%
Total	**100.0%**

Source: Interim Financial Statement 31.03.2021

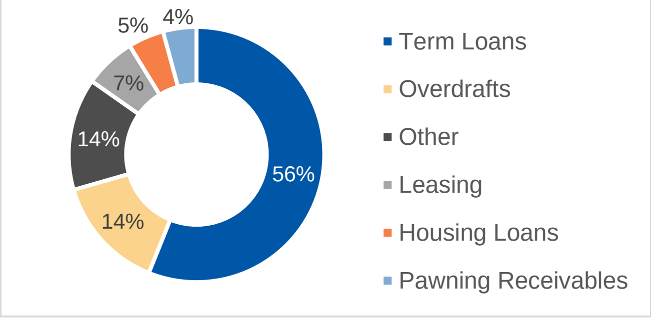
Total Operating Income by Segment (FY20)



Sectoral Classification of Loans (FY20)



Segmental Classification of Loans (FY20)



Source: Annual Report 2020

Key Performance Indicators			
	2019 YE Dec	**2020 YE DEC**	**2021 Q1 (Mar)**
Gross Income (US$ m)	342.8	314.4	73.1
Net Profit (US$ m)	21.2	16.7	5.2
Net Interest Margin (%) (*Bank*)	4.2	4.0	4.2
Operating Cost/Net Income Ratio (%)	58.8	50.3	N/A
Asset Base (US$ m)	2,843.8	2,993.5	2,828.2
Deposit Base (US$ m)	2,206.3	2,362.0	2,240.5
Shareholder Funds (US$ m)	255.3	272.4	255.6
Net Loan Portfolio (US$ m)	2,088.0	2,112.4	2,008.1
ROE (%) (*Bank*)	9.3	6.4	8.2
ROA (% after tax) (*Bank*)	0.8	0.6	1.0 (Pre-Tax)
Gross loans / Deposits (%) (calculated)	97.3	93.0	93.6
Gross NPL (%) (*Bank*)	5.8	6.4	6.4
Net NPL (%) (*Bank*)	3.7	3.7	3.3
Tier 1 CAR (%) (*Bank*)	11.3	11.5	11.0
Total CAR (%) (*Bank*)	14.8	14.3	13.6

Source: Annual Report 2020, Interim Financial Statements for the quarter ended March 2021

Union Bank of Colombo PLC (UBC) — Fitch Ratings :BBB- (lka)

Company Description

Established in 1995, UBC is a Licensed Commercial Bank listed on the Colombo Stock Exchange. UBC is Sri Lanka's 11th largest bank with an asset base of US$ 659m. In 2014, the TPG group – a US based private investment firm acquired 70% of the issued share capital of UBC. UBC offers a range of products and services to the Retail, SME and Corporate segments. It functions across a network of 67 branches and 115 ATMs island wide, while employing over 1275 personnel.

Key Business Segments

- **Retail Banking –** Retail banking includes deposit facilities (domestic and foreign currency), personal loans, housing loans, leasing, and other products.
- **SME Banking –** UBC facilitates wealth creation for SME customers through project financing, factoring, working capital solutions, trade finance, transactional banking and other services.
- **Corporate Banking –** It provides corporates with trade finance, working capital finance, term finance, forex services, and other services.

Strengths

- UBC recorded a growth in its deposit base and an improvement in the CASA ratio to 30% in 2020. The initiatives for CASA growth implementation through Retail and SME Banking functions integrating with Union Bank BizDirect being the key enablers for this growth.
- It remains well capitalized with one of the highest Tier 1 Capital Ratios among peers and a robust capital base in 2020; both Tier 1 Capital Ratio of 16.6% and a Total Capital Ratio of 16.95% which are well above the regulatory minimums.

Challenges

- In line with the industry trend, Gross NPL ratio increased to 6.05% in 2020, above the industry average of 4.7%, amidst external pressures and weakening macro-economic conditions
- Decreased profitability below the industry average of 10.9% with ROE falling to 3.24% in 2020 from 4.16% in the previous year. Post-tax profit declined to LKR 576m (~US$ 3.1m).
- Impairment charges recorded a notable increase in 2020, which amounted to LKR 735m (~US$ 3.9m), a growth of 88.5% on account of the deteriorating environment.

Recent Developments/Future Plans

- Extended LKR 1.4bn (~US$ 7.5m) under the Saubhagya Covid-19 Renaissance facility with 58% of the bank's SME portfolio being accommodated under various moratorium schemes.
- Further enhancements made to BizDirect, Union Bank's award-winning automated cash management system by on-boarding SME and corporate clients on to the platform.
- Fitch affirmed UBCs rating to BBB– (lka) with a Stable Outlook in Oct' 2020.

Current Price (US$)	0.06

Price as on July 5th, 2021 (LKR/US$ = 200)

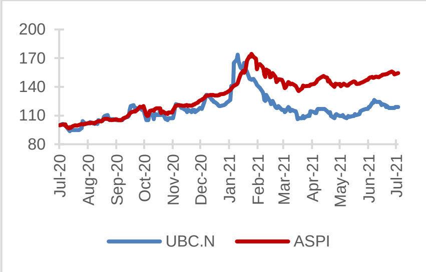
Stock Details	
Market Cap (US$ m)	61
Market Cap (%)	0.35%

Source: CSE

Group Snapshot (Key companies)	Profits FY20 (US$ m)
Union Bank	3.10
UB Finance Company Limited	(0.22)
National Assets Management Limited	0.01

Source: Annual Report 2020

Share Price Chart (Indexed)



Source: CSE

Valuation Multiples (Group)	2018	2019	2020
Year End Price (US$)	0.06	0.07	0.06
P/E(x)	23.40	19.00	20.17
P/B(x)	0.074	0.84	0.71

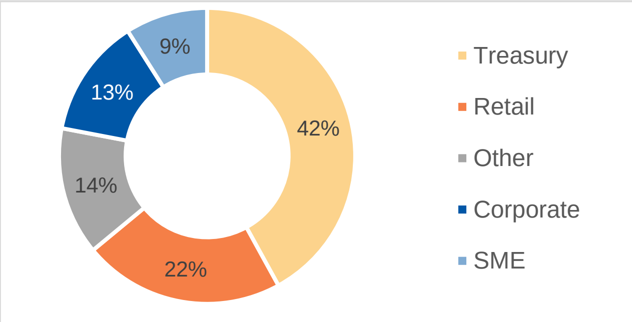
Source: Ratios calculated using data from Annual Reports, CSE

Shareholder Structure	
Culture Financial Holdings Ltd	70.8%
Vista Knowledge Pte Ltd	6.0%
Associated Electrical Corporation Ltd	2.7%
Mr. A.I. Lovell	2.2%
Mr. D.A.J Warnakulasuriya	1.8%
Other	16.5%
Total	**100.0%**

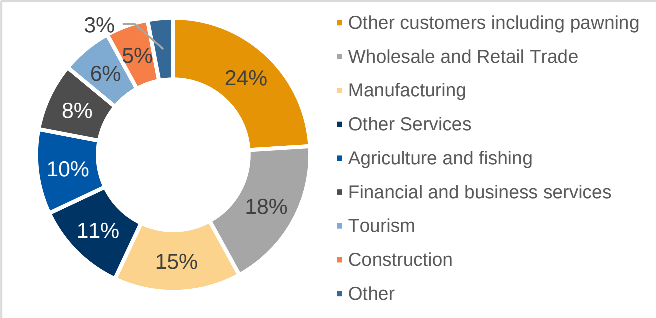
Source: Interim Financial Statement 31.03.2021

Source: UBC Annual Report 2020, CSE, Fitch Ratings, Corporate website

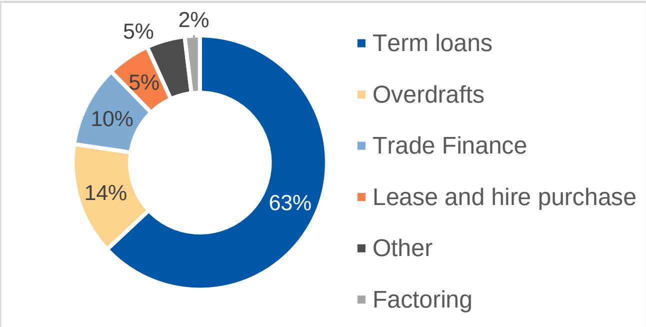
Total Operating Income by Segment (FY20)



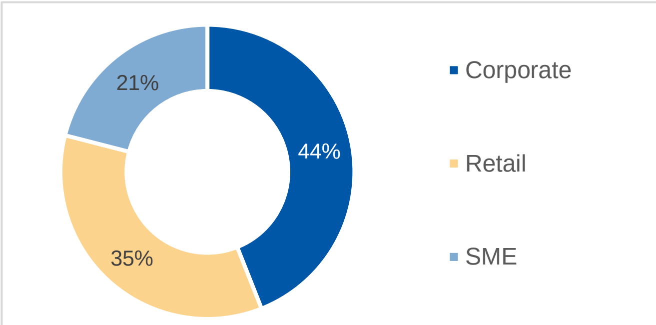
Sectoral Classification of Loans (FY20)



Segmental Classification of Loans (FY20)



Loans & Advances - Key Business Segments (FY20)



Source: Annual Report 2020

Key Performance Indicators			
	2019 YE Dec	**2020 YE DEC**	**2021 Q1 (Mar)**
Gross Income (US$ m)	93.8	80.9	17.2
Net Profit (US$ m)	4.0	3.1	1.6
Net Interest Margin (%) *(Bank)*	3.6	3.2	3.2
Operating Cost/Net Income Ratio (%) *(Bank)*	64.0	64.0	N/A
Asset Base (US$ m)	714.8	695.1	659.7
Deposit Base (US$ m)	455.6	467.3	442.9
Shareholder Funds (US$ m)	94.7	95.7	90.4
Net Loan Portfolio (US$ m)	466.8	395.8	390.8
ROE (%) *(Bank)*	4.2	3.2	6.2
ROA (after tax %) *(Bank)*	0.6	0.5	0.9
Gross loans / Deposits (%) (calculated)	105.6	88.3	91.9
Gross NPL (%) *(Bank)*	5.0	6.1	5.9
Net NPL (%) *(Bank)*	3.6	3.5	3.3
Tier 1 CAR (%) *(Bank)*	16.6	16.7	15.6
Total CAR (%) *(Bank)*	16.8	17.0	15.9

Source: Annual Report 2020, Interim Financial Statements for the quarter ended March 2021

Profiles of NBFIs

Citizens Development Business Finance PLC (CDB)

ICRA LANKA: [SL] BBB+

Company Description

Established in 1995, CDB has the 5th highest asset base amongst NBFIs in Sri Lanka and is listed on the CSE. With an asset base of US$ 477m (As at end-March 2021), 1,758 employees and 71 branches spread across the island, CDB as per brand finance is amongst the top 50 brands in Sri Lanka.

Key Business Segments

- **Leasing and Lending –** This segment comprises of Personal, Business, Home and Gold Loans as well Leasing & Hire Purchase
- **Other Services –** Margin Trading, Foreign Exchange and Islamic Finance Services are offered by CDB beyond the traditional leasing and lending services.

Strengths

- Introduction of a Robotic Process Automation (RPA) system which has the capacity to significantly streamline operational processes by transferring repetitive, monotonous tasks such as customer on-boarding, credit card operations to automated processes which frees up the human resources to be deployed to more value-added roles. These developments are reflected to an extent in the steep improvement to the firms cost to income ratio
- Introduction of revolutionary fintech services such as 'CDB iNet' – a first-of-its-kind e-finance platform in Sri Lanka which allows CDB savings account holders to transfer funds via social media platforms; and 'CDB iControl'- Sri Lanka's first credit card app; have put the company ahead of its peers, as it enabled CDB to better adapt to COVID-19 lockdowns and the new normal.
- Profitability ratios were satisfactory as bottom-line performance was positively impacted by a 14% growth in Net Interest Income along with well-managed credit quality and overheads.
- NPL's have been maintained at a lower level than most of its peers, with the Gross NPL ratio remaining within an acceptable level of 7% in FY 2021

Challenges

- Whilst the Net Interest Margin had increased from 7.17% in FY 2020 to 8.10% in FY 2021 as Net Interest Income improved, it continued to lag many of its peers.
- Nearly 70% of the loan portfolio is still concentrated in leasing and hence greater diversification is needed to mitigate risks as the government continues with import restrictions on vehicles.

Recent Developments/Future Plans

- CDB raised EUR 5m (~US$ 6m) via a subordinated debt issue from Netherlands based Tridos Investment Management in March 2021 to further strengthen its capital base.
- CDB plans to further capitalize on AI systems for data automation and other tasks previously performed by legacy systems and users. This includes launch cloud solutions to streamline applications, services and other digital resources in the coming year.
- CDB aspires to grow its asset base to reach a quarter-trillion by 2030 by driving forward tech disruption in their financial service offerings and by embracing the sustainability agenda.

Source: CDB Annual report 2020/21, ICRA Lanka, Corporate website

Current Price

Voting (US$): 0.70

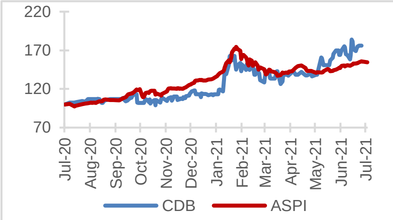
Non-voting (US$): 0.46

Price as on July 5th, 2021 (LKR/US$ =200)

Stock Details (Voting)	
Market Cap (US$ m)	46
Market Cap (%)	0.27%

Source: CSE

Share Price Chart (Indexed)



Source: CSE

Valuation Multiples (Group)

	Mar 2019	Mar 2020	Mar 2021
FY End Price - Voting (US$)	0.44	0.38	0.55
P/E(x)	2.57	2.74	3.00
P/B(x)	0.47	0.44	0.55

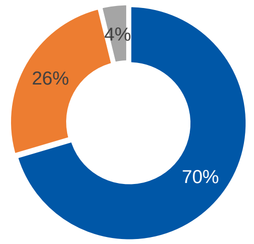
Source: Ratios calculated using data from Annual reports, CSE

Shareholder Structure (Voting)	
Ceylinco life insurance limited	32.2%
Janashakthi insurance PLC	10.1%
Cargills Bank Ltd.	4.1%
People's leasing & finance PLC/ Mr.W.P.C.M.Nanayakkara	4.0%
Commercial Bank PLC	4.0%
Others	45.6%
Total	**100.0%**

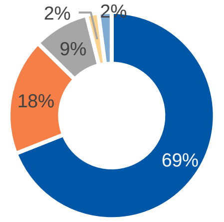
Source: Annual Report 2021

Note: See the Annexure for further details on the US$ conversion rates, Key formulae used and sources used.

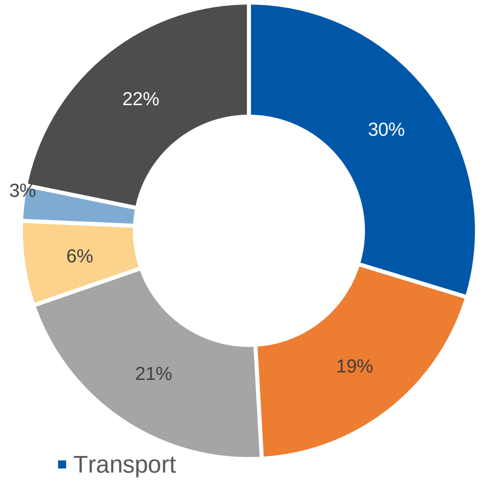
Total Operating Income by Segment (FY21)



Segmental Classification of Loans (FY21)



Sectoral Classification of Loans (FY21)



Source: Annual Report 2020/21

Note: Graphs and Tables may not sum to 100% due to rounding errors

Key Performance Indicators (Figures refer to Group values unless stated otherwise)			
	2019 YE Mar	**2020 YE Mar**	**2021 YE Mar**
Gross Income (US$ m)	96	87.8	88.2
Net Profit (US$ m)	10.3	9.2	13.6
Net Interest Margin (%) *(Company)*	6.3	7.2	8.1
Operating Cost/Net Income Ratio (%) *(Company)*	49.70	48.79	41.00
Asset Base (US$ m)	522	471	477
Deposit Base (US$ m)	268	217	246
Shareholder Funds (US$ m)	50	58	71
Net Lending Portfolio (US$ m)	406	396	391
ROE (%) *(Company)*	19.7	17.99	19.97
ROA (% after tax) *(Company)*	2.07	1.98	2.73
Gross lending / Deposits (%) (calculated)	156	173	161
Gross NPL (%) *(Company)*	6.68	7.54	7.00
Net NPL (%) *(Company)*	3.84	4.24	2.21
Tier 1 CAR (%) *(Company)*	8.09	10.25	12.10
Total CAR (%) *(Company)*	11.07	13.29	15.34

Source: Annual Reports, Interim Financial Statement

Note: The financial year ends in March. US$ based financial statements are provided in the annual reports where applicable

Central Finance Company PLC (CFIN)

Fitch Ratings : A+ (lka)

Company Description

Established in 1957, CFIN is classified as a D-SILFC and is the 4th largest LFC spearheading vehicle leasing & fleet management services with approx. 70% of its credit portfolio being concentrated in the transportation sector. The Company has over the years diversified its service offerings into Insurance Broking, Micro Finance and SME lending together with a broad portfolio of Savings and Deposit products. CFIN serves a customer base of more than 170,000 customers who are linked through 103 branches with an employee base of 1706 people. The Company is listed on the CSE.

Key Business Segments

- **Credit and Lending -** CFIN's main lending channels are business loans and leasing facilities. The segment's performance remained sluggish reflecting the lack of demand for credit and subdued economic activity in 2020/21 amidst Covid-19.
- **Leasing -** Involved in financing of registered and unregistered motor vehicles, agricultural machinery, construction machinery and equipment, the segment is a major lending line of the Company. CFIN leveraged on the rising demand for registered motor cars using the dedicated web portal 'careka.lk'.
- **Vehicle Hire -** The segment provides a plethora of options in fleet and budget hiring. Strategic advances to further diversify the portfolio were made which delivered positive outcomes.

Strengths

- CFIN saw a decline in Operating Expenses and lower income tax expenses which improved its bottom line performance recording a PAT of LKR 5.78bn (US$ 31m) in FY 2021. These improvements were also reflected in its Cost-to-Income ratio which improved to 30.9% over the same period.
- Impairment charges declined in FY 2021 to LKR 3.27bn (US$ 17.4m), from LKR 4.78bn (US$ 25m) in the previous year as collection mechanisms were improved and the economy showed signs of recovery in the latter part of FY 2021.
- CFIN maintained capital adequacy ratios well above the required minimum in FY 2021; Core Capital ratio of 32.42% and a Total Capital ratio of 32.88%.

Challenges

- In FY 2021, Interest Income recorded a decline of 17.46% due to the low interest environment while the loan portfolio contracted to LKR 64.51bn (US$ 324m) – a contraction of 17.83% in comparison to the previous year.
- Total deposits too contracted marginally by 1.54% as the firms asset composition were shifted from lending to investments in the low interest environment for financial institutions.
- Following the industry trend, CFINs asset quality deteriorated indicating a Gross NPL ratio of 13.57%, from 9.28% in the previous year.

Recent Developments/Future Plans

- CFIN's National Long-term Rating of A+ (lka) was reaffirmed by Fitch Ratings for the 14th consecutive year.

Source: CFIN Annual report 2020/21, Fitch Ratings, Corporate website

Current Price (US$)	0.45

Price as on July 5th, 2021 (LKR/US$ = 200)

Stock Details	
Market Cap (US$ m)	90.6
Market Cap (%)	0.59%

Source: CSE

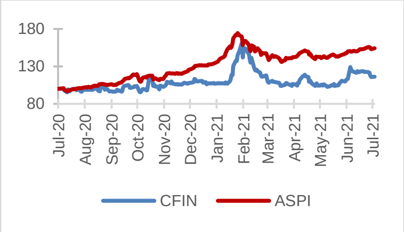
Group Snapshot (Key companies)

	PAT FY21 (US$ m)
Central Finance Company	22.0
Dehigama Hotels Company Ltd.	0.3
CF Insurance Brokers (Pvt) Ltd.	1.2
Central Industries PLC	2.1
Mark Marine Services Pvt Limited	0.3
Nations Trust Bank	5.6
Tea Smallholder Factories PLC*	0.1

Source: Annual reports

**NTB & Tea Smallholder are Associates and the table shows the share of Associate profits*

Share Price Chart (Indexed)



Source: CSE

Valuation Multiples (Group)

	Mar 2019	Mar 2020	Mar 2021
FY End Price (US$)	0.48	0.43	0.41
P/E(x)	3.70	4.55	3.26
P/B(x)	0.46	0.41	0.36

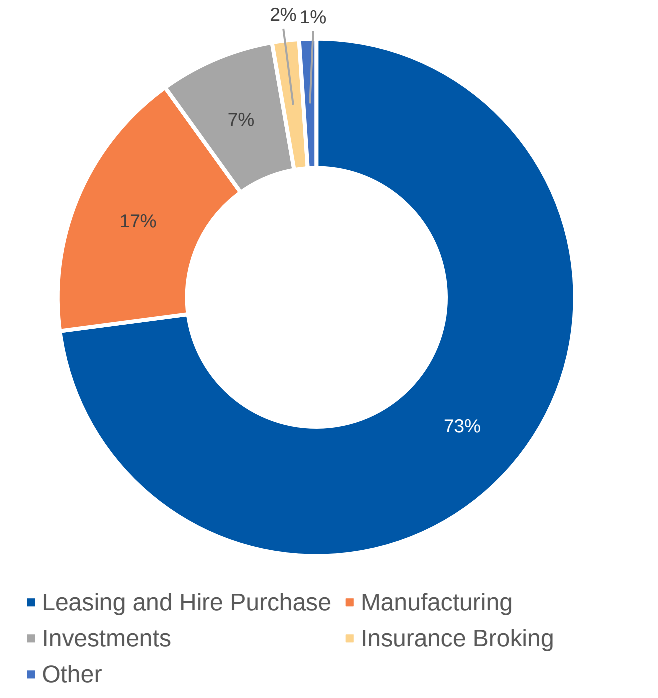
Source: Ratios calculated using data from Annual Reports, CSE

Shareholder Structure

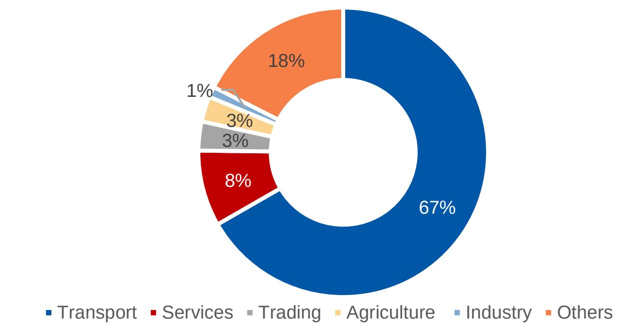
Corporate Services (Pvt) Ltd.	16.1%
E. H. Wijenaike	15.4%
Employees Provident Fund	10.7%
Thurston Investments Limited	5.8%
Hallsville Trading Group INC	5.4%
Other	46.6%
Total	**100.0%**

Source: Annual report 2020/21

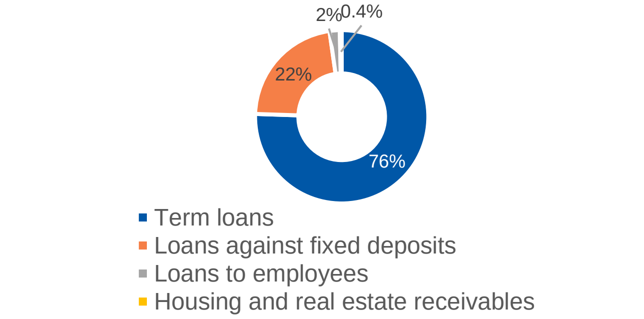
Total Operating Income by Segment (FY21)



Sectoral Classification of Loans (FY21)



Segmental Classification of Loans (FY21)



Source: Annual Report 2020/21

Key Performance Indicators (Figures refer to Group values unless stated otherwise)			
	2019 YE Mar	**2020 YE Mar**	**2021 YE Mar**
Gross Income (US$ m)	134	139	127
Net Profit (US$ m)	29	22	31
Net Interest Margin (%)	N/A	N/A	N/A
Operating Cost/Net Income Ratio (%)	31.5	31.3	30.9
Asset Base (US$ m)	626	636	575
Deposit Base (US$ m)	256	286	262
Shareholder Funds (US$ m)	238	246	259
Net Lending Portfolio (US$ m)	464	496	324
ROE (%) *(Company)*	13.34	8.40	10.94
ROA (% after tax) *(Company)*	4.39	2.78	3.96
Net lending / Deposits (%) (calculated)	181	173	124
Gross NPL (%)	5.61	9.28	13.57
Net NPL (%)	N/A	N/A	4.2
Tier 1 CAR (%) *(Company)*	26	27.73	32.42
Total CAR (%) *(Company)*	25.87	27.68	32.88

Source: Annual Reports, Interim Financial Statements

Note: The financial year ends in March. US$ based financial statements are provided in annual reports where applicable

LB Finance PLC (LFIN)

Fitch Ratings: A- (lka)

Company Description

Incorporated in May 1971, LB Finance (LFIN) is the 3rd largest LFC in terms of asset size with total assets amounting to US$ 706m as at end March 2021 and is classified as a D-SILFC. LFIN offers a diverse portfolio of financial products to corporates, SMEs and individuals alike. The Company was listed on the CSE in 1997. As at end March 2021, the company employs 3,536 staff members and serves over 600,000 customers through its extensive network of 152 branches and 17 gold loan (pawning) centers. In 2018, LFIN expanded its business operations overseas with the establishment of its subsidiary LB Microfinance Myanmar Company Ltd which has since expanded to over seven locations in Myanmar.

Key Business Segments

- **Leasing and Auto Finance-** This segment accounts for the highest contribution to the lending portfolio.
- **Micro loans –** This segment accounts for loans extended to SMEs.
- **Gold loans -** Within the LFC sector, LFIN currently dominates the gold loan space which serves over 600,000 customers via 17 Gold Loan Centers, recording a 17% growth in FY2021
- **Personal and Mortgage Loans** – The segment includes an array of financial solutions extended to individuals.

Strengths

- LFINs efficient cost management policies allowed LFIN to improve its Cost-to-Income ratio to 30.56% in FY 2021, from 33.44% in the previous year.
- LFIN recorded healthy capitalization levels in FY 2021 with Tier 1 CAR and Total CAR standing at 23.87% and 25.32% respectively which were well above the minimum requirements.
- Repricing of the deposit base marginally increased Net Interest Income to LKR 15.93bn (US$ 84m), thus positively impacting Net Interest Margins.
- Despite a decline in Interest Income, LFIN recorded a PAT of LKR 6.8bn (US$ 36m) in FY2021 which represents a growth of 31.15%, backed by growth in net interest income and effective cost management

Challenges

- Gross NPL ratio deteriorated in FY 2021 to 5.36%, affected by the disruptions caused by the consecutive waves of Covid-19 throughout the year.
- Leasing and Stock-out-on Hire segment of the lending portfolio contracted due to restrictions imposed on vehicle imports and the impacts of COVID-19. This was a key contributor to LFIN seeing an increase in NPLs earlier in the year.

Recent Developments/ Future Plans

- Sub-division of shares (1x4) declared in early 2021 increased the firm's market capitalization causing LFIN's share price to reach a historic high at end January 2021.
- LB Microfinance Myanmar added four new branches to its network bringing its total branch count to 12 as at March 2021, strengthening its roots in the Magway Region.
- LFIN raised US$ 15m on a four-year tenure from FMO - the Dutch Entrepreneurial Development Bank in May 2021.

Source: LB Finance Annual Report 2020/21, Fitch Ratings, Corporate website

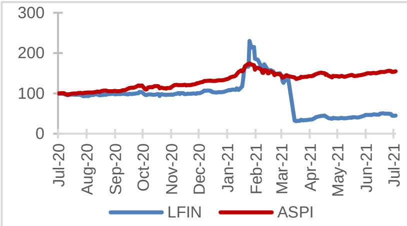
Current Price (US$)	0.31

Price as on July 5th, 2021 (LKR/US$ = 200)

Stock Details	
Market Cap (US$ m)	152
Market Cap (%)	1.00%

Source: CSE

Share Price Chart (Indexed)



Source: CSE

Valuation Multiples (Group)	Mar 2019	Mar 2020	Mar 2021
FY End Price (US$)	0.68	0.64*	0.24
P/E(x)	3.29	3.22	3.86
P/B(x)	0.97	0.73	0.83

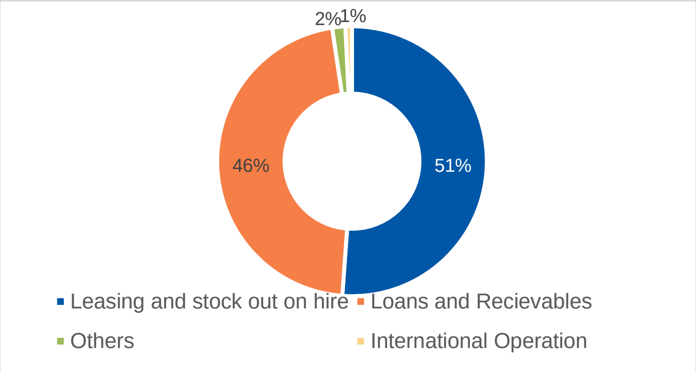
Source: Ratios as reported in Annual Report 2020/21

**Past prices have not been adjusted for a subdivision of shares which took place in FY 2021*

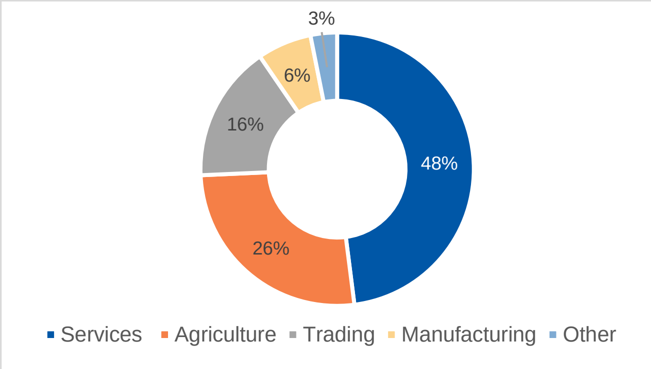
Shareholder Structure	
Vallibel One PLC	51.8%
Commercial Bank of Ceylon PLC/Royal Ceramics Lanka PLC	26.1%
Esna Holdings (Pvt) Ltd	10.2%
BNYM Re-Frontaura Global Frontier Fund LLC	1.6%
Pershing LLC	1.4%
Others	8.9%
Total	**100.0%**

Source: Annual Report 2020/21

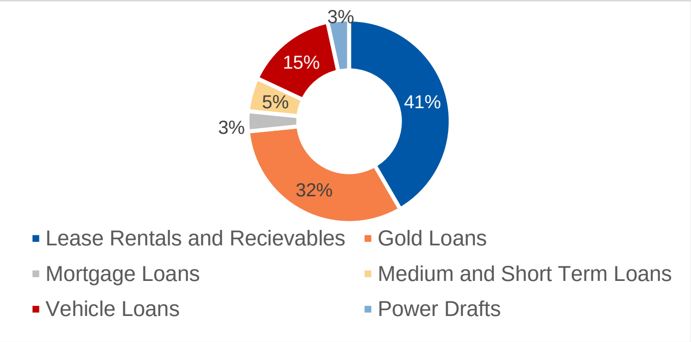
Total Operating Income by Segment (FY21)



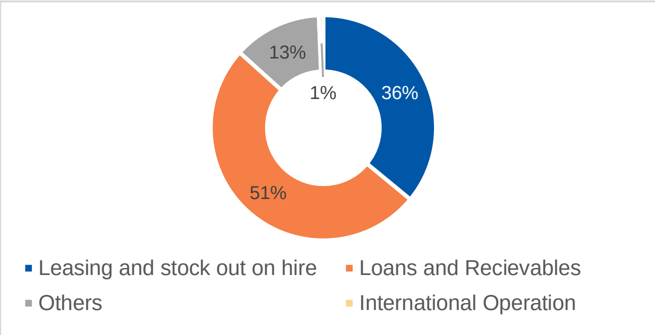
Sectoral Classification of Loans (FY21)



Segmental Classification of Loans (FY21)



Lending by Segment (FY21)



Source: Annual Report 2019/20

Key Performance Indicators (Figures refer to Group values unless stated otherwise)			
	2019 YE Mar	**2020 YE Mar**	**2021 YE Mar**
Gross Income (US$ m)	167	165	159
Net Profit (US$ m)	29	27	36
Net Interest Margin (%) (Company)	11.87	11.96	12.15
Operating Cost/Net Income Ratio (%) (Company)	34.22	33.44	30.56
Asset Base (US$ m)	775	760	708
Deposit Base (US$ m)	473	470	432
Shareholder Funds (US$ m)	105	122	143
Net Lending Portfolio (US$ m)	647	628	577
ROE (%) (Company)	29.93	25.04	26.58
ROA (% after tax) (Company)	3.93	3.70	4.78
Gross lending / Deposits (%)	136	133	140
Gross NPL (%) (Company)	2.69	3.93	5.36
Net NPL (%) (Company)	-0.21	-0.12	0.10
Tier 1 CAR (%) (Company)	15.53	19.40	23.87
Total CAR (%) (Company)	17.67	20.75	25.32

Source: Annual Reports, Interim Financial Statements

Note: Financial year ends in March. US$ based financial statements are provided in annual reports where applicable

ALPEN CAPITAL

LOLC Finance PLC (LOFC)

ICRA LANKA: A (lka)

Company Description

LOLC Finance, was incorporated in 2001 and was registered as a finance leasing establishment in 2003 and got listed on the CSE in 2011. With total assets amounting to US$ 949m as at end December 2020, LOFC is graded as a D-SILFC and is the second largest LFC in Sri Lanka. The Company employs over 2,700 personnel, serving an extensive customer base across all 9 provinces in Sri Lanka through a network of nearly 150 branches.

Key Business Segments

- **Lending** – Includes Leasing, Retail and SME Loans. Reintroduced gold loans and introduced credit card facilities in 2018 which showed strong growth in FY 2020.
- **Microfinance** – This segment comprises of both micro leases and micro loans.
- **Islamic Financing** – LOLC Al-Falaah, the Islamic Banking unit of the Company mainly serves SME, MSME and retail clients.

Strengths

- LOFC recorded strong capitalisation levels and growth in CAR ratios, fuelled by an improvement in retained profits and capital infusion through a rights issue in 2019. As at end December 2020, Core CAR stood at 15.36% and Total CAR was 16.61%, well above the regulatory minimum while the capital to deposits ratio saw an increase to 29.27%, well above the required 10%.
- Remarkable growth was recorded in digital transaction volumes on 'iPay'; LOLC's mobile payment platform, where transaction volumes grew by 681%, merchant registration grew by 303% and user registration grew by 241% in FY 2020, reflecting LOFC's expertise in digital adoption.

Challenges

- Profit after tax plunged steeply and was limited to LKR 3.78bn (approx.US$ 20m) in FY 2020, prompting a decline in ROE from 30% to ~14% - one of the steepest dips in this ratio.
- LOFC recorded one of the steepest drops in the deposits base which shrunk by 14% in FY 2020 and continued to remain subdued for the remainder of 2020 as market interest rates dipped while the CBSL reduced the maximum deposit rate.
- Net Interest Income declined by 13%, to LKR 18.9bn in FY 2020 (approx. US$ 101.6m) caused by a decline in interest income across leasing, loans and factoring which collectively dipped by 11% over the period.
- Asset quality deteriorated in the microfinance segment in FY 2020 due to spill over effects from the debt relief program in 2018, triggering high NPL values. Impairment provisions made for the period increased significantly by 29%, standing at LKR 1.77bn (US$ 9.5m) in FY2020.

Recent Developments/Future Plans

- LOFC plans to capitalize on historic highs recorded in gold prices and has extended the number of branches offering gold loan services to 78 and have plans to extend this facility to its entire branch network.
- Enhancing income channels for customers in Microfinance remain a priority for LOFC. To this end, the firm will focus on training, trade fairs and networking opportunities for micro customers and linking them to e-commerce platforms to showcase products and services.

Source: LOFC Annual Report 2020, ICRA Lanka, Corporate website

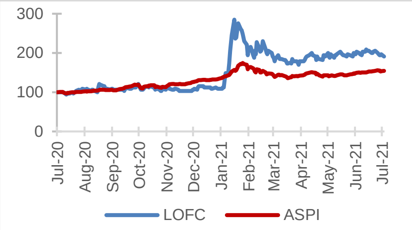
Current Price (US$)	0.03

Price as on July 5th, 2021 (LKR/US$ = 200)

Stock Details	
Market Cap (US$ m)	165
Market Cap (%)	0.97%

Source: CSE

Share Price Chart (Indexed)



Source: CSE

Valuation Multiples

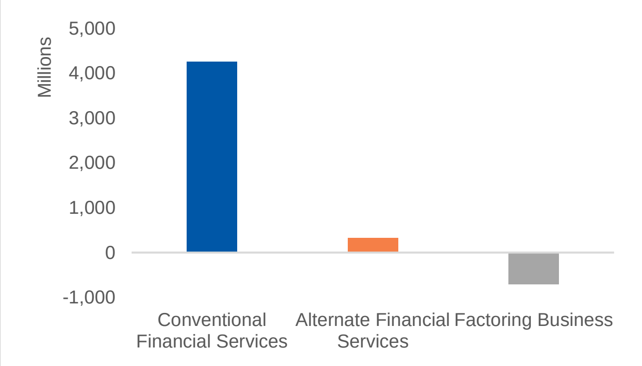
	Mar 2019	Mar 2020	Mar 2021
FY End Price (US$)	0.02	0.01	0.03
P/E(x)	2.18	2.86	6.75
P/B(x)	0.57	0.34	0.82

Source: Ratios calculated using data from Annual Reports, CSE

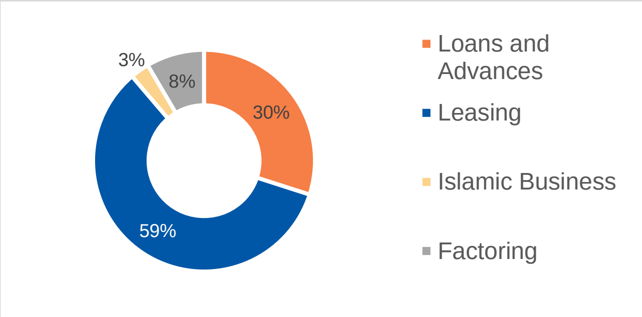
Shareholder Structure	
LOLC Group	94.6%
Saakya Capital Pvt Ltd	2.6%
Satya Capital Pvt Ltd	1.0%
Others	1.8%
Total	**100.0%**

Source: Interim Financial Statement 31.03.2021

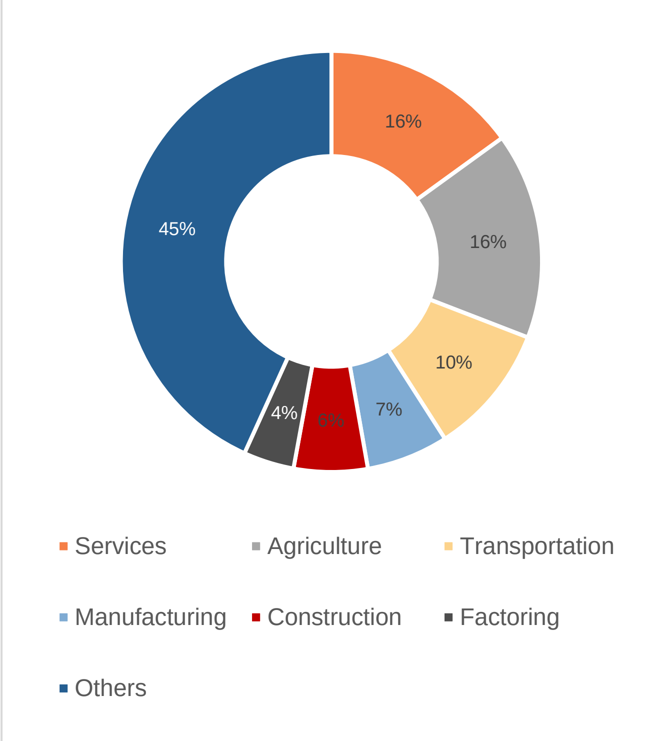
Total Operating Income - Key Segments (FY20)



Segmental Classification of Loans (FY20)



Sectoral Classification of Loans (FY20)



Source: Annual Report 2019/20

Key Performance Indicators			
	2019 YE Mar	**2020 YE Mar**	**2021 YE Mar**
Gross Income (US$ m)	265	205	N/A
Net Profit (US$ m)	34	20	23
Net Interest Margin (%)	N/A	N/A	N/A
Operating Cost/Net Income Ratio (%)	45	47	N/A
Asset Base (US$ m)	1198	1029	855
Deposit Base (US$ m)	655	533	542
Shareholder Funds (US$ m)	129	168	180
Net Lending Portfolio (US$ m)	773	719	526
ROE (%)	30.0	13.98	N/A
ROA (%)	2.80	1.88	N/A
Net lending / Deposits (%) (calculated)	118	88	N/A
Gross NPL (%)	6.38	N/A	N/A
Net NPL (%)	2.66	5.48	1.17
Tier 1 CAR (%)	10.22	13.25	15.18
Total CAR (%)	12.34	14.66	16.30

Source: Annual Reports, Interim Financial Statements

Notes: Financial year ends in March. Annual reports do not specify whether ROA is pre or post tax

People's Leasing & Finance PLC (PLC) — Fitch Ratings: AA- (lka)

Company Description

Established in 1995, People's Leasing is a subsidiary of People's Bank, one of Sri Lanka's largest State Banks. PLC is the largest LFC in terms of total assets amounting to US$ 967m as at end December 2020 and is classified as a D-SILFC. The PLC Group has six subsidiaries which includes a listed insurance company (People's Insurance PLC), a microfinance firm (People's Micro-Commerce Ltd) as well as a property development firm (People's Leasing Havelock Properties Ltd). As at end March 2020, PLC functioned across 103 branches and employed 2,401 people.

Key Business Segments

- **Leasing and Loans** – Leasing is the company's leading product in its lending portfolio accounting for 53% of its loans in FY 2020. Loans segment includes Business, Education and Home Loans. Gold loans were a new addition to this segment in 2019/20.
- **Insurance** – This segment provides personal and business insurance facilities. It accounts for the majority of business volumes and one of the most profitable segments within PLC.
- **Margin Trading and Factoring** – Margin trading offers equity and debt market investors facilities against their investments, while factoring offers capital solutions, transfer of risk and sales ledger management services, providing customers with a dedicated team to manage receivables.
- **Islamic Business -** This segment includes Ijarah, Murabah, Musharakah and Trading Murabah products offered to the customers.
- **Gold loans** - a new product launched in FY 2020 via dedicated units across 14 branches, the portfolio reached LKR 895.7m (US$ 4.8m) as at end-March 2020.

Strengths

- In FY 2020, the deposit base crossed the threshold of LKR 100bn (US$ 637m) recording a 20.8 % growth compared to FY 2019. As at end December 2020, PLC accounted for the largest deposit base in the NBFI sector.
- Reflecting the Company's strong financial and liquidity positions, Tier 1 and Total Capital Ratio stood at 15.1% and 16.0% respectively, with a liquidity ratio of 111.5%, well above all regulatory minimums during FY 2020.
- PLCs total operating income grew by 4.23% in FY 2020 due to a significant growth in fees and commission Income and Net Interest Income which grew by 12.26% and 3.18% respectively. Consequently, cost-to-income ratio improved marginally to 36.53% over the same period.

Challenges

- Credit quality deteriorated as gross NPL ratio increased to 7.62% in FY 2020 from 3.91% in FY 2019 as customers failed to meet their debt obligations. Impairment charges and other losses rose to LKR 4.64bn (US$ 24.9m) wearing down profitability ratios. ROA and ROE declined to 2.64% and 10% respectively over the same period. Fitch Ratings expect more pressure to mount on PLCs asset quality as the impacts of moratoriums on loan repayments are realized and due to its high exposure to financing commercial vehicles.

Recent Developments/Future Plans

- PLC announced in June 2021 that it plans to raise LKR 8bn(~US$ 40m) via a listed debenture issue.
- The Company withdrew its Fitch International Rating from end-April 2020 due to non-availability of foreign funding sources at competitive rates.

Source: PLC Annual Report 2019/20, Fitch Ratings, Corporate website

Current Price (US$)	0.07

Price as on July 5th, 2021 (LKR/US$ = 2008)

Stock Details	
Market Cap (US$ m)	107
Market Cap (%)	0.65%

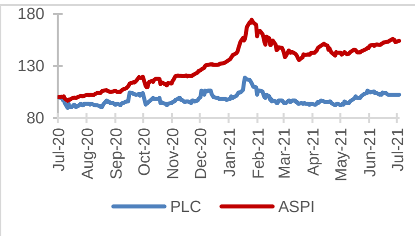
Source: CSE

Group Snapshot (Key companies)	Profits FY20 (US$ m)
People's Leasing & Finance (Company)	15.6
People's Insurance PLC*	3.4

Source: Annual report 2018/19

**People's Insurance reporting period is December 2019*

Share Price Chart (Indexed)



Source: CSE

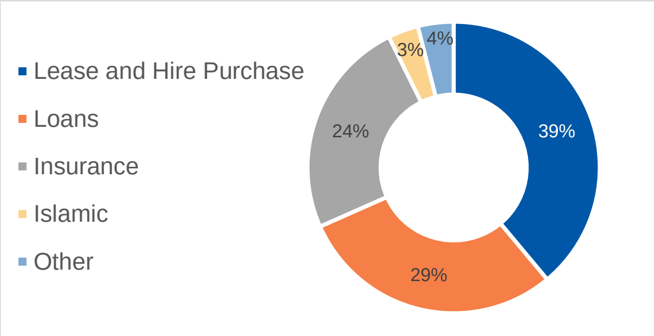
Valuation Multiples (Group)	Mar 2019	Mar 2020	Mar 2021
FY End Price (US$)	0.08	0.06	0.06
P/E(x)	4.79	6.67	0.52
P/B(x)	0.74	0.66	0.66

Source: Ratios calculated using data from Annual Reports, CSE

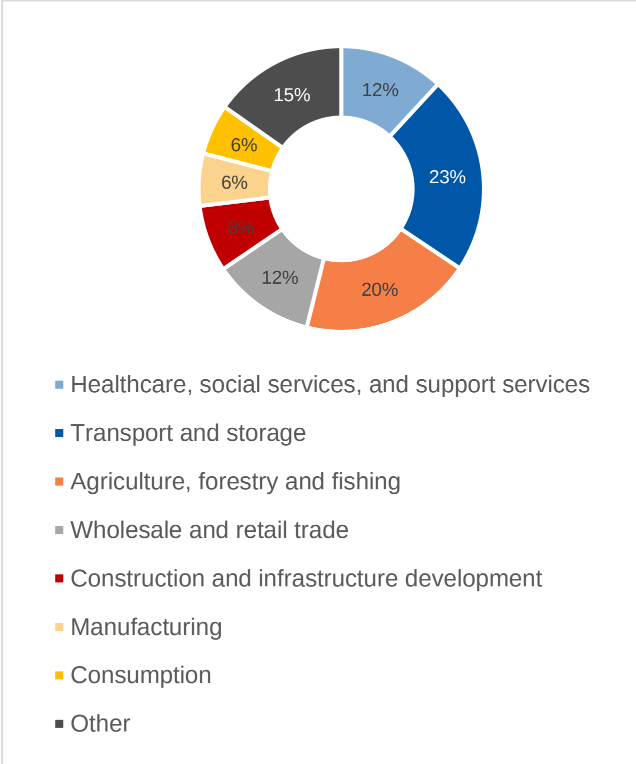
Shareholder Structure	
People's Bank	75.0%
Employees Provident Fund	5.4%
BNYM SA/NV RE-Neon Liberty Lorikeet Master Fund LP	3.8%
National Savings Bank	2.8%
Rubber Investment Trust Limited A/C # 01	1%
Others	12.0%
Total	**100%**

Source: Interim Financial Statement 31.03.2021

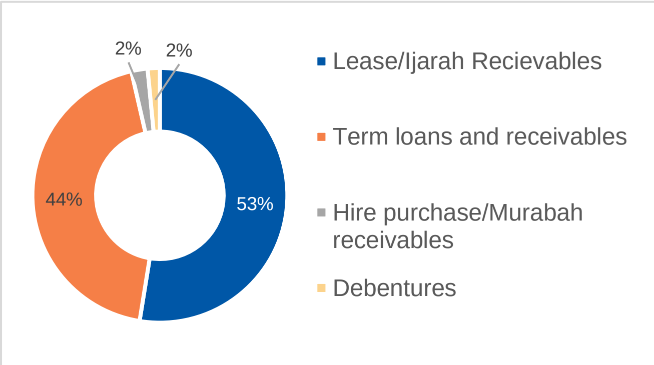
Total Operating Income by Segment – Group (FY20)



Sectoral Classification of Loans (FY20)



Segmental Classification of Loans (FY20)



Source: Annual Report 2019/20

Key Performance Indicators (Figures refer to Group values unless stated otherwise)			
	2019 YE Mar	**2020 YE Mar**	**2021 YE Mar**
Gross Income (US$ m)	218	215	169
Net Profit (US$ m)	28	19	30
Net Interest Margin (%) *(Company)*	9.7	9.68	7.58
Operating Cost/Net Income Ratio (%) *(Company)*	37.81	36.53	41.32
Asset Base (US$ Mn)	1,056	998	911
Deposit Base (US$ Mn)	505	637	521
Shareholder Funds (US$ Mn)	187	189	193
Net Lending Portfolio (US$ Mn)	891	827	750
ROE (%) *(Company)*	15.88	10.00	12.49
Pre-Tax ROA (%) *(Company)*	3.95	2.64	3.49
Gross lending / Deposits (%) (calculated)	182	145	153
Gross NPL (%) *(Company)*	3.91	7.62	8.62
Net NPL (%) *(Company)*	0.90	N/A	N/A
Tier 1 CAR (%) *(Company)*	14.36	15.12	17.72
Total CAR (%) *(Company)*	15.2	15.99	18.58

Source: Annual Report, Interim Financial Statements

Note: Financial year ends in March. US$ based financial statements are provided in annual reports where applicable

Sarvodaya Development Finance Ltd (SDF)

ICRA Ratings: [SL] B+

Company Description

Sarvodaya Development Finance commenced its lending activities in 2013 as Deshodaya Development Finance; a subsidiary of the Sarvodaya Economic Enterprise Development Service (SEEDS). SDF functions as the financial lending arm of the Sarvodaya movement. Leasing, SME and Micro lending constitute a core part of the firm's activities. In 2015, it acquired shares of George Steuart Finance PLC as part of the CBSL's consolidation plan for the financial services industry. Since then, the company has shifted its activities from micro finance to asset backed lending and introduced products such as leasing and gold loans. As at end March 2020, the two main shareholders are SEEDS (Gte) Limited (80%) and Gentosha Total Asset Consulting Inc (20%). It currently has 30 branches with 471 employees serving over 140,000 customers.

Key Business Segments

- **Leasing** – The Company provides facilities for all types of vehicles ranging from two-wheelers to heavy vehicles. This comprised of nearly 33% of SDF's total lending as at FY 2020.
- **Micro Loans** –Extended to micro scale entrepreneurs to meet working capital requirements and capital expenditure.
- **SME Loans** – Serves microfinance customers and facilitates their growth. In FY 2020, the company curtailed SME lending as a part of its restructuring process.
- **Housing loans** – The segment provides loan facilities to support house constructions, extensions, renovations or repairs. The product mainly caters to low-income micro customers.
- **Gold Loans** – Functioning across 10 centres, it is anticipated that the segment would grow in the coming years.

Strengths

- In FY 2020, SDF recorded the highest profits in its history. Profit after tax recorded a growth of 146.8%, to LKR 101.7m (approx. US$0.54m). Profitability ratios improved as ROA (after tax) and ROE increased to 1.3% and 8.87% respectively. SDF remained resilient to the mounting pressures of the Covid-19 pandemic due to its predominantly rural footprint.
- Driven by a 17.3% growth in interest income, gross income grew by 14.4% to LKR 1.8bn (approx. US$ 9.7m) in FY 2020. Despite the negative outlook that persisted during the period, the growth in SME and leasing products supported interest income growth with interest income accounting for 93.3% of SDF's total income in FY 2020.
- Growth strategies shifted to collateral-based lending and expanding leasing. The share of the gross portfolio backed by collateral, increased to 75.35% in FY 2020, compared to 69.48% in FY 2019 in line with the firm's strategy of maintaining a minimum of 70% share of collateral-based lending. The leasing product made the highest contribution on this front, registering a growth of 59% with a portfolio of LKR 1.83bn (approx. US$ 9.8m) in FY 2020.

Challenges

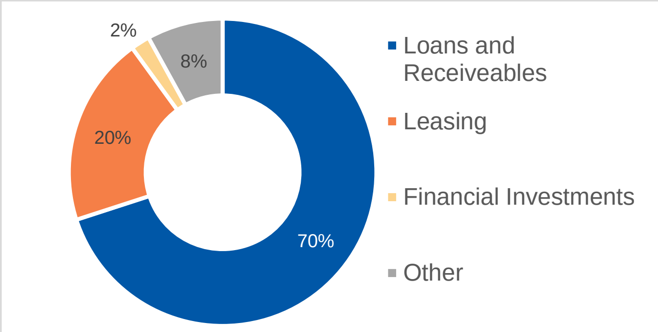
- SDF would require significant capital infusion of LKR 900m (approx. US$ 4.8m) to meet its minimum core capital requirement LKR 2bn as per the CBSL guidelines by end-December 2020.
- Diminished asset quality with Gross NPL ratio of 11.8% in FY 2020, stemming mainly from the negative impact on SME and Microfinance segment caused by the Easter Sunday attacks in 2019.
- Declining deposit base due to CBSL policy changes that narrows the interest rate gap between finance companies and banks coupled with the Company's below investment grade rating hinders its ability to attract high-net-worth depositors and investment funds.

Recent Developments/Future Plans

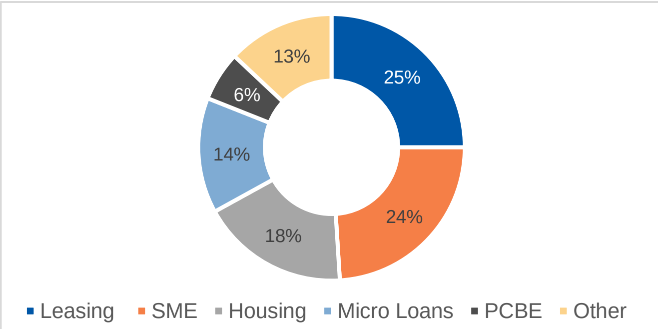
- SDF plans to expand the gold loans product through specialist guidance and aggressive marketing in order to leverage on the lucrative demand gold-backed loans in Sri Lanka's rural economy.
- In October 2020, Fitch Ratings assigned SDF with a National Long-term Rating of B+(lka) Stable Outlook.

Source: SDB Annual report 2019/20, ICRA Lanka

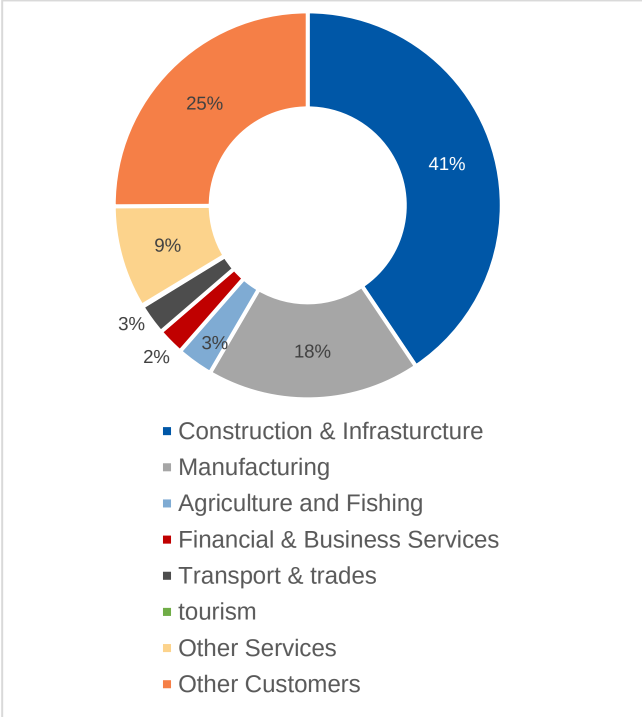
Total Operating Income by Segment (FY20)



Segmental Classification of Loans (FY20)



Sectoral Classification of Loans (FY20)



Source: Annual Report 2019/20

Key Performance Indicators	2018 YE Mar	2019 YE Mar	2020 YE Mar
Gross Income (US$ m)	8.6	9.3	9.7
Net Profit (US$ m)	0.6	0.2	0.5
Net Interest Margin (%)	14.61	12.51	12.21
Operating Cost/Net Income Ratio (%)	77.5	83.2	76.9
Asset Base (US$ m)	41	42	44
Deposit Base (US$ m)	30	31	36
Shareholder Funds (US$ m)	7.3	6.2	6.4
Net Lending Portfolio (US$ m)	34	35	28
ROE (%)	8.2	3.7	8.87
ROA (after tax %)	1.6	0.6	1.3
Gross lending / Deposits (%)	124	130	108
Gross NPL (%)	6.2	9.4	11.8
Net NPL (%)	2.6	4.7	6.1
Tier 1 CAR (%)	14.8	13.6	13.0
Total CAR (%)	14.8	14.0	13.2

Source: Annual Report, Interim Financial Statements

Note: Financial year ends in March. US$ based financial statements are provided in annual reports where applicable

Annexures

Annexure 1: Conversion rates

Rates used to convert LKR to US$ in KPI tables are given below. Other rates used are specified within the main sections of the report.

YE Dec	Dec'18	Dec'19	Dec'20	Q1 Mar'21	Used to convert
Year end	182.75	181.63	186.41	199.04	Statement of Financial Position
Average for the period	163.00	179.00	185.87	193.85	Statement of Comprehensive Income

Source: Based on data from the CBSL

YE Mar	Mar'18	Mar'19	Mar'20	Q1 Mar'21	Used to convert
Year end	155.97	176.13	188.62	199.04	Statement of Financial Position
Average for the period	153.53	169.75	180.25	188.39	Statement of Comprehensive Income

Source: Based on data from the CBSL

Annexure 2: Key formulae

Net Interest Margin	Interest income – Interest expense / Average assets
Operating Cost to Net Income	Non-interest expense / Net income – provisions and write-offs charged to income (net)
Pre-tax Return on Assets	Profit before corporate tax (annualised) / Average assets
Return on Equity	Profit after tax (annualised) / Average Equity
Gross NPL ratio	Non-Performing Loans net of interest in suspense / Total loans and advances
Net NPL ratio	Non-Performing Loans net of interest in suspense and specific loan provisions / Total loans and advances
Tier 1 CAR	Core capital / Risk-weighted assets
Total CAR	Total regulated capital / Risk-weighted assets

Source: CBSL

Annexure 3: Graphs and Tables

Certain graphs and tables may not sum to 100% due to rounding errors

All graphs and Tables have been prepared using publicly available information from what we believe to be reliable sources

Key sources Used in this report

- Company annual and quarterly financial reports
- Central Bank of Sri Lanka
- Department of Census and Statistics
- Ministry of Finance
- World Bank, IMF databases
- Fitch Ratings, ICRA Lanka ratings reports
- Colombo Stock Exchange
- Public news sources

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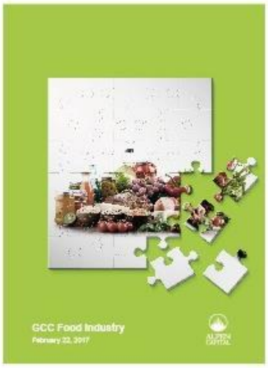

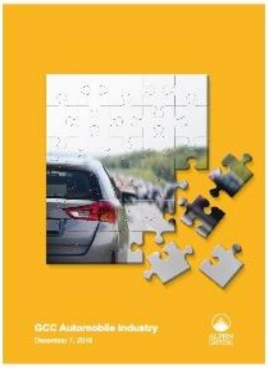

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