

Leasing & Finance Companies (LFCs)

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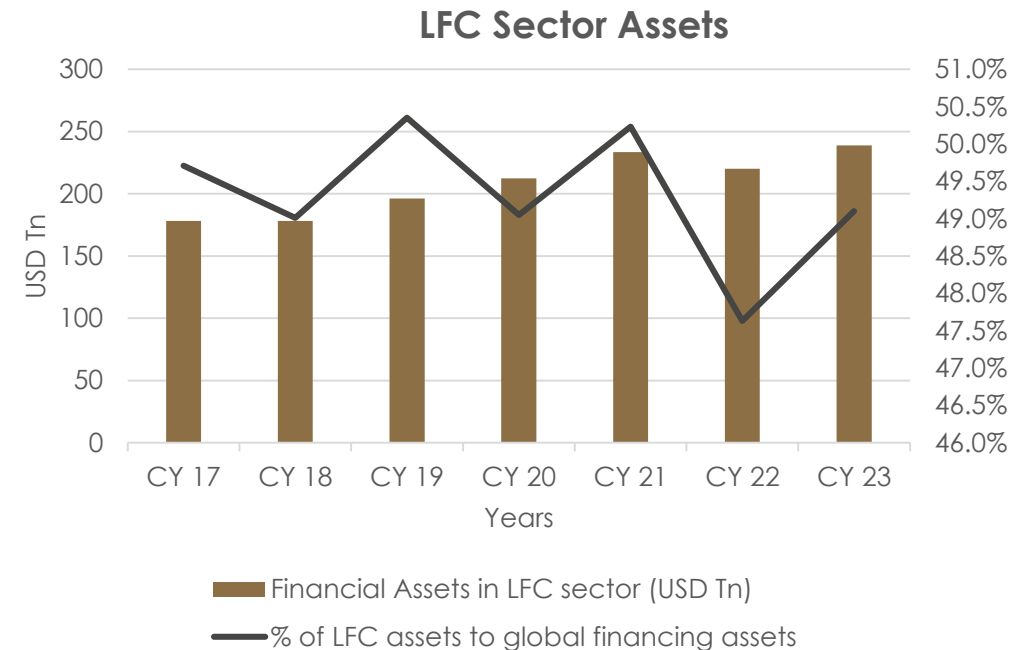


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Global NBFi Industry

- The size of the Leasing and Finance Companies (LFCs) sector increased ~8.5% in 2023, more than double the pace of banking sector growth (~3.3%), raising the NBFi share of total global financial assets to ~49.1%.
- The value of total global financial assets increased ~5.2% in 2023 and this increase was mainly driven by the increase of LFC sector.
- The growth of the LFC sector was largely attributed to higher valuations for mark-to-market instruments.
- At the jurisdictional level, increases in the LFC sector of above ~10% occurred in Brazil, the Cayman Islands, Japan, Mexico, and the United States. For most advanced economies (AEs) and emerging market economies (EMEs), the share of the NBFi sector was broadly stable year-on-year.



Snapshot of the Sri Lankan Economy

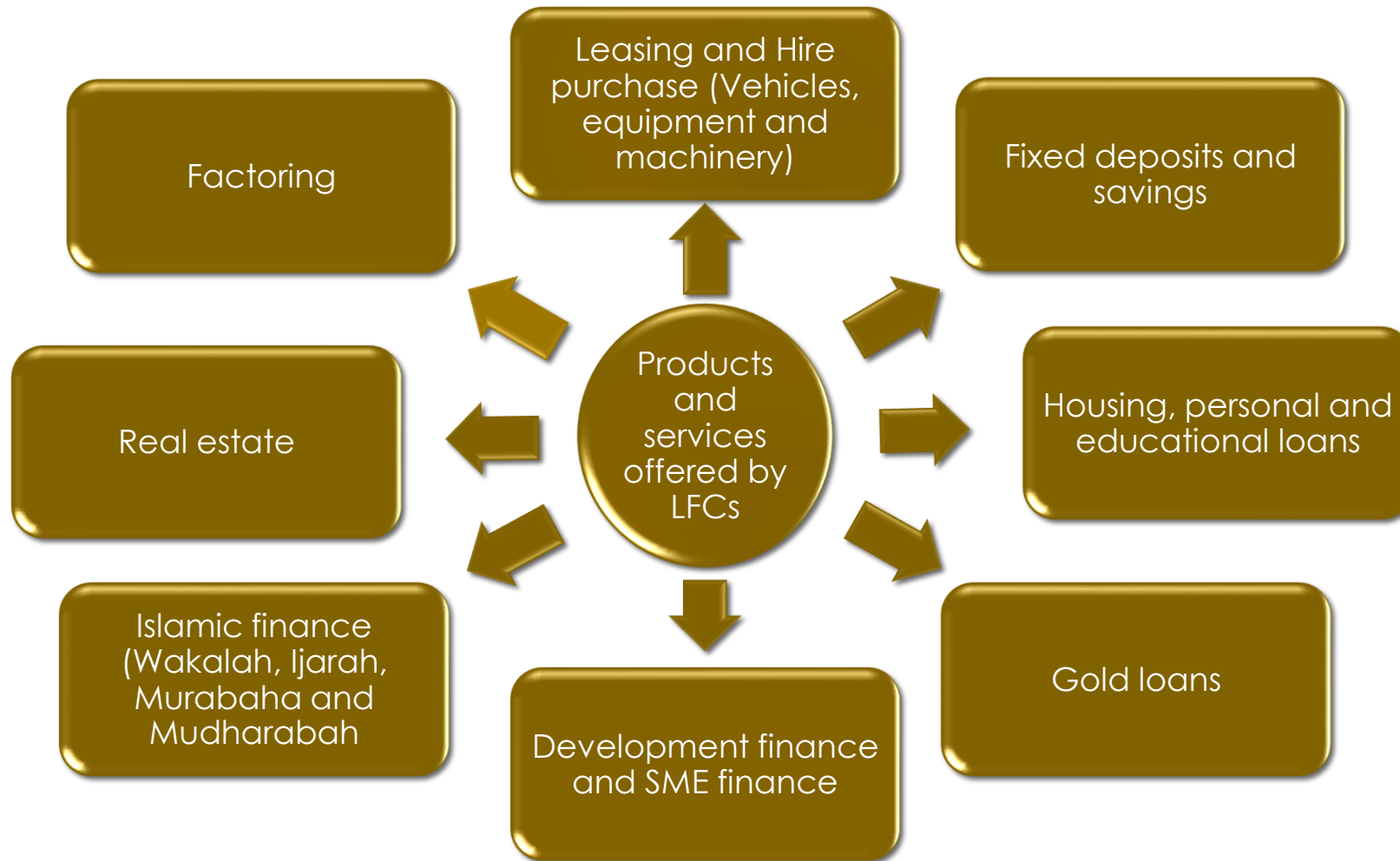
	CY18	CY19	CY20	CY21	CY22	CY23	CY24
GDP growth rate (YoY)	3.30%	2.30%	-3.60%	3.60%	-7.30%	-2.30%	*5.50%
Exchange rate (USD/LKR)	182.75	181.63	186.41	200.43	363.11	323.92	292.58
Inflation (CCPI)	4.30%	4.30%	4.60%	5.90%	57.20%	4.00%	-1.70%
SDFR	8.00%	7.00%	4.50%	5.00%	14.50%	9.00%	**8.00%
SLFR	9.00%	8.00%	5.50%	6.00%	15.50%	10.00%	
91-day T-bill rate	10.01%	7.51%	4.67%	8.16%	32.64%	14.51%	8.62%
USD bn	CY18	CY19	CY20	CY21	CY22	CY23	CY24
Current Account balance	-2.80	-1.80	-1.10	-3.34	-1.45	1.56	*1.48
Exports	11.89	11.94	10.05	12.50	13.11	11.91	12.77
Imports	22.23	19.94	16.06	20.64	18.29	16.81	18.84
Trade balance	-10.34	-8.00	-6.01	-8.14	-5.18	-4.90	-6.06
Workers' remittances	7.02	6.72	7.10	5.49	3.79	5.97	6.58
Foreign exchange reserve	6.92	7.64	5.66	3.14	1.90	4.39	6.10
Tourist Arrival ("000")	2,333.80	1,913.70	507.70	194.50	719.98	1,487.30	2,053.47

* 3QCY24

** Overnight policy rate

Leasing & Finance Companies (LFCs)

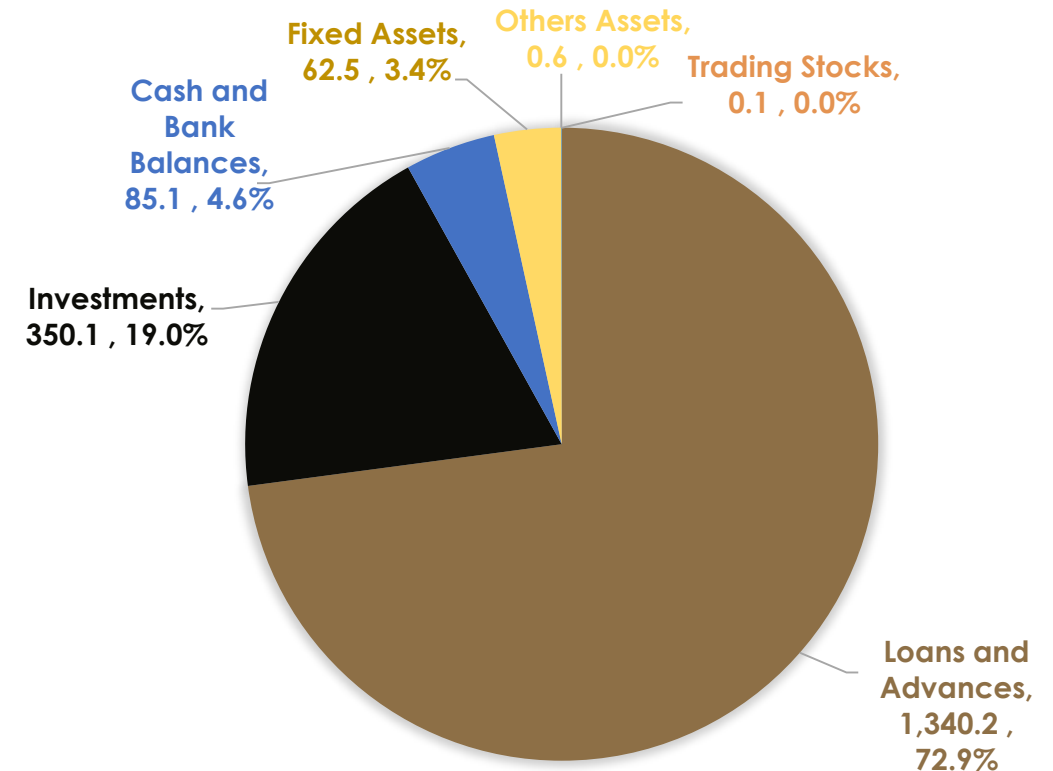
- Leasing and finance companies in Sri Lanka comprise ~33 licensed finance companies (of which ~27 are listed on the CSE) and ~1 specialized leasing company. They offer the following products and services.



Local Industry - Assets

- Total assets of the LFC sector stood at LKR~1,838bn as of 2Q FY24/25, with loans and advances accounting for LKR~1,340bn (~73%).
- The sector's total assets have grown at a CAGR of ~8.4% from FY15 to FY24 and ~4.2% from FY18 to FY24.
- The industry is skewed towards 12 largest entities holding LKR~1,478bn (~80%) of the sector's total assets as of 2Q FY24/25.
- By 2Q FY24/25, the LFC sector achieved significant asset growth, primarily driven by loans, advances, and investments.
- Loans and advances remain the largest contributor, accounting for ~72.9% of total assets, while investments represent the second-largest share.
- Meanwhile, cash and bank balances, as well as fixed assets, contributed less than ~5%, whereas trading stocks and other assets accounted for less than ~1%, making their contribution negligible.

DISTRIBUTION OF TOTAL ASSETS IN THE LFC SECTOR 2Q FY24/25 (LKR BN)



Total assets (2Q FY24/25)

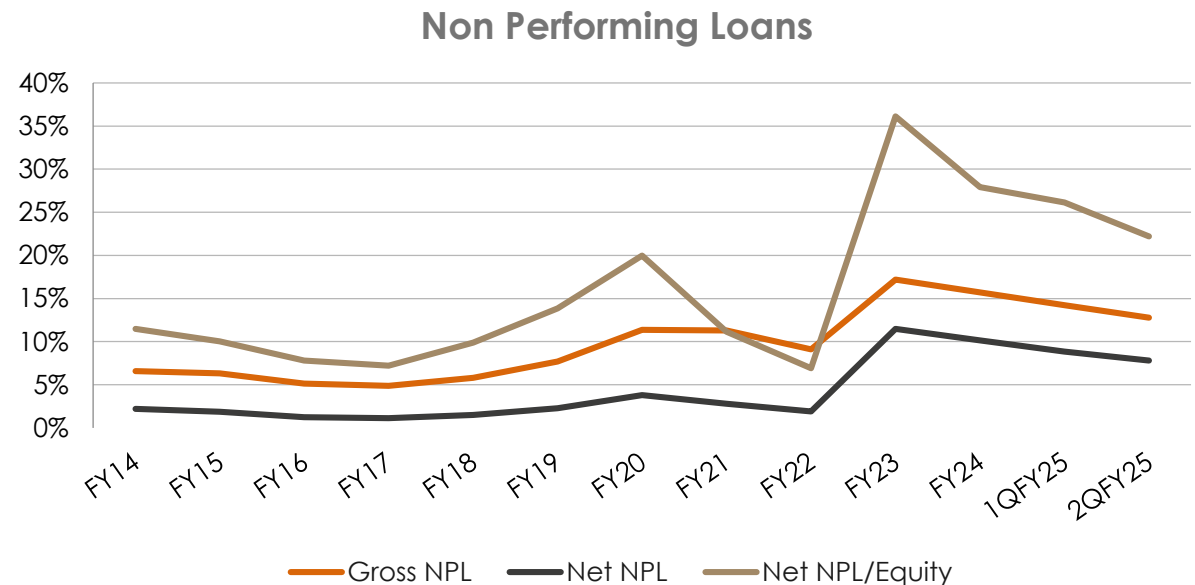
LKR~1,838bn

CAGR (FY18-FY24)

~4.2%

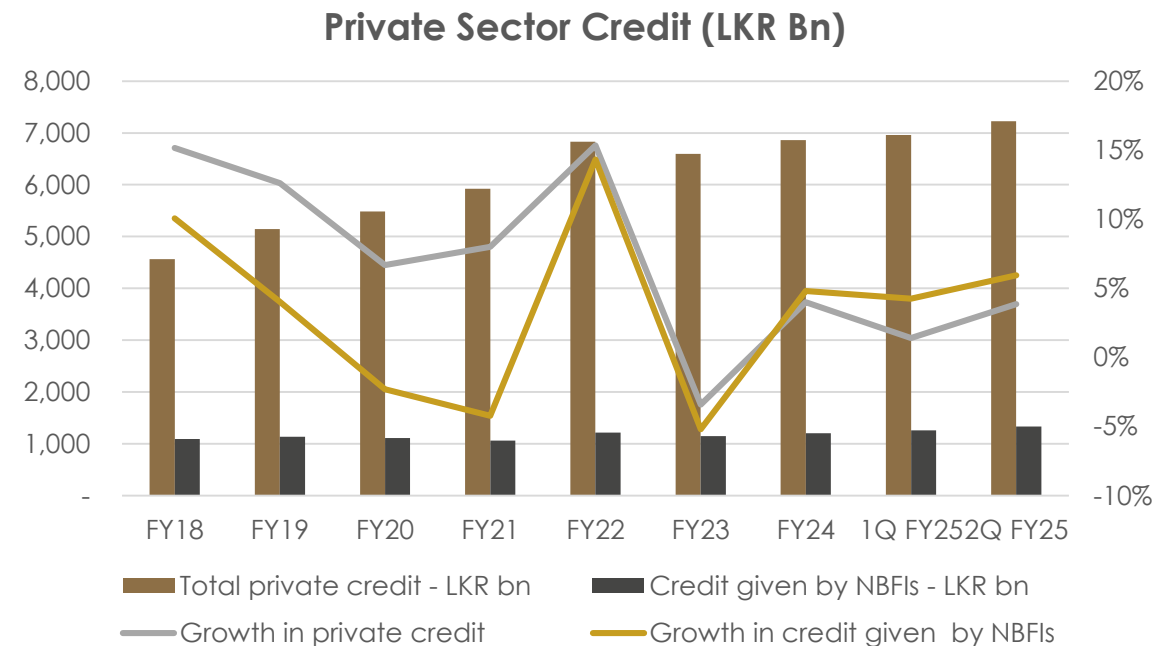
Local Industry – Asset Quality

- The sector's asset quality showed significant improvement, primarily due to a decrease in NPLs, which lowered the overall credit risk perception during the reviewed period.
- Accordingly, the gross and net NPL ratios improved to ~12.8% and ~7.8%, respectively, at the end of 2Q FY24/25, compared to ~22.0% and ~15.4% at the end of 2Q FY23/24.
- The provision coverage ratio (PCR) for NPLs also significantly improved during the period, primarily due to a decline in NPLs. The PCR was recorded at ~39.3% in 2Q FY24/25 in comparison to ~30.0% in 2Q FY23/24.
- Loans and advances in the sector gained momentum during 2Q FY24/25, driven by improved macroeconomic conditions.
- It grew to ~LKR 1.3 bn in 2Q FY24/25 from ~LKR 1.1 bn in 2Q FY23/24, reflecting a growth of ~17.9%.
- The loans and advances-to-deposit ratio of the sector stood at ~132.7% in 2Q FY24/25, compared to ~122.3% in 2Q FY23/24.
- Overall, all asset quality indicators showed considerable improvement.



Local Industry – Credit

- Private sector credit has been growing at a CAGR of ~7.2% from FY15 to FY24.
- By 2Q FY24/25, total private sector credit stood at LKR~7,127bn, of which LKR~1,340bn (~18.4%) was held by LFCs.
- Although total private sector credit by NBFIs declined significantly in FY23 by ~3% due to high interest rates, it bounced back in FY24, recording a Y-o-Y growth of ~4%.
- It was observed that the LFC sector's share of private sector credit gradually declined until the end of FY24, with larger portions shifting to the banking sector. However, a considerable recovery was seen by the end of 2Q FY24/25, increasing to ~18.41% in 2Q FY24/25 from ~17.56% in FY24.
- The LFC sector's share of private sector loans and advances declined to ~17.6% in FY24 from ~23.9% in FY18.
- Out of the total credit extended to households, ~32.1% is held by LFCs. Meanwhile, LFCs hold only ~3.7% of the credit extended to institutions, including the corporate sector, government, and public corporations.



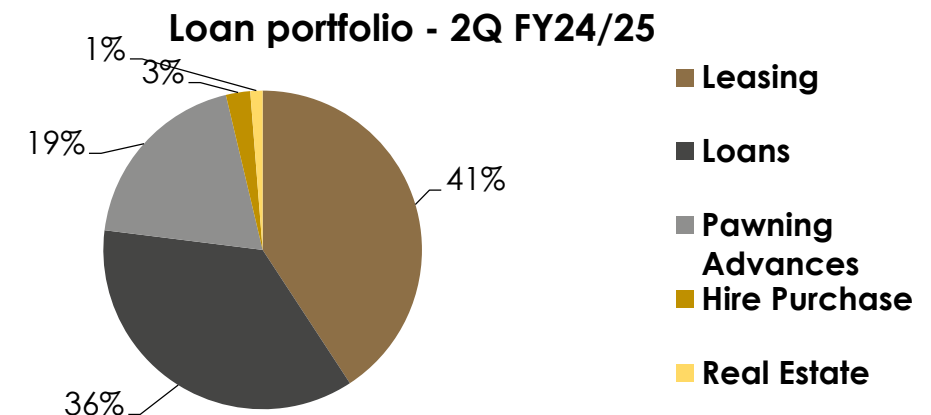
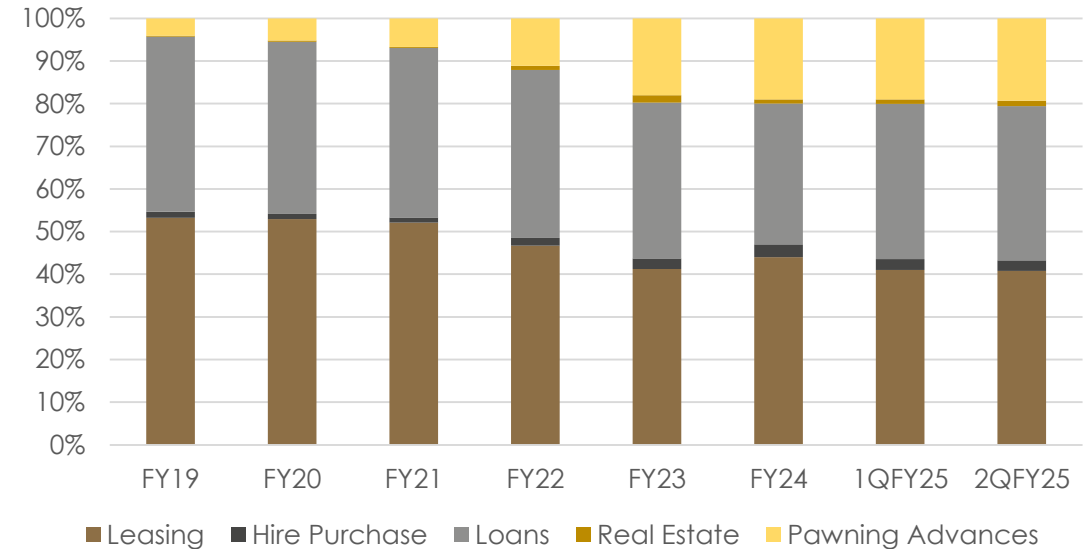
- Household sector credit, which contracted for five consecutive quarters since 3QFY23, returned to positive growth in 1Q FY24/25, signaling gradual improvements in credit demand and supply conditions.
- Household sector credit accounted for ~41.3% of total formal financial sector lending. By the end of 1Q FY24/25, total household sector credit recorded a modest growth of ~2.5%, with a notable uptick in credit granted to the household sector by NBFIs.
- The banking sector accounted for ~67.9% of household sector credit, while NBFIs held the remaining ~32.1%.
- The NBFI sector had a higher share of NPLs, indicating a greater default risk. NPLs in the LFC sector were higher than in the banking sector. For example, while LFCs accounted for ~32.1% of total household sector credit, they held ~56.8% of household sector NPLs. In contrast, the banking sector accounted for only ~43.2% of household sector NPLs in 1Q FY24/25.
- The total NPLs recorded within the Institutional sector primarily originated from the Banking sector. As of end-1Q FY24/25, the Banking sector accounted for ~82.2% of Institutional sector NPLs, while the Non-Banking sector represented ~17.8%.
- Going forward, as the economy gains momentum, credit growth in both the Household and Institutional sectors is expected to improve further.

For 1Q FY24/25,	Total loans and advances to the household sector	NPLs of the household sector
NBFIs	32.1%	56.8%
Banks	67.9%	43.2%

Local Industry – Credit

- Leasing dominates the loans and advances held by LFCs, accounting for ~41%. While it has grown significantly (CAGR of ~6.3% from FY18 to FY24), its dominance has declined due to the increase in pawning levels.
- The loans segment makes up ~36% of total loans and advances.
- Hire purchases, once popular (~12% of total assets in FY15), have declined to just ~3% following the removal of their tax advantage over leasing.
- Pawning has increased significantly over the past few years, with its share of total credit rising fivefold from ~4% in FY18 to ~19% in 2Q FY24/25.
- Loans against real estate remain a very small portion (~1% in 2Q FY24/25) of the LFC sector's loans and advances portfolio, as these are primarily a banking product.

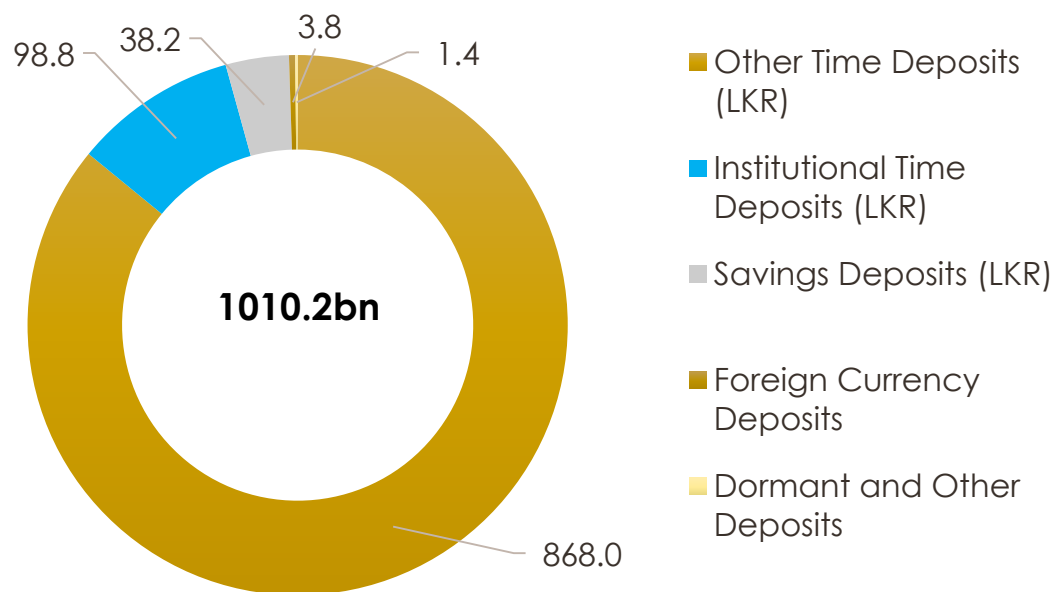
Breakdown of loans and advances held by NBFIs



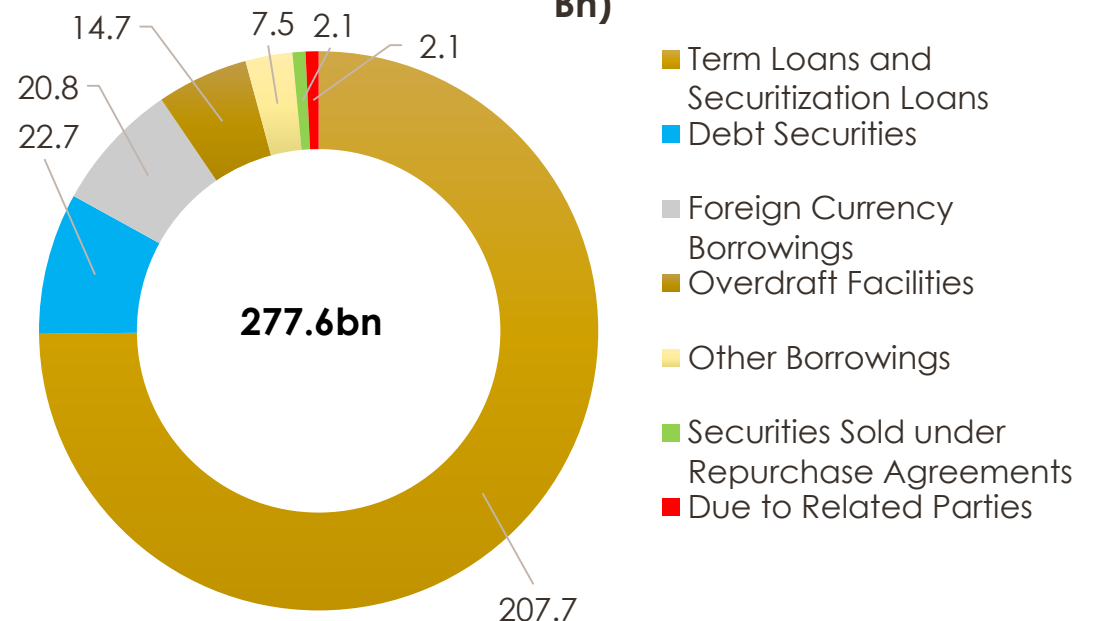
Local Industry – Liabilities

- The total liabilities of the sector increased by ~11.5% y-o-y at the end of 2Q FY24/25, primarily due to higher deposits. Borrowings also grew by ~15.2% y-o-y by the end of 2Q FY24/25.
- Most of the sector's deposits and borrowings were short-term, maturing in less than 12 months. As of end-1Q FY24/25, short-term deposits and borrowings amounted to LKR~917bn, while short-term performing loans and advances stood at LKR~644bn.
- In the sector's funding mix, deposits and borrowings accounted for ~54.9% and ~15.1% of total assets, respectively, as of 2Q FY24/25. The composition of deposits and borrowings can be represented as follows:

Composition of Deposits as of 2Q FY24/25 (LKR Bn)



Composition of Borrowings as at 2Q FY24/25 (LKR Bn)



Local Industry – Capital

- The total capital base of the industry by 2Q FY24/25 stood at LKR~358 bn, of which LKR~347bn (~97%) is Tier I (core) capital.
- Capital adequacy ratios are monitored and regulated by the CBSL. Depending on the size of the financial institution, it should maintain ~8.5% to ~10% of core capital to risk-weighted assets (RWA) and ~12.5% to ~14% of total capital to RWA (post-July 2022).
- From FY18 to FY24, the total regulatory capital base grew at a CAGR of ~16.3%. However, the credit-to-deposit ratio declined at a CAGR of -4.0% during the same period. Both core and total regulatory capital increased during this period (FY18 to 2Q FY24/25). The CAR for 1Q FY24/25 was ~23.8%.
- For FCs that do not meet the minimum capital requirements, the Central Bank continued to encourage the consolidation of companies to make the sector more resilient.

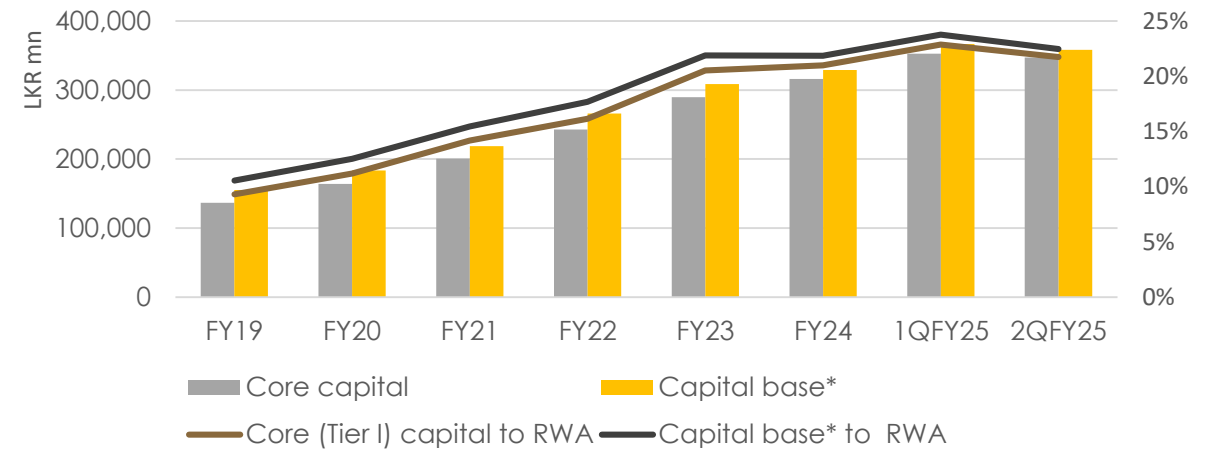
Total Capital (2Q FY24/25)

LKR~358bn

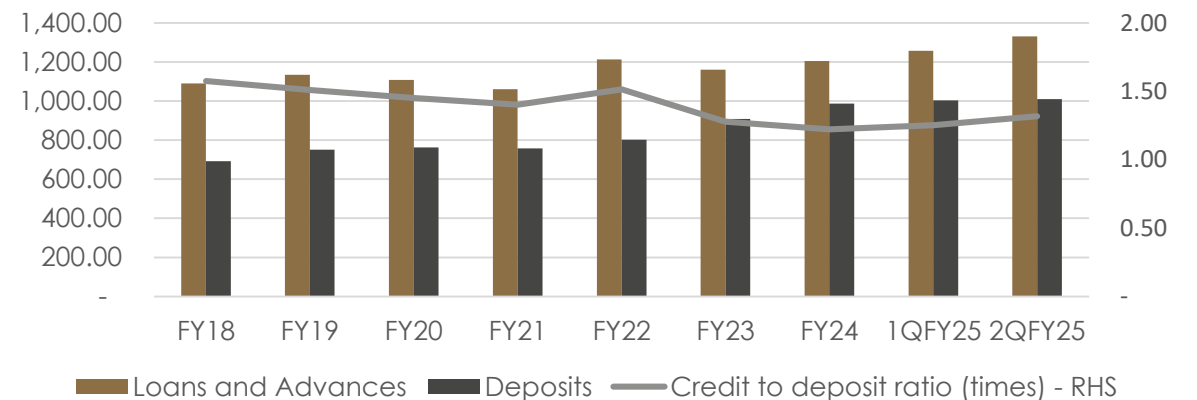
CAGR (FY18 - FY24)

~16.4%

Capital and Capital adequacy ratios

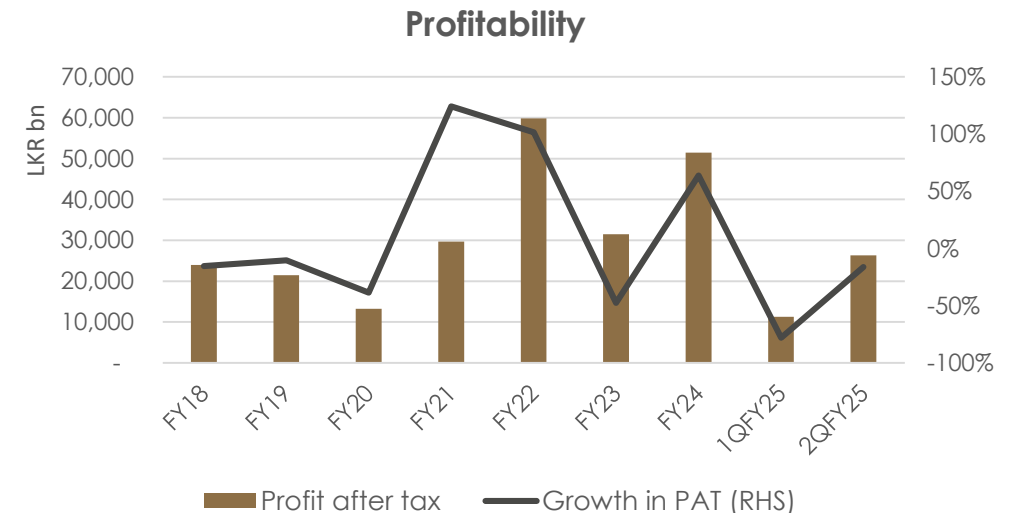
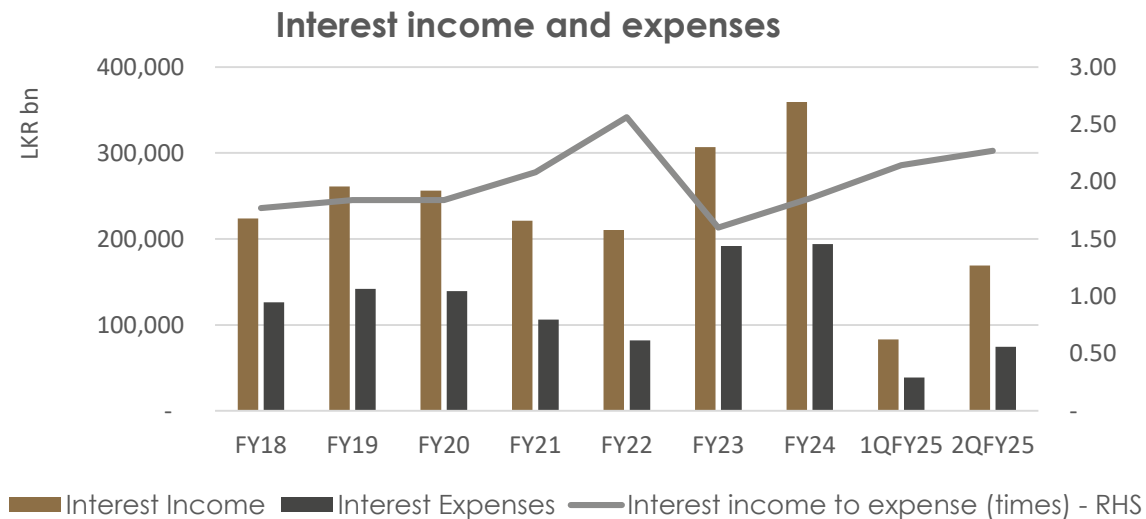


Credit to deposit ratio of LFCs



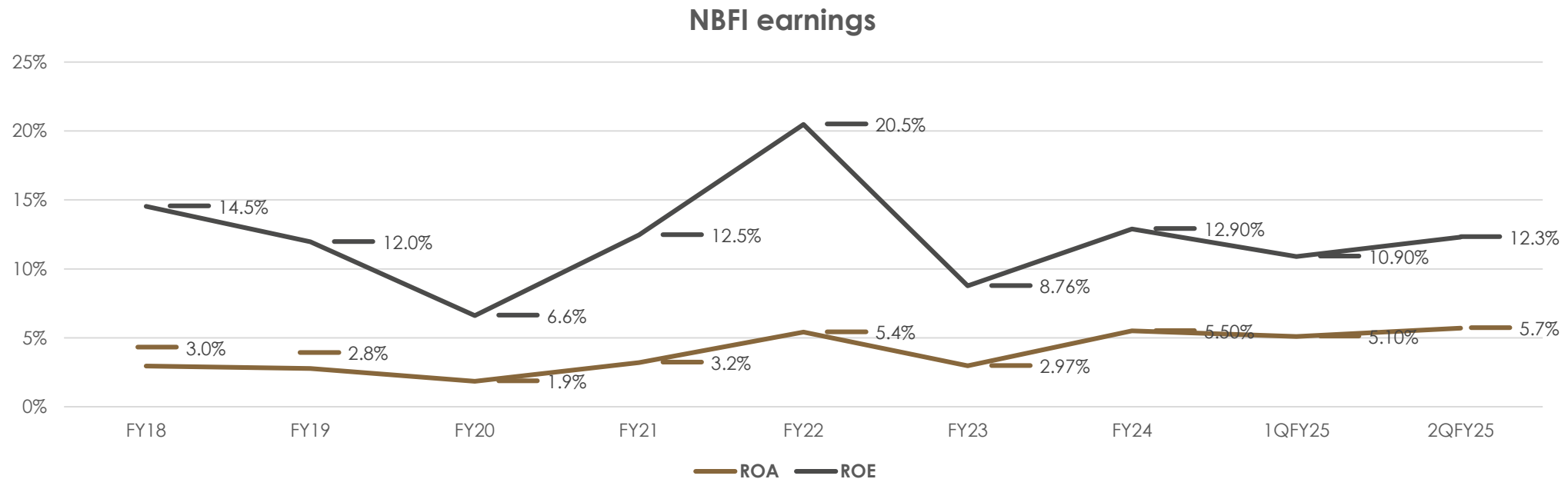
Local Industry – Profitability

- Both interest income and interest expense reported a notable increase at the end of 2Q FY24/25, resulting in the net interest margin (NIM) rising to ~10.4% in 1Q FY24/25, compared to ~8.7% in 1Q FY23/24. NII of the FC sector increased to ~94.5% at the end of 2Q FY24/25, compared to ~74.8% reported at the end of 2Q FY23/24.
- The increase in profitability in FY24 is primarily due to an increase in net interest income (~44%), compared to a ~10% reduction in FY23, and a decrease in loan loss provisions. Total expenses increased by ~0.3% during the year, while total income increased by ~5.8%, with the primary contributor being loan loss provisions (~40% decrease).
- Profitability in the LFC sector had been declining over the four years leading up to FY20. However, it saw significant growth thereafter, despite a ~47% decline in FY23. In FY24, profitability reported a ~64% increase from FY23, reaching PAT of LKR~51.5bn.
- The LFC sector recorded a PAT of LKR~26.3bn during 2Q FY24/25, compared to LKR~16.6bn reported in the corresponding period of 2Q FY23/24.



Local Industry – Earnings

- Key profitability indicators of the NBFI sector improved in 2Q FY24/25 compared to 2Q FY23/24, highlighting the sector's high earning potential.
- ROA and ROE of the sector increased to ~5.7% and ~12.3%, respectively, at the end of 2Q FY24/25, up from ~4.0% and ~8.8%, respectively, at the end of 2Q FY23/24.
- The six largest companies in the sector accounted for ~82% of sector profits at the end of 2Q FY24/25.

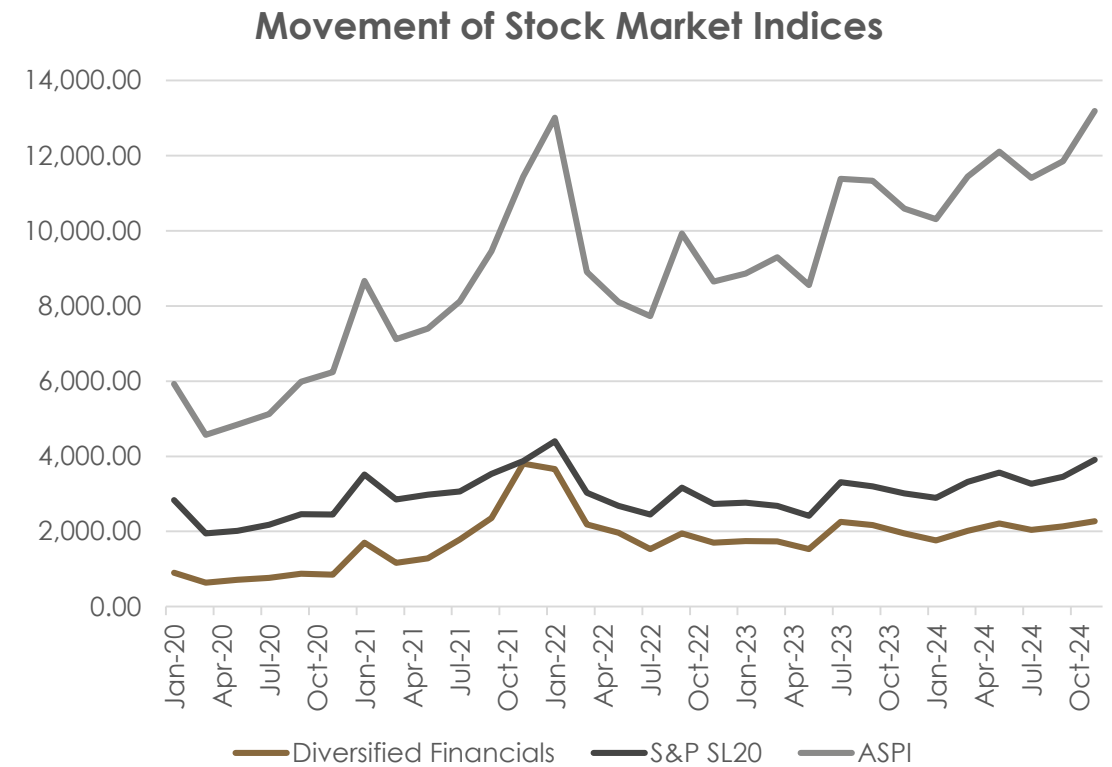
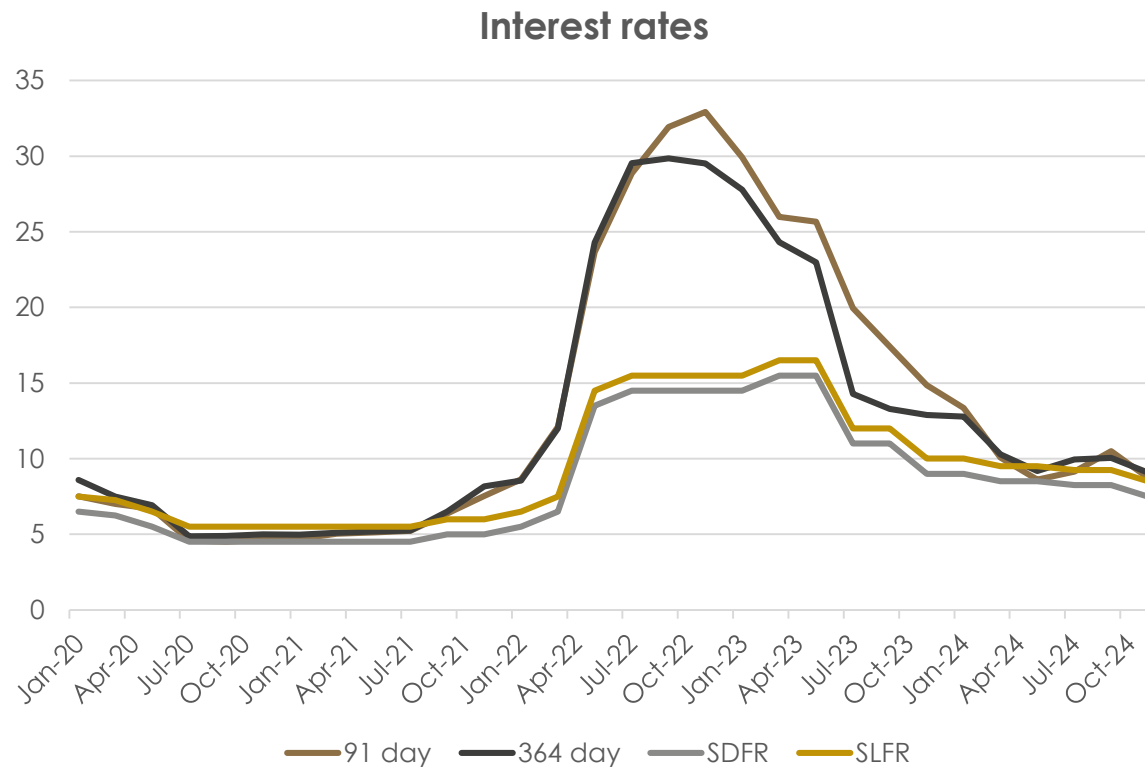


Leasing & Finance Companies (LFCs)

- As of the end of 2Q FY24/25, the earning potential of the ~12 largest NBFIs entities is as follows:

Entity Name	Market Share %	Return on Assets Ratio (%)	Advances to Deposits Ratio (%)	Liquid Assets to Total Assets Ratio (%)
LOLC Finance PLC	21.4%	5.4%	94.8%	9.2%
LB Finance PLC	11.5%	9.6%	139.8%	8.9%
People's Leasing and Finance PLC	8.0%	4.3%	124.7%	15.5%
Citizens Development Business Finance PLC	7.7%	5.4%	128.8%	13.2%
Commercial Credit and Finance PLC	6.0%	7.0%	132.4%	14.5%
Central Finance Co. PLC	5.5%	9.5%	131.3%	19.9%
Vallibel Finance PLC	5.3%	5.5%	122.7%	12.4%
Alliance Finance Co. PLC	3.8%	4.7%	172.1%	11.2%
Mercantile Investments and Finance PLC	3.2%	2.0%	110.9%	9.0%
Siyapatha Finance PLC	2.9%	5.0%	155.2%	22.3%
HNB Finance PLC	2.8%	2.5%	101.5%	16.4%
Singer Finance (Lanka) PLC	2.3%	4.0%	154.9%	7.0%

- LFC interest rates and movement in stock market indices;



The Master plan for Consolidation of NBFIs

- The Master plan for Consolidation of NBFIs was introduced in November 2020 as two-phase plan.

Phase 1 (Two Year Plan from mid 2021 to mid 2023):-

Phase 1 of the master plan aimed at consolidation of Finance Companies with capital shortfalls, FCs operating within the same group, and stand-alone Specialized Leasing Companies (SLCs).

Phase 2 (A three-year plan from 31.03.2025 to 31.03.2028) :-

The governing board of the CBSL has approved the revised framework for Phase II of the Master plan since the FCs sector was unable to meet the stipulated targets of the Phase 2 master plan introduced in 2020 due to the continued macroeconomic disruptions and the contraction of the economy and its implications on the financial institutions.

- **New framework aims to develop more resilient NBFi sector. In order to evaluate performances of FCs in the medium to long term, a scoring system is proposed to be introduced focusing on following two broad areas.**
 1. Strengthening resilience of the FCs sector
 2. Improving disclosures and transparency of FCs

Score requirement by 31.12.2027 for FCs:-

Scores a minimum of 60 and maintains the same -	Permitted to continue as a stand-alone FC
Fail to maintain minimum 60 score -	Directed to consolidate with another FC or a Licensed Commercial/ Specialized bank or gradually exit the market after settlement of the deposit liabilities

Leasing & Finance Companies (LFCs)

	Indicators	Categorization Criteria	Score allocated for each Category	Benchmarks
1	Capital related measures (Total sub score of 25)			
1.1	Total Capital Adequacy Ratio - (%) (CAR)	1) Low risk:- CAR $\geq$ Well capitalized under the Prompt Corrective Actions (PCA) capital category. 2) Moderate risk:- Minimum regulatory requirement $\leq$ CAR < Well capitalized PCA capital category 3) High risk:- CAR < Minimum regulatory requirement	25 15 0 25 15 0	FCs with Assets less than Rs.100bn: 12.5+1.5=14 1) CAR $\geq$ 14 2) $12.5 \leq$ CAR < 14 3) CAR < 12.5 FCs with Assets more than Rs. 100bn: 14.0+2.0=16 1) CAR $\geq$ 16 2) $14 \leq$ CAR < 16 3) CAR < 14
2	Performance related measures (Total sub score of 15)			
2.1	Return on Assets - (%) (ROA)	1) Low risk:- ROA $\geq$ Sector average 2) Moderate risk:- 50% less than sector average $\leq$ ROA < Sector average 3) High risk:- ROA < 50% less than sector average	15 10 0 15 10 0	At least 6.0 1) ROA $\geq$ 6 2) $3 \leq$ ROA < 6 3) ROA < 3

Scoring System for assessing FCs under Phase II of Master plan

3	Credit quality related measures (Total sub score of 30)			
3.1	Stage 3 advances against total advances - (%) (S3 to TA)	1) Low risk:- S3 to TA $\leq$ 25% less than sector average 2) Moderate risk:- 25% less than sector average < S3 to TA $\leq$ Sector average 3) High risk:- S3 to TA > Sector average	15 10 0	Not more than 13.0 1) S3 to TA $\leq$ 9.8 2) $9.8 <$ S3 to TA $\leq$ 13 3) S3 to TA > 13
3.2	Stage 3 impairment coverage (%) (IC to S3)	1) Low risk:- IC to S3 $\geq$ Sector average 2) Moderate risk:- 25% less than the sector average $\leq$ IC to S3 < Sector average 3) High risk:- IC to S3 < 25% less than the sector average	15 10 0	At least 40.0 1) IC to S3 $\geq$ 40 2) $30 \leq$ IC to S3 < 40 3) IC to S3 < 30

Leasing & Finance Companies (LFCs)

4	Liquidity related measures (Total sub score of 20)			
4.1	Liquid Assets to Short Term Liabilities (%) (LA to STL)	1) Low risk :- LA to STL $\geq$ Sector average 2) Moderate risk:- 25% less than the sector average $\leq$ LA to STL < Sector average 3) High risk :- LA to STL < 25% less than the sector average	10 5 0	<u>At least 56.0</u> 1) LA to STL $\geq$ 56 2) $42 \leq$ LA to STL < 56 3) LA to STL < 42
4.2	Liquid Assets to External Funds - (%) (LA to EF)	1) Low risk:- LA to EF $\geq$ Sector average 2) Moderate risk:- 25% less than the sector average $\leq$ LA to EF < Sector average 3) High risk:- LA to EF < less than 25% of the sector average	10 5 0	<u>At least 20</u> 1) LA to EF $\geq$ 20 2) $15 \leq$ LA to EF < 20 3) LA to EF < 15

5	Other measures (Total Sub Score of 10)			
5.1	External Credit Rating (ER)	1) Low risk:- ER $\geq$ Investment grade 2) High risk:- ER < below the investment grade	5 0	<u>Investment Grade BBB-</u> 1) ER $\geq$ BBB- 2) ER < BBB-
5.2	Listing in CSE	1) Low risk:- Listed 2) high risk:- Not Listed	5 0	1) Listed in CSE* 2) Not listed in CSE
	Total		100	

* The listing all FCs in the CSE was one of the targets set to be achieved by mid-2026.

The following are scores received from LRA clients:

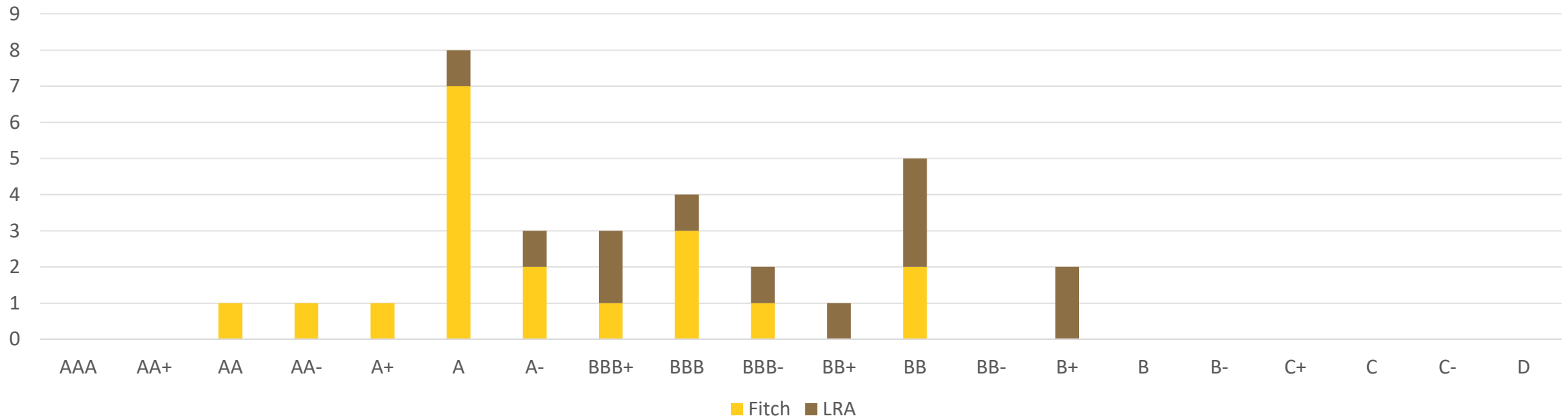
	Client Name	Current Score	Projected Score
1	Assetline Finance Limited	95%	-
2	Vallibel Finance PLC	80%	75%
3	Alliance Finance Company PLC	75%	75%
4	Associated Motor Finance	75%	70%
5	SMB Finance PLC	75%	-
6	Merchant Bank of Sri Lanka & Finance PLC	70%	-
7	Commercial Credit and Finance PLC	65%	80%
8	Lanka Credit and Business Finance PLC	65%	75%
9	LOLC Finance PLC	60%	85%
10	Orient Finance PLC	50%	65%
11	PMF Finance PLC	50%	55%
12	Sarvodaya Development Finance PLC	50%	60%

CBSL requirements for LFCs

	Requirement	
Core capital	LKR~2.5bn	
Capital adequacy for LFCs with total assets more than 100bn		
Tier 1 to RWA	10.00 by 01/07/2022	
Total capital to RWA	14.00 by 01/07/2022	
Capital adequacy for LFCs with total assets less than 100bn		
Tier 1 to RWA	8.50 by 01/07/2022	
Total capital to RWA	12.50 by 01/07/2022	
Total asset base	LKR 20bn by mid 2023	
Liquid assets	10% of time deposits + 15% of savings deposits + 5% of unsecured borrowings The above should include government treasury bills, government securities and CBSL securities equivalent to 7.5% of the average of its month end total deposit liabilities and borrowings of the 12 months of the preceding financial year.	
Single borrower limit	Individual – 15% of capital funds	Group – 20% of capital funds

Rating curve

Rating Curve LFCs



	AAA	AA+	AA	AA-	A+	A	A-	BBB+	BBB	BBB-	BB+	BB	BB-	B+	B	B-	C+	C	C-	D
Fitch			1	1	1	7	2	1	3	1		2								
LRA						1	1	2	1	1	1	3		2						
Total			1	1	1	8	3	3	4	2	1	5		2						

Rating Information – LRA

Client Name	LRA	
	Rating	Outlook
LOLC Finance PLC	A	Positive
Assetline Finance Limited	A-	Stable
Merchant Bank of Sri Lanka & Finance PLC	BBB+	Stable
Vallibel Finance PLC	BBB+	Stable
Commercial Credit and Finance PLC	BBB	Positive
Alliance Finance Company PLC	BBB-	Stable
Orient Finance PLC	BB+	Positive
Sarvodaya Development Finance PLC	BB	Stable
SMB Finance PLC	BB	Stable
Associated Motor Finance Company PLC	BB	Stable
PMF Finance PLC	B+	Stable
Lanka Credit and Business Finance PLC	B+	Positive

Leasing & Finance Companies (LFCs)

Rating Information – Fitch

Client Name	Fitch				Client Name	Fitch			
	Rating	Previous	Outlook	Action		Rating	Previous	Outlook	Action
Dialog Finance PLC	AA	AA	Stable	Affirmed	LB Finance PLC	A-	BBB+	Stable	Upgrade
Mahindra Ideal Finance	AA	AA	Stable	Affirmed	Abans Finance PLC	A-	BBB+	Negative	Upgrade
Asia Asset Finance	A+	A+	Stable	Affirmed	Singer Finance (Lanka) PLC	BBB+	BBB	Stable	Upgrade
CBC Finance LTD	A	BBB+	Stable	Upgrade	AMW Capital Leasing And Finance PLC	BBB	BBB	Negative	Affirmed
Central Finance Company PLC	A	A-	Stable	Upgrade	Citizens Development Business Finance PLC	BBB	BBB	Stable	Affirmed
HNB Finance PLC	A	BBB+	Stable	Upgrade	Senkadagala Finance PLC	BBB	BBB	Stable	Affirmed
Merchant Bank of Sri Lanka & Finance PLC	A	BBB+	Stable	Upgrade	Mercantile Investments and Finance PLC	BBB-	BBB-	Stable	Affirmed
People's Leasing & Finance PLC	A	A-	Stable	Upgrade	Fintrex Finance Limited	BB	BB-	Stable	Upgrade
Richard Pieris Finance Limited	A	A	Stable	Affirmed	UB Finance PLC	BB	BB	Negative	Affirmed
Siyapatha Finance PLC	A	BBB+	Stable	Upgrade					

Recent Developments in NBFi Sector Ratings

- Fitch Ratings recently upgraded the National Long-Term Ratings of 10 Sri Lankan non-bank financial institutions (NBFIs) while affirming the ratings of 8. This follows the recalibration of Fitch's Sri Lankan National Rating scale to reflect changes in the relative creditworthiness of issuers after the agency upgraded Sri Lanka's Long-Term Local-Currency Issuer Default Rating (IDR) to 'CCC+' from 'CCC-' on 20 December 2024.
- The rating actions on **Central Finance, LB Finance, and Fintrex Finance**, whose ratings are based on their standalone credit profiles, reflect the impact of the sovereign rating upgrade and the improving operating environment. These actions also take into account the relative strength of their credit profiles compared to other entities rated on the Sri Lankan National Rating Scale after the recalibration. Meanwhile, the affirmation of the National Ratings for **Citizen Development Business Finance, Senkadagala Finance, and Mercantile Investment Finance** signifies that their relative creditworthiness among other Fitch-rated standalone Sri Lankan entities remains unchanged following the recalibration.
- The affirmation of the National Ratings of **UB Finance, Dialog Finance, Richard Pieris Finance and AMW Capital Leasing** reflects Fitch's view that shareholder support remains unchanged. The rating action on SFP also considers its growing size relative to its parent, which may weigh on the parent's ability to provide support.
- The upgrade of **People's Leasing & Finance PLC** national rating reflects extraordinary support from People's Bank (Sri Lanka) (PB, AA- (lka)/Stable), stemming from the parent's credit profile improvement following the alleviation of sovereign-related stresses.
- **Richard Pieris Finance Limited's** outlook revision to stable from negative and **Abans Finance PLC's** upgrade with a stable outlook reflect abating downside risks to parental support due to the parents' stabilizing credit profiles as well as both Company's enhanced financial performance.

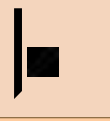
PESTEL Analysis

POLITICAL



- The newly elected government has highlighted the need to eliminate or significantly reduce the corruption in the country and stimulate economic growth and started taking action on the causes of prior corruption.
- IMF agreed with Sri Lanka on the third EFF review in November 2024, potentially releasing \$333M and bringing total disbursements to \$1.33B pending approval.
- The interim government took measures to enable the taxpayers to disclose their taxable income and thereby making it possible for the government to significantly raise their revenue.
- The government has taken steps on gradually lifting the ban on import of vehicles and is expected to be fully lifted in February 2025 which will influence the exchange rate by weakening the local currency.

ECONOMICAL



- The inflation rate has turned negative where in the months from September to December 2024 the Y-o-Y deflation rate stayed in-between 0.4% - 2.2%.
- The country is now experiencing an economic recovery, and the 3rd quarter of 2024 showed a positive economic growth of 5.5% with the key sectors contributing because of the expansionary policies implemented by the government.
- The falling interest rates throughout 2024 have now settled and remain rather stable at present and as a result private credit has increased.
- The year 2024 showed a strengthening of the LKR against the USD and in the last couple of months the exchange rate has remained stable which has ultimately smoothened out the path for importers and exporters.
- Tourism has played a significant role in strengthening the exchange rate and the increase in worker remittances
- With the increase in outward migration, there has been a corresponding increase in worker remittances, and this has also been a major cause for the stable exchange rate.

SOCIAL



- Although the cost of living has shown a decline, the disposable incomes have reduced due to the imposing of stricter policies on paying income taxes.
- The unemployment rate has continued to decline with the recovery of the economy.
- There is a significant outward migration leading to the loss of skilled labor and this could potentially result in loss of output for the economy going forward.
- Despite high literacy rates, disparities in access to quality education and healthcare persist, particularly in rural areas. Addressing these issues is crucial for long-term social stability.

PESTEL Analysis

TECHNOLOGICAL



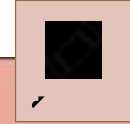
- AI now plays a major role in business and in education in general. In the recent past there has been a major shift towards self-learning with the help of AI advancements and on top of that many high-tech companies are exploiting its benefits.
- In March 2024, Sri Lanka initiated a comprehensive National AI Strategy aimed at integrating artificial intelligence across various sectors. This includes a budget allocation of LKR 1.5 billion to support early AI advancements and the establishment of a National AI Center aligned with the Digital Strategy 2030.
- There is an increased cyber security risk, as the number of online users increase on platforms, there is a higher likelihood of attracting cyber-criminal behavior.

ENVIRONMENTAL



- The United Nations Development Program (UNDP) has been actively supporting Sri Lanka in implementing its environmental policies, particularly through technical and financial assistance for the NEAP. This collaboration aims to embed biodiversity conservation and ecosystem restoration into national development efforts.
- There is an increased awareness on the environmental impacts of overusing non-renewable energy and therefore many are shifting towards more eco-friendly solutions. The demand for solar panels has increased in the last year with many investing to cover the costs of increase in electricity chargers.

LEGAL



- The non-bank sector will be strengthened by consolidating financial institutions under Masterplan2 and updating regulatory frameworks, including modernizing key finance acts.
- In 2024, the Sri Lankan government initiated the creation of several new laws aimed at embedding structural reforms. These include the Public Financial Management Bill, Public Debt Management Bill, and Economic Transformation Bill. These laws are designed to modernize governance structures, enhance transparency, and improve economic management systems, which could lead to increased efficiency in public finance and investment environments.

Outlook

▪ Macroeconomic Reforms:

- ✓ In 3Q24, the Sri Lankan economy experienced around ~5.5% growth, driven by a rebound in the industrial sector, particularly in construction and food and beverage manufacturing, as well as strong performance in tourism-related services.
- ✓ Fiscal stability was restored as a primary budget deficit of ~5.7% of GDP (LKR~1tn) in 2021 was converted into a primary budget surplus of LKR~831bn by the end of October 2024.
- ✓ Price stability was restored as inflation declined from ~70% in 2022 to a deflation of -1.7% as of December 2024.
- ✓ Gross Official Reserves (GOR) stood at USD6.5~bn (including the swap facility from the People's Bank of China) as of end December 2024

▪ Official Sector External Debt Restructuring:

- ✓ Sri Lanka negotiated restructuring of official debt with the ~17 members of the Official Creditor Committee (co chaired by Japan, India, and France), and the Exim Bank of China. Official creditors provide debt relief through maturity extensions, capital grace periods, and interest rate reductions. Face value haircuts are not provided.
- ✓ Accordingly, Sri Lanka received capital grace periods until 2028, reduced interest, and progressive amortization with final repayments in 2043. This provided Sri Lanka with significant debt relief.
- ✓ The successful execution of the bond exchange on 20th December 2024, Fitch Ratings upgraded Sri Lanka's foreign currency credit rating (IDR) to CCC+ from RD (Restricted Default).
- ✓ "Sri Lanka's foreign-currency debt restructuring offers substantial upfront debt repayment relief, with no foreign-currency bond maturities until 2029. The first amortization on the macro-linked bonds, which have low coupon rates until 2032, starts from 2029."

Outlook

- By 2Q FY24/25, the LFC sector's total assets grew to LKR~1,838bn, driven by loans and advances (accounting for ~73% of total assets), while its share of private sector credit increased to ~18.4%, liabilities rose (~11.5% Y-o-Y from 2Q FY23/24) due to higher deposits and borrowings (out of total assets ~54.9% and ~15.1% respectively), and the total capital base reached ~LKR 358bn with a strong CAR of ~23.8%. The gross and net NPL ratios improved to ~12.8% and ~7.8%, respectively, at the end of 2Q FY24/25 (~22.0% and ~15.4% as of 2Q FY23/24). The LFC sector recorded a PAT of ~LKR 26.3 bn during 2Q FY24/25, compared to ~LKR 16.6 bn reported in the corresponding period of 2Q FY23/24.
- Lanka Rating Agency (LRA) is closely monitoring the financial and operational performance of Licensed Finance and Leasing companies (LFCs) in Sri Lanka. LRA uses a strong and ongoing assessment framework to analyze the performance of these institutions. Based on this evaluation, the agency expects to upgrade the credit ratings of certain non-bank financial institutions (NBFIs) soon, provided that they meet the necessary rating criteria. In other words, if specific NBFIs demonstrate improved financial stability, risk management, and overall creditworthiness, LRA may raise their ratings, signaling stronger financial health and reduced credit risk.

Client Name	LRA	
	Rating	Outlook
LOLC Finance PLC	A	Positive
Assetline Finance Limited	A-	Stable
Merchant Bank of Sri Lanka & Finance PLC	BBB+	Stable
Vallibel Finance PLC	BBB+	Stable
Commercial Credit and Finance PLC	BBB	Positive
Alliance Finance Company PLC	BBB-	Stable
Orient Finance PLC	BB+	Positive
Sarvodaya Development Finance PLC	BB	Stable
SMB Finance PLC	BB	Stable
Associated Motor Finance Company PLC	BB	Stable
PMF Finance PLC	B+	Stable
Lanka Credit and Business Finance PLC	B+	Positive