



Media Release

RAM Ratings Lanka revises Senkadagala Finance Company Limited's rating downwards to BBB+

RAM Ratings Lanka has lowered the long-term rating of Senkadagala Finance Company Limited ("Senkadagala" or "the Company") from A- (with a negative outlook) to BBB+; the short-term rating has been reaffirmed at P2. Concurrently, the outlook on the long-term rating has been revised to stable from negative. The Company was placed on a negative outlook in November 2008 due to its deteriorating asset quality. The downgrade reflects the continued deterioration in Senkadagala's asset quality. The ratings are, nevertheless, supported by the Company's adequate capitalisation and good liquidity levels.

The backdrop of the business environment in which the Company operated in the past 12 months was not conducive to maximizing returns. The global financial crisis set off by the sub-prime mortgage meltdown in the USA created worldwide financial turmoil and its impact was felt in the Sri Lankan economy. This was exacerbated by the war in Sri Lanka rapidly increasing to its highest level of intensity before it ended in Q1-2009. In the financial services sector itself, the near-collapse of the largest player in the segment and a number of related finance companies necessitated the intervention of the Central Bank of Sri Lanka. The resulting erosion of public confidence in the sector created a difficult operating environment for most financial institutions in the sector.

Senkadagala is currently the sixth-largest registered finance company ("RFC") in Sri Lanka, accounting for 3.60% of the industry's total assets as at end-March 2009. The Company operates 30 branches island-wide and is supported by a work force of 207 employees. Senkadagala's information technology ("IT") system ranks among the best in the industry and has enabled the Company to achieve substantial cost and operational efficiencies.

In line with the aggressive expansion of Senkadagala's loan books along with the challenging macroeconomic conditions, the Company's asset quality had weakened during the past few years. Nevertheless, the Company's gross non-performing-loan ("NPL") ratio (on a 6-month classification basis) ameliorated to 3.63% as at FYE 31 March 2009 ("FY Mar 2009") from 6.33% as at end-FY March 2008, driven mainly by loan write-offs. However, the Company's absolute NPLs (after adjusting for seized stock) increased 94.88% (or LKR 167.06 million) to reach LKR 343.14 million over the ensuing eight months to November 2009, with a rapid accumulation of seized stock. Further, we note that the Company had been challenged to fully recover the dues on its repossessed stock in recent times due to the slump in the vehicle market reflecting increased market risk. Concurrently, the Company's gross NPL ratio climbed back up to 7.39% as at end-November 2009. In tandem with the macroeconomic fundamentals, rising NPLs have been an industry wide phenomenon; nevertheless, we note that Senkadagala's NPLs have accelerated relatively faster than similar rated peers.

Moreover, the gross NPL ratio as at end-FY Mar 2009 had been achieved at the expense of Senkadagala's financial performance. In line with substantial loan write-offs, provisions and losses on repossessed stocks during the reviewed period, the Company's pre-tax profit ebbed to LKR 117.82 million as at end-FY Mar 2009 (FY Mar 2008: LKR 302.25 million). Accordingly, the Company's return on assets ("ROA") fell sharply from 5.67% as at end-FY Mar 2008 to 2.01% as at end-FY Mar 2009. Going forward, we anticipate performance to ameliorate marginally as the Company resumes lending and its cost of funding recedes in line with the falling interest rates; nevertheless, a drastic improvement is unlikely in the short term given the Company's deteriorating asset quality and challenging macroeconomic conditions.

Meanwhile, Senkadagala's funding structure continues to be dominated by collateralized borrowings, which had accounted for 43.90% of its total funding as at end-FY Mar 2009. However, we note that the Company's funding structure had tilted increasingly towards deposits, with a reduced reliance on collateralised borrowings.

On a separate note, the Company's capitalization is adequate, despite its internal rate of capital generation falling in line with its declining performance. Accordingly, Senkadagala's Tier 1 and overall risk weighted capital adequacy ratios ("RWCAR") clocked in at 18.03% as at end-June 2009, well above the regulatory minimums of 5% and 10% respectively. However, in line with the weakened asset quality, the Company's ratio on net NPL to shareholders funds had deteriorated to 26.14% as at end-September 2009 (FY Mar 2009: 10.78%).

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