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Media Release

RAM Ratings Lanka reaffirms Merchant Bank of Sri Lanka's AA-/P1 rating

RAM Ratings Lanka has reaffirmed Merchant Bank of Sri Lanka's ("MBSL" or "the Company") long- and short-term financial institution ratings at AA- and P1, respectively. At the same time, the AA- ratings of the Company's LKR 300 million Unlisted Private Debentures and LKR 500 million Unlisted Public Debentures have also been reaffirmed. All the long-term ratings have a stable outlook. The ratings are premised on the financial flexibility derived from the Company's parent, the sovereign-owned Bank of Ceylon ("BOC").

MBSL is a 72.14%-owned subsidiary of BOC, i.e. Sri Lanka's largest licensed commercial bank ("LCB") in terms of assets; BOC accounted for 21.50% of the LCB industry's assets as at end-December 2009. On the other hand, MBSL remains a small player in the market, accounting for only 4.99% of the specialised leasing industry's ("SLC") asset base as at the same date. Despite its small size, MBSL's ratings remain supported by solid parental backing. BOC has consistently demonstrated its support to MBSL via equity injections and loans; in December 2009, it infused LKR 347.91 million into the Company by way of a rights issue.

On a separate note, MBSL acquired a specialised savings bank (rebranded as MBSL Savings Bank Ltd or "MBSL Savings") and an insurance company (rebranded as MBSL Insurance) in 2009; these companies had been experiencing financial difficulties amid the domestic financial turmoil. We note that the turnaround of these entities has not been as rapid as anticipated. That said, these subsidiaries had been acquired at a relative bargain, with a total investment value of LKR 238.61 million (or 10.23% of its capital) that translates into 4.28% of the Company's total assets as at end-December 2009.

Meanwhile, the Company's asset quality has remained weaker than the overall industry's - albeit having taken a turn for the better during the reviewed period. MBSL's gross non-performing-loan ("NPL") ratio ameliorated to 10.47% as at end-FY Dec 2009, from 12.46% a year earlier; the ratio had eased further to 10.16% by end-March 2010. The improvement had been primarily driven by recoveries and loan write-offs.

Despite the write-offs, the Company's performance had stayed relatively unchanged during the reviewed period - supported by non-recurring capital gains (LKR 46.73 million) on the disposal of an investment property and also gains from its equity portfolio. Under the circumstances, MBSL's net profit came up to LKR 200.98 million in FYE 31 December 2009 ("FY Dec 2009") (FY Dec 2008: LKR 205.08 million).

Meanwhile, the Company's shareholders' funds still dominate its funding structure, accounting for 46.03% of total funding following its rights issue in FY Dec 2009. Concurrently, MBSL has substituted short-term borrowings for long-term debts, to benefit from the environment of receding interest rates. However, the envisaged improvement has not materialised due to its heftier borrowings. Going forward, we are concerned about the funding commitments that MBSL may have with regard to its recently acquired subsidiaries. In addition to the LKR 1.43 billion shortfall vis-à-vis meeting the minimum capital requirement for MBSL Savings by December 2012 and the LKR 62.46 million needed by MBSL Insurance, the Company may also have to infuse additional capital to sustain its newly acquired subsidiaries.

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That said, we note that MBSL's gearing ratio of 1.18 times as at end-FY Dec 2009 is well below the regulatory cap of 7 times, thus allowing much room for further leverage. Meanwhile, we opine that the Company is adequately capitalised, with LKR 2.33 billion of shareholders' funds as at the same date.

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