

Lanka Rating Agency assigns BBB₃/L3 ratings to LB Finance Limited

LRA has assigned a long-term financial institution rating of BBB₃ (with a stable outlook) and a short-term rating of L3 to LB Finance Ltd (“LB Finance” or “the Company”). The ratings are premised on the Company's franchise as well as the apparent track record – although short - of the new management, particularly in relation to LB Finance's improving asset quality and performance (albeit still weaker relative to the industry), moderate capitalisation level and adequate funding as well as liquidity positions.

LB Finance, one of the better-known entities among Sri Lanka's registered finance companies, held 4.83% of the industry's assets as at end-December 2005; it is the third-largest deposit-taker in the industry. Presently, the Company is controlled by Mr KDD Perera, who acquired a 73.47%-stake from Vanik Inc Ltd (“Vanik”) in 2003, amid the latter's financial crisis. Subsequent to Mr Perera's acquisition, the Company has undergone a significant restructuring exercise; LB Finance's current senior management team is now composed of vastly experienced industry personalities. LRA has a favourable view of the change in management, which has led to the evident improvements in the Company's performance.

Plagued by weak asset quality, the Company's gross non-performing-loan (“NPL”) ratio (on a 6-month basis) stood at 15.02% as at the end of FYE 31 March 2005 (“FY Mar 2005”) - significantly weaker than the industry's 8.14%. In absolute terms, its NPLs deteriorated from Rs 446.66 million as at end of FY December 2003 (“FY Dec 2003”) to Rs 460.71 million as at end-FY Mar 2005¹, while its net NPL ratio came up to 3.79%. Given the Company's improved underwriting standards, LRA anticipates its gross NPL ratio to taper down to a single digit in the medium term, albeit still marginally higher than the industry. Nevertheless, we caution that any further deterioration in LB Finance's asset quality would exert downward pressure on its ratings.

Meanwhile, LB Finance's return on assets (“ROA”) improved from a mere 0.22% as at end-FY Dec 2003 to 2.30% as at end-March 2005, supported by broader margins and stronger gross income. However, LRA notes that the Company's performance has been lagging behind that of the industry, the ROA of which moved to 3.04% as at end-FY Mar 2005.

In the last 5 years, LB Finance has successfully maintained its liquidity level above the minimum requirement of 15%. The Company's bank borrowings constituted 15.83% of its total interest-bearing funds as at end-Dec 2005. Factoring in the Rs 375 million that the management intends to raise, this ratio would climb up to 23.29%, which is believed to be still manageable for LB Finance.

Elsewhere, the Company's core capital ratio stood at 9.16% while its risk-weighted capital adequacy ratio came up to 11.16% as at end-December 2005. Given its improved internal capital generation, we expect LB Finance's capitalisation level to be moderate.

To read the full report, please log on to LRA's website at <http://www.lankarating.com>

¹ After being acquired by the present shareholder, the company changed its financial year-end from December to March from 2005.

LRA's long-term rating of BBB₃ denotes financial institutions that are adjudged to offer a moderate degree of safety for timely payments of financial obligations. This level of rating indicates entities which have been significantly under-performing in some areas, however, are considered to have the capability to overcome such problems in the short term, though adverse changes in economic conditions could impair their ability to make timely payments of financial obligations. The subscript 2 indicates that the financial institution ranks at the mid point of its generic rating category. The Short term rating of L3 denotes adequate capacities for timely payments of obligations. The ability to honour the obligations is more vulnerable to adverse changes in business, economic or financial conditions

LRA is a domestic credit rating agency licensed by the Securities and Exchange Commission of Sri Lanka. LRA is a 100%-owned subsidiary of Rating Agency Malaysia Berhad ("RAM"), Malaysia's premier rating agency. RAM is also an affiliate of Standard & Poor's, the world's largest rating agency.

LRA is backed by a 40-strong team of analysts at RAM, which has rated almost all the financial institutions in Malaysia and more than 1,000 debt issues by corporates, statutory organisations and subsidiaries of foreign multinationals. These issuers are involved in the leading sectors of the Malaysian economy, which share some similarities with the potential growth sectors in Sri Lanka. In particular, LRA can leverage on RAM's fortes in the ratings of financial institutions, asset-backed securities and Islamic debt securities.

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