



Media Release

RAM Ratings reaffirms AA-/P1 ratings of Merchant Bank of Sri Lanka

RAM Ratings has reaffirmed Merchant Bank of Sri Lanka's ("MBSL" or "the Bank") long- and short-term financial institution ratings at AA- and P1, respectively; the long-term rating has a stable outlook. The ratings are supported by the credit strength and financial flexibility which stem from its parent – the state-owned Bank of Ceylon ("BOC"), the largest commercial bank in Sri Lanka. At the same time, both its LKR300 million Unlisted Private Debentures and LKR14.60 million Unlisted Public Debentures have also been reaffirmed at AA-, with stable outlooks.

MBSL is a 76%-owned subsidiary of BOC, the largest commercial bank in terms total assets. BOC is a sovereign-owned entity that has consistently demonstrated its commitment to MBSL via long- and short-term loans. Although the Bank had intended to raise LKR600 million through 2 debenture issues, it had only managed to raise half that amount due to a lack of investor interest as a result of treasury yields rising above the rate offered by MBSL. Hence in recent times, MBSL has been increasingly relying on short-term loans, underscoring the inherent funding risks in its business model. Short-term debts constituted 30.65% of the Bank's total interest-bearing funds as at the end of FYE 31 December 2007 ("FY Dec 2007") (FY Dec 2006: 20.85%). Nonetheless, the Bank had been able to secure other financing lines on top of the temporary overdraft facility provided by its parent. Moving forward, the Bank intends to apply for a specialised banking license in order to alleviate its funding risk.

The current high interest environment, coupled with MBSL's funding mix, has pushed up its interest costs. As a result, net interest income for FY Dec 2007 only nudged up 3.36% year-on-year ("y-o-y"). Even though MBSL had managed its overheads well, the Bank's cost-to-income ratio still increased marginally as result of provisioning vis-à-vis its portfolio of trading equities.

Meanwhile, the Bank's improving - albeit still weak - asset quality resulted in slightly lower provisions. MBSL's pre-tax profit was lifted 1.52% y-o-y to LKR273.36 million in FY Dec 2007. This translated into a respectable return on assets ("ROA") of 6.68% for the same period, although lower than its record of 7.56% a year earlier. A factor that enables MBSL to keep its ROA at an adequate level is its strong capitalisation. The Bank's shareholders' funds amounted to LKR1.56 billion as at end-FY Dec 2007, resulting in a gearing ratio of 1.59 times, which is deemed conservative.

RAM Ratings is a credit rating agency which is a 100%-owned subsidiary of Malaysia's premier rating agency RAM Holdings Berhad which is an affiliate of Standard & Poor's, the world's largest rating agency.

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