



LRA reaffirms BBB₃/L3 ratings to LB Finance Limited

LRA has reaffirmed the long-term financial institution rating of LB Finance Ltd (“LB” or “the Company”) at BBB₃, with a stable outlook; the short-term rating has also been reaffirmed, at L3. The ratings are premised upon the Company’s improving financial performance and adequate asset quality; however these are partially offset by its weakening funding structure and inadequate capital cushioning.

Underscored by robust loan growth and a large non-performing loans (“NPLs”) (6-months classification basis) write-off, LB recorded a significant improvement in its asset quality as at end-December 2006 (“Dec 2006”). Accordingly, the gross NPL ratio ameliorated from 12.82% (FYE Mar 2006) to an adequate 5.18%. Regardless, LRA deems LB’s asset quality to be moderate premised upon its unseasoned new-portfolio. Moving forward, it is vital that LB maintains its gross NPL ratio on par with the industry to sustain its current ratings.

In line with LRA’s expectations, LB delivered a sterling performance in FY Mar 2006. Pre-tax profit stood at Rs 203.65 million, approximately 240% higher than the previous year. This sturdy performance carried through to the following year, with a robust pre-tax profit of Rs 233.17 million for the first 9 months, which surpassed the full-year’s performance of FY Mar 2006. Annualised return on assets (“ROA”) and return on equity (“ROE”) stood at 5.72% and 71.53%, respectively, as at Dec 2006.

The Company’s aggressive loan growth has been achieved at the expense of higher funding and liquidity risks vis-à-vis its funding structure. Bank borrowings have increased, leading to deterioration in its loan-to-deposit ratio, which stood at 121% as at Dec 2006. LRA has concerns regarding the present funding strategy as secured bank borrowings not only rank above the Company’s depositors, but also introduce funding-concentration risk.

Elsewhere, overall risk-weighted capital-adequacy ratio (“RWCAR”) stood at 11.14% as at Dec 2006, slightly above the statutory minimum 10%. With a weak ‘net NPL to shareholders funds’ ratio of 43.47%, the Company’s capital buffer is considered inadequate.

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

Analyst:
Prakash Jerome
(9411) 2553089
prakash@lankarating.com