

Lanka Rating Agency assigns BBB₂/L2 ratings to Alliance Finance Company Limited

LRA has assigned a long-term financial institution rating of BBB₂ (pronounced triple B two), with a stable outlook and a short-term rating of L2 to Alliance Finance Co Ltd (“the Company” or “AFC”). The ratings are based on the Company’s healthy asset quality, improving performance and comfortable capitalisation level, moderated by its trading activities.

Incorporated in 1956, AFC is the third-oldest finance company in Sri Lanka, and is one of the 5 finance companies listed on the Colombo Stock Exchange. In addition to providing traditional financing products, the Company also participates in collaboration financing, share trading, as well as the import and trading of selected consumer goods.

Over the past few years, the Company has maintained the healthy growth of its gross loans and advances, albeit marginally below the industry average. However, the robust growth of its loan portfolio has out-paced that of its deposit base. As a result, AFC has turned to bank loans to finance its expanding lending activities, which has deteriorated its loan-to-deposit ratio, from 80.64% as at the end of FYE 31 March 2005 (“FY Mar 2005”) to 107.54% as at end-September 2005. Although secured bank borrowings offer better maturity structures, continued utilisation of the same may subordinate depositors, thus posing a concern. Under the circumstances, LRA will continue to closely monitor the Company’s borrowings.

Elsewhere, AFC’s asset quality has shown substantial improvement over the years, as the Company focuses on improving collections and recovery efforts. This, coupled with prudent provisioning and aggressive write-offs had reduced the Company’s gross non-performing-loan (“NPL”) ratio from 21.50% as at end-FY Mar 2002 to 5.91% as at end-1H FY Mar 2006. Due to its prudent policies, AFC’s asset quality is expected to remain healthy in the immediate term.

There has been a steady increase in AFC’s pre-tax profits over the past 5 years, from a modest Rs 12.68 million in FY Mar 2002 to a high of Rs 60.28 million in FY Mar 2005. The Company’s return on assets (“ROA”) had also ameliorated from 1.07% to 2.85% over the same period. While we have a favourable view of this improvement, we also note that the Company’s performance has been consistently below the industry average.

Overall, AFC’s capital cushioning has remained above the statutory minimum of 10%. As at end-1H FY Mar 2006, its risk-weighted capital adequacy ratio (“RWCAR”) stood at 10.08%, slightly lower than the 10.40% as at end-FY Mar 2005. Given the Company’s short-term plans and healthy internal capital generation, we believe it to be adequately capitalised for the immediate term.

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

LRA’s long-term rating of BBB₂ 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 L2 denotes strong capacity for timely payments of obligations.

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 some 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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