Press Release
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Lanka Rating Agency assigns A_2/L1 ratings to Mercantile Investments Limited

LRA has assigned a long-term financial institution rating of $A_{2,}$ (pronounced A two) with a stable outlook, and a short-term rating of L1 to Mercantile Investments Limited (“the Company” or “MIL”). The ratings are premised on the Company’s superior performance, sturdy capitalisation, comfortable funding position, sufficient liquidity and moderate asset quality. The ratings also consider the Company’s franchise as a leading finance company in Sri Lanka.

Established in 1964 as a financier of motor vehicles, MIL has steadily grown to become the third-largest registered finance company (“RFC”) in the country, possessing 6.45% of the industry’s assets with an asset base of Rs 5.64 billion as at end-December 2005. Over the years, MIL has built a solid franchise as a reputable vehicle financier/importer. As an RFC, MIL comes under the purview of the Central Bank of Sri Lanka. The Company’s main sphere of activities encompasses leasing and hire-purchase activities as well as accepting public deposits. Other ancillary business lines include commission income and short-term advances.

MIL’s performance in terms of return on assets (“ROA”) has remained far superior to that of the industry and its peers. The ROA of MIL for FYE 31 March 2005 (“FY March 2005”) came in at 7.71%, whereas the industry’s ROA stood at only 3.02%. Although the Company’s ROA weakened slightly to 6.02% as at end-December 2005, it remained well above the industry’s due to its low leverage. Meanwhile, MIL chalked up a return on equity (“ROE”) of 20.63% as at end-FY March 2005, followed by 16.30% as at end-December 2005.

The Company’s Tier-I capital adequacy ratio stood at a sturdy 26.61% while its risk-weighted capital adequacy ratio came up to 38.23% as at end-December 2005; these were well above the statutory minimums of 5% and 10%, respectively. This level of capitalisation provides the Company with an immense capacity to absorb bad loans and to support its loan growth. With Rs 1.41 billion of shareholders’ funds, the Company is already in compliance with the Central Bank’s minimum capital requirement of Rs 200 million.

Elsewhere, MIL’s asset-quality indicators have largely followed industry trends since FY March 2003, albeit marginally weaker. Its gross non-performing-loan (“NPL”) ratio improved to 8.75% as at end-FY March 2005 from 10.67% a year earlier. LRA notes that the industry average had also improved from 9.08% to 8.14% over the same period. Although its gross NPL ratios are slightly weaker than the industry’s, MIL has maintained better net NPL ratios due to its higher levels of provisioning.

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

LRA’s long-term rating of A_2 denotes adequate safety for timely payments of financial obligations. This level of rating indicates entities with adequate credit profiles, but which possess one or more problem areas, giving rise to the possibility of future riskiness. Entities rated in this category have generally performed at par with the industry average and are considered to be more vulnerable to changes in economic conditions than those rated in the higher categories. The short-term rating of L1, meanwhile, denotes superior 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 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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