



Lanka Rating Agency assigns AA₃/L1 ratings to Merchant Bank of Sri Lanka

LRA has assigned a long-term financial institution rating of AA₃ (with a stable outlook) and a short-term rating of L1 to Merchant Bank of Sri Lanka ("MBSL" or "the Bank"). The ratings are primarily based upon the credit strength and financial flexibility of MBSL, which stems from its parent – the state-owned Bank of Ceylon ("BOC"), i.e. the largest commercial bank in Sri Lanka.

The ratings are also supported by the Bank's strong capitalisation, improving performance, recovering liquidity levels and healthier asset quality. Furthermore, the ratings are underscored by MBSL's expansion plans for the medium term and their resultant longer-term benefits.

The sharp downturn of the stock market during 1995 - 2001 had rendered MBSL's trading portfolio, which had constituted almost 50% of its total assets, relatively illiquid. Since these investments had been funded by debt assumed during an environment of lofty interest rates, the cost of holding had been pushed beyond the recoverable values, therefore severely eroding its bottom line and liquidity. MBSL consequently restructured its capital base in FYE 31 December 2004 ("FY Dec 2004") to absorb its loss of Rs 1.45 billion, which had been accumulated over the 1995 - 2001 period. As at end-FY Dec 2005, the Bank's shareholders' funds stood at Rs 1.32 billion, making up 40.54% of its total assets. MBSL's liquidity position had also improved significantly during the year whilst its gearing ratio had been maintained at 1.25 times its shareholders' funds.

Elsewhere, the Bank reported a 10-year high for its pre-tax profit in FY Dec 2005, which clocked in at Rs 187.33 million. Aided by its healthier net interest margin and commendable cost-to-income ratio, which remained below 50%, the Bank's return on assets surfed up to 5.74% as at end-FY Dec 2005.

On another note, the Bank's portfolio quality, as indicated by its gross non-performing-loan ("NPL") ratio - which had deteriorated between FY Dec 1995 and FY Dec 2002 - took a turn for the better to 16.58% (or Rs 485.25 million) as at end-FY Dec 2005, in contrast to 36.71% (Rs 884.23 million) as at end-FY Dec 2002. The earlier deterioration in asset quality can be attributable to the Bank's aggressive lending and weak monitoring, whilst the improvement had been achieved through better recoveries, aided by more write-offs as well as an expanding loan base. Although there has been progress in MBSL's gross NPL ratio, the present level is still considered high.

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

LRA's long-term rating of AA₃ denotes high safety for timely payments of financial obligations. This level of rating indicates entities with sound credit profiles and without significant problems. Entities rated in this category are, however, considered to be somewhat more vulnerable to adverse changes in economic conditions than those entities rated in the highest category. 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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