

## ICRA Lanka Assigns [SL]A With Stable outlook to Merchant Bank of Sri Lanka and Finance PLC (MBSL)

May 16, 2016

Instrument	Amount	Rating Action
Issuer Rating	N/A	[SL]A (Stable);assigned
Proposed Subordinated Unsecured Redeemable Debenture	LKR 2,000 Mn	[SL]A-(Stable);assigned
Senior Unsecured Redeemable Debentures issued on March 28, 2013	LKR 268 Mn	[SL]A (Stable);assigned
Senior Unsecured Redeemable Debentures issued on March 28, 2013	LKR 2,000 Mn	[SL]A (Stable);assigned
Senior Unsecured Redeemable Debentures issued on December 17, 2013	LKR 1,000 Mn	[SL]A (Stable);assigned
Senior Unsecured Redeemable Debentures issued on November 13, 2014	LKR 2,000 Mn	[SL]A (Stable);assigned

ICRA Lanka Limited, Subsidiary of ICRA Limited, Group company of Moody's Investors Service, has assigned the issuer rating of [SL]A (pronounced SL A) with stable outlook to Merchant Bank of Sri Lanka and Finance PLC (MBSL or the Company). ICRA Lanka has also assigned the [SL]A- (pronounced SL A minus) with stable outlook to the proposed LKR 2,000 Mn Subordinated Unsecured Redeemable Debentures to be listed on the Colombo Stock Exchange. ICRA Lanka has also assigned the [SL]A (pronounced SL A) with stable outlook to the LKR 268 Mn Senior Unsecured Redeemable Debentures issued on November 16, 2011, LKR 2,000 Mn Senior Unsecured Redeemable Debentures issued on March 28, 2015, LKR 1,000 Mn Senior Unsecured Redeemable Debentures issued on December 17, 2013 and LKR 2,000 Mn Senior Unsecured Redeemable Debentures issued on November 13, 2014.

The rating is upheld by MBSL's 80.98% shareholding by Bank of Ceylon (BOC; rated [SL]AAA (Stable) by ICRA Lanka); the company is expected to derive operational, managerial and financial support from the strong parent, BOC. ICRA Lanka takes note of the company's currently weak but improving asset quality and solvency indicators (gross NPA at 12.6% and net NPA/ net worth at 61.1% as in Mar-16), moderate capital profile (Tier-I at 11.6% in Mar-16) and subdued profitability indicators (return on average assets, RoA<sup>1</sup> at 0.52% for QE<sup>2</sup> Mar-2016). The company's performance has been impacted in the recent past, following the merger of its erstwhile group entity, MCSL Financial Services Limited (MCSL) and its erstwhile subsidiary MBSL Savings Bank Limited (MSB) into MBSL; the above accentuated asset quality pressures and weakened its profitability profile.

MBSL is taking initiatives to improve its credit policies and augment its internal controls and monitoring processes. The company was also faced with teething issues following the merger process, which impacted incremental business during the first 6-8 months of FYE<sup>3</sup> Dec-2015; however the business processes are currently being streamlined; MBSL with its access to BOC's managerial and operational expertise in retail lending activities is expected to witness improvement in the business indicators going forward. ICRA Lanka takes cognisance of regular capital requirement by MBSL for business expansion and, for improving its solvency profile, while maintaining a conservative capital structure. ICRA Lanka

<sup>1</sup> RoA-Return on Average Assets (Consolidated MBSL,MSB and MCSL)

<sup>2</sup> QE- Quarter Ended

<sup>3</sup> FYE- Financial Year Ended

however takes comfort from MBSL's strong parentage and demonstrated equity support in the past (MBSL standalone received an equity infusion of approximately LKR 347 million from BOC in FYE Dec 2009).

MBSL's portfolio<sup>4</sup> increased from LKR 22.07 billion in Dec-14 to LKR 23.22 billion in Dec-15. As at Mar-16, the portfolio stood at LKR 25.66 billion. The combined MBSL credit portfolio was dominated by Leasing and Hire Purchase facilities which accounted for 62% of the portfolio, while term loans accounted for 35%. Leasing product has been the key growth contributor of the portfolio. As of Jun-15, Property loan (37%), lorry 18% and Car 17% were the key asset classes in which the company had exposures.

Meanwhile, the asset quality of the combined entities (MBSL, MCSL and MSB) deteriorated during FYE Dec 2014 where the Gross Non-Performing Assets (GNPA) stood at 14.3% in Dec-14 (9.2% in Dec-13). GNPA's increased further to 15.2% in Sep-15, accentuated to an extent by slower portfolio growth. The company's NPA coverage  $[(\text{gross NPA} - \text{net NPA}) / \text{gross NPA}]$  stood at 42.48% as in Sep-15, resulting in a stretched solvency profile. During the QEMar-16, asset quality of the company improved as GNPA moderated to 12.6% and NPA coverage stood at 43.6% in Mar-16.

Post the merger and conversion to a licensed finance company, MBSL has steadily increased funding from public deposits, which accounted for 71% of its total borrowings as at Mar-16 vis a vis dependence on other borrowings in the past. The company is expected to increase the share of public deposits going forward, on the back of its strong and established franchise. The overall Capital Adequacy Ratio (CAR) of the company is moderately above the regulatory minimum and stood at 11.7% as at Mar-16 vis-à-vis 13.9% in Mar-15. The gearing stood at 8.4 times as in March 2016 as compared to 8.2 times in Dec 2015 (5.3 times in Dec -14).

The company's overall earnings profile is characterized by moderation in the NIMs to about 6.3% for the QE Mar-16 (FYE Dec 2015 - 7.03%, FYE Dec 2014 - 6.18%) notwithstanding the moderation in the cost of funds, as the gearing increased. MBSL's profitability was constrained as it was faced with higher operational costs post the merger process. Overall profitability was also affected by an increase in credit costs from 1.23% in FYE Dec 2014 to 1.83% in FYE Dec 2015; during the QE Mar-16 credit cost moderated to 0.53%. Going forward, ability to rationalise the operating costs by way of optimal business growth and, its ability to control credit cost would be critical for the improvement in the profitability indicators.

## **Company Profile**

MBSL was established in 1982 as a merchant bank. The Company had two subsidiaries, MBSL Savings Bank Ltd (MSB, Licensed Specialised Bank) and MBSL Insurance Company (Composite Insurer) and two associate companies, Lanka Securities (Pvt) Ltd (registered stockbroker) and MCSL Financial Services Ltd (a licensed finance company). Pursuant to the Master Plan on Consolidation of the Financial Sector proposed by the Central Bank of Sri Lanka (CBSL), in January 2015, MBSL Savings Bank Limited (MSB) and MCSL Financial Services Limited (MCSL) was merged with MBSL.

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<sup>4</sup> Credit Assets for FY 2014 included the combined figures of MBSL,MSB and MCSL

### **Recent Results**

For the QE Mar-16, MBSL reported a PAT of LKR 37.3 million (FYE Dec 2015: loss of LKR 91.2 million) with a total asset base of LKR 28,971 million (FYE Dec 2015: LKR 28,256 million). The company operated with a net worth of LKR 2,990.83 million and a gearing of 8.39 in Mar-2016.

MBSL group reported a PAT of LKR 17.1 million for the QE Mar-16 (FYE Dec 2015: loss of LKR 19.58 million) with a total asset base of LKR 30,636 million (FYE Dec 2015: LKR 29,882 million). The group operated with a net worth of LKR 2,957 million and a gearing of 8.49 in Mar-16.

*May 2016*

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