

Update on Asset Backed Trust Certificate Programme of Merchant Bank of Sri Lanka & Finance PLC Trust - 01

July 19, 2018

Instrument	Rated Amount (LKR Mn)	Rating Action
Asset Backed Trust Certificate Programme of MBSL Trust- 01	LKR 1,463 Mn (Reduced from LKR 2,000 Mn)	[SL]A+(SO) rating outstanding; Outlook revised to Negative from Stable

Rating action

ICRA Lanka Limited, Subsidiary of ICRA Limited, group company of Moody's Investors Service, has an A+(SO) rating outstanding on the LKR1,463 Mn (reduced from LKR 2,000 Mn) Trust certificates of Merchant Bank of Sri Lanka & Finance PLC Trust-01 (MBSL Trust -01). The outlook on the rating is revised to negative from stable. Please refer to our detailed rationale dated July 19, 2018, provided for Merchant bank of Sri Lanka & Finance PLC ("MBSL" / "Company").

Rationale

The revision in the outlook follows the change in the outlook of the issuer and debt ratings of MBSL to negative. The rating for the Trust Certificates is based on the strength of senior secured debt with an exclusive charge over receivables and a receivable cover of 130%. For the purpose of calculating this receivable cover, contracts which are current or in arrears for less than two months are to be considered. ICRA Lanka observed non-compliance of certain terms of the transaction structure; however, the instrument has been serviced as per terms. ICRA Lanka has received an undertaking from the company to comply with the terms going forward. ICRA Lanka will continue to monitor the status of compliance with the terms of the structured obligation.

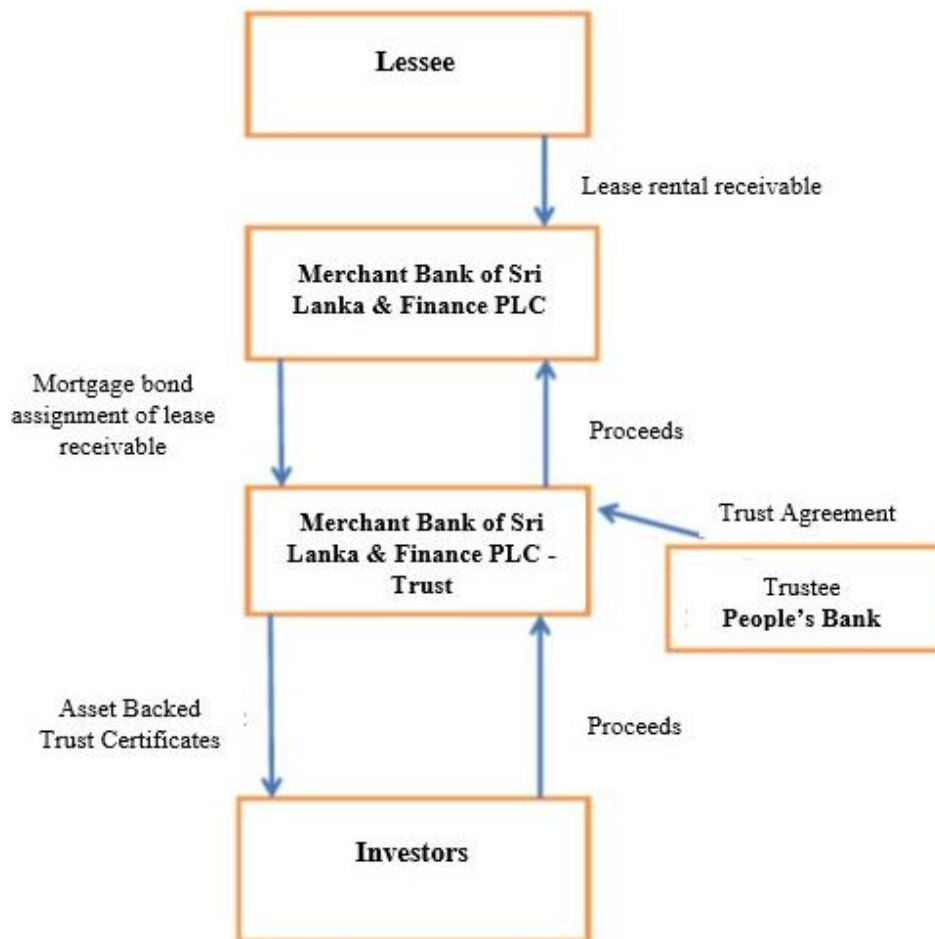
Outlook: Negative

The negative outlook on MBSL reflects the expected moderation in MBSL's financial risk profile characterized by a weakening in its capital and earnings profile. The outlook may be revised to 'stable' in case of steady improvement in MBSL's capital profile, asset quality and earnings profile. The rating may be downgraded in case of the further deterioration in the financial risk profile of the company.

Structure of the transaction

The rating for the Trust Certificates is based on the strength of senior secured debt with an exclusive charge over receivables and a receivable cover of 130%. MBSL has created a Trust by executing a Trust Deed and Peoples Bank is the Trustee. MBSL executed a Mortgage Bond in favor of the Trust thereby creating the charge in favor of the Trust over a pool of identified Finance Lease Agreements' receivables that it has originated. The certificates issued by the Trust have a predetermined interest rate and principal repayment schedule. Principal and Interest repayment on the Trust Certificates has been designed in a manner whereby aggregate receivables during the month from underlying contracts will be 130% or more over repayment on the certificates. Entire receivables collected by MBSL from underlying contracts will be deposited in an escrow account, two days prior to the repayment dates. In the event of a shortfall in any month, MBSL will deposit the requisite amount in escrow upon a demand being made by the Trustee. In

case of any event of default, Trustee can enforce the charge over the underlying contracts and sell the vehicles to recover due amounts including capital plus any accrued interest.



Issue Details:

The key issue details are summarised in the table below.

Nature of Instrument	Trust Certificates issued by Merchant Bank of Sri Lanka & Finance Plc - Trust 01
Company/ Originator	Merchant Bank of Sri Lanka & Finance Plc
Issuer	Merchant Bank of Sri Lanka & Finance Plc - Trust 01 will issue LKR 2,000 Mn Trust Certificates
Trustee	Peoples Bank
Tenor	3 years
Repayment:	Monthly
Interest	To be paid monthly at a predetermined rate

Receivables	Company would create charge in favour of the Trust over a pool of identified Finance Lease Agreements' receivables (to the extent of 130% of the issue size) that it has originated.
Structure	<ul style="list-style-type: none"> Trust Certificates issued by the Trust will have a predetermined interest rate and principal repayment schedule. All collections in respect of the collateral pool shall be deposited by the Company in the Trust account minimum two days prior to any payment date. In the event of a shortfall, the Company shall deposit the requisite amount in the Trust Account upon a demand being made by the Trustee. Top-up of collateral shall be done on a monthly basis. Top up would be carried out in such a manner that the amount due to be received from the obligors in the collateral pool (excluding dues in respect of contracts overdue by more than 60 days) is minimum 130% over the amount due to be paid to the certificate investors on any scheduled payout date.
Refund of excess funds	Amounts received by the Trustee, which are in excess of the amount necessary to settle the Investors in any given month will be refunded to the Company on the working day immediately after the date on which such settlement is made
Compliance:	Issuer shall ensure that all the terms & conditions of the transaction structure, as stated herein are complied with and report the same to ICRA Lanka.

Analytical approach: For arriving at the ratings, ICRA Lanka has notched the rating higher than the issuer rating; the notching is based on the structure of the instrument. Methodology used for arriving at the issuer rating is indicated below.

Links to applicable criteria: [ICRA Lanka's Credit Rating Methodology for Non-Banking Financial Institutions](#)

About the company:

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. MBSL offers leasing & HP, long and short-term loans, microfinance and gold loans to its clients. The company has 49 branches and employs more than 900 staff members.

MBSL Insurance Company Limited (MBSI) is 84% owned subsidiary of MBSL. The company offers life and general insurance products to its customers. MBSI has close to 50 branches and window offices covering Sri Lanka.

For the CY2017, MBSL reported a PAT of LKR 101 Mn (CY2016: LKR 79 Mn) with a total asset base of LKR 35,645 Mn as at December 31, 2017 (LKR 31,926 Mn as at December 31, 2016). For the Q1CY2018, MBSL reported a loss of LKR 83 Mn with a total asset base of LKR 33,965 Mn. The company operated with a net worth of LKR 3,150 Mn and a gearing ratio of 9.41 times as at December 31, 2017.

MBSL group reported a PAT of LKR 103 Mn for the CY2017 (CY2016: LKR 74 Mn) with a total asset base of LKR 36,917 Mn as at December 31, 2017 (LKR 33,614 Mn as at December 31, 2016). For the Q1CY2018, MBSL reported a loss of LKR 123 Mn with a total asset base of LKR 35,355 Mn. The group operated with a net worth of LKR 3,134 Mn and a gearing ratio of 9.46 times as at March 31, 2018.

Key financial indicators

	CY2016	CY2017	Q1CY2018
Net Interest Income	2,028	2,448	603
Profit after Tax	79	101	(83)
Net worth	3,107	3,234	3,150
Loans and Advances (Gross)	27,052	28,754	28,858
Total Assets	31,926	35,645	33,961
Return on Equity	2.58%	3.18%	-10.42%
Return on Assets	0.26%	0.30%	-0.96%
Gross NPA	9.27%	10.10%	10.97%
Net NPA	5.87%	6.06%	6.02%
Capital Adequacy Ratio	10.69%	15.27%	15.70%
Gearing (times)	8.8	9.7	9.4

Rating history for last three years:

Chronology of Rating History for the past 3 years						
Instrument	Type	Amount Rated (LKR Mn)	Date & Rating FY2019 Jul 2018	Date & Rating in FY2018 Jul 2017	Date & Rating in FY2017 May 2016	Date & Rating in FY2016 -
Asset Backed Trust Certificates	Long Term	1,463	[SL]A+(SO) (Negative)	[SL]A+(SO) (Stable)	N/A	N/A

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