



Lanka Rating Agency

Rating Report

Merchant Bank of Sri Lanka & Finance PLC LKR 01bn Unsecured Subordinated Debenture (1)

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Rating History

Dissemination Date	Long Term Rating	Outlook	Action	Rating Watch
01-Aug-2024	BBB	Stable	Maintain	-
01-Feb-2023	BBB	Stable	Initial	-

Rating Rationale and Key Rating Drivers

The rating reflects the robust ownership of Merchant Bank of Sri Lanka & Finance PLC ("MBSL" or "the Company") and demonstrated track record of sponsors to provide support. The Bank of Ceylon (BOC) is the largest shareholder of the Company and has provided written affirmation to support MBSL. As a fully state-owned bank and one of the systematically important banks of Sri Lanka, BOC brings stability and financial strength. MBSL is a relatively small player in the leasing industry, accounting for (~2%) of the assets in CY23, and (~3)% of deposits of the sector. The Company's gross non-performing loans (3MCY24: ~21.7%) remain above the industry average, showing stressed advances portfolio as its borrowers comprise relatively high risk segment. The recent focus on recoveries and improving macroeconomic conditions are expected to have a positive impact and reduce NPLs. The Company improved its performance in CY23 and posted PAT of LKR ~21 mln (CY22: loss of ~496 mln) on the back of substantial gain on investments and better spread. However, sustaining these performance trends is critical, going forward. MBSL was non-complaint in regulatory Capital Adequacy Ratio ("CAR") requirement in CY22, resulting in certain restrictions on its activities by the regulator. The CAR has improved to ~16.75% in CY23 and those restrictions are now removed. MBSL intends to focus on gold loans and prudent lending in the short-term as the economic activities pick up in the country.

The debenture's rating is contingent upon continued capacity and willingness of BOC to provide support. Any substantial reduction in BOC's shareholding or other restrictions imposed on the bank that would result in diminishing support prospects, would negatively impact the debenture's rating. Meanwhile, sustenance of current performance trends, complying with regulatory capital requirements and improvement in asset quality is critical.

Disclosure

Name of Rated Entity	Merchant Bank of Sri Lanka & Finance PLC LKR 01bn Unsecured Subordinated Debenture (1)
Type of Relationship	Solicited
Purpose of the Rating	Debt Instrument Rating
Applicable Criteria	Methodology Debt Instrument Rating(Jun-22),Methodology Non-Banking Finance Companies Rating(Jun-22)
Related Research	Sector Study Leasing & Finance Companies(Aug-23)
Rating Analysts	Imran Iqbal imran@lra.com.lk +94 114 500099



Leasing & Finance Companies

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Issuer Profile

Profile Merchant Bank of Sri Lanka & Finance PLC ("MBSL" or "the Company") is a registered Finance Leasing Company under the provisions of the Finance Leasing Act No. 56 of 2000 and a Finance Company licensed by the Monetary Board of Central Bank of Sri Lanka under the Finance Business Act No. 42 of 2011. In 1980, the Company operated as a management consultancy division of the Bank of Ceylon ("BOC" or "the Bank"). In 1982, it was incorporated as a limited liability company. MBSL was listed on the Colombo Stock Exchange ("CSE") in 1991. The Company merged with two other companies in the BOC group in 2015. The principal business activities of the Company are leasing and hire purchase, corporate and retail credit, corporate advisory, capital market advisory, capital market activities, lending, deposit mobilization, and the provision of financial services.

Ownership The largest shareholder of the Company is Bank of Ceylon ("BOC") which is the country's top commercial Bank solely owned by the Government of Sri Lanka. It directly owns ~76.56% of the Company. BOC Property Development & Management (Pvt) Ltd owns ~7.94%, Bank of Ceylon A/C Ceybank Unit Trust owns ~2.25%. BOC as a group owns ~86.75% of MBSL.

Governance The board consists of eight non-executive directors, out of which five are non-independent directors and three are independent directors. All the non-independent directors of the Company represent BOC.

Management MBSL has an organizational structure which is headed by the Board of Directors. The Chief Executive Officer ("CEO") is the reporting line for 11 divisions. Compliance and risk departments report directly to the IRMC, while the internal audit department reports to the BAC. The corporate management has decades of experience in their respective fields. The CEO has over 31 years of experience in leasing and banking. He has gained experience in retail banking, consumer and lease financing, real estate, product development and risk management. The Company has formed 14 management committees, and these committees help the Company to run smoothly.

Business Risk At present, there are 34 LFCs in Sri Lanka, out of which, 28 are listed in the Colombo Stock Exchange. During the nine months ending December 2023, the profit after tax (PAT) of the LFCs sector increased by 89.2 percent to LKR ~34.8 billion, compared to LKR ~18.5 billion recorded in the corresponding period of the previous year. This substantial increase in profitability was primarily driven by interest income, coupled with reduced impairment charges for loan losses. However, reducing new impairment charges while stage 3 loans are increasing may not be sustainable.

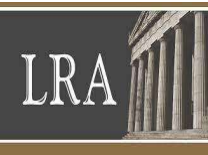
Financial Risk The company gross non-performing loans has increased over the period from 21% in CY22 to 24% in 3MCY24. This is a marginal increase of 13%.

Instrument Rating Considerations

About The Instrument Merchant Bank of Sri Lanka & Finance PLC ("MBSL" or "the Company") issued a LKR 1 billion listed, unsecured, subordinated, redeemable debenture each worth LKR 100/-. The debenture is not underwritten and the principal and the interest is not secured by any specific asset. The tenor of the debenture is 5 years. The debenture was allotted in September 2022. The issue was undersubscribed and managed to raise LKR ~67.7 million. Currently, the total subscription of the outstanding debentures amount to approximately LKR 691 million which includes a second five year debenture issued in April 2023, of approximately LKR 623 million. Type A and B offer a fixed rate of 24% and 23.5% paid annually and bi-annually respectively. Type C provides a quarterly payment with a floating rate of 364 days weighted average treasury bill rate + 300 basis points, with a cap of 29.5% per annum. The objective of the issue is to increase the medium-term fund base to match the medium to long-term lending portfolio and to enhance the total capital base.

Relative Seniority/Subordination Of Instrument The claims of the Debenture holders shall in the event of winding up of the Company rank after all the claims of the Secured and other Unsecured Creditors of the Company and any preferential claims under any Statutes governing the Company but in priority to and over the claims and rights of the Shareholders of the Company.

Credit Enhancement The Debenture I subscription closed at LKR ~67.7 million. The Debenture is not underwritten. The first payment commenced on February 15, 2023.



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Lkr mln

Merchant Bank of Sri Lanka & Finance PLC	Mar-24	Dec-23	Dec-22	Dec-21	Dec-20
Listed Public Limited	3M	12M	12M	12M	12M

A BALANCE SHEET

1 Total Finance-net	17,402	17,135	22,004	26,310	24,814
2 Investments	13,730	12,491	5,151	3,067	3,155
3 Other Earning Assets	294	1,027	637	1,267	890
4 Non-Earning Assets	1,156	1,127	1,020	1,759	1,574
5 Non-Performing Finances-net	2,221	1,920	2,419	1,875	1,974
Total Assets	34,804	33,699	31,232	34,277	32,406
6 Funding	29,568	28,785	26,520	28,766	29,731
7 Other Liabilities	1,522	1,243	1,017	1,342	1,208
Total Liabilities	31,090	30,028	27,536	30,109	30,938
Equity	3,714	3,671	3,696	4,169	1,468

B INCOME STATEMENT

1 Mark Up Earned	1,549	6,559	6,451	5,526	4,951
2 Mark Up Expensed	(1,103)	(4,919)	(4,696)	(2,676)	(3,533)
3 Non Mark Up Income	448	902	72	407	215
Total Income	895	2,543	1,828	3,257	1,633
4 Non-Mark Up Expenses	(622)	(2,302)	(2,259)	(2,059)	(1,955)
5 Provisions/Write offs/Reversals	(48)	120	(97)	(90)	(1,021)
Pre-Tax Profit	225	361	(529)	1,107	(1,343)
6 Taxes	(181)	(340)	33	(578)	235
Profit After Tax	43	21	(496)	529	(1,108)

C RATIO ANALYSIS

1 PERFORMANCE

a Non-Mark Up Expenses / Total Income	69.5%	90.5%	123.6%	63.2%	119.7%
b ROE	4.7%	0.6%	-12.6%	12.7%	-75.5%

2 CREDIT RISK

a Gross Finances (Total Finance-net + Non-Performing Advances + Non-Performing Debt Instruments) / Funding	75.2%	75.4%	102.4%	110.1%	101.6%
b Accumulated Provisions / Non-Performing Advances	54.0%	58.1%	53.1%	65.0%	63.4%

3 FUNDING & LIQUIDITY

a Liquid Assets / Funding	46.7%	45.9%	20.6%	13.1%	11.0%
b Borrowings from Banks and Other Financial Instituities / Funding	11.1%	11.6%	11.3%	22.6%	26.9%

4 MARKET RISK

a Investments / Equity	369.7%	340.3%	139.4%	73.6%	215.0%
b (Equity Investments + Related Party) / Equity	22.4%	21.9%	17.4%	17.2%	49.0%

5 CAPITALIZATION

a Equity / Total Assets (D+E+F)	10.7%	10.9%	11.8%	12.2%	4.5%
b Capital formation rate (Profit After Tax - Cash Dividend) / Equity	4.7%	0.6%	-11.9%	12.7%	-75.5%

Credit Rating

Credit rating reflects forward-looking opinion on credit worthiness of underlying entity or instrument; more specifically it covers relative ability to honor financial obligations. The primary factor being captured on the rating scale is relative likelihood of default.

Scale	Long-term Rating Definition
AAA	Highest credit quality. Lowest expectation of credit risk. Indicate exceptionally strong capacity for timely payment of financial commitments
AA+	
AA	Very high credit quality. Very low expectation of credit risk. Indicate very strong capacity for timely payment of financial commitments. This capacity is not significantly vulnerable to foreseeable events.
AA-	
A+	
A	High credit quality. Low expectation of credit risk. The capacity for timely payment of financial commitments is considered strong. This capacity may, nevertheless, be vulnerable to changes in circumstances or in economic conditions.
A-	
BBB+	
BBB	Good credit quality. Currently a low expectation of credit risk. The capacity for timely payment of financial commitments is considered adequate, but adverse changes in circumstances and in economic conditions are more likely to impair this capacity.
BBB-	
BB+	Moderate risk. Possibility of credit risk developing. There is a possibility of credit risk developing, particularly as a result of adverse economic or business changes over time; however, business or financial alternatives may be available to allow financial commitments to be met.
BB	
BB-	
B+	
B	High credit risk. A limited margin of safety remains against credit risk. Financial commitments are currently being met; however, capacity for continued payment is contingent upon a sustained, favorable business and economic environment.
B-	
CCC	Very high credit risk. Substantial credit risk “CCC” Default is a real possibility. Capacity for meeting financial commitments is solely reliant upon sustained, favorable business or economic developments. “CC” Rating indicates that default of some kind appears probable. “C” Ratings signal imminent default.
CC	
C	
D	Obligations are currently in default.

Scale	Short-term Rating Definition
A1+	The highest capacity for timely repayment.
A1	A strong capacity for timely repayment.
A2	A satisfactory capacity for timely repayment. This may be susceptible to adverse changes in business, economic, or financial conditions.
A3	An adequate capacity for timely repayment. Such capacity is susceptible to adverse changes in business, economic, or financial conditions.
A4	The capacity for timely repayment is more susceptible to adverse changes in business, economic, or financial conditions. Liquidity may not be sufficient.



**The correlation shown is indicative and, in certain cases, may not hold.*

Outlook (Stable, Positive, Negative, Developing) Indicates the potential and direction of a rating over the intermediate term in response to trends in economic and/or fundamental business/financial conditions. It is not necessarily a precursor to a rating change. ‘Stable’ outlook means a rating is not likely to change. ‘Positive’ means it may be raised. ‘Negative’ means it may be lowered. Where the trends have conflicting elements, the outlook may be described as ‘Developing’.

Rating Watch Alerts to the possibility of a rating change subsequent to, or, in anticipation of some material identifiable event with indeterminable rating implications. But it does not mean that a rating change is inevitable. A watch should be resolved within foreseeable future, but may continue if underlying circumstances are not settled. Rating watch may accompany rating outlook of the respective opinion.

Suspension It is not possible to update an opinion due to lack of requisite information. Opinion should be resumed in foreseeable future. However, if this does not happen within six (6) months, the rating should be considered withdrawn.

Withdrawn A rating is withdrawn on a) termination of rating mandate, b) the debt instrument is redeemed, c) the rating remains suspended for six months, d) the entity/issuer defaults, or/and e) PACRA finds it impractical to surveil the opinion due to lack of requisite information.

Harmonization A change in rating due to revision in applicable methodology or underlying scale.

Surveillance. Surveillance on a publicly disseminated rating opinion is carried out on an ongoing basis till it is formally suspended or withdrawn. A comprehensive surveillance of rating opinion is carried out at least once every six months. However, a rating opinion may be reviewed in the intervening period if it is necessitated by any material happening.

Note. This scale is applicable to the following methodology(s):

- a) Broker Entity Rating
- b) Corporate Rating
- c) Debt Instrument Rating
- d) Financial Institution Rating
- e) Holding Company Rating
- f) Independent Power Producer Rating
- g) Microfinance Institution Rating
- h) Non-Banking Finance Companies Rating

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Regulatory and Supplementary Disclosure

Nature of Instrument	Size of Issue (LKR)	Tenor	Security	Quantum of Security	Nature of Assets	Trustee	Book Value of Assets as at 6MCY24 (LKR)
Unsecured, Subordinated, Redeemable Debentures	67.7Mn	5 Year	N/A	N/A	N/A	HNB	

Name of Issuer	Merchant Bank of Sri Lanka & Finance PLC
Issue Date	16 Nov 2022 (Allotment Date)
Maturity	5 Years
Coupon Basis	Annually, Bi- Annually and Quartly
Repayment	At maturity
Option	NO

Merchant Bank of Sri Lanka & Finance PLC

Due Date Principal	Opening Principal	Type A	Type B	Type C	Interest Payment			Principal Payment			Principal Outstanding
	67,700,000	23,990,000	32,880,000	10,830,000	Type A	Type B	Type C	Type A	Type B	Type C	
15-Feb-23				29.50%			765,013.40				67,700,000
15-May-23				23.50%		3,660,174.61	740,067.32				67,700,000
15-Aug-23				26.14%			677,879.67				67,700,000
15-Nov-23				16.94%	5,469,720.00	3,680,285.42	439,299.21				67,700,000
15-Feb-24		24.00%	23.50%	15.99%			414,663.20				67,700,000
15-May-24				23.50%		3,660,174.61	330,303.14				67,700,000
15-Aug-24				12.90%			334,531.28				67,700,000
15-Nov-24		24.00%	23.50%	12.90%	5,469,720.00	3,680,285.42	334,531.28				67,700,000
15-Feb-25				12.90%			334,531.28				67,700,000
15-May-25				23.50%		3,660,174.61	334,531.28				67,700,000
15-Aug-25				12.90%			334,531.28				67,700,000
15-Nov-25		24.00%	23.50%	12.90%	5,469,720.00	3,680,285.42	334,531.28				67,700,000
15-Feb-26				12.90%			334,531.28				67,700,000
15-May-26				23.50%		3,660,174.61	334,531.28				67,700,000
15-Aug-26				12.90%			334,531.28				67,700,000
15-Nov-26		24.00%	23.50%	12.90%	5,469,720.00	3,680,285.42	334,531.28				67,700,000
15-Feb-27				12.90%			334,531.28				67,700,000
15-May-27				23.50%		3,660,174.61	334,531.28				67,700,000
15-Aug-27				12.90%			334,531.28				67,700,000
15-Nov-27		24.00%	23.50%	12.90%	5,469,720.00	3,680,285.42	334,531.28	23,990,000	32,880,000	10,830,000	9,484,536.71