

Rating Action & Commentary

Fitch Affirms Sri Lanka's Central Finance Company PLC at 'A+(lka)'; Outlook Stable

Fitch Ratings-Colombo/Singapore-10 December 2010: Fitch Ratings Lanka has today affirmed Central Finance Company PLC's (CF) National Long-term rating at 'A+(lka)'. The agency has also assigned an 'A(lka)' rating to CF's proposed subordinated debt issue of LKR500m with a tenor of five years. The Outlook is Stable.

The subordinated debentures, in terms of priority, will rank below deposits and all senior debt obligations, but above ordinary and preference shares. Consequently, and in accordance with the agency's criteria, the rating assigned for the subordinated debentures is one notch lower than CF's implied senior debt rating of 'A+(lka)'.

CF's ratings factor in its relatively good financial profile in the Registered Finance Company (RFC) sector in Sri Lanka. The ratings also take into account CF's lack of product and funding diversity in relation to banks (an inherent limitation of the RFC business model).

An upgrade of CF's rating is contingent upon increased diversity of its funding sources and access to capital markets commensurate to 'AA(lka)'-rated peers, as well as upon strengthening of market share of its core operations, while sustaining healthy asset quality and profitability. Conversely, a downgrade could occur in the event of a sustained weakening of CF's asset quality or profitability.

CF's loan book grew by 11% in the six months to end-September 2010 (H111) as the demand for vehicle leases increased in the post-war economy. Vehicle finance (leases and hire purchase agreements) accounted for 94% of the loan book, with the balance for loans to the SME sector and inter-company loans. CF is also the largest provider of operating leases, primarily to manage vehicle fleets of corporate clients (5% of assets at H111).

Bulk of CF's asset book was funded by time deposits (51% of assets), with a 29% yoy growth in FY10. The company's matching of interest rate sensitive assets and liabilities was good relative to peers'; at FYE10 rate sensitive assets improved to cover 88% of rate sensitive liabilities in the less-than-one-year category (FYE09: 76%). In addition, CF had interest rate swaps covering LKR1bn to mitigate interest rate mismatches at FYE10. Its statutory liquid-assets ratio remained strong at above 20% in H111.

CF's NPLs reduced in nominal terms with its NPL/gross loan reducing to 7.5% in H111 (FYE10: 9.7%) due to improving economic conditions and concerted recovery processes. The corresponding ratio for advances in arrears more than six months (6mNPLs) was 3.5% at H111 (FYE09: 4.1%). Vehicle segments that under-performed relative to CF's overall portfolio were financing of tractors, which accounted for 4% of vehicle financed, but 6mNPLs were in excess of 10%. Some of these segments were affected by inclement weather patterns that affected farmer revenues in previous agri seasons. CF's net NPL/equity ratio reduced to 9.8% in H111 (FYE10: 17.3%), from its peak of 30.5% at FYE09, this ratio was significantly better than the RFC sector's (RFCs rated by Fitch: 36.7% at FYE10). CF's inter-company loans accounted for 3.6% of the loan book at H111 (FYE10: 4%), approximately half was to a real estate venture - Hedges Court Residencies (Pvt) Ltd. Due to sluggish demand, the sale of these apartments have been delayed, and CF has provided LKR119m for impairment in value by H111 on this exposure (net exposure accounted for 6% of equity as at H111).

CF's net interest margins improved to 13% in H111 (FY10: 10%) largely due to an overall reduction in cost of funds. Over FY06-FY10, its operating cost/average assets was 6%, which was on the low side of the sector. Consequently, the company's pre-tax return on asset increased to 7.2% in H111 (FY10:

5.3%). As such, CF's internal capital generation remained strong, with equity/assets increasing to 24.2% at H111 (FYE10: 23.7%). Its profitability and capitalisation ratios were at the higher end of the sector.

CF was established as a private company in 1957, and listed on the Colombo Stock Exchange in 1969. 22.8% of shares are held by an Employees Share Option Plan and 21.4% by the Wijenaike family. CF's asset base was LKR35bn at H110, with a network of 55 branches.

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Additional information is available at www.fitchratings.com.

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Applicable Criteria and Related Research:
Global Financial Institutions Rating Criteria
Finance and Leasing Companies Criteria
National Ratings - Methodology Update

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