

Sri Lanka

Senkadagala Finance Company

National Ratings**Senkadagala Finance Company**

National long-term.....BBB+ (sri)
 OutlookStable

Issues

Senior Debentures 2005/9..... BBB+ (sri)

Summary Data

	31/3/2004	31/3/2003
Total Assets [USD mln]	15.4	10.8
Total Assets [SLR mln]	1,499.5	1,044.5
Equity [SLR mln]	278.6	226.2
Net Income [SLR mln]	63.1	41.3
ROA [%]	5.0	4.9
ROE [%]	25.0	19.7
Equity/Assets [%]	18.6	21.7

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Assessment

- Senkadagala Finance Company's (SF) rating reflects its strong asset quality, healthy profitability, and the high capitalisation.
- SF experienced relatively high portfolio growth supported by its branch expansion programme. The portfolio grew by 62% during FYE 2004 on the back of the high 93% growth recorded in FYE 2003. The growth momentum has been sustained during the first nine months of FYE 2005, with the portfolio expanding by 33%.
- SF continued to maintain relatively high operational efficiency due to its high degree of automation and investments in IT. The Cost/Income ratio improved to 44.2% in FYE 2004 from 48.8% in the previous year. In absolute terms, cost increased by 32% in FYE 2004, largely due to the cost associated with the branch expansion. Going forward Cost/income ratio is expected to remain stable in the near term and record improvements over the medium term as economies of scale are fully realised with the branch expansion.
- Return on assets (ROA) was flat at 5.0% despite the portfolio growth and remains relatively high in comparison to its peers and in the local context. Going forward ROA is expected to remain high due to healthy margins and low operational cost structure, but would be somewhat lower than the historical levels due to higher taxation.
- During the FYE 2004, asset quality weakened marginally with NPL/Gross loans increasing to 4.2% as at March 2004 from 3.3% in March 2003. The Net NPL/Equity ratio reverting back to 15.2% as at March 2004 (7.2% in March 2003). Nevertheless, SF's asset quality remains strong and healthy amongst its peers and in the local context.
- Due to the high portfolio growth, SF's reported Tier 1 capital adequacy ratio declined from 26.0% to 21.4% as at March 2004. Despite the decrease, these ratios are relatively high and remain comfortable in light of SF's present asset quality.
- SF customer deposit growth during the FYE 2004 was 15% which was below the industry average of 22%. However going forward, the management intends to actively grow the deposit base by leveraging the expanding branch network and by offering savings accounts.
- SF, to a large extent has relied on asset backed loans (medium term loans secured by the mortgage of lease receivables) to fund the expansion of its loan book. As at Dec 2004, such borrowings accounted for 48% of SF's funding. Given that the repayment terms of the loans are structured to match lease receipts, SF's asset – liability maturity structure has improved.

Support

- Given the minimal impact the possible failure of SF would have on the overall financial system, State support cannot be depended upon should it run into any difficulties. Nevertheless, it is very likely that support from the holding company would be forthcoming, should it be required.

Background

- Senkadagala Finance Company (SF), established in 1968 is a registered finance company under the Finance Companies Act 78 of 1988 and a registered establishment under the Finance Leasing Act 56 of 2000. Extending leasing finance and hire purchase finance for motor vehicles has been the main stay of the company. Currently SF has a network of eight branches operating in Kandy, Colombo, Kurunegala, Negombo, Nugegoda, Panadura and Galle. The branch operations are automated to a large extent, with all the branches being linked via an online real time network, which facilitate centralised monitoring and control.

PROFILE

- **SF has continued to consolidate its position within the industry**

Senkadgala Finance Company (SF) is a registered finance company under the Finance Companies Act 78 of 1988 which was established in 1968. SF is a registered establishment under the Finance Leasing Act 56 of 2000. Extending leasing finance and hire purchase finance for motor vehicles has been the main stay of the company. Currently SF has a network of eight branches operating in Kandy, Colombo, Kurunegala, Negombo, Nugegoda Panadura and Galle. The branch operations are automated to a large extent, with all the branches being linked via an online real time network, which facilitate centralised monitoring and control. SF is in the process of further expanding its branch network to reach 15 by the end of 2006. However, in terms of lending volumes, the Colombo and Kandy branches continue to dominate, accounting for 44% and 21% respectively during the FYE 2004.

Despite the strong growth over the last few years, SF is a medium sized finance company with a market share of c3% of industry assets.

The portfolio is dominated by vehicle leases, in line with the industry trends. However, the average size of the individual leases continued to remain relatively small due to its focus on the SME market segment. During the FYE 2004, over 90% of the leases granted were less than Rs 1 Mn. In terms of economic sector concentration, the portfolio continued to be concentrated in the Service, Transportation and Trading sectors, which accounted for over 78% of the disbursements during the year. These high sector concentrations are in line with the industry. In contrast to the industry, delivery vehicles and trucks made up 77% of new originations whilst Motor Cars accounted for only 10%.

PERFORMANCE

- **Above average profitability has been maintained**

SF continued to pursue its growth strategy during the period, with the portfolio growing by 62% in FYE 2004 and a further 33% during the first 9 months of FYE 2005 driven by the branch expansion. The majority of the growth was from SF's traditional small and medium enterprise (SME) market. Despite the high growth, SF has thus far been able to maintain its asset quality largely due to the strong systems and monitoring procedures.

The Net Interest Margin, remained healthy at 12.5% despite a marginal decline. Going forward, due to the nature of the SME market, NIM is expected to remain healthy, despite some pressure on cost of funding due to

greater reliance on borrowings to fund the portfolio growth.

SF continued to maintain relatively high operational efficiency due to its past investments in IT. The expansion in operations, enabled SF to enjoy economies of scale to some extent and the Cost/Income ratio improved to 44.2% in FYE 2004 from 48.8% in the previous year. In absolute terms, cost increased by 32% in FYE 2004, largely due to the cost associated with the branch expansion. Going forward Cost/income ratio is expected to remain stable in the near term and record improvements over the medium term as economies of scale are fully realised.

Historically SF's credit costs have been relatively low due to strong monitoring and recovery processes. Given the portfolio growth witnessed during the year, the challenge for SF would be to maintain asset quality in the future to keep credit costs at historical levels.

Return on assets (ROA) was flat at 5.0%, which is at the higher end amongst its peers and is expected to remain at close to these levels over the immediate future due to SF's ability to earn healthy margins and manage cost. However, due to the increase in effective taxation, earnings growth is expected to be more subdued in the future.

RISK MANAGEMENT

- **Strong IT support in credit risk management and monitoring has enabled SF to maintain good asset quality. Prudent provisioning policy also supports asset quality.**

Operational Risk

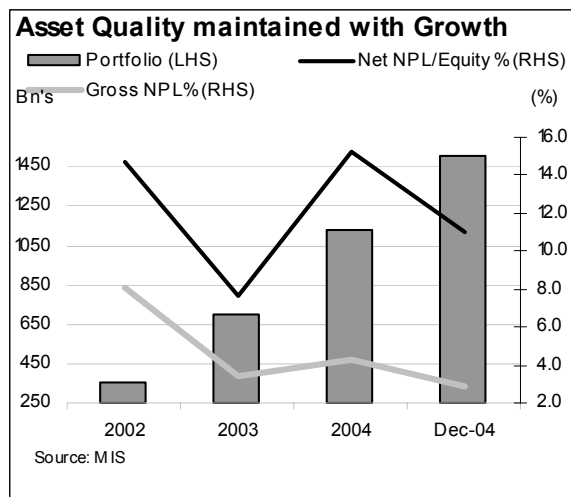
SF's operational risks are well managed with the aid of automated systems enabling effective internal controls and a documented procedure manual. Adherence to the procedures by employees is ensured through independent internal audits carried out by Ernst & Young as well as SF's own internal audit division.

The Senior Management and the Managing Director, with the aid of the IT system, constantly review the operations of SF from an overall portfolio basis and drill down on exceptional items, ensuring proactive management of operational and credit risk.

Going forward SF envisages to further streamline its operations through greater use of technology in document management, where all physical documents will be scanned and stored electronically in the server which could then be accessed by users.

Credit Risk

SF is exposed to credit risk mainly on its leasing portfolio. However, due to the relatively strong lease origination and stringent monitoring process, SF has been able to control credit risk and maintain good asset quality compared to its peers.



As at March 2004 the overall NPL/Gross Loans (defined to include leases where instalments are in arrears for over 3 months, as per classification standards mandated by CBSL for licensed commercial banks) was 4.2% compared to 3.3% as at March 2003.

In absolute terms the NPLs over 3 months have increased by 107% despite the portfolio increasing by 63%. Nevertheless, there have been some cash inflows from these NPLs, which have prevented NPL migration to the more hard core “over 6 month category”. As at Dec 2004, the Gross NPL ratio had improved to 2.8% due to reduction in absolute NPLs as well as portfolio growth. Nevertheless, SF’s NPL/Gross Loans ratio ranks favourably with its peers.

However, if NPL’s are defined as loans where instalments are in arrears for over 6 months (as per directions issued by the Central Bank to finance companies) SF does not have any non performing leases except for loans secured by cash deposits. Such loans were Rs. 1.5 Mn (0.1% of gross loans) as at March 2004.

Going forward, SF’s asset quality is expected to remain strong due to the strong origination, monitoring and recovery processes.

Loan Loss Reserves

Central Bank of Sri Lanka (CBSL) has issued two directions with regard to provisioning for Finance Companies. Currently finance companies have the option of adopting either direction.

Direction No 1 of 1991

Requires a 50% provision for all advances in arrears for 7-12 months and a 100% provision for all arrears for over 12 months or more. However in arriving at the provision the finance company may deduct the value of any land and buildings held as collateral.

Direction No 2 of 1991

Requires a 50% provision for all advances in arrears for 12-24 months and 100% provision for all advances in arrears for over 24 months. However, in this instance considering the hard core nature of the NPL and the lower chances of recovery, no deductions are allowed for collateral when computing the required provision.

SF currently follows a provisioning policy which is more stringent than the CBSL directions. Under SF’s provisioning policy all NPLs (other than those secured by cash deposits) above 6 months are fully written off at the end of the financial year, which is more conservative compared to the more stringent CBSL direction, which requires only a 50% provision. Nevertheless, due to its strong recovery skills, SF has historically been able to recover approx 70% of the bad debts written off.

As at Dec 2004, the Net NPL/Equity has weakened marginally to 11.0% from 7.2% as at March 2003 (defined to include leases where instalments are in arrears for over 3 months, for comparability with banks and other financial institutions). However if NPLs are defined according to the CBSL directive issued to finance companies, Net NPL/Equity was a negative 1.1% (ie. the loan loss provision more than fully covered the NPLs).

SF’s annual gross loan loss provisioning has historically been 2-3% of average loans over the last 5 years. Going forward, loan loss provisioning is expected to remain at the same relative levels.

Market Risk

SF is exposed to market risk largely due to the mismatch in the maturity and re-pricing cycles between the deposit and lending portfolio.

Over the last few years, SF has been diversifying its funding base through a series of medium term asset backed loans. These loans have been obtained by mortgaging the lease receivables and structured to match the maturity of the lease portfolio.

As at Dec 2004, SF had raised appx Rs. 900 Mn through the asset back borrowing program. The borrowings have improved the asset – liability maturity mismatch of SF. Further SF’s net interest margins have also been insulated to an extent since most of the borrowings are on fixed interest rates. However, the asset backed borrowings are term loans secured by the mortgage of lease receivables.

Going forward, SF intends to expand its funding base through further asset backed borrowings and issue a Rs 250 Mn Debenture to the Public which will be listed in the Colombo Stock Exchange, further improving the asset-liability maturity match and insulating SF's margins to a greater extent from market risk.

FUNDING AND CAPITAL

- **Capital base continues to remain strong**

Funding & Liquidity

Customer deposits and equity has been the traditional funding sources for SF. However, since 2002 SF began to diversify its funding base through wholesale borrowings raised through securitisation (asset backed borrowing) loans by mortgaging its leasing portfolio.

As at Dec 2004, such borrowings constituted 48% of the funding followed by deposits 29% and equity 17%. The increased use of term borrowings has also reduced the market risk to some extent.

Table 1 : Senkadagala Finance Co Ltd

Funding Mix

	2000	2001	2002	2003	2004	Dec-04
Deposits	56%	57%	58%	42%	34%	29%
Equity	31%	31%	30%	22%	19%	17%
Borrowings	0%	0%	0%	26%	39%	48%
Others	13%	12%	12%	11%	9%	6%
	100%	100%	100%	100%	100%	100%

Source: Annual Reports/MIS

SF deposit growth during the FYE 2004 was 15% which was below the industry average of 22%. SF's relatively low deposit growth during the period is partly due to the greater focus placed by the management on developing the institutional funding sources.

However going forward, the management intends to actively grow the deposit bases by utilising the expanding branch network. Further, finance companies have been allowed to offer savings accounts to its customers since January 2005. SF intends to leverage on its technological strengths and offer savings accounts to customers which can be accessed via any Master Card/Cirrus network ATMs within the next few months.

In line with the portfolio growth, Liquidity (Liquid assets/Customer deposits) declined to 24.9% as at Dec 2004 (27.2% as at March 2002), but remains comfortably above the regulatory minimum of 15%.

Going forward, medium term funding is expected to be the main source of funding for future portfolio growth of the company. The equity base which grew by 23% during the FYE 2004 is expected to show strong growth due to increased earnings coupled with high earnings retention.

Capital

The Central Bank of Sri Lanka has mandated a minimum total risk weighted capital adequacy ratio of 10%, comprising a minimum core capital ratio of 5% for all registered finance companies effective from 1st July 2003.

As at Dec 2004, SF's capital ratios were comfortable with a Tier 1 capital ratio of 19.6% (21% as March 2004). The decreases in the capital ratios are in line with FRL estimates and are due to the portfolio growth. As at Dec 2004 the core Equity/Assets ratio remained healthy at 16.5% (21.7% in March 2003). Despite the decrease, these ratios are relatively high and remain comfortable in light of SF's present asset quality.

Going forward, SF's capital ratios are likely to remain strong despite strong growth, due to equity growth resulting from high profitability couples with a high earnings retention rate.

SENKADAGALA FINANCE CO. LTD

BALANCE SHEET ANALYSIS

	2000	2001	2002	2003	2004	Dec-04
	Rs. Mn	Rs. Mn	Rs. Mn	Rs. Mn	Rs. Mn	Rs. Mn
A LOANS						
1. Customer Loans	274	328	337	684	1,111	1,482
2. Other Loans	18	24	29	22	35	45
3. (Loan Loss Reserves)	(3)	(8)	(8)	(6)	(6)	(8)
4. (Interest in Suspense)						
TOTAL A	289	345	358	700	1,140	1,518
B OTHER EARNING ASSETS						
1. Deposits with Banks	15	40	29	65	79	69
2. Treasury Bills	30	32	74	55	62	65
3. Other Securities	-	-	10	-	-	-
4. Equity Investments	29	34	45	24	16	16
TOTAL B	75	106	158	145	157	150
C TOTAL EARNING ASSETS (A + B)	364	450	516	844	1,297	1,668
D FIXED ASSETS	51	60	61	69	73	107
E NON-EARNING ASSETS						
1. Cash and Due from Banks	-	-	-	-	-	-
2. Statutory deposits with Central Bank	-	-	-	-	-	-
3. Other	55	42	60	131	130	129
TOTAL E	55	42	60	131	130	129
F TOTAL ASSETS	470	553	637	1,044	1,499	1,905
G CUSTOMER & SHORT-TERM FUNDING						
1. Demand Deposits						
2. Savings Deposits						
3. Time Deposits	257	306	332	403	474	507
4. Other	7	11	35	38	35	30
TOTAL G	264	317	367	442	509	536
H BORROWINGS						
1. Borrowings	-	-	-	267	578	909
2. Subordinate Debt	-	-	-	-	-	-
3. Hybrid Capital	-	-	-	-	-	-
TOTAL H	-	-	-	267	578	909
I OTHER (Non-int. bearing)	61	65	77	110	134	146
TOTAL LIABILITIES	324	382	444	818	1,221	1,590
J EQUITY	146	171	193	226	279	314
K MINORITY INTEREST	-	-	-	-	-	-
L TOTAL LIABILITIES & EQUITY	470	553	637	1,044	1,499	1,905

Senkadagala Finance Company: March 2005

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SENKADAGALA FINANCE CO. LTD						9 mts to
INCOME STATEMENT ANALYSIS						Dec-04
	2000	2001	2002	2003	2004	
	Rs. Mn	Rs. Mn	Rs. Mn	Rs. Mn	Rs. Mn	Rs. Mn
1	Interest Received	78	95	98	148	224
2	Interest Paid	26	34	37	55	90
3	NET INTEREST REVENUE	52	62	60	93	134
4	Other Operating Income	11	12	10	12	18
6	TOTAL INCOME	64	74	70	104	151
7	Provision for Loan Losses	(9)	10	10	10	18
8	Provisions - other	(1)	1	(1)	-	-
9	Personnel Expenses	9	11	11	14	14
10	Other Non-Int. Expense	25	17	17	37	60
11	TOTAL EXPENSES	25	39	37	61	91
12	PRE-TAX PROFIT	39	35	33	43	60
14	Taxes	6	2	3	2	16
15	NET INCOME	33	33	30	41	44

RATIO ANALYSIS (%)

I PROFITABILITY LEVEL

1.	Net Interest Margin	15.0	15.2	12.5	13.6	12.5	12.0
2.	Pre-tax profit/Total Assets (av.)	8.6	6.9	5.6	5.1	5.2	4.7
3.	Net Income/Equity (av.)	25.1	21.1	16.5	19.7	25.0	19.7
4.	Net Income/Total Assets (av.)	7.4	6.5	5.0	4.9	5.0	3.4
5.	Total Non-Int. Expense(excl provi)/ Net Int. Rev + Other Operating Income	54.4	37.0	40.3	48.8	44.2	48.7
6.	Net Interest Income/Operating Income	82.2	83.7	85.9	88.9	87.9	88.4
7.	Non Interest Income/Operating Income	17.8	16.3	14.1	11.1	12.1	11.6
8.	Net Interest Rev./Total Assets (av.)	11.7	12.1	10.1	11.0	10.5	10.5

II CAPITAL ADEQUACY (year end)

1.	Equity/Total Assets	31.0	30.9	30.3	21.7	18.6	16.5
2.	Equity/Loans	50.3	49.6	53.9	32.3	24.4	20.7
3.	Capital/Risks Assets - Tier 1	n/a	n/a	n/a	26.0	21.5	19.6
4.	Capital/Risks Assets - Total	n/a	n/a	n/a	26.0	21.5	19.6
5.	Net NPA's/Equity	n/a	n/a	14.7	7.6	15.2	11.0

III LIQUIDITY (year end)

1.	Liquid Assets/Customer Deposits	17.1	22.7	30.9	27.2	27.7	24.9
2.	Loans/Customer Deposits	109.7	108.7	97.5	158.4	223.8	283.2
3.	Loans/Customer Deposits + Borrowings	109.7	108.7	97.5	98.8	104.9	105.1

IV ASSET QUALITY

1.	Loan Loss Provisions/Loans (av.)	-3.9	3.2	2.8	1.9	2.0	1.3
2.	Loan Loss Reserves/Loans	0.9	2.2	2.3	0.9	0.6	0.5
3.	Non Performing Loans/Gross Loans	n/a	n/a	7.7	3.3	4.2	2.8
4.	Loan Write off's/Loans (av)	2.1	2.3	3.1	2.3	2.0	1.2

Senkadagala Finance Company: March 2005

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