FOR IMMEDIATE RELEASE

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ICRA Lanka assigns [SL] B with stable outlook to Nation Lanka Finance PLC

ICRA Lanka Limited, a wholly owned subsidiary of ICRA Ltd., an associate of Moody's Investors Service, has assigned an Issuer rating of '[SL] B' (pronounced SL B)[1] with stable outlook to Nation Lanka Finance PLC (NLF or the Company). The rating indicates risk-prone-credit-quality and the rated entity carries very high credit risk. The rating in Sri Lanka is assigned on an eight-point scale developed specifically for the country, and ranges from '[SL] AAA' to '[SL] D'. This rating scale ranks the relative default risk associated with issuers in Sri Lanka.

The rating factors in NLF's currently subdued core profitability, it's stretched liquidity profile, sizeable exposure to business segments that carry higher risks and its target borrower segment that is highly susceptible to economic cycles. The rating draws comfort from the strength of the promoters; Investor Access Equities and Nawaloka Group, its experienced management team and established brand franchise and, its presently favourable capitalization profile. The key rating sensitivities going forward would be on NLF's ability to mitigate the asset quality risks associated with exposures to the current business segments, improve profitability by optimizing operating cost and reducing incremental slippages, limit short term liquidity mismatches by diversifying its funding mix without impacting its overall cost of funds and, its ability to raise capital to finance future business growth.

NLF's business operations can be classified into 4 broad segments; auto-financing, microfinance, pawning and other lending operations. The lending portfolio of NLF as at May-13 was constituted by auto-financing (52%), microfinance (38%), pawning (7%) and the remaining 3% was for equipment and other financing. NLF's auto financing focuses mainly on cars for personal use, Light Commercial Vehicles for SMEs such as vans & trucks, tractors, 3- wheelers and 2-wheelers. NLF's customers largely comprise of lower-end SMEs and self-employed individuals. NLF's microfinance operations are carried out in a modified Grameen joint group lending model with aspects extracted from the ASA model. NLF is in the process of implementing and improving its operational systems with heavy investments being channeled into the same over the past 2 years. NLF operates a traditional branch based sourcing/operation model. The company also resorts to its broker network to source business though this contributes to less than 5% of NLF's total business. NLF's undertakes lending on a fixed interest rate basis; however its micro finance and pawning portfolio carries re-pricing flexibility due to the short term nature of the loans extended. ICRA also notes NLF's portfolio is highly concentrated with the top 20 customers accounting for more 15% of NLF's total portfolio as at Mar-13 (55% of the Networth). NLF proposes to focus on micro finance business going forward and has a significant overall expansion plan for its other core business which includes Leasing and Hire Purchase. ICRA Lanka would closely monitor NLF's capitalization levels, its ability to control asset quality and improve profitability as the business scale grows.

NLF's asset quality improved during FYE Mar-13 owing to the efforts put forward by the new management to control slippages, and the part write-off of the Legacy NPAs. As in Mar-13, NLF reported gross NPA ratio of 3.4% (17.2% as at Mar-12) and Net NPA ratio of 2.8% (2.5% as at Mar-12). The legacy NPAs from the past portfolio have been fully provided for by the management. ICRA however notes that the incremental slippages on an absolute basis continue to be relatively high.

NLF's regulatory capital adequacy ratio as at Mar-13 stood at 15.5% comfortably over the regulatory requirement of 10%. Nevertheless, NLF's capital adequacy ratio deteriorated from about 22.8% in Apr-12 due to the losses reported by the company. The company received equity infusions of over Rs. 1,300 Million subsequent to the takeover by the new management in 2011 and its gearing as at Mar-13 stood at 4.9 times. ICRA Lanka notes that NLF would require additional capital infusion in the current financial year and going forward also to continue with its rapid growth plans.

[1] For complete rating scale and definitions please refer to ICRA Lanka's Website www.icralanka.com or other ICRA Rating Publications

NLF's funding mix as at Mar-13 is steered through deposits, which account for more than 91% of total funding, with the rest being long term bank borrowings and bank overdrafts. NLF's liquidity profile is quite stretched; reporting significant ALM mismatches in the short term buckets. Cumulative adverse mismatches of above 36% of total assets (May-2013) was observed in the less than 1 year bracket, this is significantly weaker than peers, mainly due to the large portion of deposits in NLF's funding mix that are predominantly short term in nature. NLF is currently in negotiations with international funding partners to tie-up for longer term funding lines, which would help NLF manage its overall liquidity profile along with its overall profitability via relatively lower funding costs.

NLF reported operating level losses over the past 5 years subsequent to the Ceylinco crisis. In FYE Mar-12, as per IFRS the company reported PAT of Rs 23 Million (though the company reported operational losses) mainly due to sizeable credit provision reversals. In the FYE Mar-13, the company reported operational loss of Rs. 135 Million (a 61% increase over the previous year) due to significant increase in the interest and operating cost levels. NLF reported net loss of Rs 95 Million for FYE Mar-13. NLF's incremental profitability would be affected by the high level of its operational costs (about 12.4% of ATA as at Mar-13); therefore it would be critical for the company to augment its scale of operations without adversely impacting its portfolio quality and secure funding at favourable rates going forward.

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