

Banks Thrive While Other Businesses Struggle in Turbulent Environment

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Adverse consequences of the volatile and turbulent business environment that prevailed during the past several months were evident in the recently published financial results of several leading business organizations for the year ended 31st of March 2009. According to the Chairman's report, the net profit of Sri Lankan business conglomerate Hayleys for the financial year 2008/2009 has been reduced by 31% due to high inflation, over-valued rupee and the global economic slowdown. Reduction of net profit of another giant John Keels Holdings for the same period by 7.4% has been attributed to the global economic slowdown and loss of a highly profitable ship fuel business. The main telecommunication service provider of the country - Sri Lanka Telecom- has announced their financial results for the quarter ended 31st March 2009 stating that the profits have eroded by 42% due to increased operational expenditure and depreciation associated with unfavorable business environment. Net profit of Mobitel, a subsidiary of Sri Lanka Telecom, has fallen by 17% despite the increase in the number of subscribers by 73%. The Sri Lankan operating company of Swiss food giant Nestlé's net profit for the first quarter of this year has fallen by 30% due to similar reasons. Listed consumer durables firm Singer (Sri Lanka) has suffered a drastic reduction of 79% in their profits for the first quarter of 2009. One of the largest Insurance companies of Sri Lanka- Ceylinco Insurance- recorded a 52% reduction in profits for the financial year 2008/2009 due to unfavorable business conditions which were further aggravated by the tarnished image of "Ceylinco".

Financial results announced up to this time also show that some companies have been able to successfully manage their businesses ensuring growth in profits. For example, Sri Lanka's tobacco monopoly, Ceylon Tobacco Company, has reported a 37% profit growth during the quarter ended March 2009 despite falling sales. The company attributes the better performance to a successful productivity drive and cost cutting. Also, the Sri Lankan ship builder Colombo Dockyard has achieved a profit growth of 112%. The company says that while ship building has badly suffered from the recession its ship repair work is growing. Eagle Insurance reported that its profits were up 21% during the same period. What these different company performances tell us is that in a recession business strategies have to be rethought and opportunities for productivity growth must be exploited to remain viable.

Relatively interest rates have not helped the business sector in general. However, the banking industry that usually benefits from high government bond yields and loan rates - rate that the Central Bank in recent weeks wanted to see reduced - have reported good profits. Sri Lanka's state run Bank of Ceylon has recorded a 106% growth in profits for the quarter ended March 2009, while the Peoples Bank has achieved a growth of 23%. Out of the private banks, HSBC recorded a 40% growth, Hatton National Bank 14%, Nations Trust Bank 40%, NDB Group 30%, and Sampath Bank 18%, for the quarter ended March 2009. Only the City Bank which has a heavy international exposure has recorded a

reduction of 41.7% in profits for the first quarter of 2009 in addition to the Commercial Bank whose profits have dropped by 12.9% for the same period mainly due to a problem associated with an oil derivative sale to state run Ceylon Petroleum Corporation.

In the export sector, the Joint Apparel Association Forum (JAAF) has announced that the apparel exports have grown by 8.8% from US\$ 736.2 million to US\$ 801.3 million during the first quarter of 2009 compared to the same period last year. Although exports to the US recorded 4% decline in with exports recording US \$ 346.3 million compared to US \$ 360.9 million in the previous corresponding period, exports to the EU increased to US \$ 404.4 million in the first quarter 2009 compared to US \$ 336.0 in the previous corresponding period, recording a high positive growth of 20.3%. This is especially remarkable in the context of the recession in these export markets.

However, key agricultural exports have experienced several challenges. Tea prices at the Colombo Tea Auction have been on a decline for quite some time now due to an excess in supply. In mid May prices perked up a little. The authorities are likely to extend the restriction on private sales of low grown teas outside the main auctions in Colombo that they imposed last year in the belief that this curb will help increasing prices.

The coconut industry in Sri Lanka is divided with the current crisis of rising coconut prices leading to a possible collapse of the coconut products export industry. While the exporters of desiccated coconut, coconut milk, coconut cream and coconut milk powder claim that the prevailing high prices of coconuts at the weekly auction are due to the high demand from coconut oil manufacturers, authorities are busy trying to come up with a solution that would be beneficial to all industries.

Ceylon Grain Elevators, the country's largest player in the poultry industry and the major animal feed producer, had faced difficult challenges in 2008 leading to a loss of Rs.125.4 million in the year ended December 31, 2008, down from a profit of Rs.94.7 million in the previous year. The company attributes this loss to escalated fuel prices in the first two quarters of the year and depreciation of the rupee by 6.5% in the third quarter adversely affecting the cost of production in their feed milling business. Explaining that the major ingredient used in animal feed was imported maize, the company has stated that skyrocketing prices of fossil fuel led to a demand for bio-fuel produced from maize resulting in a shortage of this commodity for use as human and animal feed with growers choosing to sell their crops to large ethanol manufacturers. In addition to high fuel prices the US government gives a subsidy for ethanol production making it still more attractive to maize growers. This situation has compelled the feed millers to import maize at high prices. When crude oil prices declined drastically later in the year, the demand for maize eased but an Indian ban on maize exports shut off the cheapest source. Recently the government has imposed a ban on import of maize. In the light of this and the weakening Sri Lanka rupee, this company is compelled to explore avenues of producing maize locally. Three Acre Farms, a subsidiary of Ceylon Grain Elevators, has also reported a loss of Rs.170.2 million in the year ended December 31, 2008, down from a profit of Rs.61.5 million last year. The company has attributed this to a drastic drop in demand for day-old chicks compelling them to destroy a considerable number of birds. Moreover the drop in per capita chicken consumption for the year 2008 to 3.8 kg from the previous year's 4.2 kg and the drop in tourist arrivals have adversely affected the poultry industry. This company has announced that they are now destroying the parent stock as well.

Global economic crisis has adversely affected both the foreign and domestic labour markets. According to Sri Lanka Foreign Employment Bureau there are around 1.8 million Sri Lankans (20% of the domestic labour force) employed abroad remitting nearly three billion dollars a year. Many employers have resorted to laying off the employees causing a serious problem for the country but the authorities claim that they are taking steps to manage the situation despite stiff competition from regional neighbours.

In the domestic sector, the Department of Labour has announced that about 32,000 jobs have been lost due to the economic crisis. This official figure had been based on the terminations that had gone through the department but a large number of terminations have taken place without their involvement. There have been about 70 cases where employers and employees have been able to negotiate terminations on their own, as per the Commissioner General of Labour who estimates the unofficial job losses to be around 70,000. The Department has urged the employers to resolve terminations on their own as the Labour Department has no resources to intervene and conclude negotiations fast.

Amidst all these implications of the business environment, several interventions and reforms have been initiated by the government with a view to stabilizing the financial market of the country. Most of these are in respect of severally affected companies in the Ceylinco Group. The Merchant Bank of Sri Lanka (MBSL), a unit of state-run Bank of Ceylon, has been appointed by the Central Bank as managing agents of the troubled The Finance Company, taking over from another state-owned entity, Lankaputhra Development Bank which was earlier entrusted with the task of stabilizing the situation and bringing the operations back to normal. MBSL which was earlier appointed as the managing agent of the Ceylinco Savings Bank -another member of the troubled Ceylinco Group- by the Monetary Board of the Central Bank to resolve the liquidity crisis claims that it has almost completed a deal to take control of the Ceylinco Savings Bank. As per a stock exchange filing they have almost finalized an arrangement to infuse fresh capital amounting to 100 million rupees into Ceylinco Savings Bank to acquire a controlling stake of over 51 percent. MBSL had been in talks with the banking regulator, the Central Bank, to manage and rehabilitate Ceylinco Savings Bank.

Another Ceylinco company listed in Colombo stock exchange- Ceylinco Finance has announced that it is re-structuring itself under the guidance of a veteran banker to focus on leasing, and is planning to ask for a finance company license. N B S B Balalle, a former chief executive of state-run National Savings Bank, has been appointed by the Central Bank as executive chairman of this company. In the meantime, Ceylinco Finance has in a Stock Exchange filing informed the Stock Exchange that the company had made a decision to divest certain selected businesses/assets including property in Colombo and land and buildings in suburban areas mainly to improve the company's liquidity position.

In another development, Sri Lanka's Supreme Court has appointed a chief executive, an auctioneer and auditors to the collapsed Golden Key Credit Card Company - root cause of the fall of Ceylinco Group- to liquidate its assets and pay back the depositors. The chief executive would be an officer from Sri Lanka's central bank. The appointments were made on the recommendation of a committee that is overseeing the liquidation of assets and repayments to depositors. Court also ordered a revenue officer to be appointed to collect taxes due to government as depositors are repaid.

In respect of another Ceylinco member- Seylan Bank- the Central Bank recently announced that it has decided to give a second chance to five qualified investors to buy a 33 percent stake in Seylan because the bids it received earlier did not comply with the conditions set by the regulator. As such, The

Monetary Board has decided to revise the conditions for the sale and invite fresh proposals from all five selected prospective strategic investors in accordance with the revised criteria. The five investors are John Keels Holdings, Lanka ORIX Leasing Company, National Development Bank, Sampath Bank and V Karunaratne & Company.

Sri Lankan business sector has experienced many other challenges as well during this period. MBSL has finalized a deal to acquire a young Insurance firm-ABC Insurance- for 77 million rupees and has already paid half of that amount. Once taken over this company will be renamed MBSL Insurance Company. The Insurance Board of Sri Lanka (IBSL), suspended the registration of Janashakthi Insurance in terms of Section 18 of the Regulation of Insurance Industry Act, No. 43 of 2000, for a period of three weeks with effect from 12th May, 2009 but this suspension was lifted soon after Janashakthi assured that it will address regulator's concerns.

Bank of Ceylon had provided facilities to over 250,000 IDPs in Vavunia who wanted to deposit their cash and valuables, especially gold jewelry. It is reported that more than 10,000 people had opened accounts in refugee camps in the last month alone. The bank had over 40,000 accounts and over Rs 500m in deposits in cash and jewelry have been made in the last few weeks.

"Chillies Awards," the prestigious advertising awards ceremony of Sri Lanka was held during May 2009, where Leo Burnett, Triad Advertising and JWT emerged as the top three advertising agencies in the country.

Sri Lanka's tourist industry is gearing up for a revival following the end of the war. The Pacific Asia Travel Association (PATA), has elected Jetwing Chairman Hiran Cooray of Sri Lanka as Chairman Elect for 2010/2011. He will take up his position at the next AGM. This is the first time a Sri Lankan will take up this high office in PATA.

Several Sri Lankan companies clinched business deals with Maldivian counterparts at the Maldives Construction Fair held at Male recently. The three-day event was opened by the Maldivian President Mohammed Nasheed at the Dharubaaruge Exhibition Hall in Male.

The stock exchange was also quite active during the period under review. Sri Lankan shares transacted well with investors keen on blue chips, hotels and banks, encouraged by the end of the ethnic war that could see an economic revival. Investor sentiments remained upbeat and Milanka Price Index crossed the psychologically important 2,000 point mark. Just one week after the guns of the North went silent, the Colombo Stock Exchange extended its run by breaking its own record of generating over one billion rupees turnover for five consecutive market days. The earlier record stood at four consecutive one billion rupee market days in 2006 and 2003. Towards the end of May 2009, shares were subdued after profit taking while the rupee remained stable.