

RAM

RATINGS

CREDIT RATING RATIONALE

FINANCIAL INSTITUTIONS – SRI LANKA

A wholly owned subsidiary of RAM Holdings Berhad – an affiliate of Standard & Poor's

LB Finance PLC– New Issue & Rating Review

Financial Institution**Ratings:**

Long-term: BBB- [Reaffirmed]

Short-term: P3 [Reaffirmed]

Rating Outlook:

Stable

Instrument:

LKR 450 million unsecured subordinated redeemable debentures

Rating:

BB+ [Assigned]

Coupon Rates:

Class A :21.00% monthly

Class B: 24.00% annually

Class C: 3-month gross treasury bill rate + 350 basis points

Class D: 1-year gross treasury bill rate + 350 basis points

Strengths:

- Adequate asset quality
- Franchise for deposits and leasing
- Expanding branch network
- Good financial performance

Weaknesses:

- Marginal capital buffer
- Weak funding structure

Principal Activities:

Finance company engaged in leasing, hire-purchase, pawning, term loans, mortgage, and real-estate loans

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Summary

RAM Ratings has reaffirmed LB Finance PLC's ("LBF" or "the Company") long- and short-term financial institution ratings at BBB- and P3, respectively; the long-term rating has a stable outlook. The ratings are based on the Company's adequate asset quality and healthy - albeit easing - financial performance, weak funding structure, and marginal - although improving - capital adequacy. Concurrently, RAM Ratings has assigned respective long - and short-term ratings of BB+ and NP to LBF's proposed LKR 450 million unsecured subordinated redeemable debentures.

LBF is the third-largest registered finance company ("RFC") in Sri Lanka, accounting for about 8% of the industry's assets as at the end of FYE 31 March 2008 ("FY Mar 2008"). With a network of 15 branches and 40 pawnbroking centres (inclusive of branches) the Company has continued the aggressive expansion of its loan portfolio, which augmented 57.83% year-on-year ("y-o-y") in FY Mar 2008. Meanwhile, the Company has also focused on improving its asset quality. LBF wrote off LKR 326.67 million of non-performing loans ("NPLs") in FY Mar 2007, which had been fully provided for, and maintained a tight grip on new facilities. These measures, along with its expanding loan base, improved the Company's gross NPL ratio from 6.23% (industry:4.46%) as at-end-FY Mar 2007 to 4.10% as at end-FY Mar 2008 (industry:6.54%). Moreover, the Company had also adopted a more stringent provisioning directive which, though resulting in higher provisioning, had improved its NPL coverage. Notwithstanding these improvements, given the weakening economic outlook, RAM Ratings opines that LBF's asset quality may soften somewhat, albeit still adequate.

To fund the rapidly expanding portfolio LBF relies both on public deposits and secured borrowings. However, as secured borrowings rank ahead of depositors and given the increasing negative gap of asset-liability alignment, RAM Ratings deems the funding structure to be weak. Meanwhile, LBF reported a statutory liquidity asset ratio below the stipulated minimum as at end-FY Mar 2008, however, this was rectified subsequently.

LBF reported a pre-tax profit of LKR 355.21 million for FY Mar 2008 (FY Mar 2007: LKR 282.40 million). We note that its profitability indicators had eased as the high interest rates and brisk repricing of loans had exerted pressure on its margins. In addition, provisions for bad and doubtful debts had increased as the Company adopted the Central Bank's Direction 3. As a result, LBF's return on assets ("ROA") and return on equity ("ROE") eased to 4.01% (end-FY Mar 2007: 4.85%) and 45.47% (end-FY Mar 2007: 59.95%) as at end-FY Mar 2008. However, RAM Ratings notes that the Company's current performance level is still better than the industry average. Going forward, LBF's financial performance is envisaged to moderate, albeit still better than industry average.

On a related note, the Company's weakening financials and hefty tax payments have reduced its internal capital generation. Following the issuance of new and bonus shares, however, LBF has been able to maintain its Tier-1 and overall capital adequacies above the respective statutory minimums of 5% and 10%. Nevertheless, the Company's ratio on net NPLs to shareholders' funds remained vulnerable at 17.19% as at end-FY Mar 2008 (industry: about 13%). Looking ahead, RAM Ratings expects this ratio to improve given the Company's efforts in shoring up its capitalisation.

Outlook

The stable rating outlook is premised on our expectation that the Company's financial performance and asset quality will remain better than the industry's, and that its funding structure will not weaken significantly. In addition, we also anticipate an improvement in its capital adequacy.

An upward revision of the ratings could materialise if the Company improves its financial performance, asset quality and funding structure, with no breach of regulatory requirements, while improving its capital adequacy.

Conversely, the ratings will come under pressure should its financial performance and asset quality wane beyond industry averages, its funding structure weaken even further or its capital adequacy recede.

Corporate Profile

Incorporated in May 1971, LBF is one of the more prominent names in the Sri Lankan RFC industry. The Company is registered under the Finance Companies Act No. 78 of 1988, and is regulated by the Central Bank of Sri Lanka. Its franchise is attested to by its sizeable deposit and asset bases, making it the third-largest RFC in the country. In addition, LBF is only one of six RFCs listed on the Colombo Stock Exchange.

LBF is principally involved in leasing (finance and operating), hire-purchase ("HP") financing, pawnbroking and real-estate trading. On the funding side, it accepts public deposits.

LBF had been the first RFC to commence pawnbroking, and now has 40 pawning centres, inclusive of its 15 branches. In addition, the Company increased its network from 9 to 15 branches between FY Mar 2007 and FY Mar 2008. Moreover, the Company also has service centres, which services are limited to rental and loan collections, and as at end-FY Mar 2008 these centres numbered 25, further strengthening the Company's competitive position.

Ownership

Throughout its 37-year history, LBF has experienced frequent ownership changes. The Company is presently under Mr KD Dammika Perera, a prominent business personality whose interests include hospitality, finance, banking, insurance, power and energy, and entertainment. Mr Perera is the Deputy Chairman of LBF and also the Chairman-cum-Director General of the Board of Investment of Sri Lanka.

Prominent RFC in Sri Lanka

Expanding geographical reach

Part of Dammika Perera's group

Listed on Colombo Stock Exchange

Good management team

Known for achieving business goals

Staff strength complements business expansion

LBF's financial flexibility mainly stems from its listed status on the Colombo Stock Exchange. In the past 3 years under Mr Perera's leadership, the Company has been posting strong performances, thus according LBF some degree of financial flexibility.

Management & Strategies

Mr Sumith Adhietty, the Managing Director, leads a dynamic team of young but experienced professionals.

The Company successfully expanded its loan base in FY Mar 2008, surpassing its budgeted financial performance for the year. LBF had achieved its stated business targets of augmenting its portfolio amid a weakening economic climate, by exploiting high-growth segments. Accordingly, LBF focused on lease financing for 3-wheeled taxis. In addition, it broadened its branch network and marketing force, thus enabling the Company to aggressively expand its credit and deposit bases. Given the present economic scenario, the Company's short-term business objective is to grow its loan portfolio, albeit at a more moderate pace, in selected market segments. The management has already identified pawn advances as one such area. Even though the Company had earlier intended to focus more on real estate, the management - sensing the changing economic trends - had swiftly changed strategies.

RAM Ratings notes that LBF's rapid expansion has been complemented by timely staff recruitment and training (refer to Table 1). This has enabled the Company to grow while keeping a tight control over its asset quality. To maintain productivity, the executive directors of credit and recovery monitor staff performance on a daily basis.

Table 1: Head count of LBF (FY Mar 2005-FY Mar 2008)

	FY Mar 2005	FY Mar 2006	FY Mar 2007	FY Mar 2008
Number of employees	256	303	391	520
% increase	37.63%	18.36%	29.04%	32.99%

Corporate Governance

The Board convenes monthly; the 10-member Board held a respective 13 and 11 board meetings in FY Mar 2007 and FY Mar 2008. The Company's Board comprises 7 Non-Executive Directors (3 of whom are independent) and 3 Executive Directors.

The Board reviews the financial performance against the budgets; key performance indicators such as loan growth, collection and recoveries, and funding and cashflow are submitted for evaluation. In addition, it is provided with a compliance check list to ensure adherence.

Meanwhile, the Board is supported by an audit committee, which is now chaired by an independent and non-executive director. Apart from liaising with and ensuring the independence of external auditors, this committee also assesses the adequacy of controls within the organisation, assisted by its internal auditors.

Adequate asset quality

Loan growth drives asset expansion

Vehicle financing assuming more prominence

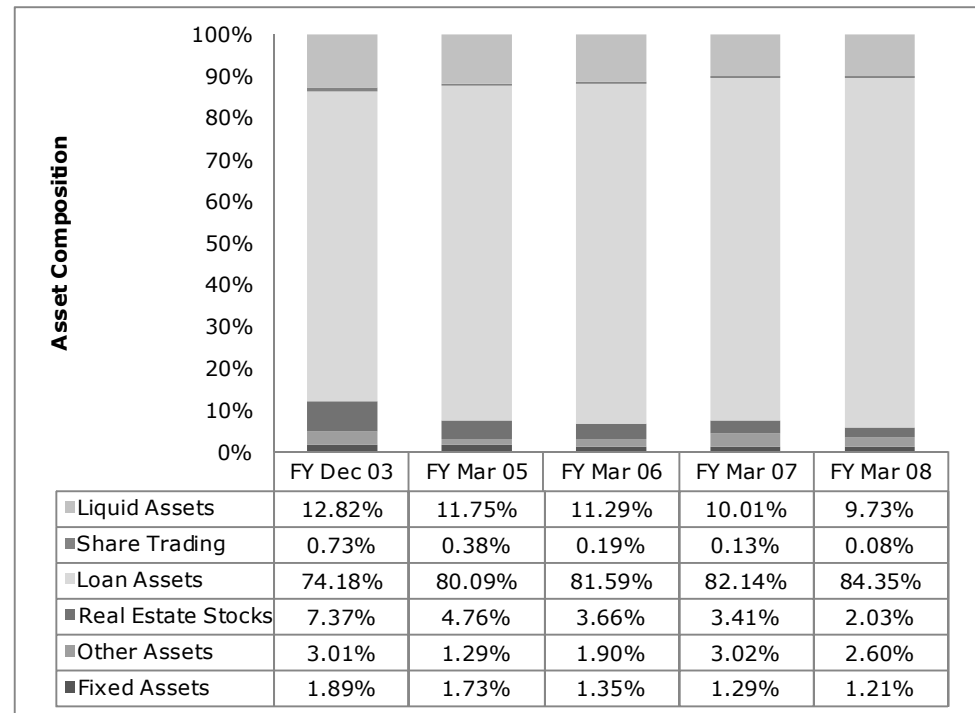
Elsewhere, RAM Ratings notes that related-party transactions have mostly benefited LBF. Significant transactions in FY Mar 2008 include a personal guarantee from the Deputy Chairman, amounting to LKR 519 million (FY Mar 2007: LKR 605 million), to secure bank funding for the Company. At the same time, the Company acquired a property and sold the same to a related party for LKR 508 million. We note that the related party had fully settled the amount due by November 2007. As at end-FY Mar 2008, related-party deposits amounted to LKR 55.91 million (end-FY Mar 2007: LKR118.48 million).

Asset Quality

LBF has kept improving the health of its loan portfolio; its gross NPL ratio was better than the industry average in FY Mar 2008. However, RAM Ratings notes that the Company will be challenged to preserve its asset quality given the weakening macro economy.

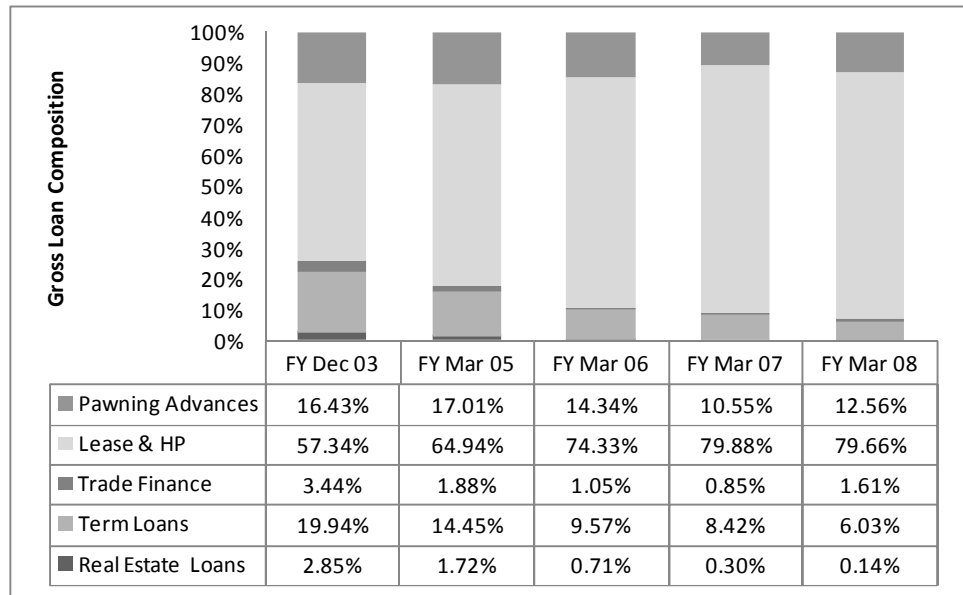
The Company’s assets, which had been growing faster than the industry’s, accelerated further in FY Mar 2008; LBF’s asset base swelled by 53.70% y-o-y, compared to 49.81% the previous year. This was mainly supported by its enlarged loan books, as net loans jumped 57.83% (FY Mar 2007: +50.80%). Accordingly, its asset mix remained largely unchanged, with its loan portfolio dominating its total assets (refer to Chart 1).

Chart 1: LBF’s asset composition



Similarly, the Company’s loan portfolio also remained somewhat unchanged. Leases and HP financing took up approximately 80% while pawnbroking remained the second-largest category of advances, with about 13% (refer to Chart 2). The remainder consisted of term loans (6%), trade financing and real-estate advances (2%) as at end-FY Mar 2008. Going forward, RAM Ratings expects leases and HP to dominate the loan portfolio while pawning advances increase in prominence as the management intends to promote this category in the short term.

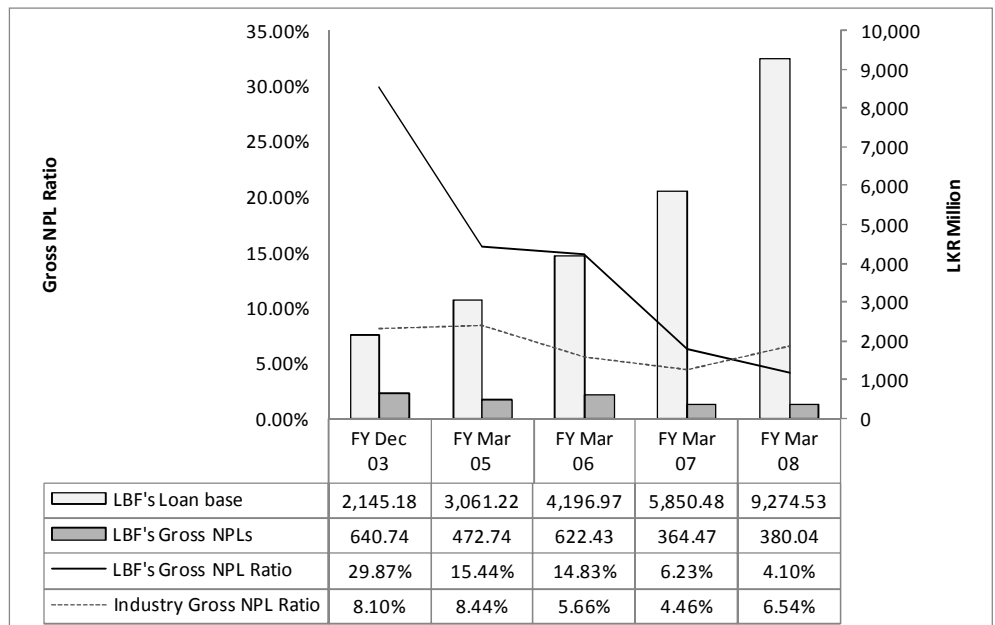
Chart 2: Loan mix of LBF



NPLs to rise but expected to remain better than industry average

In tandem with its loan growth, LBF’s asset quality has also been improving. The Company’s gross NPL ratio ameliorated from 6.23% as at end-FY Mar 2007 to 4.10% as at end-FY Mar 2008 (refer to Chart 3). It achieved a better-than-average ratio by recovering almost 90% of its new NPLs and enlarging its credit base. Its default rate on leases and HP (that take up 80% of its lending base) improved from 4.16% in FY Mar 2007 to 2.42% the same period, while trade financing and other loans (excluding pawning), although still weak, enhanced from 32.03% to 29.17%. Going forward, RAM Ratings expects LBF’s asset quality to wane given the moderating growth of its loan base and the weakening economic outlook. However, the Company’s gross NPL ratio is still expected to remain better than the industry average, owing to LBF’s stringent monitoring and collection procedures.

Chart 3: Trends in asset quality



Credit evaluation

As an RFC, the Company's portfolio consists mainly of borrowers whose access to banking lines are constrained as they are predominantly small and medium-sized enterprises that lack formal financial documentation. As a result, LBF's credit evaluation is based on the investigative reports of its marketing personnel, as well as the credit officers' subjective assessment of the borrower's creditworthiness. Consequently, portfolio monitoring becomes paramount to ensure the health of its credit base. Given the weakening economic fundamentals, however, RAM Ratings opines that collections and recoveries are likely to become more difficult. This is because the repayment capacity of borrowers will be adversely affected by high inflation and dampened business prospects.

Better provisioning

In the context of provisioning, LBF had previously followed a less stringent provisioning policy. Effective 1 April 2007, however, the mandatory adoption of Direction 3 (refer to page 11) had improved its provisioning cover from 29.85% as at end-FY Mar 2007 to 55.89% as at end-FY Mar 2008. Consequently, LBF's net NPL ratio had also improved from 4.45% to 1.85% over the same period.

Pawning advances adequately managed

In respect of pawning advances, LBF finances up to 75% of the gold sovereign's auction price. The borrowers are generally required to redeem the article within 14 months, failing which it is auctioned. RAM Ratings notes that LBF enjoys a redemption rate of about 90%. As these advances are backed by gold, recovery is relatively easy. In addition, the Company insures the value of the item in its custody and carries out weekly physical verification. In light of these controls, RAM Ratings has a positive view of this category of financing.

Modest exposure to real estate

LBF continued to have a modest exposure of 2.03% to real-estate assets as at end-FY Mar 2008. In the short term, the Company will keep disposing of its land bank, hence reducing its current exposure.

Proprietary share trading constituted a mere 0.8% of LBF's total assets as at end-FY Mar 2008. As such, RAM Ratings has no concerns in this regard.

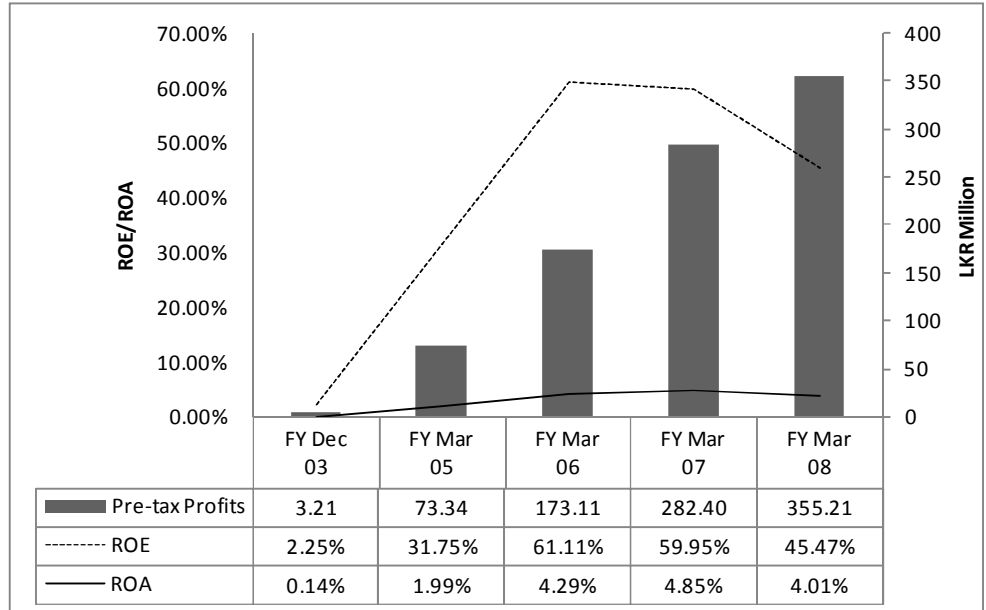
Even though RAM Ratings notes that LBF's asset quality has been improving, the Company's aggressive loan growth amid a deteriorating economic landscape is likely to weaken its asset quality over the longer term. Nevertheless, we expect the Company's overall asset quality to remain better than the industry average.

Performance**Easing but healthy performance**

Despite its buoyant loan growth, LBF's financial performance has eased from historical levels. Even though its pre-tax profit (after financial services VAT) increased from LKR 282.40 million in FY Mar 2007 to LKR 355.21 million in FY Mar 2008, profitability - as measured by its ROA and ROE (refer to Chart 4) - had declined due to contracting margins.

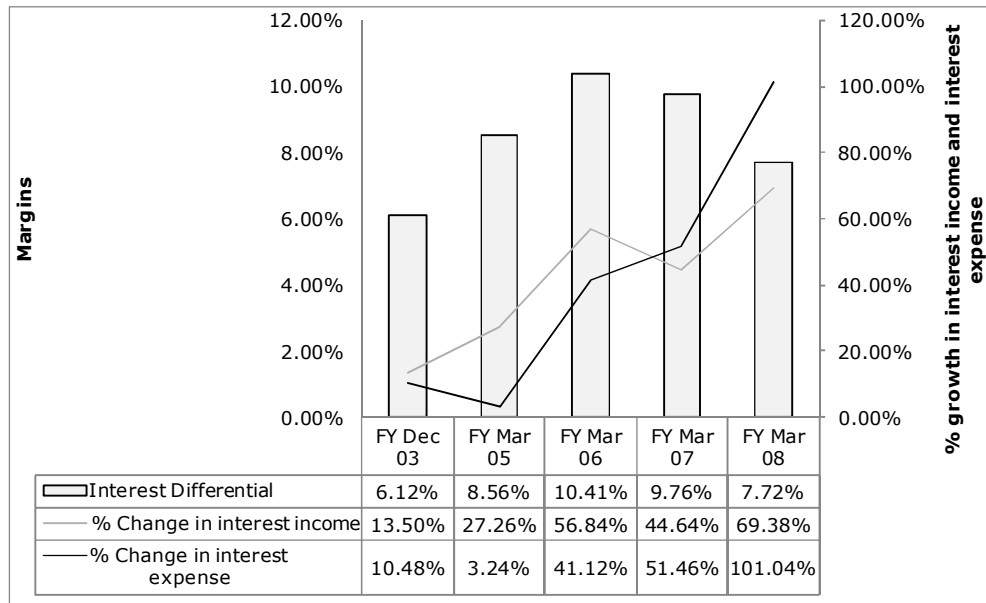
Margin compression

Chart 4: Trends in LBF's profitability



The Company's aggressive loan growth had contributed to the increase in its interest income, which appreciated 44.64% in FY Mar 2007 and 69.38% in FY Mar 2008. However, such healthy top-line growth had been outpaced by interest expenses. As a result, the Company's interest differential¹ (or "margins") had contracted (refer to Chart 5).

Chart 5: LBF's interest income and margins



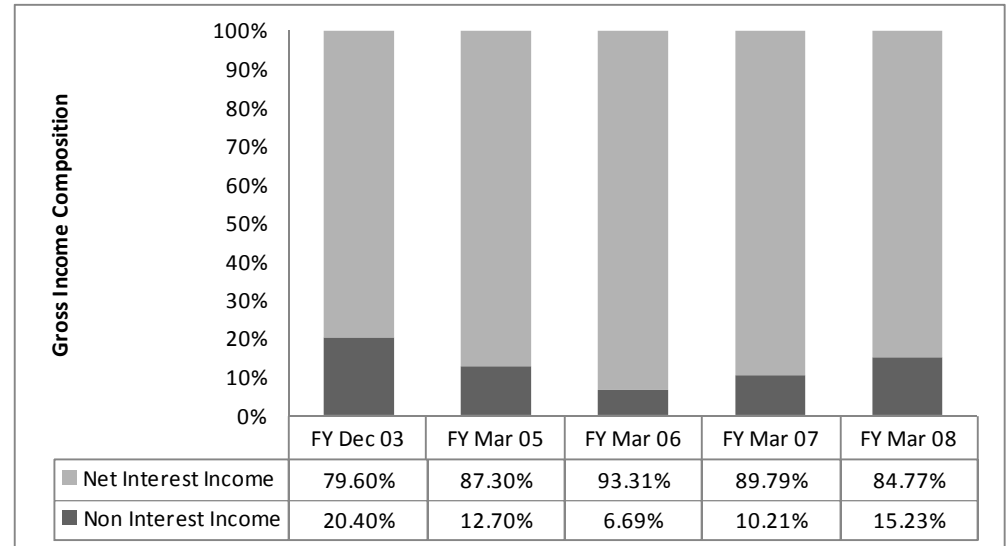
Interest income dominates

The Company's rising interest expenses have also been weighing down its interest income. Net interest income, which leapt 77.35% y-o-y in FY Mar 2006, contracted to 37.58% in FY Mar 2007 and another 33.21% in FY Mar 2008. Meanwhile, LBF augmented its non-interest income in FY Mar 2007 and FY Mar 2008. The Company's income from fee-based activities more than doubled between FY Mar 2006 and FY Mar 2007, from LKR 17.22 million to LKR 40.34 million, amid increased insurance commissions. In FY Mar 2008, apart from fee-based income, the Company enjoyed a one-off profit from the sale of the former

¹ Interest differential = Interest income on interest-earning assets - Interest expenses on interest-bearing liabilities

Australian High Commission property that it had acquired. Together, these had altered the Company's gross income composition, which had previously tilted towards net interest income (refer to Chart 6). Going forward, RAM Ratings expects the Company to retain its FY Mar 2007 composition.

Chart 6: Composition of LBF's gross income



Provisions also moderated performance

As a result of the above, LBF's gross income ascended 42.95% in FY Mar 2007 and 41.11% in FY Mar 2008. Even so, the Company was unable to translate this into a bottom-line growth as it had to provide LKR 95.37 million in FY Mar 2008 (net of recoveries). Following the adoption of the new Direction 3, the Company had to provide an additional LKR 19.68 million. As a result of this higher provision, its ROA and ROE shrank from a respective 4.85% and 59.95% in FY Mar 2007 to 4.01% and 45.47% in FY Mar 2008.

Overheads adequately managed

On a more positive note, LBF retained a tight leash on its overheads, thereby improving its cost-to-income ratio to 50.03% as at end-FY Mar 2008. RAM Ratings notes that the Company's cost-to-income ratio had been in line with the industry's, before upstaging the industry average in the last 2 years.

Profitability to moderate

Moving forward, RAM Ratings expects the Company's short-term financial performance to be hampered as margins contract and provisions increase in respect of doubtful debts. However, performance is envisaged to remain better than the industry average.

Funding & Liquidity

Public and secured borrowings support asset expansion

To support its aggressive loan growth, LBF relies both on public deposits and other secured borrowings. The Company has augmented its deposit base by 36.38% and 60.24% y-o-y in the past 2 years. As at end-FY Mar 2008, LBF's deposit base stood at LKR 7.31 billion, retaining its place as the third-largest RFC in terms of deposit size. As secured borrowings had increased to keep pace with its loan expansion, LBF's loan-to-deposit ratio remained high at 123.98% as at end-FY Mar 2008.

Treasury division manages funding and cashflow

Secured borrowings are lumpy and rank ahead of depositors, and is a concern to RAM Ratings. The Company's treasury division manages these risks by forecasting cashflows and arranging contingency lines. In addition, the division partially manages interest-rate risks by appropriate pricing of advances. As

Increasing frequency of repricing

most of its advances are fixed, however, the Company has limited capacity to reprice its loans. Moreover, the division had arranged the requisite funding to redeem the LKR 100 million of debentures that fell due in early July 2008.

In terms of maturity mismatches, deposit tenures have tilted towards the shorter end amidst high interest rates, thus increasing the frequency of repricing. Concurrently, LBF's asset-liability mismatch has worsened heightening its interest-rate and liquidity risks. LBF partially mitigates this risk via pawning advances, which have shorter tenures. Meanwhile, liquidity risk is somewhat managed by monitoring and having contingent funding lines.

Table 2 : Maturity mismatches of LBF

Maturity Bucket	FY Mar 2007				FY Mar 2008			
	Interest-bearing assets (LKR Millions)	Interest-bearing liabilities (LKR Millions)	Gap	Gap as a % of Interest-earning assets	Interest-bearing assets (LKR Millions)	Interest-bearing liabilities (LKR Millions)	Gap	Gap as a % of Interest-earning assets
Less than 3 Months	1,628	2,012	(384)	-5.96%	1,876	4,118	(2,242)	-22.18%
3 to 12 Months	1,503	2,465	(962)	-14.94%	3,044	3,241	(197)	-1.95%
1 to 3 Years	2,512	1,239	1,274	19.77%	4,026	1,302	2,725	26.96%
Over 3 Years	798	347	451	7.00%	1,161	406	754	7.46%
Total	6,442	6,063			10,108	9,068		

Liquidity ratio dipped below statutory minimum

Despite having various monitoring mechanisms, LBF's statutory liquidity ratio as at end-FY Mar 2008 was marginally below the regulator's requirement. This was due to an unexpected influx of deposits during the last week of the financial year. As the Company had channelled the bulk of this cashflow to repay its overdraft facilities, its statutory liquidity ratio had dipped below the required minimum of 15%. Even though the Company had subsequently taken steps to rectify this shortfall by investing LKR 52.34 million in treasury bills, RAM Ratings views this breach negatively.

Capital Adequacy

Capital adequacy expected to improve

RAM Ratings opines that LBF's capital adequacy is marginal at present. Upon completion of the issuance of its subordinated debentures that qualify as supplementary capital, however, the Company is expected improve its overall risk-weighted capital adequacy. RAM Ratings believes this would allow the Company to withstand the expected moderation in asset quality.

Improved capital adequacy

The Company reported a Tier-I capital of 11.88% and an overall risk-weighted capital-adequacy ratio of 12.12% as at end-FY Mar 2008 – well above the minimum statutory requirements of 5% and 10%, respectively. Nonetheless, its ratio of net NPLs to shareholders' funds was still vulnerable at 17.19% as at the same date. RAM Ratings notes, however, that this ratio has been improving in tandem with the Company's asset quality and performance. In addition, LBF embarked on 2 rounds of share issuance and a bonus issue in FY Mar 2007 and FY Mar 2008, to keep pace with its rapid loan growth. We also note that the Company intends to offer debentures in future, with another bonus issue. Under the circumstances, RAM Ratings expects LBF's capital adequacy to improve.

Industry Overview

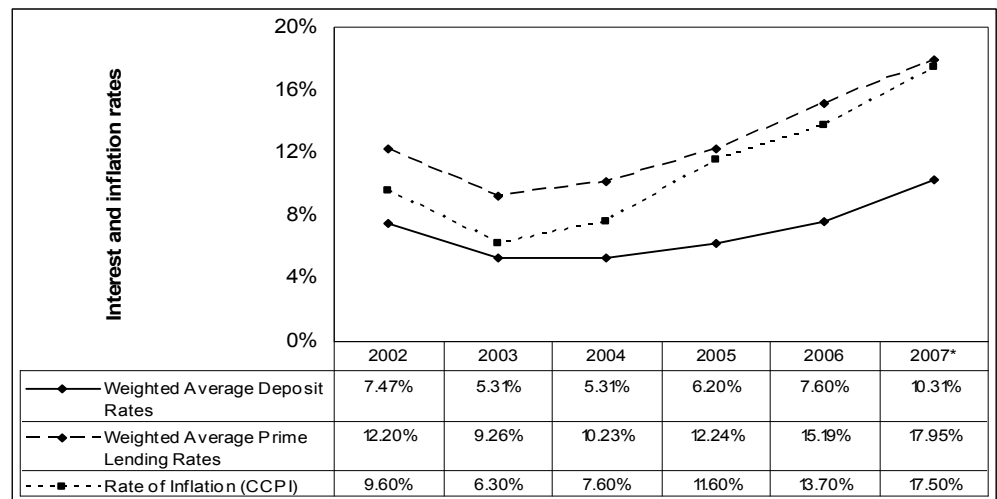
Sri Lanka's gross domestic product ("GDP") is estimated to have expanded by 6.8% in 2007 (2006: +7.7%). Growth had slowed down for all sectors, with agriculture and services recording the most acute deceleration (refer to Table I). All sub-segments within the services sector had lost momentum, with the hotel industry reporting the steepest drop. However, the financial services, insurance and real estate sub-sectors bucked the trend, advancing by 8.7% in 2007 (2006: +8.5%).

Table I: Overall and sectoral GDP growth

GDP at constant 2002 prices	2006	2007
Agriculture	6.3%	3.3%
Industry	8.1%	7.6%
Services	7.7%	7.1%
Total	7.7%	6.8%

The domestic banking sector, meanwhile, had progressed despite rising interest rates driven by housing and consumption loans. Greater inflation is likely to have propelled borrowing for consumption while easy access to credit may also have been a contributory factor. The Colombo Consumer Price Index ("CCPI") has been trending upwards since 2003, indicating that monetary measures have not yielded the desired results. Furthermore, the steeper incline of the index since 2005 may be a reflection of the escalating hostilities in the northern and eastern parts of the country (refer to Chart I). Against this backdrop, the weighted-average deposit rate² has been lower than the inflation rate, resulting in negative real returns for depositors.

Chart I: Trends in interest and inflation rates



Looking ahead, interest rates are expected to remain elevated, driven by mounting inflationary pressures; they are likely to stay at current levels due to escalating global commodity prices, growth in government credit and the nation's expanding budget deficit.

Against this backdrop, the RFC industry's asset quality is likely to weaken as a whole. RFCs predominantly deal in vehicle financing, where lending rates are

² The Central Bank calculates the Weighted Average Deposit Rate monthly, based on the weighted average of all outstanding interest-bearing deposits of commercial banks and the corresponding interest rates.

fixed and tenures usually extend from 36 to 48 months. Therefore, in an environment where interest rates are lofty, the borrower is locked in at a higher rate for a longer period. Meanwhile, rising inflation erodes the borrower's repayment capacity, resulting in more defaults. Given this, RFCs that cater to the sub-prime segment need to be cautious when expanding their portfolios. It is therefore vital for RFCs to become more stringent in their underwriting, and emphasise collection and recoveries.

RFCs are also likely to face heftier funding costs and a tilt in the funding structure towards the shorter end, as they are largely dependent on deposits. Commercial banks - their main competitors - enjoy lighter funding costs because of their large volumes of current and savings accounts, which bear low interest rates. In contrast, RFCs are expected to offer higher rates of interest on their deposit products. Even though the Central Bank has allowed RFCs to offer savings accounts, they are still at a disadvantage as they lack the infrastructure vis-à-vis branches and automated teller machines to effectively compete against commercial banks. To compound this, the current interest-rate environment is likely to further skew the funding structure towards the short end as depositors move their funds from long- to short-term facilities, in an effort to maximise their returns.

In addition, RAM Ratings notes RFCs' increasing tendency to pledge their portfolios with banks, in a bid to minimise mismatches between funding and lending. Even though RFCs could attain a better maturity structure from this strategy, it could also bring about concentration risk in relation to their funding structure. As these funding lines are based on floating interest rates, RFCs' capacity to manage their funding costs would be limited. While a large and diversified public deposit base reduces concentration risk, it also means greater leeway in managing funding costs.

The tendency of RFCs to chase short-term profits through trading activities, especially in real estate, is likely to expose them to a vast spectrum of risks, e.g. market, liquidity, counterparty and credit. Finance companies that are involved in housing and real-estate development tend to recognise trading profits upfront; this clouds comparison with other RFCs that offer financing products. Furthermore, trading activities also expose the RFCs' cashflows to volatility. Moreover, aggressive profit recognition could also deplete capital through excessive dividend payouts. Market risk arises due to inflated property prices, location risk, infrastructure facilities and extraneous social factors. On the other hand, counterparty risk would materialise should contractors fail to meet their obligations.

In terms of capitalisation, the RFC industry is anticipated to expand its capital base due to regulatory requirements. The Central Bank issued a directive in 2006, under which RFCs are required to have a minimum core capital of LKR 100 million by February 2007, and LKR 200 million by July 2008.

On the whole, the industry's profit performance - which is affected by all the abovementioned issues - is likely to be adversely affected. Nonetheless, RFCs with thin margins and high overheads are expected to feel the pinch much more than those with leaner structures and broader margins. Finally, resource allocation is also likely to be influenced by credit ratings as the public becomes more aware of such ratings and divert their funds towards better-managed RFCs.

Relevant Central Bank Directions Applicable to Registered Finance Companies

<p>Liquid assets</p>	<p>Every finance company must have a minimum holding of liquid assets at any given time. Liquid assets mean:</p> <ol style="list-style-type: none"> a) Cash in hand. b) Balances in a current or deposit account in a commercial bank, free from any banker's lien or charge. c) Sri Lankan Government Treasury Bills, free from any charge or lien. d) Sri Lankan Government Securities maturing within 1 year and free from any charge or lien. e) Central Bank securities maturing within 1 year and free from any charge or lien. f) Cash balance, if any, maintained with the Central Bank. <p>The minimum limits are as follows:</p> <ol style="list-style-type: none"> 1. For time deposits, 15% of outstanding deposits. 2. For certificates of deposits, 15% of the face value of the certificates. 3. For savings deposits, 20% of the outstanding deposits. <p>The companies should maintain the liquid assets in the form of (c), (d) and (e) above, equivalent to 10% of its average month-end deposit liabilities of the preceding financial year.</p>
<p>Provision of bad and doubtful debts</p>	<p>Every finance company had been required to follow either one of the following directions on provisioning for bad and doubtful debts until 1 April 2007:</p> <p><u>Direction No. 1 of 1991</u></p> <p>Bad and doubtful debts provided for under this direction are subject to a minimum of:</p> <ol style="list-style-type: none"> (a) 50% of all advances in arrears for a period of 7 to 12 months. (b) 100% of all advances in arrears for 13 months or more. <p>A company may deduct the value of land and buildings held as collateral for a particular advance, in arriving at the provision figure under both (a) and (b) above, subject to the following conditions:</p> <ol style="list-style-type: none"> 1. The value so deducted should not exceed the value decided by a professional valuer at the time of granting the advance. 2. In the case of residential properties occupied by the borrower or a tenant, there should be an agreement to grant vacant possession in the event of the sale of such property. <p><u>Direction No. 2 of 1991</u></p> <p>Bad and doubtful debts provided for under this direction are subject to a minimum of:</p> <ol style="list-style-type: none"> (a) 50% of all advances in arrears for a period of 12 to 24 months. (b) 100% of all advances in arrears for more than 24 months. <p>A new directive came into effect on 1 April 2007 (Direction No. 3 of 2006); this is very similar to Direction 1. However, Direction 3 requires all finance companies to follow a more stringent formula in the calculation of collateral value that is deductible for provisioning purposes.</p>

	<p>With effect from 1 April 2007, Direction No. 3 of 2006 will be applicable to every RFC and will replace Directions 1 and 2.</p> <p><u>Direction No. 3 of 2006</u></p> <p>Bad and doubtful debts provided for under this direction are subject to a minimum of:</p> <p>(a) 50% of all advances in arrears for a period of 6 to 12 months. (b) 100% of all advances in arrears for 13 months or more.</p> <p>A finance company may deduct the value of the following items held as collateral in arriving at the amount of provisioning;</p> <ol style="list-style-type: none"> 1. Sri Lankan Government securities, free from any lien or charge. 2. Central Bank securities, free from any lien or charge. 3. Time deposits in a licensed commercial bank, specialised bank or RFC, free from any lien or charge. 4. Bank guarantees. 5. With regard to repossessed vehicles and machinery, 80% of the valuation obtained in the preceding 6 months and by an approved valuer. 6. With regard to mortgaged land and buildings that are held as collateral, if the accommodation has been in arrears for a period of: <ol style="list-style-type: none"> a) 6-36 months, 100% of the value is deductible b) 37-60 months, 80% of the value is deductible c) 61-120 months, 50% of the value is deductible d) more than 120 months, 0% of the value is deductible
<p>Capital adequacy</p>	<p>Every finance company must maintain a minimum total risk-weighted capital-adequacy ratio of 10% in relation to its risk-weighted assets. The constituents of the capital are divided into:</p> <p>(a) Tier I - Core Capital</p> <p>This represents permanent shareholders' equity and reserves created or increased by appropriation of retained earnings or other surpluses, including share premiums, retained profits and other reserves. The core-capital ratio should constitute not less than 50%, i.e. this has to be at least half, of the total risk-weighted capital-adequacy ratio.</p> <p>(b) Tier II - Supplementary Capital</p> <p>Represents revaluation reserves, general provisions and other capital instruments which combine certain characteristics of equity and debt, such as hybrid capital instruments and unsecured subordinated debts. Supplementary capital should not exceed 100% of the core capital.</p> <p>The Central Bank also issues guidelines from time to time, to be used in computing total risk-weighted assets.</p>
<p>Single-borrower limit</p>	<p>In the case of an individual borrower, the maximum of a single advance or the aggregate of advances granted to, and the aggregate outstanding at any time on advances granted to, should not exceed 10% of the capital funds of the finance company.</p> <p>This limit stands at 15% for any group of corporate or unincorporated borrowers with common directors or common partners or common proprietors.</p> <p>Capital funds generally mean paid-up capital and permanent free reserves, and may include unsecured debentures and other loan stocks if approved by the Monetary Board.</p>

<p>Minimum core-capital requirement</p>	<p>Every finance company must at all times maintain an unimpaired core capital of LKR 200 million. However, companies that could not meet this requirement by February 2006 had been granted a 30-month extension, subject to the following:</p> <ul style="list-style-type: none"> (a) A finance company with a core capital of less than LKR 100 million must: <ul style="list-style-type: none"> 1. enhance its core capital to at least LKR 100 million by February 2007; and 2. bring the remaining LKR 100 million or the deficit up to the core-capital requirement of LKR 200 million by July 2008. (b) A finance company with a core capital of between LKR 100 million and LKR 200 million must bring in: <ul style="list-style-type: none"> 1. at least 50% of the deficient amount to meet the core-capital requirement of LKR 200 million by February 2007; and 2. the balance of the deficient amount up to the core capital requirement of LKR 200 million by July 2008.
<p>Investments</p>	<p>A finance company must not invest in the shares of any company</p> <ul style="list-style-type: none"> (a) In excess of 5% of its capital funds, provided that such investment does not exceed 40% of the issued share capital of the investee company (b) In aggregate, in excess of 25% of the capital funds of the finance company <p>Capital funds generally mean paid-up capital and permanent free reserves, and may include unsecured debentures and other loan stocks if approved by the Monetary Board.</p>

Corporate Information

Date of Incorporation: 30 May 1971

Commencement of Business: 1971

Major Shareholders:

Mr KDD Perera	62.42%
Royal Ceramics Lanka PLC	10.55%
SBL/Mr KDD Perera	8.91%
Pramuka Savings & Development Bank Ltd	7.04%
Rosewood (Pvt) Ltd	1.03%

Directors:

Mr BM Amarasekera	Chairman
Mr KDD Perera	Deputy Chairman
Mr Sumith Adhihetty	Managing Director
Mr Nimal Perera	Director
Mr AM Weerasinghe	Director
Mr Anuradha Perera	Director
Mr MDS Goonetilleke	Director
Dr Priyal Esantha Perera	Director
Mr Niroshan Udage	Executive Director
Mr BDSA Perera	Executive Director

Auditor: Ernst & Young

Listing: 1998 (Colombo Stock Exchange)

Key Management:

Mr Sumith Adhihetty	Managing Director
Mr Niroshan Udage	Executive Director Asset Finance
Mr BDSA Perera	Executive Director Asset Management
Mrs Sandya Silva Hasthimuni	General Manager – Administration
Mr. Manjula Gooneratne	Deputy General Manager-Credit & Operations
Mr Athula Jayasekera	Assistant General Manager - Business Development
Mr Rohitha Bandusena	Assistant General Manager – Treasury & Operations
Mr Shyamalie Weerasooriya	Senior Manager, Finance
Mr Marlon Perera	Senior Manager Deposits
Mr Roshan Jayawardena	Senior Manager Marketing

Major Subsidiaries and Associates: None

Capital History:

Year	Remarks	Amount (LKR million)	Cumulative Total (LKR million)
2005	Ordinary shares	135.00	135.00
2006	Share issue	9.28	144.28
	Bonus issue	57.71	202.00
2007	Ordinary Share + Share premium	216.41	418.41

Financial Summary - Company

BALANCE SHEET (Rs. Million)	31-Dec-03	31-Mar-05	31-Mar-06	31-Mar-07	31-Mar-08
ASSETS					
Cash & Money At Call	40.06	24.24	57.23	90.56	152.58
Deposits & Placements With Financial Institutions	95.10	140.94	171.79	247.92	415.92
Securities					
Dealing Securities	185.70	234.32	297.94	361.37	476.88
Investment Securities	18.33	12.94	9.02	9.03	9.03
Gross Loans & Advances	2,189.04	3,129.10	4,269.72	5,883.10	9,319.26
Interest-In-Suspense	43.85	61.08	72.75	32.61	44.73
General Loan Loss Reserves	0.00	0.00	0.00	0.00	0.00
Specific Loan Loss Reserves	288.16	344.21	389.49	108.81	212.40
Net Loans & Advances	1,857.03	2,723.80	3,807.49	5,741.68	9,062.13
Investments in Subsidiaries/Associates	0.00	0.00	0.00	0.00	0.00
Investment Land and Properties	184.46	161.76	170.96	238.64	218.20
Other Assets	75.40	43.87	88.80	211.04	279.59
Property, Plant and Equipment	47.24	58.96	63.12	90.28	129.77
TOTAL ASSETS	2,503.32	3,400.84	4,666.34	6,990.52	10,744.10
LIABILITIES					
Customer Deposits					
Savings	0.00	0.00	0.00	0.00	0.00
Fixed	1,915.13	2,496.38	3,344.67	4,561.45	7,309.10
NIDs	90.93	110.41	0.00	0.00	0.00
Interbank Deposits	0.00	0.00	0.00	0.00	0.00
Bills & Acceptances Payable	0.00	0.00	0.00	0.00	0.00
Securities Sold Under Repurchase Agreements	0.00	0.00	0.00	0.00	0.00
Other Borrowing	86.59	314.20	561.61	1,401.84	1,658.59
Subordinated Debt & Hybrid Capital	100.00	100.00	100.00	100.00	100.00
Other Liabilities	147.15	167.92	305.41	339.81	701.39
TOTAL LIABILITIES	2,339.80	3,188.91	4,311.69	6,403.09	9,769.08
Paid-up Capital/Stated Capital	135.00	135.00	135.00	246.71	418.41
Minority Interest	0.00	0.00	0.00	0.00	0.00
Statutory General Reserve	49.46	59.14	74.55	110.31	151.47
Retained Profits/(Loss)	(20.94)	17.79	145.10	230.41	405.13
Total Shareholders' Funds	163.52	211.93	354.65	587.43	975.02
TOTAL LIABILITIES & SHAREHOLDERS' FUNDS	2,503.32	3,400.84	4,666.34	6,990.52	10,744.10
COMMITMENTS & CONTINGENCIES	17.65	11.55	18.95	19.39	5.61
TIER 1 CAPITAL	181.77	235.02	302.00	655.22	1,007.27
CAPITAL BASE	273.26	317.32	366.14	701.35	1,027.27

Financial Summary - Company

INCOME STATEMENT (Rs. Million)	31-Dec-03	31-Mar-05	31-Mar-06	31-Mar-07	31-Mar-08
Interest Income	425.84	677.40	849.98	1,229.41	2,082.42
Less: Amortisation Of Premium/(Accretion Of Discount)	0.00	0.00	0.00	0.00	0.00
Less: Net Interest Suspended	0.00	0.00	0.00	0.00	0.00
Less: Interest Expense	297.08	383.40	432.86	655.62	1,318.06
Net Interest Income	128.75	294.00	417.12	573.78	764.36
Non-Interest Income	33.00	42.78	29.92	65.25	137.36
Gross Income	161.75	336.79	447.04	639.03	901.72
Personnel Expenses	45.67	71.37	80.94	129.64	184.52
Other Non-Interest Expenses	84.10	123.10	142.99	198.93	266.62
Loan Loss Provisions	28.78	68.97	50.00	28.05	95.37
Share of results of Associated Companies	0.00	0.00	0.00	0.00	0.00
Pre-Tax Profit	3.21	73.34	173.11	282.40	355.21
Taxation	0.00	24.94	96.05	103.63	149.38
Profit After Tax	3.21	48.41	77.06	178.78	205.83
Extraordinary Items	0.00	0.00	0.00	0.00	0.00
Prior Year Adjustments	3.55	0.00	0.00	0.00	0.00
Minority Interests	0.64	0.00	0.00	0.00	0.00
Transfer To Statutory Reserves	0.00	0.00	0.00	0.00	0.00
Transfer To Other Reserves	0.00	9.68	24.11	35.76	41.16
Dividend	0.00	0.00	13.50	0.00	68.18
Retained Profit For The Year	6.11	38.73	39.44	143.02	96.49

Financial Ratios - Company

KEY RATIOS (%)	31-Dec-03	31-Mar-05	31-Mar-06	31-Mar-07	31-Mar-08
Profitability					
Net Interest Margin	5.43%	7.97% *	10.34%	9.84%	8.62%
Non-Interest Income Margin	1.39%	1.16%	0.74%	1.12%	1.55%
Cost To Income	80.22%	57.74%	50.09%	51.42%	50.03%
Return On Assets	0.14%	1.99% *	4.29%	4.85%	4.01%
Return On Equity	2.25%	31.75% *	61.11%	59.95%	45.47%
Dividend Payout	0.00%	0.00%	17.52%	0.00%	33.12%
Asset Quality					
Gross NPL Ratio	29.87%	15.41%	14.82%	6.23%	4.10%
Net NPL Ratio	18.99%	4.72%	6.10%	4.45%	1.85%
Specific Loan Loss Provisions For Current Year	1.38%	2.07%	1.35%	0.55%	1.63%
Gross NPL Coverage	44.97%	72.81%	62.64%	29.85%	55.89%
Loan Loss Reserve Coverage	13.43%	11.22%	9.28%	1.86%	2.29%
General Loan Loss Reserve Coverage	0.00%	0.00%	0.00%	0.00%	0.00%
Liquidity & Funding					
Liquid Asset Ratio	16.25%	14.88%	15.35%	14.68%	13.34%
Statutory Liquid Asset Ratio	15.99%	15.33%	15.76%	15.34%	14.30%
Customer Deposits To Total Interest Bearing Funds	91.49%	86.29%	83.49%	75.23%	80.61%
Loans To Deposits Ratio	92.57%	104.49%	113.84%	125.87%	123.98%
Loans To Stable Funds Ratio	80.43%	85.82%	88.59%	87.52%	91.42%
Capital Adequacy					
Shareholders' Funds To Total Assets	6.53%	6.23%	7.60%	8.40%	9.07%
Tier 1 Risk Weighted Capital Adequacy Ratio	10.08%	9.50%	8.80%	11.60%	11.88%
Overall Risk Weighted Capital Adequacy Ratio	15.16%	12.83%	10.67%	12.42%	12.12%
Internal Rate Of Capital Generation	2.25%	20.95% *	22.44%	37.95%	17.62%

Note :

* annualised

NA = Not available / Not applicable

Financial Ratios - Company

Ratio Definition:-	
Net Interest Margin	Net Interest Income/Total Average Assets
Non-Interest Income Margin	Non-Interest Income/Total Average Assets
Cost To Income	Personnel & Other Non-Interest Expenses/Net Interest Income & Non-Interest Income
Return On Assets	Pre-Tax Profits/Total Average Assets
Return On Equity	Pre-Tax Profits/Average Shareholders' Funds
Dividend Payout	Dividends/Profit After Tax
Gross NPL Ratio	(Total Non-Performing Loans - Interest-In-Suspense)/(Gross Loans - Interest-In-Suspense)
Net NPL Ratio	(Total Non-Performing Loans - Specific Loan Loss Reserves - Interest-In-Suspense)/(Gross Loans - Specific Loan Loss Reserves - Interest-In-Suspense)
3-months Past Due	3-months Past Due Loans/(Gross Loans - Interest-in-Suspense)
Specific Loan Loss Provisions For Current Year	Specific Loan Loss Provisions(P&L)/Average Gross Loans
Gross NPL Coverage	General & Specific Loan Loss Reserves (B/S)/(Total Non-Performing Loans - Interest-In-Suspense)
Loan Loss Reserve Coverage	General & Specific Loan Loss Reserves (B/S)/(Gross Loans - Interest-In-Suspense)
General Loan Loss Reserve Coverage	General Loan Loss Reserves/(Gross Loans - Interest-In-Suspense - Specific Loan Loss Reserves)
Liquid Asset Ratio	Liquid Assets/Customer Deposits & Short-Term Funds
Statutory Liquid Asset Ratio	Statutory Liquid Assets/Customer Deposits
Loans To Deposits	Net Loans/Customer Deposits
Loans To Stable Funds	Net Loans/(Shareholders' Funds + Total Interest Bearing Funds + General Loan Loss Reserves - Interbank Funding - Fixed Assets - Investments in Subsidiaries/Associates)
Short-Term Funds	Interbank Deposits + Bills & Acceptances + Securities Sold Under Repos
Liquid Assets	Cash & Short-Term Funds + Securities Purchased Under Repos + Deposits & Placements With Financial Institutions + Quoted Securities
Statutory Liquid Assets	Cash & Short-Term Funds + Securities Purchased Under Repos + Deposits & Placements With Financial Institutions + Government Securities and Treasury Bills
Total Interest Bearing Funding	Customer Deposits + Interbank + Bills & Acceptances + Securities Sold Under Repos + Borrowing + Supplementary Capital
Internal Rate Of Capital Generation	Profit After Tax + Extraordinary Income - Dividend + General Loan Loss Provision/Average Shareholders' Funds

RAM RATINGS' CREDIT RATING DEFINITIONS (FINANCIAL INSTITUTIONS)

RAM Ratings' rating of a financial institution is an assessment and current opinion on the strength and performance of the rated institution.

LONG-TERM RATINGS

AAA Financial institutions rated in this category are adjudged to offer the highest safety for timely payments of financial obligations. This level of rating indicates entities with strong balance sheets, favourable credit profiles and consistent records of above-average profitability. Their capacities for timely payments of contractual financial obligations are unlikely to be impacted seriously by any foreseeable changes in economic conditions.

AA+
AA
AA- Financial institutions rated in this category are adjudged to offer high safety for timely payments of financial obligations. This level of rating indicates entities with sound credit profiles and without significant problems. Entities rated in this category are, however, considered to be somewhat more vulnerable to adverse changes in economic conditions than those entities rated in the highest category. The signs plus (+), flat and minus (-) indicate that the financial institution ranks at the higher, mid or lower end within this generic rating category respectively.

A+
A
A- Financial institutions rated in this category are adjudged to offer adequate safety for timely payments of financial obligations. This level of rating indicates entities with adequate credit profiles, but which possess one or more problem areas, giving rise to the possibility of future riskiness. Entities rated in this category have generally performed at industry average and are considered to be more vulnerable to changes in economic conditions than those rated in the higher categories. The signs plus (+), flat and minus (-) indicate that the financial institution ranks at the higher, mid or lower end within this generic rating category respectively.

BBB+
BBB
BBB- Financial institutions rated in this category are adjudged to offer only a moderate degree of safety for timely payments of financial obligations. This level of rating indicates entities which have been significantly under-performing in some areas. These entities are, however, considered to have the capability to overcome such problems in the short term, though adverse changes in economic conditions could impair their ability to make timely payments of financial obligations. The signs plus (+), flat and minus (-) indicate that the financial institution ranks at the higher, mid or lower end within this generic rating category respectively.

BB+
BB
BB- Financial institutions rated in this category are adjudged to lack key protection factors, which could result in inadequate safety for timely payments of financial obligations. This level of rating indicates that the entities may need certain favourable economic changes in order to meet financial obligations in a timely fashion. The signs plus (+), flat and minus (-) indicate that the financial institution ranks at the higher, mid or lower end within this generic rating category respectively.

B+
B
B- Financial institutions rated in this category are adjudged to be of high risk. Timely payments of financial obligations are impaired by serious problems which the entities face. Whilst entities rated in this category might be currently meeting obligations on time, continuance of this would depend upon favourable economic conditions or some degree of external support. The signs plus (+), flat and minus (-) indicate that the financial institution ranks at the higher, mid or lower end within this generic rating category respectively.

C+
C
C- Financial institutions rated in this category are adjudged to be of very high risk in relation to timely payments of financial obligations. This level of rating indicates entities with very serious problems and, unless external support is provided, they would be unable to meet their financial obligations in a timely fashion. The signs plus (+), flat and minus (-) indicate that the financial institution ranks at the higher, mid or lower end within this generic rating category respectively.

D Financial institutions rated in this category are either currently in default or expected to be in default, whether or not formally declared. This level of rating indicates that the entities are unlikely to meet maturing financial obligations, which calls for immediate external support of a high order.

SHORT-TERM RATINGS

- P1** Financial institutions in this category have superior capacities for timely payments of obligations.
- P2** Financial institutions in this category have strong capacities for timely payments of obligations.
- P3** Financial institutions in this category have adequate capacities for timely payments of obligations. The ability to honour the obligations is more vulnerable to adverse changes in business, economic or financial conditions.
- NP** Financial institutions in this category have doubtful capacities for timely payments of obligations.

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