


RATINGS

CREDIT RATING RATIONALE

FINANCIAL INSTITUTIONS – SRI LANKA

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

Senkadagala Finance Company Limited – Rating Review

Financial Institution
Ratings:

Long-term: A- [Reaffirmed]

Short-term: P2 [Reaffirmed]

Rating Outlook:

Stable

Strengths:

- Above-average profitability
- Healthy capitalisation
- Expanding branch network
- Effective IT framework

Weakness:

- Fragile funding structure

Principal Activities:

Finance company engaged in hire-purchase, leasing, retail loans and accepting public deposits

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Summary

RAM Ratings has reaffirmed the respective long- and short-term ratings of Senkadagala Finance Company Limited ("Senkadagala" or "the Company") at A- and P2; the long-term rating has a stable outlook. The ratings are premised on Senkadagala's commendable profitability, healthy capitalisation and moderating - albeit better than industry average - asset quality. The ratings are, however, constrained by the Company's fragile funding structure vis-à-vis its reliance on collateralised borrowing.

Senkadagala is the fifth-largest registered finance company ("RFC") in Sri Lanka, accounting for 4.04% of the industry's assets as at the end of FYE 31 March 2007 ("FY Mar 2007"). The Company operates through 25 branches, making it the third-largest RFC in terms of geographical reach. RAM Ratings notes that Senkadagala's powerful information-technology ("IT") infrastructure has been the driving force behind the cost and operational efficiencies enjoyed by the Company thus far.

Previously, the Company had followed a policy of writing off loans that had been in arrears for more than 6 months; however, effective FY Mar 2007, it has been instead making provisions for such loans in line with regulatory guidelines. Accordingly, the Company recorded a gross non-performing-loan ("NPL") ratio (6-month basis) of 2.88% as at end-FY Mar 2007 (industry average: 4.46%).¹ We note that this rise in NPLs had followed a period of aggressive growth and difficult economic conditions. Going forward, RAM Ratings expects the Company to decelerate its expansion and intensify its focus on collections and recoveries.

Senkadagala's profitability advanced further in the reviewed period, with a record pre-tax profit of LKR 257.75 million for FY Mar 2007; this translated into a 24.29% year-on-year ("y-o-y") growth. The growth in profits was underpinned by increased interest income, commensurate with Senkadagala's loan expansion and more lucrative yields on hire-purchase ("HP") financing. The Company's returns on assets ("ROA") remained strong at 5.73% as at end-FY Mar 2007 (industry average: 3.79%).

Collateralised borrowings were still the largest source of funding (57.23%) for Senkadagala as at end-FY Mar 2007, when almost its entire loan portfolio remained pledged against these debts. Although the management believes that this represents a cheaper source of funding, RAM Ratings' concerns hinge on the subordination of depositors' funds as a result of collateralised debts.

Nonetheless, the Company's capitalisation remained healthy with a core capital base of LKR 684.50 million as at end-FY Mar 2007, which was more than triple the regulatory minimum of LKR 200 million stipulated by the Central Bank of Sri Lanka ("Central Bank").

¹ All industry statistics for FY Mar 2007 and end-September 2007 are based on provisional financial statements released by the Central Bank.

Outlook

The stable outlook on the Company's long-term rating reflects RAM Ratings' expectations that Senkadagala will be able to maintain its profit performance, liquidity and capitalisation at current levels while not allowing its asset quality to deteriorate any further.

An upward movement in Senkadagala's ratings is unlikely in the medium term, but may be driven by a significant and sustainable improvement in the Company's funding structure and market share, whilst its asset quality revisits historical levels. Nonetheless, downward pressure on the ratings could materialise in the event of any further deterioration in asset quality or gearing levels.

Corporate Profile

40-year history

Senkadagala is an RFC licensed by the Central Bank under the Finance Companies Act No. 78 of 1988, and the Finance Leasing Act No. 56 of 2000. The Company was incorporated in Kandy in 1968, by its founder and Director, Mr EW Balasuriya.

Fifth-largest RFC

The Company is supported by 150 staff and 25 branches in the western, north-western, central and southern regions of the country. Senkadagala is Sri Lanka's fifth-largest RFC in terms of assets, accounting for 4.04% of the industry's assets as at end-FY Mar 2007. The Company's principle lines of business comprise HP financing, finance leasing, retail lending and accepting public deposits.

Ownership

Family concern

Senkadagala is a public limited company, 97%-owned and managed by the founding Balasuriya family (refer to Table 1). The Balasuriya family also has other interests in gaming, hotels and jewellery retailing. As at end-FY Mar 2007, Senkadagala held a 39%-stake in Hotel Casamara while the family owned the remaining interest.

Table 1: Shareholders of Senkadagala (as at end-FY Mar 2007)

Stakeholder	Shareholding
EW Balasuriya & Co (Pvt) Ltd	58.90%
Mr EW Balasuriya	0.08%
Mr L Balasuriya	6.56%
Dr A Balasuriya	6.56%
Mr R Balasuriya	6.56%
Dr M Balasuriya	6.56%
Dr Gayatri Madan Mohan (member of Balasuriya family)	6.56%
Mrs L Fernando (member of Balasuriya family)	5.47%
Family holdings (aggregate)	97.25%
Others	2.75%
Total	100.00%

Meanwhile, the management is going ahead with its plans to list Senkadagala on the Secondary Board of the Colombo Stock Exchange, and is in the process of fulfilling the minimum listing requirements.

Management & Strategies

Senkadagala's operations are under the purview of its Chief Executive Officer ("CEO"), Mr Lakshman Balasuriya. He is supported by an able and experienced team of senior managers, who have been the driving force behind the Company's continued success.

Branch expansion

Senkadagala added 6 more branches to its distribution network in FY Mar 2007, with a further 5 by end-December 2007. The Company now operates through 25 branches, rendering it the third-largest RFC in terms of branch network and geographical reach. Apart from this, Senkadagala maintains a strong working relationship with the Commercial Bank of Ceylon ("Commercial Bank"), enabling customers to make rental payments through any of the latter's 130-odd branches island-wide.

Emphasis on deposit mobilisation

Meanwhile, Senkadagala had emphasised its deposit-mobilisation activities during the period under review, The Company launched its new savings product in November 2007. To make its savings product more appealing to customers, the Company has also launched its own debit card-cum-automated teller machine ("ATM") card, which allows customers to access their savings accounts through any ATM linked to the Cirrus inter-bank network.

IT - a competitive strength

Meanwhile, effective use of IT has been the foundation of Senkadagala's cost and operational efficiencies. The Company has service agreements with leading software and hardware companies to minimise down-time, and maintains an off-site back-up server in case of any major breakdown of its main database. This IT system is an integral element of the Company's operations and has supported its smooth transition vis-à-vis branch expansion and the development of new products. The IT configuration enables full branch networking, and permits the management to monitor vital data and business transactions from remote locations. As the Company believes in and promotes a fully interactive, truly "paperless" environment, the management ensures that it stays abreast of changes and continually upgrades the system for the benefit of the business.

Corporate Governance

Board composition

As at end-FY Mar 2007, Senkadagala's Board comprised 6 non-executive directors and an executive director from the Balasuriya family. The Managing Director and CEO, Mr Lakshman Balasuriya, is the only Executive Director on the Board. In line with the planned listing of Senkadagala, the Company has appointed Mr SK Wickremasinghe as an independent Chairman, effective April 2008. Mr Wickremasinghe takes over from Mr EW Balasuriya, who had been the Chairman of the Company for over 30 years; the latter will remain as a Director on the Board.

We note that the Board convened 7 times in FY Mar 2007, to review the Company's performance and deliberate on strategic issues. The Board currently has 4 sub-committees: credit, audit, strategic planning, and human-resource management.

Related-party transactions

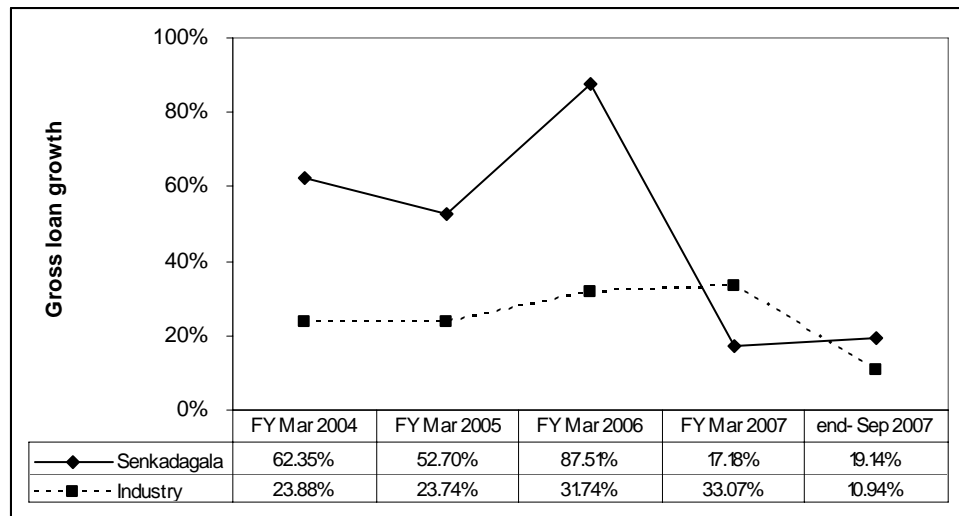
While external audits on the Company are undertaken annually by KPMG Ford Rhodes Thornton & Co, internal inspections are carried out monthly by MSL Management Audit Services Limited. RAM Ratings notes that the Company's loans to related parties, which stood at LKR 20.77 million as at end-FY Mar 2006, had been fully settled by end-FY Mar 2007. As such, there was no amount owed by related parties at the end of the last fiscal year; RAM Ratings views this positively.

Decelerating loan growth

Asset Quality

The Company's asset base stood at LKR 4.79 billion as at end-FY Mar 2007, representing a 14.16% y-o-y increase from LKR 4.20 billion a year earlier (end-September 2007: LKR 5.24 billion). The growth had been largely driven by a 15.11% y-o-y expansion in Senkadagala's net loan base, from LKR 3.28 billion to LKR 3.77 billion over the same period. Nonetheless, we note that the Senkadagala's aggressive loan expansion over the past few years moderated to 17.18% in FY Mar 2007 (refer to Chart 1), in contrast to 87.51% in FY Mar 2006; this deceleration is viewed favourably by RAM Ratings given the country's overall macroeconomic situation. Meanwhile, the Company's balance-sheet profile remained much the same as at end-FY Mar 2007, with loan assets taking up a healthy 78.70% of its asset base while liquid assets and fixed assets constituted a respective 8.08% and 4.31%.

Chart 1: Gross loan growth of Senkadagala vs the industry



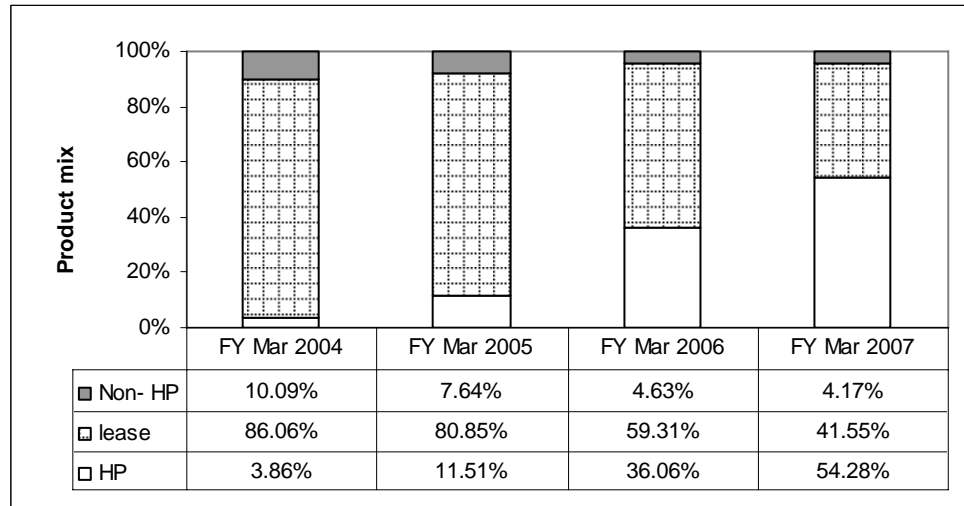
*End-September 2007 figures are annualised

HP dominates portfolio

The Company's HP business continued augmenting in FY Mar 2007, becoming the largest loan product in its portfolio (refer to Chart 2). As at end-FY Mar 2007, HP accounted for a 54.28% slice of Senkadagala's loan portfolio compared to 36.06% a year earlier. Accordingly, the proportions of the leasing and non-HP loans (pledged loans to car dealers and fixed deposits) receded to 41.55% and 4.17%, respectively (end-FY Mar 2006: 59.31% and 4.63%). The 76.41% y-o-y surge in the Company's HP portfolio can be mainly attributed to the increased popularity of HP facilities arising from exemptions on value-added tax, as well as waning demand for new vehicles due to price escalations².

² HP financing is generally used for registered/second-hand vehicles.

Chart 2: Product mix of Senkadagala



Rising NPLs

Although Senkadagala’s asset quality weakened in FY Mar 2007, it was still better than the industry’s. Previously, the Company had fully written off advances that had been in arrears for 6 months or more. Effective FY Mar 2007, the Company has instead been making provisions against these NPLs, as per the Central Bank’s guidelines. Accordingly, Senkadagala’s gross NPL ratio (6-month basis) climbed up to 2.88% as at end-FY Mar 2007, rising further to 3.17% as at end-September 2007. Nonetheless, it is pertinent to note that these NPL ratios are still below the respective industry averages of 4.46% and 5.29% as of the same dates. The decline in the Company’s asset quality had followed a period of aggressive expansion (FY Mar 2006: +87.51%), compounded by the country’s weakening economic climate, to which the RFC sector is more vulnerable.

Slip in collections

We also note a slip in the Company’s collections during the year under review; advances falling into the “0-3 months in arrears” bucket had contracted from 95% to 92% of its loan portfolio as at end-FY Mar 2007 - reflecting the pressure exerted by its aggressive loan expansion prior to FY Mar 2007. Accordingly, the proportion of loans that were 3 months past due increased from 4.01% to 8.05% over the same period. Going forward, RAM Ratings expects the management to rein in its loan expansion and concentrate on recovery efforts to secure the health of its loan portfolio. That said, further deterioration in asset quality may exert downward pressure on the Company’s ratings.

Fluctuating stock of seized vehicles

Elsewhere, Senkadagala’s stock of seized vehicles increased from LKR 97.06 million to LKR 206.18 million in FY Mar 2007 (end-September 2007: LKR 166.56 million). However, the Company maintained its policy of selling foreclosed vehicles within 3 months from the date of foreclosure.

Adequate provisioning for bad debts

As a result of the change in its bad debt policy effective FY Mar 2007, the Company has been provisioning for bad debts in accordance with the Central Bank’s Direction 3.³ Consequent to LKR 68.84 million of additional provisions during the year, the Company’s gross NPL coverage stood at 66.09% as at end-FY Mar 2007 (end-September 2007: 79.09%); this is in line with the industry average of 68.13%. Consequently, Senkadagala’s net NPL ratio came up to 1.00% as at the same date - significantly below the industry average of 2.34%.

Sufficiently diversified portfolio

Elsewhere, Senkadagala’s portfolio remained adequately diversified with its top 10 borrowers constituting less than 2% of its gross loan portfolio and less than

³ Refer to page 12 for Central Bank regulations.

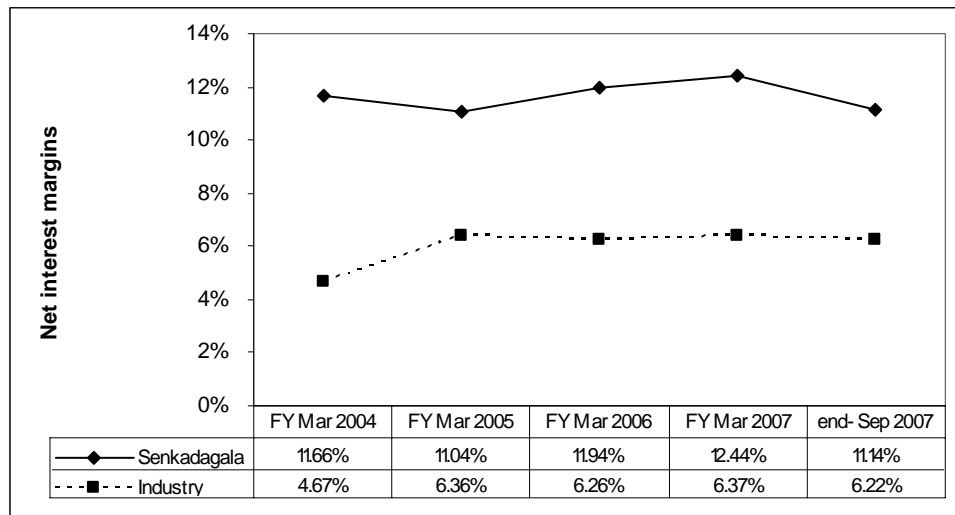
Robust profits

10% of its shareholders' funds as at end-FY Mar 2007. While 92% of the facilities had net outstanding amounts of less than LKR 1 million, these accounted for approximately 65% of the Company's total portfolio value. Meanwhile, Senkadagala also maintained a loan-to-value ratio of 60% to 70% for most of its facilities.

Performance

The Company chalked up a record pre-tax profit of LKR 257.75 million in FY Mar 2007. Despite a moderate 17.18% y-o-y advancement in gross loans, Senkadagala's net interest income surged 48.52% to LKR 559.40 million for the year (FY Mar 2006: LKR 376.64 million), supported by higher yields from HP financing and higher default interest on loans. In line with this, the Company's net interest margin ("NIM") also broadened from 11.94% to 12.44% (end-September 2007: 11.14%). As in previous years, Senkadagala's NIM stood well above the industry average of 6.37% as at the same date (refer to Chart 3).

Chart 3: NIM of Senkadagala vs the industry



*End-September 2007 figures are annualised

Escalating interest costs

On the other hand, we also note a steep spike in the rates of interest that the Company has been subject to in the past few years (refer to Table 2). In this respect, the volatile market environment and Senkadagala's reliance on external borrowings may continue exerting pressure on its margins in the foreseeable future. Although the longer tenures on the Company's borrowings (compared to the much shorter maturities for deposits) have enabled it to manage its asset-liability maturities, this does not preclude the Company from interest-rate risk, as most of these debts entail floating interest rates.

Table 2: Rates of interest earned and paid by Senkadagala

As at end-	FY Mar 2005	FY Mar 2006	FY Mar 2007	End-Sep 2007
Interest income/interest-earning assets	20.81%	23.14%	26.79%	26.32%
Interest expenses/ interest-bearing liabilities	9.56%	10.77%	13.87%	14.76%
Interest differential	11.25%	12.37%	12.92%	11.55%

*End-September 2007 figures are annualised

Stable non-interest income

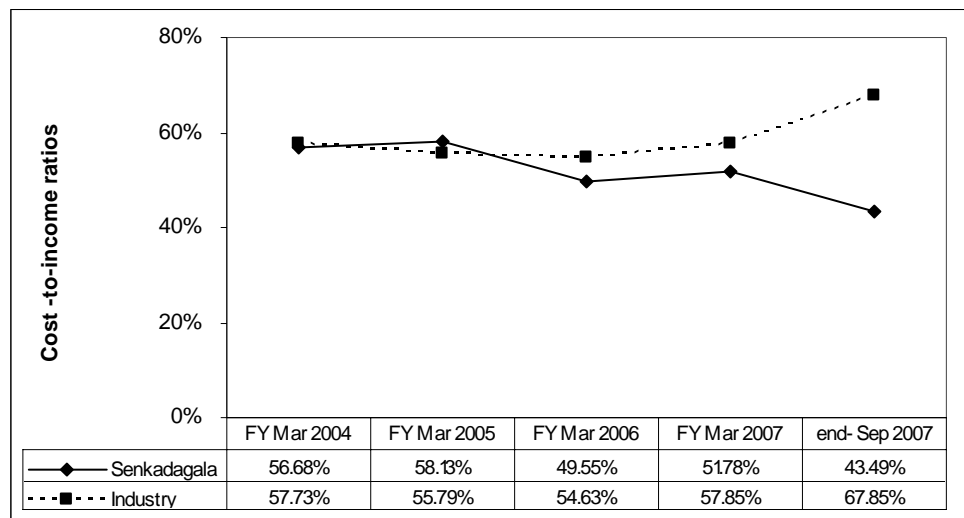
The Company's non-interest income appreciated 52.78% y-o-y to LKR 92.02 million in FY Mar 2007, supported by commissions, legal fees and profits from sales of seized vehicles. The composition of its gross income remained much the

IT framework enhances cost efficiency

same, with approximately 15% contributed from non-interest-income and 85% from net interest income.

Despite rapid branch expansion, Senkadagala has managed to keep a tight reign on its overheads - thanks to its efficient IT infrastructure. Although operating overheads (excluding loan-loss provisions) surged 55.83% y-o-y in line with its expanded operations, the Company's cost-to-income ratio only edged up from 49.55% to 51.78% as at end-FY Mar 2007 (end-September 2007: 43.49%). This compares well with the industry average of 57.85% (refer to Chart 4). Senkadagala's prudent control over its overheads, supported by the management's cost consciousness and staff productivity, is viewed favourably by RAM Ratings.

Chart 4: Cost-to-income ratios of Senkadagala vs the industry



Above industry-average ROA and ROE

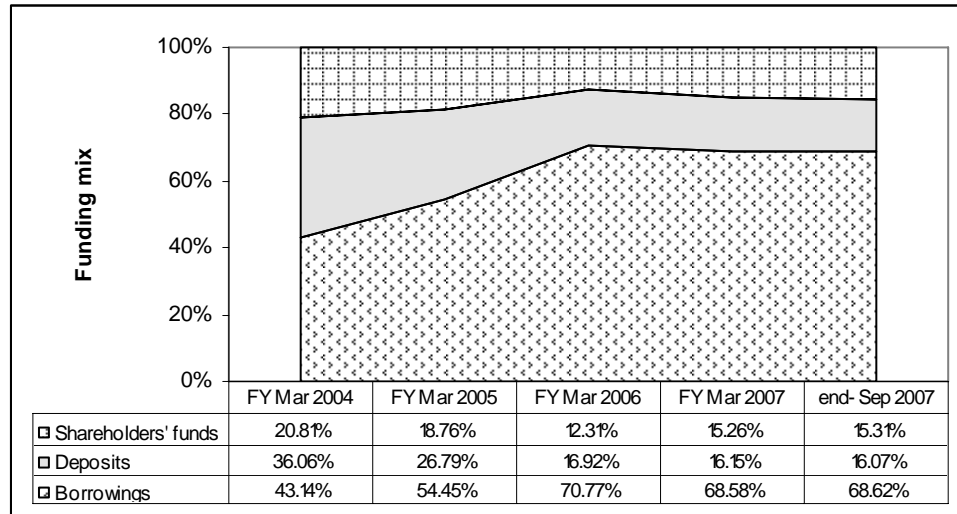
The Company posted a healthy ROA of 5.73% and return on equity ("ROE") of 44.34% as at end-FY Mar 2007. Although margins had been slightly compressed from the previous year's respective 6.58% and 49.12%, Senkadagala had been able to keep its profit margins well above industry averages in the past few years. The industry's average ROA and ROE stood at 3.79% and 24.56%, respectively, as at end-FY Mar 2007. Given Senkadagala's healthy NIM and tight cost control, RAM Ratings expects the Company's profit performance to remain above the industry average over the medium term.

Funding & Liquidity

Dependent on borrowings for funding

Senkadagala still depends on borrowings as its primary source of funding. As at end-FY Mar 2007, its secured and unsecured borrowings amounted to LKR 3.08 billion, which translated into 68.58% of the Company's total funding. Deposits and shareholders' funds, meanwhile, made up the another 16.15% and 15.26% of Senkadagala's funding. We note that its funding mix remained largely unchanged from that of the previous year (refer to Chart 5).

Chart 5: Funding mix of Senkadagala



Increased funding from debentures

The Company issued LKR 259 million of 4-year unlisted unsecured redeemable debentures in FY Mar 2007, thus increasing its funding from debentures to LKR 509 million (or 16.55% of its borrowings) as at end-FY Mar 2007. Earlier, Senkadagala had issued LKR 250 million of listed debentures in FY Mar 2006. As these debentures are subordinate debts and bear fixed interest rates, they are seen as a more attractive source of funding for the Company.

Collateralised debts pose risk to depositors

Apart from debentures, Senkadagala continues to collateralise its HP and lease receivables against its borrowings that secure its portfolio growth. As at end-FY Mar 2007, LKR 4.20 billion of HP and lease receivables were pledged against LKR 2.57 billion of securitised borrowings. In this context, RAM Ratings' concerns revolve around the subordination of depositors' funds by these lenders during distressed times.

Lower funding concentration

On a more positive note, the Company's borrowings are now fairly diversified with 10-12 lenders, thus alleviating our concerns about funding concentration. Since most of these facilities bear medium- to long-term tenures, in contrast to its deposit base that is tilted towards the short term, this has helped the Company manage its maturity mismatches within acceptable limits. Furthermore, the Company's hypothetical gearing ratio (borrowings against shareholders' funds) eased from 5.75 times as at end-FY Mar 2006 to 4.49 times as at end-FY Mar 2007, underpinned by stronger retained earnings.

Increased emphasis on deposits

Senkadagala's base of customer deposits stood at LKR 724.34 million as at end-FY Mar 2007, some 10.27% higher than a year earlier. Having realised the importance of a diversified base of retail deposits, the Company has been keenly emphasising deposit mobilisation. In line with this, Senkadagala launched a new savings product in November 2007. Although savings deposits are seen as an attractive source of low-cost funding, attracting such funds from the public amid the prevailing environment of high interest rates could prove challenging for the Company. While RAM Ratings views these efforts in a positive light, the success of Senkadagala's initiatives remain to be seen.

Statutory liquid assets intact

Owing to its small deposit base, the Company's statutory liquid-assets ratio stood at 53.46% as at end-FY Mar 2007, against the regulatory minimum of only 15%. We note that the hike in this ratio had been due to receipt of new loan proceeds, prior to disbursement.

Meets regulatory capital requirements

Capitalisation to remain healthy

Capital Adequacy

Senkadagala remained adequately capitalised with a Tier-1 risk-weighted capital-adequacy ratio ("RWCAR") of 15.56% as at end-FY Mar 2007 (end-September 2007: 16.02%) - well above the regulatory minimum of 5%. Moreover, the Company's core capital base stood at LKR 684.50 million as at the same date, i.e. triple the regulatory minimum core capital of LKR 200 million for RFCs. Since the Company's 4-year debentures do not meet the minimum 5-year maturity criteria, Senkadagala cannot classify them as Tier-2 capital. Therefore, its entire capital base comprises core capital made up of share capital and revenue reserves.

Given its weakening asset quality, the Company's ratio of net NPL to shareholders' funds went up to 5.49% as at end-FY Mar 2007 (end-September 2007: 3.69%). Even so, it was still better than the industry average of 10.48% as at the same date. Going forward, RAM Ratings expects Senkadagala's capitalisation to remain healthy, supported by its rising bottom line and substantial earnings retention; the Company's rate of internal capital generation came up to 35.52% as at end-FY Mar 2007 (industry average: 22.07%).

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 3). 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%).

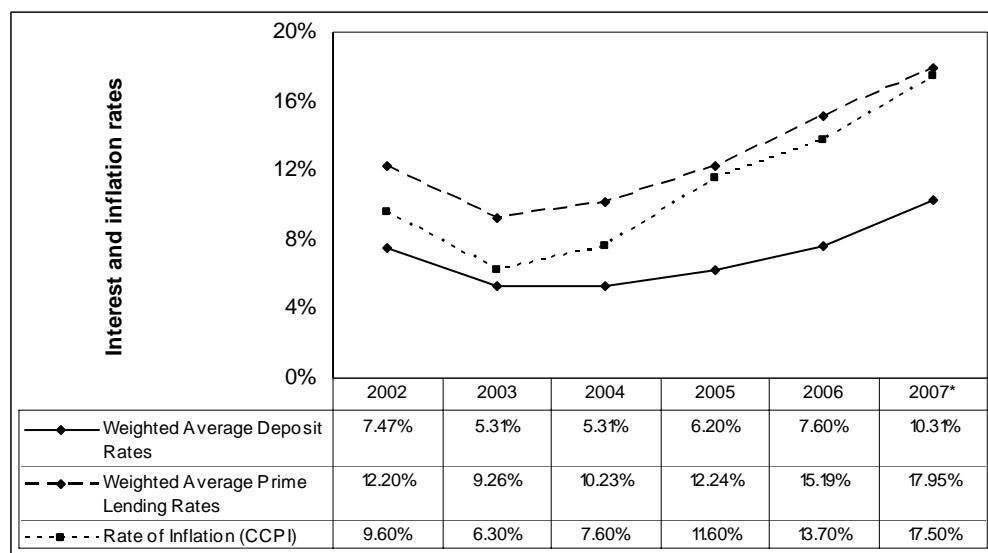
Table 3: Overall and sectoral GDP growth

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%

* Provisional

The domestic banking sector, meanwhile, had progressed despite rising interest rates driven by housing and consumption loans. Greater inflation is likely to have driven 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 6). Against this backdrop, the weighted-average deposit rate⁴ has been lower than the inflation rate, resulting in negative real returns for depositors.

Chart 6: Trends in interest and inflation rates



*Provisional

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

⁴ The Central Bank calculates the Average Weighted Deposit Rate monthly, based on the weighted average of all outstanding interest-bearing deposits of commercial banks and the corresponding interest rates.

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 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

<i>Liquid assets</i>	<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>
<i>Provision of bad and doubtful debts</i>	<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> <ul style="list-style-type: none"> (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>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: <ul 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> <ul style="list-style-type: none"> (a) Tier I - Core Capital <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> <ul style="list-style-type: none"> (b) Tier II - Supplementary Capital <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><i>Minimum core-capital requirement</i></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> <p>(a) A finance company with a core capital of less than LKR 100 million must:</p> <ol 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. <p>(b) A finance company with a core capital of between LKR 100 million and LKR 200 million must bring in:</p> <ol 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><i>Investments</i></p>	<p>A finance company must not invest in the shares of any company</p> <p>(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</p> <p>(b) In aggregate, in excess of 25% of the capital funds of the finance company</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>

Corporate Information

Date of Incorporation: 29 December 1968

Commencement of Business: 1968

Major Shareholders:

EW Balasuriya & Co (Pvt) Ltd	58.9%
Mr EW Balasuriya	0.08%
Mr L Balasuriya	6.56%
Dr A Balasuriya	6.56%
Mr R Balasuriya	6.56%
Dr M Balasuriya	6.56%
Dr Gayatri Madan Mohan	6.56%
Mrs L Fernando	5.47%

Directors:

Mr SK Wickremasinghe	Chairman
Mr L Balasuriya	Chief Executive Officer/Director
Mr EW Balasuriya	Director
Dr A Balasuriya	Director
Mr R Balasuriya	Director
Dr M Balasuriya	Director
Dr Gayatri Madan Mohan	Director
Mrs L Fernando	Director

Auditor: KPMG Ford, Rhodes, Thornton & Co

Listing: The Company is not listed, although LKR250 million of its redeemable unsecured debentures are listed since June 2005.

Key Management:

Mr L Balasuriya	Chief Executive Officer
Mr P Ikiriwatte	General Manager
Mr JK Jayatilleke	Assistant General Manager - Operations
Mr K Aturupana	Assistant General Manager - Accounts
Mr Timothy de Silva	Assistant General Manager - IT
Mr S Supramaniam	Manager, Treasury

Major Subsidiaries and Associates: Hotel Casamara (associate company)

Capital History:

Year	Remarks	Amount (LKR millions)	Cumulative Total (LKR millions)
1969	Ordinary share capital	0.23	0.23
1976	Share issue	0.001	0.23
1981	Share issue	0.03	0.26
1984	Share issue	0.12	0.38
1990	Rights issue	3.05	3.43
1990	Bonus issue	1.91	5.34
1994	Bonus issue	5.33	10.67
1998	Bonus issue	21.35	32.02
2004	Bonus issue	21.35	53.37
2005	Bonus issue	160.10	213.47

Financial Summary - Company

	Provisional					
BALANCE SHEET (LKR Million)	31-Mar-03	31-Mar-04	31-Mar-05	31-Mar-06	31-Mar-07	30-Sep-07
ASSETS						
Cash & Money At Call	34.67	79.47	30.77	381.26	307.21	349.89
Deposits & Placements With Financial Institutions	0.00	0.00	0.00	0.00	0.00	0.00
Securities Purchased Under Resale Agreements	0.00	0.00	0.00	0.00	0.00	0.00
Securities						
Dealing Securities	59.62	63.56	67.95	73.94	92.32	100.86
Investment Securities	0.21	0.21	0.21	0.21	0.21	0.21
Gross Loans & Advances	706.06	1,146.26	1,750.36	3,282.11	3,846.12	4,214.17
Interest-In-Suspense	0.00	0.00	0.00	0.00	0.00	0.00
General Loan Loss Reserves	6.39	6.33	3.78	4.41	0.00	0.00
Specific Loan Loss Reserves	0.00	0.00	0.00	0.00	73.26	105.70
Net Loans & Advances	699.67	1,139.93	1,746.58	3,277.70	3,772.86	4,108.47
Investments in Subsidiaries/Associates	19.96	13.96	13.96	13.96	13.96	13.96
Investment Land and Properties	0.00	0.00	0.00	0.00	0.00	0.00
Other Assets	130.85	129.60	143.06	312.54	400.58	426.13
Property, Plant and Equipment	69.33	72.71	105.59	139.76	206.85	245.34
TOTAL ASSETS	1,014.30	1,499.44	2,108.12	4,199.36	4,794.00	5,244.85
LIABILITIES						
Customer Deposits						
Savings	0.00	0.00	0.00	0.00	0.00	0.00
Fixed	403.43	448.01	496.83	639.56	699.65	787.89
NIDs	38.19	34.78	26.15	17.33	24.69	6.56
Interbank Deposits	0.00	0.00	0.00	0.00	0.00	0.00
Bills & Acceptances Payable	0.00	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	0.00
Other Borrowing	236.36	577.63	1,063.17	2,497.59	2,566.48	2,763.79
Subordinated Debt & Hybrid Capital	0.00	0.00	0.00	250.00	509.00	629.00
Other Liabilities	110.10	160.42	155.68	316.84	309.68	300.37
TOTAL LIABILITIES	788.07	1,220.83	1,741.83	3,721.32	4,109.50	4,487.61
Paid-up Capital	32.02	53.37	53.37	213.47	213.47	213.47
Minority Interest	0.00	0.00	0.00	0.00	0.00	0.00
Share Premium & Other Reserves	176.81	203.96	272.00	275.70	405.70	405.70
Statutory General Reserve	16.12	19.51	27.07	43.59	61.03	61.03
Retained Profits/(Loss)	1.28	1.76	13.84	(54.73)	4.31	77.04
Total Shareholders' Funds	226.23	278.60	366.28	478.03	684.50	757.23
TOTAL LIABILITIES & SHAREHOLDERS' FUNDS	1,014.30	1,499.44	2,108.12	4,199.36	4,794.00	5,244.85
COMMITMENTS & CONTINGENCIES	0.00	0.00	0.00	0.00	0.00	0.00
TIER 1 CAPITAL	226.23	278.61	366.29	478.04	684.50	757.23
CAPITAL BASE	226.23	278.61	366.29	478.04	684.50	757.23

Financial Summary - Company

						Provisional
INCOME STATEMENT (LKR Million)	31-Mar-03	31-Mar-04	31-Mar-05	31-Mar-06	31-Mar-07	30-Sep-07
Interest Income	162.51	251.18	325.55	645.33	1,058.87	574.49
Less: Amortisation Of Premium/(Accretion Of Discount)	0.00	0.00	0.00	0.00	0.00	0.00
Less: Net Interest Suspended	0.00	0.00	0.00	0.00	0.00	0.00
Less: Interest Expense	55.45	104.68	126.50	268.69	499.47	294.80
Net Interest Income	107.07	146.50	199.06	376.64	559.40	279.69
Non-Interest Income	11.92	17.91	25.93	60.23	92.02	55.87
Gross Income	118.99	164.41	224.99	436.87	651.42	335.56
Personnel Expenses	10.18	12.41	26.08	49.98	81.10	43.47
Other Non-Interest Expenses	64.26	80.77	104.72	166.48	256.20	102.47
Loan Loss Provisions	1.79	8.06	0.57	13.04	56.37	38.21
Share of results of Associated Companies	0.00	0.00	0.00	0.00	0.00	0.00
Pre-Tax Profit	42.77	63.17	93.63	207.37	257.75	151.41
Taxation	1.45	0.12	(2.06)	(6.52)	(31.12)	47.41
Profit After Tax	41.32	63.05	95.69	213.89	288.87	104.01
Extraordinary Items	0.00	0.00	0.00	0.00	0.00	0.00
Prior Year Adjustments	0.00	0.00	0.00	(64.25)	0.00	0.00
Minority Interests	0.00	0.00	0.00	0.00	0.00	0.00
Transfer To Statutory Reserves	2.07	3.40	7.56	16.52	17.43	0.00
Transfer To Other Reserves	31.00	48.50	68.04	163.80	130.00	0.00
Dividend	8.01	10.67	8.01	37.89	82.40	31.27
Retained Profit For The Year	0.25	0.48	12.08	(68.57)	59.03	72.73

Financial Ratios - Company

KEY RATIOS (%)	Provisional					
	31-Mar-03	31-Mar-04	31-Mar-05	31-Mar-06	31-Mar-07	30-Sep-07
Profitability						
Net Interest Margin	12.97%	11.66%	11.04%	11.94%	12.44%	11.14% *
Non-Interest Income Margin	1.44%	1.42%	1.44%	1.91%	2.05%	2.23%
Cost To Income	62.56%	56.68%	58.13%	49.55%	51.78%	43.49%
Return On Assets	5.18%	5.03%	5.19%	6.58%	5.73%	6.03% *
Return On Equity	20.41%	25.03%	29.04%	49.12%	44.34%	39.99% *
Dividend Payout	19.37%	16.93%	8.37%	17.72%	28.53%	30.07%
Asset Quality						
Gross NPL Ratio	0.00%	0.00%	0.00%	0.00%	2.88%	3.17%
Net NPL Ratio	0.00%	0.00%	0.00%	0.00%	1.00%	0.68%
3-months Past Due Ratio	3.15%	4.11%	2.51%	4.01%	8.05%	10.42%
Gross NPL Coverage	NA	NA	NA	NA	66.09%	79.09%
Loan Loss Reserve Coverage	0.90%	0.55%	0.22%	0.13%	1.90%	2.51%
General Loan Loss Reserve Coverage	0.90%	0.55%	0.22%	0.13%	0.00%	0.00%
Liquidity & Funding						
Liquid Asset Ratio	21.35%	29.63%	18.88%	53.88%	55.16%	56.74%
Statutory Liquid Asset Ratio	20.42%	29.21%	18.46%	68.97%	53.46%	54.95%
Customer Deposits To Total Interest Bearing Funds	65.14%	45.53%	32.97%	19.29%	19.06%	18.97%
Loans To Deposits Ratio	158.43%	236.11%	333.96%	498.97%	520.87%	517.14%
Loans To Stable Funds Ratio	85.19%	90.57%	95.10%	87.80%	88.49%	87.69%
Capital Adequacy						
Shareholders' Funds To Total Assets	22.30%	18.58%	17.37%	11.38%	14.28%	14.44%
Tier 1 Risk Weighted Capital Adequacy Ratio	26.04%	21.46%	18.16%	12.78%	15.56%	16.02%
Overall Risk Weighted Capital Adequacy Ratio	26.04%	21.46%	18.16%	12.78%	15.56%	16.02%
Internal Rate Of Capital Generation	15.90%	20.75%	27.19%	41.69%	35.52%	19.21% *

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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