CREDIT RATING RATIONALE

Financial Institutions – SRI LANKA

A wholly owned subsidiary of RAM Holdings Berhad

RAM RATINGS

LB Finance PLC – Rating Review

Financial Institution Ratings:
Long-term: BBB [Upgraded]
Short-term: P3 [Reaffirmed]

Rating Outlook:
Stable

Instrument:
i) LKR450 million unsecured subordinated redeemable debentures

Rating
(i) BBB- [Upgraded]

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
-Good financial performance
-Franchise deposits and leasing
-Broad branch network
-Healthy capitalisation

Weakness:
-Rapid growth of loan base

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

Analysts:
Prashani Illangasekera
MSc, BA
(9411) 2553089
prashani@ram.com.lk

Prakash Jerome
ACMA,ASCMA
(9411) 2503551
prakash@ram.com.lk

Summary

RAM Ratings Lanka has upgraded LB Finance PLC's ("LBF" or "the Company") long-term financial institution rating, from BBB- to BBB, with a stable outlook; the short-term rating has been reaffirmed at P3. The rating upgrade reflects LBF's healthier asset quality (which has been on an improving trend over the past 5 years), its strong financial performance and healthier capitalisation levels. Concurrently, RAM Ratings Lanka has also upgraded the respective long-and short-term ratings of LBF's LKR 450 million unsecured subordinated redeemable debentures, from a respective BB+ and NP to BBB- and P3.

The 1-notch difference between the rating of LB Finance's LKR 450 million subordinated bonds and its long-term financial institution rating mirrors the subordinated nature of the former to the Company's senior unsecured obligations.

LBF is the third-largest registered finance company ("RFC") in Sri Lanka, accounting for nearly 8.60% of the industry's assets as at end-March 2009. The Company demonstrated strong resilience in challenging economic conditions to augment its loan portfolio by 30.67% year on year ("y-o-y") during FYE 31 March 2009 ("FY Mar 2009"). The expansion was achieved through LBF's network of 21 branches and 57 pawning centers, with emphasis being placed on high-growth segments. Simultaneously, the Company also focused on improving its asset quality by strengthening its monitoring and recovery processes. Accordingly, LBF had countered the industry trend as its gross NPL ratio improved from 4.10% (industry: 5.19%) as at end-FY Mar 2008 to 3.84% (industry: 6.46%) as at end-FY Mar 2009. Nevertheless, we note a deterioration of quality in LBF's key lease and hire purchase ("HP") portfolio with the product delinquency rate weakening and reduced quality levels in the less than 3-months arrears buckets.

On a more positive note, LBF's financial performance improved during the reviewed period, in line with its robust loan growth and better overall asset quality. The company's profit after tax grew by a phenomenal 74.71% y-o-y to LKR 359.61 million during FY Mar 2009. As a result, LBF's return on assets ("ROA") and return on equity ("ROE") rose to 4.49% (end-FY Mar 2008: 4.01%) and 47.77% (end-FY Mar 2008: 45.47%) as at end-FY Mar 2009.

Further, RAM Ratings Lanka notes that the Company's performance had remained consistently better than its peers over the past 4 years. While LBF's profit growth is expected to moderate in comparison to the exceptional growth recorded last year, performance is anticipated to remain well above the industry and its peers.

Company Contact:

Adrian Perera
MBA, FCMA, FCCA, FSCMA, AIB
Chief Executive Officer
(9411) 2596099
adrian@ram.com.lk

Website: www.ram.com.lk

The Company's improved financial performance, coupled with a LKR 450 million debenture issue and a rights issue last year, had also strengthened its capital position. Accordingly, LBF has been able to maintain its Tier-1 and overall capital adequacy ratios at 12.95% and 17.26%, respectively, well above the regulatory requirement. Further, in line with the improving asset quality, LBF's net NPL to shareholders' funds ameliorated to 14.41% as at end-FY Mar 2009 (end-FY Mar 2008: 17.91%).

Meanwhile, RAM Ratings Lanka notes that LBF's funding structure remained moderate. Public deposits grew to LKR 9.56 billion as at end-FY Mar 2009 (end-FY Mar 2008: LKR 7.31 billion) amounting to nearly 75.50% of total interest-bearing borrowings. Further, the statutory liquidity-asset ratio was well within the stipulated minimum as at end-FY Mar 2009.

Outlook

The stable outlook reflects the company's healthy asset quality, which has been on an improving trend over the past 5 years, its strong financial performance and improved capitalisation levels.

Nevertheless, the ratings may come under pressure should LBF's asset quality weaken substantially, along with a deterioration in performance or liquidity.

Corporate Profile

LBF was incorporated in May 1971, and ranks among the more prominent names in the 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. LBF's substantial deposit and asset bases attest to its status in the industry, making it the third-largest RFC in the country. In addition, the Company is only 1 of 6 RFCs to be listed on the Colombo Stock Exchange.

LBF's primary activities include leasing (finance and operating), HP, pawn brokering, mortgage loans and real estate trading. On the funding side, it accepts public deposits.

Ownership & Financial Flexibility

LBF was the first RFC to commence pawn broking, and currently counts 57 access points, inclusive of its branches. Further, the Company expanded its branch network from 15 (FY Mar 2008) to 21 during FY Mar 2009.

LBF has experienced frequent ownership changes over the past two decades. The Company's major shareholder is Mr Dhammika Perera, a prominent business personality with business interests ranging from hospitality, finance, banking, manufacturing, power & energy to entertainment. Mr Perera is currently the deputy chairman of LBF whilst also holding directorships in a number of companies. He also functions as the Chairman/Director-General of the Board of Investment of Sri Lanka.

LBF obtains financial flexibility from its listed status on the Colombo Stock Exchange. Under Mr Perera's ownership, the Company has performed strongly, thereby according LBF some degree of financial flexibility.

Management & Strategies

LBF's Managing Director, Mr Sumith Adihetty, leads a dynamic team of young but experienced professionals.

Timely change in product mix

Despite the weak economic fundamentals that prevailed last year, LBF successfully outperformed its industry peers to post strong growth in its loan portfolio. This was achieved by a timely change in the existing product mix to exploit high-growth segments. Accordingly, the company astutely focused on microfinance leasing during the reviewed period, concentrating on lease financing for 3-wheeled taxis and pawning. Despite the non-conducive economic conditions that prevailed during the reviewed period, the Company was successful in expanding its portfolio, mainly owing to its strong geographical presence. Given the current economic scenario, the management intends to pursue growth in the same market segments albeit at a more moderate pace.

Focus on monitoring and recoveries

Further, continued emphasis will be placed on stringent monitoring and recovery techniques in a bid to maintain the quality of the loan portfolio. LBF's credit and recovery teams consist of committed young individuals whose performance is monitored by the executive directors on a daily basis. In addition, LBF had broadened its branch network and marketing force, thus enabling the Company to aggressively expand its credit and deposit bases. Meanwhile, in line with LBF's rapid expansion, the Company has strengthened its workforce with timely staff recruitment and training. This has enabled LBF to grow while maintaining its asset quality (refer to Table 1).

Table 1: Staff strength of LBF (FY Mar 2005-FY Mar 2009)

	FY Mar 05	**FY Mar 06**	**FY Mar 07**	**FY Mar 08**	**FY Mar 09**
Number of employees	256	303	391	520	692
% increase	37.63%	18.36%	29.04%	32.99%	33.08%

Corporate Governance

The board of directors convenes monthly; the 11-member board held a respective 14 and 11 meetings in FY Mar 2009 and FY Mar 2008. LBF's board currently comprises 8 non-executive directors (3 of whom are independent) and 3 executive directors. During the reviewed period, Dr.Priyal Perera resigned from him directorship while Mrs Kimarli Fernando and Mr Lalit N de S Wijeyratne joined the board.

The board reviews the financial performance of the Company against the budget. Further key performance indicators such as loan growth, collection and recoveries as well as funding and cash flow are also reported to the board. In addition, the board is provided with a compliance check list to ensure monitoring.

The board is supported by an audit committee, chaired by an independent and non-executive director. The internal auditors submit monthly reports pertaining to controls and procedures. Additionally, a remuneration committee, an integrated risk-management committee and a nomination committee function as sub-committees of the board.

RAM Ratings Lanka notes that LBF has mostly benefited from related-party transactions. Significant transactions in FY Mar 2009 consisted of a personal guarantee from the deputy chairman amounting to LKR 261 million (FY Mar 2008: LKR 519 million). As at end-FY Mar 2009, related-party deposits amounted to LKR 107.61 million, compared to LKR 55.91 million a year earlier.

We also note that the level of disclosure the Company has made is similar to that of higher-rated RFCs.

Asset Quality

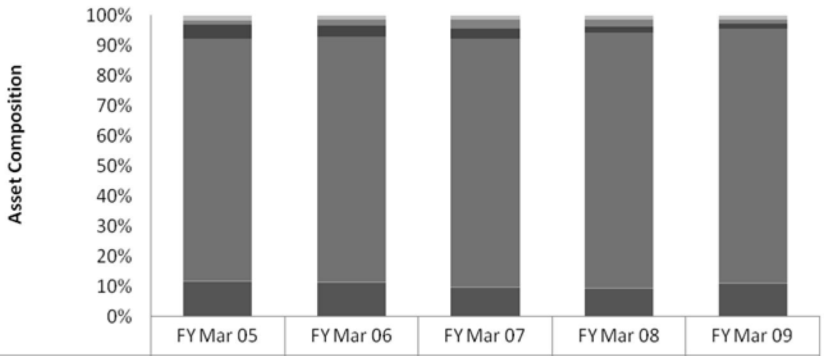
Healthy asset quality

RAM Ratings Lanka opines that LBF's asset quality is healthy; its gross NPL ratio had outperformed the industry average during the period under review. Withstanding the unfavourable economic climate, LBF has successfully countered the industry trend by improving the quality of its loan portfolio during FY Mar 2009. Going forward, LBF's asset quality is expected to be maintained at the current healthy levels, contributed by the company's stringent monitoring and the anticipated favourable macroeconomic changes.

Rapid growth in loan base

The Company's asset base continued to expand rapidly, growing by 30.39% y-o-y in FY March 2009, albeit slowing down in comparison to the growth of 53.70% recorded in FY March 2008. Expansion of the asset base was supported mainly by the enlarged loan books, with gross loans increasing 30.94% y-o-y in FY March 2009 (FY March 2008: 58.41%). The expansion in the loan books was facilitated by LBF's strong focus on high-growth segments such as leasing for 3-wheeled taxis and pawning. Meanwhile, LBF's asset composition remained largely unchanged, with the loan portfolio continuing to dominate total assets, while we note a slight tilt towards the maintenance of liquid assets (refer to Chart 2).

Chart 2: LBF's asset composition

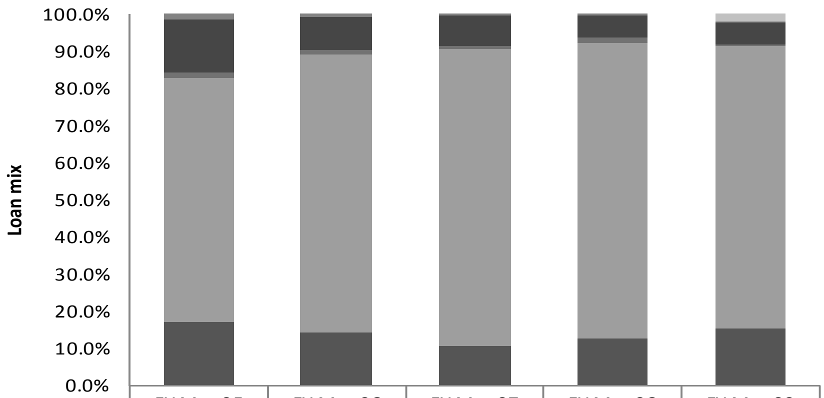


	FY Mar 05	FY Mar 06	FY Mar 07	FY Mar 08	FY Mar 09
Fixed Assets	1.73%	1.35%	1.29%	1.21%	1.36%
Other Assets	1.29%	1.90%	3.02%	2.60%	1.38%
Real Estate stocks	4.76%	3.66%	3.41%	2.03%	1.51%
Loan Assets	80.09%	81.59%	82.14%	84.35%	84.52%
Share Trading	0.38%	0.19%	0.13%	0.08%	0.04%
Liquid Assets	11.75%	11.29%	10.01%	9.73%	11.19%

Focus on high-growth segments

LBF's loan portfolio was dominated by lease and HP advances, accounting for approximately 76.31%, while pawn broking remained the second-largest category with a near-15.46% share. The remainder consisted of term loans (6.23%), vehicle loans (1.80%) and real estate loans (refer to Chart 3). A marginal change was witnessed in loan composition, with declining contributions from leases and HP in view of the non-conducive economic environment. In contrast, pawning advances increased in importance with the management aggressively pursuing growth in this segment. Going forward, RAM Ratings Lanka expects pawning advances to gain in prominence while the lease and HP portfolio is also anticipated to maintain steady growth in the medium term given the favourable economic prospects.

Chart 3: LBF's loan mix



	FY Mar 05	FY Mar 06	FY Mar 07	FY Mar 08	FY Mar 09
Vehicle loans	0.00%	0.00%	0.00%	0.00%	1.80%
Real estate loans	1.73%	0.72%	0.30%	0.14%	0.11%
Term loans	13.87%	9.05%	8.18%	6.03%	6.23%
Trade Finance	1.89%	1.05%	0.85%	1.61%	0.10%
Lease and HP	65.38%	74.76%	80.09%	79.66%	76.31%
Pawning advances	17.13%	14.42%	10.58%	12.56%	15.46%

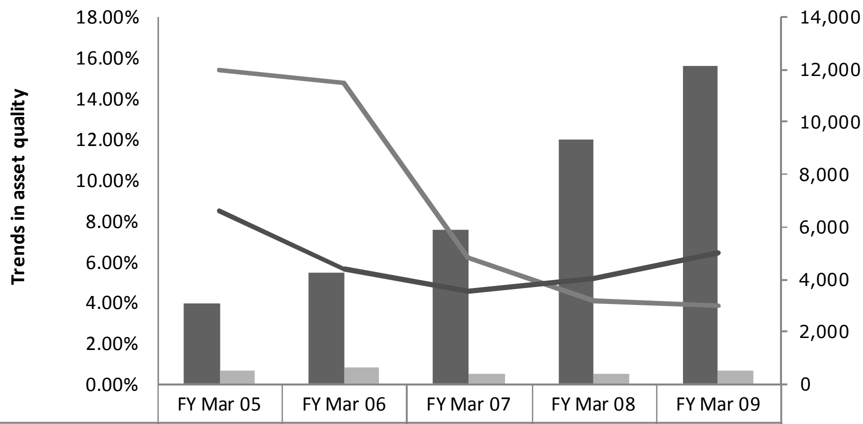
Improving gross NPL ratio

LBF's asset quality continued its improving trend, outperforming industry peers despite the challenging economic conditions. Accordingly, the gross NPL ratio declined from 4.10% in FY Mar 2008 to 3.84% in FY Mar 2009 (refer to Chart 4). The improvement in the gross NPL ratio was driven by LBF's robust loan growth and stringent monitoring and recovery procedures. Nevertheless, we note a deterioration of quality in the key lease & HP portfolio with absolute NPLs in the category rising by almost LKR 150.95 million during FY Mar 2009. Accordingly, the default rate on lease & HP increased to 3.55% from 2.42% in FY Mar 2008. In contrast, default rates on term loans improved to 14.14% in the reviewed period (FY Mar 2008:25.65%).

Signs of deterioration in loan ageing

With regard to the ageing of LB Finance's loan portfolio, we note a deterioration of quality in the "less than 3 months in arrears" buckets. This had been mainly contributed by the deteriorating quality of its key leasing and HP portfolios. Nevertheless, we note that the "over 3 months in arrears" buckets had stayed somewhat stable. Going forward, LBF's asset quality is expected to remain superior to that of its industry peers, given the Company's stringent monitoring and recovery procedures.

Chart 4: Trends in LBF's asset quality



	FY Mar 05	FY Mar 06	FY Mar 07	FY Mar 08	FY Mar 09
Loan Base	3,068.02	4,196.97	5,850.48	9,274.53	12,111.60
NPLs	472.74	621.81	364.47	380.04	464.72
LBF Gross NPL ratio	15.41%	14.82%	6.23%	4.10%	3.84%
Industry NPL ratio	8.44%	5.66%	4.56%	5.19%	6.46%

Strong emphasis on recoveries

LBF's robust loan growth has been complemented by continued emphasis on its monitoring and recovery techniques. Accordingly, the company had strengthened its recovery team during the reviewed period while the performance of the team is monitored on a daily basis. Additionally, stringent monitoring techniques are utilised continuously in order to ensure the health of the credit base.

Adequate provisioning

RAM Ratings Lanka deems LBF's provisioning to be adequate. The Company improved its provisioning cover from 55.89% as at end-FY Mar 2008 to 58.15% as at end-FY Mar 2009. Accordingly, the net NPL ratio also improved from 1.85% to 1.64% during the period under review compared to the industry average of 4.40%.

Minimum exposure to real estate

LBF's exposure to real estate assets continued to be minimal, at a near 1.51% of total assets as at end-FY Mar 2009. Further, RAM Ratings Lanka has no concerns regarding LBF's proprietary share trading portfolio as it constituted a mere 0.04% of total assets.

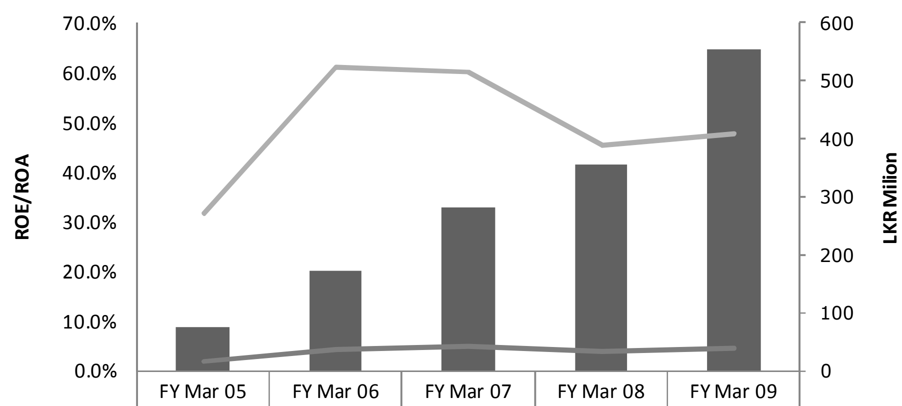
RAM Ratings Lanka notes that LBF's overall asset quality has been on the uptrend, consistently outperforming the industry. Despite the Company's buoyant loan growth, its strong focus on recoveries and stringent monitoring is expected to maintain asset quality at the current levels, while continuing to outperform industry peers.

Performance

Healthy performance

RAM Ratings Lanka deems LBF's financial performance to be good. The Company achieved an impressive 74.71% y-o-y growth in profit after tax to LKR 359.61 million in FY Mar 2009, on the back of its buoyant loan growth and strong recoveries. Profitability, as measured by ROA and ROE, had also improved despite the weakened economic conditions during the reviewed period (refer to Chart 5).

Chart 5: Trends in profitability



	FY Mar 05	FY Mar 06	FY Mar 07	FY Mar 08	FY Mar 09
Pre-tax profits	73.34	173.11	282.40	355.21	555.32
ROE	31.75%	61.11%	59.95%	45.47%	47.77%
ROA	1.99%	4.29%	4.85%	4.01%	4.49%

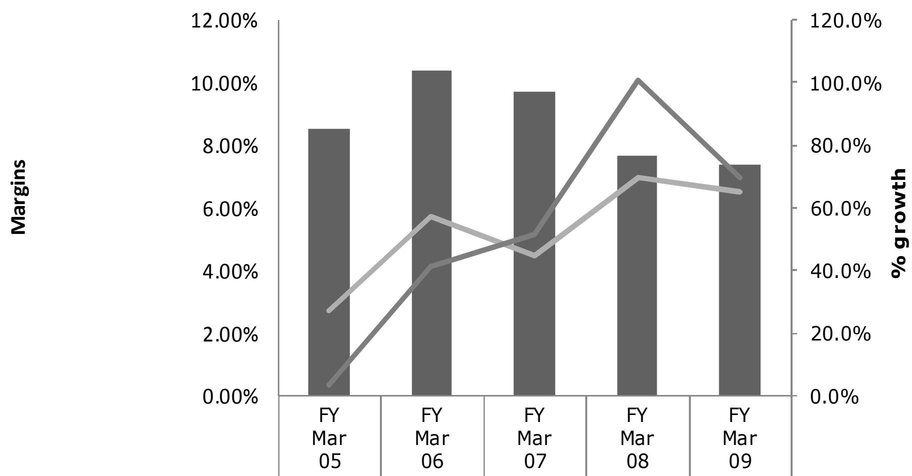
Widening NIM

The exceptional profit growth during the reviewed period was supported by strong expansion in LBF's net interest income, which had increased to 56.09% in FY Mar 2009 compared to 33.21% in FY Mar 2008. Accordingly, net interest margin ("NIM") also widened from 8.62% in FY Mar 2008 to 9.64% in FY Mar 2009.

Increasing contributions from pawn broking business

Net interest income grew in line with a strong 64.81% y-o-y growth in interest income to LKR 3.43 billion during the period under review. Income on leasing & HP activities collectively contributed nearly 69.10% to interest income, while contributions from pawning advances increased to 14.18% during FY Mar 2009 (FY Mar 2008: 11.20%) Nevertheless, the Company's interest expenses also grew by a hefty 69.86% in FY Mar 2009; mainly due to increased interest expenses on the larger deposit base amid the environment of high interest rates that prevailed during the reviewed period (refer to Chart 6).

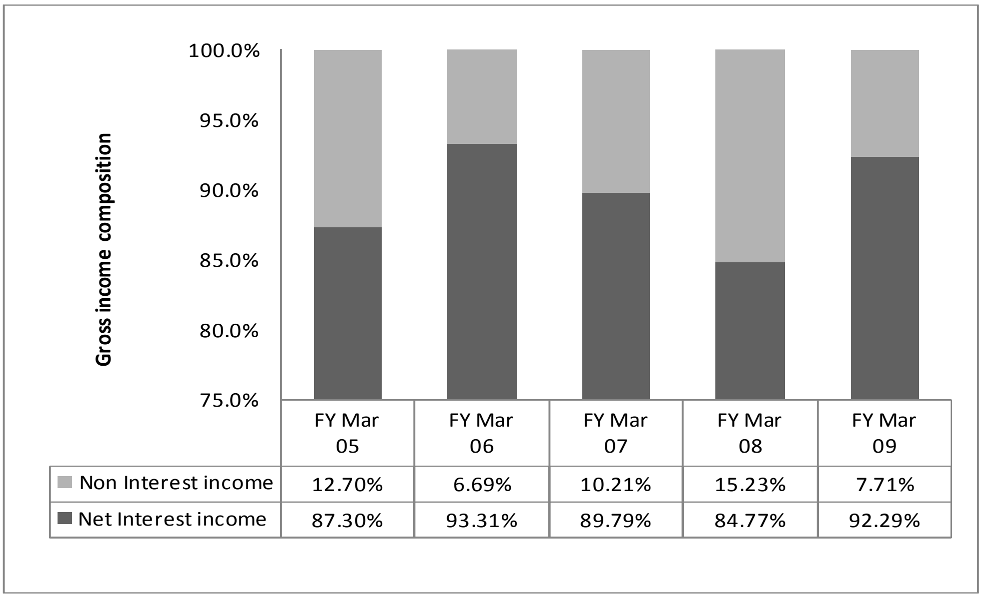
Chart 6: Growth in interest income/expenses and margins



	FY Mar 05	FY Mar 06	FY Mar 07	FY Mar 08	FY Mar 09
Interest differential	8.56%	10.41%	9.76%	7.72%	7.44%
% Change in int. income	27.26%	56.84%	44.64%	69.38%	64.81%
% Change in int. expenses	3.24%	41.12%	51.46%	101.04%	69.86%

With the strong growth in net interest income, the composition of LBF's gross income tilted more towards net interest income in FY Mar 2009 (refer to Chart 7).

Chart 7: Composition of LBF's gross income



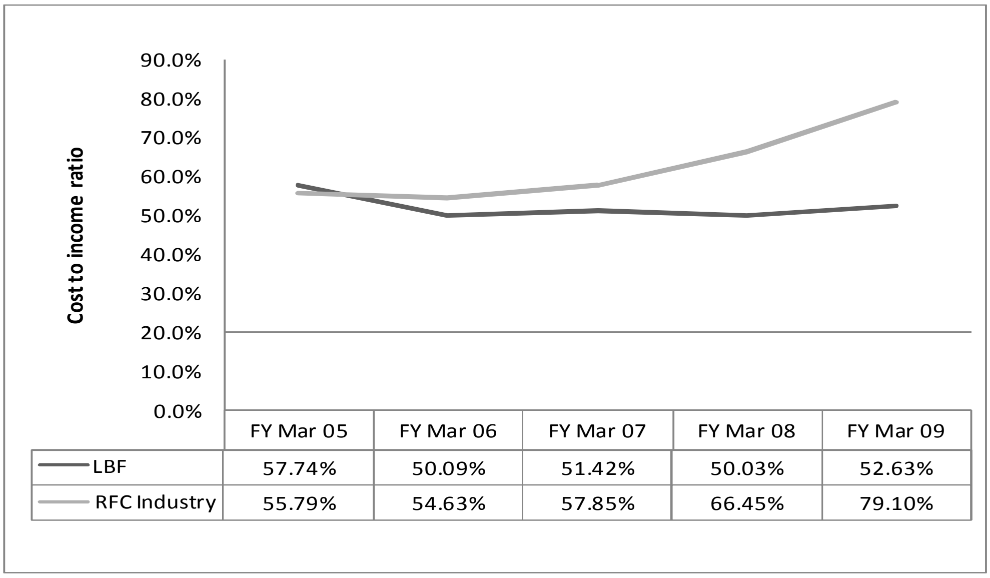
	FY Mar 05	FY Mar 06	FY Mar 07	FY Mar 08	FY Mar 09
Non Interest income	12.70%	6.69%	10.21%	15.23%	7.71%
Net Interest income	87.30%	93.31%	89.79%	84.77%	92.29%

Furthermore, LBF's provision charge for FY Mar 2009 decreased to LKR 57.11 million (FY Mar 2008: LKR 95.37 million), supported by strong recoveries during the period under review.

Better-than-industry cost-to-income ratio

LBF's cost-to-income ratio remained better than those of its industry peers, despite increasing marginally during the reviewed period. Although the Company's cost-to-income ratio increased to 52.63% as at end-FY Mar 2009 compared to 50.03% a year earlier (refer to Chart 8), it remained well below the industry average of 79.10%. The growth in the Company's cost base was mainly in view of the expansion in LBF's branch network, which had pushed up staff expenses as well as general and administration costs.

Chart 8: Trends in cost–to-income ratio



	FY Mar 05	FY Mar 06	FY Mar 07	FY Mar 08	FY Mar 09
LBF	57.74%	50.09%	51.42%	50.03%	52.63%
RFC Industry	55.79%	54.63%	57.85%	66.45%	79.10%

Going forward, RAM Ratings Lanka anticipates a moderation in LBF's bottom-line growth, as opposed to the exceptional improvement last year. Nevertheless, we believe LBF's financial performance will remain superior to that of its peers.

Funding & Liquidity

Moderate funding

RAM Ratings Lanka deems LBF's funding to be moderate. The Company benefits from a diverse funding base while the liquidity risk is mitigated by continuous monitoring and the availability of contingent funding lines.

Strong growth in deposit base

LBF's aggressive loan growth is funded by both public deposits and borrowings. The Company continued expanding its deposit base, which grew by a strong 60.24% in FY Mar 2008. Deposits augmented by a relatively slower, albeit still robust, rate of 30.77% in FY Mar 2009, thereby amounting to LKR 9.6 billion. Accordingly, LBF retained its position as the third-largest RFC in terms of deposit base. Given LBF's aggressive loan expansion, its loan-to-deposit ratio remained relatively unchanged at 123.88% as at the same date.

In terms of maturity mismatches, the prevalent scenario of high interest rates has resulted in deposit tenures tilting more towards the short term. Nevertheless, this has been mitigated somewhat by the strong growth in LBF's pawn broking advances, which tend to have short tenures, thereby moderately improving its position in the 3-month bucket (refer to Table 2).

Table 2: Maturity mismatches of LBF

	FY 2008				FY 2009			
	< 3 months	3-12 months	1-3 years	Over 3 years	< 3 months	3-12 months	1-3 years	Over 3 years
Interest earning assets	1876	3044	4026	1170	3569	3839	5149	859
Interest bearing liabilities	4118	3241	1302	406	5898	3608	1127	903
Gap	-2242	-197	2725	764	-2330	230	4022	-44
Gap as a % of interest earning assets	-119.51%	-6.47%	67.67%	65.27%	-65.28%	6.00%	78.12%	-5.12%

LBF's statutory liquidity ratio also improved to 16.40% as at end-FY Mar 2009, i.e. well above the regulatory minimum of 10%. This had been enabled by increased investments in treasury bills.

Capital Adequacy

Improving capitalisation

RAM Ratings Lanka deems LBF's capital adequacy to be healthy, backed by the issuance of LKR 450.0 million of subordinated debentures in FY Mar 2009 and the Company's strong financial performance. Accordingly, the Company's Tier-I capital ratio improved to 12.95% while its overall risk-weighted capital-adequacy ratio increased to 17.26% - well above the minimum requirements of 5% and 10%, respectively. Additionally, LBF had also issued almost 4.3 million of new shares via a LKR73.59 million rights issue in FY Mar 2009, thereby further strengthening its capital position. In line with the Company's improving capital adequacy and asset quality, ratio on net NPLs to shareholders' funds also eased to 14.41% at the end of the fiscal period.

Industry Overview

Sri Lanka's Gross Domestic Product ("GDP") expanded 1.5% in the first quarter of 2009. Although this pales in comparison to the 6.2% of the previous corresponding period, the slower growth must be seen in the context of the global downturn. Not surprisingly, all 3 major sectors of the domestic economy have been hit by the global turmoil

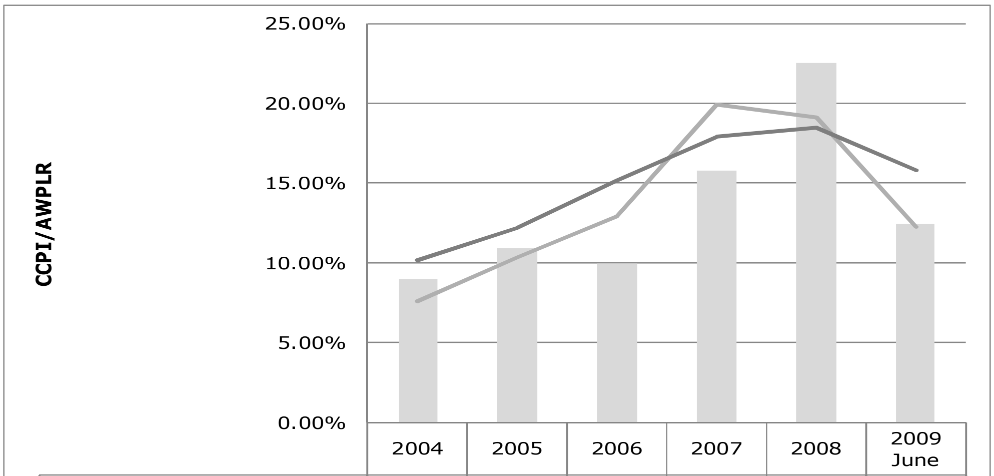
The performance of the primary sectors (agriculture, forestry and fishing) had been dented by the steep fall in tea prices, drought and slumping demand. Although value addition in tea declined 40.9%, this was partially cushioned by the expansion of other food items, including fishing. However, virtually all sub-segments within the industrial and services sectors advanced at a slower pace last year, principally due to weaker export demand (refer to Table 3).

Table 3: Overall and sectoral GDP growth in 1Q 2008 and 1Q 2009

Sector	1Q 2008	1Q 2009
Agriculture, Forestry and Fishing	5.9%	3.0%
Industry	6.0%	1.9%
Services	6.4%	1.0%
GDP	6.2%	1.5%

On a more positive note, the end of the 25-year war against the separatist Tamil Tigers has spawned renewed hope for the country. Additionally, the country's long-awaited USD 2.5 billion stand-by facility from the International Monetary Fund ("IMF") is expected to elevate the nation's sorely depleted foreign-exchange reserves. Moreover, both inflation (as measured by the Colombo Consumer Price Index) and interest rates, which peaked in 2008, have been easing consistently since early 2009 (refer to Chart 9). While this augurs well for the domestic economy, sluggish export demand is still a concern. The tapering interest rates follow the Central Bank's reversal of its tight monetary policy.

Chart 9: Inflation and interest rates



	2004	2005	2006	2007	2008	2009 June
Colombo Consumer Price Index	9.00%	11.00%	10.00%	15.80%	22.60%	12.50%
1-Year Treasury Bill Rate	7.65%	10.37%	12.96%	19.96%	19.12%	12.34%
AWPLR	10.23%	12.24%	15.19%	17.95%	18.50%	15.89%

In the context of the financial-services industry, the collapse of 2 unregulated financial institutions relatively recently had triggered a crisis of confidence among depositors. However, the contagion effects of the collapse was halted by the Central Bank. The regulator's timely move of vesting the vulnerable Ceylinco-related institutions with state-owned or state-linked enterprises has helped avert a full-blown crisis. Concurrently, there have been changes in ownership, which RAM Ratings Lanka considers positive on the whole.

On a broader note, RFCs' main revenue spinners are vehicle financing. In this regard, they compete with commercial banks. Although commercial banks have a cost advantage as their cost of funds are much lower, RFCs cater to small and medium-scale businesses as well as micro businesses that fall outside the banks' risk appetite. Hence, this segment is considered sub-prime. Although RFCs have been encouraged to finance machinery and equipment, most of them still focus entirely on vehicle financing due to lack of expertise and difficulties in legally seizing these assets.

Meanwhile, RAM Ratings Lanka observes that RFCs' lack of extensive branch networks present a challenge when trying to expand their portfolios while maintaining asset quality. RFCs are generally hindered by asset-quality issues as geographical concentration and intense competition result in financing a more risky segment. In view of the expected improvement in the economic climate and enhanced regional growth, however, we expect some RFCs to take advantage of these opportunities. Although this would entail heightened operational risk, we note that some financial institutions have already gained experience in managing such risks.

Despite easing inflation and interest rates, RFCs are still reeling from the effects of a weakened economy. With the resumption of economic activity, however, the industry's asset quality is expected to chart a healthy recovery. RAM Ratings Lanka's interaction with industry players reveals that recoveries and collections are still high on the agenda. Although we anticipate asset quality to weaken in the short run, the industry's asset-quality indicators are envisaged to improve over the medium term.

Elsewhere, RFC's that extensively deal in real estate still face liquidity issues arising from subdued demand. Going forward, RAM Ratings Lanka expects these companies to revisit their business models and craft strategies that will provide greater agility.

In the interim, RAM Ratings Lanka expects the industry's overall profit performance to come under pressure from slower loan growth. Nonetheless, this is expected to be a short-term phenomenon; the sector's profitability is expected to bottom out this in 2009. This view is anchored by our expectations vis-à-vis interest-rate trends and economic recovery.

At present, leading RFCs in the country are flushed with liquidity due to slower loan growth and augmenting deposits. Public confidence, which had ebbed in the first quarter of this year, is now staging a return. Apart from improving liquidity, the industry's funding structure - although improving - is still fragile. RFCs continue to rely on bank funding, which poses additional liquidity risk. Over the medium and long term, however, RAM Ratings Lanka expects the industry's funding structure to weaken further as RFCs resort to bank borrowings to expand their loan books.

From a regulatory perspective, the industry's capital-adequacy levels are deemed adequate as they are able to support about a 40% asset growth. However, RAM Ratings Lanka notes that the current capital-adequacy framework does not capture the entire spectrum of risks inherent in RFCs.

On a more positive note, RAM Ratings Lanka welcomes the regulator's emphasis on risk management and improved transparency. In this regard, the Central Bank has set a direction on corporate governance. Moreover, the regulator has also proposed that all RFCs be listed by June 2011 (pending formal regulation). Although these directions will be disconcerting to some market participants, RAM Ratings Lanka believes that the industry as a whole will benefit over the long haul.

Relevant Central Bank Directions Applicable to Registered Finance Companies

Liquid assets	Every finance company must have a minimum holding of liquid assets at any given time. Liquid assets mean: Cash in hand. Balances in a current or deposit account in a commercial bank, free from any banker's lien or charge. Sri Lankan Government Treasury Bills, free from any charge or lien. Sri Lankan Government Securities maturing within 1 year and free from any charge or lien. Central Bank securities maturing within 1 year and free from any charge or lien. Cash balance, if any, maintained with the Central Bank. The minimum limits are as follows: For time deposits, 15% of outstanding deposits. For certificates of deposits, 15% of the face value of the certificates. For savings deposits, 20% of the outstanding deposits. 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.
Provision of bad and doubtful debts	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: <u>Direction No. 1 of 1991</u> Bad and doubtful debts provided for under this direction are subject to a minimum of: 50% of all advances in arrears for a period of 7 to 12 months. 100% of all advances in arrears for 13 months or more. 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: The value so deducted should not exceed the value decided by a professional valuer at the time of granting the advance. 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. <u>Direction No. 2 of 1991</u> Bad and doubtful debts provided for under this direction are subject to a minimum of: 50% of all advances in arrears for a period of 12 to 24 months. 100% of all advances in arrears for more than 24 months. 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.

	With effect from 1 April 2007, Direction No. 3 of 2006 will be applicable to every RFC and will replace Directions 1 and 2. <u>Direction No. 3 of 2006</u> Bad and doubtful debts provided for under this direction are subject to a minimum of: 50% of all advances in arrears for a period of 6 to 12 months. 100% of all advances in arrears for 13 months or more. A finance company may deduct the value of the following items held as collateral in arriving at the amount of provisioning; Sri Lankan Government securities, free from any lien or charge. Central Bank securities, free from any lien or charge. Time deposits in a licensed commercial bank, specialised bank or RFC, free from any lien or charge. Bank guarantees. With regard to repossessed vehicles and machinery, 80% of the valuation obtained in the preceding 6 months and by an approved valuer. With regard to mortgaged land and buildings that are held as collateral, if the accommodation has been in arrears for a period of: 6-36 months, 100% of the value is deductible 37-60 months, 80% of the value is deductible 61-120 months, 50% of the value is deductible more than 120 months, 0% of the value is deductible
Capital adequacy	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: (a) Tier I - Core Capital 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. (b) Tier II - Supplementary Capital 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. The Central Bank also issues guidelines from time to time, to be used in computing total risk-weighted assets.
Single-borrower limit	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. This limit stands at 15% for any group of corporate or unincorporated borrowers with common directors or common partners or common proprietors. 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.

Minimum core-capital requirement	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: A finance company with a core capital of less than LKR 100 million must: enhance its core capital to at least LKR 100 million by February 2007; and bring the remaining LKR 100 million or the deficit up to the core-capital requirement of LKR 200 million by July 2008. A finance company with a core capital of between LKR 100 million and LKR 200 million must bring in: at least 50% of the deficient amount to meet the core-capital requirement of LKR 200 million by February 2007; and the balance of the deficient amount up to the core capital requirement of LKR 200 million by July 2008.

Corporate Information

Date of Incorporation:	30 May 1971	
Commencement of Business:	1971	
Major Shareholders:	Mr KDD Perera	63.53%
	Royal Ceramics Lanka PLC	9.71%
	SBL/Mr KADD Perera	7.79%
	DFCC Vardhana Bank Ltd/Esna Holdings	7.45%
	Mr. Nimal Perera	0.89%
Directors:	Mr BM Amarasekera	Chairman
	Mr KDD Perera	Deputy Chairman
	Mr Sumith Adhihetty	Managing Director
	Mr Nimal Perera	Director
	Mr AM Weerasinghe	Director
	Mr KDA Perera	Director
	Mr.MDS Goonathilake	Director
	Mrs.Kimarli Fernando	Director
	Mr.L.N. de S.Wijeyratne	Director
	Mr Niroshan Udage	Executive Director
	Mr BDSA Perera	Executive Director
Auditor:	Ernst and Young	
Listing:	1998 (Colombo Stock Exchange)	
Key Management:	Mr Sumith Adhihetty	Managing Director
	Mr Niroshan Udage	Director
	Mr BDSA Perera	Director
	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
	Ms.Shyamalie Weerasooriya	Chief Financial Officer
	Mr Marlon Perera	Assistant General Manager -Deposits
	Mr.Roshan Jayawardana	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	53.99	144.28
	Bonus issue	57.71	246.71
2007	Share issue	171.70	418.41
2008	Share issue	73.59	492.00

Financial Summary- Company

BALANCE SHEET (LKR Million)	31-Mar-05	31-Mar-06	31-Mar-07	31-Mar-08	31-Mar-09
ASSETS					
Cash & Money At Call	24.24	57.23	90.56	152.58	217.64
Deposits & Placements With Financial Institutions	140.94	171.79	247.92	415.92	550.50
Securities					
Dealing Securities	234.32	297.94	361.37	476.88	799.70
Investment Securities	12.94	9.02	9.03	9.03	6.23
Gross Loans & Advances	3,129.10	4,269.72	5,883.10	9,319.26	12,202.99
Interest-In-Suspense	61.08	72.75	32.61	44.73	91.39
General Loan Loss Reserves	0.00	0.00	0.00	0.00	0.00
Specific Loan Loss Reserves	344.21	389.49	108.81	212.40	270.23
Net Loans & Advances	2,723.80	3,807.49	5,741.68	9,062.13	11,841.37
Investments in Subsidiaries/Associates	0.00	0.00	0.00	0.00	0.00
Investment Land and Properties	161.76	170.96	238.64	218.20	211.24
Other Assets	43.87	88.80	211.04	279.59	192.87
Property, Plant and Equipment	58.96	63.12	90.28	129.77	189.92
TOTAL ASSETS	**3,400.84**	**4,666.34**	**6,990.52**	**10,744.10**	**14,009.46**
LIABILITIES					
Customer Deposits					
Savings	0.00	0.00	0.00	0.00	0.00
Fixed	2,496.38	3,344.67	4,561.45	7,309.10	9,558.37
NIDs	110.41	0.00	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	314.20	561.61	1,401.84	1,658.59	1,528.00
Subordinated Debt & Hybrid Capital	100.00	100.00	100.00	100.00	450.00
Other Liabilities	167.92	305.41	339.81	701.39	1,123.00
TOTAL LIABILITIES	**3,188.91**	**4,311.69**	**6,403.09**	**9,769.08**	**12,659.36**
Paid-up Capital/Stated Capital	135.00	135.00	246.71	418.41	492.00
Minority Interest	0.00	0.00	0.00	0.00	0.00
Statutory General Reserve	59.14	74.55	110.31	151.47	223.40
Retained Profits/(Loss)	17.79	145.10	230.41	405.13	634.70
Total Shareholders' Funds	**211.93**	**354.65**	**587.43**	**975.02**	**1,350.10**
TOTAL LIABILITIES & SHAREHOLDERS' FUNDS	**3,400.84**	**4,666.34**	**6,990.52**	**10,744.10**	**14,009.46**
COMMITMENTS & CONTINGENCIES	**11.55**	**18.95**	**19.39**	**46.36**	**45.76**
TIER 1 CAPITAL	**235.02**	**302.00**	**587.43**	**811.50**	**1,350.10**
CAPITAL BASE	**317.32**	**366.14**	**633.55**	**831.50**	**1,800.10**

Financial Summary-Company

INCOME STATEMENT (LKR Million)	31-Mar-05	31-Mar-06	31-Mar-07	31-Mar-08	31-Mar-09
Interest Income	677.40	849.98	1,229.41	2,082.42	3,431.95
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	383.40	432.86	655.62	1,318.06	2,238.85
Net Interest Income	294.00	417.12	573.78	764.36	1,193.10
Non-Interest Income	42.78	29.92	65.25	137.36	99.69
Gross Income	**336.79**	**447.04**	**639.03**	**901.72**	**1,292.79**
Personnel Expenses	71.37	80.94	129.64	184.52	267.22
Other Non-Interest Expenses	123.10	142.99	198.93	266.62	413.14
Loan Loss Provisions	68.97	50.00	28.05	95.37	57.11
Share of results of Associated Companies	0.00	0.00	0.00	0.00	0.00
Pre-Tax Profit	**73.34**	**173.11**	**282.40**	**355.21**	**555.32**
Taxation	24.94	96.05	103.63	149.38	195.71
Profit After Tax	**48.41**	**77.06**	**178.78**	**205.83**	**359.61**
Extraordinary Items	0.00	0.00	0.00	0.00	0.00
Prior Year Adjustments	0.00	0.00	0.00	0.00	0.00
Minority Interests	0.00	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	9.68	24.11	35.76	41.16	0.00
Dividend	0.00	13.50	0.00	68.18	103.89
Retained Profit For The Year	**38.73**	**39.44**	**143.02**	**96.49**	**255.72**

Financial Ratios – Company

KEY RATIOS (%)	31-Mar-05		31-Mar-06	31-Mar-07	31-Mar-08	31-Mar-09
Profitability						
Net Interest Margin	7.97%	*	10.34%	9.84%	8.62%	9.64%
Non-Interest Income Margin	1.16%		0.74%	1.12%	1.55%	0.81%
Cost To Income	57.74%		50.09%	51.42%	50.03%	52.63%
Return On Assets	1.99%	*	4.29%	4.85%	4.01%	4.49%
Return On Equity	31.75%	*	61.11%	59.95%	45.47%	47.77%
Dividend Payout	0.00%		17.52%	0.00%	33.12%	28.89%
Asset Quality						
Gross NPL Ratio	15.41%		14.82%	6.23%	4.10%	3.84%
Net NPL Ratio	4.72%		6.10%	4.45%	1.85%	1.64%
Specific Loan Loss Provisions For Current Year	2.07%		1.35%	0.55%	1.63%	0.74%
Gross NPL Coverage	72.81%		62.64%	29.85%	55.89%	58.15%
Loan Loss Reserve Coverage	11.22%		9.28%	1.86%	2.29%	2.23%
General Loan Loss Reserve Coverage	0.00%		0.00%	0.00%	0.00%	0.00%
Liquidity & Funding						
Liquid Asset Ratio	14.88%		15.35%	14.68%	13.34%	15.49%
Statutory Liquid Asset Ratio	15.33%		15.76%	15.34%	14.30%	16.40%
Customer Deposits To Total Interest Bearing Funds	86.29%		83.49%	75.23%	80.61%	82.85%
Loans To Deposits Ratio	104.49%		113.84%	125.87%	123.98%	123.88%
Loans To Stable Funds Ratio	85.82%		88.59%	87.52%	91.42%	93.26%
Capital Adequacy						
Shareholders' Funds To Total Assets	6.23%		7.60%	8.40%	9.07%	9.64%
Tier 1 Risk Weighted Capital Adequacy Ratio	9.50%		8.80%	10.40%	9.57%	12.95%
Overall Risk Weighted Capital Adequacy Ratio	12.83%		10.67%	11.22%	9.81%	17.26%
Internal Rate Of Capital Generation	20.95%	*	22.44%	37.95%	17.62%	22.00%

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

CREDIT RATING DEFINITIONS
(Financial Institution Ratings)

A Financial Institution Rating ("FIR") is RAM Ratings Lanka's current opinion on the overall capacity of a financial institution to meet its financial obligations. The opinion is not specific to any particular financial obligation, as it does not take in to account the expressed terms and conditions of any specific financial obligation.

Long-Term Ratings

AAA	A financial institution rated AAA has a superior capacity to meet its financial obligations. This is the highest long-term FIR assigned by RAM Ratings.
AA	A financial institution rated AA has a strong capacity to meet its financial obligations. The financial institution is resilient against adverse changes in circumstances, economic conditions and/or operating environments.
A	A financial institution rated A has an adequate capacity to meet its financial obligations. The financial institution is more susceptible to adverse changes in circumstances, economic conditions and/or operating environments than those in higher-rated categories.
BBB	A financial institution rated BBB has a moderate capacity to meet its financial obligations. The financial institution is more likely to be weakened by adverse changes in circumstances, economic conditions and/or operating environments than those in higher-rated categories. This is the lowest investment-grade category.
BB	A financial institution rated BB has a weak capacity to meet its financial obligations. The financial institution is highly vulnerable to adverse changes in circumstances, economic conditions and/or operating environments.
B	A financial institution rated B has a very weak capacity to meet its financial obligations. The financial institution has a limited ability to withstand adverse changes in circumstances, economic conditions and/or operating environments.
C	A financial institution rated C has a high likelihood of defaulting on its financial obligations. The financial institution is highly dependent on favourable changes in circumstances, economic conditions and/or operating environments, the lack of which would likely result in it defaulting on its financial obligations.
D	A financial institution rated D is currently in default on either all or a substantial portion of its financial obligations, whether or not formally declared. The D rating may also reflect the filing of bankruptcy and/or other actions pertaining to the financial institution that could jeopardise the payment of the financial obligations.

For long-term ratings, RAM Ratings applies signs plus (+), flat or minus (-) in each category from AA to C. The sign plus (+) indicates that the financial institution ranks at the higher end of its generic rating category; the sign flat indicates a mid-ranking; and the sign minus (-) indicates that the financial institution ranks at the lower end of its generic rating category.

Short-Term Ratings

P1	A financial institution rated P1 has a strong capacity to meet its short-term financial obligations. This is the highest short-term FIR assigned by RAM Ratings.
P2	A financial institution rated P2 has an adequate capacity to meet its short-term financial obligations. The financial institution is more susceptible to the effect of deteriorating circumstances than those in the highest-rated category.
P3	A financial institution rated P3 has a moderate capacity to meet its short-term financial obligations. The financial institution is more likely to be weakened by the effects of deteriorating circumstances than those in the higher-rated category. This is the lowest investment-grade category.
NP	A financial institution rated NP has a doubtful capacity to meet its short-term financial obligations. The financial institution faces major uncertainties that could compromise its capacity for payment of financial obligations.
D	A financial institution rated D is currently in default on either all or he D rating may also reflect the filing of bankruptcy and/or other actions pertaining to the financial institution that could jeopardise the payment of the financial obligations.

RAM Ratings (Lanka) Limited
No. 9 Arthur's Place
Colombo 4
Sri Lanka

Tel: (9411) 2553089 Fax: (9411) 2553090

E-mail: ram@ram.com.lk
Website: http://www.ram.com.lk

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