

RAM

RATINGS

## CREDIT RATING RATIONALE

FINANCIAL INSTITUTIONS – SRI LANKA

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

## Arpico Finance Company PLC – Rating Review

### Financial Institution Ratings:

Long-term: BB [Rating  
Watch, Negative Outlook]

Short-term: NP [Reaffirmed]

### Strengths:

- Better-than-industry asset quality
- Adequate NPL coverage

### Weaknesses:

- Non-compliance with regulatory capitalisation
- Limited branch network
- Manual systems

### Principal Activities:

Finance company engaged in hire-purchase, leasing, short-term loans, real estate development and accepting public deposits

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### Summary

RAM Ratings has placed Arpico Finance Company PLC's ("Arpico" or "the Company") long-term financial institution rating of BB on Rating Watch with a negative outlook; the short-term rating has been reaffirmed at NP. The Rating Watch is premised on the uncertainties surrounding Arpico's ability to meet the Central Bank of Sri Lanka's ("Central Bank") minimum core capital requirements by end-December 2008.

Although Central Bank regulations required Arpico to enhance its core capital to LKR 200 million by end-July 2008, the Company was unable to meet this requirement by the statutory deadline; as at end-June 2008, Arpico's core capital stood at LKR 133.26 million, LKR 66.74 million short of the requirement. In response, the Central Bank has issued an ultimatum granting the Company time until end-December 2008 to fully comply with the regulation. Pursuant to this action, Arpico is now formulating plans to meet the regulatory requirement via an equity injection; however, RAM Ratings' concerns hinge on the uncertainties surrounding the Company's ability to raise these funds amidst the prevailing subdued investment climate. Apart from this regulatory challenge, the Company's overall risk profile has remained largely unchanged.

Amidst challenging economic conditions, Arpico managed to further improve its asset quality during FYE 31 March 2008 ("FY Mar 2008"). The Company's gross non performing loans ("NPL") ratio improved to 5.06% as at end-FY Mar 2008, from the previous year's 7.07%, comparing favourably with the industry average of 6.54%<sup>1</sup> for the same period. The ratio was further supported by a moderate gross NPL coverage of 63.43%, which resulted in a net NPL ratio of 1.91% as at the end of the reviewed period. While we acknowledge the management's efforts to preserve asset quality, RAM Ratings opines that it would be challenging to maintain it at current levels.

Notwithstanding this, along with sliding industry performance, Arpico's performance had suffered during the period under review. Pressured by higher funding costs and overheads, both return on assets ("ROA") and return on equity ("ROE") had narrowed further to 2.04% and 10.05% respectively, from the previous year's 2.62% and 12.62%. These returns clocked in marginally lower than the respective industry averages of 2.80% and 17.90% for the same period.

Despite this, liquidity levels remained adequate during the period, with the statutory liquid assets ratio standing at 18.91% as at end-FY Mar 2008, above the regulatory minimum 15%. Although short term maturity mismatches in assets and liabilities are moderated by the Company's healthy deposit renewal rates, the absence of an effective asset liability management framework remains a concern.

<sup>1</sup> Industry statistics for FY Mar 2008 are based on un-audited financial statements

## Outlook

The rating watch on the long-term rating is premised on the uncertainties surrounding Arpico's ability to meet the Central Bank regulations pertaining to minimum core capital and the regulator's response to this. The negative outlook reflects the potential risks that may arise in the event of a breach in regulation by the Company, which could result in punitive action by the Central Bank; hence, downward pressure on the ratings will depend on the severity of such regulatory action. Conversely, reaffirmation to a stable outlook will be considered in case the above mentioned concerns are alleviated via a capital infusion as per regulatory requirements or a change in regulatory circumstances.

## Corporate Profile

Arpico is a registered finance company ("RFC") governed by the Central Bank under the Finance Companies Act No. 78 of 1988 ("FCA"). Established in 1951 by the Richard Peiris Group, it was subsequently divested to Alliance Finance Company Limited ("Alliance Finance") in the late 1960s. Arpico is a public listed company and the second oldest RFC in Sri Lanka.

Despite its long operational history, the Company has remained small and had not considered branching out until recently; it opened its first branch in Badulla in July 2008. The Company now operates with a staff strength of 99 employees through its head-office in Colombo, and sole branch in Badulla; it also opened a pawning centre in Dematagoda during August 2008. Arpico's main lines of business include hire purchase ("HP") financing, finance leasing, real estate trading, real estate easy payments ("EP"), granting personal & term loans, pawn brokering and deposit mobilisation.

## Ownership

Alliance Finance, an RFC established in 1956 (rated BBB/P2 by RAM Ratings), holds a 39.60% associate stake in Arpico. The general public held 46.16% of the Company's shares as at end-FY Mar 2008. Both Arpico and Alliance Finance are chaired by Mr Pratapkumar de Silva; a veteran professional in the finance sector. Arpico has limited financial flexibility in terms of parental support, as Alliance Finance too is a growing medium sized RFC.

## Management & Strategies

Arpico's operations fall under the purview of its 3 working directors: Mr Senakke Bandaranayake, the Joint Managing Director; Mr Bede Jayalath, the Finance Director; and Ms Ruvini Weerasinghe, the Director Legal. The operations are overseen by the Deputy Chairman, MR DLSR Perera, who is also the Finance Director of Alliance Finance.

Arpico opened its first branch in Badulla during July 2008; this outlet had been operating as an experimental window for a couple of years prior to obtaining branch approval by the Central Bank. The management intends to further strengthen its branch network, with the addition of new branches during FY Mar 2009.

Meanwhile, Arpico has also commenced pawn-brokering, with the opening of its first pawning centre in Dematagoda, during August 2008. Given the changing

**Established in  
1951**

**Limited branch  
network**

**Associate of  
Alliance Finance**

**Senior  
management**

**Branching out**

**Venturing into  
pawning**

**Manual systems a handicap**

economic trends and growing demand for pawning, the product is expected to aid the Company to expand its credit portfolio as well as earnings, owing to the broader margins. Pawning is also seen as a more secure form of lending as the lender takes physical possession of the collateral (which is gold) at the point of lending, thus reducing the need for credit evaluation & monitoring and recovery related costs.

However, as this type of business carries a higher degree of security risk, multiple security systems, insurance, and regular audits including physical verifications of pawned articles will have to be incorporated in order ensure safety against theft as well as internal and external fraud.

In the meantime, the management had continued its focus on HP, leasing and real estate during the year under review. The Company also intends to introduce leasing for motor bikes going forward. Elsewhere, the Company still depends on manual systems of operation. Although the management has been negotiating with information technology ("IT") vendors for a customised solution, there have been delays in finalising its implementation.

**Corporate Governance****Board composition**

Arpico's Board comprising 6 Directors, 3 of whom are non executive, is chaired by Mr Pratapkumar de Silva, a veteran in the financial sphere. Mr de Silva functions as a non-executive Chairman. The apex body comprises of 2 qualified accountants and an attorney-at-law. Board meetings are held monthly and additional meetings are convened to discuss specific important issues.

**Limited transactions with related parties**

Arpico's Board is supported by an audit committee and a remuneration committee. External audits are carried out by M/s Lawrie Muthu Krishna & Co. while internal audits are done by M/s H L B Edirisinghe & Co. Meanwhile, transactions with related parties remained minimal during the reviewed period, with the aggregate value of transactions amounting to LKR 4.39 million, mainly attributing to building rent and insurance brokerage commissions.

**Better-than-industry asset quality**

Arpico has recorded a significant improvement in its asset quality over the past few years (refer to Chart 1). The Company's gross NPL ratio had further ameliorated from 7.07% to 5.06% as at end-FY Mar 2008, comparing favourably with the industry average of 6.54%.

**Asset growth driven by lending & real estate**

Arpico's asset base broadened by 24.32% year-on-year ("y-o-y") to FY Mar 2008, surpassing the previous year's 21.53% y-o-y. The expansion was mainly driven by the growth in HP lending and real estate investments; total loans and advances grew by 20.01% y-o-y (LKR 109.22 million) comparing moderately with the industry growth of 15.31% y-o-y, while real estate investments grew by 70.97% y-o-y (LKR 43.36 million) as at end-FY Mar 2008. Total assets had reached LKR 1.09 billion as at end-FY Mar 2008.

**Portfolio dominated by HP**

The portfolio mix remained more or less similar to the previous year's, with HP taking the lions share of 61.05% as at end-FY Mar 2008. Leases, land EPs and other loans took up a respective 21.27%, 7.71% and 9.97% of gross loans as at the same date. HP had driven the growth in the loan base during the reviewed period, recording an expansion 25.82% y-o-y.

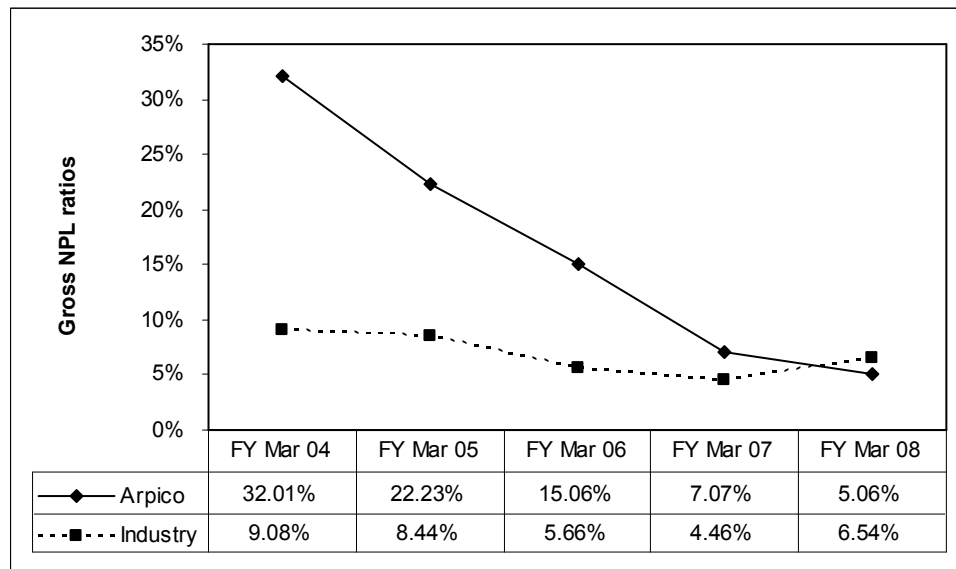
**Diversified portfolio**

**Improving gross NPL ratio**

Elsewhere, portfolio concentration remained moderate with the top 10 loans taking up less than 5% of the gross loan portfolio as at end-FY Mar 2008. Furthermore, almost 95% of the 2100 odd facilities had net outstanding amounts of less than LKR 1 million and constituted more than 70% of the total lending base as at the end of the year under review.

Arpico's gross NPL ratio has been trending downwards consistently over the past few years. The ratio improved further to 5.06% as at end-FY Mar 2008 (end-FY Mar 2007: 7.07%), comparing favourably with the industry average of 6.54% for the period (refer to Chart 1). The improvement in gross NPLs was backed by stronger collections and recoveries during the period. These efforts by the management to preserve the Company's asset quality, amidst challenging economic conditions, are viewed favourably by RAM Ratings. The agency will nonetheless closely monitor the Company's ability to sustain these results going forward.

**Chart 1: Arpico's gross NPL ratios vs the industry**



**Fall in absolute NPLs**

Total NPLs in absolute terms receded to LKR 34.27 million as at end-FY Mar 2008, down from the previous year's LKR 40.67 million. The reduction in NPLs was largely due to stronger recovery efforts; total recoveries for the reviewed period stood at LKR 17.87 million compared to LKR 12.15 million for FY Mar 2007. Total write-offs for the reviewed period stood at only LKR 1.68 million, as opposed to LKR 41.10 million the previous year. That said, RAM Ratings also notes that the NPL figures disclosed to the regulator excludes seized stocks; however, the management has undertaken to correct these errors prospectively.

**Adequate gross NPL coverage**

Arpico's gross NPL coverage has consistently remained above the industry average; RAM Ratings views this favourably. The Company's gross NPL coverage stood at 63.43% as at end-FY Mar 2008, better than the industry average of 49.30% for the period. The Company follows Central Bank's Direction 3<sup>2</sup>, which allows RFCs to set-off collateral of re-possessed stocks prior to loan loss provisioning.

**Rise in real estate investments**

Meanwhile, investments in real estate too had expanded during the year. Total investments in real estate rose from LKR 61.10 million to LKR 104.45 million as at end-FY Mar 2008 (end-June 2008: LKR 109.55 million), taking up 9.60% of

<sup>2</sup> Refer to relevant Central Bank regulations on page 12

**Non conducive investment climate may affect real estate market**

total assets as at that date. The 5 projects which were undertaken during FY Mar 2007 had been fully completed by end-June 2008. The Company had invested in 8 new projects for the 15-month period ended June 2008 (refer to Table 1). Arpicos' real estate investments entail land sales projects, where the Company buys a plot of land, develops it and then blocks it out for re-sale. As these projects are fairly small and diversified in terms of location, RAM Ratings derives comfort from Arpico's capacity to diversify its risks.

Nevertheless, the agency highlights that the weak investment climate has had a dampening effect on the property market in Sri Lanka; while the high yields offered on treasury securities are diverting investments from real assets to financial assets, rising prices are eroding consumers' purchasing power and thus demand on the other end. Under these circumstances, a slow down in take-up rates may result in an accumulation of real estate stocks; this will be viewed negatively by RAM Ratings as it will pose liquidity constraints on the Company.

**Table 1: Arpico's real estate stock as at end-June 2008**

Location	Launch Date	Budgeted time (months)	Original No. of lots	No. of lots sold to date	Carrying value of stock (LKR Mn)
Kochchikade	Dec 06	9	67	66	0.15
Kaluwarippuwa	Mar 07	8	37	37	0.13
Negombo town	Jun 07	5	11	7	9.22
Kotikawatte	Dec 07	5	10	10	0.14
Kosgama	Jan 08	6	55	10	22.14
Eluwila	Feb 08	6	32	11	17.44
Kaduwela	Mar 08	5	16	0	27.51
Katuwapitiya	Apr 08	5	15	3	2.35
Panadura	Apr 08	4	8	0	24.43
Malpitiya	May 08	5	23	9	5.39
Negombo <sup>3</sup>	Jul 01		88	86	0.65
<b>Total</b>			<b>362</b>	<b>240</b>	<b>109.55</b>

**Share investments not a major concern**

On a separate note, investments in quoted and unquoted shares stood at LKR 25.42 million as at the end of the reviewed period, taking up 12.41% of shareholders funds as that date. As this was within the regulatory threshold of 25%, RAM Ratings is not unduly concerned in this regard. However, the Agency notes that the recent slump in stock market prices have affected the Company's dealing securities portfolio; hence, the management has transferred 90% of its investments from dealing securities to investment securities. In the absence of this re-classification, the Company would have incurred LKR 4.18 million on marked-to-market losses<sup>4</sup> on its dealing securities portfolio.

**Recognition of deferred tax asset**

Elsewhere, in accordance with Sri Lanka Accounting Standards ("SLAS") 14 (revised 2006), the Company has changed its accounting policy for Deferred Taxation; accordingly, the Company has recognised a deferred tax asset of LKR 45.05 million in relation to unused tax losses to be set-off against future taxable profits. Previously, the Company had not recognised deferred tax due to sufficient taxable profit not being available for set-off against the deferred tax assets. However, as per the new amendment in the Inland Revenue Act No.10 of 2006, the management has decided that the company will have future taxable profits.

<sup>3</sup> Legal proceedings pending on 2 plots

<sup>4</sup> Dealing securities are marked-to-market, while investments securities are recognised at cost less any permanent diminution in value.

**Weakening performance**

**Narrowing NIM**

**Stronger income from real estate**

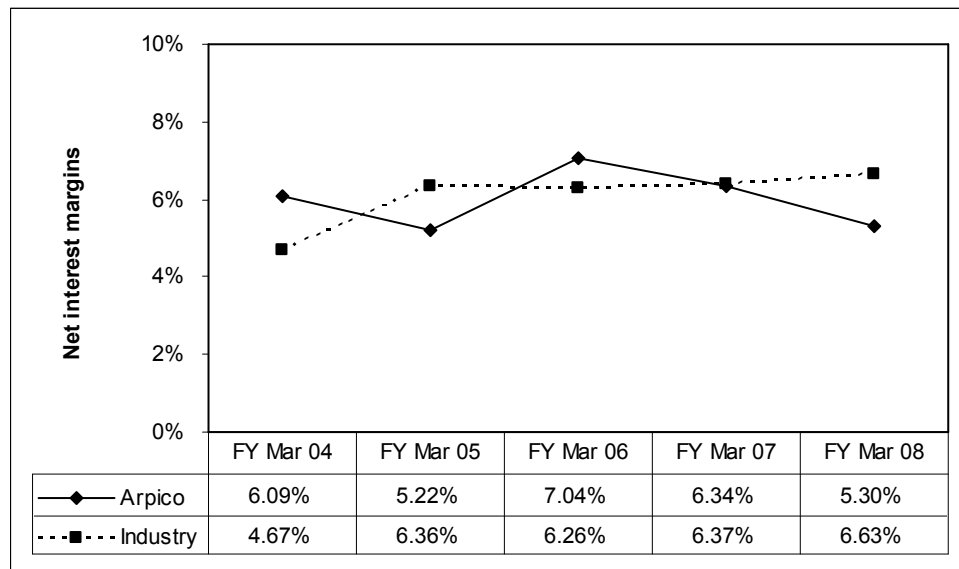
**Lofty cost-to-income ratio**

**Performance**

The weakening trend in Arpico’s performance had continued during FY Mar 2008. The high interest-high inflation economic environment had taken a toll on the Company’s margins; both ROA and ROE had weakened to 2.04% and 10.05% as at end-FY Mar 2008, from the previous year’s respective 2.62% and 12.62% (refer to Chart 3).

In line with portfolio expansion, the Company’s interest income had broadened during the year under review to LKR 174.08 million, a 33.45% y-o-y increase from the previous year. However, the more than equivalent expansion in interest expenses (52.73% y-o-y) had eclipsed these gains, resulting in just a marginal 2.98% y-o-y growth in net interest income to LKR 52.06 million for FY Mar 2008 (FY Mar 2007: LKR 50.55 million). Correspondingly, Arpico’s net interest margin (“NIM”) too had narrowed slightly from 6.34% as at end-FY Mar 2007 to 5.30% as at the end of the year under review; however, this compared moderately with the industry average of 6.63% for the same period (refer to Chart 2).

**Chart 2: Arpico’s net interest margins vs the industry**



Meanwhile, stronger contributions from real estate trading had boosted the Company’s non-interest income during the period. Total non-interest income grew by 15.01% y-o-y to LKR 43.60 million for FY Mar 2008, taking up 45.58% of gross income as at the end of the period. This over-reliance on non-interest income is viewed cautiously by RAM Ratings, as it could expose the Company to earnings volatilities, as experienced vis-à-vis the dealing securities portfolio<sup>5</sup>. Profits from share trading had reduced significantly during the period, owing to the lack lustre investment climate and slow down in share market activity. Elsewhere, as Arpico continues to recognise trading profits upfront on real estate sales carried out on EP basis, profits are less comparable with RFCs who do not engage in trading activities.

Arpico’s cost-to-income ratio had weakened further during the reviewed period, recording 87.72% for FY Mar 2008, up from 83.12% the previous year. This fared poorly with the industry average of 66.33% for the same period. RAM Ratings notes that Arpico’s high overhead structure limits its operational flexibility to withstand any sudden shocks which could arise during adverse

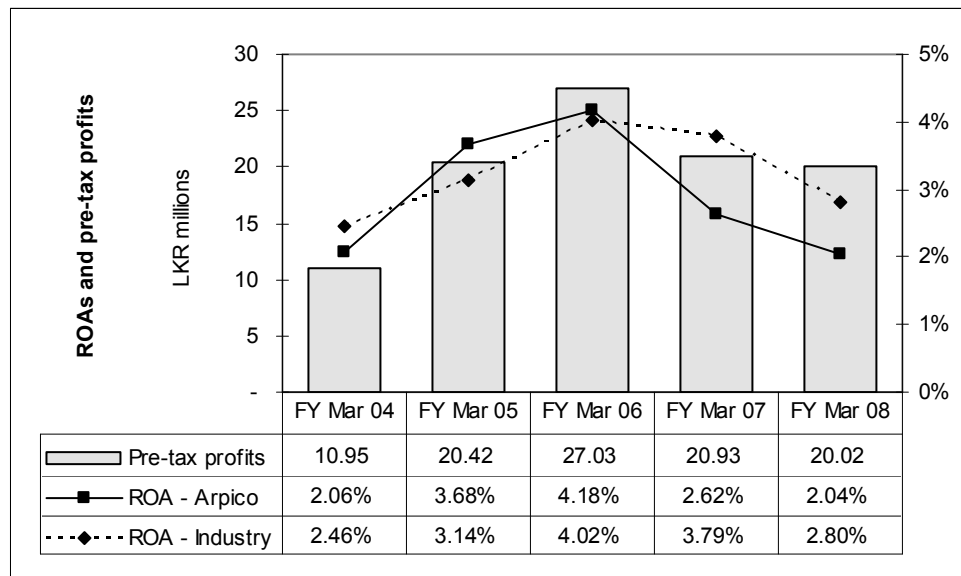
<sup>5</sup> Refer to paragraph 3 on page 5

**Weaker bottom-line**

economic conditions. Going forward, given the high inflationary environment prevailing, we expect this trend to continue into FY Mar 2009.

Overall, the rise in interest expenses and general overheads had affected Arpico’s bottom-line during the period. Pre-tax profits inched down marginally to LKR 20.02 million for FY Mar 2008, compared to the LKR 20.93 million recorded the previous year. Correspondingly, both ROA and ROE had weakened to 2.04% and 10.05% respectively as at end-FY Mar 2008, from the previous year’s 2.62% and 12.62%. These ratios fared weaker than the respective industry averages of 2.80% and 17.90% for the same period (refer to Chart 3). RAM Ratings notes that provision write-backs led by strong bad debt recoveries had aided Arpico’s performance thus far; hence, maintenance of asset quality would be a key determinant in the Company’s future performance levels.

**Chart 3 : Arpico’s returns on assets vs the industry**



**Funding & Liquidity**

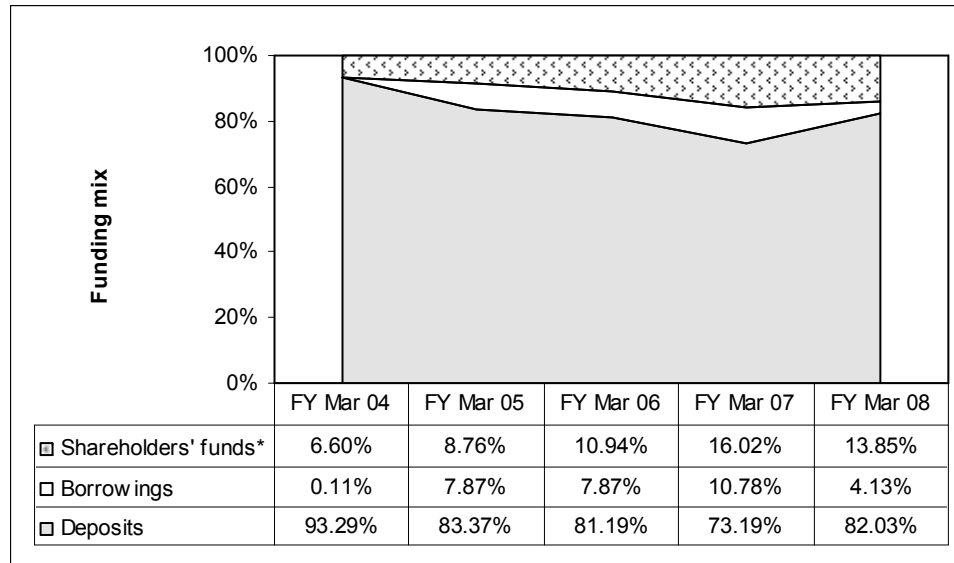
**Moderate funding structure**

The lion’s share of Arpico’s funding stemmed from its sturdy deposit base. Public deposits contributed 82.03% to the Company’s total funding while borrowings and shareholders funds contributed a respective 4.13% and 13.85% to total funding as at end-FY Mar 2008 (refer to Chart 4). Customer deposits to total interest bearing funds stood at 95.21% as at the end of the period; hence, the Company enjoys a moderate funding structure, free from heavy external borrowings.

**Liquid assets intact**

The deposit base augmented to LKR 767.47 million as at end-FY Mar 2008, from LKR 541.86 million as at end-FY Mar 2007, reflecting a 41.64% y-o-y expansion during the period. In line with deposit growth, the Company had strengthened its liquid asset portfolio during the period; the statutory liquid assets ratio improved to 18.91% as at end-FY Mar 2008, from the previous year’s 15.86%, thereby comfortably meeting the Central Banks statutory minimum of 15%. Elsewhere, deposit concentration remained moderate with the top 10 depositors taking up only 7.89% of total deposits as at end-FY Mar 2008.

Chart 4: Arpico's funding mix



\* Excluding revaluation reserves

### Inadequate ALM

Despite the healthy growth in the deposits base, however, we note that a bulk of these deposits are inclined towards the shorter-end and bear maturities of 'less than 1 year'. This has resulted in a wider negative maturity gap of LKR 273.45 million, between interest bearing assets and liabilities in the 'less than 1 year maturity bucket'. Although short term liquidity pressures are moderated to a certain extent by the healthy renewal rates on the Company's deposits, the absence of effective asset-liability management ("ALM") is considered a weakness. Liquidity risks are further heightened by the Company's exposure to the real estate sector, amidst the current adverse economic climate.

**Table 2: Arpico's maturity structure of interest bearing assets and liabilities as at end-FY Mar 2008**

Maturity period	Less than 1 year (LKR Mn)	1 to 3 years (LKR Mn)	More than 3 years (LKR Mn)
Cash and bank balances	29.14	-	-
Government securities	87.59	-	-
Deposits with banks	28.37	-	-
HP, leases, EPs and other advances	234.11	244.77	176.18
<b>Total interest-earning assets</b>	<b>379.21</b>	<b>244.77</b>	<b>176.18</b>
Public deposits	631.21	103.69	32.58
Borrowings	7.29	16.66	-
Bank overdrafts	14.16	-	-
<b>Total interest-bearing liabilities</b>	<b>652.66</b>	<b>120.35</b>	32.58
<b>Maturity gap</b>	<b>(273.45)</b>	<b>124.42</b>	<b>143.60</b>

### Capital Adequacy

### Inadequate capitalisation

Arpico's capitalisation is deemed inadequate owing to the Company's failure to meet Central Bank's minimum core capital requirement by the stipulated deadline. Arpico was required to meet the LKR 200 million minimum core capital regulation by end-July 2008. However, having failed to meet this deadline, the Company appealed to the Central Bank, for a further time extension in order to meet the short fall; Arpico's core capital stood at LKR 133.26 million as at end-June 2008, LKR 66.74 million short of the requirement.

**Further extension granted**

The Central Bank, however, has granted the Company only a very short extension up to end-December 2008 to fully comply with this regulation; failure to comply with the regulation will constitute an offence under the FCA<sup>6</sup>. Pursuant to this action, Arpico is now formulating plans to meet the regulatory requirement via an equity injection; however, RAM Ratings concerns hinge on the uncertainties surrounding the Company's ability to raise these funds amidst the prevailing subdued investment climate. Apart from this, however, Arpico had met the minimum tier-1 risk weighted capital adequacy ratio ("RWCAR") of 5%, recording 13.01% as at end-FY Mar 2008.

**Core capital enhanced by Rights issue and deferred tax adjustment**

In a bid to meet the Central Bank's first threshold of LKR 100 million core capital, the Company raised LKR 14.44 million via a rights issue in June 2008. Furthermore, as per SLAS 14, the deferred tax asset recognised during the financial period has been directly adjusted in the retained profits brought forward of the Company; this adjustment had further enhanced core capital by LKR 45.05 million as at end-June 2008. However, RAM Ratings notes that this is a material accounting adjustment and has a significant (33%) implication on its core capital base.

**Healthy solvency limits**

Meanwhile, the company's net NPLs to shareholders' funds ratio (solvency ratio) stood at 6.12% as at end-FY Mar 2008, compared to the industry average of 18.08%; reflecting the better risk absorption capacity of the Company. On a separate note, however, Arpico's internal rate of capital generation remained weak, recording only 5.48% as at the end of the year under review, when the industry average clocked in at 22.07%.

## Industry Overview

Sri Lanka's gross domestic product ("GDP") is estimated to have expanded by 7.00% in the second quarter of 2008, compared to 6.4% in the previous corresponding period. While the growth of the agriculture and services sectors had accelerated during this span, the industrial sector's pace had slowed down (refer to Table 3).

The enhanced performance of the agriculture sector had been driven by increased production levels, supported by favourable weather conditions and prices as well as more land for cultivation. The deceleration of the industrial sector, on the other hand, had been mainly due to the slowdown in the manufacturing sub-sector, particularly within the textiles, garments and leather industries. Meanwhile, the expansion in services was underscored by the transport and communication sub-sectors even while banking, insurance and real estate had lost momentum.

**Table 3: Overall and sectoral GDP growth**

At constant 2002 prices	2Q 2007	2Q 2008
Agriculture	3.7%	7.4%
Industry	7.5%	6.9%
Services	6.5%	6.9%
<b>Total</b>	<b>6.4%</b>	<b>7.0%</b>

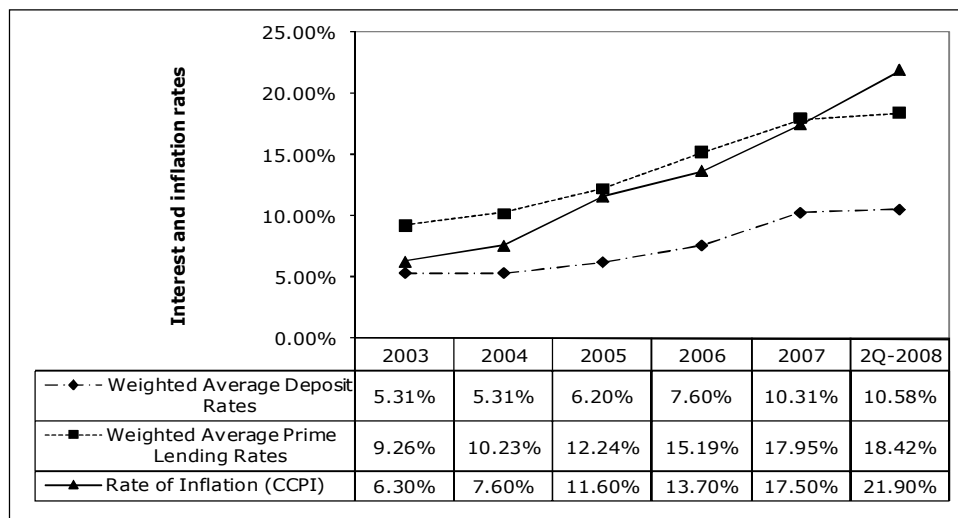
In the meantime, the rate of inflation has remained high; despite the

<sup>6</sup> As per the section 38 of the FCA, a person guilty of an offence under the Act can be liable for conviction after trial to imprisonment or fine.

implementation of the Central Bank’s tight monetary policies in the first half of 2008, the Colombo Consumer Price Index (“CCPI”) still trended upwards in the period. The CCPI, which hit an all-time high of 28.2% in June 2008, has now shown signs of deceleration - indicating that the monetary measures are yielding results, albeit with a lag effect. Looking ahead, inflation is expected to remain significant, but is likely to moderate somewhat with the benefit of easing international crude oil prices.

Concurrently, interest rates too are expected to remain elevated amid the inflationary pressures (refer to Chart 5), fuelled by the government’s domestic borrowings to bridge the expanding national budget deficit. Meanwhile, the widening gap is mainly attributable to the increase in defence and non-productive recurrent expenditure.

**Chart 5: Trends in interest and inflation rates**



Amid this environment of high inflation and lofty interest rates, the asset quality of the RFC sector has deteriorated significantly. RFCs’ inherent exposure to the sub-prime sector increases the industry’s vulnerability to economic vagaries. On this note, rising loan delinquencies had weakened the industry’s average gross NPL ratio from 4.46% as at end-FY Mar 2007 to 6.54% as at end-FY Mar 2008. In an attempt to curb rising NPLs, RFCs have curtailed lending and adopted consolidation strategies, which have resulted in an industry-wide deceleration in portfolio growth. Consequently, the industry’s loan growth almost halved from 33.07% y-o-y in FY Mar 2007 to 16.00% y-o-y in FY Mar 2008. To minimise exposure to credit risks, RFCs are introducing short-term, small-denomination loans while minimising their exposures by increasing borrowers’ contributions. These strategies are expected to curtail RFCs’ exposures to interest-rate and credit risks.

In tandem with the above, monitoring and recovery efforts have become more stringent. Most RFCs now take action to repossess collateral (mostly vehicles) as soon as debt servicing exceeds 3 months in arrears. Therefore, RAM Ratings notes an accumulation of seized vehicle stocks. In this respect, the quality of collateral takes centre stage vis-à-vis recouping outstanding advances.

In addition, competition from commercial banks has also increased, as they too have ventured into the vehicle-financing business, which is the key business segment of RFCs. This highlights the inherent product-concentration risk in the RFC business model.

Against this backdrop, RAM Ratings observes a shift in RFCs' asset mix, from lending to other non-interest-earning business pursuits such as trading in real estate. However, our concerns hinge on the weakening property market; the high yields offered on financial assets are diverting investments from real assets, hence subduing demand for real estate and heightening market risk. Moreover, investments in real estate expose RFCs to liquidity risk; this is because real-estate stocks are less liquid, render cash flows unpredictable and incur holding costs. As such, real-estate assets introduce myriad risks to financial institutions.

On the funding side, the deposit structure has tilted towards shorter tenures as depositors seek to take advantage of the volatile interest-rate environment. Consequently, many RFCs face a widening negative liquidity gap in the short term. As such, deposit franchise and asset-liability management become crucial. Although RFCs are now allowed 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. Moreover, market liquidity has waned due to the Central Bank's tight monetary policy, thereby potentially restricting institutional funding. All these factors have elevated the liquidity and interest-rate risks of RFCs.

The weakening economic climate is weighing down the financial performance of the RFC sector as a whole. Consequently, the industry's ROA declined from 3.79% as at end-FY Mar 2007 to 2.80% as at end-FY Mar 2008; this trend is expected to persist over the medium term. While the environment of lofty interest rates is squeezing interest margins at one end, mounting inflationary pressure is pushing up overheads on the other. Furthermore, rising delinquencies are narrowing portfolio yields and increasing pressure on bottom lines via heftier provisioning. RAM Ratings further notes that RFCs involved in housing and real-estate development tend to recognise trading profits upfront; this clouds profit comparisons with other RFCs, which offer only financing products.

Capitalisation-wise, although overall risk-weighted capital adequacy has improved slightly, rising defaults have weakened the industry's ratio on net NPLs to shareholders' funds, from 10.48% (end-FY Mar 2007) to 18.08% (end-FY Mar 2008). In addition, we note that some of the smaller RFCs have been unable to comply with the Central Bank's minimum core-capital requirement of LKR 200 million, and may face regulatory action.

On separate note, the Central Bank has enforced a *Direction on Corporate Governance of Finance Companies*, which will come into effect on 1 January 2009. As per transitional provision, however, a 3-year extension has been granted for full compliance. These directions are envisaged to instil more discipline vis-à-vis board responsibility and overall risk management of RFCs.

## Relevant Central Bank Directions Applicable to Registered Finance Companies

<p><b>Liquid assets</b></p>	<p>Every finance company must have a minimum holding of liquid assets at any given time. Liquid assets mean:</p> <ol style="list-style-type: none"> <li>a) Cash in hand.</li> <li>b) Balances in a current or deposit account in a commercial bank, free from any banker's lien or charge.</li> <li>c) Sri Lankan Government Treasury Bills, free from any charge or lien.</li> <li>d) Sri Lankan Government Securities maturing within 1 year and free from any charge or lien.</li> <li>e) Central Bank securities maturing within 1 year and free from any charge or lien.</li> <li>f) Cash balance, if any, maintained with the Central Bank.</li> </ol> <p>The minimum limits are as follows:</p> <ol style="list-style-type: none"> <li>1. For time deposits, 15% of outstanding deposits.</li> <li>2. For certificates of deposits, 15% of the face value of the certificates.</li> <li>3. For savings deposits, 20% of the outstanding deposits.</li> </ol> <p>The companies should maintain the liquid assets in the form of (c), (d) and (e) above, equivalent to 10% of its average month-end deposit liabilities of the preceding financial year.</p>
<p><b>Provision of bad and doubtful debts</b></p>	<p>Every finance company had been required to follow either one of the following directions on provisioning for bad and doubtful debts until 1 April 2007:</p> <p><u>Direction No. 1 of 1991</u></p> <p>Bad and doubtful debts provided for under this direction are subject to a minimum of:</p> <ol style="list-style-type: none"> <li>(a) 50% of all advances in arrears for a period of 7 to 12 months.</li> <li>(b) 100% of all advances in arrears for 13 months or more.</li> </ol> <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"> <li>1. The value so deducted should not exceed the value decided by a professional valuer at the time of granting the advance.</li> <li>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.</li> </ol> <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"> <li>(a) 50% of all advances in arrears for a period of 12 to 24 months.</li> <li>(b) 100% of all advances in arrears for more than 24 months.</li> </ol> <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"> <li>(a) 50% of all advances in arrears for a period of 6 to 12 months.</li> <li>(b) 100% of all advances in arrears for 13 months or more.</li> </ul> <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"> <li>1. Sri Lankan Government securities, free from any lien or charge.</li> <li>2. Central Bank securities, free from any lien or charge.</li> <li>3. Time deposits in a licensed commercial bank, specialised bank or RFC, free from any lien or charge.</li> <li>4. Bank guarantees.</li> <li>5. With regard to repossessed vehicles and machinery, 80% of the valuation obtained in the preceding 6 months and by an approved valuer.</li> <li>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"> <li>a) 6-36 months, 100% of the value is deductible</li> <li>b) 37-60 months, 80% of the value is deductible</li> <li>c) 61-120 months, 50% of the value is deductible</li> <li>d) more than 120 months, 0% of the value is deductible</li> </ul> </li> </ol>
<p><b>Capital adequacy</b></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"> <li>(a) Tier I - Core Capital</li> </ul> <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"> <li>(b) Tier II - Supplementary Capital</li> </ul> <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><b>Single-borrower limit</b></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 15% of the capital funds of the finance company.</p> <p>This limit stands at 20% 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><b>Minimum core-capital requirement</b></p>	<p>Every finance company must at all times maintain an unimpaired core capital of LKR 200 million. However, companies that could not meet this requirement by February 2006 had been granted a 30-month extension, subject to the following:</p> <ul style="list-style-type: none"> <li>(a) A finance company with a core capital of less than LKR 100 million must: <ul style="list-style-type: none"> <li>1. enhance its core capital to at least LKR 100 million by February 2007; and</li> <li>2. bring the remaining LKR 100 million or the deficit up to the core-capital requirement of LKR 200 million by July 2008.</li> </ul> </li> <li>(b) A finance company with a core capital of between LKR 100 million and LKR 200 million must bring in: <ul style="list-style-type: none"> <li>1. at least 50% of the deficient amount to meet the core-capital requirement of LKR 200 million by February 2007; and</li> <li>2. the balance of the deficient amount up to the core capital requirement of LKR 200 million by July 2008.</li> </ul> </li> </ul>
<p><b>Investments</b></p>	<p>A finance company must not invest in the shares of any company</p> <ul style="list-style-type: none"> <li>(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</li> <li>(b) In aggregate, in excess of 25% of the capital funds of the finance company</li> </ul> <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:** 1951

**Commencement of Business:** 1951

<b>Major Shareholders:</b>	Alliance Finance Company Ltd	39.60%
	Mr K D D Perera	6.41%
	Orient Hotels Ltd	5.25%
	Mr R K E P de Silva	4.83%
	Mr J R de Silva	4.06%
	Seylan Bank Limited	3.85%
	Dr K G G S L Perera	3.24%
	Late Mr C G W de Silva	3.03%
	Elgin Investments	2.86%
	Mrs S R L Marcelline	1.36%

<b>Directors:</b>	Mr Pratapkumar de Silva	Chairman
	Mr D L S R Perera	Deputy Chairman
	Mr Senakke R Bandaranayake	Joint Managing Director
	Mrs Ruvini E Weerasinghe	Director - Legal
	Mr Bede Jayalath	Finance Director
	Mr Romani de Silva	Director

**Auditor:** Lawrie Muthu Krishna & Company

**Listing:** Listed

<b>Key Management:</b>	Mr Senakke R Bandaranayake	Joint Managing Director
	Mr Bede Jayalath	Director - Finance
	Mrs Ruvini E Weerasinghe	Director - Legal

**Major Subsidiaries and Associates:** None

<b>Capital History:</b>	Year	Remarks	Amount (LKR Mn)	Cumulative Total (LKR Mn)
	1951	Ordinary share issue	0.38	0.38
	1972	New ordinary share issue	0.38	0.76
	1989	New ordinary share issue	3.75	4.50
	1993	New ordinary share issue	6.00	10.50
	1994	New ordinary share issue	5.25	15.75
	1951	Redeemable preference share issue	0.13	0.13
	1958	Irredeemable preference share issue	0.50	0.63
	1971	Redemption of redeemable preference shares	(0.13)	0.50

**Financial Summary - Company**

BALANCE SHEET (LKR Million)				Re-stated	Un-audited	
	31-Mar-04	31-Mar-05	31-Mar-06	31-Mar-07	31-Mar-08	30-Jun-08
<b>ASSETS</b>						
Cash & Money At Call	8.59	1.65	1.18	0.62	29.14	47.99
Deposits & Placements With Financial Institutions	19.74	19.86	21.05	25.16	28.37	45.00
Securities Purchased Under Resale Agreements	0.00	0.00	0.00	0.00	0.00	0.00
Securities						
Dealing Securities	123.12	65.45	63.44	82.20	89.49	98.94
Investment Securities	17.60	16.60	3.74	3.71	23.53	23.53
Gross Loans & Advances	445.64	507.34	644.36	643.58	723.99	766.03
Interest-In-Suspense	53.15	46.26	108.27	68.61	47.20	37.10
General Loan Loss Reserves	0.00	0.00	0.00	0.00	0.00	0.00
Specific Loan Loss Reserves	112.23	95.34	76.22	29.13	21.74	23.21
Net Loans & Advances	280.27	365.74	459.87	545.84	655.06	705.72
Investments in Subsidiaries/Associates	0.00	0.00	0.00	0.00	0.00	0.00
Investment Land and Properties	26.09	44.97	59.46	61.10	104.45	109.22
Other Assets	13.92	13.51	14.04	59.97	62.05	88.12
Property, Plant and Equipment	47.90	46.22	97.44	96.64	96.01	95.36
<b>TOTAL ASSETS</b>	<b>537.23</b>	<b>574.01</b>	<b>720.21</b>	<b>875.24</b>	<b>1,088.10</b>	<b>1,213.88</b>
<b>LIABILITIES</b>						
Customer Deposits						
Savings	0.00	0.00	0.00	0.00	0.00	0.00
Fixed	427.34	413.55	464.43	541.86	767.47	837.18
NIDs	0.00	0.00	0.00	0.00	0.00	0.00
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	0.00	38.56	44.49	79.34	38.12	38.98
Subordinated Debt & Hybrid Capital	0.50	0.50	0.50	0.50	0.50	0.50
Other Liabilities	57.39	56.20	72.98	59.70	77.23	115.12
<b>TOTAL LIABILITIES</b>	<b>485.23</b>	<b>508.81</b>	<b>582.41</b>	<b>681.39</b>	<b>883.32</b>	<b>991.78</b>
Paid-up Capital	15.75	15.75	15.75	15.75	15.75	30.19
Minority Interest	0.00	0.00	0.00	0.00	0.00	0.00
Share Premium & Other Reserves	26.37	28.87	97.32	97.32	97.32	97.32
Statutory General Reserve	11.77	14.89	19.36	22.62	25.60	25.60
Retained Profits/(Loss)	(1.89)	5.69	5.38	58.16	66.11	68.99
<b>Total Shareholders' Funds</b>	<b>52.00</b>	<b>65.20</b>	<b>137.80</b>	<b>193.85</b>	<b>204.78</b>	<b>222.10</b>
<b>TOTAL LIABILITIES &amp; SHAREHOLDERS' FUNDS</b>	<b>537.23</b>	<b>574.01</b>	<b>720.21</b>	<b>875.24</b>	<b>1,088.10</b>	<b>1,213.88</b>
<b>COMMITMENTS &amp; CONTINGENCIES</b>	<b>0.00</b>	<b>0.00</b>	<b>0.00</b>	<b>0.00</b>	<b>0.00</b>	<b>0.00</b>
<b>TIER 1 CAPITAL</b>	<b>36.12</b>	<b>44.67</b>	<b>65.80</b>	<b>78.90</b>	<b>119.64</b>	<b>133.26</b>
<b>CAPITAL BASE</b>	<b>52.69</b>	<b>49.69</b>	<b>94.69</b>	<b>113.17</b>	<b>153.92</b>	<b>174.52</b>

**Financial Summary - Company**

INCOME STATEMENT (LKR Million)				Re-stated	Un-audited	
	31-Mar-04	31-Mar-05	31-Mar-06	31-Mar-07	31-Mar-08	30-Jun-08
Interest Income	89.97	81.99	105.45	130.44	174.08	52.93
Less: Amortisation Of Premium/(Accretion Of Disc	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	57.59	53.00	59.90	79.89	122.02	40.06
Net Interest Income	32.38	29.00	45.56	50.55	52.06	12.88
Non-Interest Income	16.61	24.74	34.06	37.91	43.60	12.68
<b>Gross Income</b>	<b>48.99</b>	<b>53.74</b>	<b>79.61</b>	<b>88.46</b>	<b>95.66</b>	<b>25.56</b>
Personnel Expenses	13.82	18.71	27.01	31.22	34.99	0.00
Other Non-Interest Expenses	19.13	28.95	40.41	42.31	48.92	22.69
Loan Loss Provisions	5.09	(14.33)	(14.84)	(6.00)	(8.28)	0.00
Share of results of Associated Companies	0.00	0.00	0.00	0.00	0.00	0.00
<b>Pre-Tax Profit</b>	<b>10.95</b>	<b>20.42</b>	<b>27.03</b>	<b>20.93</b>	<b>20.02</b>	<b>2.87</b>
Taxation	0.00	4.83	4.68	4.63	5.12	0.74
<b>Profit After Tax</b>	<b>10.95</b>	<b>15.59</b>	<b>22.35</b>	<b>16.30</b>	<b>14.91</b>	<b>2.14</b>
Extraordinary Items	0.00	0.00	0.00	0.00	0.00	0.00
Prior Year Adjustments	0.00	0.00	0.00	44.51	0.00	0.00
Minority Interests	0.00	0.00	0.00	0.00	0.00	0.00
Transfer To Statutory Reserves	2.19	3.12	4.47	3.26	2.98	0.00
Transfer To Other Reserves	0.00	2.50	15.00	0.00	0.00	0.00
Dividend	0.08	2.40	3.19	4.77	3.98	0.00
<b>Retained Profit For The Year</b>	<b>8.68</b>	<b>7.57</b>	<b>(0.31)</b>	<b>52.78</b>	<b>7.95</b>	<b>2.14</b>

**Financial Ratios - Company**

KEY RATIOS (%)				Re-stated		Un-audited
	31-Mar-04	31-Mar-05	31-Mar-06	31-Mar-07	31-Mar-08	30-Jun-08
<b>Profitability</b>						
Net Interest Margin	6.09%	5.22%	7.04%	6.34%	5.30%	4.48% *
Non-Interest Income Margin	3.12%	4.45%	5.26%	4.75%	4.44%	4.41%
Cost To Income	67.25%	88.67%	84.68%	83.12%	87.72%	88.76%
Return On Assets	2.06%	3.68%	4.18%	2.62%	2.04%	1.00% *
Return On Equity	23.52%	34.85%	26.63%	12.62%	10.05%	5.30% *
Dividend Payout	0.73%	15.41%	14.27%	29.23%	26.68%	0.00%
<b>Asset Quality</b>						
Gross NPL Ratio	32.01%	22.23%	15.06%	7.07%	5.06%	4.07%
Net NPL Ratio	4.78%	1.95%	0.98%	2.12%	1.91%	0.91%
Specific Loan Loss Provisions For Current Year	1.12%	1.66%	1.30%	0.96%	1.27%	0.00%
Gross NPL Coverage	89.33%	93.03%	94.43%	71.61%	63.43%	78.28%
Loan Loss Reserve Coverage	28.59%	20.68%	14.22%	5.07%	3.21%	3.18%
<b>Liquidity &amp; Funding</b>						
Liquid Asset Ratio	35.42%	20.49%	17.69%	17.84%	18.81%	22.87%
Statutory Liquid Asset Ratio	33.31%	15.79%	14.95%	15.86%	18.91%	22.69%
Customer Deposits To Total Interest Bearing Funct	99.88%	91.37%	91.17%	87.16%	95.21%	95.50%
Loans To Deposits Ratio	65.59%	88.44%	99.02%	100.74%	85.35%	84.30%
Loans To Stable Funds Ratio	64.89%	77.56%	83.64%	75.93%	71.60%	70.33%
<b>Capital Adequacy</b>						
Shareholders' Funds To Total Assets	9.68%	11.36%	19.13%	22.15%	18.82%	18.30%
Tier 1 Risk Weighted Capital Adequacy Ratio	8.60%	9.04%	10.69%	10.81%	13.01%	13.72%
Overall Risk Weighted Capital Adequacy Ratio	12.55%	10.05%	15.39%	15.51%	16.74%	17.97%
Internal Rate Of Capital Generation	23.35%	22.51%	18.88%	6.96%	5.48%	3.94% *

**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

<b>AAA</b>	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.
<b>AA+</b> <b>AA</b> <b>AA-</b>	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.
<b>A+</b> <b>A</b> <b>A-</b>	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.
<b>BBB+</b> <b>BBB</b> <b>BBB-</b>	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.
<b>BB+</b> <b>BB</b> <b>BB-</b>	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> <b>B</b> <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.
<b>C+</b> <b>C</b> <b>C-</b>	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.
<b>D</b>	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.

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## SHORT-TERM RATINGS

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- 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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