


RATINGS

CREDIT RATING RATIONALE

FINANCIAL INSTITUTIONS – SRI LANKA
A wholly owned subsidiary of RAM Holdings Berhad

SANASA DEVELOPMENT BANK LTD – Rating Review

Financial Institution
Ratings:

Long-term: BBB

[Reaffirmed]

Short-term: P3 [Reaffirmed]

Rating Outlook:

Stable

Strengths:

- Healthy performance
- Good credit management
- Strong rural presence

Weaknesses:

- Highly risky target segment
- Small size

Principal Activities:

Deposit mobilisation, provision of micro financing, leasing and project financing

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Summary

RAM Ratings Lanka has reaffirmed Sanasa Development Bank's ("SDB" or "the Bank") respective long- and short-term financial institutions ratings, at BBB and P3; the long-term rating has a stable outlook. The ratings are supported by the Bank's healthy financial performance, stringent credit management and strong rural presence, particularly in micro financing. Nevertheless, these positives are moderated by SDB's highly risky targeted customer segment and small stature.

SDB is a licensed specialised bank ("LSB"), accounting for 2.99% of the total industry assets in an industry as at end-December 2009; the largest player took up the lion's share of 69.89%. SDB operates as the apex financial institution of the Sanasa movement - the largest cooperative network in the country, with the objective of catering to the funding needs of the rural community. The Bank provides micro-financing, leasing, housing loans and project financing, primarily to the low-income segment of the economy, which usually lies outside the risk parameters of commercial banks. SDB disburses loans to Sanasa members through grassroots-level primary societies; lending is also extended to non-members as well as small and medium-sized enterprises ("SMEs").

Despite its high-risk target market, SDB has been able to maintain its better-than-industry asset quality, supported by its stringent credit evaluation and monitoring. As such, SDB's gross non-performing-loans ("NPL") ratio dipped marginally to 6.59% as at end FYE 31 December 2009 ("FY Dec 2009"), albeit remaining better than the industry average of 10.38% as at the same date. Further, the gross NPL ratio ameliorated to 5.50% as at end-Mar 2010.

Meanwhile, SDB's high-risk target segment has enabled it to charge higher interest rates on its loans, thereby allowing it to maintain its better-than-industry net interest margin ("NIM"). As such, its NIM widened from 7.81% as at end-FY Dec 2008 to 9.01% as at end-FY Dec 2009, on the back of buoyant loan growth and healthier yields on its portfolio. The Bank's financial performance remained healthy through the review period; its pre-tax profit nearly doubled to LKR 445.51 million. RAM Ratings Lanka notes that the Bank's return on assets ("ROA"), which came up to 3.36% as at end-December 2009, has consistently surpassed the industry average.

RAM Ratings Lanka opines that SDB has moderate funding and liquidity positions. We are concerned about the widening gap in the Bank's asset-liability maturity mismatch ("ALMM") in the "less than 1 year" bucket, which accounted for 21.10% of its interest earning assets as at end-FY Dec 2009. However, this is partially alleviated by SDB's healthy renewal rates and LKR 300 million of unutilised funding lines. The Bank's statutory liquid-asset ratio stood at 25.27% as end-December 2009.

On a more positive note, SDB had been able to enhance its capital by LKR 875.64 million during the year, mainly with the support of the primary societies. This had allowed the Bank to comply with the minimum capital requirement of LKR 1.5 billion. Accordingly, SDB's tier-1 and overall risk-weighted capital-adequacy ratios ("RWCARs") improved to 16.68% and 17.39%, respectively, as at end-FY Dec 2009 - well above the regulated minimums of 5% and 10%.

Outlook

The stable outlook on the long-term rating reflects the Bank's strong rural presence, along with the expectation that its performance will be maintained while its asset quality remains intact. Meanwhile, an upward rating revision may materialise if SDB can demonstrate sustainable improvement in its asset quality while preserving its financial performance, liquidity and capital.

Corporate Profile

*Apex financial
body of Sanasa
movement*

SDB is an LSB established in 1997; it is governed by the Banking Act No. 30 of 1988 and falls under the regulatory purview of the Central Bank of Sri Lanka ("CBSL"). SDB operates as the main financial institution of the Sanasa movement, one of the largest cooperative networks in the country, with the objective of catering to the funding needs of the rural community. Since its inception in 1906, the Sanasa movement has rapidly expanded to include over 8,500 Sanasa primary societies, covering a 4-million-strong population.

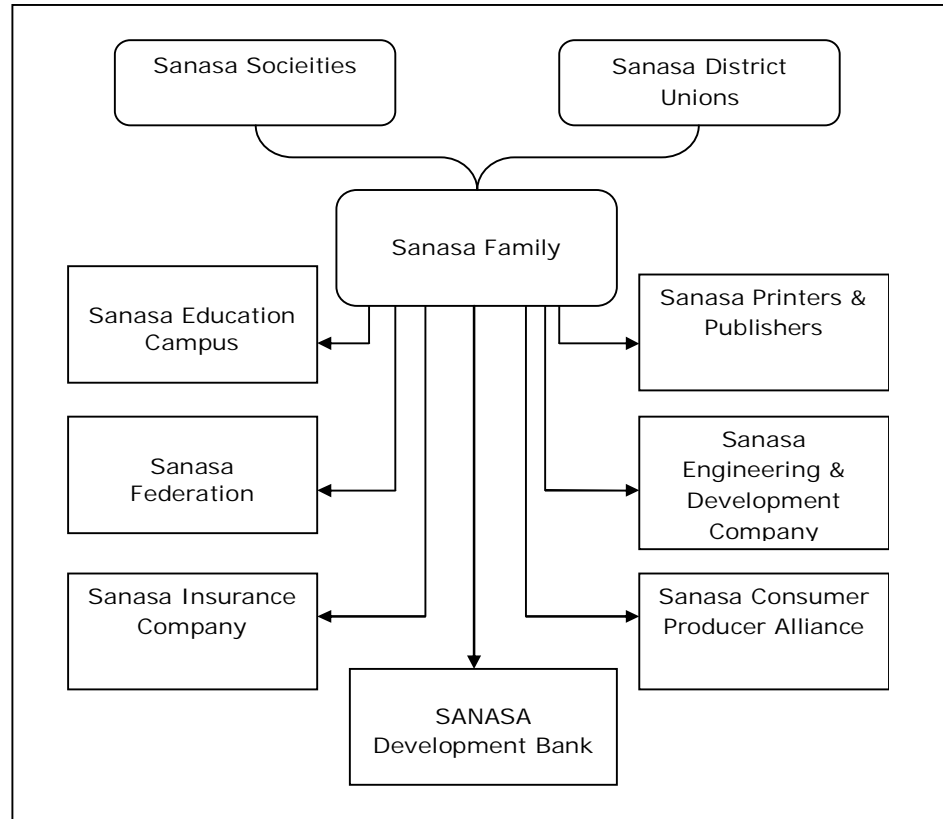
*Offers micro
financing to rural
economy*

SDB provides micro-financing, leasing, housing loans and project financing, primarily to the periphery of the economy that usually lies beyond the risk appetite of commercial banks. As such, SDB is mainly focused on promoting entrepreneurial initiatives among the rural population, thereby contributing to their economic development. The Bank also accepts public deposits; it enjoys strong growth in its deposit base, backed by its relatively recent extensive branch expansion. Concurrently, SDB has strengthened its presence in the northern and eastern provinces, and operates through 64 branches.

*International
accolades*

Meanwhile, SDB has been placed second in Microfinance Information Exchange ("MIX") Institution's 2009 MIX Global 100 composite ranking of Microfinance Institutions. The MIX Institution is based in the United States.

Chart 1: Sanasa's corporate structure



Collectively owned by primary societies

Ownership

The primary societies within the Sanasa movement collectively own the largest stake in SDB; this had increased further after capital injections during the review period. On this note, over 3,900 primary societies held approximately 85% of the Bank as at end-December 2009. These primary societies are in turn owned by their members, mainly comprising individuals from the low-income segments. At the same time, Orient Global Capital Pte Ltd, an investment organisation based in Singapore, and ETIMOS, a micro-financing body domiciled in Italy, held respective stakes of 4.64% and 3.82% in the Bank.

Well-experienced senior management

Management & Strategies

The management of SDB is led by General Manager/Chief Executive Officer (“CEO”) Nimal Mamaduwa. He is supported by a team of seasoned senior managers with widespread experience in micro-financing.

In line with the Bank’s focus on rural economic development, its loan portfolio is dominated by micro-financing, which constitutes around 50% of its entire portfolio. The Bank provides credit facilities through its primary societies, which in turn lend to their members. SDB introduced a group lending system in July 2009, as a mechanism to guarantee the repayment of non-member credit facilities. Through this arrangement, the repayment of loans extended to group members will be assured by the remaining members of the cluster, thereby curtailing credit risk. Moving ahead, the management intends to further expand the Bank’s loan portfolio by focusing on group lending products, given the simplicity of implementation and commendable recovery rates.

Expanding branch network

Meanwhile, SDB is focusing on strengthening its rural presence to enhance its links with the grassroots of the economy. In this regard, the Bank has rapidly augmented its branch network, from 15 branches in 2004 to the current 64. SDB has fortified its presence in the northern and eastern provinces of the country via new branches, business-development centres and extension offices. Going forward, the management foresees growth potential from these regions, in line with the post-war developments expected to take place over the medium term.

Conduit to channel government funds

The Bank also acts as a conduit to channel government and other institutional funds to a variety of development projects. As such, dedicated funding lines are provided at concessionary rates by an array of local and foreign institutions, including the CBSL, National Development Bank and Asian Development Bank. In line with the government's *Northern Reawakening* programme, SDB has been selected as one of the 7 banks to disperse LKR 3.0 billion of funds, with the objective of promoting economic development in that region.

Board composition

Corporate Governance

SDB's board of directors consists of 13 members and is chaired by Dr PA Kiriwandeniya, who had pioneered the Sanasa movement and is committed to the upliftment of the rural masses. Eight members of the board are representatives of the Sanasa Thrift and Credit Cooperative societies, who are elected by the shareholders; these members in turn nominate the rest of the directors. The board assembles monthly while special meetings are scheduled as and when required.

Sub-committees

The Bank has established 5 committees: audit, credit, nomination, risk management, and human resources. SDB is further supported by the internal audit and inspection department, which reports directly to the audit committee on a regular basis. The credit committee regularly reviews the Bank's credit policies by monitoring its loan portfolio, NPL movements, recoveries and provisioning information etc.

Credit-risk mitigation

Risk Management

The Bank is exposed to heightened credit risk owing to its focus on an inherently high-risk customer segment. To mitigate the higher risks, the Bank has initiated several procedures with regard to credit evaluation and approval. As such, loan assessment and endorsement are conducted at several levels, depending on the magnitude of the facility. The branch manager is authorised to grant loans of up to LKR 0.5 million while facilities below LKR 1 million will be vetted by the credit committee; any amount above this will require board approval.

Stringent monitoring

RAM Ratings Lanka notes that assessing the creditworthiness of SDB's customers is a challenge as most of the Bank's customers are incapable of furnishing the documentation pertaining to their financial feasibility and repayment capacity. Hence, the Bank mainly focuses on the potential customers' industrial experience and cashflow-generating aptitude. Moreover, credit risk is evaluated and monitored at branch level; any concerns will be addressed at the credit committee's monthly meetings.

Implemented new IT system

During the initial rating exercise, RAM Ratings Lanka had highlighted the operational risks arising from SDB's inadequate information technology ("IT") system, which was already in place in 2009. However, the Bank has managed to successfully implement a new IT system, which allows it to integrate the operations of its previously isolated branches. We note that 30 branches had been consolidated by end-June 2010; the management intends to connect all its branches by end-November this year. This new IT framework, which we view in a positive light, links the independent branch systems that had previously been consolidated manually. The Bank anticipates the new system to improve its operational efficiency and also support future expansion.

Moderate asset quality

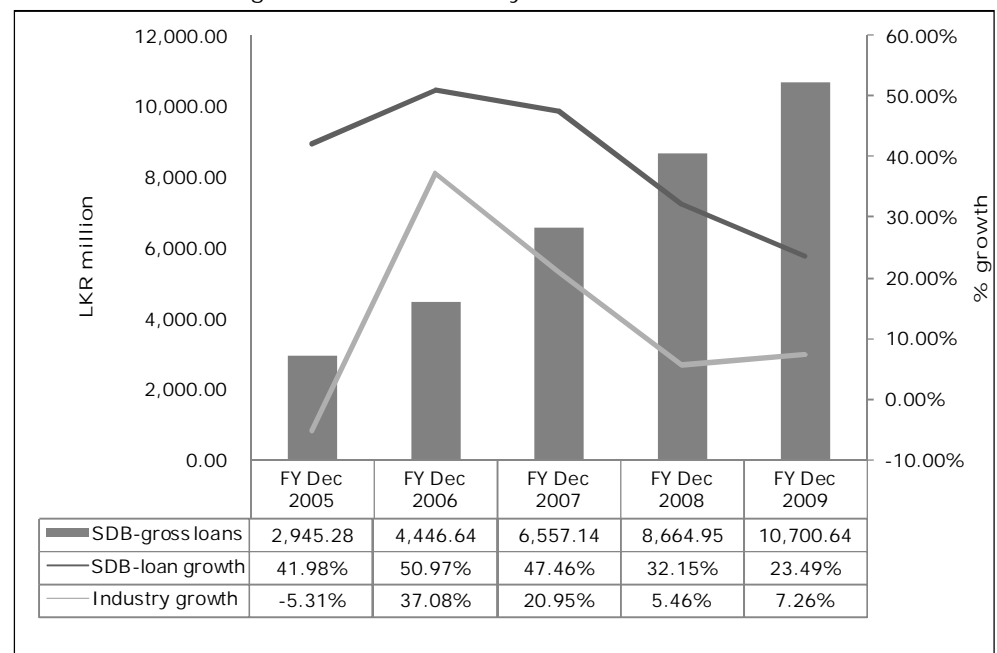
Asset Quality

RAM Ratings Lanka deems the Bank's asset quality to be moderate. Despite catering to an inherently high-risk customer segment, SDB has been recording better-than-industry asset-quality indicators. Going forward, SDB's asset quality is expected to remain at the current modest levels, underpinned by its good underwriting standards as well as stringent monitoring and credit-risk management.

Robust loan expansion

SDB's asset base has been expanding at a faster rate than the industry, supported by its aggressive loan expansion. Despite the non-conducive investment climate, the Bank's loan portfolio augmented 23.49% year-on-year ("y-o-y") to LKR 10.70 billion as at end-FY Dec 2009, albeit slower than the 32.15% of the previous year (refer chart 2). This growth momentum continued through 1Q FY Dec 2010, notching up another 11.42% (annualised) increase. The healthy growth was supported by rapid branch expansion, mainly stemming from micro-finance lending to the consumer and housing sectors. Going forward, we anticipate the Bank's loan expansion to remain aggressive, supported by group lending and stronger contributions from the northern and eastern regions over the medium term.

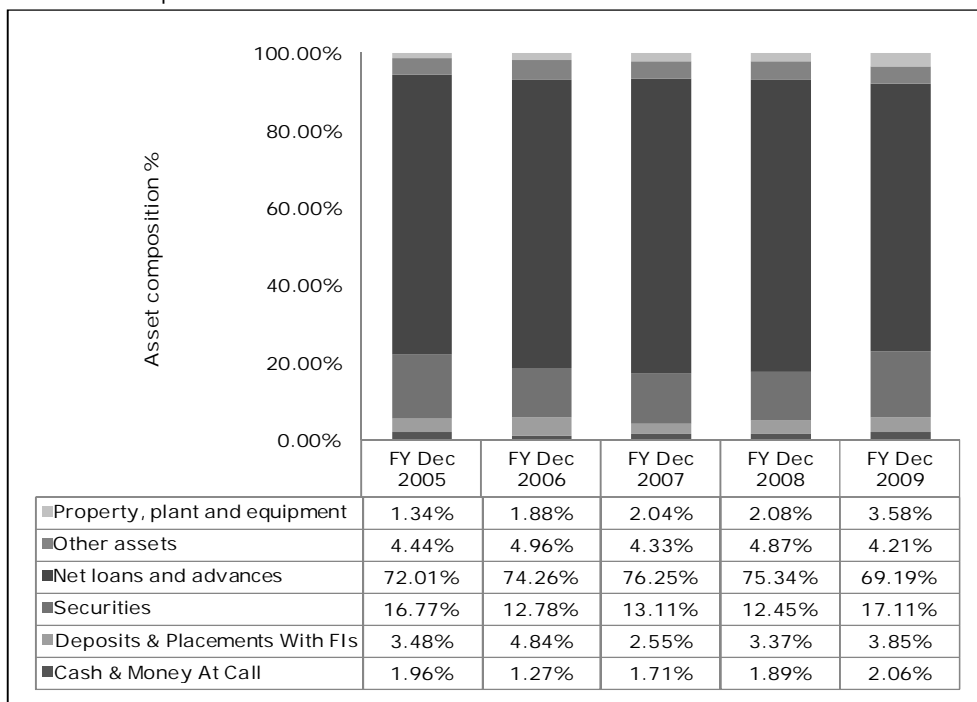
Chart 2: SDB's loan growth vs the industry



Loans dominate asset base

In line with the expansion of the Bank's lending portfolio, loans and advances continued dominating SDB's asset base, accounting for 69.19% of total assets as at end-FY Dec 2009 - albeit lower than the 75.34% of a year earlier. Moreover, investment in securities advanced to LKR 1.41 billion; this was anchored by augmented investments in commercial papers (LKR 827.35 million), in line with more favourable short-term interest rates. Overall, SDB's asset composition remained relatively unchanged during the review period (refer to Chart 3).

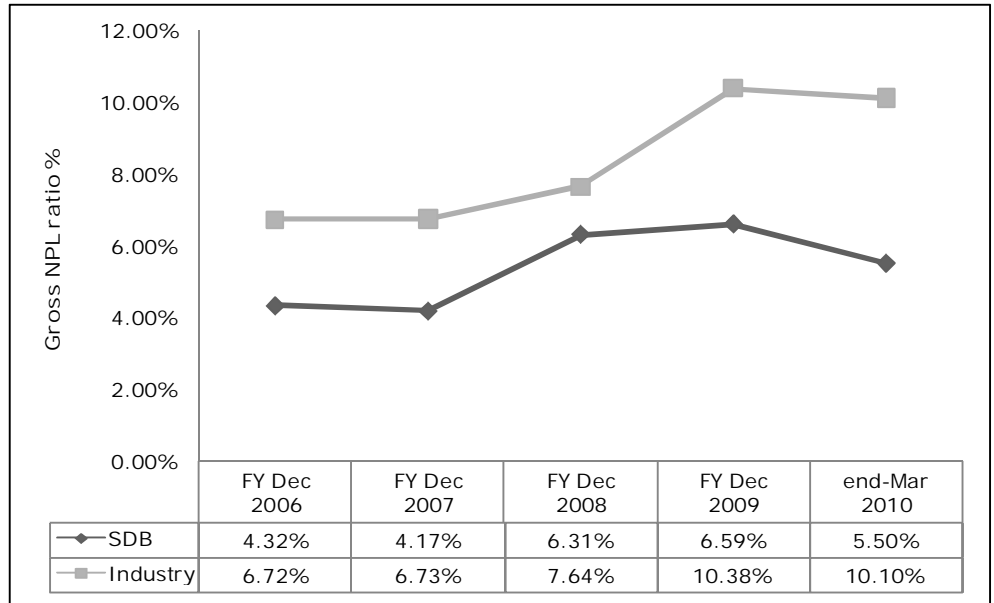
Chart 3: Composition of SDB's asset base



Better-than-industry gross NPL ratio

The Bank's gross NPL ratio deteriorated slightly to reach 6.59% as at end-FY Dec 2009 (end-FY Dec 2008: 6.31%), although still better than the industry average of 10.38%(refer to Chart 4). SDB's absolute NPLs went up LKR 159.24 million last year, mainly from the construction and trade sectors that were more vulnerable to the adverse macroeconomic conditions. On the other hand, SDB's gross NPL ratio eased to 5.50% as at end-March 2010 - outperforming the industry - despite its inherently risky target market. This was achieved through SDB's stringent credit-risk management (as discussed under *Risk Management*). Furthermore, the social pressures and stigma associated with loan defaults in rural communities have helped the Bank reduce its NPL ratios. That said, we note that SDB's credit portfolio is relatively unseasoned following the aggressive loan growth witnessed over the recent years.

Chart 4: SDB's gross NPL ratio vs the industry



Low concentration risk

Moreover, SDB's concentration risk is deemed low given the granularity of its loan portfolio. The Bank's micro-financing facilities are on average below LKR 250,000, thereby easing SDB's loan-concentration risk. As such, the Bank's top 10 loans only constituted 3.10% of its entire lending portfolio as at end-FY Dec 2009.

Healthy performance

SDB's financial performance is deemed healthy. The Bank nearly doubled its pre-tax profit to LKR 445.51 million in FY Dec 2009, on the back of buoyant loan growth and higher yields on its portfolio. Accordingly, SDB has been able to maintain its better-than-industry NIM and ROA.

Strong growth in interest income

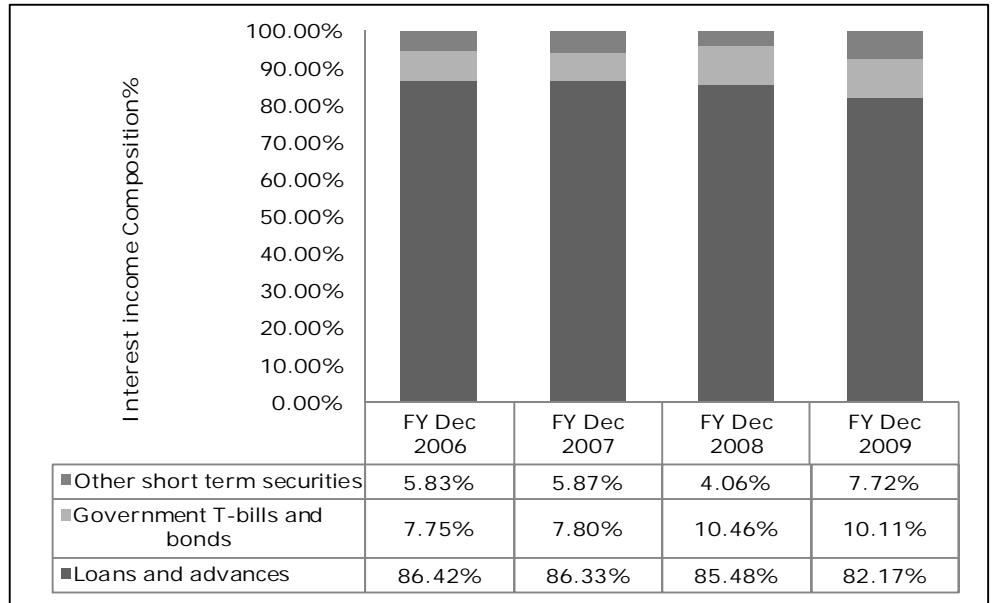
SDB's interest income, meanwhile, mirrored its loan expansion, rising at a slower pace of 34.16% in FY Dec 2009 (FY Dec 2008: 64.20%). Income from its loan portfolio continued dominating its interest income (refer to Chart 5). Furthermore, we note that contributions from short-term securities spiked up to 7.72% of the Bank's interest income as at end-FY Dec 2009, backed by heightened investments in commercial papers.

Interest expenses spiked up

Meanwhile, SDB's interest expenses increased at a slower growth of 21.24% in FY Dec 2009 (FY Dec 2008: 69.41%), constrained by receding interest rates. Consequently, its net interest income jumped 54.38% y-o-y to LKR 1.19 billion.

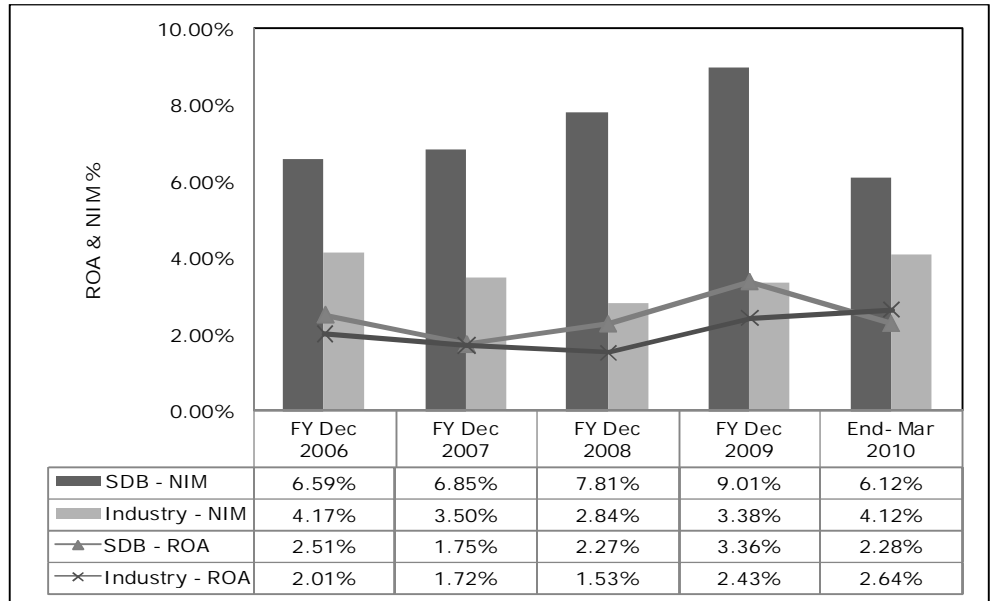
Better-than-industry NIM

Chart 5: Composition of SDB's interest income



Moreover, SDB has consistently maintained its higher-than-industry NIM (refer to Chart 6). The Bank's high-risk targeted clientele enables it to charge high interest rates on its loans. These high yields widened the Bank's NIM to 9.01% as at end-FY Dec 2009 (end-FY Dec 2008: 7.81%), compared to industry's 3.38%. Given its target segment, SDB's interest margin are expected to remain well above the industry average.

Chart 6: SDB's NIM and ROA vs the industry



Moderate overheads

RAM Ratings Lanka notes that SDB's operating expenses have been rising in recent years, driven by its expanding branch network. The Bank's overheads have been mainly pushed up by staff expenses, which were lifted 48.69% by the recruitment of new staff in fiscal 2009. However, we note that the Bank's administration costs had expanded at a slower rate of 39.63% during the review period (FY Dec 2008: 66.59%), thanks to the operational efficiencies achieved by its system integration. As a result, its cost-to-income ratio was brought down to 59.70% as at end-FY Dec 2009 (end-FY Dec 2008: 64.96%).

Profits doubled

The Bank's bottom line doubled in FY Dec 2009, supported by stronger revenue growth and relatively unchanged provisioning levels. Meanwhile, SDB's credit costs eased from 7.75% in FY Dec 2008 to 5.38% in FY Dec 2009, owing to adequately collateralised NPLs.¹ Accordingly, its pre-tax profit leapt 97.94% to LKR 445.51 million in FY Dec 2009. Moreover, its ROA and return on equity spiked up to a respective 3.36% and 33.92% as at end-FY Dec 2009, i.e. better than the industry averages (refer to Chart 6).

Going forward, RAM Ratings Lanka envisages SDB's performance to remain better than the industry's, underscored by its broader margins and the expected improvement in its operational efficiencies following the full implementation of its new IT system.

Funding & Liquidity

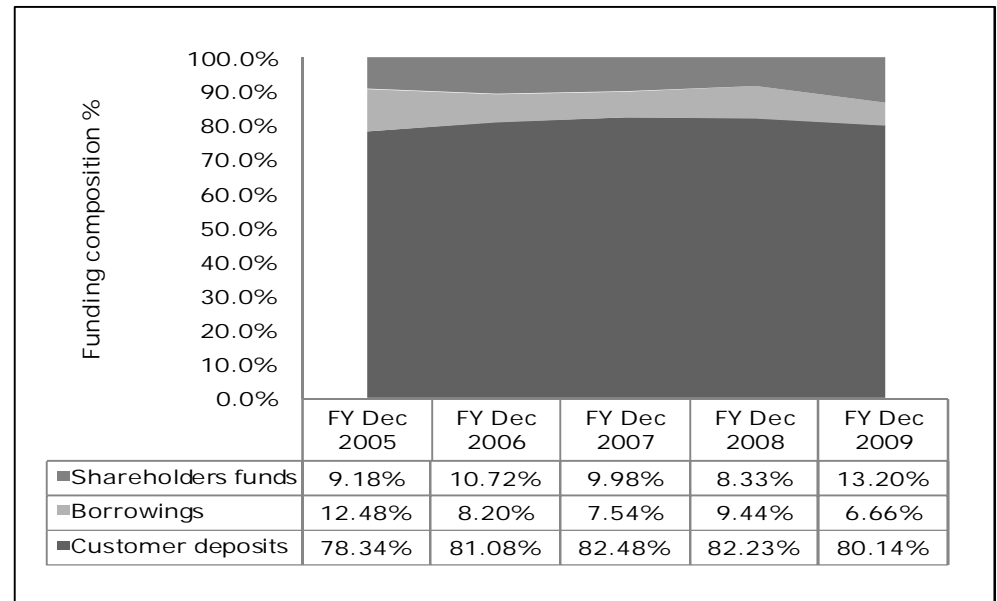
Moderate liquidity position

RAM Ratings Lanka opines SDB's funding and liquidity levels to be moderate. The Bank had beefed up its liquidity levels following increased investments in securities. Moreover, healthy renewal rates and contingency lines mitigate the risk of a widening negative ALMM gap in the short term.

Mostly funded by deposits

As at end-FY Dec 2009, the Bank's funding structure remained dominated by its deposit base, which had expanded 36.39% to LKR 10.88 billion; this accounted for 80.14% of its funding needs. That said, the contribution of deposits had diminished during the year, owing to the a LKR 875.64 million capital infusion. This had enlarged its proportion of shareholders' funds, from 8.33% as at end-FY Dec 2008 to 13.20% as at end-FY Dec 2009. We note that the fresh capital had been used to retire its debts, which in turn reduced SDB's reliance on borrowings (refer to Chart 7). As such, SDB's debt load was lightened to LKR 904.85 million as at end-FY Dec 2009 (end-FY Dec 2008: LKR 945.35 million). Going forward, the Bank's funding mix is not expected to change materially.

Chart 7: SDB's funding mix



Minimal deposit-concentration risk

RAM Ratings Lanka perceives the Bank to have minimal concentration risk given the granularity of its deposits. However, its top 20 depositors made up 11.05% of the Bank's entire deposit as at end-FY Dec 2009 (end-FY Dec 2008: 9.82%).

¹ As per the Central Bank's regulations pertaining to provisioning, which is arrived at net of collateral (refer to Direction 3 on page 13).

Weakened ALMM

We expect SDB's concentration risk to remain minimal due to its large customer base.

In terms of maturity mismatches, the prevalent scenario of reduced interest rates has tilted SDB's deposit maturities towards the short end of the spectrum. Consequently, its ALMM has weakened; the negative gap in the "less than 1 year" bucket widened to 21.10% of its interest-earning assets as at end-FY Dec 2009, from 18.68% a year earlier. However, RAM Rating Lanka's concern is partially alleviated by the Bank's LKR 300 million of unutilised contingency lines and healthy renewal rates. Moving forward, we expect SDB's ALMM structure to ameliorate as its deposit tenures tilt towards the longer term, in line with the expected increase in interest rates.

Liquidity ratio above statutory requirement

The Bank's statutory liquid-asset ratio stood at 25.27% as at end-FY Dec 2009 (end-FY Dec 2008: 18.63%). This had been facilitated by increased investments in government securities and commercial papers amid its slower loan growth. Looking ahead, RAM Ratings Lanka expects SDB's funding and liquidity positions to remain moderate.

Capital Adequacy*Capital infusion*

RAM Ratings Lanka deems SDB's capital position to be adequate. The Bank had successfully complied with the Central Bank's core-capital requirement of LKR 1.5 billion by September 2009, recording LKR 1.66 billion as at end-March 2010 (end-December 2008: LKR 0.67 billion). Likewise, its Tier-1 and overall RWCARs improved to 13.13% (end-FY Dec 2008: 10.51%) and 13.76% (end-FY Dec 2008: 10.95%), respectively, as at the same date, i.e. well above the corresponding minimum statutory requirements of 5% and 10%. SDB had also received LKR 875.64 million of capital injections from its large base of primary societies and the well-connected Sanasa Federation.

Improved net NPLs to shareholders funds

On a separate note, the Bank's ratio on net NPLs to shareholders' funds reversed its deteriorating trend to come in at 33.02% as at end-FY Dec 2009 (end-FY Dec 2008: 56.10%). The Bank's rate of internal capital generation had also eased following the expansion of its capital base, despite the doubling of its profits in FY Dec 2009. However, we expect this to ameliorate over the medium term, backed by SDB's healthy performance.

Industry Overview

Sri Lanka's gross domestic product ("GDP") expanded 7.1% in 1Q 2010, stronger than the previous corresponding period's 1.6%. The healthy expansion was supported by improving macroeconomic fundamentals, underpinned by the end of the country's 3-decade-long civil conflict and the recovery of the global economy.

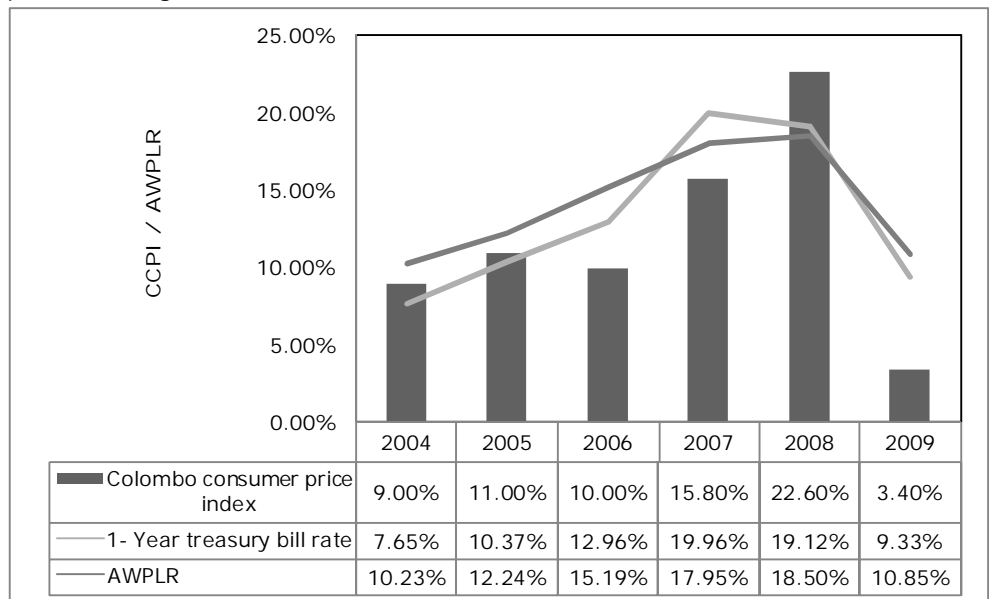
Concurrently, the performance of the nation's primary sectors had also improved (refer to Table 1). The agricultural industry had been buoyed by favourable weather conditions and a retracement in global commodity prices. At the same time, the industry and services sectors also enjoyed upticks in activity, driven by stronger internal and external demand. The "wholesale and retail trade" sub-segment within services, which contributed 22.3% of Sri Lanka's GDP in 1Q 2010, expanded 5.3% over the same period; this contrasted against a 2.5% contraction in 1Q 2009.

Table 1: Sectoral contributions to GDP

Sector	1Q 2009	1Q 2010
Agriculture, forestry and fishing	3.6%	9.0%
Industry	1.9%	6.9%
Services	3.0%	8.5%
Overall GDP growth	1.6%	7.1%

In the meantime, both inflation (as measured by the Colombo Consumer Price Index) and interest rates - which peaked in 2008 - have been easing since early 2009 (refer to Chart 1). The tapering rates are in line with the reversal of the Central Bank's tight monetary policy. While the current trend may not be sustainable given the country's budget deficit, RAM Ratings Lanka notes that interest rates will not be as lofty as the heights scaled in 2008. All said, we envisage the credit cycle to enter a more upbeat phase over the medium term.

Chart 8: Movements in the Colombo Consumer Price Index and average-weighted prime lending rate



The LSB sector, which accounted for 9.1% of all financial institutions' asset base as at end-December 2009, has remained rather resilient. Even though there are

14 entities within this segment, National Savings Bank commands the lion's share of 69.45% of the LSB segment's total assets. As such, this bank exerts a significant influence over the sector's performance.

In 2010, the 6 regional development banks in Sri Lanka were merged into a single entity, with a view to reducing costs and improving operating efficiency. Following the merger, the new entity has become the third-largest LSB in the country, accounting for some 7.7% of the industry's assets.

The LSB sector is a unique segment that has been created to finance long-term projects, housing and SMEs. It has also been the primary recipient of concessional international and state funding. As low-cost funding has receded, however, these institutions have increased their reliance on public deposits. The changing funding structure has compelled most LSBs to focus on medium-term financing; the distinction between LSBs and licensed commercial banks ("LCBs") has therefore blurred. That said, the crucial difference between LSBs and LCBs is that the latter are able to offer current accounts, and thus represent an integral component of the payment system.

In 2009, the depressed macroeconomic landscape impeded credit expansion; loan growth decelerated further to 4.5%, from 6.3% in 2008 (2007: 21.0%). Weakening macroeconomic factors had also contributed to rising delinquencies. As a result, the sector's gross NPL ratio deteriorated from 8.9% as at end-December 2008 to 12.2% as at end-March 2010.

On a more positive note, tapering loan growth and an easier monetary stance have improved the liquidity levels in the LSB sector. This segment's statutory liquidity ratio climbed up from 61.9% as at end-December 2008 to 69.3% as at end-September 2009. Most of the liquidity resided in government securities, which command high yields. Nevertheless, this pattern is expected to dissipate over the medium term as these banks resume lending.

Despite weaker credit growth, the LSB industry has been able to maintain healthy margins - thanks to higher interest rates on government securities. The sector's pre-tax ROA had improved to 2.3% by end-September 2009, from 1.4% as at end-December 2008. Going forward, the sector's performance will hinge on each bank's efficiency and credit quality.

Notably, the LSB industry has traditionally maintained high capital-adequacy levels. RAM Ratings Lanka observes that all state-owned LSBs have ample regulatory capital. However, we also acknowledge that rising NPLs have weakened the sector's capital buffer, as reflected in its ratio on net NPLs to shareholders' funds that weakened from 26.7% as at end-December 2008 to 33.3% as at end-September 2009. All said, we envisage this segment's risk profile to improve amid brighter medium-term prospects.

Relevant Central Bank Directions Applicable to Licensed Specialised Banks

<p><i>Capital adequacy</i></p>	<p>Every licensed specialised bank must maintain a minimum capital-adequacy ratio of 10% in relation to its risk-weighted assets, with core capital constituting not less than 5%, on both bank-only basis and consolidated basis; supplementary capital can make up the balance.</p> <p>Core capital means:</p> <ul style="list-style-type: none"> (a) permanent shareholders' equity; and (b) reserves created or increased by appropriation of retained earnings or other surpluses, including share premiums, retained profits, general reserves and legal reserves, excluding revaluation reserves and general provisions. <p>Supplementary capital means revaluation reserves, general provisions, hybrid capital instruments, minority interests arising from preference shares issued by subsidiaries, and approved subordinated debts.</p> <p>It is recommended that the basis of computation for capital-adequacy ratios, i.e. capital adequacy and the inclusion of non-banking and non-financial subsidiaries, be disclosed as a footnote.</p>
<p><i>Minimum capital requirements</i></p>	<p>All licensed specialised banks are required to maintain a minimum core capital of LKR 1.5 billion by end-2009. However, the capital of the bank should have been enhanced by at least 50% of any deficiency by end-2008.</p> <p>The required capital for a new specialised bank would also be LKR 1.5 billion</p>
<p><i>Liquid assets</i></p>	<p>Every licensed specialised bank must maintain minimum average monthly liquid assets of not less than 20% of its total monthly deposit liabilities. Liquid assets mean:</p> <ul style="list-style-type: none"> (a) Cash in hand (b) Balance in a current account in a licensed commercial bank (c) Balance in a deposit account in a licensed specialised bank or licensed commercial bank, provided such account has a maturity of not more than 1 year (d) Money at call in Sri Lanka (e) Treasury bills and securities issued or guaranteed by the Government of Sri Lanka, which have maturities of not more than 1 year. (f) Goods receipts (g) Import and export bills (h) Inland bills (i) Cash items in process of collection (j) Treasury bonds (k) Such other assets as may be determined by the Monetary Board
<p><i>Classification of non-performing loans and treatment of unearned interest</i></p>	<p>Loans and advances are classified as non-performing when the principal and/or the interest have been in arrears for 3 months or more.</p> <p>Any unpaid interest on loans and advances where interest has been in arrears for 3 months or more cannot be considered as income by a bank.</p>

<p><i>Classification of non-performing loans and provisioning</i></p>	<ul style="list-style-type: none"> (a) Sub-standard accounts <ul style="list-style-type: none"> - where loans have been in arrears for 6 months or more, but less than 12 months - specific provisions to be made on 20% of the outstanding amount (b) Doubtful accounts <ul style="list-style-type: none"> - where loans have been in arrears for 12 to 18 months - specific provisions to be made on 50% of the outstanding amount (c) Loss accounts <ul style="list-style-type: none"> - where loans have been in arrears for more than 18 months - specific provisions to be made on 100% of the outstanding amount
<p><i>Single-borrower limit</i></p>	<p>Granting of loans and advances is limited to 30% of the capital funds of the bank as at the end of its preceding financial year:</p> <ul style="list-style-type: none"> (a) to any single company, public corporation, group of people or individual (b) in aggregate to <ol style="list-style-type: none"> 1. an individual, their close relations or a company or firm in which they have substantial interest 2. a company and one or more of the following <ul style="list-style-type: none"> - its subsidiary - its holding company - its associate company - a subsidiary of its holding company, or - a company in which such company or its subsidiary, or its holding company, or a subsidiary of its holding company, has a substantial interest <p>If loans and advances granted to any customer referred to in (a) above or in aggregate to any customer belonging to (b) above exceeds 15% of the capital funds of the bank, such loans and advances granted in aggregate to all such customers should also not exceed 50% of the total loans and advances of the bank as at the end of the preceding financial year.</p>

Corporate Information

Date of Incorporation: 6 August 1997

Commencement of Business: 1997

Major Shareholders:	Homer Capital PTE Limited	4.64%
	ETIMOS Lanka (Pvt) Limited	3.82%
	People's Leasing Co.Ltd	3.23%
	Sanasa Federation	2.56%
	Kegalle DTCCSU Ltd	1.87%

Directors:	Dr PA Kiriwandeniya	Chairman
	Mr HMGB Hearth	Director
	Mr JH Gamage	Director
	Mr CD Senarathne	Director
	Mr J Rathnayake	Director
	Mr AD Walisinghe	Director
	Mr WRP Fernando	Director
	Dr RMK Ratnayake	Director
	Mr WMA Bandara	Director
	Mr T Karunasena	Director
	Mr DP Kumara	Director
	Mr Kuvera de Zoysa	Director
	Mr Rahul Batra	Director
	Mr M Gunarathne	Director

Auditor: Ernst and Young

Listing: Not listed

Key Management:	Mr Nimal Mamaduwa	General Manager/CEO
	Mr S Fernando	DGM-Business Development
	Ms S Kiriwandeniya	DGM-International relations
	Mr KG Leelananda	DGM-Administration and operations
	Mr N Ramanayake	Assistant General Manager-Credit
	Mr BGP Samantha	Assistant General Manager – Finance
	Mr EAAS Ediriwickrama	Assistant General Manager – Audit
	Mr HC Lokugeegana	Assistant General Manager- Training

Major Subsidiaries and Associates: None

Capital History:	Year	Remarks	Amount (LKR million)	Cumulative Total (LKR million)
	2004	Primary societies contribution		216.321
	2005	Share issue	54.464	
		Bonus issue	23.872	294.657
	2006	Share issue	151.417	446.074
	2007	Share issue	129.995	566.070
	2008	Share issue	104.951	671.022
	2009	Share issue	875.643	1,546.665
	2010	Share issue	111.950	1658.615

Financial Summary - Company

	Unaudited				
BALANCE SHEET (LKR million)	31-Dec-06	31-Dec-07	31-Dec-08	31-Dec-09	31-Mar-10
ASSETS					
Cash & Money At Call	75.25	145.56	213.75	312.27	354.60
Deposits & Placements With Financial Institutions	286.67	216.91	381.75	584.59	0.00
Securities Purchased Under Resale Agreements	0.00	0.00	0.00	0.00	0.00
Securities					
Securities Held For Trading	56.72	47.78	11.06	0.00	0.00
Securities Available-For-Sale	125.04	157.19	159.69	987.04	1,192.97
Securities Held-To-Maturity	574.69	909.15	1,237.66	1,610.41	1,686.60
Gross Loans & Advances	4,446.64	6,557.14	8,664.95	10,700.64	11,485.93
Interest-Income-In-Suspense	0.00	0.00	0.00	0.00	207.41
General Loan Loss Reserves	3.30	27.50	61.15	84.54	160.41
Specific Loan Loss Reserves	48.79	51.97	78.48	113.53	130.22
Net Loans & Advances	4,394.55	6,477.67	8,525.32	10,502.58	10,987.89
Investments in Subsidiaries/Associates	0.00	0.00	0.00	0.00	0.00
Other Assets	293.29	367.55	550.72	638.39	1,103.88
Property, Plant & Equipment	111.23	173.21	235.27	543.17	598.68
TOTAL ASSETS	5,917.44	8,495.02	11,315.22	15,178.46	15,924.61
LIABILITIES					
Customer Deposits					
Demand	0.00	0.00	0.00	0.00	0.00
Savings	1,359.62	1,594.35	1,975.36	2,702.38	2,935.53
Fixed	3,088.87	4,441.61	6,256.90	8,184.63	8,534.98
Negotiable Instruments of Deposits	0.00	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	410.71	0.00	130.00	0.00
Other Borrowing	450.11	551.79	945.35	904.85	981.29
Subordinated Debt & Hybrid Capital	0.00	0.00	0.00	0.00	0.00
Other Liabilities	430.86	766.52	1,303.67	1,463.71	1,132.38
TOTAL LIABILITIES	5,329.46	7,764.99	10,481.29	13,385.57	13,584.19
Paid-up Capital	446.07	566.07	671.02	1,546.67	1,658.62
Minority Interest	0.00	0.00	0.00	0.00	0.00
Share Premium & Other Reserves	96.39	129.92	101.00	68.41	0.00
Statutory General Reserve	11.61	16.36	21.21	31.63	67.87
Retained Profits/(Accumulated Losses)	33.91	17.67	40.70	146.18	613.93
TOTAL SHAREHOLDERS' FUNDS	587.98	730.03	833.94	1,792.88	2,340.42
TOTAL LIABILITIES & SHAREHOLDERS' FUNDS	5,917.44	8,495.02	11,315.22	15,178.46	15,924.61
COMMITMENTS & CONTINGENCIES					
COMMITMENTS & CONTINGENCIES	51.64	79.60	81.21	119.92	119.92
TIER 1 CAPITAL	558.10	809.86	821.99	1,771.14	1,766.13
CAPITAL BASE	536.93	803.59	856.54	1,846.49	1,850.53

Financial Summary - Company

INCOME STATEMENT (LKR million)	31-Dec-06	31-Dec-07	31-Dec-08	31-Dec-09	Unaudited
					31-Mar-10 3 months
Interest Income	728.44	1,207.47	1,982.61	2,659.95	592.48
Less: Accretion Of Discount/(Amortisation Of Premium)	0.00	0.00	0.00	0.00	0.00
Less: Net Interest Income Suspended	0.00	0.00	0.00	0.00	0.00
Less: Interest Expense	(400.85)	(713.93)	(1,209.44)	(1,466.32)	(354.64)
Net Interest Income	327.59	493.53	773.17	1,193.63	237.84
	0.00	0.00	0.00	0.00	0.00
Non-Interest Income	48.03	34.74	51.53	82.00	14.29
Gross Income	375.62	528.27	824.70	1,275.63	252.14
Less: Personnel Expenses	(84.08)	(137.61)	(148.92)	(221.43)	(44.78)
Less: Other Operating Expenses	(163.19)	(232.18)	(386.78)	(540.06)	(100.49)
Less: Loan Loss Provisions	(3.70)	(32.45)	(63.92)	(68.62)	(18.09)
Less: Non-Recurring Items	0.00	0.00	0.00	0.00	0.00
Share of results of Associated Companies	0.00	0.00	0.00	0.00	0.00
Pre-Tax Profit/(Loss)	124.66	126.04	225.08	445.51	88.77
Less: Taxation	(24.53)	(72.27)	(127.99)	(237.14)	(44.39)
Net Profit/(Loss)	100.12	53.76	97.09	208.37	44.39
Less: Minority Interests	0.00	0.00	0.00	0.00	0.00
Less: Transfer To Statutory Reserves	0.00	0.00	0.00	0.00	0.00
Less: Transfer To Other Reserves	0.00	0.00	0.00	0.00	0.00
Less: Dividend	(38.37)	(26.76)	(69.21)	(145.87)	0.00
Post-Appropriation Profit/(Loss)	61.75	27.00	27.88	62.50	44.39

Financial Ratios - Company

	Unaudited				
KEY FINANCIAL RATIOS (%)	31-Dec-06	31-Dec-07	31-Dec-08	31-Dec-09	31-Mar-10
PROFITABILITY					
Net Interest Margin	6.59%	6.85%	7.81%	9.01%	6.12%
Non-Interest Income Margin	0.97%	0.48%	0.52%	0.62%	0.37%
Cost To Income	65.83%	70.00%	64.96%	59.70%	57.62%
Cost Over Total Average Assets	4.98%	5.13%	5.41%	5.75%	3.74%
Return On Assets	2.51%	1.75%	2.27%	3.36%	2.28%
Return On Equity	26.72%	19.13%	28.78%	33.92%	17.18%
Dividend Payout	38.32%	49.78%	71.28%	70.01%	0.00%
ASSET QUALITY					
Gross NPLs Ratio	4.32%	4.17%	6.31%	6.59%	5.50%
Net NPLs Ratio	3.25%	3.40%	5.45%	5.59%	4.40%
3-months Past Due Ratio	4.32%	4.17%	6.31%	0.00%	0.00%
Net NPLs To Total Assets	2.42%	2.61%	4.13%	3.90%	3.08%
Specific Loan Loss Provisions For Current Period	0.10%	0.15%	0.40%	0.47%	0.41%
Gross NPLs Coverage	27.14%	29.06%	25.56%	28.07%	46.84%
Loan Loss Reserve Coverage	1.17%	1.21%	1.61%	1.85%	2.58%
General Loan Loss Reserve Coverage	0.08%	0.42%	0.71%	0.80%	1.44%
LIQUIDITY & FUNDING					
Liquid Asset Ratio	11.83%	8.62%	8.72%	16.30%	13.49%
Interbank Deposits To Total Interest Bearing Funds	0.00%	0.00%	0.00%	0.00%	0.00%
Customer Deposits To Total Interest Bearing Funds	90.81%	86.25%	89.70%	91.32%	92.12%
Loans To Deposits Ratio	98.79%	107.32%	103.56%	96.47%	95.79%
Loans To Stable Funds Ratio	81.70%	85.43%	86.66%	79.23%	76.55%
CAPITAL ADEQUACY					
Shareholders' Funds To Total Assets	9.94%	8.59%	7.37%	11.81%	14.70%
Tier 1 Risk Weighted Capital Adequacy Ratio	14.62%	15.39%	10.51%	16.68%	13.13%
Overall Risk Weighted Capital Adequacy Ratio	14.62%	15.39%	10.95%	17.39%	13.76%
Internal Rate Of Capital Generation	13.24%	7.73%	7.87%	6.54%	9.93%

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.

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