RAM

CREDIT RATING RATIONALE

September 2011

ASIAN ALLIANCE INSURANCE PLC

- Claims-Paying-Ability Ratings

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RAM RATINGS

CREDIT RATING RATIONALE

CLAIMS-PAYING ABILITY RATING

SEPTEMBER 2011

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Principal Activity:
Provision of general and life insurance coverage

Ratings:
Long-term: BBB- [Reaffirmed]
Short-term: P3 [Reaffirmed]

Rating Outlook:
Stable [Reaffirmed]

ASIAN ALLIANCE INSURANCE PLC – Rating Review

■ Summary

RAM Ratings Lanka has reaffirmed Asian Alliance Insurance PLC's ("AAI" or "the Company") long and short- term claims-paying-ability ratings at BBB- and P3; the outlook on the long-term rating remains stable. The ratings are upheld by the Company's good capitalisation and liquidity as well as its adequate financial performance in the life segment. Meanwhile, the ratings are moderated by its size, weak financial performance in the general segment and high exposure to equity investments.

AAI continues to be a medium-sized player in the insurance industry, with a composite market share of 2.44% in terms of gross written premiums ("GWP") as at end-December 2010. AAI's life segment dominated its GWP, accounting for 74.26% as at FYE 31 December 2010 ("FY Dec 2010"). Going forward, however we expect AAI to place more importance on the general division given the recent change in ownership. AAI is now owned by the Softlogic Group (94.59%), a well-diversified conglomerate. The management of AAI views the acquisition positively as it would bring many operational and financial synergies. That said, RAM Ratings Lanka envisages these benefits to only materialise over the medium to long term.

AAI's life segment, which accounts for the lion's share of its GWP (74.26%), grew at a sturdy 23.15% year-on-year ("y-o-y") during FY Dec 2010 (FY Dec 2009: 4.02%); it grew a further 17.67% (annualised) in 1H FY Dec 2011. In contrast, the general segment contracted by 13.30% y-o-y owing to the discontinuation of unprofitable contracts during fiscal 2010. However, the division turnover improved by 23.32% (annualised) in 1H FY Dec 2011, supported by the introduction of new branches.

AAI's life-underwriting performance is viewed to be adequate, with its life claims ratio being the lowest among its peers. However, as policies mature, claims have started to trickle into the life segment; absolute claims increased to LKR 103.08 million in FY Dec 2010 (FY Dec 2009: LKR 87.53 million). Meanwhile, the Company's general underwriting performance is deemed weak; its claims ratio is

the highest among its peers. That said, AAI has discontinued unprofitable business lines, as reflected by its reduced absolute claims; absolute claims reduced to LKR 246.35 million in FY Dec 2010 from LKR 272.41 million in FY Dec 2009. Going forward, however, we expect improved underwriting results in the general segment as corrective actions taken have begun to bear fruit. Moreover, during 1H FY Dec 2011, the claims ratios in both the general and life segments improved to 76.11% and 8.36% respectively on the back of the growth in GWP (1H FY Dec 2010: 91.69% and 11.15%).

Nonetheless, AAI's high overheads have continued to pressure its composite expense and combined ratios; in FY Dec 2010, these weakened to 70.50% and 97.05% respectively owing to high policy acquisition costs and branch expansions (FY DEC 2009: 59.53% and 90.94% respectively). Furthermore, AAI had to bear a portion of the parent's overheads under the previous owner. This, together with the improved top line, has seen the ratios improve in 1H FY Dec 2011.

Despite the strong growth in GWP in the life division, the Company's net underwriting margins weakened to 2.94% (or LKR 38.76 million) from 9.03% (or LKR 104.73 million) the previous year owing to high overheads as well as underwriting losses in the general division, which widened to LKR 171.72 million in FY Dec 2010 from LKR 135.17 million the previous year due to lower GWP. That said, AAI made pre-tax profits of LKR 370.58 million during fiscal 2010, an all-time high, supported by improved investment returns from its equity portfolio. On a related note, during 1H FY Dec 2011, underwriting margins in both life and general improved as policy acquisition costs reduced while the GWP of the general segment rebounded. However, pre-tax profits were affected by weak gains from the investment portfolio and general segment's performance.

Along with the upturn in the bourse, AAI had channelled a large portion of its investments to the equity market as reflected by the change in the investment composition. Equity accounted for 43.81% as at end-1H FY Dec 2011 (end-FY Dec 2010: 30.91%) while government securities accounted for 29.27% (end-FY Dec 2009: 53.39%). The Company's overall profitability improved during FY Dec 2010 with the booming bourse (investment yield: 22.81%) but was hit during 1H FY Dec 2011 with the stock market downturn and receding interest rates (investment yield: 4.19%). Meanwhile, the Company's liquidity position is considered to be good; its ratio on liquid assets to total insurance funds had improved to 1.66 times as at end-December 2010 (end-FY Dec 2009: 1.22 times), surpassing its peers.

AAI's capitalisation is deemed good. In line with the LKR 812.50 million rights issue in November 2010, AAI's ratio of shareholder funds to insurance funds and to total assets improved to 68.86% and 35.88% respectively. These capitalisation ratios have surpassed its peers. However, we note that losses in the general segment and dividends paid eroded capitalisation levels to LKR 1.28 billion as at end-June 2011 from LKR 1.56 billion as at end-December 2010. The Company's overall solvency margin stood at 2.78 times as at end-June 2011.

Company Background

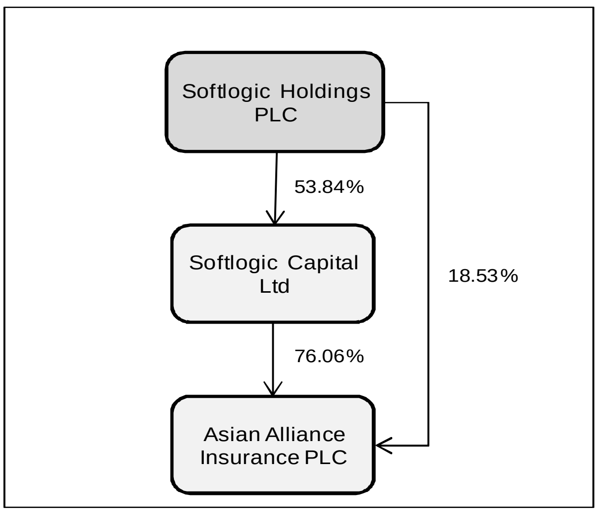
Medium-sized player accounting for 2.44% of the composite market share

Governed by the Insurance Board of Sri Lanka ("IBSL"), AAI is a relatively new insurance company; its general insurance business commenced operations in 1999 while its life operations started in 2000. Meanwhile, 74.26% of its total GWP as at end-December 2010 comprised of life premiums. AAI is a medium-sized player accounting for 2.44% of the industry's GWP as at end-December 2010. The Company currently has 24 branches, including a presence in the North and East. AAI is also listed on the Colombo Stock Exchange ("CSE").

Change in ownership

Previously, 48.95% of AAI was owned by Asia Capital PLC ("ACP") while 24.26% was owned by Fast Gain International Ltd. ACP is a diversified financial-services group engaged in stock and commodity broking, investment banking, asset management, registered finance companies, and trading in fixed-income securities. In August 2011, Softlogic Holdings PLC ("SLH" or "the Group") and its subsidiary Softlogic Capital Limited ("SCL") acquired a majority stake of AAI; the rest of the shares were acquired in September 2011 through a mandatory offer (refer to Chart 1). SLH is a well-diversified conglomerate with business interests in information and communication technology, retail, healthcare, automobiles, financial services and leisure. In particular, the Group owns and operates Sri Lanka's largest chain of private hospitals (Asiri Hospitals PLC) and is the third-largest consumer electronics retailer in the country.

Chart 1: AAI's ownership structure



Source: AAI

Industry & Business Assessment

Industry dominated by 2 large players

Sri Lanka's insurance sector only accounted for a meagre 3.2% of the financial system's total assets as at end-December 2010. The industry is dominated by 2 large players in terms of GWP, which collectively account for around 49% of the total composite GWP while the other 17 players share the rest of the market. From this, 5 players concentrate only on general insurance while 2 are exclusively into the life business.

Premium growth mainly stemming from life segment

Supported by better macro-economic conditions, industry composite premiums grew 19.42% y-o-y in FY Dec 2010. The growth in premiums mainly stemmed from the life segment, which expanded at 30.52% y-o-y in comparison with the general segment's 11.52% y-o-y. Moreover, we note that the general insurance business is pressured by intense competition owing to the increasing number of players. In this regard, insurers have been compelled to cut prices to retain the market share as reflected by underwriting losses made by most players in the general segment. In contrast, the life segment was seen as an attractive arena as the penetration level (as a percentage of the country's population) was still low at 10.9% as at end-December 2010. Nevertheless, the larger players are able to dominate the life segment given their good track records and well-known franchises.

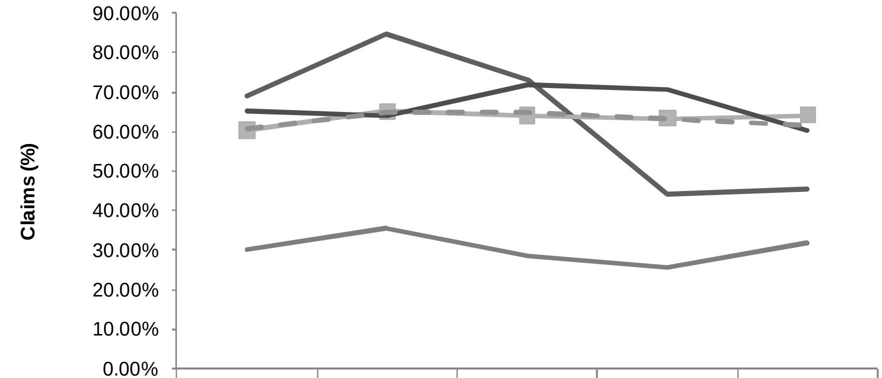
Investment income generation vital in offsetting weak underwriting performance

Owing to the weak core underwriting performance, particularly in the general segment, most players have to depend on improving profits through investment income. That said, safer government securities continued to be a vital investment income generator in the industry especially due to IBSL regulations put in place. However, yields from government securities have fallen in recent years in tandem with lower interest rates, placing downward pressure on investment income.

General claims – driven by motor claims

The industry's general claims ratio has been around 65% historically; the main contributor towards general claims has been the motor class, for which the claims ratio was around 64% in FY Dec 2011 (refer to Chart 2). The miscellaneous segment, which includes health insurance, closely followed this; most of the players incur losses in this segment due to high claim levels. Nonetheless, owing to severe competition, insurance players have been compelled to provide health insurance to retain their general business market share.

Chart 2: General claims ratio – industry



	FY Dec 2006	FY Dec 2007	FY Dec 2008	FY Dec 2009	FY Dec 2010
Fire	68.80%	84.80%	73.20%	44.40%	45.40%
Motor	60.40%	65.20%	64.10%	63.40%	64.25%
Marine	30.30%	35.60%	28.40%	25.60%	31.70%
Miscellaneous	65.20%	63.90%	71.90%	70.70%	60.40%
Total	60.60%	65%	64.90%	63.20%	61.60%

Source: Insurance Board of Sri Lanka

More stringent regulations to be put in place

IBSL has taken steps to tighten regulations to ensure that the insurance segment is more in line with international standards. In this regard, the composite insurance companies are required to separate the life and general segments into two legal entities. Furthermore, listing on the Colombo Stock Exchange is mandatory within 3-5 years for all the insurance companies. Moreover, solvency margins will also be amended to be more in line with international standards to broaden the asset classes that can be recognised as admissible.

Competitive position deemed adequate

AAI's overall competitive position is deemed adequate. The Company has retained its market position as the seventh-largest insurer in terms of composite premiums (refer to Table 1). That said, keener competition from smaller players has eroded the market share of the more established players; especially in the general insurance segment. While AAI strengthened its position by increasing its market share in the life segment to 5.21% as at end-December 2010 owing to the good franchise (FY-December 2009: 4.23%), its general segment's market share weakened slightly to 1.15% during the same period (FY-December 2009: 1.48%).

Table 1: Composite market share in terms of premiums

	FY Dec 2008	FY Dec 2009	FY Dec 2010	Rank *
Ceylinco Insurance PLC	33.60%	28.95%	26.30%	1
Sri Lanka Insurance Corporation	23.45%	23.68%	22.30%	2
Aviva NDB Insuance PLC	11.01%	12.44%	15.52%	3
Union Assurance PLC	9.78%	10.44%	10.41%	4
Janashakthi Insurance PLC	9.22%	9.88%	8.99%	5
HNB Assurance PLC	3.16%	3.53%	3.55%	6
Asian Alliance Insurance PLC	2.46%	2.63%	2.44%	7
Total Players				19

**as at end-Dec 2010*

Source: IBSL

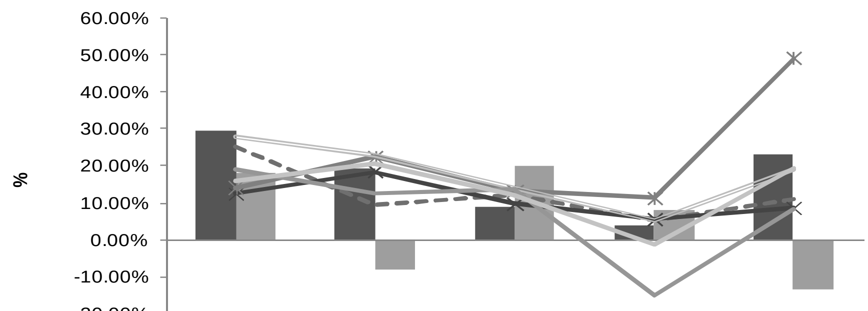
GWP dominated by life; sturdy growth observed

Life GWP accounts for the lion's share of the Company's total premiums, or 74.26% as at end-FY Dec 2010 (FY Dec 2009: 67.01%). The life segment recorded a sturdy 23.15% y-o-y growth during FY Dec 2010, in comparison with sluggish growth of 4.02% in the previous year (refer to Chart 3) owing to better macro-economic conditions and higher disposable income. Low penetration levels coupled with the improving economic landscape have made the life segment more attractive, as seen by the industry trends. While the growth in this segment eased slightly to 17.67% in 1H FY Dec 2011, we envisage this segment to continue growing at a strong level.

General segment's GWP contracted; unprofitable business lines discontinued

Meanwhile, the weeding out of unprofitable business lines resulted in a contraction of the general segment's GWPs by 13.30% y-o-y in FY Dec 2010. However, during 1H FY Dec 2011, the turnover in the general segment has rebounded with a growth of 23.32% y-o-y despite stiff competition. Nonetheless, AAI will have to continue strengthening its general segment to regain the lost market share during fiscal 2010. The Company's composite premiums grew at 11.12% y-o-y (or LKR 167.49 million) (refer to Chart 3) to LKR 1.67 billion during fiscal 2010. The growth rate further improved to 19.12% y-o-y in 1H FY Dec 2011.

Chart 3: GWP growth vs. peers



	FY Dec 2006	FY Dec 2007	FY Dec 2008	FY Dec 2009	FY Dec 2010
AAI - life	29.47%	19.10%	8.90%	4.02%	23.15%
AAI - general	18.23%	-8.16%	19.86%	8.04%	-13.30%
AAI - composite	25.20%	9.33%	12.20%	5.31%	11.12%
JIC	12.48%	18.37%	9.81%	5.65%	8.66%
Aviva NDB	14.22%	22.45%	13.29%	11.39%	48.97%
UAL	27.71%	22.68%	14.22%	5.32%	19.12%
Ceylinco	19.12%	12.56%	13.64%	-15.04%	8.47%
Industry	15.96%	20.57%	12.10%	-1.40%	19.42%

Source: Company annual reports, IBSL

Ceylinco: Ceylinco Insurance PLC; Janashakthi: Janashakthi Insurance PLC; UAL: Union Assurance PLC; Aviva NDB: Aviva NDB Insurance PLC

■ Underwriting & Risk Management

➢ **Life Business**

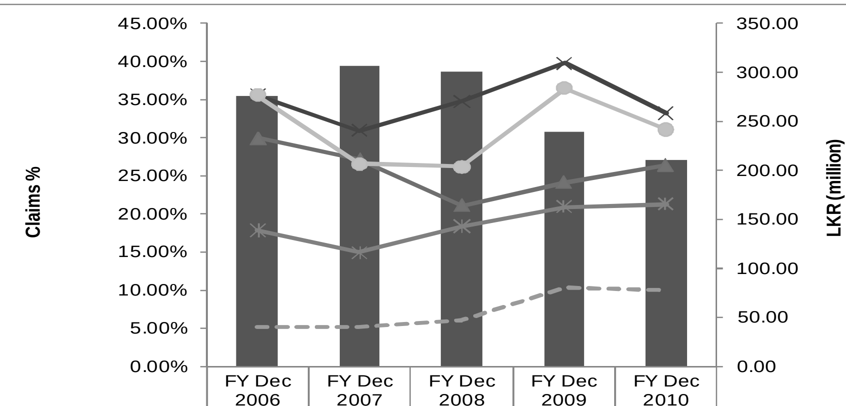
Adequate life underwriting performance

We opine that AAI's life-underwriting performance is adequate. While claims have started to trickle in with maturing of its portfolio, its life-claims ratio stands lowest amongst its peers. During 1H FY Dec 2011, AAI's life segment's net underwriting surplus improved by 35.49% y-o-y to LKR 142.59 million amid growth in top line; its expense ratio along with its combined ratio have also improved.

Life claims ratio better than peers

During fiscal 2010, the absolute life claims increased by 17.76% y-o-y to LKR 103.08 million, resulting in a life-claims ratio of 9.93% (FY Dec 2009: 10.38%) (refer to Chart 4). While claims started to trickle in as the portfolio matures, the ratio improved on the back of increased premiums. The claims ratio further improved to 8.36% in 1H FY Dec 2011 (1H FY Dec 2010: 11.15%). AAI's life claims ratio continues to be better than its peers. That said, we envisage claims to rise as the life portfolio matures.

Chart 4: AAI life claims ratio against peers



	FY Dec 2006	FY Dec 2007	FY Dec 2008	FY Dec 2009	FY Dec 2010
AAI - net underwriting surplus/ (loss)	276.38	306.11	301.68	239.90	210.49
AAI	5.18%	5.24%	6.03%	10.38%	9.93%
JIC	29.97%	27.17%	21.11%	24.17%	26.44%
Aviva NDB	35.60%	30.94%	34.78%	39.81%	33.18%
UAL	17.89%	14.99%	18.35%	20.97%	21.25%
Ceylinco	35.63%	26.50%	26.22%	36.49%	31.08%

Source: Company annual reports, IBSL

Net underwriting margins improved along with GWP

The life segment's net underwriting margin weakened in FY Dec 2010 to 20.28% from 28.44% the previous year, despite the growth in premiums underwritten, due to high overheads. The Company has now taken actions to control overheads since AAI had to bear some of the overhead costs of ACP prior to the change in ownership. Meanwhile, the life segment's expense and combined ratios weakened to 69.79% and 79.72% in FY Dec 2010 respectively (FY Dec

2009: 61.18% and 71.56%) pressured by higher policy-acquisition costs. However during 1H FY Dec 2011, the net underwriting margin improved to 23.72% owing to the top line growth (1H FY Dec 2010: 20.73%). As such, along with the overall top line improvement in 1H FY Dec 2011, the life segment's expense ratio improved to 67.92% (1H FY Dec 2010: 68.13%). The Company's life segment expense and combined ratios are in line with its peers.

- **General Business**

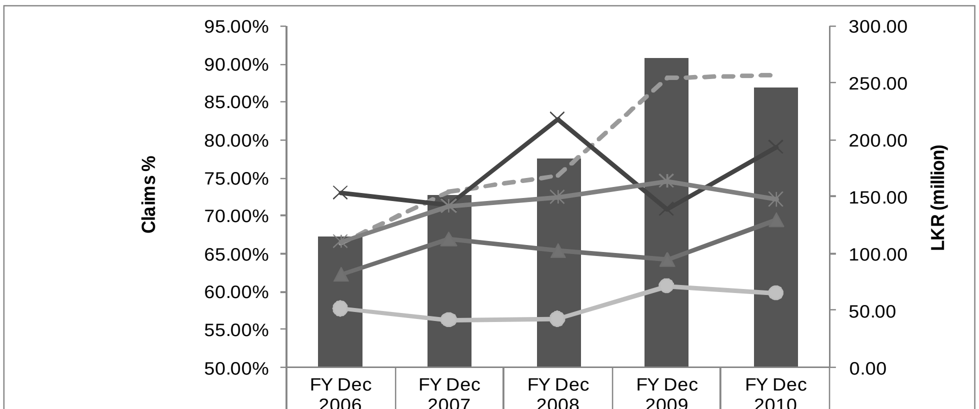
General division dominated by motor-sub class

AAI's general division contributed 25.74% of the total GWP during FY Dec 2010. In 1H FY Dec 2011, the composition remained largely unchanged at 26.64%. Within the general division, the motor sub-class dominated premium income (accounting for 53.26% of divisional underwritten premiums), followed by the miscellaneous segment, consisting primarily of health insurance.

Underwriting pressured by high claims and overheads...

AAI's general business underwriting performance is deemed weak; the claims ratio stands highest amongst its peers while its underwriting losses widened. The claims ratio weakened slightly to 88.66% in FY Dec 2010 from 88.16% the previous year and continues to remain weaker than its peers (refer to Chart 5); the claims ratio was further pressured by the contraction in the top line (or GWP) in FY Dec 2010. Nonetheless, in 1H FY Dec 2011, AAI's claims ratio improved to 76.11% (1H FY Dec 2010: 91.69%) on the back of improved premiums.

Chart 5: AAI general claims ratio against peers



	FY Dec 2006	FY Dec 2007	FY Dec 2008	FY Dec 2009	FY Dec 2010
AAI - absolute claims	115.67	151.87	183.73	272.41	246.35
AAI	66.52%	73.33%	75.42%	88.16%	88.66%
JIC	62.38%	67.00%	65.52%	64.39%	69.53%
Aviva NDB	73.11%	71.52%	82.77%	70.97%	79.14%
UAL	66.67%	71.36%	72.50%	74.58%	72.20%
Ceylinco	57.82%	56.37%	56.44%	60.81%	59.87%

Source: Company annual reports, IBSL

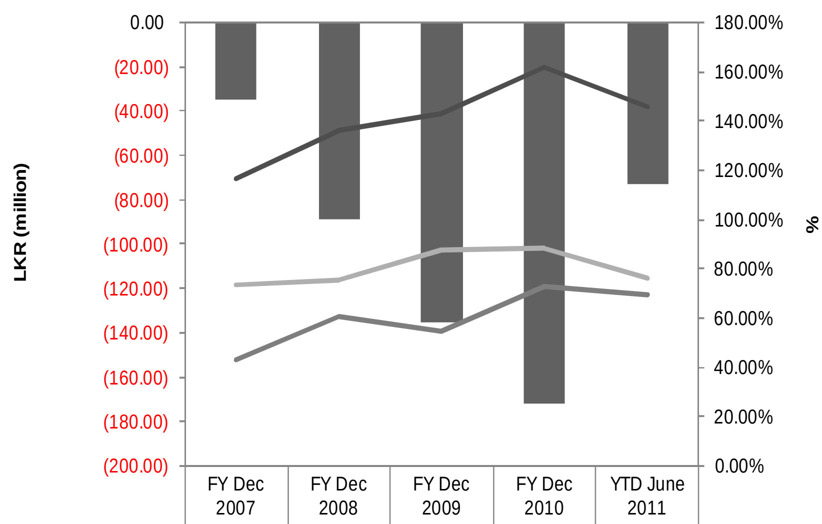
...corrective actions taken

Meanwhile, the Company has taken corrective actions to cut down on the high claims stemming primarily from motor and miscellaneous sub-classes. The motor sub-class claims ratio improved to 73.34% in FY Dec 2010 (FY Dec 2009: 88.16%) amid the strengthening of its inspections pertaining to accidents and other related motor-claims to curtail unnecessary claims. However, the claims ratio in the miscellaneous segment stood at 111.12% in FY Dec 2010, down from the previous year's 105.46% due to a hospitalisation claim from a single corporate client; the Company has discontinued this agreement. With these steps, RAM Ratings Lanka expects the general claims ratio to improve, going forward.

Net underwriting performance still weak despite recent improvement

The general segment's net underwriting losses had weakened to LKR 171.72 million in FY Dec 2010 from LKR 135.17 million the previous year (refer to Chart 6). While we note that claims paid during fiscal 2010 had reduced owing to the discontinuation of unprofitable business lines, the underwriting losses weakened owing to increased policy-acquisition costs. Nonetheless, in 1H FY Dec 2011, net underwriting losses thinned to LKR 72.47 million in line with reduced policy acquisition costs (1H FY Dec 2010: LKR 69.56 million). Previously, AAI also had to bear a portion of its parent's (ACP) overheads. In line with the reduced overheads and expanded top line, the Company's expense ratio also improved to 69.42% in 1H FY Dec 2011 from 73.14% in FY Dec 2010.

Chart 6: General underwriting performance



	FY Dec 2007	FY Dec 2008	FY Dec 2009	FY Dec 2010	YTD June 2011
Net underwriting surplus/ (loss)	(34.44)	(88.07)	(135.17)	(171.72)	(72.47)
Claims ratio	73.33%	75.42%	88.16%	88.66%	76.11%
Expense ratio	43.29%	60.73%	55.09%	73.14%	69.42%
Combined ratio	116.63%	136.15%	143.25%	161.80%	145.53%

Source: AAI

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Reinsurance deemed adequate

AAI's reinsurance arrangements are considered adequate as they comply with the regulatory requirements, which specify that only reinsurers which have investment-grade ratings or those that are sovereign-backed can be utilised (refer to Table 2). The Company's overall retention ratio stood at 78.93% as at end-December 2010 as AAI takes a risk-based strategy when evaluating risks.

Table 2: AAI's reinsurers

Name of reinsurer	Financial Strength Rating	Agency
Munich Re	AA-	Fitch
General Insurance Corporation India	A	A. M. Best
BEST Re-Malaysia	A	A. M. Best
Africa Re-Mauritius	A	A. M. Best
Asia Re	B++	A. M. Best
Lloyd Syndicate - Amlin	A	S & P
Lloyd Syndicate - Pembroke	A	S & P

Source: AAI

Management & Corporate Strategy

Team led by well-experienced management

AAI's management team is spearheaded by Chief Executive Officer Mr. Ramal Jasinghe, a well-experienced professional in the industry. The Company has 4 main divisions which are led by Mr Saliya Wickremasinghe (General Manager – Finance), Mr Siri Jayasinghe (General Manger – Life), Mr Chula Hettiarachchi (General Manager – Sales & Marketing) and Mr Udeni Kiridena (General Manager – Non-Life) and Mr Asaf Khan (General Manager – Non-Life Operations). The senior management personnel have many years of experience and are veterans in the industry.

Remedial actions to control claims have borne fruit

Remedial actions taken by the management to control the high influx of general claims during the past 2 fiscal years have now borne fruit. AAI has discontinued unprofitable business lines which brought in high claims. Moreover, the Company has strengthened its risk-evaluation procedures and claims-approval processes (especially in the motor sub-segment) while better training is being given to its staff with regards to underwriting and sales.

Broadening life and general product ranges

The life segment continues to dominate AAI's GWP composition. AAI intends to broaden its life product offerings, going forward, by launching a micro-insurance product. Furthermore, AAI has introduced a policy called "*Family Healthcare Super Benefit*" which provides a healthcare reimbursement plan along with life cover. Furthermore, during fiscal 2010 AAI introduced 2 new products under the general business category named "*Home Protector*" and "*Global Medical Insurance*". While the former covers the medium-income category for household fire and burglary, the latter is an international health-insurance policy that can be used overseas (reinsured by Lloyds).

New Branch additions

During fiscal 2010, AAI opened 2 new branches and intends to open another 5 branches during fiscal 2011-2012. A back-office marketing team carries out insurance campaigning prior to the opening of the branches to ensure speedy break even.

Positive synergies from new parent

Meanwhile, with its new owners, we foresee the further strengthening of its general segment in terms of mainly miscellaneous (health) and motor insurance. However, we envisage that the positive synergies with SLH would only materialise over the medium to long term.

■ Corporate Governance

Board represented by new owners

The board is now chaired by Mr Ashok Pathirage. Also, there have been changes to the board members subsequent to the change in ownership. Four directors have resigned and been replaced with five new directors, who had been appointed from the SLH Group (1 member represents Hirdaramani Group which has a considerable stake in SLC).

■ Investment Strategy and Liquidity

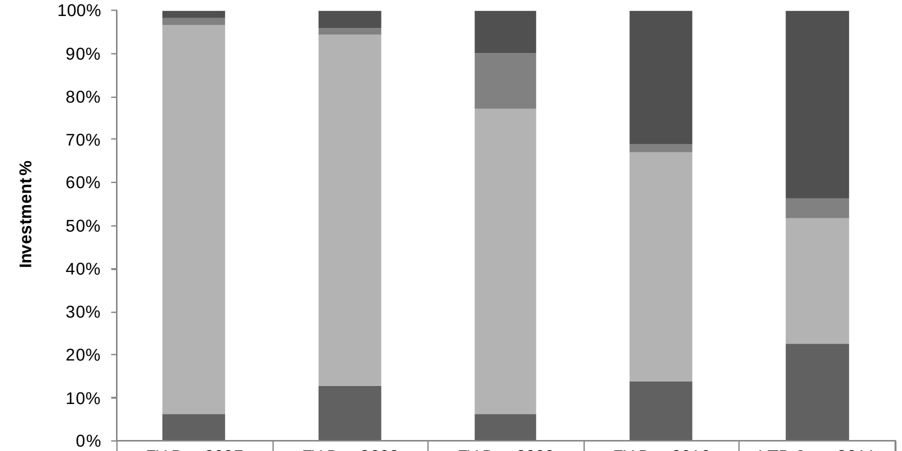
Investments tilted towards equity

Along with the upturn in the bourse, AAI had channelled a large portion of its investments to the equity market. Despite making better investment returns during FY Dec 2010, AAI's investment portfolio had been adversely affected by the stock-market downturn and receding interest rates in 1H FY Dec 2011. Looking ahead, we expect AAI to take a more conservative stance in its investment policy.

Investment portfolio increased in fiscal 2010

The Company's investment portfolio increased by 62.07% to LKR 3.75 billion as at end-December 2010 (end-December 2009: LKR 2.31 billion) as AAI channelled the funds from the rights issue in November 2010 into investments. While the bulk of the investments traditionally lay in government securities, the portfolio is now tilted towards equity, which accounted for 43.81% as at end-June 2011 (refer to Chart 7). Moreover, AAI has also increased exposure to corporate debt to increase the returns on fixed-income investments.

Chart 7: AAI's investment portfolio



	FY Dec 2007	FY Dec 2008	FY Dec 2009	FY Dec 2010	YTD June 2011
Equity	1.48%	3.81%	9.75%	30.91%	43.81%
Term Deposits	1.82%	1.80%	12.97%	2.10%	4.54%
Treasury Bonds	90.49%	81.82%	71.04%	53.39%	29.27%
Corporate debt	6.20%	12.57%	6.24%	13.59%	22.38%

Source: AAI

Adversely hit by stock market downturn...

Against a backdrop of receding interest rates during fiscal 2010, AAI channelled the majority of its investments into equity as the bourse was booming, thus making gains amounting to LKR 414.67 million in comparison with LKR 72.30 million in the previous year. While the Company's overall profitability improved during FY Dec 2010 owing to better returns from these investments (investment yield: 22.81%), AAI was adversely hit during 1H FY Dec 2011. As such, its investment yield dropped to 4.19%. Returns from investments receded to LKR 79.24 million in 1H FY Dec 2011 (from LKR 293.26 million in 1H FY Dec 2010) due to losses from its equity portfolio.

A more conservative investment approach going forward

On a positive note, with the change in ownership, the Company intends to adopt a more conservative approach in its investment portfolio. The previous owner, ACP, was largely into stockbroking, and thus influenced the Company to channel its investments towards the equity market. In this regard, we do not expect immediate reduction in exposure as AAI is waiting for more a favourable time to divest its equity portfolio.

Good Liquidity

Meanwhile, the Company's liquidity position is considered to be good. Its ratio on liquid assets to total insurance funds had improved to 1.66 times as at end-December 2010 (end-FY Dec 2009: 1.22 times) and has surpassed its peers.

Financial Performance

Financial performance eased during FY Dec 2010 owing to high overheads

During FY Dec 2010, AAI's underwriting performance eased in both the life and general segments owing to high overheads and a dip in premiums; its overall underwriting surplus weakened to LKR 38.76 million in FY Dec 2010 from LKR 104.73 million the previous year. The underwriting losses made in the general segment worsened to LKR 171.72 million during FY Dec 2010 from LKR 135.17 million the previous year due to high policy acquisition costs and a contraction in underwritten premiums. Moreover, the life division's underwriting performance also weakened owing to high overheads. That said, the Company's pre-tax profits had been boosted to LKR 370.58 million in FY Dec 2010 (FY Dec 2009: 147.11 million) by higher gains from equity investments, which amounted to LKR 414.67 million.

...however core underwriting performance improved in 1H FY Dec 2011

AAI's core underwriting performance recorded an improvement in 1H FY Dec 2011, supported by reduced overheads and an improved top line; this was further backed by the reduction in claims in the general division. However, we note that the overall performance of the Company was affected by the losses made in the investment portfolio in the general segment. Nonetheless, the improving economic landscape had improved the underwriting performance by expanding the top line of the Company in 1H FY Dec 2011 (composite underwriting surplus: LKR 70.12 million) compared to the previous year (composite underwriting surplus 1H FY Dec 2010: LKR 30.74 million). That said, AAI made a pre-tax loss of LKR 172.08 million due to the weak financial performance in the general division; the total surplus in the life segment (LKR 322.40 million) was transferred to the life fund as assessed by the actuary.

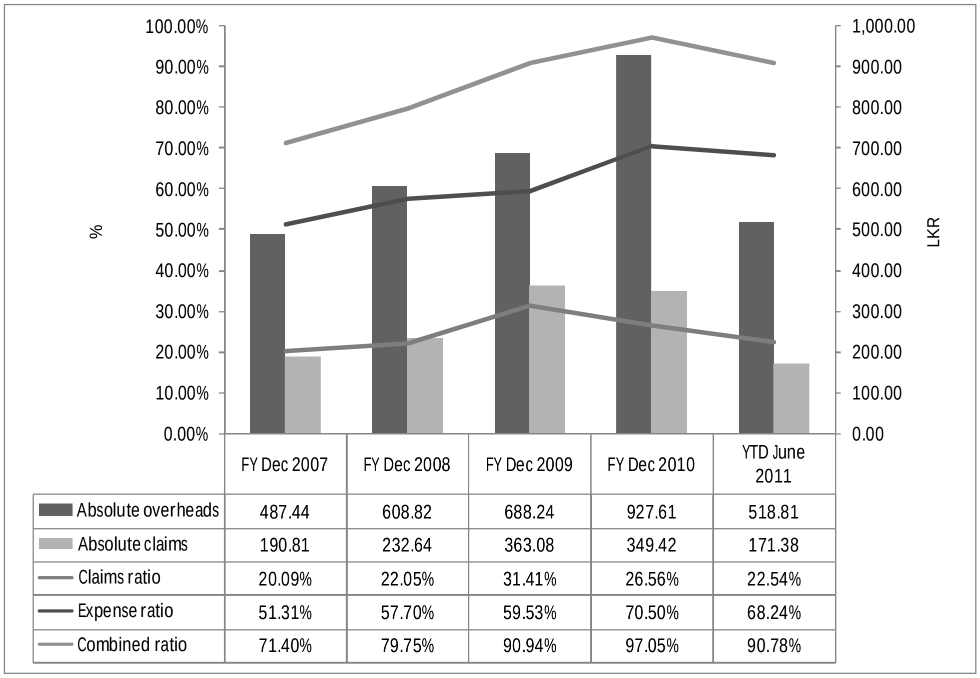
Performance in investment portfolio weakened

Meanwhile, AAI's investment portfolio's profitability thinned during 1H FY Dec 2011 owing to the weak performance in the Colombo Stock Exchange ("CSE") and receding interest rates; the investment-yield ratio eased to 4.19% y-o-y from 22.81% in FY Dec 2010. Going forward, we expect the Company to maintain more stable returns from investments by reducing its exposure to equity investments.

Overall expense ratio improved

Furthermore, AAI's overall expense ratio weakened to 70.50% in FY Dec 2010 due to high overheads owing to policy acquisition costs and branch openings. This resulted in the weakening of the overall combined ratio to 97.05% in FY Dec 2010 (FY Dec 2009: 90.94%) (refer to Chart 8). Nonetheless, these ratios are in line with its peers'. During 1H FY Dec 2011, the ratios improved on the back of the stronger top line growth. Furthermore, the Company previously had to bear a portion of the preceding parent's overheads. Therefore, we expect AAI's expense ratio to further improve, going forward.

Chart 8: AAI's overall expense ratios



	FY Dec 2007	FY Dec 2008	FY Dec 2009	FY Dec 2010	YTD June 2011
Absolute overheads	487.44	608.82	688.24	927.61	518.81
Absolute claims	190.81	232.64	363.08	349.42	171.38
Claims ratio	20.09%	22.05%	31.41%	26.56%	22.54%
Expense ratio	51.31%	57.70%	59.53%	70.50%	68.24%
Combined ratio	71.40%	79.75%	90.94%	97.05%	90.78%

Source: AAI

Reserving deemed adequate

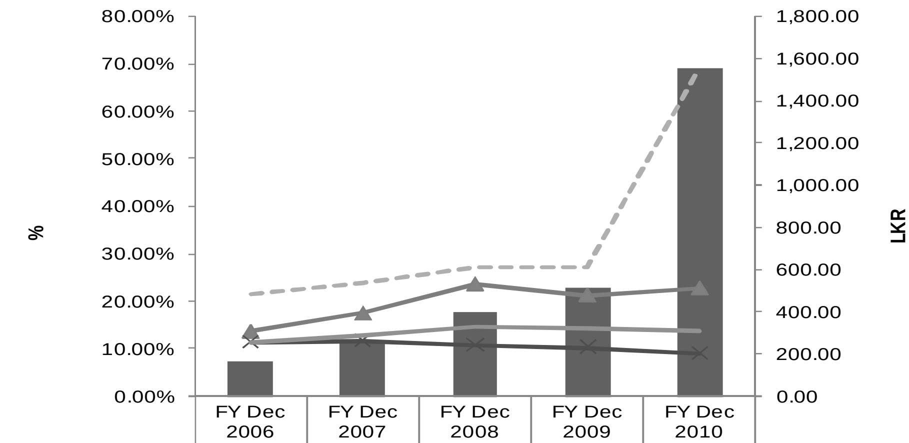
AAI's reserving is deemed adequate by the actuarial assessment in both the life and general segments. The life fund improved to LKR 2.25 billion as at end-1H FY Dec 2011 following the mid-yearly assessment done in fiscal 2010. Its actuarial needs for the general segment are fulfilled by Messrs KA Pandit Consultants and Actuaries, while the actuarial requirements for life insurance are carried out by Actuarial and Management Consultants (Pvt) Ltd.

Capital Adequacy

Capitalisation deemed to be good

AAI's capitalisation is deemed to be good; capitalisation indicators have surpassed its peers comfortably. In line with the rights issue in November 2010 that amounted to LKR 812.50 million, AAI's shareholder funds to insurance funds and shareholder funds to total assets improved to 68.86% and 35.88% respectively (refer to Chart 9). However, we note that pre-tax loss and dividends paid (LKR 112.50 million) have eroded capitalisation levels to LKR 1.28 billion as at end-June 2011 from LKR 1.56 billion as at end-December 2010. Thus, shareholder funds to insurance funds eased to 50.96% in end-June 2011 while shareholder funds to total assets eased to 28.98% during the same period. However, they are still better than its peers.

Chart 9: AAI's capitalisation



	FY Dec 2006	FY Dec 2007	FY Dec 2008	FY Dec 2009	FY Dec 2010
AAI - Equity	167.86	268.66	404.06	517.54	1,560.86
AAI	21.62%	24.10%	27.25%	27.22%	68.86%
JIC	13.76%	17.57%	23.63%	21.35%	22.77%
Aviva NDB	11.55%	11.73%	10.97%	10.43%	9.18%
Ceylinco	11.54%	13.08%	14.71%	14.45%	13.74%

Source: Company annual reports, IBSL

Eased solvency margins

The Company's solvency margin in the general segment eased to 4.37 times as at end-June 2011 as the majority of the investments lay in equity (only 30% taken as admissible assets); the margin had jumped up as at end-December 2010 to 17.43 times with the capital infusion. With regards to life, the solvency margin improved to 2.78 times as at end-June 2011; AAI has not increased its exposure to equity in the life division. Both the margins are in line with its peers in the respective segments.

Corporate Information – Asian Alliance Insurance PLC

Date of Incorporation:	April 1999	
Commencement of Business:	April 1999	
Major Shareholders (as at 30 September 2011):	Softlogic Capital Limited	76.06%
	Softlogic Holdings PLC	18.53%
Directors:	Mr Asoka K Pathirage	Chairman
	Mr James Henry Paul Ratnayake	Deputy Chairman
	Mr RG Jasinghe	Director / CEO
	Prof Lakshman R Watawala	Director
	Mr T M Iftikar Ahamed	Director
	Mr Sujeewa Rajapakse	Director
	Mr Ranil P Pathirana	Director
	Mr Suraj N Fernando	Director
Auditor:	KPMG Ford, Rhodes, Thornton & Co	
Listing:	Diri Savi board of the Colombo Stock Exchange	
Key Management:	Mr Ramal Jasinghe	Director / CEO
	Mr Siri Jayasinghe	General Manager - Life Technical
	Mr Chula Hettiarachchi	General Manager - Sales & Distribution
	Mr Saliya Wickremasinghe	General Manager – Finance
	Mr Udeni Kiridena	General Manager – Non Life
	Mr Asaf Khan	General Manager – Non Life Operations

Capital History:

Year	Remarks	Amount (LKR million)	Cumulative Total (LKR million)
2000	Issue of shares	200.00	200.00
2003	Share issue	50.00	50.00
2010	Rights issue	812.50	1062.50

FINANCIAL SUMMARY
Asian Alliance Insurance PLC – Company

					Unaudited
BALANCE SHEET (LKR Million)	31-Dec-07	31-Dec-08	31-Dec-09	31-Dec-10	30-Jun-11
ASSETS					
Cash and Bank Balances	38.01	32.80	52.14	62.44	40.82
Investments					
Properties	0.00	0.00	0.00	0.00	0.00
Fixed Income Securities	1,409.48	1,686.73	1,788.75	2,512.87	3,801.38
Unit Trust	0.00	0.00	0.00	0.00	0.00
Equity Securities	21.61	68.03	225.74	1,159.70	0.00
Fixed and Call Deposits	26.58	32.24	300.09	78.71	0.00
Investment-Linked Investments	0.00	0.00	0.00	0.00	0.00
Net Loans	6.66	13.92	31.45	45.88	51.79
Outstanding Premium from agents/brokers	78.08	105.93	74.52	102.61	119.93
Amount Due from reinsurers/ceding company	24.22	27.49	41.04	99.94	85.03
Investments in Subsidiaries/Associates	0.00	0.00	0.00	0.00	0.00
Other Assets	75.10	101.12	185.54	171.61	175.12
Property, Plant & Equipment	33.95	54.14	65.56	116.57	129.78
TOTAL ASSETS	1,713.68	2,122.41	2,764.83	4,350.33	4,403.85
LIABILITIES					
Provision for outstanding claims:					
Admitted/estimated but not yet paid & IBNR	101.27	101.72	176.15	171.70	0.00
Reserve for Unexpired Risks (General Insurance)	125.28	177.04	165.06	165.54	252.63
Actuarial Liabilities (Life Insurance)	888.39	1,203.97	1,560.40	1,929.35	2,251.75
Bonus & Unallocated surplus carried forward	0.00	0.00	0.00	0.00	0.00
TOTAL INSURANCE FUNDS	1,114.94	1,482.73	1,901.60	2,266.58	2,504.38
Amount Due to Agent, Brokers & Reinsurers	117.29	99.85	139.29	106.79	199.78
Accrued expenses & Trade and Other Creditors	194.61	120.32	183.31	364.36	421.93
Amount due to Related Companies	1.88	2.98	6.67	47.50	1.48
Bank Overdraft & Other bank borrowings	16.30	12.48	16.41	4.24	0.00
Investment-linked Liabilities	0.00	0.00	0.00	0.00	0.00
Provision for Taxation/Deferred Tax Liabilities	0.00	0.00	0.00	0.00	0.00
Provision for Dividends	0.00	0.00	0.00	0.00	0.00
TOTAL LIABILITIES	1,445.02	1,718.35	2,247.29	2,789.47	3,127.57
Paid-up Capital	250.00	250.00	250.00	1,062.50	1,062.50
Irredeemable Hybrid Capital	0.00	0.00	0.00	0.00	0.00
Share Premium & Other Reserves	0.00	0.00	0.00	0.00	0.00
Retained Profits/(Accumulated Losses)	18.66	154.06	267.54	498.36	213.78
Minority Interest	0.00	0.00	0.00	0.00	0.00
TOTAL SHAREHOLDERS' FUNDS	268.66	404.06	517.54	1,560.86	1,276.28
TOTAL LIABILITIES & SHAREHOLDERS' FUNDS	1,713.68	2,122.41	2,764.83	4,350.33	4,403.85

FINANCIAL SUMMARY
Asian Alliance Insurance – Company

INCOME STATEMENT (LKR Million)	31-Dec-07	31-Dec-08	31-Dec-09	31-Dec-10	*Unaudited* 30-Jun-11
Net Premiums	955.64	1,111.55	1,159.95	1,320.68	772.24
Less: Provision for Reserves for Unexpired Risks	(5.72)	(56.49)	(3.90)	(4.88)	(11.92)
Earned Premiums	949.93	1,055.06	1,156.05	1,315.80	760.32
Less: Claims Incurred and Claims Admitted	(190.81)	(232.64)	(363.08)	(349.42)	(171.38)
Gross Underwriting Surplus/(Deficit)	759.12	822.43	792.97	966.37	588.93
less: Underwriting Expenses (of the Funds)	(487.44)	(608.82)	(688.24)	(927.61)	(518.81)
Net Underwriting Surplus/(Deficit)	271.68	213.61	104.73	38.76	70.12
Investment Income	153.66	229.77	391.70	692.12	79.24
Other Income	2.46	3.34	7.11	8.65	0.96
Surplus / (deficit) transferred from Revenue Account					
- General Insurance	(0.81)	(28.85)	(47.89)	116.97	(172.08)
- Life Insurance	115.24	160.00	195.00	253.61	0.00
Company's Operating Turnover	114.44	131.15	147.11	370.58	(172.08)
Less: (Management expenses)	0.00	0.00	0.00	0.00	0.00
(Other expenses)	0.00	0.00	0.00	0.00	0.00
Add: Investment Income	0.00	0.00	0.00	0.00	0.00
Other Income	0.00	0.00	0.00	0.00	0.00
Operating Profit Before Depn., Interest and Tax	114.44	131.15	147.11	370.58	(172.08)
Less: Depreciation and Amortisation	0.00	0.00	0.00	0.00	0.00
Operating Profit Before Interest and Tax	114.44	131.15	147.11	370.58	(172.08)
Less: Interest and Finance Charges	0.00	0.00	0.00	0.00	0.00
Operating Profit Before Tax	114.44	131.15	147.11	370.58	(172.08)
Prior Year Adjustments	0.00	0.00	0.00	0.00	0.00
Extraordinary/Exceptional Items	0.00	0.00	0.00	0.00	0.00
Share of Associates Profit/(Loss)	0.00	0.00	0.00	0.00	0.00
Adjusted Profit/(Loss) Before Tax	114.44	131.15	147.11	370.58	(172.08)
Less: Tax	(1.14)	4.26	(2.33)	(2.57)	0.00
Adjusted Profit/(Loss) After Tax	113.30	135.40	144.78	368.01	(172.08)
Less: Minority Interests	0.00	0.00	0.00	0.00	0.00
Less: Dividends	(12.50)	0.00	0.00	0.00	0.00
Retained Profit For The Year	100.80	135.40	144.78	368.01	(172.08)

*Note: The surplus in the life segment was transferred to the life fund in 1H FY Dec 2011

FINANCIAL RATIOS
Asian Alliance Insurance – Company

KEY FINANCIAL RATIOS (%)	31-Dec-07	31-Dec-08	31-Dec-09	31-Dec-10	30-Jun-11 *Unaudited*
PROFITABILITY (%)					
Gross Underwriting Margin	79.44%	73.99%	68.36%	73.17%	76.26%
Net Underwriting Margin	28.43%	19.22%	9.03%	2.94%	9.08%
Pre-tax Operating Margin	44.77%	40.19%	43.41%	56.00%	19.47%
Pre-tax Return on Assets (av.)	29.58%	23.29%	20.61%	20.79%	6.87%
Investment Yield (av.)	13.06%	14.28%	19.23%	22.81%	4.19%
After Tax Return on Equity	42.17%	33.51%	27.98%	23.58%	(26.97%)
Return on Capital Employed	40.30%	31.65%	27.55%	23.68%	-26.97%
Claims Ratio	20.09%	22.05%	31.41%	26.56%	22.54%
Expense Ratio	51.31%	57.70%	59.53%	70.50%	68.24%
Combined Ratio	71.40%	79.75%	90.94%	97.05%	90.78%
Investment Income Ratio	16.34%	20.97%	34.38%	53.06%	10.39%
Operating Ratio	55.06%	58.78%	56.56%	43.99%	80.39%
CAPITALISATION / SOLVENCY					
Shareholder funds / Total assets	15.68%	19.04%	18.72%	35.88%	28.98%
Shareholder funds / Insurance funds	24.10%	27.25%	27.22%	68.86%	50.96%
Insurance Fund Liability Ratio	4.15	3.67	3.67	1.45	1.96
Solvency margin					
- Life	N/A	N/A	5.80	1.16	2.78
- General	N/A	N/A	5.67	17.43	4.37
LIQUIDITY					
Total Liquid Assets / Total Insurance Funds	1.31	1.21	1.22	1.66	1.52
Total Liquid Assets / Total Assets	0.85	0.84	0.84	0.86	0.86
OTHER PERFORMANCE RATIOS					
Retention Ratio	74.99%	77.74%	77.03%	78.93%	77.49%

FINANCIAL RATIOS
ASIAN ALLIANCE INSURANCE PLC-Company

Ratio Definition:-	
Gross Underwriting Margin	Gross Underwriting Profit / Net Premiums
Net Underwriting Margin	Net Underwriting Profit / Net Premiums
Pre-tax Operating Margin	Operating Profit Before Tax / Net Premiums
Pre-tax Return on Assets (av.)	Operating Profit Before Tax / Total Asset (av.)
Investment Yield (av.)	(Interest income + Dividend Income) / Total Liquid Assets/Investments (av.)
After Tax Return on Equity	Adjusted Profit After Tax / (Shareholders' Funds + Minority Interests)
Return on Capital Employed	(Pre-tax Profit + Interest) / (Total Debt + Shareholders' Funds + Minority Interests)
Claims Ratio	(Claims Paid + Changes in Provision for Outstanding Claims) / Earned Premiums
Expense Ratio	(Commission + Management Expenses + General and Administrative Expenses + Other Expenses) / Earned Premiums
Combined Ratio	Claims Ratio + Expenses Ratio
Investment Income Ratio	Investment Income / Net Premiums
Operating Ratio	Combined Ratio - Investment Income Ratio
Gearing Ratio	Total Debt / (Shareholders' Funds + Minority Interest)
Operating Profit Debt Coverage Ratio	Operating Profit Before Depreciation Interest and Tax / Total Debt
Insurance Fund Liability Ratio	Total Insurance Funds / (Shareholders' Funds + Minority Interest)
Total Surplus Assets Coverage	(Total Assets - Total Liabilities) / Total Liabilities
Retention Ratio	Net Premium / Gross Premium

The above ratios have been computed based on information from the company and published accounts. Where applicable, some items have been reclassified according to RAM's definition to facilitate meaningful comparisons between companies.

CREDIT RATING DEFINITIONS

Claims-Paying Ability Ratings

A Claims-Paying Ability ("CPA") is RAM Ratings Lanka's current opinion on the overall capacity of an insurance company to meet its financial obligations to policy/contract holders. The opinion is not specific to any particular policy/contract, as it does not take in to account the expressed terms and conditions of any specific policy/contract.

Long-Term Ratings

AAA	An insurance company rated AAA has a superior capacity to meet its financial obligations to policy/contract holders. This is the highest long-term CPA assigned by RAM Ratings Lanka.
AA	An insurance company rated AA has a strong capacity to meet its financial obligations to policy/contract holders. The insurance company is resilient against adverse changes in circumstances, economic conditions and/or operating environments.
A	An insurance company rated A has a strong capacity to meet its financial obligations to policy/contract holders. The insurance company is resilient against adverse changes in circumstances, economic conditions and/or operating environments.
BBB	An insurance company rated BBB has a moderate capacity to meet its financial obligations to policy/contract holders. The insurance company 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	An insurance company rated BB has a weak capacity to meet its financial obligations to policy/contract holders. The insurance company is highly vulnerable to adverse changes in circumstances, economic conditions and/or operating environments.
B	An insurance company rated B has a very weak capacity to meet its financial obligations to policy/contract holders. The insurance company has limited ability to withstand adverse changes in circumstances, economic conditions and/or operating environments.
C	An insurance company rated C has a high likelihood of defaulting on its financial obligations to policy/contract holders. The insurance company 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 to policy/contract holders.
D	An insurance company rated D is currently in default on either all or a substantial portion of its financial obligations to policy/contract holders, whether or not formally declared. The D rating may also reflect the filing of bankruptcy and/or other actions pertaining to the insurance company that could jeopardise the payment of financial obligations to policy/contract holders.

Short-Term Ratings

P1	An insurance company rated P1 has a strong capacity to meet its short-term financial obligations to policy/contract holders. This is the highest short-term CPA assigned by RAM Ratings Lanka.
P2	An insurance company rated P2 has an adequate capacity to meet its short-term financial obligations to policy/contract holders. The insurance company is more susceptible to the effect of deteriorating circumstances than those in the highest-rated category.
P3	An insurance company rated P3 has a moderate capacity to meet its short-term financial obligations to policy/contract holders. The insurance company 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	An insurance company rated NP has doubtful capacity to meet its short-term financial obligations to policy/contract holders. The insurance company faces major uncertainties that could compromise its capacity for payment of financial obligations.
D	An insurance company rated D is currently in default on either all or a substantial portion of its financial obligations to policy/contract holders, whether or not formally declared. The D rating may also reflect the filing of bankruptcy and/or other actions pertaining to the insurane company could jeopardise the payment of financial obligations to policy/contract holders

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

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