RAM RATINGS

CREDIT RATING RATIONALE

FINANCIAL INSTITUTIONS – SRI LANKA

A wholly owned subsidiary of RAM Holdings Berhad

BARTLEET FINANCE LIMITED – Rating Review

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

Rating Outlook:
Negative [revised from stable]

Strengths:
- Established franchise of Bartleet Group
- Good monitoring and recovery efforts
- Healthy liquidity

Weaknesses:
- Hefty overheads
- Loan concentration

Principal Activities:
Finance company engaged in leasing, hire-purchase, retail loans and acceptance of public funds

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Summary

RAM Ratings Lanka has reaffirmed Bartleet Finance Limited's ("BFL" or "the Company") long- and short-term ratings at BBB- and P3, respectively. However, the outlook on the long-term rating has been revised from stable to negative. This is premised on the heightened delinquencies from certain loan segments, which have pressured the Company's capital position. Nonetheless, BFL's ratings are still supported by its established franchise and improved liquidity position.

BFL celebrated its 25th anniversary in November 2008. The Company is part of the Barleet Group, a local conglomerate that has been in business for over a century. However, BFL remains a small player in the registered finance company ("RFC"), accounting for only 1.77% of the industry's asset base as at end-March 2009. Although the Company provides retail loans, it focuses on the disbursement of leases and hire-purchase ("HP") facilities.

We note that BFL's core portfolio of leases and HP facilities has remained healthier than the industry's. However, the Company's overall gross non-performing loans ("NPL") ratio has been weakened by defaults in few loan categories. On the other hand, BFL's portfolio of leases and HP facilities, which accounted for 87.36% of its total loans at end-September 2009, stayed healthy due to the Company's good recovery and monitoring efforts. The default rate on the Company's combined portfolio of HP facilities and leases clocked in at 4.47% as at the same date.

Meanwhile, we observe some concentration risk in its loan portfolio. Loan concentration renders the quality of the Company's credit portfolio volatile, as a few defaults can result in a substantial jump in NPLs. In this context, the Company's gross NPL ratio had climbed up to 8.87% as at end-September 2009 (end-March 2009: 3.00%), driven by defaults on few large loans from its cheque-discounting portfolio. Defaults from this portfolio accounted for 24.42% of BFL's total NPLs as at end-September 2009. We note that these had originated from a few long-standing customers that had been affected by the economic downturn. We also note that the Company had curtailed lending following the RFC crisis in Sri Lanka, instead focusing on improving its liquidity.

With high cost deposits being channelled to liquid assets, which yield less compared to credit assets, BFL's financial performance weakened in FYE 31 March 2009 ("FY Mar 2009"). The Company's net interest margin ("NIM") narrowed from 12.08% to 9.10% year-on-year ("y-o-y") (1H FY Mar 2010: 6.21%). We observe that BFL's large deposit base had been re-priced at a faster pace amid rising interest rates while loan growth had been restricted; this had hindered the Company's ability to pass on the increase in interest rates. BFL's overheads had also pressured its bottom line. Nonetheless, it had managed to stay in the black, underpinned by write-backs on provisions via recoveries.

The management's concerted efforts to beef up its liquidity amid the weakening macroeconomic conditions, together with its strong franchise, had supported BFL during the RFC crisis in early 2009. Although the Company had faced deposit-withdrawal pressures, it had managed to meet all withdrawals, including pre-mature ones. This had helped further strengthen BFL's franchise; the Company's deposit base had augmented 39.61% y-o-y as at end-September 2009. With the management having curtailed lending and increased its liquid assets, the Company reported a statutory liquid-asset ratio of 24.89% as at end-September 2009, well above the regulatory minimum of 10%.

In the meantime, the Company's heftier NPLs had pressured its capital position. It recorded a ratio on net NPLs to shareholders' funds of 31.55% as at end-September 2009, eroding the Company's cushion against NPLs. However, BFL's capital adequacy remained moderate, with tier-1 and overall risk-weighted capital-adequacy ratios ("RWCARs") of 11.85% and 12.63%, respectively, as at the same date - above the corresponding regulatory floors of 5% and 10%. Looking ahead, the management intends to list BFL on the Colombo Stock Exchange; we have a positive view of development.

Outlook

The negative outlook on BFL's long-term rating reflects the increased delinquencies in certain loan categories. The rating will come under pressure if the Company cannot demonstrate substantial improvement in its asset quality. If the Company achieves this, its rating outlook will be reinstated to stable.

Corporate Profile

Incorporated more than 2 decades ago

Incorporated in November 1983, BFL is registered under the Finance Companies Act No. 78 of 1988 and the Finance Leasing Act No. 56 of 2000; it is regulated by the Central Bank of Sri Lanka as an RFC.

The Company is headquartered in Colombo, and has 7 branches and 5 service centres. BFL recently expanded to the northern region, via a service centre in Vavuniya. Going forward, the management expects to reinforce its presence in the northern and eastern regions, with 2 planned branches in these areas.

BFL's primary concentration remains on HP and leasing while having a diverse loan portfolio, which includes pledged loans, cheque discounting and letters of credit. It also accepts public deposits.

Ownership

Part of Bartleet conglomerate

BFL is the largest subsidiary of the Bartleet Group ("the Group"). The Group is involved in commodities brokering, trading, information technology ("IT"), electronics and financial services. BFL is directly held by Bartleet TransCapital Ltd ("TransCapital"), which in turn is the financial-services arm of the Group. BFL had been a direct subsidiary of Bartleet & Company Ltd ("BCL") prior to the Group's reorganisation in 2005.

Reputable owners

BCL had been a British-owned entity since its inception in 1904, before being acquired by the Wijesinghe family. The current Chairman, Mr Eraj Wijesinghe, joined the Group in 1970 and is one of the founding members of BFL. A prominent business personality, he had previously been a chairman of the Colombo Stock Exchange and a board member of the Financial Sector Reforms Committee, apart from having served in the Capital Market Cluster of the National Council for Economic Development. In addition, he had been a director on the boards of Bank of Ceylon, BCC Lanka Ltd, Merchant Bank of Sri Lanka and United Motors Lanka Limited.

BFL's parent, TransCapital, was incorporated in September 2004. It was subsequently restructured in September 2005, as a holding company for the Bartleet Group's financial-sector subsidiaries, and became the parent of BFL.

Management & Strategies

Change in top management

During the reviewed period, there had been changes in the top management of BFL. Mr Eraj Wijesinghe, the Chairman, now heads the Company after the exit of Mr Susantha Fernando. Mr Wijesignhe is supported by 3 other directors: Mr Susantha de Alwis, Mr Buwaneka Subasighne and Mr S Raghavan. The latter is a recent addition to the board, and had been brought in to spearhead the Company's expansion into the north and east. His extensive banking experience is also expected to strengthen the Company's risk-management framework.

Diversification of asset base

The Chairman is keen to foster a culture of risk management within the Company, and to diversify its asset profile. A 4-year corporate plan is being drafted under the guidance of Mr Wijesinghe; this includes the diversification of BFL's investments to spread its risks. In this regard, the Company intends to increase its exposure to listed equity. However, such investments will be kept at prudent levels, based on factors such as capital[1] and total assets. Furthermore, equity investments are expected to be focused on banks, blue chips and diversified companies. The Company can also ride on the experience of Bartleet Mallory Stockbrokers Limited, a sister company and one of the country's leading brokerage firms. At the same time, BFL will also expand its leasing and other credit products, thus moderating its dependence on HP, which accounted for 74.92% of its loan assets as at end-FY Mar 2009. The Company has formed a credit committee specifically to vet these loans; we view this positively.

Investments in real estate

Elsewhere, investments in real estate will also be actively pursued. Nonetheless, such investments will be made on a project–by-project basis. We also see this in a favourable light. Moreover, we note that the Company adopts a more prudential profit-recognition method with regard to real-estate sales; profits are only booked after full payment has been made. In contrast, other RFCs engaged in real estate often recognise profits upon the receipt of 30% of their sales value, thereby overstating profits and leading to liquidity pressures during the RFC crisis in early 2009.

Unscathed by RFC crisis

The management's strategy of curtailing credit growth and beefing up liquidity had helped the Company weather the RFC crisis. Regular cash inflows from its healthy loan portfolio had been channelled to liquid assets. As BFL had met all deposit withdrawals during the crisis, this has strengthened its franchise; it now

[1] Refer to page 14 on existing regulations on share investments

enjoys greater confidence among depositors and maintains a deposit-renewal ratio of around 75%-80%.

Developing new products

In terms of new products, BFL is evaluating the possibility of introducing micro financing. A pilot scheme will be initiated through the Company's Negombo branch. BFL's micro-financing model involves lending small amounts to an individual within a group, thereby adding pressure on the individual not to default and to avoid social stigma. This project is also seen as part of the Company's corporate-social responsibility. RAM Ratings Lanka observes among other clients that defaults are fewer within this loan category compared to traditional loan products. Furthermore, yields on these small-ticket loans are better. Nonetheless, success in this segment will depend much on the business model used; we will monitor BFL's progress in this regard.

One-stop financial centre

In the meantime, TransCapital's wealth-management services will be offered through BFL's branches. Each branch will be staffed by personnel who will advise customers on financial planning; this includes insurance and stockbroking services. We note that BFL will not bear any liability and only provides advisory services. In this regard, the Company is expected to benefit from commission income. We note that this is a unique service in terms of the RFC sector, and has yet to be tested.

Corporate Governance

BFL's board consists of 7 members, with Mr Wijesinghe in the chair. Following the exit of Mr Susantha Fernando, the Chairman has assumed the responsibilities of the former Managing Director. He has also formed an asset-liability committee and a credit committee. An internal audit committee has also been set up; the first internal audit was recently concluded. RAM Ratings Lanka had previously highlighted the lack of such committees as a concern, and views these developments positively. Over the longer term, the management intends to list BFL on the Colombo Stock Exchange.

Asset Quality

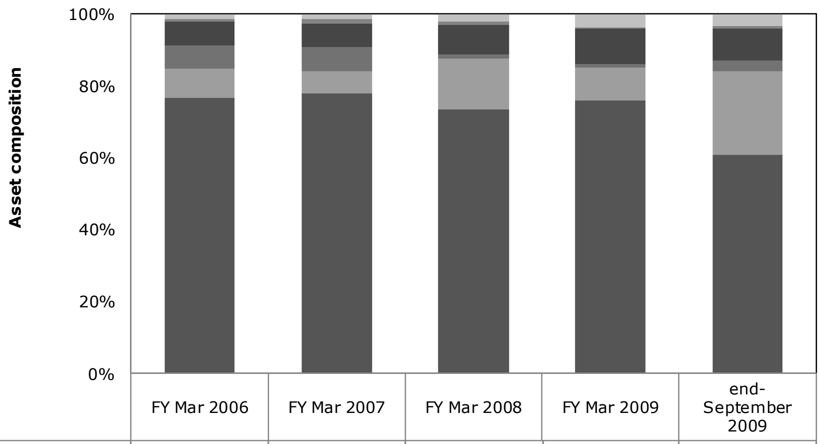
Weakening asset quality

BFL's asset quality had weakened during the review period, owing to defaults in certain loan categories that had been affected by the weak macroeconomic fundamentals. Our concerns centre on the recoverability prospects of these loans. Moreover, the Company has curtailed loan growth, concurrently building up its base of liquid assets.

Asset base tilted towards liquid assets

BFL's asset base has been tilting towards liquid assets amid the shrinking of its credit portfolio. The Company's assets augmented 31.48% in 1H FY Mar 2010, supported by an expansion in liquid assets. The management had curtailed lending during the same period, to focus on maintaining liquidity amid the bleak economic climate and the liquidity crisis that had engulfed the RFC sector. Consequently, cash and securities made up 23.20% of BFL's assets as at end-September 2009; exposure to loans and advances receded to 61.06% from 76.07% as at end-FY Mar 2009 (refer to Chart 1). RAM Ratings has a favorable view of the Company's enhanced liquidity amid the current environment.

Chart 1: BFL's asset composition

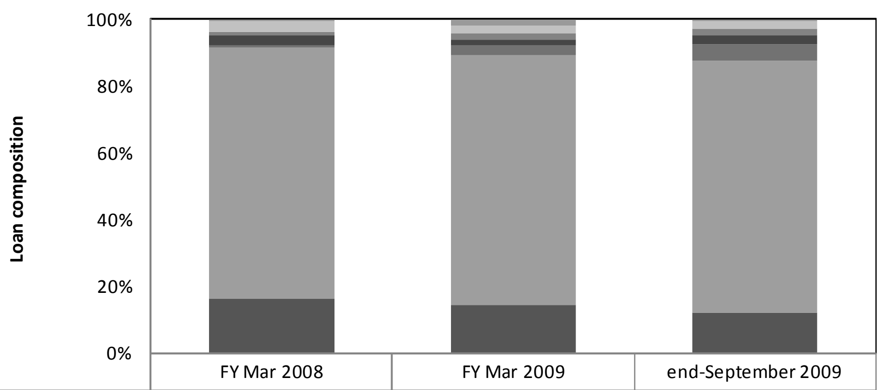


	FY Mar 2006	FY Mar 2007	FY Mar 2008	FY Mar 2009	end-September 2009
Investments in Real Estate	1.08%	1.39%	1.88%	3.45%	3.02%
Other Asssets	0.93%	0.99%	0.81%	0.48%	0.81%
Porperty, Plant & Equipment	6.87%	6.78%	8.63%	10.00%	9.07%
Dealing investments	6.24%	6.77%	1.22%	0.92%	2.85%
Cash & Securities	7.83%	6.14%	13.63%	9.08%	23.20%
Net Loans & Advances	77.05%	77.93%	73.83%	76.07%	61.06%

Stable loan mix unchanged

Meanwhile, the composition of BFL's loan portfolio remained relatively unchanged. HP facilities still dominated its loan base, accounting for 75.49% of its total loans as at end-September 2009; leases came in second with 11.87% (refer to Chart 2). The Company expanded its base of term loans as leases and HP facilities had been restricted; all term loans are backed by mortgages. Going forward, however, the Company intends to further diversify its loan portfolio, thus increasing contributions from other loan segments.

Chart 2: BFL's loan composition



	FY Mar 2008	FY Mar 2009	end-September 2009
Others	0.24%	1.85%	0.59%
Cheque Discounting	3.47%	2.20%	2.23%
Pledge Loans	0.94%	1.76%	1.82%
Short Term Loans	3.04%	1.97%	2.84%
Term Loan	0.29%	2.82%	5.17%
HP	75.70%	74.92%	75.49%
Lease	16.28%	14.49%	11.87%

Concentration risk in loan portfolio

RAM Ratings Lanka observes concentration risk arising from BFL's loan portfolio. As at end-September 2009, its top 20 loans accounted for 19.16% of its loan base. Concentration risk in the loan portfolio exposes the Company to fluctuations in asset quality, as just a few defaults can lead to a substantial jump

Several large loan defaults drove up NPL ratio

in its gross NPL ratio. This in fact materialised at the end of September 2009, as few large loans from the Company's cheque-discounting portfolio had pushed its gross NPL ratio up to 8.87% (end-FY Mar 2009: 3.00%).

NPL deteriorates due to smaller loan categories

Nevertheless, BFL's core portfolio of HP facilities and leases remained relatively healthy, with a combined default rate of 4.47% as at end-September 2009 (end-FY Mar 2009: 1.95%). This was better than the industry's (which is dominated by HP facilities and leases) average of 9.00% as at the same date (end-FY Mar 2009: 6.46%).

Cheque-discounting pushed up NPLs

BFL's cheque-discounting portfolio, which contains 4 contracts, has gone into default. This amounted to 24.42% (or LKR 47.23 million) (refer to Table 1) of its total NPLs as at end-September 2009 (end-FY Mar 2009: 0.73%). We note that this portfolio consisted of loans extended to traders in Colombo's trade hub of Pettah, all of whom had been severely affected by the economic downturn. However, the management has adopted a somewhat lax approach to recovery as these are long-standing customers of the Company. Going forward, our concerns hinge on the recoverability prospects of these loans as the macroeconomic recovery is expected to be gradual and may take some time.

Table 1: BFL's NPL profile and default rates

	FY Mar 2009		end-September 2009	
	NPL composition	Default Rate	NPL composition	Default Rate
Leases	5.13%	1.04%	11.02%	8.14%
HP	54.02%	2.12%	32.84%	3.88%
Term Loans	10.85%	10.31%	14.44%	24.07%
Cheque Discounting	0.73%	0.98%	24.42%	100.00%
Others	29.27%	NA	17.29%	NA

Provisioning for loans

The Company's provisioning levels also weakened, as gross NPL coverage waned from 98.41% as at end-FY Mar 2009 to 41.79% as at end-September 2009. We note that BFL had not provided for the defaulted cheque-discounting loans. We understand that this is because the management is confident of recouping the outstanding amounts. However, RAM Ratings Lanka views this with concern as we expect recovery to be delayed.

Real-estate investments

Meanwhile, as expected, BFL's real-estate investments had augmented but still remained at tolerable levels. Investments in properties took up 3.02% of the Company's asset base as at end-September 2009 (end-FY Mar 2008: 1.88%). Going forward, the management intends to further increase the Company's exposure to real estate. However, this will be carried out on a prudent basis; the Company will not engage in property development and will only deal with bare land. Furthermore, investments will be undertaken on a project-by-project basis, i.e. a new project will only commence after another has been completed.

Performance

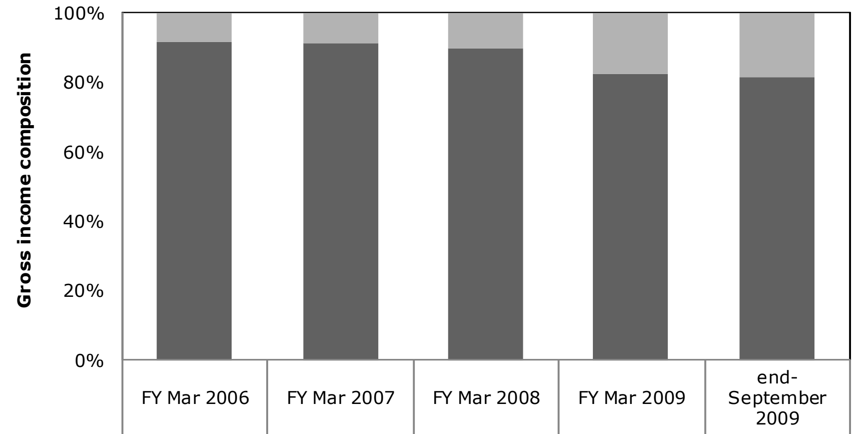
Weakening financial performance

BFL's financial performance shows a weakening trend as interest expenses have been rising faster than interest income, after the management curtailed lending. Overheads and loan-loss provisions have also pressured its bottom line. Prospectively, however, we expect BFL's performance to improve as the Company expands its loan books while high cost deposits are re-priced downwards in line with lower interest rates.

Interest income still dominates gross income

Although interest income still accounted for bulk of BFL's gross income, its composition has altered slightly; interest income constituted 82.80% of the Company's gross income in FY Mar 2009, compared to 90.05% the previous year (refer to Chart 3). This is mainly because of an increase in real-estate profits. Its interest-income mix remained unchanged, as HP accounted for most of its interest income - reflecting the Company's loan profile.

Chart 3: BFL's income composition



	FY Mar 2006	FY Mar 2007	FY Mar 2008	FY Mar 2009	end-September 2009
Non-interest income	8.15%	8.76%	9.95%	17.20%	18.52%
Interest income	91.85%	91.24%	90.05%	82.80%	81.48%

NIM narrows amid rising interest expenses

In line with our expectations, BFL's NIM narrowed from 12.08% to 9.10% as at end-FY Mar 2009 – albeit better than the industry average of 5.83%. Despite a 23.19% increase in interest income, interest expenses augmented at a faster pace of 53.40% over the same period. As a result, its net interest income declined by LKR 40.06 million to stand at LKR 268.20 million as at end-FY Mar 2009. By end-September 2009, the Company's NIM had thinned further to 6.21% after the management had curtailed lending and channelled interest-bearing deposits to liquid assets, which yield lower interest rates than credit assets. Prospectively, RAM Rating Lanka expects the Company's NIM to improve as it expands its loan portfolio, thus allowing BFL to effectively pass on its interest expenses to its customers.

Real-estate sales augment non-interest income

On the other hand, BFL's NIM non-interest margin broadened to 1.89% as at end-FY Mar 2009, thanks to real-estate sales. Going forward, non-interest income is opined to contribute a greater portion of its gross income, as the Company will focus on equity and real estate.

Overall performance pressured by overheads and loan-loss provisioning

Meanwhile, overheads and loan-loss provisions had suppressed BFL's overall financial performance. The Company recorded a cost-to-income ratio of 82.67% as at end-FY Mar 2009 (end-FY Mar 2008: 79.12%); we note that the deterioration had also been due to BFL's shrinking income base. At the same time, the Company's loan-loss provisioning climbed up to LKR 17.51 million as at end-FY Mar 2009, in line with weakening asset quality. As a result, its pre-tax profit slumped to LKR 38.61 million for the year (FY Mar 2008: LKR 61.85 million). All said, however, the Company managed to stay in the black due to recoveries. Moving forward, we expect BFL's performance to improve amid anticipated loan recoveries and the expansion of its credit portfolio.

Funding & Liquidity

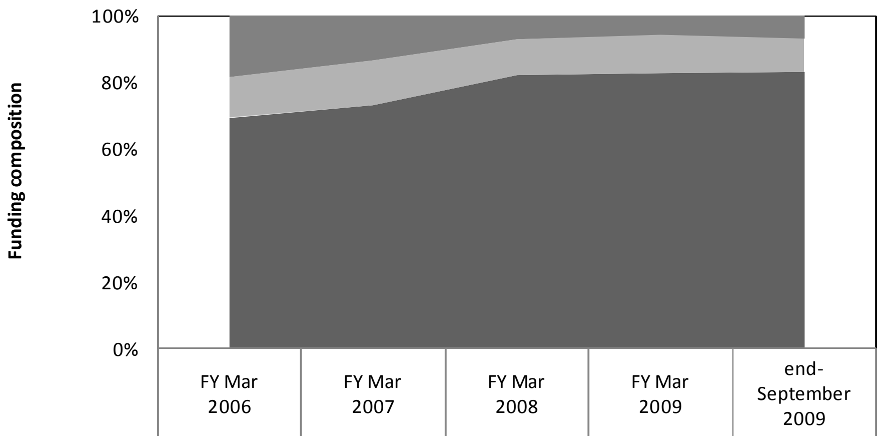
Healthy funding and liquidity positions

RAM Ratings Lanka deems BFL's liquidity and funding positions to be healthy at present. The Company's statutory liquid-asset ratio stood well above the regulatory minimum as at end-September 2009 while its funding base was dominated by public deposits.

Deposits dominate funding base

Public deposits took up the lion's share (83.00%) of BFL's funding base as at end-September 2009 (refer to Chart 4); borrowings (6.86%) and shareholders' funds (10.13%) made up the remainder. Its top 20 depositors only accounted for 4.90% of its total deposits as at the same date. During the reviewed period, the Company had ventured into securitised borrowings as this was cheaper than deposits. However, BFL does not expect to increase its exposure to asset-backed borrowings over the short term due to excess liquidity. Going forward, the Company's funding mix is not expected to change materially.

Chart 4: BFL's funding mix



	FY Mar 2006	FY Mar 2007	FY Mar 2008	FY Mar 2009	end-September 2009
Borrowings	18.45%	13.49%	7.14%	5.71%	6.86%
Shareholders' funds*	12.30%	13.53%	10.78%	11.62%	10.13%
Deposits	69.25%	72.97%	82.08%	82.66%	83.00%

**Excluding revaluation reserves*

Liquid asset ratio remains above regulatory

As BFL had curtailed lending, funding had been channelled to liquid assets. As of end-September 2009, the Company reported a statutory liquid-asset ratio of 24.89%, well above the regulatory floor of 10%. We note that this ratio had sunk to all-time low of 12.15% as at end-FY Mar 2009 (end-FY Mar 2008: 18.92%), as BFL had had to contend with deposit-withdrawal pressures amid the RFC crisis in early 2009. However, we note that BFL had placed a deposit with a troubled RFC, excluding this asset the Company's liquid asset ratio would have come up to 7.09% as at the same date. BFL has made arrangements with the RFC to recoup the Company's investment through monthly instalments over the next 3 years. As BFL had met its depositors' obligations in a timely manner, the Company has strengthened investors' confidence and now enjoys a more robust deposit franchise. Over the medium term, however, RAM Ratings Lanka expects this ratio to wane as the Company expands its loan portfolio.

Higher interest rates widen ALMM

Meanwhile, BFL's asset-liability maturity mismatch ("ALMM") deteriorated as the negative gap in the "less than 1 year" bucket widened to LKR 1.18 billion as at end-FY Mar 2009 (end-FY Mar 2008: 709.10 million) (refer to Table 2). Deposit terms are skewed towards shorter tenures, owing to the environment of rising interest rates; as at end-September 2009, 80.69% of the Company's deposits had tenures of less than 1 year. However, our concerns are mitigated by the Company's high deposit-renewal rates, which averaged between 75% and 80% during the reviewed period. Looking ahead, we expect the Company's ALMM structure to improve slightly as deposit tenures lengthen amid the prevailing scenario of low interest rates.

Table 2: BFL's ALMM structure

	FY Mar 2009				FY Mar 2008			
Maturity Bucket	Interest Earning Assets	Interest Bearing Liabilities	Gap	Cumulative Gap	Interest Earning Assets	Interest Bearing Liabilities	Gap	Cumulative Gap
Less than 1 Year	705.18	1,888.51	(1,183.33)	(1,183.33)	172.07	881.18	(709.10)	(709.10)
1 to 3 Years	1455.96	555.31	900.65	(282.68)	953.03	514.79	438.24	(270.87)
More than 3 Years	449.39	0.00	449.39	166.71	575.91	0.00	575.91	305.04
Total	**2,610.54**	**2,443.82**	166.71		**1,701.01**	**1,395.97**	305.04	

Formation of ALCO

Meanwhile, BFL has formed an asset-liability management committee ("ALCO"), which we view positively. Nonetheless, the effectiveness of the ALCO can only be assessed over time.

Capital Adequacy

Moderate capitalisation levels

BFL's capital adequacy remains moderate, with its tier-1 and overall RWCARs above the regulatory minimums. We note that weakening asset quality has exerted pressure on the Company's capital position. Its ratio on net NPLs to shareholders' funds deteriorated from 0.32% as at end-FY Mar 2009 to 31.55% as at end-September 2009.

Capital adequate for short-term growth

Meanwhile, BFL's tier-1 RWCAR ratio clocked in at 9.79% as at end-FY March 2009, higher than the regulatory minimum of 5%. On the other hand, its overall RWCAR of 10.55% was only marginally above the regulatory minimum of 10%. By end-September 2009, the tier-1 and overall RWCARs had improved to 11.85% and 12.63%, respectively, after the Company had curtailed lending and augmented its liquid assets, which have lighter risk weights. Nonetheless, we note that the Company's current level of capitalisation is adequate for its business expansion in the more immediate term. Over the long term, however, BFL intends to meet the regulatory capital requirements through internal capital.

Industry Overview

Sri Lanka's gross domestic product ("GDP") expanded 2.1% in 2Q 2009. Although this pales in comparison to the 7.0% attained in 2Q 2008, the slower growth has to be put in the context of the present global downturn. Not surprisingly, all 3 major sectors in Sri Lanka have been hit by the global upheaval.

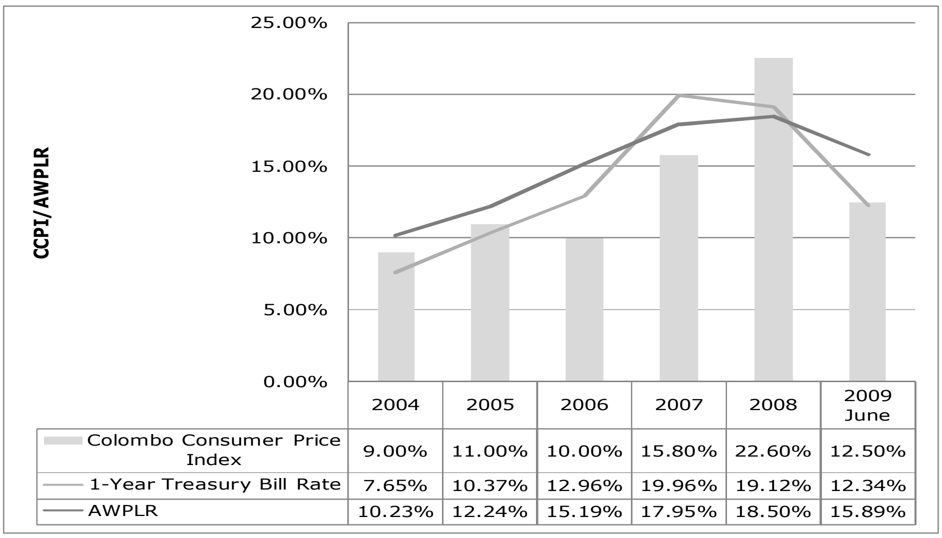
The performance of the primary sector (i.e. agriculture, forestry and fishing) has been dented by a steep fall in tea prices, drought and diminished demand. Although value addition in tea shrank 11.7% in 2Q 2009, this was partially cushioned by the expansion of other food crops, including fishing. Nonetheless, virtually all sub-sectors within the industrial and services industries had advanced at a slower pace, principally due to dampened export demand (refer to Table 3).

Table 3: Sectoral contributions to GDP

Sector	2Q 2008	2Q 2009
Agriculture, forestry and fishing	7.4%	4.4%
Industrial	6.9%	3.0%
Services	6.9%	1.1%
GDP	7.0%	2.1%

On a more positive note, the end of the 25-year war against the separatist Tamil Tigers has spawned renewed hope for the country. The arrival of the long-awaited stand-by-facility from the International Monetary Fund has also helped augment Sri Lanka's depleted foreign-exchange reserves. Moreover, both inflation (as measured by the Colombo Consumer Price Index) and interest rates - which peaked in 2008 - have been consistently easing since early 2009 (refer to Chart 5). While these augur well for the economy, sluggish export demand is still a concern. We observe that the tapering interest rates represent a reversal of the Central Bank's tight monetary policy. While continually lower interest rates may not be sustainable given the country's budget deficit, RAM Ratings Lanka also notes that interest rates would not be as high as in 2008. On the whole, however, we envisage the credit cycle to chart a rising trend.

Chart 5: Movements in Colombo Consumer Price Index and average-weighted prime lending rate



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

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

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

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

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

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

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

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

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

Relevant Central Bank Directions Applicable to Registered Finance Companies

Liquid assets	Every finance company must have a minimum holding of liquid assets at any given time. Liquid assets mean: a) Cash in hand. b) Balances in a current or deposit account in a commercial bank, free from any banker's lien or charge. c) Sri Lankan Government Treasury Bills, free from any charge or lien. d) Sri Lankan Government Securities maturing within 1 year and free from any charge or lien. e) Central Bank securities maturing within 1 year and free from any charge or lien. f) Cash balance, if any, maintained with the Central Bank. The minimum limits are as follows: 1. For time deposits, 15% of outstanding deposits. 2. For certificates of deposits, 15% of the face value of the certificates. 3. For savings deposits, 20% of the outstanding deposits. The companies should maintain the liquid assets in the form of (c), (d) and (e) above, equivalent to 10% of its average month-end deposit liabilities of the preceding financial year.
Provision of bad and doubtful debts	Every finance company had been required to follow either one of the following directions on provisioning for bad and doubtful debts until 1 April 2007: <u>Direction No. 1 of 1991</u> Bad and doubtful debts provided for under this direction are subject to a minimum of: (a) 50% of all advances in arrears for a period of 7 to 12 months. (b) 100% of all advances in arrears for 13 months or more. 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: 1. The value so deducted should not exceed the value decided by a professional valuer at the time of granting the advance. 2. In the case of residential properties occupied by the borrower or a tenant, there should be an agreement to grant vacant possession in the event of the sale of such property. <u>Direction No. 2 of 1991</u> Bad and doubtful debts provided for under this direction are subject to a minimum of: (a) 50% of all advances in arrears for a period of 12 to 24 months. (b) 100% of all advances in arrears for more than 24 months. A new directive came into effect on 1 April 2007 (Direction No. 3 of 2006); this is very similar to Direction 1. However, Direction 3 requires all finance companies to follow a more stringent formula in the calculation of collateral value that is deductible for provisioning purposes.

	With effect from 1 April 2007, Direction No. 3 of 2006 will be applicable to every RFC and will replace Directions 1 and 2. <u>Direction No. 3 of 2006</u> Bad and doubtful debts provided for under this direction are subject to a minimum of: (a) 50% of all advances in arrears for a period of 6 to 12 months. (b) 100% of all advances in arrears for 13 months or more. A finance company may deduct the value of the following items held as collateral in arriving at the amount of provisioning; 1. Sri Lankan Government securities, free from any lien or charge. 2. Central Bank securities, free from any lien or charge. 3. Time deposits in a licensed commercial bank, specialised bank or RFC, free from any lien or charge. 4. Bank guarantees. 5. With regard to repossessed vehicles and machinery, 80% of the valuation obtained in the preceding 6 months and by an approved valuer. 6. With regard to mortgaged land and buildings that are held as collateral, if the accommodation has been in arrears for a period of: a) 6-36 months, 100% of the value is deductible b) 37-60 months, 80% of the value is deductible c) 61-120 months, 50% of the value is deductible d) more than 120 months, 0% of the value is deductible
Capital adequacy	Every finance company must maintain a minimum total risk-weighted capital-adequacy ratio of 10% in relation to its risk-weighted assets. The constituents of the capital are divided into: (a) Tier I - Core Capital This represents permanent shareholders' equity and reserves created or increased by appropriation of retained earnings or other surpluses, including share premiums, retained profits and other reserves. The core-capital ratio should constitute not less than 50%, i.e. this has to be at least half, of the total risk-weighted capital-adequacy ratio. (b) Tier II - Supplementary Capital Represents revaluation reserves, general provisions and other capital instruments which combine certain characteristics of equity and debt, such as hybrid capital instruments and unsecured subordinated debts. Supplementary capital should not exceed 100% of the core capital. The Central Bank also issues guidelines from time to time, to be used in computing total risk-weighted assets.
Single-borrower limit	In the case of an individual borrower, the maximum of a single advance or the aggregate of advances granted to, and the aggregate outstanding at any time on advances granted to, should not exceed 15% of the capital funds of the finance company. This limit is 20% for any group of corporate or unincorporated borrowers with common directors or common partners or common proprietors. Capital funds generally mean paid-up capital and permanent free reserves, and may include unsecured debentures and other loan stocks if approved by the Monetary Board.

Minimum core-capital requirement	Every finance company must at all times maintain an unimpaired core capital of LKR 200 million. However, companies that could not meet this requirement by February 2006 had been granted a 30-month extension, subject to the following: (a) A finance company with a core capital of less than LKR 100 million must: 1. enhance its core capital to at least LKR 100 million by February 2007; and 2. bring the remaining LKR 100 million or the deficit up to the core-capital requirement of LKR 200 million by July 2008. (b) A finance company with a core capital of between LKR 100 million and LKR 200 million must bring in: 1. at least 50% of the deficient amount to meet the core-capital requirement of LKR 200 million by February 2007; and 2. the balance of the deficient amount up to the core capital requirement of LKR 200 million by July 2008.
Investments	A finance company must not invest in the shares of any company (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 (b) In aggregate, in excess of 25% of the capital funds of the finance company 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.

Corporate Information

Date of Incorporation: 30 November 1983

Commencement of Business: 1983

Major Shareholders:

M/s Bartleet TransCapital Ltd	87%
Mr SFH Fernando	3%
Mr Mallory Eraj Wijeshinghe	2%
M/S Gayani Weerasekara nee Abeywardene	2%
Europa Finance & Investment (Pvt) Ltd	2%

Directors:

Mr M Eraj Wijesinghe	Chairman
Mr Sunil Wijesinghe	Director
Mr Eshantha Wijesinghe	Director
Mr Indrajith Fernando	Director
Mr Buwaneka Subasinghe	Director
Mr Susantha de Alwis	Director
Mr Selvaretnam Raghavan	Director

Auditor: BDO Burah Hathy

Listing: Not listed

Key Management:

Mr M Eraj Wijesinghe	Chairman / Managing Director
Mr Sampath Nishantha	General Manager
Mr Samantha Perera	Deputy General Manager Finance & Planning
Mr Nishantha Perera	Assistant General Manager - Admin. & IT
Mr Ajith Edirisinghe	Assistant General Manager

Major Subsidiaries and Associates: None

Capital History:

Year	Remarks	Amount (LKR million)	Cumulative Total (LKR million)
1983	Ordinary shares issued	1.5	1.5
1986	Rights issue	2.0	3.5
1987	Rights issue	3.0	6.5
1988	Rights issue	0.5	7.0
1998	Bonus issue	7.0	14.0
2003	Rights issue	15.5	29.5
2004	Rights issue	1.1	30.6
2005	Rights issue	30.6	61.2

Financial Summary - Company

BALANCE SHEET (LKR Million)	31-Mar-06	31-Mar-07	31-Mar-08	31-Mar-09	30-Sep-09
ASSETS					
Cash & Money At Call	99.35	95.33	113.69	22.61	49.68
Deposits & Placements With Financial Institutions	16.35	1.22	8.25	9.59	489.84
Securities Purchased Under Resale Agreements	0.00	0.00	0.00	0.00	0.00
Securities					
Dealing Securities	121.22	147.75	35.65	27.24	98.08
Investment Securities	36.41	37.57	276.38	128.43	258.03
Gross Loans & Advances	1,596.70	1,802.86	2,240.97	2,330.39	2,189.63
Interest-In-Suspense	10.28	7.36	5.47	2.04	9.89
General Loan Loss Reserves	0.00	0.00	0.00	0.00	0.00
Specific Loan Loss Reserves	88.74	94.49	78.47	68.81	80.81
Net Loans & Advances	1,497.68	1,701.01	2,157.04	2,259.54	2,098.93
Investments in Subsidiaries/Associates	0.00	0.00	0.00	0.00	0.00
Investment Land and Properties	21.09	30.30	54.94	102.46	103.70
Other Assets	18.14	21.50	23.54	14.37	27.85
Property, Plant and Equipment	133.58	148.01	252.22	297.04	311.64
TOTAL ASSETS	**1,943.81**	**2,182.69**	**2,921.72**	**2,861.27**	**3,437.75**
LIABILITIES					
Customer Deposits					
Savings	0.00	0.00	0.00	0.00	0.00
Fixed	1,197.29	1,395.97	2,067.45	2,156.38	2,583.42
NIDs	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	0.00	0.00	0.00	0.00
Other Borrowing	318.96	258.12	179.92	149.02	213.65
Subordinated Debt & Hybrid Capital	0.00	0.00	0.00	0.00	0.00
Other Liabilities	173.53	228.30	361.55	320.27	283.85
TOTAL LIABILITIES	**1,689.79**	**1,882.38**	**2,608.92**	**2,625.67**	**3,080.92**
Paid-up Capital	61.20	61.20	61.20	61.20	61.20
Minority Interest	0.00	0.00	0.00	0.00	0.00
Share Premium & Other Reserves	55.40	111.40	111.40	111.40	111.40
Statutory General Reserve	39.07	70.00	81.39	87.76	81.39
Retained Profits/(Loss)	98.35	57.70	58.80	84.24	102.83
Total Shareholders' Funds	**254.03**	**300.31**	**312.80**	**344.60**	**356.83**
TOTAL LIABILITIES & SHAREHOLDERS' FUNDS	**1,943.81**	**2,182.69**	**2,921.72**	**2,970.27**	**3,437.75**
COMMITMENTS & CONTINGENCIES	**180.00**	**190.00**	**142.00**	**59.95**	**0.00**
TIER 1 CAPITAL	**201.88**	**284.35**	**325.29**	**265.56**	**315.43**
CAPITAL BASE	**222.58**	**305.05**	**345.99**	**286.26**	**336.13**

Financial Summary - Company

INCOME STATEMENT (LKR Million)	31-Mar-06	31-Mar-07	31-Mar-08	31-Mar-09	30-Sep-09
Interest Income	414.37	508.00	677.53	834.65	372.99
Less: Amortisation Of Premium/(Accretion Of Dis	0.00	0.00	0.00	0.00	0.00
Less: Net Interest Suspended	0.00	0.00	0.00	0.00	0.00
Less: Interest Expense	171.79	211.30	369.27	566.46	273.56
Net Interest Income	242.58	296.69	308.26	268.20	99.43
Non-Interest Income	21.52	28.47	34.05	55.72	22.60
Gross Income	**264.10**	**325.16**	**342.31**	**323.92**	**122.03**
Personnel Expenses	40.94	62.27	72.06	80.05	50.68
Other Non-Interest Expenses	90.94	155.63	198.77	187.75	71.91
Loan Loss Provisions	28.54	42.62	9.64	17.51	(3.84)
Share of results of Associated Companies	0.00	0.00	0.00	0.00	0.00
Pre-Tax Profit	**103.68**	**64.65**	**61.85**	**38.61**	**3.28**
Taxation	0.00	0.00	12.75	6.81	0.00
Profit After Tax	**103.68**	**64.65**	**49.10**	**31.80**	**3.28**
Extraordinary Items	0.00	0.00	0.00	0.00	0.00
Prior Year Adjustments	0.00	0.00	0.00	0.00	0.00
Minority Interests	0.00	0.00	0.00	0.00	0.00
Transfer To Statutory Reserves	20.74	30.93	11.39	6.36	0.00
Transfer To Other Reserves	0.00	56.00	0.00	0.00	0.00
Dividend	12.24	18.36	12.35	0.00	0.00
Retained Profit For The Year	**70.71**	**(40.65)**	**25.35**	**25.44**	**3.28**

Financial Ratios - Company

KEY RATIOS (%)	31-Mar-06	31-Mar-07	31-Mar-08	31-Mar-09	30-Sep-09
Profitability					
Net Interest Margin	14.25%	14.38%	12.08%	9.28%	6.31%
Non-Interest Income Margin	1.26%	1.38%	1.33%	1.93%	1.44%
Cost To Income	49.94%	67.01%	79.12%	82.67%	100.46%
Return On Assets	6.09%	3.13%	2.42%	1.34%	0.21%
Return On Equity	49.78%	23.32%	20.17%	11.75%	1.86%
Dividend Payout	11.81%	28.40%	25.15%	0.00%	0.00%
Asset Quality					
Gross NPL Ratio	7.79%	4.44%	3.33%	3.00%	8.87%
Net NPL Ratio	2.33%	(0.87%)	(0.19%)	0.05%	5.36%
Specific Loan Loss Provisions For Current Year	2.00%	2.74%	1.08%	1.15%	0.00%
Gross NPL Coverage	71.77%	118.54%	105.39%	98.41%	41.79%
Loan Loss Reserve Coverage	5.59%	5.26%	3.51%	2.96%	3.71%
Liquidity & Funding					
Statutory Liquid Asset Ratio	19.95%	17.64%	18.92%	7.09%	28.77%
Customer Deposits To Total Interest Bearing Funds	78.96%	84.40%	91.99%	93.54%	92.36%
Loans To Deposits Ratio	125.09%	121.85%	104.33%	104.78%	81.25%
Loans To Stable Funds Ratio	91.51%	94.17%	93.46%	96.03%	73.85%
Capital Adequacy					
Shareholders' Funds To Total Assets	13.07%	13.76%	10.71%	12.04%	10.38%
Tier 1 Risk Weighted Capital Adequacy Ratio	11.94%	14.64%	13.15%	9.79%	11.85%
Overall Risk Weighted Capital Adequacy Ratio	13.17%	15.71%	13.99%	10.55%	12.63%
Internal Rate Of Capital Generation	43.90%	16.70%	11.99%	9.67%	1.86%

Note :

* annualised

NA = Not available

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	The Financial institutions 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	The Financial institutions 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	The Financial institutions 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	The 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	The 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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