

RAM

RATINGS

CREDIT RATING RATIONALE

FINANCIAL INSTITUTIONS – SRI LANKA

A wholly owned subsidiary of RAM Holdings Berhad

PEOPLE'S MERCHANT FINANCE COMPANY LTD (formerly known as Silvereen Finance Company Ltd) - Rating Review

Financial Institution Ratings:

Long-term: BBB-[Upgraded]
Short-term: P3 [Upgraded]

Rating Outlook:

Stable

Previous Ratings:

Long-term: B+

Short-term: NP

Last Rating Action

March 2009

Strengths:

- State-owned parent
- Moderate credit standards

Weaknesses:

- Small stature
- Integration risks

Principal Activities:

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

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Summary

RAM Ratings Lanka has upgraded People's Merchant Finance Company Ltd's ("PMFC" or "the Company") long-term financial institution rating by 4 notches, from B+ to BBB-, with a stable outlook. Its short-term rating has also been revised from NP to P3. Concurrently, the Rating Watch (with a developing outlook) on PMFC's rating has been lifted. The steep upward revision of the Company's ratings is premised on the financial flexibility derived from its new ultimate, state-owned parent, People's Bank ("PB" or "the Bank").

PMFC is a small registered finance company ("RFC") that falls within the regulatory purview of the Central Bank of Sri Lanka ("Central Bank"); the Company had an asset base of LKR 299.67 million as at end-March 2009. In March 2009, People's Merchant Bank PLC ("PMB") acquired 44.02% of PMFC. In June 2009, PMB raised its stake to 99.90%, and renamed the Company as PMFC. In mid-October, PMB announced that it intended to amalgamate the assets and liabilities of PMFC by FYE 31 March 2010 ("FY Mar 2010"). PMB is an associate company of People's Bank (which owns a 39.20% stake), the second largest commercial bank in Sri Lanka. PMB's shares are listed on the Colombo Stock Exchange. PMB is presently a small specialised leasing company ("SLC"), with an asset base of LKR 2.84 billion; it comes under the regulatory umbrella of the Central Bank.

PMB's largest funding source is its ultimate parent, PB. As at end-March 2009, the Bank had extended LKR 660 million of facilities to PMB; this accounted for approximately 45% of the latter's bank borrowings. In addition, PMB has announced a rights issue for which its parent has already pledged support. PMB intends to raise LKR 250 million to retire its outstanding debentures and other short-term borrowings.

While we note that the integration process is likely to introduce additional risks, we also acknowledge that the quality of PMFC's loans is poised to improve as it adopts PMB's underwriting standards. PMB implements a more stringent 3-month classification policy when it comes to recognising non-performing loans ("NPLs"). That said, its absolute gross NPLs surged 285.02% (annualised) to LKR 700.51 million as at end-September 2009, and is viewed with concern. Although this had been largely due to weaker economic fundamentals, RAM Ratings Lanka expects the Company's NPLs to ease over the medium term, in line with the expected economic recovery.

On a separate note, the assets and liabilities of PMFC will be absorbed by PMB after the merger; PMFC will cease to exist after that. Under the circumstances, RAM Ratings Lanka would no longer have any rating obligations on PMFC.

Outlook

The stable rating outlook is based on the implied support from PMFC's ultimate parent, PB.

Corporate Profile

PMFC had previously been known as Silvereen Finance Company Ltd. Incorporated in 1981, the entity had been registered under the Finance Companies Act No. 78 of 1988 and is regulated by the Central Bank.

PMFC remains one of the smallest RFCs in Sri Lanka, with an asset base of only LKR 299.67 million as at end-FY Mar 2009. Its main operations include leasing, hire-purchase ("HP") financing, provision of demand, mortgage and other loans, and accepting public deposits.

Ownership and Group Assessment

PMFC had formerly been a closely held family concern. Its former chairman and his family members had owned a collective 63.60% stake. Meanwhile, 4 other directors had held a combined 36.21%; the remaining equity had been owned by a number of minority shareholders. In 2008, about 44.02% of the Company's shares were sold to ABC Credit Card Company ("ABC"). However, the collapse of the Golden Key Credit Card Company had severely affected ABC and, in turn, the newly acquired PMFC.

In a bid to stabilise ABC, PMB acquired the entire equity of ABC in March 2009 – in doing so, it had also bought 44.02% of PMFC. Concurrently, PMB had signed an agreement to acquire the remaining 55.88% of PMFC, with the intention of gaining an RFC licence. Consequent to the acquisition, PMB had changed the Company's name to PMFC. Going forward, PMB intends to merge its assets and liabilities with those of PMFC and thus become an RFC.

At present, PMB is a small SLC regulated by the Central Bank. As an SLC, it is prohibited from accepting public deposits. With the intended merger, however, PMB will be able to take public deposits and enhance its funding sources.

PMB is also an associate company of PB (refer to Chart 1), which is a state-owned bank. Moreover, PB is the second-largest commercial bank in Sri Lanka. Currently, PMB has 9 branches that disburse leases and HP advances. Subsequent to the merger, PMB intends to mobilise deposits from these offices too.

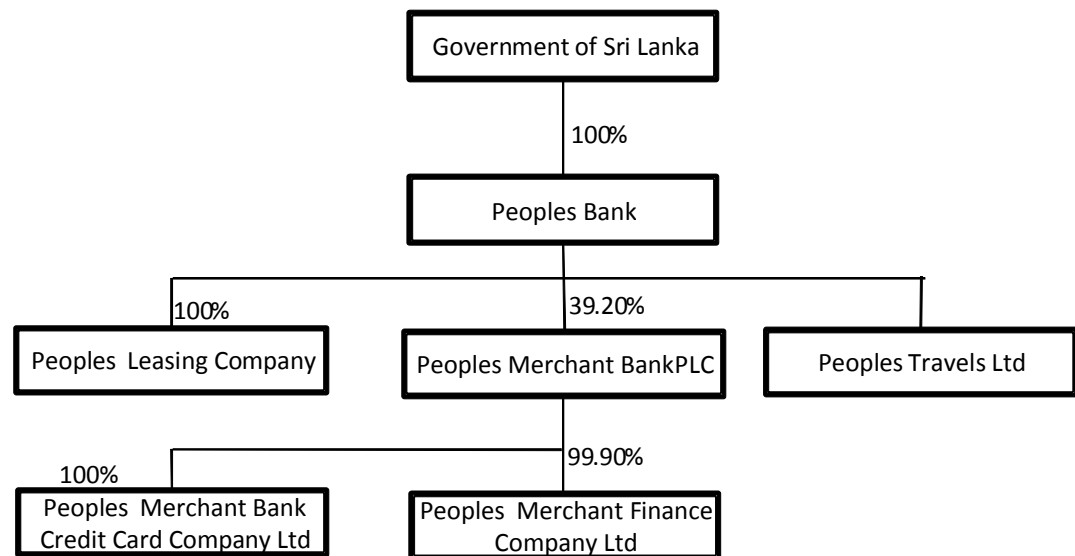
Remains a small player

Acquired by PMB

Acquisition enhances PMB's funding structure

PMB's state lineage

Chart 1: Group structure



Financial flexibility of PB

PB is the second-largest commercial bank in Sri Lanka. As at end-June 2009, its assets amounted to LKR 442.64 billion. The Bank posted a pre-tax profit of LKR 1.31 billion in 1H FYE 31 December 2009 (refer to Table 1). The Bank is a systemically important part of the Sri Lankan economy, and recently benefited from the state treasury’s LKR 1.5 billion capital injection. RAM Ratings Lanka notes that post-merger, PMB’s asset base is likely to remain below LKR 4 billion, which translates to less than 1% of its parent’s asset base.

Also within the same group, People’s Leasing Company (“PLC”) is Sri Lanka’s largest leasing company, with an asset base of LKR 25.54 billion (refer to Table 1). The Company is financially sound and independent, with LKR 1.88 billion of pre-tax profit in FY Mar 2009. During 2009, PLC acquired Seylan Merchant Leasing Company PLC.

Table 1: Financial profile of PB and PLC

LKR million	PB		PLC	
	1H FY Dec2009	FY Dec 2008	FY Mar 2009	FY Mar 2008
Total assets	442,640	397,547	25,538	20,672
Shareholders' funds	17,080	15,880	5,439	3,617
Pre-tax profit	1,310	1,112	1,890	1,353

Management & Strategies

The management of PMB is led by Mr Anura R Wickremasinghe, the Company’s managing director/chief executive officer (“MD/CEO”) who came on board in July 2009. Mr Wickremasinghe had previously been the chief representative/executive director of JP Morgan in Sri Lanka. The MD/CEO is assisted by chief financial officer, Anura Wickrematunge, and deputy general manager Charith Guneratne.

PMB’s acquisition of 99.90% of PMFC had been to broaden its funding avenues and thus improve its business model, by mobilising public deposits. It also intends to launch savings accounts once appropriate internal systems have been established. As an SLC, the Company had relied on securitised financing and bank funding, which had limited its expansion capacity.

Professional management team

Subsequent to its acquisition by PMB, the Company has adopted the underwriting standards of its parent. Going forward, PMB intends to add pawning advances (pawning of gold) to PMFC's array of lending products. The management also aims to make real estate and property development into integral components of PMFC's asset base.

To take advantage of the anticipated economic recovery, the Company aims to establish branches in Anuradhapura and Trincomalee before end-March 2010. The management also plans to open 2 more branches in 2010, although the locations have yet to be identified.

We note that investment/merchant banking in Sri Lanka has been virtually non-existent since the stock market crash in the late 1990s. On this note, PMB intends to resume its investment-banking activities over the medium term. Through this, it intends to augment its fee-based income sources.

Corporate Governance & Risk Management

The Company's 8-member board convenes monthly. The board is composed of 5 non-executive directors, of whom 2 are independent. We note that 2 of the non-executive board members are from People's Bank. In addition, PMB has audit, credit and remuneration committees. RAM Ratings Lanka has a positive view of the governance practices of PMB, which would ultimately benefit PMFC.

Under the former stewards, PMFC had adopted a basic risk-management framework. With the prospective integration of PMB's activities and processes, however, we expect an improvement in the Company's risk-management practices. Although integration risks are likely to arise during the merger process, the management of PMB is deemed to have the requisite expertise to manage these risks.

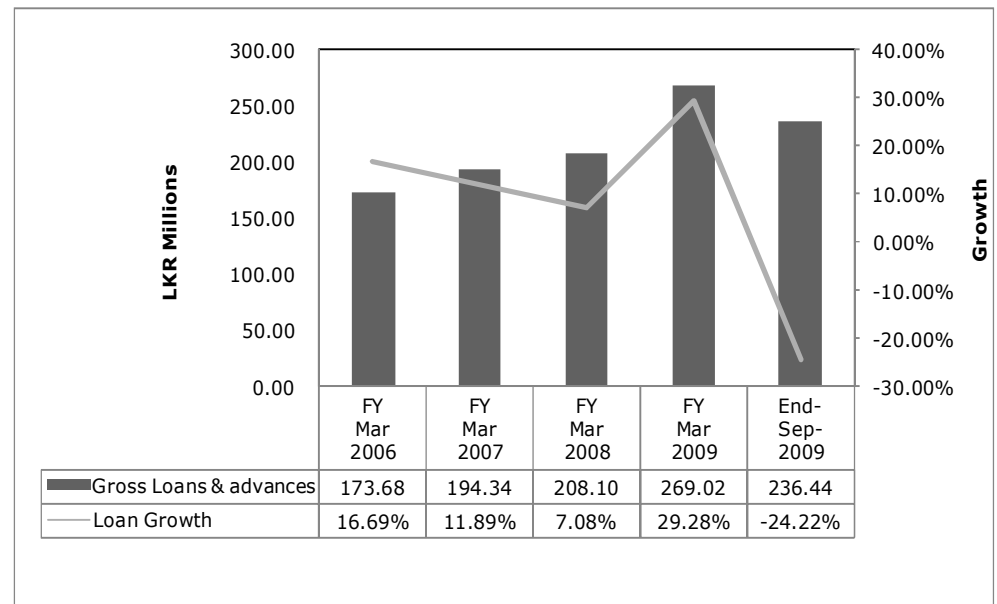
Asset Quality

RAM Ratings Lanka had previously considered the Company's asset quality as being extremely weak. The Company had been plagued by a high level of delinquencies, which continues to be the case. Over the medium to long term, however, we opine that the Company's adoption of its parent's underwriting standards, together with the more positive macroeconomic sentiments, will aid the improvement of its asset quality.

Loans have been dominating PMFC's asset base. Its net credit assets augmented 29.47% year-on-year ("y-o-y") to LKR 257.11 million as at end-March 2009. Concurrently, the lending portfolio's portion of its balance sheet increased from 78.35% as at end-FY Mar 2008 to 85.80% as at end-FY Mar 2009. Correspondingly, the Company's treasury assets contracted from 12.24% to 6.16% over the same span. However, over the ensuing 6 months, liquid assets reverted to historical levels. In addition, the Company's credit portfolio had shrunk resulting in a contraction of the asset base (refer to Chart 2).

Asset quality likely to improve over the medium term

Chart 2: Loan growth of PMFC



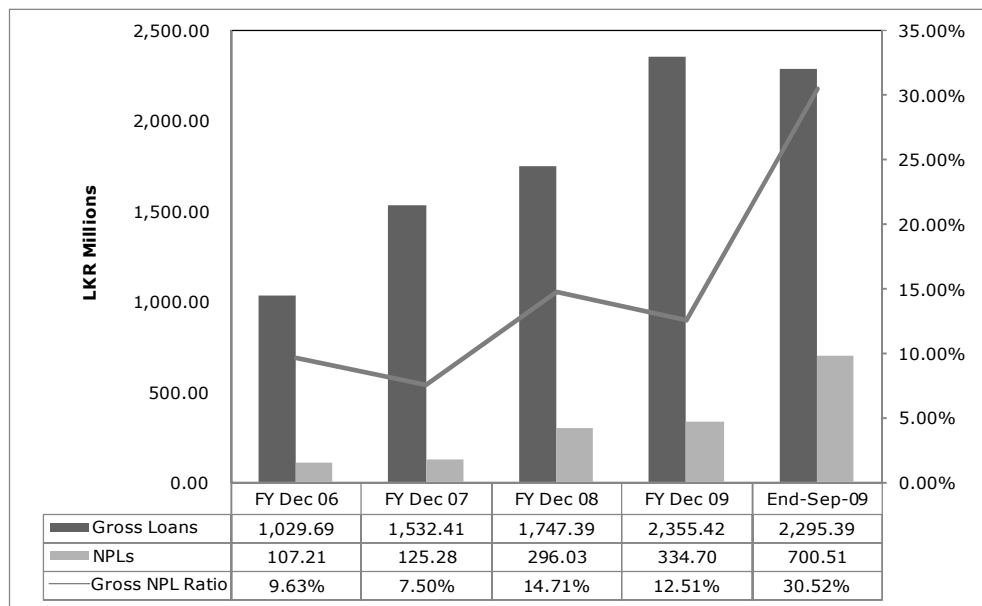
The Company’s portfolio health has also deteriorated. PMFC’s absolute NPLs increased from LKR 45.09 million as at end-March 2008 to LKR 63.66 million a year later. Simultaneously, its gross NPL ratio worsened from 22.22% to 24.21% over the same period. In the ensuing 6 months, its NPLs increased further to LKR 70 million. Given the Company’s shrinking loan portfolio and rising NPLs, its gross NPL ratio escalated to 30.55% as at end-September 2009.

Over the medium term, PMFC’s asset quality is poised to improve as it has already adopted the more stringent underwriting standards of PMB. Due to severe competition, PMFC had traditionally catered to a more risky segment of borrowers. Under the current management, the Company will have a much broader geographical reach and thus be able to compete much more effectively. Consequently, RAM Ratings Lanka opines that PMFC will be able to extend advances to better-quality borrowers, albeit within the much wider segment of small and medium-scale enterprises (or SMEs).

At present, credit assets make up about 80% of PMB’s balance sheet. Although advances had earlier constituted as much as 90% of its total assets, investments in real estate and the acquisition of ABC and PMFC has resulted in a contraction of advances to total assets. Meanwhile, vehicle financing in the form of leases and HP make up about 75% of PMB’s advances; the balance comprises bills of exchange, term and real-estate loans. Even though pawning advances are on the cards, RAM Ratings Lanka anticipates vehicle financing to still dominate the Company’s advances over the medium term.

PMB’s asset quality has been traditionally in line with that of the industry. However, its gross NPLs had surged 285.02% (annualised basis) to LKR 700.51 million by end-September 2009 owing to weak macroeconomic fundamentals (refer to Chart 3). As PMFC’s gross NPLs are small in proportion to those of PMB, the expected amalgamation of the Company’s assets will have a subdued impact on PMB’s NPLs. Based on the improving economic outlook, RAM Ratings Lanka anticipates an improvement in PMB’s credit portfolio over the medium term.

Chart 3: Trends in PMB’s loans and NPLs (on a 3-month classification basis)



PMB considers real estate as an integral part of its investment portfolio. Nonetheless, its exposure to this asset class has been modest. Real-estate investments accounted for 4.22% (or LKR 119.86 million) of its assets as at end-September 2009 (end-March 2009: LKR 156.48 million). Prospectively, RAM Ratings Lanka expects a modest increase in this segment.

Performance

PMFC’s currently feeble loan portfolio is also reflected in its financial performance. Although the Company’s profit performance has been deteriorating, its financial profile is expected to strengthen over the long haul, underpinned by the anticipated improvement in its asset quality.

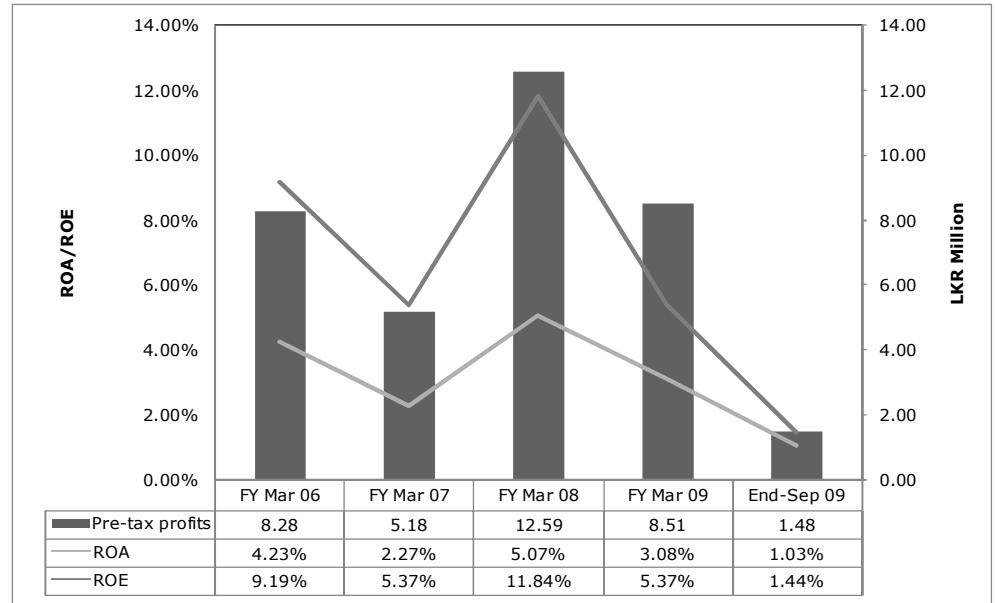
Gross income augmented by a respectable 34.44% during FY Mar 2009. Even though this is modest in comparison to the 48.83% of the previous year, we note that the advancement had been driven by loan growth. In FY Mar 2008, the Company’s gross income had been lifted by a one-off disposal of fixed assets. In 1H FY Mar 2010, its net interest income contracted as a result of its shrinking credit portfolio. In the same vein, non-interest income had also diminished.

In line with the above, the Company’s pre-tax profit declined to LKR 8.51 million in FY Mar 2009 (FY Mar 2008: LKR 12.59 million). The downtrend continued in the ensuing 6 months. In tandem with this, both its return on assets (“ROA”) and return on equity (“ROE”) had receded (refer to Chart 4).

Performance expected to be frail in short term

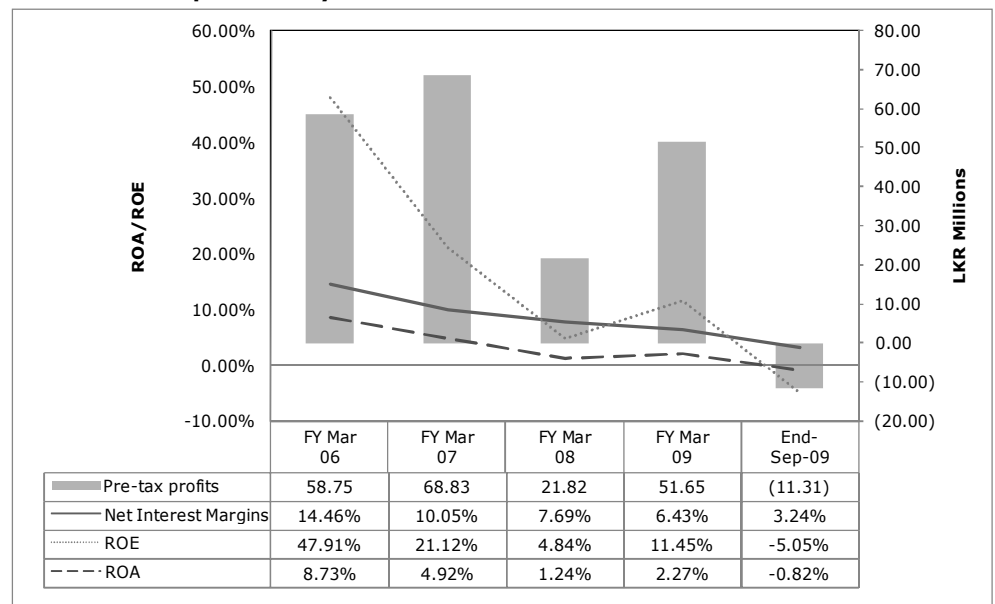
Finance costs to erode profits in near term

Chart 4: Profitability trends of PMFC



PMB’s profit performance has been weak over the past 3 years, a consequence of its receding margins (refer to Chart 5). In the last 3 years, interest expenses have outpaced the growth of interest income. Over the medium term, however, interest rates are envisaged to recede, which is likely to help the Company’s financial performance. Nonetheless, PMB’s performance FY Mar 2010 is expected to be affected by the high financing costs associated with the acquisitions of ABC and PMFC (refer to section on Funding & Liquidity)

Chart 5: PMB’s profitability trends



On a related note, the Company’s performance is also linked to demand for real estate. In FY Mar 2006, approximately 70% of its non-interest income had stemmed from real-estate income. Over the subsequent years, the composition of real estate income on non-interest income receded 43.00% as at end-FY Mar 2009. PMB recognises the entire profit on a real-estate transaction once the buyer has out up a 25% down payment. As such, its profit performance is somewhat removed from its cashflow.

Funding and liquidity levels to moderate

Funding & Liquidity

PMFC has traditionally maintained comfortable liquidity levels. In addition, the Company has been chiefly meeting its funding requirements through shareholders’ funds, rather than deposits. Both these attributes had assisted the Company to weather the deposit crisis. However, deposits have been receding of late, as PMFC has revised its deposit rates downwards.

Meanwhile, the Company’s asset-liability maturity mismatch (“ALMM”) tenures have stayed positive (refer to Table 2). Going forward, RAM Ratings Lanka expects the Company’s ALM profile to shift as the new management resumes its lending activities. We also note that PMFC has instituted an ALM committee that monitors and manages liquidity and interest-rate risks.

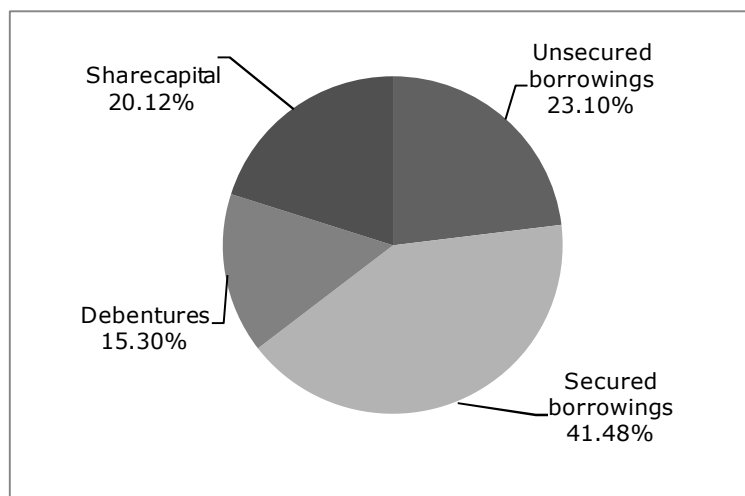
Table 2: Asset-and-liability maturity profile of PMFC as at end-September 2009

	Less than 6 months	6-12 months	1-3 years	Over 3 years
Interest-earning assets	202.74	17.00	2.88	9.46
Interest-bearing Liabilities	39.89	21.06	7.30	1.67

As an SLC, the Company depends on bank borrowings (refer to Chart 6). Subsequent to the acquisition of ABC and PMFC, PMB’s financing risks have heightened. PMB had raised LKR 310 million of debt for the acquisitions; it had partly retired its debentures through the fresh borrowings. PMB will retire its remaining LKR 100 million of debentures in FY Mar 2010.

Despite these re-financing risks, we note that PMB already has plans to raise LKR 250 million via a rights issue. People’s Bank, PMB’s parent, is its single-largest lender, accounting for approximately 45% of the latter’s bank borrowings. RAM Ratings Lanka views this as an indication of the ultimate parent’s implied support.

Chart 6: PMB’s funding structure as at FY Mar 2009

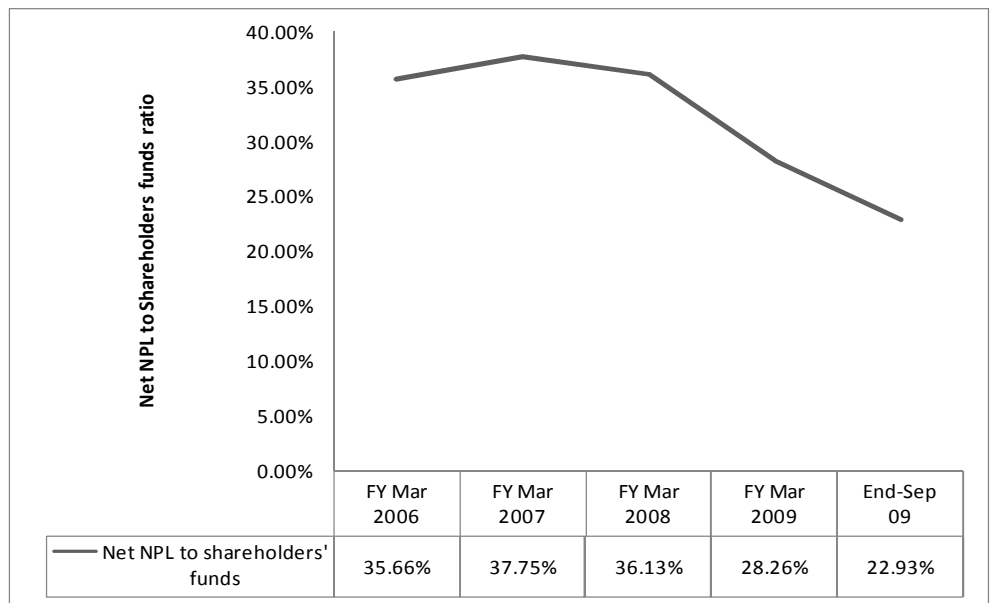


Statutory capital to normalise over the medium term

Capital Adequacy

PMFC has traditionally maintained high capitalisation levels. The Company reported lofty Tier-1 and overall risk-weighted capital-adequacy ratios ("RWCARs") of 78.01% as at end-September 2009. As such, PMFC has ample room to expand over the short to medium term. Despite the Company's healthy statutory capitalisation levels, RAM Ratings Lanka's concerns had previously hinged on PMFC's escalating NPLs and their impact on its capital cushioning. During the reviewed period, however, there was an improving trend in its ratio on net NPLs to shareholders' funds (refer to Chart 7), backed by a capital infusion to meet the regulator's minimum core-capital requirement of LKR 200 million.

Chart 7: Ratio on net NPLs to shareholders' funds



Going forward, RAM Ratings Lanka expects the Company's statutory capital-adequacy levels to recede to industry levels as the new management team resumes lending activities.

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.

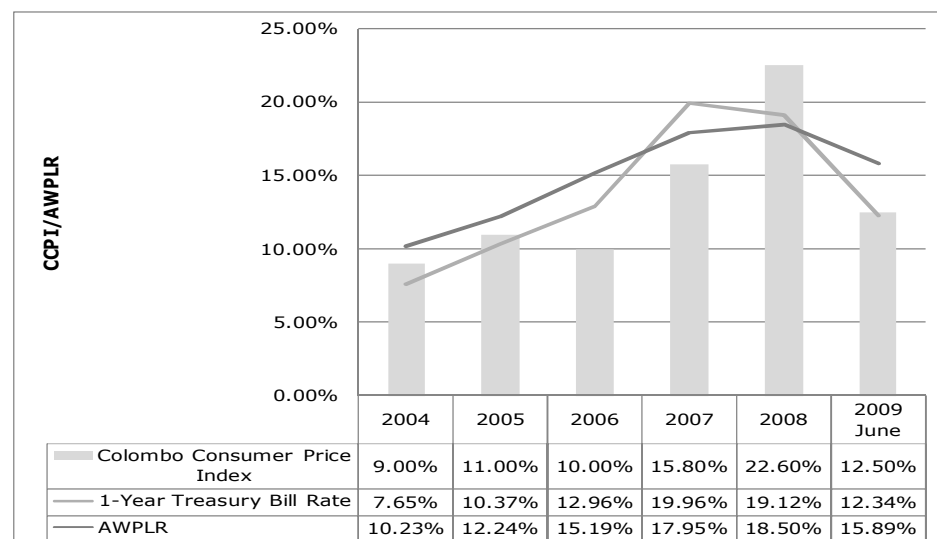
The performance of the primary sector (i.e. agriculture, forestry and fishing) has been dented by a steep fall in tea prices, drought and diminished demand. Although value addition in tea shrank 11.7% in 2Q 2009, this was partially cushioned by the expansion of other food crops, including fishing. Nonetheless, 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		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 8). 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 8: 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

<p>Liquid assets</p>	<p>Every finance company must have a minimum holding of liquid assets at any given time. Liquid assets mean:</p> <ol style="list-style-type: none"> 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. <p>The minimum limits are as follows:</p> <ol style="list-style-type: none"> 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. <p>The companies should maintain the liquid assets in the form of (c), (d) and (e) above, equivalent to 10% of its average month-end deposit liabilities of the preceding financial year.</p>
<p>Provision of bad and doubtful debts</p>	<p>Every finance company had been required to follow either one of the following directions on provisioning for bad and doubtful debts until 1 April 2007:</p> <p><u>Direction No. 1 of 1991</u></p> <p>Bad and doubtful debts provided for under this direction are subject to a minimum of:</p> <ol style="list-style-type: none"> (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. <p>A company may deduct the value of land and buildings held as collateral for a particular advance, in arriving at the provision figure under both (a) and (b) above, subject to the following conditions:</p> <ol style="list-style-type: none"> 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. <p><u>Direction No. 2 of 1991</u></p> <p>Bad and doubtful debts provided for under this direction are subject to a minimum of:</p> <ol style="list-style-type: none"> (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. <p>A new directive came into effect on 1 April 2007 (Direction No. 3 of 2006); this is very similar to Direction 1. However, Direction 3 requires all finance companies to follow a more stringent formula in the calculation of collateral value that is deductible for provisioning purposes.</p>

	<p>With effect from 1 April 2007, Direction No. 3 of 2006 will be applicable to every RFC and will replace Directions 1 and 2.</p> <p><u>Direction No. 3 of 2006</u></p> <p>Bad and doubtful debts provided for under this direction are subject to a minimum of:</p> <p>(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.</p> <p>A finance company may deduct the value of the following items held as collateral in arriving at the amount of provisioning;</p> <ol style="list-style-type: none"> 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: <ol style="list-style-type: none"> 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
<p>Capital adequacy</p>	<p>Every finance company must maintain a minimum total risk-weighted capital-adequacy ratio of 10% in relation to its risk-weighted assets. The constituents of the capital are divided into:</p> <p>(a) Tier I - Core Capital</p> <p>This represents permanent shareholders' equity and reserves created or increased by appropriation of retained earnings or other surpluses, including share premiums, retained profits and other reserves. The core-capital ratio should constitute not less than 50%, i.e. this has to be at least half, of the total risk-weighted capital-adequacy ratio.</p> <p>(b) Tier II - Supplementary Capital</p> <p>Represents revaluation reserves, general provisions and other capital instruments which combine certain characteristics of equity and debt, such as hybrid capital instruments and unsecured subordinated debts. Supplementary capital should not exceed 100% of the core capital.</p> <p>The Central Bank also issues guidelines from time to time, to be used in computing total risk-weighted assets.</p>
<p>Single-borrower limit</p>	<p>In the case of an individual borrower, the maximum of a single advance or the aggregate of advances granted to, and the aggregate outstanding at any time on advances granted to, should not exceed 10% of the capital funds of the finance company.</p> <p>This limit stands at 15% for any group of corporate or unincorporated borrowers with common directors or common partners or common proprietors.</p> <p>Capital funds generally mean paid-up capital and permanent free reserves, and may include unsecured debentures and other loan stocks if approved by the Monetary Board.</p>

<p>Minimum core-capital requirement</p>	<p>Every finance company must at all times maintain an unimpaired core capital of LKR 200 million. However, companies that could not meet this requirement by February 2006 had been granted a 30-month extension, subject to the following:</p> <p>(a) A finance company with a core capital of less than LKR 100 million must:</p> <ol style="list-style-type: none"> 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. <p>(b) A finance company with a core capital of between LKR 100 million and LKR 200 million must bring in:</p> <ol style="list-style-type: none"> 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.
<p>Investments</p>	<p>A finance company must not invest in the shares of any company</p> <p>(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</p> <p>(b) In aggregate, in excess of 25% of the capital funds of the finance company</p> <p>Capital funds generally mean paid-up capital and permanent free reserves, and may include unsecured debentures and other loan stocks if approved by the Monetary Board.</p>

Corporate Information

Date of Incorporation:	November 1981		
Commencement of Business:	1981		
Major Shareholders:	Peoples Merchant Finance PLC	90.90%	
Directors:	Mr Aruna R Wickremasinghe Mr Anura Wickramatunge Mr PV Pathirana Mr Ahamed Sabry Ibrahim	Chairman Director/Chief Executive Officer Director Director	
Auditor:	Ernst & Young		
Listing:	Not listed		
Key Management:	Mr Aruna R Wickremasinghe Mr Anura Wickramatunge Mr Jeewana De Karunasiri	Chairman Chief Executive Officer Assistant General Manager	
Major Subsidiaries and Associates:			
Capital History:			
	Year	Remarks	Amount (LKR million)
			Cumulative Total (LKR million)
	2007	Brought Forward	25.24
	2008	Share issue	7.57
	2009	Share issue	0.06
		Share issue	88.03
			120.90

Financial Summary - Company

	Unaudited				
BALANCE SHEET (LKR Million)	31-Mar-06	31-Mar-07	31-Mar-08	31-Mar-09	30-Sep-09
ASSETS					
Cash & Money At Call	6.59	7.29	4.42	2.13	18.32
Deposits & Placements With Financial Institutions	1.45	5.04	0.00	0.00	0.00
Securities Purchased Under Resale Agreements	0.00	0.00	0.00	0.00	0.00
Securities					
Dealing Securities	9.19	12.48	26.60	16.33	12.58
Investment Securities	0.00	0.00	0.00	0.00	0.00
Gross Loans & Advances	173.68	194.34	208.10	269.02	236.44
Interest-In-Suspense	7.04	8.36	5.15	6.05	6.58
General Loan Loss Reserves	0.00	0.00	0.00	0.00	0.00
Specific Loan Loss Reserves	4.39	3.82	4.37	5.87	22.99
Net Loans & Advances	162.26	182.15	198.58	257.11	206.87
Investments in Subsidiaries/Associates	0.00	0.00	0.00	0.00	0.00
Investment Land and Properties	0.00	0.00	0.00	0.00	0.00
Other Assets	6.52	10.24	9.83	9.90	22.06
Property, Plant and Equipment	26.43	26.59	14.02	14.20	16.56
TOTAL ASSETS	212.44	243.78	253.46	299.67	276.40
LIABILITIES					
Customer Deposits					
Savings	0.00	0.00	0.00	0.00	0.00
Fixed	90.22	112.14	114.02	79.50	69.93
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	18.59	14.46	10.44	4.76	0.00
Subordinated Debt & Hybrid Capital	0.00	0.00	0.00	0.00	0.00
Other Liabilities	10.67	17.10	16.29	10.94	0.51
TOTAL LIABILITIES	119.48	143.70	140.74	95.20	70.44
Paid-up Capital	25.24	32.81	32.87	120.90	120.90
Minority Interest	0.00	0.00	0.00	0.00	0.00
Share Premium & Other Reserves	0.06	60.06	60.00	60.00	60.00
Statutory General Reserve	4.49	4.84	5.48	8.88	8.88
Retained Profits/(Loss)	63.18	2.37	14.37	14.69	16.18
Total Shareholders' Funds	92.96	100.09	112.72	204.47	205.96
TOTAL LIABILITIES & SHAREHOLDERS' FUNDS	212.44	243.78	253.46	299.67	276.40
COMMITMENTS & CONTINGENCIES	0.00	0.00	0.00	0.00	0.00
TIER 1 CAPITAL	87.36	100.09	112.56	210.38	205.96
CAPITAL BASE	87.36	100.09	112.56	210.38	205.96

Financial Summary - Company

	Unaudited				
INCOME STATEMENT (LKR Million)	31-Mar-06	31-Mar-07	31-Mar-08	31-Mar-09	30-Sep-09
Interest Income	30.86	35.10	40.03	62.13	26.93
Less: Amortisation Of Premium/(Accretion Of Discount)	0.00	0.00	0.00	0.00	0.00
Less: Net Interest Suspended	0.00	0.00	0.00	0.00	0.00
Less: Interest Expense	13.32	18.08	22.25	23.44	5.72
Net Interest Income	17.54	17.01	17.77	38.69	21.21
Non-Interest Income	4.67	4.76	14.63	4.86	1.27
Gross Income	22.21	21.77	32.40	43.56	22.48
Personnel Expenses	6.60	7.50	7.59	10.70	4.01
Other Non-Interest Expenses	4.52	4.94	8.16	25.95	11.56
Loan Loss Provisions	2.82	4.15	4.06	(1.60)	5.43
Share of results of Associated Companies	0.00	0.00	0.00	0.00	0.00
Pre-Tax Profit	8.28	5.18	12.59	8.51	1.48
Taxation	0.91	(1.92)	(0.04)	1.71	0.00
Profit After Tax	7.37	7.11	12.62976	6.81	1.48
Extraordinary Items	0.00	0.00	0.00	0.00	0.00
Prior Year Adjustments	0.00	(5.92)	0.00	0.00	0.00
Minority Interests	0.00	0.00	0.00	0.00	0.00
Transfer To Statutory Reserves	0.37	0.36	0.63	0.00	0.00
Transfer To Other Reserves	0.00	60.00	0.00	0.00	0.00
Dividend	1.77	1.64	0.00	0.00	0.00
Retained Profit For The Year	5.24	(60.81)	12.00	6.81	1.48

Financial Ratios - Company

KEY RATIOS (%)	31-Mar-06	31-Mar-07	31-Mar-08	31-Mar-09	30-Sep-09
Profitability					
Net Interest Margin	8.96%	7.46%	7.15%	13.99%	14.73%
Non-Interest Income Margin	2.39%	2.09%	5.88%	1.76%	0.88%
Cost To Income	50.04%	57.13%	48.61%	84.13%	69.25%
Return On Assets	4.23%	2.27%	5.07%	3.08%	1.03%
Return On Equity	9.19%	5.37%	11.84%	5.37%	1.44%
Dividend Payout	23.97%	23.09%	0.00%	0.00%	0.00%
Asset Quality					
Gross NPL Ratio**	22.53%	22.37%	22.22%	24.21%	30.55%
Net NPL Ratio	20.43%	20.74%	20.51%	22.48%	22.83%
3-months Past Due Ratio	NA	NA	NA	NA	NA
Specific Loan Loss Provisions For Current Year	2.57%	2.92%	3.12%	6.33%	6.52%
Gross NPL Coverage	11.69%	9.19%	9.68%	9.22%	32.74%
Loan Loss Reserve Coverage	2.63%	2.06%	2.15%	2.23%	10.00%
General Loan Loss Reserve Coverage	0.00%	0.00%	0.00%	0.00%	0.00%
Liquidity & Funding					
Liquid Asset Ratio	18.18%	21.78%	26.28%	21.91%	44.19%
Statutory Liquid Asset Ratio	19.11%	22.12%	27.20%	23.22%	44.19%
Interbank Deposits To Total Interest Bearing Funds	0.00%	0.00%	0.00%	0.00%	0.00%
Customer Deposits To Total Interest Bearing Funds	82.91%	88.58%	91.61%	94.35%	100.00%
Loans To Deposits Ratio	179.85%	162.43%	174.17%	323.42%	295.83%
Loans To Stable Funds Ratio	92.54%	91.03%	88.99%	93.66%	79.77%
Capital Adequacy					
Shareholders' Funds To Total Assets	43.76%	41.06%	44.47%	68.23%	74.51%
Tier 1 Risk Weighted Capital Adequacy Ratio	42.49%	44.47%	48.27%	72.39%	78.01%
Overall Risk Weighted Capital Adequacy Ratio	42.49%	44.47%	48.27%	72.39%	78.01%
Internal Rate Of Capital Generation	6.22%	5.66%	11.87%	4.29%	1.44%

Note :

* annualised

** restated

NA = Not available / Not applicable

Financial Ratios - Company

Ratio Definition:-	
Net Interest Margin	Net Interest Income/Total Average Assets
Non-Interest Income Margin	Non-Interest Income/Total Average Assets
Cost To Income	Personnel & Other Non-Interest Expenses/Net Interest Income & Non-Interest Income
Return On Assets	Pre-Tax Profits/Total Average Assets
Return On Equity	Pre-Tax Profits/Average Shareholders' Funds
Dividend Payout	Dividends/Profit After Tax
Gross NPL Ratio	(Total Non-Performing Loans - Interest-In-Suspense)/(Gross Loans - Interest-In-Suspense)
Net NPL Ratio	(Total Non-Performing Loans - Specific Loan Loss Reserves - Interest-In-Suspense)/(Gross Loans - Specific Loan Loss Reserves - Interest-In-Suspense)
3-months Past Due	3-months Past Due Loans/(Gross Loans - Interest-in-Suspense)
Specific Loan Loss Provisions For Current Year	Specific Loan Loss Provisions(P&L)/Average Gross Loans
Gross NPL Coverage	General & Specific Loan Loss Reserves (B/S)/(Total Non-Performing Loans - Interest-In-Suspense)
Loan Loss Reserve Coverage	General & Specific Loan Loss Reserves (B/S)/(Gross Loans - Interest-In-Suspense)
General Loan Loss Reserve Coverage	General Loan Loss Reserves/(Gross Loans - Interest-In-Suspense - Specific Loan Loss Reserves)
Liquid Asset Ratio	Liquid Assets/Customer Deposits & Short-Term Funds
Statutory Liquid Asset Ratio	Statutory Liquid Assets/Customer Deposits
Loans To Deposits	Net Loans/Customer Deposits
Loans To Stable Funds	Net Loans/(Shareholders' Funds + Total Interest Bearing Funds + General Loan Loss Reserves - Interbank Funding - Fixed Assets - Investments in Subsidiaries/Associates)
Short-Term Funds	Interbank Deposits + Bills & Acceptances + Securities Sold Under Repos
Liquid Assets	Cash & Short-Term Funds + Securities Purchased Under Repos + Deposits & Placements With Financial Institutions + Quoted Securities
Statutory Liquid Assets	Cash & Short-Term Funds + Securities Purchased Under Repos + Deposits & Placements With Financial Institutions + Government Securities and Treasury Bills
Total Interest Bearing Funding	Customer Deposits + Interbank + Bills & Acceptances + Securities Sold Under Repos + Borrowing + Supplementary Capital
Internal Rate Of Capital Generation	Profit After Tax + Extraordinary Income - Dividend + General Loan Loss Provision/Average Shareholders' Funds

CREDIT RATING DEFINITIONS

(Financial Institution Ratings)

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

Long-Term Ratings

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

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

Short-Term Ratings

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

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