

RAM

RATINGS

CREDIT RATING RATIONALE

FINANCIAL INSTITUTIONS – SRI LANKA

A wholly owned subsidiary of RAM Holdings Berhad

ARPICO FINANCE COMPANY PLC – Rating Review

Financial Institution Ratings:

Long-term: BB [Reaffirmed]
Short-term: NP [Reaffirmed]

Rating Outlook:

Stable

Strengths:

- Stringent monitoring and recovery procedures
- Improved capital cushioning

Weaknesses: Small size

- Limited branch network
- Manual systems
- Hefty overheads

Principal Activities:

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

Analysts:

Prakash Jerome ACMA
(9411) 2503551
prakash@ram.com.lk

Rizna Meyen BBM (Acc)
(9411) 2553089
rizna@ram.com.lk

Company Contact:

Adrian Perera
MBA, FCMA, FCCA, FSCMA, AIB
Chief Executive Officer
(9411) 2596099
adrian@ram.com.lk

Website: www.ram.com.lk

Summary

RAM Ratings Lanka has reaffirmed the respective long- and short-term ratings of Arpico Finance Company PLC ("Arpico" or "the Company"), at BB (with a stable outlook) and NP. The ratings are premised on the Company's miniscule size and delicate financial performance. That said, the ratings also take into account the Company's moderate asset quality, improved capital adequacy and comfortable liquidity position.

Arpico, established in 1951, is the second-oldest registered finance company ("RFC") in Sri Lanka. Despite its long operating history, the Company has remained a small finance company, accounting for less than 1% of the industry's total assets as at end-March 2009.

Over the past 5 years, the Company has been focusing on improving its asset quality. Accordingly, its gross non-performing-loan ("NPL") ratio (on a 6-month classification basis) eased from 6.30 % as at the end of FYE 31 March 2008 ("FY Mar 2008") (industry: 5.19%) to 4.83% (industry: 6.46%) as at end-FY Mar 2009. Given the more recent macroeconomic fundamentals, however, Arpico's gross NPL ratio had increased to 5.90% by end-June 2009. Under these circumstances, RAM Ratings Lanka will keep a close watch on the Company's portfolio quality. All said, we note such deterioration is an industry-wide phenomenon.

While its asset quality has ameliorated, Arpico's performance remains delicate due to rising overheads and lacklustre demand for real estate. RAM Ratings Lanka also sees the Company's portfolio size as an influencing factor vis-a-vis its feeble financial profile. Although the Company's top line was lifted 55.50% during FY Mar 2009, reduced non-interest income and escalating overheads had depressed its bottom line. Arpico's cost-to-income ratio deteriorated to 90.48% as at end-FY Mar 2009 (industry: 79.10%). Accordingly, its pre-tax profit (before share of associate company profits) also contracted from LKR 19.50 million to LKR 14.57 million over the same period. The poorer performance carried through to 1Q FY Mar 2010, with the Company reporting a loss of LKR 6.30 million.

On the other hand, Arpico had successfully weathered the confidence crisis that had plagued the industry in the final quarter of 2008 and 1Q 2009. The management had even improved the Company's liquidity position, which had done much towards quelling depositors' concerns. These measures are reflected Arpico's high statutory liquid-asset ratio of 32.72% as at end-FY Mar 2009 (end-FY Mar 2008: 18.91%), which was well above the regulatory minimum of 10%. Nonetheless, RAM Ratings Lanka's concerns hinge on the Company's lack of an asset-liability management mechanism.

On a more positive note, the Company had met the Central Bank of Sri Lanka's ("Central Bank") minimum core-capital requirement of LKR 200 million by end-March 2009, via 2 rights issues in June 2008 and March 2009. Accordingly, Arpico's Tier-I capital ratio improved to 19.10% whilst its overall risk-weighted capital-adequacy ratio ("RWCAR") climbed up to 22.97% - well above the regulatory minimums of 5% and 10%, respectively.

Outlook

The stable outlook on the long-term rating reflects RAM Ratings Lanka's expectation that Arpico will maintain its moderate asset quality and liquidity profile. Even though the Company may remain in the red, its losses are anticipated to be tolerable.

An upward revision of the ratings could materialise over the longer term, whilst maintaining its asset quality at current levels, stage a significant and sustained improvement in financial performance while meeting all regulatory requirements. In addition, the scale of the Company's operations should expand, with a corresponding improvement in its risk-management framework.

Conversely, there may be downward pressure in the event of significant deterioration in Arpico's profit performance, asset quality or liquidity level, or over-exposure to real estate. Rating will also come under pressure if there are any regulatory risks.

Corporate Profile

Arpico, was incorporated in May 1951, as an associate company of the Richard Peiris Group; it is the second-oldest RFC in the sector. In 1967, the Company came under Alliance Finance Company Ltd (currently rated BBB/P2 by RAM Ratings Lanka). As a deposit-accepting institution, Company is registered under the Finance Companies Act No. 78 of 1988, and is regulated by the Central Bank. Arpico is also listed on the Colombo Stock Exchange. Despite its long history and listed status, it has remained a small player, accounting for just 0.90% of the industry's asset base as at end-FY Mar 2009.

Arpico's primary activities include leasing, hire-purchase ("HP"), pawn brokering, mortgage loans and real-estate trading. On the funding side, it accepts public deposits. The Company operates through its head office in Colombo and a single branch in Badulla. During the year under review, Arpico had expanded its pawning network to 6 outlets.

Ownership

The Company's ownership structure has changed following capital infusions in June 2008 and March 2009 (discussed under *Capital Adequacy*). Despite the change in its shareholding structure, Arpico remains within the Alliance Group's umbrella (refer to Table 1). Consequently, there has been no change in the Company's board; Mr Pratapkumar de Silva is still the chairman. Mr de Silva is also the chairman of the Alliance group of companies, and the honorary consul of the Republic of Peru in Sri Lanka.

Table 1: Top 5 shareholders of Arpico (FY Mar 2008 to FY Mar 2009)

As at end-FY Mar 2009		As at end-FY Mar 2008	
Name of Shareholder	Ownership (%)	Name of Shareholder	Ownership (%)
Alfinco Insurance Brokers (Pvt) Ltd	40.56	Alliance Finance Co PLC	39.60
Alliance Finance Co PLC	19.54	Mr KDD Perera	6.41
Mr KDD Perera	6.67	Orient Hotel Ltd	5.25
Mr JE de Silva	4.08	Mr RKEP de Silva	4.83
Capital Lanka (Pvt) Ltd	2.91	Mr JR de Silva	4.06

Senior management

Arpico's joint managing director, Mr Senakke Bandaranayake, leads the Company. He is assisted by Mr Bede Jayalath, the finance director, and Ms Ruvini Weerasinghe, the legal director. Meanwhile, the deputy chairman, Mr DLSR Perera, oversees the Company's operations.

Following capital infusions in 2008 and 2009, the management is intent on improving the overall performance of the Company. To this end, Mr Dharshan Silva joined the Company as its chief operating officer ("COO") in September 2009. He has been tasked with improving processes and overseeing the implementation of a new information-technology system.

Stringent monitoring and recovery efforts to preserve asset quality

Apart from enhancing its Arpico's internal infrastructure, the management also aims to expand the Company's loan portfolio. The management also intends to maintain its stringent monitoring criteria and recovery efforts to preserve the quality of its loan portfolio.

Corporate Governance & Risk Management

Arpico's board comprises 6 directors, 3 of whom are non-executive. Board meetings are held monthly to review the financial performance of the Company.

We note that the Company's external audits had been Messer Lawrie Muthu Krishna & Company. As it has ceased operations, however, SJMS Associates has been appointed as Arpico's new external auditors. Meanwhile, Messer H L B Edirisinghe & Company undertakes internal audits.

At present, risk management at Arpico is at a nascent stage. That said, the Company has been somewhat risk-averse in its strategies. This is evident from the scale of its operations, despite its long history. Nonetheless, RAM Ratings Lanka envisages that risk management will assume greater importance as the Company expands the magnitude of its business.

Moderate asset quality

Slightly changed balance sheet

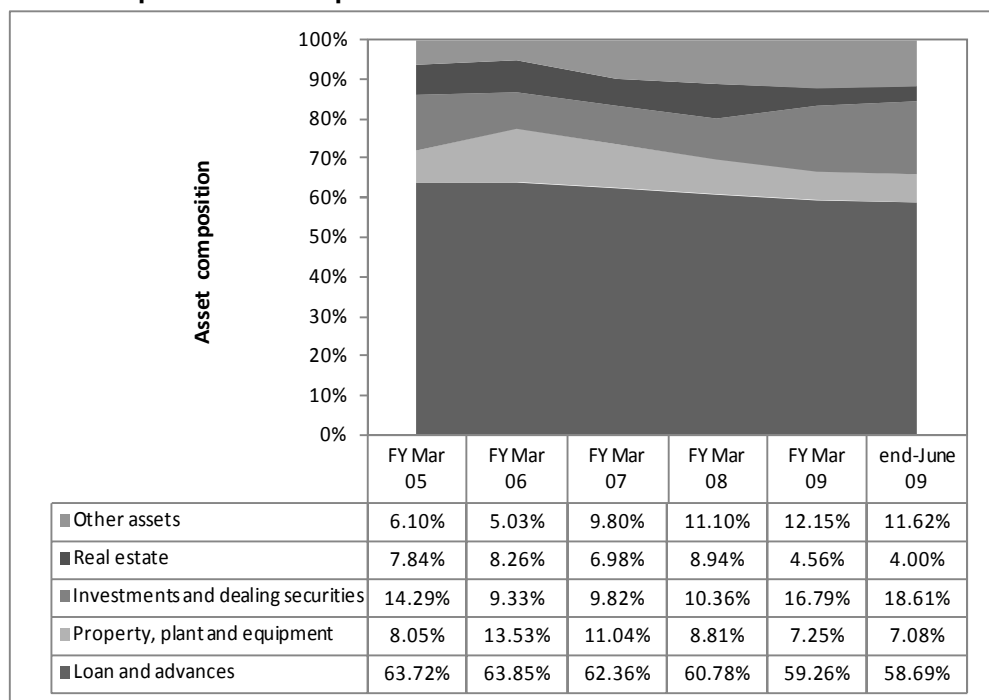
Better-than-industry NPL ratio

Asset Quality

RAM Ratings Lanka considers Arpico’s asset quality to be moderate; the Company’s asset quality has been charting an improving trend over the past 5 years. Although there was an up-tick in delinquencies as of end-June 2009, it was still below the industry average. That said, RAM Ratings Lanka notes that the Company’s asset quality will increasingly be subject to pressure over the short to medium term due to the macroeconomic scenario.

Arpico’s asset base augmented 27.91% year on year (“y-o-y”) to LKR 1.39 billion as at end-FY Mar 2009. This had been driven by credit expansion; its lending portfolio had enlarged 24.67% over the same period. Despite the buoyant growth in lending, the ratio of credit assets as a composition of its entire asset base contracted from 60.78% to 59.26% y-o-y (refer to Chart 1). Concurrently, the Company’s exposure to treasury assets increased from 10.36% to 16.79% over the same span. Meanwhile, the prominence of real-estate assets reduced to 4.56% (end-FY Mar 2007: 8.93%). These trends persisted through 1Q FY Mar 2010.

Chart 1: Arpico’s asset composition



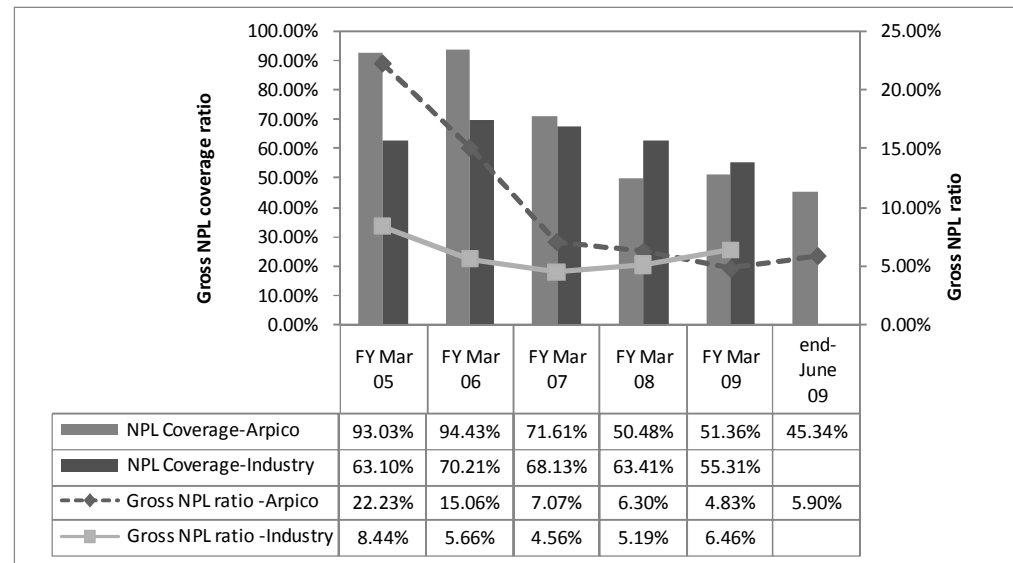
In the meantime, Arpico’s credit portfolio mix remained broadly unchanged, save for the introduction of pawning advances. The Company offered pawning or gold-backed short-term loans last year to broaden its portfolio, narrow tenure mismatches in its assets and liabilities, and reduce loss-given defaults (losses arising from a default after liquidating the collateral).

In the context of loan-monitoring and recovery efforts, the management’s emphasis in this area is bearing fruit. Arpico’s gross NPL ratio remained manageable at 4.83 % as of end-FY Mar 2009 (end-FY Mar 2008: 6.30%). This was better than the industry average of 6.46% as at the same date (refer to Chart 2). Arpico’s absolute gross NPLs contracted from LKR 43.06 million to LKR 40.92 million over the same period. In spite of its tight monitoring, its gross NPLs increased to LKR 52.67 million while the ratio climbed up to 5.90% as at

end-June 2009. Under the circumstances, it is critical that Arpico maintain strict monitoring to ensure the health of its portfolio.

On the other hand, the Company’s NPL coverage improved to 51.36% as at end-FY Mar 2009 (end-FY Mar 2008: 50.48%). Accordingly, its net NPL ratio also eased from 3.22% to 2.41% y-o-y (industry: 4.40%). In addition, loan concentration remained moderate, with its top 10 loans taking up 3.54% of its entire loan base as at end-FY Mar 2009.

Chart 2: Asset-quality indicators of Arpico vs the industry



Waning exposure to real estate

Arpico also engages in land sales, although its stock of land has contracted because the Company has abstained from increasing its land bank owing to weak demand. Total investment in real estate reduced from LKR 97.38 million as at end-FY Mar 2008 to LKR 63.50 million as at end-FY Mar 2009, declining further to LKR 59.25 million as at end-June 2009 (or 4.0% of its asset base). Going forward, the management intends to maintain the current level of investments in real estate. RAM Ratings Lanka views this positively given the currently non-conducive investment climate.

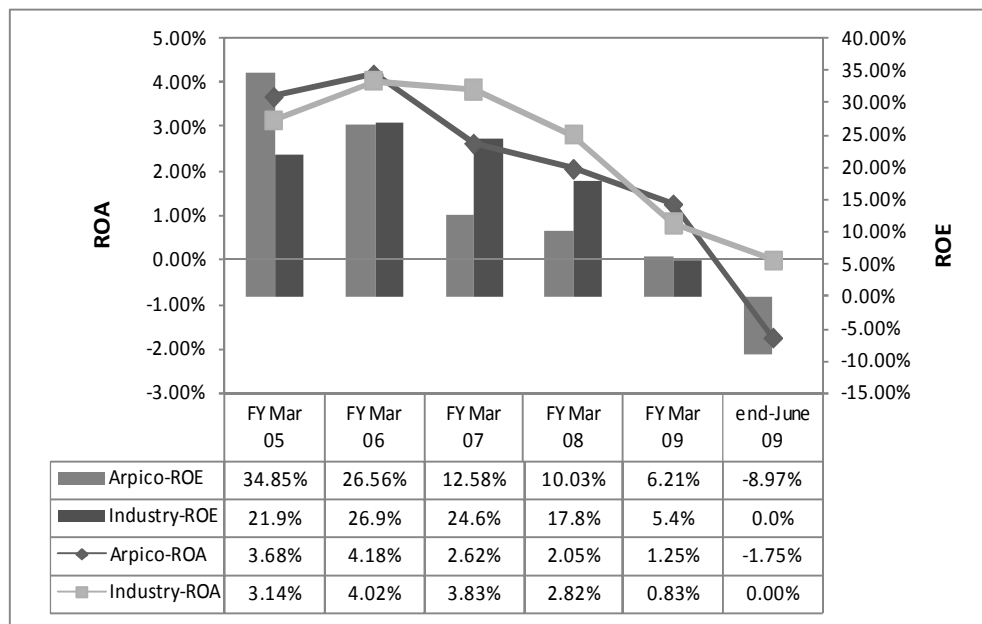
Weak financial performance

Performance

The financial performance of Arpico remains delicate due to rising overheads and lacklustre demand for real estate. RAM Ratings Lanka notes that the Company’s financials are likely to remain in the red over the next financial year due to sluggish real-estate sales. This apart, the small size of the Company’s loan book also exacerbates the weakness in Arpico’s financial profile.

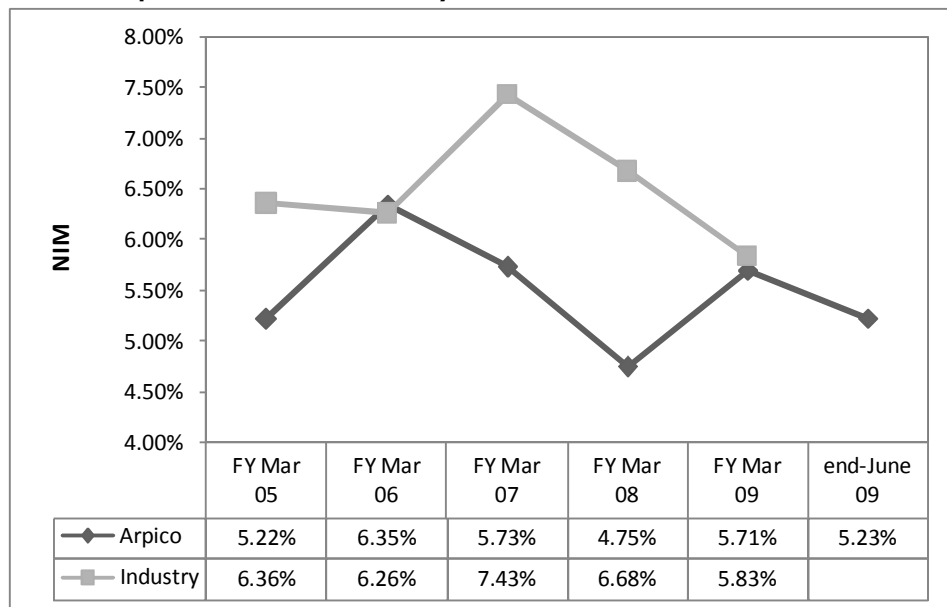
Arpico’s gross income augmented 17.81% y-o-y in FY Mar 2009. Even though this was better than the 7.54% increase the previous year, the Company was unable to lift its bottom line. Its pre-tax profit contracted to LKR 15.56 million in FY Mar 2009 (FY Mar 2008: LKR 20.14 million). The deterioration continued through 1Q FY Mar 2010, with a pre-tax loss of LKR 6.30million (refer to Chart 3).

Chart 3: Performance indicators of Arpico vs the industry



Nonetheless, Arpico was able to arrest the slide in its margins through portfolio expansion and augmenting its product range via the introduction of pawning advances. This is reflected in its net interest margin ("NIM"), which broadened from 4.75% in FY Mar 2008 to 5.71% in FY Mar 2009 (refer to Chart 4). In 1Q FY Mar 2010, its NIM narrowed slightly to 5.23%, as the Company had enlarged its exposure to relatively low-yield treasury assets.

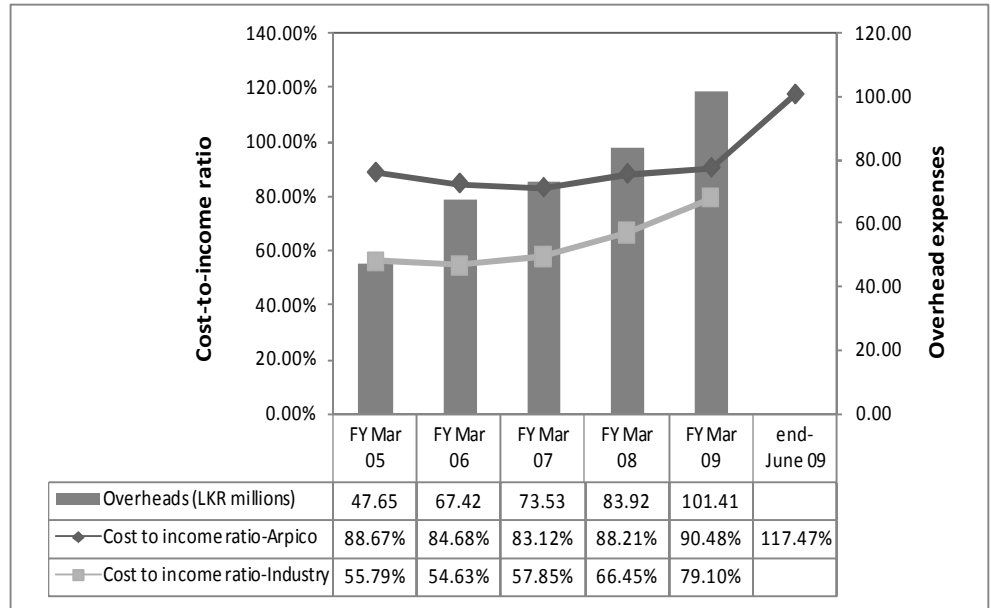
Chart 4: Arpico's NIM vs the industry



Rising cost-to-income ratio

Arpico's overheads have been traditionally heavy, as reflected in its cost-to-income ratio. In FY Mar 2009, the Company commenced the operations of 6 pawning centres, worsening its cost-to-income ratio. These centres have yet to break even and, along with the environment of inflationary pressures, had pushed the Company's overheads up by LKR 17.49 million to LKR 101.41 million in FY Mar 2009 (refer to Chart 5).

Chart 5: Cost-to-income ratio of Arpico vs the industry



Apart from increasing overheads, the slump in demand for real estate had also exacerbated the Company’s weak performance. Real-estate profits diminished to LKR 23.87 million in FY Mar 2009 (FY Mar 2008: LKR 36.84 million). The Company incurred a loss on real estate in 1Q FY Mar 2010 as the management had sought to off-load slow-moving inventory to improve liquidity. While RAM Ratings Lanka does not view the management’s strategy negatively, our concern hinges on the accounting policy pertaining to the recognition of profits from real-estate trading. Like other RFCs, Arpico also recognises the entire profit from a real-estate transaction once a 30% downpayment has been paid.

Over the short to medium term, RAM Ratings Lanka expects the Company’s financial performance to be constrained by hefty overheads and lacklustre real-estate income. Against this backdrop, the maintenance of its asset quality will be even more crucial.

Funding & Liquidity

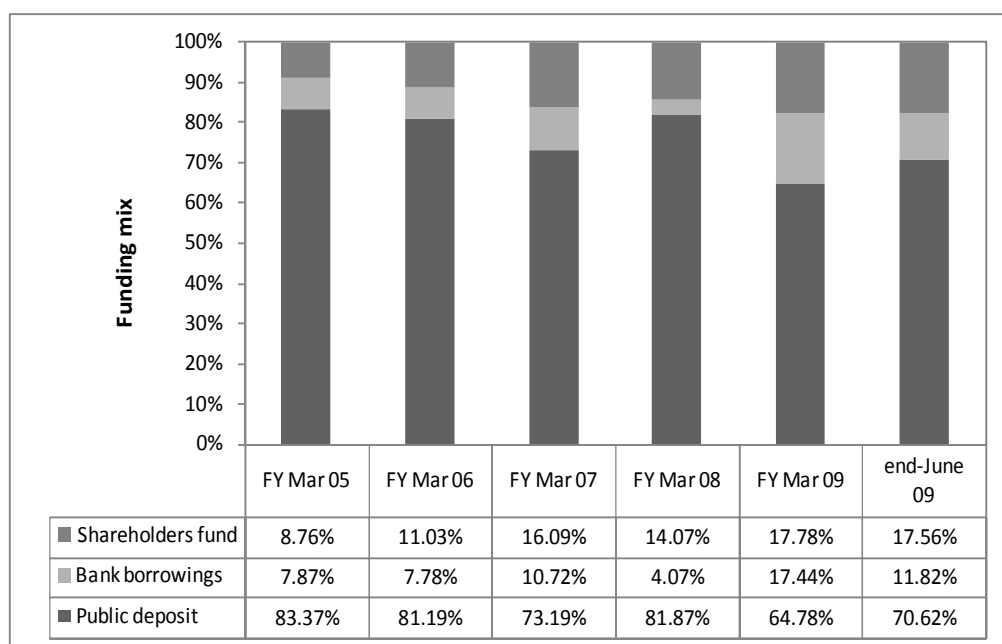
Moderate funding and liquidity levels

RAM Ratings Lanka opines that Arpico’s funding and liquidity levels are moderate. During the tumultuous period towards the end of last year and the first quarter of 2009, the Company had prudently beefed up its liquidity. This strategy had been assisted by capital injections.

Arpico had traditionally sourced its funding from public deposits. To expand its lending portfolio and mitigate interest-rate risk, however, the Company has increased bank borrowings, which had been marginally cheaper than public deposits. In this context, Arpico had sought to partially offset the effects of rising interest rates by lending at higher rates. As a result, institutional borrowings as a proportion of total funding increased to 17.48% as at end-FY Mar 2009, from 4.12% a year earlier (refer to Chart 6).

Following capital infusions in June 2008 and March 2009, ratio of the Company’s shareholders’ funds to its total funding augmented from 14.01% to 17.74%(refer to Chart 6).

Chart 6: Arpico's funding mix



Healthy pace of deposit renewals

Arpico also has a healthy rate of deposit renewals (refer to Table 2). That said, the Company experienced an exodus of deposits in fiscal 2009, as premature withdrawals escalated during FY Mar 2009, there was a slight dip in its deposit renewal ratio. Nonetheless, we note that such panic withdrawals had dissipated as reflected in its deposit renewal rate as at end-June 2009.

Table 2: Arpico's deposit movements

	FY Mar 06	FY Mar 07	FY Mar 08	FY Mar 09	end-June 09
LKR millions					
Brought forward	413.33	464.44	541.86	767.47	796.11
Add: New deposits	103.17	365.18	410.07	312.62	150.53
Less: Maturing deposits	312.95	754.62	982.88	1,356.24	519.42
Add: Deposit renewals	280.76	497.04	859.09	1,165.90	456.46
Less: Pre-Mature withdrawals	19.88	30.19	60.67	93.64	18.88
Carried forward	464.44	541.86	767.47	796.11	864.80
Deposit renewal rates	89.72%	65.87%	87.41%	85.97%	87.88%

Weak asset-liability management

Arpico's asset-liability maturity profile remains somewhat unchanged. The negative gap in the "less than 1 year" bracket narrowed slightly from LKR 273.45 million to LKR 268.93 million between end-March 2008 and end-March 2009 (refer to Table 3). That said, RAM Ratings Lanka's concerns centre on the absence of an asset-liability matching mechanism.

Table 3: Arpico's asset-liability maturity profile

	As at end-Mar 2008			As at end-Mar 2009		
	<1 year	1 to 3 years	>3 years	<1 year	1 to 3 years	>3 years
Interest earning assets	379.21	244.77	176.18	590.93	299.60	197.83
Interest bearing liabilities	652.66	120.35	32.58	859.86	111.21	39.33
Gap	(273.45)	124.42	143.60	(268.93)	188.39	158.50
Cumulative gap	(273.45)	(149.03)	(5.42)	(268.93)	(80.53)	77.97

**Moderate
capitalisation**

In line with the increase borrowings and capital infusions, Arpico's liquid assets advanced to LKR319.00 million as at end-FY Mar 2009 (end-FY Mar 2008: LKR 170.42 million). Its statutory liquidity ratio consequently improved from 18.91% to 32.72% - well above the regulatory minimum of 10%. RAM Ratings Lanka expects the Company to maintain its liquidity profile in the short term due to the sluggish growth in its credit portfolio.

Capital Adequacy

Arpico's capital adequacy is deemed moderate, subsequent to its aggregate LKR 80.06 million rights issues in June 2008 (LKR 14.44 million) and March 2009 (LKR 65.62 million). As at end-FY Mar 2009, Arpico's core capital stood at LKR 218.07 million, thus meeting the Central Bank's minimum requirement of LKR 200 million. As a result, the Company's Tier-I capital ratio improved to 19.10% while its overall RWCAR progressed to 22.97% - well above the regulatory minimum requirements of 5% and 10%, respectively. Concurrently, the ratio of the Company's net NPLs to shareholders' funds also improved from 10.30% to 6.78%. However, RAM Ratings Lanka views the slight weakening of this ratio to 10.01% as at June 2009, the agency notes that, Arpico has sufficient regulatory capital to cover its medium-term expansion plans. Although the Company's core capital could be affected by its weak financial performance, RAM Ratings Lanka does not envisage any regulatory risk.

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.

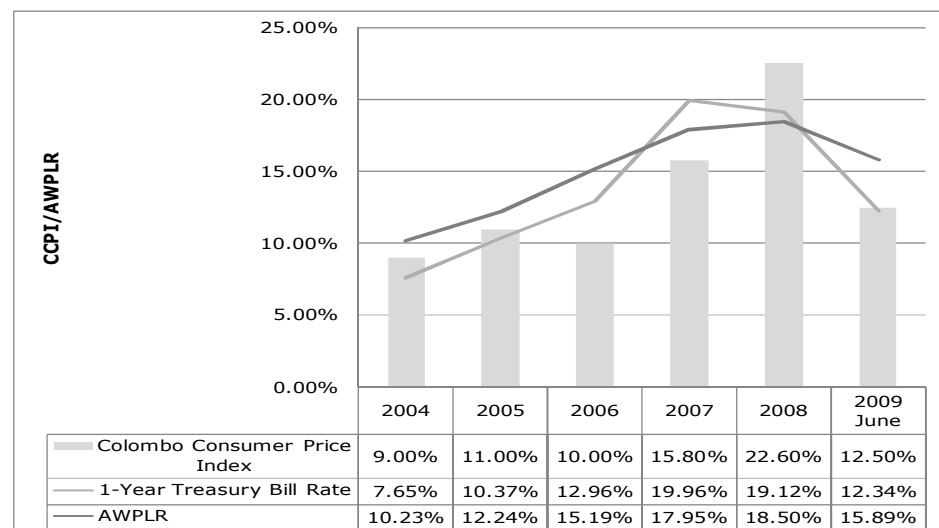
The performance of the primary sector (i.e. agriculture, forestry and fishing) has been dented by a steep fall in tea prices, drought and diminished demand. Although value addition in tea shrank 11.7% in 2Q 2009, this was partially cushioned by the expansion of other food crops, including fishing. Nonetheless, 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 4).

Table 4: Sectoral contributions to GDP

Sector	1Q2008	1Q2009
Agriculture, Forestry and Fishing	7.4%	4.4%
Industry	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 7). 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 7: 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> <ul style="list-style-type: none"> (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>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> <ul style="list-style-type: none"> (a) Tier I - Core Capital <p>This represents permanent shareholders' equity and reserves created or increased by appropriation of retained earnings or other surpluses, including share premiums, retained profits and other reserves. The core-capital ratio should constitute not less than 50%, i.e. this has to be at least half, of the total risk-weighted capital-adequacy ratio.</p> <ul style="list-style-type: none"> (b) Tier II - Supplementary Capital <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> <ul style="list-style-type: none"> (a) A finance company with a core capital of less than LKR 100 million must: <ul 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. (b) A finance company with a core capital of between LKR 100 million and LKR 200 million must bring in: <ul style="list-style-type: none"> 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> <ul style="list-style-type: none"> (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 <p>Capital funds generally mean paid-up capital and permanent free reserves, and may include unsecured debentures and other loan stocks if approved by the Monetary Board.</p>

Corporate Information

Date of Incorporation:	1951			
Commencement of Business:	1951			
Major Shareholders:	Alfinco Insurance Brokers(Pvt) Ltd	40.56%		
	Alliance Finance Company Ltd	19.54%		
	Mr KDD Perera	6.67%		
	Mr JR de Silva	4.08%		
	Capital Lands(Pvt) Ltd	2.91%		
	Mr RKEP de Silva	1.99%		
	Orient Hotels Ltd	1.85%		
	Mr OD Liyanage	1.58%		
	Seylan Bank Ltd	1.36%		
	Dr (Mrs)KGGSL Perera	1.27%		
Directors:	Mr Pratapkumar de Silva	Chairman		
	Mr DLSR Perera	Deputy Chairman		
	Mr Senakke R Bandaranayake	Joint Managing Director		
	Mrs Ruvini E Weerasinghe	Director - Legal		
	Mr Bede Jayalath	Finance Director		
	Mr Romani de Silva	Director		
	Mr Dharshan Silva	Chief Operating Officer		
Auditor:	Lawrie Muthu Krishna & Company			
Listing:	Listed			
Key Management:	Mr Senakke R Bandaranayake	Joint Managing Director		
	Mr Bede Jayalath	Director - Finance		
	Mrs Ruvini E Weerasinghe	Director - Legal		
Major Subsidiaries and Associates:	None			
Capital History:	Year	Remarks	Amount (LKR million)	Cumulative Total (LKR million)
	1951	Ordinary share issue	0.38	0.38
	1972	New ordinary share issue	0.38	0.76
	1989	New ordinary share issue	3.75	4.50
	1993	New ordinary share issue	6.00	10.50
	1994	New ordinary share issue	5.25	15.75
	1951	Redeemable preference share issue	0.13	15.88
	1958	Irredeemable preference share issue	0.50	16.38
	1971	Redemption of redeemable preference shares	(0.13)	16.25
	2008	Rights issue	14.44	30.69
	2009	Rights issue	65.62	96.31

Financial Summary - Company

		Re-stated	Re-stated		Unaudited
BALANCE SHEET (LKR Million)	31-Mar-06	31-Mar-07	31-Mar-08	31-Mar-09	30-Jun-09
ASSETS					
Cash & Money At Call	1.18	0.62	29.14	34.52	32.54
Deposits & Placements With Financial Institutions	21.05	25.16	28.37	50.67	29.68
Securities Purchased Under Resale Agreements	0.00	0.00	0.00	0.00	0.00
Securities					
Dealing Securities	16.33	22.06	1.90	11.35	51.93
Investment Securities	50.85	63.86	111.00	222.46	223.82
Gross Loans & Advances	644.37	643.58	731.06	895.23	939.30
Interest-In-Suspense	108.27	68.61	47.20	48.77	45.99
General Loan Loss Reserves	0.00	0.00	0.00	0.00	0.00
Specific Loan Loss Reserves	76.22	29.13	21.74	21.02	23.88
Net Loans & Advances	459.88	545.84	662.13	825.45	869.42
Investments in Subsidiaries/Associates	0.00	0.00	1.93	3.24	23.87
Investment Land and Properties	59.46	61.10	97.38	63.51	59.25
Other Assets	14.03	59.97	62.05	81.88	86.10
Property, Plant and Equipment	97.44	96.64	96.01	100.97	104.88
TOTAL ASSETS	720.21	875.24	1,089.91	1,394.06	1,481.48
LIABILITIES					
Customer Deposits					
Savings	0.00	0.00	0.00	0.00	0.00
Fixed	464.43	541.86	767.47	796.13	853.86
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	86.56
Other Borrowing	44.49	79.34	38.12	214.27	142.92
Subordinated Debt & Hybrid Capital	0.00	0.00	0.00	0.00	0.00
Other Liabilities	72.98	59.70	77.23	89.87	110.63
TOTAL LIABILITIES	581.91	680.89	882.82	1,100.27	1,193.98
Paid-up Capital	16.25	16.25	16.25	96.31	96.31
Minority Interest	0.00	0.00	0.00	0.00	0.00
Share Premium & Other Reserves	97.32	97.32	97.32	97.32	97.32
Statutory General Reserve	19.36	22.62	25.62	28.06	25.60
Retained Profits/(Loss)	5.38	58.16	67.89	72.09	68.26
Total Shareholders' Funds	138.30	194.35	207.09	293.78	287.49
TOTAL LIABILITIES & SHAREHOLDERS' FUNDS	720.21	875.24	1,089.91	1,394.05	1,481.47
COMMITMENTS & CONTINGENCIES	0.00	0.00	0.00	0.00	0.00
TIER 1 CAPITAL	65.80	78.90	119.64	204.38	194.51
CAPITAL BASE	94.69	113.17	153.92	245.72	235.85

Financial Summary - Company

		Re-stated	Re-stated		Un-audited
INCOME STATEMENT (LKR Million)	31-Mar-06	31-Mar-07	31-Mar-08	31-Mar-09	30-Jun-09
Interest Income	100.96	125.60	168.68	262.30	71.06
Less: Amortisation Of Premium/(Accretion Of Disc	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	59.90	79.89	122.02	191.45	52.25
Net Interest Income	41.06	45.71	46.66	70.86	18.81
Non-Interest Income	38.55	42.76	48.47	41.22	2.69
Gross Income	79.61	88.46	95.13	112.07	21.50
Personnel Expenses	27.01	31.22	34.99	41.88	10.13
Other Non-Interest Expenses	40.41	42.31	48.92	59.52	15.13
Loan Loss Provisions	(14.84)	(6.00)	(8.28)	(3.91)	2.55
Share of results of Associated Companies	0.00	0.00	0.64	0.98	0.00
Pre-Tax Profit	27.03	20.93	20.14	15.56	(6.30)
Taxation	4.68	4.63	5.12	3.37	0.00
Profit After Tax	22.35	16.31	15.02	12.19	(6.30)
Extraordinary Items	0.00	0.00	0.00	0.00	0.00
Prior Year Adjustments	0.00	44.51	1.69	0.00	0.00
Minority Interests	0.00	0.00	0.00	0.00	0.00
Transfer To Statutory Reserves	4.47	3.26	3.00	2.44	0.00
Transfer To Other Reserves	15.00	0.00	0.00	0.00	0.00
Dividend	3.19	4.77	3.98	5.55	0.00
Retained Profit For The Year	(0.31)	52.79	9.73	4.20	(6.30)

Financial Ratios - Company

KEY RATIOS (%)	31-Mar-06	Re-stated	Re-stated	31-Mar-09	Unaudited
		31-Mar-07	31-Mar-08		30-Jun-09
Profitability					
Net Interest Margin	6.35%	5.73%	4.75%	5.71%	5.23%
Non-Interest Income Margin	5.96%	5.36%	4.93%	3.32%	0.75%
Cost To Income	84.68%	83.12%	88.21%	90.48%	117.47%
Return On Assets	4.18%	2.62%	2.05%	1.25%	(1.75%)
Return On Equity	26.56%	12.58%	10.03%	6.21%	(8.97%)
Dividend Payout	14.27%	29.22%	26.48%	45.56%	0.00%
Asset Quality					
Gross NPL Ratio	15.06%	7.07%	6.30%	4.83%	5.90%
Net NPL Ratio	0.98%	2.12%	3.22%	2.41%	3.31%
Specific Loan Loss Provisions For Current Year	1.30%	0.96%	1.26%	1.47%	7.15%
Gross NPL Coverage	94.43%	71.61%	50.48%	51.36%	45.34%
Loan Loss Reserve Coverage	14.22%	5.07%	3.18%	2.48%	2.67%
Liquidity & Funding					
Liquid Asset Ratio	18.47%	18.45%	21.80%	38.72%	35.70%
Statutory Liquid Asset Ratio	14.95%	15.86%	19.15%	32.89%	31.09%
Customer Deposits To Total Interest Bearing Func	91.26%	87.23%	95.27%	78.79%	78.82%
Loans To Deposits Ratio	99.02%	100.74%	86.27%	103.68%	101.82%
Loans To Stable Funds Ratio	83.64%	75.93%	72.38%	68.79%	70.00%
Capital Adequacy					
Shareholders' Funds To Total Assets	19.20%	22.21%	19.00%	21.07%	19.41%
Tier 1 Risk Weighted Capital Adequacy Ratio	10.69%	10.81%	13.01%	19.10%	17.61%
Overall Risk Weighted Capital Adequacy Ratio	15.39%	15.51%	16.74%	22.97%	21.35%
Internal Rate Of Capital Generation	18.83%	6.94%	5.50%	2.65%	(8.97%)

Note :

* annualised

NA = Not available / Not applicable

Financial Ratios - Company

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

CREDIT RATING DEFINITIONS

(Financial Institution Ratings)

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

Long-Term Ratings

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

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

Short-Term Ratings

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

Published by RAM Ratings.
Reproduction or transmission in any form is prohibited
except by permission from RAM Ratings.

RAM Ratings (Lanka) Limited
No. 9 Arthur's Place
Colombo 4
Sri Lanka

Tel: (9411) 2553089 Fax: (9411) 2553090

E-mail: ram@ram.com.lk
Website: <http://www.ram.com.lk>

