



Media Release

RAM Ratings Lanka assigns BBB+/P2 to Construction Guarantee Fund

RAM Ratings Lanka has assigned respective long- and short-term financial enhancement ratings of BBB+ and P2 to the Construction Guarantee Fund ("CGF" or "the Fund"). The ratings are primarily based on the Fund's state linkage, healthy capitalisation and stringent underwriting standards, tempered by its inherent vulnerability to the volatile construction industry and its limited geographical reach. The ratings also take into consideration the Fund's priority level within the Government of Sri Lanka's ("GOSL") overall economic development strategy.

CGF is a Trust set up by the GOSL in 1999, to assist in the development of the construction industry by providing indirect financial assistance to domestic construction contractors. The trustees comprise high-ranking government officials and representatives from the private sector.

The Fund provides financial guarantees in the form of bid, performance, advance-payment, retention and other forms of bonds to construction contractors. Such guarantees are provided without any collateral, by evaluating the contractors' capabilities against the project requirements. CGF follows stringent underwriting standards, with guarantees only extended to contractors holding a valid grading with the Institute of Construction Training and Development ("ICTAD"); all applications are vetted by vastly experienced personnel. Furthermore, the majority of contracts are monitored regularly to ensure that project performance is as per specifications. In the event a contractor lags behind, CGF has the authority to take all necessary actions to minimize claims by ensuring total project performance.

CGF's financial performance is intertwined with the health of the construction industry. The Fund recorded its highest premium income of LKR 76.95 million in FYE 31 December 2006 ("FY Dec 2006"), boosted by increased construction activity amid the flurry of rebuilding following the havoc wreaked by the tsunami in December 2004. However, the Fund's premium income has been trending downwards in the last 3 years, from LKR 50.83 million in FY Dec 2007 to LKR 36.37 million in FY Dec 2009, as the weak macroeconomic conditions have dampened demand for construction services. Nonetheless, its overall financial performance has been supported by sturdy investment income.

We note that the Fund adopts a conservative investment strategy, maintaining a portfolio solely comprising government securities. We view this positively as these are low-risk and highly liquid investments.

On the other hand, the lack of soft capital in the form of reinsurance is a concern to RAM Ratings Lanka. Reinsurance is expected to cushion capital in the event of large claims. Although the management is evaluating reinsurance arrangements, credence will be given based on the form of reinsurance and once a fixed guideline has been put in place. Moreover, CGF's lack of branch network will hinder capital growth as new business will be limited.

Meanwhile, CGF's capitalisation levels are deemed healthy owing to implicit state support and the Fund's robust capital-adequacy ratio ("CAR"), which clocked in at 61.55% as at end-FY Dec 2009 (end-FY Dec 2008: 40.62%). Moreover, the Fund is expected to keep its leverage below 10 times, i.e. much lower than the levels of standard financial-guarantee insurers.

The credit rating is not a recommendation to purchase, sell or hold a security, inasmuch as it does not comment on the security's market price or its suitability for a particular investor, nor does it involve any audit by RAM Ratings Lanka. The credit rating also does not reflect the legality and enforceability of financial obligations, transfer and convertibility risks, repatriation risk, currency risk or any other risk apart from credit risk.

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