


**RATINGS**

# CREDIT RATING RATIONALE

**FINANCIAL INSTITUTIONS – SRI LANKA**

A wholly owned subsidiary of RAM Holdings Berhad

## The Multi Finance Company Limited- Rating Review

### Summary

**Financial Institution**
**Ratings:**

Long-term: BB- Reaffirmed]

Short-term: NP [Reaffirmed]

**Rating Outlook:**

Stable

**Strengths:**

- Improving asset quality
- Comfortable capitalisation

**Weaknesses:**

- Weak performance
- Small stature

**Principal Activities:**

Finance company engaged in vehicle hire–purchase, finance leasing and accepting public deposits

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RAM Ratings Lanka has reaffirmed the long- and short-term financial institution ratings of The Multi Finance Company Limited (“MFL” or “the Company”), at BB- (with a stable outlook) and NP, respectively. The ratings are premised on the Company’s small stature and weak performance, although supported by its improving asset quality and comfortable capital buffer.

MFL remains one of the smallest registered finance companies (“RFCs”) in Sri Lanka, accounting for only 0.21% of the industry’s assets as of September 2009. MFL’s major shareholder, Ceylinco Shriram Securities Holding, had been renamed Entrust Ltd (“Entrust”) after the Ceylinco crisis. In addition, Entrust has sought new shareholders to distance itself from the Ceylinco franchise. In this regard, Entrust is expected to be taken over by Pacific Trust<sup>1</sup>, upon obtaining the court’s final approval in the near future.

Meanwhile, MFL’s reaffirmed ratings had been underpinned by its improving asset quality as a result of regular monitoring and stronger recoveries. Its gross non-performing-loan (“NPL”) ratio had eased substantially to 1.94% as at FYE 31 March 2009 (“FY Mar 2009”) (end-FY Mar 2008: 10.20%) - better than its peers’. The ratio had eased further to 1.54% by end-September 2009, supported by a surge in the Company’s loan base - a result of internal growth and having acquired a hire-purchase (“HP”) portfolio the same year. However, loan-concentration risk remains; MFL’s top 10 loans accounted for 27.82% of its credit portfolio as at FY Mar 2009. While we acknowledge the strides that MFL has made in improving its asset quality, the Company has yet to demonstrate its ability to preserve its credit quality on a larger scale.

On a related note, MFL’s performance has remained weak, burdened by hefty overheads. While we note that one-off VAT expenses had led to a pre-tax loss of LKR 4.34 million in FY Mar 2009, heavy overheads had continued to take a toll on the Company’s profits during the first 6 months of FY Mar 2010. Accordingly, MFL’s traditionally high cost-to-income ratio remains weaker than those of its similar rated peers; the ratio stood at 78.67% as at end-September 2009. While margins are expected to uplift the Company’s performance in the short term, a sustainable improvement in its financial performance is yet to be evinced.

RAM Ratings Lanka opines that MFL has moderate funding and liquidity positions. Subsequent to Entrust’s capital infusions in FY Mar 2009, the Company’s shareholders’ funds have been its chief funding source. In the long run, however, MFL expects to derive its funding primarily from deposits. Going forward, its funding and liquidity levels are expected to recede due to loan expansion, albeit remain above the minimum statutory requirement.

<sup>1</sup> A special joint-venture company formed to take over Entrust and its respective subsidiaries.

MFL's capital is deemed sufficient to cushion defaults arising from the large exposures in its loan portfolio as at end-FY Mar 2009. Owing to limited information on its large loan exposures, however, we are concerned about the sufficiency of the Company's capital as at end-September 2009. Nonetheless, its Tier-1 and overall risk-weighted capital-adequacy ratios ("RWCAR") remained well above the regulatory minimums at 64.36% and 75.54% as at the same date, thus allowing ample room for loan growth.

### Outlook

The stable outlook reflects RAM Ratings Lanka's expectation that MFL's asset quality will be better than the industry average. Additionally, the Company's performance is anticipated to improve on the back of loan expansion, albeit still weak. Moreover, funding and liquidity levels are anticipated to recede but remain above statutory minimum.

An upward revision of the ratings could materialise if there is a significant improvement in MFL's size and performance, while asset quality remains intact and all regulatory requirements are fulfilled.

### Corporate Profile

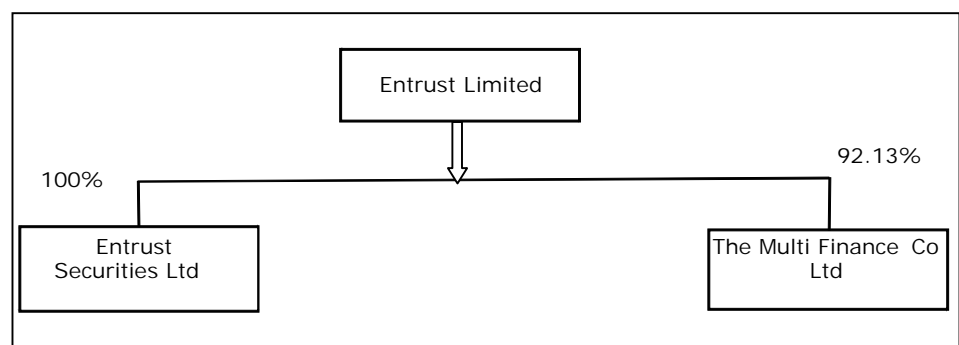
Established in 1974, MFL is registered under the Finance Companies Act No.78 of 1988 and the Finance Leasing Act No. 56 of 2000. The latter permits the Company to carry out its leasing business. Registered under the above acts, the Company thus comes under the purview of the Central Bank.

MFL remains one of the smallest RFCs in Sri Lanka, with an asset base of only LKR 360.22 million as at end-September 2009. Its main operations include HP financing for vehicles and leasing, supplemented by other credit products. On the funding side, the Company accepts public deposits and is supported by 48 employees in 5 branches.

### Ownership

The Company's largest shareholder continues to be Entrust. Apart from MFL, the parent company owns Entrust Securities Ltd (refer to Chart 1). Entrust's shares are presently held by Ceylinco Capital Investments Ltd. In the near future, Pacific Trust - a joint venture set up to take over Entrust and its subsidiaries - is expected to become MFL's ultimate parent. The change in ownership is expected to take place upon final approval from the courts.

Chart 1: Entrust Group's structure



*Incorporated in 1974*

*Still among smallest RFCs*

*Change in MFL's ultimate parent expected in the near future*

## Management & Strategies

### *New chairman*

Mr AHM Riyaz - the chief executive officer (“CEO”) – is currently acting as *pro tem* chairman as Mr HK Silva vacated his seat due to legal charges. Recently, Dr Asoka N Jinadasa was given the regulatory nod to lead the Company’s board. Dr Jinadasa has extensive consultancy experience in many sectors.

### *Loan expansion while HP remains dominant*

The management continued to pursue loan growth. However, over the reviewed period the Company acquired an HP portfolio from Ceylinco Leasing Corporation (“CLC”) - discussed in detail under *Asset Quality*. Going forward, the management expects to further augment the Company’s loan base, with lease and HP products. Nonetheless, we expect the Company’s overall portfolio to be dominated by HP.

### *Deposits to fund loan growth*

Subsequent to Entrust’s capital infusions amounting to LKR 171.17 million, the Company’s main funding source has been shareholders’ funds. Going forward, however, MFL’s loan growth is expected to be supported by deposit funding. RAM Ratings Lanka is concerned about the Company’s high deposit-concentration risk and low deposit renewal rates (discussed in detail under *Funding and Liquidity*).

### *Information risk to be mitigated*

With regard to its information technology (“IT”) system, the migration to an automated framework was accomplished in late January 2010. RAM Ratings Lanka opines that the new system is likely to provide effective monitoring and control.

## Corporate Governance & Risk Management

### *Board composition*

As at end-December 2009, the board comprised 9 members, 5 of whom were non-executive directors (“NEDs”). Meanwhile, the board is supported by a credit committee- which convenes once in 3 months, and an executive committee that convenes monthly. Monthly financials, recoveries, sales and future strategies are discussed at the executive committee meetings.

While internal audits are carried out quarterly by M/s Ernst & Young, external annual audits are carried out by M/s Udayasiri Kariyawasam & Co. Previously, its external audits were carried out by M/s BR De Silva & Co. In the context of related-party transactions, the Company had yet to receive a sum of LKR 1.06 million as at end-September 2009, from its former sister company, The Multi Traders and Agencies Limited.

### *Risk-management framework must be strengthened*

RAM Ratings Lanka opines that MFL’s risk-management framework needs to be strengthened. Although MFL’s credit risk management has enabled it to record better-than-industry gross NPL ratios during the reviewed period, loan-concentration risk was still evident in the portfolio. We therefore believe that there is room for improvement in this area. Additionally, the lack of an asset-liability committee (“ALCO”) is viewed with concern; managing internal, funding and liquidity risks become crucial as the Company seeks expansion.

## Asset Quality

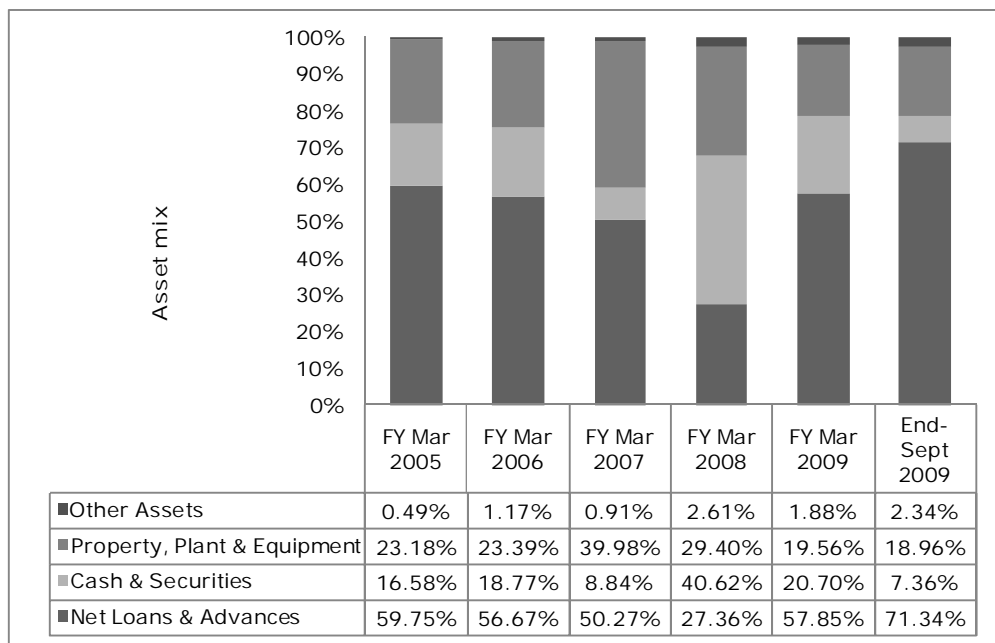
*Improving asset quality*

*Asset mix reflects loan expansion*

MFL's asset quality is improving on the back of stringent monitoring and stronger recoveries, despite the non-conducive macroeconomic conditions. This is reflected in the Company's easing gross NPL ratio, which is also lower than its peers'. That said, large loan exposures remain a concern. Moreover, as MFL pursues its expansion plans, it is vital that the Company demonstrates its ability to keep its asset quality intact.

MFL's asset base augmented 54.24% year-on-year ("y-o-y") in FY Mar 2009, supported by the acquisition of an HP portfolio and internal loan growth. Subsequent to loan expansion towards end-September 2009, the proportion of its liquid assets had receded to 7.36%, from 20.70% as at FY Mar 2009 (refer to Chart 2).

Chart 2: Asset mix



*Acquired HP portfolio; most contracts seasoned, all in performing category*

*Stronger growth compared to previous years*

*HP still dominates loan portfolio*

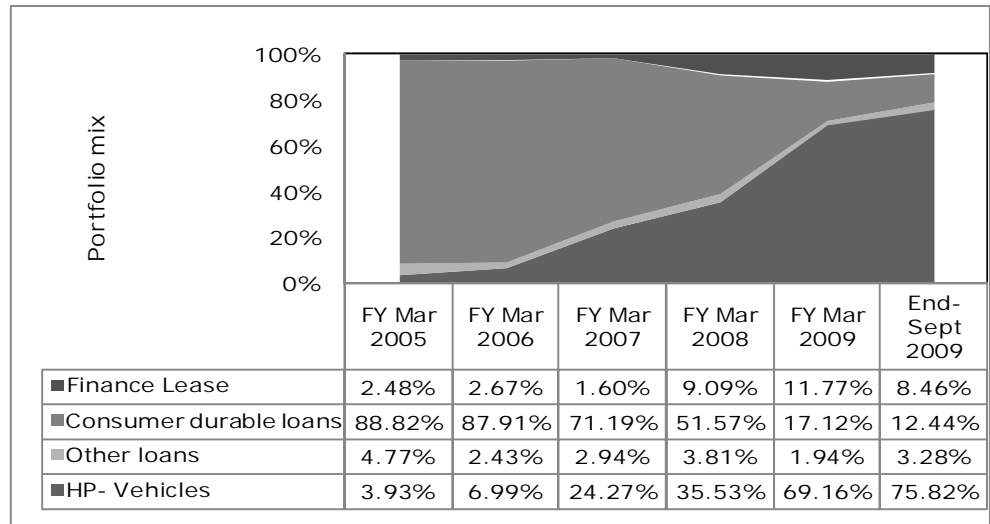
The Company's loan portfolio tripled to reach LKR 203.36 million during the year (FY Mar 2008: LKR 66.79 million). This surge was facilitated by the acquisition of LKR 78.56 million of HP contracts from CLC in FY Mar 2009. Subsequent to due diligence carried out by the CEO and the finance director ("FD"), the portfolio had been purchased in 2 stages. The first portfolio was valued at LKR 46.74 million in November 2008, followed by another LKR 31.82 million of contracts in January 2009. These portfolios had been acquired at returns of 30% and 28.50%, respectively. We note that most of the contracts are seasoned, and all are in the performing category.

Apart from the portfolio acquisition, loan books grew at a faster pace than in previous years. MFL's loans expanded by LKR 58.01 million as at FY Mar 2009 and further augmented by LKR 58.78 million over the ensuing 6 months. Due to this unprecedented loan growth, about 37% of this portfolio remains unseasoned; heightening the need to maintain vigilant monitoring.

HP continued to dominate the portfolio (refer to Chart 3) while vehicle financing remained a major portion of the HP portfolio as at end-September 2009. Going forward, its portfolio mix is expected to tilt more towards leases, with HP its

mainstay. In the meantime, MFL's loan portfolio for consumer durables continued its declining trend as lending to this delinquency-prone segment was curbed.

Chart 3: Portfolio mix



*Loan-concentration risk remains*

On a related note, loan-concentration risk remains in the portfolio. MFL's top 10 loans accounted for 27.82% of its gross loans as at end-FY Mar 2009. RAM Ratings Lanka opines that the defaults on these loans will bring about high credit costs, thus pressuring the Company's already-weak performance.

*Easing gross NPL ratio*

On a more positive note, MFL's absolute gross NPLs have been easing on the back of stringent monitoring and stronger recoveries (refer to Table 1). Lower gross NPLs together with a surge in its loan base had ameliorated its gross NPL ratio to just 1.94% as at end-FY Mar 2009 (end-FY Mar 2008: 10.20%). In this regard, MFL performed better than most of its peers.

Table 1: NPL movements

LKR millions	FY Mar 2006	FY Mar 2007	FY Mar 2008	FY Mar 2009	End-Sept 2009
Balance brought forward	9.40	6.79	4.78	6.65	3.89
Add: New NPLs	1.65	0.44	3.22	-	0.22
Less : Restructured	-	-	-	-	-
Write offs	2.02	0.95	0.11	0.07	-
Recoveries	2.24	1.50	1.24	2.69	0.02
Carried Forward	6.79	4.78	6.65	3.89	4.10

Nonetheless, MFL's absolute gross NPLs deteriorated slightly by LKR 0.21 million in the 6 months to end-September 2009. However, supported by buoyant loan expansion, its gross NPL ratio remained benign at 1.54% as at end-September 2009. Going forward, absolute gross NPLs are expected to deteriorate on the back of loan expansion; however its gross NPL ratio is expected to remain better than peers'.

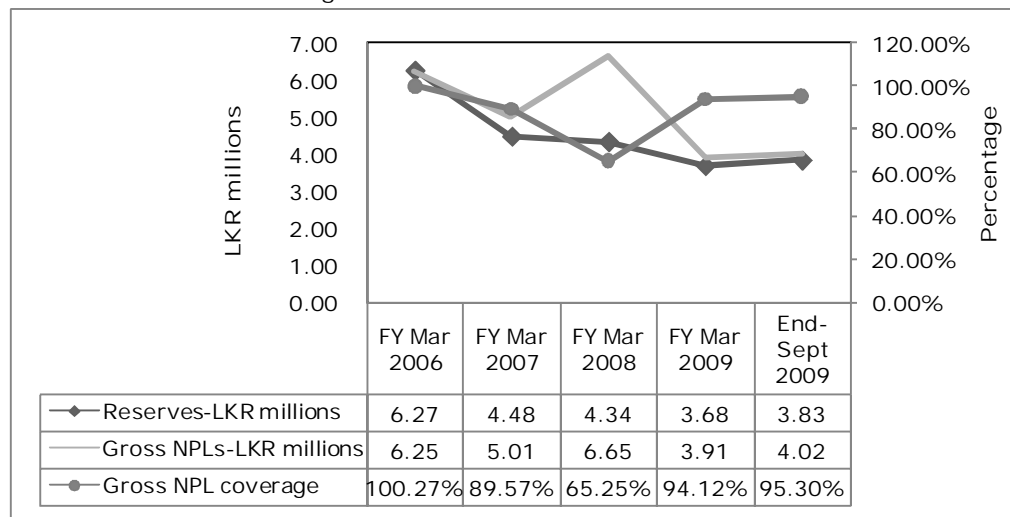
*Reviewed and revised its credit policies, regular portfolio monitoring*

We also note that the Company has reviewed and revised its credit policies. For instance, loans are now granted on the lower of forced-sale value or market price, and not on valuation. Additionally, each facility is personally vetted by the CEO or the FD before approval is granted. Meanwhile, branches conduct monitoring on a weekly basis while collection ratios are scrutinised monthly - actual collections are compared against budgeted collections. The number of loan contracts is deemed manageable at present. However, as MFL seeks growth, the robustness of the Company's system will be tested.

*Gross NPL coverage deemed sufficient*

RAM Ratings Lanka perceives MFL's gross NPL coverage to be adequate. The Company's coverage surged to 94.12% as at end-FY Mar 2009 (end-FY Mar 2008: 65.25%), underscored by a reduction in its absolute gross NPLs (refer to Chart 4). This improving trend continued into September 2009, with a gross NPL coverage of 95.30% at the end of the period. We note that coverage remained sufficient since bulk of MFL's gross NPLs were more than 1 year, requiring full provisions (79.49% of total gross NPLs). Going forward, RAM Ratings Lanka expects MFL's gross NPL coverage to decline somewhat due to the accretion of NPLs.

Chart 4: Gross NPL coverage



Performance

*Performance remains weak*

MFL's performance remains weak; its pre-tax profit continued to be weighed down by hefty overheads during the reviewed period. Consequently, its return-on-assets ("ROA") and return-on-equity ("ROE") were weaker than most of its peers'. Prospectively, however, the Company's performance is expected to ameliorate due to loan expansion, albeit still weak pressured by hefty overheads.

*Improving NIM*

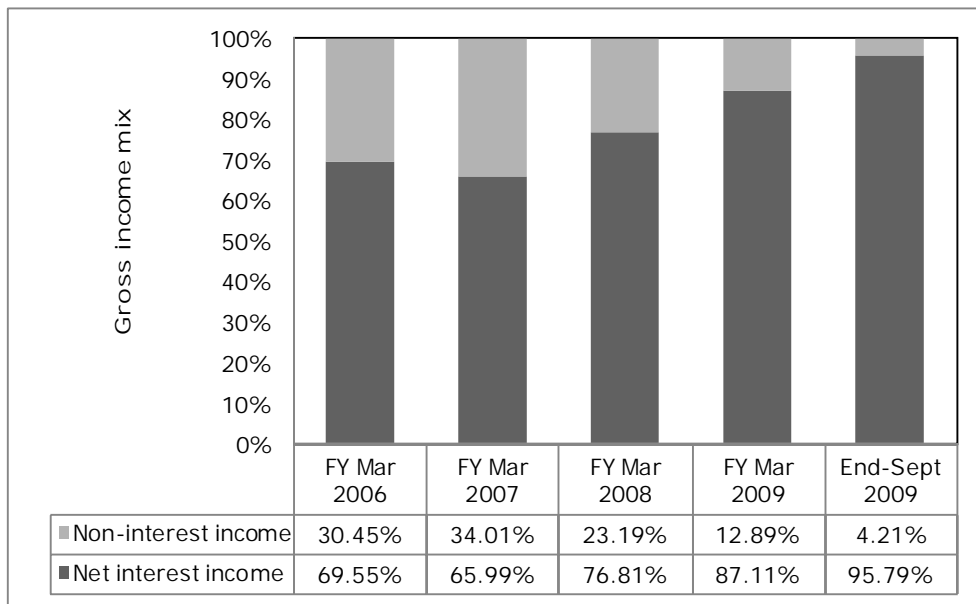
MFL's net-interest margin ("NIM") advanced from 10.68% as at end-FY Mar 2009 to 16.61% as at end-September 2009 (end-FY Mar 2008: 9.00%), outperforming its peers. This advancement was mainly a result of the higher (+61.10% y-o-y) interest income stemming from the enlarged HP portfolio. Consequently, its interest income outpaced the 26.43% growth of its interest expense in FY Mar 2009. As a result, its net interest income appreciated LKR 13.42 million to LKR 30.17 million (end-September 2009: LKR 29.20 million). In light of the receding interest-rate scenario and portfolio expansion, its NIM is expected to widen.

*Gross income mix tilted towards net interest income*

In the meantime, stronger growth in net interest income had driven a 58.79% growth in its gross income to LKR 34.63 million in FY Mar 2009. Its gross income mix therefore tilted more towards net interest income (refer to Chart 5). Meanwhile, MFL's non-interest income declined to LKR 4.46 million in FY Mar 2009 (FY Mar 2008: LKR 5.06 million), dampened by receding finance charges; finance charges have been lower as MFL no longer applies a uniform rate across all loans. Finance charges are at a fixed nominal amount depending on whether loans are greater or lesser than LKR 0.5 million.

*Cost-to-income ratio is considered high*

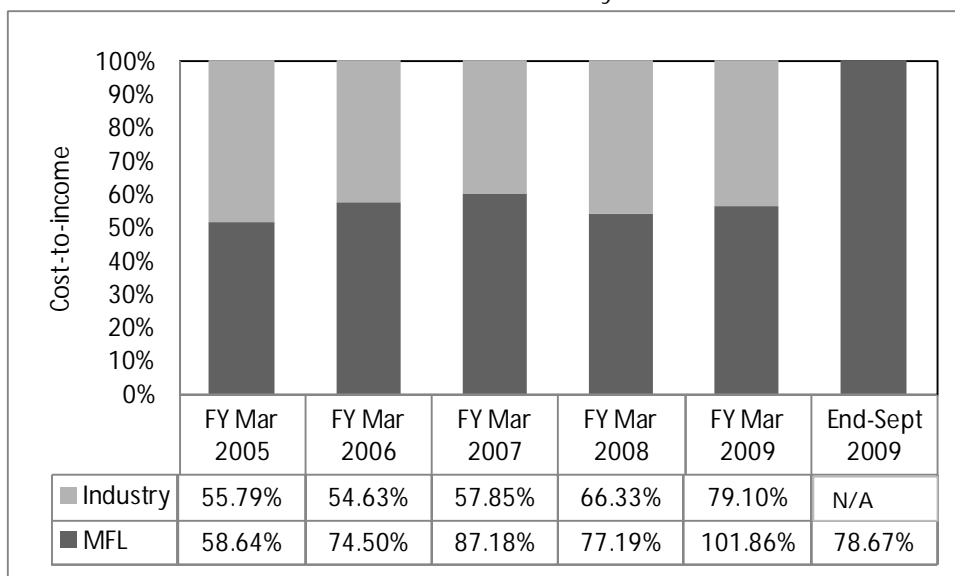
Chart 5: Gross income mix



Regardless of improving gross income, MFL’s cost-to-income ratio has remained high due to hefty overheads; worse than the industry (refer to Chart 6). The Company’s personnel expenses climbed LKR 4.38 million to LKR 12.61 million in fiscal 2009 while other overheads ascended LKR 14.06 million, pushing up its cost-to-income ratio. Other overheads had swelled, due to branch expansion and a one-off VAT charge relating to 2004 and 2005; the VAT charge rendered a pre-tax loss in FY Mar 2009 (adjusted for VAT as at end-FY Mar 2009: 82.48%). However, in the 6 months to 30 September 2009, cost-to-income ratio still remained worse than its peer category at 78.67%.

We note that MFL has projected LKR 3.0 million of savings from personnel costs following a voluntary retirement scheme (“VRS”) during the year. While this may assist easing of costs, overall costs are expected to remain hefty. Prospectively, however, its cost-to-income ratio is envisaged to ease as gross income expands, albeit still weaker than its peers’.

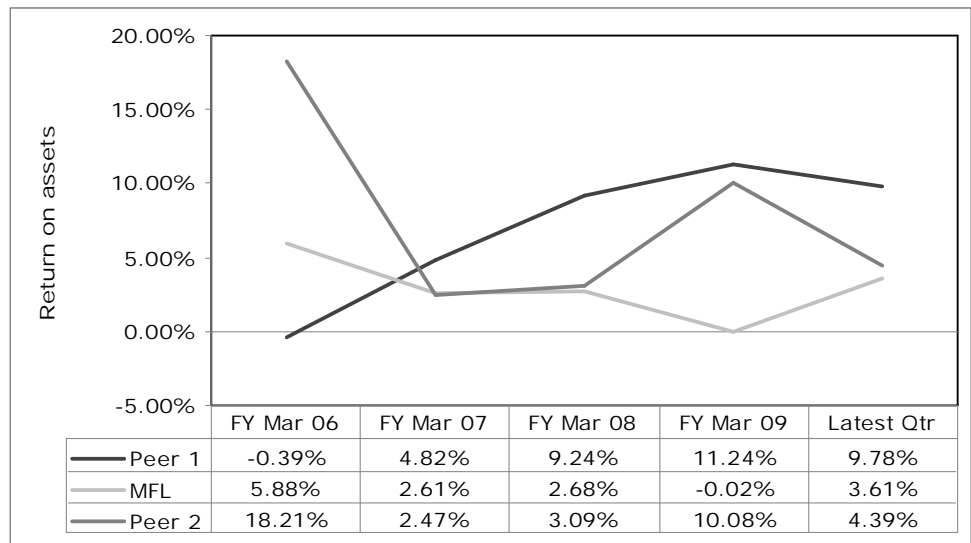
Chart 6: MFL’s cost-to-income ratio vs the industry



*ROA and ROE weaker than industry*

The Company's one-off VAT expenses resulted in a pre-tax loss of LKR 0.05 million in FY Mar 2009 (FY Mar 2008: LKR 5 million profits). RAM Ratings Lanka understands that profits are not expected to be affected by prior-year VAT charges, as VAT liabilities for 2005/06 and 2006/07 have been time-barred. Meanwhile, we note that MFL's performance had reverted to historical levels by end-September 2009. Its pre-tax profit came up to LKR 4.13 million, with a corresponding ROA of 3.61% and ROE of 5.16%. Pressured by hefty overheads, however, the ratios are still weaker than those of its similar rated peers (refer to Chart 7).

Chart 7: MFL's ROA vs those of similarly rated peers



*Funding and liquidity positions deemed moderate*

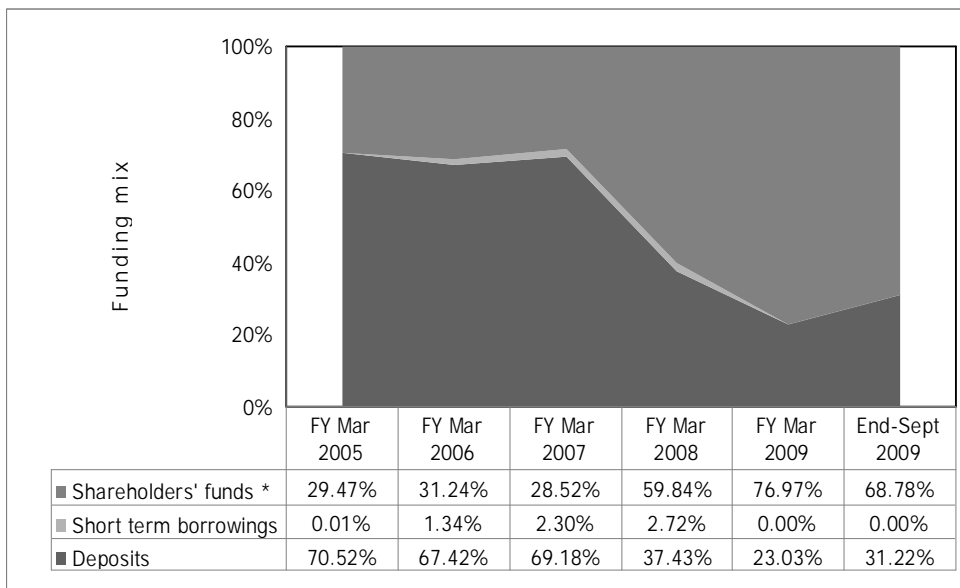
### Funding & Liquidity

MFL's funding and liquidity positions are deemed moderate. Capital infusions had resulted in a better ALM profile, while MFL's statutory liquidity ratio has receded to almost industry levels -albeit well above the regulatory minimum. Prospectively, public deposits are expected to gain more prominence within the funding base.

*Deposits expected to be main funding source*

Subsequent to Entrust's capital infusions, MFL's funding needs have been fulfilled primarily via shareholders' funds (refer to Chart 8). Nonetheless, deposits are expected to become its major funding source going forward. MFL's deposits decreased from LKR 67.51 million as at end-December 2009 to LKR 61.51 million as at end-FY Mar 2009, owing to the RFC industry crisis. However, this trend had been arrested by an LKR 33.67 million surge in deposits to LKR 95.19 million as at end-September 2009. All said, we remain concerned about MFL's lower-than-industry deposit-renewal rate of 35.87% as at end-September 2009 (RAM Ratings Lanka's portfolio average: 75%).

Chart 8: MFL's funding mix



\*Excluding revaluation reserves

*Deposit concentration still significant*

The Company's deposit base is made up of a few large depositors. Concentration risk is therefore high, with MFL's top 10 depositors accounting for 24.87% of its deposits as at end-FY March 2009.

*Better ALM profile*

On the other hand, the Company's ALM profile had improved (refer to Table 2) by end-FY Mar 2009, owing to capital infusions. RAM Ratings Lanka was unable to assess the Company's liquidity and interest rate risk as at September 2009- due to limited information. This, together with the lack of an ALCO is viewed with concern.

Table 2: MFL's asset-liability mismatch

LKR millions	FY Mar 2008				FY Mar 2009			
	Interest Earning Assets	Interest Bearing Liabilities	Gap	Cumulative Gap	Interest Earning Assets	Interest Bearing Liabilities	Gap	Cumulative Gap
Less than 1 Year	139.04	45.40	93.64	93.64	137.25	47.13	90.12	90.12
1 to 3 Years	9.29	14.46	(5.18)	88.47	97.29	12.77	84.51	174.63
More than 3 Years	0.54	8.35	(7.80)	80.66	31.33	1.68	29.65	204.28
Total	148.86	68.20	80.66		265.87	61.59	204.28	

*Statutory liquid-asset ratio above regulatory minimum*

Elsewhere, due to loan expansion, the Company's statutory liquid-asset ratio receded to 27.86% as at end-September 2009 (end-FY Mar 2009: 115.36%). Going forward, the ratio is expected to recede further but remain above the regulatory minimum of 10%.

## Capital Adequacy

*Comfortable capitalisation levels*

Despite MFL's weaker performance, its capitalisation levels have remained healthy. Its Tier-1 and overall RWCARs stayed well above the regulatory minimums, allowing ample room for loan growth. As at FY Mar 2009, MFL's capital was sufficient to cushion a few large loan defaults. However, due to the unavailability of information on the Company's large loans as of end-September 2009, RAM Ratings Lanka is unable to assess the adequacy of its capital buffer.

*Tier1 and overall RWCARs sufficient for loan expansion*

We note that MFL's Tier-1 and overall RWCARs were kept lofty at 76.59% and 90.18%, respectively, as at end-FY Mar 2009. Entrust's equity infusions had enlarged the Company's shareholders' funds to LKR 242.02 million as at the same date. Loan growth, however, had pushed these ratios down to a respective 64.36% and 75.54% as at end-September 2009. Nevertheless, MFL's Tier-1 and RWCARs were well above the respective regulatory minimums of 5% and 10%, thus permitting room for loan expansion.

*Weak internal capital generation*

Although MFL's internal capital generation clawed back up to 3.35% as at end-September 2009 (end-FY Mar 2009: -2.26%), it was still weaker than those of its similarly rated peers. Moving forward, capital generation is expected to pick up in line with the anticipated improvement in MFL's performance- albeit still weak.

## Industry Overview

Sri Lanka's gross domestic product ("GDP") expanded 4.2% in 3Q 2009. Although this was weaker than the 6.3% growth attained in 3Q 2008, the slower growth has to be put in the context of the present global downturn. Not surprisingly, all 3 major sectors of the Sri Lankan economy have been hit by the global upheaval.

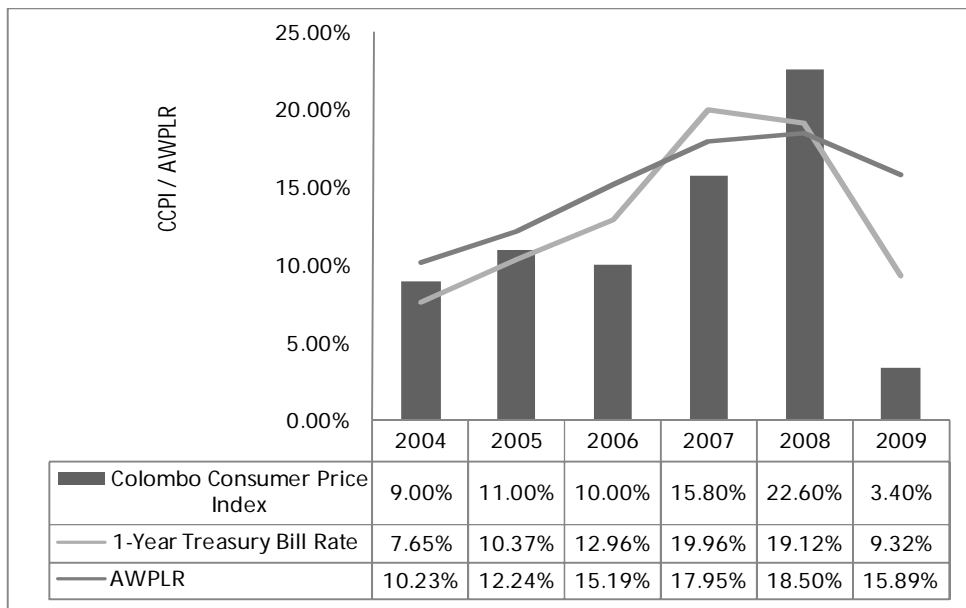
The performance of the island's primary sector (i.e. agriculture, forestry and fishing) was hampered by droughts, weaker prices and receding global demand. The sector contracted 0.9% during the period compared to the 12.4% increase the previous year. Value addition from all major export crops declined owing to droughts and reduction in production following the steep fall in commodity prices during latter 2008. Other sectors advanced at a slower pace principally due to dampened export demand (refer to Table 2). Moreover, GDP growth for 2009 is expected to clock in at 3.5%, which is significantly lower than 6.0% recorded for 2008.

Table 3: Sectoral contributions to GDP

Sector	3Q 2008	3Q 2009
Agriculture, forestry and fishing	12.4%	-0.9%
Industrial	5.6%	4.4%
Services	5.5%	5.1%
GDP	6.3%	4.2%

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 advent of the stand-by-facility from the International Monetary Fund together with the issuance of USD 500 million sovereign bonds in the latter half of 2009 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 9). While these augur well for the economy, sluggish export demand is still a concern. Furthermore, interest rates have dipped sharply as the Central Bank loosened 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 9: 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 timely intervention 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. Furthermore, the Central Bank launched a stimulus package worth LKR 4.2 billion to ease any liquidity strains on other troubled RFCs and leasing companies.

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 present 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 2010. This view is anchored by our expectations vis-à-vis low interest rates and economic recovery. The sector's funding costs have already begun to ease as deposit rates have dropped, while rates on lending have not declined in tandem.

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 last 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 notes that the industry's funding structure could weaken should 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 adequate to support asset growth nearing 40%. However, RAM Ratings Lanka notes that the current capital-adequacy framework does not capture the entire spectrum of risks inherent in RFCs.

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

## Relevant Central Bank Directions Applicable to Registered Finance Companies

Liquid assets	<p>Every finance company must have a minimum holding of liquid assets at any given time. Liquid assets mean:</p> <p>Cash in hand.</p> <p>Balances in a current or deposit account in a commercial bank, free from any banker's lien or charge.</p> <p>Sri Lankan Government Treasury Bills, free from any charge or lien.</p> <p>Sri Lankan Government Securities maturing within 1 year and free from any charge or lien.</p> <p>Central Bank securities maturing within 1 year and free from any charge or lien.</p> <p>Cash balance, if any, maintained with the Central Bank.</p> <p>The minimum limits are as follows:</p> <p>For time deposits, 15% of outstanding deposits.</p> <p>For certificates of deposits, 15% of the face value of the certificates.</p> <p>For savings deposits, 20% of the outstanding deposits.</p> <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>
Provision of bad and doubtful debts	<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>Direction No. 1 of 1991</p> <p>Bad and doubtful debts provided for under this direction are subject to a minimum of:</p> <p>50% of all advances in arrears for a period of 7 to 12 months.</p> <p>100% of all advances in arrears for 13 months or more.</p> <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> <p>The value so deducted should not exceed the value decided by a professional valuer at the time of granting the advance.</p> <p>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> <p>Direction No. 2 of 1991</p> <p>Bad and doubtful debts provided for under this direction are subject to a minimum of:</p> <p>50% of all advances in arrears for a period of 12 to 24 months.</p> <p>100% of all advances in arrears for more than 24 months.</p> <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>Direction No. 3 of 2006</p> <p>Bad and doubtful debts provided for under this direction are subject to a minimum of:</p> <p>50% of all advances in arrears for a period of 6 to 12 months. 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> <p>Sri Lankan Government securities, free from any lien or charge. Central Bank securities, free from any lien or charge. Time deposits in a licensed commercial bank, specialised bank or RFC, free from any lien or charge. Bank guarantees.</p> <p>With regard to repossessed vehicles and machinery, 80% of the valuation obtained in the preceding 6 months and by an approved valuer.</p> <p>With regard to mortgaged land and buildings that are held as collateral, if the accommodation has been in arrears for a period of:</p> <p>6-36 months, 100% of the value is deductible 37-60 months, 80% of the value is deductible 61-120 months, 50% of the value is deductible more than 120 months, 0% of the value is deductible</p>
<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 finance company with a core capital of less than LKR 100 million must:</p> <p>enhance its core capital to at least LKR 100 million by February 2007; and bring the remaining LKR 100 million or the deficit up to the core-capital requirement of LKR 200 million by July 2008.</p> <p>A finance company with a core capital of between LKR 100 million and LKR 200 million must bring in:</p> <p>at least 50% of the deficient amount to meet the core-capital requirement of LKR 200 million by February 2007; and the balance of the deficient amount up to the core capital requirement of LKR 200 million by July 2008.</p>
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## Corporate Information

Date of Incorporation: 14 October 1974

Commencement of Business: 1974

Major Shareholders:	Ceylinco Shriram Securities Holdings Ltd	92.13%
	Mrs J Kalubowila	3.13%
	Dr NW Karunaratne	0.67%
	Mr C Madugalle	0.57%
	Mr SB Rangamuwa	0.48%

Directors:	Mr AHM Riyaz	Director /Chief Executive Officer/Pro tem chairman
	Mrs JK Ranapura	Deputy Chairperson
	Mrs CJ Attapatu	Director/General Manager
	Mrs L Wickremasooriya	Finance Director
	Mr C Madugalle	Director
	Mr N Mendis	Director
	Mr S Dayarathna	Director
	Mr HK De Silva	Director

Auditor: Udayakariyawasam & Company Ltd

Listing: Not listed

Key Management:	Mr AHM Riyaz	Executive Director/Chief Executive Officer
	Mrs L Wickremasooriya	Finance Director/Compliance Officer
	Mrs CJ Atapattu	Director/General Manager
	Mr CJ Gamage	Senior Manager-Sales & Marketing
	Mr Shirantha Gannoruwa	Accountant

Major Subsidiaries and Associates:

Capital History:	Year	Remarks	Amount (LKR million)	Cumulative Total (LKR million)
	2000	Brought forward	6.79	6.79
	2000	Rights issue	0.23	7.02
	2001	Rights issue	0.06	7.08
	2003	Rights issue	0.70	7.78
	2004	Rights issue	2.10	9.87
	2005	Rights issue	3.34	13.21
	2006	Rights issue	0.50	13.71
	2007	Rights issue	0.05	13.82
	2008	Ordinary shares	71.17	84.99
	2008	Ordinary shares	100.00	189.99
	2009	Brought forward	189.99	189.99

## Financial Summary - Company

BALANCE SHEET (LKR Million)	Re-stated		Re-stated		30-Sep-09
	31-Mar-06	31-Mar-07	31-Mar-08	31-Mar-09	
<b>ASSETS</b>					
Cash & Money At Call	1.52	2.32	5.41	13.23	10.49
Deposits & Placements With Financial Institutions	11.45	3.46	3.74	1.55	0.00
Securities Purchased Under Resale Agreements	0.00	0.00	0.00	0.00	0.00
Securities					
Dealing Securities	6.51	7.17	80.83	56.18	16.03
Investment Securities	0.31	0.31	0.31	0.00	0.00
Gross Loans & Advances	68.88	81.86	66.79	203.36	262.14
Interest-In-Suspense					
General Loan Loss Reserves	2.86	1.94	1.64	1.34	1.31
Specific Loan Loss Reserves	0.00	0.00	0.00	0.00	0.00
Specific Loan Loss Reserves	6.27	4.48	4.34	3.68	3.83
Net Loans & Advances	59.75	75.43	60.81	198.34	256.99
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	1.23	1.37	5.81	6.46	8.42
Property, Plant and Equipment	24.67	59.99	65.35	67.06	68.29
<b>TOTAL ASSETS</b>	<b>105.45</b>	<b>150.06</b>	<b>222.27</b>	<b>342.82</b>	<b>360.22</b>
<b>LIABILITIES</b>					
Customer Deposits					
Savings					
Fixed	0.00	0.00	0.00	0.00	0.00
NIDs	63.11	69.25	63.58	61.51	95.19
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	1.25	2.30	4.63	0.00	0.00
Subordinated Debt & Hybrid Capital	0.00	0.00	0.00	0.00	0.00
Other Liabilities	10.35	13.14	12.71	39.29	18.89
<b>TOTAL LIABILITIES</b>	<b>74.71</b>	<b>84.70</b>	<b>80.91</b>	<b>100.80</b>	<b>114.08</b>
Paid-up Capital	13.71	13.82	84.99	189.99	189.99
Minority Interest	0.00	0.00	0.00	0.00	0.00
Share Premium & Other Reserves	12.83	48.08	47.90	47.72	47.72
Statutory General Reserve	1.79	1.83	1.91	1.91	1.91
Retained Profits/(Loss)	2.41	1.64	6.55	2.39	6.52
Total Shareholders' Funds	30.74	65.36	141.35	242.02	246.14
<b>TOTAL LIABILITIES &amp; SHAREHOLDERS' FUNDS</b>	<b>105.45</b>	<b>150.06</b>	<b>222.27</b>	<b>342.82</b>	<b>360.22</b>
<b>COMMITMENTS &amp; CONTINGENCIES</b>					
TIER 1 CAPITAL	0.00	0.00	0.00	0.00	0.00
CAPITAL BASE	29.29	28.54	101.63	205.56	209.69
	30.79	47.67	119.95	242.02	246.14

## Financial Summary - Company

INCOME STATEMENT (LKR Million)	31-Mar-06	31-Mar-07	31-Mar-08	31-Mar-09	30-Sep-09
Interest Income	19.75	21.36	25.92	41.76	36.66
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	7.63	8.59	9.17	11.59	7.46
Net Interest Income	12.11	12.77	16.75	30.17	29.20
Non-Interest Income	5.30	6.58	5.06	4.46	1.28
Gross Income	17.42	19.36	21.81	34.63	30.48
Personnel Expenses	7.28	9.45	8.22	12.61	9.61
Other Non-Interest Expenses	5.69	7.43	8.61	22.67	14.37
Loan Loss Provisions	(1.51)	(0.85)	(0.02)	(0.59)	0.15
Share of results of Associated Companies	0.00	0.00	0.00	0.00	0.00
Pre-Tax Profit	5.95	3.33	5.00	(0.05)	6.35
Taxation	1.06	2.70	1.50	4.28	2.22
Profit After Tax	4.89	0.63	3.50	(4.34)	4.13
Extraordinary Items	0.00	0.00	0.00	0.00	0.00
Prior Year Adjustments	0.00	0.00	1.50	0.18	0.00
Minority Interests	0.00	0.00	0.00	0.00	0.00
Transfer To Statutory Reserves	0.25	0.04	0.09	0.00	0.00
Transfer To Other Reserves	3.00	0.00	0.00	0.00	0.00
Dividend	1.72	1.37	0.00	0.00	0.00
Retained Profit For The Year	(0.07)	(0.78)	4.91	(4.16)	4.13

## Financial Ratios - Company

KEY RATIOS (%)	31-Mar-06	31-Mar-07	31-Mar-08	31-Mar-09	30-Sep-09
<b>Profitability</b>					
Net Interest Margin	11.99%	10.00%	9.00%	10.68%	16.61%
Non-Interest Income Margin	5.25%	5.15%	2.72%	1.58%	0.73%
Cost To Income	74.50%	87.18%	77.19%	101.86%	78.67%
Return On Assets	5.88%	2.61%	2.68%	(0.02%)	3.61%
Return On Equity	20.59%	6.93%	4.83%	(0.03%)	5.16%
Dividend Payout	35.11%	216.31%	0.00%	0.00%	0.00%
<b>Asset Quality</b>					
Gross NPL Ratio	9.47%	6.27%	10.20%	1.94%	1.54%
Net NPL Ratio	(0.03%)	0.69%	3.80%	0.12%	0.07%
Specific Loan Loss Provisions For Current Year	1.06%	0.99%	1.81%	0.64%	0.36%
Gross NPL Coverage	100.27%	89.57%	65.25%	94.12%	95.30%
Loan Loss Reserve Coverage	9.49%	5.61%	6.66%	1.82%	1.47%
<b>Liquidity &amp; Funding</b>					
Liquid Asset Ratio	30.27%	18.09%	131.93%	115.36%	27.86%
Statutory Liquid Asset Ratio	30.87%	18.69%	141.53%	115.36%	27.86%
Customer Deposits To Total Interest Bearing Funds	98.05%	96.79%	93.22%	100.00%	100.00%
Loans To Deposits Ratio	94.69%	108.92%	95.65%	322.42%	269.98%
Loans To Stable Funds Ratio	84.84%	98.06%	42.17%	83.87%	94.12%
<b>Capital Adequacy</b>					
Shareholders' Funds To Total Assets	29.15%	43.56%	63.60%	70.60%	68.33%
Tier 1 Risk Weighted Capital Adequacy Ratio	33.75%	20.95%	77.70%	76.59%	64.36%
Overall Risk Weighted Capital Adequacy Ratio	35.47%	34.98%	91.71%	90.18%	75.54%
Internal Rate Of Capital Generation	10.99%	(1.53%)	3.38%	(2.26%)	3.35%

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.

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### Long-Term Ratings

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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.*

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### Short-Term Ratings

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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 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.

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