RAM RATINGS

CREDIT RATING RATIONALE

FINANCIAL INSTITUTIONS – SRI LANKA

A wholly owned subsidiary of RAM Holdings Berhad

Associated Motor Finance Ltd-Rating Review

Financial Institution Ratings:
Long-term: BB- [Upgraded]
Short-term: NP [Reaffirmed]

Rating Outlook:
Stable

Strengths:
- Wider dealer base
- Healthy profitability
- Adequate funding
- Moderate capitalisation

Weaknesses:
- Weakening asset quality
- Small size

Previous Rating:
Long-term: B+
Short-term: NP

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

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Summary

RAM Ratings Lanka has upgraded the long-term financial institution rating of Associated Motor Finance Limited ("AMF" or "the Company") from B+ to BB-, with a stable outlook; the short-term rating has been reaffirmed at NP. The rating upgrade reflects AMF's more consistent healthy performance, but is weighed down by the Company's miniscule size and product concentration risk.

AMF is a small player, accounting for 0.30% of the assets of all domestic registered finance companies ("RFCs") as at end-March 2009. The Company is a family-held concern with Mr JPI Nalatha Dayawansa holding 90.68% of its shares as at FYE 31 March 2009 ("FY Mar 2009"). Previously, the Company was exposed to dealer concentration risk; AMF was solely dependent on David Peiris Motor Company Ltd's ("DPMC") sales outlets for business. However, over the past 2.5 years, the Company has diluted this risk by broadening its dealer base. Consequently, loan growth has been more consistent, resulting in an improved financial performance. These improvements are reflected in the Company's rating upgrade.

That said, RAM Ratings Lanka's concerns hinge on the product concentration risk. The bulk (77.87%) of its lending portfolio was dominated by motorcycle leases as at end-June 2009. Moreover, RAM Ratings Lanka notes a deterioration in asset quality; AMF's absolute gross non-performing loans ("NPL"), on a 6-month past-due basis, worsened by 96.85% to LKR 11.85 million as at end-FY Mar 2009 (FY Mar 2008: LKR 6.02 million). Additionally, 3 months from the financial year end, its absolute gross NPLs surged 134.19% on an annualised basis to LKR 15.83 million. This, together with a contracting loan base, resulted in a rise in its gross NPL ratio to 5.64% by end-June 2009 (FY Mar 2009: 3.85%). Although this ratio remains better than its peers, RAM Ratings Lanka views the pace of deterioration with concern.

Elsewhere, AMF has successfully met the minimum core capital requirement of LKR 200 million. The Company's capitalisation stood at LKR 196.37 million as at end-FY Mar 2009; this build-up was largely contributed by retained earnings. However, subsequent to a rights issue in November 2009, its core capital reached LKR 202.31 million. Meanwhile, AMF's Tier-1 capital adequacy ratio ("RWCAR") and overall RWCAR of 51.28% remained well above the regulatory minimums of 5% and 10% respectively as at end-Mar 2009.

The Company's growing capital base, coupled with restrained lending, has resulted in adequate funding and liquidity. Its main funding source remains its steady deposit base, which made up 55.28% of its funding structure as at end-June 2009. In addition, its statutory liquid asset ratio stood at 34.92% as at end-FY Mar 2009 – well above the regulatory minimum of 10%. Going forward,

as we expect the Company to resume lending, liquidity is expected to recede to historical levels.

Outlook

The stable rating outlook reflects the Company's improved earnings capacity and the capital buffer available to cushion it against rising NPLs.

On the other hand, ratings may come under pressure if there is significant deterioration in asset quality compared to its peers - taking into consideration its current portfolio and new ventures. The ratings may also be affected if there is significant erosion of its capital buffer or inadequate liquidity.

Corporate Profile

AMF, established in 1962 by the late Mr. Piyadasa, is registered under the Finance Companies Act No.78 of 1988 and the Finance Leasing Act No: 56 of 2000, under the regulatory purview of the Central Bank of Sri Lanka ("CBSL").

Less than 1% of industry's assets

It is one of the smallest RFCs, with an asset base of LKR 486.24 million; accounting for less than 1% of the industry's LKR 162.88 billion assets as at end-Mar 2009. AMF operates from a single location in Colombo with 35 staff members. The Company provides lease financing, hire purchase ("HP") mainly for motorcycles and is involved in accepting public deposits - its chief funding source.

Ownership

Family owned concern

AMF is a family-held concern. The Chairman, Mr JPI Nalatha Dayawansa, directly and indirectly holds 90.68% of AMF. Another 7.75%, which had been under testamentary action, is expected to increase Mr Dayawansa's stake to 98.43% by end-November 2009. The Company's other shareholders own the remaining 1.57%.

Mr. Dayawansa is the owner of Imperial Import and Export Company Ltd ("Imperial"), the focal family business set up to import and trade mainly heavy vehicles and cars.

Management & Strategies

Key-man risk

AMF's vision and strategies are set by the Chairman, Mr Dayawansa, and its daily operations are headed by the general manager/chief executive officer ("GM/CEO"), Mr TM Salley, who has been with the business for more than 10 years. The dependency on its GM/CEO and the absence of a succession plan exposes AMF to key-man risk.

Dealer base has expanded further

In augmenting its loan portfolio, AMF has expanded its dealer network from 72 to 99 in FY Mar 2009. The Company also continues to derive business from retail traders connected to DPMC; the market leader and sole agent for *Bajaj* motorcycles in Sri Lanka. Apart from this, AMF finances other popular motorcycle brands such as *Hero Honda, Yamaha and TVS.* The Company has also broadened its reach through group sales to government institutions (e.g. Air Force, Colombo Municipal Council).

Exploring new business avenues

Meanwhile, product concentration risk continues to exist in its portfolio, with 77.87% of loans from motorcycles and the rest from three-wheelers (21.98%) and hand tractors. Nonetheless, AMF is planning to diversify its financing to include fishing (mainly trawlers) and agricultural equipment. The Company intends to allocate LKR 50 million to financing boats and engines, following a study of the fisheries sector. Although this will aid in diversifying its portfolio, AMF's risk profile can only be gauged once a track record has been established.

Expansion of the trading business

Elsewhere, AMF continues to expand its trading business with the sale of imported heavy vehicles and 4-wheel drives - *Prime Movers and Defenders*. This exposure was expected to be capped at LKR 40 million last year; however, going forward, the Company expects to increase such investments to LKR 50 million. Since imports are made based on demand, market risks are mitigated to a certain extent.

Corporate Governance

Chaired and controlled by Mr Nalatha Dayawansa

The 3-member Board is chaired by Mr Nalatha Dayawansa and remains the ultimate decision-maker. The other 2 members are his wife, Mrs S Dayawansa, and his mother, Mrs GJ Perera - the widow of the late Mr JPI Piyadasa.

There has been no change to the Company's reporting structure from last year. Mr Salley, the GM/CEO, reports directly to the Chairman. The Board meets quarterly, to review its financial performance and the deposit interest rates. Management committee meetings are also carried out weekly. Meanwhile, external audits are carried out by SJMS Associates; however, AMF does not maintain an internal audit function to manage risks and internal control procedures.

Asset Quality

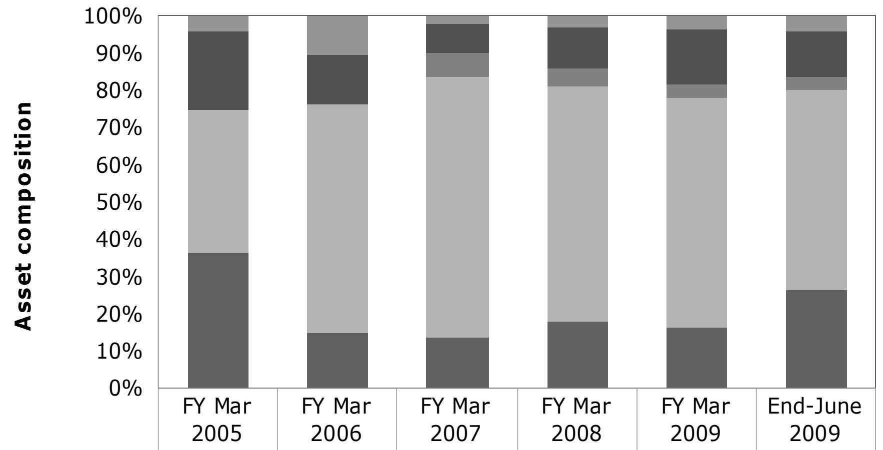
Asset quality affected by product concentration risk

Over the past few years, loan volatility, which was associated mainly with dealer concentration risk, has largely been dissipated following a broadened dealer base. However, volatility associated with product concentration risk still persists. Additionally, RAM Ratings Lanka has observed an escalation in AMF's absolute gross NPLs. This, together with a contraction in the Company's loan portfolio, has resulted in a rise in gross NPL ratio; however, this remains better than its peers. Over the long-term, we expect the gross NPL ratio to ease on the back of improving macroeconomic conditions.

Asset growth driven by increase in loan portfolio

AMF's asset base grew by 31.23% to LKR 486.24 million, driven by loan expansion as at end-FY Mar 2009. Loans advanced by 28.11% year-on-year ("y-o-y"), surpassing industry norms. The secondary driver, other assets (comprising mainly deferred tax assets and motor vehicle stocks), grew 73.06% y-o-y to reach LKR 70.94 million in FY Mar 2009. Consequently, AMF's asset mix changed slightly during the year (refer to Chart 1).

Chart 1: Asset composition



	FY Mar 2005	FY Mar 2006	FY Mar 2007	FY Mar 2008	FY Mar 2009	End-June 2009
Property, Plant and Equipment	4.00%	10.65%	2.10%	3.09%	3.91%	4.01%
Other Assets	21.09%	13.01%	7.68%	11.13%	14.64%	12.47%
Investment Land and Properties	0.00%	0.00%	6.38%	4.73%	3.57%	3.48%
Net Loans & Advances	38.75%	61.43%	69.92%	62.97%	61.47%	53.81%
Liquid assets	36.17%	14.92%	13.92%	18.08%	16.40%	26.22%

However, AMF's loan portfolio contracted by 36.28% as at end-June 2009. This contraction was counterbalanced by an increase in liquid assets. Prospectively, the composition of 'other assets' is likely to increase, as the Company intends to augment its exposure to motor vehicles stock to LKR 50 million by the end of FY Mar 2010 (end-June 2009: LKR 26.81 million).

Portfolio mix remains the same

Meanwhile, the portfolio mix has remained the same as in the year earlier, with leasing continuing to be the principal component. The lease portfolio jumped by 33.36% to LKR 430.99 million in FY Mar 2009, given the affordability of rentals due to the small ticket size of loans. While the lease portfolio continued to grow, hire purchases contracted to LKR 3.81 million as at end-FY Mar 2009.

Volatility still persists

Although AMF's portfolio volatility due to dealer concentration risk has been diluted, the volatility associated with product concentration risk prevails. This is reflected in the Company's portfolio contraction by end-June 2009. The bulk (77.87%) of AMF's loans is made up of short-tenured motorcycle financing. Consequently, AMF has to originate loans at a faster pace to make up for the faster loan depletion associated with short-tenured loans. In contrast, other finance companies' lease tenures are longer (4 - 5 years)[1]. Nevertheless, RAM Ratings Lanka anticipates that the Company will resume lending in the short-term.

Product concentration risks

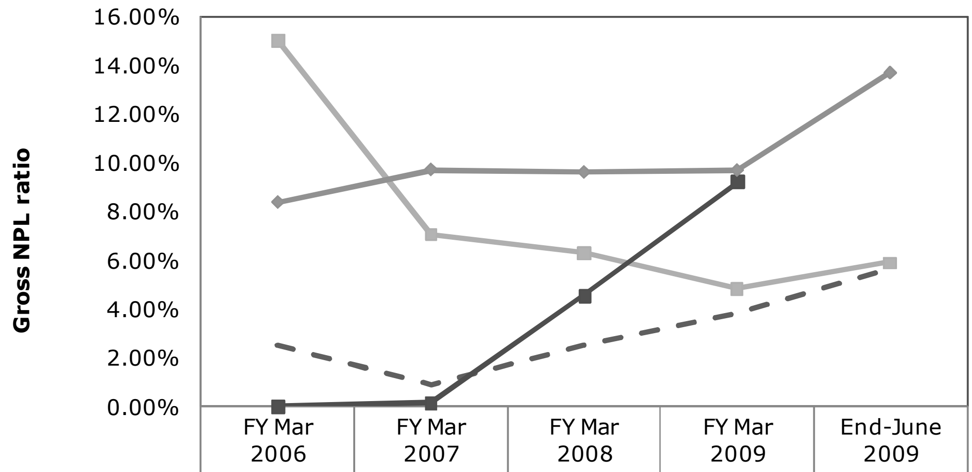
Although RAM Ratings Lanka has concerns about AMF's product concentration risk, we anticipate that this will be resolved to a certain extent in the near future. Going forward, the Company intends to venture into financing fisheries and agriculture equipment, with an emphasis on the former. Since fisheries and agriculture are untested areas, RAM Ratings Lanka will closely monitor its credit risk in this regard. Nonetheless, motorcycle leasing is expected to be the Company's mainstay over the short-term.

[1] Other finance companies' lease portfolios consist of cars and vans

Worsening gross NPLs

In line with loan expansion amidst challenging macroeconomic conditions, AMF's gross NPL ratio worsened to 3.85% in FY Mar 2009 (FY Mar 2008: 2.54%). It reached a 4-year high of 5.64% by end-June 2009 partly owing to a contracting loan base; but remains better than its peers (refer to Chart 2). That said, RAM Ratings Lanka's concerns hinge on AMF's escalating absolute gross NPLs. Gross NPLs surged by 96.85% to LKR 11.85 million as at end-FY Mar 2009 and worsened to LKR 15.83 million by end-June 2009. Although the Company's gross NPLs have traditionally been better than the industry, we view the pace of deterioration with concern.

Chart 2: Gross NPL ratio-AMF and peers



	FY Mar 2006	FY Mar 2007	FY Mar 2008	FY Mar 2009	End-June 2009
AMF	2.53%	0.92%	2.54%	3.85%	5.64%
Peer 1	15.06%	7.07%	6.30%	4.83%	5.90%
Peer 2	0.00%	0.17%	4.54%	9.20%	N/A
Peer 3	8.37%	9.71%	9.60%	9.68%	13.70%

Adequate gross NPL coverage

AMF's gross NPL coverage remained adequate at 73.76% as at end-FY Mar 2009. Consequently, the Company's net NPL ratio also stood at a low 1.04% as at the same date. Coverage slightly weakened to 70.44% by end-June 2009 as a result of rapid escalation in absolute gross NPLs.

Better recoveries

Along with its adequate gross NPL coverage, AMF has placed more emphasis on its recovery efforts. In order to ensure an optimum focus on recoveries, the Company has decided to cut back on lending. Besides, AMF has made its repayment terms to defaulters more flexible to improve recovery prospects, since the secondary market value of collateral (motorcycles) is low.

Performance

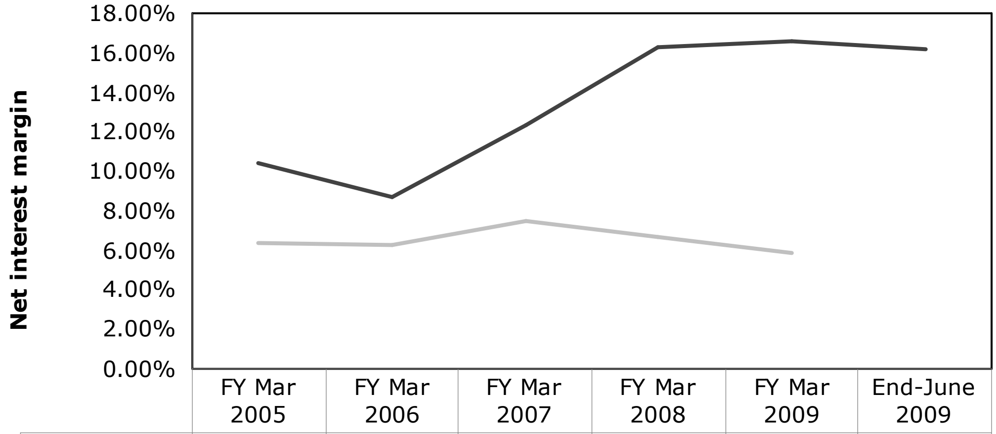
Healthy performance

Despite the product concentration risk in its portfolio, AMF displayed yet another year of improved performance. This was supported by loan expansion from a growing dealer base, and higher-than-industry yields from its product focus (financing motorcycles). Therefore, notwithstanding rising costs and increasing provisions, pre-tax profits grew by 61.51% to reach LKR 48.17 million in FY Mar 2009. Moreover, we note that the Company benefited from a one-off deferred tax adjustment amounting to LKR 21.22 million. Going forward, we expect performance to ease slightly on the back of sluggish loan portfolio growth; albeit remaining better than the industry.

Higher than industry average NIM

Alongside portfolio expansion and better-than-industry yields, AMF's interest income broadened by 43.78% to reach LKR 127.72 million during FY Mar 2009. This improvement, however, was overshadowed by the more than equivalent rise in interest expenses (55.48% y-o-y), originating from costly short-tenured deposits. As a result, net interest income grew at a slower pace (35.68% y-o-y) to reach LKR 71.21 million during the review period. Accordingly, NIM of 16.62% showed little improvement, although it ranked better than the industry average - 5.83% (refer to Chart 3) - and its peers. Further, NIM declined slightly to 16.21% owing to slower loan growth towards end-June 2009.

Chart 3: NIM-AMF and industry

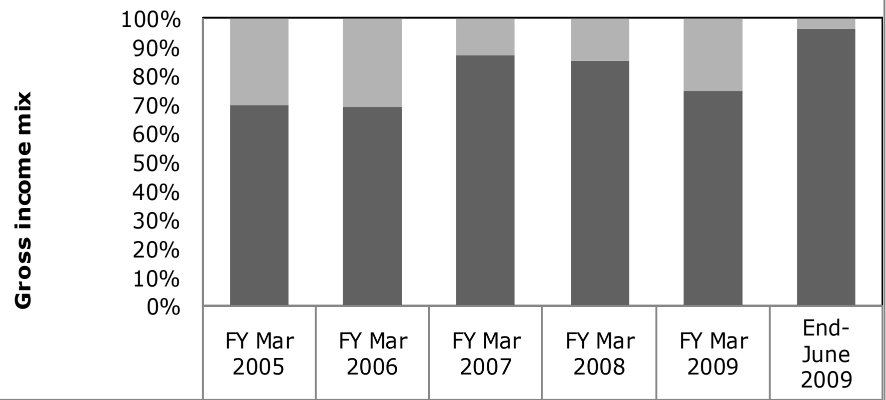


	FY Mar 2005	FY Mar 2006	FY Mar 2007	FY Mar 2008	FY Mar 2009	End-June 2009
AMF	10.39%	8.72%	12.30%	16.26%	16.62%	16.21%
Industry	6.36%	6.26%	7.43%	6.68%	5.83%	N/A

Non interest income growth driven by motor vehicle sales

Meanwhile, the Company's non-interest income ("NII") increased to LKR 23.45 million in FY Mar 2009 from LKR 9.08 million a year earlier. Sales of motor vehicles contributed 40.99% of its NII in FY Mar 2009 and amounted to LKR 9.61 million as at the same date (FY Mar 2008: LKR 3.59 million). A 27.59% contribution came from a one-off disposal of AMF's motor vehicles. The rest of the pie comprised sundry income, dividend and hire income.

Chart 4: Gross Income mix



	FY Mar 2005	FY Mar 2006	FY Mar 2007	FY Mar 2008	FY Mar 2009	End-June 2009
Non interest income	29.97%	30.74%	12.22%	14.74%	24.78%	3.24%
Net interest income	70.03%	69.26%	87.78%	85.26%	75.22%	96.76%

In line with the Company's growing non-interest income, the gross income mix over the past 3 years reflects an increasing trend in the non-interest income component (refer to Chart 4). Nevertheless, net interest income remained the predominant constituent of the gross income composition. Going forward, RAM Ratings Lanka expects a greater proportion of non-interest income to gross income, with contributions mainly from motor vehicle sales. This expectation is in line with the likely increase in demand for heavy vehicles, given the post-war development in the country. Nonetheless, net interest income is expected to continue to dominate gross income make-up.

Overhead costs doubled

AMF's overheads had climbed 41.27% y-o-y. We note that the increase was mainly due to refurbishment costs, provision charges (demurrage, falls in stock value and generator stock) and unclaimed VAT expenses for the year. However, the Company's auditors have confirmed that the latter had been incorrectly charged to the income statement in FY Mar 2009; the correction has been made and will be reflected in the following year's financials (y-o-y overhead growth, adjusted for unclaimed VAT expense: 34.67%). Personnel costs had also increased by 13.98% to LKR 17.58 million as at the same date. With more recruitment expected, in the medium term personnel costs are expected to increase further. Nevertheless, the higher growth in gross income resulted in a lower cost-to-income ratio of 43.74% (end-June 2009: 46.40%) during the year, which compared favourably with the industry average of 79.10%.

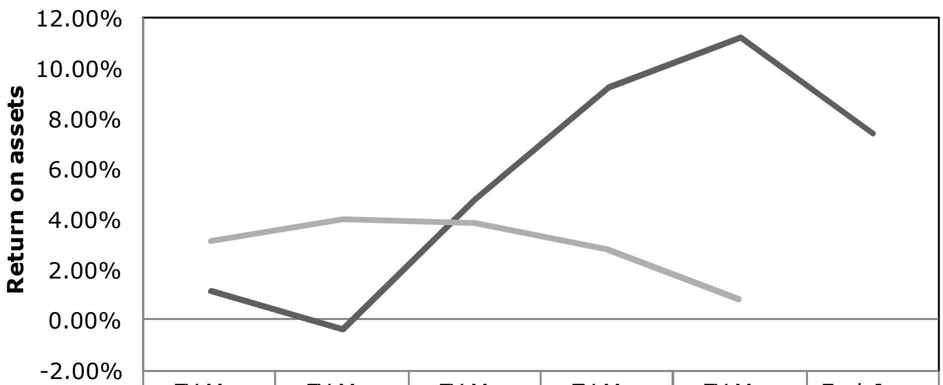
Increasing provisions

Despite the easing of AMF's cost-to-income ratio, the provision charges for loan losses had burgeoned to LKR 5.09 million by end-FY Mar 2009 compared to LKR 0.58 million in FY Mar 2007. Nonetheless, AMF's thick margin has proved sufficient to cushion the rise in provisions.

Above industry ROA and ROE

Furthermore, the Company's pre-tax profit came in at LKR 48.17 million, translating into an above-industry return on assets ("ROA") of 11.24% (refer to Chart 5). Return on equity ("ROE") of 29.87% was below the previous year's 34.44%, due to the enlarged shareholders' funds; however, it remained well above the industry average (5.45%).

Chart 5: AMF's ROA against the industry



	FY Mar 2005	FY Mar 2006	FY Mar 2007	FY Mar 2008	FY Mar 2009	End-June 2009
AMF	1.11%	-0.39%	4.82%	9.24%	11.24%	7.42%
Industry	3.14%	4.02%	3.83%	2.82%	0.83%	N/A

Reversal of deferred tax adjustments

Complementing AMF's core performance was the one-off reversal in deferred tax. Hence, post-tax profits were boosted by LKR 33.19 million to LKR 69.39 million as at end-FY Mar 2009 (FY Mar 2008: LKR 36.20 million).

Funding & Liquidity

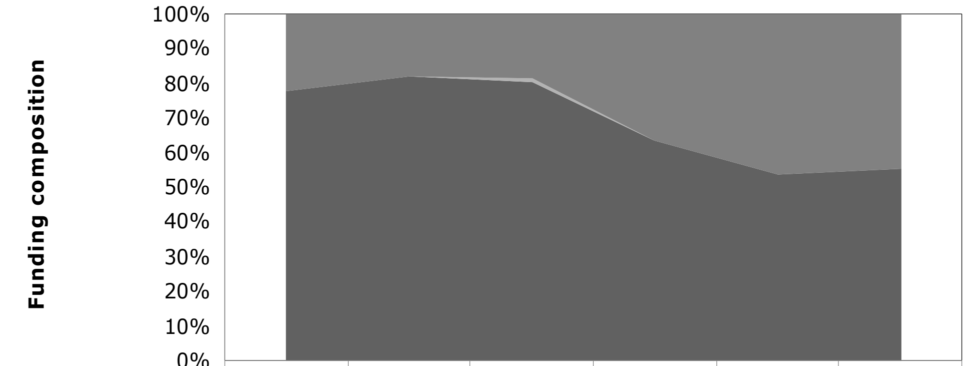
Adequate funding and liquidity

Over the last 2 years, AMF has been flushed with liquidity owing to high internal capital generation and capital infusion. By June 2009, liquidity levels elevated further, mainly due to the contraction in its loan portfolio. Prospectively, however, it is expected to recede to historical levels as AMF resumes lending.

Funding mix has tilted more towards shareholders' funds

The principal constituent of AMF's funding remained its public deposits (refer to Chart 6), amounting to LKR 228.35 million as at FY Mar 2009. This is also reflected in the Company's customer deposits to total interest bearing funds of 100% as at the same date. In addition to deposit funding, owing to profit retention over the past 2 years, the funding mix has tilted more towards AMF's secondary funding source - shareholders' funds. Nonetheless, in the long term, deposits are expected to be the Company's main funding source.

Chart 6: Funding mix



	FY Mar 2005	FY Mar 2006	FY Mar 2007	FY Mar 2008	FY Mar 2009	End-June 2009
Shareholders' funds	22.46%	17.86%	18.32%	36.44%	46.24%	44.72%
Borrowings	0.00%	0.00%	1.00%	0.00%	0.00%	0.00%
Customer deposits	77.54%	82.14%	80.68%	63.56%	53.76%	55.28%

Steady deposit growth

AMF's deposits grew by 3.74% to LKR 228.35 million in FY Mar 2009 (end-June 2009: LKR 241.46 million). It is noteworthy that the Company was able to augment its deposit base amid the domestic liquidity crisis (triggered by the fall of unregulated financial institutions). AMF's small yet loyal depositor base anchored the Company during the crisis. Furthermore, deposit concentration is at a tolerable level; top 10 depositors made up 9.42% of its total deposit base as at end-June 2009.

Adequate ALMM

Elsewhere, AMF's asset-liability maturity mismatches ("ALMM") remain intact as at end-June 2009; the Company has matched its assets and liabilities in every maturity bucket except for the "over 3 years" bucket, once again reflecting the dominance of short-tenured loans (refer to Table 1).

Table 1: Maturity structure of assets and liabilities

	FY Mar 2008			End-June 2009		
	< 1 year	1-3 years	Over 3 years	< 1 year	1-3 years	Over 3 years
Interest earning assets	194.28	98.60	0.00	270.64	126.70	0.71
Interest bearing liabilities	130.26	66.52	30.73	159.29	60.15	36.82
Gap	64.02	32.09	(30.73)	111.36	66.55	(36.11)
Cumulative gap	64.02	96.11	65.37	111.36	177.91	141.80

Statutory liquid asset ratio surpasses regulatory minimums

Additionally, the Company maintained its statutory liquid ratio of 34.92%, well above the regulatory minimum as at end-FY Mar 2009. The ratio stood at 54.38% by end-June 2009, owing to increased investments in treasury bills.

Capital Adequacy

Moderate capitalisation

AMF's capitalisation is deemed to be moderate given its sturdy internal capital generation and healthy earnings retention. These contributors have provided AMF with leeway in building its core capital (FY Mar 2009: LKR 196.37 million). Subsequent to a rights issue in November 2009, the Company is now compliant with the minimum regulatory core capital requirement of LKR 200 million (end-Nov 2009: LKR 202.31 million).

Stronger internal capital generation

Apart from its healthy profit performance, the Company's improved internal capital generation of 43.02% was backed by the one-off deferred tax reversal of LKR 21.22 million. Going forward, AMF's internal capital generation is expected to ease somewhat until the Company resumes lending.

Capital adequacy ratios are above regulatory minimums

Meanwhile, Tier-1 risk weighted capital adequacy ratio and overall RWCAR stood at a high of 56.73% as at end-June 2009, far ahead of the regulatory minimum of 5% and 10% respectively. Furthermore, the net NPL to shareholders' funds ratio of 2.40% reflects the adequacy of capital funds to cover AMF's escalation in absolute gross NPLs.

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.

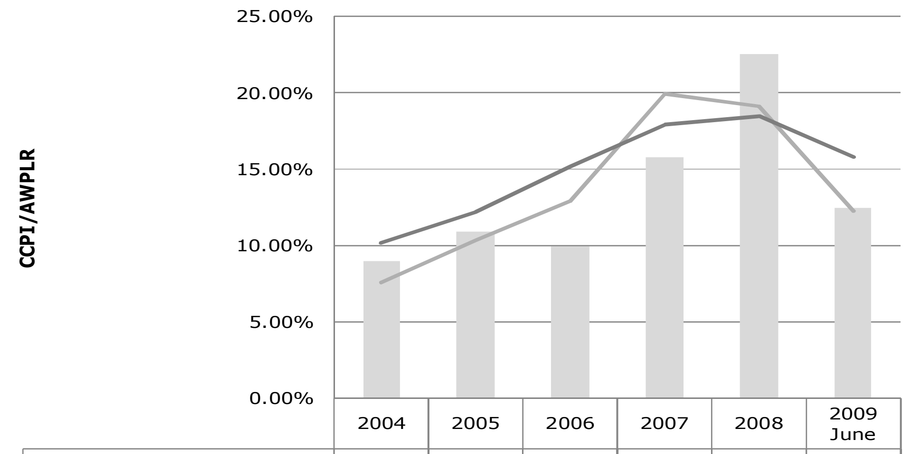
The performance of the primary sector (i.e. agriculture, forestry and fishing) has been dented by a steep fall in tea prices, drought and diminished demand. Although value addition in tea shrank 11.7% in 1Q 2009, this was partially cushioned by the expansion of other food crops, including fishing. Nonetheless, 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 2)

Table 2: Sectoral contributions to GDP

Sector	2Q 2008	2Q 2009
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 4). 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



	2004	2005	2006	2007	2008	2009 June
Colombo Consumer Price Index	9.00%	11.00%	10.00%	15.80%	22.60%	12.50%
1-Year Treasury Bill Rate	7.65%	10.37%	12.96%	19.96%	19.12%	12.34%
AWPLR	10.23%	12.24%	15.19%	17.95%	18.50%	15.89%

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 were 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 vehicle financing. In this regard, they compete with commercial banks. Although commercial banks have a cost 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 appetite. 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, RFC's 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 provide greater agility.

In the interim, RAM Ratings Lanka expects the industry's overall 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 this 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 improving liquidity, the industry's funding structure - although improving - is still fragile. RFCs continue to rely on bank funding, which poses additional liquidity risk. Over the medium and long term, however, RAM Ratings Lanka expects the industry's funding structure to weaken further as RFCs resort to bank borrowings to expand their loan books.

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

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

Relevant Central Bank Directions Applicable to Registered Finance Companies

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

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

Minimum core-capital requirement	Every finance company must at all times maintain an unimpaired core capital of LKR 200 million. However, companies that could not meet this requirement by February 2006 had been granted a 30-month extension, subject to the following: (a) A finance company with a core capital of less than LKR 100 million must: 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. (b) A finance company with a core capital of between LKR 100 million and LKR 200 million must bring in: 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.
Investments	A finance company must not invest in the shares of any company 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 In aggregate, in excess of 25% of the capital funds of the finance company Capital funds generally mean paid-up capital and permanent free reserves, and may include unsecured debentures and other loan stocks if approved by the Monetary Board.

Corporate Information

Date of Incorporation:	1962	
Commencement of Business:	1962	
Major Shareholders:	Imperial Import & Export Company Ltd (owned by Mr JPI Nalatha Dayawansa)	48.01%
	Mr JPI Nalatha Dayawansa	36.41%
	JPIP Trust	4.45%
	Late Mr JPI Piyadasa	2.31%
	Mrs S Dayawannsa	1.76%
	Master JPI Shanil Dayawansa	1.45%
	Master JPI Nadishka Dayawansa	1.45%
	Master JPI Nelaka Dayawansa	1.45%
	Kottawa Industryies & Tours Ltd (owned by the Dayawansa family)	0.99%
	Others	1.72%
Directors:	Mr JPI Nalatha Dayawansa	Chairman
	Mrs S Dayawansa	Director
	Mrs Piyadasa	Director
Auditor:	SJMS Associates Chartered Accountants	
Listing:	Not listed	
Key Management:	Mr TMA Sallay	General Manager
	Mr Jayalath Perera	Senior Manager – Loans and Deposits
	Mr KI Grero	Senior Manager - Administration
Major Subsidiaries and Associates:	None	

Capital History:

Year	Remarks	Amount (LKR million)	Cumulative Total (LKR million)
2000	Brought forward	8.09	8.09
2001	New share issue	1.00	9.09
2007	New share issue	42.99	52.08

Financial Summary- Company

BALANCE SHEET (LKR Million)	Re-Stated 31-Mar-06	31-Mar-07	31-Mar-08	31-Mar-09	Provisional 30-Jun-09
ASSETS					
Cash & Money At Call	8.22	9.72	7.33	8.17	13.23
Deposits & Placements With Financial Institutions	0.00	0.00	15.50	16.00	64.22
Securities Purchased Under Resale Agreements	0.00	0.00	0.00	0.00	0.00
Securities					
Dealing Securities	26.02	28.56	44.15	55.58	53.87
Investment Securities	0.28	0.28	0.28	0.24	0.24
Gross Loans & Advances	144.49	193.65	237.48	309.05	281.40
Interest-In-Suspense	0.63	0.35	0.62	1.40	0.70
General Loan Loss Reserves	0.00	0.00	0.00	0.00	0.00
Specific Loan Loss Reserves	2.86	0.96	3.55	8.74	11.15
Net Loans & Advances	141.00	192.33	233.32	298.90	269.55
Investments in Subsidiaries/Associates	0.00	0.00	0.00	0.00	0.00
Investment Land and Properties	0.00	17.54	17.54	17.37	17.45
Other Assets	29.57	20.86	40.97	70.94	62.22
Property, Plant and Equipment	24.44	5.77	11.43	19.03	20.11
TOTAL ASSETS	**229.53**	**275.06**	**370.53**	**486.24**	**500.89**
LIABILITIES					
Customer Deposits					
Savings	0.00	0.00	0.00	0.00	0.00
Fixed	176.68	206.93	220.11	228.35	241.46
NIDs	0.00	0.00	0.00	0.00	0.00
Interbank Deposits	0.00	0.00	0.00	0.00	0.00
Bills & Acceptances Payable	0.00	0.00	0.00	0.00	0.00
Securities Sold Under Repurchase Agreements	0.00	0.00	0.00	0.00	0.00
Other Borrowing	0.00	2.57	0.00	0.00	0.00
Subordinated Debt & Hybrid Capital	0.00	0.00	0.00	0.00	0.00
Other Liabilities	14.44	18.57	24.23	61.51	64.09
TOTAL LIABILITIES	**191.12**	**228.07**	**244.34**	**289.86**	**305.55**
Paid-up Capital	9.09	9.09	52.08	52.08	52.08
Minority Interest	0.00	0.00	0.00	0.00	0.00
Share Premium & Other Reserves	4.90	1.05	1.05	1.05	1.05
Statutory General Reserve	0.00	4.29	6.10	9.57	6.10
Retained Profits/(Loss)	24.42	32.57	66.96	133.68	136.12
Total Shareholders' Funds	**38.41**	**46.99**	**126.19**	**196.37**	**195.34**
TOTAL LIABILITIES & SHAREHOLDERS' FUNDS	**229.53**	**275.06**	**370.53**	**486.24**	**500.89**
COMMITMENTS & CONTINGENCIES	**0.00**	**0.00**	**0.00**	**0.00**	**0.00**
TIER 1 CAPITAL	**37.84**	**46.99**	**126.19**	**196.37**	**195.34**
CAPITAL BASE	**37.84**	**46.99**	**126.19**	**196.37**	**195.34**

Financial Summary-Company

	Re-Stated				Provisional
INCOME STATEMENT (LKR Million)	**31-Mar-06**	**31-Mar-07**	**31-Mar-08**	**31-Mar-09**	**30-Jun-09**
Interest Income	40.32	61.30	88.83	127.72	32.47
Less: Amortisation Of Premium/(Accretion Of Discou	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	22.14	30.27	36.34	56.51	12.47
Net Interest Income	18.18	31.03	52.48	71.21	20.00
Non-Interest Income	8.07	4.32	9.08	23.45	0.67
Gross Income	**26.25**	**35.35**	**61.56**	**94.66**	**20.67**
Personnel Expenses	9.50	11.00	15.42	17.58	4.08
Other Non-Interest Expenses	18.33	11.62	13.88	23.82	5.51
Loan Loss Provisions	(0.77)	0.58	2.43	5.09	1.93
Share of results of Associated Companies	0.00	0.00	0.00	0.00	0.00
Pre-Tax Profit	**(0.81)**	**12.15**	**29.82**	**48.17**	**9.15**
Taxation	0.40	3.57	(6.38)	(21.22)	0.00
Profit After Tax	**(1.21)**	**8.58**	**36.20**	**69.39**	**9.15**
Extraordinary Items	0.00	0.00	0.00	0.00	0.00
Prior Year Adjustments	0.00	0.00	0.00	0.80	0.00
Minority Interests	0.00	0.00	0.00	0.00	0.00
Transfer To Statutory Reserves	0.00	0.43	1.81	3.47	0.00
Transfer To Other Reserves	0.00	0.00	0.00	0.00	0.00
Dividend	0.00	0.00	0.00	0.00	0.00
Retained Profit For The Year	**(1.21)**	**8.15**	**34.39**	**66.72**	**9.15**

Financial Ratios – Company

	Re-Stated				Provisional
KEY RATIOS (%)	**31-Mar-06**	**31-Mar-07**	**31-Mar-08**	**31-Mar-09**	**30-Jun-09**
Profitability					
Net Interest Margin	8.72%	12.30%	16.26%	16.62%	16.21%
Non-Interest Income Margin	3.87%	1.71%	2.81%	5.47%	0.54%
Cost To Income	106.03%	63.99%	47.61%	43.74%	46.40%
Return On Assets	(0.39%)	4.82%	9.24%	11.24%	7.42%
Return On Equity	(2.08%)	28.45%	34.44%	29.87%	17.47%
Dividend Payout	0.00%	0.00%	0.00%	0.00%	0.00%
Asset Quality					
Gross NPL Ratio	2.53%	0.92%	2.54%	3.85%	5.64%
Net NPL Ratio	0.55%	0.42%	1.06%	1.04%	1.74%
3-months Past Due Ratio	NA	NA	NA	NA	NA
Specific Loan Loss Provisions For Current Year	(0.69%)	0.35%	1.20%	1.90%	2.61%
Gross NPL Coverage	78.69%	54.02%	58.90%	73.76%	70.44%
Loan Loss Reserve Coverage	1.99%	0.50%	1.50%	2.84%	3.97%
General Loan Loss Reserve Coverage	0.00%	0.00%	0.00%	0.00%	0.00%
Liquidity & Funding					
Liquid Asset Ratio	19.38%	18.35%	30.51%	34.98%	54.38%
Statutory Liquid Asset Ratio	19.38%	18.50%	30.43%	34.92%	54.38%
Interbank Deposits To Total Interest Bearing Funds	0.00%	0.00%	0.00%	0.00%	0.00%
Customer Deposits To Total Interest Bearing Funds	100.00%	98.77%	100.00%	100.00%	100.00%
Loans To Deposits Ratio	79.80%	92.94%	106.00%	130.90%	111.63%
Loans To Stable Funds Ratio	73.96%	76.71%	69.67%	73.68%	64.69%
Capital Adequacy					
Shareholders' Funds To Total Assets	16.73%	17.08%	34.06%	40.39%	39.00%
Tier 1 Risk Weighted Capital Adequacy Ratio	19.66%	19.86%	43.42%	51.28%	56.73%
Overall Risk Weighted Capital Adequacy Ratio	19.66%	19.86%	43.42%	51.28%	56.73%
Internal Rate Of Capital Generation	(3.11%)	20.09%	41.81%	43.02%	17.47%

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

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