OCTOBER 2009

CREDIT RATING RATIONALE

FINANCIAL INSTITUTIONS – SRI LANKA

A wholly owned subsidiary of RAM Holdings Berhad

LANKAPUTHRA DEVELOPMENT BANK LIMITED – Initial Rating

Financial Institution Ratings:
Long-term: A [Assigned]
Short-term: P1 [Assigned]

Rating Outlook:
Stable

Strength:
- State-owned entity

Weaknesses:
- Short operating history
- Large risk appetite

Principal Activities:
Deposit mobilisation, granting of finance leases, and loans to SMEs

Analysts:
Prakash Jerome ACMA
(9411) 2553089
prakash@ram.com.lk

Khailash Weeralingam BSc
(9411) 2503551
khailash@ram.com.lk

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

Website: www.ram.com.lk

Summary

RAM Ratings Lanka has assigned respective long- and short-term financial institutions ratings of A and P1 to Lankaputhra Development Bank Limited ("LDB" or "the Bank"). The ratings are primarily based on the Bank's state ownership and its strategic importance vis-à-vis the Government of Sri Lanka's ("GOSL") economic development agenda. The ratings are, however, constrained by Bank's short operating history and large risk appetite.

LDB is a licensed specialised bank ("LSB") created by the GOSL as part of the incumbent President's new economic vision of promoting the development of domestic enterprises. LDB focuses on providing funding to start-up small and medium-scale enterprises ("SMEs"), a segment overlooked by other banks due to the inherently higher risk. LDB was incorporated in 2006 following cabinet approval; it merged with 2 other state-backed development finance institutions in 2008. The Bank's strategic direction is guided by its Chairman, Mr A Sarath de Silva, who has well over 3 decades experience in the banking sector, having also served as General Manager in Sri Lanka's largest commercial bank, Bank of Ceylon. Not surprisingly, the Bank's short history meant that it accounted for only 1.51% of the LSB industry's assets as at end-December 2008.

LDB is expected to play a pivotal role in the current government's national development agenda. Given its broad vision to create and enhance entrepreneurial talent in the country, its asset quality is expected to take second place. Despite its unseasoned portfolio, the Bank's gross non-performing-loan ("NPL") ratio (on a 3-month classification basis) deteriorated swiftly to 38.96% as at end-August 2009. RAM Ratings Lanka notes that this had been primarily due the inherent concentration risk in LDB's lending portfolio. Meanwhile, the Bank has also inherited NPLs following its earlier mergers; about 25% of its NPLs as at end-August 2009 stemmed from such legacy loan portfolios. Over the longer term, however, this ratio is expected to ease as concentration risk becomes more diluted due to portfolio expansion.

LDB's current funding and liquidity positions are deemed sturdy at present, underpinned by its enlarged capital base after the recent mergers, however this is expected to reach industry levels over the medium term. The Bank is currently funded primarily by shareholders' funds, which accounted for 61.14% of its funding base as at the end of FYE 31 December 2008 ("FY Dec 2008"). Consequently, its public deposits remained negligible. In the long run, however, public deposits are expected to become a material component in the Bank's funding mix. In the meantime, LDB presently has a large USD-denominated loan, which accounts for some 31% of its funding base. Having said that, the exchange-rate risk of this loan is mitigated by investing the funds in USD-denominated deposits and debentures. All combined, the Bank's ratio on interest expense to interest-bearing funds only came up to a low 2.91% as at end-August 2009.

Thanks to LDB's low-cost funding, its financial performance appears respectable despite its weak asset quality. The Bank's post-merger pre-tax profit surged after the merger to LKR 226.65 million in FY Dec 2008 (FY Dec 2007: LKR 58.04 million). In tandem with this, its return on assets ("ROA") improved to 4.22% as at end-FY Dec 2008 (end-FY Dec 2007: 1.84%). Over the longer term, however, its profitability indicators are expected to moderate due to the normalisation of its funding costs.

We note that the Bank's key rating driver is the financial flexibility stemming from its state ownership. Its respective Tier-1 risk–weighted-capital adequacy ratio ("RWCAR") and overall RWCAR of 92.95% and 93.39% as at end-FY Dec 2008, which are well above the corresponding regulatory floors of 5% and 10%. Once again, the lofty capital-adequacy levels are viewed as a function of the Bank's short history; they should moderate over time.

Outlook

The stable outlook on the long-term rating reflects the Bank's state ownership and the available implicit support in times of distress. As such, the ratings will face downward pressure if such support is not forthcoming. Although upward revision of the ratings is unlikely in the medium term, it may materialise should LDB be able to demonstrate a material and sustained improvement in its loan portfolio.

Corporate Profile

Brainchild of incumbent President

LDB is a state-owned LSB incorporated in 2006 under the Companies Act No. 17 of 1982 (re-registered under Companies Act No 7 of 2007); it comes under the purview of the Central Bank of Sri Lanka. The Bank had been created as part of the President's (who is also the Minister of Finance and Planning) vision to promote economic growth at grassroot levels. As such, LDB is one of a handful of stated-owned and private banks playing a key role in channelling government funds to appropriate sectors. Going forward, we expect the Bank to play an increasingly vital role in the disbursement of government development funds and the execution of the country's economic policies. Besides these GOSL-based development projects, LDB caters to SMEs through working-capital and project loans.

Merged with 2 GOSL-based development finance institutions

To bolster its position, LDB has merged with 2 other state-owned development finance institutions. On 1 January 2008, the Bank merged with Small and Medium-scale Enterprise Bank Limited ("SME Bank") by way of a share swap. On 30 January last year, LDB acquired Private Sector Infrastructure Development Company Limited ("PSIDC"). PSIDC had been a government institution, tasked with providing concessionary funding for large-scale, private-sector projects. Both take-overs had been part of the nation's budget proposal.

Meanwhile, LDB had also been appointed as a managing agent for crisis ridden finance companies, following the Golden Key scandal in the early part of 2009. However, we note that the Bank is no longer acting as a managing agent.

Small player with limited branch network

LDB accounted for 1.51% of the LSB industry's assets as at end-December 2008. In comparison, the largest player took up the lion's share of 67.49% as at the same date. Although the Bank has a limited branch network (having only 6 branches as at end-September 2009), these are geographically quite well spread out.

Ownership

State-owned entity

LDB's ratings are anchored by its state ownership; the Bank had been created by the GOSL as part of the President's economic vision for the country. The Bank plays a pivotal role in the state's agenda of developing SMEs. In this context, LDB is a participating bank in several state-initiated development programmes, such as the *New Comprehensive Rural Credit Scheme* and the *Agricultural Revival* (or *Krushi Navodaya*) scheme.

Management & Strategies

Experienced management team

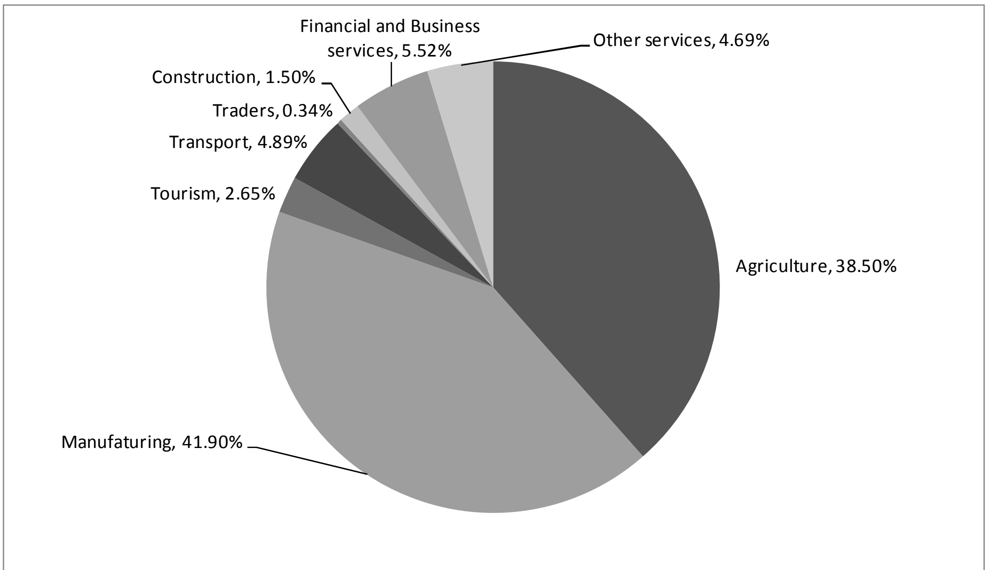
Several vacant key positions

Although LDB's senior management personnel have only been with the Bank for a short time, they are vastly experienced. The management is presently spearheaded by Chief Executive Officer ("CEO") Ravi Dassanayake, the Bank's former Chief Risk/Operation Officer. The CEO has several years' experience in evaluating and implementing project financing and had also been a consultant for several micro-finance projects. As a "young" bank, LDB's hierarchy is still uncertain, with some vacant key posts. We note that the Bank has experienced a high rate of staff turnover; the positions of Chief Operating Officer, Chief Internal Auditor and Senior Finance Manager are presently unoccupied.

Focused on providing loans to SMEs

In line with the Bank's objective of developing entrepreneurial projects, it has launched an entrepreneurship development advisory service, which evaluates the feasibility of customers' projects. Those that are deemed within its mandate and viable will be provided funding at concessional rates. In this regard, the Bank has also tied up with several state institutions, such as the Ministry of Industrial Development, to provide financing for special projects. LDB is also a participating bank in several state-funded development schemes, where the Bank distributes funds received from the treasury to target sectors. At present, around 38% (refer to Chart 1) of the Bank's portfolio is exposed to the agricultural sector; the management intends to increase LDB's exposure to this segment. In addition, the Bank provides financing assistance to promote local brands.

Chart 1: LDB's sectoral loan exposure as at end-FY Dec 2008



New products and branch expansion

Besides the entrepreneurship development advisory service, the Bank has also introduced finance leasing this year. It intends to start pawning services in the near term. Furthermore, the Bank plans to expand to the northern region to help in the rehabilitation process.

Corporate Governance

Board appointed by Ministry of Finance

The Bank's 6-member board has been convening on a monthly basis this year; previously the board met twice a month. Board members are appointed by the Ministry of Finance, which is represented by 2 appointees. The Chairman, Mr A Sarath de Silva, plays an active role in determining the long-term strategy of the Bank. He has well over 3 decades' experience in the banking sector, having also served as the General Manager of the Bank of Ceylon, i.e. Sri Lanka's largest commercial bank. Meanwhile, the board is supported by 6 committees: audit; credit; integrated risk; human resource and remuneration; procurement; and technology.

Risk Management

High-risk target segment

LDB's credit risk is heightened by its target segment; it lends to start-up SMEs, which are generally shunned by commercial banks. Although the Bank's facilities are backed by mortgages against equipment or land, recoverability prospects are hindered as LDB lacks *parate* execution rights (i.e. the ability to repossess assets without a court order). However, the Bank has made applications to the regulators to obtain such rights.

Recoverability hampered by subdued second-hand market and lack of* parate *rights

The absence of *parate* rights aside, we opine that recoverability is also hampered by the limited second-hand market for mortgaged equipment. All facilities provided by the Bank are backed by mortgages over equipment. However, the mortgaged equipment are somewhat specialised, with little demand for them.

Credit risk apart, the Bank adopts the Basic Indicator Approach when ascertaining operational and market risks, as per the BASEL II framework.

Asset Quality

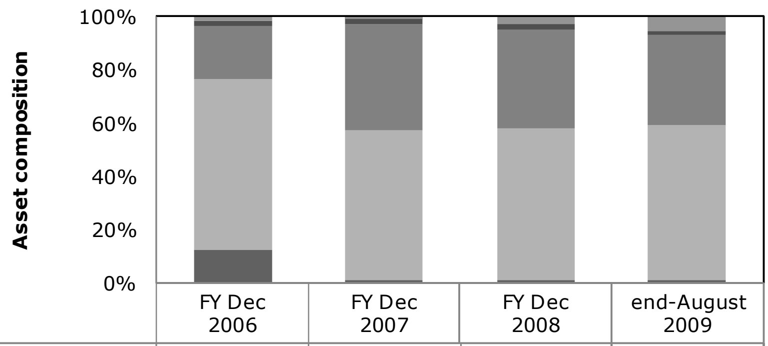
Weak asset quality

Although LDB's portfolio is still unseasoned, RAM Ratings Lanka considers its asset quality to be affected by high defaults. While concentration risk has pushed its NPL ratio to very high levels, the health of its portfolio is anticipated to improve, albeit still remaining weaker than its peers'. The expectation of a high default rate hinges on the Bank's developmental role, which takes into consideration broader national interests.

Asset base dominated by liquid assets

LDB's asset base is dominated by liquid assets, a result of its short operating history. Investment securities made up 57.27% (refer to Chart 2) of its total assets as at end-FY Dec 2008 (end-FY Dec 2007: 56.23%). Most of these investments comprised either government securities (50.66%), fixed deposits (26.06%), or debentures of a state-owned bank (15.31%) – all of which have low credit risks. Meanwhile, the Bank had also invested in LKR 300 million of preference shares issued by Mihin Lanka Limited ("Mihin Lanka") as at end-FY Dec 2008; these constituted 7.98% of LDB's total investments. Mihin Lanka is a Sri Lankan budget airline - created by the GOSL that had run into financial difficulties. However, by end-August 2009 we note that the GOSL had fully reimbursed LDB's investment and loans provided to the airline by issuing the Bank with government securities; this highlights the state support for LDB. Meanwhile, loans and advances comprised the second-largest component (37.00%) in the Bank's asset base as at end-FY Dec 2008 (end-FY Dec 2007: 39.67%).

Chart 2: LDB's asset composition



	FY Dec 2006	FY Dec 2007	FY Dec 2008	end-August 2009
Other assets	1.14%	0.22%	2.63%	5.18%
Property, plant & equipment	2.27%	2.52%	1.93%	1.71%
Net loans and advances	20.04%	39.67%	37.00%	33.51%
Investment securities	63.71%	56.23%	57.27%	58.32%
Cash	12.84%	1.36%	1.16%	1.28%

Loan base expanding rapidly

LDB's loan base has been augmenting swiftly in the past 2 years. The Bank's credit portfolio swelled from LKR 427.36 million as at end-FY Dec 2006 to LKR 2.43 billion as at end-FY Dec 2008. Loan growth had been propelled by project loans, which made up 75.17% of its total loans as at end-FY Dec 2008. In addition, the amalgamation of the loan bases of SME Bank and PSDIC with LDB's had also contributed to the rapid expansion of the Bank's credit portfolio. The Bank's loan base advanced by LKR 980.78 million over the same period; LKR 465.32 million had been introduced after the amalgamation. Meanwhile, the Bank has also acted as a conduit for state funding, disbursing government funds to specific sectors; such loans accounted for 9.62% of LDB's loan base as at end-FY Dec 2008, with working-capital loans (7.12%) and short-term facilities (8.09%) making up the remainder.

Gross NPLs pushed up by several large defaults

We note that several defaults on large loans had pushed up LDB's gross NPL ratio, highlighting the concentration risk in the Bank's credit portfolio. The Bank's gross NPL ratio deteriorated from 4.90% as at end-FY Dec 2007 to 38.96% as at end-August 2009; a single outstanding loan accounted for 18.34% of its total NPLs as at the same date. The worsening of its gross NPL ratio can also be attributed to the poor-quality portfolio inherited from SME Bank after the merger; NPLs from this portfolio accounted for 25.49% of LDB's total NPLs.

Branchless banking

LDB's credit-evaluation process is different from that of conventional banks. Loan applications are initially assessed to determine if they fall within the Bank's mandate of strengthening domestic enterprises. Thereafter, credit officers travel to the applicants' premises to gain further insight on their projects. Subsequently, cashflow projections are evaluated before loans are approved. This approach is somewhat distinct from approval for conventional loans, which also emphasises on collateral.

More emphasis on cashflow analysis

Going forward, the Bank intends to mitigate the its loan concentration risk. In this regard, it has already launched leasing and pawning advances. The Bank intends to finance machines and equipment through leases. Pawning advances will also to be introduced, although these advances are expected to be channelled to finance SME enterprises rather than consumption. These efforts are anticipated to dilute the Bank's concentration risk and help reduce the volatility of its gross NPL ratio.

Performance

Healthy performance now, but expected to weaken

At present, RAM Ratings Lanka considers LDB's performance to be healthy because of the Bank's better-than-average net-interest margin ("NIM"), supported by its low-cost funding base. However, the Bank's margins are expected to contract as interest rates on investments wane while its cost of funding may rise as the Bank increasingly relies on public funding. Furthermore, the Bank's long-term performance will hinge on its asset quality.

Better-than-average NIM

As at end-FY Dec 2008, LDB's NIM was healthier than the industry's, supported by its low-cost funding base; the Bank's NIM clocked in at 11.55% compared to the industry's 2.84%. Although the Bank provides loans at concessionary rates, its funding is dominated by shareholders' funds, which bear no interest cost, and long-term borrowings, which are below market rates. Consequently, the Bank's ratio on interest expense against interest-bearing funding eased from 10.50% as at end-FY Dec 2007 to 2.91% as at end-August 2009. Furthermore, LDB's interest income is bolstered by its investments in GOSL securities, which offered relatively higher yields. Prospectively, RAM Ratings Lanka expects the Bank's NIM to narrow as interest rates on investments weaken and its cost of funding rises as the Bank relies more on public deposits.

Table 1: LDB's interest spreads

	end-FY Dec 2006	end-FY Dec 2007	end-FY Dec 2008	end-August 2009
Interest Income / Interest Earning Assets (av.)	18.21%	11.07%	13.35%	12.30%
Interest Expense / Interest Bearing Funding (av.)	12.86%	10.50%	3.13%	2.91%
Interest Differential	5.34%	0.57%	10.22%	9.39%

Meanwhile, LDB's non-interest income margin sank into the red as the Bank had fully provided for diminution in the value of an investment. LDB had invested LKR 70 million in the preference shares of an export based company. We note that LDB had no other share exposure as of end-August 2009.

Surge in interest income offsets rising provisions

Despite its provision for diminished investment value and heightened loan-loss provisions LDB's pre-tax profit more than doubled in fiscal 2008 - supported by augmenting net interest income. Following the deterioration in its asset quality, the Bank's loan-loss provisions augmented from LKR 8.70 million as at end-FY Dec 2007 to LKR 53.77 million as at end-FY Dec 2008; provisions for the first 8 months of FY Dec 2009 came up to LKR 79.48 million. However, the jump in the Bank's gross income to LKR 620.63 million in fiscal 2008 more than compensated this (FY Dec 2007: LKR 220.35 million). As a result, the Bank's pre-tax profit spiked up from LKR 22.86 million to LKR 76.26 million between fiscal 2007 and 2008. Its ROA and return on equity, meanwhile, also improved to 4.22% and 8.49%, respectively, as at end-FY Dec 2008 (industry: 1.53% and 7.75%).

Funding & Liquidity

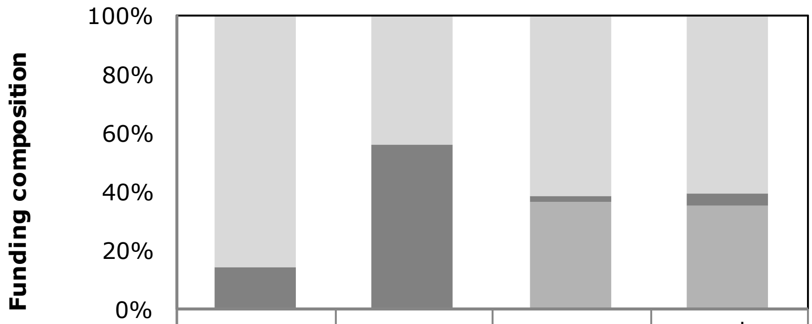
Funding and liquidity positions deemed sturdy

RAM Ratings Lanka opines that LDB's funding and liquidity positions are sturdy at present. However, this is expected to moderate over the intermediate to long term. Following the earlier mergers, LDB's shareholders' funds have become its major source of funding, accounting for 61.14% of its total funding needs as at end-FY Dec 2008. On the other hand, the mergers have also exposed the Bank to exchange-rate risk, in the form of a USD-denominated loan; at the same time we acknowledge the efforts taken by the management to mitigate this risk. Going forward, the Bank is expected to increase its reliance on public deposits.

Funding base dominated by shareholders' funds

We note that shareholders' funds dominate LDB's funding base, accounting for 61.14% as at end-FY Dec 2008 (refer to Chart 3). Meanwhile, the Bank's deposit base shrank dramatically from LKR 1.99 billion as at end-FY Dec 2007 to LKR 133.03 million as at end-FY Dec 2008. This had been caused by the conversion of SME Bank's deposits (worth LKR 1.31 billion) to capital after its merger with LDB.

Chart 3: LDB's funding composition



	FY Dec 2006	FY Dec 2007	FY Dec 2008	end-August 2009
Shareholders' funds	85.28%	43.68%	61.14%	60.53%
Deposits	14.52%	56.32%	2.14%	3.92%
Long-term borrowing	0.00%	0.00%	36.61%	35.55%
Short-term borrowing	0.20%	0.00%	0.11%	0.00%

Exchange-rate risk

Along with the mergers, LDB had also taken over a USD-denominated loan from PSIDC; this is a long-term concessionary loan from Kreditanstalt für Wiederaufbau ("KfW"), a German government-owned development bank. This loan had been provided by KfW for the development of large-scale, private-sector projects. RAM Ratings Lanka is concerned about the exchange-rate risk the loan introduces to the Bank's balance sheet; the loan accounted for 31.02% of its total funding as at end-FY Dec 2008. Nonetheless, we acknowledge the steps taken by the management to mitigate this risk; most of the proceeds have been invested in USD-denominated deposits and debentures. The management does not plan to disburse these funds as loans in the medium term.

Improved ALMM

Elsewhere, the Bank's asset-liability maturity mismatch ("ALMM") has improved, underscored by the change in its funding structure and increased investments in short-term assets. As a result the positive gap in the "less than 1 year" bucket, its ALMM ameliorated from LKR 501.03 million as at end-FY Dec 2007 to LKR 3.74 billion as at end-FY Dec 2008 (refer to Table 2). Going forward, the Bank's ALMM is expected to weaken as it focuses on loan disbursement.

Table 2: LDB's ALMM

	FY Dec 2008				
	< 3 months	3 - 12 months	1 - 3 years	3 - 5 years	over 5 years
Interest earning assets (LKR million)	2,338.61	1,651.83	437.10	594.60	1,236.03
Interest bearing liabilities (LKR million)	110.44	144.08	57.31	21.12	2,078.39
Gap	2,228.16	1,507.76	379.80	573.48	(842.35)
Cumulative gap		3,735.92	4,115.71	4,689.19	3,846.84

	FY Dec 2007				
	< 3 months	3 - 12 months	1 - 3 years	3 - 5 years	over 5 years
Interest earning assets (LKR million)	965.19	1,528.98	617.28	469.60	476.29
Interest bearing liabilities (LKR million)	58.87	1,934.27	0.65	0.00	0.00
Gap	906.32	(405.29)	616.63	469.60	476.29
Cumulative gap		501.03	1,117.65	1,587.26	2,063.55

Capital Adequacy

Capital more than doubles after mergers

Following the mergers, LDB's shareholders' funds more than doubled from LKR 1.55 billion as at end-FY Dec 2007 to LKR 3.79 billion as at end-FY Dec 2008. The Bank had issued shares as purchase consideration for SME Bank and PSIDC, thereby increasing its share capital by LKR 2.12 billion to LKR 3.62 billion as at end-FY Dec 2008. Its Tier-1 and overall RWCARs had consequently jumped up to 92.95% and 93.39%, respectively (end-FY Dec 2007: 62.79%, 63.12%), well above the corresponding regulatory minimums of 5% and 10%. Meanwhile, LDB's rate of internal capital generation advanced to 4.87% as at the same date (end-FY Dec 2007: 2.06%), supported by its healthy performance.

Capital adequate over the medium term

On another note, the Bank's ratio on net NPLs to shareholders' funds deteriorated from 4.75% as at end-FY Dec 2007 to 25.31% as at end-FY Dec 2008 - in line with its weakening asset quality. Nonetheless, the Company's capitalisation is adequate to meet its growth expectations over the medium term.

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.

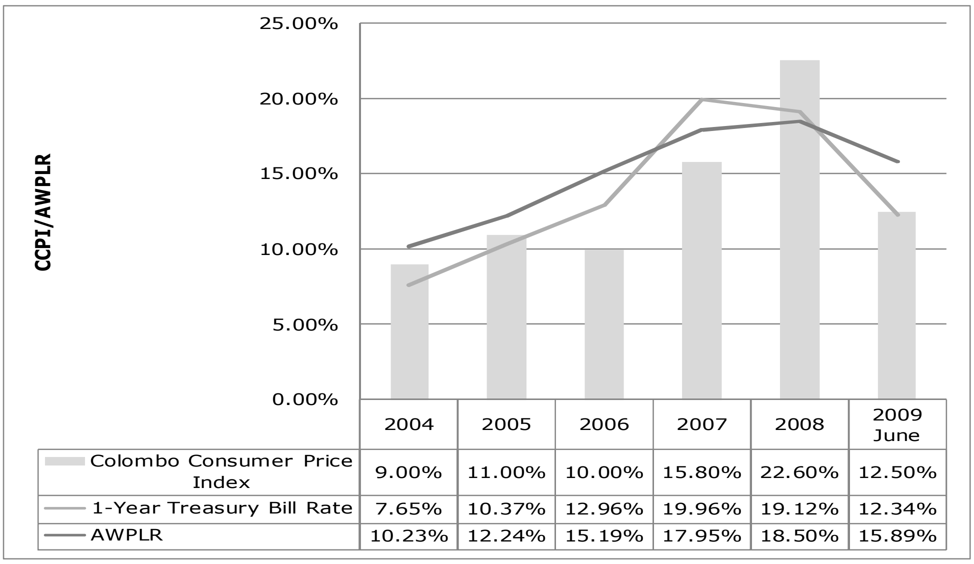
The performance of the primary sector (i.e. agriculture, forestry and fishing) has been dented by a steep fall in tea prices, drought and weaker demand. Although value addition in tea shrank 11.7% in 2Q 2009, this was partially cushioned by the expansion of other food crops, including fishing. However, virtually all sub-sectors within the industrial and services industries had advanced at a slower pace, principally due to dampened export demand (refer to Table 3)

Table 3: Sector-wise contributions to GDP

Sector	2Q2008	2Q2009
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, however, the end of the 25-year war against the separatist Tamil Tigers has spawned renewed hope for the country. Furthermore, the arrival of the long-awaited stand-by facility from the International Monetary Fund has helped elevate Sri Lanka's depleted foreign-exchange reserves. In addition, both inflation (as measured by the Colombo Consumer Price Index) and interest rates - which peaked in 2008 - have been consistently easing since early 2009 (refer to Chart 7). While these augur well for the economy, sluggish export demand is still a concern. The tapering interest rates follow the reversal of the Central Bank's tight monetary policy. While the current trend may not be sustainable given the country's budget deficit, RAM Ratings Lanka also notes that interest rates will not be as lofty as the levels reached in 2008. All said, we envisage the credit cycle to chart an upturn.

Chart 4: 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%

The LSB sector, which accounts for 9.1% of the finance industry's asset base, has remained rather resilient. Even though there are 14 institutions within this segment, National Savings Bank makes up the lion's share of 67% of its overall assets. As such, this bank single-handedly exerts a significant influence over the sector's performance. The LSB sector is a unique segment created to finance long-term projects, housing and SMEs. It had also been the primary recipient of concessional international and state funding in the past. As low-cost funding had receded, however, these institutions have increased their reliance on public deposits. The changing funding structure has also compelled most players in this sector to focus on medium-term financing; hence the distinction between LSBs and licensed commercial banks ("LCBs") has blurred. That said, the crucial difference between LSBs and LCBs is that the latter are able to operate current accounts, and thus represent an integral component of the payment system.

The earlier environment of escalating interest rates had weighted down the sector's loan expansion. The LSB sector's overall loan portfolio only expanded by a sobering 5.6% in 2008, in contrast to the 21.0% of the previous year. In addition, weakening macroeconomic factors had also contributed to rising delinquencies. As a result, the sector's gross NPL ratio had deteriorated from 6.7% as at end-December 2007 to 9.8% as at end-March 2009.

On a more positive note, tapering loan growth and an easier monetary stance have improved the liquidity levels in the LSB sector. The segment's statutory liquidity ratio climbed up from 61.0% as at end-December 2007 to 64.7% as at end-March 2009. Nevertheless, this pattern is expected to dissipate over the medium term as these banks resume lending.

Not surprisingly, slower loan growth and rising deposit costs have exerted pressure on the sector's margins. Concurrently, the environment of high inflation has pushed up overheads. In essence, this had affected the sector's bottom line – as reflected in its pre-tax ROA, which descended from 1.7% as at end-December 2007 to 1.6% as at end-March 2009.

Meanwhile, the LSB industry has traditionally maintained high capital-adequacy levels. RAM Ratings Lanka notes that all state-owned LSBs have ample regulatory capital. However, we also acknowledge that rising NPLs have weakened the sector's capital buffer, as reflected in its ratio on net NPLs to shareholders' funds that weakened from 23.0% as at end-December 2007 to 30.2% as at end-March 2009. All said, RAM Ratings Lanka envisages this segment's risk profile to improve amid brighter medium-term prospects.

Note: Industry statistics are based on Central Bank Data. Numbers for 2008 and 2009 are provisional.

Relevant Central Bank Directions Applicable to Licensed Specialised Banks

Capital adequacy	Every licensed specialised bank must maintain a minimum capital-adequacy ratio of 10% in relation to its risk-weighted assets, with core capital constituting not less than 5%, on both bank-only basis and consolidated basis; supplementary capital can make up the balance. Core capital means: (a) permanent shareholders' equity; and (b) reserves created or increased by appropriation of retained earnings or other surpluses, including share premiums, retained profits, general reserves and legal reserves, excluding revaluation reserves and general provisions. Supplementary capital means revaluation reserves, general provisions, hybrid capital instruments, minority interests arising from preference shares issued by subsidiaries, and approved subordinated debts. It is recommended that the basis of computation for capital-adequacy ratios, i.e. capital adequacy and the inclusion of non-banking and non-financial subsidiaries, be disclosed as a footnote.
Minimum capital requirements	All licensed specialised banks are required to maintain a minimum core capital of LKR 1.5 billion by end-2009. However, the capital of the bank should have been enhanced by at least 50% of any deficiency by end-2008. The required capital for a new specialised bank would also be LKR 1.5 billion
Liquid assets	Every licensed specialised bank must maintain minimum average monthly liquid assets of not less than 20% of its total monthly deposit liabilities. Liquid assets mean: (a) Cash in hand (b) Balance in a current account in a licensed commercial bank (c) Balance in a deposit account in a licensed specialised bank or licensed commercial bank, provided such account has a maturity of not more than 1 year (d) Money at call in Sri Lanka (e) Treasury bills and securities issued or guaranteed by the GOSL of Sri Lanka, which have maturities of not more than 1 year. (f) Goods receipts (g) Import and export bills (h) Inland bills (i) Cash items in process of collection (j) Treasury bonds (k) Such other assets as may be determined by the Monetary Board
Classification of non-performing loans and treatment of unearned interest	Loans and advances are classified as non-performing when the principal and/or the interest have been in arrears for 3 months or more. Any unpaid interest on loans and advances where interest has been in arrears for 3 months or more cannot be considered as income by a bank.

Classification of non-performing loans and provisioning	(a) Sub-standard accounts – where loans have been in arrears for 6 months or more, but less than 12 months – specific provisions to be made on 20% of the outstanding amount (b) Doubtful accounts – where loans have been in arrears for 12 to 18 months – specific provisions to be made on 50% of the outstanding amount (c) Loss accounts – where loans have been in arrears for more than 18 months – specific provisions to be made on 100% of the outstanding amount
Single-borrower limit	Granting of loans and advances is limited to 30% of the capital funds of the bank as at the end of its preceding financial year: (a) to any single company, public corporation, group of people or individual (b) in aggregate to 1. an individual, their close relations or a company or firm in which they have substantial interest 2. a company and one or more of the following - its subsidiary - its holding company - its associate company - a subsidiary of its holding company, or - a company in which such company or its subsidiary, or its holding company, or a subsidiary of its holding company, has a substantial interest If loans and advances granted to any customer referred to in (a) above or in aggregate to any customer belonging to (b) above exceeds 15% of the capital funds of the bank, such loans and advances granted in aggregate to all such customers should also not exceed 50% of the total loans and advances of the bank as at the end of the preceding financial year.

Corporate Information

Date of Incorporation:	24 February 2006	
Commencement of Business:	13 March 2006	
Major Shareholders:	Secretary to the treasury	99.99%
Directors:	Mr AS De Silva	Chairman
	Mr HM Gunasekera	Director
	Dr ADN De Zoysa	Director
	Mr SSC De Silva	Director
	Mr KR Wickramanayake	Director
	Dr CTSB Perera	Director
Auditor:	Messrs Ernst & Young	
Listing:	Not listed	
Key Management:	Mr Ravi Dassanayake	General Manager/Chief Executive Officer
	Mr Sumeda Edirisuriya	Chief Financial Officer
	Mr Ranjith Dissanayake	Assistant Manager – Investments
	Mrs Prassanna Karunanayake	Chief Legal Officer
Major Subsidiaries and Associates:	None	

Capital History:

Year	Remarks	Amount (LKR million)	Cumulative Total (LKR million)
2006	Share issue	1,500.00	1,500.00
2008	New share issue	2,116.38	3,616.38

Financial Summary - Company

BALANCE SHEET (LKR million)	31-Dec-06	31-Dec-07	31-Dec-08	31-Aug-09
ASSETS				
Cash & Money At Call	273.70	56.71	76.09	88.17
Deposits & Placements With Financial Institutions	0.00	0.00	980.07	1,039.26
Securities Purchased Under Resale Agreements	104.42	1,062.94	1,158.37	1,192.47
Securities				
Securities Held For Trading	0.00	0.00	0.00	0.00
Securities Available-For-Sale	1,254.18	1,284.75	1,622.65	1,794.67
Securities Held-To-Maturity	0.00	0.00	0.00	0.00
Gross Loans & Advances	427.79	1,669.03	2,660.21	2,662.58
Interest-Income-In-Suspense	0.00	3.49	59.64	98.98
General Loan Loss Reserves	0.43	8.13	17.77	19.13
Specific Loan Loss Reserves	0.00	1.00	152.50	230.62
Net Loans & Advances	427.36	1,656.41	2,430.31	2,313.86
Investments in Subsidiaries/Associates	0.00	0.00	0.00	0.00
Other Assets	24.38	9.17	173.01	357.50
Property, Plant & Equipment	48.40	105.26	127.08	118.12
TOTAL ASSETS	**2,132.44**	**4,175.24**	**6,567.56**	**6,904.04**
LIABILITIES				
Customer Deposits				
Demand	0.00	0.00	0.00	0.00
Savings	15.86	55.26	92.31	108.70
Fixed	243.50	1,938.53	40.72	142.19
Negotiable Instruments of Deposits	0.00	0.00	0.00	0.00
Interbank Deposits	0.00	0.00	0.00	0.00
Bills & Acceptances Payable	0.00	0.00	0.00	0.00
Securities Sold Under Repurchase Agreements	0.00	0.00	0.00	0.00
Other Borrowing	3.55	0.00	2,279.00	2,272.85
Subordinated Debt & Hybrid Capital	0.00	0.00	0.00	0.00
Other Liabilities	346.17	635.27	361.12	510.50
TOTAL LIABILITIES	**609.07**	**2,629.06**	**2,773.15**	**3,034.24**
Paid-up Capital	1,500.00	1,500.00	3,616.38	3,616.38
Minority Interest	0.00	0.00	0.00	0.00
Share Premium & Other Reserves	0.00	0.00	55.59	55.59
Statutory General Reserve	1.17	2.31	6.12	6.12
Retained Profits/(Accumulated Losses)	22.15	43.87	116.32	191.70
TOTAL SHAREHOLDERS' FUNDS	**1,523.32**	**1,546.18**	**3,794.41**	**3,869.80**
TOTAL LIABILITIES & SHAREHOLDERS' FUNDS	**2,132.39**	**4,175.24**	**6,567.56**	**6,904.04**
COMMITMENTS & CONTINGENCIES	**174.61**	**174.61**	**242.99**	**300.20**
TIER 1 CAPITAL	**0.00**	**1,546.18**	**3,794.41**	**0.00**
CAPITAL BASE	**0.00**	**1,554.31**	**3,812.18**	**0.00**

Financial Summary - Company

INCOME STATEMENT (LKR million)	31-Dec-06 10 months	31-Dec-07	31-Dec-08	31-Aug-09 8 months
Interest Income	156.24	338.88	689.66	520.48
Less: Accretion Of Discount/(Amortisation Of Premium)	0.00	0.00	0.00	0.00
Less: Net Interest Income Suspended	0.00	0.00	0.00	0.00
Less: Interest Expense	(14.09)	(118.53)	(69.04)	(47.80)
Net Interest Income	142.15	220.35	620.63	472.68
	0.00	0.00	0.00	0.00
Non-Interest Income	2.21	7.83	(54.03)	12.64
Gross Income	**144.36**	**228.18**	**566.59**	**485.32**
Less: Personnel Expenses	(18.68)	(61.21)	(90.87)	(55.20)
Less: Other Operating Expenses	(73.57)	(100.23)	(195.31)	(151.72)
Less: Loan Loss Provisions	(0.43)	(8.70)	(53.77)	(79.48)
Less: Non-Recurring Items	0.00	0.00	0.00	0.00
Share of results of Associated Companies	0.00	0.00	0.00	0.00
Pre-Tax Profit/(Loss)	**51.69**	**58.04**	**226.65**	**198.92**
Less: Taxation	(28.37)	(35.18)	(150.38)	(123.54)
Net Profit/(Loss)	**23.32**	**22.86**	**76.26**	**75.38**
Less: Minority Interests	0.00	0.00	0.00	0.00
Less: Transfer To Statutory Reserves	(1.17)	(1.14)	(3.81)	0.00
Less: Transfer To Other Reserves	0.00	0.00	0.00	0.00
Less: Dividend	0.00	0.00	0.00	0.00
Post-Appropriation Profit/(Loss)	**22.15**	**21.72**	**72.45**	**75.38**

Financial Ratios - Company

KEY FINANCIAL RATIOS (%)	31-Dec-06		31-Dec-07	31-Dec-08	31-Aug-09	
PROFITABILITY						
Net Interest Margin	16.00%	*	6.99%	11.55%	10.53%	*
Net Financing Margin	16.00%	*	6.99%	11.55%	10.53%	*
Non-Interest Income Margin	0.25%	*	0.25%	(1.01%)	0.28%	*
Cost To Income	63.90%		70.75%	50.51%	42.63%	
Cost Over Total Average Assets	10.38%	*	5.12%	5.33%	4.61%	*
Return On Assets	5.82%	*	1.84%	4.22%	4.43%	*
Return On Equity	8.14%	*	3.78%	8.49%	7.79%	*
Dividend Payout	0.00%		0.00%	0.00%	0.00%	
ASSET QUALITY						
Gross NPLs Ratio	0.00%		4.90%	19.18%	38.96%	
Net NPLs Ratio	0.00%		4.84%	14.15%	32.92%	
3-months Past Due Ratio	0.00%		0.00%	0.00%	0.00%	
Net NPLs To Total Assets	0.00%		1.93%	5.27%	11.13%	
Specific Loan Loss Provisions For Current Period	0.00%	*	0.00%	0.00%	0.00%	*
Gross NPLs Coverage	NA		11.19%	34.14%	25.01%	
Loan Loss Reserve Coverage	0.10%		0.55%	6.55%	9.74%	
General Loan Loss Reserve Coverage	0.10%		0.49%	0.73%	0.82%	
LIQUIDITY & FUNDING						
Liquid Asset Ratio	620.86%		102.04%	2,473.99%	1,639.99%	
Interbank Deposits To Total Interest Bearing Funds	0.00%		0.00%	0.00%	0.00%	
Customer Deposits To Total Interest Bearing Funds	98.65%		100.00%	5.52%	9.94%	
Loans To Deposits Ratio	164.78%		83.08%	1,826.88%	922.27%	
Loans To Stable Funds Ratio	24.59%		48.11%	39.86%	36.76%	
CAPITAL ADEQUACY						
Shareholders' Funds To Total Assets	71.44%		37.03%	57.78%	56.05%	
Tier 1 Risk Weighted Capital Adequacy Ratio	NA		62.79%	92.95%	NA	
Overall Risk Weighted Capital Adequacy Ratio	NA		63.12%	93.39%	NA	
Internal Rate Of Capital Generation	3.74%	*	2.06%	4.87%	6.06%	*

Note :
* annualised
NA = Not available / Not applicable

Financial Ratios - Company

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

CREDIT RATING DEFINITIONS
(Financial Institution Ratings)

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

LONG-TERM RATINGS

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

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

Short-Term Ratings

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

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

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

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