

Mr Duminda Weerasekare  
CEO/Director  
Ideal Finance Ltd,  
299, Union Place Colombo02.  
Sri Lanka.

September 19, 2016

Dear Sir,

**Re: Fitch rating action affecting the rating of Ideal Finance Ltd**

Fitch (see definition below) has affirmed the ratings described below:

National Long-Term Rating of B+(lka)/Stable.

## Key rating drivers

Ideal Finance Ltd.'s (IFL) National Long-Term Rating, affirmed at B+(lka)/Stable reflects its still small but developing domestic franchise and limited track record as a relatively recent entrant to the non-bank financial institution sector. It began commercial operation in 2012 accounting for less than 1% of total LFC sector asset in Sri Lanka at end June 2016. The rating also reflects potential pressure on asset quality due to an unseasoned loan book, small deposit base compared to higher rated peers and its substantial exposure to real estate investments.

The rating also factors in Fitch's expectation that IFL will maintain satisfactory capitalization amid improving profitability, despite continuous rapid loan expansion (15% in 1Q17). Its Tier 1 regulatory capital ratio eased to 39% at FYE16 (FYE15:69%), following loans growth of 87% in FYE16 (financial year ending March 2016).

IFL's rating takes into consideration its business model and risk appetite, which is reflected in the entity's exposure to more vulnerable customer segments. IFL's NPLs in arrears for over three months in absolute terms increased by 126% at end 1Q17 and in arrears for over six months increased by 4%. However, IFL's gross regulatory NPL ratio of only 0.7% is low due to the strong increase in loans and its unseasoned loan book. IFL's core business is geared towards vehicle financing which accounts for 94% of gross loans.

Fitch sees IFL's exposure to non-core activities, including real estate investments, as a risk which is much higher than at other Fitch rated domestic peers'. Fitch believes that the real estate exposure, 18% of equity at FYE16, tends to be cyclical in nature adding to earnings volatility. In addition the rating reflects Fitch's expectation that IFL's equity investments will remain moderate and not exceeding 20% of its equity.

IFL relies mainly on bank borrowings and its equity base to fund its operation. Customer deposits accounted for 13% of total assets at end June 2016, reflecting its small deposit base owing to its short operating history. Deposit concentrations were higher than the Fitch rated domestic peers.

Profitability has been improving, aided by portfolio growth and lower cost funding supported by a high proportion of equity funded assets. IFL's pre impairment operating profit improved to 4.8% in 1Q17 from 4.3% in FYE16 mainly supported through income generated through real estate investments which accounted for 23% pre impairment operating profit (FYE16:less than 1%).

## Rating sensitivities

An increase in IFL's scale of operations while maintaining commensurate asset quality and capitalization, as well as sustained improvement in the company's core profitability relative to its peers, could lead to an upgrade.

Deterioration in asset quality in combination with a notably reduced loss absorption buffer could lead to a rating downgrade. An increase in risk appetite through for instance the aggressive expansion of real estate investments could place downward pressure on IFL's rating.

In issuing and maintaining its ratings, Fitch relies on factual information it receives from issuers and underwriters and from other sources Fitch believes to be credible. Fitch conducts a reasonable investigation of the factual information relied upon by it in accordance with its ratings methodology, and obtains reasonable verification of that information from independent sources, to the extent such sources are available for a given security or in a given jurisdiction.

The manner of Fitch's factual investigation and the scope of the third-party verification it obtains will vary depending on the nature of the rated security and its issuer, the requirements and practices in the jurisdiction in which the rated security is offered and sold and/or the issuer is located, the availability and nature of relevant public information, access to the management of the issuer and its advisers, the availability of pre-existing third-party verifications such as audit reports, agreed-upon procedures letters, appraisals, actuarial reports, engineering reports, legal opinions and other reports provided by third parties, the availability of independent and competent third-party verification sources with respect to the particular security or in the particular jurisdiction of the issuer, and a variety of other factors.

Users of Fitch's ratings should understand that neither an enhanced factual investigation nor any third-party verification can ensure that all of the information Fitch relies on in connection with a rating will be accurate and complete. Ultimately, the issuer and its advisers are responsible for the accuracy of the information they provide to Fitch and to the market in offering documents and other reports. In issuing its ratings Fitch must rely on the work of experts, including independent auditors with respect to financial statements and attorneys with respect to legal and tax matters. Further, ratings are inherently forward-looking and embody assumptions and predictions about future events that by their nature cannot be verified as facts. As a result, despite any verification of current facts, ratings can be affected by future events or conditions that were not anticipated at the time a rating was issued or affirmed.

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Nothing in this letter is intended to or should be construed as creating a fiduciary relationship between Fitch and you or between us and any user of the ratings.

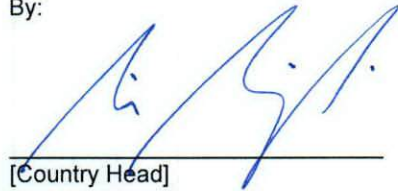
A record has been made of this rating in our permanent files, but it is our current intention that the rating will not be released publicly as the issue has been placed privately. Notwithstanding the foregoing, nothing in this letter shall limit our right to publish, disseminate or license others to publish or otherwise to disseminate the ratings or the rationale for the ratings. Investors may find Fitch's ratings to be important information, and that if you have legitimately shared the rating with a third party per the terms of the fee agreement, please note that you are responsible for communicating the contents of this letter, and any changes with respect to the rating, to any such party as well.

In this letter, "Fitch" means Fitch Ratings Limited together with any successor in interest.

We are pleased to have had the opportunity to be of service to you. If we can be of further assistance, please contact me at 2541900 .

Sincerely,

Fitch  
By:



A handwritten signature in blue ink, consisting of stylized initials, is written over a horizontal line.

[Country Head]

Handwritten scribbles and marks in the top right corner.

