

# Fitch Ratings

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

August 21, 2017

Dear Mr Weerasekare,

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

Fitch has affirmed the ratings described below;

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

Ideal Finance Ltd.'s (IFL) National Long-Term Rating, affirmed at B+(lka)/Stable, reflects its still small and developing domestic franchise - accounting for less than 1% of total LFC sector asset in Sri Lanka at end-June 2017 – and its short operating history since 2012.

The rating also reflects its high risk appetite, which is reflected in its exposure to retail and SME segments that are seen by Fitch as more susceptible to economic volatility, potential pressure on asset quality due to an unseasoned loan book, and its exposure to real estate investments compared to higher rated peers. Vehicle financing accounted for 85% of gross loans at end-June 2017.

The rating factors in Fitch's expectation of an equity infusion from its main shareholders, namely Aravinda De Silva and Nalin Welegama, to meet the enhanced regulatory minimum capital requirement of LKR 2.5bn by end 2020. Fitch believes that the IFL's earnings retention alone is not likely to be sufficient to achieve the regulatory capital requirement, despite improved profitability.

Fitch expects IFL's capitalisation to come under pressure as a result of asset quality risks stemming from a challenging operating environment and continuous rapid loan expansion. However, we believe that IFL's capital ratios will remain satisfactory for its current rating in light of its improving internal capital generation. IFL's Fitch core capital ratio eased to 30.5% at FYE17 (FYE16:39.6%), following loans growth of 49% in FYE17 (financial year ending March 2017).

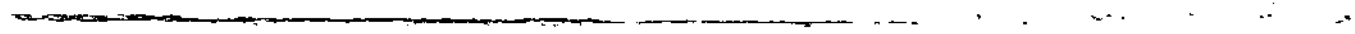
IFL's NPLs in arrears for over three months in absolute terms increased by 155% at FYE17 and in arrears for over six months increased by 90%. However, IFL's regulatory gross regulatory NPL ratio is low at just 0.94% of total advances at end March 2017, reflecting a sharply expanded loan base and unseasoned loan book.

IFL's real estate investments, accounted for 11% equity at FYE17 (FYE16: 18%). Fitch believes that real-estate based investments generally tend to be cyclical in nature and sharp increases in such investment may elevate volatility in profitability. Fitch's expects that IFL's equity investments will remain moderate and not exceed 20% of its equity which is in line with the board approved internal limit.

Fitch expects the share of funding from deposits to remain low as IFL will continue to rely mainly on bank borrowings and its equity base to fund its operations. Deposit accounted only 20% of total funding at FYE17 and has resulted in its loan/deposit ratio being much higher than that of similarly rated domestic peers.

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Profitability has been improving, due to better revenue generation stemming from higher business volumes and operational efficiencies. IFL's pre impairment operating profit improved to 4.8% in FY17 from 4.3% in FYE16. Fitch expects IFL's operating cost structure to improve further and tend towards that of the higher rated peers, as the company achieves greater economies of scale.

#### **Rating sensitivities**

An increase in IFL's scale of operations while maintaining commensurate asset quality and capitalisation, as well as a 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.

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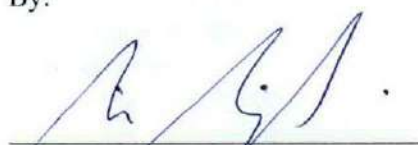
In this letter, "Fitch" means Fitch Ratings Limited together with any successor in interest.

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:



Maninda Wickramasinghe  
Country Head