Mercantile Investments and Finance PLC | Annual Report 2011/12

GROWING WITH THE FLOW

Contents

Mercantile Investments and Finance PLC

Mercantile Investments and Finance PLC is a listed company which has been in business for close to five decades. It is a licensed finance company under the Finance Business Act No. 42 of 2011. Being a premier finance company specialising in business of leasing, hire purchase financing, loans and advances and mobilisation of deposits, the Company caters to customers that come from all walks of life. In support of this, MIL has a diverse branch network scattered across the country supported by a highly skilled workforce together with the right technology to deliver an extraordinary service.

Our Vision

To be a leading financial institution committed to excellence in our sphere of activities with a deep sense of social responsibility.

Our Mission

To achieve our strategic vision, we would harness all our resources in the most productive way to be prudently managed and to serve our valuable customers in keeping with national objectives.

Our Corporate Values

- To build a lasting relationship with our customers by identifying their needs and focusing on customer care.
- To be highly competitive, and aggressively seek to expand our client base. However, we will always be fair competitors and must never denigrate other firms.
- To recognise the contribution of our employees and to foster team spirit among them.
- To be responsible to society by adopting effective corporate policies and adhering to high ethical standards.
- To our providers of capital by generating superior financial returns and securing their investment.

The Company has won the Annual Report Award for twelve consecutive years in the Finance Companies Category at the Annual Report Competition which is organised annually by The Institute of Chartered Accountants of Sri Lanka. This could be regarded as a strong endorsement of the high reporting standards maintained by the Company.

Our ‘business flows’ have been robust this year…so much so that they have allowed us to grow and expand in a significant manner. With substantial growth in lending volumes as well as deposits, among other positive aspects of performance, our business ‘flows’ in the desired direction, allowing us to expand our foot print to better serve our expanding customer base. All of this was achieved on the foundation of Mercantile Investment’s strong fundamentals and stability wrought over many years of exemplary governance and adherence to good ethics.

Just as the river wends its way across the land, enriching and nourishing life far beyond its confines, so too our increasing business flows and expansion widen the ambit of our enterprise and allows us to touch and enrich more lives across the Nation.

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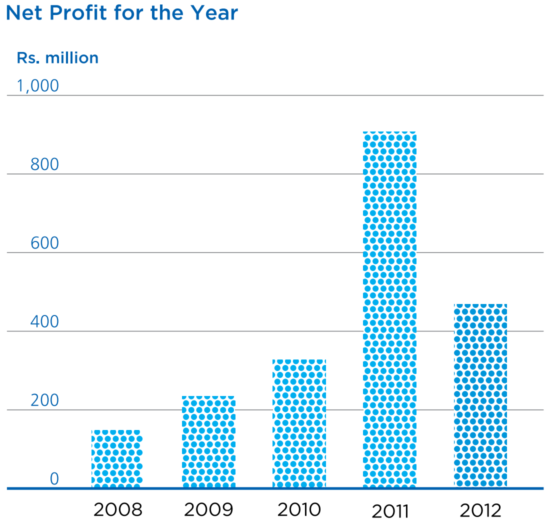
Financial Highlights

For the year ended 31 March	2012 Rs. '000	2011 Rs. '000	% Change
Results for the year			
Gross Income	2,364,841	2,214,120	7
Interest Income	1,630,558	1,497,706	9
Interest Expenses	1,006,378	679,728	48
Profit before Tax	486,874	1,048,597	(54)
Provision for Taxation	16,583	142,699	(88)
Profit after Tax	470,291	905,898	(48)
Revenue to the Government	153,141	231,236	(34)
Gross Dividend	66,132	30,000	120
Financial Position at the year end			
Shareholders' Fund (Stated Capital and Reserves)	5,311,199	4,772,300	11
Deposits from Customers	5,870,013	4,107,536	43
Loans & Advances, Leases & Hire Purchases	10,281,381	6,271,266	64
Total Assets	17,456,420	12,243,934	43
Information per Ordinary Shares			
Earnings per Share (Rs.)	156.45	301.36	(48)
Dividends per Share (Rs.)	22.00	10.00	120
Net Assets per Share (Rs.)	1,766.87	1,587.59	11
Ratios			
Return on Shareholders' Funds (%)	8.85	18.98	(53)
Return on Average Assets (%)	3.17	8.72	(64)
Year-on-Year Growth in Earnings (%)	(48.09)	175.68	(127)
Year-on-Year Growth in Dividends on Ordinary Shares (%)	120.00	117.39	2
Interest Cover (Times)	1.48	2.54	(42)
Dividend Cover (Times)	7.11	30.20	(76)
Equity: Assets (%)	30.43	38.98	(22)
Debt: Equity (%)	86.79	48.51	79
Dividend Payout Ratio (%)	14.06	3.31	325
P/E Ratio (Times)	14.06	N/A	-
Statutory Ratios			
Liquid Assets (%)	12.86	12.78	75
Core Capital Ratio (%) - Minimum Required 5%	22.40	28.50	(5)
Total Risk Weighted Capital Ratio (%) - Minimum Required 10%	27.17	34.69	(63)

Key Indicators Against Forecast

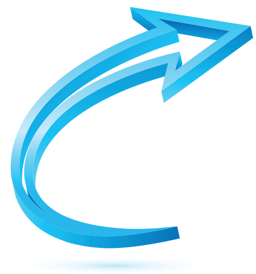
Indicator	Actual 2011/12	Forecasted for 2012/13
Return on Capital Employed (%)	8.85	Above 9.50
Earnings Per Share (Rs.)	156.45	Above 175.00
NPL (%)	2.81	Below 3.5

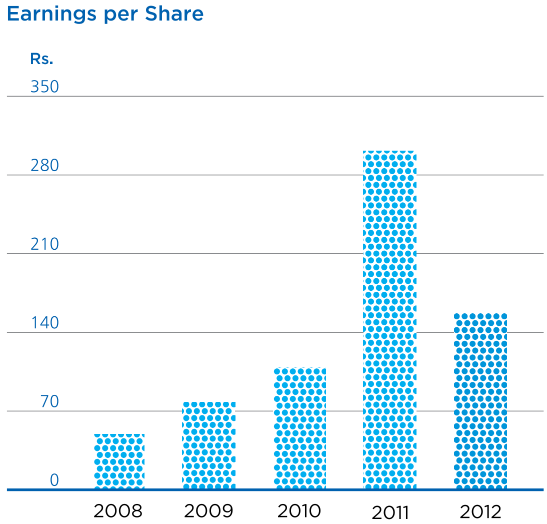
Operational Highlights



Business Growth

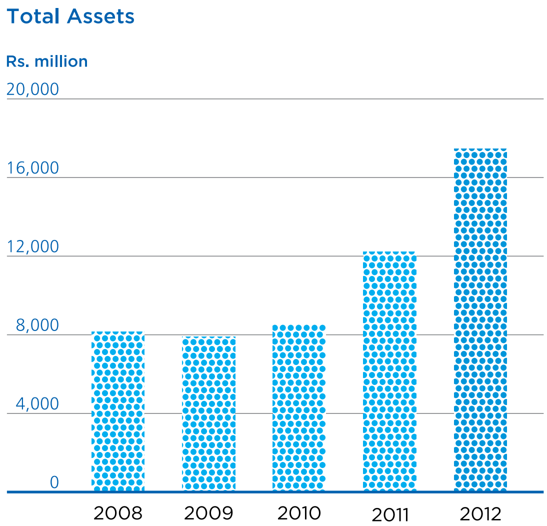
Lending Growth Topped 64% and Growth in Deposits was at 43% in 2012.





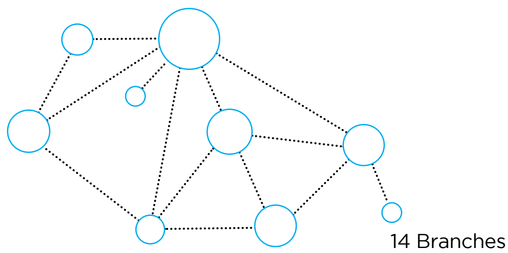
Workforce

Strengthened Staffing Level by 22% in 2012



Branch Network

Expanded the Network by 133% in 2012



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MI's eternal commitment to excellence in our spheres has made us a force to reckon with, especially considering the impact that we have instilled in our customers and because we have been able to satisfactorily enhance shareholder wealth once again in 2012 through a sound financial performance.

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Chairman's Message

Dear Shareholders,

It is with great pleasure that I warmly welcome you to the forty-ninth Annual General Meeting of Mercantile Investments and Finance PLC (MI) and present to you with pride the Annual Report and the Audited Accounts of the Company for the year ended 31 March 2012. It was yet another impressive year for the Company in terms of financial performance. Being a premier finance Company, MI once again was able to make its presence felt in the sector growing in leaps and bounds. MI's eternal commitment to excellence in our spheres has made us a force to reckon with, especially considering the impact that we have instilled in our customers and because we have been able to satisfactorily enhance shareholder wealth once again in 2012 through a sound financial performance.

Taking Over the Helm with Strategic Focus

It has been an honour for me to take over the helm as Chairman since 20 January 2012 of a Company that has a sound reputation of being true to stakeholders and a history that dates back to almost five decades. After taking over I believe, the finalisation of the three-year corporate strategic plan end of this period was momentous, as it has set the platform for the Company to be even more focused in realising our corporate objectives.

Despite the year being eventful for us with marked improvement in business volumes, the volatility of market variables including the late crunch in credit availability posed challenges to the sector. Therefore, it would be appropriate for me to take this moment to recapitulate the business environment in which businesses treaded in general.

Word Economy Pinned to Downturn

As a consequence of the elapsed global financial crises, most industries still remained passive and are yet to thrive in the international arena. The drawbacks from the crises have had lasting effects on some of the businesses even renowned ones due to closure or scaling down. The repercussions experienced from the global crises still continue to persist in most countries with no sound answers even after three years.

In essence, the global revival process that took place from early 2010 was predominantly slow paced for most nations. Nations who were more flexible and adopted swiftly tended to recover faster. Economic giants such as the United States and other western nations are yet to come to terms with their sluggish economies. If not addressed soon, the unemployment rates of such nations may exceed the alarming two digits levels. The economic dominance displayed by immerging nations such as China too have been overshadowed by its own decline in national output due to them falling victim to recession.

The advent of the Eurozone crises in early 2011, triggered by Greek debt has developed into a full blown international economic concern. This new crises could plunge the world economy into another downward spiral as warned by economist the world over. The impact of another meltdown that looms again appears far reaching this time around.

Economic Constituents that Applied Locally

In spite of raging woes globally, the Sri Lankan economy remained resilient throughout the year. The domestic economic outlook was positive, driven by the ongoing efforts of the Government and the business community. The private sector contribution to the nation's economic revival process to date was noteworthy considering the numerous initiatives extended upon dawning of peace. However, the march to prosperity for the nation was not without obstacles. The nation had to undergo its share of challenges stemming from both internal and external elements.

The said deteriorating global economic conditions was a cause for concern especially at this juncture where progress is being made in raising national output and reducing dependence on foreign debt. In this backdrop of another global economic meltdown, it was commendable for the Government to instill bold measures in driving the economy forward and to support businesses in increased production through policy changes. The ongoing construction and infrastructural initiatives including rebuilding of the liberated areas would continue to be vital in this context in lifting businesses and boosting the economy.

Maintaining an economic growth of 8.3% in 2011 over 8% recorded in 2010 indicates the extensive progress the country has undergone since the conclusion of the war. I believe, being beneficiaries of the economic resurgence that is taking place, we as the private sector have gained tremendously within this short duration. The rising business activity during the period is a good reflection of the growing demand for our financing products. With certainty, this trend should stand to continue in line with overall economic progress.

Nonetheless, the continued rise in interest rates experienced at the latter stages of the year had its effects on our financing business as it slowed down vehicle purchases. This resulted as a consequence of the current dearth of credit in the market. This could hamper the ongoing economic progress along with long-term repercussions to businesses. The high lending rates that prevail currently would increase credit risks in the sector as borrowers may face difficulty in repaying debt. The sudden devaluation in rupee that commenced in 2012 was another variable that mounted pressure on specific sectors especially institutions that dealt in international trade. Both individuals and enterprises felt the pinch of the steep rise in costs of fuel and related items again in the latter part of the year. However, inflation remained at 6.7% by the end of 2011 but could expect to rise if such price hikes are not controlled.

Nation's deteriorating relationships in the international arena was another focal point that drew significant attention in the period under review. The drop in foreign flow of direct investment and the slowing down of foreign investor interest in the stock market saw share prices plunge to its lowest levels since the boom period experienced a year before. However, the financial services sector remained stable in the midst of all these factors in contrast to the turmoil witnessed in early 2009. The stability enjoyed by the sector was an outcome of timely measures introduced by the Central Bank of Sri Lanka especially with the tightening of regulation applicable to the sector. I believe, being part of a sector that is fundamental to the overall economic stability and progress, the sector institutions should further strengthen own processors and style of management for its betterment as they evolve over time. This would enable institutions to fulfil ones obligations more effectively that will in turn increase the marketability of their offerings.

It is evident that the economy has progressed considerably in the last few years in spite of its relatively slow pace than ones anticipated. This can be extra illustrated from the following statistics for 2011 that provide an insight as both negatives and positives of a developing nation:

- The unemployment rate reduced to 4.2%.
- National savings stood at 22.1% of GDP.
- Investments of private and government both accelerated moderately to reach 23.7% and 6.3% of GDP, respectively.
- Market capitalisation of Institutions in the capital market remained high, totaling Rs. 2,213.9 Billion.
- Government revenue stood at 14.3% of GDP almost similar to 2010.
- Government debt decreased to 78.5% by the end of the year.
- Export volumes index increased to a positive of 10.4% compared to a negative of 13.3% last year.

Path to Profound Economic Growth

The strategic approach to national development adopted by the Government of Sri Lanka should pave the way for economic growth and with it a brighter outlook for all citizens. Seeing ahead, it is vital that such strategies are adopted effectively to derive its full potential for development of the nation. To support this, sound methods of review should be inculcated as a means of evaluating the effectiveness of such policies over time so that necessary changes could be affected at the right instance. There is no doubt in my mind that both public sector and private sector would need to work hand in hand and be committed if the nation is to achieve robust economic growth in the medium term. At the same time, maintaining excellent international relationship with our counterparts and obtaining their support to nation's economic development would be crucial in speeding up country's growth aspirations.

The Stance of Your Company

2012 was dedicated to business growth and therefore the Company continued to enrich its budding branch network and displayed dominance even outside the Western Province. After obtaining its listed status in June 2011, we revised our corporate name once again as Mercantile Investments and Finance PLC in observance to the new Finance Business Act. Your Company would endure its leadership role in the sector and in carrying out plans to exercise strategic priorities already established for the next few years. In serving our dear customers, we hope to put forth innovative products and services that will benefit them and at the same time add value to the overall economy. Our ongoing plans on extending our services to the rural community would play a vital role in bringing us much closer to people and their financial needs. I am confident that MI would stand committed in fulfilling set corporate objectives and with it will be able to elevate the satisfaction level of our stakeholders.

Our Gratitude to the Outgoing Chairman

Mr. Gerard G. Ondaatjie who took the helm as Chairman and Managing Director in March 2011 stepped down in January 2012 in keeping with the recent Direction on Corporate Governance issued by the Central Bank of Sri Lanka. Being our strength and a pillar of success from the time he joined the Board way back in 1993, he continues to be the Company's Managing Director upon this change. He holds a Bachelor's Degree in Accounting from the Arizona State University, United States and possesses almost 18 years experience in the financial services sector. I wish him continued success in this key role and very best in the years to follow.

Resignation of Director Deposits, Mrs. M.B. Assauw and Non-Executive Director, Mr. J.S. Dominic from the Board

Mrs. M.B. Assauw resigned from the Board in January 2012 having served as the Director Deposits of the Company. The Board warmly extends gratitude to her for the invaluable service given since 1988. Upon her resignation, the Board appointed her as a Director designate, a non-member of the Board. She continues to head the deposits division of the Company.

In keeping with the said Corporate Governance Direction, Non-Executive Director Mr. J.S. Dominic resigned in December 2011. He has been on the Board since 1967 has been one of our longest serving Directors. On behalf of the Board of Directors and staff, we extend our gratitude to him for serving the organisation during this long tenure contributing invaluably for its betterment. We wish him the very best in the years to come.

New Appointments to the Board

MI Board was strengthened with three new appointments this period in accordance with the Corporate Governance Direction issued to Finance Companies. Your Board therefore appointed Mrs. P.T.K. Navaratne w.e.f. 17 January 2012, Mr. N.H.V. Perera and Mr. S.M.S.S. Bandara on 9 February 2012 as Non-Executive Directors.

Mrs. Navaratne holds a Bachelor of Laws (LLB) Degree from the University of Colombo and is an Attorney-at-Law and is presently the Director - Legal, WSO2 Lanka (Pvt) Limited. Mr. Perera has been attached to Lucian V. Perera Associates a legal firm for over ten years and is a Director of five other organisations including Tangerine Beach Hotels PLC. Mr. Bandara is a partner of B.R. De Silva, Chartered Accountants since 2004 to date. He holds a B.Sc. Degree in Accountancy from the University of Jayawardenapura and an MBA from the University of Colombo. He is also a fellow member of The Institute of Chartered Accountants of Sri Lanka and a Fellow of the Association of Accounting Technicians of Sri Lanka.

On behalf of the Board and shareholders, I welcome warmly the three of them to our organisation and wish them success.

Appreciations

I would like to take this opportunity to thank my fellow Directors who have given their fullest support to me sharing their valued expertise at all times for the betterment of the Company. My sincere appreciation also goes out to the Management and staff of MI, for their unstinted co-operation and commitment which has brought us another years success. The sheer dedication of our employees and their determination to be the best in whatever they do has made us grow in leaps and bounds. Your relentless commitment continues to strengthen our organisation and binds us as one unique family.

I would like to take this opportunity to thank the Governor, Deputy Governor, Director-Non-Banking Supervision Department and staff of the Central Bank of Sri Lanka for their guidance and continued corporation extended to us throughout the year. We also wish to thank them for their efforts in supporting the Finance Company sector for its betterment.

Our customers, who have stood by us for decades with true loyalty has brought us pride over the years. This has made us serve you better every time. Thank you once again for keeping your trust in us. A special word of thanks goes out to our intermediaries, namely the agents for their significant contribution made towards promoting business.

Our passion to achieve has been driven by non other than our shareholders, who have placed immense trust in us to deliver sound performances right along. Thank you for keeping faith in the Board, the Management and myself especially in both good and challenging times.

I wish to assure you that MI would stay committed to serving our stakeholders to the best of our ability. On behalf of the Board of Directors, I pledge that we would continue to bring enhanced shareholder wealth as we move forward. We hope to demonstrate our eternal commitment to success through excellence and professionalism including implantation of prudent business strategies. We will continue to prosper in our sector as a rock solid institution that stands united in our aspirations on reaching greater heights. Through this we hope to bring forth value to all our stakeholders and to the national economy.

Saroja Weerasuriya
Chairman

15th May 2012

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To propel organisational growth, we pursued our plans on extending business operations to key strategic locations considering the vast opportunities that prevail currently due to the ongoing economic recovery. This however was done in keeping with our fundamentals that ensured business expansion was carried out in a sustainable manner thus securing the long-term viability of the overall business.

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Managing Director's Review

Volatility in a Reviving Economy

The financial year 2012 unfolded with great optimism for the nation, moving ahead from the consolidation phase that had already commenced a few years back. Acceleration in economic activity was sustained by positive sentiments that continued to prevail soon after cessation of hostilities in 2009. The ongoing efforts of the Government in rejuvenating livelihoods and economic activity in liberated areas of the North and East created much optimism for business to seek fresh opportunities and reach out to such communities in their own style. The private sector exhibited its commitment in capitalising on immerging opportunities having comfort of a peaceful economic setting, driving the ongoing economic resurgence forward.

However, as the year progressed, the emergence of volatility in the economic front posed fresh challenges to all. The steep rise in market interest rates resulting from the contraction in credit availability slowed the accelerating economic activity that existed in the early part of the year. The depreciation in Sri Lankan Rupee against the green back and the upward revision in prices of fuel and related commodity posed extra challenges to businesses in terms of managing the viability of their operations. The poor performance of the Colombo Stock Market this period was a reflection of reversing positive investor sentiments which crept in mid way. Nevertheless, such volatile factors did not deter spirits of a progressing economy which remained confident of moving toward economic prosperity.

Our Receptiveness Was Vital in Bringing Success Yet Again

In the midst of growing challenges, Mercantile Investments and Finance PLC stayed receptive to market changes and was able to conclude the financial year with yet another noteworthy performance. In maintaining this sound performance, numerous strategic programmes were affected over the year specifically through the extension of operations, streamlining and strengthening of processors and nurturing our work force to deliver anticipated performance standards. To propel organisational growth, we pursued our plans on extending business operations to key strategic locations considering the vast opportunities that prevail currently due to the ongoing economic recovery. This, however was done in keeping with our fundamentals that ensured business expansion was carried out in a sustainable manner thus securing the long-term viability of the overall business. Accordingly, we extended our branch network to fourteen fully-fledged branches this year from six branches last year.

The rise in demand for financing needs that surfaced with the advent of lowered import duty on vehicle imports remained a key driving factor for our core business in spite of rising market volatility and competitiveness in the sector. In this backdrop, we managed to maintain our lending growth above 60% in 2012 and at the same time improve the influx of deposits overall. Despite, Western Province yielding higher business, our presence in rural areas remained a vibrant proposition for us with potential for growth. Apart from core business revenue, non-fund based income continued to contribute significantly in maintaining anticipated overall revenue. Share trading profits nevertheless remained slow-paced than last year owing to the sluggishness of the prevailing stock market.

It must be mentioned that the skill and professionalism of our human resource has been the driving force in our forward march to excellence. MI's Senior Management took leadership in executing various strategic programmes and geared ones departmental operations in line with business expectations. As a bold measure in promoting deposit business especially at branch level, we established a separate deposit mobilising marketing team this period. We capitalised on our longstanding reputation as a stable and solid institution as means of attracting new clientele and cultivating them to be part of our growing list of loyal customers.

MI's Financial and Operational Performance

Profitability for the Year

The pre-tax profit of the Company for the 2012 financial year remained robust at Rs. 487 million declining nonetheless by Rs. 562 million or 54% from last year. The Company's post-tax profits in absolute terms remained commendable amounting to Rs. 470 million dipping in a similar way by Rs. 436 million or 48% compared to previous year's exceptional results. In a dynamic economic setting, we geared ourselves well to meet the challenges, executing our plans as anticipated enabling the Company to sustain a sound business momentum throughout the year. In contrast to the exceptional growth experienced in both lending and deposit businesses, overall profitability nevertheless showed a decline specially because of the slow-down in growth of Non-fee-based income this period. Unlike previous year, the contribution from capital gains on share trading to profits fell by Rs. 144 million from 2011 after netting off a provision made for fall in value of shares owing to the persistent sluggishness in the stock market.

Mercantile Investments and Finance PLC being in the forefront of financing business has demonstrated its ability to counter challenges well over the years and has forged ahead in both good and challenging times. The finance company sector has undergone tremendous change in the last decade hence resulting in heightened competition and posing new challenges to players in the industry. Positively, enhanced regulation, close supervision and strengthening of processors by respective institutions had made the sector stable and more attractive in terms of services offered. These measures combined with improving business conditions boosted the sector in contrast to a few years before where public confidence remained low. However, the emergence of new institutions to the sector and increased banking sector interest in financing business has intensified competition. As a result, pricing on core business products remained highly competitive thus affecting related margins enjoyed by institutions in the last few years.

A positive feature this period was the Company's ability to curtail its non-performing lending despite steep rise in the lending book. As such, the non-performing lending as a ratio remained impressively at 2.81% as at the Balance Sheet date. The Recoveries Division implemented measures that proved very effective to smoothen the daily collection process. Precision and timeliness in communiqués when instalments fall due, increased internal monitoring mechanisms and constant follow up of overdue accounts kept non-performing lendings at satisfactorily low levels. However, the continued rise in rates and other factors arising from economic volatility at the latter stages of the period began to pose concerns for the sector, especially on the borrowers' repayment ability. The Company made net provisions totalling Rs. 27 million against a net provision reversal of Rs. 45 million carried out in 2011.

As a parallel measure, greater emphasis was placed in costs management during this period especially in curtailing overhead costs. It was decided to set up a Cost Control Committee to evaluate costs elements and to propose steps to mitigate wastage and minimise undue costs. At the same time, core divisions were required to revisit their departmental procedures so that steps could be taken to eliminate non-value adding practices and to propose procedures that would enhance the effectiveness of routine operations. The overhead costs (excluding personal costs) of the Company nonetheless climbed by 39% from 2011 mainly on account of upward shift in usage levels and the general price hikes that prevailed due to inflationary factors.

Assets and Liability Position

The surge in business had an immediate impact on the total assets of the Company which advanced by 43% to Rs. 17,456 million as at 31 March 2012 from Rs. 12,244 million recorded last year. Growth in MI's loan book resulting from improved business conditions and our expansion based strategies were the foremost reasons for this asset rise. Mobilisation of deposits remained the main source of funding to back this asset expansion while borrowing was the other alternate source of funding.

Increasing MI's network of branches within the last couple of years reinforced corporate expectations on sustaining higher levels of growth in lending and deposit taking. Accordingly, MI's lending base swelled to Rs. 10,281 million as against Rs. 6,271 million recorded in the last financial year, reflecting a considerable rise of 64%. Tax concessions conferred in previous two years coupled with improving economic conditions boosted the lending business of the Company specifically our vehicle financing business. Strong emphasis was placed this year in uplifting our business loans mainly lending against property mortgage. We also afforded structured and step up lending facilities to add variation to our core products that fulfilled varying needs of our borrowers.

Additionally, the total assets of the Company grew notably as a result of the continued interest shown in the Stock Market like previous year. Despite, yielding comparatively lower returns this year by way of realised trading profits and dividends, our investment portfolio stood at Rs. 3.9 billion as at 31 March 2012. Nevertheless, owing to the poor performance of the Stock Market which saw steep fall in majority of share prices, the Company had to make a fall in value provision of Rs. 137 million as at the Balance Sheet date.

There was a marked improvement in our deposit canvassing business during this period that helped us to surpass the Rs. 5.5 billion mark in total deposits for the first time. Our growth in deposit business stood impressively at 43% in the year under review despite the staunch competition that prevailed in pricing to attract fresh customers. The tightening of sector regulations including the imposing of the compulsory deposit insurance scheme and numerous other measures introduced by the regulator has brought needed stability to the sector. Accordingly, customer perception and confidence in the sector had improved tremendously in the past couple of years giving the needed boost to deposit business.

In managing the expanding funding requirements resulting from the mounting lending business, our Treasury Division resorted to bank borrowing extensively whenever funding from deposit mobilisation was insufficient. For this purpose, fresh funding lines were secured from our traditional banking partners whilst the Company continued to fulfil temporary funding needs through unutilised facilitates. The total borrowings of the Company therefore soared to Rs. 5,115 million up by 89% from last year.

Our workforce remained the most decisive factor once again in our path to success and to deliver these sound results. In meeting corporate aspirations, MI employees yet again contributed immensely towards the growth in businesses and improving service excellence. The launch of our intense induction programmes with external expertise proved invaluable in preparing new recruits to fit into our dynamic operation with focus and right attitude. We increased the size of our workforce substantially during this period in keeping with our strategic expectations of strengthening our operational activity and broad basing the services that we offer presently.

Credit Rating

RAM Ratings (Lanka) Limited revised the Company's respective long-term financial institution rating in February 2012 to 'RAM BBB+' (Positive outlook) and the short-term rating to 'RAM P2'.

Creation of Wealth to Shareholders

Based on our sound results, the Company paid dividends totalling Rs. 66 million for the financial year ended 31 March 2012 compared to Rs. 30 million incurred in the previous year. Our relentless commitment in yearning for financial success paved the way in enhancing shareholder wealth yet again.

MI's Annual Report Adjudged the Winner for the 12th Consecutive Year

For the 12th consecutive year running, MI's Annual Report produced for 2010/11 was acclaimed as the Winner in the Finance Company Category receiving the prestige Gold Award at the Annual Reports Awards Competition held in 2011 organised by The Institute of Chartered Accountants of Sri Lanka. I believe, winning this award astoundingly for over a decade clearly endorses the high reporting standards that we have been maintaining over the years and portrays our commitment towards transparency.

CSR (Corporate Social Responsibility) Programmes Initiated

The 'Sustainability Report' given in the Annual Report provides an in-depth coverage to our readers of our CSR accomplishments this period. This report demonstrates the Company's continued commitment in meeting societal, economic and environmental obligations. We have presented our report in accordance with the 'Global Reporting Initiatives framework' (GRI) similar to last year. An Assurance Report was obtained from our External Auditors in relation to this year's sustainability supplement as an additional step.

Future Outlook

My belief is that the nation will remain resilient in the years to follow in its path to national development and prosperity in-spite of immerging fresh challenges both in the domestic front and internationally. In the financial services sector, the immediate challenge would be to negotiate the credit contraction and rising interest rates that could trigger higher defaults from borrowers again. Similarly, prudent management of costs would be vital for corporates if they are to remain competitive in pricing and to record consistent performances as before.

The on going economic developments that are transpiring currently are bound to bring forth tremendous advantage to the nation including better quality of life. The business community should be weary of the opportunities that still lay uncovered and immerging if they are to thrive in this environment. It is the view of most that the opening of the Southern Highway and other bold initiatives in progress of the Government is bound to stimulate our economy that is yet to mature and will play a key role in driving the economy forward in the longer horizon. In execution of these measures both the public and private sectors equally have a hand to play if the nation is to achieve lasting prosperity in the foreseeable future. Growth stimulating macroeconomic policies of the government including infrastructural development and reconstruction efforts in the liberated areas coupled with other immerged positives especially the surge in tourism that devolved as a result of peace can be the foundation for the business community to reap greater success. This I believe will be the stepping stone for the dawned decade on which the business community should capitalise on and transform themselves to be world-class organisations.

MI's Role Beyond 2012

The demand for leasing and hire purchase financing that slowed down in the latter part of the financial year 2012, should accelerate once interest rates start its decent gradually. It is anticipated that the annual credit growth of the sector in the forth-coming period would remain lower than the concluded period but would still exceed 20% considering the optimism placed in the overall economy. In this context, the Company needs to be receptive once more towards changes that are bound to occur, so that we could improvise ourselves better and be competitive in terms of our pricing and service standards. To remain a dominant player, we would have to be bold in our approach specifically in bringing innovative offerings to the market. Customers mind set of seeking optimal pricing solutions should be substituted with other differentiating factors including quality of service to attract new clientele to the organisation. The financial services sector is rapidly changing and hence fine-tuning operations with the intent of adding enhanced value to our offerings through improved processors, advanced technology and tighter regulation and control hence become vital ingredients for success.

MI's three year strategic plan will be the guiding instrument for the Company in terms of maintaining the required strategic focus and fulfilling of set corporate objectives more scrupulously. Our efforts would mainly revolve around reinforcing ourselves in areas we are strong as means of differentiation, extending our services as means of growth and nurture staff to bring out the best in them. We would persevere in keeping costs at manageable levels and avoid wastage through the closer management of costs, continuing on the programmes set up this year.

Reinforcing the Strengths we Possess

Our consistent performance over the years has enabled us to accumulate a formidable capital base that provides us the needed leeway in terms of pursuing growth aspirations. In support, we have a capable workforce who have the necessary skills and attitude to perform their functions to the expectations of the enterprise. Since operating for almost five decades, we have abundance of knowledge in credit and financing and have the necessary infrastructure including advanced technology to back related operations. Our expertise in credit and recovery gives us the edge to hold and cultivate a quality lending portfolio. Our aim is to manage non-performing lending so that it is kept minimal despite planned growth in the lending book in the next few years.

Strategically our aim is to broaden our deposit base and concurrently deepen our lending base. We hope to capitalise on the group synergies we hold to provide our valued customers a one-stop shop for financial services. We hope to attract high net worth individuals who are financially sound for our lending business. Our practice of obtaining absolute ownership of leased assets would prevail in the hope of minimising credit exposure as it will allow us the option of selling and realising the asset in the event of a default. On the other hand we are fortunate to have a well-diversified deposit portfolio which comprises long standing loyal customers, individuals and corporates.

Our commitment in instilling good governance practices, craving for sound values including transparency and most of all our longstanding reputation will secure the trust placed in us. We would cement confidence in our depositors with these credentials to create lasting relationships. To sustain competitiveness in a complex sector like ours, we will strive to adopt universal risk management techniques as means of cutting down exposure to core risk. Specifically, we will keep close watch on assets and liability mismatches, maintain anticipated spread levels and place strong emphasis to operational and compliance requirements on an on going basis.

Spreading Out to New Territories

Taking stock of the current slowdown experienced in the financial sector, we may resort to a more conservative approach to our proposed branch expansions next year. As a company that is on the verge of attaining 50 long years in operation, we nevertheless hope to extend our services systematically to locations that are perceived as beneficial. MI's branch operation that falls under a regional structure is overlooked by separate officers currently at senior manager grade.

We hope to proceed with this structure as it enables us to provide a speedier service and helps us to understand and monitor customers better.

In the next few years, we intend consolidating our position outside Western Province more. In doing so, we would initiate adequate feasibility studies prior to making capital investments. Plans are already underway to set up a City Office in Colombo as means of strengthening our position in the Western province as well. In boosting both lending and deposit business, we hope to utilise MI's developing network to create increased awareness among localities and to meet financial needs of the middle and lower classes attached to such rural communities.

Adoption of IFRS for Financial Reporting

As an organisation that strives for excellence in financial reporting, measures have already been taken to ensure that we adopt the International Financial Reporting Standards (IFRS) that is effective from this calendar year. This is bound to further enrich our financial reporting in the near future. As done over the years, MI will remain committed in providing our stakeholders comprehensive, timely and transparent financial disclosures at all times.

Nurturing an Expanding Workforce

We hope to follow through with the stream of initiatives commenced this year in improving productivity levels of our human resources. Training and development programmes will be used extensively for the front line staff as means of preparing them for future challenges. In sufficing staffing requirements, our strengthened human resource department will play a coordinating role in the selection and recruitment process to identify most suited individuals.

Words of Appreciation

Firstly, I extend my gratitude to the Chairman and Board of Directors for giving me their unstinted support right along through invaluable advice, expertise, and encouragement. To the team at MI, I once again extend a warm thank you for your enormous efforts especially your relentless dedication in bringing success to the organisation yet again. This also gives me an opportunity to extend my sincere appreciation to the Governor of the Central Bank and his able staff for their cooperation and support extended towards us throughout the year. I take this opportunity further to thank our customers who have chosen us to be your business partner once again. Finally, I wish to thank the shareholders in placing their continued trust in the Board and myself to deliver to expectations. I believe MI is well geared and on the right path in achieving greater success. Using the on-going transformation of the economy as a medium, I am confident that Mercantile Investments and Finance PLC will forge ahead to new heights and continue to be recognised as a dominant player in the financial services sector.

Gerard G. Ondaatjie
Managing Director

15th May 2012

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Our desired business flow has always been towards the empowerment, sustenance and prosperity of our customers. In helping them grow their own resources and build sustainable livelihoods, we play a significant role in fulfilling their aspirations…to the brim!

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Management Discussion and Analysis

Overview of Business

Mercantile Investments and Finance PLC popularly known as MI is a licensed finance company regulated by the Central Bank of Sri Lanka. The Company specialises mainly in finance leasing, hire purchase financing, fleet management, business loans and mobilisation of deposits. From June 2011, in line with statutory regulations, MI is a listed company on the Diri Savi Board of the Colombo Stock Exchange. Operating in the finance company sector, MI is subject to strong regulations especially requirements placed by the Central Bank of Sri Lanka. The Finance Business Act No. 42 of 2011 covers a stream of regulatory requirements some of which have been newly introduced to better govern the Licensed Finance Companies (LFCs). These regulations ensure that institutions in the sector end up being prudently managed and remain stable at all times.

MI being a premier Finance Company for over four decades has moved from strength to strength despite growing competition in the sector. The sector has gathered momentum once again with rise in demand for lease finance and hire purchase financing, particularly after the post-war period and with the economic resurrection that ensued. During the period under review, Mercantile Investments was able to successfully capitalise on this improved business conditions. As a main highlight this period, MI's business volumes rose to new heights specifically in its lending business. The Company was therefore able to add value to its shareholders satisfactorily yet again, while parallely fulfilling corporate expectations towards other key stakeholders.

Status of the Nation's Economy

The Sri Lankan economy showed progress in 2011 continuing from the economic consolidation made in the previous year, reaping benefits of peace after an expensive three decade-long war. The economy was able to sustain a healthy growth in GDP of 8.3 % following through from a 8% growth recorded a year before. This economic acceleration process revived most business sectors including the finance companies sector which began to realise a boom in business volumes within the last two years. National emphasis on development and growth continued with especial attention placed in consolidating previous war-torn provinces of the North and East. The emergence of private sector enterprises in these regions continued to expand especially in a backdrop of on-going development projects including infrastructure development initiatives that have been conducted by the Government. The gradual rise in interest rates that remained low previously reflected the rise in demand for credit. Attracting foreign direct investment therefore became a necessity in this period with institutions in banking and our sector requested to seek international funding as a source of additional funding.

Despite a positive outlook in the domestic economic front, internationally, countries especially in Europe and Americas are faced with additional woes since dipping into global recession from 2008. The Eurozone crises that emerged in this period with Greece succumbing to debt soon boomed into a multinational crises for the related nations in concern. The Middle East uprising that came about in this period also has had dramatic impacts to the global economic setting in some form or the other. The rise in unemployment rates and the growing debt continue to haunt economic giants including United States of America and England. Global economic deterioration could ripple out again to the domestic economy front especially industries that are heavily dependent on international trade.

A more in-depth brief on the economic setting that prevailed in the country for the calendar year 2011 is provided for in our section 'Sri Lankan Economy at a Glance' in the Annual Report.

Non-Bank Financial (NBF) Sector

The Non-Bank Financial Sector that consists of Licensed Finance Companies (LFCs) and Specialised Leasing Companies (SLCs) continued its growth momentum during 2011. The main indicators in respect of capital, profitability, asset quality, credit growth and deposit base recorded impressive growths. However, a few LFCs continued to experience deterioration of capital and shortage of liquidity. During the period under review, the Central Bank of Sri Lanka diligently monitored the resolution measures implemented with regard to restructuring of several distressed Non-Bank Financial Institutions (NBFIs) to ensure that the sector remains financially stable.

Growth in Assets of NBF Sector

The NBF Sector's total asset base grew by 26% during 2011 to Rs. 490 billion compared with a growth of 30% recorded in 2010. The main contributory factor in the expansion of the asset base has been the growth of the accommodations portfolio. Accommodations grew by 46% to Rs. 388 billion as at end 2011, compared to a growth rate of 35% during 2010. Finance leases, hire purchases and other secured advances were the major sources of the increase in accommodations accounting for 43%, 30% and 15%, respectively of total accommodations. Among the products, finance leasing, other secured loans and pawning indicated higher growth rates of 90%, 58% and 35%, respectively. However, the investment portfolio of the sector has shown a decrease of 46%, mainly due to the cancellation of the licence of a diversified leasing company, upon its migration to a holding company status.

Liabilities of NBF Sector

Deposits were the major source of funding for the LFCs, while borrowings were the major source of funding for the SLCs, representing 38% and 35%, respectively of the total NBF liabilities. Deposits grew by 27% to 186 billion as at end 2011, compared with the 22% growth in 2010, reflecting the regaining of confidence in the LFC sector. Deposit mobilisation was mainly through time deposits, which accounted for nearly 97% of the total deposits. LFCs have raised funds through borrowings as well. The total borrowings in the NBF sector, as at end 2011 reached Rs. 172 billion, an increase of 24% compared to the growth rate of 49% recorded in 2010. The capital increased by a robust 60% to Rs. 77 billion as at end 2011, compared to an increase of 17% in 2010. In strengthening the capital funds of the sector, sustained profitability and the revival of the distressed companies were the instrumental factors.

Composition of Assets and Liabilities of NBFIs Sector

Item	2010 Rs. billion	**2011 (a)** **Rs. billion**
Assets:		
Accommodation	265.5	**388.4**
Finance Leasing	87.5	**166.1**
Hire Purchase	96.0	**118.4**
Investments	25.2	**13.5**
Others	97.2	**88.0**
Liabilities:		
Total Deposits	146.1	**186.0**
Total Borrowings	138.9	**171.6**
Capital Elements	48.1	**77.0**
Total Funds	333.2	**434.6**
Others	54.7	**55.3**
Total Assets/Liabilities	387.9	**489.9**

(a) *Provisional*

(b) *Information given is as at 31 December for columns 1, 2 & 3 and its source being the Annual Report of Central Bank of Sri Lanka.*

Profitability of the NBF Sector

The NBF Sector profitability continued to improve during 2011 mainly due to the prevailing business environment. The sector benefited also from the single digit interest rates that prevailed since 2010. As a consequence of these factors, the sector posted a remarkable profit after tax of Rs. 16 billion during 2011 compared to a profit of Rs. 5 billion in 2010. This was mainly attributed to the improvement in net interest income due to the growth of core business of NBFs and the reversal of loan loss provisions due to reduced provisioning requirements and recoveries. The increase in profits was reflected in improved Return on Assets and Return on Equity which stood at 5% and 25%, respectively, in 2011 compared to 3% and 11%, respectively in 2010.

Composition of Income and Expenses of NBFIs Sector

Item	2010 Rs. billion	**2011 (a)** **Rs. billion**
Interest Income	53.3	**64.9**
Interest Expense	29.9	**33.7**
Net Interest Income	23.4	**31.1**
Non-Interest Income	12.3	**14.7**
Non-Interest Expenses	20.3	**25.0**
Staff Cost	6.7	**8.4**
Loan Loss Provisions (Net)	4.5	**(1.5)**
Profit before Tax	10.8	**22.3**
Tax	5.9	**6.4**
Profit after Tax	4.9	**15.8**

(a) *Provisional*

(b) *Information given is as at 31 December for columns 1, 2 & 3 and its source being the Annual Report of Central Bank of Sri Lanka.*

Supervisory and Regulatory Developments in the Sector

Other than the Finance Business Act No. 42 of 2011 enacted in November 2011, three new directions were issued to LFCs, with respect to assessment of fitness and propriety of Directors and officers performing executive functions; reporting requirements, introducing sanctions for non-compliances; and increasing the minimum core capital to Rs. 400 million. Further, all LFCs were required to list on the Colombo Stock Exchange by 30th June 2011. As at end 2011, 28 LFCs were listed.

Risks and Uncertainties Prevalent in LFC Sector

MI being in the LFC Sector is faced with numerous risks and challenges especially because of business needs and operations of the industry are ever changing and is highly dynamic. This has resulted in changing customer needs, stringent regulation, increased competition, economic and political changes, technological changes, varying human resource expectations, environmental anticipations etc., that has brought rise to risks, challenges and complexities for institutions operating in the sector.

Significant challenges currently facing our sector together with MI's response/actions in countering them are outlined below:

Key challenges posed	MI's response/action update 2012
Exceeding Expectations in Service Excellence Increased customer sophistication resulting from revolutionary changes in technology has raised customer expectations to new heights. Greater access to information and intense competition has resulted in higher demand for service excellence. This calls for a nurtured team that possesses adequate capability, right attitude and relentless commitment.	• Finalisation of comprehensive operational procedures for core business functions coupled with extensive staff training aimed at lifting service standards. • Modifications to specific parts of the core system as means of enhancing system functionalities to support both front end and back office operations to deliver an enhanced service.
Sustaining Business Volumes is Challenging Finance company sector has become severe in competition in the last decade. In this context gaining and even sustaining market share is quite challenging. The on-going economic resurgence provides the right platform for business growth but nevertheless has been slow paced than anticipated.	• In line with corporate goals, MI was able to further expand its presence outside western province, setting up six new branches during this period. • The development of a 'strategic plan' which stresses the necessity to sustain continuous growth through numerous set strategies. • To drive the growing core business operations of credit and deposit business, the Company expanded its workforce relatively higher than a normal year.
Difficulties in Sustaining a Reasonable Spread The rise in competition especially from outside the sector such as banks etc., offering competitive pricing has eroded margins somewhat for the sector. Institutions that are fast in adapting to change, who can offer a better value added service would have an edge over others in terms of enjoying better margins.	• Monitored pricing closely and the spread levels including comparison of market rates at management committee meetings. • Fine-tuned information systems enabling management to obtain information on interest rates drilled down to product wise statistics etc. • Linking of price expectations to staff targets especially for lending and apprising them periodically. • Gathered information on customer perceptions, changing needs, market pricing changes etc., on a frequent basis.
Challenges in Retaining Staff Having a workforce that is highly skilled is a pre-requisite of success for any service organisation. It is therefore vital that the Company attracts and retain suitable individuals for achieving organisational goals and strives towards one's vision. Nevertheless, this task has become challenging owing to numerous other job opportunities prevalent in the market.	• Annually, remuneration levels of staff are reviewed in comparison to their performance and market levels to assess adequacy. The Company extended its performance appraisal methodology to all divisions this year and identified high performers. • The Company continued to provide both monitory and non-monitory benefits to attract and sustain its work force. • Training was used heavily as means of enhancing skills and competencies of staff so that they are better prepared to face growing challenges.

Key challenges posed	MI's response/action update 2012
Stream of Sector Regulations Pose Challenges Range of regulations applies to the sector aimed at protecting varying stakeholders. The introduction of the Finance Business Act and other stream of new requirements increased regulation.	• The Company worked closely with relevant bodies to ensure that the implementation process is carried out smoothly in line with regulations. Accordingly, the Company obtained a listing to adhere to requirements of the regulator during this period. • MI's workforce comprises staff well conversant to implement on-going changes to regulations. • MI has an established mechanism to monitor the level of compliance to prevailing regulations through the internal audit process.
Greater Dependence on the use of Information Technology Possesses Challenges Technology plays a significant role in improving the final output of our offerings and is a pre-requisite in being competitive. However, the nature of technology is such that it is never constant and is ever changing. Existing technology especially information systems have to be reviewed periodically to maintain its efficiency and competitiveness.	• MI possesses a skilled Information Technology team that has been in the field for years who are familiar with existing systems to cater to growing information demands. • A comprehensive gap analysis was carried out during this period by comparing MI's core system with another similar system in the market. Resultant gaps were bridged accordingly.

SWOT Analysis

The strategic plan of the Company prepared this year addressed the following key strengths, weaknesses, threats and opportunities that prevail for Mercantile Investments and Finance PLC.

Key Strengths Identified

Key strengths of MI	MI's response
Reputed registered Finance Company for over four decades.	Strategies, policies and practices developed are aligned to ensure MI maintains its good name in all its activities.
Strong capital base providing room for expansion.	Continue to generate and retain annual profits to strengthen capital for planned growth.
Human resource base that is skilled and loyal to the Institution with long service periods.	Ongoing initiatives to nurture and retain MI work force.
MI comes under the umbrella of a financially strong group diverse in business including hotel trade.	Wherever possible capitalising on the Group's diversification especially to communicate financial strength.
The Company is listed in the Colombo Stock Exchange.	Capital market provides opportunity to mobilise equity funding when needed for expansion purposes etc.
Well-developed IT system and conversant IT support staff	Numerous IT-related initiatives have been executed to support core business operations especially to support the expansion drive
Branch network reasonably spread and expanding	Provides enough flexibility for the Company to pursue growth and to increase its market presence.

Key Weaknesses

Key weaknesses	MI's Response
Growth revolved around main product lines - i.e. Hire purchase, lease financing and deposits.	Greater emphasis was placed in delivering a wide ranging product portfolio. This included increased attention on promoting the mortgaged backed loan business, introduction of structured and step up facilities to core products, pledge loan facilities etc.
Significant portion of income comprise non-core business income in past few years.	Stream of strategic initiatives have been introduced to address the need to build-up core business volumes.
Recent branches of MI branch network is relatively new to their locations in comparison to competitors	Planned initiatives extended to strengthen MI's presence in those regions that we are relatively new.
Over 40% of the deposit base comprises of senior citizens	Plans are under way to broad base MI's customer segments through range of focused strategies.

Opportunities that Prevail in the LFC Sector

Opportunities that exist in the sector along with MI's responses to them are indicated below:

Opportunities	**MI's response**
Improved economic conditions boosted by the on-going post-war initiatives has resulted in rising GDP levels for the nation. As a result, demand for financial products too has remained on the rise and positive.	MI's strategic plan addresses the need to harness emerging opportunities within the sector. This includes proposed plans to broad base MI's product range, market segments and market share in keeping with the improved economic setting.
Greater regulations imposed upon finance companies in recent years have strengthened the sector whilst boosting public confidence.	Being a registered finance company with a sound reputation and track record, the Company would continue to strategise in harnessing deposits which have come to surge in recent years. Marketing and advertising budgets have been raised for the forthcoming period to increase awareness especially in areas we have recently established branches.
Advancement in technology in the financial service sector is rapidly changing and would continue to be a key differentiating factor.	The Company would continue to invest in technology to support our operations and will be receptive to technology advancement.
Dawn of peace has attracted foreign investments and foreign collaborations to various sectors including ours.	Plans to pursue foreign funding as means of optimising cost of funding and to support planned business growth.
Increased focus on sustainable practices to meet economic, societal and environment relations.	The Company initiated numerous activities to promote sustainable development in these key categories and would continue to give due attention to this subject even in the future .
Market is bias towards organisations that retain their trust and is respected in the corporate world. Hence, companies that maintain public confidence right-through would stand to gain both in attracting fresh business and sustaining repeat business in the longer term.	MIs reputation as a premier finance company that has stayed true to its customers for decades enable us to retain and attract customers more easily. We would continue to adopt ethical practices and promote good governance in all our activities as means of maintaining public trust in the enterprise.

Threats that Prevail in the LFC Sector

As an institution in the finance services sector, MI faces numerous threats of which mentionable ones are outlined below with our responses:

Threats	MI's response
Numerous investment options have begun to emerge for investors since dawning of peace to the nation.	We were able to afford attractive returns to our depositors through constant review and revision of rates throughout this period. Our depositors have the benefit of investing in a sound and reputed organisation whilst reaping good returns at the same time.
Number of finance companies competing in the industry has increased in the past few years. Further, there are a number of other financial institutions including Banks carrying out similar business lines.	We have been able to retain and attract customers and grow our lending portfolio and deposits base notably during this period, by being receptive to market needs and delivering a superlative service.
In the light of growing competition in the sector, customers are more attuned to pricing thus eroding sector spreads.	Strong emphasis was placed to improving productivity and level of service afforded to customers. Increased attention in costs management during this period too enabled us to offer better pricing to customers passing down any benefits derived from such cost savings wherever possible.
Negative outcomes from deteriorating global economic position including concerns from the Euro-zone crises could have repercussions to rest of the world economies including ours.	The Company would remain mindful of economic changes that may materialise due to international changes. We will be vigilant and would make necessary changes to proposed strategies if required to reach organisational objectives more effectively.

Lending Business

MI's processes and procedures relating to lending business are designed to ensure customer needs are attended to swiftly, with optimal convenience. Our sales and marketing programmes on lending business are directed at providing customers an enhanced service in keeping with our primary mottos; '**The customer is King**' and '**Service that extends beyond**'. The Company practices an all encompass strategy when providing a speedy and high quality service when disbursing credit. This involves coupling of expertise, understanding, perseverance and a combined sustainable firmness bound with sophisticated technology. MI's approach is to offer a more personalised service aimed at creating lasting relationships extending beyond just the lending process. We reiterate the need to build a mutually beneficial relationship that could be sustained through both good and challenging times.

In the period under review, our lending growth reached remarkable levels surging over 50% while total loans and advances gross outstanding as at the Balance Sheet date reached the Rs. 11 billion mark for the first time. Our core lines of products in lending that include finance leases, hire purchase financing, vehicle loans and business loans were the main contributors that supported this notable growth. A notable feature in the lending mix this year was the increased focus in granting business loans that mainly consist of loans granted against property mortgages which gained new heights.

Owing to the increased credit risk attributable to this business, MI's credit granting process including documentation requirements were further strengthened during the year. As significant strategies in creating higher lending volumes, the Company resorted to a number of initiatives that included the expansion of MI's branch network, business process improvements, information technology advancements and strong emphasis being given on employee training including formal induction programmes for all new recruits.

During this period alone, the Company commenced operations in key provinces including Galle, Matara, Kurunegala and Anuradhapura increasing our total Branch network to 14, a 133 % growth in the branch network from a year before. The expansion drive was aimed not only to target new opportunities outside Western Province but furthermore to strengthen the historic ties MI has held with some of these regions.

Galle Branch Opening

MI's fully-fledged network of branches handle both credit disbursements and the mobilisation of deposits. To support the growing network, MI's work force was strengthened especially with frontline sales and marketing staff. In carrying out new recruitments the company preferred to give priority to candidates residing close to these locations, especially for higher positions, considering their experience in such vicinities.

Existing processors and procedures were revisited to increase efficiency in the credit disbursement process including tightening of credit control procedures. MI's core information system was reviewed and modifications made to specific system features to support lending operations especially to shorten lead times and to improve responsiveness to inquiries. Improvements to the lending module by enhancing features on customer inquiry and user notification options including prompt screens were added to improve the efficiency of the frontline operations. Plans are also underway to implement an online loan appraisal system that will further enhance operations in the near future.

As part of our staff development process, significant attention was made in increasing the skill and competency level of our human resource base attached to the credit function. We provided training to enhance one's skills, knowledge accretion and to improve leadership skills thus grooming them to deliver anticipated sales targets. Monthly credit meetings were conducted to assess performances of individual sales officers against pre-determined targets. It also provided a platform for sales teams to interact with senior management more and to communicate valuable ideas, suggestions, feedback on customer preferences and changes in market variables etc.

Number of street promotions were carried out by sales staff who distributed brochures that carry information about MI products especially in newly set up locations to raise awareness among those communities. Through strict recovery procedures, MI's Recovery Division was able to smoothen the collection process and ensure timely recovery of due installments keeping tab of accounts moving to overdue category. Greater emphasis was given to down-graded and slow-moving lending accounts and accordingly management pursued recovery action as appropriate. The non-performing lending levels commendably reduced to Rs. 308 million recording an absolute decline of Rs. 121 million from a year before.

Deposit Business

As a main highlight for the sector, the market interest rates tended to gradually rise as the year unfolded, breaking away from the low interest regime that remained for the last two years. The Company too had to revise its own interest rates on deposits frequently to be competitive during the period. We afforded attractive returns that enabled MI to capture streams of fresh businesses and at the same time retain existing customers. Our deposit business was driven by the reputation that we hold as a premier finance company. We healthily sustained an exceptional deposit growth which stood at 43% upon conclusion of the current financial year. Through this growth momentum, we were able to exceed Rs. 5.5 billion in total deposits outstanding in 2012.

Workshop Team

Out of the total deposit base, fixed deposits contributed 97% towards the deposit mix while the balance 3% was derived from our savings and Certificate of Deposits products. The trend of placing deposits for over one year was once again reversed as most preferred to invest in the short term one year period or below in anticipation of a continued rise in rates. Out of the total deposits placed with us, 82% was secured from individual customers whilst the balance component was canvassed from corporate entities indicating a similar pattern to last year.

The downturn in the stock market experienced this period and investor preference to remain with less risky investments helped boost deposits business in the sector. Likewise, within the sector, public were additionally mindful of investing in secure registered institutions like ours seeing past negative experiences. MI's speedy and personalised service together with sound annual performances coupled with a strong capital base made it possible for the Company to sustain continued loyalty among our depositors, some of whom have stayed with us for decades.

To improve related business, management placed significant emphasis on establishing a separate sales and marketing team to handle mobilisation of deposits at branch level. This was coupled with the revamping of branch deposit operations as means of moving towards greater decentralisation in the near future. It was commendable for the Company to mobilise Rs. 3,056 million as new deposits within this financial period together with the aid of our budding branch network.

Customer Insurance Operation

Insurance department of MI was established to cater to insurance needs of customer's as an additional service to support our vehicle financing business. The department provides convenience to customers by fulfilling their insurance requirements without them having to seek insurance directly outside. The Insurance department through a comprehensive service was able to process gross written premiums totalling Rs. 362 million in 2012 indicating a rise of 16% from last year. Through this, the Company was able to better last year's performance by recording commission income amounting to Rs. 32 million up by Rs. 7 million or a 28% rise. The department was also successful in recovering claims of Rs. 47 million for 2012 financial year, maintaining a noteworthy track record.

Vehicle Workshop Operation

As an additional service afforded to our customers who obtain financing for owning a vehicle, the Company houses a fully-fledged workshop division at Kohuwela that provide range of vehicle-related services. The division caters to vehicle servicing needs, vehicle repair and painting requirements of customers and is run as a separate strategic business unit. The division in 2012 was able to generate reasonable level of revenue totalling Rs. 66 million to cover for its operational overheads, despite recording a net loss this year.

Differentiating Attributes of MI Offerings

Being a service provider that caters to a wide audience, in a highly competitive environment, we have been able to adequately differentiate our offerings to stay ahead. Our processors address the need to uphold **'customer care'** in all respects when executing a transaction. We understand the importance of keeping our valued customers gratified in whatever we do for them. To be competitive, considerable level of resources have been spent on delivering a professional service. We have stressed the importance of maintaining optimal efficiency and reliability while being innovative on operational precepts to raise service excellence to new heights.

We have deplored considerable resources to maintain our unrivalled speed of service in which customer expectations are dealt by a well-integrated, highly skilled and empowered team. Considerable effort has been made in training front line and back office staff, educating them on our niche especially on providing a speedy, efficient and loyal service. In pursuit of excellence, we have nurtured our workforce to cater to widening demands of the financial services sector.

Increased regulation coupled with own measures within the sector has brought about greater stability to the finance company sector thus negating whatever negative perceptions that prevailed in the past. Our endless efforts on accumulating a strong capital base and commitment towards transparency and good governance in this context has paid rich dividend as it has enabled us to attract customers to our doorstep freely while facilitating continued loyalty. Through a personalised service, we have managed to minimise barriers and offer optimal rates that fit the requirements of our customers enabling greater access to our services for individuals to realise their dream of vehicle ownership while simultaneously affording optimal returns to depositors.

MI has gradually raised its range of offerings in the past few years and caters to a broader scale of customers through a more customised service. Our customers can discover a range of special conveniences available as part of our product profile. Through MI's corporate web site ***www.mi.com.lk*** customers have access to information about the company and its product offerings. Additionally, MI upon being listed this period upload periodic financials and other corporate information to the Colombo Stock Exchange website to provide current information to potential investors and analyst.

Financial Review

The financial performance of the Company remained satisfactory in this financial period ended 31 March 2012. MI managed to record robust profits for another consecutive year despite growing volatility again in the financial services sector. It was an all out effort, from numerous fronts that made it possible for the Company to sustain sound profits even though it was not to the extent as recorded in the previous financial year.

The year commenced with noticeable improvement in general economic conditions that assisted core business activities and made it possible for institutions to consolidate their positions in the finance company sector. The growing demand for financing products coupled with our attempts in extending our presence beyond the western province paid reasonable dividend. In the period under review, MI's lending business soared to a new high thus reflecting an impressive growth rate of 64% highest in recent times. To commensurate this acceleration in credit business, the Company was able to simultaneously maintain a healthy deposit growth rate of 43% in spite of rising competitiveness within the sector.

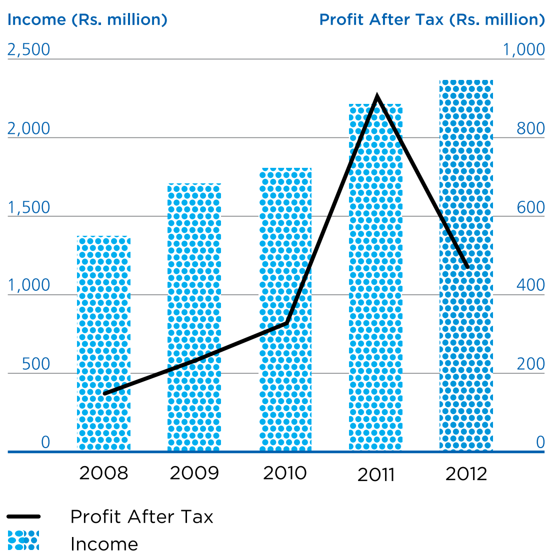
The positive conditions that prevailed at the commencement of the year nonetheless turned relatively volatile especially after the steep fall in credit availability in the market. The continued rise in interest rates that followed posed new challenges to the sector including rise in risk of creditor default and thinning of margins enjoyed. To add to this, the vehicle sales market suffered a significant set-back soon after the Government imposed higher taxes for specified categories including the three wheeler market. The steep rise in fuel prices in this financial year too had its effects on the repayment ability of individuals and corporates together to a certain degree. Despite these challenges, the Company remained optimistic and concentrated on boosting the core business profitability. A notable drawback to our progress this year was the decline observed in share trading profits unlike last year due to the sluggishness of the Colombo Stock Market.

The ensuing paragraph's outline MI's financial position and results of operations for the financial year ended 31 March 2012 with comparative information. It provides an in-depth financial analysis of MI's performance for the period under review while accentuating on the progress made. This part of the report should be read in conjunction with the Financial Statements of the Company that appear in the financial reports section of the Annual Report.

Another Year of Robust Profits

The Company ended the 2012 financial year with yet another year of satisfactory results posting Rs. 487 million in Net Profit Before Tax. Nevertheless, this reflected a reduction in profits of Rs. 562 million or a 54% drop compared to 2011's recorded pre-tax profit of Rs. 1,049 million. At the same time, in absolute terms, MI was able to conclude the 2012 financial year with impressive post-tax profits of Rs. 470 million. This however reflected a Rs. 436 million drop or a 48% decline in post-tax profits compared to the last financial year.

Operating Performance

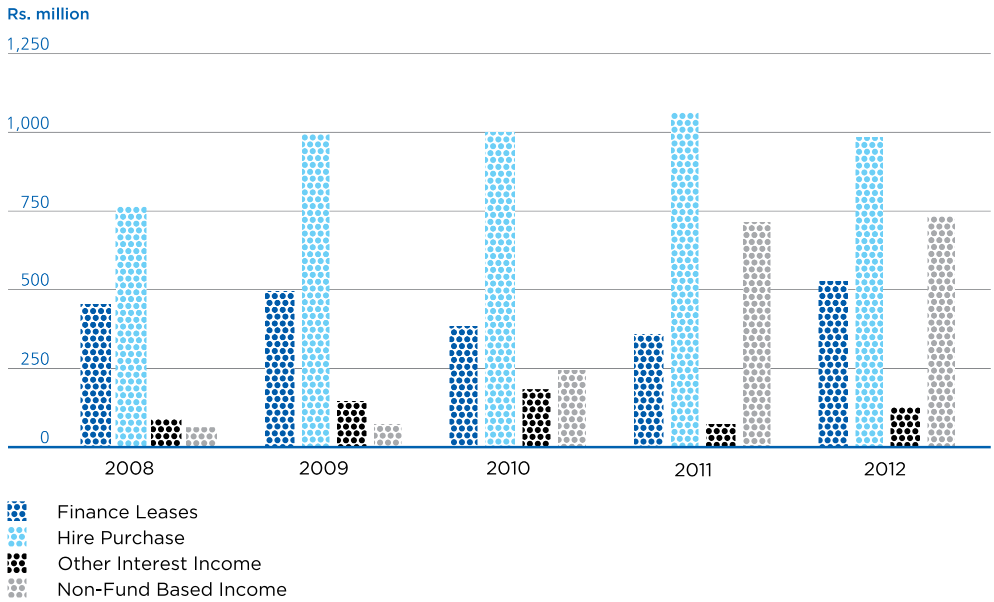


In general, the financial year under review, offered mixed results to the Company in terms of key financial variables owing to the explained changes in market variables and the resultant volatility that persisted as the year progressed. Nevertheless, banking on our operating strength together with our unvarying commitment and perseverance set the tone for us to deliver sound results once again.

During this period under review MI's total revenue remained confined at Rs. 2,365 million, rising moderately by Rs. 151 million or 7% over 2011. To boost revenue from core business, significant effort was placed in increasing the contribution outside the Colombo Region, utilising our strengthened branch network. These efforts together with improved volumes within Colombo Region arising from the positive conditions that existed in the economy-drove core business revenue moderately advancing by Rs. 133 million or 9% from a year before.

However, the main cause for the slow-down in total revenue compared to 2011 was because of the decelerated growth in non-fund based income that consist mainly of realised share trading profits. The percentage growth in non-fund based income was marginal at 2% chiefly because of the bearish stock market that persisted over the year. To counter resultant slow-down, the Company put forth range of measures to generate revenue from our core line of business. This involved broad basing of MI's product range, promoting personal loan and pledge loan services in greater scale and stiffening periodic targets of our front line staff.

Composition of Revenue



Net Interest Income (NII) derived from core business experienced a 24% reduction and remained at Rs. 624 million in the year under review. The main contributory factor for this slowing down was the thinning in margins from core business especially on account of the rise in market interest rates in the latter half of the year and the relentless competitiveness in the sector in terms of pricing.

With the intent of improving overall profitability, management focused on curtailing the annual rise in operating expenses through the constant review of recurring costs and by seeking measures to minimise wastage. Despite these steps, the operating expenses (excluding personal cost) for 2012 remained high escalating by 39% mainly due to inflationary factors and increases in usage driven by our expanding operations. By marking to market the dealing share portfolio, the Company also had to make a Rs. 137 million fall in value provision that stemmed the overall profitability further.

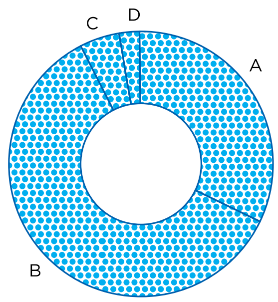
Interest Income

The total interest income of the Company advanced by Rs. 133 million or 9% from previous year, reaching Rs. 1,631 million by end March 2012. Our core business of leasing and hire purchase financing were the main contributors toward interest income while business loans showed marked growth providing a higher contribution than before.

The acceleration in economic activity drove the lease and hire purchase market upward at the commencement of the year, gathering momentum as the year progressed. As means of exploiting these prevalent opportunities, MI forged ahead with its plans on branch expansion that supported in growing the lending book to anticipated levels, boosting related income. At the same time, we were compelled to revise upward our lending rates owing to the persistent rise in market interest rates during the latter part of the year hence lifting interest income as a result.

The business of hire purchase financing was the highest contributor towards the interest income generating Rs. 982 million for the financial year 2012. This represented a 60% proportion out of the total interest income despite observing a marginal decline of 8% in relevant income over the previous year. However, interest income from finance leases remained heartening at Rs. 525 million rising by Rs. 165 million or 46% from 2011. To propel core revenues, management concentrated additionally on promoting higher yielding products like our business loans which remained an attractive proposition. As a result, interest income from loans rose to Rs. 84 million up by Rs. 48 million or 133% from a year before.

Components of Interest Income - 2012



A - Finance Leases 32%
B - Hire Purchase 60%
C - Short -Term Advances 5%
D - Others 3%

Interest Expenses

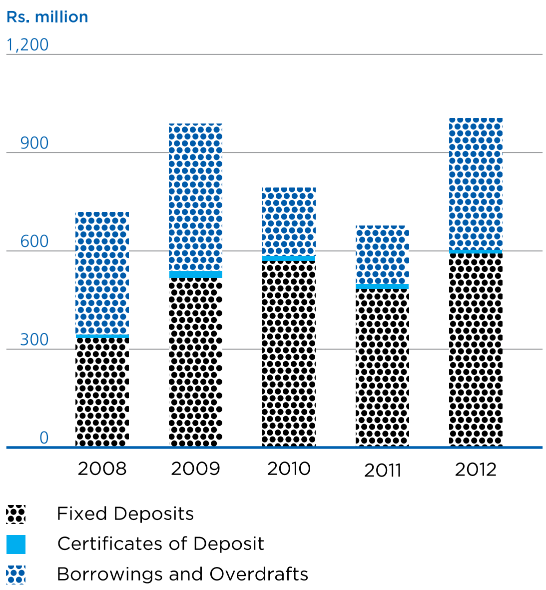
Total interest expenses in this period stood at Rs. 1,006 million, reflecting an absolute rise of Rs. 326 million or a 48% increase year on year. To meet immediate funding needs arising from the substantial rise in MI's loan book, the Company resorted to its two main sources of funding being its deposits and borrowings. The persistent rise in interest rates for both deposits and borrowing especially in the latter stages of 2012 coupled with the notable rise in funding requirements for the organisation, drove the interest expenses significantly upward compared to previous year.

The foremost portion of Company's interest expense comprises of its cost on Deposits that totalled Rs. 603 million for the year up by 21% from 2011. In 2012, more than the deposit cost, the borrowing costs of the company showed a rapid increase surging by 121% to Rs. 403 million compared to a lower borrowing cost of Rs. 182 million recorded in the previous period.

Apart from the general growth in the deposit base, the interest cost remained high as we had to renew deposits at a higher cost due to the prevailed status of our deposits maturity profile. Accordingly, notable part of deposits matured in the short term and had to be renewed at relatively higher rates than a year before. To add to surge in interest cost, the persistent rise in market borrowing rates that resulted from the lack of fund availability in the financial services sector increased our total borrowing cost in the last quarter of 2012 financial year.

In the backdrop of this interest rate volatility, MI's treasury division was able to efficiently manage funding needs, seeking best possible rates from our banking partners whilst pursuing alternative source of funding such as commercial paper and international funding lines to meet rising funding needs.

Analysis of Interest Expense



Net Interest Income (NII)

The Company's NII dipped to Rs. 624 million by end March 2012 compared to Rs. 818 million recorded in 2011. The contraction in NII arose due to a combination of factors including the maturity profile of our assets and liabilities coupled with a rising interest rate scenario. While a notable portion of our deposit base comprised short-term deposits that were subsequently renewed at higher rates within the year, the lending portfolio was of a longer duration with an average maturity period of four years that comprised lendings some of which were done at relatively lower rates. This phenomenon brought down the spread and with it the total NII derived from core business despite achieving a higher lending volume than last year.

To counter thinning of core business margins in the sector, we continued to pursue our strategy of lifting business volumes through our expansion drive whilst making an attempt to keep our weighted average cost of funding low as possible. The significant expansion of our loan book in this period coupled with above average margins enjoyed on specific lending such as our business loans, enabled us to sustain a reasonable NII upon conclusion of the year. Meanwhile, our efforts this period in keeping non-performing lending at bay in spite of the said rise in the loan book controlled the suspension of interest on slow-moving accounts thus avoiding any material negative effects to the NII.

Nevertheless, the explained decline in NII during this period, coupled with the relatively higher increase in total assets arising from the loan growth and investment in share trading eroded MI's Net Interest Margin that fell from 7.9% in 2011 to 4.2% this year.

	2012 Rs. million	2011 Rs. million
Total Interest Income	1,631	1,498
Total Interest Expense	1,006	680
Net Interest Income	624	818
Average Total Assets	14,850	10,383
Net Interest Margin		
(Net Interest Income as a Percentage of Average Total Assets)	4.2%	7.9 %

To boost NII levels in the coming period, we have established measures to mitigate any margin erosions. We strictly refrain from doing business below our break-even levels, and, at the same time would strive to keep our cost of funding low as possible. Whilst continuing to strategise in increasing lending volumes, we would make every effort to find best sources of funds that match our assets in an optimal way to minimise interest rate risk.

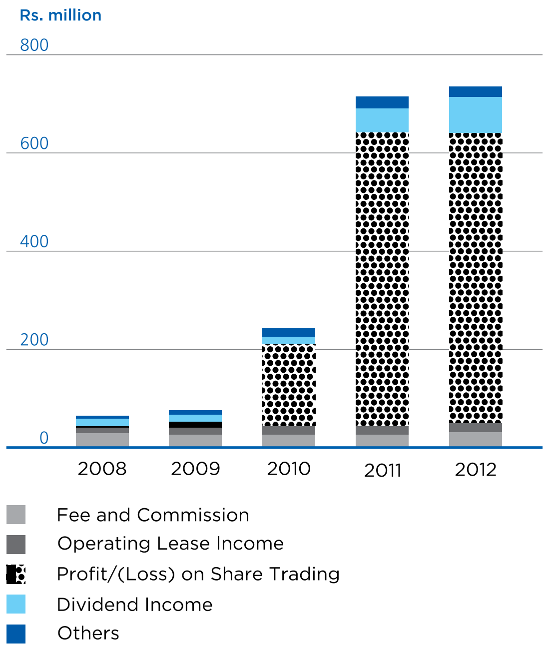
Non-Fund-Based Income (NFBI)

Similar to last year, the Company's NFBI was a significant contributor to total income, providing Rs. 734 million for the current financial year. The major contribution to the NFBI was derived from realised trading profits from share investments. When compared to a year before, the NFBI grew only moderately due to the lower contribution from share trading profits dragged down by the persistent sluggishness of the stock market in contrast to a bullish market experienced in 2011. As a result realised share trading profits recorded in 2012 stood at Rs. 591 million falling by 1% year on year.

The contribution from dividend income towards NFBI in 2012 was noteworthy amounting to Rs. 72 million up by 48% from 2011 being the second highest contributor. At the same time, fee and commission income solely derived from insurance commission income boosted the NFBI by a further Rs. 32 million thus reflecting a satisfactory rise of 28% from a year ago. The other key source of NFBI came from our operating lease business that remained at similar levels like last year, subdued at Rs. 19 million.

The NFBI remains a key source of income for MI. Improving related sources of income is a high priority for the Company in the forthcoming year, especially since the contribution NFBI makes to total operating income continues to be on the high side at 54% in 2012 against 47% recorded previous year.

Non-Fund Based Income



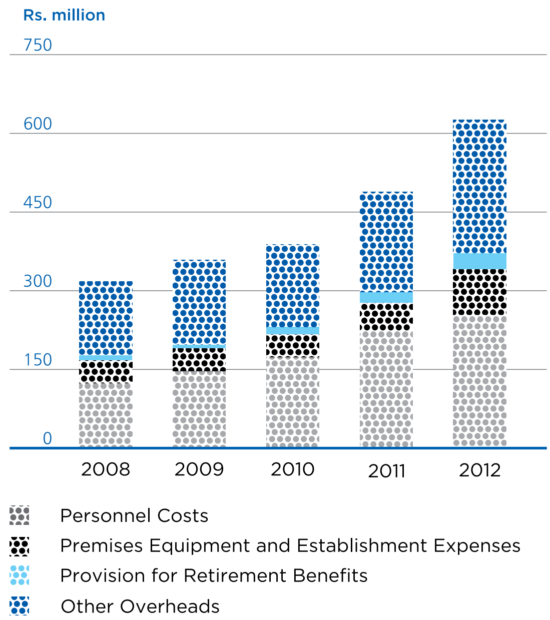
Operating Expenses

Operating expenses escalated by 29% to Rs. 628 million at the end of the current financial year from Rs. 488 million recorded in 2011. Apart from the general rise in prices of goods and services on account of annual inflationary factors, personal costs remained high owing to the expanding workforce in the wake of increasing branch operations. Accordingly, personal cost advanced to Rs. 254 million in 2012 remaining one of the highest cost components under operating expenses rising by 14% from 2011.

Furthermore, overhead costs remained high at Rs. 343 million despite management's strong emphasis in controlling cost especially keeping tab of key expenses by imparting numerous control measures and initiating action to eliminate non-value adding activities. As at 31 March 2012, MI's cost to income ratio increased to 55% compared to 37% recorded one year ago. This deterioration in the ratio came about due to the explained high total overhead cost together with the decline in share trading profit that brought down operating income.

In spite of us possessing still a reasonably satisfactory cost income ratio, we are mindful of rising recurring costs as a result of our expanding branch network. We were nevertheless conservative this period when deciding on large capital investments especially when setting up branches. To ensure viability from our expansion strategies, all recently opened branches were established with minimal start up costs. Furthermore, we are able to reap benefits from use of existing information technology through our well-established support network without having to make material investment especially since initial capital outlays on them have been made in earlier years. The required setting up and related modifications were handled in-house at very minimal costs.

Composition of Operating Cost



Provisioning on Loan Losses

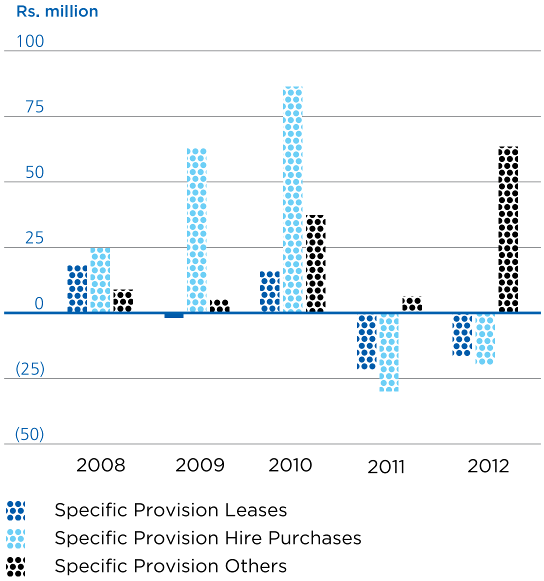
As evidenced in recent years, the on-going economic revival and the acceleration in business activity improved generally the debt servicing capacity of borrowers than before. For MI, the collection of repayments in respect of lending was satisfactory. This enabled us to keep the rise in non-performing advance (NPA) levels intact despite the huge rise MI's loan book. To support the recovery process, stringent measures were instilled by the Recoveries Department. This included a closer follow up of slow moving accounts, daily monitoring of contracts in arrears against anticipated targets and speedy measures initiated by our legal division for long overdues where other actions have failed.

Parallely, as means of lowering contracts moving into arrears, effective steps were taken to enhance the quality of our credit portfolio. Management resorted to a stringent credit evaluation process prior to disbursements and made plans to continuously review concerning accounts and initiated timely action on delinquent accounts as means of minimising bad debt provisioning. During the year 2012, total net provisions made to the Income Statement on account of NPA totalled Rs. 27 million as opposed to a reversal of Rs. 45 million in 2011.

	2012 Rs. million	2011 Rs. million
Total Net Cumulative Provision	365	339
Loans and Advances (Net of Interest in Suspense before B & D)	10,645	6,610
Provision as a % of Loans and Advances (Net of Interest in Suspense before B & D)	3.4%	5.1%
Provision as a % of Non-Performing Lending	119%	79%

The significant growth in loans and advances reduced the ratio on total provisions expressed as a percentage of total lending from 5.1% to 3.4% as at 31 March 2012. At the same time, MI's loan loss provision cover remained healthy increasing from 79% to 119% in 2012. By tightening of MI's credit disbursement process together with our aggressive provisioning in earlier years enabled us to proceed with a clear loan book this period. Nonetheless, the Company is weary of the persistent rise in interest rates that has raised financing rates over 25% that may pose a threat to the current smooth collection process which in turn could lead to higher NPA.

Analysis of Specific Provision



Total Assets

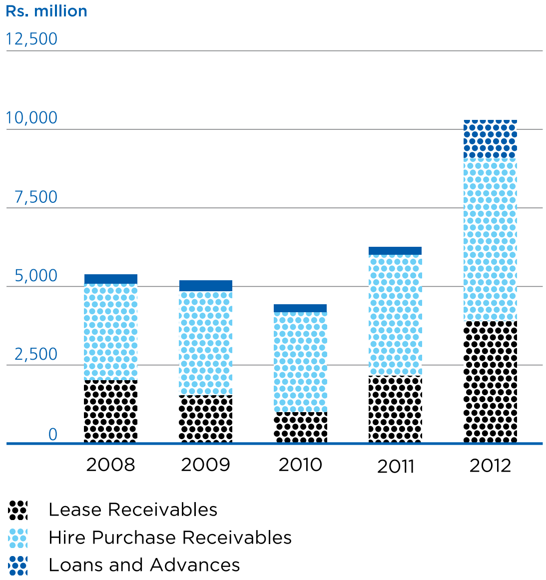
The total assets of the Company that stood at Rs. 17,456 million as at 31 March 2012 indicated a 43% shift upward, a clear reflection of the pick-up in business owing to the improved business environment. MI's gross lending portfolio topped Rs. 11 billion (before interest in suspense and provisioning) remaining the largest asset item in our books while investments in shares remained the next highest totalling Rs. 3.9 billion as at the Balance Sheet date. The Net book value of Property, Plant and Equipment stood at Rs. 1.5 billion as at the Balance Sheet date.

Performance in Lending

The heightened business conditions experienced from previous year continued to boost the lending business across the sector. The improved purchasing power of consumers resulted in the rise in demand for goods and services including luxury items of cars, vans etc. This coupled with positive sentiments of a booming economy drove our sector forward with increased financing and other borrowing requirements for both individuals and corporates. However, the change in key market variables in the latter part of the year namely the increased duty on selected vehicle types and the steep upward movement in leasing and hire purchase financing rates brought down the hype witnessed earlier in the year.

Yet, the rise in demand for machinery and construction-related vehicles such as lorries, tippers etc. and the evolution of smaller forms of vehicles at affordable prices continued to stimulate the vehicle sales market thus driving the financing business even in a high interest rate regime. Like most in the sector, MI persisted to strategise in venturing out to other regions considering the emerging opportunities that prevail in the rural sector upon dawning of peace to the country. Owing to all these factors, our total loans and advances outstanding rose substantially from Rs. 6,271 million to Rs. 10,281 million as at the Balance Sheet date, signifying a remarkable growth of 64% from 2011. When pursuing expansion, we placed strong emphasis on optimising the corporate product mix to maintain the overall yield at anticipated levels to ensure a reasonable profit is derived from core operations.

Composition of Total Lending



New Lendings Carried Out

	New Facilities Secured in 2012 Rs. million	New Facilities Secured in 2011 Rs. million	Growth %
Hire purchase business	4,400	3,072	43
Lease financing business	2,953	1,858	59
Other lending business	1,519	150	913

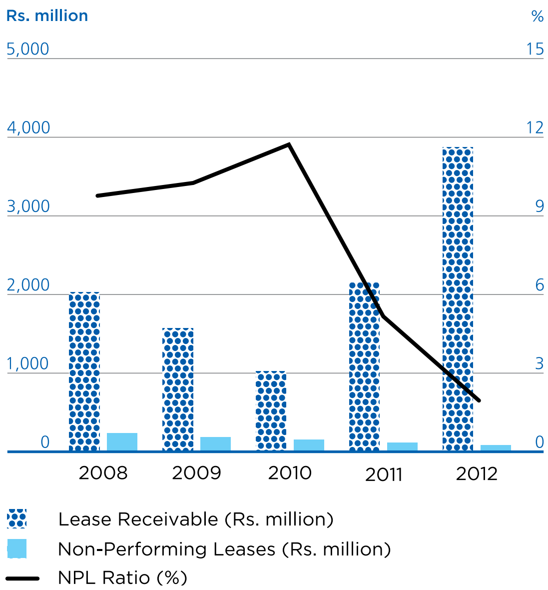
A total of Rs. 8,872 million was secured as new lending facilities during the year, indicating a substantial rise of Rs. 3,792 million or a 75% annual growth, when compared to a rise of 90% recorded in 2011. We were able to sustain these healthy growth levels mainly through our core product lines of hire purchase and lease financing. As new facilities from our hire purchase business, we were able to secure Rs. 4,400 million, up by 43% from 2011 while lease financing business slowed down somewhat in growth momentum rising moderately by 59% in contrast to a remarkable 432% growth in 2011. However in contrast, the growth in our loan business picked up handsomely especially loans granted against property mortgage and other short-term personal loans. As a result, as opposed to a decline of 20% experienced a year ago, the new lending in loans in 2012 financial year showed a leap of 913%.

Finance Lease Receivables

Despite the upward shift in duty tariffs on vehicles during this period, the demand for brand new vehicle imports remained positive especially for lower and mid-price ranged vehicles. The on-going infrastructural projects across the country including the setting up of the Northern Highway created significant demand for construction and reconstruction machinery which also boosted demand for leases. As such we sustained a reasonable growth in finance lease business aided additionally by the extension of our services beyond Western Province to areas that have begun to rejuvenate in economic activity since post-war. MI's total finance lease portfolio that comprise both individuals and corporates seeking financing grew exceptionally by 81% and stood at Rs. 3,876 million compared to Rs. 2,144 million recorded last financial year.

Despite heaps of positives surrounding the lease business, the prevailing Value Added Tax system continued to be a drawback in creating additional demand for leases as opposed to hire purchase business. The rise in competition with new entrants to the sector coupled with increased emphasis by the banking sector in this area of business as opposed to the last decade has saturated the market somewhat. Nevertheless, the on-going economic revitalisation and the emerging opportunities across industries are sure to bring renewed impetus to the lease industry in the future as well.

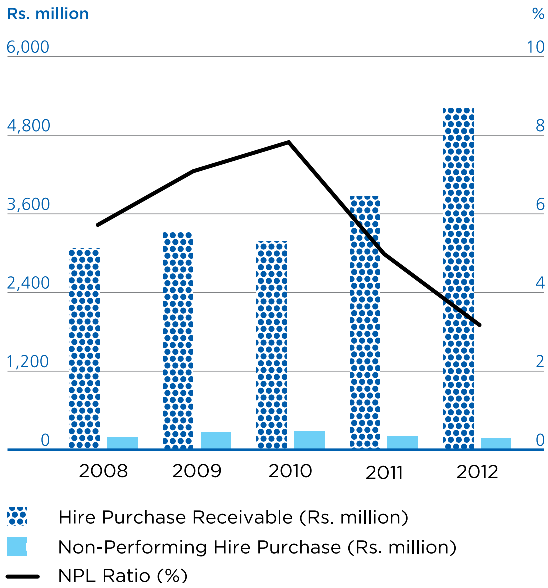
Analysis of Lease Portfolio with Its Non-Performing Status



Hire Purchase Receivables

Out of MI's total loans and advances outstanding, hire purchase receivables was the largest component amounting to Rs. 5,220 million, growing impressively in absolute terms by Rs. 1,362 million or 35% as at the Balance Sheet date. The business of hire purchase financing continues to be lucrative as the customer demand for owning registered vehicles used over twelve months remains high due to a number of contributory factors. The influx of brand new vehicles in the last two years has created demand once again for the second hand vehicle market especially as customers prefer to shift to better models with time. In addition, hire purchase financing business does not involve Value Added Tax unlike the leasing business, hence providing extra flexibility in terms of pricing.

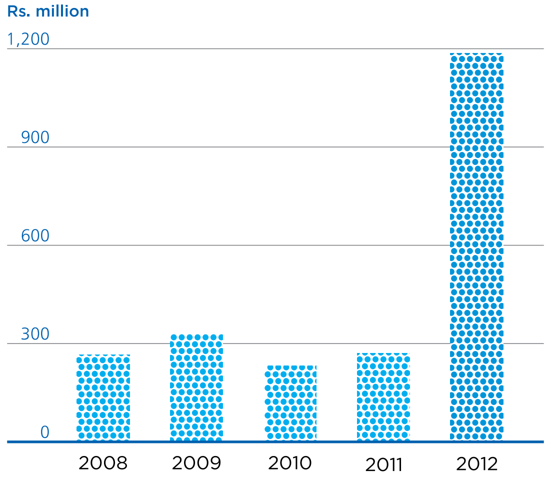
Analysis of Hire Purchase Portfolio with Its Non-Performing Status



Loans and Advances

To optimise the lending mix, the importance of rejuvenating our personal loan businesses was high on the agenda this period. Therefore, personal loans in the form of short-term loans mainly top up, structured personal loans and mortgage over property loans was extensively promoted in the second half of the year as means of boosting the average yield. However, since this type of business involves a greater risk of default, parallely, stringent credit control measures were maintained prior to disbursement. Our loans and advances outstanding stood at Rs. 1,185 million as at 31 March 2012 rising pleasingly by 341% from last year.

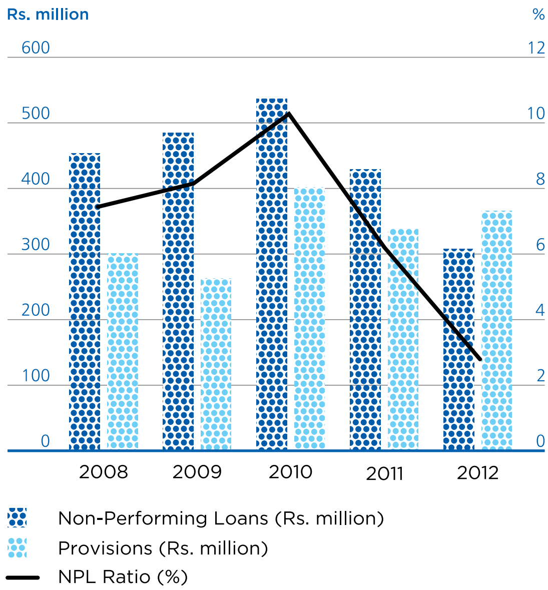
Loans and Advances Outstanding



Lending Portfolio and Non-Performing Status

It was a noticeable phenomenon that borrowers who suffered financially during the economic meltdown that started in 2008 had recovered to a greater extent by this period owing to the improvement in the state of the economy. While witnessing a marked improvement in collection of repayments on lendings in this period, we managed to curtail new contracts from going into non-performing status despite the rise in the loan book. The gross non-performing lending ratio therefore remained satisfactory at 2.81% coming down positively from previous year's recorded 6.20%.

Total Non-Performing Loans Status and Provisions



Total Liabilities

MI's total liabilities advanced from Rs. 7,472 million to Rs. 12,145 million as at 31 March 2012 up by Rs. 4,673 million or 63% from 2011 on account of increased funding requirements driven by the significant growth in lendings. While the Company's deposit base remained the largest item representing 48% of the total liabilities, this year closing Balance Sheet showed a notable rise in borrowings that was necessary to fund the growth in the lending book. The increased utilisation of bank facilities upped total borrowings by almost two folds in 2012.

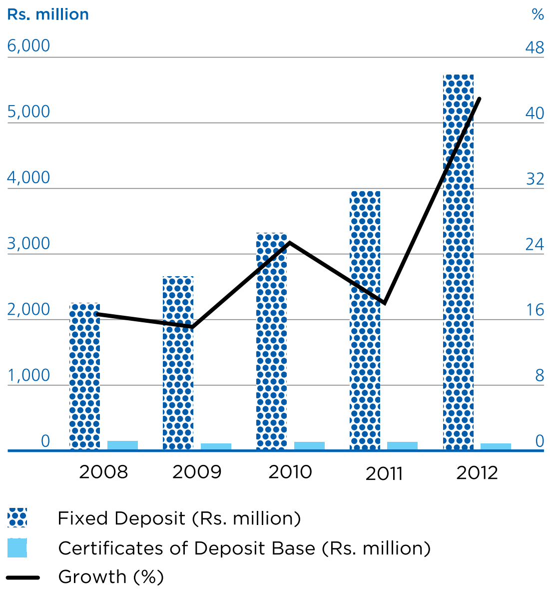
Deposit Portfolio

Deposit mobilisation remained challenging throughout the period in concern especially considering the stiff competition that prevailed within the sector for this type of business. In spite of this, we were able to mobilise deposits at a very satisfactory rate. MI's total deposit base grew by Rs. 1,763 million reaching Rs. 5,870 million, up commendably by 43% from a year before. The negative sentiments that crept into the stock market saw the flow of investments back into the financial service sector that gained in public confidence in recent years.

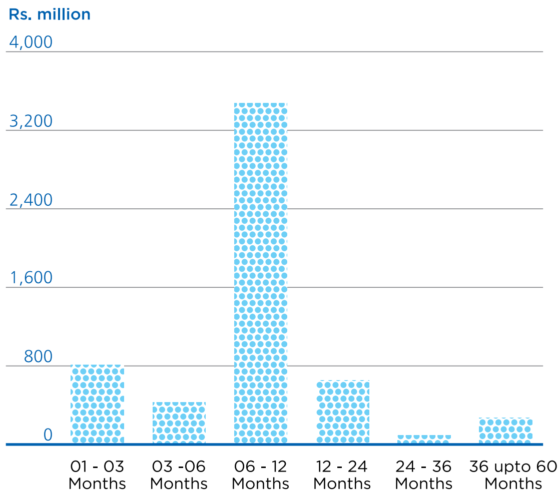
To counter price sensitivity of customers, our deposit division displayed outstanding commitment in providing a superior service that kept our loyal customers close to the Company once again. At the same time, constant rate revisions were carried out to sustain an attractive deposit rate structure on par with our peers. We offered higher interest rates to our depositors as the year progressed in keeping with the rise in rates in the market. Senior citizens who placed deposits with us were given an additional per centum over the normal rates in keeping with the industry. During our campaigns it was quite evident that depositors preferred to remain with stable and reputed regulated institutions like ours to invest their hard-earned savings.

Fixed deposits continued to be the highest contributor to the total deposit base from MI's deposit mix, similar to the configuration in 2011. In contrast to a year before, depositors preferred to place fixed deposits one year and below anticipating interest rates to continue its ascend over the period. As a result, deposits placed in the one year category remained very substantial.

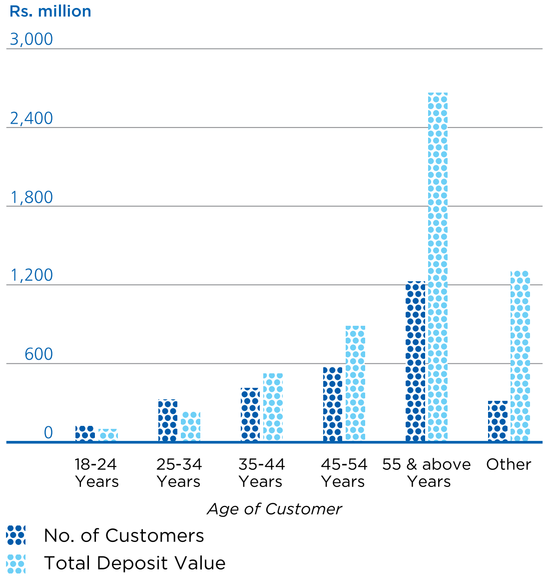
Deposit Mix



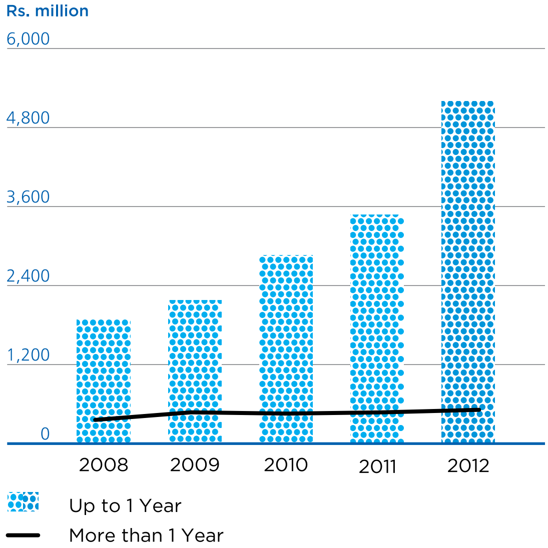
Deposit Base on Original Term - 2012



Age Analysis of Depositors - 2012



Fixed Deposits Maturity



Fixed Deposits

The fixed deposit base grew at a reasonable pace surpassing the Rs. 5 billion physiological mark for the first time, finally settling down at Rs. 5,729 million by the close of year end. This reflected a commendable growth of 45% compared to 2011 achieved amidst rising competition and other investment opportunities that have emerged with the dawn of peace. During this period under review, it was heartening to observe that our new fixed deposits canvassed amounted to Rs. 2,988 million while deposit refunds were curtailed to Rs. 1,211 million.

We remained optimistic of boosting volumes related to fixed deposits even amidst tighter competition especially through our expanding branch network as opposed to limiting ourselves to only the western province. The focus was to canvass more long-term deposits over one year and above to support funding requirements of a longer horizon including the lending operation. Our continued attention in clawing our way beyond Western Province, has afforded our customers greater access and convenience.

In our campaigns, we highlighted MI's sound reputed background that signifies financial stability, differentiating ourselves using our very successful track record. Accordingly, media advertising and direct promotion played a vital role in communicating our range of offerings whilst providing a comprehensive résumé about the organisation. In order to gain renewed customer attention, we plan to use these methods more extensively in the forthcoming period.

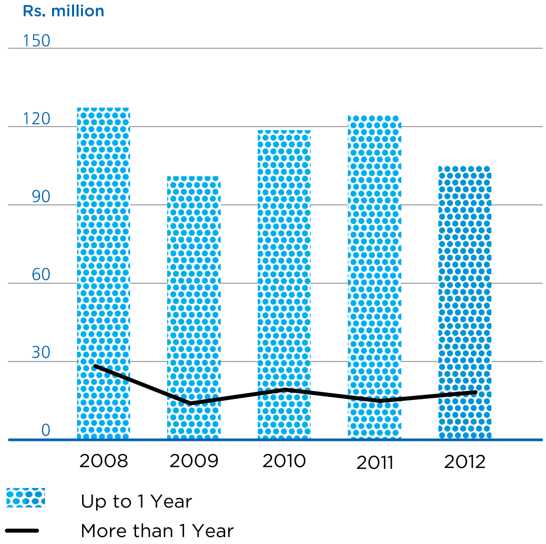
Savings Deposits

MI's savings product was another contributor towards the total deposits of the Company, growing this year by 6 % nonetheless negligible in absolute value terms. The savings base stood at Rs. 18 million in 2012 compared to Rs. 17 million recorded in 2011. The low attention paid in past years on promoting this product reflected in the small quantum currently held. Nevertheless, plans are underway to revamp and reintroduce our savings brand in the near future considering the enormous potential attached to the product. The current savings brands MI Max and MI Kids would be promoted extensively at branch level accordingly. We hope to pursue the possibility of providing additional convenience to customers by affording ATM services also in the near future.

Certificates of Deposit (CD)

Management's keenness to promote Certificates of Deposit in the past remained subdued owing to the prevailing laws on Know Your Customer that requires institutions to accept deposits only on proper customer identification. MI's CD base stood at Rs. 123 million as at the close of the current financial year showing a marginal reduction from last year.

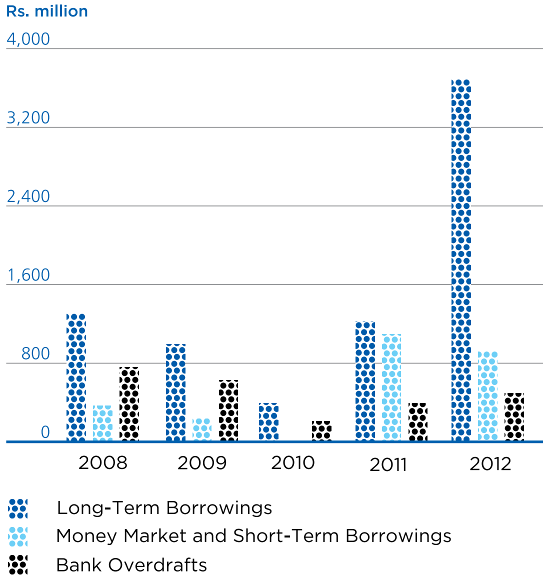
Certificates of Deposit Maturity



Borrowings

There was increased dependence on borrowings to support the growing loan book this year. Total borrowings therefore rose sharply by 89% and stood at Rs. 5,115 million as at the Balance Sheet date. A notable component of our borrowing liability comprised long-term borrowings obtained through the banking sector that totalled Rs. 3,692 million growing by 200% from 2011. Even though borrowing rates offered by banks were on the high side, owing to the crunch in credit availability at the latter stages, optimal rates were secured wherever possible.

Composition of Borrowings

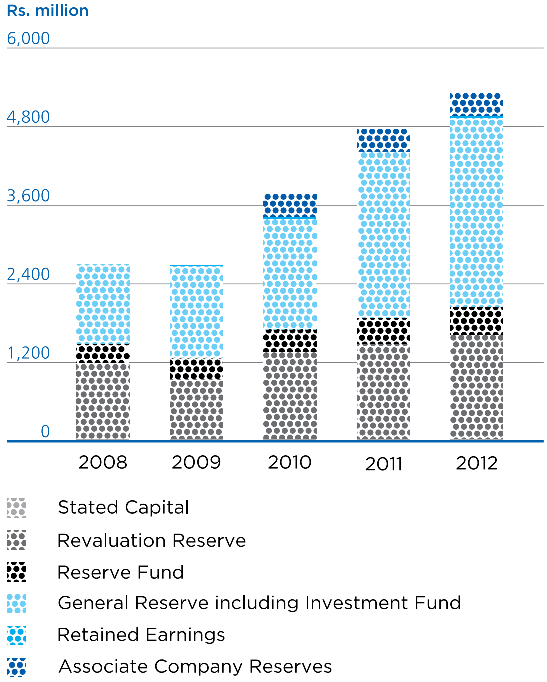


To bridge funding requirements in the shorter horizon, MI resorted to short-term facilities again mainly resorting to unutilised facilities afforded to us by our banking partners. As at 31 March 2012, our total short-term borrowings amounting to Rs. 1,423 million comprised mostly of money market loans, bank overdrafts and other short-term borrowings mainly commercial paper. Despite securing optimal borrowing rates, to maintain reasonable spreads, we were compelled to raise our lending rates over the year like others in the sector.

Shareholders' Funds

As at the Balance Sheet date, the total shareholder funds grew by 11 % to Rs. 5,311 million from Rs. 4,772 million recorded in 2011. The consistent rise in shareholder equity over the years reflects MI's earnings capacity that has enabled us to possess a superior capital structure todate. Through effective conduct of business operations and by putting capital to best use has enabled the Company to reap sound returns for our shareholders over the years. Our policy of retaining internally generated profits provided us the needed flexibility when putting forth growth related strategies that we are pursuing currently.

Shareholders' Funds



Dividends

For the year 2012, the Company declared dividends totaling to Rs. 66 million compared to Rs. 30 million paid in 2011 indicating a 120% rise year on year. The Board was able to declare a sound dividend this year as well considering the healthy results achieved in the period under review. Nonetheless, the dividend payout was decided after giving due consideration for the necessity to retain sufficient funds within the Company for the planned growth in business in the next few years.

Performance of MI Branches

Through the on going expansion in business operations outside the western province, the management was able to achieve anticipated overall performance targets especially in terms of meeting its lending volumes. Our branch performance mainly revolved around our long standing branches situated in Kohuwala, Negombo, Balangoda and Mahara Kadawatha while relatively newer locations such as branches in Galle, Matara and Kurunegala too displayed immense potential through reasonable level of lending.

As part of raising volumes, stiff lending targets were given to all branches that rose to the task well, amidst heightened competition. During the year, deposit campaigns were organised at newly set up locations and even among staff to boost the overall deposit flow. Focusing on decentralisation as opposed to a centralised approach taken before, the Company streamlined its deposit procedures at branch level this period. This was implemented so that branches could move towards handling deposit acceptance and related operations directly from such locations with on line system support without head office intervention.

Branches that have been in operation for over two years ended the year profitable mainly boosted by higher turnover levels than before. Recent initiatives in setting up a regional structure with dedicated senior managers responsible for their regional performance enabled the Company to obtain anticipated results from the network within a short span of time.

Other Key Financial Indicators

MI's Market Share

In the NBFI sector, MI's market share stood at 3.2 % in terms of total assets. This was based on the NBFI's total assets of Rs. 490 billion recorded as at 31st December 2011.

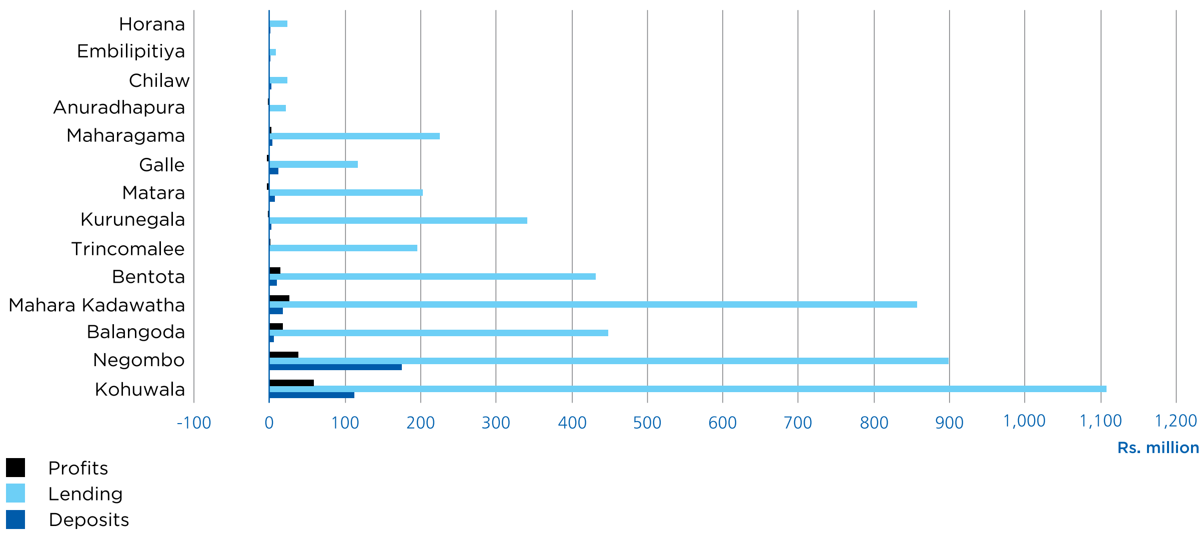
Value Addition to the Economy

In terms of value addition, MI's contribution to the economy totalled to Rs. 938 million as at 31 March 2012 down by 34% from last year. Most of the value addition was kept retained for the Company's future growth and expansion, while the remainder was distributed to other key parties that included 30% as salaries to employees and 16% by way of taxes to the Government.

Earnings per Share (EPS)

The significant deceleration in post-tax profits in 2012 reduced the Company's EPS for the year reflecting a 48% dip compared to a growth of 175 % recorded in 2011. The EPS of Rs. 301.36 per share recorded last year fell to Rs. 156.45 per share in 2012.

Branch Performance - 2012



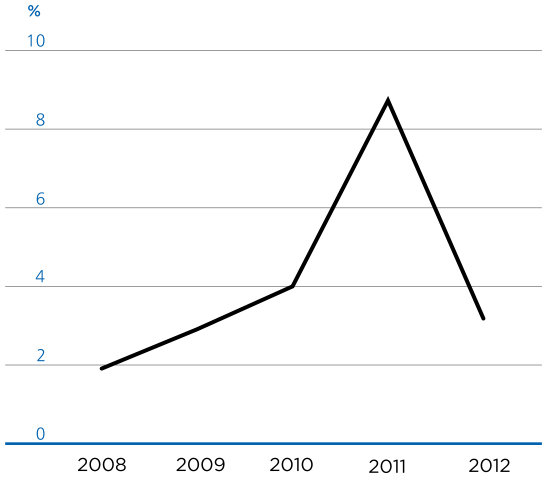
Net Assets Per Share (NAPS)

MI possess a marvelous high NAPS which stood at Rs. 1,767 per share this year up by 11% from 2011. This reflects our strong net asset base strengthened year on year through steady performances and consistent creation of wealth to shareholders over the years. The relatively high share price of Rs. 2,200/- recorded as at 31 March 2012 for MI's ordinary shares in the stock market is thus a reflection of this sound net asset position.

Return on Average Assets (ROA)

The ROA of the Company reduced from previous years recorded 8.72% to 3.17% as at 31 March 2012. This was because, the organisation's total assets grew substantially on account of the reported growth in loan book and on account of share investments. This was opposed to a decline in overall post-tax profits in the period under review compared to a year before.

Return on Average Assets



Productivity of Our Workforce

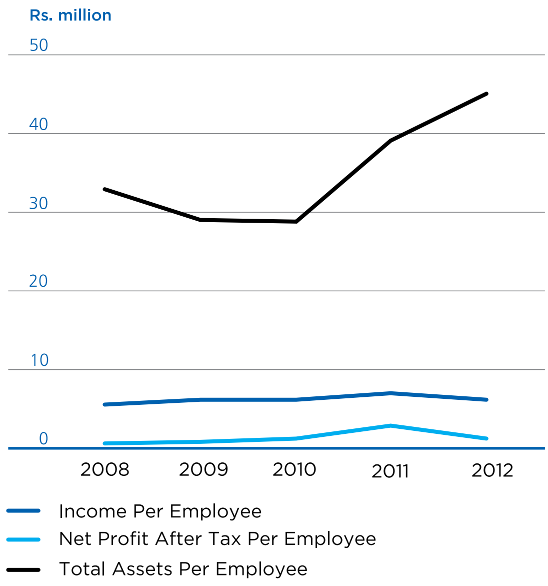
To support business growth our workforce was notably strengthened in this period especially marketing and other front line staff. MI's total number of staff therefore increased to 387 from 316 in 2011 indicating a 22 % increase. In spite of this rise, we still possess relatively lower levels of human capital in relation to the size of our organisation in terms of assets, volumes and profitability. As means of grooming individuals to perform functions more productively, we provide necessary training and development including hands on experience that give them adequate skills, knowledge and autonomy within their job functions.

Similar to last year, staff productivity ratio's remained relatively high especially income per employee and total assets per employee which stood at Rs. 6.1 million and Rs. 45 million respectively. In contrast, net profit after tax per employee fell to Rs. 1.2 million from Rs. 2.9 million recorded in 2011 due to the declined profitability levels as against a rising workforce.

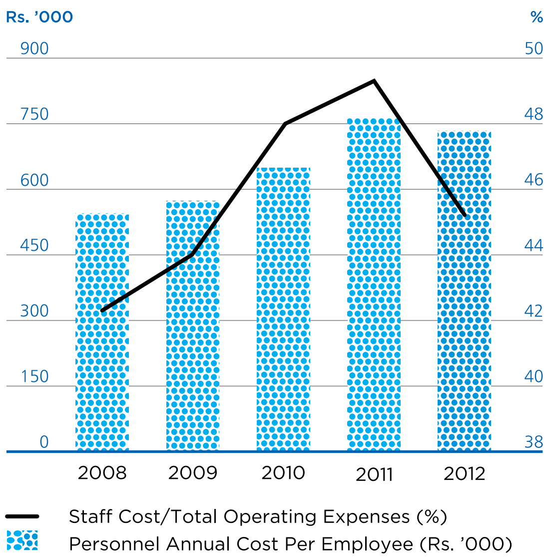
The annual personal cost per employee remained similar to last year at Rs. 0.7 million in 2012 despite increase in the workforce. A Company-wide salary revision was carried out in 2012. The revision was based on a thorough staff appraisal that linked annual staff performance to reward as means of boosting productivity. As means of motivation, we provide a range of other benefits to staff in addition to their basic pay that include staff loans, medical insurance, vehicle loans etc. Our salary scales are competitive and are on par with market expectations. This has made it possible for us to retain a satisfied workforce, low in labour turnover levels.

	2008 Rs. million	2009 Rs. million	2010 Rs. million	2011 Rs. million	**2012** **Rs. million**
Income per Employee	5.6	6.3	6.3	7.0	**6.1**
Net Profit after Tax per Employee	0.6	0.9	1.1	2.9	**1.2**
Total Assets per Employee	33	29	29	39	**45**
No. of Employees	247	273	289	316	**387**

Employee Productivity



Personnel Cost Analysis



Cash Flow Position

Operating Cash Flows

Net movement of MI's operating cash flows fluctuated from a negative of Rs. 1,919 million to a negative of Rs. 2,034 million in 2012. Operating cash outflows mainly resulted from funds advanced to customers, interest payments, personnel costs and other overheads. At the same time, inflow of operating cash mainly arose from interest and commission receipts, net increase in deposits, and inflows from other short-term negotiable securities.

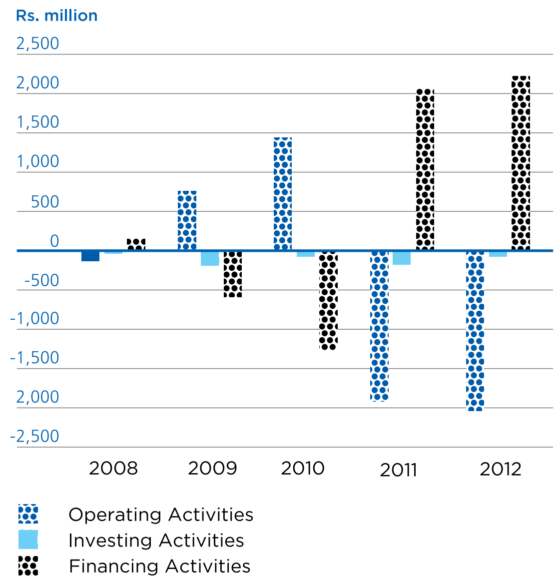
Cash Flow from Investment Activity

MI's cash flow from investment activities showed an outflow in 2012 amounting to a (negative) of Rs. 79 million from a (negative) Rs. 175 million recorded in 2011. The main outflow items include the purchase of Property, Plant & Equipment and purchase of non-dealing securities while dividends was the main investment cash inflow during this period.

Cash Flow from Financing Activity

Financing activities of the Company yielded net positive cash inflows totalling Rs. 2,228 million as at 31 March 2012 compared to positive cash flows amounting to Rs. 2,052 million recorded in 2011. MI's significant rise in borrowings over the year to fund core business operations was the core reason for the higher inflow from financing activities.

Cash Flow Analysis



Management of Liquidity

The rapid rise in MI's lending portfolio coupled with the dearth in credit experienced in the market especially in the latter part of the period mounted pressure on funding and liquidity requirements to a certain extent. To meet immediate liquidity requirements, we were able to fall back on our unutilised credit lines that were at our disposal. Therefore, as a consequence of extensive utilisation this period, our unutilised credit lines reduced to Rs. 777 million as at the Balance Sheet date. To counter this and to boost funding availability, already MI management has laid out plans to seek other facilities, other funding sources including international investors within this calendar year.

The statutory liquid assets ratio was monitored daily and maintained well above the minimum requirements specified by the regulator during the 2012 period. MI's statutory liquid assets as at 31 March 2012 amounted to Rs. 755 million being Rs. 167 million over the requirement as against the total deposit liability.

Management of Capital

Consistent accumulation of retained profits over the years, has allowed MI to hold capital over Rs. 5 billion. This strength in capital enables the Company greater flexibility, to seek emerging opportunities in the market on which organisational growth can be sustained. By holding a large capital base relative to our assets, we have been able to maintain the regulatory capital adequacy ratios almost threefold over the required limits consistently in recent times. As such, MI's Core Capital Ratio and the Total Risk Weighted Capital Ratio stood at 22.40% and 27.17% above the minimum ratio limits of 5% and 10% respectively laid down by the regulator.

In spite of this period's rapid advancement in total assets especially due to rise in loans and advances and share investments which are considered 100% risk in terms of risk weighted assets, we held exceptionally high capital adequacy ratios. Furthermore, as a result of the accumulation in retained profits, we were able to boost our Tier I capital once again.

Information Technology at MI

Information technology like in the past played a significant role in enhancing business operations, playing a supporting function in terms of achieving ultimate organisational objectives. MI has made considerable investment in information technology to computerise core business functions and provide updated features for its users annually.

MI's information systems evolved from a PC- based system to a highly reliable and stable multi-user client server system. To execute core operations of the Company, a stable and reliable platform is facilitated through a world renowned Oracle database management system. The network runs on a Microsoft Windows server 2009 while the mail server and proxy server both run on Linux protected state-of-the-art firewall and virus wall functions. To add to this, both MI head office and its branch network is interconnected using IP VPN technology enabling remote access on an online, real time basis. Further, to enable speedier data processing and improved compatibility with new operating systems and hardware, MI's software module uses a ".Net" platform.

To meet internal and external business requirements more effectively, our core functions such as lending operations, fixed deposits and savings business, insurance, payments, receipting, general ledger etc. are fully automated. Numerous features have been embedded into the core system that enables users to discharge their job functions effectively. We have been able to improve our systems hugely concentrating on enhancing system reliability, efficiency and effectiveness and by instilling stability. A recent addition is the Document Management System which enables archiving of significant documents in soft-form. This minimises the need for storage space and facilitates speedy retrieval online.

Our system protocols place great emphasis on system security as means of retaining the credibility and performance of the system. Accordingly, measures have been instilled to secure the network using Group policies applied at various levels in line with relevant user categories. Furthermore, restrictions are in place for accessing the database which is possible only through software applications and its protection is preserved as the database itself is password protected. MI's engineering workshop houses the Oracle back-up server which reduces the risk of system malfunctioning or breakdown. This is because it ensures that a back-up copy of our main system is available on line at all times. It also enables quick restoration of operations in the event of a main system failure at head office, with up-to-date information available at the back up site. As an additional feature in the system, for protection, data would be recovered automatically in the event of a crash in-server.

This period, our team of IT experts worked tirelessly to enhance system features. They carried out a comprehensive gap analysis in comparison to another advanced system afforded in the market. Through this exercise, our core system was upgraded further incorporating specific user friendly features to the existing system. To improve lending business, customer inquiry features in the system were enhanced facilitating prompt response and follow up for the relevant division. The customer appraisal process was also systemised in 2012 to provide a speedier service. Furthermore, two new modules were introduced to the core system by automating our insurance handling operation and incorporating an inventory management system for current operation.

Outlook for the Future

Despite a new wave of economic downturn looming internationally especially in Europe, stemming from the Euro Zone crises and continued recession still in most parts of the world, we believe our nation would stand strong and would prevail with minimum drawbacks similar to 2009. Already we are witnessing heightened business activity in most sectors of the economy and in turn rising GDP levels as we enjoy the fruits of a peaceful environment. The country's GDP growth rate is bound to improve beyond the 9% level in the foreseeable future if it stays committed. Initiatives carried out in the last two years in the liberated areas and other under developed areas is bound to yield results from here on.

Already tourism is bouncing back to best levels seen in decades with the rise in tourist arrivals. Boom in tourism is bound to provide stimuli to other sectors as well including the financial services sector. Despite the mediocre inflow seen in foreign direct investments this period, we could be hopeful that with time, international investors, international donors and the Sri Lankan Diaspora would place greater confidence in the nation's economy. The business community would continue to have tremendous opportunities in terms of growth potential in the next two to three years.

The Government's on going initiatives on propelling the economy towards prosperity through various macroeconomic policies and other focused measures are sure to create an appealing environment for businesses. On the flip side however, the slow rate of foreign direct investment, devaluation of rupee in recent times coupled with gradual rise in market interest rate is bound to have temporary drawbacks to nation's growth momentum. Further, the negative sentiments that prevail internationally related to the concluded war could continue to dampen the ongoing efforts in rejuvenating the economy to a certain degree in the medium term. The slide in the stock markets all share price index (ASPI) and the havening of the market price earnings (PE) in this period portray somewhat the negative sentiments that still linger.

In the midst of foreseeable challenges, despite the better economic environment for businesses, private sector would need to buckle up and do its part in harnessing emerging opportunities by being committed, and by having continued focus and being bold in one's actions. It is imperative that the acceleration witnessed in the financial services sector would continue in parallel with development initiatives being initiated by institutions in other sectors.

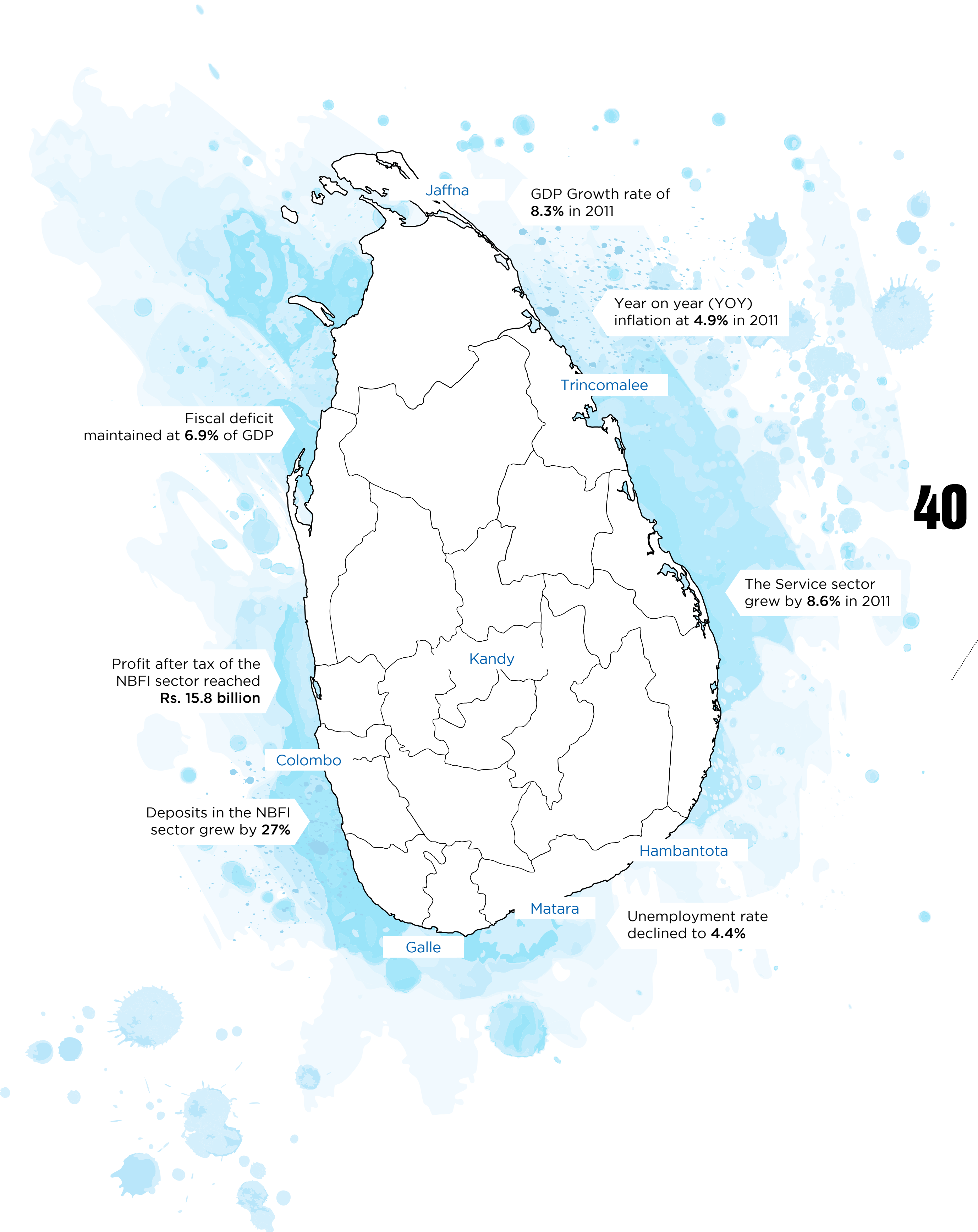
Considering the overall economic outlook that appears mixed in the medium term, MI would need to be weary of the challenges ahead amidst increased opportunity and optimism. We would need to harness our workforce even better to increase productivity as a counter measure against thinning of margins in the backdrop of rising competition. We have the right workforce who possesses the necessary ingredients to exploit opportunities, who can face challenges better especially in times of expansion. We hope to create a strong culture which promotes team work while practicing greater empowerment that is bound to create innovation unearthing hidden talent of staff and bringing it to practice. Our practices would ensure that employees are kept motivated striking a balance between work and family life. Training and development would play a significant role in guiding staff to face growing business challenges and at the same time nurture them to excel in their fields, enabling a win-win situation for either party.

We will aim to fulfil our immediate goals in the short and medium term and be committed in our pursuit on business success that will improve our bottom line even more. Identifying low cost funding would continue to be vital in maintaining adequate spreads amidst competition. We will seek all possible avenues to identify funding sources including tying up with international investors. To do so, the capital strength of the Company would play a significant part in attracting potential funding sources in times of a credit crunch. The determining factor however would be seeking funding at optimal rates especially in a rising interest rate scenario as prevalent presently. At the same time, we would have to provide a superlative service in both our lending and deposit businesses as means of maintaining healthy volumes to support the rising cost structure. Simultaneously, we will continue to focus on keeping costs low through the identification and elimination of wastage and look to cut down on usage wherever possible.

In conclusion, we are optimistic about the future, seeing the development and rapid progress the country has undergone in the last few years. At the same time, we are also ready to confront challenges with the right mindset. In this context, MI's financial soundness, profound reputation and business knowhow and the unique style of carrying on business is sure to lead us ahead in our sector in the years to follow.

Sri Lanka Economy at a Glance

"The expansion in economic activity was reflected in the unemployment rate, which declined to 4.2% in 2011, the lowest recorded level"



Overview

The Sri Lankan economy grew by 8.3% in 2011, the highest in its post-independence history, sustaining a growth momentum of over 8% for the first time in two consecutive years. Improved consumer and investor confidence arising from the peace dividend, favourable macroeconomic conditions, increased capacity utilisation, expansion of infrastructural facilities and renewed economic activity in the Northern and Eastern provinces underpinned this growth. The industry and Services sectors were the drivers of the high growth momentum in 2011. The Agriculture sector rebounded from the output loss recorded due to adverse weather conditions during the beginning of the year. The expansion in economic activity was reflected in the unemployment rate, which declined to 4.2% in 2011, the lowest recorded level.

The Government reiterated its commitment to the fiscal consolidation process by maintaining the key fiscal indicators broadly in line with the budgetary estimates for 2011. Despite the shortfall in revenue collection, prudent management of recurrent expenditure helped maintain the fiscal deficit at 6.9% of GDP, marginally above the budgetary target of 6.8% of GDP. The budget for 2011 introduced major tax reforms to simplify the tax system, broaden the tax base and improve tax compliance with the objective of strengthening tax collection, while creating an environment to attract private investment. The external sector, which strengthened in the first half of 2011, came under pressure during the latter part of the year due to adverse global developments and rapid growth in imports. Despite the healthy growth in exports by 22.4% during the year, significantly high import expenditure reflecting high oil prices and a surge in investment and intermediate good imports by 50.7%, led to a rise in the trade deficit to an unprecedented high level. The current account deficit as a percentage of GDP, increased to 7.8% in 2011 from 2.2% in 2010. To cover part of the trade deficit, improved foreign inflows through private remittances and other inflows to the services account helped to a notable degree.

Real Sector Developments

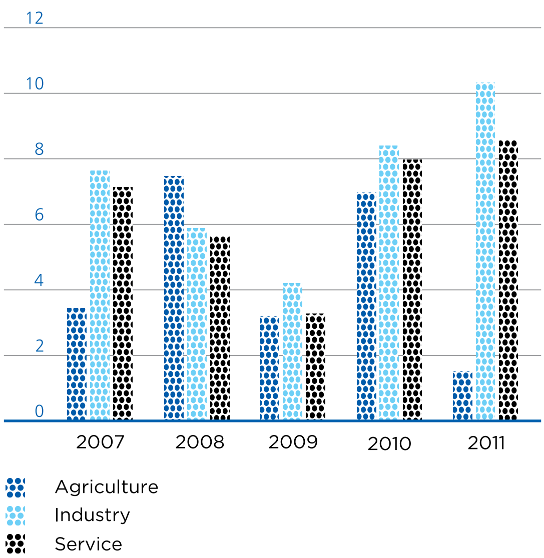
Following a growth of 8% in 2010, in real terms, the Sri Lankan economy grew by an impressive 8.3% in 2011. Strong growth in the Industry and Services sectors, amidst a setback in the Agriculture sector, underpinned the high economic growth. The Industry and Services sectors grew by 10.3% and 8.6%, respectively in 2011.

The Industry sector growth was largely propelled by factory industry and construction activities. The growth in the Industry sector in 2011 was the highest growth recorded during the past 33 years in value added terms. Consequently, the Industry sector increased its share in GDP to 29.3% in 2011 from 28.7% in the previous year.

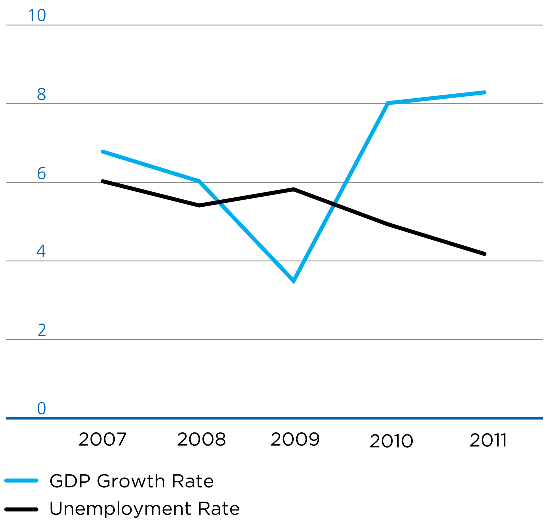
Meanwhile, the Services sector maintained its growth momentum, with notable contributions from wholesale and retail trade, transport and communication, banking, insurance and real estate subsectors. Improved performance in all key sectors of the economy helped to generate a higher level of employment in 2011. Accordingly, the unemployment rate declined to its lowest level of 4.2% in 2011 from 4.9% in 2010. The total number unemployed was estimated at 342,000 in 2011 compared to 401,000 in the previous year. The Services sector, which made the highest contribution to economic growth during the last few years, continued to generate more employment opportunities this year as well.

The Agriculture sector recorded a moderate growth of 1.5% due to severe crop damage from the adverse weather conditions that prevailed during the first quarter of the year. The *Maha* paddy production and other field crop output, which were adversely affected by severe flooding in the first quarter of the year, recorded a substantial decline. A remarkable turnaround nevertheless was witnessed in the Agriculture sector during the second half of the year. The recovery was largely attributable to the favourable performance in paddy cultivation in the *Yala* season and increased output in vegetables and highland crops supported by conducive weather conditions.

Annual Sectoral Growth (%)



GDP Growth Rate and Unemployment Rate (%)



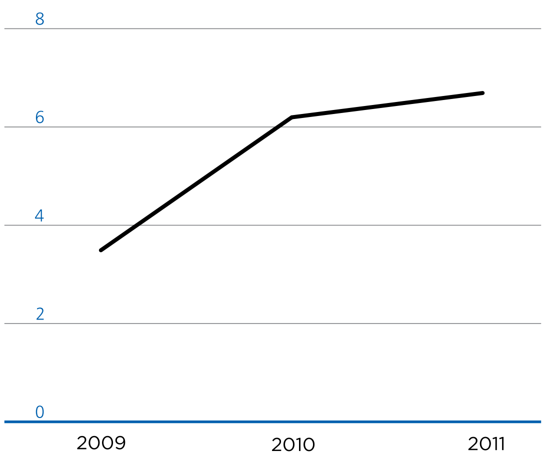
Inflation

For the third consecutive year in 2011, inflation continued to remain at single digit levels. Year-on-year inflation and annual average inflation have remained at single digit levels since February 2009 and August 2009, respectively. In 2011, annual average inflation, as measured by the Colombo Consumers' Price Index (CCPI) (2006/07=100), moved upward gradually since February to reach its peak level of 7.2% in September before decelerating to 6.7% by year end. Year-on-year inflation, which followed an increasing trend from February 2011, reached 8.9% in April 2011 and moderated thereafter recording 4.9% in December 2011.

The relatively high inflation observed during the first few months of the year was mainly due to an upsurge in prices as a result of supply disruption caused by adverse weather conditions that prevailed in major cultivation areas. Although the escalation of prices due to supply disruption was temporary, the increase in inflation on a year-on-year basis remained for a few months owing to the low base in 2010. Further, several upward revisions of administered prices, especially of LP Gas and petroleum products during the year also impacted directly and indirectly on inflation, at varying intensities.

The real wage increases during the year also exerted some pressure on prices from the demand side. However, significant improvements in the domestic supply conditions coupled with the moderation of prices of food commodities in the international market, amidst a relatively stable exchange rate helped contain inflation in 2011. Benign inflation expectations also helped restrain any undue pressure on the general price level. Meanwhile, year-on-year core inflation, which continued to follow an increasing trend from March 2011 to July 2011, dropped markedly in August 2011 and continued the downward trend reaching 4.7% in December 2011.

Colombo Consumer Price Index (%)



CCPI (2006/07 - 100) Annual Average

Interest Rates

In January 2011, policy interest rates of the Central Bank were adjusted downward and remained unchanged thereafter during the year. In order to facilitate investments further and to support continued economic expansion, the Repurchase and Reverse Repurchase rates were reduced by 25 basis points and 50 basis points, respectively, in January 2011 and stood at 7% and 8.5%, respectively, thereafter. Meanwhile, the Bank rate continued to remain unchanged at 15% in 2011. Market interest rates including yields on Government Securities remained broadly stable during the first three quarters of 2011.

Nevertheless, with the declining excess liquidity in the domestic money market, an upward movement in market interest rates and yield on Government Securities were observed during the fourth quarter of 2011. Meanwhile, in February 2012, the Central Bank raised its policy rates by 50 basis points each, and accordingly, the Repurchase rate and the Reverse Repurchase rate increased to 7.5% and 9% respectively.

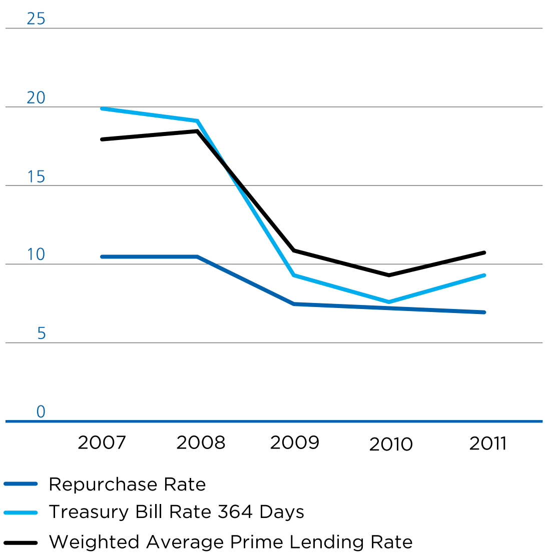
Interest Rates Movements

Interest Rates (%)	2007	2008	2009	2010	2011 (a)
Treasury Bill Rate (364 days)	19.96	19.12	9.33	7.55	**9.31**
Repurchase Rate	10.50	10.50	7.50	7.25	**7.00**
Commercial banks' Avg. Weighted Prime Lending Rate (AWPLR)	17.95	18.50	10.91	9.29	**10.77**

(a) Provisional

** Source: Central Bank of Sri Lanka*

Market Interest Rates (%)



Equity Market

The price indices of the Colombo Stock Exchange (CSE) declined during 2011 following an upsurge in the previous two years. The All Share Price Index (ASPI) and the Milanka Price Index (MPI) dropped by 9% and 26%, respectively, by end 2011. Equity prices rose to an all-time high in mid-February 2011 and moved downward thereafter, due to restrictions on credit extended by brokers, continued net foreign outflows, a liquidity drain on account of several Initial Public Offerings (IPOs), Rights Issues (RIs) and Private Placements as well as the impact of the global financial markets. The decline in the price indices resulted in a market correction following the upsurge in prices since mid-2009. The price indices of the majority of sectors declined in 2011. Consequently, the market price earnings ratio (PER) of the CSE declined from 25 at end 2010 to 16 times end December 2011.

Share Market Performance

	2010	2011
All Share Price Index (a)	6635.9	**6,074.4**
Year on year Change (%)	96.0	**(8.5)**
Milanka Price Index (a)	7,061.5	**5,229.2**
Year-on-year Change (%)	83.4	**(25.9)**
Market Capitalisation (Rs. billion) (a)	2,210.5	**2,213.9**
As a percentage of GDP (%)	39.4	**33.8**
Market Price Earning Ratio (a)	25.2	**15.8**
Turnover to Market Capitalisation (%)	25.8	**24.7**
Value of Shares Traded (Rs. billion)	570.3	**546.3**
Number of Shares Traded (million)	18,489	**24,543**
Number of Companies Listed	242	**272**
Introductions (b)	2	**16**
Number of Initial Public Offers (IPOs)/ Offers for Sale (b)	8	**13**
Number of Rights Issues	31	**22**
Amount Raised through Rights Issues & IPOs (Rs. billion)	28.7	**47.2**

Source: Colombo Stock Exchange

(a) End of the year

(b) There are 3 methods to obtain a listing i.e., an introduction where no public issue is required, an offer for sale where already existing shares are issued to the public and an offer for subscription where new shares are issued to the public.

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Key Economic Indicators

	2007	2008	2009	2010	**2011 (a)**
Demography					
Mid-year population ('000 persons)	20,039	20,217	20,450	20,653	**20,869**
Population density (persons per sq. km.)	319	322	326	329	**333**
Labour force ('000 persons)	7,489	8,082	8,074	8,108	**8,236**
Unemployment rate (percentage of labour force)	6.0	5.4	5.8	4.9	**4.2**
Output					
GDP at current market prices (Rs. billion)	3,579	4,411	4,835	5,604	**6,543**
Per capita GDP at market prices (Rs.)	178,845	218,167	236,445	271,346	**313,511**
Real Output (Percentage change)					
GNP	7.1	4.6	4.8	7.9	**8.4**
GDP	6.8	6.0	3.5	8.0	**8.3**
Sectoral Classification of GDP					
Agriculture	3.4	7.5	3.2	7.0	**1.5**
Industry	7.6	5.9	4.2	8.4	**10.3**
Services	7.1	5.6	3.3	8.0	**8.6**
Aggregate Demand and Savings (Percentage of GDP)					
Domestic savings	17.6	13.9	17.9	19.3	**15.4**
Net factor income	5.8	3.9	5.8	6.1	**6.7**
National savings	23.3	17.8	23.7	25.4	**22.1**
Prices and Wages (Percentage change)					
Colombo Consumers' Price Index (2006/07 = 100) - Annual average	–	–	3.5	6.2	**6.7**
Government Finance (Percentage of GDP)					
Revenue	15.8	14.9	14.5	14.6	**14.3**
Expenditure and net lending	23.5	22.6	24.9	22.9	**21.4**
Current account deficit (-)/surplus (+)	(1.6)	(2.0)	(3.7)	(2.1)	**(1.1)**
Overall deficit (-)/surplus (+)	(6.9)	(7.0)	(9.9)	(8.0)	**(6.9)**
Government debt	85.0	81.4	86.2	81.9	**78.5**

	2007	2008	2009	2010	**2011 (a)**
Exchange Rates					
Annual Average					
Rs./US$	110.62	108.33	114.94	113.06	**110.57**
Rs./SDR	169.37	171.24	177.22	172.50	**174.54**
Year End					
Rs./US$	108.72	113.14	114.38	110.95	**113.90**
Rs./SDR	171.57	174.27	178.67	170.84	**174.87**
Interest Rate (Percent per Annum at End of Period)					
Repurchase rate (overnight)	10.50	10.50	7.50	7.25	**7.00**
Reverse Repurchase rate (overnight)	12.00	12.00	9.75	9.00	**8.50**
Treasury Bill rate 91 days	21.30	17.33	7.73	7.24	**8.68**
Treasury Bill rate 364 days	19.96	19.12	9.33	7.55	**9.31**
Deposits Rates					
Commercial bank's weighted average deposit rate	10.31	11.63	8.01	6.23	**7.24**
Commercial bank's 12 month fixed deposit rate	20.00	20.25	19.00	17.00	**11.00**
Lending Rates					
Commercial bank's weighted average prime lending	17.95	18.50	10.91	9.29	**10.77**
Capital Market					
All Share Price Index (1985 - 100)	2,541.0	1,503.0	3,385.6	6,635.9	**6,074.4**
Milanka Price Index (1998 Dec. - 1000)	3,291.9	1,631.3	3,849.4	7,061.5	**5,229.2**
Value of shares traded (Rs. million)	104,985	110,454	142,463	570,327	**546,256**
Market capitalisation (Rs. billion)	820.7	488.8	1,092.1	2,210.5	**2,213.9**

(a) - Provisional
Source: Central Bank of Sri Lanka

Board of Directors

1. **S.H.J. Weerasuriya**
   Chairman

2. **Gerard G. Ondaatjie**
   Managing Director

3. **S.H. Jayasuriya**
   Finance Director

4. **Travice J. Ondaatjie**
   Director

5. **Ms. Anjeline M. Ondaatjie**
Director

6. **P.M. Amarasekara**
Director - Recoveries

7. **H.A.S.T. Senanayake**
Director

8. **Ms. P.T.K. Navaratne**
Director

9. **N.H.V. Perera**
Director

10. **S.M.S.S. Bandara**
Director

Saroja Hemakumar Jayawickrema Weerasuriya -

Chairman

First appointed to the Board on 26 January 2011 .

B.Sc. (Lond.), MICE. FIE (SL), FSSE (SL), C.Eng.

Director of: International Civil Engineering Consultants (Pvt) Limited.

Counts over 33 years experience as a Consultant in Civil/Structural Engineering Design and Project Management in UK, Sri Lanka, India and Maldives.

No. of shares held: Nil

Gerard George Ondaatjie -

Managing Director

First appointed to the Board on 02 December 1993.

Holder of a B.Sc. Degree in Accountancy from Arizona State University, United States.

Chairman of: Nilaveli Hotel (Pvt) Limited

Chairman and Managing Director of: Mercantile Fortunes (Pvt) Limited, Grand Hotel (Pvt) Limited, The Nuwara Eliya Hotels Co. PLC, Fairview Hotel (Pvt) Limited.

Executive Deputy Chairman of: Nilaveli Beach Hotels (Pvt) Limited.

Director of: Tangerine Beach Hotels PLC, Royal Palms Beach Hotels PLC, Security Ceylon (Pvt) Limited, Tangerine Tours (Pvt) Limited, Global Films Limited, International Fortunes (Pvt) Limited, Mercantile Orient (Pvt) Limited.

Possesses almost 20 years experience in the Financial Services, Tourism and Trading sectors.

No. of shares held: 477,213 (Voting)

Shermal Hemaka Jayasuriya -

Finance Director

First appointed to the Board on 5 January 2001.

Associate Member of The Institute of the Chartered Accountants of Sri Lanka.

Fellow Member of the Chartered Institute of Management Accountants - UK.

Fellow Member of the Society of Certified Management Accountants of Sri Lanka.

Holder of a Master's Degree in Business Administration (MBA) from the Postgraduate Institute of Management of the University of Sri Jayawardenapura, Sri Lanka.

Director of: Mercantile Fortunes (Pvt) Limited, Security Ceylon (Pvt) Limited.

Currently Vice-Chairman of The Finance Houses Association of Sri Lanka.

Counts over 20 years experience in the Financial Services, Insurance, Manufacturing and Trading sectors.

No. of shares held: Nil

Pathiranage Mahesh Amarasekara -

Director - Recoveries

First appointed to the Board on 01 December 1995.

Possesses almost 27 years experience in the Financial Service sector.

No. of shares held: Nil

Angeline Myrese Ondaatjie -

Director

First appointed to the Board on 20 January 1992.

Holder of Master's Degree

Holder of B.Sc. Degree

Managing Director of: Tangerine Tours (Pvt) Limited

Joint Managing Director of: Tangerine Beach Hotels PLC, Royal Palms Beach Hotels PLC

Director of: Security Ceylon (Pvt) Limited, Nilaveli Beach Hotels (Pvt) Limited, Global Films Limited, International Fortunes (Pvt) Limited, The Nuwara Eliya Hotels Co. PLC, Mercantile Orient (Pvt) Limited, Mercantile Fortunes (Pvt) Limited, Grand Hotel (Pvt) Limited, Fairview Hotel (Pvt) Limited, Nilaveli Hotel (Pvt) Limited.

Counts over 20 years experience in the financial services, Tourism and Manufacturing sectors.

No. of shares held: 477,213 (Voting)

Travice John Ondaatjie -

Director

First appointed to the Board on 13 July 1995.

Holder of B.Sc. Degree

Managing Director of: Nilaveli Beach Hotels (Pvt) Limited, Nilaveli Hotel (Pvt) Limited

Director of: Tangerine Beach Hotels PLC, Royal Palms Beach Hotels PLC, Security Ceylon (Pvt) Limited, Fairview Hotel (Pvt) Limited, Tangerine Tours (Pvt) Limited, Global Films Limited, International Fortunes (Pvt) Limited, The Nuwara Eliya Hotels Co. PLC, Mercantile Orient (Pvt) Limited, Mercantile Fortunes (Pvt) Limited, Grand Hotel (Pvt) Limited.

Counts over 20 years experience in the Financial Services and Tourism sectors.

No. of shares held: 477,213 (Voting)

Henaka Arachchillage Sajitha Tilakasiri Senanayake -

Director

First appointed to the Board on 3 February 2011 .

Associate Member of The Institute of Chartered Accountants of Sri Lanka.

Associate Member of Chartered Institute of Management Accountants - UK.

Counts over 16 years experience in Audit, Accounts and Management and Finance Planning fields.

No. of shares held: Nil

Ms. Punyakanthi Tikiri Kumari Navaratne -

Director

First appointed to the Board on 17 January 2012.

Holder of Bachelor of Laws (LLB) Degree from the University of Colombo and an Attorney-at-Law.

She has been associated with Paul Ratnayake Associates as an Associate Lawyer from 1995 to 1997 and has been a Partner of the same firm from 1997 to December 1998.

Director of: WSO2 Lanka (Pvt) Limited

No. of shares held: Nil

Mr. Nawagamuwage Hasantha Viraj Perera -

Director

First appointed to the Board on 9 February 2012.

Director of: Tangerine Beach Hotels PLC, Royal Palms Beach Hotels PLC, Blue Oceainc Beach Hotel, Yala Safari Beach Hotels Limited, Southasia Economic and Trade Corporation (Pvt) Limited.

He has been attached to Lucian V. Perera Associates a legal firm for over a period of ten years.

No. of shares held: 10,020

Mr. Singappuli Mudiyanselage Susantha Sanjaya Bandara -

Director

First appointed to the Board on 9 February 2012.

Fellow Member of The Institute of the Chartered Accountants of Sri Lanka.

Fellow Member of the Association of Accounting Technicians of Sri Lanka.

Holder of a Master’s Degree in Business Administration (MBA) from the University of Colombo, Sri Lanka.

Holder of a Bachelor’s Degree in Accountancy from the University of Sri Jayawardenapura.

He has been a Partner of B.R. De Silva & Co., Chartered Accountants since 2004.

No. of shares held: Nil

Senior Management Team

1. **Mrs. M.B. Assauw**
   Director (Deposits)

2. **Mr. Dhanushka Fonseka**
   GM (Credit & Marketing)

3. **Mr. Ravi Ekanayake**
   GM - (Workshop)

4. **Mr. Buddika Kasturiratne**
   AGM (Recoveries)

5. **Mr. Deva Anthony**
   AGM (Finance)

6. **Mrs. Jayanka Kahawevithana**
   Senior Manager (Legal)

7. **Mr. Hirantha Pandithasekera**
   Senior Manager (Co-operate Leasing)

8. **Mr. Dharshana V. Senarath**
   Senior Manager (Leasing & Hire Purchase)

9. **Mr. Ravi de Mel**
   Senior Manager (Credit Administration)

10. **Mr. Shehan Cooray**
    Senior Manager (Recoveries)

11. **Mr. Prasad Wickramesinghe**
    Senior Manager (Payments)

12. **Mr. Chandana Nanayakkara**
    Senior Manager (Finance)

13. **Mr. Prasad Indika**
    Senior Manager (Software Development)

14. **Mr. Lahiru Dayananda**
    Senior Manager (Leasing)

OUR BUSI
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VALUES A

They say that water from a running stream is safe to drink...and the reason the water runs is because there are no impediments to its progress. It's much the same with our enterprise. Our foundations are rock solid…good governance helps us avoid impediments and blocks and keeps business flowing smoothly…providing pristine products and services that nurture and nourish the lives and livelihoods of our customers.

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Corporate Governance Report

Chairman's Statement

Extensive focus on the subject of corporate governance placed by the regulator and institutions in the sector has strengthened the industry significantly in recent times. The adoption of best practices on corporate governance has also boosted public confidence in the sector tremendously countering negative perceptions that prevailed as a consequence of specific past events. Key lessons learnt from corporate collapses internationally point to poor governance exercised by individuals from the very top of the corporate hierarchies. Therefore, I believe it was pertinent that such regulations were applied across the sector despite the difficulties and effort required to adhere to such requirements.

The enactment of the Finance Business Act in 2011 can be viewed as a significant initiative in strengthening regulatory operations of the sector in this period. It is apparent that such tighter regulation enhances the profile of organisations including their practices and process that is necessary for the conduct of operations of a financial company in an effective manner. The onus is now on the individuals who operate the institutions to follow such regulations and to ensure that there is proper governance of their enterprises. The benefit of adherence is immense since organisations become automatically geared and focused in fulfilling corporate obligations towards its owners and other stakeholders.

I must reiterate that MI as an organisation that values good governance has always been committed in establishing best corporate governance practices. This year was no exception, as we reviewed our corporate governance framework thoroughly and were able to bring in additional changes necessary to either improve and in certain instances fall in line with best practices and regulations which were currently prevalent.

Our Corporate Governance Report presented herewith provides disclosures about the organisations corporate governance framework and practices followed to uphold prevailing norms and regulations. Our report this year is in two parts. Statement 01 provides a comprehensive report on our compliance to the Code of Best Practice on Corporate Governance issued jointly by the Securities and Exchange Commission of Sri Lanka and The Institute of Chartered Accountants of Sri Lanka. Statement 02 provides disclosures on MI's level of compliance to the Direction on corporate governance issued to finance companies by the Central Bank of Sri Lanka.

As an establishment that has stayed true to its stakeholders for decades through sound practices, it was indeed with pride that I took over the realm of being the Chairman of the Company from January 2012. I wish to emphasise that our institution would continue to carry sound corporate practices so that our stakeholders' respect and loyalty towards us is safeguarded at all times. I believe blending MI's invaluable corporate ethos coupled with sound leadership qualities at all levels of the corporate hierarchy would be fundamental to continued good governance while we pursue our aspirations.

Saroja Weerasuriya
Chairman

15th May 2012

Corporate Governance Principles Practiced

Corporate governance at MI is an established framework that sets the rights, roles and responsibilities of individuals attached to the Company right from the Board level to bottom levels of the corporate hierarchy. In essence, it is a system of internal controls and procedures by which our activities are governed. MI's Board takes responsibility for the management of the Company ensuring business is conducted in a sound and prudent manner. Our corporate governance practices thus ensure we seek corporate objectives with utmost care displaying high standards of industrial and professional ethics so that we can safeguard the interest of stakeholders.

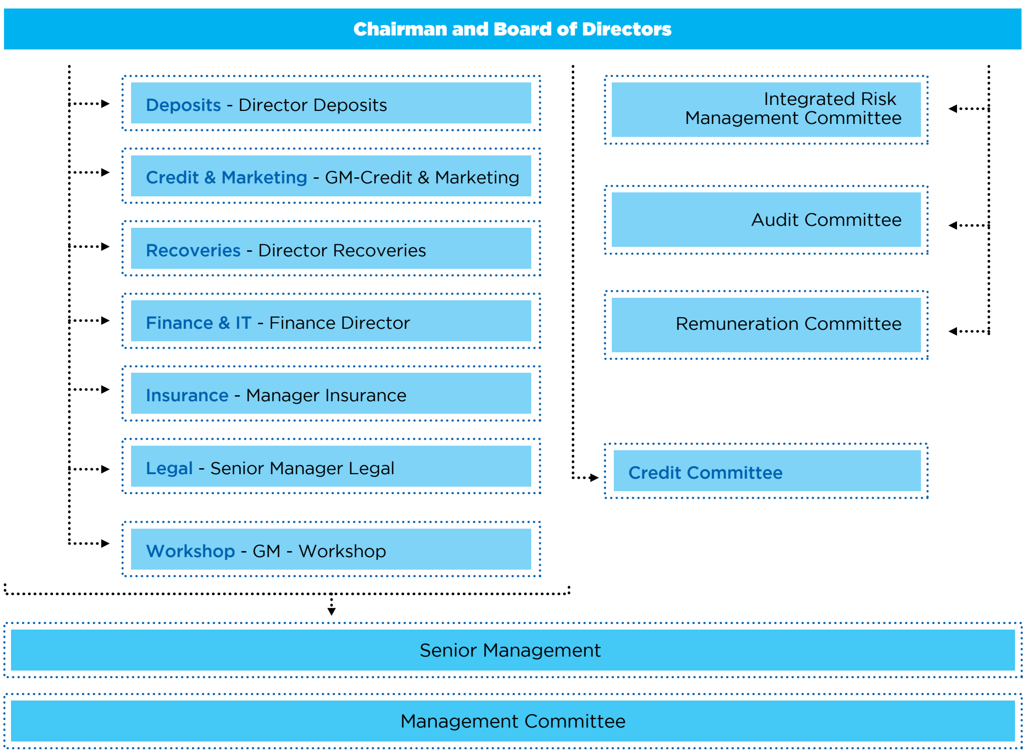
The Board of MI discharges its primary goal of creating wealth to its shareholders by managing business operations in an orderly manner. The Board is also accountable to other stakeholders especially to its depositors and MI customers who seek our offerings. As the leader, MI Board sets the Company's strategic aims, establishing appropriate policies while providing financial, human and other resources necessary for achievement of corporate objectives. The Board has established an effective system of internal controls that provide assurance on proper operations whilst complying with prevalent laws and regulations. Our practices go beyond commercial requirements as we continue to show our commitment towards sustainable development by our contributions to the economy, respect to the society at large and the environment.

Moreover, we are renowned for our excellence in financial reporting for decades portraying our commitment to transparency, an essential attribute to good corporate governance. Most of all, we have displayed accountability for our corporate actions right throughout our journey. These values have built lasting trust and bondage between MI and our stakeholders over the years, a hallmark in our road to success.

MI's Corporate Governance Framework

Corporate governance is a fundamental part of our business practices and is embedded in the enterprise's culture. In practice, we adopt a sound framework that follows best practices and industry standards on corporate governance. MI's governance structure depicted below indicates a top down vertical governance approach from the Board of Directors being the upper most level of the governance structure to the lowest level of the hierarchy. The Board exercises its powers through MI's Corporate Management to conduct daily business functions. In turn, the Corporate Management oversees functions of their divisional staff in ensuring that they perform specific duties with outmost care, following established corporate policies and procedures in the process. As part of the framework, separate Board appointed committees have been formed to monitor and provide feedback on core aspects of business to the Board. At Senior Management level a separate Management Committee has been established to monitor corporate performance closely as means of being more proactive in core areas of business.

Governance Structure at MI



Adoption Status of Corporate Governance Rules and Principles

Two separate statements have been provided to illustrate MI's level of conformity with prevailing regulations and best practices on corporate governance.

Statement One provides disclosure on MI's level of conformity with the recommended Code of Best Practice on Corporate Governance issued to public companies jointly by the Securities and Exchange Commission of Sri Lanka (SEC) and The Institute of Chartered Accountants of Sri Lanka (ICASL) in June 2008.

Statement Two provides disclosure on MI's level of compliance to the Direction issued on corporate governance to finance companies by the Central Bank of Sri Lanka under Direction No. 03 of 2008 and amendments thereto effective 1st January 2009.

Statement 01

Code of Best Practice on Corporate Governance

Corporate governance principles	Reference to SEC and ICASL code	Adoption status	MI's extent of adoption (2012 update)
Section 1: The Company			
A. Directors			
A.1 The Board	Code - A.1	Adopted	The Board of MI comprises the Chairman, Managing Director, Executive Directors, and Non-Executive Directors who possess a range of skills and experience necessary in satisfactorily discharging their duties competently with integrity. The Board of MI directs, lead and control operations of the Company effectively in a prudent manner.
1. Meetings	Code - A.1.1	Adopted	A total of 12 Board meetings were held for the concluded financial year. Level of participation by each Director at Board meetings is illustrated in the ensuing paragraphs of the report under 'Meetings of the Board'.
2. Responsibilities of the Board	Code - A.1.2	Adopted	The Board has a wide scope of responsibilities covering a range of duties that strengthen the safety and soundness of the Company. These responsibilities ensure that the Board directs the affairs of the Company in an effective manner with due care on all its activities.
			Main responsibilities of the Board includes: ***Strategic nature responsibilities:*** ● Setting down strategic objectives and corporate values and communicating them to the relevant management for adoption. ● Formulation and implementation of business strategies. A formal strategic plan with a three-year forecast was developed during this period. ● Identifying and designating key management personnel and assigning areas of authority and key responsibilities for the Board and the key management personnel. ● Ensuring that there is adequate oversight of affairs of the Company by key management personnel that is consistent with the strategies and policies authorised. ● Identifying and managing risk by implementing appropriate systems to help counter risk effectively. Reviewing the adequacy and the integrity of the Company's internal control systems and of its Management Information Systems. ● Initiate meetings with key management personnel on a frequent basis to monitor progress in reaching set corporate objectives and reviewing policies and establishing lines of communication.

Corporate governance principles	Reference to SEC and ICASL code	Adoption status	MI's extent of adoption (2012 update)
			● Ensuring that the management team possesses the required skills, knowledge and experience necessary to execute the strategy. ● Assessing the effectiveness of Company's corporate governance practices. ● Understanding the regulatory environment and ensuring compliance. ● Adopting set methods of communication with stakeholders including depositors, creditors, shareholders and borrowers.
			Financial nature decisions and responsibilities: ● Ensuring appropriate accounting policies are adopted and maintaining compliance to financial regulations. In doing so, monitoring processes, controls and procedures to maintain the integrity of the Company's accounting and financial records and statements. ● Strategic financial decisions on funding, pricing, liquidity and decisions on capital expenditure are overseen by the Board. ***Equity and related decisions:*** Deciding on interim and final dividend based on, ongoing performance etc. Making decisions on share issues, allotments and bonus share considerations when needed. ***Other decisions and responsibilities:*** ● Ensuring compliance with laws, regulations and ethical standards. ● Ensuring key stakeholder interest is considered when making corporate decisions.
3. Access to professional advice	Code - A.1.3	Adopted	To make decisions individually and collectively to discharge their obligations, the Board provides autonomy for Directors to obtain sufficient independent professional advice in the course of their duties at the expense of the Company. Formal procedures will be introduced in this regard this year.
4. Company Secretary	Code - A.1.4	Adopted	The Board of Directors have direct access to advice and services of the Company Secretary when necessary. The Company Secretary is responsible to ensure that Board procedures are followed together with applicable rules and regulations.
5. Independent judgments and dedicating time and effort	Code - A.1.5 and A.1.6	Adopted	Extensive time and effort is devoted by the Directors in performing their duties towards the Board. Majority of Directors have been appointed to Board subcommittees enabling them to exercise effective control over strategic, financial, compliance and governance issues. In doing so, considerable technical knowledge is brought in by each Board member in his/her respective fields. The Directors provide their own independent judgments through deliberations and discussions during meetings.
6. Training needs	Code - A.1.7	Adopted	The Board continuously assesses skills and experience of each member to meet business challenges and complexities. The Directors have had adequate exposure and training in their relevant areas of expertise necessary to discharge ones obligations to the Board. They are encouraged to attend specialised training and to participate in seminars and workshops covering current topics. Hence, Directors are regularly updated on recent changes in relation to regulations, practices, etc. in the sector.

Corporate governance principles	Reference to SEC and ICASL code	Adoption status	MI's extent of adoption (2012 update)
A.2 Chairman and Chief Executive Officer	Code A.2.1	Adopted	From January 2012 the Board appointed a separate Chairman and a separate Managing Director. Both these key roles were kept separate in line with the Corporate Governance Direction. (No separate Chief Executive Officer.)
A.3 Chairman's role	Code A.3 and A.3.1	Adopted	Leadership is provided by the Chairman to the Board by running the Board and preserving order and facilitating the effective discharge of Board functions. Effective participation is obtained from all Directors so that they support the Chairman in contributing to the Board through their core competencies. The Chairman maintains the balance of the Board with the appropriate blend of Executive and Non-Executive Directors.
A.4 Financial acumen	Code - A.4	Adopted	The Board possesses members with adequate financial wisdom. The Finance Director possesses vast experience in financial management together with necessary qualifications in finance being an Associate Member of The Institute of Chartered Accountants of Sri Lanka, Fellow Member of the Chartered Institute of Management Accountants (UK), and a Fellow member of the Certified Management Accountants of Sri Lanka and holds an MBA from the University of Sri Jayawardenapura of Sri Lanka.
A.5 Board balance	Code - A.5 and A.5.1 to A.5.3	Ongoing See extent	The Board of MI has the required blend of Executive and Non-Executive Directors as required by the Finance Companies (Corporate Governance Amendment) Direction No. 04 of 2008 issued by the Central Bank of Sri Lanka.
	Code - A.5.5	Adopted	The Board considers the following Directors as Independent Non-Executive Directors taking into account the criteria specified in Section 4.4 of the Corporate Governance Direction issued by CBSL. Mr. S.H.J. Weeerasuriya Mr. H.A.S.T. Senanayake Ms. P.T.K. Navaratne Mr. S.M.S.S. Bandara
	Code A.5.6 and A.5.7	Adopted	Chairman and Managing Directors roles have been separated from January 2012.
	Code A.5.9	Adopted	Matters that need resolution are appropriately recorded in minutes.
A.6 Supply of information	Code - A.6, A.6.1 and A.6.2	Adopted	Seven days prior notice is given through circulation of the agenda and information with adequate content and quality for the Board to discharge its obligations effectively. Circulated information include, monthly management accounts, regulatory ratios and other portfolio statistics that elaborate monthly performance against comparatives.
A.7 Appointments to the Board	Code - A.7.2 and A.7.3	Adopted See extent	Board evaluates recommendations made to appoint new Directors when need arises. A background review is carried out to assess the suitability of a nominee. Formal procedures on appointments to be drafted with the setting up of a Nominations Committee. In the year under review, there were three new appointments to the Board. The Section on 'Board of Directors' in the Annual Report provide a brief resume of new appointed Directors including their areas of expertise. Additionally, the level of independence of new Directors has been established in this supplement.

Corporate governance principles	Reference to SEC and ICASL code	Adoption status	MI's extent of adoption (2012 update)
A.8 Re-election	Code - A.8	Adopted	One-third of the Directors for the time being are required to submit themselves for re-election by the shareholders at every Annual General Meeting. The Managing Director shall not while holding that office be subject to retirement by rotation.
A.9 Appraisal of Board performance	Code - A.9	Adopted See extent	Board makes appraisals of its own performance and of its subcommittees by monitoring progress against core objectives thereby controlling their effective and efficient functioning. Formal procedures are to be introduced to streamline the appraisal process from next year.
A.10 Disclosure of information on Directors	Code - A.10.1	Adopted	Brief profile of each Director is provided in pages 48 and 49 under the Section on 'Board of Directors'. Details of Director participation at Board meetings and at subcommittee meetings with information on such committees are available in the ensuing paragraphs of this supplement.
B. Directors' Remuneration			
B.1 Remuneration procedure	Code - B.1.1 and B.1.2	Adopted	The Remuneration Committee established by the Board comprises of Non-Executive Directors who oversee matters on Board remuneration and makes recommendations on related matters. Remuneration Committee Report is given on page 152 to the Annual Report.
	Code - B.1.3	Adopted	The Chairman and members of the Remuneration Committee are listed in the Annual Report in page 77.
B.2 The level and make up of remuneration	Code - B.2	Adopted	Remuneration levels are sufficient to attract and retain both Executive and Non-Executive Directors.
B.3 Details of remuneration	Code - B.3	Adopted See extent	The remuneration of the Directors in aggregate is disclosed in the 'related party disclosure' in the Notes to the Financial Statements in page 188.
C. Relations with Shareholders			
C.1 Constructive use of AGM	Code - C.1	Adopted	The Company's Annual General Meetings serve as the primary method of communication between the organisation and the shareholders. The Annual Report becomes the main information document to its shareholders and is released with adequate prior notice to shareholders in accordance with the Companies Act.
C.2 Major transactions	Code - C.2	Adopted	There were no material proposed transactions that have been entered into by the Company which may affect the net asset base during the year. In the event, such major transactions are planned, disclosure would be given, in MI's half year/annual Financial Statements.

Corporate governance principles	Reference to SEC and ICASL code	Adoption status	MI's extent of adoption (2012 update)
D. Accountability and Audit			
D.1 Financial reporting	Code - D.1	Adopted	Through a comprehensive Annual Report that incorporates the Audited Financial Statements for the financial year, the Company has presented a balanced and understandable assessment of its financial position, performance and prospects that prevail.
	Code - D.1.1	Adopted	In presenting the Annual Report and the Audited Financial Statements, the Company has followed the applicable accounting standards and regulatory requirements. Accordingly, compliance aspects on applicable regulations and standards have been addressed in the 'Annual Report of the Board of Directors'. In addition, half yearly accounts are published in all three languages and conform to the regulatory interim publication format and the applicable accounting standards.
7. Directors' Report	Code - D.1.2.	Adopted	The Directors' Report (Annual Report of the Board of Directors) is given on pages 141 to 145 in the Annual Report. The transactions of the Directors/Key Management Personnel have been disclosed under the Directors' Interest in Contracts on pages 146 to 149 and 'related party disclosure' in the Notes to the Financial Statements on page 188.
8. Directors' Responsibility Statement	Code - D.1.3	Adopted	The Directors' Responsibility Statement is given on page 148 of the Annual Report.
9. Management Report	Code - D.1.4	Adopted	The Management Discussion and Analysis report is given on pages 16 to 39 in the Annual Report.
D.2 Internal Controls - Maintaining a sound system of internal controls	Code - D.2	Adopted	An effective system of internal controls has been established by the Board to safeguard the assets of the Company. Various systems of internal controls have been designed to counter risks that arise from dealing in financial transactions and other general risks. To manage risks such as failure to meet businesses objectives and to provide reasonable assurance against material misstatements or losses, internal controls play a significant role. These controls have been embedded onto routine operations of the Company while staff who execute them understands its importance in mitigating potential risks. The corporate structure has clear demarcations on management responsibility and accountability for application of individual controls.
10. Reviewing effectiveness of internal controls	Code - D.2.1	Adopted	The effectiveness of internal controls that have been instilled is reviewed through the Audit Committee a subcommittee of the Board. Assurance on the proper functioning of internal controls is independently overseen by the Committee that comprises mainly nominated Board members. Whenever necessary, the Committee provides feedback to the Board on significant matters needing Board's attention. The Company's Internal Auditors and External Auditors have access directly to communicate to the Board on any material matters they feel require special attention.
11. Internal Audit function	Code - D.2.2	Adopted	Messrs Ernst & Young, Chartered Accountants are the Internal Auditors for the Company. They perform periodic reviews covering critical operations of the organisation through a set annual audit programme. The Auditors ensure high risk functions are identified and reviewed at both head office and branch level to give greater emphasis for priority areas.

Corporate governance principles	Reference to SEC and ICASL code	Adoption status	MI's extent of adoption (2012 update)
D.3 Audit Committee	Code - D.3, D.3.1, D.3.2, D.3.3 & D.3.4.	Adopted	The Audit Committee is chaired by an Independent Non-Executive Director who is also a Chartered Accountant with years of experience behind him in the accounting and the finance fields. He is supported by two other Directors who are also Independent Non-Executive Directors. Information on names of members forming the Audit Committee together with their level of participation at meetings has been disclosed on page 77. The Committee has written terms of reference by which it governs its activities. Broadly, the Committee is entrusted to oversee and discharges its duties in relation to the application of internal control principles, selecting and applying accounting policies, financial reporting and dealing in matters related to the Company Auditors. The Audit Committee performs following duties independently on behalf of the Board: ● Making recommendations on appointment of Auditors, their service periods, and any resignations or dismissal of the Auditors. ● Reviewing the scope, functions and resources of internal audit function and the adequacy of audit programmes. ● The Committee is entrusted with appointing and reviewing the Auditors' remuneration. ● Evaluating the scope of audit work and its cost effectiveness with final results whilst ensuring that the required level of independence and objectivity is maintained at all times. ● Monitoring the integrity of financial information that is generated by Management. This includes the review of Annual Reports, accounts and periodic reports, application of the relevant accounting standards, changes in accounting policies and importantly compliance to Sri Lanka Accounting Standards and the Companies Act on financial reporting. ● Monitoring the volume and nature of non-audit services provided by the Auditors to maintain a balance between objectivity and value addition. ● Investigating on significant matters that are brought to the Committee's attention. Matters raised by staff on a confidential note are followed up on a case by case basis. ● Obtaining feedback from External Auditors on their completed statutory audits and following up on significant observations raised in the Management letter to the Board. ● Reviewing the process of risk management including risk assessments exercised by the Management.
D.4 Code of Business Conduct and Ethics	Code - D.4	Ongoing	Human Resource Division has designed a formal code on business conduct and ethics which is to be formally introduced to staff from next period.
D.5 Corporate Governance Disclosure	Code - D.5	Adopted	MI's Corporate governance report provides detail disclosure on Company's corporate governance practices against regulatory requirements and recommended best practices.

Corporate governance principles	Reference to SEC and ICASL code	Adoption status	MI's extent of adoption (2012 update)
Section 2: Shareholders			
E. Institutional Investors	Code - E.1	Adopted	MI's shareholder base comprises a few investors who are institutional. The Company became quoted in the Colombo Stock Exchange from this period.
F. Other Investors	Code - F.1	Adopted	Individual shareholders are encouraged to carry out their own analysis or seek independent advice on investing or divesting decisions.

Statement 02

Finance Companies (Corporate Governance) Direction No. 03 of 2008 and Related Amendments

Direction requirement (with section number of the Direction)	Complied	Not complied	N/A	Extent of adoption (2012 update)
2. (1) The Responsibilities of the Board of Directors				
a. Approving and overseeing the finance company's strategic objectives and corporate values. Communicating strategic objectives and corporate values throughout the Company.	✓			A strategic plan for the Company with a three-year forecast was prepared during this period for approval of the Board. The plan consists of strategic objectives and corporate values that were communicated to key staff members of divisions during this period.
b. Approving the overall business strategy of the finance company, including the overall risk policy and risk management procedures and mechanisms with measurable goals, for at least immediate next three years.	✓ See extent			The strategic plan prepared for approval of the Board covers overall business strategies with measurable goals for the next three years. During this period, the Board approved terms of reference of the Audit Committee and the Integrated Risk Management Committee as means of overseeing aspects on risk management and internal controls of the Company.
c. Identifying risks and ensuring implementation of appropriate systems to manage the risks prudently.	✓			Heads of divisions have been entrusted to assess risk related to their work areas and to apply systems and controls to manage risks. (MI's risk management process is outlined in pages 82 to 97 on the Annual Report.) As a special assignment during this period, Internal Auditors were requested to document risks and control processes in place for each significant business activity to assess its adequacy. The assignment is in progress.
d. Approving a policy of communication with all stakeholders, including depositors, creditors, shareholders and borrowers.	✓			A communication policy was prepared for the Company during this period and approved by the Board.

Direction requirement (with section number of the Direction)	Complied	Not complied	N/A	Extent of adoption (2012 update)
e. Reviewing the adequacy and the integrity of the finance company's internal control systems and management information systems.	✓			Internal control systems and management information systems are reviewed periodically by the Internal Auditors. The Audit Committee overseas aspects raised on internal controls and financial reporting by the internal audit. As stated in c. above, the special assignment on assessing the adequacy of internal controls is in progress by the internal audit.
f. Identifying and designating Key Management Personnel, who are in a position to: (i) significantly influence policy; (ii) direct activities; and (iii) exercise control over business activities, operations and risk management.	✓			
g. Defining the areas of authority and key responsibilities for the Board and for the Key Management Personnel.	✓ See extent			Responsibilities of the Board have been defined. Job descriptions for key positions in the corporate management are being prepared to define areas of responsibilities.
h. Ensuring that there is appropriate oversight of the affairs of the finance company by key management personnel, that is consistent with the finance company's policy.	✓			Monthly Board meetings are held to review Company's performance and to monitor the key areas of business. Separately, Board subcommittees and other committees set up have been entrusted to review and monitor identified areas of business and to provide feedback on any deviations etc.
i. Periodically assessing the effectiveness of its governance practices, including: (i) the selection, nomination and election of Directors and appointment of key management personnel; (ii) the management of conflicts of interests; and (iii) the determination of weaknesses and implementation of changes where necessary.	✓			During this period, material changes were affected to the Board's composition to comply with the Corporate Governance Direction. In addition, steps were taken to adopt other effective governance practices as appropriate for the better conduct of the Company.
j. Ensuring that the finance company has an appropriate succession plan for key management personnel.	✓			
k. Meeting regularly with the key management personnel to review policies, establish lines of communication and monitor progress towards corporate objectives.	✓			Management Committee meetings are held weekly commencing from August 2011 to monitor Company performance closely in the presence of all key managers with adequate Director participation.
l. Understanding the regulatory environment;	✓			
m. Exercising due diligence in the hiring and oversight of External Auditors.	✓			The Audit Committee on behalf of the Board handles the hiring and oversight of External Auditors.

Direction requirement (with section number of the Direction)	Complied	Not complied	N/A	Extent of adoption (2012 update)
2. (2) The Board shall appoint the Chairman and the Chief Executive Officer and define and approve the functions and responsibilities of the Chairman and the Chief Executive Officer in line with paragraph 7 of this Direction.	✓ See extent			The Board has appointed a Non-Executive Chairman and a separate Managing Director w.e.f January 2012. (No separate Chief Executive Officer.)
2. (3) There shall be a procedure determined by the Board to enable Directors, upon reasonable request, to seek independent professional advice in appropriate circumstances, at the finance company's expense. The Board shall resolve to provide separate independent professional advice to Directors to assist the relevant Director(s) to discharge their duties to the finance company.	✓ See extent			Board provides autonomy for Directors to seek independent professional advice whenever needed. Formal procedures on seeking advice would be drafted this year.
2. (4) A Director shall abstain from voting on any Board resolution in relation to a matter in which he or any of his relatives or a concern in which he has substantial interest, is interested, and he shall not be counted in the quorum for the relevant agenda item at the Board meeting.	✓			
2. (5) The Board shall have a formal schedule of matters specifically reserved to it for decision to ensure that the Direction and control of the finance company is firmly under its authority.	✓ See extent			An agenda is prepared for each Board meeting with due notice given to members. A formal schedule of matters specifically reserved for the Board is being developed.
2. (6) The Board shall, if it considers that the finance company is, or is likely to be, unable to meet its obligations or is about to become insolvent or is about to suspend payments due to depositors and other creditors, forthwith inform the Director of the Department of Supervision of Non-Bank Financial Institutions of the situation of the finance company prior to taking any decision or action.	✓			Not required as Company fulfilled its obligations accordingly.
2. (7) The Board shall include in the finance company's Annual Report, an annual corporate governance report setting out the compliance with this Direction.	✓			
2. (8) The Board shall adopt a scheme of self-assessment to be undertaken by each Director annually, and maintain records of such assessments.		✓		A format for a scheme of self-assessments has been developed and would be introduced from this year.

Direction requirement (with section number of the Direction)	Complied	Not complied	N/A	Extent of adoption (2012 update)
3. Meetings of the Board **3. (1)** The Board shall meet at least twelve times a financial year at approximately monthly intervals. Obtaining the Board's consent through the circulation of written or electronic resolutions/ papers shall be avoided as far as possible.	✓			Twelve meetings were held for the financial year.
3. (2) The Board shall ensure that arrangements are in place to enable all Directors to include matters and proposals in the agenda for regular Board meetings where such matters and proposals relate to the promotion of business and the management of risks of the finance company.	✓			
3. (3) A notice of at least 7 days shall be given of a regular Board meeting to provide all Directors an opportunity to attend. For all other Board meetings, a reasonable notice shall be given.	✓			
3. (4) A Director who has not attended at least two-thirds of the meetings in the period of 12 months immediately preceding or has not attended the immediately preceding three consecutive meetings held, shall cease to be a Director. Provided that participation at the Directors' meetings through an alternate Director shall, however, be acceptable as attendance.	✓			All Directors have participated over the minimum participation requirement.
3. (5) The Board shall appoint a Company Secretary whose primary responsibilities shall be to handle the secretarial services to the Board and shareholder meetings and to carry out other functions specified in the statutes and other regulations.	✓			
3. (6) If the Chairman has delegated to the Company Secretary the function of preparing the agenda for a Board meeting, the Company Secretary shall be responsible for carrying out such a function.	✓			
3. (7) All Directors shall have access to advice and services of the Company Secretary with a view to ensuring that Board procedures and all applicable laws, directions, rules and regulations are followed.	✓			The Board of Directors have direct access to advice and services of the Company Secretary.
3. (8) The Company Secretary shall maintain the minutes of Board meetings and such minutes shall be open for inspection at any reasonable time, on reasonable notice by any Director.	✓			Minutes of all meetings held are available with the Company Secretary and is open for inspection by Directors at his/her request.
3. (9) Minutes of Board meetings shall be recorded in sufficient detail.	✓			Minutes of all meetings are duly recorded in sufficient detail and retained by the Company Secretary under the supervision of the Chairman.

Direction requirement (with section number of the Direction)	Complied	Not complied	N/A	Extent of adoption (2012 update)
4. Composition of the Board				
4. (1) Subject to the transitional provisions contained herein, the number of Directors on the Board shall not be less than 5 and not more than 13.	✓			
4. (2) Subject to the transitional provisions contained herein and subject to paragraph 5.(1) of this Direction the total period of service of a Director other than a Director who holds the position of Chief Executive Officer or Executive Director shall not exceed nine years.	✓			
4. (3) Subject to the transitional provisions contained herein, an employee of a finance company may be appointed, elected or nominated as a Director of the finance company (hereinafter referred to as an 'Executive Director') provided that the number of Executive Directors shall not exceed one-half of the number of Directors of the Board. In such an event, one of the Executive Directors shall be the Chief Executive Officer of the Company.			✓	
4. (4) With effect from three years from the date of this Direction, the number of Independent Non-Executive Directors of the Board shall be at least one-fourth of the total number of Directors.	✓			The Company has the required number of Independent Non-Executive Directors as per the Direction.
4. (5) In the event an Alternate Director is appointed to represent an Independent Non-Executive Director, the person so appointed shall also meet the criteria that apply to the Independent Non-Executive Director.				
4. (6) Non-Executive Directors shall have necessary skills and experience to bring an objective judgment to bear on issues of strategy, performance and resources.	✓			
4. (7) With effect from three years from the date of this Direction, a meeting of the Board shall not be duly constituted, although the number of Directors required to constitute the quorum at such meetings is present, unless at least one-half of the number of Directors that constitute the quorum at such meetings are Non-Executive Directors.	✓			
4. (8) The Independent Non-Executive Directors shall be expressly identified as such in all corporate communications that disclose the names of Directors of the finance company. The finance company shall disclose the composition of the Board, by category of Directors, including the names of the Chairman, Executive Directors, Non-Executive Directors and Independent Non-Executive Directors in the Annual Corporate Governance Report which shall be an integral part of its Annual Report.	✓			Details on Board composition including names and category of Directorship has been given in page 76 in the Corporate Governance Report. In addition, a profile of each Director is given in page 48 and 49 forming part of the Annual Report.

Direction requirement (with section number of the Direction)	Complied	Not complied	N/A	Extent of adoption (2012 update)
4. (9) There shall be a formal, considered and transparent procedure for the appointment of new Directors to the Board. There shall also be procedures in place for the orderly succession of appointments to the Board.	✓ See extent			The Board evaluates recommendations made to appoint new Directors when the need arises. A sufficient background review is carried out to assess the suitability of a nominee prior to appointment. Formal procedures on appointments to be drafted with the setting up of a Nominations Committee.
4. (10) All Directors appointed to fill a casual vacancy shall be subject to election by shareholders at the first General Meeting after their appointment.	✓			
4. (11) If a Director resigns or is removed from office, the Board shall announce to the shareholders and notify the Director of the Department of Supervision of Non-Bank Financial Institutions of the Central Bank of Sri Lanka, regarding the resignation of the Director or removal and the reasons for such resignation or removal, including but not limited to information relating to the relevant Director's disagreement with the Board, if any.	✓			All Director resignations and new appointments for the period have been informed to the Department of Supervision of Non-Bank Financial Institutions accordingly. Shareholders are informed through announcements made to the Colombo Stock Exchange.
5. Criteria to Assess the Fitness and Propriety of Directors **5. (1)** Subject to the transitional provisions contained herein, a person over the age of 70 years shall not serve as a Director of a finance company.	✓			
5. (2) A Director of a finance company shall not hold office as a Director or any other equivalent position in more than 20 companies/societies/ corporate bodies, including associate companies and subsidiaries of the finance company. Provided that such a Director shall not hold office of a Director or any other equivalent position in more than 10 companies that are classified as Specified Business Entities in terms of the Sri Lanka Accounting and Auditing Standards Act No. 15 of 1995.	✓			No Director holds office in over 20 companies.
6. Delegation of Functions **6. (1)** The Board shall not delegate any matters to a Board committee, Chief Executive Officer, Executive Directors or key management personnel, to an extent that such delegation would significantly hinder or reduce the ability of the Board as a whole to discharge its functions.				
6. (2) The Board shall review the delegation processes in place on a periodic basis to ensure that they remain relevant to the needs of the finance company.	✓			

Direction requirement (with section number of the Direction)	Complied	Not complied	N/A	Extent of adoption (2012 update)
7. The Chairman and the Chief Executive Officer				
7. (1) The roles of Chairman and Chief Executive Officer shall be separated and shall not be performed by the one and the same person after 3 years commencing from 1 January 2009.	✓			The Board has appointed a Non-Executive Chairman and a separate Managing Director keeping the roles separate. (No separate Chief Executive Officer.)
7. (2) The Chairman shall be a Non-Executive Director. In the case where the Chairman is not an Independent Non-Executive Director, the Board shall designate an Independent Non-Executive Director as the Senior Director with suitably documented terms of reference to ensure a greater independent element. The designation of the Senior Director shall be disclosed in the finance company's Annual Report.	✓			
7. (3) The Board shall disclose in its Corporate Governance Report, which shall be an integral part of its Annual Report, the name of the Chairman and the Chief Executive Officer and the nature of any relationship [including financial, business, family or other material/relevant relationship(s)], if any, between the Chairman and the Chief Executive Officer and the relationships among members of the Board.	✓			No material relationship between Chairman and Managing Director. Directors, Mr. Gerard G. Ondaatjie, Ms. Angeline M. Ondaatjie and Mr. Travice J. Ondaatjie are of the same family.
7. (4) The Chairman shall - (a) provide leadership to the Board; (b) ensure that the Board works effectively and discharges its responsibilities; and (c) ensure that all key issues are discussed by the Board in a timely manner.	✓			
7. (5) The Chairman shall be primarily responsible for the preparation of the agenda for each Board meeting. The Chairman may delegate the function of preparing the agenda to the Company Secretary.	✓			The Chairman makes certain, that matters of importance are taken up for discussion through a formal agenda prepared by the Company Secretary. The agenda is duly circulated to the Directors early for effective participation.
7. (6) The Chairman shall ensure that all Directors are informed adequately and in a timely manner of the issues arising at each Board meeting.	✓			
7. (7) The Chairman shall encourage each Director to make a full and active contribution to the Board's affairs and take the lead to ensure that the Board acts in the best interests of the finance company.	✓			
7. (8) The Chairman shall facilitate the effective contribution of Non-Executive Directors in particular and ensure constructive relationships between Executive and Non-Executive Directors.	✓			
7. (9) Subject to the transitional provisions contained herein, the Chairman, shall not engage in activities involving direct supervision of key management personnel or any other executive duties whatsoever.	✓			

Direction requirement (with section number of the Direction)	Complied	Not complied	N/A	Extent of adoption (2012 update)
7. (10) The Chairman shall ensure that appropriate steps are taken to maintain effective communication with shareholders and that the views of shareholders are communicated to the Board.	✓			The Company AGM provides opportunity for shareholders to interact with the Board. Matters raised at AGMs are taken up for subsequent deliberation by the Board depending on its significance.
7. (11) The Chief Executive Officer shall function as the apex executive-in-charge of the day-to-day management of the finance company's operations and business.	✓			Managing Director functions as the apex executive-in-charge of the day-to-day management. (In place of a Chief Executive Officer.)

8. Board Appointed Committees

Direction requirement (with section number of the Direction)	Complied	Not complied	N/A	Extent of adoption (2012 update)
8. (1) Every finance company shall have at least two Board committees set out in paragraphs 8.2 and 8.3 here of. Each committee shall report directly to the Board. Each committee shall appoint a Secretary to arrange its meetings, maintain minutes, records and carry out such other secretarial functions under the supervision of the Chairman of the Committee. The Board shall present a report on the performance, duties and functions of each committee, at the Annual General Meeting of the Company.	✓			The Board appointed Audit Committee and the Integrated Risk Management Committee have been set-up in line with the Direction. Separate reports of the two Committees for the period have been disclosed in the Annual Report.
8. (2) Audit Committee The following shall apply in relation to the Audit Committee:	✓			
8.2 a. The Chairman of the Committee shall be a Non-Executive Director who possesses qualifications and experience in accountancy and/or audit.	✓			
8.2 b. The Board members appointed to the Committee shall be Non-Executive Directors.	✓			
8.2 c. The Committee shall make recommendations on matters in connection with - (i) the appointment of the External Auditor for audit services to be provided in compliance with the relevant statutes; (ii) the implementation of the Central Bank guidelines issued to Auditors from time to time; (iii) the application of the relevant accounting standards; and (iv) the service period, audit fee and any resignation or dismissal of the Auditor, provided that the engagement of an audit partner shall not exceed five years, and that the particular audit partner is not re-engaged for the audit before the expiry of three years from the date of the completion of the previous term.	✓			
8.2 d. The Committee shall review and monitor the External Auditor's independence and objectivity and the effectiveness of the audit processes in accordance with applicable standards and best practices.	✓			

Direction requirement (with section number of the Direction)	Complied	Not complied	N/A	Extent of adoption (2012 update)
8.2 e. The Committee shall develop and implement a policy with the approval of the Board on the engagement of an External Auditor to provide non-audit services that are permitted under the relevant statutes, regulations, requirements and guidelines.	✓			
8.2 f. The Committee shall, before the audit commences, discuss and finalise with the External Auditors the nature and scope of the audit.	✓			
8.2 g. The Committee shall review the financial information of the finance company, in order to monitor the integrity of the Financial Statements of the finance company, its Annual Report, accounts and periodical reports prepared for disclosure, and the significant financial reporting judgments contained therein.	✓			
8.2 h. The Committee shall discuss issues, problems and reservations arising from the interim and final audits, and any matters the Auditor may wish to discuss including those matters that may need to be discussed in the absence of key management personnel, if necessary.	✓			
8.2 i. The Committee shall review the External Auditors' management letter and the management's response thereto.	✓			
8.2 j. The Committee shall take the following steps with regard to the internal audit function of the finance company: i. Review the adequacy of the scope, functions and resources of the Internal Audit Department, and satisfy itself that the department has the necessary authority to carry out its work.	✓			
ii. Review the internal audit programme and results of the internal audit process and, where necessary, ensure that appropriate actions are taken on the recommendations of the Internal Audit Department.	✓			
iii. Review any appraisal or assessment of the performance of the head and senior staff members of the Internal Audit Department.	✓			
iv. Recommend any appointment or termination of the head, senior staff members and outsourced service providers to the internal audit function.	✓			
v. Ensure that the Committee is apprised of resignations of senior staff members of the Internal Audit Department including the Chief Internal Auditor and any outsourced service providers, and to provide an opportunity to the resigning senior staff members and outsourced service providers to submit reasons for resigning.	✓			
vi. Ensure that the internal audit function is independent of the activities it audits and that it is performed with impartiality, proficiency and due professional care.	✓			

Direction requirement (with section number of the Direction)	Complied	Not complied	N/A	Extent of adoption (2012 update)
8.2 k. The Committee shall consider the major findings of internal investigations and management's responses thereto.	✓			
8.2 l. The Chief Finance Officer, the Chief Internal Auditor and a representative of the External Auditors may normally attend meetings. Other Board members and the Chief Executive Officer may also attend meetings upon the invitation of the Committee. However, at least once in six months, the Committee shall meet with the External Auditors without the Executive Directors being present.	✓ See extent			External Auditors are invited at least once a year.
8.2 m. The Committee shall have - (i) explicit authority to investigate into any matter within its terms of reference; (ii) the resources which it needs to do so; (iii) full access to information; and (iv) authority to obtain external professional advice and to invite outsiders with relevant experience to attend, if necessary.	✓			
8.2 n. The Committee shall meet regularly, with due notice of issues to be discussed and shall record its conclusions in discharging its duties and responsibilities.	✓			
8.2 o. The Board shall, in the Annual Report, disclose in an informative way (i) details of the activities of the Audit Committee; (ii) the number of Audit Committee meetings held in the year; and (iii) details of attendance of each individual member at such meetings.	✓			Details of the Audit Committee have been disclosed in pages 61 and 77 in the Annual Report.
8.2 p The Secretary to the Committee (who may be the Company Secretary or the head of the internal audit function) shall record and keep detailed minutes of the Committee meetings.	✓			
8.2 q The Committee shall review arrangements by which employees of the finance company may, in confidence, raise concerns about possible improprieties in financial reporting, internal control or other matters. Accordingly, the Committee shall ensure that proper arrangements are in place for the fair and independent investigation of such matters and for appropriate follow-up action and to act as the key representative body for overseeing the finance company's relations with the External Auditor.	✓			

Direction requirement (with section number of the Direction)	Complied	Not complied	N/A	Extent of adoption (2012 update)
8. (3) Integrated Risk Management Committee (IRMC)				
The following shall apply in relation to the Integrated Risk Management Committee: 8.3 a. The Committee shall consist of at least one Non-Executive Director, CEO and key management personnel supervising broad risk categories, i.e., credit, market, liquidity, operational and strategic risks. The Committee shall work with key management personnel closely and make decisions on behalf of the Board within the framework of the authority and responsibility assigned to the Committee.	✓			A separate update is given under the caption 'Integrated Risk Management Committee' on page 78 in the Corporate Governance Report.
8.3 b. The Committee shall assess all risks, i.e., credit, market, liquidity, operational and strategic risks to the finance company on a monthly basis through appropriate risk indicators and management information.	✓ See extent			The relevant members of the Committee are expected to monitor key risks aspects under their purview closely and thereafter meet on a quarterly basis to submit matters that are deemed significant for the Committee's deliberation.
8.3 c. The Committee shall review the adequacy and effectiveness of all management level committees such as the Credit Committee and the Asset Liability Committee to address specific risks and to manage those risks within quantitative and qualitative risk limits as specified by the Committee.	✓ See extent			The Committee reviews reports issued by the Internal Auditors of the Company on the level of compliance to regulatory requirements etc. Reviewing the effectiveness of the Credit Committee and the Management Committee to be looked at from the next period.
8.3 d. The Committee shall take prompt corrective action to mitigate the effects of specific risks in the case such risks are at levels beyond the prudent levels decided by the Committee on the basis of the finance company's policies and regulatory and supervisory requirements.	✓			
8.3 e. The Committee shall meet at least quarterly to assess all aspects of risk management including updated business continuity plans.	✓			
8.3 f. The Committee shall take appropriate actions against the officers responsible for failure to identify specific risks and take prompt corrective actions as recommended by the Committee, and/or as directed by the Director of the Department of Supervision of Non-Bank Financial Institutions of the Central Bank of Sri Lanka.	✓			

Direction requirement (with section number of the Direction)	Complied	Not complied	N/A	Extent of adoption (2012 update)
8.3 g. The Committee shall submit a risk assessment report within a week of each meeting to the Board seeking the Board's views, concurrence and/or specific directions.	✓ See extent			The Board to be informed of matters on potential risks as and when material and deemed necessary. The Committee prepares a report on their scope and broad activities carried out for the period which is disclosed in the Annual Report.
8.3 h. The Committee shall establish a compliance function to assess the finance company's compliance with laws, regulations, directions, rules, regulatory guidelines, internal controls and approved policies on all areas of business operations. A dedicated compliance officer selected from key management personnel shall carry out the compliance function and report to the Committee periodically	✓ See extent			The review of company's level of compliance to laws and regulations has been entrusted to the Internal Auditors who are independent of officers handling operations of the Company. Their findings are directly reviewed by the Committee to assess compliance risk.
9. Related Party Transactions				
9. (1) The following shall be in addition to the provisions contained in the Finance Companies (Lending) Direction No. 1 of 2007 and the Finance Companies (Business Transactions with Directors and their Relatives) Direction No. 2 of 2007 or such other Directions that shall repeal and replace the said Directions from time to time.	✓			
9. (2) The Board shall take the necessary steps to avoid any conflicts of interest that may arise from any transaction of the finance company with any person, and particularly with whoever shall be considered as 'related parties' for the purposes of this Direction.	✓			No favourable treatment has been given to related parties for transactions effected. Transactions with related parties are done only after necessary due diligence.
9. (3) The transactions with a related party that are covered in this Direction shall be the following: a. Granting accommodation. b. Creating liabilities to the finance company in the form of deposits, borrowings and investments. c. Providing financial or non-financial services to the finance company or obtaining those services from the finance company. d. Creating or maintaining reporting lines and information flows between the finance company and any related party which may lead to share proprietary, confidential or otherwise sensitive information that may give benefits to such related party.	✓			
9. (4) The Board shall ensure that the finance company does not engage in transactions with a related party in a manner that would grant such party 'more favourable treatment' than that is accorded to other similar constituents of the finance company.	✓			

Direction requirement (with section number of the Direction)	Complied	Not complied	N/A	Extent of adoption (2012 update)
10. Disclosures	✓			
10. (1) The Board shall ensure that - (a) annual Audited Financial Statements and periodical Financial Statements are prepared and published in accordance with the formats prescribed by the regulatory and supervisory authorities and applicable accounting standards, and that (b) such statements are published in the newspapers in an abridged form, in Sinhala, Tamil and English.				In preparing the Audited Financial Statements, the Company has followed the applicable accounting standards and regulatory requirements. Half yearly publication of financials is done in all three languages and conforms to the regulatory interim publication format and the applicable accounting standards.
10. (2) The Board shall ensure that at least the following disclosures are made in the Annual Report:				
10.2 a. A statement to the effect that the Annual Audited Financial Statements have been prepared in line with applicable accounting standards and regulatory requirements, inclusive of specific disclosures.	✓			Relevant disclosures available in the Directors' Responsibility Statement given in Page 150 in the Annual Report.
10.2 b. A report by the Board on the finance company's internal control mechanism that confirms that the financial reporting system has been designed to provide a reasonable assurance regarding the reliability of financial reporting, and that the preparation of Financial Statements has been done in accordance with relevant accounting principles and regulatory requirements.	✓			A report by the Board on the effectiveness of the Company's Internal Control mechanism is given on page 153 in the Annual Report.
10.2 c. The External Auditors' certification on the effectiveness of the internal control mechanism in respect of any statements prepared or published after 31 March 2010.	✓			As required, the Company obtained External Auditors' certification on the effectiveness of the Internal Control mechanism during the period.
10.2 d. Details of Directors, including names, transactions with the finance company.	✓			The transactions of the Directors have been disclosed under the Directors' Interest in Contracts on pages 146 to 149 and in the 'related party disclosure' in the Notes to the Financial Statement on page 188.
10.2 e. Fees/remuneration paid by the finance company to the Directors in aggregate, in the Annual Reports published after 1 January 2010.	✓			Remuneration paid to Directors has been disclosed in aggregate on page 188 in notes to the financials.
10.2 f. Total net accommodation as defined in paragraph 9 (4) outstanding in respect of each category of related parties and the net accommodation outstanding in respect of each category of related parties as a percentage of the finance company's capital funds.	✓			Net accommodation to related parties has been disclosed on pages 146 to 149 in the Annual Report.

Direction requirement (with section number of the Direction)	Complied	Not complied	N/A	Extent of adoption (2012 update)
10.2 g. The aggregate values of remuneration paid by the finance company to its key management personnel and the aggregate values of the transactions of the finance company with its key management personnel during the financial year, set out by broad categories such as remuneration paid, accommodation granted and deposits or investments made in the finance company.	✓			The transactions of key management personnel have been disclosed under 'Directors Interest in Contracts' on pages 146 to 149 and in the 'related party disclosure' in the Notes to the Financial Statements on page 188.
10.2 h. A report setting out details of the compliance with prudential requirements, regulations, laws and internal controls and measures taken to rectify any non-compliances.	✓			'The Annual Report of the Board of Directors' signed by the Directors given on pages 141 to 145 gives a collective confirmation on compliance with applicable laws and regulations. 'The Directors responsibility for Financial Reporting' given on page 150 provides confirmation on regulations relating to financial reporting.
10.2 i A statement of the regulatory and supervisory concerns on lapses in the finance company's risk management, or non-compliance with the Act, and rules and directions that have been communicated by the Director of the Department of Supervision of Non-Bank Financial Institutions, if so directed by the Monetary Board to be disclosed to the public, together with the measures taken by the finance company to address such concerns.	✓			None so requested to be disclosed.
10.2 j The External Auditor's certification of the compliance with the Act and rules and Directions issued by the Monetary Board in the Annual Corporate Governance Reports published after 1 January 2011.	✓ See extent			As required, External Auditors certification of the compliance to Act, rules and directions was obtained for the period. The matter highlighted by the External Auditors will be dealt with in the next financial year.

Meetings of the Board

Board Meetings are held in monthly intervals to ensure operations are conducted effectively and to monitor Company performance closely. The Company Secretary circulates the Notice of Meeting with relevant information seven days prior to the date of meeting for Directors to be better prepared. For this purpose, the monthly management accounts with key statistics are circulated to all members together with information pertaining to other matters that are planned to be taken up for the meeting. Opportunity is given for Directors to incorporate significant matters, proposals and statistics in the agenda for the meetings.

To discharge one's obligations, the Board of MI oversees and directs the Company in both the shorter period and the longer horizon. This involves strategy setting, policy making and issuing outboard decisions to the corporate management for their implementation and separate monitoring progress. During meetings, Board papers tabled by heads of divisions are taken up for discussion and approved. The Board also authorises circulars and deliberates on significant matters that require their attention and expertise.

MI Board comprises members who have vast work experience and members who possess qualifications relevant to their specific expert areas. The Board has been enriched with new members in the last two years including three new members during this period. The influx of additional knowledge and expertise accordingly has been fruitful as meetings are conducted with intense discussion and deliberation when forming decisions.

Directors' attendance at Board meetings for the financial year 2012 is as follows:

Subcommittees of the Board

To effectively discharge Board's duties several sub-committees have been set up with Director participation. Members have been selected based on their level of experience and expertise in relation to respective committees to ensure each committee performs its specific role more effectively. The subcommittees in essence oversee specific critical aspects handled by the Corporate Management to whom authority has been delegated by the Board for the conduct of daily tasks.

The Board understands the importance of monitoring key business areas more closely especially credit, liquidity, interest rates etc. The subcommittees see that the management exercises its authority within the framework stipulated by the Board. In effect, it is vital for the Board to obtain feedback from subcommittees on the status of implementation with regard to strategies and policies set forth by them and to identify potential risks that prevail and to recommend counter measures.

The Audit Committee

Range of duties handled by the Audit Committee is explained in Code D.3 in Statement 01 on Adoption of Corporate Governance Principles given in this supplement. During this period, in line with the Corporate Governance Direction, the Audit Committee appointed a new Chairman for the Committee. The Chairman, Mr. H.A.S.T. Senanayake, is an Associate Member of The Institute of Chartered Accountants of Sri Lanka and Mr. S.M.S.S. Bandara of the Committee is a Fellow Member of The Institute of Chartered Accountants of Sri Lanka with extensive experience in the finance, audit and other related fields.

Name of Director	Directorship status	Number of meetings held in F/Y 2012	Meetings attended in F/Y 2012
S.H.J. Weerasuriya	Chairman (Independent Non-Executive Director)	12	11
Gerard G. Ondaatjie	Managing Director	12	11
S.H. Jayasuriya	Executive Director	12	12
M.B. Assauw*	Executive Director	12	09
P.M. Amarasekara	Executive Director	12	10
Angeline M. Ondaatjie	Executive Director	12	10
Travice J. Ondaatjie	Executive Director	12	11
J.S. Dominic*	Independent Non-Executive Director	12	09
H.A.S.T. Senanayake	Independent Non-Executive Director	12	10
P.T.K. Navaratne**	Independent Non-Executive Director	12	03
N.H.V. Perera***	Non Executive Director	12	02
S.M.S.S. Bandara***	Independent Non-Executive Director	12	02

** Resigned as Director in December 2011 and January 2012 respectively.*

*** Joined the Board as Non-Executive Director from January 2012.*

**** Joined the Board as Non-Executive Directors from February 2012.*

In the course of executing its role, the Committee invites Internal Auditors for all meetings to deliberate and discuss matters raised by them in their periodic review reports. The Committee also ensures that it invites the Company's External Auditors annually for Committee meetings to obtain feedback on important matters identified during their statutory review. In addition, the Audit Committee calls for supplementary reports from the management to meet ultimate objectives of the Committee.

The Report of the Audit Committee is shown in page 154 of the Annual Report.

Audit Committee meetings held for the year including details on member participation is shown below:

Name of Director	Directorship status	Number of meetings held in F/Y 2012	Meetings attended in F/Y 2012
H.A.S.T. Senanayake (Chairman of the Committee)	Independent Non-Executive Director	02	02
S.H.J. Weerasuriya	Chairman (Independent Non-Executive Director)	02	02
J.S. Dominic*	Independent Non-Executive Director	02	01
S.M.S.S. Bandara**	Independent Non-Executive Director	02	–

** Resigned from the Audit Committee in December 2011.*

*** Joined the Audit Committee in February 2012 on appointment to the Board.*

The Remuneration Committee

During the period, the Board appointed a new Chairman to head the Remuneration Committee. The Committee comprises three members of the Board that meet to look into matters on remuneration and related policies. The Committee's main task is the evaluation of remuneration of Board members and recommendations relating to the Board members remunerations. Furthermore, when need arises, the Committee involves itself in decisions on retirement benefits as part of its scope.

The Remuneration Committee Report is given on page 152 in the Annual Report.

Information on Committee meetings held with attendance of members are given below:

Name of Director	Directorship status	Number of meetings held in F/Y 2012	Meetings attended in F/Y 2012
S.H.J. Weerasuriya (Chairman of the Committee)	Chairman (Independent Non-Executive Director)	01	01
H.A.S.T. Senanayake	Independent Non-Executive Director	01	01
J.S. Dominic*	Independent Non-Executive Director	01	–
N.H.V. Perera**	Non-Executive Director	01	–

** Resigned from the Remuneration Committee in December 2011.*

*** Joined the Remuneration Committee in February 2011 on appointment to the Board.*

The Integrated Risk Management Committee

The newly appointed Chairman of the Committee in 2012 is a Non-Executive Director while balance members comprise three other Directors who oversee core areas of the business in their executive function. Main task of the Committee is the overseeing function related to the Company's risk management process with the intention of closely monitoring types of risk and the issue of instructions to strengthen the risk management process. The establishment of this higher authoritative Committee provides the right supervisory role to the senior management when managing risks to either avoid or mitigate risks inherent to the Company that specially focuses on interest rate risk, credit risk, operational risk and liquidity risk.

As part of its tasks, the Committees carried out risk assessments related to core functions of the business and determined risk levels in relation to described core risk categories. As part of managing potential risks, the Committee reviewed the existing risk management policies and controls in place and oversaw the effectiveness of the Management's risk handling process. When reviewing liquidity risk, the Committee studied maturity mismatches in the short and long-term periodically. As means of minimising any prevalent maturity mismatches or gaps, the Committee decided on various courses of actions including exploring means of obtaining longer term funding. The Committee evaluated liquidity mismatches against expectable norms and brainstormed to develop effective strategies to minimise gaps.

The Committee extended its scope by reviewing prevailing interest rate structures, comparing such rates against market rates to determine the Company's competitiveness in the light of growing players in the sector. Any effects of interest rate changes in the light of macro and microeconomic changes affecting the bottom line of the Company was evaluated to establish the Company's level of exposure to interest rate risks. As other key risks, the Committee reviewed operational risk factors through the review of department specific procedure manuals and periodic internal audit reports to establish effectiveness of current procedures in the light of growing business changes and evolving risk patterns.

The Report by the Integrated Risk Management Committee has been disclosed in page 151 in the Annual Report.

Details of meetings held by the Committee for the year and level of member participations are given below:

Name of Director	Directorship status	Number of meetings held in F/Y 2012	Meetings attended in F/Y 2012
N.H.V. Perera** (Chairman of the Committee)	Non- Executive Director	04	01
Gerard G. Ondaatjie	Managing Director	04	04
S.H. Jayasuriya	Executive Director	04	04
P.M. Amarasekara	Executive Director	04	04
J.S. Dominic*	Independent Non-Executive Director	04	03
M.B. Assauw*	Executive Director	04	03

** Resigned from the Integrated Risk Management Committee in December 2011 and January 2012 respectively.*

*** Joined the Committee from February 2012 as the Chairman of the Committee.*

Other Committees

The Credit Committee

The Credit Committee of the Company is headed by the Managing Director of the Company acting as the Chairman of the Committee and is joined by the Director - Recoveries and GM - Credit and Marketing to closely review critical matters on credit.

As part of its scope, the Committee reviews existing lending policies, credit risk evaluations of customers and the creditworthiness of customers and guarantors of high risk accounts. To fulfil main objectives of the Committee which include minimising the possibility of customer default and facilitating quality lending, large value lending accounts are reviewed constantly. As a practice, lending over a stipulated limit is scrutinised so that the recovery process takes place smoothly. Exposure limits that set the parameters for selecting customer accounts for review take into consideration lending growth percentages, absolute exposure values and risk levels of counterparties. The review process also takes note of the Company's exposure levels to various sectors. Considering this, the Committee carries out assessments to gather extent of risks prevalent in such sectors which enable the Credit Division to decide feasible sectors to lend.

Human Resource Management

Human resource policies and practices of the Company including aspects on career development, staff evaluation process, working environment and staff benefits have been discussed in-depth under the section 'Employee Obligations' in our Sustainability Report on pages 113 to 119.

Initiatives on Corporate Social Responsibility

The Sustainability Report given on pages 100 to 134 provides a comprehensive account of our CSR initiatives taken this year covering the economic, social and environmental aspects. We have understood the necessity to bring forth sustainable development practices on a continuous basis with the hope of fostering a sustainable nation as we bear fruits from our own successful business journey.

Compliance to Laws and Regulations

The newly introduced Finance Business Act to the finance company sector in this period consequent to the Finance Companies Act and related amendments that were effective previously are now applicable to the Company. The prevailing statutory regulations on 'capital adequacy' and 'liquidity' have been complied by the Company through a close monitoring process adopted by the management of MI.

In addition, the Company complies with requirements pertaining to the Corporate Governance Direction No. 03 of 2008 and related amendments that have become essential in improving governance practices to sustain continued security and stability to the sector. The 'Statement on Adoption of Corporate Governance Principles' given in this supplement provides the Company's compliance to the said Corporate Governance Direction in addition to disclosure on MI's level of adoption to best practices laid down by other bodies.

As other key enactments related to the sector, we follow requirements of the Companies Act No. 07 of 2007, and complies with the Financial Transactions Reporting Act No. 06 of 2006 (FTRA) on Anti-Money Laundering and the Combating of Financing for Terrorism. In following the FTRA, we have established standard review policies on customer identification for our core business of deposits and lending prior to transacting with a third party. General business regulations such as the Inland Revenue Act No. 10 of 2006 and related amendments that prevail on taxation is adhered in co-ordination with our tax consultants after seeking necessary clarification when new regulations are enacted. Furthermore, to keep abreast of prevailing regulations, training is provided to MI staff by sending key officers for seminars and workshops externally. Similarly, in-house training is provided on selected topics depending on resource availability.

The Audit Committee, as part of their scope, overseas the Company's level of compliance to these wide-ranging applicable laws and regulations. The internal audit provides feedback to the Committee periodically on Company's level of compliance to these key regulations. As appropriate, new enactments are communicated to the Board by relevant heads of divisions while following up on matters arising from such regulations to ensure implementations take place promptly.

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Healthy business flows nourish and nurture our business landscape and yield fruits of enterprise that are not only attractive…but completely safe to saviour sans any risk.

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Risk Management

Financial Business and Risk Management

Finance business like any other industry inherits various forms of risks but is highly susceptible to risk such as credit risk, interest rate risk and operational risk. The financial crises witnessed globally in the recent past provide sufficient evidence of these significant risks eventually materialising, bringing the downfall of even renowned international financial businesses that were not geared for such crises and that had under par risk management practices.

Transactions related to Finance business evolve daily and have become complex over the years. This has created additional risks to the sector and has brought about the need to adopt sound risk management techniques to prevent or mitigate core risks and to safeguard annual profits and assets of a company. Risk management objectives of companies are therefore aligned to strike an appropriate balance between risk and rewards in order to maximise shareholder wealth. To prevent losses to stakeholders of finance companies, a surge of regulations were introduced by the regulator in recent years to counter potent risks. These attempts have stabilised the sector and revitalised public confidence once again.

MI's Strategy for Risk Management

MI adopts a risk management strategy that focuses initially on understanding the potential risk the company faces, making risk assessments and measuring risk levels. The risk management process entails the implementation of policies and procedures laid forth to counter risk at various levels and to monitor the level of risk continuously to evaluate the effectiveness of techniques adopted in risk mitigation.

MI has adopted own policies and procedures that have evolved over the years coupled with industry best practices to create an effective risk management system. Our processes revolve around achieving an appropriate trade-off between risk and rewards to deliver a superior shareholder value. Annually, we deploy considerable level of resources to maintain this process in an effective manner.

We continuously review risk management practices to ensure that it is streamlined to achieve objectives of our risk management system. Other than meeting shareholder perception, risk management objectives are aimed at ultimately meeting customer expectations and obligations while preserving the solvency of the enterprise according to the risk profile expectations laid down preliminarily.

To execute the risk management process, MI adopts a formal top down hierarchical approach that commences from Board level and passes down to the next level being the senior management level. Senior management is entrusted with the task of managing risk within their area of duty while carrying out routine functions relevant to the department. An illustrative representation of the risk management structure at MI is given below and explained in depth in ensuing paragraphs. The structure maps the importance of specific committees and the audit function in keeping together a well-balanced risk management framework that requires governance from Board level to independent reviews being carried on an ongoing basis.

Board's Governance in Meeting Risk Management Obligations

The ultimate responsibility for risk management lies with the Board of MI. The Board in discharging its obligations towards risk management has established two key sub-committees for monitoring key risk attributable to the Company, i.e., the Audit Committee and the Integrated Risk Management Committee (IRMC). These subcommittees have adequate representation of Board members who are well-conversant on the subject. The Board is able to obtain first-hand information on specific risk and closely monitors risk through these committees and reviews measures taken at subcommittee level and at management level in mitigating such risk on an ongoing basis.

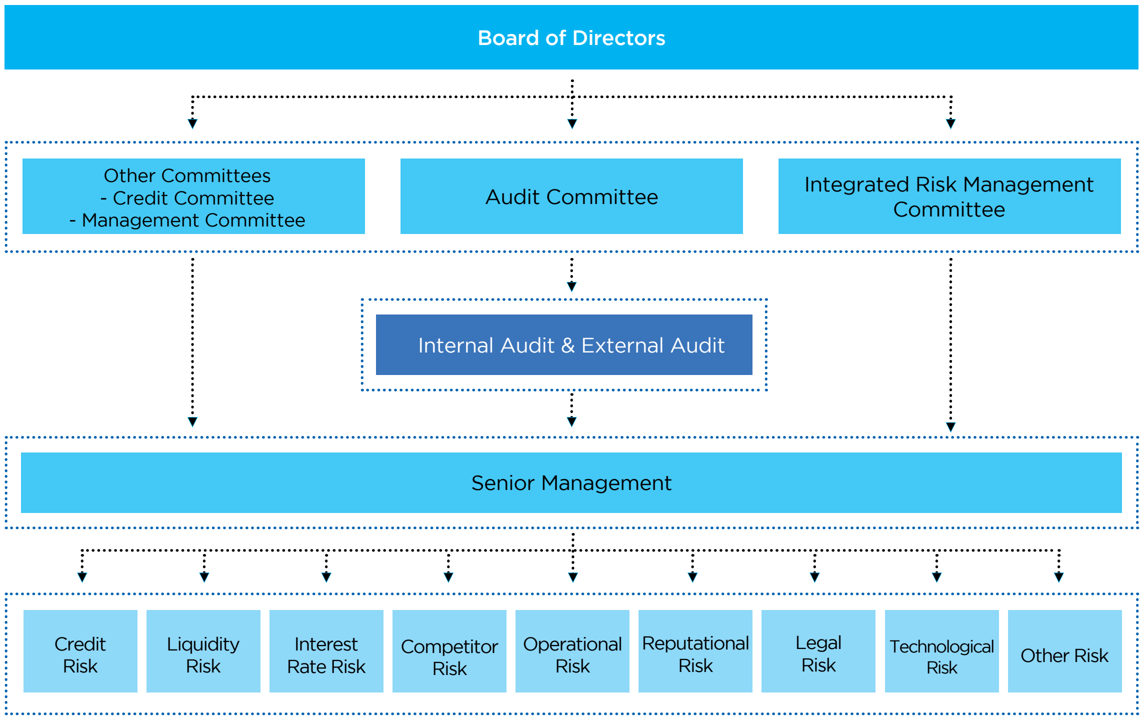
IRMC's Role in Risk Management

The IRMC assists the Board by overseeing MI's risk management strategies, policies and processes that have been established to safeguard earnings and assets of the company. The Committee meets on a quarterly basis and carries out risk assessments on key risk including liquidity risk, interest rate risk and operational risk by studying reports and statistics tabled by respective heads of divisions. This includes reviewing the maturity profile of MI's assets and liabilities and current strategies that have been put forward to address existing mismatches in the short and long term. The Committee in meeting its obligations reviewed interest rates on lending and deposits together while correlating information on their applicable periods. These studies enable the Committee to assess anticipated rate changes and its impact to profitability. To assess operational risk, the Committee recently reviewed the adequacy of current procedures and policies that have been adopted by respective core operational divisions including Credit, Deposits and Recoveries.

Audit Committee's Role in Risk Management

The Audit Committee assists the Board in reviewing the adequacy of internal controls that have been instilled in our operations and processes to safeguard Company's assets and to counter risks at transaction level as well as risk at macro level. The Committee reviews quarterly reports of Internal Auditors to obtain a feedback of management's compliance to laid-down procedures and controls including adherence to laws and regulations.

MI's Risk Management Structure



The Audit Committee maintains its independence as it comprises of independent Non-Executive Directors, who when need arises, report to the Board on any significant matters they would come across when discharging their obligations. As part of its scope, the Committee meets the External Auditors on the annual statutory audit to discuss any significant risk matters and review reporting requirements of the Company.

Significance of Other Committees in Supporting Risk Management

Specific committees that meet at management level periodically focus on core aspects of business more closely and support in managing risk associated with their respective areas. Namely:

- **Credit Committee**

The Committee is entrusted to monitor the quality of credit granted and to manage risk inherent to lending. The Committee monitors high value overdue accounts and establishes strategies to improve credit quality and reduce overdue levels.

- **Management Committee**

Management Committee was set up during this period with the intention of monitoring organisation's performance very closely and commenced meeting regularly on a weekly basis. The Committee reviewed in-depth actuals against targets on lending, deposits canvassing, other business, costs and profitability. The Committee comprises of key members of divisions headed by the Managing Director. Having set up this Committee in mid-August 2011, the senior management of the Company was able to acquire up to date information more frequently which enabled them to be more proactive in a volatile setting. By having a close monitoring process on core activities we were able to resolve prevalent gaps speedily and reduce risks more effectively than before.

Senior Management's Role in Risk Management

The responsibility to actually implement the established risk management policies and procedures is ultimately passed down to the senior management of the Company. MI's corporate management structure has been established with clear separation of organisational functions and responsibilities, on a set of tools and procedures that encompasses a system of in-house control checks that direct the needed precision in carrying out operations. To execute this structure in an efficient manner, the Company possesses highly competent and experienced staff who have the precise management orientation needed to perform given tasks.

The senior management is required to carry out risk assessments related to their departmental functions and to implement the appropriate risk mitigation techniques. Each division is expected to constantly review existing processes and controls and the extent of its implementation in the light of the changing environment and take appropriate precautions by updating existing procedures and controls when necessary. The Company's 'Procedure Manual' prepared in 2009 was a significant development that enabled senior management to communicate standard practices to their subordinates in respective divisions. Through clear communication of operational guidelines to staff, management of the Company has been able to guide new recruits and staff with new roles to fit into their assigned positions quite efficiently thus minimising operational lapses.

Mi's Approach to Managing Significant Risks

Credit Risk

Credit risk arises when a borrower is unable to meet his financial obligations towards the lender. Being in the business of lending, credit risk is regarded as the most potential risk facing the sector. Managing credit risk is considered priority, since, if handled inappropriately, it could result in bad debts that will eventually bring down the profitability of a company. To counter credit risk, MI has laid down stringent procedures for disbursement of credit which is documented and covers practices until the borrower completes his repayments in full. By establishing well-defined credit policies and resorting to sound credit practices, MI has been able to possess a quality lending portfolio with a low level of non-performing lending accounts. The credit disbursement process is streamlined to ensure authority is properly delegated to credit officers depending on their grade. This process takes into account relevant staff members' work experience and skill level. The credit policies outline authorisation limits that extend up-to Director level depending on the value and complexity of the credit to be disbursed.

As means of credit control, proposed facilities are subject to an independent review by the next level of authority. Significant Lendings that have experienced deterioration in repayment are regularly subject to credit examinations. The Credit Committee provides its expert knowledge by reviewing accounts needing their attention which are generally of high value. At the same time, MI's Internal Auditors carry out comprehensive credit reviews periodically based on a predetermined audit programme. They cover the adequacy of existing credit policies, procedures and compliance to them including adherence to credit regulation. Their observations and suggestions on Improving existing control systems and processes especially related to credit are informed to the Audit Committee via periodic reports. The Audit Committee in turn reviews the adequacy of existing controls on behalf of the Board and follows up on such audit observations and recommendations.

Prior to disbursement, MI's Credit Division follows a checklist of standard verifications to ensure the quality of lending is safeguarded. This encompasses review of a customer's credit worthiness including reference to the Credit Information Bureau (CRIB) and carrying out site visits. At the preliminary stage, information is gathered on the borrower's financial position, assessing and concluding on the current financial position and the repayment capacity through a formal 'credit appraisal'. Thereafter the credit approval process takes into account the type of credit arrangement, either for a given transaction or total exposure to the client or to a particular industry sector. To minimise the Company's exposure to credit risk, appropriate collateral is obtained as an additional safeguard covering the required exposure levels. We ensure that lending is backed by realisable security and is carried out in accordance with prevailing regulations.

To improve skills in credit disbursement, officers attached to the Credit and Marketing are subject to thorough training programmes that cover aspects on credit appraisal, credit procedures and focus on enhancing quality of credit decisions. In house lecture programmes coupled with on the job training provides first-hand experience to our new recruits on the essentials of the credit process. The Recoveries Division of MI works hand in hand with the Credit and Marketing Division to ensure smooth collection of instalments with special attention given to overdue accounts.
To support the credit and recovery process, the Finance Division together with IT Division provides weekly and monthly statistics and financial reports for recovery officers to assess collection performance levels and to plan recovery targets. These practices have enabled management to cut down MI's non-performing lending levels significantly within the last two years.

Interest Rate Risk

As a recent trend, finance companies have witnessed a decline in its spread from core business especially due to price competition within the sector and also due to pressure exerted by the Banking Industry. Despite this, the on going resurgence in the economy has significantly boosted the sector which is evident from the rise in business volumes and overall profitability levels. Nevertheless, the current rise in interest rates and its continued uncertainty and volatility necessitates a dire need to manage associated risks in a more meaningful manner. Managing interest rate risk therefore is vital in maintaining the required margins for businesses to remain profitable.

Monetary policy changes that affect interest rates influence the interest paid on deposits and borrowings and interest received from lending and securities. These changes can lead to fluctuations in net interest income, eventually affecting the bottom line and cash flows of the Company. Interest rate fluctuations could impact MI's (i) ability to canvass deposits and grant loans; (ii) the fair values of financial assets and liabilities; and (iii) average duration of mortgage-backed lease and hire purchase portfolios and other interest earning assets. Interest rate risk, therefore to an extent is unavoidable as in most instances when maturities of assets are not identically matched to those of liabilities as is the case for most companies in the sector.

Rate structures at MI are decided by the Finance Director who oversees the Treasury function of the Company. This is done after giving due consideration to the current market rates, funding position, economic fundamentals, current trends, applicable Central Bank interest rates on Government Securities and by referencing to related regulations. To maintain an optimal level of return, reference is made to Company's average yield level, cost of funding, and the acceptable level of spread. At the same time, on a monthly basis, the maturity profile of assets and liabilities of the Company is reviewed to determine any material impacts to profitability from anticipated rate fluctuations.

In managing associated risk, the Management Committee monitors MI's rate structures against market rates weekly. The Committee evaluates any potential adverse effects that may arise from situations when the cost of funding rises at a relatively higher pace than the yield earned on lending and other investments. Similarly, management closely monitors any decline in interest rates that may affect the Company's net interest income and spread level if interest income from lending and investments fall faster than cost of funding. MI maintains its interest rate risk at moderate levels through a close watch on rates and margins which has enabled management to be proactive in its related decisions.

Liquidity Risk

Seeing liquidity pressures that emerged in 2009 for the sector, finance companies are more prepared nowadays in managing liquidity risks so that they can safeguard public confidence better. The sector has bounced back strongly with improved liquidity positions in recent years and enjoys fruits of the ongoing resurgence in economy. Stringent controls and greater regulation placed on the sector has brought about the needed stability for the sector during this path to recovery. Nevertheless, monitoring liquidity risk is essential for a finance company's success at any point in time especially to ensure there is no disruption to business due to lack of funding and to ensure a liquid position enough to pursue growth aspirations.

Liquidity management objectives of MI primarily focus on maintaining a consistent cash flow that is adequate to fund operations and meet obligations and other commitments on a timely manner, in a cost-effective way. We are financially sound and strong in liquidity. Having cash, other liquid assets and possessing easy access to money markets enable us to meet ongoing operational cash outflows arising from obligations including overhead expenses. Furthermore, we have the needed flexibility to incur capital expenditure for necessary growth when the need arises. Other than our lending portfolio, we possess a share investment portfolio that is liquid and can be traded at any moment in the Colombo Stock Market. We are not exposed to real estate investments that have seen a decline in demand and have become illiquid in recent times. In managing liquidity, we maintained our statutory liquid assets ratio above the regulatory limit during the period in concern. As a practice, we ensure that our statutory liquid assets position is monitored daily especially in the light of a steeply rising deposit base.

MI's liquidity management policy approved by the Board entrusts the routine management of liquidity with the Finance Division that is responsible for all Treasury-related activities. To manage liquidity, the Department daily reviews the funding position against cash commitments and bridges funding needs through available funding sources in the short and medium term. In addition, the Integrated Risk Management Committee as part of their primary objectives oversees and monitors liquidity risk especially on a longer term perspective. The Committee meets quarterly and studies maturity mismatches enabling them to identify maturity gaps early and implement strategies in the medium and long term. To identify associated risks, the Committee reviews the maturity profile of assets and liabilities, growth rates in lending, deposits and the status of our borrowings and gathers knowledge on the prevailing trends in the sector for our main lines of business.

Operational Risk

Operational risk arises from failed or inadequate internal processes, people and systems or from external events leading to losses for an organisation. To mitigate risk arising from operations, appropriate controls have been instilled by the management to detect possible human errors, fraud, faulty internal processors and systems, non-adherence to procedures and non-compliance to regulation. MI adopts a company-wide internal control system that has evolved over the years. Further, we have a comprehensive 'procedure manual' for the organisation which provides clear policies and procedures for each key division so that staff is guided when executing tasks.

MI operational risk management techniques involve the segregation of duties, job rotation, staff training and keeping back-up of significant documents and staff functions. Respective divisions are responsible to execute and monitor internal controls linked to their activities and to evaluate their acceptability over time. This is done through self-assessment and established monitoring mechanisms within divisions. Corporate Management meetings are arranged separately to deliberate on key operational matters and identify issues and risky operations so that specific course of action can be put forth to mitigate related risk and thereafter establish methods to monitor its progress.

Independent verifications carried out by the Internal Auditors on operational activities improve current business processes and practices. When necessary they recommend best operational practices to corporate management with the intention of overcoming related risks. The audit function also provides insight into any operational lapses that may prevail and is an early warning mechanism for management so that management is proactive in its actions thus avoiding operational losses. Furthermore, embedded as part of our corporate culture, each staff member understands the need to follow organisational procedures at all times and takes it seriously.

Information technology plays a major role in operational risk management since required controls could be coupled to our core system operations through the use of state-of-the-art technology. To avoid unauthorised access, infiltration of data and system errors, numerous security controls have been in-built to the main systems. Specific limits have been placed for various user levels for authorisation of a transaction and in certain instances a system of dual control is inbuilt to provide better control over system transactions. Various exception reports are available in the system for management to monitor material transactions on a routine basis. Standard practices ensure that new modules introduced are tested in the live environment and reports are produced for user department's verification, prior to their live implementation. Daily backing-up of the database in a secure off-site location secures company data from system malfunction and corruption. MI systems are appraised closely by well-trained and experienced IT staff who are conversant in the field of IT systems.

A Business Continuity Plan (BCP) for MI was developed in-house in 2009 so that management is better prepared to face any company-wide contingency event which may materialise and disrupt operations. The document sets out prevalent risks especially focusing on operational risk and has time-lined implementation of proposed strategies department-wise to mitigate potential risks related to their functions. This takes into account significant disaster events including flooding, fire, earthquake etc. The BCP Committee set-up upon finalisation of the document is expected to take over disaster management in such an event so that it minimises disruptions to business operations greatly. In addition to these initiatives, MI possesses a strong capital base that is able to withstand potential losses that may arise from specifically operational risk. MI's capital adequacy ratios have been exceptional almost threefold above the prudential norms and hence the Company has the ability to absorb considerable level of unexpected losses in the event of a contingency occurring.

Legal Risk

Legal risk can arise when a transaction cannot be legally enforced or will become unenforceable over time or when a contractual obligation cannot be fulfilled. Non-adherence to legal and regulatory requirements can also spiral out to legal woes for companies. Dealing in financial transactions exposes companies to legal risk to a greater extent than others and thus requires closer management. Legal consequences of a transaction or action, inadequate documentation and adverse judgments would cause unexpected financial losses. Various sanctions and penalties may be imposed by regulatory bodies for non-compliance to laws and regulations. Management of MI is mindful of changes in statutes, regulations including changes in interpretation or implementation of statutes, regulations and policies that could lead to legal risk if not handled appropriately. We are aware that this may bring about additional cost of compliance, may limit the type of financial services and products that could be offered in the market and in certain instances, increase chances of competitors capitalising on their own offerings. Legal risk could not only affect a business financially, it can damage one's reputation leading to loss of public faith and expose a company to other risk.

The Board of MI has established an effective management system to handle legal risk entrusting the Legal Division to provide assistance to other divisions when executing transactions in the light of imposed regulations. As a prudent measure, relevant core divisions refer customer agreements, additional clauses and changes to agreements for the advice of the Legal Division. Depending on the complexity, newly introduced laws and regulations are implemented by the respective divisions in co-ordination with the Legal Division for matters that require legal clarification and advice. Separately, the Board of MI, monitors compliance to applicable laws and regulations through the Audit Committee that in turn obtains feedback on the level of compliance by respective divisions through reports furnished by Internal Audit at least annually.

Competitor Risk

The lucrative market for financing and related products in recent years has seen the finance company sector progress rapidly with increased competition among players. The customers in the sector have ranging requirements both financing and deposit placing equally, hence it is fundamental that we anticipate them early to be proactive and competitive in our actions. We actively participate in the sector by being customer oriented, offering lending products that are in demand while continuing to mobilise deposits at a descent pace. In competing with other institutions, MI is aware that leasing companies tend to offer finance facilities at competitive rates. To add to this, financial Institutions large in capital structure and technology especially banks have shifted their focus to certain products that finance companies offered thus intensifying competition further.

To stay in competition, considerable amount of resources have been directed at maintaining our critical success factors; namely our service excellence in delivery, affordable pricing and our reputation as a financially strong finance company that have differentiated us from most other players. To be above the rest, MI would continue to devote its resources to ensure we keep on enhancing value of our final output to the customer. As an ongoing exercise, refinements would be made to our operations to meet changing market needs and also to our pricing structures to be competitive. The expansion of our branch network at a reasonable pace in the last couple of years has enabled us to service our customers more effectively raising our competitiveness further. Utilising sophisticated technology to execute operations related to our core business of lending and deposit taking has enhanced our service and delivery operations keeping us ahead in the industry.

We continue to adopt unique human resource management strategies that increase productivity of our staff and keep their morale and motivation high which has enabled us to retain an invaluable resource for decades. We also have the needed flexibility to meet future challenges through our strong capital base that has grown year on year through a consistent performance. We would continue to strategise as we go along, knowing the competitive nature of our sector with advancements that continue to happen in technology, competitive structures arising from business amalgamations and consolidations and the tighter regulations coming into effect.

Technology Risk

Like most industries, our sector too is heavily dependent on technology to fulfil customer needs more efficiently and to gain competitive advantage. Use of technology is however a costly affair especially if such investment does not yield the expected results. While appropriate use of technology paves the way for business success, its incorrect management or lack of understanding could lead to serious consequences to an organisation. Heavy reliance placed on technology, mainly due to the use of information systems could harm business operations if not handled the right way. It could result in system failures and interruptions and can extend to breaches in security leading to enormous consequences. System failures over long periods would adversely affect the customer monitoring systems, general ledger, deposits, loans and other sub systems. At the same time, technology risk could damage the Company's reputation, affect business volumes and even subject the Company to additional regulatory scrutiny. These repercussions could even spiral out and expose the company to unnecessary litigation and possible financial liabilities. It is also a known phenomenon that no assurance can be placed in avoiding any such failures, interruptions or security breaches or if such instances arise that they will be dealt with adequately.

We continue to adopt technology as a key element in our strategies in such a way that it is combined together with our core activities to deliver a superior service. Technology has been a material feature in our business in meeting needs of our customers and in providing a service that is gratifying, creating the right level playing field to face competition. Efficient use of technology has brought MI high service standards and with it improved results and has supported us in minimising cost. Use of advanced technology has been customary whenever new technology is available with notable investments made to our core information system especially to improve features to the modules it encompasses. MI's branch network is supported with a fully integrated network system that enables speedy on line processing of balances and also provides lot of other features that support staff in providing an efficient service.

Since heavy reliance is placed on technology, the organisation takes related risks seriously. The Company therefore resorts to strict policies and procedures that have been designed to address associated risk specifically in the area of Information technology. Special system audits are performed annually on existing and newly introduced systems to identify and address emerging risks. To curtail related risks, we recruit officers who are technology savvy, who have a good understanding of the systems being operated in their working environment. Staff attached to the IT Division possesses the necessary expertise in software development and follow software development standards including adoption of user requirement documentation, system testing, implementation standards, user acceptance testing procedures etc. At the same time, hardware for our core systems have been purchased from reputable organisations with necessary maintenance agreements to minimise delays that may occur from equipment malfunction.

Reputation Risk

As a direct or indirect consequence of earlier explained risks materialising, a Company could be subject to reputational risk. Reputational risk could also arise if a company creates business relationships with parties whose character or business practices do not meet right standards and ethics. As an immediate consequence, one would face a drop in customer confidence which could affect immediate business volumes and eventually hamper growth prospects. As a result of specific events that occurred in 2009, the finance company sector underwent inconvenience which saw a decline in public confidence at that time. Nevertheless, the Industry bounced back strongly through tighter regulation and measures instilled by respective companies in the sector that saw a positive turnaround of public perception in the years that followed. Any negative perceptions that prevailed after 2009 have now been reversed and the Industry has witnessed a sharp rise in business volumes.

Strong emphasis placed in the last couple of years in streamlining business operations especially front line operations has benefited the Company in keeping a lid on key risks and in turn managing reputational risks indirectly. One such initiative is that we provide greater autonomy to our managers to reduce lead times in completing a transaction. Senior Management is expected to keep a close tab of changes in the business environment and has appropriately responded well to changes in markets and regulations governing the Industry. Right through MI has maintained a good track record in resolving any shortcomings that arise, having clear awareness of pressing issues. We have adopted confidentiality polices to our practices and use customer information responsibly, retaining the trust and loyalty of our customers. The Company's fundamentals are built on sound values and adopt a high level of ethical standards right across all operations that have enabled us to safeguard our reputation for this long.

Dealing routinely in financial transactions, we like others in the sector, run the risk of exposing ourselves to money laundering and to the threat of terrorist financing. With the intention of avoiding risks that may arise from this, MI has formulated policies and procedures on anti-money laundering and combating terrorist financing in line with prevailing regulations. Accordingly, in identifying a party, we adopt standard practices on Know-Your-Customer (KYC) prior to executing a transaction. These practices enable us to protect the good name of the Institution through early detection and also act as a deterrent against unsuspecting parties.

Human Resource Related Risk

As a service-oriented institution, we depend significantly on our human resources in meeting anticipated service standards. Our workforce plays an integral part in driving the business forward and also managing various risks in the process. Therefore, there is a growing need to attract and retain staff that possesses the necessary skills to perform duties of a high caliber. Nevertheless, identifying experienced staff has become somewhat challenging owing to market competition on recruitment. In addition, associated risk increases as we depend on staff who are highly experienced in their related fields and have been with us for a considerable period. Thus, we understand that losing their service at any point in time could create a vacuum in meeting anticipated standards. This is because finding suitable replacements in the short term is not easy. We are also mindful of the fact that we do not practice employment agreements with our officers holding senior positions.

We understand the importance that our employees play in our success story and adopt specific methodologies to enhance their value and at the same time bring down human resource risks. As an initiative, we recognise valuable input of our staff and reward them for any significant contributions. We have established a clear communication channel between management and staff in promoting concise dialog that has helped minimise misunderstandings and improved staff morale in the process. We use training and development as a tool in increasing the intrinsic value of MI employees which has kept them motivated and reciprocally brought the Company success in its endeavours. In the current environment, training has become crucial in grooming staff to face up to growing challenges in the industry and to deliver up to expectations. As an outcome of all these initiatives, we are proud to hold exceptionally low levels of labour turnover in spite of numerous other prospects available in the job market.

Risk Related to Indemnity Arrangements

Indemnity arrangements facilitate a financial restoration of the aggrieved party to the level prior to accident, injury or illegal act. Indemnity arrangements are used by businesses to seek protection over loss and damage claims filed by another party. A plaintiff would be awarded compensation from the defendant for his or her wrong acts on the basis that it only brings back the plaintiff to a state of wholeness. Indemnity acts as a yardstick for measuring the extent of damage for civil court actions and related laws. In this process, real losses suffered by a plaintiff are repaid in whatever way. However, punitive damages are separately considered altogether.

To minimise associated risks, as a standard credit practice, we make sure adequate asset cover is obtained from the borrower, prior to releasing funds so that it minimises the exposure to credit. As an additional precaution, we ensure that the absolute ownership of the asset is retained with us to compensate for any future losses or damages our customers may encounter. As part of our credit disbursement process, when deciding on a lending value, our policies specify that we consider a combination of variables including the value of security offered. As a general rule, our lending to customers is limited to a percentage of the security offered which minimises our exposure and secures the Company from unnecessary credit exposure that may arise if the borrower defaults or market values of the security decline. By adopting this approach, we also ensure that the value of the asset offered is comparable with the value of other vehicles with similar conditions any time in future.

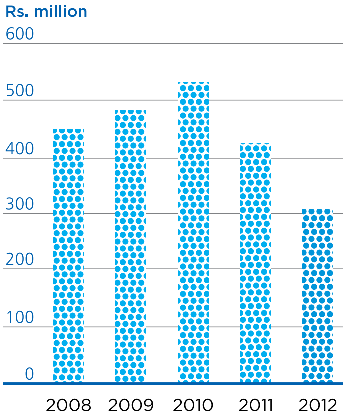
Furthermore, our lease agreements have been structured in a way that it protects both the lessor and the lessee. The lessee is aware that he or she has the full rights to the property without fear of sudden seizure or eviction. The lessor at the same time is aware that a legally-binding contract obligates the lessee to make regular payments throughout the life of the lease. As another prudent measure, MI policies ensure that our clients sign-off an agreement which contains indemnity clauses preventing court action being brought against us for damages caused by the use of the asset in concern.

Risk Control Dash Board

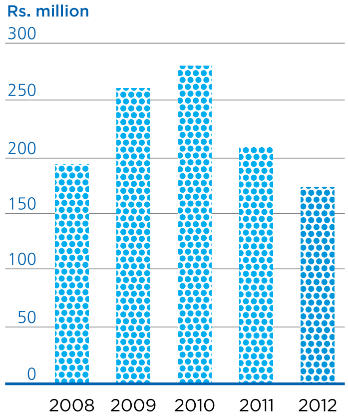
Risk type	Risk rating	Risk assessment	Strategies on risk mitigation - 2012 update
Credit Risk **Risk of default by borrower** • Effectiveness of the credit disbursement process and related policies	Moderate	Existing credit policies and procedures including the core information system was reviewed during this period with the intention of improving the credit disbursement process.	Completion of a comprehensive 'credit operational manual' that provides detailed guidance on steps to follow to meet effective credit disbursement standards. Similarly, credit review practices were made stringent for risky transactions while improvements were effected to the core information system so that users could perform their credit operations efficiently in keeping with set procedures.
		Noted that the steep rise in lending during this period coupled with high lending rates could trigger rise in NPA in future.	To mitigate credit risk arising from changes in business conditions and exploring of new markets, the Credit and Marketing Department was strengthened further with additional frontline staff. The credit disbursement limits of each grade were also revised accordingly.
• Availability of credit information and its accurate recording for decision making and borrower follow up	Low	IT systems were reviewed to provide greater management information to support credit operations.	Over 10 new MIS reports were developed during this period to support credit staff in their routine operations. Eg: Daily lending by product type with related weighted average costs etc.
		Proposed IFRS requirements on lending and provisioning, CRIB reporting requirements etc., were reviewed with current practices.	Accounts division in co-ordination with credit and IT division have commenced activities to adopt requirements arising from accounting standards LKAS 32 and LKAS 39 on financial instruments that include changes to the recording process of lending and provisioning.
• Effectiveness of credit Portfolio monitoring	Low	Handling over 10,000 credit contracts require a well-established monitoring process that ensures credit does not move into arrears and monthly collections are kept within anticipated levels.	Through periodic meetings, Credit and Recoveries divisions reviewed current status of credit disbursed very closely. For this purpose, a range of information is available in our core systems. i.e., Information on borrower repayments together with contracts in arrears month-wise etc.
		We have been able to curtail our non-performing lending levels quite well despite a growing loan book.	Separately, special credit reports with borrower performance can be extracted from the system, functional manager-wise for closer monitoring. Regional credit managers/branch managers present their performance against targets on a monthly basis. Separately, MI's Recoveries division carries out their own review including assessing actual recovery against their officer's individual targets. These meetings facilitate management to take appropriate action whenever any contract falls overdue. It also provides a platform for divisions to buckle-up and make necessary improvements to the credit disbursement process when necessary. In parallel, the Credit Committee of the Company meets to take up high value accounts and high risk accounts, accounts under litigation etc. Based on their reviews they initiate various recovery strategies to address slow-moving and non-performing accounts.

Risk type	Risk rating	Risk assessment	Strategies on risk mitigation - 2012 update

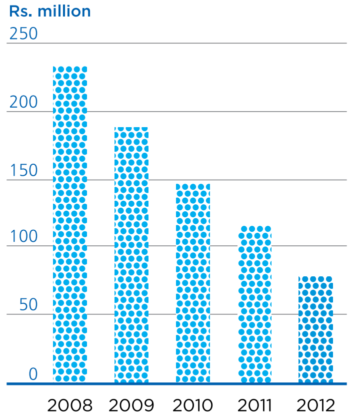
Non-Performing Lending - Overall



Non-Performing Lending - Hire purchase

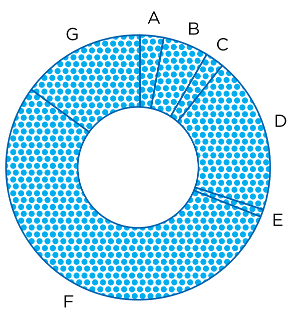


Non-Performing Lending - Leases



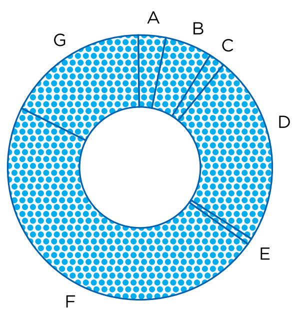
Risk type	Risk rating	Risk assessment	Strategies on risk mitigation - 2012 update
Credit Concentration Risk			
• Risk of insufficient diversification of the credit portfolio	Moderate		Matters pertaining to adequacy of diversification of the credit portfolio are taken up specifically by the Credit Committee. The Committee assesses exposure to high risk industries and develops potential strategies to penetrate into low risk industries.

Sector-wise Analysis of Finance Lease 2012



A - Agriculture 3%
B - Industrial 5%
C - Tourism 2%
D - Trading 19%
E - Construction 1%
F - Services 55%
G - Others 15%

Sector-wise Analysis of Hire Purchase 2012



A - Agriculture 3%
B - Industrial 6%
C - Tourism 2%
D - Trading 23%
E - Construction 1%
F - Services 47%
G - Others 18%

Risk type	Risk rating	Risk assessment	Strategies on risk mitigation - 2012 update
	Low		MI's rapid branch expansion beyond Western Province in recent years was initiated with the intention of growing market share and concurrently diversifying and extending the credit portfolio without being dependent on a single province. We managed to open six new branches outside Western Province in this period.

Concentration of Lending Exposure Province-wise in 2012

Province	Hire Purchase Rs. '000	Lease Rs. '000	Other Loans Rs. '000	Lending Outstanding Rs. '000
Central	58,768	24,493	1,944	85,205
Eastern	59,985	134,124	–	194,109
North-Central	42,243	19,047	300	61,590
North-Western	399,287	169,353	2,103	570,743
Northern	3,450	–	–	3,450
Sabaragamuwa	325,260	115,521	26,758	467,538
Sourthern	340,833	161,499	3,330	505,662
Uva	75,723	31,575	–	107,298
Western	4,309,412	3,381,985	1,288,911	8,980,308
Total	**5,614,960**	**4,037,597**	**1,323,346**	**10,975,903**

Risk type	Risk rating	Risk assessment	Strategies on risk mitigation - 2012 update
	Low	10 largest credit as a % of total exposure	MI's is not exposed unnecessarily to a few credit customers and is within regulatory single borrower limits.

Ten Largest Credit Exposure

	2010/2011	**2011/2012**
Ten Largest Credit as a % of Exposure	5.58	**8.58**
Ten Largest Credit (Rs. '000)	385,701	**941,588**
Total Exposure (Rs. '000)	6,912,145	**10,975,903**

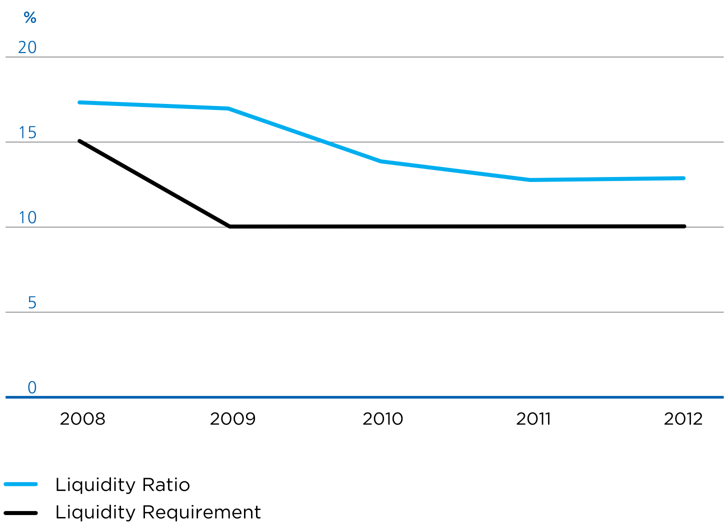
Risk type	Risk rating	Risk assessment	Strategies on risk mitigation - 2012 update
	Moderate	Exposure by counterparty	MI's credit portfolio has a reasonable blend of both corporates and individuals with varying lending levels.

Exposure by Counterparty

	2010/2011 Rs. '000	**2011/2012 Rs. '000**
Corporate Over Rs. 10 million	530,355	**1,250,645**
Corporate below Rs. 10 million and above Rs. 5 million	234,204	**313,942**
Corporates below Rs. 5 million	462,565	**486,834**
Individuals Over Rs. 5 million	998,890	**2,041,355**
Individuals below Rs. 5 million	4,686,132	**6,883,127**
Total	6,912,145	**10,975,903**

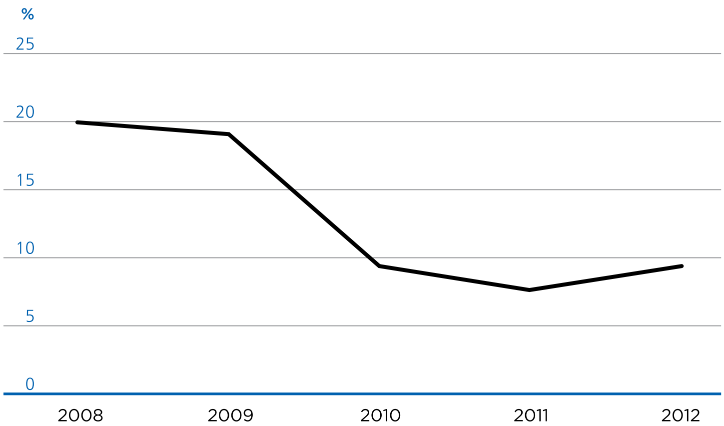
Risk type	Risk rating	Risk assessment	Strategies on risk mitigation - 2012 update
Liquidity Risk			
• Risk arising from inability to meet depositor liabilities on their maturity	Moderate	Monitoring of liquidity position on a daily basis by Finance Department.	Greater emphasis was placed in decentralising major part of deposits canvassing operation to branches. During the period, deposit operation was streamlined with procedural changes including issue of a temporary deposit receipt at branches level by making core system modifications.
		Monthly review of Assets and liability maturity gaps for pre-defined maturity buckets.	Increased focus on canvassing long-term fixed deposits with a view to bridging mismatches in maturity gap. Continued policy on minimal exposure to property investments that have been illiquid in recent years.
		Quarterly review of Company's medium and long-term liquidity by the Integrated Risk Management Committee to assess prevailing risk and propose risk mitigation strategies.	Treasury division was able to sustain continued funding through Bank borrowings to meet immediate requirements whenever funding from deposits was insufficient. Pursuing new funding lines including submission of a proposal to obtain foreign investor funding pending finalisation.

Statutory Liquid Assets Ratio



Risk type	Risk rating	Risk assessment	Strategies on risk mitigation - 2012 update
Interest Rate Risk			
• Risk arising from fluctuations in interest rates	Moderate	Review of interest rates for both deposits and lending products with comparatives closely.	On a weekly basis the Management Committee represented by all core divisions meets and reviews rate structures. An analysis was carried out to determine the impact to net interest income and profitability when business volumes are varied keeping anticipated margins.
		Review of margins enjoyed, and prevailing market rates to ensure that our pricing is competitive and profitable.	By keeping a close watch on rates, management was able to make pricing changes on a frequent basis to ensure anticipated margins are maintained throughout especially considering the steep rise in market rates in the latter stages of the period in concern. To improve margins, management pursued revitalising its higher yield personal loan products especially loans against property mortgage. The Integrated Risk Management Committee kept a close watch on thinning margin levels in the sector and reviewed the necessity to seek cheaper funding sources to bring down overall weighted average cost.

One Year Treasury Bill Rate



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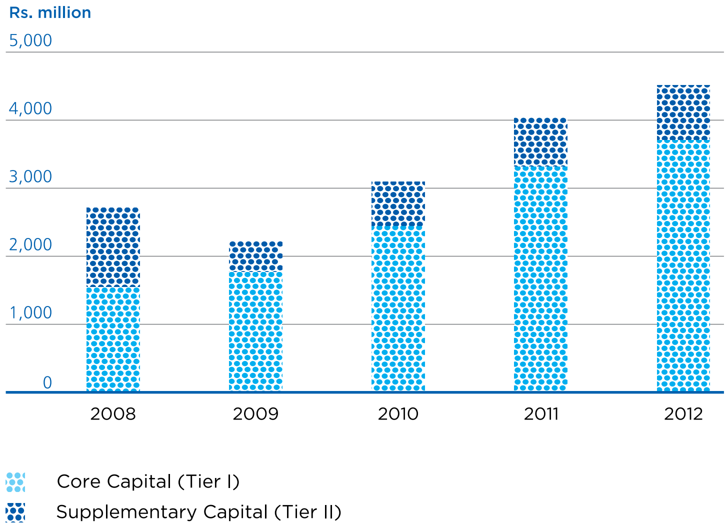
Risk type	Risk rating	Risk assessment	Strategies on risk mitigation - 2012 update
Operational Risk			
• Risk arising from faulty processors and control systems, acts of fraud and natural disasters	Low	Continuous review and updating of procedures and policies to minimise faults at departmental level. MI procedures have been established on a strong set of internal controls to safeguard company assets.	Making changes to specific procedures in the current period and documenting such changes and incorporating them to the Company's procedure manual issued previously. Independent periodic review of existing internal controls by our Internal Auditors, Ernst & Young based on a predefined annual audit programme.
	Low	Reviewing Company's capital position and related statutory ratios on a periodic basis.	The Audit Committee obtains feedback from the internal audit on status of operational controls in place and its level of compliance including operational lapses noted. The Committee accordingly, followed up on recommended practices to ensure smooth function of daily operations including rectification of operational lapses.

Capital Base



	Moderate	A Business Continuity Plan is available to guide management in the event of a company-wide contingency event happening. To overcome potential risk noted in the BCP development stage, certain initiatives were followed up this period as well.	Ongoing activities to safeguard documents in hard form including greater use of fire proof cabinets. Use of the recently introduced 'Document Management System' as a means of archiving key documents. Reviewed existing fire precautionary measures of the building, plant and machinery. A physical inspection was carried out by the fire officers of the Colombo Fire Brigade and their recommendations are being followed up currently. Obtaining insurance cover for Company assets including inclusion of new assets to the cover and closely monitoring value changes of assets and ensuring renewal of policies are done up front.

Risk type	Risk rating	Risk assessment	Strategies on risk mitigation - 2012 update
Technology Risk			
• Technology risk arising from core systems malfunction, errors in new module implementations and changes in environment affecting technology	Moderate	Core information system is assessed on an on going basis by relevant user departments so that improvements could be made when needed.	From this period, user divisions are required to complete a 'user requirement request form' to ensure modifications and new modules are in line with user expectation.
		Stringent testing procedures are adopted by the IT division prior to live implementation of proposed modules to avoid errors and shortcomings.	A comprehensive study was carried out in this period to identify gaps in the core system against another system available in the market. IT department was able to fulfil key gaps identified from this exercise prior to year end.
		Annually, a thorough review of the main system is carried out by the internal audit to evaluate the accuracy and reliability of the system.	The Company continued its policy on its daily backing up of the database and off storage. IT division staff have been trained to handle system related issues with minimum inconvenience to operations.
Reputational Risk - Actions and events that adversely impact the good name of an institution in the minds of others • Risks arising from poor operational practices that could lead to reputational risk	Moderate	Last few years have seen pressure building on the finance companies sector in protecting an institution's good name in light of the recent debacles.	The adoption of required corporate governance practices, departmental procedure manuals, compliance checking are some of the actions taken to ensure business is conducted prudently and highest level of ethical and operational standards are maintained at all times. Staff from top to the lowest levels are expected to ensure instilled procedures and policies are adhered to at all times when performing tasks. Strict disciplinary action is carried out on employees who deviate from these internal regulations.
• Lack of attention in the area of corporate social responsibility	Low	Company is reputed for over four decades as a trusted provider of financial services by its depositors, borrowers and other stakeholders.	Setting up of a CSR Committee from this period to sustain Company's vision of providing a deep sense of social responsibility. Our sustainability supplement given in the Annual Report provides an in-depth disclosure on MI's initiatives this period.
People Risk • Inability to attract and retain quality staff who are skilled and have the experience to handle significant job functions	Low	Emergence of various job opportunities in other competitive markets has increased scope for individuals.	Encouraging performance related benefits has created a productive workforce for us. As this approach identifies high performers, we envisage a win-win situation for either party in the longer term. Through this we are able to nurture the selected individuals to fit into more demanding roles as and when the need arises.
		MI with over four decades in business with an excellent track record in being a premier finance company has created the right reputation to attract good quality staff.	Continued training and development remained central to knowledge enhancement of the workforce. Through this, we have kept staff well updated with developments in the industry and have kept their motivation and morale intact.

Risk type	Risk rating	Risk assessment	Strategies on risk mitigation - 2012 update
Legal and Regulatory Risk - Legal risk Risk of faulty documentation that could lead to legal risk	Low	The legal department comprises experienced staff who works closely with core business divisions to ensure Company is protected when executing transactions.	Legal division worked closely with credit and recoveries divisions in improving documentation requirements and executed necessary litigations against defaulters in an efficient manner.
Risk of Non-compliance to Anti-Money Laundering (AML) regulations	Low	MI has set up strong AML policies to curb money laundering risk. Credit, deposits and recoveries divisions are expected to identify their customers through standard verification documents.	Core divisions were informed to comply with the March 2011 Gazette issued on Anti-Money Laundering and Combating of Terrorists Financing and revisions to other related acts. An independent annual audit was carried out by our Internal auditors Ernst & Young on MI's compliance to AML regulations.

Stress Testing

A fundamental role of risk management is to ensure organisations do anticipate for worst case events early and strategies appropriately as they plan their path to success. Stress testing helps MI to evaluate potential impacts to its key financial variables due to adverse changes in business conditions or market variables so that we could be better prepared.

Base Data (All figures are in Rs. '000 and as 31 March 2012)

Capital Adequacy Ratio (CAR) (%)	27.17
Capital base	4,518,294
Risk-Weighted assets	16,628,396
Total Gross NPA	308,409
Equity market value	3,390,331
Deposit liability	5,870,013
Liquid assets	754,633
Liquid assets ratio (%)	12.86
Gross loans	10,975,951
NPL ratio (%)	2.81

Stress Tests	Exposure Rs. '000	Original Position 31 March 2012	Magnitude of Shock		
			5%	10%	15%
		CAR %	Revised CAR %		
A. Credit Risk					
Negative shift in non-performing advances*	308,409	27.17%	27.08%	27.00%	26.91%
B. Equity Price Risk					
Fall in stock market prices	3,390,331	27.17%	26.51%	25.84%	25.16%

Conclusion: No significant impact to capital adequacy due to shocks from credit risk or equity risk.

Stress Tests	Exposure Rs. '000	Original Position 31 March 2012	Magnitude of Shock		
			5%	10%	15%
	Statutory Liquid assets ratio %		Revised Statutory Liquid Assets Ratio %		
A. Liquidity Risk					
Fall in statutory liquid Assets	754,633	12.86%	12.21%	11.57%	10.93%

Conclusion: Even after worse case scenario the liquid asset ratio would remain above regulatory requirements.

Stress Tests	Exposure Rs. '000	Original Position 31 March 2012	Magnitude of Shock		
			5%	10%	15%
		NPL %	Revised NPL %		
A. Credit Risk					
Negative shift in Non Performing Loans*	308,409	2.81%	2.95%	3.09%	3.23%

Conclusion: The worse case rise in NPA ratio to 3.23% is still below 3.5% anticipated level forecasted in the medium term.

** Composition of NPA Categories*

Category	In Category Rs.	%
Accommodation in Arrears > 6 Months < 12 Months - 50% provision	31,446	10.20
Accommodation in Arrears > 12 Months - 100% provision	276,963	89.80
	308,409	100.00

BUILDING SUSTAINA BEYOND T OF OUR RI ENTERPRI

We derive so much satisfaction from knowing that the positive effects of our business spread far beyond the office…into businesses and homes all across the country, building a sustainable future for our people and the Nation.

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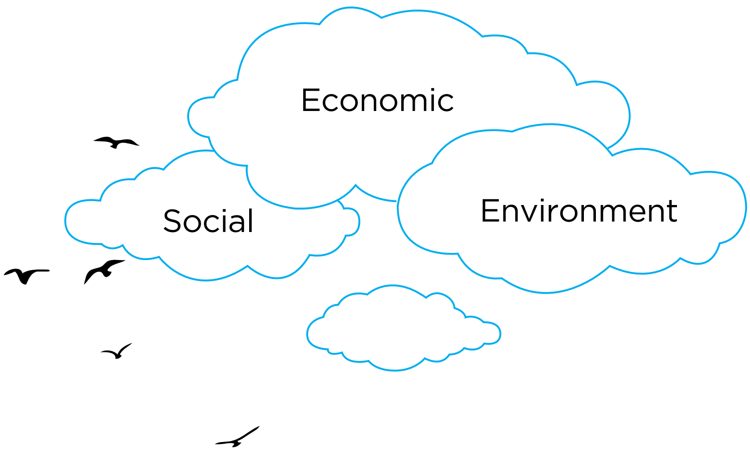
Sustainability Report

Managing Director's Statement



"I feel that the first and most achievable social support that we can offer to rural communities is to extend our financial services to those deserving individuals."

Our immediate aim is to extend our reach right across the nation, so that we could be of greater service to all communities.

Proud to be Part of the Nation's Resurgence

As the nation continues to embark on post-conflict reconstruction and development, citizens of the country remain optimistic of a brighter future ahead. Indeed it is a dire need for corporates of the country to join hands with the public sector in providing the necessary impetus for rapid economic and social development. The opportunities for business growth have expanded with the emergence of peace in the nation. At the same time, we should be wary of our obligations towards society and the environment while we pursue the aspirations of our investors. The time has dawned for us to provide opportunities to deprived communities including low income earners and small scale entrepreneurs, particularly those in the liberated North and East of the country that would support sustainable livelihoods.

Strategic Sustainable Development

The Vision of Mercantile Investments encapsulates the necessity for the Company to be socially responsible in the corporate world. Hence, we have integrated our sustainability values into the overall business strategy of the Company, which in turn guides our day-to-day operations. In keeping with our Mission, we provide financial services to a wide spectrum of customers from all segments of society, whatever be their needs or financial status. The prevailing socio-economic environment provides us with an excellent opportunity to expand our operations across new frontiers. Our aim therefore is to reach out to the various communities across the country with the view to fostering financial inclusivity and broad-based development. I feel that the first and most achievable social support that we can offer to rural communities is to extend our financial services to those deserving individuals.

We Stand Committed

As Mercantile Investments (MI) continues to excel in its sphere of activities in the financial services sector, we make it a point to ensure that as we move along we also create value to our stakeholders in terms of fulfilling their economic, environmental and social aspirations. We have been a committed enterprise in terms of inculcating sustainability values as part of our business ethics. Each year, we initiate numerous activities and programmes which are directed at our customers, investors, staff, and local communities, all of which are an integral part of our core business activities.

Adoption of the Global Reporting Initiative (GRI) reporting framework from FY 2010/11 has enabled us to provide an effective and quantifiable report structure when reporting on our sustainability practices each year, thus facilitating enhanced communication to our stakeholders. As an environmental initiative, we also commenced producing a carbon neutral Annual Report.

Outlook

Despite the prevailing positive sentiments with the emergence of peace, the nation faces varying obstacles in rebuilding the overall economy, and specifically raising the quality of life of low income groups. The corporate community therefore would need to play a bigger role than before in accelerating economic growth and income levels. The financial services sector should create greater opportunities for small-scale entrepreneurs to have access to financing in addition to the plethora of other services currently available. Involvement in the revival of business and socio-economic activities in the Northern and Eastern parts of the country is another area that presents immense opportunities for finance companies such as ours.

Organisations today need to demonstrate their intent in meeting social and environmental obligations more than before. We have continued to adopt an integrated business model that embraces the three pillars - people, planet and profits - through Company-wide sustainability policies and practices. We strive to enhance the total value of our product and service offerings to customers, invest in human resource development for mutual benefit, adopt sound environmental management principles and embrace responsible business practices that add value to the company and society. Our immediate aim is to extend our reach right across the nation, so that we could be of greater service to all communities.

Gerard G. Ondaatjie
Managing Director

15th May 2012

Sustainability Reporting

The sustainability report provides a platform for the Company to communicate its sustainability practices in the context of its stakeholders, who comprise parties internal or external to the organisation. The report offers an insight into how economic, social and environmental aspects are integrated into the Company's business practices.

We are proud to say that our business ethos goes beyond the conventional shareholder bottom-line approach. Mercantile Investments (MI) has aligned its main business strategies with sustainability principles, thereby producing greater value to the Company, and creating the path towards achieving our corporate vision. Sustainability practices of the Company are wide ranging, and are intended to address some of the needs of our key stakeholders. These initiatives cover aspects on environmental protection, social responsibility and economic value creation, while striving to meet the expectations of our customers and nurturing our workforce.

Reporting framework adopted

Our report on sustainability has been designed in accordance with the Global Reporting Initiative (GRI), an internationally accepted reporting framework. The framework facilitates enhanced disclosure, based on a set of principles, protocols and indicators that enable us to measure and report our yearly economic, environmental and social performance. For the purpose of evaluating performance over time, our report contains comparative information wherever necessary for key quantifiable topics addressed in this Report.

Report Parameters

1. Reporting Principles

a. Defining Report Content

In order to ensure a balanced and reasonable presentation of the Company's sustainability performance, the principles given below were considered when determining the content of our report.

- **Materiality**

  The topics and indicators selected in our report recognise the importance of materiality. When explaining our performance related to economic, environmental and social impacts, we have attempted to disclose topics of a significant nature that would be useful to our readers, which could substantively influence stakeholders in their assessments and decisions.

  We have ensured that our report prioritises the selected topics wherever necessary when making disclosures. In deciding on the report content, we have considered to a reasonable degree the following external and internal factors prescribed under materiality principles.

Materiality Test

Significance to the Organisation

- Key organisational values, policies, strategies, operational management systems, goals and targets.
- Interest/expectations of stakeholders, particularly those concerned with the success of the Company such as shareholders, employees and customers.
- Significant risk to the Company.
- Critical factors for enabling organisational success.
- The ability or effects of MI's core competencies in contributing to sustainable development.

Significance to Stakeholders

- Future challenges imminent and aspects relevant to society
- Relevant laws and regulations with strategic significance to the Company's stakeholders

Other Material Considerations

- Reasonably estimable sustainability impacts, risks or opportunities based on available expertise

- **Stakeholder Inclusiveness**

  Expectations and interests of our stakeholders were a key reference point when deciding on the report content; especially on scope, boundary, and application of indicators. We define our main stakeholders as being our investors, customers, employees, local communities and the environment. Each of the identified stakeholders brings in variety of expectations towards the Company; as such our objectives towards them are wide, and varies from one stakeholder to another.

Stakeholder category	Key expectation	Objectives for MI
Investors	The need to enhance wealth through superior earnings in terms of their investment	Through sound yearly earnings, creating sustainable wealth to our shareholders and in turn supporting sector and economic growth.
Customers	Fulfilling ones financing and other borrowing needs or seeking attractive returns for deposits placed.	Providing a superlative service beyond customer expectations.
Employees	To receive intrinsic and extrinsic return by performing ones job function.	Affording tangible and intangible benefits to employees in line with their service and expectations. In doing so, create a platform for open dialogue and harmony among ones superiors, colleagues and subordinates.
Local Communities	Societal expectations on better health, education, improved livelihood and safeguarding of local community rights.	Initiating specific CSR programmes directed at improving the well-being of society. Further, carrying out our operations in a responsible manner without hindrance to local communities.
Environment	Conservation of natural resources, minimise waste and consumption and protect the environment from hazards of industrialisation	Identifying and introducing best practices on environmental conservation and preservation including the safeguarding of fauna and flora.

- **Sustainability Context**
  MI's performance explained in this supplement has given consideration to the wider context of sustainability. Wherever possible, we have explained the performance of the organisation in the context of the limits and demands placed on economic, environmental and social factors to present a better and broader view of our efforts on sustainability.

- **Completeness**
  To ensure the completeness of our report, we have given consideration to the dimensions of its scope, report boundary and time. As part of scope, our range of topics provides sufficient information on our economic, environmental and social performance. We have identified that the boundary of reporting captures the Company's activities whose performance is adequately represented by the report. Furthermore, the selected information is complete for the time period specified in this report.

b. Specifying the Report Quality

Dimensions of report quality	Elements of dimension
Balanced	To maintain balance in reporting, we have maintained required transparency in our topics. The disclosures reflect an unbiased position of the organisation's performance.
Comparable	We have explained our performance in both qualitative and quantitative terms. Quantitative indicators have been supported with comparable information.

Dimensions of report quality	Elements of dimension
Accurate	The information has been presented with accuracy and is adequately detailed towards assessing the organisation's performance in selected topics.
Timeliness	The information provided is recent and is relative to the reporting period to ensure compliance with the principles of timeliness.
Clarity	For report clarity, information has been made available in a manner that is easily understandable and accessible to stakeholders.
Reliability	Information and processes used in the preparation of our report have been compiled and analysed in a way that establishes the quality and materiality of the information.

c. Specifying the Report Boundary

Our report has been prepared giving due consideration to the requirements on setting the report boundary. As there are no subsidiary companies under Mercantile Investments and Finance PLC, the report covers performance of the Company.

2. Standard Disclosures Forming the Report

In accordance with the framework, our report covers the three types of disclosures necessary when presenting MI's performance.

a. Strategy and Profile

Our report provides disclosures that set the overall context for understanding our performance such as strategy, profile and governance.

b. Management Approach

Wherever possible, in order to provide context in understanding performance in a specific area, our disclosures address how the management of MI approached the related topic.

c. Performance Indicators

The report provides indicators that elicit comparable information on the economic, environmental and social performance of the organisation.

3. Protocols Relating to the Framework

Protocols forming part of the GRI framework given below were referred to when defining report content and providing standard disclosure including performance indicators.

- Indicator Protocols
- Technical Protocols

4. GRI Application Level

Based on the extent of disclosure given in our sustainability report, the Company has made a self-declaration in accordance with GRI's application level requirements. (Refer section on GRI index and grading forming part of this report)

5. Independent Assurance

This year, to enhance the credibility of our report, an independent assurance report was obtained from our External Auditors, Messrs Cecil Arsecularatne & Company, Chartered Accountants. Their report is disclosed in this supplement.

MI's Strategy Towards Sustainability

Approach to Sustainability

MI's vision fittingly encapsulates the need to adopt a deep sense of social responsibility while excelling in our sphere as a leading finance company. Our clear corporate vision augments our business aspirations with social responsibility values, thus illustrating our desire to emulate responsible practices for the benefit of the society.

We adopt both corporate and social values and practise CSR-related initiatives as an integral part of our business operations that fulfil the core objectives of the organisation. Our sustainability practices comprise a combination of strategies that meet the needs of our stakeholders, including investors. As illustrated in Diagram 1, our core business strategies encompass economic, environmental and social aspects that would deliver competitive advantage over time by building the loyalty and trust of all our stakeholders. MI would thus be judged as a responsible corporate citizen that balances the diverse interests of stakeholders to create long-term value to its investors.

Sustainability ownership at MI

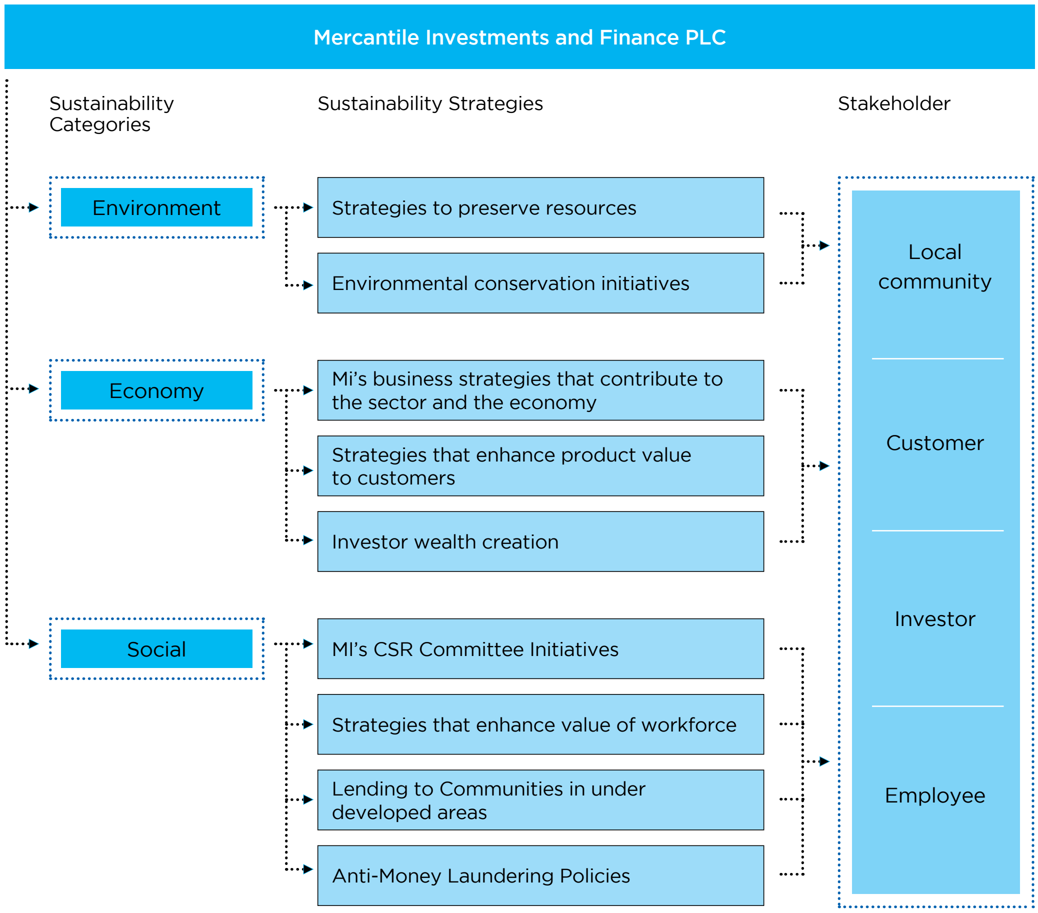
Sustainable development is viewed positively from the very top of MI's hierarchy, embedding related principles to our governance practices as depicted in Diagram 2.

We adopt a top down approach so that all employees become part of our sustainability focus. Accordingly, a significant part of its ownership has been entrusted with the Corporate Management. As a recent step towards upholding sustainability practices, a CSR Committee was set up in August 2011. The Committee which operates on a specified CSR budget comprises GM Credit and Marketing, AGM Recoveries, AGM Finance, Manager Deposits and Senior Executive Human Resources.

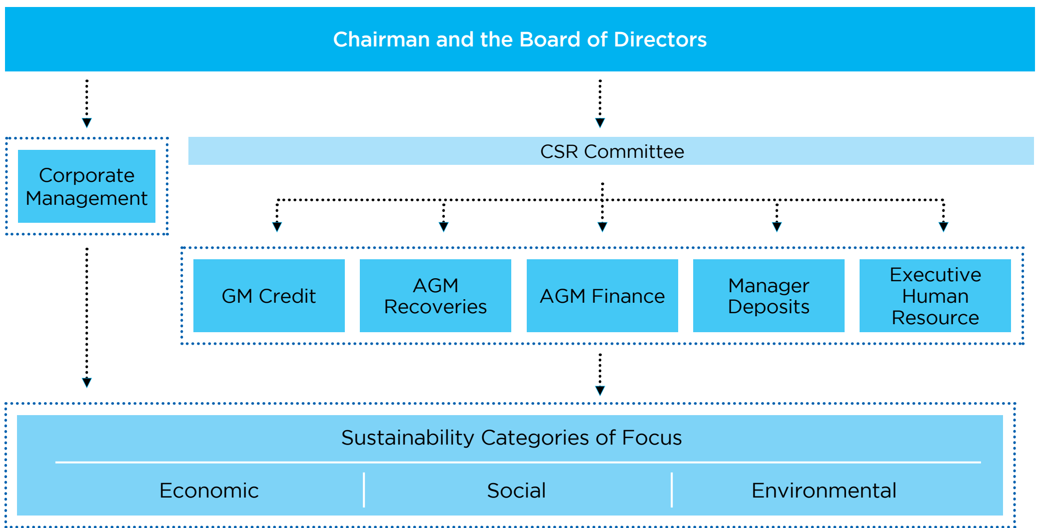
Soon after its formation, the CSR Committee involved itself in numerous initiatives that addressed social and environmental expectations, namely;

- Meeting the social needs of the poor and underprivileged.
- General social initiatives for the benefit of the society.
- Initiatives to preserve the environment, including indigenous fauna and flora of the country.
- Providing financial assistance to the needy.

MI's Strategic Focus on Sustainability



Sustainability Structure at MI



Key Sustainability Impacts

Risk arising from key impacts and management's approach in handling them

Sustainability Category	Potential Impacts	Risk from Impact	Addressed by
Economic	• National growth with dawn of peace	• Competitive offerings afforded by other institutions could make our offerings unattractive.	• Products and service enhancements to provide greater value to customers. • Focusing on expanding market entry and market share. • Being receptive towards customer needs and introducing new products and service offerings.
	• Change in thinking and behavioural patterns of society	• Public well conversant when selecting institutions and their offerings.	• Strengthening governance and corporate practices to sustain loyalty of customers.
	• Changes in consumption patterns and wealth creation	• Decline in demand for offerings from certain segments of the society and vice versa from other segments.	• Continuous evaluation of market changes and consumption patterns to provide a more suited offering.
Environmental	• Increased consumption of natural resources resulting from expansion in population and industrialisation	• Dearth in natural resources would cause cost increases. • Fall in future availability of natural resources would affect local community.	• Initiatives to control consumption levels of water and electricity.
	• Global warming and eco system changes	• Increase in environmental-led diseases.	• Initiatives to reduce carbon emissions to the environment.
		• Decline in forestry and animal population.	• CSR activities directed at protecting the environment and nature including the animal population.
Social	• Changing needs of society	• As human wants would vary over time, institutions that are not proactive and flexible would see decline in level of business.	• MI caters to a wider audience in terms of its offerings and is attentive and flexible in meeting business demands arising from societal changes.
	• Disparity in wealth among society	• For those low income earning categories, their quality of life and level of spending will decline.	• Initiatives to nurture and increase value of our staff. • Initiatives directed at assisting the poorest of the poor through various CSR projects.

Opportunities arising from key impacts and managements approach in harnessing them

Sustainability Category	Potential Impacts	Opportunity from Impact	Addressed by
Economic	• Dawn of peace and its positive economic effects	• Improved business conditions for companies to contribute to the sector and the economy	• Strategic focus on extending our market presence to developing areas. • Tightening performance targets and keeping a closer watch to ensure that Company grows in volume and profitability.
	• Changes in consumption patterns and wealth creation	• Rising demand for specific products and services that had low preference before	• Wherever possible, tailoring existing offerings to meet customer expectations; e.g.. Structured and step up financing facilities.

Sustainability Category	Potential Impacts	Opportunity from Impact	Addressed by
Environmental	• Greater use of natural resources • Environmental changes	• Decline in natural resources would require institutions to adopt green practices. An organisation's reputation would be enhanced further by this.	• Adoption of green practices wherever possible.
		• Opportunity for companies to actually bring down costs incurred on resources	• Periodic review of expenses on water and electricity to evaluate progress on conservation and waste minimisation.
Social	• Society advancing in literacy and wealth.	• Greater demand for luxury goods in the longer term	• Expansion drive to establish our services across the nation. This will enable MI to reach out to communities through our financial products, in the process, enriching lives and livelihoods of local communities.
	• Greater role played by women	• Increase in women candidates for vacancies as they play an important role in businesses in recent decades.	• Human Resource Division plays a significant role in selecting right candidates and maintains the needed blend of gender, youth and experience.
	• Increased focus on sustainable development	• Companies that contribute to society more will reap greater benefit in the longer term with increasing awareness of the society on good sustainable practices.	• Adoption of a systematic approach to meeting sustainability obligations. • Effective commutation of our sustainability practices and initiatives periodically.

Management Approach

Key Sustainability Principles Practiced at MI

MI's business philosophy is governed by a set of principles that takes note of varying stakeholder expectations. They are, namely;

- Ensuring that our business decisions consider environmental, ethical and societal impacts when attempting to meet corporate objectives.
- Empowering and uplifting society through initiatives that add value in the longer term.
- Meeting customer expectations by providing them with superior products and service.
- Nurturing a workforce that is committed to sound and ethical business practices.
- Creating wealth to our investors.
- Ensuring that we do no harm to the environment, preserving it in every possible way.

Sustainability Values Practised

Our sustainability values and related characteristics have evolved systematically over time and have become pivotal in our road to success. Our thinking is that by adopting these values, the Company is respected as a trustworthy business partner and a corporate that adds value not only to its investors but also to society and other stakeholders.

Safeguarding our Brand Reputation

Closing in on half a century in reputed entrepreneurship, MI has been a responsible corporate citizen in all its activities with an enviable track record of being a trusted player to all our stakeholders. We believe business growth is fuelled by implementing responsible business practices. Internally, such practices have helped motivate our employees, who in turn have contributed long years of service towards organisational successes with a high level of morale and motivation.

Externally, responsible and ethical business practices have enabled us to build strong relationships with the public, carrying an unblemished corporate image from inception. For instance, most of our loyal depositors continue to remain with us for decades despite varying investment options. We have been able to build strong inseparable bonds with customers using our unblemished reputation and trustworthy superlative service.

MI - A Trusted Partner for Close to Half a Century

Corporate Governance practices

Our management framework facilitates the conduct of the Company's business in a responsible and accountable manner, adopting sound financial practices to safeguard various stakeholder interests. These good governance practices not only ensure prudent conduct of business to safeguard our investors and depositors but they also stimulate and strengthen the overall stability of the financial services sector, which in turn benefits the whole economy.

Sound leadership is provided by the Board of MI, particularly to the Corporate Management team for setting forth prudent and effective controls which facilitate management of risks. The Board is responsible to initiate strategies to meet corporate objectives, while ensuring that the necessary financial and other resources are provided for its execution. A three-year strategic plan was developed during the year under review. The plan specifies a predetermined set of values and standards, objectives, financial forecast and proposed strategies in meeting organisational aspirations. The Board plays a supervisory role and monitors progress of proposed strategic activities including the implementation process. Specialised committees of the Board have been set up to monitor areas that are considered high priority and needing closer attention of the Board. MI's Board was strengthened further during the year with the appointment of three new Non-Executive Directors.

Risk Management

Risk is present in any business organisation, but it needs to be managed in order to yield optimal business results. It is necessary to counter risks so that customers, suppliers and the larger community do not suffer, while at the same time delivering wealth to shareholders through an appropriate trade-off between risk and returns.

As part of our risk management process, we carry out risks assessments, its impact and wherever possible its measurement, and finally to counter potential risks through the application of risk mitigation strategies. The policies and procedures together with inbuilt internal controls established are reviewed continuously in this process for refinement considering the dynamics of the business we are in. Stringent risk management techniques have been adopted in critical functions to protect the business from core risks such as credit risk, interest rate risk and liquidity risk. On a broader perspective, the Company's Integrated Risk Management Committee has been entrusted with a supervisory role, reviewing areas that may pose potential risk to the Company. High risk operations of the Company are reviewed to determine prevailing safety levels so that appropriate practices and controls could be recommended when necessary.

Transparency Through Excellence in Reporting

The Company has paid significant attention to the need for transparency in its endeavours over the years. Our excellence in financial reporting has been a significant hallmark of our enterprise for the last decade. We have produced outstanding annual reports over the years and our winning the Gold Award for twelve consecutive years in the finance companies category strongly confirm our high reporting standards and commitment to transparency.

Use of Technology as Means of Security

As a financial services provider, information security continued to be an essential area of focus in FY 2011/12. Maintaining the confidentiality of customer information and protecting sensitive Company information from intruders have taken centre stage when deciding on information technology solutions. Standard system security measures such as passwords for users, backing up of data, virus protection, etc. is available in MI's core IT systems. To enhance data protection, we have inbuilt state-of-the-art firewalls together with new security policies for user authentication. The recently developed data imaging module has the capacity to store extensive amounts of data electronically. The introduction of CCTV technology in early 2011 to review specific operations of the Company has improved the physical security process. Plans are under way to extend this technology to our branch operations in the near future.

Meeting Needs of our Stakeholders

The Company's core business decision making process invariably takes into account related environmental and socio-economic aspects. As a financial service provider, MI caters to a significant segment of the Sri Lankan society in fulfilling their funding aspirations. The invaluable commitment of our employees in meeting needs of customers has not only raised the profile of our institution within the corporate sector but also has brought in numerous contributions to the economy, society and environment. A focus on increasing productivity has supported the Company in raising business volumes tremendously in a short time span, while bringing benefits to the economy too. The deposit base of the Company has expanded almost five-fold over the past decade, signifying our notable presence in the sector.

From another perspective, we firmly believe in providing opportunities for development and improving the quality of life of our employees. Likewise, we are dedicated in uplifting the quality of life of the communities within which we work, including the most disadvantaged groups. In building larger social wealth, we have focused on initiatives that cover education, training, health and social welfare.

By extending our network of branches to rural locations outside the Colombo District we are now better equipped to assess the funding requirements of those communities and offer our services in a more personalised way. At a micro level, we have reached out to individuals in local communities, with a range of tailor-made credit offerings that fit their anticipations and budget, which in turn assist them in realising their personal and entrepreneurial aspirations.

For each stakeholder group, we give below a disclosure on the stakeholder engagement process together with initiatives undertaken by the Company in meeting our obligations towards them.

Customer Obligations

We serve our customers to our utmost potential, going that extra mile to provide an optimal service. Our customers come from all walks of life, spanning across key provinces. Their needs are varying with expectations that have grown with the passage of time. As such, we recognise the need to be customer focused and sensitive to their needs, enabling us to offer superlative products and services in-line with their expectations.

MI's Motto "Service That Extends Beyond" Says It All

Fulfilling a range of customer needs in a highly competitive environment is a challenging task. We have nonetheless been equal to the task and have made tremendous progress in meeting, if not exceeding, customer expectations over the years. MI's primary strategies are well focused and have been developed after intense study of customer segments in the market. Our motto **"Service that extends beyond"** exemplifies the need to provide a superior customer service which is necessary if we are to be ahead of competition.

We are renowned for our speed of service with minimal inconvenience to the customer, which has effectively added value to our offerings. Our operational processes have been refined over the years to meet the anticipated levels of service standards. In deposit mobilisation, we have paid constant attention in maintaining a healthy customer retention percentage.

Rightly, our service excellence has enabled us to build strong customer relationships and bonding which, in turn, has helped us to retain the cream of clientele while attracting new customers. The rise in core business volumes over the years reflects our successes in meeting these service standards.

Product Development and Enhancements

Market studies are carried out regularly to ensure that MI's product portfolio is potent and caters to changing customer needs and expectations over time. During the year under review, revisions were made to specific operational procedures to improve the speed of service in both lending and deposit businesses. Changes were made to front-end operations together with notable modifications to core systems to improve user friendliness with the intention of minimising service delivery times.

During FY 2011/12, we expanded our product range by introducing extended offerings coupled with core products in our lending business. This included structured and step up lease and hire purchase financing. Additionally, we joined with specific vendors of renowned brands to provide financial assistance to our customers to own new vehicles. We are now in the process of evaluating the feasibility of introducing innovative lending products and other standard products including pawn broking.

Greater Accessibility for Our Customers

In keeping with MI's strategy, the branch network was more than doubled during the year. It now consists of fourteen fully-automated branches. The eight new branches that were opened during this period are located in contrasting regions of the country. These bold measures have given us an opportunity to reach a wider audience who are in need of our services, thus fulfilling their financial needs that may be personal or entrepreneurial. We have consciously moved into new regions after assessing the financial needs of such diverse communities who have had little opportunity to access financial services due to constraints including the remoteness of location.

Matara Branch Opening

Mercantile Investments and Finance PLC's Head Office and Branch Network Locations

The map shown herein represents our budding branch network that has begun to claw out to strategic locations across the country. Most of our newly opened branches are located outside the Western Province, thus increasing accessibility to the general public.

Registered Office
No. 236, Galle Road,
Colombo 3.

Head Office
No. 236, Galle Road,
Colombo 3.
Telephone: 2343720–7
Fax: 2434524
E-mail: mercantile@mi.com.lk
Website:
http//www.mi.com.lk

Branches

Negombo Branch
No. 28, Colombo Road
Negombo.
Telephone: 031-2221160-1
E-mail:
minegombo@mi.com.lk

Kohuwala Branch
No. 28, Sunethradevi Road,
Kohuwala.
Telephone: 2814181-2
E-mail:
mikohuwala@mi.com.lk

Mahara Kadawatha
No. 381/C, Kandy Road,
Mahara, Kadawatha
Telephone: 2921205-7
E-mail:
mikadawatha@mi.com.lk

Balangoda Branch
No. 118, Barnes,
Ratwaththa Mawatha,
Balangoda.
Telephone: 045-2287605
E-mail:
mibalangoda@mi.com.lk

Bentota Branch
No. 149, 1/2,
Colombo Road,
Bentota.
Telephone: 034-2275402
E-mail: mibentota@mi.com.lk

Trincomalee Branch
No. 256,
Anuradhapura Junction,
Trincomalee.
Telephone: 026-2226456
E-mail: mitrinco@mi.com.lk

Kurunegala Branch
No. 233 A, Negombo Road,
Kurunegala.
Telephone: 037-2222027
E-mail:
mikurunegala@mi.com.lk

Matara Branch
No. 531, Pamburana,
Matara.
Telephone: 041-2235377
E-mail: mimatara@mi.com.lk

Galle Branch
No. 12, Park Road,
Kaluwella, Galle
Telephone: 091-2246387
E-mail: migalle@mi.com.lk

Anuradhapura Branch
No. 521/5, Maithreepala
Senanayake Mawatha,
Anuradhapura.
Telephone: 025-2224886
E-mail:
mianuradhapura@mi.com.lk

Maharagama Branch
No. 176, Lake Road,
Maharagama.
Telephone: 2849979
E-mail:
mimaharagama@mi.com.lk

Chilaw Branch,
No. 86, Puttalam Road,
Chilaw.
Telephone: 032-2224244
E-mail: michilaw@mi.com.lk

Embilipitiya Branch
No. 127C, New Town,
Embilipitiya.
Telephone: 047-2261351
E-mail:
miembilipitiya@mi.com.lk

Horana Branch
No. 439A, Panadura Road,
Galedandugoda,
Horana.
Telephone: 034-2265411
Email: mihorana@mi.com.lk

Safeguarding the Trust and Confidence Placed in Us

Our corporate values require that we maintain highest level of ethical standards in all our activities. Though our financial soundness has been a key strength in attracting customers, our procedures, processors and controls call for strict adherence to sound corporate practices to safeguard public funds and not mere profit accretion. Our recruitment system focuses on selecting individuals of high integrity by making appropriate background checks and sufficient evaluations prior to recruitment. Customer confidentiality is another subject treated with utmost respect and therefore strong confidentiality policies and procedures have been incorporated onto our daily operations. MI's IT systems have been set up with state-of-the-art software to protect against unauthorised access and data corruption.

Physical Safety of Customers

Our orientation towards customers is not merely focusing on creating superior offerings. It also extends to basic necessities such as the physical safety of customers. MI's head office located at Kollupitiya in the heart of Colombo has standard safety features such as escape routes and fire extinguishers in case of emergency situations. Safety of individuals within the premises is monitored by the Security Coordinating Officer who carries out routine rounds to ensure that standard security procedures are followed.

Customer Engagement and Interaction

MI's customer engagement process revolves around building a lasting bond between the Company and its valued customer, who is considered to be a key stakeholder. The engagement process aims to identify customer expectations and tries to capture suggestions which would help us raise our service standards and improve the ultimate value of our offerings.

The engagement process involves the use of standard communication practices as well as more personalised interactive methods. Company communiqués to customers via newspapers are used as primary means of communicating important information of the Company. In addition, specific information documents such as Company profile documents, annual reports etc. are displayed in the corporate web for our customers and users of reports to access more freely. However, to facilitate customer interaction, we also adopt a more personalised approach. This includes customer visits and arranging face-to-face meetings at a convenient location enabling us to understand customer requirements much better so that we could offer a more personalised service.

Other communication tools include use of direct mail, e-mail and telephone calls. Inviting key customers for Company events such as special promotions and celebrations has also been practised right along as a means of interacting more freely with customers, helping the Company to constantly review our product range with their changing needs. Additionally, customers have the opportunity to communicate more formally on their views by dropping their suggestions or grievances in 'suggestion boxes' located at core divisions of the Company. Further, as a means of recognising continuing loyalty, our valued depositors and agents are remembered annually, during festive seasons through the distribution of gifts and greeting cards.

Matara Street Promotion by MI sales staff

Fixed Deposits Brochure

Key Customer Initiatives During 2011/12

Aspect	Description	Key Initiatives Undertaken
Product development and enhancements	Introducing new products to broaden the existing product portfolio and enhancing features of existing products to provide greater value to customers.	• Introducing structured hire purchase and personal loans, launching of pledge facilities and a mortgage loan product. • Providing units of eight different brands with bundled financing services, eg. Tata Nano, Bajaj • Streamlining existing procedures and upgrading core systems to provide an enhanced service.
Special benefits to customers	Senior citizens are given additional percentage points on the interest rate for their deposits.	• Senior citizens were given between an additional 0.5% to 1%, as applicable.
Easing borrower repayments based on their payment ability	Rescheduling specific lending based on revised conditions depending on borrower background and creditworthiness.	• Total re-schedulements amounted to Rs. 90 million.
Prompt attention to customer request	Inquires made by customers on financing and other borrowings were promptly followed up by front line staff.	• Specific system enhancements to "customer inquiry system" provided prompt reminders to sales staff which enabled them to follow up inquiries better.
Creating greater awareness of product range	Resorted heavily to media advertising than before to create greater awareness of MI's product range. Also, prevailing rates were parallely advertised on a periodic basis.	• Introduced an advertising budget separately for credit business. There was heavy use of advertising this year with the total costs totalling Rs. 12 million.
Customer complaints	Customer complaints are made direct to relevant divisional heads or through the suggestion box placed in Credit and Recoveries. Head of legal is responsible to follow up any outstanding matters raised by the Financial Ombudsman.	• Total of nineteen complaints were received to the suggestion boxes during the period. Except for one matter being followed up for resolution, other matters have already been responded. • There were no pending claims or petitions against the Company before the Financial Ombudsman to date.
Adoption of sound corporate practices	Adoption of numerous regulations imposed by the regulator to the sector has enhanced the safety of our customers, especially the depositors.	• Specific steps taken to comply with the Corporate Governance Direction. • Further enhancements to KYC procedures to minimise related risks. • Listing the Company has enhanced reporting and provides a path for future capital needs.

Employee Obligations

Being a services sector organisation, we consider our workforce to be our most valuable asset. The human resource base of the organisation comprises individuals who are both skilled and experienced, who have been nurtured over the years to become financial specialists. They have been instrumental in our success story. MI considers its employees to be the brain and brawn of the Company, the people who provide life to the Company's vision, who take enterprise from the drawing board to the customer and beyond. The contributions made by our valued staff are immense and have been the differentiating factor in our road to success.

This year too our staff played a significant role in improving core business. They also well managed the challenges posed by our expansion strategies and changing market conditions. Over the years, our employees have shown immense potential in raising standards in our sphere of business while being dedicated to organisational growth. Nurturing and building staff skills and competencies at various levels have paved the way in realising organisational goals more effectively, thus enabling MI to be among the top companies in the sector.

We understand the importance of managing our staff effectively to improve productivity levels while maintaining the right level of employee morale and motivation. Thus MI has been a caring employer, nurturing employees and bringing about the best in people. Our employee-centric approach has helped us to build a team which is passionate about what they do; who are positive thinkers by nature, and who are adequately empowered to initiate value addition where it matters. Right along MI has been committed towards non-discriminatory practices and equality in the workplace. We have been a preferred employer by job seekers, attracting a wide and deep pool of skills and talent whenever vacancies exist in the Company.

Employee Engagement

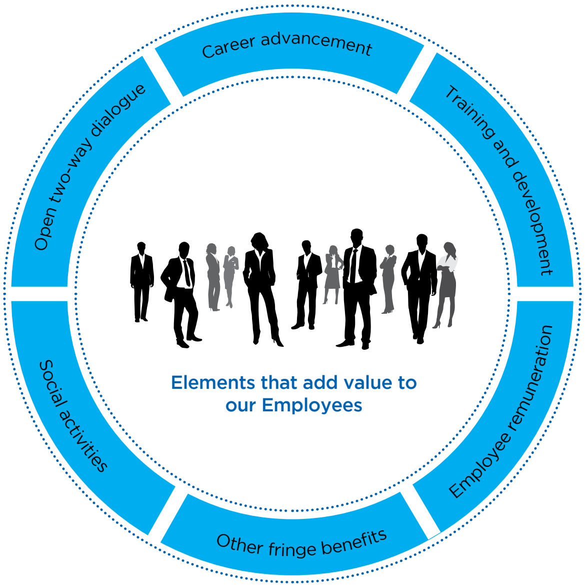
Empowering staff to engage more freely in corporate activities while facilitating good communication has raised productivity levels over time and has also kept staff morale high. We adopt an "open door policy" for our staff that enable easy two-way dialogue between employee and employer, eliminating any inhibitions.

This practice has enabled the Company to handle staff complaints and grievances better. Through this approach management is able to resolve matters speedily thus avoiding conflict and minimising any resultant impact on productivity. Open dialogue has reduced employee-employer barriers and has been a gateway for the free flow of invaluable suggestions that have helped improve MI operations.

As a means of reaping one's knowledge and expertise, staff of key divisions are nominated to be part of various committees. They include committees set up to implement special projects, Company events, etc. over the year. While this approach brings in abundance of knowledge to share among staff, it inculcates team building between divisions and with the senior management.

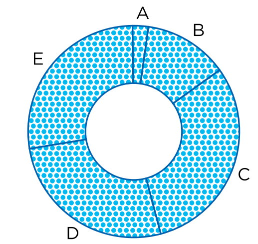
In 2011, MI's Human Resource Division was instrumental in issuing a Corporate Newsletter to MI employees covering a range of topics, both technical and general. The newsletter provides an excellent platform for staff to share their expertise with others in the Company. It also provided feedback to staff on Company's general progress and key activities and events that were just concluded, and notices on ones that are scheduled for the forthcoming period. A similar newsletter is planned to be issued in 2012.

Elements that Add Value to Our Employees



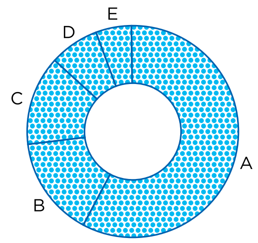
Staff Strength (%)

		2008	2009	2010	2011	2012
A	Directors	4	4	4	3	3
B	Managers	10	10	10	12	13
C	Executives	25	28	28	29	30
D	Clerical and Allied	29	24	25	28	27
E	Office Assistants and Others	32	34	34	27	27



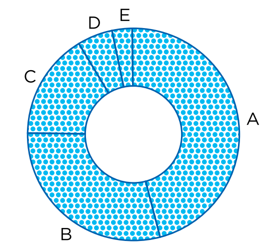
Service Analysis (%)

		2008	2009	2010	2011	2012
A	Below 5 years	37	47	50	51	58
B	6-10 years	28	23	19	17	15
C	11-15 years	20	16	17	17	14
D	16-20 years	11	10	10	9	8
E	Over 20 years	4	4	4	5	5



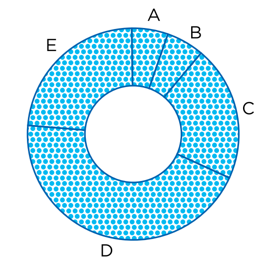
Age Analysis (%)

		2008	2009	2010	2011	2012
A	21-30 years	44	43	44	41	46
B	31-40 years	32	29	29	32	29
C	41-50 years	14	18	18	17	17
D	51-60 years	6	6	6	6	5
E	Above 60 years	4	4	3	4	3



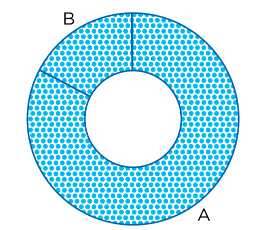
Staff Recruitment (%)

		2010	2011	2012
A	Directors	0	0	6
B	Managers	7	4	6
C	Executives	14	34	20
D	Clerical and Allied	48	38	44
E	Office Assistants and Others	31	23	24



Gender Distribution (%)

		2008	2009	2010	2011	2012
A	Male	80.97	80.97	82.35	82.91	82.43
B	Female	19.03	19.03	17.65	17.09	17.57



MI Board and Other Key Committee Gender Breakdown

The Board/Committee	Male	Female	Female % from total	Age 30-50	Age 50-70
The Board of Directors	8	2	20	8	2
Audit Committee	3	–	–	1	2
Integrated Risk Management Committee	4	–	–	2	2
Remuneration Committee	3	–	–	2	1
Credit Committee	3	–	–	2	1
Management Committee	20	2	9	20	2

Staff Distribution by Province

Branch	Province	2010	2011	2012
Trincomalee Branch	Eastern	–	3	7
	Eastern Total	–	3	7
Anuradhapura Branch	North Central			4
	North Central Total	–	–	4
Kurunegala Branch	North Western	–	2	6
Chillaw Branch	North Western			4
	North western Total	–	2	10
Balangoda Branch	Sabaragamuwa	5	7	5
Embilipitiya Branch	Sabaragamuwa			3
	Sabaragamuwa Total	5	7	8
Bentota Branch	Southern	4	4	6
Galle Branch	Southern	–	–	6
Matara Branch	Southern	–	–	9
	Southern Total	4	4	21
Head Office	Western	262	277	298
Negombo Branch	Western	6	8	10
Kohuwala Branch	Western	8	9	12
Kadawatha Branch	Western	4	6	9
Maharagama Branch	Western	–	–	6
Horana Branch	Western	–	–	2
	Western Total	280	300	337
Grand Total		289	316	387

Candidate Selection and Recruitment Style

Through the human resource recruitment process, the Company attracts the right people in the market, who can add value to the Company in the years to come, leading to a win-win position for either party. Diligent screening during the selection and recruitment process avoids the possibility of subsequent resignations, thus minimising a waste of resources.

Our recruitment and selection process works on a set criteria which involve evaluating standard requirements and attributes that a candidate should possess including adequate qualifications, experience in the related field, basic knowledge and aptitude, personality, and finally seeking reference. In this process, we sometimes recognise cultural and psychological similarities that prevail among friends and therefore in certain instances provide opportunity for staff to suggest candidates for vacancies within the Company. We augment this people-friendly approach with standard recruitment assessment tools to shortlist and select ideal candidates. However in most instances, we advertise potential vacancies by calling for applications through newspaper notices. The Human Resource Division coordinates with relevant divisions in the selection process, subjecting candidates through a stringent interview and recruitment procedure.

Employee Training and Development

Effective from 2012, all new recruits are subject to an intensive induction programme. This is, thereafter, followed up by subsequent training and development activities as they continue their service. Our corporate culture heavily promotes knowledge accretion, that eventually benefits both the organisation and the individual in the longer term. Employees are provided an equal opportunity to realise career aspirations to their fullest potential. We practice an ongoing system of training and development across divisions enabling staff to enhance knowledge in their fields as they progress in their careers.

The training programmes conducted internally cover topics that are essential to an employee in executing ones routine functions. Separately, external training is afforded to key divisional staff so that they can be well prepared to handle changes happening to regulations, changes in the sector, etc. Similarly, top officials heading core functions of divisions have been sent on overseas training with the intention of providing them broader knowledge and skills to further improve their management capabilities.

In parallel, we encourage employees to learn a cross-section of work under their functional areas, thus enabling them to become multi-skilled. This, we believe, will groom them for varying challenges in the future. It not only increases the individual's value to the organisation but also facilitates personal development and fulfillment of career aspirations. Furthermore, staff members are accustomed to MI's unique culture that fosters creativity and recognises committed individuals. This has set a platform for the birth of potential leaders within the workforce, who are innovative thinkers.

Through this mechanism we continue to receive invaluable suggestions from our members at our weekly corporate forums.

Induction Programme Agenda

1. Grooming new recruits to the Company culture including corporate -
   - Vision, Mission & Values
2. Code of Conduct
3. Use of effective communication
4. Human Resources elements -
   - Leave
   - Performance management
   - Career progression
   - Grievance procedure
   - Team work
5. Telephone etiquettes
6. Personal grooming
7. Service comparison using RATER method -
   - Reliability
   - Assurance
   - Tangible
   - Empathy
   - Responsiveness

In house - Training

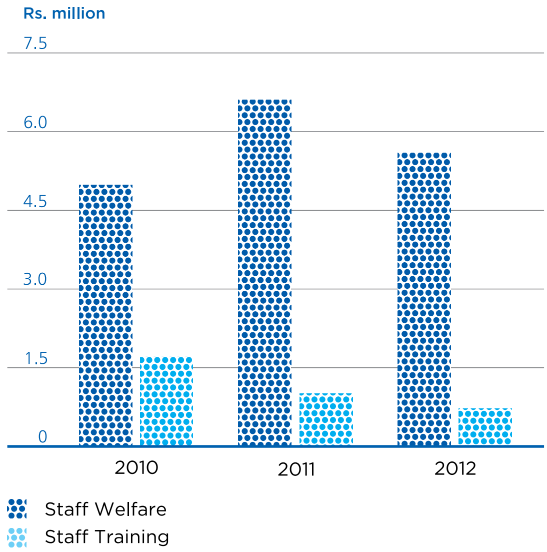
MI Training Summary

Training/Institute	Grade	No. of hours	No. of participants
Leasing Association of Sri Lanka	Managerial	07	03
CIMA Business Leaders Summit - CIMA Sri Lanka	Managerial	07h 30 min	01
Budget Seminar - CIMA	Managerial	03	01
Budget Highlights - ICASL	Managerial & Executive	05	02
Asian Pathfinder Legal Consultancy Services	Director	05	01
Institute of Certified Management Accountants of Sri Lanka	Managerial	05	01
Financial Intelligence - Centre for Banking Studies	Managerial	07h 30 min	05
Auto Painting - India	Assistant	28	02
Cheque Frauds, Hire Purchase, Leasing - BAR Association of Sri Lanka	Managerial & Executive	05	05
Leasing, Hire Purchase Seminar - The Finance Houses Association of Sri Lanka	Assistant & Executive	04	09
Financial Reporting - Leasing Association of Sri Lanka	Managerial	07	02
Budget Discussion - Alumni Association University of Colombo	Managerial	07	02
Workshop on Debt Recovery Special Provisions Act - Asian Centre for Lease Education	Assistant & Executive	05	06
New Parliamentary Acts, Property Mortgages'	Executive	05	04
Sri Lanka Insurance Institute	Managerial	05	02
Induction for New Recruits	Assistant, Executive & Managerial	18	30

In-house training on Anti-Money Laundering (two hour programme)

Grade	2008/09	2009/10	2010/11	No. of staff **2011/12**
Managers and above	13	8	4	**5**
Executives/ Assistants	19	17	21	**21**
Total	32	25	25	**26**

Staff Cost on Welfare and Training



Demonstrating Corporate Values

Our business philosophy embodies the need for employees to possess and practise sound corporate values at all times. The need to display integrity in all our activities is considered the most essential attribute for our staff members and is at the helm in our corporate values. These values, combined with employees' experience and qualifications, provide us the right set of individuals to fulfil corporate aspirations effectively.

Our adoption of these sound values has enabled us to manage our business prudently. In effect, there are established corporate rules explicitly stated in a standard employee letter of appointment for them to follow. There are also communiqués from management emphasising the need for staff to act with caution and to meet the highest ethical standards when executing one's duties. Any violations of professional and personal ethics are viewed seriously and are dealt with strongly by management. These practices have safeguarded our corporate name in the eyes of external parties.

Ideal Work Environment

Our work environment encourages staff to act independently, develop one's professional life and play a leading role in corporate endeavours. We provide all necessary tools and motivate them to efficiently perform their functions. MI's organisation structure facilitates efficient reporting and is not complex. Having a simple structure promotes free communication across divisions, enables smoother operations and effective decision-making.

The Company concluded its physical restructuring exercise of rearranging floor areas of core divisions for the purpose of streamlining work processes and to encourage free flow of information among staff. As expected, this effectively reduced communication delays and created better working relationships and team spirit among divisions. In the same way, MI's branches have been designed meticulously to create the needed ambiance for a work environment that facilitates efficient work flow. At the same time, we own or occupy business premises that ensure such properties are built on accepted building standards that provide the needed physical safety for all staff members.

Performance Appraisal

We adopt performance appraisal as a methodology to evaluate staff performance annually. Through this, divisional heads are able to closely monitor their staff performance against pre-determined expectations. This methodology supports the Senior Management in aligning individual corporate objectives with broader aspirations and goals of the Company and thus ensures goal congruence. At the commencement of the year, goals for each staff member are decided together with relevant quantifiable targets. Thereafter, at the end of the period, heads of divisions carry out a formal appraisal for each of their staff members on the degree of attainment of these pre-defined aims in consultation with the relevant employee. This is carried out through a comprehensive formal appraisal document that gives appropriate weightage to each human resource aspect including attainment of specified goals.

The appraisal process becomes essential for main divisions additionally since the Company's annual reward system for such staff is directly correlated with their performance. The formal appraisal system provides the basis for deciding annual increments of employees, special rewards, and training needs and serves as a basis for identifying promotional prospects. Seeing the success of this approach, the Company's Human Resource Division has made plans to roll out the appraisal system to all divisions by the end of 2012.

Recognising the Contributions of Employees

MI strongly believes in rewarding its employees, based on their level of commitment and the value each member brings to the organisation. An attractive remuneration package is afforded to employees, based on their annual performance, grade and years of service in the organisation. Salary scales are reviewed annually to ensure that it is competitive and is in line with current market levels. Our remuneration policies ensure that there is no discrimination based on gender.

Other than standard perks afforded to staff including annual bonuses, staff loans and health insurance, the Company recognises their relentless commitment by presenting special awards for best attendance and cash awards for long service. Monetary benefits are not the only perks that staff receive for their tireless efforts. MI affords a range of non-monetary benefits too that keep staff satisfaction and motivation levels high. These initiatives include social events such as the MI sports meet, annual get-together and cultural events. External gym facilities have been afforded to staff in the manager grade to relieve themselves of daily stresses so that they maintain a healthy lifestyle.

Intangibly, staff receive inspiration to align with organisational aspirations since they automatically become part of MI's well-knit corporate culture. This friendly culture brings out togetherness and a sense of family among each MI member within the organisation. Our grievance handling practices are not restricted to work only but reach out to personal and other distresses of employees that hinder performance. Similarly, MI's free flowing work environment facilitates the ideal backbone for employees to advance in their careers.

Low Staff Turnover Levels

Effective human resource management practices coupled with sound reward systems have kept staff motivation and morale high at all levels. Hence, we hold low staff turnover levels compared to the total staff size. Some of our employees have served us for decades while almost 50% of staff has been with the Company for over five years.

Staff Turnover

	2010	2011	2012
Managers and above - Resigned	2	1	3
Other Staff - Resigned	13	16	32
Resigned as a % of Total Staff	5%	5%	9%

Events and Achievements in FY 2011/12

- **Pirith Ceremony**
  A Pirith Ceremony was held at Mercantile Investments and Finance PLC head office for the second consecutive year on 30th July 2011. This event was an idea which was originated by our Managing Director to bless the Board of Directors and all staff of the Company. For this religious event, the Chief Priest of Gangarama Temple was invited while the heel dana was given to the Gangarama Temple the following morning. Staff members and people within the vicinity were invited to lunch on the following day, which saw a notable participation of close to 500 individuals for the event.

- **Annual get-together**
  Annual staff get-together was held on 3 December 2011 at the Waters Edge in grand style, providing an opportunity for all staff members to interact with fellow members of the MI team in a more informal way.

- **Reaching Quarter-final stage in Cricket**
  MI's cricket team managed to enter quarter final stages of the Mercantile "E" Division Cricket Tournament organised by the Mercantile Cricket Association for the year 2012. The team received a special award for scoring over 400 runs in one innings and our staff member Mr. Prasad Senaratne attached to MI's Recoveries Division was the recipient of the Best Batsman Award.

Key Human Resource Initiatives for FY 2011/12

Aspect	Description	Key Initiatives Undertaken
Improve efficiency of operations and practices	Improving quality of operations has been a focal point for the company throughout this period. To maintain excellence in service, considerable effort was made in improving productivity levels and delivery standards.	The Company obtained expert assistance from a consultant to review our operations. After a thorough review of our current operations and information systems, specific modifications were made to the core systems to accommodate for enhanced information requirements to perform functions more effectively. The HR Division was given greater autonomy to implement best practices across the Company. The Division was strengthened by recruiting additional officers.
Strict policies on principles of discipline and punctuality	The Company enforced standard policies on punctuality through the use of technology.	A finger-print system was introduced to record staff attendance. In addition to better monitoring of attendance history, this module supports in providing accurate and speedy information for preparation of the payroll.
Expanding workforce	Meeting staffing needs in keeping with expansion strategies of the Company was a focal aspect throughout the year.	Staffing of new branches that were opened during the year through new recruits, particularly for tasks attached to credit and marketing.
Expanding the knowledge base	MI's culture fosters learning and facilitates continuous enhancement of one's knowledge base a necessity in a growing and complex business world. This not only creates value to an individual but also contributes to the success of the enterprise.	• Setting up special induction programmes for new recruits covering basic principles on general corporate ethos and other aspects specific to finance business. • Sales related training for front line officers to provide an efficient service. • Training programmes, workshops and seminars for staff handling specialised functions. Related topics included financial reporting, corporate governance, aspects on CRIB handling, taxation, KYC requirements, etc.
Safety of employees		Reviewed existing fire precautionary measures of the building, plant and machinery. A physical inspection was carried out by the fire officers of the Colombo fire brigade and accordingly their recommendations for improvements are being implemented. A fire drill including an evacuation drill is planned to be performed as part of these safety measures.
Human resource information system	A system that houses a database of information of all employees of the organisation.	Ongoing development of an electronic HR system for personal files of each staff member. The project is planned to be completed during 2012.
Increasing insurance cover	As a staff welfare initiative, medical insurance cover granted to staff to be upgraded.	The need to upgrade existing individual medical insurance cover was decided, and is planned to be effected from 2012.

Investor Obligations

Shareholder Value Creation

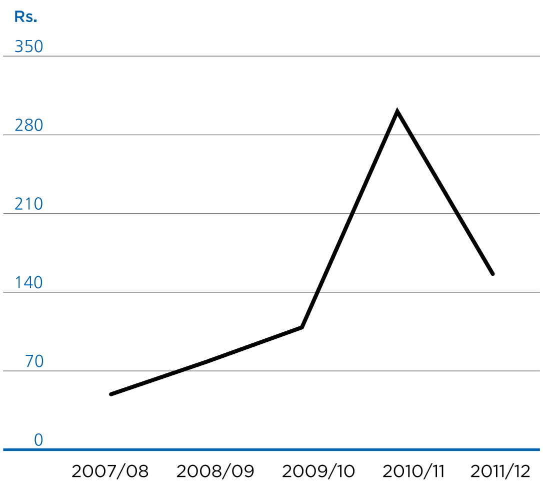
The need to augment shareholder wealth and to provide above average returns to our investors is one of our primary objectives. MI's business strategies, therefore has been aligned to achieve shareholder wealth accretion as one of its primary goals. MI's strategic plan developed during FY 2011/12 maps out strategies for the next three years, focusing on total revenue growth and improving core business profitability. Business operations therefore have been streamlined for greater productivity and enhancing final value of our product that would keep us ahead of competition. Our tireless efforts have already brought us consistent financial performance in the recent past. As promised, we delivered sound returns to our shareholders, thus securing their trust in the MI Board and the Company's Management.

MI is now a Listed Company

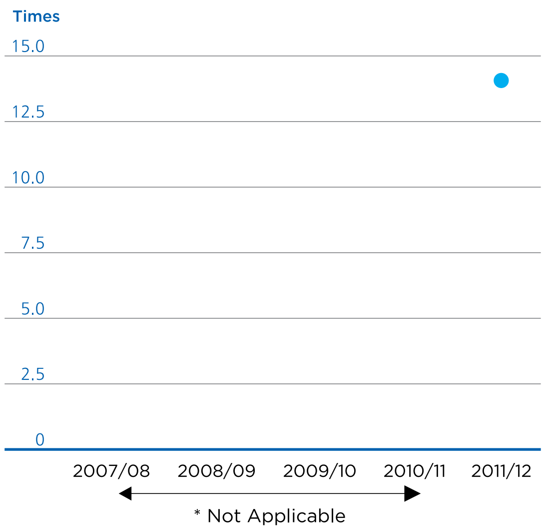
To fall in line with sector regulations, the Company proceeded in obtaining a listing in the Diri Savi Board of the Colombo Stock Exchange effective from June 2011. This expands the avenues for the Company to obtain capital when the need arises and enables investors to transact their shares more freely. As we continue to post consistent and superior financial results, our investors will reap the dual benefits of growth in the Company's share value as well as higher returns from dividends.

	2007/08	2008/09	2009/10	2010/11	**2011/12**
Earnings per Share (Rs.)	49.52	77.79	109.31	301.36	**156.45**
Dividend Yield (%)	N/A	N/A	N/A	N/A	**1**
Asset growth YOY (%)	9	-3	8	44	**42.57**
Return on capital employed (%)	5	9	9	19	**9**
Share price - Ordinary voting (Rs.)	N/A	N/A	N/A	N/A	**2,200.00**
Dividend (Rs. '000)	14,049	9,750	13,800	30,000	**66,132**
Price Earnings ratio (times)	N/A	N/A	N/A	N/A	**14.06**

Earnings Per Share

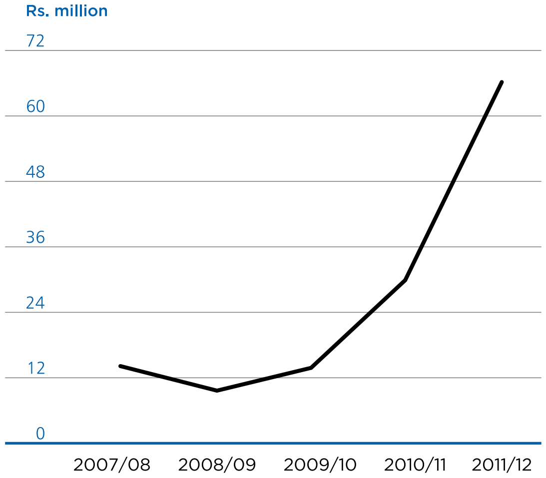


Price Earnings Ratio

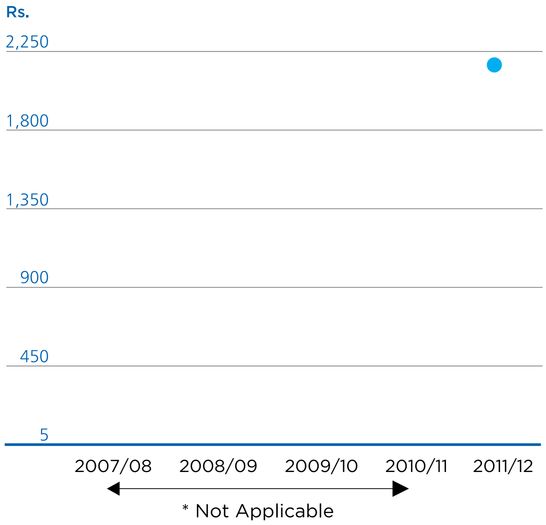


** Obtained Listing Status Commencing June 2011*

Dividends Paid



Share Price



** Obtained Listing Status Commencing June 2011*

Adoption of International Financial Reporting Standards (IFRS)

Plans are under way to implement requirements of now applicable IFRS that is bound to enrich financial disclosure through greater transparency. An internal technical committee has been set up with an external consultant's support so that gaps can be identified and bridged to ensure a smooth transition to these international standards. Being in the forefront of providing timely and transparent information, we will adopt these standards within the specified timeframe. Continued excellence in reporting standards would provide confidence to users of our corporate reports, especially investors and potential investors. As a result, the Company would be on a better footing to negotiate funding lines from even international investors and lenders.

Investor Engagement

Mercantile Investments and Finance PLC's diversity in terms of investor participation is presently limited as it comprises only a few large investors. Nevertheless, investor participation is bound to increase with time especially with the Company going quoted. The Company issues a comprehensive Annual Report and holds an Annual General Meeting (AGM) in line with the Companies Act. The AGM provides an ideal opportunity for interaction with shareholders and to brief MI's yearly progress and performance and to obtain their invaluable feedback.

Our corporate website provides extensive information on Company background and recent financial statistics that is helpful to investors. Additionally, we provide annual and by-annual financial information through Colombo Stock Exchange website as per regulations of the CSE.

Awards and Special Recognitions

- Annual Report Awards Ceremony organised by the Institute of Chartered Accountants in 2011.

  MI was adjudged the winner of the gold award in the Finance Company Sector category for producing an outstanding Annual Report yet again. This was our 12th consecutive year of winning this award.

Receiving the Annual Report Award

MI Team with Annual Report Award

Local Community Obligations

Right through our long history, we have stood by our core values and have not failed to assess the needs of the local community. We consciously focus on a range of initiatives that support the upliftment of communities in areas that we are actively present in.

Our initiatives go beyond creating access to financing, and include health, education and other activities that benefit society at large. The recently set up Corporate Social Responsibility (CSR) Committee has increased our emphasis on meeting societal aspirations more than before. As illustrated in the schedule below, the Company with the support of the CSR Committee was able to initiate more projects directed toward enriching community relations compared to a year before. Our total community projects this year amounted to 0.35% of profit before tax.

Meeting the Financing Needs of Communities

While pursuing business growth, we have also been an understanding partner to local communities by being alert to their financial needs, and in the process, we have fostered lasting bonds. Extensive growth in MI's branch network in the last couple of years has opened a gateway for the Company to expand its offerings and to increase its presence also in the suburbs and provinces. This has enabled the Company to interact with such local communities that MI did not have access to before. Such communities comprise enterprising individuals who have urgent financial needs, either personal or entrepreneurial. Our presence outside the Western Province has grown in the recent years, signifying our commitment towards uplifting the rural economy.

			Rs. million
	09/10	10/11	**11/12**
Outside Western Province;			
Loan Portfolio	360	650	1,812
Deposit Mobilisation	5	7	39

Fair Competition in the Sector

MI's business practices have been aligned to follow accepted industry norms and ethics. These practices reflect Company's ethos on fair competition against other players in the financial sector. We refrain from engaging in activities that are detrimental to fair play in business. To maintain fellowship and interaction among our counterparts, the Company participates in industry events and continues to participate as a member of key Associations including The Finance Houses Association and The Leasing Association of Sri Lanka.

Project Undertaken in FY 2011/12	Description of Activities Under the Project	Incurred Costs Rs.
Distribution of medicines to fight cancer	MI assisted the National Cancer Institute, Maharagama by donating medicines that were needed to help patients	Incurred Rs. 60,080/- for the project in January 2012.
Reactivation of water holes to provide drinking water to animals	MI contributed to the restoration of selected water holes in the Yala game sanctuary	Incurred Rs. 104,000/- for the project in March 2012.
Controlling the breeding among stray dogs in the city and rabies	A campaign was organised in the outskirts of Moratuwa where over 40 stray dogs were vaccinated to control breeding and spread of rabies	Incurred Rs. 51,800/- for the project in March 2012.
Assistance to schools	Financial assistance for school fund raising to support various projects	Assistance to a number of schools during FY 2011/12 totalled Rs. 313,000/-
Assistance to religious places	Financial assistance for religious activities of temples and churches.	Assistance to a number of religious institutions during FY 2011/12 totalled Rs. 148,000/-
Donation to Lanka Alzheimer's Foundation	Financial assistance to the Foundation	Donated Rs. 10,000/- to the Foundation in April 2011
Donation to Sri Lanka Military Police	Donated for the concert organised on the theme *'Vinaya Arakshawa'*	Donated Rs. 50,000/- in December 2011.

Supply of water holes to animals at Yala

Dog Vaccination Campaign

Medicines to Cancer Hospital

Employee Participation in Community Service

As part of our close knit culture, MI employees also have voluntarily taken the initiative over the years to support social activities and community development in many ways. FY 2011/12 was no exception. A fully-fledged blood donation campaign was organised with the Blood Bank in December 2011 which saw over 50 MI members contributing blood for this worthy cause.

Blood Donation Campaign

Practices on Anti-Money Laundering (AML)

Numerous steps have been taken to counter Money Laundering and Terrorist Financing in line with current regulations. A separate policy document on AML was prepared specifying requirements of regulations and practices on customer identification including background verification documents to be obtained. These procedures minimise MI's exposure to money laundering that may be carried out by external parties through financial transactions. The use of sound controls on AML assists in curbing crime rates in general and minimises corrupt practices, thus adding value to society.

Environmental Obligations

Electricity consumption

50,725 (kWh)

Water usage

723 (Units)

Photocopy paper usage

2,853 Packets of A4 paper

We continued to develop practices that are environmental friendly, building on initiatives that have evolved over time. These practices reflect MI's growing commitment towards environmental obligations. Being a service oriented organisation our interaction with the environment as a business mainly revolve around use of resources. We adopt green practices that conserve use of resources and protect the environment that we are exposed to. During FY 2011/12, we also undertook initiatives to show our commitment to the long-term preservation of the environment and habitats.

A Carbon Neutral Annual Report

This year too, we have produced a carbon neutral Annual Report. The greenhouse gas emissions resulting from the designing, photography, production, project management, usage of paper and printing were offset using verified carbon offsets.

Controlling the use of Stationary and Consumables

All staff are encouraged to conserve paper usage as a means of cutting down wastage. Depending on the importance of documents, as a standard practice, recycled paper is used for internal documents, drafts, etc. As another step, each Division is required to monitor their own use of stationery consumption by keeping records of stock, once items are issued from the main stores.

Since existing cartridges are reused through a refilling process, consumption of printer cartridges are controlled. Further, the recent implementation of the "Document Management System" has enabled Credit, Recoveries and Legal Divisions to scan and archive important documents that would otherwise need to be stored physically. This reduces the need for greater paper utilisation while freeing storage space for more productive use.

Trend in Usage of Consumables

Type of Item	2009/10	2010/11	**2011/12**
Photocopy paper: (reams)			
- A4	1,467	1,638	**2,382**
- Legal	131	156	**178**
- A4R	229	279	**293**
Total	1,827	2,073	**2,853**
Printer cartridges (No. of cartridges)	322	153	**389**
Photocopy Toner, Fax Cartridge & Laser Jet Printer Toners (No. of Units)	284	271	**420**
Box Files (No. of box files)	215	178	**436**

Sustaining an Eco-Friendly Environment

We have been accustomed to standard green practices that have kept the environment and surroundings clean and better protected. Maintaining cleanliness at all MI locations has been practiced right through, a reflection of our commitment to a healthy environment. As a standard practice, waste items and garbage are efficiently collected and disposed of daily, without harming the surroundings. At departmental level, management has initiated communiqués on the need to keep one's surroundings clean as an attempt to create awareness among all staff. Notices have been displayed in washrooms to maintain hygiene and to use water sparingly.

Practices on Conserving Energy

As a result of industrialisation and population growth, demand for energy has increased vigorously while energy resources continue to be scarce. Hence, conserving energy resources has become a focal point in recent times. To add to this, as a by-product of the use of fuel and other energy resources, carbon dioxide and other greenhouse emissions are released to the environment triggering climate change and added environmental hazards.

As means of minimising energy use and countering emissions to the environment numerous measures have been initiated by our Engineering Division. Use of CFL and fluorescent tube lights at all MI locations in the recent past has contributed in controlling energy usage notably. We use a capacitor bank to manage reactive power draw from the mains. Windows at our head office building are tinted to reduce air conditioning loads, and hence minimise electricity consumption. As another step, unless specifically needed, the central air conditioner at our head office is switched off at 5.00 p.m.

Trend in Average Monthly Electricity Utilisation (MI Head Office)

	2010	2011	**2012**
Electricity - kWh	47,122	49,105	**50,725**

Electrical energy consumption is measured in kilowatt hours (kWh)

Controlling Water Usage

The Engineering Division of MI has taken numerous steps in controlling water usage to minimise water consumption levels. During FY 2011/12, plans were initiated to minimise use of water in washrooms by introducing a special flushing system. In the future it is proposed to adopt a tube well system in place of pipe borne for the same operation.

Trend in average monthly water utilisation (at MI head office)

	2010	2011	**2012**
Water - (units)	638	634	**723**

Reducing Fuel Consumption

The Company's own Workshop Division attends promptly to periodic servicing of MI's vehicle fleet used for employee transport. This ensures efficient use of fuel and controls greenhouse gas emissions to the environment. Performance of each vehicle is monitored closely through monthly meter readings compared against related fuel consumption. Vehicle-wise fuel costs statements are reviewed by divisional heads as means of curtailing related usage and costs.

Quantity of Fuel Consumed during the last 3 years

	2010	2011	**2012**
Fuel			
Petrol (Litres)	94,418	86,578	**121,626**
Diesel(Litres)	29,255	18,101	**20,167**

Limiting Hazardous Emissions

Fuel emission certificates were obtained by our Transport Division for our fleet of vehicles in line with prevailing road regulations. This minimises hazardous emissions being released to the environment from the use of vehicles.

Conservation of Animal Population in Yala

During FY 2011/12, a number of display boards with important conservation messages, were handed over to the Yala National Park by the Company. This exercise portrayed the dire need in halting the shrinking animal population in the sanctuary.

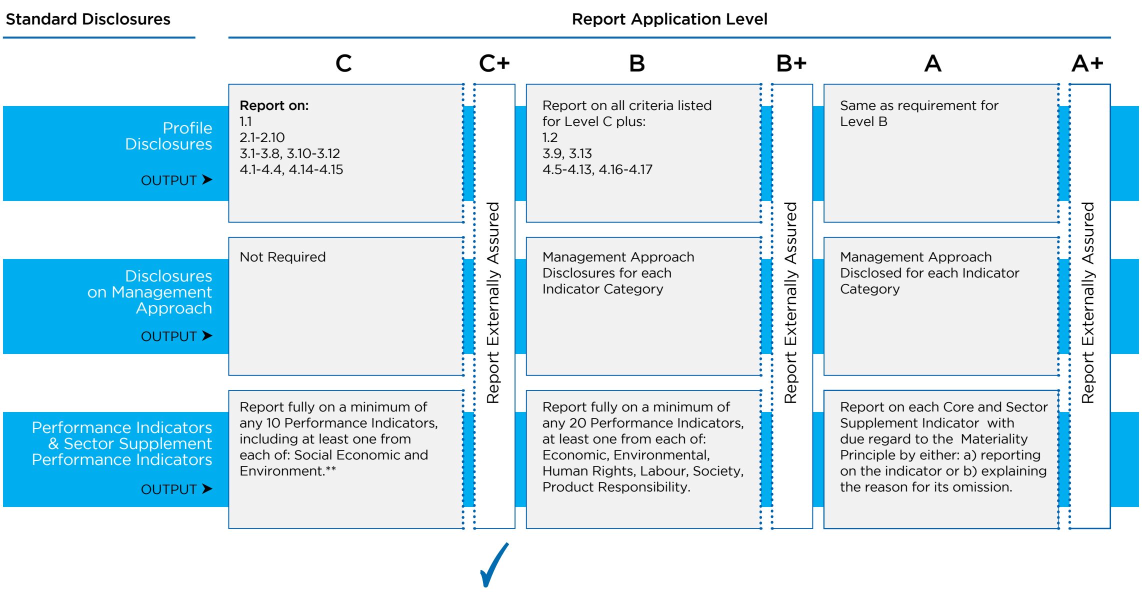
Yala Boards on Animal Conservation

Key Sustainability Performance Indicators

Section	Key Sustainability Performance Indicators	Page No./s
Customer obligations	Number of branches opened - 8	
	Number of service centres opened - None	
	New products launched/product extensions - 2	
	Number of direct written customer complaints - 19	
Employee obligations	Total staff by grade, gender, service and age/staff distribution by province	114 and 115
	Training hours/Training costs and welfare costs	116 and 117
	Staff turnover/new recruitments	118/114
Investor obligations	Investor performance indicators	120 and 121
Community obligations	Community projects initiated	122 and 123
	Training hours on Anti-money laundering	117
	Donations to schools, religious institutions and other	122
Environmental obligations	Stationery and consumable costs trend	124
	Electricity consumption	125
	Fuel consumption	125
	Water consumption	125

The Global Reporting Initiative Grading and Index

MI's sustainability report this year has been based on the G3.1 version of the GRI framework. Based on the extent of reporting, we have self-assessed our reporting to be application level "C". Our application level has been checked independently by Messrs Cecil Arsecularatne, Chartered Accountants and therefore a "C+" has been given.



Global Reporting Initiatives (GRI) serve as a structured framework for us to report MI's organisation's economic, environmental, and social initiatives and performance. Accordingly, herein we provide the GRI Index with reference to key sustainability categories and related aspects including performance indicators in line with the framework.

No.	Description	Disclosure	Page No./s
Profile			
1. Strategy and Analysis			
1.1	Statement from the Managing Director	• Sustainability Report	101
1.2	Description of key impacts, risks and opportunities	• Sustainability Report	106 and 107
2. Organisational Profile			
2.1	Name of Reporting Organisation	Mercantile Investments and Finance PLC	
2.2	Primary brands, products and services	• A Licensed finance leasing company that primarily deals with lease financing, hire purchase financing and mobilisation of deposits. We do not use outsourcing for the provision of key services	
		• Management Discussion & Analysis	16 to 39
2.3	Operational structure of the organisation	• Organisations governance structure	55
		• The Company does not have subsidiaries for purpose of reporting.	
2.4	Location of organisations headquarters	236, Galle Road, Colombo 03	
2.5	Number and name of countries with operations	Only operated in Sri Lanka	
2.6	Nature of ownership and legal form	Corporate Information	Inner Back Cover
2.7	Markets served	• Management Discussion & Analysis	16 to 39
		• Segmental Analysis	189
2.8	Scale of the reporting organisation	• Number of staff as at 31 March 2012 - 387	
		• Sales, debt to equity and other information	Financial Highlights
		• 10 year summary	200
		• Number of operations - Two significant operations involve credit disbursement and deposit mobilisation	
2.9	Significant changes during the reporting period	No significant changes other than structural changes to the Board	48 and 49
2.10	Awards received	Best Annual Report for 12 consecutive years in the finance companies sector organised by ICASL	
3. Report Parameters			
Report Profile			
3.1	Reporting period	1 April 2011 to 31 March 2012	
3.2	Date of most recent previous report	31 March 2011	
3.3	Reporting cycle	Annual	
3.4	Contact point	Accounts Department, Mercantile Investments and Finance PLC 236, Galle Road, Colombo 03	

No.	Description	Disclosure	Page No./s
Report Scope and Boundary			
3.5	Defining report content	Defining report content	102 and 103
3.6	Boundary of report	Defining boundary of report	103
3.7	Limitations to scope	No material limitation	
3.8	Basis for reporting subsidiaries, joint ventures etc.	Not applicable	103
3.9	Data measurement techniques	GRI and Company specific performance indicators have been adopted using data available	
3.10	Restatements	None	
3.11	Significant changes	None	
3.12	GRI content index	Detail cross references given in GRI table	
3.13	External assurance	External assurance obtained	135
4. Governance, Commitments and Engagement			
4.1	Governance structure	• Corporate Governance Report • Sustainability Report - gender/age of members of key committees	54 to 79 115
4.2	Chair of the highest governance body	• Corporate Governance Report	54 to 79
4.3	Highest governance body	• Corporate Governance Report	54 to 79
4.4	Mechanism for employees/shareholders to provide recommendations/direction to the Board	• Sustainability Report - Employees engagement • Sustainability Report - Investor obligations	113 120 and 121
4.5	Compensation and performance	• Sustainability Report	117 and 118
4.6	Process for avoiding conflict of interest	• Corporate Governance	54 to 79
4.7	Expertise of governance body	• Board Composition	48 and 49
4.8	Mission and value statements	• Annual Report - Vision, Mission and Values	Inner Front Cover
4.9	Procedures of the highest governance body for overseeing sustainability	• Sustainability Report	104 and 105
4.10	Process of evaluating the highest governance body's own performance	To be done from next period.	
4.11	Precautionary approach	• Risk Management	82 to 97
4.12	Externally developed initiatives	None.	
4.13	Membership in associations	• Member of The Finance Houses Association of Sri Lanka • Member of the Leasing Association of Sri Lanka • Member of Ceylon Chamber of Commerce	

No.	Description	Disclosure	Page No./s
4.14	List of stakeholder groups	• Stakeholder Inclusiveness	103
4.15	Identification and selection of stakeholders	• Sustainability Report	102 to 125
4.16	Approaches to stakeholder engagement	• Sustainability Report	102 to 125
4.17	Key issues and concerns of stakeholders	• Sustainability Report	102 to 125

Economic

5. Economic Dimension

No.	Description	Disclosure	Page No./s
	Management approach	• Management Discussion & Analysis (Economy & RFC sector, challenges, opportunities and threats, future outlook)	16 to 39
		• Sri Lanka Economy at a Glance	40 to 45
		• Sustainability Report - Investor Obligations	120 and 121
5.1 Economic Performance			
EC1	Economic value generated and distributed	• Economic Value Added	193
		• Value Added Statement	194
		• Sources and Utilisation of Income	195
EC2	Financial implications of climate change	• No material effect to business due to climate changes	
		• Sustainability Report	124 and 125
EC3	Organisation's defined benefit pension plan	Defined benefit plans - Accounting Policies to the Financial Statements	168
EC4	Financial assistance from Government	None for this period	
5.2 Market Presence			
EC5	Entry-level wage - local minimum wage by gender	• Sustainability Report	117 and 118
EC6	Policy, practices and proportion of spending on locally based suppliers	Not reported	
EC7	Hiring of employees	Employees recruited are mostly residing within close proximity to the Company's head office or to the branch they are allocated	
EC8	Development and impact of infrastructure investments	Not reported	

No.	Description	Disclosure	Page No./s
EC9	Indirect economic impacts	• Sustainability Report • Other economic impacts from business; - Expansion to parts of the country supports businesses of those regions. - Training and development of staff raises productivity and hence overall output. - Our social and environmental initiatives support economic upliftment indirectly. - Good governance practices protects stakeholders and in turn the financial system, bringing in economic stability.	106 and 107
Environmental			
6. Environmental Dimension			
	Management approach	• Sustainability Report	124 and 125
6.1 a Materials			
EN1	Materials used by weight or volume	• Stationary and printer cartridge usage	Page 124
EN2	Percentage of materials used that are recycled input materials	Not relevant for 'C' level reporting	
6.1. b Energy			
EN3	Direct energy consumption by primary energy source	Not relevant for 'C' level reporting	
EN4	Indirect energy consumption by primary source	• Sustainability Report	124 and 125
EN5	Energy saved due to conservation and efficiency improvements	Not relevant for 'C' level reporting	
EN6	Initiatives to provide energy-efficiency improvements	Not relevant for 'C' level reporting	
EN7	Initiatives to reduce indirect energy consumption and reductions achieved	• Sustainability Report	124 and 125
6.2 Water			
EN8	Total water withdrawal by source	• Sustainability Report	125
EN13	Habitats protected	• Sustainability Report - conservation of animal population	122, 123 and 125
	Sections EN9 - EN12, EN14 - EN 15 & EN16 - EN17, EN19 - EN25, EN27	Not relevant for 'C' level reporting	

No.	Description	Disclosure	Page No./s
6.3 Emissions, Effluents and Waste			
EN18	Initiatives to reduce emissions and reductions achieved	• Fuel emission test for the Company vehicle fleet	125
		• Controlling fuel used for vehicles	125
6.4 Products and Services			
EN26	Initiatives to mitigate environmental impacts of products and services, and extent of impact mitigation	Not applicable	
6.5 Compliance			
EN28	Monitory value of significant fines and total number of non-monetary sanctions for non-compliance with environmental laws and regulations	Not applicable	
6.6 Transport			
EN29	Significant environmental impacts of transporting products and other goods and materials used for the organisation's operations, and transporting members of the workforce	• No material environmental impact • Fleet vehicles used for staff transportation is subject to fuel emission test requirements	
6.7	Overall		
EN30	Total environmental protection expenditures and investments by type	• Fuel emission test	125

Social - Labour

7. Labour Practices and Decent Work			
	Management approach	• Sustainability Report	Page 113
7.1 Employment			
LA1	Breakdown of total workforce	• Sustainability Report	114 and 115
LA2	Total number of new employees and employee turnover	• Sustainability Report	114 and 118
LA3	Benefits provided to full time employees	• Sustainability Report	117 and 118
7.2 Labour/Management Relations			
LA4	Collective bargaining agreements	Not applicable	
LA5	Notice period regarding operational changes	At the discretion of the management	

No.	Description	Disclosure	Page No./s
7.3 Occupational Health and Safety			
LA6	Management-worker health and safety committees	Not relevant for 'C' level reporting	
LA7	Rates of injury, lost days, absenteeism and fatalities	Not reported.	
LA8	Educating staff on serious communicable diseases	Not relevant for 'C' level reporting	
LA9	Health and safety in union agreements	Not applicable	
7.4 Training and Education			
LA10	Hours of training	• Sustainability Report	116 and 117
LA11	Programmes for skills management and lifelong learning	• Sustainability Report	116 and 117
LA12	Regular performance reviews by gender	Sustainability Report Performance appraisal are applied to both genders without differentiation	117
7.5 Diversity and Equal Opportunity			
LA13	Employees according to diversity	• Sustainability Report (Gender distribution/age group graphs)	114 and 115
LA14	Basic salary of men and women	• Sustainability Report Salary scales are unbiased towards gender.	117 and 118
	Aspect: Employment		
LA15	Return to work and retention rates after parental leave, by gender	Not reported.	

8. Human Rights Dimension

No.	Description	Disclosure	Page No./s
	Management approach	• Sustainability Report	113 to 118
8.1 Investment and Procurement Practices			
HR1	Investments with HR clauses and HR screening	Not reported	
HR2	Suppliers that underwent HR screening	Not reported	
HR3	Employees training on human rights	No programmes done this period.	
8.2 Non-discrimination			
HR4	Incidents of discrimination	None reported	
8.3 Freedom of Association (FOA) and Collective Bargaining			
HR5	Operations an significant suppliers identified in which FOA and collective bargaining may be violated	None material to report.	

No.	Description	Disclosure	Page No./s
8.4 Child Labour			
HR6	Child labour	Not applicable as our workforce does not include child labour	
8.5 Forced and Compulsory Labour			
HR7	Forced or compulsory labour	None reported	
8.6 Security Practices			
HR8	Security personnel trained in human rights	No programmes done this period.	
8.7 Indigenous Rights			
HR9	Rights of indigenous people	None reported	
	Aspect : Assessment		
HR10	Percentage and total number of operations that have been subject to human rights reviews	Not reported	
HR11	Number of grievances related to human rights filed, addressed and resolved	None reported	
9. Society Dimension			
	Management approach	• Sustainability Report	122 and 123
9.1 Local Communities			
SO1	Percentage of operations with implemented local community engagement, impact assessments and development programmes.	• Sustainability Report	122 and 123
9.2 Corruption			
SO2	Analysis of risk related to corruption	• Risk Management	Page 96
SO3	Training in anti-corruption	• Training organised on Anti Money Laundering includes policies and practices aimed at avoiding corruption.	117 and 124
SO4	Instances of corruption	None reported.	
9.3 Public Policy			
SO5	Public policy development and lobbying	Not relevant for 'C' level reporting	
SO6	Contributions to political parties or related institutions	Not relevant for 'C' level reporting	
9.4 Anti-Competitive Behaviour			
SO7	Legal actions for anti-competitive, anti-trust and monopoly practices	None reported.	

No.	Description	Disclosure	Page No./s
9.5 Compliance			
SO8	Monitory value of significant fines	No significant fines to report.	
	Aspect local Communities		
SO9	Operations with negative impacts on local communities	None material to report.	
SO10	Preventive measures implemented in operations with negative impacts on local communities.	Not reported.	

Product Responsibility

10. Product Responsibility Dimension

No.	Description	Disclosure	Page No./s
	Management approach	• Sustainability Report	109 to 112
10.1 Customer health and safety			
PR1	Life cycle stages in which health and safety impacts are assessed	Not relevant for 'C' level reporting	
PR2	Non-compliance with regulations/codes	None reported.	
10.2 Product and Service Labelling			
PR3	Information required by procedures	Not relevant for 'C' level reporting	
PR4	Non-compliance concerning labelling	Not relevant for 'C' level reporting	
PR5	Customer satisfaction	• Sustainability Report	109 to 112
10.3 Marketing Communications			
PR6	Adherence to laws, standards and codes	Being a Finance company prevailing regulations have been followed on publication of deposit information.	
PR7	Non-compliance concerning marketing	None reported.	
10.4 Customer Privacy			
PR8	Complaints on breach of customer privacy	Not relevant for 'C' level reporting	
10.5 Compliance			
PR9	Non-compliance with laws/regulations	Not relevant for 'C' level reporting	

Independent Assurance Report

Cecil Arseculeratne & Company
CHARTERED ACCOUNTANTS
No. 3, Dr. Lester James Peiris Mawatha, Colombo 05, Sri Lanka.
Telephone: +94 112 503628, +94 112 503629
Fax: +94 112 585901
E-Mail: sec@cecilarseculeratne.com
Web Site: www.cecilarseculeratne.com
J. C. M. Arseculeratne F. C. A.

INDEPENDENT ASSURANCE REPORT TO MERCANTILE INVESTMENTS AND FINANCE PLC (MI)

Introduction

We were engaged by the Management of MI to provide assurance on the following elements of the Sustainability Report 2012 ("Report") for the year ended 31 March 2012.

- Reasonable assurance on the data on financial performance, as reported on page 126 of the sustainability Report.
- Limited assurance on Performance Indicators and other information presented in the Report.

Managements' Responsibilities

Management of MI is responsible for the preparation and presentation of the Report in accordance with the GRI (G 3.1) Sustainability Reporting Guidelines as described in the Report and the information and assertions contained within it for determining the Company's objectives in respect of sustainable development performance and reporting, including the identification of stakeholder and material issues, and for establishing and maintaining appropriate performance management and internal control systems from which the reported performance information is derived.

Our Responsibilities and Compliance

Our responsibility in this regard is to carry out a reasonable & limited assurance engagement and to express a conclusion based on the work performed. We conducted our engagement in accordance with the Sri Lanka Standard on Assurance Engagements 3000: Assurance Engagements other than Audits or Reviews of historical Financial Information, issued by The Institute of Chartered Accountants of Sri Lanka.

This Standard requires amongst others that we comply with applicable ethical requirements, including independence requirements and plan and perform the engagement to obtain reasonable and limited assurance about whether the Report is free of material misstatement.

Outline of Work Performed

Reasonable Assurance

A reasonable assurance engagement on financial performance reported on page 126 of the Report involves verification that they were properly derived from the audited financial statements of the company for the year ended 31 March 2012 and other statistics as applicable.

Limited Assurance

A limited assurance engagement on Performance Indicators and other information in the Report covers inquiries made primarily of officers responsible for the preparation of information presented in the Report and applying analytical and other evidence gathering procedures, as appropriate. These procedures involve;

- Inquiries of management to gain an understanding of the Company's processes for determining key topics concerning stakeholder groups.
- Inquiries about the design and implementation of the systems and methods used to collect and process the information reported, including the aggregation of data into information as presented in the Report.
- Discussions with senior management and relevant staff concerning sustainability strategy and policies for key topics, and the implementation of these across the business.
- Interviews with relevant staff at corporate and business unit level responsible for providing the information in the Report.
- Collaborating the information presented in the Report to determine whether it is in line with our overall knowledge of, and experience with, the sustainability performance of the Company.
- Comparing the information presented in the Report to corresponding information in the relevant underlying sources to determine whether all the relevant information contained in such underlying sources has been included in the Report.

Our Conclusion

On the basis of the procedures performed, as described above, we conclude that;

- The data on financial performance, as reported on page 126 of the Report 2011/12 are properly derived from the financial statements of the Company for the year ended 31 March 2012 and from other statistics as applicable.
- Nothing has come to our attention that causes us to believe that the Performance Indicators and other information presented in the Report are not fairly presented, in all material respects, in accordance with the GRI (G 3.1) Sustainability Reporting Guidelines, as prescribed in the report.

Cecil Arseculeratne & Co

Chartered Accountants

15th May 2012
Colombo

CRYSTAL TRANSPA FLOWS A OUR ENTE

At any stage of our business flow, one encounters crystal clarity in every aspect… strategy, design and process. Our financial disclosures are as complete and as transparent as we can make them.

CLEAR
RENCY
CROSS
RPRISE

FINANCIAL 2011/12

REPORTS

2011/12
Financial Calendar

1st Interim Dividend for 2011/12 paid on 24 August 2011
2nd Interim Dividend for 2011/12 paid on 17 October 2011
Annual Report and Accounts for 2011/12 signed on 15 May 2012
49th Annual General Meeting to be held on 29 June 2012

Proposed Financial Calendar - 2012/13
1st Interim Dividend for 2012/13 to be paid in September 2012
2nd Interim Dividend for 2012/13 to be paid in March 2013
Annual Report and Accounts for 2012/13 to be signed on 20 May 2013
50th Annual General Meeting to be held on 28 June 2013

Annual Report of the Board of Directors

Annual Report of the Board of Directors on the affairs of the Company and Statement of Compliance of the contents of the Annual Report.

The details set out herein provide the information required by the Section 168 of the Companies Act No. 07 of 2007 and recommended best accounting practice.

1. General

The Directors of Mercantile Investments and Finance PLC have pleasure in presenting to the shareholders this Report together with the Audited Financial Statements for the year ended 31 March 2012 and the Auditors' Report on those Financial Statements, conforming to the requirement of the Companies Act No. 07 of 2007, Finance Business Act 42 of 2011 and the Directions issued thereunder.

Mercantile Investments and Finance PLC is a public limited liability company incorporated in Sri Lanka on 15 June 1964 under the Companies Ordinance No. 51 of 1938 and re-registered under the Company Act No. 07 of 2007 and a Licensed Finance Company under the Finance Business Act 42 of 2011.

The ordinary shares of the Company are quoted on the secondary board of the Colombo Stock Exchange since June 2011. Ram Ratings Lanka Limited. has assigned BBB+ and P2 long-term and short-term financial institution ratings respectively to the Company.

The Registered Office of the Company is situated at No. 236, Galle Road, Colombo 03, which is also its Head Office.

This Report provides the information as required by the Companies Act No. 07 of 2007, Finance Companies (Corporate Governance) Direction No. 03 of 2008 and subsequent amendments thereto, Listing Rules of the Colombo Stock Exchange and recommended best practices on Corporate Governance. This Report was approved by the Board of Directors on 15 May 2012.

2. Review of Business

2.1 Vision, Mission and Corporate Conduct

The Company's Vision and Mission are given on inner front cover of this Annual Report. The business activities of the Company are conducted with the highest level of ethical standards in achieving its Vision and Mission.

2.2 Review on Operations of the Company

A review of operations of the Company during the financial year and results of those operations are contained in the Chairman's Message & Managing Director's Review on pages 5 to 7 and 9 to 13 and Management Discussion and Analysis on pages 16 to 39 of this Annual Report.

2.2.1 Principle Activities of the Company

The principle activities of the Company consist of finance leasing, hire purchase financing, term loan financing, fleet management, share trading and mobilisation of deposits. There have been no significant changes in the nature of the principal activities of the Company during the financial year under review.

2.3 Financial Statements of the Company

The Financial Statements of the Company duly certified by the Chief Financial Officer and approved by two Directors in compliance with the requirements of the Sections 151 and 168 (1) (b) of the Companies Act No. 07 of 2007 are given on pages 156 to 190 of the Annual Report.

2.4 Directors' Responsibility for Financial Reporting

The Directors are responsible for the preparation of Financial Statements of the Company to reflect a true and fair view of the state of its affairs. The Directors are of the view that Income Statement, Balance Sheet, Statement of Changes in Equity, Cash Flow Statement, Significant Accounting Policies and Notes thereto appearing on page 156 to 190 have been prepared in accordance with the requirements of the Sri Lanka Accounting Standards as mandated by the Sri Lanka Accounting and Auditing Standards Act No. 15 of 1995 and the Companies Act No. 07 of 2007. Further, these Financial Statements also comply with the requirements of the Finance Business Act 42 of 2011 and the Listing Rules of the Colombo Stock Exchange. The Statement of Directors' Responsibilities is given on page 150 of this Annual Report forms an integral part of this Report.

2.5 Auditors' Report

Company's Auditors, Messrs Cecil Arseculeratne & Company performed the audit on the Financial Statements for the year ended 31 March 2012 and the Auditor's Report on the Financial Statements is given on page 155 of this Annual Report as required by Section 168 (1) (c) of the Companies Act No. 07 of 2007.

2.6 Accounting Policies and Changes during the Year

The Significant Accounting Policies adopted in the preparation of Financial Statements is given on pages 161 to 169 of this Annual Report as required by Section 168 (1) (d) of the Companies Act No. 07 of 2007. There were no changes to these Accounting Polices during the year under review and are consistent with those adopted in the previous financial year as required by Sri Lanka Accounting Standard No. 3 (Revised 2005) on 'Presentation of Financial Statements'.

2.7 Interests Register

The Interests Register is maintained by the Company, as per the Companies Act No. 7 of 2007. All Directors have made declarations as provided for in Section 192 (1) & (2) of the Companies Act aforesaid. The related entries were made in the Interest Register during the year under review. The share ownership of Directors is indicated on page 144 of this Report Entries were made in the Interests Register on share transaction, Directors' Interest in Contracts, and remuneration paid to the Directors etc. The Interest Register is available for inspection as required by the Section 119 (1) (d) of the Companies Act No. 07 of 2007.

2.8 Directors' Remuneration and Other Benefits

Directors' remuneration and other benefits, in respect of the Company for the financial year ended 31 March 2012 is given in Note 39.3 to the Financial Statements on page 188 of this Annual Report as required by Section 168 (1) (f) of the Companies Act No. 07 of 2007.

2.9 Corporate Donations

During the year, the Company made donations amounting to Rs. 1.461 million (2011 - Rs. 1.1 million). The donations made to the Government approved charities from the above amounted to Rs. Nil (2011 - Rs. Nil). The information given above on donations forms integral part of the Report of the Board of Directors as required by the Section 168 (1) (g) of the Companies Act No. 07 of 2007.

2.10 Future Developments

Future developments activities of the Company will be discussed under the Managing Director's Review on page 11 of this Annual Report.

3. Gross Income

The income of the Company for the year ended 31 March 2012 was Rs. 2,365 million (year ended 31 March 2011 - Rs. 2,214 million). An analysis of the income is given in Notes 3 & 4 to the Financial Statements on page 170 of this Annual Report.

4. Dividend and Reserves

4.1. Profit and Appropriations

The profit before income tax of the Company for the year ended 2012 was Rs. 486 million (Rs. 1,049 million in 2011) and the profit after tax for the year ended 2012 was Rs. 470 million (Rs. 906 million in 2011).

The details of profit relating to the Company are tabled below:

As at 31 March	**2012** **Rs. '000**	2011 Rs. '000
Profit before Tax	486,874	1,048,597
Taxation	16,583	142,699
Profit after Tax	470,291	905,898
Balance brought forward	4,339	13,441
Available for Appropriation	474,630	919,341
Transfer to Statutory Reserve	(30,000)	(50,000)
Transfer to General Reserve	(320,000)	(835,000)
Transfer to Investment Fund	(41,951)	–
Interim Dividend Paid	(66,132)	(30,000)
Balance Carried forward	16,547	4,339

4.2 Dividend on Ordinary Shares

The following interim dividend was declared and paid for the financial year ended 31 March 2012 (Rs. 10/- per share 2011):

Dividend	Rate of Payment
1st Interim	Rs. 10/- per share
2nd Interim	Rs. 12/- per share

4.3 Provision for Taxation

Income tax for 2012 has been provided at 28% (35% - 2011) on taxable income arising from the operations of the Company and has been disclosed in accordance with Sri Lanka Accounting Standards. Profits of the Company are also liable for Value Added Tax on Financial Services at the rate of 12% (20% - 2011).

The Company has also provided deferred tax on all known temporary differences under the liability method, as permitted by the Sri Lanka Accounting Standard No. 14 on 'Income Taxes'.

Information on Income Tax Expenses and Differed Taxes is given in Notes 10 and 29 to the Financial Statements on pages 171 and 185 respectively, of this Annual Report.

4.4 Reserves

The Company's total reserves as at 31 March 2012 amounted to Rs. 5,275 million (2011 - Rs. 4,736 million). The movement of the reserves are given on page 158 under Statement of Changes in Equity and Notes 32 to 35 of the Financial Statements of this Annual Report.

5. Property, Plant & Equipment and Leasehold Property and Intangible Assets

Capital expenditure incurred on property, plant & equipment is as follows:

Year	2012 Rs. million	2011 Rs. million
Property, Plant & Equipment	102	219
Leasehold Property	Nil	Nil
Intangible Assets	0.2	7.7

Details of which are given in Notes 23 to 25 on pages 180 to 183 in the Financial Statements. Capital expenditure approved and contracted for is given in Note 36 to the Financial Statements on page 187 of this Annual Report.

6. Market Value of Freehold Properties

All freehold land and building of the Company were revalued by a professionally qualified independent valuer as at 31 March 2012, and brought into the Financial Statements. The Directors' are of the opinion that the revalued amounts are not in excess of the current market values of such properties. The details of freehold properties owned by the Company are given in Notes 23.2 to the Financial Statements on page 181.

7. Stated Capital

The stated capital of the Company as at 31 March 2012 was Rs. 36 million comprising 3,006,000 ordinary shares. (2011 - Rs. 36 million). The details of the stated capital is given in Note 31 to the Financial Statements on page 186 of this Annual Report.

8. Share Information

Details of share-related information are given on page 196 to 199 of this Annual Report and information relating to earnings, dividends and net assets per share is given in the Financial Highlights on page 2 of this Annual Report.

8.1 Issue of Shares

The Company did not make any share issues during the year under review.

Class of Shares	Voting Ordinary Shares 2012	2011
Number of shares issued	Nil	6,000

Ordinary shares that were issued during the last financial year have been issued through a capitalisation of reserves.

9. Substantial Shareholding

The list of Twenty Largest Shareholders as at 31 March 2012 are as follows:

Nilaveli Beach Hotel (PVT) Limited	626,240
Mr. G.G. Ondaatjie	477,213
Ms. A.M. Ondaatjie	477,213
Mr. T.J. Ondaatjie	477,213
Mercantile Fortunes (Pvt) Limited	410,820
Mr. G.L.A. Ondatjie	268,535
Tangerine Tours (Pvt) Limited	200,469
Mrs. P.R. Divitotawela/R.D. Madugalla	12,525
Mrs. P.R. Divitotawela/A.D. Galagoda	12,525
Mr. N.H.V. Perera	10,020
Mr. R.M.D. Abeygunewardena	10,020
Mr. J.A.S.S. Adhihetty	10,020
Mr. S. Fernando	5,010
Mr. S. Senanayake	5,010
Mr. C.A. Ondaatjie	2,004
Mr. A.D. Rajapaksha	501
Mr. A.M. Rajapaksha	501
Mr. A.M. Dominic and J.S. Dominic	151
Mr. H.W.M. Woorward	10

9.1 Equitable Treatment to all Stakeholders

While valuing the patronage of all our stakeholders, the Company has made all endeavours to ensure equitable treatment to all our shareholders.

10. Directors

10.1 Information on Directors of the Company

10.1.1 List of Directors

The Board of Directors of the Company as at 31 March 2012 comprised of 10 Directors with extensive financial and commercial knowledge and experience. The qualifications and experience of the Directors are given in the 'Board of Directors - Profile' on pages 48 and 49 of this Annual Report.

Names of the persons holding office as Directors of the Company as at the end of the year and the names of persons, who ceased to hold office as Directors of the Company any time during the year 2012, as required by Section 168 (1) (h) of the Companies Act No. 07 of 2007 are given below:

Name of the Director	Executive/ Non-Executive	Independence/ Non-Independency
Mr. Gerard G. Ondaatjie	Executive	Non-Independent
Miss. Angeline M. Ondaatjie	Executive	Non-Independent
Mr. Travice J. Ondaatjie	Executive	Non-Independent
Mr. S.H. Jayasuriya	Executive	Non-Independent
Miss. M.B. Assauw	Executive	Non-Independent
Mr. P.M. Amarasekara	Executive	Non-Independent

Name of the Director	Executive/ Non-Executive	Independence/ Non-Independency
Mr. J.S. Dominic	Non-Executive	Independent
Mr. S.H.J. Weerasuriya	Non-Executive	Independent
Mr. H.A.S.T. Senanayake	Non-Executive	Independent
Ms. P.T.K. Navaratne	Non-Executive	Independent
Mr. N.H.V. Perera	Non-Executive	Non-Independent
Mr. S.M.S.S. Bandara	Non-Executive	Independent

New Appointments

1. Ms. P.T.K. Navaratne on (w.e.f. 17.01.12)
2. Mr. N.H.V. Perera on (w.e.f. 09.02.12)
3. Mr. S.M.S.S. Bandara on (w.e.f. 09.02.12)

Resignation/Cessations

1. Mr. J.S. Dominic (w.e.f. 31.12.11)
2. Mrs. M.B. Assauw on (w.e.f. 13.01.12)

10.1.2 Recommendation for Re-election

In terms of Section 23 (7) of the Articles of Association, Ms. Angeline M. Ondaatjie, Mr. Travice J. Ondaatjie and Mr. P.M. Amarasekara retire by rotation and being eligible, offer themselves for re-election.

In terms of Section 23 (3) of the Articles of Association, Ms. P.T.K. Navarathne, Mr. N.H.V. Perera and Mr. S.M.S.S. Bandara retire and being eligible offer themselves for re-election.

10.2 Board Subcommittees

Information with regard to Board subcommittees is given under the Corporate Governance on pages 54 to 79 of this Annual Report.

11. Disclosures of Directors Dealing in Shares

11.1 Directors' Interest in Ordinary Shares of the Company

	31.03.12	31.03.11
Mr. G.G. Ondaatjie	477,213	477,213
Ms. A.M. Ondaatjie	477,213	477,213
Mr. T.J. Ondaatjie	477,213	477,213
Mr. S.H. Jayasuriya	Nil	Nil
Mr. P.M. Amarasekara	Nil	Nil
Mr. S.H.J. Weerasuriya	Nil	Nil
Mr. H.A.S.T. Senanayaka	Nil	Nil
Ms. P.T.K. Navaratne	Nil	–
Mr. N.H.V. Perera	10,020	–
Mr. S.M.S.S. Bandara	Nil	–

11.1.1 There is no Chief Executive Officer in the Company. Mr. Gerard G. Ondaatjie serves as Managing Director.

11.1.2 The number of ordinary shares held by the public as at 31 March 2012 was 326,802 (2011 - 336,822) which amounted to 10.87% (2011 - 11.20%) of the stated capital of the Company.

12. Directors' Interests in Contracts or Proposed Contracts

Directors have no direct or indirect interest in any contract or proposed contract with the Company for the year ended 31 March 2012. Further information is given on page 146 to 149 of this Annual Report.

The Directors have disclosed their interest in other companies so as to ensure that they refrain from voting on a matter in which they have an interest.

13. Environmental Protection

The Directors, to the best of their knowledge and belief, are satisfied that the Company has not engaged in any activities, which have caused adverse effects on the environment and it has complied with the relevant environmental regulations.

14. Statutory Payments

The Directors, to the best of their knowledge and belief, are satisfied that all statutory payments in relation to the Government and employees have been paid up to date.

15. Events After the Balance Sheet Date

There have been no material events occurring after the Balance Sheet date that would require adjustments to or disclosure in the Financial Statements as disclosed in Note 40 to the Financial Statements on page 189 of this Annual Report.

16. Going Concern

The Board of Directors had reviewed the Company's business plans and is satisfied that the Company has adequate resources to continue its operation in the foreseeable future. Accordingly, the Financial Statements of the Company is prepared based on the going concern concept.

17. Appointment of External Auditors

The Financial Statements for the year have been audited by Messrs Cecil Arseculeratne & Company, Chartered Accountants, who offer themselves for re-appointment. A resolution to re-appoint them as Auditors and authorise the Directors to fix their remuneration will be proposed at the Annual General Meeting.

18. Auditors' Remuneration and Interest in Contracts with the Company

The Auditors, Messrs Cecil Arseculeratne & Company was paid Rs. 0.8 million (Rs. 0.6 million in 2011) as audit fees by the Company. Apart from that the Company has engaged External Auditors to obtain an assurance report for the year under consideration.

As far as the Directors are aware, the Auditors do not have any other relationship or interest in contracts with the Company.

19. Risk Management and System of Internal Controls

19.1 Risk Management

Specific steps that have been taken by the Company in managing both business risk and financial risk are detailed on pages 82 to 97 of this Annual Report.

19.2 System of Internal Controls

The Board of Directors has established an effective and comprehensive system of Internal Controls to ensure that proper controls are in place to safeguard the assets of the Company, to detect and prevent fraud and irregularities, to ensure that proper records are maintained and Financial Statements presented are reliable. Monthly Management Accounts are prepared, giving management with relevant, reliable and up-to-date Financial Statements and key performance indicators.

The Audit Committee reviews on regular basis, the reports, policies and procedures to ensure a comprehensive Internal Control framework is in place. More details in this regard can be seen in the 'Report by the Board on Internal Controls' on page 153 of this Annual Report.

19.3 Audit Committee

The composition of the Audit Committee and their Report is given on page 154 of this Annual Report.

20 Corporate Governance

The Company is committed to high standards of Corporate Governance. The main Corporate Governance practices of the Company are set out on pages 54 to 79 of this Annual Report.

21. Human Resources

The Company continues to regard communication with its employees as a key aspect of its policies. Information is given to employees about employment matters and about the financial and economic factors affecting the Company's performance. Employees are encouraged to discuss operational and strategic issues with their line management and to make suggestions aimed at improving performance. Specific measures taken in this regard are detailed in the Sustainability Report on page 100 to 134 of this Annual Report.

22. Compliance with Applicable Laws and Regulations

To the best of our knowledge there has been no violation or possible violation of laws or regulations in any jurisdiction whose effect should be disclosed. There have been no irregularities involving management or employees that could have material financial effect or otherwise.

23. Outstanding Litigation

In the opinion of the Directors and in consultation with the Company Lawyers, litigation currently pending against the Company will not have material impact on the reported financial results or future operations of the Company.

24. Notice of Meeting

The details of the Annual General Meeting are given in the Notice of Meeting on page 202 of this Annual Report.

25. Acknowledgement of the Contents of the Report

As required by Section 168 (1) (k) of the Companies Act No. 07 of 2007 the Board of Directors hereby acknowledge the contents of this Report.

For and behalf of the Board,

Gerard G. Ondaatjie
Managing Director

Angeline M. Ondaatjie
Director

Ms. Sonali Pethiyagoda
Company Secretary

Colombo
15 May 2012

Directors' Interests in Contracts with the Company

Related Party Disclosures as required by the Sri Lanka Accounting Standard No. 30 on Related Party Disclosure (Revised 2005), is detailed in Note 39 to the Financial Statement on Page 188 of this Annual Report. In addition, the Company carries out transactions in the ordinary course of the business in an arm's length basis with entities where the Chairmen or a Director of the Company is the Chairmen or Director of such entities as detailed below:

	Company	Relationship	Accommodation Granted/ Deposits or Services Rendered	Balance Outstanding as at 31.03.2012 Rs. '000	Balance Outstanding as at 31.03.2011 Rs. '000	Balance Outstanding as at 31.03.2010 Rs. '000
(a)	**Gerard G. Ondaatjie**					
	Mercantile Fortunes (Pvt) Limited	Managing Director	Deposits	–	–	–
			Loan	–	23,484	10,000
			Motor vehicle hire & repairs, others	2,776	3,794	2,340
	Tangerine Beach Hotels PLC	Director	Deposits	52,539	10,000	50
			Loan	25,009	29,829	34,678
			Motor vehicle hire & repairs, others	2,814	2,734	2,640
	Royal Palms Beach Hotels PLC	Director	Deposits	98,652	87,884	6,130
			Loan	12,376	13,848	16,319
			Motor vehicle hire & repairs, others	649	875	391
	Nuwara Eliya Hotels Company PLC	Managing Director	Deposits	–	–	2,592
			Loan	–	–	–
			Motor vehicle hire & repairs, others	872	858	1,342
	Tangerine Tours (Pvt) Limited	Director	Deposits	54,060	58,417	3,474
			Loan	–	–	–
			Motor vehicle hire & repairs, others	2,132	1,629	1,798
	Nilaweli Beach Hotels (Pvt) Limited	Ex. Deputy Chairman	Deposits	136,895	143,769	12,722
			Loan	30,969	37,691	45,229
			Motor vehicle hire & repairs, others	322	415	295
	Security Ceylon (Pvt) Limited	Director	Deposits	–	–	895
			Loan	–	–	–
			Motor vehicle hire & repairs, others	111	109	105
	Mercantile Orient (Pvt) Limited	Director	Deposits	3,653	3,349	479
			Loan	–	–	–
			Motor vehicle hire & repairs, others	250	–	–
	Global Films Limited	Director	Deposits	1,066	1,021	–
			Loan	–	–	–
			Motor vehicle hire & repairs, others	–	–	–
	Grand Hotels (Pvt) Limited	Managing Director	Deposits	102,315	83,431	–
			Loan	–		–
			Motor vehicle hire & repairs, others	102	102	–
	Fair View Hotel (Pvt) Limited	Managing Director	Deposits	30,429	–	–
			Loan	–	–	–
			Motor vehicle hire & repairs, others	17	–	–

Company	Relationship	Accommodation Granted/ Deposits or Services Rendered	Balance Outstanding as at 31.03.2012 Rs. '000	Balance Outstanding as at 31.03.2011 Rs. '000	Balance Outstanding as at 31.03.2010 Rs. '000
(b) Angeline M. Ondaatjie					
Mercantile Fortunes (Pvt) Limited	Director	Deposits	–	–	–
		Loan	–	23,484	10,000
		Motor vehicle hire & repairs, others	2,776	3,794	2,340
Tangerine Beach Hotels PLC	Joint Managing Director	Deposits	52,539	10,000	50
		Loan	25,009	29,829	34,678
		Motor vehicle hire & repairs, others	2,814	2,734	2,640
Royal Palms Beach Hotels PLC	Joint Managing Director	Deposits	98,652	87,884	6,130
		Loan	12,376	13,848	16,319
		Motor vehicle hire & repairs, others	649	875	391
Nuwara Eliya Hotels Company PLC	Director	Deposits	–	–	2,592
		Loan	–	–	–
		Motor vehicle hire & repairs, others	872	858	1,342
Tangerine Tours Limited	Managing Director	Deposits	54,060	58,417	3,474
		Loan	–	–	–
		Motor vehicle hire & repairs, others	2,132	1,629	1,798
Nilaweli Beach Hotels Limited	Director	Deposits	136,895	143,769	12,722
		Loan	30,969	37,691	45,229
		Motor vehicle hire & repairs, others	322	415	295
Security Ceylon (Pvt) Limited	Director	Deposits	–	–	895
		Loan	–	–	–
		Motor vehicle hire & repairs, others	111	109	105
Mercantile Orient (Pvt) Limited	Director	Deposits	3,653	3,349	479
		Loan	–	–	–
		Motor vehicle hire & repairs, others	250	–	–
Global Films Limited	Director	Deposits	1,066	1,021	–
		Loan	–	–	–
		Motor vehicle hire & repairs, others	–	–	–
Grand Hotels (Pvt) Limited	Director	Deposits	102,315	83,431	–
		Loan	–	102	–
		Motor vehicle hire & repairs, others	102	102	–
Fair View Hotel (Pvt) Limited	Director	Deposits	30,429	–	–
		Loan	–	–	–
		Motor vehicle hire & repairs, others	17	–	–

Company	Relationship	Accommodation Granted/ Deposits or Services Rendered	Balance Outstanding as at 31.03.2012 Rs. '000	Balance Outstanding as at 31.03.2011 Rs. '000	Balance Outstanding as at 31.03.2010 Rs. '000
(c) Travice J. Ondaatjie					
Mercantile Fortunes (Pvt) Limited	Director	Deposits	–	–	–
		Loan	–	23,484	10,000
		Motor vehicle hire & repairs, others	2,776	3,794	2,340
Tangerine Beach Hotels PLC	Director	Deposits	52,539	10,000	50
		Loan	25,009	29,829	34,678
		Motor vehicle hire & repairs, others	2,814	2,734	2,640
Royal Palms Beach Hotels PLC	Director	Deposits	98,652	87,884	6,130
		Loan	12,376	13,848	16,319
		Motor vehicle hire & repairs, others	649	875	391
Nuwara Eliya Hotels Company PLC	Director	Deposits	–	–	2,592
		Loan	–	–	–
		Motor vehicle hire & repairs, others	872	858	1,342
Tangerine Tours Limited	Director	Deposits	54,060	58,417	3,474
		Loan	–	1,629	1,798
		Motor vehicle hire & repairs, others	2,132	1,629	1,798
Nilaweli Beach Hotels (Pvt) Limited	Managing Director	Deposits	136,895	143,769	12,722
		Loan	30,969	37,691	45,229
		Motor vehicle hire & repairs, others	322	415	295
Security Ceylon (Pvt) Limited	Director	Deposits	–	–	895
		Loan	–	–	–
		Motor vehicle hire & repairs, others	111	109	105
Mercantile Orient (Pvt) Limited	Director	Deposits	3,653	3,349	479
		Loan	-	–	–
		Motor vehicle hire & repairs, others	250	–	–
Global Films Limited	Director	Deposits	1,066	1,021	–
		Loan	–	–	–
		Motor vehicle hire & repairs, others	–	–	–
Grand Hotels (Pvt) Limited	Director	Deposits	102,315	83,431	–
		Loan	–	–	–
		Motor vehicle hire & repairs, others	102	102	–
Fair View Hotel (Pvt) Limited	Director	Deposits	30,429	–	–
		Loan	–	–	–
		Motor vehicle hire & repairs, others	17	–	–

	Company	Relationship	Accommodation Granted/ Deposits or Services Rendered	Balance Outstanding as at 31.03.2012 Rs. '000	Balance Outstanding as at 31.03.2011 Rs. '000	Balance Outstanding as at 31.03.2010 Rs. '000
(d)	**S.H. Jayasuriya**					
	Mercantile Fortunes (Pvt) Limited	Director	Deposits	–	–	–
			Loan	–	23,484	10,000
			Motor vehicle hire & repairs, others	2,776	3,794	2,340
	Security Ceylon (Pvt) Limited	Director	Deposits	–	–	895
			Loan	–	–	–
			Motor vehicle hire & repairs, others	111	109	105
(e)	**Mr. P.M. Amarasekara**					
	Security Ceylon (Pvt) Limited	Director	Deposits	–	–	896
			Loan	–	–	–
			Motor vehicle hire & repairs	111	109	105
(f)	**Mr. N.H.V. Perera**					
	Tangerine Beach Hotels PLC	Director	Deposits	52,539	–	–
			Loan	25,009	–	–
			Motor vehicle hire & repairs	2,814	–	–
	Royal Palms Beach Hotels PLC	Director	Deposits	98,652	–	–
			Loan	12,376	–	–
			Motor vehicle hire & repairs	649	–	–

Directors' Responsibility for Financial Reporting

The following statement sets out the responsibilities of the Directors in relation to the preparation and presentation of the Financial Statements of the Company.

As per the Sections 148 (1) and 151 (1) of the Companies Act No. 07 of 2007, Directors of the Company have responsibility for ensuring that the Company keeps proper books of account of all the transactions and prepare Financial Statements that give a true and fair view of the state of affairs and of the profits/losses for the year.

Accordingly, the Directors have caused the Company to maintain proper books of account and reviewed the financial reporting system at their regular meetings and through the Audit Committee. The Audit Committee Report is given on page 154 of this Report. The Financial Statements for the year 2012 prepared and presented in this Report are consistent with the underlying books of account and are in conformity with the requirements of the Companies Act, Sri Lanka Accounting Standards, the Finance Business Act No. 42 of 2011. The Directors consider that, in preparing the Financial Statements exhibited on pages 156 to 190 inclusive, they have adopted appropriate accounting policies on a consistent basis and supported by reasonable and prudent judgments and estimates.

The Directors also have the responsibility to ensure that the Company maintains adequate general supervision, control and administration of the affairs and business of the Company.

The Directors are of the opinion that the Internal Control System, in place, is capable of safeguarding the assets, preventing and detecting fraud and errors, ensures accuracy and completeness of the accounting records and timely preparation of reliable financial information.

The Directors confirm that to the best of their knowledge all taxes, statutory dues and levies payable by the Company as at the Balance Sheet date have been paid or, where relevant, provided for.

The Company's Auditors, Messrs Cecil Arseculeratne & Co., carry out reviews and sample checks on the system of internal controls as they consider appropriate and necessary for expressing their opinion on the Financial Statements.

Messrs Cecil Arseculeratne & Co., the Auditors of the Company have examined the Financial Statements made available by the Board of Directors together with all the financial records, related data, and minutes of shareholders' and Directors' meetings and express their opinion which appears as reported by them on page 155 of this Report.

By Order of the Board,

S Pethiyagoda

Mercantile Investments and Finance PLC
Sonali Pethiyagoda
Company Secretary

15th May 2012

Integrated Risk Management Committee Report

The Composition of the Integrated Risk Management Committee

The Committee consists of the following members who are also Directors of the Board:

N.H.V. Perera *(Non-Executive Director and Chairman of the Committee)*

Gerard G. Ondaatjie *(Managing Director)*

S.H. Jayasuriya *(Executive Director)*

P.M. Amarasekara *(Executive Director)*

Integrated Risk Management Committee (IRMC)

The IRMC was established by the Board of Directors, to be in line with sections 8.1 and 8.3 of the Finance Companies (Corporate Governance) Direction, No. 3 of 2008 issued by the Monetary Board under the Finance Companies Act No. 78 of 1988. The scope and functions of the Committee conform with the provisions of section 8.3 b of the aforesaid Direction.

The Committee held four meetings, in quarterly intervals during the year, for the year under review. The attendance of each member at meetings is illustrated in the table given on page 78 of the Annual Report.

Approach adopted by the Integrated Risk Management Committee

The Committee has the right blend of members who currently represent core divisions covering areas in credit, recoveries and finance while its newly appointed Chairman in 2012 is a Non-Executive Director of the Board.

During this financial period, the Committee activities revolved around the following functions:

- Assessed risk related to liquidity, credit, market and operational by making reference to reports and other risk indicators tabled at meetings by relevant Heads of Divisions.
- Ensured that the risks of the Company are within prudent levels accepted by the Committee. When necessary, the Committee deliberated corrective course of action to manage risk to prudent levels.
- Communicated with the relevant Heads of Divisions on the needed course of action to improve the overall effectiveness of risk management at MI.
- The Business Continuity Plan of the Company developed in 2010 was reviewed to understand the main risks and counter strategies proposed and implemented.

In the forthcoming period, the Committee intends to study more intensively impacts of market variables on the Company's bottom line and balance sheet especially observing the volatility in interest rates witnessed during the latter part of the year.

N.H.V. Perera
Chairman
Integrated Risk Management Committee

15th May 2012

Remuneration Committee Report

Committee Composition

The Committee comprises of three Non-Executive Directors and is chaired by Mr. S.H.J. Weerasuriya who is an Independent Non-Executive Director of the Company.

Name of Director	Directorship Status
S.H.J. Weerasuriya (Chairman of the Committee)	Chairman (Independent Non-Executive Director)
H.A.S.T. Senanayake	Independent Non-Executive Director
J.S. Dominic *	Independent Non-Executive Director
N.H.V. Perera **	Non-Executive Director

** Resigned from the Remuneration Committee in December 2011.*

*** Joined the Remuneration Committee in February 2011 on appointment to the Board.*

Committees Role

The Committee is responsible for setting up the remuneration policy and making recommendations to the Board on the following matters:

- A competitive and fair remuneration package payable to the Executive Directors including the Managing Director of the Company, which is satisfactory to both the interests of the shareholders and the member in concern.
- Evaluating prevailing market remuneration levels when making remuneration policy amendments.

Guiding Principles when Setting Remuneration

In order to remunerate individuals in an effective manner, the Board has set forth guiding principles that should be followed when deciding on remuneration.

- Deciding on standard pay that will enable the Company to attract and retain high caliber personalities.
- Remuneration should be aligned in a way that it satisfies both shareholder and member's interest.
- The Committee to meet annually to recommend increments to the Managing Director and Executive Directors.
- Evaluating the prevailing remuneration levels in the market in general when deciding on salary revisions.

Meeting Information

Number of committee meetings held with attendance of members is given on page 77 to the Annual Report.

Mr. Saroja Weerasuriya
Chairman
Remuneration Committee

15th May 2012

Report by the Board on Internal Control

Board's Responsibility

This Report on internal control has been presented in accordance with section 10.2 b of the Finance Companies (Corporate Governance) Direction, No. 03 of 2008.

The Board of Directors is responsible for the adequacy and effectiveness of the Company's system of internal controls. The system of internal control has been however designed to manage the Company's key risk areas within an acceptable risk profile, rather than to eliminate the risk of failure to achieve the Company's policies and objectives. Hence, MI's internal control system can only provide reasonable but not absolute assurance against material misstatements of management and financial information and records or against financial losses.

The Board has established a mechanism for identifying, evaluating and managing material risks. This process includes enhancing the system of internal controls when needed in line with changes in the business environment or regulation. The management of MI assists the Board in the implementation of the policies and procedures on risk and control by identifying and assessing the risks faced, and in the design, operation and monitoring of suitable internal controls to control risks.

Broad Process Adopted in Applying and Reviewing the Design and Effectiveness of the Internal Control Mechanism on Financial Reporting

The salient processes that have been established in reviewing the adequacy and integrity of the system of internal controls pertaining to financial reporting are as follows:

- Relevant Heads of Departments have been delegated the task of applying controls to capture their related transactions on to a defined and structured recording information system that supports in financial reporting. At the same time, the Finance Department headed by the Finance Director has been delegated the task of preparing the accounts and annual Financial Statements in line with applicable Sri Lanka Accounting Standards and other applicable regulations.
- Messrs Ernest & Young, Chartered Accountants have been entrusted with the task of carrying out the Company's internal audit function on a periodic basis to verify the compliance with policies and procedures and the effectiveness of the internal control systems and providing feedback of such reviews to the Audit Committee on any non-compliance.
- The Audit Committee of the Company meets to review internal control issues identified by Internal Auditors in their periodic reviews, External Auditors' queries raised from their statutory reviews and other matters that are important to financial reporting. The Committee evaluates the adequacy and effectiveness of the Company's risk management process and internal control systems. The Committee further reviews work of Internal Auditors on their scope and quality of audits. The Committee follows up with relevant management and in turn provides feedback to the Board on any concerning matters for their deliberation and resolution.
- Other Subcommittees appointed by the Board assist the Board in reviewing and providing feedback to the Board on the effectiveness of areas specifically entrusted upon to such Committees through periodic supervision. This includes reviewing related operations to ensure they are in line with corporate objectives, policies and established procedures.

Confirmation by the Board

The Board is of the view that the system of internal controls in place is sound and adequate to provide reasonable assurance regarding the reliability of financial reporting. Based on the established internal control mechanism explained above, the Board confirms that the financial reporting system of the Company has been designed to provide reasonable assurance regarding the reliability of financial reporting and the preparation of Financial Statements for external purposes is done in line with Sri Lanka Accounting Standards and requirements of the regulator.

External Auditors' review of the Statement

The External Auditors have reviewed the above 'Report of the Board on Internal control' for the year ended 31 March 2012 included in the Annual Report of the Company. They reported to the Board that nothing has come to their attention that causes them to believe that the statement is inconsistent with their understanding of the process adopted by the Board in the review of the design and effectiveness of the Internal Control System of the Company over financial reporting.

By Order of the Board,

H.A.S.T. Senanayake
Chairman - Audit Committee

Saroja Weerasuriya
Chairman

Gerard G. Ondaatjie
Managing Director

15th May 2012

Audit Committee Report

The Board of Directors has established the Audit Committee in accordance with Best Practices on Audit Committees. The Audit Committee comprises three Independent Non-Executive Directors and a Secretary for the Committee. The Committee is chaired by an Independent Non-executive Director while the Company Secretary functions as the Secretary to the Committee.

During the period, the Finance Director and representatives from Internal Auditors were present at meetings by invitation.

The Board of Directors have empowered amongst other things, to examine any matter in connection with financial and other related affairs of the Company, to review all Internal and External audit and inspection programmes, internal control system and procedures, accounting policies and the compliance to statutory and regulatory requirements, etc., thus ensuring that a sound financial reporting framework is in place, which is well-monitored to provide accurate, appropriate and timely information to the Board of Directors, Management, Regulatory Authorities and Share owners.

The Audit Committee assures that the Company's policies and activities comply with the rules and regulations and accepted ethical guidelines.

The Committee held two meetings during the financial year 2011/12 and performed the undermentioned tasks:

1. Reviewed the Internal Audit Report on Branch activities and certain aspects of Head Office activities and discussed measures to be taken on deficiencies and shortcomings that have been pointed out through the Internal Audit Reports.
2. Met with the External Auditors at the conclusion of the Annual Audit and reviewed the Auditors' Management Letter, together with the management's response thereto. The annual Financial Statements were also reviewed with the External Auditors.
3. Regularly monitored the effectiveness of the internal controls and the procedures established by the management to safeguard the assets of the Company.
4. The annual evaluation on the effectiveness of the Audit Committee was carried out by the rest of the Board of Directors, who evaluated the overall outcome as satisfactory.
5. Reviewed quarterly, the Company's compliance with regulatory bodies and other statutory requirements.

The Audit Committee submits their Report to the Board of Directors on a regular basis. The effectiveness of the Committee is evaluated by the Board of Directors at the end of each financial year.

The Committee is of the view that adequate controls and procedures are in place to provide reasonable assurance that the Company's assets are safeguarded and that the financial position of the Company is well-monitored.

The Committee has recommended to the Board of Directors that Messrs Cecil Arseculeratne & Co. be reappointed as Auditors for the year ending 31 March 2013, subject to the approval of shareholders at the Annual General Meeting. The Audit Committee will recommend the fees payable to the Auditors for approval by the Board.

H.A.S.T. Senanayake
Chairman
Audit Committee

15 May 2012

Independent Auditor's Report

CECIL ARSECULERATNE & COMPANY
CHARTERED ACCOUNTANTS
No. 3, Dr. Lester James Peiris Mawatha, Colombo 05, Sri Lanka.
Telephone: +94 112 503628, +94 112 503629
Fax: +94 112 585901
E-Mail: sec@cecilarseculeratne.com
Web Site: www.cecilarseculeratne.com
J. C. M. Arseculeratne F. C. A.

TO THE SHAREHOLDERS OF MERCANTILE INVESTMENTS AND FINANCE PLC

Report on the Financial Statements

We have audited the accompanying financial statements of Mercantile Investments and Finance PLC which comprise the balance sheet as at March 31, 2012, and the Income Statement, Statement of changes in Equity and Cash Flow statement for the year then ended, and a summary of significant accounting policies and other explanatory notes.

Management's Responsibility for the Financial Statements

Management is responsible for the preparation and fair presentation of these financial statements in accordance with Sri Lanka Accounting Standards. This responsibility includes; designing, implementing and maintaining internal controls relevant to the preparation and fair presentation of financial statements that are free from material misstatement, whether due to fraud or error; selecting and applying appropriate accounting policies; and making accounting estimates that are reasonable in the circumstances.

Scope of Audit and Basis of Opinion

Our responsibility is to express an opinion on these financial statements based on our audit. We conducted our audit in accordance with Sri Lanka Auditing Standards. Those standards require that we plan and perform the audit to obtain reasonable assurance whether the financial statements are free from material misstatement.

An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation.

We have obtained all the information and explanations, which to the best of our knowledge and belief were necessary for the purposes of our audit. We therefore believe that our audit provides a reasonable basis for our opinion.

Opinion

In our opinion, so far as appears from our examination, the Company maintained proper accounting records for the year ended march 31, 2012 and the financial statements give a true and fair view of the Company's state of affairs as at March 31, 2012 and its profit and cash flows for the year then ended in accordance with Sri Lanka Accounting Standards.

Report on Other Legal and Regulatory Requirements

In our opinion, these financial statements also comply with the requirement of Section 151 (2) of the Companies Act No. 07 of 2007 and the Finance Business Act No. 42 of 2011.

CHARTERED ACCOUNTANTS
Colombo
15th May 2012

Income Statements

For the year ended 31 March	Note	**2012 Rs. '000**	2011 Rs. '000	2010 Rs. '000 (Restated)
Income	3	2,364,842	2,214,120	1,806,966
Interest income	4	1,630,558	1,497,706	1,563,999
Interest expenses	5	(1,006,378)	(679,728)	(791,308)
Net Interest Income		624,180	817,978	772,691
Fee and commission income		31,968	25,433	25,365
Operating lease income		19,140	19,930	18,351
Other income	6	683,176	671,051	199,251
Operating Income		1,358,463	1,534,392	1,015,657
Less: Operating Expenses	7			
Personnel costs		254,265	223,296	173,361
Premises, equipment and establishment expenses		87,485	55,679	44,973
Provision for retirement benefits		29,697	17,347	14,262
Other overheads		256,264	191,740	156,801
		627,712	488,062	389,396
Operating profit before provision for loan losses & fall in value of investments		730,751	1,046,330	626,261
Provision for loan losses	8.1	(26,827)	45,348	(139,600)
Provision for fall in value of investments	8.2	(136,784)	–	–
Operating profit before VAT on financial services and income taxation		567,140	1,091,679	486,661
Less: VAT on financial services		125,657	81,518	61,022
		441,483	1,010,161	425,639
Add: Share of associates company profit/(loss)	9	45,390	38,436	15,396
Profit before taxation		486,874	1,048,597	441,035
Less: Income tax expenses	10	16,583	142,699	112,436
Profit after taxation		470,291	905,898	328,600
Basic earnings per share (Rs.)	11	156.45	301.36	109.53
Diluted earnings per share (Rs.)	11	156.45	301.36	109.53
Dividend per ordinary share (Rs.)	12	22.00	10.00	4.60

The significant accounting policies and the notes from page 161 to 190 form and integral part of these Financial Statements.

Balance Sheet

As at 31 March	Note	2012 Rs. '000	2011 Rs. '000	2010 Rs. '000 (Restated)
Assets				
Cash and short-term funds	13	229,822	118,654	161,275
Government Treasury Bills & Bonds	14	452,495	363,343	237,185
Placement with other banks		110,688	43,000	85,023
Dealing securities	15	2,574,528	2,411,995	900,852
Investment securities	16	815,803	982,768	860,480
Loans and advances	17	1,185,308	269,450	230,599
Lease receivable	18	3,875,965	2,144,048	1,019,633
Hire purchase receivable	19	5,220,108	3,857,768	3,180,163
Investment in associates	20	598,818	493,555	456,363
Inventories	21	340,244	24,780	4,851
Other assets	22	439,683	268,353	304,658
Property, plant & equipment	23	1,565,620	1,214,751	1,037,007
Leasehold property	24	44,481	44,950	45,418
Intangible assets	25	2,855	6,521	–
Total Assets		17,456,420	12,243,935	8,523,507
Liabilities & Equity				
Bank overdraft		505,815	397,246	213,394
Deposits from customers	26	5,870,013	4,107,536	3,479,291
Borrowings	27	4,609,399	2,315,206	403,599
Tax liabilities	28	34,931	39,142	128,928
Deferred tax liability	29	139,852	139,695	129,012
Other liabilities	30	985,211	472,810	393,268
Total Liabilities		12,145,221	7,471,635	4,747,491
Equity				
Stated capital	31	36,000	36,000	30,000
Reserves				
Revaluation reserve	32	1,585,811	1,451,044	1,330,560
Statutory reserve fund	33	421,400	391,400	341,400
General reserve	34	2,851,430	2,531,430	1,702,430
Associates company reserves		358,060	358,086	358,184
Investment Fund	35	41,951	–	–
Retained earnings		16,547	4,340	13,442
Total Equity		5,311,199	4,772,300	3,776,016
Total Liabilities and Equity		17,456,420	12,243,935	8,523,507
Net Assets per Share		1,766.87	1,587.59	1,258.67

The Significant Accounting Policies and the Notes from page 161 to 190 form and integral part of these Financial Statements.

Certification

I certify that the above Financial Statements give a true and fair view of the state of affairs as at 31 March 2012 and its profit for the year ended 31 March 2012.

S.H. Jayasuriya
Finance Director

The Board of Directors is responsible for the preparation and the presentation of these Financial Statements.

Approved and signed for and on behalf of the Board,

Angeline Ondaatjie

Gerard G. Ondaatjie
Managing Director

Angeline M. Ondaatjie
Director

Colombo
15 May 2012

Statement of Changes in Equity

			Statutory Reserve	Other Reserves						
		Stated Capital	Statutory Reserve Fund	Property, Plant & Equipment Revaluation Reserve	Long-Term Quoted Investments Revaluation Reserve	Associate Company Reserve	General Reserve Fund	Investment Fund Reserve	Unappropriated Profit/(Loss) Carried Forward	Total Equity
	Note	Rs. '000	Rs. '000	Rs. '000	Rs. '000		Rs. '000		Rs. '000	Rs. '000
Balance as at 01.03.2009		**30,000**	**321,400**	**614,226**	**307,713**	**–**	**1,402,430**	**–**	**18,642**	**2,694,411**
Restated Net profit for the period		–	–	–	–	–	–	–	328,600	328,600
Dividends for 2009	12	–	–	–	–	–	–	–	(13,800)	(13,800)
Revaluation surplus/ (deficit) on investments		–	–	–	529,367	–	–	–	–	529,367
Changes in share of associates company reserves		–	–	–	–	358,184	–	–	–	358,184
Transfers during the year (Refer Notes 33, 34, 35)		–	20,000	–	–	–	300,000	–	(320,000)	–
Deferred Tax effect on revaluation of property, plant & equipment		–	–	5,402	–	–	–	–	–	5,402
Balance as at 31.03.2010		30,000	341,400	619,628	837,080	358,184	1,702,430	–	13,442	3,902,164
Prior year adjustments		–	–	–	(126,148)	–	–	–	–	(126,148)
Balance as at 01.04.2010 - Restated		**30,000**	**341,400**	**619,628**	**710,932**	**358,184**	**1,702,430**	**–**	**13,442**	**3,776,016**
Net profit for the Period		–	–	–	–	–	–	–	905,898	905,898
Issue of shares		6,000	–	–	–	–	(6,000)	–	–	–
Dividends for 2010	12	–	–	–	–	–	–	–	(30,000)	(30,000)
Revaluation surplus/ (deficit) on investments		–	–	–	120,484	–	–	–	–	120,484
Changes in share of associates company reserves		–	–	–	–	(98)	–	–	–	(98)
Transfers during the year (Refer Notes 33, 34, 35)		–	50,000	–	–	–	835,000	–	(885,000)	–
Balance as at 31.03.2011		**36,000**	**391,400**	**619,628**	**831,416**	**358,086**	**2,531,430**	**–**	**4,340**	**4,772,300**
Net profit for the period		–	–	–	–	–	–	–	470,291	470,291
Dividends for 2011	12	–	–	–	–	–	–	–	(66,132)	(66,132)
Revaluation surplus (deficit) on investments and land & buildings		–	–	312,789	(166,965)	–	–	–	–	145,824
Deferred tax effect on revaluation of property plant & equipment		–	–	(11,058)	–	–	–	–	–	(11,058)
Changes in share of associates company reserves		–	–	–	–	(26)	–	–	–	(26)
Transfers during the year (Refer Notes 33, 34, 35)		–	30,000	–	–	–	320,000	41,951	(391,951)	–
Balance as at 31.03.2012		**36,000**	**421,400**	**921,359**	**664,451**	**358,060**	**2,851,430**	**41,951**	**16,547**	**5,311,199**

The Significant Accounting Policies and the Notes from pages 161 to 190 form and integral part of these Financial Statements.

Cash Flow Statements

For the year ended 31 March	**2012 Rs. '000**	2011 Rs. '000	2010 Rs. '000
Cash flow from Operating Activities			
Interest and commission receipts	**1,662,519**	1,484,703	1,590,964
Interest payments	**(1,003,270)**	(687,682)	(756,085)
Cash receipts from customers	**96,002**	157,682	(1,657)
Cash payments to employees and suppliers	**(691,948)**	(534,805)	(453,005)
Operating profit before changes in operating assets and liabilities (Note A)	**63,303**	419,897	380,217
(Increase)/decrease in operating assets			
Short-term funds	**108,568**	(36,823)	73,045
Deposits held for regulatory or monetary control purposes	**(156,840)**	(84,135)	89,271
Funds advanced to customers	**(4,013,203)**	(1,712,217)	572,841
Other short-term negotiable securities	**291,599**	(913,580)	(312,946)
Increase/(Decrease) in operating liabilities			
Deposits from customers	**1,762,478**	621,683	678,718
Negotiable certificate of deposit	**–**	1,000	23,100
Savings deposits	**–**	5,562	2,498
	(1,944,094)	(1,698,613)	1,506,744
Income taxes paid	**(93,323)**	(220,563)	(63,926)
Net cash from operating activities	**(2,037,417)**	(1,919,176)	1,442,818
Cash Flows from Investing Activities			
Dividends received	**71,610**	48,259	13,735
Proceeds from sale of non-dealing securities	**–**	684	–
Purchase of non-dealing securities	**(70,000)**	(2,581)	(32,135)
Proceeds from sale of property, plant & equipment	**20,835**	6,987	16,347
Purchase of property, plant & equipment	**(101,668)**	(221,035)	(71,462)
Acquisition of intangible assets	**(253)**	(7,731)	–
Net cash from investing activities	**(79,476)**	(175,417)	(73,515)
Cash Flows from Financing Activities			
Net increase/(decrease) in borrowings	**2,294,193**	2,081,974	(1,245,385)
Dividends paid	**(66,132)**	(30,000)	(13,800)
Net cash from financing activities	**2,228,061**	2,051,974	(1,259,185)
Net increase in cash and cash equivalents	**111,168**	(42,621)	110,118
Cash and cash equivalents at beginning of period	**118,654**	161,275	51,157
Cash and cash equivalents at end of period (Note B)	**229,822**	118,654	161,275

For the year ended 31 March	**2012** **Rs. '000**	2011 Rs. '000	2010 Rs. '000
A. Reconciliation of Profit before Tax with Cash Inflow from Operating Activities			
Profit before tax	486,874	1,048,597	441,036
Profit on sale of investments	(590,916)	(597,563)	(168,279)
Dividend from investing securities	(71,610)	(48,259)	(13,735)
Provision for fall in value of investments	136,784	–	–
Share of profit of associates	(45,390)	(38,436)	(15,396)
(Profit)/loss on sale of property, plant & equipment	1,529	113	400
Depreciation	41,223	35,767	32,767
Amortisation of leasehold property	468	468	468
Amortisation of intangible assets	3,919	–	–
Provision for bad and doubtful debts	26,827	(45,348)	139,600
Retirement benefit provision	29,697	17,347	14,262
Retirement benefit paid	(2,008)	(2,792)	(3,718)
Increase/(Decrease) in interest payable	–	(11,785)	32,229
(Increase)/Decrease in other receivables	(151,028)	43,380	(111,625)
Increase/(Decrease) in other payables	512,400	38,333	32,453
(Increase)/Decrease in stocks	(315,465)	(19,928)	(245)
	63,303	419,893	380,219

B. Cash and Cash Equivalents at the end of period			
Cash in hand	197,452	61,548	82,342
Balance with banks	32,370	57,106	78,933
	229,822	118,654	161,275

The Significant Accounting Policies and the Notes from page 161 to 190 form and integral part of these Financial Statements.

Significant Accounting Policies

1. Corporate Information

1.1 Reporting Entity

Mercantile Investments and Finance PLC is a public limited liability company, listed on the Colombo Stock Exchange incorporated on 15 June 1965 and domiciled in Sri Lanka. It is a Licensed Finance Company regulated under the Finance Business Act No. 42 of 2011. The Company was re-registered under the Companies Act No. 07 of 2007. The Registered Office of the Company is located at No. 236, Galle Road, Colombo 03.

The staff strength of the Company as at 31 March 2012 was 387 (316 as at 31 March 2011).

1.2 Approval of Financial Statements by Board of Directors

The Financial Statements of Mercantile Investments and Finance PLC for the year ended 31 March 2012 was authorised for issue in accordance with the resolution of Board of Directors passed on 15 May 2012.

1.3 Principal Activities and Nature of Operations

Company

The Company provides a comprehensive range of financial services including accepting deposits, granting of loans, lease financing, hire purchase financing, fleet management and share trading.

Associates

The principal activities of the Company's Associates, namely Nuwara Eliya Hotels Company PLC, and Fair View Hotels (Pvt) Limited are engaged in the business of hoteliering.

There were no significant changes in the nature of the principal activities of the Company and its Associates during the financial year under review.

1.4 Parent Enterprise and Ultimate Parent Enterprise

The Company doesn't have an identifiable parent of its own.

2. Significant Accounting Policies

Responsibility for Financial Statements

The Board of Directors is responsible for the preparation and presentation of the Financial Statements of the Company as per the provision of the Companies Act No. 07 of 2007 and the Sri Lanka Accounting Standards.

The Board of Directors acknowledge this responsibility as set out in the 'Annual Report of the Board of Directors', 'Directors' Responsibility for Financial Reporting' and in the statement following Balance Sheet on pages 141, 150 and 157 respectively.

These Financial Statements includes the following components

- An Income Statement providing the information on the financial performance of the Company for the year under review (refer page 156).
- A Balance Sheet providing the information on the financial position of the Company as at year end (refer page 157).
- A Statement of Changes in Equity depicting all changes in shareholders' equity during the year under review (refer page 158).
- A Cash Flow Statement providing the information to the users on the ability of the Company to generate cash and cash equivalents and the needs to utilisation of those cash flow (refer pages 159, 160).
- Notes to the Financial Statements comprising Accounting Policies used and other Notes (Refer pages 161 to 190).

Statement of Compliance

The Financial Statements which comprise of the above components mentioned above have been prepared and presented in accordance with the Sri Lanka Accounting Standards laid down by The Institute of Chartered Accountants of Sri Lanka (ICASL) and in compliance with the requirements of the Companies Act No. 07 of 2007 and the Finance Business Act No. 42 of 2011.

The Company did not adopt any inappropriate accounting treatment which is not complying with the requirements of the Sri Lanka Accounting Standards and other laws and regulations governing the preparation and presentation of Financial Statements.

Basis of Preparation

The balances reflected in the Financial Statements of the Company are prepared under the historical cost convention, except Dealing Securities and Land & Buildings that are stated at valuation as explained in Notes 15, 23 on pages 173, 180 to 183 respectively to the Financial Statements. Assets and liabilities are grouped by nature and listed in an order that reflects their relative liquidity. Where appropriate the significant accounting policies are disclosed in the succeeding notes. No adjustments have been made for inflationary factors affecting the Financial Statements.

The Financial Statements are prepared in Sri Lankan Rupees which is the Company's functional currency unless otherwise stated.

Going Concern

Company Directors have made an assessment of the Company's ability to continue as a going concern and they do not intend either to liquidate or cease trading.

Comparative Information

The Accounting Policies adopted by the Company are consistent with those of the previous financial year as permitted by Sri Lanka Accounting Standard No. 3 - (Revised 2005) on 'Presentation of Financial Statements'.

However, when the presentation or classification of items in the Financial Statements is amended comparative amounts are also reclassified to comply with the current year in order to provide a better presentation.

Materiality and Aggregation

Each material class of similar items is presented separately in the Financial Statements. Items of dissimilar nature or functions are presented separately unless they are immaterial as permitted by the Sri Lanka Accounting Standard No. 03 - (Revised 2005) on 'Presentation of Financial Statements'.

Offsetting

Assets and liabilities and income and expenses are not set-off unless permitted by the Sri Lanka Accounting Standards.

Changes to the Accounting Policies and Effect of Accounting Standards issued but not yet Effective Changes to Accounting Policies

There were no changes to the Accounting Policies adopted by the Company during the year under review.

Effect of Accounting Standards Issued but not yet Effective

Following the convergence of Sri Lanka Accounting Standards with the International Financial Reporting Standards, all existing Sri Lanka Accounting Standards have been prefixed as Sri Lanka Financial Reporting Standards (SLFRS) or Sri Lanka Accounting Standards (LKAS) which commonly refer to as 'Sri Lanka Accounting Standards corresponding' to International Financial Reporting Standards (IFRS) or International Accounting Standards (IAS), respectively. The Council of The Institute of Chartered Accountants of Sri Lanka mandated all specified business enterprises to adopt these new Accounting Standards effective for financial periods beginning on or after 01 January 2012.

Accordingly, the Company will be adopting the new Sri Lanka Accounting Standards (new SLFRS) comprising LKAS and SLFRS applicable for financial periods commencing from 01 January 2012 as issued by The Institute of Chartered Accountants of Sri Lanka. The Company has commenced reviewing its Accounting Policies and Financial Reporting in readiness for the transition. As the Company has a March 31 year end, priority has been given to considering the preparation of an opening Balance Sheet in accordance with the new SLFRS as at 01 April 2011. This will form the basis of accounting for the new SLFRSs in the future, and is required when the Company prepares its first new SLFRS compliant Financial Statements for the year ending 31 March 2013. Set out below are the key areas where Accounting Policies will change and may have an impact on the Financial Statements of the Company. The Company is in the process of quantifying impact on the Financial Statements arising from such changes in Accounting Policies.

(a) SLFRS 1 on 'First Time Adoption of Sri Lanka Accounting Standards' will require the Company to prepare and present opening new SLFRS Financial Statements as at date of transition to new SLFRS. The Company shall use the same Accounting Policies in its opening new SLFRS Financial Statements and throughout all periods presented in its first new SLFRS Financial Statements. Those Accounting Policies should comply with each new SLFRS effective as at 31 March 2013.

(b) LKAS 16 on 'Presentation of Financial Statements' will require an entity to present, in a Statement of Changes in Equity, all owner changes in equity. All non-owner changes in equity are required to be presented in one Statement of Comprehensive Income or in two Statements (a separate Income Statement and a Statement of Comprehensive Income). Components of comprehensive income are not permitted to be presented in the Statement of Changes in Equity. This standard also requires the Company to disclose information that enables users of its Financial Statements to evaluate the Company's objectives, policies and processes for managing capital.

(c) LKAS 16 on 'Property Plant and Equipment' will require the Company to initially measure an item on Property Plant & Equipment at cost, using the cash price equivalent at the recognition date.

If payment is deferred beyond normal credit terms, the difference between the cash price equivalent and the total payment is recognised as interest over the period, unless such interest is capitalised in accordance with LKAS 23 on 'Borrowing Costs'.

All the site restoration costs including other environmental restoration and similar costs must be estimated and capitalised at initial recognition , in order that such costs can be depreciated over the useful life of the asset.

This standard requires depreciation of assets over their useful lives, where the residual value of assets is deducted to arrive at the depreciable value. It also requires that significant parts of and asset be evaluated separately for depreciation.

(d) LKAS 32 on 'Financial Instruments: Presentation,' LKAS 39 on 'Financial Instruments: Recognition and Measurement' and SLFRS 7 on 'Financial Instruments: Disclosures' will result in changes to the current method of recognising Financial Assets, Financial Liabilities and Equity Instruments. These standards will require measurement of Financial Assets and Financial Liabilities at fair value at initial measurement. The subsequent measurement of Financial Assets classified as Fair Value through Profit or Loss and available for sale will be at fair value, with the gains and losses routed through the Statements of Comprehensive Income and Other Comprehensive Income respectively.

Financial Assets classified as Held to Maturity and Loans and Receivables will be measured subsequently at amortised cost. These assets will need to be assessed for any objective evidence of impairment as a result of one or more events that occurred after the initial recognition of the asset (a 'loss event') and that loss event (or events) has an impact on the estimated future cash flows of the Financial Asset or Group of Financial Assets that can be reliably estimated. As such the current method of assessing for impairment will have to be based on the requirements of these new standards.

(e) SLFRS 2 on 'Share-based Payment', will require the Company to reflect in its Profit or Loss and Financial Position, the effects of share-based payment transactions, including expenses associated with share options granted to employees. An entity is required to recognise share-based payment transactions when goods are received or services obtained based on the fair value of goods or services or the fair value of equity instruments granted. Hence, the Company will be required to determine the fair value of options issued to employees as remuneration and recognise an expense in determining the Profit or Loss for the period. This standard is not limited to options and extends to all forms of equity-based remuneration and payments.

(f) SLFRS 3 on 'Business Combinations' will require the Company to apply this standard to transactions and other events hat meet the new definition of a business i.e. an integrated set of assets (inputs) and activities (processes) which are capable of being conducted and managed to provide a return, as opposed to a mere asset acquisition. Under the new acquisition method of accounting, in addition to recognising and measuring in its Financial Statements the identifiable assets acquired and liabilities assumed, the standard also requires recognition and measurement of any non-controlling interest in the acquiree and re-measuring to fair value and previously held interests which could have an impact on the recognition of goodwill. Subsequent to the acquisition of control, any acquisitions or disposals of non-controlling interest without loss of control will be accounted for as equity transactions and cannot be recognised as profit or loss on disposal of investments in the Statement of Comprehensive Income.

(g) LKAS 23 on 'Borrowing Costs', the Company must capitalise borrowing costs in relation to a qualifying asset. Since the current policy is to expense all borrowing costs, this will result in a change in accounting policy.

(h) LKAS 12 on 'Income Taxes' will require deferred tax to be provided for in respect of temporary differences which will arise as a result of adjustments made to comply with the new SLFRS.

(i) LKAS 18 'Revenue' will require the Company to measure revenue at fair value of the consideration received or receivable. It also specifies recognition criteria for revenue, and the Company needs to apply such recognition criteria to the separately identifiable components of a single transaction in order to reflect the substance of the transaction.

Significant Accounting Judgments, Estimates and Assumptions

In the process of applying the Company's Accounting Policies, the management is required to make judgments, apart from those involving estimation, which may have a significant effect on the amounts recognised in the Financial Statements. The key estimates concerning the future and other key sources of assumptions uncertainty at the Balance Sheet date that have a significant risk of causing material adjustments to the carrying amounts of assets and liabilities within the next financial year are discussed below.

Impairment Losses on Loans and Advances

In addition to the provision made for possible loan losses based on the parameters and directives for specific provisions on Loans and Advances by the Central Bank of Sri Lanka, the Company reviews its Loans and Advances portfolio at each reporting date or more frequently, if events or changes in circumstances necessitates to assess whether a further provision for impairment against exposure which although not specifically identified as requiring specific provisions have a greater risk of default than when originally granted.

Review of Impairment Losses on Non-Financial Assets

The Company assesses whether there are any indicators of impairment for all non-financial assets at each reporting date or more frequently if events or changes in circumstances require doing so. This requires the estimation of the value in use of the cash-generating units. Estimating value in use requires management to make an estimate of the expected future cash flows from the cash-generating unit and also to select a suitable discount rate in order to calculate the present value of the relevant cash flows. This valuation requires the Company to make estimates about expected future cash flows and discount rates and hence, they are subject to uncertainty.

Defined Benefit Plans

The defined benefit obligation and the related charge for the year is determined using actuarial valuation. The actuarial valuations involve making assessment about discount rates, future salary increases and mortality rates. Due to the long-term nature of such obligations, these estimates are subject to significant uncertainty.

Taxation

Income Tax

We provide for the income tax liability on the basis of the profit for the year as adjusted for taxation purposes in accordance with the provisions of the Inland Revenue Act No. 10 of 2006 and the amendments thereto.

We measure current income tax assets and liabilities for the current and prior periods at the amount expected to be recovered from or paid to the Commissioner General of Inland Revenue. The tax rates and tax laws used to compute the amount are those that are enacted or substantively enacted by the Balance Sheet date.

Deferred Taxation

We provide deferred income tax, using the liability method, on all temporary differences at the Balance Sheet date between the tax bases of assets and liabilities and their carrying amounts for financial reporting purposes.

We recognise deferred income tax liabilities for all taxable temporary differences:
except -

- Where the deferred income tax liability arises from the initial recognition of an asset or liability in a transaction that is not a business combination and, at the time of the transaction, affects neither the accounting profit nor the taxable profit or loss; and
- In respect of taxable temporary differences associated with investments in subsidiaries, associates and interests in joint ventures, except where the timing of the reversal of the temporary differences can be controlled and it is probable that the temporary differences will not reverse in the foreseeable future.

We recognise deferred income tax assets for all deductible temporary differences, carry-forward of unused tax assets and unused tax losses, to the extent that it is probable that taxable profit will be available against which the deductible temporary differences and the carry-forward of unused tax assets and unused tax losses can be utilised:
except -

- Where the deferred income tax asset relating to the deductible temporary difference arises from the initial recognition of an asset or liability in a transaction that is not a business combination and, at the time of the transaction, affects neither the accounting profit nor the taxable profit or loss; and
- In respect of deductible temporary differences associated with investments in subsidiaries, associates and interests in joint ventures, deferred tax assets are only recognised to the extent that it is probable that the temporary differences will reverse in the foreseeable future and taxable profit will be available against which the temporary differences can be utilised.

We review the carrying amount of deferred income tax assets at each Balance Sheet date and reduced to the extent that it is no longer probable that sufficient taxable profit will be available to allow all or part of the deferred income tax asset to be utilised.

We measure deferred income tax assets and liabilities at the tax rates that are expected to apply to the year when the asset is realised or the liability is settled, based on tax rates (and tax laws) that have been enacted or substantively enacted at the Balance Sheet date.

We recognise in equity the deferred income tax relating to items recognised directly in equity, and not in the Income Statement.

Post Balance Sheet Events

We consider all material events occurring after the Balance Sheet date and, where necessary we make adjustments or disclosures to these Financial Statements.

Borrowing Cost

We recognise borrowing costs as an expense in the Income Statement, in the period in which they are incurred in terms of the Sri Lanka Accounting Standard No. 20 on 'Borrowing Costs'.

Foreign Currency Translation

The Financial Statements are presented in Sri Lankan Rupees, which is the Company's functional and presentation currency.

We do not engage in any foreign currency transactions at present that may require additional adjustments or disclosures in the Financial Statements.

Valuation of Assets and their Basis of Measurements

Cash and Cash Equivalents

We consider highly liquid investment instruments with an original maturity of three months or less to be cash and cash equivalents.

For the purpose of Cash Flow Statement, cash and cash equivalents consist of cash in hand and deposits in banks net of outstanding bank overdrafts. Investments with short maturities as defined above are also treated as cash equivalents.

Finance Leases

We classify assets leased to customers, which transfer substantially all the risks and rewards associated with the ownership other than legal title and are accounted as finance lease in accordance with the Sri Lanka Accounting Standard No. 19 - (Revised 2005) on 'Leases'.

Amount receivable under finance leases net of initial rentals received, unearned lease income, interest in suspense and provision for rentals doubtful of recovery are classified as lease receivable in the Balance Sheet.

Operating Leases

We classify assets leased to customers under agreements in which we retain substantially all the risks and rewards associated with ownership and legal title as operating leases. We recognise such assets as property, plant & equipment in the Balance Sheet.

Hire Purchase Agreements

We classify advances granted under agreements that transfer substantially all the risks and rewards associated with ownership other than legal title, as hire purchase advances.

Amount receivable under hire purchases net of unearned interest, interest in suspense and provision for rentals doubtful of recovery are classified as Hire Purchases Receivable in the Balance Sheet.

Loans and Advances

We determine the carrying amounts of loans and advances to customers in the Balance Sheet netting off provisions for possible loan losses and also the interest, which we have not accrued to revenue.

Provision for Loan Losses

We determine the adequacy of provisions for possible loan losses in accordance with Finance Companies (Provision for bad and doubtful debts) Direction No. 03 of 2006 issued by the Monetary Board of the Central Bank of Sri Lanka based on an aged classification of advances as follows:

Period Outstanding	Minimum Provision Made Net of Realisable Value of Security
6 - 12 months	50%
13 months and over	100%

We perform regular ongoing reviews to identify any further provisions need to be made.

Investments in Treasury Bills and Bonds

We record investment in Treasury Bills and Treasury Bonds at the value of the Bills/Bonds purchased and the discount/premium accrued thereon based on a pattern reflecting a constant yield being earned on the investment.

Investments

Dealing Securities

In accordance with Sri Lanka Accounting Standard No. 22 - on 'Accounting for Investments' we classify marketable securities acquired and held with the intention of resale over a short period of time as dealing securities. We record such securities at the lower of cost and market value determined on an aggregate portfolio basis in total, with any resulting gain or loss recognise in the Income Statement.

The cost of an investment is the cost of acquisition inclusive of brokerages, fees, duties and bank fees.

Investment Securities

We record long-term quoted investments at their revalued value based on the market value of such investments on individual investment basis. We recognise any appreciation as an appropriation and credit to the long-term investment revaluation reserve in accordance with Sri Lanka Accounting Standards. We charge any decrease in carrying amount arising from the revaluation of a long-term investment to the revaluation reserve to the extent that it offsets a previous increase, for the same investment, that has been credited to the revaluation reserve. In all other instances, any decrease in carrying amount we recognise as an expense. We also recognise any increase on revaluation directly as an income to the extent it relates to a previous decrease in carrying amount for the same investment that was recognised as an expense.

We determine the market value of such investments based on the last traded price of the security for the financial year.

Investment in Associates

Investment in Associates is accounted for under the equity method in the Financial Statements in accordance with the Sri Lanka Accounting Standard No. 27 - (Revised 2005) on 'Investments in Associates'. An associate is an entity in which the Company has significant influence and which is neither a subsidiary nor a joint venture.

Under the equity method, the investment in an associate is carried in the balance sheet at cost plus post acquisition changes in the Company's share of net assets of the associate. Goodwill relating to an associate included in the carrying amount of the investment is not amortised. The Income Statement reflects the share of the result of the operation of the associate, where there has been a change recognised directly in the equity of the associate, the Company recognised its share of any such change and disclose this, when applicable in the Statement of Changes in Equity.

The reporting dates of the Associates and the Company are identical and the Associate's accounting policies confirm to those used by the Company for like transactions and events in similar circumstance.

Inventory

Inventory consists of spare parts, lubricants and others. We value inventories at the lower of cost and estimated net realisable value, after making due allowance for obsolete and slow moving items, using weighted average cost formula. We determine the cost of stock at actual cost.

Property, Plant & Equipment

We state Property, Plant & Equipment at cost, excluding the costs of day-to-day servicing, less accumulated depreciation and accumulated impairment in value. Such cost includes the cost of replacing part of the plant and equipment when that cost is incurred, if the recognition criteria are met.

We measure land and buildings at fair value less depreciation on buildings and impairment charged subsequent to the date of the revaluation.

We perform valuations on every 3-5 years to ensure that the fair value of a revalued asset does not differ materially from its carrying amount.

We credit any revaluation surplus to the revaluation reserve included in the equity section of the Balance Sheet, except to the extent that it reverses a revaluation decrease of the same asset previously recognised in profit or loss, in which case the increase is recognised in profit or loss. We recognise a revaluation deficit in profit or loss, except that a deficit directly offsetting a previous surplus on the same asset is directly offset against the surplus in the asset revaluation reserve.

Subsequent Cost

These are costs that are recognised in the carrying amount of an item if it is probable that the future economic benefits embodied within that part will flow to the Company and it can be measured.

Restoration Cost

Expenditure incurred on replacement, repairs or maintenance of Property, Plant & Equipment in order to restore or maintain the future economic benefits expected from the originally assessed standard of performance is recognised as an expense when incurred.

Derecognition

We derecognise an item of Property, Plant & Equipment upon disposal or when no future economic benefits are expected from its use or disposal. Any gain or loss arising on derecognition of the asset (calculated as the difference between the net disposal proceeds and the carrying amount of the asset) is included in the Income Statement in the year the asset is derecognised.

Depreciation

We calculate the provision for depreciation using straight-line method to write down cost of property, plant & equipment to their residual values over following useful lives. We do not depreciate land.

Buildings	40 to 75 Years
Plant and Machinery	5 Years
Computer Equipment	4 Years
Office Equipment	10 Years
Furniture and Fittings	10 Years
Fixtures	10 Years
Motor Vehicles	6 2/3 Years
Office Bicycles	10 Years
Tools	4 Years

We now determine the depreciation charge separately for each significant part of an item of property, plant & equipment and begin to depreciate when it is available for use, rather than adopting a method whereby Property, Plant & Equipment are depreciated fully in the year of disposal with no such charge being accounted for in the year of purchase.

Leasehold Property

Leasehold property is stated at recorded carrying value as per the Sri Lanka Accounting Standard No. 19 (Revised 2005) on 'Leases'. Such carrying amounts are amortised over the remaining lease term or useful life of the leased property whichever is shorter. No further revaluations of this leasehold property will be carried out.

Intangible Assets

Basis of Recognition

An intangible asset is recognised if it is probable that future economic benefits that are attributable to the asset will flow to the entity and the cost of the asset can be measured reliably in accordance with the Sri Lanka Accounting Standard No. 37 - on 'Intangible Assets'. Accordingly, these assets are stated in the Balance Sheet at cost, less accumulated amortisation and accumulated implement losses, if any.

Subsequent Expenditure

Subsequent expenditure on Intangible Assets is capitalised only when it increases the future economic benefits embodied in these assets. All other expenditure is charged to the Income Statement when incurred.

Useful Economic Lives, Amortisation and Impairment

The useful lives of intangible assets are assessed to be either finite or indefinite. The Company does not possess intangible assets with indefinite useful lives. Useful economic lives, amortisation and impairment of finite and indefinite intangible assets are described below:

Intangible Assets with Finite Lives and Amortisation

Intangible assets with finite lives are amortised over the useful economic lives. The amortisation period and the amortisation method for an intangible asset with finite useful lives are reviewed at least at each Balance Sheet date. Changes in the expected useful life or the expected pattern of consumption of future economic benefit embodied in the assets are accounted for by changing the amortisation period or method, as appropriate, and are treated as changes in accounting estimates. The amortisation expense on intangible assets with finite lives are recognised in the Income Statement as an expense.

Computer Software

All computer software costs incurred, licensed for use by the Company, which are not integrally related to associated hardware, which can be clearly identified, reliably measured and it is probable that they will lead to future economic benefits, are included in the Balance Sheet under the category of intangible assets and carried at cost, less accumulated amortisation and accumulated impairment losses, if any.

Amortisation of Intangible Assets

Intangible assets are amortised using the straight-line method to write down the cost over its estimated useful economic lives. Effective rates are as follows:

Class of Assets	% per Annum
Computer Software	50% (2 years)

The unamortised balances of intangible assets with finite lives are reviewed for impairment whenever there is an indication for impairment and recognised as expenses in the Income Statement to the extent that they are no longer probable of being recovered from the expected future benefits.

Intangible Assets with Indefinite Lives

Intangible assets with indefinite useful lives are not amortised but are tested for impairment annually either individually or at the cash-generating unit level as appropriate, when circumstances indicate that the carrying values is impaired. The useful life of an intangible asset with an indefinite life is reviewed annually to determine whether indefinite life assessment continues to be supportable. If not, the change in the useful life assessment from indefinite to finite is made on a prospective basis.

Derecognition of Intangible Assets

Intangible assets are derecognised on disposal or when no future economic benefits are expected from its use. Gains or losses arising from recognition of an intangible asset are measured as the difference between the net disposal proceeds and the carrying amount of the assets are recognised in the Income Statement.

Other Assets

Other assets are stated at the amounts they are estimated to realise net of provisions for bad and doubtful receivables.

Liabilities and Provisions

Deposits from Customers

Deposits from customers include term deposits, certificate of deposits and savings deposits. They are stated in the Balance Sheet at amounts payable. Interest paid/payable on these deposits is charged to Income Statement.

Borrowings

Borrowings include refinancing borrowings, money market borrowings and borrowings from financial institutions and are shown at the gross value of the outstanding balance. Borrowings too are stated in the Balance Sheet at amounts payable. Interest paid/payable on these borrowings is charged to the Income Statement.

Other Liabilities

Other liabilities include interest, fees and expenses and amounts payable for gratuity and other provision. These liabilities are recorded at amounts expected to be payable at the Balance Sheet date .

Provisions

When the Company has a present obligation (legal or constructive) as a result of a past event, where it is probable that an outflow of resources embodying economic benefits will be required to settle the obligation and the Company can reliably estimate the amount of the obligation, we recognise it as a provision in accordance with the Sri Lanka Accounting Standard No. 36 - on 'Provisions, Contingent Liabilities and Contingent Assets'.

Retirement Benefit Obligations

Defined Benefit Plan - Gratuity

A defined benefit plan is a post-employment benefit plan other than a defined contribution plan. The Company measure the present value of the promised retirement benefits for gratuity, which is a defined benefit plan with the advice of an independent professional actuary using the Projected Unit Credit (PUC) method as required by Sri Lanka Accounting Standard No. 16 - (Revised 2006) -'Employees Benefits'. The present value of the defined benefit obligation is determined by discounting the estimated future cash outflow using interest rates that apply to the currency in which the benefits will be paid.

Company policy is to perform actuarial valuation once in every three years and the last valuation was done as of 31 March 2010. However adequate provision has been made for the financial year ended 31 March 2012.

Provision has been made for retirement gratuities from the first year of service for all employees in conformity with the SLAS 16 - (Revised 2006) on 'Retirement Benefit Costs'.

However, under the Payment of Gratuity Act No. 12 of 1983, the liability to an employee's arises only on completion of 5 years of continued services.

Defined Contribution Plans - Employees' Provident Fund and Employees' Trust Fund

Employees are eligible for Employees' Provident Fund Contributions and Employees' Trust Fund Contributions in line with the respective statutes and regulations. Our Company contributes 12% and 3 % of gross emoluments of our employees to Employees' Provident Fund and Employees' Trust Fund respectively.

Commitments and Contingencies

All discernible risks are taken into account in determining the liabilities of the Company. All other capital commitments and contingencies, for which the Company is liable, are disclosed in Notes 36 and 37 to the Financial Statements.

Income Statement

Revenue Recognition

We recognise revenue to the extent that it is probable that the economic benefits will flow to the Company and such revenue can reliably measure the associated costs incurred or to be incurred. We measure revenue at the fair value of the consideration received or receivable net of trade discounts and sales taxes. We use the following specific criteria for the purpose of recognition of revenue.

Interest Income

We recognise interest income on an accrual basis. We do not accrue interest when the recovery of principal or interest is in arrears for six months or more. Thereafter we account for interest on cash basis. We transfer the interest falling due on non-performing advances to Interest in Suspense Account.

Finance Lease Income

We consider the excess of aggregate rentals receivable over the cost of the leased asset as unearned interest income. We recognise the interest income from unearned income on the lease on an accrual basis over the term of the lease in proportion to the remaining balance of the lease. However, we cease the recognition of income when the recovery of principal or interest is in arrears for six months or more. Thereafter, we account interest income on a cash basis. We transfer interest falling due on non-performing leases to Interest in Suspense Account.

Operating Lease Income

We recognise rental income as revenue on an accrual basis. However, we do not accrue rental as income when such rentals are in arrears for six months or more. Thereafter, we account for rental income on cash basis.

Interest Income from Other Sources

We recognise interest income from Government of Sri Lanka Treasury Bills on a time proportion basis as discounts on purchase are amortised to income on a straight-line basis over periods of maturity. We also recognise income from all other interest-bearing investments as revenue on an accrual basis.

Dividend Income

We recognise dividend income when our right as shareholders to receive the payment is established.

Gains or Losses on Share Trading

We determine net gains and losses resulting on share trading on an accrual basis.

Gains or losses on Disposal of Property, Plant & Equipment

We account for net gains and losses resulting from the disposal of property, plant & equipment on an accrual basis.

Commission Income

We recognise commission income on insurance on a cash basis.

Rental Income

We recognise rental income on an accrual basis.

Other Income

We recognise other income on an accrual basis.

Expenses Recognition

All expenditure incurred in the running of our business and in maintaining the Property, Plant & Equipment in a state of efficiency has been charged to income in arriving at the profit for the year. We recognise expenses in the Income Statement on the basis of a direct association between the cost incurred and the earning of specific items of income.

We use accrual basis to calculate the interest payable.

For the purpose of presentation of the Income Statement our Directors are of the opinion that nature of expenses method presents fairly the elements of the Company's performance, and hence such presentation method is adopted.

Cash Flow Statement

We prepare the Cash Flow Statement using the 'Direct Method', whereby gross cash receipts and gross cash payments of operating activities, finance activities, and investing activities have been recognised.

Segment Reporting

We present segment information in respect of our Company's business in accordance with the Sri Lanka Accounting Standard No. 28 - on 'Reporting Financial Information by Segment'. These segments comprise finance lease, hire purchasing, insurance, investments/property and operating lease.

Notes to the Financial Statements

For the year ended 31 March	**2012 Rs. '000**	2011 Rs. '000	2010 Rs. '000
3. Income			
Interest income **(refer Note 4)**	1,630,558	1,497,706	1,563,999
Fee and commission income	31,968	25,433	25,365
Operating Lease income	19,140	19,930	18,361
Other income **(Note 6)**	683,176	671,051	199,251
Total	2,364,842	2,214,120	1,806,,966
4. Interest Income			
Income from lease	525,138	359,992	385,616
Income from hire purchase	982,461	1,064,597	998,059
Income from loans	83,792	35,963	89,463
Income from Treasury Bills	28,262	34,182	74,173
Income from deposits	10,904	2,972	16,688
Total	1,630,558	1,497,706	1,563,999
5. Interest Expense			
Interest on fixed deposits & savings	590,646	482,839	570,818
Interest on certificate of deposits	12,593	14,590	17,485
Interest on bank overdraft	36,406	37,314	31,926
Interest on bank borrowings	366,733	144,985	171,080
Total	1,006,378	679,728	791,308
6. Other Income			
Capital gain from sale of dealing securities	590,916	597,563	168,279
Dividend income	71,610	48,259	12,427
Rent income	6,495	3,125	3,240
Profit/(loss) from engineering workshop & service station	(6,765)	(3,591)	(51)
Profit/(loss) on sale of property, plant & equipment	(1,529)	(113)	(400)
Other operating income	22,448	25,808	15,756
Total	683,176	671,051	199,251
7. Operating Expenses			
Operating expenses include the following:			
Depreciation on property, plant & equipment	41,223	34,556	32,767
Auditors' remuneration	825	625	525
Directors' emoluments	35,465	31,776	25,727
Retirement benefit provision	29,697	17,347	14,262
Donations	1,462	1,120	936
Employer's contribution to Employees' Provident Fund	21,481	11,044	14,390
Employer's contribution to Employees' Trust Fund	5,284	2,761	3,914
Amortisation of leasehold property	468	468	468
Amortisation of intangible assets	3,919	1,211	–

For the year ended 31 March	**2012 Rs. '000**	2011 Rs. '000	2010 Rs. '000
8. Provisions for Loan Losses & Fall in Value of Investments			
Specific loan loss provision **(Note 8.1)**	**26,827**	(45,348)	139,600
Fall in value of investments **(Note 8.2)**	**136,784**	–	–
Total	**163,611**	(45,348)	139,600
8.1 Specific Provisions for Bad and Doubtful Debts			
Specific provision on lease receivable	**(16,582)**	(21,400)	16,052
Specific provision on hire purchase receivable	**(19,828)**	(29,967)	86,344
Specific provision on loans and advances	**63,237**	6,019	37,204
Sub Total	**26,827**	(45,348)	139,600
8.2 Provisions for fall in value of investments			
Fall in value of dealing securities	**136,784**	–	–
Sub Total	**136,784**	–	–
9. Share of Associates Company Profit/(Loss)			
Nuwara Eliya Hotels Company PLC	**45,178**	38,436	15,396
Fair View Hotels (Pvt) Limited	**212**	–	–
Total	**45,390**	38,436	15,396
10. Income Tax Expenses			
Income tax expenses on profits for the year	**29,934**	153,781	163,018
(Over)/under provision in respect of previous year	**(2,450)**	(21,765)	29,395
Deferred tax (reversal)/charged **(Note 29)**	**(10,901)**	10,683	(79,978)
Total	**16,583**	142,699	112,436
10.1 Reconciliation of Accounting Profit to Income Tax Expense			
Profit before tax	**481,895**	1,010,161	426,948
Add: Tax effect of non-deductible expenses	**1,549,207**	984,986	797,051
Less: Tax effect of deductible expenses	**(1,239,042)**	(919,932)	(588,708)
Less: Tax effect of allowable credits	**(702,938)**	(645,822)	(182,014)
Assessable income	**89,122**	429,393	453,277
Less: Qualifying payments	**–**	–	–
Taxable income	**89,122**	429,393	453,277
Income tax expense @ 28%	**24,954**	152,542	161,027
Share of income tax expense of associates **(Note 10.2)**	**4,980**	1,239	1,992
	29,934	153,781	163,018
Effective Tax Rate (Excluding Deferred Tax)	**5.70%**	13.07%	45.07%

The Company is liable for income tax at 28% on the taxable income for the current year (2011 - 35%).

The Company has taken into account the full benefit of capital allowances arising in terms of Section 23 of the Inland Revenue Act No. 10 of 2006 and amendments thereto in determining the taxation on profits for the year.

The Company's properties have been revalued in the financial year 2011/12 resulting in book values being written up by Rs. 312,789,000/- of which Rs. 220,169,820/- is related to land and this surplus if realised would not be liable to income tax.

10.2 Break up of the Associate Company Income Tax Expenses

	2012 Rs. '000	2011 Rs. '000	2010 Rs. '000
Nuwara Eliya Hotels Company PLC	4,980	1,239	1,992
Fair View Hotels (Pvt) Ltd.	–	–	–
Total	4,980	1,239	1,992

10.3 Notional Tax Credit for Withholding Tax on Government Securities on Secondary Market Transactions

The Inland Revenue Act No. 10 of 2006 and the amendments thereto, provide that a company which earns interest income from the secondary market transaction in Government Securities (earned on or after 1 April 2002) would be entitled to a notional tax credit (being one-ninth of the net interest income), provided such interest income forms part of statutory income of the Company for that year of assessment.

Accordingly, the net interest income earned by the Company on the secondary market transaction in Government Securities for the year, has been grossed up in the Financial Statement and the resulting notional tax credit amounted to Rs. 2,762,689/- (Rs. 3,410,208/- in 2011).

11. Basic/Diluted Earnings per Ordinary Share

Basic earnings per share is calculated by dividing the net profit for the year attributable to ordinary shareholders by the weighted average number of ordinary shares outstanding during the year, as required by the Sri Lanka Accounting Standard No. 34 (Revised 2005) on 'Earning per Share'. The weighted average number of ordinary shares outstanding during the year and the previous year are adjusted for events that have changed the number of ordinary shares outstanding, without a corresponding change in the resources such as a bonus issue.

Diluted earnings per share is calculated by dividing the net profit attributable to ordinary shareholders by the weighted average number of ordinary shares outstanding during the year (adjusted for the effects all dilutive potential ordinary shares).

	2012 Rs. '000	2011 Rs. '000	2010 Rs. '000
Amount Used as the Numerator			
Net profit attributable to equity holders of the Company	470,291	905,898	328,600
Net profit attributable to equity holders of the Company for basic and diluted earnings per share	470,291	905,898	328,600
Number of Ordinary Shares Used as the Denominator			
Weighted average number of ordinary shares	3,006	3,006	3,000
Weighted average number of ordinary shares used for basic and diluted earnings per share	3,006	3,006	3,000
Basic Earnings per Share (Rs.)	156.45	301.36	109.53
Diluted Earnings per Share (Rs.)	156.45	301.36	109.53

12. Dividends	66,132	30,000	13,800

Interim dividend of Rs. 22 per share each was paid during the year under consideration to ordinary shareholders of the Company. (The interim dividends paid for the year 2011 and 2010 were Rs. 10 and Rs. 4.6 per share each respectively.)

	2012 Rs. '000	2011 Rs. '000	2010 Rs. '000
13. Cash and Short-Term Funds			
Cash in hand	197,452	61,548	82,342
Balances with banks	32,370	57,106	78,933
Total	229,822	118,654	161,275
14. Government Treasury Bills & Bonds	452,495	363,343	237,185
Total	452,495	363,343	237,185

As at 31 March	2012 No. of Ordinary Shares	2012 Cost of Investment Rs. '000	2012 Market Value Rs. '000	2011 No. of Ordinary Shares	2011 Cost of Investment Rs. '000	2011 Market Value Rs. '000
15. Dealing Securities						
Quoted Shares						
Bank, Finance & Insurance						
Commercial Bank of Ceylon PLC	9,900,066	1,281,245	990,007	3,900,000	1,071,259	1,036,620
Lanka Orix Finance	100,000	1,213	450	–	–	–
LB Finance	953,600	176,735	128,641	–	–	–
Sampath Bank PLC	20,358	5,836	3,660	19,900	5,836	5,737
Singer Finance PLC	400,000	19,351	6,480	300,000	16,116	10,950
Vallibel Finance PLC	50,000	2,463	1,940	50,000	2,463	2,475
		1,486,843	1,131,178		1,095,673	1,055,782
Diversified Holdings						
Aitken Spence & Co. PLC	15,000	343	1,691	15,000	343	2,435
John Keells Holding PLC	179,599	38,364	36,997	4,700	899	1,342
Richard Pieris & Co. PLC	16,035,995	96,585	120,270	16,035,995	96,582	218,090
Vallibel One PLC	5,176,000	144,896	98,344	2,090,000	52,250	52,250
		280,188	257,302		150,074	274,116
Hotels & Travels						
Amaya Leisure PLC	860,000	56,488	65,962	2,245,088	147,474	269,635
Asian Hotels Properties PLC	3,000,000	60,112	234,000	3,889,000	155,863	730,743
Eden Hotels PLC	1,049,600	17,738	32,328	1,049,600	17,738	53,740
Fortress Resort	100,000	2,844	1,720	–	–	–
Hotel Sigiriya PLC	38,900	1,620	2,785	38,900	1,620	2,960
Hunas Falls Hotels PLC	899,000	30,833	53,580	899,000	30,833	76,415
John Keells Hotels PLC	13,000,000	209,107	163,800	13,000,000	209,107	223,600
Light House Hotels PLC	7,656,500	220,555	382,825	7,656,500	220,555	428,764
Marawila Hotel PLC	507,000	20,467	12,776	507,000	20,467	17,238
Riverina Hotel PLC	400,000	25,913	37,160	400,000	25,913	51,480
Trans Asia Hotels PLC.	–	–	–	1,758,000	66,301	344,216
		645,678	986,937		895,873	2,198,791
Investment Trust						
Environmental Resources PLC	61,800	7,157	1,038	61,800	7,157	4,320
		7,157	1,038		7,157	4,320
Manufacturing						
Royal Ceramic PLC	550,000	89,930	63,250	550,000	89,930	86,350
		89,930	63,250		89,930	86,350
Power & Energy						
Lanka IOC PLC	118,500	5,308	2,299	118,500	5,308	2,086
		5,308	2,299		5,308	2,086
Land & Property Development						
Colombo Land & Development Company PLC	–	–	–	100,000	2,931	2,160
East West Properties PLC	50,000	2,471	655	–	–	–
		2,471	655		2,931	2,160

As at 31 March	2012 No. of Ordinary Shares	2012 Cost of Investment Rs. '000	2012 Market Value Rs. '000	2011 No. of Ordinary Shares	2011 Cost of Investment Rs. '000	2011 Market Value Rs. '000
Motor						
United Motors PLC	100,000	18,701	10,800	100,000	18,701	15,220
		18,701	10,800		18,701	15,220
Telecommunication						
Dialog Axiata PLC	11,000,000	118,130	78,100	11,000,000	118,130	127,600
		118,130	78,100		118,130	127,600
Plantation						
Tess Agro PLC		–	–	4,929,200	16,703	13,802
		–	–		16,703	13,802
Construction & Engineering						
Colombo Dockyard PLC	161,000	44,966	37,030		–	–
		44,966	37,030		–	–
Trading						
Odel PLC	300,000	11,943	5,940		–	–
		11,943	5,940		–	–
Beverage, Food & Tobacco						
Distilleries Co. of Sri Lanka PLC	–	–	–	90,100	11,515	16,218
		–	–		11,515	16,218
Total		2,711,315	2,574,528		2,411,995	3,796,445

16. Investment Securities

Quoted						
Investments with Related Parties						
Royal Palms Beach Hotels PLC	8,576,700	124,582	471,719	8,576,700	124,582	600,369
Tangerine Beach Hotels PLC	3,909,644	26,343	343,658	3,909,644	26,343	381,972
	–	150,925	815,376	–	150,925	982,341
Total Investments in Quoted Equity Securities		150,925	815,376		150,925	982,341
Unquoted						
Investments with Related Parties						
Security Ceylon (Pvt) Limited	250	200	200	250	200	200
	–	200	200	–	200	200
Investments with Other Parties						
Credit Bureau of Sri Lanka	269	27	27	269	27	27
Finance Houses Consortium	20,000	200	200	20,000	200	200
	–	227	227	–	227	227
Total Investments in Unquoted Equity Securities		427	427		427	427
Total gross investments in equity securities		151,351	815,803		151,352	982,768
Investment revaluations		664,452			831,417	
Total net cost of investments in equity securities		815,803	815,803		982,768	982,768
Total		815,803	815,803		982,768	982,768

As at 31 March	**2012 Rs. '000**	2011 Rs. '000	2010 Rs. '000
17. Loans and Advances			
17.1 Loans and Advances	1,323,394	344,505	297,895
Initial rentals received	(264)	(123)	(123)
Interest in suspense	(6,174)	(6,521)	(4,775)
Provision for credit losses **(Note 17.5)**	(131,648)	(68,411)	(62,398)
Total	1,185,308	269,450	230,599
17.2 Loans Rentals Receivable within one year from Balance Sheet Date	684,924	221,438	169,905
Initial rentals received	(264)	–	–
Interest in suspense	(6,174)	(6,521)	(4,775)
Provision for credit losses	(8,892)	(55,218)	(43,384)
Sub Total	669,594	159,699	121,746
17.3 Loans Rentals Receivable after one year but before five years from Balance Sheet Date	538,686	123,067	127,991
Initial rentals received	–	(123)	(123)
Interest in suspense	–	–	–
Provision for credit losses	(22,756)	(13,193)	(19,014)
Sub Total	515,930	109,873	108,977
17.4 Loan Rentals Receivable after five years			
Initial rentals received	99,784	–	–
Initial in suspense	–	–	–
Provision for credit losses	(100,000)	–	–
Sub Total	(216)	–	–
17.5 Movement in Provision for Credit Losses			
Balance brought forward	(68,411)	(62,398)	(25,194)
Specific provision made	(106,560)	(14,374)	(37,172)
Debts written off	930	1,309	41
Specific provision written back	42,393	7,052	(73)
Sub Total	(131,648)	(68,411)	(62,398)
17.6 Non-Performing Loans on which Interest is not being Accrued			
6 to 12 months outstanding	–	1,803	7,929
13 months and over outstanding	51,454	96,008	94,537
Sub Total	51,454	97,811	102,466
18. Receivable on Leases			
18.1 Gross Investment in Leases	5,420,595	2,996,141	1,646,954
Initial rentals received	(5,104)	(4,959)	(3,857)
Unearned interest	(1,382,998)	(694,531)	(381,029)
Interest in suspense **(Note 18.6)**	(81,206)	(60,705)	(129,138)
Provision for credit losses **(Note 18.5)**	(75,322)	(91,898)	(113,298)
Total	3,875,965	2,144,048	1,019,633

As at 31 March	**2012 Rs. '000**	2011 Rs. '000	2010 Rs. '000
18.2 Lease Rentals Receivable within one year from Balance Sheet Date	**1,824,594**	1,112,283	819,635
Initial rentals received	**(961)**	(1,043)	(786)
Unearned interest	**(598,299)**	(324,720)	(220,647)
Interest in suspense	**(49,521)**	(14,596)	(53,252)
Provision for credit losses	**(72,938)**	(51,847)	(49,428)
Sub Total	**1,102,875**	720,077	495,522
18.3 Lease Rentals Receivable after one year but before five years from Balance Sheet date	**3,578,029**	1,867,550	827,320
Initial rentals received	**(4,143)**	(3,916)	(3,071)
Unearned interest	**(783,457)**	(368,818)	(160,382)
Interest in suspense	**(31,285)**	(46,109)	(75,886)
Provision for credit losses	**(2,385)**	(40,051)	(63,870)
Sub Total	**2,756,760**	1,408,657	524,111
18.4 Lease Rentals Receivable after five years	**17,972**	16,308	–
Initial rentals received	**–**	–	–
Unearned interest	**(1,242)**	(994)	–
Interest in suspense	**(400)**	–	–
Provision for credit losses	**–**	–	–
Sub Total	**16,329**	15,314	–
18.5 Movement in Provision for Credit Losses			
Balance brought forward	**(91,898)**	(113,298)	(97,246)
Specific provision made	**(22,064)**	(31,298)	(78,097)
Debts written-off	**15,274**	–	2,110
Specific provision written back	**23,367**	52,698	59,936
Sub Total	**(75,322)**	(91,898)	(113,298)
18.6 Movement in Interest in Suspense			
Balance brought forward	**(60,705)**	(129,138)	(181,089)
Interest suspended during the Year	**(37,553)**	(9,143)	(59,587)
Suspended interest recovered	**17,452**	77,576	111,538
Sub Total	**(81,206)**	(60,705)	(129,138)
18.7 Non-performing Leases on which Interest is not being Accrued			
6 to 12 months outstanding	**7,925**	46,597	69,173
13 months and over outstanding	**71,360**	71,679	79,263
	79,285	118,277	148,436

18.8 Concentration of Credit Risk

Sector-wise analysis of Company's finance lease portfolio reflecting the exposure to credit risk in the various sectors of the economy is given below:

	2012		2011		2010	
	Rs. '000	**%**	Rs. '000	%	Rs. '000	%
Agriculture	**169,855**	**3**	129,784	4	114,390	7
Industrial	**293,753**	**5**	223,680	7	133,919	8
Tourism	**122,356**	**2**	57,057	2	11,082	1
Trading	**1,037,194**	**19**	525,060	18	247,838	15
Construction	**41,734**	**1**	37,772	1	155,169	9
Services	**2,938,487**	**54**	1,409,584	47	108,720	7
Others	**817,216**	**15**	613,203	20	875,837	53
	5,420,595	**100**	2,996,141	100	1,646,954	100

As at 31 March	2012 Rs. '000	2011 Rs. '000	2010 Rs. '000
19. Receivable on Hire Purchase			
19.1 Hire Purchase Rentals Receivable	7,565,224	5,555,647	5,078,070
Initial rentals received	(1,688)	(1,550)	(1,319)
Unearned interest	(1,950,264)	(1,289,618)	(1,427,954)
Interest in suspense **(Note 19.6)**	(234,641)	(228,354)	(241,457)
Provision for credit losses **(Note 19.5)**	(158,523)	(178,357)	(227,177)
Total	5,220,108	3,857,768	3,180,163
19.2 Hire Purchase Rentals Receivable within One Year from Balance Sheet Date	2,927,495	2,490,445	2,399,356
Initial rentals received	(203)	(425)	(66)
Unearned interest	(958,435)	(705,993)	(850,894)
Interest in suspense	(194,480)	(167,982)	(88,028)
Provision for credit losses	(150,682)	(146,246)	(83,415)
Sub Total	1,623,696	1,469,799	1,376,953
19.3 Hire Purchase Rentals Receivable after One Year but before Five Years from Balance Sheet Date	4,623,863	3,063,862	2,678,644
Initial rentals received	(1,486)	(1,124)	(1,252)
Unearned interest	(990,573)	(583,563)	(577,058)
Interest in suspense	(40,126)	(60,330)	(153,428)
Provision for credit losses	(7,760)	(32,111)	(143,762)
Sub Total	3,583,918	2,386,733	1,803,144
19.4 Hire Purchase Rentals Receivable after Five Years	13,866	1,340	70
Initial rentals received	–	–	–
Unearned interest	(1,256)	(63)	(2)
Interest in suspense	(36)	(42)	(2)
Provision for credit losses	–	–	–
Sub Total	12,575	1,236	66
19.5 Movement in Provision for Credit Losses			
Balance brought forward	(178,356)	(227,177)	(140,833)
Specific provision made	(43,739)	(58,999)	(167,828)
Debts written-Off	11,013	18,854	2,866
Specific provision written back	52,559	88,966	78,617
Sub Total	(158,523)	(178,357)	(227,177)
19.6 Movement in Interest in Suspense			
Balance brought forward	(228,354)	(241,457)	(289,134)
Interest suspended during the year	(45,019)	(16,686)	(133,334)
Suspended interest recovered	38,732	29,790	181,011
Sub Total	(234,641)	(228,354)	(241,457)
19.7 Non-performing Hire Purchase on which Interest is not being Accrued			
6 to 12 months outstanding	22,490	49,157	110,209
13 months and over outstanding	155,182	163,460	174,859
Sub Total	177,672	212,618	285,069

19.8 Concentration of Credit Risk

Sector-wise analysis of Company's hire purchase portfolio reflecting the exposure to credit risk in the various sectors of the economy is given below:

	2012		2011		2010	
	Rs. '000	**%**	Rs. '000	%	Rs. '000	%
Agriculture	254,787	3	200,238	4	229,668	5
Industrial	442,232	6	412,235	7	89,331	2
Tourism	149,305	2	105,385	2	305,537	6
Trading	1,738,809	23	816,698	15	426,390	8
Construction	45,277	1	80,908	1	338,192	7
Services	3,600,286	48	2,339,649	42	454,208	9
Others	1,334,528	18	1,600,534	29	3,234,743	64
	7,565,224	100	5,555,647	100	5,078,070	100

As at 31 March	**2012 Rs. '000**	2011 Rs. '000	2010 Rs. '000 (Restated)
20. Investment in Associates			
Nuwara Eliya Hotels Company PLC **(Note 20.1)**	528,606	493,554	456,363
Fair View Hotels (Pvt) Limited **(Note 20.2)**	70,212	–	–
Total	598,818	493,554	456,363
20.1 Nuwara Eliya Hotels Company PLC			
Quoted			
Carrying value at the beginning of the year	493,554	456,363	53,948
Increase/(decrease) in investment	–	92	32,135
Add: Share of associates profit/(loss) before tax	45,179	38,436	15,396
Share of Associates tax expenses	(4,980)	(1,239)	(1,992)
Less: Dividend received from associates	(5,122)	–	(1,308)
Current year retained profit	35,077	37,197	12,096
Changes in equity not recognised in prior periods	(26)	(98)	358,184
Carrying value at the end of the year	528,606	493,554	456,363

Nuwara Eliya Hotels Company PLC

Company has a 26.12% (2011 - 26.12%) holding in Nuwara Eliya Hotel PLC which is a quoted public company and involved in the business of the hoteliering.

As at 31 March	**2012 Rs. '000**	2011 Rs. '000	2010 Rs. '000
Nuwara Eliya Hotels Company PLC			
Share of associate's Balance Sheet			
Current assets	97,811	87,423	26,773
Non-current assets	487,804	461,805	460,839
Current liabilities	(38,089)	(38,274)	(11,189)
Non-current liabilities	(18,920)	(17,400)	(20,060)
Net assets	528,606	493,554	456,363
Share of associate's revenue and profit			
Revenue	151,490	117,925	76,579
Profits	45,179	38,436	15,396
Unquoted			
20.2 Fair View Hotels (Pvt) Limited			
Carrying value at the beginning of the year	–	–	–
Increase/(decrease) in investment	70,000	–	–
Add: Share of associates profit/(loss) before tax	212	–	–
Share of Associates tax expenses	–	–	–
Less: Dividend received from associates	–	–	–
Current year retained profit	212	–	–
Changes in equity not recognised in prior periods	–	–	–
Carrying value at the end of the year	70,212	–	–

Fair View Hotels (Pvt) Limited

Company has a 38.88% (2011 - Nil) holding in Fair View Hotels (Pvt) Limited of which operations have not been commenced yet and will be involved in the business of the hoteliering.

Fair View Hotels (Pvt) Limited

As at 31 March	**2012 Rs. '000**	2011 Rs. '000	2010 Rs. '000
Share of associate's Balance Sheet			
Current assets	48,008	–	–
Non-current assets	22,251	–	–
Current liabilities	(47)	–	–
Non-current liabilities	–	–	–
Net assets	70,212	–	–
Share of associate's revenue and profit			
Revenue	435	–	–
Profits	212	–	–

As at 31 March	**2012 Rs. '000**	2011 Rs. '000	2010 Rs. '000
21. Inventories			
Spare parts	**4,317**	3,211	3,229
Lubricants and others	**1,600**	1,696	1,622
Vehicle stocks	**334,327**	19,873	–
	340,244	24,780	4,851
22. Other Assets			
VAT recoverable	**185,283**	93,188	148,917
Staff loans **(Note 22.1)**	**38,812**	21,595	16,132
Other receivables	**215,587**	153,570	288,377
	439,683	268,353	304,658
22.1 Staff Loans			
Balance B/F	**21,595**	16,132	16,773
Granted during the year **(Note 22.2)**	**27,740**	15,509	9,176
Recovered during the year	**(10,523)**	(10,046)	(9,817)
	38,812	21,595	16,132

22.2 During the financial year ended 31 March 2012, Company has granted as staff loan to 51 employees (2011 - 40).

	Balance as at 01.04.2011 Rs. '000	Additions/ Transfers Rs. '000	Disposals/ Transfers Rs. '000	Balance as at 31.03.2012 Rs. '000
23. Property, Plant & Equipment				
Gross Carrying Amounts				
At Cost/Cost Incurred Since Last Revaluation				
Land	102,563	18,530	121,093	–
Buildings	109,166	5,996	115,162	–
Plant and machinery	21,753	1,347	–	23,100
Computer hardware	42,234	12,372	1,086	53,520
Office equipment	28,758	6,018	–	34,776
Furniture and fittings	24,827	8,122	–	32,949
Fixtures	2,391	–	–	2,391
Motor vehicles	266,999	45,006	27,168	284,838
Office bicycles	3,919	4,236	550	7,605
Tools	173	40		213
	602,784	101,668	265,059	439,393
At Valuation				
Freehold land	373,437	341,263	–	714,700
Buildings	365,188	162,041	–	527,229
	738,625	503,304	–	1,241,929
Assets on Operating Leases				
Motor vehicles	61,485	–	4,850	56,635
	61,485	–	4,850	56,635
	1,402,894	604,971	269,909	1,737,956
Depreciation				
At Cost				
Buildings	6,491	2,302	8,793	–
Plant & machinery	20,566	610	–	21,176
Computer hardware	32,848	4,629	1,086	36,391
Office equipment	17,000	2,358	–	19,358
Furniture & fittings	13,319	2,162	–	15,481
Fixtures	1,604	151	–	1,755
Motor vehicles	45,333	14,006	7,031	52,308
Office bicycles	695	580	186	1,089
Tools	91	44		135
	137,947	26,843	17,096	147,694
At Valuation				
Buildings	29,562	7,386	36,948	–
	29,562	7,386	36,948	–
Assets on Operating Leases				
Motor vehicles	20,634	6,994	2,986	24,641
	20,634	6,994	2,986	24,641
	188,143	41,222	57,030	172,335
	1,214,751			1,565,621

	2012 Rs. '000	2011 Rs. '000
Net Book Values		
At cost/cost incurred since last revaluation	291,699	464,838
Assets on operating leases	31,993	40,850
At valuation	1,241,929	709,063
Total carrying amount of property, plant & equipment	1,565,621	1,214,751

Reconciliation of Net Book Values		
Net book value at the beginning of the year	1,214,751	1,037,008
Cost of additions/transfers/acquisitions	604,971	219,399
Depreciation charge for the year	(41,222)	(34,557)
Cost of disposals/transfers	(269,909)	(12,482)
Accumulated depreciation on disposals/transfers	57,030	5,383
Net book value at the end of the year	1,565,621	1,214,751

23.1 Revaluation of Property, Plant & Equipment

The land and buildings were revalued during the financial year 2011/12 by an independent valuer. The results of such revaluation was incorporated in these Financial Statements from its effective date which was 31 March 2012. Such assets were valued on an open market value for an existing use basis. The surplus arising from the revaluation was transferred to revaluation reserve.

23.2 Information on the freehold land & Buildings of the Company

As required by Rule No. 7.6 (viii) of the continuing listing requirements of the Colombo Stock Exchange.

Location	Extent (Perches)	Buildings (Square Feet)	Revalued Amounts Building Rs. '000	Revalued Amounts Land Rs. '000	Net Book Value Rs. '000	As a % of Total NBV
Kollupitiya						
No. 236, Galle Road, Colombo 03	32.56	46,777	304,100	227,900	532,000	42.84
Maharagama						
No. 176, Lake Road, Maharagama.	168.74	22,912	18,800	135,000	153,800	12.38
Maharagama						
No. 16, Batadombagahawatte Lane, Godigamuwa, Maharagama.	104.00	9,355	8,500	52,000	60,500	4.87
Kohuwala						
No. 28, Sunethara Devi Road, Kohuwala	88.00	27,543	59,829	176,000	235,829	18.99
Kohuwala						
No. 30/8, Sunethara Devi Road, Kohuwala	17.80	1,700	4,200	17,800	22,000	1.77
Borella						
No. 219, Dr. N.M. Perera Mw, Colombo 08	9.46	–	–	30,000	30,000	2.42
Nilaweli						
Nilaweli Village, Pulmoddai Road, Trincomalee	438.00	–	–	59,000	59,000	4.75
Negombo						
No. 26A, Colombo Road, Negombo	13.87	–	–	17,000	17,000	1.37
Kollupitiya						
No. 75-17/4, Kollupitiya Road, Colombo 03.	–	1,210	23,800	–	23,800	1.92
Kollupitiya						
No. 89-28/4 & 89-28/5, Kollupitiya Road, Colombo 03	–	3,583	71,000	–	71,000	5.72
Kollupitiya						
No. 4-7/7, Col. T.G. Jayawardana Mw, Colombo 03	–	2,042	37,000	–	37,000	2.98
Total			527,229	714,700	1,241,929	100.00

23.3 Revaluation

Freehold land & building of the Company were revalued by professionally qualified independent value as at 31 March 2012.

Valuation as at 31st March 2012

Location	Address	Name of the Valuer	Method of Valuation	NBV before revaluation as at 31 March 2012 Buildings Rs. '000	NBV before revaluation as at 31 March 2012 Land Rs. '000	Revalued Amount of Buildings Rs. '000	Revalued Amount of Land Rs. '000	Revaluation Gain/(Loss) Recognised on Buildings Rs. '000	Revaluation Gain/(Loss) Recognised on Land Rs. '000
Kollupitiya	No. 236, Galle Road, Colombo 03	P.P.T. Mohideen	Investment Method	253,309	134,500	304,100	227,900	50,791	93,400
Maharagama	No. 176, Lake Road, Maharagama	P.P.T. Mohideen	Open Market Basis	13,275	84,362	18,800	135,000	5,525	50,638
Maharagama	No. 16, Batadombagahawatte Lane, Godigamuwa, Maharagama	P.P.T. Mohideen	Open Market Basis	4,375	29,925	8,500	52,000	4,125	22,075
Kohuwala	No. 28, Sunethara Devi Road, Kohuwala	P.P.T. Mohideen	Open Market Basis	46,084	124,650	59,829	176,000	13,745	51,350
Kohuwala	No. 30/8, Sunethara Devi Road, Kohuwala	P.P.T. Mohideen	Open Market Basis	265	16,872	4,200	17,800	3,935	928
Borella	No. 219, Dr. N.M. Perera Mw, Colombo 08	P.P.T. Mohideen	Open Market Basis	–	29,345	–	30,000	–	655
Nilaweli	Nilaweli Village, Pulmoddai Road, Trincomalee	P.P.T. Mohideen	Open Market Basis	–	58,480	–	59,000	–	520
Negombo	No. 26A, Colombo Road, Negombo	P.P.T. Mohideen	Open Market Basis	–	16,396	–	17,000	–	604
Kollupitiya	No. 75-17/4, Kollupitiya Road, Colombo 03	P.P.T. Mohideen	Open Market Basis	20,970	–	23,800	–	2,830	–
Kollupitiya	No. 89-28/4 & 89-28/5, Kollupitiya Road, Colombo 03	P.P.T. Mohideen	Open Market Basis	62,893	–	71,000	–	8,107	–
Kollupitiya	No. 4-7/7, Col. T.G. Jayawardana Mw, Colombo 03	P.P.T. Mohideen	Open Market Basis	33,438	–	37,000	–	3,562	–
Total				**434,609**	**494,530**	**527,229**	**714,700**	**92,619**	**220,170**

The carrying amounts of revalued assets, that would have been included in the Financial Statements, had the assets been carried at cost are as follows:

	Cost Rs. '000	Cumulative Depreciation Rs. '000	**Net Carrying Amount 2012 Rs. '000**	Net Carrying Amount 2011 Rs. '000	Net Carrying Amount 2010 Rs. '000
Class of Asset					
Freehold land	160,521	–	**160,521**	39,428	39,428
Freehold buildings	230,953	42,348	**188,607**	62,516	70,236
Total	391,476	42,348	**349,128**	101,944	109,664

23.4 During the financial year, the Company acquired property, plant & equipment to the aggregate value of Rs. 101,668,000/- (2011 - Rs. 219,399,000/-) . Cash payments amounting to Rs. 101,668,000/- (2010 - Rs. 219,399,000/-) were made during the year for purchase of property, plant & equipment.

23.5 There were no temporary idle property, plant & equipment or any asset retired from active use and held for disposal on the date of Balance Sheet.

23.6 The cost of property plant equipment as at Balance Sheet date includes the fully-depreciated assets amounting Rs. 83,866,791/- (2011 - Rs. 78,334,855/-).

23.7 Land with a carrying amount of Rs. 311,000,000/- (2011 - Rs. 209,012,200/-) are subject to a primary mortgage of Rs. 200,000,000/- to secure the bank overdraft facilities.

23.8 Title Restriction in Property, Plant & Equipment

There were no restrictions that existed in the title of the property, plant & equipment of the Company as at Balance Sheet date.

24. Leasehold Property

	Balance as at 01.04.2011 Rs. '000	Additions/ Transfers Rs. '000	Disposals/ Transfers Rs. '000	**Balance as at 31.03.2012 Rs. '000**
At Cost/Valuation				
Land	46,354	–	–	**46,354**
	46,354	–	–	**46,354**
Accumulated Amortisation				
Land	1,404	468	–	**1,872**
	1,404	468	–	**1,872**
Net book value	44,950	–	–	**44,482**

The leasehold rights to land is disclosed under the leasehold property as per a ruling issued by the Urgent Issues Task Force (UITF) of The Institute of Chartered Accountants of Sri Lanka, which does not permit revaluation of leasehold property.

25. Intangible Assets

	Balance as at 01.04.2011 Rs. '000	Additions/ Transfers Rs. '000	Disposals/ Transfers Rs. '000	**Balance as at 31.03.2012 Rs. '000**
At Cost/Valuation				
Computer Software	7,732	253	–	**7,985**
	7,732	253	–	**7,985**
Accumulated Amortisation				
Computer Software	1,211	3,919	–	**5,130**
	1,211	3,919	–	**5,130**
Net book value	6,521	–	–	**2,855**

As at 31 March	**2012 Rs. '000**	2011 Rs. '000	2010 Rs. '000
26. Deposits			
Fixed deposits **(Note 26.1)**	**5,729,048**	3,951,871	3,330,188
Certificate of deposits **(Note 26.2)**	**122,640**	139,000	138,000
Savings deposits	**18,325**	16,665	11,103
	5,870,013	4,107,536	3,479,291
26.1 Analysis of Fixed Deposits by Maturity Date			
1 to 90 days	**2,187,214**	1,458,703	1,094,358
91 to 365 days	**3,019,031**	2,018,290	1,778,495
More than 365 days	**522,804**	474,878	457,336
	5,729,048	3,951,871	3,330,188
26.2 Analysis of Certificate of Deposits by Maturity Date			
1 to 90 days	**88,660**	77,500	23,300
91 to 365 days	**15,891**	46,600	95,400
More than 365 days	**18,089**	14,900	19,300
	122,640	139,000	138,000

As at 31 March	**2012 Rs. '000**	2011 Rs. '000	2010 Rs. '000
27. Borrowings			
Money market borrowings	**200,000**	300,000	–
Short-term borrowings **(Note 27.1)**	**200,000**	785,877	–
Long-term borrowings **(Note 27.2)**	**3,692,417**	1,229,330	403,599
Commercial Papers	**516,983**	–	–
	4,609,399	2,315,207	403,599

	2012 Rs. '000	2011 Rs. '000	2010 Rs. '000	Terms of Repayment Interest Rate	Period	Payment Terms
27.1 Short-Term Borrowings						
National Development Bank PLC	–	250,000	–			
Commercial Bank of Ceylon PLC	–	300,000	–			
Seylan Bank PLC	**200,000**	200,000	–	15%	6 months	At Maturity
Sanasa Insurance Limited	–	10,494	–			
National Savings Bank	–	25,383	–			
	200,000	785,877	–			
27.2 Long-Term Borrowings						
Central Bank of Sri Lanka (Refinanced Borrowings)	**70,313**	85,938	101,563	3%	8 years	Semi Annually
Securitised Borrowings	**1,414,700**	39,854	286,736	AWPLR+ 1.25%, 11.5% & 12.17%	3-4 years	Variable Monthly Instalment
Sampath Bank PLC	**168,750**	243,750	–	12.00%	4 Years	Fixed Monthly Instalment
Sampath Bank PLC	**193,750**	268,750	–	13.30%	4 Years	Fixed Monthly Instalment
Sampath Bank PLC	**212,500**	293,122	–	13.30%	4 Years	Fixed Monthly Instalment
Sampath Bank PLC	**489,500**	–	–	15.00%	4 Years	Fixed Monthly Instalment
Sampath Bank PLC	**395,000**	–	–	13.80%	4 Years	Fixed Monthly Instalment
Commercial Bank of Ceylon PLC	**256,250**	–	–	13.40%	4 Years	Fixed Monthly Instalment
Hatton National Bank PLC	**72,908**	–	–	11.27%	4 Years	Fixed Monthly Instalment
Hatton National Bank PLC	**149,996**	200,000	–	11.27%	4 Years	Fixed Monthly Instalment
Hatton National Bank PLC	**268,750**	97,916	–	11.52%	4 Years	Fixed Monthly Instalment
Others	–	–	15,300			
	3,692,417	1,229,330	403,599			

Maturity analysis of borrowings is given in Note 43.

As at 31 March	**2012 Rs. '000**	2011 Rs. '000	2010 Rs. '000
28. Tax Liabilities			
Income tax payable	**34,931**	39,142	128,928
	34,931	39,142	128,928

29. Deferred Tax Liabilities

Summary of Net Deferred Tax Liability

	2012		2011		2010	
	Temporary Difference	Tax Effect	Temporary Difference	Tax Effect	Temporary Difference	Tax Effect
As at the beginning of the year	399,128	111,756	368,605	129,012	612,549	214,392
Amount originating/(reversing) during the year	60,850	17,038	30,523	10,683	(228,509)	(79,978)
Deferred tax effect on revaluation surplus on property	39,493	11,058	–	–	(15,434)	(5,402)
As at the end of the year	499,471	139,852	399,128	139,695	368,605	129,012

As at 31 March	2012 Rs. '000	2011 Rs. '000	2010 Rs. '000
30. Other Liabilities			
Accrued interest	303,559	209,566	221,351
Provision for gratuity payable **(Note 30.1)**	101,186	73,682	59,127
Other creditors	580,466	189,562	112,788
	985,211	472,810	393,266
30.1 Provision for Gratuity Payable			
Balance at the beginning of the year	73,682	59,127	48,583
Expenses recognised in the Income Statement **(Note 30.2)**	29,512	17,347	14,262
Payments made during the year	(2,008)	(2,792)	(3,718)
Balance at the end of the year	101,186	73,682	59,127
30.2 Gratuity Expenses Recognised in the Income Statement			
Interest cost	8,104	6,504	5,773
Current Service cost	7,568	5,982	4,471
Actuarial (Gain)/Loss	13,840	4,861	4,018
	29,512	17,347	14,262

No actuarial valuation of the gratuity liability was carried out as at 31 March 2012, since Company Policy is to carry out actuarial valuation once in three years. But reasonable provision has been provided for the year ended 31 March 2012.

Last actuarial valuation of the gratuity liability was carried out as at 31 March 2010 by Messrs Actuarial and Management Consultants (Pvt) Limited, a firm of professional actuaries. The valuation method used by the actuaries to value the fund is the 'Projected Unit Credit Method' (PCU), the method recommended by the Sri Lanka Accounting Standard No. 16 - (Revised 2006) on 'Employee Benefits'.

30.3 Actuarial Assumptions - Demographic

Mortality

In service - A 67/70 Mortality table issued by the Institute of Actuaries, London.

Withdrawal

The withdrawal rate at an age represents the probability of an employee leaving within one year of that age due to reasons other than death, ill health and normal retirement. Withdrawal rates used in this valuation have been determined based on the staff turnover statistics of the Company.

Disability

The disability rate at an age represents the probability of an employee leaving within one year of that age due to ill health/disability. Assumptions similar to those used in other comparable plans for disability were used as the data required to do a 'scheme specific' study was not available.

Normal Retirement Age

55 years. The employees who are aged over the specified retirement age have been assumed to retire on their respective next birthdays.

Actuarial Assumptions - Financial

Rate of Discount

In the absence of a deep market in long-term Bonds in Sri Lanka, a long-term rate of discount of 11.00% has been used having given weightage to the anticipated long-term rate of inflation.

Salary Increases

A 10% p.a. salary increment rate has been used in respect of the active employees.

As at 31 March	**2012 Rs. '000**	2011 Rs. '000	2010 Rs. '000
31. Stated Capital/Share Capital			
Opening balance	**36,000**	30,000	30,000
Issue of ordinary shares during the year	–	6,000	–
Closing balance	**36,000**	36,000	30,000
Movement in Number of Ordinary Shares			
Opening balance	**3,006,000**	3,000,000	3,000,000
Issue of ordinary shares during the year	–	6,000	–
Closing balance	**3,006,000**	3,006,000	3,000,000

As at 31 March	**2012 Rs. '000**	2011 Rs. '000	2010 Rs. '000
32. Capital Reserve - Revaluation Reserve			
Balance at the beginning	**1,451,045**	1,330,561	921,939
Additions in	**312,789**	120,484	534,770
Transfers out	**(178,023)**	–	(126,148)
Balance at the end	**1,585,811**	1,451,045	1,330,561

The revaluation reserve relates to revaluation of land & buildings and long-term investment and represents the increase in the fair value of the land & buildings and long-term investment at the date of revaluation.

As at 31 March	**2012 Rs. '000**	2011 Rs. '000 (Restated)	2010 Rs. '000
33. Statutory Reserve Fund			
Balance at the beginning	**391,400**	341,400	321,400
Addition in	**30,000**	50,000	20,000
Balance at the end	**421,400**	391,400	341,400

Note: Statutory Reserve Fund which is a capital reserve, was created in accordance with Finance Companies Direction No. 1 of 2003 issued by Central Bank of Sri Lanka.

	2012 Rs. '000	2011 Rs. '000	2010 Rs. '000
34. General Reserve			
Balance at the beginning	2,531,430	1,702,430	1,402,430
Additions in	320,000	835,000	300,000
Transfer out	–	(6,000)	–
Balance at the end	2,851,430	2,531,430	1,702,430

The Company maintains the general reserve to retain funds for future expansion. This comprises Rs. 200 million set aside by the management to cover general risk involved in its operations.

	2012 Rs. '000	2011 Rs. '000	2010 Rs. '000
35. Investment Fund Reserve			
Opening Balance	–	–	–
Transfer from the income statement	41,951	–	–
Closing balance	41,951	–	–

As per the Budget proposal 2011, finance companies were required to establish and operate an Investment Fund Account (IFA) commencing from January 2011. According to the guidelines issued by the Central Bank of Sri Lanka, finance companies are required to transfer 8% of the profits calculate for the payment of Value Added Tax (VAT) on financial services and 5% of the profit before tax calculated for payment of income tax.

36. Capital Commitments

There are no significant capital commitments which have been approved or contracted for by the Company as at 31 March 2012.

37. Contingencies

There are no contingencies as at 31 March 2012, other than a few litigations filed by the customers against the Company. Although, there can be no assurance, the Directors believe, based on the information currently available, that the ultimate resolution of such legal procedures would not likely to have a material adverse effect on the results of operations, financial position or liquidity. Accordingly, no provision for any liability has been made in these Financial Statements.

38. Trust Activities

The Company is not engaged in any trust activities which may have an impact on its financial results, financial position or liquidity of the Company.

39. Related Party Disclosure

The Company carries out transactions in the ordinary course of business on an arm's length basis at commercial rates with Related Parties. Except for the transactions that Key Management Personnels (KMPs) have made under schemes uniformly applicable to all the staff at concessionary rates, transactions with the related parties listed below have been at commercial rates.

39.1 Parent & Ultimate Controlling Party

The Company does not have an identifiable Parent of its own.

39.2 Transactions with Key Management Personnel

Key Management Personnel (KMPs) include members of the Board of Directors of the Company and Key Employees of the Company who are having authority and responsibility for directing and planning the activities of the Company and its related entities.

39.3 Remuneration of Board Members and Key Managerial Personnel

The members of the Board received remuneration totalling Rs. 45,420,778/- (2011 - Rs. 39,429,000/-) during the financial year under consideration. Key Managerial Personnel received a salary and related expenses totalling Rs. 55,376,911/- (2011 - Rs. 50,372,444/-) in the same financial year.

A total of Rs. 3,621,052/- (2011 - Rs. 2,648,771/-) as defined contribution plan costs was contributed by key managerial personnel during the financial year under consideration. The contribution in respect of same by the Company was Rs. 6,789,482/- (2011 - Rs. 4,992,157/-).

39.4. Transactions involving Key Management Personnel (KMPs) & their Close Family Members (CFMs)

Balance Sheet (31 March)	**2012 Rs. '000**	2011 Rs. '000	2010 Rs. '000
Loan & advances	–	–	–
Other receivables	–	–	–
Total	–	–	–
Deposits	**71,905**	58,068	29,351
Total	**71,905**	58,068	29,351

Income Statements (For the year ended 31 March)	**2012 Rs. '000**	2011 Rs. '000	2010 Rs. '000
Interest income	–	–	–
Interest expenses	**7,686**	5,454	2,810
Other income	–	–	–

39.5 Entities which are controlled by Key Management Personnel (KMPs) & their Close Family Members (CFMs).

Balance Sheet (31 March)	**2012 Rs, 000**	**Accommodation as a % of Capital Funds**	2011 Rs, 000	Accommodation as a % of Capital Funds	2010 Rs, 000	Accommodation as a % of Capital Funds
Loans & advances	**68,354**	**1.51**	104,854	2.59	106,227	3.41
Other receivables	**10,045**		10,771		9,061	
Total	**78,399**		115,625		115,288	
Deposits	**479,611**		387,874		258,767	
Total	**479,611**		387,874		258,767	

For the year ended 31 March	**2012 Rs. '000**	2011 Rs. '000	2010 Rs. '000
Income Statements			
Interest income	**7,650**	6,629	6,088
Interest expenses	**44,200**	33,520	28,085
Other income	**11,459**	11,411	5,888

40. Events after the Balance Sheet Date

Subsequent to the date of the Balance Sheet, no circumstances have arisen which would require adjustments to or disclosure in the Financial Statements.

41. Assets Pledged

The following assets have been pledged as securities against the long-term and short-term borrowings that have been disclosed under the Note 27 to the Financial Statements.

Nature of Assets	Nature of Liability	**Carrying Amount Pledged 2012 Rs. '000**	Included Under
Leases & hire purchase receivable	Long-term & Short-term borrowings	3,587,594	Lease & hire purchase rental receivable
Shares	Bank Overdraft	396,299	Dealing securities
Shares	Bank Overdraft	814,497	Investment securities
Shares	Bank Overdraft	482,367	Investments in Associates
Immovable properties	Bank Overdraft	311,000	Property, plant & equipment

42. Financial Reporting by Segments as per the Provisions of the Sri Lanka Accounting Standard No. 28

The primary business segment reporting format is determined to be business segment as nature of the products and services provided, with each segment representing a strategic business unit that offers different products and serves different markets.

The following table presents financial information regarding business segments:

42.1 Business Segments

	Finance Lease		Hire Purchase & Loans		Investments/ Property		Insurance		Operating Lease		Unallocated		Total	
For the year ended 31 March	**2012 Rs. '000**	2011 Rs. '000	**2012 Rs. '000**	2011 Rs. '000	**2012 Rs. '000**	2011 Rs. '000	**2012 Rs. '000**	2011 Rs. '000	**2012 Rs. '000**	2011 Rs. '000	**2012 Rs. '000**	2011 Rs. '000	**2012 Rs. '000**	2011 Rs. '000
Income from External Operations														
Interest	525,138	359,992	1,066,253	1,100,560	39,166	37,154	–	–	–	–	–	–	1,630,557	1,497,706
Commissions	–	–	–	–	–	–	31,968	25,433	–	–	–	–	31,968	25,433
Rent	–	–	–	–	6,495	3,125	–	–	19,180	19,930	–	–	25,675	23,055
Capital gains	–	–	–	–	590,916	597,563	–	–	–	–	–	–	590,916	597,563
Dividends	–	–	–	–	71,610	48,259	–	–	–	–	–	–	71,610	48,259
Other	–	–	–	–	–	–	–	–	–	–	14,114	22,104	14,114	22,104
Total revenue	525,138	359,992	1,066,253	1,100,560	708,187	686,101	31,968	25,433	19,180	19,930	14,114	22,104	2,364,840	2,214,120
Profit before tax	–	–	–	–	–	–	–	–	–	–	–	–	612,531	1,130,115
Taxation	–	–	–	–	–	–	–	–	–	–	–	–	(142,240)	(224,217)
Profit after tax	–	–	–	–	–	–	–	–	–	–	–	–	470,291	905,898
Other Information as at 31 March														
Segment assets	3,875,965	2,144,048	6,405,416	4,127,218	3,953,515	3,801,106	–	–	7,965	40,851	3,213,559	2,130,712	17,456,420	12,243,935
Segment liabilities	2,696,684	1,308,366	4,456,538	2,518,558	2,750,639	2,319,555	–	–	5,542	24,929	2,235,818	1,300,228	12,145,221	7,471,635
Net assets	1,179,281	835,682	1,948,878	1,608,660	1,202,876	1,481,551	–	–	2,423	15,922	977,741	830,484	5,311,199	4,772,300
Information on Cash Flows														
Cash flows from operating activities	(1,735,842)	1,463,396	(2,327,541)	373,949	590,916	(913,580)	(328,032)	25,433	19,140	19,930	1,743,942	(2,888,306)	(2,037,417)	(1,919,178)
Cash flows from investing activities	–	–	–	–	1,610	46,363	–	–	–	(4,317)	20,835	–	22,445	42,046
Cash flows from financing activities	–	–	–	–	–	–	–	–	–	–	2,228,061	2,051,974	2,228,061	2,051,974
Capital expenditure	–	–	–	–	–	–	–	–	–	–	(101,921)	(217,465)	(101,921)	(217,463)
Net cash flow	(1,735,842)	1,463,396	(2,327,541)	373,949	592,526	(867,217)	(328,032)	25,433	19,140	15,613	3,890,917	(1,053,797)	111,168	(42,621)

43. Maturity Analysis

An analysis of the interest-bearing assets and liabilities employed by the Company as at 31 March 2012, based on the remaining period at the Balance Sheet date to the respective contractual maturity date is given below:

	Up to 3 months Rs. '000	3 to 12 months Rs. '000	1 to 3 years Rs. '000	3 to 5 years Rs. '000	More than 5 years Rs. '000	Total Rs. '000
Cash and Short-Term Fund	229,822	–	–	–	–	229,822
Placements with other Banks	35,687	75,000	–	–	–	110,687
Treasury Bills & Bonds	392,678	21,446	–	–	38,371	452,495
Loans and Advances	400,493	284,431	272,211	266,475	99,784	1,323,394
Finance Lease Rentals Receivable	400,894	825,401	1,946,083	848,490	16,729	4,037,597
Hire Purchase Instalments Receivable	605,906	1,363,154	2,833,209	800,080	12,611	5,614,960
Total Interest-Bearing Assets	**2,065,481**	**2,569,432**	**5,051,503**	**1,915,044**	**167,495**	**11,768,955**
Percentage (%)	**17.55**	**21.83**	**42.92**	**16.27**	**1.42**	**100.00**
Bank Overdraft	505,815	–	–	–	–	505,815
Bank Borrowings	889,105	1,438,649	1,725,763	555,882	–	4,609,399
Fixed Deposits	2,187,214	3,019,031	522,804	–	–	5,729,048
Certificate of Deposits	88,660	15,891	18,089	–	–	122,640
Savings Deposits	18,325	–	–	–	–	18,325
Total Interest-Bearing Liabilities	**3,689,118**	**4,473,571**	**2,266,656**	**555,882**	**–**	**10,985,227**
Percentage (%)	**33.58**	**40.72**	**20.63**	**5.06**	**0.00**	**100.00**

The Capital Adequacy Position

A financial institution's financial strength and stability can be signified by measuring its capital adequacy. The capital adequacy measurement is a widely accepted concept which specifies the limit up to which a business can expand in terms of its risk weighted assets. In pursuit of business expansion and diversification, finance companies could engage themselves in activities that regularly change their risk profile. Therefore, regulatory capital requirements have been brought about as means of bringing down undue expansion beyond specified limits. This ensures institutions do not take undue risk through growth of its assets especially in areas risky than others. An enterprises capital in this context serves as a cushion in absorbing any unexpected losses that may arise. Hence capital is a good indicator of an institutions level of safety towards varying stakeholders including depositors.

The Central Bank of Sri Lanka being the regulator in our sector has introduced two measures in ratio terms which define acceptable levels of capital that finance companies should maintain at any given moment. Namely; The Core Capital Ratio and the Total Risk Weighted Capital Ratio. The recommended minimum capital adequacy ratios are 5% for Core Capital Ratio (CCR) and 10% for Total Risk Weighted Capital Ratio (TRWCR). Institutions who possess a higher capital adequacy ratio in general have a greater capacity to absorb any negative profitability impacts that may materialise unexpectedly and vice versa.

The computation of the ratios has two parts that involve firstly a working to arrive at the Tier I capital and the capital base for the two ratios CCR and TRWCR respectively. A separate computation is carried out to derive at the total Risk-Weighted Assets as at a given date.

The capital base comprises of two elements, namely Tier I and Tier II capital.

Tier I capital comprises the stated capital, statutory reserve fund, retained profits, general and other reserves excluding the revaluation reserve.

Tier II capital consists of the revaluation reserve of which only 50% could be taken for the computation. Other Tier II components include the general provision, approved subordinated term debts and other hybrid capital instruments. The Tier II capital should not exceed 100% of the Tier 1 capital for the Total Risk-Weighed Capital Ratio.

In deriving at the total Risk-Weighted Assets, each asset category in the Balance Sheet is arranged in the order of their risk and available security and thereafter pre-defined risk weights are assigned to each such category to compute the total risk-weighted value. As an example, loans and advances that are not cash backed or is without acceptable security are termed high risk and a 100% risk weight is assigned. Assets which comprise investments held in secure Government Securities are considered no risk and a 0% risk weight is assigned.

Total Risk-Weighted Assets Computation

As at 31 March	Balance			Risk Weight Factor %	Risk-Weighted Balance		
	2012 Rs. '000	2011 Rs. '000	2010 Rs. '000 (Restated)		**2012 Rs. '000**	2011 Rs. '000	2010 Rs. '000 (Restated)
Assets							
Cash and bank balances	**229,822**	118,654	161,275	0	–	–	–
Treasury Bills and Bonds	**452,495**	363,343	237,185	0	–	–	–
Investments in shares and unit trusts	**3,989,149**	3,888,317	2,217,695	100	**3,989,149**	3,888,317	2,217,695
Bank deposits	**110,688**	43,000	85,023	20	**22,138**	8,600	17,005
Loans against fixed deposits	**57,159**	54,751	45,570	0	–	–	–
Loans and advances	**1,128,151**	214,699	185,029	100	**1,128,151**	214,699	185,029
Finance lease receivable	**3,875,965**	2,144,048	1,019,633	100	**3,875,965**	2,144,048	1,019,633
Hire purchase receivable	**5,220,108**	3,857,768	3,180,163	100	**5,220,108**	3,857,768	3,180,163
Inventories	**340,244**	24,780	4,851	100	**340,244**	24,780	4,851
Other assets	**442,538**	274,874	304,658	100	**442,538**	274,874	304,658
Property, Plant & Equipment	**1,610,101**	1,259,701	1,082,425	100	**1,610,101**	1,259,701	1,082,425
Total Risk-Weighted Assets	**17,456,420**	12,243,935	8,523,507		**16,628,394**	11,672,787	8,011,459

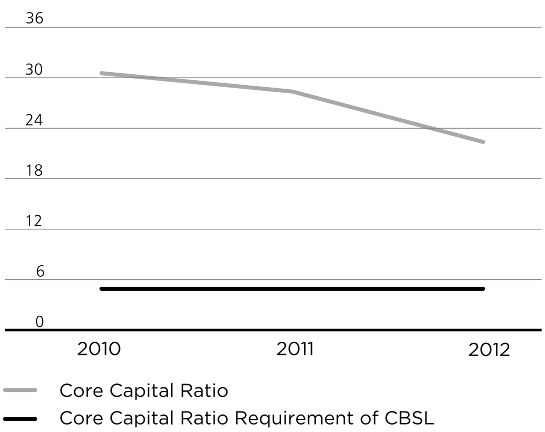
Total Capital Base Computation

As at 31 March	**2012 Rs. '000**	2011 Rs. '000	2010 Rs. '000 (Restated)
Tier I: Core Capital			
Stated capital	**36,000**	36,000	30,000
Reserve fund	**421,400**	391,400	341,400
General reserve	**2,893,382**	2,531,430	1,702,430
Associate company reserves	**358,060**	358,086	358,184
Retained earnings	**16,547**	4,340	13,442
Total Tier I capital	**3,725,389**	3,321,256	2,445,456
Tier II: Supplementary Capital			
Revaluation reserves	**792,905**	725,522	665,280
Total Tier II capital	**792,905**	725,522	665,280
Capital base	**4,518,294**	4,046,778	3,110,736

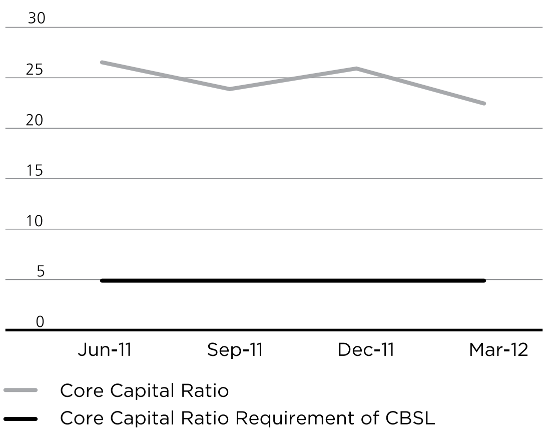
Capital Adequacy Ratios

As at 31 March			**2012**	2011	2010 (Restated)
Core Capital Ratio	=	$\frac{\text{Tier I Capital}}{\text{Risk-Weighted Assets}}$	22.40%	28.50%	30.52%
Total Risk-Weighted Capital Ratio	=	$\frac{\text{Capital Base}}{\text{Risk-Weighted Assets}}$	27.17%	34.69%	38.82%

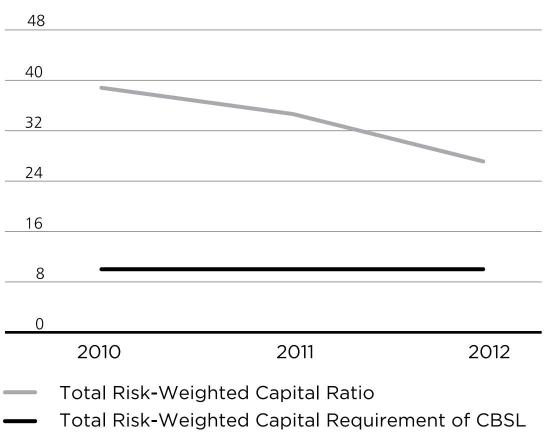
Core Capital Ratio - Annual (%)



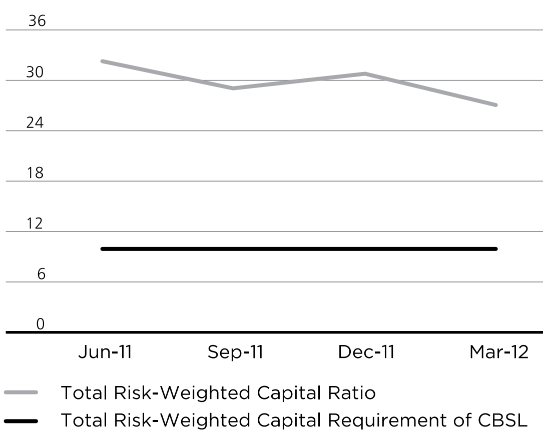
Core Capital Ratio - Quarterly (%)



Total Risk-Weighted Capital Ratio - Annual (%)



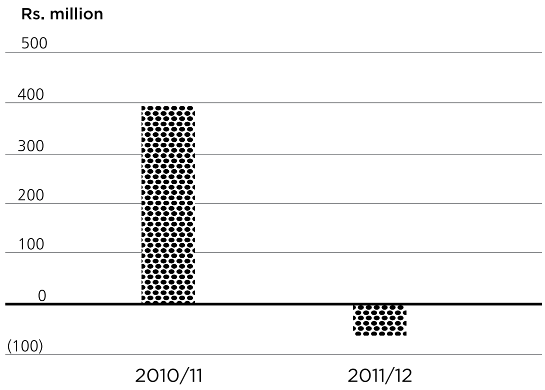
Total Risk-Weighted Capital Ratio - Quarterly (%)



Economic Value Added

	2011/12 Rs. '000	2010/11 Rs. '000
Invested Equity		
Shareholders funds	5,311,199	4,772,300
Add: Accumulated provision for credit losses	365,493	338,666
	5,676,692	5,110,966
Earnings		
Net Profit After Tax	470,291	905,898
Add: Provision/(reversal) of credit losses	26,827	(45,348)
	497,118	860,550
Cost of equity % (Average 12 months Treasury Bill rate + 2% risk premium)	10.38	10.05
Cost of average equity	559,879	466,815
Economic value added	(62,761)	393,735

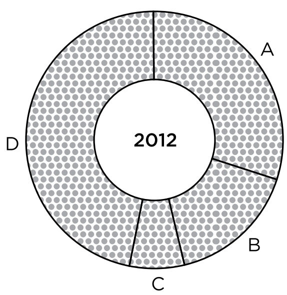
Economic Value Added

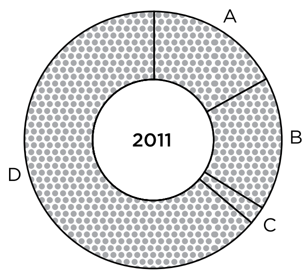


Value Added Statement

For the year ended 31 March	**2012** Rs. '000	%	2011 Rs. '000	%	2010 (Restated) Rs. '000	%
Value Added						
Income	2,364,841		2,214,120		1,806,966	
Interest expenses	(1,006,378)		(679,728)		(791,308)	
Cost of external services	(420,747)		(122,059)		(216,128)	
	937,716		1,412,333		799,530	
Value Distribution						
To employees as remuneration	283,962	30	240,643	17	187,623	26
To Government as taxes	153,141	16	231,236	16	262,636	36
To shareholders as dividends	66,132	7	30,000	2	13,800	2
Retained within the business						
- as depreciation	41,223	4	34,556	2	32,767	5
- as reserves	393,258	43	875,898	62	302,704	31
	937,716		1,412,333		799,530	

Value Distribution



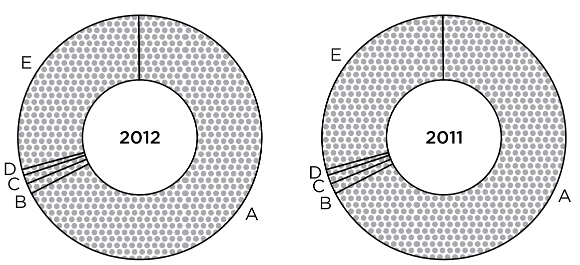


	2012 %	2011 %
A - To Employees	30	17
B - To Government	16	17
C - To Providers of Capital	7	2
D - To Expansion and Growth	47	64

Sources and Utilisation of Income

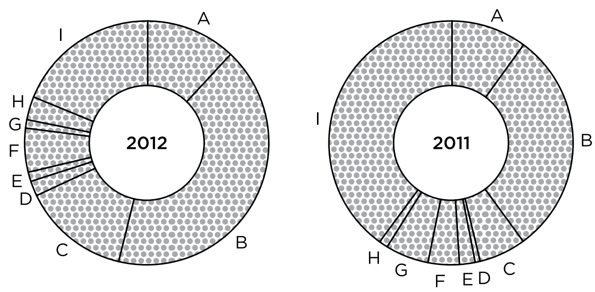
For the year ended 31 March	2012 Rs. '000	%	2011 Rs. '000	%	2010 (Restated) Rs. '000	%
Sources of Income						
Loans and advances	1,591,391	67.29	1,460,552	65.97	1,473,138	81.53
Government Securities	28,262	1.20	34,182	1.54	74,173	4.10
Commission income	31,968	1.35	25,433	1.15	25,365	1.40
Operating lease income	19,140	0.81	19,930	0.90	18,351	1.02
Other income	694,081	29.35	674,022	30.44	215,939	11.95
Total	2,364,842	100.00	2,214,120	100.00	1,806,966	100.00
Utilisation of Income						
To Employees						
Personnel expenses	283,962	12.01	240,643	10.87	187,623	10.38
To Suppliers						
Interest paid	1,006,378	42.56	679,728	30.70	791,308	43.76
Other expenses	321,492	13.59	135,611	6.12	132,629	8.19
Depreciation	41,223	1.74	34,556	1.56	32,767	1.81
Provision for credit losses	26,827	1.13	(45,348)	(2.05)	139,600	7.72
To Government						
Value Added Tax and other taxes	131,954	5.58	90,333	4.08	68,202	3.77
Income tax	16,583	0.70	142,699	6.44	112,436	6.11
To Shareholders						
Dividends	66,132	2.80	30,000	1.35	13,800	0.76
Retained profit	470,291	19.89	905,898	40.91	328,600	17.50
Total	2,364,842	100.00	2,214,120	100.00	1,806,966	100.00

Sources of Income



	2012 %	2011 %
A - Loans and Advances	68	66
B - Government Securities	1	2
C - Commission Income	1	1
D - Operating Lease Income	1	1
E - Other Income	29	30

Utilisation of Income



	2012 %	2011 %
A - Personnel Expenses	12	11
B - Interest Paid	42	31
C - Other Expenses	13	6
D - Depreciation	2	1
E - Provision for Credit Losses	1	(2)
F - Value Added Tax and Other Taxes	6	4
G - Income Tax	1	6
H - Dividends	3	1
I - Retained Profit	20	40

Investor Relations

Listing Rule No. 7.6, Contents of the Annual Report, at a Glance

Rule No	Disclosure Requirement	Section Reference	Page Reference
7.6 (i)	Names of persons who held the positions of Directors during the financial year	Annual Report to the Board of Directors on the Affairs of the Company	143 to 144
7.6 (ii)	Principal activities of the Entity during the year and any changes therein	Significant Accounting Policies	161
7.6 (iii)	The names and the number of shares held by the 20 largest holders of voting and non-voting shares and the percentage of such shares held	Investor Relations (Section 09)	199
7.6 (iv)	The Public Holding percentage	Investor Relations (Section 02)	197
7.6 (v)	The statement of each Director's holding and Chief Executive Officer's holding in shares of the Entity at end of financial year	Annual Report to the Board of Directors on the Affairs of the Company.	144
7.6 (vi)	Information pertaining to material foreseeable risk factors of the Entity	Risk Management	82 to 97
7.6 (vii)	Details of material issues pertaining to employees and industrial relations of the Entity	Not Applicable	–
7.6 (viii)	Extents, locations, valuations and the number of buildings of the Entity's land holdings and investment properties.	Notes to the Financial Statements (Note 23.3)	182
7.6 (ix)	Number of shares representing the Entity's stated capital	Notes to the Financial Statements (Note 31) Investor Relations (Section 02)	186 197
7.6 (x)	A distribution schedule of the number of holders in each class of equity securities, and the percentage of their total holdings	Investor Relations (Section 02)	197
7.6 (xi)	Equity Ratios Market Value	Investor Relations (Sections 04 and 05) Investor Relations (Section 06)	198
7.6 (xii)	Significant changes in the Equity's fixed assets and the market value of land, if the value differs sustainability from the book value	Notes to the Financial Statements	180 to 182
7.6 (xiii)	Details of funds raised through Public issues, Rights issues and Private Placements during the year	Not Applicable	–
7.6 (xiv)	Information in respect of Employee Share Option Plan and Employee Share Ownership Plan	Not Applicable	–
7.6 (xv)	Disclosures pertaining to Corporate Governance practices in terms of Rules 7.10.3, 7.10.5 c. and 7.10.6 c. of Section 7 of the Rules	Corporate Governance Report	54 to 79
7.6 (xvi)	Disclosure on Related Party Transactions exceeding 10% of the Equity or 5% of the total assets of the Entity as per Audited Financial Statements, whichever is lower	Investor Relations (Section 10)	199

1. STOCK EXCHANGE LISTING

The issued ordinary shares of Mercantile Investments and Finance PLC are listed with the Colombo Stock Exchange. Interim Financial Statements of the Company have been submitted to the Colombo Stock Exchange within two months of the Balance Sheet date.

Stock Exchange Code for Mercantile Investments and Finance PLC share is 'MERC'.

2. Ordinary Shareholders Share Information - Voting & Non-Voting

There were 3,006,000 registered Voting Shareholders as at 31 March 2012 (2011: 3,006,000) distributed as follows.

Share Information - Voting

	Resident			Non-Resident			Total		
	No. of Share-holders	No. of Shares	%	No. of Share-holders	No. of Shares	%	No. of Share-holders	No. of Shares	%
1 - 1,000	3	1,153	0.04	1	10	0.00	4	1,163	0.04
1,001 - 10,000	3	12,024	0.40	–	–	–	3	12,024	–
10,001 - 100,000	5	55,110	1.83	–	–	–	5	55,110	–
100,001 - 1,000,000	7	2,937,703	97.73	–	–	–	7	2,937,703	–
Over 1,000,000	–	–	–	–	–	–	–	–	–

Analysis of Shareholders

Resident/Non-Resident

	31 March 2012			31 March 2011		
	No. of Shareholders	No. of Shares	%	No. of Shareholders	No. of Shares	%
Resident	18	3,005,990	100	17	3,006,000	100
Non-Resident	1	10	–	–	–	–
Total	19	3,006,000	100	17	3,006,000	100

Individuals/Institutions

	31 March 2012			31 March 2011		
	No. of Shareholders	No. of Shares	%	No. of Shareholders	No. of Shares	%
Individuals	16	1,768,461	58.83	15	1,768,461	58.83
Institutions	3	1,237,539	41.17	3	1,237,539	41.17
Total	19	3,006,000	100.00	18	3,006,000	100.00

As per the rule No. 7.6 (iv) of Colombo Stock Exchange, percentage of public holding as at 31 March 2012 was 10.87%. (2011 - 11.20%).

Share Information - Non-Voting

There were no non-voting shares issued by the Company as at 31 March 2012 and 31 March 2011

3. Share Trading

	2011/12
Number of transactions	1
Number of shares traded	10
Value of shares traded	22,000

4. Dividends

	2011/12	2010/11
1st Interim	10	10
2nd Interim	12	
Dividend per share (Rs.)	22	10
Dividend payout ratio (%)	14.06	3.32

5. Earnings

	2011/12	2010/11
Earnings per share (Rs.)	156.45	301.36
Price earnings ratio (Times)	14.06	N/A *

The Company was listed on Colombo Stock Exchange on 2nd June 2011 and classified under the banks, finance & insurance sector on *Diri Savi* Board.

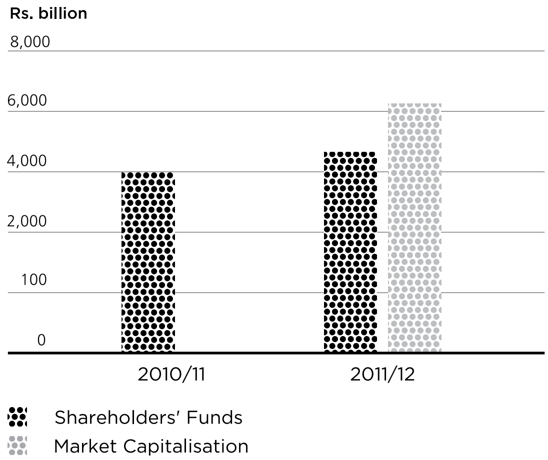
6. Market Value & Net Assets per Share

		2011/12	2010/11
6.1 Market Value per Share	Highest	2,200	–
	Lowest	2,200	–
	Year End	2,200	–
6.2 Net assets per share (As at 31st March)		1,766.87	1,587.59

7. Market Capitalisation (As At 31St March)

	Capital & Reserves Rs. '000	MI Market Capitalisation Rs. '000	CSE Market Capitalisation Rs. '000	MI Market Capitalisation as a % CSE Market Capitalisation
31.03.2011	4,772,300	N/A	N/A	N/A
31.03.2012	5,311,199	6,613,200	2,012,873,661	0.33

Shareholders' Funds and Market Capitalisation



8. Information on Movement in Share Capital

Year	Issue	No. of Shares
2011/12	Before to Listed in Colombo Stock Exchange	3,006,000
2011/12	After Listed in Colombo Stock Exchange	–
	Total	3,006,000

9. Twenty Major Shareholders (Voting) of the Company As At 31 March 2012

Name		% on Total Capital	% on Total Voting Capital	**No. of Shares 2012**	No. of Shares 2011
1.	Nilaveli Beach Hotels (Pvt) Limited	20.83	20.83	**626,240**	626,250
2.	A.M. Ondaatjie	15.88	15.88	**477,213**	477,213
3.	G.G. Ondaatjie	15.88	15.88	**477,213**	477,213
4.	T.J. Ondaatjie	15.88	15.88	**477,213**	477,213
5.	Mercantile Fortunes (Pvt) Limited	13.67	13.67	**410,820**	410,820
6.	G.L.A. Ondaatjie	8.93	8.93	**268,535**	268,535
7.	Tangerine Tours (Pvt) Limited	6.67	6.67	**200,469**	200,469
8.	P.R. Divitotawela/R.D. Madugalla	0.42	0.42	**12,525**	12,525
9.	P.R. Divitotawela/A.D. Galagoda	0.42	0.42	**12,525**	12,525
10.	N.H.V. Perera	0.33	0.33	**10,020**	10,020
11.	J.A.S.S. Adhihetty	0.33	0.33	**10,020**	10,020
12.	R.M.D. Abeygunawardena	0.33	0.33	**10,020**	10,020
13.	S. Fernando	0.17	0.17	**5,010**	5,010
14.	S. Senanayake	0.17	0.17	**5,010**	5,010
15.	C.A. Ondaatjie	0.07	0.07	**2,004**	2,004
16.	A.D. Rajapaksha	0.02	0.02	**501**	501
17.	A.M. Rajapaksha	0.02	0.02	**501**	501
18.	A.M. Dominic	0.01	0.01	**151**	151
19.	H.W.M. Woodward	0.00	0.00	**10**	0
	Total	100.00	100.00	3,006,000	3,006,000

10. Related Party Transactions Exceeding 10% of the Equity or 5% of the Total Assets

The Company carried out transactions in the ordinary course of the business with related parties and aggregate monetary value of these transactions have not been exceeded 10% of the share holders equity of the Company as at 31 March 2012.

Decade at a Glance

For the year ended 31 March	**2012**	2011	2010 (Restated)	2009	2008	2007	2006	2005	2004	2003
	Rs. '000	Rs. '000	Rs. '000	Rs. '000	Rs. '000	Rs. '000	Rs. '000	Rs. '000	Rs. '000	Rs. '000
Operating Results										
Income	**2,364,841**	2,214,120	1,806,966	1,708,609	1,372,133	1,092,335	974,491	799,488	637,052	453,269
Interest expense	**1,006,378**	679,728	791,308	989,662	720,125	447,070	335,390	241,252	172,334	171,720
Non-interest expenses	**871,589**	485,795	574,623	464,225	420,723	307,953	278,318	246,254	180,272	124,497
Profit before tax	**441,483**	1,048,597	441,035	254,409	231,285	337,312	360,783	311,981	284,446	157,052
Provision for taxation	**16,583**	142,699	112,436	21,034	82,716	100,327	77,096	24,938	19,527	6,048
Net profit for the year	**470,291**	905,898	328,600	233,375	148,569	236,985	283,687	287,043	264,919	151,004
Dividends	**66,132**	30,000	13,800	9,750	14,049	60,080	29,321	42,189	12,500	18,750
As at 31 March										
Assets										
Liquid assets	**793,006**	524,997	483,483	462,636	416,332	261,874	304,074	289,111	222,948	178,170
Investments	**3,390,331**	3,394,763	1,761,332	930,836	1,196,974	1,189,991	1,028,824	891,671	475,452	310,635
Debentures	–	–	–	–	2,232	3,040	3,040	3,560	4,470	3,120
Advances	**10,281,382**	6,271,266	4,430,395	5,205,265	5,377,167	4,843,254	4,282,982	3,164,702	2,126,195	1,436,352
Other assets	**779,927**	293,133	309,509	217,281	268,717	350,865	213,665	116,826	77,033	87,832
Property, plant & equipment	**1,565,620**	1,214,751	1,037,007	1,015,271	888,378	859,202	367,231	376,762	344,165	286,176
Leasehold property	**44,481**	44,950	45,418	45,886	–	–	–	–	–	–
Intangible assets	**2,855**	6,521	–	–	–	–	–	–	–	–
Investment in associates	**598,818**	493,554	456,363	–	–	–	–	–	–	–
Total assets	17,456,420	12,243,934	8,523,507	7,877,174	8,149,800	7,508,226	6,199,816	4,846,192	3,250,263	2,302,286
Liabilities										
Bank overdraft	**505,815**	397,246	213,395	625,709	765,175	461,328	22,774	138,663	189,202	40,488
Borrowings	**4,609,399**	2,315,206	403,599	1,236,670	1,679,362	1,804,044	1,991,577	1,037,946	220,000	20,000
Deposits from customers	**5,870,013**	4,107,536	3,479,291	2,774,974	2,409,257	2,065,644	1,811,049	1,618,996	1,418,966	1,185,570
Other liabilities	**1,159,994**	651,647	651,206	545,411	583,950	593,986	250,878	247,725	200,587	193,549
	12,145,221	7,471,635	4,747,491	5,182,764	5,163,968	4,627,506	4,076,278	3,043,330	2,028,755	1,439,607
Shareholders' Funds										
Share capital	**36,000**	36,000	30,000	30,000	30,000	30,000	30,000	30,000	25,000	25,000
Reserves	**5,275,199**	4,736,300	3,746,016	2,664,410	2,682,055	2,812,095	2,116,312	1,772,862	1,196,508	837,679
Total shareholders' funds & Total liabilities	17,456,420	12,243,934	8,523,507	7,877,174	8,149,800	7,508,226	6,222,590	4,846,192	3,250,263	2,302,286
Information on Ordinary Shares										
Earnings per share (Rs.)	**156.45**	301.36	109.53	77.79	49.52	79	94.56	95.68	105.97	60.40
Net assets per share (Rs.)	**1,766.87**	1,587.59	1,258.67	898.14	908.98	861.07	715.44	600.95	488.60	345.07
Interest cover (times)	**1.48**	2.54	1.56	1.26	2.29	2.29	2.65	2.29	2.65	1.91
Dividend cover (times)	**7.11**	30.20	23.81	23.94	3.94	3.94	9.68	6.80	21.29	8.05
Ratios (%)										
Return on shareholders' funds (%)	**9**	19	9	9	5	9	14	17	22	18
Liquid assets as a % of deposits (%)	**14**	13	14	17	17	13	17	18	16	15
Growth in income (%)	**7**	23	6	25	26	12	22	25	41	2
Growth in interest expenses (%)	**48**	(14)	(20)	37	61	33	39	40	0	(9)
Growth in other expenses (%)	**79**	(15)	27	10	37	4	13	37	45	(1)
Growth in profit after tax (%)	**(48)**	176	36	57	(37)	(17)	1	18	75	38
Growth in advances (%)	**64**	42	(15)	(3)	11	11	35	49	48	20
Growth in deposits (%)	**43**	18	25	15	17	12	12	14	20	12
Growth in shareholders' funds (%)	**11**	26	31	1	5	23	15	39	42	20

Glossary

Corporate Governance
The process by which corporate institutions are governed. It involves the way in which authority is exercised over the management and the direction of the Company, the supervision of executive roles and the responsibility and accountability towards owners and other parties.

Sustainability Report
Sustainability reporting is a practice of measuring, disclosing, and being accountable for organisational performance while working towards the goal of sustainable development. A sustainability report provides a balanced and reasonable representation of the sustainability performance of the reporting organisation.

Segmental Analysis
Analysis of financial information by segments of an organisation specifically, the different Industries and the different business lines in which it operates.

Net Interest Income
The difference between what a financial institution earns on assets such as loans and securities and what it incurs on liabilities such as deposits and borrowings.

Cost to Income Ratio
Total operating expenses before provision for bad and doubtful debts expressed as a percentage of operating income.

Capital Adequacy Ratios
The relationship between capital and the risk-weighted assets as prescribed by the Central Bank of Sri Lanka developed by modifying international best practices on maintenance of capital for financial institutions, to suit the local requirements.

Tier I Capital
Core capital representing permanent shareholders' equity and reserves created or increased by appropriations of retained earnings or other surpluses.

Tier II Capital
Supplementary capital that consists of revaluation reserves, general provisions and debt instruments such as subordinated term debts and other hybrid capital instruments that combine characteristics of equity and debt.

Risk-Weighted Assets
On-Balance Sheet assets and the credit equivalent of Off-Balance Sheet assets multiplied by the relevant risk-weighting factors prescribed by the Central Bank of Sri Lanka.

Liquid Assets Ratio
Assets that are held in cash or in a form that can be converted to cash readily (as prescribed by the Central Bank of Sri Lanka) divided by the total deposits.

Non-Performing Loans
A loan placed on a cash basis (i.e. Interest Income is only recognised when cash is actually collected) after when six instalments or more are overdue, as there is reasonable doubt regarding the collectability of its instalments of capital and interest.

Interest In Suspense
Interest suspended on non-performing hire purchase contracts, lease contracts and other loans and advances without recognising to the Income Statement.

Provision for Bad and Doubtful Debts
Amounts set aside against possible losses on hire purchases, leases and other loans and advances as a result of their becoming partly or wholly uncollectable.

Non-Performing Ratio
Total non-performing loans expressed as a percentage of the total loans and advances.

Provision Cover
Total provision for bad and doubtful debts expressed as a percentage of non-performing loans net of interest in-suspense before discounting for provisions for non-performing loans.

Return on Average Assets
Net profit after tax divided by the average assets.

Return on Shareholders' Funds
Net profit after tax divided by the average Shareholders' Funds.

Earnings per Share
Net profit after tax and after dividend on preference shares divided by the number of ordinary shares in issue.

Net Assets per Share
Shareholders' Funds excluding preference shares divided by the number of ordinary shares in issue.

Price Earnings Ratio
Market price of an ordinary share divided by earnings per share.

Dividend Yield
Dividend earned per share as a percentage of its market value.

Dividend Cover
Profit after tax divided by gross dividends. This ratio measures the number of times dividend is covered by the current year's distributable profits.

Interest Cover
Profits before interest and taxes divided by the interest cost. This ratio measures the number of times interest is covered by the current year's profits before interest and taxes.

Shareholders' Funds
Total of stated capital plus capital and revenue reserves.

Debt to Equity
Total borrowings expressed as a percentage of equity.

Effective Income Tax Rate
Provision for taxation divided by the net profit before taxation.

Deferred Tax
Sum set aside in the Financial Statements for taxation that would become payable/receivable in a financial year other than the current financial year.

Value Added
Value of wealth created by providing financial and other related services, less the cost of providing such services.

Economic Value Added
A measure to assess productivity of a business that takes into consideration cost of total invested equity.

Related Parties
Parties where one party has the ability to control the other party or exercise significant influence over the other party in making financial and operating decisions.

Notice of Meeting

NOTICE IS HEREBY given that the Forty-Ninth Annual General Meeting of MERCANTILE INVESTMENTS AND FINANCE PLC will be held at No. 236, Galle Road, Colombo 3, on 29 June 2012, at 11.00 a.m. for the following purposes:

- To receive and consider the Report of Directors and the Statement of Accounts for the year ended 31 March 2012 and the Report of the Auditors thereon.
- To re-elect Directors retiring by rotation in terms of Article 23 (7) of the Articles of Association.
- To re-elect Directors retiring in terms of Section 23 (3) of the Articles of Association.
- To ratify the 2nd Interim Dividend of Rs. 12/- per share declared on 30 September 2011 as the final dividend for the financial year ended 31 March 2012.
- To reappoint Messrs Cecil Arseculeratne & Co., Auditors and to authorise the Directors to determine their remuneration.
- To authorise the Board of Directors to determine donations.

By Order of the Board,

S Pethiyagoda

Sonali Pethiyagoda
Company Secretary

Colombo
15th May 2012

Notes

1. *A member who is entitled to attend and vote at the abovementioned meeting is entitled to appoint a proxy, who need not also be a member to attend instead of him/her.*
2. *A Form of Proxy is enclosed in the Report.*
3. *The completed Proxy Form should be deposited at the Registered Office of the Company at No. 236, Galle Road, Colombo 3, not less than 48 hours before the time fixed for holding the meeting.*

Form of Proxy

I / We ....of

....

being a member/members of MERCANTILE INVESTMENTS AND FINANCE PLC, hereby appoint:

Mr. Saroja Hemakumar Jayawickrema Weerasuriya	of Colombo (or failing him)
Mr. Gerard George Ondaatjie	of Colombo (or failing him)
Mr. Shermal Hemaka Jayasuriya	of Colombo (or failing him)
Mr. Pathiranage Mahesh Amarasekara	of Colombo (or failing him)
Ms. Angeline Myrese Ondaatjie	of Colombo (or failing her)
Mr. Travice John Ondaatjie	of Colombo (or failing him)
Mr. Henaka Arachchillage Sajitha Tilakasiri Senanayake	of Colombo (or failing him)
Ms. Punyakanthi Tikiri Kumari Navaratne	of Colombo (or failing her)
Mr. Nawagamuwage Hasantha Viraj Perera	of Colombo (or failing him)
Mr. Singappuli Mudiyanselage Susantha Sanjaya Bandara	of Colombo (or failing him)

....of

....

as my/our proxy to represent me/us and vote for me/us on my/our behalf at the Forty-Ninth Annual General Meeting of the Company to be held at 11.00 a.m. on 29 June 2012, at No. 236, Galle Road, Colombo 3 and at any adjournment thereof and at every poll which may be taken in consequence thereof.

As witness my hand/our hands this .... day of .... two thousand and twelve.

....

Signature

Instructions as to Completion

1. Kindly perfect the Form of Proxy, after filling in legibly your full name and address by signing in the space provided and please fill in the date of signature.
2. If the Proxy Form is signed by an Attorney, the relative Power of the Attorney should also accompany the Proxy Form for registration, if such Power of Attorney has not already been registered with the Company.
3. In the case of a Company/Corporation, the proxy must be under its Common Seal which should be affixed and attested in the manner prescribed by its Articles of Association.
4. The completed Form of Proxy should be deposited at the Registered Office of the Company at No. 236, Galle Road, Colombo 3, not less than 48 hours before the time of the meeting.

Corporate Information

Name of the Company
Mercantile Investments and Finance PLC

Legal Form
Public limited liability company incorporated in Sri Lanka under the Companies Ordinance No. 51 of 1938 and re-registered under the Companies Act No. 07 of 2007. A licensed finance company under the Finance Business Act No. 42 of 2011.

Company Registration Number
PB 76 PQ

Tax Payer Identification Number
104021794

VAT Registration Number
104021794 7000

Registered Office
No. 236, Galle Road, Colombo 3

Head Office
No. 236, Galle Road, Colombo 3
Telephone: 2343720-7
Fax: 2434524
Email: mercantile@mi.com.lk
Website: http//www.mi.com.lk

Board of Directors
Saroja Hemakumar Jayawickrama Weerasuriya *(Chairman)*
Gerard George Ondaatjie *(Managing Director)*
Shermal Hemaka Jayasuriya *(Finance - Director)*
Pathiranage Mahesh Amarasekera *(Director - Recoveries)*
Angeline Myrese Ondaatjie
Travice John Ondaatjie
Henaka Arachchillage Sajitha Tilakasiri Senanayake
Punyakanthi Tikiri Kumari Navaratne
Nawagamuwage Hasantha Viraj Perera
Singappuli Mudiyanselage Susantha Sanjaya Bandara

Company Secretary
Sonali Pethiyagoda

Audit Committee
Henaka Arachchillage Sajitha Tilakasiri Senanayake *(Chairman of the Committee)*
Saroja Hemakumar Jayawickrama Weerasuriya
Singappuli Mudiyanselage Susantha Sanjaya Bandara

Credit Committee
Gerard George Ondaatjie *(Chairman of the Committee)*
Pathiranage Mahesh Amarasekera
Dhanushka Fonseka *(GM - Credit & Marketing)*

Remuneration Committee
Saroja Hemakumar Jayawickrama Weerasuriya *(Chairman of the Committee)*
Henaka Arachchillage Sajitha Tilakasiri Senanayake
Nawagamuwage Hasantha Viraj Perera

Integrated Risk Management Committee
Nawagamuwage Hasantha Viraj Perera *(Chairman of the Committee)*
Gerard George Ondaatjie
Pathiranage Mahesh Amarasekera
Shermal Hemaka Jayasuriya

External Auditors
Cecil Arseculeratne & Co.
Chartered Accountants

Internal Auditors
Ernst & Young
Chartered Accountants

Bankers
Commercial Bank of Ceylon PLC
Hatton National Bank PLC
Seylan Bank PLC
Sampath Bank PLC
NDB Bank PLC
Nations Trust Bank PLC
HSBC Limited
People's Bank
Bank of Ceylon
ICICI Bank Limited

Credit Rating
RAM Ratings (Lanka) Limited revised the Company's respective long-term financial institutions rating in February 2012 to "RAM BBB+" (positive outlook) and the short-term rating to "RAM P2".

Management Team
M.B. Assauw *(Director - Deposits)*
Dhanushka Fonseka *(GM - Credit & Marketing)*
Buddika Kasturiratne *(AGM - Recoveries)*
Deva Anthony *(AGM - Finance)*
Ravi Ekanayake *(GM - Work Shop)*
Jayanka Kahawevithana *(Senior Manager - Legal)*
Hirantha Pandithasekara *(Senior Manager - Corporate Leasing)*
Ravi De Mel *(Senior Manager - Credit Administration)*
Darshana Senarath *(Senior Manager - Leasing)*
Lahiru Dayananda *(Senior Manager/Regional Manager)*
Shehan Cooray *(Senior Manager - Recoveries)*
Prasad Wickramasinghe *(Senior Manager - Payments)*
Chandana Nanayakkara *(Senior Manager - Finance)*
Indika Prasad *(Senior Manager - IT Software Development)*
Raminda Maganaarachchi *(Accountant)*
Kumudini Jayasekara *(Manager - Insurance)*
Chaminda Paranayapa *(Manager - Insurance)*
Kingsly Lowe *(Manager - Negombo)*
Wiraj Arachchi *(Manager - IT)*
Uma Maheswaran *(Manager - Deposits)*
Dinesh Perera *(Manager - Leasing - Negombo)*
Avindra Wijesundara *(Manager - Credit)*
U.M.M.K Bandara *(Manager - Credit)*
Wasantha Sisira Kumara *(Manager - Kurunegala)*
Kushan Gunasekara *(Manager - Deposits and Marketing)*
Sonali Pethiyagoda *(Company Secretary)*
Fawziya Swangsa *(Chairman's Secretary)*

★
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Mercantile Investments and Finance PLC | 236, Galle Road, Colombo 3, Sri Lanka. | T. +94 11 2343720-7 | F. +94 11 2434524
E. mercantile@mi.com.lk | W. www.mi.com.lk