



Mercantile Investments and Finance PLC

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INDEPENDENT AUDITOR'S REPORT TO THE SHAREHOLDERS OF MERCANTILE INVESTMENTS & FINANCE PLC

Report on the Audit of Financial Statements

Opinion

We have audited the financial statements of Mercantile Investments & Finance PLC (the Company), which comprise the statement of financial position as at 31 March 2024, and the statement of profit or loss and other comprehensive income, statement of changes in equity and statement of cash flows for the year then ended, and notes to the financial statements, including material accounting policy information.

In our opinion, the accompanying financial statements give a true and fair view of the financial position of the Company as at 31 March 2024 and of its financial performance and its cash flows for the year then ended in accordance with Sri Lanka Accounting Standards.

Basis for opinion

We conducted our audit in accordance with Sri Lanka Auditing Standards (SLAuSs). Our responsibilities under those standards are further described in the Auditor's responsibilities for the audit of the financial statements section of our report. We are independent of the Company in accordance with the Code of Ethics for Professional Accountants issued by CA Sri Lanka (Code of Ethics) and we have fulfilled our other ethical responsibilities in accordance with the Code of Ethics. We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our opinion.

Key Audit Matters

Key audit matters are those matters that, in our professional judgment, were of most significance in our audit of the financial statements of the current period. These matters were addressed in the context of our audit of the financial statements as a whole, and in forming our opinion thereon, and we do not provide a separate opinion on these matters.

Key Audit Matter

Allowances for Impairment of Financial Assets

Allowances for impairment of financial assets amounting to LKR 2.1 Bn arising from loans and advances of LKR 19.7 Bn (Note 23) and Finance leases & Hire Purchases of LKR 28.2 Bn (Note 24 & 25) and Other financial assets of LKR 0.6 Bn (Note 26.1) is determined by the management based on the accounting policies described in Note 3.2.

This was a key audit matter due to

- the involvement of significant management judgements, assumptions and level of estimation uncertainty associated in management's expectation of future cash flows to recover such financial assets; and
- the materiality of the reported amount of allowance of impairment and use of complex calculations in its determination.

Key areas of significant judgements, assumptions and estimates used by management included - assumed future occurrence of events and/or transactions and forward-looking macroeconomic scenarios and their associated weightages, which are subject to inherently heightened levels of estimation uncertainty.

Information Technology (IT) systems related internal controls over financial reporting

Company's financial reporting process is significantly reliant on multiple IT systems and related internal controls. Further, key financial statement disclosures are prepared using data and reports generated by IT systems, that are compiled and formulated with the use of spreadsheets.

Accordingly, IT systems related internal controls over financial reporting were considered a key audit matter.

How our audit addressed the key audit matter

In addressing the adequacy of the allowances for impairment of financial assets, our audit procedures included the following key procedures:

- Assessed the alignment of the Company's allowances for impairment computations and underlying methodology including responses to economic conditions with its accounting policies, based on the best available information up to the date of our report.
- Evaluated the design, implementation and operating effectiveness of controls over estimation of impairment, which included assessing the level of oversight, review and approval of allowances for impairment, policies and procedures by the Board and the management.
- Checked the completeness, accuracy and reasonableness of the underlying data used in the impairment computations by cross checking to relevant source documents and accounting records of the Company.
- Evaluated the reasonableness of credit quality assessments and related stage classifications.
- Assessed the reasonableness of the judgements, assumptions and estimates used by the Management in assumed future occurrence of events and/or transactions including the value and the timing of cash flow forecasts, status of recovery actions of the collaterals, forward-looking macroeconomic scenarios and their associated weightages.
- Assessed the adequacy of the related financial statement disclosures set out in notes 23, 24, 25 and 26.1 and accounting policies described in note 3.2.

Our audit procedures included the following key procedures.

- Obtained an understanding of the internal control environment of the relevant significant processes and tested key controls relating to financial reporting and related disclosures.
- Involved our internal specialized resources and:
 - Obtained an understanding of the IT Governance Structure of the Company
 - Identified, evaluated and tested the design and operating effectiveness of IT systems related internal controls over financial reporting, relating to user access and change management
 - Obtained a high-level understanding of the cybersecurity risks relevant to the Company and the actions taken to address these risks primarily through inquiries related to processes and controls implemented to address cybersecurity risks.
- Tested source data of the reports used to generate disclosures for accuracy and completeness.

Other Information included in the Company's 2024 Annual Report

Other information consists of the information included in the Company's 2024 Annual Report, other than the financial statements and our auditor's report thereon. Management is responsible for the other information. The Company's 2024 Annual Report is expected to be made available to us after the date of this auditor's report.

Our opinion on the financial statements does not cover the other information and we do not express any form of assurance conclusion thereon.

In connection with our audit of the financial statements, our responsibility is to read the other information and, in doing so, consider whether the other information is materially inconsistent with the financial statements, or our knowledge obtained in the audit or otherwise appears to be materially misstated. If, based on the work we have performed, we conclude that there is a material misstatement of this other information, we are required to report that fact. We have nothing to report in this regard.

Responsibilities of management and those charged with governance for the financial statements

Management is responsible for the preparation of financial statements that give a true and fair view in accordance with Sri Lanka Accounting Standards, and for such internal control as management determines is necessary to enable the preparation of financial statements that are free from material misstatement, whether due to fraud or error.

In preparing the financial statements, management is responsible for assessing the Company's ability to continue as a going concern, disclosing, as applicable, matters related to going concern and using the going concern basis of accounting unless management either intends to liquidate the Company or to cease operations, or has no realistic alternative but to do so.

Those charged with governance are responsible for overseeing the Company's financial reporting process.

Auditor's responsibilities for the audit of the financial statements

Our objectives are to obtain reasonable assurance about whether the financial statements as a whole are free from material misstatement, whether due to fraud or error, and to issue an auditor's report that includes our opinion. Reasonable assurance is a high level of assurance, but is not a guarantee that an audit conducted in accordance with SLAuSs will always detect a material misstatement when it exists. Misstatements can arise from fraud or error and are considered material if, individually or in the aggregate, they could reasonably be expected to influence the economic decisions of users taken on the basis of these financial statements.

As part of an audit in accordance with SLAuSs, we exercise professional judgment and maintain professional scepticism throughout the audit. We also:

- Identify and assess the risks of material misstatement of the financial statements, whether due to fraud or error, design and perform audit procedures responsive to those risks, and obtain audit evidence that is sufficient and appropriate to provide a basis for our opinion. The risk of not detecting a material misstatement resulting from fraud is higher than for one resulting from error, as fraud may involve collusion, forgery, intentional omissions, misrepresentations, or the override of internal control.
- Obtain an understanding of internal control relevant to the audit in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the Company's internal control.
- Evaluate the appropriateness of accounting policies used and the reasonableness of accounting estimates and related disclosures made by management.
- Conclude on the appropriateness of management's use of the going concern basis of accounting and, based on the audit evidence obtained, whether a material uncertainty exists related to events or conditions that may cast significant doubt on the Company's ability to continue as a going concern. If we conclude that a material uncertainty exists, we are required to draw attention in our auditor's report to the related disclosures in the financial statements or, if such disclosures are inadequate, to modify our opinion. Our conclusions are based on the audit evidence obtained up to the date of our auditor's report. However, future events or conditions may cause the Company to cease to continue as a going concern.
- Evaluate the overall presentation, structure and content of the financial statements, including the disclosures, and whether the financial statements represent the underlying transactions and events in a manner that achieves fair presentation.

We communicate with those charged with governance regarding, among other matters, the planned scope and timing of the audit and significant audit findings, including any significant deficiencies in internal control that we identify during our audit.

We also provide those charged with governance with a statement that we have complied with relevant ethical requirements regarding independence, and to communicate with them all relationships and other matters that may reasonably be thought to bear on our independence, and where applicable, actions taken to eliminate threats or safeguards applied.

From the matters communicated with those charged with governance, we determine those matters that were of most significance in the audit of the financial statements of the current period and are therefore the key audit matters. We describe these matters in our auditor's report unless law or regulation precludes public disclosure about the matter or when, in extremely rare circumstances, we determine that a matter should not be communicated in our report because the adverse consequences of doing so would reasonably be expected to outweigh the public interest benefits of such communication.

Report on other legal and regulatory requirements

As required by section 163(2) of the Companies Act No. 07 of 2007, we have obtained all the information and explanations that were required for the audit and, as far as appears from our examination, proper accounting records have been kept by the Company.

CA Sri Lanka membership number of the engagement partner responsible for signing this independent auditor's report is 2471.

29 May 2024
Colombo

Partners: D. K. Hulangamuwa FCA FCMA LLB (London), A. P. A. Gunasekera FCA FCMA, Ms. Y. A. De Silva FCA, Ms. G. S. Manatunga FCA, W. K. B. S. Fernando FCA FCMA, B. E. Wijesuriya FCA FCMA, R. de Saram ACA FCMA, Ms. N. A. De Silva FCA, N. M. Sulaiman ACA ACMA, Ms. L. K. H. Fonseka FCA, Ms. P. K. N. Sajeeva FCA, A. A. J. R. Perera FCA ACMA, N. Y. E. L. Fernando ACA, D. N. Ganage ACA ACMA, C. A. Yalagala ACA ACMA

Principals: T. P. M. Ruberu FCA FCMA MBA (US-SL), G. B. Goudan ACMA, Ms. P. S. Paranavitane ACA ACMA LLB (Colombo), D. B. Karunathilaka ACMA, W. S. J. De Silva BSc (Hons) - MIS - MSc - IT, V. Shaktivel B.Com (Sp)

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STATEMENT OF PROFIT OR LOSS AND OTHER COMPREHENSIVE INCOME		
For the Year ended 31 March	2024 Rs. '000	2023 Rs. '000
Gross income	10,948,958	9,035,723
Interest income	10,628,251	8,749,868
Interest expenses	(6,441,603)	(6,134,824)
Net interest income	4,186,648	2,615,044
Fee and commission income	75,732	75,568
Net fee and commission income	75,732	75,568
Other operating income	244,975	210,288
Total operating income	4,507,355	2,900,900
Impairment (charge)/reversal for loans and receivables and other financial assets	(7,911)	276,201
Net operating income	4,499,443	3,177,101
Less: Operating expenses		
Personnel expenses	(1,592,749)	(1,302,861)
Depreciation of PPE and Right-of-use assets and amortization of intangible assets	(162,490)	(161,831)
Other operating expenses	(1,516,724)	(1,267,105)
Total operating expenses	(3,271,963)	(2,731,798)
Operating profit before VAT on financial services	1,227,480	445,304
Value Added Tax on financial services	(559,538)	(331,848)
Operating profit after VAT on financial services	667,943	113,456
Add: Share of associate company's profit / (Loss) net of tax	151,837	19,365
Profit before taxation from operations	819,780	132,820
Less: Income tax expenses	(263,966)	(26,767)
Profit for the year	555,814	106,053
Other comprehensive income/(expenses)		
Other comprehensive income/(expenses) to be reclassified to profit or loss in subsequent periods		
Changes in fair value of financial investments through OCI	-	-
Other comprehensive income/(expenses) to be reclassified to profit or loss in subsequent periods		
Other comprehensive income/(expenses) not to be reclassified to profit or loss in subsequent periods		
Changes in fair value of financial investments through OCI	458,573	196,647
Net change in revaluation surplus on Land & Buildings	324,211	-
Deferred tax effect on revaluations surplus on Land & building	(97,263)	(169,086)
Share of other comprehensive income of associates (net of tax)	13,897	(98,662)
Actuarial gain/(loss) on retirement benefit obligation	(60,120)	(13,210)
Deferred tax effect on actuarial gain	14,073	19,927
Net other comprehensive income/(expenses) not to be reclassified to profit or loss in subsequent periods	653,371	(64,383)
Other comprehensive income/(expenses) for the year (net of tax)	653,371	(64,383)
Total comprehensive income/(expenses) for the year (net of tax)	1,209,184	41,670
Earnings per share		
Basic earnings per share (Rs.)	184.90	35.28
Diluted earnings per share (Rs.)	184.90	35.28
Dividend per ordinary share (Rs.)	20	-

STATEMENT OF FINANCIAL POSITION		
As at 31 March	2024 Rs. '000	2023 Rs. '000
Assets		
Cash and cash equivalents	2,492,057	1,791,064
Placement with banks at Amortized cost	3,460	1,422
Financial investments - At FVOCI (quoted)	6,427,831	6,303,228
Financial investments - At FVPL	329,519	3,250
Loans and receivables at Amortized Cost	16,591,202	13,593,368
Finance leases receivables at Amortized Cost	20,302,868	19,026,269
Hire purchase receivables at Amortized Cost	101,631	127,176
Financial investments - at FVOCI (unquoted)	70,427	70,427
Other financial assets	289,256	442,950
Inventories	101,181	314,853
Other assets	179,493	230,244
Current tax refunds	-	117,327
Investment in associates	1,404,225	1,255,524
Investment property	260,055	227,219
Property, Plant and Equipment	4,391,241	3,930,649
Right-of-use assets	215,306	139,667
Leasehold property	38,866	39,334
Intangible assets	32,094	9,335
Total assets	53,230,713	47,623,304
Liabilities		
Bank overdraft	317,122	93,518
Deposits due to customers at Amortized Cost	36,104,935	31,223,715
Debt instruments issued and other borrowings at Amortized Cost	2,441,542	3,487,442
Other financial liabilities	430,673	378,645
Current tax liabilities	236,812	-
Deferred tax liabilities	750,164	795,864
Other liabilities	114,915	112,023
Retirement benefit obligations	396,405	337,518
Lease Liability	273,077	178,573
Total liabilities	41,065,645	36,607,298
Shareholders' funds		
Stated capital	36,000	36,000
Revaluation reserve	2,884,448	2,643,604
Statutory reserve fund	887,400	857,400
General reserves	4,086,430	4,086,430
Retained earnings	3,122,457	2,721,856
Regulatory loss allowance reserve	1,067,522	1,043,234
Fair Value through OCI reserve	80,812	(372,519)
Total shareholders' funds	12,165,069	11,016,006
Total liabilities and shareholders' funds	53,230,713	47,623,304
Net assets per share (Rs.)	4.047	3.665

CERTIFICATION:

I certify that these financial statements have been prepared in compliance with the requirements of the Companies Act No. 07 of 2007.

Deva Anthony

Chief Financial Officer / Director (Non-Board)

The Board of Directors are responsible for these Financial Statements. The Financial Statements were authorized for issue by the Directors on 29 May 2024. The Directors have the power to amend and reissue the Financial Statements. Signed for and on behalf of the Board by:

Gerard G. Ondaatje

Managing Director

29 May 2024 - Colombo

Shermal H. Jayasuriya

Finance Director

SELECTED KEY PERFORMANCE INDICATORS				
Item	As at 31st March 2024		As at 31st March 2023	
	Actual	Required	Actual	Required
Regulatory Capital Adequacy (%)				
Tier 1 Capital Adequacy Ratio	16.49%	8.50%	16.45%	8.50%
Total Capital Adequacy Ratio	17.88%	12.5%	18.02%	12.5%
Capital Funds to Deposit Liabilities Ratio	28.92%	10.0%	30.27%	10.0%
Quality of Loan Portfolio (%)				
Gross Stage 3 loan ratio		9.81%		10.74%
Net Stage 3 loan ratio		6.77%		8.62%
Net stage 3 loans to core capital ratio		31.28%		39.09%
Stage 3 impairment coverage ratio		33.76%		31.67%
Total impairment coverage ratio		3.88%		4.67%
Profitability (%)				
Net Interest Margin		9.79%		6.46%
Return on Assets		1.54%		0.28%
Return on Equity		4.57%		0.96%
Cost to Income Ratio		85.0%		105.6%
Liquidity (%)				
Available Liquid Assets to Required Liquid Assets (Minimum 100%)		196.18		187.65
Liquid Assets to External Funds		18.45		17.07
Memorandum information				
Number of Branches		51		43
External Credit Rating		Long-term Financial Institution Rating at BBB-(lka) (Stable Outlook) by Fitch Ratings		Long-term Financial Institution Rating at BBB-(lka) (Rating Watch Negative) by Fitch Ratings

The Company does not have any regulatory penalties or regulatory restrictions on deposits, borrowings and lendings during the period ended 31st March 2024 and 2023.

CERTIFICATION:

We, the undersigned, being the Chief Financial Officer, Finance Director, Managing Director and the Compliance Officer of Mercantile Investments and Finance PLC certify jointly that:

- (a) the above statements have been prepared in compliance with the format and definitions prescribed by the Central Bank of Sri Lanka (CBSL);
- (b) the information contained in these statements have been extracted from the unaudited financial statements of the Licensed Finance Company unless indicated as audited.

Deva Anthony

Chief Financial Officer / Director (Non-Board)

Ramidu Costa

Compliance Officer

Shermal H. Jayasuriya

Finance Director

Gerard G. Ondaatje

Managing Director