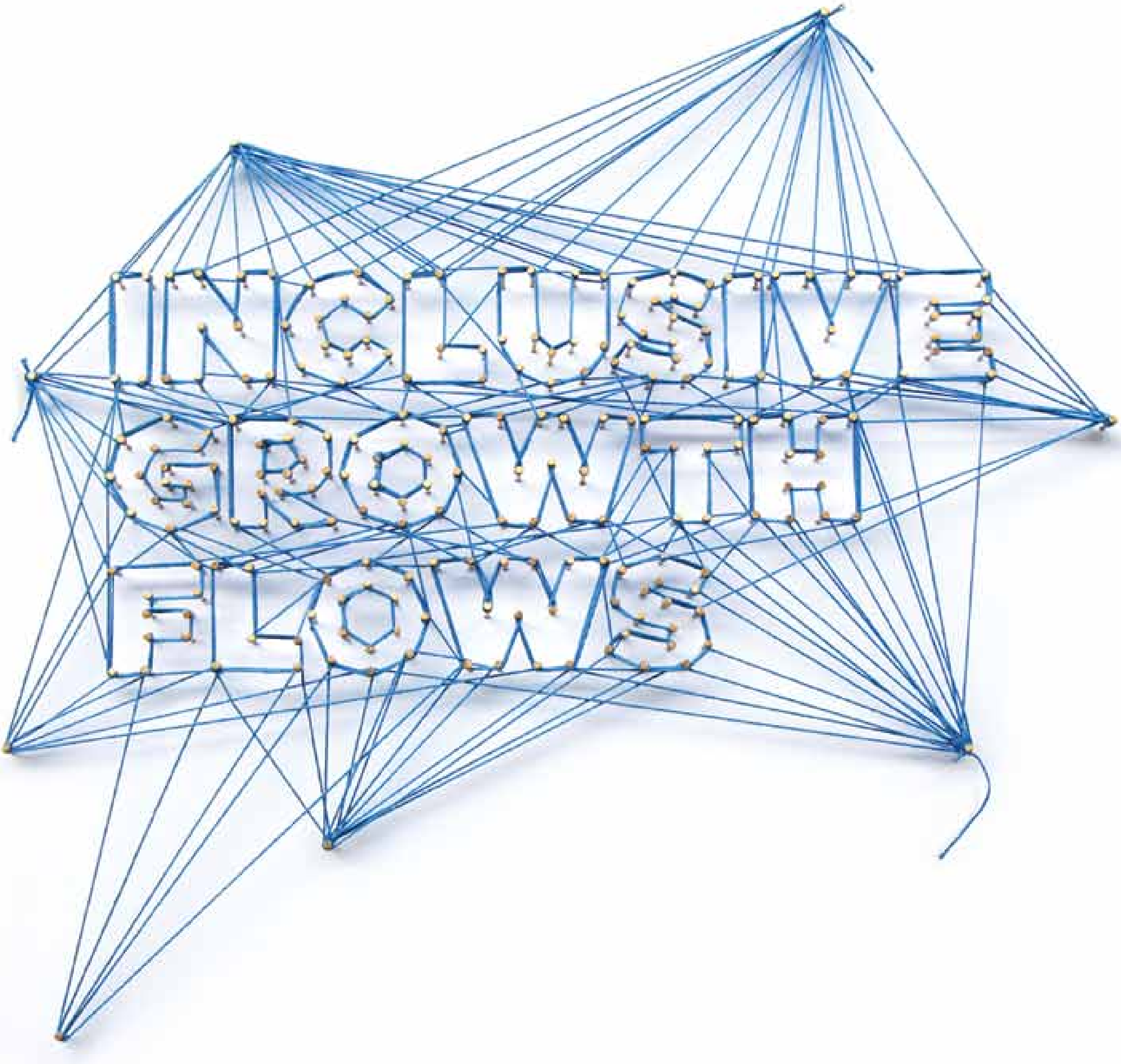
Mercantile Investments and Finance PLC Annual Report 2012/13



Mercantile Investments and Finance PLC

The quintessential feature of our growth is ‘inclusiveness’, reflecting the genuine will to include all stakeholders in the success. ‘Our prosperity without your prosperity’ has no place in our business lexicon. Thus, it is with purpose and intent that we chose the title for this report…**Inclusive Growth Flows...**

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, MI 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.

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FINANCIAL HIGHLIGHTS

For the year ended 31 March	Actuals 2013 Rs. '000	Actuals 2012 Rs. '000	% Change	Budgeted 2012/13 Rs. '000	Forecasted* 2013/14 Rs. million
Results for the year					
Gross Income	3,338,044	2,362,026	41	3,019,278	>4,500
Interest Income	3,055,684	1,627,742	88	2,957,570	> 4,400
Interest Expenses	1,867,700	1,009,874	85	1,706,833	>2,400
Profit before Tax	732,069	625,755	17	662,094	>1,000
Provision for Taxation	101,278	15,667	546	131,610	>280
Profit after Tax	630,791	610,088	3	530,484	>800
Revenue to the Government	175,263	141,324	24	179,554	>300
Gross Dividend	82,665	66,132	25	43,587	>54
Financial Position at the year end					
Shareholders' Fund (Stated Capital and Reserves)	5,704,846	5,474,606	4	5,880,063	>6,000
Deposits from Customers	8,424,720	6,137,897	37	9,771,424	>15,000
Loans & Advances, Leases and Hire Purchases	13,844,647	10,446,514	33	18,063,942	>25,000
Total Assets	21,222,944	17,607,237	21	24,771,123	>32,000
Information per Ordinary Shares					
Earnings per Share (Rs.)	209.84	202.96	3	176.48	>250
Dividends per Share (Rs.)	27.50	22.00	25	14.50	>15
Net Assets per Share (Rs.)	1,897.82	1,821.23	4	1,956.11	>2,000
Ratios					
Return on Shareholders' Funds (%)	11.06	11.14	(1)	9.02	>11
Return on Average Assets (%)	3.25	3.89	(17)	2.50	>2.5
Year on Year Growth in Dividends on Ordinary Shares (%)	25.00	120.00	(79)	51.72	>20
Interest Cover (Times)	1.39	1.63	(15)	1.39	>1
Dividend Cover (Times)	7.63	9.23	(17)	12.17	>12
Equity: Assets (%)	26.88	31.09	(14)	23.74	>20
Debt: Equity (%)	91.72	84.73	8	115.09	<120
Dividend Payout Ratio (%)	13.10	10.84	21	8.22	>6
P/E Ratio (Times)	10.48	10.84	(3)	12.47	>8
Non-Performing Loans Ratio (%)	3.10	2.87	8	3.50	<3.5
Advance Growth (%)	33.00	62.83	(47)	72.92	>25
Deposit Growth (%)	37.26	42.81	(13)	59.20	>30
Statutory Ratios					
Liquid Assets (%)	17.11	12.86	33	12.00	>12
Core Capital Ratio (%) - Minimum Required 5%	20.83	21.45	(3)	17.75	>15
Total Risk Weighted Capital Ratio (%) - Minimum Required 10%	22.40	23.30	(4)	20.43	>17

* *Based on strategic plan forecast.*

OPERATIONAL HIGHLIGHTS - 2012/13

Branches/ Service Centres

New Branch Opened

03

New branches opened at
Tissamaharama, Gampaha and Ampara

New Service Centres

02

New service centres opened at
Kottawa and Minuwangoda

Business Growth

Net Lending Growth

31%

Growth in Deposits

37%

Growth in Workforce

18%

Strengthened Staffing Level by
adding 66 New employees to
Total Workforce.
(Net of Resignations)

Sustainability Projects

11 CSR Committee
Projects Executed

Annual Report Awards 2012/13

MI's Annual Report 2011/12 was adjudged the winner of the Silver Award in the Finance Company Sector category at the CA Sri Lanka Annual Report Awards in 2012

MI's Annual Report 2011/12 won a Bronze Award in Financial Diversified category at the LACP Awards held in New York 2012

MI's Annual Report 2011/12 was adjudged Silver Award winner for its Cover and Design in Financial Services General category at the ARC Awards held in New York in 2012

INCLUSIVE GROWTH FLOWS

1964

1964 Founding of Mercantile Investments Ltd. and Launch of Our Products, Hire Purchase, Lease and Deposits

1964 Established

1968 Established Mercantile Motors

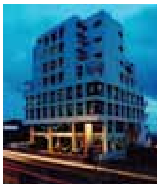
1970

1980

Mercantile Investments Ltd.

1989 Launch of New Group Symbol of MI

1990



1993 Shifted to Own Premises at 236, Galle Road

Post-Independence Era

Adoption of Nationalisation Policies of Key Economic Industries

Adoption of Open Market and Liberalisation Policies in 1977

1983 Start of the Civil War in Sri Lanka

1995 Sri Lanka Became Worlds Largest Tea Exporter with a 23% Share of Global Tea Exports

2000

1st Branch

2004 MI Opened
First Branch in
Negombo

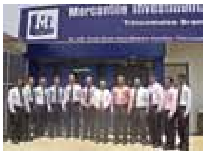
2008 MI Opened
First Branch in
Sabragamuwa
Province

5th Branch

2009 MI Opened
First Branch in
Southern
Province

2010

2010 MI Opened
First Branch in
Eastern Province



2011 MI Opened
First Branch in
North-Western
Province

2012 MI Opened
First Branch in North-
Central Province

10th Branch

2012 MI Opened
10th Branch in
Anuradhapura

2013 MI Opened
1st Service Centre
in Kottawa

15th Branch

2012 MI Opened
15th Branch in
Tissamaharama

17th Branch

2013 MI Opened
17th Branch in
Ampara

20th Branch

Planning to Open
in 2013

**Interest Income in
2015 > Rs. 6 billion**

**Interest Income 31.03.2013
Rs. 3 billion**

2012 Listed in
Colombo Stock
Exchange in the
Name of Mercantile
Investments and
Finance PLC

First Medium Term Management Plan

	2012/13	2013/14	2014/15
Interest Income	Rs. >3 billion	Rs.>4 billion	Rs.>6 billion
Operating Income	Rs.>1.3 billion	Rs.>2 billion	Rs.>3 billion

Stable Growth

- **Tsunami Disaster in 2004**
- **2009 End of the Civil War in Sri Lanka**

**Post-War Development
Era of Sri Lanka**

CHAIRMAN'S MESSAGE

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THERE WAS NOTABLE GROWTH IN BUSINESS VOLUMES

to speak of our efforts in both our lending and deposit business. We certainly did not end there and continued to search for excellence in how we do business. Our intention was to pursue growth by making a positive difference to the lives of our stakeholders.

My Dear Shareholders,

While drawing to a close the financial period with sound results, let me warmly welcome you to a proud moment in time, this being the fiftieth Annual General Meeting of Mercantile Investments and Finance PLC (MI). Firstly, let me with pride present to you the Annual Report and the Audited Accounts of the Company for the year ended 31 March 2013.

I am pleased to announce that the performance of MI this financial period was very commendable considering the depth of our accomplishments that finally reflected in our robust results. Particularly, our focused business strategies were directed at improving our main lines of business which enabled us to conclude the year with profitability beyond our expectations. Yet again, we were able to make a material impact to our customer thinking and create an eternal mark in their minds. There was notable growth in business volumes to speak of our efforts in both our lending and deposit business. We certainly did not end there and continued to search for excellence in how we do business. Our intention was to pursue growth by making a positive difference to the lives of our stakeholders.

Creating Value Beyond the Bottom Line

I am proud to declare that your Company ended the financial year 2013 admirably with a pre-tax profit of Rs. 732 million and a post-tax profit of Rs. 631 million up by 17% and 3% respectively year-on-year thus showing our commitment towards the accretion of shareholder value. We managed to sustain this performance level through a concise strategic framework from the start. In terms of the quality of our lending, MI's NPL ratio as at 31 March 2013 stood at 3.10% reflecting one of the lowest in the industry.

Our progress this year was not only in Rupees and Cents but also was measured in terms of how we enhanced value of our other stakeholders that we perceive as pivotal. This was not limited to aspects on good governance, ethics and prudent business practices, but went beyond, outside our boundaries. Our efforts in nurturing our work force, MI's environmental initiatives and focused social programmes initiated towards society at large, is certain to have made a positive impact to society in some way. At the same time, I believe MI reciprocally benefitted immensely from such initiatives. Our Annual Report theme this year tries to portray the importance of 'stakeholder inclusivity' in our path to growth and unparalleled success. Our theme signifies this two way mutually benefitting relationship where MI together with our stakeholders have prospered as a result.

Let me from here present briefly the backdrop on which your Company operated to reach these accomplishments, drawing attention to the business environment that prevailed for finance companies in the 2013 financial period and the role played by MI then and what is necessitated from us seeing the future.

Shifts in Economic Fortunes Internationally

The global downturn that dampened the progress of the global economy, half a decade ago, continued to persist and is yet to be overshadowed. As the world economies strive to fully recover from the global financial crises, the overwhelming consequences of the ongoing sovereign debt crises had its own unprecedented drawbacks, suppressing European economies like never before.

However, as seen in the past few years, fortunes of economic giants from east to west have changed during this volatile period. As Western giants including the United States of America and European nations continues to struggle in reviving their economies to the state that it once was, China and India being economic giants of Asia have taken a leading role in economic affairs globally. The contribution to global economy from Asian region remains high with profound growth statistic compared to most regions.

I believe that these changes in economic demographics with Asia becoming a key economic hub, provides our nation with a golden opportunity to work closely with such nations to boost our own domestic economy. Through diplomacy, we need to build stronger business ties with key nations so that we can bring our local enterprises to the international stage.

Sri Lankan Economy Progresses Amidst Tighter Policy

The domestic economic outlook remained positive, driven by the post-war development efforts and macroeconomic policies initiated by the Government. In spite of facing numerous challenges, the business community too remained optimistic observing the vast opportunities that now prevail to grow one's businesses with greater economic activity taking place than before. In contrast to the persisting economic downturn internationally, Sri Lankan economy remained resilient recording a GDP growth of 6.4% in 2012 however, going below the 8% mark achieved in previous concluded two years.

Let me share some of the key economic variables for the year 2012 that projected the state of economic progress compared to the year before:

- National savings standing at 24% of GDP.
- The unemployment rate reduced to 4%.
- Investments of private and Government both remained almost similar to last year at 23.7% and 6.9% of GDP, respectively.
- Market capitalisation of Institutions in the capital market totalled to Rs. 2,167.6 billion.
- Government revenue stood at 13% of GDP.

- Export volumes index decreased to a negative of 0.4% compared to a positive of 10.2% last year.
- Government debt marginally increased to 79.1% from 78.5% of GDP by the end of the year.

Nonetheless, the rise in inflation levels from 4.9% last year to 9.2% in year 2012 and the sudden depreciation in Rupee against dollar in recent times were growing causes for concern as the cost of living kept spiralling up, while imports remained more costly. Most significantly, the flow of FDI's remained relatively slow-paced than anticipated considering its importance in speeding up the development process.

However, as a member of the business community, I must commend the excellent progress made by Government in initiating large infrastructural projects that include the development of highways and supply of water and electricity to areas ones considered very remote. Other initiatives such as large hotel projects that are underway in collaboration with international chains and efforts in beautifying the outskirts of Colombo are certain to attract tourism giving further impetus to the already revived tourism sector. This is bound to stimulate other sectors as well.

Tougher Conditions for Finance Company Sector

From the commencement of 2013 financial period, credit availability in the market was on the ebb, continuing from the latter part of last year. The challenge for the sector was to manage business volumes and margins amidst steep rise in market interest rates resulting from the contraction in credit. Thus, when taking deposits and obtaining borrowings, the sector had to incur higher cost leading to higher cost of funding than before. The growing competitiveness in terms of pricing made the LFC sector very competitive aggravated further by outside pressure exerted by Banks and other deposit canvassing institutions than in the past. In this backdrop investors remained wary of other investment opportunities such as property and stock market and majority opted for safer investments in registered deposit taking institutions. To bring down cost of funding there was increased efforts by some of the institutions to seek international funding.

In this setting, it was challenging for the sector to maintain lending volumes while retaining the quality of the credit portfolio when interest rates climbed high. In the meantime, the sector, while concentrating on traditional financing, moved into higher yield bearing lending such as property mortgage and personal loans to counter thinning margins. Nevertheless, in spite of stiffer credit control measures, there was pressure exerted on retaining quality lending portfolio with rising repossessions as the year unfolded. Yet, the sector remained cautious about the deteriorating credit conditions of their borrowers and continued to be vigilant so that NPL's do not shoot up alarmingly.

Mercantile Investments Thrived Staying Strategically Focused

When reflecting back on this period, this being my second year as Chairman of your Company, I can undoubtedly say that we had deep sense of focus in terms of what needs to be done from the beginning. The Board approved a strategic plan which sets out the path for the organisation for the next three years commencing in April 2012. Building on this excellent platform that we have put in place, the Company progressed tremendously, implementing strategic business priorities for the attainment of corporate objectives.

We ended the year convincingly, improving our performance in all facets of our business. Our efforts in developing our branch network in terms of setting-up further locations, strengthening staffing and affording operational training paid-off handsomely. Branches contributed significantly to core business volumes and supported in creating awareness among communities in this short twelve month period.

Perpetuating Enterprise-Wide Prudent Governance, Transparency and Ethical Practices

In ensuring MI stands on a sound footing in terms of safety and soundness, our corporate governance framework has evolved forward to embrace regulatory as well as other practices recommended by top bodies. In this period, we embraced a number of practices to strengthen governance practices right from Board level to, corporate management and below all of which was to ensure that there is prudent management of affairs of the Company to safeguard stakeholder interest.

In ensuring standard policy on governing employees, a human resource handbook was issued this year to all the employees to adhere to. We require all our staff to be well-disciplined and want them to display sound ethical practices when carrying out their duties. I affirm that no material violations have taken place either at Board level or from any employees of MI which are against disciplined business conduct and ethical requirements of the Company.

In terms of transparency, MI is renowned for its superior financial reporting practices adopted over a decade ago. This year, we commenced adopting IFRS and have gone on to provide extensive disclosure of our financial results and other disclosure requirements in keeping with international standards, for the readership of our stakeholders.

Serving Stakeholders Through a Clear Approach

I am proud to say that our actions are not limited to enhancing satisfactory returns to our shareholders. In creating sustainable value, our practices moreover extend to serve all MI's stakeholders who form the economic, environmental and social chain. In realising our vision which encapsulates the need to address the triple bottom line virtues, I can firmly say that MI has made significant progress. In a short span of time we have extended our reach, affording financial assistance to communities even at very remote sites. By offering our expanding range of financial products, we have touched the lives of individuals who have varying financial needs.

In addition to financial support, we serve the wider community initiating targeted CSR programmes over the year. In supporting the environment, we continue to adopt sound practices that save energy and safeguard the surroundings. In showing our commitment to going-green, we hope to adopt solar technology as opposed to national grid for energy requirements at our head office.

What the Future Holds

The country in moving towards a USD 100 billion economy and a per capita of USD 4,000 before 2016, is certain to undergo significant transformation in the next few years. As the business community, we should be wary of this, being receptive to changes in macro and microeconomic environment and plan our business strategies in keeping to changes at national level. Since it is expected that real GDP growth will remain above 7% in the next three years, there is enough potential for continued business sustenance and opportunity for the corporate society. To sustain economic growth, as policy priorities, it is planned to raise productivity, lower unemployment below 3%, maintain exchange rate stability and control inflation keeping it within single digit.

Taking impetus from the 2013 road map, the national vision of implementing effectively the '5 + 1 Hubs' concept which cover aviation hub, maritime hub, energy hub, commercial hub and knowledge hub coupled with tourism hub being pivotal plans ahead, MI when devising growth strategies will be wary of these planned developments considering we are interlinked to all of these major constituents in some way. MI in keeping to our medium terms strategic plan will pursue growth in terms of setting up fresh locations in economically viable places.

Seeing the visible changes in dynamics, we hope to introduce our products and services convincingly with a touch of innovation to suit the sophistication in the market .

MI will remain strategically focused, knowing that business dynamics would change with fluctuations in the macroeconomic environment. For instances MI's lending approach to various sectors would require re-strategising since it is anticipated that the sectorial composition of GDP would shift nationally once structural changes take place in the economy. Our risk management techniques will be attuned to picking up changes to risk profiles specifically paying attention to interest rate movements and dynamics concerning credit quality. Our yearning towards good governance practices will play an integral part in sustaining a safe and sound operation thus instilling stability in the minds of our customers and public.

Appreciations

I take this moment very specially to thank my fellow Directors who have given their unstinted support, sharing their valued expertise for the betterment of the Company at all times. I wish to also express sincere appreciation to the Management and staff of MI, for their eternal co-operation, dedication and perseverance in pursuit of organisational excellence. Our employees have shown tremendous determination and courage in meeting demands and challenges placed upon themselves. They have been the main pillar in our quest to continued success from the beginning.

I would like to take this opportunity to sincerely express our thanks to the Governor, Deputy Governor, Director - Non-Banking Supervision Department and staff of the Central Bank of Sri Lanka for giving guidance and for the continued corporation extended to us. At this moment, I wish to express my appreciation to all of them for their efforts in supporting the Finance Company sector to aspire for its perfection.

To our dear customers who have stood by us for decades showing your true loyalty, I wish to thank you once again for keeping your trust in us. Your loyalty has made us proud and driven us all the way to serving you better. A special note of thanks extends to our intermediaries as well, namely the agents for their significant contribution made towards promoting business of MI.

Our shareholders who have been our true pillars of strength, placing immense trust in us to deliver sound performances right along, also deserve a special word of appreciation. Your belief in us has boosted our passion to achieve greater and I pledge that MI through prudent business strategies will enhance shareholder value annually. Thank you for keeping your faith in the Board, the Management and myself in both good and challenging moments.

I assure all of you that MI will grow with stakeholder inclusivity, building closer bonds with members of the society adding value and fostering mutual benefit. We will remain a committed enterprise, displaying our excellence and professionalism towards implementation of our business strategies. Being on the verge of celebrating 50 years in business operations, I wish to emphasise that your Company will constantly strive towards excellence, prospering as a financially sound rock solid organisation, with the aim of adding value to our stakeholders, sector and national economy.

Saroja Weerasuriya
Chairman

21 May 2013

MANAGING DIRECTOR'S REVIEW

In enhancing investor returns, we stuck to our game plan, staying focused on our core business. In driving our core business forward,

WE EMBRACED A STRATEGIC APPROACH FROM MANY ANGLES

A Commendable Year for Us

The financial year concluded was certainly a year that Mercantile Investments and Finance PLC (MI) could be proud of both financially as well as operationally. I can confirm that whatever we aspired to do in terms of improving our business has been met with complete success, which gives us tremendous satisfaction.

To end 2013 financial year with excellent results was gratifying especially considering the growing challenges faced by the finance companies sector.

In enhancing investor returns, we stuck to our game plan, staying focused on our core business. In driving our core business forward, we embraced a strategic approach from many angles. In the face of growing challenges, despite greater optimism in the market, we remained conservative but agile. It is pleasing to note that we have ended the year under review on a sound note, posting positive performance not only in profitability but also against other key measures.

Looking back, I can affirm that MI was able to derive maximum benefit from the positives of post-war development which have unfolded within the last few years. When devising a strategic plan in 2012, we remained receptive to the business changes that were transpiring around us and rightfully aligned our business strategies in keeping with developments at national level.

The gratifying performance detailed throughout this Annual Report was a culmination of all the efforts we made throughout the year. From the Board room right down to our Corporate Management Team and every other employee, there was relentless commitment to improve performance standards despite evolving challenges.

A Mixed Business Environment

The Sri Lankan economy remained robust driven by Government development initiatives as well as private sector efforts to improve business, particularly in the post-war period. To propel economic growth, the Government accelerated its development efforts and improved its reserve position while keeping inflation in single digit territory. Moreover, the Government was able to instill financial stability in the financial services sector and drive the economic system forward in stark contrast to the continued economic recession that prevails internationally. Yet, the badly needed influx of foreign direct investment remained an elusive factor aggravated by negative international sentiments that continued to dampen the speedier progress of the economy.

Inspite of numerous obstacles, economic transformation and positive sentiments continued to rejuvenate most sectors. MI for its part consolidated its position in the market using the improved economic setting recording satisfactory growth in core business turnover. However, unlike in the previous year, the business environment for the sector remained somewhat volatile owing to changes in economic policy and macroeconomic movements.

Although persistent demand remained for motor vehicle financing, there was a noticeable slowdown in vehicle ownership especially for unregistered vehicles caused by the rise in interest rates as well as escalating prices of vehicles. The main cause for the surge in vehicle prices was the prevailing high import duty structure that continued to hamper the once lucrative vehicle market. The other factor influencing cost escalation was the recent devaluation of the Rupee which made imports more costly. Nevertheless, the demand for non-traditional lending such as personal loans, property mortgage loans and microfinance showed tremendous potential especially in the backdrop of the persistent credit contraction experienced right throughout the period.

At the same time, the general public showed a preference for the savings habit as opposed to luxury spending and opted to remain with stable forms of investment in contrast to high yield risk taking options. As a consequence, our deposit business remained healthy and was an attractive proposition. Investors were able to enjoy high rates afforded during this period.

Our Financial and Operational Achievements

MI was able to record a commendable pre-tax profit growth of 17% for the financial year ending 31 March 2013 concluding at Rs. 732 million. At the same time, it was pleasing to note that we ended the year with a post-tax profit of Rs. 631 million indicative of a 3% increase in profitability over the previous year. 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 order to better explain the financial transformation we have undergone in terms of profitability, size and other financial expectations, I wish to compare our exceptional business accomplishments of this period with the results we recorded half a decade ago:

	Then (In 2008/09)	**Now (In 2012/13)**
Net Profit before Tax	Rs. 254 million	**Rs. 732 million**
Net Profit after Tax	Rs. 233 million	**Rs. 631 million**
Gross Income	Rs. 1,709 million	**Rs. 3,338 million**
Lending Outstanding	Rs. 5,205 million	**Rs. 13,844 million**
Deposit Outstanding	Rs. 2,775 million	**Rs. 8,425 million**
Branches/Service Centres	4	**19**
Non-performing Lending Ratio (%)	8.17%	**3.10%**

I wish to stress that sustaining these performance levels in a challenging and highly competitive environment was no easy task. To attain success, we remained dedicated and professional and embraced a strategic approach in pursuing corporate objectives.

Adopting a Successful Strategic Framework

To attain predicted success, we stuck to a framework that was unique to MI, which embraced a focused strategic approach and blended it with visionary thinking. Our sole aim was to excel in our key areas of enterprise as we have been doing for close to half a century, staying true to our vision of being a premier finance company.

From the commencement of the 2012/13 period, there was clear communication of organisational objectives to our entire management team. Our Corporate Management in turn devised sub-goals/ targets for their respective divisions in keeping to these main objectives while gaining full co-operation of all employees for its attainment.

We got like co-operation from all departmental heads in strategy development, to come up with concise targets for their divisions. Of course stiff performance targets were assigned at departmental level, cluster level as well as individual employee level. For the successful implementation of the framework, we had a strict monitoring system. We improved our MIS systems to feed corporate management with a range of information on a continuous basis.

In being successful, we remained strategically focused on specific aspects of business which I would like to elaborate on as follows.

Attaining Sustainable Growth

Firstly, we remained very positive again this period in harnessing emerging opportunities that have devolved on the business community since the war ended. I can state with confidence that the strategies we embraced laid an excellent platform for the Company to pursue growth in a sustainable manner.

We devised strategies at organisational level as well as functional level to improve performance financially and operationally. We intensified penetration levels in markets that are familiar to us and in parallel pursued market development strategies for both our lending and deposit business. We continued to focus on expanding our branch network like we did during the previous year. However, branch network expansion which showed a 36% rise was carried out responsibly in a conservative manner considering the existing demand and market volatility.

Whilst embracing the upside of the post-war era, we remained cautious about its downside and took a balanced view, keeping to MI's fundamentals and values, all the while pursuing sustainable growth.

Concentrating purely on Core Business

The main centre of attention during the year under review was on boosting core business income in contrast to a few years before where non-fee based income use to contribute substantially to MI's turnover. In marketing our core products, we placed heavy emphasis on improving service standards, enhancing existing operational practices to provide speedier and more efficient service.

Concurrently, we were able to step up our marketing and promotional campaigns in most areas that we operate in, at present. By directing our resources to core business activity, through the efforts of our dedicated workforce we managed to lift core business volumes. As a result MI's net interest income for 2013 grew notably, reaching Rs. 1,188 million, up by 92% from a year before.

Income from non-fund based business remained subdued mainly due to lower contribution from share trading profits. The sudden pick-up of share prices and the revival experienced at times during the year however, continued to be sporadic in contrast to the share market performance witnessed during the period 2009 to 2011. Accordingly, the capital gain from sale of equity stood at Rs. 123 million in contrast to Rs. 591 million recorded in 2012, while we had to make Rs. 304 million fair value adjustment to the available-for-sale reserve in equity on account of the decline in market value of the equity portfolio.

Broad-Based Lending Opportunities

To improve lending volumes we expanded our product range, introducing MI microfinancing and professional loan services for the first time in 2012/13 period. However, apart from traditional lending carried out through lease and hire purchase financing, term loan lending contributed notably, playing a significant part in lending growth unlike earlier years growing significantly by 84% from 2012. In addition to property mortgage loans, personal loans and corporate loans, we offered structured and step-up lending facilities to add variation to our traditional lending products to cater to the varying needs of borrowers.

MI's main lending products in the lease and hire purchase segment continued to be the main driver and contributor to our lending business. By maintaining sound volumes over the period, we managed to exceed the Rs. 14 billion mark in total gross lending outstanding by end March 2013, while reflecting a satisfactory net lending growth of 33% over 2012. At the same time, we kept to our anticipated margins, maintaining overall yield from new lendings at above 25% on average over the year, combining low risk traditional products with high yield term lending.

Maintained Exceptional Asset Quality

The steep rise in lending rates that at times reached levels beyond 27% combined with the relative slowing down of economic activity when compared with the last two years, posed concerns to borrowers in the sector who found repayment challenging. Our Recoveries division was equal to the task, remaining well focused on keeping non-performing lending to manageable levels whilst instilling stringent recovery measures. In fact, the division commendably maintained the NPL ratio at 3.10% under these circumstances and at the same time kept in check absolute NPL rise in spite of the loan booking growing during the period under review.

Healthy Deposit Growth Levels

From the perspective of our deposit business, total deposits grew healthily by 37% and this enabled the total deposit base to exceed the Rs. 8 billion mark before the closure of the financial period. Being MI's key contributor to total deposits, we placed great emphasis in improving our fixed deposit business during this period. Through the co-ordinated efforts of the deposit marketing division that was set-up last year, deposit canvassing at branch level improved tremendously.

THE MAIN CENTRE OF ATTENTION DURING THE YEAR UNDER REVIEW WAS ON BOOSTING CORE BUSINESS INCOME

In contrast to a few years before where non-fee based income use to contribute substantially to MI's turnover

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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. Customer confidence remained high for the sector thus giving needed impetus for companies to boost deposit business.

As a result of the explained growth levels in core business lines, total assets of the Company too advanced by 21% to Rs. 21,223 million as at 31 March 2013 from Rs. 17,607 million recorded in the last financial year.

Seeking Alternate Funding Sources

Strategically, to counter the rising competition in deposit canvassing and resultant thinning of margins, we pursued other means of low cost funding. MI's Treasury Division played a significant role in identifying borrowings at optimal pricing mainly derived from our local banking partners and some as debt security. Debt security borrowings alone totalled Rs. 941 million while total borrowing surged to Rs. 6,232 million, up by 21% over last year.

In keeping with the proposed policy prevailing in the financial services sector to promote the accessing of international funding, MI too pursued foreign borrowing to bring down total cost of funding in 2013. We are in the process of negotiating a funding line from a foreign counterparty that we hope to secure early part of next financial period.

Cost Control Initiatives

Management considers cost control as integral in improving overall profitability of the Company. Therefore, a Cost Control Committee was established during this period. I am glad to say that the Committee was very active from its inception and was able to review and recommend cost reduction measures for key overhead cost elements. The Committee even organised a Company-wide cost reduction competition and recognised employees who came up with practical cost control proposals.

As another measure, departments were asked to review existing processes, to identify any duplication of practices and to identify opportunities to eliminate waste. All these efforts helped control the rise in overhead costs (excluding personal cost) which showed a 15% rise from 2012. The upward shift was mainly on account of increased annual usage levels due to branch expansion and the general price hikes that prevailed due to inflationary factors.

A Well-Nurtured Workforce

It is with sincere appreciation that I mention at this point the collective effort of our committed workforce, who have played an enormous role for MI this year. They have stayed on top of all areas of challenge and, performed to their potential generating improvement to business from all departments. While we nurtured our employees through formal training and career development programmes, the management continued to build close relationships with each individual and have ironed out issues in their daily routine work life to improve overall productivity.

In keeping to our business strategy, we strengthened our front line workforce through a stream of recruitments especially to support the budding branch network. In all 109 staff members joined MI during this period. Most of them were put through intense training which enabled them to fit into MI's dynamic working environment and to adjust to a target-oriented culture.

The Company remains a life-long partner to its employees offering job security, competitive remuneration as well as career advancement and personal development opportunities. We are proud of our highly motivated 'family'.

Strengthening Governance, Compliance and Risk Management

Both the stringent regulations that are in force for Finance Companies, as well as some of the measures introduced in the last few years by the regulator, have strengthened governance and risk management practices associated with the sector and have raised public confidence yet again. On our part, we continued to enhance our corporate governance framework in keeping with regulations and best practices. We also made tremendous progress in improving risk management practices and went on to strengthen the compliance and audit function during this period.

Enhanced Reporting Embracing IFRS

MI successfully adopted International Financial Reporting Standards (IFRS) applicable to the sector this year. With the support of Messrs Ernst and Young who are our Consultants for the IFRS implementation project, necessary modifications were affected to Information Communication Technology (ICT) systems, internal processes and reporting formats to embrace related requirements in their entirety. This has enriched MI's financial reporting further and provides our investors and other key stakeholders with enhanced disclosures. Certainly, I believe keeping to international reporting standards would open a gateway for our sector to compete internationally for business and to seek foreign funding. Our Company, as done in the past, will remain committed to all our stakeholders in providing comprehensive, timely and transparent financial disclosures at all times.

Performance Monitored Closely

Heavy emphasis was placed on monitoring performance closely for all our key business lines taking note of the volatility in market variables observed over the year. For purpose of strategy review, we embraced the balance score card measurement tool to assess performance of our lending business and overall MI performance. We complemented the balance score card appraisals with other performance measurements, carrying out weekly, monthly, quarterly and annual reviews.

I was able to meet the corporate management at least weekly to review performance and take appropriate steps when we were at times off course from our intended targets. Having a stringent performance monitoring system enabled us to stay focused on our ultimate objectives.

Dividends to Shareholders

Based on our sound results, the Company paid dividends totalling Rs. 83 million for the concluded financial year compared to Rs. 66 million declared in 2012. The Board and management stand committed to shareholder wealth accretion at all times and will continue to deliver sound performance annually.

Upholding Sustainability

From its inception, MI has believed in upholding sustainability and has therefore aligned sustainability requisites to business objectives. We consider this approach to be integral in MI's continued search for excellence and meeting stakeholder expectations. Apart from the progress made from an economic view point, we initiated numerous CSR programmes in 2012/13 mainly focusing on improving children's education, poverty alleviation, health and other key social facets. At the same time, we have embraced sound green practices in support of conserving resources and safeguarding the environment.

In terms of sustainability reporting, we enhanced its scope this year by incorporating additional performance indicators and other disclosures in relation to economic, environmental and social dimensions.

Other Proud Achievements

Heap of Accolades for MI's Annual Report

MI's Annual Report 2011/12 was admired locally as well as internationally, winning the Silver Award in the Finance Company Sector category at CA Sri Lanka Annual Report Awards held in 2012 and two International Awards.

I believe, winning these awards and being 12 time Gold winners consecutively in the past endorses MI's high standard of reporting and portrays our commitment towards transparency yet again.

Winning the Mercantile Cricket 'E' Division Trophy in 2013

Our cricket team emerged champions winning the Mercantile Cricket 'E' Division Trophy in 2013 beating Dialog Axiata in the finals. It was a proud moment for us to remain unbeaten right throughout the tournament, excelling in all departments of the game.

Outlook

National Level Perspective

Drawing attention to the proposed 2013 Road Map presented by the Governor of CBSL for national economic prosperity, I believe it signifies great opportunity for the business community if we gear for it from now onwards. In moving towards a USD 100 Billion economy and a USD 4,000 per capita income nation, there lies great challenge for both the public sector and private sector in the medium term. As done successfully in the past, financial stability would need to be maintained at all times while keeping inflation in single digit territory, if the Nation is to sustain reasonable economic growth levels in the years to come. Greater emphasis would need to be paid to enhancing productivity and keeping unemployment low as mentioned in the Road Map.

The business community should be cautiously hopeful of the growing opportunity cascading from continued infrastructural development and the positive economic policy of the Government which seeks to boost economic activity. The opening of the Southern Highway and the ongoing development to interlink major highways right from Negombo to Galle and beyond Matara is certain to bring communities closer and provide more opportunity for businesses by attracting customers from remote corners of the country.

Internationally, it is essential that the necessary environment continues to be created to attract foreign direct investment to fund local projects and industries if the nation is to see speedier economic results. Already the country has benefited from the surge in tourism which continues to attract foreign exchange and is sparking a revival of the hotel industry. Nevertheless, more needs to be done, to improve the image of the Nation, in the eyes of the international community. The performance of the Colombo Stock Market that stayed subdued even in this period could be revived if high net worth foreign investors can be attracted back to our shores yet again.

Finance Company Perspective

The high interest rate regime may remain for the short term and would continue to pose difficulty to the finance company sector especially in terms of sustaining quality lending portfolios. The sector NPL's may deteriorate in these circumstances unless stringent credit controls are established upfront by the sector. This situation I believe would ease once the interest rates stabilise at manageable levels when there is adequate credit available in the market.

The high import duty and depreciation of the Sri Lankan Rupee against the Dollar would remain a cause for concern for the sector as it handles significant vehicle-related financing. The sector would have to focus on affording better pricing for customers despite the existing competitiveness and thinning margins. Seeking low cost funding, improving productivity and prudent management of overhead costs will play an integral role in bringing down overall costs in order that customers could be offered an attractive pricing regime.

Mercantile Investments Perspective

Remaining Strategically Focused

In the medium term, MI's growth trajectory in core business lines would revolve around the strategic measures commenced in the past few years and others planned for the future. Whilst we rightly applaud the sound growth levels maintained in both lending and deposits for the last two years which remained well above 25%, I am very confident that we will be able to sustain these growth levels into the future. As the Nation embarks on a Road Map that leads to an estimated GDP growth of between 7%-8% over the next three years, we at MI have devised our strategies with high optimism to grab the emerging opportunities to be had from a growing economy.

The strategic plan of the Company would remain its guiding instrument for the next few years despite volatility in market variables forecast originally. Staying receptive to market changes and having a strategic focus especially for our main lines of business would assure us better results, in spite of growing market volatility. I must reiterate here that while one needs to be aggressive in this environment of opportunity, this has to be tempered with a certain level of caution. By staying close to market happenings including changes in interest rates and addressing all plausible occurrences, we hope to do business more predictably.

Sustainable Growth Trajectory

Considering the consistent annual demand that prevails for finance business and also anticipating credit growth of the sector to be above 20% in the forthcoming period, MI is well-poised to seize business with its strong network of branches strategically located in key hubs of the country.

In keeping to fundamentals, expansion in business would be undertaken in a plausible manner. We will remain selective when setting up branches and would do so on the basis of achieving sustainable growth from all our locations. Construction is in progress for MI's proposed City Office in the heart of Colombo as a means of strengthening our position in the Western Province. Nonetheless, in meeting the growing demand for financing amongst the middle and low income sectors of society, we hope to place more emphasis on building our presence outside the Western Province.

Grooming Employees to Face a Challenging Environment

MI's core competencies lie in the hands of our able workforce. I believe investing in them constantly in terms of growing their knowledge base and keeping them motivated is vital for us to succeed in these challenging times. Staff training and development programmes will play an integral role in improving productivity. The past few years were devoted to setting up branches and supporting the branch structure through strategic recruitment of the required HR base. Comparatively, recruitment levels will ease out and our next task would be to groom the workforce to face future challenges. The aim is to possess a highly motivated, well-knit team to operate all facets of our operation in a productive way.

Building on Our Strengths

As an institution that has operated for close to half a century, MI has an abundance of intellectual knowledge in credit operations and deposit business to efficiently operate and offer our main lines of enterprise to a larger segment of society. To support the growing operation and business sophistication, MI's ICT network has the required degree of flexibility to adapt, backed by a highly experienced IT support team who can make necessary enhancements to systems without difficulty. Other than the intangible power of our workforce, MI's strength lies in its financial strength being especially fortunate to possess a formidable capital base. This affords management the choice for capital investment to pursue organisational expansion that is planned for the future.

Staying Focused on our Priorities

In spite of possessing a sound customer base for both lending and deposit business, it will be essential that we maintain a close relationship with them on a continuous basis to secure their long-term trust and loyalty. At the same time, a lot needs to be done to grow the customer base.

In raising the bar on business, we plan to focus on nurturing our workforce further to improve productivity. We will make necessary system changes to enhance front end operations to provide better quality service keeping speed, efficiency and convenience in mind. The financial services sector is rapidly changing and hence fine-tuning operations with the intent of adding enhanced value to our offerings through improved processes, advanced technology and tighter regulation and control hence become vital ingredients for success.

Our central focus in the next few years would be to attract a stream of new customers whom we can retain with loyalty. Strategically our plan in the medium term is to broaden our deposit base and concurrently deepen our lending base through our traditional products. However, to be competitive, we will resort to innovative thinking especially considering that finance business is becoming complex with an ever widening range of product offerings that transcend traditional lines. Coupling value added benefits with existing products will be another area we hope to pursue to broad base our offerings in the near future.

As pricing remains vital in attracting and retaining customers especially depositors, we will concentrate on keeping costs low and avoid wastage through more stringent management of costs. I believe attracting low cost funding in the medium term will enable us to be competitive in terms of pricing but will not be the only differentiating factor. Quality of service, will be equally important and therefore our aim is to further develop overall service excellence around the country and possibly introduce convenient finance business practices such as ATM facilities, extended finance business hours, a customer hotline and carry out direct sales campaigns to selected customer segments.

Showcasing Exemplary Corporate Conduct

As an establishment that upholds sound values and ethical practices from its inception, MI will stay committed to being a responsible corporate citizen in all its endeavours. In retaining public confidence, we hope to prudently manage our business from opposing challenges and will continue to adopt good corporate governance practices without being slack at any moment.

Words of Appreciation

I wish to express gratitude to the Chairman and Board of Directors for their advice, guidance, encouragement and continued support. Similarly, I wish to applaud MI's truly dedicated team for their unstinted efforts, which have brought success yet again to our proud establishment. I would like to extend my appreciation to the Governor of the Central Bank and his able staff for their co-operation and support extended towards us throughout the year. As for our customers, I take this opportunity to thank you for choosing us to be your business partner once again, placing trust in us. Likewise, I express gratitude to our shareholders for the faith that you have placed in the Board and myself for the deliverance of continued success.

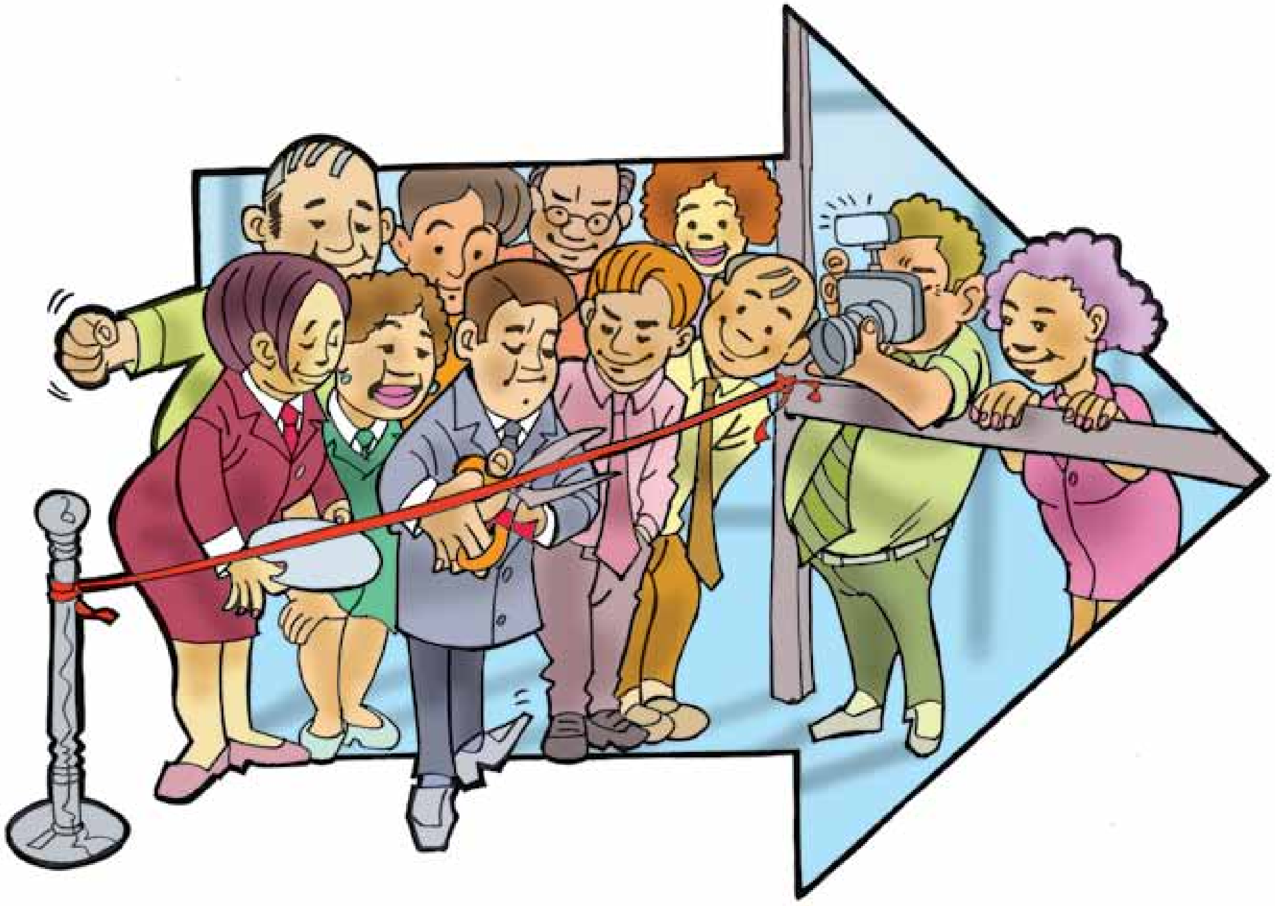
Reflecting on our proud performance this year and looking towards the future with a high level of optimism whilst understanding the true challenges, I can firmly say that Mercantile Investments and Finance PLC has in place a solid business foundation for continued success.

Finally, I wish to mention that MI would be celebrating 50 years in business operations in the next financial year and we plan to dedicate all our past success to our dear customers. We hope to recollect our accomplishments thus far and take positives from the past to forge ahead as a premier finance Company. MI will remain a dominant player in our sector and would contribute our share towards the well-being of the national economy and our stakeholders.

Gerard G. Ondaatjie
Managing Director

21 May 2013

INCLUSIVE GROWTH FLOWS, PROFITABLY



Our expanding reach, increasing customer contact and convenience and greater visibility are just a few of the benefits of the inclusive growth that flows across our business and the stakeholder community which thus improved our performance.

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MANAGEMENT DISCUSSION AND ANALYSIS

OVERVIEW

Mercantile Investments and Finance PLC popularly known as MI is a licensed finance company regulated by the Central Bank of Sri Lanka under the Finance Business Act No. 42 of 2011. MI is a listed company on the Diri Savi Board of the Colombo Stock Exchange since June 2011. As a finance company that is on the verge of celebrating fifty years in successful business operations, MI in this period under review, continued to intensify its activities in the area of finance leasing and hire purchase financing and heightened its term loan lending's, property mortgage loans, personal loans and concentrated on broad-basing its deposit base on a larger scale.

In reporting MI's performance for the financial year 2012/13, this report initially provides an economic overview on which our performance was built referring to the world economy, Sri Lankan economy and the state of the finance company sector together with a detailed analysis on internal and external factors that affected MI and the approach the Company took for each of them. The Management Discussion and Analysis (MD&A) goes on to provide a detailed account of the strategic business framework embraced this period in attaining success together with a comprehensive management commentary covering financial and non-financial aspects, with necessary comparatives. In order to give a futuristic view of the discussion areas, this report provides the outlook for each of the key topics and subtopics discussed.

WORLD ECONOMY

World economic conditions improved modestly with global growth increasing by around 3% and improved further in the fourth quarter of 2012 and thereafter. Financial conditions across the world stabilised to an extent during this period, despite the growing concern over the Euro Zone crises that continued to drag prominent European nations towards debt. The crises caused civil unrest in certain European nations which came about as a result of various austerity measures and social reforms undertaken by the governments in concern. Apart from this rising cause for concern, most nations continued to struggle in reviving their economies and were far from fully recovering from the shocks of recession. In this volatile global setting, China remained the dominant economic force among the rest of the world contributing significantly to the global economic output while western giants such as United States of America remained relatively passive compared to the pre-recession era. At the same time, emerging market economies became the main source of acceleration with capital flows to such markets remaining strong.

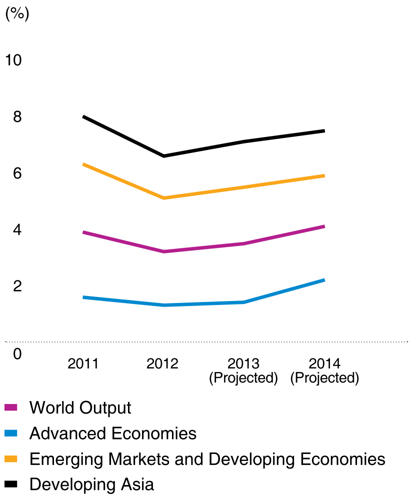
In spite of a turn around in the housing market, United States including other dominant nations is yet faced with national concerns. The booming unemployment rates and slow progress in businesses across the board have been a constant battle for such nations over the past number of years. To add to these persisting drawbacks, rising natural disasters experienced all over the world in this period caused great expense to governments in rehabilitating those areas affected. The rising tensions in the Middle East and pressure exerted on oil prices have already had its domino effect to nations experiencing inflationary concerns as a result of being dependent on such rich resources. However, to an extent, policy actions initiated by various governments in conjuncture with other nations have lowered acute crises risks that still linger from recession, but the return to recovery after a protracted contraction is expected to delay than expected. Global growth is projected to increase during 2013, as the factors underlying soft global activity are expected to subside. As per IMF growth forecast, by 2014 advanced economies will grow at around 2% while emerging markets would sustain a healthy growth rate close to 6% and moreover developing Asia is expected to sustain its growth level above 7% during this time frame. Despite, Japan sliding into recession and continues to struggle since the aftermath of 2011 tsunami, planned stimulus is expected to boost growth in the near term. At the same time, policies have supported a modest growth pickup in some emerging market economies, although others continue to remain with weak external demand and domestic bottlenecks. If crises risks do not materialise and financial conditions improve, global growth could be stronger than projected. But weaknesses in advanced economies will weigh on external demand, as well as on the terms of trade of commodity exporters. However, downside risk yet remain significant, including possible renewed setbacks in the Euro Zone and risks of excessive near-term fiscal consolidation in the United States. In this backdrop, IMF projections imply strengthening of global growth, averaging 3.5% on an annual basis for 2013 showing a moderate rise year on year.

World Economic Growth Outlook

	Year 2011** %	Year 2012** (Estimates) %	Year 2013** (Projected) %	Year 2014** (Projected) %
World Output	3.9	3.2	3.5	4.1
Advanced Economies	1.6	1.3	1.4	2.2
Emerging Market and Developing Economies	6.3	5.1	5.5	5.9
Developing Asia	8.0	6.6	7.1	7.5

** Source IMF - World economic outlook update January 2013*
*** Annual percentage change*

World Growth Trajectory



SRI LANKAN ECONOMY

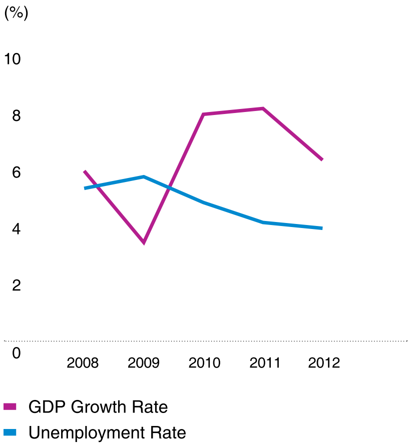
Synopsis of the State of Economy in 2012

The real growth rate of the economy contracted to an extent and stood at 6.4% in 2012 when compared with previous year's commendable 8.2% growth. In the backdrop of the slowdown experienced in both advanced and emerging economies coupled with the uncertainty emerging from the European sovereign debt crises, rising oil prices and other fiscal sector concerns in the western world had a negative effect on our exports. Despite challenges both internationally and domestically, it was commendable for the Sri Lankan economy to sustain this growth level above 6% while the world economy was growing at around 4% in this period.

The Sri Lankan economy continued to propel and showed growth in the midst of positive investor sentiments supported by the relatively stabilised interest rates and exchange rate positions and the lowering of tax structures. Nonetheless, this led to an imbalance in the trade account of the balance of payments while broad money growth was at elevated levels with an increase in credit growth. The various policy measures initiated by the Government and the Central Bank to improve the macroeconomic environment thus lowered domestic demand. Per capita income rose by 18.9% from 2011 mainly due to the increase in nominal GDP during the year. This increase in income was reflected in wages in both public and private sector but showed a relative slowed down growth in US dollar terms in 2012 as a result of the depreciation of the rupee. This level of growth in per capita income will thus be required in the next few years if the nation is to reach the planned 4,000 US dollar target in 2016 in keeping with the economic road map presented in 2013.

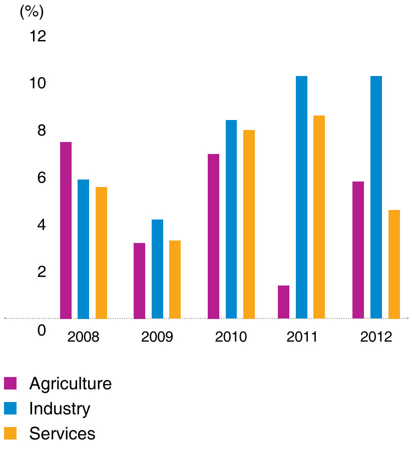
It was also noteworthy to observe domestic savings improve by 27.6% in 2012 recovering from the contraction observed in the past year. The lower growth in consumption expenditure mainly due to lower imports improved domestic savings rate. Nevertheless, the progress of domestic savings was negatively impacted by the increase in Government dis-savings which resulted finally in the widening of the current account deficit. From a positive side, the continued expansion in private remittances from overseas supported overall national savings during the year which stood at 24% of GDP. While globally the rising unemployment rates remain a challenge for most large economies including Unites States of America, it was particularly pleasing to note that domestic unemployment rate remained at a manageable level and in fact was further brought down to 4% in 2012 from 4.2% previous year.

GDP Growth Rate and Unemployment Rate



SECTORIAL PERFORMANCE THAT IMPACTED THE ECONOMY

Annual Sectorial Growth



Agriculture Sector

It was pleasing to observe agriculture sector growing in 2012 at a higher rate than the year before in spite of the sector facing disruptions. Conducive weather conditions in the first half of the year supported in producing a bountiful *Maha* season but were short-lived with droughts and floods that occurred thereafter that affected normal agricultural seasons. Despite these challenges, a growth of 5.8% was recorded in this sector in 2012 as against just 1.4% observed in 2011. In reaching these growth levels, tea, rubber and minor export crops contributed commendably.

Industry Sector

The expansion in the Industry sector by 10.3% boosted from all sub sectors fuelled economic growth from the production side notably. The increase in construction activity and growth in the construction subsector especially mining and quarrying significantly contributed to the overall growth. However, manufacturing, the largest sub sector within the industry sector, reduced in terms of value added growth. The main cause for factory industry to grow at a slow pace at 5.2% as opposed to 8.3% recorded in 2011 was the sluggishness in global markets for exports and low domestic demand reflecting the impacts of policy measures adopted.

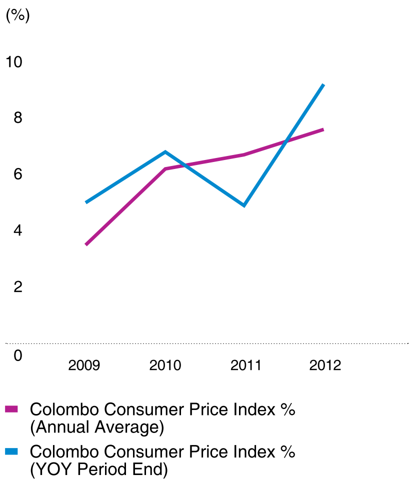
Services Sector

Services sector being the largest sector of the economy accounted for 58.5% of GDP in 2012, slowing down to 4.6% growth from last year’s higher growth level of 8.6%. This was caused by the slowdown in external trade resulting from both international and domestic factors. The fragility in global economic conditions specifically those in Europe limited the growth expectations attached to the export trade sub sector. Domestically, policy measures initiated at the commencement of 2012 to stabilise the macroeconomic setting restricted imports of specific items resulting in a slowdown in import trade compared to 2011.

Inflation

Inflation was contained at single digit levels for the fourth consecutive year despite its growth in 2012 mostly due to supply side shocks. The headline inflation denoted by the Colombo Consumer Price Index (CCPI - 2006/07=100) year on year period end rose to 9.2% compared to 4.9% recorded in 2011 while CCPI annual average too rose to 7.6% in 2012 from 6.7% recorded last year. The rising trend in inflation since second quarter of 2012 occurred mainly from the upward revisions made in petroleum based products, LP Gas, electricity and bus fare hikes. Apart from these, inflation rise was fuelled by the depreciation of the rupee, increased duty on selected items and because of the rise in food prices primarily resulting from both drought and floods. On a positive note, improved supply conditions of agricultural production, downward revisions of some administered prices and duties on import items and demand management strategies together with managed inflation kept inflation below double digit right throughout the year.

Inflation - Colombo Consumer Price Index



** Information Based on: Colombo Consumer Price Index (2006/07=100) Percentage Change*

Wages

In both the public and private sector, nominal wages of employees rose while in terms of real wages only private sector employees’ wages witnessed an increase. Real wages of public sector employees recorded a marginal decline of 0.6% as the nominal wage increase was more than offset by the increase in price levels in 2012. However, the formal private sector continued to realise increase in both nominal and real wages whose wages are governed by the Wages Boards Trades. Informal private sector employees too enjoyed rise in both nominal and real wages whose wages are determined freely in the labour market demand and supply factors.

External Sector Developments

Despite the challenging global economic setting, Sri Lankan external sector strengthened in 2012 aided by the prudent policy package implemented by Central Bank and the Government early 2012. The strong policy package included allowing greater flexibility in the exchange rate, increasing the policy interest rates, imposing a ceiling on the growth of credit granted by licensed banks and raising customs duties on selected imports. These measures resulted in import expenditure falling by 5.4% in 2012. As a result of allowing greater flexibility in the exchange rate by limiting Central Bank intervention in the domestic foreign exchange market, the rupee depreciated by 14.56% *vis-à-vis* the US dollar in the first half of 2012 and registered an appreciation by 4.83% in the second half of 2012 aided by increased foreign currency inflows from tourism, worker remittances and inflows to stock market.

Nation's balance of payments registered a surplus in 2012 supported by the significant improvement in the current account and the continued inflows to capital and financial account. The higher earnings from tourism and transportation, and rise in worker remittances together with the contraction in trade deficit led to a decline in the current account deficit. Foreign Direct Investment (FDI) continued to be a major inflow to the financial account of the BOP despite sluggish global economic performance. FDIs, including loans received to BOI approved companies, recorded the highest ever inflow amounting to US dollars 1,338 million.

Fiscal Policy

The Government's fiscal policy strategy focused towards strengthening the fiscal consolidation process expecting improvements in the medium-term. In this challenging environment Government maintained the budget deficit at 6.4% of GDP in 2012 which was below the 6.9% deficit recorded in 2011. The strengthening process involved streamlining the tax policy reforms to broaden the tax base, simplify the tax structure to increase Government revenue while rationalising recurrent expenditure, and maintaining public investments to stimulate the economy. Measures introduced in income tax in 2012 were mainly focused on creating an investor friendly environment in the country to encourage investments. Nonetheless, total Government revenue as a percentage of GDP declined to 13% in 2012 entirely due to decline in tax revenue.

Monetary Policy

Driven by positive economic sentiments, credit extended to the private sector by commercial banks grew significantly from the second half of 2011, raising risk of propelling demand driven inflation and thus impacting macroeconomic stability of the country. To address this situation, the Central Bank tightened its monetary policy significantly during the first half of 2012. Consequently, policy interest rates were raised while separately imposing a ceiling on credit expansion for banks and allowing more flexibility in the determination of interest rates. However, Central Bank was able to ease the tightened monetary policy as the year drew to a close with the expected stabilisation outcomes taking place.

Interest Rates

The increase in policy interest rates, the high borrowing requirements of the Government and tight liquidity conditions caused the yield rates of Government securities in the primary market to rise. Deposit rates which began increasing at a faster pace during the fourth quarter of 2011, too continued to ascend in 2012 and showed a similar pattern throughout 2012. Tight liquidity conditions coupled with aggressive deposit mobilisation by financial institutions kept deposit rates at peak levels. Accordingly, owing to the higher policy interest rates along with the credit ceiling, tight liquidity and increased cost of funding resulting from high deposit rate structures, made the financial services sector adjust lending rates upward in tandem in 2012.

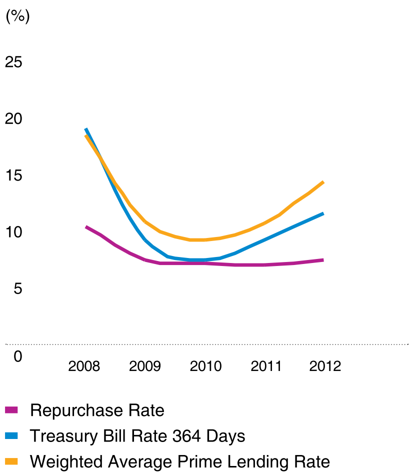
Interest Rates Movements

Interest Rates (%)	2008	2009	2010	2011	2012 (a)
Treasury Bill Rate (364 days)	19.12	9.33	7.55	9.31	11.69
Repurchase Rate	10.50	7.50	7.25	7.00	7.50
Commercial Banks' Average Weighted Prime Lending Rate (AWPR)	18.50	10.91	9.29	10.77	14.40

(a) Provisional

** Source: Central Bank of Sri Lanka*

Market Interest Rates



Equity Market

Unlike the upsurge witnessed a few years before, equity market performance remained rather subdued in 2012 but showed signs of recovery as the year progressed. The All Share Price Index (ASPI) declined by 7% in 2012 as against a drop of 8.5% recorded in 2011. However, the market regained some upward momentum during the second half of the year, mainly because of the recovery of the rupee against the US dollar amidst slowing imports, policy interest rate revisions by the Central Bank and relaxation of rules by the SEC on broker credit and trading and continued foreign investor participation in the equity market.

Share Market Performance

	2011	2012
All Share Price Index (a)	6,074.4	5,643.0
Year on year Change (%)	(8.5)	(7.0)
Milanka Price Index (a)	5,229.2	5,119.1
Year on year Change (%)	(25.9)	(2.0)
Market Capitalisation (Rs. billion) (a)	2,213.9	2,167.6
As a percentage of GDP (%)	33.9	28.9
Market Price Earnings Ratio (a)	15.8	15.9
Turnover to Market Capitalisation (%)	24.7	9.9
Value of Shares Traded (Rs. billion)	546.3	213.8
Number of Shares Traded (million)	24,543	9,691
Number of Companies Listed	272	287
Introductions	16	11
Number of Initial Public Offers (IPO's)/ Offers for sale	13	6
Number of Rights Issues	22	19
Amount Raised through Rights Issues and IPO's (Rs. billion)	45.1	13.3

Source: Colombo Stock Exchange

(a) End of the year

Key Economic Indicators

	2008	2009	2010	2011	2012 (a)
DEMOGRAPHY					
Mid Year Population ('000 persons)	20,217	20,450	20,653	20,869	20,328
Population Density (Persons per sq.km.)	322	326	329	333	324
Labour Force ('000 persons)	8,082	8,074	8,108	8,555	8,465
Unemployment Rate (per cent of labour force)	5.4	5.8	4.9	4.2	4
OUTPUT					
GDP at Current Market Prices (Rs. billion)	4,411	4,835	5,604	6,544	7,582
Per Capita GDP at Market Prices (Rs.)	218,167	236,445	271,346	313,576	373,001
REAL OUTPUT (Percentage Change)					
GNP	4.6	4.8	7.9	8.4	5.5
GDP	6.0	3.5	8.0	8.2	6.4
Sectoral Classification of GDP					
Agriculture	7.5	3.2	7.0	1.4	5.8
Industry	5.9	4.2	8.4	10.3	10.3
Services	5.6	3.3	8.0	8.6	4.6
AGGREGATE DEMAND AND SAVINGS (Per cent of GDP)					
Domestic Savings	13.9	17.9	19.3	15.4	17.0
Net Factor Income	3.9	5.8	6.0	6.6	7.0
National Savings	17.8	23.7	25.3	22.0	24.0
PRICES AND WAGES (Percentage Change)					
Colombo Consumers' Price Index (2006/07 = 100) - Annual Average	–	3.5	6.2	6.7	7.6
Colombo Consumer Price Index (2006/07=100) - year on year-end Period	–	5.0	6.8	4.9	9.2
GOVERNMENT FINANCE (Per cent of GDP)					
Revenue	14.9	14.5	14.6	14.3	13.0
Expenditure and Net Lending	22.6	24.9	22.9	21.4	19.7
Current Account Deficit (-)/Surplus (+)	(2.0)	(3.7)	(2.1)	(1.1)	(1.4)
Overall Deficit (-)/Surplus (+)	(7.0)	(9.9)	(8.0)	(6.9)	(6.4)
Government Debt	81.4	86.2	81.9	78.5	79.1

(a) Provisional

Source: Annual Report 2012 of the Central Bank of Sri Lanka

	2008	2009	2010	2011	2012 (a)
EXCHANGE RATES					
Annual Average					
Rs./US$	108.33	114.94	113.06	110.57	127.60
Rs./SDR	171.24	177.22	172.50	174.54	195.38
Year end					
Rs/US$	113.14	114.38	110.95	113.90	127.16
Rs/SDR	174.27	178.67	170.84	174.87	195.31
INTEREST RATES (Per cent per Annum at End Period)					
Repurchase Rate (overnight)	10.50	7.50	7.25	7.00	7.50
Reverse Repurchase Rate (overnight)	12.00	9.75	9.00	8.50	9.50
Treasury Bill Rate 91 days	17.33	7.73	7.24	8.68	10.00
Treasury Bill Rate 364 days	19.12	9.33	7.55	9.31	11.69
Deposits Rates					
Commercial Bank's Weighted Average Deposit Rate	11.63	8.01	6.23	7.24	10.10
Commercial Bank's 12-month Fixed Deposit Rate	20.25	19.00	17.00	11.00	17.00
Lending Rates					
Commercial Bank's Weighted Average Prime Lending	18.50	10.91	9.29	10.77	14.40
CAPITAL MARKET					
All Share Price Index (1985=100)	1,503.0	3,385.6	6,635.9	6,074.4	5,643.0
Milanka Price Index (1998 Dec=1000)	1,631.3	3,849.4	7,061.5	5,229.2	5,119.1
Value of Shares Traded (Rs. million)	110,454	142,463	570,327	546,256	213,827
Market Capitalisation (Rs. billion)	488.8	1,092.1	2,210.5	2,213.9	2,167.6

(a) Provisional

Source: Central Bank of Sri Lanka

FUTURE OUTLOOK OF THE SRI LANKAN ECONOMY

The Sri Lankan economy is expected to grow at about 7.5% by end 2013 and inflation to fall down to 7% considering the proposed initiatives of the Government. It is also anticipated that the economy would move to a higher growth trajectory of over 8% in the medium term. Monetary policy moving ahead in the short term will focus on managing aggregate demand in order to keep inflation expectations under tight control while facilitating the economy to achieve its full potential. In managing this expectation, policy interest rates and the interest rate corridor would again become the key policy instruments for the Central Bank.

It is expected that both the interest rates as well as inflation would fall in the latter part of 2013 supported by market pricing energy which will lower credit pressure. Ongoing reforms in state energy pricing at CEB and Ceylon Petroleum Corporation will further assist in bringing down credit growth and interest rates in the future.

As the country strives to achieve its per capita income target of US dollars 4,000 in 2016, planned initiatives in improving nation's social infrastructure system to evolve into an international competitive service framework will enable the country to cope with the growing demands of the population. Sri Lanka's achievement of many of the Millennium Development Goals ahead of the target year 2015 is commendable and its benefits are bound to have a positive effect on poverty alleviation, uplifting primary education, greater promotion of gender equality and empowerment of women, better health care and affording of safe drinking water and better sanitation, heading to the future.

The country's external sector is expected to strengthen over the medium term, enhancing its resilience to external shocks. Export of goods is expected to regain the upward momentum underpinned by the recovery in world economic activity and positive effects of implementing measures to enhance exports. Foreign inflows to the Government and private sector FDI flows are expected to increase in 2013 and beyond, off-setting the current account deficit, thereby resulting in significant BOP surpluses in the medium term. Nonetheless, maintaining a sound relationship with the international community including Asian economic giants such as China and India will be decisive in sustaining sound bilateral trade and inflow of investment for nation's speedier economic progress.

Financial Sector Performance

The financial services sector was a major driver in economy's growth momentum expanding satisfactorily and remaining stable despite challenging market conditions. The risk absorption capacity of the sector improved amidst higher capital levels, adequate liquidity buffers and sound earnings. As seen in recent years, the supervisory and regulatory framework was strengthened further. The financial safety nets in place boosted confidence towards the sector and promoted financial system soundness. During the year, the branch networks of the sector which include Banks, LFC's and leasing companies expanded providing greater access to finance.

Banking Sector

The banking sector in 2012 experienced healthy asset growth but saw a curtailment in credit growth unlike in 2011. The growth in assets remained unchanged at 20% resulting from the imposition of the ceiling on credit which held the surge in lending seen in previous period of the sector under tight control with lending growth moderating to 21% in 2012. The sector remained stable and maintained a dominant role in the financial services sector with its assets rising to 56.4% by end 2012. The sector continued to expand the range of products and services offered while concentrating on extending reach as done in the past. By end 2012, 33 local and foreign banks operated and the sector comprised 6,374 banking outlets with 2,390 ATM's scattered island wide.

Licensed Finance Companies (LFC) Sector

The Non-Bank Financial Institutions (NBFI's) sector that comprises of Licensed Finance Companies (LFC's) and Specialised Leasing Companies (SLC's) recorded a stable 22% growth aided by the improvement seen in asset quality and boost in confidence levels that had positive effect on business volumes. Liquidity levels too were at a healthy level, while adequate profitability and sufficient capital levels were observed within the sector. However, the main drawbacks for the sector's finance business remained the decline in vehicle imports on account of higher duty applied from previous period along with the devaluation in rupee that raised prices of vehicles being imported.

The number of LFC's carrying on business stood at 47 by end 2012 which included four new entrants to the sector. Together with SLC's, the branch network of the NBFI sector expanded with 206 branches being newly established raising total branches to 972 by end 2012. The highlight here was that majority of the branches opened during this period were established outside the Western Province.

Assets Growth of LFC's

LFC's together with SLC's contributed to Rs. 597 billion worth of assets in 2012 showing a growth of 22% for the NBFI sector compared to a growth of 26% recorded last year. Accommodation growth was the main cause for this total asset growth which showed a rise of 21% by end 2012 in contrast to a higher growth of 46% recorded in 2011. Finance leases, hire purchases and other secured advances were the major sources of accommodation, which accounted for 46%, 26% and 16% respectively, of the total accommodations. On the other hand, investment portfolio of the sector grew by 14% in 2012 as against a negative growth of 46% recorded a year ago.

Liability Position of LFC's

Deposits being the main source of funding for LFC's accounted for 43% of total liabilities of the NBFI's, growing by 37% to Rs. 254 billion by end 2012 compared to a growth of 27% recorded in 2011. LFC's mobilised funds mainly by way of time deposits which accounted for 98% of the total deposit liability. Apart from this, borrowings were the other main source of funding amounting to Rs. 176 billion increasing by 3% year on year in contrast to a 24% rise recorded in 2011.

Capital Position of LFC's

Capital funds of the NBFI sector increased by 27% in 2012 to Rs. 86 billion in contrast to a higher growth of 57% registered year before. The capital adequacy ratios of the NBFI's remained above the required minimum levels due to the enhancement of capital funds mainly aided by the accumulation of retained profits of institutions in the sector and capital funds worth Rs. 5 billion being infused through rights issues, strategic investments and capital investments during this period.

Composition of Assets and Liabilities of NBFIs Sector Vs MI Position

Item	NBFI Actual 31 December 2011 Rs. billion	NBFI Actual 31 December 2012 (a) Rs. billion	MI's Actual 31 March 2013 Rs. billion	MI's Actual 31 March 2013 (as a % of Sector Item)
Assets:				
Accommodation	388.4	471.7	13.8	0.3%
Finance Leasing	166.1	214.9	4	1.9%
Hire Purchase	118.4	123.0	5.7	4.6%
Investments	13.5	15.4	4	26%
Others	88.0	109.6	3.4	3.1%
Liabilities:				
Total Deposits	186.0	254.1	8.4	3.3%
Total Borrowings	171.6	176.0	5.3	3%
Capital Elements	77.0	94.9	5.7	6%
Total Funds	**434.6**	**525.0**	**19.2**	**3.7%**
Others	55.3	71.6	1.8	2.5%
Total Assets/Liabilities	**489.9**	**596.6**	**21.2**	**3.6%**

(a) Provisional

(b) Source for columns 1, 2: Annual Report of Central Bank of Sri Lanka

Profitability of LFC sector

Despite the pressure on margins and the contraction in demand for vehicle leases due to high import duty rates, the sector profitability was at healthy levels. NBFI's posted a profit after tax of Rs. 15 billion in 2012 compared to a higher Rs. 19 billion recorded a year ago. The decline in profits was mainly because of the reduction in non-interest income and the rise experienced in non-interest expense. The ROA and ROE of NBFI's showed a decline reaching to 4% and 19% respectively in 2012 compared to 6% and 34% recorded in 2011.

MI's Standing in the Non-Bank Financial Institution (NBFI) Sector

Composition of Income and Expenses of NBFI sector Vs MI Performance

Item	NBFI Actual 31 December 2011 Rs. billion	NBFI Actual 31 December 2012 (a) Rs. billion	MI's Actual 31 March 2013 Rs. billion	MI's Actual 31 March 2013 (As a % of Sector Item)
Interest Income	68.0	92.9	3	3.2%
Interest Expense	35.1	52.6	1.9	3.6%
Net Interest Income	**32.9**	**40.3**	**1.1**	**2.7%**
Non-Interest Income	17.2	13.3	0.2	1.5%
Non-Interest Expenses	26.0	30.1	0.5	1.7%
Staff cost	8.7	11.0	0.2	1.8%
Loan Loss Provisions (Net)	(1.4)	1.5	0.03	2%
Profit Before Tax	**25.6**	**22.7**	**0.7**	**3%**
Tax	6.6	6.5	0.1	1.5%
Profit After Tax	**19.0**	**14.9**	**0.6**	**4%**

(a) Provisional

(b) Source for columns 1, 2: Annual Report of Central Bank of Sri Lanka

Supervisory and Regulatory Developments Related to LFC's

Two new directions were issued to LFC's during the year focusing on enhancing the framework of IT operations of institutions and the other specifying caps on deposit interest rates. In order to ensure that the audits of the sector meet the required standards, a panel of external auditors was appointed and guidelines issued to the selected panel of auditors to maintain standards. Furthermore, during 2012, the Central Bank closely monitored the progress made by the sector in moving towards IFRS implementation by seeking feedback at various points in time. In accordance with the Finance Business Act, No. 42 of 2011, the Central Bank monitored finance businesses through both on site and off site surveillance and initiated course of action against conduct of finance business without authority and for non-submission of information.

Key Regulations Imposed in 2012 by CBSL Applicable to LFC's

Directions/Circular	Key Requirements of the Direction
Finance Companies (Information systems security policy) Direction No. 04 of 2012	● LFC's to maintain a well-documented Information systems security policy (ISSP). ● LFC's to review periodically the requirements of the ISSP including conducting information systems audits. ● Requiring of a Business Continuity Plan for LFC's covering disaster management and risk analysis.
Finance Companies (Interest rate) Direction No. 05 of 2012	● Specifies maximum annual rate of interest which may be paid by a LFC on a time deposit, savings and non-transferable Certificate of deposit.
Finance Companies (Panel of External Auditors) circular No. 01 of 2012	● Commencing from next financial year, LFCs are required to appoint an external auditor from the panel of external auditors approved by the CBSL.

Future Outlook of the LFC Sector

In the medium term, the main challenge for the LFC sector would be to sustain healthy business volumes amidst the depleted vehicle import market and the lowered demand caused by the higher vehicle pricing resulting from the high import duty. Eventhough, the exchange rate has stabilised to an extent the impact already caused from the depreciation in rupee in the past will continue to impact vehicle pricing hence affecting the demand for related financing. Sector competition will remain high with the increased number of players now in the sector despite the policy decision by regulator on putting on hold new entrants to the LFC sector.

The main boost to the LFC sector going forward will be the growing positive economic sentiments and actual plans already undertaken by both Government and business community and ones that are in the pipeline for the nation's march towards economic prosperity with planned USD 100 billion economy and projected growth in per capita income. The benefit of increased economic activity taking place now than before should trickle down significantly to most sectors in the foreseeable future, apart from the already rejuvenated tourism industry. This is bound to further drive the financial sector including LFC sector, which remains dependent on the successes of other industries to create demand for its own businesses of lending and deposit taking.

The LFC sector is sure to diversify its businesses going into the future and is certain to introduce innovative solutions that will stimulate demand and create fresh markets more so from a long term perspective. With time, the distinction between Banking sector and LFC sector would narrow down especially with the growing sophistication and capability of the LFC sector. In terms of regulation, there will continue to be stringent monitoring of the sector but certain level of flexibility and leeway would be given for the sector to perform at peak levels. The current policies of encouraging Finance companies to seek foreign funding and the easing of exchange control regulations together with the improved confidence levels towards the sector will create more opportunity and competitiveness for the sector in the future. At the same time, it is fair to expect government fiscal policy to ease in the longer horizon to boost the vehicle market sector with tax reforms beneficial to the industry. Moreover, the demand for financing will improve in the medium term as the high market interest rate positions will start to reverse once there is greater credit availability especially with the expected easing of government borrowing and higher FDI levels expected to flow.

Prevailing Risks and Uncertainties Affecting LFC Sector

The sophistication and dynamism associated with the LFC sector poses a range of risks and challenges to its participants. Specifically, there are immediate risks and challenges posed due to changes that occur in customer needs, regulation, level of competition, economic and political semantics, technological advancement, human resource expectations, environmental and societal expectations.

Key challenges impacting LFCs and how MI responded to them are outlined below:

Key Challenges to LFC Sector	MI's Response Update 2013
Credit Crunch and Steep Rise in Market Rates As key negatives, high interest rate market structure impacted volumes, cost of funding, business margins, liquidity and raises bad debt levels if not appropriately managed.	● Seeking optimal sources of funding. Pursued foreign funding. ● Keeping overhead costs well monitored and passing down benefit to customers. Eg. Cost Control Committee initiatives ● Focused Recovery monitoring process for all lendings. ● Radical changes to boost overall deposit base in the short-term. ● Stringent credit evaluation process prior to disbursement.
Mounting Customer Expectations Customers being well informed of market variables, mainly pricing and expectation of high service standards raises competition level. Customer wants have expanded and have become complex and sophisticated than before.	● Strong frontline work force to handle customer needs. Marketing arm of Deposit division was strengthened specifically. ● Special training aimed at maintaining high service standards. ● Review of existing operational processes and procedures to reduce processing times. Eg. Changes made to branch deposit processing procedures ● Broadening benefits from use of Information systems technology. E.g. Modifications to core systems to support frontline operations.
Rising Competition Level The expansion of the number of players in the sector and stiff competition coming from the Banking sector have raised competition levels, affecting anticipated volumes.	● Having strong strategic focus especially in times of renewed economic activity with emerging opportunities. Eg. Development of a strategic plan, strengthening sales team, Receptiveness to market rate changes etc. ● Pursuing business expansion strongly. Expanded the Branch network this year as well.
Erosion of Core Business Margins Price sensitiveness of customers coupled with stiffer competition somewhat affected margins derived from core business.	● Close review of market interest rate movements. E.g. Weekly management meetings addressing rate fluctuations. ● Finding cheaper sources of funding to sustain anticipated margin levels. ● Increasing volumes of higher yield bearing lending products such as term loans and property mortgage loans.
Rising Cost Structures Amidst Relatively Slowed Down Revenue Growth Sustaining anticipated profitability amidst rising cost structures year on year was a core challenge. Rising personnel costs, costs increases due to expansion and inflationary effects on recurring costs upped cost structures in spite of decelerated turnover growth in this period.	● Cost reduction initiatives proposed by the Cost Control Committee set up in 2012. ● Close management review of overall and departmental cost elements to identify waste and to devise means of better managing large cost items. ● Maintained a healthy cost to income ratio through a concise effort. E.g. Managing branch costs in relation to their income generation.
Depleted Vehicle Sales Market Introduction of higher duty for vehicle imports coupled with the deprecating rupee had a strong negative impact on vehicle sales market affecting the business of financing.	● Introducing tailor-made product extensions such as structured facilities and bullet payments to traditional financing ● Promoting other non-traditional lending such as term loans to boost volumes. ● Affording new lending services such as micro financing and professional loans.
Broadened Regulatory Framework Finance companies have to operate within a strong regulatory environment than before. Business operations have to incorporate a stream of requirements that have been introduced to safeguard varying stakeholder interests.	● Qualified and experienced team that is conversant on regulatory framework especially to carry out smooth transition to imposed regulations. ● Mechanisms to obtain feedback of MI's level of compliance to regulations. Recruitment of a Manager Compliance and Risk in 2012 to oversee related aspects. ● Continued training for staff on applicable regulations. Eg. In house and external training.

ANALYSIS OF BUSINESS ENVIRONMENT

SWOT Analysis

The company's strategic plan prepared in 2012, identified organization's strengths, weaknesses, opportunities and threats. It set forth a strategic platform for the company to harness key strengths while capitalizing on opportunities available in the market. Same time it strategized on how to counter weaknesses and imminent threats. Given below is an illustration of MI's responses to the main aspects of the SWOT.

STRENGTHS

- **Phenomenal reputation**
- **Strong capital base**
- **Skilled and loyal human capital**
- **Group diversification and synergy**
- **Growing product range**
- **Well-developed IT system and conversant IT support staff**
- **Branch network spread across the country**

Adopt strict, policies and practices to safeguard reputation.

Continuous improvements to core systems to support business operations.

Pursuing expansion optimally with existing resources.

Maintaining healthy spreads in core businesses by keeping cost of funding at optimal low levels.

Using workforce to sustain sound volumes and profits.

Boosting volumes and overall yields by capitalising on new products and markets.

WEAKNESSES

- **Growth revolved around main product lines**
- **Significant portion of last few years profitability comprised non-core business income**
- **Majority of branches established within last 3-4 years**
- **Significant component of the deposit-base comprises of senior citizens**
- **Large costs structure resulting from expansion**

Continuous focus in broad basing product range.

Emphasis on promotional activities to strengthen market presence in newly setup locations.

Great focus on niche segments and enhancing depositor base.

Strengthening deposit marketing and branch operations.

Cost saving initiatives.

OPPORTUNITIES

- **Growing economy**
- **Unexplored market potential**
- **Public confidence high for financially sound institution**
- **Advancement in technology in the financial service sector**
- **Foreign collaborations and investment**
- **Increased focus on sustainable practices**

Focus to harness emerging opportunities, arising from the economic turnaround.

Creating awareness across the country on MI's financial strengths to attract investments.

Adoption of sound governance practices and risk management activities to sustain public confidence.

Upholding socially responsible practices aggressively.

Aggressive expansions drive to exploit untapped and emerging markets.

THREATS

- **Availability of numerous investment options**
- **Stiff competition within sector and from banking sector**
- **Price sensitiveness of customers than before**
- **Job opportunities for skilled workers in finance field**
- **Vehicle market hit by rising import duty and other levies**
- **Continuation of global meltdown in major economies**

Affording convenient methods of transacting and a speedier service.

Tailor-made lending products to suit budget.

Identifying best performers and rewarding them.

Affording optimal prices by keeping low costs structure.

Promoting range of offerings that yield attractive prices.

Political

- Political stability despite international pressure.
- Macroeconomic policies of the government to boost economic activities after three decade of war.
- Massive development projects and opportunities in the North and East been undertaken.

Economic

- Global economic crisis continues especially in Europe.
- Emerging Global economies in Asian region.
- Consistent GDP growth and increased per capita income in North and East province.
- High interest rate regime and credit contraction.
- Increase of interest rate in Sri Lanka
- Rise in inflation
- Motor vehicle tax policy changes restricting related imports

Social

- Improvement in Per Capita Income and standard of living .
- Improved Public perception towards finance companies
- Increased price consciousness of customers
- Customers well informed of market through effective communication channels.

PES

TLE

Technological

- High end technology use by banking and finance sector.
- Rapid acceleration in use of social media and mobile usage
- Greater need of MIS for decision making due to constant market changes.
- Customers seek convenience when transacting.

Legal

- Stringent Regulatory framework for Banks and LFC's e.g. Finance Business Act.
- More focus on anti-money laundering activities and KYC to mitigate associated risk.
- Emphasis placed on corporate governance.
- Restriction in granting licenses for Finance companies.

Environmental

- Increase attention on CSR and environmental issues by both public and private sector
- Demand for more financial and non-financial disclosures on business environmental effect.
- International focus on creating a greener environment.

PESTEL Analysis

Political

LFC Sector

- LFC sector has gained momentum soon after the acceleration seen in post-war economic activity. Nevertheless, growth has been at a relatively slow pace than anticipated. The inherent weakness in nation's infrastructure and the slow paced business growth yet in most sectors remain an indirect challenge for the sector in the short term.

- Despite political stability, the international pressures exerted on the country affected somewhat the inflow of FDIs, thus effecting fund availability needed to harness immerging prospects. Nonetheless, economic pick-up, influx of tourist, emergence of new industries and revitalisation of existing business enterprises has contributed to the sector in posting healthy results than before.

MI's Response

- Possessing a strong capital strength MI had enough flexibility to capitalise on post-war positives. This was pursued however, conservatively to ensure long-term viability of decisions taken. The Company ventured out from traditional product range and focused on specific market segments to boost volumes.

- In keeping with MI's vision, we extended our presence from urban to rural areas to assist those communities affording tailor-made financial offerings.

- There was strong strategic focus to extend business operations beyond Western Province with the network almost doubling within a two-year span. MI established branches in North and East with Ampara branch being the new addition in this period.

Economic

LFC Sector

- The steep growth in credit disbursements since post war had an immediate effect on the current period. The sudden credit contraction due to lack of funds in the market saw the emergence of a high interest rate regime that persisted throughout the year. The already effected vehicle sales market was dealt with a further blow of another rise in import duty.

- Nonetheless the overall improvements in economic conditions than before continue to boost the sector. The emergence of new industries, infrastructure development activities and positive post war sentiments continued to assist the sector in maintaining a constant growth across the period. However the rise in inflation and slow progress in growth among other sectors remains a challenge for the sector to sustain short term aspirations.

MI's Response

- The Company remained receptive to economic changes by keeping constant watch on key variable such as interest rate, liquidity, spreads business volumes etc. To counter any business effects due to rise in interest rates such as margin erosion the Company pursued broad basing its traditional products range.

- To sustain anticipated overall yields, greater emphasis was placed in products such as personal loans and property mortgage that yielded higher returns.

- The introduction of tailor-made product offerings as an extension of traditional financing products suited varying customer budgets. To capitalise on improving economic setting, we strengthened our branch network and frontlines sales staff while creating greater awareness in regions to boost volumes.

Social

LFC Sector

- The continued social upliftment and standard of living of society had direct impact on the sector. A reasonable consistent demand persisted for financing related products especially to own semi luxury and upper-end market products. In parallel, similar demand remained for entrepreneurial needs due to society becoming more literate and business oriented even amongst the rural community.

- The LFC sector was very receptive to customer preferences especially in terms of meeting price expectations and at the same time not compromising on service standards.

MI's Response

- MI too remained very receptive to social changes and needs. In terms of pricing, we were able to meet customer needs across all segments ranging from lower to higher income groups. This included meeting needs of aging population by affording customised packages that added extra value.

- The Company ventured into microfinancing and professional loans this period in order to meet specific customer expectations beyond traditional financing.

- Individuals who had the desire for financial assistance but lacked accessibility to credit were specifically targeted through our budding branch network.

Technological

LFC Sector

- As the LFC sector is service driven there has always been dependence on technology to upholds convenience and sustain repeat business. Sector has evolved from basic information systems to highly sophisticated technology to support core business activity and back office operations. There is strong competition from banking sector in terms of use of technology considering the high resource capability that they possess.
- The sector depends on constant stream of MIS to take concise speedier decision in terms of implementing strategy including pricing and securing optimal funding lines.

MI's Response

- Radical improvements were made to core system to support front line staff to provide efficient and speedier service. To minimize response time and follow-up inquires efficiently; online user friendly systems with prompt screens were developed.
- To boost constant information flow to management significant amount of MIS reports were made available in the system on a daily basis. System has enough flexibility supported by well conversant in-house IT team to cater to information requirements of management through adhoc and customised reports.
- Our core systems are well integrated and support the ongoing branch expansion. We have embraced best in the industry technology to stay head of competition.
- The financial systems were redesigned to meet requirement of IFRS and other information needs arising from changes to regulation.

Legal

LFC Sector

- To stabilise and strengthen the LFC sector, stream of regulations were introduced by the regulator within a short span of time. The introduction of the Finance Business Act, and other regulations such as deposit insurance scheme and corporate governance requirements have placed the sector on a stronger footing despite the sector having to meet vast amount of requirements for compliance.
- Specific to the sector, the Financial Transaction Reporting Act has also placed stream of regulations to curb money laundering activity.
- This period specifically saw the sector converging to new requirements of the IFRS that required tremendous amount effort from institutions.
- Despite the sector expanding in terms of number of players CBSL proposed to restrict further entrant's in the near future.

MI's Response

- The restructuring of the Board including the appointment of a Non-Executive Chairman was done to strengthen corporate governance practices within the Company.
- MI has a well-established process to deal with new regulations as an when they are imposed. The recruitment of Manager-Risk and Compliance in 2012 was another step in that direction.
- With the assistance of Ernst and Young, the Company was able to adopt requirements of IFRS with ease and improve on disclosure for better reporting and transparency.

Environmental

LFC Sector

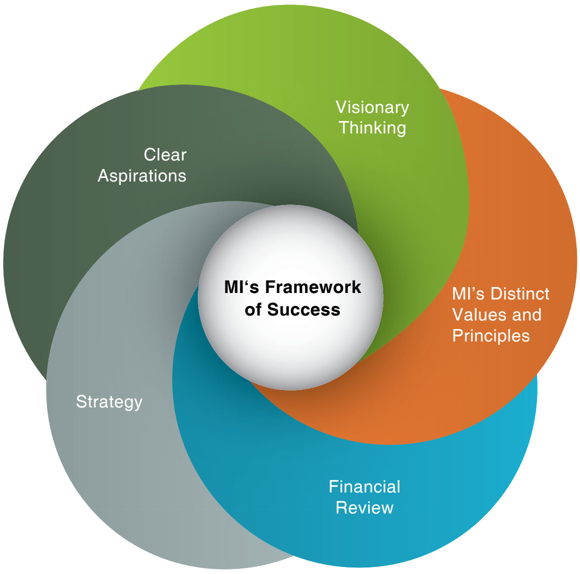
- As a sector that is service-oriented, environmental impact is not significant as that of the manufacturing industry. Nevertheless in the last decade there is growing importance on adopting sound environmental practices within the operational process. Certain business practices have evolved upholding these green ideologies.
- It is customary, now for the industry to declare what they follow to support long-term sustainability of the environment. LFCs in their corporate communicaes on CSR and sustainability tends to provide disclosure on such environmental practices adapted.

MI's Response

- Already, the Company has paid attention to the need to secure environment and its habitats. Specific CSR programmes were launched aimed at securing the well-being of the animal population.
- Each year, the Company adopts new green practices to combine with existing practices that have evolved overtime. Extensive focus has been given on saving energy. Environmental initiatives have been extensively detailed out in our sustainability report further on.

MI'S UNIQUE FRAMEWORK FOLLOWED IN ACHIEVING SUCCESS

The formula to our success has been the unique approach that we adopt that encapsulates visionary thinking and organisation wide focus in attainment of our goals and objectives through a well-defined strategic process. Broad elements attributable to the framework illustrated below formed the basis for our success this year and would continue to be the model for us in the medium term to sustain strategic advantage in our lines of business.



Visionary Thinking

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

MI 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.

Success did not come to us by chance but it was achieved through a planned and focused effort right from the very beginning. From the moment our organisation's founder Chairman George Ondaatjie laid forth his visionary ideologies of becoming a premier financial Institution, employees have worked tirelessly with passion and charisma to raise service standards to deliver a **"Service that extends beyond"** which is also MI's tag line. The Company has been able to bring a positive impact to the sector and the economy in many ways. In keeping with MI's Vision, we remained deep rooted in our value system to be a socially responsible enterprise, extending a helping hand to the society in many ways commercial and otherwise.

● A Visionary Leadership Style

Under the visionary leadership of our Company's Managing Director Gerard Ondaatjie, the organization has progressed in the last decade rapidly in terms of growth, fortifying MI's dominance as a premier finance company. The Management style embraced during this period emulated one of vigor coupled with strong core values that laid a sound foundation for achievement of challenging aspirations. During this period of economic revitalisation in the country, MI's management pursued organisational growth responsibly despite being aggressive in its strategies. Business growth was harmonised well, in keeping to our fundamentals and laurels. We adopted sustainable business practices and decisions that proclaimed long term financial viability as opposed to ad-hoc reactive measures.

Increased emphasis was also placed by management in enhancing governance practices within the organisation with the advent of stricter regulations being imposed on the Industry by the regulator. The Company underwent radical changes to its Board structure with the appointment of a Non-Executive Chairman in 2012 while appointing three new Non-Executive Directors for further strengthening of the Board.

Internally, management continued to groom employees to meet complex demands of the industry through focused training and development programs. Our employees have been trained to be leaders themselves to take initiative in a rapidly moving industry. We have become very futuristic and believe in planning ahead and getting everybody's consensus on what we need to do, to achieve our goals. Our management is very pro-active in its decision making and embraces a futuristic approach. Our thought process follows the saying;

> *"Create your future from your future, not your past"*
>
> ***Werner Erhard***

Values and Principles

Values

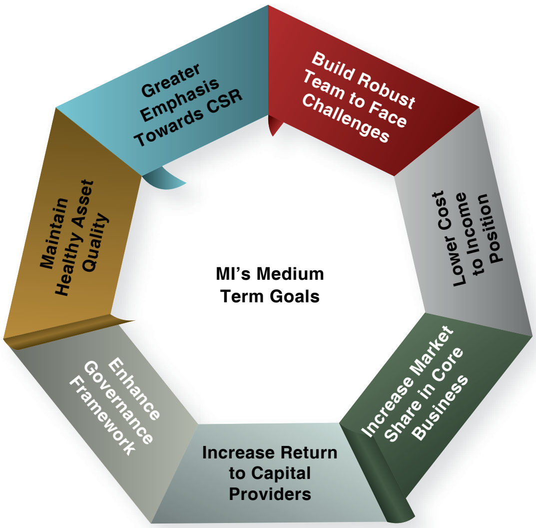
- **Customer Bondage**
- **Recognising Employee Efforts**
- **Team Spirit**
- Securing Investor Capital
- Socially Responsible and Ethical Actions
- Fair But Aggressive Competitor

Principles

- **Fulfil Customer Needs Beyond Expectations**
- **Create Lasting Bonds with People**
- Deliver Customers a Service that is World Class
- Business Practices Must Compliment Core Values

Clear Aspirations

Management followed an optimistic approach in realising its medium term aspirations this period as well, considering the extensive progress already made over the past 3 - 4 years. Shown below are the key goals that remained applicable in the concluded FY 2012/13, stemming from the strategic plan of the Company;



OPERATIONAL REVIEW

Financial year 2012/13 can be attributed as a period of consolidation for the Company in terms of growing its core businesses initiating bold measures in extending business presence, improving operational efficiency and sustaining asset quality, while upholding sound governance practices.

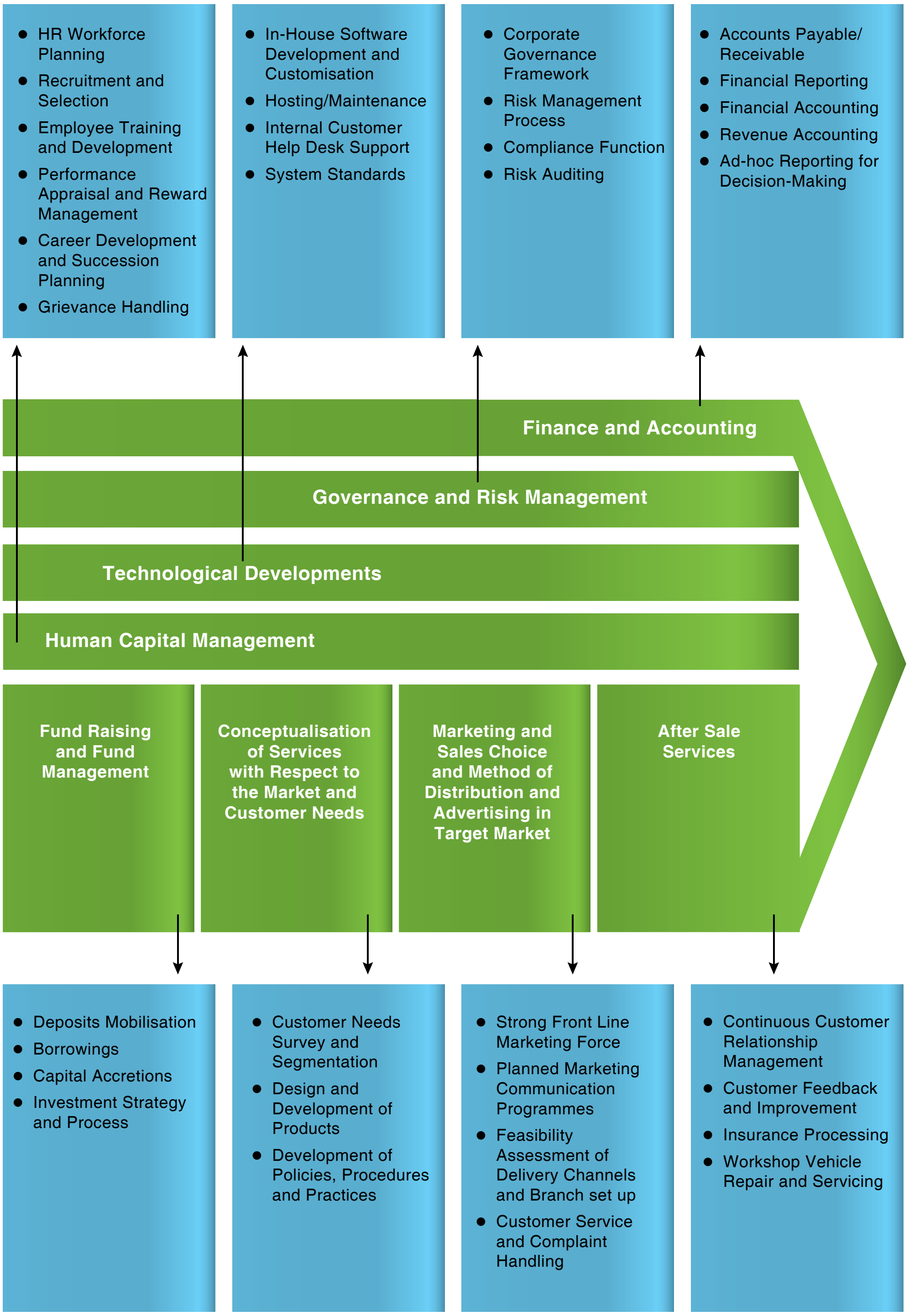
Operational Highlights

36%	**Branch Network Growth**
33%	**Net Lending Growth**
37%	**Deposits Growth**
3.10%	**Non-Performing Lending Position**
3	**New Products Introduced**
443	**Workforce Strength**
11	**CSR Programmes Initiated**
13	**New Governance Practices**

MI's operational achievements against targets

Key Business Goals	Operational targets	Level of achievement in FY 2012/13
Increased returns to capital providers	• Sustaining profitability growth • Sustaining anticipated margins on core business • Bringing down cost of funding • Broad-basing the product range to improve average yields	• Managed to sustain growth in core business profits and net interest margins (NIM) as explained in the financial review section of the MD&A. • Managed to secure funding at optimal pricing in addition to deposits, securing borrowing facilities from local banking partners. • Extended the product range to include micro financing and professional loans. Strong emphasis on term loans and other higher yielding products.
Increased market share in core business	• Expand branch network outside Western Province • Strengthen our presence in Western Province • Promote MI offerings at branch level • Relocate selected branches	• Opened branches in Tissamaharama, Gampaha and Ampara and opened service centers in Kottawa and Minuwangoda. • Initiated street promotions in Matara, Galle and Ampara. Other promotions including Riya Pola's were initiated in Negombo, Matara and Kohuwala. • Relocated Kurunegala branch to a better location. • Managed to sustain healthy growth levels in both lending and deposits.
Maintain healthy asset quality	• Maintain the non performing lending (NPL) ratio below 3.5%	• Through close recovery monitoring process discussed later in the MD&A, NPL was kept below targets this period.
Selecting and building a robust team	• Effective recruitment process to keep up with dynamism in business. • Strong emphasis in building knowledge of work force.	• 109 recruitments took place in this period through a thorough recruitment process. • 367 employees took part in training programs this period either those conducted in-house or through external training.
Low cost to income position	• Strong emphasis on cost control • Business growth based on due feasibility	• A stream of cost reduction initiatives mentioned later in this supplement including establishing of a Cost Control Committee (CCC) supported in keeping costs low. • Over 20 key cost reduction proposals were initiated by the CCC in this period. • All branch openings were carried out after analyzing its cost benefit. Due consideration was given to the future sustainability of related branches in terms of expected income as opposed to the incremental cost effect.
Enhanced governance framework	• To adopt and adhere to best practices related to corporate governance • Strong focus on Risk management • Strengthen audit and compliance function	• Setting up of an own Internal audit division. • Recruitment of a Manager Compliance and risk. • Introduction of a Branch compliance checklist to confirm periodic compliance. • Development of a Risk Policy for MI • Introduction of a "Risk Register" to identify key areas of risk in departments with counter measures.
Greater emphasis towards corporate social responsibility	• To initiate more CSR programs • Contribute towards sustainable development of the nation	• The CSR committee initiated eleven CSR programs aimed at uplifting social welfare in this financial period. • A number of new sustainable practices covering economic, social and environmental aspects were adopted as given in our Sustainability Report.

Business Overview - MI's Service Value Chain



- HR Workforce Planning
- Recruitment and Selection
- Employee Training and Development
- Performance Appraisal and Reward Management
- Career Development and Succession Planning
- Grievance Handling

- In-House Software Development and Customisation
- Hosting/Maintenance
- Internal Customer Help Desk Support
- System Standards

- Corporate Governance Framework
- Risk Management Process
- Compliance Function
- Risk Auditing

- Accounts Payable/ Receivable
- Financial Reporting
- Financial Accounting
- Revenue Accounting
- Ad-hoc Reporting for Decision-Making

Finance and Accounting

Governance and Risk Management

Technological Developments

Human Capital Management

Fund Raising and Fund Management

Conceptualisation of Services with Respect to the Market and Customer Needs

Marketing and Sales Choice and Method of Distribution and Advertising in Target Market

After Sale Services

- Deposits Mobilisation
- Borrowings
- Capital Accretions
- Investment Strategy and Process

- Customer Needs Survey and Segmentation
- Design and Development of Products
- Development of Policies, Procedures and Practices

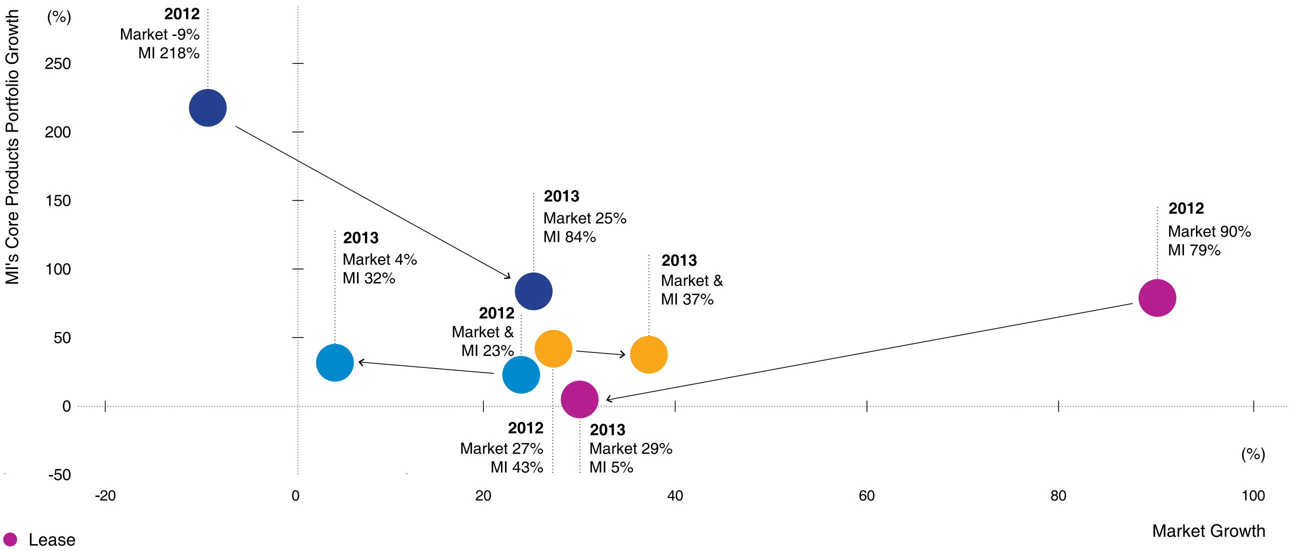
- Strong Front Line Marketing Force
- Planned Marketing Communication Programmes
- Feasibility Assessment of Delivery Channels and Branch set up
- Customer Service and Complaint Handling

- Continuous Customer Relationship Management
- Customer Feedback and Improvement
- Insurance Processing
- Workshop Vehicle Repair and Servicing

MI's Product Portfolio

Mercantile Investments is renowned to offer a range of financial services, in a way that builds lasting relationships with its customers, constantly identifying needs and focusing on customer care. Our aim is to create lasting value to our customers through fulfillment of their needs beyond expectations.

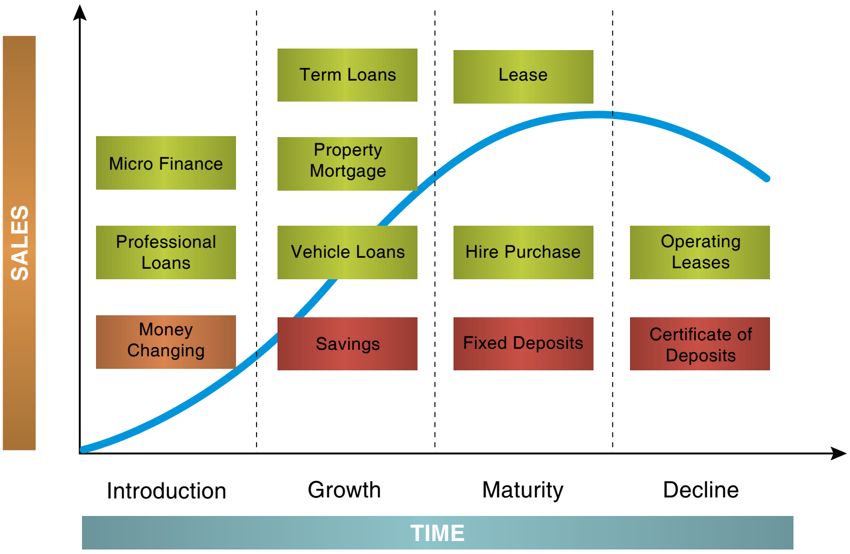
Core Product Portfolio Position Against Market



● Lease
● Hire Purchase
● Deposits
● Other Loans

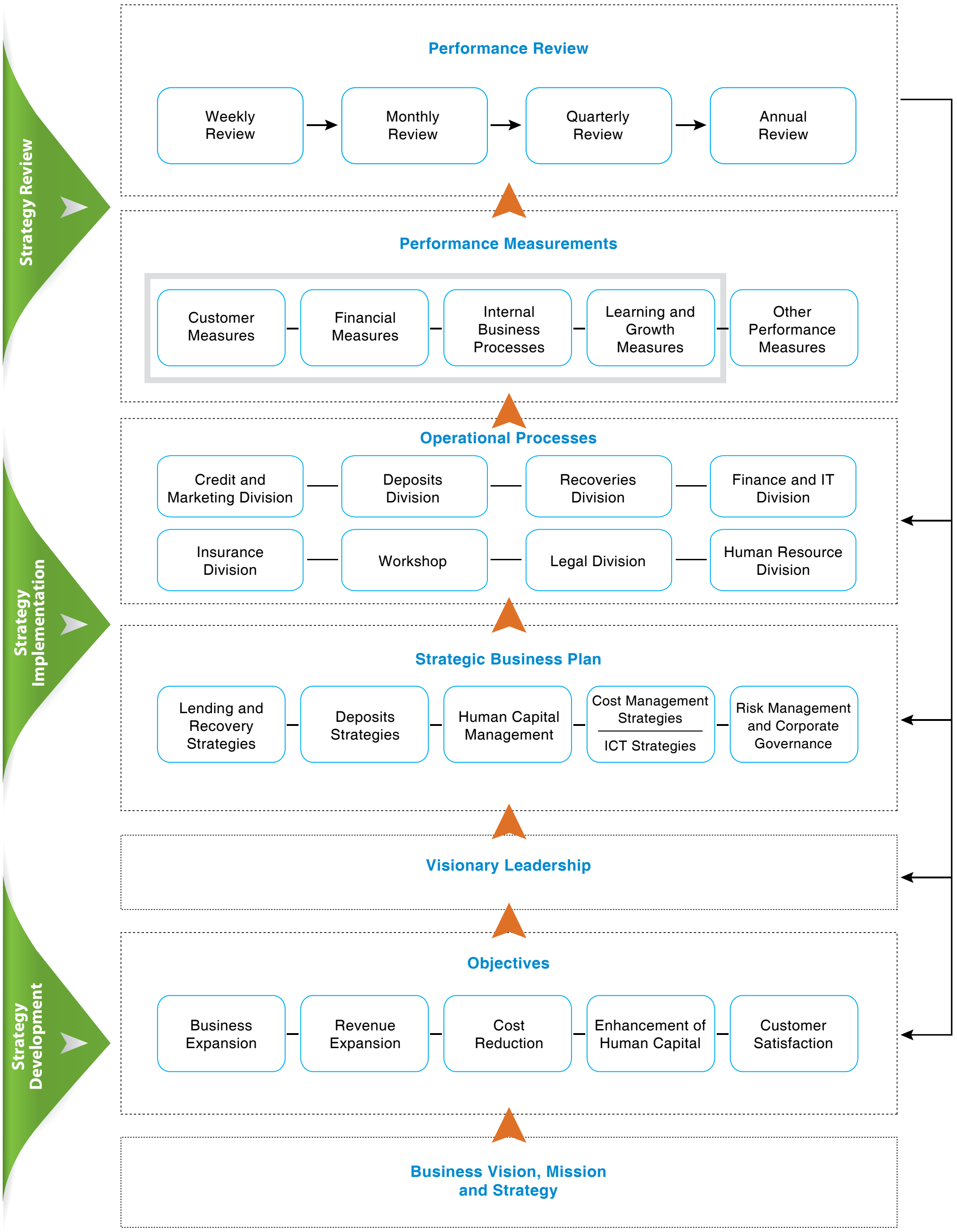
Note: Market growth rates are based on Central Banks Annual Report data.

MI's Product Life Cycle



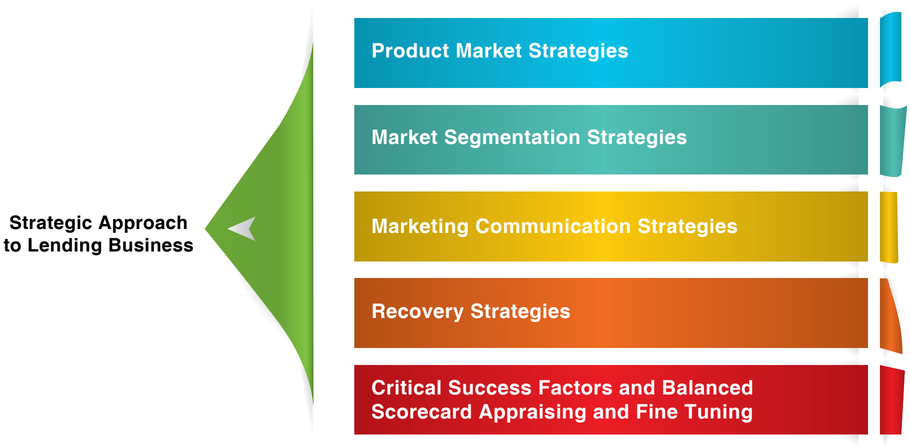
STRATEGY IN ACHIEVING SUCCESS

We uphold a comprehensive strategic structure that commences with the identification of objectives and then goes on to define strategy under the 'Strategy development' phase. The strategies so developed are then implemented through a well-defined operational process as illustrated in MI's strategic structure diagram. To complete the process, we lastly review strategy implementation and do so by adopting the Balanced Score Card approach, identifying Key Performance Indicators (KPIs) and its level of attainment within the given period. In keeping to this, periodic review secessions were conducted with the senior management of the Company to communicate status and to devise suitable rectification measures for any detected deviations.



Lending Business Strategy

For the overall success of the Company, MI's lending business remained high priority this period and as such a comprehensive strategic approach was taken for the purpose of building related business, aligning its related core elements including operational, sales and marketing processes in line with strategic expectations that encompassed planned gradual volume growth and its sustenance.



Product Market Strategies Pursued on Lending Business

	Existing Products	**New Products**
Existing Market	Corporate Term Loans Personal Loans Operating Lease	Vehicle Loans Property Mortgage
New Market	Lease Hire Purchases	Professional Loans Micro Finance

Until a few years before, MI's traditional financing products being the lease and hire purchase financing business was predominantly targeted towards a selective audience who were mainly located in the Western Province and in a smaller scale derived from a few outside branches. To capture market share and boost lending volumes from these traditional lines, a conscious effort was made in 2012/13 in pursuing market development strategies continuing from last year. In accordance with our strategic plan, we continued to strengthen our presence outside the Western Province as a means of securing new customers. In offering a superlative service, our branches were streamlined with necessary staffing, on line network capabilities and other operational support. All branch locations were carefully selected in strategic hubs of the country, allowing greater flexibility for branches to seek a wider spectrum of customers and to grow business.

Ampara Branch Opening

In parallel, to sustain anticipated average lending yields, strong emphasis was placed this period in promoting our term based lending which included personal loans and corporate term loans that in previous years were not promoted extensively. We adopted a strategy of market penetration for these higher yielding products which grew tremendously in terms of volume during this period. During this period, we launched micro financing and professional loans as new additions to our product range. A strategy of diversification was adopted specifically for these products, pursuing new markets as a means of speedily establishing the product commercially. However, our operating leases business was run moderately unlike earlier periods owing to the decline in demand seen in general in the industry for this form of services.

In terms of product development, recently introduced property mortgage loans and vehicle loans were promoted extensively than before to the existing markets. In particular, notable demand persisted for property mortgage loans which were mainly disbursed centrally from our head office. In handling these higher risk higher return lending's, credit documentation and processes were strengthened in consultation with our legal division to minimise any negative effects of potential defaults.

Market Segmentation Strategy

Moving away from the traditional approach of affording all products to all segments, a more streamlined approach was adopted for our lending business through a thorough understanding of potential segments. With the increasing diversity in the Sri Lankan financial markets arising from positive economic shifts, technology advancement, social changes, stiff sector competition and increased pressure to sustain volumes, market segmentation was used as an imperative strategic tool to support the Company in gaining further ground in our lending business.

Considering the product market strategies and market segmentation developed, an optimal product mix structure was proposed in the medium term as a means of sustaining optimal margins, diversifying business risk and improving volumes in the medium term.

Optimising Lending Product Mix

Product	Actual Volume 2012/13 %	Budgeted Volume 2012/13 %
Lease	18%	33%
Hire Purchase	37%	28%
Property Mortgage	11%	10%
Personal Loans	19%	10%
Vehicle loans	14%	10%
Micro Finance	1%	5%
Gold Loans	–	2%
Operating Leases	–	2%
Total	100%	100%

Marketing Communication Strategy

Brand Development remained a key element in MI's marketing strategy with the organisation moving ahead with its planned organisational growth. It was necessary that MI pursued Marketing communication strategies to create awareness among the community in a planned manner to support the relatively new network of branches. Both above the line and below the line activities were used extensively, however in keeping to a moderate advertising budget.

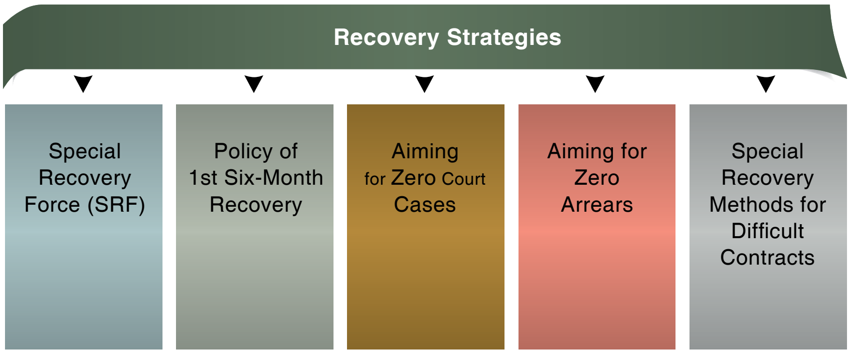
Marketing Communication Costs

	Actual 2012/13 Rs.	Budgeted 2012/13 Rs.
Above the line		
Targeted Mass Advertising - Radio/TV	1,055,220	500,000
Press Advertising	730,997	800,000
Below the Line		
Hoardings at Target Town Locations	1,557,071	2,000,000
Promotions across Branches Network	1,861,849	1,500,000
Leaflet Printing	1,016,900	200,000
Total Cost	6,222,037	5,000,000

During this period, spot commercials on TV/ radio channels, web advertising, hoardings and SMS promotions were utilised extensively for promotion apart from traditional newspaper advertising. To increase awareness about our lending product range, street storming promotions were initiated in recently established locations of Tissamaharama, Ampara, Gampaha and Kottawa.

Through MI's recently relaunched corporate web site **www.mi.com.lk** customers have access to information about the Company and its product offerings. Periodically, financials and other corporate information is uploaded to the Colombo Stock Exchange website to provide current information to potential investors and analysts.

Recovery Strategies

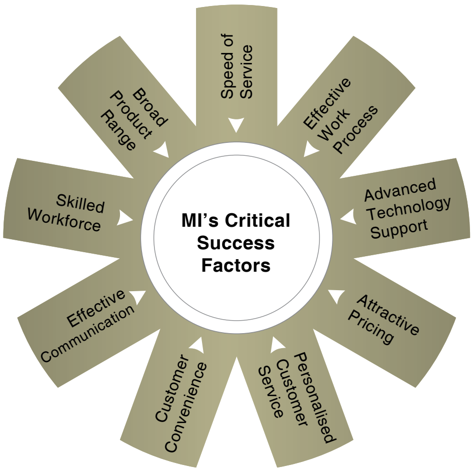


Management ensured that there was adequate jelling of credit operation right from the loan processing and disbursement stage to the final recovery of due installments. There was constant focus on borrower repayments and coordination between the Credit division and the Recoveries Division to maintain a quality portfolio. In keeping to the strategic plan, the Recovery Division was given the task of keeping the non-performing lending ratio below industry levels. It was noteworthy for the division to maintain the NPL ratio below budgeted NPL level of 3.5% in this period despite seeing deterioration in credit worthiness of borrowers yet again in the market.

A specialised team called the Special Recoveries Force was set-up this period, within the Recovery division to provide a 24 hours x 7 days a week effort for attainment of specific recovery targets. Unique to MI, special recovery techniques were adopted for difficult long overdue accounts. The Recoveries division adopted a policy of zero arrears and established a goal of attaining zero court cases by 2015 and complimented these expectations with a policy of no arrears within the first six months by identifying bad cases at the initial stages. A stringent follow up mechanism was adopted so that borrowers were kept informed of dues in a timely manner and a recovery process expedited efficiently for contracts in arrears beyond tolerance levels. Through an effective process, repossession of assets and legal proceedings were initiated for long overdue accounts through a specialised team of officers in coordination with the legal department.

Building on Our Critical Success Factors for Differentiation

The management stressed on the need to build on the critical success factors of the Company that made MI competitive all this while and set-forth parameters for its accomplishment. This helped the Company in differentiating its main businesses from competition through our core competencies, raising standards at various stages in our operations over the course of the year.

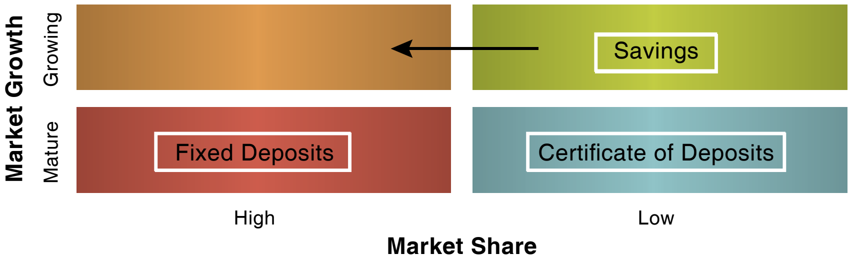


Appraising Lending Business Performance

In strategically aligning lending business activity to the vision and objectives of the organisation and reviewing its progress and then for fine-tuning of operations as necessary, the management appraised lending business performance based on the balanced score card technique. The specially designed lending balanced score card covers critical success factors identified in lending business together with operation specific KPI's, in keeping with the Company's objectives and overall balanced score card (Given later in this supplement).

Perspectives	Balanced Score Card - Lending business (KPI)	Measures	
		Actual 2012/13	**Budgeted 2012/13**
Financial Performance	Assets acquisition - Amount Financed	Rs. 10.15 billion	>Rs. 11 billion
	Net Interest Margin	6.1%	>8%
	Interest Income Growth	88%	>25%
	Recovery Ratio	96%	>75%
	1st 6 Months Ratio	83%	90%
	NPL Ratio	3.1%	<3.5%
	Market Share Retention	3.6%	>7.5%
Customer Value Proposition	MI Branding Campaigns	17	20
	Branch Expansion	3	5
	Speed and Reliability	80%	80%
Internal Business Process	Marketing Target Achievements	95%	100%
	Cross Selling (Deposits/Internal - Inventory)	Implemented in 2012/13	Initiate
	Inventory Management and Maximisation	Rs. 333 million	Inventory Rs. 100 million
	Promotion Organisation and Participation	38	40
	New Product Introduction	2	3
	Process Improvement	3	4
Learning and Growth	New Customer Introduction	61%	50%
	Credit Knowledge Improvement	11 training programmes	Number of training planned 10
	Product Knowledge and Utilisation	Initiated knowledge sharing sessions monthly	Initiate

Deposit Business Strategy



MI's Deposit business revolved around its fixed deposits that accounts for over 95% of total business while the balance comprised of savings deposits and certificates of deposit at a relatively smaller quantum compared to a larger market that exist in the financial services sector. MI's fixed deposits was the primary funding source growing at over 30% on average for the last two years despite being in a mature market where stiff competition prevailed. It was therefore necessary to devise suitable strategy at the commencement of the period to sustain reasonable growth in related business.

In parallel, the management took initiatives to revitalise other deposit products specially savings deposits as a means of boosting total deposits to support the funding needs arising from planned lending growth. MI's savings brands MI Kids and MI Max were relaunched to the market through the newly set up deposit marketing team taking note of the revitalisation of the economy and gradual rise in savings habit among individuals. However, in contrast certificate of deposits was not concentrated upon heavily owing to the nature of the product especially due to constraints placed on customer confidentiality. CD's remain in a non-growing market and hence was promoted as a value addition to the customer rather than as a direct product.

Deposits Business Highlights

2012/13

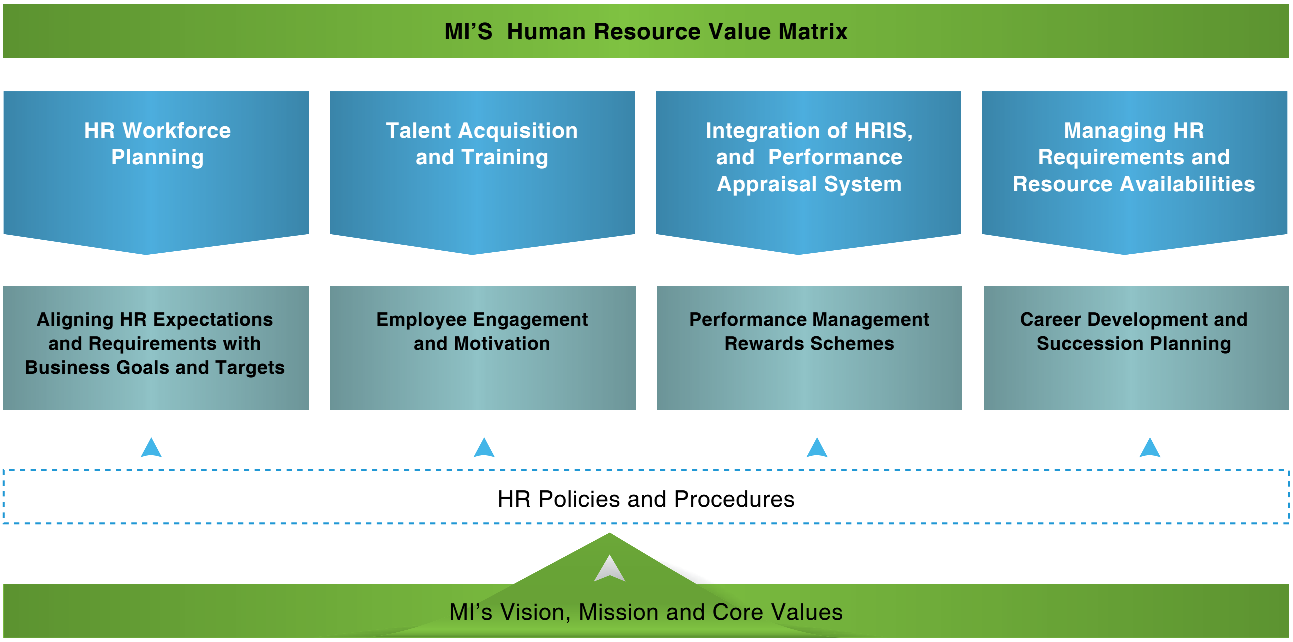
- Strong deposit mobilisation promotional campaigns e.g. Town storming, e-media
- Maintenance of an Attractive Interest Rate Structure
- Special customer promotions and schemes
- Setting-up a Separate Deposit Marketing Division
- Product relaunchings

  e.g. MI Savings, MI kids
- Radical Changes to Operational Procedures at Branches to Improve Speed and Convenience
- Branch Deposit Mobilisation Drives

Human Capital Management

Human capital is recognised as the most integral resource, the one that actually sets in motion corporate aspirations to manifest and materialise and to finally become actual reality. Hence, it is the HR policy of the Company to nurture the workforce to enhance their value for the betterment of the organisation as well as for their personal career development. We do this while staying committed to non-discriminatory practices and propagating equality in the workplace. We have been a caring employer and a motivator to all our employees, displaying employee-centric values right through our business journey. We have inculcated strong values among our staff specifically focusing on integrity while fostering an atmosphere that promotes team building.

MI's Human resource division centrally located at MI's head office is responsible for instilling best human resource policies and practices that reflects MIs core values, mission and vision creating a path for its attainment. This involves HR workforce planning, talent acquisition and training, having HR information systems, performance appraisal and reward mechanisms and managing HR requirements through career development and succession planning. How these core HR elements blend together within the organisation's strategic framework is illustrated below from the **"MI's Human resource value matrix"**.



The metric provides a transparent declaration of our people strategy, which is aligned to the overall MI business strategy. This is the blueprint for the generation of MI's HR Policies and procedures which support the navigation of HR activities throughout the employee life cycle. At the manpower planning stage, an initial analysis of the quantity and the quality requirements of the workforce are decided by the respective division in consultation with the MI's HR Division considering the vacancies at hand while making reference to future needs of business. Through an effective recruitment and selection process we have managed to attract best talent within the financial services sector. In keeping with MI's expansion plans, high level recruitments were made to the Credit and Marketing Divisions during this period as well.

Talent acquisition and training element is taken as a progressive measure, where employees are encouraged to sustain their passion and commitment in enhancing their total value towards the Company. It not only involves direct training on knowledge and skills development, it also provides positive reinforcement, mentoring, coaching and even moral support to the individual when required.

Employee appraisal and reward system is another key feature of MI's human resource management chain that is used across key divisions of the enterprise. We adopt formal appraisal measures to identify performance of employees annually. Employee salary increments and other benefits including career advancement aspects are derived from such annual appraisals. Already, we are in the process of extending the Human Resource Information System (HRIS) to incorporate assessment tools to extract individual balanced score card measures for appraising staff. Presently the HRIS provides master information of staff, career history and track record of performance for specific officers.

Integral to the management of Human Resource requirements, we placed emphasis on a career development and succession planning aspects of the workforce. We assessed the necessity for recruitment versus affording 'job enhancement' or 'job enrichment' to high-performers within the organisation who have the potential to climb the corporate ladder. Through a comprehensive HR approach, we have been able to sustain a workforce that possesses the right skills and experience to face complex demands of the industry. Simultaneously, we have been able to maintain the right morale and motivation among staff, finally confirmed through our exceptionally low staff turnover levels.

Additional information on MI's human resource management process is given under 'MI's labour practices' from pages 232 to 243 in the Sustainability Report. This covers extensive disclosure on employee engagement methods, staff selection and recruitment process, training and development, work environment, health and safety, performance appraisal, corporate vales and employee benefits.

Inculcating Seven Good Habits

Through the initiation of HR Division in 2013, from the heads of divisions to the lower levels of the hierarchy, employees have been encouraged to inculcate following seven good habits that are deemed necessary to be effective people.

Seven Habits of Highly Effective People

- Be Pro-active
- Begin with the end in mind
- Put first things first
- Think win-win
- Seek first to understand, then to be understood
- Synergise
- Sharpen the saw

The management felt that high performers of the Company had most of these habits under them but required rest of the MI team to inculcate the habits so that it would become useful for them in their daily working lives. In fact, as part of the performance appraisal process, management plans to incorporate the seven habits as part of the employee assessment process as another initiative from 2013 onwards.

Key Human Resource Initiatives

Aspect	Description	Key Initiatives Undertaken in FY 2012/13
Improving Human Resource Policies and Practices	Human resource practices were revisited and improved. These practices were applied across the organisation to improve security, discipline and punctuality aspects.	● Issuing a handbook that specifies internal code of conduct for employees ● Introduction of staff identity card system for all staff
Strengthening of Total Workforce	There was an immediate requirement to strengthen the workforce especially to cater to support the branch network.	A stream of recruitments was made to boost front line operations related to Credit and Marketing divisions similar to last year.
Development of Employee Knowledge and Skills	Demands placed due to competitiveness in business, regulatory changes taking place, employee productivity requirements etc. are important facets that need be addressed. Therefore, there is a growing need to train employees on an on going basis.	● Annual training and development activities that include- - Service excellence training for new recruits. - Initiated in-house training on topics such as anti-money laundering regulations, sales and marketing, recovery practices, cashiering and deposit mobilisation. - Sending staff for external training programmes.
Improve Operational Activities of Staff	To meet growing demands of the customers, it is essential that we maintain service excellence through an efficient operational process	● With the support of a consultant, key operational processes were reviewed for improvement. To speed workflow, specific activities related to deposit mobilisation were streamlined in co-ordination with IT Department. ● Strict application of procedure manuals developed. Updating staff on required practices to improve efficiency and speed.
Human Resource Information System (HRIS)	As our staff strength has now exceeded 400, it was necessary that we upgrade existing HR information system.	● A comprehensive HR information system was developed by HR Division with the support of IT Department. It is now possible to extract a stream of Management Information reports related to employees with minimum lead-times.
Reviewing Staff Benefits to Maintain Motivation	To maintain motivation and improve productivity, annually a review was carried out to assess adequacy of our employee reward system and to make necessary revisions.	● Annual increments were affected based on employee appraisals. ● Upward revision of medical insurance cover grade wise.
Safety of Employees	Attention on employee security especially on how we could prevent negative impacts from fire has been a continuous area of attention.	Based on the physical inspection carried out by the fire officers of the Colombo Fire Brigade last year, an ongoing review is being carried out which include plans for a fire drill for all MI staff.

FUTURE OUTLOOK - HR

Commitment to HR Excellence would remain pivotal in the succeeding financial year as it had been in the recent history of MI. As a mid-sized company, MI is delighted in its ability to regenerate motivation levels which are often battered by stringent market demands and organisational objectives. Highlighted by the low staff turnover rates, this fact provides significant impetus for individuals joining the Company.

With this in mind, MI plans to revise the organisational structure, to fast track career progression. The proposed structure will be a transparent declaration of the career path and its composite reward potential. Fused with the plans to gradually expedite career progression, measures are being devised to introduce a new performance review system and a market oriented career development plan for each staff member. Both these initiatives shall aim to support staff members in providing them with not only the required technical skills, but also the behavioural competencies, benchmarked according to industry standards. Corresponding to this aim, will be the requirement for an increased staff training and development budget to be identified to respective cost and profit centres. The preceding training and development methodology is to be restructured to cater to growing complexities in business and changes in regulations.

MI believes in understanding employee perception about its strategic HR focus. In this light, there will be a comprehensive HR survey done in the near future, through which management plans to obtain feedback on grey areas that urgently require their attention. This survey however, shall only be a part of our existing ‘open communication initiatives’. In addition, there will be initiatives to enhance two way communication among staff at all levels of the hierarchy. Aim is to setup ‘focused group discussions’ with greater attention on dissecting ‘content’. This would be a cornerstone for cross functional team building for the workforce, going to the future.

Cost Management

To sustain a healthy cost to income position, a number of initiatives were carried out during the period. The aim was to analyse existing cost elements and to devise appropriate measures to counter wastage of resources and rising overhead cost structure.

Strategies on Cost Control 2013

- Established a Cost Control Committee to analyse and recommend cost reduction initiatives. The Committee reviewed recurring cost items and proposed measures for controlling of such cost.
- Held a Cost Control Competition among staff to identify areas of duplication, wastage and costs that could be reduced at departmental level. This also inculcated the need for cost saving among staff especially to cut waste. Over 40 proposals were received and top three winners were awarded gift vouchers at the annual get-together held in December 2012.
- Provision of department-wise cost information on a frequent basis and review of key cost elements at management committee meetings. This enabled management to devise measures to eliminate waste and to cut down on large cost items.

Area of Focus	Key Cost Reduction Initiatives 2012/13
Colour Printer Cartridge Usage	• Replaced printers to use black and white cartridges at majority of locations as opposed to colour printing.
Motor Vehicle Fleet	• Restructured the motor vehicle fleet of MI reducing total number of vehicles keeping only what is required.
Electricity Usage	• Completed setting up either LED or CFL bulbs at all key locations of MI operations. • Strict policy to turn off air conditioning after office hours unless specifically requested.
Water Usage	• Use of well water for specific operations of the Company that do not require pipe borne water.
Fuel Usage	• Periodic review by heads of divisions on their staff fuel usage. • Prompt service and maintenance of fleet vehicles to maintain fuel efficiency.
Stationary Usage	• Inculcated the habit of recycling among divisions and increased use of paperless processes as opposed to dealing in hard copy form.
Telephone Usage	• Renegotiated terms with mobile service provider to obtain their services in larger scale at optimal pricing. • Introduced land line telephone system that is cost free within the head-office and branch network. • Provision of e-fax solutions on mobile as opposed to high cost standard fax machines.

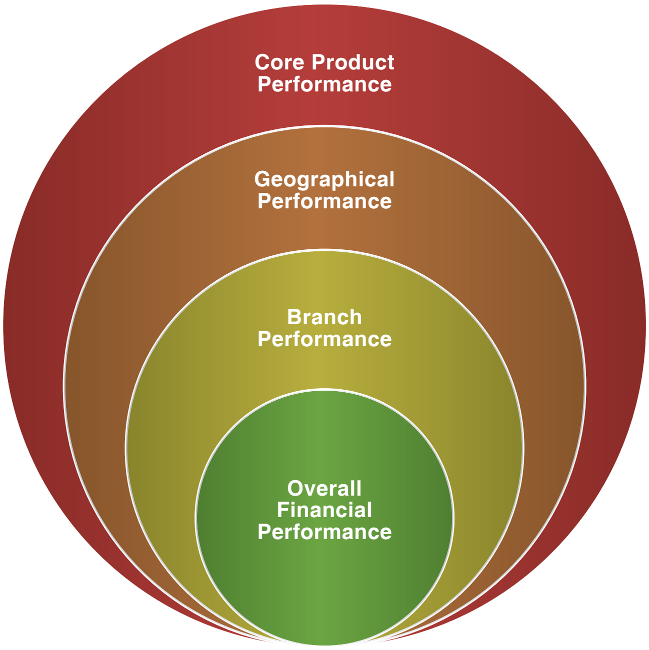
Future Outlook - Costs

With the ongoing branch expansion, overhead cost is bound to rise, further fuelled by the gradual increase in inflation that is moving towards the two digit levels again. Cost control would remain a key area of focus especially considering the competitiveness in the sector for pricing and with it the thinning of sector margins than before. MI would continue its policy of setting of branches with minimal start-up cost as opposed to investing heavily in capital expenditure.

There would be strong monitoring of overhead costs at departmental level with periodic assessment of costs at the Management Committee meetings to see how rising costs could be better managed. In spite of plans to promote business in key locations, advertising and other promotional costs would be tightly monitored in keeping with budgets. Cost reduction would play a major role in assessment of branch and departmental performance in the next few years to improve overall profitability. We will strive towards maintaining a healthy cost to income position at branch level so that it will improve overall cost to income position and raise profitability levels. We plan to embrace cost effective eco solutions as we move along to uphold our support to environment and conservation of energy. Use of solar power and adopting eco designs for our branch network are some of the initiatives sought after, moving ahead.

Financial Review

We have covered this year's financial review under the following broad areas of performance to provide a more comprehensive review.



MI's Financial Performance in 2012/13

The financial review given in ensuing paragraphs outlines MI's product-wise, geographical, branch-wise and overall financial position and results of operations for the financial year ended 31 March 2013 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 and outlook. This part of the report should be read in conjunction with the SLFRS/LKAS based financial statements of the Company that appear in the financial reports section of the Annual Report.

Unless otherwise stated, information disclosed in the financial review section hereon, which includes commentary, tables and graphs indicating actual current year and comparative information (Financial Years 2012/13 and 2011/12 for the Income Statement/Statement of Comprehensive Income and financial years 2012/13, 2011/12 and 2010/11 for Statement of Financial Position) are SLFRS/LKAS based. Comparative information given for years prior to these years specified have been based on previous method of accounting based on SLAS (Sri Lanka Accounting Standards). Graphs have been appropriately shaded to signify this differentiation when providing both actuals and comparatives.

Transition Process from Sri Lanka Accounting Standards (SLAS) to Sri Lanka Financial Reporting Standards (SLFRS)/Lanka Accounting Standards (LKAS)

Diagnostic Stage

- Impairment for Non-collectability of financial assets
- Rental receivable on lease assets, hire purchase and operating leases
- Dealing securities
- Investment securities
- Investments in Government Securities
- Deposits for customers
- Loans and advances for customers
- Borrowings
- Non-interest bearing refundable deposits
- Placements in other banks
- Staff loans at below market level

Design, Planning and Solution Development

- Initial measurement of financial assets and liabilities
- Classification of financial assets
- Classification and subsequent measurement of financial liabilities
- Subsequent measurements of financial assets repurchase agreements/ investments in government Securities/investments in quoted and unquoted ordinary shares
- Impairment testing process

Implementation

- Classification of financial assets of MI as follows:
  - Loans and receivables
  - Available for sale financial assets.
- Classification of financial liabilities of MI as follows:
  - Amortised cost
- Impairment testing conducted as follows:
  - Individual impairment methodology
  - Collective impairment methodology
- Recognition of staff loans at fair value basis

Post Implementation

- Re-engineering of MI's IT system to match desired IFRS requirements
- Ongoing training and support for finance, credit and other impacted divisions
- Revising specific internal MIS formats to embrace IFRS changes
- Review and acceptance by External Auditors
- Continuous reviewing and updating of ongoing changes to IFRS and impact of those changes to MI

CORE PRODUCT PERFORMANCE

Lending Product Performance

MI's lending business remained satisfactory recording overall portfolio growth in this period driven by the strong operational backbone, aided by MI's network of branches. Total new lending carried out in FY 2012/13 indicated a healthy rise this period, with contrasting movements in types of lending as reflected in the composition table given below:

New Lendings Carried Out

	New Facilities Secured in 2012/13 Rs. million	New Facilities Secured in 2011/12 Rs. million	Growth/ (Decline) %
Hire Purchase Business	3,805	3,561	7
Lease Financing Business	1,887	2,953	(36)
Term and Other Lending Business*	4,459	2,358	89
Total	10,151	8,872	14

** This includes vehicle loans, personal loans, property mortgage loans, pledge loans, microfinance, professional loans and other short and long-term loans.*

A total of Rs. 10,151 million was secured as new lending facilities during the year, indicating a noteworthy rise of Rs. 1,279 million or a 14% annual growth, when compared to a rise of 75% recorded in 2012. In sustaining these volumes, we remained anchored to our core lending business of hire purchase and lease financing while simultaneously improvising on yielding higher volumes from our non-traditional lines. As new facilities from our hire purchase business, we secured Rs. 3,805 million, up by 7% from 2012 while new lendings on lease financing business showed a decline falling by 36% in contrast to a growth of 59% recorded last year. The significant pick up however came from our term lending that showed substantial growth year on year. The term and other lending showed a commendable rise of 89% in this period compared to 913% growth witnessed in 2012. The main reasons for term lending business to pick up was the rise in demand for vehicle loans, personal loans and property mortgage related loans stemming from improved economic conditions.

Finance Leases

The demand for finance lease business remained somewhat contracted owing to specific setbacks especially the sudden rise in import duty structures coupled with the depreciation of the rupee against other currencies that saw a steep rise in brand-new vehicles cost. Despite these setbacks, we experienced reasonable demand for lease financing especially by borrowers to own lower and mid-price ranged vehicles. At the same time, the ongoing national development including various infrastructural projects undertaken has raised demand for construction-related vehicles and machinery.

Under these circumstances, through the support of the budding branch network MI was able to sustain its finance lease business at a reasonable pace. As such MI's total finance lease receivable portfolio outstanding which comprise both individuals and corporate customers showed a moderate growth of 5% rising to Rs. 4,072 million compared to Rs. 3,888 million recorded last financial year.

Indicator	2012/13 Rs. million	2011/12 Rs. million	% Change	Industry Lease Growth % in 2012	Budgeted 2012/13 Rs. million
Lease Outstanding	4,072	3,888	5	29.37	5,419
Interest Income on Leases	842	531	59	Not available	804

Number of Lease Customers 2012/13	Number of Lease Customers 2011/12	Change %
5,356	4,412	21

Actual Lease NPL % 2012/13	Actual Lease NPL % 2011/12	Budgeted Lease NPL % 2012/13
3.24	1.99	3.62

NPL is SLAS based.

Outlook - Leases

Going forward, lease business will remain highly competitive as seen in recent times. The rise in interest rates by banks that have cheaper sources of funding backed by well-established branch coverage is bound to be a stiff challenge for the LFC sector. The emerging mergers and consolidations in the leasing industry is bound to raise leasing to new heights and heighten competition further despite the slowing down of demand in the leasing market. In this competitive setting, it is imperative that the leasing industry will have no option but to come up with fresh strategies to expand market share and possibly introduce innovative leasing solutions than what has been practiced thus far.

Analysis of Lease Portfolio with its Non-Performing Status

- *Lease receivables - 3 years SLFRS/LKAS based and other years SLAS based.*
- *NPL statistics - SLAS based.*

In this backdrop, MI will continue to pursue its drive in raising its strongly held leasing business aided by the growing branch network considering the relentless opportunities that are emerging in all parts of the nation, which is bound to bring renewed impetus on the leasing industry. We plan to couple our expanding reach with our profound expertise in vehicle sales in attracting a fresh stream of customers hoping to write more leases from outside the Western Province than before. In moving forward, our growth will be dependent on MI inventory sales which houses brand-new vehicles such as three wheelers, lorries and small cars which will expand further and will be promoted through the branch network coupled with our leasing options.

Hire Purchase Financing

As the importation of brand-new vehicles remained costlier than in the past, a notable shift in customer preferences was observed where customers compromised and preferred to own registered vehicles used over twelve months to keep total financing value at manageable levels. Furthermore, the influx of brand-new vehicles in the past few years sustained demand for the second hand vehicle market since customers preferred to shift to better models and brands with time. In addition, as hire purchase financing business did not involve value added tax unlike the leasing business, customers enjoyed extra flexibility in terms of pricing.

Out of MI's total loans and advances outstanding, hire purchase receivables remained yet again the largest lending component amounting to Rs. 5,754 million as at 31 March 2013, growing satisfactorily in absolute terms by Rs. 1,379 million or 32% compared to 23% growth recorded last year.

Indicator	2012/13 Rs. million	2011/12 Rs. million	% Change	Industry Hire Purchase Growth % in 2012	Budgeted 2012/13 Rs. million
Hire Purchase Outstanding	5,754	4,375	32	3.88	9,393
Interest Income on Hire Purchases	1,446	871	66	Not available	1,523

Number of Hire Purchase Customers 2012/13	Number of Hire Purchase Customers 2011/12	Change %
7,385	6,451	14

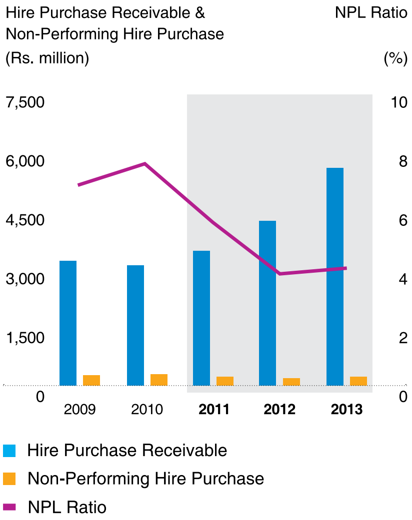
Actual Hire Purchase NPL % 2012/13	Actual Hire Purchase NPL % 2011/12	Budgeted Hire Purchase' NPL % 2012/13
4.13	3.92	3.78

NPL is SLAS based.

Outlook - Hire Purchase

Going to the future, the main boost to the hire purchase financing business will be the ongoing economic resurgence taking place that is bound to keep demand for related business reasonably high at a constant level despite the increase in number of financial institutions doing similar business. The demand for hire purchases will mainly come from the motor vehicle market like earlier but will remain at reasonable levels mainly supported by the growing demand for machinery and construction related vehicles considering the revitalisation of most industries and the infrastructural development activities taking place such as the development of highways and reconstruction of roads.

Analysis of Hire Purchase Portfolio with its Non-Performing Status



- *Hire purchase receivables - 3 years SLFRS/LKAS based and other years SLAS based.*
- *NPL Statistics - SLAS Based.*

For MI, its hire purchase business will be the core area of concentration going to the future considering the potential of the product that remains yet and MI's growing capability of accommodating larger volumes aided by a better geared branch network than in the past. Management's further plans on establishing branches outside the Western Province will provide impetus for the Company to capture new hire purchase customers in those areas where some of the development activities are now taking place. We hope to provide a more tailored approach to hire purchase financing and will pursue improvised budget repayments through our structured repayment plans.

Term Loans

In keeping to our strategy, we concentrated on our drive to diversify the lending business and focused more on higher yield bearing products, mainly term based lending. By improving on our lending mix and doing more volumes in term lendings, we were able to maintain anticipated weighted average yields well above 25% this period from total new lendings. Similar to previous year, we saw substantial growth in this line of business which mainly included personal loans, corporate loans, professional loans and pledge loan facilities. Accordingly, MI's term loan outstanding's increased to Rs. 2,868 million as at 31 March 2013 growing commendably by 78% year on year.

Indicator	2012/13 Rs. million	2011/12 Rs. million	% Change	Budgeted 2012/13 Rs. million
Term Loans Outstanding*	2,868	1,611	78	2,290
Interest Income on Term Loans	418	169	147	307

** For reporting purpose, this includes personal loans/professional loans/pledge loan facilities and excludes micro finance and property mortgage loans as it is reported separately.*

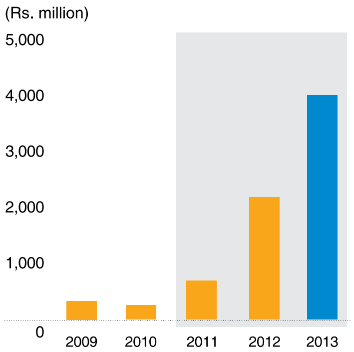
Number of Term Loan Customers 2012/13	Number of Term Loan Customers 2011/12	Change %	New Term Loan Facilities 2012/13 Rs. million	New Term Loan Facilities 2011/12 Rs. million	Change %
1,526	721	112	3,391	1,715	98

Considering the nature of term lending and higher credit risk associated, Management established stringent credit control measures especially prior to disbursement to ensure asset quality and continued to monitor related facilities over the year. As such, term loan non-performing component remained at 1.69%, well within budgeted levels.

Actual Term Loans NPL % 2012/13	Actual Term Loans NPL % 2011/12	Budgeted Term Loans NPL % 2012/13
1.69	3.19	3.09

NPL is SLAS based.

Other Loans and Receivables



- *Shaded 3 years SLFRS/LKAS based and other years SLAS based.*
- *Graph includes term loans and other term based lending.*

Outlook - Term Loans

In terms of sustaining higher lending volumes, term based lending will play a major role in the future for the sector compared to a decade ago. Demand for this type of lending will remain at a higher level going to the future considering the speed, flexibility and convenience afforded by the LFC sector against other financial institutions. Term based lending will be a key component for MI's lending mix to sustain overall yields at healthy levels considering that we now have the right backbone to seek fresh business from even remote areas of the country. Our internal processes will be smoothened out further to cater to this growing demand and anticipation of a superlative service especially in enhancing speed of processing in relation to these types of facilities. We will be in an excellent position to boost personal types of lending including professional loans since we are present in most of the key provinces. MI going forward has the capability and manpower to tap into such local communities that are in need of financial assistance for their personal and entrepreneurial needs.

Property Mortgage Loans

MI's property mortgage lending which commenced only a few years back showed tremendous progress and in fact performed well beyond original estimates. The total outstanding property mortgage lending as at 31 March 2013 stood at Rs. 1,193 million showing a rise of 93% from last year. In co-ordination with MI's Legal Division, internal documentation of the Company for this type of lending was strengthened owing to the risks associated with property backed lending. The Company strictly resorted to the obtaining of valuation reports both external as well as internal as deemed necessary prior to disbursement and conducted site visits as appropriate. As property mortgage loans attract higher yield rates for the Company, we were able to blend this form of high return high risk lending with low risk low return lending to maintaining overall anticipated lending yields at optimal levels whilst keeping credit risk low within MI's risk appetite.

Indicator	2012/13 Rs. million	2011/12 Rs. million	% Change	Budgeted 2012/13 Rs. million
Property Mortgage Outstanding	1,193	618	93	952
Interest Income from Property Mortgages	255	18	1,322	204

Number of Property Mortgage Customers 2012/13	Number of Property Mortgage Customers 2011/12	Change %	New Property Mortgage Facilities 2012/13 Rs. million	New Property Mortgage Facilities 2011/12 Rs. million	Change %
200	51	292	1,068	644	66

Since we practiced strict credit control policy on property mortgage loans by carrying out additional credit verifications and obtaining documents to confirm quality of security, we were able to keep default rates and NPL impact at manageable levels.

Actual Property Mortgage NPL % 2012/13	Actual Property Mortgage NPL % 2011/12	Budgeted Property Mortgage NPL % 2012/13
0.94	–	1.73

NPL is SLAS based.

Outlook - Property Mortgage

We will see more property mortgage loan facilities being executed by the LFC sector in the future considering its demand and foreseeing customer preference for speedy disbursement. In raising absolute levels in property backed lending, MI would continue to target corporate business more and will also pursue individual requirements on a case by case basis. Plans are underway to streamline and simplify documentation processing under back office functions including legal support to fast track the disbursement process. The objective is to complete the full process at least two days prior to current lead times, moving ahead. In terms of credit evaluation, we plan to maintain a consistent approach to all future business of this nature especially on the comprehensive review and report procedures that we uphold now.

Micro Financing

We commenced micro financing recently and managed to make reasonable ground by the conclusion of this financial period. Total outstanding in micro finance lending stood at Rs. 10 million for this period mainly revolving around the efforts of specific branches rather than from the total network. In Noth-East, strong demand remained for this form of lending especially considering the agriculture and farming taking place and the rising necessity for micro financing related borrowing.

Indicator	2012/13 Rs. million	2011/12 Rs. million	% Change	Budgeted 2012/13 Rs. million
Micro Financing Outstanding	10.0	–	–	8.0
Interest Income on Micro Financing	0.9	–	–	0.7

Number of Micro Financing Customers 2012/13	Number of Micro Financing Customers 2011/12	Change %	New Micro Financing Facilities 2012/13 Rs. million	New Micro Financing Facilities 2011/12 Rs. million	Change %
236	–	–	12	–	–

Actual Micro Financing NPL % 2012/13	Actual Micro Financing NPL % 2011/12	Budgeted Micro Financing NPL % 2012/13
–	–	1.73

NPL is SLAS based.

Outlook - Micro Financing

Huge potential would remain for micro finance-based lending owing to the current economic revitalisation taking place especially in suburbs and the increasing focus yet again on country's agriculture and farming-based commerce. Meeting micro financing needs of individuals will be of paramount importance in the years to come because of the financial assistance it provides socially to uplift livelihoods of people living even in far out places. Our aim is to gradually build this form of business from targeted locations. We hope to strengthen cadre and provide further resources for areas that remain lucrative than others especially for locations were micro-based business activity is taking place.

Operating Leases

Performance of our operating lease business remained contracted similar to previous year with total operating lease outstanding growing by 12% from Rs. 8 million to Rs. 9 million as at the Balance Sheet date. Management consciously carried out this form of business selectively considering the contracted market demand that prevailed in the past few years unlike earlier.

Indicator	2012/13 Rs. million	2011/12 Rs. million	% Change	Budgeted 2012/13 Rs. million
Operating Leases Outstanding	9	8	12	9
Interest Income from Operating Leases	14	19	(26)	14

Number of Operating Lease Customers 2012/13	Number of Operating Lease Customers 2011/12	Change %	New Operating Lease Facilities 2012/13 Rs. million	New Operating Lease Facilities 2011/12 Rs. million	Change %
4	9	(55)	–	–	–

Actual Operating Lease NPL % 2012/13	Actual Operating Lease NPL % 2011/12	Budgeted Operating Lease NPL % 2012/13
–	–	3.5

NPL is SLAS based.

Outlook - Operating Leases

Despite there being demand for operating leases, we would continue to observe relative decline in related demand and therefore the sector’s preference in doing this form of business would continue to remain subdued in the foreseeable future. The lowered interest shown in the past is certain to pass on to the future considering the low level of demand for operating leases. However, we will pursue this business depending on the future changes in demand taking cognisance of the economic boom that is happening around which may stimulate this form of business yet again.

DEPOSIT PRODUCT PERFORMANCE

In keeping with MI's strategy of concentrating on core business and seeking funding at optimal prices for MI's lending business, the Company managed to secure reasonable level of deposits in spite of the competitiveness seen in the market.

New Deposits Canvassed and Deposit Refunds

	New Deposits Secured in 2013 Rs. million	New Deposits Secured in 2012 Rs. million	Growth in New Deposits %	Deposit Refunds in 2013 Rs. million	Deposit Refunds in 2012 Rs. million	Change % on Deposit Refunds
Fixed Deposits	4,959	2,988	66	3,272	1,211	170
Savings Deposits	76	60	27	81	58	40
Certificates of Deposit	11	8	38	21	24	(13)
Total	5,046	3,056	65	3,374	1,293	161

New deposits canvassed grew at a healthy pace primarily boosted by MI's fixed deposit business which reflected a 66% growth in new deposits year on year. MI's savings business remained subdued with a 27% rise in new savings compared to previous year while new CD growth was at 38%.

Total deposit refunds rose in 2013 and were at Rs. 3,374 million compared to refunds totalling to Rs. 1,293 million in 2012. There was severe competition on pricing within the LFC sector and emerging other investment avenues making related business highly competitive.

Fixed Deposits

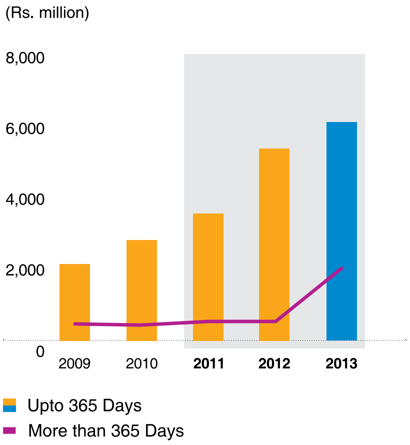
MI's fixed deposit business remained robust growing healthily surpassing Rs. 8 billion mark for the first time, finally settling down at Rs. 8,294 million by the end of 2013 financial period. This reflected a sound growth of 38% recorded amidst rising competition year on year and indicated MI's commitment in boosting this line of business in keeping with its business strategy. The strategy adopted was two phased, targeting heavily on mobilising new deposit business while cementing the existing base by affording attractive returns. We concentrated on enhancing the level of service given from all service points. With the support of MI's deposit division, training was initiated for staff attached to both head office and branches on deposit operational areas to improve service standards.

	2012/13	2011/12	Growth %
Fixed Deposits Outstanding (Rs. million)	8,294	5,996	38
Number of Fixed Depositors (in Number)	3,781	3,184	19

The steep rise in market interest rates, compelled MI to raise its fixed deposit interest rates to peak levels, remaining very competitive right throughout the year. Frequent upward rate revisions were carried out during the period under review through a close watch on market rates to ensure there is no erosion of business. We used our branch network effectively to promote our fixed deposit business extensively, carrying out various promotional activities, specifically targeting newly established localities in addition to general awareness programmes initiated from head office mainly carried out via media advertising. We continued to offer special rates for customers depending on the quantum they placed and period of deposit while continuing to afford senior citizens higher rates.

We tightened our branch deposit operation and marketing activity by setting up a dedicated deposit unit at head office. In keeping with this expectation, we set up a special deposit marketing team to promote deposits products and to assist branches to promote and recoup fresh deposit business going beyond the Western Province.

Fixed Deposits Maturity



- *Shaded 3 years SLFRS/LKAS based and other years SLAS based.*

Outlook - Fixed Deposits

Based on overall economic predictions, public savings is bound to improve further in the medium term aided by the economic growth and increased per capita income. In this context, there would be ample demand for term based deposits considering it is placed in stable and established institutions. MI's fixed deposit business will be of central focus for MI going forward, considering its strategic importance to the Company. The aim in the next few years is to utilise the current network of branches to mobilise higher level of fixed deposits guided by the experienced head office deposit marketing team. Attention would be given on increasing awareness amongst community around branches, to convey MI's financial strength and stability and winning long-term trust of customers attached to newly set up locations as well. In the next few years we hope to build on fresh target segments as means of diversifying our deposit base especially targeting youth to have a blend in terms of age of depositors. Emphasis would be placed in canvassing deposits from middle income earners and individuals who are below 35 years of age and targeting deposits of minors to broad-base the deposit portfolio.

Savings Deposits

MI's savings deposits was the other main deposit product promoted during the year but remained yet again subdued showing a decline of 17%, and falling to an absolute value of Rs. 15 million at the close of the year compared to Rs. 18 million recorded in 2012. MI's savings brands MI Max and MI Kids continued to be the main sub products under this deposit type which was extensively promoted at head office and at branch level considering that this form of product is advantageous for the Company in maintaining optimal cost of funding. However, despite the aggressiveness, it was challenging to raise volumes in this form of business considering the competitiveness and level of convenience afforded by Banks.

	2012/13	2011/12	Growth
Savings Deposits Outstanding (Rs. million)	15	18	(17%)
Number of Savings Depositors (in Number)	303	314	(4%)

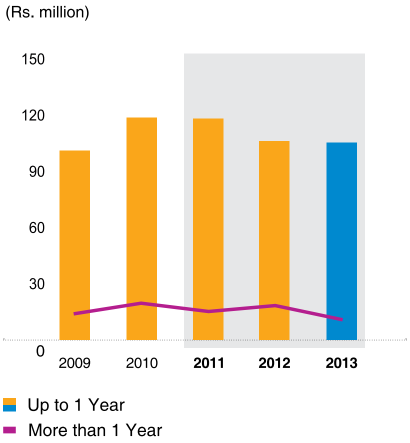
Outlook of Savings Deposits

Savings deposit business would remain strategically important to MI going forward considering the enormous potential the product possess and also considering the fact that we now have a strong branch network in place compared to a few years before. In this context, we hope to pursue the possibility of providing additional convenience to customers by seeking ATM services and coupling this facility with our main savings sub brands as a means of boosting this product in the near future.

Certificates of Deposit

Total Certificates of Deposit (CD's) outstanding declined by 6% and stood at Rs. 116 million as at end March 2013 compared to Rs. 124 million registered last year. This marginal decline in the CD base was reflective of the fact that the management is not so keen in promoting this line of business owing to the noticeable decline in demand experienced unlike earlier. This was primarily because of the prevailing laws on Know Your Customer (KYC) that prevent investments that have no proper identity.

Certificate of Deposits Maturity



- *Shaded 3 years SLFRS/LKAS based and other years SLAS based.*

Outlook - Certificates of Deposit

Management does not foresee a significant change in promoting CD business considering the low level of demand for this business and therefore would pursue CD's as an ancillary product to our main fixed deposit business. We hope to run this business in parallel to our main deposit business to sustain overall demand for our products and meet our customer expectations to the fullest.

SUPPORT SERVICES

Customer Insurance Operation

MI's insurance department caters to insurance needs of MI customers as an ancillary service stemming from its main business of providing financing for vehicle ownership. MI customers are afforded this service as a means of convenience, fulfilling their insurance requirements in-house rather than them needing to go directly to an insurance company. Through a comprehensive service, the division was able to process gross written premiums totaling Rs. 424 million (Rs. 362 million in 2012) indicating a rise of 17% from last year. The insurance division was also successful in improving previous year's performance in terms of generating commission income which amounted to Rs. 46 million (Rs. 32 million in 2012) up by Rs. 14 million or a 44% rise. At the same time, the department maintained a noteworthy track record recovering claims totalling to Rs. 52 million (Rs. 47 million for 2012) for this financial year.

Vehicle Workshop Operation

To complement the financing business, MI has established a fully-fledged workshop division at Kohuwela that undertake vehicle servicing and repairs. The division provides services to both finance related customers who end up owning a vehicle and also to outside parties. The division was able to generate revenue totaling Rs. 74 million this period as against Rs. 66 million done in 2012. Nevertheless, workshop division operates mainly as a support centre rather than as a fully-fledged business unit.

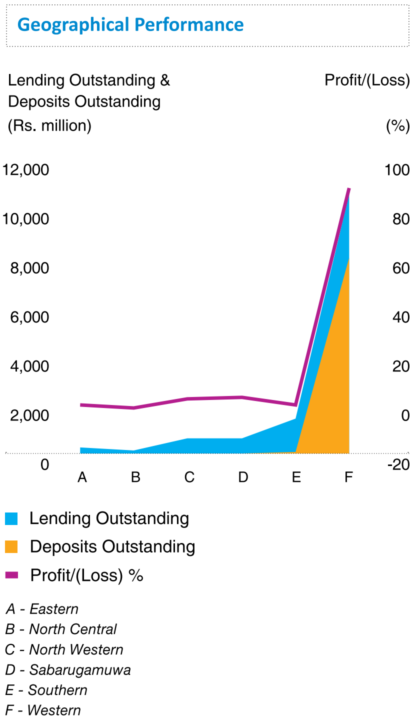
Geographical Performance

Province	Lending Outstanding Rs. '000	Non-Performing Lending Rs. '000	Deposit Outstanding Rs. '000	Profit/(Loss) Rs. '000
Eastern	265,120	–	1,906	1,584
North Central	142,180	–	1,448	(2,795)
North Western	646,419	3,413	18,392	21,288
Sabarugamuwa	639,475	3,850	7,004	24,261
Southern	1,497,219	4,451	86,697	2,501
Western	10,972,195	434,706	8,309,273	583,952

** Based on business location.*

*** NPL is SLAS based.*

MI's dependence in the Western Province in sustaining growth in core business in the past has gradually shifted in recent years with the establishment of more branches in regions outside the Western Province. It was heartening to observe that 22% of lending outstanding was derived from business generated outside the Western Province.



Branch-Wise Performance

Branch	Lending Outstanding Rs. '000	Non-Performing Lending* Rs. '000	Deposit Outstanding Rs. '000	Cadre (In Number)	Overheads Rs. '000	Cost Efficiency (Overheads/ Cadre) Rs. '000	Profit/(Loss) Rs. '000
Ampara	38,106	–	1,606	5	2,927	585	(2,824)
Anuradhapura	142,180	–	1,448	5	7,270	1,454	(2,795)
Balangoda	496,031	3,850	6,724	8	7,545	943	25,248
Benthota	579,624	4,061	23,376	8	6,801	850	12,830
Chilaw	191,100	1,859	14,152	6	5,732	955	2,616
Embilipitiya	143,444	–	280	6	6,177	1,030	(987)
Galle	353,211	–	33,151	10	9,358	936	2,042
Gampaha	136,548	–	17,798	3	3,946	1,315	2,031
Horana	158,274	–	2,590	8	7,373	922	8,171
Kadawatha	1,015,230	18,015	50,477	14	15,354	1,097	17,292
Kohuwala	1,357,320	4,671	162,723	12	19,785	1,649	19,095
Kurunagala	455,319	1,554	4,240	7	10,489	1,498	18,672
Maharagama	390,573	–	34,756	7	6,608	944	3,454
Matara	455,405	390	29,473	10	11,517	1,152	(10,743)
Negombo	1,080,944	19,030	219,424	12	21,852	1,821	37,084
Tissamaharama	108,979	–	697	6	5,851	975	(1,628)
Tricomalee	227,014	–	300	6	7,356	1,226	4,408

** NPL is SLAS based.*

Outstanding performance in terms of business growth and profitability were displayed by our long standing branches situated in Kohuwela, Negombo, Balangoda and Mahara - Kadawatha, while our relatively newer locations such as branches located in Maharagama, Galle and Matara displayed immense potential in terms of core business volumes.

Dedicated senior credit managers oversee their cluster of branches, setting weekly, monthly, quarterly and annual targets to the branch frontline staff to attain minimum lending volumes and deposit targets.

A number of recruitments were carried out to strengthen branch operations to speed processing time. In terms of deposit mobilisation, most of the newly established branches carried out promotional campaigns in the vicinity of their branches to raise awareness levels. Most of the newly established branches were able to meet their anticipated lending targets and were able to post reasonable level of profits. The seasoned branches performed well in terms of profitability similar to last year, boosted by the robust turnover recorded by each of them.

Overall Financial Performance

Financial year 2012/13 was a commendable year in terms of financial performance as MI was able to post robust profits while excelling financially in other areas of business. The growth witnessed in both pre-tax profit and post-tax profits year on year was a culmination of a total effort made by all the staff to meet organisational objective of surpassing the Rs. 500 million mark in terms of post-tax profits.

The Company in sustaining sound profits had to overcome numerous challenges posed during the year especially countering the negative impact experienced from rising interest rates coupled with the slow-down experienced in the vehicle market on account of high import duties imposed in the past. However, MI capitalised on its strengthened branch network to gain ground in its core business of lending and deposit taking, maintaining anticipated margins throughout the year.

As reflected below from MI's overall balance score card prepared as at 31st March 2013, the Company was able to excel in most of the perspectives as planned.

Key Performance Measurements of MI

Measurement	Review		Budgeted	Targeted
	2011/12	2012/13	2012/13	2013/14
Financial Perspective				
Revenue Growth				
● Interest Income Growth (%)	9	88	44	>50
● Fee and Other Income Growth (%)	2	(62)	(3)	>(7.5)
● Total Revenue Growth (%)	7	41	45	>50
Operating Cost to Income Ratio (%)	47	51	50	<45
Operating Income (Rs. million)	709	711	470	>1,003
Return on Average Asset Ratio (%)	3.89	3.25	2.5	>2.5
Profit After Taxes (Rs. million)	610	631	530	>800
Value Added (Rs. million)	970	1,031	1,000	>1,000
Customer Perspective				
Number of Branches	14	17	18	>20
Number of New Customers % of Total Customers				
● Deposits %	15	20	20	>20
● Lending %	28	61	20	>25
Number of Loyal Customers % Total Customers				
● Deposits %	85	80	20	>25
● Lending %	72	39	20	>25
On time Delivery of Service Ratio on Lending (%)	75	80	80	>95
Provincial Customer Reach (No. of provinces)	6	6	7	8
Number of Promotional Campaigns	30	38	>30	>40
Number of Cooperative Efforts	0	3	5	>8

Measurement	Review 2011/12	2012/13	Budgeted 2012/13	Targeted 2013/14
Internal Business Perspective				
Employees				
Number of Employees				
● Executive and Above	167	213	220	>240
● Clerical Staff	210	230	250	>260
Number of Promotions				
● Executive and Above	24	27	–	–
● Clerical Staff	12	33	–	–
Welfare and Training Cost per Employee (Rs.)	16,124	18,146	18,000	>20,000
Number of Events Organised for Staff	7	8	–	–
Employees Below 40 Years (%)	75	78	75-80	75-80
Workforce Gender Diversity Male : Female	5:1	5:1	5:2	5:2
Suppliers				
Registered Agents for Stocks (Nos.)	9	7	–	–
Registered Agents for Deposit Development (Nos.)	0	1	–	–
Learning and Growth Perspective				
Number of New Branches Opened	8	3	>5	>5
Number of New Products Launched	3	3	>2	>2
Total Asset Base of the Company (Rs. billion)	17.6	21.2	25	>32
Portfolio Values (Rs. billion)				
● Lending	10.4	13.8	18	>25
● Deposits	6.1	8.4	10	>15
Number of Depositors	3,498	4,084	5,000	>6,000
Number of Lending Customers				
Employees Training Hours (hrs.)	1,041	2,897	2,500	>3,000
New Process Improvement Projects	3	5	8	>8
New IT Systems Implemented	4	7	4	2

Improved Profitability Position

Mercantile Investments for the financial year ended 2012/13 was able to post sound financial results recording a Net Profit Before Tax of Rs. 732 million compared to Rs. 626 million recorded in the previous year, reflecting a growth of 17% year on year. At the same time, the Company concluded 2012/13 financial period with a satisfactory post-tax profit which amounted to Rs. 631 million compared to Rs. 610 million recorded in 2012 indicating a rise of 3% from 2012. To maintain these levels of profitability, there was tremendous effort from our dedicated staff who managed to keep anticipated performance levels throughout the year from all possible financial angles. As we pursed growth in total turnover mainly targeting our primary lines of business, we kept focus on keeping overall average cost of funding at optimal levels and tackled overhead cost escalation through concise means of cost management to finally reach current levels of profitability.

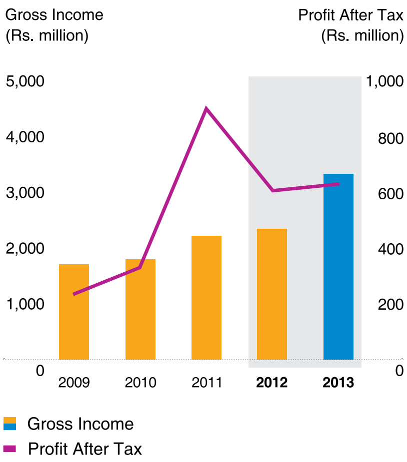
Total gross income of the Company rose to Rs. 3,338 million in 2013, up by 41% from a year before as a result of management's perseverance in raising lending volumes whilst maintaining healthy average yields from new business. Management was able to maintain strong momentum in total revenue growth unlike previous year, in keeping to a pace envisaged in the strategic plan. In boosting revenue, core business of lending contributed 89% to the total gross income growing handsomely by 86% from 2012 whilst revenue contribution from non-fund based income (NFBI) was at 8%, showing a notable fall in contribution of 62% from recorded NFBI last year. MI's main business of lending more than compensated for the slowdown experienced in NFBI, primarily its share trading income that remained rather subdued owing to the fallback of the share market since last year.

Interest Income

By end March 2013, MI's total interest income rose to Rs. 3,056 million showing an increase of Rs. 1,428 million or 88% from previous year's interest income of Rs. 1,628 million. MI's financing products of leasing and hire purchase remained the key contributors towards interest income again while income generated from term based lending contributed profoundly to interest income growth more than any year.

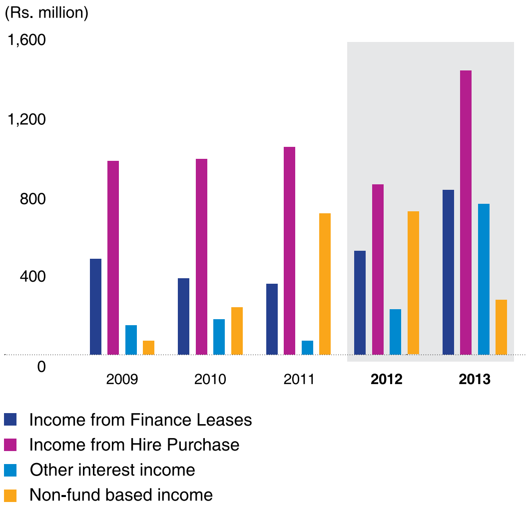
The Company's hire purchase financing business income grew at 66% and continued to be the highest contributor towards the interest income generating Rs. 1,446 million for the financial year 2013, representing a 47% share of the total interest income. MI's lease financing interest income too showed a growth of 59% in 2013 rising to Rs. 842 million in spite of a general slow-down witnessed in the lease market across the LFC sector.

Operating Performance



• *Shaded 2 years SLFRS/LKAS based and other years SLAS based.*

Composition of Gross Income

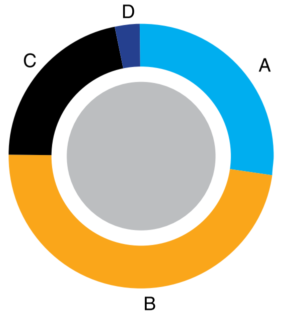


• *Shaded 2 years SLFRS/LKAS based and other years SLAS based.*

The highlight in credit business this period though was the significant income growth observed from MI's term based lending which stood at Rs. 674 million, thus reflecting an astounding growth of 260% year on year.

The acceleration in economic activity continued to create demand for hire purchase market as well as term based borrowing by customers, in contrast to a somewhat depleted market for leases resulting from the high prices for both brand-new and unregistered import vehicles. The growth in lending book, aided by the increased levels of new lending business volumes generated in the period under review contributed towards higher interest income. The other factor for the rise in income was because of the high lending rates applied on most of our products, similar to rates offered by others in the sector during this period to cover the rising cost of funding.

Components of Interest Income - 2013



A - Interest Income from Finance Leases - 28%
B - Interest Income from Hire Purchase - 47%
C - Interest Income from Other
Loans and Advances - 22%
D - Interest Income from Treasury Bills,
Bonds and Fixed Deposits - 3%

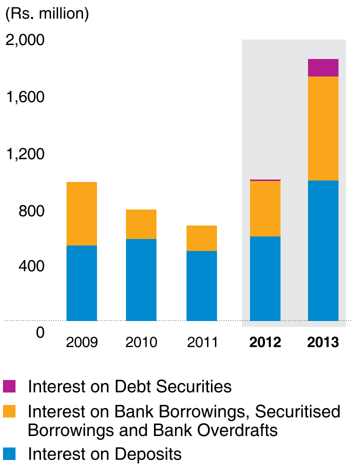
Interest Expenses

Total interest expense of the Company rose to Rs.1,868 million in 2013, reflecting an absolute rise of Rs. 858 million or a 85% increase from Rs. 1,010 million recorded in 2012. As a key feature of this period, cost of funding of the Company showed a marked increase, resulting from persistent rise in interest rates for funding in the market and also because of the continued requirement for additional funding to back our lending business, which raised interest expense on both deposit business and corporate borrowings than last year.

Deposit interest cost remained the main component of interest expense totaling to Rs. 1,001 million for the year, up by 65% from 2012. The growth experienced in deposit base coupled with the high rates offered mainly for fixed deposits contributed to this increase in deposit interest cost. There too, due to the prevailing status of our deposits maturity profile, renewal of deposits too were carried out at higher rates thus raising total cost of funding.

Similarly, the borrowing costs of the Company too showed a rapid increase surging by 114% to Rs. 866 million compared to a borrowing cost of Rs. 404 million recorded in the previous period. In the backdrop of rising interest rates and its persistent volatility, MI pursued optimal funding sources, seeking best possible rates from our banking partners and alternative sources of funding. This included debt securities that consisted solely of commercial paper that had a strong customer demand because of its attractive pricing. Accordingly, interest cost on debt securities amounted to Rs. 125 million as at 31 March 2013, up notably by Rs. 115 million or 1,150% from 2012.

Analysis of Interest Expense



- *Shaded 2 years SLFRS/LKAS based and other years SLAS based.*

Net Interest Income (NII) and Net Interest Margin (NIM)

	2013 Rs. million	2012 Rs. million
Total Interest Income	3,056	1,628
Total Interest Expense	1,868	1,010
Net Interest Income	1,188	618
Average Total Assets	19,415	15,676
Net Interest Margin (Net Interest Income as a Percentage of Average Total Assets)	6%	4%

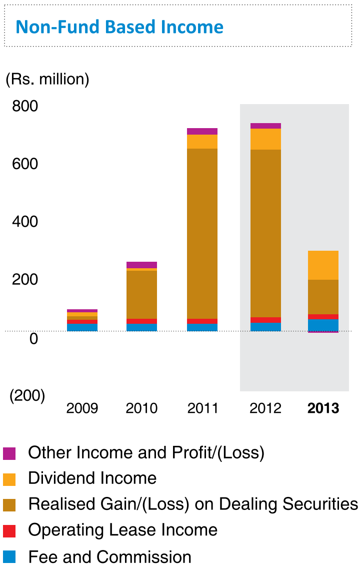
There was a noticeable improvement in the NII of the Company brought about as a result of the management's continuous focus over the year in sustaining growth in core business volumes whilst managing to keep anticipated margins from new business, keeping interest cost at optimal levels while maintaining sound lending yields when effecting new lendings. Accordingly, the Company experienced a 92% growth in NII which rose to Rs. 1,188 million by end March 2013. Management's continuous interest in boosting its term based lending products which mainly comprised personal loans, pledge loans and property mortgage loans this period specifically improved overall average yields. At the same time, the impact experienced on the re-pricing cost arising from renewal of deposits was lesser than in the previous year. However, this was somewhat overshadowed because the Company had to sustain newly canvassed deposits at higher rates to be competitive in the market.

In a similar way, MI's NIM too showed a marked improvement compared to the previous year, rising from 4% to 6% indicative of the said NII progress which grew at a relatively higher pace compared to the total average assets growth of the Company witnessed this period. In boosting NII and NIM, management kept to its policies on mitigating any margin erosions and strictly refrained from doing business below break-even levels, and at the same time strived to keep cost of funding as low as possible. MI was weary of the thinning of margins within the LFC sector due to competition and focused on volume growth as a counter strategy in boosting overall profitability.

Non-Fund Based Income (NFBI)

The total NFBI which comprises other operating income and the fee and commission income showed a marked decline from previous year dropping by 62% to Rs. 282 million from Rs. 734 million recorded in 2012. The key reason for the drop in NBFI was the significant decline recorded in realised share trading gains recorded during this period compared to a year before, dragged down by the persistent sluggishness of the stock market which remained contracted in terms of trading activity. As a result, realised gains from share trading profits stood at Rs. 123 million compared to Rs. 591 million recorded in 2012, a significant decline of 79% from 2012.

Nevertheless, the contribution derived from dividend income grew by 44% amounting to Rs. 103 million accruing from the declared dividends arising from solid performance recorded by some of the blue chip companies. MI's fee and commission income being the other contributor to NFBI solely derived from insurance commission income rose satisfactorily by 44% to stand at Rs. 46 million in 2013. However, operating lease income remained subdued similar to the previous year at Rs. 14 million, dropping by 26% owing to the reduced demand for related business in the sector. A noticeable highlight was the relatively lower dependence on NFBI this year unlike previous two years and management's strong focus on widening core business incomes contribution to total income as means of upholding a stronger sustainable business. However, NFBI would remain integral to MI towards boosting total income and would be pursued strategically based on prevalent market demands and predictions in moving ahead.

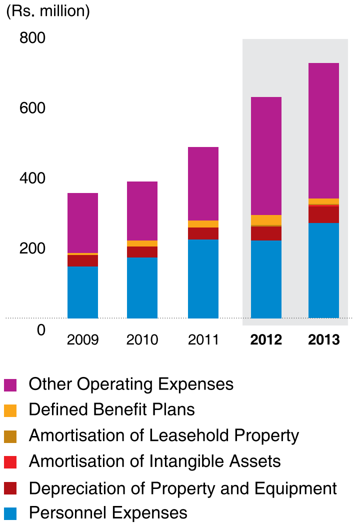


- *Shaded 2 years SLFRS/LKAS based and other years SLAS based.*

Operating Expenses

Total operating expenses increased to Rs. 727 million at the end of the current financial year from Rs. 629 million recorded in 2012, indicating an escalation of 16% from a year before. Personnel costs remained high due to greater number of recruitments made on the wake of MI's branch expansion and also partly because of the increments given to staff commencing January 2013. Accordingly, personnel cost stood at Rs. 292 million in 2013 remaining one of the highest cost components under operating expenses rising 17% year on year.

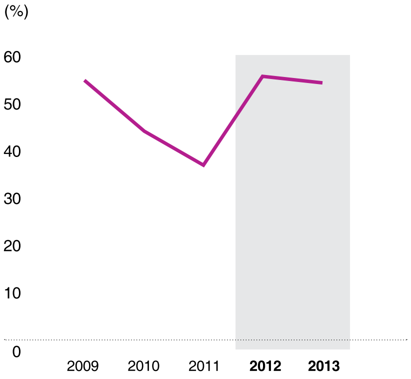
Composition of Operating Expenses



- *Shaded 2 years SLFRS/LKAS based and other years SLAS based.*

Moreover, overhead costs other than personnel cost comprising of premises equipment and establishment expenses and other operating expenses remained the other highest cost component for MI and showed an escalation, rising by 15% from Rs. 380 million in 2012 to Rs. 436 million in 2013 mainly because of increased operations and general inflationary effects. Management's strong emphasis in controlling cost especially keeping tab of key expenses by introducing numerous control measures and initiating action to eliminate non-value adding activities kept the cost to income ratio at a satisfactory level at 54% compared to 56% recorded in 2012.

Cost to Income Ratio



- *Shaded 2 years SLFRS/LKAS based and other years SLAS based.*

The Company was conservative during the year in its decisions on capital investments especially when setting up new branch operations. All branch investments were therefore made only after due feasibility study with minimal start-up costs. We were not compelled to incur heavy cost related to information technology this year since we already possessed suitable IT infrastructure to expand at minimal cost with a well-established support network that we managed to establish in earlier years. The required setting up and related modifications were handled in-house without having to incur large modification costs.

Impairment Charges on Loans and Receivables

In accordance with SLFRS/LKAS requirements, the time based provisioning policy of the Company was substituted with the impairment methodology which considered individual and collective impairment aspects to arrive at the impairment charge. When arriving at the collective impairment, MI divided its loan portfolio into several buckets based on the homogeneous risk characteristics associated with different products. For instance, the lease and hire purchase portfolios were segregated based on vehicle type and nature of asset kept as security and then further evaluated on their associated risk variables. Accordingly, in formulating the collective impairment provision, Company reverted to historical loss experience of these buckets expressed in terms of Loss Given Default (LGD) and Probability of Given Default (PGD).

As for individual impairment, a threshold limit was decided by the management to conduct impairment testing on significant loans which adequately represented the total loan portfolio of the Company. These loans were tested against predetermined individual impairment indicators approved by the management based on feedback received from credit division of the Company.

Based on SLFRS/LKAS, the impairment charge/(gain) effected based on above approach is as follows:

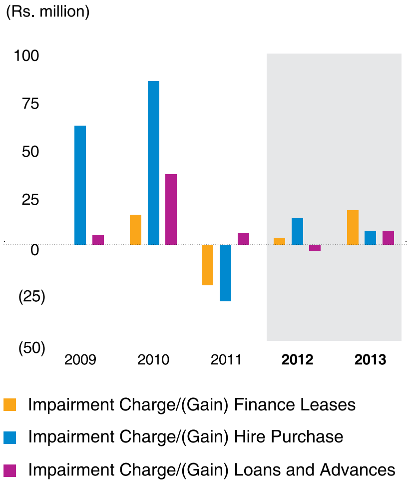
	FY 2012/13 Rs. '000	FY 2011/12 Rs. '000	Growth Rs. '000
Individual Impairment	7,047	53,531	(46,484)
Collective Impairment	25,230	(38,843)	64,073
Total Impairment Charge	32,277	14,688	17,589

Impact of adopting SLFRS/LKAS impairment based provisioning method as opposed to previous time based provisioning policy under SLAS:

	FY 2012/13 Rs. '000	FY 2011/12 Rs. '000	Growth Rs. '000
Total Impairment Charge/(Gain) as per SLFRS/LKAS	32,277	14,688	17,589
Total Loan Loss Provision as per SLAS - charge/(reversal)	(25,584)	26,827	(52,411)
Impact to current year profitability resulting from shift in policy - negative impact/ (positive impact)	57,861	(12,139)	70,000

As a result of the transition from SLAS to SLFRS/LKAS, impairment charge for 2012/13 reflected a negative impact of Rs. 58 million to current year profitability considering a reversal of loan loss provisioning estimated for the same period based on previous SLAS time based method. However, an opposite impact was observed for financial year 2011/12 where the impairment charge recorded was lower than the estimated SLAS based provisioning estimates.

Analysis of Impairment Charge/(Gain) for Loans and Receivables



- *Shaded 2 years SLFRS/LKAS impairment based and other years on SLAS time based specific provisioning.*

Total Assets

As a result of the sound core business momentum maintained, the total assets of the Company reached Rs. 21,223 million as at 31 March 2013 showing a growth of 21%. Out of the total assets, gross loans and advances receivable topped Rs. 14 billion (before impairment) remaining the largest asset item in MI's books while financial investments - available-for-sale comprising of share investments (other than investments in associates) and investments made in Government Securities remained the next highest totalling Rs. 3.5 billion as at the balance sheet date. The net book value of property, plant & equipment stood at Rs. 1.5 billion without any noticeable fluctuation since last year as there were no major property related investments made during the period.

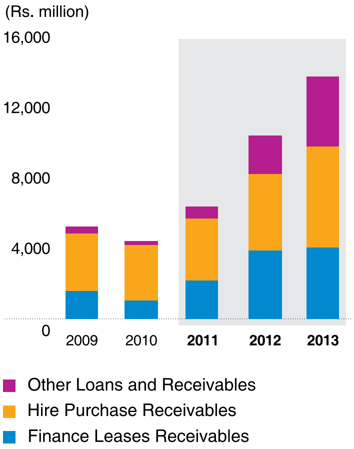
Loans and Advances Outstanding

Total net loans and advances outstanding rose from Rs. 10,447 million to Rs. 13,844 million as at the balance sheet date, signifying a commendable growth of 33% from a year before, despite the challenging environment that prevailed. The heightened business conditions experienced from previous year continued to boost lending across the sector in spite of the stiff competitiveness seen on pricing. Nonetheless, steep rise in market interest rates and the high pricing of imported vehicles owing to increased duty coupled with the observed depreciation of the rupee against dollar continued to negatively impact the demand for related financing business.

Nonetheless, the Company was able to sustain these levels of growth driven by the rise in demand for term based lending and financing required for machinery and construction related vehicles and the evolution of smaller types of vehicles at affordable prices. Strategically, we were able to exploit these opportunities quite pleasingly, supported by our strengthened branch network.

By venturing out to regions beyond the Western Province gave us that extra flexibility. To maintain overall lending volumes without compromising on yields, we improvised ourselves by broad-basing our lending mix as well as paying greater attention on building our non-traditional term based lending.

Composition of Total Lending



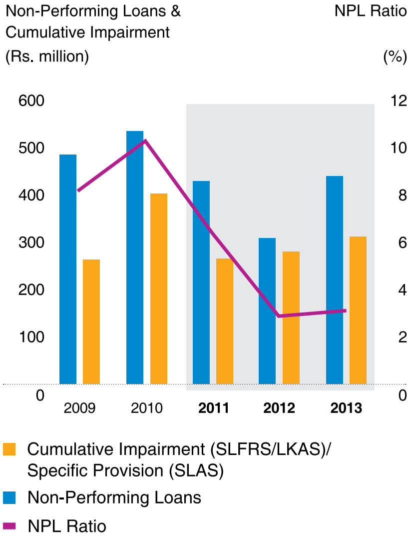
- *Shaded 3 years SLFRS/LKAS based and other years SLAS based.*

Total Non-Performing Lending Position

The gross non-performing lending ratio showed a marginal rise from 2.87% to 3.10% in 2013 but was commendably below the industry average levels observed during 2013 and was at pleasingly low levels in spite of the Company's growing loan book and the deterioration seen in borrowers' creditworthiness across the sector which remained a concern for the financial services sector over the year.

Recovery division was committed to upholding a tight recovery monitoring system through close follow-up of slow moving accounts. They focused on daily monitoring of contracts in arrears against anticipated targets and initiated actions to speed recovery including executing a swift repossession process and smooth transfer of problematic files to the legal division for necessary action where all other efforts have failed. In sustaining asset quality, management continued to resort to a more stringent credit evaluation process than in the past especially for transactions related to riskier lending products.

Total Non-Performing Loan Status and Impairment



- *Cumulative Impairment - 3 years SLFRS/LKAS based and other years SLAS based*
- *NPL Statistics - SLAS Based.*

Impairment Provision Cover

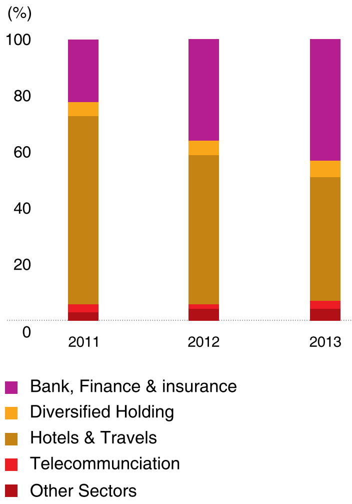
	2013 Rs. million	2012 Rs. million
Total Cumulative Impairment	312	279
Non-Performing Loans and Advances (Net of Interest in Suspense before B&D) as per SLAS	440	308
Cumulative Impairment Provision as a percentage of Non-Performing Lending	71%	91%

Provision cover remained satisfactory at 71%, despite falling from last year's sound cover of 91% but remained healthily over the 50% standard excepted industry norm cover.

Financial Investments - Available-for-Sale

Equity based investments amounted to Rs. 2,980 million forming the larger component of the financial investments - available-for-sale, while investments in Treasury Bills and Bonds was the other main component totaling Rs. 476 million as at 31 March 2013. MI's equity investment portfolio showed a decline of 12% owing to disposals made during the period as well as on account of the fair value adjustments. As a result of share investments and disposals over the last three years, the sector wise composition showed a shift more towards the Banking, Finance and Insurance sectors.

Sectorwise Equity Based Investment Portfolio Mix Based On Market Value



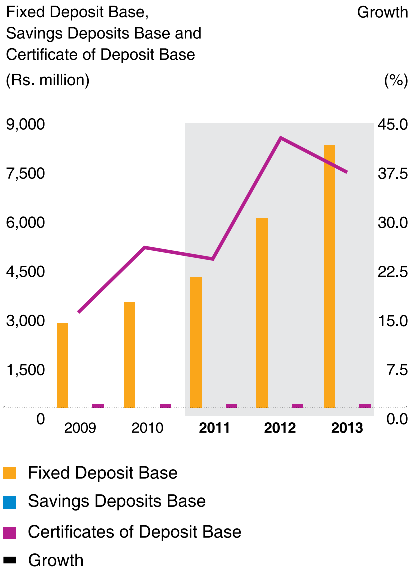
Total Liabilities

Total liabilities rose from Rs. 12,133 million to Rs. 15,518 Million, increasing by Rs. 3,386 million or 28% from 2012 resulting from the pick-up in business as explained earlier, which called for continuous inflow of funding. Deposit liability was the largest liability item representing 54% of the total liabilities while borrowings including overdrafts represented 40% of total liabilities.

Deposit Portfolio

In spite of a highly competitive market for deposit business, the Company managed to mobilise deposits at a very satisfactory rate growing the total deposit outstanding to reach Rs. 8,425 million from Rs. 6,138 million, up by Rs. 2,287 million by the conclusion of this financial period. This reflected a sound deposit growth of 37% in comparison to a growth of 43% recorded a year before. In sustaining these growth levels in a highly competitive market, pricing remained yet again the most critical factor that tended to override other differentiating factors such as quality of service, risk levels and customer convenience. As such, our deposit pricing was targeted across the board to provide very attractive returns to our depositors whilst reaffirming to them the stability and financial strength of our institution.

Deposit Mix

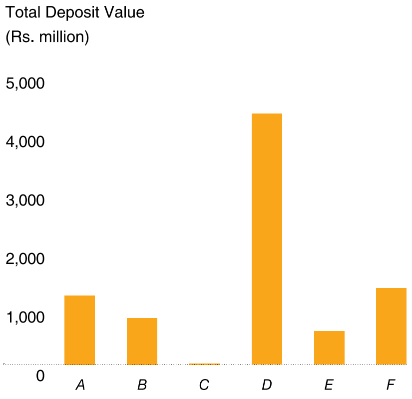


- *Shaded 3 years SLFRS/LKAS based and other years SLAS based.*

Out of total deposits, fixed deposits continued to be the largest component in MI's deposit mix representing 98%, similar to the composition recorded in 2012.

As the rise in interest rates have almost reached peaked levels and shows signs of reversing, depositors preferred to place most fixed deposits for one year and above. As a result deposits placed in the one year to two year category remained significantly high as depicted in the graph below:

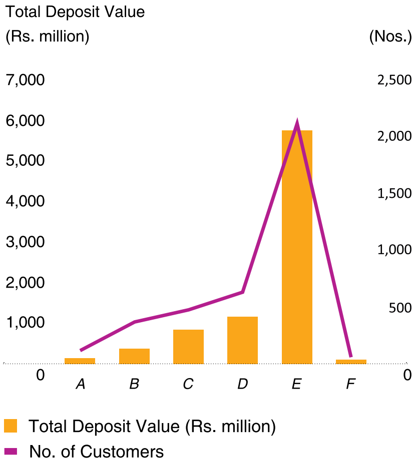
Deposit-Base on Original Term - 2013



A - 01 to 03 months
B - 03 to 06 months
C - 06 to 12 months
D - 12 to 24 months
E - 24 to 36 months
F - 36 up to 60 months

From the total deposits placed with us, 84% was secured from individual customers while balance component was canvassed from corporate entities indicating a pattern similar to last year. In keeping to MI's deposit strategy, there was heavy focus on seeking new market segments and at the same time deepening penetration in existing markets. A key focus was to seek potential depositors who were either young or middle aged to widening the customer base to couple with existing depositor base that comprises largely senior citizens as shown in the graph below:

Age Wise Deposit Base -2013



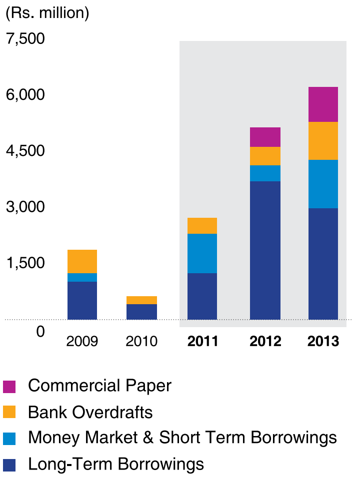
A - 18-24 years
B - 25-34 years
C - 35-44 years
D - 45-54 years
E - 55 & above years
F - Other

Borrowings

Total borrowings of the Company stood at Rs. 6,232 million rising sharply by 21% as at end of March 2013. Out of the total borrowing liability, long-term borrowings obtained primarily from our banking partners remained the largest borrowing category totaling Rs. 2,992 million indicating nevertheless a decline of 20% from 2012. In contrast, money market and other short-term borrowings including overdrafts and funding from commercial paper showed a marked rise compared to the year before, increasing by 128% to Rs. 3,240 million in 2013.

Higher funding requirements arising from growth in lending volumes necessitated a continuous flow in funding which needed to be supported by borrowing when deposit flow was insufficient at various points in time. In spite of the steep rise in market borrowing rates, MI treasury division was able to keep close tab of funding partners who were able to provide funding at optimal rates to bridge both temporary and long-term funding needs of the Company.

Composition of Total Borrowings

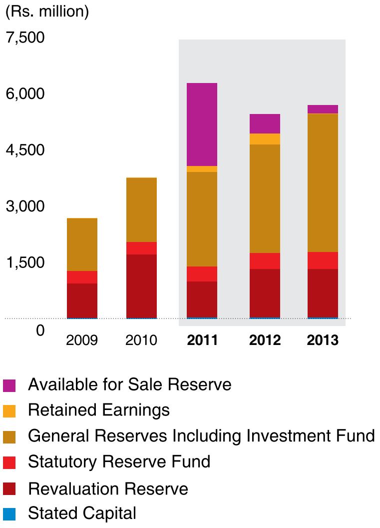


- *Shaded 3 years SLFRS/LKAS based and other years SLAS based.*

Equity Position

The total shareholder funds rose by 4% to Rs. 5,704 million by the end of March 2013 from Rs. 5,475 million recorded in 2012 in keeping to SLFRS/LKAS based financial reporting requirements. Our strong entrepreneurial skills and earnings capacity over the years has enabled us to possess a superior capital structure to-date. As practiced right throughout, MI's policy had been to retain a large component of our internally generated profits within the Company offering the Company enough flexibility to pursue growth related strategies in going to the future. By effectively putting the capital to best use, we have been able to reap sound returns to our shareholders on a constant basis providing sound dividends as well as appreciation in their investment value.

Shareholders' Funds

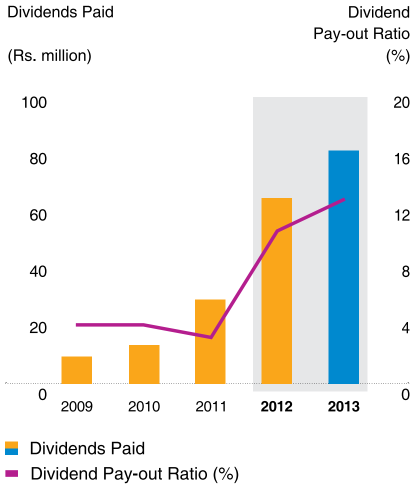


- *Shaded 3 years SLFRS/LKAS based and other years SLAS based.*

Dividends

The Board declared dividends totaling to Rs. 83 million compared to Rs. 66 million paid in 2012 indicating a 26% increase year on year compared to 120% dividend growth registered last year. The dividend payout was decided after giving due consideration for the need to keep a balance between providing a satisfactory return to our investors as well as maintaining sufficient level of funds retained within the Company for planned future growth in business.

Dividend Pay-out



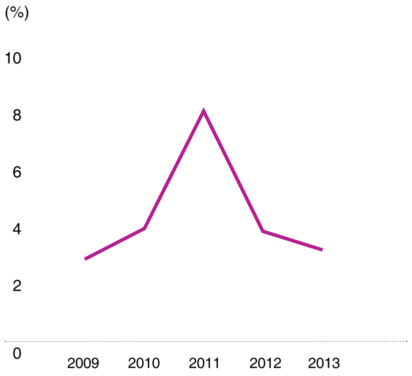
- *Shaded 2 years SLFRS/LKAS based and other years SLAS based.*

Efficiency and Other Key Financial Ratios

Return on Average Assets (ROA)

The ROA of the Company stood at 3.25% for the year ended 31 March 2013 as against an ROA of 3.89% registered for previous year. This period's profitability levels against the organisation's total average assets growth was relatively lower than the previous year thus reflecting this dip in ROA year on year.

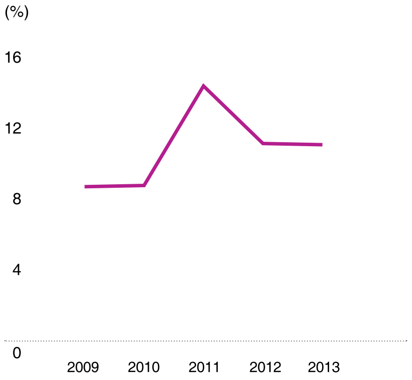
Return on Average Assets



Return on Equity (ROE)

ROE recorded upon the conclusion of the 2012/13 financial year was 11.06% as against 11.14% registered in 2012, a reflection of management's commitment in ensuring satisfactory returns to MI's investors yet again.

Return on Equity



Earnings per Share (EPS)

The basic EPS of the Company rose as a result of the improved profitability recorded for the year, up by 3% in contrast to a contraction observed in 2012 of 33%. Accordingly, MI's EPS stood at Rs. 209.84/- per share in comparison to Rs. 202.96/- per share reported in 2012.

Net Assets Per Share (NAPS)

The net assets position of the Company continued to move upward raising the net assets per share to Rs. 1,898/- per share in comparison to Rs. 1,821/- per share recorded last year, reflective of MI's increased net worth position on account of sound profitability this period.

Cash Flow Position

Cash Flow from Operating Activities

Net movement of MI's operating cash flows showed variance from a negative of Rs. 2,425 million in 2012 to a negative of Rs. 437 million in 2013. Operating cash outflows mainly resulted from funds advanced to customers, interest payments, personnel costs and other overheads. Inflow of cash from operating activities on the other hand arose mainly from interest and commission receipts, net increase in deposits and inflows from other short-term negotiable securities.

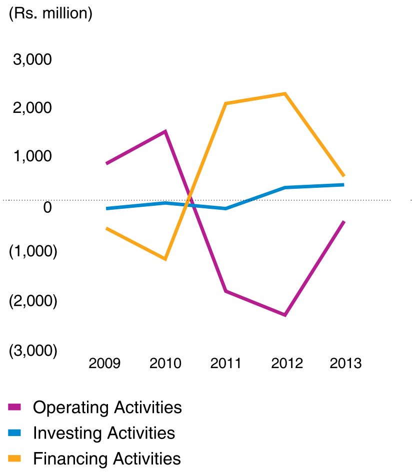
Cash Flow from Investing Activities

MI's cash flow from investing activities reflected an inflow amounting to Rs. 328 million compared to an inflow of Rs. 282 million recorded in 2012. Dividends received, proceeds from sale of securities and proceeds from sale of Property, Plant and Equipment were the main inflows.

Cash Flow from Financing Activities

Cash flow from financing activities yielded net positive cash flows totalling to Rs. 571 million as at 31 March 2013 compared to Rs. 2,254 million recorded in 2012. MI's increased dependence on borrowings again to fund core business operations contributed to the inflow reported from financing activities this period.

Cash Flow Analysis



MI'S FINANCIAL IMPACT TO ECONOMY

MI's Market Share

MI's market share in the NBFI sector stood at 3.6% (comparing statistics available for NBFI sector) for current year in line with a similar share secured last year on the basis of total assets of the sector. The NBFI sector showed growth in total assets which reached Rs. 596.6 billion by 31 December 2012 at a somewhat similar pace as MI's asset growth keeping MI's market share at almost similar levels as last year.

MI's Value Addition

In terms of value addition for the period under review, MI's contribution to the economy totaled to Rs. 1,031 million up by 6% from 2012. A major part of the value addition created this period was retained for the Company's future growth and expansion, while remainder was distributed. A distribution of 27% was made as salaries to employees and 17% by way of taxes to the Government.

Please refer the Value Added Statement appearing on page 349 for analysis of the value addition and its distribution details for current year compared to past years.

MI's Economic Value Addition (EVA)

MI's economic value addition though remained marginally negative at Rs. 21 million taking three years EVA net position. Nevertheless, with the witnessing of steady growth in MI's business and with it the rise in levels of turnover, asset value and capital size, MI remains a finance company of noticeable size with a systemic importance to the sector and economy.

Page 348 provides an analysis of MI's economic value addition for the FY 2012/13 compared to previous periods.

HUMAN CAPITAL PERFORMANCE

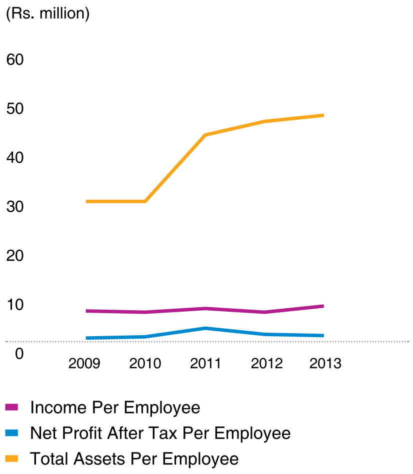
Expanding Workforce

MI’s staffing level was expanded to assist growing business demands in this period especially to support front line operations involving credit and marketing, deposits and recovery processes. The total number of staff thus increased in 2013 to 443 from 377 indicating an 18% increase from a year before.

Workforce Productivity

There was strong emphasis on raising productivity levels of our workforce through focused career development programmes mainly aimed at enhancing skills of individuals. As such, income per employee and total assets per employee that stood at Rs. 6.3 million and Rs. 47 million climbed to Rs. 7.5 million and Rs. 48 million respectively as at 31 March 2013. Net profit after tax per employee nevertheless declined to Rs. 1.4 million compared to Rs. 1.6 million reported in 2012.

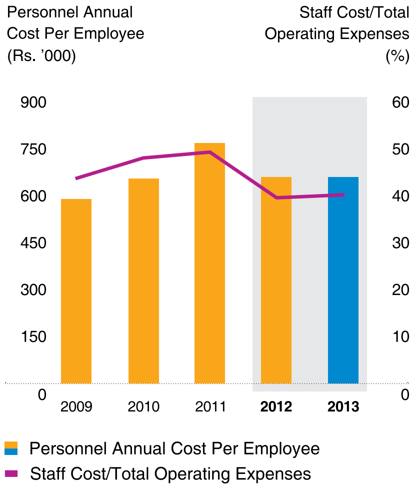
Employee Productivity



Cost of Sustaining a Strong Team

The annual personnel cost per employee stood at Rs. 0.659 million in 2013 without much variance compared to Rs. 0.662 million recorded last year, inspite of annual increments affected during 2013. MI also incurred staff related costs other than basic pay for the benefit of employees. Our salary scales are competitive and are on par with market expectations and is coupled with other fringe benefits to sustain a satisfied workforce, low in labour turnover levels.

Personnel Cost Analysis



- *Shaded 2 years SLFRS/LKAS based and other years SLAS based.*

Structure and Other Statistics of MI’s Workforce

Description of Disclosure	Page Number Reference
Staff Strength	234
Staff Service Analysis	234
Staff Age Analysis	235
Staff Recruitment	235
Gender Distribution	235
Staff Ethnicity	237
Staff Religion	237
MI Board and Other Committees Gender/ Age Composition	215
Staff Distribution by Province	236
Staff Training Information	237 to 239
Staff Turnover	242

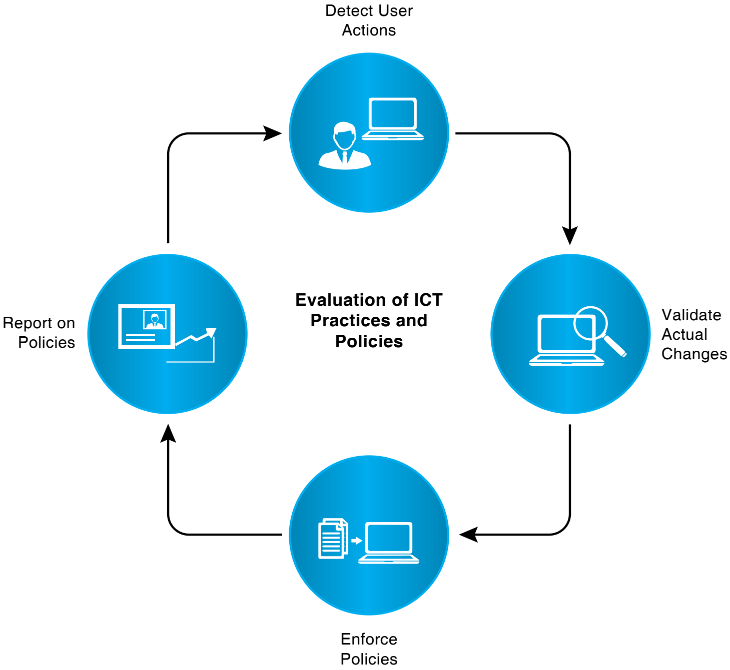
INFORMATION AND COMMUNICATION TECHNOLOGY (ICT) MANAGEMENT

Information and Communication Technology is a fundamental pillar and in the forefront as a strategic partner in MI’s business, providing appropriate technological capacity that is agile and scalable to meet changing needs. This period specifically there was major focus on streamlining and effective implementation of the MI’s ICT governance framework that embraces best ICT management practices that are of international standards.

Maintaining ICT Standards at Optimum Level

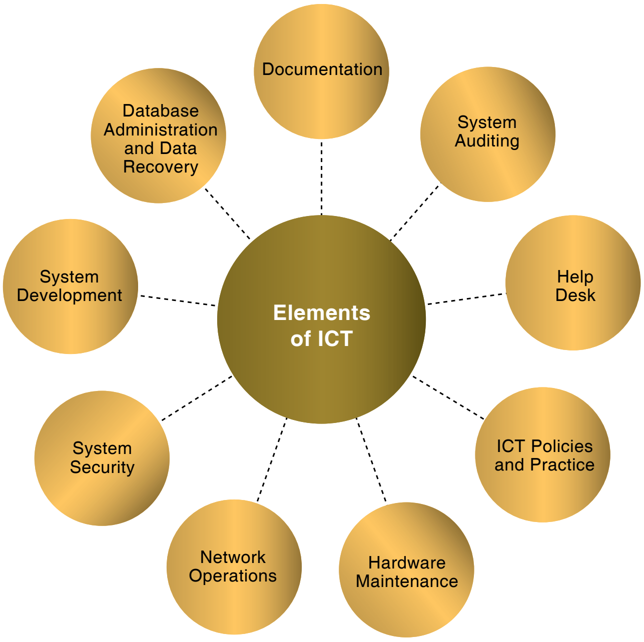
MI’s ICT Department’s functions are governed in accordance with approved and recognised standards by the ICT industry. Required ICT Standards have been set-forth through specific IT related manuals developed for the Company, namely by adopting an ICT Procedure Manual (IPM), Information System Security Policy (ISSP), System Development Standards (SDS) and an ICT Contingency Plan. These standards have been introduced to maintain an effective ICT environment that supports organisational information needs, within acceptable rules and norms.

MI’s ICT policies and practices have evolved through a formal process that firstly identifies user actions and then validate actual changes so that effective policies could be developed and can be enforced. These policies are eventually reported back to the end users. For instance, improvements were made to ‘message labs - cloud service’ which filters e-mails, viruses and unwarranted messages, with the feedback received from daily use of information systems.



Elements of ICT

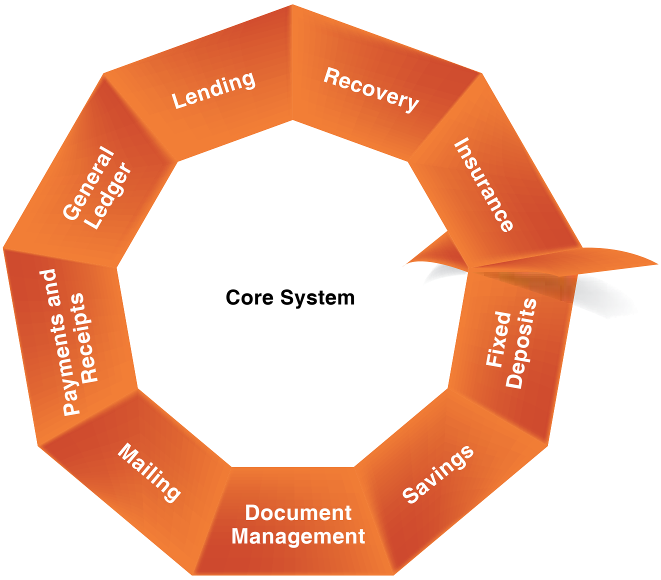
ICT services at MI have been designed to extensively cater to both internal and external customers. Our ICT services consist of nine core elements for administrative purposes. This is outlined in the diagram below:



System development, Network operations, System security and Information database functions are some of the key aspects managed by the central ICT department at head office. To enable online processing, MI's branch network is linked to head office main-servers, interconnected using IP-VPN technology through a renowned ISP provider in Sri Lanka.

Information Technology a Backbone to Operations

MI's information system evolved from a PC-based network system to a highly reliable and stable multi-user client server architecture. To execute core operational functions of the Company, a stable and reliable platform has been put in place through a world renowned Oracle database management system. The network servers run on Microsoft Windows server 2008/2012, while the mail server and proxy server both run on Linux. To enable speedier data processing and improved compatibility with new operating systems and new hardware, MI's software modules use '.NET' platform.



To meet internal and external business requirements more effectively, core operational functions covering lending operations, recovery operations, fixed deposits, savings, insurance, payments and receipting, general ledger, document management etc. have been fully automated and forms part of the core information system. Numerous features have been embedded into the core system that enables users to discharge their duties effectively. Significant improvements have been made to the system specifically in this period concentrating heavily on enhancing system reliability, efficiency and effectiveness. To make this happen, we adopted specific information technology advancements keeping pace with growing business complexities.

Salient Achievements in ICT in 2013

- **Development and Implementation of ICT Standards**
- **Revamping of parts of core system to cater to enhanced front-end operational features**
- **WSNET-MI Workshop System**
  This system was specially designed for payments and receipting operations of the motor repairs and service station.
- **Stationary Purchasing and Monitoring System**
  This system maintains supplier details, stock handling, departmental wise costing and re-order levels.
- **Modifications to Comply to IFRS Requirements**
  Changes were made to core modules including lending, deposits and general ledger to incorporate IFRS requirements.
- **Company Website www.mi.com.lk**
  Redesigned the MI website to cater to a dynamic market moving with technical trends, improving user friendliness and modern browser compatibilities.
- **MI Network Expansions**
  IP-VPN network has been expanded to link 22 geographically different locations of the island. Also, VLAN infrastructures have been implemented to maintain an efficient and secured network for MI's core application systems.

Supportive features of MI Workshop System introduced in 2013

Invoicing	This module allows add, edit and cancel for all types of invoices. Also. it provides logs of all activities of invoices.
Receipting	Allows adding of payment entries from customers and suppliers. Also, it indicates all outstanding invoice amounts to be settled. Available payment modes cash, cheques and credit card.
Refunds	Refunds can be made through this module. A separate voucher for excess amounts paid by the customer can be generated as per customer request.
Inquiry	This module allows users to search the relevant details of the invoices, receipts, customer and supplier details as and when required.

System Security and Business Continuity

MI recognises that the drive towards electronic governance inevitably increases reliance on ICT. Hence, information technology brings forth its share of risks to the operational environment. The growing pace of change in the use of ICT means that a full inventory review and an overhaul of contingency plans must become a regular process rather than a one-off event. MI has in place an overall plan and management structure to deal with major catastrophes that could impact the ICT environment through the Business Continuity Plan (BCP). BCP focuses on disaster recovery from potential disaster events to minimise disruptions that could occur to the ICT environment. It aims to provide cost effective solutions to assure business continuity within that framework. In this period key risks and functions were identified and allocated to the recovery team.

- Central file servers, data base servers and automated data replication servers are in place to replicate data to the special disaster recovery sites (DR) of MI to minimise data losses. Furthermore, these systems are backed up by UPS Systems and by auto starting power generators.
- The Company network is fully secured from the external and internal threats by implementing firewalls, cloud security services, Active Directory (AD) security policies, virus walls and VLAN infrastructures.

Broadening Management Information Supply

For effective and speedier decision-making, it is vital that there is a constant supply of management information that is accurate and timely to all parts of the organisation. Towards this endeavour, considerable level of changes were effected to the core system in this period, to generate a stream of additional reports either daily, weekly, monthly or as and when required to sustain the information of the team.

Division	Description of new report developed in 2012/13	Frequency
Credit	Last six months arrears summary	Monthly
	Credit officer-wise performance reports	Daily
Finance	Interest yield at maturity	Monthly
	Maturity of new lending	Daily
	Average balance sheet	Monthly
Recoveries	Sector-wise non-performing schedule	Monthly
	Target vs actual contracts in arrears report	Monthly
Deposits	Branch deposit performance report	Weekly
	Deposit officer-wise performance reports	Daily
	Largest savings deposits report	Monthly
	Dormant accounts on savings report	Daily
	Savings account status report	Daily
Insurance	Insurance claim receivable report	Weekly

Training of Users to ICT Environment

For new users at head office, ICT department provides one-on-one training to individuals on the use of computer peripherals including how to log in to their PC, how to use their storage path, how to use email and log in mechanism to their respective system modules.

Upon setting up of a new branch, ICT department officers provide branch staff with necessary training at the location itself. While providing training on basic use of computer systems, staff are also briefed on maintenance and troubleshooting aspects related to PCs, printers and local area networks.

As the next phase, Company-wide training sessions will be conducted to all users on the application of Company's IT security policies and other related standards that are required to be followed by users to safeguard ICT environment and to maintain uniformity.

Future Outlook - ICT

The role ICT would take centre stage in the next decade or so considering the dependence that our sector has on its use. We hope to develop our systems as we move along, embracing advancements that are bound to happen in terms of sophistication and user friendliness in applications in the years to come.

Already plans are under way to introduce the new Oracle 11g database system to enhance MI's core system, to cater to the growing branch network. Database vaults, Self Managing, Automatic Memory Management, invisible indexes and flashback data archiving are a few handy features of Oracle 11g database system that would improve the efficiency of the system. To compliment this proposal we plan to introduce the latest .NET and web technology which would boost MI's core system capabilities further.

As the ICT environment has evolved to a complex and sophisticated operation, greater emphasis would also be placed in affording continuous training to both technical staff as well as end users. We hope to afford training on standard user policies including system security to create awareness among users on the importance of maintaining confidentiality of information etc.

COMPLIANCE TO REGULATORY REQUIREMENTS

Management of Liquidity

MI's statutory liquid assets position was monitored daily by the Finance Division under the supervision of the Finance Director. The Company maintained its statutory liquid assets ratio and minimum approved securities requirement above the minimum requirements specified by the regulator for the financial year ended 2012/13.

	CBSL Minimum Requirement as at 31 March 2013	Actual	
		31 March 2013	31 March 2012
Total Liquid Assets (Rs. '000)	812,234	1,389,107	754,633
Statutory Liquid Assets Ratio (%)	10.00	17.11	12.86
Minimum Approved Securities (Rs. '000)	383,638	404,918	414,124

The Company had sufficient funding lines to manage daily cash flow requirements including amounts necessary in maintaining required statutory liquid assets levels. In meeting liquidity requirements, we secured sufficient borrowing lines mainly from our traditional banking partners in addition to the unutilised credit lines that were at our disposal. The total unutilised credit lines available stood at Rs. 422 million as at 31 March 2013 compared to Rs. 777 million that was available at the conclusion of the previous year.

Management of Capital

MI held a strong capital position as at the balance sheet date, supported by accumulated retained profits that has grown year on year through MI's ability to consistently deliver sound financial performance annually. MI was able to hold a tier 1 capital of Rs. 4.1 billion and capital base of Rs. 4.4 billion as at 31 March 2013 thus meeting required capital adequacy ratio requirements with ease.

	CBSL Minimum Requirement as at 31 March 2013	Actual	
		31 March 2013	31 March 2012
Total Tier I Capital (Rs. '000)	985,273	4,104,006	3,601,073
Total Capital Base (Rs. '000)	1,970,547	4,413,820	3,910,887
Core Capital Ratio (%)	5	20.83	21.45
Total Risk Weighted Capital Ratio (%)	10	22.40	23.30

Holding a sound capital position that reflected capital in excess of more than twofolds the statutory requirement provided the Company enough flexibility to proceed on its expansion drive. The capital levels were sufficient to meet CAR requirements despite the growing loan book and the large share investment portfolio that MI possesses. Please refer pages 345 to 347 in the notes to the Financial Statements which provide a detailed breakdown of MI's capital adequacy position.

Submission of CBSL Web Returns

All required CBSL web returns were submitted by the Company on or before the due dates for submission. There were no late submission penalties imposed by CBSL for 2012/13 financial year.

Report	Periodicity	Number of Reports Submitted in 2012/13	Compliance Status
Liquid Assets	Weekly/Monthly	60	Complied
Deposit Liability	Weekly	48	Complied
Advances	Monthly	12	Complied
Rate of Interest	Monthly	12	Complied
Balance Sheet	Monthly	12	Complied
Profit and Loss	Monthly	12	Complied
Classification of Advances	Monthly	12	Complied
Secured Large Exposures	Monthly	12	Complied
Unsecured Large Exposures	Monthly	12	Complied
Advances to Related Parties	Monthly	12	Complied
Investments in Equity	Monthly	12	Complied
Maturity Gap Analysis	Monthly	12	Complied
Interest Rate Sensitivity	Monthly	12	Complied
Capital Adequacy Ratio	Monthly	12	Complied
Sector-wise Credit Exposure	Monthly	12	Complied
Interest Spread	Monthly	12	Complied
Balance Sheet - Audited	Annually	1	Complied
Profit & Loss Account - Audited	Annually	1	Complied
Capital Adequacy Ratio - Audited	Annually	1	Complied
Financial Intelligence Unit Report - More than 1 million Cash Transaction Report	Bimonthly	24	Complied
Total Reports Submitted		**303**	

Compliance to CBSL Regulations

MI being a finance company adheres to the regulator's requirements and accordingly reviews its level of compliance to the Central Bank Directions, rules, determinations, notices and guidelines through its Compliance Manager periodically. The Company has complied with the following regulations as at 31 March 2013.

Rule/Direction/Guideline Number	Description of Rule/Direction/Guideline
Licensing of Finance Companies	
Rule No. 01 of 2012	Finance Companies (Application)
Rule No. 02 of 2012	Annual License Fee
Capital	
Direction No. 01 of 2003	Capital Fund
Direction No. 02 of 2006	Risk Weighted Capital Adequacy Ratio
Direction No. 01 of 2011	Minimum Core Capital Adequacy
Credit	
Direction No. 03 of 2006	Provision for Bad and Doubtful Debts
Direction No. 04 of 2006	Single Borrower Limit
Liquidity	
Direction No. 01 of 2009	Liquid Assets
Operational	
Direction No. 03 of 1991	Writing off of Loans and Advances
Direction No. 10 of 1991	Register of Written-off Loans
Direction No. 01 of 2005	Deposits
Direction No. 02 of 2007	Business Transactions with Directors and their Relatives
Direction No. 02 of 2010	Insurance of Deposit Liabilities
Direction No. 04 of 2012	Information System Security Policy
Direction No. 05 of 2012	Interest Rates
Corporate Governance	
Direction No. 03 of 2008	Corporate Governance
Direction No. 04 of 2008	Corporate Governance Amendment
Direction No. 03 of 2011	Assessment of Fitness and Propriety of Directors and Officers Performing Executive Functions
Reporting Requirement	
Direction No. 16 of 1991	Audited Accounts
Direction No. 02 of 2011	Reporting Requirements
Other Directions	
Direction No. 04 of 1991	Transfer of Assets
Direction No. 11 of 1991	Fixed Assets
Direction No. 15 of 1991	Accrued Interest
Direction No. 05 of 2001	Deposits-Incentive Schemes
Direction No. 04 of 2005	Closure of Office/s for Business
Direction No. 05 of 2005	Structural Changes
Direction No. 06 of 2005	Opening/Shifting/Closure of Branches/Offices

Rule/Direction/Guideline Number	Description of Rule/Direction/Guideline
Rules	
Rule No. 01 of 2006	Advertisements
Circulars	
Circular No. 01 2012	Panel of External Auditors
Guidelines	
Guidelines No. 01 of 2006	Opening of Branches/Offices
Guidelines No. 02 of 2006	Publication of Half Yearly Financial Statements
Guidelines No. 01 of 2007	Maintenance of Savings Accounts for Minors
Instructions	Collection of Information for the Facts Book
	Operation of Investment Fund Account
Circulars issued by Bank Supervision Department	
	Regulations
	Sri Lanka Deposit Regulations No. 01 of 2010
	Sri Lanka Deposit Regulations No. 01 of 2011
	Sri Lanka Deposit Regulations No. 02 of 2010
	Circulars
	Sri Lanka Deposit Insurance Scheme Circular No. 01 of 2010
	Sri Lanka Deposit Insurance Scheme Circular No. 02 of 2010
	Sri Lanka Deposit Insurance Scheme Circular No. 01 of 2011

Social and Environmental Protection

MI's 'Sustainability Report' given on pages 197 to 262 provides an extensive coverage on economic, social and environmental protection initiatives that were carried out by the Company in this period. The report disclosures have been developed in accordance with Global Reporting Initiative (GRI) requirements.

Corporate Governance

Information relating to MI's corporate governance framework and good governance initiatives carried out this period have been disclosed in our 'Corporate Governance Report' given on pages 103 to 163.

Risk Management

Risks that prevail in our business and how it is managed within the Company together with recent initiatives that have been effected to improve risk management practices of the Company have been disclosed in our 'Risk Management Report' given on pages 167 to 195.

What the Future Holds

The future at it stands looks positive for the businesses community, considering the national plans put forward in the proposed 2013 road map. The optimistic sentiments of a planned USD 100 billion economy and an anticipated growth in per capita income to USD 4,000 with a healthy 7% GDP growth level by 2016 is bound to stimulate economic activity overall and would sustain the growth momentum transpired since post war. In this backdrop, foreign direct investment will remain a decisive factor for the Sri Lankan economy for its speedier progress towards a middle income nation.

Transcending national development initiatives and industrial growth notably the boost in tourism sector is certain to have significant beneficial effect on other industries including the financial services sector. With all these positives transpiring and as the economy alleviates to a higher platform there would be continued opportunity for the financial service sector to expand beyond current levels. Maintaining credit growth beyond 25% in this instance would not be much challenging if the sector is ready to go beyond traditional banking and finance boundaries and be innovative. Similarly, the finance company sector too would be able to gain higher ground to attract a fresh stream of business assuming there is adequate planning and focus right through. To counter the devolving competitiveness in the sector and growing market saturation the sector too needs to move beyond traditional products and services and start rethinking strategically how market penetration levels could be increased as well as how new markets could be created through profound innovativeness and out of the box thinking.

While the demand for the vehicle financing would remain at steady levels like in the past, the sector would need to improvise and be receptive to changes in customer preferences. In the medium-term, the sector would need to change gear to do more financing for other than traditional vehicle ownership needs such as financing for industrial projects, construction sector and other commercial related financing. To sustain anticipated yields on lending, our sector will need to persist in its strategy of intensifying its concentration on its non-traditional form of lending. In broad-basing avenues of generating income term lending, microfinance, property mortgage lending and personal lending will play a significant part in the next few years considering the untapped potential that remains especially outside the Western Province. To counter the current high interest rate regime that is bound to continue in the foreseeable future, remaining at these high levels for longer period than earlier anticipated, in spite of rates not further rising, the sector would need to remain strong in its recovery strategies and risk management approach towards credit if the quality of lending portfolio is to be retained.

In terms of maintaining continuous flow in funding, the sector will need to move outside traditional deposit mobilisation that is construed as being very competitive since lately. As some of the players have done in the recent past, in seeking fresh sources of funding, best option will be to go beyond our shores to find international partners who could offer attractive low cost funding. In meeting expanded cost structures and deriving anticipated profitability levels, the sector would need to stay focused on maintaining sound business margins to remain successful in the midst of rising costs and customer sophistication.

Futuristic Direction and Strategy of the Company

In forging ahead with success this decade, Mercantile Investments will remain close to it fundamentals and follow-suit its systematic business model that encapsulates clear strategy for each line of business and for all other key facets of business. Next few years will see the Company moving ahead full gear in implementing most of the plans that have been set forth in the medium-term strategic plan which goes on from April 2013 till March 2015.

MI has set forth a clear vision, mission and measurable objectives for all within the organisation and have gained their support in gradually moving towards organisational aspirations. MI has already created a culture that is performance driven. Already in keeping to the budget of 2013/14, departmental level overall targets, subtargets and officer level targets have been established for the next financial period. Moreover, the targets set-forth have been aligned to the overall company objectives and any material deviations from the forecast given in the strategic plan has been dealt with by laying down additional strategy or devising new strategy.

Core Strategies of MI going into the Future

The formulated strategies given below would stay central for the Company in the next few years considering its importance in bringing forth greater profitability, more volumes in business and success that would bring positive impact not only to the sector but also to national economy.

Area of Focus	Strategy Going into the Future	Underlying Goals	Financial Targets in the Medium-Term
Credit Business	**Growing the branch network** To intensify lending volume generation at branches as a means of spreading business and geographic risk diversification. The aim is to sustain more than 60% of new lending business to come from the branch network.	Increase lending volumes/ Credit risk minimisation	Lending growth to exceed 25%
	Broad-basing of the product and service range Through our innovativeness, we hope to provide flexible lending solutions by planning to introduce new products and further adding on extensions to existing products.	Customer convenience/ Increase revenue generating avenues	
Deposit Business	**Using extensively the branch network to bring more business as opposed to central business operation**	Increase deposit mobilisation	Deposit growth to exceed 30%
	Increasing public awareness of MI's services Initiating strong advertising and promotion campaigns across the country	Attracting new customers	
Recovery Operation	**Instilling tight control over past due customers** Initiating recovery action early through close monitoring of accounts in arrears. Repossession or court action process to be made more brisk by upholding speedy operational practices supported by right caliber of recovery and legal staff.	Maintaining sound asset quality	Non-performing lending ratio to be kept below 3.5%
Treasury Management	**Managing spread by seeking low cost funding avenues** Strong emphasis will be placed to seek foreign borrowing at cheaper pricing.	Maintaining sound core business profitability	Spread from core business to exceed 8%
Human Resource	**Increasing productivity of Staff** To expand business volumes without a relative increase in staffing and to manage with current cadre. Training and development, succession planning and other motivational mechanisms will be maneuvered to raise productivity levels gradually in the next few years.	Keep personnel cost at manageable levels whilst raising income levels	Annual staff turnover to be kept below 5%

Area of Focus	Strategy Going into the Future	Underlying Goals	Financial Targets in the Medium-Term
Information Technology	**Embracing sophisticated technological breakthroughs to enhance service standards** To improve front end operations and even enhance risk management and compliance practices, we hope to embrace suitable software solutions for our types of business. The aim is to develop solutions in-house for greater flexibility.	Enhance operational practices/ Improve efficiency of risk management and compliance function	To set aside 40% of capital budget for IT advancement programmes
Cost Control	**Having a tight control over expenditure** Development of a CAPEX budget and setting related controls over capital expenditure. Performance of all departments to be linked to their respective cost elements. Seeking cost effective methods of doing business. E.g.: Use of solar power in the future.	Control escalation of overhead costs	To keep annual overhead cost escalation below 5%

Please refer pages 17 to 19 of the Managing Director's Review which provides further disclosure on the outlook and MI's plans moving forward in line with above future expectations.

BOARD OF DIRECTORS

S.H.J. Weerasuriya

Gerard G. Ondaatjie

Angeline M. Ondaatjie

P.M. Amarasekara

P.T.K. Navaratne

N.H.V. Perera

S.H. Jayasuriya

Travice J. Ondaatjie

H.A.S.T. Senanayake

S.M.S.S. Bandara

Saroja Hemakumar Jayawickrema Weerasuriya

Chairman

First appointed to the Board on 26 January 2011.

BSc (Lond.), MICE. FIE (SL), FSSE (SL), C.Eng.

Director of International Civil Engineering Consultants (Pvt) Limited.

Counts over 34 years experience as a Consultant in Civil/Structural Engineering Design and Project Management in UK, Sri Lanka, India and Maldives.

Proprietor of Saro Weerasinghe Associates.

No. of shares held: Nil

Gerard George Ondaatjie

Managing Director

First appointed to the Board on 2 December 1993.

Holder of a BSc 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 21 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 and has CGMA status (Chartered Global Management Accountants).

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 Director of The Finance Houses Association of Sri Lanka.

Counts over 21 years experience in the Financial Services, Insurance, Manufacturing and Trading sectors.

No. of shares held: Nil

Travice John Ondaatjie

Director

First appointed to the Board on 13 July 1995.

Holder of BSc Degree

Managing Director of Nilaveli Beach Hotels (Pvt) Limited, Nilaveli Hotels (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 21 years experience in the Financial Services and Tourism sectors.

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

Angeline Myrese Ondaatjie

Director

First appointed to the Board on 20 January 1992.

Holder of Master's Degree

Holder of BSc 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 Hotels (Pvt) Limited.

Counts over 21 years experience in the financial services, Tourism and Manufacturing sectors.

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

Pathiranage Mahes Amarasekara

Director - Recoveries

First appointed to the Board on 1 December 1995.

Possesses almost 28 years experience in the Financial Service sector.

Director of Security Ceylon (Pvt) Limited.

No. of shares held: Nil

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 Oceanic 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 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

CORPORATE MANAGEMENT TEAM

Mrs. M.B. Assauw - Director Deposits (Non Board Member)

Mr. Dhanushka Fonseka - General Manager (Marketing and Credit)

Mr. Ravi Ekanayake - General Manager (Workshop)

Mr. Prasad Wickramesinghe - Senior Manager (Payments)

Mr. Chandana Nanayakkara - Senior Manager (Finance)

Mr. Hirantha Pandithasekera - Senior Manager (Corporate Leasing)

Mr. Dharshana V. Senarath - Senior Manager (Leasing)

Mr. Buddika Kasturiratne - Assistant General Manager (Recoveries)

Mr. Deva Anthony - Assistant General Manager (Finance)

Mrs. Jayanka Kahawevithana - Senior Manager (Legal)

Mr. Shehan Cooray - Senior Manager (Recoveries)

Mr. Prasad Indika - Senior Manager (Software Development)

Mr. Lahiru Dayananda - Senior Manager (Leasing)

Mr. Ravi de Mel - Senior Manager (Administration)

Mrs. M.B. Assauw

Director Deposits (Non Board Member)

Mrs. Assauw currently functions as the Head of the Deposit Department with over 38 years experience in the financial service sector. She was a Board member previously and resigned from the Board on 13 January 2012 and continued in this current capacity.

Mr. Dhanushka Fonseka

General Manager - Marketing and Credit

Mr. Fonseka currently serves as the General Manager - Marketing and Credit. He has over 15 years experience in the financial service sector, and is a finalist of Chartered Institute of Marketing and Holds a Master's Degree in Business Administration (MBA) from the University of Wales. He also serves as a member of the Credit Committee of the Company.

Mr. Buddika Kasthuriratne

Assistant General Manager-Recoveries

Mr. Kasthuriratne currently functions as the Assistant General Manager - Recoveries and has over 19 years experience in the financial services sector.

Mr Deva Anthony

Assistant General Manager - Finance

Mr. Anthony currently serves as Assistant General Manager - Finance. He is an Associate member of The Institute of the Chartered Accountants of Sri Lanka and also he is an Associate Member of Chartered Institute of Management Accountants (UK) and holds CGMA status (Chartered Global Management Accountant). He is also a member of Associate Certified Management Accountants (Sri Lanka) and an Associate Member of Chartered institute of Marketing. Mr. Anthony has over 10 years experience in financial service sector and 5 years experience in audit and accounting.

Mr. Ravi Ekanayake

General Manager - Workshop

Mr. Ekanayake currently functions as the General Manager - Workshop. Mr. Ekanayake has over 14 years experience in the same field and holds a Diploma in Engineering from City and Guilds (UK).

Mrs. Jayanka Kahawevithana

Senior Manager - Legal

Mrs. Kahawevithana currently serves as the Senior Manager - Legal. She has over 2 years' experience in the financial service sector and is an Attorney-at-Law, Notary Public, Commissioner for Oaths and also holds a LLB (Hons.).

Mr. Shehan Cooray

Senior Manager - Recoveries

Mr. Cooray currently serves as the Senior Manager - Recoveries, and has over 5 years experience in the financial services sector.

Mr. Prasad Wickramasinghe

Senior Manager - Payments

Mr. Wickramasinghe serves as the Senior Manager - Payments with over 25 years experience in the financial services sector. He holds a Diploma in Taxation from Chartered Institute of Accountants of Sri Lanka.

Mr. Chandana Nanayakkara

Senior Manager - Finance

Mr. Nanayakkara currently serves as the Senior Manager - Finance. He is an Associate Member of Chartered Accountants and also a Fellow Member of Associate Certified Management Accountants. Mr. Nanayakkara has over 8 years experience in the financial service sector and 4 years experience in audit and assurance field.

Mr. Indika Prasad

Senior Manager - Software Development

Mr. Prasad currently serves as Senior Manager - Software Development. He holds a Diploma in NIBM and is a Fellow Member of British Computer Society and has over 10 years experience in the financial services sector.

Mr. Hirantha Pandithasekara

Senior Manager - Corporate Leasing

Mr. Pandithasekara currently functions as the Senior Manager - Corporate Leasing with over 11 years experience in the financial services sector and 2 years experience in the insurance field.

Mr. Darshana Senerath

Senior Manager - Leasing

Mr. Senerath Currently serves as Senior Manager - Leasing. He has over 15 years experience in the financial services sector.

Mr. Lahiru Dayananda

Senior Manager - Leasing

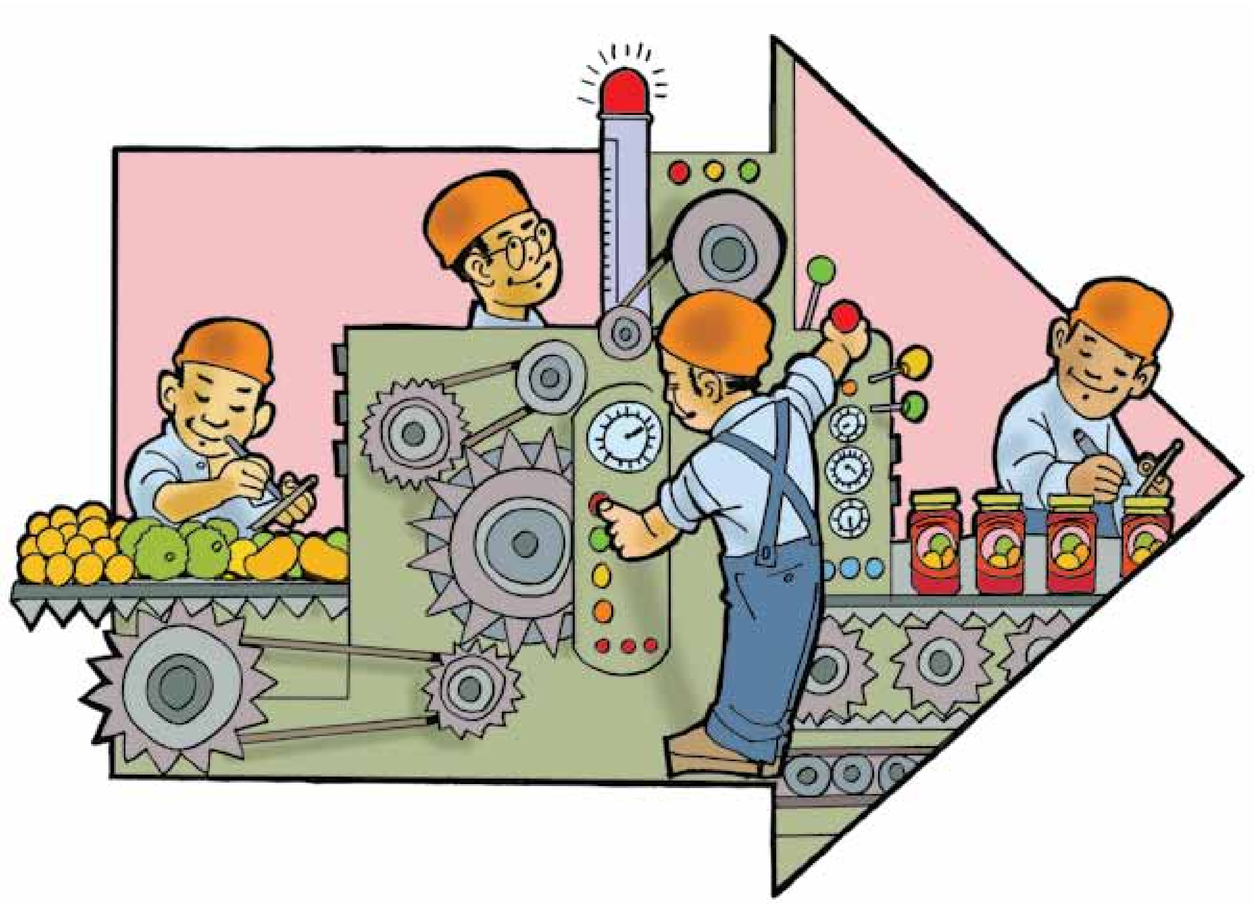
Mr. Dayananda currently serves as Senior Manager - Leasing. He has over 13 years experience in the financial services sector.

Mr. Ravi De Mel

Senior Manager - Administration

Mr. De Mel currently serves as the Senior Manager - Administration and holds a Master's Degree in Business Administration (MBA) from the University of Wales and has over 12 years experience in the financial services sector.

INCLUSIVE GROWTH FLOWS, ACCOUNTABLY



Good governance and accountability flow seamlessly across every facet of our operations.

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CORPORATE GOVERNANCE REPORT

CHAIRMAN'S STATEMENT

Sound Governance System a Necessity

I believe, being part of the finance company sector which composite varying stakeholders, it is of paramount importance that we consistently adopt the right approach to govern our businesses prudently. Sound corporate governance practices are essential in ensuring that a company's assets are safeguarded and also to secure the interests of its key stakeholders especially its depositors.

I acknowledge the extensive efforts undertaken by the Central Bank of Sri Lanka in bringing forth a stream of measures for improving governance practices within the finance company sector. The enactment of the Finance Business Act in 2011 was a significant step towards strengthening regulations applicable to finance companies introducing a series of compliance requirements to the sector. Timely introduction of stringent prudential regulations combined with increased emphasis on corporate governance has strengthened the sector than before. This enabled the sector to regain the confidence of its customers in a short span of time which led to a boom in business in the last few years.

MI Board Sets High Governance Standards

In strengthening the corporate governance framework, Mercantile Investments Board initiated a significant re-structuring process at the beginning of 2012. This was the year in which I took over the helm as the newly-appointed Chairman of the Company, which I accepted with great pride and responsibility. MI's Board is well balanced in terms of having equal representation of both Executive and Non-Executive Directors.
The Directors have the necessary experience and knowledge to contribute to the Board in discharging its duties. They actively participate at meetings and continue to provide invaluable advice for the betterment of the Company.

The Board meets on a monthly basis to discuss a broad range of matters so that there is constant review of the Company's performance. The Board oversees aspects such as strategy implementation, resolution of unsolved matters and takes up new challenges in the context of the volatile and competitive market. I believe, our Board has the necessary expertise and the leadership qualities from all fronts to maneuver the Company's business to new heights despite challenges associated with the sector.

Mi's Governance Initiatives In 2012/13

In keeping to MI's strategic plan and medium-term objectives, it was necessary that we placed emphasis on strengthening corporate governance practices within the Company. I can confidently say that we have been able to successfully strengthen our governance framework within the last few years. Of course 2012/13 was certainly another commendable year where we initiated a stream of measures to improve our corporate governance practices which we have disclosed in our report.

This year's corporate governance report provides extensive disclosures about the organisation's corporate governance framework and practices adopted while mapping them out against best recommended practices and prevailing regulations. Accordingly, we separated our report into two parts. Part 01 provides an update on MI's extent of adherence 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. Part 02 provides disclosure on MI's level of compliance to the Central Bank Direction on Corporate Governance issued to finance companies.

Governance at MI in Going Forward

The Board of MI would stay committed to upholding sound governance practices at all times to safeguard interests of our shareholders, customers including interest of our depositors, employees and all other key stakeholders. Being a finance company, we will continue to place significant importance on adopting sound governance practices. I wish to reiterate that through a sound governance system, MI Board will provide the necessary hindsight to our employees to excel in our businesses. We will continue to display true leadership in all our endeavours to prudently guide the organisation in meeting success in whatever we do.

Saroja Weerasuriya
Chairman

21 May 2013

Corporate Governance

Mercantile Investments has a well-established corporate governance framework that sets out the roles, responsibilities and rights of each individual from the Board level to corporate management and right down to every other employee attached to the corporate hierarchy. The framework revolves around a formal governance structure together with a process that is built on a set system of internal controls and procedures to govern operations of the Company. Overall responsibility for governing the Company falls on MI's Board of Directors who takes leadership and a supervisory role in ensuring that the business is conducted in a sound and prudent manner. Thus, the Board of MI discharges its primary goal of creating wealth to its shareholders by managing business operations efficiently to optimise their return. At the same time, in conducting affairs of the Company, the Board is also required to safeguard interests of other key stakeholders mainly MI's customers, lenders, suppliers, employees and other parties directly transacting with the Company.

In governing the operations of the Company, MI Board ascertains its core objectives and devises strategic plans in keeping with its corporate vision and mission. The Board as part of its duties establishes policies and practices for smooth conduct of operations while providing financial, human and other resources for the attainment of corporate objectives. An effective system of internal controls has been put in place to provide assurance on proper conduct of business operations in line with organisational expectations that include proper adherence to laws and regulations.

In our pursuit on attainment of corporate goals, we take utmost care in whatever we do, displaying high standards of commercial and professional ethics so that we can safeguard the interest of stakeholders. A well-structured risk management system has been established to handle key risks associated with our business to eliminate risk or at least minimise risk and associated drawbacks.

MI continues to excel in the area of financial reporting that we are renowned for, portraying our commitment towards transparency, a key feature of an enterprise practicing sound corporate governance practices. Mercantile Investments has always displayed accountability for its corporate actions.

Another feature of our operations is that our goals go beyond commercial requirements of seeking profit. As such, we have shown tremendous commitment towards the subject of sustainable development in core areas of economy, environment and society.

All of these initiatives put-together have enabled the Company to build lasting bondage between us and our shareholders, customers and other key stakeholders thus securing their trust and loyalty.

Corporate Governance Framework at MI

MI's corporate governance framework has been established based on recommended best practices and industry standards. The framework was further strengthened in the last two to three years to adopt additional requirements of the regulator.

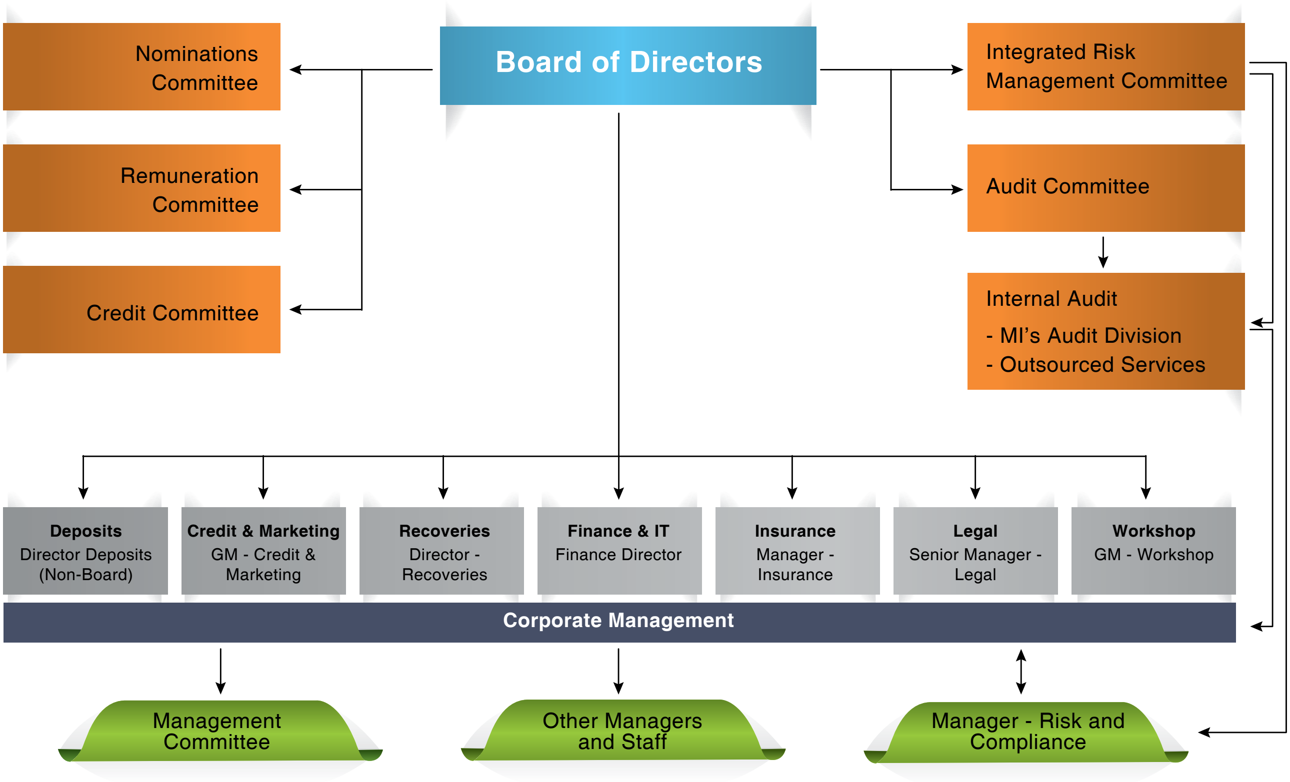
The Board's Role in Governance

The governance structure adopted by the Company is a standard top down approach from the Board of Directors right down to the lowest levels of the hierarchy. (Please see diagram) The Board in parallel has formed several subcommittees to monitor and provide feedback to the Board on key areas of business. The powers of the Board are delegated to MI's corporate management to ensure routine business operations function in an appropriate manner.

Corporate Management's Role in Governance

The corporate management in-turn has been entrusted with managing respective parts of the operation through their departmental staff. They are required to take appropriate decisions in the best interest of the Company. Through a supervisory role, guidance is given by corporate management to their staff to ensure they perform their work duties with due care in line with corporate policies and procedures. For reviewing performance related to core business areas corporate management has set up various management level committees. The weekly Management Committee meetings provide an ideal opportunity for management to assess performance of their divisions, giving them timely information to manage their departmental processes and activities better.

MI's GOVERNANCE FRAMEWORK



Key Corporate Governance Initiatives in 2012/13

Initiative

- Adopting a strategic management approach to plan and govern functions of the enterprise. Setting forth a three-year Strategic Plan for the Company.
- Setting up of a Nominations Committee and approving the Credit Committee as a Board Subcommittee with specified limits.
- Setting up of MI's own Internal Audit Division.
- A 'Whistle-blowing and Fraud Policy' was approved by the Audit Committee of the Company. This policy document provides a formal process by which employees could raise concerns to higher management and how investigation would take place.
- Recruitment of a full-time Compliance Officer to oversee and report on MI's compliance to applicable laws and regulations.
- Requesting Ernst and Young to carry out a special assignment on adequacy of internal controls within the Company so that any gaps are bridged in a timely manner.
- Approval of a procedure for Directors to seek outside professional advice.
- Scheme of self-assessment on Board performance by Directors individually.
- Approval of a 'Risk policy document' for the Company and the ongoing preparation of a formal risk management procedure document.
- Maintenance of a 'Risk Register' to record key risks and counter measures as means of accountability.
- Introduction of a Branch compliance check list to minimise operational lapses.
- Tabling of a quarterly risk report and a compliance checklist report to the Integrated Risk Management Committee.
- Submission of an 'Activity Report' to the Board by the Integrated Risk Management Committee, highlighting their key observations and recommendations.

Embracing a Formal Strategic Management Process to Govern Operations

In order to have a professional approach to governing the operations of the enterprise, a three-year strategic plan approved by the Board was put into action during this period. The plan was devised with acceptance by heads of all functional areas and reviewed by an independent consultant to ensure innovative ideas are inbuilt to the strategies proposed. The plan maps out a clear path for all employees to follow, setting forth medium term corporate objectives and proposing strategies for key business functions so that all within the organisation could work towards the corporate mission and one vision.

Please refer pages 38 to 56 in the MDA that provide a brief on the framework adopted by the Company in moving towards business excellence and success.

Strengthening the Oversight Function

Setting up MI's Own Internal Audit Division

With the initiation of the Audit Committee, an Internal Audit Division was set up within the Company in December 2012. The division works independent from other divisions and reports directly to the Audit Committee on findings. The division's main focus is to review the operations and compliance status of the expanding MI branch network. They would operate in parallel with MI's present Internal Auditors, Messrs Ernst and Young Advisory Services (Pvt) Limited.

Strengthening the Compliance Function

To oversee growing regulatory demands expected from various regulatory bodies and enactments it was necessary that there is a mechanism for the Board as well as the management to obtain feedback on Company's level of compliance to such regulations. Apart from review reports submitted by internal audit as well as matters raised by External Auditors there was a necessity to set up a unit to oversee compliance matters on a full time basis.

Accordingly, in September 2012 management recruited a manager at senior level to oversee compliance aspects of the Company. He reports to the Integrated Risk Management Committee on a quarterly basis. Being the Compliance Officer for purpose of Financial Transactions Reporting Act training sessions were conducted by him for the staff on applicable regulations.

Strengthening the Risk Management Process

A number of measures were effected this financial year to boost the risk management capabilities of the Company. To handle growing complexities in finance business and to mitigate risks, management resorted to following broad risk management initiatives:

- The Committee established a 'Risk Policy' for the Company to streamline the process of risk management identifying who should do what.
- Preparation of a formal risk Management procedure document which is going on and is expected to be finalised before end 2013.
- To improve quality of information received by the Integrated Risk Management Committee, a comprehensive Risk report is tabled periodically by the Risk Manager through the CFO.

Please refer pages 180 to 192 in the Risk Management Report for detailed disclosure on risk management initiatives carried out this period.

MI's Extent of Compliance to Regulations and Best Practices on Corporate Governance

To illustrate the Company's level of conformity with prevailing regulations and best practices on corporate governance, we disclose two separate compliance statements as follows:

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 1 January 2009.

Statement - 01

MI's Compliance to the Code of Best Practice on Corporate Governance

Corporate Governance Principles	Reference to SEC and ICASL Code	Adoption Status	MI's Extent of Adoption (2013 Update)
Section 1: The Company			
A. Directors			
A.1 The Board	Principle - A.1	Adopted	MI Board is led by a high calibre team of Board members who involve themselves in directing, leading and controlling affairs of the Company. The Board of Directors provides the necessary leadership in moving towards its visionary thinking, setting the strategic direction for the Company, upholding a successful framework that couples effective strategic management with good governance and sound controls. MI Board is headed by a Non-Executive Chairman who is ably supported by the Managing Director, Executive Directors and Non-Executive Directors. The Board members have necessary experience and qualifications to satisfactorily discharge their duties competently. The Director Board comprises of professionals in the fields of Accounting, Legal, Audit, Engineering and some leading entrepreneurs in other businesses holding vast experience, skills and knowledge.
1. Board meetings	Code - A.1.1	Adopted	During the FY 2012/13 a total of 12 Board meetings were held by the Company. The usual practice is to hold regular Board meetings at monthly intervals. Director participation status at each Board meeting is disclosed on page 155. All Directors were duly informed to attend meetings through a formal Notice of Meeting with an agenda issued by the Company Secretary that is sent in advance giving adequate time for preparation. Other than regular Board meetings, there were no special Board meetings held during the financial period 2012/13.
2. Responsibilities of the Board	Code - A.1.2	Adopted	MI Board affirms its key responsibility towards its shareholders to enhance shareholder returns through the prudent management of business. The Board also recognises its responsibility towards other key stakeholders including its depositors when directing the affairs of the Company. In discharging the obligations of the Board in an effective and prudent manner, MI Board takes responsibility for matters that are of strategic nature, financial and otherwise: **Strategic Matters;** ● MI Board approved a medium term **'strategic plan'** on 27 April 2012 covering financial periods 2012/13 to 2014/15. By devising the strategic plan, the Board intends to put into perspective MI's corporate vision and mission, setting forth overall business objectives, business strategies, policies and processes for divisions and employees to adhere and concentrate moving forward.

Corporate Governance Principles	Reference to SEC and ICASL Code	Adoption Status	MI's Extent of Adoption (2013 Update)
			• The Board ensured that the corporate objectives and goals, corporate values and strategies so devised have been communicated to the corporate management and all key officers to set the path for implementation of proposed strategy. The Board monitors the progress made so far in strategy implementation and the attainment of annual targets. Please see pages 70 to 71 in the MD&A for a summary of MI's actual financial performance in 2012/13 against set annual targets. • The Managing Director and Corporate Management Team has the necessary skills, experience and knowledge to execute the strategic plan devised. The names, experience and qualifications attained by each member of the Corporate Management Team is explained on pages 98 to 101. • Key responsibilities of the Board have been defined and circulated to all Board members. Executive Board members involve themselves with core functional areas including credit, recoveries and finance to ensure adequate oversight of core functional areas of the Company. The roles and responsibilities of Corporate Management are also specified based on their designations to ensure clear demarcation of authority and accountability within the organisational hierarchy. • The Board accepts its obligations towards managing of risks and for this purpose has established an Integrated Risk Management Committee and an Audit Committee to oversee and obtain feedback on the soundness of the risk management and internal control mechanisms in place. The Board carried out an assessment by obtaining an independent report from Ernst & Young Advisory Services (Pvt) Limited on the adequacy of internal controls in place including controls that have been established to safeguard the assets of the Company during this period. • MI Board takes responsibility for the maintaining of an effective accounting and financial reporting system that is accurate and that can be relied upon. They monitor related processes, controls and procedures and ensure appropriate accounting policies and financial regulations are followed at all times. • Apart from the Audit Report, a separate Assurance Report was obtained from External Auditors on the adequacy of controls in place for ensuring the reliability of financial reporting which is disclosed on page 165. • As a routine practice, the Executive Board members initiate periodic meetings with Corporate Management and other key officers to monitor progress. They instruct and guide Corporate Management in identifying gaps and means of bridging them. For this purpose, the Executive Directors review existing policies and procedures while establishing lines of communication among employees. • The Board takes responsibility to conduct a sound corporate governance framework that takes into account best practices and regulatory requirements. A number of new changes were initiated by the Board for 2012/13 to improve the governance framework and practices as disclosed on page 106.

Corporate Governance Principles	Reference to SEC and ICASL Code	Adoption Status	MI's Extent of Adoption (2013 Update)
			● The Board has also set in place a 'Communication Policy' specifying upfront the communication methods and channels that would be adopted when interacting with MI's shareholders, depositors, creditors, borrowers and other stakeholders considered key to the Company. **Other Matters Financial and Otherwise;** ● The Board involves itself in making strategic financial decisions on funding, pricing, liquidity and decisions on capital expenditure. The Board during this period decided on dividends after analysing the overall performance of the Company and future plans. ● To safeguard the integrity of the Management Information System, Board has established Information Communication Technology (ICT) standards in keeping to international practices. There is adequate independent review on ICT to ensure information contained in such systems is safeguarded appropriately while maintaining its reliability and integrity. ● To monitor MI's compliance to laws and regulations, the Board has established a sound compliance system. The Board has hand-picked knowledgeable officers to head core divisions, individuals who are conversant with applicable regulations. To strengthen the monitoring process on compliance, key recruitments were carried out at both manager level and officer grade during this period. ● Further, through Board subcommittees, feedback is given to the Board on MI's level of compliance to regulations. The Board through these committees oversees application of policies, procedures and controls by employees as a means of ensuring compliance.
3. Compliance with laws and access to independent professional advice	Code - A.1.3	Adopted	The Board affirms collectively and also the Directors individually their duty to abide by the laws of this land for the running of the Company. The Company's compliance status to applicable laws and regulations is mentioned in Section 10.2.j in this supplement. On 31 December 2012, the Board approved a formal policy for Directors to obtain independent professional advice when it is deemed necessary at the expense of the Company. This procedure was implemented so that Directors could remain independent in their views and also maintain high quality in decision-making by seeking appropriate external advice.
4. Company Secretary	Code - A.1.4	Adopted	Mrs. Sonali Pethiyagoda, a qualified Chartered Secretary with over 20 years experience in related fields, was appointed by the Board as the Company Secretary since 1999. The Board of Directors has direct access to her advice and services at all times. She is responsible to the Board in ensuring that Board procedures are followed and applicable rules and regulations are complied with. She advises the Board on prevailing rules on corporate governance and also co-ordinates the scheduling of monthly Board meetings and handles related duties.

Corporate Governance Principles	Reference to SEC and ICASL Code	Adoption Status	MI's Extent of Adoption (2013 Update)
5. Independent judgment	Code - A.1.5	Adopted	Equal opportunity is provided to all Directors to express their views and independent judgment for all matters taken up by the Board. The Directors have ample time to review Board papers and other circulated information prior to a meeting. All Executive Directors as well as majority of the Non-Executive Directors some of whom hold membership in Board subcommittees are able to involve themselves in strategic, financial, compliance and governance matters more closely. They pass down their knowledge independently and provide considerable degree of technical advice based on experience they have gained in their respective fields. The Chairman and the Managing Director act impartially to proposals of all Directors, encouraging them to profess their own views on matters brought up at the meetings. All Non-Executive Directors have attended most of the meetings and have devoted their time adequately despite their undertaking in other institutions.
6. Dedicating time and effort	Code - A.1.6	Adopted	All Directors nominated to Board's subcommittees have devoted their time and effort in expediting the obligations passed down to such committees. Please refer pages 158 to 161 on details related to Board subcommittees and Director participation levels at such meetings.
7. Training needs of Directors	Code - A.1.7	Adopted	Individuals hand-picked for all Board appointments have the required knowledge, skills and dynamism to deal with matters of the Board. The Directors have had adequate exposure and training in their relevant areas of expertise necessary to discharge their obligations to the Board. Nevertheless, considering evolving complexities in finance business, knowledge and skill levels of Directors are continuously assessed to identify training needs. Directors are therefore encouraged by the Board to attend seminars and workshops covering current topics. Finance Director attended training on the International Financial Report Standards and attended a seminar on Budget highlights arranged by Ernst & Young. The Managing Director together with the Finance Director attends CEO and CFO seminars respectively and other meetings conducted by the Central Bank and the Finance Houses Association of Sri Lanka.
			Other Executive Directors also participated in seminars and programmes related to their work functions and professional fields during this period. There were presentations carried out by Executive Directors, Corporate Management and external experts on new developments, changes to regulations and other current happenings to appraise fellow Directors either at Board meetings or at subcommittee meetings.
A.2 Chairman and Chief Executive Officer	Principle - A.2	Adopted	A Non-Executive Chairman and a separate Managing Director have been appointed since January 2012. The Chairman takes leadership for the running of the Board and discharging Board functions. The Managing Director on the other hand has the executive responsibility for the management of the Company (No separate Chief Executive Officer).

Corporate Governance Principles	Reference to SEC and ICASL Code	Adoption Status	MI's Extent of Adoption (2013 Update)
8. Keeping separate the role of Chairperson and Chief Executive	Code - A.2.1	Adopted	To maintain Board balance, the roles of Chairperson and Chief Executive have been kept separate at MI. The Managing Director (MD) is in charge the Company's chief executive role, managing day-to-day running of the Company. Based on the delegated authority given to him by the Board, the MD gives leadership to the Corporate Management in handling routine affairs of the Company. As part of his role, MD updates Board on status of Company performance, proposes strategies and advises Board on operational aspects.
A.3 Chairman's Role	Principle - A.3	Adopted	As Chairman of the Board Mr. Saroja Weerasuriya gives leadership to the Board in effectively discharging Board functions in an orderly manner. He is supported by a well-blended Director Board comprising equal number of Executive and Non-Executive Directors.
9. Chairperson's role in conducting Board proceedings	Code - A.3.1	Adopted	Being a Non-Executive Director with years of experience behind him, Mr. Saroja Weerasuriya is able to maintain independence and impartiality in Board matters. As Chairman, he is able to obtain advice across the Board considering the mix of expertise MI Directors possess. To ensure all significant matters are taken up for Board meetings, there is a formal agenda reserved for the Board prepared and circulated under his supervision. As Chairman of the Company he is bound to discharge a range of duties/responsibilities: • Being the leader of the Board, he ensures that Board functions are effectively discharged by taking up matters raised by Directors and members of the Corporate Management and ensuring resolution through a process of deliberation and then decision-making. • Ensuring that all Directors actively participate for Board meetings. • Approving the agenda prepared for Board meetings by the Company Secretary. • Ensuring there is adequate blending of Executive Directors and Non-Executive Directors, encouraging all Directors to profess their views equally for quality decision-making. • Ensuring that the Board is sufficiently appraised with current and reliable information, financial and non-financial in a timely manner for Directors to assess MI's performance on a continuous basis and also for purpose of taking up matters put forward to the Board. • Approving the Board minutes prepared by the Company Secretary. • Convening special meetings when need arises and maintaining Board order during such meetings. • Ensuring that an Annual General Meeting is held within the specified regulatory period and meeting shareholders and public to convey Company plans as well as obtaining views from them. • In co-ordination with Managing Director and Company Secretary instilling a sound corporate governance framework for the Company right from Board level to other levels of the hierarchy.

<table>
<tr><th>Corporate Governance Principles</th><th>Reference to SEC and ICASL Code</th><th>Adoption Status</th><th>MI's Extent of Adoption (2013 Update)</th></tr>
<tr><td>A.4 Financial Acumen
10. Availability of sufficient financial wisdom and knowledge within the Board</td><td>Principle - A.4</td><td>Adopted</td><td>The Finance Director of the MI Board is highly qualified in the field of finance and accountancy and possesses the necessary financial wisdom to advise the Board.

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, a 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 Jayewardenepura of Sri Lanka.

Board has the luxury of having three other Directors who possess qualifications in the field of finance and accountancy to obtain advice and guidance. They are:

<table>
<tr><th>Name of Director</th><th>Director Category</th><th>Accounting and Financial Qualifications</th></tr>
<tr><td>Mr. Gerard G. Ondaatjie</td><td>Managing Director</td><td>BSc Degree in Accountancy from Arizona State University, United States.</td></tr>
<tr><td>Mr. H.A.S.T. Senanayake</td><td>Independent Non-Executive Director</td><td>Associate Member of The Institute of Chartered Accountants of Sri Lanka.
Associate Member of The Chartered Institute of Management Accountants of UK.</td></tr>
<tr><td>Mr. S.M.S.S. Bandara</td><td>Independent Non-Executive Director</td><td>Fellow Member of The Institute of Chartered Accountants of Sri Lanka.
Fellow Member of the Association of Accounting Technicians of Sri Lanka.
Bachelor's Degree in Accountancy from the University of Sri Jayawardenapura.</td></tr>
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<tr><td>A.5 Board Balance</td><td>Principle - A.5</td><td>Adopted</td><td>MI Board has the right blend of Executive and Non-Executive Directors as required by the Finance Companies Corporate Governance Direction No. 03 of 2008 issued by the Central Bank of Sri Lanka.</td></tr>
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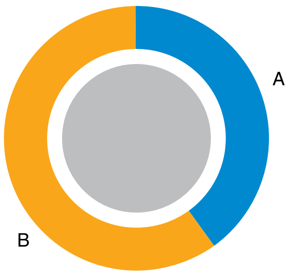
Corporate Governance Principles	Reference to SEC and ICASL Code	Adoption Status	MI's Extent of Adoption (2013 Update)
11. Presence of Non-Executive Directors	Code - A.5.1	Adopted	One-half of MI Board are Non-Executive Directors (Five Non-Executive Directors altogether) including the Chairman. The ratio of 50% being Non-Executive Directors to total Director was maintained right throughout the period. The ratio of 50% complies with the minimum requirement as per the Code. **Executive Vs. Non-Executive Directors**  A - Non-Executive Directors - 50% B - Executive Directors - 50%
12. Independent Directors	Code - A.5.2	Adopted	The four Independent Non-Executive Directors remained with the Board right throughout the period. This ratio of Independent Non-Executive Directors to total Directors of 40% did not vary over the period and complies with the minimum requirement as per the Code. **Independent Vs. Non-Independent Directors**  A - Independent Directors - 40% B - Non-Independent Directors - 60% All four Independent Non-Executive Directors remained independent from management and free from other relationships that could affect their decision-making.

Corporate Governance Principles	Reference to SEC and ICASL Code	Adoption Status	MI's Extent of Adoption (2013 Update)
13. Criteria for evaluating Independence of Non-Executive Directors	Code - A.5.3	Adopted	Based on Section 4.4 of the Corporate Governance Direction issued by CBSL independence of the four Independent Non-Executive Directors was established again this period.
14. Signed independence declaration by the Non-Executive Directors	Code - A.5.4	Adopted	All Non-Executive Directors made written submission as part of their annual declaration on their independence in accordance with schedule H of the code.
15. Determination of independence of Non-Executive Directors	Code - A.5.5	Adopted	Based on the written submissions made by the Non-Executive Directors and taking into account the criteria specified in Section 4.4 of the Corporate Governance Direction issued by CBSL, the Board considers the following Directors as Independent Non-Executive Directors: 1. Mr. S.H.J. Weerasuriya 2. Mr. H.A.S.T. Senanayake 3. Ms. P.T.K. Navaratne 4. Mr. S.M.S.S. Bandara
16. Senior Independent Director (SID)	Code - A.5.6	N/A	Chairman and Managing Directors' roles have been separated since January 2012 and hence this section does not apply.
17. Confidential discussion with SID	Code - A.5.7	N/A	Please see Code A.5.6 above.
18. Meeting of Non-Executive Directors	Code - A.5.8	Adopted	The Chairman held a meeting with Non-Executive Directors without the presence of the Executive Directors once during 2012/13.
19. Recording of concerns in Board minutes	Code - A.5.9	N/A	There were no concerns about matters of the Company which could not be unanimously resolved that required to be recorded in minutes.
A.6 Supply of Information	Principle - A.6	Adopted	Prior notice of seven days is given through circulation of the agenda together with information in adequate content and quality for the Board to discharge its obligations effectively.
20. Information to the Board by Management	Code - A.6.1	Adopted	For Board's information purpose and to take-up relevant matters, monthly management accounts, regulatory ratios, portfolio statistics, Board papers, circulars for Board's approval and other information necessary is made available to Directors in advance. The Corporate Management is on-call during Board meetings and is required to furnish additional information when requested. The Executive Directors brief the Board on the functional areas of Credit, Finance and Recoveries that they oversee. The Board on other functional matters deals with the Managing Director or the heads of those respective departments when necessary.
21. Adequate time for effective meetings	Code - A.6.2	Adopted	The Company Secretary ensured that the required Notice of Meeting, agenda and information documents including Board papers were sent to all Directors at least seven days prior to holding of a Board meeting to provide adequate time for Directors to prepare themselves for the upcoming meeting.

Corporate Governance Principles	Reference to SEC and ICASL Code	Adoption Status	MI's Extent of Adoption (2013 Update)
A.7 Appointments to the Board	Principle - A.7	Adopted	To streamline the process of appointment of Directors, a formal procedure was established giving powers to a Nominations Committee with effect from 2013. The Chairman of the Committee is Mr. Saroja Weerasuriya who is also the Non-Executive Chairman of the Company.
22. Nominations Committee	Code - A.7.1	Adopted	A Nominations Committee was set up with due terms of reference for the Committee to handle all future new appointments to the Board. The terms and reference of the Committee was approved by the Board on 14 February 2013. Pages 160 to 161 provides information of the Committee composition and other related details. The Nominations Committee Report for the financial period 2012/13 is given on page 279 in the Annual Report. Appointments prior to the set-up of the Committee were effected directly by the Board after assessing capabilities of the proposed individuals against strategic demands of the Company. Background review checks were duly carried out to assess the suitability of a nominee. In the year under review, there were no new appointments to the Board.
23. Board assessment by the Nominations Committee	Code - A.7.2	Adopted	In keeping with the terms of reference, the Nominations Committee carried out an annual assessment of MI Board's composition to ascertain the level of experience, skills, knowledge and qualifications the members possess to deal with growing strategic needs of the Company. The Committee took into account complexities associated with the industry in terms of structural changes, competition and regulatory changes. The Committee concluded that the current Board possesses individuals with required capabilities to meet demands of the enterprise. There was no immediate requirement for new appointments.
24. Disclosure of appointments to shareholders	Code - A.7.3	Adopted	There were no new Director appointments in 2012/13 requiring disclosure to the shareholders. The Nominations Committee would take-up future nominations and would seek approval from the Director Non-Banking Supervision of the Central Bank of Sri Lanka in keeping to requirements of the 'fit and proper test'. Already the Annual Report contain a brief résumé of all Directors that include his/her area of expertise and experience gained, qualifications possessed, names of companies in which they hold Directorship if any and details pertaining to category of Directorship independent or otherwise.
A.8 Re-Election	Principle - A.8	Adopted See Extent	The Nominations Committee recommends the Directors who are retiring by rotation annually for shareholder approval at the AGM. 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.

Corporate Governance Principles	Reference to SEC and ICASL Code	Adoption Status	MI's Extent of Adoption (2013 Update)
25. Appointment of Non-Executive Directors	Code - A.8.1	Adopted	In terms of the Articles of Association of the Company, All Non-Executive Directors are required to retire by rotation once in three years and is required to stand for re-election by the shareholders at the Annual General Meeting.
26. Election of Directors by Shareholders	Code - A.8.2	Adopted See Extent	In terms of the three-year requirement, no Non-Executive Directors retires by rotation in 2012/13 since all of the five Non-Executive Directors have not completed three years serving the Board in their current category.
A.9 Appraisal of Board Performance	Principle - A.9	Adopted	As explained in principle A.8 above.
27. Appraisal of Board performance	Code - A.9.1	Adopted See Extent	An annual appraisal by each Director on the Board performance was carried out for 2012/13. A Board performance self-assessment checklist was made available for Directors to assess the effectiveness of the Board for 2012/13. At the Board meeting held on 20 March 2013 a Summary Report of the assessments made was tabled to appraise the Board and highlight areas that require improvement. A similar self-assessment process would be carried out by the Audit Committee and the Integrated Risk Management Committee next period.
28. Annual self-assessment of the Board and its committees	Code - A.9.2	Adopted See Extent	Please see A.9.1 above.
29. Disclosure of method of appraisal	Code - A.9.3	Adopted	Please see A.9.1 above.
A.10 Disclosure of Information on Directors	Principle - A.10	Adopted	Information of Directors is made available to the shareholders through the Annual Report.
30. Director information	Code - A.10.1	Adopted	Profile of Directors which includes information on their experience, qualifications and Directorships in Boards is provided on pages 94 to 97. Details of Director participation at Board meetings and at Subcommittee meetings with information on such committees is given later in this report.
A.11 Appraisal of the Chief Executive Officer	Principle - A.11	Adopted	The performance of the Managing Director (No separate Chief Executive Officer) is reviewed on a continuous basis by the Chairman and other Board members.

Corporate Governance Principles	Reference to SEC and ICASL Code	Adoption Status	MI's Extent of Adoption (2013 Update)
31. Targets for Managing Director	Code - A.11.1	Adopted	The Board upon approving the Strategic Plan of the Company in April 2012, has specified the corporate objectives and annual forecasted targets for the Company. The Managing Director being the apex Chief Executive of the Company is entrusted by the Board to conduct day-to-day operations effectively to attain these set targets/goals after giving necessary consideration to market realities and changes in relevant variables. The Managing Director's performance is reviewed on an ongoing basis by the Board based on the duties assigned to him and the extent to which organisational objectives have been achieved.
32. Evaluation of MD's performance	Code - A.11.2	Not Complied	The requirement to have formal annual appraisal for MD will be looked into.
B. Directors Remuneration			
B.1 Remuneration Procedure	Principle - B.1	Adopted	The Board has established a formal procedure through the Remuneration Committee to decide on remuneration of Executive Directors without any Director deciding individually on his or her own remuneration.
33. Remuneration Committee	Code - B.1.1	Adopted	The Remuneration Committee in making recommendations to the Board on remuneration related to the Executive Directors keeps to its policy on remuneration as described in the Remuneration Committee Report given on Page 278 in the Annual Report.
34. Remuneration Committee composition	Code - B.1.2 and	Adopted	Remuneration Committee comprises of three Non-Executive Directors while the Chairman of the Committee Mr. Saroja Weerasuriya is also the Chairman of the Company.
	Code - B.1.3	Adopted	The Committee composition and details of meetings held and participation status is given later in this report.
35. Remuneration of Non-Executive Directors	Code - B.1.4	Adopted	Deciding of Non-Executive Director remuneration is handled by the Board and is a collective decision. The Non-Executive Directors are paid a fee for either attending Board or other committee meetings or carrying out other Non-Executive duties based on their responsibilities assigned. The Non-Executive Directors do not involve themselves of executive functions and hence do not receive any fees that are performance related.
36. Remuneration Committee's access to MD and professional advice	Code - B.1.5	Adopted	Based on the Remuneration Committee composition, the advice of the Chairman of the Company is already available since he also chairs the Committee. Further, when deciding on remuneration of other Executive Directors, the Committee also obtains advice from the Managing Director as necessary.

Corporate Governance Principles	Reference to SEC and ICASL Code	Adoption Status	MI's Extent of Adoption (2013 Update)
B.2 The level and make-up of remuneration structure	Principle - B.2	Adopted See Extent	MI Board and the Remuneration Committee is aware of the necessity to attract and retain high calibre individuals to be on the Board. The remuneration policy of the Company has been devised therefore in a way that it considers retention requirements. Necessary consideration is given to annual performance of Executive Directors when deciding on their remuneration. The need to establish a formal review mechanism will be looked into.
37. MD's remuneration	Code - B.2.1	Adopted	The Remuneration Committee makes assessment on the sufficiency of remuneration of Executive Directors to ensure a strategy of retention. They evaluate prevailing market remuneration levels and makes policy amendments on remuneration when deemed necessary. To ensure fair policy on remuneration, Executive Director including performance of MD is evaluated annually when deciding on their remuneration levels by the Committee.
38. Comparison of remuneration with other institutions	Code - B.2.2	Adopted	The Remuneration Committee when deciding levels of remuneration makes due references to pay levels for similar positions in the market. This is combined with the Directors' performance for the year and also considers pay levels of peers.
39. Remuneration comparison with other group companies	Code - B.2.3	Adopted	MI's does not have subsidiary companies or a parent company under its structure to which it could draw reference to. However, pay levels of peer Directors within the Company are considered when deciding on Executive Director remunerations.
40. MD's performance-related payments	Code - B.2.4	Adopted	Please refer principle B.2 and Code B.2.1 above.
41. Executive share options	Code - B.2.5	N/A	There was no executive share options scheme offered to any Director during 2012/13 period.
42. Deciding Executive Director - Remuneration	Code - B.2.6	Adopted See Extent	In deciding remuneration of Executive Directors, the Remuneration Committee referred provisions set out in Schedule D of the Code. Please see comments given in Principle B.2 for details on Executive Director Remuneration. There were no long-term incentive schemes or share option schemes proposed for Executive Director during this period.
43. Early terminations related to Directors	Code - B.2.7	N/A	Not applicable to MI Board members.
44. Early terminations not covered in service contracts	Code - B.2.8	N/A	No terminations were effected during this period.

Corporate Governance Principles	Reference to SEC and ICASL Code	Adoption Status	MI's Extent of Adoption (2013 Update)
45. Level of Remuneration of Non-Executive Directors	Code - B.2.9	Adopted	No share options schemes where afforded to Non-Executive Directors during 2012/13. Non-Executive Directors are paid a fee for their services as mentioned in Code B.1.4.
B.3 Disclosure of Remuneration	Principle - B.3	Adopted See Extent	Page 278 contains details related to the basis on which Executive Directors' remuneration is decided. Please refer Code B.3.1 below for details of remuneration of the Board as a whole.
46. Names of members in the Remuneration Committee and remuneration paid to Directors	Code - B.3.1	Adopted	Page 159 provides composition details of the Remuneration Committee with meetings held and participation status of members. The remuneration paid to Executive and Non-Executive Directors in aggregate is disclosed in the Notes to the Financial Statements on page 321.
C Relations with Shareholders			
C.1 Constructive use of AGM	Principle - C.1	Adopted	The Annual General Meeting is used by the MI Board to communicate with shareholders directly to have an open two-way dialog. In spite of the number of investors being minimal for MI, the Board always encourages all of them to participate at such meetings and to convey their views and suggestions.
47. Level of proxies at AGMs	Code - C.1.1	Adopted	Notice of Annual General Meeting with Proxy Forms is made available in the Annual Report that is released with adequate prior notice to all shareholders in accordance with the Companies Act. The Company Secretary's division monitors level of proxies that are submitted and discloses level of proxies lodged for and against each resolution at the AGM.
48. Propose separate resolutions for each separate issue	Code - C.1.2	Adopted	A separate resolution is passed for the adoption of the 'Report of the Directors' and 'Statement of Accounts and the Report of the Auditors' contained in the Annual Report. Separate resolutions are proposed for other substantial issues the Board deems necessary.
49. Availability of Chairmen of all Board Subcommittees at AGMs	Code - C.1.3	Adopted	To answer any questions, the Chairpersons of all Board Subcommittees were present at the AGM held in June 2012 in relation to the financial period 2011/12. i.e., the Chairman of the Audit Committee, the Chairman of the Integrated Risk Management Committee, the Chairman of the Remuneration Committee and the Chairman of the Nominations Committee.

Corporate Governance Principles	Reference to SEC and ICASL Code	Adoption Status	MI's Extent of Adoption (2013 Update)
50. Adequate notice of the AGM	Code - C.1.4	Adopted	The Company Secretary's division ensures that the Annual Report including Financial Statements and the Notice of the Meeting are sent to shareholders at least 15 working days prior to the date of the AGM in keeping to the Companies Act. By sending information early, the shareholders have the opportunity to update themselves and raise any matters with the Company on the circulated documents.
51. Voting procedures at General Meetings	Code - C.1.5	Adopted	Except for the AGM, there were no other general meetings held during the 2012/13 financial period. Notice circulated to shareholders on holding of the Annual General Meeting carries a summary of the procedures governing voting at such meetings.
C.2 Major transactions	Principle - C.2	Adopted	Directors in all instances would disclose any material transactions proposed that would alter or vary the net asset position of MI either through its Audited Financial Statements or in interim publications or by making communiqués to the Colombo Stock Exchange.
52. Disclose material facts of major transactions	Code - C.2.1	Adopted	No material proposed corporate transactions have been entered into by the Company as at the Balance Sheet date that could affect the net asset base of MI. This disclosure was based as Section 185 of the Companies Act which defines major transactions.
D. Accountability and Audit			
D.1 Financial Reporting	Principle - D.1	Adopted	To present a balanced and understandable assessment of MI's financial position, performance and prospects that prevail, MI has published a comprehensive Annual Report which incorporates the Audited Financial Statements together with management commentary on the performance and outlook.
53. Balanced and understandable assessment of the Company	Code - D.1.1	Adopted	In presenting a true and fair set of Financial Statements that provide a sound overview of MI's financial performance and position for the financial year ended 31 March 2012, the Company followed applicable Sri Lanka Accounting Standards (LKAS) and other regulations specified in the Finance Business Act No. 42 of 2011, Companies Act No. 07 of 2007 and Colombo Stock Exchange Rules. MI's interim accounts have been published in a timely manner in three languages and conform to the regulatory interim publication format and the applicable Accounting Standards and requirements specified in all other regulations mentioned in previous paragraph. Other reports and publications released by the Company, either as press releases or through the Colombo Stock Exchange website, reports to regulators and information made available in MI website also present a balanced and true representation of facts.

Corporate Governance Principles	Reference to SEC and ICASL Code	Adoption Status	MI's Extent of Adoption (2013 Update)
54. Directors' Report	Code - D.1.2	Adopted	The Annual Report of the Board of Directors (Directors' Report) given on pages 267 to 271 indicates Company's compliance to laws and regulations, confirms the going concern assumption and the effectiveness of Internal Control System that is in place. Transactions related to Directors/Key Management Personnel have been disclosed under the Directors' Interest in Contracts on pages 272 to 275 and in the Notes to the Financial Statements on page 322.
55. Directors' and Auditors' responsibility statement	Code - D.1.3	Adopted	The Directors' Responsibility for Financial Reporting given on page 276 provides a statement setting out the responsibilities of the Board for the preparation and presentation of the Financial Statements. The Auditors' Report given on page 281 specifies reporting responsibilities of both the Management and the Auditors.
56. Management Discussion and Analysis	Code - D.1.4	Adopted	A comprehensive management commentary covering all requirements referred to in Code - D.1.4 is given on pages 21 to 93 in the 'Management Discussion and Analysis'.
57. Directors' affirmation of going concern	Code - D.1.5	Adopted	Page 270 in the Annual Report of the Board of Directors (Directors' Report) provides disclosure affirming the going concern of the Company.
58. Calling of an EGM when net assets fall below 50% of shareholders' funds	Code - D.1.6	Adopted	The Company has a strong net asset position. The chance that the net assets would drop below 50% of the value of shareholders' funds, having this position, therefore is very remote. If such a situation were to arise the provisions of this Code will be followed.
D.2 Internal Controls - Maintaining a sound system of internal controls	Principle - D.2	Adopted	The Board has established an effective System of Internal Controls to safeguard the assets of the Company. The system of internal controls in place has been designed to counter various risks that could either arise from dealing in financial transactions or from other events and changes in environment and business conditions. MI understands the importance of internal controls in managing risks and has established a corporate structure designed with clear demarcations on management responsibility together with well-defined system of individual controls. These controls have been embedded as part of MI's routine operations. All employees are required to ensure strict compliance with the set procedures of internal controls.

Corporate Governance Principles	Reference to SEC and ICASL Code	Adoption Status	MI's Extent of Adoption (2013 Update)
59. Reviewing effectiveness of Internal Control System	Code - D.2.1	Adopted	The Audit Committee periodically assesses the effectiveness of internal controls that have been instilled. The Committee comprises Non-Executive Directors who make an independent assessment on adequacy and application of internal controls and provides feedback to the Board on matters they deem material. The Board also has direct access to the Company's Internal Audit and also to the External Auditors to clarify any material matters they feel are necessary. Internal Auditors' Ernst & Young Advisory Services (Pvt) Limited completed their special assignment on the adequacy of Internal Control Systems in place and issued their report during this period. The recommendations stated therein by them were followed-up with Corporate Management.
60. Internal Audit function	Code - D.2.2	Adopted	During this period, a separate Internal Audit Division was set-up to work in parallel with Ernst & Young Advisory Services (Pvt) Limited who have been handling the internal audit function of the Company in the past. Monthly/quarterly reviews are conducted by both sets of Internal Auditors based on approved annual audit programmes.
D.3 Audit Committee - A Committee to Review Financial Reporting Aspects, Internal Controls and Maintain Relationship with Company Auditors	Principle - D.3	Adopted	The Board of MI has established an Audit Committee that operates independently under specified terms of reference covering review of financial reporting aspects, internal controls and maintaining relationship with Company Auditors, internal and external, in accordance with the provisions of this Code.
61. Audit Committee composition	Code - D.3.1		The Audit Committee is chaired by Mr. H.A.S.T. Senanayake, an Independent Non-Executive Director who is also a Chartered Accountant with years of experience behind him in the Accounting and the Finance field. He is supported by two other Directors who are also Independent Non-Executive Directors. The Committee met four times during the year. The names of Directors forming the Audit Committee and their participation level at meetings are disclosed on page 158.
62. Reviewing objectivity, effectiveness and independence of External Auditors	Code - D.3.2	Adopted	The Audit Committee in keeping with its terms of reference monitors the objectivity, effectiveness and independence of MI's External Auditors, Messrs Cecil Arsecularatne and Co., Chartered Accountants. This is done on a continuous basis based on best audit practices and prevailing regulations on audit requirements applicable to the industry. In accordance with recent regulations by the CBSL, the Audit Committee in their Report disclosed on page 280 proposed Messrs BDO Partners as MI's new External Auditors for 2013/14 period. This change was made merely because Messrs Cecil Arsecularatne have been MI's External Auditor for over 5 years and therefore required change based on rotation requirements of CBSL regulations.

Corporate Governance Principles	Reference to SEC and ICASL Code	Adoption Status	MI's Extent of Adoption (2013 Update)
			Messrs Cecil Arseculаratne does not handle substantial volume of Non-Audit Services of the Company. As a practice MI has been referring most Non-Audit Services to Messrs Ernst & Young, Chartered Accountants including the implementation work undertaken by them on IFRS during 2012/13.
63. Terms of reference of the Audit Committee	Code - D.3.3	Adopted	Written terms of reference approved by the Board govern the activities of the Audit Committee. In accordance with these terms, the Committee objectives are to: ● Overseeing the quality of financial reporting including accounting policies adopted, compliance to disclosure requirements arising from accounting standards and regulations specified by regulatory bodies including CBSL. ● Setting up a process that provides continuous feedback of the Internal Control Systems including its adequacy and situations where there is non-compliance. ● Dealing in matters related to the Company External Auditors and their nominations annually. ● Keeping the Board appraised of any significant matters that come to their attention. ● Dealing with the Internal Auditors to review their scope of work and follow-up on their observations and recommendations. ● Being a central point of obtaining employee feedback of concerns and carrying out independent reviews as deemed necessary. ● Making continuous assessment of MI's going concern by correlating information presented to the Committee. During 2012/13 period, in accordance with these objectives, key duties of the Audit Committee involved: ● Reviewing the scope, functions and resources of Internal Audit function and the adequacy of audit programmes, appointing and reviewing the Auditor's remuneration. ● Recommendations on appointment of External Auditors. Evaluating the scope of external audit work and its cost effectiveness with final results and ensuring that the required level of independence and objectivity is maintained. ● Reviewing integrity of the financial information that is generated by Finance Department in consultation with the CFO. The Committee closely reviewed information disclosed in Annual Reports including financials, interim accounts and other periodic reports. They evaluated the accounting policies, accounting standards adopted and reporting requirements stemming from other regulations such as the Companies Act, Finance Business Act and Colombo Stock Exchange Rules.

Corporate Governance Principles	Reference to SEC and ICASL Code	Adoption Status	MI's Extent of Adoption (2013 Update)
			● Followed up with corporate management on material observations highlighted by Internal Auditors. At each meeting, Internal Auditors was asked to present key observations to the Committee and to provide a status report on the remedial action taken by management. ● Followed-up on material observations highlighted in the management letters by External Auditors during their statutory audit of previous period. The Committee invited the External Auditors once this period to meet and discuss key matters. ● Reviewed the process of risk management including risk assessments exercised by Management to ensure Company meets required risk management standards to mitigate risk. ● Requested an independent report on adequacy of Internal Control System of the Company from Internal Auditors. Identified gaps were bridged in consultation with the Corporate Management. Please refer Sections 8.2.a to 8.2.q in part 2 of this supplement to obtain further information regarding the composition, objectives and duties of the Audit Committee.
64. Disclosures of the Audit Committee	Code - D.3.4	Adopted	The names of Directors forming the Audit Committee and their participation level at meetings are disclosed in this report. Report of the Audit Committee is given on page 280.
D.4 Code of Business Conduct and Ethics	Principle - D.4	Adopted	The Company believes in maintaining high standards in business conduct and ethics for all its employees.
65. Compliance to requirements on business conduct and ethics	Code - D.4.1	Adopted	In 2013, a formal document that incorporate aspects on employee conduct was issued to all employees through the HR division. The 'Human Resource Handbook' specified organisation's expectation from all employees in terms of abiding to set HR policies while practicing sound business conduct and ethics at all times. This handbook is applicable for all levels of the hierarchy. The Board is not aware of any material violations by any Director or an employee on specified requirement of the Company on business conduct and ethics.
66. Affirmation by Chairman that no individual has violated business conduct and ethical requirements of the Company	Code - D.4.2	Adopted	The Chairman's affirmation that he is not aware of any violations to requirements of the Company on specified business conduct and ethics is given in the 'Chairman's Message' on page 10.
D.5 Corporate Governance Disclosures	Principle - D.5	Adopted	The Board of Directors upholds adopting sound corporate governance practices at all times.
67. Disclosure on Corporate Governance	Code - D.5.1	Adopted	MI's Corporate Governance Report for 2012/13 provides extensive disclosure on Company's corporate governance practices against recommended best practices and regulations.

Corporate Governance Principles	Reference to SEC and ICASL Code	Adoption Status	MI's Extent of Adoption (2013 Update)
Section 2: Shareholders			
E. Institutional Investors			
E.1 Shareholder voting - Institutional shareholders	Principle - E.1	Adopted	MI's shareholder base comprises small number of investors with minimal institutional shareholding. The Company obtained listing status in Colombo Stock Exchange *Diri Savi* Board in June 2011.
68. Constructive dialog between shareholders and Company	Code - E.1.1	Adopted	All shareholders have the liberty to express their views at Annual General Meetings and also to convey any matter outside such meetings as well. Under the supervision of the Chairman, Company Secretary's Division minutes discussions and views of all that is present at AGMs. Views and other material matters of shareholders when deemed necessary are taken up at Board meetings.
E.2 Evaluation of Governance Disclosures	Principle - E.2	Adopted	As mentioned in above Code - E.1.1 views and other material matters of shareholders are subsequently taken-up at Board meetings when necessary. Based on this, due weightage would be given to matters raised on governance structures including Board composition raised by any shareholder at an AGM.
F. Other Investors			
F.1 Individual Shareholders	Principle - F.1	Adopted	Individual shareholders are encouraged to carry out their own analysis or seek independent advice on investing or divesting decisions.
F.2 Shareholder Voting	Principle - F.2	Adopted	MI's shareholder base comprises a small base of investors with a very few individual investors. All investors are encouraged to participate in general meetings of the Company.

Statement - 02

MI's Compliance Status to Finance Companies (Corporate Governance) Direction No. 03 of 2008 and its Related Amendments

Direction Requirement (With Section Number of the Direction)	Complied	Not Complied	N/A	Extent of Adoption (2013 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.	✓			**Strategic Objectives and Corporate Values** MI Board approved a three year strategic plan in April 2012 which specified strategic objectives and corporate values that were derived from MI's vision and mission statements. Key corporate objectives revolved around gaining market share in terms of core business and achieving higher returns for our capital providers above market return on investment. Profit maximisation was complimented with other essential requirements including maintaining good Board governance and instilling a sound system of risk management. The highlight in this plan was MI's aspirations on enhancing corporate social activity to compliment the commercial objectives. **Communication** A presentation was held to communicate elements of the strategic plan to the Corporate Management and all key officers of the Company. The strategic plan document was made available in all divisions for Heads/ Managers to pass down organisational expectations to their subordinates.
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;	✓			**Strategic Focus** Overall business strategies were approved with measurable goals for next three years incorporated in MI's medium term strategic plan. The main focus on strategy development was devising separate strategy related to key functions such as Credit, Recoveries, Finance and Deposits for the attainment of overall objectives. The strategic focus hovered around the attainment of corporate objectives mainly on improving core business and enhancing productivity to maximise profitability in the medium term. **Risk Policy** Another key highlight during this period was the approving of MI's Risk policy document on 17 January 2013 which formalised the approach necessitated by the Board and management for better managing of risk associated with MI's business operation. The risk policy was developed within MI's successful strategic framework keeping in tact ultimate corporate objectives within sight. There was clear separation of duties at levels of the corporate structure in terms of risk management. The Board's role in handling risk and Corporate Management's responsibility in devising and maintaining sound risk management practices were key requisites highlighted.

Direction Requirement (With Section Number of the Direction)	Complied	Not Complied	N/A	Extent of Adoption (2013 Update)
				Overall Risk Management After setting up the Integrated Risk Management Committee, the Board initiated a few other measures to enhance overall risk management. The recruitment of a risk manager during this period and entrusting him to submit a continuous stream of information to the IRMC which included a quarterly risk report and the on going development of a formal risk management document covering core risk areas was vital for the Company in streamlining current risk control practices and to identify gaps early.
c. Identifying risks and ensuring implementation of appropriate systems to manage the risks prudently;	✓			**Risk Management** In keeping with the approved risk policy, each division is entrusted with assessing risk related to their work functions and to apply systems and controls to manage risks. (MI's risk management process is outlined on pages 167 to 195 in the Annual Report) Already a formal risk management document is being developed which would demarcate as to who would handle what in terms of managing risk to counter key risk. **Risk Assessment Report** In June 2012 Internal Auditors submitted a special assignment report documenting main processes of the Company and risks associated with each activity. The report also specified their assessment of the adequacy of internal control mechanisms in place to counter such risk. Recommendations made are being followed up for implementation.
d. Approving a policy of communication with all stakeholders, including depositors, creditors, shareholders and borrowers;	✓			**Communication Policy Document** An approved communication policy is in place which specifies MI's policy of communication with stakeholders. There is specific mention on the communication approach Management would take in terms of dealing with MI's shareholders, depositors and lending customers when need arises. In keeping to MI's vision, the Company's stakeholder list broadens to include MI's suppliers, potential investors and society. An appropriate communication approach is laid down for them as well.

Direction Requirement (With Section Number of the Direction)	Complied	Not Complied	N/A	Extent of Adoption (2013 Update)
e. Reviewing the adequacy and the integrity of the finance company's Internal Control Systems and management information systems;	✓			**Internal Control System** The Board has established a System of Internal Control to manage risk associated with finance business. There is a clear demarcation of functions across the organisation based on a formal organisational structure which is supported by allocation of responsibility to Managers and their subordinates in handling routine operations with clear communication of envisaged internal controls that should be followed at all times. A comprehensive 'Procedure Manual' is in place covering all key operations. **Internal Control Review** Internal Auditors provide monthly/quarterly review reports to the Audit Committee specifying matters on internal controls based on a set annual audit programme. The Audit Committee in turn provides due feedback to the Board on material concerns and lapses. The special assignment report completed by Internal Auditors, Ernst & Young in June 2012 assessing the adequacy of internal controls in place was aimed at improving MI's existing internal control processes. Already a stream of additional measures has been established in keeping with their recommendations. **Reviewing Management Information Systems (MIS)** By developing a formal Information Security Policy during this period, the quality of generated MIS is safeguarded especially through a structured and professional approach. This secures the reliability of information generated. In keeping with the Audit Programme, an annual review is carried out by Ernst & Young focusing on the effectiveness of MI's Management Information System. The establishing of MI's own internal audit division this period strengthened further the review process in this area.
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.	✓			**High Profile Board** MI Board comprises of high calibre individuals who possess vast experience and knowledge and is capable of directing the affairs of the Company. **Nominations Committee** In 2013, the Board set-up a Nominations Committee entrusting the Committee with the tasks of selecting future Director appointees through a formal process.

Direction Requirement (With Section Number of the Direction)	Complied	Not Complied	N/A	Extent of Adoption (2013 Update)
				Strong Recruitment Policy Key recruitments or promotions for Corporate Management are carried out with utmost understanding of the job role at hand versus the capabilities of the individuals. Only high calibre individuals are selected for these key roles and thus their experience in the needed field is vital in designating Key Management Personnel to top posts. As a further step, the Human Resource Division is in the process of revamping the grading and career path structure of the organisation considering the future demands of human resource due to sophistication and evolution that is happening in the finance business arena.
g. Defining the areas of authority and key responsibilities for the Board and for the Key Management Personnel;	✓			**Board's Responsibility Document** Responsibilities of the Board have been defined through a formal "Board's responsibility" document that is prepared which specifies job responsibilities of the Chairman, the Managing Director, Executive Directors as well as the role of Non-Executive Directors. **Role of Key Management** All individuals holding high level positions of the Corporate Management understand their job scope, authority and responsibilities that fall under them based on the nature of position they hold. Upon commencement of the year, job requirements and other specific targets are specified. Later, actual performance is appraised against expectations.
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;	✓			**The Oversight Process Top to Bottom** Board meetings are held in monthly intervals which enable Directors to keep close review of Company's performance and to monitor key areas of business. Board subcommittees closely oversee specific aspects of finance business operation. Feedback is provided to the Board on any material matters. The Board has delegated management of key operational functions to heads of divisions most of whom are at the executive Director capacity. To oversee performance and manage operations effectively the Directors initiate periodic meetings with management. This includes credit and marketing meetings and recoveries meetings that enable Corporate Management to keep close watch on operations.

Direction Requirement (With Section Number of the Direction)	Complied	Not Complied	N/A	Extent of Adoption (2013 Update)
				MI's Procedure Manual and Employee Handbook By having a set of clear operational instructions and setting forth procedures and practices in handling routine operations, all staff are governed well. MI's 'Procedure Manual' issued to all departments enable top management to maintain a consistent and professional approach in daily operational activities. In parallel, the Employee Hand book issued in 2013 clearly specifies employees' role in keeping to set organisational rules and procedures so that individuals do not fall short of their responsibilities towards the Company.
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.	✓			MI has put in place a strong corporate governance framework as explained in this supplement. In assessing the effectiveness of the governance framework overall and adhering to related regulations, MI's Board carries out independent reviews on a continuous basis. To bridge gaps identified, the Board takes numerous measures over the period, establishing best practices to improve the existing framework as necessary. Various governance initiatives were affected in 2012/13 as mentioned on page 106 in this supplement. As a key highlight, a Nominations Committee was set up in this financial year to handle future director nominations and related matters. The Company since 2012 has restructured the Board itself and its subcommittees to set best governance standards and comply with prevailing regulations. E.g. Appointment of a Non-Executive Director, who is a qualified accountant to head the Audit Committee.
j. Ensuring that the finance company has an appropriate succession plan for Key Management Personnel;	✓			There is adequate succession planning for identified Key Management Personnel with a clear career path within departments. The human resource division is in the process of revamping the grading and career path structure of the organisation which would further assist in streamlining succession planning across the Company for all grades.

Direction Requirement (With Section Number of the Direction)	Complied	Not Complied	N/A	Extent of Adoption (2013 Update)
k. Meeting regularly with the Key Management Personnel to review policies, establish lines of communication and monitor progress towards corporate objectives;	✓			Directors' meetings are held at least once a month while Executive Directors communicate with each other and line management frequently on routine matters. Executive Directors meet with Corporate Management on a frequent basis to assess performance and to decide on key matters. Weekly management committee meetings are held comprising of Executive Directors and Corporate Management and other Key Managers to assess performance closely. Marketing meetings are held with all credit and marketing staff on a monthly basis to review credit related aspects. Recoveries meetings are also held on a monthly basis with Director Recoveries and all recoveries staff to discuss key matters including recovery targets, devise strategies to maintain low NPL levels and processes related to recovery.
l. Understanding the regulatory environment;	✓			Head of divisions/ Managers and their subordinates are very knowledgeable and conversant with regulations related to their functional areas. Legal Division's advice is sought by other divisions when new regulations are imposed or when changes to regulations occur. Manager Compliance and Risk being the compliance officer follows up on adherence to regulations related to anti-money laundering and other key regulations. He updates the Integrated Risk Management Committee quarterly through the CFO on MI's compliance status.
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. The Committee reviews the quality of work carried out by External Auditors including the audited accounts, management letter and any other documents referred to the Audit Committee. Messrs Cecil Arsecularatne and Co. has been the Company's External Auditors for over five years and hence based on changes to related regulations new external audit firm BDO Partners is to be nominated by the Committee for the next financial period which will be taken up at the Annual General Meeting.

Direction Requirement (With Section Number of the Direction)	Complied	Not Complied	N/A	Extent of Adoption (2013 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.	✓			The functions and responsibilities of the Non-Executive Chairman and the Managing Director (No separate Chief Executive Officer) have been separately defined and approved by the Board. As the Chairman, he is required to provide leadership to the Board to ensure that the Board effectively discharges its responsibilities. The Managing Director on the other hand being an Executive Director is responsible for effective running of day-to-day operations of the Company.
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 the duties to the finance company.	✓			Directors have the liberty to seek independent professional advice at the expense of the Company whenever needed. A formal procedure on seeking independent professional advice was approved by the Board on 31 December 2012. The procedure refers to instances upon which Directors can seek independent professional advice and is not limited by the references given in the document. All Directors have been informed of this new procedure. Approval limits on related fee payments have been specified in procedures so that Directors could seek advice without delay.
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.	✓			MI Board understands the importance of matters on conflict of interest. The Board has taken steps to ensure that when similar situations are prevalent, Directors are advised to disclose such instances to the Board so that relevant Director can refrain from voting or presenting their view in such instances. There is proper identification and disclosure of Directors Interest in Contracts and Related Party Transactions through proper recording, annual declaration by Directors and disclosure in Financial Statements.
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.	✓			On 20 March 2013, the Board approved a formal schedule of matters specifically reserved for the Board. Accordingly, for the Directors to take up associated matters, the agenda together with relevant supporting information is circulated to the Directors in advance.

Direction Requirement (With Section Number of the Direction)	Complied	Not Complied	N/A	Extent of Adoption (2013 Update)
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. The Company is solvent and is a going concern as declared in the 'Annual Report of the Board of Directors'. MI makes payment of interest and capital on due maturity dates to its depositors and also to its borrowers as required.
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.	✓			Through the disclosures given in this supplement this requirement is fulfilled.
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 scheme of annual self-assessment by each Director on Board performance was carried out for the period 2012/13. Areas needing improvement were summarised and tabled for the deliberation of the Board.
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 Board meetings were held for the financial period 2012/13. Please refer Section A.1.1 of the SEC and ICASL Code given. As much as possible, Board papers and other matters needing Board's consent is taken up directly at Board meetings. Only very urgent matters are sent on circulation for Board's approval.
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.	✓			The agenda prepared by Company Secretary under the guidance of the Chairman includes proposals submitted by Directors on the promotion of business and management of risk and other areas operational and otherwise for the betterment of the 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.	✓			For regular Board meetings, at least 7 days of notice is given to all Directors providing them with adequate time to review circulated Board papers and to take up other matters of importance. Reasonable notice is given for any other meetings held by the Board other than regular Board meetings.

Direction Requirement (With Section Number of the Direction)	Complied	Not Complied	N/A	Extent of Adoption (2013 Update)
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 of at least attending two-thirds of the meetings held in 2012/13. No Directors have been absent from three consecutive Board meetings during 2012/13 financial period. Attendance of Directors at Board meetings is given later on in this report. During this period there were no instances where an Alternate Director was nominated.
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.	✓			Please refer Section A.1.4 of the SEC and ICASL Code for related information.
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 function.	✓			The Company Secretary has been delegated with the responsibility of preparing the agenda for the Board meeting under the supervision of the Chairman. Prior to circulation, she obtains Chairman's approval for the notice of meeting and agenda.
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 Company Secretary attends all Board meetings and is readily accessible to Directors when they require her advice and services. Mrs. S. Pethiyagoda has over 20 years of experience in company secretarial position and keeps herself updated on all current regulations applicable on Board procedures, corporate governance requirements and other requirements related to company secretarial responsibilities.
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.	✓			Duly perfected minutes of all Board meetings held are available with the Company Secretary. Upon request Directors can inspect minutes at any point in time. She obtains approval of the Chairman for the minutes prior to its circulation to Directors.
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 (2013 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.	✓			Right throughout the period MI's Board comprised of ten Directors in keeping to the provisions of this section.
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.	✓			In keeping with Section, no Non-Executive Director holds his/her position exceeding nine years as given below:

Name of Director	Directorship Status	Number of Years in Position 31 March 2013
S.H.J. Weerasuriya	Chairman (Independent Non-Executive Director)	Completed 2 Years
H.A.S.T. Senanayake	Independent Non-Executive Director	Completed 2 Years
P.T.K. Navaratne	Independent Non-Executive Director	Completed 1 Year
N.H.V. Perera	Non-Executive Director	Completed 1 Year
S.M.S.S. Bandara	Independent Non-Executive Director	Completed 1 Year

Direction Requirement (With Section Number of the Direction)	Complied	Not Complied	N/A	Extent of Adoption (2013 Update)
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.	✓			There is equal (50%) representation by both Executive Directors (Five Directors) and Non-Executive Directors (Five Directors) and is within the provisions of this Section.
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.	✓			MI's Board consists of four Independent Non-Executive Directors as against total a of ten Directors (40%) and hence is within the requirement to have one fourth (25%) of the total number of Directors as Independent Non-Executive Directors. Please refer Section A.5.5 of the SEC and ICASL Code for related information.

Direction Requirement (With Section Number of the Direction)	Complied	Not Complied	N/A	Extent of Adoption (2013 Update)
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.			✓	Alternate Director appointments were not made during this period.
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.	✓			MI Board's five Non-Executive Directors possess adequate skills and experience to contribute to the Board in effectively discharging its obligations. Pages 96 to 97 provides a brief on the experience level of each Non-Executive Director.
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 meeting is present, unless at least one half of the number of Directors that constitute the quorum at such meeting are Non-Executive Directors.	✓			In keeping to this section, in all Board meetings convened in 2012/13 financial period, number of Non-Executive Directors present were more than one half of the number that constitute the quorum.
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.	✓			Board composition detailing Director names and their Directorship category is given on page 155 in the Corporate Governance Report. Names of the four Independent Non-Executive Directors are mentioned therein.
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 Nominations Committee set up this period is entrusted with the new appointment of Directors. A formal transparent procedure has been established for appointments. Please refer Section A.7 of the SEC and ICASL code for details on committee composition, duties, related matters of the committee and appointments to the Board.

Direction Requirement (With Section Number of the Direction)	Complied	Not Complied	N/A	Extent of Adoption (2013 Update)
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.			✓	No Directors were appointed to fill casual vacancies during the 2012/13 financial period.
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 are informed to the Department of Supervision of Non-Bank Financial Institutions and also to the Colombo Stock Exchange by the Company Secretary in compliance with this section and related provisions as per Colombo Stock Exchange rules. No such Director resignations or appointments were carried out this period that required reporting.
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.	✓			No Director of the MI Board is over the age of 70 years as at 31 March 2013.
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/bodies corporate, including associate companies and subsidiaries of the finance company. Provided that such 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 of MI Board holds office in over 20 companies contravening the provisions of this Section. Pages 155 to 157 provides a schedule detailing Directorships held by each MI Director in other companies as at the Balance Sheet date.

Direction Requirement (With Section Number of the Direction)	Complied	Not Complied	N/A	Extent of Adoption (2013 Update)
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.	✓			The Board makes necessary assessment of delegated authority especially assessing capabilities of various Board subcommittee limits given on credit disbursements, payment authorisations, authorisation on rebates and approving authority for various corporate documents including issue of deposit certificates. There were no material changes effected to the delegation process during this period and the delegated authority given to either Executive Directors, Corporate Management or other key officers remained similar to those of the previous period.
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.	✓			Please refer comments given on 6.1 above.
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 appointed a Non-Executive Chairman and a separate Managing Director in January 2012 keeping the roles separate. (No separate Chief Executive Officer) Please refer Sections A.2 and A.3 of the SEC and ICASL Code for further details.
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.	✓			The Chairman of MI Board is Mr. Saroja Weerasuriya, an Independent Non-Executive Director who was appointed to the Board in January 2011.

Direction Requirement (With Section Number of the Direction)	Complied	Not Complied	N/A	Extent of Adoption (2013 Update)
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.	✓			The Chairman of MI Board is Mr. Saroja Weerasuriya while Mr. Gerard G. Ondaatjie is the Managing Director. No material relationship including financial, business or family exists between the Chairman and the Managing Director. Directors, Mr. Gerard G. Ondaatjie, Ms. Angeline M. Ondaajie and Mr. Travice J. Ondaatjie are of the same family. The Chairman in conducting affairs of the Board obtains fullest corporation of other fellow Directors and also advice of Company Secretary on Board procedures when necessary.
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.	✓			The Chairman of the Company has led from the front, dealing closely with other Directors in all key matters for Board to effectively discharge its responsibilities. Please refer Sections A.2 and A.3 of the SEC and ICASL Code for further details.
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	✓			A formal agenda is prepared by the Company Secretary under Chairman's guidance. The agenda covers key matters to be taken up supported by information necessary for Directors to obtain initial information on company performance and matters to be taken up. The agenda is then approved by the Chairman prior to its circulation.
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.	✓			The agenda with Notice of Meeting is duly circulated to the Directors at least seven days prior to the 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.	✓			All Directors' both Executive and Non-Executive are encouraged to actively participate in affairs of the Board for effective governance of the Company.

Direction Requirement (With Section Number of the Direction)	Complied	Not Complied	N/A	Extent of Adoption (2013 Update)
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	✓			All Non-Executive Directors including Chairman himself effectively contributes to the Board through the vast experience and wide knowledge base that they gained within the industry as well as experience gained from their professional fields. There is constructive relationships among all Directors. Apart from Board meetings, Directors meet at other Company events that enable them to keep close rapport amongst each other. All Directors attended majority of Board meetings giving them due opportunity to convey their concerns or contribute to matters taken up at meetings.
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.	✓			The Chairman being a Non-Executive does not involve himself with direct supervision of Key Management Personnel or handle executive duties. The duties of the Chairman have been defined and approved by the Board. This does not involve executive duties whatsoever.
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 Chairman facilitates interaction with shareholders at each Annual General Meeting (AGM) providing opportunity for them to express views and recommendations. Any matter deemed material raised at the AGMs is taken up for subsequent deliberation of the Board.
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, Mr. Gerard G. Ondaatjie functions as the apex executive in charge of managing routine operations of the Company. (In place of a Chief Executive Officer) He works closely with the Corporate Management Team to ensure smooth running of day-to-day operations. His role and responsibilities as the Managing Director has been defined and approved by the Board.

<table>
<tr><th>Direction Requirement
(With Section Number of the Direction)</th><th>Complied</th><th>Not Complied</th><th>N/A</th><th>Extent of Adoption
(2013 Update)</th></tr>
<tr><td>8. Board Appointed Committees</td><td></td><td></td><td></td><td></td></tr>
<tr><td>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.</td><td>✓</td><td></td><td></td><td>There are five Board appointed subcommittees which include the Audit Committee and the Integrated Risk Management Committee operating based on specific terms of reference, directly reporting to the Board.

The other committees being the Remuneration Committee, Credit Committee and the Nominations Committee also report to the Board.

Minutes are kept for each of the above committees under the supervision of the Chairman relating to each committee.

A report on the performance, duties and functions of each Committee has been made available in the Annual Report published for the Annual General Meeting.

<table>
<tr><th>Committee</th><th>Report Reference Page</th></tr>
<tr><td>Audit Committee</td><td>280</td></tr>
<tr><td>Integrated Risk Management Committee</td><td>277</td></tr>
<tr><td>Remuneration Committee</td><td>278</td></tr>
<tr><td>Nominations Committee</td><td>279</td></tr>
<tr><td>Credit Committee</td><td>161</td></tr>
</table>
</td></tr>
<tr><td>8.2 Audit Committee
The following shall apply in relation to the Audit Committee:</td><td></td><td></td><td></td><td></td></tr>
<tr><td><i>8.2.a</i> The Chairman of The Committee shall be a Non-Executive Director who possesses qualifications and experience in accountancy and/or audit.</td><td>✓</td><td></td><td></td><td>Mr. H.A.S.T. Senanayake, a qualified Chartered Accountant and an Independent Non-Executive Director of the Company acts as the Chairman of the Audit Committee. While possessing two accounting qualifications, he has a wealth of experience in the field of Audit, Accounts and Management and Finance Planning so that he could oversee the Committee’s functions effectively.</td></tr>
<tr><td><i>8.2.b</i> The Board members appointed to The Committee shall be Non-Executive Directors.</td><td>✓</td><td></td><td></td><td>All three Directors appointed to the Audit Committee are Independent Non-Executive Directors. The Committee composition remained unchanged throughout the period.

Please refer Sections D.3.1 to D.3.4 of the SEC and ICASL Code for detailed disclosure.</td></tr>
</table>

Direction Requirement (With Section Number of the Direction)	Complied	Not Complied	N/A	Extent of Adoption (2013 Update)
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.	✓			Please refer Sections D.3 to D.3.4 of the SEC and ICASL Code for details related to provisions of this Section. Information on appointment of External Auditors is given in Section 2.1.m of this part of the Report.
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.	✓			The Audit Committee while meeting External Auditors during this period on outstanding matters from statutory audit discussed and reviewed the effectiveness of the auditing process being adopted by them, based on auditing standards and industry practices. The Committee evaluated the independence of Messrs Cecil Arsecularatane as the External Auditors of the Company for the concluded year.
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.	✓ See extent			As a practice MI's non-audit services are handled by Ernst & Young and not by the External Auditors.
8.2.f The Committee shall, before the audit commences, discuss and finalise with the External Auditors the nature and scope of the audit.	✓			The Audit Committee during their meeting with the External Auditors discussed the nature and scope of the ensuing audit to be commenced by them for the financial year end 2012/13.

Direction Requirement (With Section Number of the Direction)	Complied	Not Complied	N/A	Extent of Adoption (2013 Update)
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.	✓			The Committee reviewed the Financial Statements and the Annual Report to ascertain the quality and integrity of the information contained therein. Based on the review of the Committee, necessary changes were made by the Finance Department to the Financial Statements and other information contained in the Annual Report.
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.	✓			The Committee discussed concerned matters with External Auditors on the previous year's statutory audit performed, meeting once this financial year.
8.2.i The Committee shall review the External Auditor's management letter and the management's response thereto.	✓			The Committee reviewed the 2011/12 management letter issued by the External Auditors together with management responses to ascertain material concerns that exist that require their immediate attention for resolution in the presence of the Finance Director.
8.2.j The Committee shall take the following steps on internal audit:				
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;	✓			Based on the initiation of the Audit Committee, commencing December 2012, an Internal Audit Division was set-up located at Head Office in addition to the outsourcing of Ernst & Young Advisory Services (Pvt) Limited who have been the Internal Auditors of the Company. It was necessary that there was increased focus on Branch audits with the rise in the network from just 4 to almost 20 stations in the last four years. Hence the Company's own Internal Audit Division was entrusted with the task of covering the full network at least once a year and to report to the Audit Committee. Ernst & Young continued to carry out their audits quarterly covering both head office and branch operations. The Committee reviewed the functions and resources applicable to both sets of Auditors especially to ascertain the capability of individuals handling the audit function and assess resource availability.

Direction Requirement (With Section Number of the Direction)	Complied	Not Complied	N/A	Extent of Adoption (2013 Update)
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;	✓			The Audit Committee was submitted with separate Audit Programmes by Ernst & Young and the Internal Audit Division of the Company for the year 2013 which were affirmed by the Committee. The Audit Committee met with both sets of Internal Auditors to take up significant observations, seek management's position on them and then follow up on its resolution considering recommendations proposed.
iii. Review any appraisal or assessment of the performance of the head and senior staff members of the Internal Audit Department;	✓			Performance of Ernst & Young as Auditors was reviewed this period by the Committee. Concluded that all required audit deadlines were met and quality of reports were satisfactory. There were no changes to partner in charge during this period. Appraisal of the newly established Internal Audit Division would be carried out next period since it was set-up only four months before. Nevertheless, as mentioned in next Section iv the senior officers of the Division have the capability to perform there audit duties effectively.
iv. Recommend any appointment or termination of the head, senior staff members and outsourced service providers to the internal audit function;	✓			There were two recruitments made for the newly set-up internal Audit Division under the review of the Audit Committee members. The recruits have the necessary exposure to audit and possess adequate qualifications in the field of accountancy. The Audit Committee continued to seek outsourced audit services from Ernst & Young while having the Internal Audit Division operates in parallel for 2013 calendar year.
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;			✓	There were no changes/resignations of senior officers handling MI's internal audit function from either Ernst & Young or from MI's own Internal Audit Division.
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;	✓			Messrs Ernst & Young Advisory Services (Pvt) Limited is an independent institution from MI who have the expertise to handle internal audit services impartially with professionalism. Similarly, the newly established Internal Audit Division too functions independently from other divisions and reports directly to the Audit Committee.

Direction Requirement (With Section Number of the Direction)	Complied	Not Complied	N/A	Extent of Adoption (2013 Update)
8.2.k The Committee shall consider the major findings of internal investigations and management's responses thereto;	✓			There were no special investigations carried out by Internal Audit or any other party in 2012/13 period. Based on periodic internal audit reports, the Audit Committee took steps to avoid repeating of specific shortcomings at branch level. As per the recommendations of the Committee in 2013, the branches are required to submit a periodic confirmation to the Compliance Officer of the Company based on a detail checklist format.
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			The Finance Director being the CFO attended meetings on invitation in addition to the Head of Internal Audit of Ernst & Young as well as MI's own Internal Audit Officers. At the same time the External Auditors were invited once to meet the Committee and discuss matters arising from their statutory audit. The Committee plans to meet with External Auditors without the Executive Directors being present after the conclusion of the 2012/13 audit.
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.	✓			**Terms of Reference** The terms of reference of the Audit Committee approved by the Board, allows the Committee to investigate into any matter that it deems necessary within its wide powers. The terms of reference also cover: ● The Committee's right to obtain full access to information from Management. ● Authority to seek external professional advice if needed. ● Invite any party internal or outside with experience to enlighten the Committee on the concerns at hand. ● Decide on resource requirements to carry out special assignments and investigations if deemed necessary by them.
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.	✓			The Committee met four times during the 2012/13 financial year. Audit Committee meeting minutes have been duly perfected by the Secretary to the Audit Committee in a manner that captures the essence of the meeting discussions and conclusions. Please refer section on 'Audit Committee' in this supplement for more information.

Direction Requirement (With Section Number of the Direction)	Complied	Not Complied	N/A	Extent of Adoption (2013 Update)
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.	✓			The activities of the Audit Committee and meetings held during this period with participation status have been disclosed later on in this report. Further information is disclosed in Section D.3 of the SEC and ICASL Code on the Committee's scope of activities. The Audit Committee Report for 2013 provides information relating to the Committee's scope and activities carried out during 2012/13 financial period.
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.	✓			The Company Secretary, Mrs. S. Pethiyagoda acts as the secretary to the Audit Committee keeping record of meeting proceedings. Please refer 8.2.n above for further information on keeping minutes.
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.	✓ See extent			**Open door policy** MI's open door policy allows any employee to approach any member of the Corporate Management, Human Resource Department or failing which to meet the Managing Director and express their views and concerns at any given moment. Stemming from such feedback, management would decide and initiate course of action or investigation depending on the seriousness of the matter at hand. No material matters were reported by employees to Human Resource Department necessitating investigation during this period. **Whistle-Blowing and Fraud Policy** To formalise the process of informing frauds and matters of concern to Management and investigation, the Audit Committee approved a **'Whistle-Blowing and Fraud Policy'** for the Company in March 2013. The policy specifies the formal process by which employees could raise concerns of a possible fraud or material concern to the top management and how an investigation process would be initiated. **Relationship with External Auditors** The Audit Committee keeps rapport with the External Auditors annually meeting them at least once to discuss matters. The External Auditors have direct access to the Committee to raise any concerns so that any such matter could be followed upon independently without hindrance or distortion.

Direction Requirement (With Section Number of the Direction)	Complied	Not Complied	N/A	Extent of Adoption (2013 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.				**Integrated Risk Management Committee (IRMC)** Non-Executive Director Mr. N.H.V. Perera is the Chairman of IRMC while Mr. Gerard G. Ondaatjie, Managing Director and two other Executive Directors, Mr. P.M. Amarasekera, Director Recoveries and Mr. S.H. Jayasuriya, Finance Director comprise the other members of the Committee. The Committee works within its scope given in the terms of reference approved by the Board. The Committee met four times during the 2012/13 financial year to discuss key matters pertaining to: • Credit risk - Reviewing mechanisms in place to identify and manage credit risk. • Interest rate risk - Studying rate structures and sensitivity analysis on rate change to profitability etc. to understand impacts and to propose counter measures. • Liquidity risk - Periodic review of maturities of MI's assets and liabilities to identify maturity gaps and propose methods to minimise them in future. • Studying the quarterly 'risk report' tabled by the Finance Director to assess initial risk aspects. • Developing the 'Risk policy' for the Company as a means of streamlining the risk management process in a formal manner. • Obtaining MI's compliance status on the existing rules and statutory regulations through MI's Manager Compliance and Risk. • Providing feedback through a quarterly 'Activity Report' to the Board on key risk and IRMC's assessment of such risk with any recommendations to mitigate risk. • Studied the Business Continuity Plan of the Company and requested a status report from each responsible department through the Manager Compliance and Risk. • Review of the effectiveness of the Management Committee. Further information related to the IRMC is given later on in the Corporate Governance Report.

Direction Requirement (With Section Number of the Direction)	Complied	Not Complied	N/A	Extent of Adoption (2013 Update)
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			In accordance with the terms and reference, the Committee monitors key risks closely. Therefore the Committee meets on a quarterly basis and reviews areas of credit risk, interest rate risk, market risk, operational and other risks as deemed necessary. Please refer section *8.3.a* above on key risk areas handled by the Committee.
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 commenced reviewing the effectiveness of the Integrated Risk Management Committee (IRMC) by studying management information presented at weekly forums. The Committee plans to conduct a separate review of the effectiveness of the Credit Committee during the ensuing year.
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.	✓			With regard to credit risk, liquidity risk and interest rate risk, the Committee did not come across risks that went beyond the prudent levels of risk based on MI's policies and prevailing regulations. The Committee is in the process of laying down additional monetary limits to exposures on credit and liquidity to be applied from next financial year.
8.3.e The Committee shall meet at least quarterly to assess all aspects of risk management including updated business continuity plans.	✓			The Committee met four times during this financial year. Page 160 provides information on meetings held and level of participation by Directors. Please refer section *8.3.a* above on key risk areas handled by the Committee.
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.	✓			During the 2012/13 financial year, the Committee did not come across any such material violations of not identifying risks and not implementing appropriate measures by any particular officer. Any non-compliances to regulations would be followed up by the Committee with the Board for its resolution as and when detected.
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.	✓			Commencing from 2013 an 'activity report' is submitted by the IRMC to the Board, detailing a summary of key risks, together with risk mitigating actions proposed by the Committee.

Direction Requirement (With Section Number of the Direction)	Complied	Not Complied	N/A	Extent of Adoption (2013 Update)
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	✓			Commencing from this period, a dedicated compliance officer at senior level was recruited to oversee compliance requirements and to provide feedback to the IRMC. Accordingly, a compliance checklist was prepared and tabled through Finance Director for the appraisal of the Committee. Pages 89 to 90 in the Management Discussion and Analysis provides a disclosure on MI's compliance status on CBSL Direction requirements/rules.
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.	✓			Directions relating to the Finance Companies (Lending) No. 1 of 2007 and the Finance Companies (Business Transactions with Directors and their Relatives) Direction, No. 2 of 2007 have been complied. No lendings have been made to Directors of the Company as per above Direction.
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 those who shall be considered as 'related parties' for the purposes of this Direction.	✓			No favourable treatment has been given to related parties for transactions effected by the Company directly with such parties. Transactions with related parties are done only after necessary due diligence. Any transaction entered into by the Company with any such related party has been carried out on an arms-length basis at prices that were applicable to similar other unrelated customers of the Company depending on the risk profile of the entity and MI's pricing structure. The process of capturing related party transaction information was streamlined further during this period in accordance with the provisions of this Section and Sri Lanka Accounting Standard (LKAS - 24) on 'Related Party Transactions'.

Direction Requirement (With Section Number of the Direction)	Complied	Not Complied	N/A	Extent of Adoption (2013 Update)
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.	✓			Particulars relating to related party transactions have been disclosed in the Notes to the Financial Statements. Further, pages 272 to 275 discloses information relating to Directors Interests in Contracts. All such transactions mentioned therein have been carried out on an arms-length basis as per provisions of this section.
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.	✓			The Company has not entered into any transaction in a manner that would grant the related party 'more favourable treatment' than if dealt with an unrelated customer. Please see section 9.3 above that refers to the 'related party transactions' and 'Directors interests in contracts' disclosures.
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.	✓			The Company has complied with applicable accounting standards including the IFRS requirements introduced this period by the CA Sri Lanka. The Financial Statements also conform to other regulatory requirements given in the Finance Business Act, the Companies Act and rules specified by Colombo Stock Exchange. Half yearly financials are also published in all three languages and conform to the regulatory interim publication format and the applicable accounting standards.

Direction Requirement (With Section Number of the Direction)	Complied	Not Complied	N/A	Extent of Adoption (2013 Update)
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.	✓			The Directors Responsibility Statement given on page 276 provides an affirmation that the annual Audited Financial Statements have been prepared in line with applicable accounting standards and applicable regulatory requirements.
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.	✓			The Board's Report on the effectiveness of the Company's internal control mechanism over financial reporting has been given under the 'Report by the Board on Internal Control' on page 164 in the Annual Report.
10.2.c The External Auditor's certification on the effectiveness of the internal control mechanism in respect of any statements prepared or published after 31 March 2010.	✓			The External Auditor's certification on the effectiveness of the internal control mechanism over financial reporting was obtained for the financial period 2012/13. No significant matters needing attention was highlighted as per the Report. The External Auditors Assurance Report on the effectiveness of the internal controls over financial reporting has been disclosed on page 165 in the Annual Report.
10.2.d Details of Directors, including names and transactions with the finance company.	✓			Names and other Director information is provided on pages 94 to 97 while their transaction details are disclosed under the "Directors' Interest In Contracts' and in the 'Related Party Disclosure' note in the Financial Statements.
10.2.e Fees/remuneration paid by the finance company to the Directors in aggregate, in the Annual Reports published after 1 January 2010.	✓			Details of Directors' remuneration in aggregate are disclosed in Notes to the Financial Statements.

Direction Requirement (With Section Number of the Direction)	Complied	Not Complied	N/A	Extent of Adoption (2013 Update)
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 272 to 275. The net accommodation granted to each category of related party is given below as a percentage of the Company's capital funds. Category of Related Party / Amount Rs. / % Against Company's capital funds: Key Management Personnel / 5,601,187 / 0.1%; Associate Companies / – / –; Other / 53,347,367 / 1% There have not been related party transactions exceeding 10% of the equity during the 2012/13 financial year.
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.	✓			Transaction details of Key Management Personnel is disclosed under "Directors' interests in Contracts" on pages 272 to 275 and in the 'related party disclosure' in the Notes to the Financial Statements on pages 321 to 322 as per the Company's classification, apart from Directors, senior management comes under the definition of Key Management Personal for the provisions of this section.
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.	✓			Pages 89 and 90 in the Management Discussion and Analysis provides CBSL Directions, rules, guidelines and circulars complied by MI. 'The Annual Report of the Board of Directors' signed by the Directors given on pages 267 to 271 gives a collective confirmation on compliance with applicable laws and regulations. 'The Directors' Responsibility for Financial Reporting' given on page 276 confirms MI's compliance to regulations on financial reporting.

Category of Related Party	Amount Rs.	% Against Company's capital funds
Key Management Personnel	5,601,187	0.1%
Associate Companies	–	–
Other	53,347,367	1%

Direction Requirement (With Section Number of the Direction)	Complied	Not Complied	N/A	Extent of Adoption (2013 Update)
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 with the measures.	✓			No such direction has been made for disclosures.
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.	✓			As required, External Auditor's certification of the compliance to Act, Rules and Directions was obtained for 2012/13 period. Non-Compliance aspects highlighted by the External Auditors will be dealt with in the next financial year.

Board Meetings

Mercantile Investments Board was strengthened in 2012 with the addition of three Non-Executive Directors. The Board has the right blend of both Executive and Non-Executive Directors equally who possess necessary experience and qualifications enriching the overall decision-making process.

In closely overseeing the affairs of the Company, MI Board meets regularly at monthly intervals. For this purpose, the Company Secretary circulates the Notice of Meeting with agenda and other applicable information documents to all Board members. The circulation of the information is done at least seven days prior to the date of the Meeting to ensure Directors are notified early of latest performance information and other pertinent matters to be taken up by the Directors. There is adequate opportunity given for Directors to submit matters of importance, proposals and statistics in the agenda to be taken up for meetings as and when need arises. Information that is generally circulated include the monthly management accounts with other financial information such as MI's position in relation to prudential ratios, non-performing lending position and other financial statistics on performance.

The Board in discharging its responsibilities provides leadership to the management and involves itself in policy making. The Board's duties include overall supervision and guidance in relation to the conduct of affairs of the Company. This mainly involves strategy setting, policy making and decision-making and finally setting up monitoring systems to track progress. Board papers on strategic changes, policy reviews and changes to existing practices proposed by management are deliberated by Director Board and approved depending on its viability.

Attendance of Director's at Board meetings for the financial year 2012/13 is as follows:

Name of the Director	Type of Directorship			Attendance at Board Meetings in 2012/13											
	Executive	Non-Executive	Independent Non-Executive	27 April 2012	15 May 2012	29 June 2012	27 July 2012	30 August 2012	25 September 2012	10 October 2012	14 November 2012	11 December 2012	17 January 2013	14 February 2013	20 March 2013
01. Mr. S.H.J. Weerasuriya *(Chairman)*			✓	✓	✓	✓	✓	✓	✓	✓	✓	✓	✓	✓	✓
02. Mr. Gerard G. Ondaatjie *(Managing Director)*	✓			✓	✓	✓	✓	✓	✓	✓	✓	✓	✓	✓	✓
03. Mr. S.H. Jayasuriya	✓			✓	✓	✓	✓	✓	✓	✓	✓	✓	✓	✓	✓
04. Mr. P.M. Amarasekara	✓			✓	✗	✓	✓	✓	✓	✓	✓	✓	✓	✓	✓
05. Ms. Angeline M. Ondaatjie	✓			✗	✓	✓	✓	✓	✓	✓	✓	✗	✓	✓	✓
06. Mr. Travice J. Ondaatjie	✓			✓	✓	✓	✗	✓	✓	✗	✓	✓	✗	✓	✓
07. Mr. H.A.S.T. Senanayake			✓	✗	✓	✓	✓	✓	✗	✓	✓	✓	✓	✓	✓
08. Ms. P.T.K. Navaratne			✓	✓	✓	✓	✓	✓	✓	✓	✓	✓	✓	✓	✗
09. Mr. N.H.V. Perera		✓		✓	✗	✓	✓	✓	✓	✓	✗	✓	✓	✓	✓
10. Mr. S.M.S.S. Bandara			✓	✓	✓	✓	✓	✓	✓	✓	✓	✗	✓	✓	✓

Total Number of Papers Approved by the Board in 2012/13

Status	Main Board	Integrated Risk Management Committee	Audit Committee	Remuneration Committee	Nomination Committee
Submitted	50	03	13	01	01
Approved	50	03	12	01	01

Directorates/Equivalent Positions Held in Other Institutions by Directors - Summary

Name of the Director	No. of Directorates/ Equivalent Positions Held in Other Companies/Societies/ Body Corporate	No. of Directorates/ Equivalent Positions Held in Specified Business Entities
01. Mr. S.H.J. Weerasuriya	02	Nil
02. Mr. Gerard G. Ondaatjie	13	03
03. Mr. S.H. Jayasuriya	02	Nil
04. Mr. P.M. Amarasekara	01	Nil
05. Ms. Angeline M. Ondaatjie	16	04
06. Mr. Travice J. Ondaatjie	13	03
07. Mr. H.A.S.T. Senanayake	Nil	Nil
08. Ms. P.T.K. Navaratne	01	Nil
09. Mr. N.H.V. Perera	05	02
10. Mr. S.M.S.S. Bandara	01	Nil

Other Directorates/Equivalent Positions Held by Directors as at 31 March 2013 - Detailed Disclosure

Company/Society/Body Corporate Including Associate Companies and Subsidiaries of the Finance Company	Designation	*Whether the Entity is a Specified Business Entity	No. of Shares %
Mr. S.H.J. Weerasuriya			
International Civil Engineering Consultants (Pvt) Limited	Director	No	(1 share)
Saro Weerasuriya Associates	Proprietor	No	Nil
Mr. Gerard G. Ondaatjie			
Mercantile Fortunes (Pvt) Limited	Managing Director	No	23.33
Nilaveli Beach Hotels (Pvt) Limited	Ex. Deputy Chairman	No	23.3
Tangerine Beach Hotels PLC	Director	Yes	0.66
Royal Palms Beach Hotels PLC	Director	Yes	0.34
The Nuwara Eliya Hotels Company PLC	Managing Director	Yes	10.64
Tangerine Tours (Pvt) Limited	Director	No	14
Security Ceylon (Pvt) Limited	Director	No	5
Global Films Limited	Director	No	0.04
Grand Hotel (Pvt) Limited	Managing Director	No	Nil
International Fortunes (Pvt) Limited	Director	No	1.33
Mercantile Orient (Pvt) Limited	Director	No	Less than 1% (1 share)
Fair View Hotel (Pvt) Limited	Managing Director	No	Less than 1% (100 shares)
Niaveli Hotels (Pvt) Limited	Chairman	No	20
Mr. S.H. Jayasuriya			
Mercantile Fortunes (Pvt) Limited	Director	No	Nil
Security Ceylon (Pvt) Limited	Director	No	Nil
Mr. P.M. Amarasekara			
Security Ceylon (Pvt) Limited	Director	No	Nil
Ms. Angeline M. Ondaatjie			
Mercantile Fortunes (Pvt) Limited	Director	No	23.33
Nilaveli Beach Hotels (Pvt) Limited	Director	No	23.3
Tangerine Beach Hotels PLC	Jt. Managing Director	Yes	0.82
Royal Palms Beach Hotels PLC	Jt. Managing Director	Yes	0.4
The Nuwara Eliya Hotels Company PLC	Director	Yes	0.57
Tangerine Tours (Pvt) Limited	Managing Director	No	14.5
Security Ceylon (Pvt) Limited	Director	No	5
Global Films Limited	Director	No	0.04
Grand Hotel (Pvt) Limited	Director	No	Nil
International Fortunes (Pvt) Limited	Director	No	1.33
Mercantile Orient (Pvt) Limited	Director	No	Nil
Fair View Hotel (Pvt) Limited	Director	No	Less than 1% (100 shares)
Niaveli Hotels (Pvt) Limited	Director	No	20
The Light House Hotel PLC	Director	Yes	Nil
Phoenix Industries Limited	Director	No	Nil
Brushco (Pvt) Limited	Director	No	Nil

Company/Society/Body Corporate Including Associate Companies and Subsidiaries of the Finance Company	Designation	*Whether the Entity is a Specified Business Entity	No. of Shares %
Mr. Travice J. Ondaatjie			
Mercantile Fortunes (Pvt) Limited	Director	No	23.33
Nilaveli Beach Hotels (Pvt) Limited	Managing Director	No	23.4
Tangerine Beach Hotels PLC	Director	Yes	0.89
Royal Palms Beach Hotels PLC	Director	Yes	1
The Nuwara Eliya Hotels Company PLC	Director	Yes	0.57
Tangerine Tours (Pvt) Limited	Director	No	14
Security Ceylon (Pvt) Limited	Director	No	5
Global Films Limited	Director	No	0.04
Grand Hotel (Pvt) Limited	Director	No	Nil
International Fortunes (Pvt) Limited	Director	No	1.33
Mercantile Orient (Pvt) Limited	Director	No	Nil
Fair View Hotel (Pvt) Limited	Director	No	Less than 1% (100 shares)
Nilaveli Hotels (Pvt) Limited	Managing Director	No	20
Mr. H.A.S.T. Senanayake			
NONE			
Ms. P.T.K. Navaratne			
WSO2 Lanka (Pvt) Limited	Director - Legal	No	
Mr. N.H.V. Perera			
Royal Palms Beach Hotels PLC	Director	Yes	0.54%
Tangerine Beach Hotels PLC	Director	Yes	0.45%
Blue Oceanic Beach Hotel Limited	Director	No	Less than 10%
Yala Safari Beach Hotel Limited	Director	No	Nil
South Asia Economic and Trade Corporation (Pvt) Limited	Director	No	Less than 10%
Ceylon Ecectro Mechanical Services (Pvt) Limited	Director	No	Less than 10%
FAB Construction (Pvt) Limited	Director	No	Less than 10%
Mr. S.M.S.S. Bandara			
B.R. De Silva & Co.	Partner	No	Nil

Board Subcommittees

Several subcommittees have been set up by the Board to closely oversee vital aspects related to finance business so that Board is able to discharge its duties effectively. When selecting members to these committees, due consideration has been given to their experience, qualifications and suitability related to the tasks at hand for such committees to be effective.

Scope and tasks of each subcommittee vary but ultimately revolve around supervision of vital business areas especially matters on risk management, internal control and aspects related to remuneration and appointments to the Board. Subcommittees are required to provide feedback to the Board on the status of areas coming under their purview while highlighting key matters needing urgent attention of the Board.

Information pertaining to each Board subcommittee, namely, the Audit Committee, Integrated Risk management Committee, Remuneration Committee, Credit Committee and the Nominations Committee is disclosed below:

The Audit Committee

In keeping with the Corporate Governance Direction, in 2012 Mr. H.A.S.T. Senanayake, being a qualified professional accountant, was appointed as the Chairman of the Audit Committee. He is an Associate Member of The Institute of Chartered Accountants of Sri Lanka. In the same year, to strengthen the Committee composition, Mr. S.M.S.S. Bandara, being a Fellow Member of The Institute of Chartered Accountants of Sri Lanka with extensive experience in the finance, audit and other related fields, was appointed to the Committee.

During Committee meetings, the Internal Auditors are called upon to present key findings which are then deliberated and thereafter taken up with corporate management. The Finance Director being CFO of the Company is invited for all meetings while the External Auditors are invited annually to take up material observations related to their statutory audit. The Audit Committee as part of its tasks calls for supplementary reports from management to review specific matters in keeping with the scope of the Committee.

A comprehensive disclosure on the objectives and duties of the Audit Committee is given under Code D.3.3 of the Code on Corporate Governance in part 01 of this supplement.

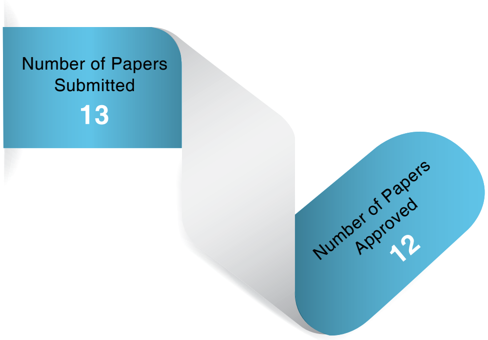
The report of the Audit Committee is shown in page 280 of the Annual Report.

Meetings of the Audit Committee held for the year together with level of member participation is shown below:

Name of the Director	Type of Directorship			Attendance at Meetings in 2012/13			
	Executive	Non-Executive	Independent Non-Executive	15 May 2012	7 November 2012	11 February 2013	14 March 2013
01. Mr. H.A.S.T. Senanayake *(Chairman of the Committee)*			✓	✓	✓	✓	✓
02. Mr. S.H.J. Weerasuriya			✓	✓	✓	✓	✓
03. Mr. S.M.S.S. Bandara			✓	✓	✓	✓	✓

- *The Company Secretary acts as the Secretary to the Audit Committee.*

Board Paper Submission Status of the Audit Committee



The Remuneration Committee

The Remuneration Committee meets to decide on Board remuneration specially focusing on Executive Directors' remuneration and to decide on remuneration related policies. The Committee comprises of three Non-Executive Directors, chaired by Mr. S.H.J. Weerasuriya, the Chairman of the Company. In discharging the Committee's duties, the members meet to evaluate remuneration of relevant Board members, making recommendations after assessing market and peer remuneration levels. The Committee is responsible to decide on matters pertaining to retirement benefits related to Board members as and when need arises.

The Remuneration Committee report is given on page 278 of the Annual Report.

Remuneration Committee Meetings held with level of participation of each member is as follows:

Name of the Director	Type of Directorship			Attendance at Meetings in 2012/13
	Executive	Non-Executive	Independent Non-Executive	17 January 2013
01. Mr. S.H.J. Weerasuriya *(Chairman of the Committee)*			✓	✓
02. Mr. H.A.S.T. Senanayake			✓	✓
03. Mr. N.H.V. Perera		✓		✓

The Integrated Risk Management Committee

The Integrated Risk Management Committee (IRMC) was formed in 2009 in keeping with the Corporate Governance Direction requirements. The new Chairman of the Committee appointed in 2012 is a Non-Executive Director and the Committee comprises of three other Executive Directors. The main role of the Committee is to oversee risk management aspects of the Company and involve monitoring key risks associated with the business. For this purpose, the Committee reviews information supplied by respective divisions and discusses concerns with key officers. The aim of the Committee is to identify key risks and propose risk mitigation practices in areas that it is lacking so that it will help avert losses and other negative impacts to the organisation. The establishment of this high caliber Committee minimises Company's exposure to risk through its close supervision and guidance.

The Committee's tasks involve making assessments related to key risks namely; interest rate risk, credit risk, operational risk and liquidity risk. By determining the level of risk attached to Company's businesses periodically, the Committee is able to propose specific strategies and counter mechanisms to management early. The Committee was able to propose specific recommendations and policy decisions to negate adverse liquidity positions created from short-term mismatches in assets and liabilities.

Commencing 2nd quarter this period, a 'Risk Report' is prepared by the Risk Manager providing an in-depth analysis of the Company's position in relation to each core risk with proposed risk mitigation measures for the Committee's evaluation. The report also provides a thorough study on MI's asset and liability maturity mismatches in both short-and long-term time horizons for the Committee to assess position and devise plans to bridge prevailing gaps. This period, specific attempts were made to boost long-term funding by way of deposit mobilisation, which helped in bringing down mismatches. Since borrowings were deemed relatively costly during this period, the Committee pursued options on boosting deposits especially utilising the growing branch network of MI.

In terms of monitoring interest rate risk the Committee studied effects of interest rate changes to profitability. For this purpose, a sensitivity analysis was carried out this period, the results of which are disclosed on pages 341 & 342 Additionally, pricing structures of core businesses were compared against the market interest rates to determine MI's competitiveness and to monitor and sustain anticipated profit margins.

In overseeing operational risk, the Committee studied existing procedure manuals and periodic internal audit reports to identify process lapses and operational concerns. Suitable changes were made to existing procedures to strengthen operational activities overall. This was essential considering evolving complexities in finance business and to cope with rising demands of customers, regulatory changes and stiff competition.

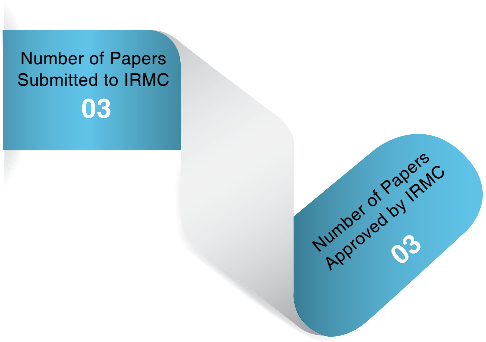
For purpose of strengthening the oversight function on compliance to prevailing laws and regulations, the Committee requested the Manager Compliance to update MI's compliance status on a quarterly basis commencing from 2013. Matters deemed significant arising from such reviews were reported to the Board for its deliberation and resolution.

The report by the Integrated Risks Management Committee has been disclosed on page 277 in the Annual Report.

Information on Integrated Risk Management Committee meetings held for the year and the level of member participation is given below:

Name of the Director	Type of Directorship			Attendance at Meetings in 2012/13			
	Executive	Non-Executive	Independent Non-Executive	29 July 2012	14 November 2012	14 February 2013	20 March 2013
01. Mr. N.H.V. Perera *(Chairman of the Committee)*		✓		✓	✓	✓	✓
02. Mr. Gerard G. Ondaatjie	✓			✓	✓	✓	✓
03. Mr. S. H. Jayasuriya	✓			✓	✓	✓	✓
04. Mr. P. M. Amarasekara	✓			✓	✓	✓	✓

Board Paper Submission Status of the Integrated Risk Management Committee



The Nominations Committee

Commencing from 2013, based on approved terms of reference, a Nominations Committee was established by the Board. The Committee functions independent of the Board and was set-up to handle future appointment of members to the Board. The Committee is headed by a Non-Executive Director and has the services of the Managing Director and two other Non-Executive Directors.

The Committee in discharging its duties would assess the necessity for additional Board members on an on-going basis based on growing industry demands placed on Director Boards of finance companies. The Committee would make its assessment of an individual's suitability impartially in a formal manner for all future appointments.

The report of the Nominations Committee is given on page 279 in the Annual Report.

Given below is the participation status of Committee members for the Nominations Committee meetings held during 2012/13 period:

Name of the Director	Type of Directorship			Attendance at Meetings in 2012/13
	Executive	Non-Executive	Independent Non-Executive	20 March 2013
01. Mr. S.H.J. Weerasuriya *(Chairman)*	✓			✓
02. Mr. Gerard G. Ondaatjie *(Managing Director)*	✓			✓
03. Mr. S.M.S.S. Bandara			✓	✓
04. Mr. N.H.V. Perera		✓		✓

The Credit Committee

In March 2013, the Board approved following members to the Credit Committee while specifying the credit threshold limit for this Board subcommittee to review and approve pending credits:

Name of the Director	Type of Directorship		
	Executive	Non-Executive	Independent Non-Executive
01. Mr. Gerard G. Ondaatjie *(Managing Director)*	✓		
02. Mr. P.M. Amarasekara	✓		
03. Mr. S.H. Jayasuriya	✓		

- *GM Credit and Marketing acts as the Secretary to the Committee and is a Non-Director member forming the four-member Credit Committee.*

In keeping with its objectives, the Committee's tasks mainly involve the review of existing credit practices, monitoring large accounts in arrears and assessing lending trends to decide on best course of action to minimise credit-related risk.

During this period, the Committee appraised existing lending policies and carried out credit risk evaluations of large lending's and high risk accounts including guarantors. Lending's over stipulated limit was scrutinised to identify risk and to plan out smooth recovery of due installments. The Committee reviewed existing and proposed exposure limits on customers against set parameters giving consideration to aspects such as lending growth, exposure values, risk levels of counterparties, overall sector exposure levels and demographic exposure levels.

When evaluating exposure to various sectors, the Committee carried out assessments on sector risk including prevalent trends to decide on suitable sectors to focus, while dissuading industries deemed risky. During this period, to improve overall spreads, increased emphasis was placed in moving towards higher yielding lending products such as mortgage loans and other term loan products. To counter higher risk associated with these types of lending, the Committee proposed stringent credit evaluation practices in consultation with the legal division. Under the guidance of the Committee, credit documentation requirements were strengthened especially for property mortgage loans.

Management level Committees

Management Committee

The Management Committee headed by the Managing Director was set up in August 2011 to mainly have a close review of financial performance of the Company. Apart from having the participation of key senior officers of the Company representing key divisions, majority of Executive Directors also attends meetings that are conducted on a weekly basis. The finance division conducts the meeting and presents a stream of financial information in relation to lending, deposits, profitability, spread levels, market statistics and forecast. Through these meetings, Executive Directors and Corporate Management are apprised of financial performance on an ongoing basis.

These meetings have been beneficial to management since it provides early warning signs and a platform for decision making to take proactive measures to meet anticipated performance standards and to develop strategies to tackle prevailing issues. During the financial year 2012/13, the Committee successfully met weekly with majority of Executive Directors and Corporate Management attending all meetings.

Laws and Regulations

Key Regulations Affecting the Governance of the Company in Summary

Internal	External
Articles of Association	Directions, rules, determinations, notices and guidance issued by the CBSL
Procedure Manual	Finance Business Act No. 42 of 2011
Terms of Reference for Committees Audit Committee Integrated Risk Committee Nomination Committee	Code of Best Practice on Corporate Governance issued jointly by The Institute of Chartered Accountants of Sri Lanka and the Securities and Exchange Commission
Investment Policy	Listing Rules of Colombo Stock Exchange
Remuneration Policy	Companies Act No. 07 of 2007
Branch Compliance Checklist	Sri Lanka Deposit Insurance Scheme Regulations and Circulars
Human Resource handbook	Financial Transactions Reporting Act No. 06 of 2006
Communication Policy	Know Your Customer (KYC) and Consumer Due Diligence (CDD) Rules
Liquidity policy	Inland Revenue Act No. 10 of 2006

Compliance Status to CBSL Directions, Rules, Determinations, Notices and Guidance

The status of MI's compliance to laws and regulations with specific focus on CBSL Directions is reported by Risk Manager to the Integrated Risk Management Committee. (Please refer pages 87 to 90)

In parallel, the Internal Auditors carry out periodic reviews on MI's compliance level in relation to key laws and regulations and provide feedback to the Audit Committee. The Audit Committee in-turn appraises the Board on any unresolved matters and other concerns arising from such reviews for their attention and resolution.

The Finance Business Act No. 42 of 2011

A stream of new regulations has been introduced through the Finance Business Act No. 42 of 2011 that is applicable to the finance companies sector, replacing the previous Finance Companies Act. In keeping with regulations, we continued to maintain our capital adequacy and liquidity positions above the statutory requirements as at the Balance Sheet date. MI possesses a strong capital structure with a comfortable capital adequacy position based on past accumulation of retained earnings that has strengthened overall capital levels of the Company.

The Company has established a close monitoring process to ascertain liquidity levels and compare against organisational requirements. The Finance Department reviews liquidity position on a daily basis and maintains statutory liquid assets above the prevailing thresholds.

Corporate Governance Direction No. 03 of 2008

Mercantile Investments has adopted sound practices in terms of adhering to corporate governance requirements to ensure operations of the enterprise are governed for the best interest of all its key stakeholders. MI's compliance level in adoption of the Corporate Governance Direction No. 03 of 2008 and related amendments issued by the Central Bank has already been disclosed in this supplement. Separate disclosure has also been made on MI's level of adoption to the Code of Best Practice on Corporate Governance.

Companies Act No. 07 of 2007 and Colombo Stock Exchange Rules

We abide by regulations related to the Companies Act No. 07 of 2007 and Colombo Stock Exchange rules which are applicable to us as a public listed limited liability company. Page 351 provides disclosure on MI's compliance status to CSE rules.

Financial Transactions Reporting Act No. 06 of 2006 (FTRA)

In addition to the above requirements, regulations related to the Financial Transactions Reporting Act No. 06 of 2006 (FTRA) on Anti-Money Laundering and the Combating of Financing for Terrorism are directly applicable to MI since we deal in financial transactions.
In adopting the FTRA, we have developed a comprehensive AML Policy document" setting forth internal requirements on customer identification for employees to follow.

Inland Revenue Act No. 10 of 2006

The Inland Revenue Act No. 10 of 2006 and other tax laws are referred to by the Company to decide on corporate tax, value added tax, stamp duty and to arrive at other tax liabilities and levies.
In coordination with our tax consultants, Messrs. Ernst and Young, we comply with these tax regulations. We obtain their services whenever material changes occur to tax laws and when we require other tax clarifications.

Returns Submitted as per Prevailing Regulations

Requirement 2012/13	Compliance
Inland Revenue	26
EPF and ETF	26
Gratuity	1
Registrar of Companies	1
CSE	3
Central Bank of Sri Lanka	303
Municipal Council	4
SLAAS Monitoring Board	1
Financial Intelligence Unit	12

Employee Training on Regulations

To ensure smooth implementation of regulations related to finance business and other laws, employees are afforded training either arranged in house or through external training sources.
In-house training on regulations covered topics on anti-money laundering and related provisions of the FTRA. Training was separately given on regulations related to lending business specially focusing on legal aspects covering documentation. Employees were also sent for training seminars and workshops conducted by the Center for Banking Studies of the Central Bank and training afforded by The Institute of Chartered Accountants of Sri Lanka, the Finance Houses Association and other bodies that provide training.

Human Resource Management

A detailed brief on MI's human resource management practices is provided in our section on 'Labour practices and decent work' on pages 232 to 243 under the social dimension in MI's Sustainability Report. This section provides disclosure on key human resource topics such as career development, staff evaluation process, working environment, staff benefits and HR initiatives applicable to the financial period.

Corporate Social Responsibility

A comprehensive account of CSR initiatives undertaken by the Company under economic, social and environmental dimensions is given in our Sustainability Report on pages 219 to 252. As part of the business community, we continue to enjoy fruits of peace which has set the stage for commercial sector to prosper including our industry. In this backdrop, being an active player in the private sector, we understand the need to bring forth sustainable development practices with the hope of bettering our future as a nation.

External Auditors Certification

We obtained services of External Auditors to certify that the contents stated in the Corporate Governance report in relation to the finance Companies (Corporate Governance) Direction No. 03 of 2008 do not have any inconsistencies with the practices, processes and policies adopted by the Company. External Auditors confirmed that the disclosures given are in order as per their report of agreed upon procedures dated 21 May 2013.

S Pethiyagoda.

Mrs. S. Pethiyagoda
Company Secretary

Mr. R. Costa
Manager Compliance and Risk

Mr. Saroja Weerasuriya
Chairman

21 May 2013

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 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 indentifying, 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 Sri Lanka Accounting Standards and other applicable regulations.
- MI's own Internal Audit Division and Ernest and Young, Advisory Service (Pvt) Limited have been jointly 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 (SLFRS/ LKAS)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 2013 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

21 May 2013

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.

TO THE BOARD OF DIRECTORS OF MERCANTILE INVESTMENTS AND FINANCE PLC

Introduction

We were engaged by the Board of Directors of Mercantile Investments and Finance PLC ("Mercantile Investments") to provide assurance on the Directors' Statement on Internal Control ("the Statement") included in the annual report on page 164 for the year ended 31st March 2013.

Management's Responsibility on Internal Control

Management is responsible for the sufficiency and reliability of internal controls in place for the company as specified in the Finance Companies (Corporate Governance) Direction, No. 3 of 2008 ("the direction") and to prepare and present a statement on internal control as required by paragraph 10 (2) (b) in accordance with the said direction.

Our Responsibilities and Compliance with SLSAE 3050

Our responsibility is to issue a report to the board on the Statement based on the work performed. We conducted our engagement in accordance with Sri Lanka Standard on Assurance Engagements 3050 – Assurance Report for Banks on Directors' Statement on Internal Control (SLSAE 3050), issued by the Institute of Chartered Accountants of Sri Lanka.

Summary of Work Performed

Our engagement has been conducted to assess whether the Statement is both supported by the documentation prepared by or for Directors and appropriately reflects the process the Directors have adopted in reviewing the system of internal control for the company.

To achieve this objective, appropriate evidence has been obtained by performing the following procedures:

a. Reviewed the documentation prepared by the Directors to support their Statement made.
b. Reviewed the minutes of the meetings of the Board of Directors and of relevant Board Committees.
c. Attended meetings of the audit committee at which the annual report, including the Statement on Internal Control is considered and approved for submission to the Board of Directors.
d. Reviewed the Statement made by the Directors with our knowledge of the Company obtained during the audit of the financial statements.

SLSAE 3050 does not require us to consider whether the Statement covers all risks and controls, or to form an opinion on the effectiveness of the company's risk and control procedures. It also does not require us to consider whether the processes described to deal with material internal control aspects of any significant problems disclosed in the annual report will, in fact, remedy the problems.

Our Conclusion

Based on the procedures performed, nothing has come to our attention that causes us to believe that the Statement included in the annual report on page 164 is inconsistent with our understanding of the process the Board of Directors have adopted in the review of the design and effectiveness of internal control of Mercantile Investments and Finance PLC.

Cecil Arseculeratne & Co

Chartered Accountants
Colombo.
21st May 2013

INCLUSIVE GROWTH FLOWS, PRUDENTLY

Prudent risk management founded on pragmatic research and forward planning allows our business to take that 'leap of faith' with confidence.

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RISK MANAGEMENT REPORT

Managing Risks Associated with Finance Business

As finance business involves dealing with a multitude of risks that is potent and even lethal, risk management has become an integral part of our business strategy each year. We understand the importance of aligning risk management objectives of the company in a way that it strikes an appropriate balance between risk and rewards in order to maximise shareholder wealth, as primary tasks. Finance business involves dealing in various forms of financial assets and liabilities which are susceptible to a stream of risks which fall under core categories of risk, namely, credit risk, liquidity risk, market risk and operational risk. If these risks are not managed appropriately, finance companies face the threat of experiencing serious adverse financial impacts. This could even lead to large scale corporate collapses those witnessed globally in the recent past. Organisations that lacked sound risk management practices, which were not geared to face material events and setbacks such as the global financial crises faced severe setbacks despite their previous sound track records.

In the midst of an ever changing business environment, Mercantile Investments has stayed committed to the adoption of sound risk management techniques to counter potent risks inherent in our business with the intention of safeguarding assets and annual profits of the company. We adhere to a surge of regulations that have been introduced by the regulator especially in recent times to counter key risks prevalent in the finance company sector. To strengthen and uphold risk management practices within the organisation, during this period, a separate Manager Risk and Compliance was recruited specifically to oversee and to implement related practices across the enterprise. He was also entrusted with the role of overseeing the Company's compliance to various laws and regulations including Anti-Money Laundering practices. On top of this, with the interaction of the Integrated Risk Management Committee established in 2009, the Company closely supervises various risk management practices to counter key risks. Through the committee, we continue to uphold best suited risk management techniques in countering evolving, risk patterns due to the complexity of the industry we are in.

Risk Management Strategy

Risk management traditionally has been viewed as a controlling and loss mitigation function that supports the organisation to minimise the potential risks. MI believes in the use of risk management beyond the traditional boundaries, by considering risk management as a business tool. MI's strategy is to optimise the value of its stakeholders through Preemptive Risk Exposure Management, identifying the best trade-off between risk and reward in all major business decisions. In order to maximise shareholders' value and in prudently managing risk portfolios in best suited way, MI reviews position to determine suitable action, accurately pricing products and services.

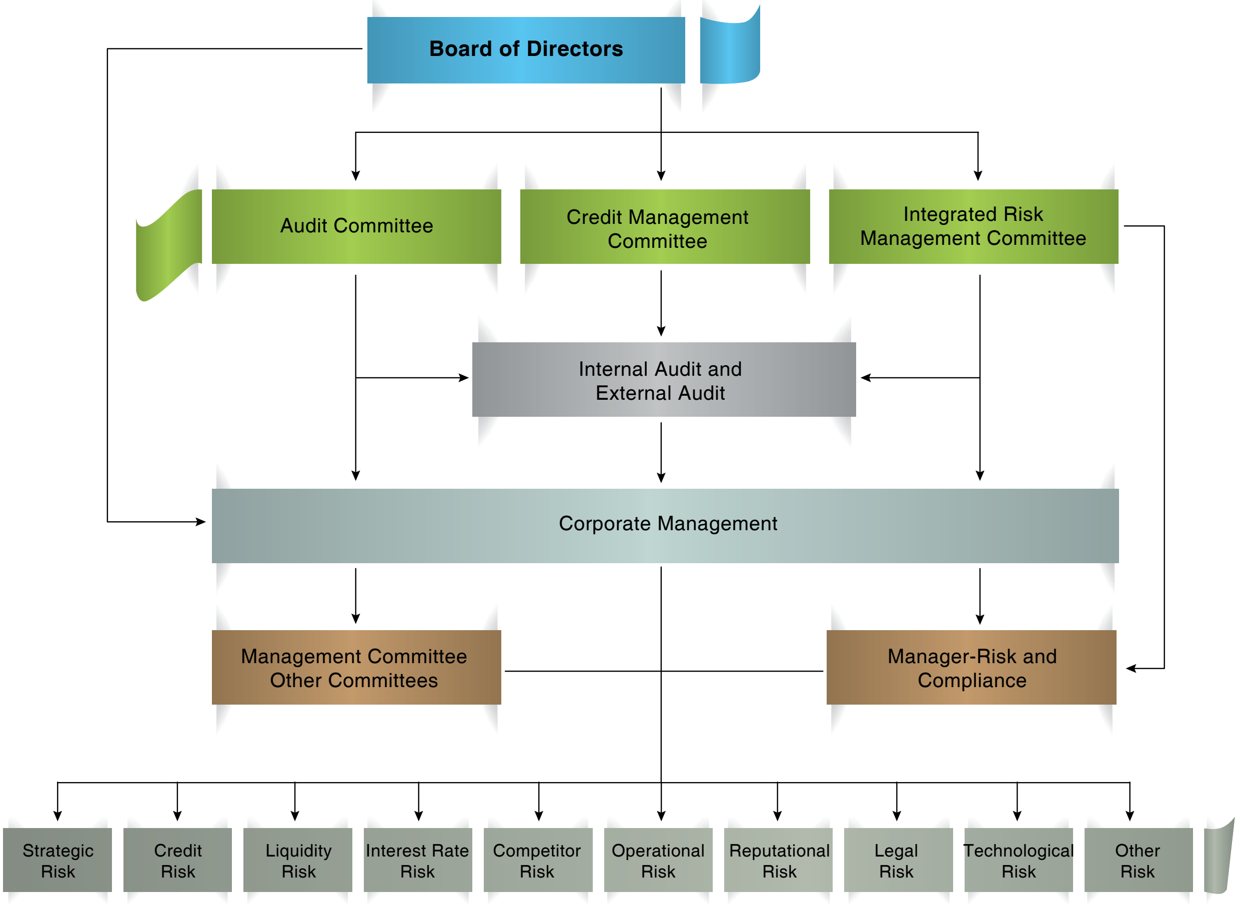
As part of our risk management strategy, we adopt an ongoing process of risk identification, which encompasses the assessment and measuring of risk levels and includes on a case-by-case basis making improvements to existing risk mitigation practices. MI's risk management process encapsulates a stream of policies and procedures laid forth to counter risk at various levels. At the same time, we monitor risks on a continuous basis, in certain instances comparing actuals against prudent norms to identify material deviations. This provides us the opportunity to assess the level of risk exposure that we face and enables us to take timely counter measures. It also enables us to constantly keep appraised of the effectiveness of existing risk mitigation techniques.

Mercantile Investments continues to adopt its own policies and procedures that have evolved over the years together with standard risk management practices that are universal as means of operating an effective risk management program throughout the year. Annually, we deploy a considerable level of resources to maintain this process in an effective manner so that we continue to harness an appropriate trade-off between risk and rewards. Other than the shareholder perception, MI's risk management objectives are further aimed at safeguarding other key stakeholder expectations especially those of our customers while preserving the overall solvency of the enterprise according to the originally laid down risk profile expectations.

Risk Management Structure

In running our risk management framework we adopt a formal top down hierarchical approach giving autonomy to the corporate management to implement risk management practices within their line of operations as depicted in the diagram 1. The responsibility for risk management starts from the Board level and passes down to the next level being the corporate management that comprises heads of divisions and other managerial level officers of the Company. The task of managing day to day risks lies with the heads of divisions and relevant senior management within their functional areas. Other than the role played by the Board and Corporate Management , the structure maps out the importance of specific committees and the audit function in keeping together a well- balanced risk management framework. The Manager Risk and Compliance's role in the risk framework is one of supervision and reporting as depicted in the diagram.

Risk Management Structure (Diagram 1)



Board's Governance in meeting Risk Management Requisites

The Board of Mercantile Investments leads from the front, overseeing corporate management actions by establishing necessary committees and other initiatives to expedite their responsibilities on management of risk related to the company. The Board has established several sub-committees for monitoring of key forms of risk with the intention of discharging board's obligations related to risk management, i.e the Audit Committee, the Integrated Risk Management Committee (IRMC) and the Credit Committee. The sub-committees with active Director participation discharge their duties effectively by meeting periodically. The members are well conversant of the subject matter at hand and thus play a significant part in overseeing various risk and counter mechanisms in place. They evaluate the appropriateness and adequacy of related internal controls adopted across key divisions. Through these sub-committees, the Board is able to obtain first-hand information on associated risks that are considered potentially threatening so that remedial action could be initiated early.

Corporate Management's role in Risk Management

MI's corporate management comprising mainly of senior managerial officers have been entrusted with the task of actually implementing risk management policies and procedures within their functional areas and monitoring them to ensure its constant application. MI's corporate management structure has been established with clear separation of organisational functions and responsibilities, on a set of tools and procedures. This encompasses a system of in-house control checks that set the needed precision for officers for them to execute their tasks well in keeping to the expectations of the Board. For the efficient operating of risk management policies, the Company possesses highly competent and experienced staff, who have the precise management orientation to perform functions effectively in a professional manner.

Divisional heads have the direct responsibility of ensuring that necessary risk assessments related to their departmental functions are done including assessing the adequacy of prevailing risk management practices within the relevant divisions. Respective divisions are required to review existing processes and controls on an on- going basis in the light of the changing environment so that appropriate updations and improvements could be made to existing procedures and controls. Already procedural updates have been effected through addendums made to the Company's 'Procedure Manual' for purpose of strengthening specific operations. Having a well-documented procedure manual minimises operational lapses and guide staff on what needs to be done operationally. It supports managers as a training tool for managers to train their respective departmental staff without ambiguity to uphold sound organisational practices.

Integrated Risk Management Committee (IRMC)

The Integrated Risk Management Committee comprises of four members, who operate under Board approved terms of reference. The main duties of the Committee is to oversee MI's risk management practices that include reviewing strategies on risk management and related policies and processes that are practiced across the company. The Committee meets on a quarterly basis and reviews reports and statistics tabled by respective heads of divisions for purpose of assessing main risks such as credit risk, liquidity risk, interest rate risk and operational risk. Through a thorough assessment IRMC makes suitable recommendations to avert impending risk or to improve risk management controls. In making assessments, IRMC reviews the Company's maturity profile of assets and liabilities periodically and proposes strategies to counter prevalent mismatches both in the short and long term. In terms of managing market risk, the Committee reviewed the prevalent interest rate structure for both MI's lending and deposits business to ascertain the adequacy of spreads enjoyed from core business. During this period, for further analysing market risk, the committee was able to study impacts to profitability based on anticipated interest rate changes initiating sensitivity analysis under various possibilities.

In covering operational risks, the Committee reviewed departmental procedures through available manuals and review reports that shed a light on existing policies and procedures and obtained feedback on MI's level of compliance to such requirements. The Committee was able to suggest improvements to processes and internal controls wherever it was lagging as means of strengthening internal practices to safeguard assets of the Company.

Audit Committee's role in Risk Management

The Board primarily has entrusted the Audit Committee to review the adequacy of internal controls that have been instilled in MI's operations and processes. The Committee provides feedback and recommendations to them on any material concerns so that timely decisions could be taken to address such issues. The Committee meets on a periodic basis and reviews reports of Internal Auditors to ascertain management's compliance to laid-down procedures and controls including adherence to laws and regulations. The Audit Committee was restructured in 2012 in keeping with best corporate governance practices to maintain full independence by having only independent Non-Executive Directors. The Chairman of the Audit Committee is a Chartered Accountant who has the necessary experience and qualifications to carry out Committee's supervisory role effectively in the areas of financial reporting, audit and internal controls, compliance to laws and regulations.

Credit Committee

To minimise credit risk, The Board has under it, a credit committee which oversees large level lending above authorised threshold.

For purpose of monitoring the quality of credit granted and to manage risk inherent to lending the Committee meets on a regular basis so that timely action can be initiated for contracts moving into arrears. The Committee's tasks involve approving high value credit and monitoring large overdue accounts and establishing strategies to improve quality of credit, reducing overdue levels and deciding on Company's exposure to various sectors.

Management Level Committees role in supporting Risk Management

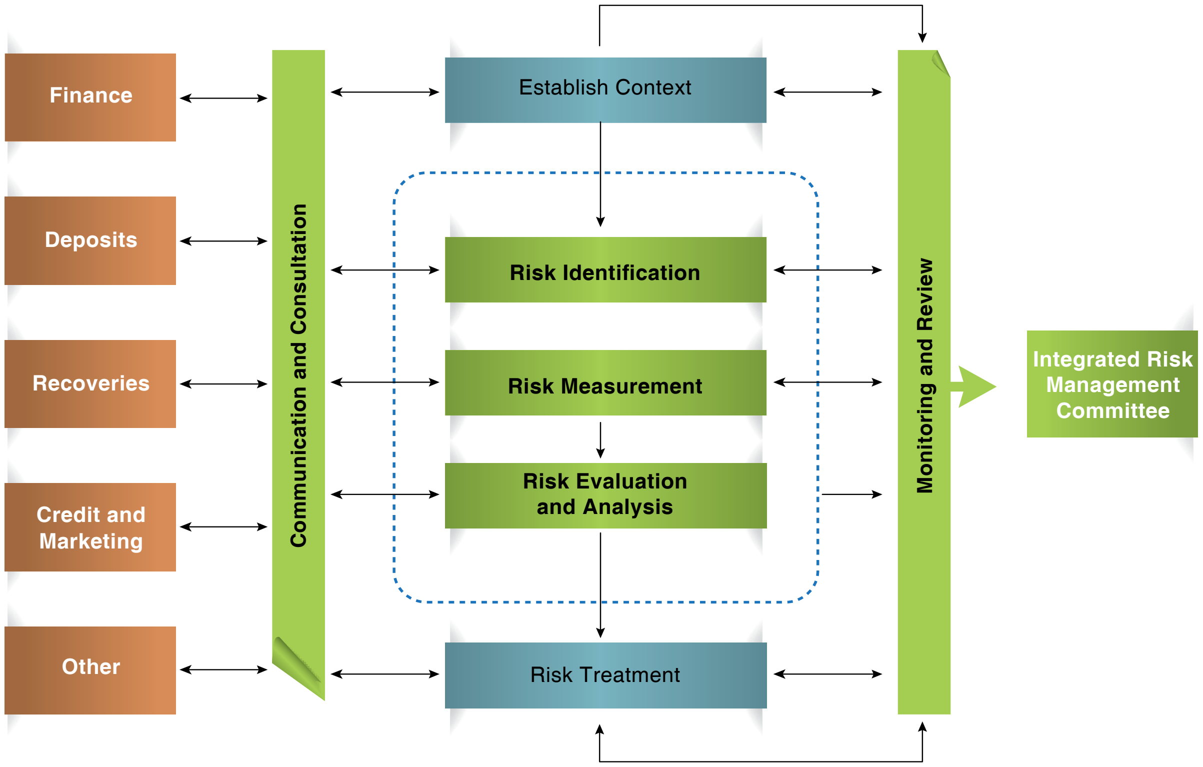
There are several Management level Committees that have been set up to oversee specific aspects on core business especially to review areas related to performance, ascertain prevailing risk etc. by analysing vital information, namely;

- **Management Committee**

The Management Committee that was set up in July 2011 monitors operational performance which involves review of interest rate movements, trends in credit and other risk that impact performance on an on-going basis. The Committee closely reviews profitability of core business operations, volumes achieved, spreads and a stream of other financial information to ascertain actual performance against expectations and to identify any imminent threats early. The Committee comprises of key officers in manager grade and above who represent core business divisions chaired by the Managing Director. By having regular meetings and absorbing large amount of information, departmental managers are able to take timely decisions especially to re-strategise according to the situation and also to come up with counter mechanisms whenever risk arise. This close monitoring process has benefitted the organisation immensely in identifying prevalent gaps early in relation to our core business operations in terms of spread, volume etc., thus averting any negative impacts.

MI adopts a structured risk management process that is aligned with recommended international standard of ISO 31000 on risk practices. The management process executed strengthen MI's chances of success, encouraged by proactive management, dealing effectively with opportunities and threats, improving governance, complying with regulatory requirements, encouraging stakeholder confidence and trust, enhancing strategic planning, minimising financial, environmental and safety losses and improving organisational resilience and performance.

MI's Risk Management Process



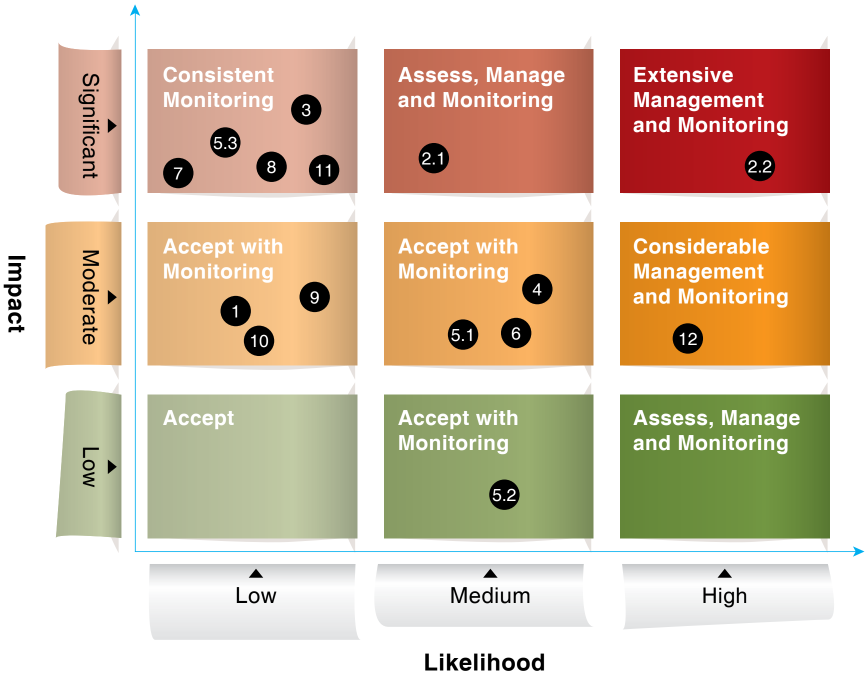
Assessment of Key Risks

MI carried out a thorough risk assessment of all the main risks of the Company, based on likelihood of occurrence and impact of the consequence. Likelihood of the occurrence assessment is done based on the past experience and risk mitigation measures in place. Based on the assessment ranking of high, medium and low probabilities are assigned to each risk type. Impact of each risk is assessed by determining the financial and non-financial loss of each event. The impact of each risk has been classified as low, moderate and significant based on the seriousness of each risk related impact.

MI's approach to Significant Risks

Depending on each category of Risk, our risk management approach varies and thus understanding types of risk, their nature and then making assessment is necessary to devise suitable counter mechanisms.

In keeping with Sri Lanka Financial Reporting Standard (SLFRS 7 - Financial instruments: disclosure) commencing from this financial year both qualitative and quantitative disclosures on risk arising from various financial instruments and MI's approach in managing them is discussed in depth under each risk category. In the next section, in articulating prevalent risk, their measurement and our approach taken in managing risk is captured in our 'Risk Control Dashboard' supported by quantifiable information.



Impact	Low	Medium	High
Significant	Consistent Monitoring 3, 5.3, 7, 8, 11	Assess, Manage and Monitoring 2.1	Extensive Management and Monitoring 2.2
Moderate	Accept with Monitoring 9, 1, 10	Accept with Monitoring 4, 5.1, 6	Considerable Management and Monitoring 12
Low	Accept	Accept with Monitoring 5.2	Assess, Manage and Monitoring

Risk Profile

1. Strategic Risk
2. Credit Risk
    2.1 Default Risk
    2.2 Credit Concentration Risk
3. Liquidity Risk
4. Interest Rate Risk
5. Operational Risk
    5.1 Internal Control Risk
    5.2 Operating Environment Risk
    5.3 Unforeseen Natural Disaster
6. Technology Risk
7. Reputational Risk
8. People Risk
9. Legal Risk
10. Regulatory and Compliance Risk
11. Corporate Governance Risk
12. Equity Risk

Credit Risk

Credit Disbursement and Recovery Process

Lending business being a primary part of finance companies core business operations inherently exposes related organisations to credit risk on a constant basis. Credit risk arises when a borrower fails to discharge their contractual obligations towards the lender. Credit risk is treated as the most applicable risk for a finance company as the related business involves dealing in large volumes of lending. Hence, we take managing of credit risk as an area of paramount importance. We understand that credit risk if not handled appropriately, could result in bad debts that will eventually bring down organisation's profitability.

As a means of countering credit risk, stringent policies and procedures have been laid down by the Company in relation to our lending business. The operational manual on credit specifies clear policies, processes and procedures to follow in the credit granting and recovery process. This includes adherence to authority levels applicable, documents to obtain and follow up procedures from the moment credit is disbursed until the borrower completes his repayments in full. The Company has established well defined credit policies in keeping with best industry practices which encompass a system to closely monitor contracts in arrears. By having a well-integrated lending and collection process we have been fortunate to possess a quality lending portfolio as at the balance sheet date. Accordingly, the non-performing lending levels have remained marginally over 3% in 2013.

As a main element, MI's credit disbursement process has been structured with authority levels that delegates authority to credit officers depending on their grade. 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 part of our credit control practices, lending facilities are subject to an independent review by the next level of authority. In addition, significant loans that have experienced deterioration in repayment are regularly subject to credit examinations. At the same time, expert knowledge is provided by the Credit Committee through the reviewing of large accounts beyond specified threshold credit value.

Prior to the disbursement of credit, as part of sustaining lending quality, the Credit Division carries out standard verifications in keeping with organisation's policies running through a detailed checklist. The credit review process involves assessment of the customer's credit worthiness, mainly analysing his repayment ability, borrower's past track record by referring to the Credit Information Bureau (CRIB) and also carrying out site visits. At the preliminary stage, a formal 'credit appraisal' is completed for the borrower by gathering information about the borrower's financial position,assessing and concluding on his/ her's repayment ability in relation to the value in concern. When analysing customer credit exposure, the credit approval process refers to the type of credit arrangement, either for a given transaction or total exposure to the client. The credit exposure evaluation then extends to ascertain MI's overall exposure to a given industry of geographical exposure as a result of the proposed credit.

Internal Auditors as part of their annual audit programme cover organisation's compliance to set credit policies and procedures on an on-going basis that includes a comprehensive review of lendings done by branches. Their observations and suggestions on Improving existing control systems and processes especially related to credit are informed to the Audit Committee. Material matters highlighted in audit reports are thereafter taken up by the Audit Committee with respective officers of senior management. The Audit Committee provides feedback to the Board on any vital observations that include credit concerns together with their recommendations as deemed necessary.

To mitigate exposure to credit risk, we take appropriate collateral from the borrower as an additional safeguard to cover against lending exposure. As a practice, collateral is taken for most of our financing and term lendings. To counter any risk of non-payment, as a sound credit practice, we ensure that lending is backed by adequate realisable security in line with prevailing regulations on lending. At the same time, with the efforts of our Recoveries Division which works hand in hand with the Credit and Marketing division, we ensure smooth recovery of installments from our borrowers. The Recoveries Division has put in place a tight monitoring system that ensures reminder letters are sent to borrowers of installments falling due for its timely collection. Recovery action is initiated for past due accounts based on the period overdue and nature of default. As part of the recovery process, it is the Company's policy to dispose of repossessed vehicles in an orderly fashion so that related proceeds are used to reduce the outstanding exposure.

Finance division presents weekly performance statistics to the Credit and Recovery teams at the management committee meetings and additionally provides daily, weekly and monthly statistics and financial reports for them to initiate action and make timely decisions. Through this, recovery officers are able to assess their respective collection performance levels periodically so that they can plan future recovery targets.

In spite of doing a relatively higher quantum of term loan related lending at high rates during this period, it was heartening to observe that we were able to curtail non-performing lending through these sound credit risk management techniques. Furthermore, training and development of officers attached to both the Credit and Recoveries divisions was deemed top priorities in 2012/13 and was initiated on an on-going basis. These programs provided comprehensive knowledge accretion to frontline and back office credit and recovery officers. Training programs henceforth covered the credit appraisal process, credit procedures applied, how to enhance quality of credit decisions and recovery procedures that is specific to MI.

Liquidity Risk

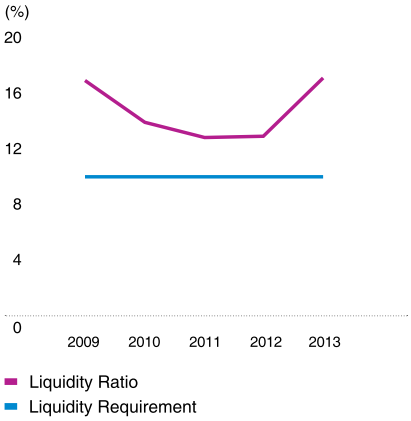
Liquidity risk arises when a company encounters difficulty in meeting its obligations associated with financial liabilities that are settled either through cash or any other financial asset. This risk could develop if liquidity management is not handled appropriately to ensure that the Company meets its payment obligations when they fall due. To avert instances of liquidity pressures similar to what was witnessed in 2009, finance companies have come to embrace a stream of liquidity risk management practices with greater focus. While these practices have gone on to safeguard the sector from liquidity risk, it has simultaneously boosted public confidence once again. On top of this, a range of regulations have been imposed by the regulator within the last few years as a means of strengthening governance and risk management practices of finance companies especially to boost management of liquidity risk. For instance, the Deposit Insurance Scheme introduced in recent times was aimed at tackling liquidity concerns of the sector.

At MI, the objective of liquidity management revolves mainly around maintaining a constant stream of cash flow that is adequate and timely to fund operations and meet obligations and other commitments whilst being cost-effective. Our Company is a financially sound institution that has been strong in liquidity right-through. In meeting liquidity requirements, the Company resorts to an array of diversified funding sources in addition to its core deposit mobilisation business. Similarly, MI adopts a strict policy of managing its assets keeping liquidity as a vital focus and therefore monitors liquidity on a daily basis. We possess adequate cash and other liquid assets including bank funding lines and access to money market instruments. Having adequate funding lines has enabled us to meet ongoing operational cash outflows easily from numerous obligations including settling of overhead expenses.

We had enough flexibility in terms of funding during this period to pursue on our growth aspirations, to incur capital expenditure with adequate flexibility. Further, the Company has not been exposed to real estate investments considered somewhat an illiquid asset with the decline in demand in the past few years. Major part of our asset base is constituted by MI's loans and advances portfolio while the share investment portfolio is the second largest component. In spite of the temporary decline seen in share value in the current period which we have accounted for in the financial statements, our investments have been made primarily in blue chips which can be disposed of at any time, once the anticipated price is attained.

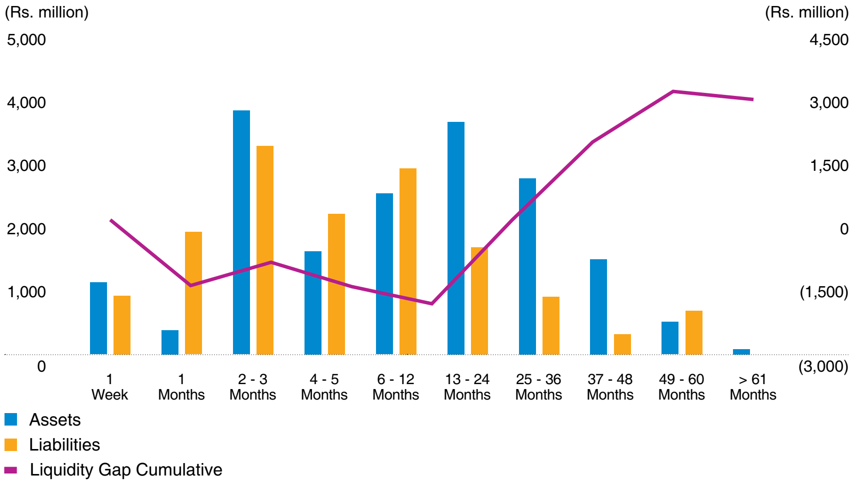
The Company has a Board approved liquidity management policy that entrusts daily management of liquidity to the Finance division headed by the Finance Director who oversees the treasury function of the Company. As part of the liquidity management process, there is a daily review of the funding position against anticipated cash payments and commitments to ascertain additional funding needs so that funds could be obtained promptly through the available funding sources. To ensure that the Company complies with statutory regulations on liquidity, we monitor liquidity position on a daily basis to maintain statutory limits.

Statutory Liquid Assets Ratio for Last 5 Years



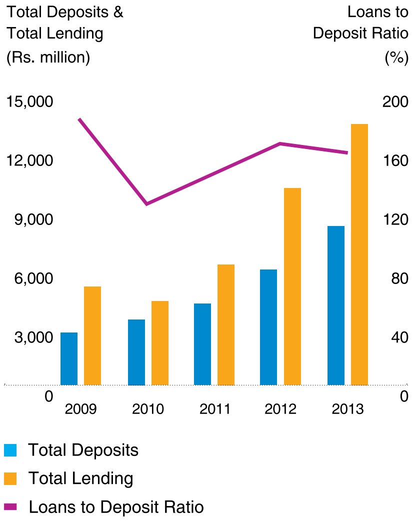
In parallel, the Integrated Risk Management Committee is entrusted by the Board to review the liquidity position of the Company in both shorter and longer duration. The IRMC analyses maturity profiles related to financial assets and financial liabilities closely to ascertain gap's and propose suitable action. The Committee meets quarterly to review strategies to see its extent of implementation and effectiveness, in coordination with respective divisions. In identifying associated risk, IRMC studies growth rates and status in lending, deposits, borrowings and analyses other financial statistics including ratios. They evaluate main lines of business as a means of understanding prevailing trends to determining potential towards liquidity risk.

Liquidity Gap Analysis



Maturity analysis of assets and liabilities and related commentary is given in the Notes to the Financial Statements given on page 340.

Advances to Deposits



Market Risk

Market risk would arise when the fair value or future cash flows of financial instruments of the Company fluctuate due to changes in market variables such as interest rates, exchange rates and equity prices. Currently, exchange rate risk to MI however is negligible since the Company does not hold or transact materially on foreign exchange despite having a money changing license.

Interest rate risk being a significant risk factor for the sector is managed closely by the Company to ensure there is no erosion of spreads and no impact to final profitability. Similarly, equity price risk being the other main market risk is managed at individual investment level as well as on a portfolio basis, based on whether the portfolio is trading or non-trading. Impact of these two main market risks on our business is discussed below;

Interest Rate Risk

The high interest rate structure that was prevalent during this financial period, pressured institutions to pay greater emphasis in managing interest rates to sustaining reasonable spreads from core business operations. The rise in the number of players has raised competition level in the sector and has eroded overall sector spreads than before. Banking sector's increased drive to promote their own financing products in recent times has aggravated this position further.

Interest rate risk arises from the possibility that changes in interest rates will affect future cash flows or fair values of financial instruments. Interest bearing instruments include financial assets mainly MI's loans and advances portfolio and fixed income securities that are held as available-for-sale. Financial liabilities mainly comprise of deposits and borrowings. Hence, interest rate movements play a significant part in altering core business margins and ultimate profitability. It is therefore essential that interest rate risk is managed tightly instilling close monitoring mechanisms so that any negative fluctuations in interest rates are anticipated early to device suitable counter measures.

Interest rate changes are influenced by monitory policy changes that ultimately affect the interest paid on deposits and borrowings and interest received from lending and securities. Hence, changes that happen at macro level could ultimately fluctuate a company's net interest income, affecting its profitability levels and cash flows. From MI's perspective, interest rate fluctuations could impact (i) our 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. As is the case for companies in the sector, Interest rate risk remains a potent risk because most of the Company's maturities of assets are not identically matched to those of its liabilities mainly due to the mismatches in timing of core business of lending and deposits. Therefore, as means of assessing impacts of interest rate changes on MI's profitability, we performed sensitivity analysis for our interest bearing instruments.

Fixed and Floating Assets and Liabilities as at 31 March 2013

	Fixed Rate Rs. '000	Floating Rate Rs. '000	Total Rs. '000
Assets			
Cash and Short-Term Funds	632,238		632,238
Placement with Other Banks	364,330		364,330
Financial Investments - Available-for-Sale	3,467,280		3,467,280
Loans and Receivables	4,017,478		4,017,478
Lease Receivables	4,072,783		4,072,783
Hire Purchase Receivables	5,754,386		5,754,386
Investment in Associates	695,670		695,670
Other Financial Assets	172,148		172,148
Inventories	221,220		221,220
Other Assets	240,986		240,986
Property, Plant & Equipment	1,535,731		1,535,731
Leasehold Property	44,013		44,013
Intangible Assets	4,681		4,681
Total Assets	21,222,944		21,222,944
Liabilities and Shareholder's Funds			
Bank Overdraft		999,036	999,036
Deposits due to Customers	8,424,720		8,424,720
Debt Instruments Issued and Other Borrowings	1,617,440	3,614,891	5,232,331
Other Financial Liabilities	551,874		551,874
Current Tax Liabilities	81,322		81,322
Deferred Tax liability	93,817		93,817
Other Liabilities	17,096		17,096
Retirement Benefit Obligation	116,390		116,390
Equity	5,706,358		5,706,358
Total Liabilities and Shareholder's Funds	16,609,017	4,613,927	21,222,944

Interest Rate Risk on Non-Trading Financial Assets and Liabilities

MI's Treasury Division reviews market rates on an on-going basis to decide and manage the rate structures at MI. The division reviews applicable Central Bank interest rates on government securities and other related considerations including MI's funding position, profitability levels, economic fundamentals and current trends before deciding on pricing for main business lines.

In maintaining an optimal level of return for our core business, average yield levels and cost of funding,is monitored on a weekly basis and presented at management meetings to decide on pricing matters. The Management 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 anticipates and plans for decline in interest rates that may affect the Company's net interest income and spread level in the event interest income from lending and investments fall faster than cost of funding. MI by having a strict monitoring system maintained its interest rate risk at moderate levels despite volatility in rates in the market in the concluded period.

Equity Risk

Equity risk arises when the fair value of equity investments decreases as a result of changes in market prices of related individual stock. MI monitors its equity price risk very closely as Company holds Rs. 3.7 Billion in share investments as at the Balance Sheet date. The Company's Accounting Policies ensure that we reflect share investments at fair value recognising any realised gains/losses through the profit and loss and unrealised gains/ losses through equity.

Operational Risks

Failed or inadequate internal processes, people and systems or adverse external events could result in operational risk to a company that could lead to various consequences including losses. In curtailing operational risk, the Company has implanted various internal controls to detect possible human errors, fraud, faulty internal processes and systems, non-adherence to procedures and non-compliance to regulation. MI adopts a company-wide internal control system and requires all staff to adhere to set policies and procedures that are clearly detailed out in the 'procedure manual' developed for the organisation.

Frequent audits are conducted to ensure employees stay compliant to set policies and procedures including internal controls and also as means of identifying process weaknesses for immediate correction. During this process, auditors in certain instances suggest operational solutions when they are lacking and highlight operational weaknesses and recommends necessary changes with the intention of overcoming risks. The audit function also provides insight into any operational lapses that may prevail and is an early warning mechanism for management so that they in-turn can take pro-active measures to avoid operational losses. The auditing structure at MI was strengthened this financial period with the advent of MI's own Internal Audit division.

We adopt a stream of techniques to manage operational risk that include segregation of duties of staff, job rotation, staff training and backing up of core systems, employee operations and important documents. The responsibility to establish internal controls lies with respective heads of divisions for their operational activities while overall leadership for it stems from the Board. To ensure effectiveness of established controls, respective divisions are expected to monitor such controls over time and make changes as and when needed. In deliberating on operational matters, core divisional heads meet with their staff frequently and obtain feedback on operational concerns in the process of assessing performance. This allows departments to correct any operational weaknesses then and there and to devise permanent fixes to counter potential operational risks.

In managing operational risk, we place heavy reliance on Information technology by use of state-of-the-art technology for our core systems. Numerous security controls have been in-built to core systems to eliminate possibility of unauthorised access, infiltration of data and system errors. Specific user limits have been established at various levels for authorisation of a transaction and a system of dual control has been instilled in core systems for specific operational activities of importance. Separately, for purpose of monitoring, our core system provides a stream of MIS including exception reports to managers to analyse operational efficiency. As a standard practice, daily back up is done of the database and secured at an off-site location as a prudent measure in countering potential risk of system malfunction and corruption of data. We possess a team of IT experts experienced in their field to handle all IT related aspects including software development. Whenever new modules are introduced or material changes are made to existing modules, in accordance with our Information system policy documents, we carry out adequate system testing and thereafter obtain user acceptance for it formally prior to moving ahead with live implementation.

We developed a Business Continuity Plan (BCP) in 2009 which spells out potential risk to operations and to the people in the event of a company-wide contingency event occurring such as a fire. The BCP goes on to specify steps management should follow and strategies that need to be implemented to minimise potential impact from such disaster events. Time lines have been specified by relevant departments for the implementation of proposed counter strategies to ensure minimal disruption to operations and to bring down any resultant impacts to the business as a consequence.

Whilst being proactive to operational risk, we are at the same time fortunate to possess a strong capital base that is able to absorb potential losses. MI's Capital Adequacy position that is almost two folds of the expected ratio as per prudential requirements gives us the needed cushion to absorb any potential unforeseen operational losses if it were to materialise.

Other Risk

Legal Risk

Legal risk can occur when a transaction cannot be legally enforced or will become unenforceable over time or when a contractual obligation cannot be fulfilled. Legal risk could also occur when a company does not comply with legal and regulatory requirements as stipulated. As a consequence of this form of risk, unexpected financial losses could arise from a transaction or action or due to inadequate documentation and in certain instances because of adverse judgments if not prevented appropriately. Repercussions could come in the form of sanctions and penalties imposed by regulatory bodies for non-compliance to stipulated laws and regulations. As a company that deals in various financial transactions and being in a highly regulated industry, we take the management of legal risk as a priority.

Employees are required to be conversant with regulations related to their area of work and therefore are continuously afforded training so that they appraise themselves of changes to statutes, regulations including changes in interpretation or implementation of statutes, regulations and policies for its due compliance.

We understand that regulatory changes may result in 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. It is therefore essential that legal risk be managed appropriately to avoid undue impact to businesses financially and to avoid damage to reputation that could lead to loss of confidence.

The recruitment of a separate Manager Compliance and Risk Management further strengthened the compliance function in 2012/13 period. The Manager is responsible to oversee Company's compliance to regulations including practices related to the Financial Transactions Reporting Act on Money Laundering and also to provide feedback to the Board and relevant heads of divisions on any matters of concern. Separately, in managing legal risk, MI's Legal division plays a significant role, providing advice and assistance to other divisions on prevailing laws and regulations and also guiding officers towards compliance when new laws are enacted and whenever changes happen to existing laws. Their advice is sought especially on customer agreement clauses, changes to agreements, recovery proceedings and whenever new regulations related to products and services are introduced or are changed. The Board of MI separately monitors management's level of compliance to prevailing statutory regulations through the Audit Committee. For this purpose, Internal Auditors provide periodic feedback to the Audit committee on the status of Company's compliance to such regulations.

Technology Risk

In providing a superlative service, we have always placed heavy reliance on technology as means of gaining competitive advantages. Thus appropriate use of technology is vital for business success while as the flip side, its incorrect management or lack of understanding could lead to various negative consequences to an organisation. Being dependent on information systems for the daily running of operations exposes the organisation to technology risk especially in instances of system failures and interruptions. System failure over long periods would adversely affect the customer monitoring systems, general ledger, deposits, loans and other sub systems. At the same time, lapses in technology can extend to breaches in security and derailing of Company's confidentiality policies that could lead to other consequences. 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. Since it is a known phenomenon that no assurance can be placed on avoiding any such failures, interruptions or security breaches, the best counter mechanism is to manage associated risk through sound universally adopted practices.

Mercantile Investments continues to uphold technology as a key feature in driving our business forward which is considered integral to our core business operations. We adopt technology in most of our business activities so that we meet needs of our customers more effectively. Technology has played an integrated part in improving our service standards and in minimising cost through automation. We continue to invest in technology especially in terms of bringing in new modules, features to core systems and carrying out upgrades in line with expectations of users and industry changes. In supporting our expanding branch network, we have put in place a fully integrated network system that enables speedy on line processing of balances, remote processing of documents pertaining to our lending and deposit business and numerous other features that support users in completing routine tasks. During this period, notable changes were effected to systems to incorporate IFRS requirements i.e. changes to lending module, deposit module and the general ledger.

As there is great reliance on Information technology, MI has established clear ICT policies and procedures that include the information system security policies introduced in 2012 that require IT and other divisional staff to follow information technology standards set by the organisation. We seek internal auditor's assistance to review and conclude on specific aspects of the systems and to report on any inherent risks in newly introduced systems to ensure their smooth running without drawbacks. We have made plans to carry out a thorough system audit through an external consulting party commencing next financial period.

Officers recruited to our IT division are highly conversant in their areas of expertise and are technology savvy. They have a good understanding of the systems operated within the Company and possess the capability to grasp system issues early and have the experience to resolve them then and there. We have specialised officers for software development who have the necessary technical know how, who follow software development standards including adoption of user requirement documentation, system testing, implementation of standards, user acceptance testing procedures as part of MI's ICT Policy framework. When selecting hardware for our core systems, we remain with reputable organisations for our purchases and sign up for maintenance agreements with them to cope with possible equipment breakdowns and malfunction.

Reputation Risk

A company could be subject to reputational risk arising as a direct or indirect consequence of any of the other risk previously explained materialising. This form of risk can further arise when companies engage in parties who do not abide to right standards and ethical business practices. As a direct consequence of reputational risk, companies would experience deterioration in confidence of their customers which can directly affect business volumes and profitability in the longer horizon. Finance Company Sector which underwent pressures due to negative events in 2009, has seen a tremendous turnaround since then and has regained public confidence gradually again. In its part to gaining reputation, the sector had to tighten its governance practices and had to bear increased regulation. This eventually stabilised the industry and improved public perception tremendously within a short span of time.

Mercantile Investments continues to adopt sound measures as a means of safeguarding our reputation that we have managed to successfully secure all these years. To manage reputational risk, considerable resources and effort is placed in reviewing the business environment. Based on prevailing elements we have aligned our operations and practices especially front end processes to guide the organisation to perfection. We provide greater autonomy to our managers to reduce lead times in completing a transaction whilst placing higher level supervision and control over transactions that are material in nature.

The MI team is highly conversant of their work duties and has the ability to respond well to changes in markets and regulations governing the Industry. The Company from inception has been focused on tackling pressing issues and has maintained a good track record in resolving any shortcomings that tend to arise whilst in the course of carrying out daily operations. We have adopted confidentiality policies to our practices and use customer information responsibly, retaining the trust and loyalty of our customers. In safeguarding our reputation over the years we have stuck to our fundamentals that inculcate practices of sound values and high ethical standards that are adopted across all our business activities.

We have formulated policies and procedures on anti-money laundering and combating terrorist financing in line with prevailing regulations and require staff to strictly adhere to them as a means of protecting the good name of the Institution. We have strengthened our human resource policies in the last few years and issued a HR handbook for our employees in this year. Staff are expected to perform their duties to the best of their abilities and to continue safeguarding the reputation of the Company like we have done in the past. We resort to strict disciplinary action against individuals who fail to abide by the set rules of the organisation and adopt a zero tolerance approach in such instances.

Competitor Risk

Financing being a popular method of funding among borrowers and since becoming a lucrative form of business has gained tremendous progress since lately. Accordingly, the sector witnessed a surge of new institutions joining the industry in the last decade. Our sector caters to a wide customer audience through a broad product range that has expanded from mere financing and deposit taking to tailor-made product offerings that meet varying customer needs. It is therefore vital to be receptive to customer needs in a highly competitive market like ours if the organisation is to thrive and succeed.

Owing to the plethora of other investment and borrowing options available to customers in the market competition remained high. Also, financial institutions with large capital structures and technology such as banks have also shown increased liking to financing that our sector is accustomed to, intensifying competition in a somewhat saturated market.

Mercantile Investments actively participates in the sector and has been in the forefront of delivering customer-centric offerings that fit varying expectations of our customers by being innovative and persevering in whatever we do. To sustain competitive advantages, the Company strives to keep overall cost at optimal levels so that competitive rates could be offered for both our lending and deposit business. Customers in recent times have become price sensitive and therefore we remained committed to our critical success factors to differentiate our offerings amidst heightened competition.

The Company invested considerable level of resources in sustaining its core capabilities and critical success factors over the years; namely to maintain a superlative service and excellence in delivery. We have been able to provide tailor-made solutions and affordable pricing. To enhance the value of our final output, refinements are made to our operational practices to keep pace with market changes and challenging expectations of customers which are carried out on an ongoing basis. We have been able to strategically expand our business within a short time span allowing the Company to expand its reach in the market and improve market share.

We utilise state-of-the-art technology to execute core operations which has improved our service and delivery times tremendously. In parallel, the Company adopts a unique human resource management style that compliments work life balance for our staff. Our style of management attempts to secure employee morale and motivation most of the time as a means of sustaining optimal productivity levels in all our operations. In meeting future challenges, we are fortunate to possess a strong capital structure that gives us the opportunity and the needed flexibility to make broad strategic decisions.

Human Resource Related Risk

Being a service organisation, there is high dependency on our human capital in driving our business forward, in meeting anticipated service standards. A lot depends on the performance of our workforce in the achievement of organisational objectives and other aspirations to remain successful. Hence attracting and retaining high caliber staff, who possesses the necessary experience and skills to perform duties is integral if MI is to continue on its path to success. This of course has become a challenge especially since the job market is flooded with numerous job opportunities for capable individuals both within and outside our sector. For MI, this risk is relevant especially because most of our staff have been with us for at least five years or more, who have gained enormous experience in their related fields. Losing services of these experienced personnel hence at any point in time can create a vacuum in meeting anticipated standards and disrupt smooth running of operations temporarily. We are mindful of the fact that finding suitable replacements in the short-term would not be easy. Moreover, related risk rises since we do not practice employment agreements with our officers holding senior positions.

In managing human resource risk, the Company resorts to specific human resource management practices that revolve around maintaining staff morale and motivation to secure our workforce in the longer term. In motivating employees, we recognise valuable input of our staff by showing appreciation by giving benefits including salary increments, handing out special recognition awards and letters of commendation. In improving staff morale, clear communication channels have been established between management and staff in promoting concise dialog that has helped minimise misunderstandings. We use training and development as a tool in increasing the intrinsic value of MI employees which has kept them motivated and has reciprocally benefited the Company. Training and development have also played a key role in grooming staff to face complex business challenges. MI's exceptionally low turnover levels suggest that we are a preferred employer especially because of our reputation as a financially sound institution. MI's financial stability thus has been a source of strength for our employee's in terms of job security and career advancement.

Risk Related to Indemnity Arrangements

As a risk minimising technique, indemnity arrangements are used in transactions for financial restoration of an aggrieved party to the level prior to accident, injury or illegal act. Indemnity arrangements allow businesses to seek protection over loss and damage claims filled by another party. On the basis that such arrangements only bring back the plaintiff to a state of wholeness, it allows a plaintiff to obtain compensation from the defendant for his or her wrong acts. The principle of 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. Nonetheless, punitive damages are considered altogether as a separate matter.

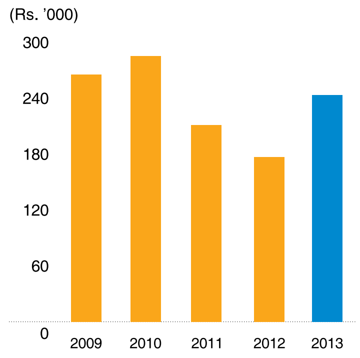
To execute lease transactions, standard lease agreements have been structured in coordination with our legal division in a way that it protects both the lessor and the lessee. The lessee is aware that he or she has the full rights to the property without fear of sudden seizure or eviction. The lessor at the same time is aware that a legally-binding contract obligates the lessee to make regular payments throughout the life of the lease. In mitigating risk related to Indemnity arrangements, as a policy of the Company, we ensure that our clients sign-off an agreement which contains indemnity clauses. These clauses have been designed to prevent court action being brought against the Company for damages caused by the use of the related asset.

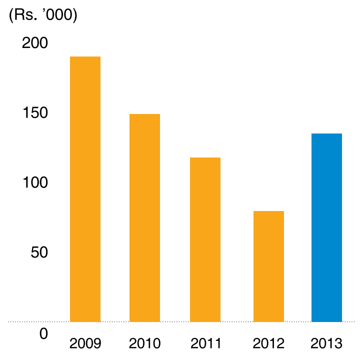
As part of our credit process, in reducing credit and associated risk, we resort to obtaining of adequate asset cover to counter credit exposure prior to releasing funds for our lending business. In addition, our credit policies require that the absolute ownership of the asset is retained with us to compensate for any future losses or damages that maybe encountered by our borrower. For purpose of establishing the lending value for a particular transaction, our credit policies specify that we consider a combination of variables including the value of security offered. As a standard credit control policy, lending to customers is limited to a percentage of the security offered. This minimises MI's total exposure and secures the Company from unnecessary credit exposure that may arise if the borrower defaults or market values of the security decline. Further our credit practices require that we make an assessment to ensure that the value of the asset offered is comparable with the value of other vehicles with similar conditions any time in future.

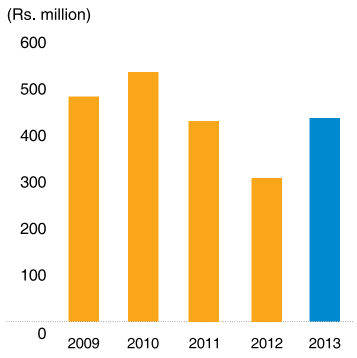
Risk Control Dashboard

Risk Type	Likelihood	Impact Level to MI	Risk Assessment	Strategies on risk mitigation - 2013 update
Strategic Risk				
● Strategic risk is defined as the risk associated with future business plans and strategies, including plans for entering new business lines, expanding existing services through organic business growth, mergers and acquisitions or exposure loss resulting from a strategy that turn out to be defective or inappropriate.	Low	Moderate	The Board of Directors is accountable to manage and control the operation of MI in a prudent manner according to the rules and procedures stipulated by the Companies Act, Finance Business Act, Colombo Stock Exchange, Securities and Exchange Commission and Central Bank Code of Governance. MI Board's performance is assessed annually by Directors. In doing so, they refer to success level of strategies so far implemented and progress of the Company in terms of decisions taken.	Management reviewed actual performance against targets regularly referring to business strategies effected and success of their implementation. MI's annual corporate governance report was reviewed and certified by the External Auditors this financial period. The Company Secretary guided the Board on corporate governance and Board procedural requirements. MI Directors participated in training and awareness programs organised by the CBSL and other training institutions.
Credit Risk				
Risk of default by Borrower ● Effectiveness of the credit disbursement process and related policies	Medium	Significant	Regular reviewing of the existing credit policies and procedures including core information systems in order to improve the credit disbursement process. Rise in rates above 25% had a moderate impact on our NPL's. Certain borrowers faced difficulties in repaying higher installment values. To a certain degree, their businesses were also impacted due to persistent volatility in economic variables.	Use of a comprehensive 'credit operational manual' that provides detailed guidance on steps to follow to meet effective credit disbursement standards. Accordingly, 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. We paid greater attention in strengthening our relationships with customers, paying attention to customer payment behaviors. Specifically, we ensured that we assessed individual circumstances and reasons for arrears beforehand agreeing our solutions with customers. This ensured that arrangements are affordable to them which eventually supported them in repayment of arrears in a timely and sustainable manner. Strengthened staffing at Recoveries department and Credit and Marketing department to support in driving an effective credit and recovery operation. Credit disbursement limits were revised upward to meet rising demand for our lending products based on grade and capability of respective credit officers.

Risk Type	Likelihood	Impact Level to MI	Risk Assessment	Strategies on risk mitigation - 2013 update
• Effectiveness of Credit Policies	Low	Moderate	Risk arises where credit policy amendments do not update with the pace and changes happening in market environment. Company's credit risk policy is regularly reviewed at weekly management meetings and at monthly credit meetings. The process is complemented by the Credit Committee which meets periodically to review and direct various aspects of the lending process of the Company. Credit approval process was revisited and specific amendments made.	Comprehensive credit policy manual and Lending guidelines have been established by the Company to ensure consistent high quality lending discipline. A well-defined delegated approval process based on hierarchy supported by high ethical standards, well established policies and procedures provide a robust framework for the organisation and management of credit risk. Risk management procedures on credit are updated on an ongoing basis to keep pace with changes in local business environment and will be formally laid down next period. This will be done after reviewing the performance of the Company against internally defined risk appetite and direction by the Integrated Risk Management Committee. Currently, policy changes are communicated on an ongoing basis to all related staff at head office and branches through corporate management.
• Availability of credit information and its accurate recording for decision making and borrower follow up	Low	Moderate	In FY 2012/13, a comprehensive review of the IT systems was conducted for purpose of enhancing level of information generated specifically to support credit decision making.	More than 10 new MIS reports were developed during this period to assist Credit and Finance staff in their routine operations. The IT systems were revamped with the guidance of the Finance, Credit and Recovery division to facilitate the requirements arising from, IFRS specifically accounting standard LKAS 32 and 39 on financial instruments.
• Effectiveness of Credit Portfolio Monitoring	Low	Moderate	We have in place a solid monitoring process to oversee more than 10,000 lending customers to ensure quality of our portfolio. A daily report on contracts repayment position and those in arrears are reviewed to ensure smooth recovery of installments based on suitable recovery measures. In assessing creditworthiness of customers we obtain CRIB reports and carry out field visits as appropriate. In deciding on level of NPA and provisioning requirements, we embraced IFRS and accordingly analysed the probability of default and loss given default based on past data. We remained strong in collections and managed to control NPA despite general credit deterioration in the market.	Credit disbursement process of the Company was extensively reviewed during monthly meetings of both Credit and Recoveries divisions. Information pertaining to borrower repayments together with analysis on contracts in arrears month wise is made available for management daily through the core lending module. For the purpose of monitoring performance of credit operations functional managers can obtain other exception reports from the system. Regional credit managers/branch managers present their performance against targets on a monthly basis. Additionally, Recoveries division carries out their own appraisals comparing actual collections against respective officer's individual targets. Monthly Recoveries division's meetings facilitate management to take appropriate action on long overdue contracts. Legal action is sought in extreme cases promptly or repossession based on circumstances. Periodic credit committee meetings focus on high value accounts and high risk accounts and also accounts under litigation.

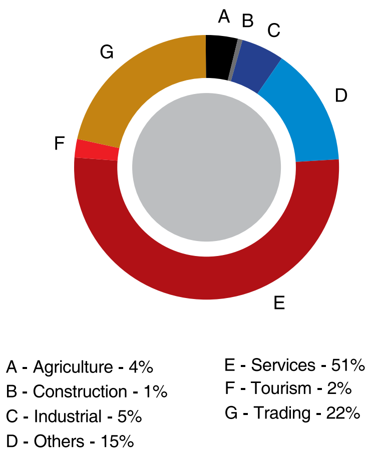

Non-Performing - HP


Non-Performing - Lease

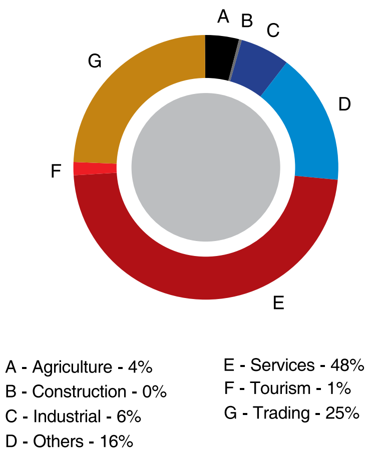

Non Performing level-Overall

Risk Type	Likelihood	Impact Level to MI	Risk Assessment	Strategies on risk mitigation - 2013 update
Credit Concentration Risk ● Concentration risk is the probability of loss due to insufficient diversification of the credit portfolio with respect to industry or geographical area.	High	Significant	Risk is assessed on the basis of quarterly studies on prospective different sectors in the market using available business publications and in-house research information. Through these studies, MI identifies warning indicators, high risk level of any related industry or particular location as the case maybe.	To mitigate concentration risk arising from changes due to the market conditions, MI's Credit Committee reviews risk exposure of Company's credit portfolio on an ongoing basis. Based on the market conditions and analysis of reports, Committee decides on industry and products limits. We diversified our presence further going beyond Western province, establishing branches in all parts of the country in a short period. There were three new branches and two service centers opened during this period. The Credit Committee strategised to improve the penetration of low risk sectors and geographical areas in the market and conversely reduce the exposure to high risk sectors and geographical areas. MI's is not exposed unnecessarily to a few credit customers and is within regulatory single borrower limits. MI's credit portfolio has a reasonable blend of both corporates and individuals with varying lending levels.

Lease Sector Wise Concentration



Hire Purchase Sector Wise Concentration

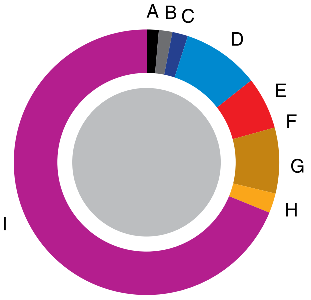


Risk Type	Likelihood	Impact Level to MI	Risk Assessment	Strategies on risk mitigation - 2013 update

Concentration of Lending Exposure Province-wise in 2013

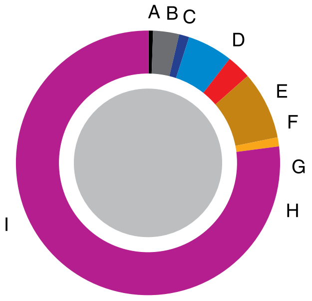
Province	Hire Purchase Rs. '000	Lease Rs. '000	Other Loans Rs. '000	Lending Outstanding Rs. '000
Central	75,969	22,026	17,238	115,233
Eastern	112,031	145,526	20,350	277,907
North-Central	104,952	41,168	25,297	171,417
North-Western	556,880	231,683	81,144	869,707
Northern	3,687	4,194	942	8,823
Sabaragamuwa	374,000	124,506	80,386	578,892
Sourthern	481,654	352,845	356,960	1,191,459
Uva	123,633	42,789	20,736	187,158
Western	4,081,104	3,212,222	3,468,686	10,762,012
Total	5,913,910	4,176,959	4,071,739	14,162,608

Hire Purchase Province Wise Concentration



A - Central - 1%
B - Eastern - 2%
C - North Central - 2%
D - North Westeren - 9%
E - Northern - 0%
F - Sabaragamuwa - 6%
G - Sourthern - 8%
H - Uva - 2%
I - Western - 70%

Lease Province Wise Concentration



A - Central - 1%
B - Eastern - 3%
C - North Central - 1%
D - North Westeren - 6%
E - Northern - 0%
F - Sabaragamuwa - 3%
G - Sourthern - 8%
H - Uva - 1%
I - Western - 77%

Risk Type	Likelihood	Impact Level to MI	Risk Assessment	Strategies on risk mitigation - 2013 update

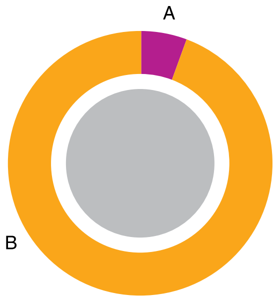
Ten Largest Credit as a % of Total Exposure

	2012/13	2011/12
Ten Largest Credit as a % of Exposure	5.77	8.77
Ten Largest Credit (Rs.)	817,604	941,588
Total Exposure	14,162,608	10,732,821

Exposure by Counterparty

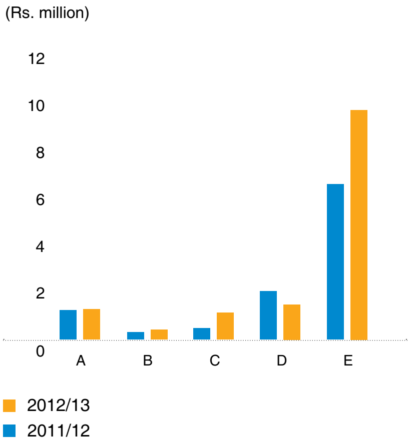
	2012/13	2011/12
Corporate Over Rs 10 Million	1,288,598	1,250,645
Corporate below Rs 10 Million and above Rs 5 Million	415,861	313,942
Corporates below Rs 5 Million	1,156,810	486,834
Individuals Over Rs 05 Million	1,485,241	2,041,355
Individuals below Rs 5 Million	9,816,098	6,640,045
Total	14,162,608	10,732,821

Ten Largest Credit Exposure Against Total Credit Exposure



A - Ten Largest Credit as a % of Exposure - 6%
B - Total Exposure - 94%

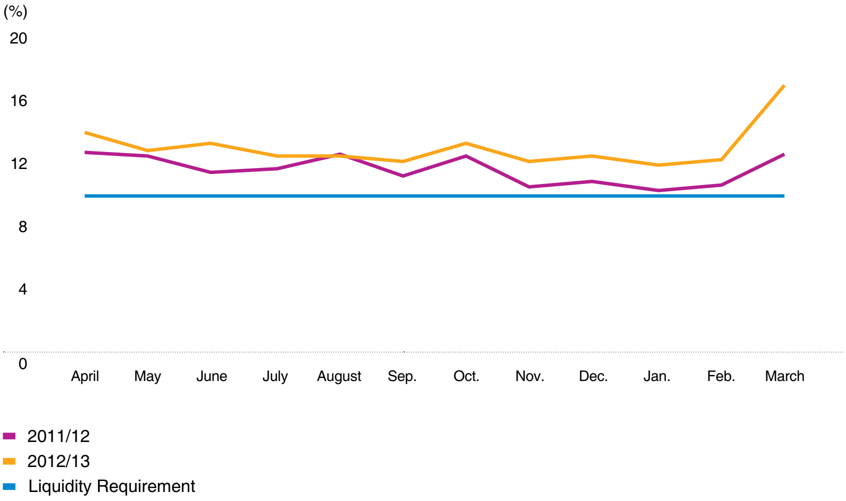
Credit Exposure by Counterparty



A - Corporate > Rs. 10 million
B - Corporate < Rs. 10 million > Rs. 5 million
C - Corporates < Rs. 5 million
D - Individuals > Rs. 5 million
E - Individuals < Rs. 5 million

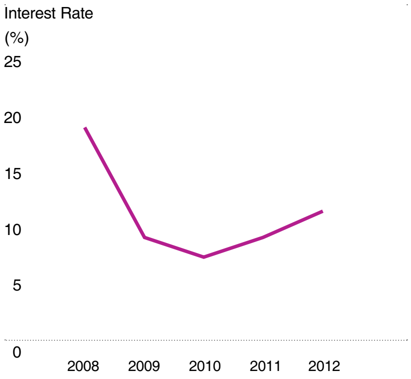
Risk Type	Likelihood	Impact Level to MI	Risk Assessment	Strategies on risk mitigation - 2013 update
Liquidity Risk				
● Risk arising from inability to meet depositor liabilities on their maturity	Low	Significant	MI has identified key liquidity indicators, namely net advances to total assets ratio, liquid assets ratio and net advances to deposits ratio which are monitored on a regular basis in order to ensure that MI sustains strong liquidity position. Monthly review of Assets and liabilities maturity gaps for pre-defined maturity buckets. Periodic review of Company's medium and long term liquidity by the Integrated Risk Management Committee to assess prevailing risk and propose risk mitigation strategies.	Greater emphasis was placed on decentralising major part of deposits canvassing operation to branches. During the period, deposit operation was streamlined with procedural changes made to speed up operation. Issue of a temporary deposit receipt at branch level with adequate transaction details was initiated through appropriate system modifications. Increased the focus on introduction of Deposit promoting agents island wide to improve the fixed deposit portfolio of MI. This strategy contributed substantially in improving new deposits, this year. There was also more focus on canvassing long-term fixed deposits with a view to bridging mismatches in maturity gap while monitoring the lending disbursements and recovery collection on a weekly basis. MI persisted on its policy on minimal exposure to land and property investment considered illiquid and held minimal property portfolio. 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. In keeping with CBSL requirements MI continued to subscribe to the Deposit Insurance Scheme meeting due monthly payments to the scheme.

Statutory Liquid Assets Ratio



Risk Type	Likelihood	Impact Level to MI	Risk Assessment	Strategies on risk mitigation - 2013 update
Interest Rate Risk ● Risk arising from fluctuations in interest rates	Medium	Moderate	This period saw a steep rise in interest rates and its persistent volatility especially experienced in the latter part of this period.	Gap analysis on rate sensitive liabilities and rate sensitive assets is monitored periodically to decide on appropriate strategies to mitigate exposure to interest rate based on future interest rate forecasts. The Management committee represented by all divisions meets and reviews rate structures on a weekly basis. To determine the impact to net income and profitability when business volumes are varied, extensive analyses were carried out which included extensive sensitivity analysis and stress testing. MI interest rate risk remained lower since we have only Rs. 4,613 million liabilities at floating interest rates and also manage fixed rate pricing by monitoring closely market rates and spreads. Management kept close watch on rates, to ensure anticipated margins are maintained for entire period considering the steep rise in market rates and other economic changes in industry of the period concern. To manage fluctuating rate positions thus affecting MI's pricing on main business line, we adopted a very close check on market rate movements, daily, weekly and monthly. We resolved to sensitivity analysis to determine impacts to profitability due to possible volatility. In maintaining margins, MI introduced few higher yield products such as micro finance, and increased volume in personal loans and property mortgage lending, and also redesigned a few other products to improve the interest yield. From the angle of cost, we pursued cheaper funding sources to bring down overall weighted average cost which was one of the key goals. Treasury division managed to seek optimal funding in all possible instances.

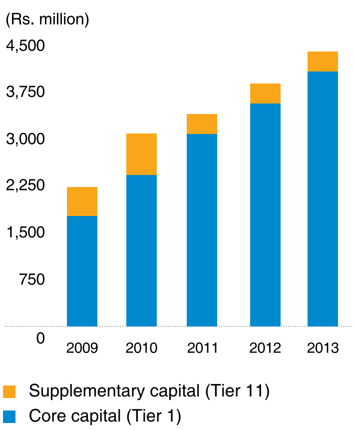
One Year Treasury Bill Rate



Source: Central Bank Annual Report of 2012
(For the Calender Year)

Please refer pages 341 to 342 for interest rate sensitivity analysis information.

Risk Type	Likelihood	Impact Level to MI	Risk Assessment	Strategies on risk mitigation - 2013 update
Operational Risk				
● Risk arising from faulty processes and control systems, acts of fraud and natural disasters	Low	Moderate	Procedures, policies and internal control mechanisms are continuously evaluated to see its adequacy and appropriateness in the light of sophistication in the industry, minimise operational faults and risks impacts at departmental level. Comprehensive internal controls and procedures have been established as safety devices to secure Company assets. Company's capital position and related statutory ratios are reviewed periodically.	Procedures and internal controls were put to practice and reviewed periodically to ensure compliance, and documenting any deviation from the procedures and incorporating those to the Company's procedure manual. Independent periodic review of existing internal controls by our Internal Auditors, Ernst & Young based on a predefined annual audit program and continuous audits done by MI's internal auditors ensure the strength of the internal control process of the Company. Internal Audit Division mainly focuses on operation of branches. All the operational control practices are reviewed by the Internal Audit division periodically and report compliance lapses to the Audit Committee. The Committee ensures smooth function of daily operations including the rectification of operation lapses by following up on the recommended practices of internal auditors.


Capital Base

Risk Type	Likelihood	Impact Level to MI	Risk Assessment	Strategies on risk mitigation - 2013 update
• Operating Environment Risk	Medium	Low	Continuously reviewed existing facilities and operating environment risk such as any loss or damage to capabilities due to the problems with premises, facilities, services or equipment.	Combined effort of MI's Finance, IT and Administration divisions with business units ensure that this risks are well managed by executing periodic maintenance and routine checks, monitoring processes and follow up of actions stated in the Business Continuity Plan.
• Unforeseen Natural Disasters	Low	Significant	MI closely monitors probability of losses caused by unusual climatic condition including heat, fire, flood, cold, drought, tsunami and storms etc. Continuously updating of Business Continuity Plan to guide management safeguarding MI from event of company wide contingency events.	Additional measures were taken in this period to overcome potential sub risk arising from company wide risk in BCP plan, namely; Insurance is the fundamental mitigating strategy for unforeseen disasters. Therefore MI's Insurance Department has taken precautions to ensure the adequacy and effectiveness of insurance coverage in key areas of natural disasters. MI has given high priority in its BCP plan for the area of climate and weather risk as well. Fire proof cabinets have been used to safeguard all the important documents. MI preserves important documents aided by the recently introduced 'Document Management System' through archiving. Internal Audit division reviews this process periodically. Reviewed existing fire precautionary measures of the building, and machinery. Recommendations of the Colombo Fire Brigade given in previous year are being followed up currently.
Technology Risk				
• Technology risk arising from core systems malfunction, errors in new module implementations and changes in environment affecting technology	Medium	Moderate	Core information system is assessed on an on-going basis by the IT division in coordination with relevant user departments so that improvements could be made when needed. Stringent testing procedures are adopted by the IT division prior to live implementation of proposed modules to avoid errors and shortcomings.	In accordance with CBSL requirements a 'System Security Policy Document' was developed and approved by the Board in June 2012. In accordance with ICT policies, divisions must complete a 'user requirement request form' when requesting for updates to ensure that all modification, new modules and updates are aligned with user division expectations and requirements. To safeguard data, a range of system controls covering user access, e-mail usage and aspects on information confidentiality were incorporated as one comprehensive ICT policy document.

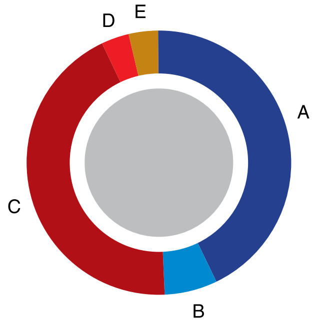
Risk Type	Likelihood	Impact Level to MI	Risk Assessment	Strategies on risk mitigation - 2013 update
			Periodically, reviews of the system functionalities are carried out by the Internal Audit to evaluate the accuracy and reliability of the system.	The Company continued its policy on its daily backing up of the database and off storage. IT division staff have been trained to handle system related issues with minimum inconvenience to operations. Updating of the IT policies and procedures are done regularly in order to maintain the IT system on par with the dynamic business environment. There is continuous monitoring of staff adherence to the information security policy for the purpose of safeguarding confidentiality of information. Comprehensive staff training on MI's ICT policy framework is planned to be given early next period. Risk review of the IT systems have been done and contingency plans incorporated in the BCP for all IT dependent processes in order to successfully face any unpredictable technological contingencies.
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	Low	Significant	As a finance company, protecting the institution's good name is of outmost importance given the current context.	MI has implemented required corporate governance practices, risk assessment measures, departmental procedure manuals and further carries out due compliance checking to ensure business is conducted in a professional, ethical and prudent manner. Regardless of corporate hierarchy, all the employees of the MI are expected to live by core values of the Company. Deviations from MI's strict policies and procedure guidelines and rules result in strict disciplinary action for employees. MI has educated its operational staff on customer response and grievance handling, and also improved their capacity by new recruitments. MI recently started on public relations management and corporate campaigns in order to enhance the brand name of the Company. In lieu of our operational excellence and financial stability, we have gained reputation as a sound organisation in the minds of all our stakeholders.

Risk Type	Likelihood	Impact Level to MI	Risk Assessment	Strategies on risk mitigation - 2013 update
• Lack of attention in the area of corporate social responsibility	Low	Significant	MI is committed in its quest to upholding responsible practices in enhancing economy, social and environmental welfare.	MI executed a number of CSR programs within the year to sustain Company's vision of providing a deep sense of social responsibility. Please refer our Sustainability Report forming part of the annual report which provides a detailed report on our sustainability performance.
People Risk				
• Inability to attract and retain quality staff who are skilled and have the experience to handle significant job functions	Low	Significant	This is a critical area of focus since commencement of our expansion drive. MI successfully managed this aspect through concise planning of manpower aligned with the strategic plans of the Company. Retaining qualified and skilled employees is challenging due to emergence of various job opportunities in a competitive market and trend in seeking overseas employment. However MI with its reputed brand name and close to five decades in business with an excellent track record of upholding an employee friendly culture has created a solid foundation to attract and retain good quality staff in the industry.	Performance based culture has created a productive workforce for MI. This approach identifies high performers and through this we envisage a win-win situation for either party in the longer term. This process enables MI to nurture the selected high flyers to fit into more demanding roles as and when the need arises and also lays a solid platform for succession planning. Continued identification of the training and development needs of the employees and providing suitable in-house and outside training remained central to knowledge enhancement of our workforce. Through this, we have kept staff well updated with developments in the industry and have kept them motivated and their morale intact. We adopt effective HR policies and procedures and comprehensive grievance handling mechanisms.
Legal Risk				
• Risk of faulty documentation that could lead to legal risk	Low	Moderate	Legal department consists of professional and experienced staff who advise and work closely with core business divisions to ensure Company conforms to legal requirements and procedures when business transactions are executed.	Legal division advises and works closely with Credit and Recoveries Divisions in order to enhance the documentation requirements and also execute necessary litigations against defaulters in an efficient manner.

Risk Type	Likelihood	Impact Level to MI	Risk Assessment	Strategies on risk mitigation - 2013 update
Regulatory and Compliance Risk	Low	Moderate	MI has set up a well-structured regulatory compliance framework to manage this form of risk that consists adoption of AML policies to curb money laundering risk. Credit, Deposits, and Recoveries divisions are expected to monitor their customers through standard verification documents and to carry out continuous due diligence until we complete and close respective customer files.	Compliance is an integral part of the culture at MI. Company holds itself to high standards of integrity and behavior which sustains trust while complying with regulatory requirements. In order to ensure all regulations are conformed to, the Company has put in place a vigorous compliance review and reporting process. The Compliance function headed by compliance and risk manager ensures that the compliance process operates effectively and monitors to ensure that statutory and regulatory requirements are adhered, and ensures that breaches are promptly reported. There has been considerable attention on implementing the new directives and statutory requirements related to anti money laundering and financial crimes. Accordingly, MI has educated all the divisions on anti-money laundering and financial crime through continuous training programs. Further, MI has introduced comprehensive KYC measures, payments/receipts documents and customer due diligence measures in order to mitigate money laundering and financial crimes. An independent annual audit is carried out by our internal auditors Ernst & Young on MI’s compliance to AML regulations. Regular Audits are parallely carried out by MI’s own Internal Audit division in this area.

Risk Type	Likelihood	Impact Level to MI	Risk Assessment	Strategies on risk mitigation - 2013 update
Corporate Governance Risk				
Failure of Directors to fulfill their personal statutory obligations in managing and controlling the affairs of the Company according to sound corporate governance expectations.	Low	Significant	The Board of Directors is accountable to manage and control the affairs of the Company according to the rules and procedures stipulated by Companies Act, Finance Business Act, Colombo Stock Exchange, Securities and Exchange Commission and Central Bank Code on Corporate Governance.	The Company has a well-established governance framework that is in accordance with best practices and regulations. A number of initiatives were taken this period to improve Board governance aspect that is explained in our "Corporate Governance Report".
Equity Risk				
● Risk that Company's investments value will depreciate because of stock market forces causing losses.	High	Moderate	MI has notable investments in the capital market. Therefore, MI stands vulnerable to equity risk. Prevailing capital market condition remains volatile despite showing improvement with the growing influx of foreign investments and rising positive economic sentiments yet again.	MI has a diversified capital market portfolio, and has it's investments in mostly Blue Chips. MI's share portfolio has a high percentage in hotel shares which is bound to appreciate in the backdrop of the booming tourism industry. MI monitors the share market fluctuation closely and analyses effect of the market fluctuations against the prevailing shareholdings of the Company. Share diversification and holding decisions are taken based on capital market analysis reports submitted by the Capital Market analysis team of MI. We carry out stress testing on our equity portfolio based on possible downward market changes.

Sector Wise Equity Based Investment Portfolio



A - Bank, Finance & Insurance - 43%
B - Diversified Holdings - 6%
C - Hotels & Travels - 44%
D - Telecomunications - 3%
E - Other Sectors - 4%

Comparison of MI's Risk Exposures as at 31 March 2013 against Risk Policy Ranges and Limits

Type of Risk and Parameter	Measure	Policy Range/Limit	Current Position as at 31 March 2013	Actions
Credit Risk				
Credit Quality	Gross NPA Ratio	Below 3.5%	3.1%	
	Net NPA Ratio	Below 3%	2.81%	
	Provision Cover	Above 50%	71%	
Concentration Risk	Credit exposure lent to			
	Agricultural sector	Below 5%	4%	
	Consumption	Below 4%	2%	
	Services	Below 50%	50.5%	Credit concentration of service sector slightly above the policy range. Management would monitor risk levels attached to these sectors on an ongoing basis. Currently, these sectors do not pose any significant risk.
Liquidity Risk	Net Advances to Deposits	Below 90%	164%	Management plans to bring this ratio below 120% as per forecast within the next financial year with the planned growth in deposits.
	Liquidity Gap			
	1-7 Days Bucket		Rs. 236 million	Board of Directors and the Corporate Management is currently in the process of analysing the liquidity gap buckets, for implementing a policy range/limit for next financial year.
	1 Months Bucket		Rs. (1,362 million)	
	2-3 Months Bucket		Rs. (815 million)	
	4-5 Months Bucket		Rs. (1,500 million)	
	6-12 Months Bucket		Rs. (1,830 million)	
Interest Risk	Interest Rate Shock	Below Rs. 50 million	Rs. 1.123 million	
Statutory Risk	Statutory Liquid Assets Ratio	Above 10%	17%	
	Core Capital Ratio	Above 5%	20.83%	
	Total Risk-Weighted Capital Ratio	Above 10%	22.40%	
	Single Borrower Limit	Below 15%	5.8%	

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 2013)

Capital adequacy ratio (CAR) (%)	22.40
Capital base	4,413,820
Risk-weighted assets	19,705,469
Total gross NPA	439,639
Equity market value	3,467,280
Deposit liability	8,424,720
Liquid assets	1,389,107
Liquid assets ratio (%)	17.11
Gross loans	14,162,608
NPL ratio (%)	3.10

Stress Tests	Exposure Rs. '000	Original Position 31 March 2013	Magnitude of Shock		
			5%	10%	15%
		CAR%		Revised CAR%	
A. Credit Risk					
Negative shift in non-performing advances	439,639	22.40%	22.29%	22.19%	22.08%
B. Equity Price Risk					
Fall in stock market prices	3,467,280	22.40%	21.79%	21.18%	20.55%

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 2013	Magnitude of Shock		
			5%	10%	15%
		Statutory Liquid Assets Ratio%	Revised Statutory Liquid Assets Ratio%		
A. Liquidity Risk					
Fall in statutory liquid Assets	1,389,107	17.11%	15.66%	14.84%	14.02%

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

Stress Tests	Exposure Rs. '000	Original Position 31 March 2013	Magnitude of Shock		
			5%	10%	15%
		NPL%	Revised NPL%		
A. Credit Risk					
Negative shift in Non-performing loans	439,639	3.10%	3.26%	3.41%	3.57%

Conclusion: The rise in NPA on worst case scenario is just above 3.5% of the level forecasted in the medium term.

INCLUSIVE GROWTH FLOWS, SUSTAINABLY

The same degree of nurturing and care we lavished when we were but ‘a sapling’ in the garden of business prevails today, as we continue to build a sustainable enterprise.
>>

SUSTAINABILITY REPORT

MI'S SUSTAINABILITY STRATEGY AND PROFILE

MANAGING DIRECTOR'S MESSAGE

IN THIS POSITIVE BACKDROP, EFFORTS OF THE BUSINESS COMMUNITY SHOULD NOT BE LIMITED TO THAT OF PROFIT-MAKING INITIATIVES ONLY

>

This, I believe is the best moment for business leaders to show their commitment to the environment and the society at large in more ways than one.

Ideal Moment to Pursue Needs of Citizens

The stage is set for the country to embark on a more focused programme of economic development and resurrection with peace remaining the constant factor. While the Government pursues its economic policies and plans to achieve middle income status for the nation, we the business community should be the leading force in driving the economy forward, seizing whatever opportunities that prevail, even going global if deemed possible.

Sustainable Development in a New Era

In this positive backdrop, efforts of the business community should not be limited to that of profit making alone. This I believe is the best moment for business leaders to show their commitment to the environment and society at large in more ways than one. Corporates should engage more with local communities by offering business solutions that probably were not available a few years ago. The needs of society are many and may not have been fulfilled due to accessibility issues in the past, whilst in certain instances they may remain largely unaddressed.

From the perspective of the financial services sector, greater financing opportunities should flow to low income earners and small scale entrepreneurs, particularly those living in under developed areas. This approach in essence is bound to boost the overall economy and bring benefit to society over time. On the other hand, our industry should identify societal needs beyond provision of financial services such as health, education, shelter, sanitation etc. Greater emphasis should be paid to the careful use of the earth's resources especially when there is a gradual expansion of the population and industrialisation. The interest shown by corporates in recent years has been heartening.

MI Remains Connected to Sustainability Values

In keeping with our vision, we have embraced sustainability values as part of our business strategy. We continue to pursue sustainable practices in relation to economic, social and environmental dimensions. MI is committed in its quest to provide a range of financial services to a wide spectrum of customers from all segments of society. The positive economic environment that now prevails provides us with an excellent opportunity to expand our operations across new frontiers. In this context, our aim is to reach out to the various communities across the country with a view to fostering stakeholder inclusivity and broad-base our presence. We succeeded in expanding our reach to 19 locations within a short-time span, going quite substantially beyond the Western Province than ever before.

Outside business boundaries, we were able to initiate productive CSR campaigns mainly directed towards the local community, this year as well. Our assistance in setting up a library for a children's home and also repair work carried out at an elders' home together with the provision of essentials to the needy were some of the key initiatives we undertook. To disclose all our sustainability related initiatives, we have adhered to the Global Reporting Initiative (GRI G3.1) reporting framework and enhanced reporting to B+ application level for the period under review.

Futuristic Perspective on Sustainability

While the Government strives to increase the per capita income of the nation and raise the quality of life of low income earners, the business community too needs to extend their support to sustainable development initiatives more than before. The financial services sector should continue to provide greater accessibility to their offerings to commensurate with the on-going developmental activities initiated by the Government in liberated areas and other under developed locations. The industry should also concentrate more on assisting emerging businesses and small scale entrepreneurs by broad basing existing product ranges.

Mercantile Investments will remain close to its integrated business model that embraces the three pillars people, planet and profits through Company wide sustainability policies and practices. In our quest to enhance shareholder wealth, we would stay receptive to the needs of our customers so that we can continue to offer superior products and services to them which will in turn keep us successful. In terms of people, we hope to propagate sound human resource practices like in the past and gradually build on the corporate social initiatives that we carry out annually. To safeguard the planet, we hope to embrace sound environmental practices and initiatives to a greater degree in the future.

Gerard G. Ondaatjie
Managing Director

21 May 2013

INTRODUCTION TO THE SUSTAINABILITY REPORT

This is the third consecutive year that MI is adopting the Global Reporting Initiative (GRI) framework to publish the Company's sustainability report. Our report has been prepared to articulate the Company's performance to our readers in terms of the sustainability viewpoint. Our report hence provides a year on year assessment of the Company's performance in terms of economic, social and environmental perspectives which are central to sustainability. The report has been prepared in accordance with sustainability reporting guidelines version G3.1 issued by GRI that is applicable for the current reporting period.

In preparing our report we have collated and presented information from various sources, both financial and non-financial. Wherever applicable, financial information has been extracted from the Company's Audited Financial Statements and Notes to the Accounts. Other financial information has been compiled by obtaining information from source documents available within related departments of the Company. For reporting purposes, training hours have been compiled by the Human Resource division while data relating to energy and water has been provided by the engineering division.

As part of our efforts to enhance reporting at all levels, MI's sustainability report 2012 /13 has been broadened with additional performance indicators and extension of disclosures related to topics addressed in previous years. Our previous year's sustainability report has been registered with the GRI and is included in the GRI's online database of reports under ***www.database.globalreporting.org***. This year too we will proceed to include our report in the list of featured reports upon releasing of the Annual Report.

REPORT PARAMETERS

Adopting a global reporting frame work such as the Global Reporting Initiative (GRI) facilitates reporting of our sustainability performance in a structured way. The framework is built on reporting principles and guidance, and related technical protocols which are fundamental to the framework. This involves dimensions of report content, report quality and boundary setting that are discussed in the ensuing paragraphs.

At the same time, the framework in parallel is established on standard disclosure together with its related indicator protocols. Strategy and profile, management approach and performance indicators cover the standard disclosure aspects that facilitate the measuring and reporting of the economic, environmental and social performance of the organisation. Our report has been prepared in accordance with these reporting fundamentals as applicable.

Reporting Principles and Guidance

a. Defining the Report Content

Principles of materiality, stakeholder inclusiveness, sustainability context and completeness were followed when determining the content of our report. By following these principles, the contents of our report deliver a balanced and reasonable presentation of the Company's sustainability performance,

i. Materiality

The Company recognises the importance of the principle of materiality in preparing such as report. Hence, when deciding on the contents of this report, we have identified material topics that should be covered under the broad parameters of sustainability, viz - the economy, environment and society. These topics have been selected considering their levels of significance and importance to key stakeholders, as they could substantively influence them in their assessments and decisions. From the topics selected, we ensured that our report prioritises key areas for in-depth disclosure wherever necessary.

The report content was decided on after giving due consideration to the following factors essential to topic selection:

Significance to the Organisation

- Impacts of risks and opportunities that prevail for the organisation
- Organisational Objectives, strategies, policies and procedures relating to sustainability
- Key stakeholder expectations especially of the investors, customers and employees
- Critical factors that would facilitate organisational success in the area of sustainability
- MI's core competencies and how this could contribute to sustainable development

Significance to Stakeholders

- Topics that would be of interest to key stakeholders
- Topics that are relevant and could be compared by stakeholders with our peers and competitors

Other Material Considerations

- Reasonably estimable sustainability impacts, risks or opportunities prevalent in general for businesses and local community
- Aspirations of society, burning sustainability issues and other topics that are current

Based on the materiality principle, the contents of our report revolve around the following core focus areas;

- Customer satisfaction
- Business growth and product development
- Risk management
- Compliance with policies and regulations
- Ethics and corporate governance
- Value creation for investors
- Value of business to the economic system
- Employee recruitment and nurturing
- Social and community responsibility
- Environmental initiatives
- Product responsibility
- Human rights

ii. Stakeholder Inclusiveness

For purpose of deciding on the report content, especially on setting the scope, boundary, and for the application of performance indicators, key stakeholder groups have been defined upfront. The main stakeholders that are applicable to MI are its investors, customers, employees, suppliers, regulatory bodies, local communities and social groups. Each of the identified stakeholder's expectations and interest towards the Company are unique and can be depicted as follows:

MI's Stakeholder Categories	Their Key Expectations and Interest
Investors	Generating above average returns for the investment made in the Company.
Customers	Seeking attractive returns for deposits placed and for the borrowers, obtaining credit facilitates at optimal rates by way of financing and other loan products.
Employees	To receive intrinsic and extrinsic return for the effort and commitment in executing one's job function.
Suppliers	To obtain a fair price for the supplies made and to maintain a healthy relationship with the organisation by adhering to anticipated standards.
Regulatory Bodies	To ensure our business is run soundly in a prudent and acceptable manner within given parameters and requirements specified.
Local Communities	Societal expectations on better health, education, improved livelihood and safeguarding local community rights.
Social Groups	Conserving natural resources, minimising waste and consumption and protecting the environment from hazards of commercialisation.

iii. Sustainability Context

In developing the report content, other than disclosing organisational performance data pertaining to sustainability, we have gone on to explain MI's impact and contribution towards economic, social and environmental considerations, in the wider context of sustainability wherever applicable. In such disclosure, as necessary, we have attempted to describe 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.

iv. Completeness

To ensure completeness of our report, we have adopted related dimensions of scope, boundary and time as appropriate. Hence, the coverage of material topics and indicators, defining of the report boundary and describing MI's performance for the concluded financial year with comparative information as necessary enable stakeholders to assess our sustainability performance more comprehensively.

b. Specifying the Report Quality

Key dimensions of report quality were considered when presenting our report for effective transparency in reporting. Maintaining report quality enhances our disclosure content, enabling users of our report to make a sound and reasonable assessment of our sustainability performance.

Dimensions of Report Quality	Application of Dimensions of Quality in Report
Balanced ➤	The contents of our report provide an unbiased portrayal of the organisation's performance. Financial information has been given with comparatives so that both positive and negative trends could be highlighted year on year.
Comparable ➤	Information provided has been reported consistently from first disclosure so that it can be compared annually. By selecting significant and applicable topics, users of our report are able to compare our performance against others in the sector.
Accurate ➤	Quantitative information has been compiled with accuracy while qualitative information has been given with clarity, detail and balance in presentation.
Timeliness ➤	The information provided is current and is relative to the reporting period. The performance indicators are updated annually for readers to make informed assessments.
Clarity ➤	Information provided has been made available in a manner that is easily understandable and accessible to key stakeholders.
Reliability ➤	Scope and extent of external assurance has been disclosed in the report. Original source of information related to performance indicators can be traced back to organisational records.

c. Report Boundary

The report provides in-depth disclosure on the sustainability performance of Mercantile Investments and Finance PLC. The Company does not have subsidiary companies under its control and hence reporting is limited to the activities of the Company.

Standard Disclosures

In accordance with the GRI framework, the ensuing paragraphs contain the following types of standard disclosure that are essential in describing MI's approach, strategy and performance in relation to sustainability.

a. Strategy and Profile

Disclosures relating to the profile of the company and MI's strategy and governance related to sustainability are set out in ensuing paragraphs to set the overall context for understanding performance.

b. Management Approach

Disclosure is provided henceforth on management's approach to key sustainability categories - economic, social and environmental - in order to provide context for understanding related performance.

c. Performance Indicators

Financial and other statistical performance indicators have been provided for key sustainability topics disclosing current and comparable information on the company's economic, environmental and social performance. From the year under review, we have adopted IFRS requirements for the preparation of our financial statements. As appropriate, we have drawn attention to this change whenever we have provided performance indicators that have embraced IFRS in this report.

3. Protocols of the Framework

Both technical protocols and indicator protocols have been referred to as applicable when adopting report principles and standard disclosure, integral to the GRI framework.

4. Assurance Report from External Auditors

As was done last year, an independent assurance report was obtained from our External Auditors, M/s Cecil Arsecularatne & Company, Chartered Accountants for this year's sustainability report. The contents of their report are disclosed at the end of this supplement.

5. GRI Application Level

Based on the extent of disclosure and the External Auditor's assurance report, a 'B+' has been self-declared for our sustainability report in accordance with GRI's application level requirements.

PROFILE OF MERCANTILE INVESTMENTS

Legal Form, Nature of Ownership and Operational Structure

Mercantile Investments and Finance PLC (MI) is a Licensed Finance Company under the Finance Business Act No. 42 of 2011, listed on the Diri Savi Board of the Colombo Stock Exchange. MI 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 Companies Act No. 07 of 2007 and is on the verge of completing five decades of operations. MI is a private sector company with no subsidiaries, carrying out operations only in Sri Lanka. Its ownership currently lies with a few large investors.

The Company's core business of credit and deposit mobilisation is handled by two separate divisions. To support core business divisions, a number of other support divisions have been set up which include Recoveries, Legal, Finance, and Human Resource to meet main operational requirements effectively. More information relating to the Company is available in the inner back cover of the Annual Report.

Primary Brands, Products and Services

The lending business primarily revolves around MI's lease financing and hire purchase product range which in the last decade has expanded to cover term loans, personal loans, and property mortgage loans and more recently, microfinancing and professional loans. For purpose of branding, lending products are chiefly promoted under MI's common logo.

Mobilisation of fixed deposits and on a smaller scale, our savings deposits business, have remained MI's core deposit products since inception. MI's savings product range includes normal savings and minor savings, branded through the Company's MI Max and MI Kids logos.

Please refer page 43 in the MDA which maps out MI product offerings.

Markets Served

We cater to the domestic market meeting financial needs of customers who come from all walks of life from various locations of the country. Our target market is broad based and focuses on all strata of society, individual or corporate, whose needs vary from being personal to entrepreneurial. The Company has been successful in growing both its deposit base and lending portfolio consistently in recent times aided by a strong network of branches and a workforce that's skilled and dedicated to serve customers to their utmost satisfaction. During the period 2012/13, 3 branches and 2 service centres were established adding to the growing network which stands at 17 branches and 2 service centres as at the end of the year under review.

Registered Office
No. 236, Galle Road, Colombo 3

Head Office
No. 236, Galle Road, Colombo 3
Telephone: 0112343720-7
Fax: 0112434524
E-mail: mercantile@mi.com.lk
Website: http//www.mi.com.lk

Branches

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

Kohuwala Branch
No. 28, Sunethradevi Road,
Kohuwala
Telephone: 0112814181-2
E-mail: mikohuwala@mi.com.lk

Mahara Kadawatha
No. 381/C, Kandy Road,
Mahara, Kadawatha
Telephone: 0112921205-7
E-mail: mikadawatha@mi.com.lk

Balangoda Branch
No. 143/A-B, Barnes Ratwaththa
Mawatha, Balangoda
Telephone: 045-2287605-6
E-mail: mibalangoda@mi.com.lk

Bentota Branch
No. 149, 1/2, Colombo Road,
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Trincomalee Branch
No. 256, Anuradhapura Junction,
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Kurunegala Branch
No. 233 A, Negombo Road,
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Matara Branch
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Galle Branch
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E-mail: mianuradhapura@mi.com.lk

Maharagama Branch
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Chilaw Branch
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E-mail: michilaw@mi.com.lk

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

Horana Branch
No. 439A, Panadura Road,
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Email: mihorana@mi.com.lk

Tissamaharama Branch
No. 19/6, Sagara Building,
Palliyawatte, Tissamaharama
Telephone: 047-2239341
Email: mitissa@mi.com.lk

Gampaha Branch
No. 152/1, Miriswatte, Mudungoda,
Gampaha
Telephone: 033-2234453
Email: migampaha@mi.com.lk

Ampara Branch
No. 774, Browns Junction,
D.S. Senanayake Street, Ampara
Telephone: 063-2224282
Email: miampara@mi.com.lk

Kottawa Service Centre
No. 358, High Level Road,
Pannipitiya, Kottawa
Telephone: 011-2838145-6
Email: mikottawa@mi.com.lk

Minuwangoda Service Centre
No. 52E, Negombo Road,
Minuwangoda
Telephone: 011-2294008
Email: miminuwangoda@mi.com.lk

Scale of Operations

Within the last decade, the Company has seen its turnover, total assets, lending book and deposits surge thus moving the organisation from a small scale to a more medium sized organisation. The section 'decade at a glance' appearing on page 355 provides a snap shot of MI's financial performance and position for the last decade.

A summarised view of MI's scale of operations for the last decade is given below:

Status	2013	2012	2011	2010	2009
Number of Employees	443	377	313	286	266
Number of Operations	3	2	2	2	2
Quantity of Products and Services Provided	10	7	7	7	7
Income (Rs. '000)	3,338,044	2,362,026	2,214,120	1,806,966	1,708,609
Market Capitalisation (Rs. '000)	6,613,200	6,613,200	–	–	–
Debt (Rs. '000)	5,232,331	4,638,644	2,318,481	403,599	1,236,670
Equity (Rs. '000)	5,704,846	5,474,606	6,293,078	3,776,015	2,694,410
Lending (Rs. '000)	13,844,647	10,446,514	6,416,176	4,447,126	5,222,013
Deposits (Rs. '000)	8,424,720	6,137,897	4,297,801	3,479,291	2,774,974

** 2012 and 2013 - Income Statement information is SLFRS/LKAS Based.*

2011, 2012 and 2013 - Statement of Financial Position Information is SLFRS/LKAS Based.

Information related to business segments is given on page 323 while geographic segmental information pertaining to lending and deposits is given on page 68. The financial highlights given on page 4 provides a summary of MI's financial performance for 2012/13 in comparison to previous year.

Outsourcing

As a prudent practice, the Company does not outsource any of its core functions, operational or otherwise. Only the following functions have been outsourced:

- Security services
- IT support services
- Internal Audit (In parallel with MI's own Internal audit division)

Material Changes in Size, Structure, or Ownership

There were no material changes in organisation size, structure or ownership during the period under review.

Awards Received in the Reporting Period

- Annual Report Awards Ceremony organised by The Institute of Chartered Accountants of Sri Lanka in 2012.

MI was adjudged the winner of the Silver Award in the finance company sector category for producing an outstanding Annual Report yet again in 2012. We have been twelve time gold winners in this category in the preceding years.

- Annual Report Awards organsed by the League of American Communication Professionals (LACP) held in New York in 2012

MI's Annual Report 2011/12 won the Bronze Award in the Financial Diversified (below USD 100 million turnover) category at the LACP awards held in New York in 2012, beating some of the world's more prestigious Annual Reports.

- 2012 International ARC Awards held in United States

MI's Annual Report 2011/12 was adjudged silver award winner for its cover and design in the Financial Services General Category at the ARC awards held in New York. ARC Awards attracts over 2,000 entries from 32 countries around the world and is popularly dubbed as the Academy Awards of Annual Reports.

- Received a certificate of merit for MI's 2010/11 Annual Report at the SAFA Annual Report competition held in 2013 in the category 'Financial Services Sector'.

MI'S SUSTAINABILITY STRATEGY

APPROACH TO SUSTAINABILITY

Vision and Corporate Values

MI's corporate vision enunciates our organisation's longing to adopt a deep sense of social responsibility whilst pursuing excellence in our business field as a premier finance company. Our corporate values rightly reflect the importance of sustainability especially in the current context where wealth creation is not merely the only aspiration. MI's corporate values thus highlight the necessity to build lasting relationships with our customers, whilst being fair competitors. It also encompasses the need to recognise our employee's contributions and to foster team spirit. Moreover, our corporate values encapsulate the desire to be responsible to society by adopting effective corporate policies and adhering to sound governance practices and ethical standards.

Embracing Sound Values

In conducting business in a prudent and fair manner, MI has continued to remain close to its ideologies and values, a fundamental part of our business, which has brought us success over the years. Our value system encapsulates both wealth creation and sustainable ideologies together. Having a broad value system with right business strategies, the Company has gained the respect of the business community and the public as a trustworthy business partner, a corporate entity that enhances value not only to the economy but also contributes to society and environment in our own way.

MI's Corporate Values	Sustainability Category Impacted
To build a lasting relationship with our customers by identifying their needs and focusing on customer care	Economic
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	Economic/ Social
To recognise the contribution of our employees and to foster team spirit among them	Social
To be responsible to society by adopting effective corporate policies and adhering to high ethical standards	Economic/ Social/ Environmental
To our providers of capital by generating superior financial returns and securing their investment	Economic

Sustainable Business Objectives

In keeping with the vision and corporate values of the Company, we strive to fulfill our sustainable business objectives which are listed below vis-a-vis each key stakeholder. Our overall business plans have been devised to tackle such objectives, the achievement of which would support sustainable development from a broader perspective. Meeting expectations of our key stakeholders would eventually entail making a positive impact on economic, social and environmental dimensions discussed later in this supplement.

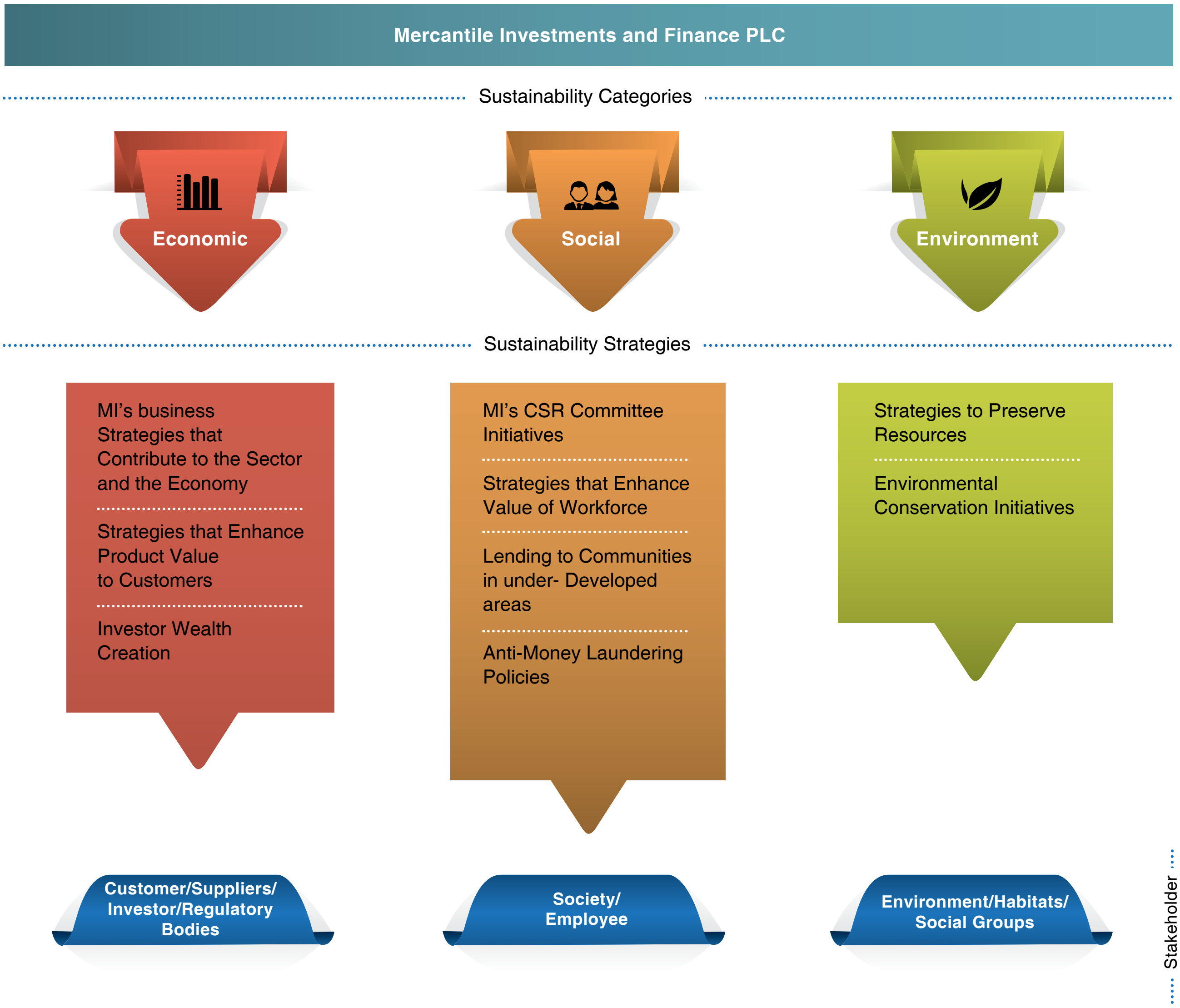
Sustainability Dimension	Key Stakeholders Targeted	Sustainable Business Objectives/Goals
Economic	Investors	● Sustaining a constant stream of earnings for the capital invested and maximising shareholder wealth consistently. ● Sound conduct of business and management of risk versus return to add value for investors, the sector and the overall economy.
	Customers	● Enhancing value of MI products and services to fulfill varying customer needs. ● Safeguarding the interests of customers especially the monies placed by our depositors.
	Suppliers	● Meeting procurement requirements in the most efficient way whilst sustaining sound relationships with our suppliers.
	Regulatory Bodies	● Instilling a sound compliance and control environment to abide by regulations, for the prudent conduct of business.
Societal	Employees	● Nurturing staff to bring out the best in them while rewarding them for their efforts thereby creating a win-win position for both the organisation and the employee. ● Creating a work environment that fosters healthy communication and team building among employees.
	Local Community	● Addressing needs of society by initiating CSR programs in healthcare, education and poverty alleviation. ● Conducting business operations without hindrance to society while adding value to the local community through the provision of credit and other financial services.
Environmental	Environment/social Groups/ Habitats	● Seeking means of protecting the environment by embracing sound green practices that safeguard fauna and flora for the sustenance of life and natural resources.

Sustainability Strategies

Embracing sustainability within our visionary thinking and aligning related ideologies to MI's corporate objectives, goals and business strategies ensure we contribute profoundly to sustainable development. Sustainability has always been a focal point in our business practices over the years but its growing importance internationally and within the local business community has sharpened our focus even more, in recent times. At MI, sustainability development is constantly in our sights. The sustainable practices that we uphold now are sure to evolve further and adapt to the needs of the future.

To set the process in motion, there is vision and leadership from the hierarchy from the strategic perspective right down to the operational level as we put strategy into practice. MI's governance structure facilitates a comprehensive approach to sustainability in meeting the organisation's economic, social and environmental aspirations. In meeting sustainable business objectives and the goals explained earlier, the Company has in place a combination of strategies that have evolved over time. These strategies address needs of key stakeholders of our enterprise which fulfill economic, social and environmental aspects related to sustainability. This is depicted in Diagram 1.

MI's Strategic Focus on Sustainability



Mercantile Investments and Finance PLC

Sustainability Categories

Economic

Social

Environment

Sustainability Strategies

MI's business Strategies that Contribute to the Sector and the Economy

Strategies that Enhance Product Value to Customers

Investor Wealth Creation

MI's CSR Committee Initiatives

Strategies that Enhance Value of Workforce

Lending to Communities in under- Developed areas

Anti-Money Laundering Policies

Strategies to Preserve Resources

Environmental Conservation Initiatives

Stakeholder

Customer/Suppliers/ Investor/Regulatory Bodies

Society/ Employee

Environment/Habitats/ Social Groups

Focusing on the **economic angle**, we understand the constant need to contribute to national output, being a leading establishment in the corporate world. This is especially relevant in the current context, at a time when the nation is at a transformational stage and heading towards an economic prosperity that eluded the citizens of Sri Lanka for over three decades due to the conflict. As a financial institution that offers services ranging from the disbursement of credit to mobilisation of deposits, MI is able to fulfill aspirations of both individuals and corporates who require either financial assistance or seek sound returns for their investments in the Company.

Mercantile Investments through its range of products and services continues to play a significant role as a primer finance company to economy. Our business impact has widened especially with the expansion of our network to various parts of the nation in recent years. Being receptive to the needs of our customers, affording greater choice and accessibility to finance, we are able to fulfil customer requirements that are vast and ever changing.

MI as a leading institution that is renowned for its financial strength and sound financial performance over the years, has commendably delivered a constant stream of returns to its investors over the years. Furthermore, strategising to improve internal processes, risk management practices and governance practices among other aspects has led to prudent conduct of operations, further cementing the confidence we enjoy with the general public. We are proud of our efforts and the value addition it has brought over the years to the sector and to the overall national economy.

From a **societal angle**, significant progress has been made in the past couple of years especially after our CSR Committee was setup in 2011. The Committee remains completely focused, reaching out to various strata of society to catalyze better health care, poverty alleviation, supporting the lesser privileged and carrying out other community service activities.

From the perspective of our invaluable workforce, who remain an integral cog in our success, we continued to create a harmonious relationship through the years, nurturing, skilling and developing them through the employment of various methodologies. While this brings success to the Company, it affords a reciprocal benefit to our employees, giving them the opportunity to forge a highly successful career at MI with attractive rewards for their efforts.

From the **environmental perspective**, the Company has made headway in improving business practices in support of protecting the environment. The Company understands the growing need to conserve energy, protect the surroundings that we thrive in and work towards the health and well-being of our habitat. The Company's internal practices support the harmonizing of operational requirements with these ideologies. We are hopeful that the green practices that we adopt would continue to evolve and strengthen to bring enhanced benefit to the environment. As an indirect measure, we envisage the development of processes to handle lending to specific businesses of our borrowers, which could pose harmful effects to the environment such as pollution.

Sustainability structure at MI

In meeting our visionary aspirations, the needed sustainable focus is displayed from the very top of MI's hierarchy, under the leadership of our Managing Director. Diagram 2 provides an overview of the sustainability stewardship at MI. As shown, the Company adopts a top down approach in driving sustainable practices, obtaining the support of all employees' right down to operational level. In this structure, the corporate management plays a leading role in executing strategy on specific aspects of sustainability depending on their area of expertise.

Sustainability Stewardship at MI (Diagram 2)

In parallel, the CSR Committee, remains committed to its cause of pursuing socially responsible programmes that add value to the overall sustainable development process taking place, which are initiated and conducted throughout the year. The Committee operates on a specified CSR budget. It comprises of GM Credit and Marketing, AGM Recoveries, AGM Finance, Manager Deposits and Assistant Manager - Human Resources.

Within its ambit, the CSR Committee was able to address specific social and environmental expectations during 2012/13 period, some of which include;

- Fulfilling specific needs of the poor and under-privileged including financial assistance to needy.
- Community service exercises for the benefit of society.
- Educational programmes for children in need.
- Initiatives to preserve the environment including indigenous flora and fauna of the country.

KEY IMPACTS, RISKS AND OPPORTUNITIES

1. Organisation's Impacts on Sustainability

The table below specifies the organisation's key impacts on sustainability and their related effect on MI's stakeholders. It also specifies how MI addresses associated challenges and opportunities arising from such impacts.

Key impacts from Organisation	Sustainability Category/ Stakeholder Impacted	Challenges and Opportunities from Impacts	How MI Addresses Impacts
Considerable business growth achieved by MI in terms of core businesses thus intensifying competition within the sector	Economic/Customer/Investor	● The need to safeguard public money at all times. ● Maintaining financial stability through prudent conduct of business is essential for the stability of the sector and the economy as a whole. ● Maintaining depositor loyalty amidst other competitors ● Yielding best returns for investors through consistent performance	● Adherence to sound corporate governance practices and regulations. ● Significant focus on risk management in recent years. Appointing a separate Compliance and Risk Officer during this period. ● Development of the 'Strategic Plan' for the Company in 2012. ● Taking proactive decisions based on close monitoring of performance against targets.
Increased business presence through sizeable branch expansion in the past 2-3 years	Economic/Social/Customer/ Employees	● MI's customer base cuts across large section of society, with varying profiles and needs. ● Increased presence has created opportunities for both the organisation and related communities. MI has to compete with other players doing business in such locations.	● Continuing to place greater emphasis in meeting customer needs outside Western Province. ● Promoting MI products in greater scale in new branch locations. ● Key recruits are handpicked from within the local community in close proximity to branch.
With increased presence, MI interacts more with local community and large cross section of society now	Social/Local Community	● To nurture the already close business interaction we have with local community in each branch location, there is a growing need to go beyond business aspirations and meet their social needs whilst safeguarding their business interest with us.	● In meeting some of the social issues of local community, the CSR Committee and respective branches initiated specific CSR programmes. ● We abide by good governance practices, operational practices, ethics and value system in conducting business. A separate branch Internal auditor was recruited to review branch operations during this period.
MI's workforce has expanded due to organisational growth in recent years	Social/Employees	● Managing a large workforce and meeting their own aspirations while nurturing them to meet organisational aspirations is challenging.	● We have strengthened our human resource policies and practices whilst balancing organisational expectations with staff's own aspirations. ● Greater emphasis is placed in broad basing knowledge of staff to support them in their careers.
As a service organisation, our direct environmental impact is minimal. Nevertheless, use of energy, water and material has increased due to expansion in our operations	Environment/People/Habitats	● From a sustainability angle attempting to curtail consumption would preserve natural resource and directly support us in cutting down cost.	● MI continues to adopt specific green practices including energy saving methodologies as part of our business practices. ● As done in the past, the CSR Committee would continue to remain committed in initiating programmes to protect the environment.

2. Sustainability Impacts on the Organisation

Impacts resulting from sustainability trends and its effects (risk and opportunities) to the Company are identified below together with MI's approach in dealing with such impacts.

Risk Arising from Key Impacts:

Sustainability Category	Potential Impacts from Sustainability	Risk from Impact	How MI Addresses Impacts
Economic	● Ongoing economic transformation, post war	● Increased competitiveness of others in the sector in terms of product and service offerings. ● If not receptive, changes in customer perceptions and spending patterns can make our products and services unattractive.	● Expanding MI range of offerings and tailoring existing products to suit the varying customer needs. ● Being focused on the ongoing economic transformation and effects to business lines. Pursued growth strategies to penetrate in markets outside Western Province.
	● Increasing economic activity in areas outside Western Province which remained passive in the past	● Competition to secure business in liberated and rejuvenated locations.	● Already the Company has set-up locations in certain strategic hubs and plans to further extend its presence to other feasible locations in time to come.
	● Change in thinking, behavioural patterns of customers	● Customers are well-informed of market position and therefore are more demanding. They tend to stay with reputed institutions. ● Building loyalty when customers have a wide array of options is a challenge.	● Continuously fine tuning our products and services including the way we do business in terms of processors and procedures to satisfy customers. ● Strategically staying close to customers through a personalised service. Adopting sound corporate practices to safeguard our reputation.
Social	● There is a segment of society who continues to struggle to fulfil basic needs.	● Increased awareness and CSR activities taking place among business community.	● We initiated specific CSR programs directed at the needy and less privileged in society, details of which are given under "Social dimension" in this supplement.
	● Increased demands placed on the workforce with rise in competition and the sophistication in business itself	● Work fatigue and stress could hinder performance of staff. ● If not adequately rewarded, could lead to high labor turnover.	● Our workforce has been nurtured to sustain right motivation levels and productivity. Staff are able to equally benefit through career advancement and reward.
Environmental	● Greater industrialisation, deforestation etc. increases global warming and eco system changes with long-term consequences	● There is growing importance in adopting green practices among the business community.	● We have adopted specific green practices that have been detailed under the 'Environment Dimension' in this supplement.
	● Plummeting natural resources with population expansion and industrialisation	● Scarceness of natural resources especially energy, water and other materials has led to decline in supply and rise in related cost of usage.	● Management pays continuous attention in controlling consumption levels of stationery, consumables, water and electricity through various business practices. ● The Cost Control Committee that was set-up in 2012 was able to cut down on wastage, suggest means of alternate use of resources and eliminate duplication.

Opportunities Arising from Key Impacts:

Sustainability Category	Potential Impacts from Sustainability	Opportunity from Impact	How MI Addresses Impacts
Economic	● Positive economic outlook due to development and heightened business activity post war.	● The boom witnessed in most sectors would indirectly boost the financial sector, creating greater opportunity.	● Strategic focus in terms of growing volumes and market presence. ● Continuous focus in improving productivity, creativity and innovation among workforce.
	● Greater accumulation of wealth and rising purchasing power of consumers.	● Emerging business opportunities and wider spectrum of customers.	● Broad-based product range tailored to suit customer needs. E.g. Structured hire purchase and lease financing.
Social	● Rise in education and literacy levels.	● Greater choice for organisations when recruiting suitable candidates.	● To support the expansion drive, considerable level of recruitments were effected especially in sales and marketing staff. They were able to fit into demanding roles with ease.
	● Women seek career aspirations at a greater scale than before.	● Organisations are able to maintain a sound blend of workers to meet aspirations.	● The role played by women in MI's key operations has expanded compared with the past.
	● Greater need and attention being focused on sustainable development practices.	● Organisations who uphold sustainability would receive due recognition.	● Annually, we contribute to sustainable development in many ways as explained in this supplement.
Environmental	● Greater expectation from business community to display sound environmental practices.	● Organisations that adopt green practices would receive positive recognition. ● Implementation of green practices can save cost for organisations in the long term.	● MI would continue to explore and strategise on best environmental practices in addition to its current green practices. ● Recent initiatives in energy conservation have helped the Company to control cost on electricity and water despite growth in business operations. Other conservation practices including use of solar power are being explored.

GOVERNANCE, COMMITMENTS AND ENGAGEMENTS

In managing the Company's operations in a prudent manner, we resort to a sound corporate governance framework, in the best interests of our stakeholders. These practices ensure that our attempts in meeting economic, social and environmental expectations are secured through a concise governance framework. We are committed to good governance practices upon which our organisational fundamentals are based. Being a significant player in our sector, such practices not only build confidence among stakeholders they also bring financial stability to the sector and eventually add value to the overall economic system.

In governing the organisation, the Board of MI leads from the front. A three year strategic plan has been approved for the Company, incorporating the organisation's vision, mission, values, objectives and strategies in meeting corporate aspirations. Organisational objectives cover sustainability values, especially the need to be a socially responsible corporate. The strategic plan has been communicated to all divisions to ensure participation and commitment of staff at various levels of the hierarchy for the achievement of overall objectives. Annually, actual performance in terms of economic, social and environmental parameters is assessed against objectives and remedial action proposed for any areas of underperformance.

The Corporate Management and CSR Committee jointly address organisational aspirations on sustainability from various facets. The Managing Director together with the Board provides leadership to Corporate Management and the CSR Committee to ensure organisational aspirations and responsibilities on sustainability are fulfilled to expectations.

The Board has set up several subcommittees with Director participation, to closely monitor progress of key areas of operations and also to assess how well-management is handling risks. In management of risks, the Board has set forth effective controls to safeguard interest of stakeholders.

Each Board member reviewed MI Board's performance for the concluded financial period 2012/13 by completing a standard checklist. The Board was apprised of the outcome of this review at a subsequent meeting held.

A detailed description of MI's corporate governance practices is provided in the 'Corporate Governance Statement' given in the Annual Report.

Composition of the Board and its Subcommittees

MI's Board comprises an appropriate blend of Executive and Non-Executive Directors and is chaired by a Non-Executive Director in keeping with sound corporate governance practices. For the Board to discharge its duties, active participation is sought from Directors so that their invaluable advice and guidance, complemented by the reservoir of knowledge and experience they possess, can be put into practice.

Information pertaining to the Composition of the Board and its subcommittees are detailed in the Corporate Governance report and a brief profile of each Director is given on pages 96 and 97.

Additional information pertaining to the composition of the Board and its subcommittees including gender and age of Directors' has been illustrated below:

MI Board and Other Key Committee Gender Break Down 31 March 2013

The Board/Committee	Male	Female	Female % from total	Age 30-40	Age 40-50	Age 50-60
The Board of Directors	8	2	20%	2	6	2
Audit Committee	3	–	–	2	–	1
Integrated Risk Management Committee	4	–	–	–	3	1
Remuneration Committee	3	–	–	1	1	1
Credit Committee	4	–	–	1	2	1
Nomination Committee	4	–	–	1	2	1

Board's Interaction with Shareholders

The Annual General Meeting of the Company provides opportunity for shareholders to interact with the Board of MI. It facilitates investors to communicate views, raise concerns and to clarify doubts. Any concerned shareholder additionally could access the Board and the Company Secretary via correspondence or by scheduling a meeting. Furthermore, the Annual Report contains an affixed feedback form for purpose of obtaining stakeholder feedback especially that of shareholders.

Board's Interaction with Employees

Maintaining effective dialogue between employees and the highest governance body has been a key feature in our business. Executive Directors interact regularly with the corporate management. This enables them to grasp underlying concerns and facilitate communication of key decisions down the chain, to relevant employees. Weekly meetings held in presence of key Executive Directors chaired by the Managing Director provide an excellent platform for frontline officers to raise any concerns, views and suggestions for the betterment of the organisation. Furthermore, MI's open door culture enables employees to freely communicate concerns and helps management to handle grievances appropriately.

Linking Board and Senior Management Performance to Compensation

The Remuneration Committee of the Company is entrusted with the task of assessing performance of Executive Board members for purpose of establishing remuneration levels. (Information pertaining to the Remuneration Committee is given on page 159) Separately, to assess and to appropriately reward members of the corporate management and other employees, their work performance is appraised by their subordinates periodically through a structured appraisal system.

Nominations Committee

The Nominations Committee set-up during this period was mainly vested with the task of assessing requirements of new members to the Board and recommending future appointments. (Information pertaining to the Nominations Committee is given on pages 160 and 161).

Memberships 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

Precautionary Approach

In a dynamic and complex business environment, managing risks related to one's business is of paramount importance. We at MI understand the need to manage risks as a means of sustaining wealth to our shareholders through an appropriate trade-off between risk and returns. The Company's risk management practices are mainly aimed at countering core risk related to finance business. This includes managing of credit risk, interest rate risk, liquidity risk and operational risk so that our investors, customers, suppliers and indirectly our employees and the larger community is safeguarded.

MI's process of risk management commences with a comprehensive assessment of prevalent risks and potential impacts risk could have on the organisation. Thereafter, as a means of countering potential risks, various risk mitigation strategies are adopted at different levels of the organisational through a comprehensive set of policies and procedures that employees are expected to follow. These policies and procedures together with inbuilt internal controls established, are reviewed continuously and when necessary, fine-tuned to cope with environmental and business changes.

To oversee risk management practices from a broader perspective, MI Board has established the Integrated Risk Management Committee. The Committee is required to review main business areas that may pose potential risk, establish the adequacy of risk management practices being adopted by management and to advise on other risk countering mechanisms including establishing of safety limits when necessary. In addition, the Audit Committee supervises the appropriateness of the financial reporting system and application of internal controls. The Committee obtains necessary feedback from Internal Auditors periodically.

MI's process of risk management is explained through material appearing under the caption 'Risk Management' on pages 167 to 195.

In developing the Strategic Plan of the Company, a comprehensive SWOT analysis was carried out to identify MI's potential strengths and weaknesses, prevalent opportunities and threats in the business environment prior to setting organisational objectives and then devising suitable strategies.

The Business Continuity Plan developed in 2009 was designed by setting forth plans to prepare the organisation to face large scale contingency events that could materialise such a fire, earthquake etc. The document maps out proactive measures that need to be implemented and the course of action to follow, to keep damage to business as minimal as possible in the event a catastrophic event were to materialise.

Global Compact Considerations

MI endorses the global compact considerations upheld by the United Nations Global Compact (UNGC), namely the 10 universally accepted principles in the area of human rights, labour, environment and anti-corruption. The sustainability values inbuilt in these principles reflect the way we operate as an enterprise and uphold our own corporate values.

Global Compact Considerations 10 Principles		How MI Embraces These Values
Human Rights	1. Businesses should support and respect the protection of internationally proclaimed human rights	We at MI uphold human rights requirements in all our endeavours. Our human resource policies and practices have been established giving due consideration to these values.
	2. Make sure that they are not complicit in human rights abuses	As we adopt a humane approach to management of our workforce as well as when dealings with external parties, we have not encountered any incidents of human rights abuses or violations during the period under review.
Labour	3. Businesses should uphold the freedom of association and the effective recognition of the right to collective bargaining	All employees can express their views and concerns to the Board or Management of the Company freely. The feedback that we derive from our employees is deemed constructive and not obstructive. However, we do not have collective agreements with our workforce. The management and workforce have sustained a harmonious relationship all this while.
	4. The elimination of all forms of forced and compulsory labour	We do not employ child labour or forced labour.
	5. The effective abolition of child labour	We recognise and abide by the fact that children should not be employed in any capacity whatsoever.
	6. The elimination of discrimination in respect of employment and occupation	We do not practice discrimination in any form whether by age, sex, ethnicity or religion. Our employment standards are purely based on performance, knowledge, experience and qualifications.
Environment	7. Businesses should support a precautionary approach to environmental challenges	We are constantly aware of the need to safeguard our environment. We monitor our practices to ensure there is little or no impact to our surroundings. We hope to inbuild environmental controls to our risk management framework in the ensuing year.
	8. Undertake initiatives to promote greater environmental responsibility	Please refer pages 229 to 232 which provide an overview of our environmental protection efforts.
	9. Encourage the development and diffusion of environmentally-friendly technologies	We have already devised a number of initiatives via technology to minimise use of resources. We plan to adopt solar power as part of our energy consumption as a future green exercise.
Anti-Corruption	10. Businesses should work against corruption in all its forms, including extortion and bribery	We have put in place a strong governance and control culture with strict punishment and disciplinary action for individuals who do not comply. A 'Whistle Blowing and Fraud Policy' is in place to identify and take action against malpractice.

Adoption of International Financial Reporting Standards (IFRS)

The Company commenced adoption of the IFRS reporting requirements from this financial reporting period. As a Company that has been in the forefront of delivering high standards in financial reporting, these international standards will enhance our financial disclosure further. Superlative financial reporting is bound to boost confidence of users of our corporate reports. Our stakeholders can obtain a stream of financial information to assess organisational performance and status quo that is of world class standard.

Stakeholder Engagement

Through various channels of communication, we continue to engage with our stakeholders throughout the year. Through this, we are able to obtain their invaluable feedback on suggestions, recommendations, grievances and advice. Stakeholder engagement also facilitates information flow from the organisation to respective stakeholders so that both parties could better relate to a topic of discussion. The process of stakeholder engagement is carried out between MI and its customers, shareholders, suppliers, employees, regulatory bodies, local community and social groups.

The engagement process undertaken for each of these stakeholder groups together with topics covered is disclosed under economic, social and environmental dimensions explained in the ensuing sections.

THROUGH VARIOUS CHANNELS OF COMMUNICATION, WE CONTINUE TO ENGAGE WITH OUR STAKEHOLDERS THROUGHOUT THE YEAR

>

Through this, we are able to obtain their invaluable feedback on suggestions, recommendations, grievances and advice.

MANAGEMENT APPROACH AND PERFORMANCE INDICATORS

This section of the report provides disclosure on Mercantile Investment's management approach to economic, social and environmental dimensions, fundamental to sustainability. Under each dimension, we have gone on to provide extensive disclosure with applicable Performance Indicators to demonstrate MI's sustainability performance during this period.

In presenting this, as illustrated below, we have described associated stakeholder responsibility under each dimension and then gone on to disclose our performance under each of them.

ECONOMIC DIMENSION

MANAGEMENT APPROACH TO ECONOMIC DIMENSION

MI's profound business growth in the recent years has made the Company a material force to be reckoned with within the industry and the business community. Our business strategies target primarily the generation of greater financial returns to our investors year on year. In moving towards this, MI has been a committed player in terms of business excellence. We have stamped a mark in the minds of our customers affording them a product range that has evolved over time bringing forth superior value to them. In doing business, we have improved our relations with suppliers especially the vehicle sales vendors who form an integral connection to our main business of financing.

Within the Company, we have maintained a close bond with our MI team most of whom have been within the Company for over five years. We have remunerated them adequately for their dedicated efforts which encompass monetary and non-monetary benefits. Through these positives, MI has remained a primer institution in our sector serving people from all walks of life within society to realise their dream of either fulfilling a financial need or seeking employment or other aspirations, becoming another catalyst in the Nation's march toward economic prosperity.

Organisation-wide Goals

In creating investor wealth and aspiring to meet other broad organisation-wide objectives, the Management pursued the implementation of the Board approved medium-term strategic plan commencing in the financial year 2012/13. To ensure critical aspects of the plan are implemented, corporate management monitors actual organisational performance against overall targets periodically, keeping core aspirations in sight. Financial highlights given on page 4 provide a summary of MI's financial performance against the previous financial year. It separately provides comparison of actuals against forecasted results for 2012/13 in respect of specific key performance indicators.

Policies Practiced

Economic policies of the Company are driven by the organisation's vision, mission and the value system that is aimed at maximising shareholder wealth and bringing forth a sustainable economic performance that will pass on to other stakeholders of the organisation positively.

Economic Performance, Market Presence and Indirect Economic Impacts

For each significant stakeholder under the economic dimension, we have spelled out aspects of economic performance, market presence and indirect economic impacts as explained in the next few sections together with other aspects including the stakeholder engagement process.

INVESTOR RESPONSIBILITY UNDER ECONOMIC DIMENSION

Investor Base at MI

Presently, the investor base of Mercantile Investments and Finance PLC is relatively small comprising of a few large investors. However, being a listed Institution, there is potential for the Company to seek fresh capital if the need arises, thus broad-basing the investor base.

Methods of Investor Engagement

Importance Placed	Process of Engagement	Frequency	Matters Taken Up
We consider our shareholders as our key stakeholder being our capital providers. Thus, maintaining close relationship is essential to apprise them of our plans, aspirations, and decisions and also to obtain their feedback and recommendations.	● Shareholder meetings/AGM Releasing of annual report and obtaining feedback form	Annual	● Financial performance ● Dividend payments ● Commentary of performance and proposed plans
	● Announcements and issuing of Annual/interim results to CSE	At least quarterly	● Changes to Board structure ● Financial results
	● MI website information updates	Regular basis	● Achievements/Milestones/New developments ● Information on available Products and services.
	● Press releases and articles in magazines	Atleast one release per quarter	● Annual and interim position updates ● CSR programmes initiated ● Future plans

By releasing a comprehensive annual report and holding the Annual General Meeting (AGM), MI has been able to interact with investors freely. The AGM provides an ideal platform for shareholders to voice their concerns and to provide feedback and recommendations to the Board.

The corporate website redesigned in 2012 provides adequate information on Company background, products and services and latest information including financial performance that is helpful to investors and analysts. Biannually, MI's interim Financial Statements are published in the newspapers in three languages in keeping with regulations. These publications are supported by special announcements and media releases as means of communicating organisational performance, changes and events.

Investor Wealth Creation

Our main aspiration annually is to strive to provide above average returns to our investors. Of all our organisational objectives, shareholder wealth creation is regarded as the most significant. The strategic plan of the Company spells out a range of business strategies to sustain reasonable returns to our investors in the medium term. The plan maps out strategies, focusing on total revenue growth and sustaining a constant stream of profits for the next 3 years.

Through the efficient conduct of business, MI was able to maintain a sound financial performance as anticipated. During the last decade our investors have enjoyed sound returns in terms of dividends and have seen their investments grow through a constant accumulation of shareholder funds that stand in excess of Rs. 5 billion. The graph below indicates a gradual upward trend in terms of dividends paid in absolute terms for the last five years:

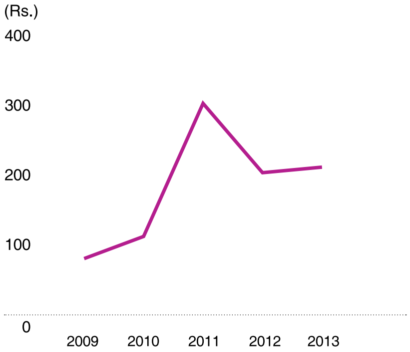
	2009	2010	2011	2012	2013
Earnings per Share (Rs.)	77.79	109.31	301.36	202.96	209.84
Dividend Yield (%)	N/A	N/A	N/A	1%	1%
Asset growth YOY (%)	(3)	8	61	28	21
Return on capital employed (%)	9	9	5	11	11
Share price - Ordinary voting (Rs.)	N/A	N/A	N/A	2,200.00	2,200.00
Price Earnings ratio (times)	N/A	N/A	N/A	10.84	10.48
Dividend (Rs. '000)	9,750	13,800	30,000	66,132	82,665

MI being a listed company on the Colombo Stock Exchange, affords investors the option of disposing their shares for a sound price considering the strong net asset position. Upon listing, Mercantile Investment shares have fetched an astounding market price of Rs. 2,200/- per ordinary share indicative of the Company's potential earnings capacity and capital strength.

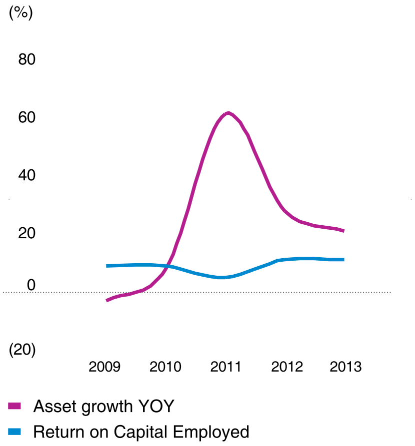
Societal and National Expectations Under Economic Dimension

From a broader perspective, the economic impact resulting from our business has deepened in the last decade especially with the profound growth that we have experienced within a short span of time. Indirect economic impact arising from MI's business to various segments of society has become widespread as we have managed to expand and go beyond the Western Province and reach out to communities even in the remotest areas of the country.

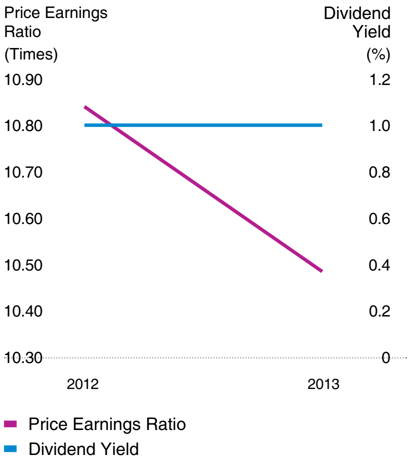
Earnings Per Share



Assets Growth and ROCE



Price Earning Ratio and Dividend Yield



Note: For disclosure of above Information/Ratios/Graphs:

*a. Years 2012 to 2013 Income Statement information is SLFRS/LKAS based.
Other years as per SLAS.*

*b. Years 2011, 2012 and 2013 Statement of Financial Position information is SLFRS/LKAS based.
Other years as per SLAS.*

In demonstrating MI's overall economic impact to the nation, we have disclosed the following economic data for the last three years:

Measures to Demonstrate Economic Impact	Page Reference
Economic Value Addition (EVA)	348
Value Added Statement	349
Sources and Utilisation of Income	350

MI's financial performance in terms of profitability and other standard financial indicators for the past decade has been commendable. (Refer section on 'decade at a glance' in page 355 in the Annual Report) These sound performances have supported in MI contributing to the sector and economy. Moreover, the consistent accumulation of shareholder wealth, sound levels of remuneration to our employees and payment to government agencies via taxes has been significant as well.

During 2012/13, no financial assistance was received from the Government. Furthermore, there has not been any direct impact to the organisation including financial implications due to climate change. However, indirect consequences of climate change if any to our borrowers, affecting their repayment ability has not been quantified.

CUSTOMER RESPONSIBILITY UNDER ECONOMIC DIMENSION

Years of commitment and perfection has enhanced the value of our offerings, bringing greater benefit to our customers than before. We strive to achieve excellence in customer service as a means of affording a total product that yields value for money for our customers. To achieve this, we have a team that is completely dedicated to the task, professionals in every sense, who are ready to serve customers from every strata of society. In meeting varying customer expectations, the MI team is ready to deliver a service that goes beyond boundaries. MI's fundamentals have been wrought with customer-centric ideologies that have been central to our success story. This has enabled MI to create long standing loyalty and strong bonding with customers. In understanding changing customer preferences, concerns and ideas we constantly engage with them through effective interactive modes.

Customer Engagement Process

Importance Placed	Process of Engagement	Frequency	Matters Taken Up
Customers are the reason that we are in business. We perceive our customers as a highly influential stakeholder. They impact our business operation and the way we do business. Thus, understanding their needs and concerns is of paramount importance to our business success.	● Marketing visits/Field visits	Credit customers - Once upon transacting Deposit customers - Ad-hoc periods and selective	In general, the following matters are taken up: ● To promote products and services. ● Background assessment of customer ● To remind customers of payments due ● To obtain feedback on customer preferences and needs ● Communicating customer complaints and resolution ● To convey important Company information on products and services
	● Direct customer feedback to our service points/One to one meetings	Regular basis	
	● Use of customer suggestion box	Regular basis	
	● Telephone discussions/E-mails	Regular basis	
	● Advertising campaigns	Regular basis	
	● SMS Alerts	Ad-hoc frequency	
	● MI corporate website	Regular basis	

The customer engagement process at MI primarily focuses on obtaining feedback so that we can serve them better in future. The engagement process involves use of standard communication practices as well as more personalised methods. We ensure that these channels facilitate an appropriate two way interaction. Corporate communiqués published via newspapers enable MI to communicate important Company information to our customers and the general public. Other information released via mediums such as the Annual Report, information available in our corporate web and interim information made available in the Colombo Stock Exchange web provide a stream of financial information that is current.

In facilitating greater interaction with customers, we also practice personalised communication methods. Our credit officers carry out customer visits and arrange face to face meetings with customers during the course of executing business. In communicating MI's available products and services and related information we use direct mail, e-mail and telephone calls extensively.

As a means of recognising continuing loyalty, our valued depositors and agents are remembered annually during festive seasons. The Company sends out greeting cards and hands out gifts for high value customers. We invite key customers for Company events such as special promotions and celebrations as a means of sustaining a healthy customer relationship. Furthermore, we have placed suggestion boxes at our Head Office to help customers communicate concerning their suggestions and grievances.

Expanding Range of Offerings to Customers

To cater to a wider network of customers, MI is committed to identifying emerging financial needs of individuals and to develop and introduce new products and services that meet with their satisfaction. During 2012/13, we introduced microfinancing and professional loans to our product range. Several product extensions and variations were also made to afford customers wider options.

This was in addition to structured and step up lease and hire purchase financing that we commenced within the past few years. In addition, we have joined hands with selected vendors of renowned brands and provide financial assistance to our customers to help them acquire brand new vehicles. We hope to expand our lending products range and are currently evaluating other products including pawning.

During this period, operational procedures in respect of lending and deposit mobilisation were again reviewed and further improvements were carried out especially to improve the documentation gathering process and to provide a speedier and more efficient service. System modifications and upgrading were made to core business front-end and back office operations to provide users greater flexibility and improve delivery times.

Matara Street Promotion by MI sales staff

Staying True to Our Motto

Meeting varying expectations of customers who come from all segments of society is challenging for any business. Nonetheless, we have been successful in attracting and retaining customers over the years, providing a differentiated offering that comprises a service that goes beyond customer expectations. We have been able to stay committed to our motto '**Service that extends beyond**' which has helped us to remain ahead of the competition, even in difficult periods. MI's primary strategies are well focused and have been developed after intense study of customer segments in the market.

Each year a tremendous effort is made by our credit staff to deliver speed of service when executing transactions, from initial inquiry to the disbursement stage, with minimal inconvenience to customers. Our operational processes have been fine-tuned over time so that we stay competitive. We have gone to great

Kottawa Branch Openning

Bondage with Customers

lengths to provide a unique personalised service especially fine tuning the operational process related to deposit mobilisation to sustain repeat business. This has enabled us to build lasting relationships with depositors and to grow the depositor base on average over 20% for the last five years.

Providing Customer's Greater Accessibility

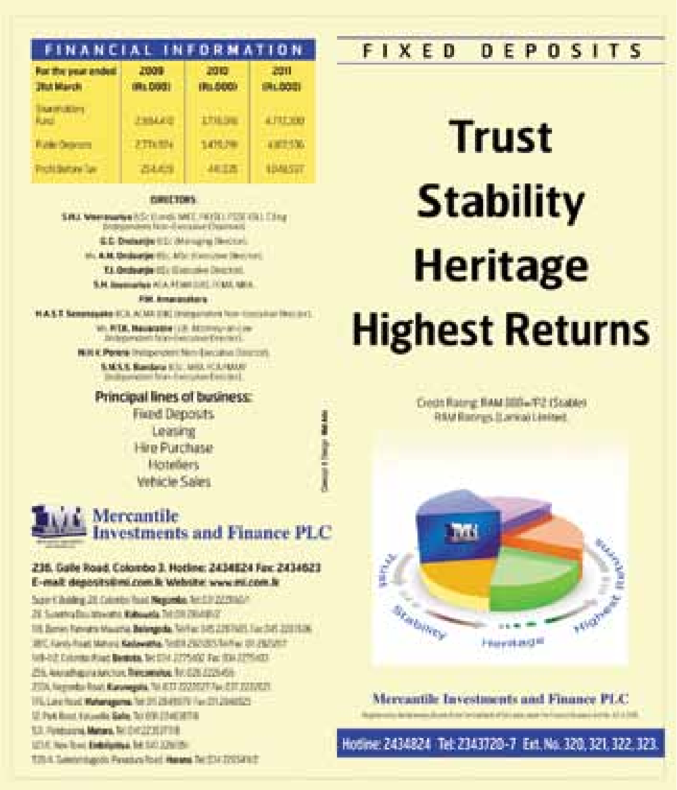
In the last few years, management has placed strong emphasis on extending our financial services to various strata of society. For this purpose branches were set up in strategic locations of the country. MI's branch network comprises seventeen fully-fledged branches strategically located to serve varied sections of society. 11 branches have been established outside the Western Province. This indicates our commitment to go beyond the suburbs to even remote parts of the nation to extend our services to individuals who have had limited choice in obtaining finance previously. By adopting this approach, we are able to reach a wider audience who are in need of finance or who are in search of a secure institution to place their investments and realise a sound return for their hard earned savings.

See page 204 detailing information on MI's branch network demography.

Safeguarding Trust and Confidence of Customers

MI's corporate value system has been established embracing the highest level of integrity and ethical standards right from inception. By displaying responsible and ethical business practices over our many successful years in business, we have succeeded in building strong bonds with our customers. We profess an unblemished corporate image which we are proud of and has led a robust business enjoying a growing market share each year. Inspite of a variety of other investment opportunities put forth by competitors, our loyal depositors continue to remain with us, some of whom have been with us for decades.

We have put in place sound procedures, processes and controls and expect employees to strictly adhere to these best corporate practices to safeguard public funds. Our recruitment system ensures that we carryout adequate background verification of potential recruits to establish their integrity and standing in the corporate world. With a track record of close upon five decades in reputed entrepreneurship, MI has continued to stay responsible in its corporate practices with an enviable track record of being a trusted player among our customers and other stakeholders.



FINANCIAL INFORMATION

FIXED DEPOSITS

Trust
Stability
Heritage
Highest Returns

Principal lines of business:
Fixed Deposits
Leasing
Hire Purchase
Hoteliers
Vehicle Sales

Mercantile Investments and Finance PLC

Mercantile Investments and Finance PLC

Hotline: 2434824 Tel: 2343720-7 Ext. No. 320, 321, 322, 323.

Fixed Deposits Brochure

MERCANTILE INVESTMENTS AND FINANCE PLC

MI - A Trusted Partner for Close to Half a Century

Significant Customer Initiatives Carried Out During 2012/13

Area of Focus	Background	Key Initiatives Undertaken
Customer convenience	To provide enhanced value to our customers beyond financing, we coupled other services as well to strengthen our offering.	● We have set up an active island-wide branch network so that our customers can access any location to obtain any of our services. ● We assist financing customers in obtaining insurance cover for their asset all of which is handled under one roof at MI head office. ● Our fully-fledged workshop, repair and service centre provides premier repair and servicing facilities for the vehicles of our vehicle financing customers.
New product introductions and extensions	MI's significant organisational expansion beyond the Western Province necessitates increased focus on meeting fresh and unique financial needs of society.	● Introduction of microfinance business especially in rural areas such as Trincomalee during this period. ● Introduction of loans to professionals and commencing authorised money changing business. ● Strong emphasis in affording term loan products that are structured to suit requirements of borrowers. Eg. Structured term loans, property mortgage loans, pledge facilities.
Customer benefits	To provide greater benefit, management continued to offer special rates for specific types of depositors.	● Special interest rates were afforded to depositors who are senior citizens.
Speed of Service	Improving speed of delivery has been a continued area of focus. Service excellence has been a key differentiating factor for us.	● System enhancements were carried out to strengthen customer inquiry and follow up. ● Streamlined and strengthened front line staff to provide swift service.
Easing borrower repayment difficulties	To support borrowers in difficulty as well as to cater to special requests, re-schedulement of facilities were considered for specific borrowers after making due assessments.	● Lending re-schedulements for the period totalled Rs. 685 million.
Creating greater customer awareness of available services	There is a continuing need to make customers aware of our offerings as a consequence of setting up of branches in fresh locations.	● Advertising costs this year stood at Rs. 18 million especially on account of increased media coverage of the products and services we offer.
Attending to customer concerns and complaints swiftly	A suggestion box has been placed in the Credit and Recoveries divisions. Apart from conveying concerns to departmental managers, customers are able to communicate with us in writing by dropping-off their comments at our Head Office. The Legal division handles any outstanding matters raised by customers through the Financial Ombudsman.	● 3 complaints were received to the suggestion boxes during the period. All matters have been resolved. ● There were no pending claims/or petitions against the Company before the Financial Ombudsman to date.
Improving internal processes and practices for the efficient and prudent conduct of operations	Having an efficient process with set procedures and practices with clear instructions is very essential to minimise errors and malpractices.	● Reviewed and issued additional procedures/instruction for enhancing operational practices and initiated appropriate training. ● Strengthened audit and compliance function by recruiting capable personnel. ● Strengthened cadre to boost operational efficiency to cater to growing customer demand.

Supplier Responsibility Under Economic Dimension

Unlike a manufacturing organisation, finance business does not involve use of supplies as a direct input. Nevertheless, we consume stationery and other general consumables in our daily operations. For this purpose, we deal with a few reputed suppliers in accordance with the organisation's policies and procedures on purchasing. A separate Purchasing Department handles the acquisition of fixed assets while purchase of stationery-related items is handled by the stores division.

From another angle, MI as part of its main lending business deals with suppliers of vehicles for purpose of finalising financing transactions with our customers. We have managed to forge strong bonds with some of them as we have been in the financing business for a considerable period of time.

Policies, Practices and Proportion of Spending on Locally-Based Suppliers

Currently, we adopt a centralised approach for most of our general purchasing such as stationery and items needed for day-to-day consumption. The supplies are directly sent to our Head Office and then distributed later to respective departments and branches. In selecting suppliers periodically, we adopt standardised selection practices that include cost and quality considerations including past supplier performance for main stationery and consumable items. We have maintained long-term relationships with key suppliers who have continued to provide us optimal pricing.

Employee Responsibility Under Economic Dimension

Our achievements in terms of profitability, organic growth and strong financial stability have not only benefited the organisation, but also generated career development opportunities and a quality range of perks for our employees. While we provide our staff job security, they are nurtured to become specialists in their fields. We afford training and other career development activities to boost their knowledge and capability. They in turn have reciprocated through their expertise and talents to improve overall business volumes and standards of service.

Supplier's Engagement Process

Importance Placed	Process of Engagement	Frequency	Matters Taken Up
MI promotes sound relationships with long-standing suppliers. Materially, we keep in close communication with specific vehicle suppliers for the purpose of vehicle financing	● Arrange meetings/ Telephone discussions	Regular basis	● Identification of required supply
	● Call for Quotations/ Estimates for general supplies	Regular basis	● Finalisation of pricing and follow up of payments
	● Visits from either party	Regular basis	● Passing down product-related information ● Quality aspects

Wage by Gender

In terms of staff remuneration, the Company has different salary scales mainly based on the grade and experience of a staff member. There is no gender bias when deciding on employee remuneration and other benefits.

Grade	Male and Female Starting Wage at MI	Market Average Rate
Manager	Rs. 65,000 and above	Rs. 60,000 and above
Executive	Rs. 25,000 and above	Rs. 22,000 - Rs. 55,000
Non-executive	Rs. 15,000 - Clerks Rs. 10,000 - Peons	Rs. 6,500 - Rs. 22,000

Coverage of Defined Benefits and Contribution Plans

Defined Benefit Plans

Mercantile Investment employees are entitled to retirement gratuity upon completion of five years of continued service in accordance with the Payment of Gratuity Act No. 12 of 1983. An actuarial valuation is carried out every three years to ensure adequacy of the gratuity provision available to settle gratuity liability. Additional information in this regard is disclosed under accounting policies in the Financial Statements given on page 296.

Defined Contribution Plans

Based on respective statutes and regulations, MI employees are eligible for Employees' Provident Fund Contributions (EPF) and Employees' Trust Fund Contributions (ETF). The Company contributes 12% and 3% of gross emoluments for our employees to EPF and ETF respectively.

Local Hiring

When hiring senior officers including branch managers, we have shown preference to recruit candidates who reside in the area that the relevant branch is located. The benefit of hiring officers who are familiar with the local community and business surroundings has been immense and has been a feature in branch recruitments.

Branch/Service Centre	Total Staffing	Local Hired (In No's)	Not Locally Hired (In No's)
Anuradhapura	5	5	0
Balangoda	8	8	0
Bentota	8	7	1
Embilipitiya	6	6	0
Galle	10	9	1
Gampaha	3	3	0
Kottawa	6	5	1
Kurunegala	7	6	1
Maharagama	7	5	2
Matara	10	9	1
Trincomalee	6	6	0
Tissamaharama	6	5	1
Minuwangoda	6	6	0
Ampara	5	5	0
Kadawatha	14	11	3
Chillaw	6	4	2
Negombo	12	9	3
Kohuwala	12	10	2
Horana	8	5	3
	145	124	21

ENVIRONMENTAL DIMENSION

MANAGEMENT APPROACH TO ENVIRONMENTAL DIMENSION

We recognise the growing importance of safeguarding the environment that we thrive and do business in. Industrialisation and population growth has led to the degradation of the environment including its ozone layer and declining natural resources such as trees and natural habitats. As a member of the business community, we understand our role in protecting the environment at least by instilling measures within the organisation to minimise negative impacts from our operational processes.

Mercantile Investments adopts specific green practices that have evolved over time as a means of minimising our own impact on the environment. However, it is fair to say that being a service organisation, our direct impact to the environmental is minimal. Hence, our focus is mainly on curtailing the use of natural resources and dealing with possible environmental hazards related to our business activities directly. Indirectly, in future, we aim to adopt additional practices to ensure that our lending business takes cognisance of the need for our commercial borrowers also to have safe environmental practices.

Environmental Policy

In keeping with our values, environmental considerations are given priority when taking broad business decisions such as selecting branch locations, effecting structural or cosmetic changes to premises or initiating significant operational changes that may affect the environment indirectly. We have established standard organisational policies and practices that are designed to safeguard the environment and minimise impact. In support of this, we continue to emphasise on improving the green practices that we adopt.

MI Annual Report is Carbon Neutral

In keeping with our commitment to a greener environment, the Annual Report in your hands is a carbon neutral publication, similar to our previous year's report. The greenhouse gas emissions resulting from the design, photography, production, project management, usage of paper and printing were offset using verified carbon offsets.

PARTNER
Carbonfree®
Carbonfund.org

Controlling Consumption of Stationery and Consumable Items

There is growing importance among divisions to use stationery and related items sparingly without wastage. As a standard practice, recycled paper is used for internal documents and drafts on a selective basis. After stationery and related items are issued from our main stores, divisions are expected to monitor their use maintaining a sub record for material items. Furthermore, to optimise purchase of costly printer cartridges, we operate a system to reuse existing cartridges through a refilling process.

49,962 KWh
ELECTRICITY CONSUMPTION >>

733 Units
WATER USAGE >>

3,386 Reams
PHOTOCOPY PAPER USAGE >>

The percentage of materials used that are recycled input materials from our consumables remained notable.

Individual Recycling Status of Each of Those Items is as Follows:

Recycled Item	No. of Items Consumed in 2012/13	Items Recycled in 2012/13	% of Items Recycled Against Total Consumption
Box Files	400	200	50%*
Ink Cartridge/Fax	387	17	4.4%
Photo Copy Toner, Fax Toner and Laser Jet Printer Toners	625	538	86%

**Approximate 50% recycled as per general pattern.*

Stationery and Consumable Usage Trend

Type of Item	2010/11	2011/12	2012/13
Photo Copy Paper (Reams)			
- A4	1,638	2,382	2,900
- Legal	156	178	151
- A4R	279	293	335
Total	2,073	2,853	3,386
Ink Cartridges/Fax (No. of Cartridges)	153	389	387
Photo Copy Toner, Fax Toner & Laser Jet Printer Toners (No. of Units)	271	420	625
Box Files (No. of Box Files)	178	436	400

Paperless Office Concept

With the introduction of the 'Document Management System' core divisions are now able to scan and store important documents thus cutting down on use of stationery and physical space. We have systemised the loan approval process recently, thus eradicating the requirement for hard copies and moving to a more paper-less office concept.

Eco-Friendly Environmental Practices

In promoting an eco-friendly environment, we emphasise on maintaining a clean business environment, keeping premises and surrounding areas clean. Waste items and garbage are collected daily by our own janitorial staff and disposed of without harming the surroundings. Notices are displayed near washrooms on the need to conserve water and to maintain hygiene. At departmental level, staff are expected to maintain tidy work stations.

Recycling

Furthermore, we are aware that the use of fuel and other energy resources releases carbon dioxide and other greenhouse emissions to the environment triggering climate change and other environmental hazards. In a bid to minimise harmful effects to the environment, fuel emission certificates were obtained by our transport division for our fleet vehicles in line with prevailing road regulations.

Conservation of Energy

The growing demand for energy arising from industrialisation and population expansion has made energy scarce despite the emergence of energy-generating options. There is increased focus within the business community on implementing energy conservation methods that will preserve this scarce resource and eventually bring down related cost.

MI's Engineering division has taken the initiative to implement direct energy saving practices and is on the verge of introducing Solar Power Technology in combination with power from the national grid. The adoption of CFL and fluorescent tube lights at most MI locations have contributed in controlling energy usage. Further, a capacitor bank is used to manage reactive power draw from the mains, as a means of saving electricity. To minimise electricity consumption, windows at our Head Office building are treated with UV repelling film thus helping to control internal temperature and reduce air conditioning loads considerably. As a standard practice we shut-off central air conditioning at our Head Office after 5.00 p.m.

Average Monthly Electricity Utilisation (MI Head Office)

	2011	2012	2013
H/O Electricity - KWh	49,105	50,725	49,962

Electricity energy consumption is measured in kilowatt hours (kWh).

Conserving Water

In controlling water usage, the engineering division of MI has introduced specific measures at our Head Office. For example, one of the key water draw-off areas is the washroom and MI operates special systems to help optimise water usage. In parallel, it is further proposed to adopt a tubewell system in place of pipe borne water as a means of preserving water and cease reliance on the national supply.

Average Monthly Water Utilisation (at MI Head Office)

	2011	2012	2013
H/O Water - (In Units)	634	723	733

Monitoring Fuel Consumption

As a practice, monthly mileage is recorded for all fleet vehicles as a means of monitoring fuel consumption. Periodically, vehicle-wise fuel cost statements are submitted to divisional heads so that usage levels could be closely monitored. The Transport division in co-ordination with MI's vehicle servicing division maintains the Company's fleet of vehicles. This involves systematically overseeing aspects on vehicle performance including fuel efficiency.

Fuel Consumption Level

	2011	2012	2013
Fuel			
Petrol (Litres)	86,578	121,626	213,902
Diesel (Litres)	18,101	20,167	18,938

Biodiversity

Whilst MI's network of branches reach far and wide across the country, we have ensured that their location does not compromise designated protected areas or areas of high significance in terms of bio-diversity. In any event, being a service organisation, the direct impact to the environment including affects to surrounding habitat of our organisation's operations and related products and services is negligible.

In service to the protection of habitat and to redress the shrinking animal population, we concluded work on the following project initiated the previous year:

- Activation of water holes in the Yala National Park to provide drinking water to animals inside the sanctuary.

Activation of water holes in the Yala National Park

Environment-Related Fines and Sanctions

The Company has not violated any environmental standards and was not called upon to settle any fines. Further no sanctions were imposed as a result of non-compliance with any environmental regulations during this period. Assurance to this effect is provided on page 270 in the Annual Report of the Board of Directors.

Practices Proposed for a Greener Future

- Plans are underway to adopt solar power energy at head office premises to minimise direct energy consumption from the national grid.
- Incorporating green principles to our lending evaluation process. i.e. verifying borrower's own standards/ practices relating to environmental protection especially when assessing lending for industrial projects.
- It is proposed to change current display lights to LED fully by next year end.
- On-going plans to revamp the existing air conditioning system or replace fully with a new system afforded in the market which will facilitate lower usage of energy.

SOCIAL DIMENSION

MANAGEMENT APPROACH TO SOCIAL DIMENSION

There is a heightened desire amongst the business community to adopt socially sound practices whilst pursuing profit maximisation. These practices accrue long term benefit to companies rather than immediate but short-lived benefits to the detriment of society. Our organisation understands the importance of this approach especially considering the wider and deeper benefit social activities have on our workforce, society and finally the nation. When it comes to people, be they our customers, employees or individuals from the local community, we make a special effort in understanding their needs at times going beyond boundaries to support them socially in whatever way possible.

In this dimension, we have explained our approach and performance with regard to core social areas of labour responsibility, societal responsibility, human rights responsibility and product responsibility.

Labour Responsibility

Labour Practices and Decent Work

Management Approach to Labour

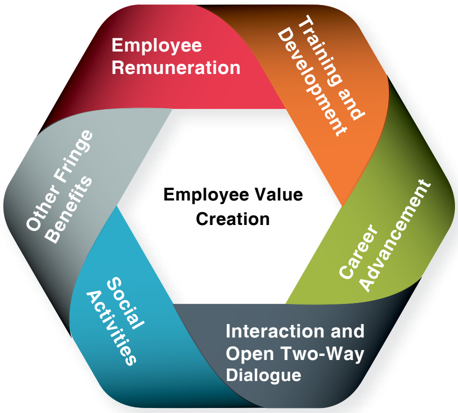
From inception, our workforce has displayed immense commitment to the organisation and has been instrumental in MI's continuing success. The Company considers its employees as its most valuable asset; the brain and brawn of the Company, the people who provide life to the Company's vision, who take enterprise from the drawing board to the customer and beyond. The contributions made by our valued staff are many and have been the differentiating factor in our road to success. The MI team comprises of a set of individuals who are highly skilled and experienced, most of whom we have groomed and nurtured to become financial specialists and experts in their fields.

We understand the importance of human capital management especially in sustaining employee morale and motivation consistently as a means of improving productivity. MI has been a caring employer, nurturing them over the years 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.

Human Resource Policy

In co-ordination with our Human Resource Division which was strengthened in recent times, we have embraced sound human resource policies across the Company. Our aspiration is to continuously nurture our workforce to enhance their value to the Company and for their personal career growth. Nurturing and building skills and competencies of employees at all levels of the hierarchy has enabled the Company to meet organisational goals more effectively and to remain ahead of the competition. At the same time, the organisation has displayed its commitment towards non-discriminatory practices and equality in the workplace in all instances.

Our labour policies are aimed at grooming an effective individual who is capable of dealing with the sophistication in the financial services sector, whilst guiding them through MI's value system. These policies engrave in them the importance of good governance and accountability and the need to display honesty, integrity and ethical behaviour in all instances.



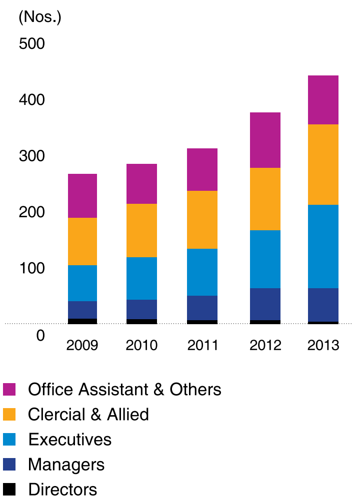
Employee Engagement Process

Engaging staff more closely on corporate matters and obtaining feedback from them on suggestions, concerns and grievances through formal and informal channels has improved the productivity of our workforce and kept staff morale and motivation high.

Importance Placed	Process of Engagement	Frequency	Matters Taken Up
Our dedicated team of employees being MI's most decisive asset needs to be continually guided, motivated and nurtured over their tenure with us. We need to foster sound relationship right-through for mutual benefit ensuring productivity within a caring open system.	● An 'open door policy' that fosters effective dialogue between employer and employee. This system allows free flow of information to move up the organisation's hierarchy, even up to Managing Director level through direct employee - employer contact.	Regular basis	● Passing down instructions to respective employee ● Technical training sessions ● Performance assessment ● For devising strategies and setting targets ● Conveying general Company information ● Obtaining feedback of employees on proposals, recommendations and concerns. ● Reward-related topics ● Succession planning ● Grievances
	● Training and development process	Regular basis	
	● Performance appraisal	Annual	
	● Corporate Newsletters	Biannual	
	● Management meetings	Weekly	
	● Corporate communiqués via circulars, memos and e-mails	Regular	
	● Company events including get-togethers, sports day and celebrations and religious events	MI Get-together - Annual Other events - Ad hoc	
	● Strategic planning sessions	Once in three years	

KEY PERFORMANCE INDICATORS OF LABOUR PRACTICES AND DECENT WORK

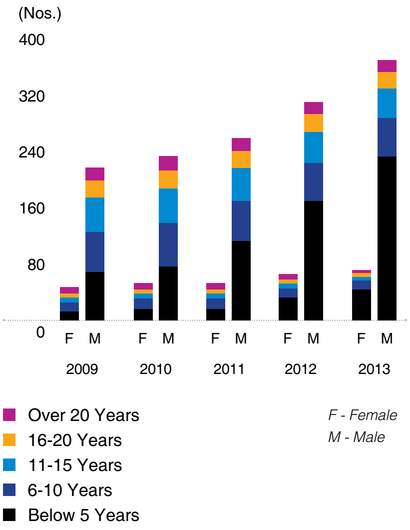
Staff Strength



Staff Strength

	2013		2012		2011		2010		2009	
	Male	Female	Male	Female	Male	Female	Male	Female	Male	Female
Directors	4	1	5	2	5	2	6	2	6	2
Managers	53	7	52	6	38	6	32	4	30	2
Executives	112	36	74	28	60	24	51	24	43	22
Clerical & Allied	116	28	81	30	82	21	73	23	63	22
Office Assistant and Others	86		99		75		71		76	
Total	371	72	311	66	260	53	233	53	218	48

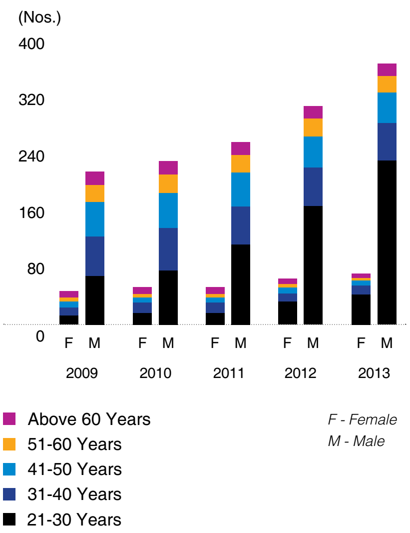
Service Analysis of Employees



Service Analysis

	2013		2012		2011		2010		2009	
	Male	Female	Male	Female	Male	Female	Male	Female	Male	Female
Below 5 Years	234	43	170	33	114	17	77	17	70	13
6-10 Years	54	13	54	12	55	14	61	14	56	12
11-15 Years	43	7	45	8	48	8	50	8	49	8
16-20 Years	23	4	25	5	25	5	26	5	24	6
Over 20 Years	17	5	17	8	18	9	19	9	19	9
Total	371	72	311	66	260	53	233	53	218	48

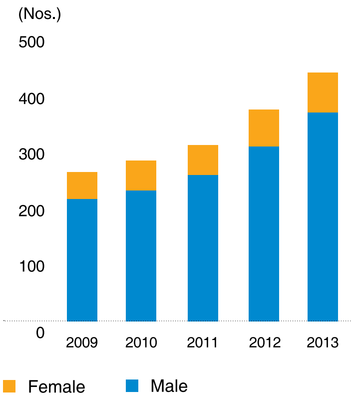
Age Analysis of Employees



Age Analysis

	2013		2012		2011		2010		2009	
	Male	Female	Male	Female	Male	Female	Male	Female	Male	Female
21-30 Years	187	41	139	35	101	20	77	19	72	15
31-40 Years	104	15	94	14	78	16	74	16	68	15
41-50 Years	51	13	49	14	51	14	50	15	47	15
51-60 Years	18	2	18	2	19	2	20	2	19	2
Above 60 Years	11	1	11	1	11	1	12	1	12	1
Total	371	72	311	66	260	53	233	53	218	48

Gender Distribution of Employees



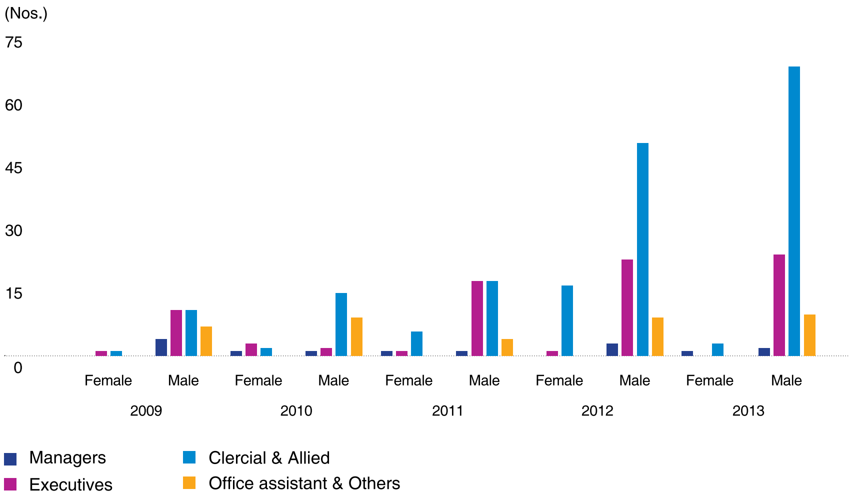
Gender Distribution

	2013	2012	2011	2010	2009
Male	371	311	260	233	218
Female	72	66	53	53	48
Total	443	377	313	286	266

Staff Recruitment

	2013		2012		2011		2010		2009	
	Male	Female	Male	Female	Male	Female	Male	Female	Male	Female
Managers	2	1	3		1	1	1	1	4	
Executives	24		23	1	18	1	2	3	11	1
Clerical & Allied	69	3	51	17	18	6	15	2	11	1
Office assistant and Others	10		9		4		9		7	

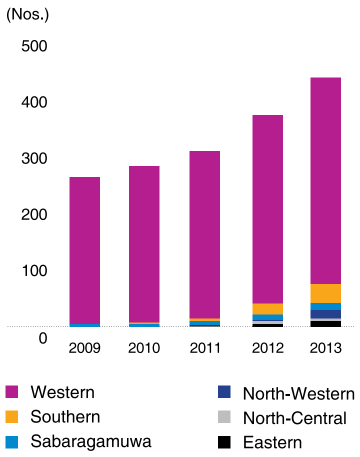
Staff Recruitments



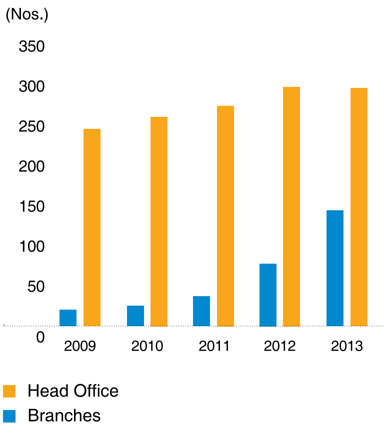
Branch-Wise/Province-Wise Breakdown of Human Capital as at 31 March 2013

		2013		2012		2011		2010		2009	
Branch	Province	Male	Female	Male	Female	Male	Female	Male	Female	Male	Female
Trincomalee	Eastern	6		5		3					
Ampara	Eastern	4	1								
Total		10	1	5	0	3	0	0	0	0	0
Anuradhapura	North-Central	4	1	4							
Total		4	1	4	0	0	0	0	0	0	0
Kurunegala	North-Western	7		3							
Chillaw	North-Western	5	1								
Total		12	1	3	0	0	0	0	0	0	0
Balangoda	Sabaragamuwa	7	1	6		7		4		5	1
Embilipitiya	Sabaragamuwa	5	1	3							
Total		12	2	9	0	7	0	4	0	5	1
Bentota	Southern	8		6		4		4			
Tissamaharama	Southern	5	1								
Galle	Southern	7	3	5							
Matara	Southern	8	2	7	2						
Total		28	6	18	2	4	0	4	0	0	0
Head Office	Western	241	57	238	61	225	51	209	52	199	47
Negombo	Western	11	1	9	1	7	1	7		6	
Kohuwala	Western	10	2	11	1	8	1	5	1	4	
Kadawatha	Western	14		9		6		4		4	
Maharagama	Western	7		5	1						
Horana	Western	7	1								
Gampaha	Western	3									
Minuwangoda	Western	6									
Kottawa	Western	6									
Total		305	61	272	64	246	53	225	53	213	47
Grand Total		371	72	311	66	260	53	233	53	218	48

Provincial-wise Breakdown of Human Capital



Head Office vs Branches Human Capital



Staff Ethnicity/Religion Gender-Wise

Count of Religion		Ethnic Group				
Gender	Religion	Burgher	Muslim	Sinhala	Tamil	Grand Total
Male	Buddhist			300		300
	Catholic	3		35	5	43
	Christian			10	2	12
	Hindu				5	5
	Islam		5			5
	Methodist			1		1
Male Total		3	5	346	12	366
Female	Anglican			2		2
	Buddhist			52		52
	Catholic	3		11	2	16
	Hindu				1	1
	Islam		1			1
Female Total		3	1	65	3	72
Grand Total		6	6	411	15	438

Excludes members of the Director Board.

Staff Selection and Recruitment

The Company has attracted individuals with suitable background who possess the right ingredients to fit into various challenging roles associated with the finance business, thus ensuring that the organisation operates efficiently and effectively. We have long been a preferred employer, attracting a wide and deep pool of skills and talent. Our employees possess the experience and qualifications that are required to successfully perform the tasks before them and to fit in perfectly with the close knit MI culture. As expected our employees have contributed immensely to our successes in the recent past.

To make it all happen, right from the beginning, our selection and recruitment process ensures that the most suited individuals are recruited through a diligent screening process, Our selection and recruitment process is well structured and coordinated to precision by the Human Resource division to ensure that we select the right candidate whilst avoiding any misgivings for either party.

The selection criteria is wide and involves the evaluation of the candidate's basic skills, knowledge, experience and qualifications, which are essential for the performance of their daily duties.

In addition, we carry out reference checks apart from assessing the individual's basic communication skills and personality and other traits essential for the role at hand. When recruiting, in certain instances, we have considered and given credence to cultural and psychological similarities that prevail among friends and have provided 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 candidates. However, we resort more to paper advertisements for recruitment which we consider to be an effective communication channel.

Selected applicants have to go through a rigorous interview process that involves screening done by the Head of the respective division.

Training and Development

We understand the importance of nurturing our workforce being a service oriented company. Our values in this regard reflect the phrase -

> *"The most important thing is the human being. You may have the best projects in the world, or the most sophisticated equipment but without good employees you have nothing"*
>
> ***Yashiki Yamasaki***

Human capital development has been of prime importance to us especially with the expanding workforce. To provide training needs, a number of training programs were made available to staff during the year under review. Continuing from 2012, new recruits were subjected to an induction programme covering various topics including standard human resource policies related to the organisation. Apart from this, employees attached to various departments were periodically subjected to training related to their routine work areas. Training was either carried out through in house programs or through external training sessions. We practice an ongoing system of training and development as a means of broad-basing the skills of our workforce. The main purpose is to assist them to perform their duties efficiently and to boost their knowledge to propel their careers.

MI's learning culture provides equal opportunity for all individuals so that related benefits will pass on to both the organisation and the individual. Senior officers of core divisions have been handpicked and sent for overseas training as a means of widening management skills and to groom them to face challenges and complexities associated with the finance business. We practice job rotation for specific tasks so that staff gradually become multi skilled. This strategy has already benefited the Company as staff are able to cope better and more efficiently with increasing operational demands during peak periods.

MI's unique learning culture has fostered creative ideas and practices from employees over the years. Fostering this form of open environment has set a platform for the birth of potential leaders within the workforce. Some of them have gone on to take up demanding roles within the organisation, even taking up positions on the Board - a clear testimony to their commitment and perseverance.

Staff Training

Training Conducted in-House on Anti-Money Laundering (Two-Hour Programme)

No. of Staff

Grade	2008/09	2009/10	2010/11	2011/12	2012/13
Managers and above	13	8	4	5	14
Executives/Assistants	19	17	21	21	52
Total	32	25	25	26	66

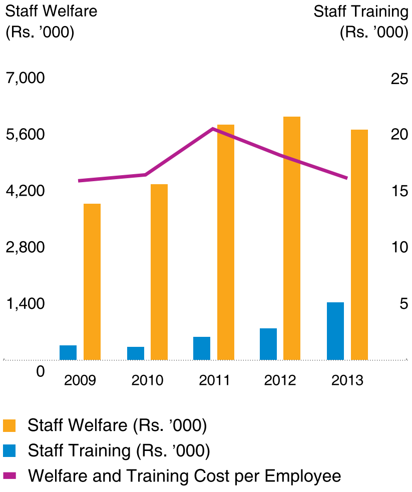
Service Excellence Programme Contents

- Excellence in customer care
- Business etiquette and personal grooming
- Personal/Career development
- Know your competition
- Group assignment
- Fellowship session

Training by Gender and Hours of Training

Field of Training	Gender		Total	Hours
	Male	Female	Participants	Training
Recoveries Skill-Building Training	15	3	18	4
Confidence-Building Training (Effective Communication)	1	0	1	4
Recoveries Training	35	0	35	8
HR - Managing Leave and Absenteeism at Work Place	1	0	1	8
Provisions of Law	4	1	5	8
Taxation	2	0	2	4
Banking Studies	2	2	4	16
IFRS for Banks	2	0	2	8
Accounting and Finance Management	0	1	1	16
Operational Risk Management	1	0	1	8
Valuation of Motor Vehicles	3	0	3	8
Operation Risk Management for Banks and Finance Institutes	1	0	1	8
Conference of CA Sri Lanka	2	0	2	8
Outward Bound Training	95	20	115	8
Valuation of Motor Vehicles	5	0	5	8
Regulatory Framework Relating to Non-bank Financial Institutions	4	1	5	14
Budget Seminar	2	0	2	4
Marketing Workshop	2	0	2	8
In house Training Programme - Anti-Money Laundering/CFT Regulations and Procedures/Deposits and Cashiering Procedures	50	16	66	4
Internal Controls and Auditing for Financial Institutions by CBS	1	0	1	14
Indispensable Assistant	0	1	1	8
Customer Care Training	37	8	45	4
Foundation Course in Marketing	21	0	21	30
Emotional Intelligence	7	0	7	4
Fraud Detection in Financial Institutions - CBS	1	0	1	7
Integrated Reporting - ACCA	2	0	2	7
Seminar by Colombo Law Society	0	2	2	3
Seminar on Enterprise Risk Management	1	0	1	2
Financial Intelligence for Banking and Financial Institutions	11	1	12	7
IT Auditing	3	0	3	14

Staff Cost on Welfare and Training



Training Participants by Grade and Gender

Grade	Gender		Total
	Male	Female	
Managers and Above	76	5	81
Executives/Assistants	235	51	286
Total	311	56	367

Work Environment, Health and Safety

The working environment that prevails encourages staff work independently and to be creative. This also encourages them to develop their own professional lives. The Company provides necessary resources to employees for them to efficiently perform their functions while keeping them motivated. Despite the notable rise in staff size in recent times, our organisational structure nevertheless remains simple, facilitating efficient communication and speedier decision making within divisions. In keeping with our people-centric culture, handling of staff grievances are not confined only to their work related concerns but reach out to personal and other distress areas.

During the year under review, changes were effected through re-organisation of work stations and floor design at our Head Office building. These changes helped facilitate the smooth flow of our operations as well as the timely dissemination of information amongst staff, whilst making the work environment more attractive. Similarly, when setting up branches, emphasis was laid on selecting premises that were spacious to provide a conducive atmosphere for our staff.

Necessary safety features are available in all Company premises to safeguard staff and customers alike. The recommendations made by the Colombo Fire Brigade during the previous year on fire safety measures were reviewed and plans are under way to provide training to staff at our Head Office, on evacuation procedures to be followed in the event of fire.

In terms of staff health benefits, during 2012 a revision was effected to the staff medical insurance scheme by increasing the medical insurance covers provided to staff and their families in respect of all in-patient medical costs.

Injuries or Fatalities/Lost Days/Absenteeism

No. of Head Office Staff	Fatalities (In No.)	Injuries (In No.)	Lost days (Based on average number of days per employee) during 2012/13	Absenteeism (in days) During 2012/13
226	Nil	Nil	4	65

Note: Report excludes Senior Managers and above and branch staff.

A System of Appraising Performance

Performance of employees is annually assessed through a structured approach covering key divisions. At the commencement of the year, staff are given specific individual targets based on departmental goals developed in line with the overall objectives of the Company. Divisional heads are required to monitor staff performance on an on-going basis so that any significant deviations could be identified and corrected in a timely manner.

At the end of the year, Heads of Divisions carry out a formal appraisal for each of their staff members for purpose of identifying the degree of attainment of pre-defined targets in consultation with the relevant employee. A comprehensive formal appraisal document has been tailor-made giving appropriate weightage for attainment of specified elements and goals. The appraisal process has been beneficial to the organisation as well as the staff member since the Company's annual employee reward system is directly correlated with their performance. Not only is the formal appraisal system used to decide annual increments it also provides insights as to the training needs of employees and serves as a basis for identifying promotional prospects.

The percentage of staff formally appraised from total workforce was 61.4% and should increase once this system is extended across all divisions.

Performance Appraisals Done in 2013

Division	No. of Staff Evaluated	No. of Staff Not Evaluated	% Appraised
Credit and Marketing	162	24	87.10
Deposits	4	10	28.57
Recoveries	48	18	72.73
Finance	20	5	80.00
Legal	10	2	83.33
HR	2	1	66.67
Workshop	0	25	0.00
Insurance	11	4	73.33
IT	8	1	88.89
Other	4	79	4.82
Total	**269**	**169**	**61.41**

** Excluding the Members of the Director Board.*

Fostering Corporate Values

We foster sound values as part of our corporate culture and encourage MI employees to practice such values in their daily work life. Apart from standard attributes of experience and qualifications, integrity is considered as one of the fundamental attributes a new recruit needs to possess, to be a part of the MI team.

At the initiation of our HR division, an 'Human Resource handbook' was released in 2012/13 period incorporating HR policies and procedures including employee Code of conduct. One of the main purposes of this was to bring these core values to the fore, which we consider essential in maintaining our unblemished reputation. The letter of appointment issued to recruits further reiterates the importance of abiding by the organisation's core values, especially on maintaining good conduct with integrity.

The importance of carrying out their duties with diligence and in adherence to the highest ethical standards has been conveyed to senior officers as well as others via a series of communiqués from senior management. In keeping with our human resource policies, violations of professional and personal ethics are viewed seriously and are dealt with strongly by management.

HR Handbook released in 2013

MI's Well-Knit Culture

Employee Benefits

The commitment shown by each member of the MI team is recognised each year by management. We reward employees based on their performance, responsibilities and the value that each member brings to the organisation. The remuneration package that is afforded to employees when joining is reviewed annually against the formal appraisals prepared for each staff member based on their job performance. Additionally, salary scales are compared against the market periodically to ensure our remuneration packages remain attractive at all times. The remuneration package of staff includes annual bonuses, health insurance and for higher grades, vehicle loans as additional perks. Apart from this, the Company recognises exceptional performances of staff, presenting them with awards for exceptional achievements such as longevity of service, best attendance and for winning Company-wide competitions held annually. In December 2012, special awards were handed out for winners of the cost reduction competition organised by the Cost Reduction Committee.

Similarly, apart from monetary benefits there are also several non-monetary benefits afforded to MI employees. Annual social events that are organised such as the MI get-together, MI sports day, other events including day outs, cultural events etc., enable the Company to foster close harmony among its staff members and to promote team building. Managers of the Company are also provided external gym facilities as part of MI's staff welfare programme affording them the opportunity to relax, unwind and maintain good physical health.

Being part of MI's well-knit corporate culture, staff could look forward to a long relationship with the Company and continue to aspire to reaching the pinnacle in their career, growing in success with the Company. We are proud of our unique friendly culture that has brought about a sense of togetherness among staff both in favourable as well as challenging times.

Equality in Job Opportunity and Remuneration

Equal opportunity is available for both males and females to join the organisation and to progress in their careers without bias and unfairness. Similarly, we do not show any gender bias when deciding on remuneration for our workforce. Our salary scales are based purely on formal assessment criteria.

Labour/Management Relations

We do not have collective bargaining agreements with our employees. Salary scale changes are at the discretion of the management. Material operational changes to staff's job functions are rare and if it were to happen are usually discussed with the relevant member. However, there is no minimum notice period specified for such changes and is at the Management's discretion.

Staff Retention

We are proud to observe that a considerable number of our staff members have stayed with Mercantile Investments for over five years and others even over a decade or more. In fact MI's staff turnover levels are at 7.9% and can be considered noteworthy being in a competitive environment with numerous job opportunities offered by other institutions. Effective human resource policies together with our unique work culture and most of all, Mercantile Investments proud history has motivated employees to remain with us.

Total Staff Turnover

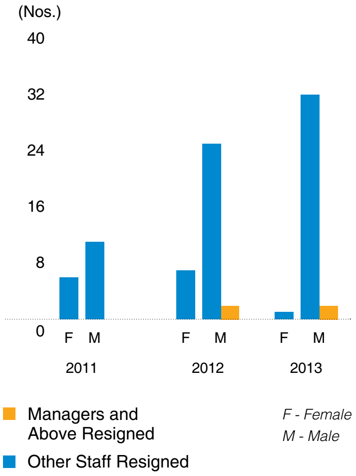
	2013 %	2012 %	2011 %
Staff Turnover as a % of Total Staff	8	9%	5%

	2013		2012		2011	
	Male	Female	Male	Female	Male	Female
Managers and Above Resigned	2	–	2	–	–	–
Other Staff Resigned	32	1	25	7	11	6
Total	34	1	27	7	11	6

Human Resource Initiatives undertaken in FY 2012/13 has been disclosed in page 54 in the Management Discussion and Analysis.

Total Staff Turnover

Staff Turnover Gender Wise



Events and Achievements in FY 2012/13

- MI emerged victorious winning the Mercantile Cricket ‘E’ division trophy in 2013

MI’s Winning Cricket Team 2013

Receiving Mercantile Cricket ‘E’ Division Trophy

It was a proud moment when the Company beat Dialog Axiata in the finals to emerge winners in the Mercantile ‘E’ division cricket tournament organised by the Mercantile Cricket Association for the year 2013. MI remained unbeaten right-throughout the tournament and excelled in all departments of the game.

Mr. Dinesh Seneviratne of MI was awarded Man of the Match for his performance with both bat and ball in the finals. It was also commendable to see MI’s Mr. Kavindu Ashan receiving the series Best Batsman award for his outstanding batting skills displayed during the tournament.

MI’s Annual Get-together at Waters Edge - December 2012

- MI Annual Get-Together
  MI annual staff get-together was held on 8 December 2012 at the Water’s Edge in grand style. MI get-togethers provide excellent opportunity for staff members to interact with fellow members of the MI team and mingle with their superiors more freely in an informal manner.

Societal Responsibility

Management Approach to Societal Responsibility

The interaction that MI has with local communities within which it operates is growing. This is because of the business expansion that has taken place of late, widening our ambit and increasing the interaction we have with various segments of society. In keeping with our vision and ideologies on social responsibility, we continue to identify needs of local communities and to assist them mainly through our core business of providing financial assistance. As a parallel move, we have established a CSR Committee that initiates various programmes in service to society that cover health, education, and other community-based projects annually.

Our organisation is devoted to ensuring sound corporate governance practices at all times and has set strong controls to ensure compliance to existing regulations that govern finance companies and other laws applicable to a corporate. These practices ensure prudent conduct of business whereby stakeholder interest is safeguarded eg - public monies invested with the Company.

MI's core business values clearly spell out the need to be fair competitors in the industry whilst ensuring that we do not denigrate other firms when doing business. We take a leading role in our sector, actively participating in associations such as The Finance Houses Association of Sri Lanka. Through the FHA member finance companies can join together to discuss common matters concerning the industry for its betterment.

Goals and Performance

Annually, within the approved CSR budget, the CSR Committee is expected to initiate programmes that are aimed at uplifting society. Prior to conclusion of the financial year, the Committee reviews its progress and if necessary initiates additional CSR initiatives in keeping with the overall CSR budget. The actual planned CSR programmes for the current year against actually initiated indicated a 70% successful completion rate with seven projects completed out of ten planned.

As part of training and development, training sessions are conducted for employees on Anti-Money Laundering procedures in house. As done for the last three consecutive years, this financial year a comprehensive training seminar was organised in-house and held at the Sri Lanka Insurance Institute with the participation of over sixty staff members.

Process of Engagement with Local Community/Social Groups

Importance Placed	Process of Engagement	Frequency	Matters Taken Up
The importance of being receptive to the needs of the local community and social groups has grown in the last decade. This applies to the Finance Company sector as well. MI has paid greater attention to social and environmental aspirations of society than before.	● Identification of social needs via meetings, social media and discussions.	Regular	● Understanding community needs ● Environmental aspects
	● Initiating CSR programmes for local community	Monthly to Annual	● Planning CSR campaigns ● Conveying CSR activities carried out
	● Initiating events and gatherings to convey Company offerings and opportunities	Ad hoc	● Financial assistance ● Employment opportunities available

Policy

Our policy in this regard is to create and sustain greater value to society from all possible fronts going that extra mile to serve various strata of society. By aspiring to serve society more, we hope to be a valued organisation among the local community, supporting them to fulfil their dreams and aspirations.

Organisational Responsibility

MI's Board provides leadership to corporate management and the CSR Committee to drive the organisation's social aspirations forward. The CSR Committee has been given the mandate to seek and fulfil social needs of society outside the sphere of MI's core business of financing. In parallel, the corporate management which heads core business divisions is responsible to promote MI's products and services to the localities that we currently operate in, to fulfil their wide ranging financial needs.

Training and Awareness

Currently our training and development programme do not cover specific training to raise awareness among staff in relation to societal aspects. Nevertheless, there is increased awareness among staff especially after the set-up of the CSR Committee to support community service by joining in on specific campaigns. Staff have given their fullest co-operation for example, when a blood donation campaign was organised last year. They also initiated a campaign to provide clothes and other essentials to Internally Displaced People of North and East.

Monitoring and Follow Up

A continuous review is carried out to assess financing needs of various segments of society covering different locations of the country. Adequate cost benefit studies are carried out prior to entering new localities so that we could gauge demand levels for financing to improve returns as well as to be of greater service to society.

Separately, we identify various needs of society other than their financing needs mainly collaborating with non-profit organisations that help the poor and needy. We also refer other sources that provide feedback on needs of society that are yet to be fulfilled especially in the area of poverty alleviation, education, and health related needs.

Key Performance Indicators Related to Societal Responsibility

Extending Financial Services Beyond the Western Province

Rapid expansion in our branch network within the last 2-3 years has enabled MI to extend its services and reach out to remote parts of the country. In keeping with our aspirations, our business has penetrated beyond the Western Province on a greater scale than before.

Outside Western Province	2009/10 Rs. million	2010/11 Rs. million	2011/12 Rs. million	2012/13 Rs. million
Lending Business	360	650	1,812	2,601
Deposit mobilisation	5	7	39	115
Branches/Service Centres	2	3	9	11

The Company has expanded its network considerably within the last two years and deployed significant number of staff members in branches that are scattered across the country in key regional hubs. In our pursuit of rapid business growth, we have been able to identify and fulfil varying financial needs of local communities in proximity to MI branches. Staying alert to their financial needs, we have already begun to cement lasting bonds between people in those localities.

Initiation of CSR Programmes

The CSR Committee was able to organise a number of programmes during the year in review, mainly aimed at providing assistance to the needy in the areas of education, health, accommodation, sanitation and other community projects. In addition, financial assistance was given to religious institutions and schools in the form of donations and other assistance for their special events and other needs.

CSR Programmes Done in FY 2012/13	Description of Organisation/ Project	Description of CSR Activities	Budgeted Cost Rs.	Actual Cost Rs.
Initiated by CSR Committee				
1. Sarvodaya - Street Children Programme 	This establishment provides education, vocational training and day-care services to street children. (November 2012)	MI assisted by donating the following items to improve educational facilities for children: ● Two lockable library cupboards ● Two open shelf library cupboards ● Fifteen small student chairs ● Staff donated over 100 books to the children's library		58,114
2. a. Home for the Elders - Borella 	This home currently houses senior citizens (male only) and provides for their daily needs. The establishment runs solely on the donations given by the community. (November 2012)	● Renovations to leaking roof and ceiling		36,618
	(February 2013)	● Donated appliances to improve living conditions: - 2 Gas Cookers - 4 Ceiling Fans - 2 Aluminum Pots - 1 Coconut Scraper		28,000
b. Mallika Niwasa Samithiya (Society) Ltd. 	This home currently houses senior citizens (female) and provides for their daily needs. (November 2012)	Two writing tables to replace old broken ones		25,605

CSR Programmes Done in FY 2012/13	Description of Organisation/ Project	Description of CSR Activities	Budgeted Cost Rs.	Actual Cost Rs.
3. Missionaries of Charity 'Prem Nivasa' 	The Missionaries provide shelter and care for orphans and other needy children. (December 2012)	Donated a 35 Ltr. Water Boiler Donated 25 towels and two fly catching units		29,730
4. National Cancer Institute Maharagama 	Leading Cancer Institute in the country that assist patients nation-wide	Donated medicines		99,850
5. Animal welfare project through Blue Paw Trust 	The Blue Paw Trust involves professional veterinary surgeons who carry out surgeries, vaccinations and other medical support for animals such as dogs and cats. (February 2013)	Through the 'Blue Paw Trust' MI extended its previous year programme, carrying out following on domestic animals: Vaccinations - 89 Surgeries - 21 Treatments - 10		91,147
6. Ceylon School for Deaf and Blind 	Institute for Deaf and Blind. (March 2013)	Almsgiving Food, stationary and toys		39,925
Total			500,000	408,989

CSR Programmes Done in FY 2012/13	Description of Organisation/ Project	Description of CSR Activities	Budgeted Cost Rs.	Actual Cost Rs.
Initiated Projects Outside CSR Committee				
7. Development of Parish Community Hall in St. Mary's Church, Bambalapitiya 	St. Mary's Church, Bambalapitiya has planned an ongoing project to construct a community hall for the parishioners. (April 2012)	Provided financial assistance	N/A	250,000
8. Sri Parakum Housing Project	An institute that supports lower income groups. (May 2012)	Donation to celebrate Esela Poya Day		25,000
9. Opening savings accounts for children at Keppetipola Maha Vidyalaya	To cultivate savings habit among schoolchildren we commenced opening savings accounts. (August 2012)	Opened savings accounts for two schoolchildren at Keppetipola Maha Vidyalaya		5,000
10. Donations to Schools/ Institutes	Individual development education school			28,000
	Lyceum International School			50,000
	St. Peter's College			50,000
	St Joseph's College			3,000
	Trinity College			10,000
	Royal College			9,000
	Royal-Thomian Stallions			5,000
	Musaeus College			9,500
	OLV Convent			5,000
	Nalanda College			5,000
	Sri Lanka Insurance Institute			13,000
	Dharmapala Vidyalaya			5,000
	Sri Lanka Institute of Credit Management			75,000

CSR Programmes Done in FY 2012/13	Description of Organisation/ Project	Description of CSR Activities	Budgeted Cost Rs.	Actual Cost Rs.
11. Donations to religious institutions	Church of the Good Shepherd			5,000
	Ruhunu Maha Kataragama Devala			10,000
	Archbishop of Colombo			20,000
	St. Michael's Church			5,000
	Shri Jinaratana Bhikku Abhyasa Vidyalaya			80,000
	Little Sisters of the Poor			25,000
12. Other Donations	Sri Lanka Army			10,000
	Samata Sarana			10,000
	CR and FC			10,000
	Donation to a by-pass patient			100,000
	Medical Students Welfare Society			4,000
	Sri Lanka Soccer Masters Association			5,000
	Catholic Society of Inland Revenue			25,000
	Taprobane Holdings PLC			10,000
Total				1,275,489

During this period, MI's total expenditure on community projects as a percentage of profit before tax stood at 0.17%.

Practices on Curbing Money Laundering

Through the newly recruited Manager - Compliance and Risk, the compliance function has been strengthened, especially to ensure procedures and practices relating to Anti-Money Laundering (AML) are correctly adopted by the Company in keeping with regulations. A policy document incorporating related regulations and practices on combating money laundering is available covering customer identification procedures, reporting requirements, record keeping and other important requirements for departments to adhere to. By keeping to these sound practices we can better prevent money laundering and other financial crime thus safeguarding society from resultant repercussions.

Incidents of Corruption

During the year 2012/13, there were no reported incidents of money laundering or any other corruption.

Public Policy Positions and Participation

No official of the Company holds public positions or participates in the development of public policy.

Contributions to Politicians and Political Parties

During this period, the Company has not made any form of contribution to politicians and political parties.

Being Fair Competitors in the Industry

The Company refrains from engaging in activities that are detrimental to fair play in business while our business practices have been aligned to follow accepted industry norms and ethics. We continue to maintain fellowship and interaction among our counterparts, participating in key Associations established for the sector including The Finance Houses Association and The Leasing Association of Sri Lanka.

Significant Fines and Sanctions

There were no significant fines or any sanctions imposed for breach of laws and regulations.

HUMAN RIGHTS RESPONSIBILITY

Our Approach to Human Rights

In conducting our business activities and handling of staff, we follow basic human rights elements, adopting related practices and policies. Even though, human rights aspects are not taken up as a separate subject, our business practices and processes including human resource policies have been designed in keeping with human rights values.

Human Rights Policy

The Management of the Company takes note of human rights requirements when making business decisions.
Our organisational policies do not undermine the need to sustain sound human rights practices within the organisation. Our human resource policies ensure that there is clear demarcation on age limit for all recruitments, maintain proper health and safety standards and ensure that we set a clear code of conduct for employees.

Handling Staff Grievances

Staff attached to the Human Resource Division are fully trained to handle employee concerns, particularly their grievances, either work related or personal. We hope to provide training to the management team on human resource handling and aspects related to human rights practices in the near future.

Investments and Procurement Practices

As a practice, we do not discriminate against any individual based on their gender, religion or race and expect parties that transact with us also to uphold similar values. However, since our dealings with suppliers are limited, our contracts with them do not specify these human rights elements and also the Company does not subject them to screening on aspects related to human rights currently.

Non-Discrimination

There were no incidents of discrimination formally reported within the Company from any MI employee during this period.

Child Labour and Forced and Compulsory Labour

Our recruitment process is strictly conducted based on prevailing labour laws that require strict compliance to the minimum age limit for employment, that being 18 years. No individual is subject to forced labour or have been engaged against their free will.

Security Practices

MI’s security operations have been outsourced. The assigned security staff allocated to MI are trained officers in relation to the handling of security aspects of the organisations. Nevertheless, they have not obtained separate training on human rights aspects as part of their training at the moment.

Indigenous Rights

Even though Mercantile Investment’s operations have expanded to new regions including areas considered rural, the Company’s operation has no direct impact on indigenous people. There were no incidents of violations by the Company involving rights of indigenous people during this reporting period.

Assessment on Human Rights

During this period, no part of MI’s operation was subject to human rights reviews, impact studies or assessments.

Remediation

No grievances related to human rights were reported to our Human Resources Department through our formal grievance reporting channels in this period.

PRODUCT RESPONSIBILITY

Our Approach to Product Responsibility

As a finance company, our product range caters primarily to financing requirements and deposit placing needs of customers. As a result, our offerings do not pose any material direct health and safety issues to customers. Nevertheless, to ensure that we maintain product and service delivery standards, we expect our staff to comply with the organisation’s set operational standards at all times. These procedures have been designed in line with best industry practices. Our practices ensure that the products and services that are marketed are fair in competition and have been developed with due care. Our activities on marketing communication are carried out with integrity and honesty, in a socially acceptable manner. We uphold customer confidentiality for all our transactions and have allocated considerable resources to safeguard related information through the development of sophisticated information technology systems.

Process of Engagement with Regulatory Bodies

As Finance Company business involves deposit taking, the sector is subject to rigorous regulatory review and this calls for us to have a process of engagement with regulatory bodies.

Importance Placed	Process of Engagement	Frequency	Matters Taken Up
Since the economic downturn and drawbacks seen in our sector in the last half a decade, regulatory bodies play a significant role in overseeing and laying down requirements for finance companies.	● Discussions, correspondence, submission of returns and status report	Regular	● Conveying actual position against regulations to identify level of compliance
	● Meetings/Workshops with regulatory bodies	Monthly to Annual	● Providing information to ascertain soundness of operations
	● Submission of special reports	Ad hoc	● Conveying rules and guidance

Policy on Product Responsibility

In keeping with our corporate values, we take due care to ensure that our products and services stay competitive, adding optimal value to our customers. We expect our employees to maintain laid down standards in operations, execution and delivery while remaining a fair player in the sector without denigrating other firms.

Goals and Performance

Based on market perception and customer preference the Company continues to be innovative adding new products and services to our existing, annually. We have extended our lending products, tailoring lease, hire purchase and term facilities to meet specific requirements of borrowers. Our step-up and structured financing facilities were introduced keeping this in mind. In keeping to our strategic plan, core business divisions are expected to strive towards maintaining growth levels above 20%. This requires taking initiative in the area of new product development and product extension as an ongoing strategy to seek constant growth.

Marketing Communications

When placing advertisements to promote our products range, we follow regulations specified by the Central Bank of Sri Lanka on media advertising especially seeking their concurrence whenever it is applicable. In effectively promoting our products, we resort to the use of the following marketing communication methods deemed effective for our lines of business:

Organisational Responsibility

The area of product responsibility comes under the purview of the Heads of Divisions for lending and deposits separately under overall guidance of the Managing Director. The staff who come under the two Heads of Divisions are expected to ensure that product related requirements and standards are adhered to at all times. This includes strict adherence to operational manuals that specify matters relating to product development, product marketing and communication, record keeping and monitoring.

Training and Awareness

Front line staff attached to both lending and deposit divisions are given training in relation to products and service deliverables they handle including basic processes that need to be followed to maintain product responsibility. Training is used as a means of conveying product features, operational procedures to front line staff and also to improve their service standards and communication skills.

Monitoring and Follow-Up

Periodically, we keep strategic focus on all our core products, to ascertain their success levels. We monitor progress of each of our lending and deposit products on a weekly basis making comparisons with their past performance levels. These meetings set the platform for respective managers to post their concerns and to iron-out drawbacks. We were able to obtain considerable mileage from our advertising and promotion campaigns carried out this year considering the higher advertising expenditure incurred in the period.

Product Responsibility Performance Indicators

Customer Health and Safety

The business of providing financial services does not bring direct health and safety hazards to our customers. However, standard physical safety measures are in place to protect customers at our premises island-wide. MI Head Office located at Kollupitiya in the heart of Colombo has standard safety features to adequately cover emergency situations. We have entrusted the review of security practices to our Security Co-ordinating Officer who ensures standard security procedures are in place. He is responsible to ensure that all individuals within our premises abide by organisational rules on security at all times.

Product and Service Labelling

For branding purposes, most of MI's products carry the standard logo of Mercantile Investments. For the execution of a lending transaction or to complete a deposit transaction, we have developed industry compliant standard documentation including lending agreements and deposit certificates setting out clear terms and conditions for transacting parties.

Customer Privacy

Being a financial institution that possesses a substantial customer portfolio and thus holds considerable levels of customer information, strong emphasis has been placed on maintaining customer privacy through information security policies. Keeping customer information confidential without divulgence to external sources and away from intruders has been a vital necessity when deciding on information technology solutions in recent years. For this purpose, we have inbuilt system security features as part of MI's core information system. These measures include passwords for users, automatic backing-up of data and virus protection. To protect the database, our core system is supported by state-of-the-art fire walls together with various security policies to establish user authentication prior to granting access.

Compliance to Product Responsibility Aspects

During this period, there were no significant fines against the Company for non-compliance with laws and regulations concerning the provision and use of products and services including aspects related to product information and labelling. Similarly, there have not been any incidents of non-compliance with regulations concerning health and safety impacts of our products and services.

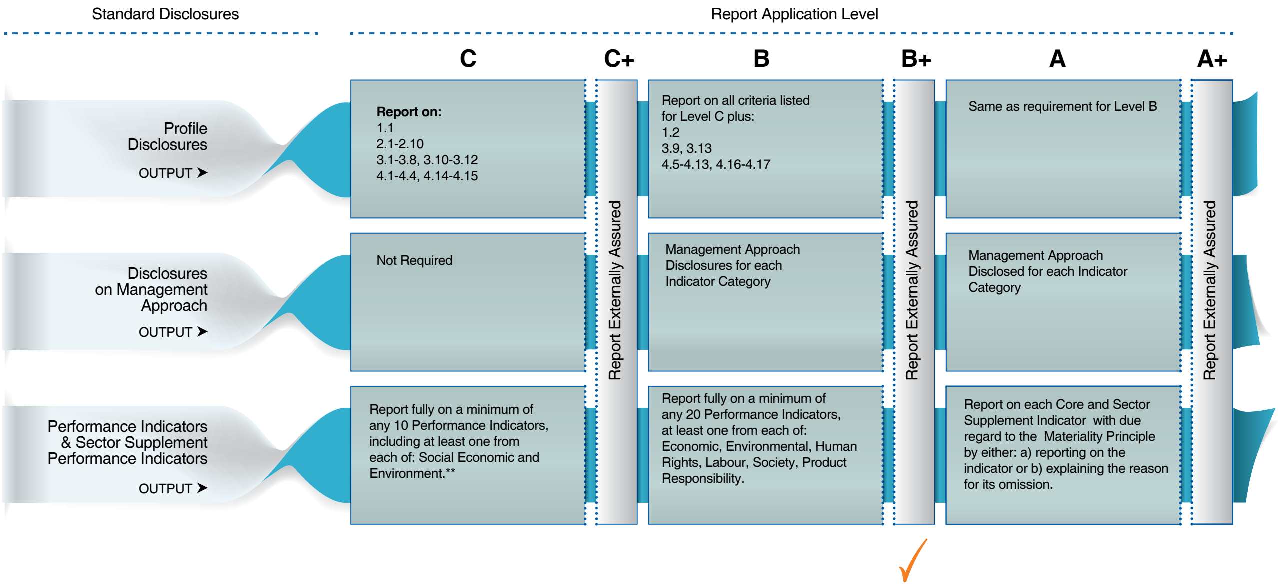
There have not been any reported incidents of non-compliance with regulations concerning marketing communications. Further, there have not been any breaches of customer privacy during this period.

Key Sustainability Performance Indicators

Section	Key Sustainability Performance Indicators	Page Numbers in Annual Report
Economic Dimension	Economic Value Added	222
	Sources and Utilisation of Income	222
	Value Added Statement	222
	Wage Rates	228
	Local Hiring	228
	Number of Branches Opened - 03	
	Number of Service Centres Opened - 02	
	New Products Launched/Product Extensions - 03	
	Number of Direct Written Customer Complaints - 03	
	Investor Performance Indicators	221
Environmental Dimension	Recycling of Consumables	229 to 230
	Stationary and Consumable Costs Trend	230
	Electricity Consumption	231
	Fuel Consumption	231
	Water Consumption	231
Societal Dimension	Total Staff by Grade, Gender, Service and Age	234 & 235
	Staff Distribution by Province Gender-Wise	236
	Staff Ethnicity Gender-wise	237
	Staff Religion Gender-wise	237
	Training Hours/Training Costs and Welfare Costs	239
	Staff Turnover/New Recruitments	242/235
	Staff Injuries or Fatalities/Lost Days/Absenteeism	240
	Human Rights Violations - None	
	Business Volume Outside Western Province	245
	Community Projects Initiated	246 to 249
	Training Hours on Anti-Money Laundering	238
	Donations to Schools, Religious Institutions and Other	248 & 249
	Product Responsibility Violations Significant Fines - None	

The Global Reporting Initiative Grading and Index

Our Sustainability Report 2012/13, has been prepared using GRI framework's G3.1 version. Accordingly, in keeping with the framework's application level, assessment guidelines and considering the in-depth level of disclosure made, we have self-assessed our report to be application level 'B'. The application level has been reviewed independently by Cecil Arsecularatne, Chartered Accountants and therefore our overall report has been given a 'B+'.



Standard Disclosures	Report Application Level					
	C	C+	B	B+	A	A+
Profile Disclosures OUTPUT ➤	**Report on:** 1.1 2.1-2.10 3.1-3.8, 3.10-3.12 4.1-4.4, 4.14-4.15	Report Externally Assured	Report on all criteria listed for Level C plus: 1.2 3.9, 3.13 4.5-4.13, 4.16-4.17	Report Externally Assured	Same as requirement for Level B	Report Externally Assured
Disclosures on Management Approach OUTPUT ➤	Not Required		Management Approach Disclosures for each Indicator Category		Management Approach Disclosed for each Indicator Category	
Performance Indicators & Sector Supplement Performance Indicators OUTPUT ➤	Report fully on a minimum of any 10 Performance Indicators, including at least one from each of: Social Economic and Environment.**		Report fully on a minimum of any 20 Performance Indicators, at least one from each of: Economic, Environmental, Human Rights, Labour, Society, Product Responsibility.		Report on each Core and Sector Supplement Indicator with due regard to the Materiality Principle by either: a) reporting on the indicator or b) explaining the reason for its omission.	
				✓		

The ensuing pages provide the GRI Content Index with reference to key sustainability topics and aspects including related performance indicators under core sustainability categories - economic, environment and society. Cross reference has been made between the sustainability report and other statements appearing in the Annual Report as applicable to the relevant aspect or topic.

No.	Description	Disclosure	Page No./s
PROFILE			
1. Strategy and Analysis			
1.1	Statement from the Managing Director	● Sustainability Report	198
1.2	Description of key impacts, risks and opportunities	● Sustainability Report	212 to 214
2. Organisational Profile			
2.1	Name of Reporting Organisation	Mercantile Investments and Finance PLC	
2.2	Primary brands, products and services	● Sustainability Report	203
2.3	Operational structure of the organisation	● Corporate governance - organisation structure There are no subsidiary companies coming under MI's control for purpose of reporting.	105
2.4	Location of organisations headquarters	236, Galle Road, Colombo 3, Sri Lanka	
2.5	Number and names of countries with operations	Operations carried out entirely in Sri Lanka	
2.6	Nature of ownership and legal form	● Sustainability Report ● Corporate Information Page	203 IBC
2.7	Markets served	● Sustainability Report ● Management discussion and analysis	203 46 & 51
2.8	Scale of the reporting organisation	● Sustainability Report ● Summary of financials. ● Decade at a glance	205 4 355
2.9	Significant changes during the reporting period	No significant changes to size, structure or ownership from last year	
2.10	Awards received	● Sustainability Report	206 & 243
3. Report Parameters			
Report Profile			
3.1	Reporting period	1 April 2012 to 31 March 2013	
3.2	Date of most recent previous report	31 March 2012	
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	199
3.6	Boundary of report	Defining boundary of report	202
3.7	Limitations to scope	No material limitation	
3.8	Basis for reporting subsidiaries, joint ventures etc.	Not applicable	
3.9	Data measurement techniques	GRI and Company specific performance indicators have been adopted using data available	
3.10	Restatements	In accordance with Sri Lanka Financial Reporting Standards (SLFRS/LKAS) requirements, prior year figures given in Financial Statements have been changed from previous SLAS based reporting to SLFRS/LKAS reporting from this period. Hence, wherever material changes have been affected to financial information given in the Sustainability Report, we have mentioned this changeover below respective table/graph.	
3.11	Significant changes	None, other than the adoption of IFRS for financial reporting commencing from this period	205
3.12	GRI content index	Detail cross references given in GRI table	255 to 262
3.13	External assurance	External assurance obtained	263
4. Governance, Commitments and Engagement			
4.1	Governance structure	● Corporate Governance Report ● Sustainability Report	105 211
4.2	Chair of the highest governance body	● Sustainability Report ● Corporate Governance Report	215 105
4.3	Highest governance body	● Corporate Governance Report	105
4.4	Mechanism for employees/shareholders to provide recommendations/direction to the Board	● Sustainability Report	216
4.5	Compensation and performance	● Sustainability Report	216
4.6	Process for avoiding conflict of interest	● Corporate Governance Report	150
4.7	Expertise of governance body	● Board Composition	96 & 97
4.8	Mission and value statements	● Annual Report - Vision, Mission and Values	38 & 39
4.9	Procedures of the highest governance body for overseeing sustainability	● Sustainability Report	215
4.10	Process of evaluating the highest governance body's own performance	● An evaluation was carried out on Boards own performance by each Director this period	215
4.11	Precautionary approach	● Sustainability Report	216

No.	Description	Disclosure	Page No./s
4.12	Externally developed initiatives	None	
4.13	Membership in associations	● Sustainability Report	216
4.14	List of stakeholder groups	● Sustainability Report	201
4.15	Identification and selection of stakeholders	● Sustainability Report	218 to 252
4.16	Approaches to stakeholder engagement	● Sustainability Report	218 to 252
4.17	Key issues and concerns of stakeholders	● Sustainability Report	218 to 252
ECONOMIC			
5.	**Economic Dimension**		
	Management approach	● Sustainability Report	219
5.1	**Economic Performance**		
EC1	Economic value generated and distributed	● Sustainability Report ● Economic Value added ● Value Added Statement ● Sources and Utilisation of Income	221 to 222 222 222 222
EC2	Financial implications of climate change	● Sustainability Report	222
EC3	Organisation’s defined benefit pension plan	● Sustainability Report	228
EC4	Financial assistance from Government	None for this period	222
5.2	**Market Presence**		
EC5	Entry-level wage - local minimum wage by gender	● Sustainability Report	228
EC6	Policy, practices and proportion of spending on locally based suppliers	● Sustainability Report	227
EC7	Hiring of employees	● Sustainability Report	228
EC8	Development and impact of infrastructure investments	Not reported	
EC9	Indirect economic impacts	● Sustainability Report	221

No.	Description	Disclosure	Page No./s
ENVIRONMENTAL			
6. Environmental Dimension			
	Management approach	● Sustainability Report	229
6.1 a Materials			
EN1	Materials used by weight or volume	● Sustainability Report	229 & 230
EN2	Percentage of materials used that are recycled input materials	● Sustainability Report	229 & 230
6.1. b Energy			
EN3	Direct energy consumption by primary energy source	● We do not use energy as direct input for our operations being a service oriented organisation. We use energy for day-to-day running of the Company.	
EN4	Indirect energy consumption by primary source	● Sustainability Report	230 & 231
EN5	Energy saved due to conservation and efficiency improvements	● Sustainability Report	230 & 231
EN6	Initiatives to provide energy-efficiency improvements	● Sustainability Report	230 to 232
EN7	Initiatives to reduce indirect energy consumption and reductions achieved	● Sustainability Report	230 & 231
6.2 Water			
EN8	Total water withdrawal by source	● Sustainability Report	231
6.3 Biodiversity			
EN13	Habitats protected	● Sustainability Report	231
	Sections EN 9-EN 12, EN 14-EN 15 & EN16-EN17, EN19-EN25, EN27	Not relevant for ‘B’ level reporting	
6.4 Emissions, Effluents and Waste			
EN18	Initiatives to reduce emissions and reductions achieved	● Sustainability Report	230
6.5 Products and Services			
EN26	Initiatives to mitigate environmental impacts of products and services, and extent of impact mitigation	● Sustainability Report	230 to 232

No.	Description	Disclosure	Page No./s
6.6 Compliance			
EN28	Monetary value of significant fines and total number of non-monetary sanctions for non-compliance with environmental laws and regulations	● Sustainability Report	232
6.7 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	● Sustainability Report	231
6.8	**Overall**		
EN30	Total environmental protection expenditures and investments by type	● Sustainability Report Related cost information will be reported next period	231
SOCIAL - LABOUR			
7. Labour Practices and Decent Work			
	Management approach	● Sustainability Report	232
7.1 Employment			
LA1	Breakdown of total workforce	● Sustainability Report	234
LA2	Total number of new employees and employee turnover	● Sustainability Report	235 & 242
LA3	Benefits provided to full-time employees	● Sustainability Report	241
7.2 Labour/Management Relations			
LA4	Collective bargaining agreements	● Sustainability Report	242
LA5	Notice period regarding operational changes	● Sustainability Report	242
7.3 Occupational Health and Safety			
LA6	Management-worker health and safety committees	● Sustainability Report	240
LA7	Rates of injury, lost days, absenteeism and fatalities	● Sustainability Report	240
LA8	Educating staff on serious communicable diseases	Not Covered this Period	
LA9	Health and safety in union agreements	Not applicable	

No.	Description	Disclosure	Page No./s
7.4 Training and Education			
LA10	Hours of training	● Sustainability Report	239
LA11	Programmes for skills management and life-long learning	● Sustainability Report	238 & 239
LA12	Regular performance reviews by gender	● Sustainability Report	240
7.5 Diversity and Equal Opportunity			
LA13	Employees according to diversity	● Sustainability Report	237
LA14	Basic salary of men and women	● Sustainability Report	228
	Aspect: Employment		
LA15	Return to work and retention rates after parental leave, by gender	Not covered during this period	
8. Human Rights Dimension			
	Management approach	● Sustainability Report	250
8.1 Investment and Procurement Practices			
HR1	Investments with HR clauses and HR screening	● Sustainability Report	250
HR2	Suppliers that underwent HR screening	● Sustainability Report	250
HR3	Employees training on human rights	● Sustainability Report	250
8.2 Non-Discrimination			
HR4	Incidents of discrimination	● Sustainability Report	250
8.3 Freedom of Association (FOA) and Collective Bargaining			
HR5	Operations an significant suppliers identified in which FOA and collective bargaining may be violated	Not applicable	
8.4 Child Labour			
HR6	Child labour	● Sustainability Report	250
8.5 Forced and Compulsory Labour			
HR7	Forced or compulsory labour	● Sustainability Report	250
8.6 Security Practices			
HR8	Security personnel trained in human rights	● Sustainability Report	250
8.7 Indigenous Rights			
HR9	Rights of indigenous people	● Sustainability Report	250

No.	Description	Disclosure	Page No./s
8.8 Assessment			
HR10	Percentage and total number of operations that have been subject to human rights reviews	● Sustainability Report	250
8.9 Remediation			
HR11	Number of grievances related to human rights filed, addressed and resolved	● Sustainability Report	250
9. Society Dimension			
	Management approach	● Sustainability Report	244
9.1 Local Communities			
SO1	Percentage of operations with implemented local community engagement, impact assessments and development programmes	● Sustainability Report	244 to 249
9.2 Corruption			
SO2	Analysis of risk related to corruption	● Sustainability Report	249
SO3	Training in anti-corruption	● Sustainability Report	238
SO4	Instances of corruption	● Sustainability Report	249
9.3 Public Policy			
SO5	Public policy development and lobbying	● Sustainability Report	249
SO6	Contributions to political parties or related institutions	● Sustainability Report	249
9.4 Anti-Competitive Behaviour			
SO7	Legal actions for anti-competitive, anti-trust and monopoly practices	● Sustainability Report	249
9.5 Compliance			
SO8	Monetary value of significant fines	● Sustainability Report	249
	Aspect Local Communities		
SO9	Operations with negative impacts on local communities	No direct material operational impacts to report	
SO10	Preventive measures implemented in operations with negative impacts on local communities	Not applicable as no direct material operational impacts	

No.	Description	Disclosure	Page No./s
PRODUCT RESPONSIBILITY			
10.	**Product Responsibility Dimension**		
	Management approach	● Sustainability Report	250 & 251
10.1	**Customer Health and Safety**		
PR1	Life cycle stages in which health and safety impacts are assessed	● Sustainability Report	252
PR2	Non-compliance with regulations/codes	● Sustainability Report	252
10.2	**Product and Service Labelling**		
PR3	Information required by procedures	● Sustainability Report	252
PR4	Non-compliance concerning labelling	● Sustainability Report	252
PR5	Customer satisfaction	● Sustainability Report	251 & 252
10.3	**Marketing Communications**		
PR6	Adherence to laws, standards and codes	● Sustainability Report	251 & 252
PR7	Non-compliance concerning marketing	● Sustainability Report	252
10.4	**Customer Privacy**		
PR8	Complaints on breach of customer privacy	● Sustainability Report	252
10.5	**Compliance**		
PR9	Non-compliance with laws/regulations	● Sustainability Report	252

INDEPENDENT ASSURANCE REPORT

CECIL ARSECULERATNE & COMPANY
CHARTERED ACCOUNTANTS
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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 2013 ("Report") for the year ended 31 March 2013.

- Reasonable assurance on the data on financial performance, as reported on page 253 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 and 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 253 of the Report involves verification that they were properly derived from the audited financial statements of the company for the year ended 31 March 2013 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 253 of the Report 2012/13 are properly derived from the financial statements of the Company for the year ended 31 March 2013 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.

Chartered Accountants
21st May 2013
Colombo

INCLUSIVE GROWTH FLOWS, TRANSPARENTLY

The results that stack ever higher with each passing year in our financial charts, speak eloquently and clearly of our growth.

>>

FINANCIAL REPORTS 2012/13

2012/13 Financial Calendar

1st Interim Dividend for 2012/13 paid on 28 September 2012
2nd Interim Dividend for 2012/13 paid on 8 March 2013
Annual Report and Accounts for 2012/13 signed on 21 May 2013
50th Annual General Meeting to be held on 28 June 2013

Proposed Financial Calendar - 2013/14
1st Interim Dividend for 2013/14 to be paid in September 2013
2nd Interim Dividend for 2013/14 to be paid in March 2014
Annual Report and Accounts for 2013/14 to be signed on 20 May 2014
51st Annual General Meeting to be held on 27 June 2014

CONTENTS >

Financial Reports

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 practices.

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 2013 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 21 May 2013.

Section 168 of the Companies Act No. 07 of the 2007, requires the following information to be published in the Annual Report, Prepared for the for the year under review (i.e., for the year ended 31 March 2013).

2. Review of Business

2.1 Vision, Mission and Corporate Conduct

The Company's Vision and Mission are given on page 2 of this Annual Report. The business activities of the Company are conducted maintaining 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 Reviews, Managing Director's Review on pages 8 to 19 and Management Discussion and Analysis on pages 21 to 93 of this Annual Report.

2.2.1 Principal Activities of the Company

The principal business 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 282 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 & fair view of the state of its affairs. The Directors are of the view that Statement of Comprehensive income, Statement of Financial Position, Statement of Changes in Equity, Cash Flow Statement, Significant Accounting Policies & Notes thereto appearing on pages 282 to 347 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 No. 42 of 2011 and the listing rules of the Colombo Stock Exchange. The Statement of 'Directors Responsibilities' appearing on page 276 of this Annual Report forms an integral part of this report.

2.5 Auditors' Report

Company's Auditors, Messrs Cecil Arsecularatne & Co. performed the audit on the Financial Statements for the year ended 31 March 2013 and the Auditor's Report on the Financial Statements is given on page 281 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 Company prepared their Financial Statements for all periods up to and including the year ended 31 March 2012, in accordance with Sri Lanka Accounting Standards which were in effect up to that date. Following the convergence of Sri Lanka Accounting Standards with the International Financial Reporting Standards (IFRSs), all existing/new Sri Lanka Accounting Standards were prefixed as SLFRs and LKAS to represent Sri Lanka Accounting Standards corresponding to International Financial Reporting Standards and Sri Lanka Accounting Standards corresponding to International Accounting Standards (IASs), respectively. Accordingly, the company adopted these new Sri Lanka Accounting Standards (Which are known as SLFRSs) applicable for Financial periods commencing from 01 January 2012. These Financial Statements for the year ended 31 March 2013 are the first Financial Statements of the Company prepared in accordance with SLFRS and Sri Lanka Accounting Standards - SLFRS 1 on 'First-time Adoption of Sri Lanka Accounting Standards'. The Significant Accounting Policies adopted in the preparation of Financial Statements of the company are given on pages 288 to 299 of the Annual Report.

2.7 Interest Register

The Interests Register is maintained by the Company, as per the Companies Act No. 07 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 disclosed on page 270 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 Interests 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 2013 is given in Note 46.3 to the Financial Statements on page 321 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. 1.360 million (2012 - Rs. 1.4 million). The donations made to the Government approved charities from the above amounted to Rs. Nil (2012 - 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 pages 12 to 19 of this Annual Report.

3. Gross Income

The income of the Company for the year ended 31 March 2013 was Rs. 3,334 million (year ended 31 March 2012 - Rs. 2,362 million). An analysis of the income is given in Note 7 to the Financial Statements on page 300 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 2013 was Rs. 732 million (Rs. 625 million in 2012) and the profit after tax for the year ended 2013 was Rs. 635 million (Rs. 610 million in 2012).

4.2 Dividend on Ordinary Shares

The following interim dividend was declared and paid for the financial year ended 31 March 2013 (Rs. 22/- per share 2012):

Dividend	Rate of Payment
1st Interim	Rs. 13.50 per share
2nd Interim	Rs. 14/- per share

4.3 Provision for Taxation

Income tax for 2013 has been provided at 28% (28% - 2012) 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% (12% - 2012).

The Company has also provided deferred tax on all known temporary differences under the liability method, as permitted by the Sri Lanka Accounting Standard - LKAS 12 on 'Income Taxes'.

Information on Income Tax Expenses and Deferred Taxes is given in Notes 14 and 34 to the Financial Statements on pages 301 and 308 respectively, of this Annual Report.

4.4 Reserves

The Company's total Reserves as at 31 March 2013 amounted to Rs. 5,689 million (2012 - Rs. 5,275 million). The movement of the reserves are given on

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

As at 31 March	2013 Rs. '000	2012 Rs. '000
Profit before Tax	732,069	625,755
Taxation	(101,278)	(15,667)
Profit after Tax	630,791	610,088
Balance brought forward	292,243	140,239
Available for Appropriation	923,034	750,327
Transfer to Statutory Reserve	(50,000)	(30,000)
Transfer to General Reserve	(735,000)	(320,000)
Transfer to Investment Fund	(48,755)	(41,951)
Interim Dividend Paid	(82,655)	(66,132)
Balance Carried forward	10,176	292,243

page 285 under Statement of Changes in Equity and Notes 37 to 42 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	2013 Rs. million	2012 Rs. million
Property, Plant & Equipment	60	101
Leasehold Property	Nil	Nil
Intangible Assets	5.3	0.2

Details of which are given in Notes 28 to 30 on pages 312 to 316 in the Financial Statements. Capital expenditure approved and contracted for is given in Note 43 to the Financial Statements on page 321 of this Annual Report.

6. Market Value of Freehold Properties

All freehold land and buildings 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 Note 28.2 to the Financial Statements on page 314.

7. Stated Capital

The stated capital of the Company as at 31 March 2013 was Rs. 36 million comprising 3,006,000 ordinary shares. (2012 - Rs. 36 million). The details of the stated capital is given in Note 36 to the Financial Statements on page 320 of this Annual Report.

8. Share Information

Details of share-related information are given on pages 351 to 354 of this Annual Report and information relating to earnings, dividends and net assets per share is given in the Financial Highlights on page 4 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 2013	2012
Number of shares issued	Nil	Nil

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

9. Substantial Shareholdings

The list of Twenty Largest Shareholders as at 31 March 2013 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. Ondaatjie	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 2013 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 94 to 97 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 2013, 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. S.H.J. Weerasuriya	Non-Executive	Independent
Mr. G.G. Ondaatjie	Executive	Non-Independent
Miss A.M. Ondaatjie	Executive	Non-Independent
Mr. T.J. Ondaatjie	Executive	Non-Independent
Mr. S.H. Jayasuriya	Executive	Non-Independent
Mr. P.M. Amarasekara	Executive	Non-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

10.1.2 New Appointments & Resignations

There were no new appointments during the financial year.

Resignation/Cessations

There were no resignations/cessations during the financial year.

10.1.3 Recommendation for Re-election

In terms of Section 23 (7) of the articles of association, Mr. S.H. Jayasuriya, Mr. H.A.S.T. Senanayake and Mr. S.H.J. Weerasuriya retired by rotation and being eligible offer themselves for re-election.

10.1.4 Board Sub-committees

Information with regard to Board sub-committees is given under the Corporate Governance on pages 103 to 163 of this Annual Report.

11. Disclosures of Directors Dealing in Shares

11.1 Directors' Interest in Ordinary Shares of the Company

Mr. G.G. Ondaatjie	477,213
Ms. A.M. Ondaatjie	477,213
Mr. T.J. Ondaatjie	477,213
Mr. S.H. Jayasuriya	Nil
Mr. P.M. Amarasekara	Nil
Mr. S.H.J. Weerasuriya	Nil
Mr. H.A.S.T. Senanayake	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. G.G. Ondaatjie serves as Managing Director.

11.1.2 The number of ordinary shares held by the public as at 31 March 2013 was 326,802 (2012 - 326,802) which amounted to 10.87% (2012 - 10.87%) 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 2013. Further information is given on pages 272 to 275 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 47 to the Financial Statements on page 322 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

According to the guideline issued by the monetary board of the Central Bank of Sri Lanka under Section 30(2) of the Finance Business Act No. 42 of 2011, Company required to appoint an external auditor from the panel of external auditors listed in the said guideline. Therefore present auditors Messrs Cecil Arsecularatne & Company will be retiring as auditors of the Company.

Messrs BDO Partners have agreed to function as Auditors to the Company.

A resolution to appoint BDO Partners as Auditors and granting authority to the Directors to fix their remuneration will be proposed at the forthcoming 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 2012) as audit fees by the Company. Apart from that the Company has not engaged external auditors for any other permitted non-audit services.

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 place to identify, evaluate and manage both business risk and financial risk are detailed on pages 167 to 195 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 'Audit Committee Report' on page 280 of this Annual Report.

19.3 Audit Committee

The composition of the Audit Committee and their Report is given on page 280 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 103 to 163 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 Human Capital Report on pages 197 to 262 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 358 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 Ondaatje

A.M. Ondaatjie
Director

S Pethiyagoda

Ms. Sonali Pethiyagoda
Company Secretary

Colombo
21 May 2013

DIRECTORS' INTERESTS IN CONTRACTS WITH THE COMPANY

Related Party Disclosures as required by the Sri Lanka Accounting Standard LKAS 24 on Related Party Disclosures is detailed in Note 46 to the Financial Statement on Pages 321 to 322 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 31.03.2013 Rs. '000	Balance Outstanding as at 31.03.2012 Rs. '000	Balance Outstanding as at 31.03.2011 Rs. '000
(a)	**Mr. G.G. Ondaatjie**					
	Mercantile Fortunes (Pvt) Limited	Managing Director	Deposits	–	–	–
			Loan	–	–	23,484
			Motor vehicle hire & repairs	102	2,776	3,794
	Tangerine Beach Hotels PLC	Director	Deposits	55,933	52,539	10,000
			Loan	20,708	25,009	29,829
			Motor vehicle hire & repairs	–	2,814	2,734
	Royal Palms Beach Hotels PLC	Director	Deposits	70,097	98,652	87,884
			Loan	10,025	12,376	13,848
			Motor vehicle hire & repairs	–	649	875
	Nuwara Eliya Hotels Company PLC	Managing Director	Deposits	66,326	–	–
			Loan	–	–	858
			Motor vehicle hire & repairs	26	872	–
	Tangerine Tours (Pvt) Limited	Director	Deposits	20,000	54,060	58,417
			Loan	–	–	1,629
			Motor vehicle hire & repairs	–	2,132	–
	Nilaweli Beach Hotels (Pvt) Limited	Ex. Deputy Chairman	Deposits	141,488	136,895	143,769
			Loan	22,615	30,969	37,691
			Motor vehicle hire & repairs	–	322	415
	Security Ceylon (Pvt) Limited	Director	Deposits	3,212	–	–
			Loan	–	–	109
			Motor vehicle hire & repairs	–	111	–
	Mercantile Orient (Pvt) Limited	Director	Deposits	4,050	3,653	3,349
			Loan	–	–	–
			Motor vehicle hire & repairs	–	250	–
	Global Films Limited	Director	Deposits	1,119	1,066	1,021
			Loan	–	–	–
			Motor vehicle hire & repairs	–	–	–
	Grand Hotels (Pvt) Limited	Managing Director	Deposits	12,432	102,315	83,431
			Loan	–	–	102
			Motor vehicle hire & repairs	–	102	–

Company	Relationship	Accommodation Granted/ Deposits or Services Rendered	Balance Outstanding as at 31.03.2013 Rs. '000	Balance Outstanding as at 31.03.2012 Rs. '000	Balance Outstanding as at 31.03.2011 Rs. '000
Fair View Hotel (Pvt) Limited	Managing Director	Deposits	2,500	30,429	–
		Loan	–	–	–
		Motor vehicle hire & repairs	–	17	–
(b) Ms. A.M. Ondaatjie					
Mercantile Fortunes (Pvt) Limited	Director	Deposits	–	–	–
		Loan	–	–	23,484
		Motor vehicle hire & repairs	102	2,776	3,794
Tangerine Beach Hotels PLC	Director	Deposits	55,933	52,539	10,000
		Loan	20,708	25,009	29,829
		Motor vehicle hire & repairs	–	2,814	2,734
Royal Palms Beach Hotels PLC	Director	Deposits	70,097	98,652	87,884
		Loan	10,025	12,376	13,848
		Motor vehicle hire & repairs	–	649	875
Nuwara Eliya Hotels Company PLC	Director	Deposits	66,326	–	–
		Loan	–	–	858
		Motor vehicle hire & repairs	26	872	–
Tangerine Tours Limited	Director	Deposits	20,000	54,060	58,417
		Loan	–	–	1,629
		Motor vehicle hire & repairs	–	2,132	–
Nilaweli Beach Hotels Limited	Director	Deposits	141,488	136,895	143,769
		Loan	22,615	30,969	37,691
		Motor vehicle hire & repairs	–	322	415
Security Ceylon (Pvt) Limited	Director	Deposits	3,212	–	–
		Loan	–	–	109
		Motor vehicle hire & repairs	–	111	–
Mercantile Orient (Pvt) Limited	Director	Deposits	4,050	3,653	3,349
		Loan	–	–	–
		Motor vehicle hire & repairs	–	250	–
Global Films Limited	Director	Deposits	1,119	1,066	1,021
		Loan	–	–	–
		Motor vehicle hire & repairs	–	–	–
Grand Hotels (Pvt) Limited	Director	Deposits	12,432	102,315	83,431
		Loan	–	–	102
		Motor vehicle hire & repairs	–	102	–

Company	Relationship	Accommodation Granted/ Deposits or Services Rendered	Balance Outstanding as at 31.03.2013 Rs. '000	Balance Outstanding as at 31.03.2012 Rs. '000	Balance Outstanding as at 31.03.2011 Rs. '000
Fair View Hotel (Pvt) Limited	Managing Director	Deposits	2,500	30,429	–
		Loan	–	–	–
		Motor vehicle hire & repairs	–	17	–
(c) Mr. T.J. Ondaatjie					
Mercantile Fortunes (Pvt) Limited	Director	Deposits	–	–	–
		Loan	–	–	23,484
		Motor vehicle hire & repairs	102	2,776	3,794
Tangerine Beach Hotels PLC	Director	Deposits	55,933	52,539	10,000
		Loan	20,078	25,009	29,829
		Motor vehicle hire & repairs	–	2,814	2,734
Royal Palms Beach Hotels PLC	Director	Deposits	70,097	98,652	87,884
		Loan	10,025	12,376	13,848
		Motor vehicle hire & repairs	–	649	875
Nuwara Eliya Hotels Company PLC	Director	Deposits	66,326	–	–
		Loan	–	–	858
		Motor vehicle hire & repairs	26	872	–
Tangerine Tours Limited	Director	Deposits	20,000	54,060	58,417
		Loan		–	1,629
		Motor vehicle hire & repairs	–	2,132	–
Nilaweli Beach Hotels (Pvt) Limited	Director	Deposits	141,488	136,895	143,769
		Loan	22,615	30,969	37,691
		Motor vehicle hire & repairs	–	322	415
Security Ceylon (Pvt) Limited	Director	Deposits	3,212	–	–
		Loan	–	–	109
		Motor vehicle hire & repairs	–	111	–
Mercantile Orient (Pvt) Limited	Director	Deposits	4,050	3,653	3,349
		Loan	–	–	–
		Motor vehicle hire & repairs	–	250	–
Global Films Limited	Director	Deposits	1,119	1,066	1,021
		Loan	–	–	–
		Motor vehicle hire & repairs	–	–	–

	Company	Relationship	Accommodation Granted/ Deposits or Services Rendered	Balance Outstanding as at 31.03.2013 Rs. '000	Balance Outstanding as at 31.03.2012 Rs. '000	Balance Outstanding as at 31.03.2011 Rs. '000
	Grand Hotels (Pvt) Limited	Director	Deposits	12,932	102,315	83,431
			Loan	–	–	102
			Motor vehicle hire & repairs	–	102	–
	Fair View Hotel (Pvt) Limited	Managing Director	Deposits	2,500	30,429	–
			Loan	–	–	–
			Motor vehicle hire & repairs	–	17	–
(d)	**Mr. S.H. Jayasuriya**					
	Mercantile Fortunes (Pvt) Limited	Director	Deposits	–	–	–
			Loan	–	–	23,484
			Motor vehicle hire & repairs	102	2,776	3,794
	Security Ceylon (Pvt) Limited	Director	Deposits	3,212	–	–
			Loan	–	–	–
			Motor vehicle hire & repairs	–	111	109
(e)	**Mr. P.M. Amarasekara**					
	Security Ceylon (Pvt) Limited	Director	Deposits	3,212	–	–
			Loan	–	–	–
			Motor vehicle hire & repairs	–	111	–
(f)	**Mr. N.H.V. Perera**					
	Tangerine Beach Hotels PLC	Director	Deposits	55,933	52,539	–
			Loan	20,708	25,009	–
			Motor vehicle hire & repairs	–	2,814	–
	Royal Palms Beach Hotels PLC	Director	Deposits	70,097	98,652	–
			Loan	10,029	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 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 280 of this Report. The Financial Statements for the financial year 2013 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 282 to 347 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 281 of this Report.

By Order of the Board,

SPethiyagoda

Mercantile Investments and Finance PLC
Sonali Pethiyagoda
Company Secretary

21 May 2013

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:

Name of Director	Directorship Status
Mr. N.H.V. Perera	*Non-Executive Director and Chairman of the Committee*
Mr. Gerard G. Ondaatjie	*Managing Director*
Mr. S.H. Jayasuriya	*Executive Director*
Mr. P.M. Amarasekara	*Executive Director*

Integrated Risk Management Committee (IRMC)

The IRMC was established by the Board of Directors, in keeping 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 conforms to the provisions of Section 8.3.b of the aforesaid Direction.

The Committee held four meetings for the year under review. The attendance of each member at meetings is illustrated in the table given on page 160 of the Annual Report.

Duties and Responsibilities of the Committee

Based on the Board approved 'Terms and Reference' and 'Risk Policy' developed in 2012/13, following are the key responsibilities of the Integrated Risk Management Committee.

a. Establish a method of overseeing the overall risk management procedures of the Company. Set the tone and influence the culture of risk management within MI.

   This includes:
   - Communicating MI's approach to risk
   - Determining what types of risk are acceptable and which are not
   - Setting the standards and expectations of staff with respect to conduct and integrity.

b. Determine the appropriate risk appetite or level of exposure for MI.

c. Approve major decisions affecting MI's risk profile or exposure.

d. Identify risks and monitor the management of fundamental risks to reduce the likelihood of unwelcome surprises.

e. Satisfy itself that the less fundamental risks are being actively managed, with the appropriate controls in place and working effectively.

f. Periodically review MI's approach to risk management and approve changes or improvements to key elements of its processes and procedures.

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 Chairman appointed in 2012 is a Non-Executive Director of the Board.

During this financial period, the Committee activities revolved around the following broad 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.
- Recruited a Manager - Risk and Compliance to monitor and review the risk and compliance aspects of the Company.
- 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.
- Introduction of a 'Risk Register' to gather potential risk of departmental level and to map out counter mechanisms in place to ascertain adequacy of controls and for future reference.
- Introduced a compliance check list for Branches to ensure they adhere to regulations and internal control procedures of the Company.
- Submitted a quarterly 'Activity Report' to the Board from 2013 to update Directors on key risk related matters and to convey recommendations made by the Committee.
- Ongoing follow up on implementation status of proposed strategies related to the Business Continuity Plan of the Company.
- Reviewed compliance status of MI to prevailing laws and regulations with specific focus on CBSL requirements.

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

21 May 2013

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
Mr. S.H.J. Weerasuriya (Chairman of the Committee)	Chairman (Independent Non-Executive Director)
Mr. H.A.S.T. Senanayake	Independent Non-Executive Director
Mr. N.H.V. Perera	Non-Executive Director

Committee's 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 during 2012/13 with attendance status of members is given on page 159 in the Annual Report.

Mr. Saroja Weerasuriya
Chairman
Remuneration Committee

21 May 2013

NOMINATION COMMITTEE REPORT

Composition of the Nomination Committee

The Nomination committee comprise of the following Directors of MI:

Name of Director	Directorship Status
Mr. S.H.J Weerasuriya (Chairman of the Committee)	Chairman (Independent Non-Executive Director)
Mr. Gerard G. Ondaatjie	Managing Director
Mr. N.H.V. Perera	Non-Executive Director
Mr. S.M.S.S. Bandara	Independent Non-Executive Director

Objectives of the Committee

The Nomination Committee was established in 2013 in order to strengthen the Director appointment process specifically focusing on -

I. Identifying individuals qualified to serve as Board members, consistent with criteria approved by the Board.

II. Recommending to the Board the Director nominees for election or appointment after ascertaining the necessity of additional Directors.

Committee Duties, Responsibilities and Process

I. Conduct continuing study of the size, structure and composition of the Board and periodically recommend to the Board whether to increase the number of Directors, or whether to decrease the number of Directors.

II. Seek out possible candidates to fill Board positions, and aid in attracting qualified candidates to the Board.

III. Evaluate nominees for Director submitted by any shareholder of the Company.

IV. Recommend to the Board, prior to the solicitation of proxies, an account of qualified candidates for election to the Board at each meeting of shareholders of the Company at which Directors are to be elected and, in the case of a vacancy on the Board, a candidate to fill that vacancy.

V. Evaluate the performance of incumbent Directors upon the expiration of their terms.

VI. Prepare evaluation forms for all Board members and all members of Board committees and, at least annually, receive comments from all members of the Board and report to the Board with an assessment of the Board's performance.

VII. Oversee the orientation and training of new Directors.

VIII. Recommend ways in which the Board could improve its performance.

Meeting Information

Number of committee meetings held during 2012/13 with attendance status of members is given on page 161 in the Annual Report.

Mr. Saroja Weerasuriya
Chairman
Nomination Committee

21 May 2013

AUDIT COMMITTEE REPORT

The Board of Directors has established the Audit Committee in accordance with Best Practices on Audit Committees. The Audit Committee comprises of 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 and External 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 four meetings during the financial year 2012/13 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.
6. The Audit Committee, through its initiation set up, the Company's own Internal Audit Division this period, apart from outsourcing part of the Internal Audit function to Messrs Ernst and Young Advisory Services (Pvt) Limited.

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 BDO Partners be appointed as Auditors for the year ending 31 March 2014, 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

21 May 2013

INDEPENDENT AUDITOR'S REPORT

CECIL ARSECULERATNE & COMPANY
CHARTERED ACCOUNTANTS
No. 3, Dr. Lester James Peiris Mawatha, Colombo 05, Sri Lanka.
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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 Statement of Financial Position as at 31 March 2013, and the Statement of Comprehensive Income, 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 31 March 2013 and the financial statements give a true and fair view of the Financial Position of the Company as at 31 March 2013 and of its Financial Performance and its cash flow 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
21st May 2013

INCOME STATEMENTS

For the year ended 31st March	Note	2013 Rs. '000	2012 Rs. '000
Gross Income	7	3,338,044	2,362,026
Interest income	7.1	3,055,684	1,627,742
Interest expenses	8	(1,867,700)	(1,009,874)
Net Interest Income		1,187,985	617,868
Fee and commission income		45,936	31,968
Net Fee and Commission Income		45,936	31,968
Other Operating Income	9	236,423	702,316
Total Operating Income		1,470,345	1,352,152
Impairment (gain)/loss for loans and receivables	10	32,277	14,687
Net Operating Income		1,438,067	1,337,465
Operating Expenses			
Personnel expenses	11	(273,413)	(219,811)
Depreciation of property and equipment		(46,858)	(41,223)
Amortisation of Intangible assets		(3,550)	(3,919)
Amortisation of leasehold property		(468)	(468)
Defined benefit plans		(18,391)	(29,697)
Other operating expenses	12	(384,792)	(333,604)
Total Operating Expenses		(727,472)	(628,722)
Operating profit /(loss) before value added tax on financial services		710,595	708,743
Value added tax on financial services		(73,985)	(125,657)
Operating profit /(loss) after value added tax on financial services		636,610	583,086
Add: Share of associate company's profit	13	95,459	42,669
Profit before taxation from operations		732,069	625,755
Taxation	14	(101,278)	(15,667)
Profit for the year		630,791	610,088
Earnings per share			
Basic earnings per share (Rs.)	15	209.84	202.96
Diluted earnings per share (Rs.)	15	209.84	202.96
Dividend per share ordinary share (Rs.)	16	27.50	22.00

The significant accounting policies and the notes from pages 288 to 347 form and integral part of these Financial Statements.

STATEMENT OF COMPREHENSIVE INCOME

For the year ended 31st March	2013 Rs. '000	2012 Rs. '000
Profit for the Year	630,791	610,088
Other Comprehensive Income		
Revaluation of land and buildings	–	312,789
Deferred tax effect on revaluations surplus on Land and Buildings	(14,875)	(11,058)
Changes in fair value of available-for-sale financial assets	(301,090)	(1,695,517)
Add/(less): Share of other comprehensive income of associates	(409)	31,358
Other Comprehensive Income	(316,374)	(1,362,428)
Total Comprehensive Income for the Year	314,417	(752,340)

STATEMENT OF FINANCIAL POSITION

	Note	As at 31 March 2013 Rs. '000	As at 31 March 2012 Rs. '000	As at 1 April 2011 Rs. '000
Assets	17			
Cash and cash equivalents	18	632,238	229,822	118,654
Placements with bank	19	364,330	118,000	43,425
Financial investments - available-for-sale	20	3,467,280	3,829,777	5,139,414
Loans and receivables	21	4,017,478	2,183,130	687,171
Finance leases receivables	22	4,072,783	3,888,783	2,171,979
Hire purchase receivables	23	5,754,386	4,374,601	3,557,026
Other financial assets	24	172,148	79,801	28,387
Inventories	25	221,220	340,244	24,780
Other assets	26	240,987	321,726	218,075
Investment in associates	27	695,670	628,397	493,555
Property, plant & equipment	28	1,535,731	1,565,620	1,214,750
Leasehold property	29	44,013	44,481	44,950
Intangible assets	30	4,681	2,855	6,521
Total assets		21,222,944	17,607,237	13,748,687
Liabilities	17			
Bank overdraft		999,036	505,815	397,246
Deposits due to customers	31	8,424,720	6,137,897	4,297,801
Debt instruments issued and other borrowings	32	5,232,331	4,638,644	2,318,481
Other financial liabilities	33	551,874	513,478	182,173
Current tax liabilities		81,322	34,931	39,142
Deferred tax liabilities	34	93,817	139,852	139,695
Other liabilities		17,097	60,828	7,389
Retirement benefit obligations	35	116,390	101,186	73,682
Total Liabilities		15,516,586	12,132,631	7,455,609
Shareholders' Funds				
Stated capital	36	36,000	36,000	36,000
Revaluation reserve	37	1,291,958	1,310,804	977,714
Statutory reserve fund	38	471,400	421,400	391,400
General reserves	39	3,586,430	2,851,430	2,531,430
Investment fund reserve	40	90,706	41,951	–
Available-for-sale reserve	41	219,688	520,778	2,216,295
Retained earnings	42	10,176	292,243	140,239
Total Shareholders' Funds		5,706,358	5,474,606	6,293,078
Total Liabilities and Shareholders' Funds		21,222,944	17,607,237	13,748,687
Net Assets Per Share (Rs.)		1,898.32	1,821.23	2,093.51

The Significant Accounting Policies and the Notes from pages 288 to 347 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 2013 and its profit for the year ended 31 March 2013.

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,

Gerard G. Ondaatjie
Managing Director

Angeline Ondaatje
Angeline M. Ondaatjie
Director

Colombo
21 May 2013

STATEMENT OF CHANGES IN EQUITY

		Revaluation Reserves							
	Issued Capital	Land & Buildings	Associate Company Reserve	Statutory Reserves	General Reserves	Investments Fund	Available for sale Reserve	Retained Earnings	Total
	Rs. '000	Rs. '000	Rs. '000	Rs. '000	Rs. '000	Rs. '000	Rs. '000	Rs. '000	Rs. '000
As at 1 April 2011	36,000	619,628	358,086	391,400	2,531,430	–	831,416	4,340	4,772,300
Effect of transitional provisions	–	–	–	–	–	–	–	–	–
Impairment adjustments to opening retained earnings	–	–	–	–	–	–	–	126,020	126,020
Deposits Investments EIR adjustments to Opening retained earnings	–	–	–	–	–	–	–	(15)	(15)
Borrowings EIR adjustments to opening retained earnings	–	–	–	–	–	–	–	9,894	9,894
Changes in fair value in AFS investments	–	–	–	–	–	–	1,384,879	–	1,384,879
Adjusted SLFRS balance as at 1 April 2011	–	–	–	–	–	–	–	–	–
	36,000	**619,628**	**358,086**	**391,400**	**2,531,430**		**2,216,295**	**140,239**	**6,293,078**
Total comprehensive Income for the Year									
Profit for the period	–	–	–	–	–	–	–	610,088	610,088
Other comprehensive income	–	301,732	31,358	–	–	–	(1,695,517)	–	(1,362,427)
Total comprehensive income	–	301,732	31,358	–	–	–	(1,695,517)	610,088	(752,339)
Dividends to equity owners	–	–	–	–	–	–	–	(66,133)	(66,133)
Transfer	–	–	–	30,000	320,000	41,951	–	(391,951)	–
As at 1 April 2012	**36,000**	**921,360**	**389,444**	**421,400**	**2,851,430**	**41,951**	**520,778**	**292,243**	**5,474,606**
Total comprehensive Income for the year									
Profit for the period	–	–	–	–	–	–	–	630,791	630,791
Other comprehensive income	–	(14,875)	(409)	–	–	–	(301,090)	–	(316,374)
Total comprehensive income	–	(14,875)	(409)	–	–	–	(301,090)	630,791	314,417
Dividends to equity owners	–	–	–	–	–	–	–	(82,665)	(82,665)
Transfer of realised gain on disposal of revalued building	–	(3,562)	–	–	–	–	–	3,562	–
Transfer	–	–	–	50,000	735,000	48,755	–	(833,755)	–
At 31 March 2013	**36,000**	**902,923**	**389,035**	**471,400**	**3,586,430**	**90,706**	**219,688**	**10,176**	**5,706,358**

The Significant Accounting Policies and the Notes from pages 288 to 347 form and integral part of these Financial Statements.

CASH FLOW STATEMENTS

For the year ended 31 March	2013 Rs. '000	2012 Rs. '000
Cash Flow from Operating Activities		
Interest and commission receipts	3,101,621	1,627,742
Interest payments	(1,867,700)	(1,009,874)
Cash receipts from customers	13,488	51,129
Cash payments to employees and suppliers	(732,352)	(679,072)
Operating profit before changes in operating assets and liabilities (Note A)	515,057	10,075
(Increase)/decrease in operating assets		
Deposits held for regulatory or monetary control purposes	(246,330)	(153,820)
Funds advanced to customers	(3,429,787)	(4,059,239)
Other short-term negotiable securities	493,221	108,569
Other receivables	(44,153)	(470,529)
Other payables	(5,332)	384,744
Increase/(Decrease) in operating liabilities		
Deposits from customers	2,286,823	1,840,096
	(430,501)	(2,340,104)
Income taxes paid	(6,186)	(84,879)
Net cash from operating activities	(436,687)	(2,424,983)
Cash Flows from Investing Activities		
Dividends received	102,895	71,610
Proceeds from sale of non-dealing securities	229,123	968,754
Purchase of non-dealing securities	–	(677,158)
Proceeds from sale of property, plant & equipment	61,845	20,835
Purchase of property, plant & equipment	(60,405)	(101,668)
Acquisition of intangible assets	(5,376)	(253)
Net cash from investing activities	328,082	282,120
Cash Flows from Financing Activities		
Net increase/(decrease) in borrowings	593,686	2,320,163
Dividends paid	(82,665)	(66,132)
Net cash from financing activities	511,021	2,254,031
Net increase in cash and cash equivalents	402,416	111,168
Cash and cash equivalents at beginning of period	229,822	118,654
Cash and cash equivalents at end of period (Note B)	632,238	229,822

For the year ended 31 March	2013 Rs. '000	2012 Rs. '000
A. Reconciliation of Profit before Tax with Cash Inflow from Operating Activities		
Profit before tax	732,069	625,755
Profit on sale of investments	(123,179)	(590,916)
Dividend from investing securities	(102,895)	(71,610)
Share of profit of associates	(95,459)	(42,669)
(Profit)/loss on sale of property, plant & equipment	6,100	1,529
Depreciation	46,858	41,223
Amortisation of leasehold property	468	468
Amortisation of intangible assets	3,550	3,919
Provision for bad and doubtful debts	32,277	14,687
Retirement benefit provision	18,391	29,697
Retirement benefit paid	(2,962)	(2,008)
	515,057	10,075
B. Cash and Cash Equivalents at the end of period		
Cash in hand	610,797	197,452
Balance with banks	21,441	32,370
	632,238	229,822

The Significant Accounting Policies and the Notes from pages 288 to 347 form and integral part of these Financial Statements.

SIGNIFICANT ACCOUNTING POLICIES

1. Reporting Entity

1.1 Corporate Information

Mercantile Investments and Finance PLC is a public limited liability company, listed on the Colombo Stock Exchange incorporated on 15 June 1964 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 31 was 443 (387 as at 31 March 2012).

1.2 Principal Activities and Nature of Operations

Company

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

Associates

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

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

1.3 Parent Enterprise and Ultimate Parent Enterprise

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

2. Basis of Preparation

2.1 Statement of Compliance

The Financial Statements of the Company have been prepared in accordance with Sri Lanka Accounting Standards comprising SLFRS and LKAS (hereafter "SLFRS"), as issued by Institute of Chartered Accountants of Sri Lanka and in compliance with the requirements of the Companies Act No. 07 of 2007 and Finance Business Act No. 42 of 2011, provide appropriate disclosure as required by Listing Rules of the Colombo Stock Exchange. These Sri Lanka Accounting Standards are available at www.casrilanka.com.

For all periods up to and including the year ended 31 March 2012, the Company prepared its financial statements in accordance with SLASs effective up to 31 March 2012. These financial statements for the year ended 31 March 2013 are the first the Company has prepared in accordance with SLASs (SLFRS and LKAS) effective for the periods beginning on or after 01 January 2012. (Refer Note 51) for explanation of the transition).

Subject to certain transition elections and exceptions disclosed in Note 51 the Company has consistently applied the accounting policies used in preparation of its opening SLFRS statement of financial position at 01 April 2011 through all periods presented, as if these policies had always been in effect.

Note 51 discloses the impact of the transition to SLFRS on the Company's reported financial position and cash flows, including the nature and effect of significant changes in accounting policies from those used in the Company's financial statements for the year ended 31 March 2012 prepared under SLASs.

2.2 Responsibility for Financial Statement

The Board of Directors is responsible for the preparation and presentation of the Financial Statement of the Company as per the provision of the companies Act No. 07 of 2007 and the new Sri Lanka Accounting Standard.

The Board of Directors acknowledges this responsibility as set out in the 'Annual Report of the Board of Directors', 'Statement of Directors Responsibility' and in the statement following the Statement of Financial Position on pages 267, 276 and 284 respectively.

These Financial Statements includes the following component-

- Statement of Comprehensive Income providing the information on the financial performance of the Company for the year under review (refer page 282).
- Statement of Financial Position providing the information on the financial position of the Company as at year end (refer page 284).
- A statement of Changes in Equity depicting all changes in shareholders' equity during the year under review (refer page 285).
- Statement of Cash flows providing the information on the users on the ability of the Company to generate cash & cash equivalents and the needs to utilisation of those cash flow (refer page 286).
- Notes to the Financial Statement comprising Accounting Policies used and other Notes (Refer pages 288 to 299).

2.3 Date of Authorisation for Issue

The Financial Statements of Mercantile Investments and Finance PLC for the year ended 31 March 2013 (including comparatives) were approved and authorised for issue by the Board of Directors passed on 21 May 2013.

2.4 Basis of Measurement

The Financial Statements have been prepared on a historical cost basis, except for available-for-sale financial assets & Land and Building that have been measured at fair value.

2.5 Functional Currency & Presentation Currency

The Financial Statements are presented in Sri Lankan Rupees except when otherwise indicated.

2.6 Presentation of Financial Statements

The assets and liabilities of the Company presents in its Statement of Financial Position are grouped by nature and listed in an order that reflects their relative liquidity and maturity pattern. No adjustments have been made for inflationary factors affecting the Financial Statements. Maturity Analysis is presented in Note 50 on page 324.

Financial assets and financial liabilities are offset and the net amount reported in the statement of financial position only when there is a legally enforceable right to offset the recognised amount and there is an intention to settle on a net basis, or to realise the assets and settle the liability simultaneously .Income and expenses are not offset in the statement of comprehensive income unless required to permitted by an Accounting Standards or interpretation, and as specific disclosed in the Accounting Policies of the Company.

2.7 Materiality and Aggregation

Each material class of similar items is presented separately in the Financial Statements .Items of dissimilar nature or function are presented separately unless they are immaterial as permitted by Sri Lanka Accounting Standards LKAS 1 ‘Presentation of Financial Statements’.

2.8 Rounding

The amounts in the Financial Statements have been rounded-off to the nearest Rupees thousands, except where otherwise indicated as permitted by the Sri Lanka Accounting Standards LKAS 1 ‘Presentation of Financial Statements.

2.9 Offsetting

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

2.10 Significant Accounting Judgments, Estimates and Assumptions

The preparation of the Company’s financial statements requires management to make judgments, estimates and assumptions that affect the reported amounts of revenues, expenses, assets and liabilities, and the accompanying disclosures, and the disclosure of contingent liabilities. Uncertainty about these assumptions and estimates could result in outcomes that require a material adjustment to the carrying amount of the asset or liability affected in future periods. The most significant areas of estimation, uncertainty and critical judgments in applying accounting policies that have most significant effect on the amounts recognised in the Financial Statements of the Company are as follows:

2.10.1 Going Concern

The Company’s management has made an assessment of its ability to continue as a going concern and is satisfied that it has the resources to continue in business for the foreseeable future. Furthermore, management is not aware of any material uncertainties that may cast significant doubt upon the Company’s ability to continue as a going concern. Therefore, the Financial Statements continue to be prepared on the going concern basis.

2.10.2 Fair value of financial instruments

When the fair value of financial assets and financial liabilities recorded in the statement of financial position cannot be derived from active markets, their fair value is determined using valuation techniques including the discounted cash flow model. The inputs to these models are taken from observable markets where possible, but where this is not feasible, a degree of judgment is required in establishing fair values. The judgments include considerations of inputs such as liquidity risk, credit risk and volatility. Changes in assumptions about these factors could affect the reported fair value of financial instruments. The valuation of financial instruments is described in more detail in the Note 52 on page 331.

2.10.3 Impairment Losses on Loans and Advances

The Company reviews its individually significant loans and advances at each statement-of-financial-position date to assess whether an impairment loss should be recorded in the income statement. In particular, management’s judgment is required in the estimation of the amount and timing of future cash flows when determining the impairment loss. These estimates are based on assumptions about a number of factors and actual results may differ, resulting in future changes to the allowance.

Loans and advances that have been assessed individually and found not to be impaired and all individually insignificant loans and advances are then assessed collectively, in groups of assets with similar risk characteristics, to determine whether provision should be made due to incurred loss events for which there is objective evidence, but the effects of which are not yet evident.

The collective assessment takes account of data from the loan portfolio (such as levels of arrears, credit utilisation, loan-to-collateral ratios, etc.), and judgments on the effect of concentrations of risks and economic data (including levels of unemployment, real estate prices indices, country risk and the performance of different individual groups).The impairment loss on loans and advances is disclosed in more detail in Notes 21, 22 and 23.

2.10.4 Impairment of Available-for-Sale Investments

The Company reviews its debt securities classified as available-for-sale investments at each reporting date to assess whether they are impaired. This requires similar judgment as applied to the individual assessment of loans and advances.

Company also records impairment charges on available for sale equity investments when there has been a significant or prolonged decline in the fair value below their cost. The determination of what is ‘significant’ or ‘prolonged’ requires judgement. In making this judgment, the Company evaluates, among other factors, historical share price movements and duration and extent to which the fair value of an investment is less than its cost.

2.10.5 Impairment of Non-Financial Assets

Impairment exists when the carrying value of an asset or cash generating unit exceeds its recoverable amount, which is the higher of its fair value less costs to sell and its value in use. The fair value less costs to sell calculation is based on available data from binding sales transactions, conducted at arm observable market prices less incremental costs for disposing of the asset. The value in use calculation is based on a discounted cash flow model. The cash flows are derived from the budget for the next five years and do not include restructuring activities that the Company is not yet committed to or significant future investments that will Enhance the asset discount rate used for the discounted cash flow model as well as the expected future cash-inflows and the growth rate used for extrapolation purposes.

2.10.6 Deferred Tax Assets

Deferred tax assets are recognised for unused tax losses to the extent that it is probable that taxable profit will be available against which the losses can be utilised. Significant management judgment is required to determine the amount of deferred tax assets that can be recognised, based upon the likely timing and the level of future taxable profits together with future tax planning strategies.

2.10.7 Defined Benefit Obligations

The cost of defined benefit plans are determined using actuarial valuations. An actuarial valuation involves making various assumptions which may differ from actual developments in the future. These include the determination of the discount rate, future salary increases, mortality rates and future pension increases. Due to the complexity of the valuation and long-term nature, a defined benefit obligation is subject to significant uncertainty.

Significant Accounting Policies

Accounting Policies set out below have been applied consistently to all periods presented in the Financial Statements of the Company in preparing the opening SLFRS Statement of Financial Position at 01 April 2011 for the purpose of the transition to SLFRSs, unless otherwise indicated.

The Accounting policies have been applied consistently by the Company.

3. Significant Accounting Policies - Statement of Financial Position

3.1 Investment in an Associate

A company investment in associates is accounted by using the equity method in terms of the Sri Lanka Accounting Standard - LKAS 28 on “Investments in Associates”. An associate is an entity in which the Company has significant influence. Significant Influence is presumed to exist when the Company holds between 20% and 50% of the voting power of another entity.

Under the equity method, the investment is initially recognised at cost. The carrying amount of the investment is adjusted to recognise changes in the Company's share of net assets of associate since acquisition date.

Goodwill relating to the associate is included in the carrying amount of the investment and is neither amortised nor individually tested for impairment.

The income statement reflects the Company's share of results of operations of the associate. When there has been a change recognised directly in the equity of the associate, the Company recognises its share of any changes, when applicable, in the statement of changes in equity. Unrealised gains and losses resulting from transactions between the Group and the associate are eliminated to the extent of the interest in the associate.

The Company’s share of the profit or loss of an associate is shown on the face of the income statement and represents profit or loss after tax and non-controlling interests in the subsidiaries of the associate.

The Financial Statements of the associate are prepared for the same reporting period as the Company. When necessary, adjustments are made to bring the accounting policies in line with those of the Company.

After application of the equity method, the Company determines whether it is necessary to recognise an impairment loss on its investment in its associate. The Company determines at each reporting date whether there is any objective evidence that the investment in the associate is impaired. If this is the case, the Company calculates the amount of impairment as the difference between the recoverable amount of the associate and its carrying value and recognises the amount in 'share of losses of an associate' in the income statement.

Upon loss of significant influence over the associate, the Company measures and recognises any retained investment at its fair value. Any difference between the carrying amount of the associate upon loss of significant influence and the fair value of the retaining investment and proceeds from disposal is recognised in profit or loss.

3.2 Foreign Currency Translation

The Financial Statements are presented in Sri Lanka Rupees, which is the Company's functional and Presentation currency.

3.3 Financial Instruments - Initial Recognition, Classification and Subsequent Measurement

3.3.1 Date of Recognition

All financial assets and liabilities are initially recognised on the trade date, i.e., the date that the Company becomes a party to the contractual provisions of the instrument. This includes regular way trades, means purchases or sales of financial assets that require delivery of assets within the time frame generally established by regulation or convention in the market place. Those trades are initially recognised on the settlement date.

3.3.2 Initial Measurement of Financial Instruments

The classification of financial instruments at initial recognition depends on their purpose and characteristics and the management's intention in acquiring them. All financial instruments are measured initially at their fair value plus transaction costs, except in the case of financial assets and financial liabilities recorded at fair value through profit or loss as per the Sri lanka Accounting Standard - LKAS 39 on "Financial Instrument: Recognition and Measurement". Transaction cost in relation to financial assets and financial liabilities at fair value through profit and loss are dealt with through the statement of Comprehensive Income.

3.3.3 'Day 1' Profit or Loss

When the transactions price differs from the fair value of other observable current market transactions in the same instruments, or based on a valuation technique whose variables include only data from observable markets, the Company immediately recognises the difference between the transaction price and fair value (a 'Day 1' profit or loss) in 'Interest Income and Personnel Expenses'. In cases where fair value is determined using data which is not observable, or when the instrument is derecognised, The 'Day 1 loss' arising in the case of loans granted to employees at concessionary rates under uniformly applicable schemes is deferred and amortised using Effective Interest Rates (EIR) over the remaining service period of the employees or tenure of the loan whichever is shorter.

3.3.4 Classification and Subsequent Measurement of Financial Assets

At inception a financial asset is classified into one of the following categories:

At fair value through profit or loss:
- Held for trading; or
- Designated at fair value through profit or loss.

Available-or Sale:
- Loans and receivables;
- Held to maturity; or

The subsequent measurement of financial assets depends on their classification.

3.3.5 Loans and Receivables

Loans and receivables are non-derivative financial assets with fixed or determinable payments that are not quoted in an active market. After initial measurement, such financial assets are subsequently measured at amortised cost using the effective interest rate method (EIR), less allowance for impairment. Amortised cost is calculated by taking into account any discount or premium on acquisition and fees or costs that are an integral part of the EIR. The EIR amortisation is included in finance income in the income statement. The losses arising from impairment are recognised in the income statement in administration costs.

'Loans and receivables to includes, Loans & Advances, Finance Leases Receivable, Hire Purchase and Placements with the Bank'

3.3.6 Available-for-Sale Financial Investments

Available-for-sale investments include equity and debt securities. Equity investments classified as available for sale are those which are neither classified as held for trading nor designated at fair value through profit or loss.

Debt securities in this category are intended to be held for an indefinite period of time and may be sold in response to needs for liquidity or in response to changes in the market conditions.

Company has not designated any loans or receivables as available for sale. After initial measurement, available for sale financial investments are subsequently measured at fair value. Unrealised gains and losses are recognised directly in equity (Other comprehensive income) in the 'Available-for-sale reserve'. Interest earned whilst holding available for sale financial investments is reported as interest income using the EIR. Dividends earned whilst holding available-for-sale financial investments are recognised in the income statement as 'Other operating income' when the right of the payment has been established. The losses arising from impairment of such investments are recognised in the income statement in 'Impairment losses on financial investments' and removed from the 'Available-for-sale reserve'.

3.3.7 Cash & Cash Equivalents

We consider highly liquid investment instruments with an original maturity of three months or less to be cash & cash equivalents.

For the purpose of cash flow statement, cash and cash equivalents consist of cash in hand and deposits in banks. Investments with short maturities as defined above are also treated as cash equivalents.

3.3.8 Classification and Subsequent Measurement of Financial Liabilities

At inception a financial liability is classified into one of the following categories:

At fair value through profit or loss or

- Held for trading; or
- Designated at fair value through profit or loss.

At amortised cost

The subsequent measurement of financial liabilities depends on their classification.

3.3.9 Financial Liabilities at Amortised Cost

Financial instruments issued by the Company that are not designated at fair value through profit or loss, are classified as liabilities under ‘Due to Companies’, ‘Debt Securities Issued’ or ‘Subordinated Term Debts’ as appropriate, where the substance of the contractual arrangement results in the Company having an obligation either to deliver cash or another financial asset to the holder, or to satisfy the obligation other than by the exchange of a fixed amount of cash or another financial asset for a fixed number of own equity shares.

After initial recognition, such financial liabilities are subsequently measured at amortised cost using the EIR method. Amortised cost is calculated by taking into account any discount or premium on acquisition and fees or costs that are an integral part of the EIR. The EIR amortisation is included in ‘Interest Expenses’ in the statement of Comprehensive Income when the liabilities are derecognised as well as through the EIR amortisation process.

3.3.10 Reclassification of Financial Instruments

Reclassifications are recorded at fair value at the date of reclassification, which becomes the new amortised cost.

For a financial asset reclassified out of the ’available-for-sale’ category, any previous gain or loss on that asset that has been recognised in equity is amortised to profit or loss over the remaining life of the investment using the EIR. Any difference between the new amortised cost and the expected cash flows is also amortised over the remaining life of the asset using the EIR. If the asset is subsequently determined to be impaired, then the amount recorded in equity is recycled to the income statement.

The Company may reclassify a non-derivative trading asset out of the ‘held for trading’ category and into the ‘loans and receivables’ category if it meets the definition of loans and receivables and the Company has the intention and ability to hold the financial asset for the foreseeable future or until maturity. If a financial asset is reclassified, and if the Company subsequently increases its estimates of future cash receipts as a result of increased recoverability of those cash receipts, the effect of that increase is recognised as an adjustment to the EIR from the date of the change in estimate.

Reclassification is at the election of management, and is determined on an instrument by instrument basis. The Company does not reclassify any financial instrument into the fair value through profit or loss category after initial recognition.

3.3.11 Derecognition of Financial Assets and Financial Liabilities

(i) Financial Assets

A financial asset (or, where applicable a part of a financial asset or part of a group of similar financial assets) is derecognised when:

- The rights to receive cash flows from the asset have expired
- The Company has transferred its rights to receive cash flows from the asset or has assumed an obligation to pay the received cash flows in full without material delay to a third party under a ‘pass-through’ arrangement; and either:

The Company has transferred substantially all the risks and rewards of the asset; or

The Company has neither transferred nor retained substantially all the risks and rewards of the asset, but has transferred control of the asset

When the Company has transferred its rights to receive cash flows from an asset or has entered into a pass-through arrangement, and has neither transferred nor retained substantially all of the risks and rewards of the asset nor transferred control of the asset, the asset is recognised to the extent of the Company’s continuing involvement in the asset. In that case, the Company also recognises an associated liability. The transferred asset and the associated liability are measured on a basis that reflects the rights and obligations that the Company has retained.

Continuing involvement that takes the form of a guarantee over the transferred asset is measured at the lower of the original carrying amount of the asset and the maximum amount of consideration that the Company could be required to repay.

(ii) Financial Liabilities

A financial liability is derecognised when the obligation under the liability is discharged or cancelled or expires.

Where an existing financial liability is replaced by another from the same lender on substantially different terms, or the terms of an existing liability are substantially modified, such an exchange or modification is treated as a de-recognition of the original liability and the recognition of a new liability. The difference between the carrying value of the original financial liability and the consideration paid is recognised in profit or loss.

3.3.12 Determination of Fair Value

The fair value for financial instruments traded in active markets at the reporting date is based on their quoted market price or dealer price quotations (bid price for long positions and ask price for short positions), without any deduction for transaction costs.

For all other financial instruments not traded in an active market, the fair value is determined by using appropriate valuation techniques. Valuation techniques include the discounted cash flow method, comparison with similar instruments for which market observable prices exist, options pricing models, credit models and other relevant valuation models.

Certain financial instruments are recorded at fair value using valuation techniques in which current market transactions or observable market data are not available. Their fair value is determined using a valuation model that has been tested against prices or inputs to actual market transactions and using the bank's best estimate of the most appropriate model assumptions. Models are adjusted to reflect the spread for bid and ask prices to reflect costs to close out positions, credit and debit valuation adjustments, liquidity spread and limitations in the models.

Also, profit or loss calculated when such financial instruments are first recorded ('Day 1' profit or loss) is deferred and recognised only when the inputs become observable or on derecognition of the instrument An analysis of fair values of financial instruments and further details as to how they are measured are provided.

3.3.13 Impairment of Financial Assets

The Company assesses at each reporting date, whether there is any objective evidence that a financial asset or a group of financial assets is impaired. A financial asset or a group of financial assets is deemed to be impaired if, and only if, there is objective evidence of impairment as a result of one or more events that have occurred after the initial recognition of the asset (an 'incurred loss event') and that loss event (or events) has an impact on the estimated future cash flows of the financial asset or the Group of financial assets that can be reliably estimated.

Evidence of impairment may include: indications that the borrower or a group of borrowers is experiencing significant financial difficulty; the probability that they will enter bankruptcy or other financial reorganisation; default or delinquency in interest or principal payments; and where observable data indicates that there is a measurable decrease in the estimated future cash flows, such as changes in arrears or economic conditions that correlate with defaults.

(i) Financial Assets Carried at Amortised Cost

For financial assets carried at amortised cost (such as loans and advances to customers as well as held to maturity investments), the Company first assesses individually whether objective evidence of impairment exists for financial assets that are individually significant, or collectively for financial assets that are not individually significant. If the Company determines that no objective evidence of impairment exists for an individually assessed financial asset, it includes the asset in a group of financial assets with similar credit risk characteristics and collectively assesses them for impairment. Assets that are individually assessed for impairment and for which an impairment loss is, or continues to be, recognised are not included in a collective assessment of impairment.

If there is objective evidence that an impairment loss has been incurred, the amount of the loss is measured as the difference between the assets's carrying amount and the present value of estimated future cash flows (excluding future expected credit losses that have not yet been incurred). The carrying amount of the asset is reduced through the use of an allowance account and the amount of the loss is recognised in the income statement. Interest income continues to be accrued on the reduced carrying amount and is accrued using the rate of interest used to discount the future cash flows for the purpose of measuring the impairment loss.

The interest income is recorded as part of 'Interest and similar income'. Loans together with the associated allowance are written off when there is no realistic prospect of future recovery and all collateral has been realised or has been transferred to the Company. If, in a subsequent year, the amount of the estimated impairment loss increases or decreases because of an event occurring after the impairment was recognised, the previously recognised impairment loss is increased or reduced by adjusting the allowance account. If a future write-off is later recovered, the recovery is credited to the 'Credit loss expense'.

The present value of the estimated future cash flows is discounted at the financial asset's original EIR. The calculation of the present value of the estimated future cash flows of a collateralised financial asset reflects the cash flows that may result from foreclosure less costs for obtaining and selling the collateral, whether or not foreclosure is probable.

For the purpose of a collective evaluation of impairment, financial assets are grouped on the basis of the Company's internal credit grading system that considers credit risk characteristics such as asset type and other relevant factors.

Future cash flows on a group of financial assets that are collectively evaluated for impairment are estimated on the basis of historical loss experience for assets with credit risk characteristics similar to those in the Group. Historical loss experience is adjusted on the basis of current observable data to reflect the effects of current conditions on which the historical loss experience is based and to remove the effects of conditions in the historical period that do not exist currently.

Estimates of changes in future cash flows reflect, and are directionally consistent with, changes in related observable data from year to year (such as changes in unemployment rates, property prices, commodity prices, payment status, or other factors that are indicative of incurred losses in the Group and their magnitude). The methodology and assumptions used for estimating future cash flows are reviewed regularly to reduce any differences between loss estimates and actual loss experience.

See Notes 21, 22 and 23 for details of impairment losses on financial assets carried at amortised cost.

(ii) Available-for-Sale Financial Investments

For available-for-sale financial investments, the Company assesses at each reporting date whether there is objective evidence that an investment is impaired.

In the case of equity investments classified as available for sale, objective evidence would also include a 'significant' or 'prolonged' decline in the fair value of the investment below its cost. The Company treats 'significant' generally as 20% and 'prolonged' generally as greater than six months. Where there is evidence of impairment, the cumulative loss measured as the difference between the acquisition cost and the current fair value, less any impairment loss on that investment previously recognised in the income statement - is removed from equity and recognised in the income statement. Impairment losses on equity investments are not reversed through the income statement; increases in the fair value after impairment are recognised in other comprehensive income.

(iii) Renegotiated Loans

Where possible, the Company seeks to restructure loans rather than to take possession of collateral. This may involve extending the payment arrangements and the agreement of new loan conditions. Once the terms have been renegotiated, any impairment is measured using the original EIR as calculated before the modification of terms and the loan is no longer considered past due. Management continually reviews renegotiated loans to ensure that all criteria are met and that future payments are likely to occur. The loans continue to be subject to an individual or collective impairment assessment, calculated using the loan's original EIR.

(iv) Collateral Valuation

The Company seeks to use collateral, where possible, to mitigate its risks on financial assets. The collateral comes in various forms such as cash, securities, letters of credit/guarantees, real estate, receivables, inventories, other non-financial assets and credit enhancements such as netting agreements. The fair value of collateral is generally assessed, at a minimum, at inception and based on the Company's quarterly reporting schedule, however, some collateral, for example, cash or securities relating to margining requirements, is valued daily.

To the extent possible, the Company uses active market data for valuing financial assets, held as collateral. Other financial assets which do not have a readily determinable market value are valued using models. Non-financial collateral, such as real estate, is valued based on data provided by third parties such as valuers, audited financial statements, and other independent sources.

(v) Offsetting Financial Instruments

Financial assets and financial liabilities are offset and the net amount reported in the Statement of financial position if, and only if, there is a currently enforceable legal right to offset the recognised amounts and there is an intention to settle on a net basis, or to realise the asset and settle the liability simultaneously. This is not generally the case with master netting agreements, therefore, the related assets and liabilities are presented gross in the Statement of financial position.

3.3.14 Finance Leases

We classify assets leased to customers, which transfer substantially all the risk and rewards associated with the ownership other than legal title are accounted as finance lease in accordance with the LKAS 17 Leases.

Amount receivable under finance leases net of unearned interest and provision for impairment is shown as Finance Lease Receivable in the Balance Sheet.

3.3.15 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.

3.3.16 Hire Purchase Receivables

We classify advances granted under agreements that transfer substantially all the risks and rewards associated with ownership other than legal title, as hire purchase receivables.

Amount receivable under hire purchases net of unearned interest and provision for impairment is shown as Hire Purchases Receivable in the Balance Sheet.

3.3.17 Inventories

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.

3.3.18 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.

3.3.19 Intangible Assets

Basis of Recognition

An Intangible Asset is recognise 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 LKAS 38 ‘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 life 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 asset 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 is 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 asset and are recognised in the Income Statement.

3.3.20 Debt issued and Other Borrowed Funds

Financial instruments issued by the Company that are not designated at fair value through profit or loss, are classified as liabilities under 'Debt issued and other borrowed funds', where the substance of the contractual arrangement results in the Company having an obligation either to deliver cash or another financial asset to the holder, or to satisfy the obligation other than by the exchange of a fixed amount of cash or another financial asset for a fixed number of own equity shares.

After initial measurement, debt issued and other borrowings are subsequently measured at amortised cost using the EIR. Amortised cost is calculated by taking into account any discount or premium on the issue and costs that are an integral part of the EIR.

3.3.21 Deposits due to Customers

These include fixed deposits, savings deposits & certificate of deposits. Subsequent to initial recognition deposits are measured at their amortised cost using the effective interest method. Interest paid/payable on these deposits is recognised in profit or loss.

3.3.22 Other Liabilities

Other liabilities include fees, expenses & amount payable to suppliers' .Theses liabilities are recorded at amounts expected to be payable at the reporting date.

3.3.23 Provisions

When 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 LKAS 37 - Provisions, Contingent Liabilities and Contingent Asset

3.3.24 Employee Benefits

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 LKAS 16 on 'Employee 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 2013.

Provision has been made for retirement gratuities from the first year of service for all employees in conformity with the Sri Lanka Accounting Standard LKAS 16 on 'Employee Benefits'.

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 & 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.

3.3.25 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.

3.3.26 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 43 & 44 to the Financial Statements.

3.3.27 Earnings per Share

Basic EPS is calculated by dividing the profit or loss attributable to ordinary shareholders of the Company by the weighted average number of ordinary shares outstanding during the period. Diluted EPS is determined by adjusting the profit or loss attributable to ordinary shareholders and the weighted average number of ordinary shares outstanding for the effects of all dilutive potential ordinary shares, which comprise share options granted to employees.

Details of earnings per share are given in Note 15 on page 302.

3.3.28 Segment Reporting

An operating segment is a component of the Company that engages in business activities from which it may earn revenues and incur expenses, including revenues and expenses that relate to transactions with any of the Company's other components, whose operating results are reviewed regularly by the Company Management Committee (being the chief operating decision-maker) to make decisions about resources allocated to each segment and assess its performance, and for which discrete financial information is available.

No revenue from transactions with a single external customer or counterparty amounted to 10% or more of the Company's total revenue in 2013 or 2012.

Detailed information on the results of each reportable segment as required by the Sri Lanka Accounting Standard - SLFRS 8 on 'Operating Segments' is provided in Note 49 on page 323.

3.3.29 Effect of Accounting Standards Issued but not Effective as at Balance Sheet Date

Standards issued but not yet effective up to the date of issuance of the Company's financial statements are listed below. This listing is of standards and interpretations issued, which the Company reasonably expects to be applicable at a future date. The Company intends to adopt those standards when they become effective.

SLFRS 9 Financial Instruments

IFRS 9 as issued reflects the first phase of the IASB's work on the replacement of IAS 39 and applies to classification and measurement of financial assets and financial liabilities as defined in IAS 39. The standard is effective for annual periods beginning on or after 1 January 2015. In subsequent phases, the IASB will address hedge accounting and impairment of financial assets. The completion of this project is expected over the course of 2011. The adoption of the first phase of IFRS 9 will have an effect on the classification and measurement of the Company's financial assets, but will potentially have no impact on classification and measurements of financial liabilities. The Company will quantify the effect in conjunction with the other phases, when issued, to present a comprehensive picture.

IFRS 12 Disclosure of Involvement with Other Entities

IFRS 12 includes all of the disclosures that were previously in IAS 27 related to consolidated financial statements, as well as all of the disclosures that were previously included in IAS 31 and IAS 28. These disclosures relate to an entity's interests in subsidiaries, joint arrangements, associates and structured entities. A number of new disclosures are also required. This standard becomes effective for annual periods beginning on or after 1 January 2014.

IFRS 13 - Fair Value measurement

IFRS 13 establishes a single source of guidance under IFRS for all fair value measurements. IFRS 13 does not change when an entity is required to use fair value, but rather provides guidance on how to measure fair value under IFRS when fair value is required or permitted. The Fund is currently assessing the impact that this standard will have on the financial position and performance. This standard becomes effective for annual periods beginning on or after 1 January 2014.

FIRST-TIME ADOPTION OF SLFRSs

These financial statements, for the year ended 31 March 2013, are the first the Company has prepared in accordance with SLFRSs. For periods up to and including the year ended 31 march 2012, the Company prepared its financial statements in accordance with Sri Lanka Accounting Standards as issued by the Institute of Chartered Accounts of Sri Lanka.

Accordingly, the Company has prepared financial statements which comply with SLFRSs applicable for periods ended on or after 31 march 2013, together with the comparative period data as at and for the year ended 31 March 2012, as described in the accounting policies. In preparing these financial statements, the Company's opening statement of financial position was prepared as at 01 April 2011, the Company's date of transition to SLFRSs. Note 51 explains the principal adjustments made by the Company in restating its statement of financial position as at 1 April 2011 and its previously published financial statements as at and for the year ended 31 March 2012.

4. Significant Accounting Polices - Recognition of Income and Expenses

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.

4.1 Interest and Similar Income and Expense

For all financial instruments measured at amortised cost, interest bearing financial assets classified as available for sale and interest income or expense is recorded using the EIR. EIR is the rate that exactly discounts estimated future cash payments or receipts through the expected life of the financial instrument or a shorter period, where appropriate, to the net carrying amount of the financial asset or financial liability.

The calculation takes into account all contractual terms of the financial instrument (for example, prepayment options) and includes any fees or incremental costs that are directly attributable to the instrument and are an integral part of the EIR, but not future credit losses.

The carrying amount of the financial asset or financial liability is adjusted if the Company revises its estimates of payments or receipts. The adjusted carrying amount is calculated based on the original EIR and the change in carrying amount is recorded as 'Interest and similar income' for financial assets and 'Interest and similar expense' for financial liabilities.

Once the recorded value of a financial asset or a group of similar financial assets has been reduced due to an impairment loss, interest income continues to be recognised using the rate of interest used to discount the future cash flows for the purpose of measuring the impairment loss.

4.2 Fee and Commission Income

The Company earns fee and commission income from a diverse range of services it provides to its customers. Fee income can be divided into the following two categories:

4.2.1 Fee Income Earned from Services that are Provided Over a Certain Period of Time

Fees earned for the provision of services over a period of time are accrued over that period. These fees include commission income and asset management, custody and other management and advisory fees.

4.2.2 Fee Income from Providing Transaction Services

Fees arising from negotiating or participating in the negotiation of a transaction for a third party, such as the purchase or sale of business is recognised on completion of the underlying transaction. Fees or components of fees that are linked to a certain performance are recognised after fulfilling the corresponding criteria.

4.3 Dividend Income

Dividend income is recognised when the Company's right to receive the payment is established.

4.4 Net Trading Income

Results arising from trading activities include interest income or expense and dividends for financial assets.

4.5 Borrowing Cost

Borrowing costs directly attributable to the acquisition, construction or production of an asset that necessarily takes a substantial period of time to get ready for its intended use or sale are capitalised as part of the cost of the respective asset. All other borrowing costs are expensed in the period in which they occur. Borrowing costs consist of interest and other costs that an entity incurs in connection with the borrowing of funds.

4.6 Profit on Disposal of Property, Plant & Equipment

Profits or losses resulting from disposal of property, plant & equipment have been accounted on cash basis in the Income Statement

5. Significant Accounting Policies - Tax Expense

5.1 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.

5.2 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 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 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.

5.3 Value Added Tax on Financial Services

The base for the computation of Value Added Tax on Financial Services is the accounting profit before emoluments paid to employees and income tax, which is adjusted for the depreciation computed on prescribed rates. The amount of Value Added Tax charged in determining the profit or loss for the period is given in the Income Statement on page 282.

6. Statement of Cash Flow Statement

We prepare the Cash Flow Statement using the “Direct Method” in accordance with the Sri Lanka Accounting Standard - LKAS 7 on Statement of Cash Flow' , whereby gross cash receipts and gross cash payments of operating activities, finance activities, and investing activities have been recognised.

NOTES TO THE FINANCIAL STATEMENTS

For the year ended 31 March	2013 Rs. '000	2012 Rs. '000

7. Gross Income

Interest income **(Refer Note 7.1)**	3,055,684	1,627,742
Fee and commission income	45,936	31,968
Other income **(Note 9)**	236,423	702,316
Total	3,338,044	2,362,026

7.1 Interest Income

Income from finance lease	842,281	530,514
Income from hire purchase	1,446,418	870,809
Income from loans & advances	674,194	187,253
Income from treasury bills & bonds	59,584	28,262
Income from fixed deposits	33,207	10,904
Total	3,055,684	1,627,742

8. Interest Expense

Interest on fixed deposits	987,376	589,930
Interest on savings deposits	1,656	1,711
Interest on certificate of deposits	12,060	13,790
Interest on bank overdraft	79,945	36,406
Interest on debts securities	125,362	9,951
Interest on bank & securitised borrowings	661,301	358,086
Total	1,867,700	1,009,874

9. Other Operating Income

Capital gain from sale of quoted shares	123,179	590,916
Dividend income	102,895	71,610
Rent income	6,660	6,495
Profit/(loss) from engineering workshop & service station	(10,738)	(6,765)
Profit/(loss) on sale of property, plant & equipment	(6,100)	(1,529)
Operating lease rental income	14,270	19,140
Other operating income	6,258	22,449
Total	236,423	702,316

10. Impairment (Gain)/Loss for Loans and Receivables

Charge /(gain) to the income statement on impairment – Loans & advances	7,106	(3,250)
Charge/(gain) to the income statement on impairment – Finance leases receivables	18,110	3,912
Charge/(gain) to the income statement on impairment – Hire purchase receivables	7,061	14,025
Total	32,277	14,687

11. Personnel Expenses

Salary and bonus	228,194	184,084
Employer's contribution to EPF	26,998	21,481
Employer's contribution to ETF	6,681	6,832
Other allowances & staff related expenses	11,540	7,413
Total	273,413	219,811

For the year ended 31 March	2013 Rs. '000	2012 Rs. '000

12. Other Operating Expenses

Director's emoluments	43,260	35,465
Audit fees & expenses	965	825
Non–audit fees & expenses	122	28
Professional & legal expense	3,514	4,967
Advertising & business promotion expenses	27,472	20,651
Insurance premium	18,061	14,918
Donations	1,360	1,462
Office & building maintenance	22,791	53,589
Computer equipment maintenance	5,538	3,857
Others	261,710	197,843
	384,792	333,604

12.1 Director's Emoluments

Director's emoluments represents the fees and salaries paid to both Executive & Non Executive Directors of the Company.

13. Share of Associates Company Profit/(Loss)

Nuwara Eliya Hotels Company PLC	94,481	42,457
Fair View Hotels (Pvt) Limited	978	212
Total	95,459	42,669

14. Income Tax Expenses

Income tax expenses on profits for the year	163,698	29,017
(Over)/under provision in respect of previous year	(1,510)	(2,450)
Deferred tax (reversal)/charged **(Refer Note 34)**	(60,910)	(10,900)
	101,278	15,667

14.1 Reconciliation of Accounting Profit to Income Tax Expense

Profit before tax	732,069	481,895
Add: Tax effect of non–deductible expenses	1,375,907	1,549,207
Tax effect of deductible expenses	(1,387,603)	(1,239,042)
Tax effect of allowable credits	(198,354)	(702,938)
Assessable income	522,019	89,122
Qualifying payments	–	–
Taxable income	522,019	89,122
Income tax expense @ 28%	146,165	24,954
Share of income tax expense of associates **(Note 14.2)**	17,533	4,063
	163,698	29,017
Effective Tax Rate (Excluding Deferred Tax)	22.36%	6.02%

The Company is liable for income tax at 28% on the taxable income for the current year (2012 - 28%).

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.

14.2 Break up of the Associate Company Income Tax Expenses

	2013 Rs. '000	2012 Rs. '000
Nuwara Eliya Hotels Company PLC	17,446	4,063
Fair View Hotels (Pvt) Ltd.	87	–
Total	17,533	4,063

14.3 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. 5,383,099/– (Rs. 2,762,689/– in 2012).

15. 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 (LKAS) No. 33 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).

	2013	2012
Amount Used as the Numerator		
Net profit attributable to equity holders of the Company (Rs. '000)	630,791	610,088
Net profit attributable to equity holders of the Company for basic and diluted earnings per share (Rs. '000)	630,791	610,088
Number of Ordinary Shares Used as the Denominator		
Weighted average number of ordinary shares	3,006	3,006
Weighted average number of ordinary shares used for basic and diluted earnings per share	3,006	3,006
Basic Earnings per Share (Rs.)	209.84	202.96
Diluted Earnings per Share (Rs.)	209.84	202.96

16. Dividends

	2013			2012		
	Gross Dividend Rs. '000	Dividend Tax Rs. '000	Net Dividend Rs. '000	Gross Dividend Rs. '000	Dividend Tax Rs. '000	Net Dividend Rs. '000
1st Interim dividend paid						
Out of dividend received–free of tax	40,581	–	40,581	30,060	–	30,060
Out of normal profits	–	–	–	–	–	–
Cash dividend paid	40,581	–	40,581	30,060	–	30,060
2nd Interim dividend paid						
Out of dividend received –free of tax	42,084	–	42,084	14,310	–	14,310
Out of normal profits	–	–	–	21,762	2,176	19,585
Cash dividend paid	42,084	–	42,084	36,072	2,176	33,896
Total	82,665		82,665	66,132	2,176	63,955
Dividend per ordinary Share (Rs.)	27.50		–	22.00	–	–

17. Analysis of Financial Instrument by Measurement Basis

17.1 Analysis of Financial Instrument by Measurement Basis As at 31 March 2013

Financial instruments are measured on an ongoing basis either at fair value or at amortised cost. The summary of significant policies describes how the classes of financial instruments are measured and how income and expense, including fair value gains and losses are recognised. The following table analyses the carrying amounts of the financial instruments by category as defined in LKAS 39 and by headings of the Statement of Financial Position.

	Held for Trading (HFT) Rs. '000	Held for Maturity (HTM) Rs. '000	Loans and Receivables (L & R) Rs. '000	Available for Sale (AFS) Rs. '000	Others Rs. '000	Total Rs. '000
Assets						
Cash and cash equivalents	–	–	632,238	–	–	632,238
Placements with bank	–	–	364,330	–	–	364,330
Financial investments – available for sale	–	–	–	3,467,280	–	3,467,280
Loans & receivables	–	–	4,017,478	–	–	4,017,478
Finance leases receivables	–	–	4,072,783	–	–	4,072,783
Hire purchase receivables	–	–	5,754,386	–	–	5,754,386
Other financial assets	–	–	172,148	–	–	172,148
Total financial assets	–	–	15,013,363	3,467,280	–	18,480,642
Inventories	–	–	–	–	221,220	221,220
Other assets	–	–	–	–	240,987	240,987
Investment in associates	–	–	–	–	695,670	695,670
Property, plant & equipment	–	–	–	–	1,535,731	1,535,731
Leasehold property	–	–	–	–	44,013	44,013
Intangible assets	–	–	–	–	4,681	4,681
Total non–financial assets	–	–	–	–	2,742,302	2,742,302

	Held for Trading (HFT) Rs. '000	Amortized Cost Rs. '000	Others Rs. '000	Total Rs. '000
Liabilities				
Bank overdraft	–	999,036	–	999,036
Deposits due to customers	–	8,424,720	–	8,424,720
Debt instruments issued and other borrowed funds	–	5,232,331	–	5,232,331
Other financial liabilities	–	551,874	–	551,874
Total financial liabilities	–	15,207,960	–	15,207,960
Current tax liabilities	–	–	81,322	81,322
Deferred taxation liability	–	–	93,817	93,817
Other liabilities	–	–	17,097	17,097
Retirement benefit obligations	–	–	116,390	116,390
Total non–financial liabilities	–	–	308,626	308,626

17.2 Analysis of Financial Instrument by Measurement Basis As at 31 March 2012

	Held for Trading (HFT) Rs. '000	Held for Maturity (HTM) Rs. '000	Loans and Receivables (L & R) Rs. '000	Available for Sale (AFS) Rs. '000	Others Rs. '000	Total Rs. '000
Assets						
Cash and cash equivalents	–	–	229,822	–	–	229,822
Placements with bank	–	–	118,000	–	–	118,000
Financial investments – available–for–sale	–	–	–	3,829,777	–	3,829,777
Loans & receivables	–	–	2,183,130	–	–	2,183,130
Finance leases receivables	–	–	3,888,783	–	–	3,888,783
Hire purchase receivables	–	–	4,374,601	–	–	4,374,601
Other financial assets	–	–	79,801	–	–	79,801
Total financial assets	–	–	10,874,137	3,829,777	–	14,703,914
Inventories	–	–	–	–	340,244	340,244
Other assets	–	–	–	–	321,726	321,726
Investment in associates	–	–	–	–	628,397	628,397
Property, plant & equipment	–	–	–	–	1,565,620	1,565,620
Leasehold property	–	–	–	–	44,481	44,481
Intangible assets	–	–	–	–	2,855	2,855
Total non–financial assets	–	–	–	–	2,903,323	2,903,323

	Held for Trading (HFT) Rs. '000	Amortized Cost Rs. '000	Others Rs. '000	Total Rs. '000
Liabilities				
Bank overdraft	–	505,815	–	505,815
Deposits due to customers	–	6,137,897	–	6,137,897
Debt instruments issued and other borrowed funds	–	4,638,644	–	4,638,644
Other financial liabilities	–	513,478	–	513,478
Total financial liabilities	–	11,795,834	–	11,795,834
Current tax liabilities	–	–	34,931	34,931
Deferred taxation liability	–	–	139,852	139,852
Other liabilities	–	–	60,828	60,828
Retirement benefit obligations	–	–	101,186	101,186
Total non–financial liabilities	–	–	336,797	336,797

17.3 Analysis of Financial Instrument by Measurement Basis As at 01st April 2011

	Held for Trading (HFT) Rs. '000	Held for Maturity (HTM) Rs. '000	Loans and Receivables (L & R) Rs. '000	Available for Sale (AFS) Rs. '000	Others Rs. '000	Total Rs. '000
Assets						
Cash and cash equivalents	–	–	118,654	–	–	118,654
Placements with bank	–	–	43,425	–	–	43,425
Financial investments – available–for–sale	–	–	–	5,139,414	–	5,139,414
Loans & receivables	–	–	687,171	–	–	687,171
Finance leases receivables	–	–	2,171,979	–	–	2,171,979
Hire purchase receivables	–	–	3,557,026	–	–	3,557,026
Other financial assets	–	–	28,387	–	–	28,387
Total financial assets	–	–	6,606,642	5,139,414	–	11,746,056
Inventories	–	–	–	–	24,780	24,780
Other assets	–	–	–	–	218,075	218,075
Investment in associates	–	–	–	–	493,555	493,555
Property, plant & equipment	–	–	–	–	1,214,750	1,214,750
Leasehold property	–	–	–	–	44,950	44,950
Intangible assets	–	–	–	–	6,521	6,521
Total non–financial assets	–	–	–	–	2,002,631	2,002,631

	Held for Trading (HFT) Rs. '000	Amortized Cost Rs. '000	Others Rs. '000	Total Rs. '000
Liabilities				
Bank overdraft	–	397,246	–	397,246
Deposits due to customers	–	4,297,801	–	4,297,801
Debt instruments issued and other borrowed funds	–	2,318,481	–	2,318,481
Other financial liabilities	–	182,173	–	182,173
Total financial liabilities	–	7,195,701	–	7,195,701
Current tax liabilities	–	–	39,142	39,142
Deferred taxation liability	–	–	139,695	139,695
Other liabilities	–	–	7,389	7,389
Retirement benefit obligations	–	–	73,682	73,682
Total non–financial liabilities	–	–	259,908	259,908

18. Cash and Cash Equivalents

	31 March 2013 Rs. '000	31 March 2012 Rs. '000	1 April 2011 Rs. '000
Cash in hand	610,797	197,452	61,548
Balances with the bank	21,441	32,370	57,106
	632,238	229,822	118,654

	31 March 2013 Rs. '000	31 March 2012 Rs. '000	1 April 2011 Rs. '000

19. Placement with the Bank

	31 March 2013 Rs. '000	31 March 2012 Rs. '000	1 April 2011 Rs. '000
Fixed deposits with bank	364,330	118,000	43,425
	364,330	118,000	43,425

20. Financial Investments – Available for Sale

	31 March 2013 Rs. '000	31 March 2012 Rs. '000	1 April 2011 Rs. '000
Quoted Investments			
Government debt securities	476,488	439,446	360,201
Equities (Note 20.1)	2,979,592	3,389,904	4,778,786
Corporate debt securities (Note 20.2)	10,773	–	–
Unquoted Investments			
Equities (Note 20.3)	427	427	427
	3,467,280	3,829,777	5,139,414

As at 31 March	2013			2012		
	No. of Shares	Cost Rs. '000	Market Value Rs. '000	No. of Shares	Cost Rs. '000	Market Value Rs. '000
20.1 Equities (Quoted)						
Bank, Finance & Insurance						
Commercial Bank of Ceylon PLC	10,075,806	1,281,245	1,138,566	9,900,066	1,281,245	990,007
Lanka Orix Finance PLC	100,000	1,213	330	100,000	1,213	450
LB Finance PLC	953,600	176,735	126,543	953,600	176,735	128,641
Sampath Bank PLC	20,830	5,836	4,685	20,358	5,836	3,660
Singer Finance PLC	400,000	19,351	5,040	400,000	19,351	6,480
Vallibel Finance PLC	50,000	2,463	1,415	50,000	2,463	1,940
		1,486,843	1,276,579		1,486,843	1,131,178
Diversified Holdings						
Aitken Spence & Co. PLC	15,000	343	1,794	15,000	343	1,691
John Keells Holding PLC	6,266	1,338	1,548	179,599	38,364	36,997
Richard Pieris & Co. PLC	16,035,995	96,582	105,838	16,035,995	96,585	120,270
Vallibel One PLC	5,176,000	144,896	82,816	5,176,000	144,896	98,344
		243,159	191,996		280,188	257,302
Hotels & Travels						
Amaya Leisure PLC	860,000	56,488	65,790	860,000	56,488	65,962
Asian Hotels Properties PLC	1,099,500	22,026	76,965	3,000,000	60,112	234,000
Eden Hotels PLC	1,049,600	17,738	36,736	1,049,600	17,738	32,327
Fortress Resource PLC	100,000	2,844	1,500	100,000	2,844	1,720
Hotel Sigiriya PLC	38,900	1,620	3,073	38,900	1,620	2,785
Hunas Falls Hotels PLC	–	–	–	899,000	30,833	53,580
John Keells Hotels PLC	13,000,000	209,107	171,600	13,000,000	209,107	163,800
Light House Hotels PLC	7,656,500	220,555	362,918	7,656,500	220,555	382,825
Marawila Hotel PLC	507,000	20,467	9,988	507,000	20,467	12,776
Riverina Hotel PLC	200,000	25,913	19,100	400,000	25,913	37,160
Royal Palms Beach Hotels PLC	8,576,700	124,582	300,184	8,576,700	124,582	471,719
Tangerine Beach Hotels PLC	3,909,644	26,343	255,036	3,909,644	26,343	343,658
		727,683	1,302,890		796,602	1,802,312

As at 31 March	2013			2012		
	No. of Shares	Cost Rs. '000	Market Value Rs. '000	No. of Shares	Cost Rs. '000	Market Value Rs. '000
Investment Trust						
Environmental Resource Investments PLC	61,800	7,157	964	61,800	7,157	1,038
		7,157	964		7,157	1,038
Manufacturing						
Royal Ceramic PLC	550,000	89,930	54,725	550,000	89,930	63,250
		89,930	54,725		89,930	63,250
Power & Energy						
Lanka IOC PLC	118,500	5,308	2,418	118,500	5,308	2,299
		5,308	2,418		5,308	2,299
Land & Property Development						
East West Properties PLC	50,000	2,471	650	50,000	2,471	655
		2,471	650		2,471	655
Motor						
United Motors PLC	100,000	18,701	9,600	100,000	18,701	10,800
		18,701	9,600		18,701	10,800
Telecommunication						
Dialog Axiata PLC	11,000,000	118,130	99,000	11,000,000	118,130	78,100
		118,130	99,000		118,130	78,100
Construction & Engineering						
Colombo Dockyard PLC	161,000	44,966	34,470	161,000	44,966	37,030
		44,966	34,470		44,966	37,030
Trading						
Odel PLC	300,000	11,943	6,300	300,000	11,943	5,940
		11,943	6,300		11,943	5,940
Total		2,756,291	2,979,592		2,862,239	3,389,904

20.2 Corporate Debt Securities

	2013 Cost Rs. '000	2013 Market Value Rs. '000	2012 Cost Rs. '000	2012 Market Value Rs. '000
Debentures	10,000	10,773	–	–
	10,000	10,773	–	–

As at 31 March	2013			2012		
	No. of Shares	Cost Rs. '000	Market Value Rs. '000	No. of Shares	Cost Rs. '000	Market Value Rs. '000
20.3 Equities (Non–Quoted)						
Security Ceylon (Pvt) Ltd.	250	200	200	250	200	200
Credit Bureau of Sri Lanka	269	27	27	269	27	27
Finance Houses Consortium	20,000	200	200	20,000	200	200
		427	427		427	427

All unquoted available for sale equity investments are recorded at cost since the fair value of these investments cannot be reliably measured.

There is no market for these investments and company intends to hold for them in the long term.

	31 March 2013 Rs. '000	31 March 2012 Rs. '000	1 April 2011 Rs. '000
21. Loans and Receivables			
Gross loans and receivables	5,761,987	3,066,600	889,416
Prepaid rentals	(418)	(397)	(171)
Unearned interest	(1,690,247)	(836,337)	(152,087)
Allowance for impairment	(53,843)	(46,736)	(49,987)
Net loans and advances	4,017,478	2,183,130	687,171
21.1 Loans and Advances Receivable within one Year			
Gross loans and advances	2,438,286	1,270,490	363,219
Prepaid rentals	–	(264)	(48)
Unearned interest	(772,040)	(310,325)	(67,819)
Net loans and advances	1,666,246	959,901	295,352
21.2 Loans and Advances Receivable from one to five Years			
Gross loans and advances	3,309,672	1,676,712	486,829
Prepaid rentals	–	(133)	(123)
Unearned interest	(916,867)	(512,445)	(84,217)
Net loans and advances	2,392,806	1,164,135	402,489
21.3 Loans and Advances Receivable after five Years			
Gross loans and advances	14,029	119,398	1,040
Unearned interest	(1,340)	(13,568)	(51)
Net loans and advances	12,689	105,830	989
21.4 Movement in Allowance for Impairment			
Opening balance	46,736	49,987	62,398
Charge/(Write back) to the Income statement	7,107	(3,251)	(12,411)
Closing Balance	53,843	46,736	49,987
21.5 Sectorwise Analysis of Loans and Advances			
Agriculture	133,040	61,332	17,788
Industrial	276,028	153,330	44,471
Tourism	142,266	76,665	53,365
Trading	1,097,504	613,320	177,883
Construction	46,601	30,666	17,788
Services	3,186,253	1,686,630	400,237
Others	880,295	444,657	177,883
	5,761,987	3,066,600	889,416

	31 March 2013 Rs. '000	31 March 2012 Rs. '000	1 April 2011 Rs. '000

22. Finance Leases Receivables

Gross Finance Leases Receivables	5,731,410	5,420,595	2,996,141
Prepaid rentals	(4,913)	(5,104)	(4,959)
Unearned interest	(1,554,452)	(1,445,557)	(741,965)
Allowance for impairment	(99,262)	(81,151)	(77,238)
Net Finance Leases Receivables	4,072,783	3,888,783	2,171,979

22.1 Finance Leases Receivable within one Year

Gross Finance Leases Receivables	2,196,637	1,824,594	1,112,283
Prepaid rentals	(746)	(961)	(1,043)
Unearned interest	(820,473)	(660,858)	(372,153)
Net Finance Leases Receivables	1,375,419	1,162,775	739,087

22.2 Finance Leases Receivable from one to five Years

Gross Finance Leases Receivables	3,531,761	3,578,029	1,867,550
Prepaid rentals	(4,167)	(4,143)	(3,916)
Unearned interest	(733,737)	(783,457)	(368,818)
Net Finance Leases Receivables	2,793,857	2,790,429	1,494,816

22.3 Finance Leases Receivable after five Years

Gross Finance Leases Receivables	3,012	17,972	16,308
Unearned interest	(242)	(1,242)	(994)
Net Finance Leases Receivables	2,770	16,730	15,314

22.4 Movement in Allowance for Impairment

Opening balance	81,151	77,238	113,298
Charge/(Write back) to the Income statement	18,111	3,913	(36,060)
Closing Balance	99,262	81,151	77,238

22.5 Sectorwise Analysis of Finance Leases Receivables

Agriculture	222,020	169,855	129,784
Industrial	290,177	293,753	223,680
Tourism	138,188	122,356	57,057
Trading	1,260,965	1,037,194	525,060
Construction	32,973	41,734	37,772
Services	2,956,626	2,934,487	1,409,584
Others	830,461	821,216	613,204
	5,731,410	5,420,595	2,996,141

23. Hire Purchases Receivables

	31 March 2013 Rs. '000	31 March 2012 Rs. '000	1 April 2011 Rs. '000
Gross Hire Purchases Receivables	8,349,374	6,348,172	5,047,213
Prepaid rentals	(1,099)	(1,555)	(1,502)
Unearned interest	(2,435,465)	(1,820,652)	(1,351,346)
Allowance for impairment	(158,425)	(151,364)	(137,339)
Net Hire Purchases Receivables	5,754,386	4,374,601	3,557,026

23.1 Hire Purchases Receivable within one Year

	31 March 2013 Rs. '000	31 March 2012 Rs. '000	1 April 2011 Rs. '000
Gross Hire Purchases Receivables	3,540,898	2,536,939	2,336,620
Prepaid rentals	(189)	(203)	(425)
Unearned interest	(1,337,030)	(1,020,982)	(843,846)
Net Hire Purchases Receivables	2,203,680	1,515,755	1,492,348

23.2 Hire Purchases Receivable from one to five Years

	31 March 2013 Rs. '000	31 March 2012 Rs. '000	1 April 2011 Rs. '000
Gross Hire Purchases Receivables	4,806,580	3,807,259	2,708,243
Prepaid rentals	(910)	(1,352)	(1,077)
Unearned interest	(1,098,292)	(799,551)	(507,488)
Net Hire Purchases Receivables	3,707,378	3,006,356	2,199,678

23.3 Hire Purchases Receivable after five Years

	31 March 2013 Rs. '000	31 March 2012 Rs. '000	1 April 2011 Rs. '000
Prepaid rentals	1,896	3,973	2,350
Unearned interest	(143)	(119)	(12)
Net Hire Purchases Receivables	1,753	3,854	2,338

23.4 Movement in Allowance for Impairment

	31 March 2013 Rs. '000	31 March 2012 Rs. '000	1 April 2011 Rs. '000
Opening balance	151,364	137,339	227,177
Charge/(Write back) to the Income statement	7,061	14,025	(89,838)
Closing Balance	158,425	151,364	137,339

23.5 Sectorwise Analysis of Hire Purchases Receivables

	31 March 2013 Rs. '000	31 March 2012 Rs. '000	1 April 2011 Rs. '000
Agriculture	345,877	214,021	182,217
Industrial	490,713	371,475	375,134
Tourism	120,736	125,416	95,900
Trading	2,033,427	1,460,600	743,195
Construction	27,007	38,033	73,626
Services	4,007,236	3,024,240	2,129,081
Others	1,324,378	1,114,388	1,448,060
	8,349,374	6,348,172	5,047,213

24. Other Financial Assets

	31 March 2013 Rs. '000	31 March 2012 Rs. '000	1 April 2011 Rs. '000
Insurance receivables	78,992	55,806	664
Operating leases receivables	8,948	7,966	9,413
Other receivables	84,208	16,028	18,310
	172,148	79,801	28,387

25. Inventories

	31 March 2013 Rs. '000	31 March 2012 Rs. '000	1 April 2011 Rs. '000
Spare Parts	6,081	4,317	3,211
Lubricant & Others	2,151	1,600	1,696
Vehicle Stocks	212,988	334,327	19,873
	221,220	340,244	24,780

26. Other Assets

	31 March 2013 Rs. '000	31 March 2012 Rs. '000	1 April 2011 Rs. '000
Other receivables	170,282	265,102	186,466
Deposit and prepayments	20,121	11,712	2,800
Unamortised staff cost	9,697	8,013	2,705
Sundry receivables	40,887	36,899	26,104
	240,987	321,726	218,075

27. Investment in Associates

	31 March 2013 Rs. '000	31 March 2012 Rs. '000	1 April 2011 Rs. '000
Investment in Associates – Quoted **(Note 27.1)**	624,567	558,185	493,555
Investment in Associates – Unquoted **(Note 27.2)**	71,103	70,212	–
Total	695,670	628,397	493,555

27.1 Quoted

Nuwera Eliya Hotels Company PLC

	31 March 2013 Rs. '000	31 March 2012 Rs. '000
Carrying Value at the beginning of the Year	558,185	535,815
Increase/(Decrease) in Investment	–	–
Add: Share of Associates Profit/(Loss) before tax	94,481	42,457
Share of Associates tax expenses	(17,446)	(4,063)
Less: Dividend Received from Associates	(10,244)	(5,122)
Current Year Retained Profit	66,792	33,272
Changes in Equity not recognised in prior periods	(410)	(10,902)
Carrying Value at the end of the Year	624,567	558,185

Nuwera Eliya Hotels Company PLC

Company has a 26.12% (2012 – 26.12%) holding in Nuwera Eliya Hotel PLC which is a quoted public company and involved in the business of the hoteliering.

Share of Associate's Balance Sheet	31 March 2013 Rs. '000	31 March 2012 Rs. '000
Current Assets	159,213	97,543
Non–Current Assets	520,615	517,645
Current Liabilities	(36,218)	(39,514)
Non–Current Liabilities	(19,043)	(17,489)
Net Assets	624,567	558,185

Share of Associate's Revenue and Profit	31 March 2013 Rs. '000	31 March 2012 Rs. '000
Revenue	202,292	152,575
Profits	94,481	42,457

	31 March 2013 Rs. '000	31 March 2012 Rs. '000
27.2 Unquoted		
Fair View Hotels (Private) Limited		
Carrying Value at the beginning of the Year	70,212	–
Increase/(Decrease) in Investment	–	70,000
Add: Share of Associates Profit/(Loss) before tax	978	212
Share of Associates tax expenses	(87)	–
Less: Dividend Received from Associates	–	–
Current Year Retained Profit	891	212
Changes in Equity not recognized in prior periods	–	–
Carrying Value at the end of the Year	71,103	70,212

Fair View Hotels (Private) Limited

Company has a 38.88% (2012– 38.88%) holding in Fair View Hotel (Private) Limited of which operations have not been commenced yet and involved in the business of the hoteliering.

Share of Associate's Balance Sheet		
Current Assets	43,640	48,008
Non–Current Assets	27,495	22,251
Current Liabilities	(32)	(47)
Non–Current Liabilities	–	–
Net Assets	71,103	70,212
Share of Associate's Revenue and Profit		
Revenue	1,465	435
Profits	891	212

28. Property, Plant & Equipment

	Balance as at 01.04.2012 Rs. '000	Additions/ Transfers Rs. '000	Disposals/ Transfers Rs. '000	Balance as at 31.03.2013 Rs. '000
Gross Carrying Amounts				
At Cost/Cost Incurred Since Last Revaluation				
Land	–	–	–	–
Buildings	–	1,216	–	1,216
Plant and machinery	23,100	1,959	162	24,897
Computer hardware	53,520	10,151	240	63,431
Office equipment	34,776	8,728	–	43,505
Furniture and fittings	32,949	13,445	105	46,289
Fixtures	2,391	–	–	2,391
Motor vehicles	284,838	20,052	30,304	274,586
Office bicycles	7,605	4,758	1,231	11,132
Tools	213	96	–	309
	439,393	60,405	32,042	467,756
At Valuation				
Freehold land	714,700	–	–	714,700
Buildings	527,229	–	37,000	490,229
	1,241,929	–	37,000	1,204,929
Assets on Operating Leases				
Motor vehicles	56,635	–	26,058	30,577
	56,635	–	26,058	30,577
	1,737,956	60,405	95,099	1,703,261

	Balance as at 01.04.2012 Rs. '000	Charge for the year Rs. '000	Disposals/ Transfers Rs. '000	Balance as at 31.03.2013 Rs. '000
Depreciation				
At Cost				
Buildings	–	24	–	24
Plant and machinery	21,177	772	162	21,787
Computer hardware	36,392	7,213	240	43,365
Office equipment	19,359	2,917	–	22,276
Furniture and fittings	15,482	3,331	–	18,813
Fixtures	1,755	151	–	1,906
Motor vehicles	52,307	15,430	8,787	58,950
Office bicycles	1,089	1,143	423	1,809
Tools	134	43		177
	147,695	31,024	9,612	169,107
At Valuation				
Buildings	–	10,298	493	9,805
	–	10,298	493	9,805
Assets on Operating Leases				
Motor vehicles	24,641	5,536	17,048	13,129
	24,641	5,536	17,048	13,129
	172,336	46,858	27,154	192,041
	1,565,620			1,511,221
Capital Work–in–Progress	–	24,511	–	24,511
	1,565,620	–	–	1,535,731

	2013 Rs. '000	2012 Rs. '000
Net Book Values		
At cost/cost incurred since last revaluation	298,649	291,698
Assets on operating leases	17,448	31,994
At valuation	1,195,124	1,241,929
Capital Work–in–Progress	24,511	–
Total carrying amount of property, plant & equipment	1,535,731	1,565,620
Reconciliation of Net Book Values		
Net book value at the beginning of the year	1,565,620	1,214,751
Cost of additions/transfers/acquisitions	84,915	604,970
Depreciation charge for the year	(46,858)	(41,222)
Cost of disposals/transfers	(95,099)	(269,909)
Accumulated depreciation on disposals/transfers	27,154	57,030
Net book value at the end of the year	1,535,731	1,565,620

28.1 Revaluation of Property, Plant & Equipment

The land and buildings were revalued during the financial year 2011/2012 by a professionally qualified 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.

28.2 Information on the Freehold Land and Building 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 Amount Buildings Rs. '000	Revalued Amount Land Rs. '000	Net Book Value as at 31.03.2013 Rs. '000	As a % of Total NBV as at 31.03.2013	Net Book Value as at 31.03.2012 Rs. '000	As a % of Total NBV as at 31.03.2012
Kollupitiya								
No. 236, Galle Road, Colombo 03	32.56	46,777	304,100	227,900	525,918	43.96	532,000	42.84
Maharagama								
No. 176, Lake Road, Maharagama.	168.74	22,912	18,800	135,000	154,658	12.93	153,800	12.38
Maharagama								
No. 16, Batadombagahawatte Lane, Godigamuwa, Maharagama.	104.00	9,355	8,500	52,000	60,330	5.04	60,500	4.87
Kohuwala								
No. 28, Sunethara Devi Road, Kohuwala	88.00	27,543	59,829	176,000	234,709	19.62	235,829	18.99
Kohuwala								
No. 30/8, Sunethara Devi Road, Kohuwala	17.80	1,700	4,200	17,800	21,916	1.83	22,000	1.77
Borella								
No. 219, Dr. N.M. Perera Mw, Colombo 08	9.46	–	–	30,000	30,000	2.51	30,000	2.42
Nilaweli								
Nilaweli Village, Pulmoddai Road, Trincomalee	438.00	–	–	59,000	59,000	4.93	59,000	4.75
Negombo								
No. 26A, Colombo Road, Negombo	13.87	–	–	17,000	17,000	1.42	17,000	1.37
Kollupitiya								
No. 75–17/4, Kollupitiya Road, Colombo 03.	–	1,210	23,800	–	23,324	1.95	23,800	1.92
Kollupitiya								
No. 89–28/4 & 89–28/5, Kollupitiya Road, Colombo 03	–	3,583	71,000	–	69,580	5.82	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**	**1,196,435**	**100**	**1,241,929**	**100**

28.3 Revaluation

Freehold land and building of the Company were revalued by professionaly qualified independent value as at 31 March 2012.

Valuation as at 31 March 2012

				NBV before Revaluation as at 31 March 2012		Revalued Amount of		Revaluation Gain/ (Loss) Recognised on	
Location	Address	Name of the Valuer	Method of Valuation	Buildings Rs. '000	Land Rs. '000	Buildings Rs. '000	Land Rs. '000	Buildings Rs. '000	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, Sunethra 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, Sunethra 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

28.4 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 2013 Rs. '000	Net Carrying Amount 2012 Rs. '000	Net Carrying Amount 2011 Rs. '000
Class of Asset					
Freehold land	160,521	–	160,521	160,521	39,428
Freehold buildings	230,953	46,967	183,986	188,607	62,516
	391,476	46,967	344,507	349,128	101,944

28.5 During the financial year, the Company acquired Property, Plant & Equipment to the aggregate value of Rs. 60,405,000 (2012 Rs. 101,668,000/–). Cash payments amounting to Rs. 60,405,000/– (2012 Rs. 101,668,000/–) were made during the year for purchase of Property, Plant & Equipment.

28.6 Temporary Idle Property, Plant & Equipment

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.

28.7 Fully Depreciated Property, Plant & Equipment

The cost of Property Plant & Equipment as at Balance Sheet date includes the fully depreciated assets amounting to Rs. 96,604,973/– (2012 – Rs. 83,866,791/–).

28.8 Property, Plant & Equipment Pledged as Securities for Liabilities

Land with a carrying amount of Rs. 389,367,000/– (2012–Rs. 209,012,200/–) are subject to a primary mortgage to secure the Bank overdraft facilities.

28.9 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.

28.10 Compensation from third parties for items of Property, Plant & Equipment

There were no compensation received/receivable from third parties for items of Property Plant & Equipment that were impaired, lost or given up.

29. Leasehold Property

	Balance as at 01.04.2012 Rs. '000	Additions/ Transfers Rs. '000	Disposals/ Transfers Rs. '000	Balance as at 31.03.2013 Rs. '000
At Cost/Valuation				
Land	46,354	–	–	46,354
	46,354	–	–	46,354
Accumulated Amortisation				
Land	1,873	468	–	2,341
	1,873	468	–	2,341
Net Book Value	44,481			44,013

30. Intangible Assets

	Balance as at 01.04.2012 Rs. '000	Additions/ Transfers Rs. '000	Disposals/ Transfers Rs. '000	Balance as at 31.03.2013 Rs. '000
At Cost/Valuation				
Computer Software	7,984	5,376	–	13,360
	7,984	5,376	–	13,360
Accumulated Amortisation				
Computer Software	5,130	3,550	–	8,679
	5,130	3,550	–	8,679
Net Book Value	2,855			4,681

	31 March 2013 Rs. '000	31 March 2012 Rs. '000	1 April 2011 Rs. '000
31. Deposits due to Customers			
Fixed deposits **(Note 31.1)**	8,293,764	5,995,527	4,148,059
Certificate of deposits **(Note 31.2)**	115,773	124,045	133,076
Savings deposits	15,182	18,325	16,666
	8,424,720	6,137,897	4,297,801
31.1 Analysis of Fixed Deposits by Maturity Date			
1 to 90 days	2,512,875	2,332,779	1,458,759
91 to 365 days	3,690,360	3,104,687	2,138,790
More than 365 days	2,090,528	558,061	550,510
	8,293,764	5,995,527	4,148,059
31.2 Analysis of Certificate of Deposits by Maturity Date			
1 to 90 days	45,933	88,660	77,500
91 to 365 days	58,580	17,296	40,676
More than 365 days	11,260	18,089	14,900
	115,773	124,045	133,076
32. Debts Instruments Issued and Other Borrowings			
Money market borrowings	200,000	200,000	300,000
Short–term borrowings **(Note 32.1)**	1,100,000	200,000	785,877
Long–term borrowings **(Note 32.2)**	2,991,610	3,721,661	1,232,604
Commercial Papers	940,721	516,983	–
	5,232,331	4,638,644	2,318,481

	31 March 2013 Rs. '000	31 March 2012 Rs. '000	1 April 2011 Rs. '000	Terms of Repayment		
				Interest Rate	Period	Payment Terms
32.1 Short–Term Borrowings						
National Development Bank PLC	400,000	–	250,000	18.00%	1 Month	At Maturity
Commercial Bank of Ceylon PLC	–	–	300,000			
Seylan Bank PLC	–	200,000	200,000			
Sanasa Insurance Limited	–	–	10,494			
National Savings Bank	–	–	25,383			
Union Bank PLC	200,000	–	–	18.00%	1 Month	At Maturity
Pan Asia Bank PLC	100,000	–	–	20.00%	3 Month	At Maturity
Pan Asia Bank PLC	400,000	–	–	16.25%	3 Month	At Maturity
	1,100,000	200,000	785,877			

	31 March 2013 Rs. '000	31 March 2012 Rs. '000	1 April 2011 Rs. '000	Terms of Repayment		
				Interest Rate	Period	Payment Terms
32.2 Long–Term Borrowings						
Central Bank of Sri Lanka (Refinanced Borrowings)	54,688	70,313	85,938	6%	8 Years	Fixed Monthly Instalment
Securitized Borrowings	1,099,264	1,443,944	43,128	AWPLR+1.5% to 3.5%	4 Years	Variable Monthly Instalment
Sampath Bank PLC	93,750	168,750	243,750	15.35%	4 Years	Fixed Monthly Instalment
Sampath Bank PLC	118,750	193,750	268,750	14.85%	4 Years	Fixed Monthly Instalment
Sampath Bank PLC	137,500	212,500	293,122	14.85%	4 Years	Fixed Monthly Instalment
Sampath Bank PLC	269,000	489,500	–	15.35%	4 Years	Fixed Monthly Instalment
Sampath Bank PLC	363,500	395,000	–	17.35%	4 Years	Fixed Monthly Instalment
Commercial Bank of Ceylon PLC	181,250	256,250	–	13.85%	4 Years	Fixed Monthly Instalment
Hatton National Bank PLC	99,992	72,908	–	14.90%	4 Years	Fixed Monthly Instalment
Hatton National Bank PLC	47,900	149,996	200,000	14.90%	4 Years	Fixed Monthly Instalment
Hatton National Bank PLC	193,750	268,750	97,916	15.15%	4 Years	Fixed Monthly Instalment
Hongkong & Sanghai Banking Corporations Limited	208,333	–		SLIBOR + 4.5%	4 Years	Fixed Monthly Instalment
Hongkong & Sanghai Banking Corporations Limited	123,933	–		SLIBOR + 4.5%	4 Years	Fixed Monthly Instalment
	2,991,610	3,721,661	1,232,604			

Maturity analysis of borrowings is given in Note 50 to the Financial Statements.

33. Other Financial Liabilities

	31 March 2013 Rs. '000	31 March 2012 Rs. '000	1 April 2011 Rs. '000
Vendor payable	469,698	464,477	107,858
Insurance payable	60,259	30,731	40,250
Other payable	21,917	18,271	34,065
	551,874	513,478	182,173

34. Deferred Tax Liabilities

Summary of Net Deferred Tax Liability

	31 March 2013		31 March 2012		1 April 2011	
	Temporary Difference	Tax Effect	Temporary Difference	Tax Effect	Temporary Difference	Tax Effect
As at the beginning of the year	499,471	139,852	399,128	111,756	368,605	129,012
Amount originating/(reversing) during the year	(217,534)	(60,910)	60,850	17,038	30,523	10,683
Deferred tax effect on revaluation surplus on property	53,126	14,875	39,493	11,058	–	–
As at the end of the year	335,063	93,817	499,471	139,852	399,128	139,695

	31 March 2013 Rs. '000	31 March 2012 Rs. '000	01 April 2011 Rs. '000

35. Retirement Benefit Obligations

35.1 Provision for Retirement Benefit Obligations

	31 March 2013 Rs. '000	31 March 2012 Rs. '000	01 April 2011 Rs. '000
Balance at the beginning of the year	101,185	73,682	59,127
Expenses recognised in the Income Statement (Note 35.2)	18,391	29,512	17,347
Payments made during the year	(3,186)	(2,008)	(2,792)
Balance at the end of the year	116,390	101,186	73,682

35.2 Expenses Recognised in the Income Statement

	31 March 2013 Rs. '000	31 March 2012 Rs. '000	01 April 2011 Rs. '000
Interest cost	11,130	8,104	6,504
Current Service cost	9,354	7,568	5,982
Actuarial (Gain)/Loss	(2,093)	13,840	4,861
	18,391	29,512	17,347

Actuarial valuation of the gratuity liability was carried out as at 31 March 2013 by Messrs Actuarial & Management Consultants (Pvt) Ltd., 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 (LKAS 19) on 'Employee Benefits'.

35.3 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 rate (9%) 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 12% p.a. salary increment rate has been used in respect of the active employees.

	31 March 2013	31 March 2012	1 April 2011

36. Stated Capital/Share Capital

	31 March 2013	31 March 2012	1 April 2011
Opening balance (Rs.)	36,000	36,000	36,000
Issue of ordinary shares during the year	–	–	–
Closing balance (Rs.)	36,000	36,000	36,000
Movement in Number of Ordinary Shares			
Opening balance (numbers)	3,006,000	3,006,000	3,006,000
Issue of ordinary shares during the year	–	–	–
Closing balance (numbers)	3,006,000	3,006,000	3,006,000

37. Capital Reserve – Revaluation Reserve

	31 March 2013	31 March 2012	1 April 2011
Balance at the beginning	1,310,804	977,714	977,812
Additions in	–	333,090	–
Transfers out	(18,846)	–	(98)
Balance at the end	1,291,958	1,310,804	977,714

The revaluation reserve relates to revaluation of land & buildings of the Company and its associate company and represents the increase in the fair value of the land & buildings at the date of revaluation.

38. Statutory Reserve Fund

	31 March 2013 Rs. '000	31 March 2012 Rs. '000	1 April 2011 Rs. '000
Balance at the beginning	421,400	391,400	341,400
Additions in	50,000	30,000	50,000
Balance at the end	471,400	421,400	391,400

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.

39. General Reserve

	31 March 2013 Rs. '000	31 March 2012 Rs. '000	1 April 2011 Rs. '000
Balance at the beginning	2,851,430	2,531,430	1,702,430
Additions in	735,000	320,000	835,000
Transfers out	–	–	(6,000)
Balance at the end	3,586,430	2,851,430	2,531,430

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.

40. Investment Fund Reserve

	31 March 2013 Rs. '000	31 March 2012 Rs. '000	1 April 2011 Rs. '000
Opening Balance	41,951	–	–
Transfer from the income statement	48,755	41,951	–
Closing balance	90,706	41,951	–

As per the Budget proposal 2011, finance companies were required to establish and operate an Investment Fund Accounts (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.

	31 March 2013 Rs. '000	31 March 2012 Rs. '000	1 April 2011 Rs. '000
41. Available–for–Sale Reserve			
Opening balance	520,778	2,216,295	710,932
SLFRS adjustments	–	–	1,384,879
Net gain and losses on remeasuring available–for–sale financial assets	(301,090)	(1,695,517)	120,484
Closing balance	219,688	520,778	2,216,295

	31 March 2013 Rs. '000	31 March 2012 Rs. '000	1 April 2011 Rs. '000
42. Retained Earnings			
Opening balance	292,243	140,239	4,340
SLFRS adjustments	–		135,899
Total Comprehensive Income			
Profit for the year	630,791	610,088	
Transfer to other reserves	(830,192)	(391,951)	–
Dividends	(82,665)	(66,133)	–
Closing balance	10,176	292,243	140,239

43. Capital Commitments

There are no significant capital commitments which have been approved or contracted for by the Company as at 31 March 2013.

44. Contingencies

There are no contingencies as at 31 March 2013, 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.

45. 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.

46. 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 Personnel (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.

46.1 Parent & Ultimate Controlling Party

The Company does not have an identifiable Parent of its own.

46.2 Transactions with the 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.

46.3 Remuneration of Board Members and the Key Managerial Personnel

The members of the Board received remuneration totalling Rs. 43,259,515/- (2012 - Rs. 45,420,778/-) during the financial year under consideration. Key Managerial Personnel received a salary and related expenses totalling Rs. 59,796,497/– (2012 - Rs. 55,376,911/-) in the same financial year.

A total of Rs. 4,783,719/- (2012 - Rs. 3,621,052/-) 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. 8,969,473/- (2012 - Rs. 6,789,482/-).

46.4. Transactions involving Key Management Personnel (KMPs) & their Close Family Members (CFMs)

Statement of Financial Position	31 March 2013 Rs. '000	31 March 2012 Rs. '000	1 April 2011 Rs. '000
Loan & advances	5,601	5,706	–
Other receivables	–	–	–
Total	5,601	5,706	–
Deposits	161,349	71,905	58,068
Total	161,349	71,905	58,068

Income Statements (For the year ended 31 March)	2013 Rs. '000	2012 Rs. '000	2011 Rs. '000
Interest income	1,776	617	–
Interest expenses	5,902	7,686	5,454
Other income	–	–	–

46.5 Entities which are controlled by Key Management Personnel (KMPs) & their Close Family Members (CFMs).

Statement of Financial Position	2013 Rs. '000	Accommodation as a % of Capital Funds	2012 Rs. '000	Accommodation as a % of Capital Funds	2011 Rs. '000	Accommodation as a % of Capital Funds
Loans & advances	53,347	1.21	68,354	1.88	104,854	3.20
Other receivables	128		10,045		10,771	
Total	53,475		78,399		115,625	
Deposits	377,159		479,611		387,874	
Total	377,159		479,611		387,874	

Income Statements	31 March 2013 Rs. '000	31 March 2012 Rs. '000	1 April 2011 Rs. '000
Interest income	5,260	7,650	6,629
Interest expenses	39,270	44,200	33,520
Other income	13,584	11,459	11,411

47. 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.

48. 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 32 to the Financial Statements.

Nature of Assets	Nature of Liability	Carrying Amount Pledged 2013 Rs. '000	Included Under
Leases & hire purchase receivable	Long–term Short–term borrowings	3,362,067	Lease & hire purchase rental receivable
Shares	Long–term Short–term borrowings	679,657	Financial Investments – Available–for–Sale
Shares	Bank Overdraft	769,335	Financial Investments – Available–for–Sale
Shares	Bank Overdraft	503,089	Investments in Associates
Immovable properties	Bank Overdraft	389,367	Property, plant & equipment

49. Financial Reporting by Segments as per the Provisions of Sri Lanka Financial Reporting Standard (SLFRS) 08

The operating business are organized and managed separately according to the nature of the products and services provided with each segment representing a strategic business unit that offers different products and serves different market.

The following table presents the income, profit and assets and liability information on the Company business's segment for the year ended 31 March 2013 and Comparative figures for the year ended 31 March 2012.

49.1 Business Segments

	Finance Lease		Hire Purchase		Loans and Advances		Investments		Unallocated		Total	
For the year ended 31 March	2013 Rs. '000	2012 Rs. '000	2013 Rs. '000	2012 Rs. '000	2013 Rs. '000	2012 Rs. '000	2013 Rs. '000	2012 Rs. '000	2013 Rs. '000	2012 Rs. '000	2013 Rs. '000	2012 Rs. '000
Income from external operations												
Interest	842,281	530,514	1,446,418	870,809	674,194	187,253	92,791	39,166	–	–	3,055,684	1,627,742
Capital gains	–	–	–	–	–	–	123,179	590,916	–	–	123,179	590,916
Dividends	–	–	–	–	–	–	102,895	71,610	–	–	102,895	71,610
Others	–	–	–	–	–	–	–	–	56,286	39,822	56,286	71,758
Total income from external operations	842,281	530,514	1,446,418	870,809	674,194	187,253	318,865	701,692	56,286	39,822	3,338,044	2,362,026
Profit before tax	–	–	–	–	–	–	–	–	–	–	732,069	625,755
Taxation	–	–	–	–	–	–	–	–	–	–	(101,278)	(15,667)
Profit after tax	–	–	–	–	–	–	–	–	–	–	630,791	610,088
Other Information as at 31 March												
Segment assets	4,072,783	3,888,783	5,754,386	4,374,601	4,017,478	2,183,130	3,831,609	3,829,895	3,546,688	3,330,828	21,222,944	17,607,237
Segment liabilities	2,977,706	2,679,760	4,207,165	3,014,538	2,937,271	1,504,395	2,801,378	2,639,181	2,593,066	2,294,758	15,516,586	12,132,631
Net assets	1,095,077	1,209,023	1,547,221	1,360,063	1,080,207	678,735	1,030,231	1,190,714	953,622	1,036,070	5,706,358	5,474,606
Information on Cash Flows For the year ended 31 March												
Cash flows from operating activities	–	–	–	–	–	–	–	–	–	–	(574,897)	(2,575,597)
Cash flows from investing activities	–	–	–	–	–	–	–	–	–	–	388,487	383,788
Cash flows from financing activities	–	–	–	–	–	–	–	–	–	–	511,021	2,254,031
Capital expenditure	–	–	–	–	–	–	–	–	–	–	(60,405)	(101,668)
Net cash flow	–	–	–	–	–	–	–				264,206	(39,446)

50. Maturity Analysis

An analysis of the interest–bearing assets and liabilities employed by the Company as at 31 March 2013, 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	632,238	–	–	–	–	632,238
Financial investments – available–for–sale	101,530	304,588	–	–	70,370	476,488
Loans and receivables	634,296	1,046,116	1,480,899	830,736	25,430	4,017,477
Finance lease rentals receivable	475,702	937,899	2,068,380	557,299	33,503	4,072,783
Hire purchase installments receivable	862,922	1,409,042	2,904,316	637,818	1,753	5,815,851
Total interest–bearing assets	2,706,689	3,697,645	6,453,594	2,025,853	131,056	15,014,837
Percentage (%)	18.03	24.63	42.98	13.49	0.87	100.00
Bank overdraft	799,229	199,807	–	–	–	999,036
Bank borrowings	2,445,560	1,207,729	1,361,761	196,772	20,509	5,232,331
Deposits due to customers	2,573,991	3,748,940	1,280,499	821,290	–	8,424,720
Total interest–bearing liabilities	5,818,780	5,156,476	2,642,260	1,018,062	20,509	14,656,087
Percentage (%)	39.70	35.18	18.03	6.45	0.14	100.00

51. Explanation of Transition to New Sri Lanka Accounting Standards (SLAS)

As stated in Note 2 (1), these are the Company's first Financial Statements prepared in accordance with the new Sri Lanka Accounting Standards prefixed both SLFRS (corresponding to IFRS) and LKAS (corresponding to IAS), promulgated by The Institute of Chartered Accountants of Sri Lanka.

The Accounting Policies set out in Notes 3 to 6 have been applied in preparing the Financial Statements for the year ended 31 March 2013, the comparative information presented in these Financial Statements for the year ended 31 March 2012 and in the preparation of an Opening Statement of Financial Position as at 1 April 2011 (the Company's date of transition)

In preparing its opening new SLAS Statement of Financial Position , the Company has adjusted amounts reported previously in Financial Statements prepared in accordance with the previous SLAS. An explanation of how the transition from previous SLAS has affected the Company's financial position and financial performance is set out in the following tables and notes.

Reconciliation of Equity as at 01 April 2011 (Date of Transition to SLFRS)

	Previous SLAS Rs. '000	Effect of transition to SLAS Rs. '000	New SLFRS/LKAS Rs. '000
Assets			
Cash and bank balances	118,654	–	118,654
Placements with bank	43,440	(15)	43,425
Financial instruments – available–for–sale	3,754,535	1,384,879	5,139,414
Loans and receivables	662,226	24,945	687,171
Finance leases receivables	2,144,048	27,931	2,171,979
Hire purchase receivables	3,483,882	73,144	3,557,026
Other financial assets	28,387	–	28,387
Inventories	24,780	–	24,780
Other assets	218,075	–	218,075
Investment in associates	493,555	–	493,555
Property, plant & equipment	1,214,750	–	1,214,750
Leasehold property	44,950	–	44,950
Intangible assets	6,521	–	6,521
Total assets	12,237,803	1,510,884	13,748,687
Liabilities			
Bank overdraft	397,246	–	397,246
Deposits due to customers	4,307,695	(9,894)	4,297,801
Debt instruments issued and other borrowed funds	2,318,481	–	2,318,481
Other financial liabilities	182,173	–	182,173
Current tax liabilities	39,142	–	39,142
Deferred tax liabilities	139,695	–	139,695
Other liabilities	7,389	–	7,389
Retirement benefit obligations	73,682	–	73,682
Total liabilities	7,465,503	(9,894)	7,455,609
Shareholders' funds			
Stated capital	36,000	–	36,000
Revaluation reserve	619,628	–	619,628
Statutory reserve fund	391,400	–	391,400
Associates company reserve	358,086	–	358,086
General reserves	2,531,430	–	2,531,430
Investment fund reserve	–	–	–
Available–for–sale reserve	831,416	1,384,879	2,216,295
Retained earnings	4,340	135,899	140,239
	4,772,300	1,520,778	6,293,078
Total liabilities and shareholders' funds	12,237,803	1,510,884	13,748,687

Reconciliation of Equity as at 31 March 2012

	Previous SLAS Rs. '000	Effect of transition to SLAS Rs. '000	New SLFRS/LKAS Rs. '000
Assets			
Cash and bank balances	229,822	–	229,822
Placements with bank	118,046	(46)	118,000
Financial instruments – available–for–sale	3,836,666	(6,889)	3,829,777
Loans and receivables	2,092,462	90,668	2,183,130
Finance leases receivables	3,875,965	12,818	3,888,783
Hire purchase receivables	4,343,754	30,847	4,374,601
Other financial assets	79,801	–	79,801
Inventories	340,244	–	340,244
Other assets	321,726	–	321,726
Investment in associates	598,818	29,579	628,397
Property, plant & equipment	1,565,620	–	1,565,620
Leasehold property	44,481	–	44,481
Intangible assets	2,855	–	2,855
Total assets	17,450,257	156,977	17,607,237
Liabilities			
Bank overdraft	505,815	–	505,815
Deposits due to customers	6,145,601	(7,704)	6,137,897
Debt instruments issued and other borrowed funds	4,637,367	1,277	4,638,644
Other financial liabilities	513,478	–	513,478
Current tax liabilities	34,931	–	34,931
Deferred tax liabilities	139,852	–	139,852
Other liabilities	60,828	–	60,828
Retirement benefit obligations	101,186	–	101,186
Total liabilities	12,139,058	(6,427)	12,132,631
Shareholders' funds			
Stated capital	36,000	–	36,000
Revaluation reserve	921,360	–	921,360
Statutory reserve fund	421,400	–	421,400
Associates company reserve	358,060	31,384	389,444
General reserves	2,851,430	–	2,851,430
Investment fund reserve	41,951	–	41,951
Available–for–sale reserve	664,451	(143,673)	520,778
Retained earnings	16,547	275,696	292,243
	5,311,199	163,407	5,474,606
Total liabilities and shareholders' funds	17,450,257	156,980	17,607,237

Reconciliation of Comprehensive Income Statement for the year ended 31 March 2012

	Previous SLAS Rs. '000	Effect of transition to SLAS Rs. '000	New SLFRS/LKAS Rs. '000
Interest income	1,630,558	(2,816)	1,627,742
Interest expenses	(1,006,378)	(3,496)	(1,009,874)
Net interest income	624,180	680	617,868
Fees and commission income	31,968	–	31,968
Net fee and commission income	31,968	–	31,968
Other operating income	702,316	–	702,316
Total operating income	1,358,464	680	1,352,152
Impairment (charges)/reversal for loans and other losses	(26,827)	41,514	14,687
Provision for fall in value of investments	(136,784)	136,784	
Net operating income	1,194,853	178,978	1,337,465
Operating expenses			
Personnel costs	(218,800)	(1,011)	(219,811)
Depreciation of property & equipment	(41,223)	–	(41,223)
Amortisation of intangible assets	(3,919)	–	(3,919)
Amortisation of leasehold property	(468)	–	(468)
Defined benefit plans	(29,697)	–	(29,697)
Other operating expenses	(333,604)	–	(333,604)
Operating profit before valued added tax on financial services	567,142	179,989	708,743
Financial services VAT	(125,657)	–	(125,657)
Add: share of associate company's profit	45,390	(2,721)	42,669
Profit before taxation from operations	486,875	177,268	625,755
Taxation	(16,583)	916	(15,667)
Profit for the year	470,292	176,352	610,088

Explanation of Transition to SLFRS

Notes to the Reconciliations

(a) Placements with the Banks

The interest receivable on placement with the bank was recognised as a part of the placement at the year end as part of amortised cost according to the new SLAS requirement. The respective interest receivable balance was previously classified under other assets.

The impact arising from the change is summarised as follows:

	31.03.2011 Rs. '000	01.04.2011 Rs. '000
Statement of Financial Position		
Placement value as reported previously	110,688	43,000
Transfer of interest receivable form other assets	7,358	440
EIR adjustments	(46)	(15)
	118,000	43,425

(b) Financial Investments - Available-For-Sale

Company invests on certain assets with the intention of holding them maturity. These assets are now categorised under 'Financial Investments, Available-for-Sale and recorded in the Statement of Financial Position at market value. The difference between the cost and the fair value is accounted in the Statement of Changes in Equity through 'Other Comprehensive Income'.

The impact arising from the change is summarised as follows:

	31.03.2012 Rs. '000	01.04.2011 Rs. '000
Statement of Comprehensive Income		
Mark to market valuation on Government Securities	(6,889)	429
Mark to market valuation on quoted shares	(136,784)	1,384,450
	(143,673)	1,384,879
Statement of Financial Position		
New SLAS adjustments		
Mark to market valuation on Government Securities	6,889	429
Mark to market valuation on quoted shares	–	1,384,450
	6,889	1,384,879

(c) Loans, Hire Purchases & Lease Receivables

The impact arising from the change is summarised as follows:

Statement of Comprehensive Income		
Reversal of interest in suspense	3,827	–
Impairment charge for loan loss	14,687	–
	18,514	–
Statement of Financial Position		
New SLAS Adjustments		
Reversal of provision for credit losses as per CBSL	365,493	338,666
Reversal of interest in suspense	48,091	50,918
Allowance for impairment	(279,251)	(264,564)
Unamortised staff cost	(8,013)	(2,705)

(d) Other Assets

The impact arising from the change is summarised as follows:

Resulting changes due to the classification as per new SLAS

Statement of Financial Position		
Reclassification		
Interest Receivable on placements with bank	7,358	440
New SLAS Adjustments		
Unamortised staff cost	8,013	2,705
	15,371	3,145

(e) Deposits due to Other Customers

Interest payable to customers classified under the other liabilities has now been added back to 'Deposits due to other customers' as a part of amortised cost. Further, interest on deposits being recorded using EIR.

The impact arising from the change is summarised as follows:

	31.03.2012 Rs. '000	01.04.2011 Rs. '000
Statement of Comprehensive Income		
EIR adjustment on deposits	2,190	–
Statement of Financial Position		
Reclassification		
Interest payable on deposits	275,588	206,291
New SLAS Adjustments		
EIR Adjustments	(7,704)	(9,894)
	267,884	196,397

(f) Debts Instruments Issued and Other Borrowed Funds

Interest payable on borrowings has now been added back to borrowings.

The impact arising from the change is summarised as follows:

Statement of Comprehensive Income		
EIR adjustments on borrowings	1,274	–
	1,274	–
Statement of Financial Position		
Reclassification		
Interest payable on borrowings	27,971	3,275
New SLAS Adjustments		
EIR adjustments	1,274	–
	29,245	3,275

(g) Other Liabilities

Interest payabel on Deposits and Borrowings recognised under the 'Other Liabilities' has now been reclassified under the 'Deposits due to other customers' and Borrowings.

The impact arising from the change is summarised as follows:

Statement of Financial Position		
Reclassification		
Interest payable on deposits & borrowings	(303,559)	(209,566)
	(303,559)	(209,566)

(h) Retained Earnings

Impact arising due to new SLAS adjustments is summarised as follows:

	31.03.2012 Rs. '000	01.04.2011 Rs. '000
Statement of Financial Position		
New SLAS Adjustments		
Reversal of provision for credit losses as per CBSL	365,493	338,666
Reversal of interest in suspense	48,091	51,918
Allowance for impairment	(279,251)	(264,564)
Fair value adjustment on available-for-sale	136,784	–
EIR Adjustments on deposits & borrowings	6,384	9,879
Share of profit/(loss) from Associates	(1,805)	–
	275,696	135,899

(i) Available -for-Sale Reserves

Company invests on certain assets with the intention of holding them maturity. These assets are now categorised under 'Financial Investments, Available-for-sale and recorded in the Statement of Financial Position at market value. The difference between the cost and the fair value is accounted in the Statement of Changes in Equity through 'Other Comprehensive Income'.

Impact arising from the changes is summarised as follows:

	31.03.2012 Rs. '000	01.04.2011 Rs. '000
Statement of Financial Position		
New SLAS Adjustments		
Mark to market valuation on Government Securities	(6,889)	429
Mark to market valuation on quoted shares	(136,784)	1,384,450
	(143,673)	1,384,879

(j) Interest Income

Arising due to amortisation of day one difference on staff loans granted at concessionary rate and due to reversal of interest in suspense.

	31.03.2012 Rs. '000	01.04.2011 Rs. '000
Amortised staff cost - interest income	1,011	–
Net reversal of interest in suspense	(3,827)	–
	(2,816)	–

(k) Interest Expense

Arising due to EIR adjustment on deposits & borrowings:

EIR adjustments on deposits & borrowings	3,496	–
	3,496	–

(l) Personal Expenses

There was a difference as a result of amortisation of day one difference on staff loans granted at concessionary rate and was duly accounted.

Impact arising from the changes is summarised as follows:

Statement of Comprehensive Income		
Amortised staff cost - personal expense	1,011	–
	1,011	–

52. Fair Value of Financial Instruments

Financial Instruments Recorded at Fair Value

The following is a description of how fair values are determined for financial instruments that are recorded at fair value using valuation techniques. These incorporate the company's estimate of assumption that a market participant would make when valuing the instrument.

Financial Investments - Available-for-Sale

Available-for-sale financial assets, primarily consists of quoted equities and Government debt securities that are valued using valuation techniques or pricing models. These assets are valued using models that use observable data. Government debts securities are valued using yield curves published by the Central Bank of Sri Lanka and quoted equities are valued using quoted market prices in the active market as at the reporting date.

Determination of Fair Value and Fair Value Hierarchy

For all financial instruments where fair values are determined by referring to externally quoted price or observable pricing inputs to models, independent price determination or validation is obtained. In an inactive market, direct observation of a trade price may not be possible. In these circumstances the Company uses alternative market information to validate the financial instrument's fair value with greater weight given to information that is considered to be more relevant and reliable.

Fair Values are Determined according to the following Hierarchy

Level 1 - Quoted market price (unadjusted): financial instruments with the quoted prices in active markets.

Level 2 - Valuation technique using observable inputs: financial instruments with quoted prices for similar instruments in active markets or quoted prices for identical or similar instruments in inactive markets and financial instruments are valued using models where all significant inputs are observable.

Level 3 - Valuation technique with significant unobservable inputs: financial instruments are valued using valuation techniques where one or more significant inputs are unobservable.

The following table shows an analysis of financial instruments recorded at fair value by the level of the fair value hierarchy.

	Level 1 Rs. '000	Level 2	Level 3	31.03.2013 Total Rs. '000
Financial investments available-for-sale				
Quoted investments	2,979,592	–	–	2,979,592
Government debt securities	476,488	–	–	476,488
Corporate debts securities	10,773	–	–	10,773
	3,466,853	–	–	3,466,853

	Level 1 Rs. '000	Level 2	Level 3	31.03.2012 Total Rs. '000
Financial investments available-for-sale				
Quoted investments	3,389,904	–	–	3,389,904
Government debt securities	439,446	–	–	439,446
	3,829,350	–	–	3,829,350

There were no transfer between Level 1 and Level 2 during the 2012 & 2013.

Set out below is a comparison of the carrying amounts and fair values of the company's financial instruments by classes, that are not carried at fair value in the Financial Statements. This table doesn't include the fair values of non-financial assets and non-financial liabilities.

	31.03.2013 Carrying Amount Rs. '000	31.03.2013 Company Fair Value Rs. '000
Financial assets		
Cash and cash equivalents	632,238	632,238
Placements with bank	364,330	364,330
Loans & receivables	4,017,478	4,017,478
Finance leases receivables	4,072,783	4,072,783
Hire purchase receivables	5,754,386	5,754,386
Other financial assets	172,148	172,148
	15,013,363	15,013,363
Financial liabilities		
Bank overdraft	999,036	999,036
Deposits due to customers	8,424,720	8,424,720
Debt instruments issued and other borrowings	5,232,331	5,232,331
Other financial liabilities	551,874	551,874
	15,207,960	15,207,960

	31.03.2012 Carrying Amount Rs. '000	31.03.2012 Company Fair Value Rs. '000
Financial assets		
Cash and cash equivalents	229,822	229,822
Placements with bank	118,000	118,000
Loans & receivables	2,183,130	2,183,130
Finance leases receivables	3,888,783	3,888,783
Hire purchase receivables	4,374,601	4,374,601
Other financial assets	79,801	79,801
	10,874,137	10,874,137
Financial liabilities		
Bank overdraft	505,815	505,815
Deposits due to customers	6,137,897	6,137,897
Debt instruments issued and other borrowings	4,638,644	4,638,644
Other financial liabilities	513,478	513,478
	11,795,834	11,795,834

Fair Value of the Financial Assets and Liabilities Not Carried at Fair Value

The following describes the methodologies and assumptions used to determine fair values for those financial instruments which are not already recorded at fair value in the Financial Statements.

Assets for which Fair Value Approximate Carrying Value

For financial assets and liabilities that have a short-term maturity it is assumed that carrying amount approximate their fair value. This assumption is also applied to savings accounts which doesn't have specific maturity.

Reclassification of the Financial Assets

There have been no reclassification during the 2012 & 2013.

53. Financial Risk Management

Over the past decade, risk management and reporting issues related to financial institutions valuations of complex and liquid financial instruments, and their impact for capital requirement and profitability of financial institutions, have received a momentous consideration.

Importance of robust risk management and control process around the measurement of fair value accounting to a wide range of financial instruments reliably is critical to any finance company together with experience from the recent market turmoil's.

53.1 As a Finance Company MI is exposed to following key risks arising from dealing in Various Financial Assets and Liabilities

- Credit risk
- Liquidity risk
- Market risk
- Operational risk

This note discloses information on MI's exposure to each of above risks and company's management process for risk identification, risk measurement and monitoring risk. MI's risk management process is streamlined in effect to ensure there is appropriate balance between risk and rewards. Through instilling of controls and strategies management mitigates and avoid risk and aims at maximising profitability in turn.

53.2 Risk Management Framework

53.2.1 Board Role in Risk Management

The Board of Directors has overall responsibility for the establishment and oversight of the MI's overall risk management framework. The Board discharges its governance responsibility through two key Board Subcommittees. Namely; the Board Integrated Risk Management Committee (IRMC) and the Audit Committee. Other committees established either at Board subcommittee level or Management level, concentrate on specified aspects of business further assist indirectly the IRMC in upholding a sound risk management process.

Based on IRMC's terms of reference, a formal risk management policy was established in the year under review to identify and analyse the risks specific to the company and set forth a mechanism to counter potential risks. The established risk management policy, controls and systems in place are reviewed quarterly to ensure they are adequate in the light of market sophistication and changes occurring to products and services offered. At MI, risks are measured using appropriate techniques based on type of risk involved and uses several measures to obtain correct measurement at any given time. MI also carries out sensitivity analysis and stress testing of key risks to ascertain worst case scenarios and forecast scenarios based on specific assumptions, the results of which are reported to the Board through the IRMC.

MI's risk management policies have been aligned to overall businesses strategy. Hence based on specified risk limits and other accepted industry norms on risk tolerance levels, any negative deviations and exceeding of limits are captured through a sound process of risk measurement and appropriately reported to IRMC for their guidance and instructions.

53.2.2 Corporate Managements Role in Risk Management

It is the responsibility of the head of following departments forming part of MI's corporate management to instill appropriate controls within their scope to minimise and mitigate risk, based on the approved 'Risk Policy' of the Company.

1. Credit and Marketing Division including Branches.
2. Deposits Division.
3. Recoveries Division.
4. Finance Division.
5. Legal Division.
6. Other Support Divisions.

Please refer page 160 which details the composition of the IRMC and their duties performed and page 142 to 147 to obtain full particulars relating to the Audit Committee including its composition and task performed.

53.3 Credit Risk

Credit risk is the risk of financial loss to the company if a borrower to a financial instrument fails to meet its contractual obligations. This arises principally from the company's loans and advances portfolio and from other similar financial instruments including investments in debt securities.

MI takes into account all elements of credit risk exposures both at micro and macro level including individual obligor default risk, industry and geographical risk for its credit risk management process.

53.3.1 Credit Risk Management Process

The Credit and Marketing Division is responsible to ensure strict credit policies, procedures and practices are followed that specify clear controls in mitigating credit risk. From the moment of customer inquiry to final disbursement and then to the process of collection, that is handled by the Recoveries Division. In addition, the Credit Committee is entrusted to review and approve high value credit and make necessary changes to credit practices as deemed necessary.

As part of mitigating credit risk, the company falls back on various types of collaterals which are valued by recognized external parties together with an internal valuation as suitable. The details of valuations are recorded in the credit appraisal form and considered for purpose of granting credit. The credit division is expected to take collateral against proposed lending merely as a precaution, as a secondary source of payment in the event of a borrower default.

In parallel, at macro level the IRMC through the risk manager carries out monthly, quarterly and annual risk assessment related to credit risk and propose suitable recommendations for its mitigation.

Credit Operation Manual

MI's credit operation manual plays a key role in managing daily credit operations specifying collateral requirements, document requirements, laying down credit assessment process with applicable credit authority limits. MI has developed a credit manual which includes customer selection, early alert reporting, due diligence, statutory requirements and portfolio monitoring. The manual is reviewed periodically by the credit committee of the company and reports to the Board on due changes necessary as and when the need arises. The committee ensures that the credit manual is aligned at all times with MI's overall business strategy and changing business needs.

Loan Origination

Loan origination process of MI encompasses initial screening and credit appraisal. This process focuses on customer's creditworthiness by referring to CRIB and by carrying out direct inspection though site visits. As an integral part of the risk mitigation process, MI reviews type and the quality of collaterals given to the company in the loan origination process.

Credit Authorisation Structure

Credit authorisation limits have been specified based on credit officer's grade. Credit facilities exceeding these threshold values require approval from either the head of credit, Credit Committee or the Board of Directors depending on the value in concern.

Credit Appraisal Process

Reviewing and assessing credit risk is done by credit officers and then reviewed by relevant manager/senior manager/General Manager – credit and marketing. They assess all credit exposures within their designated limits prior to granting the facility to the customer in concern and assess the adequacy of the collaterals given against proposed credit as a ratio as a key risk mitigating factor. Renewals of facilities are also subject to the same risk appraisal process.

Credit Administration and Distribution

MI's loan portfolio is centrally administrated through the head office which primarily handles efficient disbursement of credit, settlement recovery, processing renewal notices and customer educating and advising.

Branches in parallel support in bring in credit business and involve themselves in initial credit documentation collection and review, credit appraisal and recommending credit or approving them as appropriate and also support in collection of installments for the lending's carried out.

Credit Measurement and Monitoring

The IRMC measures and tracks the status of the credit portfolio periodically, by scenario analysis, impact studies and by identifying early warning signals. The committee also prepares a credit risk dashboard bimonthly with the help of Manager – Risk and Compliance to review the key credit portfolios in concern. The overall accountability of the credit risk function vest with the IRMC of the company. Any related concerns or adverse trends are addressed by the Committee in coordination with the relevant officers of the corporate management.

A periodic review of credit risk is done by the IRMC committee by comparing actual credit exposures against set internal limits, including those for selected industries, geographical areas and product types.

Recovery Process

MI's problematic loan portfolio is managed by the Recoveries Division. This division is totally accountable for overall aspects of non–performing loan facilities, restructuring of credit facilities, reviewing the value of collaterals, legal documentation and liaising with the customer for recovery collection. Recoveries division functions are impeccably aligned with credit administration and credit risk management process to ensure a sound and effective credit disbursement and recovery system to maintain organisational objectives on asset quality.

Regular Audit of Divisions

Based on a predefined annual audit programme that covers credit review requirements, continuous audits are done by MI's internal audit division jointly with Ernst and Young Advisory Services (Pvt) Limited.

Definitions Related to Credit

- *Impairment*

This occurs when recoverable amount of an asset is less than its carrying amount. Please refer pages 289 to 290 in notes to the Financial Statements for details on impairment methodology adopted and related policies.

- *Past Due*

MI considers that any amount uncollected one day or more beyond their contractual due date are 'past due'.

53.3.2 Credit Quality by Class of Financial Assets

MI ascertains the credit quality of financial asset using a company specific credit quality categorisation method based on collateral buffer and loss rate indicators. Below table shows the credit quality of MI's financial assets by its class as at the end of the financial year based on the credit risk categorisation mechanism of MI.

53.3.2.a Credit Quality by class of Financial Assets

As at 31st March 2013

	Neither past due nor Impaired			Past due not impaired	Individually impaired	Total
	High grade Rs. '000	Standard grade Rs. '000	Low grade Rs. '000	Rs. '000	Rs. '000	Rs. '000
Financial Assets						
Cash & short term funds	632,238	–	–	–	–	632,238
Placement with other banks	364,330	–	–	–	–	364,330
Financial investments – available for sale	3,467,280	–	–	–	–	3,467,280
Other financial assets	172,148	–	–	–	–	172,148
Hire purchase receivables	888,469	2,509,762	849,022	1,428,160	238,496	5,913,909
Finance lease receivables	1,433,848	1,583,554	–	1,025,186	134,371	4,176,959
Loans and receivables	3,516,412	–	–	493,418	61,909	4,071,739
Total	**10,474,725**	**4,093,316**	**849,022**	**2,946,764**	**434,776**	**18,798,603**

Commentary

More than 55% of MI's financial assets are of 'high grade' which are neither past due nor impaired mainly comprising of the lending's and financial investments – available–for–sale. There is constant review of individual impaired past due not impaired and low grade accounts by MI's recovery division to sustain overall asset quality, taking appropriate recovery measures on a timely manner.

53.3.2.b Past due (facilities in arrears of 1 day and above) but not Impaired Age Analysis by Class of Financial Assets;

	Past due not impaired					Total
	Less than 30 days Rs. '000	31 to 60 days Rs. '000	61 to 90 days Rs. '000	91 to 120 days Rs. '000	120 to 180 days Rs. '000	Rs. '000
Hire Purchase Receivables	839,603	369,075	128,646	66,779	24,057	1,428,160
Finance Leases Receivables	595,480	245,384	92,536	62,509	29,277	1,025,186
Loans & Receivables	289,771	124,172	33,072	28,561	17,842	493,418
Total	**1,724,855**	**738,630**	**254,254**	**157,849**	**71,176**	**2,946,764**

53.3.2.c. Types of Collateral Taken Minimise Credit Exposure

Type of Lending	Collateral generally obtained
Lease	Agricultural land and vehicles, Commercial property, Computer hardware and equipment, Dual purpose vehicles, Land vehicles, Motor bicycles, Motor cars, Motor coaches, Motor lorries, Motor Tricycles, Non–agricultural land vehicles, Other equipment, Other machinery, Prime movers, Tractor three wheels and tractor four wheels.
Hire Purchase	Same as above
Personal Loans/Term Loans	Same as above except Residential property.
Micro Finance	Promissory notes

The Company resorts to repossession of assets kept as security when the borrowers default goes beyond the specified credit period. The sales proceeds resulting from the subsequent sale of such assets are then used to minimise credit risk exposure.

53.3.3 Analysis of Risk Concentration

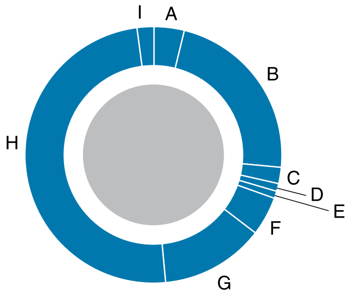
MI monitors credit concentration risk by referring to the degree of credit exposure by MI to various sectors and by geographic location.

53.3.3. a Sectorwise Analysis

The following table shows the maximum credit exposure of MI's loans and advances to various sectors as at the end of the financial year:

Concentration by Sector	As at 31.03.2013 Rs. '000	%	As at 31.03.2012 Rs. '000	%
Agriculture	496,549	4%	329,809	3%
Commercial	3,189,934	23%	2,370,206	22%
Consumption	317,340	2%	204,950	2%
Finance	75,665	1%	90,365	1%
Housing and Property	76,575	1%	70,937	1%
Industrial	755,880	5%	593,999	6%
Others	1,787,398	12%	1,476,434	14%
Services	7,150,707	50%	5,390,278	50%
Tourism	312,560	2%	205,843	2%
Total	14,162,608	100%	10,732,821	100%

Sectorwise Credit Concentration 2012/13



A - Agriculture - 4%
B - Commercial - 23%
C - Consumption - 2%
D - Finance - 1%
E - Housing and Property - 1%
F - Industrial - 5%
G - Others - 12%
H - Services - 50%
I - Tourism - 2%

Commentary

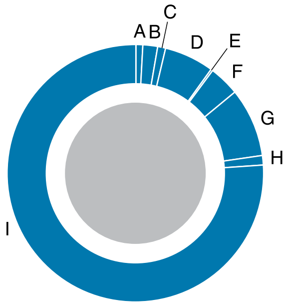
There is a high percentage lending to services sector reaching 50% of total lending mainly attributed to lending's carried out for transportation services. Management would monitor risk levels attached to these sectors on an ongoing basis. Currently, these sectors do not pose any significant risk.

53.3.3.b Province–Wise Analysis

This table below discloses MI's credit exposure to various provinces based on the lending carried out by MI's branch network that is scattered across the country.

Concentration by Province	As at 31.03.2013 Rs. '000	%	As at 31.03.2012 Rs. '000	%
Western	10,762,012	75.99%	8,737,225	81.41%
Central	115,233	0.81%	85,205	0.79%
Eastern	277,907	1.96%	194,109	1.81%
North Central	171,417	1.21%	61,590	0.57%
North Western	869,707	6.14%	570,743	5.32%
Northern	8,823	0.06%	3,450	0.03%
Sabaragamuwa	578,892	4.09%	467,539	4.36%
Southern	1,191,459	8.41%	505,662	4.71%
Uva	187,158	1.32%	107,298	1.00%
Total	14,162,608	100.00%	10,732,821	100.00%

Provincewise Credit Concentration 2012/13



A - Central - 1%
B - Eastern - 2%
C - North Central - 1%
D - North Western - 6%
E - Northern - 0%
F - Sabaragamuwa - 4%
G - Sourthern - 8%
H - Uva - 1%
I - Western - 76%

Commentary

MI lending mainly concentrated around Western province with a 76% contribution towards total lending compared to last year's 81%. In keeping to MI's expansion strategy and volume growth expectation outside western province, there is already a clear indication of diversification to other regions, in particular to Southern province.

53.4 Liquidity Risk

Liquidity Risk arises when the Company encounters difficulties in meeting its financial liabilities by settlements made either in cash or through another financial asset.

MI is a financially sound institution that has been strong in liquidity throughout its history. The key sources of funding for the Company is its capital base, core deposits mobilised from customers, borrowings obtained from money market instruments and bank funding lines. MI has implemented strict policies on managing of its assets, keeping liquidity as a vital focus, monitoring the liquidity position on a daily basis.

The Company has developed adequate control mechanisms to manage liquidity both in short and longer horizon by estimating future cash flows. In devising the three year strategic plan, long–term cash flow position was projected so that appropriate strategic measures could be devised to manage future liquidity requirements.

The responsibility for treasury management function lies with the finance division under the leadership of the Finance Director who is also the CFO of the Company. During the year, in managing short and medium term funding needs, the division resorted to following measures to mobilise funds in addition to encouraging significantly its primary source of funding being its deposit business:

1. Utilising existing borrowing lines from MI’s traditional borrowing partners.
2. Seeking fresh funding lines from other banks and funding lines.
3. Seeking negotiation for a foreign funding line.
4. Alternative borrowing such as commercial paper and short term borrowing derived from individuals and corporate institutions.

53.4.1.a Exposure to Liquidity Risk

Ratio	2013	2012
Net Loans/Customer Deposits	164%	170%
Net Loans/Total Assets	65.2%	59.3%
Statutory Liquid Asset Ratio (LAR):		
Average for the year	13.1%	11.7%
Minimum for the year	12%	10.3%
Maximum for the year	17.1%	12.9%

Commentary

MI was able to maintain statutory liquidity ratio well above the minimum requirement as at the balance sheet date. MI’s net loans to deposits ratio is at 164% and Management plans to bring this ratio below 120% as per forecast within the next financial year with the planned growth in deposits.

53.4.1.b Analysis of Assets and Liabilities by Remaining Contractual Maturities

The following tables show the maturity gap analysis of MI's financial assets and financial liabilities based on their remaining period to maturity undiscounted as at 31 March 2013.

Contractual Maturities of Undiscounted Cash Flows of Assets and Liabilities – As at 31 March 2013

	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	Unclassified Rs. '000	Total Rs. '000
Assets							
Cash & short–term funds	632,238	–	–	–	–	–	632,238
Placement with other banks	91,082	273,248	–	–	–	–	364,330
Financial investments – available for sale	2,536,673	304,588	–	–	70,370	555,649	3,467,280
Loans and receivables	634,296	1,046,116	1,480,899	830,736	12,689	12,742	4,017,478
Financial lease receivables	475,702	937,899	2,068,379	557,299	2,770	30,734	4,072,783
Hire purchase receivables	862,922	1,409,042	2,904,315	637,818	1,753	(61,464)	5,754,386
Investment in associates	–	–	–	–	–	695,670	695,670
Other financial assets	129,111	43,037	–	–	–	–	172,148
Inventories	93,426	85,196	42,598	–	–	–	221,220
Other assets	80,689	160,297	–	–	–	–	240,986
Property, plant & equipment	–	–	–	–	–	1,535,731	1,535,731
Leasehold property	–	–	–	–	–	44,013	44,013
Intangible assets	–	–	–	–	–	4,681	4,681
Total assets	**5,536,139**	**4,259,423**	**6,496,191**	**2,025,853**	**87,582**	**2,817,756**	**21,222,944**
Liabilities							
Bank overdrafts	799,229	199,807	–	–	–	–	999,036
Deposits from customers	2,573,991	3,748,940	1,280,499	821,290	–	–	8,424,720
Borrowings	2,445,560	1,207,729	1,361,761	196,772	20,509	–	5,232,331
Other financial liabilities	434,450	117,424	–	–	–	–	551,874
Tax liabilities	–	81,322	–	–	–	–	81,322
Deferred tax liability	–	–	–	–	–	93,817	93,817
Other liabilities	17,096	–	–	–	–	–	17,096
Retirement benefit obligations	–	–	–	–	–	116,390	116,390
Equity	–	–	–	–	–	5,706,358	5,706,358
Total liabilities	**6,270,326**	**5,355,222**	**2,642,260**	**1,018,062**	**20,509**	**5,916,565**	**21,222,944**
Total net assets/(liabilities)	**(734,187)**	**(1,095,799)**	**3,853,931**	**1,007,791**	**67,073**	**(3,098,809)**	
Cumulative total net assets/(liabilities)	**(734,187)**	**(1,829,986)**	**2,023,945**	**3,031,736**	**3,098,809**		

Commentary

To bridge the less than one year maturity gap of Rs. 1.8 billion, MI continues to focus on obtaining deposits that of longer term and plans to seek borrowings that are either medium term or longer. It is a common factor that the LFC sector operates on a negative gap in the shorter run based on the nature of doing business.

53.5 Market Risks

Market risk would arise when the fair value or future cash flows of financial instruments of the Company fluctuate due to changes in market variables such as interest rates, exchange rate and equity prices. MI's market risk exposure primary revolves around interest rate risk and equity price risk. As the authorised money changing business commenced only recently and transaction values and exposure involved is negligible, MI is not faced with exchange rate risk materially at present.

53.5.1 Interest Rate Risk

Interest Rate Risk arises due to fluctuations in the interest rate resulting in adverse impact to future cash flows or the fair values of financial instruments of the Company.

MI's approach in managing interest rate risk is to continuously monitor positions on a daily basis to levels that are viable and prudent. In analysing impacts of interest rate movements on profitability, The Management carried out sensitivity analysis on MI's financial assets and liabilities to various interest rate scenarios.

53.5.1.a Interest Rate Sensitivity Analysis

Given below is a sensitivity analysis carried out as at 31 March 2013 that demonstrates possible impact to MI's Income Statement due to a given change in interest rates, keeping all other variables constant.

	Market Rates up by 1% effect to the Interest Income/(Expenses) Rs. '000	Market Rates drop by 1% effect to the Interest Income/(Expenses) Rs. '000
Effect on Rate sensitive Assets	146,561	(146,561)
Effect on Rate sensitive Liabilities	(145,438)	145,438
Sensitivity/Effect to Income statement	1,123	(1,123)

53.5.1.b Financial Assets and Financial Liabilities Exposed to Interest Rate Risk

Disclosed below are the Company’s financial assets and financial liabilities exposed to interest rate risk as at 31 March 2013. The financial assets and financial liabilities so disclosed are at their carrying amounts and categorised by the earlier of contractual repricing or maturity dates.

Interest Rate Sensitivity Gap Analysis of MI as at 31 March 2013

	Up to 3 months Rs. ’000	4 to 5 months Rs. ’000	6 to 12 months Rs. ’000	1 to 3 years Rs. ’000	3 to 5 years Rs. ’000	More than 5 Years Rs. ’000	Non-Sensitive Assets/ Liabilities Rs. ’000	Total Rs. ’000
Liabilities & Shareholders’ Funds								
Bank overdraft	999,036							999,036
Deposits due to customers	2,573,991	1,548,965	2,199,975	1,280,499	821,290			8,424,720
Debt instruments issued and other borrowings	1,992,880	34,565	303,776	2,163,097	683,325	54,688		5,232,331
Other financial liabilities							551,874	551,874
Current tax liabilities							81,322	81,322
Deferred tax liability							93,817	93,817
Other liabilities							17,096	17,096
Retirement benefit obligation							116,390	116,390
Equity							5,706,358	5,706,358
Total Liabilities & Shareholders’ Funds (b)	**5,565,907**	**1,583,530**	**2,503,751**	**3,443,596**	**1,504,615**	**54,688**	**6,566,857**	21,222,944
Assets								
Cash & short–term funds							632,238	632,238
Placement with other banks	272,362	40,442	51,526					364,330
Financial investments – Available–for–sale	165,902	151,135	89,080			70,370	2,990,793	3,467,280
Loans and receivables	1,007,948	338,096	455,380	676,192	755,854	676,192	107,816	4,017,478
Lease receivables	(17,184)	14,537	111,676	1,778,987	2,134,838	20,201	29,728	4,072,783
Hire purchase receivables	2,209	24,323	265,496	2,756,009	2,687,223	14,958	4,168	5,754,386
Investment in associates							695,670	695,670
Other financial assets							172,148	172,148
Inventories							221,220	221,220
Other assets							240,986	240,986
Property, plant & equipment							1,535,731	1,535,731
Leasehold property							44,013	44,013
Intangible assets							4,681	4,681
Total assets (a)	1,431,237	568,533	973,158	5,211,188	5,577,915	781,721	6,679,192	21,222,944
Repricing gap (a–b)	(4,134,670)	(1,014,997)	(1,530,593)	1,767,592	4,073,300	727,033		
Cumulative repricing gap	(112,335)	4,022,335	5,037,332	6,567,925	4,800,333	727,033		

Commentary

MI possesses interest rate sensitive assets of Rs. 14.7 billion and rate sensitive liabilities of Rs. 14.5 billion. Currently the impact from an interest rate fluctuation of 1%+ or (1%) is negligible.

53.5.2 Equity Risk

Equity risk is the risk of the Company's equity investments value depreciating because of stock market forces causing losses. MI has a significant level of equity investments and thus keeps close watch on movements in share prices to ascertain equity risk. MI possesses a well–diversified share portfolio that has been primarily invested in large blue chip institutions that are in mostly hotel and banking sector.

MI monitors the share market movements against the prevailing shareholding of the Company and ascertains impacts to profitability on an on–going basis. MI share portfolio analysis reports are generated periodically for the Corporate Management. They review these reports closely to take prudent decisions based on market conditions, predictions and trends mentioned in such reports.

The Company carried out a risk analysis on its share portfolio based on possible downward market changes, considering the last three years lowest market prices recorded in the Colombo Stock Market for this financial year. Based on this analysis, the maximum amount of equity risk effect to the comprehensive statement of income is Rs. 543 million as at the end of 31 March 2013.

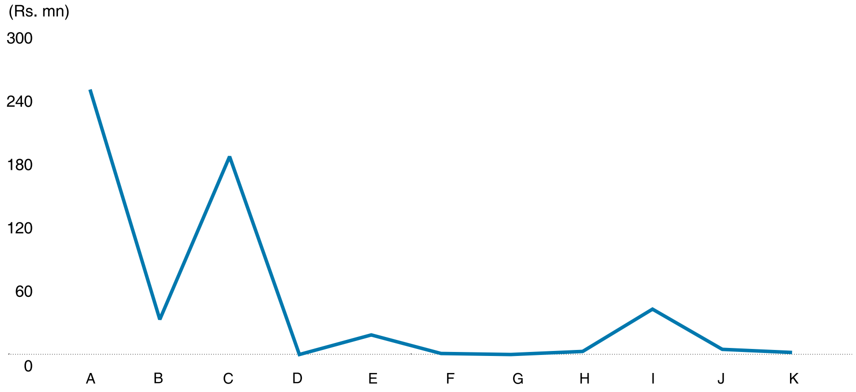
53.5.2.a Risk Analysis of Equity–based Investment Portfolio

The table below demonstrates the maximum equity risk exposure as at 31 March 2013 industry wise for the equity investment holding of MI:

Industry	Market Value as at 31 March 2013 (Rs. '000)	Lowest Market Value for Last 3 Years Lowest (Rs. '000)	Effect to the Comprehensive Statement of Income if Market drop to the recorded lowest market price (Rs. '000)
Banks, Finance & Insurance	1,276,579	1,025,884	250,695
Diversified Holdings	191,996	159,012	32,984
Hotels & Travels	1,302,890	1,115,632	187,258
Investment Trust	964	674	290
Manufacturing	54,725	36,575	18,150
Power & Energy	2,417	1,778	640
Land & Property Development	650	400	250
Motor	9,600	6,400	3,200
Telecommunication	99,000	56,100	42,900
Construction & Engineering	34,470	29,463	5,007
Trading	6,300	4,800	1,500
Total	**2,979,591**	**2,436,718**	**542,873**

Equity Risk Exposure

Effect to the Comprehensive Statement of Income if Market Drops to the Recorded Lowest Market Price



A - Banks, Finance and Insurance
B - Diversified Holdings
C - Hotels and Travels
D - Investment Trust
E - Manufacturing
F - Power and Energy
G - Land and Property Development
H - Motor
I - Telecomunication
J - Construction and Engineering
K - Trading

Commentary

MI has a significant equity risk impact from the share investments in banking, finance and insurance sector and hotel sector Rs. 251 million and Rs. 187 million respectively. MI has a maximum equity risk exposure of Rs. 543 million, in an event that all share prices of MI's equity portfolio reach lowest market price of last 3 years. This is a highly unusual occurrence and a remote factor and thus probability of total impact is negligible. MI's share portfolio is well diversified and its main investment banking and hotel sector are uncorrelated share investments that show potential for capital appreciation.

53.6 Operational Risk

Operation risk is the risk of direct or indirect loss arising from a wide variety of causes associated with MI when dealing in operations that relate to processes, procedures, personnel, technology and infrastructure, and from external factors other than credit, market and liquidity risks such as those arising from legal and regulatory requirements and generally accepted standards of corporate behavior.

MI's objective is to manage operational risk so as to maintain appropriate balance by the avoidance of financial losses and damage to MI's reputation whilst in parallel maintaining overall cost effectiveness by avoiding control procedures which restrict initiative and creativity.

Corporate management is primary responsible for the development and implementation of controls to address operational risks. Additionally company's risk manager supports by providing advice, ascertaining risk levels and at the same time reviews all control procedures introduced by divisional heads of the Company.

MI has implemented following key procedures in order to mitigate the operational risk exposure to the Company:

- Segregation of the duties including the independent authorisation of transactions.
- Execution of reconciliation and monitoring of transactions.
- Establishment and documentation of comprehensive internal controls and procedures.
- Compiled with required regulatory enactments and other regulations.
- Periodic assessment of the adequacy and effectiveness of controls and procedures.
- Reporting of operational losses with remedial actions.

- Updating of the status against expectations laid down in the Business Contingency Plan.
- Providing in–house and external professional development training.
- Application of risk mitigating techniques such as insurance cover to avert losses wherever effective.
- Introduction of ethical and business standards to employees through issue of the 'Human Resource Handbook'.

MI's initiative of introducing a branch compliance and control checklist on branch operations further enriched the risk mitigation mechanism at branch level.

53.7 Capital Management

MI considers capital management integral in meeting any unforeseen risk and hence monitors its capital adequacy position closely. Capital adequacy is a measure of the Company's ability to tolerate associated risks in doing its finance business. The main objective of maintaining adequate capital in terms of regulatory capital adequacy ratios is to safeguard the depositors, whilst sustaining customer confidence. The capital adequacy measurement being a widely accepted concept specifies the limit up to which MI can expand in terms of its risk weighted assets. In pursuit of business expansion and diversification, MI engages itself in activities dealing in financial instruments that regularly change the risk and capital profile of the Company. Thus regulatory capital requirements ensure that the company does not move into undue expansion beyond specified limits and signals the Company to be cautious and not to take undue risk through growth of its assets especially in areas risky than others.

MI's capital strength in this context serves as a cushion in absorbing any unexpected losses that may arise and is a good indicator of MI's levels of safety towards stakeholders more importantly its depositors. MI's policy on capital is to retain a strong capital base at all times so as to ensure investor, creditor and market confidence and to back the sustainable growth of the company.

MI measures its capital adequacy ratios (CAR) on a monthly basis. The Company's Core Capital Ratio and Total Risk Weighted Capital Ratio (TRWCR) were well above the minimum regulatory requirements of 5% and 10% respectively throughout 2012/13 financial period.

The computation of the CAR ratios is in two parts and involves firstly a working to arrive at the Tier 1 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 1 and Tier 2 capital.

Tier 1 capital comprises the stated capital, statutory reserve fund, retained profits, general and other reserves excluding the revaluation reserve.

Tier 2 capital consists of the revaluation reserve of which only 50% could be taken for the computation. Other Tier 2 components include the general provision, approved subordinated term debts and other hybrid capital instruments. The Tier 2 capital is not allowed to 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.

53.7.1 Total Risk–Weighted Assets Computation

	Balance			Risk Weight Factor %	Risk Weighted Balance		Balance
As at 31 March	2013 Rs. '000	2012 Rs. '000	2011 Rs. '000		2013 Rs. '000	2012 Rs. '000	2011 Rs. '000
Assets							
Cash and cash equivalents	632,238	229,822	118,654	0	–	–	–
Government debt securities	476,488	439,446	360,201	0	–	–	–
Financial investments – available–for–sale	3,686,462	4,018,728	5,272,768	100	3,686,462	4,018,728	5,272,768
Placements with other bank	364,330	118,000	43,425	20	72,866	23,600	8,685
Loans against fixed deposits	117,284	57,157	54,751	0	–	–	–
Loans and receivables	3,900,194	2,125,973	632,420	100	3,900,194	2,125,973	632,420
Finance lease receivable	4,072,783	3,888,783	2,171,979	100	4,072,783	3,888,783	2,171,979
Hire purchase receivable	5,754,386	4,374,601	3,557,026	100	5,754,386	4,374,601	3,557,026
Inventories	221,220	340,244	24,780	100	221,220	340,244	24,780
Other assets	437,645	401,527	246,462	100	437,645	401,527	246,462
Property, plant & equipment	1,559,913	1,612,956	1,266,221	100	1,559,913	1,612,956	1,266,221
Total Risk–Weighted Assets	21,222,943	17,607,237	13,748,687		19,705,469	16,786,412	13,180,341

Total Capital Base Computation

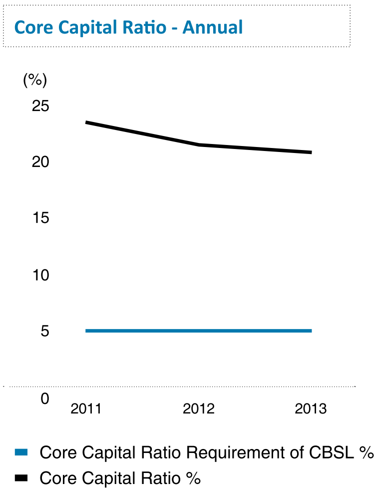
As at 31 March	2013 Rs. '000	2012 Rs. '000	2011 Rs. '000
Tier 1: Core Capital			
Stated capital	36,000	36,000	36,000
Reserve fund	471,400	421,400	391,400
General reserve	3,586,430	2,851,430	2,531,430
Retained earnings	10,176	292,243	140,239
Total Tier 1 capital	4,104,006	3,601,073	3,099,069
Tier 2: Supplementary Capital			
Revaluation reserves (as approved by CBSL)	309,814	309,814	309,814
Total Tier 2 capital	309,814	309,814	309,814
Capital Base	4,413,820	3,910,887	3,408,883

Capital Adequacy Ratios

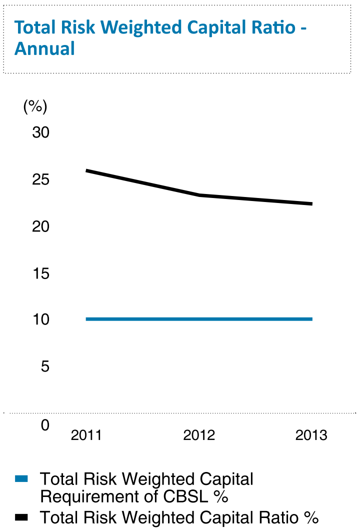
As at 31 March			2013 %	2012 %	2011 %
Core Capital Ratio	=	$\frac{\text{Tier 1 Capital}}{\text{Risk–Weighted Assets}}$	20.83	21.45	23.51
Total Risk–Weighted Capital Ratio	=	$\frac{\text{Capital Base}}{\text{Risk–Weighted Assets}}$	22.40	23.30	25.86

Commentary

MI's strength in capital has enabled the Company to possess statutory capital adequacy ratios well above statutory limits. The continuous rise in risk weighted assets due to growth in lending base is offset significantly from the consistent annual profits generated.



Core Capital Ratio - Annual

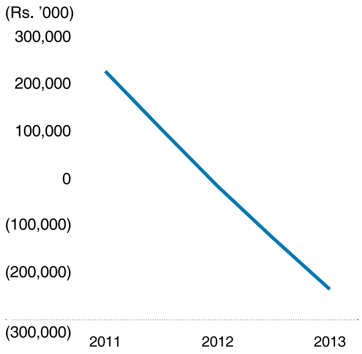


Total Risk Weighted Capital Ratio - Annual

ECONOMIC VALUE ADDED

As at 31 March	2012/13 Rs. '000	2011/12 Rs. '000	2010/11 Rs. '000
Invested Equity			
Shareholders' funds	5,704,846	5,474,606	6,293,078
Add: Cumulative loan loss provision/provision for impairment	311,530	279,251	264,564
Total	6,016,376	5,753,857	6,557,642
Earnings			
Net profit after tax	630,791	610,088	905,898
Add: Loan losses and provisions/impairment provision	32,279	14,687	(138,309)
Total	663,070	624,775	767,589
Cost of equity (based on 12 months weighted average treasury bill rate plus 2% for the risk premium)	15.25%	10.38%	10.05%
Cost of average equity	897,480	638,967	539,511
Economic value added	(234,410)	(14,192)	228,078

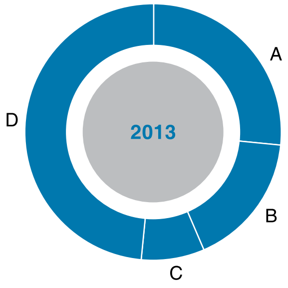
Economic Value Added



VALUE ADDED STATEMENT

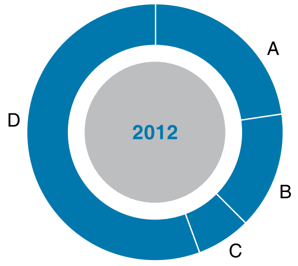
For the year ended 31 March	2013 Rs. '000	%	2012 Rs. '000	%	2011 Rs. '000	%	2010 Rs. '000	%	2009 Rs. '000	%
Value Added										
Income	3,338,044		2,362,026		2,214,120		1,806,966		1,708,609	
Interest expenses	(1,867,700)		(1,009,874)		(679,728)		(791,308)		(989,662)	
Cost of external services	(439,640)		(382,375)		(122,059)		(216,128)		(230,132)	
	1,030,704		969,777		1,412,333		799,530		488,815	
Value Distribution										
To employees as remuneration	273,413	27	219,811	23	240,643	17	187,623	23	155,981	32
To Government as taxes	175,263	17	147,621	15	231,236	16	262,636	33	122,756	25
To shareholders as dividends	82,665	8	66,132	7	30,000	2	13,800	2	9,750	2
Retained within the business										
- as depreciation	46,696	4	41,223	4	34,556	2	32,767	4	31,150	6
- as reserves	452,667	44	494,990	51	875,898	62	302,704	38	169,178	35
	1,030,704		969,777		1,412,333		799,530		488,815	

Value Distribution



A - To Employees - 27%
B - To Government - 17%
C - To Providers of Capital - 8%
D - To Expansion and Growth - 48%

Value Distribution

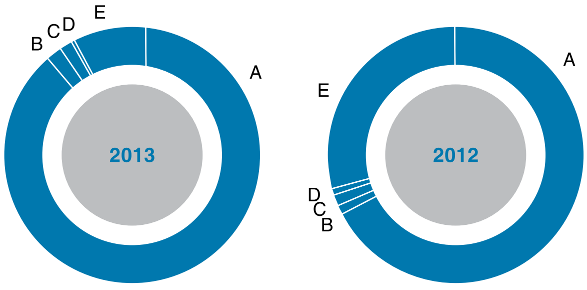


A - To Employees - 23%
B - To Government - 15%
C - To Providers of Capital - 7%
D - To Expansion and Growth - 55%

SOURCES AND UTILISATION OF INCOME

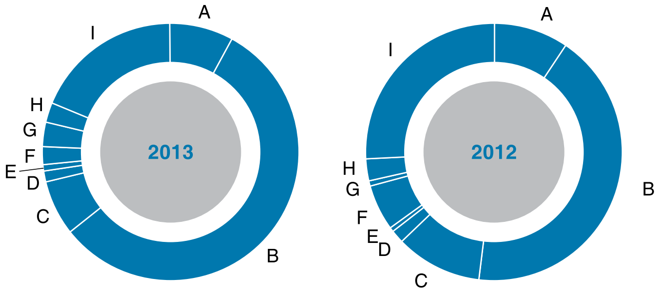
For the year ended 31 March	2013 Rs. '000	%	2012 Rs. '000	%	2011 Rs. '000	%	2010 Rs. '000	%	2009 Rs. '000	%
Sources of Income										
Loans and advances	2,962,893	88.76	1,588,576	67.25	1,460,552	65.97	1,473,138	81.53	1,488,057	87.09
Government Securities	59,584	1.78	28,262	1.20	34,182	1.54	74,173	4.10	55,607	3.25
Commission income	45,936	1.38	31,968	1.35	25,433	1.15	25,365	1.40	27,532	1.61
Operating lease income	14,270	0.43	19,140	0.81	19,930	0.90	18,351	1.02	13,726	0.80
Other income	255,361	7.65	694,080	29.38	674,022	30.44	215,939	11.95	123,687	7.24
Total	3,338,044	100.00	2,362,026	100.00	2,214,120	100.00	1,806,966	100.00	1,708,609	100.00
Utilisation of Income										
To Employees										
Personnel expenses	273,194	8.18	219,811	9.31	240,643	10.87	187,623	10.38	156,294	9.15
To Suppliers										
Interest paid	1,867,000	55.93	1,009,874	42.75	679,728	30.70	791,308	43.76	989,662	57.92
Other expenses	230,158	6.89	252,590	10.69	135,611	6.12	132,629	8.19	159,642	9.34
Depreciation	46,696	1.40	41,223	1.75	34,556	1.56	32,767	1.81	31,150	1.82
Provision for credit losses/ impairment	32,277	0.97	14,687	0.62	(45,348)	-2.05	139,600	7.72	67,772	3.97
To Government										
Value added tax and other taxes	73,985	2.22	131,954	5.59	90,333	4.08	68,202	3.77	39,930	2.34
Income tax	101,278	3.03	15,667	0.66	142,699	6.44	112,436	6.11	21,034	1.23
To Shareholders										
Dividends	82,665	2.48	66,132	2.80	30,000	1.35	13,800	0.76	9,750	0.57
Retained profit	630,791	18.90	610,088	25.83	905,898	40.91	328,600	17.50	233,375	13.66
Total	3,338,044	100.00	2,362,026	100.00	2,214,120	100.00	1,806,966	100.00	1,708,609	100.00

Sources of Income



	2013	2012
A - Loans & Advances	89%	68%
B - Government Securities	2%	1%
C - Commission Income	1%	1%
D - Operating Lease Income	0%	1%
E - Other Income	8%	29%

Utilisation of Income



	2013	2012
A - Personnel Expenses	8%	9%
B - Interest Paid	57%	42%
C - Other Expenses	7%	11%
D - Depreciation	1%	2%
E - Provision for Credit Losses/Impairment	1%	1%
F - Value Added Tax and Other Taxes	2%	6%
G - Income Tax	3%	1%
H - Dividends	2%	3%
I - Retained Profit	19%	25%

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	269 to 270
7.6 (ii)	Principal activities of the Entity during the year and any changes therein	Significant Accounting Policies	288
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)	354
7.6 (iv)	The Public Holding percentage	Investor Relations (Section 02)	352
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	270
7.6 (vi)	Information pertaining to material foreseeable risk factors of the Entity	Risk Management	167 to 195
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 28.2)	314
7.6 (ix)	Number of shares representing the Entity's stated capital	Notes to the Financial Statements (Note 36) Investor Relations (Section 2)	352
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 2)	352
7.6 (xi)	Equity Ratios Market Value	Investor Relations (Sections 4 and 5) Investor Relations (Section 6)	353
7.6 (xii)	Significant changes in the Equity's fixed assets and the market value of land, if the value differs substantially from the book value	Notes to the Financial Statements	312 to 315
7.6 (xiii)	Details of funds raised through Public Issues, Rights Issues and Private Placements during the year	Investor Relations (Section 8)	–
7.6 (xiv)	Information in respect of Employee Share Option Plan and Employee Share Ownership Plan	Notes to the Financial Statements	–
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	103 to 163
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 12)	354

1. Stock Exchange Listing

The issued ordinary shares of Mercantile Investments and Finance PLC are listed with the Colombo Stock Exchange. The audited Income Statement for the year ended 31st March 2013 and the audited Balance Sheet of the Company as at date have been submitted to the Colombo Stock Exchange within three months of the Balance Sheet date.

Stock Exchange Code for Mercantile Investments & Finance PLC share is 'MERC'.

2. Ordinary Shareholders Share Information - Voting

There were 3,006,000 registered voting shareholders as at 31 March 2013 (2012: 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	–	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 2013			31 March 2012		
	No. of Shareholders	No. of Shares	%	No. of Shareholders	No. of Shares	%
Resident	18	3,005,990	100	18	3,005,990	100
Non-Resident	1	10	–	1	10	–
Total	19	3,006,000	100	19	3,006,000	100

Individuals/Institutions

	31 March 2013			31 March 2012		
	No. of Shareholders	No. of Shares	%	No. of Shareholders	No. of Shares	%
Individuals	16	1,768,461	58.83	16	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	19	3,006,000	100.00

As per the Rule No. 7.6 (iv) of Colombo Stock Exchange, percentage of public holdings as at 31 March 2013 was 10.87% (2012 - 10.87%).

Share Information - Non-Voting

There were no non-voting shares issued by the Company.

3. Share Trading

	2012/13
Voting	
Number of transactions	Not traded
Number of shares traded	
Rank (As per CSE)	
Value of shares traded	

4. Dividends

	2012/13	2011/12
Interim (Rs.)		
1st Interim - August 2011	13.50	10
2nd Interim - October 2011	14.00	12
Dividend per share (Rs.)	27.50	22
Dividend payout ratio (%)	13.10	10.83

5. Earnings

	2012/13	2011/12
Earnings per share (Rs.)	209.84	202.96
Price earnings ratio (Times)	10.48	10.83

6. Market Value A net Assets per share.

	Highest Rs.	Lowest Rs.	Year End Rs.
2012/13 - Voting	Not traded	Not traded	Not traded

	2012/13	2011/12
Net Assets per share	1897.81	1821.22

7. Market Capitalisation (As at 31 March)

	Capital & Reserves Rs. '000	MI Market Capitalisation* Rs. '000	CSE Market Capitalisation Rs. '000	MI Market Capitalisation as a % CSE Market Capitalisation	Market Capitalisation Ranking
2011/12	5,474,606	6,613,200	2,012,873,661	0.33	
2012/13	5,706,358	6,613,200	2,199,960,000	0.30	

** Mercantile Investments and Finance PLC Capitalisation includes only Voting Shares.*

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 MI as at 31 March 2013

Name		% on Total Capital	% on Total Voting Capital	No. of Shares 2013	No. of Shares 2012
1.	Nilaveli Beach Hotels (Pvt) Limited	20.83	20.83	626,240	626,240
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	0.42	0.42	12,525	12,525
9.	P.R. Divitotawela	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	10
	Total	100.00	100.00	3,006,000	3,006,000

10. Twenty Major Shareholders (Non-Voting) of the MI as at 31 March 2013

Name	% on Total Capital	% on Total Voting Capital	No. of Shares 2012	No. of Shares 2011
Company has not issued non-voting shares.				

11. Related Party Transactions Exceeding 10% of the Equity or 5% of the Total Assets

Number of any Related party transactions during the year.

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 shareholders equity of the company as at 31 March 2013.

DECADE AT A GLANCE

	Based on SLFRS/LKAS			Based on SLAS						
For the year ended 31 March	2013	2012	2011	2010	2009	2008	2007	2006	2005	2004
	Rs. '000	Rs. '000	Rs. '000	Rs. '000	Rs. '000	Rs. '000	Rs. '000	Rs. '000	Rs. '000	Rs. '000
Operating Results										
Income	3,338,044	2,362,026	2,214,120	1,806,966	1,708,609	1,372,133	1,092,335	974,491	799,488	637,052
Interest expense	1,867,700	1,009,874	679,728	791,308	989,662	720,125	447,070	335,390	241,252	172,334
Non-interest expenses	738,275	726,397	485,795	574,623	464,225	420,723	307,953	278,318	246,254	180,272
Profit before tax	732,069	625,755	1,048,597	441,035	254,409	231,285	337,312	360,783	311,981	284,446
Provision for taxation	101,278	15,667	142,699	112,436	21,034	82,716	100,327	77,096	24,938	19,527
Net profit for the year	630,791	610,088	905,898	328,600	233,375	148,569	236,985	283,687	287,043	264,919
Dividends	82,665	66,132	30,000	13,800	9,750	14,049	60,080	29,321	42,189	12,500
As at 31 March										
Assets										
Liquid assets	1,473,056	756,041	522,280	483,483	462,636	416,332	261,874	304,074	289,111	222,948
Investments	2,980,019	3,421,558	4,779,213	1,761,332	930,836	1,196,974	1,189,991	1,028,824	891,671	475,452
Debentures	10,773	–	–	–	–	2,232	3,040	3,040	3,560	4,470
Advances	13,844,645	10,446,514	6,416,176	4,430,395	5,205,265	5,377,167	4,843,254	4,282,982	3,164,702	2,126,195
Other assets	658,865	741,771	271,242	309,509	217,281	268,717	350,865	213,665	116,826	77,033
Property, plant & equipment	1,511,221	1,565,620	1,214,750	1,037,007	1,015,271	888,378	859,202	367,231	376,762	344,165
Leasehold property	44,013	44,481	44,950	45,418	45,886	–	–	–	–	–
Intangible assets	4,681	2,855	6,521	–	–	–	–	–	–	–
Investment in associates	695,670	628,397	493,555	456,363	–	–	–	–	–	–
Total assets	21,222,943	17,607,237	13,748,687	8,523,507	7,877,174	8,149,800	7,508,226	6,199,816	4,846,192	3,250,263
Liabilities										
Bank overdraft	999,036	505,815	397,246	213,395	625,709	765,175	461,328	22,774	138,663	189,202
Borrowings	5,232,331	4,638,644	2,318,481	403,599	1,236,670	1,679,362	1,804,044	1,991,577	1,037,946	220,000
Deposits from customers	8,424,720	6,137,897	4,297,801	3,479,291	2,774,974	2,409,257	2,065,644	1,811,049	1,618,996	1,418,966
Other liabilities	862,013	850,275	442,081	651,206	545,411	583,950	593,986	250,878	247,725	200,587
	15,518,100	12,132,631	7,455,609	4,747,491	5,182,764	5,163,968	4,627,506	4,076,278	3,043,330	2,028,755
Shareholders' Funds										
Share capital	36,000	36,000	36,000	30,000	30,000	30,000	30,000	30,000	30,000	25,000
Reserves	5,668,846	5,438,606	6,257,078	3,746,016	2,664,410	2,682,055	2,812,095	2,116,312	1,772,862	1,196,508
Total shareholders' funds & total liabilities	5,704,846	5,474,606	6,293,078	8,523,507	7,877,174	8,149,800	7,508,226	6,222,590	4,846,192	3,250,263
Information on Ordinary Shares										
Earnings per share (Rs.)	209.84	202.96	301.36	109.53	77.79	49.52	79	94.56	95.68	105.97
Net assets per share (Rs.)	1,897.82	1,821.23	2,093.51	1,258.67	898.14	908.98	861.07	715.44	600.95	488.60
Interest cover (times)	1.39	1.62	2.54	1.56	1.26	2.29	2.29	2.65	2.29	2.65
Dividend cover (times)	7.63	9.23	30.20	23.81	23.94	3.94	3.94	9.68	6.80	21.29
Ratios (%)										
Return on shareholders' funds (%)	11	11	14	9	9	5	9	14	17	22
Liquid assets as a % of deposits (%)	17	13	12	14	17	17	13	17	18	16
Growth in income (%)	41	7	23	6	25	26	12	22	25	41
Growth in interest expenses (%)	85	50	-14	-20	37	61	33	39	40	0
Growth in other expenses (%)	2	50	-15	27	10	37	4	13	37	45
Growth in profit after tax (%)	3	-33	176	36	57	-37	-17	1	18	75
Growth in advances (%)	33	63	45	-15	-3	11	11	35	49	48
Growth in deposits (%)	37	43	24	25	15	17	12	12	14	20
Growth in shareholders' funds (%)	4	-13	67	31	1	5	23	15	39	42

GLOSSARY

A

Accounting Policies

The specific principles, bases, conventions, rules and practices adopted by an entity in preparing and presenting Financial Statements.

Accrual Basis

Recognising the effects of transactions and other events when they occur without waiting for receipt or payment of cash or its equivalents.

Amortisation

The systematic allocation of the depreciable amount of an asset over its useful life.

Associate

An entity, including an unincorporated entity such as a partnership, over which the investor has significant influence and that is neither a subsidiary nor an interest in joint venture.

Available-for-Sale

All assets not in any of the three categories, namely, held to maturity, Fair Value through Profit or Loss and Loans & Receivable. It is a residual category. It does not mean that the entity stands ready to sell these all the time.

C

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.

Collective Impairment Provisions

Impairment is measured on a collective basis for homogeneous groups of loans that are not considered individually significant.

Contingencies

A condition or situation existing at Balance Sheet date where the outcome will be confirmed only by occurrence or non-occurrence of one or more future events.

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 supervisions of executive roles and the responsibility and accountability towards owners and other parties.

Cost Method

This is a method of accounting for an investment whereby the investment is initially recognised at cost. The investor recognises income from the investment only to the extent that the investor receives distribution from accumulated profits of the investee arising after the date of acquisition. Distributions received in excess of such profits are regarded as a recovery of investment and are recognised as a reduction of the cost of the investment.

Cost to Income ratio

Total operating expenses before provision for bad and doubtful debts expressed as a percentage of operating Income.

Credit Rating

An evaluation of a corporate's ability to repay its obligations or the likelihood of not defaulting, carried out by an independent rating agency.

Credit Risk

Credit risk is the risk of financial loss to the Company if a customer or counter party to a financial instrument fails to meet its contractual obligations, and arises principally from the loans and advances to customers and banks and investment debt securities.

D

Debt to Equity

Total Borrowings expressed as a percentage of equity.

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.

Dividend Cover

Profit after tax divided by gross dividends. This ratio measures the number of times dividends is covered by the current year's distributable profits.

Dividend Yield

Dividend earned per share as a percentage of its market value.

E

Earnings Per Share

Net profit after tax and after dividend on Preference shares divided by the number of ordinary shares in issue.

Economic Value Added

A measure to assess productivity of a business that takes into consideration cost of total invested equity.

Effective Income Tax Rate

Provision for taxation divided by the net profit before taxation.

F

Fair Value

Fair Value is the amount for which an asset could be exchanged, or a liability settled, between a knowledgeable, willing buyer and a knowledgeable, willing seller in an arm's length transaction.

Finance Lease

A contract whereby a lessor conveys to the lessee the right to use an asset for rent over an agreed period of time which is sufficient to amortise the capital outlay of the lessor. The lessor retains ownership of the asset but transfers substantially all the risks and rewards of ownership to the lessee.

Financial Instrument

A financial instrument is any contract that gives rise to both a financial asset in one entity and a financial liability or equity instrument in other entity.

I

Impairment

This occurs when recoverable amount of an asset is less than its carrying amount.

Impaired Loans

Loans where identified impairment provisions have been raised and also include loans which are collateralized or where indebtedness has already been written down to the expected realisable value. The impaired loan category may include loans, which, while impaired, are still performing.

Impairment Allowances

Impairment allowances are a provision held as a result of the rising of a charge against profit for the incurred loss. An impairment allowance may either be identified or unidentified and individual (specific) or collective (portfolio).

Individually Assessed Impairment

Exposure to loss is assessed on all individually significant accounts and all other accounts that do not qualify for collective assessment.

Intangible Asset

An Intangible Asset is an identifiable non-monetary asset without physical substance.

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.

L

Liquid Assets

Assets that are held in cash or in a form that can be converted to cash readily, such as deposits with banks and Treasury Bills and Bonds.

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.

Loans and Receivables

Conventional loan assets that are unquoted (originated).

M

Market Risk

This refers to the possibility of loss arising from changes in the value of a financial instrument as a result of changes in market variables such as interest rates, exchange rates, credit spreads and other asset prices.

Materiality

The relative significance of a transaction or an event, the omission or misstatement of which could influence the economic decisions of users of Financial Statements.

N

Net Assets Per Share

Shareholders' funds excluding preference shares divided by the number of ordinary shares in issue.

Net Interest Income (NII)

The difference between the amount a financial institution earns on assets such as loans and securities and what it incurs on liabilities such as deposits and borrowings.

Net Interest Margin

Net interest income expressed as a percentage of average interest earning assets.

Non-Performing Loans

A loan placed on a cash basis (i.e. interest income is only recognized 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.

Non-Performing Ratio

Total non-performing loans expressed as a percentage of the total loans and advances.

O

Operational Risk

This refers to the risk of loss resulting from inadequate or failed internal processes, peoples and systems or from external events.

P

Price Earnings Ratio

Market price of an ordinary share divided by earnings per share.

Impairment Provision Cover

Total impairment provision expressed as a percentage of non-performing loans.

R

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.

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.

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.

S

Segmental Analysis

Analysis of financial information by segments of an organisation specifically, the different Industries and the different business lines in which it operates.

Shareholders' Funds

Total of stated capital plus capital and revenue reserves.

Sustainability Report

Sustainability reporting is a practice of measuring, disclosing, and being accountable for organizational 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 organization.

T

Tier I Capital

Core capital representing permanent shareholders' equity and reserves created or increased by appropriations of retained earnings or other surpluses.

Tier 11 Capital

Supplementary capital that consist 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.

V

Value Added

Value of wealth created by providing financial and other related services less the cost of providing such services.

NOTICE OF MEETING

NOTICE IS HEREBY given that the Fiftieth Annual General Meeting of MERCANTILE INVESTMENTS AND FINANCE PLC will be held at No. 236, Galle Road, Colombo 3, on 28 June 2013, 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 2013 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 ratify the 2nd Interim Dividend of Rs. 14/- per share declared on 14 February 2013 as the final dividend for the financial year ended 31 March 2013.
- To appoint Messrs BDO Partners, 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
21 May 2013

Notes

1. *A member who is entitled to attend and vote at the above-mentioned 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.*

NOTES

NOTES

FORM OF PROXY

I / We ....of

....
being a *member/members of MERCANTILE INVESTMENTS AND FINANCE PLC, hereby appoint:

.... of .... or failing him/her

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 Mahes 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

as *my/our proxy to represent *me/us and vote for *me/us on *my/our behalf at the Fiftieth Annual General Meeting of the Company to be held at 11.00 a.m. on 28 June 2013, 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 thirteen.

....
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.

VOTING AT MEETINGS OF SHAREHOLDERS

Article 14 of the Articles of Association of the Company, dealing with voting is quoted below, for information of shareholders:

Voting at Meetings of Shareholders

1. In the case of a meeting of shareholders unless a poll is demanded, voting at the meeting shall be by whichever of the following methods as determined by Chairperson of the meeting:
   (a) Voting by voice ; or
   (b) Voting by show of hands.

2. A declaration by the chairperson of the meeting that a resolution is carried by the requisite majority is conclusive evidence of that fact, unless a poll is demanded in accordance with Article 14(3).

3. At a meeting of shareholders, a poll may be demanded by-
   (a) Not less than three (3) shareholders having the right to vote at the meeting; or
   (b) A shareholder or shareholders representing not less than ten per centum of the total voting rights of all shareholders having the right to vote at the meeting.

4. A poll may be demanded either before or immediately after the vote is taken on a resolution.

5. If a poll is taken, votes must be counted according to the votes attached to the shares of each shareholder present and voting.

6. The Chairperson of a shareholder’s meeting is not entitled to a casting vote.

7. If a poll is duly demanded (and the demand be not withdrawn) it shall be taken in such manner (including the use of ballot or voting papers or tickets) as the person presiding at the meeting may direct and the result of a poll shall be deemed to be the resolution of the meeting at which the poll was demanded. The person presiding may (and if so requested shall) appoint a scrutiniser and may adjourn the meeting to some place and time fixed by him for the purpose of taking and declaring the result of the poll.

8. The demand for a poll shall not prevent the continuance of a meeting for the transaction of any business other than the question on which the poll has been demanded.

9. No objection shall be made to the validity of any vote except at the meeting or poll at which such vote shall be tendered and every vote to which no objection shall be made at such meeting or poll shall be deemed valid for all purposes of such meeting or poll whatsoever.

STAKEHOLDER FEEDBACK FORM

For purpose of submitting a comment or query,
please complete the following and return this page to:

Finance Director,
Mercantile Investments and Finance PLC,
236, Galle Road, Colombo 03.

Details of party submitting comment or query -

Name (Individual/Corporate) : ....

Permanent Mailing Address : ....

....

Contact Number : ....

E-mail : ....

Stakeholder Category : ....
(Investor/Customer/Supplier/ General Public/Other)

Comment or query :

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 Mahes 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
Sonali Pethiyagoda - Company Secretary *(Secretary to the Committee)*

Credit Committee
Gerard George Ondaatjie *(Chairman of the Committee)*
Pathiranage Mahes Amarasekera
Shermal Hemaka Jayasuriya
Dhanushka Fonseka
GM - Credit & Marketing
(Secretary to the Committee)

Remuneration Committee
Saroja Hemakumar Jayawickrama Weerasuriya *(Chairman of the Committee)*
Henaka Arachchillage Sajitha Tilakasiri Senanayake
Nawagamuwage Hasantha Viraj Perera

Nominations Committee
Saroja Hemakumar Jayawickrama Weerasuriya *(Chairman of the Committee)*
Gerard George Ondaatjie
Singappuli Mudiyanselage Susantha Sanjaya Bandara
Nawagamuwage Hasantha Viraj Perera

Integrated Risk Management Committee
Nawagamuwage Hasantha Viraj Perera *(Chairman of the Committee)*
Gerard George Ondaatjie
Pathiranage Mahes 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
Union Bank PLC
Pan Asia Bank PLC

Credit Rating
RAM Ratings (Lanka) Limited reaffirmed the Company's respective long-term financial institutions rating in January 2013 to 'RAM BBB+' (positive outlook) and the short-term rating to 'RAM P2'.

Management Team
M.B. Assauw *(Head of Deposits)*
Dhanushka Fonseka *(GM - Credit & Marketing)*
Buddika Kasturiratne *(AGM - Recoveries)*
Deva Anthony *(AGM - Finance)*
Ravi Ekanayake *(GM - Workshop)*
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 - Leasing)*
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)*
M.D.R Induruwage (*Marketing Manager - Deposits)*
Ramidu Costa *(Manager - Risk and Compliance)*
Dinesh Perera *(Manager - Leasing - Negombo)*
Avindra Wijesundara *(Manager - Credit)*
U.M.M.K. Bandara *(Manager - Credit)*
Wasantha Sisira Kumara *(Manager - Kurunegala)*
Fawziya Swangsa *(Chairman's Secretary)*
A.E Ganegoda *(Manager - Recoveries)*

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