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CORPORATE INFORMATION

REGISTERED NAME

Lankaputhra Development Bank Limited

LEGAL STATUS

A Licensed Specialized Bank established under the Banking Act No.30 of 1988. A Public Limited Liability Company incorporated in Sri Lanka under the provisions of the Companies Act No.17 of 1982

DATE OF INCORPORATION

24th February 2006

BOARD OF DIRECTORS

A. de Vass Gunawardena

B.A. (Ceylon)

Chairman

(Resigned w.e.f. 31-03-2008)

A Sarath de Silva

B.A.(Public Administration), F.C.I.B.(London),F.I.B.(Sri Lanka)

Director

(Appointed as Chairman w.e.f. 01-04-2008)

M.P.T.Cooray

B.A. (Hons), B.Phil. (International Economics.)

Director

S.S.C.De Silva

Director

Mrs.M. Ganagatharan

B.A.(Jaffna), P.G.Dip.(Moratuwa & IDEAS-Japan), M.A. (Leeds-UK)

Director

(Resigned w.e.f. 31-12-2007)

H.M.Gunasekara

B.A.(Hons), P.G.Dip.(Population Studies.), M.Sc.(University of Hague-Netherlands)

Director

K. R. Wickramanayake

Bachelor of Business Administration & Economics (USA)

Director

(Appointed w.e.f. 01-01-2008)

P.Amarasinghe

B.A.(Hons),M.A.(Econ),Mc. Master Canada, FIB(Sri Lanka),FCDAS (Mc.Gill Canada)

Director

(Deceased 01-08-2007)

COMPANY SECRETARY

Mrs. Karnika Jayatilake

BA (Col), LLM (UK), Attorney-at-Law

REGISTERED OFFICE & COLOMBO BRANCH

No.34, Maitland Crescent, Colombo-07.

Telephone : 0112675891-5

Facsimile : 0112675890

E-mail : info@lankaputhra.lk

Web : www.lankaputhra.lk

BRANCH OFFICES

Hambanthota Branch

No. 01, Galwala Junction,

Hambanthota

Telephone : 047-2222385-7

Facsimile : 047-2222388

E-mail : wasanthin@lankaputhra.lk

Polonnaruwa Branch

No.55, Habarana Road

Polonnaruwa

Telephone : 027-2226576-9

Facsimile : 027-2226580

E-mail : anurad@lankaputhra.lk

Kandy Branch

No. 335, Peradeniya Road,

Kandy.

Telephone : 081-2222468-9

Facsimile : 081-2222459

E-mail : udair@lankaputhra.lk

Kegalle Extension Office

No. 247, Main Street

Kegalle

Telephone : 035-2221302

Facsimile : 035-2221304

E-mail : udulab@lankaputhra.lk

AUDITORS

Messrs Ernst & Young

Chartered Accountants

No. 201, De Saram Place

Colombo-10.

BANKERS

Bank of Ceylon

NOTICE OF MEETING

NOTICE IS HEREBY GIVEN THAT THE SECOND ANNUAL GENERAL MEETING OF THE LANKAPUTHRA DEVELOPMENT BANK LIMITED WILL BE HELD ON 23RD MAY 2008 AT 4.00 P.M. AT NO. 34, MAITLAND CRESCENT, COLOMBO 7.

Agenda

1. To receive and to consider the Report of the Directors and Audited Financial Statements for the year ended 31st December 2007 and the Report of Auditors.
2. To re-appoint Auditors Messrs. Ernst & Young, Chartered Accountants for the year 2008 and to authorize the Board of Directors to determine their remuneration.

BY ORDER OF THE BOARD

(Sgd)
Mrs. Karnika Jayatilake
Company Secretary

Colombo
01st May 2008

Note:

- a) *A Shareholder is entitled to appoint a Proxy to attend and vote instead of him/her. A Proxy need not be a member of the Bank. A form of Proxy is enclosed for this purpose.*
- b) *The instrument appointing a Proxy and the Power of Attorney (if any), under which it is signed or a notarially certified copy thereof should be lodged with the Bank at No. 34, Maitland Crescent, Colombo 7 not later than 48 hours before the time fixed for the Annual General Meeting.*

CHAIRMAN'S MESSAGE

In Annual Reports of banks, it is customary to find expositions on the world economy, national economy and also the latest fad CSR or corporate social responsibility, sometimes mistaken to be philanthropy. I wish to deviate from this practice and focus on the objectives of this Bank and how far it's activities have contributed to achieving these during the year 2007.

The establishment of the LDB in 2006 under the "Mahinda Chinthanaya" fulfilled a long felt need in the development finance sector. With the unwise decision of a previous dispensation to privatize the state-owned development banks in the early nineties, development finance, specially to the small and medium sector was virtually forgotten, displaying an unforgivable disregard for this sector. With the recognition of this inadequacy in development banking facilities, the expectation of the government in creating the LDB, was to address this long felt need for rural credit, the small and medium sector and other development activities in the hitherto neglected regions.

The Bank in it's first full year of operations has achieved considerable progress in it's given task. The loan portfolio in the year 2007 increased to Rs. 1665.5 million compared to Rs. 427.8 million during it's first year of operations, commencing in the latter half of 2006. The sectoral distribution of advances shows a significant increase in agricultural and fisheries sectors at Rs. 400.5 million, which is 24% of the total advances compared with only 10% in the previous year. The manufacturing sector too has recorded an increase of Rs. 722.6 million or 57% of the total portfolio. Agricultural, fisheries and the industrial sectors has accounted for over 80% of the total advances given. This sectoral distribution gives an indication of the potential that is awaiting to be harnessed in these areas. During the year the Bank has made a profit of Rs. 58Mn. of which taxation expenditure is Rs. 35Mn., leaving a net profit of Rs. 23 Mn. for the year 2007.

In an effort to widen the coverage of the Bank's presence at the grass root level, branches at Hambantota, Polonnaruwa and an extension office at Kegalle commenced operations during the year under review. It

is proposed a few more branches will be established in 2008 to further widen the reach of the Bank to needed areas. Extending the reach of the Bank would not itself contribute to the Bank achieving the desired results in terms of it's objectives without the availability of adequate financial resources. The LDB being a state-owned institution funding is provided through budgetary resources. In this respect an important proposal made in the 2007 Budget was the amalgamation of the SME Bank and the Private Sector Infrastructure Development Company Ltd. (PSIDC) with the Lankaputhra Development Bank. The objective of the proposal was to create a premier development bank with substantial financial resources to reach out and cater to the funding needs of the diverse sectors of the economy. The amalgamation of SME Bank increases the capital base of LDB to Rs. 3000 Mn. approximately and in addition, financial resources of the hitherto inactive PSIDC amounting to US\$. 13 million will be available to the LDB.

Consequent to the amalgamation, resulting in the enhancement of the availability of funds, the LDB would be in a position to widen it's scope of activities to cater to the financial needs of projects in the micro and small and medium sectors as well as in providing support for the development of infrastructure projects. This would enable the Bank to cover a wide spectrum of economic activities in the country, concentrating mainly in the areas outside the Western Province.

One matter that has been widely commented in the public media is the high lending rates of interest and the consequent very high profits made by the banks. Low lending rates as well as stable interest rates are critical to facilitate healthy economic activities and enhance development. This is not obtainable in Sri Lanka and the government's requests to the Banks to reduce the lending rates by keeping lower margins has had no effect. The Banks continue to operate on very much higher spread than what is prevalent in the region. This is further exacerbated by the announcement of huge end of the year profits. Should this shylockian hold be allowed to continue, for a few to swim in riches and the majority drown in poverty, pollution and violence? Thus, a fresh look at the lending rates would be a necessity, if the

CHAIRMAN'S MESSAGE (Contd.)

drive to develop the agricultural, industrial and the infrastructure sectors is to materialize meaningfully. What needs to be done is to remove the stranglehold of the banks' as the sole provider of finance by developing alternative mechanisms to provide the required finances at much more affordable rates to ensure the growth of the economy.

In this context, I can do no better than to quote Mahathir Mohammed, the architect of modern Malaysia.

“As a human being, who has journeyed far and wide over highways bustling with traffic as well as on the roads less travelled, I have never ceased to be amazed by how very generous poor people can be in their daily lives; I have never ceased to be amazed by how often the poor are willing to share what little they have. I have at the same time, never ceased to be amazed by how very little some of the very rich can spare for the impoverished. I

have never ceased to be amazed by how selfish, self-centered, greedy, avaricious, grasping and rapacious some of the very rich are”

In conclusion, I wish to record my appreciation of the continuous support and active role played by my colleagues in the Board, contributing to a successful year and last but not the least is the hard work contributed by the staff of the Bank at all levels, which continues to be a source of strength to the Bank.

(Sgd.)

A. de Vass Gunawardena
Chairman

Colombo
01st May 2008

GENERAL MANAGER/CHIEF EXECUTIVE OFFICER'S MESSAGE

The Lankaputhra Development Bank, a creation of the "Mahinda Chintanaya" was established with a view to strengthen the small and medium scale entrepreneurs to provide financial assistance to nurture their entrepreneurship. It is with this concept in mind that His Excellency the President Mahinda Rajapakse inaugurated the Bank on 24th February 2006.

The emphasis during this year was to identify small and medium scale projects which would enhance the economic development in the provinces thus increasing job opportunities, creating economic activities and social development in sectors such as agriculture, fisheries, mining, production, construction, services etc.

With this vision in focus our aim is to join hands with our team and take the bank forward in order that we may contribute in a significant way to overcome disparities in income distribution and alleviate poverty in our country.

Our team has always displayed professionalism and has been a source of strength to successfully implement some of the national projects we support. The majority of our team consists of graduates in various disciplines and they possess a wealth of experience in development and commercial lending. We will continue in our endeavors to create professional excellence by enhancing their skills and competencies by offering local and international training at all levels. We will also strive to cater to the ever changing demands of our customers, information technology, corporate relationships and financial markets.

We have shown an impressive achievement in our growth during this short period of time. Despite the volatile conditions in the country and the competition around us, our efforts to help the small and medium scale entrepreneurs to become major stakeholders of the national economy has generated a positive thrust in meeting the expectations of the government. We have been instrumental in creating direct and indirect employment and contribute towards reducing the poverty gap.

Our bank concentrated on lending to the agriculture sector through various schemes that the government implemented to benefit the farmers and facilitate self employment activities.

The Krushi Navodaya loan scheme was successfully launched not only in our bank but also through other PFI's with LDB taking the leaderships. Some of the other schemes we have implemented are the Kapruka Ayojana loan scheme and Footwear loan scheme. The Mahaweli loan scheme was implemented in collaboration with the Ministry of Agriculture and Agrarian Services and Sri Lanka Mahaweli Authority to grant loans to the second generation Mahaweli settlers. Under the New Comprehensive Rural Credit Scheme (NCRCS) loans were granted to finance alternative crops specifically identified by the Central Bank of Sri Lanka. Financial support was also given to the closed down garment factories to fulfill Budget Proposal, where we identified selected garment factories to commence active operations to enter into export markets once again.

We also focused on actively entering into savings mobilization by educating the low income earners to save for a 'rainy day'. Our lending schemes cater to the young and old giving them attractive interest rates. The introduction of the Western Union Money Transfers assisted many individuals who live in villages to encash remittances.

The bank established 03 new customer centres during the year in Hambantota, Polonnaruwa and Kegalle. In implementing a Budget Proposal, the bank was also successful in concluding the merger with SME Bank and thereby from the 1st January 2008 the LDB started on a new journey to be the Premier Development Bank with a strong capital base.

The bank continues to create strategic alliances with Government, Semi Government and Private Institutes enabling greater partnership and flexibility to enhance services provided to small and medium scale entrepreneurs. We have teamed up with the "Gama Naguma" and the "Nanasala" programs under the flagship of the Ministry of Science and Technology with the aim of nurturing the skills and fulfilling the ambitions of the younger generation.

GENERAL MANAGER/CHIEF EXECUTIVE OFFICER'S MESSAGE (Contd.)

2008 and Beyond

Challenges lie ahead of us to encourage and increase self sufficiency levels amongst the people, thus reducing the stigma of unemployment. We have planned to extend our services to Kandy, Wennappuwa, Tangalle and Monaragala during the year 2008 and have branches in these areas to stimulate economic activities.

In order to enhance the core banking system of LDB we have signed up with National Technology (Pvt) Ltd in India to introduce Bancmate , which is a development banking module catering to the rural banking industry in India. This will also enable us to increase our efficiency in our operations and serving our customers. Plans are also underway to launch our Deshanthara Savings scheme to assist the Sri Lankan diaspora in the Middle East.

We have been fortunate to receive assistance from many individuals and institutions. I take this opportunity to

thank the Secretary to the Treasury and all his officials, the Governor of the Central Bank of Sri Lanka and his staff for their support throughout the year. My gratitude goes to our Chairman for the encouragement and guidance and our Board of Directors for the continuous support to the development of the Bank. I also take this opportunity to thank the LDB team for their passion and dedication and loyalty to the Bank and also to our Auditors M/S Ernst and Young for the efforts to guide the Bank to maintain compliance.

(Sgd.)

Mrs. Siromi Wickramasinghe
General Manager/Chief Executive Officer

Colombo

01st May 2008

PRODUCTS AND SERVICES

Lakmuthu Children Savings Account

A novel children's savings account specially designed to build a better tomorrow for our future generation.

Deshabhimani Normal Savings Account

Deshabhimani Savings account could be opened with a minimum of Rs. 500/-. Attractive interest rates together with 100% government guarantee are some of the benefits.

Suruviru Term Deposits

Suruviru is a fixed deposit scheme. The minimum initial deposit is Rs. 10,000/- .

Deshanthara Foreign Currency Accounts

Deshanthara Non Resident Foreign Currency Account (NRFC) and Resident Foreign Currency Account (RFC) have been introduced for Sri Lankan expatriate workers.



Project Loans

A Term Loan scheme designed to help small and medium scale entrepreneurs at concessionary rates and terms. Loan could be obtained to start a new project or expansion of an existing business, acquiring advance technology and construction of factory buildings, laboratories, hotel complex and obtaining professional services for specific projects.

Micro Lending

A Term Loan scheme specially designed to help small scale entrepreneurs at concessionary rates mainly for self employment projects.

Working Capital Loans

Permanent and regular working capital financing would be considered for the projects which are financed by LDB only.



PRODUCTS AND SERVICES (Contd.)

Krushi Navodaya Loan Scheme

A special agricultural base credit scheme to the small farmers to purchase agricultural equipments, services and other inputs. The scheme envisages enhancing income generating avenues of the farming community.

Kapruka Coconut Development Loan Scheme



A credit scheme that facilitate to increase production of coconuts, productivity of coconut lands, employment opportunities in coconut plantations and enhance farm income and standard of living of coconut farmers.

New Comprehensive Rural Credit Scheme (NCRCS)

A special loan scheme introduced for small farmers to ensure a market with better price to cultivate paddy and subsidiary food crops as approved by Central Bank of Sri Lanka and pre (production of seed and planting materials) and post cultivation activities (purchase and storage of paddy and other agricultural products.)



Loan Scheme to SMEs in the Mahaweli Area.

A credit scheme for small and medium entrepreneurs in Mahaweli areas gazetted under the Mahaweli Authority Act, which is implemented jointly with the Mahaweli Authority of Sri Lanka.

Footwear Association Loan Scheme

This loan scheme has been introduced under a project launched by the Sri Lanka Footwear Association together with the Ministry of Industrial Development, to finance small timers involved in the Footwear Industry in upgrading and modernizing their production process.

MANAGEMENT TEAM

Mrs. Siromi Wickramasinghe

General Manager/Chief Executive Officer

Mrs. Wickramasinghe is the General Manager/CEO of LDB, who brings in with her 27 years of Senior Management experience in the banking sector. As an Attorney-at-Law and a Fellow of the Chartered Management Institute (UK), Mrs. Wickramasinghe adds professionalism to the Bank's Apex. She is also a Company Secretary, Commissioner of Oaths and a Notary-Public. Corporate Banking Credit Development and Investment Management, Procurement and Expense Control, Corporate Relationship Development are some of the skilled areas Mrs. Wickramasinghe possesses.

Mr. Ranjith Dissanayake

Assistant General Manager - Investments

Mr. Dissanayake is a career banker with 20 years experience in Commercial Banking. A University Graduate with a Bachelor of Commerce Degree -02nd Class upper and an Associate Member of the Institute of Bankers of Sri Lanka. Mr. Dissanayake brings into LDB his banking expertise coupled with the experience he gained in Australia for 05 years in the Accounting field. He heads the Investment Division as Assistant General Manager and oversees the functions of all Branches and divisions of Krushi Navodaya, Projects, Micro and SME.

Mrs. Karnika Jayathilake

Assistant General Manager – Legal/Company Secretary

Performs the dual function of Assistant General Manager-Legal and Company Secretary of LDB. An Attorney-at-Law, she holds a Bachelor of Arts Degree (Honors) from the University of Colombo. She completed her Masters in Law (LLM) at University of Southampton-UK and also holds a Diploma in International Relations from the BCIS. She brings in with her expertise in project loan appraisal and documentation and company secretarial experience.

Mr. C. Maxwell Jansz

Senior Manager – Human Resources & Administration

Mr. Jansz is a career banker, with over 18 years of Commercial Banking and over 08 years of experience in Human Resources and Training & Development. He holds a Hons. Degree in Social Science and Mass Communication and is presently reading for his Masters in Development Studies at the University of Colombo. He also holds a Diploma in Personnel Management, and is a Member of the Association of Business Executives UK, a Member of the Institute of Management (MIM)

and an Associate Member of the Institute of Training & Development. As the Senior Manager, he is heading the divisions of HR & Administration.

Mr. Mewan Dissanayake

Senior Manager – Finance

Mr. Dissanayake heads the Finance Division of Lankaputhra Development Bank as Senior Manager-Finance. Mr. Dissanayake is a Member of the Institute of Chartered Accountants of Sri Lanka and a finalist of Association of Certified Chartered Accountants of UK. He holds a Bachelor of Business Administration degree, specialized in financial management from University of Colombo and possesses over eight years experience in Auditing, Accounting & Banking.

Mr. Ranil Satharasinghe

Internal Auditor / Compliance Officer

Mr. Satharasinghe is a Graduate in Business Management from University of Kelaniya with specialization in Accountancy and an Associate Member of the Institute of Chartered Accountants of Sri Lanka (ICASL). He is a finalist of Chartered Institute of Management Accountants (UK) as well. He counts more than 06 years of Audit & Accounts experience with KPMG Ford Rhodes & Company, prior to joining LDB as Internal Auditor and Compliance Officer.

Mr. Vajira Jayasinghe

Senior Manager – IT

Mr. Jayasinghe heads the IT Division of the LDB. He holds a Bachelor of Science Degree in Engineering from the University of Moratuwa, a Master of Business Administration (MBA) and a Master of Engineering Degree from the University of Colombo. Mr. Jayasinghe is a Chartered Engineer in Information and Communication Technology and a member of Computer Society of Sri Lanka. He carries with him more than 17 years of work experience in the field of Information Technology out of which more than 09 years as Head of IT in VANIK Incorporation Ltd and SME Bank Ltd.

BOARD OF DIRECTORS

A. de Vass Gunawardena

B.A. (Ceylon)
Chairman
(Resigned w.e.f. 31-03-2008)

Appointed as Chairman/ Director, Lankaputhra Development Bank Limited in February 2006. Mr. Gunawardena has served as Chairman of several key public sector institutions including Sri Lanka Ports Authority, Board of Investment of Sri Lanka, National Development Bank and State Pharmaceuticals Corporation.

A. Sarath de Silva

B.A. (Public Administration), FCIB (London), FIB (Sri Lanka)
Director
(Appointed as Chairman w.e.f 01-04-2008)

Appointed as Director, Lankaputhra Development Bank Limited in January 2008.

Mr. de Silva was the Former General Manager, Bank of Ceylon. He is the Chairman/Director General, National Enterprise Development Authority and Chairman of LankaClear (Pvt) Ltd. He is also a Director of the State Pharmaceuticals Corporation, National Wealth Corporation Ltd, Strategic Enterprise Management Agency, Local Loans & Development Fund and Oasis (Pvt) Ltd.

M.P.T. Cooray

B.A. (Hons), B.Phil. (International Economics.)
Director

Appointed as a Director, Lankaputhra Development Bank Limited in February 2006. Mr. Cooray has served as Director General in Department of Budget Implementation of the Ministry of Finance & Planning and Deputy Director General of Board of Investments in Sri Lanka. Mr. Cooray served as the first CEO of the Bank and relinquished his duties as CEO on 31st March 2007.

S.S.C. De Silva

Director

Appointed as a Director, Lankaputhra Development Bank Limited in February 2006. Mr. Silva is the Chairman of International Foodstuff Co. (Pvt) Limited, and the incumbent President of Sri Lanka Fruit and Vegetable Producers, Processors & Exporters Association.

Mrs. M. Gangatharan

B.A.(Jaffna), P.G.Dip.(Moratuwa & IDEAS-Japan), M.A.(Leeds-UK)
Director
(Resigned w.e.f. 31-12-2007)

Appointed as a Director, Lankaputhra Development Bank Limited in February 2006. Ms. Gangadaran is the Deputy Director – Department of National Budget of the Ministry of Finance & Planning and also serves as a Board Member in the Road Development Authority.

H.M. Gunasekara

B.A.(Hons), P.G.Dip.(Population Studies.), M.Sc.(University of Hague-Netherlands)
Director

Appointed as a Director, Lankaputhra Development Bank Limited in February 2006. Mr. Gunasekara is the Deputy Director General – Department of Development Finance of the Ministry of Finance & Planning. He also serves as a Board Member of Sri Lanka Rupavahini Corporation, National Development Trust Fund and Maturata Plantations Limited.

K. R. Wickramanayake

Bachelor of Business Administration & Economics (USA)
Director
(Appointed w.e.f 01-01-2008)

Appointed as a Director, Lankaputhra Development Bank Limited in January 2008. Mr. Wickramanayake is the Vice President of Federation of Chamber of Commerce & Industry and is a Director of Kosala Enterprises (Pvt) Ltd and Sterling Jersey Company Ltd. He has also served as President of the Sri Lanka Chamber of Small Industry, a Director of SME Bank Ltd and a Board Member of Sri Lanka Tourism.

P. Amarasinghe

B.A (Hons), M.A.(Econ), Mc. Master Canada, FIB (Sri Lanka), FCDAS (Mc.Gill Canada)
Director
(Deceased 01-08-2007)

The Board announces with regret the demise of Mr. P Amarasinghe, former Deputy Governor of the Central Bank, who was a member of the first Board of Directors of LDB. Mr. Amarasinghe had wide experience in both public and private sector institutions and served LDB with much enthusiasm and commitment.

COMPANY SECRETARY

Mrs. Karnika Jayatilake
B.A. (Hons) (Col), LL.M (UK), Attorney-at-Law

DIRECTORS' REPORT

The Directors of the Lankaputhra Development Bank Limited have pleasure in submitting their Report and the Audited Financial Statements for the year ended 31st December 2007. These were approved by the Board of Directors at its meeting held on 26th March 2008.

The Bank was re-registered during the year as required by the Companies Act No.7 of 2007. Previous and new registration numbers of the Bank are N(PBS) 1306 and PB (52) respectively.

REVIEW OF THE YEAR

The Chairman's Review together with the Chief Executive Officer's review on pages 4,5 & 6,7 respectively, deals with the overall activities of the Bank during the period under review. These reports form an integral part of the Directors' Report.

PRINCIPAL ACTIVITIES

There were no significant changes in the nature of the principal activities of the Bank during the financial year under review. The Bank's core activity continues to be development lending. The Bank focuses in providing project loans and project loan related working capital loans with a particular emphasis on the regions, covering major sectors such as agriculture, manufacture, industry and infrastructure. The Bank also implements special credit schemes on behalf of the Government, relating to rural agriculture, rehabilitation of closed down garment factories and leather manufacturing industry. The Bank is also engaged in mobilization of savings and term deposits.

PROFITS AND APPROPRIATIONS

	2007 Rs.
Profit for the year ended 31 st December before taxation after charging All expenses including depreciation etc.	58,043,800
Provision for Taxation	35,179,782
Profit for the year ended 31 st December after taxation after charging All expenses including depreciation etc.	22,864,018
Transferred to Reserve Fund	1,143,201
Retained profit at the beginning of the year	22,149,308
Retained profit to be carried forward	43,870,125

CAPITAL EXPENDITURE

The details of Property, Plant & Equipment is given in note 14 to the Financial Statements.

SHARE CAPITAL

The issued and paid up Share Capital of the Company were Rs. 1,500,000,000/= consisting of 15,000,000 ordinary shares of Rs. 100/= each as at 31st December 2007. There were seven shareholders holding ordinary voting shares.

HUMAN RESOURCES

The Bank implements appropriate human resource management policies and practices to enhance employee's skills and performance and to ensure optimum contribution to achieve the Bank's goals and objectives.

There were 114 employees serving the Bank as at 31st December 2007.

Grade	No. of Staff
General Manager	1
Asst. General Manager	3
Senior Manager	3
Manager	6
Assistant Manager	15
Executive Staff	22
Non-Executive Staff	40
Secretaries and other support staff	24

DIRECTORS' REPORT (Contd.)

The Bank's employment policy is structured to include requirements from external sources (public advertisement) as well as internal promotions. The Bank provides career opportunities irrespective of gender, race or religion. Medical insurance under group cover is available for all employees. The Bank encourages sports and recreational activities by supporting staff welfare society which organizes such events.

DIRECTORATE

The Board of Directors of Lankaputhra Development Bank Limited comprised of six directors. The entire Board of Directors were appointed by the Secretary to the Treasury. With the merger of the SME Bank Limited with the Lankaputhra Development Bank Limited effective 01st January 2008, the Board was reconstituted by the Secretary to the Treasury. Mr. A. Sarath De Silva and Mr. K.R. Wickramanayake were appointed to the reconstituted Board. Mrs. M. Gangatharan ceased to be a member of the Board with effect from 31st December 2007.

DIRECTORS INTEREST IN SHARES AS AT 31ST DECEMBER 2007

		No. of Ordinary Shares
Mr. A. de Vass Gunawardena	Chairman	1
Mr. M. P. T. Cooray	Director	1

Directors' shareholdings have not changed subsequent to the date of the Balance Sheet up to Report date.

DIRECTORS INTEREST IN CONTRACTS

Directors interest in contracts or proposed contracts with the Bank are disclosed below. These interests have been declared at the Directors meetings. Directors have no direct or indirect interest in any other contract or proposed contract with the Bank. An interest register in terms of the Companies Act No. 7 of 2007 has been maintained.

Company	Name of Director	Details of Transaction			
Mihin Lanka (Pvt) Ltd	A de Vass Gunawardena- Chairman Father of the CEO of the company Mr. Sajin de Vass Gunawardena	As at 31.12.2007 LDB has invested Rs. 300Mn in Cumulative Redeemable Preference Shares @ 15% dividend. No dividend was paid for 2007.	Facility	Approved Amount	Amount O/s Rs.
		Letter of Guarantee (LG) facilities through BOC	Rs. 100 Mn		72,810,016.00
		Outstanding Bills Value			3,608,645.57
		LG - through LDB (Gte Claim)	Rs. 45.0 Mn		42,080,000.00
Sarvodaya Economic Enterprises Development Services (Guarantee) Ltd. (SEEDS)	P. Amarasinghe Vice Chairman	Revolving credit facility of Rs. 100 M			
Tarmac Quarry Products (subsidiary of Tarmac Investments Ltd)	M.P.T. Cooray Shareholder (holder of 200,000 fully paid ordinary shares) of Tarmac Investments Ltd.	Term loan of Rs. 15 Mn	Rs. 13,779,783.00		

DIRECTORS' REPORT (Contd.)

DIRECTORS' REMUNERATION AND OTHER BENEFITS

Directors' remuneration for the financial year ended 31st December 2007 is Rs. 2,110,000/=.

CORPORATE DONATIONS

During the year the Bank made a charitable donation amounting to Rs. 500,000/- to Vajirasri Children's Home at Pitakotte.

POST BALANCE SHEET EVENTS

The post balance sheet events are disclosed under note 24 to the financial statements. No events have taken place which requires any adjustments or disclosures other than the above.

RE-APPOINTMENT OF AUDITORS

The financial statements for the year ended 31st December 2007 have been audited by Messrs. Ernst & Young, Chartered Accountants who offer themselves for re-appointment. The Audit Committee and Directors of the Bank recommended their re-appointment. In Accordance with the Companies Act No. 7 of 2007, a resolution will be proposed at the forthcoming Annual General Meeting. The notice of meeting is on page 03 of the Annual Report.

BY ORDER OF THE BOARD

(Sgd)

Mrs. Karnika Jayatilake
Company Secretary

Colombo
01st May 2008

CORPORATE GOVERNANCE

"We believe results are important. We also believe how we achieve results is equally important..."

Our commitment to this principle has enabled us to achieve our corporate objectives within a sound framework of controls maintaining high standards of industrial and professional ethics, whilst being mindful of the best interest of all stakeholders.

In a broader perspective, our endeavour to achieve exemplary corporate governance takes up a view of all our stakeholders



Promoting the spirit of good corporate citizenship the Bank has adopted necessary measures to support the Government's effort to combat terrorism and financial crime, by adhering to the Convention on the Suppression of Terrorist Financing Act No. 25 of 2005 (CSTFA), The Prevention of Money Laundering Act No. 5 of 2006 (PMLA), and The Financial Transactions Reporting Act No. 6 of 2006 (FTRA).

Following are the governance practices followed by the Bank.

The Board of Directors

In its role as the Bank's primary governing body, the Board sets the strategic direction, guides the corporate values and constantly strive to improve and build on the Bank's strong corporate governance practices, whilst being mindful of their responsibility to all stakeholders concerned. The Board lays strong emphasis on transparency, accountability, and integrity of transactions, in line with some of the recent papers issued on sound governance practices by the Central Bank.

While the Board is entrusted with the responsibility of providing leadership in terms of the strategic aims of the Bank, it is the responsibility of the corporate management to ensure the implementation of these strategies where the Board has delegated its authority to the corporate management in operational areas within clearly defined limits.

Board Meetings

Monthly meetings of the Board are held to review the performance of the Bank where Directors are furnished with monthly reports on the Bank's performance. Additional meetings are convened whenever necessary. Directors also have access to members of the Corporate Management and services of the Secretary to the Board to facilitate them to discharge their duties.

Corporate Management

The corporate management is headed by the General Manager/ CEO, who is accountable to the Board for achieving corporate objectives of the Bank. In discharging the duties of the General Manager/ CEO, following are considered as the responsibilities:

- * Management and operations of the Bank.
- * Liaison with relevant regulatory authorities.
- * Ensure sustainable growth of the Bank.
- * Structuring and restructuring of reporting lines and authority levels, improve employee productivity through training.
- * Monitor the Treasury functions and assets and liability management operations.
- * Determine the adequacy and effectiveness of the Bank's internal control system and continuous evaluation of the operation.

Audit Committee

The Audit Committee of the Bank comprise of three Directors. The responsibility of the committee encompasses review and evaluation of activities of the Bank and to report to the Board of Directors on the Bank's adequacy of internal controls and management of risk. In so doing the committee takes the following action:

CORPORATE GOVERNANCE (Contd.)

- * Provide periodic reports to the Board of Directors highlighting the level of business risk and adequacy of internal control systems
- * Ensure proper processes are maintained to provide timely and accurate financial and related information
- * Regular evaluation of the achievement of strategies and objectives of the Bank
- * Ensure Bank's adherence to regulatory norms and guidelines
- * Constructive interpretation of laws and regulations to facilitate Bank operations.
- * Ensure Bank's activities are conducted in par with laws and regulations pertaining to the industry.
- * Ensure adherence of all staff to accept ethical standards in discharging their duties.
- * Provision of incessant updates to create awareness amongst Bank staff on changes in legislation and regulations.

Human Resources Committee

The Committee is responsible for maintaining the Bank's performance and market oriented remuneration policy for its staff and thereby attracting and retaining quality staff with proven business experience and other required qualities. The responsibility of the committee also encompasses review of recruitment and promotions of senior management and executive officers, ensuring the existence of an effective succession plan in the Bank. The Committee comprises of Chairman and two Directors serving on it.

Credit Committee

The Credit Committee comprises of three Directors. The Credit Committee is empowered to approve credit proposals, which have been referred by the Management.

Procurement Committee

The Procurement Committee, being a sub-committee of the Board comprises of three Directors. The responsibility of the committee encompasses the review of matters pertaining to all procurement requirements of the Bank.

Compliance

In a rapidly transforming economic environment, prone to continuous evolution and changing laws and regulations, lapses would be inevitable. The Bank has a Compliance Officer to identify and assist the Bank complying with the laws pertaining to the industry tasked with the following:

Internal Control

The systems of internal control are designed to manage rather than eliminate the risk of failure to achieve the objectives of the Bank. The Board is vested with the ultimate responsibility for the operation of an adequate system of internal controls. The Audit Committee oversees the review and assessment of internal controls.

Corporate Governance Culture

It is corporate culture, championed by leadership and sustained by every associate within the Bank that determines corporate ethics. One way we build and protect our culture is by aggressively promoting our Bank's core values to associates at all times.

We also know that actions speak louder than words. In the hindsight, we foster a culture of openness, in which healthy debate is encouraged and associates are expected to blow the whistle on improper activity. We also do not hesitate to separate ourselves from individuals who violate our values or ethical standards, regardless of performance or potential.

STATEMENT OF THE DIRECTORS' RESPONSIBILITY FOR THE PREPARATION OF FINANCIAL STATEMENTS

This statement sets out the responsibilities of the Directors in relating to the Financial Statements of the Bank. The responsibilities of the Auditors in relation to the financial statements are set out in the Report of the Auditors on page 20 of the Annual Report.

1. The provisions of the Companies Act No. 7 of 2007 requires the Directors to prepare Financial Statements for each financial year giving a true and fair view of:

* The state of affairs of the Bank as at the end of the financial year, together with

* The profit or loss of the Bank for the financial year and to place them before a general meeting. The Directors are also responsible for ensuring that proper accounting records are kept to disclose, with reasonable accuracy, the financial position and to enable the preparation of the Bank's financial statements.

2. In preparing these Financial Statements the Directors are required to

* Select appropriate accounting policies and apply them consistently (material departures, if any, have been disclosed and explained);

* Make judgments and estimates that are prudent and reasonable and

* Ensure that all applicable accounting standards have been followed.

3. The Directors are also required to ensure that the Bank has adequate resources to continue in operation to justify applying the going concern basis in preparation of these financial statements.

4. Further, the Directors have a responsibility to ensure that the Financial Statements presented comply with the requirements of the Companies Act, No. 7 of 2007 and the Banking Act.

5. The Directors have to institute effective and comprehensive systems of Internal Control. This comprises Internal Check, Internal Audit and the whole system of financial and other controls required to carry on the business of insurance in an orderly manner, safeguard the Bank's assets and secure as far as practicable the accuracy and reliability of the records.

6. The Directors are responsible for providing the Auditors with every opportunity to carry out the necessary audit work in enabling them to present their audit report.

The Directors are of the view that they have discharged their responsibilities as set out in this statement.

By the Order of the Board

**(Sgd.)
Mrs. Karnika Jayatilake
Company Secretary**

Colombo
01st May 2008

COMPLIANCE REPORT

We hereby confirm the Compliance of the following by the bank during the period under consideration.

1. All documentary requirements imposed by the Companies Act No.07 of 2007 with regard to filing of various returns and documents with Registrar of Companies have been duly completed and compliance has been made with all other legal requirements in connection with the said Companies Act.
2. The Bank has submitted all reports required and requested by Central Bank of Sri Lanka.
3. The Directors to the best of their knowledge and belief are satisfied that all statutory payments due to the Government of Sri Lanka and in relation to the employees have been paid.
4. Complying with the capital measurement and standard of Banking Regulations and Supervisory Practices Committee, (BASEL Committee) the Central Bank of Sri Lanka has made it mandatory for all licensed specialized banks to maintain an amount of minimum capital that could be invested by the shareholders of the Bank. In keeping with current international practices, and the requirements as per the Central Bank of Sri Lanka, the minimum capital adequacy standard to be achieved is a risk weighted asset ratio of 10% with core capital constituting not less than 5%.

Bank's Capital Adequacy ratio is 62.79% for Tier 1 and 63.12% for Tier 2. This is above the minimum requirements of Central Bank of Sri Lanka.

(Sgd)
Ranil Satharasinghe
Compliance Officer

Colombo
01st May 2008

AUDIT COMMITTEE REPORT

The Audit Committee comprises of 3 non-executive Directors. The General Manager/CEO, Heads of the departments, Head of Internal Audit and representative of External Auditors attend meetings by invitation. The Committee held 8 meetings during the year under review.

The Audit Committee is empowered to examine the adequacy and effectiveness of Internal Control Systems, assess compliance with regulatory requirements, review the statutory accounts and published financial statements, and consider contents of Internal Audit Reports.

The Audit Committee reviews Internal Audit Reports and consider findings, recommendations and corrective action taken by Management to overcome the noted deficiencies, with a view to manage significant business risks and improve controls. The Committee also advises all levels of management and keeps Board of Directors instructed on the Bank's system of internal controls and the state of the management risk.

Audit Committee also liaises with External Auditors and assesses the independence of the External Auditor and monitor the external audit function and follows up on External Auditors' Management Letters.

The Committee is of the view that controls and procedures are in place and improvements are being pursued to provide reasonable assurance to the Directors that the Bank's assets are safeguarded and the results disclosed in the Accounts are free from material misstatements.

The Audit Committee has recommended to the Board that, Messrs Ernst & Young be re-appointed as banks Auditors for the year ending 31st December 2008 subject to the approval of shareholders at the Annual General Meeting.

(Sgd.)

S.S.C. de Silva

Chairman - Audit Committee

Colombo

01st May 2008

AUDITORS' REPORT



■ Chartered Accountants
201 De Saram Place
P.O. Box 101
Colombo 10
Sri Lanka

■ Telephone : (0) 11 2463500
Fax Gen : (0) 11 2697369
Tax : (0) 11 5578180
E-Mail : eysl@lk.ey.com

INDEPENDENT AUDITORS' REPORT TO THE SHAREHOLDERS OF LANKAPUTHRA DEVELOPMENT BANK LIMITED

Report on the Financial Statements

We have audited the accompanying financial statements of Lankaputhra Development Bank Limited, which comprise the balance sheet as at December 31, 2007, and the income statement, statement of changes in equity and cash flow statement for the year then ended, and a summary of significant accounting policies and other explanatory notes.

Management's Responsibility for the Financial Statements

Management is responsible for the preparation and fair presentation of these financial statements in accordance with Sri Lanka Accounting Standards. This responsibility includes: designing, implementing and maintaining internal control 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 Bank maintained proper accounting records for the year ended December 31, 2007 and the financial statements give a true and fair view of the Bank's state of affairs as at December 31, 2007 and its profit and cash flows for the year then ended in accordance with Sri Lanka Accounting Standards, so far as concerns the shareholders of the Bank.

Report on Other Legal and Regulatory Requirements

In our opinion, these financial statements also comply with the requirements of Sections 151(2) of the Companies Act No. 7 of 2007.

Colombo
February 27, 2008.

■ Partners : A D B Talwatte FCA FCMA T K Bandaranayake FCA M P D Cooray FCA FCMA
Ms. Y A De Silva ACA W R H Fernando FCA FCMA W K B S P Fernando FCA ACMA
A P A Gunasekera FCA FCMA A Herath FCA D K Hulangamuwa FCA FCMA LLB (Lond)
A S M Ismail FCA FCMA H M A Jayasinghe FCA FCMA Ms. G G S Manatunga ACA
Ms. L C G Nanayakkara FCA FCMA

INCOME STATEMENT

Year ended 31 December 2007

	Note	From 1 January 2007 to 31 December 2007 Rs.	From 13 March 2006 to 31 December 2006 Rs.
GROSS INCOME	3	346,602,926	158,317,503
Interest Income	4	338,880,938	156,240,041
Interest Expense	5	(118,526,052)	(14,088,931)
NET INTEREST INCOME		220,354,886	142,151,110
Fees and Commission Income		7,721,989	2,077,462
Other Operating Income		107,409	133,945
NET INCOME		228,184,284	144,362,517
Less : Operating Expenses			
Personnel Costs		60,250,279	24,331,648
Provision for Staff Retirement Benefits		958,475	-
Premises, Equipment and Establishment Expenses		65,248,476	21,131,442
Other Operating Expenses		16,977,643	34,704,669
Provision for Loan Losses		8,699,726	427,108
		152,134,599	80,594,867
Profit from Operating Activities	6	76,049,685	63,767,650
Less: Value Added Tax		18,005,885	12,081,792
Profit before Taxation		58,043,800	51,685,858
Less: Taxation	7	35,179,782	28,370,797
Profit after Taxation		22,864,018	23,315,061
Earnings per Share - Basic	8	1.52	1.55

The Notes to the Financial Statements from pages 25 to 38 form an integral part of these Financial Statements.

Colombo
February 27, 2008

BALANCE SHEET

As at 31 December 2007

	Note	As At 31 December 2007 Rs.	As At 31 December 2006 Rs.
ASSETS			
Cash and Short Term Funds	9	56,705,054	273,704,935
Government Treasury Bills	10	1,977,694,077	1,358,596,662
Investment Securities	11	370,000,000	-
Loans and Advances	12	1,656,407,358	427,359,170
Other Assets	13	9,169,724	24,378,620
Property, Plant & Equipment	14	105,262,209	48,398,886
Total Assets		<u>4,175,238,422</u>	<u>2,132,438,273</u>
LIABILITIES			
Deposits	15	1,993,786,206	259,356,276
Due to Banks		-	3,551,555
Other Liabilities	16	629,530,965	344,916,461
Deferred Liabilities	17	5,742,172	1,298,919
Total Liabilities		<u>2,629,059,343</u>	<u>609,123,212</u>
SHAREHOLDERS' FUNDS			
Stated Capital	18	1,500,000,000	1,500,000,000
Reserve Fund	19	2,308,954	1,165,753
Revenue Reserves	20	43,870,125	22,149,308
Total Shareholders' Funds		<u>1,546,179,079</u>	<u>1,523,315,061</u>
Total Liabilities and Shareholders' Funds		<u>4,175,238,422</u>	<u>2,132,438,273</u>
Commitments and Contingencies	21	<u>174,605,786</u>	<u>150,695,706</u>

Certification

I certify that the above Financial Statements give a true and fair view of the state of affairs as at 31st December 2007 and of its profit for the year then ended.

(Sgd)

Mewan Dissanayake
Senior Manager - Finance

The Notes to the Financial Statements from pages 25 to 38 form an integral part of these Financial Statements.

The Board of Directors is responsible for the preparation and presentation of these financial statements. Approved and signed for and on behalf of the Board by;

(Sgd)

A de Vass Gunawardena
Chairman
Colombo
February 27, 2008

(Sgd)

S. S. C. De Silva
Director

(Sgd)

Mrs. S. Wicramasinghe
General Manager / CEO

STATEMENT OF CHANGES IN EQUITY

Year ended 31 December 2007

	Note	Stated Capital Rs.	Reserve Fund Rs.	Revenue Reserves Rs.	Total Rs.
Balance as at 13 March 2006		-	-	-	-
Issue of Share capital	18	1,500,000,000	-	-	1,500,000,000
Profit for the period		-	-	23,315,061	23,315,061
Transfers during the year	19	-	1,165,753	(1,165,753)	-
Balance as at 31 December 2006		1,500,000,000	1,165,753	22,149,308	1,523,315,061
Profit for the year	19	-	-	22,864,018	22,864,018
Transfers during the year		-	1,143,201	(1,143,201)	-
Balance as at 31 December 2007		<u>1,500,000,000</u>	<u>2,308,954</u>	<u>43,870,125</u>	<u>1,546,179,079</u>

The Notes to the Financial Statements from pages 25 to 38 form an integral part of these Financial Statements.

Colombo
February 27, 2008

CASH FLOW STATEMENT

Year ended 31 December 2007

Note	From 01 January 2007 to 31 December 2007 Rs.	From 13 March 2006 to 31 December 2006 Rs.
Cash Flow from Operating Activities		
Interest Received	342,504,939	93,303,497
Fees and Commission Received	8,343,079	2,077,462
Exchange Gain	107,409	133,945
Interest Paid	(30,276,591)	(1,762,810)
Payments to Employees and Suppliers	(152,065,222)	(69,707,254)
Net Cash flow from Operating Activities before Income Tax (A)	<u>168,613,614</u>	<u>24,044,840</u>
Income Tax paid	(43,383,554)	(14,159,396)
Operating Profit before Changes in Operating Assets and Liabilities	<u>125,230,060</u>	<u>9,885,444</u>
(Increase)/Decrease in Operating Assets		
Treasury Bill Investments	(625,999,275)	(1,304,000,522)
Loans & Advances	(1,228,555,850)	(425,360,081)
Other Assets	9,294,689	(18,464,412)
	<u>(1,845,260,436)</u>	<u>(1,747,825,015)</u>
Increase/(Decrease) in Operating Liabilities		
Customer Deposits	1,734,429,932	259,356,276
Other Liabilities	211,097,483	299,759,727
	<u>1,945,527,415</u>	<u>559,116,003</u>
Net Cash Flow from Operating Activities	<u>225,497,039</u>	<u>(1,178,823,568)</u>
Cash Flows from Investing Activities		
Purchase of Property, Plant & Equipment	14.1 (68,945,365)	(51,023,052)
Investment in Shares	11 (370,000,000)	-
	<u>(438,945,365)</u>	<u>(51,023,052)</u>
Cash Flows from Financing Activities		
Issue of Ordinary Shares	-	1,500,000,000
	-	1,500,000,000
Net Increase/(Decrease) in Cash & Cash Equivalents	(213,448,326)	270,153,380
Cash and Cash Equivalents at the beginning of the period	270,153,380	-
Cash and Cash Equivalents at the end of the year	<u>56,705,054</u>	<u>270,153,380</u>
Reconciliation of Cash & Cash Equivalents		
Cash in Hand	3,473,052	497,035
Balances with Banks	52,940,897	1,461,560
Money at Short Notice	291,105	268,194,785
	<u>56,705,054</u>	<u>270,153,380</u>
A. Reconciliation of Profit before Taxation		
Profit before taxation	58,043,800	51,685,858
Depreciation	11,460,952	2,624,166
Provision for Doubtful Debts	8,699,726	427,108
Provision for Gratuity	958,475	-
Loss on PPE Disposal	621,090	-
(Increase) / Decrease in Interest Receivable	3,624,001	(62,936,544)
Increase / (Decrease) in Interest Payables	88,249,461	12,326,120
Increase/ Decrease in Other Debtors/ Creditors	(3,043,891)	19,918,132
	<u>168,613,614</u>	<u>24,044,840</u>

The Notes to the Financial Statements from pages 25 to 38 form an integral part of these Financial Statements.

Colombo
February 27, 2008

NOTES TO THE FINANCIAL STATEMENTS

Year ended 31st December 2007

1. CORPORATE INFORMATION

1.1. General

Lankaputhra Development Bank Limited (the 'Bank') is a licensed specialized bank established under the Banking Act No. 30 of 1988. It is a public limited liability company, incorporated and domiciled in Sri Lanka. The registered office of the Bank is located at No. 34, Maitland Crescent, Colombo 07.

The Financial Statements of Lankaputhra Development Bank Ltd., for the year ended December 2007 were authorised for issue in accordance with the resolution of the Board of Directors on 27th February 2008.

1.2. Principal Activities

The Bank provides a range of financial services including the acceptance of savings and term deposits, financing project loans and short term working capital requirements.

2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

2.1 Basis of Preparation

The Financial Statements of the Bank have been prepared on a historical cost basis. Assets and liabilities are grouped by nature and are listed in an order that reflects their relative liquidity.

No adjustments have been made for inflationary factors affecting these financial statements. Financial Statements are prepared and presented in Sri Lanka rupees.

The preparation and presentation of these financial statements is in compliance with the requirements of the Companies Act No. 7 of 2007 and the Banking Act No. 30 of 1988 and amendments thereto.

2.1.1 Statement of Compliance

The Financial Statements of the Bank have been prepared in accordance with the Sri Lanka Accounting Standards (SLAS).

2.1.2 Prior Year Figures and Phrases

Certain prior year figures and phrases are rearranged whenever necessary to confirm to the current presentation.

2.1.3 Changes in Accounting Policy

The accounting policies are consistent with those used in the previous year except as follows:

The Bank has adopted the new standard SLAS 41 on Impairment of Assets. This adoption did not have a significant impact on the financial statements. (Refer accounting policy 2.8)

NOTES TO THE FINANCIAL STATEMENTS (Contd.)

Year ended 31 December 2007

2.2 Significant Accounting Estimates and Assumptions

In the process of applying the Bank's Accounting Policies, management is required to make estimates and assumptions that affect the amounts recognized in the financial statements. Use of available information and application of judgment are inherent in the formation of estimates, and the differences may be material to the financial statements.

The following is a brief description of the Bank's critical accounting estimates and assumptions.

Losses for Loans and Advances

It is the Bank's policy to establish through charges against profits, specific and general provisions in respect of estimated and inherent credit losses in its portfolio as described in Note 2.7.2 to these Financial Statements.

Impairment of Non Financial Assets

The Bank assesses whether there are any indicators of impairment for all non financial assets at each reporting date. Non financial assets are tested for impairment when there are indicators that the carrying amount may not be recoverable. When value in use calculations are undertaken, management must estimate the expected future cash flows from the asset or cash generating unit and choose a suitable discount rate in order to calculate the present value of those cash flows. Further details are given in Note 2.8.

2.3 Foreign Currency Translation

The financial statements are presented in Sri Lankan Rupees, which is the Bank's functional and presentation currency. All foreign exchange transactions are converted to Sri Lankan Rupees, at the spot rate prevailing on the date the transactions were effected. Monetary assets and liabilities denominated in foreign currencies are translated to Sri Lankan Rupee equivalents using year-end foreign exchange rates. The resulting gains and losses are accounted for in the Income Statement. Non- monetary assets and liabilities that are measured in terms of historical cost in a foreign currency are translated to Sri Lankan Rupees using the exchange rates as at the dates of the initial transactions.

2.4 Going Concern

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

2.5 Taxation

(a) Income Tax

The provision for income tax is based on the elements of the income and expenditure as reported in the financial statements and computed in accordance with the provisions of the Inland Revenue Act.

Income tax liabilities for the current period are measured at the amount expected to be paid to the taxation authority in accordance with the provisions of the Inland Revenue Act No. 10 of 2006.

NOTES TO THE FINANCIAL STATEMENTS (Contd.)

Year ended 31 December 2007

Income tax on profit from the operations is calculated at the rate of 35%.

(b) Deferred Income Tax

Deferred income tax is provided using the liability method on temporary differences at the balance sheet date between the tax bases of assets and liabilities and their carrying amounts for financial reporting purposes.

Deferred income tax liabilities are recognised for all taxable temporary differences except:

- * Where the deferred income tax liability arises from initial recognition of goodwill or of an asset or liability in a transaction that is not a business combination and, at the time of transaction, affects neither the accounting profit nor taxable profit or loss; and
- * in respect of taxable temporary differences associated with investments in subsidiaries, where the timing of reversal of the temporary differences can be controlled and it is probable that the temporary differences will not reverse in the foreseeable future.

Deferred income tax assets are recognised for all deductible temporary differences, carry-forward of unused tax credits 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 credits and unused tax losses can be utilised except:

- * where the deferred income tax asset relating to the deductible temporary difference arises from initial recognition of an asset or liability in a transaction that is not a business combination and, at the time of transaction, affects neither the accounting profit nor taxable profit or loss; and
- * in respect of deductible temporary differences associated with investments in subsidiaries, deferred income tax assets are recognised only 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.

The carrying amount of deferred income tax assets is reviewed 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. Unrecognised deferred income tax assets are reassessed at each balance sheet date and are recognised to the extent that it has become probable that future taxable profit will allow the deferred tax asset to be recovered.

Deferred income tax assets and liabilities are measured at the tax rates that are expected to apply to the year when the asset is realised or the liability is settled, based on the tax rates and tax laws that have been enacted or subsequently enacted as at the balance sheet date.

Deferred income tax relating to items recognised directly in equity is recognised in the equity statement and not in the income statement.

NOTES TO THE FINANCIAL STATEMENTS (Contd.)

Year ended 31 December 2007

Deferred income tax assets and deferred income tax liabilities are offset, if a legally enforceable right exists to set off current tax assets against current income tax liabilities and the deferred income taxes relates to the same taxable entity and the same taxation authority.

(c) Value Added Tax

During the period, the Bank's total value addition was subjected to a 20% Value Added Tax on Financial Services as per Section 25 A of the Value Added Tax Act No. 14 of 2002 and amendments thereto.

(d) Social Responsibility Levy

As per the provisions of the Finance Act, No. 5 of 2005, as amended by the Finance Act No 11 of 2006, Social Responsibility Levy (SRL) was introduced with effect from 01 January 2005. SRL is payable at the rate of 1% on all taxes and levies chargeable as specified in the First Schedule of the Act.

2.6 Events after the Balance Sheet Date

All material events occurring after the balance sheet date are considered and appropriate adjustments and /or disclosures have been made in the financial statements, where necessary.

2.7 Valuation of Assets and their Measurement Bases

2.7.1 Investments

a) Investments in Treasury Bills held to Maturity

Investments in Treasury Bills are reflected at the value of the bills purchased and the discount/premium accrued thereon. Discount received/premium paid is taken to the Income Statement based on a pattern reflecting a constant periodic rate of return.

b) Securities purchased under Re-sale Agreements (Reverse Repurchase Agreements)

These are advances collateralized by purchase of treasury bills and treasury bonds subject to a commitment to re-sale them at a predetermined price. Such securities remain on the Balance Sheet of the Bank and the asset is recorded in respect of the consideration paid and interest accrued thereon.

2.7.2 Loans and Advances to Customers

(a) Loans and Advances to customers are stated in the Balance Sheet net of provisions for possible loan losses and net of interest, which is not accrued to revenue.

(b) Specific provisions for possible loan losses are made on the basis of a continuous review of all advances to customers in accordance with Sri Lanka Accounting Standards No 23 on Revenue Recognition & Disclosures in the Financial Statements of Banks and the guidelines issued by the Central Bank of Sri Lanka as follows;

NOTES TO THE FINANCIAL STATEMENTS (Contd.)

Year ended 31 December 2007

Period Outstanding	Classification	Provision made net of realizable value of securities
6 to 12 Months	Substandard	20%
12 to 18 Months	Doubtful	50%
Over 18 Months	Loss	100%

- (c) In addition, a general provision is made at the rate of 0.1% per quarter on performing loans and advances commencing from the fourth quarter 2006, as per the direction from the Central Bank of Sri Lanka, which requires that a general provision upto 1% on total performing loans and advances be made on or before the end of the first quarter 2009.

2.7.3 Property, Plant & Equipment

(a) Freehold Assets

Property, Plant and Equipment is stated at cost, excluding the costs of day to day servicing, less accumulated depreciation and accumulated impairment. Such cost includes the cost of replacing part of the plant and equipment when that cost is incurred, if the recognition criteria are met.

(b) Depreciation

Depreciation is calculated on all assets excluding land on a straight line basis over the useful life of the assets as given below.

Leasehold Improvements	15 years
Motor vehicles	05 years
Office & Electrical Equipment	10 years
Computer Software & Equipment	05 years
Furniture & Fittings	10 years

The assets residential values, useful lives and method of depreciation are reviewed, and adjusted if appropriate, at each financial period end.

(c) Derecognition

An item of property, plant and equipment is derecognised 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.

2.8 Impairment of Non Financial Assets

The Bank assesses at each reporting date whether there is an indication that an asset maybe impaired. If any such indication exists, or when annual impairment testing for an asset is required, the Bank estimates the asset's recoverable amount. An asset's recoverable amount is the higher of an asset's or cash generating unit's fair value less costs to sell and its value in use and is determined for an individual asset, unless the asset does not

NOTES TO THE FINANCIAL STATEMENTS (Contd.)

Year ended 31 December 2007

generate cash inflows that are largely independent of those from other assets or groups of assets. Where the carrying amount of an asset exceeds its recoverable amount, the asset is considered impaired and is written down to its recoverable amount. In assessing value in use, the estimated future cash flows are discounted to their present value using a pre-tax discount rate that reflects current market assessments of the time value of money and the risks specific to the asset.

Impairment losses of continuing operations are recognised in the Income Statement in those expense categories consistent with the function of the impaired asset.

For assets, an assessment is made at each reporting date as to whether there is any indication that previously recognised impairment losses may no longer exist or may have decreased. If such indication exists, the Bank makes an estimate of recoverable amount. A previously recognised impairment loss is reversed only if there has been a change in the estimates used to determine the asset's recoverable amount since the last impairment loss was recognised. If that is the case the carrying amount of the asset is increased to its recoverable amount. That increased amount cannot exceed the carrying amount that would have been determined, net of depreciation, had no impairment loss been recognised for the asset in prior years. Such reversal is recognised in the income statement unless the asset is carried at revalued amount, in which case the reversal is treated as a revaluation increase.

2.9 Liabilities and Provisions

2.9.1 Provisions

Provisions are recognised when the Bank has a present obligation (legal / constructive) as a result of past event, its probable that an out flow of resources embodying economic benefits will be required to settle the obligation and a reliable estimate can be made of the amount of the obligation.

2.9.2 Commitments and Contingencies

All discernible risks are accounted for in determining the amount of other liabilities of the bank.

2.9.3 Retirement Benefit Obligations

(a) Defined Benefit Plan – Gratuity

Gratuity is a Defined Benefit Plan. The Bank is liable to pay gratuity in terms of the relevant statute. In order to meet this liability a provision is carried forward in the Balance Sheet, equivalent to an amount calculated based on a half month's salary as of the last month of the financial year of all employees for each completed year of service, commencing from the first year of service. The gratuity liability is not externally funded or actuarially valued.

However, as per the provision of the Payment of Gratuity Act No.12 of 1983, this liability only arises upon completion of 5 years of continued service.

(b) Defined Contribution Plans – Employees' Provident Fund and Employees' Trust Fund

Employees are eligible for Employees' Provident Fund and Employees' Trust Fund contributions in line with respective statutes and regulations. The Bank contributes to the Employees' Provident Fund and the Employees' Trust Fund 15% and 3% respectively.

NOTES TO THE FINANCIAL STATEMENTS (Contd.)

Year ended 31 December 2007

2.10 Income Statement

(a) Interest Income from customer advances

In terms of the provisions of the Sri Lanka Accounting Standard No. 23 on Revenue Recognition and Disclosures in the Financial Statements of Banks and the guidelines issued by the Central Bank of Sri Lanka, interest receivable is recognised on an accrual basis. Interest ceases to be taken into revenue when the recovery of interest or principal is in arrears for over three (3) months and interest accrued until such advances being classified as non-performing are also eliminated from interest income and transferred to interest in suspense. The interest income on non-performing advances is recognised on a cash basis.

(b) Fees and Commission Income

Fees and commission income comprise mainly of fees receivable from customers for guarantees and letter of credit facilities provided by the Bank. Such income is recognised as revenue as the services are provided.

(c) Other Income

Other income is recognized on an accrual basis.

2.11 Expenses

Interest payable is recognized on an accrual basis. Other expenses are recognized in the financial statements, in the period to which they relate.

2.12 Cash Flow Statement

The Cash Flow Statement has been prepared by using the "Direct Method" whereby gross cash receipts and gross cash payments of operating activities, finance activities and investing activities have been recognized. Cash and cash equivalents comprise mainly of cash balances, net of bank over drafts for the purpose of cash flow.

2.13 Future Changes in Accounting Policies

Standards Issued but not yet Effective:

Sri Lanka Accounting standards 16 (Revised) – Employee Benefits

SLAS 16 (Revised) was issued in 2007, and becomes effective for financial years beginning on or after 1st July 2007. Accordingly, the Financial Statements for the year ending 31st December 2008 will adopt the revised SLAS 16.

As a result of the revision, all short term employee benefits of the bank will require to be recognized when an employee has rendered service in exchange for those benefits. For post employment benefits, the bank will be required to involve a qualified actuary in their measurement. Pending a full study of this revised standard, the financial impact is not yet known and reasonably estimated.

2.14 Directors' Responsibility Statement

The Board of Directors takes the responsibility for the preparation and presentation of these financial statements.

NOTES TO THE FINANCIAL STATEMENTS (Contd.)

Year ended 31 December 2007

	From 1 January 2007 to 31 December 2007 Rs.	From 13 March 2006 to 31 December 2006 Rs.
3. GROSS INCOME		
Interest Income	338,880,938	156,240,041
Fees and Commission Income	7,721,989	2,077,462
	<u>346,602,926</u>	<u>158,317,503</u>
4. INTEREST INCOME		
Customer Advances	121,275,788	9,397,853
GOSL Treasury Bills	217,386,047	141,138,608
Other Interest Income	219,103	5,703,580
	<u>338,880,938</u>	<u>156,240,041</u>
5. INTEREST EXPENSE		
Customer Deposits	118,526,052	14,088,931
	<u>118,526,052</u>	<u>14,088,931</u>
6. PROFIT BEFORE TAXATION		
Is stated after charging the following among others;		
Included In Personnel Cost		
Defined Contribution Plan Cost - EPF & ETF	5,965,701	2,229,208
Included in Premises, Equipment & Establishment Cost		
Depreciation	11,460,952	2,624,166
Legal Expenses	752,790	180,750
Provision for Bad & Doubtful Debts	8,699,726	427,108
Donations	500,000	56,598
Business Promotion & Advertising	13,940,965	33,751,382
	<u>11,460,952</u>	<u>2,624,166</u>
	<u>752,790</u>	<u>180,750</u>
	<u>8,699,726</u>	<u>427,108</u>
	<u>500,000</u>	<u>56,598</u>
	<u>13,940,965</u>	<u>33,751,382</u>
7. TAXATION		
Income Tax on Profit for the period (7.1)	31,695,004	27,071,878
Deferred Income Tax Charge (Refer Note 17.1)	3,484,778	1,298,919
	<u>35,179,782</u>	<u>28,370,797</u>
7.1 Reconciliation of Accounting Profit and Taxable Income		
Accounting Profit before Taxation	76,049,685	63,767,650
Disallowable Expenses	25,325,062	19,410,113
	<u>101,374,747</u>	<u>83,177,763</u>
Less: Allowable Expenses	(15,943,764)	(6,595,365)
Taxable Income	<u>85,430,983</u>	<u>76,582,398</u>
Income Tax Expense (Y/A 2007/2008)	29,900,844	26,803,839
Income Tax Expense (Y/A 2006/2007)	1,480,348	-
	<u>31,381,192</u>	<u>26,803,839</u>
Social Responsibility Levy (SRL) @ 1%	313,812	268,038
Current Income Tax Expense	<u>31,695,004</u>	<u>27,071,878</u>
Effective Income Tax Rate	<u>60.61%</u>	<u>54.89%</u>

NOTES TO THE FINANCIAL STATEMENTS (Contd.)

Year ended 31 December 2007

8. EARNINGS PER SHARE

Basic Earning Per Share is calculated by dividing the profit for the period attributable to ordinary shareholders by the weighted average number of ordinary shares in issue during the period.

	From 1 January 2007 to 31 December 2007	From 13 March 2006 to 31 December 2006
	Rs.	Rs.
Amount Used as the Numerator:		
Net Profit Attributable to Ordinary Shareholders	22,864,018	23,315,061
Number of Ordinary Shares Used as the Denominator:		
Weighted Average Number of Ordinary Shares in issue	15,000,000	15,000,000
Earnings per Ordinary Share	1.52	1.55

9. CASH AND SHORT TERM FUNDS

	As at 31.12.2007	As at 31.12.2006
	Rs.	Rs.
Cash in Hand	3,473,052	497,035
Balances with Banks	52,940,897	5,013,115
Money at Short Notice	291,105	268,194,785
	56,705,054	273,704,935

10. GOVERNMENT TREASURY BILLS

Govt. Treasury Bills held to Maturity	914,751,793	1,254,181,153
Treasury Bills under Reverse Repo's	1,062,942,284	104,415,509
	1,977,694,077	1,358,596,662

11. INVESTMENT SECURITIES

Mihin Lanka (Pvt) Limited 3,000,000 Cumulative, Redeemable Preference Shares of Rs. 100/= each	300,000,000	-
HVA Lanka Exports (Pvt) Ltd. 7,000,000 Cumulative, Redeemable Preference Shares of Rs. 10/= each	70,000,000	-
	370,000,000	-

12. LOANS AND ADVANCES

Working Capital Loans	214,053,690	187,035,549
Term Loans	1,316,601,427	216,608,969
Short Term Loans	96,878,469	24,141,760
Krushni Navodhaya Loans	23,118,117	-
Micro Credit Finance Loans	16,059,252	-
Kapruka Ayojana Loan	2,315,365	-
	1,669,026,320	427,786,278
Less:		
Loan Loss Provision	9,126,834	427,108
Interest in Suspense	3,492,128	-
	1,656,407,358	427,359,170

12.1 Movement in the Provision for Bad & Doubtful Debts & Suspended Interest

	Provision Against Loans and Advances			Suspended Interest Rs.
	Specific Rs.	General Rs.	Total Rs.	
As at the beginning of the period	-	427,108	427,108	-
Provision made during the period	996,499	7,703,227	8,699,726	3,492,128
As at the end of the period	996,499	8,130,335	9,126,834	3,492,128

NOTES TO THE FINANCIAL STATEMENTS (Contd.)

Year ended 31 December 2007

12. LOANS AND ADVANCES

12.2 Concentration of Credit Risk

Analysis of the Bank's Advances portfolio reflecting the exposure to credit risk in various sectors of the economy is detailed below.

Sector	2007 Rs.	%	2006 Rs.	%
Agriculture and Fishing	400,529,356	24.05%	42,945,308	10.04%
Manufacturing	949,165,209	56.99%	226,580,267	52.97%
Tourism	21,974,006	1.32%	5,028,519	1.18%
Transport	42,380,885	2.54%	2,972,106	0.69%
Traders	1,371,766	0.08%	2,430,450	0.57%
Construction	8,977,247	0.54%	-	0.00%
Financial and Business services	74,486,319	4.47%	92,398,942	21.60%
Other Services	166,649,404	10.01%	55,430,685	12.96%
	<u>1,665,534,192</u>	<u>100.00%</u>	<u>427,786,278</u>	<u>100.00%</u>

13. OTHER ASSETS	As at 31.12.2007 Rs.	As at 31.12.2006 Rs.
Interest Receivable	-	5,914,208
Deposits and Prepayments	9,169,724	18,464,412
	<u>9,169,724</u>	<u>24,378,620</u>

14. PROPERTY, PLANT & EQUIPMENT	Balance as at 01.01.2007 Rs.	Additions during the period Rs.	Disposals during the period Rs.	Balance as at 31.12.2007 Rs.
14.1 Gross Carrying Amounts At Cost				
Lease Hold Improvements	12,262,928	21,532,072	645,842	33,149,158
Land & Building	-	15,000,000	-	15,000,000
Motor Vehicles	11,858,650	3,634,425	-	15,493,075
Office & Electrical Equipment	6,961,633	12,369,557	-	19,331,190
Computer Software & Equipment	17,558,678	10,756,288	-	28,314,966
Furniture & Fittings	2,381,163	5,653,023	-	8,034,186
Total Value of Depreciable Assets	<u>51,023,052</u>	<u>68,945,365</u>	<u>645,842</u>	<u>119,322,575</u>
14.2 Depreciation At Cost				
Lease Hold Improvements	372,508	1,586,278	24,752	1,934,034
Motor Vehicles	814,569	2,907,413	-	3,721,982
Office & Electrical Equipment	259,088	1,512,744	-	1,771,832
Computer Software & Equipment	1,091,997	4,830,010	-	5,922,007
Furniture & Fittings	86,004	624,507	-	710,511
Total Depreciation	<u>2,624,166</u>	<u>11,460,952</u>	<u>24,752</u>	<u>14,060,366</u>
14.3 Net Book Value At Cost	<u>48,398,886</u>			<u>105,262,209</u>

NOTES TO THE FINANCIAL STATEMENTS (Contd.)

Year ended 31 December 2007

	As at 31.12.2007 Rs.	As at 31.12.2006 Rs.
15. DEPOSITS		
15.1 Analysis of Deposits		
Savings Deposits	55,255,860	15,857,276
Time Deposits	<u>1,938,530,346</u>	<u>243,499,000</u>
	<u>1,993,786,206</u>	<u>259,356,276</u>
15.2 Sources of Deposits		
Deposits from Banks	1,310,000,000	100,000,000
Deposits from Other Customers	<u>683,786,206</u>	<u>159,356,276</u>
	<u>1,993,786,206</u>	<u>259,356,276</u>
16. OTHER LIABILITIES		
Accrued Expenditure	11,385,240	7,836,339
Interest Payable	100,575,581	12,326,120
Amounts due to Related Parties	310,803,209	299,759,727
GOSL Financial Assistance for Re-opening of closed down Factories (Note 16.1)	200,054,000	-
Tax Payable	<u>6,712,935</u>	<u>24,994,275</u>
	<u>629,530,965</u>	<u>344,916,461</u>
16.1 GOSL Financial Assistance for Re-opening of closed down Factories		
Balance as at the beginning of the period	-	-
Receipts	750,000,000	-
Disbursements	<u>(549,946,000)</u>	-
Balance as at the end of the period	<u>200,054,000</u>	-
16.2 A revolving short term loan facility of Rs. 55,297,328/- and Letter of Credit/Shipping Guarantee Facility of Rs. 56,072,290/- secured by the above is included in Loans and Advances (Note 10) and Commitments and Contingencies (Note 21.1) respectively.		
Refer Note 23.1 for further details on the funds received.		
17. DEFERRED LIABILITIES		
Deferred Taxation (17.1)	4,783,697	1,298,919
Retirement Benefits-Gratuity	<u>958,475</u>	-
	<u>5,742,172</u>	<u>1,298,919</u>
17.1 Deferred Taxation		
Balance as at the beginning of the period	1,298,919	-
Charge/(Reversal) made during the period	<u>3,484,778</u>	<u>1,298,919</u>
Balance as at the end of the period	<u>4,783,697</u>	<u>1,298,919</u>
17.2 Deferred Tax Liability		
Accelerated depreciation allowances for tax purposes (Property, Plant & Equipment)	5,119,163	1,298,919
Defined Benefit Plan Liability	<u>(335,466)</u>	-
	<u>4,783,697</u>	<u>1,298,919</u>

NOTES TO THE FINANCIAL STATEMENTS (Contd.)

Year ended 31 December 2007

	As at 31.12.2007 Rs.	As at 31.12.2006 Rs.
18. STATED CAPITAL		
Ordinary Share Issued and Fully Paid (No.)	<u>15,000,000</u>	<u>15,000,000</u>
Fully paid Ordinary Shares	<u>1,500,000,000</u>	<u>1,500,000,000</u>

With the enactment of the Companies Act. No. 7 of 2007 effective from 3rd May 2007, the concept of authorised capital and par value is no longer applicable. Therefore, comparative figures have been restated accordingly. The total amount receivable by the Company or due and payable to the Company in respect of the issue of shares are referred to as Stated Capital.

19. RESERVE FUND

As at the beginning of the period	1,165,753	-
Transferred during the period	<u>1,143,201</u>	<u>1,165,753</u>
As at the end of the period	<u><u>2,308,954</u></u>	<u><u>1,165,753</u></u>

Five per centum of profits after tax is transferred to the Reserve Fund as required by Section 20 (1) of the Banking Act No. 30 of 1988. This Reserve Fund will be used only for the purposes specified in section 20 (2) of the Banking Act No. 30 of 1988.

20. RESERVES

20.1 Revenue Reserves

As at the beginning of the period	22,149,308	-
Profit for the period	22,864,018	23,315,061
Transfers to Reserve Fund during the period	<u>(1,143,201)</u>	<u>(1,165,753)</u>
As at the end of the period	<u><u>43,870,125</u></u>	<u><u>22,149,308</u></u>

21. COMMITMENTS AND CONTINGENCIES

21.1 Contingencies

In the normal course of business, the Bank makes various commitments and incurs contingent liabilities with legal recourse to its customers. No material losses are anticipated as a result of these transactions.

Documentary Letters of Credits	73,246,292	127,634,786
Guarantees	<u>101,359,494</u>	<u>23,060,920</u>
	<u><u>174,605,786</u></u>	<u><u>150,695,706</u></u>

21.2 Capital Commitments

There were no material capital expenditure approved by the Board of Directors as at the Balance Sheet date.

21.3 Litigation against the Bank

There were no litigation against the Bank as at the Balance Sheet date.

NOTES TO THE FINANCIAL STATEMENTS (Contd.)

Year ended 31 December 2007

22. ASSETS PLEDGED

The following assets have been pledged as security for liabilities.

Nature of assets	Nature of Liability	Carrying Amount Pledged as at 31 December 2007 Rs.	Included under
Investments in Treasury Bills	Mortgage for the Letter of Credit and Guarantee Facilities	218,257,233	Government Treasury Bills

23. RELATED PARTY DISCLOSURES

Details of significant related party disclosures are as follows:

23.1 Transactions with the State (GOSL) and State Controlled Entities

Name of Related Party	State 2007 Rs.	Entities either controlled or in which significant influence is held by the state **		
		2006 Rs.	2007 Rs.	2006 Rs.
Balance Sheet				
Assets				
Money at Short Notice	-	-	291,105	268,194,850
Due From Banks	-	-	52,940,897	5,013,115
Loans and Advances	-	-	42,080,000	-
Investments in Government Securities	-	-	1,977,694,075	1,358,596,663
Investments in Non Quoted Preference Shares	-	-	300,000,000	-
Liabilities				
Deposits	-	-	1,897,657,839	126,800,000
Funds Received for Disbursements to Closed down Garment Factories *	750,000,000	-	-	-
Other Liabilities	-	-	310,803,210	303,311,282
Equity				
Investment in Shares	1,499,999,400	-	-	-
Off Balance Sheet Items				
Guarantees / Collateral given	-	-	81,161,266	-
Income Statement				
Interest Income earned from Related Parties	-	-	217,697,553	146,465,973
Interest Paid to Related Parties	-	-	96,173,742	3,471
Other Income earned from Related Parties	-	-	2,169,244	-
Expenses relating to Services Obtained/ Taxes	-	-	64,515,606	41,748,357

* The funds received for disbursement to closed down garment factories is pursuant to a decision by the Cabinet of Ministers (Reference No. 07/0147/207/008) where the Ministry of Finance is acting as the facilitator to implement a scheme to restructure/ rehabilitate closed factories as envisaged in the Budget Proposal - 2007. Such funds include interest free loan facilities amounting to Rs. 525 Mn., a further loan facility on commercial terms amounting to Rs.75 Mn and a revolving credit facility amounting to Rs. 200 Mn. of which, the bank is yet to receive a sum of Rs. 50 Mn (from the Government of Sri Lanka) to be disbursed in this regard.

** Entities either controlled or in which significant influence is held by the state include Bank of Ceylon, Central Bank of Sri Lanka, Employees Provident Fund, Mihin Lanka (Pvt) Ltd, SME Bank Ltd, Private Sector Infrastructure Development Co. Ltd, National Water Supply & Drainage Board, Ceylon Electricity Board, Department of Inland Revenue, National Savings Bank, Employees Trust Fund, Sri Lanka Telecom Ltd & Samurdhi Authority of Sri Lanka.

23.2 Transactions with Key Management Personnel

Key Management Personnel include the Board of Directors of the Bank and Chief Executive Officer.

Compensation to Key Management Personnel	2007 Rs.	2006 Rs.
Emoluments / Fees	4,260,000	2,605,000

NOTES TO THE FINANCIAL STATEMENTS (Contd.)

Year ended 31 December 2007

24. POST BALANCE SHEET EVENTS

There are no events occurring after the Balance Sheet date, which required adjustment to or disclosure in the financial statements except for the following,

a. Merger with SME Bank Limited

On 1st January 2008, Lankaputhra Development Bank Limited merged with SME Bank Limited in accordance with the Companies Act No. 07 of 2007 whereby the whole of the assets, undertakings, property, business and liabilities of SME Bank Limited were vested in Lankaputhra Development Bank Limited. All legal proceedings concerned with the merger have been considered by the management and Lankaputhra Development Bank Limited remained as the continuing entity.

The merger is to be effected by way of a share swap.

b. Liquidation of Private Sector Infrastructure Development Company Limited

The Shareholders of Private Sector Infrastructure Development Company Limited (PSIDC) has passed a resolution to wind up the Company and have also appointed a liquidator to commence the winding up. All assets and liabilities of PSIDC have been transferred to Lankaputhra Development Bank Limited on 30.01.2008.

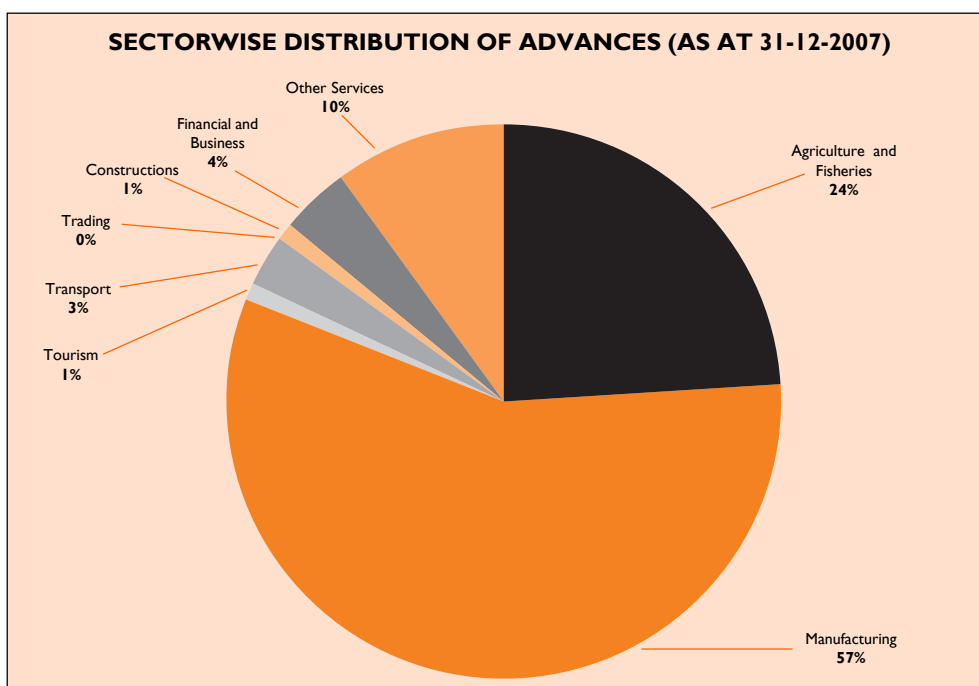
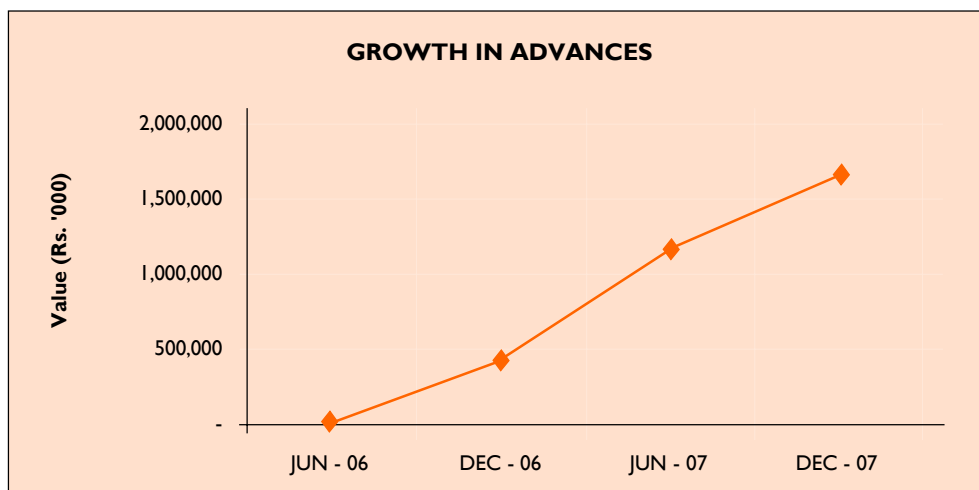
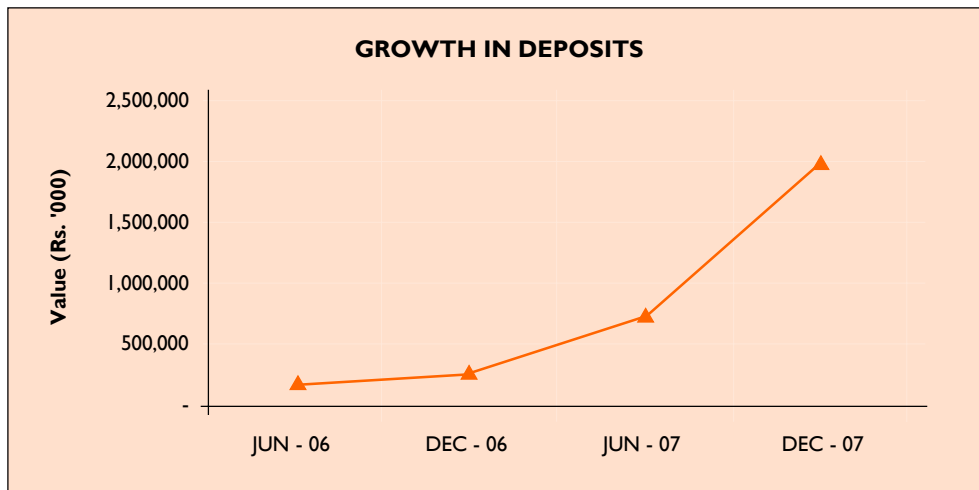
25. MATURITY ANALYSIS

Assets	upto 3 Months Rs.'000	3 to 12 Months Rs.'000	1 - 3 Years Rs.'000	3 - 5 Years Rs.'000	Over 5 Years Rs.'000	Total Rs.'000
Interest Bearing Assets						
Treasury Bills held to maturity	-	914,752	-	-	-	914,752
Treasury Bills under Reverse Repo's	754,959	307,983	-	-	-	1,062,942
Due from Banks	53,232	-	-	-	-	53,232
Investment in Securities	-	-	-	-	370,000	370,000
Loans & Advances	156,997	306,240	617,277	469,604	106,290	1,656,408
	<u>965,188</u>	<u>1,528,975</u>	<u>617,277</u>	<u>469,604</u>	<u>476,290</u>	<u>4,057,334</u>
Non-Interest bearing Assets						
Cash & Short Term Funds	3,473	-	-	-	-	3,473
Other Assets	1,565	4,348	-	-	3,256	9,169
Property, Plant & Equipment	-	-	-	-	105,262	105,262
	<u>5,038</u>	<u>4,348</u>	<u>-</u>	<u>-</u>	<u>108,518</u>	<u>117,904</u>
Total Assets	<u>970,226</u>	<u>1,533,323</u>	<u>617,277</u>	<u>469,604</u>	<u>584,808</u>	<u>4,175,238</u>
Liabilities						
Interest Bearing Liabilities						
Deposits	58,868	1,934,268	650	-	-	1,993,786
	<u>58,868</u>	<u>1,934,268</u>	<u>650</u>	<u>-</u>	<u>-</u>	<u>1,993,786</u>
Non- Interest bearing liabilities						
Other Liabilities	330,189	99,178	110	-	209,887	639,364
Share Capital	-	-	-	-	1,500,000	1,500,000
Reserves	-	-	-	-	42,088	42,088
	<u>330,189</u>	<u>99,178</u>	<u>110</u>	<u>-</u>	<u>1,751,975</u>	<u>2,181,452</u>
Total Liabilities	<u>389,057</u>	<u>2,033,446</u>	<u>760</u>	<u>-</u>	<u>1,751,975</u>	<u>4,175,238</u>

FINANCIAL HIGHLIGHTS

	I January 2007 to 31 December 2007 (Rs.)	I 3 March 2006 to 31 December 2006 (Rs.)	%
			Change
Results for the year			
Income	346,602,926	158,317,503	119%
Interest Income	338,880,938	156,240,041	117%
Interest Expenses	(118,526,052)	(14,088,931)	741%
Net Interest Income	220,354,886	142,151,110	55%
Other Income	7,829,398	2,211,407	254%
Operating Expenses	152,134,599	80,594,867	89%
Profit from Operating Activities	76,049,685	63,767,650	19%
Financial Services Value Added Tax	18,005,885	12,081,792	49%
Net Profit before Tax	58,043,800	51,685,858	12%
Income Tax on Profit	35,179,782	28,370,797	24%
Net Profit after Tax	22,864,018	23,315,061	(2%)
Assets			
Cash in Hand/ Short Term Funds	56,705,054	273,704,935	(79%)
Government Treasury Bills	1,977,694,077	1,358,596,662	45%
Investment Securities	370,000,000	-	100%
Loans and Advances	1,656,407,358	427,359,170	288%
Other Assets	9,169,724	24,378,620	(62%)
Property Plant and Equipment	105,262,209	48,398,886	117%
Total Assets	4,175,238,422	2,132,438,273	96%
Liabilities			
Deposits	1,993,786,206	259,356,276	669%
Due to Banks	-	3,551,556	(100%)
Other Liabilities	629,530,965	344,916,461	82%
Deferred Liabilities	5,742,172	1,298,919	342%
Total Liabilities	2,629,059,343	609,123,212	332%
Shareholder's Funds			
Share Capital	1,500,000,000	1,500,000,000	0%
Reserve Fund	2,308,954	1,165,753	98%
Revenue Reserves	43,870,125	22,149,308	98%
Total Shareholders' Funds	1,546,179,079	1,523,315,061	1%
Total Liabilities and Shareholders' Funds	4,175,238,422	2,132,438,273	96%
Ratios			
Liquid Assets Ratio	96.67%	671%	
Capital Adequacy Ratio Tier 1	62.79%	229%	
Tier 2	63.12%	229%	

FINANCIAL HIGHLIGHTS (Contd.)



SIGNIFICANT RISKS ASSOCIATED WITH THE BANK OPERATIONS

Effective management of risk is crucial for success in financial services and constitutes the central philosophy of the Board of Directors and Corporate Management Team of LDB. We continuously review and upgrade our processes to be in line with bank's specific development and regulatory requirements...

Credit Risk

Credit risk is the risk of losses arising due to the unwillingness or inability of borrowers to meet their financial obligations in time and in full. Credit risk is considered as the most important in risks affecting financial institutions. Maintaining control of this risk protects customers, investors, employees, and other stakeholders and the banking community at large.

In keeping with the development mandate, the Bank deems that it is important to lend to relatively higher risk projects, which are considered to be indispensable in terms of economic and social aspects. The effective credit policies with well defined risk parameters laid down by the Board of Directors, which constantly adapt to the changing operating environment, have been the constant reassurance under such scenarios. The strict perusal of the credit proposals by the Credit Committee of the Bank also enables mitigation of credit risk exposure.

The foundation to minimise the default risk the bank's comprehensive and effective credit evaluation mechanism is in place. A detailed credit evaluation process is carried out by well trained credit officers. The ability of the credit officers to accurately blend the borrower's credit requirement with their ability to repay have helped the bank to minimise the risk of default. Concentration risk in terms of geographical region, industry sector, single client and group exposure is minimised through constant monitoring of the credit portfolio.

Operational Risk

Operational risk arises from human activities, technology, and natural incidents. The sources of operational risk include fraud, technology failure, model failure, technological obsolescence, and inadequate internal control procedures. While operational risk cannot be completely eliminated, the bank endeavours to control such risks wherever possible by continuously assessing and refining the system of internal controls, adopting data security measures, access authorisation system, and by creating awareness amongst staff to improve process discipline. An effective compliance function is also designed to ensure adherence to internal policies and regulations as well as external regulatory and statutory requirements.

Market Risk

Market risk refers to the risk of losses accruing to the bank due to the changes in market prices and interest rates. Market risk can be categorised into four main types, namely; interest rate risk, equity prices risk, exchange rate risk, and

commodity prices risk. Under the current operating context the bank is exposed to interest rate risk, which depends on the re-pricing mismatch of maturing assets and liabilities. This pricing mismatch under adverse interest rate scenarios leads to a reduction in net interest income. ALCO regularly reviews the Maturity Gap Statement of the Bank to ensure that gaps in each maturity bucket are within acceptable norms and minimise the adverse impact of the structural mismatch on future profitability.

Proactive measures adopted by the senior management in terms of policy formulation and implementation also help minimise the adverse impact interest rate movements that may have on the bank's earnings.

Liquidity Risk

Liquidity risk arises when the bank is unable to meet payment obligations in time and in full, at a reasonable cost. The bank's liquidity risk management approach includes regular analysis and monitoring of the liquidity position, investing in GOSL securities such as treasury bills, repurchase agreements, which are readily convertible if and when necessary.

Legal Risk

Legal risk arises due to unenforceable transactions in law or the failure to successfully defend legal action against the bank. Legal risk management commences from prior analysis and from a thorough understanding of an adherence to related legislation by the staff. Necessary precautions are taken at the designing stage of transactions to minimise legal risk exposure. In case of an emergence of a risk factor, immediate action is taken to rectify the situation by the legal department of the bank with external legal consultation being used when required.

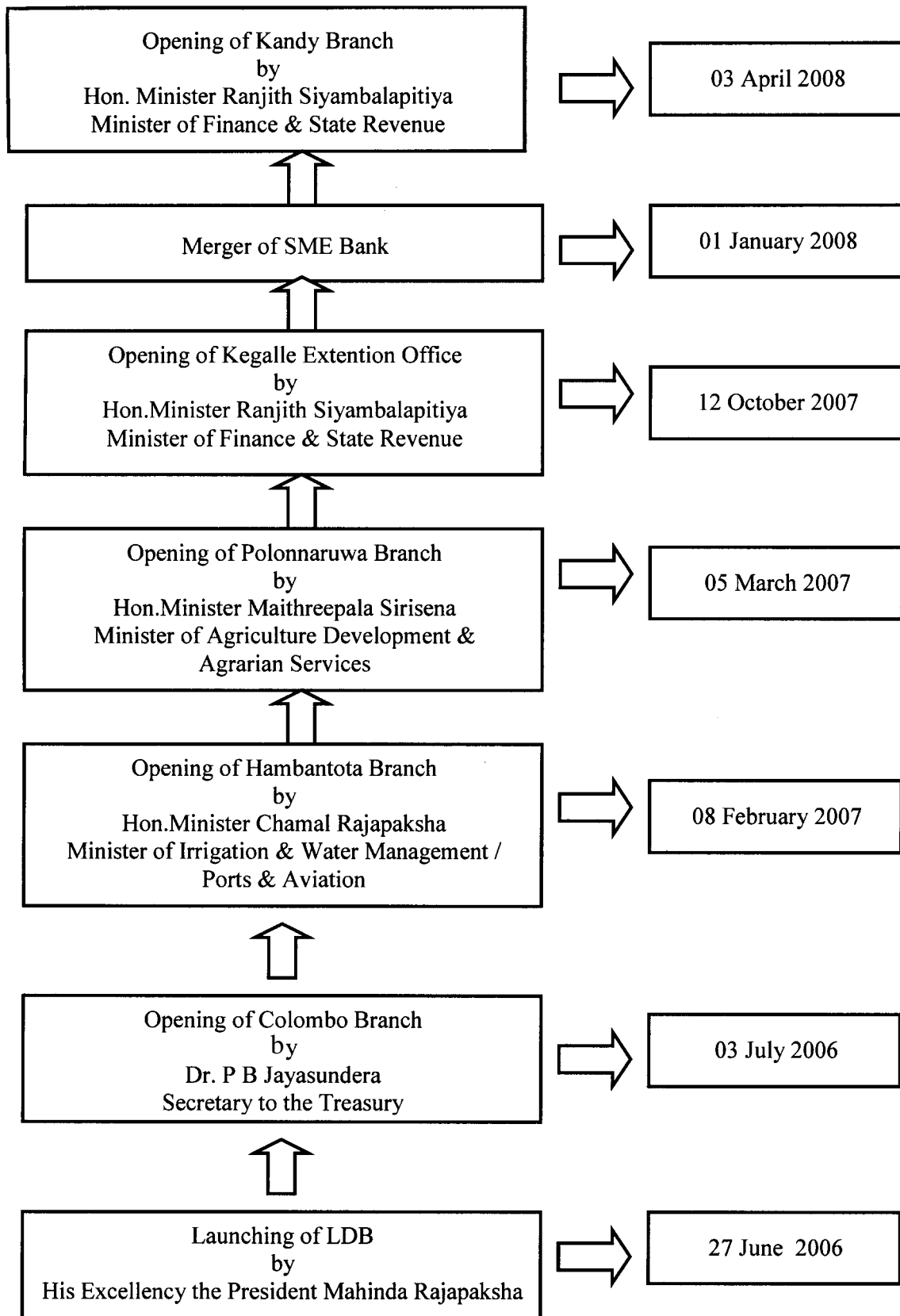
Reputation Risk

An organisation's reputation is its greatest asset. If impacted the consequences on financial performance and licence to operate can be detrimental. In order to maintain its reputation and preserve the confidence of the banks numerous stakeholders the bank has in place a comprehensive compliance system. A culture of compliance permeates in all levels of the bank and the compliance officer monitor adherence to all applicable laws, regulations, and statutory requirements.

Adherence to BASEL II

The Bank is committed to achieving full compliance with each of the progressive initiatives that have been and will be initiated by the Central Bank. This enduring commitment has enabled the Bank to adopt effective risk management policies by fine tuning the risk weightings and allocation of minimum Capital, to be calculated on Credit, Market and Operational risk, for the 'risk weighted' assets.

LDB MILESTONES



FORM OF PROXY

LANKAPUTHRA DEVELOPMENT BANK LIMITED

I/We,

of

.....

being a member/members of the above named Bank hereby appoint

.....

of failing

him of

..... as my/our proxy to represent me/us and vote for me/us on my/our behalf at the Annual General Meeting of the Bank to be held on the **23rd May 2008** and at any adjournment thereof.

To receive and to consider the Report of the Directors and Audited Financial Statements for the year ended 31 st December 2007 and the Report of Auditors.	In favour/against*
To re-appoint Auditors Messrs. Ernst & Young, Chartered Accountants for the year 2008 and to authorize the Board of Directors to determine their remuneration.	In favour/against*

* Please select whatever is required and delete others.

Signed thisday of 2008

.....
Signature of Shareholder