



HNB



Hatton National Bank

Annual Report 2006



UPWARDLY MOBILE

Driven by a new vision and guided by a new mission, we set out to achieve certain corporate goals. We are happy to report that we have not merely succeeded in achieving our objectives, but we have superseded every parameter we had set out to fulfill during our growth process. Receiving the prestigious Bracken Award for the “Sri Lankan Bank of the Year 2006” by globally acclaimed “The Banker” publication is considered a landmark achievement reflecting the commitment and passion of our team to settle for nothing less than the best!

We look back upon the year with positive satisfaction, knowing that we have worked tirelessly as one team to drive our Bank to the top most echelons in the industry. Our achievements, we dedicate to the outstanding HNB team, who will continue to power the Bank’s progress into the future.

new vision



To be the acknowledged leader and chosen partner in providing financial solutions through inspired people

new mission

Combining entrepreneurial spirit with empowered people and leading edge technology to constantly exceed stakeholder expectations

new values



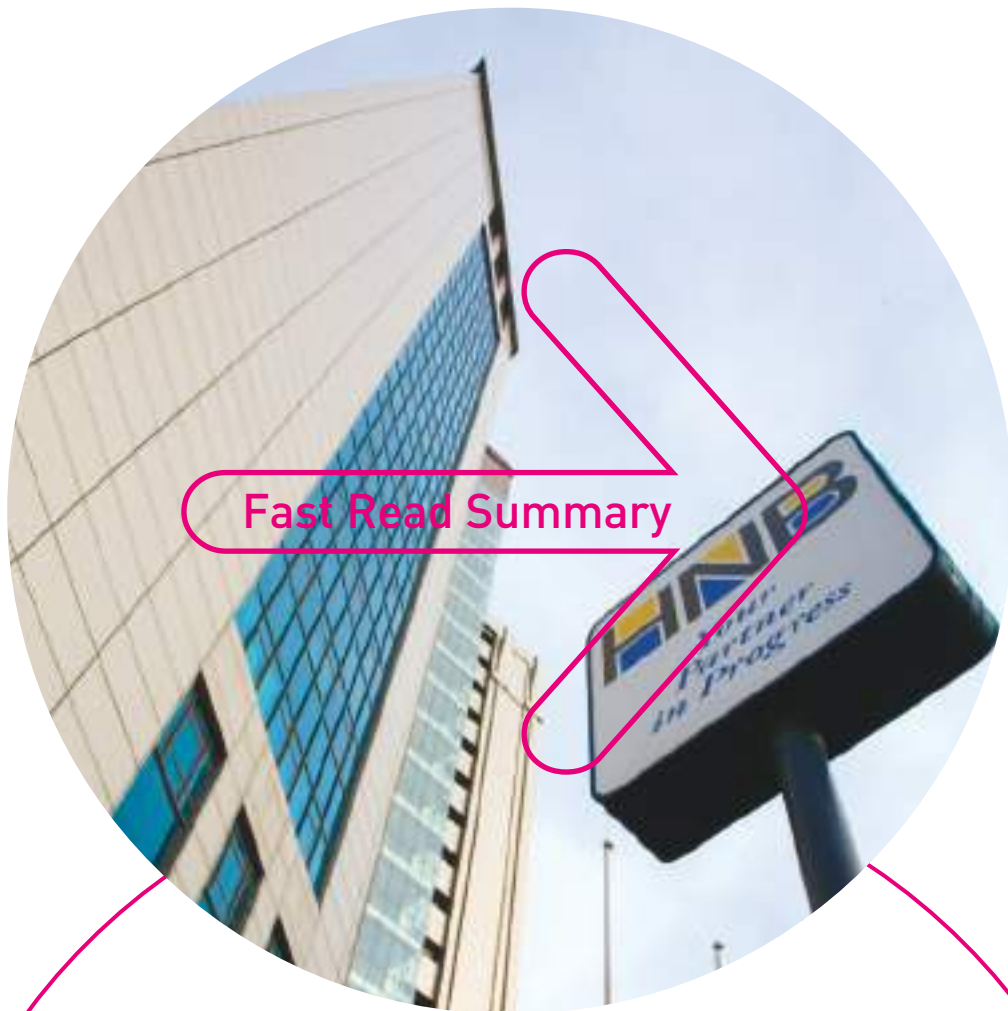
- Treasure professional & personal integrity at all times
- Demonstrate mutual respect in all interactions
- Passionate about everything we do
- Committed to being customer centric
- Courage to change, challenge and be different
- Demonstrate unity in Diversity



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Fast Read Summary

OUR PAST TO OUR FUTURE

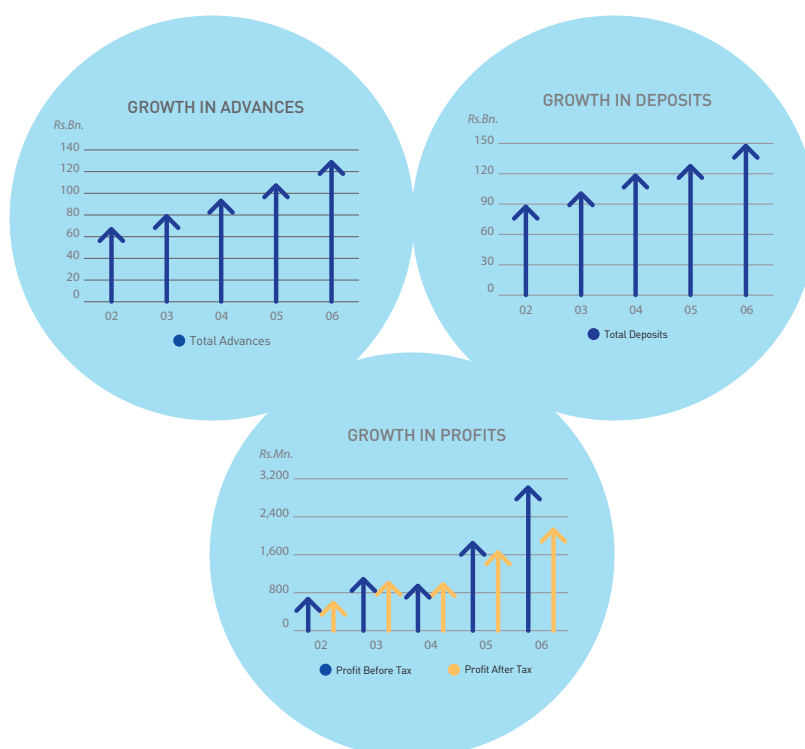
HNB, today, stands as Sri Lanka's premier private sector Bank. An acknowledged leader as the Bank of the Year 2006, we reflect the quintessence of being 'truly Sri Lankan'. Our ethos espouses unity in diversity and we revel in our ability to formulate and fortify relationships across communities using the strengths of a gamut of financial products and service solutions that encompass the entire nation and beyond. The strong branding depicted via the three robust letters of 'HNB' captures the spirit behind every smile in Sri Lanka and the portfolio of offerings that HNB has to offer to every single Sri Lankan or global customer who singles out HNB as their partner in progress.

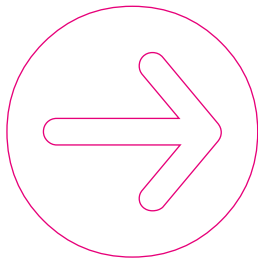
The Hatna Team has for long been an integral link in the continuous chain of relationships. Through the relationships they have nurtured with our customers, they have built a strong foundation of trust, loyalty and long standing commitment that forms an umbrella of brands and services to touch, cherish and foster interaction.

HNB's strategic intent is emblazoned through its vision. We intend our growth path to be etched with pioneering endeavours and leadership initiatives that increase stakeholder value. Our growth will be sustainable, innovative and focused. We will seek opportunities to grow, organically or through collaboration, but all the while strengthening our presence, creating financial landscapes and working towards our vision of being the acknowledged leader and chosen partner in providing financial solutions through inspired people.

FINANCIAL HIGHLIGHTS

	2006 Rs.000	2005 Rs.000	% Change
Results for the year			
Income	21,513,173	16,915,314	+ 27.18
Net profit before income tax	3,019,450	1,849,962	+ 63.22
Income tax on profits	798,961	195,400	+ 308.88
Net profit after taxation	2,220,489	1,654,562	+ 34.20
Gross dividends	588,824	471,058	+ 25.00
Profit available after appropriation	1,631,665	1,183,504	+ 37.87
At the year end			
Shareholders' funds (Capital and Reserves)	12,929,808	11,239,260	+ 15.04
Deposits from customers	147,882,025	128,283,681	+ 15.28
Advances to customers including Leasing and Bills of Exchange	128,171,701	107,133,793	+ 19.64
Total Assets	196,429,028	166,012,410	+ 18.32
Information per ordinary share			
Earnings (Rs.)	18.86	15.09	+ 24.98
Dividends (Rs.)	5.00	4.00	+ 25.00
Dividend Yield (%)	3.21	3.56	- 9.83
Net Asset Value (Rs.)	109.79	95.44	+ 15.04
Market Value (Rs.) - Voting	155.75	112.50	+ 38.44
Market Value (Rs.) - Non Voting	70.00	41.50	+ 68.67
Ratios			
Return on average shareholders' funds (%)	18.37	16.31	+ 12.63
Price earning (Times)	8.26	7.46	+ 10.72
Dividend cover (Times)	3.77	3.51	+ 7.40
Capital Adequacy ratios			
Tier 1 (%)	10.23	10.87	- 5.89
Tier 1 & 2 (%)	11.32	11.55	- 1.99





OPERATING HIGHLIGHTS

- Growth of Deposits by 15%
- Growth of Advances by 20%
- ROA improved by 18%
- Pre Tax Profit with 63% increase over 2005
- Post Tax Profit with 34% increase over 2005
- NPA ratio with 16% improvement over 2005
- Provision Cover 74%
- Market Capitalisation with 38% increase over 2005

FINANCIAL GOALS / PERFORMANCE

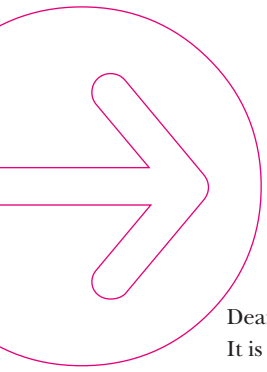
For the year ended 31st December 2006

	Medium Term Goals	2006	Performance			
			2005	2004	2003	2002
Return on average assets (%)	over 1.5 %	1.2%	1.0%	0.7%	0.8%	0.6%
Return on average shareholders' funds	over 20 %	18.4%	16.3%	12.2%	15.2%	9.8%
Cost/Net income ratio (1)	65 %	66.1%	62.3%	70.4%	63.2%	72.8%
Dividend rate	30 %	50%	40%	35%	40%	30%
Capital Adequacy						
Tier 1 Capital ratio	9.00 %	10.23%	10.87%	9.83%	8.06%	9.98%
Total Capital ratio	12.50 %	11.32%	11.55%	11.26%	11.47%	12.40%

(1) Operating expenses as a percentage of net income.

Operating expenses consist of staff costs, premises costs, financial VAT and establishment expenses and other overhead expenses.

Net income consist of net interest income, foreign exchange income, commission income, dividend income and other income.



From the Desk of the Chairman

Dear Shareholder,

It is my pleasure to welcome you to the thirty eighth Annual General Meeting of Hatton National Bank and present the Annual Report which gives a comprehensive review of the year 2006.

The year 2006 saw the Bank performing exceptionally well with all the financial indicators displaying healthy growth and exceeding the targets. HNB has from its inception recognised the importance of serving all segments of the population and placed emphasis on providing financial services to the rural sectors in addition to their core business of commercial banking. With the present Government's declared policy of promoting the rural economy, in particular areas outside the Western Province, the Bank was able to make good use of its well spread branch network to complete the year with excellent results. In tandem, we also carried out several exercises to meet community needs under our well-focused policy of fulfilling corporate social responsibility.

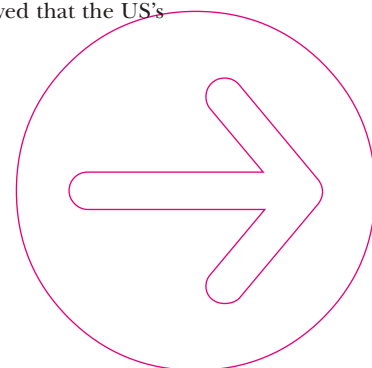
In view of the encouraging results amidst difficult conditions, the Board recommends a final dividend of Rs 2.50 per ordinary share, making the total dividend for the financial year Rs 5.00 per ordinary share. Total dividend payout for 2006 will be Rs 589 million, reflecting a growth of 25% over 2005. Furthermore, the Board also recommends a scrip issue on the basis of one ordinary share for every ordinary share on the existing share capital, for your approval. More information on the performance indicators are detailed in the MD/CEO's Assessment of the Year, Management Discussion & Analysis and in the Statement of Accounts found later on, in this Annual Report.

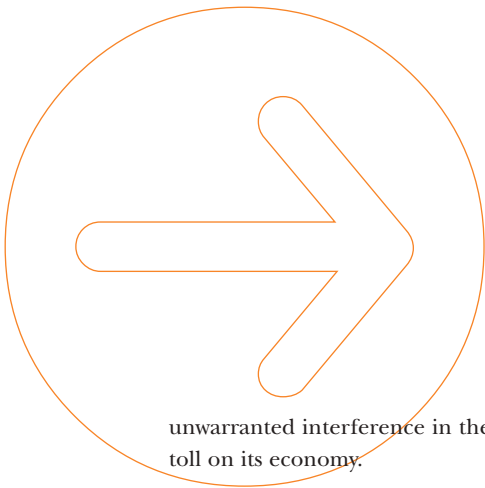
The global economy and its influence

Despite oil prices topping US \$75 a barrel during the year, world GDP growth is estimated to have strengthened in 2006, coming in at 3.9 percent, compared with 3.5 percent in 2005. This strong global performance reflects the very rapid expansion in developing economies, which grew by 7.0 percent. Overall, 38 percent of the increase in global output originated in developing countries, far exceeding their 22 percent share in world GDP. Developing countries are expected to continue this faster growth trend in the next two decades which will eventually see their share of world output rise to about 31 percent by 2030. China contributed immensely to world GDP, growing at a rapid 10.4 percent and contributing 0.5 percent to global growth, while world industrial production also grew at an average of 6.7 percent.

However, there are some inflationary trends that have emerged over the last year with high oil prices and the rapid pace of global growth contributing to a gradual increase in median inflation among developing countries, while contrastingly, inflation in high income countries saw a decline post October 2006 due to reducing oil prices. In many developing countries, inflation first picked up in response to higher oil prices, but has since declined, reflecting both solid productivity growth and the impact of more credible monetary policies that have helped anchor inflation expectations.

Several years of loose monetary policy, an ample supply of global savings, business-sector consolidation in the United States and Asia and high savings rates in the fastest-growing sectors of the world economy have combined to buoy global liquidity which has translated into financial conditions for developing countries remaining favourable, despite high short term interest rates. It is estimated that high-income liquidity exceeds historical norms by between 15 and 17 percent and although interest rates are projected to increase, liquidity is estimated to remain relatively abundant and be a crucial factor behind strong developing-country growth. The Chinese and Indian economies seem to be getting more strident each year, showing signs of becoming certain economic giants and surpassing the US, which has for long held the position of being the benchmark of the world economy. The West, meanwhile continues to struggle with the protracted Iraq war, especially the US which has seen its economic indicators slide. With vast amounts of resources being channeled towards the Iraq war by the US, it can be perceived that the US's





unwarranted interference in the Middle East has taken a heavy toll on its economy.

GDP in the South Asian region has expanded at rapid pace settling in at 8.2 percent and attributed to progress in promoting private sector led growth, improved macro management and greater integration. Astute fiscal policies and strong remittance inflows also played a role in boosting domestic demand, while the re-imposition of restrictions on Chinese exports of textiles and clothing, combined with strong external demand kept export growth strong. But inflation within the region continued to rise due to an excess of demand over supply which resulted in net exports actually contributing to a reduction of 1.7 percent in GDP growth. Strong remittance inflows have supported the growth trend in the region especially in post tsunami Sri Lanka. The largest economy in the region, India, expanded 8.7 percent with non-agricultural growth exceeding 10 percent. An improved business climate and increased savings have augmented higher investment rates to help sustain stronger growth.

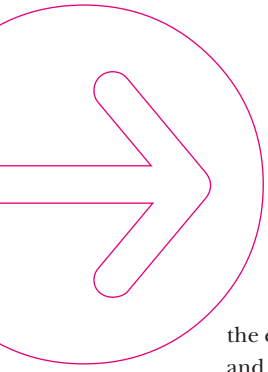


Economic outlook

It has been a year that has seen Sri Lanka and the world undergo numerous challenges, where political and economic instability has had definite impact on nations, people and development. The US involvement in Iraq has seen the world change and become even more polarized. The cascading effect of the Iraqi war had heavy impact on aid allocations by donor agencies to developing countries like ours as was reflected in the tsunami donor funds, which though pledged initially were dismally lacking in realization. The world's priorities changed and Sri Lanka and other developing countries were left to manage the best we could. Another concern is that a large percentage of the resources that should be allocated for emerging and developing economies are used quite generously towards administrative and other expenditure of the very donor agencies that are supposedly distributing these resources to the developing nations. This, in event, leaves very little of the allocated funds to be distributed for donor purposes. There is justification therefore, in the argument that NGOs are wasteful and I do believe that even organizations like the UN do have to re-look at the true objective of their existence and rework their agendas accordingly.

At the same time, in Sri Lanka, our priorities too kept changing. The tsunami reconstruction was carried out but less emphasis was made on achieving timelines and in garnering and pushing for the promised funding. Instead, a battle on two fronts has been witnessed – the escalation of fighting in the North and East and fighting economic battles which are both taking priority. With the Chinese and Indian economies getting stronger, Sri Lanka has had to cope with the strident impact both these countries have had on our exports and trade. The positive factors however, are that Sri Lanka continues to be held in favour by both the US and Europe, our biggest trading partners and in fact, US Ambassador Robert Blake and British High Commissioner Dominick Chilcott have both spoken very favourably for Sri Lanka at various forums and have vowed to assist in the fight against terrorism, which augurs well in our global standing. The Sri Lankan government however, must use these signals to its advantage and garner the support necessary to return to the negotiating table and in tandem, grow the country's economy using a long term focus and not one that's based on political gain.

The deteriorating law and order situation and the sheer indifference to continuous media reports about endless corruption, particularly in public organizations, is a major cause for concern to all citizens of this country. Those of us who manage organizations are struggling to cut costs, make transactions more efficient and improve productivity and it is a very sad scenario to see the imposition of extremely heavy taxes on the very people who continue to drive



the engines of growth and such revenue of the Government drained out on waste and mismanagement, inefficiency and corruption.

For almost three decades, the private sector has performed exceptionally under very trying conditions, contributing to the country's economy in every possible manner despite heavy obstacles mainly due to the ethnic/security problem.

One can well imagine what more benefits could have been accrued to the country, for our industry and our organizations if we were able to work in a more peaceful environment. Therefore, it is of utmost importance for every one of us, as well as the political leadership, to ensure that future managers are given an opportunity to manage their organizations in a more peaceful environment.

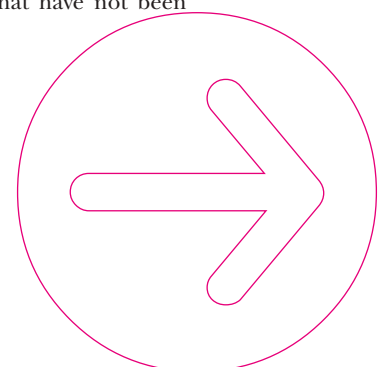
Sri Lanka's GDP stands at 7.5 percent at end of the third quarter of 2006, despite the several major challenges that the country faced during the year with spiraling oil prices and the escalation of violence being two primary factors that the country had to deal with. Excluding tea, all other agricultural sectors continued to expand, while the industry sector also increased growth benefiting from the rapid global economic growth and domestic demand. Telecommunications, ports, domestic and international trade and financial services also posed as healthy contributors to the services sector growth. But inflation remains at a high of 19 percent during each of the last two months of the year and core inflation which is directly caused by demand pressures, rising to 15 percent in November 2006.

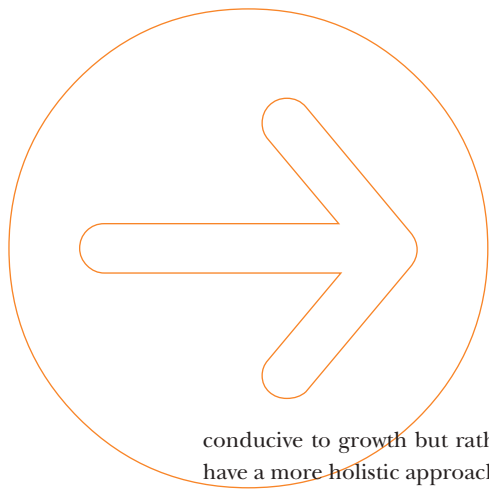
Savings and investment, both recording upward trends, saw domestic private savings standing at 19.4 percent of GDP, while national savings, which result from increased savings by expatriate Sri Lankans and private sector investment, has also increased considerably. The latter accounts for 87 percent of total investment - an increase of 31.4 percent. More emphasis on infrastructure development, community development and tsunami related construction is believed to have triggered 7.5 percent growth in public sector investment as well.

During the year, the Central Bank of Sri Lanka implemented a number of supervisory and regulatory measures into the banking and financial sector operations in a bid to improve risk management, further efficiency of the financial sector and enhance access to finance. Banks are required to include market risk in the computation of capital adequacy to ensure adequate capitalization designed to meet any adverse fluctuations in market prices and able to weather unanticipated shocks. The Central Bank also drafted and declared a public policy regarding the regulatory framework.

However, while the regulatory framework for banks and financial institutions continues to be stringent, it can be clearly seen that Sri Lanka's economic black market continues to thrive, which in effect impacts the country's balance of payment and inflows. This is one important area that the government needs to look at urgently as the taxation net at this point of time, excludes the thriving black economy which can, if brought into the tax net, contribute considerably towards the country's balance of payment equation.

I also find that commercial banks have to compete on an uneven playing field with the state banks enjoying privileges and political patronage extensively. We do require firm apolitical financial leadership to ensure that the financial services sector is able to achieve full potential, which unfortunately has not materialized thus far. It is imperative that the Central Bank, which is the custodian of the country's economy must and has to remain unbiased and impartial, taking decisive actions that would aid the growth of this sector rather than work towards stifling the goose that lays the golden eggs. The past year has seen numerous diktats aimed at banks that have not been





conducive to growth but rather been short sighted and repressive. It is imperative that financial leadership must have a more holistic approach to development and growth and not work on a short term agenda that will eventually have repercussions on the entire economy of the country.

In conclusion

At Hatton National Bank, we draw from a rich heritage and legacy that has today evolved into an innovative forward thinking institution. Your Bank, whilst perusing exciting growth opportunities and through prudent policies and developing modern soft skills, particularly in marketing, customer segmentation and performance management, continues to drive HNB towards newer and broader horizons.

Appreciation

I would like to take this opportunity to thank my fellow Directors who have given me their unstinted co-operation and support. The Management and staff worked tirelessly to post encouraging results despite unsettled conditions in the country.

I take this opportunity to thank all members of the Management and staff for a job well done.

None of this would be possible if we did not have a loyal clientele who continued to be with us despite strong pressure from our competitors.

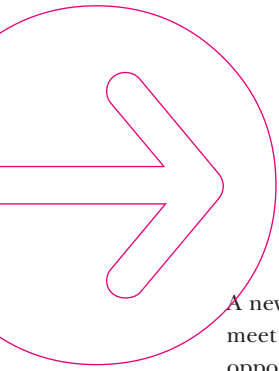
I take this opportunity to thank His Excellency the President and Minister of Finance Mahinda Rajapakse and officials at his Ministry and the Governor of the Central Bank of Sri Lanka, Ajith Nivard Cabraal and his officials for their guidance and continued support during 2006. Finally, I would like to thank all shareholders for the trust and confidence they place in our Bank.

On behalf of the Board of Directors, I wish to pledge that we will continue to add to shareholder wealth through prudent and carefully planned business strategies.

Rienzie T Wijetilleke

February 15th, 2007

Colombo, Sri Lanka



MD/CEO's Assessment of the Year

A new vision, mission and values signaled a renaissance for the Bank this year. Having implemented strategies to meet the challenges we had faced in the last few years, our genesis into newly defined dimensions to meet the opportunities that will characteristically arise, now that we have re-established ourselves into a premier position within the industry, has clearly seen results even in this short span of one year. The vision, mission and values have redefined our journey and set ambitious albeit achievable goals. The foundation we have laid is certain to etch the lines of growth even further into the coming years, as we strongly believe that HNB is now poised on the threshold of exciting but sustainable growth for the coming years.

Financial overview

The year posted several challenges in the domestic environment with escalation of violence in the North and East of the country, impact of increasing oil prices, spiraling inflation and rising interest rates. Despite this, the Bank has demonstrated its resilience by outperforming several of the internal targets we set ourselves. Hatton National Bank, its subsidiaries and associate companies recorded a Pre tax profit this year of Rs 3,095 million compared to Rs 2,008 million last year, which is a significant growth of 54% in 2006. The Bank alone recorded a Pre tax profit of Rs 3,019 million which is a 63% growth over the previous year.

Working on a paradigm of consistent sustainable growth, net interest income has continued to be the major contributor to the bottom line accounting for 74% of the net income (before operational expenses).

The Sri Lankan Rupee depreciated against the US Dollar by 5.5% during the year to Rs 107.65. This helped HNB in posting an exchange profit of Rs 792 million despite being vary of trading in derivatives and bullion based on a clearly defined strategy established last year.

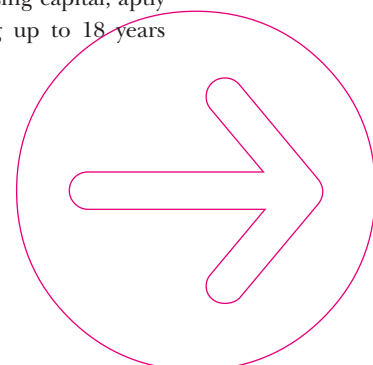
Commission, dividend and other income reached Rs 2,269 million up by 6.1% compared to the previous year. While the non – funded aspects saw mixed reactions this year, especially in tourism in Sri Lanka, we have been compensated by other sectors including construction. Trading in Fixed Income securities remained at a low due to the volatility in interest rates while the equity trading portfolio contributed Rs 91million.

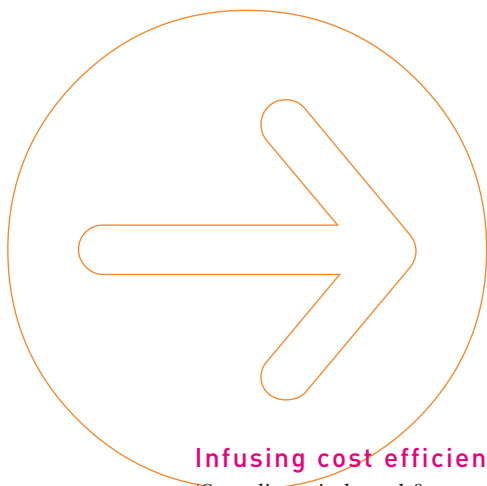
We continued the trend shown last year by meeting our entire operating expense bill of Rs 7,733 million from Net interest income, another facet that examples the sustainable growth pattern we are espousing despite signs of unpredictability seen in the local economy. Total operating expenses, including the loan losses and provisions, increased from the previous year's Rs 7,784 million to Rs 8,677 million which was an increase of 11.5%.

Provision for corporate tax for 2006 was Rs 798.9 million resulting in the after-tax profit recording Rs 2,220 million, an increase of 34% which is pleasing as we think it shows a healthy sustainable outlook for the next few years.

The Group's assets increased by 18% during the year to Rs 206.9 billion as at 31st December 2006. While the Bank's asset base of Rs 196.4 billion is one of the largest among private sector commercial banks in Sri Lanka, our emphasis is to retain and grow profitability. Return on Assets (ROA) as at 31st December 2006 was 1.23% which is in line with our medium term goal of exceeding 1.5% and has heralded our qualification for development oriented refinance schemes such as the JBIC (Japan Bank for International Cooperation) funded SMILE III scheme in the SME segment.

Capital adequacy, an issue we addressed two years ago today, stands at a commendable 11.32%. Our goal however is to exceed 12% despite the payout challenges, which looking at our progress we are confident is achievable, giving us the impetus to grow our business. We continue to explore numerous innovative means of raising capital, aptly exemplified last year by our ability to raise Rs 1.12 billion in debentures with tenures ranging up to 18 years successfully, a unique proposition in Sri Lanka.





Infusing cost efficiencies

'Spending wisely and for good value' remained the axiom upon which we focused our cost consolidation measures. We imbued aggressive cost efficiencies into our operational portfolio in a bid to expeditiously manage our cost/net income ratio which in past years has been one of the highest in the banking industry. Even though expenses have shown an increase of 29% over last year, the aggressive approach we deployed in cost cutting has seen a manageable cost milieu evolve.

An important driver has been our focus in controlling our non-performing advances ratio which has decreased by almost 16%. Sound inventory management, waste minimization and building sustainable partnerships with our valued business partners in ensuring level negotiations for long term benefits have seen the aggression in implementing and executing our cost efficiencies which infused the desired positives. Collate these ingredients under the common umbrella of a 4,000 strong team working towards one vision and one focus has seen operating costs (including provisions for bad and doubtful debts) increase by only 11.5%, despite 19% inflation.

Excellent teamwork


Having been somewhat challenged in the past due to lack of astute infrastructure to pursue a bigger market share in retaining our market leadership position, this year the team worked on the single minded focus of identifying and righting weaknesses, recognizing and building on strengths and ascertaining opportunities from a top down and bottom up approach. The commendable growth in bottom line profits of 127% in the last two years, despite a flat head count, showcases the incisive deployment and utilization of resources we have instigated in our restructuring efforts. I am exceptionally proud of Team HNB which has put their shoulder to the wheel in ensuring that the Bank remains aligned to its vision and mission, instilling the ingrained values into our culture so that we can be acknowledged as the leader in our industry.

We infuse best practices in line with world class practices permeated via specifically designed training and development programmes that will meet our goal to be the best. The MaFoi Employee Engagement survey we conducted this year among our Team for the first time has opened communication lines, shown us the paths we should take to bond better and above all, tangibly displayed that the Team shares equal ownership in the future of the Bank. It is also significant that nearly 85% of the team undertook the survey online, which displays the increasing utilization of IT being used as a tool by the Team.

Winning the Bracken Award this year was certainly the single highest honour HNB has been bestowed within the recent past, giving credence to the fact that we have achieved a tenet of our vision in being 'acknowledged' by our peers internationally as a leader in the Sri Lankan financial industry. We also passed the Rs 2 billion mark in After-tax profit, for the first time in our history. All this signals the sharp and perceptive workings of a Top Team!

Implementing tools effectively

The commendable recovery seen in our non-performing loan portfolio is a result of an aggressive focused formula which hedged on using good negotiating tools for key recovery efforts that would instigate a win-win milieu for all. The new portfolio in tandem then, is being built on a qualitative platform where strong infrastructure compliments timely forewarning signals that have blended well this year. The risk management unit established just two years ago has now matured to work independently, utilizing the right tools and know how, wherein risk is minimized through an alert cautionary framework in place.



We do expect to use these tools more emphatically in the next year to pursue the SME sector which we believe is a vital cog in the wheel of the nation's economy but has not received the due recognition or emphasis it should in being a crucial contributor to growth. Given the current national agenda in focusing more on this key area of development, we remain totally committed to grow this segment of the economy in order to make it a sustainable and viable facet in our operations. We have already set in motion plans that will professionalize our delivery methodologies especially in the rural areas, establishing the apt risk management tools and the appropriate human resources and training implements together with the IFC, to build capacity that would showcase the desired deliverables in the SME segment within the next two years. Garnered from the pioneering 15 years experience we have in micro finance, we aim to similarly, vigorously concentrate on micro finance which we perceive has immense potential, professionalizing delivery in order to instigate smart portfolio diversification while delivering an appropriately priced product that ensures bottom line contribution as well.

Beyond customer expectations

Customers continue to be the quintessence to our existence, the pivot upon which our success is built upon. We have continued to innovate, create, develop and present customer conveniences that bring banking to the home of the customer, whose profile spans the entire economic and social strata of the country. Acknowledged as the most powerful brand in the financial services sector in Sri Lanka in a survey conducted in LMD by Sting Consultants, our brand remains at top of the mind recall among the people of this country which underscores the strong bonding we continue to maintain with our customers and valued business partners. We also conducted a customer engagement survey through AC Nielson and continuously conduct sub surveys on a regular basis to be atop customer expectations. The findings stress the need for continued improvement and allow us to set our goals beyond industry benchmarks.

A technology revolution has also taken place at HNB where customer convenience deliveries have undergone a facelift. SMS banking with Mobitel and Lanka Bell coupled with a host of account related conveniences was launched with more rollouts expected through other telecommunication service providers in the next year and a Virtual Branch has been introduced enabling transactions 24/7 all year around, anytime, anyplace, anywhere in the world. These are two of the most significant achievements this year in implementing our IT convenience platform for our personal banking portfolio.

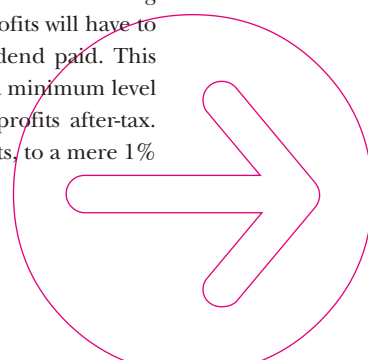
Remittances also showed immense progress this year, a significant contributor to the foreign exchange coffers of the economy. Positioning ourselves with a mix of international channel partners in strategic countries mainly in the Middle East and signing up with Italy and the UK this year, complimented by HNB Team members also placed in four locations for noteworthy value addition into our operations, we have significantly captured 35% of the remittance business. This global focus will be strengthened to other markets that house a considerable Sri Lankan diaspora spreading into other countries in the Middle East and Canada and Australia as well.

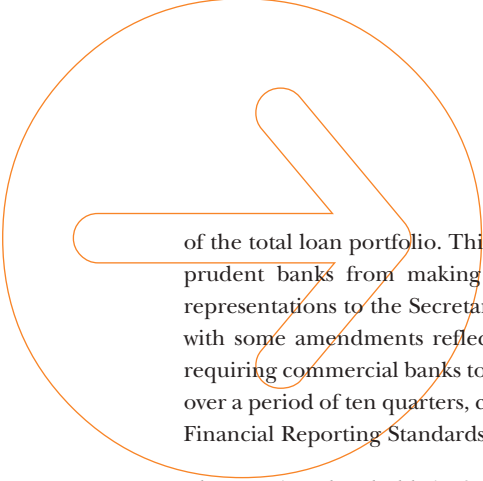
To exceed in compliance

Going beyond compliance remains a priority when in governance and the structure that enfolds it. As we have progressed according to guidelines laid down by the Institute of Chartered Accountants of Sri Lanka, the Central Bank of Sri Lanka and ACCA UK as well as other statutory bodies both in Sri Lanka and internationally, I do believe that the HNB internal governance structure has improved tremendously in the last few years. This is due to the strong foundation built on the philosophy that success at business must not be at the expense of governance, but rather be achieved by retaining integrity, values, ethics and exceeding compliance at all times. The multi-skilled composition of the Board of Directors has ensured that the independent structure of the Board is maintained, while the clearly defined roles of the Chairman and the Managing Director/CEO assist in preserving and maintaining policy, strategy and operational features autonomously.

Macro industry perspectives

The 2007 Budget proposed two new pieces of legislation which will have a depressing impact on the banking industry. Firstly, banks which do not meet the 'deemed dividend payout' of 25% of distributable profits will have to pay an additional 15% on the difference between deemed dividend payout and the actual dividend paid. This obviously has not considered the regulatory obligation on licensed commercial banks to maintain a minimum level of capital to support its growth and normal business which is invariably financed by retained profits after-tax. Secondly, banks will have to limit the deduction of Specific Loan Loss Provision from Taxable Profits, to a mere 1%





of the total loan portfolio. This proposal appears to be counter-productive, since such restriction would discourage prudent banks from making provisions in excess of the minimum regulatory requirements. We have made representations to the Secretary of Treasury through the Sri Lanka Banks Association, to reconsider the proposals with some amendments reflecting the above concerns. The recent direction by the Central Bank of Sri Lanka requiring commercial banks to “build up” a General Provision of a further 1% of performing and overdue portfolios over a period of ten quarters, certainly runs counter to Sri Lanka’s journey towards adopting the set of International Financial Reporting Standards (IFRS) which fundamentally frowns upon the creation of General Reserves.

The taxation thresholds in Sri Lanka remain high, especially for the banking industry. We firmly believe that by almost unfairly imposing a very stringent taxation regime for the very engine of growth that is one of Sri Lanka’s best performing sectors from an investor’s view point, the immense potential the industry has in enticing investment will continue to dim. What we see unfortunately, is a compromise of long term benefits for short term gains, which should be re-strategized if the country hopes to leverage on the investment potential that the financial industry possesses.

We also firmly believe that consolidation and convergence must and has to be deployed and encouraged in enhancing HNB’s presence as a regional and a global player. There has to be clear articulation between restricting ownership in a business sense and managing fears in terms of ownership concentration, through the infusion of good governance structures and monitoring. The right to buy and sell should be market driven in order to develop the much maligned capital market. Sri Lanka does not yet sport large banks akin to those in India or Pakistan to be a significant player regionally. Strong banks are important and we must be given the opportunity of being robust and dynamic, being able to introduce ourselves into the big league.

The future in perspective

Our new vision, mission and values will undoubtedly take us vibrantly into the next two to three years pointing Team HNB in the direction we must take to regain and consolidate our leadership position, which I must stress, has to be acknowledged by others. Winning the Bracken Award where we excelled in key drivers from among several local and foreign banks operating in Sri Lanka was our first step in getting closer to our vision.

The initiatives taken in extending our reach by increasing our network of branches, constantly improving our delivery and distribution channels, especially with the use of IT, enhancing our products to suit changing mindset, customer profiles and categories and in strengthening Team HNB to exceed stakeholder expectations, continues to remain a priority for us. India will continue to remain an attraction while also a challenge to the local banking industry but we are currently pursuing a number of options in our quest to enter the Indian market.

The focus on compliance with BASEL II will see us investing more in technology to comply with that roadmap and with the Anti-Money Laundering diktat. The Core Banking system, which we feel has reached its full potential but will not from this point onwards add further value to our future direction, will also be revamped with the rollout expected in the first half of 2007.

I would like to extend my appreciation to the Governor of the Central Bank and his staff for their support throughout the year. My deep gratitude to the Chairman and Board of Directors of the Bank for their encouragement and guidance and for giving me the impetus to lead Team HNB to deliver good results. Team HNB continues to be my motivation and I do thank them very sincerely for their unstinted support and co-operation in having the confidence to undertake this journey, driving the momentum for when HNB will once again be acknowledged as the leader in the financial services industry.



Rajendra Theagarajah

February 15th, 2007

Colombo, Sri Lanka

Our Visionaries



CHAIRMAN

MR RIENZIE T WIJETILLEKE

F.C.I.B. (London), F.I.B. (Sri Lanka)

Chairman since March 2004. He was Managing Director & Chief Executive Officer from July 1988 to December 2004 and counts over 46 years in Banking including overseas assignments. He is Chairman of HNB Assurance Limited, HNB Stockbrokers (Pvt) Limited, HNB Securities Limited, Sithma Development (Pvt) Limited, Sunshine Holdings Limited. He is a Director of Colombo Stock Exchange, Nawaloka Hospitals Limited, Ceylon Biscuits Limited.



DEPUTY CHAIRMAN

DR. V P VITTACHI

B.Com. (London), Ph.D.

Director since 1988. He was the past Head of Sri Lanka Customs, past Chairman of several public corporations and past Governing Council Member of the Peradeniya and Moratuwa universities. He is Chairman of Distilleries Company of Sri Lanka Ltd., Lanka Milk Foods (CWE) Ltd., Stassen Group of Companies and Browns Beach Hotels Ltd.



MANAGING DIRECTOR/CHIEF EXECUTIVE OFFICER

MR RAJENDRA THEAGARAJAH

F.C.M.A. (U.K.), F.C.A. (Sri Lanka), M.B.A. (Cranfield)

He was appointed Director/General Manager/Chief Executive Officer in December 2004. He was appointed Managing Director/Chief Executive Officer in December 2005. He was a Member of the Corporate Management of HNB since 1997. He counts over 22 years in Banking including overseas assignments. He is a Director of HNB Assurance Ltd., HNB Securities Ltd., HNB Stockbrokers (Pvt) Ltd., Sithma Development (Pvt) Ltd., Lanka Clear (Pvt) Ltd and Lanka Financial Services Bureau Ltd. He is a Board Member of the Asian Banks Association and Sri Lanka Bankers Association. He is also the President of the Association of Professional Bankers in Sri Lanka.



DIRECTOR

MR D H S JAYAWARDENA

Director since 1988. He is Chairman of Sri Lankan Airlines Ltd., the national carrier, Aitken Spence & Co. Ltd., Sri Lanka Insurance Corporation Ltd., Lanka Bell (Pvt) Ltd. and Periceyl (Pvt) Ltd. He is the Managing Director and Chief Executive Officer of Distilleries Company of Sri Lanka Ltd., Lanka Milk Foods (CWE) Ltd., Stassen Group of Companies and the Managing Director of Balangoda Plantations Ltd. and Madulsima Plantations Ltd. He is a Director of Browns Beach Hotels Ltd. and Apollo Hospital (Pvt) Ltd. He is also Consul General for Denmark in Sri Lanka.



DIRECTOR

MR M V THEAGARAJAH

F.C.M.A., F.C.I.A.A., F.I. Mgt. (London)

Associated with the Bank since its inception and a Director since 1979, M V Theagarajah retired as Chairman of the Browns Group of Companies on 30th June 2006. He has over 40 years experience in commerce, finance, industry and management.





DIRECTOR
MR R K OBEYESEKERE

Director since 1998. He is the Deputy Chairman of Sri Lanka Insurance Corporation Ltd. He is a Director of Stassen Group of Companies, Lanka Milk Foods (CWE) Ltd., Distilleries Company of Sri Lanka Ltd., Madulsima Plantations Ltd., Balangoda Plantations Ltd. and Lanka Dairies (Pvt) Ltd.



DIRECTOR
MRS PAMELA C COORAY

LL.B.

Appointed Director in April 2004. She was a past Director of Board of Investment of Sri Lanka and Associated Battery Manufacturers (Ceylon) Ltd.



DIRECTOR
MR RATNA SIVARATNAM (*Absent*)

Appointed Director in December 2004. He is a Director of Aitken Spence & Co. Ltd., Acme Printing & Packaging Ltd and Lanka Aluminium Industries Ltd. He was past Chairman and Managing Director of Aitken Spence Group of Companies, past Chairman - Employers Federation of Ceylon, Steering Committee of the Airports & Port Development and past Executive Chairman – Sri Lanka Export Development Board. He was past President – Association of Group Tour Agencies, past Vice President – Ceylon Tourist Hotels Association and Travel Agents Association of Sri Lanka. He is the Consul General for Finland in Sri Lanka and an Executive Committee Member – Ceylon Chamber of Commerce.



DIRECTOR
MR RASHID GHAZALLI (*Absent*)

B.Sc (Econ) (Banking & Finance) – University of Wales/Institute of Science & Technology, Wales

Appointed Director in September 2005. He is the Chief Executive Officer of MAA Corporate Advisory Sdn Bhd, Malaysia, the investment advisory division of the Melewar Group, Malaysia a conglomerate with core interests in financial and industrial services sector. He has wide experience in financial services industry in Malaysia and overseas. He is a Director of Eversendai Group, Malaysia, a steel engineering group. He held Executive Directorships previously in the Maju Group, Malaysia – a conglomerate with core interests in property development, toll highways, manufacturing steel and trading in building materials.



DIRECTOR ALTERNATE (TO MR R GHAZALLI)
MR YEO TOOK KEAT (*Absent*)

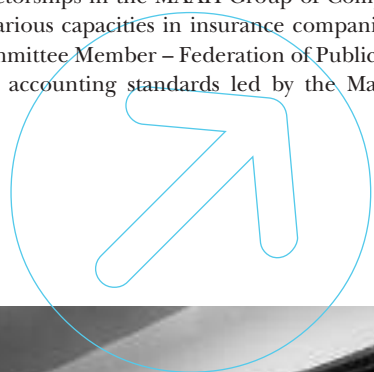
F.C.C.A

Director – HNB Assurance Ltd. He is Group Chief Operating Officer – MAA Holdings Berhad (MAAH), Malaysia. He is a Director of MAAH from February 2005 and holds several Directorships in the MAAH Group of Companies. He has vast experience in accounting and finance, having served in various capacities in insurance companies and audit firms upon completion of studies in 1980. He is an Executive Committee Member – Federation of Public Listed Companies Berhad and has contributed to the Working Groups on accounting standards led by the Malaysian Accounting Standards Board.



BOARD SECRETARY
MS INDRANI GOONESEKERA

ATTORNEY-AT-LAW & NOTARY PUBLIC





Management Discussion
and Analysis

OPERATIONAL REVIEW

CORPORATE BANKING

PRODUCTS & SERVICES

Term finance including syndicate loans, Overdraft facilities, Import & Export Finance by way of Letters of Credit, Import/Export loans, Guarantee facilities, Money Market Loans, Commercial Paper, Bonds and other financial instruments.

THE YEAR IN FOCUS

The Bank continued to perform above the forecasted figures due to a number of internal initiatives implemented in order to optimise the synergies within the Bank more strategically. Given that corporate banking is a critical business segment, infusing the principles of being upwardly mobile and working on strategies that would challenge and beat competition, one of the most significant among the change initiatives implemented was the centralization and consolidation of the Treasury, Project Finance and Corporate Banking divisions. In addition, from September 2006, corporate banking functions which were earlier spread out over the branch network, were centralized at the Head Office to ensure a speedier more efficient response time, while the branches operate as distribution units. This has led to strengthening existing relationships and forging potential relationships built on pragmatic tenets being put into place, as maintaining a healthy portfolio that would result in the desired growth within a competitive environment remained critical throughout the year. The significant results were also aided by the upward trend in the economy and the opportunities resultant from it. Agriculture, telecommunication, construction, leisure, health, apparel, manufacturing, finance and offshore banking were the thrust areas that brought in the desired results during the year. The Project Finance Division's diversified portfolio comprises 35% in FCBU loans for local BOI projects and overseas investments, with the leisure sector contributing 27%, power and energy 20% and real estate 15% to the portfolio with a total value of Rs 6.65 billion, a growth of 14% from Rs 5.8 billion displayed at 31st December 2005. Loans approved during the year totaled Rs. 1.93 billion with 60% approved for leisure projects in both Sri Lanka and the Maldives, 16% for the real estate sector and 4% for power and energy projects. While 2005 saw more emphasis on mini-hydropower projects due to the availability of refinancing under the World Bank's RERED Credit Line this year, the sector aggressively pursued the high potential area of offshore leisure projects, approving FCBU facilities totaling US \$ 15.6 million for offshore projects.



Catering to an extensive but qualitative portfolio of corporate and medium to large domestic commercial clientele, the corporate banking sector comprises 41% of the Bank's total loans and advances.

Having signed the agreement for the EIB credit lines to be extended for tsunami related projects in September this year, we already have about Rs 1.5 billion projects which commenced work this year and need to be worked through to the next.

IN 2007, UPWARD MOBILITY WILL CONTINUE BY...

- Being more aggressive in the thrust industries of off shore leisure, infrastructure, telecommunications, construction and real estate,
- Implementing the projects already earmarked for the e-Friends loans and expanding the EIB credit lines,
- Venturing into Islamic banking,
- Taking advantage of economic growth patterns and investments coming into the country and lobbying for investor friendly policies,
- Continuing to build on the principle of a quality portfolio and being more risk conscious, disciplined and astute in our investment decisions improving asset quality and aggressively reducing our NPAs.

OPERATIONAL REVIEW

PERSONAL BANKING

PRODUCTS & SERVICES

Savings Accounts: Pathum Vimana/Pathum Udananaya/Singithi Surakum/Singithi Pathum Minors Savings Scheme/Saubhagya Planned Savings Scheme/Divi Shakthi/Senior Citizen Scheme; **Current Accounts:** Lifeline/Shareline for HNB Shareholders; **Time Deposits:** Certificates of Deposit/Term Deposit Accounts; **Loan Schemes:** Shanthi Housing Loans/Group Consumer Loans/HNB Personal Loans/Dream Drive Vehicle Loans/HNB Graduateship Educational and Career Development Loan scheme. Special Educational loans for CIMA/Danuma Educational loans exclusively for ETF members; **Credit Cards:** HNB Master card and HNB Visa card. Hot Shot Credit Card for teenagers; **Leasing:** Lease Master/Finance Leasing/Wasi Leasing/Finance Leasing; **Other:** Virtual Banking/Teleline Banking/Hatna SMS/Cashline ATM facilities/Safe deposit lockers/HNB Home Care accounts for utility bill payments/money transfer services/insurance/share broking/sale of gold; **Pawning Services**

THE YEAR IN FOCUS

The year notched good growth with all sectors recording significant upward trends including the Card Centre, home loans, leasing and pawning contributing commendably to the bottom line. Competition has been intense and the challenges immense, which led us to realign our stance and be more astute in our focus, working towards a more qualitative portfolio rather than a volume oriented one.

Promotions for our key products, namely Pathum Vimana, Singithi Pathum, Divi Shakthi, housing loans, leasing, pawning, credit cards and personal loans were stepped up with internal target achievement via a well balanced distribution mix including the island wide branch network. The Pathum Vimana Savings Scheme, home loans, leasing, pawning, credit cards and personal loan segments of our products were revamped during the year to provide more strategic focus to the business in line with the competitive external milieu.

Our most significant innovation this year has been the establishment of the 'Virtual Branch'. Using the IT platforms that are now available within the global banking industry, as a spin off to the HNB web page, a Virtual Branch was conceptualized, with the aim of taking the comfort of personal banking to the customer's home. All functions performed within a branch will be infused into the Virtual Branch, showcasing the momentum that HNB has employed in being upwardly mobile this year and unleashing untapped potential in the coming years.

HNB's continued focus has been to augment and intensify the emphasis on the upward growth curve. Realising that banking in the current context continues to remain a retail oriented one, we have ensured that our products continue to achieve good results, despite very stiff competition within the industry, employing creativity and



innovation to maintain market leadership in most product areas. Our products embrace the concept of a partnership from cradle to twilight years, starting from Singithi which has seen HNB even tie up with the main hospitals in order to instill the savings culture permeating from the parents to a new born, right up to the Senior Citizens Scheme.

Our flagship product, Pathum Vimana, which has mobilized a savings base of Rs 50.7 billion, a growth of 7% compared to Rs 47.4 billion last year, has seen over 8,000 customers rewarded with numerous prizes, including luxury vehicles. Conceptualized to inculcate the savings habit among people, HNB also has 152 school banking units located island wide, mobilized by students themselves, which infuses the positives of a savings culture among students and young people, while at the same time inculcating the rudiments of banking among them. Our minor savings portfolio grew by Rs 400 million this year. A major attraction to the 'young' savers has been the gift of the trademark unique elephant till of which HNB has already distributed over 500,000 numbers country wide.

The HNB Five year Fixed Deposit scheme recorded a base of Rs 1.2 billion, a growth of 23% over last year, while the Senior Citizens scheme showed an increase of 154%.

Branch Network

HNB continued to increase its presence around the country and beyond, boosting the branch network to 151 customer centers. During the year, five customer centers in Akurana, Peradeniya, Kahawatte, Seeduwa and Hatton were relocated with a view to provide more spacious and convenient banking facilities. Strengthening the distribution channel, this year HNB introduced "Saturday Banking" through 30 customer centres, which saw a significant increase in business and positive customer testimony to the conveniences extended by the Bank.

Leasing

The leasing market too has remained extremely competitive. Achieving targets remained a challenge with the market reacting negatively to the volatility and high interest rates regime experienced during the year. Despite this however, leasing achieved an impressive gain, showcasing Rs 6.8 billion in disbursements, an increase of 21% from Rs 5.6 billion last year, while the leasing portfolio showed growth of 30.6% over 2005. Having foreseen the challenges leasing would be up against this year, HNB worked on customized promotions to ensure a positive growth pattern for this segment. The innovative promotions included those conducted with major vehicle agents for the leading brands of Proton, TATA, Eicher, Maruti, Toyota, Kelisa and Mahendra complimented by location based 'Town Storming' campaigns.

Pawning

Our advantages within the pawning industry lies with the extensive HNB branch network, wherein almost every branch has a dedicated fully equipped Pawning Unit/lobby manned by a professional officer to cater to a broad based clientele segment. Our portfolio was enhanced by about Rs 1 billion despite aggressive competition. We have also seen a marked increase in business in the North and East. Strategic initiatives during the year to reduce the NPA ratio from 5% to about 2% proved to be very successful.

Shanthi Housing Loans

One of the high growth areas over the past few years has been the housing loans segment. On average, HNB disbursed 300 loans monthly through the Shanthi Housing Loan scheme, which marked its tenth anniversary this year. Total outstanding advances also grew by 25% over last year. Perceiving the competition however, and in the stance of being upwardly mobile, HNB imbued a number of value additions into the existing scheme including the Second Home Loan and Home Loan Wipe off. The Second Home Loan is available to those customers who have already repaid a substantial portion of their loan and are pursuing the purchase or construction of a second home for residential or rental options.

HNB Personal Loan Scheme

The Bank's Subasiri Personal Loan Scheme, encompassing almost the entire gamut of personal requirements was re-launched towards the latter part of this year with expectations of better results next year. Due to streamlining processes being introduced prior to the re-launch, loans disbursed have not shown any increase during the year.

Credit Card Business

HNB continues to remain a significant player in the Credit Card market, issuing both Mastercard and Visa. The business segment grew impressively by 55% to Rs 265.5 million compared to 26% last year with the total advances portfolio growing by 23%. The majority income is derived from interest and other income recording 33% growth and merchant commission seeing 25% growth.

However, with competition within the industry continuing unabated, HNB constantly infuses value additions to make HNB credit cards more attractive to customers. The value additions this year included the annual discount brochure with offers from over 50 merchant outlets, the 0% instalment scheme for purchase of consumer durables and the introduction of the IDD calling card. The Avurudu Usage Promotion and the 31 days of Christmas promotion were significant contributory factors to the growth of the Bank's Credit Card advances portfolio. The Bank's Maldives Acquiring Business also recorded a growth of 54% in profit.

SMS alerts, which aid credit card users immediately on any transactions effected have also gained popularity with a 28% growth in messages sent.

SMS Banking

In August this year, SMS banking using 'Over the Air' menu driven solutions, the first of its kind in Sri Lanka, in partnership with Mobitel and Lanka Bell was launched. This allows HNB credit card customers to view balances and settle monthly bills via SMS. The Bank has also tied up with various other service providers to enhance the product scope.

IN 2007, UPWARD MOBILITY WILL CONTINUE BY...

- Relaunching of Pathum Vimana and Pathum Udananaya Savings Schemes with extensive value additions,
- Augmenting the key growth areas of housing, leasing, pawning, development banking and credit card business through value additions and innovations and employing the extensive branch network to deliver speedy solutions efficiently,
- Enhancing virtual banking with four strategically placed kiosks,
- Adding customer centres,
- Introducing extended banking hours and withdrawals via cards,
- Setting ourselves a target to achieve an increase of Rs 1.5 billion in the pawning business augmented by increased promotions and strategic marketing initiatives, while using the upward trend in gold prices to our advantage,
- Pursuing mortgage financing for high value real estate developments through the tri-partite agreement initiated by the Bank,
- Further ingratiating our presence in the housing loan market by adding a home improvement loan scheme,
- Promoting the HNB Personal Loan Scheme extensively vis a vis target mass media communication campaigns,
- Conceptualizing value additions for existing products and innovating newer products including a new savings product, to reach outwards regionally and meet increasing competition in the retail banking sector,
- Improving the existing IT platform used in pawning to deliver enhanced customer service, product diversification and centralized control for accelerated growth; use the advantages prevalent in the high value customer segment of the market for larger pawning facilities to be used for alternate working capital or investment finance,
- Being the most sought after finance lessor in the market.



OPERATIONAL REVIEW

DEVELOPMENT BANKING

PRODUCTS & SERVICES

Rural Credit: Tea Development Project (TDP), Second Perennial Crop Development Project Credit Revolving Fund (SPCDPC), New Comprehensive Rural Credit Scheme (NCRC), Coconut Development Project Scheme (Kapruka Ayojana), Southern Province Rural Economic Advancement Project (SPREAP), Poverty Alleviation Micro Finance Project (PAMP), Aquatic Resources & Quality Improvement Development Project (ARQIDP); **Microfinance:** Gami Pubuduwa, German Savings Banks Funded Credit Scheme; **SME:** SMILE I Revolving, SMILE III, e-Friends II

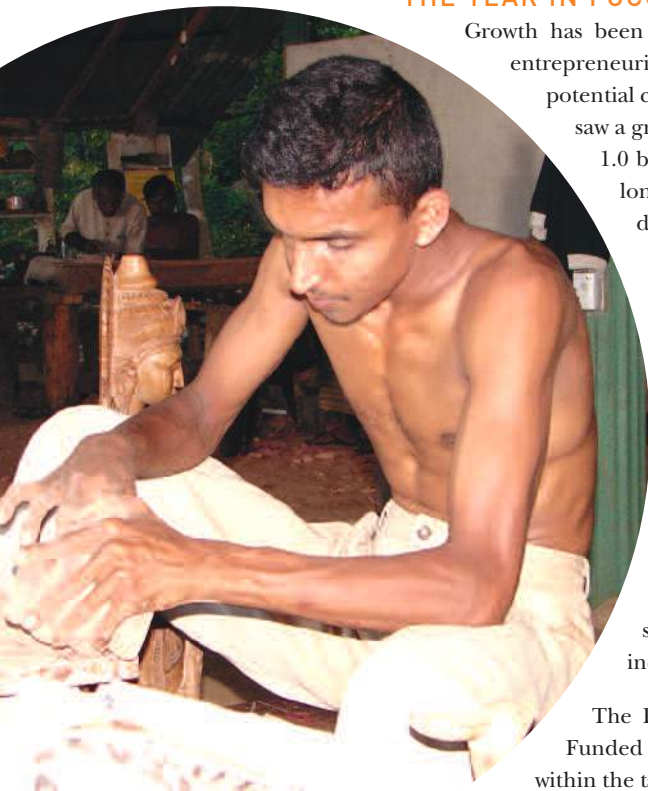
THE YEAR IN FOCUS

Growth has been seen in all sectors with more emphasis nationwide being made on entrepreneurial ventures and the re-emergence of micro, small and medium sectors as potential contributors to the economy. The financing of rural agricultural activities saw a growth of 28 % to Rs 2.65 billion with a loan disbursement portfolio of Rs 1.0 billion. Nearly 40% of the total portfolio is contributed by medium and long term agricultural projects for tea, coconut and perennial crop development.

Gami Pubuduwa, HNB's successful micro finance programme continued its upward curve, growing by 37%, to disburse Rs 900 million, over 5,000 micro enterprises benefiting about 15,000 families. Conducted on the platform of sustainable development to develop the rural economy of the country, the collective portfolio comprises 15,000 loans amounting to Rs 1.8 billion, with 31% of the portfolio covered by refinance funds and a creditable collection ratio of over 95%. Rs 1.0 billion has also been mobilized as rural deposits through Gami Pubuduwa. With 17 years experience in this segment of the market, HNB uses its strengths to ensure that financed projects are sustainable, aided by 120 trained field officers, some of whom are specialist agricultural executives working throughout the country, including the North and East.

The Bank also became an active participant in the German Savings Bank Funded Credit Scheme (GSBFCS) to facilitate funding to micro enterprises within the tsunami affected areas. Earmarked for disbursement over a period of two years, HNB's efficient and speedy processes saw the target met within one year. With this success, the Bank signed the Second Agreement for a loan component of Euro 3 million (Rs 390 million approximately) and has already disbursed Rs 220 million to date.

An innovative micro insurance product was launched in partnership with HNB Assurance designed to cover both life and the liability of borrowers in the micro finance sector. This is a pioneering product within the insurance industry in Sri Lanka.



HNB remains emphatic on developing the SME sector seeing the potential of its contribution to the economy. Aiding the funding process, the Bank is currently participating in the e-Friends II Credit Line and SMILE I Revolving Credit Line. As a result of the success seen from SMILE I Revolving Credit Line, which eventually evolved into the SMILE II and III Credit Lines, the SME portfolio has increased by 20%. To be more efficient and speedier in implementing initiatives, we also employed the novel approach of categorizing and sub-segmenting the SME sector in order to be more focused in our mission, whilst also re-energizing the Head Office SME Unit by bringing it under the umbrella of the Development Banking Division.

IN 2007, UPWARD MOBILITY WILL CONTINUE BY...

- Speedily and efficiently disbursing the balance loan disbursement of Rs 170.million under GSBFCS ahead of time,
- Increasing our e-Friends II, SMILE III and SMILE I Revolving Loan Disbursement Portfolio by 50%, 10% and 40% respectively,
- Creating more innovative products to add value to our philosophy of sustainable development,
- Continuing to be emphatic about creating an entrepreneurial culture, especially among the rural economy by deploying the necessary resources to achieve growth.

OPERATIONAL REVIEW

INTERNATIONAL OPERATIONS

PRODUCTS & SERVICES

The scope of International Operations encompasses Correspondent Banking, Inward Remittances, Issue and Encashment of Travellers Cheques, Foreign Currency Drafts and Currency Notes, Issue of Guarantees on behalf of our Correspondents, International Trade pertaining to imports & exports, Formulation and Reviewing Anti Money Laundering Policy and Know Your Customer Policy, Treasury Back & Middle Office operations and handling of communications between correspondents via SWIFT.

THE YEAR IN FOCUS

During the year 2006, evaluation and analysis of correspondent relationships received priority status with a view to rationalize relationships to build on efficient and cost effective relationships resulting in a saving of around 40% of costs. This is an ongoing exercise and is expected to produce a cost saving, in this sphere of operation, of around 30% in 2007.

Establishment of relationships for inward remittances from Saudi Arabia and Italy are significant breakthroughs considering the fact that the Sri Lankan expatriate community had limited avenues of remitting their earnings back home from these countries. The placement of additional representatives in the Middle East region and also in Italy has contributed towards harnessing a large volume of inward remittances. A total volume of Rs 115 billion was achieved as inward remittances during the year 2006. This is an increase of around 13% over the previous year.

Infrastructural projects in Sri Lanka supported by European donor funding mainly provided us with opportunities to participate in the issue of bid bonds, performance bonds, advance payment guarantees and Letters of Guarantee on behalf of our correspondents. An increase in volume of around 15% was achieved during 2006 in comparison to 2005.

International Trade Services offers customers products such as issue of import LCs, processing of import bills under LCs, import collections, issue of shipping guarantees, endorsement of advance documents/airway bills, granting import loans, avalisation of import collections, advising of export LCs, adding confirmation to export LCs, transfer of export LCs, export collections, processing bills under export LCs, negotiation of LCs, discounting of export bills and pre - shipment export loans.

HNB's Trade Services, being ISO 9001:2000 and a centralized operation, has continued to have a positive impact in maintaining our upwardly mobile positioning in a highly competitive environment.



Our Representative Offices in Chennai and Karachi have been supporting the trade operations by facilitating trade contacts for our customers especially in relation to the products that qualify for concessions under the respective Free Trade Agreements.

We also pursued a strategy to reach out to the non urban areas using our branch network with the objective of converting these indirect exporters and local traders to direct exporters and importers respectively.

Income from trade services exceeded the performance levels of the previous year by 25%.

HNB played a lead role in the incorporation of Lanka Financial Services Bureau Ltd., which brings 21 banks/financial institutions under its umbrella and will facilitate the operation of a SWIFT Service Bureau in the country. This move will result in tremendous cost savings for inward and outward SWIFT message traffic by exploiting synergies.

Having comprehensively trained our staff in Anti Money Laundering and Know Your Customer compliance it should be noted that our forte has been recognized within the industry with HNB being requested to train other banks as well. We have already trained those in the Bank of Maldives and aim to conduct a few more training programmes offshore. This emphasizes the best practices already employed at HNB with regard to compliance and also extends a sense of confidence to our clientele as it is understood with these examples that HNB remains above par on the issues of quality, governance and compliance.

IN 2007, UPWARD MOBILITY WILL CONTINUE BY...

- Taking the import/export service to the rural sector, thereby strengthening the relationships and also enhancing volumes,
- Conducting workshops and seminars targeted for customers in and around Colombo and also for others in the rural areas emphasizing the advantages of the Free Trade Agreements with India and Pakistan,
- Developing an IT platform in the field of trade business to meet customer expectations,
- Penetrating European markets where there is a high concentration of Sri Lankan community to attract remittances through recognized banking channels from these regions,
- Playing an active role in the SWIFT Service Bureau Sri Lanka which goes live in March 2007,
- Ensuring quality and productive Correspondent Banking Arrangements throughout the globe,
- Ensuring all relationships are compliant with best practices of AML and KYC and comply with local and international laws.

OPERATIONAL REVIEW

TREASURY

PRODUCTS & SERVICES

Spot & Forward FX, FX Swaps, Derivatives, Repos, Bonds

THE YEAR IN FOCUS

The thrust of the Treasury was focused on the areas of improving overall fund management and increasing market share through strengthened relationships and value additions and maintaining the Bank's premier position in the forex and money markets. However, lack of depth and lower trading volumes coupled with a volatile external environment resulting from the Central Bank's stringent monetary policies, saw bond trading come to a virtual standstill. While policy rates increased by 1.25% during the year, real interest rates continued to be negative, giving rise to anticipation of further interest rate hikes. The inability to short – sell bonds continues to act as a further constraint to the development of the bond market.

But the Bank's drive to continue its upward journey saw the sector differentiating itself from competition by forging closer ties with corporate clients and infusing value added services including stronger communications, consultation and advice to strengthen relationships. This has led to a significant portion of the income pertaining to Treasury coming from corporate clientele.

In aligning ourselves to being upwardly mobile, stringent cash management, yield enhancement techniques and active participation in the forex and money markets were undertaken. Trading in foreign bank notes also gained momentum.

IN 2007, UPWARD MOBILITY WILL CONTINUE BY...

- Differentiating our strengths of service, quality and value additions,
- Building deeper, stronger and more meaningful relationships with our clients,
- Continuing to efficiently manage our funds,
- Launching a 3 year High Yield Fixed Deposit denominated in USD,
- Facilitating trade related options for processed oil on behalf of a processed oil importer.



OPERATIONAL REVIEW

INVESTMENT BANKING

PRODUCTS & SERVICES

Corporate Finance & Advisory, Equities, Fixed Income, Loan Syndications & Structured Finance, Derivatives & Treasury Products

THE YEAR IN FOCUS

HNB offers a full range of investment banking products and services including corporate finance & advisory, equities and loan syndications & structured finance. Corporate finance & advisory capabilities include the handling of transactions relating to mergers & acquisitions and capital raising advisory services. Our equity capabilities include the origination, structuring and transaction management of IPO's, follow on issues, convertible issues, private placements, underwriting, listing services and proprietary trading. HNB's loan syndications & structured finance product offering includes the structuring and arranging of syndicated lending, management of loan syndications, acquisition & leveraged finance, and the origination and placement of a wide range of securitised instruments.

HNB's full service investment banking capability was further strengthened with measures taken to amalgamate the equities brokerage and fixed income dealing activities under the newly formed HNB Investment Banking Group. Completion of the amalgamation process would result in all investment banking activities being vested with HNB Investment Banking Group enabling the realisation of significant synergies and cost efficiencies while further leveraging our capabilities as a full-service investment banking services provider. We firmly believe that the strategic amalgamation is timely and will further strengthen capabilities and improve our competitiveness in a difficult and fragmented market.

Corporate Finance

Corporate Finance activities remained subdued during the year under review in a volatile and sentiment driven market. Equity markets performed below expectations on account of the volatile political situation. Large equity market transactions consisted mainly of block sales involving selected blue chip and value driven stocks. There was a lack of quality IPO's coming to the market as prospective issuers adopted a wait and see policy. However, proprietary equity trading activities undertaken on behalf of HNB achieved a significant degree of success and positive results are expected to continue in the coming year. Some of the key transactions successfully completed during the year were as follows:



Loan Syndications

- HNB was the Lead Bank and Co-Arranger for a LKR 4,700 million syndicated credit facility for Celltel Lanka (Private) Limited.
- HNB was the Lead Bank and Lead Arranger for a USD 17.5 million syndicated credit facility for Yacht Tours Maldives (Private) Limited for the development of a resort project.
- HNB was the Lead Bank and Lead Arranger for a LKR 1,600 million syndicated credit facility for a mixed real estate development project promoted by the Ceylon Theatres Group.

Equities and Listing Services

- HNB was the Lead Manager for the acquisition of 20% equity stake in Colombo Dockyards Limited by Horizon Energy LLC.
- HNB is currently mandated for two IPO's and two introductory listings. We are also mandated as the Advisor and Manager for a block sale of equity by a leading listed company.

Structured Finance

- HNB was the Manager and Arranger for asset backed financing of LKR 500 million through securitisation of lease receivables for Commercial Leasing Company Limited.

Transaction & Advisory Services

- HNB was the Manager to the mandatory offer by Sri Lanka Insurance Corporation Limited, for acquisition of the controlling interest of the Lanka Hospitals Corporation Limited. The mandatory offer was successfully concluded.
- HNB was the Manager to the mandatory offer by Sri Lanka Insurance Corporation Limited, for acquisition of the controlling interest of Asiri Surgical Hospitals Limited.

Primary Dealership

Having seen a year where the market remained inactive, HNB Securities hopes that the security and economic situation within the country will be more conducive to a sentiment change resulting in better business prospects. However, predictions are difficult at this point of time with Government policy and direction yet to be seen for the coming year in order to affect our strategic initiatives.

IN 2007, UPWARD MOBILITY WILL CONTINUE BY...

- Wider consolidation of Group synergies realised through the full amalgamation of all investment banking activities including HNB Securities, HNB Stockbrokers and Corporate Finance within the Investment Banking Group,
- Leveraging on the strengths of the activities within the Group to build a sustainable and strong portfolio whilst rolling out new product lines,
- Using the extensive specialised Human Resources resultant of the amalgamation as a strategic selling point in building the business.

OPERATIONAL REVIEW

INFORMATION TECHNOLOGY

THE YEAR IN FOCUS

The Bank implemented the much anticipated cheque imaging and truncation system on a nationwide initiative of the Central Bank of Sri Lanka, which has benefited a large number of our clients through the one day clearing umbrella. The one day clearing initiative will be extended to all parts of the island during 2007.

Constantly looking towards value addition, Internet Banking was replaced with the innovative Virtual Banking Suite providing a varied gamut of convenient features which includes third party fund transfer to any account within HNB and added flexibility in managing funds.

Augmenting our IT platform into the sphere of telecommunications, HNB signed up with both Mobitel and Lanka Bell to present customers with a unique menu driven option for banking transactions. This pioneering effort by HNB is a result of substantial background work in the past that has now taken SMS Banking to CDMA telephone units as well.

Fully automated self service kiosks were added to the Internet services offered by the Bank in December this year, with the added feature of bill payment receipts being issued.

IN 2007, UPWARD MOBILITY WILL CONTINUE BY...

- Replacing the Bank's existing core banking platform with a new banking solution to support current and future growth,
- Strengthening our IT platform to give more value additions via our products to our customer base including HNB Money2Home facility,
- Implementing an efficient 24/7 funds transfer facility for exchange houses,
- Expanding the HNB Easy Pay payment portal.



OPERATIONAL REVIEW

MARKETING

HNB affirmed the foundation already created that we are a bank that has truly become one with the people. In communicating this message, we emphasized that our products and services encompass the essence of the Sri Lankan citizen, from an infant to a senior citizen giving them the stability and security they have always wanted. We have also worked on the aspect that the citizens of this country should have equal opportunity wherever they are, to have the basic rights of having banking services offered to them devoid of hassles.

THE YEAR IN FOCUS

Our marketing approach has been consolidated to reflect top-of-the-mind recall for Brand HNB.

We have striven to give our stakeholders the philosophy that HNB is accessible to all with an extensive product portfolio that would encompass every single person who aspires to build a relationship with HNB. This anthology of products comes under the overarching branding of HNB to ensure that stakeholders are aware that Sri Lanka's premier private sector bank will live up to its promises and brand values. Innovation and thinking out-of-the-box have remained key elements in retaining our product leadership positions in most areas. HNB has been a pioneer in innovating product development especially in the retail banking areas of housing, children's savings and rewards programmes.

While we did use the traditional media channels of TV, radio and print to communicate our message, one of our innovative communication strategies this year was to have universal HNB branding for all our branches. Facades and interiors were streamlined to reflect a common branding strategy with easily identifiable signage across the country. In addition, our Wattala branch launched the initiative of making every HNB branch more accessible to customers requesting assistance with mobility, a strategy which will gather momentum during the next four years. Other product delivery mechanisms including the school units, micro finance centres and mobile units were strengthened. Envelope messaging via our credit card and account statements innovatively communicated new products or services being launched to customers, while road shows, tie-ups with local radio stations for promotions and town storming activities augmented our communication methodologies.

In addition to a number of social community projects conducted by HNB which are detailed in the Sustainability Report, some of the highlights of our marketing activities pursuant to products and brands this year are given below:



- With HNB winning the Bank of the Year 2006 award, a concerted corporate media campaign was spread across the print media.
- Pathum Vimana 2006 was re-launched under the theme, 'Better, Bigger and Back Again' with a value addition of a mid year premium for an Audi A4 car and the grand year end draw for a Mercedes Benz E-Class. The Pathum Vimana 2006 concept was also given a value extension with the introduction of a TV game show with all participants winning cash prizes.
- The HNB Shanthi Housing Loan scheme celebrated ten years with a promotion that presented a grand prize of wiping off a housing loan of up to Rs 2 million among a host of other prizes.
- The minor savings scheme, Singithi Pathum, was launched with a special promotion of gifts presented to our young customers who deposited stipulated amounts during the promotional period, over and above the usual prizes won at the raffle.
- HNB Leasing strengthened its image and brand this year with a number of strategic tie-up and promotions with vehicle dealers. Around 25 localised promotions were carried out in tandem with aggressive town storming events in locations with a HNB branch presence.
- HNB credit cards launched two usage promotions during the Sinhala New Year and Christmas, the latter themed 'The 31 days of Christmas' supported by print, radio and point-of-sale material.
- HNB Fixed Deposits offered attractive interest rates periodically communicated through print and radio.
- Driven mainly via print and radio, HNB Subasiri personal loans were re-branded as HNB Personal Loans.
- HNB Pawning was aggressively promoted throughout the year with the introduction of special promotions including the presentation of gifts to customers, driven through print, radio and TV advertising as well as localized promotions in selected areas with strong HNB branch presence.
- Giving customers secure online access to current, savings and credit card accounts, HNB launched its 'Virtual Branch', styled on internet banking services. Customers can also use the Virtual Branch for bill payment facilities for utility services including the CEB, Dialog, Mobitel, Celltel, HNB Assurance and Lanka Bell. E-banking kiosks were also introduced as a service value addition for remote internet banking as a part of HNB's e-banking strategy for 2006.
- In partnership with Mobitel, HNB introduced the first ever OTA (Over the Air) menu driven SMS banking service in Sri Lanka, allowing customers to avail themselves of information on accounts, fund transfers, credit card inquiries and bill payment as well as online settlement of mobile phone bills and top ups.
- SMS Banking was further expanded in partnership with Lanka Bell when HNB pioneered the usage of CDMA technology allowing customers to use the fixed line telephone systems for their inquiries.

IN 2007, UPWARD MOBILITY WILL CONTINUE BY...

- Strengthening our product delivery channels for accessibility, especially to remote areas so that HNB will be at top-of-the-mind recall,
- Re-furbishing the mobile units with stronger branding and a face lift,
- Pursuing non-traditional methods of communication to spread our message,
- Continuing to make our Customer Centres accessible to those requiring assistance with mobility.

OPERATIONAL REVIEW

SUBSIDIARY OPERATIONS

HNB Stockbrokers (Pvt) Limited

The year for HNB Stockbrokers has been a challenging one despite market gains and the ASPI growing by 41.6% and the Stock Exchange recording some significant trading benchmarks. Despite a slow start to the year, market picked up towards latter part of 2006, surpassing the 27.6% ASPI growth witnessed in year 2005. However, the market turnover declined by 8.29% to stand at Rs. 210 billion when compared to last year's figure of Rs. 229 billion.

However, HNB Stockbrokers continues to reflect the upwardly mobile attitude permeated by the Bank, by being ranked among the top four stock brokering companies in the country on the basis of the number of transactions effected at the Colombo Stock Exchange. The average market share registered was 7% (or the highest market share registered was in the month of July at 19%). A turnover of Rs. 14.5 billion is recorded for 2006 with a pre tax profit of Rs. 33 million reflected from a brokerage income of Rs. 100 million. Net assets stand at Rs. 120.8 million this year a significant 433% increase from 2001 when HNB Stockbrokers became a fully owned subsidiary of Hatton National Bank.

HNB Stockbrokers participated in numerous road shows conducted by the Colombo Stock Exchange interacting with a number of investors who were interested in Sri Lanka. The most evident facet from the feedback received was that while investors remain positive about Sri Lanka's investment potential, peace and stability remain a priority for attracting investors and until a stable solution is achieved, full potential of the investment will not be experienced by the country.



THE YEAR IN FOCUS

- **Jayathura Lottery:** The first brokerage house in the industry to launch a rewards scheme for HNB and HNB stock broking clients in 2005, we extended the reach of the Jayathura Lottery. Having begun with just one sponsor, Etihad Airways, in 2006 we aligned the scheme to Singhagiri Limited, the sole agents for Samsung and Galway Hotels was also added.
- **HNB Stock Web and Retail Market Booster:** In a bid to infuse state-of-the-art technology into daily operations, the Company launched www.hnbstock.com in March 2006, a comprehensive website together with the 'Retail Market Booster – Internet Trading System', which won the Gold Award in the financial services sector and a silver award in the overall category at the National Best Quality Software Awards. The system was developed by Messrs Affno (Pvt) Ltd. This facilitates online trading in a speedier and more efficient environment, giving the company an edge in technological advancement over competition. Better time management and a more effective usage of technology which spreads to clients in any part of the world is also a result of this development.

- **Awareness programmes on the Stock Market:** Distribution of literature on the stock market, its workings and requirements were effected to existing and potential clients through direct mailers, the HNB Card Centre and HNB branches.
- **Stock Exchange Investment Advisor Programme:** A total of 27 who underwent training at the Stock Market Training Centre were nominated to follow the Stock Exchange Investment Advisor Programme as a preamble to the promotion of share trading through HNB branches.
- **Road Shows:** HNB Stockbrokers were active participants at the road shows conducted by Colombo Stock Exchange in Australia, New Zealand, and Singapore. Road shows were also held to coincide with the World Bank and Commonwealth Finance Ministers' meetings held in Singapore where the top four listed companies were showcased to promote Sri Lanka as an investment destination. Our GM/CEO along with a group of CEO's of member firms visited the Nasdaq, New York Stock Exchange, Boston Stock Exchange, International Derivatives Exchange of New York in USA and the Canada Stock Exchange as a part of a familiarization program.
- **Research Publications:** An active component of the Company, the Research Department publishes regular Industry and Company Research, Strategy and Economic Reports, Weekly Reports, Daily Reports and daily valuations continue to be published. This year, the Research Department published a comprehensive report on a number of conglomerates in Sri Lanka, a report on the Banking sector and an analysis on Budget 2007 and its impact on the stock market, the economy and major industry.

IN 2007, UPWARD MOBILITY WILL CONTINUE BY...

- Aggressively promoting internet trading for high net worth clients as well as offshore clients,
- Taking initiatives to implement internet payment and receipt methodologies for stock market transactions,
- Introducing internet trading to ten HNB branches, equipping them with a special trading area manned by a banking assistant /a stockbroker, complimented by regular awareness campaigns,
- Commencing SMS market alerts,
- Enhancing communication via mass media especially overseas for publication of research reports and other required information,
- Publishing research reports on the telecommunication, banking and healthcare industries and the Market Strategy Report for 2007.

SUBSIDIARY OPERATIONS HNB Securities (Pvt) Limited

HNB Securities Ltd., weathered a number of shocks during the year 2006, stemming from the continued uncertainty over the peace process and the resultant volatility in the political and economic arena.

Rising interest rates and adverse inflationary trends had a negative impact on the bottom-line of the Company in the form of losses on government securities. The Company ended the year with a net loss after tax of 18.2 million compared to a net profit after tax of Rs. 87.4 million during the previous year.

Although, the domestic government securities market remained subdued during most parts of the year, the Company maintained a strong presence in the retail sector.



OPERATIONAL REVIEW

SUBSIDIARY OPERATIONS HNB Assurance

The aggressive but astute stance pursued by HNB Assurance Ltd, saw the Company achieve the milestone of reaching a combined annual turnover of Rs 1 billion this year, crossing the mark within just five years since inception, the fastest within the industry to achieve this milestone. The commendable figures were further augmented when at the end of the year, the Company posted a combined turnover of Rs 1,122 million, amounting to a growth of 36% over the turnover registered last year. The Company does utilize the significant advantage of being a subsidiary of one of the premier banks in the country but has continued to hold its own individual stance as well. At the Annual Report Awards 2006 conducted by the Institute of Chartered Accountants of Sri Lanka, HNB Assurance was placed third and awarded a merit certificate in the Insurance Sector, a significant achievement for a relatively young company in a highly competitive industry.

The Company's General Insurance premium grew by 32% to reach Rs. 619 million while its Life Insurance premium grew by 42% to reach Rs. 503 million. The profitability of the Company improved further registering a net profit after tax of Rs. 91.3 million, recording a growth of 51.5% over the last year. General Insurance business contributed Rs. 62.7 million to the profit before tax of Rs. 92.7 million while the contribution of the Life Insurance business stood at Rs. 30.0 million.



In a bid to expand the product portfolio aiming towards above industry growth, during the latter part of the year the Company launched Travel Assist which supplements the existing range of travel insurance products that include Travel Pal, Travel Max and 70+. Pitched as a travel assistance product rather than the conventional travel insurance to give customers a more rounded package of services, the product was launched to bridge a gap within the travel insurance market which has hitherto remained untapped. The Company also launched a new Medical Insurance Plan targeting the top end of the retail market.

Together with parent HNB, the company also launched a unique micro insurance product aimed specifically for micro entrepreneurs wherein the entrepreneur's entire risk is borne by HNB Assurance. The product, worked on an affordable premium, gives multiple cover for all eventualities. This initiative has seen immense success in areas as diverse as Akkaraipattu, Chilaw, Nochchiyagama and Galle with over 500 policies issued and a monthly growth rate of 20%.

The increasing popularity of our motor insurance product 'Motorguard' assisted in achieving a growth of 36% in the premium income from motor insurance. We also launched a cashless hospitalization facility for corporate health insurance plans facilitated through a tie-up with Medilink, a specialist third party administrator of claims. The Company also introduced a web-based facility through which marine open cover certificates could be printed online by customers.

The total number of branches opened this year stands at six with new branches opened in Embilipitiya, Ja-ela, Ambalangoda, Bandarawela, Ambalantota and Gampola to further strengthen the distribution network. New Insurance Desks were also established at Polonnaruwa, Kalmunai and Batticaloa within HNB branch premises.

OPERATIONAL REVIEW

**SUBSIDIARY
OPERATIONS**
Sithma Development (Pvt) Limited

PRODUCTS & SERVICES

Manage HNB Towers/Develop other potential real estate sites

Our main source of income is generated through our tenants, HNB, our parent company who occupies 80% of HNB Towers and other Organizations. With prudent management of operational and maintenance costs, we have curtailed our loss this year to Rs. 22.5 million, which is 55% lower than the previous year. Our strength lies in a committed small in-house team of technical personnel who has mastered the efficient utilisation of the advanced energy saving systems installed for the first time in Sri Lanka at HNB Towers.

We have, this year ventured into a real estate development project at Havelock Road, Colombo 5. "Spathodea Residencies", 48 luxury apartments situated in a prime residential area, due for completion in 2008. We believe the completion of this project will augment our income and will look forward to tapping the resources of more real estate opportunities that may arise.



OPERATIONAL REVIEW

ASSOCIATE
COMPANY
Lanka Ventures

Reflecting the vicissitudes inherent in our business, we faced a challenging year, largely due to the decline in investment income by 14% over last year, recording an income of Rs 73 million compared to last year's Rs 85 million. We exited from two venture capital investments and partially exited from another during the year, but the realized capital gains were much less than gains realized previously. However, taking advantage of the buoyant stock market conditions that prevailed during some part of the financial year, we exited from several stock market investments at a substantial profit.

Past records show that we have realized substantial capital gains when exiting investments through the stock market and would welcome the opportunity to maximize exits through this route. However, promoters of many companies, specifically medium sized enterprises that do have good listing potential as an avenue to raise capital, prefer to remain unlisted on the belief that through the exposure of a public listing, they will face innumerable challenges including the fear of losing management control, stringent disclosures and complex listing requirements. Hence, in the immediate past, majority of our exits was achieved through redemptions or sale of investment back to the promoters.



Being aware of our responsibilities to our shareholders, we are pursuing avenues of sustainable and stable income in the future. Furthermore, being a listed company, we cannot afford to function within a milieu of uncertainty. We have identified power and energy and healthcare sectors as those with potential for growth and will be seeking opportunities in these sectors for investment. LVL Energy Fund was incorporated this year to aggressively pursue this growth strategy with future investments in the power and energy sector being channeled through this subsidiary. We were also the pioneers in assisting the setting up of the leading dedicated private heart-care centre in the country and given the response to these niche healthcare segments, we will be pursuing further opportunities akin to this in the coming year.

Global Presence

- Americas**
 - Argentina
 - Bahamas
 - Bermuda
 - Brazil
 - Canada
 - Chile
 - Colombia
 - Hawaii
 - Mexico
 - Peru
 - Uruguay
 - United States of America
- Middle East & Africa**
 - Bahrain
 - Botswana
 - Egypt
 - Ethiopia
 - Ghana
 - Iran
 - Israel
 - Jordan
 - Kenya
 - Kuwait
 - Lebanon
 - Libya
 - Mauritius
 - Oman
 - Qatar
 - Saudi Arabia
 - Sierra Leone
 - Somalia
 - South Africa
 - Sudan
 - Swaziland
 - United Arab Emirates
 - Yemen
 - Zambia
 - Zimbabwe
- Europe**
 - Austria
 - Belgium
 - Cyprus
 - Czech Republic
 - Denmark
 - Finland
 - France
 - Germany
 - Gibraltar
 - Greece
 - Hungary
 - Ireland
 - Italy
 - Netherlands
 - Norway
 - Poland
 - Portugal
 - Romania
 - Russian Federation
 - Serbia & Montenegro
 - Spain
 - Sweden
 - Switzerland
 - Turkey
 - United Kingdom
- Asia & Pacific**
 - Australia
 - Bangladesh
 - China
 - Fiji Islands
 - Hong Kong
 - India
 - Indonesia
 - Japan
 - Korea
 - Maldives Islands
 - Malaysia
 - Nepal
 - New Zealand
 - Pakistan
 - Philippines
 - Singapore
 - Taiwan
 - Thailand
 - Uzbekistan
 - Vietnam

Customer Centre Network

HNB Customer Centres to be opened during the 1st quarter of the year 2007

• Nikaweratiya • Wellawatte - 2nd Office • Wariyapola • Hettipola • Alawwa

HNB Student Banking Centres - 152

HNB Gami Pubuduwa Banking Centres - 109

Village Based - 23 Branch Based - 86

HNB Mobile Banking Centres - 2

Hotel Culture Club and Kandalama Hotel - Dambulla

Overseas Representative Offices

Chennai - India and Karachi - Pakistan

Western Province

	IWMI - Pelawatta	
	Ja-Ela	
	Jampettah Street	
	Kadawatha	
	Kaduwela	
	Kalutara	
	Kandana	
	Katunayake	Nittambuwa
	Kiribathgoda	Nugedoda
	Kirindiwela	Overseas School of Colombo
	Kirullapone	Padukka
	Kollupitiya	Panadura
	Kollupitiya Extension Office	Panchikawatte
	Kotahena	Pettah
	Kottawa	Pettah - 3rd Office
	Kotte	Piliyandala
	Maharagama	Ports Authority
	Main Branch	Ragama
	Malabe	Ratmalana
	Maligawatte	Sea Street
	Maradana	Seeduwa
	Marandagahamulla	Sri Jayewardenepura Hospital
	Minuwangoda	Sri Lankan Airlines
	Mirigama	Administrative Complex
	Mirihana	Talangama
	Moratumulla	Thalawathugoda
	Moratuwa	Thimbirigasyaya
	Mt. Lavinia	Wattala
	Mutwal	Wellawatte
	Narahenpita	Wijerama
	Nawaloka Hospital	
	Nawam Mawatha	
	Negombo	
	Negombo Extension Office	
Airport Office		
Aluthgama		
Aluthkade		
Apollo Hospitals		
Asha Central Hospital		
Athurugiriya		
Avissawella		
Bambalapitiya		
Biyagama		
Boralesgamuwa		
Borella		
Cinnamon Gardens		
City Office		
Dehiwela		
Delgoda		
Dematagoda		
Emirates		
Gampaha		
Grandpass		
Gunasinghepura		
Hanwella		
Head Office Branch		
Homagama		
Horana		
Hulftsdorp		

North Western Province

Chilaw
Dankotuwa
Kuliyapitiya
Kurunegala
Kochchikade
Marawila
Nawinne Ext-Kurunegala
Puttalam
Wennappuwa

Northern Province

Chunnakam
Jaffna
Jaffna - 2nd Office
Mannar
Manipay
Nelliyady
Vavuniya

Eastern Province

Akkaraipattu
Ampara
Batticaloa
Kalmunai
Kantalai
Kattankudy
Trincomalee
Trincomalee - Courts Road

North Central Province

Anuradhapura
Nochchiyagama
Polonnaruwa
Thambuttegama

Central Province

Akurana
Bogawantalawa
Dambulla
Gampola
Geli Oya
Hatton
Kandy
Katugastota
Maskeliya
Matale
Nawalapitiya
Nuwara Eliya
Peradeniya
Pilimathalawa
Pussellawa

Sabaragamuwa Province

Balangoda
Embilipitiya
Kahawatte
Kegalle
Mawanella
Pelmadulla
Pinnawela
Ratnapura

Southern Province

Akuressa
Ambalangoda
Ambalantota
Deniyaya
Elpitiya
Galle
Hambantota
Koggala
Matara
Pitigala
Suriyawewa
Tangalle
Tissamaharama

Uva Province

Badulla
Bandarawela
Buttala
Moneragala
Welimada
Wellawaya

FINANCIAL REVIEW



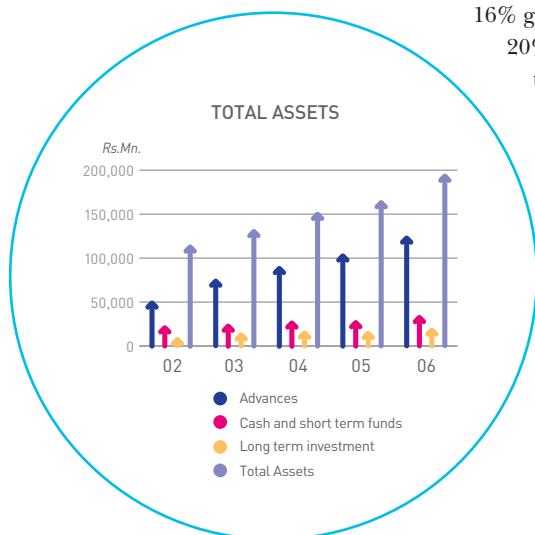
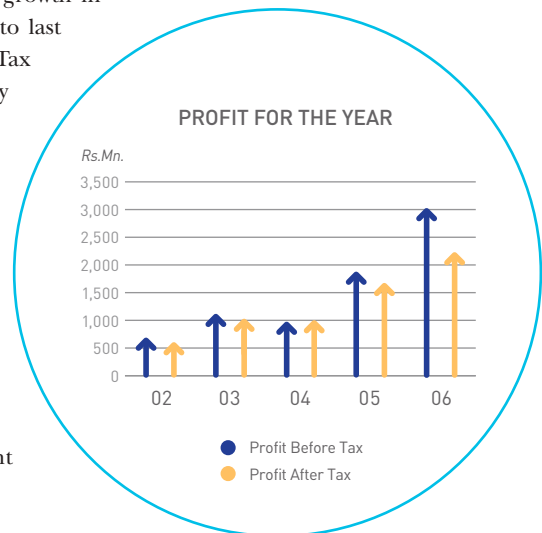
HNB's astute initiatives implemented in the last two years saw fruition to post positive results in most areas despite 2006 having been a challenging year for the financial services industry in Sri Lanka. In terms of our core business, we have been able to achieve the set targets commendably mainly due to the singular focus we had in achieving our objectives. We do believe that this trend will be sustainable in the medium term future. The results we have seen in our multi dimensional objectives and targets do indicate that the upward trend has been built on a sound sustainable financial platform that will continue into the future.

The sound management practices at HNB combined with this focused journey have allowed us to manage the external financial policies and stringent taxation regime that posed the majority of the challenges over the year. Yet, the Bank posted a significant growth in Profit Before Tax of 63% displaying Rs 3,019 million compared to last year's Rs 1,850 million. For the first time, the Bank's Profit After Tax figure crossed the Rs 2 billion threshold which is an extremely noteworthy achievement for us and showcased an increase of 34.2% over the Rs 1,654 million shown in 2005.

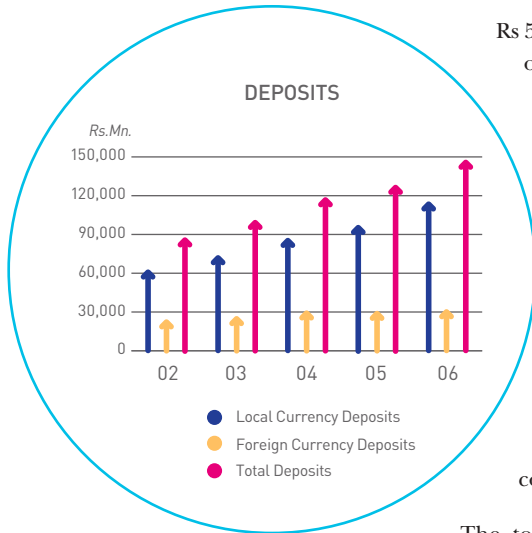
The Bank's income tax expense significantly increased by 308% to Rs 798.9 million during the year. The main reasons for the increase in income tax were the upward revision in tax rate by 5% and the growth in pre tax profits.

5% increase in income and financial services value added tax rates are indications that this source of revenue to the Government may increase in the future. Hence, the taxation regime in place at present does not signal a pro-growth environment for the Bank.

Total assets recorded at Rs 196 billion, a modest growth of 18% over last year's Rs 166 billion. Cash and short term funds as well as Advances (post provisioning) displayed at Rs 55 billion and Rs 128 billion respectively, propped the figures significantly. Loans under FCBU net of provisioning also had an increase of Rs 2.6 billion. Housing and pawning, our main retail products of the asset categories reported 16% growth and the growth in the corporate segment was posted at 20%. The interest earning assets of the Bank as a percentage of total assets now lies at 86.6% and this ratio was 86.4% in 2005.

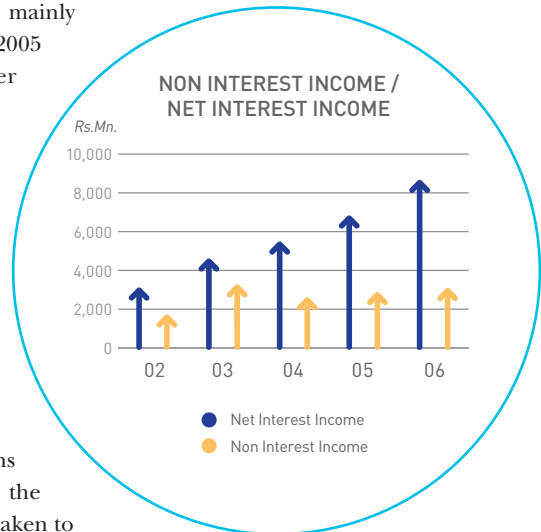


The Bank's deposit base showed a growth of 15% to Rs 148 billion, certainly a witness to the concentrated drive the Bank employed this year to increase its deposit base. Savings deposits saw a growth of 7% over the year, while both Demand Deposits and Minor Savings Deposits grew at 1% and 14.9% respectively. However, despite some concerted marketing efforts including the popular Pathum Vimana scheme, Fixed Deposits still hold more attraction due to the higher interest rate which, this year, averaged at 12% as opposed to 9% during the last year. Fixed and Call Deposits also posted final figures of

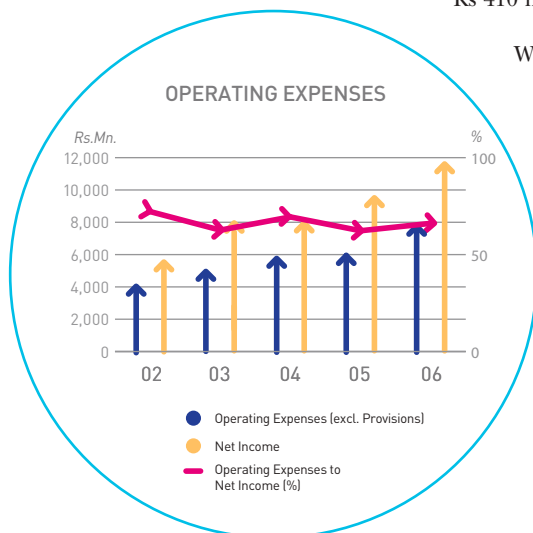


Rs 52 billion compared to Rs 37 billion last year which is an increase of 40%, while NRFC/RFC/EFC deposits posted a growth of 4% to stand at Rs 32 billion at end of 2006. Interest expenditure also rose by 35% during the year. Matured deposits getting reinvested at higher rates and regular savings accounts shifting to Fixed Deposits due to the higher rate were significant causes of interest expenditure increase. However, over this year, HNB was emphatic on managing the interest rate margin and curtailing growth in operational costs, transforming its nationwide penetrative capabilities and humane approach to take the banking concept closer to all strata of society, results of which will be seen in the next few years. This will ensure judicious management of operational expenditure, while not compromising on growth opportunities.

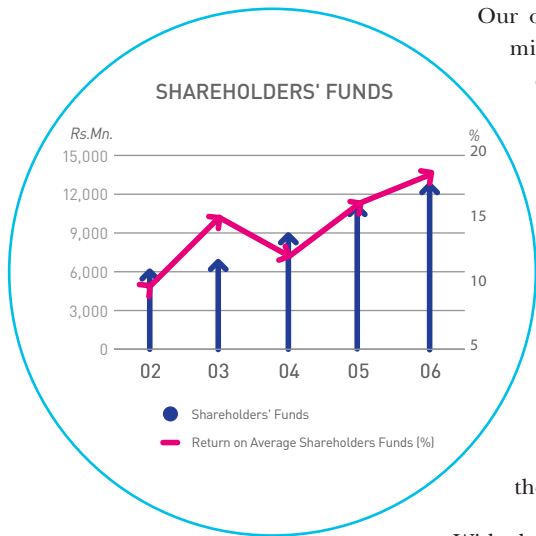
The total revenue of the Bank increased by 27.2% over the year. Interest income showed a growth of 30.5%, Net interest income by 26%, Commissions & Fee income by 7.9% and Exchange income by 22.5%. The noteworthy increase in interest income is mainly due to the Bank's collection ratio being above industry average of 2005 and this year showing a ratio of 90.65%. The Bank further concentrated on acquiring a high quality portfolio by working through a weaning process, which would, in the long run, add value to the bottom line with the growth in advances. However, interest income increased more than the growth in advances, which could be attributed largely to good loan recoveries during the year and the rise in interest rates. Exchange income which encompasses a significant component of non interest income recorded a growth of 22.5% this year, posting Rs 792 million, depreciation of the Sri Lankan Rupee by 5.5% through the year and an increase in volumes have contributed to the good figures displayed in Exchange income. Increase in the Fee & Commission income was a modest 7.9% and capital gains earned from fixed income securities reduced significantly due to the escalation of domestic interest rates. Further, a conscious decision taken to reduce the scale of activities in derivatives and bullion trading due to their associated high volatility and risks, also reduced an avenue of other income.



Other Income is displayed at Rs 396 million compared to the 2005 figure of Rs 410 million.



We took a cautious approach with our equity trading portfolio and made investments with a two-year horizon in mind. The exposure which was at Rs 345 million at the end of the 2005 was increased to Rs 400 million after the Geneva Rounds of Peace Negotiations commenced. Commencement of hostilities between the Government forces and LTTE subsequent to the blocking of Marvilaaru anicut reduced our exposure and the realization of part of the capital gains from the portfolio. Thus, the contribution to the other income from the equity portfolio has decreased. However, the Rs 77 million provision made in 2005 for diminution in value is fully recovered as the current portfolio has performed well above its cost.

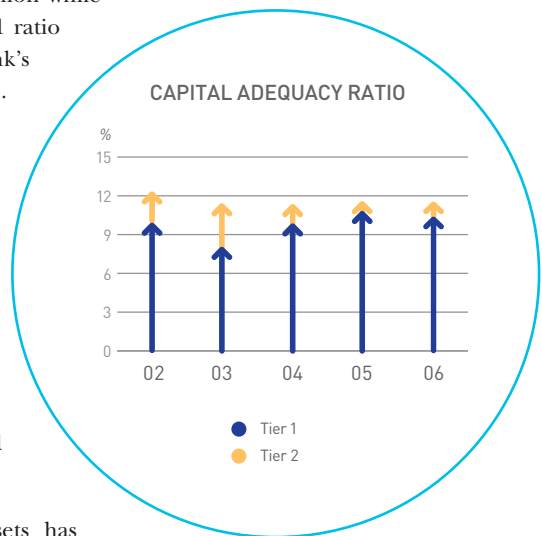


Our operating expenses however, increased by 29% to Rs 7,732 million over last years Rs 6,001 million, with the main contributory factors being staff emoluments, financial value added tax, advertising, fuel, rent and rates. We continue to manage our expenses with the staff head count remaining the same but have employed effective strategies in utilizing our human resources more astutely to ensure enhanced productivity which in effect will continue to contribute positively.

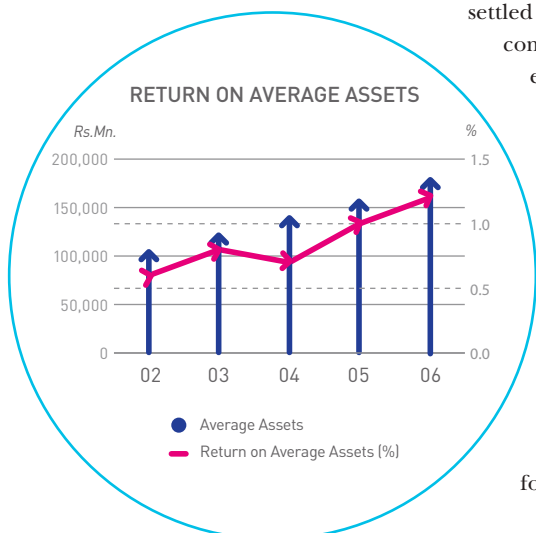
The advances to deposits ratio which reflects the efficiency at which the deposits are utilized to grant advances was maintained around 80% during the year. The liquid asset ratio which reflects the liquidity position of the Bank was also maintained above 22% which is well above the stipulated minimum by CBSL.

With the Rs 2.22 billion after tax profit, we realized this year, total shareholders funds grew to Rs 12.93 billion. Conscious curtailment in growth of non interest bearing assets has increased the free capital from Rs 3.7 billion in 2005 to Rs 6.4 billion in 2006, which now stands at 49% of the shareholders' funds.

The Bank's Core Capital as at end 2006 stands at Rs 12,691 million while Total Capital is displayed at Rs 14,049 million. The Bank's Tier 1 ratio recorded a marginal decrease of 0.6% to reach 10.23%. The Bank's Total Capital Adequacy Ratio stands at 11.32% down from 11.55%. The main reason for the decrease in the Tier 1 capital is, as directed by the Central Bank of Sri Lanka, the risk weighting for loans secured by primary mortgage over residential property increased from 50% to 55% and risk weighting for other loans increased from 100% to 110%. These changes have resulted in an increase in the risk weighted asset base by approximately Rs 8.4 billion. Bank raised Rs 1.12 billion at the beginning of the year through a series of debentures with maturities running up to 18 years. Such long tenure instruments not only compliments the capital but smoothens the depreciation process stipulated by the regulator and reduces the maturity mismatch of long end assets and liabilities.



Return on average assets has settled on a comfortable 1.23% compared to last year's 1%, which



essentially reflects the firm stand taken by the Bank over the last two years that balance sheet growth must concentrate largely on the productivity of the asset, while maintaining the profitability equilibrium. We have trusted upon ourselves to improve the ROA to 1.5% within the next three years and this will be achieved by consciously monitoring the need of acquiring non interest bearing assets in the future, managing the margins realized from each asset class, managing on time collections and facilitating a steady growth in asset portfolio.

With the strategic initiatives that have been implemented in the last two years and augmented this year, the Bank looks forward to a post-tax profit growth of above 20% in 2007.

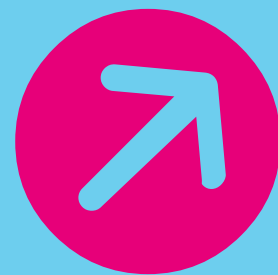




PREAMBLE

As an organisation whose core existence and sustainability is totally dependent on our relationship with each stakeholder segment, at each level of our interaction, we remain acutely aware that sustainability is now a business fundamental, an aspect that HNB must and has to be completely and holistically committed to. Sustainability is defined as 'meeting the needs of the present generation without compromising the ability of future generations to meet their own needs', which to us is the axiom upon which our value truss is built upon.

HNB is a bank whose history spans 118 years. We have seen and been a part of history making epochs, not only in an economic and business sense but also in the attitudinal change and dynamic demand trends of customers, valued business partners, investors, the community and the general public. We have seen the basic fundamental facets of our business convert from creating wealth for our shareholders to encompassing the complete landscape of sustainability, where the focus has transformed to the socio-economic aspects of environmental and social change within the macro picture of sustainable development. Thus sustainability now co-relates to the entire gamut of transparency, accountability and sincerity of action on our part with each stakeholder segment demanding responsible business actions, minimising negative impacts economically, socially and environmentally. It is this thought flow that has spurred HNB to spearhead a more systematic approach towards sustainability where a committed team focuses on predetermined platforms to ensure that the Bank remains aligned to its vision, mission and values within the larger picture of sustainability.



“SUSTAINABILITY – AN ETHOS, NOT JUST RHETORIC.”

“We have often asked ourselves the question, ‘Where do we want to be in the next three to five years?’ And the response has unwaveringly been ‘As the Leader’. But leadership is not an aspect that comes overnight and it is not for us to call ourselves leaders but for others to recognise us in that unquestionable position and emulate our example. We want to be the most preferred bank in the country where HNB would be the partner in progress of our stakeholders. And we don’t want to be simply perceived as a Bank but rather as an entity that strongly believes in, contributes and partners development that will create a sustainable economic and social milieu for all stakeholders to grow and thrive in the long term.

We have now taken our sustainability philosophy to the next level – reporting on our sustainability initiatives. A Sustainability Report is an important tool which encapsulates the true meaning of the entity, not just on corporate social responsibility but by providing a sustainable business platform to survive and to engage in the environment around it. In that process, we have looked at the facets of a customer, valued business partner, shareholder, team member and citizen and have demonstrated the initiatives we have established and implemented in creating a sustainable model for HNB. Having the Report independently validated too became important and for the first time last year, we engaged the services of KPMG Ford Rhodes Thornton & Co as an independent assurance provider to validate our Report. From a shareholders’ perspective it is imperative to note that HNB is no longer a locally owned bank but rather one that encompasses international investors. The moment we open ourselves to the world, we also bare ourselves to international scrutiny and are bound to maintain international best practices and standards. A Sustainability Report also becomes a risk management tool and is currently being used constructively to better the standards, trouble shoot and create a sustainable economic platform which anticipates and manages risks better.

We have always espoused the true ethos of sustainability, not merely talking about making a difference to each of our stakeholder segments, but in a true sense, conceptualizing and driving initiatives that will make a difference in their economic and social fabric. We have analyzed the impacts our decisions will make on stakeholders and have consciously tried to maintain a platform of equality, fairness, sincerity of action, accountability and transparency in everything we have set out to do. Our relationships thus have grown and strengthened and we have seen the image of HNB become one with the people, becoming a part of their lifestyles and their future decisions. This we feel is the all important thread that should run through in sustainability, where a strong partnership has been created between our stakeholders and ourselves, built on a long term vision of growth, development and sustenance.

Sustainability to us is creating an entrepreneurial culture; thinking out of the box and being innovative to sustain a leadership stance; living in harmony with the environment to ensure that future generations will continue to enjoy a similar or better quality of life than us; being philanthropic in lending a helping hand as the first step towards empowerment and espousing the true tenets of an ethical and responsible corporate citizen who sets an example for others to follow.

We hope this Report in which we have explained to you our actions, will assist you in gauging our performance against your expectations of the HNB Group as one of Sri Lanka’s premier financial service providers. We value your comments with a view to further enhance our service levels and product portfolios and to augment the sustainability of your Bank. An Investor Feedback Form is appended for your ease of use. Your feedback is important to us”.

Rajendra Theagarajah
MD/CEO

PURPOSE OF THIS REPORT

Sustainability Reporting, as we understand in HNB, is the practice of measuring, disclosing and being accountable to internal and external stakeholders for HNB's performance towards the goal of sustainable development. We have developed this Report with the view to provide a balanced and reasonable representation of the sustainability performance of HNB, including both positive and negative contributions.

The Global Reporting Initiative (GRI) which is an official Collaborating Centre of the United Nations Environment Programme located in Amsterdam, is a long term, multi-stakeholder organization whose mission is to develop and disseminate globally applicable Sustainability Reporting Guidelines (Guidelines). These Guidelines are intended to serve as a generally accepted framework for reporting on an organisation's economic, environmental and social performance. We have endeavoured to compile this Report based on the GRI Guidelines and have disclosed outcomes and results that occurred within the reporting period in the context of HNB's commitments, strategy and management approach.

REPORTING PRINCIPLES

SCOPE

The Sustainability Report covers HNB's activities and performance in the field of sustainability. It includes qualitative and quantitative data about the year ended 31 December 2006.

SELECTION OF TOPICS

Most topics in this Report are based upon our continuous interactions with our stakeholders on what they feel is of importance to form opinion on our sustainability behaviour. We have used the GRI Guidelines to ensure that we cover relevant topics identified by a broad range of stakeholders, which are generic to sustainability reporting. This Report has been compiled based on GRI's Guidelines (G3 version) and its supplement for the financial services sector. The guidelines comprise of several sections of which the two most important ones are the Reporting Principles and Standard & Guidance Disclosures.

REPORTING PROCESS

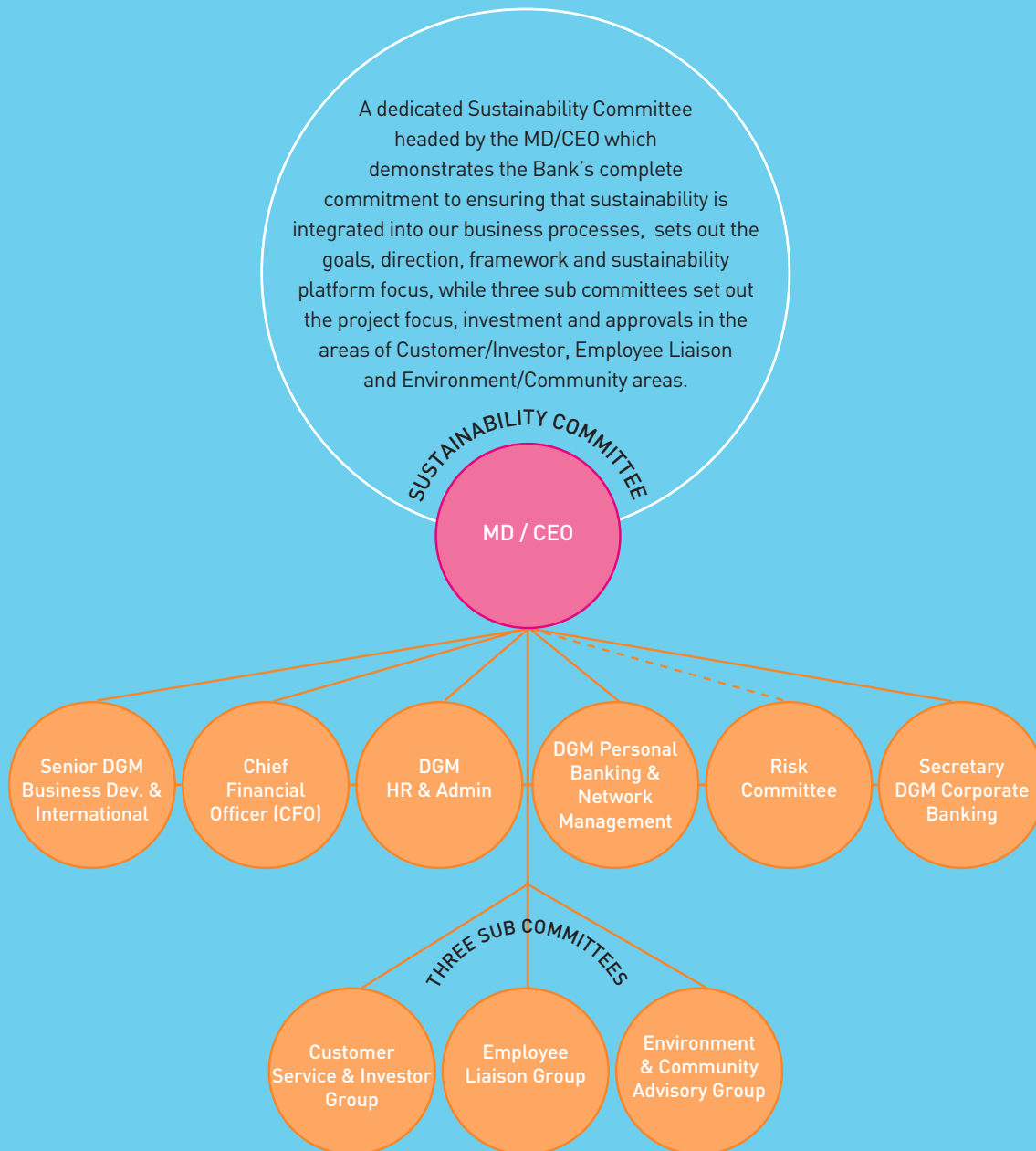
We have no overall information system in place for sustainability comparable to the systems used for obtaining financial information for the Annual Report. Nevertheless, whenever possible we use corporate information systems for gathering data. Only for those indicators that we considered to be relevant, but that were not covered in an existing system, did we use local information systems and questionnaires to aggregate the information. We verified such information via one-to-one conversations with the Heads of the respective Business Units and in meetings of the sustainability committee. Although we are confident of the overall reliability of the data reported, we recognized that some of this information was subject to a degree of uncertainty because of limitations associated with measuring, calculating or estimating it.

ASSURANCE REPORT

We have asked KPMG Ford Rhodes Thornton & Co (KPMG) to review HNB's Sustainability Report 2006 to provide the readers with a reasonable level of assurance on selected financial data and limited level of assurance on Key Performance Indicators (KPI) and the other information in the Report. The Report, including the identification of material issues is our responsibility. Based on the defined scope, KPMG decided to perform the activities described in the assurance report on page 78.

We realize that building sustainability into our business process is an ongoing process and that the quality of data collection and analysis, and internal controls at product/service division and corporate level, need our continuous attention. We are in the process of improving this and we anticipate that in the coming years we will have the reliability of information for a selection of material subjects to be reviewed by KPMG. Accordingly, we will be reassessing the scope of the assurance assignment, in order to further optimize the added value of the assurance process for our stakeholders and its contribution to internal improvements.

SUSTAINABILITY STEWARDSHIP



DUTIES OF THE SUSTAINABILITY COMMITTEE

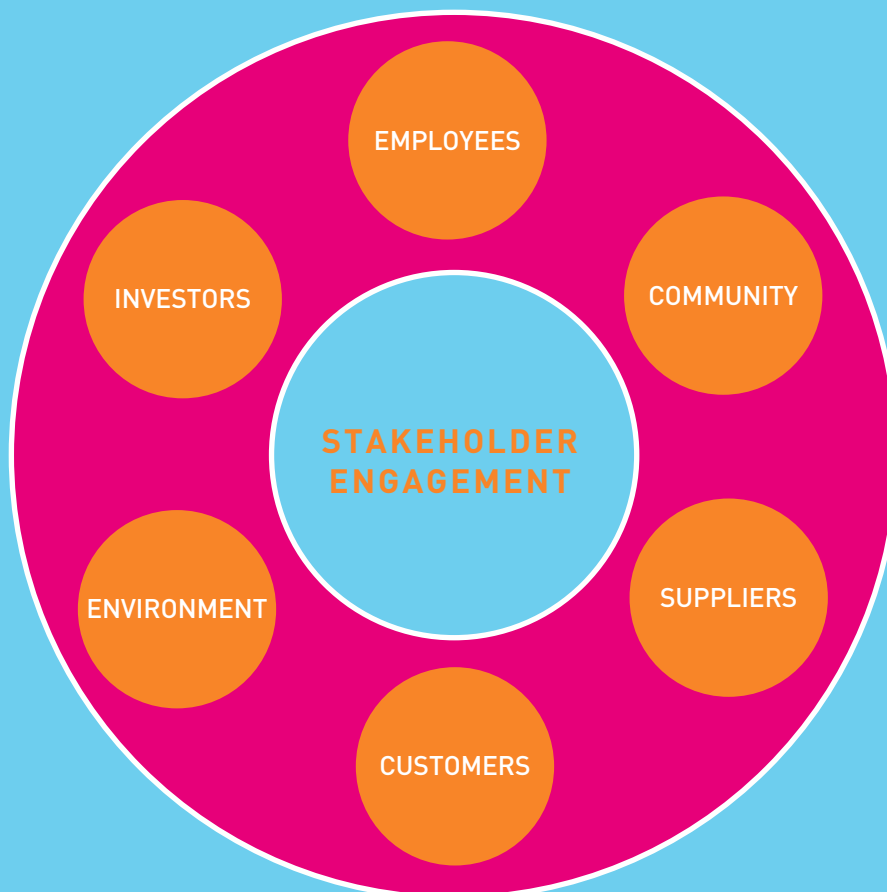
- Act as the think tank in developing the Sustainability Agenda for the Bank
- Oversee progress in economic, business, employee, community and environmental projects
- Set standards for policies and procedures in meeting Sustainability Principles
- Ensure business and operational initiatives conform to all Sustainability Principles.
- Proactively evaluate all decisions that would have an impact on the reputation, ethics and values of the Bank
- Identify and manage areas of non-compliance within the Sustainability Principles

SUSTAINABILITY STRUCTURE AT HNB

With the Sustainability Committee driving direction and giving leadership, the sustainability reporting focus is now under the focused platforms of:

INVESTOR RELATIONS	creating wealth for shareholders, managing risk prudently and professionally contributing to the larger economic picture whilst setting benchmarks for the industry.
EMPLOYEE RELATIONS	creating two-way relationships that inculcate team spirit within the Hatna Family concept and pursuing excellence.
SUPPLIER RELATIONS	focussing on long lasting partnerships on qualitative platforms.
CUSTOMER RELATIONS	ensuring that service excellence remains a fundamental in the delivery of superlative products and services and building our business on the foundation of trust and confidentiality.
COMMUNITY RELATIONS	creating sustainable communities through enhanced education opportunities, entrepreneurial assistance and improved health conditions.
ENVIRONMENTAL RELATIONS	ensuring a sustainable planet through conservation and preservation of the environment by introducing best practices.

TOTAL INVESTMENT DISBURSED ON SUSTAINABILITY PROJECTS THAT ENCOMPASS COMMUNITY AND ENVIRONMENTAL RELATIONS THIS YEAR IS RS 16 MILLION.



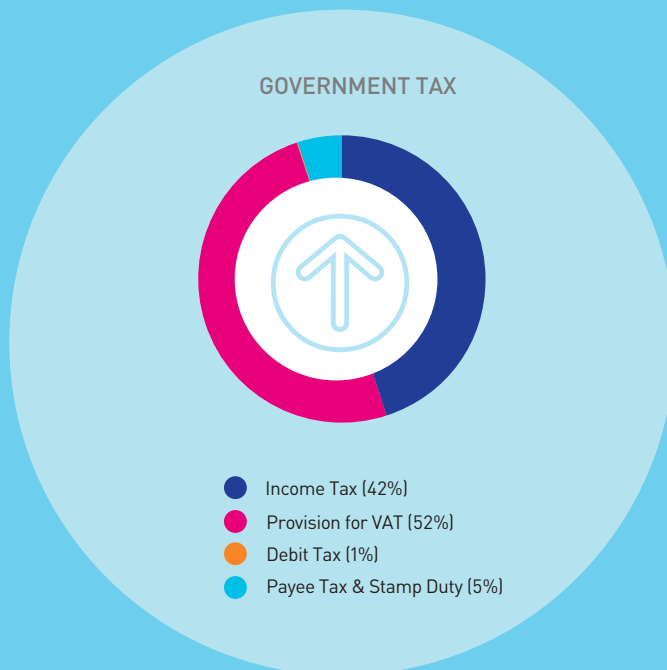
CONTRIBUTING TO THE SRI LANKAN ECONOMY

Dating back to 1888, HNB's history has evolved from being a bank that was formed to cater to the emerging needs of the European planters, to merging with the Sri Lankan operation of National and Grindlays Bank to become Hatton National Bank Limited, to today being recognised and honoured by local and global compatriots as a bank that espouses industry leadership, entrepreneurial spirit, community empathy and people power. The exponential growth the Bank has showcased over the centuries has seen the Bank's contribution to the national economy continuing to grow, a contribution that has been utilised for national development and the upliftment of the people of Sri Lanka.

BANKS' CONTRIBUTION TO THE ECONOMY IN 2006

Banks' expenditure	Rs. 17.64 billion
Of this, amount spent on wages / salaries, etc	Rs. 3.165 billion
Banks' tax contribution (PAYE, VAT, Income Tax and other taxes)	Rs. 1.872 billion

- There are 16,839 shareholders (Resident-16,654, Non Resident-185) the Bank pays in dividends each year.
- HNB Market capitalization Rs. 14,672 million.
- More than 4200 employees work for Hatton National Bank Ltd.



Income Tax	799 Mn *	42%
Provision for VAT	973 Mn *	52%
Debit Tax	9 Mn	1%
Payee Tax & stamp duty	91 Mn *	5%

* Provisional figures

CUSTOMER RELATIONS



Our customers remain the catalyst to our service ethos and we have strived throughout the years to introduce and initiate products and services that satisfy their financial needs and wants and foster long term partnerships spanning their whole life, from birth to the twilight years. Whilst most of our product and service enhancements and introductions are covered elsewhere in this Report, we detail below some of the other important aspects of our enduring service commitment.

LISTENING AND RESPONDING

Two Customer Satisfaction Surveys that gave the Bank a comprehensive and scientific feedback and analysis of customer satisfaction were conducted this year.

INTERNAL CUSTOMER SATISFACTION SURVEY

Conducted twice a year through the Regional Offices, the survey is randomly conducted among 50 customers of each branch to gauge service and delivery levels. The findings are the basis for the annual competition conducted by the Bank for the region-wise Inter-Branch Customer Service Award.

Responses received:(2006) 1,865

Aspects of Service rated as Excellent/V. Good

- Overall Staff Competence
- Courtesy of Branch Staff and Willingness to Help
- Accessibility to Senior Branch Officers

Aspects of Service where need for improvement is indicated (at some branches)

- Parking and other similar facilities
- Counter Service
- ATM Service
- Despatch of Current Account Statements & Debit/Credit Advices

EXTERNAL CUSTOMER SATISFACTION SURVEY 2006

TNS Lanka (Pvt) Ltd., the local subsidiary of a global market research agency, conducted this survey among 1,200 customers in the Personal Banking and Small & Medium Business segments drawn from Outstation Branches.

Results of the External Customer Satisfaction Survey

Overall Customer Satisfaction Index/Score (Out of a maximum of 120)	89
Customer Satisfaction Index/Score for Personal Banking Customers	81
Customer Satisfaction Index/Score for Small & Medium Business Customers	97

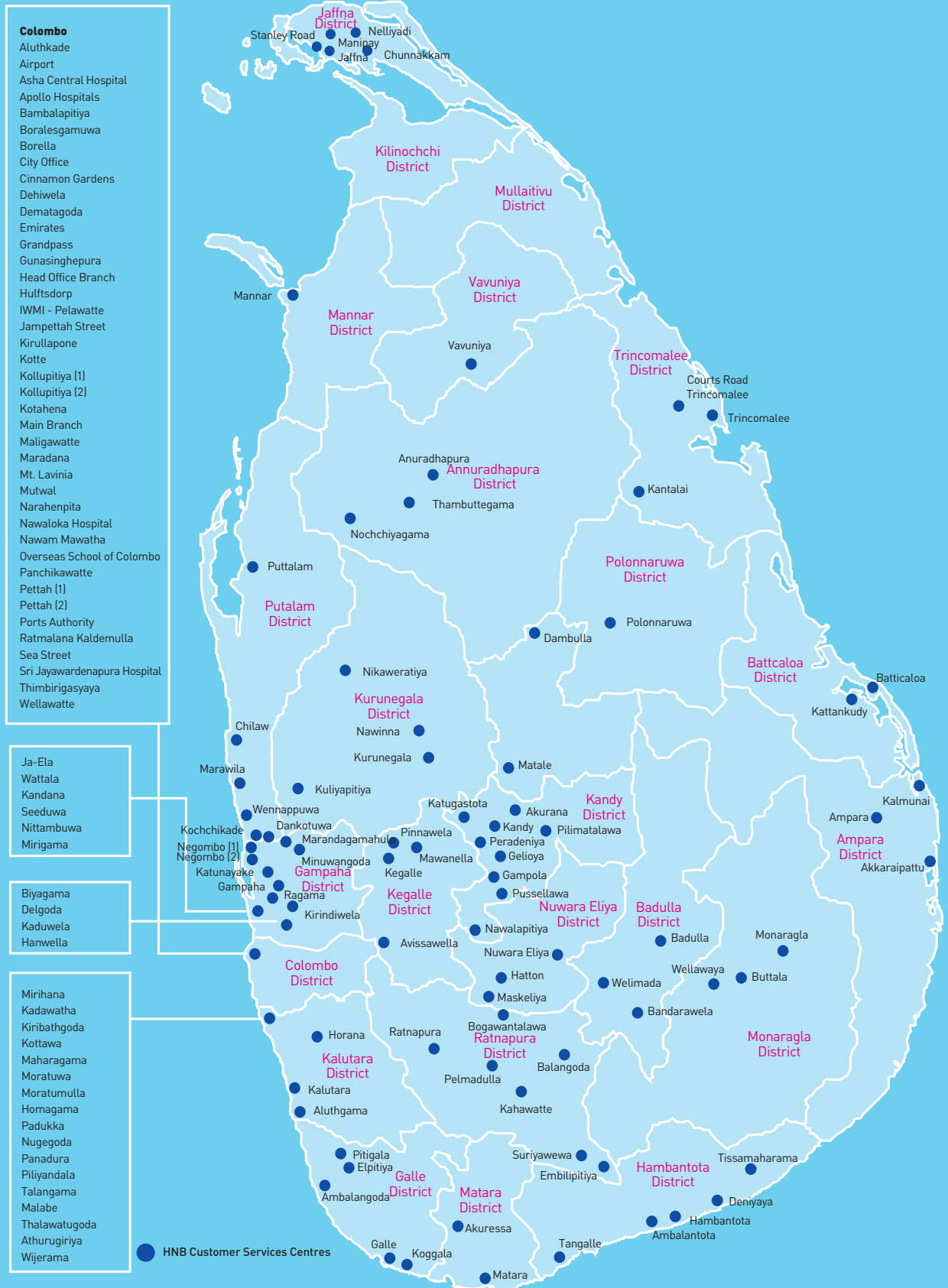
Other key findings of the Survey

Personal Banking Segment		Small & Medium Business Segment	
Strengths	Weaknesses	Strengths	Weaknesses
<ul style="list-style-type: none"> Staff Courtesy and Quality of Customer-Staff Interaction ATM Services General Image of the Bank as a Modern and Trustworthy Partner 	<ul style="list-style-type: none"> Delay in Credit Delivery Processes Response/Delivery Times(Other Products) - Not up to Expectations <ul style="list-style-type: none"> - Issue of Cheque Books - Issue of Cashline Cards - Despatch of Current Account Statements Unattractive Interest Rates for Savings Inadequate Customer Information (Regarding Products and Services) 	<ul style="list-style-type: none"> Staff Courtesy and Quality of Customer-Staff Interaction Courtesy and Accessibility of Branch Manager General Image of the Bank as a Modern and Trustworthy Partner 	<ul style="list-style-type: none"> Unattractive Lending Rates Security for Advances (Too Stringent & Complex) and Delivery Delays Professionalism of Branch Staff /Officers - Not up to Customer Expectations Inadequacies in the Technology Driven Delivery/Distribution Processes including ATMs Business Hours (Need to be Extended)

Action taken to address weaknesses in Service Delivery

- A major upgrade of the ATM operations is under way with network expansion and service enhancement
- Continuous staff training is being given top priority to enhance professional standards. About 15 training programs were conducted during the year on various aspects of credit for different categories of staff.
- Weekend banking has commenced at about 30 branches (including Colombo branches) to provide extended time for customer transactions.
- Action is being taken to improve parking facilities and other service logistics at branches.
 - Parking facility has been improved at three Customer Service Centres as a result of re-locations done during the year,
 - Two of the three new Customer Service Centres opened during the year have been provided with adequate parking facility,
 - Most of the new Customer Service Centres to be opened during 2007 will have adequate parking facility. This aspect is an important consideration now in identifying buildings/sites for new branches.

NETWORK STRENGTH



USING THE TECHNOLOGY ADVANTAGE IN A QUEST TO EXPAND PRESENCE

HNB has continued to use the advantages of our IT platforms to deliver superior services to our customers, which essentially reach out to all parts of the country.

The entire ATM network is being technologically enhanced and the implementation of this project is to be fast – tracked next year. 30 ATMs have already been upgraded. The daily cash withdrawal limit has been increased from Rs. 20,000 to Rs. 40,000 and third party fund transfers have also been introduced. We also expanded our ATM delivery network with two additional ATMs which takes our total ATM strength to 145 machines under the umbrella of the 'Anywhere Banking Facility' which we proudly espouse.

INTERNET BANKING

Total number of customers - end of 2006	5,191
Total number of customers - end of 2005	2,447
Growth over last year	112%
New services this year	Bill payments for HNB Assurance, Mobitel, Dialog, Lanka Bell, CEB and Celltel

SMS BANKING

Total number of Customers - end of 2006	1,099
Total number of customers - end of 2005	278
Growth over last year	295%

VALUE ADDED SERVICES – SMS BANKING

This is a partnership that was implemented with Mobitel for value added services including bill payments, pre-paid payments, credit card payments and fund transfers. Similar arrangements are being negotiated with Dialog Telekom for implementation in 2007.

EXPANDING PRESENCE

Accessibility to our products and services is a priority in our service delivery channels and expanding our presence remain at the top of the agenda. Our presence in all nine provinces enables us to reach out to even the most difficult parts of the country ensuring that our services are available equally to all strata of society. Three new Customer Service Centres were opened this year bringing the total number to 151. Our total ATMs now stand at 145 with the two new installations this year. 2007 will see approximately 15 new Customer Service Centres established and about 80 new ATMs installed either at new locations or as replacements to further augment our network expansion.

Awareness continues to be created through our network of 151 Customer Service Centres. A dedicated team of field staff of 109 Agri Officers and Gami Pubuduwa Upadeshakas assist with our activities in the rural areas especially in micro finance and micro savings.

Mobile campaigns were also carried out regularly this year through the Mobile Units via the nine Regional Offices. The new HNB Internet Portal, the Virtual Branch, SMS Banking for alerts on products, interest and exchange rates, direct mailers, leaflets, posters, brochures, banners, customized envelopes and extensive advertising in the mass media and promotional campaigns have also enabled customer information and awareness to be extensively and effectively cascaded. The ATMs too are being utilized for product information to be displayed with posters at the locations and some of the newly installed ATMs themselves providing customer information and advertising options.



Four e-Banking kiosks were installed during the year at specially selected locations to enable customers to perform their internet banking functions and access information on products and services at their convenience.

A successful initiative begun last year, Weekend Banking was extended to 15 more branches in Colombo and the outstations with a total of 30 branches now open for weekend banking.

OUR OVERSEAS PRESENCE

We continue to augment our presence overseas in order to ensure that the essential Sri Lankan spirit is permeated to those living overseas. Having already established Representative Offices in both Chennai and Karachi to facilitate regional trading activities and having HNB team members positioned in Abu Dhabi, Dubai, Bahrain and Kuwait in order to assist Sri Lankan expatriates working in those countries, this year we initiated the following to continue extending our services overseas:

- Launched Tele Money, a web-based remittance product of the Arab National Bank of Saudi Arabia and Fast Cash, also a web-based remittance product of the Currency Exchange Corporation, UK to promote remittances from UK and Australia.
- Signed Remittance Agreements with a leading banking Group with 1,172 branches to facilitate remittances from Italy to Sri Lanka.
- Also signed four other Remittance Agreements with Exchange Houses and Banks in the Middle East to facilitate easy remittances from the Middle East to Sri Lanka.

GIVING MORE

Our team remains constantly aware of the necessity to stay ahead in a challenging environment and is in constant pursuit of innovativeness in conceptualising, creating and imparting service excellence. To aid this single minded philosophy of being a leader, our training and development processes incorporate programmes that emphasize customer service as an essential ingredient to the Bank's sustainable success. As an example, this emphasis led to an unprecedented 66 special training programmes being conducted specifically on customer service and its rudiments, with other training programmes also incorporating some modules that detail the concept of service excellence.

DEVELOPING STUDENT BANKERS

One of our most significant achievements has been the inculcation of the savings culture among students through Singithi Accounts which gives them an overarching knowledge of rudiments of banking as they are also encouraged to manage their own accounts, create awareness among other students and participate in banking activities. This spearheaded the formation of a Student Bankers' Association in 2001 comprising Student Managers from 32 Colombo and suburban schools. Under the aegis of HNB, the Student Bankers have earmarked community projects over the years while also fostering the spirit of teamwork through sports and extra curricular activities. This year, the Association organised a six-a-side Cricket Tournament to foster fellowship among its members with eight schools participating and the unique feature of a women's cricket match added to the lustre and appeal of the event. Members of the Sri Lanka Cricket Team were present at the tournament to make presentations to the winning teams and sign autographs.



HNB PATHUM VIMANA

Conducted continuously for 14 years is yet another example of successful customer relations. HNB Pathum Vimana is a unique rewards programme that has seen customers win houses, luxury cars, and a whole range of durables and cash. This year, HNB Pathum Vimana broke new ground with its launch as a TV Game Show, with 22 Pathum Vimana Account Holders picked at random monthly and invited to compete in the Show, where each winner is presented with a cash prize ranging from Rs 10,000 to Rs 200,000.

EQUAL ACCESS FOR ALL

We also remain conscious of granting equal access to anyone who visits the Bank and are in the process of making our branches accessible to all and empathically welcoming those customers requiring some assistance with mobility to conduct their banking transactions with the minimum hassle. This year, we reconstructed ten more branches to meet with this ideal and aim to extend this concept to 34 more branches next year.

CUSTOMER EDUCATION

Developing/improving customer knowledge, awareness and skills were further encouraged this year with the organization of:

- A special presentation on treasury products to about 50 corporate customers by the Treasury Division.
- An international trade seminar styled as 'International Trade – The Future' for about 125 corporate clients.
- A Customer Awareness Programme/Workshop by the Development Banking Division for about 60 small entrepreneurs in Kalutara, aimed at enhancing the technical knowledge of these entrepreneurs.
- Student Banking Convention 2006 - With a view to enhance the information technology skills of school students who are exposed to and familiar with the banking function, the HNB Student Bankers' Association organized a seminar for three hundred students. Chosen as they indicated an interest in the Banking industry and functioned as Student Managers attached to Singithi Savings Units in schools in and around Colombo and its suburbs, the focus of the seminar was to create further interest in the sector. The seminar consisted of four sessions conducted by IT specialists who spoke on the importance of IT in the modern world. Recognizing a possible dearth in banking expertise in the future, the Student Bankers' Association proactively organizes similar events to enhance the attractiveness of the industry to future career seekers. The Association has been functioning for over five years and has been instrumental in identifying and formulating a series of training and development programs for the benefit of the student population of Sri Lanka.



COMPLAINTS HANDLING

A systematic and vibrant complaints handling process is implemented under the Financial Ombudsman Scheme and it is handled by the specially dedicated Complaints Handling Unit established at Head Office. The Unit has resolved 134 complaints this year, while 8 complaints referred to the Independent Financial Ombudsman have also been resolved satisfactorily. Most of the complaints received from customers related to the following:

- Loans related issues - delays and refusals
- Cheque returns and other issues arising from the newly introduced Cheque Imaging and Truncation System
- ATM related issues/problems
- Customer handling and counter service

CUSTOMER SAFETY & SECURITY

HNB follows stringent guidelines on safety requirements at all our Customer Service Centres based island wide.

Branches which are specially designed with safety being a priority are equipped with appropriate fire fighting devices and other safety equipment. Fire drills form a part of the Training & Development calendar with all employees thoroughly conversant to cope in case of emergencies.

Specially trained armed security guards are also in attendance during business hours at 107 of the 151 Customer Service Centres and all Customer Service Centres have 24 hour security provided by professional security firms. All on-site ATMs are covered by CCTV cameras.

SMS Alerts give customers the unique added benefit of instant information on credit card transactions. This is a free service already enjoyed by about 7,500 of our card holders. Firewalls, passwords, PIN numbers and internal information access controls are also in place to ensure exceptional IT security.

Funds lying to the credit of dormant or deceased accounts are especially protected with the segregation of such accounts and appropriate restrictions placed on the reactivation process. The account mandates of these accounts are secured in the vaults of the Bank under the custody of the Branch Manager.

IGNITING THE ENTREPRENEURIAL SPARK OF ECONOMICALLY CHALLENGED CUSTOMERS

HNB's flagship micro finance programme, Gami Pubuduwa continues to be the lifeline in reawakening villages towards development and sustainability. Using both social and commercial dimensions in this unique programme, Gami Pubuduwa empowers poor rural communities to embark on entrepreneurial ventures, funding and advising these entrepreneurs to ensure sustainability of the ventures. Corporate Management undertook a field tour to obtain first hand experience of the rural entrepreneurs under the Gami Pubuduwa scheme in the Dambulla and Sigiriya areas.



MICRO INSURANCE WITH HNB ASSURANCE

A unique micro insurance product was launched this year in partnership with our subsidiary HNB Assurance, the first of its kind in Sri Lanka that covers both life and the loan liability of the borrower. All micro entrepreneurs under the Gami Pubuduwa umbrella are eligible. One of the most notable features of the insurance scheme is that the Bank bears 50% of the single premium and in the event of death or total disability, HNB Assurance will settle the outstanding liability on the loan to the Bank, while also paying the sum assured to the next of kin of the customer.

More information on sustainable Gami Pubuduwa programmes is detailed under Community Relations.

Mr. Upali Jayalal Fernando, a customer of HNB Moratumulla Branch, lost his entire family, except his 8-year-old daughter to the train catastrophe during the tsunami. HNB, which has always instilled the caring partner in progress tenet to its stakeholders, wrote off all outstanding loans which would otherwise have been a financial burden on the customer's family, while also giving protection to the orphaned daughter by reverting the title of the mortgaged property in her name.



EMPLOYEE RELATIONS



Our people continue to be the nucleus to our existence and sustainable success, ensuring that continuous improvement, upward mobility, creativity and innovation become the formative trusses for the umbrella of customer service excellence which is inbuilt at the very core of our operations. The upwardly mobile facet is augmented by:

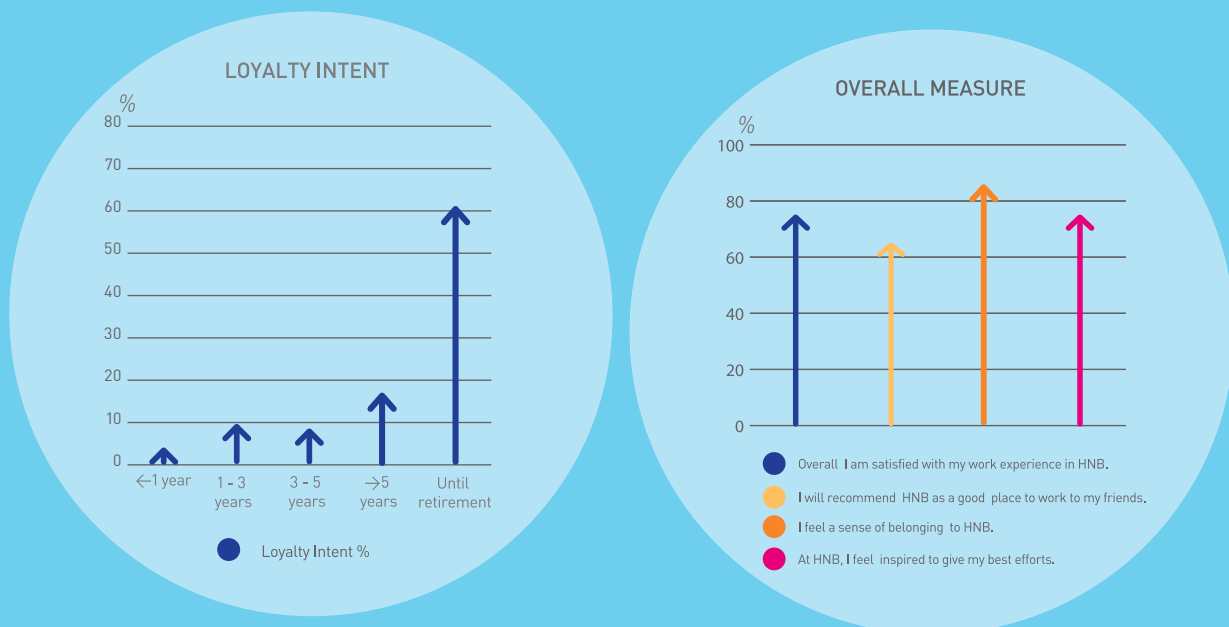
- Creating a culture and an understanding that emphasizes individual and organizational growth which includes continuous professional development, acquisition of skills and capabilities and managing attitudinal and transformational change.
- Implementing a measurement based performance driven culture with rewards and career progress linked to performance.
- Creating a sense of ownership to inspire individual career aspirations towards alignment with organizational vision with a participatory bottom-up management framework aiding the process. The SEARCH suggestion scheme, Quality Circles, In-house publications and Cross Functional committees representing the team at all hierarchical levels give impetus to this.
- Continuous training and development on and off the job is assisted by comprehensive skills inventory and regular performance appraisals which identifies strengths, weaknesses and avenues to bridge gaps.
- Harnessing a cordial relationship through harmonious industrial relations and assisting team members during crisis.
- Identifying the Best Branch, region wise, to support the concepts of leadership, teamwork and high productivity.

Believing strongly that an united and harmonious working environment will always herald better productivity and higher performance, we have striven to inculcate the 'Hatna Family' concept among our team members. The Share Option Scheme complements the ownership principle and ensures a sense of belonging.

KEY INDICATORS THAT ILLUSTRATE MEETING OF HR GOALS

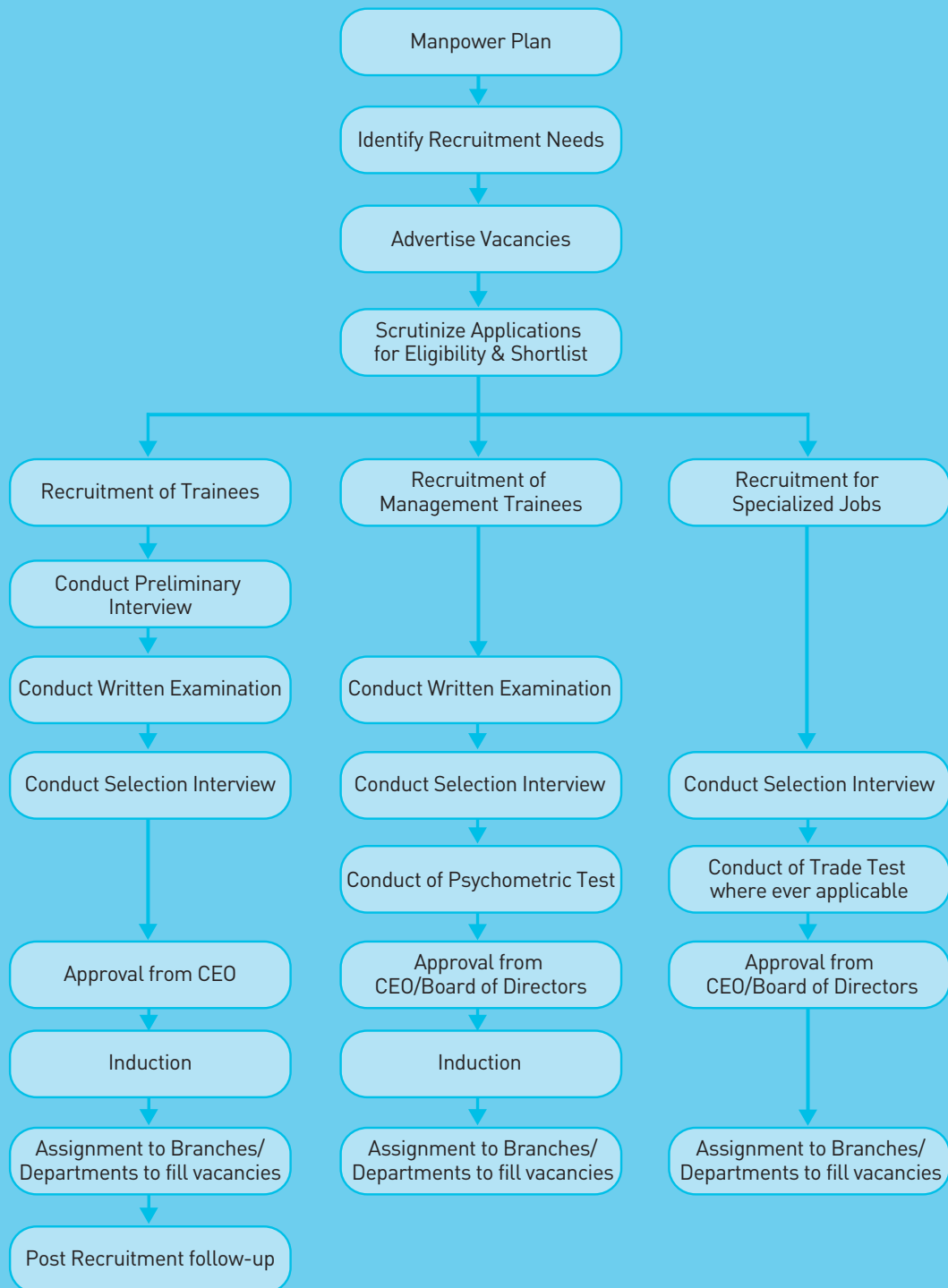
- A competent, committed and contented workforce demonstrated by the Employee Satisfaction Survey carried out in partnership with Ma Foi this year.
- A professional target-driven team equipped with the required competencies, skills and knowledge to optimize their performance.
- HNB is considered one of the preferred employers in the financial services industry in Sri Lanka.
- Fast career progression exemplified by a relatively young managerial team.
- Employee turnover at senior management and corporate management level remaining at a low 1.67%, indicative of the Bank's ability to retain these specialist jobs and meet career goals and aspirations.
- No industrial disputes for the last six years due to timely signing of Collective Agreements and remuneration and rewards remaining above market rates.
- Remaining mindful of all ILO conventions and maintaining internationally accepted labour standards.
- Emphasis on creating an enabling culture for the differently abled.
- An equal opportunity employer that works on stringent meritocracy rules.

EMPLOYEE SATISFACTION SURVEY



RECRUITMENT PROCESS

Bestowed with the label of being a preferred employer in the financial services industry, HNB always espouses the credo of being an equal opportunity employer whose recruitment, promotion, rewards and remuneration features remain transparent and built on meritocracy. At executive level, we strive to build an internal succession concept identifying promising personnel from our branch network.



TRAINING & DEVELOPMENT

Creating a learning culture on the foundations of knowledge, skills and competence, enhances our ability to create a motivated team which we firmly believe is necessary for us to meet our determined goals. Training and Development therefore, remain an integral factor to personal, professional and corporate growth. The in-house training plan, formulated by the HNB Training Centre is designed in accordance with the Training Needs Analysis which is compiled based on information, data and recommendations received through performance appraisals and questionnaires filled in by heads of department and regional managers.

The overarching factors integrated into the HR training plan include:

- The need to train and develop a team aligned to the vision and mission of the Bank,
- Strategic focus given to business growth, cost management, HR, productivity, control and compliance, portfolio quality and customer care,
- The need to develop managerial competence among executives and supervisory staff,
- Continuous training on service quality and achieving customer service excellence levels,
- Create a marketing and selling culture,
- Understand the importance of self management in realizing individual and organizational objectives,
- Pursue multi-skilling to support succession planning and job rotation.

More trainers were also mobilized during the year to implement and achieve the far reaching goals of the Training Plan, which included a total of 172 internal and external training workshops, retreats and programmes covering a total of 3789 team members over 2432 training hours which was supported by a comprehensive e-learning system. The main T&D programmes conducted by HR this year were focused around the subject areas of Management/Leadership, Operations, Credit, International, Skills Development, Information Technology, Self Development and Customer Care. Stepping up the emphasis on customer care, we conducted an unprecedented 22 programmes within the branch network on customer service this year and in complementing the holistic features of our training, also held a series of programmes on Personal Grooming and Image Building in 15 branches.

Category	No of staff trained
Corporate Management	22
Senior Management	110
Management	68
Executives	452
Junior Executives	1084
Banking Assistants	1226
GPUs	188
Stenos, Typists	199
Confidential Secretaries	30
Trainees	247
Support Staff	163

One of the most significant features in the programmes conducted by our Training Centre this year was the first ever international training programme in Male for 40 staff of the Bank of Maldives, a definite testimony that our training methodologies and processes are being recognized beyond the shores of Sri Lanka.



INCORPORATING IT INTO THE HR PROCESS

To further facilitate our HR goals, we launched a number of initiatives including an in-house developed Training Management System to aid training for self development and increase productivity within the Training Centre.

A new interface will be introduced into our e-learning modules next year linking all 150 branches online. The interface aids faster access and a host of new features to enable location based training with interactive modules. Comprehensive details of all courses, chat rooms, Q&A sessions and mock examinations for preparation are currently included in the feature and in the future, online examinations and virtual classrooms will also be facilitated. We already have 2,700 team members registered online for e-learning facilities with daily usage a commendable 200 hits which is an indicator of the success in using IT as a platform to enhance knowledge development.

This year, we enabled all executive staff to have online facilities to aid performance management, in order to give them first hand insight into the training required for their job profile, their current skill

status, requirements for the future and training programmes currently in place. These details are also available to HR in the process of streamlining training needs efficiently and speedily.

Performance evaluation is also being performed online from this year. This brings transparency into the evaluation process. All Executives are rated on merit based on individual Balanced Scorecards and core competencies. A performance accountable system ensures that qualitative results and target based evaluations are linked and balanced. Target achievements focus on financial rewards and promotions while the evaluation of core competencies forms the basis for personal development reviews leading to skill and knowledge development and the competencies available for particular job roles, job rotation, job changes etc.

BRINGING THE HATNA FAMILY TOGETHER

On the firm belief that contented people make a happy and productive workplace, the Bank continues to have annual and periodic events that bring the entire team and their families together. Hence, while the Bank strives to become a knowledge centre for its Team to improve and develop professionally, we also encourage participation in extracurricular activities to ensure a holistic people development aspect into the workplace.

A healthy workforce remains a priority and the Bank has now opened the facilities of its Gymnasium within the Head Office building and also conducts regular health awareness programmes.

SCHOLARSHIP SCHEME FOR HNB EMPLOYEES' CHILDREN

This year the Bank finalized the introduction of a scholarship scheme for children of employees who have excelled at district level at the GCE A/level examination. The Bank has provided an investment of Rs 25 million initially for this purpose, with upto 15 scholarships to be disbursed annually under this scheme, to enable University education.

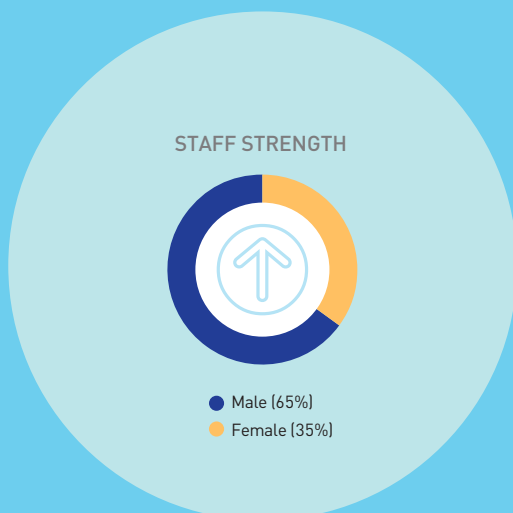
FELICITATING BEST RESULTS

For the first time, an employee's child Master B M K Fernando, obtained an all island ranking with the second highest marks at the GCE O/level examination 2005. A modest ceremony was held at the MD/CEO's office in June 2006 to felicitate the student with a gift of Rs 50,000 credited to his Singithi Account.



EMPLOYEE AND FAMILY EVENTS

- Sports fiesta covering the regions
- Bhakthi Gee
- Christmas Carols and Christmas Party
- 25 year service awards



WORK / LIFE BALANCE - OUR ACHIEVEMENTS THIS YEAR

CRICKET

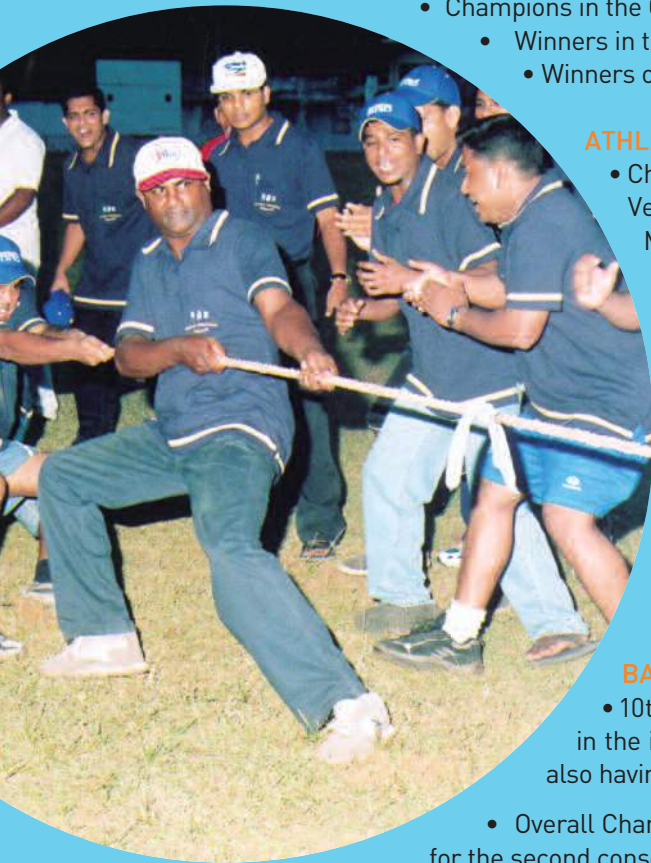
- Triple Champions in Mercantile Cricket.
- HNB A Team toured Singapore and won the trophy against Lanka Lions SC.
- Organised Inter-bank six-a-side Cricket tournament in July.

SOCCER

- Triple Champions in Mercantile soccer winning the Mercantile Knockout A Division, Mercantile Seven-a-side Championship and Mercantile League A Division Championship.

NETBALL

- National Champions in Netball for the 11th consecutive year, we also won several Championships in Netball in 2006.
 - Champions in the Open Club Netball Tournament.
 - Winners in the Deluxe Ronuk Trophy A Division.
 - Winners of the Mercantile Netball Challenge Trophy.



ATHLETICS

- Champions in the Novices category, First Runner Up at the Overall Veterans Event and Second Runner Up Overall at the Athletics Meet 2006.
- Sponsored Dhammika Menike whose Sri Lankan records in the 800m and 1500m set in 1992 remain unbroken, for the Thailand Open Master Athletic Championship in March 2006. She won a gold medal in the 800m and a silver in the 1,500 m 35 to 40 age group. She also set a new record in the 400m at the National Master Athletic Championships in the same age group.
- Sponsored Dulal Dalpathado to the Asian Master Athletics Championships 2006 held in Bangalore in November. He won a Gold Medal for the High Jump event in the 50 to 55 age group.

BADMINTON

- 10th South Asian Games – Two team members won Bronze Medals in the individual event and a Silver medal in Ladies Doubles with one also having participated in the Indian Satellite Championship.
- Overall Champions in Mercantile Individual Open Badminton Championship for the second consecutive year.

BASKETBALL

- Champions in the Mercantile five-a-side tournament.

HOCKEY

- League Tournament champions in Mercantile Hockey Association Tournament.
- Seven a side tournament champions in Mercantile Hockey Association Tournament.
- Bronze medals won by team members at the South Asian Games 2006.

TOASTMASTERS' SPECIAL

Two of our team members now hold key positions in the main body of the Toastmasters' Club with HNB having begun a Toastmasters' Club three years ago, a testimony to the success of this initiative of setting up the club.

FUTURE PLANS

We aim to leverage on the human development initiatives we have already implemented to ensure the continued development of individuals within a performance oriented culture. Knowledge, competency building and empowerment will be key thrust areas that human resources will link to business. We remain acutely conscious of the need to extract the best from our team and impress upon them the role they have to play in sustaining the business. This can only be achieved through a thorough understanding of the organization they work in.



INVESTOR RELATIONS



The year has seen HNB create new history! The Bank has been judged on its adherence to global standards, prevalent industry standards and conformance to stringent governance diktats. The Bank has displayed its resilience in a volatile economic environment through astute decision making and sustainable leadership, which translates into long term partnerships with our investors who are confident of the stability of the organisation and the transparency and accountability that form the firm foundation of the Bank.

BRACKEN AWARD – SRI LANKAN BANK OF THE YEAR 2006

Adjudged by the prestigious publication, 'The Banker', at a glittering ceremony held in London in November this year, HNB accepted the coveted Bracken Award as the Bank of the Year 2006 for Sri Lanka. Assessed on stringent criteria from among the leading banks operating in Sri Lanka and overseas including incorporating performance indicators, qualitative achievements and strategic business initiatives, HNB has also proven to have broken new grounds in efficiencies, effectiveness and profitability.

ANNUAL REPORT AWARDS 2006

HNB was placed 2nd Runner Up in the Banking Institutions Sector category at the Annual Report Awards 2006 organised by the Institute of Chartered Accountants of Sri Lanka.

LMD 50 RANKING

HNB went up two positions in the LMD 50 Leaderboard 2005/6 Ranking in the results published in the LMD December 2006 issue, akin to Sri Lanka's version of THE FORTUNE 500. HNB also had the distinction of leading the banking sector, retaining its leading listed bank tag for the second consecutive year.

In addition, in the December 2005 issue of LMD, in a survey conducted by Sting Consultants and Brand Finance, HNB was ranked as the No 1 Brand in the financial sector and the third leading brand in the country with top of the mind recall.

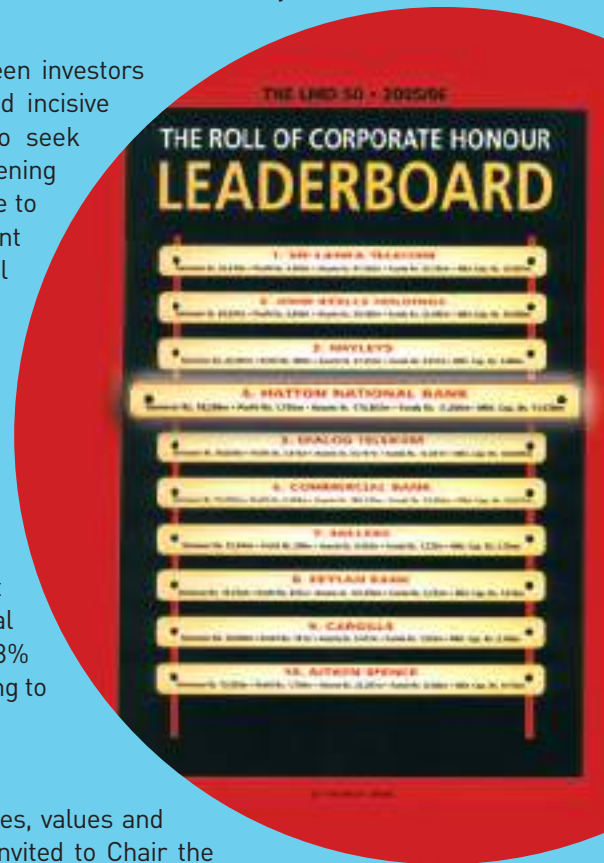
HNB was also ranked amongst Top 10 of the most reputed entities in Sri Lanka for 2006 by LMD.

A proven track record of tangible and sustainable growth has seen investors enjoy consistency, stability and a certain sense of innovative and incisive thinking for the future which has held HNB in good stead to seek opportunities to enhance growth. Focused on building and strengthening investor relations to ensure that HNB would continuously add value to investment while also minimizing risk and adhering to stringent governance principles, HNB strives to create a relationship of mutual trust, strong ethics and values and consistent growth.

Thus being acknowledged by the industry and others with accolades including being named among the Top Ten Leaderboard of the LMD 50, being acknowledged internationally by The Banker as the Bank of the Year 2006 in Sri Lanka and the HNB Brand being ranked first in the financial sector and third as the leading brand in the country according to Brand Finance UK and LMD Sri Lanka have certainly been added imperatives that would encourage investors to perceive HNB as a bank with a robust investment potential. With profitability rising significantly, improved capital formation supported by better asset quality and increased ROA of 18% year on year, Fitch Ratings upgraded HNB's national long term rating to A+ (LKA) this year.

ASIAN BANKS' ASSOCIATION CONVENTION

HNB's path of progress imbued with its good governance principles, values and ethics were further acknowledged this year when the CEO was invited to Chair the Technical Session of Financial Sector Reforms at the Asian Banks' Association (ABA) Convention in Taipei. The ABA includes a membership of 120 leading banks from the Asia Pacific Region, with this year's convention having the participation of over 200 senior bankers from South, South East and East Asia and presentations from eminent regulators and industry practitioners.



ICICI "INDIA UNLIMITED" ANNUAL CONFERENCE

HNB was invited for two successive years to profile the Bank at ICICI's annual profiling of top corporates from India and other South Asian countries. At the annual conference, some of the leading fund managers from the region attend to get an insight view on the corporate. The event is attended by such prominent personalities as Marc Faber, Central Bank Governors, Finance Ministers and CEOs of top corporates in India. HNB is the only Sri Lankan bank to be profiled at the conference. This stems from the special relationship HNB and ICICI Securities fostered three years ago.

SHARING THE EXPERIENCE OF MICROFINANCING IN GERMANY

HNB strengthened its ties with Germany in 2006. At the invitation of the Savings Banks Foundation for International Cooperation (SBFIC), the HNB management team took part in a ten day visit to Germany to share the experience of micro financing in Sri Lanka. The co-operation between the two institutions was increased beyond tsunami reconstruction work. The visit enabled HNB to develop links to further strengthen the micro finance sector, develop a partnership for remittance from EU member countries, learn the latest trends in the IT industry and share resource persons on specific training programs.

HNB first entered into a partnership with SBFIC in August 2005. The initial goal was to assist micro and small entrepreneurs by providing financial assistance to help reconstruct their businesses and uplift economic/employment activities in areas affected by the tsunami.

To date, the Bank has provided financial assistance to 1,907 entrepreneurs amounting to Rs 469 million. As a result of this initiative, approximately 5,000 new employment opportunities were created and 7,000 families (directly and indirectly) affected by the tsunami benefited from the partnership micro finance program.

HNB SHARELINE CARD - AN ADDITIONAL BENEFIT TO SHAREHOLDERS

HNB's unique Shareline Card to all shareholders enables numerous benefits that would complement the returns our shareholders gain from the Bank. HNB Shareline exempts cardholders from annual and registration fees for local and Gold Mastercards and half yearly fees on current accounts. The card also ensures VIP treatment at all HNB branches and easy access to front office services. In addition, commission is not charged for the issue of travelers cheques, drafts and standing orders and no internal documentation fees will be levied for facilities above Rs 1 million.



INDICATORS THAT DEPICT THE SUSTAINED GROWTH OF HNB

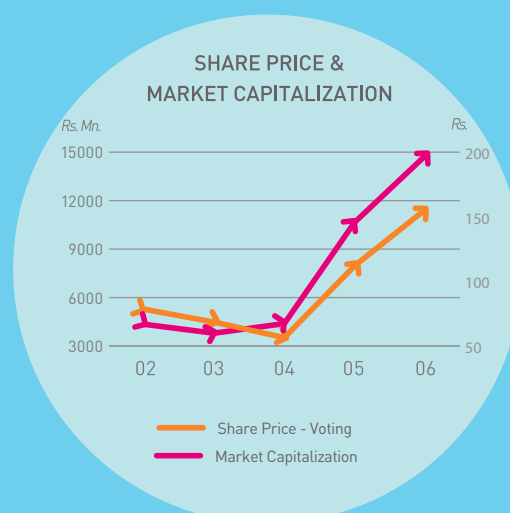
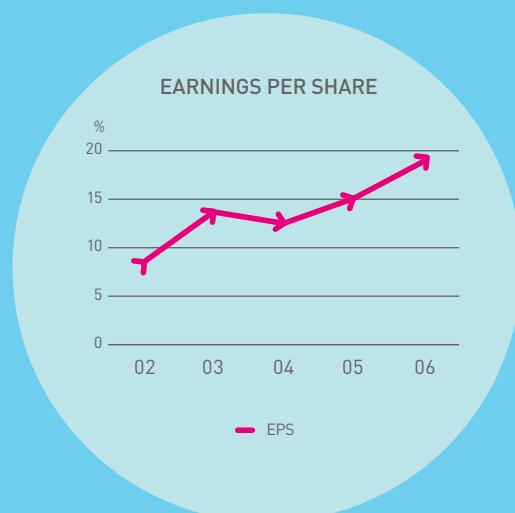
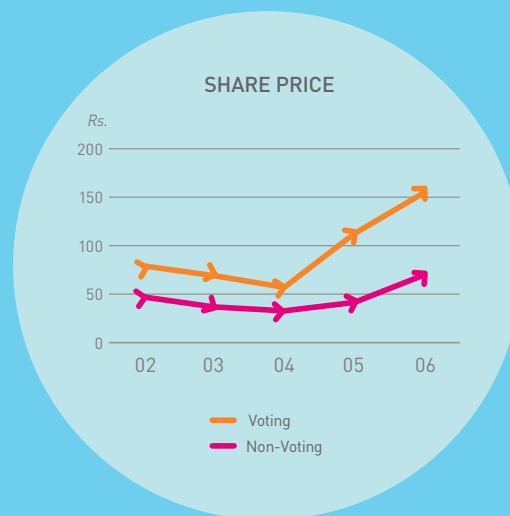
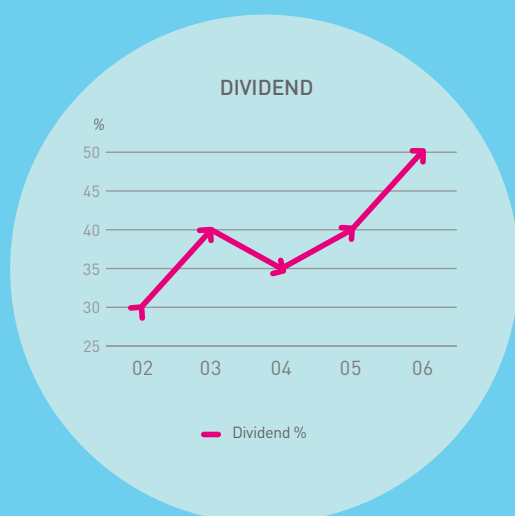
	2002	2003	2004	2005	2006
EPS	8.00	13.69	12.51	15.09	18.86
Dividend yield (%) - Voting	3.80	5.80	6.14	3.56	3.21
Dividend yield (%) - Non Voting	6.38	10.88	10.69	9.64	7.14
Asset Growth (year on year %)	16.45	15.50	14.59	8.66	18.32
Holding Period Return - Voting (%)**	73.46	(7.59)	(10.29)	104.39	42.89
Holding Period Return - Non Voting (%)**	52.78	(13.30)	-	38.93	80.72
Operating Cost - Efficiency Ratio (%)	72.80	63.20	70.35	62.29	66.11
Share Price - Voting	79.00	69.00	57.00	112.50	155.75
- Non Voting	47.00	36.75	32.75	41.50	70.00
Dividends	30%	40%	35%	40%	50%*

* Inclusive of final dividends of 25% for year 2006 (To be approved at the AGM & payable on 10th April 2007).

** No. of shares in year 2000 is assumed to be 1000

	2004	2005	2006
Market Value Addition (Rs. Bn.)***	(4.1)	0.2	3.2
Economic Value Addition (Rs. Bn.)	(0.7)	(0.6)	(0.8)

*** For market value addition the share price of GDR is considered as equivalent to the local market price of shares.



SUPPLIER RELATIONS



HNB has always emphasized on long lasting partnerships among all stakeholders and valued business partners too come under this umbrella. We believe that our platform should be driven on a qualitative relationship that espouses values, ethics, integrity, transparency in processes, value for money and cohesive but open dialogue. We have striven to instill the tenets of quality products and services being imparted from our suppliers through constant interaction and relationship building. We firmly believe that being a leader in the banking industry in Sri Lanka, examples and benchmarks must be set by us for others to emulate and have emphasized the need for our suppliers too to work together with us on this strategy.

All suppliers are required to register with the Bank, encouraging micro, small and medium organizations also to apply.

The entire selection process remains absolutely transparent with each step documented and available for inspection at any time.

The selection process for procurements above Rs. 100,000/- is by tender and entails the following:

- Tenders are called for on a cyclical basis to enable a fair and just chance for all suppliers to tender,
- Procurement procedures are conducted according to a streamlined framework which remains transparent right throughout the process,
- The primary criteria for awarding the tender is tabulated on the quality of the product and the price quoted.

Prior to supply of goods stringent verification procedures including supplier audits are implemented at the time of registration. On delivery, the following is done:

- Physical verification of items delivered,
- Sample testing of the products,
- Quality of paper based supplies tested with a GSM machine,
- Inspection of large suppliers' factory or source.

These procedures have ensured that the quality of products supplied to HNB remains superior and that in the event of the products not meeting the stringent quality standards that HNB promotes, suppliers are required to rethink their quality strategies and processes, which have resulted in the subsequent improvement of the end product.

COMMUNITY RELATIONS



Community relations are an integral aspect of taking the concept of sustainability to a higher realm. Our team is aware of the importance of building relationships among the communities we operate in, the impact our decisions will have on the community and hence hedge our community projects towards the betterment and sustainability of those communities, rather than on a philanthropic course of action. The primary platform that HNB builds its community relations is on sustainability of the community.

MICRO FINANCE AS A SUSTAINABLE TOOL

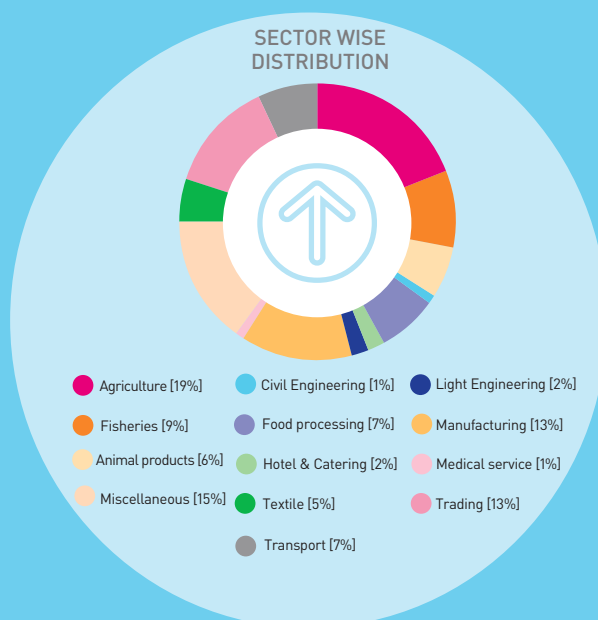
SAVINGS BANKS' FOUNDATION FOR INTERNATIONAL CO-OPERATION (SBFIC)

HNB, through its partnership with SBFIC, which is the advisory body to one of the largest financial groups worldwide housing an umbrella of 489 Savings Bank Groups and joint institutions, assists micro and small entrepreneurs directly or indirectly affected by the tsunami to reposition their livelihoods and reconstruct their businesses. Joint awareness programmes were conducted by HNB and SBFIC aimed at giving more impetus for micro entrepreneurs to re-establish themselves in a sustainable vocation. Corporate management and a group of journalists too visited the sites to gain first hand information.

Initial refinance funding fully utilised within one year	Euro 2 million
Second partnership agreement in progress	Euro 3 million
Directly financed	1,907 projects
Existing portfolio	Rs. 451 million
New employment opportunities created	5,000
Families benefited	7,000 approx.

The Distribution of micro finance projects funded through SBFIC are given below:

Category	No of Loans	Amount (Rs Mn)
Agricultural	345	62.4
Fisheries	178	40.6
Animal products	113	10.4
Civil engineering	24	8.6
Food processing	142	29.9
Hotel & Catering	47	22.3
Light engineering	43	11.6
Manufacturing	252	65.5
Medical service	12	5.9
Miscellaneous	272	83.7
Textile	94	25.0
Trading	248	68.2
Transport	137	35.1



GAMI PUBUDUWA

As mentioned earlier, the unique Gami Pubuduwa Micro Finance Scheme, which completes 17 years in 2006, emphasizes the fundamentals of sustainability, harnessing the entrepreneurial spirit of poverty stricken villagers and empowering them towards their own development and thereby their own communities. Gami Pubuduwa comes under HNB’s Micro Finance Banking Scheme which essentially began in 1973 as a rural village upliftment programme and migrated to the flagship programme of Gami Pubuduwa in 1989.

Total Number of Projects financed - cumulative	65,000
Total Exposure	Rs 3.5 billion
Existing Portfolio	Rs. 1.84 billion
Existing portfolio caters to	14,812 projects
NPA Rate	4.9%

The objectives of Gami Pubuduwa include sustainable development of the rural community via funding, skills and community development, building sustainable relationships between HNB and the community, positively contributing towards micro sector sustainability through total financial solutions, technical advice and assistance and seeing contribution from the micro finance sector contributing to bottom line growth. The critical success factors in micro financing have been customer focus, innovation, teamwork, sustainability, outreach, cost effectiveness and risk management.

EMPOWERING WOMEN IN MUKKUTHODUWAWA – INVESTMENT RS 2.1 MILLION

On a unique initiative, the spouses of the fisherfolk in a poverty stricken village whose source of income decreases during the fishing off season, were granted micro loans through the Women's Society. In a bid to supplement the meager fishing income affected drastically due to the vagaries of the weather, 39 women have been initially granted loans totalling Rs 2.1 million accommodated under the German Savings Bank Foundation for International Co-operation Credit Line. This is the fifth time that loans have been granted via this society to the women of this village.

CONSTRUCTION OF CAUSEWAY BRIDGE – INVESTMENT RS 200,000

Signifying the essence of teamwork, a group of Gami Pubuduwa Field Officers in association with the Avissawella branch volunteered cash, time and energy to construct a small causeway bridge for the benefit of the villagers in Hingurana, 20 kms to the interior of Deraniyagala town. With the village being essentially dependent on agriculture, a motorable road was a dire need to transport produce and the timely action by the team has been lauded by the villagers. The bridge was declared open in February 2006.



VALUE ADDITIONS TO INCREASE OUTREACH

Innovativeness being one of the key factors in the longevity and sustainability of the micro finance programme, HNB continues to conceive, craft and design products and services that will continuously add value to the existing product.

- Partnership with post offices in remote areas for credit delivery, repayment and savings mobilisation.
- Mobile ATMs in rural areas.
- Convenient migrant remittance channels through the Internet Money to Home system.
- Online loan approval system.

MADURU OYA REAWAKENED – INVESTMENT RS 6.1 MILLION

The poverty stricken fishing village of Maduru Oya in Padiyathalawa was completely 'reawakened' to celebrate the Shanthi Housing tenth anniversary. Having observed the abject poverty prevalent in the village due to the Bank's involvement in the project 'Help Protect Maduru Oya Inland Fishery Project', the team was spurred into action to construct 28 homes and equip the fishermen with 70 fishing nets through micro finance support, construction of a library for the village school and a trading centre for the Maduru Oya fishing village. The reason for the dwindling income among the fishermen was due to the use of inappropriate fishing nets being used for fishing in the tank, which disrupted the breeding cycle and thus destroyed the inland fishery population. The Bank continues to monitor and impart technical advice to the fishermen to ensure that correct methodologies are used in their vocation for a sustainable balance of economy and environment. The library constructed for the village school is now a new building under the HNB Nena Pubuduwa 100 library project.

Utilising the funds usually allocated by HNB for the Wesak greeting advertisements in print media, a home was constructed for Y A Kusumalatha in Kirindiwela who has to look after her very ill mother, while living in abject poverty with no permanent income.

EMERGENCY RELIEF FOR REFUGEES – INVESTMENT RS 1 MILLION

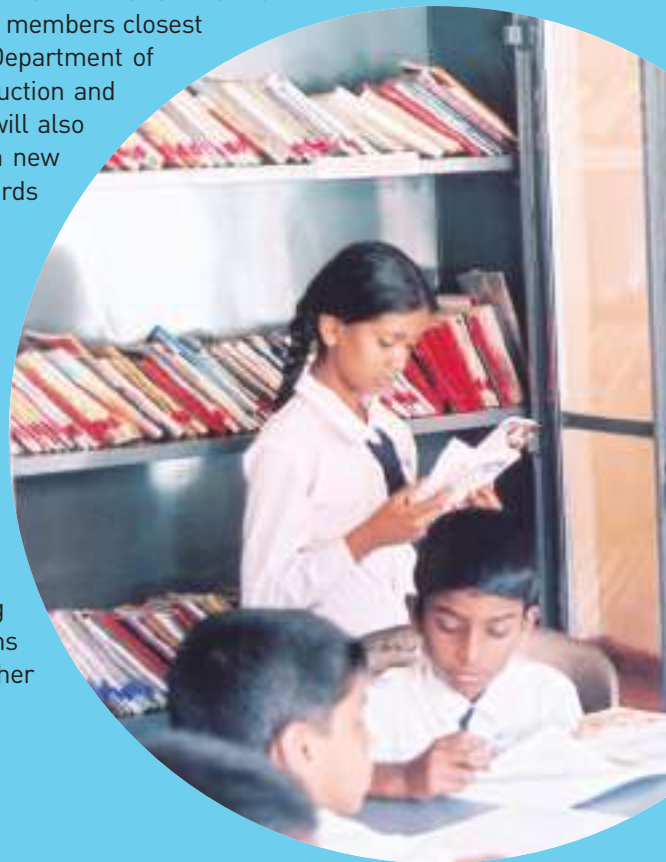
HNB was the first bank to initiate a relief programme for refugees in the Mutur and Kinniya areas, left stranded and bereft due to resumed fighting in the North and East during August 2006. Essential items including dry rations, clothes, medicines and recreational items were transported to the refugee camps in Trincomalee and Kantale facilitated under the Bank's Emergency Relief Operations operated by the HNB Customer Centres in the areas affected. This was a team effort that brought together the Hatna Family under the unifying umbrella of caring for fellow human beings, irrespective of caste, creed or religious beliefs.

RECONSTRUCTION OF THE TANK AND DEVELOPING THE VILLAGE – INVESTMENT RS 2 MILLION

The 431 underprivileged families in a farming community located in the small village of Mankadawela had to make ends meet with a neglected 300-year-old water tank. The tank is the lifeline for 250 acres of paddy. With the participation of team members closest to the area, the Anuradhapura Irrigation Engineer and the Department of Irrigation, HNB has now identified the need for the reconstruction and rehabilitation of the entire infrastructure of the tank which will also include four canals and three bathing areas. This will give a new lease of life to the deprived village and will direct them towards sustained livelihoods and better sanitation.

'NANA PUBUDUWA' – 100 SCHOOL LIBRARY PROJECT – INVESTMENT RS 8.1 MILLION

A laudable corporate social responsibility exercise being implemented on the platform of education, HNB's 100 school library project initiated last year saw 94 libraries completed by December 2006. Schools, especially those in impoverished villages around the country, were identified and given this impetus of knowledge gaining ground. However, what must be noted is that the Bank has plans of exceeding the 100 libraries mark and continues identifying more schools in dire need, while investing in the existing libraries to ensure that a sustainable knowledge base remains vibrant and continuously updated with more books and other facilities and equipment being installed.



ENVIRONMENTAL RELATIONS



The sustainability of the planet depends on mankind's actions – both positive and negative. Benchmarked as an industry leader, we firmly believe that we must set an example in creating the necessary awareness and in actioning initiatives that would spearhead the conservation and preservation of the environment.

CLEARING INVASIVE SPECIES AT BUNDALA – INVESTMENT RS 560,000

One of our most significant projects during the year has been a project that brought together the HNB Team and the Wildlife and Nature Protection Society of Sri Lanka. HNB funded the clearing of the five hectares of jungle which had been attacked by two invasive species in Bundala. The Bundala wetlands is known as one of the best wetlands in the world, comprising lagoons, a reservoir and shrub jungle which is home to numerous migrant birds, some of them from as far as Siberia and is also a nesting ground for very rare sea turtles. The Bundala wetlands is identified as a RAMSAR site of Southern Sri Lanka, an important waterfowl habitat and economic zone. The invasive species has brought with it habitat problems for the birds, animals, insects, amphibians and other beings within the Park. On completion of this project, HNB will undertake to continue the preservation of the environment within and surrounding the Bundala National Park, instigating a programme that would make the park a sanctuary for the abundant bird and insect life based within. The HNB Team intend to get personally involved in clearing the site in the future.

MADURU OYA FISHING VILLAGE PROJECT – INVESTMENT RS 6.1 MILLION

It was brought to the attention of HNB that the fish population within the Maduru Oya tank at Padiyatalawa was fast dwindling as the fishing nets and equipment used by the less educated fishermen was completely destroying the breeding cycle and systematically eliminating the small fish. A two pronged approach by HNB to address the vocational problems of the fishermen and to sustainably develop the village were quickly put into action. While the village upliftment is detailed in the Community Relations section of this Report, HNB assisted the fishermen under the micro finance scheme with more appropriate fishing nets and gear to ensure that the fishery life inside the Maduru Oya tank will remain unharmed and continue to breed, while the fishermen will continue with their known livelihood uninterrupted.

ENERGY SAVING

HNB Head Office is considered the most energy efficient building in Colombo as it used revolutionary technology at the time of construction to ensure that environmentally friendly best practices are infused into everyday operations as much as possible. The energy saving features within the HNB Tower includes variable air volume units which control the supply of air temperature and the rate of airflow based on actual demand, fans connected to the air volume units are of variable speed type and a demand controlled ventilation system comprises an energy saving feature that controls the amount of outdoor air supplied based on carbon dioxide levels within the air conditioned space. The system is also designed to eliminate 'Sick Building Syndrome' risks by reducing odors, air pollutants, colds and virus causing germs. In addition, the air conditioning system is controlled and monitored by the EBI Excel 5000 Building Management System from Honeywell Singapore. General lighting too has energy efficient fluorescent fixtures and an intelligent microprocessor which senses the daylight component to provide only the necessary levels of illumination. The exterior of the building uses energy efficient high pressure sodium vapor, metal halide and compact fluorescent lamps.

In addition, energy saving measures have been introduced into the branches with team members urged to switch off unnecessary lights and energy saving computers being pursued as a future procurement imperative. We encourage our team members also to use the intranet and email facilities as often as possible to minimise the usage of paper in printing.

KEY PERFORMANCE INDICATORS

CUSTOMER RELATIONS

Customer Satisfaction Survey

The results of the Customer Satisfaction Survey conducted by both internal and external resources are given on pages 48 and 49.

Customer Care

Ten branches were reconstructed during the year to better facilitate the needs of those customers requiring some assistance with mobility.

Customer Education

Details of the number of customer awareness programs conducted during the year are given on page 53.

EMPLOYER RELATIONS

Employment - Gender Analysis of Staff

	Female	Male	Total	Female % of total
Corporate Management	5	15	20	25
Executives	143	410	553	26
Junior Executives	332	652	984	34
Banking Assistants	392	1042	1434	27
Trainees	200	230	430	46
Allied Grades	402	13	415	97
Support Staff	-	406	406	-
Contract Staff	11	34	45	24
Total	1485	2802	4287	

Training and Education

Categorywise training details are given on pages 59 and 60.

SCHOLARSHIP SCHEME FOR CHILDREN OF HNB EMPLOYEES

Investment by HNB	-	Rs 25mn
Number of scholarships to be disbursed annually	-	15

EMPLOYEE SATISFACTION SURVEY

Details are given on page 57.

EMPLOYEE TURNOVER

Employee turnover at Senior/ Corporate Management levels	-	1.67%.
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INVESTOR RELATIONS

Indicators that depict the sustained growth of HNB are given on page 67.

BRAND STRENGTH

Bracken Award – Sri Lankan Bank of the year 2006

LMB 50 Leaderboard 2005/6 ranking	-	4th
Fitch Rating	-	A+ (LKA)

SUPPLIER RELATIONS

Selection Process for Procurement

The selection of suppliers is by tender for procurements above the sum of Rs 100,000.

COMMUNITY RELATIONS

Assistance to Micro and Small Entrepreneurs:

Details of the assistance to micro and small entrepreneurs affected by the Tsunami are given on page 70.

Micro Financing Scheme – Gami Pubuduwa

The details are given on page 71.

School Library Project

Number of libraries completed by December 2006 - 94

Village Development

Developing a village - Mankadawela

Reconstruction of a water tank and village development - Rs 2 Mn

ENVIRONMENTAL RELATIONS

Preservation of the Environment

During the year the Bank had invested Rs 6.6 Mn on two projects:

- Clearing invasive species at Bundala - Rs 560,000
- Investment on the Maduru Oya Fishing Project - Rs 6.1Mn

Environment Risk Assessment for Project Financing

The Bank performs a high-level assessment of environmental risks when it lends to corporate and institutional customers for Special Projects based on the nature and locality.



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ASSURANCE REPORT
TO THE READERS OF THE SUSTAINABILITY REPORT 2006

INTRODUCTION

We have been engaged by Hatton National Bank Limited (HNB) to review the Sustainability Report 2006 (further referred to as The Report). The Report, including the identification of material issues, is the responsibility of HNB's management. Our responsibility is to issue an assurance report on The Report.

CONTEXT AND SCOPE

In The Report HNB describes its efforts and progress in relation to Sustainability. Our engagement was designed to provide the readers of The Report with:

- reasonable assurance on whether:
 - the data on financial performance, as specified on page 67 of The Report are properly derived from financial statements of HNB for the year ended 31 December 2006;
- limited assurance on whether:
 - the data on Key Performance Indicators for 2006 specified on pages 76 and 77 are fairly stated ;
 - the other information in The Report is fairly stated.

'Fairly stated' means that the reported information properly reflects the information contained in the underlying sources such that it is consistent with the source information. Reasonable assurance is a higher level of assurance than limited assurance, which is reflected in the nature and depth of the work performed.

STANDARDS AND CRITERIA

We conducted our engagement in accordance with the Sri Lanka Auditing Practice Statement (SLAPS 3) applicable to review engagements, and the International Standard on Assurance Engagements (ISAE 3000): *Assurance Engagements other than Audits or Reviews of Historical Financial Information*, issued by the International Auditing and Assurance Standards Board. Amongst others, these standards require that:

- the assurance team members possess the specific knowledge, skills and professional competencies needed to understand and review the information in The Report;
- when providing limited assurance, which is a lower level than reasonable assurance, a negative form of conclusion is used.

There are no generally accepted standards for reporting sustainability performance. HNB applies its own internal sustainability reporting criteria, derived from Sustainability Reporting Guidelines of the Global Reporting Initiative and its stakeholder engagement process as detailed on page 44 of The Report.

CONSIDERATIONS AND LIMITATIONS

Environmental and social performance data are subject to inherent limitations given their nature and the methods used for determining, calculating and estimating such data.

To obtain a thorough understanding of the financial results and financial position of HNB, the reader should consult HNB's audited financial statements for the year ended 31 December 2006, included in the Annual Report from page 106 to 172.

WORK UNDERTAKEN AND CONCLUSIONS

We reviewed the reliability of the data on Key Performance Indicators for 2006 based on:

- visits to selected project sites and branches to review systems and data;
- And reviews of:
 - the systems used to generate, aggregate and report these data.
 - the data reported by the relevant business units to corporate level;
 - the data validation processes at corporate and business level;
 - the data trends in discussions with management.

Based on the above, the data for Key Performance Indicators for 2006, specified on pages 76 and 77 do not appear to be unreliable.

FINANCIAL DATA

We have reconciled the data on financial performance reported on page 67 of The Report with the audited financial statements of HNB for the year ended 31st December 2006.

Based on the above, we conclude that the data on financial performance reported on page 67 are properly derived from the financial statements of HNB for the year ended 31 December 2006 for which the independent auditors issued an unqualified audit opinion dated 15 February, 2007 on page 105 of the Annual Report.

OTHER INFORMATION

We reviewed the other information in The Report, based on:

- an analysis of the systems and processes used to generate this information;
- review of internal documentation and sources;
- interviews with staff for the information;
- our knowledge and understanding of the sector and HNB's business.

Based on the above, the other information in The Report does not appear to be unfairly stated.

Harold Elwood Thornton & Co

CHARTERED ACCOUNTANTS

15 February 2007
 Colombo, Sri Lanka

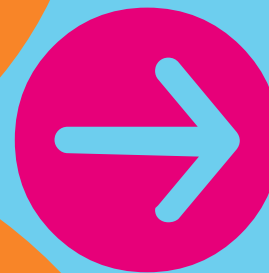
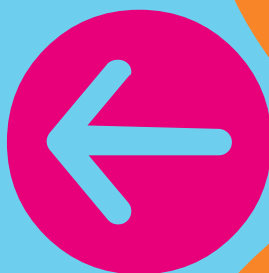
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ANCHORING FOR THE FUTURE

We have always remained optimistic even in the face of dire challenges believing strongly that our astute decisions, unfailing leadership and constant care imparted to the community around us will be the panacea in fashioning a strong and dynamic triple bottom line. Our new vision of being the acknowledged leader and chosen partner in providing financial solutions and mission in combining entrepreneurial spirit with empowered people and leading-edge technology to constantly exceed shareholder expectations encapsulates our ethos in looking forward to a sustainable future where all stakeholders will play a vital part in our forward journey.



THE FIVE KEY INITIATIVES that are embedded into our very existence to continue as a leader in the financial industry are:

- ➔ Increased focus on small and medium sized enterprises through careful segmentation for growth thereby creating a culture composed of entrepreneurs who will build a sustainable economy for future generations.
- ➔ Single minded drive towards improved asset quality which will focus on investing and creating a healthy risk management philosophy with optimal risk/return balance in order to create a sustainable wealth portfolio for our shareholders.
- ➔ Drive for productivity and economies of scale through greater efficiencies, enhanced competencies and creating a knowledge centric framework built on customer focus for our team, who will be passionately empowered to use world class best practices to achieve our vision.
- ➔ Using IT as a fundamental driver to reap the full potential of competitive advantage.
- ➔ Helping to create a sustainable base where environmentally friendly practices and preservation and conservation of the environment around us become integral to our culture.

Corporate Management



R Theagarajah
M.B.A. (Cranfield), F.C.M.A., F.C.A. (Sri Lanka)
**Managing Director/
Chief Executive Officer**



J M J Perera
F.C.I.B. (London)
**Senior Deputy General Manager -
Business Development &
International**



J D N Kekulawala
M.B.A. (Manchester), F.C.I.B. (London),
F.C.A. (England & Wales)
Chief Financial Officer



U A C Obeyesekere
F.I.P.M. (Sri Lanka)
**Deputy General Manager -
Human Resources & Administration**



C P Abeywickrema
B.Com. (Special) Sri Lanka
**Deputy General Manager -
Personal Banking & Network
Management**



Ms I Goonesekera
Attorney-at-Law & Notary Public
**Deputy General Manager -
Legal / Board Secretary**



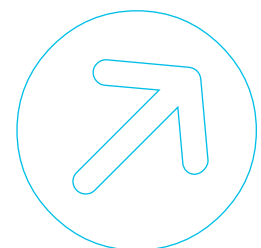
Ms S N Wickramasinghe
Attorney-at-Law & Notary Public,
F.C.M.I. (UK)
**Deputy General Manager -
Senior Relationships**



N Hapuarachchy
M.B.A. (Sri J.), Dip. in Bank Mgmt.
**Deputy General Manager -
Credit Supervision & Recoveries**



A S Ibrahim
B.Sc. (Hons) Colombo, F.C.I.B. (London)
**Deputy General Manager -
Corporate Banking & Treasury**





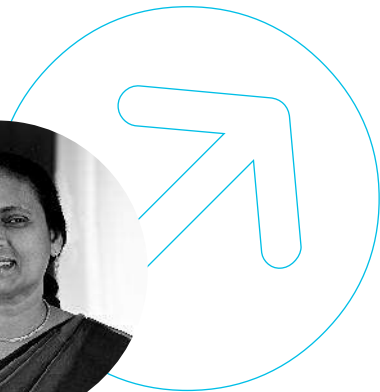
Ms D C Cooke
F.C.A. (Sri Lanka)
Deputy General Manager -
Operations & Systems



Ms I R D Thenabadu
F.C.I.B. (London), F.C.M.A.
Deputy General Manager -
Corporate Banking



Ms L L C C Thambiah
Assistant General Manager - Zone II



P D Hennayake
M.B.A. (A.I.T.) Thailand, P.G Dip. (Eng.),
B.Sc. Eng. (Hons) Moratuwa,
C.Eng., M.I.E. (Sri Lanka)
Assistant General Manager - Services



J R P M Paiva
B.A. (Hons) Ceylon
Assistant General Manager -
Human Resources & Administration



P Sridharan
Assistant General Manager -
Personal Financial Services
& Business Development



G Ramanan
C.F.A., A.C.M.A.
Assistant General Manager -
Investment Banking /
Chief Executive Officer -
HNB Securities Ltd.



D Rodrigo
M.B.A. (Cranfield), F.C.M.A., F.C.C.A.
Assistant General Manager -
Risk & Compliance



H N J Chandrasekera
Assistant General Manager - Zone III



R H Abayasekara
Assistant General Manager -
International



A Ratnasabapathy
F.P.M.A.
Assistant General Manager - Zone I

Senior Management



B J Sinniah

Chief Manager - Risk & Compliance

Ms R P P Wickremasinghe

B.Dev.Studies (Hons) Colombo,
Dip. in Personnel Management (N.I.B.M.),
Dip. in Counselling (S.L.F.I.)

Chief Manager - Employee Relations

A P L Fernando

F.I.B. (SL), Dip. in Bank Mgmt.

Chief Manager - Credit Supervision & Recoveries

V G P Vidyaratne

P.G.Dip.(Ind.Eng.), B.Sc. (Eng.)Cey., C.Eng., M.I.E. (SL)

Chief Manager - Premises & Engineering

R M P Ratnayake

M.B.A. [Southern Queensland - Aus.], P.G. Dip. Busi. & Fin.
Admin. (I.C.A.S.L. & Cranfield), A.I.B. (SL), M.A.A.T.

Chief Manager - International Operations

V K A F Rajasekara

MPMA (UK)

Chief Manager -South Western Region

A N J De Silva

Chief Manager - Business Development - Subsidiaries

M K Nambiyarooran

M.B.A.(Sri J.), F.C.M.A., F.S.C.M.A., F.I.B.(SL)

Chief Manager - Treasury

K L Wijesooriya

LL.B

Chief Manager - Remittances

D St E Fernando

Chief Manager - Operations

V Vijayakumar

M.Sc. (I.T.) UK, A.I.B. (SL), M.I.M.I.S.(Lond.), A.M.I.A.P.
(Lond.),M.A.A.T.(SL)

Chief Manager - Information Technology

T Govinthadas

M.B.A. (Colombo), B.Sc. (Hons) P.F.T. Cey., A.C.I.B.(Lond.)

Chief Manager- Network Banking

I H A Wickramasinghe

M.B.A. (Sri J.), A.M.I.E. (SL),M.C.I.M. (UK), M.S.L.I.M.

Chief Manager - Project Finance

B K Wijeratne

B.Sc. (Physical Science) Colombo

Chief Manager - Leasing

N U Jumat

A.I.B. (SL)

Chief Manager - Trade Services

P G Wilson

B.Sc. (Kelaniya), Dip. in I.T. (N.I.B.M.)

Chief Manager - IT Research & Development

J U N Chandrasena

M.A. (Econ) Colombo, A.C.M.A.

Chief Manager - Planning

R J Thambirajah

Chief Manager - Colombo Region

I A Baduge

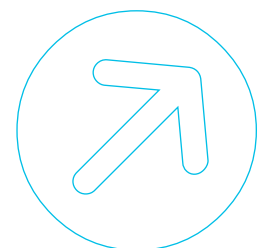
Dip.in Bank Mgmt., A.I.C.M.

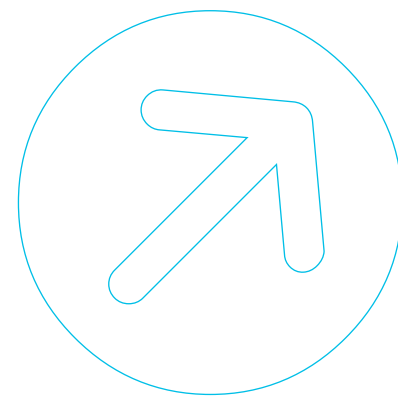
Chief Manager - Corporate Banking

R M P Dayawansa

M.B.A. (Sri J.), F.I.B. (SL), M.C.I.M. (UK), M.S.L.I.M.

Chief Manager - Greater Colombo Region





S L Wijayasinghe

B.Com. (Australia), F.C.M.A, C.P.A. - Australia, A.C.I.B. (London)

Chief Manager - Finance

S Sivalingam

A.C.I.B. (London)

Chief Manager - Procurement & Logistics

T M A Mutaliph

A.I.B.(SL), Dip. in Bank Mgmt.

Senior Manager - Operational Risk

N Premakumar

Senior Manager - Admin & Trade Services (City)

J J Namasivayam

Senior Manager - Currency Division

A Goonesekere

M.B.A. (Sri J.), A.C.A. (Sri Lanka), A.S.C.M.A.

Senior Accountant

U N I Elapata

B.A. (Hons) - Univ. of Texas (Austin)

Senior Manager - Head Office Branch

Ms N M C P Wettasinha

Attorney-at-Law & Notary Public

Senior Manager - Legal

E C Alles

B. Sc. (Bangalore)

Senior Manager - Cinnamon Gardens

R B Warnakulasuriya

B.Com. (Special) Kelaniya, M.A.A.T., A.I.C.M.

Senior Manager - North Western Region

V Ratnasabapathy

A.C.I.B. (London)

Senior Manager - Credit Risk 2

D L V Chandrasekera

Senior Manager - Leasing

S Udayakumar

M.C.M.I. (Lond), A.M.S.L.I.M, Dip. in Busi.Mgmt & Admin (UK), Dip. in Sales Mgmt & Marketing (UK)

Senior Manager - Operational Risk [Zone II]

J T M Weeresinghe

Senior Manager - Credit Risk

N Premarajah

Higher Dip. in Int. Busi. Mgmt. - Chennai

Senior Manager - Consumer Banking & Housing Finance

Mrs M K Rambukwella

M.B.A. [Sri J.], M. Sc. [Pera.], B.A [Hons] Pera., A.C.I.M. (UK), A.M.I.T.D.(SL)

Senior Manager - Training & Development

Mrs R Prabhakaran

A.I.B. (SL)

Senior Manager - Treasury Operations

W D A G Wickrama

Senior Manager - Pettah

B K Achan

M.Sc. (Bombay), B.Sc. (Hons) (Calcutta),C.A.I.I.B.(India)

Chief Representative Officer - Chennai

A B Shahid

M.B.A, B.Sc. (Univ. of Karachi), F.I.B. (Pakistan)

Chief Representative Officer - Karachi

Risk Management

Effective management of risk is crucial for success in financial services and is fundamental to HNB's strategy. Risk management aspires to be a culture inherent in all our associates which comprehends the downside and effectively manages risk based on pre-set parameters while leveraging on areas where upside potential exists. The focus across HNB is to manage risk effectively to generate sustainable profits.

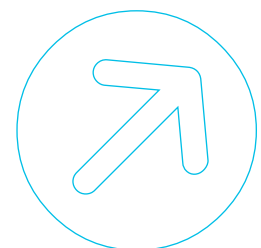
HNB set up a dedicated risk management unit two years ago to drive better understanding of risk management across the network and to set the platform for compliance required by BASEL II. The Bank formulated a Risk Charter at the beginning of the year against which progress and achievements are reviewed. A robust IT platform too is being established to enforce this single minded focus which is extremely crucial at this juncture.

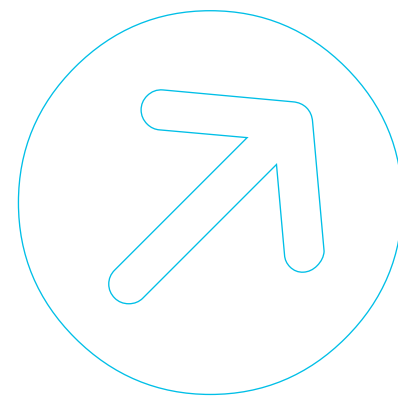
The Risk Management Committee chaired by the Chief Executive Officer, serves as the principal Risk Strategy and Risk Policy decision making body within the Bank and provides the Board the assurance on the performance of the overall Risk Management Framework.

RISK FACTORS

The following are the key risk factors that may impact HNB's future results:

Credit Risk	Credit risk arises from potential that a borrower or counter-party to a transaction will fail to perform on an obligation.
Market Risk	Market risk is the risk to a financial institution's condition resulting from adverse movement in market rates or prices including interest rates, foreign exchange rates and equity prices.
Operational Risk	Operational risk arises from the potential that inadequate information systems, operational problems, breaches in internal controls, fraud or unforeseen catastrophes will result in unexpected losses.
Liquidity Risk	Liquidity risk works on the probability that a bank will be unable to meet its obligations as they become due, owing to the inability to liquidate assets or obtain adequate funding (referred to as 'funding liquidity risk') or that it cannot easily unwind or offset specific exposures without significantly lowering market prices due to inadequate market depth or market disruptions (market liquidity risk).
Legal / Compliance Risk	Legal risk arises from the potential that unenforceable contracts, lawsuits, or adverse judgments can disrupt or otherwise negate operations or the condition of the organization.
Reputation /Strategic Risk	Reputation risk is the likelihood that negative publicity regarding an institution's business practices, whether true or not, will cause a decline in the customer base, costly litigation, or revenue streams. This arises from bad and poor management decisions, strategic planning, and dissatisfied stakeholders.





HNB's Risk Management platform encompasses the following:

People

- Skilled staff with extensive experience
- Active Board and Senior Management oversight

Policies

- Defined Risk Appetite
- Structured Risk Acceptance Criteria

Systems

- Comprehensive Internal Controls
- Regular measurement, analysis and actioning cycle for key risk areas

Given that finance and banking remain in the frontline of a number of risks in any environment, HNB continuously monitors and anticipates its risk environment, essentially but not limited to:

- Regular feedback from the extensive branch network
- Staying abreast of local and international events
- Regular scenario analysis
- Changes in the Regulatory Framework

Credit Risk has been identified as a major risk factor that HNB is exposed to. The following initiatives were introduced during the year to strengthen the process:

- Dedicated Relationship Managers for Key Accounts
- An improved credit monitoring and actioning culture
- A watchlisting process

Compliance Initiatives	Monitored by	Execution
Single Borrower Limit	Compliance	Credit
Related Party Transactions	Compliance	Credit
Capital Adequacy Ratio	Finance	Treasury / ALCO
Liquidity Ratio	Finance	ALCO (Asset & Liability Committee)
Other Monthly and Quarterly Returns	Compliance	Relevant Departments

PROGRESS ACHIEVED AGAINST RISK CHARTER IN 2006

Risk Mitigation Strategies	Actions Taken
<p>1. CREDIT RISK</p> <p>1.1 Portfolio Issues</p> <p>a) Review the effectiveness of credit risk strategies and monitor their ongoing review.</p> <p>b) Review the adequacy of portfolio monitoring</p> <p>c) Review Large and High Risk Accounts that could potentially have a material impact on future Asset Quality.</p>	<p>Periodic Review of Existing Product Portfolios and Risk Review of New Products</p> <p>New KPI Format introduced for reporting of Network performance</p> <p>Introduced Performance Dashboards for Credit Meetings</p> <p>Industry Reports for Poultry, Plantations – Tea, Rubber, Coconut, Construction, Apparel and Sugar sectors were reviewed and implications on HNB's portfolio observed.</p> <p>Branch Reviews – Eight Large Branches comprising 260 Middle Market Clients were reviewed</p> <p>Miscellaneous reports on topical issues affecting industries & country trading partners.</p> <p>Top 10 Local and Foreign Currency Loan Reviews (Quarterly)</p> <p>High Risk Accounts (Internally Risk Rated CCC and below) Customer Reviews (Quarterly)</p> <p>Review of Watchlisted accounts (Quarterly)</p>

1.2 Policy Issues

- | | |
|--|---|
| d) Review the effectiveness of credit risk policies and monitor their ongoing review. | Adequacy and Effectiveness of Credit Policies were evaluated in Monthly Meetings
Simplifying and Standardising Credit Documentation to enhance effectiveness |
| e) Review delegated commitment authorities. | Amended Credit Approval Guidelines enhancing the level of autonomy |
| f) Mandate Head of Credit to decide on watch listed and high risk credits and refer findings for Committee review. | Framework developed for identification and reporting of Watchlisted Exposures
Independent Review of Watchlisted Exposures for actioning |

2 REGULATORY / COMPLIANCE RISK

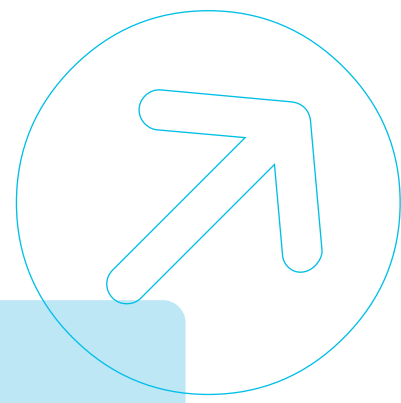
- | | |
|---|--|
| a) Review the adequacy and effectiveness of HNB's compliance management framework. | Successfully migrated to submit returns electronically to CBSL.
All returns submitted on time.
* Report on adherence submitted to Audit Committee, Quarterly
* Business Continuity Planning documented across the network |
| b) Review of compliance monitoring plans and results. | Audit Management Letter and CBSL Inspection Reports recommendations followed through and actioned. |
| c) Oversee compliance by HNB with applicable laws, regulations and regulatory requirements that may impact HNB's risk management. | New Regulations proposed / introduced during the year (e.g. CB Anti Money Laundering and FTR Regulations, Parate Ruling) impact assessed and followed through in terms of changes to internal policy, systems and guidelines |

3 MARKET RISK

- | | |
|---|---|
| a) Review HNB's market risk control framework and assess whether it is appropriately independent from the line of business and comprehensive. | Structure ensures independence in reporting between Front Office and Back Office. Approved Limits are monitored by Middle Office |
| b) Review appropriateness of Limit/Exposure position in light of prevailing market conditions | Focus is on covering Corporate Banking Positions with minimal trading on own account under the guidance of ALCO and Treasury Committee. |
| c) Evaluate models to be used to measure risks and decide on risk appetite | Revisiting existing models and review of its appropriateness is being carried out with a view to introducing a new Treasury Trading System. |

4 OPERATIONAL RISK

- | | |
|--|---|
| a) Review the operational risk profile and operational risk strategy/appetite of HNB and monitor HNB's overall risk control framework. | Operational Risk Management Structure in place to carry out Risk Assessments across the network
Operational loss reporting across the network reviewed and learnings shared across the network on an ongoing basis |
| b) Review the IT Risk Profile and Strategy based on the Risk Appetite of HNB | Monitored through internal control systems / reviews and independent IT Audits conducted by our External Auditors. |
| c) Review Plan to make major modifications / enhancements to the system | HNB is in the process of migrating to a new Core Banking System, the process of selection, implementation planning and review is managed through a separate committee that meets on a regular basis |



5 LEGAL RISK

- | | |
|--|--|
| a) Review litigation and any trends arising from litigation against HNB from a risk management perspective | Ongoing follow up. |
| b) Review HNB's Legal policies and practices from a risk management perspective | Ongoing review of legal documentation and Service Standards. |

6 LIQUIDITY

- | | |
|--|--|
| a) Review the effectiveness of the risk management systems and policies adopted by the ALCO to manage structural interest rate risk. | Ongoing Review through post implementation follow up of major decisions taken |
| b) Review new Balance Sheet Management policies | Capital Management Committee reviews Capital Structure, Structure and Composition of the Balance Sheet in the context of Capital Adequacy Regulations and liquidity. Its recommendations are presented to the ALCO Committee and actioned. |

7 REPUTATION /STRATEGIC RISK

- | | |
|--|--|
| a) Review strategic risks identified by the CFO. | Reviewed as an integral part of the Strategic Planning and Budgeting process. Specific action plans developed for key risks (competitor strategies, regulatory changes etc.) identified. |
| b) Decide on risk appetite and /or those requiring escalation to the Board of Directors | System in place to escalate all quantified risks above a threshold level to the Board Audit Committee on a regular basis |
| c) Review CSR / Sustainability Reporting policies and compliance with Bank's Risk Management Framework | Sustainability Committee meets to discuss and implement approved CSR Projects |

The focus this year has been on enforcing a strong risk culture, implementing robust system support and setting the platform for BASEL II IRB initiatives that will take precedence into next year as well. We strongly believe that our reporting and control mechanisms remain above par to the industry and in line with global norms. Our ethos of portraying stability, sustainability, compliance and good governance continue to remain an integral facet within our workings. The features which we feel have contributed immensely to our emphasis of being true to our ethos are:

- Board composition and independence
- Integrity and oversight of management – Risk Charter and Risk Management Committee
- Effective use of internal and external audit functions
- Higher level of disclosure and transparency
- Greater engagement with investors – listed in Luxembourg Stock Exchange and CSE.



BEYOND 2007

Looking beyond 2007, key priorities over the Medium Term would be to gear ourselves for a BASEL II IRB Platform.

Enforcing a Strong Risk Culture

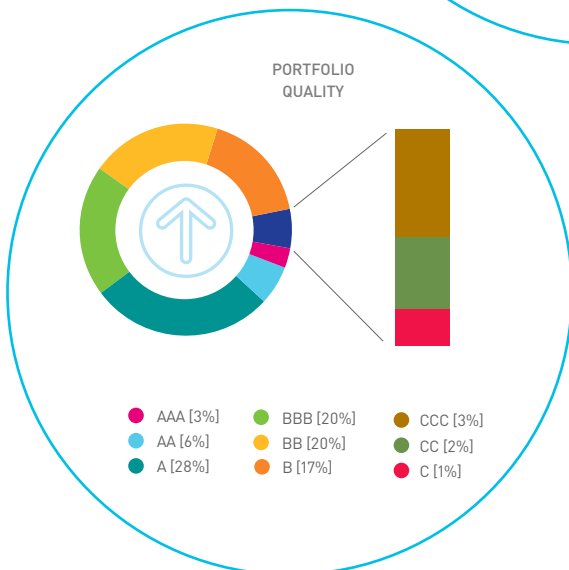
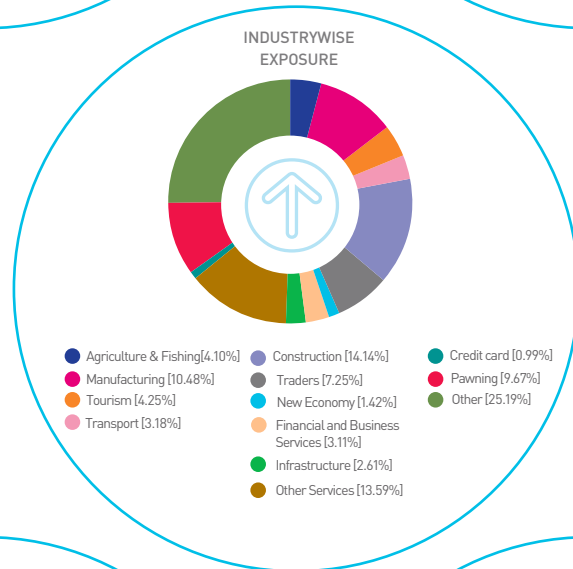
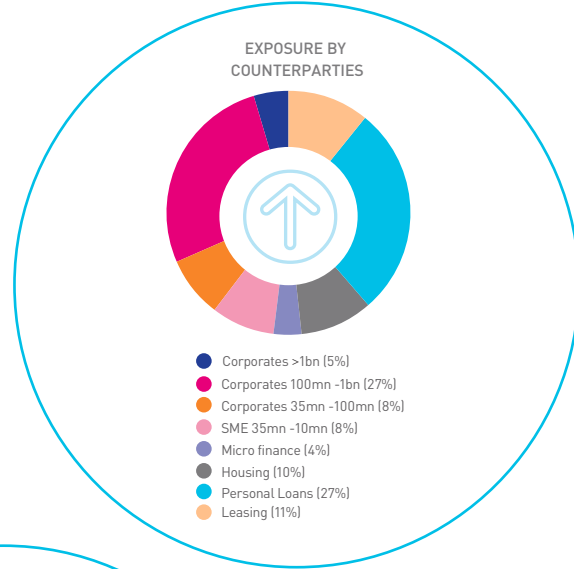
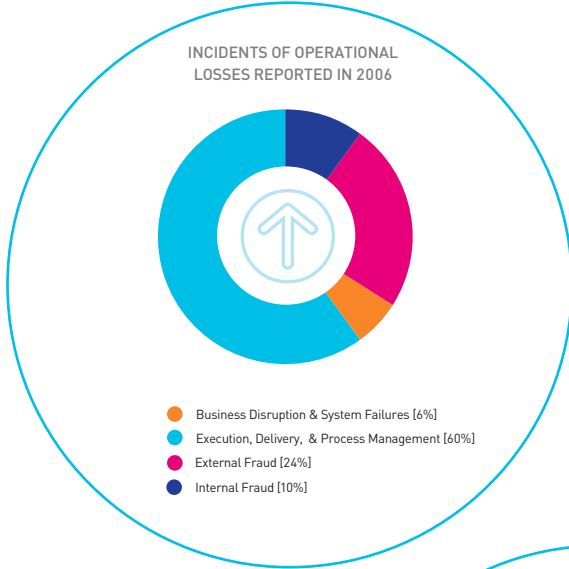
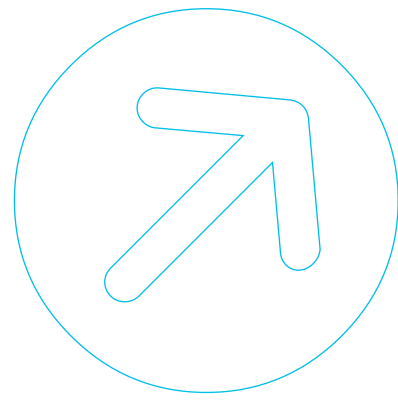
- Developing Meeting Dashboards
- Data clean up exercise across the network
- Improving Performance KPI's across all units
- Credit Skills Training of our staff

Implementing Robust System Support

- Enhancement of Compliance Risk Mitigation through the introduction of new Core Banking System
- Introduction of AML Monitoring Tools with appropriate software support
- Developing an MIS to be able to better support growth in SME and Micro-Finance Segments

Setting the platform for BASEL II IRB Approach

- Revisiting existing Risk Management Structure in line with global best practices
- Ensuring more effective use of Internal Risk Ratings for booking Quality Credits and effectively managing the Credit Portfolio
 - Developing Internal Credit Rating Score Sheets for SME and Retail Segments



Corporate Governance



Being continuously committed to reviewing and improving our conformance and compliance initiatives and practices, the Board of Directors institute transformational change wherever necessary to ensure best practices are maintained and enhanced according to the principles of Corporate Governance. The Board of Directors remain the catalyst in governance, recognizing that both corporate governance and business governance are integral to maintaining a sustainable enterprise which displays continued growth performance and value creation for our stakeholders.

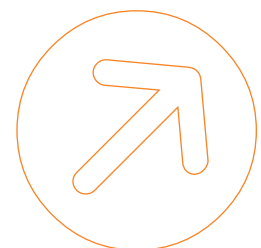
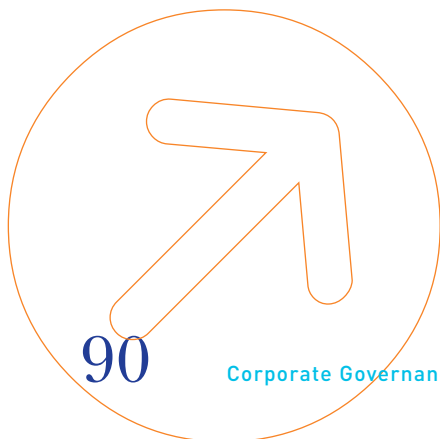
At HNB, the Board of Directors, lead by the Chairman, is responsible for the governance of the Bank, and establishes effective governance practices to meet challenges, both in the short and long term and ensure value creation to the stakeholders. The Board of Directors emphasizes the role of the executive management team in monitoring compliance with the established governance framework of the Bank to ensure that all business activities are conducted in accordance with the legal and regulatory framework applicable to the industry.

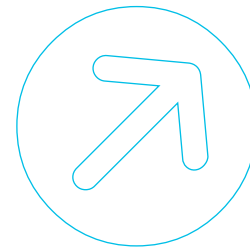
In a broader perspective, our shared responsibility towards good governance includes:

- Protecting our franchise by placing long term shareholder value ahead of short term gains,
- Providing our customers with superior products and services and good advice, while not compromising on the highest standards of integrity,
- Practicing the principles of good corporate citizenship, playing an active role in the communities around us,
- Instilling a culture of excellence amongst our team by proffering upwardly mobile opportunities to high achievers, promoting mutual respect, tolerance and unity within an inspiring work environment,
- Continuously reviewing and strengthening our conformance and performance strategies including the control environment and risk management strategies.

HNB incorporates in its governance code the guidelines prescribed in the Code of Best Practices on Corporate Governance issued by the Institute of Chartered Accountants of Sri Lanka, the Code of Corporate Governance for Banks and Financial Institutions issued by the Central Bank of Sri Lanka and the Exposure Draft on Rules on Corporate Governance for Listed Companies issued jointly by the Institute of Chartered Accountants of Sri Lanka and the Securities and Exchange Commission of Sri Lanka.

The extent of compliance by HNB for the year ended 31st December 2006 with the said principles and best practices are disclosed in the table on Pages 91 to 97 of the Annual Report.





DIRECTORS

The Board of Directors

Composition	<p>The Board comprises nine Directors, all of whom are non-executive with the exception of the CEO. All Directors possess a wide range of skills and experience complimented with a high sense of integrity, independent judgment and considerable knowledge to add value to their roles and the ultimate performance of the Bank.</p> <p>The profiles of the Directors are on pages 12 and 13 of the Annual Report.</p>
Meetings	<p>Monthly meetings of the Board are held to review the Bank's performance and to determine whether its strategies and business practices are aligned with stakeholders' expectations. Additional meetings are convened whenever necessary.</p> <p>The number of meetings of the Board, Board appointed sub-committees and individual attendance by members are given on page 97 of the Annual Report.</p>
Availability of a formal schedule of matters for Board discussion	<p>Roles and responsibilities are formalized via a Board Charter, which also defines matters reserved for the Board and its Committees and those delegated to management. In summary the Board is accountable to the stakeholders for the Bank's overall performance and its responsibilities include;</p> <p>Strategy - Providing strategic direction and formulating corporate strategic initiatives.</p> <p>Board Performance and Composition - Evaluating the performance of non-executive Directors, determining the size and composition of the Board and making recommendations to shareholders on the appointment and removal of Directors.</p> <p>Leadership Selection & Succession Planning - Appointing, evaluating and providing direction to the CEO and CFO and developing plans for Board and executive management.</p> <p>Remuneration - Determining the remuneration of the CEO and non-executive Directors.</p> <p>Financial Reporting - Reviewing and monitoring the process, controls and procedures which are in place to maintain the integrity of the Bank's accounting and financial records and statements. Considering and approving quarterly and annual financial statements.</p> <p>Risk Management - Approving and monitoring the effectiveness of the Bank's risk management strategy.</p> <p>Relationship with Stock Exchanges, Regulators and Continuous Disclosure - Maintaining a direct and ongoing dialogue with the SEC and other stock exchanges where our securities are listed, ensuring that the market and our stakeholders are kept informed of material developments.</p> <p>Social Responsibility - Considering the social, ethical and environmental impacts of our activities, setting standards and monitoring compliance with our social responsibility policies and practices.</p> <p>Audit - Recommending to shareholders the appointment of the External Auditor based on the review process conducted by the Audit Committee, and the direct ongoing dialogue with the External Auditor.</p> <p>The following responsibilities have been delegated by the Board to the Corporate management:</p> <p>Strategy - Developing and implementing corporate strategies and making recommendations to the Board on significant strategic initiatives.</p> <p>Senior Management Selection - Recommending senior management selection and appointments, terms of appointment, performance evaluation and succession planning.</p> <p>Financial Performance - Developing the annual budget and managing day to day operations in line with budgetary forecasts.</p> <p>Risk Management - Maintaining an effective risk management framework.</p> <p>Continuous Disclosure - Keeping the Board and market fully informed of material developments,</p> <p>Social Responsibility - Maintaining standards of social, ethical and environmental practices established by the Board.</p>

Obtaining independent professional advice	The procedures for Directors, in the furtherance of their duties, to seek advice at the Bank's expense is co-ordinated through the Company Secretary.
Company Secretary	All Directors have access to the Company Secretary who is an Attorney-at-Law by profession. She is responsible for supporting and advising the Chairman and the Board on all corporate governance matters, Board procedures and compliance with applicable rules and regulations.
Independent judgment	All Directors exercise their independent and objective judgment on issues of strategy, policy, resources and standards of conduct. The Board is conscious of its obligations to ensure that Directors avoid conflicts of interest (both real and apparent) between their duty to HNB and their other interests. The Board has adopted a procedure to ensure that conflicts and potential conflicts of interest of Directors are disclosed to the Board. Any Director with a material personal interest in a matter being considered by the Board must declare their interest and unless the Board resolves otherwise, they do not participate in boardroom discussions or vote on matters in which they face a conflict. All related party transactions and Director's interest in contracts are disclosed on pages 155 to 169 of the Annual Report.
Dedication of adequate time and effort for the matters of the Board and the Company.	The Chairman & members of the Board dedicate adequate time for the fulfillment of their duties as Directors of the Bank. In addition to attending Board meetings, they attend sub-committee meetings and make decisions via circular resolution. The Board sub-committees include; - Nomination Committee - Audit Committee - Credit Committee - Procurement Committee - Human Resources/Remuneration Committee - Asset Disposal Committee
Training for new Directors	Directors undertake such professional development as they consider necessary in assisting them to carry out their duties as Directors. Presentations are made to the Board by the senior management of the Bank from time to time on industry related matters.

Chairman & CEO

Division of responsibilities of the Chairman & MD/CEO
The functions of the Chairman and MD/CEO are clearly separated in order to ensure a balance of power and authority, such that no individual has unfettered powers of decision.

Presence of a strong non-executive element on the Board
All nine Directors are non-executive with the exception of the MD/CEO.

Chairman's Role

Role of the Chairman
The Chairman of the Bank is an independent non-executive Director, elected by the Board. The Chairman's role encompasses:
- Ensuring that Board members undertake appropriate induction covering terms of appointment, duties and responsibilities.
- Providing effective leadership in formulating Board strategy.
- Representing the views of the Board to the public.
- Ensuring regular meetings, the minutes of which are accurately recorded and where appropriate included the individual and collective views of the Directors.
- Encouraging effective participation of all Directors in the decision making process to optimize contribution.
- Developing the agenda together with the Company Secretary and conducting Board meetings.



**Corporate Governance
Principle**

Level of Compliance

Financial Acumen

Availability of sufficient financial acumen and knowledge

The MD/CEO is a fellow member of the Institute of Chartered Accountants of Sri Lanka and a fellow member of the Chartered Institute of Management Accountants – UK. In addition, the Board includes a fellow member of the Chartered Institute of Management Accountants – UK. These members of the Board have the ability to offer guidance on matters of finance to the Board.

Board Balance

Balance of the Board

The Board consists of eight non-executive Directors and only one Executive Director, who is also the MD/CEO. Each of them brings to the Board, wide experience and an independent and objective view point, and carries significant weight in the Board's decisions.

In exercising independent judgment, the Board has established a procedure which is discussed above under "Independent Judgment".

Supply of Information

Timely and accurate management information

All Directors receive accurate, timely and clear information on all relevant matters. Any requests for further information are co-ordinated by the Board Secretary.

Appointments to the Board

Availability of a formal and transparent procedure for new appointments.

The Nomination Committee of the Bank is comprised of five Directors including the CEO. The composition of the Board is subject to continuous review by the Nomination Committee, and one of the responsibilities of the Board is identifying, evaluating and selecting candidates for suitable positions to ensure succession planning within the Bank.

All new appointments as well as continuing directorships are reviewed by the Nomination Committee. Directors are required to report any substantial change in their professional responsibilities, occupation or business associations to the Nomination Committee, which will examine the facts and circumstances and make recommendations to the Board.

Disclosure of details of new Directors to shareholders

Details of new Directors are disclosed to the shareholders on their appointment. Prior notice on appointment of new Directors is given to the Director of Bank Supervision.

Re - election

Re - election of Directors

According to the Articles of Association of the Bank, each Director other than the Managing Director/ CEO and any nominee Director, retires by rotation once every three years and is required to stand for re-election by the shareholders at the Annual General Meeting. The Nomination Committee will consider their independence at that time and the proposed re-election of Directors is subject to prior review by the full Board.

Appraisal of Board Performance

Appraisal of Board performance

The performance of the Board and its committees is evaluated by the Chairman to ensure that the Board functions effectively and efficiently, although such evaluation is not formally documented.

Appraisal of the CEO

Appraisal of the MD/CEO

The performance of the MD/CEO is reviewed every year by the full Board against financial and non financial targets which are in line with the short, medium and long term objectives of the Bank.

DIRECTORS' REMUNERATION

Remuneration Procedure

The Remuneration Committee comprises of three non-executive Directors. The CEO attends meetings on invitation.

The Remuneration Committee is responsible for assisting the Board with regard to remuneration policy for non-executive Directors and for making all relevant disclosures.

The Remuneration Committee determines and agrees with the Board, the broad policy framework for the remuneration of the CEO. The MD/CEO does not participate in such meetings.

The level and make up of remuneration	The remuneration package of the MD/CEO is structured to link rewards to corporate and individual performance. Non-executive Directors receive a nominal fee as disclosed in this Annual Report.
Disclosure of remuneration.	The details of the total remuneration of the Directors are disclosed on page 125 of the Annual Report.

RELATIONS WITH SHAREHOLDERS

Constructive use of the Annual General Meeting	The Board remains mindful of being accountable to the shareholders and the need for transparency at all levels, striving to maintain this value framework in all shareholder dealings and communications. The primary modes of communication between the Bank and the shareholders are the Annual Report and the Annual General Meeting. Information is received by the shareholders prior to the AGM to give them an opportunity to exercise the prerogative to raise any issues relating to their shareholdings and the business, either verbally or in writing prior to the AGM. The Board which includes the Chairmen of the Audit, Remuneration and Nominations Committees are present to answer any questions.
Circularization of notice of the AGM	The Annual Report, financial statements and the notice of the meeting are sent to shareholders at least 21 calendar days prior to the date of the AGM. The Bank proposes a separate resolution for each item of business, giving shareholders the opportunity to vote on each substantially different issue.
Major transactions	During 2006 there were no major transactions which materially affected the Bank's net asset base. Transactions, if any, which materially affect the net assets of the Bank will be disclosed in the annual/quarterly financial statements.

ACCOUNTABILITY AND AUDIT

Financial Reporting

Statutory and regulatory reporting	The Bank has presented a balanced and understandable assessment of Company's position and prospects for the year ended 31st December and at the end of each quarter. In the preparation of quarterly and annual financial statements, the Bank had strictly complied with the requirements of the Companies Act No.17 of 1982, the Banking Act No. 30 of 1988 and amendments thereto, and are prepared and presented in conformity with Sri Lanka Accounting Standards. The Bank has complied with the reporting requirements prescribed by the regulatory authorities such as the Central Bank and CSE. As the Bank's Global Depository Receipts (GDRs) are listed in the Luxemburg Stock Exchange, the Bank has also complied with all the reporting requirements of the Luxemburg Stock Exchange.
Directors' report in the Annual Report	The Directors' report is given on pages 100 to 102 of the Annual Report.
Statement of Directors' on their responsibility on the preparation and presentation of financial statements	The statement of Directors' responsibility for financial reporting is given on page 103 of the Annual Report.
Statement of the External Auditors' on their reporting responsibilities.	The Auditor's Report given on page 105 of the Annual Report includes the scope of their responsibilities and their opinion on the financial statements.
Management report in the Annual Report	The Management Discussion and Analysis is given on pages 14 to 40 of the Annual Report.
Declaration by the Board that the business is a going concern	This is given in the Directors' report on page 100 of the Annual Report.
Summoning an EGM to notify shareholders if net assets fall below one half of the shareholders' funds.	Likelihood of such occurrence is remote. However, should the situation arise, an EGM will be called for and shareholders will be notified.



**Corporate Governance
Principle**

Level of Compliance

Internal Control

Maintaining a sound system of internal control and risk management

The Board is ultimately responsible for the Bank's systems of internal control and for reviewing their effectiveness. These systems manage the risk of the Bank's business and ensure that the financial information on which business decisions are made and which is published is reliable, and also ensures that the Bank's assets are safeguarded.

The systems of internal control are designed to manage rather than eliminate the risk of failure to achieve business objectives. In pursuing these objectives, internal controls are aimed at providing reasonable and not absolute assurance against material misstatement or loss.

The Board of Directors is satisfied with the effectiveness of the system of internal control.

A detailed Risk Management Report is given on pages 84 to 89 of the Annual Report.

Reviewing the effectiveness of the internal control system

The Internal Audit Division of the Bank carries out regular reviews on the internal control system. A control self assessment is also being used by the Bank over the past three years as a means to enhancing process discipline and internal control.

The Audit Committee monitors and reviews the effectiveness of the Bank's internal audit function and the internal control system.

Audit Committee and Auditors

Availability of an Audit Committee with a written terms of reference comprising of at least three non-executive Directors

The Audit Committee of the Bank is comprised of three non-executive Directors, majority of whom are independent, and meets regularly throughout the year. The Committee has also co-opted an external consultant, who is a fellow member of the Institute of Chartered Accountants of Sri Lanka and the Institute of Chartered Accountants, England & Wales, to attend every meeting and provide the necessary financial expertise. The Company Secretary functions as the Secretary to the Audit Committee. The CEO attends meetings on invitation.

The role and responsibilities of the Audit Committee is set out in the Audit Committee Charter.

The Committee reviews the Bank's internal control and risk management systems with particular reference to internal controls over financial reporting.

The Committee monitors the integrity of the Bank's financial statements and formal announcements relating to the Bank's financial performance by reviewing the presentation of such reports and significant financial judgments/ estimates contained in them.

The Audit Committee also reviews issues relating to breach of ethics, such matters as fraud, accounting issues, employee wrong-doing and regulatory violations and the arrangements by which the staff of the Bank may in confidence raise concerns about possible irregularities. The Committee also ensures that the procedures for the independent investigations of such matters are appropriate.

A continuous review of the performance of the Audit Committee has been set up by retaining an independent consultant who is considered a financial expert, and has wide experience in audit and governance best practices. The consultant participates at all meetings of the Committee and provides feedback. He also meets separately with the Corporate Management and makes recommendations to the Committee in order to improve the effectiveness of the financial reporting process and control environment.

The Audit Committee Charter specifies a set of terms of reference defining its scope of authority, which includes review of internal and external audit process, the adequacy of internal controls, accounting policies and compliance with accounting standards.

The report of the Audit Committee of the Bank for the year 2006 is given on page 104 of the Annual Report.

Review of the audit function and relationship with External Auditor

The Audit Committee monitors and reviews the effectiveness of the Bank's Internal Audit function, the External Auditor's independence, objectivity, and the effectiveness of the audit process taking into account relevant professional and regulatory requirements. The Committee also sets out the policy for the engagement of the External Auditor to provide non-audit services, taking into account relevant ethical guidance with regard to the provision of non-audit services by the External Auditor. The Audit Committee has the primary responsibility for making a recommendation on the appointment, re-appointment or removal of the External Auditor in-line with professional standards and regulatory requirements.

Corporate Governance

Disclosure on the adherence to the principles and best practices of Corporate Governance.

The Board of Directors is of the view that it has put in place the resources and the process to ensure that the Bank is substantially compliant with the Code of Best Practices on Corporate Governance issued by Institute of Chartered Accountants of Sri Lanka, throughout the year ended 31st December 2006.

COMPLIANCE

Regulatory Compliance

An independent risk & compliance function is in place to ensure that the Bank complies with applicable laws and regulations.

The Compliance Reports signed by the MD/CEO and CFO are reviewed by the Audit Committee prior to publishing interim financial statements. The CFO is required to submit a report on whether the Bank is up to date in the settlement of statutory payments.

CONTROLLED ENTITIES

Monitoring of Controlled Entities

The activities of every company in the Group are overseen by their own Board of Directors.

Directors of each of the controlled entities are provided with corporate governance guidelines, which have been approved by the main Board of the Bank. The corporate governance guidelines set out the specific roles, duties and responsibilities of the Directors of controlled entities. Such guidelines set out the key expectations that the Board would have, from the Boards of controlled entities. The guidelines have been specifically tailored to the different entities, depending on the nature of its business and activities.

Confidence is maintained in the activities of a controlled entity Board through high quality of the Boards of the controlled entities and their commitment to Group objectives.

OTHER CORPORATE GOVERNANCE INITIATIVES

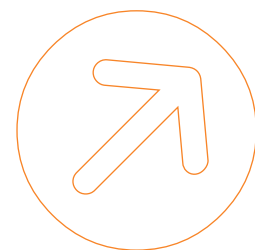
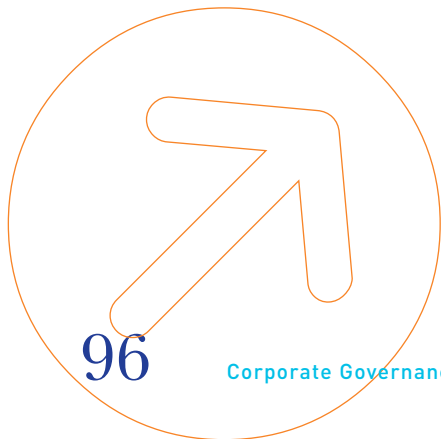
Corporate Governance Culture

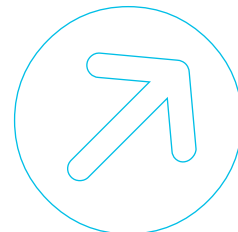
With a view to embedding in our culture, the highest standards of integrity and professionalism, and to instill in our employees an appreciation of our core values, our shared responsibilities and provide them with opportunities and tools required to accomplish their goals, continuing education is provided at different levels. Orientation is provided to all new managers as well as to new employees. Manager training is provided to all existing managers. We strive to develop our talent and help our managers reach their potential through executive development programs and regular assessment and feedback.

Corporate Social Responsibility

In keeping with our core value of serving the community in which we live and work, the Bank has embarked on several ventures details of which are discussed on pages 41 to 79 in the Sustainability Report which was compiled based on the Global Reporting Initiative (GRI) guidelines. The Bank has set up a Sustainability Committee, which has three sub-committees addressing the social responsibility issues relating to our key stakeholders, namely

- Customer Service and Investor Group
- Employee Liaison Group
- Environmental and Community Advisory Group





MEETINGS

The number of meetings of the Board, Board appointed sub-committees and individual attendance by members is shown below:

	Board Meetings	Audit Committee	Nomination Committee	Remuneration Committee
Total No. of meetings in 2006	14	4	1	3 (Note a)
Mr Rienzie T Wijetilleke	14	****	1	3
Dr V P Vittachi	13	****	****	****
Mr R Theagarajah	14	4 (Note b)	1	3 (Note b)
Mr D H S Jayawardena	14	4	1	****
Mr M V Theagarajah	13	****	1	****
Mr R K Obeyesekere	11	****	1	3
Mrs P C Cooray	14	4	****	3
Mr R Sivaratnam	8	1	****	****
Mr D R Ghazalli	3	****	****	****

	Credit	Asset Disposal	Procurement Committee
Total No. of papers approved in 2006	321	10	11
Mr Rienzie T Wijetilleke	283	****	****
Dr V P Vittachi	13	****	****
Mr R Theagarajah	318 (Note c)	10	11
Mr D H S Jayawardena	9	****	****
Mr M V Theagarajah	174	****	9
Mr R K Obeyesekere	100	10	8
Mrs P C Cooray	180	10	4 (Note d)
Mr R Sivaratnam	64	6	7
Mr D R Ghazalli	63	****	****

Note a - In addition, 17 papers were reviewed and approved by circulation during 2006

Note b - Mr. R Theagarajah attended all meetings by invitation.

Note c - Includes 59 papers approved by Messrs J M J Perera & J D N Kekulawela as alternates to Mr. R Theagarajah

Note d - While Mrs. P C Cooray is not a regular member of this committee, she has been co-opted in lieu of a regular committee member when not available.

**** - Not a committee member.

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FINANCIAL



REPORTS

FINANCIAL CALENDAR

2006

1st Quarter Results 2006 released on
2nd Quarter Results 2006 released on
3rd Quarter Results 2006 released on
25% Interim Dividend for 2006 paid on
Annual Report for 2006 on
38th Annual General Meeting
25% Final Dividend for 2006 payable on

23rd May, 2006
28th July, 2006
15th November, 2006
11th December, 2006
6th March, 2007
29th March, 2007
10th April, 2007

2007

1st Quarter Results 2007
2nd Quarter Results 2007
3rd Quarter Results 2007
*.....% Interim Dividend for 2007
Annual Report for 2007
39th Annual General Meeting
*.....% Final Dividend for 2007
*(*subject to confirmation by Directors)*

April, 2007
July, 2007
October, 2007
December, 2007
March, 2008
March, 2008
April, 2008

Report of the Directors

The Directors take pleasure in presenting to members their report and the audited accounts of the Company for the year ended 31st December 2006. This was approved by the Directors at a meeting held on 15th February, 2007.

Principal Activities

The principal activities of the Bank and the Group during the year were general banking, development banking, mortgage financing, lease financing, corporate financing, dealing in government securities and quoted equities, pawn broking, stock broking, providing insurance services, property development, credit card facilities and other financial services. There have been no significant changes in the nature of the principal activities of the Bank and the Group during the financial year under review.

Review of Operations

A review of the operations of the Bank during the financial year and results of those operations are contained in the Chairman's Statement and in the Managing Director's Assessment of the year on Pages 4 to 11 of this Annual Report. These reports form an integral part of the Directors' Report.

New Product Development

During the year 2006 the Bank introduced "HNB Virtual Branch" which is the Internet Banking Solution for customers.

For the first time in Sri Lanka the Bank introduced "HNB SMS Banking" using an Over the Air menu driven service, in collaboration with Mobitel (Pvt) Ltd.

The Bank also introduced "A Life & Liability" Insurance Cover to our Micro Finance Customers (Gami Pubuduwa) through HNB Assurance where HNB bears 50% of the insurance premium.

In addition to the above the Bank introduced "0% Interest Installment Scheme" through HNB Credit Cards.

Branch Expansion

During the year the Bank opened/relocated the following Customer Centres

Customer Centres opened -

- 1) Jampettah Street
- 2) Pettah 3rd Customer Centre
- 3) Kochchikade

Customer Centres Relocated -

- 1) Peradeniya
- 2) Akurana
- 3) Hatton
- 4) Kahawatte
- 5) Seeduwa

Risk & Internal Control

The Board considers that strong internal controls are integral to the sound management of the Bank, and it is committed to maintaining strict financial, operational and risk management controls over all its activities.

The Directors are ultimately responsible for the Bank's system of internal control and for reviewing its effectiveness. Such a system is designed to manage, rather than eliminate, the risk of failure to achieve business objectives and can provide only reasonable and not absolute assurance against material misstatement or loss. There is an ongoing process for identifying, evaluating and managing the risks that are faced by the Bank, and the Directors have reviewed this process, through the Audit Committee.

The Board of Directors is satisfied with the effectiveness of the system of internal control for the year under review and up to the date of approval of the Financial Statements and Annual Report.

Corporate Governance

The Board is committed to maintaining high standards of corporate governance, the process by which the Bank is directed and managed, risks are identified and controlled and effective accountability assured. The Board of Directors is of the view that it has put in place the resources & the process to ensure that the Bank is substantially compliant with the Code of Best Practices on Corporate Governance issued by Institute of Chartered Accountants of Sri Lanka, throughout the year ended 31st December 2006. The Corporate Governance Report is given on pages 90 to 97 of the Annual Report.

Audit Committee

The Audit Committee comprises entirely of Non-executive directors all of whom served throughout the year. The members of the Committee are :

- Mr R Sivaratnam (Chairman)
- Mr D H S Jayawardena
- Mrs P C Cooray
- Mr Ranjan Seevaratnam (Consultant)

The Report of the Audit Committee is given on page 104 of the Annual Report.

Going Concern

The Board is satisfied that the Bank has adequate resources to continue its operations in the foreseeable future. Therefore, we continue to adopt the going-concern basis in preparing the Financial Statements.

Code of Corporate Conduct

The Management has in clear terms emphasized amongst staff the need to uphold and maintain the highest standards of Corporate Conduct. At the point of entry, every staff member is issued with a letter of appointment and a separate document setting out the code of conduct expected of them which demand strict adherence. Their acceptance and understanding of the expectations of the Management in respect of corporate conduct is obtained by requiring them to subscribe to these documents. The Bank has in place, apart from its Vision & Mission Statements, a Value Statement enshrining the following :-

- Treasure professional & personal integrity at all times
- Demonstrate mutual respect in all interactions
- Passionate about everything we do
- Committed to being customer centric
- Courage to change, challenge and be different
- Demonstrate Unity in Diversity

The need for compliance and upholding of these values is re-emphasized by the CEO in his New Year message to the entire staff annually.

Ensuring secrecy, which is considered to be paramount, is protected by way of the Information Security Policy which prevents staff from disclosing information to unauthorized parties. The acceptance of any improper gratification for personal gain is strictly prohibited and the projected image of the Bank in the public eye is given significance in all interactions and transactions. Non compliance or the slightest deviation of the norms, rules and regulations set by the Management in respect of discipline are not condoned with and offenders are dealt with severely after just and equitable inquiry. The stern and uncompromising stand taken by the Management towards the enforcement of discipline has

proven to be a deterrent to indiscipline and reinforcement for good conduct and behaviour among staff.

Turnover/Gross Income

The Turnover/Gross Income of the Group for 2006 was Rs. 23,233,201,000/- (2005 - Rs. 18,216,726,000/-). An analysis of the Income is given in Note No. 1 to the Financial Statements.

Profit

	2006 Rs.000	2005 Rs.000
The Group Profit for the year ended 31st December 2006 after payment of all expenses of management and providing for depreciation and contingencies	3,095,211	2,008,350
Less: Income tax expense	819,575	213,813
Group Profit for the period	2,275,636	1,794,537
Less: Minority Interest	36,530	24,116
Unappropriated Profit Brought forward from previous year	1,141,653	642,660
Transfer from Capital Reserve (revaluation surplus on property disposed)	-	19,251
Deferred tax liability for revaluation reserve	66,377	-
Balance available for Appropriation	3,447,136	2,432,332

Appropriations

	2006 Rs.000	2005 Rs.000
Transfer to General Reserve	1,150,000	850,000
Transfer to Reserve Fund	45,000	55,000
25% Interim Dividend paid (20% - 2005)	294,412	235,529
Final Dividend 2005/2004.	235,529	150,150
Balance carried forward as at 31.12.2006	1,722,195	1,141,653

Taxation

It is the Bank's policy to provide for deferred taxation on all known timing differences on the liability method.

Income tax rate applicable on the Bank's domestic operations and FCBU on-shore Banking Operations is 35%. The off-shore operations of the FCBU is taxed at 20%.

The Bank was also liable for Financial Services VAT at 20%.

Statutory Payments

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

Dividends

The Directors recommend a 25% (2005 - 20%) Final Dividend to be paid on 10th April 2007 to holders of Issued and paid up Ordinary shares of the Company as at the close of business on 29th March 2007 subject to tax from the balance carried forward as at 31.12.2006 [Note 25]. This Dividend together with the Interim Dividend of 25% (2005 - 20%) paid on 11th December 2006 amounts to a total dividend of 50% (2005 - 40%) for the year 2006.

A part of the interim dividend paid for the year represents a redistribution of the exempt dividends received by the company and will therefore be free of income tax in the hands of the

shareholders. On this basis 94.25% of the 25% Interim dividend paid for 2006 is subject to taxation.

Corporate Donations

During the year the Bank made donations amounting to Rs. 33,477,000/- (2005 - Rs. 19,641,891/-) in terms of the resolution passed at the last Annual General Meeting. No donations have been made to Government approved charities during the year (2005 - Rs. 540,860/-).

Customers

One of the Bank's primary objectives is to provide a caring customer service. To achieve this the Bank carries out regular customer service campaigns amongst its entire staff on the provision of a Courteous, Friendly and Caring Service to its customers. In addition the Bank also carries out customer awareness programmes at Branch level on new products and services offered by the Bank. The Bank offers financial services to both corporate and retail customers.

Suppliers

It is the Bank's policy to call for competitive quotations for the supply of goods and services. Suppliers of goods and services are paid promptly.

Employment Policies

The Bank endeavours to employ, train, develop and retain the best talent available. The needs of the organization propel the employment policies of the Bank which are accordingly tuned from time to time.

A manpower plan is prepared at the beginning of each year on the basis of which recruitment levels are defined. Aspects including Information Technology, Profitability, Projected Growth, Overhead to Net Income Ratio, Optimum Utilization of Resources, Productivity, Work Volumes and Multi Skills come into play when deciding on staff in-take.

Being an equal opportunity employment company, males and females from varying racial, religious and social backgrounds are recruited. Moreover, the island-wide branch network of the Bank provides ample opportunities to youth from the various districts and remote areas to secure employment, provided they satisfy the necessary eligibility criteria.

The Bank fills vacancies through external and internal sources in accordance with the schemes of recruitment which are applicable to different categories of jobs. Due process is followed and every endeavour taken to recruit staff who would fit different jobs. Induction and placement are key aspects in the process of recruitment and selection while strategies are employed to develop and retain staff on a continuous basis.

Capital Expenditure

The total capital expenditure on acquisition of Property, Plant & Equipment, Intangible Assets and Investment Property amounted to Rs. 586,184,000/- (2005 - 545,681,000/-) details of which are given in Notes 20,21 and 22 to the Financial Statements. Capital Expenditure approved and contracted for after the year end is given in Note 33 to the Financial Statements.

Property, Plant & Equipment

The details of the property, plant, and equipment of the company are shown in Note 21 on page 142.

Market Value of Freehold Properties

The value of freehold properties owned by the Bank as at 31st December 2006 is included in the accounts at Rs. 1,407,735,000/- (2005 - Rs. 1,579,147,000/-). A panel of Chartered

Valuers/Licensed Surveyors carried out a re-valuation of the Bank's freehold properties in December 1993. The details of freehold properties owned by the Bank are shown in Note 21(b) on pages 144 to 147.

Reserves

The Group Reserves consist of :

	2006 Rs.000	2005 Rs.000
Share Premium	2,704,096	2,704,096
Capital Reserve	240,262	306,639
Reserve Fund	669,707	624,707
Repairs & Renovation Reserve	6,700	6,700
Revenue Reserve	8,117,195	6,386,653
Total	11,737,960	10,028,795

The movement in these reserves is shown in the Statement of Changes in Equity on page 108.

Share Capital

The total issued and fully paid up capital as at 31st December 2006 was Rs. 1,177,647,000/- consisting of 94,664,700 ordinary shares of Rs. 10/- each voting and 23,100,000 ordinary shares of Rs. 10/- each non-voting.

Shareholding

As at 31st December 2006 there were 14,655 Registered shareholders. The distribution is indicated on pages 187 and 191.

Share Information

Information relating to earnings, dividend, net assets and market price per share is given in Financial Highlights on page 2 of the Annual Report. Information on share trading is given in Note 3 on page 188 of the Annual Report.

Major Shareholders

The twenty largest voting shareholders of the Bank as at 31st December 2006 are given on page 191 together with an analysis of the shareholding.

Future Developments

Information relating to the future developments in the operations of the Bank which will not, in the opinion of the Directors, be prejudicial to the Bank's interest, is contained in the Chairman's Statement and Managing Director's Review of operations.

The Bank whilst implementing and reviewing strategies specified under its business plan, would closely monitor the possible challenges imposed by the fiscal and monetary policy framework. The Bank would continue the initiatives taken in extending the reach by aggressively increasing the branch network island wide and constantly improving the delivery and distribution channels specifically with the use of IT. The Bank also intends to draw synergies from its subsidiaries to harness greater business opportunities for the Group and consolidate the relationships developed so far for better profitability.

Directors

The Board of Directors of Hatton National Bank Limited consists of nine Directors with wide financial and commercial knowledge and experience.

The Directors of the Company and their experience as at the date of the report are shown on pages 12 and 13.

In accordance with the provisions of Article 87 of the Articles of Association, Mr R T Wijetilleke and Mr D H S Jayawardena retire by rotation and both being eligible offer themselves for re-election with the unanimous support of the Board.

In accordance with the provisions of Article 93 of the Articles of Association, Mr M V Theagarajah offers himself for re-election with the unanimous support of the Board. Special Notice have been given pursuant to Sections 138 and 182 of the Companies' Act No. 17 of 1982 of the intention to propose a Special Resolution for such re-election, notwithstanding the age limit of 70 years stipulated by section 181 of the Companies Act.

Directors' Interests

Directors' interests in contracts with the Company, both direct and indirect are referred to in Note 34 to the Accounts. These interests have been declared at the Directors' Meeting held on 25th January, 2007. The Directors have no direct or indirect interest in any other contract or proposed contract with the company.

Directors' Interest in Shares and Debentures

Shareholdings of Directors together with their spouses and dependent children are as follows:

	As at 31/12/06	As at 31/12/05
Mr R T Wijetilleke	3,913	3,913
Dr V P Vittachi	5,005	5,005
Mr R Theagarajah	9,322	9,322
Mr D H S Jayawardena	5,005	5,005
Mr M V Theagarajah	133,374	120,974
Mr R K Obeyesekere	5,005	5,005
Mrs P C Cooray	12,505	12,505
Mr R Sivaratnam	5,040	5,040
Mr D R Ghazalli	500	-

No Director directly holds debentures of the Bank

There has been no change in their interests between 31st December 2006 and 15th February 2007 being the date of Notice of the Annual General Meeting.

Events occurring after the Balance Sheet date

No circumstances have arisen, since the balance sheet date which would require adjustments to or disclosure in the Financial Statements, except those disclosed in the Note 38 to the Financial Statements.

Annual General Meeting

The 38th Annual General Meeting of the Bank is convened on Thursday the 29th day of March 2007 at 10.00 in the forenoon at the Auditorium on Level 22 of "HNB Towers" (Registered Office) at No: 479, T.B. Jayah Mawatha, Colombo 10. The Notice of the 38th Annual General Meeting is on page 197 of this Report.

The Auditors

The retiring Auditors KPMG Ford, Rhodes, Thornton & Company have expressed their willingness to continue in office. In accordance with the Companies Act No: 17 of 1982, a resolution relating to their re-appointment and authorising the Directors to fix their remuneration will be proposed at the forthcoming Annual General Meeting.

By Order of the Board



Indrani Goonesekera

Deputy General Manager
(Legal) Board Secretary

15th February, 2007
Colombo, Sri Lanka

Directors' Responsibility for Financial Reporting

The Bank's Financial Statements for the year ended 31st December 2006 prepared and presented in this report are in conformity with the requirements of Sri Lanka Accounting Standards, the Banking Act No: 30 of 1988, the amendments thereto and Companies Act No. 17 of 1982. The Financial Statements reflect a true and fair view of the state of affairs of the Group as at the date. Financial information presented in this report is consistent with that in the Financial Statements.

The Board of Directors has instituted 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 banking in an orderly manner, safeguard its assets and secure as far as practicable the accuracy and reliability of the records.

The Bank's Auditors, KPMG Ford Rhodes, Thornton & Co. carry out reviews and test checks on effective internal control as they consider appropriate and necessary for providing their opinion on the Financial Statements.

The Board of Directors oversee the management's responsibilities for financial reporting through their regular meeting reviews and the Audit Committee. The Audit Committee comprises three non-executive directors who are responsible for reviewing and approving financial information contained in the Annual Report and overseeing the management's responsibilities for the preparation and presentation of Financial Statements and the effectiveness of the

internal control system in the Bank. Mr R. Seevaratnam former partner, KPMG Ford Rhodes Thornton & Co functions as a Consultant to the Committee. The Board of Directors also reviews interim Financial Statements prior to their release. The Chief Financial Officer is required to submit a report explaining the fundamental accounting principles adopted and material variances in order that the Board of Directors may examine and obtain, all information and explanation required to ensure the reliability of the financial information presented therein.

KPMG Ford Rhodes Thornton & Co are the auditors appointed by the shareholders on the recommendation of the Audit Committee. They have examined the Financial Statements made available by the Board of Directors together with all financial records, related data, minutes of shareholders and Directors meetings and express their opinion which appears as reported by the Auditors on page 105 of the annual report.

By Order of the Board



Indrani Goonesekera
Deputy General Manager
(Legal) Board Secretary

15th February, 2007
Colombo, Sri Lanka

Audit Committee Report

Composition

The Audit Committee comprises three Non-Executive Directors a majority of whom are independent. Mr Ranjan Seevaratnam who is a fellow member of the Institute of Chartered Accountants of Sri Lanka and the Institute of Chartered Accountants, England & Wales and considered a financial expert with wide experience in audit and governance best practices, serves on the audit committee in the capacity of a consultant.

The Directors serving on the Audit Committee are:

Mr R Sivaratnam (Chairman)

Mr D H S Jayawardena

Mrs P C Cooray

The Company Secretary functions as the Secretary to the Audit Committee.

Meetings

The Audit Committee met four times during the year. Attendance by the committee members at each of these meetings is given in the table on page 97. The MD/CEO, CFO and the Internal Auditor also attended these meetings by invitation.

The consultant was in communication with the Internal Audit team and other key management personnel several times during the year.

Financial Reporting

The Committee, as part of its responsibility to oversee the Bank's financial reporting process on behalf of the Board of Directors, has reviewed and discussed with the Management the annual and the quarterly financial statements prior to their release, including the extent of compliance with the Sri Lanka Accounting Standards and disclosure requirements. Matters of special interest in the current environment and the processes that support certifications of the financial statements by the Bank's MD/CEO and CFO were also brought up for discussion.

The Committee also confirmed with the Chief Financial Officer that financial reporting requirements relating to the GDR listing have been complied with.

Risks and Controls

During the year, the Committee reviewed the effectiveness of the framework of the Bank's systems of internal control and has received quarterly reports on all unexpected losses resulting from frauds or operational failures.

The Committee has reviewed the processes for identification, evaluation and management of all significant risks throughout the Bank. The Committee received reports on all significant matters discussed by the Risk Committee.

External Audit

The Audit Committee undertook the annual evaluation of the independence and objectivity of the External Auditor and the effectiveness of the audit process.

The Committee met with the External Auditor during the year to discuss the internal control report and their audit approach and procedures, including matters relating to the scope and auditor independence. The lead audit partner is rotated every five years.

The Committee reviewed the internal control report issued by the external auditor together with the management responses thereto.

The Audit Committee reviewed the non-audit services provided by the external auditor and was of the view that such services were not within the category of services identified as restricted under;

(i) The guideline issued by the Central Bank of Sri Lanka, for external auditors, relating to their statutory duties in terms of section 39 of Banking Act No.30 of 1988 and as amended by Banking Act No.33 of 1995.

(ii) The guidelines for Listed Companies on Audit and Audit Committees issued by the Securities and Exchange Commission of Sri Lanka.

The Letter of Representation issued to the External Auditors was tabled at an Audit Committee meeting.

The Audit Committee has recommended to the Board the remuneration and the re-appointment of KPMG Ford, Rhodes, Thornton & Co. for approval by the shareholders at the Annual General Meeting.

Internal Audit

During the year, the Audit Committee reviewed the performance of the internal audit function, the findings of the audits completed, the Department's resource requirements including succession planning and also approved the internal audit plan.

During the year under review, a vacancy arose for the position of Head of Internal Audit. The Committee is in the process of evaluating a suitable candidate for the post.

Regulatory Compliance

The Committee reviewed the procedures established by management for compliance with the requirements of regulatory bodies. Assistant General Manager Risk & Compliance submitted to the Audit Committee on a quarterly basis, a report on the extent to which the Bank was in compliance with mandatory banking and statutory requirements.

Committee Evaluation

A self evaluation on the effectiveness of the Committee was carried out during the year.

Others

The Audit Committee reviewed issues relating to breach of ethics and the arrangements by which the staff of the Bank may in confidence raise concerns about possible improprieties. The Committee also ensured that the procedures for the independent investigations of such matters are appropriate and are in place.



R Sivaratnam
Chairman

15th February, 2007
Colombo, Sri Lanka.

Auditors' Report



KPMG Sri Lanka, Chartered Accountants
 15th February 2007
 15, Summer Road, Colombo 10, Sri Lanka

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 Website: www.kpmg.lk

REPORT OF THE AUDITORS

TO THE MEMBERS OF HATTON NATIONAL BANK LIMITED

We have audited the balance sheet of Hatton National Bank Ltd as at 31 December 2006, the consolidated balance sheet of the Company and its subsidiaries as at that date, and the related statements of income, changes in equity and cash flows for the year then ended, together with the accounting policies and notes exhibited on pages 106 to 172 of the Annual Report.

Respective Responsibilities of Directors and Auditors

The directors are responsible for preparing and presenting these financial statements in accordance with the Sri Lanka Accounting Standards. Our responsibility is to express an opinion on these financial statements, based on our audit.

Basis of Opinion

We conducted our audit in accordance with the Sri Lanka Auditing Standards, which require that we plan and perform the audit to obtain reasonable assurance about whether the said financial statements are free of material misstatements. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the said financial statements, assessing the accounting principles used and significant estimates made by the directors, evaluating the overall presentation of the financial statements, and determining whether the said financial statements are prepared and presented in accordance with the Sri Lanka Accounting Standards. We have obtained all the information and explanations, which to the best of our knowledge and belief were necessary for the purposes of our audit. We therefore believe that our audit provides a reasonable basis for our opinion.

Opinion

In our opinion, so far as appears from our examination, the Company maintained proper books of account

for the year ended 31 December 2006, and to the best of our information and according to the explanations given to us, the said balance sheet and related statements of income, changes in equity and cash flows and the accounting policies and notes thereto, which are in agreement with the said books and have been prepared and presented in accordance with the Sri Lanka Accounting Standards, provide the information required by the Companies Act No 17 of 1982 and the Banking Act No.30 of 1988 and give a true and fair view of the Company's state of affairs as at 31 December 2006 and of its profit and cash flow for the year then ended.

In our opinion, the consolidated balance sheet and related statements of income, changes in equity and cash flows and the accounting policies and notes thereto have been properly prepared and presented in accordance with the Companies Act No 17 of 1982, the Banking Act No.30 of 1988 and the Sri Lanka Accounting Standards, and give a true and fair view of the state of affairs as at 31 December 2006, and of its profit and cash flow for the year then ended of the Company and its subsidiaries dealt with thereby, so far as concerns the members of the Company.

Directors' Interests in Contracts with the Company

According to the information made available to us, the directors of the Company were not directly or indirectly interested in contracts with the Company during the year ended 31 December 2006, except as stated in Note 34 to these financial statements.

CHARTERED ACCOUNTANTS

15th February, 2007
 Colombo, Sri Lanka.

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 සීමා කළ නොහැක.

Income Statement

For the year ended 31st December	Note	Bank		Group	
		2006 Rs.000	2005 Rs.000	2006 Rs.000	2005 Rs.000
INCOME	1	21,513,173	16,915,314	23,233,201	18,216,726
Interest income	2	18,451,961	14,129,874	19,321,247	14,740,829
Less: Interest expenses	3	9,816,927	7,280,851	10,807,794	8,069,768
Net interest income		8,635,034	6,849,023	8,513,453	6,671,061
Foreign exchange profit		792,303	646,460	792,699	646,166
Fee and commission income		1,795,340	1,663,545	1,860,960	1,639,249
Dividend income	4	76,983	65,050	56,842	65,866
Other income	5	396,586	410,385	1,201,453	1,124,616
OPERATING INCOME		11,696,246	9,634,463	12,425,407	10,146,958
Less:					
OPERATING EXPENSES	6				
Personnel costs		2,765,728	2,415,295	2,894,711	2,533,087
Premises, equipment and establishment expenses		1,905,132	1,732,762	1,751,975	1,536,264
Fee and commission expenses		102,036	116,611	124,051	117,571
Provision for staff retirement benefits		399,189	326,361	400,602	328,321
Bad debts written off		12,205	23,477	10,796	23,477
Provision for loan losses	7	931,828	1,759,444	931,828	1,759,444
Provision for fall in value of investments		-	-	9,482	1,234
Amortization of goodwill/(negative goodwill)		-	-	-	(353)
Other expenses		2,560,678	1,410,551	3,220,368	1,856,725
		8,676,796	7,784,501	9,343,813	8,155,770
PROFIT FROM OPERATIONS		3,019,450	1,849,962	3,081,594	1,991,188
Share of Associate Companies' profit before taxation		-	-	13,617	17,162
PROFIT BEFORE TAXATION		3,019,450	1,849,962	3,095,211	2,008,350
Less: Income tax expense	8	798,961	195,400	819,575	213,813
PROFIT FOR THE PERIOD		2,220,489	1,654,562	2,275,636	1,794,537
Attributable to:					
Equity Holders of the Bank		2,220,489	1,654,562	2,239,106	1,770,421
Minority Interest		-	-	36,530	24,116
PROFIT FOR THE PERIOD		2,220,489	1,654,562	2,275,636	1,794,537
BASIC EARNINGS PER SHARE (Rs.)	9	18.86	15.09	19.01	16.14
DIVIDEND PER SHARE (Rs.)		*5.00	4.00	*5.00	4.00

The Significant Accounting Policies and the Notes from pages 110 to 172 form an integral part of these financial statements.

* Calculated on Interim Dividend paid and Final Dividend proposed, which is to be approved at the Annual General Meeting.

Balance Sheet

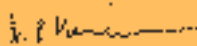
As at 31st December	Note	Bank		Group	
		2006 Rs.000	2005 Rs.000	2006 Rs.000	2005 Rs.000
ASSETS					
Cash and cash equivalents	10	23,308,095	21,200,074	23,343,809	21,193,935
Statutory deposit with Central Bank of Sri Lanka	11	12,016,532	8,565,629	12,016,532	8,565,629
Government Treasury Bills		-	139,340	2,451,695	2,001,340
Commercial papers		290,667	434,073	290,667	434,073
Securities purchased under re-sale agreements		-	-	4,393,281	3,881,251
Dealing securities	12	738,719	313,113	975,153	319,707
Investment securities	13	21,006,789	17,284,945	22,659,639	18,816,694
Bills of Exchange	14	1,910,852	2,026,977	1,910,852	2,026,977
Loans and advances	15	114,708,374	96,242,465	114,276,870	95,675,726
Lease rentals receivable within one year	16	3,796,067	3,112,469	3,796,067	3,112,469
Lease rentals receivable after one year	16	7,756,408	5,751,882	7,756,408	5,751,882
Non-current assets held for sale	17	6,556	-	6,556	-
Investments in Associate Companies	18	132,326	132,326	164,869	170,592
Investments in Subsidiary Companies	19	2,293,663	2,293,663	-	-
Investment properties	20	189,855	-	185,025	-
Property, Plant and Equipment	21	2,907,789	3,059,478	7,385,573	7,552,751
Intangible assets	22	231,975	310,891	259,740	339,403
Other assets	23	5,134,361	5,145,085	5,105,828	5,144,676
Total Assets		196,429,028	166,012,410	206,978,564	174,987,105
LIABILITIES					
Deposits from customers	24	147,882,025	128,283,681	147,787,806	128,130,801
Dividends payable	25	38,103	50,291	38,103	50,291
Borrowings	26	11,031,501	3,940,111	11,031,501	3,940,111
Securities sold under re-purchase agreements		6,736,714	6,113,644	13,892,671	12,103,873
Bills payable		1,190,056	2,226,745	1,190,056	2,226,745
Long-term insurance fund	27	-	-	507,721	300,818
Non-life insurance reserves	28	-	-	319,538	267,020
Subordinated debentures	29	5,120,000	4,000,000	7,083,450	5,976,791
Current tax liability		761,729	5,992	774,035	36,826
Deferred tax liability	30	313,756	313,756	317,675	316,317
Other liabilities	31	10,425,336	9,838,930	10,940,075	10,282,275
Total Liabilities		183,499,220	154,773,150	193,882,631	163,631,868
EQUITY					
Share capital - Voting	32	946,647	946,647	946,647	946,647
Share capital - Non-Voting	32	231,000	231,000	231,000	231,000
Statutory Reserve Fund		669,707	624,707	669,707	624,707
Retained Earnings		1,736,396	1,174,471	1,722,195	1,141,653
Other reserves		9,346,058	8,262,435	9,346,058	8,262,435
Total Equity attributable to Equity Holders of the Bank		12,929,808	11,239,260	12,915,607	11,206,442
Minority Interest		-	-	180,326	148,795
Total Equity		12,929,808	11,239,260	13,095,933	11,355,237
Total Liabilities and Equity		196,429,028	166,012,410	206,978,564	174,987,105
Commitments and Contingencies	33	44,784,964	44,763,208	44,784,964	44,763,208

The Significant Accounting Policies and the Notes from pages 110 to 172 form an integral part of these financial statements.

For and on behalf of the Board



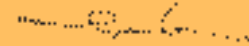
Rienzie T Wijetilleke
Chairman



Dr V P Vittachi
Deputy Chairman



Rajendra Theagarajah
Managing Director/
Chief Executive Officer



Indrani Goonesekera
Deputy General Manager
Legal/Board Secretary

Thursday 15th, February 2007
Colombo, Sri Lanka

Statement of Changes in Equity

For the year ended 31st December 2006

Bank	Attributable to Equity Holders of the Bank									Total
	Share Capital		Statutory Reserve Fund	Other Reserves				Retained Earnings	Minority Interest	
	Voting Shares	Non-Voting Shares		Share Premium	Capital Reserve	General Reserve	Repairs & Renovation Reserve			
	Rs.000	Rs.000	Rs.000	Rs.000	Rs.000	Rs.000	Rs.000	Rs.000	Rs.000	
Balance as at 31.12.2004	770,000	231,000	569,707	1,962,246	325,890	4,395,000	6,700	791,337	-	9,051,880
Transfer of revaluation surplus on property disposed	-	-	-	-	(19,251)	-	-	19,251	-	-
Share issue as underlying for Global Depository Receipts	176,647	-	-	741,850	-	-	-	-	-	918,497
Net profit for the year 2005	-	-	-	-	-	-	-	1,654,562	-	1,654,562
Final dividend for 2004	-	-	-	-	-	-	-	(150,150)	-	(150,150)
Interim dividend for 2005	-	-	-	-	-	-	-	(235,529)	-	(235,529)
Transfers during the year 2005	-	-	55,000	-	-	850,000	-	(905,000)	-	-
Balance as at 31.12.2005	946,647	231,000	624,707	2,704,096	306,639	5,245,000	6,700	1,174,471	-	11,239,260
Net profit for the year 2006	-	-	-	-	-	-	-	2,220,489	-	2,220,489
Final dividend for 2005	-	-	-	-	-	-	-	(235,529)	-	(235,529)
Interim dividend for 2006	-	-	-	-	-	-	-	(294,412)	-	(294,412)
Deferred tax liability for Revaluation Reserve	-	-	-	-	(66,377)	-	-	66,377	-	-
Transfers during the year 2006	-	-	45,000	-	-	1,150,000	-	(1,195,000)	-	-
Balance as at 31.12.2006	946,647	231,000	669,707	2,704,096	240,262	6,395,000	6,700	1,736,396	-	12,929,808

Group	Attributable to Equity Holders of the Bank									Total
	Share Capital		Statutory Reserve Fund	Other Reserves				Retained Earnings	Minority Interest	
	Voting Shares	Non-Voting Shares		Share Premium	Capital Reserve	General Reserve	Repairs & Renovation Reserve			
	Rs.000	Rs.000	Rs.000	Rs.000	Rs.000	Rs.000	Rs.000	Rs.000	Rs.000	
Balance as at 31.12.2004	770,000	231,000	569,707	1,962,246	325,890	4,395,000	6,700	642,660	124,679	9,027,882
Transfer of revaluation surplus on property disposed	-	-	-	-	(19,251)	-	-	19,251	-	-
Share issue as underlying for Global Depository Receipts	176,647	-	-	741,850	-	-	-	-	-	918,497
Net profit for the year 2005	-	-	-	-	-	-	-	1,770,421	24,116	1,794,537
Final dividend for 2004	-	-	-	-	-	-	-	(150,150)	-	(150,150)
Interim dividend for 2005	-	-	-	-	-	-	-	(235,529)	-	(235,529)
Transfers during the year 2005	-	-	55,000	-	-	850,000	-	(905,000)	-	-
Balance as at 31.12.2005	946,647	231,000	624,707	2,704,096	306,639	5,245,000	6,700	1,141,653	148,795	11,355,237
Net profit for the year 2006	-	-	-	-	-	-	-	2,239,106	36,530	2,275,636
Final dividend for 2005	-	-	-	-	-	-	-	(235,529)	(4,999)	(240,528)
Interim dividend for 2006	-	-	-	-	-	-	-	(294,412)	-	(294,412)
Deferred tax liability for Revaluation Reserve	-	-	-	-	(66,377)	-	-	66,377	-	-
Transfers during the year 2006	-	-	45,000	-	-	1,150,000	-	(1,195,000)	-	-
Balance as at 31.12.2006	946,647	231,000	669,707	2,704,096	240,262	6,395,000	6,700	1,722,195	180,326	13,095,933

Statutory Reserve Fund represents the statutory requirement in terms of section 20 (1) and (2) of the Banking Act No. 30 of 1988.

Share Premium account is generally used for writing-off of share issue expenses. There are no restrictions on the distribution of balance to shareholders.

Capital Reserve relates to revaluation of Freehold Land & Buildings carried out in 1989 and 1993 and includes the surplus on revaluation of those assets.

General Reserve comprises the amounts appropriated by the Board of Directors as a general banking reserve.

Repairs and Renovation Reserve includes the amounts allocated for repairs and renovation.

The Significant Accounting Policies and the Notes from pages 110 to 172 form an integral part of these financial statements.

Cash Flow Statement

For the year ended 31st December	Bank		Group	
	2006 Rs.000	2005 Rs.000	2006 Rs.000	2005 Rs.000
Cash flows from operating activities				
Interest and commission receipts	20,247,301	15,793,419	21,115,183	16,380,078
Interest payments	(9,816,927)	(7,280,851)	(10,807,794)	(8,069,768)
Receipts from other operating activities	1,017,922	860,276	1,800,866	1,572,249
Cash payments to employees	(3,164,917)	(2,741,656)	(3,295,313)	(2,863,595)
Cash payments to suppliers	(1,373,520)	(1,238,441)	(1,117,766)	(1,070,864)
Payments for other operating activities	(2,801,356)	(1,529,384)	(3,388,173)	(1,826,964)
Operating profit before changes in operating assets and liabilities [Note (a)]	4,108,503	3,863,363	4,307,003	4,121,136
(Increase)/Decrease in operating assets:				
Treasury bills/commercial papers	282,746	108,702	(306,949)	(1,009,016)
Deposits held for regulatory or monetary control purposes	(3,450,903)	554,762	(3,450,903)	554,762
Loans and advances	(21,939,672)	(14,898,628)	(21,957,993)	(14,769,828)
Other short term assets	123,722	525,299	(69,013)	2,202,340
Increase/(Decrease) in operating liabilities:				
Deposits from customers	19,884,021	10,573,449	19,942,682	10,602,565
Negotiable certificates of deposit	(285,677)	(813,702)	(285,677)	(813,702)
Other liabilities	(1,036,689)	558,571	(777,268)	558,571
Net cash from operating activities before income tax	(2,313,949)	471,816	(2,598,118)	1,446,828
Income taxes paid	-	-	(21,210)	(9,509)
Net cash generated from/(used in) operating activities	(2,313,949)	471,816	(2,619,328)	1,437,319
Cash flows from investing activities				
Dividend income	76,983	65,050	56,842	64,818
Income from investment securities	188,141	122,433	188,141	122,665
Net proceeds from sale of securities	(296,402)	284,526	(1,295,057)	284,526
Net proceeds from sale of investment securities	(3,932,135)	(500,162)	(3,703,326)	(1,046,263)
Purchase of Property, Plant & Equipment	(483,396)	(312,520)	(559,443)	(350,560)
Purchase of Intangible assets	(21,200)	(184,091)	(26,716)	(195,096)
Improvements to Investment properties	(25)	-	(25)	-
Proceeds from sale of Property, Plant & Equipment	11,268	10,710	11,268	10,734
Net cash used in investing activities	(4,456,766)	(514,054)	(5,328,316)	(1,109,176)
Cash flows from financing activities				
Increase in Debentures	1,120,000	-	1,106,659	(6,659)
Increase of borrowings	7,714,460	1,229,267	8,880,188	740,608
Net increase in other liabilities	586,405	(569,550)	657,800	(456,277)
Dividends paid	(542,129)	(443,687)	(547,129)	(443,687)
Proceeds from issue of shares	-	918,497	-	918,497
Net cash generated from financing activities	8,878,736	1,134,527	10,097,518	752,482
Net increase in cash and cash equivalents	2,108,021	1,092,289	2,149,874	1,080,625
Cash and cash equivalents at beginning of the year	21,200,074	20,107,785	21,193,935	20,113,310
Cash and cash equivalents at end of the year [Note (10)]	23,308,095	21,200,074	23,343,809	21,193,935
Note (a) Reconciliation of operating profit				
Profit before taxation	3,019,450	1,849,962	3,095,211	2,008,350
Dividend income	(76,983)	(65,050)	(56,842)	(65,866)
Income from investment securities	(188,141)	(152,389)	(188,141)	(151,573)
(Profit)/loss on sale of Property, Plant and Equipment	(4,064)	7,749	(4,064)	7,749
Bad debts recovered	(209,120)	(142,095)	(209,120)	(142,095)
Loss on FCBU revaluation	58,603	29,956	58,603	29,956
Depreciation of Property, Plant and Equipment	430,211	457,229	523,343	551,943
Depreciation of Investment properties	1,284	-	4,487	-
Amortization of Intangible assets	100,116	37,092	106,379	42,116
Provision for loan losses	931,828	1,759,444	931,828	1,759,444
Loss on marked to market valuation of dealing securities	45,319	81,465	45,319	81,465
Goodwill/(Negative goodwill) amortization	-	-	-	(353)
	4,108,503	3,863,363	4,307,003	4,121,136

The Significant Accounting Policies and the Notes from pages 110 to 172 form an integral part of these financial statements.

Significant Accounting Policies

REPORTING ENTITY

Hatton National Bank Limited ("Bank") is a public quoted company incorporated on 5th March 1970 with limited liability and domiciled in Sri Lanka. The registered office of the Bank is situated at No. 479, T B Jayah Mawatha, Colombo 10. The staff strength as at 31st December 2006 is 4,287 (2005 - 4,259).

The consolidated financial statements of the Bank for the year ended 31st December 2006 cover the Bank and its Subsidiaries, HNB Securities Limited, HNB Stockbrokers (Pvt) Limited, HNB Assurance Limited and Sithma Development (Pvt) Limited (together referred to as the "Group") and the Group's interest in its Associate companies M/s Lanka Ventures Limited and Browns Engineering (Pvt) Limited.

There were no significant changes in the nature of the principal activities of the Bank and the Group during the financial year under review.

The principal activities of the Bank continued to be banking and related activities such as accepting deposits, corporate and retail credit, personal financial services, off shore banking, foreign currency operations, trade services, investment banking, development banking, rural finance, project finance, dealing in government securities, etc.

The principal activities of HNB Securities Limited, HNB Stockbrokers (Pvt) Limited, HNB Assurance Limited and Sithma Development (Pvt) Limited are dealing in government securities as primary dealer, stock brokering, insurance services and property development respectively.

The principal activities of Lanka Ventures Limited and Browns Engineering (Pvt) Limited are providing venture capital services, construction and engineering.

1. APPROVAL OF FINANCIAL STATEMENTS BY DIRECTORS

The financial statements were authorised for issue by the Board of Directors on Thursday, 15th February 2007.

2. STATEMENT OF COMPLIANCE

The Balance Sheet, Income Statement, Statement of Changes in Equity and Cash Flow Statement have

been prepared in accordance with the Sri Lanka Accounting Standards laid down by the Institute of Chartered Accountants of Sri Lanka.

3. BASIS OF PREPARATION

The financial statements are prepared under historical cost convention and applied consistently with no adjustments being made for inflationary factors affecting the financial statements, except for the following;

- Land and buildings are measured at cost at the time of acquisition and subsequently at revalued amounts, which are the fair values at the date of revaluation less any accumulated depreciation and impairment losses, if any. Land and buildings are revalued on a rolling basis with the view of completing the revaluation of this class of asset within a short period.
- Dealing securities are measured at market value.
- Foreclosed properties are measured at market value on an individual property basis.

Where appropriate, the policies are explained in the accompanying notes.

The accounting policies of the Bank have been consistently applied by Group entities where applicable and any deviations have been disclosed accordingly.

4. FUNCTIONAL AND PRESENTATION CURRENCY

The financial statements are presented in Sri Lanka Rupees, which is the Group's functional currency. Except as indicated, financial information presented in Sri Lankan Rupees has been rounded to the nearest thousand.

5. USE OF ESTIMATES AND JUDGEMENTS

The preparation of financial statements requires management to make judgments, estimates and assumptions that affect the application of accounting policies and the reported amounts of assets, liabilities, income and expenses. Actual results may differ from these estimates.

Estimates and underlying assumptions are reviewed on an ongoing basis. Revisions to accounting estimates are recognised in the period in which the estimate is revised and in any future periods affected.

6. MATERIALITY AND AGGREGATION

Each material item is presented separately in the financial statements. Other amounts are aggregated with amounts of similar nature or function.

7. BASIS OF CONSOLIDATION

All entities which are controlled by the Bank are consolidated in the financial statements. The consolidated financial statements are prepared on the historical cost basis except that certain assets are stated at their fair value. Such assets are dealing securities, certain land and buildings and foreclosed properties.

7.1 Subsidiaries

Subsidiaries are entities that are controlled by the Bank. Control exists when the Bank has the power, directly or indirectly, to govern the financial and operating policies of an entity so as to obtain benefits from its activities. In assessing control, potential voting rights, that presently are exercisable are taken into account. The financial statements of Subsidiaries are included in the consolidated financial statements from the date that control effectively commences until the date that control effectively ceases.

The Minority Interest are presented in the consolidated Balance Sheet within Equity, separately from the equity attributable to the Equity Holders of the Bank. Minority Interest in the profit or loss of the Group are disclosed separately in the consolidated Income Statement.

The consolidated accounts are prepared to a common financial year end of 31st December. A list of Subsidiaries within the Group is provided in Note No. 19.

7.2 Associates

Associates are entities in which the Group has significant influence, but not control over the financial and operating policies. The consolidated financial statements include the Group's share of the total recognised

gains and losses of Associates under the equity method, from the date that significant influence effectively commences until the date that significant influence effectively ceases. A list of Associates within the Group is provided in Note No. 18.

7.3 Transactions Eliminated on Consolidation

Intra-group balances and transactions and any unrealised gains arising from intra-group transactions, are eliminated in preparing the consolidated financial statements. Unrealised gains arising from transactions with Associates are eliminated to the extent of the Group's interest in the Associate against the investments in the Associate. Unrealised losses are eliminated in the same way as unrealised gains except that they are only eliminated to the extent that there is no evidence of impairment.

8. FOREIGN CURRENCY TRANSLATION

8.1 Transactions in foreign currencies are translated to Sri Lanka Rupees at the middle rate of exchange ruling at the date of the transaction.

Monetary assets and liabilities denominated in foreign currencies are stated at historical cost at the Balance Sheet date and are translated at the middle rate of exchange ruling at that date. Foreign exchange differences arising on the settlement or reporting of the Bank's monetary items at rates different from those which were initially recorded are dealt with in the Income Statement.

Non-monetary assets and liabilities denominated in foreign currency that are stated at historical cost at the Balance Sheet date are translated to Sri Lanka Rupees at the foreign exchange rates ruling at that date.

8.2 Forward Exchange Contracts are valued at the forward market rates ruling on the date of the Balance Sheet. Resulting net unrealised gains and losses are dealt with through the Income Statement.

9. ASSETS AND BASES OF THEIR VALUATION

9.1 Cash and Cash equivalents

Cash and cash equivalents include cash in hand, balances with banks, placements with banks, money at call and short notice and money market funds. They are brought to account at the face value or the gross value where appropriate.

9.2 Statutory Deposit with Central Bank of Sri Lanka

The Monetary Law Act requires that all commercial banks operating in Sri Lanka maintain reserves against all deposit liabilities denominated in Sri Lanka Rupees. The reserve is an amount equal to 10% of the total of such rupee deposit liabilities.

9.3 Securities Purchased Under Re-sale Agreements

Securities purchased under re-sale agreements are recorded separately in the financial statements at cost. The difference between the purchase and sale price represents interest income and is recognized in the Income Statement over the period of the resale agreement.

9.4 Investments

9.4.1 Dealing Securities

These are marketable securities acquired and held with the intention of resale over a short period of time. Such securities are recorded at market value. Adjustment for changes in market value is accounted for in the Income Statement.

The quoted ordinary shares classified as dealing securities were recorded at the lower of cost or market value on an aggregate portfolio basis in the previous years. The requirement to mark to market was stipulated by the direction issued by the Central Bank of Sri Lanka on "Prudential norms for classification, valuation and operation of the Bank's investment portfolio" dated 1st March 2006.

9.4.2 Investment Securities

These are acquired and held for yield or capital growth in the medium/long term with

the positive intent and ability to hold until maturity. Such securities are recorded at cost. Interest and dividend income are accrued. Changes in market values of these securities are not taken into account, unless there is considered to be a diminution in value which is other than temporary.

9.4.2(a) Amortization of Premium/Discount on Foreign Bonds

The Bank holds foreign treasury bonds as long term investments. The premium/discount on the bonds is amortized on a straight line basis over the period to maturity.

9.4.3 Investments in Subsidiaries

Investments in Subsidiaries are stated at cost in the Bank's financial statements.

9.4.4 Investments in Associates

Investments in Associates are accounted for at cost in the Bank's financial statements and under Equity method in the consolidated financial statements.

Under the Equity method, the investments in Associates are initially accounted for at cost, and the carrying amount is adjusted for post acquisition changes in the Group's share of net assets of the Associates, less any impairment in the Group's net investments in Associates.

9.5 Non-Current Assets held for Sale

Non-current assets are classified as "Non-current assets held for sale" once identified that the carrying amount will be recovered principally through a sale transaction rather than through continuing use. These are assets which are available for immediate sale in its present condition, subject only to terms that are usual and customary for sale of such assets and its sale is highly probable.

"Non-current assets held for sale" are presented separately on the face of the balance sheet at the lower of its carrying amount and fair value less costs to sell.

Assets classified as "Non-current assets held for sale" are neither amortized nor depreciated.

9.6 Loans and Advances to Customers

Loans and advances to customers are stated in the Balance Sheet at the recoverable amount represented by the gross value of the outstanding balance adjusted for provision for loan losses and interest in suspense (interest which is not accrued to revenue).

9.6.1 Non-performing Loans

Loans, advances and finance leases which are 90 days or more in arrears of due capital and/or interest are classified as non-performing. Provision for possible loan losses are made on the basis of a continuous review of all advances to customers, in accordance with the Sri Lanka Accounting Standard 23, "Revenue Recognition" and the directions issued by the Central Bank of Sri Lanka and disclosed in the financial statements of the Bank.

9.6.2 Foreclosed Properties

Foreclosed properties represent properties acquired in full or partial settlement of loans and advances and are yet to be disposed. These are accounted for at the lower of cost or market value on an individual property basis. The shortfall between the prevailing market value of the foreclosed property and the related loan outstanding is recognised as a provision for loan losses in the Income Statement during the year of acquiring the foreclosed property in satisfaction of the debt. Any shortfall between the carrying amount of the foreclosed properties and their respective market values identified subsequently is charged as a provision for loan losses in the Income Statement. Subsequent gains and losses on the disposal of the foreclosed properties are treated as provisions written back or charged to the Income Statement respectively. Foreclosed properties are recorded under loans and advances until they are disposed.

9.6.3 Provision for Loan Losses

Specific provisions for loan losses are made as follows:

Period outstanding	Classification	Provision made net of realisable value of security
6-12 months	Sub-standard	20%
12-18 months	Doubtful	50%
18 months and over	Loss	100%

The provision made relates to all categories of advances including pawning and leasing identified as sub-standard, doubtful and loss.

Where necessary, specific provisions have been made over and above the minimum percentages stipulated above, on a case by case basis.

9.6.4 Revenue Recognition on Non-performing Loans

When an advance is classified as non-performing as set out in Accounting Policy No. 9.6.1, interest income ceases to be recognized and is taken to income only on a cash basis.

9.6.5 General Provision

A general provision of 0.1% of the total portfolio of pawning facilities, 2% of the lease receivables (net of specific provision) and 0.2% of the total portfolio of Shanthi Housing Loans is made in conformity with industry practice.

The direction issued by the Monetary Board of the Central Bank of Sri Lanka on 5th December 2006, in terms of Section 46 of the Banking Act No 30 of 1988, as amended on "Requirements to maintain a general provision for Advances", requires all licensed commercial banks to maintain a general provision of 1% of the total performing loans and advances and overdue loans and advances, net of Interest in Suspense and loans and advances secured by cash deposits, gold or Government securities. The general provision is to commence with a 0.1% provision as at 31st December 2006 and thereafter, incremental provisions of 0.1% every quarter till 31st March 2009, with the view of meeting the

total provision requirement of 1% not later than 31st March 2009.

9.7 Finance Leases

Assets leased to customers which transfer substantially all the risks and rewards associated with ownership other than legal title, are classified as finance leases. Amounts receivable under finance leases are included under 'Lease Rentals Receivable'. Leasing balances are stated in the Balance Sheet after deduction of initial rentals received, unearned lease income and the provisions for rentals doubtful of recovery.

9.7.1 Provision for Lease Receivables

Specific provision has been made in relation to identified bad and doubtful leases as stated above in Accounting Policy No 9.6.3. In addition, a general provision has been made as stated above in Accounting Policy No 9.6.5.

9.8 Intangible Assets

9.8.1 Basis of Recognition

An intangible asset is recognized if it is probable that the future economic benefits that are attributable to the asset will flow to the entity and the cost of the assets can be measured reliably.

9.8.1 (a) Goodwill

Goodwill arising on the acquisition represents the excess of the cost of acquisition over the Group's interest in the net fair value of the acquiree's identifiable assets, liabilities and contingent liabilities at the date of acquisition. Upon transition to revised Sri Lanka Accounting Standard 25 "Business Combinations", goodwill will no longer be amortized. Instead, goodwill will be tested for impairment annually and assessed for any indication of impairment at each reporting date to ensure that its carrying amount does not exceed its recoverable amount. If an impairment loss is identified, it will be recognised immediately in the Income Statement.

9.8.1 (b) Software

All computer software costs incurred, licensed for use by the Bank, which are not integrally related to associated hardware, which can be clearly identified, reliably

measured and its probable that they will lead to future economic benefits, are included in the Balance Sheet under the category intangible assets and carried at cost less cumulative amortization and any accumulated impairment losses.

9.8.2 Subsequent Expenditure

Expenditure incurred on intangible assets is capitalized only when it increases the future economic benefits embodied in the specific asset to which it relates. All other expenditure is expensed as incurred.

9.8.3 Amortization

Intangible assets, except for goodwill are amortized on a straight line basis in the Income Statement from the date when the asset is available for use, over the best estimate of its useful economic life. The estimated useful life of intangible assets is six years.

9.9 Investment Properties

Investment properties are properties held either to earn rental income or for capital appreciation or both.

9.9.1 Basis of Recognition

The Bank applies the cost model for investment properties in accordance with Sri Lanka Accounting Standard 40 - "Investment Property" (revised 2005). Accordingly, land classified as investment properties are stated at cost and buildings classified as investment properties are stated at cost less any accumulated depreciation and any accumulated impairment losses.

9.9.2 Depreciation

Depreciation is provided on a straight line basis over the estimated life of the class of asset.

Hatton National Bank	
Freehold buildings	2.5% per annum
Sithma Development (Pvt) Ltd	
Freehold buildings (Smart building)	2.5% per annum
Plant, machinery & equipment integral to freehold buildings	20% per annum

Depreciation is provided from the date of purchase up to the date of disposal.

9.9.3 Derecognition

Investment properties are derecognised when disposed of, or permanently withdrawn from use because no future economic benefits are expected. Transfers are made to and from investment property only when there is a change in use.

9.10 Property, Plant and Equipment

9.10.1 Recognition and Measurement

Property, Plant and Equipment are recorded at cost of purchase or construction or valuation together with any incidental expenses thereon less accumulated depreciation and any accumulated impairment losses.

Cost includes expenditure that is directly attributable to the acquisition of the asset. The cost of self constructed assets includes the cost of materials and direct labour, any other costs directly attributable to bringing the asset to a working condition for its intended use and the costs of dismantling and removing the items and restoring the site on which they are located. Purchased software that is integral to the functionality of the related equipment is capitalized as part of computer equipment.

The Bank applies the revaluation model for the entire class of freehold land and buildings. Such properties are carried at a revalued amount, being its fair value at the date of revaluation less any subsequent accumulated depreciation and subsequent accumulated impairment losses. Freehold land & buildings of the Bank are revalued every seven years to ensure that the carrying amounts do not differ materially from the fair values at the balance sheet date. Freehold land and buildings are revalued on a rolling basis, so as to complete the revaluation within a short period.

On revaluation of an asset, any increase in the carrying amount is credited directly to equity, under capital reserve or used to reverse a previous revaluation decrease relating to the same asset, which was debited to the Income Statement. In this circumstance, the increase is recognized as income to the extent of the previous write down. Any decrease in the carrying amount is recognized as an expense in the Income

Statement or debited directly to equity under revaluation reserve to the extent of any credit balance existing in the capital reserve in respect of that asset.

The Bank applies the cost model for all the other Property, Plant and Equipment and they are carried at cost less any accumulated depreciation and any accumulated impairment losses.

9.10.2 Subsequent Costs

The cost of replacing part of an item of Property, Plant and Equipment is recognized in the carrying amount of the item if it is probable that the future economic benefits embodied within the part will flow to the Bank and its cost can be measured reliably. The costs of day to day servicing of Property, Plant and Equipment are charged to the Income Statement as incurred.

When replacement costs are recognized in the carrying amount of an item of Property, Plant and Equipment, the remaining carrying amount of the replaced part is derecognized. Major inspection costs are capitalized. At each such capitalization, the remaining carrying amount of the previous cost of inspections is derecognised.

9.10.3 Depreciation

The Bank and its Subsidiary companies provide depreciation from the date the assets are available for use up to the date of disposal, at the following rates on a straight line basis over the periods appropriate to the estimated useful lives of the different types of assets, except for which are disclosed separately.

HNB and Subsidiary companies (except for Sithma Development (Pvt) Ltd.)

	% per annum
Freehold buildings	2.5
Motor vehicles	25
Computer equipment	
- Additions before 1.7.2000	25
- Additions after 1.7.2000	16.7
- Additions before 1.1.2005 (HNB Assurance)	25
- Additions after 1.1.2005 (HNB Assurance)	16.7
Office equipment	20
Furniture and fittings	10
Fixtures	10

Depreciation is not provided for freehold land. Improvements made to leasehold buildings are amortized over the lease period except for HNB Stockbrokers (Pvt) Ltd who amortizes at 20% per annum.

Sithma Development (Pvt) Ltd.	% per annum
Freehold buildings	
- Sithma building	1
- Smart building	2.5
Generators, generator panels and associated power cables	2
Chillers, cooling towers and associated equipment	4
Lifts and escalator	4
Building management systems	4
Plant and machinery	20
Equipment	20
Motor vehicle	25

9.10.4 Capital Work-in-Progress

Capital work-in-progress is stated at cost. These are expenses of a capital nature directly incurred in the construction of buildings, major plant and machinery and system development, awaiting capitalization.

9.10.4.(i) Sithma Development (Pvt) Ltd.

Sithma Development (Pvt) Ltd. commenced a project to develop a residential apartment complex. The expenses that are of a capital nature will be accounted as capital work-in-progress until the completion of the project.

9.10.5 Borrowing Costs

Borrowing costs that are directly attributable to the acquisition, construction or production of a qualifying asset have been capitalised as part of the cost of the asset in accordance with Sri Lanka Accounting Standard 20, "Borrowing Costs". Capitalisation of borrowing costs cease when substantially all the activities necessary to prepare the qualifying asset for its intended use are completed.

10. IMPAIRMENT

10.1 Financial Assets

The Bank assesses at each Balance Sheet date whether there is objective evidence that a financial asset or a portfolio of financial assets is impaired. A financial asset or portfolio of financial assets is impaired and

impairment losses are incurred if and only if, there is objective evidence of impairment as a result of one or more loss events that occurred after the initial recognition of the asset and prior to the balance sheet date ("a loss event"), and that loss event or events have had an impact on the estimated future cash flows of the financial asset (or the portfolio), that can be reliably estimated.

The Bank first assesses whether objective evidence of impairment exists individually for financial assets that are individually significant and collectively for financial assets that are not individually significant (except for loans and advance, which is explained below). Assets that are individually assessed for impairment and for which an impairment loss is or continues to be recognised are not included in a collective assessment of impairment.

For loans and advances, impairment loss is measured individually and collectively as explained in Accounting Policy No 9.6. When a loan is uncollectible, it is written off against the related provision. Such loans are written off after all the necessary procedures have been completed and the amount of the loss has been determined. Subsequent recoveries of the amounts previously written off is included under "Other Income" in the Income statement.

If in a subsequent period, the amount of the impairment loss decreases and the decrease can be related objectively to an event occurring after the impairment was recognised, the previously recognised impairment loss is reversed by adjusting the impairment provision account. The amount of the reversal is recognised in the Income Statement.

10.2 Non Financial Assets

Tangible and intangible assets (excluding deferred tax assets which is explained in Accounting Policy No. 15.3.2) are written down to recoverable amount where their carrying value exceeds recoverable amounts.

The carrying values of Property, Plant and Equipment are reviewed for impairment annually or when events or changes in circumstances indicate that the carrying value may not be recoverable. If such indications exist and where the carrying values exceed the estimated recoverable amount, the assets are written down to their recoverable amount. Impairment losses are recognised in the Income Statement unless it reverses a previous revaluation surplus for the same asset.

Assets with an indefinite useful life, including goodwill, are not subject to amortization and are tested on an annual basis for impairment and additionally whenever an indication of impairment exists. Assets that are subject to amortization are reviewed for impairment whenever events or changes in circumstances indicate that the carrying amount may not be recoverable.

The recoverable amount of an asset is the higher of its fair value less costs to sell or its value in use. Any decrease in the carrying value is recognised as an expense in the Income Statement in the reporting period in which the impairment loss occurs.

For assets that do not generate largely independent cash inflows, the recoverable amount is determined for the cash generating unit to which that asset belongs. Management judgement is applied to establish cash generating units. Each of these cash generating units is represented by an individual primary reporting segment, or a subdivision of a primary segment.

An impairment loss in respect of goodwill is not reversed. In respect of other assets impairment losses recognised in prior periods, are assessed at each balance sheet date for any indications that the loss has decreased or no longer exists. An impairment loss is reversed if there has been a change in estimates used to determine the recoverable amount. An impairment loss is reversed only to the extent that the assets carrying amount does not exceed the carrying amount that

would have been determined, net of depreciation or amortization, if no impairment loss had been recognised.

11. LIABILITIES AND PROVISIONS

11.1 Deposits from Customers

Deposits include non interest bearing deposits, savings deposits, term deposits, deposits redeemable at call and certificate of deposits. They are brought to account at the gross value of the outstanding balance. Interest paid is charged to the Income Statement.

11.2 Dividends Payable

Provision for dividends is recognised at the time the dividend recommended and declared by the Board of Directors is approved by the shareholders.

11.3 Borrowings

Borrowings include refinance borrowings, call and time deposits, vostro balances and borrowings from financial institutions. They are brought to account at the gross value of the outstanding balance.

11.4 Securities Sold under Re-purchase Agreement

Securities sold under agreements to re-purchase are recorded separately in the financial statements. The difference between the sale and the purchase price represents interest expense, which is recognized in the Income Statement over the period of the re-purchase agreement.

11.5 Bills Payable and Other Liabilities

Bills payable and other liabilities include all financial liabilities, interest, fees, expenses payable and securities purchased but not delivered. These liabilities are recorded at the cash value to be realized when settled.

11.6 Employee Benefits

11.6.1 Pensions and Retirement Benefits

The Bank operates an approved Pension Fund to facilitate the following payments for permanent staff of the Bank:

a) Pensions to retiring staff

b) Benefits to staff who opted for the Optional Scheme for Pension introduced in 2005

c) Gratuity

Monthly provision is made by the Bank to the Pension Fund, based on a percentage of the gross salary of employees. The percentage of contributions will be determined by an independent actuary and retirement benefits are provided to all permanent staff. The Bank carries out an actuarial valuation of the Pension Fund in December each year to ascertain the full liability of the Fund.

An actuarial valuation of the pension fund was carried out as at 31st December 2006 by M/s Actuarial and Management Consultants (Pvt) Ltd., a firm of professional actuaries. The valuation method used by the actuaries to value the Fund is the "Projected Unit Credit Method", the benchmark method recommended by the Sri Lanka Accounting Standard No. 16 "Retirement Benefit Cost" [SLAS 16].

The principal financial assumptions used in the valuation are as follows:

Long term rate of interest (Gross)	12% p.a.
Salary increases (long term)	10% p.a.
Increase in Cost of Living Allowance (long term)	10% p.a.

The demographic assumptions underlying the valuation are retirement age (55 yrs.), early withdrawals from service and retirement on medical grounds, death before and after retirement etc.

The results of the actuarial valuation indicate that the actuarial present value of the promised retirement benefit is Rs. 4,071 Mn. and that the fair value of the fund assets is Rs. 3,229 Mn. resulting in a past service deficit of Rs. 842 Mn. (2005 - 1,885.9 Mn.) in the Pension Fund due to the changes in actuarial assumptions that took place since the previous actuarial valuation as at 31st December 2005.

The actuary recommended the amortization of the past service deficit by regular contributions over the full working lifetime of

the current employees by incorporating it into the ongoing contribution rate.

Accordingly, the Bank contributes on the following basis for the employees to the Pension Fund:

Pensionable Employees - 24.34%

Employees who opted for the Optional Scheme - 23%

The amount recognized as an expense for the current year is Rs. 399.2 Mn. (2005 - 326.3 Mn.). The assets of the fund, which are independently administered by the Trustees as per the provision of the Trust Deed held separately from those of the Bank.

No additional provision has been made in the accounts of the Bank for gratuities to employees who complete five or more years of service, payable under the Payment of Gratuity Act No. 12 of 1983, as the Bank contributes for all permanent employees to its own non-contributory pension scheme which is in force.

11.6.2 Widows, Widowers and Orphans Pension Fund

The Bank operates a separate Widows, Widowers and Orphans Pension Scheme (WW & OP) which was established with effect from 1st September 1995.

The actuarial valuation of Widows, Widowers and Orphans Pension Scheme is carried out by the same actuary, who carried out the actuarial valuation of the Pension Fund using the same method and same assumptions detailed in Note 11.6.1 above.

The results of the actuarial valuation of the Widows, Widowers and Orphans Pension Scheme indicates that the actuarial present value of the promised benefit is Rs.307 Mn. and that the fair value of the fund assets is Rs. 229 Mn. resulting in a past service deficit of Rs. 78 Mn. (2005 - 216.8 Mn.) in the Widows, Widowers and Orphans Pension Scheme as at 31st December 2006.

The actuary has confirmed that the ongoing rate of contribution which is 3% of the Gross Salary contributed by the members of the fund

is sufficient to cover the total liability of the fund, including the past service deficit.

The amount contributed by the members for the current year is 21.4 Mn. (2005 - Rs. 24.6 Mn.).

11.6.3 Defined Contribution Plans

Contributions to defined contribution pension plans are recognised as an expense in the Income Statement as and when incurred.

Provident Fund

The Bank and employees contribute to the approved private Provident Fund. The total amount recognised as an expense for the current year is Rs.208.1 Mn. (2005 - Rs. 180 Mn.).

Trust Fund

The Bank contributes to the Employees' Trust Fund. The total amount recognised as an expense for the current year is Rs.52 Mn. (2005 - Rs. 45 Mn.).

11.6.4 Employee Share Option Plan

The Bank continued the Employee Share Option Plan to executive and higher rank officers which was introduced in 2005. The amount released to the employees who left the service in 2006 is Rs. 9 Mn. No new shares were offered to the employees during 2006 under the plan.

11.6.5 HNB Securities Limited

Defined Benefit Plan

Provision has been made for retirement gratuities from the first year of service for all employees in conformity with SLAS - 16. However, under the Payment of Gratuity Act No. 12 of 1983, the liability to an employee arises only on completion of five years of continual service. The gratuity liability is not externally funded.

Defined Contribution Plan

Obligations for contributions to Provident and Trust Funds covering all employees are recognised as an expense in the Income Statement.

11.6.6 HNB Stockbrokers (Pvt) Limited

Defined Benefit Plan

Provision has been made for retirement gratuities from the first year of service for all employees in conformity with SLAS - 16. However, under the Payment of Gratuity Act No. 12 of 1983, the liability to an employee arises only on completion of five years of

continual service. The gratuity liability is not externally funded.

Defined Contribution Plan

Obligations for contributions to Provident and Trust Funds covering all employees are recognised as an expense in the Income Statement.

11.6.7 HNB Assurance Limited

Defined Benefit Plan

Retiring gratuity is provided for in the financial statements. An actuarial valuation of the retirement benefit is performed by a qualified actuary as at the Balance Sheet date using the "Projected Unit Credit Method". The liability is not externally funded.

Defined Contribution Plan

All employees of the company are members of the Employees' Provident Fund (EPF) and Employees' Trust Fund (ETF) to which the company contributes 12% and 3% respectively of the basic salary. These are charged to the Income Statement.

11.6.8 Sithma Development (Pvt) Limited

Defined Benefit Plan

Provision is not made for retirement gratuities as all the employees of the company are either on contract basis or seconded by the Bank and are not entitled for gratuity from the company under the Payment of Gratuity Act No. 12 of 1983.

Defined Contribution Plan

Obligations for contributions to Employee's Provident and Trust Fund are recognized as an expense in the Income Statement.

12. PROVISIONS

Provisions are recognised when a legal or constructive obligation exists as a result of a past event and it is probable that an outflow of benefits will be required to settle the obligation and it can be reliably estimated. Provisions for non-performing loans and advances are made as set out in Accounting Policy No 9.6.3.

12.1 Operational Risk Events

Provisions for operational risk events are recognised for losses incurred by the Bank, which do not relate directly to amounts of principal outstanding for loans and advances.

The amount recognised as a provision is the best estimate of the expenditure required to settle the present obligation as at the Balance Sheet date, taking into account the risks and uncertainties that surround the events and circumstances that affect the provision.

13. COMMITMENTS AND CONTINGENCIES

All discernible risks are accounted for in determining the amount of all known liabilities. The Bank's share of any contingencies and capital commitments of a Subsidiary or an Associate for which the Bank is also liable severally or otherwise is also included with appropriate disclosures.

Contingent liabilities are possible obligations whose existence will be confirmed only by uncertain future events or present obligations where the transfer of economic benefit is not probable or cannot be reliably measured. Contingent liabilities are not recognised in the Balance Sheet but are disclosed unless they are remote.

14. EVENTS OCCURRING AFTER THE BALANCE SHEET DATE

All material and important events which occur after the Balance Sheet date have been considered and disclosed in Note No 38.

15. INCOME STATEMENT

15.1 Revenue Recognition

15.1.1 Interest Income

Interest receivable is recognised on an accrual basis. Interest from loans and advances ceases to be accrued when the recovery of interest or principal is in arrears for ninety days. Interest on non-performing loans and advances is accounted for on a cash basis. Interest on non-performing loans and advances is credited to the 'Interest in suspense account' which is netted in the Balance Sheet against the relevant loans and advances.

Interest income from investments is recognized on an accrual basis.

15.1.2 Dividend Income

Dividend income is recognised in the Income Statement on an accrual basis when the Bank's right to receive the dividend is established.

15.1.3 Lease Income

The excess of aggregate lease rentals receivable over the cost of the leased assets constitutes the total unearned lease income at the commencement of a lease. The unearned lease income is taken into income over the term of the lease commencing with the month in which the lease is executed in proportion to the declining receivable balance.

Gross earnings under finance leases in respect of lease rentals due, cease to be taken to revenue when they are in arrears for three (3) months. Thereafter, such income is recognised on a cash basis.

15.1.4 Discount on Bills of Exchange

Income on discounting Bills of Exchange is recognised proportionately over the period of the instrument.

15.1.5 Trading Income

Gains or losses arising from the sale of investment securities, dealing securities, shares and units are accounted for on the date of transaction in the Income Statement.

15.1.6 Fee and Commission Income

Fee and commission income relating to specific transactions or events are recognised in the Income Statement in the period in which they are earned. However, when they relate to services provided over a period, they are recognised in the Income Statement on an accrual basis.

15.1.7 Profit/loss from Sale of Property, Plant and Equipment

Profit/loss from sale of Property, Plant and Equipment is recognised in the period in which the sale occurs and is classified as other income.

15.1.8 Profit/loss from Sale of Investment Properties

Any gains or losses on retirement or disposal of investment properties are recognised in the month of retirement or disposal.

15.1.9 Rental Income

Rental income is recognised on an accrual basis.

15.2 Interest and Other Expenses

15.2.1 Interest Expenses and Other Expenses

Interest payable and other expenses are recognised on an accrual basis.

15.2.2 Operating Leases

Payments made under operating leases are recognised in the Income Statement on a straight-line basis over the term of the lease. The future monthly commitments on operating leases are shown in Note 33(b).

15.2.3 Fee and Commission Expenses

Fee and commission expenses are recognised on an accrual basis.

15.3 Taxation

15.3.1 Income Tax

Provision for taxation is based on the profit for the year adjusted for taxation purposes in accordance with the provisions of the Inland Revenue Act No. 10 of 2006 at the rates specified in Note No. 8 of the financial statement.

15.3.2 Deferred Tax

Deferred taxation is provided using the balance sheet liability method, providing for temporary differences between the carrying amounts of assets and liabilities for financial reporting purposes and the amounts used for taxation purposes. The amount of deferred tax provided is based on the expected manner of realisation or settlement of the carrying amount of assets and liabilities, using tax rates enacted or substantively enacted by the reporting date. Deferred tax liabilities are not recognised for the following temporary differences: the initial recognition of goodwill, the initial recognition of assets and liabilities in a transaction that is not a business combination and that affects neither accounting nor taxable profit and differences relating to investments in subsidiaries to the extent that they probably will not reverse in the foreseeable future.

Deferred tax assets, including those related to temporary tax effects of income tax losses and credits available to be carried forward are recognised only to the extent that it is probable that future taxable profits will be

available against which the asset can be utilised. Deferred tax assets are reviewed at each reporting date and are reduced to the extent that it is no longer probable that the related tax benefit will be realised.

15.3.3 Withholding Tax on Dividends Distributed by Subsidiaries and Associate Company

Dividend distributed out of taxable profit of the Subsidiaries and Associate company attracts a 10% deduction at source and is not available for set off against the tax liability of the Bank. Thus, the withholding tax deducted at source is added to the tax expense of the Subsidiary companies and Associate companies in the Group financial statements as a consolidation adjustment.

15.3.4 Value Added Tax on Financial Services

The base for the computation of Value Added Tax on Financial Services is the accounting profit before income tax adjusted for the economic depreciation, computed on prescribed rates and emoluments of employees.

16 INSURANCE BUSINESS

16.1 Non-life (General) Insurance Business

16.1.1 Premium

Upon inception of the policy, premiums are recorded as written and are earned primarily on a pro-rata basis over the term of the related policy coverage. However, for those contracts for which the period of risk differs significantly from the contract period, premiums are earned over the period of risk in proportion to the amount of insurance protection provided.

16.1.2 Outward Reinsurance

Premiums ceded to reinsurers are recognised as an expense in accordance with the pattern of reinsurance services received. Accordingly, a portion of outward reinsurance premium is treated at the Balance Sheet date as a prepayment.

16.1.3 Unearned Premium

The unearned premium reserve represents the portion of the premiums and outward reinsurance premiums written in the current year in respect of risks related to

subsequent periods. Unearned premiums are calculated on the 24th basis in accordance with the Regulation of Insurance Industry Act No. 43 of 2000.

16.1.4 Unexpired Risk

Provision is made where appropriate for the estimated amount required over and above unearned premiums to meet future claims and related expenses on the business in force as at end of the year.

16.1.5 Deferred Acquisition Expenses

Deferred acquisition expenses represent net commissions relating to unearned premiums.

16.1.6 Receivables

All premiums and other debtors are recognised at the amounts receivable, as they are due for settlement no more than 60 days from the date of recognition. Collectibility of premiums and other debtors is reviewed on an ongoing basis. Debts, which are known to be uncollectible, are written off. A provision for doubtful debts is provided on the following basis:

Debt outstanding	Provision
180 - 270 days	25%
271 - 365 days	50%
Over 365 days	100%

Reinsurance assets include the balances due from both insurance and reinsurance companies for paid and unpaid losses and loss adjustment expenses. Amounts recoverable from reinsurers are estimated in a manner consistent with the claim liability associated with the reinsured policy. Reinsurance is recorded gross in the Balance Sheet unless a right to offset exists.

16.1.7 Claims

Claims incurred include provisions for the estimated cost of claims and related handling expenses in respect of incidents up to 31st December, including those which had not been notified, net of salvage, anticipated reinsurance and other recoveries. The provision in respect of claims Insured But Not Reported (IBNR) is actuarially valued to

ensure a more realistic estimation of the future liability based on the past experience and trends. Actual valuations are performed on an annual basis.

Whilst the Directors consider that the provision for claims are fairly stated on the basis of information currently available, the ultimate liability will vary as a result of subsequent information and events. This may result in adjustments to the amounts provided. Such amounts are reflected in the financial statements for that period. The methods used and the estimates made are reviewed regularly.

16.2 Life (Long Term) Insurance Business

16.2.1 Premiums (Revenue)

Premiums are accounted for as and when received and in the same period as the policy liabilities are created.

16.2.2 Reinsurance

Reinsurance premium expense is accrued on active policies on a monthly basis.

16.2.3 Benefits, Losses and Expenses

Expenses on the life insurance revenue account relate to the acquisition and maintenance of life insurance business and include investment expenses not treated as part of the capital cost of investment.

Claims by death and maturity are charged against revenue on notification of death or on expiry of the term.

The interim payments and surrenders are accounted for only at the time of settlement.

The actuarial valuation takes into account all liabilities and is based on assumptions recommended by the Consultant Actuary.

17. SEGMENT REPORTING

A business segment is a group of assets and operations engaged in providing products or services that are subject to risks and returns different from those of other business segments. For the purposes of segment reporting disclosures, the information is presented in respect of the Group's business segments, which is based on the Group's management and internal reporting

structure. The Group comprises the following major business segments which are banking, leasing, dealing, property and insurance.

Measurement of segment assets, liabilities, segment revenue and results is based on the accounting policies set out above. Segment revenue results, assets and liabilities include items directly attributable to segments as well as those that can be allocated on a reasonable basis.

Unallocated items include depreciation and amortization costs.

18. CASH FLOW STATEMENT

The Cash Flow Statement has been prepared using the "Direct Method" of preparing of Cash Flows in accordance with the Sri Lanka Accounting Standard 9, "Cash Flow Statements". Cash and cash equivalents comprise short term, highly liquid investments that are readily convertible to known amounts of cash and are subject to an insignificant risk of changes in value. The cash and cash equivalent include cash in-hand, balances with banks, placements with banks, money at call and short notice and money market funds.

Notes to the Financial Statements

For the year ended 31st December	Bank		Group	
	2006 Rs.000	2005 Rs.000	2006 Rs.000	2005 Rs.000
1. INCOME				
Interest income (Note 2)	18,451,961	14,129,874	19,321,247	14,740,829
Foreign exchange profit	792,303	646,460	792,699	646,166
Fee & commission income	1,795,340	1,663,545	1,860,960	1,639,249
Dividend income (Note 4)	76,983	65,050	56,842	65,866
Other income (Note 5)	396,586	410,385	1,201,453	1,124,616
	21,513,173	16,915,314	23,233,201	18,216,726
2. INTEREST INCOME				
Government securities	1,295,466	952,475	1,326,477	952,475
Placements with Banks	525,053	418,585	525,053	418,585
Customer advances	16,188,917	12,670,259	16,188,917	12,668,067
Other interest income	442,525	88,555	1,280,800	701,702
	18,451,961	14,129,874	19,321,247	14,740,829
Notional Credit for Withholding Tax on Government Securities on Secondary Market Transactions				
Section 123 A of the Inland Revenue (Amendment) Act, No. 19 of 2003 provides that a company which derives interest income from the secondary market transactions in Government securities (on/after 1st April 2002) would be entitled to a notional credit (being one ninth of the net interest income) provided such interest income forms part of the statutory income of the company for that year of assessment.				
Accordingly, the net income earned from secondary market transactions in Government securities for the year has been grossed up in the financial statements and the resulting notional tax credit amounts to Rs. 5.58 Mn. (2005 - Rs. 1.14 Mn.) for the Bank and Rs. 12.05 Mn. (2005 - Rs. 7.91 Mn.) for the Group.				
3. INTEREST EXPENSES				
Short term borrowings	1,162,752	900,399	1,916,594	900,399
Refinance borrowings	138,265	109,798	138,265	109,798
Customer deposits	7,624,051	5,533,455	7,622,307	5,522,777
Interest paid on debentures	637,964	472,405	876,135	472,405
Other interest expenses	253,895	264,794	254,493	1,064,389
	9,816,927	7,280,851	10,807,794	8,069,768
4. DIVIDEND INCOME				
Dealing securities	12,054	6,173	12,054	6,173
Investment securities - quoted	64,692	58,645	44,551	59,461
Investment securities - unquoted	237	232	237	232
	76,983	65,050	56,842	65,866

For the year ended 31st December	Bank		Group	
	2006 Rs.000	2005 Rs.000	2006 Rs.000	2005 Rs.000
5. OTHER INCOME				
Profit/(loss) from sale of dealing securities	(39,402)	141,839	(36,033)	143,803
Income from investment securities	188,141	122,433	188,141	122,433
Loss on marked to market valuation of dealing securities	(45,319)	(81,465)	(45,319)	(81,465)
Rent received	84,168	70,982	89,272	70,982
Rent received from Investment properties	16,134	-	29,981	-
Bad debts recovered [Note 15(a) and 16(c)]	209,120	142,095	209,120	142,095
Profit/(loss) from sale of Property, Plant and Equipment	4,064	(7,749)	4,064	(7,749)
Profit from sale of Foreclosed properties	21,783	21,483	21,783	21,483
Gain on sale of Government securities	1,789	4,179	1,789	19,433
Profit on gold/silver trading	11,617	19,026	11,617	19,026
Loss on FCBU revaluation	(58,603)	(29,956)	(58,603)	(29,956)
Others	3,094	7,518	785,641	704,531
	396,586	410,385	1,201,453	1,124,616
6. OPERATING EXPENSES				
Operating expenses, amongst others include the following:				
Legal expenses	38,202	14,430	38,439	14,430
Depreciation of Property, Plant and Equipment	430,211	457,229	523,343	551,942
Amortization of Intangible assets	100,116	37,092	106,379	42,116
Depreciation of Investment property	1,284	-	4,487	-
Directors' emoluments [Note 6(a)]	24,505	11,911	31,015	12,351
Auditors' remuneration - Audit fees	2,900	2,600	3,763	3,560
- Non audit fees	360	300	360	300
Donations	33,477	19,642	33,677	19,642
6 (a) Directors' emoluments				
Emoluments of Chairman	3,168	3,168	3,228	3,228
Emoluments of Executive Director/s	20,317	7,723	26,357	7,723
Emoluments of other Directors (fee only)	1,020	1,020	1,430	1,400
	24,505	11,911	31,015	12,351
7. PROVISION FOR LOAN LOSSES				
Specific provision for loans and advances	435,997	1,396,837	435,997	1,396,837
Specific provision for Foreclosed properties	99,379	233,349	99,379	233,349
General provision for pawning advances	-	8,250	-	8,250
General provision for housing advances	6,275	4,300	6,275	4,300
Statutory general provision for performing and overdue loans and advances	294,363	-	294,363	-
Provision for loans and advances [Note 15(a)]	836,014	1,642,736	836,014	1,642,736
Specific provision for Bills of Exchange [Note 14(a)]	-	772	-	772
General provision for leases [Note 16(c)]	53,084	42,826	53,084	42,826
Specific provision for leases [Note 16(c)]	42,730	73,110	42,730	73,110
Total provision made during the year	931,828	1,759,444	931,828	1,759,444

For the year ended 31st December	Bank		Group	
	2006 Rs.000	2005 Rs.000	2006 Rs.000	2005 Rs.000
8. INCOME TAX EXPENSE				
a) Current tax expense				
Income tax on profits for the year	795,454	232,000	809,961	267,518
Under provision during prior years	3,507	-	2,883	(18,922)
Income tax on profits on Associate companies	-	-	5,373	1,429
	798,961	232,000	818,217	250,025
b) Deferred tax expense				
Adjustments to opening deferred tax liability resulting from increase in tax rate	89,482	-	89,482	-
Net opening balance adjustment (Note 30(c))	(81,933)	-	(81,933)	-
Reversal from deferred taxation	(7,549)	(36,600)	(6,191)	(36,212)
	-	(36,600)	1,358	(36,212)
Total income tax expense	798,961	195,400	819,575	213,813
c) Income tax on profits of Subsidiary companies				
HNB Assurance Limited	-	-	2,000	1,550
HNB Stockbrokers (Pvt) Ltd.	-	-	12,507	19,259
HNB Securities Limited	-	-	-	14,709
d) Income tax on profits of Associate companies				
Lanka Ventures Limited	-	-	5,373	1,429
Total			19,880	36,947
e) Reconciliation of Accounting Profit and Taxable Income				
Profit before taxation	3,019,450	1,849,962	3,081,594	1,991,188
Disallowable expenses	7,517,312	5,037,696	7,571,217	5,076,929
Allowable expenses	(3,794,009)	(3,143,378)	(3,819,351)	(3,161,668)
Tax exempt income	(3,036,505)	(2,492,506)	(3,051,712)	(2,528,132)
Tax losses brought forward and not utilised	(3,673,795)	(4,111,916)	(3,880,997)	(4,396,206)
Tax losses not utilised and carried forward	2,376,608	3,673,795	2,491,225	3,880,997
Taxable Income	2,409,061	813,653	2,391,976	863,108
Income tax provision for the year is made up of the following:				
Income taxable at 35%	713,455	-	725,838	-
Income taxable at 32.5%	-	-	-	33,968
Income taxable at 33 1/3%	-	-	1,984	-
Income taxable at 30%	-	179,537	-	181,087
Income taxable at 20%	74,124	52,463	74,124	52,463
	787,579	232,000	801,946	267,518
Social Responsibility levy at 1%	7,875	-	8,015	-
Income tax on profits for the year	795,454	232,000	809,961	267,518
Effective tax rate	26.34%	12.54%	26.28%	13.44%

- f)** The Bank's Domestic Banking Unit (DBU) is liable for taxation on its income from banking operations at the rate of 35% (2005 - 30%) for the year. The taxable income of On Shore Operations of Foreign Currency Banking Unit (FCBU) is liable for taxation at the rate 35% for the year (2005 - 30%). The taxable income from Off Shore Operations of FCBU is liable for taxation at the rate of 20% (2005 - 20%).

The Bank has recorded a taxable income of Rs. 2,409 Mn. during the year 2006. The cumulative tax losses, which are available for setting off against future taxable income amounted to Rs. 2,376.6 Mn. as at 31st December 2006 (31st December 2005 - Rs. 3,673.7 Mn.). The amounts reflected above are provisional.

Sithma Development (Pvt) Ltd. enjoys a tax holiday as per the agreement signed with the Board of Investment of Sri Lanka. As such, no provision for income taxation has been made in the Financial Statements of the Company.

HNB Stock brokers (Pvt) Ltd., is liable for income taxation at the rate of 35% (2005 - 32.5%) on its taxable income. Provision has been made in the financial statements accordingly.

HNB Assurance Ltd., is liable for income taxation at the rate of 33 1/3% (2005 - 30%) on its taxable income. Provision has been made in the financial statements accordingly.

HNB Securities Ltd., is liable for income taxation at the rate of 35% (2005 - 32.5%) on its taxable income. Provision has been made in the financial statements accordingly.

9. BASIC EARNINGS PER SHARE

Basic Earnings per Share (EPS) has been calculated by dividing the Profit for the period attributable to Equity Holders of the Bank, by the number of ordinary shares on issue (both Voting and Non-Voting) during the year ended 31st December 2006, calculated as per the requirements of the Sri Lanka Accounting Standard 34 - "Earnings per Share".

For the year ended 31st December	Bank		Group	
	2006	2005	2006	2005
Profit attributable to Equity Holders of the Bank, (Rs.000)	2,220,489	1,654,562	2,239,106	1,770,421
Number of ordinary shares used as the denominator ('000)	117,764	109,682	117,764	109,682
Basic Earnings per Share (Rs.) [Note 38(b)]	18.86	15.09	19.01	16.14

As at 31st December	2006	2005	2006	2005
	Rs.000	Rs.000	Rs.000	Rs.000

10. CASH AND CASH EQUIVALENTS

Local currency in hand	1,866,835	1,946,367	1,869,645	1,940,228
Foreign currency in hand	164,731	138,042	164,731	138,042
Balances with local banks	204	15,107	33,108	15,107
Balances with foreign banks	8,695,017	9,930,384	8,695,017	9,930,384
Money at call and short notice	5,500,000	1,150,000	5,500,000	1,150,000
Money market funds	5,194,968	5,366,187	5,194,968	5,366,187
Placements with banks by FCBU	1,886,340	2,653,987	1,886,340	2,653,987
	23,308,095	21,200,074	23,343,809	21,193,935

11. STATUTORY DEPOSIT WITH CENTRAL BANK OF SRI LANKA

Statutory deposit with Central Bank of Sri Lanka	12,016,532	8,565,629	12,016,532	8,565,629
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As required by the provisions of Section 93 of Monetary Law Act, a cash balance is maintained with the Central Bank of Sri Lanka. As at 31st December 2006, the minimum cash reserve requirement is 10% of the rupee deposit liabilities. There are no reserve requirement for deposit liabilities of the Foreign Currency Banking Unit and foreign currency deposits liabilities in the Domestic Banking Unit.

12. DEALING SECURITIES

12 (a) Quoted shares - Bank

As at 31st December	2006				2005		
	No of Ordinary Shares of Rs.10/- each	Cost of Investment Rs.000	% of Total Cost	Market Value Rs.000	No of Ordinary Shares of Rs.10/- each	Cost of Investment Rs.000	Market Value Rs.000
Banks, Finance and Insurance							
Housing Development Finance Corporation Bank of Sri Lanka							
	-	-	-	-	16,600	3,828	3,171
Seylan Bank Ltd.							
	-	-	-	-	17,400	826	639
Seylan Bank Ltd, Non-Voting							
	-	-	-	-	839,300	20,446	13,639
Union Assurance Ltd.							
	332,300	23,895	8.42	34,061	335,400	23,689	32,198
		23,895	8.42	34,061		48,789	49,647
Beverage Food and Tobacco							
Distilleries Company of Sri Lanka Ltd							
	561,900	51,149	18.01	50,852	-	-	-
Construction and Engineering							
Colombo Dockyard Ltd.							
	721,955	23,000	8.10	25,990	100,000	3,543	2,225

12. DEALING SECURITIES (Contd.)

12 (a) Quoted shares - Bank (Contd.)

As at 31st December	2006				2005		
	No of Ordinary Shares of Rs.10/- each	Cost of Investment Rs.000	% of Total Cost	Market Value Rs.000	No of Ordinary Shares of Rs.10/- each	Cost of Investment Rs.000	Market Value Rs.000
Diversified Holdings							
Hayleys Ltd.	258,600	26,416	9.30	33,489	-	-	-
Hemas Holdings Ltd.	150,200	17,401	6.13	17,536	50,000	3,509	5,187
John Keells Holdings Ltd.	-	-	-	-	150,000	21,348	19,388
		43,817	15.43	51,025		24,857	24,575
Hotel and Travel							
Aitken Spence Hotel Holdings Ltd.	-	-	-	-	54,500	5,738	3,706
Asian Hotels & Properties Ltd.	-	-	-	-	135,300	8,420	5,615
Connaissance Holdings Ltd.	307,520	11,371	4.00	11,378	-	-	-
Galadari Hotel Lanka Ltd.	-	-	-	-	170,600	3,178	1,919
John Keells Hotels Ltd.	-	-	-	-	25,051	2,529	2,029
Riverina Hotels Ltd.	-	-	-	-	32,300	1,046	703
		11,371	4.00	11,378		20,911	13,972
Manufacturing							
ACL Cables Ltd.	200,000	24,865	8.76	42,550	-	-	-
Caltex Lanka Lubricants Ltd.	-	-	-	-	726,200	56,525	42,119
Dankotuwa Porcelain Ltd.	-	-	-	-	1,207,400	30,230	18,111
Kelani Tyres Ltd.	-	-	-	-	346,800	6,278	3,208
Richard Pieris and Co Ltd.	401,900	36,940	13.01	31,348	374,700	34,546	25,386
Sierra Cables Limited (Rs.1 per share)	-	-	-	-	4,432,000	13,464	11,080
Tokyo Cement (Lanka) Ltd.	74,000	14,042	4.95	14,412	-	-	-
Tokyo Cement (Lanka) Ltd.	-	-	-	-	-	-	-
Non-Voting	1,000,000	14,305	5.04	17,000	-	-	-
		90,152	31.76	105,310		141,043	99,904
Power & Energy							
Lanka IOC Ltd.	-	-	-	-	927,900	41,702	30,621
Plantations							
Horana Plantations Ltd.	162,500	3,926	1.38	2,966	-	-	-
Telecommunications							
Dialog Telekom (Rs. 1 per share)	-	-	-	-	550,000	10,300	9,075
Sri Lanka Telecom Ltd.	1,565,400	36,497	12.85	43,440	2,334,800	54,604	38,524
		36,497	12.85	43,440		64,904	47,599
Trading							
Odd lots & delisted shares	-	139	0.05	5	-	135	-
Total		283,946	100.00	325,027		345,884	268,543
Marked to market valuation gain/(loss)		41,081				[77,341]	
Total Quoted Shares - Bank		325,027		325,027		268,543	268,543

12. DEALING SECURITIES (Contd.)

12 (b) Quoted shares - Subsidiaries

As at 31st December	2006				2005		
	No of Ordinary Shares of Rs.10/- each	Cost of Investment Rs.000	% of Total Cost	Market Value Rs.000	No of Ordinary Shares of Rs.10/- each	Cost of Investment Rs.000	Market Value Rs.000
	Lanka IOC Ltd.	-	-	-	-	25,000	1,265
Sri Lanka Telecom Ltd.	-	-	-	-	350,000	9,211	5,775
	-	-	-	-	-	10,476	6,594
Provision for diminution in market value						(3,882)	-
Total Quoted Shares - Subsidiaries						6,594	6,594

As at 31st December	2006		2005	
	Cost of Investment Rs.000	Market Value Rs.000	Cost of Investment Rs.000	Market Value Rs.000

12 (c) Bonds - Bank

Government of Sri Lanka Treasury Bonds

Face Value	Year of Maturity	Discounted Value (Rs. 000)				
Rs. 50 Mn.	2009	48,694	48,694	43,379	48,694	44,570
			(5,315)		(4,124)	
			43,379	43,379	44,570	44,570

Foreign Currency Bonds

Face Value	Year of Maturity	Discounted Value				
US\$ 5 Mn.	2010	US\$ 4,959,169	532,863	370,313	-	-
			(162,550)			
			370,313	370,313		
Total Bonds - Bank			413,692	413,692	44,570	44,570
Total Dealing Securities - Bank [Note 12 (a) & (c)]			738,719	738,719	313,113	313,113

12 (d) Bonds - Subsidiaries

Government of Sri Lanka Treasury Bonds

Face Value	Year of Maturity	Discounted Value (Rs.000)				
Rs. 15 Mn.	2007	14,811				
Rs. 142 Mn.	2008	142,008				
Rs. 93 Mn.	2009	88,943	245,762	239,331	-	-
			(6,431)			
			239,331	239,331		
Total Bonds - Subsidiaries			239,331	239,331		
Inter company adjustment			(2,897)	(2,897)		
Total Dealing Securities - Group			975,153	975,153	319,707	319,707

13. INVESTMENT SECURITIES

13 (a) Quoted shares

As at 31st December	2006			2005		
	No. of Ordinary Shares of Rs.10/- each	Cost of Investment Rs.000	Market Value of Shares Rs.000	No. of Ordinary Shares of Rs.10/- each	Cost of Investment Rs.000	Market Value of Shares Rs.000
Bank						
Asha Central Hospital Ltd	120,000	1,578	4,890	120,000	1,578	2,850
Browns Beach Hotels Ltd	75,000	1,622	2,100	75,000	1,622	1,725
Commercial Bank of Ceylon Ltd	825,332	61,645	156,813	825,332	61,645	111,832
DFCC Bank	10,581,037	519,711	1,899,296	7,054,025	519,711	1,551,886
Distilleries Company of Sri Lanka Ltd (Rs.1/- per share)	1,481,500	11,158	134,076	1,481,500	11,158	51,853
Lanka Hospital Corporation Ltd	1,455,000	22,055	37,830	1,455,000	22,055	26,918
Magpek Exports Ltd	359,000	14,360	*	359,000	14,360	*
Metal Recyclers Colombo Ltd	69	3	*	69	3	*
		632,132	2,235,005		632,132	1,747,064
Provision for diminution in market value b/f		(14,363)			(14,363)	
Total Quoted Shares - Bank		617,769	2,235,005		617,769	1,747,064
<i>* Shares delisted - Market value shown as nil.</i>						
Subsidiaries						
Commercial Bank of Ceylon Ltd. cumulative redeemable preference shares	725,000	7,250	6,706	725,000	7,250	7,069
Hemas Holdings Ltd.	4,200	447	490	-	-	-
John Keells Holdings Ltd.	20,000	2,672	3,900	-	-	-
Dialog Telecom Ltd.	100,000	2,075	2,650	-	-	-
Sri Lanka Telecom Ltd.	100,000	2,101	2,775	-	-	-
		14,545	16,521		7,250	7,069
Provision for diminution in value of investment		(545)	-		(181)	-
Total Quoted Shares - Subsidiaries		14,000	16,521		7,069	7,069
Total Quoted Shares - Group		631,769	2,251,526		624,838	1,754,133

13 (b) Unquoted shares

As at 31st December	2006			2005		
	No. of Ordinary Shares of Rs.10/- each	Cost Rs.000	Directors' Valuation Rs.000	No. of Ordinary Shares of Rs.10/- each	Cost Rs.000	Directors' Valuation Rs.000
Bank						
Browns Group Motels Ltd	50,000	500	500	50,000	500	500
Credit Information Bureau of Sri Lanka (Shares of Rs.100/- each)	5,300	530	530	5,300	530	530
Fitch Rating Lanka Ltd	62,500	625	625	62,500	625	625
Lanka Clear (Pvt) Ltd	2,200,000	22,000	22,000	2,200,000	22,000	22,000
S.W.I.F.T.	21	2,051	2,051	21	2,051	2,051
Total Unquoted Shares - Bank		25,706	25,706		25,706	25,706

13. INVESTMENT SECURITIES (Contd.)

13 (c) Bonds and debentures

As at 31st December	2006		2005	
	Cost	Directors'	Cost	Directors'
	Rs.000	Rs.000	Rs.000	Rs.000
Bank				
13(c)i Long Term Investments				
Long Term Non-negotiable Bonds maturing on 14.11.2016	489,000	489,000	489,000	489,000
Mercantile Leasing Ltd - Debentures	60,000	60,000	100,000	100,000
People's Leasing Co. Ltd. - Securitised Notes Trust 04	5,341	5,341	39,791	39,791
People's Leasing Co. Ltd. - Securitised Notes Trust 10	83,333	83,333	137,500	137,500
People's Leasing Co. Ltd. - Securitised Notes Trust 14	125,000	125,000	187,500	187,500
People's Leasing Co. Ltd. - Securitised Notes Trust 20	72,917	72,917	97,917	97,917
People's Leasing Co. Ltd. - Securitised Notes Trust 29	177,978	177,978	-	-
Sri Lanka Development Bonds matured in 2006	-	-	3,205,678	3,205,678
Sri Lanka Development Bonds maturing in 2008	4,202,859	4,202,859	-	-
Sri Lanka Development Bonds maturing in 2009	2,794,740	2,794,740	-	-
Total	8,011,168	8,011,168	4,257,386	4,257,386

As at 31st December

2006		2005	
Cost of Investment	Market Value	Cost of Investment	Directors' Valuation
Rs.000	Rs.000	Rs.000	Rs.000

13(c)ii Government of Sri Lanka Treasury Bonds

Face value	Year of Maturity	Discounted Value (Rs.000)		
Rs.2,717.80 Mn	2007	2,927,974		
Rs. 3,699.10 Mn	2008	3,932,724		
Rs. 2,740.00 Mn	2009	2,989,517		
Rs. 251.00 Mn	2013	266,239	10,116,454	*8,978,231
			10,053,956	10,053,956

* Government of Sri Lanka Treasury Bonds with a face value of Rs. 9.408 Bn. were purchased for Rs. 10.116 Bn., incurring a premium of Rs. 0.708 Bn. Rs. 0.445 Bn. of the premium has been amortized to date and the amortized amount is included in other liabilities (Note 31).

The net value of the investment as at 31.12.2006 is therefore Rs. 9.671 Bn.

As at 31st December

2006	
Cost of Investment	Directors' Valuation
Rs.000	Rs.000

13(c)iii Foreign Currency Bonds

Face value	Year of Maturity	Value US\$	Equivalent in SLR (Rs.000)		
US\$ 10 Mn.	2009	9,872,726	1,060,824		
Foreign Investments		10,934,088	1,174,868	2,235,692	2,235,692
Total Bonds and Debentures - Bank				20,363,314	19,225,091
Total Investment Securities - Bank				21,006,789	17,284,945

13. INVESTMENT SECURITIES (Contd.)

Bonds and debentures

As at 31st December

2006		2005	
No. of Debentures	Cost of Investment Rs.000	No. of Debentures	Cost of Investment Rs.000

Subsidiaries

13(c)iv Quoted Debentures

Commercial Bank of Ceylon Ltd- Debentures (Rs. 1000/- each)	7,250	7,250	7,250	7,250
DFCC Bank (Rs. 1000/- each)	10,000	10,000		
Seylan Bank Ltd. (Rs. 100/- each)	150,000	15,000		
Singer (Sri Lanka) Ltd. (Rs. 100/- each)	50,000	5,000		
Total Quoted Debentures - Subsidiaries		37,250		7,250

As at 31st December

2006		2005	
Market Value Rs.000	Cost of Investment Rs.000	Directors' Valuation Rs.000	Cost of Investment Rs.000

13(c)v Government of Sri Lanka Treasury Bonds

Face value	Year of Maturity	Discounted Value (Rs.000)		
Rs. 1,139 Mn.	2007	1,154,901		
Rs. 90 Mn.	2008	90,458		
Rs. 296 Mn.	2009	290,611		
Rs. 67 Mn.	2010	65,630	1,539,654	1,601,600
Total Bonds and Debentures - Subsidiaries			1,576,904	1,638,850
Total Bonds and Debentures - Group			21,940,218	22,002,164
Total Investments Securities - Group			22,659,639	18,816,694

As at 31st December	Bank		Group	
	2006 Rs.000	2005 Rs.000	2006 Rs.000	2005 Rs.000

14. BILLS OF EXCHANGE

Inland bills	372,205	335,258	372,205	335,258
Import bills	458,655	222,831	458,655	222,831
Export bills	954,300	1,060,293	954,300	1,060,293
	1,785,160	1,618,382	1,785,160	1,618,382
Foreign Currency Banking Unit bills	416,863	696,639	416,863	696,639
	2,202,023	2,315,021	2,202,023	2,315,021
Less: Specific provision [Note 14(a)]	291,171	288,044	291,171	288,044
	1,910,852	2,026,977	1,910,852	2,026,977

14 (a) Movement in provision for Bills of Exchange

Balance brought forward	288,044	288,763	288,044	288,763
Exchange rate variance on foreign currency provision	3,127	[1,491]	3,127	[1,491]
Specific provision made during the year (Note 7)	-	772	-	772
	291,171	288,044	291,171	288,044

As at 31st December	Bank		Group	
	2006	2005	2006	2005
	Rs.000	Rs.000	Rs.000	Rs.000
15. LOANS AND ADVANCES				
Sri Lanka Rupee loans and advances				
Overdrafts	27,455,224	22,952,834	27,023,615	22,386,095
Trust receipts	6,876,898	5,193,080	6,876,898	5,193,080
Packing credit loans	618,787	523,517	618,787	523,517
Staff loans	4,818,325	4,104,142	4,818,430	4,104,142
Term loans	37,130,160	31,667,736	37,130,160	31,667,736
Housing loans	12,987,528	10,224,844	12,987,528	10,224,844
Pawning advances	13,446,308	12,521,666	13,446,308	12,521,666
Foreclosed properties [Note 15(f)]	69,420	139,224	69,420	139,224
	103,402,650	87,327,043	102,971,146	86,760,304
Foreign currency loans and advances				
Overdrafts	1,588,638	1,668,881	1,588,638	1,668,881
Trust receipts	1,647,432	1,423,649	1,647,432	1,423,649
Packing credit loans	3,460,009	812,883	3,460,009	812,883
Term loans	10,892,995	10,737,166	10,892,995	10,737,166
Housing Loans	399,933	320,543	399,933	320,543
Foreclosed properties [Note 15(f)]	423,250	418,316	423,250	418,316
	18,412,257	15,381,438	18,412,257	15,381,438
Sri Lanka Rupee and Foreign currency loans and advances				
	121,814,907	102,708,481	121,383,403	102,141,742
Less:				
Specific provision for loans and advances	5,449,958	5,099,566	5,449,958	5,099,566
Specific provision for Foreclosed properties [Note 15(f)]	468,218	420,451	468,218	420,451
General provision for pawning advances	16,473	16,473	16,473	16,473
General provision for housing loans	26,775	20,500	26,775	20,500
Statutory general provision for performing and overdue loans and advances	294,363		294,363	
Total provision for loan losses [Note 15(a)]	6,255,787	5,556,990	6,255,787	5,556,990
Loans and advances after provision	115,559,120	97,151,491	115,127,616	96,584,752
Less: Interest in suspense [Note 15(e)]	850,746	909,026	850,746	909,026
Net loans and advances	114,708,374	96,242,465	114,276,870	95,675,726
15 (a) Movement in provision for loan losses				
Balance brought forward	5,556,990	4,654,271	5,556,990	4,654,271
Exchange rate variance on foreign currency provision	165,251	(55,550)	165,251	(55,550)
	5,722,241	4,598,721	5,722,241	4,598,721
Provision made during the year (Note 7)	836,014	1,642,736	836,014	1,642,736
Fully provided debts written off	(101,900)	(549,337)	(101,900)	(549,337)
Recoveries made during the year	(200,568)	(132,334)	(200,568)	(132,334)
Reversals made from General provision	-	(2,796)	-	(2,796)
	6,255,787	5,556,990	6,255,787	5,556,990

15. LOANS AND ADVANCES (Contd.)

15(b) Total provision for loan losses

As at 31st December	2006		2005	
	Rs.000	Rs.000	Rs.000	Rs.000
15(b)i Specific provision				
Bills of Exchange	291,171		288,044	
Loans and advances	5,918,176		5,520,017	
Lease rentals receivable within one year	248,227	6,457,574	214,484	6,022,545
15(b)ii General provision				
Loans and advances	43,248		36,973	
Lease rentals receivable within one year	80,801		66,938	
Lease rentals receivable after one year	154,964		115,727	
Statutory general provision for performing and overdue loans and advances	294,363	573,376	-	219,638
Total provision [Note 14(a), 15(a) and 16(c)]		7,030,950		6,242,183

As explained in Significant Accounting Policy no 9.6.5, the Bank has made additional general provision to meet the regulatory requirement. The total general provision of Rs 294.4 Mn. is 0.56% of the total performing and overdue loans and advances, net of interest in suspense as at the Balance Sheet date and is above the regulatory requirement of 0.1% as at 31st December 2006.

As at 31st December	2006		2005	
	Rs.000		Rs.000	
15(c) Asset quality - Bank				
Non-performing lending portfolio				
Bills of Exchange		297,189		300,081
Loans and advances		9,072,583		9,181,535
Foreclosed properties		492,670		557,540
Lease rental receivable		518,882		363,664
		10,381,324		10,402,820
Less: Specific provisions				
- Bills of Exchange	291,171		288,044	
- Loans and advances	5,449,958		5,099,566	
- Foreclosed properties	468,218		420,451	
- Lease rental receivable	248,227	6,457,574	214,484	6,022,545
		3,923,750		4,380,275
Less: Interest in suspense		850,746		909,026
Net non-performing lending portfolio		3,073,004		3,471,249

15(d) Credit risk - Bank

15(d)i Collateral wise analysis of gross non-performing lending portfolio

The Bank holds collateral against its lending portfolio in the form of mortgage interest over property, other registered securities and assets. Estimation of fair value / realisable value are based on the value of collateral assessed at the time of lending and generally are not updated except when a loan is individually assessed as non-performing.

As at 31st December	2006		2005	
	Rs.000	%	Rs.000	%
Secured by immovable assets	5,582,734	54	4,960,486	48
Secured by movable assets	1,343,955	13	2,290,430	22
Secured by cash/shares	409,260	4	1,119,938	11
Other securities	1,418,634	14	1,522,389	15
Clean	1,626,741	15	509,577	4
	10,381,324	100	10,402,820	100

15. LOANS AND ADVANCES (Contd.)

15(d) Credit risk - Bank (Contd.)

15(d)ii Sector/Productwise analysis of gross lending portfolio

The Bank monitors concentration of credit risk by sectors. An analysis of concentration of credit risk as at the Balance Sheet date is shown below:

Sector/Type of Loan	Overdrafts Rs.000	Short Term Loans Rs.000	Medium Term Loans Rs.000	Long Term Loans Rs.000	Pawning Rs.000	Total Rs.000	%
Bank - 2006							
Food, beverages and tobacco	827,071	1,447,401	1,188,518	971,986	-	4,434,976	3.24
Agriculture, agro business and fisheries	1,164,392	1,591,911	1,882,628	1,065,122	-	5,704,053	4.17
Textiles and wearing apparel	1,514,654	1,599,581	1,862,494	1,707,790	-	6,684,519	4.89
Wood and paper products	205,257	320,054	351,341	216,364	-	1,093,016	0.80
Rubber and leather products	439,025	858,715	206,214	288,766	-	1,792,720	1.31
Metals, chemicals and engineering	2,094,038	1,577,494	1,860,076	3,467,819	-	8,999,427	6.58
Hotels	507,700	51,733	702,354	822,350	-	2,084,137	1.52
Services	2,385,341	1,795,575	3,663,720	3,295,731	-	11,140,367	8.14
Foreclosed properties	-	-	-	492,670	-	492,670	0.36
Others	18,317,747	15,096,666	22,970,719	24,571,446	13,446,308	94,402,886	68.99
Total	27,455,225	24,339,130	34,688,064	36,900,044	13,446,308	136,828,771	100.00
Gross Loans and Advances (Note 15)						121,814,907	89.03
Lease Rentals Receivable (Note 16)						15,013,864	10.97
						136,828,771	100.00
The "others" category comprises the following advances:							
Exports	525,510	998,262	340,776	360,250	-	2,224,798	2.36
Imports	1,358,493	3,544,561	503,801	616,636	-	6,023,491	6.38
Trading	3,978,768	1,113,713	1,987,816	779,297	-	7,859,594	8.33
Financial	1,597,645	419,677	1,851,222	1,709,185	-	5,577,729	5.91
Housing	-	99,202	1,902,238	11,386,021	-	13,387,461	14.18
Consumption	5,064,223	4,403,939	7,543,128	5,176,783	-	22,188,073	23.50
Miscellaneous	5,793,108	4,517,312	8,841,738	4,543,274	13,446,308	37,141,740	39.34
Total	18,317,747	15,096,666	22,970,719	24,571,446	13,446,308	94,402,886	100.00
Bank - 2005							
Food, beverages and tobacco	772,303	1,210,154	1,034,262	482,100	-	3,498,819	3.07
Agriculture, agro business and fisheries	1,063,720	1,373,757	1,545,722	842,548	-	4,825,747	4.23
Textiles and wearing apparel	1,363,807	1,311,776	1,569,483	1,535,139	-	5,780,205	5.07
Wood and paper products	177,822	216,582	285,091	150,130	-	829,625	0.73
Rubber and leather products	353,902	795,298	118,226	247,894	-	1,515,320	1.33
Metals, chemicals and engineering	1,894,105	1,222,324	1,685,961	3,383,443	-	8,185,833	7.18
Hotels	444,224	28,032	640,918	808,628	-	1,921,802	1.69
Services	2,022,454	1,311,845	3,094,082	3,110,230	-	9,538,611	8.36
Foreclosed properties	-	-	-	557,540	-	557,540	0.49
Others	16,529,378	10,094,855	17,999,786	20,247,262	12,521,666	77,392,947	67.85
Total	24,621,715	17,564,623	27,973,531	31,364,914	12,521,666	114,046,449	100.00
Gross Loans and Advances (Note 15)						102,708,481	90.06
Lease Rentals Receivable (Note 16)						11,337,968	9.94
						114,046,449	100.00
The "others" category comprises the following advances:							
Exports	207,751	235,096	87,909	335,869	-	866,625	1.12
Imports	1,115,525	2,749,100	303,541	485,202	-	4,653,368	6.01
Trading	3,299,676	127,768	578,999	698,638	-	4,705,081	6.08
Financial	1,117,581	260,263	1,536,820	1,747,281	-	4,661,945	6.02
Housing	-	66,944	723,083	8,269,358	-	9,059,385	11.71
Consumption	4,867,381	3,222,888	6,940,532	4,715,741	-	19,746,542	25.51
Miscellaneous	5,921,464	3,432,796	7,828,902	3,995,173	12,521,666	33,700,001	43.55
Total	16,529,378	10,094,855	17,999,786	20,247,262	12,521,666	77,392,947	100.00

15. LOANS AND ADVANCES (Contd.)

15(d) Credit risk - Bank (Contd.)

15(d)ii Sector/Productwise analysis of gross lending portfolio (Contd.)

Sector/Type of Loan	Overdrafts	Short Term	Medium Term	Long Term	Pawning	Total	
	Rs.000	Loans Rs.000	Loans Rs.000	Loans Rs.000		Rs.000	Rs.000
Group - 2006							
Food, beverages and tobacco	827,071	1,447,401	1,188,518	971,986	-	4,434,976	3.25
Agriculture, agro business and fisheries	1,164,392	1,591,911	1,882,628	1,065,122	-	5,704,053	4.18
Textile and wearing apparel	1,514,654	1,599,581	1,862,494	1,707,790	-	6,684,519	4.90
Wood and paper products	205,257	320,054	351,341	216,364	-	1,093,016	0.80
Rubber and leather products	439,024	858,714	206,215	288,767	-	1,792,720	1.31
Metals, chemicals and engineering	2,094,038	1,577,494	1,860,075	3,467,820	-	8,999,427	6.60
Hotels	507,700	51,733	702,354	822,350	-	2,084,137	1.53
Services	2,385,341	1,795,575	3,663,720	3,295,731	-	11,140,367	8.17
Foreclosed properties	-	-	-	492,670	-	492,670	0.36
Others	17,886,137	15,096,772	22,970,719	24,571,446	13,446,308	93,971,382	68.90
Total	27,023,614	24,339,235	34,688,064	36,900,046	13,446,308	136,397,267	100.00
Loans and Advances (Note 15)						121,383,403	90.01
Lease Rentals Receivable (Note 16)						15,013,864	9.99
						136,397,267	100.00
The "others" category comprises the following advances:							
Exports	525,509	998,262	340,776	360,249	-	2,224,796	2.37
Imports	1,358,493	3,544,561	503,801	616,636	-	6,023,491	6.41
Trading	3,978,768	1,113,713	1,987,816	779,297	-	7,859,594	8.36
Financial	1,597,645	419,677	1,851,222	1,709,185	-	5,577,729	5.94
Housing	-	99,202	1,902,238	11,386,021	-	13,387,461	14.25
Consumption	5,064,224	4,403,939	7,543,128	5,176,784	-	22,188,075	23.60
Miscellaneous	5,361,498	4,517,418	8,841,738	4,543,274	13,446,308	36,710,236	39.07
Total	17,886,137	15,096,772	22,970,719	24,571,446	13,446,308	93,971,382	100.00
Group - 2005							
Food, beverages and tobacco	772,303	1,210,154	1,034,262	482,100	-	3,498,819	3.08
Agriculture, agro business and fisheries	1,063,720	1,373,757	1,545,722	842,548	-	4,825,747	4.25
Textiles and wearing apparel	1,363,807	1,311,776	1,569,483	1,535,139	-	5,780,205	5.09
Wood and paper products	177,822	216,582	285,091	150,130	-	829,625	0.73
Rubber and leather products	353,902	795,298	118,226	247,894	-	1,515,320	1.34
Metals, chemicals and engineering	1,894,105	1,222,324	1,685,961	3,383,443	-	8,185,833	7.21
Hotels	444,224	28,032	640,918	808,628	-	1,921,802	1.69
Services	2,022,454	1,311,845	3,094,082	3,110,230	-	9,538,611	8.41
Foreclosed properties	-	-	-	557,540	-	557,540	0.50
Others	15,962,639	10,094,855	17,999,786	20,247,262	12,521,666	76,826,208	67.70
Total	24,054,976	17,564,623	27,973,531	31,364,914	12,521,666	113,479,710	100.00
Gross Loans and Advances (Note 15)						102,141,742	90.01
Lease Rentals Receivable (Note 16)						11,337,968	9.99
						113,479,710	100.00
The "others" category comprises the following advances:							
Exports	207,751	235,096	87,909	335,869	-	866,625	1.13
Imports	1,115,525	2,749,100	303,541	485,202	-	4,653,368	6.06
Trading	3,299,676	127,768	578,999	698,638	-	4,705,081	6.12
Financial	1,117,581	260,263	1,536,820	1,747,281	-	4,661,945	6.07
Housing	-	66,944	723,083	8,269,358	-	9,059,385	11.79
Consumption	4,867,381	3,222,888	6,940,532	4,715,741	-	19,746,542	25.70
Miscellaneous	5,354,725	3,432,796	7,828,902	3,995,173	12,521,666	33,133,262	43.13
Total	15,962,639	10,094,855	17,999,786	20,247,262	12,521,666	76,826,208	100.00

15. LOANS AND ADVANCES (Contd.)

As at 31st December	2006 Rs.000	2005 Rs.000
15(e) Movement in Interest in Suspense - Bank		
Balance brought forward	909,026	1,028,502
Interest suspended	280,784	352,025
Amounts recovered	(315,850)	(375,520)
Interest written off	(23,214)	(95,981)
	850,746	909,026

As a policy, the Bank seals off interest on non-performing loans and advances after one year of classification (after 18 months). However, at the time of recovery, further interest on such advances is calculated from the date on which interest was sealed off.

15(f) Movement in Foreclosed properties		
Balance brought forward	137,089	506,473
Disposals during the year	(69,804)	(170,175)
Exchange translation	(11,085)	(1)
Reclassified to provision for loan losses	43,410	-
Provision for the year	(99,379)	(233,349)
Provision recoveries during the year	24,221	34,141
Balance as at 31st December	24,452	137,089

The total of Foreclosed properties and related provisions have been classified under loans and advances

Sri Lanka Rupee loans and advances	69,420	139,224
Foreign currency loans and advances	423,250	418,316
Specific provision for foreclosed properties [Note 15(g)]	(468,218)	(420,451)
	24,452	137,089

15(g) Movement in provision for Foreclosed properties		
Balance brought forward	420,451	235,102
Reclassified to provision for loan losses	(43,410)	-
Exchange rate variance in foreign currency provision	16,019	(2,348)
Specific provisions made during the year	99,379	233,349
Recoveries made during the year	(24,221)	(34,610)
Fully provided debts written off	-	(11,042)
	468,218	420,451

15(h) Provisions for discount of securities

As per an amendment to the directions issued by the Central Bank of Sri Lanka on 15th August 2003 (effective from 1st January 2004) under section 46 (A) of the Banking Act No. 30 of 1988, as amended by Banking (Amendment) Act No. 33 of 1995, the initial and progressive discounts that need to be applied to the forced sale value of immovable properties held as collateral are as follows:

At the time of first provisioning for a loan, only 75% of the forced sale value (FSV) of the property based on a current professional valuation report is considered as the value of collateral (i.e. an initial haircut of 25% will be applied);

When an advance is transferred to the 'Loss' category, the following progressive discounts apply to the forced sale value of immovable property held as collateral, based on a current professional valuation report, depending on the time period for which it remains in the 'Loss' category:

No. of years in loss category	% of FSV of immovable property that can be considered as the value of collateral
1 - 2 years	60%
2 - 3 years	50%
3 - 4 years	40%

All immovable property held as collateral, relating to loans in the 'Loss' category for more than four years are reviewed on a regular basis and discounted further at the discretion of management.

15. LOANS AND ADVANCES (Contd.)

15(i) Provision for Kabool Lanka (Pvt) Ltd.

The Bank continued to increase the provisions against the exposure to Kabool Lanka (Pvt) Ltd. of approximately Rs. 2.8 Bn. as a measure of prudence, despite the fact that land and building has a value adequate to cover the un-provided exposure.

The assets jointly owned by Hatton National Bank Ltd. and Bank of Ceylon, acquired through the legal process was subsequently acquired by the Government under the Provisions of the Land Acquisition Act and the Banks have lodged their claim for compensation.

Total provision made by the Bank up to 31st December 2006 is Rs. 2.6 Bn.

As at 31st December	Bank		Group	
	2006 Rs.000	2005 Rs.000	2006 Rs.000	2005 Rs.000
16. TOTAL LEASE RENTALS RECEIVABLE				
Gross lease rentals receivable	24,521,330	18,953,416	24,521,330	18,953,416
Initial rentals received	(127,769)	(137,873)	(127,769)	(137,873)
Lease rentals received	(9,379,697)	(7,477,575)	(9,379,697)	(7,477,575)
Total Lease rentals receivable	15,013,864	11,337,968	15,013,864	11,337,968
16(a) Lease rentals receivable within one year				
Lease rentals receivable within one year from				
Balance Sheet date	5,639,588	4,520,433	5,639,588	4,520,433
Unearned lease income	(1,514,493)	(1,126,542)	(1,514,493)	(1,126,542)
Provision for lease receivable				
- Specific [Note 16(c)]	(248,227)	(214,484)	(248,227)	(214,484)
- General [Note 16(c)]	(80,801)	(66,938)	(80,801)	(66,938)
	3,796,067	3,112,469	3,796,067	3,112,469
16(b) Lease rentals receivable after one year				
Lease rentals receivable after one year from				
Balance Sheet date	9,374,276	6,817,535	9,374,276	6,817,535
Unearned lease income	(1,462,904)	(949,926)	(1,462,904)	(949,926)
Provision for lease receivable				
- General [Note 16(c)]	(154,964)	(115,727)	(154,964)	(115,727)
	7,756,408	5,751,882	7,756,408	5,751,882

There were no lease rentals receivable beyond five years.

16(c) Movement in provision for lease rentals receivable

As at 31st December	Bank		Group	
	2006 Rs.000 Specific	2006 Rs.000 General	2005 Rs.000 Specific	2005 Rs.000 General
Bank				
Balance brought forward	214,484	182,665	150,384	140,617
Exchange rate variance on foreign currency provision	-	16	-	(27)
	214,484	182,681	150,384	140,590
Additional provision made (Note 7)	42,730	53,084	73,110	42,826
Recoveries made during the year	(8,552)	-	(9,010)	(751)
Fully provided debts written off	(435)	-	-	-
	248,227	235,765	214,484	182,665
Group				
Balance brought forward	214,484	182,665	150,384	140,617
Exchange rate variance on foreign currency provision	-	16	-	(27)
	214,484	182,681	150,384	140,590
Additional provision made (Note 7)	42,730	53,084	73,110	42,826
Recoveries made during the year	(8,552)	-	(9,010)	(751)
Fully provided debts written off	(435)	-	-	-
	248,227	235,765	214,484	182,665

17. NON CURRENT ASSETS HELD FOR SALE

As at 31st December 2006

	Bank	Group
	Carrying amount Rs.000	Carrying amount Rs.000
Reclassified from Property, Plant and Equipment (Note 21)		
Freehold land [Note 17(a)]	5,614	5,614
Computer equipment	378	378
Equipment, furniture and fixtures	564	564
	6,556	6,556
17(a) Freehold land	Extent (perches)	Cost of land Rs.000
Land at No. 118A, Negombo Road, Narammala	40	4,159
Land at No. 67/11, Kumaradola Road, Monaragala	20	1,455
		5,614

As required by Sri Lanka Accounting Standard 38 (revised 2006) - "Non-Current Assets Held for Sale and Discontinued Operations" (SLAS 38), assets previously classified under Property, Plant & Equipment which met the definition of Non-Current Assets Held for Sale, have been reclassified during the year. The effective date of SLAS 38 is 1st April 2006, as such comparatives have not been reclassified.

18. INVESTMENTS IN ASSOCIATE COMPANIES

As at 31st December

	Principal Activity	2006			2005		
		% Holding	Balance Rs.000	Market Value Rs.000	% Holding	Balance Rs.000	Market Value Rs.000
18(a) Bank							
Quoted							
Lanka Ventures Ltd	Venture Capital	20.07	132,326	132,980	20.07	132,326	122,944
(10,036,250 shares of Rs.10/- each)							
			132,326	132,980		132,326	122,944
Unquoted							
Browns Engineering (Pvt) Ltd.	Engineering	32.63	20,560		32.63	20,560	
(2,056,000 ordinary shares of Rs.10/- each)							
Provision for diminution in value			(20,560)			(20,560)	
Total for the Bank			132,326			132,326	

Browns Engineering (Pvt) Limited is under liquidation and the Bank's investment has been fully provided for.

18. INVESTMENTS IN ASSOCIATE COMPANIES (Contd.)

As at 31st December		2006		2005			
		Principal Activity	% Holding	Balance Rs.000	Market Value Rs.000	% Holding	Balance Rs.000
18(b) Group							
Quoted Investments							
Investment in Associate companies (at cost)				132,326		132,326	
Negative goodwill on acquisition				5,830		5,830	
Group share of Associate company retained profits				-		-	
Balance as at 1st January				32,436		31,598	
Current year's share of profits after tax				8,244		15,734	
Dividends received during the year				(13,967)		(14,896)	
Group share of Associate company net assets				164,869		170,592	
Unamortized negative goodwill carried forward [Note 18(b)i]				-		-	
Group investment in Associate companies (equity basis)				164,869		170,592	
18(b)i Negative goodwill on acquisition							
Unamortized negative goodwill brought forward				-		1,166	
Amortized during the year				-		(1,166)	
Balance as at 31st December				-		-	

19. INVESTMENTS IN SUBSIDIARY COMPANIES

Bank

19(a) Quoted

HNB Assurance Ltd. (14,996,500 shares of Rs. 10/- each)	Insurance	60	149,965	374,912	60	149,965	191,205
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19(b) Unquoted

	Principal Activity		2006		2005		
			Balance Rs.000	Directors' Valuation Rs.000	Balance Rs.000	Directors' Valuation Rs.000	
Sithma Development (Pvt) Ltd (106,000,000 ordinary shares of Rs.10/- each/Rs. 9/- each called up, 100,000,000 ordinary shares of Rs. 9/- each called up as at 31 December 2003)	Property Development	100	1,973,000	1,973,000	100	1,973,000	1,973,000
HNB Securities Ltd (15,000,000 ordinary shares of Rs.10/- each)	Primary Dealer in Government Securities	100	150,000	150,000	100	150,000	150,000
HNB Stockbrokers (Pvt) Ltd (3,600,000 ordinary shares of Rs.10/- each)	Share Broking	100	20,698	20,698	100	20,698	20,698
			2,143,698	2,143,698			2,143,698
Total for Bank			2,293,663				2,293,663

20. INVESTMENT PROPERTIES

	Bank	Group
	Rs.000	Rs.000
Cost as at 1st January 2006	-	-
Reclassified from Property, Plant and Equipment Improvements	195,480	242,474
	25	25
Cost as at 31st December 2006 [Note 20 (a)i and 20(a)ii]	195,505	242,499
Accumulated depreciation as at 1st January 2006	-	-
Reclassified from Property, Plant and Equipment	4,366	52,987
Charge for the year	1,284	4,487
Accumulated depreciation as at 31st December 2006	5,650	57,474
Net book value as at 31st December 2006	189,855	185,025

As required by Sri Lanka Accounting Standard 40 (revised 2005) - "Investment Property" (SLAS 40), assets previously classified under Property, Plant & Equipment which met the definition of Investment property, have been reclassified during the year. The effective date of SLAS 40 is 1st January 2006, as such comparatives have not been reclassified.

Land situated at No.479, T B Jayah Mw., Colombo 10 on which HNB Towers is built, is leased to Sithma Development (Pvt) Ltd and the Bank receives ground rent. Accordingly, this land was classified as Investment property in the Balance Sheet of the Bank. However, according to SLAS 40, the said land is treated as Property, Plant & Equipment in the Group Balance Sheet, since the land is leased to a Group entity.

20(a) Investment Properties

20(a)i Bank

	Cost/Carrying amount			Fair Value				
	Building sq.ft	Extent perches	Land Rs.000	Building Rs.000	Total Rs.000	Land Rs.000	Building Rs.000	Total Rs.000
As at 31st December 2006								
23 & 23 1/1 Independence Avenue Colombo 7	9,975	60.40	37,081	47,754	84,835	472,500	42,500	515,000
479 T B Jayah Mawatha Colombo 10	Land	100.00	75,781	-	75,781	508,320	-	508,320
21, 21A, 23 & 25 Janadhipathi Mawatha Colombo 1	Land	26.62	34,889	-	34,889	39,930	-	39,930
					195,505			1,063,250

20(a)ii Group

	Cost/Carrying amount			Fair Value				
	Building sq.ft	Extent perches	Land Rs.000	Building Rs.000	Total Rs.000	Land Rs.000	Building Rs.000	Total Rs.000
As at 31st December 2006								
23 & 23 1/1 Independence Avenue Colombo 7	9,975	60.40	37,081	47,754	84,835	472,500	42,500	515,000
Smart building 21, 21A, 23 & 25 Janadhipathi Mawatha Colombo 1	42,765	-	-	157,664	157,664	-	197,050	197,050
					242,499			712,050

The fair value of the Investment properties as at 31.12.2006 was based on market valuations carried out as at Balance Sheet date by Messrs J M J Fernando, F. I. V., D.I.V. (Sri Lanka), K C B Condegama, A.I.V. (Sri Lanka) members of the Institute of Valuers of Sri Lanka, who are independent valuers not connected with the Bank.

21. PROPERTY PLANT AND EQUIPMENT

Bank								
	Leasehold Buildings	Freehold Land and Buildings	Computer Equipment	Equipment Furniture and Fixtures	Motor Vehicles	Capital Work-in- Progress	2006 Total	2005 Total
	Note 21(c) Rs.000	Note 21(b) Rs.000	Note 21(a) Rs.000	Rs.000	Rs.000	Rs.000	Rs.000	Rs.000
Cost/Valuation								
as at 31/12/2005	623,256	1,714,564	1,943,480	1,746,043	87,594	87,826	6,202,763	5,790,083
Transfers to								
Intangible assets	-	-	(611,422)	-	-	-	(611,422)	(427,331)
Adjusted Cost/Valuation								
as at 31/12/2005	623,256	1,714,564	1,332,058	1,746,043	87,594	87,826	5,591,341	5,362,752
Transfers to								
Investment property	-	(195,480)	-	-	-	-	(195,480)	-
Transfers to Non-current assets held for sale	-	(5,614)	(6,559)	(48,183)	-	-	(60,356)	-
Sub category transfers	6,801	(2,390)	(181,619)	177,208	-	-	-	-
Additions and improvements	31,525	26,213	64,767	117,875	31,384	211,632	483,396	312,520
Disposals during the year	(2,621)	(1,193)	(7,004)	(31,603)	-	-	(42,421)	(83,931)
Transfers from capital work-in-progress	2,957	24,420	38,811	5,043	-	(71,231)	-	-
Cost/Valuation								
as at 31/12/2006	661,918	1,560,520	1,240,454	1,966,383	118,978	228,227	5,776,480	5,591,341
Accumulated depreciation								
as at 31/12/2005	286,389	135,417	1,289,690	1,046,470	74,428	-	2,832,394	2,403,545
Transfers to								
Intangible assets	-	-	(300,531)	-	-	-	(300,531)	(263,439)
Adjusted accumulated depreciation as at 31/12/2005	286,389	135,417	989,159	1,046,470	74,428	-	2,531,863	2,140,106
Transfers to								
Investment property	-	(4,366)	-	-	-	-	(4,366)	-
Transfers to Non-current assets held for sale	-	-	(6,181)	(47,619)	-	-	(53,800)	-
Sub category transfers	734	(507)	(151,295)	151,068	-	-	-	-
Charge for the year	68,634	22,247	93,468	235,979	9,883	-	430,211	457,229
Disposals during the year	(1,294)	(6)	(6,348)	(27,569)	-	-	(35,217)	(65,472)
Accumulated depreciation								
as at 31/12/2006	354,463	152,785	918,803	1,358,329	84,311	-	2,868,691	2,531,863
Net book value								
as at 31/12/2006	307,455	1,407,735	321,651	608,054	34,667	228,227	2,907,789	
Net book value								
as at 31/12/2005	336,867	1,579,147	342,899	699,573	13,166	87,826		3,059,478

As set out in Significant Accounting Policy No.9.10.1, the Bank is in the process of revaluing its freehold land & building on a rolling basis. Based on the revaluations completed as at Balance Sheet date, the surplus on revaluation amounted to Rs. 704 Mn. The Bank has not recognised this surplus in the Statement of Changes in Equity and will credit the total surplus to Capital Reserve on completion of the revaluation process in 2007.

21. PROPERTY PLANT AND EQUIPMENT (Contd.)

Group	Leasehold	Freehold	Computer	Equipment	Motor	Capital	2006	2005
	Buildings	Land and Buildings	Equipment	Furniture and Fixtures	Vehicles	Work-in Progress	Total	Total
	Note 21(c)							
	Rs.000	Rs.000	Rs.000	Rs.000	Rs.000	Rs.000	Rs.000	Rs.000
Cost/Valuation								
as at 31/12/2005	623,256	4,311,255	2,031,371	3,882,016	98,872	87,826	11,034,596	10,573,268
Transfers to								
Intangible assets	-	-	(650,935)	-			(650,935)	(455,839)
Adjusted Cost/Valuation								
as at 31/12/2005	623,256	4,311,255	1,380,436	3,882,016	98,872	87,826	10,383,661	10,117,429
Transfers to								
Investment property	-	(212,925)	-	(29,549)	-	-	(242,474)	-
Transfers to Non-current assets held for sale	-	(5,614)	(6,559)	(48,183)	-	-	(60,356)	-
Sub category transfers	6,801	(2,390)	(181,619)	177,208	-	-	-	-
Additions and improvements	31,525	26,213	77,318	132,099	31,384	260,904	559,443	350,560
Disposals	(2,621)	(1,193)	(7,004)	(31,916)	-	-	(42,734)	(84,328)
Transfers from capital work-in-progress	2,957	24,420	38,811	5,043	-	(71,231)	-	-
Cost/Valuation								
as at 31/12/2006	661,918	4,139,766	1,301,383	4,086,718	130,256	277,499	10,597,540	10,383,661
Accumulated Depreciation								
as at 31/12/2005	286,389	227,876	1,318,504	1,226,196	83,477	-	3,142,442	2,614,228
Transfers to								
Intangible assets	-	-	(311,532)	-	-	-	(311,532)	(269,415)
Adjusted accumulated depreciation as at 31/12/2005	286,389	227,876	1,006,972	1,226,196	83,477	-	2,830,910	2,344,813
Transfers to								
Investment property	-	(23,438)	-	(29,549)	-	-	(52,987)	-
Transfers to non-current assets held for sale	-	-	(6,181)	(47,619)	-	-	(53,800)	-
Sub category transfers	734	(507)	(151,295)	151,068	-	-	-	-
Charge for the year	68,634	50,701	101,026	291,621	11,361	-	523,343	551,942
Disposals during the year	(1,294)	(6)	(6,348)	(27,851)	-	-	(35,499)	(65,845)
Accumulated Depreciation								
as at 31/12/2006	354,463	254,626	944,174	1,563,866	94,838	-	3,211,967	2,830,910
Net book value								
as at 31/12/2006	307,455	3,885,140	357,209	2,522,852	35,418	277,499	7,385,573	
Net book value								
as at 31/12/2005	336,867	4,083,379	373,464	2,655,820	15,395	87,826		7,552,751

21. PROPERTY PLANT AND EQUIPMENT (Contd.)

21(a) Computer Equipment - Bank

	Additions Prior to 1.7.2000 Rs.000	Additions After 1.7.2000 Rs.000	2006 Total Rs.000	2005 Total Rs.000
Rate of depreciation	25%	16.67%		
Cost/valuation as at 01.01.2006	646,047	686,011	1,332,058	1,787,119
Additions and improvements	-	64,767	64,767	186,005
Transfers from capital work-in-progress	-	38,811	38,811	-
Sub category transfers	(61,019)	(120,600)	(181,619)	-
Transfers to Non-current assets held for sale	(4,097)	(2,462)	(6,559)	-
Transfers to Intangible assets	-	-	-	(611,422)
Disposals during the year	(4,109)	(2,895)	(7,004)	(29,644)
Cost/Valuation as at 31.12.2006	576,822	663,632	1,240,454	1,332,058

21(b) Freehold Land and Buildings - Bank

	Buildings Sq.ft.	Extent (perches)	Cost of Land Rs.000	Cost of Buildings Rs.000	Total Value Rs.000	Accumulated Depreciation Rs.000	Net Book Value Rs.000
Within Colombo City Limits							
Borella Branch 53/1 D S Senanayake Mawatha Borella	7,530	28.00	21,702	37,232	58,934	2,789	56,145
Gunasinghepura Pay Office & Stores 11 Mohandiram's Road Colombo 12	4,835	37.53	28,411	8,025	36,436	1,508	34,928
Bambalapitiya Branch 285 Galle Road Colombo 4 City Office	12,786	20.00	10,000	28,044	38,044	6,411	31,633
16 Janadhipathi Mawatha Colombo 1 & 25 Chatham Street Colombo 1	28,900	84.00	100,800	84,110	184,910	23,725	161,185
Centralized Operations Bldg. 90 Vinayalankara Mawatha Colombo 10	92,008	249.00	145,599	32,046	177,645	1,493	176,152
Main Branch 10 R A De Mel Mawatha Colombo 03	36,379	40.00	32,000	81,516	113,516	21,776	91,740
Pettah Extension Office 149-151 Main Street Colombo 11	3,708	7.60	9,099	892	9,991	12	9,979

21. PROPERTY PLANT AND EQUIPMENT (Contd.)

21(b) Freehold Land and Buildings - Bank (Contd.)

	Buildings Sq.ft.	Extent (perches)	Cost of Land Rs.000	Cost of Buildings Rs.000	Total Value Rs.000	Accumulated Depreciation Rs.000	Net Book Value Rs.000
Within Colombo City Limits (Contd.)							
Sea Street Branch 60 Sea Street Colombo 11	3,652	6.93	8,200	53,635	61,835	10,054	51,781
Wellawatte Branch 102 Galle Road Wellawatte	18,040	36.05	29,854	62,658	92,512	5,834	86,678
Grandpass Branch 182 St. Joseph Street Colombo 14	9,325	24.00	9,359	22,337	31,696	2,211	29,485
Pettah Branch 88 Main Street Colombo 11	9,732	7.56	33,919	93,484	127,403	10,954	116,449
Total freehold land and buildings within Colombo City Limits			428,943	503,979	932,922	86,767	846,155
Outside Colombo City Limits							
Akkaraipattu Branch 1 Main street Akkaraipattu	7,700	19.32	3,351	20,811	24,162	809	23,353
Ambalangoda Branch 94/1 New Road Ambalangoda	4,950	29.90	3,102	9,022	12,124	2,146	9,978
Badulla Branch 15 151/1 Udayaraja Mawatha Badulla.	3,584	28.44	2,418	11,390	13,808	2,778	11,030
Boralesgamuwa Branch 24 Maharagama Road Boralesgamuwa	3,500	30.34	5,048	15,442	20,490	1,768	18,722
Dambulla Branch 622 Anuradhapura Road Dambulla	6,600	100.00	14,565	18,456	33,021	623	32,398
Galle Branch 3 Wakwella Road Galle	4,988	13.80	11,000	18,949	29,949	2,943	27,006
Gampola Branch 12 Kandy Road Gampola	5,604	11.88	8,319	3,221	11,540	958	10,582
Hatton Branch 78 Dambulla Road Hatton	5,500	70.02	10,456	7,301	17,757	887	16,870

21. PROPERTY PLANT AND EQUIPMENT (Contd.)

21(b) Freehold Land and Buildings - Bank (Contd.)

	Buildings Sq.ft.	Extent (perches)	Cost of Land Rs.000	Cost of Buildings Rs.000	Total Value Rs.000	Accumulated Depreciation Rs.000	Net Book Value Rs.000
Outside Colombo City Limits (Contd.)							
"Mount Bungalow" 7 Mount Road Hatton	4,200	160.00	3,620	4,958	8,578	224	8,354
Jaffna Property							
181/5C Ponnambalam Road Jaffna	Under Development	80.00	1,994	34	2,028	7	2,021
Kandy Branch 1 Dalada Veediya Kandy	10,600	78.90	38,627	16,298	54,925	3,913	51,012
Kurunegala Branch 6 St. Anne's Street Kurunegala	9,600	16.25	3,250	8,553	11,803	1,879	9,924
Nawalapitiya Branch 92 Gampola Road Nawalapitiya	2,324	46.00	875	8,049	8,924	1,413	7,511
Negombo Branch 18 Rajapakse Broadway Negombo	3,504	8.88	1,776	14,930	16,706	3,731	12,975
Nittambuwa Branch 22 Kandy Road Nittambuwa	4,000	14.50	687	10,291	10,978	2,267	8,711
Nochchiyagama Branch 10 Puttalam Road Nochchiyagama	1,800	40.00	320	11,140	11,460	1,988	9,472
Wattala Branch 270, 270/1 Negombo Road Wattala	6,400	53.00	10,399	22,510	32,909	3,356	29,553
Kuliyapitiya Additional Property 225 Madampe Road Kuliyapitiya	Bare Land	8.80	883	-	883	-	883
Kurunegala New Property 34/16 St. Anne's Road Kurunegala	Bare Land	20.00	6,759	-	6,759	-	6,759
Nugegoda Branch 181 High Level Road Nugegoda	11,639	19.50	7,550	28,678	36,228	6,807	29,421
Nuwara Eliya Branch /Bungalow 42 Queen Elizabeth Drive Nuwara Eliya	7,150	64.36	11,504	23,976	35,480	2,809	32,671

21. PROPERTY PLANT AND EQUIPMENT (Contd.)

21(b) Freehold Land and Buildings - Bank (Contd.)

	Buildings Sq.ft.	Extent (perches)	Cost of Land Rs.000	Cost of Buildings Rs.000	Total Value Rs.000	Accumulated Depreciation Rs.000	Net Book Value Rs.000
Outside Colombo City Limits (Contd.)							
Trincomalee Branch 59 Ahambaram Road Trincomalee	6,802	20.51	1,451	16,236	17,687	3,403	14,284
Anuradhapura Branch 30 Maithripala Senanayake Mawatha Anuradhapura	2,000	25.59	5,337	13,247	18,584	2,769	15,815
Maskeliya Branch 9 New Town Maskeliya	1,900	20.32	1,948	2,619	4,567	527	4,040
Mannar Branch 68 Main Street Mannar	4,200	23.00	619	5,271	5,890	954	4,936
Ratnapura Branch 21 & 23 Senanayake Mawatha Ratnapura	3,048	21.01	12,479	11,062	23,541	2,044	21,497
Ja - Ela Branch 73 Old Negombo Road Ja - Ela	4,300	19.00	2,729	10,016	12,745	1,915	10,830
Matale Branch 660 Trincomalee Road Matale	7,615	22.08	3,459	11,814	15,273	2,647	12,626
Kuliyapitiya Branch 225 Main Street Kuliyapitiya	4,273	24.00	3,483	4,725	8,208	1,058	7,150
Mount Lavinia Branch 100 Galle Road Mount Lavinia	12,674	28.46	10,294	26,800	37,094	4,196	32,898
Marawila Branch 534 Chilaw Road Marawila	4,640	23.30	3,916	8,372	14,715	2,038	12,677
Marawila Staff Quarters	1,733	23.30	2,427				
Matara Branch 29 Anagarika Dharmapala Mw Matara	6,988	26.00	5,136	21,361	26,497	3,161	23,336
Kegalle Property Main Street Kegalle	Bare Land	48.70	15,600	-	15,600	-	15,600
Kahawatte Branch 772A Main Street Kahawatta	14,652	16.14	2,265	24,420	26,685	-	26,685
Total freehold land and buildings outside Colombo City Limits			217,646	409,952	627,598	66,018	561,580
Total freehold land and buildings as at 31st December 2006			646,589	913,931	1,560,520	152,785	1,407,735

21. PROPERTY PLANT AND EQUIPMENT (Contd.)

21(c) Leasehold Buildings

As at 31st December	Bank			Group			Bank	Group
	2006			2006			2005	2005
	Cost of Buildings Rs.000	Accumulated Depreciation Rs.000	Net Book Value Rs.000	Cost of Buildings Rs.000	Accumulated Depreciation Rs.000	Net Book Value Rs.000	Net Book Value Rs.000	Net Book Value Rs.000
Lease Period								
Up to 1 year	18,504	13,855	4,649	18,504	13,855	4,649	-	-
01 - 05 years	112,390	94,038	18,352	112,390	94,038	18,352	24,093	24,093
05 - 10 years	143,795	101,739	42,056	143,795	101,739	42,056	42,763	42,763
10 - 15 years	49,634	30,142	19,492	49,634	30,142	19,492	24,309	24,309
15 - 20 years	2,759	950	1,809	2,759	950	1,809	245,702	245,702
Above 20 years	334,836	113,739	221,097	334,836	113,739	221,097	-	-
	661,918	354,463	307,455	661,918	354,463	307,455	336,867	336,867

21(d) Freehold Land and Buildings - Subsidiaries

As at 31st December	Buildings Sq.ft.	2006				2005
		Cost of Buildings Rs.000	Total Value Rs.000	Accumulated Depreciation Rs.000	Net Book Value Rs.000	Net Book Value Rs.000
Smart Building						
21 21A 23 25 Janadhipathi Mawatha Colombo 1	42,765	128,115	128,115	22,275	105,840	109,043
Sithma Building						
479 T B Jayah Mawatha Colombo 10	499,554	2,468,576	2,468,576	101,841	2,366,735	2,395,189
		2,596,691	2,596,691	124,116	2,472,575	2,504,232

21(e) Fully depreciated property

The initial cost of fully depreciated Plant, Machinery and Equipment as at 31st December 2006, which are still in use as at Balance Sheet date.

	Rs.000
Motor vehicles	73,482
Computer equipment	807,228
Equipment, furniture and fixtures	312,418

22. INTANGIBLE ASSETS

As at 31st December	Bank		Group	
	2006 Rs.000	2005 Rs.000	2006 Rs.000	2005 Rs.000
Cost as at 1st January	611,422	-	650,935	-
Reclassified from Property, Plant and Equipment	-	427,331	-	455,838
Additions and improvements during the year	21,200	184,091	26,716	195,096
Cost as at 31st December	632,622	611,422	677,651	650,934
Accumulated amortization as at 1st January	300,531	-	311,532	-
Reclassified from Property, Plant and Equipment	-	263,439	-	269,415
Amortization for the year	100,116	37,092	106,379	42,116
Accumulated amortization as at 31st December	400,647	300,531	417,911	311,531
Net book value as at 31st December	231,975	310,891	259,740	339,403

As stated in Significant Accounting Policy No.9.8.1(b), all computer software costs incurred by the Bank which are not integrally related to associated hardware have been classified as Intangible assets. The comparatives have been adjusted to reflect this reclassification.

23. OTHER ASSETS

	Bank		Group	
	2006 Rs.000	2005 Rs.000	2006 Rs.000	2005 Rs.000
As at 31st December				
Deposits and prepayments	2,642,806	2,191,046	2,642,806	2,191,046
Items in transit	361,617	1,583,030	361,617	1,583,030
Claims receivable	393,607	170,476	393,607	170,476
Other debtors	1,736,331	1,200,533	1,707,798	1,200,124
	5,134,361	5,145,085	5,105,828	5,144,676

24. DEPOSITS FROM CUSTOMERS

Local Currency Deposits

Current account deposits	12,635,473	12,511,256	12,588,089	12,369,491
Savings deposits	50,697,086	47,380,753	50,697,076	47,373,887
Time deposits	48,869,303	33,587,699	48,836,363	33,583,449
Certificates of deposit	3,348,716	3,634,393	3,348,716	3,634,393
	115,550,578	97,114,101	115,470,244	96,961,220

Foreign Currency Deposits

Current account deposits	1,188,634	1,013,589	1,188,634	1,013,589
Savings deposits	13,600,463	14,166,198	13,586,578	14,166,199
Time deposits	17,542,350	15,989,793	17,542,350	15,989,793
	32,331,447	31,169,580	32,317,562	31,169,581
Total deposits	147,882,025	128,283,681	147,787,806	128,130,801

24 (a) Analysis of Deposits

Deposits from Non-Bank Customers	147,463,803	127,577,487	147,369,584	127,428,685
Deposits from Banks	24,354	462,778	24,354	462,778
Deposits from Finance Companies	393,868	243,416	393,868	239,338
	147,882,025	128,283,681	147,787,806	128,130,801

25. DIVIDENDS PAYABLE

Balance as at 1st January	50,291	108,299	50,291	108,299
Dividends declared during the year	529,941	385,679	529,941	385,679
Dividends paid	(542,129)	(443,687)	(542,129)	(443,687)
Balance as at 31st December	38,103	50,291	38,103	50,291

The 25% interim dividend paid on 11th December 2006 included a re-distribution of tax exempt dividends of Rs. 16,926,771/- (2005 - Rs. 23,120,368/-) received by the Bank. Under the Inland Revenue Amendment Act No.10 of 2002, a withholding tax of 10% has been imposed on dividends declared from 1st April 2004.

Proposed final dividend

Board of Directors have recommended the payment of a final dividend of 25% for the year ended 31st December 2006 (2005 - 20%), which is to be approved at the Annual General Meeting to be held on 29th March 2007. In accordance with Sri Lanka Accounting Standard No. 12-(Revised), "Events After the Balance Sheet Date", this proposed final dividend has not been recognised as a liability as at 31st December 2006.

26. BORROWINGS

	Bank		Group	
	2006 Rs.000	2005 Rs.000	2006 Rs.000	2005 Rs.000
As at 31st December				
Call and time deposits from banks	4,584,620	510,517	4,584,620	510,517
Refinance borrowings	3,582,587	2,711,810	3,582,587	2,711,810
Borrowings from foreign banks	864,294	717,784	864,294	717,784
Borrowings from local banks	2,000,000	-	2,000,000	-
	11,031,501	3,940,111	11,031,501	3,940,111

27. LONG TERM INSURANCE FUND

Long Term Insurance Fund balance represents the Life Fund of the Subsidiary HNB Assurance Ltd., which is carrying out life and non-life insurance business. This balance represents the amounts attributable to life policy holders included in the Group's net assets.

The valuation of the Long Term Insurance Fund as at 31st December 2006 was made by Mr M Poopalanathan, AIA, of M/s Actuarial and Management Consultants (Pvt) Ltd. for and on behalf of HNB Assurance Ltd. The life fund stands at Rs. 507.72 Mn. as at 31st December 2006 (2005 - Rs 300.82 Mn.) and in the opinion of the Actuary this amount is adequate to cover the liabilities pertaining to the long term insurance business of HNB Assurance Ltd., as per the Actuary's Report dated 2nd February 2007.

28. NON-LIFE INSURANCE RESERVES

Non Life Insurance Reserves represents the following which are included in the financial statements of HNB Assurance Ltd., subsidiary of the Bank, as required by the Statement of Recommended Practice of Institute of Chartered Accountants of Sri Lanka (ICASL) and in accordance with the regulation of Insurance Industry Act No. 43 of 2000:

Group				
As at 31st December	2006	2006	2005	2005
	Rs.000	Rs.000	Rs.000	Rs.000
Unearned premium - Gross		327,174		237,059
- Reinsurance		(101,057)		(57,152)
- Net		226,117		179,907
Deferred acquisition expenses		(393)		(7,283)
Unexpired Risk Reserve		4,489		1,365
		230,213		173,989
Claims outstanding - Gross	82,207		78,061	
Claims incurred but not reported - Gross	7,118	89,325	14,970	
Claims reserve - Gross				93,031
Total		319,538		267,020

29. SUBORDINATED DEBENTURES

As at 31st December	Bank		Group	
	2006 Rs.000	2005 Rs.000	2006 Rs.000	2005 Rs.000
Balance as at 1st January	4,000,000	4,000,000	5,976,791	5,983,450
Debentures issued	1,120,000	-	1,120,000	-
Debentures held by Group Companies	-	-	(13,341)	(6,659)
Balance as at 31st December	5,120,000	4,000,000	7,083,450	5,976,791

- i Consists of twenty million unsecured, subordinated, redeemable debentures of Rs.100/- each. The six types of debentures have fixed or floating interest rate options as follows:

Redemption Period	5 year	7 year	10 year
	p.a.	p.a.	p.a.
Fixed	13.75%	14.00%	14.20%
Effective annual yield	14.22%	14.49%	14.70%
Floating	TB + 1%	TB + 1.1%	TB + 1.25%

The floating rate is based on the six month treasury bill rate with a cap of 17% p.a. and a floor of 12% p.a. Based on the duration, the debentures are redeemable on September 11th 2007, September 11th 2009 and September 11th 2012. These debentures are listed on the Colombo Stock Exchange.

- ii Consists of twenty million unsecured, subordinated, redeemable debentures of Rs. 100/- each. The two types of debentures have fixed or floating interest rate options as follows:

Redemption Period	5 Year p.a.
Fixed	10.00%
Effective annual yield	10.25%
Floating	TB + 2.00%

The debentures are redeemable on July 23rd 2008 and are listed on the Colombo Stock Exchange.

- iii Consists of eleven million two hundred thousand unsecured, subordinated, redeemable debentures of Rs.100 /- each. The five types of debentures have fixed or floating interest rate options as follows:

Redemption Period	6 Year	7 Year	8 Year	15 Year	18 Year
	p.a.	p.a.	p.a.	p.a.	p.a.
Fixed				11%	11.25%
Effective annual yield				11%	11.25%
Floating	TB + 2.25%	TB + 2.25%	TB + 2.25%		

The floating rate is based on the six month treasury bill rate with a cap of 16% p.a. and a floor of 8 % p.a. Based on the duration, the debentures are redeemable on 31st March 2012, 31st March 2013, 31st March 2014, 31st March 2021 and 31st March 2024. These debentures are not listed on the Colombo Stock Exchange as at 31.12.2006.

30. DEFERRED TAX LIABILITY

	Bank		Group	
	2006 Rs.000	2005 Rs.000	2006 Rs.000	2005 Rs.000
As at 31st December				
Deferred tax liability [Note 30(a)]	618,828	313,756	622,747	316,317
Deferred tax asset [Note 30(b)]	(305,072)	-	(305,072)	-
	313,756	313,756	317,675	316,317

30(a) Deferred Tax liability

	Bank				Group			
	2006		2005		2006		2005	
	Temporary Difference Rs.000	Tax Effect Rs.000	Temporary Difference Rs.000	Tax Effect Rs.000	Temporary Difference Rs.000	Tax Effect Rs.000	Temporary Difference Rs.000	Tax Effect Rs.000
Balance as at 01/01/2006	1,045,853	313,756	1,167,854	350,356	1,054,390	316,317	1,175,097	352,529
Originating/(Reversal) during the year	(21,569)	(7,549)	(122,000)	(36,600)	(17,689)	(6,191)	(120,707)	(36,212)
Impact on rate increase	255,663	89,482	-	-	255,663	89,482	-	-
Opening balance adjustment as per transitional provision	637,540	223,139	-	-	637,540	223,139	-	-
		618,828		313,756		622,747		316,317

30(b) Deferred Tax asset

	2006			
	Bank		Group	
	Temporary Difference Rs.000	Tax Effect Rs.000	Temporary Difference Rs.000	Tax Effect Rs.000
Balance as at 01/01/2006	-	-	-	-
Opening balance adjustment as per transitional provision	871,634	305,072	871,634	305,072
		305,072		305,072

30 (c) Application of transitional provision

As per the transitional provision in Sri Lanka Accounting Standard 14 - "Income Taxes", (SLAS 14) the Bank has made an irrevocable choice to recognise the opening balance increase on a straight line basis over two years from 1st January 2006, the date of adoption of this standard.

i) The amount recognised in the current year

	2006	
	Bank Rs.000	Group Rs.000
Deferred tax asset	305,072	305,072
Deferred tax liability	(223,139)	(223,139)
Income tax expense [Note 8(b)]	81,933	81,933
ii) The net amount of increase to be recognised next year	81,933	81,933

30 (d) Unrecognised Deferred Tax asset

A deferred tax asset of Rs.527 Mn. arising from the balance carry forward unutilised tax losses of Rs. 1,505 Mn. has not been recognized as at 31st December 2006.

Recognition of the total unutilised tax losses would result in an additional credit of Rs. 527 Mn., to the Income Statement, which will cause wide fluctuation in the Income Statement this year being the year of adoption of SLAS 14 as these tax losses will be fully utilised in the immediate future.

31. OTHER LIABILITIES

	Bank		Group	
	2006 Rs.000	2005 Rs.000	2006 Rs.000	2005 Rs.000
As at 31st December				
Cheques sent on clearing	1,216,711	2,395,504	1,216,711	2,395,504
Accrued expenditure and interest	5,059,193	3,389,960	5,059,193	3,389,960
Claims payable	175,939	183,323	175,939	183,323
Margins	1,463,057	1,004,758	1,463,057	1,004,758
Pension fund	1,235,693	745,715	1,235,873	745,715
Widows'/widowers' & orphans' pension fund	228,862	225,119	228,862	225,119
Employees provident fund	106,904	1,004,823	106,904	1,004,023
Other creditors	938,977	889,728	1,453,536	1,333,873
	10,425,336	9,838,930	10,940,075	10,282,275

32. SHARE CAPITAL - BANK AND GROUP

	2006 Rs.000	2005 Rs.000
As at 31st December		
AUTHORISED		
1 Billion ordinary shares of Rs.10/- each	10,000,000	10,000,000
ISSUED AND FULLY PAID - VOTING ORDINARY SHARES		
As at 1st January		
94,664,700 (2005 - 77 Mn.) voting ordinary shares of Rs.10/- each	946,647	770,000
Shares issued during the year		
17,664,700 voting ordinary shares of Rs. 10/- each	-	176,647
As at 31st December		
94,664,700 voting ordinary shares of Rs.10/- each	946,647	946,647
ISSUED AND FULLY PAID - NON-VOTING ORDINARY SHARES		
As at 31st December		
23,100,000 non-voting ordinary shares of Rs.10/- each	231,000	231,000

The Non-Voting shares rank pari passu in respect of all rights with the ordinary shares of the Bank except voting rights on resolutions passed at general meetings. If the Bank fails to pay dividends for three consecutive years, these shares will automatically be converted into voting ordinary shares.

33. COMMITMENTS AND CONTINGENCIES - BANK AND GROUP

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

33(a) Capital commitments

Capital expenditure approved by the Board of Directors for which provision has not been made in the accounts amount to approximately Rs. 225.5 Mn.

	2006 Rs.000	2005 Rs.000
As at 31st December		
Approved and contracted for	225,527	19,957
	225,527	19,957

33. COMMITMENTS AND CONTINGENCIES - GROUP AND BANK (Contd.)

33(b) Future monthly commitments on operating leases - Bank

As at 31st December	2006 Rs.000	2005 Rs.000
1 - 5 years	6,971	3,294
6 - 10 years	1,578	3,510
11 - 15 years	859	705
16 - 20 years	-	200
	9,408	7,709

33(c) Irrevocable commitments - Bank

Commitments as at Balance Sheet date that cannot be revoked at the discretion of the Bank without the risk of incurring significant penalty or expense amounted to Rs. 23.894 Mn. (2005 - Rs. 21.016 Mn)

33(d) Contingent liabilities

Acceptances	3,626,830	3,983,731
Documentary credits	7,408,853	6,306,610
Guarantees	16,485,243	14,710,250
Bills for collection	7,198,400	6,147,266
Interest rate swap	499	1,761
	34,719,825	31,149,618
Forward Exchange Contracts	10,065,139	13,613,590
Total Contingencies		
Group and Bank	44,784,964	44,763,208

33(e) Litigation against the Bank

- (i) Three claims for damages made by customers in Cases Nos. 9030/M, 9272/M and 1773/M in the DCs in respect of cheques dishonoured.
- (ii) HC (Civil) Case No. 132/2001 (i) a depositor's claim for damages against Habib Bank AG Zurich Sri Lanka Branch (HBZ) for setting-off a customer liability with a deposit - the Bank substituted with acquisition of HBZ business.
- (iii) Labour Tribunal Cases Nos. 08/2674/96, 13/42/98, 03/148/99, 18022, 08/2114/2002, 08/2115/2002, 08/2176/2002, 23/7957/2002, 26/02/2004, 26/122/2004, 26/06/2005, 9/11/2005, 21/Addl./489/05, 3/149/2005 and LT Appeal Cases Nos. HCA/74/2005 and HCA/224/2005.

Based on the available information and current status of the above cases, the Bank is not in a position to quantify the potential financial impact if any, as at the Balance Sheet date. Further, the Bank confirms that there is no case which is not disclosed above which would have a material impact on the financial position of the Bank.

33(f) Tax assessments against the Bank

- (i) VAT on financial services for 2003 and 2004, amounting to Rs. 247 Mn. on Assessment Nos. VATFS/06/0312/06, VATFS/U6/0401/01, VATFS/J6/0402/02, VATFS/U6/0403/03, VATFS/U6/0404/04 and VATFS/U6/0405/05 against which, the Bank has appealed to the Board of Review.
- (ii) VAT for the year 2003, taxes amounting to Rs. 323.8 Mn. on Assessment Nos. 8290566, 8290567, 8290568, 8290569, 8290570, 8290571, 8290572, 8290573, 8290574, 8290575, 8290576 and 8290577 against which, the Bank has duly appealed.
- (iii) VAT for the year 2004, taxes amounting to Rs. 74.4 Mn. on Assessment Nos. 8325523, 8325524, 8325525, 8325526, 8325527, 8325528, 8325533 and 8325534 have been received on 02.02.07.

The Bank is of the view that the above assessments will not have any material impact on the financial statements.

34. DIRECTORS' INTEREST IN CONTRACTS WITH THE BANK

34(a) Trading transactions

Name of Related Party	Name of Director (Relationship)	2006	2005	Nature of Transactions
		Amount Rs. Mn.	Amount Rs. Mn.	
Brown & Co. Ltd.	Mr M V Theagarajah (Chairman till 30.06.2006)	30.585	13.795	Payment for purchase of plant, equipment, repairs to assets and service agreements.
		8.000	26.250	Payment for purchase of generators and generator service agreements.
		0.018	0.042	Two premises were vacated in June 2005 and the last one was vacated in November 2006.
Madulsima Plantations Ltd.	Dr V P Vittachi (Chairman) Mr D H S Jayawardena (Managing Director) Mr R K Obeyesekere (Director)	0.900	0.720	Payment for lease of holiday bungalow at Bogawantalawa.
Lanka Bell (Pvt) Ltd. (from June 2005)	Mr D H S Jayawardena (Chairman)	10.000	1.360	Payment for voice communication charges.
		5.000	1.811	Payment for data communication charges.
		7.893	1.163	Telephone charges paid.
Sri Lanka Insurance Corporation Ltd.	Mr D H S Jayawardena (Chairman) Mr R K Obeyesekere (Deputy Chairman)	56.004	49.052	Insurance premiums paid, inclusive of taxes.
Stassen Exports Ltd.	Dr V P Vittachi (Chairman) Mr D H S Jayawardena (Managing Director) Mr R K Obeyesekere (Director)	-	0.906	Payment for purchase of promotional material.
Aitken Spence Printing (Pvt) Ltd.	Subsidiary of Aitken Spence Co. Ltd.	15.986	2.714	Printing charges

The details of the lending transactions with companies in which there is an interest by Directors of the Bank are disclosed in Note No. 35 "Related Party Transactions".

34. DIRECTORS' INTEREST IN CONTRACTS WITH THE BANK (Contd.)

34(b) Credit Card facilities to Directors

	Limit Rs. Mn.	Outstanding as at 31.12.06 Rs. Mn.
Mr R T Wijetilleke (Chairman)	0.500	0.330
Dr V P Vittachi (Deputy Chairman)	0.500	0.040
Mr D H S Jayawardena*	12.500	2.310
Mr M V Theagarajah	0.500	0.007
Mr R K Obeyesekere	0.500	0.050
Mrs P Cooray	0.500	0.002
Mr R Sivaratnam*	1.240	0.180
Mr R Theagarajah	0.400	0.002

* Rs. 0.5 Mn clean and the balance is secured by cash deposits.

34(c) Accommodation granted to Directors

Name of Director	Aggregate amount of accommodation		Security
	Limit Rs. Mn.	Outstanding as at 31.12.06 Rs. Mn.	
Mr R T Wijetilleke	0.72	0.67	Cash deposits
Mr M V Theagarajah	4.60	-	Cash deposits
Mr R Sivaratnam	1.50	0.24	Quoted company shares/cash deposits
Mr R Theagarajah	*5.00	0.80	Provident Fund balance

* Original amount of loan granted at staff rate.

All facilities outstanding in the names of the Directors are performing.

35. RELATED PARTY TRANSACTIONS

The Bank carries out transactions in the ordinary course of its business with parties who are defined as related parties in Sri Lanka Accounting Standard 30 "Related Party Disclosures (revised 2005)", the details of which are reported below. The pricing applicable to such transactions is based on the assessment of risk and the pricing model of the Bank and is comparable with what is applied to transactions between the Bank and its unrelated customers.

35 (a) Transactions with/between Subsidiaries

35(a)i Sithma Development (Pvt) Ltd.

Sithma Development (Pvt) Ltd. ("Sithma"), is a wholly owned subsidiary of Hatton National Bank Ltd. (HNB).

The details of the overdraft facility with HNB are as follows:

Type of Facility	Rate of Interest	Limit Rs. Mn.	Outstanding as at 31/12/06 Rs.000	Security	Review
Overdraft	2% above the one year *WATB. to be reviewed every 6 months.	800	414,787	Registered primary floating mortgage for Rs. 1,800 Mn. over land and building at No. 479, T B Jayah Mw., Colombo 10.	May-07

*WATB - Weighted Average Treasury Bill Rate

35. RELATED PARTY TRANSACTIONS (Contd.)

35(a) Transactions with/between Subsidiaries (Contd.)

35(a)i) Sithma Development (Pvt) Ltd. (Contd.)

A summary of transactions of Sithma with HNB and other group companies are given below:

	HNB SECURITIES Rs.000	HNB STOCKBROKERS Rs.000	HNB ASSURANCE Rs.000	HNB Rs.000
Rent income received	5,898	6,622	-	428,062
Rent advance received (as at 31.12.2006)	1,498	1,778	-	108,952
Refundable deposit received	3,000	3,000	-	500,000
Insurance premium paid	-	-	3,720	-
Interest paid	-	-	-	57,360
Ground rent paid	-	-	-	3,752

35(a)ii) HNB Securities Ltd.

HNB Securities Ltd. ("Securities"), is a fully owned subsidiary of Hatton National Bank Ltd.

Securities maintains a current account with HNB and the balance as at 31.12.2006 amounts to Rs. 4.6 Mn. (2005-Rs. 23.02 Mn.).

A summary of transactions of Securities with HNB and other group companies are given below:

	SITHMA Rs.000	HNB STOCKBROKERS Rs.000	HNB ASSURANCE Rs.000	HNB Rs.000
Interest received	-	-	-	14,342
Insurance premium paid	-	-	103	-
Interest paid	-	-	17,400	19,947
Rent paid	5,898	-	-	-
Rent advance paid (as at 31.12.2006)	1,498	-	-	-
Refundable deposit paid	3,000	-	-	-

35(a)iii) HNB Assurance Ltd.

HNB Assurance Ltd. ("Assurance"), is a subsidiary of Hatton National Bank Ltd.

Assurance held deposits with the Bank amounting to Rs. 63 Mn. (2005 - Rs. 43.7 Mn.) as at 31.12.2006. Further company held debentures of the Bank amounting to Rs. 36.6 Mn. (2005 - Rs.16.6 Mn.)

A summary of transactions of Assurance with HNB and other group companies are given below:

	SITHMA Rs.000	HNB STOCKBROKERS Rs.000	HNB SECURITIES Rs.000	HNB Rs.000
Premium received	3,720	364	103	14,572
Interest received	-	-	17,400	5,194
Rent paid	-	-	-	13,415
Commission paid	-	-	-	37,462
Dividend paid	-	-	-	7,500

35. RELATED PARTY TRANSACTIONS (Contd.)

35 (a) Transactions with/between Subsidiaries (Contd.)

35(a)iv HNB Stockbrokers (Pvt) Ltd.

HNB Stockbrokers (Pvt) Ltd. ("Stockbrokers"), is a wholly owned subsidiary of Hatton National Bank Ltd.

Stockbrokers held deposits with the Bank and the balance as at 31.12.2006 amounts to Rs. 18.7 Mn. (2005 - Rs 78.9 Mn.)

A summary of transactions of Stockbrokers with HNB and other group of companies are given below:

	SITHMA	HNB	HNB	HNB
		ASSURANCE	SECURITIES	
	Rs. 000	Rs. 000	Rs. 000	Rs. 000
Interest received	-	-	-	125
Insurance premium paid	-	364	-	-
Interest paid	-	-	-	202
Rent paid	6,622	-	-	-
Rent advance paid (as at 31.12.2006)	1,778	-	-	-
Refundable deposit paid	3,000	-	-	-
Commission paid	-	-	-	17,062

Mr R T Wijetilleke, who is the Chairman of the Bank is also the Chairman of the above four subsidiary companies.

Mr R Theagarajah, a Director of the Bank, is also a Director of the four subsidiary companies mentioned above.

Mr Yeo Took Keat alternate to Mr D R Ghazalli, Director of the Bank is also a Director of HNB Assurance Ltd.

35(b) Transactions with Associates

Lanka Ventures Ltd.

Lanka Ventures Ltd. has invested Rs. 23.5 Mn. in quoted debentures of HNB and has term deposits of Rs.60 Mn. placed with the Bank as at 31st December 2006, in respect of which interest amounting to Rs. 6.813 Mn. has been paid by the Bank for the financial year 2006.

35(c) Transactions with Key Management Personnel of the Bank

Key Management Personnel (Board of Directors) and their close family members' transactions with the Bank/Group during the year are disclosed under Note No.34(b) and 34(c).

35(d) Compensation of Key Management Personnel

Compensation paid to Key Management personnel of the Bank/Group is disclosed in under Note No 6(a).

35. RELATED PARTY TRANSACTIONS (Contd.)

35 (e) Transactions with other related parties

Name of Related Party	Name of Director (Relationship)	Nature of Transaction	Aggregate Amount of Accommodation			Security
			Limit (Rs. Mn.)	Outstanding as at (Rs. Mn.)		
				31.12.06 Direct	Indirect	
Stassen Exports Ltd.	Dr V P Vittachi	Overdraft I	753.00			Cash Deposits Quoted Co. Shares Inventories
	Chairman	Overdraft II	60.00	1,142.06	-	
	Mr D H S Jayawardena	Temporary Overdraft	400.00			
	Managing Director	Letters of Guarantee	60.00	-	58.44	
	Mr R K Obeyesekere	Director	Letters of Credit	15.00	-	
			1,288.00	1,142.06	68.57	
Stassen International Ltd	Dr V P Vittachi	Letters of Credit	70.00	-	51.90	Cash Deposits Quoted Co. Shares Inventories
	Chairman	Overdraft	20.00	5.19	-	
	Mr D H S Jayawardena					
	Managing Director	Letters of Guarantee	125.00	-	101.89	
Mr R K Obeyesekere	Director		215.00	5.19	153.79	
Milford Exports (Cey) Ltd	Dr V P Vittachi	Letters of Credit	2.00	-	0.21	Quoted Co. Shares Inventories
	Chairman	Overdraft	0.50	-	-	
	Mr D H S Jayawardena					
	Managing Director	Letters of Guarantee	30.00	-	31.20	
Mr R K Obeyesekere	Director		32.50	-	31.41	
Madulsima Plantations Ltd	Dr V P Vittachi	Overdraft	175.20	134.63	-	Cash Deposits Quoted Co. Shares Mortgage over leasehold property.
	Chairman	Loan	4.76	4.76	-	
	Mr D H S Jayawardena	Letters of Guarantee	1.00	-	0.15	
	Managing Director	Temp. Letters of Credit	-	-	3.23	
	Mr R K Obeyesekere					
Director		180.96	139.39	3.38		
Stassen Natural Food (Pvt) Ltd	Dr V P Vittachi	Letters of Guarantee	15.00	-	15.00	Quoted Company Shares
	Chairman	Letters of Credit	6.00	-	1.94	
	Mr D H S Jayawardena					
	Managing Director					
Mr R K Obeyesekere	Director		21.00	-	16.94	
CBD Exports Ltd	Dr V P Vittachi	Letters of Guarantee	10.00	-	-	Quoted Company Shares
	Chairman					
	Mr R K Obeyesekere					
Managing Director		10.00	-	-		
Browns Beach Hotels Ltd	Dr V P Vittachi	Temp. Letters of Credit	-	-	2.39	Inventories
	Chairman					
	Mr D H S Jayawardena					
Director		-	-	2.39		

35. RELATED PARTY TRANSACTIONS (Contd.)

35 (e) Transactions with other related parties (Contd.)

Name of Related Party	Name of Director (Relationship)	Nature of Transaction	Aggregate Amount of Accommodation			Security
			Limit (Rs. Mn.)	Outstanding as at (Rs. Mn.)		
				31.12.06 Direct	Indirect	
Sri Lanka Insurance Corporation	Mr D H S Jayawardena Chairman	Letters of Guarantee	0.77	-	0.77	Cash Deposits
	Mr R K Obeyesekere Deputy Chairman	Letters of Credit	4.00	-	4.00	
			4.77	-	4.77	
Lanka Milk Foods (CWE) Ltd	Dr V P Vittachi Chairman	Letters of Credit	400.00	-	244.71	Quoted Company Shares Immovable Property (Leasehold)/Plant & Machinery
	Mr D H S Jayawardena Managing Director	Letters of Guarantee	20.00	-	16.73	
	Mr R K Obeyesekere Director	Overdraft	200.00	173.78	-	
			620.00	173.78	261.44	
Lanka Dairies (Pvt) Ltd	Dr V P Vittachi Chairman	Overdraft	30.00	21.31	-	Quoted Company Shares
	Mr D H S Jayawardena Managing Director	Letters of Credit	10.00	-	-	
	Mr R K Obeyesekere Director					
			40.00	21.31	-	
Ambewela Products (Pvt) Ltd	Mr D H S Jayawardena Managing Director	Overdraft	10.00	10.04	-	Quoted Company Shares
	Mr R K Obeyesekere Director	Letters of Credit	50.00	-	14.49	
			60.00	10.04	14.49	
Ambewela Livestock Co. Ltd	Dr V P Vittachi Chairman	Overdraft	50.00	42.75	-	Quoted Company Shares
	Mr D H S Jayawardena Managing Director	Letters of Credit	10.00	-	2.59	
	Mr R K Obeyesekere Director					
			60.00	42.75	2.59	
Pattipola Livestock Co. Ltd	Dr V P Vittachi Chairman	Overdraft	50.00	33.87	-	Quoted Company Shares
	Mr D H S Jayawardena Managing Director	Letters of Credit	10.00	-	-	
	Mr R K Obeyesekere Director					
			60.00	33.87	-	
Distilleries Company of Sri Lanka Ltd	Dr V P Vittachi Chairman	Letters of Credit	6.31	-	96.01	Cash Deposits
	Mr D H S Jayawardena Managing Director	Letters of Guarantee	2.87	-	2.87	
	Mr R K Obeyesekere Director					
			9.18	-	98.88	

35. RELATED PARTY TRANSACTIONS (Contd.)

35 (e) Transactions with other related parties (Contd.)

Name of Related Party	Name of Director (Relationship)	Nature of Transaction	Aggregate Amount of Accommodation			Security
			Limit	Outstanding as at		
			(Rs. Mn.)	31.12.06 Direct	(Rs. Mn.) Indirect	
Periceyl (Pvt) Ltd	Mr D H S Jayawardena Chairman	Letter of Guarantee	1.00	-	1.00	Cash Deposits
			1.00	-	1.00	
Lanka Hospitals Ltd	Mr D H S Jayawardena Director	Letter of Credit	80.00	-	-	Mortgage over movable and immovable assets
		Import Loan	(80.00)	80.00	-	
		Overdraft	220.00	178.37	-	
		Syndicate Loan	200.00	138.54	-	
			500.00	396.91	-	
Balangoda Plantations Ltd	Dr V P Vittachi Chairman	Letters of Guarantee	0.03	-	0.03	Immovable Property (Leasehold) Cash Deposits
	Mr D H S Jayawardena Managing Director	Overdraft	45.00	-	-	
	Mr R K Obeyesekere Director	Development Loan	13.06	13.06	-	
			58.09	13.06	0.03	

Name of Related Party	Name of Director (Relationship)	Nature of Transaction	Aggregate Amount of Accommodation			Security
			Limit	Outstanding as at		
			(US\$. Mn.)	31.12.06 Direct	(US\$. Mn.) Indirect	
Texpro Industries Ltd	Mr D H S Jayawardena Chairman	Letters of Credit	1.60	-	0.90	Immovable Property / Machinery Cash deposits Inventories
		Export Loans	(1.60)	0.24	-	
		Term Loan	0.50	0.50	-	
		Term Loan	0.36	0.36	-	
		Term Loan	0.11	0.11	-	
		Term Loan	0.15	0.15	-	
		Overdraft	0.05	0.05	-	
		Overdraft	(Rs.Mn) 7.20	(Rs.Mn) 6.69	-	
		Letters of Guarantee	-	-	(Rs. Mn) 0.22	
			(US\$.Mn) 2.77	1.41	0.90	
			(Rs.Mn) 7.20	6.69	0.22	

35. RELATED PARTY TRANSACTIONS (Contd.)

35 (e) Transactions with other related parties (Contd.)

Name of Related Party	Name of Director (Relationship)	Nature of Transaction	Aggregate Amount of Accommodation			Security
			Limit (Rs. Mn.)	Outstanding as at		
				31.12.06 Direct	(Rs. Mn.) Indirect	
Falcon Commodities (Pvt) Ltd	Mr D H S Jayawardena Through the share- holding of Stassen Exports Ltd. in Falcon Commodities (Pvt) Ltd (Since disposed)	Overdraft/Import Bills	Cancelled	84.85	228.36	Cash Deposits Inventories Accommodation granted to Falcon Commodities (Pvt) Ltd continues to be classified as non-performing. The outstanding of Rs. 326.0 Mn as at 31.12.2006 is fully covered by the capital provisioning of Rs. 276.0 Mn made during the previous years.
		Overdraft (Habib Bank AG Zurich Ltd)	-	13.20	-	
			Nil	98.05	228.36	
Exposure to Aitken Spence Group						
Elpitiya Plantations Ltd	(Subsidiary of Aitken Spence Plantation Management Ltd)	Overdraft Overdraft Commercial Paper/ Money Mkt Loan/ Standby Overdraft Term Loan Term Loan Revolving Loan Short Term Loan Leases	25.00 50.00 100.00 (100.00) 6.28 8.44 5.00 12.00 13.34	*84.51 - 100.00 - 6.28 8.44 5.00 12.00 13.34	- - - - - - - - -	Inventories Immovable Property Absolute ownership of the equipment / vehicles leased
			220.06	229.57	-	
Kandalama Hotels Ltd	(Subsidiary of Aitken Spence Hotels Ltd)	Letter of Guarantee	0.36	-	0.36	Indemnity
			0.36	-	0.36	
Aitken Spence Travels Ltd	(Subsidiary of Aitken Spence & Co. Ltd)	Foreign Drafts & Travellers Cheque Purchase	3.00	0.78	-	Cash Deposits
			3.00	0.78	-	

35. RELATED PARTY TRANSACTIONS (Contd.)

35 (e) Transactions with other related parties (Contd.)

Exposure to Aitken Spence Group (Contd.)

Name of Related Party	Name of Director (Relationship)	Nature of Transaction	Aggregate Amount of Accommodation			Security
			Limit (Rs. Mn.)	Outstanding as at (Rs. Mn.)		
				31.12.06 Direct	Indirect	
A E N Palm Oil Processing (Pvt) Ltd	(Subsidiary of Aitken Spence & Co. Ltd)	Term Loan	58.46	58.46	-	Immovable property (leasehold)
			58.46	58.46	-	
Ace Containers (Pvt) Ltd	(Subsidiary of Aitken Spence & Co. Ltd)	Overdraft	28.00	26.82	-	Corporate Guarantee
			28.00	26.82	-	
Ace Distriparks (Pvt) Ltd	(Subsidiary of Aitken Spence & Co. Ltd)	Overdraft	10.00	1.09	-	Corporate Guarantee
			10.00	1.09	-	
Ace Container Repair (Pvt) Ltd	(Subsidiary of Aitken Spence & Co. Ltd)	Temp. Letter of Credit	-	-	7.61	Corporate Guarantee
			-	-	7.61	
Ace Freight Management (Pvt) Ltd	(Subsidiary of Aitken Spence & Co. Ltd)	Overdraft	2.00	-	-	Corporate Guarantee
			2.00	-	-	
			Limit (US\$. Mn.)	Outstanding as at 31.12.06 (US\$. Mn.)		
				Direct	Indirect	
Aitken Spence Garments Ltd	(Subsidiary of Aitken Spence & Co. Ltd)	Letters of Credit	1.50	-	0.22	Immovable property Quoted Company Shares
		Export Loan	(1.50)	0.50	-	
		Overdraft	0.25	0.02	-	
		Overdraft	(Rs.Mn) 2.50	(Rs.Mn.) 0.66	-	
		Letter of Guarantee	(Rs.Mn) 0.96	-	(Rs.Mn.) 0.96	
			(US\$.Mn) 1.75	0.52	0.22	
			(Rs.Mn) 0.96	0.66	0.96	
Cowrie Investments (Pvt) Ltd	(Subsidiary of Aitken Spence Hotel Holdings Ltd)	Term Loans	4.71	4.71	-	Immovable property (leasehold)
		Overdraft	2.00	1.86	-	
			(US\$.Mn) 6.71	6.57	-	
Ace Power Generation Horana (Pvt) Ltd	Mr D H S Jayawardena Director	Letters of Credit	0.39	-	0.39	Immovable property Bank Guarantee
		Term Loan	0.43	0.43	-	
		Term Loan	1.18	1.18	-	
		Overdraft	1.20	0.10	-	
		Standby Letters of Credit	(Rs.Mn)150.00	-	(Rs.Mn)150.00	
		Overdraft	(Rs.Mn)(120.00)	-	-	
		Letter of Guarantee	(Rs.Mn) (0.08)	-	(Rs.Mn) 0.08	
			(US\$.Mn) 3.20	1.71	0.39	
			(Rs.Mn) 150.00	-	150.08	

35. RELATED PARTY TRANSACTIONS (Contd.)

35 (e) Transactions with other related parties (Contd.)

Exposure to Aitken Spence Group (Contd.)

Name of Related Party	Name of Director (Relationship)	Nature of Transaction	Aggregate Amount of Accommodation			Security
			Limit (US\$. Mn.)	Outstanding as at (US\$. Mn.)		
				31.12.06 Direct	Indirect	
Ace Power Generation Matara (Pvt) Ltd	Mr D H S Jayawardena Director	Term Loan	0.29	0.29	-	Immovable Property (Leasehold) / Plant & Machinery Bank Guarantee
		Term Loan	0.97	0.97	-	
		Letters of Credit	0.43	-	0.43	
		Overdraft	1.20	-	-	
		Letters of Credit (Rs. Mn)150.00			-(Rs. Mn)150.00	
		Letter of Guarantee (Rs. Mn) 0.13			-(Rs. Mn) 0.13	
		Overdraft (Rs. Mn)(120.00)	(Rs. Mn.) 3.10		-	
		(US\$. Mn) 2.89	1.26	0.43		
		(Rs. Mn) 150.13	3.10	150.13		
Ace Power Generation Embilipitiya (Pvt) Ltd	(Subsidiary of Aitken Spence & Co. Ltd)	Term Loan	0.37	0.37	-	Immovable Property Machinery
		Term Loan	1.58	1.58	-	
		Overdraft	0.62	0.98	-	
		Overdraft	2.63	-	-	
		Letter of Credit	0.13		0.13	
		Letter of Guarantee (Rs. Mn) 44.67			-(Rs. Mn) 44.67	
		Overdraft (Rs. Mn) 200.00			-	
		(US\$. Mn) 5.33	2.93	0.13		
		(Rs. Mn) 244.67	-	44.67		
Elpitiya Lifestyle Solutions (Pvt) Ltd	(50% owned by Elpitiya Plantations Ltd)	Term Loan	0.22	0.22	-	Immovable Property (Leasehold) /Plant & Machinery
			0.22	0.22	-	
Cey Capital (Pvt) Ltd	(50% owned by Aitken Spence & Co. Ltd)	Term Loan	3.24	3.24	-	Vessel
			3.24	3.24	-	

			Limit (Rs. Mn.)	Outstanding as at 31.12.06 Direct	Outstanding as at (Rs. Mn.) Indirect	
Exposure to Browns Group						
Brown & Co. Ltd	Mr M V Theagarajah Chairman (till 30.06.2006)	Letter of Credit	-	-	6.90	Immovable property Absolute ownership of the leased assets Inventories
		Letter of Credit	-	-	31.03	
		Import Loan	-	172.11	-	
		Letters of Guarantee	315.00	-	23.85	
		Overdraft (79.00)		72.38	-	
		One off Import Loans	175.00	175.00	-	
		Term Loan	339.26	339.26	-	
		Term Loan	134.00	134.00	-	
Lease	6.06	6.06	-			
		969.32	898.81	61.78		
Browns Group Industries Ltd	Mr M V Theagarajah Chairman (till 30.06.2006)	Letter of Credit	15.00	-	33.33	Immovable Property Inventories Cash Margin
		Letter of Credit	35.00	-	-	
		One off Letter of Credit	21.00	-	21.00	
		Letter of Guarantee	9.64	-	9.64	
		80.64	-	63.97		

35. RELATED PARTY TRANSACTIONS (Contd.)

35 (e) Transactions with other related parties (Contd.)

Exposure to Browns Group (Contd.)

Name of Related Party	Name of Director (Relationship)	Nature of Transaction	Aggregate Amount of Accommodation		Security	
			Limit (Rs. Mn.)	Outstanding as at 31.12.06 Direct Indirect (Rs. Mn.)		
I.G. Browns Rubber Industries Ltd	Mr M V Theagarajah Chairman (till 30.06.2006)	} Letter of Credit Letter of Guarantee Overdraft Lease	2.50	-	0.94	} Immovable Property. Absolute ownership of the leased assets. Cash Deposits
			0.40	-	0.40	
			0.40	-	-	
			2.93	2.93	-	
			6.23	2.93	1.34	
Browns Dimo Industrial Products Ltd	Mr M V Theagarajah Chairman (till 30.06.2006)	} Letter of Credit Letter of Guarantee	4.00	-	4.24	} Cash Deposits
			0.28	-	0.28	
			4.28	-	4.52	
Engineering Services Ltd	Mr M V Theagarajah Chairman (till 30.06.2006)	} Overdraft Letter of Guarantee Lease	3.00	2.09	-	} Absolute ownership of the leased assets Cash Margin
			2.16	-	2.16	
			0.42	0.42	-	
			5.58	2.51	2.16	
Walker & Greig Ltd	Mr M V Theagarajah Chairman (till 30.06.2006)	} Letter of Credit Overdraft Lease	6.00	-	7.29	} Inventories Absolute ownership of the leased assets
			5.00	7.98	-	
			0.38	0.38	-	
			11.38	8.36	7.29	
Browns Tours Ltd	Mr M V Theagarajah Chairman	} Letters of Guarantee (till 30.06.2006)	10.00	-	9.77	} Quoted Company Shares
			10.00	-	9.77	
			10.00	-	9.77	
Snowcem Products Lanka (Pvt) Ltd	Mr M V Theagarajah Chairman (till 30.06.2006)	} Letters of Credit Trust Receipt Overdraft	0.80	-	-	} Cash Deposits Corporate Guarantee of Brown & Co. Ltd
			(0.80)	-	-	
			2.50	0.85	-	
			3.30	0.85	-	
Exposure to Ceylon Biscuits Group						
Ceylon Biscuits Ltd	Mr R T Wijetilleke Director	} One off Letter of Credit Lease Lease	99.65	-	9.96	} Absolute ownership of the leased vehicles
			1.80	1.80	-	
			10.35	3.58	-	
			111.80	5.38	9.96	
Plenty Foods (Pvt) Ltd	[Subsidiary of Ceylon Biscuits Ltd]	} Lease	8.92	8.92	-	} Absolute ownership of the leased equipment
			8.92	8.92	-	
Soy Foods (Lanka) Ltd.	[Subsidiary of Ceylon Biscuits Ltd]	} Overdraft Letter of Guarantee Short Term Loan Letter of Credit	15.00	-	-	} Negative pledge over the project assets
			23.00	-	3.55	
			20.00	-	-	
			40.00	-	42.11	
			98.00	-	45.66	
Cecil Food (Pvt) Ltd.	[Subsidiary of Ceylon Biscuits Ltd]	} Lease	0.16	0.16	-	} Absolute ownership of the leased vehicle
			0.16	0.16	-	

35. RELATED PARTY TRANSACTIONS (Contd.)

35 (e) Transactions with other related parties (Contd.)

Name of Related Party	Name of Director (Relationship)	Nature of Transaction	Aggregate Amount of Accommodation			Security
			Limit (Rs. Mn.)	Outstanding as at (Rs. Mn.)		
				31.12.06 Direct	Indirect	
Exposure to Sunshine Group						
Sunshine Holdings Ltd.	Mr R T Wijetilleke Chairman	} Term Loan	40.55	40.55	-	} Corporate Guarantee
			40.55	40.55	-	
Wawala Plantations Ltd.	} (Subsidiary of Sunshine Holdings Ltd)	Letter of Credit	5.00	-	-	} Mortgage over Immovable property (Leasehold) Inventories Absolute ownership of the vehicle, machinery etc leased
		Overdraft	100.00	57.19	-	
		Term Loan I	14.00	14.00	-	
		Term Loan II	14.99	14.99	-	
		Leases	15.33	15.33	-	
		E-Friends Loans	6.40	6.40	-	
		Packing Credit	50.00	-	-	
	Letters of Guarantee	5.00	-	10.57		
			210.72	107.91	10.57	
Swiss Biogenics Ltd.	} (Subsidiary of Sunshine Holdings Ltd)	Letter of Credit		-	117.29	} Inventories Corporate Guarantee
		Import Bills	145.00	-	-	
		Import Loans		7.64	-	
		Overdraft	5.00	-	-	
			150.00	7.64	117.29	
Sunshine Travels & Tours Ltd.	} (Subsidiary of Sunshine Holdings Ltd)	Letter of Guarantee	10.00	-	10.00	} Cash Deposits
		Overdraft	5.00	-	-	
			15.00	-	10.00	
Sunshine Teas (Pvt) Ltd.	} (Subsidiary of Swiss Biogenics Ltd)	Letters of Credit	50.00	-	-	} Inventories Mortgage over Machinery
		Short Term Loan	(25.00)	-	-	
		Overdraft	(25.00)	13.33	-	
		Letter of Guarantee	10.00	-	8.97	
		Term Loan	(US\$.Mn) 0.16(US\$.Mn) 0.16	-	-	
		Packing Credit Loans	(US\$.Mn) 1.70(US\$.Mn) 0.50	-	-	
	Export Bill Discounting	(US\$.Mn) (1.00)	-	-		
		(Rs.Mn) 60.00	13.33	8.97		
		(US\$.Mn) 1.86	0.66	-		
Exposure to Nawaloka Group						
Nawaloka Hospitals Ltd.	Mr R T Wijetilleke Director	} Temporary Overdraft	50.00	49.98	-	} Personal Guarantee of the shareholding Directors
			50.00	49.98	-	
New Nawaloka Hospitals Ltd.	} (Subsidiary of Nawaloka Hospitals Ltd)	Letter of Credit	10.00	-	-	} Mortgage over immovable property
		Term Loan I	71.26	71.26	-	
		Term Loan II	69.99	69.99	-	
		Import LC/Term Loan	109.18	109.18	-	
		Overdraft	10.00	9.89	-	
			270.43	260.32	-	

35. RELATED PARTY TRANSACTIONS (Contd.)

35 (f) Related Party Transaction - Group

35 (f)i Sithma Development (Pvt) Ltd.

Transactions with related parties

Name of Related Party	Name of Director (Relationship)	Nature of Transaction	Amount (Rs. Mn.)
Sri Lanka Insurance Corporation Ltd.	Mr D H S Jayawardena Chairman	Insurance premium paid Debenture interest paid (Rs. 2 Bn. debenture)	15.91
	Mr R K Obeysekera Deputy Chairman		242.61

35 (f)ii HNB Securities Ltd

Transactions with related parties

Name of Related Party	Name of Director (Relationship)	Nature of Transaction	Cumulative Investment/ Face Value (Rs. Mn)	Cumulative Interest paid/ Recd (Rs. Mn)	Balance Outstanding (Rs. Mn)
Ceylon Biscuits Ltd.	Mr R T Wijetilleke Director	Sale of Treasury Bills	25.10	-	-
		Repurchase Agreements of Treasury Bonds/Bills	107.10	0.40	-
Sunshine Holdings Ltd.	Mr R T Wijetilleke Director	Repurchase Agreements of Treasury Bonds/Bills	16.70	0.03	5.60
Colombo Stock Exchange	Mr R T Wijetilleke Director	Repurchase Agreements of Treasury Bonds/Bills	185.00	1.07	-
Sri Lanka Insurance Corporation Ltd. - Life Fund	Mr D H S Jayawardena Chairman Mr R K Obeysekera Director	Sale of Treasury Bonds	250.00	-	-
Snowcem Products Lanka (Pvt) Ltd.	Mr M V Theagarajah Chairman (till 30/06/2006)	Repurchase Agreements of Treasury Bonds/Bills	8.00	0.18	2.00
Engineering Services Ltd.	Mr M V Theagarajah Chairman (till 30/06/2006)	Sale of Treasury Bills	31.40	-	-
		Purchase of Treasury Bills	13.50	-	-
Sunshine Travels & Tours Ltd.	Subsidiary of Sunshine Holdings Ltd.	Repurchase Agreements of Treasury Bonds/Bills	7.20	0.17	1.30

35(f)iii HNB Stockbrokers (Pvt) Ltd

Transactions with related parties

Name of Related Party	Name of Director (Relationship)	Nature of Transaction	Amount (Rs. Mn.)
Sri Lanka Insurance Corporation Ltd.	Mr D H S Jayawardena Director	Brokerage income	4.76
	Mr R K Obeysekera Director		
Sri Lanka Insurance Corporation Ltd. Life Fund	Mr D H S Jayawardena Director	Brokerage income	7.71
	Mr R K Obeysekera Director		
Sunshine Holdings Ltd.	Mr R T Wijetilleke Director	Brokerage income	0.20

35. RELATED PARTY TRANSACTIONS (Contd.)

35 (f) Related Party Transaction - Group (Contd.)

35(f)iv HNB Assurance Ltd.

Transactions with related parties

Name of Related Party	Name of Director (Relationship)	Nature of Transaction	Amount (Rs. Mn.)
Stassen Exports Ltd	Dr V P Vittachi	Non-life insurance business	10.67
	Chairman		Claims payable
	Mr D H S Jayawardena	Managing Director	
	Mr R K Obeyesekera		Director
Stassen International Ltd.	Dr V P Vittachi	Non-life insurance business	0.21
	Chairman		
	Mr D H S Jayawardena		
	Mr R K Obeyesekera		
Stassen Natural Foods (Pvt) Ltd.	Dr V P Vittachi	Non-life insurance business	0.13
	Chairman		
	Mr D H S Jayawardena		
	Mr R K Obeyesekera		
Texpro Industries Ltd.	Mr D H S Jayawardena	Non-life insurance business	0.39
	Chairman	Claims payable	0.78
Milfrod Exports (Ceylon) Ltd.	Dr V P Vittachi	Non-life insurance business	0.02
	Chairman		
	Mr D H S Jayawardena		
	Mr R K Obeyesekera		
Aitken Spence (Garments) Ltd.	Subsidiary of Aitken Spence & Co. Ltd.	Non-life insurance business	0.20
Elpitiya Plantations Ltd.	Subsidiary of Aitken Spence Plantation Management Ltd.	Non-life insurance business	0.08
Sri Lanka Insurance Corporation Ltd.	Mr D H S Jayawardena	Co-insurance	6.13
	Managing Director		
	Mr R K Obeyesekera		
	Deputy Chairman		

35. RELATED PARTY TRANSACTIONS (Contd.)

35 (f) Related Party Transaction - Group (Contd.)

35(f)iv HNB Assurance Ltd. (Contd.)

Name of Related Party	Name of Director (Relationship)	Nature of Transaction	Amount (Rs. Mn.)
Brown & Co. Ltd.	Mr M V Theagarajah Chairman (till 30.06.2006)	Non-life insurance business	0.48
		Claims payable	0.32
		Purchase and maintenance of office equipment	4.24
Browns Group Industries Ltd.	Mr M V Theagarajah Chairman (till 30.06.2006)	Non-life insurance business	0.06
I G Browns Rubber Industries Ltd.	Mr M V Theagarajah Chairman (till 30.06.2006)	Non-life insurance business	0.11
Browns Tours Ltd.	Mr M V Theagarajah Chairman (till 30.06.2006)	Non-life insurance business	0.02
		Purchase of air tickets	0.98
Browns Dima Industrial Products (Pvt) Ltd.	Mr M V Theagarajah Chairman (till 30.06.2006)	Non-life insurance business	0.04
Snowcem Products Lanka (Pvt) Ltd.	Mr M V Theagarajah Chairman (till 30.06.2006)	Non-life insurance business	0.01
Engineering Services Ltd.	Mr M V Theagarajah Chairman (till 30.06.2006)	Non-life insurance business	0.06
		Claims payable	0.04

36. MATURITY ANALYSIS - BANK

An analysis of the total assets and liabilities of the Bank as at 31st December based on the remaining period at the balance sheet date to the respective contractual maturity dates is given below:

	Upto 3 Months Rs.000	3 to 12 Months Rs.000	1 to 3 Years Rs.000	3 to 5 Years Rs.000	More Than 5 Years Rs.000	Total 2006 Rs.000
Interest earning assets						
Cash and cash equivalent	12,581,512	-	-	-	-	12,581,512
Balances with Foreign Banks which are interest bearing	8,695,017	-	-	-	-	8,695,017
Commercial paper	290,667	-	-	-	-	290,667
Investment securities-Bonds & Debentures	-	2,927,974	16,429,206	517,134	489,000	20,363,314
Bills of Exchange	1,515,247	338,961	56,644	-	-	1,910,852
Loans & advances	20,989,773	33,124,124	20,011,820	21,970,673	18,611,984	114,708,374
Lease rentals receivable	196,382	801,936	3,440,088	6,912,844	201,225	11,552,475
	44,268,598	37,192,995	39,937,758	29,400,651	19,302,209	170,102,211
Non interest earning assets						
Cash and cash equivalent	2,031,566	-	-	-	-	2,031,566
Statutory deposit with CBSL	12,016,532	-	-	-	-	12,016,532
Dealing securities	738,719	-	-	-	-	738,719
Quoted shares	617,769	-	-	-	-	617,769
Unquoted shares	25,706	-	-	-	-	25,706
Investment in Associate companies	-	-	-	-	132,326	132,326
Investment in Subsidiary companies	-	-	-	-	2,293,663	2,293,663
Intangible assets	-	-	-	-	231,975	231,975
Investment properties	-	-	-	-	189,855	189,855
Property, Plant & Equipment	-	-	-	-	2,907,789	2,907,789
Non-current assets held for sale	6,556	-	-	-	-	6,556
Other assets	5,134,361	-	-	-	-	5,134,361
	20,571,209	-	-	-	5,755,608	26,326,817
Total assets	64,839,807	37,192,995	39,937,758	29,400,651	25,057,817	196,429,028
Percentage - 31/12/2006	33.01	18.93	20.33	14.97	12.76	100
Percentage - 31/12/2005	33.44	22.24	15.79	15.15	13.38	100
Interest bearing liabilities						
Deposits from customers	77,539,614	37,318,429	10,567,860	4,919,296	3,712,719	134,057,918
Borrowings - Money at call	4,584,620	-	-	-	-	4,584,620
Borrowings - Refinance	2,481,897	43,068	122,920	355,283	579,419	3,582,587
Borrowings - Local Banks	-	2,000,000	-	-	-	2,000,000
Borrowings - Foreign Banks	864,294	-	-	-	-	864,294
Securities sold under repo agreements	6,736,714	-	-	-	-	6,736,714
Subordinated Debentures	-	1,759,148	2,127,628	-	1,233,224	5,120,000
	92,207,139	41,120,645	12,818,408	5,274,579	5,525,362	156,946,133
Non Interest bearing liabilities						
Deposits from customers	13,824,107	-	-	-	-	13,824,107
Dividend payable	38,103	-	-	-	-	38,103
Bills payable	1,190,056	-	-	-	-	1,190,056
Current tax liability	761,729	-	-	-	-	761,729
Deferred tax liability	313,756	-	-	-	-	313,756
Other liabilities	10,425,336	-	-	-	-	10,425,336
Equity	-	-	-	-	12,929,808	12,929,808
	26,553,087	-	-	-	12,929,808	39,482,895
Total liabilities and Equity	118,760,226	41,120,645	12,818,408	5,274,579	18,455,170	196,429,028
Percentage - 31/12/2006	60.46	20.93	6.53	2.68	9.40	100
Percentage - 31/12/2005	64.87	16.83	6.70	2.58	9.02	100

"Up to 3 months" deposits include the Bank's Savings Deposit Base of Rs. 64.3 Bn. (2005 - Rs. 61.5 Bn.).

37. Segment Reporting

Business segments - Group

	Banking		Leasing		**Dealing		Property		Insurance		Eliminations		Consolidated /Unallocated	
	2006 Rs.000	2005 Rs.000	2006 Rs.000	2005 Rs.000	2006 Rs.000	2005 Rs.000	2006 Rs.000	2005 Rs.000	2006 Rs.000	2005 Rs.000	2006 Rs.000	2005 Rs.000	2006 Rs.000	2005 Rs.000
Revenue from external customers :														
Interest	16,835,610	12,907,337	-	-	864,275	624,931	-	-	82,520	46,106	1,538,842	1,162,455	19,321,247	14,740,829
Exchange/Premium	792,303	646,460	-	-	396	(294)	-	-	801,868	573,218	-	-	1,594,567	1,219,384
Lease/Brokerage	-	-	1,538,842	1,162,455	97,673	4,889	-	-	-	-	(1,538,842)	(1,162,455)	97,673	4,889
Commissions/Rent	1,858,180	1,704,334	-	-	5,409	1,008	18,951	20,378	-	-	-	-	1,882,540	1,725,720
Other	356,100	344,246	-	-	1,215	180,842	-	-	691	816	-	-	358,006	525,904
Total revenue from external customers	19,842,193	15,602,377	1,538,842	1,162,455	968,968	811,376	18,951	20,378	885,079	620,140	-	-	23,254,033	18,216,726
Inter-segment revenue	132,138	150,482	-	-	17,364	55,394	441,653	412,578	39,294	33,592	(630,449)	(652,046)	(20,832)	-
Total revenue	19,974,331	15,752,859	1,538,842	1,162,455	986,332	866,770	460,604	432,956	924,373	653,732	(630,449)	(652,046)	23,233,201	18,216,726
Segment result	2,616,096	1,700,873	947,170	666,887	22,391	142,756	58,204	37,250	108,832	74,422	(24,366)	(8,830)	3,727,437	2,613,358
Unallocated expenses													645,843	622,170
Profit from operations													3,081,594	1,991,188
Income from associates													13,617	17,162
Income tax expense													(819,575)	(213,813)
Profit for the period													2,275,636	1,794,537
Minority interests													(36,530)	(24,116)
Profit for the Equity Holders of the Bank													2,239,106	1,770,421
Segment assets	151,943,853	128,035,145	11,552,475	8,864,351	8,268,188	7,597,672	4,820,926	4,884,220	1,475,485	1,106,409	(1,753,941)	(2,358,209)	176,306,986	148,129,588
Investment in associates													164,869	170,592
Unallocated assets													30,506,709	26,686,925
Total Assets													206,978,564	174,987,105
Segment liabilities	137,519,606	121,646,075	11,552,475	8,864,351	7,641,013	6,973,851	3,085,193	3,125,967	1,024,673	734,421	(1,367,466)	(1,975,521)	159,455,494	139,369,144
Unallocated liabilities													34,427,137	24,262,724
Total liabilities													193,882,631	163,631,868
Cash flows from operating activities	(2,318,263)	468,521	4,314	3,295	3,654	38,022	188,381	30,075	340,809	279,628	(838,223)	617,778	(2,619,328)	1,437,319
Cash flows from investing activities	(4,456,766)	(514,054)	-	-	(20,206)	3,116	(49,902)	17,986	(292,373)	(279,199)	(509,069)	(337,025)	(5,328,316)	(1,109,176)
Cash flows from financing activities	8,878,736	1,134,527	-	-	-	(53,386)	-	-	(610)	(356)	1,219,392	(328,303)	10,097,518	752,482
Capital Expenditure	504,598	495,594	23	1,017	7,488	7,744	49,012	7,599	25,063	34,035	-	(333)	586,184	545,656
Depreciation	430,257	456,837	1,238	392	3,657	3,219	80,724	83,600	11,954	8,155	-	(261)	527,830	551,942
Amortization	98,343	36,205	1,773	887	1,517	839	-	4,303	4,746	4,256	-	(4,374)	106,379	42,116

**Stock Broking & Securities Dealings

38. EVENTS OCCURRING AFTER THE BALANCE SHEET DATE

There are no events occurring after the Balance Sheet date, which require adjustments to or disclosures in the financial statements, other than those disclosed below:

38(a) Proposed dividends

Refer Note No. 25

38(b) Issue of Bonus Shares

Board of Directors have recommended an issue of 1:1 bonus shares (one ordinary share for each ordinary share outstanding as at 31st December 2006), which is to be approved at the Annual General Meeting to be held on 29th March 2007.

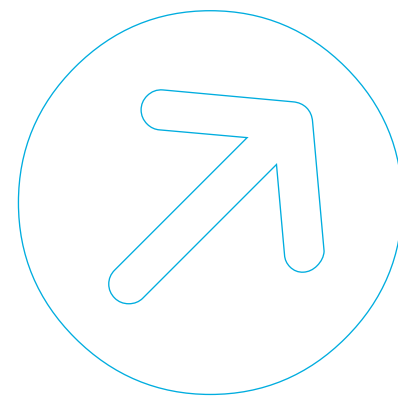
The Basic Earnings per Share (EPS) disclosed on the Income Statement and in Note No. 9 to the financial statements has not been adjusted for the said bonus issue. If the bonus shares are considered for the EPS computation, the adjusted EPS would be Rs. 9.43 for the Bank and Rs. 9.51 for the Group.

39. COMPARATIVE INFORMATION

Comparative information has been restated, wherever necessary, to conform to the current year's presentation and classification.

40. DIRECTORS' RESPONSIBILITY STATEMENT

The Board of Directors is responsible for the preparation and presentation of these financial statements. Please refer page 103 for the statement of the Directors' Responsibility for Financial Reporting.



Capital Adequacy

The principal objective of the Central Bank of Sri Lanka's Capital Adequacy requirement is to ensure that an adequate level of capital is maintained to withstand any losses which may result from the risks in a Bank's Balance Sheet, in particular, "credit risk" and "market risk". Our risk based capital adequacy requirements are consistent with the international standards of Basel Committee on Banking Regulations and Supervisory Practices. The framework has three basic aspects - the capital base elements, the required capitalisation level and the risk weighting.

The capital base is comprises of two elements, namely Tier 1 and Tier 2 capital after certain deductions.

Tier 1 capital includes paid up ordinary share capital, paid up non cumulative, non redeemable preference shares, share premium, statutory reserve fund, published retained earnings, general and other reserves less Goodwill.

Tier 2 capital includes 50% of asset revaluation reserves, general provision for doubtful debts, hybrid debt/equity instruments and approved subordinated term debts.

Equity investments in unconsolidated banking and financial subsidiaries and investments in capital of other banks/financial associates are deducted from total Tier 1 and 2 in arriving at the capital base. Sri Lankan banks are required to maintain a minimum total risk weighted capital ratio of 10% in respect of domestic (DBU) and off-shore banking operations (FCBU) since 2003. Tier 1 capital must be at least 50% of the minimum capital requirements.

In order to determine the capital adequacy ratio, all assets are risk weighted in order to provide a broad indication of credit risk. Seven risk weightings applicable as at 31st December 2006 are 0%, 10%, 20%, 50%, 55%, 100% and 110% (0%, 10%, 20%, 50% and 100% up to September 2006) and the assets to which those weightings apply are described below. Off balance sheet transactions are converted to credit equivalents, using a credit conversion factor, before being allocated a risk weighting.

To ascertain the credit risk, off balance sheet items are categorised as follows:

- Direct credit substitutes
- Transaction-related contingencies
- Short term self liquidating trade related contingencies
- Sale and Repurchase Agreements & Assets sale with recourse where the credit risk remains with the bank
- Obligations under an On-going Underwriting Agreement
- Other commitments with an original maturity upto one year or which can be unconditionally cancelled at any time
- Other commitments with an original maturity of over one year
- Foreign Exchange and Interest Rate Contracts

With effect from 31st March 2006, all banks were required to compute a capital charge for market risk in keeping with current international practice and the requirements of the Basel Committee as per the directions given by the Monetary Board of the Central Bank of Sri Lanka.

The total of the risk weighted assets for credit risk and market risk together with the risk assessed off balance sheet items is then related to the capital base and resultant risk ratio is used as a measure of capital adequacy.

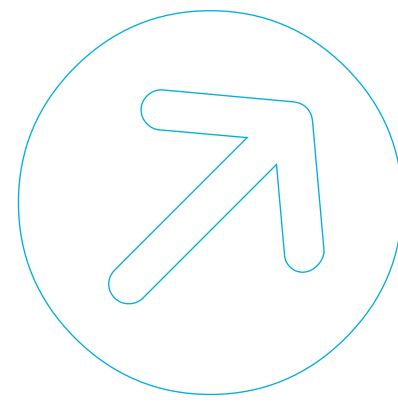
The following table provides details of Tier 1 & Tier 2 capital position and risk adjusted assets and off-balance sheet exposure.

Capital Adequacy

Capital Base as at 31 st December	2006	2005
Rupees Million		
TIER 1		
Voting ordinary shares	947	947
Non-Voting ordinary shares	231	231
Share premium	2,704	2,704
Statutory reserve fund	670	625
Published retained profits	1,736	1,174
General and other reserves	6,402	5,252
Total Tier 1 Capital	12,691	10,933
TIER 2		
Approved assets revaluation reserves (1)	120	153
General provisions	573	219
Debentures	2,462	2,119
Total Tier 2 Capital	3,155	2,491
Total Tier 1 and Tier 2 Capital	15,846	13,424
Less: Holdings of other Banks/ Financial Associates (2)	1,797	1,808
Capital Base	14,049	11,616
Risk Adjusted Capital Ratios		
Tier 1 (Statutory minimum ratio required is 5%)	10.23	10.87
Total (Statutory minimum ratio required is 10%)	11.32	11.55

ADJUSTED ASSETS AND OFF-BALANCE SHEET EXPOSURE

As at 31st December	Balance		Risk Weights %	Risk Adjusted Balance	
	2006	2005		2006	2005
Rupees Million					
ASSETS					
Cash, Treasury Bills, statutory reserves with Central Bank	31,263	24,138	0	-	-
Loans secured by cash and guaranteed					
by Central Bank of Sri Lanka	30,582	26,204	0	-	-
Guaranteed by OECD Central gov./Central banks	1,511	1,176	10	151	118
Due from Local/Foreign Banks/Financial Institutions	18,216	17,023	20	3,643	3,405
Loans secured by residential properties	26,628	24,889	**55	14,645	12,443
Loans guaranteed by external agencies	4,812	4,017	50	2,406	2,009
Loans and advances secured by:					
Other forms of securities	70,517	56,222	**110	77,569	56,222
Other assets	11,697	10,809	100	11,697	10,809
Total assets	195,226	164,478		110,111	85,006



Capital Adequacy

OFF-BALANCE SHEET EXPOSURE

Rupees Million	Amount of Off-Balance Sheet Items	Credit Equivalent Amount	Risk Weights	Risk Weighted Balance	
As at 31st December	2006	2006	%	2006	2005
Financial guarantees, Bank acceptances and other guarantees	11,355	11,355	0 - 100	11,355	15,061
Performance related guarantees and warranties, stand by credit lines	5,178	2,589	0 - 100	1,495	212
Shipping guarantees, Documentary Letter of Credit	10,965	2,193	0 - 100	-	-
Undrawn term and overdraft facilities < 1 year	18,594	-	0 - 100	-	-
> 1 year	4,321	2,160	0 - 100	-	-
Foreign Exchange Contracts	10,065	201	0 - 100	-	-
Foreign Interest rate Contracts	5,532	387	0 - 100	194	261
Total off- balance sheet exposures	66,010	18,885		13,044	15,534
Total risk adjusted assets				110,111	85,006

CAPITAL CHARGE FOR MARKET RISK

(With effect from 31st March 2006)

Rupees Million	Capital charge	Risk adjusted assets
As at 31st December	2006	2006
Interest rate	1.5	15
Equity	54.6	546
Foreign Exchange and Gold	34.7	347
Total risk adjusted assets for market risk	90.8	908
Total risk adjusted assets for credit risk, market risk and off - balance sheet exposure		124,063
		100,540

NOTES:

(1) The Central Bank of Sri Lanka permits only 50% of the revaluation gains to be taken to the Tier 2 Capital.

(2) Holdings of other Banks/ Financial Associates	2006 Rs. Mn.	2005 Rs. Mn.
Additional Investment in Sithma Development (Pvt) Ltd.	900	900
Employee share option plan	145	135
Others	752	773

(3) The Capital Adequacy computation has been indicated for the Bank only.

** The risk weightings of these two types of assets in year 2005 were 50% and 100%.

These two weightings have been increased to 55% and 110% respectively with effect from December 2006.

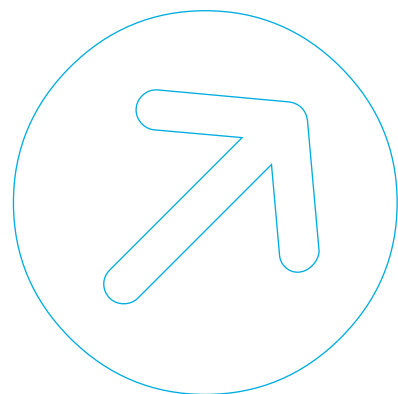
Income Statement in US Dollars

For the year ended 31st December	Bank		Group	
	2006 US\$.000	2005 US\$.000	2006 US\$.000	2005 US\$.000
INCOME	200,221	165,674	216,223	178,420
Interest income	171,726	138,393	179,816	144,376
Less: Interest expenses	91,363	71,311	100,584	79,038
Net interest income	80,363	67,082	79,232	65,338
Foreign exchange profit	7,374	6,332	7,377	6,329
Fee and commission income	16,709	16,293	17,319	16,055
Dividend income	716	637	529	645
Other income	3,691	4,019	11,182	11,015
OPERATING INCOME	108,853	94,363	115,639	99,382
Less:				
OPERATING EXPENSES				
Personnel costs	25,740	23,656	26,940	24,810
Premises equipment and establishment expenses	17,730	16,971	16,305	15,047
Fee and commission expenses	950	1,142	1,155	1,151
Provision for staff retirement benefits	3,715	3,197	3,728	3,216
Bad debts written off	114	230	101	230
Provision for loan losses	8,672	17,233	8,672	17,233
Provision for fall in value of investment	-	-	88	12
Amortization of goodwill/(negative goodwill)	-	-	-	(4)
Other expenses	23,831	13,815	29,971	18,185
	80,752	76,244	86,960	79,880
PROFIT FROM OPERATIONS	28,101	18,119	28,679	19,502
Share of Associate Companies' profit before taxation	-	-	127	168
PROFIT BEFORE TAXATION	28,101	18,119	28,806	19,670
Less: Income tax expense	7,436	1,914	7,627	2,094
PROFIT FOR THE PERIOD	20,665	16,205	21,179	17,576
Attributable to:				
Equity Holders of the Bank	20,665	16,205	20,839	17,340
Minority Interest	-	-	340	236
PROFIT FOR THE PERIOD	20,665	16,205	21,179	17,576
BASIC EARNINGS PER SHARE (US\$)	0.18	0.15	0.18	0.16
DIVIDEND PER SHARE (US\$)	*0.05	0.04	*0.05	0.04

Exchange rate of US\$ 1 was Rs. 107.45 as at 31.12.2006 (Rs. 102.10 as at 31.12.2005)

* Calculated on Interim Dividend paid and Final Dividend proposed, which is to be approved at the Annual General Meeting.

The Income Statement given on this page is solely for the convenience of the shareholders, bankers, investors, customers and other users of financial statements and do not form part of the audited financial statements.



Balance Sheet in US Dollars

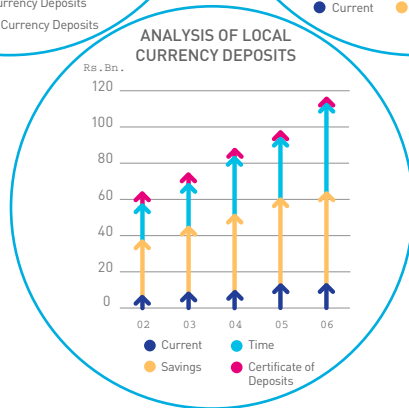
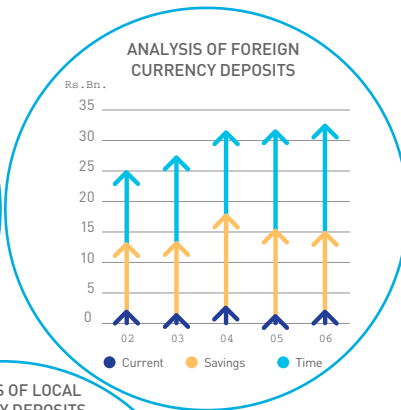
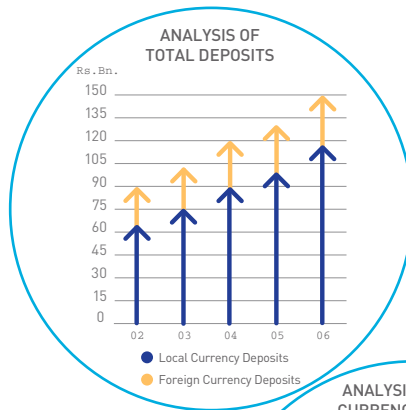
As at 31st December	Bank		Group	
	2006 US\$.000	2005 US\$.000	2006 US\$.000	2005 US\$.000
ASSETS				
Cash and cash equivalents	216,920	207,640	217,253	207,580
Statutory deposit with Central Bank of Sri Lanka	111,834	83,894	111,834	83,894
Government Treasury Bills	-	1,365	22,817	19,602
Commercial papers	2,705	4,251	2,705	4,251
Securities purchased under re-sale agreements	-	-	40,887	38,014
Dealing securities	6,875	3,067	9,075	3,131
Investment securities	195,503	169,294	210,886	184,297
Bills of Exchange	17,784	19,853	17,784	19,853
Loans and advances	1,067,551	942,629	1,063,535	937,079
Lease rentals receivable within one year	35,329	30,485	35,329	30,485
Lease rentals receivable after one year	72,186	56,336	72,186	56,336
Non-current assets held for sale	61	-	61	-
Investments in Associate Companies	1,231	1,296	1,534	1,671
Investments in Subsidiary Companies	21,346	22,465	-	-
Investment properties	1,767	-	1,722	-
Property, Plant and Equipment	27,062	29,966	68,735	73,974
Intangible assets	2,159	3,045	2,417	3,324
Other assets	47,784	50,393	47,518	50,389
Total Assets	1,828,097	1,625,979	1,926,278	1,713,880
LIABILITIES				
Deposits from customers	1,376,287	1,256,451	1,375,410	1,254,954
Dividends payable	355	493	355	493
Borrowings	102,666	38,591	102,666	38,591
Securities sold under re-purchase agreements	62,696	59,879	129,294	118,549
Bills payable	11,076	21,809	11,075	21,809
Long-term insurance funds	-	-	4,725	2,946
Non-life insurance reserves	-	-	2,974	2,615
Subordinated debentures	47,650	39,177	65,923	58,539
Current tax liability	7,089	59	7,204	361
Deferred tax liability	2,920	3,073	2,957	3,098
Other liabilities	97,025	96,366	101,816	100,708
Total Liabilities	1,707,764	1,515,898	1,804,399	1,602,663
EQUITY				
Share capital - Voting	8,810	9,272	8,810	9,272
Share capital - Non-Voting	2,150	2,262	2,150	2,262
Statutory Reserve Fund	6,233	6,119	6,233	6,119
Retained Earnings	16,160	11,503	16,028	11,182
Other reserves	86,980	80,925	86,980	80,925
Total Equity attributable to Equity Holders of the Bank	120,333	110,081	120,201	109,760
Minority Interest	-	-	1,678	1,457
Total Equity	120,333	110,081	121,879	111,217
Total Liabilities and Equity	1,828,097	1,625,979	1,926,278	1,713,880
Commitments and Contingencies	416,865	438,425	416,865	438,425

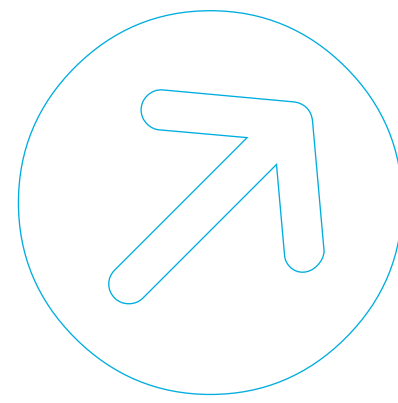
Exchange rate of US\$ 1 was Rs. 107.45 as at 31.12.2006 (Rs. 102.10 as at 31.12.2005)

The Balance Sheet given on this page is solely for the convenience of the shareholders, bankers, investors, customers and other users of financial statements and do not form part of the audited financial statements.

Analysis of Deposits

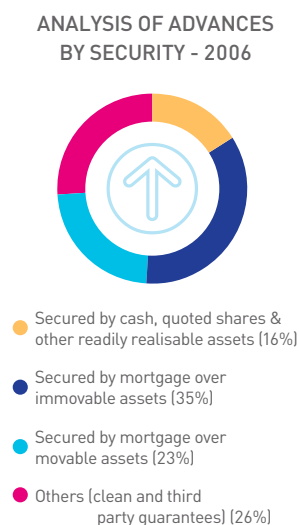
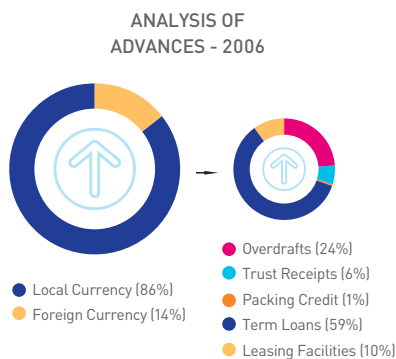
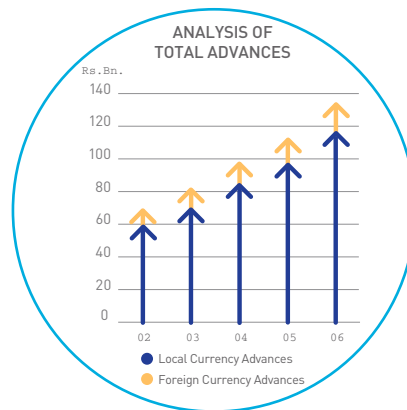
	2002 Rs.000	2003 Rs.000	2004 Rs.000	2005 Rs.000	2006 Rs.000
Local Currency Deposits					
Current	6,191,913	7,929,485	8,852,609	12,511,256	12,635,473
Savings	30,627,485	36,452,976	42,108,475	47,380,753	50,697,086
Time	19,872,255	23,502,610	31,920,537	33,587,699	48,869,303
Certificate of Deposits	6,677,438	5,861,618	4,448,095	3,634,393	3,348,716
	63,369,091	73,746,689	87,329,716	97,114,101	115,550,578
Foreign Currency Deposits					
Current	1,679,540	1,154,625	2,331,555	1,013,589	1,188,634
Savings	11,171,199	11,936,063	15,009,655	14,166,198	13,600,463
Time	11,664,587	14,188,135	13,853,008	15,989,793	17,542,350
	24,515,326	27,278,823	31,194,218	31,169,580	32,331,447
Total Deposits	87,884,417	101,025,513	118,523,934	128,283,681	147,882,025
Refinance	1,659,069	1,764,014	2,066,198	2,711,810	3,582,587
Total Deposits and Refinance	89,543,486	102,789,527	120,590,132	130,995,491	151,464,612





Analysis of Advances

	2002	2003	2004	2005	2006
	Rs.000	Rs.000	Rs.000	Rs.000	Rs.000
Local Currency Advances					
Overdrafts	16,786,380	17,247,347	20,165,063	22,952,834	27,455,224
Trust Receipts	4,228,258	3,880,713	4,957,006	5,193,080	6,876,898
Packing Credit	329,217	557,260	521,945	523,517	618,787
Term Loans	32,757,990	41,880,705	50,714,867	58,657,612	68,451,741
	54,101,845	63,566,025	76,358,881	87,327,043	103,402,650
Leasing Facilities	4,032,043	5,084,773	6,838,367	8,864,351	11,552,475
Total	58,133,888	68,650,798	83,197,248	96,191,394	114,955,125
Foreign Currency Advances	10,195,368	12,314,964	13,702,580	15,381,438	18,412,257
Total	68,329,256	80,965,762	96,899,828	111,572,832	133,367,382

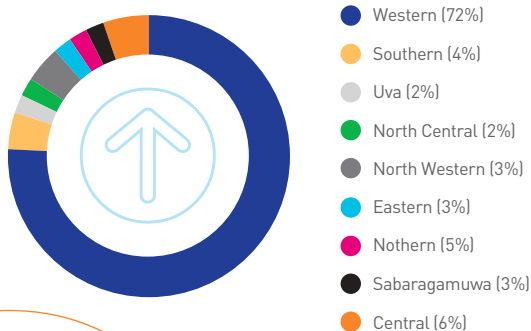


Provincewise Analysis of Deposits & Advances

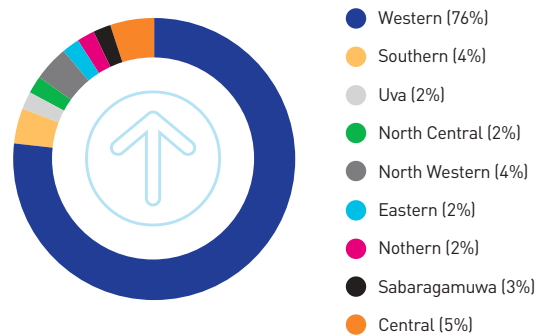
Provincewise Analysis of Deposits & Advances
as at 31st December 2006

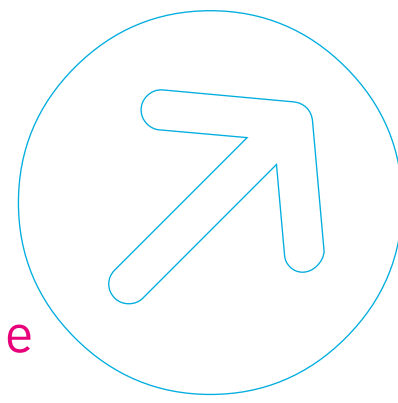
Province	No of Customer Centres	Deposits (Rs. Mn.)	%	Advances Including Leasing (Rs. Mn.)	%	Deposit Utilisation %
Western	82	106,612	72	101,520	76	94
Southern	12	5,498	4	5,744	4	104
Uva	6	2,884	2	2,642	2	92
North Central	4	2,239	2	2,058	2	92
North Western	8	5,136	3	5,275	4	103
Eastern	8	5,001	3	2,948	2	59
Northern	7	7,116	5	2,970	2	42
Sabaragamuwa	9	3,709	3	3,165	3	85
Central	15	9,687	6	7,045	5	73
Total	151	147,882	100	133,367	100	90

PROVINCEWISE DEPOSITS - 2006



PROVINCEWISE ADVANCES - 2006





Sources & Utilisation of Income

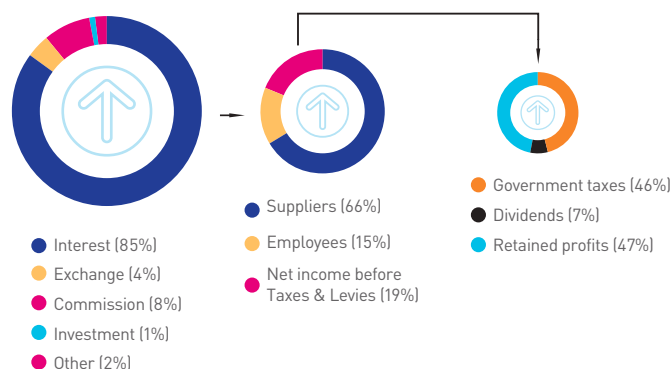
Sources of Income

For the year ended 31st December	2002 Rs.000	2003 Rs.000	2004 Rs.000	2005 Rs.000	2006 Rs.000
Interest	9,398,781	11,536,552	11,469,335	14,129,874	18,451,961
Exchange	382,272	506,436	662,176	646,460	792,303
Commission	755,384	1,241,588	1,519,924	1,663,545	1,795,340
Investments	303,507	356,830	288,193	329,322	225,722
Other	959,485	1,189,156	147,730	146,113	247,847
Total	11,799,429	14,830,562	14,087,357	16,915,314	21,513,173

Utilisation of Income

For the year ended 31st December	2002 Rs.000	2003 Rs.000	2004 Rs.000	2005 Rs.000	2006 Rs.000
Employees					
Salaries and other payments to staff	1,778,250	2,320,427	2,414,137	2,741,656	3,164,917
Suppliers					
Interest paid	6,257,761	6,909,095	5,962,041	7,280,851	9,816,927
Other expenses	3,004,516	4,440,289	4,418,999	4,922,800	4,529,175
	9,262,277	11,349,384	10,381,040	12,203,651	14,346,102
Net Income before Government Taxes & Levies	758,902	1,160,751	1,292,180	1,970,007	4,002,153
Government					
Provision for Income tax, Provision for financial services VAT, Debit Tax and Defence Levy/National Security Levy	170,052	152,466	315,799	396,910	1,781,665
Shareholders					
Dividends	214,500	286,000	350,350	471,059	588,824
Retained Profit	374,350	722,285	626,031	1,102,038	1,631,665
Total	11,799,429	14,830,562	14,087,357	16,915,314	21,513,173

SOURCES & UTILISATION OF INCOME - 2006

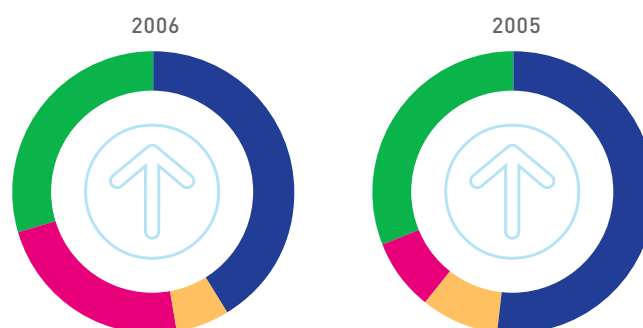


Within the context of the economy at large, the Bank acts as a financial intermediary with revenues from customers flowing to employees, depositors, the government and shareholders. The Bank retains part of the shareholder segment to support future growth and investments.

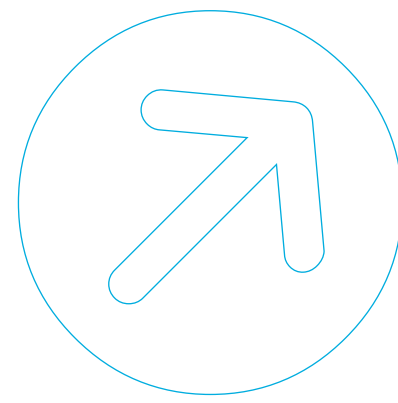
Value Added Statement

	2006 Rs.000	%	2005 Rs.000	%
Value added				
Income earned by providing banking services	21,248,724		16,581,974	
Cost of services	12,882,663		9,868,421	
Value added by banking services	8,366,061		6,713,553	
Non-banking income	264,449		333,340	
Provision for bad debts	(931,828)		(1,759,444)	
	7,698,682		5,287,449	
Value allocated to employees				
Salaries, wages and other benefits	3,164,918	41.11	2,741,656	51.85
To providers of capital				
Dividends to shareholders	588,824	7.65	471,059	8.91
To Government				
Provision for financial services VAT	972,657		194,000	
Provision for Income Tax	798,961		232,000	
Debit Tax	8,977		7,510	
Stamp Duty	1,070	23.14	-	
	1,781,665		433,510	8.20
To expansion and growth				
Retained income	1,631,665	21.19	1,183,503	22.38
Depreciation/Amortization	531,611	6.91	494,321	9.35
Deferred taxation	-	-	(36,600)	(0.69)
	7,698,682	100.00	5,287,449	100.00

ANALYSIS OF VALUE ADDITION



- Value allocated to employees 2006 - (41.11%) 2005 - (51.85%)
- To providers of capital 2006 - (6.12%) 2005 - (8.91%)
- To Government 2006 - (23.14%) 2005 - (8.20%)
- To expansion and growth 2006 - (29.63%) 2005 - (31.04%)

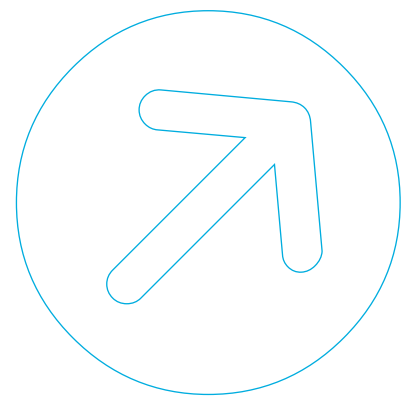


Quarterly Statistics

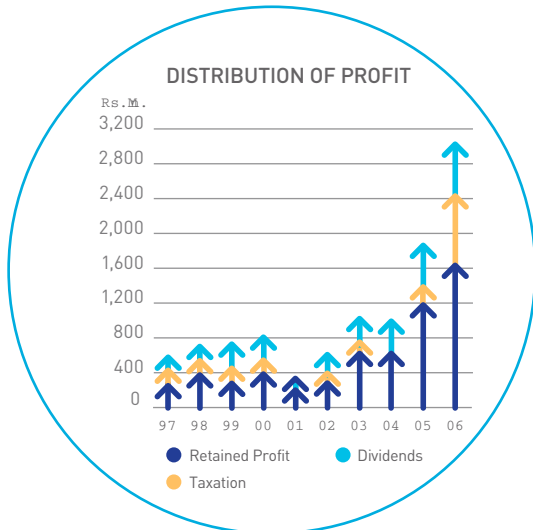
For the three months ended	2006				2005			
	December 31st	September 30th	June 30th	March 31st	December 31st	September 30th	June 30th	March 31st
Balance Sheet Data								
(Rs. Million)								
Total Assets	196,429	187,196	178,416	174,652	166,012	160,493	158,944	155,653
Loans, Leases and Bills	136,053	129,091	121,327	116,487	114,285	111,235	106,839	101,504
Deposits	147,882	141,063	137,623	133,089	128,284	124,597	119,657	121,157
Shareholders' Funds	12,930	12,347	11,758	11,264	11,239	10,895	10,470	9,149
Average Assets	191,813	182,806	176,534	170,332	163,253	159,718	158,299	154,217
Income Statement Data								
(Rs.000)								
Net Interest Income	2,386,120	2,270,315	2,166,387	1,915,135	1,888,511	1,801,941	1,655,938	1,502,633
Foreign Exchange Profit	264,603	186,993	171,738	168,969	143,402	169,755	172,767	160,536
Other Income	756,163	504,157	498,368	366,044	668,656	514,801	482,217	465,058
Total Revenue	3,406,886	2,961,465	2,836,493	2,450,148	2,700,569	2,486,497	2,310,922	2,128,227
Provision for Loan Losses	(330,012)	(93,717)	(115,211)	(195,973)	(636,299)	(372,122)	(387,666)	(363,357)
Non-interest Expenses	(1,982,864)	(2,078,764)	(1,997,394)	(1,841,607)	(1,395,678)	(1,609,237)	(1,526,678)	(1,485,216)
Provision for Income Tax	(233,846)	(200,615)	(212,438)	(152,062)	(35,400)	(80,000)	(48,000)	(32,000)
Net Profit after Tax	860,164	588,369	511,450	260,506	633,192	425,138	348,578	247,654
Ordinary Share Information								
Market Price								
per share (Rs.)	V	NV	V	NV	V	NV	V	NV
High	161.00	74.25	120.00	53.75	132.00	58.50	133.50	60.75
Low	115.75	51.00	100.00	42.00	100.00	42.25	100.00	39.00
Closing	155.75	70.00	119.50	53.75	103.75	43.00	121.25	55.00
Book value per Ordinary Share	109.79	104.84	99.85	95.65	95.44	92.50	88.90	91.40
V - Voting NV - Non-Voting								
Financial Measures								
Profitability								
Return on Average Shareholders' Equity	6.81%	4.88%	4.44%	2.32%	5.72%	3.98%	3.55%	2.72%
Productivity								
Non-interest Expenses to Total Revenue	58.20%	70.19%	70.42%	75.16%	51.68%	64.72%	66.06%	69.79%
Capital								
Risk weighted capital ratios								
Tier 1	10.23%	9.88%	10.25%	10.78%	10.87%	9.87%	10.38%	9.59%
Total (Tier 1 + 2)	11.32%	10.86%	12.02%	12.32%	11.55%	10.46%	11.85%	11.05%
*2006 figures are based on both credit risk and market risk								
Asset Quality								
Provision for Credit losses to average loans	0.25%	0.07%	0.10%	0.17%	0.56%	0.34%	0.37%	0.37%

Ten Year Statistical Summary

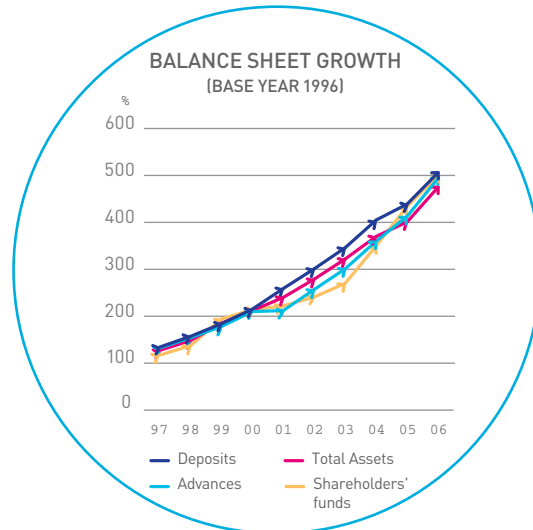
Year ended 31st December (Rs. Mn.)	1997	1998	1999	2000	2001	2002	2003	2004	2005	2006
OPERATING RESULTS										
Income	6,116	6,704	7,723	9,641	11,564	11,799	14,831	14,087	16,915	21,513
Interest Income	4,964	5,400	6,480	7,940	9,336	9,399	11,537	11,469	14,130	18,452
Interest Expenses	3,355	3,316	4,088	5,281	7,201	6,258	6,909	5,962	7,281	9,817
Exchange Income	395	428	313	364	516	382	506	662	646	792
Other Income	757	868	930	1,337	1,712	2,018	2,788	1,956	2,139	2,269
Operating Expenses	2,036	2,531	2,741	3,411	4,061	4,873	6,830	7,175	7,785	8,677
Profit before Income Tax	725	858	894	949	301	669	1,092	950	1,850	3,019
Income Tax on Profit	172	175	176	149	(2)	80	83	(26)	195	799
Profit after Taxation	553	683	718	800	303	589	1,008	976	1,655	2,220
SHAREHOLDERS' FUNDS										
Share Capital	200	300	650	650	650	715	715	1,001	1,178	1,178
Reserves	2,814	3,237	4,358	4,898	5,103	5,520	6,278	8,051	10,062	11,752
LIABILITIES										
Customer Deposits	39,303	46,032	53,858	62,758	75,599	87,884	101,026	118,524	128,284	147,882
Refinance Borrowings	954	1,129	1,636	1,655	1,565	1,659	1,764	2,066	2,712	3,583
Other Liabilities	9,243	13,805	15,732	17,540	15,999	19,354	23,161	22,788	23,463	31,720
Deferred Taxation	59	87	121	155	215	304	387	350	314	314
ASSETS										
Bills of Exchange	3,935	3,824	3,122	4,546	3,153	2,690	2,412	2,077	2,027	1,911
Loans and Advances	28,343	33,988	40,328	46,904	49,006	59,991	71,426	84,379	96,242	114,708
Lease Rentals Receivable	1,947	2,078	2,741	2,969	2,898	4,032	5,085	6,838	8,864	11,552
Cash, Short Term Funds and Statutory Deposits with Central Bank of Sri Lanka	10,585	14,495	17,325	15,212	18,844	23,640	25,019	29,228	29,766	35,325
Property, Plant & Equipment	1,437	1,675	1,914	2,273	2,509	2,781	3,414	3,387	3,059	2,908
Other Assets	6,327	5,003	10,924	15,752	22,722	22,301	25,975	26,870	26,053	30,025
RATIOS										
Return on Average Shareholders' Funds (%)	20	21	17	15	5	10	15	12	16	18
Income Growth (%)	28	10	15	25	20	2	26	(5)	20	27
Return on Average Assets (%)	1.2	1.2	1.0	1.0	0.3	0.6	0.8	0.7	1.0	1.2
Rate of Dividends (%)	50	45	40	40	15	30	40	35	40	50
Dividend Cover (times)	5.5	5.1	2.8	3.1	3.1	2.8	3.5	2.8	3.5	3.8
Gross Dividends (Rs. Mn.)	100	135	260	260	98	215	286	350	471	589
Advance to Deposits & Refinance (%)	85	85	82	84	71	76	77	77	82	85
Property, Plant & Equipment to Shareholders' Funds (%)	48	47	38	41	43	45	49	37	27	22
Total Assets to Shareholders' Funds (times)	17	18	15	16	17	19	19	17	15	15
(As specified in Banking Act No. 30 of 1988)										
Capital Funds to Liabilities including Contingent Liabilities (%)	1.2	1.2	1.0	1.2	1.2	1.2	1.0	1.0	1.0	1.0
Liquid Assets to Liabilities (%)	23	27	25	25	28	32	27	25	24	22
SHARE INFORMATION										
Market Value per Share (Rs.)										
- Voting	225.00	174.00	87.00	46.25	52.00	79.00	69.00	57.00	112.50	155.75
- Non-Voting	-	-	-	36.75	36.00	47.00	36.75	32.75	41.50	70.00
Earnings per Share (Rs.)	7.51	9.27	9.75	10.86	4.11	8.00	13.69	12.51	15.09	18.86
Price Earnings Ratio	29.96	18.77	8.92	4.26	12.65	9.88	5.04	4.56	7.46	8.26
Net Assets per Share (Rs.)	150.70	117.90	77.05	85.35	88.51	87.20	97.81	90.43	95.44	109.79
OTHER INFORMATION										
No. of Employees	3,433	3,744	4,035	4,119	4,137	4,280	4,203	4,180	4,259	4,287
No. of Customer Centres	92	103	111	117	123	137	138	142	148	152
No. of other Financial Centres	61	72	95	104	110	110	110	110	113	113



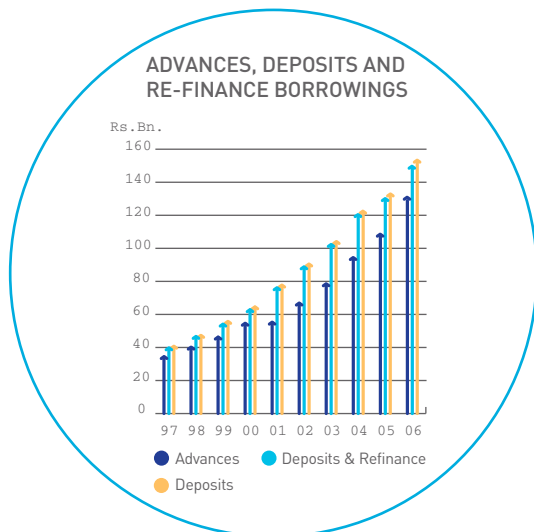
Ten Year Graphical Review



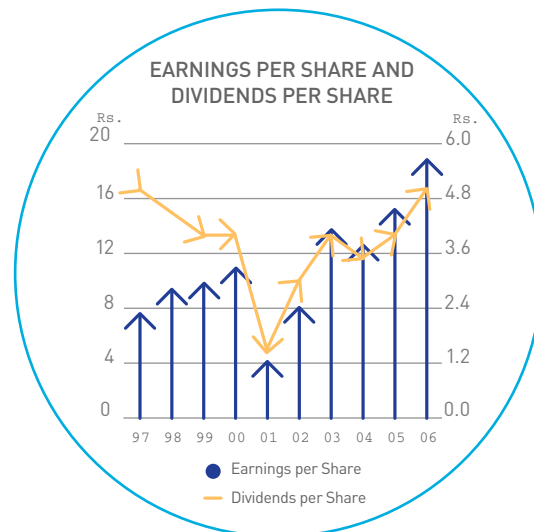
The graphs shows the distribution of before tax profit segregated into dividends, taxes and profits retained within the business



The graphs shows the growth in deposits, advances, total assets and shareholders' funds. Year 1996 has been considered as the base year.



The graphs shows the growth in deposits and refinance borrowings compared with the volume of advances.

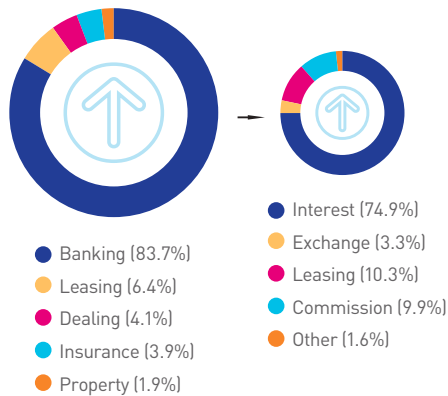


Segmental Analysis

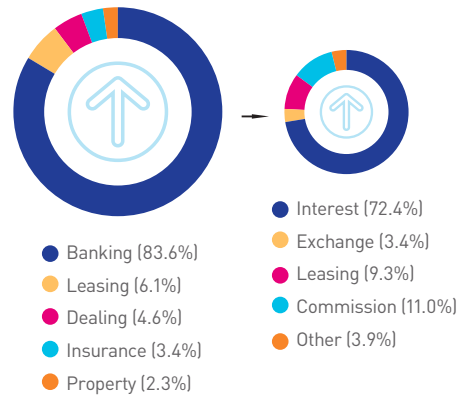
Business segments	Banking		Leasing		**Dealings		Property		Insurance		Total	
	2006 Rs.000	2005 Rs.000	2006 Rs.000	2005 Rs.000	2006 Rs.000	2005 Rs.000	2006 Rs.000	2005 Rs.000	2006 Rs.000	2005 Rs.000	2006 Rs.000	2005 Rs.000
Interest	16,913,119	12,967,419	-	-	878,742	680,325	-	52	105,977	64,989	17,897,838	13,712,785
Exchange	792,303	646,460	-	-	396	(294)	-	-	-	-	792,699	646,166
Lease/Premium/ Brokering Income	-	-	1,538,842	1,162,455	100,570	4,889	-	-	817,705	587,927	2,457,117	1,755,271
Commissions/Rent	1,895,642	1,734,527	-	-	5,409	1,008	460,604	432,904	-	-	2,361,655	2,168,439
Other	373,267	404,453	-	-	1,215	180,842	-	-	691	816	375,173	586,111
Total revenue	19,974,331	15,752,859	1,538,842	1,162,455	986,332	866,770	460,604	432,956	924,373	653,732	23,884,482	18,868,772

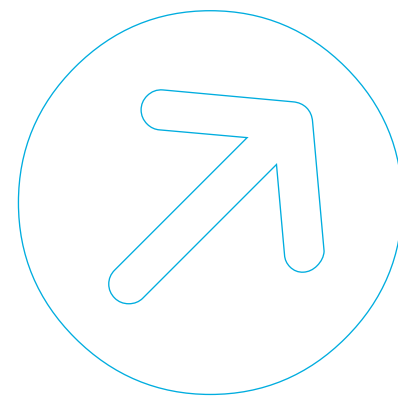
**Stock Broking and Securities Dealings

SEGMENTAL ANALYSIS OF REVENUE - 2006



SEGMENTAL ANALYSIS OF REVENUE - 2005





Share Information

1. Stock Exchange Listing

The issued ordinary shares of Hatton National Bank Limited are listed with the Colombo Stock Exchange. The audited Profit and Loss account for the year ended 31st December 2006 and the audited Balance Sheet of the Bank as at date have been submitted to the Colombo Stock Exchange within three months of the Balance Sheet date.

Stock exchange code for Hatton National Bank Limited shares is "HNB". Reuter code of Hatton National Bank Limited is "HNBL"

2. Ordinary Shareholders

SHARE INFORMATION - VOTING

As at 31 December 2006

	Resident			Non-Resident			Total			
	No of share-holders	No of shares	%	No of share-holders	No of shares	%	No of share-holders	No of shares	%	
1 -	250	2,069	0.25	26	2,489	0.01	2,095	181,775	0.19	
251 -	500	768	0.40	9	3,860	0.02	777	294,068	0.31	
501 -	1,000	588	0.62	12	9,291	0.04	600	456,631	0.48	
1,001 -	2,000	379	0.79	4	5,575	0.03	383	577,101	0.61	
2,001 -	5,000	344	1.57	15	46,427	0.21	359	1,185,151	1.25	
5,001 -	10,000	203	1.94	11	76,550	0.34	214	1,482,975	1.57	
10,001 -	20,000	120	2.27	4	49,000	0.22	124	1,692,884	1.79	
20,001 -	30,000	35	1.13	1	27,775	0.12	36	847,060	0.89	
30,001 -	40,000	31	1.54	1	34,400	0.15	32	1,150,978	1.22	
40,001 -	50,000	15	0.93	1	50,000	0.22	16	720,401	0.76	
50,001 -	100,000	29	2.73	1	55,000	0.25	30	2,031,414	2.15	
100,001 -	1,000,000	22	6.18	-	-	-	22	4,476,909	4.73	
Over	1,000,000	12	79.65	2	21,887,303	98.38	14	79,567,353	84.05	
		4,615	72,417,030	100.00	87	22,247,670	100.00	4,702	94,664,700	100.00

Analysis of shareholders

Resident/Non-Resident

	31/12/2006			31/12/2005		
	No of share-holders	No of shares	%	No of share-holders	No of shares	%
Resident	4,615	72,417,030	76.50	4,871	71,815,975	75.86
Non-Resident	87	22,247,670	23.50	91	22,848,725	24.14
Total	4,702	94,664,700	100.00	4,962	94,664,700	100.00

Individuals/Institutions

	31/12/2006			31/12/2005		
	No of share-holders	No of shares	%	No of share-holders	No of shares	%
Individuals	4,439	10,720,705	11.32	4,680	11,109,746	11.74
Institutions	263	83,943,995	88.68	282	83,554,954	88.26
Total	4,702	94,664,700	100.00	4,962	94,664,700	100.00

As at 31/12/2006, the average size of holding of ordinary shareholding was 20,133 voting shares. (31/12/2005 - 19,078 voting shares)

As per the Rule No. 8.7(h) of the Colombo Stock Exchange, the percentage of public holding as at 31st of December 2006 was 52.70 approximately.

SHARE INFORMATION - NON VOTING

As at 31 December 2006

	Resident			Non-Resident			Total			
	No of share-holders	No of shares	%	No of share-holders	No of shares	%	No of share-holders	No of shares	%	
1 -	250	6,002	740,285	3.27	33	4,353	0.99	6,035	744,638	3.22
251 -	500	1,235	466,301	2.06	8	3,022	0.69	1,243	469,323	2.03
501 -	1,000	1,777	1,187,171	5.24	11	7,786	1.77	1,788	1,194,957	5.17
1,001 -	2,000	1,711	2,234,851	9.86	23	31,934	7.25	1,734	2,266,785	9.81
2,001 -	5,000	778	2,376,250	10.49	12	39,490	8.96	790	2,415,740	10.46
5,001 -	10,000	302	2,152,571	9.50	6	44,580	10.12	308	2,197,151	9.51
10,001 -	20,000	141	1,957,342	8.64	2	26,000	5.90	143	1,983,342	8.59
20,001 -	30,000	33	807,667	3.56	1	22,000	4.99	34	829,667	3.59
30,001 -	40,000	12	413,570	1.83	-	-	-	12	413,570	1.79
40,001 -	50,000	11	506,822	2.24	-	-	-	11	506,822	2.19
50,001 -	100,000	15	976,392	4.31	1	77,000	17.48	16	1,053,392	4.56
100,001 -	1,000,000	21	4,378,876	19.32	1	184,400	41.86	22	4,563,276	19.75
Over	1,000,000	1	4,461,337	19.69	-	-	-	1	4,461,337	19.31
		12,039	22,659,435	100.00	98	440,565	100.00	12,137	23,100,000	100.00

Analysis of shareholders

Resident/Non-Resident

	31/12/2006			31/12/2005		
	No of share-holders	No of shares	%	No of share-holders	No of shares	%
Resident	12,039	22,659,435	98.09	12,154	22,815,585	98.77
Non-Resident	98	440,565	1.91	95	284,415	1.23
Total	12,137	23,100,000	100.00	12,249	23,100,000	100.00

Individuals/Institutions

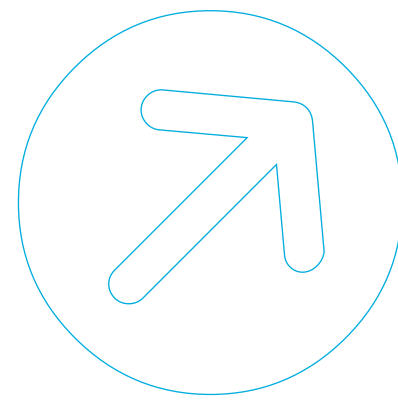
	31/12/2006			31/12/2005		
	No of share-holders	No of shares	%	No of share-holders	No of shares	%
Individuals	11,897	13,547,311	58.65	12,023	13,562,183	58.71
Institutions	240	9,552,689	41.35	226	9,537,817	41.29
Total	12,137	23,100,000	100.00	12,249	23,100,000	100.00

As at 31/12/2006 the average size of holding of ordinary shareholding was 1,903 voting shares.
(31/12/2005-1,886 non-voting shares)

As per the Rule No. 8.7 (h) of Colombo Stock Exchange, the percentage of public holding as at 31st December 2006 was 95.42 approximately.

3. Share Trading

	2006	2005
Voting shares		
Number of transactions	3,400	8,132
Number of shares traded (Mn.)	5.6	19.7
Rank (as per CSE)	78	46
Value of shares traded (Rs. Mn.)	706.7	2,019.8
Rank (as per CSE)	32	11
Non-Voting shares		
Number of transactions	5,146	4,933
Number of shares traded (Mn.)	4.99	5.3
Value of shares traded (Rs. Mn.)	290.3	267.3



4. Dividends

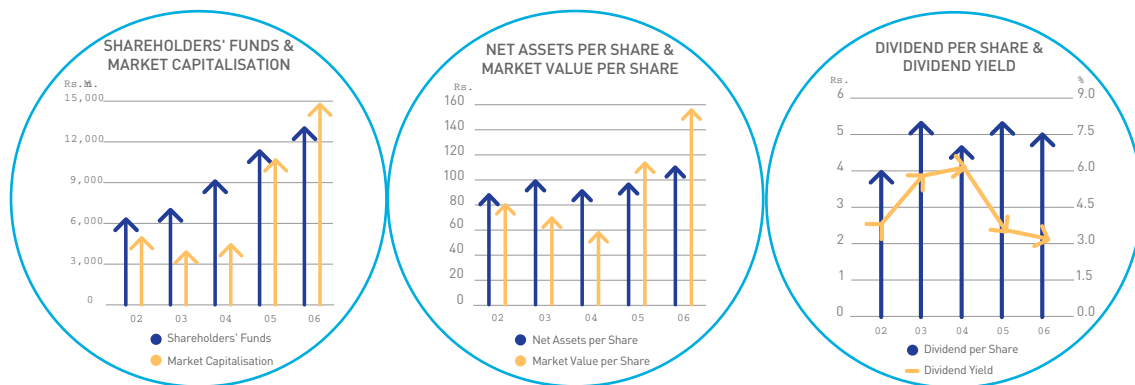
	2006	2005
Interim	25% Paid in December 2006	20% Paid in December 2005
Final	25% Proposed in April 2007	20% Paid in April 2006

5. Earnings

	2006	2005
Earnings per share (Rs.)	18.89	15.09
Price earnings ratio (Times)	8.25	7.46

6. Market Value

	Highest Rs.	Lowest Rs.	Year End Rs.
2002 - Voting	80.00	42.00	79.00
- Non Voting	48.50	28.25	47.00
2003 - Voting	120.00	68.00	69.00
- Non Voting	75.00	35.00	36.75
2004 - Voting	80.00	50.25	57.00
- Non Voting	47.00	30.00	32.75
2005 - Voting	148.00	51.75	112.50
- Non Voting	65.75	32.25	41.50
2006 - Voting	161.00	101.00	155.75
- Non Voting	74.25	39.25	70.00



7. Market Capitalisation (As at 31st December)

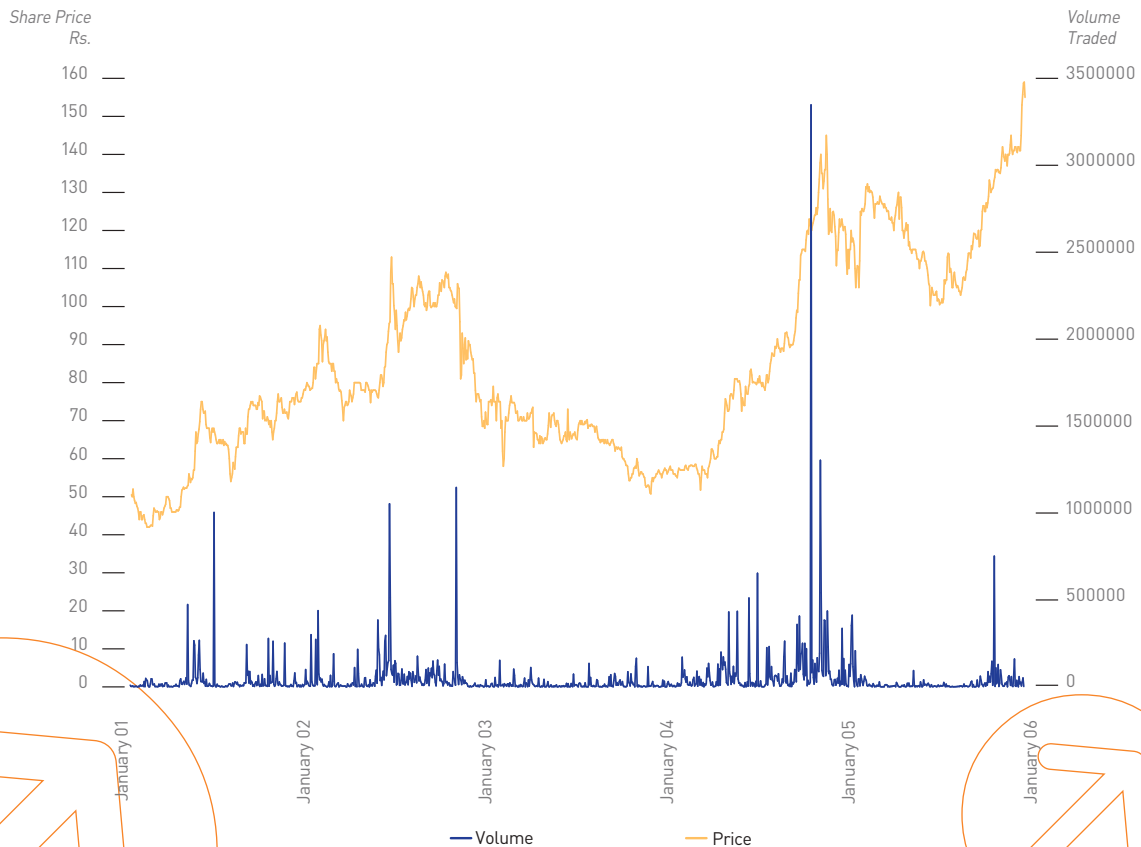
	Capital & Reserves Rs. Mn	HNB Market Capitalisation Rs. Mn	CSE Market Capitalisation Rs. Mn	HNB Market Capitalisation as a % of CSE Market Capitalisation	Market Capitalisation Ranking
2002	6,235	4,345	162,600	2.67	7
2003	6,993	3,795	262,838	1.44	15
2004	9,052	4,389	382,065	1.15	20
2005	11,239	10,649	584,040	1.82	10
2006	12,930	14,744	834,763	1.76	10

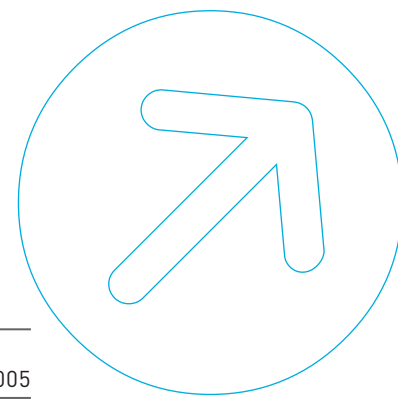
8. Record of Scrip Issues

Year	Issue	Basis	No. of Shares	Increase in Share Capital (Rs.)	Share Capital (Rs.)
	Prior to public issue		50,000	500,000	500,000
1971	Public issue		220,000	2,200,000	2,700,000
1977	Rights issue (@ Rs. 10/-)	42:50	230,000	2,300,000	5,000,000
1980	Rights issue (@ Rs. 10/-)	1:1	500,000	5,000,000	10,000,000
1982	Bonus	1:1	1,000,000	10,000,000	20,000,000
1988	Bonus	1:1	2,000,000	20,000,000	40,000,000
1990	Bonus	1:2	2,000,000	20,000,000	60,000,000
1993	Bonus	1:1	6,000,000	60,000,000	120,000,000
1996	Bonus	2:3	8,000,000	80,000,000	200,000,000
1998	Bonus	1:2	10,000,000	100,000,000	300,000,000
1999	Bonus	2:3	20,000,000	200,000,000	500,000,000
1999	Rights (non-voting @ Rs. 70/-)*	3:10	15,000,000	150,000,000	650,000,000
2001	Bonus	1:10	6,500,000	65,000,000	715,000,000
2004	Rights (voting @ Rs. 55/-)	2:5	22,000,000	220,000,000	935,000,000
2004	Rights (non-voting @ Rs. 33/-)	2:5	6,600,000	66,000,000	1,001,000,000
2005	Issue of underlying shares for GDR	-	17,664,700	176,647,000	1,177,647,000
Total			117,764,700	1,177,647,000	

* Unsubscribed shares were issued to public

9. Price Volume Chart





20 MAJOR VOTING SHAREHOLDERS – 31ST DECEMBER 2006

Name	% on total capital	No. of shares	
		2006	2005
1. Deutsche Bank Trust Company Americas	15.00%	17,664,700	17,664,700
2. Brown & Co. Ltd	7.17%	8,441,760	8,441,760
3. CBD Exports Ltd	6.53%	7,692,300	7,692,300
4. Milford Exports (Cey) Ltd	6.53%	7,686,525	7,686,525
5. Stassen Exports Ltd	5.66%	6,662,425	6,662,425
6. Panchalingam Associates (Pvt) Ltd	5.19%	6,116,471	6,116,471
7. Sri Lanka Insurance Corporation Ltd – Life Fund/Gen. Fund	4.88%	5,749,566	5,749,566
8. Standard Finance Ltd	4.77%	5,620,360	5,620,360
9. Taprobane Fund Management (Pvt) Ltd	3.98%	4,685,193	4,685,193
10. Sonetto Holdings Ltd	3.59%	4,222,603	4,222,603
11. Distilleries Co. of Sri Lanka Ltd	2.53%	2,980,854	2,980,854
12. Mr S V Somasundaram	1.42%	1,669,600	692,000
13. Indra Traders (Pvt) Ltd	0.88%	1,031,300	-
14. Mr S Visuvanathan	0.38%	448,832	448,832
15. Masons Mixture Ltd	0.34%	399,520	399,520
16. Mr Y S H Indra Kumar Silva	0.34%	397,990	397,990
17. Associated Battery Manufacturers (Cey) Ltd	0.26%	300,902	300,902
18. Investment Link (Pvt) Ltd	0.21%	245,800	-
19. DPMC Financial Services (Pvt) Ltd A/c No 1	0.20%	240,000	619,900
20. Mr Narhari Choonilal Bhatt	0.15%	172,480	172,480
Sub Total	69.99%	82,429,181	80,554,381
Balance held by 4,682 Voting Shareholders	10.39%	12,235,519	14,110,319 (4,942 V.Sh)
Total Voting Shares	80.38%	94,664,700	94,664,700
Shares held by 12,137 Non-Voting Shareholders	19.62%	23,100,000	23,100,000 (12,249 NV.Sh)
Total No. of Ordinary Shares	100.00%	117,764,700	117,764,700

20 MAJOR NON-VOTING SHAREHOLDERS

Name	% on total capital	No. of shares	
		2006	2005
1. Legalink Trustee Services (Pvt) Ltd	3.88%	4,566,637	4,566,637
2. Nawaloka Developments (Pvt) Ltd	0.61%	715,000	715,000
3. Mr K V M Fernando & Mrs K W S H Fernando	0.34%	405,300	156,600
4. DFCC Bank A/c No.1	0.33%	388,800	426,000
5. Distilleries Co. of Sri Lanka Ltd	0.29%	337,566	337,566
6. Mr D K Weeratunga & Mr D K A K Weeratunga	0.27%	318,880	216,580
7. Standard Finance Ltd	0.23%	269,600	269,600
8. Mr S Visuvanathan	0.19%	220,000	220,000
9. Mr D F G Dalpethado	0.17%	194,554	267,574
10. Citygroup Global Markets Financial Products LLC	0.16%	184,400	-
11. Hatton National Bank Ltd A/c No.2	0.14%	169,319	169,319
12. M C A Trading Co. (Pvt) Ltd	0.14%	165,000	165,000
13. Ms S A Fernando	0.13%	157,200	94,000
14. Ceylon Grain Elevators Ltd	0.12%	137,500	137,500
15. Employees Trust Fund Board	0.11%	132,090	-
16. Asia Fort Assets Management (Pvt) Ltd	0.10%	120,000	-
17. H L L M Nanayakkara	0.10%	117,100	-
18. Lanka Synthetic Fibre Co.Ltd	0.09%	110,000	110,000
19. Mrs S F H Alexander	0.09%	108,970	108,970
20. Ms W N C Fernando	0.09%	105,200	94,000
Sub Total	7.58%	8,923,116	8,054,346
Balance held by 12,137 Non-Voting Shareholders	12.04%	14,176,884	15,045,654 (12,229 NV.Sh)
Total No. of Ordinary Shares	19.62%	23,100,000	23,100,000
Balance held by 4,702 Voting Shareholders	80.38%	94,664,700	94,664,700 (4,927 NV.Sh)
Total No. of Ordinary Shares	100.00%	117,764,700	117,764,700

HNB DEBENTURES 2002

i) Market Value

12 months ended 31st December 2006

	Highest Rs.	Lowest Rs.	Year End Rs.
5 year Fixed Rate (13.75% p.a.)	101.71	93.00	98.00
5 year Floating Rate (TB + 1.00% p.a.)	96.63	96.50	96.63
7 year Fixed Rate (14.00% p.a.)	98.00	98.00	98.00
7 year Floating Rate (TB + 1.10% p.a.)	99.75	99.75	N/T
10 year Fixed Rate (14.20% p.a.)	104.00	98.05	98.05
10 year Floating Rate (TB + 1.25% p.a.)	N/T	N/T	N/T

N/T – Not Traded for the period

ii) Interest Income

12 months ended 31st December

Coupon Interest (Rs.)	2006	2005
5 year Fixed Rate (13.75% p.a.)	13.75	13.75
5 year Floating Rate (TB + 1.00% p.a.)	12.00	12.00
7 year Fixed Rate (14.00% p.a.)	14.00	14.00
7 year Floating Rate (TB + 1.10% p.a.)	12.00	12.00
10 year Fixed Rate (14.20% p.a.)	14.20	14.20
10 year Floating Rate (TB + 1.25% p.a.)	12.00	12.00

For an investment of Rs. 100/-. The above rupee coupon interest rates are applicable for the next interest payment due on the 15th of February 2007.

iii) Yield to Maturity of last trade done (% p.a)

12 months ended 31st December

	2006	2005
5 year Fixed Rate (13.75% p.a.)	16.69	15.07
5 year Floating Rate (TB + 1.00% p.a.)**	N/A	N/A
7 year Fixed Rate (14.00% p.a.)**	14.77	13.98
7 year Floating Rate (TB + 1.10% p.a.)**	N/A	N/A
10 year Fixed Rate (14.20% p.a.)	14.65	14.65
10 year Floating Rate (TB + 1.25% p.a.)**	N/A	N/A

** The yield to maturity calculation is not applicable for floating rate debentures.

iv) Yield as at last trade done (% p.a)

12 months ended 31st December

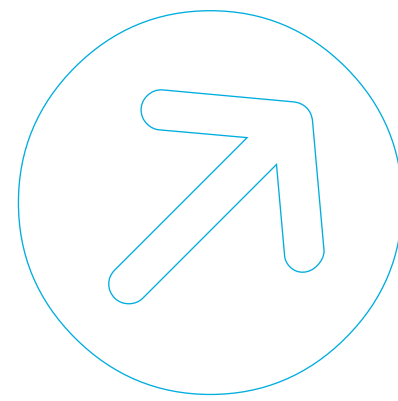
	2006	2005
5 year Fixed Rate (13.75% p.a.)	14.03	14.03
5 year Floating Rate (TB + 1.00% p.a.)	12.42	12.50
7 year Fixed Rate (14.00% p.a.)	14.29	14.00
7 year Floating Rate (TB + 1.10% p.a.)	12.03	12.03
10 year Fixed Rate (14.20% p.a.)	14.48	14.48
10 year Floating Rate (TB + 1.25% p.a.)	N/T	N/T

N/T – Not Traded as at ended 31 December

v) Yield on Equivalent Government Security (% p.a)

	2006	2005
5 year Treasury Bond	13.95	11.45
6 year Treasury Bond	14.00	11.50
10 year Treasury Bond	N/A	11.75

N/T – Not Traded for the period ended 31 December



HNB DEBENTURES 2003

i) Market Value

12 months ended 31st December 2006

	Highest Rs.	Lowest Rs.	Year End Rs.
5 year Fixed Rate (10.00% p.a.)	94.12	86.00	90.00
5 year Floating Rate (TB + 2.00% p.a.)	94.93	90.99	90.99

ii) Interest Income

12 months ended 31st December

	2006	2005
Coupon Interest (Rs.)		
5 year Fixed Rate (10.00% p.a.)	10.00	10.00
5 year Floating Rate (TB + 2.00% p.a.)	14.39	12.24

For an investment of Rs. 100/-. The above rupee coupon interest rates are applicable for the next interest payment due on the 15th of June 2007.

iii) Yield to Maturity of last trade done (% p.a)

	2006	2005
5 year Fixed Rate (10.00% p.a.)	17.56	15.77
5 year Floating Rate (TB + 2.00% p.a.) **	N/A	N/A

** The yield to maturity calculation is not applicable for floating rate debentures.

iv) Yield as at last trade done (% p.a)

	2006	2005
5 year Fixed Rate (10.00% p.a.)	11.11	11.35
5 year Floating Rate (TB + 2.00% p.a.)	13.58	N/T

v) Yield on Equivalent Government Security (% p.a)

	2006	2005
5 year Treasury Bond	13.95	11.45
6 year Treasury Bond	14.00	11.50
10 year Treasury Bond	N/A	11.75

N/T – Not Traded for the period ended 31 December

HNB DEBENTURES 2006

6 Yrs (Rs.262.5 Mn) 6 Months net TB rate + 2.25% p.a.
 7 Yrs (Rs.250.0 Mn) 6 Months net TB rate +2.25% p.a.
 8 Yrs (Rs.300.0 Mn) 6 Months net TB rate +2.25% p.a.
 15 Yrs (Rs.107.5 Mn) 11.00% p.a. cumulated till maturity
 18 Yrs (Rs.200.0 Mn) 11.25% p.a. cumulated till maturity

} With a floor of 8% and cap of 16% payable bi-annually

Bi annual interest payment

Period	Net TB rate	Applicable rate
01-04-06 to 30-06-06	10.37 %	12.62%
01-07-06 to 31-12-06	12.70 %	14.95%

Ratios

	2006	2005
Debt to equity ratio (%)	40%	36%
Interest cover (Times)	5.73	4.92
Quick asset ratio (%)	56%	61%

Glossary of Financial/Banking Terms

BIS Surplus

The total Capital Adequacy in excess of the minimum stipulated by Basel International Standards and as modified to suit local requirements by the Central Bank of Sri Lanka.

Capital Reserve

Capital Reserves consist of revaluation reserves arising from revaluation of properties owned by the Bank and Reserve Fund set aside for specific purposes defined under the Banking Act of 1988 and shall not be reduced or impaired without the approval of the Monetary Board.

Capital Adequacy Ratio

The percentage of risk-adjusted assets supported by capital as defined under the framework of risk-based capital standards developed by the Bank for International Settlements (BIS) and as modified to suit local requirements by the Central Bank of Sri Lanka.

Commitment to Extend Credit

Credit facilities available to clients either in the form of loans, bankers' acceptances and other, on-balance sheet financing, or through off-balance sheet products such as guarantees and letters of credit.

Contingent Liabilities

Conditions or situations at the balance sheet date, the financial effect of which are to be determined by the future events which may or may not occur.

Cost Income Ratio

Operating expenses as a percentage of net income.

Cost-push Inflation

A continuous increase in average price levels due to an increase in production costs.

Deferred Tax

Sum set aside in the Financial Statements for taxation that may become payable in a financial year other than the current financial year.

Dividend Yield

Dividend earned per share as a percentage of its market value.

Dividend Cover

Profit after tax divided by gross dividends. This ratio measures the number of times dividend is covered by current year's distributable profits.

Documentary Letters of Credit (L/Cs)

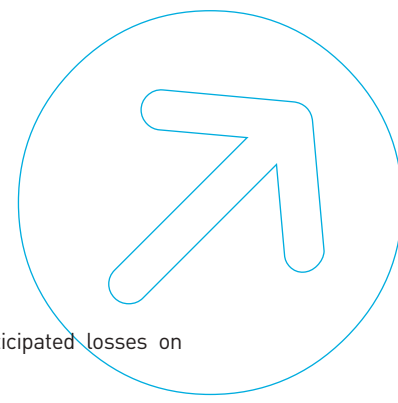
Written undertakings by a bank on behalf of its customer authorising a third party to draw on the bank up to a stipulated amount under specific terms and conditions. Such undertakings are established for the purpose of facilitating international trade.

Earnings Per Share (EPS)

Profit attributable to ordinary shareholders divided by the number of ordinary shares in issue.

Foreign Exchange Income

The realised gain recorded when assets or liabilities denominated in foreign currencies are translated into Sri Lankan Rupees on the balance sheet date at prevailing rates which differ from those rates in force at inception or on the previous balance sheet date. Foreign exchange income also arises from trading in foreign currencies.

**General Provisions**

Are established for leasing transactions, housing loans, pawning advances and others for anticipated losses on aggregate exposures where credit losses cannot yet be determined on an individual facility basis.

Gross Dividends

The portion of profit inclusive of tax withheld distributed to shareholders.

Guarantees

Primarily represent irrevocable assurances that a bank will make payments in the event that its customer cannot meet his/her financial obligations to third parties. Certain other guarantees represent non-financial undertakings such as bid and performance bonds.

Impairment

When recoverable amount declines below carrying amount.

Intangible Asset

An identifiable non-monetary asset without physical substance held for use in the production/supply of goods/services or for rental to others or for administrative purposes.

Interest Margin

Net interest income as a percentage of average interest earning assets.

Interest Spread

Represents the difference between the average interest rate earned and the average interest rate paid on funds.

Liquid Assets

Assets that are held in cash or in a form that can be converted to cash readily, such as deposits with other banks, bills of exchange and treasury bills.

Loan Loss Provision (please refer Provision for Bad and Doubtful Debts)

Market Capitalisation

Number of ordinary shares in issue multiplied by the market value of each share at the year end.

Net Asset Value Per Share

Shareholders' Funds divided by the number of ordinary shares in issue.

Net-Interest Income

The difference between what a bank earns on assets such as loans and securities and what it pays on liabilities such as deposits, refinance funds and inter-bank borrowings.

Non-Performing Advances

All loans are classified as non-performing when a payment is 90 days in arrears.

Non-Performing Advances Cover (NPA Cover)

Cumulative loan provision as a percentage of total Non-Performing Advances (net of Interest in Suspense).

NPA Ratio

Total non-performing advances (net of Interest in Suspense) divided by total advances portfolio (net of Interest in Suspense).

Price Earnings Ratio (P/E Ratio)

Market price of an ordinary share divided by earnings per share (EPS).

Provision for Bad and Doubtful Debts

A charge to income which is added to the allowance for loan losses. Specific provisions are established to reduce the book value of specific assets (primarily loans) to estimated realisable values.

Return On Average Assets (ROA)

Net income expressed as a percentage of average total assets, used along with ROE, as a measure of profitability and as a basis of intra-industry performance comparison.

Return On Average Equity (ROE)

Net income, less preferred share dividends if any, expressed as a percentage of average ordinary shareholders' equity.

Revenue Reserve

Reserves set aside for future distribution and investment.

Reverse Repo

A purchase of government securities with an agreement to resell them at a given price on a specific future date.

Risk-Adjusted Assets

Used in the calculation of risk-based capital ratios. The face amount of lower risk assets is discounted using risk weighting factors in order to reflect a comparable risk per rupee among all types of assets. The risk inherent in off-balance sheet instruments is also recognised, first by adjusting notional values to balance sheet (or credit) equivalents and then by applying appropriate risk weighting factors.

Rights Issue

Issue of shares to the existing share holders at an agreed price, generally lower than market price.

Segment Reporting

Segment reporting indicates the contribution to the revenue derived from business segments such as banking operations, leasing operations, stock broking & securities dealings, property and insurance.

Share Premium

Amount paid by a shareholder, over and above the par value a share.

Shareholders' Funds

Shareholders' funds consist of issued and fully paid ordinary share capital plus capital and revenue reserves.

Swaps (Currency)

The simultaneous purchase of an amount of a currency for spot settlement and the sale of the same amount of the same currency for forward settlement. Alternatively a simultaneous spot sale and forward purchase of a currency.

Tier 1 Capital

Consists of the sum total of paid up ordinary shares, non cumulative, non redeemable preference shares, share premium, statutory reserve fund, published retained profits, general and other reserves less goodwill.

Tier 2 Capital

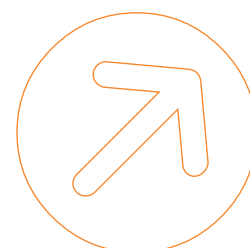
Consists of the sum total of revaluation reserves, general provisions, hybrid capital instruments and approved subordinated debentures.

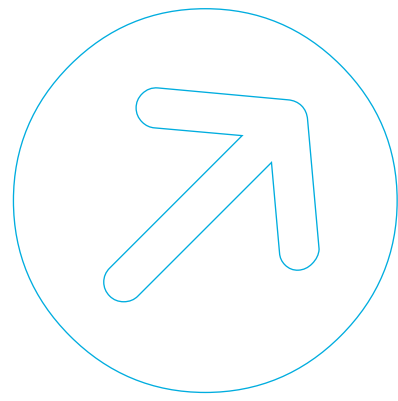
Total Capital

Is the sum of Tier 1 and Tier 2 capital.

Value Added

Value added is the wealth created by providing banking services less the cost of providing such services. The value added is allocated among the employees, the providers of capital, to government by way of taxes and retained for expansion and growth.





Notice of Meeting

Notice is hereby given that the Thirty Eighth (38th) Annual General Meeting of the Hatton National Bank Limited is convened on the twenty ninth (29) day of March 2007 at the Auditorium on Level 22 of "HNB Towers" at No: 479, T.B. Jayah Mawatha, Colombo 10, at 10.00 in the forenoon when the following Ordinary Business will be transacted.

ORDINARY BUSINESS

To receive and consider the Report of the Directors, the Statement of Accounts and the Balance Sheet of the Company for the year ended 31st December 2006 with the Auditors' Report thereon.

To declare a final dividend of 25% as recommended by the Directors to the shareholders.

To re-elect Mr R T Wijetilleke who retires by rotation at the Annual General Meeting in terms of Article 87 of the Articles of Association of the Company, as a Director of the Company.

To re-elect Mr D H S Jayawardena who retires by rotation at the Annual General Meeting in terms of Article 87 of the Articles of Association of the Company, as a Director of the Company.

To re-elect Mr M V Theagarajah in terms of Article 93 of the Articles of Association of the Company as a Director of the Company, special notice having been given pursuant to sections 138 & 182 of the Companies Act No.17 of 1982 of the intention to propose the following resolution:-

Resolution

"That Mr Manickam Vallipuram Theagarajah, who has attained the age of 70 years on 13th October 2001 and is of the age of 75 years be and is hereby re-elected as a Director of the Company and it is hereby declared that the age limit of 70 years referred to in Section 181 of the Companies Act No.17 of 1982, shall not apply to the said Director."

To re-appoint Auditors for the ensuing year and to authorise the Directors to fix their remuneration.

To authorise the Directors to determine payments for the year 2007 for charitable and other purposes set out in the Companies Donations Act (Cap. 147).

By Order Of The Board

INDRANI GOONESEKERA

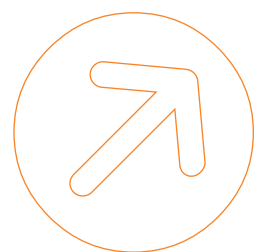
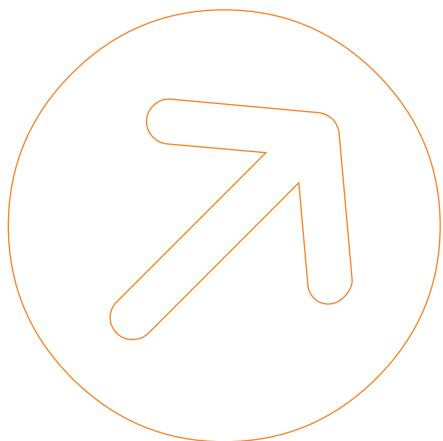
DGM-LEGAL/BOARD SECRETARY

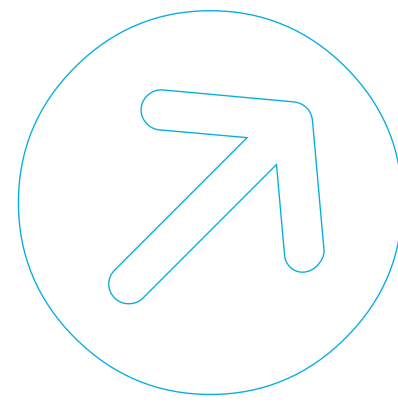
Colombo, Sri Lanka.

Thursday, February 15th, 2007.

Notes :

1. A member entitled to attend or attend and vote at the meeting is entitled to appoint a proxy to attend or attend and vote as the case may be, in his stead.
2. A proxy need not be a member of the Company. The Form of Proxy is enclosed.
3. The completed Form of Proxy should be deposited at the Registered Office of the Company at No: 479, T.B. Jayah Mawatha, Colombo 10 before 10.00 in the forenoon on 27th March, 2007





Form of Proxy - Voting

I/We
of being a member/members of the Hatton National Bank Ltd, hereby appoint, Rienzie Theobald Wijetilleke or failing him Vijaya Perera Vittachi or failing him Rajendra Theagarajah or failing him Don Harold Stassen Jayawardena, or failing him Manickam Vallipuram Theagarajah, or failing him Rajpal Kumar Obeyesekere or failing him Pamela Christine Cooray, or failing her Ratneswara Sivaratnam, or failing him Rashid Ghazalli or failing him..... of as my/our proxy, to represent me/us and to vote for me/us on my/our behalf at the Thirty Eighth (38th) Annual General Meeting of the Company to be held at the Auditorium on Level 22 of "HNB Towers" at No. 479, T B Jayah Mawatha, Colombo 10 on the 29th day of March 2007 at 10.00 in the forenoon and at any adjournment thereof and at every poll which may be taken in consequence thereof to vote :

	In favour	To declare a final dividend of 25%
	Against	
	In favour	To re-elect Mr R T Wijetilleke, Director who retires by rotation
	Against	
	In favour	To re-elect Mr D H S Jayawardena, Director who retires by rotation.
	Against	
	In favour	To re-elect Mr M V Theagarajah as a Director of the Company
	Against	
	In favour	To re-appoint Auditors for the ensuing year/authorise the Directors to fix their remuneration.
	Against	
	In favour	To authorise the Directors to determine payments for charitable and other purposes
	Against	

Signed this day 2007.

Signature/s

.....

Please provide the details :	
Shareholder's NIC No./Company Registration No.
Folio No./Number of Shares held
Proxy holder's NIC No. (if not a Director)

Notes :

i) In terms of Article 67 of the Articles of Association of the Company –

This instrument appointing a proxy shall be in writing and

- (a) in the case of an individual shall be signed by the appointor or by his attorney, and
- (b) in the case of a company or corporate body shall either be under its Common Seal or signed by its attorney or by an officer on behalf of the Company or corporate body in accordance with the Articles of Association of that Company or corporate body.

The Company may, but shall not be bound to, require evidence of the authority of any such attorney or officer.

In terms of Article 68 of the Articles of Association of the Company –

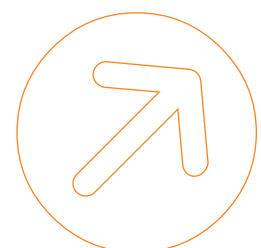
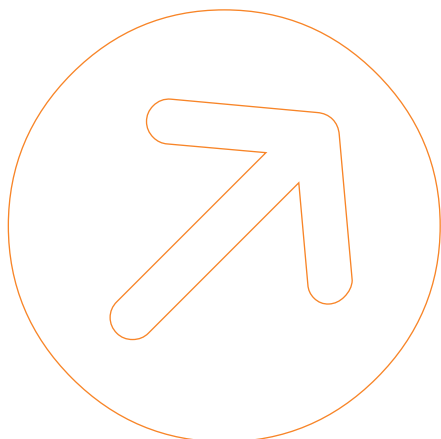
The instrument appointing a proxy shall be lodged and the Power of Attorney (if any) under which it is signed or a notarially certified copy thereof shall if required be deposited for inspection at the office, in each case not less than forty eight hours before the time appointed for holding the meeting or adjourned meeting, or in the case of a poll before the time appointed for taking of the poll at which the person named in the instrument proposes to vote and in default the instrument of proxy shall not be treated as valid.

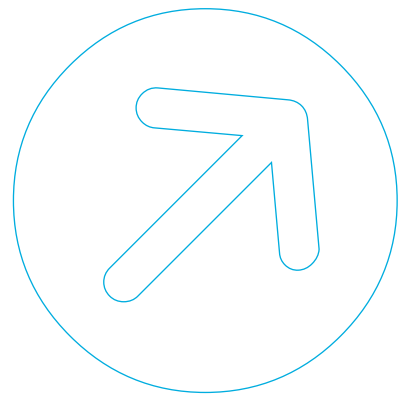
In terms of Article 62 of the Articles of Association of the Company –

In the case of joint-holders of a share, the vote of the senior who tenders a vote, whether in person or by proxy or by attorney or by representative, shall be accepted to the exclusion of the votes of the other joint-holders and for this purpose seniority shall be determined by the order in which the names stand in the Register of Members in respect of the joint-holding.

The first joint-holder thereby has power to sign the proxy without the concurrence of the other joint-holders.

- ii) The full name and the registered address of the shareholder appointing the proxy should be legibly entered in the form of proxy.
- iii) To be valid the completed form of proxy should be deposited with the Board Secretary at the Registered Office of the Company at No: 479, T B Jayah Mawatha, Colombo 10, before 10.00 in the forenoon on 27th March 2007.
- iv) Every alteration or addition to the Form of Proxy must be duly authenticated by the full signature of the shareholder signing the Form of Proxy. Such signature should as far as possible be placed in proximity to the alteration or addition intended to be authenticated.





Form of Proxy - Non Voting

I/We

of being a member/members of the Hatton National Bank Ltd, hereby appoint, Rienzie Theobald Wijetilleke or failing him Vijaya Perera Vittachi or failing him Rajendra Theagarajah or failing him Don Harold Stassen Jayawardena, or failing him Manickam Vallipuram Theagarajah, or failing him Rajpal Kumar Obeyesekere or failing him Pamela Christine Cooray, or failing her Ratna Sivaratnam, or failing him Rasheed Ghazalli or failing him..... of as my/our proxy, to represent me/us at the Thirty Eighth (38th) Annual General Meeting of the Company to be held at the Auditorium on Level 22 of "HNB Towers" at No. 479, T B Jayah Mawatha, Colombo 10 on the 29th day of March, 2007 at 10.00 in the forenoon and at any adjournment thereof:

Signed this day 2007.

Signature/s
.....

Please provide the details :

Shareholder's NIC No./Company Registration No.

Folio No./Number of Shares held

Proxy holder's NIC No. (if not a Director)

Notes :

- i) In terms of Article 67 of the Articles of Association of the Company –

This instrument appointing a proxy shall be in writing and

- (a) in the case of an individual shall be signed by the appointor or by his attorney, and
(b) in the case of a company or corporate body shall either be under its Common Seal or signed by its attorney or by an officer on behalf of the Company or corporate body in accordance with the Articles of Association of that Company or corporate body.

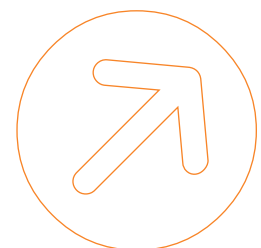
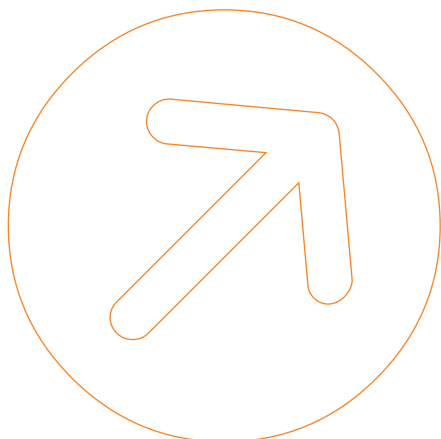
The Company may, but shall not be bound to, require evidence of the authority of any such attorney or officer.

In terms of Article 68 of the Articles of Association of the Company –

The instrument appointing a proxy shall be lodged and the Power of Attorney (if any) under which it is signed or a notarially certified copy thereof shall if required be deposited for inspection at the office, in each case not less than forty eight hours before the time appointed for holding the meeting or adjourned meeting.

The first joint-holder thereby has power to sign the proxy without the concurrence of the other joint-holders.

- ii) The full name and the registered address of the shareholder appointing the proxy should be legibly entered in the form of proxy.
iii) To be valid the completed form of proxy should be deposited with the Board Secretary at the Registered Office of the Company at No: 479, T B Jayah Mawatha, Colombo 10, before 10.00 in the forenoon on 27th March 2007.
iv) Every alteration or addition to the Form of proxy must be duly authenticated by the full signature of the shareholder signing the form of proxy. Such signature should as far as possible be placed in proximity to the alteration or addition intended to be authenticated.



CORPORATE INFORMATION

NAME OF COMPANY

HATTON NATIONAL BANK LIMITED

LEGAL FORM

A quoted public company incorporated in Sri Lanka in March 1970, with limited liability

COMPANY REGISTRATION NO.

PBS/613

STOCK EXCHANGE LISTING

The Ordinary Shares and the Unsecured Subordinated Redeemable Debentures of the Company are listed on the Colombo Stock Exchange in Sri Lanka
Global Depository Receipts of the Company are listed on the Luxemburg Stock Exchange

REGISTERED OFFICE

No. 479, T.B. Jayah Mawatha (Darley Road),
P.O. Box 837, Colombo 10, SRI LANKA.

HEAD OFFICE

“HNB Towers”,
No: 479, T.B. Jayah Mawatha (Darley Road),
P.O. Box 837, Colombo 10, SRI LANKA.
Cable Address : HATNABANK
Telephone Nos. 2664664, 2662772, 4764764
Fax Nos. 2662814, 2662832 International – 2446523
Telex Nos. 21259 Hatnbk Ce, 2166 Haynfx Ce
Swift : Bic Code – HBLILKXX
Email : moreinfo@hnb.net
Web: www.hnb.net

BOARD OF DIRECTORS

Mr. Rienzie T. Wijetilleke (Chairman)
Dr. V. P. Vittachi (Deputy Chairman)
Mr. R. Theagarajah (Managing Director/CEO)
Mr. D. H. S. Jayawardena
Mr. M. V. Theagarajah
Mr. R. K. Obeyesekere
Mrs. P. C. Cooray
Mr. R. Sivaratnam
Mr. D. R. Ghazalli
Mr. Y. T. Keat (Alternate Director to Mr. D. R. Ghazalli)

BOARD SECRETARY

Ms. Indrani Goonesekera
Attorney-at-Law & Notary Public

AUDIT COMMITTEE

Mr R Sivaratnam (Chairman)
Mr D H S Jayawardena
Mrs P C Cooray

Mr R Seevaratnam (Consultant)
former Partner KPMG Ford Rhodes Thornton & Co.

AUDITORS

KPMG Ford, Rhodes, Thornton & Co.,
Chartered Accountants
No. 32A, Sir Mohamed Macan Markar Mawatha,
Colombo 3, SRI LANKA.

CREDIT RATINGS

The Bank has been assigned SLA+ national credit rating for implied long term unsecured senior debt by Fitch Ratings Lanka Limited

ASSOCIATE COMPANIES

Browns Engineering (Pvt) Ltd. <i>Construction & Engineering</i>	32.63%
Lanka Ventures Ltd <i>Venture Capital</i>	20.07%

SUBSIDIARY COMPANIES

Sithma Development (Pvt) Limited <i>Property Development</i>	100.00%
HNB Securities Ltd <i>Dealing in Government Debt Securities</i>	100.00%
HNB Stockbrokers (Pvt) Ltd <i>Stock Broking</i>	100.00%
HNB Assurance Limited <i>Insurance</i>	59.986%

INVESTOR INFORMATION

Institutional Investors, Stock Brokers and Security Analysts requiring financial information should contact the Chief Financial Officer at
“HNB Towers”, (Level 16),
No: 479, T.B. Jayah Mawatha, (Darley Road),
Colombo 10, SRI LANKA.
Telephone : 2662705, 2664705
Fax : 2662815
E-mail : nihalke@hnb.lk
Correspondents throughout the world

