

## MANAGEMENT REPORT

## CEO'S MESSAGE



An effective business case study not only illuminates best practices and valuable lessons learned; it also presents measurable outcomes. In the case of Seylan Bank, I am pleased to report that this institution's return to financial stability under the guidance of our new board of directors has yielded gratifyingly positive financial results.

This Annual Report documents the first full financial year since the Central Bank of Sri Lanka took steps to establish a new management mandate at Seylan Bank. In the preceding section, we took the unusual route of chronicling those efforts in the form of an analytical case study. In the pages that follow, we complete the analysis by setting out the benchmarks for Seylan Bank's success, reviewing both the impressive results our team has achieved to date and the clear milestones we've set along the road ahead.

Seylan Bank's after-tax profit for 2009 was Rs. 543.301 Mn., which represents an increase of 250% over the previous financial year. During the same period, the Bank's cost-to-income ratio showed a marked improvement, decreasing from 75.79% to 67.82%, while our total capital adequacy ratio - under severe pressure during the crisis at the end of 2008 - rose from 8.06% to 11.74%.

The recent global economic downturn, precipitated by a sharp decline in financial markets in late 2008, had a particularly strong impact on the domestic economy of Sri Lanka. Compounding the negative impact on Seylan Bank was the collapse of the Golden Key Credit Card Co. Limited, which resulted in many of the Ceylinco Group Companies facing a liquidity crisis resulting in those companies defaulting

on loans from our institution. An increase in the non-performing loans coupled with a 23% contraction of the loan book increased the ratio of non-performing assets to 33.61% from 16.93% 12 months earlier.

The positive indicators, and the many others detailed in the following Management Report and financial summaries, have brought a corresponding rise in confidence among both depositors and shareholders. Seylan Bank now meets or exceeds the liquidity targets stipulated by the Central Bank. And our share price, which returned to pre-crisis levels immediately following the appointment of the new board, has continued to gain strength as management at all levels implements the wide-ranging initiatives set out in our new strategic plan.

In short, Seylan Bank has made a series of decisive strides forward from the brief, galvanising crisis covered in the opening chapters of this Report. In the sections that follow, we examine in more detail the Bank's progress on a range of fronts, from the adoption of new procedures for managing risk to the refinement of our corporate governance practices. We also review ongoing sustainability efforts, looking at all aspects of corporate responsibility - social, environmental and economic. We examine some of the key operational areas, from marketing to information technology, where the introduction of new standards and processes is prompting positive change. And we review Seylan Bank's financial performance, applying the objective rigour expected of a leading financial institution.

For more than 20 years, Seylan Bank has proudly called itself "The Bank with a Heart," and we have worked to live up to that credo in everything we do. As we tackled the unprecedented challenges of the past year, the dedicated men and women who make up this institution never lost heart. Buoyed by the continued support of our customers, we redefined our vision and improved management practices from the top down. At the same time, we reaffirmed the commitment that has guided Seylan Bank from the day our first branch opened its doors: to provide the best possible service while practicing innovative, responsible management to the benefit of all stakeholders.

It is enormously satisfying to table an Annual Report that we feel lives up to the high expectations of all who believe in Seylan Bank. I am confident that the positive momentum we've fostered and sustained will only continue in the years ahead.

A handwritten signature in black ink, appearing to read 'Ajita Pasqual'.

**Ajita Pasqual**  
General Manager/CEO  
17th February 2010

## FINANCIAL REVIEW

It is no exaggeration to say that the year under review was a memorable one for Seylan Bank. The collapse of the Golden Key Credit Company which was a member of the Ceylinco Group, of which the Bank too was then a member, sent shock waves through Sri Lankan society as well as through the country's economy and financial services industry. Naturally, Seylan Bank was affected in several ways. The confidence of our depositors was temporarily shaken, though in fact the Bank was in a good position to meet its obligations. Happily, confidence was restored when the Central Bank of Sri Lanka (CBSL) stepped into the picture, appointing the Bank of Ceylon as Seylan Bank's managing agent and averting a run on deposits. Subsequently, CBSL appointed a new board of directors, empowered by its Monetary Board to manage Seylan Bank independently.

Despite this severe setback, and against a background of global financial turmoil and economic recession, Seylan Bank was able to regain investor and depositor confidence; our share price rebounded immediately following the CBSL announcement, and the Bank now meets or exceeds all the statutory requirements laid down by the regulator. These outcomes represent a complete recovery from its troubles for the Bank and a strong vote of confidence in its solidity and stability from those who matter most: our shareholders and customers.

Developments in the wider world were hardly conducive to such a quick recovery. The first half of 2009 was characterised by limited economic activity as investors took a wait-and-see attitude in the face of economic uncertainty and the escalation of the war. The clothing and export industries, fearing the consequences of losing the preferential status granted to them by the EU under the GSP+ exemption to WTO rules, were particularly affected. The banking sector also had its own special difficulties, among them a fall of nearly 10% in interest rates, which had a cooling effect on both lending and borrowing, as well as continued high taxation. However, declining interest rates enabled Seylan Bank to earn substantial profits from its investments in Government securities. Another bright spot in a generally gloomy picture was the

recovery of tourism, which led a modest revival of the economy in the second half of 2009 and general anticipation of better things to come in 2010.

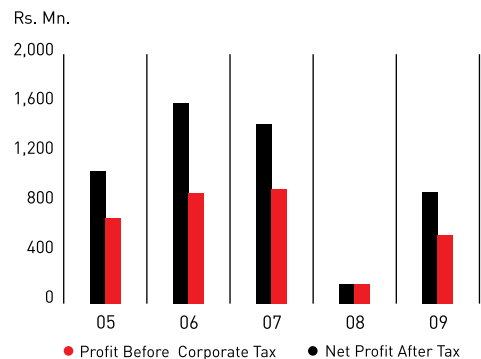
By far, the year's most significant achievement was restoring the stability and liquidity of the Bank. This was achieved through a number of means.

Taking advantage of the buoyant stock market, Seylan Bank made a public issue of 54,290,000 ordinary shares at Rs. 35/- per share on 22nd September. The desirability of the issue was bolstered by the aggregate 28% stake taken in Seylan Bank by two State institutions, the Bank of Ceylon and the Sri Lanka Insurance Corporation. The success of the issue clearly demonstrated the recovery of investor confidence in the Bank, being fully subscribed before the closing date. Market capitalisation of Seylan Bank grew 288% in the course of the year, from Rs. 1.2 Bn. at the end of 2008 to Rs. 4.8 Bn. by the end of 2009. The Bank now has adequate capital to support the current business volumes as well as the growth plans and we do not foresee the need for any further re-capitalisation effort in the near future.

## Profitability

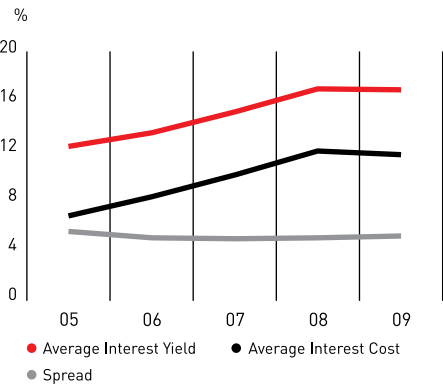
In retrospect, 2009 marked a commendable return to form for Seylan Bank. Special mention deserves to be made of the Bank's Treasury division, which performed extremely well in a year when the focus of many other departments was on Non-Performing Loans recovery and consolidation.

### Profit before Corporate Tax & Net Profit After Tax

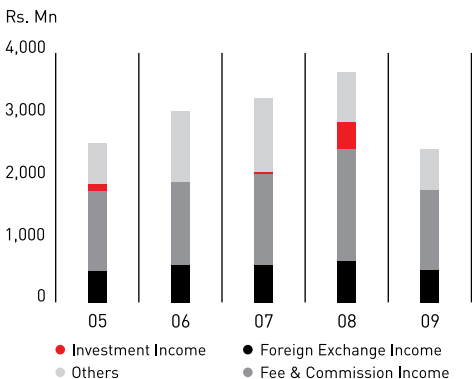


Profit before tax of the Bank increased from Rs. 155.241 Mn. in 2008 to Rs. 892.572 Mn., an increase of 475%. This is as a result of operating expenses and provisions for loan losses decreasing by 21.05% (Rs. 1.729 Bn.) and 11.51% (Rs. 284 Mn.) respectively as against a drop in net income of 11.77% (Rs. 1.275 Bn.). Despite a contraction in business volumes, fund-based operations resulted in a marginal increase in net interest income in the backdrop of an improvement in interest spread. However, income from fee-based operations and investments recorded a substantial drop. Profit after tax increased from Rs. 155.241 Mn. in 2008 (in the absence of any tax liability) to Rs. 543.301 Mn. after making a provision of Rs. 349.271 Mn. towards income tax.

### Yield, Cost & Spread



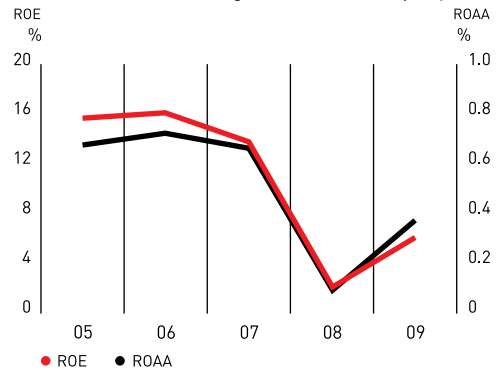
### Other Income



Profit before tax of the Group increased from a restated loss for 2008 of Rs. 735.579 Mn. to a profit of Rs. 933.630 Mn., an increase of 227%. Loss before tax of Rs. 71.820 Mn. for 2008 as published in the last year's Annual Report had to be restated due to the delayed audit of Seylan Merchant Bank concluding during the year with a higher loss for 2008. Group profit after tax too improved from a restated loss of Rs. 799.803 Mn. in 2008 to a profit of Rs. 448.761 Mn. for 2009.

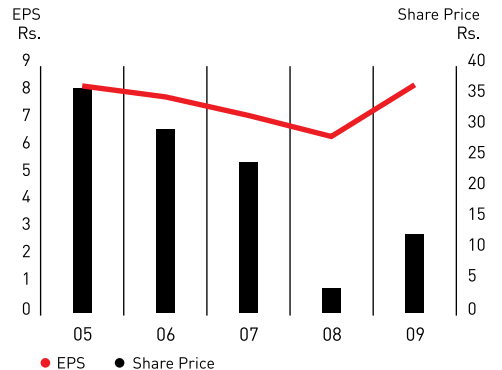
Resulting from the improved profitability, Return on Assets and Return on Equity too improved from 0.10% and 2.22% to 0.38% and 6.20% respectively.

### Return on Average Assets & Equity



The underlying gearing levels have improved to 16.3 times from 22.2 times in 2008. Earnings per share of the Bank grew from Rs. 0.90 for 2008 to Rs. 2.83 during the year under review.

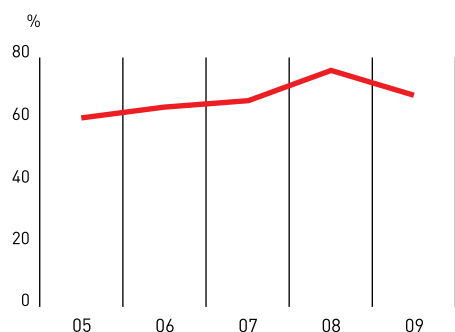
### Shareholder Return



## Operational Efficiency

Several structural changes effected helped the Bank realise certain economies of scale and improve the Cost-to-Income ratio by an unprecedented 8% from 75.79% to 67.82%. Some of the specific initiatives taken in this regard included formalising procurement procedure, elimination of unnecessary costs and a better control over costs.

### Cost to Income Ratio



## Business Volumes

Consequent to the crisis the Bank went through as detailed in chapters one to six of this Annual Report, the Bank experienced a drop in the business volumes. Though recovered to some extent with the restoring of the customer confidence, they fell short of the levels reported as at 31st December 2008, as detailed below:

Item	2009 Rs. Mn.	2008 Rs. Mn.	Variance %
Net Loans & Advances	<b>80,287.81</b>	104,154.13	(23%)
Deposits	<b>104,815.90</b>	107,938.80	(3%)
Total Assets	<b>132,775.87</b>	154,046.25	(14%)

## Liquidity

A combination of factors such as the issue of shares, recovery of non-performing advances, curtailed lending and improved profitability of the Bank substantially boosted liquidity ratio of the Bank from 20% in December 2008 to 29% in December 2009, a pattern that the entire banking industry witnessed due to a negative growth in credit outstanding in the country. Operating activities generated a positive

cash flow of Rs. 20.869 Bn. for the Bank as against a negative of Rs. 6.595 Bn. in 2008 which was used in investing and financing activities.

## Productivity

Contraction of business volumes partly set-off by the drop in staff numbers from 3,923 to 3,733 caused the assets per staff member to decrease marginally from Rs. 39.2 Mn. in 2008 to Rs. 35.6 Mn. Improved profitability during 2009 resulted in the profit after tax per staff member to increase from Rs. 0.040 Mn. to Rs. 0.146 Mn.

## Asset Quality

Loss of customer confidence was not the only difficulty the Bank suffered as a consequence of the collapse of the former Group company. Increased reputation risk was paralleled by real financial losses, since the Bank had extended loan facilities to a number of Ceylinco Group companies, the economic impact of the collapse sent these loans into default. This coupled with economic recession and a contraction in the loan book caused the rise in the Bank's NPL ratio in the year under review.

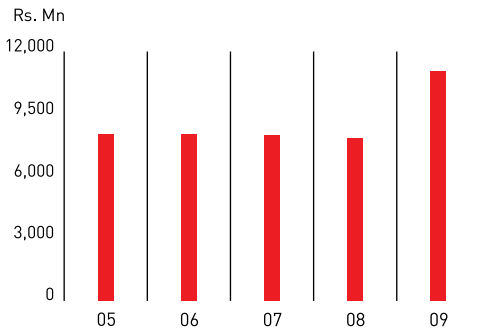
	Non-Performing Assets		Non-Performing Assets Ratio	
	2009 Rs. Mn.	2008 Rs. Mn.	2009 %	2008 %
Gross NPL	<b>31,149.96</b>	19,428.23	<b>33.61</b>	16.93
Net NPL	<b>25,491.07</b>	15,905.54	<b>29.29</b>	14.30

## Stability

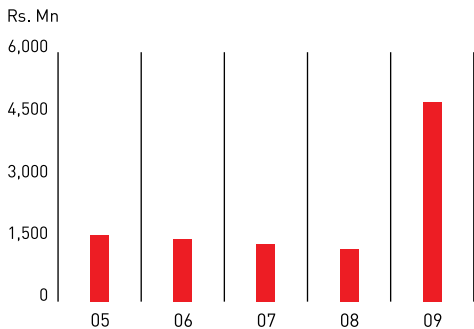
Total capital adequacy ratio which was below the statutory minimum of 10% at 2008 year-end improved to a comfortable level of 11.74% during the year under review. Fitch Ratings Lanka Ltd's rating of Seylan Bank is BBB+ and the outlook is "Stable".

Consequent to the issue of shares and improved profitability, regulatory capital of the Bank increased from Rs. 9,054.08 Mn. as at 31st December 2008 to Rs. 11,612.48 Mn. as at 31st December 2009. Market capitalisation too witnessed a four-fold increase from Rs. 1.2 Bn. to Rs. 4.8 Bn. as at 31st December 2009. The increase in the number of shareholders from 7,812 to 11,039 reflects the increased investor interest in the Bank.

### No. of Ordinary Shareholders



### Market Capitalisation



### Corporate Governance

With a view to enhance corporate governance practices, several structural improvements were effected in the course of the year. These are detailed in the Corporate Governance Report on page 75.

### Operations

Despite the year's troubles, we took a firm decision to continue increasing the reach and relevance of Seylan Bank to customers through the expansion of our network of outlets, especially in the North of the country. A new fully-fledged branch was opened at Nelliady and new 'convenient banking centres' at Manipay and Chankanai. Our established branches at Ja-Ela and Malabe were relocated in the interests of greater efficiency and customer access. Pawning centres were set up at the Bank's branches, and four more ATMs were added to the network.

### Marketing

Marketing activity was emphasised in retail banking, where competitive pressures increased last year. We continued to offer a number of loyalty and rewards programmes to our customers, such as the Merit Rewards scheme on savings and current accounts, the *Thilina Sayura* scheme for foreign-currency account holders and a gift scheme for our *Tikiri* savings accounts for minors.

A special deposit-mobilisation campaign was held from June to August 2009. The objective of the campaign was to raise Rs. 2 Bn. in 50 days. The campaign exceeded its target by as much and more, raising a total of Rs. 4.2 Bn. and was judged a great success.

During the period when the troubles of the Ceylinco Group impacted strongly on the Bank, we commenced a special effort to retain customers through a house-to-house campaign known as *Jaya Maga*. The campaign, still under way, has yielded very good results.

The Marketing Department undertook a customer satisfaction survey in the course of the year. The survey revealed that perceptions of service quality were good, with the Bank receiving an average score of 74% on the parameters tested.

### Information technology

Modern banking is uncompromisingly technological. Seylan Bank's 100-plus branches and convenient-banking centres are linked through a single automated network, which makes possible customer service quality and product access anywhere on the network and to customers overseas as well as in Sri Lanka. This network supports and enables all the features customers expect of a modern bank: ATMs, telephone, mobile and Internet banking, and credit cards, as well as traditional high street banking services and Seylan's pioneering mobile branches. All these are connected via state-of-the-art IT.

Improvements to our IT capability during the course of the year included enhancements to the SMS banking module and greater functionality with respect to funds transfers, utility-bill payments, etc. We also supported the introduction of the Seylan Bank MasterCard.

## Subsidiaries and Associates

The board decided during the course of the year on a gradual divestiture of the Bank's investment in Seylan Merchant Bank PLC (SMB). Accordingly, SMB ceased to be a Seylan Bank subsidiary on 1st October 2009.

Investments in our other subsidiaries, Seylan Bank Asset Management Limited (a primary dealer) and Seylan Developments PLC, remain unchanged.

## Looking Forward

With our difficulties now behind us, we are free to consider our strengths and capitalise on the opportunities opened up by the end of the war and the consequent opening-up of business opportunities in the North and the East, as well as the revival of tourism and the expected 'peace dividend'.

Today, Seylan Bank finds itself in an enviable position. Financially, it is stronger and more stable than ever. In terms of expertise and personnel resources, it can draw on a team of effective and experienced staff, many of whom enjoy long-established and close employee-employer relationships with the Bank. On the technology side, we are a fully-functional modern bank with a platform capable of rolling out innovative, in-demand services. Best of all, recent troubles have not affected the Bank's large and loyal customer base.

Our current priorities are to release funds tied up in non-performing accounts, capitalise on business opportunities in the North and the East, and establish synergies with our new strategic investors, Sri Lanka Insurance Corporation,

Browns and LOLC. Going forward, we see a lucrative market in services to the small- and medium-scale enterprise (SME) sector and have begun plans to expand our coverage in this market. Also in the pipeline are moves to drive growth in fee-based income and a number of new products targeting well-defined market segments. Further alignment of products and services, marketing strategy, organisational structure and corporate governance practices, systems and procedures and productivity enhancements, customer segmentation and enhancing operational efficiencies too will continue to be priorities over the next several years.

Financial projections in the 3-year Strategic Plan 2009-11, that is currently guiding the Bank on a focussed path of stabilisation and consolidation are based on the successful implementation of these initiatives which are expected to position the Bank as follows by 2011:

Indicator	Projected 2011
Loans and advances (Rs. Bn.)	158
Customer Deposits (Rs. Bn.)	170
Total Assets (Rs. Bn.)	195
Profit after taxation (Rs. Mn.)	2,301
Return on Equity (%)	17
Net NPL Ratio (%)	10
Cost to income ratio (%)	60