

CHAIRPERSON'S STATEMENT



" We hold a premier position in the financial services segment. Careful monitoring of credit policies and risk mitigation strategies has enabled us to build a business model that is unique in itself"

It gives me great pleasure to present to you the Annual Report and Audited Accounts for the Financial Year 2007/08. For LOLC, it has been an exceptional year of achievement not only from a financial perspective but more so from an operational perspective as we unveiled a series of activities and initiatives keeping in line with our strategic direction. However, let us take a closer look at the global, and the local economic and financial market activity so as to set the stage for the operational environment within which our business functioned during the year.

Global Economic & Financial Market Overview

After four years of robust GDP and trade growth, conditions in global financial markets have turned from favorable to less stable and less predictable. Global GDP growth eased to 3.6% in 2007 from 3.9% in the preceding year. However, developing economies grew 7.4% in 2007.

On average, developing countries were affected only modestly by the economic slowdown in the United States during the year 2007, which is now anticipated to continue in 2008. Therefore, GDP growth among low- and middle-income economies eased only by approximate 0.1 percentage points in 2007 from the strong 7.5% recorded in 2006.

The global oil crisis exerted inexplicable pressures on all economies except those oil producing nations that flourished in the year. Hitting an all time high USD 120 a barrel in March 2008, price speculation is expected to drive prices up to as much as USD 200 in the coming year. Continued high and increasing oil prices have stimulated the utilisation of food crops for bio-fuels without the consideration of a sustainable balance as world food stockpiles drastically diminished. Consequently, prices of maize and vegetable oils increased by 33% and 50% respectively, during 2007.

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Wheat production fell short of consumption partly due to adverse weather conditions. As a result, stocks reached historic lows, and wheat prices increased by 30%. Rice prices hit an all time high of USD 1,000 a ton as panicking suppliers scrambled to secure supplies exacerbating tightness provoked by export restrictions imposed by Vietnam, India, Egypt, China and Cambodia.

From a macroeconomic perspective, the effects on low-income countries have the most adverse effect resulting in a terms-of-trade loss equal to 0.5 percentage points of their GDP, with the poorest urban and non-farming rural segments of the population bearing the greatest burden.

Moreover, the financial turbulence that emerged by mid 2007 demonstrated how sudden and pervasive the effects of adjustments in financial markets could be. But capital flows to developing countries helped to soften effects of the market disruptions. Emerging markets rebounded and out-paced gains in mature markets. Following the sudden and sharp drop in market valuations of U.S. mortgage-backed securities in mid-2007, global markets entered a phase of heightened uncertainty. Furthermore, the sub-prime market effects have been reflected globally in increased volatility in equity markets, commodity prices, and exchange rates. We at LOLC expect this scenario, in particular the resultant credit crunch to impact negatively on our foreign funding in the up coming year.

Sri Lankan Economy & Financial Market Overview

The Sri Lankan economy grew by 6.8% in the year 2007, down marginally from the 7.4% growth in 2006. However, official statistics indicate that the annual average rate of unemployment reached 6%, an all time low - while per capita income increased to settle at USD 1,617 during the year. Complimenting the figures stated by the Central Bank of Sri Lanka (CBSL), the Census and Statistics Department's five year household income and expenditure survey indicate a drop in the number of people below the official poverty line to 15% from 22.7% in 2002.

The monetary policy strategy of the CBSL with a focused quantitative target approach was more effective in containing monetary expansion, thereby curtailing demand-pull inflation. However, global rising oil, commodity and food prices propelled top-line inflation to the region of 18% by the end of 2007, thereby rapidly increasing the cost

of living and propelling interest rates upwards which constrained both corporate and personal borrowings due to high cost of debt servicing.

The growth in reserve money was contained well within the targets and restricted to 10.2%, the lowest growth in the last five years. This assisted in neutralizing almost fully, the borrowings by the government from the banking sector, which increased significantly in 2006, but remained within the budgeted level during 2007.

The financial sector remained resilient and stable in 2007, despite increased pressures from external and domestic macroeconomic and financial market developments. The key financial institutions maintained their soundness through high profitability, increased capital adequacy levels and improved asset quality within an enhanced regulatory and supervisory framework, which strengthened their resilience and risk absorption capacity.

During 2007, the reach of the banking sector in the country improved with the expansion of the branch network of both Licensed Specialized Banks (LSB) and Licensed Commercial Banks (LCB).

The supervisory and regulatory framework governing the financial sector was upgraded with several directives and measures introduced to strengthen the soundness of both banks and non-bank financial institutions. Furthermore, the preparatory work for the implementation of the BASEL II Capital Adequacy Framework for banks from 2008 was completed. The adoption of BASEL II is expected to improve the soundness and risk management of banks by better aligning the bank's capital with its risk profile and by providing more comprehensive capital coverage for credit, market and operational risks.

A direction on Corporate Governance for banks was issued by CBSL and a mandatory code for companies listed on the CSE was issued by the Securities and Exchange Commission (SEC) with the aim of further tightening the regulatory framework of publicly quoted companies.

The latter part of the year 2007, witnessed the Sri Lankan Rupee stabilizing against the USD. LIBOR declined impacting on LOLC's foreign borrowings positively, however from a totality imports decreased as a result of decreased economic earnings whilst exports lost competitiveness due to a strong Rupee.

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LOLC: A Clarion Call for Change

As the regulatory framework tightens with increased focus by the authorities to monitor provisions and liquidity ratios of all financial ratios, we at LOLC make a clarion call for a level operational playing field. Our greatest concern at this point in time remains the fact that despite being governed and regulated within the realm of the regulatory framework in place for Commercial Banks, from an operational perspective we continue to be curtailed by the scope of permissible business as a financial institution with the restrictions imposed on us in relation to deposit mobilisation.

The continued and escalating conflict in the North persists in constraining business potential. However, we are confident that as in the East - where we have witnessed the gradual return to normalcy and a democratic process of governance after twenty five years - that the liberation of the people of the North, will enhance the macro-economic situation. We are confident that such a situation will enable us to actively assist the population of the North to recommence their livelihood in a sustainable manner.

Inflation and Interest rates pose the greatest danger to LOLC as it does to other financial institutions. As disposable incomes fall due to an increasing cost of living, borrowings for investment will continue to decline exacerbated by rising costs of debt servicing. The long term balance of priorities therefore is a question to be reckoned with. Moreover, our funding base to critical masses such as the Micro-Finance and SME sector will continue to face increasing pressures in debt servicing. As a result, it is pertinent for the Government to consider a solution to the current interest rate scenario.

During the year, financial institutions performed commendably as is reflective in LOLC's top-line growth of 50% over that of 2006/2007. However, the high costs of funds had a negative effect on the bottom line.

I am extremely happy to inform you, our shareholders that all businesses recorded healthy growth in top line contributing well towards Groups' performance. Despite the increases seen in operating expenses, the Group, through effective management of expenses was able to record healthy bottom line growth.

The Group Profit After Tax increased to Rs. 1.3 Bn, a 25% growth over the last year. This includes goodwill on consolidation of Rs. 131.2 Mn, on account of Touchwood Investments Ltd and Sundaya Lanka (Pvt) Ltd.

The profits of the Company remained at the same level as last year mainly due to the investments made in the new acquisitions, capitalization of the 100% owned subsidiaries and increase in borrowing costs. The Profit After Tax of the Company was lower at Rs. 977 Mn compared with Rs. 986 Mn recorded for the previous year.

As a result, the Return on Equity for the Company declined by 5% and was 25% at the year end. The total equity of the Company grew to Rs. 4.3 Bn. The gearing ratio of the Company at 5.1 times is on the increase due to higher borrowings supporting the higher executions and investments of the Company. However, this is well within the stipulated limits by the CBSL and is superior compared with similar financial institutions.

An interim dividend of Rs. 2.25 per share was paid during the year. LOLC's shares traded between Rs.81.00 and Rs.167.50 increasing the market capitalization to Rs. 5.6 Bn at the year end.

The Company's rating remained stable at A(Ika) while the Company's fully owned subsidiary LOFIN's rating also remained stable at BBB+(Ika).

Future Direction

We hold a premier position in the financial services segment. Careful monitoring of credit policies and risk mitigation strategies has enabled us to build a business model that is unique in itself. Our concentration on SME's and a dedicated finance line for Micro Finance has added to the individuality of this model, thereby allowing us to differentiate from the traditional operations of a financial services institution.

Our regional development policy - as evident through our recent agreement with Lanka Indian Oil Company (LIOC) - to increase accessibility to the grass roots whilst also propelling revolutionary services to the SME and Micro Finance segment is a key to our differentiation strategy of sustainable business, an ethos that has

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been moulded through the years, through the association of our funding partners and support extended by ORIX Corporation.

In implementing our three year strategic plan, Business Units (BUs) will align with greater fervour towards the business functions as the years progress, creating synergies and exploring opportunities, as has been evident in 2007/2008's initial implementation of the plan. The centralised service units are already reaping the benefits of greater synergy and efficiency and effectiveness improvements.

Going forward, LOLC will progress towards accelerating development in the impoverished areas especially in the Eastern Province where speedy infrastructure and livelihood development are a prerequisite for the people of the province to break free from the shackles of prolonged conflict.

Our ethical investment strategy will be a key to our future growth. Much like our investments this financial year into TIL and Sundaya as well as our foray into the region through investments into PRASAC Micro Finance Institution, Cambodia we will continue to employ investment as a growth strategy.

It is in line with this long term growth strategy that we acquired a 67% stake of Commercial Leasing Company PLC in May 2008, which we believe will add synergetic benefits to the Group.

The strength of ORIX coupled with our more than respectable ratings for LOLC and LOFIN will, we believe pave the way in building a strong foundation for LOLC in the future. By sharing best practices in governance, enterprise risk management as well as practices in operational excellence with ORIX we offer an unblemished pillar of strength to our customer base and this will continue to be our infallible strength in the years to come.

In Conclusion

I would like at this stage to welcome yet another stalwart from Sri Lanka's financial circles, our new Group Managing Director/Chief Executive Officer Kapila Jayawardena who joins us from Citibank after a 28 year tenure with the global financial giant. I believe, as he has told me personally, many a time that he was inspired to join a leading organisation in Sri Lanka that has the vision and the capability

to make a difference to the Sri Lankan economy and her people. I can assure Mr. Jayawardena that he is with the right institution and I warmly welcome him to our team.

I wish to thank Mr. Y. Uchida and Mr. M. Shioda, Alternate Directors who resigned from the Board and the Chairman, Board of Directors and Senior Management of ORIX Corporation for their continuous support and guidance.

I wish to place on record my sincere appreciation to the foreign Directors of the company Mr. N. Esaki & Mr. M. Shioda Alternate Director who resigned from the Board during the year for being very close to us and for their valuable contribution. I would also like to thank Mr. Y. Uchida and Mr. E. Mutsumoto who resigned as Alternate Directors for their contribution. I would like to warmly welcome Mr. K Fushitani who joins our Board from this year as a representative of ORIX Corporation of Japan.

Our people are the very force behind LOLC. I express my earnest gratitude to the corporate management team and the staff for their invaluable support which paved the way for superior performance of the Group.

Our ability to grow our business as desired was made possible by the ready support and confidence placed on us by the local commercial banks and our foreign funding partners. I wish to extend my sincere gratitude to these institutions.

I wish to extend my sincere appreciation, to our stakeholders and the supportive shareholders who have placed their confidence in us. Thank you for making LOLC what it is today and let us continue to reach new heights in the years ahead.



Mrs. Rohini Nanayakkara

Chairperson

DEPUTY CHAIRMAN'S REVIEW



"Our vision has moved beyond that of the traditional and conventional corporate expectation. We operate in a new realm; we embrace the next paradigm shift where corporates will lead the way in shaping tomorrow's world through poverty alleviation and environmental balance"

The previous financial year was a year in which LOLC laid firm foundations for exciting new avenues of enterprise and growth. Building on these foundations, the year 2007/08 has been one in which we have accelerated growth initiatives to new heights. I am pleased to say that LOLC's strategic direction is now well embedded in an ethos of sustainable development.

Very simply, our future lies in how best we manage our resources for the future. By this I refer to more than just the LOLC Group. It is a principle, which if practiced by all, will ensure that economic development is maintained within acceptable levels of global resource depletion and environmental pollution. This is the only solution for sustainable growth.

In this sense, our vision has moved beyond that of the traditional and conventional corporate expectation. We operate in a new realm; we embrace the next paradigm shift where corporates will lead the way in shaping tomorrow's world through poverty alleviation and environmental balance.

Let us face it. Across the world there is evidence of a growing gap between the rich and the poor. In Sri Lanka, a critical issue has been the rapid broadening of this gap. As a financial services provider primarily set up to develop the SME sector, we have identified the need to be involved progressively and to act as a catalyst in changing the prevalent pattern. We were instrumental in spearheading the revolution of the SME sector, by providing them with the required financial solutions over

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the last twenty eight years, and the company is enriched with this expertise. We will continue to serve this sector meeting with the challenges of a dynamic environment by introducing innovative financial solutions with enhanced service efficiency.

Now we are moving on to the next level, the mammoth Micro sector. We are addressing many of the issues faced by this sector by facilitating entrepreneurship at grass root levels. Our proactive and growing emphasis on the Micro Finance sector to facilitate farmer-based, agri-related industries and skill-enabled financing will eventually contribute in two ways towards our goal. Firstly, it will without doubt address the issue of poverty alleviation and self sustenance from a community perspective. Secondly, as is very evident today, to combat global scarcity of food resources, it is incumbent of both governments and corporations to work together to address the global food crisis. What we are experiencing today is possibly the tip of the iceberg; the true impact of the food crisis, I believe, will be experienced by global economies in the years to come. LOLC's approach in providing financing to agri-business is fuelled by the determination to overcome the impending issues of the next decade and to support the Micro sector with necessary capital to move the nation towards self sufficiency and to be equipped to face this challenge.

LOLC first entered the Micro Finance sector through the Renewable Energy for Rural Economic Development (RERED) project, a solar financing project initiated by the World Bank for rural electrification. Accordingly We are a preferred financial institution for solar financing, a clear market leader in volumes. The experience gained through this project has placed LOLC in a stronger position to enter into the Micro Finance sector with a better understanding of the segment's needs, as well as having the reach and infrastructure to support.

During the fiscal year, we turned our attention to identified segments of the Micro Finance market. Women are typically targeted for Micro Finance initiatives as this promotes gender equality within a country, stability of the family unit, as well as positively impacting the desirous goal of poverty alleviation. We have also experienced that women are more attuned to the concept of micro entrepreneurship and better adapted to resourcefully utilising the services we provide.

Dairy farming has been another area of focus for LOLC. We are working on multiple strategies to achieve our goal and we have entered into the agri-dairy sector with a view to revive the ailing industry. Going beyond the conventional financier's role, we have invested in providing advice and technical know-how to the farmer on a variety of areas across the value chain in order to ensure that the farmer receives his rightful share of returns. A similar program is in place for paddy farming.

Providing financing for farming equipment has been a key business for LOLC in the past. With the rejuvenated initiatives in the Micro Finance business we are witnessing quantum growth in this sector. Also with numerous strategic partnerships along the value chain, both sides have emerged winners. All in all, the acceptance of Micro Finance by the targeted segments has been very encouraging.

From an international perspective, in 2007/08, to propel our learnings in Micro Finance and for greater knowledge sharing of Micro Finance strategies, LOLC was actively involved with PRASAC in Cambodia, capitalising on the investment the Company made in the previous year.

PRASAC is considered to be one of the leading Micro Finance institutions in Asia and has a reputation as a leader in Best Practices of Micro Finance. Together with a consortium of international investors - Dragon Capital Group, The Netherlands Development Finance Company (FMO), Belgium Investment Organization (BIO) and Oikocredit, we invested in PRASAC with the intention of expanding our business horizon and creating a two-way learning stream for both entities.

PRASAC supports 16 provinces in and around Phnom Penh for projects in the agricultural sector and is rich with expertise from whom LOLC can benefit significantly. Cambodia we feel, with a population of 15 Mn people provides us with great potential for expansion.

Further, it is our intention to capitalise on the expertise that we have gained from the RERED project in Sri Lanka, for rural electrification in Cambodia. Our investment of 51% in one of Sri Lanka's largest and most prolific solar system manufacturing and servicing entities, Sundaya Lanka will enable us to successfully penetrate the market not only in terms of selling panels but also to be part of the entire value network in the future.

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In our pursuit of sustainable development, having outlined our efforts in poverty alleviation, let's now move on to the other crucial area of contention - that of the environment and the increasingly critical need to manage environmental pressures from pollution, deforestation and upsetting of eco-systems as a result of economic activity.

There is without doubt a crisis in climate change - the direct impact of what we all know as global warming - which has already started taking its toll on humanity and mother earth. As a corporate, our approach to environmental wealth creation has been through ethical investment strategies, strengthened by the best practices adopted from the positive influences of our global financiers and partners. The most prominent of these strategies adopted in the financial year 2007/2008 was the investment in Touchwood Investments Limited (TIL) acquiring an approximately 29% stake.

Originally incorporated in Sri Lanka in June 1999, TIL was later listed on the Colombo Stock Exchange. The company has established more than 20 greenfield sites in Sri Lanka, and LOLC's strategic intent with regard to the company is to rapidly expand the size and scope of the business so that large scale reforestation of greenfield sites will be achieved in the upcoming year and the years to come. We foresee great promise in the venture both from a financial as well as a societal perspective, as this program can contribute to a reduction in carbon emissions and the resultant damage.

Similarly, the Gal Oya Plantations, formerly known as Hingurana Sugar Industries, progressed into cultivation of sugar cane during the year. For those of our shareholders who may not be so well informed of the project, let me elaborate. Incorporated in 1991 to manage the country's first large scale sugar plantation in the Ampara district, Hingurana Sugar Industries was essentially inoperative for over a decade. LOLC together with Brown & Company, signed a public private partnership with the Government to reactivate the plant in 2007.

Placed in the previously conflict ridden East, the plant's revival is considered one of the very first steps taken by both the public and the private sector to breath a new life into the province. Moreover with over 4,000 families dependent, directly and indirectly, the plant has been a catalyst in changing the lives of the people.

Poised to produce not only sugar, the plant will also produce ethanol as a bio-fuel as a by product of sugar production, fuelling the generation of electricity through a 6 MW power plant. It is expected that this will assist in relieving the strain and dependency of the area on the national grid whilst increasing the efficiency of the overall plant. In addition, this will contribute to reducing the country's dependency on imported fossil fuel, as most of the country's thermal power plants are operated on fossil fuel, the price of which during recent times have risen to record levels given the global demand for energy. Further, farmers and the peripheral community will have access to fodder - again a by product from the sugar production process - for dairy farming.

As I noted previously, LOLC's investments in Sundaya Lanka will see a greater focus towards renewable energy. As proponents of renewable energy sources we will actively propagate the use of solar energy amongst rural communities to assist in farming methodologies and to decrease their dependency on less efficient/more expensive fossil fuel energy sources.

In the previous year we embarked on another visionary project under the purview of LOPD - to manufacture Precipitated Silica using Rice Husk Ash - which was further developed during the year. LOPD acquired patent rights and technology from AgriTec Incorporated, in Houston, U.S.A. for use of the technology in seventeen rice growing countries. Precipitated Silica has a world market value of USD 2 Bn. The conversion of rice husk ash to Precipitated Silica is far more energy efficient compared to the conventional production of Precipitated Silica. The fact that it is manufactured from rice husk - which is waste normally disposed of in land fills, further substantiates the eco-friendliness of the product and the process. The first project is planned to be implemented in Thailand.

These numerous investments made in sustainable development have opened up avenues for the Company to enter the market of carbon trading, a completely new market created following the Kyoto Protocol. LOLC's investments in such ventures are aligned to an objective towards a sustainable environment, also guided by a detailed environmental policy laid down by the Company.

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Thus, for LOLC, this past year has been a hallmark year. It has been a year in which we have stretched our limits and embarked on initiatives which will not only shape our future but also the future of many Sri Lankans.

The active involvement and participation in sustainable development programs by the Company has made LOLC a conduit to achieve the development goals of our funding partners. The Company's superior performance has enhanced their confidence and prompted them to channel their development finance over and over again through LOLC.

With their association we ourselves have moulded our own identity through strategic alignment. We are pleased, that in the current context, our relationship has progressed to one of partnership, wherein we work as one to take forward this philosophy to those who really matter - you, our shareholders, our customers, our employees and of course the planet and her people.



Ishara Nanayakkara
Deputy Chairman