

Corporate Social Responsibility

What exactly does it mean?

'Corporate Social Responsibility' is now a popular, frequently used slogan. 'Social Responsibility' can be defined as an instance or situation, where those with the extra resources, privileges and strengths share these with the less fortunate within the same community – a habit that has been practised for centuries. Lord Buddha, shortly after attaining enlightenment visited Sri Lanka – long before the advent of Buddhism to the country – to settle a dispute between two feuding groups – a classic display of Social Responsibility. Jesus Christ put it in one succinct sentence that covered every facet of Social Responsibility: – "Love thy neighbour as thyself." Mahatma Gandhi, with no political ambitions in mind, strove tirelessly towards fulfilling his mission: – "Removing tears from the teeming millions" – to end the discrimination of colonial rule towards millions of poor Indians.

Today, many corporates have realized the importance of sharing with the have-nots. This is of utmost relevance to Sri Lanka where more than 70% are reportedly below the poverty line. They need sympathy and more importantly, material assistance to raise their living standards. Corporate Social Responsibility has now become a prerequisite for recognition by the community.

However, the focus on what 'Corporate Social Responsibility' actually stands for is increasing. The World Business Council for Sustainable Development, in its publication *'Making Good Business Sense'* by Lord Holme and Richard Watts used this description: "Corporate Social Responsibility is the continuing commitment by business to behave ethically and contribute to economic development while improving the quality of life of the workforce and their families as well as of the local community and society at large." This, briefly, means that CSR is all about how companies manage business processes to produce a comprehensively positive impact on society. Overall, CSR is more than an exercise in philanthropy. Profits made by companies are unhindered – except by taxation. They donate a certain share to charitable causes – and it is seen as tainting the act for a company to receive any benefit from its largesse. For some, much more is focused on operating the core business in a socially responsible way, complemented by investment in communities for solid business case reasons. This, from one view-point is more sustainable since CSR becomes an integral part of wealth creation, which, with proper management, will not only enhance competitiveness of business, but also maximise the value of wealth creation to society – and

considerably lessen the risk of CSR being jettisoned in the event of a change in the economic environment.

Corporate Governance and Business Integrity

At HNB, we have a strong and continuing commitment to the highest standards of corporate governance. Corporate governance is usually defined as a system by which companies are directed and controlled from within. This, in recent times, has been the subject of an ever-increasing focus and external demands made on public companies to conform to a set of rules and regulations – sometimes sets of them – to give businesses and governments a conscience and help spread prosperity in a world where the distribution of wealth is, to say the least, uneven. Our own systems enable us to be socially and morally responsible for all actions we take internally and externally to touch all people directly or indirectly.

Today, the concept of corporate governance extends to address not only shareholders' expectations about effective employment of capital to provide returns, but broader perspectives on how companies should operate. HNB has always abided by the credo that we continue to maintain the highest standards in business ethics, sincerity, truthfulness, the keeping of promises and being transparently accountable to stakeholders. It is indeed a pleasure to be able to support our claim of adherence, through the numerous awards our Annual Reports have garnered year after year at home and abroad – we have won the South Asia Federation of Accountants Award (SAFA) many times – and in fact, during the late '90s, for three successive years.

A heart in our core business!

Companies cannot be substitutes for governments. They cannot direct how countries should be governed. But they can lead by example and bring considerable influence to bear through good practices and it is imperative for each company to demonstrate it is operating responsibly with customer benefits that improve with time. HNB operates throughout the length and breadth of this country and we are only too well aware that, since financial needs vary to a considerable degree, the role involves improving life – across the board – with a range of products that will cater to the needs of people from all walks of life. Our 'Shanthi Home Loans' for instance have a built-in flexibility that can accommodate the construction of the most humble home. HNB was the first

Corporate Social Responsibility

private commercial bank to introduce Pawning, bringing a new dimension, the highest ethics and even technology to the industry. Pathum Vimana continues to be instrumental in creating national wealth through an increased savings base that is being utilized by the Bank, both meaningfully and beneficially. Singithi – the Minors' Savings Account, was introduced to not only inculcate the savings habit in children, but as importantly to also familiarize them with the banking habit. Savings in a Singithi account are further facilitated by Savings Centres in over 100 schools at present.

At grassroots level

HNB, as far back as 1989, inaugurated a revolutionary idea called 'Gami Pubuduwa' (Village Reawakening) scheme. The core of the concept was the redefinition of micro financing for development among people below the poverty line. Under this scheme, financing apart, the bank also provides guidance and advice towards increasing productivity and counsel against risks – and even failure. For future embellishment of assistance, recipients are assisted with the maintenance of records. Since its inception, the Scheme has created over 50,000 direct employment opportunities and indirect employment for over 500,000 people.

Commitment to CSR at work

HNB regards CSR in the broader perspective. The comprehensive set of policies, practices and programmes are not only geared for the creation and distribution of wealth among the community served, but also among the bank's employees. The Employee Share Option Plan (ESOP) is in the process of being implemented and this key wealth distribution programme will be based on a performance-oriented formula.

Giving back to society...

HNB's CSR activities include study tours abroad for farmers from the front-line farming districts. In 1989, eight farmers visited China for a first hand view of the latest technology, while more recently, thirteen others visited research institutions, fertilizer plants and more in India. Other activities include the construction of three houses for needy families in Suriyawewa, Kiribathgoda and Kurunegala. A settlement of 800 families in Muthurajawela benefited from a joint

venture between the Bank and the Rotary Club of Wattala with the construction of badly needed toilet facilities. HNB donated an air-conditioning unit to Dambulla Hospital, thus fulfilling another crying need. The Bank has also linked with



Mr. Rienzie Wijetilleke, Chairman presents a cheque to a recipient of one of three houses (at Suriyawewa, Kiribathgoda and Kurunegala) HNB is helping to construct.

the National Housing Development Authority (NHDA), supporting the programme of providing one home each to poor families in every district. Contributions were made to the Bar Association of Sri Lanka for the National Law Conference, the Sri Lanka Medical Association for academic services and the International Asia Pacific Regional Conference held in Sri Lanka on Alzheimer's disease. In addition, HNB sponsored a publication of the Institute of Road Association entitled 'Driving challenges and Essential Skills' and was also involved in the collection of funds and the organizing of a charity dinner at the Taj Samudra Hotel by the National Stroke Association.

The Bank has also made a firm commitment to a project of the Ministry of Agriculture, under which three tanks in Gampaha, Tissamaharama and Anuradhapura will be rehabilitated.

The recent devastation by the tsunami that saw, not only Sri Lankans but also the world come forward voluntarily to assist the people, the tremendous goodwill and spontaneous generosity by numerous countries, institutions, corporates and individuals show clearly that Corporate Social Responsibility has come to stay.

HNB's ideal is to have a sustainable programme to fulfil Corporate Social Responsibility on a continuing basis for the greater benefit of the larger community.

Corporate Governance

Importance of Corporate Governance

The Board of Directors and the Management of HNB are responsible for corporate governance of the Company and its controlled entities (the Group) and remain committed to upholding the high standards of integrity and transparency in their governance of the Group. Hatton National Bank aspires to be in the forefront of internationally acclaimed best practices in governance. The manner in which the group is governed is crucial to ensuring that we live by our core values, serve the interests of our owners and maintain the trust of our service partners, employees and other stakeholder community. The main corporate governance practices that were in place during the year to 31 December 2004 or otherwise as undernoted are discussed below.

Core beliefs

- Creating long term shareholder value
- Engaging in constructive dialogue with our stakeholders as an 'on-going' exercise.
- Creating an inspiring working environment for our staff
- Creating value within the communities in which we serve
- Maintaining the trust of our service partners and customers

Statement of Compliance

As a company listed in the Colombo Stock Exchange, HNB complies with The Institute of Chartered Accountants of Sri Lanka (ICASL) Code of Best Practice.

For the year ended 31st December 2004, HNB complied with the provisions set out therein except for the appointment of a Remuneration Committee. The functions of the Remuneration Committee are performed by the Human Resources Committee which deals with compensation and performance issues of the executive management whereas the appointment and evaluation of the performance of the CEO is carried out by the Board of Directors. During the ten months of March to December 2004, the functions of the Chairman and CEO were performed by the same person. This was necessitated due to the sudden demise of the previous Chairman. The roles have since been segregated, with the appointment of a CEO who focuses on policy implementation while the Chairman has reverted to his true role of policy advocacy.

Board of Directors

The Board is the principal decision making forum for the company. It has overall responsibility for leading and controlling the company and is responsible to its shareholders for financial and operational performance. The Board approves Group strategy and monitors performance. The Board is also responsible for the corporate governance of the Company, including the establishment of relevant committees.

The Chairman leads the Board and ensures effective engagement and contribution of all Non-Executive Directors. Policy development, formulation of strategies and operational implementation is delegated to the members of Corporate Management.

Corporate Governance

All Directors participate in discussing strategy, performance and financial / risk management of the group. Meetings are structured to facilitate open discussion. The Board usually meets twelve times a year with additional meetings as and when required.

It is usually supplied with comprehensive papers in advance of Board meetings, on financial and business activities covering the Group's principal activities. Members of Corporate Management are invited to attend and make presentations at meetings of the Board. The Board comprises of eight Directors who provide the group with the knowledge, mix of skills, experience and network of contacts and also the comfort that no undue burden is placed on any one individual. Seven of these Directors are Non-Executive members while the CEO is the sole Executive Director.

Independence of the Directors

The Board regularly assesses the independence of each Director. For this purpose an independent director is a non-executive director whom the Board considered to be independent of management and free of any business or other relationship that could materially interfere with the exercise of unfettered and independent judgement. Directors are required to be meticulous in their disclosure of any material contract or relationship in accordance with the Accounting Standards and Banking Act.

Full details of related party dealings are set out in notes to the Company's Financial Statements as required by the Accounting Standard.

Meetings

The number of meetings of the Board and the Audit Committee and individual attendance by members is shown below :

	BOARD	AUDIT
J C R Cooray (Deceased March 2004)	04	
Rienzie T Wijetilleke	16	
V P Vittachi	13	
D H S Jayawardena	16	03
M V Theagarajah	16	05
R K Obeyesekere	15	05
Mrs Pamela Cooray	10	02
R Sivaratnam	-	
R Theagarajah	-	
TOTAL	16	05

- Mrs Pamela Cooray was appointed to the Board on 23rd April 2004.
- Mr R Sivaratnam and Mr R Theagarajah were appointed to the Board on 14th December, 2004.

Audit Committee

The Audit Committee comprises three Non-Executive Directors of the Bank with the Board Secretary acting as the Committee Secretary. The Managing Partner of Ernst & Young Sri Lanka has been invited to serve as a consultant to this committee and attend committee meetings. The Committee is responsible for assisting the Board in discharging its responsibilities in relation to the financial affairs of the Group. This includes but is not confined to the arrangements for accounting and financial reporting and

Corporate Governance

regulatory compliance, the standards of internal control and arrangements for internal audit, risk management and the external auditors. The Audit Committee meets the Director/CEO, Members of management and the External and Internal Auditors privately.

The Audit Committee is satisfied that a strong control environment exists within the Group arising from the effectiveness of organizational structures and compliance with the Group's accounting and operational policies.

The Audit Committee undertakes an annual evaluation to assess the independence and objectivity of the external auditors and the effectiveness of the audit process, taking into consideration professional and regulatory requirements. The Committee has recommended to the Board of Directors that M/s. KPMG Ford Rhodes Thornton & Co. be re-appointed as auditors for the Financial Year ending 31st December 2005, subject to the approval of Shareholders at the next Annual General Meeting.

Credit Risk Committee

The Credit Risk Committee comprises of the Chairman, CEO and one other Non-Executive Director on a rotational basis. The committee ensures that strong credit appraisal, monitoring and recovery systems are in place to continuously enhance the quality of the lending portfolio of the Company, and achieve portfolio outcomes consistent with the Company's risk/return expectations. In addition, the committee reviews the company's credit portfolio and

recommendations by management for provisioning for non-performing loans and advances.

Human Resources Committee

The Human Resources Committee is responsible for the recruitment, remuneration and promotion of executive officers and also ensures that proper career planning/management succession plan for executive officers is in place.

Relationship with Shareholders

Hatton National Bank has more than 17,000 shareholders from the institutional and individual investor communities. The company has developed a proactive approach in dealing with these shareholders. The CEO and members of Corporate Management meet regularly with key institutional and individual shareholders and makes presentation on performance and strategic re-direction issues. Regular communication via print and electronic media is also undertaken to reach out to the investor base.

The bank makes constructive use of the Annual General Meeting with the Chairman of the Audit Committee and representatives of external auditors being present to clarify any issues raised by shareholders. All resolutions are put to the house to ensure that shareholder views are adequately and democratically reflected.

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

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 Hatnbc Ce, 2166 Haynfx Ce
Swift : Bic Code – HBLILK LX
Email : moreinfo@hnb.net
Web: <http://www.hnb.net>

BOARD OF DIRECTORS

Mr. Rienzie T. Wijetilleke (Chairman/Managing Director)
Dr. V.P. Vittachi (Deputy Chairman)
Mr. D.H.S. Jayawardena
Mr. M.V. Theagarajah
Mr. R.K. Obeyesekere
Mrs P C Cooray
Mr R Sivaratnam
Mr R Theagarajah (General Manager/CEO)

BOARD SECRETARY

Ms. Indrani Goonesekera
Attorney-at-Law & Notary Public

AUDIT COMMITTEE

Mr. D.H.S. Jayawardena (Chairman)
Mrs P C Cooray
Mr R Sivaratnam

MR. G. GUNATILLEKE – CONSULTANT
Managing Partner – Ernst & Young

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
SL A national credit rating for implied long term unsecured senior debt by Fitch Ratings Lanka Limited.

ASSOCIATE COMPANIES

Company	Holding	Principal Activity
Browns Engineering (Pvt) Ltd.	32.63%	Construction & Engineering
Lanka Ventures Ltd.	20.07%	Venture Capital

SUBSIDIARY COMPANIES

Company	Holding	Principal Activity
Sithma Development (Pvt) Limited	100.00%	Property Development
HNB Securities Ltd	100.00%	Dealing in Government Debt Securities
HNB Stockbrokers (Pvt) Ltd	100.00%	Stock Broking
HNB Assurance Limited	59.986%	Insurance

INVESTOR INFORMATION

Institutional Investors, Stock Brokers and Security Analysts requiring financial information should contact the Chief Financial Officer at “HNB Towers”,
(Level 20), No: 479, T.B. Jayah Mawatha, (Darley Road), Colombo 10, Sri Lanka.
Telephone : 2662705, 2664705 Fax : 2662815 E-mail : kekulawe@sri.lanka.net

Correspondents throughout the world

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Our Vision

is to provide leadership in nurturing the development of the emerging financial landscape

Our Mission

To be the most caring and versatile provider of excellence in financial services creating opportunities for more people in more places.

Values

To act as catalyst for the rapid growth and development of the financial services industry while proactively responding beyond expectation to customers' needs with professionalism and excellence.

To recognize our staff as our most valuable asset and linking rewards exclusively to performance and contribution, whilst providing opportunities for career development, within our organization.

To constantly endeavour to maintain financial stability and sustainable growth, whilst enhancing shareholder wealth.

To elevate our status as a socially responsible corporate that consistently surpasses the ethical, legal, commercial and public expectations.

To inculcate amongst all our employees, a culture of following and practicing ethical guidelines based on those adopted by relevant professional bodies or developed by our Bank, while continuously striving to improve them.

Financial Calendar

2004

1 st Quarter Results 2004 released on	22 May, 2004
2 nd Quarter Results 2004 released on	26 August, 2004
3 rd Quarter Results 2004 released on	30 November, 2004
20% Interim Dividend for 2004 paid on	28 December, 2004
Annual Report for 2004 on	6 th March, 2005
36 th Annual General Meeting	30 th March, 2005
15% Final Dividend for 2004 payable on	6 th April, 2005

2005

1 st Quarter Results 2005	April, 2005
2 nd Quarter Results 2005	August, 2005
3 rd Quarter Results 2005	October, 2005
*.....% Interim Dividend for 2005	December, 2005
Annual Report for 2005	March, 2006
37 th Annual General Meeting	March, 2006
*.....% Final Dividend for 2005	April, 2006

(*subject to confirmation by Directors)

Financial Goals/Performance

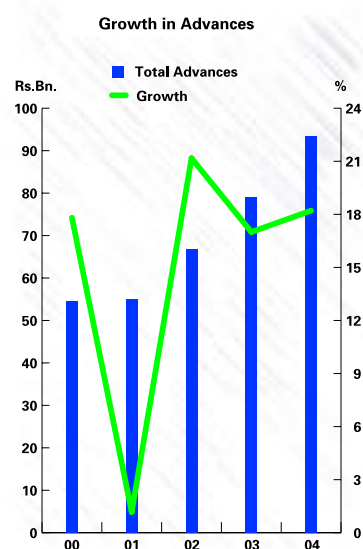
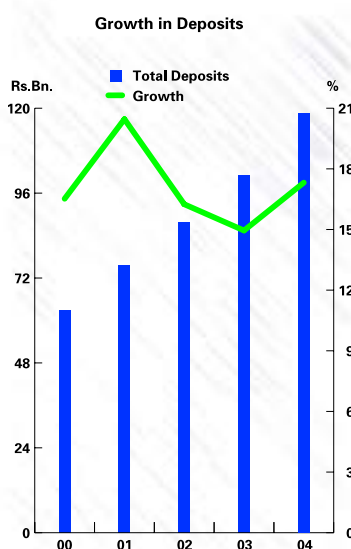
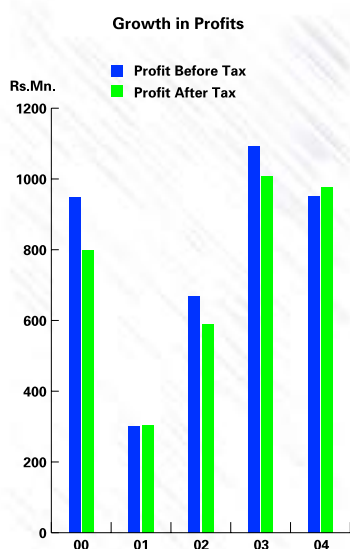
For the year ended 31st December	Medium Term		Performance			
	Goals	2004	2003	2002	2001	2000
Return on average assets (%)	over 1.5%	0.7%	0.8%	0.6%	0.3%	1.0%
Return on average shareholders' funds	over 20%	12.2%	15.2%	9.8%	5.4%	15.2%
Cost/Net income ratio (1)	65%	70.4%	63.2%	72.8%	80.4%	69.8%
Dividend rate	30%	35%	40%	30%	15%	40%
Capital Adequacy						
Tier 1 Capital ratio	9.00%	9.83%	8.06%	9.98%	9.59%	10.13%
Total Capital ratio	12.50%	11.26%	11.47%	12.40%	9.53%	11.02%

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

Operating expenses consist of staff costs, premises costs and establishment expenses and other overhead expenses.
Net income consists of net interest income, foreign exchange income, commission income and other income.

Financial Highlights

	2004 Rs.000	2003 Rs.000		%
				Change
Results for the year				
Income	14,087,358	14,830,562	-	5.01
Net profit before income tax	950,055	1,091,585	-	12.97
Income tax on profits	(26,326)	83,300	-	131.60
Net profit after taxation	976,381	1,008,285	-	3.16
Gross dividends	350,350	286,000	+	22.50
Retained profit	626,031	722,285	-	13.33
At the year end				
Shareholders' funds (Capital and reserves)	9,051,880	6,993,098	+	29.44
Deposits from customers	118,523,934	101,025,512	+	17.32
Advances to customers including Leasing and Bills of Exchange	93,294,521	78,922,443	+	18.21
Total assets	152,779,694	133,330,746	+	14.59
Information per ordinary share				
Earnings (Rs.)	12.51	13.69	-	8.62
Dividends (Rs.)	3.50	4.00	-	12.50
Dividend Yield (%)	6.14	5.80	+	5.86
Net asset value (Rs.)	90.43	97.81	-	7.55
Market value (Rs.) - Voting	57.00	69.00	-	17.39
Market Value (Rs.) - Non voting	32.75	36.75	-	10.88
Ratios				
Return on average shareholders' funds (%)	12.17	15.24	-	20.14
Price earnings (Times)	4.56	5.04	-	9.52
Dividend cover (Times)	2.78	3.52	-	21.02
Capital adequacy ratios				
Tier 1 (%)	9.83	8.06	+	21.96
Tier 1 & 2 (%)	11.26	11.47	-	1.83



Sri Lankan Economic Profile

Key Country Statistics

Land Area (Sq. Km.)	65,610
Population (Mn.) 2004 mid-Year estimate	19.4
Population Growth (%)	1.0
Population Density (People/Sq. Km.)	310
Life Expectancy (Years)	73
Literacy Rate (%)	90.2
Secondary School Enrolment (%)	85
Income Distribution (Gini Coefficient)	0.4637

Internal Economic Indicators

	2003	2004(P)	2005(F)
Gross Domestic Product (US\$Bn)	22.2	19.3	21.7
GDP Growth (%)	5.9	5.2	5.8
GDP Per Capita (US\$)	949	1,011	1,099
GDP Per Capita Growth (%. US\$ Terms)	8.8	6.5	8.7
Inflation % (GCCPI)	3.6	6.0	6.0
(SLCPI)	2.6	7.0	6.5
Domestic Savings Rate (% of GDP)	16.0	16.1	17.0
Gross Domestic Investment (% of GDP)	22.3	28.1	29.0
Fiscal Deficit (% of GDP)	8.0	8.7	8.5

External Economic Indicators

	2003	2004(P)	2005(F)
Trade Balance (in US\$ Bn.)	-0.9	-1.9	-2.0
(% of GDP)	-4.1	-13.5	-9.2
Current Account Balance (US\$ Bn.)	-0.2	-1.1	-1.3
(% of GDP)	-0.9	-5.7	-6.0
External Reserves (US\$ Bn.)	3.2	3.1	3.5
(Months of Imports)	5.8	4.6	5.0
Exchange Rate (US\$ End Year)	96.74	104.61	100.56
(Euro)	121.6	142.32	140.93

Monetary and Financial Indicators

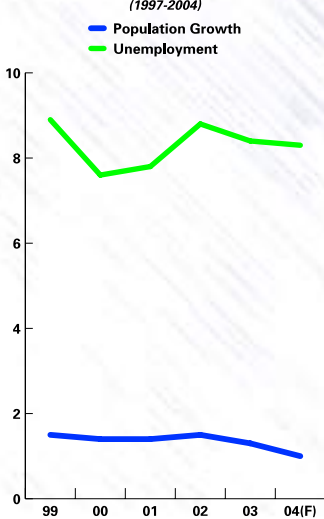
	2002	2003
M2 Growth (%)	13.4	15.3
Assets of the Banking System (Rs. Bn.)	788	885
Financial Net Worth of Banking System (Rs. Bn.)	51.7	55.1
Banking Density (The number of com.bank branches 10,000 people)	0.61	0.69

Share Market Indicators (Year End)

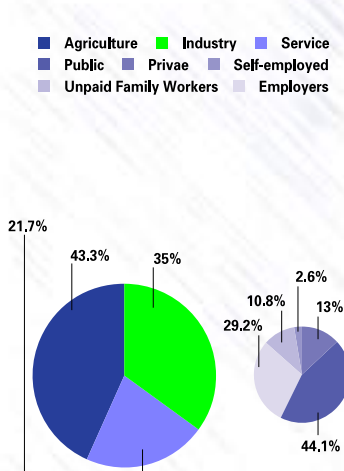
	2003	2004
ASPI (Year End)	1,062	1,507
MPI (Year End)	1,898	2,074
Market Capitalisation (US \$ Bn.)	2.7	3.8
Net Foreign Activity (Purchases - Sales) (US \$ Mn.)	1.3	11

P=Provisional
F=Forecast

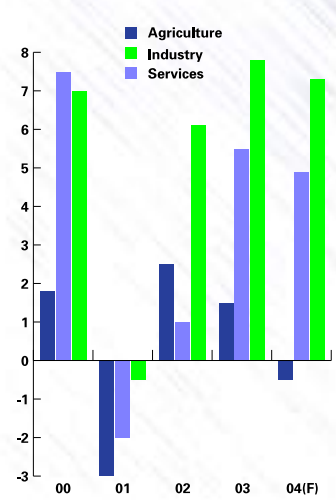
Population Growth & Unemployment (1997-2004)



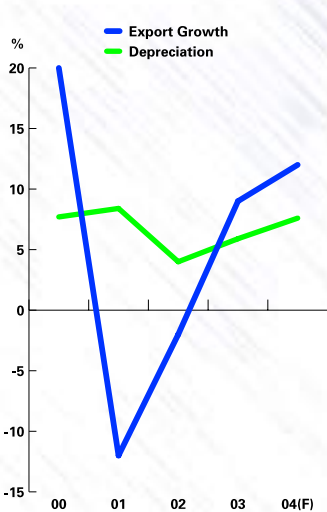
Employment by Sector (2003)



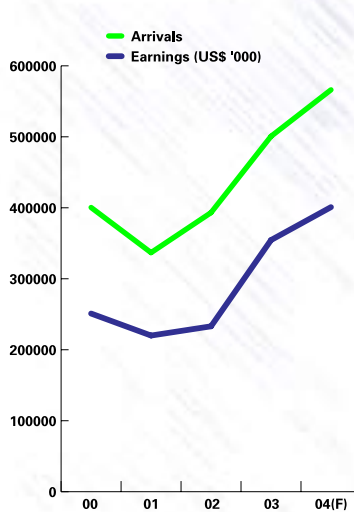
Sectoral Growths (1999-2003)



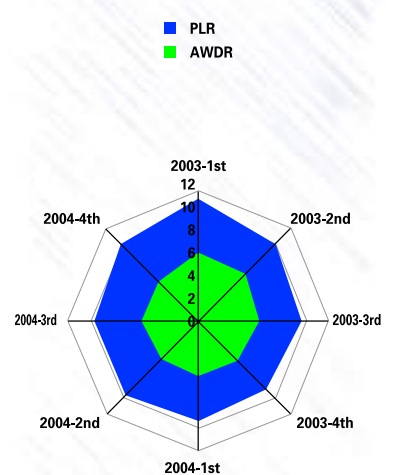
Export Growth & Depreciation



Tourism Industry



Commercial Banks Deposit & Advances Rates



Board of Directors

CHAIRMAN

MR RIENZIE T WIJETILLEKE

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

Managing Director & Chief Executive Officer since 1988.

Appointed Chairman in March 2004 and has stepped down from the position of Chief Executive Officer with effect from 15th December 2004. Over forty-four years in banking including overseas assignments.
Director – Colombo Stock Exchange, Chairman- HNB Assurance Ltd, Chairman – HNB Stockbrokers (Pvt) Ltd,
Chairman- HNB Securities Ltd, Chairman- Sithma Development (Pvt) Ltd, Director- DFCC Bank,
Director – Nawaloka Hospitals Ltd, Board Member – Asian Bankers Association.

DEPUTY CHAIRMAN

DR V P VITTACHI

B.Com. (London) Ph.D.

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

DIRECTOR

MR D H S JAYAWARDENA

Director since 1988. Past Chairman- Air Lanka, the National Carrier,
Managing Director and Chief Executive Officer – Distilleries Company of Sri Lanka Ltd,
Managing Director and Chief Executive Officer- Lanka Milk Foods (CWE) Ltd, two large manufacturing organizations.
Managing Director and Chief Executive Officer – Stassen Group of Companies, a widely diversified Group with interest in import and export trade.
Director- Colombo Stock Exchange, Managing Director of Balangoda and Madulsima Plantations Ltd,
Chairman – Aitken Spence & Co Ltd and Sri Lanka Insurance Corporation Ltd, Consul General for Denmark in Sri Lanka,
Director – Board of Investment of Sri Lanka, Member of the Board of Management of the National Council for Economic Development,
Senior Advisor to Her Excellency the President of Sri Lanka on International Trade and Investment.

DIRECTOR

MR M V THEAGARAJAH

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

Associated with the Bank since its incorporation. Director since 1979.
Formerly Deputy Chairman and now Chairman – Browns Group of Companies since March 2004.
Browns Group of Companies is a highly diversified Group with interests in Engineering, Trading, Manufacturing, Hoteliering and Tourism.
Over forty years experience in Commerce, Industry, Finance and Marketing.

DIRECTOR

MR R K OBEYSEKERE

Director since 1998. Director- Stassen Group of Companies, Deputy Chairman – Sri Lanka Insurance Corporation Ltd,
Director – Madulsima Plantations Ltd, Director – Balangoda Plantations Ltd and Director – Lanka Dairies (Pvt) Ltd.

DIRECTOR

MRS PAMELA C COORAY

LL. B. (Ceylon)

Appointed Director in April 2004. Director – Board of Investment of Sri Lanka. Director- Associated Battery Manufacturers (Ceylon) Ltd

DIRECTOR

MR RATNA SIVARATNAM

Appointed Director in December 2004. Former Chairman and Managing Director – Aitken Spence Group of Companies,
Past Chairman- Employers Federation of Sri Lanka, Executive Committee Member – Ceylon Chamber of Commerce,
Past President – Association of Group Tour Agencies, Past Vice President – Ceylon Tourist Hotels Association,
Past Vice President – Travel Agents Association of Sri Lanka, Former Chairman - Steering Committee of the Airports and Port Development,
Former Executive Chairman – Sri Lanka Export Development Board, Hony Consul General for Finland in Sri Lanka.

GENERAL MANAGER/ CHIEF EXECUTIVE OFFICER /DIRECTOR

MR RAJENDRA THEAGARAJAH

FCMA (UK) FCA (Sri Lanka) MBA (Cranfield)

Appointed Director/General Manager/ Chief Executive Officer in December 2004.
Member of the Corporate Management of HNB since 1997. Director- HNB Securities Ltd,
Director – HNB Stockbrokers (Pvt) Ltd, Director - Sithma Development (Pvt) Ltd, Director - HNB Assurance Ltd.

BOARD SECRETARY

MS I GOONESEKERA

Board of Directors



SEATED FROM LEFT TO RIGHT

MRS PAMELA C COORAY - DIRECTOR

DR V PVITTACHI - DEPUTY CHAIRMAN

MR RIENZIE T WIJETILLEKE - CHAIRMAN

MR D H S JAYAWARDENA - DIRECTOR

STANDING FROM LEFT TO RIGHT

MR RATNA SIVARATNAM - DIRECTOR

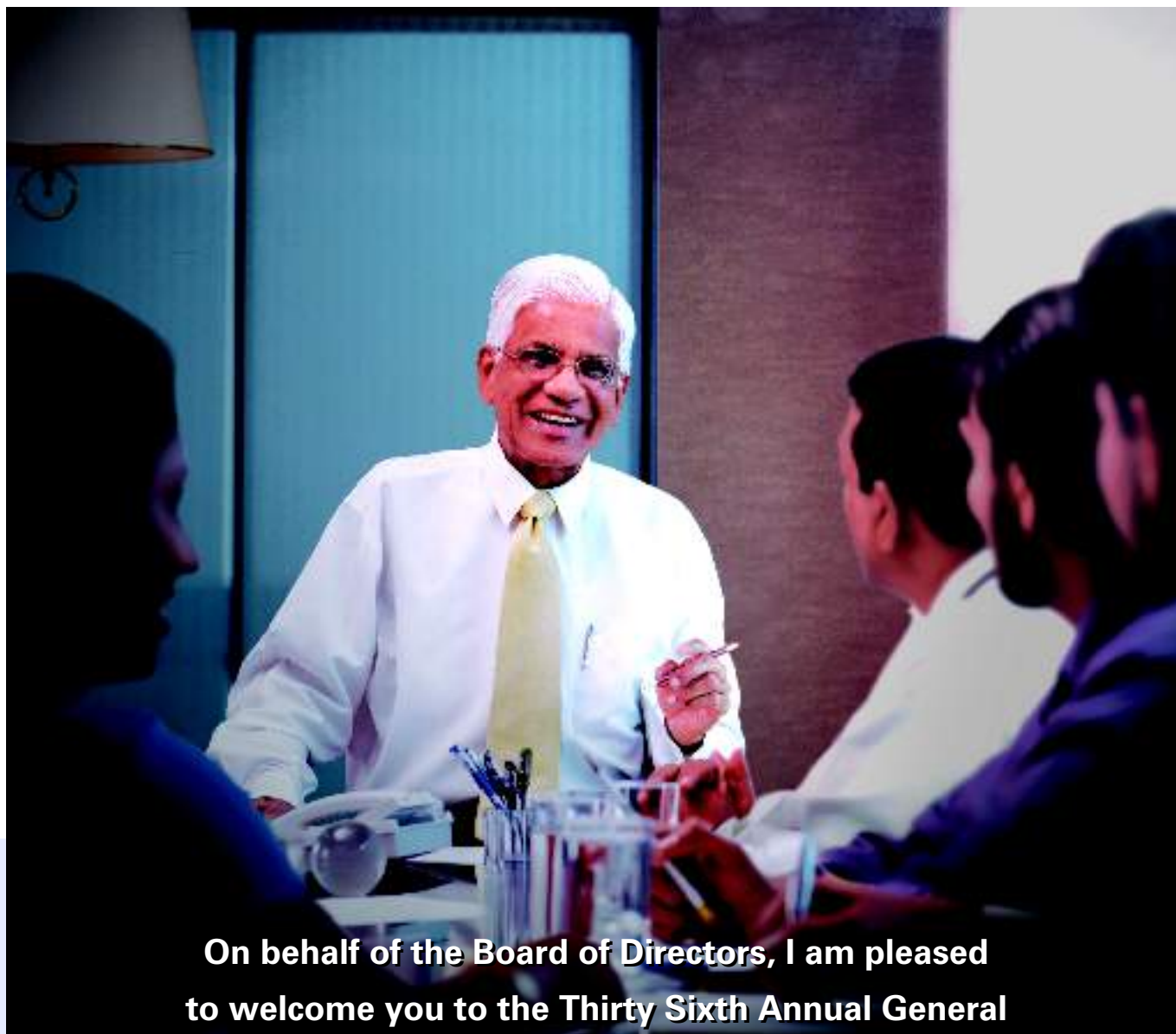
MR R K OBEYESEKERE - DIRECTOR

MR RAJENDRA THEAGARAJAH - GENERAL MANAGER/CHIEF EXECUTIVE OFFICER /DIRECTOR

MR MV THEAGARAJAH - DIRECTOR

MS I GOONESEKERA - BOARD SECRETARY

Chairman's Statement



On behalf of the Board of Directors, I am pleased to welcome you to the Thirty Sixth Annual General Meeting. As Chairman, I am privileged to present to our shareholders the Annual Report and Accounts of our Bank for the year 2004.

Before I commence my formal statement, it is with a deep sense of sorrow that I have to refer to the sudden demise of Mr. J Chrisantha R Cooray on 11th March 2004.

Mr. Cooray (F.C.M.A., M.I Mgt.) was appointed Director / Chairman of the Board of Directors in February 1989 which positions he held until his death. As Chairman of the Bank for over a period of 15 years, he made an invaluable

contribution towards its growth. During his tenure of office the assets of the Bank grew from Rs. 4 Bn to Rs. 133 Bn, profits increased from Rs. 52 Mn to over Rs. 1 Bn and the branch network expanded from 33 to nearly 140.

His strong and committed leadership enabled the Bank to achieve the position of being the largest private sector commercial bank in the country. Mr. Cooray possessed great

Chairman's Statement



analytical skills and innovative ideas, which he imparted to the top management of the Bank. Under his stewardship, the Bank was highly focused not only on its own growth but also extending maximum benefits to all its stakeholders. Mr. Cooray always conducted himself with great dignity and commanded the highest respect from not only the business community but also all leaders and society as a whole. The magnificent building, HNB Towers - a monument to his efforts will stand tall for generations.

There is no doubt that his sudden demise is a great loss to all of us at HNB.

Financial Performance

During the year under review, the Bank recorded a pre-tax profit of Rs. 950 Mn. and its post-tax profit reached Rs. 976 Mn. In the group accounts, the HNB Group achieved a pre tax profit of Rs. 832 Mn. and a post tax profit (after minority interest) of Rs. 756 Mn. During the year, the Bank made provisions for bad and doubtful debt amounting Rs. 1.57 Bn, equivalent to 165% of its pre tax profits. This is in comparison to Rs 1.72 Bn. provision for bad and doubtful debt made in 2003.

As in previous years, increase in the net interest income (NII) was the main factor behind the growth in Bank's core revenue. Although the interest received on advances and interest paid on deposits were reduced due to the general decline in market rates, the NII showed a satisfactory improvement.

Unlike in the previous year, the Bank's other income recorded a notable decline largely due to a reduction in the Treasury Income. In a stagnant interest rate environment, opportunities for trading in Government Bonds was limited

and therefore HNB Treasury was not able to produce the same level of profitability in 2004 compared to the previous year. The same reason caused a sharp reduction in profits made by the Bank's primary dealing arm- HNB Securities Limited, which is reflected in the Group results.

Global and Local Economic Environment

The growth momentum experienced in the world's largest economies continued into 2004, with US, China and the UK leading the way. China's economy continued to display impressive progress, spurring growth in other Asian economies - which are now increasingly dependent on trade with this economic giant.

However, the robust growth in the US economy – largely a result of enormous fiscal and monetary stimulus given during the preceding period, began to proliferate inflation, which resulted in the US Federal Reserve commencing a monetary tightening cycle towards the third quarter of the year. This process culminated in the US benchmark rates doubling from the levels that existed before, halting the surge in consumer demand and asset price inflation. The rise in inflation also prompted other Central Banks, notably the Bank of England to raise interest rates during the year. The global economy also had to come to terms with fuel prices rising to unprecedented levels. Although the oil price hike did not have a discernible impact on larger economies, it did have an effect on many smaller countries including Sri Lanka.

Sri Lanka's economy showed signs of sustaining itself with the economy posting over 5% growth during the year, mainly due to the continued peaceful environment in the country. The early part of the year was characterized by political uncertainty leading up to the general election in April. The new administration advocated people-friendly strategies, which were markedly different to the more serious growth-oriented policies of the previous regime.

Whilst appreciating the need for extending relief to the people through such policies, we believe that a concerted effort is necessary to continue economic reforms and the deregulation process, if we are to achieve significant progress in long-term economic prosperity and poverty reduction.

Although the external environment remained very conducive to an export led growth, the country was not in a position to capitalize on this situation owing to continued high oil prices and uncertainty in the political scene. High oil prices resulted in higher cost of production for domestic businesses and it also led to a sharp increase in cost of living and a deterioration of real wages. The country's Balance of Payments was under

Chairman's Statement

considerable pressure with foreign reserves coming down to precariously low levels. However, continued buoyancy in the tourism sector as well as an increase in remittances and steady prices for primary exports, helped ward off a BOP crisis.

The Central Bank of Sri Lanka maintained its key benchmark rates despite inflationary pressures. This, coupled with extensive intervention by the government in the primary debt market, kept a tab on interest rates, resulting in most money market instruments yielding negative real returns. Under pressure of mounting inflation, the CBSL finally raised interest rates in November.

As the year was drawing to a close and the country was poised to enter the New Year with much hope and expectations, the Tsunami disaster on the 26th of December caused widespread destruction and death to thousands of people living in the Northern, Eastern and Southern coastal belts of the country. The damage to infrastructure and property is estimated to be well over US \$ 1 Bn. The manner in which the whole world turned to support our country amidst all this destruction gave us much hope. The empathy felt by the world community for the victims of the Tsunami disaster and the magnificent generosity shown by them to the rehabilitation and reconstruction of the devastated areas have given us new hope that the year 2005 and beyond, will see a transformation of our country, provided the authorities manage the exercise of reconstruction in an efficient manner.

Our Strategy

During the year, the Bank continued to work on its medium term business plan, drawn in the previous year. The main factors of the plan were the restructuring and reorganization of core functional areas, setting up of effective credit delivery and credit monitoring facilities, further outsourcing of non-core activities, enhancing customer services and delivery channels and the development of important ancillary functions to support core activities (e.g. Economic Research and Business Development Units).

With the demise of our late Chairman in March, your Board entrusted the responsibilities of the Chairmanship to me and I functioned in the twin capacity of Chairman and CEO.

In December, in the interests of better Corporate Governance, where the roles of Chairman and CEO should be separate, the Board unanimously decided to appoint Mr. Rajendra Theagarajah as General Manager/Chief Executive Officer/Director of the Bank. Mr Rajendra Theagarajah received his primary and secondary education at Royal College, Colombo.

An alumnus of Price Waterhouse Coopers, Sri Lanka, he is a Fellow Member of the Institute of Chartered Accountants of Sri Lanka and Chartered Institute of Management Accountants, U.K. Having obtained his MBA from the Cranfield Business School in the U.K., Mr Theagarajah joined the Chase Manhattan Bank (now known as J P Morgan Chase) in London and worked in General Auditing, Global Custody, Area Operations and Systems Departments with extensive exposure to the Bank's branches in Europe, Middle East and the North African Region. He returned to Sri Lanka in 1992 and joined Banque Indosuez (now known as CALYON) Colombo branch and served as the Deputy General Manager until the Bank was acquired in 1997 by Hatton National Bank. As a member of HNB's Corporate Management team since 1997, he served as Head of its City Office, International and Corporate Finance Divisions while also serving as a Director of HNB Stockbrokers (Pvt) Limited, HNB Assurance Limited, HNB Securities Limited, Sithma Development (Pvt) Limited and Smart Development (Pvt) Limited.

With a view to enforcing a discernible line of control over various strategies encompassed into the Bank's business plan and to facilitate better implementation, the Board decided to appoint Mr. Nihal Kekulawela (up to that time Senior Deputy General Manager -Strategic Development and Planning) in August 2004 as the Bank's Chief Financial Officer.

As our late Chairman indicated in the last Year's Annual Report, one of the key challenges faced by the Bank in the short to medium term was the impact of capital adequacy - to have an adequate level of capitalization to support Balance Sheet Growth. During 2004, the Bank undertook a major capital raising exercise through a Rights Issue of both voting and non-voting shares. This brought in close to Rs 1.4 Bn in new equity, which helped to strengthen Bank's core capital.

However, due to a ruling given by the Central Bank of Sri Lanka, our investments of Rs. 900 Mn in the property development subsidiary Sithma Development (Pvt) Ltd., and approximately Rs. 147 Mn in the proposed Employees Share Option Scheme (ESOP) have to be directly deducted from the capital base of the Bank prior to calculation of Capital Adequacy as at end of the year. The benefits derived from the Rights Issue will therefore be neutralized to a great extent as a result of the above deductions.

As in previous year, the Bank maintained its focus on consumer lending, realizing its potential in an expanding economy and in a low interest rate regime. Whilst pursuing balance sheet growth, the Bank also strengthened its Risk Management function with the appointment of Zonal Risk

Chairman's Statement

Management Officers reporting to the DGM (Corporate Relationships & Risk Management). Prudential risk management and risk monitoring resulted in improved asset quality in the Bank's portfolio.

During the year, the Bank also concentrated on deriving more income through its subsidiaries. The bank appointed a senior officer of the Bank, specifically to derive greater income through subsidiary activities such as Insurance, Stock brokering and primary dealing.

Future Outlook

As the country gradually gets over its worst ever natural disaster, there appears to be HOPE amidst all this destruction. The manner in which the world community as well as the Sri Lankans reached towards those affected with immediate assistance, gave us HOPE. The magnificent generosity shown by the community of nations in the form of definite material assistance in providing not only emergency aid but also assistance to rebuild the infrastructure, gives us HOPE. We strongly believe that the disaster we all faced as a nation, has united its people and placed us on a path of rapid economic progress, which now hopefully lies in the hands of our leaders. We sincerely trust that this situation will not once again be transformed into a crisis. We have an extremely good chance to turn the crisis into an opportunity, which this country desperately needs after decades full of disputes.

The Bank as a responsible Corporate Citizen will play an integral part in the post disaster recovery process. As the first step, we have identified all our customers in the devastated areas who have been directly and indirectly affected and we will offer them quick assistance to revive their normal livelihoods. The Bank will also take an active interest in the reconstruction and rehabilitation process and through our network of branches in the affected areas we will play a strong intermediary role in restoring normality in the regions.

The bank will continue to work on its Business Plan, implementing strategies drawn up, monitoring results and re-formulating strategies, where necessary. The Bank's capital structure will be further enhanced in the New Year, with the inflow of the GDR proceeds during the first quarter of 2005. The Bank will also continue to work on its balance sheet consolidation process aimed at improving Capital Adequacy as well as the ROA. The bank will continue to lay emphasis on Risk Management aimed at further enhancing the asset quality.

The Bank will also make concerted efforts to derive greater ancillary income through synergies with its subsidiaries. We will also be looking at strengthening our overseas operations

and in particular, converting our existing Representative Office in India into a branch.

With the advent of a new management structure, the Bank will be focusing on its core competencies and enhancing its competitiveness. The Bank will also pay considerable attention to its Human Capital, continually developing and training staff as well retaining key staff, which is crucial to the Bank's long-term progress and success.

Appreciations

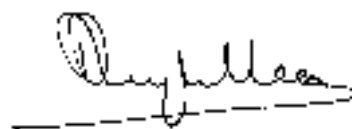
I wish to express my deep appreciation of the support and guidance that I received from the Board of Directors and the excellent co-operation extended to me by my colleagues in the corporate management, senior management and staff at all levels, particularly during the period that I played the dual role of Chairman/Managing Director.

On behalf of the Board and the Management, I also wish to thank our shareholders who generously contributed towards the Rights Issue. My thanks also go out to our loyal clientele who continue to maintain their relationship with us despite strong pressure from our competitors.

I take this opportunity to thank the Minister of Finance, the Hon Sarath Amunugama and the officials of the Ministry of Finance, the Governor of the Central Bank of Sri Lanka, Mr. Sunil Mendis and all his officials, particularly the Director of Bank Supervision for their guidance and continued support during 2004.

Finally, I wish to thank all our shareholders for the confidence and trust placed in the Bank.

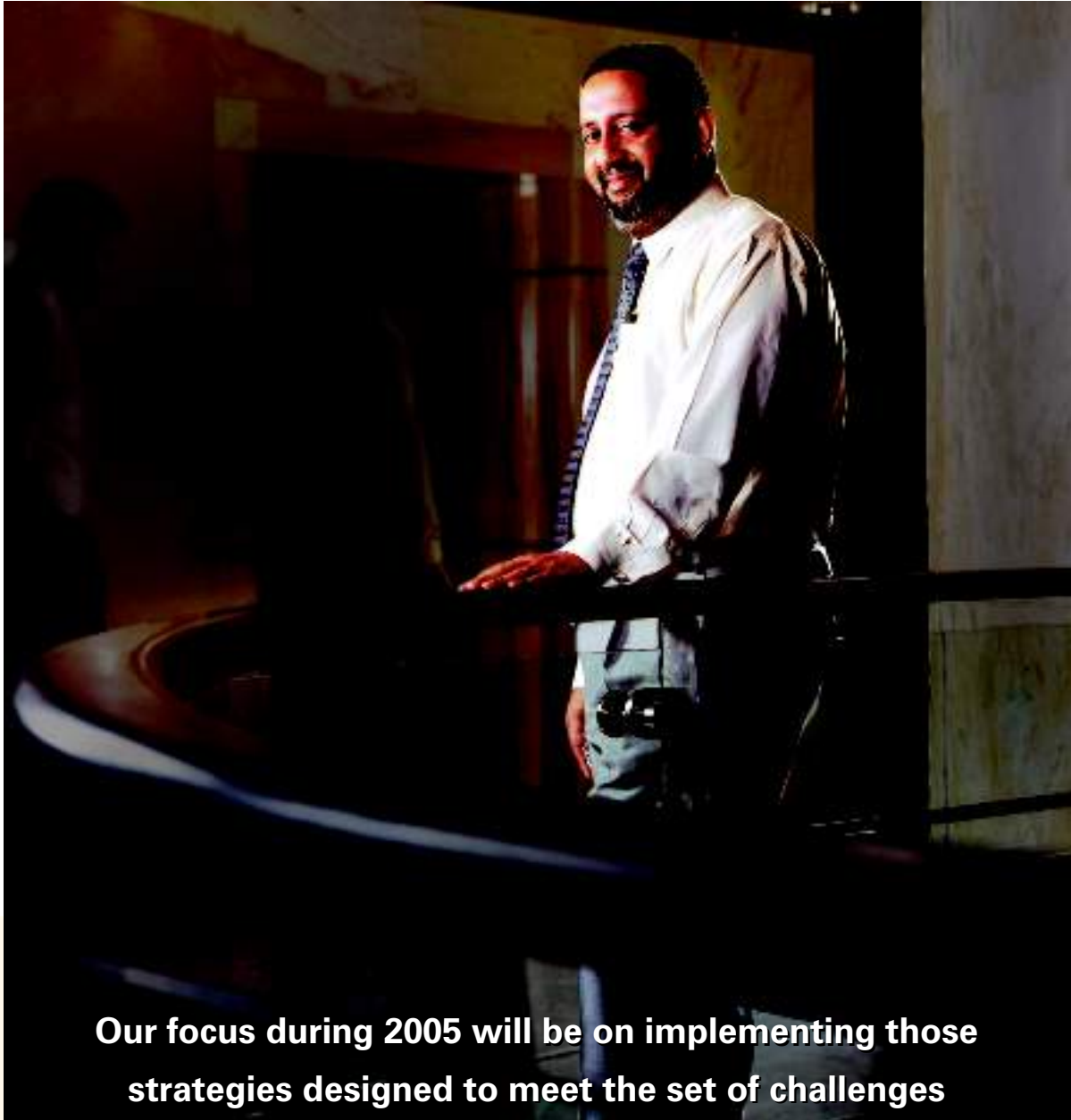
I pledge that through prudent management, the Board of Directors will continue to create value for all stakeholders and I thank everybody very sincerely for the continued patronage and confidence in our organization.



RIENZIE T WIJETILLEKE

Friday, February 18th, 2005.
Colombo, SRI LANKA

..... Chief Executive Officer's Review of Operations



Our focus during 2005 will be on implementing those strategies designed to meet the set of challenges we have identified as critical for delivering superior value to our stakeholders in a consistent manner.

Financial Performance

The year 2004 was somewhat of a mixed year for the Sri Lankan Economy. The 5% economic growth could have been higher if not for the uncertainty that prevailed throughout the year both on account of local political

developments and impasse in the peace process. Significant increases in international crude oil prices constantly challenged domestic stability. Excessive intervention by the government in the domestic money markets resulted in negative real interest rates prevailing throughout most of the year (due to nominal interest rates not adjusting for rising inflation). This

Chief Executive Officer's Review of Operations

made deposit mobilization, a considerable challenge for banks. The tsunami disaster, which occurred in December 2004, shocked the nation but also brought the international community to its rescue. This latter development resulted in a positive outlook for the country in 2005.

In 2004, the bank posted a pre tax profit of Rs.950 Mn, compared to Rs.1,092 Mn made in the year 2003. The post tax profit was Rs.976 Mn compared to Rs.1,008 Mn made in the previous year. As a group, HNB recorded a Rs.832 Mn pre tax profit, compared to Rs.1,731 Mn made during the year 2003. Similarly, in post tax profits, HNB group made Rs.756 Mn (after minority interest) compared to Rs.1,500 Mn made during the previous year. The results reflected a 13% decline in pre tax profits and a 3% decline in post tax profits for the bank. In the group accounts the above results reflected a 52% decline in pre tax profits and a 50% decline in post tax profits.

As expected at the outset, the profitability of the bank was considerably affected by the large provisions the bank had to make on account of Non Performing loans. The tsunami disaster also had an impact on some of bank's constituents in the affected areas. The bank made an additional specific provision of Rs.60 Mn for possible loan losses and collateral damage on account of the affected constituents.

Income

The bank's primary source of income, its interest income showed a 0.6% decline during the year. However, bank's interest expenses showed a larger decline of 13.7%. The net effect was a substantial 19% increase in net interest income. Further, the bank's foreign exchange and commission income posted growths of 31% and 22% respectively. Growth in foreign exchange income was largely due to the increased rate of depreciation of the Sri Lanka Rupee while continued focus on fee based activities contributed to an increased in commission income. The

bank's other income, however, posted a substantial decline largely owing to a significant drop in bond trading income. The static interest rates experienced in the country and the rise in US and UK interest rates were largely accountable for this depressed performance.

Operational Expenses

Total operational expenses of the bank rose by 14%, mainly due to the increase in other overhead expenses. A 43% increase in the latter was largely due to the increase in the applicable VAT rate for banks (on staff emoluments & net profits) from 10% to 15% and the impact of rising inflation on bank's consumables.

During the year, the bank had good control over its staff related expenditure. Staff costs increased by a modest 3% during the year while the bank's staff cadre remained fairly stable at 4180.

Due to the larger increase in operational expenses over net income, the cost to income ratio (CIR) of the bank increased to 70% from 63% in 2003.

Deposits

During the year, the bank's total deposit base increased by 17%. All categories of Rupee interest bearing deposits (i.e. savings and time deposits) showed satisfactory increases despite the prevalence of low interest rates, and real returns being negative. The bank's NRFC base reflected a 12% growth as interest rates on most foreign currencies rose during the year. The bank's demand deposit base continued to grow strongly reflecting a 23% growth over the previous year.

Advances

The bank's advances portfolio reflected a 18% growth during the year. As in the previous year, growth in the advances base was mainly supported by the growth in Consumer

Chief Executive Officer's Review of Operations

lending. Prevalence of low interest rates was particularly conducive for the promotion of consumer lending. The Housing portfolio sustained its growth momentum, reflecting an increase of 37% during the year. Despite intensive competition from peer banks and other institutions, the bank's pawning portfolio reflected a substantial 44% growth during the year.

Whilst growing its loan book through the consumer arm, the bank also maintained its focus on Corporate Lending with the year seeing a number of landmark facilities disbursed to reputed corporate entities. Under its Business Plan, the bank is placing concerted focus on this sector through active relationship management and through the provision of value added solutions.

The bank continued to place emphasis on effective Credit Risk Management as well as continually monitoring the growth in advances in relation to Capital Adequacy. During the year, the bank strengthened its Risk Management Function with the appointment of Zonal Level Risk Managers reporting to the DGM - Corporate Relationships & Risk Management. Three senior officers of the bank, assumed duties as the Head of Risk Management in each of the bank's three Zones from January 2004.

Provisions

During the year, bank's total provision for bad debts amounted to Rs.1.56 Bn, compared to Rs.1.72 Bn made in 2003. This also includes the Rs.0.5 Bn provision on account of FCBU advances. The bank's NPA cover as at end 2004 improved to 55%, from 34% as at end 2003 while the NPA ratio also improved from 13.7% (in 2003) to 9.7%.

Capital Adequacy

The bank's capital adequacy ratio as at end of year 2004, stood at 11.3%. This figure was arrived at after consolidating the assets of the DBU and the FCBU. The statutory requirement on Capital Adequacy (on a consolidated basis) for the year was 10%. The bank received a much needed capital infusion during the year, with the successful completion of a Rights Issue towards the 3rd quarter of the year. The Rights Issues brought in Rs.1.4 Bn to strengthen the tier 1 capital. However, the bank had to make provisions for its second tranche of investment in its Property Development subsidiary - Sithma Development (Pvt) Ltd. amounting to Rs.900 Mn and its investment in the ESOP fund, amounting to Rs.147 Mn. against its capital funds as directed by the Central Bank of Sri Lanka.

Regulatory Environment

During the year, the government brought in a landmark legislation abolishing the controversial 'tax amnesty' granted by the previous administration. The amending legislation also removed the tax concessions hitherto applicable to bond trading income with retrospective effect from 2002 (later amended to 2003). This would have an impact on the bank and its securities dealing subsidiary - HNB Securities, in the years to come.

The new government's maiden budget had a number of concessions towards the development of domestic capital markets and the measure brought to remove the tax on equity trading gains was particularly encouraging. The bank, which is an active player in the local bourse through its equity trading portfolio would benefit from this measure.

As in the previous years, the bank maintained vigilance over Corporate Governance Issues as well as complying with strict Anti Money Laundering measures advocated by the regulatory authorities. The bank also closely liaised with the newly established Banking Ombudsman, in bringing about satisfactory resolution in a number of issues involving the bank's customers.

Chief Executive Officer's Review of Operations

The Future

The unfortunate disaster of 26th December, 2004 caused significant devastation to many parts of Sri Lanka. We recognize that this could have a short term impact on business, but remain confident of the country's ability to translate international sentiment and relief measures into positive economic value addition. We are committed to taking an active part in the reconstruction and rehabilitation process through our wide distribution network and in depth knowledge of the rural economy. **Our focus during 2005 will be on implementing those strategies designed to meet the set of challenges we have identified as critical for delivering superior value to our stakeholders in a consistent manner.**

Having recognized that competition would apply constant pressure on corporate margins, we intend defending our overall net interest margin expectation by strategically growing the consumer banking business. While the Customer Centre network would be enhanced with new centres identified for 2005, our main aim would be to spearhead an ATM led growth strategy which would encompass a combination of pricing, product redefinition and delivery.

The last quarter of 2004 saw the bank raise approximately 60% of the planned capital for its tier 1 enhancement. We would continue our drive to mobilize the balance 40% during 2005 and further strengthen the capital base by enhancing tier 2 capital by way of long term subordinated debt.

Our group structure is already in place to take advantage of increased integration in the financial services sector. Our wholly owned subsidiaries in stock broking and fixed income securities will continue adding value to our customer pool. The insurance industry is expected to reap the benefits of increased penetration rates and potential cross selling opportunities that would contribute towards enhancing the share of non interest income.

We would continue leveraging on Information Technology as a strategic differentiator. Key deliverables in 2005 would be the implementation of HNB's own Payment Gateway and continuation with the migration of our customer centers to benefit from the Globus T 24 core banking solution with a 24 x 7 capability. The 24 x 7 operating capability would also enable us to re-launch Telebanking and Internet banking solutions to their true capabilities.

Return on Assets at approximately 0.7% is one of the lowest among peer group local private sector commercial banks. We will vigorously ensure that balance sheet growth is not achieved at the expense of profitability. At the same time, the bank's balance sheet will be further analysed and appropriate strategies adopted to improve asset yield.

The bank would continue paying close attention to its Human Resources by recruiting, training, developing and retaining a quality pool of human talent. The Employee Share Option scheme would be launched in 2005 with the objective of developing a highly motivated and contended workforce which would have the opportunity of being rewarded by adopting a performance oriented culture.

My fellow members of staff and management team have worked as one family in delivering very satisfactory results during the year. I wish to convey my sincere appreciation to all of them and look forward to realizing our business plan through their collective efforts.

The guidance received from my Chairman and colleagues on the Board has been invaluable. I wish to convey my deep gratitude and look forward to their continued support.



RAJENDRA THEAGARAJAH

Friday, February 18th, 2005.
Colombo, SRI LANKA

Business Review

The continued peaceful conditions in the country maintained a conducive environment for the promotion of bank's business. Following on from the previous year, the bank pursued action under its Business Plan, and implemented strategies that were earmarked for the year. It also had the opportunity of reviewing the results of some of the strategies implemented in the previous year.

Corporate Banking

During the year under review, the bank's Corporate Banking portfolio grew by 16%, which was in line with our projections. The bank's Corporate banking business constituted approximately 67% of the total advances portfolio and the contribution of the division to the overall profitability of the Bank was maintained at a satisfactory level despite pressure on margins and the increased competition in the market. During the year, the division expanded facilities to the construction, telecommunication, health and leisure sectors, while inroads were also made into new areas such as securitisation.

We continue to recognise that relationships are a Critical Success Factor in Corporate Banking. Whilst being conscious of this fact and building on our existing strengths, we are mindful that the corporate sector is constantly in search of new financial solutions, which we as a Bank remain committed to provide.

Project Finance

With the internal restructuring process effected in the latter part of 2003, Project Division was placed under the purview of the Corporate Banking Division. The division directly handles all project proposals over Rs. 10.0 Mn and provides a total package consisting of medium to long term loans for capital investments as well as working capital for large industrial enterprises and infrastructure projects.

The total portfolio of the Project Division as at 31st December 2004 was Rs. 5.32 Bn. The Division has aligned its activities with Corporate Social Responsibility by taking part in Energy Services Delivery (ESD) and Renewable Energy for Rural Economic Development (RERED) projects of the World Bank. Under these programs, the bank financed 16 Mini Hydropower Projects and 50 Off Grid community-based Village Hydropower Projects. The latter has provided electricity to over 2000 village households, which hitherto had no access to electricity. The bank's Off Grid Village Hydropower financing scheme received a Runners-up Award in the Development Project Financing category at the Asian Banking Awards 2004.

Personal Banking

Deposit Mobilisation

Introduction of the Bank's New Corporate Identity was followed by a focussed promotional effort to create awareness, and enhance the bank's Customer Base. The promotional campaign covered core Personal Banking products such as Pathum Vimana, Singithi, Shanthi Housing Loans, Leasing, Pawning and Credit Cards. During the year, the bank's Rupee savings base grew by Rs 5.6Bn. Several Promotional campaigns were carried out during the year, to market the bank's Minor Savings product. These included a Special Promotion with the "Muralitharan Gunesekera Foundation" where Exercise books with inspirational pictures and messages of the cricketing legend, Muttiah Muralidaran were gifted to school children.

Further identifying the most pressing needs of the elderly, "HNB Senior Citizens' Scheme" was re-launched during the year, with a higher interest rate and with the added benefit of Free Health Insurance cover up to the age of 70 years - a first in the Industry.

Strategy of the bank was to consolidate its position in the market by offering value additions to our major brands and thereby capturing various niche markets.

Consumer Banking

The Consumer Banking loan portfolio consists of the bank's Shanthi Housing Loans, Pawning, Subasiri Personal Loan scheme, Consumer Loans and Consumer Lease facilities.

Continued promotional activities and effective marketing resulted in the bank's Consumer Loan Portfolio increasing by 32% during the year.

The 'Hatna - U' loan processing system and the 'Recos' loan recovery and follow up systems were fully implemented during the year. This is expected to improve the delivery time and facilitate efficient monitoring of the Personal Banking credit portfolio. Further, by out sourcing part of the recovery process, the bank managed to achieve processing efficiency and cost saving.

Development Banking

Development Banking division consists of Rural Credit & Gami Pubuduwa units engaged in providing financial assistance to the Agriculture Sector, Micro Industries and the self employment sector.

Bank's Rural Credit schemes achieved a 30% growth during the year. As at end 2004, Bank's Rural Credit portfolio stood

Business Review

at Rs 1.59 Bn with a client base of 14,500. New loans to the value of Rs.775 Mn were disbursed during the year, which constituted 7,700 new facilities. Over 60% of these facilities were refinance backed and interest subsidized by the Central Bank of Sri Lanka (CBSL) and other institutions.

Bank's flagship Gami Pubuduwa (GP) scheme completed 15 years of dedicated service to the rural community of the country. The GP scheme achieved a 36% growth during the year and has maintained a recovery ratio of over 94%.

Credit Cards

The credit card business continued to record a satisfactory growth in all areas of operation. During the year, the Card Issuance increased by 28% while transaction volume increased by 38%. Bank's Acquiring Business also recorded a substantial growth of 56%.

The growth in card numbers and usage were largely attributable to the "Royalty 2004" - the Credit Card Loyalty programme of the bank. The Bank also had various tie-ups with prominent merchants and Airlines, which extended exclusive offers to HNB cardholders.

During the year, the bank introduced the 'SMS alert' system whereby transactions performed are instantly alerted to the cardholder's mobile phone together with the available balance on the Credit Card. HNB was the first bank to introduce this feature in Sri Lanka, which helped to minimize Credit Card frauds

Treasury and International Operations

Treasury Operations

HNB treasury maintained its position as a major player in the local Foreign exchange market, posting a near 25% growth from last year. During the year, the Treasury continued its campaign to increase its market share from corporate clients, through improved customer service and development of new products.

The Bank was able to structure the largest interest rate swap/derivatives transaction in Sri Lanka, to date, for USD.36.5Mn with a local Independent Power Producer.

The Bank also continued to maintain its prominent role as a currency notes exporter, in the country, exporting US\$ 85 Mn in currency notes during the year.

International Operations

Centralization of the back office functions of Trade Services Units at branches enabled the branch network to re-deploy

staff and resources to interface with customers more effectively. This also ensured that Trade Services ably supported banks' Corporate Relationship Managers in offering Value Added solutions to Trade Financing requirements of our customers.

The bank was awarded the prestigious ISO 9001:2000 standard certification for its Trade Service operations from BVQI, under the accreditation of the United Kingdom Accreditation Services (UKAS) - a world-renowned body for awarding such certifications.

Import turnover in 2004 recorded an increase of 24%, while export volumes decreased by 15%. During the year there was increased concern over the post-MFA viability of many local garment exporters while many exporters preferred to use direct export channels with buyers using the existing relaxed regulations.

With improved customer focus in mind, a Remittances Centre was set up during the year at our Office at the Galadari Hotel, Colombo, to process cash payout pertaining to specific International Remittance products such as Money Gram and Ez Remit. Inward remittances continued to grow during the year recording a 32% growth.

The bank's two Representative Offices in India and Pakistan continued to play an active role in servicing existing relationships and establishing new ones. The Chennai Office was instrumental in professionally handling negotiations and documentation formalities on behalf of several Sri Lankan companies, enabling them to setup outlets at the Sri Lankan Trade Centre in Chennai and other cities in India as a launching pad for promoting their products in the Indian market.

In keeping abreast with international requirements we have formulated our Anti Money Laundering (AML) and Know Your Customer (KYC) policies using the framework of Financial Action Task Force (FATF) and the draft regulations of the State that are currently being finalised. Regular training programmes were held to educate the staff of AML & KYC policies on an ongoing basis.

We have successfully adapted ourselves to the enhancement in global network capability of Society for Worldwide Inter-bank Financial Telecommunications (SWIFT) and the SWIFT NET system is now fully operational.

Our payment systems and technology today process large value Rupee denominated payments, electronically, on a real time basis under the Real Time Gross Settlement System (RTGS) ensuring a safe, secure and efficient payment mode. Our participation in US\$ clearing locally has been of immense benefit to our customers in terms of reduced realization time for US\$ drafts.

Business Review

Corporate Finance Activities

Corporate Finance activities remained subdued in the Financial Year 2004 as market conditions were not very conducive for large capital market transactions for much of the period under review following elections in the early part of the year and continued uncertainty over the peace process. Growth in the equity market was largely driven by speculative investment in shares by domestic retail investors. Furthermore, with the exception of Lanka IOC, there was a lack of quality IPOs coming to the market as prospective companies adopted a wait and see policy. Some of the key transactions successfully completed by the division during the year were as follows:

- Manager to the Rs. 1,400 million Rights issue by HNB. The issue was oversubscribed on the opening day.
- Lead Bank and Co-Arranger for a Rs. 2,000 million, syndicated credit facility to Celltel Lanka Limited.
- Manager and Arranger for asset backed financing of Rs. 300 million through securitisation of lease receivables for Senkadagala Finance Company Limited.

A notable achievement during the year was the formation of a strategic alliance with Deutsche Bank AG Colombo Branch for Corporate Finance activities in Sri Lanka through a Memorandum of Understanding. The primary objective of this strategic alliance was to enable the bank to offer cross border and international capital raising expertise to Sri Lankan corporates through a range of equity, debt and hybrid products. This relationship is expected to yield benefits in the future.

Information Technology

The year 2004 was a busy one for the Information Technology Division. Emphasis was placed on consolidating the IT Infrastructure of the bank.

HNB, in order to mitigate the threat of unauthorized penetration of its IT Systems, engaged the services of reputed overseas resource personnel to carry out both External and Internal Penetration Tests of its firewalls. The firewalls successfully withstood these penetration tests.

As part of the Bank's IT rollout plan, the migration from Globus G11 to Globus 14 (T24) was carefully planned and executed. This process was preceded by the mandatory migration of the existing 'Universe' database to the jbase database. The initial teething problems of this migration were overcome during a short time period. This major upgrade to the core banking application would enable HNB to progress towards

accommodating all CoBAS branches under the single GLOBUS umbrella. This would provide our customers with a 24-hour, online banking facility, 365 days a year facilitated through a simple core banking application.

Performance of Subsidiaries/Associate Companies

Lanka Ventures Limited

Lanka Ventures Limited (LVL) recorded a pre-tax profit of Rs. 76 million for the year ended 31 March 2004, which represented a 31% increase over the previous year. A tax refund of Rs. 130 million received during the year, which can be regarded as a one-off exceptional item, boosted the post-tax profit. As a result, LVL's post-tax profit for the year increased to Rs. 206 million. This was the highest ever post-tax profit recorded by LVL. In light of the exceptionally high post-tax profit recorded during the year, LVL paid a dividend of 27.5% for the year ended 31 March 2004 which was also the highest ever dividend paid by the company.

LVL's pre-tax profit in the current financial year is considerably higher than in the previous year due to profitable exit from several investments during the year. The provisional accounts upto 31 December 2004 indicated a pre-tax profit of Rs. 104 Mn compared to Rs. 54 Mn in the comparative period last year.

CF Venture Fund Limited

During the year, the bank exited from its investment in CF Venture Fund Limited, disposing off its stake in the Colombo bourse. The bank realised a loss of Rs 43 Mn with the disposal of this investment.

HNB Stock Brokers (Pvt.) Ltd.

The Colombo Stock Exchange (CSE) experienced yet another resounding year with both All Share Price Index (ASPI) and Blue Chip Milanka Price Index (MPI) appreciating considerably. The ASPI gained 444.8 points or 41.9% during the year, while the Milanka Price Index posted a 175.9 points or 9.3% improvement compared to the previous year's close. The market activity was dominated by retail participation, with low valued counters attracting investor attention. In the backdrop of these conditions market recorded an annual turnover of Rs.59 billion, at a daily average of Rs.246 million.

HNB Stock Brokers continued to post excellent results, with the company registering its highest ever transaction volume of Rs.11.9 Billion during the year 2004. A Brokerage Income of Rs.84mn and a net profit of Rs.17.2mn were recorded for the year 2004. The company was ranked among the top three Stock-Brokering companies based on Turnover.

Business Review

HNB Securities Ltd.

The year 2004 was one of the more challenging years for HNB Securities Ltd. Interest rates rose during the early part of the year due to high level of volatility stemming from economic and political factors. The rise in interest rates adversely affected the company in the form of mark to market losses.

However, during the second part of the year, strong intervention in the primary market to arrest the increase in interest rates, saw interest rates stabilizing at lower levels. The company's outstanding inventory was reduced enabling it to realize profits. Total profits earned from the latter development more or less equalled the mark to market losses incurred during the early part of the year.

In addition to the volatile interest rates, the primary dealer industry also saw the introduction of a new retrospective tax. This resulted in primary dealers being asked to pay back taxes from the year 2002, which was later amended to 2003. The dual impact of uncontrolled rise in interest rates during the early part of the year and retrospective taxes resulted in HNB Securities Ltd posting a marginal loss of Rs 13 Mn for the year.

Sithma Development (Pvt.) Ltd & Smart Development (Pvt.) Ltd

Sithma Development (Pvt.) Ltd. (Sithma) and Smart Development (Pvt.) Ltd (Smart) are fully owned subsidiaries of the bank engaged in the activity of property development. Sithma - a BOI Flagship Company, owns the 22-storied HNB Towers, while Smart was the owner of the 7-storied building at 21 Janadhipathi Mawatha, Colombo 1.

As of 31st December 2004, the business of Smart was transferred to Sithma pursuant to a court order and with the approval of the BOI. Sithma issued Rs.160 million in shares to the parent company, HNB, as consideration for the transfer of the assets of Smart. In December 2004, Sithma floated an unquoted debenture of Rs. 2 Billion, with the proceeds going into the settlement of loans at People's bank and HNB, and the reduction of the overdraft facility at HNB.

HNB Towers is presently occupied by HNB as well as several non-group tenants such as WNS Customer Solutions (Pvt) Ltd and MTN Networks (Pvt) Ltd.

The Smart building at Janadhipathi Mawatha is leased out to a Ministry of the government of Sri Lanka.

The acquisition of the assets of Smart by Sithma was effected since both companies were engaged in the business of property development. Merging also gave the benefit of

economies of scale to the merged entity and would facilitate the ease of bookkeeping and maintenance of the buildings as one entity.

HNB Assurance Ltd

HNB Assurance was able to maintain its growth momentum during the year 2004 in respect of both general and life insurance business. The general insurance premium income grew by 39% over the last year to record Rs.338.7 million while the life insurance premium income grew by 97% to reach Rs.205.9 million. At the end of 2004, HNB Assurance was able to climb up one notch to sixth position in terms of general insurance market share while it remained in the seventh place in terms of life insurance market share.

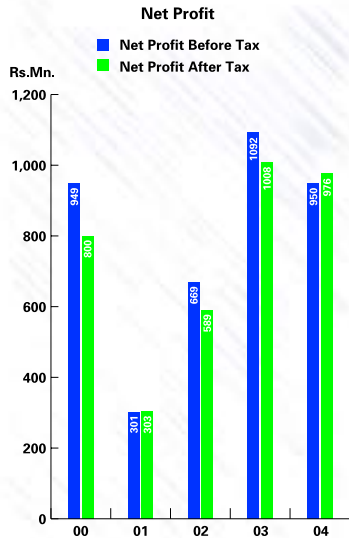
Profitability for the year was significantly affected due to the December 2004 Tsunami disaster, which resulted in an additional net claims cost (including provisions) of Rs.25.1 million. With this, the net result for the year was a profit before tax of Rs.17.1 million and a profit after tax of Rs.16.4 million. The latter was 54% reduction compared to the profit after tax of Rs.35.8 million recorded in the previous year. Had it not been for this unfortunate natural disaster, the profit after tax of the company would have been Rs.41.5 million, which would have exceeded last year's profit after tax by a healthy 16%.

While business generated through the branch network of HNB continued to account for a major share of the company's premium income, it's relative share dropped due to the planned growth of other distribution channels such as tied agents, brokers and direct sales. During the year, the company expanded its own branch network by opening a new Regional Development Centre in Trincomalee and setting up Customer Centres at Moneragala and Colombo. The total number of insurance advisors attached to the branch network as at end 2004 exceeded 1000.

A significant step taken during the year to strengthen company's technical capabilities crystallised with the finalisation of a strategic alliance with ICICI Prudential Life Insurance Company Ltd. - India's largest private sector life insurance company. Through this alliance, ICICI Prudential will offer technical assistance to HNB Assurance to develop its life insurance business.

The Company recently formulated a 3 year corporate plan through a formal strategic planning process and expects to become a leading player in the insurance market by end-2007 through the implementation of this plan from the beginning of 2005.

Financial Review

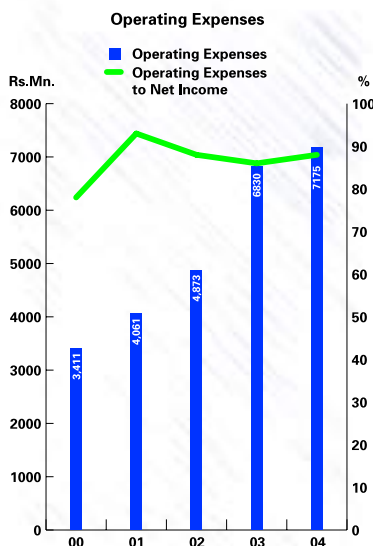
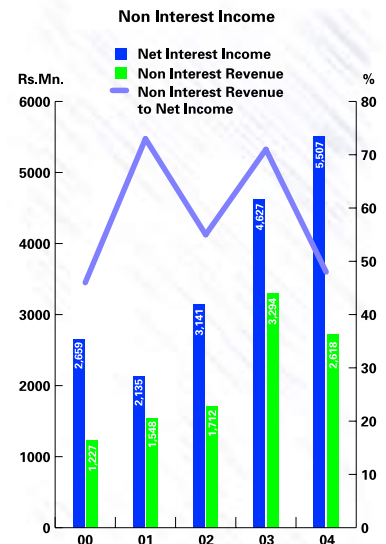


Net Profit Before and After Tax

Reduction in bond income in a stagnant interest environment and adverse inflationary trends impacted the profitability of the Bank recording a net profit before tax of Rs. 950Mn. a decline of 13% over the corresponding year's Rs. 1,092Mn. A commendable growth of 19% in net interest income coupled with appreciative gains from exchange and fees/commission income contained the adverse impact to profit before tax which was arrived after a specific provision of Rs.60Mn for Tsunami affected loans. Bank's strategy in realigning the core business was positively reflected in the gains recorded from the above two vital sources. Sustained benefits from taxation enjoyed by the Bank continued in the year 2004 too, to reap maximum benefits particularly from Leasing business. Decreasing trends in investment of fixed assets over the years along with recent rate reduction in capital allowances for fixed assets contributed to a reversal in deferred tax charge for the year. Consequently Net profit after tax was improved to Rs.976.3 Mn. representing a moderate decline of 3% over corresponding year's Rs.1,008Mn.

Non Interest Income

Stagnant interest rates during the year had a direct impact on bond income. Consequently non interest income recorded a negative growth of 21% against the previous year. Capital gains from trading on Government of Sri Lanka Treasury Bills & Bonds reduced from previous years Rs.870 Mn to Rs.90 Mn in 2004. This coupled with loss on silver/gold trading of Rs.228 Mn accounted for the drop in non interest income. Excluding these, non interest income in fact recorded a positive growth of 2%, through the growth recorded in foreign exchange income (31%) and fees and Commission income (22%). Overall decline in non interest income together with 19% gain in net interest income pulled down the ratio of non interest income over net interest income to 48% in 2004 from 71% in 2003.

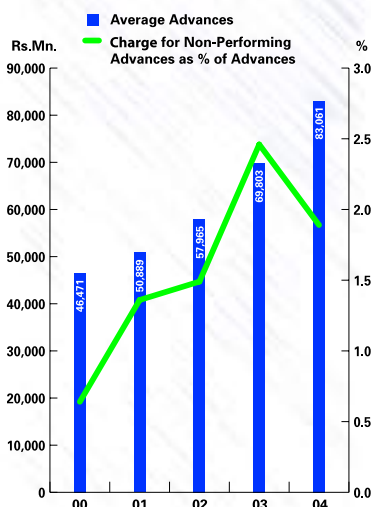


Operating Expenses

Operating expenses of the bank increased by 5% during the year and the corresponding increase in total income was only 3%. This raised the ratio of total expenses over total income to 88% from 86% in 2003. A major contributor to the growth in expenses was the 43% increase in other overhead expenses. Significant components that fuelled the growth of other overheads were Financial VAT on profit and emoluments, Advertising charges and Visa/Master card related payments.

Financial Review

Provision for Non-Performing Advances (NPA)



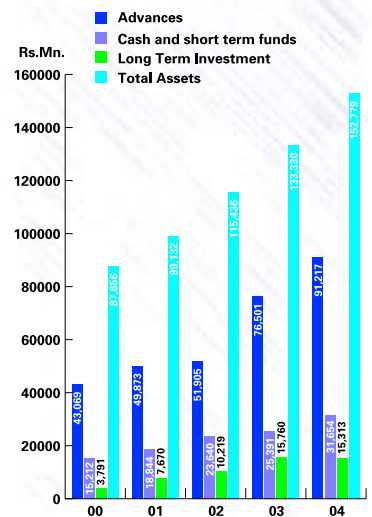
Provision for Non-Performing Advances (NPA)

Substantial provision made in 2003 on account of few large accounts paved the way for a 9% reduction in the B&D provision in 2004. Charge was reduced to Rs.1.6Bn from Rs.1.7 Bn. previous year. Effective risk management established through the zonal and regional management reduced the provisioning requirement of new advances. Accordingly there was a commendable reduction in the ratio of non performing advances over total advances from 14% in 2003 to 10% in the year under review.

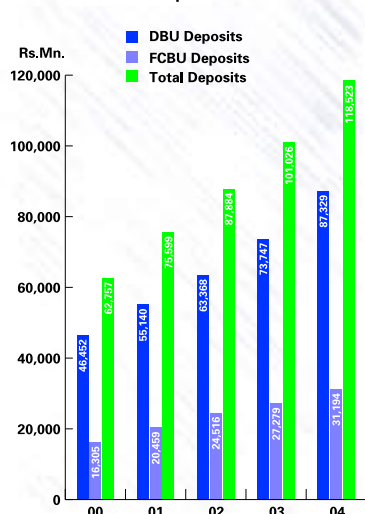
Total Assets

Total assets of the Bank were Rs.152.8Bn. in December 2004 up 15% from Rs. 133.3Bn. in 2003. This growth was boosted by Rs. 14.1Bn increase in total advances, a 19% growth by itself. Cash and short term funds too contributed to the growth by adding Rs. 3.6Bn, a healthy increase of 19%. Highlights in growth of total advances were, term loans by 19%, pawning by 44%, overdrafts by 14%, and housing loans by 37%. Notable decrease was the 55% reduction in Packing Credit Loans.

Total Assets



Deposits



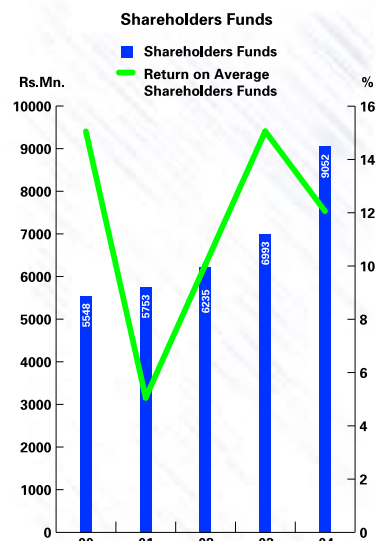
Current, Savings and Other Deposits

Continuous decline in interest rates did not prevent the Bank in achieving an encouraging growth of 17% in total deposits reaching Rs.118.5Bn. This was an increase of Rs.17Bn from the corresponding year's Rs. 101Bn. Notable increases in savings deposits of Rs.8.7Bn., Time deposits of Rs.8.0 Bn., and current accounts of Rs. 2.1Bn accounted for the growth while certificate of deposits declined by Rs.1.4 Bn. DBU and FCBU deposits grew by 18% and 14% respectively. Growths of 26% and 102% in savings and current deposits highlighted the increase in FCBU deposits.

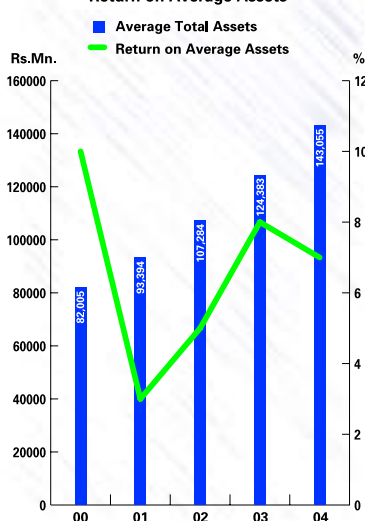
Financial Review

Shareholders' Funds

Shareholders' funds increased by 29% during the year, boosted by the Rights Issue proceeds and post tax profit. Consequently return on average shareholders' funds dropped to 12% from previous year's 15%. It is pertinent to note that the inflow from the Share Issue came only in November 2004.



Return on Average Assets



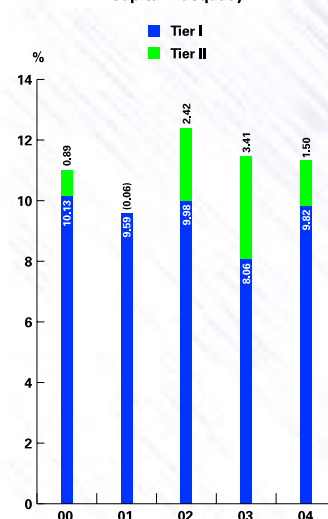
Return on Average Assets (ROA)

Decline in net profit during 2004 reduced the ROA from 0.81% in 2003 to 0.68% in 2004. High net profit growth of 71% in 2003 was driven by the capital gains from Govt. Securities that did not recur in 2004 with the same momentum thus recording a negative growth of 3%.

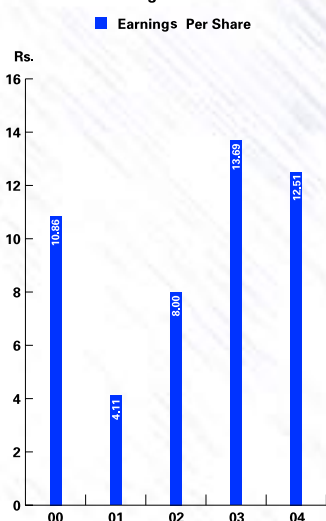
Capital Adequacy

The increase of 31% in the Tier 1 capital coupled with 12% increase in the Tier II capital helped the Bank to record a sound total risk weighted capital adequacy ratio of 11.3% as at 31st December 2004. This was despite the deductions totaling to Rs.1.0Bn from the capital base on account of ESOP (Rs.0.1Bn.) and investment in Sithma Development (Pvt) Ltd., (Rs.0.9Bn.), a fully owned subsidiary of the Bank, as required by the Central Bank of Sri Lanka. Without these adjustments, the previous year's ratio stood at 11.47%. Growth in Tier 1 capital was fuelled by the capital inflow from the new Rights issue and the retained profit. The bank was able to fully utilize the debenture entitlement for Tier II capital in 2004 due to the growth in Tier1 capital, which was limited to a maximum of 50% of the Tier1 capital in 2003.

Capital Adequacy



Earnings Per Share



Earnings Per Share

Basic Earnings per share decreased from Rs.13.69 in 2003 to Rs. 12.51 in 2004, a decline of 9%. This decrease was the combined result of negative growth of 3% in net profit after tax and the increase of 28.6mn shares following the Rights issue in November 2004.

Products & Services



A comprehensive portfolio that is structured to serve all segments of our society in the broadest spectrum: from the constructing of an extension to a home to building national infrastructure.

Products & Services

Personal Banking

- Certificates of Deposit
- Savings Accounts
- "Pathum Vimana" Savings Scheme
- "Singithi Pathum" Minors' Savings Scheme
- "Saubhagya" Planned Savings Scheme
- Divi Shakthi Accounts
- Senior Citizen Scheme
- Current Accounts
- Lifeline scheme
- "Shareline" Current Account for HNB Shareholders
- Term Deposit Accounts
- "Shanthi" Housing Loans
- Consumer loans
- Group Consumer Loans & Leasing Schemes
- HNB "MasterCard" (Local & International)
- HNB "VisaCard" (Local & International)
- "Hot-Shot" credit card for teenagers
- "Subasiri" Personal Loans
- Dream Drive Vehical Loans
- Lease Master
- Consumer Leasing
- 'Wasi Leasing' Leasing Scheme
- 'Uda Tharuwa' easy payment scheme'
- Pawning Services
- HNB Graduateship Educational & Career Development Loans Scheme
- Special Educational Loans for CIMA
- "Danuma" Educational Loans exclusively for ETF members
- "Teleline" Banking
- HNB "Bankline"
- Hatna-I
- 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

Development Banking

- Sarusara - Agricultural Loan Scheme
- Animal Husbandry loans
- Inland & Marine Fisheries loans
- Loans for farm machinery, land development & irrigation systems
- Long - term loans for traditional plantations & perennial crops
- Special loans schemes for estate workers in plantation sector
- Loans for agri business & enterprises
- Gami Pubuduwa (Microfinance)
- Micro & Small loans for Rural & Semi urban population, specially unemployed youth
- Group loans in collaboration with Non-Governmental Organizations (NGOs')
- State sponsored special self employment loans
- Entrepreneur Development Programmes
- Loans for unemployed women
- Mobilization of Rural Savings

Corporate Banking

- Letters of Credit
- Bank Guarantee
- Import & Export Finance
- Working Capital Finance
- Commercial Paper Facility / Money Market Loans
- Finance Leasing
- Medium and Long Term Loans
- Securitisations
- Cheque Purchase Facilities
- Off-Shore Banking Facilities
- Loans Syndications

Project Financing

- Industrial Loans for Manufacturing, Processing etc.
- Loans for Factory Re-location, Re-habilitation
- Infrastructure Development Projects
- Special Financing for Energy Projects under Re-finance Schemes
- Real Estate & property Development
- Loan for Small & Medium Enterprises
- Loans for Tourism & Leisure Industry
- Loans for financing of Fixed Assets & Working Capital

International Banking

- Non Resident Foreign Currency Accounts
- Non - Resident Foreign Currency "Singithi Surakum" Minors' Savings Accounts
- Millenium Shield Cover
- Resident Foreign Currency Accounts
- Resident Non-National Foreign Currency Accounts
- Resident Guest Foreign Currency Accounts
- Foreign Currency Banking Unit
- Export and Import Financing
- Share Investment External Rupee Accounts
- Trade Information & Assistance
- "Traveline" Foreign Travel Loan Scheme
- "Pathum Udanaya" Foreign Currency Savings & Fixed Deposits Scheme
- Foreign Currency Leasing
- Travellers Cheque Issues
- Foreign Draft Issues
- Exporters Foreign Currency Accounts
- Inward/ Outward Remittances
- Rupee Accounts for Non Resident Sri Lankan Investment (RANSI)
- Shanthi Foreign Currency Housing Loan Scheme
- International Inward Remittances
- Issue of International Guarantees

Corporate Finance

- Equity and Debt Issue Underwriting and Issue Management
- Private Placement of Equity
- Mergers and Acquisition Advisory Services
- Capital and Management Restructuring
- Margin Trading facility for shares
- Loan syndications & structured finance

Financial Services/Treasury Products

- Forward Contracts
- Currency SWAPS
- REPO
- Reverse REPO
- Money Market Loan
- Options
- Interest Rate Swaps (IRS)
- Futures
- Various Structured Products
- LKR Bonds
- US Treasuries
- Gilts
- Bunds

Customer Centre Network



Our network covers the length and breadth of the country and is digitally linked to provide easier access, keeping the advantages of HNB banking within reach of all.

Customer Centre Network

North Western Province

- Chilaw
- Dankotuwa
- Kuliypitiya
- Kurunegala
- Marawila
- Nawinne Ext-Kurunegala
- Puttalam
- Wennappuwa

Western Province

- 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
- IWMI - Palawatta
- Ja-Ela
- Kadawatha
- Kaduwela
- Kalutara
- Katunayake
- Kiribathgoda
- Kirindiwela
- Kirillapone
- Kollupitiya
- Kollupitiya Extension Office
- Kotahena
- Kottawa
- Kotte
- Maharagama
- Main Branch
- Malabe
- Maligawatte
- Maradana
- Marandagahamulla
- Minuwangoda
- Mirihana
- Moratumulla
- Moratuwa
- Mt. Lavinia
- Mutwal
- Narahenpita
- Nawaloka Hospital
- Nawam Mawatha
- Negombo
- Negombo Extension Office
- Nittambuwa
- Nugegoda
- Overseas School of Colombo
- Padukka
- Panadura
- Panchikawatte
- Pettah
- Piliyandala
- Ports Authority
- Ragama
- Ratmalana
- Sea Street
- Seeduwa
- Sri Jayewardenepura Hospital
- SriLankan Airlines Administrative Complex
- Talangama
- Thalawathugoda
- Thimbrigasyaya
- Wattala
- Wellawatte

North Central Province

- Anuradhapura
- Nochchiyagama
- Polonnaruwa
- Thambuttegama

Northern Province

- Chunnakam
- Jaffna
- Mannar
- Nelliya
- Vavuniya

Central Province

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

Southern Province

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

Eastern Province

- Akkaraipattu
- Ampara
- Batticaloa
- Kalmunai
- Kantalai
- Kattankudy
- Trincomalee
- Trincomalee - Extension Office

Uva Province

- Badulla
- Bandarawela
- Buttala
- Moneragala
- Welimada
- Wellawaya

HNB Customer Centres to be opened during the 1st quarter of the year 2005

- Kandana
- Mihirigama
- Deniyaya

HNB Student Banking Centres - 152

HNB Gami Pubuduwa Banking Centres - 104

- Village Based - 24
- Branch Based - 80

HNB Mobile Banking Centres - 2

- Hotel Culture Club - Dambulla
- Kandalama Hotel - Dambulla

Overseas Representative Offices

- Chennai - India
- Karachi - Pakistan

Global Presence



Wherever you go in the world,
you'll find we have a correspondent bank to meet
your international needs.

Global Presence

Europe

- Austria
- Belgium
- Croatia
- Cyprus
- Czechoslovakia
- Denmark
- Finland
- France
- Germany
- Greece
- Hungary
- Ireland
- Italy
- Netherlands
- Norway
- Poland
- Portugal
- Romania
- Russian Federation
- Spain
- Sweden
- Switzerland
- Turkey
- United Kingdom

Americas

- Argentina
- Bahamas
- Bermuda
- Brazil
- Canada
- Chile
- Colombia
- Hawaii
- Mexico
- Peru
- Uruguay
- United States of America

Asia & Pacific

- Australia
- Bangladesh
- China
- Fiji Islands
- Hong Kong
- India
- Indonesia
- Japan
- Korea
- Maldive Islands
- Malaysia
- Nepal
- New Zealand
- Pakistan
- Philippines
- Singapore
- Taiwan
- Thailand
- Uzbekistan
- Vietnam

Middle East & Africa

- Bahrain
- Botswana
- Egypt
- Ethiopia
- Ghana
- Iran
- Israel
- Jordan
- Kenya
- Kuwait
- Lebanon
- Libya
- Mauritius
- Oman
- Qatar
- Saudi Arabia
- Somalia
- South Africa
- Sudan
- Swaziland
- Syria
- United Arab Emirates
- West Africa
- Yemen
- Zambia
- Zimbabwe

HR Review

The people factor at HNB is a strong contributor to organizational performance. The Hatna family comprising of almost 4200 people is the nucleus of the Bank's hub of activities in our passion to enhance the value of our stakeholders. The Human Resources Division is driven by one of our core beliefs in creating an inspiring work environment for our staff.

The HR objectives of the Bank are as follows.

- To ensure excellence in customer satisfaction through staff.
- To attract, recruit, select and retain the best talent
- To utilize and continuously develop our staff with the view to achieving optimum productivity.
- To motivate, recognize and reward our employees
- To ensure credibility, integrity, honesty and high ethical standards among the workforce.
- To create a feeling of membership and belongingness through a participatory style of management.
- To promote harmonious Industrial Relations within the enterprise.
- To be a socially responsible citizen

HR Practices & Business

The bank believes that a close link between HR practices and business strategies is important if a great measure of success is to be achieved. This important aspect is focussed by assessing the emerging HR issues in the context of a dynamic business environment. A highly customer focussed approach has been activated under the theme 'Service Excellence – Our Passion'. Guidelines for quality customer service have been set out in a booklet which has been issued to all staff members.

Resourcing Strategies

The Bank strives to recruit, train, develop and retain the best talent. We have structured the selection process to ensure quality recruitment. Ability tests pertaining to achievements, aptitude, and personality are used for selection. Selection interviews are conducted by the senior officers in various disciplines. The process of induction whether it be in the case of new recruits or promotees from within the bank is carried out based on specially designed programmes. Placement of staff is dependent on the needs of the organization and the specific backgrounds of the recruits. The HR initiatives do not end with the completion of recruitment and selection in that there are training and development strategies which ensure that staff are moulded for the future. Optimum utilization of Human Resources is stressed on.

Continuous Professional Development (CPD)

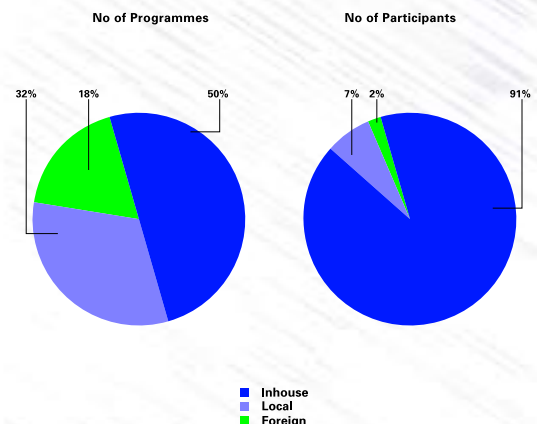
From the point of recruitment, in-house exams are available at different stages as an ongoing process so that staff can acquire CPD points which are used as a qualifying criteria for the process of career progression through internal promotions. Focus on Training and education covers the broad policy of helping employees to learn job related skills and obtain knowledge to improve their performance and further the organization's goals. The education factor is to provide employees an opportunity to equip themselves to expand their capacity to learn and to perform in the future.

Training Policy of The Bank

A comprehensive Training Policy strategises the training related activities of the bank. A Training Needs Analysis (TNA) was carried out to ascertain the training needs in terms of the individual and the organization. Training needs were sought from all levels of Management in the Bank including the Corporate Management, the Senior Management and the Middle Level Management. The annual performance appraisals were also used for this purpose.

Training Plan

Based on the TNA a detailed Training Plan was formulated to conduct training programmes. The bank reaped the benefits of setting up the two Regional Training Centres in Kandy and Panadura by accelerating the activities and offering various training programmes to the staff in all branches island wide. The details are as follows.



HR Review

	In House	Local	Foreign	Total
Number of Programmes	128	83	47	258
Number of Participants	4165	304	84	4553

Apart from local training, certain staff members were sent overseas for training in countries such as India, Singapore, Philippines, Thailand, Japan, Australia, United Kingdom and USA. This process has helped to enhance the scope of management development for our Officers.

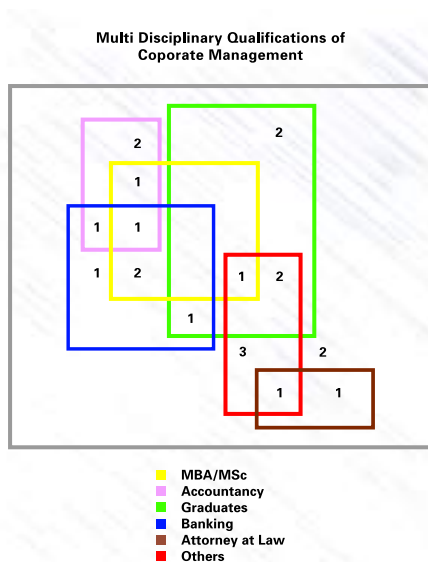
Some key features of training are given below:

a. Positive projection

Preparing the work force to project itself in terms of key attributes like customer orientation, understanding of the business organization, total commitment to cost effectiveness, and productivity orientation.

b. Quality of Managerial effectiveness

There was a clear focus on developing the Bank's executive staff into a highly effective Management team. To this end the bank solicited the expertise from external resource persons and training institutions both local and international.



c. Multiple Skills

Training on Multi Skilling was effectively utilized as a tool to increase manpower utilization and thereby improve productivity.

d. IT culture within the HNB workforce

An IT Training Cell was set up to accelerate IT knowledge among staff. As a result the staff members were accorded the opportunity to enhance their IT knowledge in terms of system related training and other general areas like MS Office, e mail and Internet.

e. Competency Based Training:

A system is in place to judge the competency levels of the participants at the end of each programme. A standardized form of training was adopted to ensure the quality and uniformity of training outcomes.

f. Team Building:

A continuous process of team building in branches and departments was carried out on a regular basis for greater effectiveness. The Outward Bound training programmes involving outdoor activity in Dambulla brought about the bonding of the teams with enhanced self confidence. These programmes were followed by Review Programmes to ascertain the impact and to reiterate the learning.

Performance Management

The Executive Performance Management system is based on the Balanced Scorecard which ensures objective setting under four Key Areas viz. Financial Perspective, Customer Perspective, Internal Business Processes and Learning & Growth Outcomes. This target driven system is backed up by qualitative assessment of staff and a personal development review for each staff member. A highly performance driven culture has shown certain positive trends in employee productivity.

Compensation/Rewards

The organization's compensation policy is benchmarked and aligned with market standards. A Collective Agreement between the Management and the Ceylon Bank Employees' Union covers the area of salaries and benefits to those covered by the agreement.

HR Review

Performance plays a key role and rewards particularly at the Executive level are based on the achievement of measurable targets. Thus variable pay and variable bonus are strong indicators of a performance driven culture within the organization.

Code of Conduct

The need to uphold high standards of Corporate and Business ethics is greatly emphasized throughout the Bank. The Code of Ethics places paramount importance on integrity and honesty of staff. Staff are required to treat all the Bank's customers alike irrespective of racial, religious, language and other differences.

The Bank's operations which are driven by its objectives and strategies are performed within accepted business norms and those who deviate from such standards of conduct and behaviour are dealt with under the rules of discipline. Staff are also required to subscribe to an Information Security Policy which creates precautions to ensure that internal information will not be disclosed to unauthorized persons.

Employee Relations

The employee communication network of the organization enables free communication between employees and the Management.

Employee participation in management processes further sets up a participative management system. This system is supported by key initiatives such as an in-house magazine "HATNAMAG" which enables the sharing of information among staff. A monthly Newsletter on Human Resources activities is published. Monthly staff meetings are held with active staff participation. Employees are co-opted into Customer Service Committees in branches which is a useful mechanism in solving customer service problems. Staff members are deployed in teams for deposit mobilization, recoveries etc. Informal discussions are conducted between management and staff.

Employee Share Option Scheme

The Board of Directors approved an Employee Share Option (ESOP) Scheme for the Executive staff to the value of Rs.175Mn. This Scheme was approved at an extraordinary general meeting of the shareholders on 11th September 2004. The ESOP Trust acquired shares worth Rs.164Mn at the Bank's Rights Issue at an average cost of Rs.33/- per share. The ESOP is fully funded by HNB with employees having a beneficial interest which would be liquidated at the market price at the time of retirement or resignation of the relevant staff members. The liquidated shares will then be allocated to any new Executive of the Bank. This is yet another opportunity for employee participation by which the mobilization of employee commitment would be further stabilized.

Industrial Relations

The Bank has maintained harmonious Industrial Relations by maintaining open communication with the Ceylon Bank Employees' Union and the Officers' Association. Monthly meetings have been a regular feature between the Management and the Unions. Formal grievance handling, employee counselling and a dispute procedure set out in the Collective Agreement are some key features in a normative Industrial Relations system of the Bank.

Welfare Services & Recreation

Caring for the well being of people has been an important factor in creating employee motivation and increasing morale. Working conditions are consistently improved with staff quarters being provided in outstation areas. On the recreation side, the Bank's Sports Club is an active body and nurtures the various sports and recreation activities of the staff. The Bank has a large number of sportsmen and women who represent the organization and the country in many sports such as Cricket, Netball, Basketball, Rugby, Hockey, Athletics and indoor games.

Corporate Management

1 R Theagarajah

M.B.A. (Cranfield), F.C.M.A., F.C.A. (Sri Lanka)
General Manager/
Chief Executive Officer/Director

2 J M J Perera

F.C.I.B. (London)
Senior Deputy General Manager -
Corporate Banking

3 G P Karunaratne

F.C.M.I. (UK)
Senior Deputy General Manager -
Treasury

4 J D N Kekulawala

*M.B.A. (Manchester),
F.C.I.B. (London), F.C.A. (England & Wales)*
Chief Financial Officer

5 P R Nayagam

M.C.M.I. (UK)
Deputy General Manager -
Operations

6 U A C Obeyesekere

F.I.P.M. (Sri Lanka)
Deputy General Manager -
Human Resources & Administration

7 C P Abeywickrema

B.Com. (Special) - Sri Lanka
Deputy General Manager -
Personal Banking

8 Ms I Goonesekera

Attorney-at-Law & Notary Public
Deputy General Manager -
Legal /
Board Secretary

9 Ms S N Wickramasinghe

Attorney-at-Law, F.C.M.I. (UK)
Deputy General Manager -
Banking Services

10 K V P Fernando

*B.Sc. (Eng.), M.I.E. (Sri Lanka), C.Eng.,
M.I.C.E. (London)*
Deputy General Manager -
Premises & Engineering

C C Hemachandra 11

B.Sc. (Hons) London, M.B.C.S., M.A.C.S.
Deputy General Manager -
Information Technology

N Hapuarachchy 12

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

Ms A M Karunaratne 13

F.C.M.A.
Deputy General Manager -
Corporate Credit

Mr A S Ibrahim 14

B.Sc. (Hons) Colombo, F.C.I.B. (London)
Deputy General Manager -
Corporate Relationships & Risk Management

Ms L L C C Thambiah 15

Assistant General Manager -
Zone II

P D Hennyake 16

*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 -
Zone III

Ms D C Cooke 17

F.C.A. (Sri Lanka)
Assistant General Manager -
Audit

J R P M Paiva 18

B.A. (Hons) Ceylon
Assistant General Manager -
Zone I

P Sridharan 19

Assistant General Manager -
Card Centre

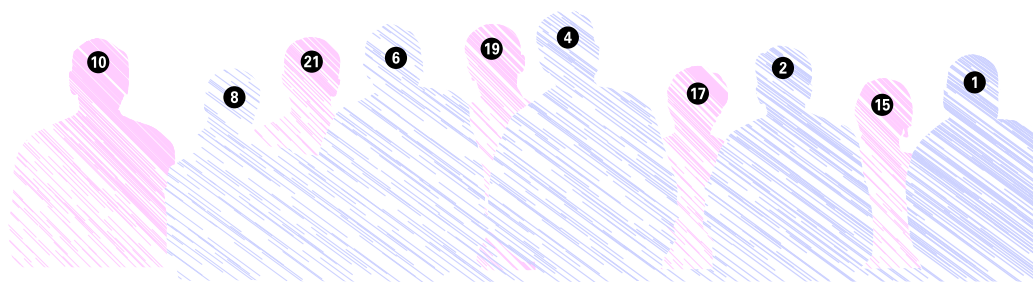
Ms I R D Thenabadu 20

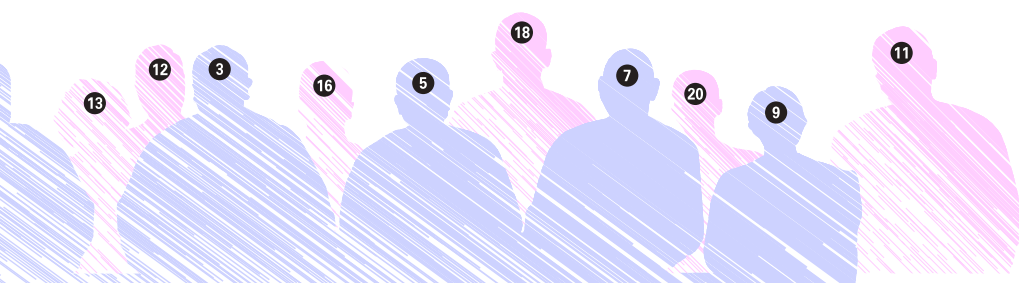
F.C.I.B. (London), F.C.M.A.
Assistant General Manager -
City Office

A J Alles 21

M.B.A. (Stirling), A.I.B. (Sri Lanka)
Assistant General Manager -
Head Office Branch

..... Corporate Management





Senior Management

B J Sinniah

Chief Manager - Central Credit

A G Mendis

Chief Manager -
Human Resources & Administration

Ms R P P Wickremasinghe

B.Dev.Studies (Hons) Colombo,
Dip. in Personnel Management (N.I.B.M.)
Chief Manager - Human Resources Development

A P L Fernando

A.I.B. (SL), Dip. in Bank Mgmt.
Chief Manager - Credit Supervision & Recoveries

V G P Vidyaratne

PG.Dip.(Ind.Eng.), B.Sc. (Eng.)Cey., C.Eng., M.I.E. (SL)
Chief Manager - Premises & Engineering

R W Jayasinghe

A.C.M.A.
Chief Accountant

R M P Ratnayake

PG. Dip. Busi. & Fin. Admin. (I.C.A.S.L. & Cranfield),
A.I.B. (SL), Cert.Corp.Busi.Fin. (PI.M.), M.A.A.T.
Chief Manager – International Settlements

V K A F Rajasekara

Chief Manager -
South Western Region

A N J De Silva

Chief Manager -
Business Development - Subsidiaries

R H Abayasekara

Chief Manager -
International & FCBU

M K Nambiyarooran

M.B.A.(Sri J.), F.C.M.A., F.S.C.M.A., A.I.B.(SL)
Chief Manager - Corporate Planning

K L Wijesooriya

LL.B
Chief Manager - Marketing

H N J Chandrasekera

Chief Manager -
Colombo Region

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

D K Ratwatte

B.A. (Hons) Econ - London
Chief Manager - Treasury

A Ratnasabapathy

F.P.M.A. Chief Manager - Commercial & Corporate
Banking (Head Office Branch)

T Govinthadas

M.B.A. (Colombo), B.Sc. (Hons), P.F.T. Cey., A.C.I.B.(Lond.)
Chief Manager - Risk Zone II

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

G Ramanan

C.F.A., A.C.M.A.
Chief Executive Officer - HNB Securities Ltd

N U Jumat

A.I.B. (Sri Lanka)
Chief Manager - Central Trade Services

K M B S Silva

Dip.in Business Mgmt. (Chennai)
Senior Manager - Special Recoveries

T M A Mutaliph

A.I.B.(SL), Dip. in Bank Mgmt.
Senior Manager - Risk Zone I

P G Wilson

B.Sc. (Kelaniya), Dip. in I.T. (N.I.B.M.)
Senior Manager – IT Research & Development

J U N Chandrasena

M.A. (Econ) Colombo, A.C.M.A.
Senior Manager -
Corporate Finance/Investment Banking

Ms N Y S Bodinagoda Rodrigo

A.I.B. (Sri Lanka)
Senior Manager - Risk Zone III

N Premakumar

Senior Manager -
Administration & Trade Services (City)

R J Thambirajah

Senior Manager -
Greater Colombo Region

G Jayasinghe

A.M.I.A.E. (Sri Lanka)
Senior Manager - Vehicle Maintenance & Transport

J J Namasivayam

Senior Manager -
Currency Division

S Sivalingam

A.C.I.B. (London)
Senior Manager - Productivity

I A Baduge

Dip.in Bank Mgmt., A.I.C.M.
Senior Manager - Cinnamon Gardens Branch

R M P Dayawansa

M.B.A. (Sri J.), F.I.B. (SL), M.C.I.M. (UK), M.S.L.I.M.
Senior Manager - North Western Region

A Goonasekera

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

U N I Elapata

B.A. (Hons) Texas
Senior Manager - Personal Financial Services (Head
Office Branch)

Mrs N M C P Wettasinha

Attorney-at-Law & Notary Public
Senior Manager - Legal

B K Achan

M.Sc.,B.Sc. (Hons),C.A.I.I.B.
Chief Representative Officer - Chennai

Risk Management

As the largest private bank in Sri Lanka with over 140 Customer Centres spread across the island and offering a full spectrum of financial services to its diverse clientele, HNB encounters a wide range of both financial and non-financial risks which need to be proactively managed in order to safeguard the interests of its various stakeholders.

Risk Management at HNB originates from the Board of Directors who defines the Bank's risk appetite. This is a dynamic process and is periodically reviewed in the light of the prevalent economic and business conditions and the needs of the stakeholders. The Board then, in consultation with the Corporate Management of the Bank, establishes policies, processes and the structures necessary to ensure that the risks are managed within the defined risk appetite while achieving the Bank's overall business objectives. The risk management function is delegated to the Corporate Management of the bank who are assisted in this endeavour by the Asset Liability Committee (ALCO), the Credit Policy Committee and the Treasury Committee.

The risk management function also works closely with the Bank's Audit department to identify any weaknesses in the processes and control systems that could expose the bank to risk. Audit periodically updates Management with an independent opinion on the efficacy and adequacy of the controls in place.

Risk management begins with the proper identification of risks that the bank exposes itself to in the pursuit of its commercial objectives. The bank has identified the following as the major risk areas that it faces.

Credit Risk

Credit Risk is defined as the risk of loss due to a default by a borrower or counterparty to a transaction. As a full service commercial Bank, credit risk constitutes the single largest risk to HNB.

In today's increasingly competitive environment, the bank is mindful of the need to quickly and effectively deliver its

financial services while ensuring that the risks undertaken are mitigated and managed so as to provide the bank with a reliable and consistent source of earnings.

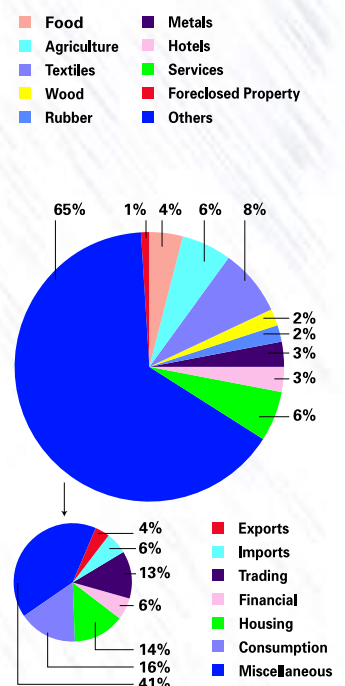
The credit approval system was refined to speed up the decision making process while ensuring high quality credit assessment. Central to this were the decentralization of the bank into Zones and Regions and the delegation of credit approval discretions to individual officers and sanctioning committees based on an assessment of their abilities and experience. The approval process itself has been streamlined through the use of technology for on-line approvals, standardized documentation and an objective, standardized and forward looking appraisal system. In the Consumer banking division a sophisticated credit scoring system and on-line approval systems are used to assess and manage credit risks.

The Bank's Credit Policies which act as both a guide to the lending officers and also defines the parameters of the credit risks acceptable to the bank are regularly updated in line with recent developments. A risk rating system and a risk based pricing model are integral parts of the policy.

Credit limits are set at the individual borrower level, industry segment and product levels to ensure there is no undue concentration of risk. This is buttressed by regular reviews of individual credits and portfolios.

Automated systems are in place for the proper recording of exposures and their monitoring and control. Ongoing review

Analysis of Advances by Sector



Risk Management

of individual credits with a view towards the early identification of warning signs contribute to maintaining the health of the portfolio. Exposures that exhibit signs of problems are vigorously followed up and actioned early to minimize the impact on the bank's earnings. The management of problem advances is assigned to a specialized unit that is dedicated to this task. This Unit works with clients experiencing difficulties to restructure their businesses and borrowing arrangements with a view to restoring their financial health. If and when the unit decides that the business cannot be restored to commercial viability arrangements are made to seize and realize on the collateral held.

Liquidity Risk

This is the risk that the bank will be unable to fulfill its contractual obligations when they are due. This involves:

- having funds available to meet financial commitments when they fall due, and
- ensuring that funds are available to take advantage of opportunities when they arise

The management of these issues has been entrusted to the Asset Liability Committee (ALCO) whose primary tasks are to act as a guide for profit planning, compliance with regulatory requirements and ensuring the bank has sufficient liquidity to meet its contractual obligations and growth aspirations.

The ALCO includes the GM/CEO, Head of Treasury, Business Heads, Chief Financial Officer and Head of Risk and meets on a fortnightly basis. ALCO achieves its principal objectives by:

- analysing business and economic conditions, both locally and internationally
- forecasting for changes in interest rates
- anticipating changes in the volume and mix of loan and investment portfolios
- reviewing and anticipating changes in the volume and mix of the bank's funding sources
- analysing the maturity distribution of assets and liabilities and ensuring they are within agreed limits

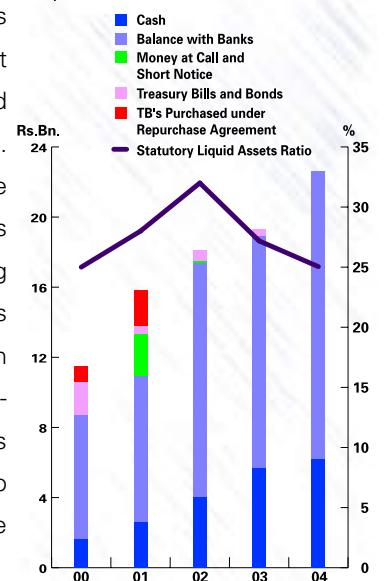
- ensuring the adequacy of alternative sources of funding
- periodically revisiting prevailing loan, investment and funding strategies
- reviewing current pricing levels and performing a competitor rate analysis
- monitoring asset – deposit ratios for compliance with prudential guidelines
- monitoring liquidity ratios for compliance with statutory and prudential guidelines

Liquidity is managed on a daily basis by holding a mix of marketable securities and other short term investments that can be readily converted to cash. HNB's strengths in the deposit garnering area has resulted in high liquidity and a stable, low cost deposit base;

over 50% of the Bank's Rs.100 Bn plus deposit base consists of Demand and Savings deposits.

This component of the Bank's funding sources has been growing steadily over the years providing it with an effective source of long-term funds to match its long term assets and also provides a major source of liquidity to the bank.

Cash, Short Term Funds & Government Securities



Market Risk

This is the risk of loss that arises from the holding of "price sensitive" assets and liabilities and is caused by volatility in interest rates, exchange rates, and equity and commodity prices. As a significant facilitator of foreign trade for its wide spectrum of clients and a major player in the foreign exchange, money and Capital markets, HNB is exposed to market risks. These risks are managed by the Bank's Treasury using a combination of overall, intra-day, overnight and loss limits on its trading portfolio positions. These limits are set by the Board of Directors.

Risk Management

For day to day monitoring and control of market risks, the Bank has an independent market risk management function (Mid-Office), with clear independence and authority, to ensure that the following responsibilities are carried out:

- the development of risk limit policies (in consultation with ALCO and the Treasury Committee) and the monitoring of transactions and positions for adherence to these policies
- the design of revenue reports quantifying the contribution of various risk components, and of market risk measures
- the review and approval of pricing models and valuation systems used by front and back-office personnel, and the development of reconciliation procedures.

Operational Risk

The Basel Committee's definition of Operational Risk is:

"The risk of loss resulting from inadequate or failed internal processes, people and systems, or from external events".

Operational risk is an inherent risk in each of the Bank's business units and key support functions. Such risks manifest themselves in various breakdowns, errors and business interruptions, and potentially result in financial losses and other damages. To monitor and control such risks the Bank maintains a comprehensive system of policies and a control framework designed to provide a sound and well-controlled operational environment throughout the organisation.

Specific initiatives towards effective Operational risk management include:

- Reinforcing a Bank-wide approach to self-assessment, capitalising on the strong practices of the Bank's heritage systems;
- Business continuity and IT disaster recovery procedures;
- Information security policies and awareness programmes;
- Continuous review and improvement of business processes.

The primary responsibility for managing operational risk rests with business managers. Finance, Audit, and other support functions also play a key role in reviewing and maintaining the integrity of the control environment

Legal Risk and Compliance Risk

Legal and compliance risks arise from the possibility of legal or regulatory changes, which may affect the Bank's position, the indirect impact of global regulatory issues and uncertainties with regard to the enforceability of the obligations of customers and counterparties to the Bank.

To manage bank-wide risks, specialist groups including the Legal Department assist the business units in the development and implementation of risk management practices, whilst industry standard agreements are used wherever applicable. An example of such an effort being the company-wide implementation of an anti-money laundering policy which was prepared having consideration to the FATF 40 recommendations.

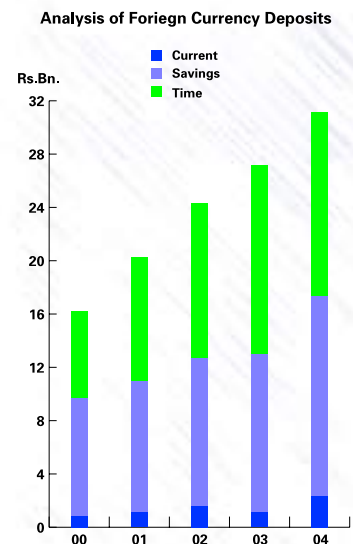
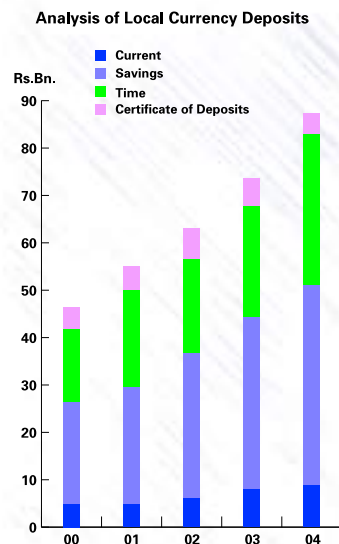
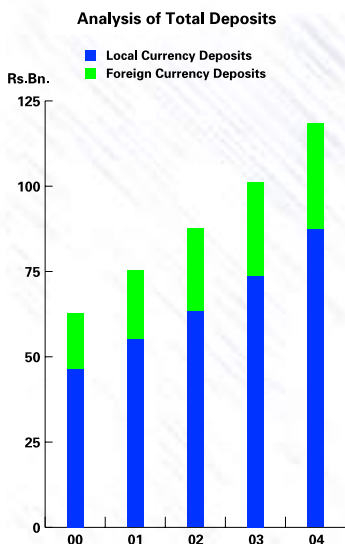
Reputational Risk

Reputation risk is the current and prospective impact on earnings and capital arising from negative public opinion. The management is aware that reputation risk can arise from many sources including financial performance and profitability, corporate governance and quality of management, social, ethical and environmental performance, employee and corporate culture, marketing innovation, and customer relations as well as regulatory compliance and litigation, and communication and crisis management.

In mitigating reputation risk, management anticipates and responds to changes of a market or regulatory nature that impacts its reputation.

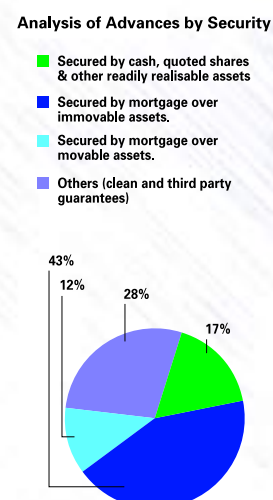
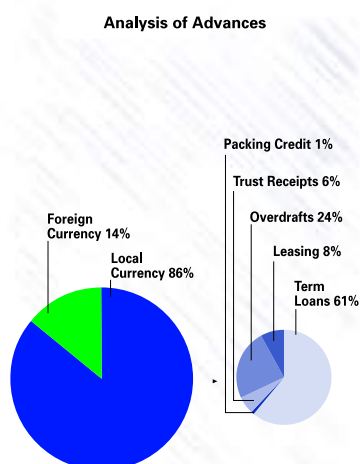
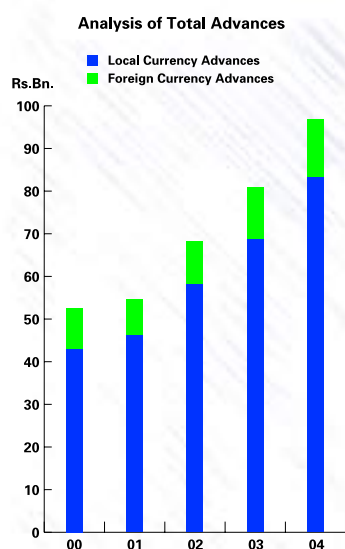
Analysis of Deposits

	2000 Rs.000	2001 Rs.000	2002 Rs.000	2003 Rs.000	2004 Rs.000
Local Currency Deposits					
Current	4,906,440	4,846,459	6,191,913	7,929,485	8,852,609
Savings	21,525,767	24,746,904	30,627,485	36,452,976	42,108,475
Time	15,457,007	20,603,261	19,872,255	23,502,610	31,920,537
Certificate of Deposits	4,563,384	4,944,472	6,677,438	5,861,618	4,448,095
	46,452,598	55,141,096	63,369,091	73,746,689	87,329,716
Foreign Currency Deposits					
Current	853,244	1,159,328	1,679,540	1,154,625	2,331,555
Savings	8,806,655	9,962,977	11,171,199	11,936,063	15,009,655
Time	6,645,259	9,335,857	11,664,587	14,188,135	13,853,008
	16,305,158	20,458,162	24,515,326	27,278,823	31,194,218
Total Deposits					
Refinance	1,655,369	1,564,826	1,659,069	1,764,014	2,066,198
Total Deposits & Refinance	64,413,125	77,164,084	89,543,486	102,789,527	118,523,934



Analysis of Advances

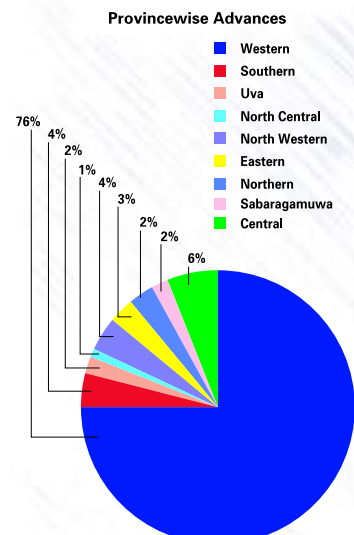
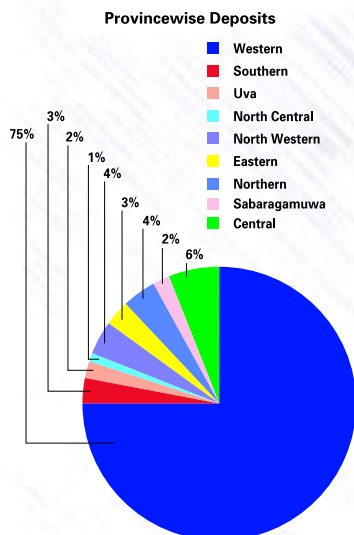
	2000 Rs.000	2001 Rs.000	2002 Rs.000	2003 Rs.000	2004 Rs.000
Local Currency Advances					
Overdrafts	14,533,021	15,794,397	16,786,380	17,247,347	20,165,063
Trust Receipts	3,478,192	3,163,759	4,228,258	3,880,713	4,957,006
Packing Credit	464,039	483,248	329,217	557,260	521,945
Term Loans	21,610,254	23,786,022	32,757,990	41,880,705	50,714,867
	40,085,506	43,227,426	54,101,845	63,566,025	76,358,881
Leasing Facilities					
Total	2,969,226	2,898,214	4,032,043	5,084,773	6,838,367
	43,054,732	46,125,640	58,133,888	68,650,798	83,197,248
Foreign Currency Advances					
Total	9,606,442	8,649,230	10,195,368	12,314,964	13,702,580
	52,661,174	54,774,870	68,329,256	80,965,762	96,899,828



Provincewise Analysis of Deposits & Advances

**Provincewise Analysis of Deposits & Advances
as at 31st December, 2004**

Province	No of Customer Centres	Deposits (Rs.Mn.)	%	Advances Including Leasing (Rs.Mn.)	%	Deposit Utilisation %
Western	77	88,834	75	73,868	76	83
Southern	11	3,763	3	3,535	4	94
Uva	6	2,223	2	1,694	2	76
North Central	4	1,717	1	1,247	1	73
North Western	7	4,070	4	3,936	4	97
Eastern	8	3,140	3	2,285	3	73
Northern	5	4,812	4	2,250	2	47
Sabaragamuwa	9	2,846	2	2,043	2	72
Central	15	7,119	6	6,042	6	85
Total	142	118,524	100	96,900	100	82



Sources & Utilisation of Income

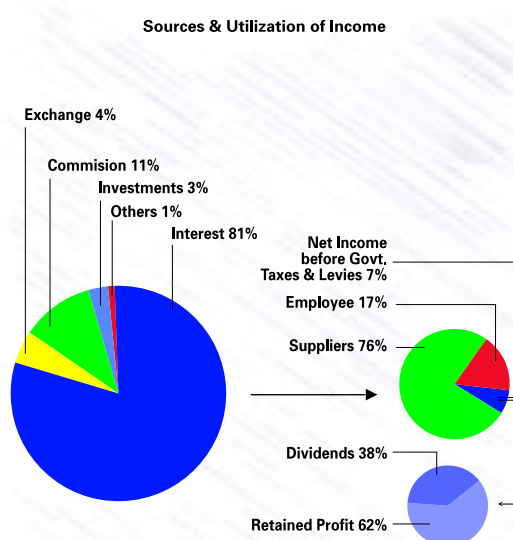
Sources of Income

For the year ended 31st December,	2000 Rs.000	2001 Rs.000	2002 Rs.000	2003 Rs.000	2004 Rs.000
Interest	7,940,240	9,335,933	9,398,781	11,536,552	11,469,335
Exchange	364,061	516,176	382,272	506,436	662,176
Commission	570,565	615,179	755,384	1,241,588	1,519,924
Investments	47,514	84,424	307,875	356,830	288,193
Other	719,085	1,012,117	955,177	1,189,156	147,730
Total	9,641,465	11,563,829	11,799,429	14,830,562	14,087,358

Utilisation of Income

For the year ended 31st December,	2000 Rs.000	2001 Rs.000	2002 Rs.000	2003 Rs.000	2004 Rs.000
Employees					
Salaries and other payments to staff	1,403,726	1,626,189	1,778,250	2,320,427	2,414,137
Suppliers					
Interest paid	5,280,944	7,201,421	6,257,761	6,909,095	5,962,041
other expenses	1,884,457	2,307,849	3,004,516	4,509,455	4,868,552
	7,165,401	9,509,270	9,262,277	11,418,550	10,830,593
Net Income before Government Taxes & Levies	1,072,338	428,370	758,902	1,091,585	842,628
Government					
Income tax, turnover tax & defence levy/National Security levy	272,300	125,277	170,052	83,300	(26,326)*
Shareholders					
Dividends	260,000	97,500	214,500	286,000	350,350
Retained Profit	540,038	205,593	374,350	722,285	518,604
Total	9,641,465	11,563,829	11,799,429	14,830,562	14,087,358

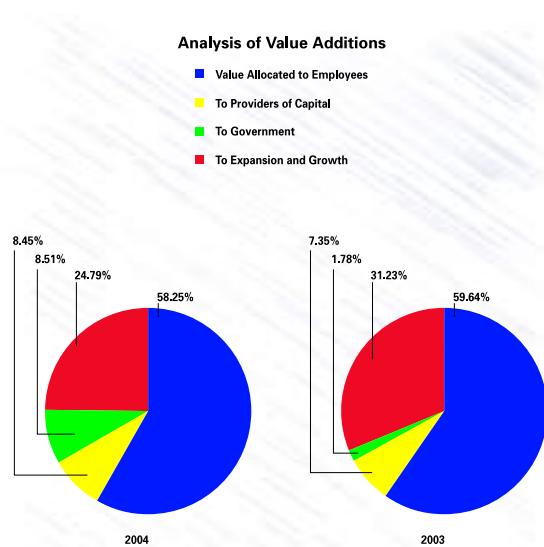
* Reversal of Taxation



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 investment.

Value Added Statement

	2004 Rs.000	%		2003 Rs.000	%
Value added					
Income earned by providing banking services	13,752,577			13,485,896	
Cost of services	8,375,890			9,224,413	
Value added by banking services	5,376,687			4,261,483	
Non-banking income	334,781			1,344,666	
Provision for bad debts	(1,566,493)			(1,715,697)	
	4,144,975			3,890,452	
Value allocated to employees					
Salaries,wages & other benefits	2,414,137	58.25		2,320,427	59.64
To providers of capital					
Dividends to shareholders	350,350	8.45		286,000	7.35
To Government					
Value Added tax	336,692			64,635	
National Security levy	10,409			-	
Debit tax	5,433	8.51		4,531	1.78
To expansion and growth					
Retained income	626,031	15.10		722,285	18.57
Depreciation	438,658	10.58		409,274	10.52
Deferred taxation	(36,735)	(0.89)		83,300	2.14
	4,144,975	100.00		3,890,452	100.00



Quarterly Statistics

For the three months ended	2004				2003			
	December 31st	September 30th	June 30th	March 31st	December 31st	September 30th	June 30th	March 31st
Balance Sheet Data								
(Rs. Million)								
Total Assets	152,780	144,617	135,943	133,112	133,330	129,750	122,724	119,619
Loans, Leases & Bills	93,295	86,742	81,494	80,360	78,922	74,301	71,396	69,397
Deposits	118,524	109,278	105,339	102,071	101,026	100,478	93,706	90,481
Shareholders' Funds	9,052	7,516	7,364	7,031	6,993	6,801	6,703	6,363
Average Assets	148,699	140,280	134,528	133,221	131,540	126,237	121,172	117,528
Income Statement Data								
(Rs.000)								
Net Interest Income	1,590,924	1,508,690	1,225,058	1,182,622	1,413,047	1,078,604	940,296	981,481
Foreign Exchange Income	146,084	169,288	192,474	154,330	120,715	135,358	127,504	121,437
Other Income	627,970	266,190	485,195	576,492	757,259	540,992	965,949	678,523
Total Revenue	2,364,978	1,944,168	1,902,727	1,913,444	2,291,021	1,754,954	2,033,749	1,781,441
Provision for Credit Losses	(597,876)	(320,632)	(345,929)	(302,056)	(700,791)	(320,869)	(389,960)	(295,042)
Non-interest Expenses	(1,523,149)	(1,471,652)	(1,207,402)	(1,406,566)	(1,257,072)	(1,306,279)	(1,273,959)	(1,225,609)
Provision for Income Tax	66,326	-	(16,000)	(24,000)	1,700	(30,000)	(29,000)	(26,000)
Net Profit after Tax	310,279	151,884	333,396	180,822	334,858	97,806	340,830	234,790

ORDINARY SHARE INFORMATION

Market Price per share (Rs.)	V	NV	V	NV	V	NV	V	NV	V	NV	V	NV	V	NV	V	NV
High	60.00	35.00	71.00	41.00	74.00	44.00	80.00	47.00	109.25	63.50	111.00	67.00	120.00	75.00	100.00	63.00
Low	50.25	30.00	59.00	35.00	60.00	35.00	58.00	32.00	68.00	35.80	87.00	54.00	74.75	46.25	70.00	42.50
Closing	57.00	32.75	60.00	35.00	66.75	40.50	72.00	43.50	69.00	36.75	106.25	55.00	105.50	63.75	76.25	47.00
Book value per																
Ordinary Share		90.43		105.12		103.00		98.33		97.81		95.12		93.75		88.99

V - Voting NV - Non-Voting

FINANCIAL MEASURES

Profitability

Return on average																
Shareholders' Equity		3.75%		2.04%		4.63%		2.58%		4.86%		1.45%		5.22%		3.73%

Productivity

Non-interest Expenses																
to Total Revenue		64.40%		75.69%		63.46%		73.51%		54.87%		71.68%		62.64%		68.80%

Capital

Risk weighted capital ratios (DBU)

Tier 1		* 9.83%		* 7.42%		* 7.95%		* 8.00%		* 8.06%		7.72%		8.48%		9.22%
Total (Tier 1 + 2)		* 11.26%		* 10.03%		* 11.27%		* 11.36%		* 11.47%		10.49%		10.63%		11.44%

* DBU & FCBU

Asset Quality

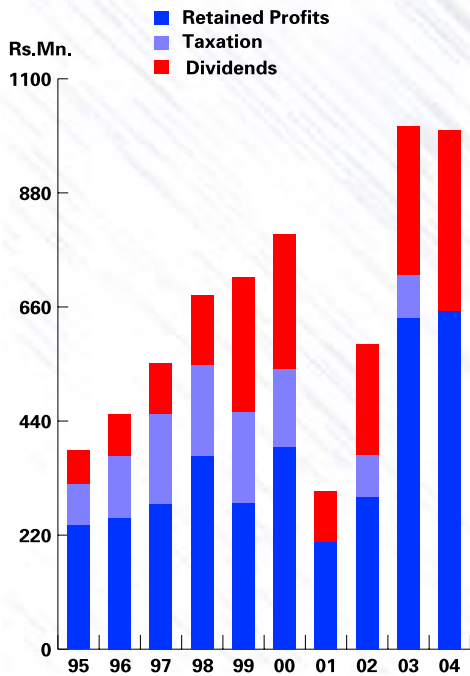
Provision for Credit losses																
to average loans		.66%		.38%		.43%		.38%		.86%		.44%		.55%		.44%

Ten Year Statistical Summary

Year ended 31st December (Rs.Mn.)	1995	1996	1997	1998	1999	2000	2001	2002	2003	2004
OPERATING RESULTS										
Income	3,567	4,792	6,116	6,704	7,723	9,641	11,564	11,799	14,831	14,087
Interest Income	2,924	4,037	4,964	5,400	6,480	7,940	9,336	9,399	11,537	11,469
Interest Expenses	1,859	2,811	3,355	3,316	4,088	5,281	7,201	6,258	6,909	5,962
Exchange Income	170	215	395	428	313	364	516	382	506	662
Other Income	472	539	757	868	930	1,337	1,712	2,018	2,788	1,956
Operating Expenses	1,144	1,408	2,036	2,531	2,741	3,411	4,061	4,873	5,009	5,716
Profit before Income Tax	564	573	725	858	894	949	301	669	1,092	950
Income Tax on Profit	80	120	172	175	176	149	(2)	80	83	(26)
Profit after Taxation	483	453	553	683	718	800	303	589	1,008	976
SHAREHOLDERS' FUNDS										
Share Capital	120	200	200	300	650	650	650	715	715	1,001
Reserves	2,018	2,387	2,814	3,237	4,358	4,898	5,103	5,520	6,278	8,051
LIABILITIES										
Customer Deposits	22,417	29,234	39,303	46,032	53,858	62,758	75,599	87,884	101,026	118,524
Refinance Borrowings	678	913	954	1,129	1,636	1,655	1,565	1,659	1,764	2,066
Other Liabilities	4,805	8,592	9,243	13,805	15,732	17,540	15,999	19,354	23,161	22,788
Deferred Taxation	47	56	59	87	121	155	215	304	387	350
ASSETS										
Bills of Exchange	2,448	3,517	3,935	3,824	3,122	4,546	3,153	2,690	2,412	2,077
Loans and Advances	16,251	20,830	28,343	33,988	40,328	46,904	49,006	59,991	71,426	84,379
Lease Rentals Receivable	1,175	1,595	1,947	2,078	2,741	2,969	2,898	4,032	5,085	6,838
Cash, Short Term Funds and Statutory Deposits with Central Bank of Sri Lanka	6,635	9,124	10,585	14,495	17,325	15,212	18,844	23,640	25,019	31,654
Property, Plant & Equipment	1,076	1,261	1,437	1,675	1,914	2,273	2,509	2,781	3,414	3,387
Other Assets	2,500	5,055	6,327	5,003	10,924	15,752	22,722	22,301	25,975	24,445
RATIOS										
Return on Average Shareholders' Funds (%)	25	19	20	21	17	15	5	10	15	12
Income Growth (%)	28	34	28	10	15	25	20	2	26	(5)
Return on Average Assets (%)	1.8	1.3	1.2	1.2	1.0	1.0	0.3	0.6	0.8	0.7
Rate of Dividends (%)	40	40	50	45	40	40	15	30	40	35
Dividend Cover (times)	7.5	5.7	5.5	5.1	2.8	3.1	3.1	2.8	3.5	2.8
Gross Dividends (Rs.Mn.)	64	80	100	135	260	260	98	215	286	350
Advance to Deposits & Refinance (%)	86	86	85	85	82	84	71	76	77	77
Property, Plant & Equipment to Shareholders' Funds (%)	50	49	48	47	38	41	43	45	49	37
Total Assets to Shareholders' Funds (times)	14	16	17	18	15	16	17	19	19	17
(As specified in the Banking Act No. 30 of 1988)										
Capital Funds to Liabilities including Contingent Liabilities (%)	1.9	1.7	1.2	1.2	1.0	1.2	1.2	1.2	1.0	1.0
Liquid Assets to Liabilities (%)	23	23	23	27	25	25	28	32	27	25
SHARE INFORMATION										
Market Value per Share (Rs.)										
- Voting	570.00	260.00	225.00	174.00	87.00	46.25	52.00	79.00	69.00	57.00
- Non-Voting	-	-	-	-	-	36.75	36.00	47.00	36.75	32.75
Earnings per Share (Rs.)	6.56	6.15	7.51	9.27	9.75	10.86	4.11	8.00	13.69	12.51
Price Earnings Ratio	86.89	42.28	29.96	18.77	8.92	4.26	12.65	9.88	5.04	4.56
Net Assets per Share (Rs.)	178.17	129.35	150.70	117.90	77.05	85.35	88.51	87.20	97.81	90.43
OTHER INFORMATION										
No. of Employees	2,690	2,951	3,433	3,744	4,035	4,119	4,137	4,280	4,203	4,180
No. of Customer Centres	66	78	92	103	111	117	123	137	138	142
No. of other Financial Centres	44	56	61	72	95	104	110	110	110	110

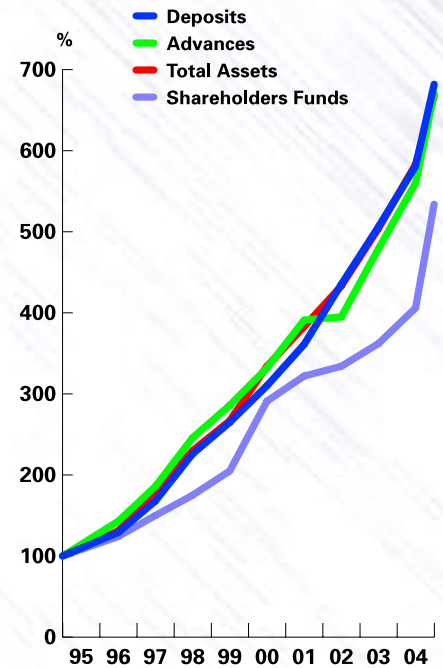
Ten Year Graphical Review

Distribution of Profits



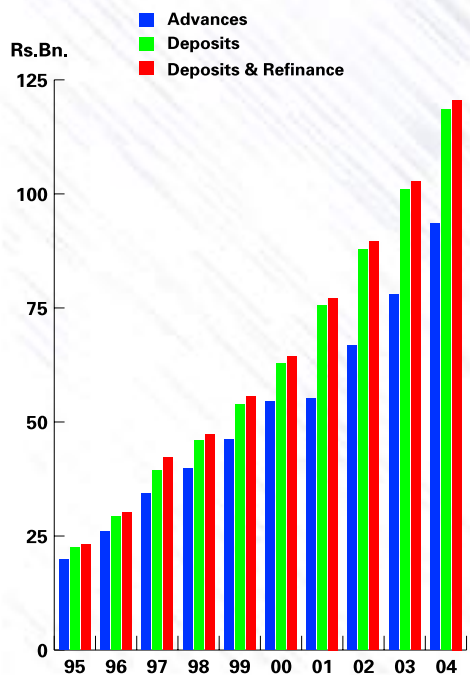
The graph shows the distribution of before tax profit segregated into dividends, taxes and profits retained within the business.

Balance Sheet Growth (Base Year 1994)



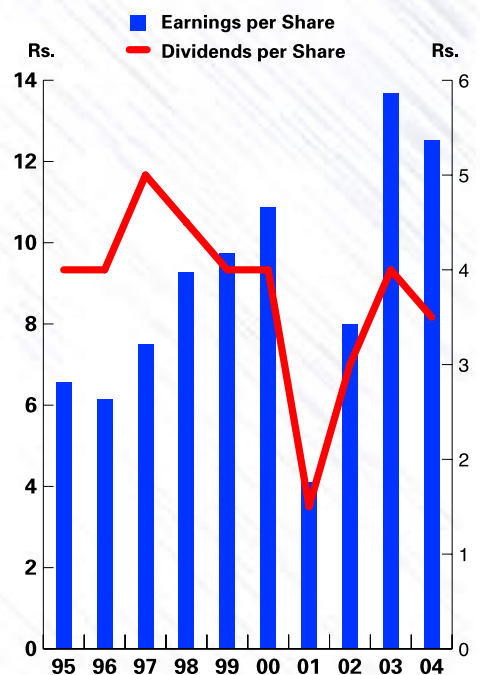
The graph shows the growth in deposits, advances, total assets and shareholders' funds. Year 1994 has been considered as the base year.

Advances, Deposits and Re-Finance Borrowings



The graph shows the growth in deposits and refinance borrowings compared with the volume of advances.

Earnings per Share & Dividends per Share

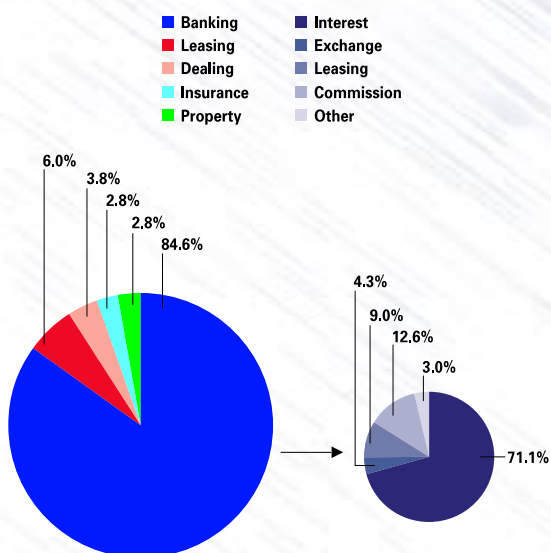


Segmental Analysis

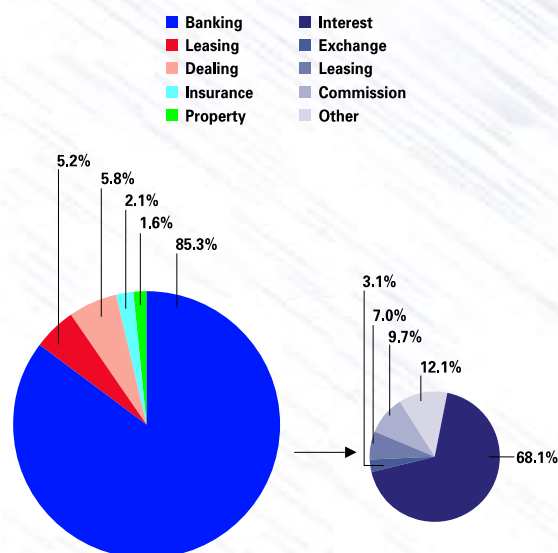
Business segments	Banking		Leasing		**Dealings		Property		Insurance		Total	
	2004 Rs. 000	2003 Rs. 000	2004 Rs. 000	2003 Rs. 000	2004 Rs. 000	2003 Rs. 000	2004 Rs. 000	2003 Rs. 000	2004 Rs. 000	2003 Rs. 000	2004 Rs. 000	2003 Rs. 000
Interest	10,539,437	10,687,788	-	-	465,359	443,821	238	-	43,296	34,785	11,048,330	11,166,394
Exchange	662,176	506,436	-	-	684	(42)	-	-	-	-	662,860	506,394
Lease/Premium/ Brokering Income	-	-	929,898	848,764	84,000	90,527	-	346,775	388,757	215,503	1,402,655	1,154,794
Commissions/Rent	1,519,924	1,241,588	-	-	-	1,461	434,835	-	-	-	1,954,359	1,589,824
Other	435,923	1,545,986	-	-	34,496	423,446	-	-	-	14,160	470,419	1,983,592
Total revenue	13,157,460	13,981,798	929,898	848,764	584,539	959,213	434,673	346,775	432,053	264,448	15,538,623	16,400,998

**Stock Broking & Securities Dealings

Segmental Analysis of Revenue-2004



Segmental Analysis of Revenue-2003



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, 2004 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

As At 31st December 2004

Voting

	Resident			Non-Resident			Total		
	No of share holders	No of shares	%	No of share holders	No of shares	%	No of share holders	No of shares	%
1 - 250	2,017	182,118	0.26	22	2,254	0.04	2,039	184,372	0.24
251 - 500	838	315,737	0.45	7	2,929	0.05	845	318,666	0.41
501 - 1,000	636	478,773	0.68	10	7,141	0.11	646	485,914	0.63
1,001 - 2,000	444	666,745	0.94	7	10,753	0.17	451	677,498	0.88
2,001 - 5,000	376	1,218,602	1.72	9	26,897	0.43	385	1,245,499	1.62
5,001 - 10,000	246	1,690,769	2.39	11	73,167	1.17	257	1,763,936	2.29
10,001 - 20,000	144	1,946,093	2.75	2	23,630	0.38	146	1,969,723	2.56
20,001 - 30,000	40	941,111	1.33	1	27,775	0.45	41	968,886	1.26
30,001 - 40,000	35	1,264,084	1.79	-	-	-	35	1,264,084	1.64
40,001 - 50,000	14	627,767	0.89	1	50,000	0.80	15	677,767	0.88
50,001 - 100,000	34	2,282,010	3.22	2	110,000	1.76	36	2,392,010	3.11
100,001 - 1,000,000	29	7,045,088	9.96	5	1,680,415	26.94	34	8,725,503	11.33
Over 1,000,000	10	52,103,539	73.63	1	4,222,603	67.70	11	56,326,142	73.15
	4,863	70,762,436	100.00	78	6,237,564	100.00	4,941	77,000,000	100.00

Analysis of shareholders

Resident/Non-Resident

	31/12/2004			31/12/2003		
	No of share holders	No of shares	%	No of share holders	No of shares	%
Resident	4,863	70,762,436	91.90	4,704	50,660,729	92.11
Non-Resident	78	6,237,564	8.10	74	4,339,271	7.89
Total	4,941	77,000,000	100.00	4,778	55,000,000	100.00

Individuals/Institutions

	31/12/2004			31/12/2003		
	No of share holders	No of shares	%	No of share holders	No of shares	%
Individuals	4,670	13,326,736	17.31	4,524	10,512,845	19.11
Institutions	271	63,673,264	82.69	254	44,487,155	80.89
Total	4,941	77,000,000	100.00	4,778	55,000,000	100.00

As at 31/12/2004 the average size of holding of ordinary shareholding was 15,584 voting shares. (31/12/2003 - 11,511 voting shares)

Share Information

Non-Voting

	Resident			Non-Resident			Total		
	No of share holders	No of shares	%	No of share holders	No of shares	%	No of share holders	No of shares	%
1 - 250	5,964	760,201	3.33	31	4,177	1.37	5,995	764,378	3.31
251 - 500	1,216	452,665	1.99	9	3,433	1.13	1,225	456,098	1.97
501 - 1,000	1,858	1,215,575	5.33	13	9,786	3.22	1,871	1,225,361	5.30
1,001 - 2,000	1,884	2,442,613	10.72	20	27,734	9.13	1,904	2,470,347	10.69
2,001 - 5,000	842	2,533,626	11.11	11	33,257	10.95	853	2,566,883	11.11
5,001 - 10,000	320	2,249,990	9.87	4	29,980	9.87	324	2,279,970	9.87
10,001 - 20,000	154	2,095,867	9.19	1	11,000	3.62	155	2,106,867	9.12
20,001 - 30,000	36	874,978	3.84	2	50,480	16.61	38	925,458	4.01
30,001 - 40,000	15	518,456	2.27	-	-	-	15	518,456	2.24
40,001 - 50,000	13	611,997	2.68	-	-	-	13	611,997	2.65
50,001 - 100,000	16	1,071,792	4.70	2	134,000	44.10	18	1,205,792	5.22
100,001 - 1,000,000	18	3,918,552	17.19	-	-	-	18	3,918,552	16.96
Over 1,000,000	1	4,049,841	17.77	-	-	-	1	4,049,841	17.53
	12,337	22,796,153	100.00	93	303,847	100.00	12,430	23,100,000	100.00

Analysis of shareholders

Resident/Non-Resident

	31/12/2004			31/12/2003		
	No of share holders	No of shares	%	No of share holders	No of shares	%
Resident	12,337	22,796,153	98.68	12,254	16,296,617	98.77
Non-Resident	93	303,847	1.32	90	203,383	1.23
Total	12,430	23,100,000	100.00	12,344	16,500,000	100.00

Individuals/Institutions

	31/12/2004			31/12/2003		
	No of share holders	No of shares	%	No of share holders	No of shares	%
Individuals	12,212	13,800,548	59.74	12,126	11,947,920	72.41
Institutions	218	9,299,452	40.26	218	4,552,080	27.59
Total	12,430	23,100,000	100.00	12,344	16,500,000	100.00

As at 31/12/2004 the average size of holding of ordinary shareholding was 1,858 non-voting shares. (31/12/2003 - 1,337 non-voting shares)

3 Share Trading

	2004	2003
Voting Shares		
Number of transactions	2,348	6,389
Number of shares traded (Mn.)	3.4	12.8
Rank(As per CSE)	90	36
Value of shares traded (Rs.Mn.)	224.4	1219.3
Rank(As per CSE)	55	15
Non-Voting Shares		
Number of transactions	2,549	6,611
Number of shares traded (Mn.)	2.7	8.4
Value of shares traded (Rs.Mn.)	103.5	466.3

Share Information

4 Dividends

	2004	2003
Interim	20% paid in December 2004	20% paid in December 2003
Final	15% proposed in April 2005	20% paid in April 2004

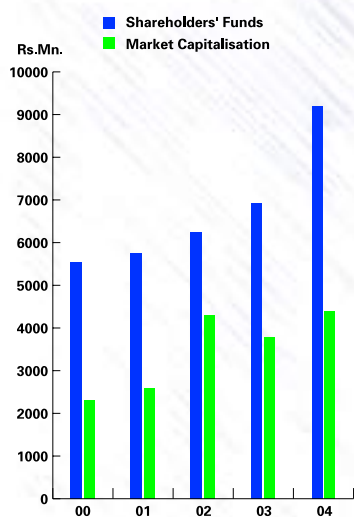
5 Earnings

	2004	2003
Earnings per share (Rs.)	12.51	13.69
Price earnings ratio(Times)	4.56	5.04

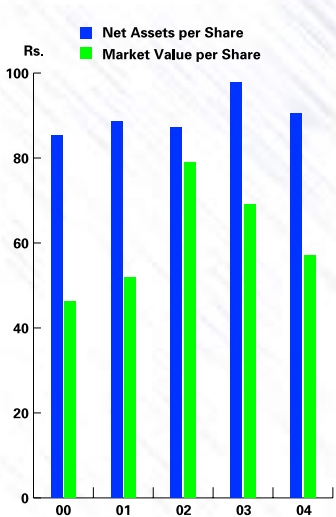
6 Market Value

	Highest Rs.	Lowest Rs.	Year End Rs.
2000 - Voting	87.50	42.00	46.25
- Non Voting	68,50	31.00	36.75
2001 - Voting	64.00	31.00	52.00
- Non Voting	55.00	24.00	36.00
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

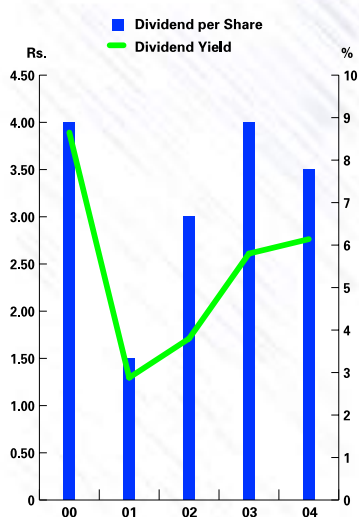
Shareholders' Funds & Market Capitalisation



Net Assets per Share & Market Value per Share



Dividend per Share & Dividend Yield



07 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
2000	5,548	2,313	88,800	2.60	7
2001	5,753	2,600	124,000	2.10	10
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

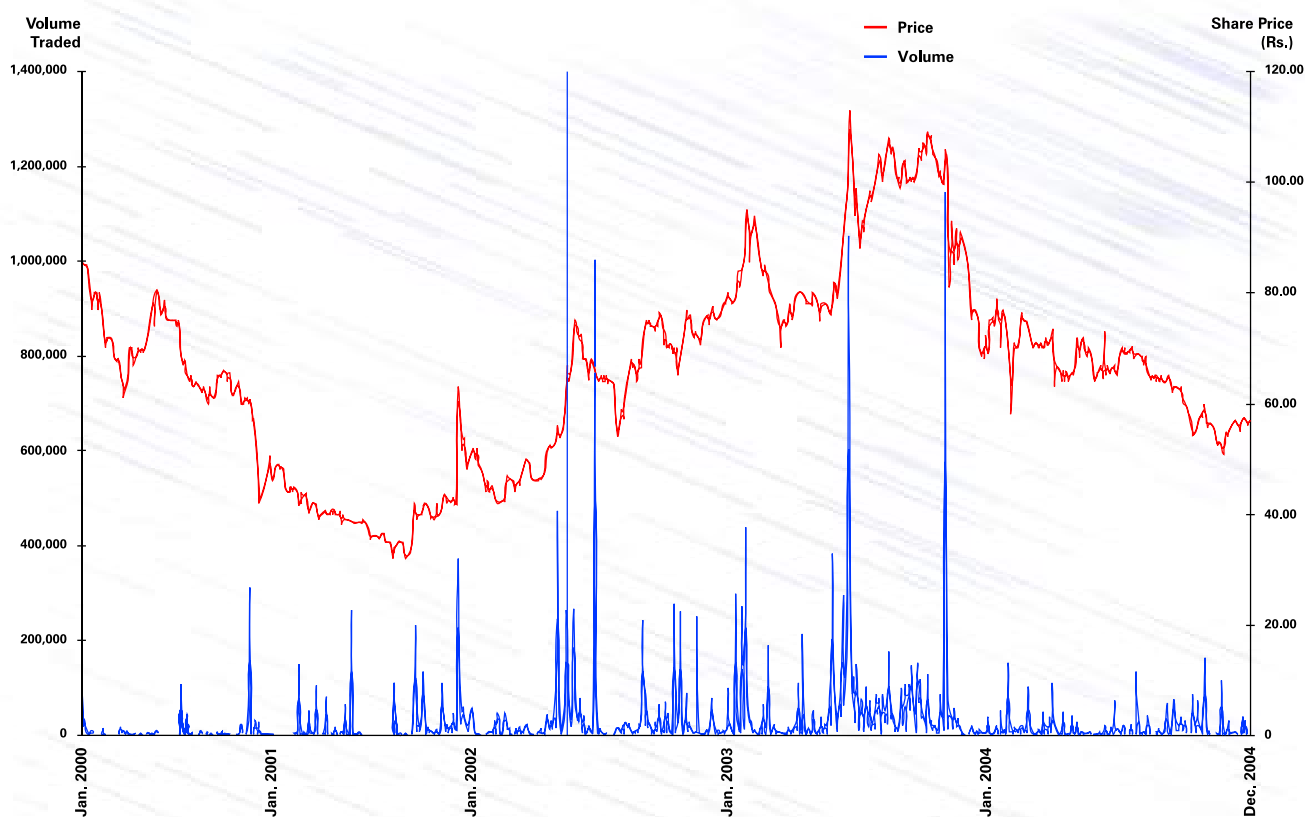
Share Information

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	<u>1,001,000,000</u>
Total			100,100,000	1,001,000,000	

* Unsubscribed shares were issued to public

9 Price Volume Chart



Share Information

10.1 Twenty Largest Voting Shareholders As At 31st December 2004

NAME	%	NO. OF SHARES		
		2004	2003	
Standard Finance Limited	11.24	11,252,020	11,220,660	
C B D Exports Limited	7.68	7,692,300	5,494,500	
Milford Exports (Ceylon) Limited	7.68	7,686,525	5,490,375	
Stassen Exports Limited	6.66	6,662,425	4,758,875	
Panchalingam Associates (Pvt) Limited	6.11	6,116,471	2,200,000	
Sri Lanka Insurance Corporation Ltd - Life Fund	5.35	5,358,262	-	
Sonetto Holdings Limited	4.22	4,222,603	3,016,145	
Distilleries Company of Sri Lanka Limited	2.98	2,980,854	2,129,182	
Brown & Company Limited	2.30	2,300,000	2,300,000	
National Savings Bank	2.05	2,054,682	1,467,630	
Elgin Investments Limited	0.95	946,900	853,300	
Bank of Ceylon c/o Ceybank Investment Centre	0.68	679,600	680,200	
Mr. Velupillai Ponnampalam Parama Lingam & Mrs. Sivasakthy Parama Lingam	0.60	600,900	600,900	
Mrs. Mavis Rita Gardiner & Mr. Sanjeev Edward Chittampalam Gardiner	0.55	550,000	550,000	
Mrs. Mavis Rita Gardiner	0.52	522,527	522,527	
Mr. Sinnathamby Visuvanathan	0.45	448,832	-	
Masons Mixture Limited	0.40	399,520	399,520	
Sri Lanka Insurance Corporation Ltd - General Fund	0.39	391,304	279,504	
DBIL - Kapital Fonds LK-Kapfnds LK Schwellenlander				
UN Capital Fonds LK-Kapfnds LK	0.35	350,400	-	
Associated Battery Manufacturers (Ceylon) Limited	0.30	300,902	435,902	
Sub Total	61.46	61,517,027	42,399,220	
Balance held by 4,921 Voting Shareholders	15.47	15,482,973	12,600,780	(4,761 V.Sh)
Total Voting Shares	76.92	77,000,000	55,000,000	
Shares held by 12,430 Non-Voting Shareholders	23.08	23,100,000	16,500,000	(12,344 NV.Sh)
Total No. of Ordinary Shares	100.00	100,100,000	71,500,000	

10.2 Twenty Largest Non-voting Shareholders As At 31st December 2004

NAME	%	NO. OF SHARES		
		2004	2003	
Hatton National Bank ESOP Trust	17.53	4,049,841	-	
Nawaloka Development (Pvt) Limited	3.10	715,000	715,000	
Legalinc Trustee Services (Pvt) Ltd/HNBL ESOP Trust	1.78	411,496	-	
Distilleries Company of Sri Lanka Limited	1.46	337,566	287,566	
Standard Finance Limited	1.17	269,600	-	
DFCC Bank A/C 1	1.00	231,000	165,000	
Mr. Sinnathamby Visuvanathan	0.95	220,000	220,000	
Mr. Dickowita Kankanamge Weeratunga/ Mr. Dikowita Kankanamge Athula Kithsiri Weeratunga	0.94	216,580	94,300	
Mr. Velupillai Ponnampalam Parama Lingam/Mrs. Sivasakthy Parama Lingam	0.90	208,150	208,150	
Mr. Dueleep Fairlie George Dalpethado	0.80	183,884	-	
Hatton National Bank Limited - A/C No. 2	0.73	169,319	169,319	
M C A Trading Co (Pvt) Limited	0.71	165,000	165,000	
Ceylon Grain Elevators Limited	0.60	137,500	137,500	
Mrs. Sembukuttiarachchige Fidelis Hemamalie Alexander	0.49	113,970	88,550	
Employees Trust Fund Board	0.48	111,990	111,990	
Lanka Synthetic Fibre Co. Limited	0.48	110,000	110,000	
Delmege Forsyth & Company (Shipping) Limited	0.48	110,000	110,000	
Waldock Mackenzie Ltd / A H Udeshi	0.46	106,000	106,000	
Sri Lanka Insurance Corporation Ltd - General Fund	0.44	101,497	-	
Seneviratne Trading Company (Pvt) Limited	0.43	100,000	100,000	
Sub Total	34.93	8,068,393	2,788,375	
Balance held by 12,410 Non-voting Shareholders	65.07	15,031,607	13,711,625	(2003-12,329 NV.Sh)
Total No. of Ordinary Shares	100.00	23,100,000	16,500,000	

Share Information

HNB Debentures 2002

i) Market Value	Highest	Lowest	Year End
5 year Fixed Rate (13.75% p.a.)	104.50	95.00	98.00
5 year Floating Rate (TB + 1.00% p.a.)	102.00	100.00	100.00
7 year Fixed Rate (14.00% p.a.)	100.25	100.25	100.25
7 year Floating Rate (TB + 1.10 p.a.)	99.75	99.75	99.75
10 year Fixed Rate (14.20% p.a.)	104.50	82.50	100.00
10 year Floating Rate (TB + 1.25 p.a.)	N/T	N/T	N/T

N/T - Not Traded for the period ended 31st December 2004.

ii) Interest Income

Coupon Interest (Rs.)*	2004	2003
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 2005.

iii) Yield to maturity of last trade done (% p.a)

	2004	2003
5 year Fixed Rate (13.75% p.a.)	14.66%	12.52%
5 year Floating Rate (TB + 1.00% p.a.)**	N/A	N/A
7 year Fixed Rate (14.00% p.a.)**	13.91%	13.92%
7 year Floating Rate (TB + 1.10 p.a.)**	N/A	N/A
10 year Fixed Rate (14.20% p.a.)	14.19%	13.49%
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 on equivalent government security

	2004	2003
5 year Treasury Bond	10.00%	8.75%
6 year Treasury Bond	10.25%	6.67%
10 year Treasury Bond	N/T	6.65%

N/T - Not Traded for the period ended 31st December 2004

HNB Debentures 2003

i) Market Value	Highest Rs.	Lowest Rs.	Year End Rs.
5 year Fixed Rate (10.00% p.a.)	92.00	82.50	86.00
5 year Floating Rate (TB + 2.00% p.a.)	N/T	N/T	N/T

N/T - Not Traded for the period ended 31st December 2004.

ii) Interest Income

Coupon Interest (Rs.)*	2004	2003
5 year Fixed Rate (10.00% p.a.)	10.00	N/A
5 year Floating Rate (TB + 2.00% p.a.)	9.40	N/A

*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 2005.

iii) Yield to maturity of last trade done (% p.a)

	2004	2003
5 year Fixed Rate (10.00% p.a.)	15.27%	N/A
5 year Floating Rate (TB + 1.00% p.a.)**	N/A	N/A

**The yield to maturity calculation is not applicable for floating rate debentures.

iv) Yield on equivalent government security

	2004	2003
5 year Treasury Bond	10.00%	N/A
6 year Treasury Bond	10.25%	N/A
10 year Treasury Bond	N/T	N/A

N/T - Not Traded for the period ended 31st December 2004

Ratios

	2004	2003
Debt to equity ratio (%)	44%	57%
Interest cover (Times)	3.24	3.64
Quick asset ratio (%)	69%	78%

Definitions

Debt to equity ratio (%)	$\frac{\text{Subordinated Debentures}}{\text{Shareholders Fund}}$
Interest cover (Times)	$\frac{\text{PBT+Debenture Interest}}{\text{Debenture Interest}}$
Quick asset ratio (%)	$\frac{\text{Liquid Assets*}}{\text{Current Liabilities}}$

* Liquid Assets - cash and short term funds, treasury bills, commercial paper and treasury bills purchased under repo agreements, dealing securities, bills of exchange, loans and advances due within one year, lease rentals receivable within one year and other assets.

Record of Events

JANUARY



HNB Your Partner in Progress

- With the beginning of the New Year, a new corporate image and the new corporate identity was launched.
- HNB Development Banking held the traditional Harvesting Ceremony at Tissamaharama.
- Our growing customer base necessitated the opening of second Unit at Negombo.
- Cricket - HNB emerged champions in the Mercantile 'B' Division Indoor Cricket Tournament.

APRIL



- HNB SMS Alert Service was introduced as a safeguard for Credit Card holders – a facility where credit card holders are immediately notified via SMS when their Credit Cards are being used.
- Development Banking Division together with HNB – Biyagama, Mt. Lavinia and Nugegoda staged an Avurudu Pola in each of these locations.
- The Mirihana Customer Centre was relocated.

FEBRUARY



- Hockey - HNB emerged champions of Mercantile 'A' and 'B' divisions of both the League and Knockout tournaments. The HNB 'A' team was also awarded the inaugural Dennis de Rosairo Fair Play Trophy introduced by the Mercantile Hockey Association.
- HNB linked with Motor Marvels (Pvt) Ltd in a Leasing promotion for Suzuki & Land Rover vehicles.

MAY



- HNB diverted cost of Vesak greetings advertisements towards the donation of three houses to the needy.
- HNB International Division held a seminar on International Trade.
- HNB staged a Vesak Lantern competition among the branches.

MARCH



- The Pathum Udanaya Grand Draw 2003 was held in Kuwait and a musical show was staged in Qatar.
- HNB sponsored the Mercantile Cricket Association "C" Division 50 overs League tournament.
- Badminton – HNB emerged champions of the men's Singles and Doubles Novices Championship.

JUNE



- HNB signed a US\$ 36.5 million Interest Rate Swap deal with Heladhanavi Ltd., A power generating company - the biggest IRS deal clinched in Sri Lanka to date.
- Leasing promotion campaign was launched with Sathosa Motor Company.

Record of Events

JULY



- HNB was awarded ISO 9001-2002 Certificate for Trade Services by Bureau Veritas Quality International (BVQI).
- HNB IT Division launched a 'CC-On line' service that enables credit card holders to access details via Internet.
- HNB-Card Centre with Malaysian Airlines launched an Air ticket promotion for credit card holders.

AUGUST



- The MOU between HNB and Deutsche Bank AG Colombo Branch for corporate finance activities was signed.
- The Extension Office at Seeduwa was opened.
- Soccer – HNB 'A' team won the Mercantile Knockout Tournament.

SEPTEMBER



- A HNB Customer Centre at Nellyyadi was opened.
- HNB arranged a study tour to India for selected farmer customers.
- The Muralidaran-Gunasekara Foundation and HNB combined to launch the 'Muralidharan Exercise Books' for school children.
- HNB Customer Centre at Piliyandala moved to new premises.

OCTOBER



- HNB was adjudged the second runner up of the overall National HRM Awards by IPM.
- The HNB Senior Citizens Scheme was re-launched.
- HNB in tandem with DIMO staged a promotion for TATA Indica and Indigo cars.
- Cricket - HNB emerged champions of the 20 x 20 cricket tournament.
- HNB came out Champions at the Inter-Bank Sports Festival organized by the People's Bank.

NOVEMBER



- HNB Gami Pubuduwa celebrated its 15th Anniversary an occasion that was graced by the Hon. Prime Minister.
- The HNB Rights Issue of Rs. 1.4 Bn was over subscribed on the opening day of Issue.
- Hatna-U and Hatna Recos IT Systems were duly completed.
- Yet another Extension Office was opened – at Pilimathalawa.
- Netball – HNB emerged the Knockout Champions in the Gamini Dissanayake Memorial Trophy Tournament.

DECEMBER



- HNB emerged winner of the National Business Excellence Award under the Banking/Insurance Sector at the ceremony organized by the National Chamber of Commerce.
- A ceremony to mark HNB's signing of a Syndicated Term Loan Facility of Rs. 2,000 Million for Celltel Lanka (Pvt) Ltd. was held.
- HNB netball team emerged champions of Mayors Cup tournament.

Report of the Directors

The Directors have pleasure in presenting to members their report and the audited accounts of the Company for the year ended 31st December 2004. This was approved by the Directors at a meeting held on 18th February, 2005.

Principal Activities

The principal activities of the Bank and the Group during the year were general banking, development banking, mortgage financing, lease financing, investment banking, corporate financing, dealing in government securities, 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 the Chief Executive Officer's Review of Operations on Pages 14 to 21 of this Annual Report. These reports form an integral part of the Directors' Report

Product Development

During the year the Bank introduced value additions to the following existing products:

- Senior Citizen Scheme
- Additional interest on their deposits under "Premium Interest"
- A free hospitalization cover under "Health Plus"
- Loan facility for self-employment under "Business Aid"
- Subasiri Personal Loan Scheme
The Dream Drive Vehicle Loan scheme was introduced to offer an incentive to customers who wished to purchase vehicles by obtaining a Personal Loan
- Graduateship – Educational Loan Scheme
CIMA students were granted loans for CIMA examinations.

Branch Expansion

- During the year the Bank opened 4 Customer Centres at Nelliady, Pilimatalawa, Seeduwa & a 2nd Customer Centre in Negombo

Internal Control

The Board has overall responsibility for the Bank's systems of internal financial control. Although no system of internal financial control can provide absolute assurance against material misstatement or loss, the Bank's internal control systems have been designed to provide the Directors with reasonable assurance that assets are safeguarded, transactions are authorised and properly recorded and material errors and irregularities are either prevented or detected within a reasonable period of time. The Board is satisfied with the effectiveness of the system of financial control for the period up to the date of signature of the accounts.

Corporate Governance

The main Corporate Governance practices of the Bank are given on pages 3 to 5 of this Annual Report.

Audit Committee

The members of the Audit Committee at the date of the Report of the Directors are :

Mr. D.H.S. Jayawardena (Chairman)
Mrs P C Cooray
Mr R Sivaratnam
Mr. Gemunu Gunatilleke (Consultant)

All members of the committee are non-executive Directors and their report is contained on page 66. of this 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 accounts.

Code of Corporate Conduct

The code of Corporate conduct of the Bank is set out under HR Review on page 37 of this Annual Report.

Turnover/Gross Income

The Turnover/Gross Income of the Group for 2004 was 14,502,961,000 [2003 - Rs. 15,873,259,000/-]. An analysis of the income is given in note 1 to the Accounts.

Profit	2004 Rs.000	2003 Rs. 000
The Group Profit for the year ended 31 st December 2004 after payment of all expenses of management and providing for depreciation and contingencies	832,310	1,731,416
Add/(Less)Taxation	15,114	(99,926)
Group Net Profit after taxation	847,424	1,631,490
Taxes imposed with retrospective effect	-	(71,579)
Minority Interest	(91,818)	(59,974)
Unappropriate Profit Brought forward from previous year	778,133	48,946
On merger of subsidiaries	(27,879)	
Balance available for Appropriation	1,505,860	1,548,883

Report of the Directors

Appropriations	2004 Rs.000	2003 Rs.000
Transfer to General Reserve	500,000	500,000
Transfer to Reserve Fund	20,000	20,500
20% Interim Dividend paid (20% - 2003)	200,200	143,000
Final Dividend 2003/2002	143,000	107,250
Balance carried forward as at 31.12.2004	642,660	778,133

The Directors recommend the payment of a final dividend for the year of 15% (20% - 2003) subject to tax from the balance carried forward as at 31.12.2004 (Note 23)

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 are 30%. The off-shore operations of the FCBU are being taxed at 20%. Share Trading operations are taxed at 15% until 31 December 2004.

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 15% (2003-20%) Final Dividend to be paid on 6th April 2005 to holders of Issued and paid up Ordinary shares of the Company as at the close of business on 24th March 2005. This Dividend together with the Interim Dividend of 20% (2003 - 20%) paid on 28th December 2004 amount to a total dividend of 35% (2003- 40%) for the year 2004.

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 81.21% of the 20% Interim dividend paid for 2004 is subject to taxation.

Corporate Donations

During the year the Bank made donations amounting to Rs.155,000 (2003 - 3,295,800/-) in terms of the resolution passed at the last Annual General Meeting. The donations made to Government approved charities from the above sum amount to Rs.140,000 (2003 - 3,115,800/-).

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's Employment Policies are set out under "HR Review" on page 35 of this Annual Report.

Capital Expenditure

The total capital expenditure incurred on the acquisition of fixed assets during the year amounted to Rs.701,865,000/- (2003 - 1,719,381,000/-) details of which are given in Note 20 to the Accounts.

Property, Plant & Equipment

The details of the property, plant, and equipment of the company are shown in Note 20 on pages 97 to 101.

Market Value of Freehold Properties

The carrying value of freehold properties owned by the Bank as at 31st December 2004 is included in the accounts at Rs.1,510,696,000/- (2003 - Rs. 1,544,334,000/-). A panel of Chartered Valuers/Licensed Surveyors carried out a re-valuation of the Bank's freehold properties in December 1993. Properties acquired after 31st December 1993 are reflected at book-values as their appreciation is insignificant. In the opinion of the Directors this figure is not in excess of the current market value. The details of freehold properties owned by the Bank are shown in Note 20.2 on pages 98 to 101 of this Annual Report.

Reserves

The Group Reserves consists of:

	2004 Rs.000	2003 Rs.000
Share Premium	1,962,246	822,645
Capital Reserve	325,890	334,575
Reserve Fund	569,707	549,707
Repairs & Renovations	6,700	6,700
General Reserves	5,037,660	4,673,133
Total	7,902,203	6,386,760

The movement in these reserves is shown in the Statement of Changes in Equity on page 70.

Share Capital

The total issued and fully paid up capital as at 31st December 2004 was Rs.1,001,000,000/- consisting of 77,000,000 ordinary shares of Rs. 10/- each voting and 23,100,000 ordinary shares of Rs. 10/- each non-voting.

Report of the Directors

Shareholding

As at 31st December 2004 there were 14,856 Registered shareholders. The distribution is indicated on pages 53 and 54 of this Annual Report.

Share Information

Information relating to earnings, dividend, net assets and market price per share is given in Financial Highlights on page 10 of this Annual Report. Information on share trading is given in Note item 3 on page 54 of this Annual Report.

Major Shareholders

The twenty largest voting shareholders and non-voting shareholders of the Bank as at 31st December 2004 are given on page 57 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 CEO's Review of Operations.

The Bank would continue implementing strategies under its Business Plan, which was developed in the previous year. Whilst closely following post-Tsunami economic developments, the Bank would take an active role in the reconstruction and rehabilitation process utilizing its wide presence in the affected areas. The Bank also intends to draw synergies from its subsidiaries to harness greater business opportunities for the Group.

Directors

The Board of Hatton National Bank Limited consists of eight 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 page 12.

In accordance with the provisions of Article 87 of the Articles of Association, Mr R K Obeyesekere retires by rotation and being eligible offers himself for re-election with the unanimous support of the Board.

In accordance with the provisions of Article 93 of the Articles of Association, Mrs P. C. Cooray & Mr R Sivaratnam offer themselves for re-election with the unanimous support of the Board.

Directors' Interests

Directors' interests in contracts with the Company, both direct and indirect are referred to in Note 33 to the Accounts. These interests have been declared at the Directors' Meeting held on 06th January 2005. 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 dependant children are as follows:

	As at 31/12/04	As at 31/12/03
Mr R T Wijetilleke	14,914	10,654
Dr. V P Vittachi	5,005	3,575
Mr D H S Jayawardena	5,005	3,575
Mr M V Theagarajah	73,874	18,693
Mr R K Obeyesekere	5,005	3,575
Mrs P C Cooray	3,300	-
Mr R Sivaratnam	5,040	-
Mr R Theagarajah	9,322	-

No Director directly holds debentures of the Bank

There has been no change in their interests between December 31st, 2004 and 18th February, 2005 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.

Annual General Meeting

The 36th Annual General Meeting of the Bank will be held at the Auditorium on Level 22 of "HNB Towers" (Head Office) at No: 479, T.B. Jayah Mawatha, Colombo 10 on the 30th day of March 2005 at 10.00 a.m. in the forenoon. The Notice of the 36th Annual General Meeting is on page 123 of this report.

The Auditors

The retiring Auditors KPMG Ford, Rhodes, Thornton & Co. 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
DGM – Legal/Board Secretary

Friday, February 18th, 2005.
Colombo, SRI LANKA

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Director's Responsibility for Financial Reporting

The Bank's Financial Statements for the year 2004 prepared and presented in this report are in conformity with the requirements of Sri Lanka Accounting Standards, Companies Act No. 17 of 1982 and the Banking Act No. 30 of 1988. The Financial Statements reflect a true and fair view of the state of affairs of the Group as at that 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. During the year the Committee appointed Mr. Gemunu Gunatilleke, Managing Partner, Ernst & Young 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.

The Bank Supervision Department of the Central Bank of Sri Lanka carries out periodical examinations of the records and the affairs of the Bank as deemed necessary to ensure conformity to the provisions of the Banking Act and the regulations formulated in accordance therewith. It also checks and ascertains whether certain financial ratios prescribed by it are being observed to ensure safety of the interests of depositors and shareholders in conformity with sound financial management.

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 67 of the annual report.

By Order Of the Board



INDRANI GOONESEKERA
Deputy General Manager (Legal)/
Board Secretary

Friday, February 18th, 2005.
Colombo, SRI LANKA

Audit Committee Report

Report of the Chairman Audit Committee

During the year under review the Committee met five times. The consultant to the Audit Committee met separately with the senior management of the Bank on two occasions.

The CEO attended meetings on invitation. The CFO and senior management was invited to attend meetings as necessary and the Committee also met with the Asst. General Manager– Audit on a regular basis.

Financial Reporting

The Committee reviewed the procedure for the closing of month and year-end accounts, considered how management develops its financial results including the procedure for finalizing loan loss provision. A review of interim and year-end financial statements was carried out prior to their release.

The Committee also reviewed the extent of compliance with Accounting Standards and disclosure requirements. Reviewed significant accounting and reporting issues and considered their impact on financial statements

Internal Control

Considered how management has established internal controls, including IT security and control.

Reviewed the reports made by the external auditors and management's response to these findings. Reviewed with internal auditors their assessment of weaknesses in internal control systems. Considered whether the internal control recommendations made by internal and external auditors have been implemented by management.

Compliance with Laws and Regulations

The Committee reviewed management's procedures for monitoring compliance with laws and regulations. The monitoring procedure was strengthened by introducing structured reporting with oversight being performed by the Bank's Compliance Officer.

Reviewed with management, as appropriate, the findings of regulatory examinations and considered the implications on financial statements and financial reporting.

External Audit

Considered the independence of the external auditor. During the year under review non- audit work was not carried out by the principal auditor. The Committee also considered the extent to which other accounting and auditing firms were used and examined the rationale for using them.

Internal Audit

Reviewed the structure and the activities of internal audit. Reviewed the internal audit plan with the Asst. General Manager-Audit particularly with regard to internal control and the financial reporting process.

Reviewed significant findings and ensured that management responded to these findings. Reviewed the staffing, training and budget of the internal audit function.



D.H.S. JAYAWARDENA
Chairman Board Audit Committee

Friday, February 18th, 2005.
Colombo, SRI LANKA

Auditors' Report



KPMG Ford, Rhodes, Thornton & Co.
(Chartered Accountants)
32 A, Sir Mohamed Macan Markar Mawatha,
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Colombo 00300,
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2446 058, 254 1249.
Internet : www.lk.kpmg.com

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 31st December 2004, 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 68 to 117 of the Annual Report.

Respective Responsibilities of Directors & 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 31st December 2004, 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 31st December 2004 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 31st December 2004 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' Interest 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 31st December 2004 except as stated in Note 33 to these financial statements.

CHARTERED ACCOUNTANTS

Colombo
18th February, 2005

KPMG Ford, Rhodes, Thornton & Co.,
a Sri Lankan partnership, is the Sri Lankan member
firm of KPMG International, a Swiss corporate

R.N. Asirwatham FCA
R. Seevaratnam FCA
M.R. Mihular FCA
P.Y.S. Perera FCA
T.J.S. Rajakarier FCA
Ms. S. Joseph ACA

A.N. Fernando FCA
S. Sirikanathan FCA
Ms. M.P. Perera FCA
C.P. Jayatilake FCA
W.W.J.C Perera FCA

Income Statement

For the year ended 31st December	Note	Bank		Group	
		2004 Rs.000	2003 Rs.000	2004 Rs.000	2003 Rs. 000
INCOME	1	14,087,358	14,830,562	14,502,961	15,873,259
Interest income	2	11,469,335	11,536,552	11,579,556	11,930,043
Interest expenses	3	5,962,041	6,909,095	6,361,766	7,335,002
Net interest income		5,507,294	4,627,457	5,217,790	4,595,041
Foreign exchange income		662,176	506,436	662,860	506,394
Fee & commission income		1,519,924	1,241,588	1,574,282	1,315,178
Other income	4	435,923	1,545,986	686,263	2,121,644
		8,125,317	7,921,467	8,141,195	8,538,257
Less:					
OPERATING EXPENSES	5				
Personnel costs		2,180,272	2,113,804	2,284,860	2,183,671
Premises equipment & establishment expenses		1,620,796	1,508,321	1,409,430	1,320,081
Other overhead expenses		1,681,263	1,179,610	1,941,175	1,312,140
Provision for staff retirement benefits		233,865	206,623	235,249	207,535
Bad debts written off		-	14,222	-	14,222
Provision for bad & doubtful debts	6	1,566,493	1,715,697	1,566,493	1,715,683
Provision for /(writeback of) investments		(107,427)	36,373	(105,000)	36,373
Amortization of Goodwill/(Negative goodwill)	21	-	55,232	(353)	54,879
		7,175,262	6,829,882	7,331,854	6,844,584
OPERATING PROFIT BEFORE INCOME TAXES		950,055	1,091,585	809,341	1,693,673
Share of associate companies' profit before taxation		-	-	22,969	37,743
PROFIT BEFORE INCOME TAXES		950,055	1,091,585	832,310	1,731,416
Add/(Less): Taxation	7	26,326	(83,300)	15,114	(171,505)
PROFIT AFTER INCOME TAXES		976,381	1,008,285	847,424	1,559,911
Minority Interest		-	-	(91,818)	(59,974)
NET PROFIT FOR THE YEAR		976,381	1,008,285	755,606	1,499,937
EARNINGS PER SHARE (RS.)	8	12.51	13.69	9.68	20.37
DIVIDEND PER SHARE (RS)		*3.50	4.00	*3.50	4.00

The attached Accounting Policies and the Notes from Pages 73 to 117 form an integral part of these financial statements.

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

Balance Sheet

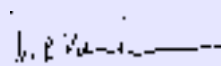
As at 31st December	Note	Bank		Group	
		2004 Rs.000	2003 Rs.000	2004 Rs.000	2003 Rs.000
ASSETS					
Cash & short term funds	9	22,534,097	18,956,277	22,539,622	19,013,516
Statutory deposit with Central Bank of Sri Lanka	10	9,120,391	6,062,445	9,120,391	6,062,445
Government of Sri Lanka treasury bills and bonds		-	372,311	744,282	3,379,863
Commercial papers		682,115	512,770	682,115	512,770
Treasury bills purchased under repurchase agreements		-	-	5,650,256	1,448,700
Dealing securities	11	403,233	430,687	416,933	430,687
Investment securities	12	15,313,634	15,760,633	16,334,526	17,577,754
Bills of exchange	13	2,077,466	2,411,950	2,077,466	2,411,950
Loans and advances	14	84,378,688	71,425,720	83,701,444	69,629,250
Lease rentals receivable - within one year	15	2,564,267	2,033,636	2,564,267	2,033,636
Lease rentals receivable - after one year	16	4,274,100	3,051,137	4,274,100	3,051,137
Investment in associate companies	17	132,326	157,582	168,588	190,309
Investment in subsidiary companies	18	2,293,663	1,343,663	-	-
Other assets	19	5,619,176	7,398,391	5,526,803	7,258,747
Property, plant & equipment	20	3,386,538	3,413,544	7,959,040	7,891,810
Goodwill on consolidation	21	-	-	813	1,626
Total Assets		152,779,694	133,330,746	161,760,646	140,894,200
LIABILITIES					
Deposits from customers	22	118,523,934	101,025,512	118,341,938	100,947,748
Dividends payable	23	108,299	40,757	108,299	40,757
Borrowings	24	8,824,489	7,525,969	15,303,376	14,392,206
Bills payable		1,668,174	1,249,984	1,668,174	1,249,984
Other liabilities	25	10,414,757	12,219,618	10,789,262	12,497,010
Long-term insurance funds	26	-	-	169,493	84,229
Non life insurance reserves	27	-	-	174,223	114,306
Taxation		(162,195)	(111,283)	(157,981)	(96,328)
Deferred Taxation	28	350,356	387,091	352,529	389,375
Subordinated debentures	29	4,000,000	4,000,000	5,983,450	3,983,450
Total Liabilities		143,727,814	126,337,648	152,732,763	133,602,737
SHAREHOLDERS' FUNDS					
Ordinary Shares - Voting	30	770,000	550,000	770,000	550,000
Ordinary Shares - Non-Voting	30	231,000	165,000	231,000	165,000
Statutory Reserve fund		569,707	549,707	569,707	549,707
Reserves		7,481,173	5,728,391	7,332,496	5,908,632
		9,051,880	6,993,098	8,903,203	7,173,339
MINORITY INTEREST					
		-	-	124,680	118,124
		9,051,880	6,993,098	9,027,883	7,291,463
Total Liabilities, Shareholders' Funds & Minority Interest		152,779,694	133,330,746	161,760,646	140,894,200
Commitments & Contingencies	31	45,221,843	55,266,271	45,221,843	55,266,271

The attached Accounting Policies and the Notes from pages 73 to 117 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



R Theagarajah
Director/
Chief Executive Officer



Indrani Goonesekera
Deputy General Manager
Legal/Board Secretary

Friday, 18th February 2005
Colombo, SRI LANKA.

Statement of Changes in Equity

FOR THE YEAR ENDED 31 DECEMBER, 2004 - Bank

	Share Capital		Share Premium	Capital Reserve	Statutory Reserve Fund	General Reserve	Repairs & Renovation Reserve	Income Statement	Total
	Voting Shares	Non-Voting Shares							
	Rs. 000	Rs. 000	Rs. 000	Rs. 000	Rs. 000	Rs. 000	Rs. 000	Rs. 000	Rs. 000
Balance as at 31.12.2002	550,000	165,000	822,645	325,890	529,207	3,395,000	6,700	440,621	6,235,063
Net profit for the year 2003	-	-	-	-	-	-	-	1,008,285	1,008,285
Final Dividend for 2002	-	-	-	-	-	-	-	(107,250)	(107,250)
Interim Dividend 2003	-	-	-	-	-	-	-	(143,000)	(143,000)
Transfers during the year 2003	-	-	-	-	20,500	500,000	-	(520,500)	-
Balance as at 31.12.2003	550,000	165,000	822,645	325,890	549,707	3,895,000	6,700	678,156	6,993,098
Rights Issue of Shares	220,000	66,000	1,139,601	-	-	-	-	-	1,425,601
Net Profit for the year 2004	-	-	-	-	-	-	-	976,381	976,381
Final dividend for 2003	-	-	-	-	-	-	-	(143,000)	(143,000)
Interim dividend for 2004	-	-	-	-	-	-	-	(200,200)	(200,200)
Transfers during the year 2004	-	-	-	-	20,000	500,000	-	(520,000)	-
Balance as at 31.12.2004	770,000	231,000	1,962,246	325,890	569,707	4,395,000	6,700	791,337	9,051,880

FOR THE YEAR ENDED 31 DECEMBER, 2004 - Group

	Share Capital		Share Premium	Capital Reserve	Statutory Reserve Fund	General Reserve	Repairs & Renovation Reserve	Income Statement	Total
	Voting Shares	Non-Voting Shares							
	Rs. 000	Rs. 000	Rs. 000	Rs. 000	Rs. 000	Rs. 000	Rs. 000	Rs. 000	Rs. 000
Balance as at 31.12.2003	500,000	165,000	822,645	334,575	529,207	3,395,000	6,700	48,946	5,852,073
Net Profit for the year As previously stated 2003	-	-	-	-	-	-	-	1,571,516	1,571,516
Taxes imposed with retrospective effect (Note 7(c))	-	-	-	-	-	-	-	(71,579)	(71,579)
Restated amount for 2003	-	-	-	-	-	-	-	1,499,937	1,499,937
Final Dividend 2002	-	-	-	-	-	-	-	(107,250)	(107,250)
Interim Dividend 2003	-	-	-	-	-	-	-	(143,000)	(143,000)
Transfers during the year 2003	-	-	-	-	20,500	500,000	-	(520,500)	-
Balance as at 31.12.2003	550,000	165,000	822,645	334,575	549,707	3,895,000	6,700	778,133	7,101,760
Net Profit for the year 2004	-	-	-	-	-	-	-	755,606	755,606
Final Dividend for 2003	-	-	-	-	-	-	-	(143,000)	(143,000)
Interim Dividend 2004	-	-	-	-	-	-	-	(200,200)	(200,200)
Rights Issue of Shares	220,000	66,000	1,139,601	-	-	-	-	-	1,425,601
On Merger of Subsidiaries	-	-	-	(8,685)	-	-	-	(27,879)	(36,564)
Transfers during the year 2004	-	-	-	-	20,000	500,000	-	(520,000)	-
Balance as at 31.12.2004	770,000	231,000	1,962,246	325,890	569,707	4,395,000	6,700	642,660	8,903,203

Share premium account is generally used for writing-off of share issue expenses.

Capital Reserve relates to revaluation of Land & Buildings done in 1993 and includes the increase in the fair value of the properties.

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

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

The attached Accounting Policies and the Notes from pages 73 to 117 form an integral part of these financial statements.

Cash Flow Statement

For the year ended 31st December	Bank		Group	
	2004 Rs.000	2003 Rs.000	2004 Rs.000	2003 Rs.000
Cash flows from operating activities				
Interest and commission receipts	12,989,259	11,747,389	13,153,838	12,214,469
Interest payments	(5,962,041)	(6,256,670)	(6,361,766)	(6,682,577)
Receipts from other operating activities	740,621	1,953,111	980,717	2,340,596
Cash payments to employees	(2,414,137)	(2,301,882)	(2,520,109)	(2,372,661)
Cash payments to suppliers	(1,182,138)	(1,014,836)	(871,889)	(741,314)
Payments for other operating activities	(1,740,569)	(1,433,981)	(1,820,737)	(1,366,027)
Operating profit before changes in operating assets and liabilities [Note (a)]	<u>2,430,995</u>	<u>2,693,131</u>	<u>2,560,054</u>	<u>3,392,486</u>
(Increase)/Decrease in operating assets:				
Treasury bills/commercial papers	202,966	1,816,511	(3,795,655)	848,197
Deposits held for regulatory or monetary control purposes	(3,057,946)	(539,281)	(3,057,946)	(539,281)
Funds advanced to customers	(17,072,208)	(12,261,551)	(18,227,434)	(11,932,754)
Other short-term assets	1,049,752	(260,332)	2,896,299	(429,462)
Increase/(Decrease) in operating liabilities:				
Deposits from customers	18,911,945	13,956,915	18,801,867	13,933,999
Negotiable certificates of deposit	(1,413,523)	(815,820)	(1,407,677)	(821,666)
Other liabilities	418,190	832,242	418,190	832,242
Net cash from operating activities before income tax	<u>1,470,171</u>	<u>5,236,183</u>	<u>(1,812,302)</u>	<u>5,098,129</u>
Income taxes (paid)/credit	-	(5,763)	(92,912)	(22,528)
Net cash generated from/(used in) operating activities	<u>1,470,171</u>	<u>5,230,420</u>	<u>(1,905,214)</u>	<u>5,075,601</u>
Cash flows from investing activities				
Income from dealing and investment securities	107,183	335,976	83,315	322,789
Income from unquoted investment securities	182,164	81,430	114,664	81,430
Proceeds from sales of securities	628,394	764,429	628,394	766,391
Proceeds from Disposal of Associate Company	27,237	-	27,237	-
Net proceeds from investment securities	878,061	(6,672,703)	2,940,738	(8,294,190)
Purchase of property, plant & equipment	(516,281)	(1,103,112)	(701,865)	(1,729,810)
Proceeds from sale of property, plant & equipment	98,750	3,938	98,750	4,188
Net cash generated/(used in) investing activities	<u>1,405,508</u>	<u>(6,590,042)</u>	<u>3,191,233</u>	<u>(8,849,202)</u>
Cash flows from financing activities				
Increase in debentures	-	1,000,000	2,000,000	985,000
Increase of long-term borrowings	1,298,519	346,556	911,170	2,863,711
Net increase in other borrowings	(1,746,321)	1,764,603	(1,821,026)	1,775,441
Dividends paid	(275,658)	(231,461)	(275,658)	(231,461)
Proceeds from Rights Issue	1,425,601	-	1,425,601	-
Net cash generated from financing activities	<u>702,141</u>	<u>2,879,698</u>	<u>2,240,087</u>	<u>5,392,691</u>
Net increase in cash and cash equivalents	3,577,820	1,463,507	3,526,106	1,562,251
Cash and cash equivalents at beginning of period	<u>18,956,277</u>	<u>17,492,770</u>	<u>19,013,516</u>	<u>17,450,995</u>
Cash and cash equivalents at end of period [Note (9)]	<u>22,534,097</u>	<u>18,956,277</u>	<u>22,539,622</u>	<u>19,013,516</u>

Cash Flow Statement

Note (a) Reconciliation of operating profit

For The Year Ended 31 December

	2004	Bank	2004	Group
	Rs.000	2003	Rs.000	2003
		Rs.000		Rs.000
Operating profit before income tax	950,055	1,091,585	809,341	1,693,673
Income from dealing and investment securities	(107,183)	(335,976)	(83,315)	(322,789)
Income from unquoted investment securities	(182,164)	(81,430)	(114,664)	(81,430)
Profit/loss on sale of property, plant & equipment	(26,295)	2,160	(26,295)	2,160
Bad debts and written off debts recovered	(101,142)	(187,365)	(101,142)	(187,749)
Depreciation	438,658	409,274	537,541	494,105
Bad debt provision	1,566,493	1,703,278	1,566,493	1,703,264
Provision for diminution in value of investments	(107,427)	36,373	(27,552)	36,373
Goodwill amortization	-	55,232	(353)	54,879
	<u>2,430,995</u>	<u>2,693,131</u>	<u>2,560,054</u>	<u>3,392,486</u>

The attached Accounting Policies and Notes from Pages 73 to 117 form an integral part of these financial statements.

Accounting Policies

GENERAL

Hatton National Bank Limited is a company domiciled in Sri Lanka. The consolidated financial statements of the Bank for the year ended 31st December 2004 cover the Bank and its subsidiaries (together referred to as the "Group") and the Group's interest in associates. The financial statements were authorised for issue by the Directors on February 18th, 2005.

The principal activities of the Bank and the Group during the year were general banking, development banking, mortgage financing, lease financing, investment banking, corporate financing, dealing in government securities, pawn broking, stock broking, providing insurance services, credit card facilities and other financial services.

1 ACCOUNTING CONVENTION

The financial statements are presented in Sri Lanka rupees, rounded to the nearest thousand.

The Balance Sheet, Income Statement, Statement of Changes in Equity and Cash Flow Statement are prepared in conformity with generally accepted accounting principles and the Sri Lanka Accounting Standards laid down by the Institute of Chartered Accountants of Sri Lanka, applied consistently on a historical cost basis, with no adjustments being made for inflationary factors affecting the financial statements except that certain land and buildings, dealing securities and foreclosed properties are stated at valuation. Where appropriate, the policies are explained in the succeeding notes.

1.1 Foreign currency translation

1.1(1) Monetary assets and liabilities denominated in foreign currencies are translated at the middle rate of exchange ruling on the date of the Balance Sheet. Translation gains and losses are dealt with through the Income Statement.

1.1(2) Transactions in foreign currencies are translated, to Sri Lanka Rupees at the middle rate of exchange ruling at the date of the transaction. 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. 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.

2 BASIS OF CONSOLIDATION

The consolidated financial statements are prepared on the historical cost basis except that certain assets are stated at their fair value such assets are investments held for trading and foreclosed properties. The accounting policies have been consistently applied by Group enterprises.

2.1 Subsidiaries

Subsidiaries are those enterprises controlled by the Bank. Control exists when the Bank has the power, directly or indirectly, to govern the financial and operating policies of an enterprise so as to obtain benefits from its activities. 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 consolidated accounts are prepared to a common financial year end of 31st December. A list of subsidiaries within the group is provided under Note 18.

2.2 Associates

Associates are those enterprises 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 on an equity accounted basis, from the date that significant influence effectively commences until the date that significant influence effectively ceases.

2.3 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 enterprise. Unrealised gains resulting from transactions with associates are eliminated 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.

2.4 Goodwill

Goodwill arising on an acquisition represents the excess of the cost of the acquisition over the fair value of the net identifiable assets acquired. Goodwill is stated at cost less accumulated amortization. In respect of associates, the carrying amount of goodwill is included in the carrying amount of the investment in the associates. Goodwill is amortized over a period of 5 years from the date of initial recognition.

2.5 Negative Goodwill

Negative goodwill arising on an acquisition represents the excess of the fair value of the net identifiable assets acquired over the cost of acquisition. In respect of associates, the carrying amount of negative goodwill is included in the carrying amount of the investment in the associate. The carrying amount of other negative goodwill is deducted from the carrying amount of intangible assets.

Accounting Policies

3 LOANS AND ADVANCES TO CUSTOMERS

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

3.1 Provisions for Loan Losses

Provision for possible loan losses are made on the basis of a continuous review of all advances to customers, in accordance with the applicable accounting standards laid down by the Institute of Chartered Accountants of Sri Lanka and the directions issued by the Central Bank of Sri Lanka based on an aged classification of loans and advances 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 identified bad and doubtful advances except for pawning where a general provision has been made. In addition to a specific provision, general provision is also made for Shanthi Housing Loans.

3.2 Provision for leases, pawning and Shanthi housing loans

A specific provision has been made in relation to identified bad and doubtful leases. In addition a general provision of 0.1% on total portfolio of pawning facilities, 0.2% on total portfolio of Shanthi housing loans and 2% of the net investment on leases is made in conformity with industry practice.

4 INVESTMENTS

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 the lower of cost and market value on an aggregate portfolio basis. Adjustment for fall in market value below cost, if relevant, is accounted by charging the difference to the Income Statement.

4.2 Investment securities

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

4.3 Foreclosed properties (formerly classified as Investment Properties)

Foreclosed properties acquired in full or partial settlement of loans and advances, 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 properties in satisfaction of the debt. Any shortfall between the carrying amount of the foreclosed properties and their respective market value identified subsequently is charged as a provision for loan losses in the Income Statement. Gains and losses on the disposal of the foreclosed properties are treated as provisions written back or charged to the Income Statement respectively.

Accounting Policies

4.4 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 over the period to maturity.

5 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 and the provision for reduced future rentals.

6 PROPERTY, PLANT AND EQUIPMENT

6.1 Property, Plant and Equipment are recorded at cost of purchase or construction or valuation together with any incidental expenses thereon. The assets are stated at cost less accumulated depreciation which is provided for on the basis specified in 6.2 below.

6.2 Depreciation is provided at the following rates on a straight line basis over the periods appropriate to the estimated useful lives of the different types of assets:

(i) Hatton National Bank			
Freehold Buildings	2.5%	per annum	
Motor Vehicles	25%	per annum	
Computer Equipment - Additions before 1.7.2000	25%	per annum	
- Additions after 1.7.2000	16.7%	per annum	
Office Equipment	20%	per annum	
Furniture and Fittings	10%	per annum	
(ii) Subsidiary Company HNB Securities Ltd			
Office Equipment	25%	per annum	
Computer Equipment	33.33%	per annum	
Furniture and Fittings	15%	per annum	
(iii) Subsidiary Company Sithma Development (Pvt) Ltd.			
Freehold Buildings - Sithma Building	1%	per annum	
Smart Building	2.5%	per annum	
Generators, Generator Panels and associated power cables	2%	per annum	
Chillers, Cooling Towers and associated equipment	4%	per annum	
Lifts and escalator	4%	per annum	
Building Management System	4%	per annum	
Motor Vehicles	25%	per annum	
Plant & Machinery	20%	per annum	
Equipment	20%	per annum	
Year of Purchase:-			
Assets purchased in the first half of the year		1/2 year depreciation	
Assets purchased in the second half of the year		No depreciation	
Year of Sale:-			
Assets sold in the first half of the year		No depreciation	
Assets sold in the second half of the year		1/2 year depreciation	
Depreciation is not provided on freehold land.			
(iv) Subsidiary Company HNB Stockbrokers (Pvt) Ltd			
Furniture and Fittings	15%	per annum	
Office Equipment	25%	per annum	
Computer Equipment	33.33%	per annum	
Motor Vehicles	25%	per annum	

Plant and Equipment are depreciated from the month of purchase to the month of sale.

Accounting Policies

6 PROPERTY, PLANT AND EQUIPMENT (Contd.)

(v) Subsidiary Company HNB Assurance Ltd

Office Equipment and Machinery	20%	per annum
Computer Equipment	25%	per annum
Furniture and Fittings	10%	per annum

Full depreciation is provided in the month of purchase and no depreciation is provided in the month of disposal.

6.3 Leasehold buildings and improvements effected to leasehold buildings are amortized over the lease period.

6.4 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.

6.5 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.

7. EMPLOYEE BENEFITS

7.1 Pensions and retirement benefits

The Bank operates an approved Pension Fund for the payment of pensions and monthly contributions are made by the Bank to the pension fund based on a percentage of the gross emoluments, excluding certain allowances. The percentage of contributions was determined by an independent actuary and retirement benefits are provided for all members of the permanent staff. The Bank carries out an actuarial valuation of the Pension Fund once in three years, to ascertain the full liability.

An actuarial valuation of the pension fund was carried out as at 31st December 2002 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.

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

Long term rate of interest	11% p.a.
Salary increases (long term)	10% p.a.
Increase in Salaries and Allowances (long term)	10% p.a.
Increase in Cost of Living Allowances (long term)	8% p.a.
Increase in Pensions	6% p.a.

The demographic assumptions underlying the valuation are retirement age (55 yrs.), early withdrawals from service, 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. 2,820.1 Mn. and that the fair value of the fund assets is Rs. 1,767.6 Mn. resulting in a part service deficit of Rs. 1,052.5 Mn. in the Pension Fund due to the charges in actuarial assumptions that took place since the previous actuarial valuation as at 31st December 1999.

However, since Pension Fund is solvent on discontinuance basis (i.e. assuming that the fund is terminated on the valuation date) the actuary recommended the amortization of the past service deficit by regular contributions over the full working life time of the current employees by incorporating it into the ongoing contribution rate.

The amount recognised as expense for the current year is Rs. 233.8 Mn. (2003 – 206.6 Mn). The assets of the Fund, which are independently administered by the Trustees as per the provision of the Trust Deed are held separately from those of the Bank.

No 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 has its own non-contributory pension scheme in force.

Accounting Policies

7. EMPLOYEE BENEFITS (Contd.)

Provision has been made in the accounts of the subsidiaries, HNB Stock Brokers (Pvt) Ltd, HNB Securities Ltd and HNB Assurance Ltd for retiring gratuities payable under the Payment of Gratuity Act. No. 12 of 1983 for all employees including those who have completed less than five years of continuous service.

7.2 Widows, widowers and orphans pension fund

The Bank operates a separate widows, widowers and orphans pension scheme (W & 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 7.1 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. 151.0 Mn. and that the fair value of the fund assets is Rs. 125.0 Mn. resulting in a past service deficit of Rs. 26 Mn. in the widows, widowers and orphans pension scheme as at 31st December 2002.

However, since the widows, widowers and orphans pension scheme is solvent on discontinuance basis the actuary has recommended similar course of action as recommended for the Pension Fund as detailed in Note 7.1 above.

The amount recognised as an expense for the current year is 23.7 Mn. (2003 - Rs. 19.9 Mn.)

7.3 Defined contribution plans

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

7.3(1) 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. 163.8 Mn. (2003 - Rs. 144.7 Mn.).

7.3(2) Trust fund

The Bank contributes to the Employees' Trust Fund. The total amount recognised as an expense for the current year is Rs. 42.9 Mn. (2003 - Rs. 36.2 Mn.).

8. INCOME STATEMENT

8.1 Revenue recognition

8.1(1) Interest income

Interest receivable is recognised on an accrual basis. Interest ceases to be accrued when the recovery of interest or principal is in arrears for three (3) months. 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 balance.

Interest income from Investments is recognized on an accrual basis.

8.1(2) Dividend income

Dividend income from shares is recognised in the period in which it is declared.

8.1(3) Accounting for 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.

8.1(4) Income on discounting of Bills of Exchange is recognised proportionately over the period of the instrument.

Accounting Policies

8. INCOME STATEMENT (Contd.)

8.1(5) Gains or losses arising from the sale of investment securities, dealing securities, shares, units and property, plant and equipment are accounted for on the date of transaction in the Income Statement.

8.1(6) Commission and fee income are recognised in the Income Statement when the services are provided.

8.2 Terminal Benefits

The Bank subscribes to a managed fund to provide pensions for all eligible salaried staff. Pension costs are charged to the Income Statement in the year in which such costs are determined.

The actual amounts paid as pensions and retirement gratuities are charged to the Pension Fund.

8.3 Expenses

8.3(1) Interest expenses and other expenses

Interest payable is recognised on an accrual basis. Other expenses are recognised in the accounts as they are incurred, in the period to which they relate.

8.3(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 commitments on operating leases are shown in Note 31(d).

8.4 Taxation

8.4(1) Income tax

Provision for income tax is made on the basis of the profit for the year as adjusted for taxation purposes in accordance with the provisions of the Inland Revenue Act No:38 of 2000 and amendments thereto.

8.4(2) Deferred tax

Deferred tax is provided on the liability method and the balance of the deferred taxation account represents income tax applicable to the difference between the written down values for tax purposes of the assets on which depreciation allowances are claimed and the net book value of such assets.

No provision has been made for deferred taxation on assets leased to customers since timing differences on these assets are not expected to reverse for the next three years and is unlikely to reverse within a reasonable period or thereafter, in view of the bank maintaining or increasing its scale of leasing activity.

9 COMMITMENTS AND CONTINGENCIES

All discernible risks are accounted for in determining the amount of all known liabilities.

10 INSURANCE BUSINESS

10.1 Non-life (general) insurance business

10.1(1) Gross written premium

Gross written premium relates to insurance business received during the year.

10.1(2) Reinsurance premium

Reinsurance premium expense is accounted for in the same accounting period as the gross written premium to which it relates.

10.1(3) Unearned premiums

Unearned premiums are the portion of gross written premiums and reinsurance premiums written in the current year in respect of risks relating to subsequent periods. Unearned premiums are calculated on the 24ths basis in accordance with the Control of Insurance (Miscellaneous Provisions) Regulations 1987.

10.1(4) Deferred acquisition expenses

Deferred acquisition expenses represent commissions relating to unearned premiums and are arrived at using the same basis used for unearned premiums.

Accounting Policies

10 INSURANCE BUSINESS (Contd.)

10.1(5) Claims

Claims incurred include provisions for the estimated cost of claims and related handling expenses for incidents upto 31st December, including those which had not been notified, net of anticipated reinsurance and other recoveries.

The provisions in respect of Claims Insured But Not Reported (IBNR) are provided as a defined percentage of claims incurred. The difference between the estimated costs and settlements, if any, is accounted in the Insurance Revenue Accounts of the subsequent years.

10.2 Life (long term) insurance business

10.2(1) Premiums (income recognition)

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

10.2(2) Reinsurance premium

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

10.2(3) Benefits, losses and expenses

Expenses in 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.

11 SEGMENT REPORTING

Segment information is presented in respect of the Group's business. These segments comprise banking, leasing, dealing, property and insurance.

12 CASH FLOW STATEMENT

The Cash Flow Statement has been prepared by 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 cash balances, call deposits and placements.

13 COMPARATIVE INFORMATION

Where necessary, comparative information has been restated to conform to the current year's presentation and classification.

Since the Bank has adopted a line by line consolidation of the Foreign Currency Banking Unit accounts with the Domestic Banking Unit accounts from January 1st 2004, the comparative figures in the Income Statement for the year 2003 have been restated to conform, to the current year's presentation and classification.

14 DIRECTORS' RESPONSIBILITY STATEMENT

The Board of Directors takes the responsibility for the preparation and presentation of these financial statements. Please Refer page 65 for the statement of the Directors' responsibility.

Notes to the Accounts

For the year ended 31st December	Bank		Group	
	2004	2003	2004	2003
	Rs.000	Rs.000	Rs.000	Rs.000
1. INCOME				
Interest income (Note 2)	11,469,335	11,536,552	11,579,556	11,930,043
Foreign exchange income	662,176	506,436	662,860	506,394
Fees & commission income	1,519,924	1,241,588	1,574,282	1,315,178
Other income (Note 4)	435,923	1,545,986	686,263	2,121,644
	14,087,358	14,830,562	14,502,961	15,873,259
2. INTEREST INCOME				
Customer advances	10,225,782	10,036,285	9,902,188	10,034,503
Treasury Bills and placements with other Banks	957,650	1,219,863	959,033	1,219,863
Other interest income	285,903	280,404	718,335	675,677
	11,469,335	11,536,552	11,579,556	11,930,043
Notional Credit for With Holding 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. 13.7 Mn. (2003 - Rs. 34.5 Mn.) for the Bank and Rs. 21.6 Mn. (2003 - Rs. 43.2 Mn.) for the Group.				
3. INTEREST EXPENSES				
Customer deposits	4,344,167	5,213,673	4,153,970	5,210,117
Short term borrowings & refinance	923,618	256,754	923,618	256,754
Interest paid on debentures	484,042	437,290	476,047	436,420
Other interest expenses	210,214	1,001,378	808,131	1,431,711
	5,962,041	6,909,095	6,361,766	7,335,002
4. OTHER INCOME				
Income from dealing securities (quoted)	35,783	251,806	36,840	251,806
Income from investment securities (quoted)	70,246	84,170	45,321	84,170
Income from investment securities (unquoted)	182,164	20,854	114,664	81,430
Bad debts recovered [see Note 14(a)]	101,142	187,365	101,142	187,365
Profit/(Loss) from sale of property, plant & equipment (net)	26,295	(2,160)	26,295	(2,160)
Gain on sale of government securities	90,238	870,294	90,237	870,294
Profit/(Loss) on gold/silver trading	(228,467)	113,313	(228,467)	113,313
Gain on interest rate SWAPS	71,162	-	71,162	-
Gain/(Loss) on FCBU revaluation	42,990	(33,803)	42,990	(33,803)
Others	44,370	54,147	386,079	569,229
	435,923	1,545,986	686,263	2,121,644

Notes to the Accounts

	Bank		Group	
For the year ended 31st December	2004	2003	2004	2003
	Rs.000	Rs.000	Rs.000	Rs.000
5. OPERATING EXPENSES				
Operating expenses, among other expenses, include the following:				
Legal expenses	6,215	18,463	6,215	18,463
Depreciation of property, plant and equipment	438,658	409,274	537,541	494,556
Directors' emoluments (refer 5.1)	12,597	8,395	12,597	8,395
Auditors' remuneration	2,600	2,000	3,385	2,755
Fees paid to Auditors for other assignments	148	978	148	978
Donations	155	3,296	155	3,296
5.1 Directors' emoluments				
Emoluments of Chairman (fee only)	79	60	79	60
Emoluments of highest paid Director	12,123	8,035	12,123	8,035
Emoluments of five other Directors (fee only)	395	300	395	300
	12,597	8,395	12,597	8,395
6. PROVISION FOR BAD AND DOUBTFUL DEBTS				
Specific provision for loans and advances	1,326,494	1,649,216	1,326,494	1,649,216
Specific Provision for foreclosed properties	95,317	12,419	95,317	12,419
Provision for Tsunami affected customers	60,000	-	60,000	-
General provision for pawning advances	3,000	3,000	3,000	3,000
General provision for housing advances	3,600	3,600	3,600	3,600
(Note 14a)	1,488,411	1,668,235	1,488,411	1,668,235
Provision for bills of exchange	1,245	6,267	1,245	6,267
General provision for leases	40,067	18,306	40,067	18,306
Specific provision for leases	36,770	22,889	36,770	22,889
	1,566,493	1,715,697	1,566,493	1,715,697
Less : Reversal of excess provisions	-	-	-	(14)
	1,566,493	1,715,697	1,566,493	1,715,683

Provision for Tsunami affected customers

The Bank has made an assessment of the possible losses that could arise due to the customers of the Bank who were affected by the Tsunami catastrophe that occurred on 26 December 2004 becoming unable to settle their dues and / or the securities pledged for the facilities obtained being lost in the said disaster. Based on this assessment the Bank has arrived at a provision for possible losses due to specific customers affected by Tsunami amounting to Rs. 60 Mn. and provided the same in the accounts for the year.

7. TAXATION

a) Charge to taxation

Income tax on profits for the year	(10,409)	-	(21,621)	(86,434)
Reversal from/(transfer to) deferred taxation	36,735	(83,300)	36,735	(85,071)
	26,326	(83,300)	15,114	(171,505)

Notes to the Accounts

7. TAXATION (Contd.)

For the year ended 31st December	2004 Rs.000	2003 Rs.000
b) Reconciliation of Accounting Profit and Taxable Income - Bank		
Net Profit as per the Income Statement	950,055	1,091,585
Disallowable expenses	850,653	825,252
Allowable expenses	(1,962,018)	(1,686,041)
Losses applicable for Off Shore Banking Unit	313,393	870,143
Tax losses brought forward and not utilised	(570,132)	(1,263,873)
Losses of prior periods set off against current year liabilities	(83,367)	(42,454)
Exempt Dividends and Interest Income	(166,406)	(364,744)
Tax losses not utilised and carried forward	709,158	570,132
	<hr/>	<hr/>
Taxable Income	41,336	-
	<hr/>	<hr/>
Income tax provision for the year is made up of the following:		
Income taxable at 30%	8,418	-
Income taxable at 15%	1,991	-
	<hr/>	<hr/>
	10,409	-
	<hr/>	<hr/>
Effective tax rate	1.10%	-

- c) The Bank's Domestic Banking Unit (DBU) is liable for income taxation on its income from banking operations at the rate of 30% (2003 - 30%) for the year. However, the non banking income of the Bank is liable for income taxation at the rate of 30% and the profits from share trading activities are liable for income taxation at the rate of 15%. The taxable income of On Shore Operations of Foreign Currency Banking Unit (FCBU) is liable for income taxation at the rate of 30% for the year (1st half of 2003 - 15% and 2nd half of 2003 - 30%) and the taxable income from Off Shore Operations of FCBU is liable for income taxation at the rate of 20% with effect from 1 April 2004. The income of Off Shore Operations of FCBU was exempt from income taxation prior to that.

The banking operations of DBU of the Bank incurred a tax loss of Rs. 136 Mn. (2003 - Rs. 755 Mn. Assessable income) during the year. However, the non banking operations of DBU and the Bank's share trading activities recorded taxable profit of Rs. 25 Mn. and Rs. 13 Mn. respectively and provision has been made in the accounts for income taxation on these activities using the applicable rates. The cumulative tax losses of the Banking Operation of DBU that is available for setting off against future taxable income amounts to Rs. 709 Mn. as at 31 December 2004. (31 December 2003 - Rs. 656 Mn.). The cumulative tax losses from leasing activity that is available to utilize against future taxable leasing profits, which is not included in the above, amounts to Rs. 1,802 Mn. as at 31 December 2004 (31 December 2003 - Rs. 1,769 Mn.).

Both the On Shore Operations and the Off Shore Operations of FCBU incurred tax losses during the year and no provision for income taxation has been made for those units. The cumulative tax losses that are available for setting off against future taxable income for On Shore Operations and the Off Shore Operation of FCBU amount to Rs. 1,540 Mn. and Rs. 61 Mn. respectively as at 31 December 2004. (Rs. 1,025 Mn. and Nil respectively for 31 December 2003).

The amounts reflected above are provisional.

HNB Stock Brokers (Pvt) Ltd., is liable for income taxation at the rate of 32.5% (2003 - 32.5%) on its taxable profits. Provision has been made in the accounts accordingly.

HNB Securities Ltd., is liable for income taxation at the rate of 32.5% (2003 - 32.5%) on its taxable profits. No provision has been made in the accounts due to the Company incurring tax losses.

Taxes imposed with retrospective effect

The profits arising from trading in government securities were exempt from income tax in terms of section 15 (t) of the Inland Revenue Act, No. 38 of 2000. The Inland Revenue (Amendment) Act, No. 12 of 2004 withdrew this exemption with effect from 1st April 2002. The Fiscal Proposals included in the Government budget for 2005 intimated that the repeal of this section would be deferred to the year of Assessment 2003/2004.

The income tax liability on the profits arising from trading in Government securities as per the above, earned during the year 2003, amounting to Rs.71.6 Mn, which has been paid by HNB Securities Ltd, has been treated as a prior year adjustment and charged against the retained earnings of 2003.

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 accounts of the Company.

HNB Assurance Ltd., is liable for income tax at the rate of 30% (2003 - 32.5%) on its taxable income. However, no provision has been made in the accounts due to the Company incurring tax losses.

- d) The Bank's properties have been revalued in 1989 and 1993, resulting in the book values being written up by Rs.324 million.

Notes to the Accounts

8. EARNINGS PER SHARE

Earnings per share (EPS) have been calculated by dividing the profit after taxation for the year attributable to ordinary shareholders by 78.05 Mn. shares being the weighted average number of ordinary shares in issue (both voting & non-voting) during the year ended 31st December 2004 calculated as per the requirements of Sri Lanka Accounting Standard 34 - Earnings Per Share. The previous year's EPS has been restated.

As at 31st December	Bank		Group	
	2004 Rs.000	2003 Rs.000	2004 Rs.000	2003 Rs.000
9. CASH AND SHORT-TERM FUNDS				
Local currency in hand	1,693,161	1,485,974	1,698,686	1,554,213
Foreign currency in hand	258,132	339,242	258,132	328,242
Balances with local banks	19,440	17,078	19,440	17,078
Balances with foreign banks	13,529,169	10,488,727	13,529,169	10,488,727
Money market funds	4,215,046	3,899,765	4,215,046	3,899,765
Placements with banks by FCBU	2,819,149	2,725,491	2,819,149	2,725,491
	<u>22,534,097</u>	<u>18,956,277</u>	<u>22,539,622</u>	<u>19,013,516</u>

10. STATUTORY DEPOSIT WITH CENTRAL BANK OF SRI LANKA

Statutory deposit with Central Bank of Sri Lanka	<u>9,120,391</u>	<u>6,062,445</u>	<u>9,120,391</u>	<u>6,062,445</u>
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A cash balance is maintained with the Central Bank of Sri Lanka according to statutory requirements. As at 31st December 2004, the minimum cash reserve requirement is 10% of the deposit liabilities. There is no reserve requirement for deposit liabilities of the Foreign Currency Banking Unit.

11. DEALING SECURITIES - BANK AND GROUP

As at 31st December	2004				2003		
	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							
Asia Capital Ltd	-	-	-	-	2,700,000	25,486	36,450
Central Finance Co. Ltd	30,000	3,913	0.97	8,100	90,000	11,739	17,550
Commercial Bank, Non-voting	229,900	24,161	5.99	20,691	29,900	3,653	3,005
Ceylinco Insurance Co Ltd	-	-	-	-	432,996	13,431	15,371
Merchant Bank of Sri Lanka Ltd	604,150	6,765	1.68	5,588	1,161,150	13,003	10,450
Mercantile Leasing Co. Ltd	-	-	-	-	500,000	11,127	11,750
National Development Bank	461,700	40,266	9.99	73,872	392,700	29,182	55,862
Nations Trust Bank Ltd	588,300	14,907	3.70	10,737	127,500	4,917	3,634
NDB Bank Ltd.	-	-	-	-	131,200	2,804	2,624
Seylan Bank Ltd	297,300	14,417	3.58	8,919	-	-	-
Seylan Bank Ltd, Non-voting	-	-	-	-	225,000	5,645	4,556
The Finance Co Ltd	131,180	2,880	0.71	2,492	267,380	5,871	4,412
		<u>107,309</u>	<u>26.62</u>	<u>130,399</u>		<u>126,858</u>	<u>165,664</u>
Beverages, Food and Tobacco							
Tea Smallholder Factories Ltd	-	-	-	-	24,400	716	592
Chemicals and Pharmaceuticals							
Haycarb Ltd	62	3	-	3	16,062	752	514
Diversified Holdings							
Hayleys Ltd	553,829	78,303	19.42	69,921	429,781	68,210	51,574
Hemas Holdings Ltd.	289,000	22,844	5.67	27,889	252,000	18,473	17,640
John Keells Holdings Ltd	436,793	45,824	11.36	48,047	421,903	48,666	41,768
		<u>146,971</u>	<u>36.45</u>	<u>145,857</u>		<u>135,349</u>	<u>110,982</u>
Footwear and Textile							
Veyangoda Textiles Ltd	5,000	122	0.03	-	5,000	122	-
Kuruwita Textiles Ltd	247,500	1,980	0.49	12,004	211,400	1,901	9,302
		<u>2,102</u>	<u>0.52</u>	<u>12,004</u>		<u>2,023</u>	<u>9,302</u>

Notes to the Accounts

11. DEALING SECURITIES - BANK AND GROUP (Contd.)

As at 31st December

	No of Ordinary Shares of Rs.10/- each	2004 Cost of Investment Rs.000	% of Total Cost	Market Value Rs.000	No of Ordinary Shares of	2003 Cost of Investment Rs.000	Market Value Rs.000
Hotel and Travel							
Asian Hotels & Properties Ltd.	-	-	-	-	236,600	1,986	5,264
Aitken Spence Hotel Holdings Ltd	-	-	-	-	344,100	24,547	21,850
Ceylon Holiday Resorts Ltd.	-	-	-	-	2,100	267	137
Galadari Hotel Lanka Ltd.	55,000	972	0.24	880	-	-	-
Hotel Developers (Lanka) Ltd.	7,800	876	0.22	796	-	-	-
Habarana Lodge Ltd.	-	-	-	-	2,500	186	150
John Keells Hotels Ltd.	25,051	2,529	0.63	2,186	-	-	-
Taj Lanka Hotels Limited	-	-	-	-	95,700	733	1,531
Trans Asia Hotels Ltd.	22,000	1,782	0.44	1,639	14,000	648	721
		<u>6,159</u>	<u>1.53</u>	<u>5,501</u>		<u>28,367</u>	<u>29,653</u>
Health Care							
Ceylon Hospitals Ltd.	10,800	273	0.07	248	-	-	-
Investment Trust							
Central Securities Ltd	-	-	-	-	7,600	349	78
Land and Property							
Ceylinco Housing and Real Estate Co. Ltd	25	1	-	-	12,125	248	121
Collettes Ltd	50	11	-	-	50	11	-
		<u>12</u>	<u>-</u>	<u>-</u>		<u>259</u>	<u>121</u>
Manufacturing							
ACL Cables Ltd	-	-	-	-	302,200	16,709	9,973
ACL Plastics Ltd.	257,600	10,256	2.54	7,342	-	-	-
Caltex Lanka Lubricants Ltd	276,200	25,929	6.43	17,608	237,600	23,345	17,107
Dankotuwa Porcelain Ltd	390,700	11,670	2.89	6,154	-	-	-
Kelani Tyres Ltd	346,800	6,278	1.56	3,381	346,800	6,278	1,994
Lanka Cement Ltd	210,000	2,100	0.52	1,627	-	-	-
Lanka Ceramics Ltd	2,044,400	49,488	12.28	40,888	2,044,400	49,488	30,666
Pelwatte Sugar Industries Ltd	350,000	4,855	1.20	3,325	1,138,500	15,809	7,400
Richard Peiris and Co Ltd	-	-	-	-	13,100	1,099	1,900
Royal Ceramics Lanka Ltd	-	-	-	-	1,068,300	19,148	18,695
Tokyo Cement Lanka Ltd	-	-	-	-	25,000	2,058	3,125
		<u>110,576</u>	<u>27.42</u>	<u>80,325</u>		<u>133,934</u>	<u>90,860</u>
Motors							
Associated Motorways Ltd	-	-	-	-	18,612	1,918	1,173
Lanka Ashok Leyland Ltd	1,000	141	0.04	97	5,000	707	120
Sathosa Motors Ltd	-	-	-	-	98,600	4,102	3,007
United Motors Lanka Ltd.	-	-	-	-	13,100	555	373
		<u>141</u>	<u>0.04</u>	<u>97</u>		<u>7,282</u>	<u>4,673</u>

Notes to the Accounts

11. DEALING SECURITIES - BANK AND GROUP (Contd.)

As at 31st December

	No of Ordinary Shares of Rs.10/- each	2004 Cost of Investment Rs.000	% of Total Cost	Market Value Rs.000	No of Ordinary Shares of Rs.10/- each	2003 Cost of Investment Rs.000	Market Value Rs.000
Power & Energy							
Lanka IOC Ltd.	600,000	18,445	4.57	25,950	-	-	-
Plantations							
Balangoda Plantations Ltd	54,700	1,454	0.36	902	119,700	3,182	1,466
Kelani Valley Plantations Ltd	90,100	1,904	0.47	1,577	306,200	6,469	4,287
Maskeliya Plantations Ltd	-	-	-	-	113,000	4,850	2,034
Watawala Plantations Ltd	-	-	-	-	89,200	1,212	758
Kotagala Plantations Ltd	-	-	-	-	100,000	1,125	700
Namunukula Plantations Ltd	-	-	-	-	127,000	2,211	953
Talawakalle Plantations Ltd	-	-	-	-	450,000	8,595	5,850
		<u>3,358</u>	<u>0.83</u>	<u>2,479</u>		<u>27,644</u>	<u>16,048</u>
Telecommunications							
Sri Lanka Telecom Ltd.	408,900	7,883	1.95	6,338	100,000	2,504	1,800
Trading							
Shaw Wallace and Hedges Ltd	-	-	-	-	10,000	1,021	400
Others (odd lots of shares)	-	1	-	-	-	1	-
		<u>1</u>	<u>-</u>	<u>-</u>		<u>1,022</u>	<u>400</u>
Total		<u>403,233</u>	<u>100.0</u>	<u>409,201</u>		<u>467,059</u>	<u>430,687</u>
Less:							
Provision for diminution in Market Value b/f		(36,372)					
Provision written back/(made)		36,372			(36,372)	(36,372)	-
Total for Bank		<u>403,233</u>		<u>409,201</u>		<u>430,687</u>	<u>430,687</u>
Subsidiaries - Sithma Development (Pvt) Ltd.							
Quoted Shares							
Commercial Bank of Ceylon Ltd. (Voting)	8,900	864	5.36	801			
NDB Bank Ltd.	29,200	812	5.04	759			
Nations Trust Bank Ltd.	108,900	2,502	15.51	1,987			
Chemical Industries (Col.) Ltd.	13,587	1,990	12.34	1,699			
Caltex Lanka Lubricants Ltd.	97,700	7,337	45.50	6,229			
Grain Elevators Ceylon Ltd.	33,700	541	3.35	362			
Sri Lanka Telecom Ltd.	120,000	2,079	12.89	1,860			
John Keells Hotels Ltd.	37	2	0.01	3			
		<u>16,127</u>	<u>100.0</u>	<u>13,700</u>			
Less: Provision for diminution in market value (made)		<u>2,427</u>		<u>-</u>			
Total for Subsidiaries		<u>13,700</u>		<u>13,700</u>			
Total for Group		<u>416,933</u>		<u>422,901</u>		<u>430,687</u>	<u>430,687</u>

Notes to the Accounts

12. INVESTMENT SECURITIES

As at 31st December	Bank		Group	
	2004 Rs.000	2003 Rs.000	2004 Rs.000	2003 Rs.000
12.1 Quoted - shares/units				
Balance b/f	667,744	619,297	674,994	619,297
Additions	-	38,318	158	45,568
Disposals	(36,951)	(39,961)	(36,951)	(39,961)
Transfers	(23,770)	50,090	(23,770)	50,090
Provision Written Back	26,946	-	26,946	-
Balance c/f (Refer Note 12.4)	<u>633,969</u>	<u>667,744</u>	<u>641,377</u>	<u>674,994</u>
12.2 Unquoted - shares				
Balance b/f	25,956	35,956	25,956	35,956
Additions	-	-	-	-
Disposals	-	(10,000)	-	(10,000)
Balance c/f (Refer Note 12.5)	<u>25,956</u>	<u>25,956</u>	<u>25,956</u>	<u>25,956</u>
12.3 Bonds and debentures				
Balance b/f	15,066,933	9,564,191	16,876,804	9,514,191
Additions	3,735,634	8,989,075	3,735,634	11,961,928
Redemptions	(4,148,858)	(3,486,333)	(4,945,245)	(4,599,315)
Balance c/f (Refer Note 12.6)	<u>14,653,709</u>	<u>15,066,933</u>	<u>15,667,193</u>	<u>16,876,804</u>
Total Investment Securities	<u>15,313,634</u>	<u>15,760,633</u>	<u>16,334,526</u>	<u>17,577,754</u>

12.4 Investment Securities Quoted-shares/units

Bank	2004			2003		
	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
ACL Plastics Ltd	-	-	-	250,000	10,000	5,125
Lanka Hospital Corporation Ltd	1,455,000	22,055	18,551	1,455,000	22,055	17,096
Asha Central Hospital Ltd	120,000	1,578	1,830	120,000	1,578	1,560
Browns Beach Hotels Ltd	75,000	1,622	2,344	75,000	1,622	1,013
Commercial Bank of Ceylon Ltd	412,666	61,645	65,923	412,666	61,645	58,805
Dankotuwa Porcelain Ltd	-	-	-	390,700	11,670	5,861
Distilleries Company of Sri Lanka Ltd (Rs.1/- per share)	1,481,500	11,158	42,223	1,481,500	11,158	36,297
DFCC Bank	7,054,025	519,711	1,453,129	5,290,519	519,711	1,428,440
Lanka Cement Ltd	-	-	-	280,000	2,800	2,030
Lanka Walltile Ltd	-	-	-	32,100	1,605	963
Magpek Exports Ltd	359,000	14,360	*	359,000	14,360	*
Metal Recyclers Colombo Ltd	69	3	*	479,669	21,585	959
National Equity Fund	1,629,450	16,200	22,144	1,629,450	16,200	21,623
People's Merchant Bank Ltd	-	-	-	1,250,000	12,500	15,000
Renuka City Hotels Ltd	-	-	-	15,717	564	1,194
		<u>648,332</u>	<u>1,606,144</u>		<u>709,053</u>	<u>1,595,966</u>
Provision for diminution in market value b/f	(41,309)				(41,309)	
Provision write back/(made)	26,946	(14,363)			-	-
Total Quoted - Shares / Units - Bank		<u>633,969</u>	<u>1,606,144</u>		<u>667,744</u>	<u>1,595,966</u>

*Shares delisted – Market value shown as Nil.

Notes to the Accounts

12. INVESTMENT SECURITIES (Contd.)

As at 31 December	2004	2003		2004	2003	
	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
Subsidiaries - HNB Assurance Ltd.						
Quoted Shares						
Commercial Bank of Ceylon Ltd.						
- Preference Shares	725,000	7,250	7,250	725,000	7,250	7,069
Lanka IOC Ltd.	5,800	158	251		-	
Total for Quoted Investment - Subsidiaries		<u>7,408</u>	<u>7,501</u>	725,000	7,250	7,069
Total Quoted - Shares / Units - Group		<u>641,377</u>	<u>1,613,645</u>		674,994	1,603,035

As at 31 December	2004	2003		2004	2003	
12.5 Unquoted Shares	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 and Subsidiaries						
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
Janashakthi Insurance Co Ltd	25,000	250	250	25,000	250	250
S.W.I.F.T.	21	2,051	2,051	21	2,051	2,051
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
Total Unquoted Shares - Bank and Group		<u>25,956</u>	<u>25,956</u>		25,956	25,956

12.6 Bonds and debentures

Bank

Mercantile Leasing Ltd - Debentures	140,000	140,000	180,000	180,000
HNB Securities Ltd - Debentures	50,000	50,000	50,000	50,000
Asian Paints Zero Coupon Bonds	-	-	117,475	117,475
Sri Lanka Development Bonds maturing on 25.06.2006	3,285,634	3,285,634	967,000	967,000
Long Term Non-negotiable Bonds maturing on 14.11.2016	489,000	489,000	489,000	489,000
People's Leasing Co. Ltd. Securitised Notes Trust 04	78,601	78,601	122,162	122,162
People's Leasing- Securitised Notes Trust 10	187,500	187,500	-	-
People's Leasing - Securitised Notes Trust 14	250,000	250,000	-	-
	<u>4,480,735</u>	<u>4,480,735</u>	1,925,637	1,925,637

Government of Sri Lanka Treasury Bonds

Face value	Year of Maturity	Discounted Value (Rs.000)
Rs. 1 Mn	2005	1,001
Rs. 1300 Mn	2006	1,331,294
Rs. 2,717.8 Mn	2007	2,995,404
Rs. 2,299.1 Mn	2008	2,561,882
Rs. 2,740 Mn	2009	3,017,154
Rs. 251 Mn	2013	266,239

	<u>10,172,974</u>	<u>10,172,974</u>	13,141,296	13,141,296
Total Bonds and debentures - Bank	<u>14,653,709</u>	<u>14,653,709</u>	15,066,933	15,066,933

Notes to the Accounts

12. INVESTMENT SECURITIES (Contd.)

12.6 Bonds and debentures (Contd.)

As at 31 December

	2004	Directors'		2003	Directors'
	No. of Ordinary Shares of Rs.10/- each	Cost Rs.000	Valuation Rs.000	No. of Ordinary Shares of Rs.10/- each	Cost Rs.000 Valuation Rs.000
Subsidiaries - HNB Assurance Ltd					
Quoted Debentures					
Commercial Bank of Ceylon Ltd-Debentures	72,500	7,250		72,500	7,250
Subsidiaries - HNB Securities Ltd					
Government of Sri Lanka Treasury Bonds					
Face value	Year of Maturity	Discounted Value (Rs.000)			
Rs. 981 Mn.	2007	1,056,234			
		1,056,234		1,852,621	
Less: Investment in subsidiary by the Bank					
HNB Securities Ltd, 500,000 13% debentures of Rs. 100		(50,000)		(50,000)	
Total Bonds and debentures - Group		15,667,193		16,876,804	

12.7 INVESTMENT SECURITIES - Group

As at 31 December

	2004	2003
	Cost Rs.000	Cost Rs.000
Total cost of investment for Bank (as per Note 12.4, 12.5 and 12.6)	15,313,634	15,760,633
Subsidiaries - HNB Assurance Ltd / HNB Securities Ltd.		
Quoted shares	7,408	7,250
Quoted debentures	7,250	7,250
Government of Sri Lanka Treasury Bonds	1,056,234	1,852,621
Less: Investment in subsidiary debentures by the Bank	(50,000)	(50,000)
Total Cost of Investment for Group	16,334,526	17,577,754

	Bank		Group	
As at 31 December	2004	2003	2004	2003
	Rs.000	Rs.000	Rs.000	Rs.000
13. BILLS OF EXCHANGE				
Inland bills	340,047	549,669	340,047	549,669
Import bills	276,727	278,842	276,727	278,842
Export bills	1,158,182	1,192,573	1,158,182	1,192,573
	1,774,956	2,021,084	1,774,956	2,021,084
Foreign Currency Banking Unit bills	591,273	716,199	591,273	716,199
	2,366,229	2,737,283	2,366,229	2,737,283
Less: Specific Loan loss provision [Note 14(b)]	288,763	325,333	288,763	325,333
	2,077,466	2,411,950	2,077,466	2,411,950

Notes to the Accounts

As at 31 December	Bank		Group	
	2004	2003	2004	2003
	Rs.000	Rs.000	Rs.000	Rs.000
14. LOANS AND ADVANCES				
Sri Lanka rupee loans and advances				
Overdrafts	20,165,063	17,247,347	19,486,668	16,349,299
Trust receipts	4,957,006	3,880,713	4,957,006	3,880,713
Packing credit loans	521,945	557,260	521,945	557,260
Staff loans	3,634,411	2,886,265	3,635,562	2,887,843
Term loans	27,804,595	25,150,623	27,804,595	24,250,623
Housing loans	7,593,169	5,529,606	7,593,169	5,529,606
Pawning advances	11,432,733	7,952,660	11,432,733	7,952,660
Foreclosed properties [Note 14 (f)]	249,959	361,551	249,959	361,551
	<u>76,358,881</u>	<u>63,566,025</u>	<u>75,681,637</u>	<u>61,769,555</u>
Foreign currency loans and advances				
Overdrafts	1,249,346	1,528,732	1,249,346	1,528,732
Trust receipts	1,424,943	1,214,573	1,424,943	1,214,573
Packing credit loans	895,731	2,628,465	895,731	2,628,465
Term loans	9,654,803	6,332,678	9,654,803	6,332,678
Foreclosed properties [Note 14 (f)]	477,757	610,516	477,757	610,516
	<u>13,702,580</u>	<u>12,314,964</u>	<u>13,702,580</u>	<u>12,314,964</u>
Total Sri Lanka Rupee and Foreign currency loans and advances	<u>90,061,461</u>	<u>75,880,989</u>	<u>89,384,217</u>	<u>74,084,519</u>
Less:				
Specific loan loss provision	4,488,324	3,234,829	4,488,324	3,234,829
Specific provision for foreclosed properties [Note 14 (f)]	138,727	43,410	138,727	43,410
General provision for pawning advances	11,020	8,020	11,020	8,020
General provision for housing loans	16,200	12,600	16,200	12,600
Total loan loss provision [Note 14(a)]	<u>4,654,271</u>	<u>3,298,859</u>	<u>4,654,271</u>	<u>3,298,859</u>
Loans & Advances after loan loss provision	85,407,190	72,582,130	84,729,946	70,785,660
Less: Interest in suspense [Note 14(e)]	1,028,502	1,156,410	1,028,502	1,156,410
	<u>84,378,688</u>	<u>71,425,720</u>	<u>83,701,444</u>	<u>69,629,250</u>

In previous years Foreclosed Properties were shown as Investment Properties. As per Central Bank directive dated 31 December 2004 on "Accounting for Properties Acquired by Foreclosure of Collateral/Part Settlement of Debt", they are now re-categorized under Loans & Advances.

14(a) MOVEMENT IN LOAN LOSS PROVISION

Balance brought forward	3,298,859	2,603,871	3,298,859	2,603,871
Reclassified to Bills of Exchange	42,418	-	42,418	
Exchange rate variance on foreign currency provision	142,183	(15,772)	142,183	(15,772)
	<u>3,483,460</u>	<u>2,588,099</u>	<u>3,483,460</u>	<u>2,588,099</u>
Additional provision made (Note 6)	1,488,411	1,668,235	1,488,411	1,668,235
Fully provided debts written off	(216,458)	(770,110)	(216,458)	(770,110)
Recoveries made during the year	(101,142)	(187,365)	(101,142)	(187,365)
	<u>4,654,271</u>	<u>3,298,859</u>	<u>4,654,271</u>	<u>3,298,859</u>

Notes to the Accounts

14. LOANS AND ADVANCES (Contd.)

14(b) ANALYSIS OF PROVISION FOR LOAN LOSSES AND INTEREST IN SUSPENSE - BANK

As at 31 December	Loan Loss Provision			Interest In Suspense	
	Rs.000	2004 Rs.000	2003 Rs.000	2004 Rs.000	2003 Rs.000
Bills of exchange (Note 13)	288,763		325,333	-	-
Loans and advances (Note 14)	4,654,271	4,943,034	3,298,859	1,028,502	1,156,410
Lease rental receivable (Note 15)	205,004		161,617		
Lease rental receivable (Note 16)	85,997	291,001	55,217		
		5,234,035		1,028,502	1,156,410

14(c) ASSET QUALITY - BANK

Non performing advances

As at 31 December	2004 Rs.000	2003 Rs.000
Bills of exchange	326,540	337,893
Loans and advances	9,167,850	10,889,738
Foreclosed properties	727,716	972,067
Lease rental receivable	343,920	284,306
	10,566,026	12,484,004
Less: Specific provisions - Bills of exchange	288,763	325,333
- Loans and advances	4,488,324	3,234,829
- Foreclosed properties	138,727	43,410
- Lease rental receivable	150,384	116,360
	5,499,828	8,764,072
Less: Interest in suspense	1,028,502	1,156,410
Net non-performing advances	4,471,326	7,607,662

14(d) SECURITYWISE ANALYSIS OF GROSS NON-PERFORMING ADVANCES - BANK

As at 31 December	Amount Outstanding			
	2004 Rs.000	%	2003 Rs.000	%
Secured by immovable assets	5,388,673	51	7,418,752	59
Secured by movable assets	2,007,545	19	1,957,029	16
Secured by cash/shares	211,321	2	230,239	2
Other securities	1,584,904	15	1,381,432	11
Clean	1,373,583	13	1,496,552	12
	10,566,026	100	12,484,004	100

14(e) MOVEMENT IN INTEREST IN SUSPENSE - BANK

	2004 Rs.000	2003 Rs.000
Balance b/f	1,156,410	1,733,793
Interest suspended	579,693	715,484
Amounts recovered	(381,150)	(998,990)
Interest written off	(326,451)	(293,877)
	1,028,502	1,156,410

Bank, as a policy, seals off interest on Non-performing advances which are in arrears over one year. However, at the time of recovery, further interest on such advances is calculated from the date on which interest is sealed off.

Notes to the Accounts

14. LOANS AND ADVANCES (Contd.)

14(f) MOVEMENT IN FORECLOSED PROPERTIES	2004 Rs.000	2003 Rs.000
Balance as 01st January	928,657	397,019
Additions during the year	3,331	678,713
Disposals during the year	(382,981)	(117,434)
Transfers during the year	(10,210)	(29,580)
Exchange Translation	50,192	(61)
Balance as at 31st December	<u>588,989</u>	<u>928,657</u>
The net total of foreclosed properties has been included under		
Sri Lanka Rupee loans and advances	249,959	361,551
Foreign currency loans and advances	477,757	610,516
Specific provision for foreclosed properties	(138,727)	(43,410)
	<u>588,989</u>	<u>928,657</u>

14(g) 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 discount that need to be applied to the forced sale value of immovable properties held as collateral are as follows:

Category	% of Forced Sale Value of Immovable Property that can be considered as the Value of Security
At the time of 1st provisioning	75%
1 to 2 years in the loss category	60%
2 to 3 years in the loss category	50%
3 to 4 years in the loss category	40%
Over 4 years in loss category	Reviewed regularly and discounted further at the discretion of the management.

14(h) Provision for Kabool Lanka (Pvt) Ltd.

Kabool Lanka (Pvt) Ltd. ("KLPL") was banking with Emirates Bank, Colombo Branch which was acquired by HNB in 1989 and the relationship with KLPL continued thereafter. During the 1997 East Asian crisis, KLPL's parent company in Korea was also adversely affected and the local Sri Lankan Company too faced financial difficulties. HNB however continued to accommodate the working capital requirements of KLPL in view of the national importance of this particular industry, which we believed had very good prospects. During the latter half of 2003, the Korean Directors suddenly left the country compelling the closure of the factory and the plant. In order to safeguard its interests, HNB along with the other creditor bank jointly acquired the assets of KLPL through the legal process. The Bank's exposure to KLPL is approximately Rs. 2.8 Bn. and the proportionate value of the tangible assets available to HNB as security is approximately Rs. 1.13 Bn., based on the professional valuation of land, buildings carried out by Mr J M J Fernando, Consultant Valuer and machinery valuation carried out by Mr. R.B. Kalugalagedera, Chartered Valuation Surveyor using the Current Open Market Value basis.

The abovementioned valuations particularly for the machinery were obtained late last year at a time when we were almost finalizing a restructuring plan with an outside investor. The immediate working capital requirements to recommence work were also worked out and we were almost on the verge of signing a Memorandum of Understanding with the said investor. However, due to the sudden political developments during late 2003 the investor withdrew his offer. The Bank has been maintaining the machinery, land and other assets of the KLPL at an enormous cost throughout this period.

Meanwhile, the new Government has considered the situation as a national/social problem and has been endeavouring at the highest level to identify ways to revive the industry. A Presidential Committee has been appointed to proceed on this basis.

The Department of Development Finance of the Ministry of Finance has called a meeting among all stakeholders to devise a strategy to revive KLPL. Given these circumstances, the Bank is very confident that with the assistance of the Government authorities there is a strong possibility of the Bank being able to recommence this project without additional finance from the Bank.

Several other investors too have been seriously evaluating the project for revival and at least two such investors have made positive proposals, which are being reviewed by the Bank. The Bank has however, emphasized that any party who wishes to revive this project should be in a position to advance a minimum of US\$ 5 Mn. out of their own funds before the Bank signs a MOU. The Minister of Finance too in his recent budget speech specifically mentioned the need to resurrect this particular project in view of its social implications.

The Bank has made full provision as at 31 December 2004, after considering the value of land, building and machinery. The Bank is confident that there will not be a deterioration of the value of the said security during the interim period. The Bank, however will continue to progressively make further provisions during 2005 as a measure of prudence, despite the fact that land, buildings and machinery have a realizable value more than adequate to cover the present unprovided exposure.

Notes to the Accounts

14. LOANS AND ADVANCES (Contd.)

14(i) Provision for Lanka Glass Manufacturing (Pvt) Limited

As part of the consortium of lenders, HNB has funded the manufacturing project of Lanka Glass Manufacturing (Pvt) Ltd. ('LGM') in 1995-96. Due to various technical problems the commencement of commercial production was delayed and with adverse market conditions for products manufactured by LGM the factory was closed in October 1998. Subsequently, in order to demonstrate that the factory could be technically operated for commercial production, for which prospective investors had concerns, the consortium of banks, including HNB, extended financial support by way of new working capital accommodations for the factory to be restarted in November 2002. However, due to the financially viable level of production being higher than the level of production for which funding could be accommodated by the consortium of Banks, the production activities of LGM factory were ceased by October 2003.

The exposure to the Bank as at 31 December 2004 amounts to Rs.235 Mn and the total lending by the consortium of banks is secured by the property and machinery owned by LGM. The proportionate forced sale value of the secured assets attributable to the Bank as per the arrangements among the consortium of Banks amounts to Rs.161.9 Mn based on the professional valuation carried out by Ariyatillake & Co. (Pvt) Ltd, Chartered valuers. The provision of Rs. 164 Mn. already made adequately covers net exposure computed strictly in terms of classification guidelines.

The Bank will continue to regularly review this account, and make additional provisions required, if any, due to uncertainties regarding the realisable value of the factory referred above. The consortium of Banks are reviewing the offers made by three prospective buyers to dispose of the LGM factory.

	Bank		Group	
As at 31st December	2004	2003	2004	2003
	Rs.000	Rs.000	Rs.000	Rs.000
15. LEASE RENTALS RECEIVABLE WITHIN ONE YEAR				
Total Lease rentals receivable [refer Note 15(a)]	8,635,918	6,492,630	8,635,918	6,492,630
Lease rentals receivable after one year from Balance Sheet date	(5,001,262)	(3,568,440)	(5,001,262)	(3,568,440)
Lease rentals receivable within one year from Balance Sheet date	3,634,656	2,924,190	3,634,656	2,924,190
Unearned lease income	(865,385)	(728,937)	(865,385)	(728,937)
Provision for bad & doubtful debts - Specific	(150,384)	(116,360)	(150,384)	(116,360)
- General	(54,620)	(45,257)	(54,620)	(45,257)
	2,564,267	2,033,636	2,564,267	2,033,636
15(a) TOTAL LEASE RENTALS RECEIVABLE				
Cost of equipment	10,792,259	8,270,728	10,792,259	8,270,728
Unearned lease income	3,516,769	2,914,436	3,516,769	2,914,436
Total lease rentals receivable	14,309,028	11,185,164	14,309,028	11,185,164
Initial rentals received (prepaid)	(124,617)	(122,200)	(124,617)	(122,200)
Lease rentals received	(5,548,493)	(4,570,334)	(5,548,493)	(4,570,334)
Lease rentals receivable	8,635,918	6,492,630	8,635,918	6,492,630
16. LEASE RENTALS RECEIVABLE AFTER ONE YEAR				
Lease rentals receivable after one year from Balance Sheet date	5,001,262	3,568,440	5,001,262	3,568,440
Unearned lease income	(641,165)	(462,086)	(641,165)	(462,086)
Provision for bad & doubtful debts - General	(85,997)	(55,217)	(85,997)	(55,217)
	4,274,100	3,051,137	4,274,100	3,051,137

There were no lease rentals receivable beyond 5 years.

Notes to the Accounts

As at 31 December	Bank		Group	
	2004	2003	2004	2003
	Rs.000	Rs.000	Rs.000	Rs.000
16(a) ANALYSIS OF ADVANCES AND LEASES BY SECTOR				
Food, beverages and tobacco	3,906,878	3,564,451	3,906,878	3,564,451
Agriculture, agro business and fisheries	5,975,482	4,533,665	5,975,482	4,533,665
Textiles and wearing apparel	7,958,695	10,328,116	7,958,695	10,328,116
Wood and paper products	1,572,300	1,232,812	1,572,300	1,232,812
Rubber and leather products	2,210,269	1,388,098	2,210,269	1,388,098
Metals, chemicals and engineering	3,541,182	3,504,988	3,541,182	3,504,988
Hotels	3,091,064	2,070,767	3,091,064	2,070,767
Services	5,765,386	4,155,385	5,765,387	4,155,385
Foreclosed properties	727,716	972,067	727,716	972,067
Others*	63,948,407	50,623,270	63,271,162	48,826,800
	98,697,379	82,373,619	98,020,135	80,577,149
Loans and Advances (Note.14)	90,061,461	75,880,989	89,384,217	74,084,519
Leases (Note 15a)	8,635,918	6,492,630	8,635,918	6,492,630
	98,697,379	82,373,619	98,020,135	80,577,149
* The "others" category comprises the following advances:				
Exports	2,501,385	3,912,209	2,501,385	3,912,209
Imports	3,781,684	4,429,442	3,781,684	4,429,442
Trading	8,424,469	10,432,558	8,424,469	10,432,558
Financial	4,204,411	1,304,069	4,204,411	1,304,069
Housing	8,855,979	5,809,839	8,855,979	5,809,839
Consumption	10,096,004	3,912,209	10,096,004	3,912,209
Miscellaneous	26,084,475	20,822,944	25,407,230	19,026,474
	63,948,407	50,623,270	63,271,162	48,826,800
17. INVESTMENT IN ASSOCIATE COMPANIES				
Balance as at 1st January	157,582	157,582	190,309	161,426
Disposal	(68,149)	-	(19,548)	-
Transfer to Dealing Securities	(1,216)	-	-	-
Provision Written Back	44,109	-	-	-
Consolidation Adjustment	-	-	(2,173)	28,883
Balance as at 31st December	132,326	157,582	168,588	190,309

Notes to the Accounts

17. INVESTMENT IN ASSOCIATE COMPANIES (Contd.)

As at 31st December			2004			2003	
	Principal Activity	% Holding	Balance Rs.000	Market Value Rs.000		Balance Rs.000	Market Value Rs.000
					%		
17.1 Bank							
Quoted							
Lanka Ventures Ltd (10,036,250 shares of Rs.10/- each)	Venture Capital	20.07	132,326	97,853	20.07	132,326	100,363
CF Venture Fund Ltd (4,592,009 shares of Rs.10/- each as at 31 December 2003))	Venture Capital	-	-	-	30.61	69,365	22,960
Less: Provision for diminution in value			-	-		(44,109)	-
			<u>132,326</u>	<u>97,853</u>		<u>157,582</u>	<u>123,323</u>
Unquoted							
Browns Engineering (Pvt) Ltd. (2,056,000 ordinary shares of Rs.10/- each)	Engineering	32.63	20,560		32.63	20,560	
Less: Provision for diminution in value			<u>(20,560)</u>			<u>(20,560)</u>	
Total for the Bank			<u>132,326</u>			<u>157,582</u>	
17.2 Group							
Quoted Investments							
Investment in associate companies (at cost)			132,326			192,979	
Negative goodwill on acquisition			5,830			3,000	
Group share of associate company retained profits							
Balance as at 1st January			34,992			(31,494)	
Current year's share of profits after tax			21,531			37,743	
Dividends received during the year			(24,925)			9,587	
Balance as at 31st December			<u>31,598</u>			<u>3,338</u>	
Group share of associate company net assets			169,754			192,641	
Unamortized negative goodwill carried forward [Note 17.2(a)]			(1,166)			(2,332)	
Group investment in associate companies (equity basis)			<u>168,588</u>			<u>190,309</u>	
17.2(a) Negative goodwill on acquisition			<u>5,830</u>			<u>5,830</u>	
Amortization of negative goodwill							
Balance as at 1st January			(3,498)			(2,332)	
Amortized during the year			(1,166)			(1,166)	
Balance as at 31st December			<u>(4,664)</u>			<u>(3,498)</u>	
Unamortized negative goodwill			<u>1,166</u>			<u>2,332</u>	

Notes to the Accounts

18. INVESTMENT IN SUBSIDIARY COMPANIES

	Bank	
As at 31 December	2004	2003
	Rs.000	Rs.000
18.1 Quoted		
Balance as at 1st January	149,965	-
Transfers from unquoted investments	-	149,965
Balance as at 31st December	149,965	149,965
Unquoted		
Balance as at 1st January	1,193,698	1,443,663
Additions	900,000	-
On merger of subsidiaries (Net)	50,000	-
Transfers to quoted investments	-	(149,965)
Disposal	-	(100,000)
Balance as at 31st December	2,143,698	1,193,698
Total	2,293,663	1,343,663

During the year, Smart Development (Pvt) Ltd. merged its operations with Sithma Development (Pvt) Ltd. and consequently Smart Development (Pvt) Limited ceased to exist as at 31st December 2004.

	2004				2003		
As at 31 December							
18.2 Quoted							
	Principal Activity	% Holding	Balance Rs.000	Market Value Rs.000	% Holding	Balance Rs.000	Market Value Rs.000
HNB Assurance Ltd. (14,996,500 shares of Rs. 10/- each)	Insurance	59.986	149,965	187,456	59.99	149,965	157,463

Notes to the Accounts

18. INVESTMENT IN SUBSIDIARY COMPANIES (Contd.)

As at 31 December

	Principal Activity	% Holding	2004		2003		
			Balance Rs.000	Directors' Valuation Rs.000	Balance Rs.000	Directors' Valuation Rs.000	
18.3 Unquoted							
Bank							
Sithma Development (Pvt) Ltd (196,000,000 ordinary shares of Rs.10/- each/Rs.9/- each called up, 900,000,000 ordinary shares of Rs. 9/- each called up as at 31 December 2003)	Property Development	100	1,973,000	1,973,000	100	913,000	913,000
HNB Securities (Pvt) 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 Stock Brokers (Pvt) Ltd (3,600,000 ordinary shares of Rs.10/- each)	Share Broking	100	20,698	20,698	100	20,698	20,698
Smart Development (Pvt) Ltd (10,000,000 ordinary shares of Rs. 10/- each as at 31 December 2003)	Property Development	-	-	-	100	110,000	110,000
			2,143,698	2,143,698		1,193,698	1,193,698
Total for Bank			2,293,663			1,343,663	

19. OTHER ASSETS

As at 31 December	Bank		Group	
	2004 Rs.000	2003 Rs.000	2004 Rs.000	2003 Rs.000
Deposits and prepayments	2,115,150	1,961,711	2,126,800	1,461,711
Items in transit	2,053,362	3,013,411	2,053,362	3,013,411
Claims receivable	130,692	117,834	130,692	117,834
Other debtors	1,319,972	2,305,435	1,215,949	2,665,791
	5,619,176	7,398,391	5,526,803	7,258,747

Notes to the Accounts

20. PROPERTY PLANT AND EQUIPMENT

	Leasehold Buildings Note 20.3 Rs.000	Freehold Land and Buildings Note 20.2 Rs.000	Computer Equipment Note 20.1 Rs.000	Equipment and Furniture Rs.000	Motor Vehicles Rs.000	Capital Work-in Progress Rs.000	2004 Total Rs.000	2003 Total Rs.000
Bank								
Cost/Valuations as at 31.12.2003	571,247	1,648,832	1,641,151	1,542,472	101,713	4,087	5,509,502	4,548,532
Additions for the year	24,665	63,313	97,107	125,578	2,314	203,304	516,281	1,103,112
On disposals	-	(107,915)	(54,336)	(24,129)	(17,146)	-	(203,526)	(87,322)
Transfers/Adjustments	16,003	20,524	103,197	8,051	-	(147,348)	427	-
Write downs/Deletions	(32,601)	-	-	-	-	-	(32,601)	(54,820)
Cost/Valuation as at 31.12.2004	<u>579,314</u>	<u>1,624,754</u>	<u>1,787,119</u>	<u>1,651,972</u>	<u>86,881</u>	<u>60,043</u>	<u>5,790,083</u>	<u>5,509,502</u>
Accumulated Depreciation as at 31.12.2003	204,490	104,498	957,410	762,457	67,103	-	2,095,958	1,767,908
Charge for the year	58,974	19,570	180,081	166,081	13,952	-	438,658	409,274
On disposals	(32,224)	(10,010)	(53,533)	(20,524)	(14,780)	-	(131,071)	(81,224)
Accumulated Depreciation as at 31.12.2004	<u>231,240</u>	<u>114,058</u>	<u>1,083,958</u>	<u>908,014</u>	<u>66,275</u>	<u>-</u>	<u>2,403,545</u>	<u>2,095,958</u>
Net book Value as at 31.12.2004	<u>348,074</u>	<u>1,510,696</u>	<u>703,161</u>	<u>743,958</u>	<u>20,606</u>	<u>60,043</u>	<u>3,386,538</u>	
Net book Value as at 31.12.2003	<u>366,757</u>	<u>1,544,334</u>	<u>683,741</u>	<u>780,015</u>	<u>34,610</u>	<u>4,087</u>		<u>3,413,544</u>
Group								
Cost/Valuation as at 31.12.2003	571,247	4,236,986	1,675,603	3,496,381	109,754	17,132	10,107,103	8,537,480
Additions for the year	24,665	64,251	108,630	295,155	5,860	203,304	701,865	1,719,381
On disposals	-	(107,915)	(54,336)	(24,129)	(17,146)	-	(203,526)	(94,717)
Transfers/Adjustments	16,003	20,524	116,242	8,051	-	(160,393)	427	-
Write downs/Deletions	(32,601)	-	-	-	-	-	(32,601)	(54,820)
Cost/Valuation as at 31.12.2004	<u>579,314</u>	<u>4,213,846</u>	<u>1,846,139</u>	<u>3,775,458</u>	<u>98,468</u>	<u>60,043</u>	<u>10,573,268</u>	<u>10,107,324</u>
Accumulated Depreciation as at 31.12.2003	204,490	136,606	963,472	829,149	74,041	-	2,207,758	1,809,019
Charge for the year	58,974	48,340	192,393	222,328	15,506	-	537,541	494,556
On disposals	(32,224)	(10,010)	(53,533)	(20,524)	(14,780)	-	(131,071)	(88,061)
Accumulated Depreciation as at 31.12.2004	<u>231,240</u>	<u>174,936</u>	<u>1,102,332</u>	<u>1,030,953</u>	<u>74,767</u>	<u>-</u>	<u>2,614,228</u>	<u>2,215,514</u>
Net Book Value as at 31.12.2004	<u>348,074</u>	<u>4,038,910</u>	<u>743,807</u>	<u>2,744,505</u>	<u>23,701</u>	<u>60,043</u>	<u>7,959,040</u>	
Net Book Value as at 31.12.2003	<u>366,757</u>	<u>4,092,844</u>	<u>712,131</u>	<u>2,667,233</u>	<u>35,713</u>	<u>17,132</u>		<u>7,891,810</u>

The Bank had a valuation carried out on all its freehold properties during the year 1993, excluding the Pettah Branch premises which was under construction, and the land in Jaffna, by a panel of Chartered Valuers/Licensed Surveyors and one half of the increase in the valuation of properties amounting to Rs.152,575,000/- was written up in the book value of the freehold properties in 1993 and the balance of Rs.152,575,000/- was written up in 1994. The Bank has obtained the necessary approval of the Monetary Board for the increase in the valuation.

Notes to the Accounts

20. PROPERTY PLANT AND EQUIPMENT (Contd.)

20.1 COMPUTER EQUIPMENT - BANK

	Additions Prior to 1.7.2000 (Rs.000)	Additions After 1.7.2000 (Rs.000)	2004 Total (Rs.000)	2003 Total (Rs.000)
Rate of depreciation Cost/Valuations as at 01.01.2004	(25%)	(16.67%)		
	714,007	927,144	1,641,151	1,480,299
Additions for the year	-	97,107	97,107	225,914
Transfers	-	103,197	103,197	-
Disposals during the year	(52,478)	(1,858)	(54,336)	(65,062)
Cost/Valuation as at 31.12.2004	<u>661,529</u>	<u>1,125,590</u>	<u>1,787,119</u>	<u>1,641,151</u>

20.2 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 53/1 D. S. Senanayake Mawatha Borella	7,530	28	21,702	37,228	58,930	928	58,002
Colombo 12 property 11, Mohandiram's Road Colombo 12	4,835	37.53	28,411	7,669	36,080	1,111	34,969
Bambalapitiya Branch 285, Galle Rd, Colombo 4	12,786	20.00	10,000	25,931	35,931	5,048	30,883
City Office 16, Janadhipathi Mawatha Colombo 1 25, Chatham Street Colombo 1	28,900	84.00	100,800	82,117	182,917	19,535	163,382
Darley Road Property 479, T B Jayah Mawatha Colombo 10	Land	100.00	75,781	-	75,781	-	75,781
Centralized Operations Bldg. 90 Vidyalankara Mawatha Colombo 10	92,008	249	145,599	18,126	163,725	-	163,725
Head Office 10, R A De Mel Mawatha Colombo 3	36,379	40.00	32,000	79,689	111,689	17,756	93,933
Managing Director's Residence 23 & 23 1/1 Independence Avenue Colombo 7	9,975	60.40	37,081	46,709	83,790	3,277	80,513
* Pettah Branch 88, Main Street, Colombo 11	3,708	7.60	9,099	14,842	23,941	2,689	21,252
Sea Street Branch 60, Sea Street Colombo 11	3,652	6.93	8,200	52,107	60,307	7,416	52,891

Notes to the Accounts

20. PROPERTY PLANT AND EQUIPMENT (Contd.)

20.2 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
Janadhipathi Mawatha property 21 21A, 23 & 25 Janadhipathi Mawatha Colombo 1	39,410	26.62	34,889	-	34,889	-	34,889
Wellawatte Property 102 Galle Road Wellawatte	18,040	36.05	29,854	57,858	87,712	3,121	84,591
Grandpass 182 St. Joseph Street Colombo 14	9,325	24	9,359	21,987	31,346	1109	30,237
Colombo Central 149-151 Main Steet Colombo 11	9,732	7.56	30,000	80,867	110,867	3,771	107,096
* Condominium property			572,775	525,130	1,097,905	65,761	1,032,144

Outside Colombo City Limits

Akkaraipattu Property 1, Main Street, Akkaraipattu	Under Development	19.32	3,351	-	3,351	-	3,351
Ambalangoda Branch 94/1, New Road Ambalangoda		29.9	3,129	8,784	11,913	1,511	10,402
Badulla Branch No:15, 151/1, Udayaraja Mawatha,Badulla		28.44	2,418	11,372	13,790	2,209	11,581
Galle Branch 3, Wakwella Road Galle		13.80	11,000	8,977	19,977	1,892	18,085
Gampola Branch 12, Kandy Road Gampola		11.88	8,319	3,180	11,499	938	10,561
Hatton Branch 78, Dimbulla Rd Hatton		53.50	1,075	3,671	4,746	648	4,098
"Mount Bungalow" 7, Mount Road Hatton		160.00	3,620	4,264	7,884	991	6,893
Jaffna Property 181/5C, Ponnampalam Road Jaffna	Under Development	80.00	1,994	30	2,024	-	2,024

Notes to the Accounts

20. PROPERTY PLANT AND EQUIPMENT (Contd.)

20.2 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
Kandy Branch 1, Dalada Veediya Kandy	10,600	78.90	38,627	15,678	54,305	3,114	51,191
Kurunegala Branch 6, st. Anne's Street Kurunegala	9,600	16.25	3,250	8,077	11,327	1,468	9,859
Nawalapitiya Branch 92, Gampola Road Nawalapitiya	2,324	46.00	875	5,466	6,341	1,064	5,277
Negombo Branch 18, Rajapakse Broadway Negombo	3,504	8.88	1,776	14,269	16,045	2,988	13,057
Nittambuwa Branch 22, Kandy Road Nittambuwa	4,000	14.50	687	9,564	10,251	1,762	8,489
Nochchiyagama Branch 10, Puttalam Rd Nochchiyagama	1,800	40.00	320	10,911	11,231	1,438	9,793
Wattala Property 270, 270/1 Negombo Road Wattala	6,400	53	10,399	18,811	29,210	1,995	27,215
Kuliyapitiya (Additional Property) 225 Madampe Road Kuliyapitiya	3,795	8.8	883	-	883	-	883
Kurunegala (New Premises) 34/16 St. Anne's Street Kurunegala	Bare Land	20	6,759	-	6,759	-	6,759
Dambulla (New Premises) 622 Anuradhapura Road Dambulla	Bare Land	100	14,565	-	14,565	-	14,565
Boralessgamuwa 24 Maharagama Road Boralessgamuwa	3,500	30.34	5,048	14,358	19,406	1,026	18,380
Monaragala (New Premises) Kumaradola Road Monaragala	Bare Land	20	1,455	-	1,455	-	1,455
Nugegoda Branch 181, High Level Road Nugegoda	11,639	19.50	7,550	27,602	35,152	5,404	29,748
Nuwara Eliya Branch/Bungalow 42, Queen Elizabeth Drive Nuwara Eliya	7,150	64.36	11,504	21,853	33,357	1,643	31,714
Trincomalee Branch 59, Ahambaram Rd Trincomalee	6,802	20.51	1,451	16,182	17,633	2,592	15,041
Anuradhapura Branch 30, Maithripala Senanayake Mawatha, Anuradhapura	2,000	25.59	5,337	12,811	18,148	2,117	16,031
Maskeliya Branch 9, New Town Maskeliya	1,900	20.32	1,948	2,385	4,333	398	3,935
Mannar Branch 68, Main Street Mannar	4,200	23.00	619	5,167	5,786	692	5,094
Ratnapura Branch 21 & 23 Senanayake Mawatha Ratnapura	3,048	21.01	12,479	10,117	22,596	1,509	21,087

Notes to the Accounts

20. PROPERTY PLANT AND EQUIPMENT (Contd.)

20.2 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
Ja-Ela Branch 73, Old Negombo Road, Ja-Ela Matale Branch 660, Trincomalee Road Matale	4,300	19.00	2,729	9,590	12,319	1,435	10,884
Kuliyapitiya Branch 225, Main Street, Kuliyapitiya Mount Lavinia Property 100, Galle Road Mount Lavinia	7,615	22.08	3,459	11,500	14,959	2,061	12,898
Marawila Branch 534, Chilaw Road, Marawila Marawila Staff Quarters	2,750	24.00	3,483	4,676	8,159	823	7,336
Matara Branch 29, Anagarika Dharmapala Mw Matara	12,674	28.46	10,294	26,207	36,501	2,864	33,637
Narammala Hewankumbura Narammala Kegalle Main Street, Kegalle	4,640	23.3	3,916	7,469	11,385	1,485	9,900
	1,733	23.3	2,427	900	3,327	135	3,192
	6,988	26	5,136	21,337	26,473	2,094	24,379
	Bare Land	40	4,159	-	4,159	-	4,159
	Bare Land	48.7	15,600	-	15,600	-	15,600
Total freehold land and building outside Colombo city limits			211,641	315,208	526,849	48,297	478,552
Total freehold land and building as at 31st December 2004			784,416	840,338	1,624,754	114,058	1,510,696

20.3 LEASEHOLD BUILDINGS

As at 31 December	Bank 2004		Group 2004		Bank 2003		Group 2003	
	Cost of Buildings Rs.000	Accumulated Depreciation 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	Net Book Value Rs.000
Lease Period								
Up to 1 year	84,500	73,914	84,500	73,914	10,586	2,681	10,586	2,681
1 - 05 years	129,751	84,421	129,751	84,421	45,330	45,115	45,330	45,115
5 - 10 years	32,017	13,232	32,017	13,232	18,785	289,468	18,785	289,468
10 - 15 years	6,454	1,659	6,454	1,659	4,795	6,770	4,795	6,770
15 - 20 Years	326,592	58,014	326,592	58,014	268,578	22,723	268,578	22,723
	579,314	231,240	579,314	231,240	348,074	366,757	348,074	366,757

20.4 FREEHOLD LAND AND BUILDINGS - SUBSIDIARIES

As at 31 December	Buildings Sq.ft.	Cost of Buildings Rs.000	Total Value Rs.000	Accumulated Depreciation Rs.000	2004 Net Book Value Rs.000	2003 Net Book Value Rs.000
Smart Building 21, 21A, 23, 25, Janadhipathi Mawatha Colombo 1	42,765	128,115	128,115	15,869	112,246	115,449
Sithma Building 479 T B Jayah Mawatha Colombo 10	499,554	2,460,977	2,460,977	45,009	2,415,968	2,433,061
	542,319	2,589,092	2,589,092	60,878	2,528,214	2,548,510

Notes to the Accounts

As at 31st December	2004		2003	
	Goodwill	Negative Goodwill	Goodwill	Negative Goodwill
	Rs.000	Rs.000	Rs.000	Rs.000
21. GOODWILL ON CONSOLIDATION				
21.1 (a) Group				
Balance b/f	5,200	3,574	63,032	5,361
Arising during the year	-	-	-	-
Less: Amortization during the year	2,600	1,787	57,832	1,787
Balance c/f	<u>2,600</u>	<u>1,787</u>	<u>5,200</u>	<u>3,574</u>
Goodwill arising on acquisition	13,000	8,935	85,408	8,935
Less: Amortization as at 31st December	10,400	7,148	80,208	5,361
	<u>2,600</u>	<u>1,787</u>	<u>5,200</u>	<u>3,574</u>
C/F in Balance Sheet	<u>813</u>		<u>1,626</u>	
Goodwill on Consolidation charged to Income Statement				
Acquisition of Subsidiaries	2,600	1,787	57,832	1,787
Investment in Associate companies	-	1,166	-	1,166
	<u>2,600</u>	<u>2,953</u>	<u>57,832</u>	<u>2,953</u>
Net charge to Income Statement		<u>(353)</u>	<u>54,879</u>	
21.1 (b) Bank				
	2004		2003	
	Rs.000		Rs.000	
Balance b/f	-		55,232	
Acquisition of Habib Bank AG Zurich Sri Lankan Branches	-		-	
Less: Amortization for the year	-		55,232	
C/F in Balance Sheet	<u>-</u>		<u>-</u>	
Goodwill charged to Income Statement	<u>-</u>		<u>55,232</u>	

The Goodwill arose from the acquisition of Habib Bank AG Zurich, Sri Lanka Branches and was amortized in full during 2003 in order to conform to the requirements of the Section 22 of the Banking Act No. 30 of 1988 as amendment by Banking (Amendment) Act No. 33 of 1995 to facilitate the payment of dividends by the Bank.

Notes to the Accounts

As at 31st December	Bank		Group	
	2004	2003	2004	2003
	Rs.000	Rs.000	Rs.000	Rs.000
22. DEPOSITS FROM CUSTOMERS				
Local Currency Deposits				
Current account deposits	8,852,609	7,929,485	8,809,217	7,885,026
Savings deposits	42,108,475	36,452,976	42,080,321	36,445,467
Time deposits	31,920,537	23,502,610	31,810,087	23,482,660
Certificates of deposit	4,448,095	5,861,618	4,448,095	5,855,772
Foreign Currency Deposits				
Current account deposits	2,331,555	1,154,625	2,331,555	1,154,625
Savings deposits	15,009,655	11,936,063	15,009,655	11,936,063
Time deposits	13,853,008	14,188,135	13,853,008	14,188,135
	<u>118,523,934</u>	<u>101,025,512</u>	<u>118,341,938</u>	<u>100,947,748</u>
22(a) ANALYSIS OF DEPOSITS				
Deposits From Non-Bank Customers	118,072,406	100,582,261	117,890,410	100,504,497
Deposits From Banks	90,078	60,319	90,078	60,319
Deposits From Finance Companies	361,450	382,932	361,450	382,932
	<u>118,523,934</u>	<u>101,025,512</u>	<u>118,341,938</u>	<u>100,947,748</u>
23. DIVIDENDS PAYABLE				
Balance as at 1st January	40,757	21,968	40,757	21,968
Dividends declared during the year	343,200	250,250	343,200	250,250
Dividends settled	(275,658)	(231,461)	(275,658)	(231,461)
Balance as at 31st December	<u>108,299</u>	<u>40,757</u>	<u>108,299</u>	<u>40,757</u>
<p>The 20% interim dividend paid on 28th December 2004 included a re-distribution of tax exempt dividends of Rs.37,618,955/- (2003 - Rs.34,917,324/-) 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.</p> <p>Directors have recommended the payment of a final dividend of 15% for the year ended 31st December, 2004 (2003 - 20%), which will be declared at the Annual General Meeting to be held on 30th March, 2005. 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, 2004.</p>				
24. BORROWINGS				
Call and time deposits from banks	1,104,650	1,682,727	1,104,650	1,682,727
Refinance borrowings	2,066,198	1,764,014	2,066,198	1,764,014
Foreign bank borrowings	1,043,043	1,836,187	1,043,043	1,836,187
Borrowings under repurchase agreements	4,610,598	2,243,041	11,089,485	7,602,872
Other borrowings	-	-	-	1,506,406
	<u>8,824,489</u>	<u>7,525,969</u>	<u>15,303,376</u>	<u>14,392,206</u>

Notes to the Accounts

As at 31 December	Bank		Group	
	2004	2003	2004	2003
	Rs.000	Rs.000	Rs.000	Rs.000
25. OTHER LIABILITIES				
Cheques sent on clearing	1,836,378	1,954,814	1,836,378	1,954,814
Accrued expenditure and interest	3,396,237	3,555,366	3,404,282	3,555,366
Claims payable	642,288	1,990,265	642,288	1,990,265
Margins	854,777	778,258	907,102	778,258
Pension fund	289,546	625,123	289,546	625,123
Widows'/widowers' & orphans' pension fund	188,588	153,486	188,588	153,486
Employees provident fund	2,227,254	1,809,141	2,227,254	1,809,141
Gold Investment Account	3,235	3,610	3,235	3,610
Other creditors	976,454	1,349,555	1,290,589	1,626,947
	<u>10,414,757</u>	<u>12,219,618</u>	<u>10,789,262</u>	<u>12,497,010</u>

26. LONG TERM INSURANCE FUND

Long Term Insurance Fund balance represents the Life Fund of the subsidiary, HNB Assurance Ltd., which carries 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 2004 was made by Mr M Poopalanathan, AIA, of M/s Acturial and Management Consultants (Pvt) Ltd. for and on behalf of HNB Assurance Ltd. The life fund stands at Rs. 169,493 Mn. as at 31st December 2004 and in the opinion of the Actuary this amount is adequate to cover the liabilities pertaining to long term insurance business of HNB Assurance Ltd., as per the Actuary's Report dated 10 February 2005.

27. 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 industry practice and in accordance with the Control of Insurance (Miscellaneous provisions) Regulation 1987.

As at 31st December	Group	
	2004	2003
	Rs.000	Rs.000
Unearned premium	122,058	97,136
Deferred acquisition expenses	(4,027)	(5,495)
Technical reserves	118,031	91,641
Claims outstanding	46,772	19,253
Claims incurred but not reported	9,420	3,412
	<u>174,223</u>	<u>114,306</u>

As at 31st December	Bank		Group	
	2004	2003	2004	2003
	Rs.000	Rs.000	Rs.000	Rs.000
28. DEFERRED TAXATION				
Balance brought forward	387,091	303,791	389,375	305,760
Add/(Less): Charge/(Reversal)during the year	(36,735)	83,300	(36,846)	83,615
	<u>350,356</u>	<u>387,091</u>	<u>352,529</u>	<u>389,375</u>
29. SUBORDINATED DEBENTURES				
Balance as at 1st January	4,000,000	3,000,000	3,983,450	2,998,450
Debentures issued	-	2,000,000	2,000,000	2,000,000
Debentures redeemed	-	(1,000,000)	-	(1,000,000)
Debentures held by Group Companies	-	-	-	(15,000)
Balance as at 31st December (a)	<u>4,000,000</u>	<u>4,000,000</u>	<u>5,983,450</u>	<u>3,983,450</u>

Notes to the Accounts

29. SUBORDINATED DEBENTURES (Contd.)

- (a) 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:

	<u>5 year</u>	<u>7 year</u>	<u>10 year</u>
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 6 month treasury bill rate with a cap of 17% and a floor of 12%. 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:

	<u>5 Year</u>
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.

As at 31 December	2004	2003
	Rs.000	Rs.000

30. SHARE CAPITAL - GROUP AND BANK AUTHORISED

1Billion ordinary shares of Rs.10/- each	<u>10,000,000</u>	<u>1,000,000</u>
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The authorized share capital was increased pursuant to a resolution adopted at an extra-ordinary general meeting held on 09 October 2004

ISSUED AND FULLY PAID - VOTING ORDINARY SHARES

As at 1st January		
55Mn voting ordinary shares of Rs.10/- each	550,000	550,000
Rights issue of 2:5		
22Mn voting ordinary shares of Rs.10/- each	220,000	-
As at 31st December	<u>770,000</u>	<u>550,000</u>
77Mn (2003-55 Mn) voting ordinary shares of RS.10/- each		

ISSUED AND FULLY PAID - NON-VOTING ORDINARY SHARES

As at 1st January		
16.5Mn non-voting ordinary shares of Rs.10/- each	165,000	165,000
Rights issue of 2:5		
6.6Mn non-voting ordinary shares of Rs.10/- each	66,000	-
As at 31st December	<u>231,000</u>	<u>165,000</u>
23.1Mn (2003 - 16.5Mn) non-voting ordinary shares of Rs.10/- each		

The new voting and non-voting shares as rights issue were allotted on 10 November 2004.

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 a dividend for three consecutive years, these shares automatically convert into voting ordinary shares.

Notes to the Accounts

31. COMMITMENTS AND CONTINGENCIES - GROUP AND BANK

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.

As at 31 December	2004 Rs.000	2003 Rs.000
a) Commitments		
Commitment for unutilised facilities (direct advances)	5,223,078	8,018,188
b) Contingent Liabilities		
Acceptances	3,038,626	2,336,277
Documentary credits	6,682,773	10,202,597
Guarantees	13,845,805	16,451,726
Bills for collection	5,118,633	5,035,268
	28,685,837	34,025,868
Forward Exchange Contracts (net)	16,536,006	21,240,403
Total Commitments and Contingencies Group and Bank	45,221,843	55,266,271

c) Litigation against the Bank

- 1) Nine Claims for damages made by customers in Case Nos.17343/MR, 24440/MR, 23434/MR, 6607/M, 9030/M, 1773/M, 23897/MR and 7638 in the District Courts/Commercial HC (Civil) in respect of cheques dishonoured/debits to Accounts.
- 2) A guarantor in the District Court Case No.5383/Land is challenging his signature on a Mortgage Bond over immovable property.
- 3) Labour Tribunal Case Nos. 8/2674/96, 13/42/98, 3/148/99, 13/609/99, 18022/1263/2001, 8/2114/2002, 8/2115/2002, 8/2176/2002, 27/1030/2002, 23/7957/2002, 26/02/2004, 26/122/2004 and HCA/66/2004 are pending, 1/48/95, 13/1970/97, 13/884/2000 and 2addl./2402/2002 are laid by.
- 4) Action filed in Commercial High Court Case No. 132/2001(1)) by a depositor against Habib Bank AG Zurich Sri Lanka Branch (HBZ) challenging the HBZ's action in setting off a customer liability against the deposit and claiming damages - With the business acquisition of HBZ the Bank has been substituted, as the defendant in the legal action.

In the opinion of the Directors, based on their assessment and in consultation with the Bank's legal counsel, litigation which is currently pending will not have a material impact on the reported financial results or the future operations of the Bank.

d) Future commitments on operating leases - Bank

Upto 1 year	-	78
1 - 5 years	3,458	75,364
5 - 10 years	3,667	155,610
10 - 15 years	572	83,194
15 - 20 years	132	22,683
	7,829	336,929

- e) Sri Lanka Customs is investigating the software imports by the bank to assess for duties/taxes due. The outcome of this investigation is unknown. However the bank has resisted any claim on the basis that such import is not covered by regulation.

- f) Taxes amounting to Rs. 56 Mn. on assessment Nos, 9345857, 9390676, 9342313, 9355747, 9442055 and 9499956 is pending settlement for which the Bank has resorted to legal advice.

Notes to the Accounts

32. CAPITAL COMMITMENTS

- (a) Capital expenditure approved by the Board of Directors for which provision has not been made in the accounts amount to approximately, Rs. 120.3 Mn.

As at 31st December	2004	2003
	Rs.000	Rs.000
Approved and contracted for	93,910	88,337
Approved but not contracted for	26,384	15,664
	<u>120,294</u>	<u>104,001</u>

- (b) Capital expenditure approved by the Board of Directors for fully-owned subsidiaries of the Bank for which provision has not been made in the accounts are:

Sithma Development (Pvt) Ltd		
Approved and contracted for	-	361,390
Approved but not contracted for	<u>17,175</u>	<u>-</u>

33. DIRECTORS' INTEREST IN CONTRACTS WITH THE BANK

- (1) Mr M.V. Theagarajah, who is a Director of the Bank, is also the Chairman of Brown & Company Ltd, which Company:-

- (a) Leased residential premises at Hatton to the Bank at an annual rental of Rs. 63,000/- (2003 - Rs. 63,000/-).
- (b) Provided office space, for the Registered Office, No.481, T B Jayah Mawatha, Colombo 10 to the Bank for a payment of Rs. 156,348/- per annum. (2003 - Rs. 156,348/-).
- (c) Sold to the Bank office equipment amounting to Rs. 10,592,289/- (2003 - Rs.51,630,796/-) and items, to be given as prizes for competitions, amounting to Rs. 9,648,937/- (2003 - Rs. 24,145,920/-).

- (2) Mr M V Theagarajah who is a director of the Bank is also a director of Browns Tours Ltd. who occupied a total of 1855 sq.ft. at HNB Towers, 479, T B Jayah Mawatha, Colombo 10. Rs. 1.96 Mn. has been recognised as rental income for the year (2003 - Rs. 1.98 Mn.). These premises were vacated on 31.12.04.

Mr M V Theagarajah is a director of the Bank and also a director of B G Air Services (Pvt) Ltd. who occupied 900 sq. ft. at HNB Towers, 479 T B Jayah Mawatha, Colombo 10. Rs. 1.2 Mn. has been recognized as rental income for the year (2003 - Rs. 849,100). These premises were vacated on 31.10.04.

- (3) The Bank carries out transactions in the ordinary course of business on an arm's length basis with companies in which there is a substantial interest by directors of the bank. Details of these transactions are given in Note 34 (f).

- (4) Transactions with subsidiary companies are given in Note 34 (e).

Notes to the Accounts

34. RELATED PARTY TRANSACTIONS

(a) **Brown & Company Ltd.**

The Bank carried out transactions in the ordinary course of business on an arm's length basis with its shareholders and the companies in which such persons have a significant influence by representation on the board of directors and not by substantial shareholdings. These Companies, names of Directors their relationship and the nature of transaction entered into are listed below.

Name of Company	Name of Director	Nature of Transaction
Companies of the Browns Group	Mr M V Theagarajah Chairman	Banking Facilities

The Browns Group of Companies which has a substantial holding in the Bank, has borrowings aggregating to Rs. 1,135 Mn. (2003 Rs.1,134 Mn.) net of cash deposits. These transactions are on an arm's length basis. Total borrowing of the group is well within the single borrower limit of Rs. 2,423 Mn. as at 31.12.2004 established according to the directions issued by the Central Bank of Sri Lanka based, on the Capital Funds. All facilities are current.

Brown & Company Limited having successfully fulfilled the terms and conditions of a MOU for restructuring, signed between the Bank and the Company in March 2003 has maintained and serviced the facilities well within the approved limits throughout 2003 and 2004 and all facilities are current and performing.

(b) **Sithma Development (Pvt) Ltd.**

During the current financial year, with the approval from the Central Bank of Sri Lanka, Hatton National Bank (HNB) invested a further sum of Rs. 900 Mn. in Sithma Development (Pvt) Ltd. With the infusion of capital the equity investment by HNB in Sithma Development (Pvt) Ltd. was increased to Rs. 1,813 Mn.

Towards the latter part of the year, with the approval from the Board of Investment of Sri Lanka (BOI), the assets of Smart Development (Pvt) Ltd. a fully owned subsidiary of the Bank was transferred to Sithma Development (Pvt) Ltd.. As consideration for the transfer of assets, Sithma Development (Pvt) Ltd. issued further 1.6 Mn shares of Rs. 10/- each to the Bank. As a result, Smart Development (Pvt) Ltd. now ceases to exist. The total issued share capital of Sithma Development (Pvt) Ltd. as at 31/12/04 is Rs. 1,960 Mn. With the additional shares issued to HNB the total equity investment of HNB in Sithma Development (Pvt) Ltd. is Rs. 1,973 Mn.

In order to consolidate borrowings from banks, during the 4th quarter of the year, Sithma Development (Pvt) Ltd. placed debentures to the value of Rs. 2 Bn with a leading financial institution. With the proceeds of the debenture issue, Sithma Development (Pvt) Ltd. settled in full, the loans taken from the People's Bank and HNB. Presently, Sithma Development (Pvt) Ltd. operates only an overdraft facility with HNB.

Type of Facility	Rate of Interest	Limit Rs.	Outstanding as at 31/12/04 (Rs.)	Security	Review
Overdraft of Rs. 900 Mn.	9.5% (2% above the AWTBR). To be reviewed every 6 months.	900,000,000	615,856,356	Assignment/Set-off Lease rentals payable on the HNB Ltd. Head Office building.	September 2005

Total interest payments paid by Sithma Development (Pvt) Ltd. during the year are as follows:

Overdraft interest paid to HNB	83,594,000
Loan interest paid to HNB	82,308,000
Loan interest paid to People's Bank	102,160,000
Total	<u>268,062,000</u>

As reported in the previous year's financial statements (Note 35) HNB refrained from recognizing the interest of Rs. 156 Mn. received from Sithma Development (Pvt) Ltd. as a measure of prudence. However, with the improved cash flow of Sithma Development (Pvt) Ltd. and settlement of term loans the said interest income which was excluded from the profits in the year 2003, was recognized during the 3rd quarter of 2004 in the accounts of HNB.

Notes to the Accounts

34. RELATED PARTY TRANSACTIONS (Contd.)

(c) Accommodation Granted to Directors for Credit Cards

	Limit (Rs. Mn.)	Outstanding as at 31.12.04 (Rs. Mn.)
Mr R T Wijetilleke (Chairman)	6.90	0.46
Dr V P Vittachi (Deputy Chairman)	3.71	Nil
Mr D H S Jayawardena	15.00	1.81
Mr M V Theagarajah	4.02	0.40
Mr R K Obeyesekere	1.23	0.21
Mrs P Cooray	1.00	0.07
Mr R Sivaratnam	0.62	Nil
Mr R Theagarajah	0.40	0.11

(d) Facilities Granted to Directors

Name of Director	Aggregate Amount of Accommodation		Security
	Limit (Rs.Mn.)	Outstanding as at 31.12.04 (Rs.Mn.)	
Mr R T Wijetilleke	15.45	15.24	- Immovable property - Cash deposits - Surrender value of Life Policies
Mr M V Theagarajah	4.60	1.85	- Cash deposits
Mr R Sivaratnam	1.50	0.89	- Quoted Company Shares

(e) Transactions with Subsidiaries

Sithma Development (Pvt) Ltd

Sithma had an overdraft facility with the Bank with a balance of Rs. 618 Mn. (2003 - Rs.885 Mn.) as at 31.12.04. The Company has paid interest amounting to Rs. 166 Mn. in respect of both the overdraft and the long term loan which was settled during the year in full. A ground rent of Rs. 2.4 Mn. (2003 - Rs. 2.4 Mn.) has been paid during the year by the Company to the Bank. The Bank occupies office premises owned by the Company and has paid Rs. 397 Mn (2003 - Rs. 315 Mn.) as rental for the year. The Bank has made a prepayment of rental and the balance as at 31.12.2004 amounts to Rs. 500 Mn.

HNB Securities Ltd.

Rent for office space of Rs. 5.2 Mn. (2003 - Rs. 2.1 Mn.) has been paid by the Company to Sithma Development (Pvt) Ltd. The Company maintains a current account with the Bank and the balance as at 31.12. 2004 amounts to Rs. 10 Mn. favourable balance (2003 favourable of Rs. 11.5 Mn). The Bank has invested in debentures issued by the Company to the value of Rs. 50 Mn. as at 31.12.2004 and the Company paid Rs. 6.5 Mn. as debenture interest during the year (2003 - Rs. 6.5 Mn). The Bank has paid Rs. 64.2 Mn. to the Company as interest on repurchase agreements during the year (2003 - Rs. 52.8 Mn.)

HNB Assurance Ltd

The Company held deposits with the Bank amounting to Rs. 145.4 Mn. (2003 Rs. 38.4 Mn) as at 31.12.2004. The Bank has paid Rs. 6.5 Mn (2003-Rs.2.9 Mn) as interest to the Company for the deposits held by the Company. HNB has placed non life insurance business with the Company to the value of Rs. 30 Mn. during the year.

HNB Stockbrokers (Pvt) Ltd

The Company maintains current accounts with the Bank and the balance as at 31.12.2004 amounts to Rs.9.5 Mn. (2003 - Rs. 7.5 Mn). The balance in the savings account maintained by the Company in the Bank amounted to Rs. 6.9 Mn as at 31.12. 2004 (2003 - Rs. 6.3 Mn).

Smart Development (Pvt) Ltd.

A building rental of Rs. 6.0 Mn. (2003 - Rs. 24.2 Mn.) has been paid during the year by the Bank to the Company for occupying the office premises owned by the Company.

A ground rent of Rs. 1.3 mn. (2003 - R. 1.2 Mn.) and motor vehicle rent amounting to Rs. 1.5 Mn. (2003 - Rs. 1.5 Mn.) have been paid by the Bank to the Company during the year.

The assets and liabilities of Smart Development (Pvt) Ltd. had been acquired by Sithma Development (Pvt) Ltd. On 30 December 2004 for the consideration of 160,000 fully paid ordinary shares of Sithma Development (Pvt) Ltd. being issued to the shareholder of Smart Development (Pvt) Ltd., Hatton National Bank Ltd.

Mr R T Wijetilleke who is the Chairman of the Bank is also the Chairman of the above five companies. Mr J C R Cooray who was the Chairman of the Bank until 11 March 2004 was also the Chairman of HNB Assurance Ltd. until that date.

Mr R Theagarajah, a Director of the Bank with effect from 15 December 2004, is also a Director of the five companies mentioned above.

Notes to the Accounts

34. RELATED PARTY TRANSACTIONS (Contd.)

(f) The Bank carries out transactions in the ordinary course of its business on an arm's length basis with its shareholders and companies in which such persons have a significant influence by representation on the Board of Directors and not by substantial shareholdings. These companies, names of Directors, their relationship and the nature of transaction entered into are listed below:

Party/ies Accommodated	Name of Director Relationship	Aggregate Amount of Accommodation			Nature of Transaction	Security
		Limit (Rs.Mn.)	Outstanding as at 31.12.04			
			Direct	Indirect		
Stassen Exports Ltd	Dr V P Vittachi Chairman/Shareholder	313.50	699.85	-	Overdraft Standby Overdraft Temp.Overdraft	Cash Deposits Quoted Company Shares Inventories Company Indemnity
	Mr D H S Jayawardena Managing Director/ Shareholder	200.00				
	Mr R K Obeyesekere Director/Shareholder	300.00				
		50.00	-	24.27	Letters of Guarantee Letters of Credit	
		2.00	-	2.81		
		<u>865.50</u>	<u>699.85</u>	<u>27.08</u>		
Stassen International Ltd	Dr V P Vittachi Chairman	70.00	-	22.09	Letters of Credit	Cash Deposits Quoted Company Shares Inventories Company Indemnity
	Mr D H S Jayawardena Managing Director	20.00	13.46	-		
	Mr R K Obeyesekere Director	50.00	-	47.99	Letters of Guarantee	
		<u>140.00</u>	<u>13.46</u>	<u>70.08</u>		
Stassen Natural Food (Pvt) Ltd	Dr V P Vittachi Chairman	-	-	15.00	Temp. Letters of Guarantee Temp. Overdraft	Quoted Company Shares Company Indemnity
	Mr D H S Jayawardena Managing Director	-	0.74	-		
	Mr R K Obeyesekere Director	-	-	2.14	Temp. Letters of Credit	
		<u>-</u>	<u>0.74</u>	<u>17.14</u>		
Madulsima Plantations Ltd	Dr V P Vittachi Chairman	25.00	18.91	-	Overdraft	Cash Deposits Quoted Company Shares Company Indemnity
	Mr D H S Jayawardena Managing Director	1.00	-	0.74		
	Mr R K Obeyesekere Director					
		<u>26.00</u>	<u>18.91</u>	<u>0.74</u>		
Distilleries Co. of Sri Lanka Ltd	Dr V P Vittachi Chairman	-	-	94.28	Temp. Letters of Credit	Company Indemnity
	Mr D H S Jayawardena Managing Director	105.04	-	103.11		
	Mr R K Obeyesekere Director					
		<u>105.04</u>	<u>-</u>	<u>197.39</u>		

Notes to the Accounts

34. RELATED PARTY TRANSACTIONS (Contd.)

Party/ies Accommodated	Name of Director Relationship	Aggregate Amount of Accommodation			Nature of Transaction	Security
		Limit (Rs.Mn.)	Outstanding as at 31.12.04 (Rs.Mn.)			
			Direct	Indirect		
Lanka Dairies (Pvt) Ltd	Dr V P Vittachi Chairman	30.00	16.82	-	Overdraft	Immovable Property (Leasehold)/Plant & Machinery
	Mr D H S Jayawardena Managing Director	10.00	-	-	Letters of Credit	
	Mr R K Obeyesekere Director					
		<u>40.00</u>	<u>16.82</u>	<u>-</u>		
Lanka Milk Foods (CWE)Ltd	Dr V P Vittachi Chairman	270.00	-	130.39	Letters of Credit	Immovable Property (Leasehold)/ Plant & Machinery Quoted Company Shares
	Mr D H S Jayawardena Managing Director	14.08	-	0.51	Letters of Guarantee	
	Mr R K Obeyesekere Director	-	23.25	-	Temp. Overdraft	
		<u>284.08</u>	<u>23.25</u>	<u>130.90</u>		
Milford Exports (Cey.) Ltd	Dr V P Vittachi Chairman	-	-	0.41	Letters of Credit	Quoted Company Shares Inventories Company Indemnity
	Mr D H S Jayawardena Managing Director	0.50	0.17	-	Overdraft	
	Mr R K Obeyesekere Director	24.00	-	21.70	Letters of Guarantee	
		<u>24.50</u>	<u>0.17</u>	<u>22.11</u>		
Falcon Commodities (Pvt) Ltd.	Mr D H S Jayawardena Through the shareholding of Stassen Exports Ltd. in Falcon Commodities (Pvt) Ltd. (since disposed)	Cancelled	84.64	228.36	Letters of Credit Overdraft	Inventories Cash Deposits
		<u>Nil</u>	<u>84.64</u>	<u>228.36</u>		

Accommodation granted to Falcon Commodities (Pvt) Ltd. continues to be classified as non-performing. The outstanding of Rs. 313 Mn. as at 31.12.2004, is fully covered by the capital provisioning of Rs. 263 Mn. made during the previous years.

Danish Dairy Products Lanka (Pvt) Ltd.	Dr. V P Vittachi Chairman				Overdraft	Immovable Property (Leasehold)/Plant & Machinery
	Mr D H S Jayawardena Managing Director	10.00	-	-		
	Mr R K Obeyesekere Director	<u>10.00</u>	<u>-</u>	<u>-</u>		
Balangoda Plantations Ltd.	Dr V P Vittachi Chairman	-	-	0.08	Letters of Guarantee	Cash Deposits Company Indemnity
	Mr D H S Jayawardena Managing Director	-	0.15	-	Temp. Overdraft	
	Mr R K Obeyesekere Director	-	-	-		
		<u>-</u>	<u>0.15</u>	<u>0.08</u>		

Notes to the Accounts

34. RELATED PARTY TRANSACTIONS (Contd.)

Party/ies Accommodated	Name of Director Relationship	Aggregate Amount of Accommodation			Nature of Transaction	Security
		Limit (Rs.Mn.)	Outstanding as at 31.12.04 Direct Indirect			
Ambewela Livestock Co. Ltd	Dr. V P Vittachi Chairman	30.00	17.57	-	Overdraft	Immovable Property (Leasehold)/Plant & Machinery
	Mr D H S Jayawardena Managing Director	10.00	-	-	Letters of Credit	
	Mr R K Obeyesekere Director					
		<u>40.00</u>	<u>17.57</u>	<u>-</u>		
Pattipola Livestock Co. Ltd	Dr. V P Vittachi Chairman	30.00	2.77	-	Overdraft	Immovable Property (Leasehold)/Plant & Machinery
	Mr D H S Jayawardena Managing Director	10.00	-	1.84	Letters of Credit	
	Mr R K Obeyesekere Director					
		<u>40.00</u>	<u>2.77</u>	<u>1.84</u>		
Periceyl (Pvt) Ltd	Mr D H S Jayawardena Chairman	1.00	-	-	Letters of Guarantee	
	Mr R K Obeyesekere Director	-	-	0.31	Letters of Credit Temp. Overdraft	
		-	4.51	-		
		<u>1.00</u>	<u>4.51</u>	<u>0.31</u>		
Selimpex (Pvt) Ltd	Mr D H S Jayawardena Director	-	4.66	-	Temp. Overdraft	Quoted Company Shares
	Mr R K Obeyesekere Director	-	-	-		
		-	4.66	-		
		<u>-</u>	<u>4.66</u>	<u>-</u>		
Trade & Investment Lanka (Pvt) Limited	Mr D H S Jayawardena Director	-	-	5.00	Temp. Letters of Guarantee	Quoted Company Shares Company Indemnity
	Mr R K Obeyesekere Director	-	-	-		
		-	-	5.00		
		<u>-</u>	<u>-</u>	<u>5.00</u>		
CBD Exports Ltd.	Dr V P Vittachi Director	-	-	10.00	Temporary Letters of Guarantee	Quoted Company Shares Company Indemnity
	Mr R K Obeyesekere Director	-	-	-		
		-	-	10.00		
		<u>-</u>	<u>-</u>	<u>10.00</u>		
		Limit (US\$.Mn.)	Outstanding as at 31.12.04 Direct Indirect			
Texpro Industries Ltd.	Mr D H S Jayawardena Chairman	1.00	-	1.33	Letters of Credit	Immovable Property/ Machinery Cash Deposits Inventories
		0.60	-	-	Temp. Letters of Credit	
		(1.00)	0.27	-	Export Loans	
		0.87	0.91	-	Term Loan	
		0.98	0.98	-	Term Loan	
		0.04	0.04	-	Term Loan	
		0.05	0.04	-	Overdraft	
	<u>3.54</u>	<u>2.24</u>	<u>1.33</u>			

Notes to the Accounts

34. RELATED PARTY TRANSACTIONS (Contd.)

Party/ies Accommodated	Name of Director Relationship	Aggregate Amount of Accommodation			Nature of Transaction	Security
		Limit (Rs.Mn.)	Outstanding as at 31.12.04 (Rs.Mn.)			
			Direct	Indirect		
Kandalama Hotels Ltd.		0.36	-	0.36	Letter of Guarantee	Company Indemnity
		<u>0.36</u>	<u>-</u>	<u>0.36</u>		
Ace Distriparks (Pvt) Ltd.	Mr D H S Jayawrdena Director	11.00	-	11.00	Letter of Guarantee	Cash Margin
		<u>11.00</u>	<u>-</u>	<u>11.00</u>		
Elpitiya Plantations Ltd	Mr D H S Jayawardena Director	125.00	140.61	-	Overdraft/Commercial Paper/Money Mkt. Loan/Term Loan Leases	Inventories Immovable Property Absolute ownership of the equipment/vehicles leased.
		15.00	-	-		
		17.72	17.72	-		
		6.60	6.60	-		
		<u>164.32</u>	<u>164.93</u>	<u>-</u>		
Aitken Spence (Garments) Ltd	Mr D H S Jayawardena Director	1.00	-	0.18	Letters of Credit	Immovable Property
		(1.00)	0.59	-	Export Loan	
		(0.04)	0.04	-	Term Loan	Bank Guarantee
		0.25	-	-	Overdraft	Quoted Company Shares
	(Rs.Mn)	(25.00)	Rs.Mn 22.55-	Overdraft		
	(Rs.Mn)	3.01	-	(Rs. Mn.) 3.01	Letters of Guarantee	Company Indemnity
Aitken Spence Hotel Management (Pvt) Ltd.		0.10	-	0.10	Bid Bond	Immovable Property (Leasehold)
Cowrie Investments (Pvt) Ltd		3.19	3.19	-	Term Loan	
		1.00	0.89	-	Temp. Overdraft	
Ace Power Generation Horana (Pvt) Ltd		0.47	-	0.47	Standby Letter of Credit	
		0.81	0.81	-	Term Loan	
		2.18	2.18	-	Term Loan	
		0.30	-	-	Overdraft	
	(Rs.Mn)	80.00	-	(Rs.Mn.) 80.00	Standby Letters of Credit	
	(Rs.Mn.)	(30.00)	Rs.Mn 20.19	-	Overdraft	
Ace Power Generation Matara (Pvt) Ltd		0.62	0.62	-	Term Loan	
		2.12	2.12	-	Term Loan	
		0.49	-	0.49	Standby Letters of Credit	
		1.20	-	-	Overdraft	
	(Rs.Mn)	80.00	-	(Rs.Mn.) 80.00	Standby Letters of Credit	
	(Rs.Mn)	(120.00)	Rs. Mn 22.74	-	Overdraft	
Ace Power Generation Embilipitiya (Pvt) Ltd.		2.50	-	2.50	Performance Bond	
		0.44	0.44	-	Term Loan	
		1.86	1.52	-	Term Loan	
		0.62	0.003	-	Overdraft	
		2.63	-	-	Overdraft	
Elpitiya Lifestyle Solutions (Pvt) Ltd.		0.25	0.05	-	Term Loan	Cash Deposits
		-	0.08	-	Temporary Overdraft	
Ceyserv Lines (Pvt) Ltd.		3.50	3.44	-	Term Loan	Cash Deposits Vessel
	(US\$.Mn)	<u>25.53</u>	<u>15.97</u>	<u>3.74</u>		
	(Rs.Mn)	<u>163.01</u>	<u>65.48</u>	<u>163.01</u>		

Notes to the Accounts

34. RELATED PARTY TRANSACTIONS (Contd.)

Exposure to Browns Group

Party/ies Accommodated	Aggregate Amount of Accommodation			Nature of Transaction	Security	
	Limit (Rs.Mn.)	Outstanding as at 31.12.04 (Rs.Mn.)				
		Direct	Indirect			
Brown & Co. Ltd.	315.00	-	38.43	Letters of Credit Import Loan Letters of Guarantee Overdraft Term Loan Term Loan Lease	Immovable Property Absolute ownership of the leased assets.	
		54.25	-			
		-	28.67			
		185.01	-			
		452.42	452.42			-
		158.00	158.00			-
0.52	0.52	-				
	<u>925.94</u>	<u>850.20</u>	<u>67.10</u>			
Browns Group Industries Ltd.	5.00 (5.00) 0.77 - -	-	7.81	Letters of Credit Letters of Credit Lease Overdraft Letters of Guarantee	Absolute ownership of the leased assets. Cash margin.	
		-	15.53			
		0.77	-			
		10.03	-			
		-	1.66			
	<u>5.77</u>	<u>10.80</u>	<u>25.0</u>			
I.G. Browns Rubber Industries Ltd	0.56 0.40	0.56	-	SMILE Loan Overdraft	Immovable Property	
		-	-			
		<u>0.96</u>	<u>0.56</u>			<u>-</u>
Browns Dimo Industrial Products (Pvt) Ltd.	4.00 1.00	-	9.64	Letters of Credit Overdraft	Cash Deposits	
		-	-			
		<u>5.00</u>	<u>-</u>			<u>9.64</u>
Engineering Services Ltd.	2.00 20.00 (22.00) 3.00 0.63 5.00 1.19	-	-	Letters of Credit Once off Letter of Credit Import Loans Overdraft Term Loan Letters of Guarantee Lease	Quoted Co. Shares Indemnity Cash Margin Absolute ownership of the leased assets.	
		-	-			
		20.80	-			
		2.48	-			
		0.63	-			
		-	3.82			
		1.19	-			
	<u>31.82</u>	<u>25.10</u>	<u>3.82</u>			
Walker & Greig Ltd.	10.00 10.00 15.00 29.20 1.16	-	4.01	Letters of Credit Overdraft Overdraft Term Loan Lease	Inventories Absolute ownership of the leased assets.	
		9.02	-			
		16.63	-			
		29.20	-			
		1.16	-			
	<u>65.36</u>	<u>56.01</u>	<u>4.01</u>			
Browns Tours Ltd.	8.00 0.56	-	9.53	Letters of Guarantee Lease	Cash Deposits, Absolute ownership of the leased assets. Indemnity	
		0.56	-			
		<u>8.56</u>	<u>0.56</u>			<u>9.53</u>

Notes to the Accounts

34. RELATED PARTY TRANSACTIONS (Contd.)

Exposure to Browns Group (Contd.)

Party/ies Accommodated	Aggregate Amount of Accommodation			Nature of Transaction	Security
	Limit (Rs.Mn)	Outstanding as at 31.12.03 (Rs.Mn.)			
		Direct	Indirect		
Masons Mixture Ltd.	40.00	-	7.12	Letter of Credit	Inventories Immovable property/ machinery Indemnity Absolute ownership of the leased assets
	}	26.02	-	Import Loan/Trust Recept.	
	55.00	-	-	Pledge Loan	
	}	59.53	-	Overdraft	
	4.60	-	-	Temp. Overdraft	
	}	7.50	-	Term Loan	
	0.36	0.36	-	Term Loan	
	}	2.00	-	Term Loan	
	1.00	-	0.47	Letters of Guarantee	
	}	-	5.23	Cheque Purchase	
	0.26	0.26	-	Lease	
	<u>116.72</u>	<u>95.67</u>	<u>12.82</u>		
Snowcem Products Lanka (Pvt) Ltd.	0.80	-	0.59	Letter of Credit	Cash Deposits Corporate Guarantee of Brown & Co. Ltd.
	(0.80)	0.14	-	Trust Receipt	
	2.50	2.94	-	Overdraft	
	}			Temporary Overdraft	
	<u>3.75</u>	<u>3.08</u>	<u>0.59</u>		

The Bank carries out the above related party transactions in the ordinary course of business on an arm's length basis with companies in which there is a substantial interest by directors of the bank. 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. Details of these transactions are given from page 108 - 115.

Notes to the Accounts

35. MATURITY ANALYSIS - BANK

An analysis of the interest bearing assets & liabilities based on the remaining period at the balance sheet date to the respective contractual maturity dates.

	Upto 3 Months Rs.000	3-12 Months Rs.000	1-3 Years Rs.000	3-5 Years Rs.000	More Than 5 Years Rs.000	Total 2004 Rs.000
Money at call & short notice	9,004,928	-	-	-	-	9,004,928
Balances with Foreign Banks which are Interest Bearing	13,529,169	-	-	-	-	13,529,169
Government of Sri Lanka Treasury Bills	-	-	-	-	-	-
Commercial Paper/Treasury Bills under repurchase agreements	682,115	-	-	-	-	682,115
Investment Securities-Bonds & Debentures	22,600	136,200	7,873,134	5,866,536	755,239	14,653,709
Bills of Exchange	929,956	243,266	384,204	397,431	122,609	2,077,466
Loans & Advances	21,099,969	17,343,596	19,551,247	14,930,583	11,453,293	84,378,688
Lease Rentals Receivable	183,405	524,962	2,789,513	2,822,142	518,345	6,838,367
Total interest earning assets	45,452,142	18,248,024	30,598,098	24,016,692	12,849,486	131,164,442
Total non-interest earning assets	-	-	-	-	-	21,615,252
Total assets						152,779,694
Deposits	75,162,823	25,475,549	10,530,622	4,435,647	2,919,293	118,523,934
Borrowings - Money at call	1,104,650	-	-	-	-	1,104,650
Borrowings - Refinance	1,563,813	169,213	103,309	105,893	123,971	2,066,199
Borrowings - Repo Agreements	4,610,598	-	-	-	-	4,610,598
Borrowings - Foreign Banks	1,043,043	-	-	-	-	1,043,043
Subordinated Debentures	-	-	1,759,148	2,127,628	113,224	4,000,000
Total interest bearing liabilities	83,484,927	25,644,762	12,393,079	6,669,168	3,156,488	131,348,424
Total non-interest bearing liabilities	-	-	-	-	-	12,379,390
Shareholders' funds	-	-	-	-	-	9,051,880
Total liabilities and shareholders' funds						152,779,694

* "Upto 3 months" deposits include the Bank's Savings Deposit Base of Rs. 57.1 billion (2003 - Rs. 48.3 billion).

Notes to the Accounts

36. SEGMENT REPORTING

Business segments - Group

Revenue from external customers :

	Banking		Leasing		**Dealing		Property		Insurance		Eliminations/Unallocated		Consolidated	
	2004	2003	2004	2003	2004	2003	2004	2003	2004	2003	2004	2003	2004	2003
	Rs. 000	Rs. 000	Rs. 000	Rs. 000	Rs. 000	Rs. 000	Rs. 000	Rs. 000	Rs. 000	Rs. 000	Rs. 000	Rs. 000	Rs. 000	Rs. 000
Interest	10,372,081	10,672,880	-	-	400,219	389,223	238	-	33,358	5,828	773,660	862,112	11,579,556	11,930,043
Exchange/Premium	662,176	506,436	-	-	684	(42)	-	-	357,165	195,734	-	-	1,020,025	702,128
Lease/Brokerage	-	-	929,898	848,764	56,904	91,988	-	-	-	-	(929,898)	(848,764)	56,904	91,988
Commissions/Rent	1,517,378	1,235,089	-	-	-	-	18,886	1,105	-	-	-	-	1,536,264	1,236,194
Other	379,649	1,515,338	-	-	34,496	423,446	-	-	-	14,160	(100,933)	(40,038)	310,212	1,912,906
Total revenue from external customers	12,931,284	13,929,743	929,898	848,764	492,303	904,615	19,124	1,105	390,523	215,722	(257,171)	(26,690)	14,502,961	15,873,259
Inter-segment revenue	229,176	52,055	-	-	93,236	54,598	415,549	345,670	41,530	48,726	(778,491)	(527,889)	-	-
Total revenue	13,160,460	13,981,798	929,898	848,764	585,539	959,213	434,673	346,775	432,053	264,448	(1,035,662)	(527,889)	14,502,961	15,873,259
Segment result	814,794	983,047	573,919	566,945	14,069	460,481	(2,597)	(77,727)	101,833	89,640	(254,019)	129,694	1,247,999	2,152,080
Unallocated expenses													438,658	458,407
Profit from operations													809,341	1,693,673
Income from associates													22,969	37,743
Income tax expense													15,114	(171,505)
Minority interests													(91,818)	(59,974)
Net profit for the year													755,606	1,499,937
Segment assets	118,110,642	99,228,703	6,846,944	5,095,717	7,440,812	6,389,079	5,002,102	4,907,979	745,188	545,291	(1,949,750)	(2,967,959)	136,195,938	113,198,810
Investment in associates													168,588	190,309
Unallocated assets													25,396,120	27,505,081
Total Assets													161,760,646	140,894,200
Segment liabilities	113,353,741	97,190,721	6,846,944	5,095,717	6,940,425	5,746,196	3,193,161	4,017,958	433,490	165,750	(1,562,128)	(2,508,575)	129,205,633	109,551,528
Unallocated liabilities													23,527,130	24,051,209
Total liabilities													152,732,763	133,602,737
Cash flows from operating activities	819,785	4,137,412	650,386	1,093,008	(6,924)	510,227	335,751	44,357	74,355	83,357	(3,778,567)	(978,392)	(1,905,214)	5,075,601
Cash flows from investing activities	1,405,508	(6,590,042)	-	-	49,791	(399,098)	(86,993)	(575,442)	(60,901)	(74,247)	1,883,828	(1,210,373)	3,191,233	(8,849,202)
Cash flows from financing activities	702,141	2,879,698	-	-	81,518	(6,500)	(268,062)	(795)	-	-	1,724,490	2,520,288	2,240,087	5,392,691
Capital Expenditure	516,057	1,102,895	224	217	5,552	17,092	163	575,443	30	23,744	179,839	(40)	701,865	1,719,381
Depreciation	436,576	407,333	2,082	1,941	6,200	2,391	68,107	85,866	10,586	2,728	13,990	(5,703)	537,541	494,556
Amortisation	58,974	50,214	-	-	-	-	-	-	-	-	-	-	58,974	50,214

**Stock Broking & Securities Dealings

37. EVENTS OCCURRING AFTER THE BALANCE SHEET DATE

There are no events occurring after the Balance Sheet date, which requires adjustment to or disclosure in the financial statements.

Capital Adequacy

The principal objective of the Central Bank of Sri Lanka's Capital Adequacy requirements 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". Our risk based capital adequacy requirements are consistent with the international standards of Basle 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 comprised 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 un-consolidated 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 weighted in order to provide a broad indication of credit risk.

There are five risk weightings (0%, 10%, 20%, 50%, 100%) 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.

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 of upto one year or which can be unconditionally cancelled at any time
- * Other commitments with an original maturity of over one year
- * Foreign Exchange & Interest Rate Contracts

The total of the risk weighted assets plus the risk assessed off-balance sheet items is then related to the capital base and the 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 31st December,	2004	2003
Rupees Million		
TIER 1		
Voting ordinary shares	770	550
Non-Voting ordinary shares	231	165
Share premium	1,962	823
Statutory reserve fund	570	549
Published retained profits	791	678
General & other reserves	4,402	3,902
Total Tier 1 Capital	8,726	6,667
TIER 2		
Approved assets revaluation reserves (1)	163	163
General provisions	167	121
Debentures	2,837	3,334
Total Tier 2 Capital	3,167	3,618
Total Tier 1 & Tier 2 Capital	11,893	10,285
Less: Deductions;		
Holdings of other Banks/Financial Associates (2)	(1,893)	(798)
Capital Base	10,000	9,487
Risk Adjusted Capital Ratios		
Tier 1 (Statutory minimum ratio required is 5%)	9.83	8.06
Tier 2	1.43	3.41
Total (Statutory minimum ratio required is 10%)	11.26	11.47

ADJUSTED ASSETS AND OFF-BALANCE SHEET EXPOSURE

	Balance	Risk Adjusted	Risk	2004	2003
As At 31st December	2004	Balance	Weights	2004	2003
Rupees Million		2003	%		
ASSETS					
Cash, Treasury bills, statutory reserves with Central Bank	25,161	22,253	-	-	-
Loans secured by cash and guaranteed by Central Bank of Sri Lanka	22,212	17,027	-	-	-
Due from Foreign Currency Banking Unit (F.C.B.U.)	-	-	10	-	-
Due from Local/Foreign Banks/Financial Institutions	18,608	15,460	20	3,722	3,092
Loans secured by residential properties and guaranteed by external agencies	24,224	17,937	50	12,112	8,969
Loans and advances secured by other form of securities	50,854	45,390	100	50,854	45,390
Other assets	10,076	11,834	100	10,076	11,834
Total assets	151,136	129,901		76,764	69,285

Capital Adequacy

OFF-BALANCE SHEET EXPOSURE

Rupees Million As At 31st December	Amount of Off-Balance Sheet Items 2004	Credit Equivalent Amount 2004	Risk Weights %	Risk Weighted Balance 2004	2003
Financial guarantees, Bank acceptances and other guarantees	13,003	13,003	0-100	11,691	12,886
Performance related guarantees and warranties, stand by credit lines	3,507	1,754	0-100	340	512
Shipping guarantees, Documentary Letters of Credit	6,584	1,317	0-100	-	-
Undrawn term and overdraft facilities < 1 year	13,628	-	0-100	-	-
> 1 year	555	277			
Foreign Exchange Contracts	16,500	330	0-100	-	-
Total off-balance sheet exposures	53,778	16,681		12,031	13,398
Total risk adjusted assets				76,764	69,285
Total risk adjusted assets and off-balance sheet exposure				88,796	82,683

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	2004 Rs.Mn.	2003 Rs.Mn.
Sithma Additional Investment	900	-
Employee share option plan	147	-
Others	846	798

(3) The Capital Adequacy computation has been indicated for the bank only.

..... Glossary of Financial/Banking Terms

BIS Surplus

The total Capital Adequacy in excess of the minimum stipulated by Basle 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.

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/C's)

Written undertakings by a bank on behalf of its customer (typically an importer), authorising a third party (e.g. an exporter) to draw drafts 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 and for pawning advances 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 its financial obligations to third parties. Certain other guarantees represent non-financial undertakings such as bid and performance bonds.

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, 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.

..... Glossary of Financial/Banking Terms

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

A loan placed on a cash basis (i.e. interest income is only recognised when cash is received) because, in the opinion of management, there is reasonable doubt regarding the collectability of principal or interest. Loans are automatically placed on cash basis when a payment is 90 days past due. 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.

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.

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 Sixth (36th) Annual General Meeting of the Hatton National Bank Limited will be convened at the Auditorium on Level 22 of "HNB Towers" at No: 479, T.B. Jayah Mawatha, Colombo 10 on Wednesday the 30th day of March, 2005, at 10.00 in the forenoon when the following Ordinary/Special Business will be transacted.

ORDINARY BUSINESS

To receive and consider the Report of the Directors and the Statement of Accounts and Balance Sheet of the Company for the year ended 31st December 2004 with the Auditors' Report thereon.

To declare a final dividend of 15% as recommended by the Directors, to the shareholders.

To re-elect Mr.R.K. Obeyesekere 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 Mrs. P.C. Cooray in terms of Article 93 of the Articles of Association of the Company, as a Director of the Company.

To re-elect Mr. R. Sivaratnam in terms of Article 93 of the Articles of Association of the Company, as a Director of the Company.

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 2005 for charitable and other purposes set out in the Companies Donations Act (Cap. 147).

SPECIAL BUSINESS

To pass the following resolution as a **Special Resolution**:

"That the"Articles of Association of the Company be altered as follows :

(1) - By deleting Article 4 (v)

(2) - By - (i) inserting in the place of Article 37 (i) the following Article, viz:

"Notwithstanding any provision in these Articles suggesting the contrary, the Board may in its absolute discretion and without assigning any reason therefor decline to register any transfer of shares (not being fully paid shares) to a person of whom they shall not approve and they may also decline to register any transfer of shares (not being fully paid shares) on which the company has a lien."

(ii) deleting Article 37 (ii)

(iii) re-numbering Article 37 (iii) as Article 37 (ii)

(iv) adding after Article 37 (ii) the following proviso, viz :

"Notwithstanding anything to the contrary in these Articles, as long as the shares of the Company are quoted in the Colombo Stock Exchange, the Board may register without assuming any liability therefore any transfer of shares which is in accordance with the rules and regulations in force for the time being and from time to time as laid down by the Colombo Stock Exchange and/or by the Central Depository Systems of the Colombo Stock Exchange."

(3) - By omitting in Article 152 the following words "once in any leading Colombo daily newspaper" and substituting therefor the following words, viz: "in Sinhala, Tamil & English national daily newspapers."

(4) - By substituting Article 74 with the following new Article, viz:

The Directors of the Company shall not be less than 5 nor more than 10 in number and for this purpose no alternate Director and no alternate for a nominee director (as referred to in Article 106) shall be counted.

(The amendments (1) - (3) to the Articles are to conform to the Rules of the Colombo Stock Exchange.)

By Order Of The Board



INDRANI GOONESEKERA
DGM-LEGAL/BOARD SECRETARY
Colombo. Sri Lanka.

Friday, February 18th, 2005.
Colombo, SRI LANKA

Notes :

1. A member entitled to attend and vote at the meeting is entitled to appoint a proxy to attend and vote 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 28th March, 2005.

..... Notes
