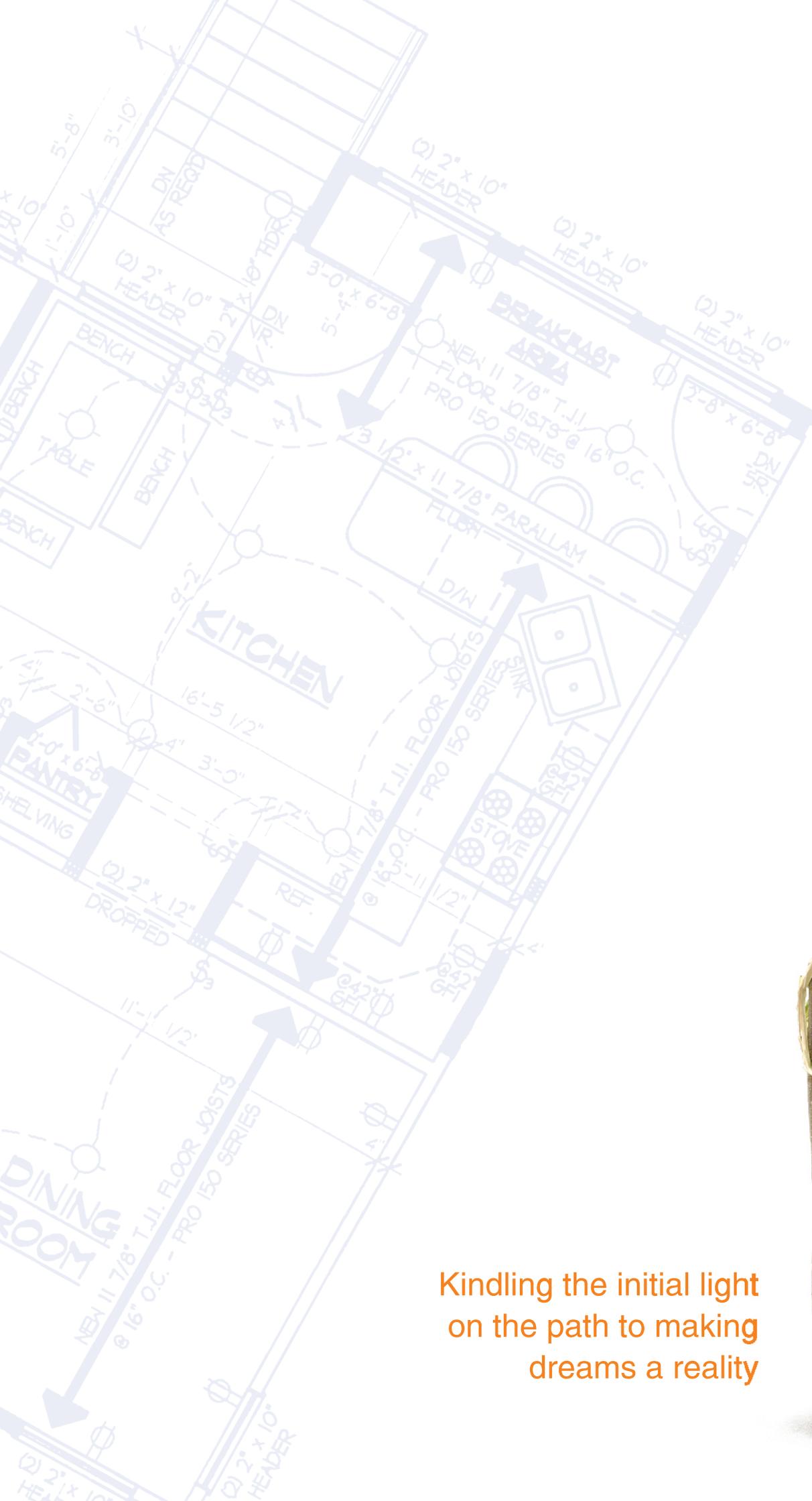




Annual Report 2006



Kindling the initial light
on the path to making
dreams a reality



Our Vision

To be the premier financial services institution for purposes of enhancement of lifestyles of Sri Lankans.

Our Mission

To be a dominant player in the financial services sector by delivering innovative solutions to meet the needs of housing and construction sector, with best-in industry service excellence, creating superior long-term shareholder value and contributing to economic development in Sri Lanka through an inspired team.

Our Objectives

Customers

To provide a caring customer service, anticipating solutions required by our customers and innovatively satisfying them beyond expectations.

Shareholders

To optimise return on shareholders' funds.

Organisation

To commit ourselves to the highest standards in corporate and business ethics whilst maintaining financial stability and growth.

Employees

To motivate, develop, recognise and reward our employees.

Community

To be strongly committed to contribute to the national goal of providing shelter for all.

Industry

Setting industry benchmarks of international standard in delivering customer value through our comprehensive product range, customer service and all our activities.

Ethics

Maintaining the highest ethical standards worthy of a leading corporate citizen.

Contents

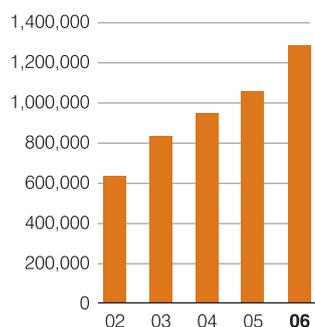
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Financial Highlights

Results for the year	2006 Rs. '000	Bank 2005 Rs. '000	Change %
Income	1,285,643	1,056,033	21.74
Profit before tax	308,640	217,391	41.97
Provision for tax	136,166	100,619	35.33
Profit after tax	172,474	116,772	47.70
Gross dividends	64,710	30,613	111.38
At the year end			
Shareholders' funds	1,800,480	1,642,877	9.59
Gross loans & advances to customers	10,181,757	8,143,271	25.03
Total assets	10,704,857	8,833,267	21.19
For the year ended			
Gross loans & advances to customers	3,476,465	1,923,903	80.70
Number of loans	13,689	7,276	88.14
Information per Ordinary Share			
Earnings - basic (Rs.) **	27.39	26.71	2.57
Dividends (Rs.)	10.00	5.00	100.00
Net assets per share (Rs.)	278.16	268.33	3.63
Market value at the year end	174.75	191.00	(8.51)
Ratio			
Return on average shareholder's fund	10.02	8.79	13.92
Return on average assets %	1.77	1.44	22.25
Price earnings (times)	6.38	7.15	(10.80)
Dividend yield %	5.72	2.62	118.6
Dividend cover (times)	2.74	3.81	(30.13)
Statutory Ratio			
Liquid assets %	12.94	16.29	(20.56)
Capital Adequacy Ratios			
Tier - 1	37.63	42.15	(10.72)
Tier - 11	37.80	42.41	(10.87)
EARNINGS PER SHARE			
Earnings per share has been calculated by dividing the profit after taxation by the weighted average number of ordinary shares.			
Weighted average number of shares	6,296,761	4,372,500	
Profit after taxation	172,474	116,772	
Basic earnings per share	27.39	26.71	

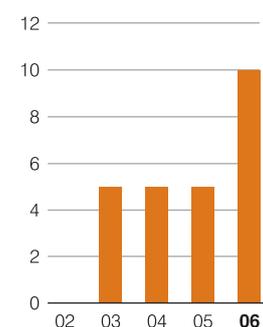
Income

(Rs. '000)



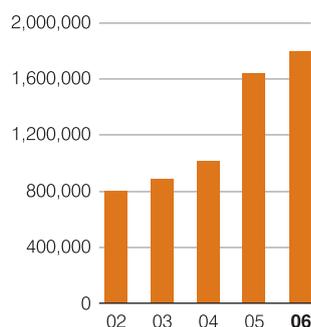
Dividends

(Rs.)



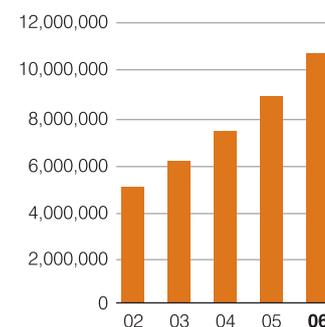
Shareholders' Funds

(Rs. '000)



Total Assets

(Rs. '000)



Chairman's Review



“HDFC is a bank that is consistent in its values and principles while also holding the capacity to dispense a convenient and speedy service.”

On behalf of the Board of Directors of HDFC Bank, I am pleased to present the Annual Report and Accounts of the Bank for the period ended 31st December 2006.

ECONOMIC PERFORMANCE

The Sri Lankan economy enjoyed another year of high growth in 2006. The 7.4% real GDP expansion, the highest since 1978 and an unemployment rate of 6.5% the lowest ever, clearly displayed the country's favourable economic position.

The on going internal momentum, especially led by the private sector highlighted the improved structure of the domestic economy and its strong resilience to weather external volatilities. The enlarged private investment, in particular, reflects firmer investor confidence in the country's economic environment and prospects. In this context, the strong support of the banking system has continued to add dynamism to the economy.

In the public sector front, the budgetary measures ensure adequate infrastructure facilities to support the development of the construction sector as well as related industries.

The challenges in maintaining the fine performance of the economy over the long term will fall squarely on both the private and public sectors. The current national plan, in this regard has provided clear policy directions and strategies in terms of meeting future socio-economic targets. In the meantime, the immediate management objective is to ensure that issues relating to inflation, interest rates, the balance of payments, national resource imbalances and increasing strain in factor markets including infrastructure, are effectively addressed.

CORPORATE DEVELOPMENT

The Sri Lankan banking industry has changed rapidly in the present era of globalisation. Housing banks meet the challenges presented in this constantly evolving scenario by offering customers a variety of modified products. Banks are competing among themselves to satisfy customer needs and to prove their efficiency. Trends at HDFC Bank show that the Bank is competent enough to meet the global challenges in banking namely:

- Enhancement of customer service
- Innovations in technology
- Improvement of risk management systems
- Diversifying products, etc.

FINANCIAL PERFORMANCE

The continuing growth in the Sri Lankan economy and its effect on inflationary pressures and interest rates were the influencing external factors on the Bank's financial performance. Despite a rise in interest rates, the Bank increased its pre-tax profits by 38% from Rs. 217 million in 2005 to Rs. 308 million. The profit after tax, too, increased during the year under review to Rs. 172 million from Rs. 116 million in 2005. The increase in profits was due to the Bank taking advantage of the continuous demand for housing loans, strategic asset and liability management and a continuing effort to reduce the level of non-performing assets which have indicated a decline over the years.

Asset growth of the Bank increased to 21% compared to a growth of 19% the previous year from Rs. 8,833 million in 2005 to Rs. 10,705 million in 2006. The substantial growth was mainly in loans with an increase of Rs. 2,025 million and the total loan portfolio amounts to 94.66% of total assets. Total deposits and borrowings grew by 18.55% from Rs. 6,501 million to Rs. 7,707 million. Total shareholders' funds also rose by Rs. 158 million. or

Chairman's Review

9.62% to Rs. 1,800 million, from Rs. 1,642 million as a result of higher retained earnings.

BUSINESS OPERATIONS

The individual lending operations of the Bank experienced an eventful year compared to the previous year and geared up for its project lending scheme during the year under review. During the last quarter of the year, the lending operations however, experienced a consolidation phase as rising cost of funds was a major concern. The Bank is in the process of diversifying into related business activities and services, which are fee based, to improve its earnings base.

PROSPECTS

The Bank's restructuring exercise which is expected to be introduced in its corporate plan commencing in 2007, will further strengthen the Bank's financial position and open up opportunities for more growth and expansion including the possibility of becoming a complete housing financial supermarket. We also believe that the collective agreement the management entered into with the Bank Employees' Union, would further enhance industrial harmony and employee productivity of the Bank in the years ahead.

PRODUCT AND BRAND INNOVATION AND IMAGE

The impact of our brand was evidenced when LMD together with Brand Finance Lanka Ltd., ranked HDFC among the top 50 brands of all the listed companies in Colombo Stock Exchange, in both brand value and brand power. The HDFC Bank brand has been valued at Rs. 127 million while the brand power

has been ranked as B+. This is a notable accolade in view of the fact that the bank competed against hundreds of brands from companies listed in the Stock Exchange. We believe that we have differentiated ourselves from other banks, by adapting ourselves to fulfil the needs of our customers by conceptualising products and services to meet their aspirations and expectations.

We are now an easily recognisable brand and our customers believe that HDFC is a bank that is consistent in its values and principles while also holding the capacity to dispense a convenient and speedy service.

CORPORATE SOCIAL RESPONSIBILITY

Our Corporate Social Responsibility (CSR) initiatives, since recent years, have been more cohesive, long-term, and empowering. The focus has been primarily on children, youth, education, culture and nature. I would say that it would be fair to consider our whole business as a part of CSR as housing plays such a vital role in moulding the life-style of the community, particularly through the provision of housing finance for the low income category who have less access to financial institutions.

Our target and most ambitious project was conceived, designed and implemented with the clear objective of focussing on the development of children by providing them with free special education for the year five scholarship examination and also awarding gifts for outstanding performers bringing them recognition, encouragement and motivation to better themselves.

Another noteworthy project initiated by HDFC is to provide solar power for the island's only training institution, propagating the value of natural resources, in an environmentally sustainable project located amidst the woods and cascades of the country's wet zone.

APPRECIATION

The continued growth and expansion of the Bank and its favourable performance have been due to the commitment of the CEO, management and staff as well as the support of the Bank's clients, customers and business associates. I am indeed grateful to these parties for their contributions which have resulted in the Bank being able to record another year of success.

I would also like to record my appreciation to Mr. Sunil Kannangara who left the Board of the Bank during the year, for his invaluable contribution and support to the Bank throughout his tenure in office. I also take this opportunity to thank the Hon. Minister of Housing and Common Amenities, officials at the Ministry and the Governor of the Central Bank of Sri Lanka, Mr. Ajith Nivard Cabraal and his officials for their guidance and support during the year. In conclusion, my gratitude goes to shareholders for the confidence reposed in our Bank and pledge our commitment to an onward journey, which includes strategies to increase shareholder value.



S.M.M. Yaseen
Chairman

28th February 2007

Board of Directors



Mr. S.M.M. Yaseen



Mr. Sunil Kannangara



Mr. K.D. Ranasinghe



Mr. L.P. Andrahennadi



Mr. W.J.L.U. Wijeyaweera

SEYAD MOHAMED MOHAMED YASEEN*Chairman*

Mr. S.M.M. Yaseen was appointed to the Board in June 2004. He is an Attorney-at-Law and he holds a Bachelor of Laws Degree from the University of Colombo. After enrolling as an Attorney-at-Law, he joined the chambers of Mr. M.M. Zuhair, President's Counsel, and started active practise in Civil and Criminal Courts. While continuing his practise as a lawyer in 1994 he became the Co-ordinating Secretary to Hon. M.H.M. Ashroff who was then the Minister of Ports, Shipping, Rehabilitation and Construction. In year 2000, he was appointed as the Private Secretary to the Hon. Ferial Ashroff, Minister of Eastern Development and Rural Housing. He participated in the following courses also,

- Executive programme in Housing conducted by Department of Real Estate National University of Singapore
- Fundamentals of Islamic Banking & Finance conducted by International Islamic University of Malaysia
- US Housing Finance system conducted by Fanni Mae in United State of America.

Currently, he is a Member of the Director Board of the Ocean Development Company which is a joint venture company of Urban Development Authority and National Housing Development Authority.

LALITHA PADMAN ANDRAHENNADI*Director*

Mr. L.P. Andrahennadi joined the Board in June 2004. He is an Attorney-at-Law by profession, who is in active practise from 1981, in both civil & criminal courts. He also holds a Bachelor of Science Degree from the University of Kelaniya. He was appointed as a judicial officer in 1988 and served as a Magistrate and Additional District Judge for a period of six years. He is currently the Chairman/Managing Director of the Building Materials Corporation Ltd. He has served as the Chairman of Ceylon Fisheries Corporation also.

WALLABA JAYATISSA LIYANAGE UPALI WIJEYAWEERA*Director*

Mr. W.J.L.U. Wijeyaweera joined the Board in February 2004. He holds a Bachelor of Commerce (Special) Degree from the University of Kelaniya and also a Postgraduate Diploma in Public Administration from SLIDA (Sri Lanka). He has more than 20 years

experience in public service, having joined the Sri Lanka Administrative Service in 1984. He has joined the Department of Labour in 1985 and during his tenure he held several posts, as Assistant Commissioner of Labour, Senior Assistant Commissioner of Labour and Deputy Commissioner of Labour. In 1997, he was posted as the counsellor in the Sri Lankan Embassy in the State of Kuwait. In 1999, he was posted as the Counsellor in the Sri Lankan Embassy in the Kingdom of Saudi Arabia. In year 2000, he was appointed as the Commissioner of Labour Standards. Currently, he is functioning as the Commissioner of Employees, Provident Fund in the Department of Labour.

MOHAMED IBRAHIM MOHAMED RAFEEK*Director*

Mr. M.I.M. Rafeek joined the Board in June 2006. He was the Private Secretary to Hon. M.H.M. Ashroff from the year 1989 to 1994, and Private Secretary to the Hon. Ferial Ashroff, Minister of Development, Rehabilitation, Reconstruction of the East and Rural Housing Development and Construction from the year 2002 to 2004. He has held the post of the Vice Chairman of Sri Lanka Ports Authority (from 1994-2000) and the Chairman of Rehabilitation Authority (from 2001-

2002). Currently, he is the Chairman of the National Housing Development Authority, Consultant to the Port Operations and Member of the Board of Directors of Urban Development Authority (UDA), Palmyrah Development Board, Real Estate Exchange (Pvt.) Ltd. (REEL) and Ocean View Development Company Ltd. (OVDC).

KOSGALLANA DURAGE RANASINGHE*Director*

Mr. K.D. Ranasinghe holds a Bachelor of Arts (Economics) Degree from the University of Colombo and obtained a Masters' Degree in Economics from the Michigan State University, Michigan, United States of America. He began his career in 1984 as an Assistant Lecturer in Economics at the Institute of Workers' Education (IWE), University of Colombo. Thereafter, he joined the Central Bank in 1986. During his banking career of 21 years he held numerous posts within the Central Bank in the Banking Department, Economic Research Department, in the Rural Credit Department. Currently he is a Deputy Director of the Economic Research Department at the Central Bank of Sri Lanka. He joined to the Board of the HDFC Bank in June 2004.

Board of Directors



Mr. M.M. Abdul Kalam



Mr. P. Sumanapala



Mr. W.A.T. Fernando



Mr. M.I.M. Rafeek



Mrs. Dharshini De Silva (Company Secretary)

MOHAMED MUSTHAFA ABUL KALAM

Director.

Mr. M.M. Abul Kalam is an Attorney-at-Law and he holds a Bachelor of Laws Degree from the University of Colombo. He has obtained his Post graduate Degree from the World Maritime University, Sweden. After enrolment as an Attorney-at-Law he joined the chambers of M.M. Zuhair, PC and M.H.M. Ashroff, PC and practised both in Criminal and Civil Courts. Currently he is the Chairman of Condominium Management Authority (CMA). He is Involved in State Aided Post-Tsunami Relief, Rehabilitation & Reconstruction (RRR) works as an Institutional Head (CMA) under the Ministry of Housing. Mr. Kalam is an Advisory Board Member and Ex-Member of the Board of Directors of the Sri Lanka Broadcasting Corporation (SLBC). He was the Executive Director of the Ceylon Shipping Corporation from 1994 to 2001. He is also a Governing Council Member of the Eastern University of Sri Lanka (EUSL) since 2005 up to date. He joined to the Board of the HDFC Bank in June 2006.

PATHIRANNEHELAYA SUMANAPALA

Director

Mr. P. Sumanapala holds a Bachelor of Arts (Economics) Hons. Degree from the University of Peradeniya. He has obtained Master of Arts Degree (Regional Development and Planning) from the Institute of Social Studies, the Netherlands. He began his career in 1979, as an Assistant Lecturer at the University of Peradeniya. In 1982, he joined the Department of National Planning as a Planning Officer and he has held numerous posts, as an Assistant Director, Deputy Director and Additional Director. Currently, he is one of the Directors of the Department of National Planning in the Ministry of Finance and Planning. He joined to the Board of the HDFC Bank in January 2006.

AJITH FERNANDO

Director

Mr. W.A.T. Fernando is a Fellow of the Chartered Institute of Management Accountants, United Kingdom and has a M.A. in Financial Economics from the University of Colombo. He started his career at George Steuarts Ltd. as a money broker and later worked at MB Financial Services Ltd. (now First Capital Treasuries Ltd.) and Vanik

Incorporation Ltd. He co-founded Capital Alliance Ltd. in 2000. Currently, he is in the Director Boards of Capital Alliance Ltd., Ashtthi Holdings (Pvt.) Ltd., Capital Alliance Money Brokers (Pvt.) Ltd., Capital Alliance Fund Management Ltd., Ceylon Tea Brokers Ltd., Lanka Call (Pvt.) Ltd., ADZ Insurance Brokers (Pvt.) Ltd., Lanka Financial Services Bureau Ltd., Paradise Tea Co. (Pvt.) Ltd., Capital Alliance Holdings Ltd., Capital Alliance Securities (Pvt.) Ltd., The Financial Ombudsman Sri Lanka (Guarantee) Ltd. He joined to the Board of the HDFC Bank in June 2004.

SUNIL KANNANGARA

Director

Mr. S. Kannangara was appointed to the Board in 5th January 2006. He holds a Bachelor of Arts (Special) Degree from the University of Sri Jayewardenapura and obtained two Postgraduate Diplomas in Public Administration & General Management. He began his career in 1985, having joined the public service. During his career of 21 years, he held posts, such as, Assistant Director (Department of Social Services, Colombo) Assistant Government Agent, Divisional Secretary (Divisional Secretariat, Mahaoya), Divisional Secretary (Divisional Secretariat,

Ampara), Deputy Director Establishment (Ministry of Public Administration), Director Administration (Vocational Training Authority), Director Development (Ministry of Eastern Development Rehabilitation, Reconstruction and Rural Housing Development), Director Development (Ministry of Eastern Development and Muslim Religious Affairs), Director Eastern Education and Irrigation Development (Ministry of Housing Construction Industries, Eastern Province Education and Irrigation Development), Director (Housing and Acting Commissioner of National Housing Ministry of Housing and Construction)

Further, he was a Member of the Board of Directors of the Regional Rural Development Bank, Ampara, Acting Assistant Director, Small Industries, Ampara District, Acting Assistant Director, Textile Industries, Ampara, District, Acting Assistant Commissioner, Motor Traffic of the Ampara District, Acting Assistant Commissioner, Corporative Development of Ampara Region and Chairman, Deegawapi Development Task Force.

Currently he is the Government Agent & District Secretary of Ampara Administrative District.

Chief Executive Officer/General Manager's Report



“2006 was a successful year for the Bank in terms of its ability to proactively adapt to a changing environment, which was necessary to achieve the Bank's goals, in the face of a highly volatile and competitive market.”

Trends over the recent past indicate that the field of housing finance has recorded substantial growth in the face of stiff competition, both globally and in Sri Lanka. In fact, it has been identified as the key driver of economic growth, within the retail lending sector.

These facts have been taken into account in the formulation of our strategy in evolving our new Corporate Plan for the period 2007 to 2011.

THE HOUSING FINANCE SECTOR

In contrast to other countries in the region, and in spite of considerable study and research enacted by various organisations over the years, the Government of Sri Lanka and the regulators have been unable to formulate a clear, medium term vision for the housing finance sector.

The necessity to develop such a vision and a road map for the housing financial services sector, as opposed to merely

focussing on institutional, regulatory and operational issues, has been brought up by HDFC at forums such as National Housing Steering Committee meetings as well as meetings with other state agencies.

In my opinion, if a comprehensive strategy for the development of the housing finance sector is not finalised and implemented quickly, the ability of the sector to support the ambitious housing development plans of the country, will be seriously impaired.

Towards this end, the important and high priority areas that have to be addressed urgently are - the facilitation of the development of long-term money markets via appropriate application of fiscal incentives, the enactment of mandatory provisions that direct long-term sources of funding for investment in the housing finance sector thus ensuring a maturity matching process and the integration of various agencies related to the housing and construction industry.

STRATEGY AND NEEDS FOR 2006

2006 was a successful year for the Bank in terms of its ability to proactively adapt to a changing environment, which was necessary to achieve the Bank's goals, in the face of a highly volatile and competitive market.

Our business strategy is one of evolution and adaptation to facilitate a seamless delivery of a broad range of services, including those complementary to financial services, through appropriate organisational structures and processes that encompass subsidiaries and strategic alliances. The process continues to evolve, whilst creating shareholder value and sustainable growth through meeting the aspirations of all our stakeholders.

Chief Executive Officer/General Manager's Report

Aspiration must be supported by a strategic framework and a commitment not merely to change, but to transform as well. It will take time, resources and dedicated hard work to convert vision into reality. There will be difficult trade offs to be made between short-term costs and long-term gains.

We can now build on our strengths, which include strong capitalisation, an asset portfolio of high quality, a state-of-the-art IT system and an inspired workforce. This is indeed a formidable foundation for growth.

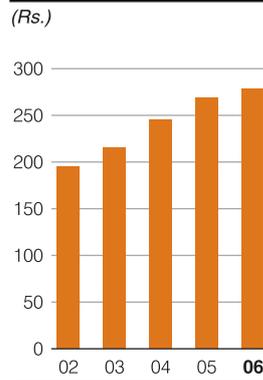
We will supplement our individual loan products with project financing products targeted at a wider customer segment including the corporate sector.

We will also recognise the special needs of low and middle income earners, who form the largest segment in the housing market. The HDFC Bank enjoys unique positioning in this category, with a solid track record of financing this segment.

The Bank is also focusing on the nature of the growing demand in the housing market. Deposit and savings mobilisation from minors, will form a core element of our strategy as it provides matching long-term funds at low cost for financing the loan portfolio.

All these efforts are aimed at higher internal accruals so as to achieve a robust balance sheet and a strong bottom line.

Net Assets per Share

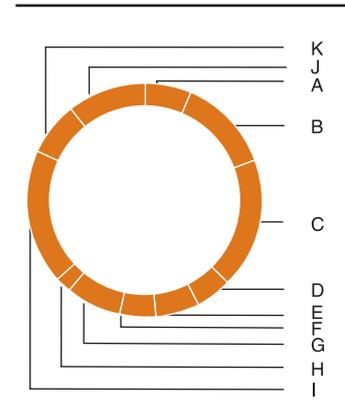


In order to achieve these objectives, we need to build a far reaching branch network together with a customer service culture. We also need to construct an enterprise-wide risk management process which will encompass new business risks and integrate with our existing processes.

Our IT systems must enable and support the achievement of our evolving business goals. Management information systems must be geared to provide the pertinent data needed to manage business units and people. We need to invest in the people on whom we will depend, to achieve our goals.

Our direction is clear, and we are confident of achieving success over our planned time horizon. We will then be uniquely positioned to play the lead role in changing the lifestyle of Sri Lankans in accordance with the current trends of a modern, contemporary world, through the provision of finance to the housing finance and allied sectors in the country, for the ultimate benefit of all stakeholders.

Functional Classification of Human Resources - 2006



A	Chairman's & CEO/ GM's Office	6%
B	Credit	13%
C	Recovery	18%
D	Legal	5%
E	Technical & Valuation	6%
F	IT	5%
G	HR & Admin and Marketing	8%
H	Project Finance	2%
I	Finance & Treasury	19%
J	Transport	7%
K	Branches	11%

HUMAN RESOURCES

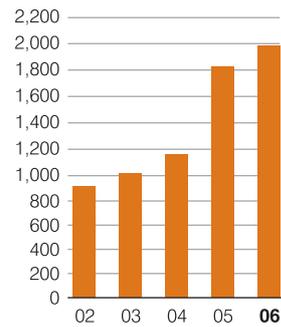
Currently, an exhaustive study is being carried out by external consultants to determine available levels of proficiency and to identify gaps in skills of employees from different levels of management of the Bank.

Process re-engineering continued during the year under review, towards achieving compliance with ISO 9000. The exercise is nearing completion and has contributed immensely towards the enhancement of employee competencies. Any gaps identified will be addressed through future training and development programmes. This exercise will also be used to improve succession planning.

Chief Executive Officer/General Manager's Report

Shareholders' Funds

(Rs. million)



The Bank is fully committed to investing in people, as it is they who provide its competitive advantage within the knowledge economy in which we operate today.

The Bank has also entered into a collective agreement with the HDFC Branch of the Ceylon Bank Employees' Union, which I believe will strengthen the morale of the employees, as it has addressed vital areas of our HR management such as our policies on transfers, promotion & training and development. This has fostered confidence within the employees as regards their future prospects and career progression with the Bank.

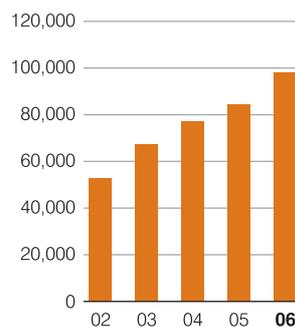
OPERATIONAL AND FINANCIAL PERFORMANCE

Whilst our operational and financial performance is reviewed in detail elsewhere in this report, it is pertinent to comment on some highlights of the year under review.

A comprehensive, strategic study is underway in the corporate Project Finance sector, which is regarded as a key growth area for the Bank.

Growth of Loan Portfolio by Volume

(No.)



Organisational and leadership changes have occurred. Risk management, back office activities and IT processes and strategies are being reviewed in order to raise them to new generation banking standards.

Quality objectives have been separately established for all banking operations, to comply with ISO 9000 standards.

Despite this period of significant change and heightened management activity that we envisage will continue through 2007, the financial performance of HDFC Bank improved significantly.

Profit attributable to shareholders increased by 47%, to Rs.172 million, in comparison with 2005. It should be noted however, that the Bank will need to make substantial investment in business expansion if it is to achieve its long-term, strategic vision. Such investment will need to continue over the next few years with substantial gains resulting only thereafter.

Our financial results reflect the strengths gained from adapting to a changing environment. Thus, growth in revenues from fee based activities in 2006, grew by 250% when compared to results of

2005. Key influencing factors were the reducing interest margins from the lending portfolio due to intense competition and increasing market rates of interest for deposits.

MY THANKS

None of this would have been possible without the commitment, hard work and understanding of our employees, as we strove to manage transformational change and operational growth simultaneously. I thank them all, for the excellent co-operation they have extended to me, and sincerely appreciate their dedicated effort over the year gone by.

I am very confident that their dedicated support which underpins all our plans, will be as readily forthcoming as we face the challenges of the future.

I take this opportunity to convey gratitude and sincere thanks to the Chairman and the Board of Directors, for their continued direction, support and guidance.

I also thank the various agencies of the Government, our numerous customers and lending agencies for their continued patronage, support and confidence placed in HDFC Bank.

I wish to assure them all that HDFC Bank will continue to work with dedication to safeguard their valuable trust whilst building a successful enterprise in the coming years.

C.A. Sarathchandra
CEO/General Manager

28th February 2007

Corporate Management Team



Left to right: Mr. A.D.P. Baddevithana, Mr. D.V. Pathirana, Mr. C.A. Sarathchandra, Mr. P.D. Goonesekera, Mr. S. Dissanayake

MR. C.A. SARATHCHANDRA

(Chief Executive Officer/General Manager)

Fellow Member of the Chartered institute of Management Accountants (CIMA) - UK. Member of the International Export Association (IEA) - UK. Postgraduate Diploma in Bank Management (Institute of Bankers, Sri Lanka). Member of the Economics Association (Sri Lanka). Member of the Association of Professional Bankers. Member of the Chartered Institute of Management (MCIM) - UK. Ms.c. Management - Sri Jayawardenepura, MBA (USA) Postgraduate Diploma in Development Economics (University of Colombo) Fellow Member of Society of Certified and Management Accountants (SL).

Mr. C.A.Sarathchandra counts over 30 year experience in the field of Finance and Banking in Sri Lanka and UK. His career began as an executive at People's Bank in 1973. He worked in the United Kingdom from 1982 to 1984. He joined the Merchant Bank of Sri Lanka Ltd. as a Finance officer to the Trade Paper Department in 1986, later becoming the Manager, Trade Finance from where he rose to the position of Consultant - Trade Finance and thereafter to the position of Assistant Director - Trade Finance. After leaving Merchant Bank of Sri Lanka Ltd. in 1994, he joined the People's Bank as Director - Finance and Management Services and served at People's Bank until he joined the Seylan Merchant Bank in 1996 as the Chief Executive

Officer/Executive Finance Director. In 1997 Mr. Sarathchandra joined the HDFC Bank as Deputy General Manager (Finance). In 2004, Mr. Sarathchandra was appointed by the World Bank as a short term consultant for the South Asia Sector Unit as a Housing Finance Specialist. In this capacity he was instrumental in setting up the HDFC Bank in the Maldives.

MR. P.D. GOONESEKERA***(Compliance Officer)***

Mr. Goonesekera passed out as an Attorney-At-Law in 1970 and had been in practice at the Colombo Bar for a period of three years before joining the People's Bank as an Assistant Law Officer in January 1974. After serving many regions in the island, particularly Kandy, Bandarawela, Badulla, Batticaloa, Anuradhapura, Kurunegala and Colombo, he was appointed as the Chief Legal Officer of the People's Bank in 1990. He was appointed as the Chief Compliance Officer of the Bank in the year 2000 and was instrumental in introducing an Anti-Money Laundering Policy, Know Your Customer Policy, an Anti-Money Laundering Hand Book and a Hand Book on Compliance. He has been a Faculty Member of the Bankers Training Institute and the Centre for Banking Studies of the Central Bank of Sri Lanka. He retired from the service of the People's Bank in September 2005, after serving for a period of 31 years.

He was also the Legal Consultant to the Asian Development Bank on Rural Finance and is a certificate holder in Human Resources Management and Development. Mr. Goonesekera joined Housing Development Finance Corporation Bank of Sri Lanka in July 2006 as Compliance Officer and acts as Consultant on all legal issues of the Bank. He had formulated the Know Your Customer Policy and Anti-Money Laundering Policy for the Housing Development Finance Corporation Bank.

MR. S. DISSANAYAKE***Deputy General Manager (Finance)***

Mr. Dissanayake is an Associate Member of the Institute of Chartered Accountants of Sri Lanka (ICASL). He also holds a B.Sc. (Business Admin.) Degree (Special) from the University of Sri Jayewardenepura. He joined the HDFC Bank in December 1995 as Assistant General Manager (Finance).

MR. A.D.P. BADDEVITHANA***Deputy General Manager (Credit)***

Mr. Baddevithana is a life member of PIM Professional Association Holding an MBA from the Postgraduate Institute of Management of University of Sri Jayewardenepura. He is a Certified Professional Marketer (Asia Pacific marketing Federation) and a Fellow member of the ACPM. He is also a member of SLIM. He possesses a BA General (BPU) Degree, as well as a MA (Kelaniya) Degree. He counts over 25 years of experience during which he held several senior positions in the field of Housing Finance, Administration, Advertising and Marketing in the UK and Sri Lanka before joining the Bank in 2002.

MR. D.V. PATHIRANA***Assistant General Manager (Project Finance & Administration)***

Mr. Pathirana is an Associate Member of the Institute of Chartered Accountants of Sri Lanka (ICASL), (ACA) and a Fellow Member of the Society of Certified Management Accountants of Sri Lanka (FSCMA). Mr. Pathirana holds a B.Sc. (Special - Public Administration) degree from the University of Sri Jayewardenepura.

He has nearly 10 years experience in the field of Finance and as a Management Accountant both in Sri Lanka and overseas. He is responsible for all the project promotions, studying the feasibility of such projects and the implementation of all new projects. He joined HDFC Bank in September 2004.

Executive Management Team



First Row Left to Right

1. Mr. L.H. Nihal
Manager - Training, Research & Development
2. Mrs. P.L.A.S.I. Cooray
Manager - Credit
3. Mrs. W.N.D. Boteju
Accountant - Treasury
4. Mr. M.Y. Piyasena
Senior Manager - Recovery
5. Mrs. W.W.D.S.C. Perera
Manager - Legal
6. Mr. K.R.M.A. Bandara
*Chief Internal Auditor
(Cover Up)*

Second Row Left to Right

7. Mr. W.M.A. Bandara
Chief Manager - Information Technology
8. Mr. C.R.P. Balasooriya
Accountant - Finance
9. Mrs. W.A.K. Dissanayake
Unit Head - Recovery
10. Mrs. G.L. Pandigama
Manager - Technical, Maintenance & Procurement
11. Mrs. H.S. Gunatilake
Manager - Project Finance & Branch Supervision
12. Mrs. C.P.K. Hewage
Manager - Human Resources
13. Mr. W.M. Chandrasena
Manager - Valuation

CSR & Sustainability Report

Commitment towards our stakeholders...

We keep striving to deliver beyond expectations, for the benefit of our customers and shareholders, the well-being of the community, industry and prosperity of the national economy.

OUR ACCOUNTABILITY AND GOVERNANCE

Accountability

We at HDFC Bank as a corporate body emphasise our accountability in two key directions:

- Towards shareholders, with the assumption that all shareholders want to maximise their wealth on short-term profits; and
- Towards the rights and claims of many non-shareholder groups such as customers, employees, lenders, depositors, prospective investors, community and the government who have a stake in the outcome of HDFC's operations.

As an influential semi-governmental corporate citizen, HDFC Bank of Sri Lanka believes that it can play a significant role in shaping the future of the nation by addressing the need of decent housing for all. HDFC has always been mindful of its social responsibility and embedded principles of sustainable development and empowerment, in daily business practices. We create wealth for our shareholders; contribute towards sustainable prosperity of our nation and build long lasting relationship with our customers, employees and all other stakeholders.

The constant drive for operational excellence, coupled with a focus on cost control and value creation has enabled HDFC to establish repeated records in terms of volume and value of loans, cash generation and sustainable profitability as reflected by 213% higher dividends to shareholders in comparison to 2005.

We are aware that the way the Company is perceived by society is the result of many factors, including our commitment to sustainability. These factors make up part of our social licence to operate and contribute to the maintenance of our market leadership in LIG and MIG. The image and reputation that result from this perception directly influence the Company's value; permitting cost reductions by anticipating and preventing conflicts, facilitating access to capital and motivating our employees and suppliers.

This chapter encompasses HDFC Bank's endeavour to offer the best contribution to the non-shareholding stakeholders in society. Our performance in 2006 is presented in this publication from the ten perspectives that reflect our strategy for growth and sustainable productivity:

- Value creation and our performance in the national economy.
- Our contribution towards sustainable development of the industry.
- Sustainability in our operation and customer satisfaction.
- Human resource development & training.
- Environment & resources utilisation.
- Social participation.

- Awards & recognition.
- Challenges.
- Future outlook .
- Sustainability index.

This is the 3rd Annual Report, in which HDFC Bank reports about its social and environmental actions. In 2006, we sought to be more closely aligned with the reporting principles of international bodies that guide sustainable reports. We have also included a cross index with available comparative information for the last two years. This effort will be reinforced in the future and editions of the report will be more closely aligned with principles of the Global Reporting Initiative (GRI).

All aspects of the sustainability of our operations are fully reported, together with the common challenge in the housing finance industry.

Corporate Governance

Good corporate governance is fundamentally important for corporate entities. This is more so in the case of banks and financial institutions as their failure could create a substantial financial impact on the national economy and also on society as a whole. Banks therefore, have to be conscious of this important factor and wholeheartedly and effectively practice good corporate governance. Stakeholders and the general public require that the Board of Directors in their capacity as the agents of such stakeholders ensure the safety of the interests of the Bank by maintaining a strong capital base, ensuring sustainable profitability and enhancing shareholder value.

CSR & Sustainability Report

The HDFC Bank of Sri Lanka realised the advantages of sound corporate governance, where in the face of increasingly integrated capital markets, it sought to distinguish itself in the global economy. The Board of Directors of the Bank is committed, on a continuous basis, to the enhancement of the Bank's corporate governance regime. In so doing, they will create a controlled environment in order to give a reasonable assurance of ethical, effective and efficient operations and ensure the existence of proper internal financial and other controls, compliance with laws and regulations with a sound management of the wide variety of risks faced by the Bank, by being aware of such risks before hand.

In order to safeguard the Bank, its depositors and stakeholders as well as to maintain the integrity of its financial systems, the Board of Directors intends to adhere to the principals and guidelines set out in the Code of Corporate Governance for Banks and Other Financial Institutions by the Central Bank of Sri Lanka. As a Licensed Specialised Bank quoted in the Colombo Stock Exchange, the HDFC Bank has also adopted the recommendations published in the Code of Best Practice introduced by the committee appointed by the Institute of Chartered Accountants of Sri Lanka on 'Financial Aspects of Corporate Governance'.

Accordingly, the Board of Directors of the Bank has appointed a Compliance Officer in order to create an effective and efficient operational environment in compliance with the laws and regulations introduced by the legislature and the

regulator and applicable to the Bank. The Compliance Officer reviews all business decisions taken by the Bank and reports on any issues of non-compliance that may arise, to the Audit Committee.

The Board of Directors

The Board of Directors of the HDFC Bank of Sri Lanka comprises nine Non-Executive Directors who are independent and eminent leaders with distinguished backgrounds in the housing, real estate, finance, economics, business, administration and law. They provide a wealth of practical experience and commercial orientation required to drive the much needed changes necessary to create a truly sustainable and independent bank. They are nominated and appointed according to the provisions of the Housing Development Finance Corporation Act No.7 of 1997 and its amendment Act No.15 of 2003.

Corporate Management

Whilst providing leadership in attaining the strategic aims of the Bank is the responsibility of the Board, ensuring the implementation of those strategies is the responsibility of the Corporate Management, headed by the Chief Executive Officer/General Manager. The Board, in order to achieve this goal, has delegated its authority to the Corporate Management in operational areas within clearly established limits. The Corporate Management of HDFC Bank is composed of a very distinguished group of committed senior executives who are experts in banking, finance, investments, credit, marketing, accountancy, human resources management, development and project lending, administration, law and compliance.

"HDFC has become a household name since it began operations as a Building Society in 1984, helping low income families like ours. My family's association with HDFC began more than a decade ago, when my father who was a farmer obtained a 'kedella' housing loan, to build our home.

As the years passed, I obtained employment as a teacher and left my parents to start my own family. I obtained a 'Gurusevena' home loan from HDFC Bank to make another dream a reality. I now have a son and daughter of my own, who are third generation customers of HDFC Bank. I believe that their HDFC 'Thilina' minor's accounts will provide them a



safe and secure future. My family and I wish HDFC more success in its mission to cater to the home and lifestyle needs of Sri Lankans from all walks of life."

G.P.A. Gajanayake

Board and Management**Sub-Committees**

There are several management committees and Board sub-committees with defined scope of work and terms of reference. These committees provide independent and expert advice to the Board on assigned subjects.

Audit and Management Committee

The Audit and Management Committee is headed by a Non-Executive Director representing the General Treasury and two other Directors. The Committee, inter alia, reviews all internal control systems of the Bank and verifies whether there is proper adherence to risk management measures and compliance with mandatory banking requirements as per guidelines issued by the Regulator and other statutory requirements. The Chief Executive Officer/General Manager, attends the meetings by invitation. The meetings are held on a quarterly basis. The full report of this committee is included elsewhere in the report.

Recovery Sub-Committee

The Recovery Sub-Committee consists of four Directors of the Board and is formed specially to dispose the lands which were acquired by the HDFC Bank, under the provision of Recovery of Loans by Banks (Special Provisions) Act No. 4 of 1990. The aforesaid sub-committee assists the Bank to gain the maximum market rates when the Bank is dealing with such properties.

The Assets and Liabilities**Committee**

The Assets and Liabilities Committee is composed of the Chairman, two Non-Executive Directors, the Chief Executive Officer/General Manager, Deputy General Manager (Finance), Deputy General Manager (Credit & Marketing). It ensures the maintenance of liquidity levels as required by the Regulator and also monitors the maturity matching of Assets with Liabilities.

The investment of surplus fund and short-term borrowings are all reviewed and approved by the Assets and Liabilities Committee.

Credit Committee

The Credit Committee comprises of the Chief Executive Officer/General Manager, Deputy General Manager (Credit and Marketing), Deputy General Manager (Finance) and Assistant General Manager (Project Finance & Administration). The Committee formulates the credit policy of the Bank. The management of credit risks is also the responsibility of this Committee. Credit facilities above the delegated authority of the individual officers are referred to this committee for approval.

Human Resources Committee

Human Resources Committee is headed by the Chief Executive Officer/General Manager. The rest of the members are the Deputy General Manager (Finance), Deputy General Manager (Credit and Marketing) and Assistant General Manager (Project Finance and Administration).

The Committee is responsible for reviewing the recruitment and promotions of the staff of the Bank. It is also responsible for the formulation of a remuneration policy for its staff which is commensurate with that payable in the market, in order to attract and retain experienced and qualified staff with proven track records. One of the key responsibilities of the Committee is to ensure that an effective succession plan is in place in the Bank.

Valuation Review Committee

The main function of this committee is to review the valuation of securities offered by customers for large loans. This committee is headed by a former Chief Valuer.

Transparency and Compliance

The HDFC Bank has always endeavoured to maintain transparency in all its activities. It also has an established process now to ensure that there is a compliance with all applicable laws of the land as well as regulations and directions issued by its Regulator. Regular reports on compliance are submitted to the Board Audit Committee and to the Central Bank of Sri Lanka. Regulatory compliance is ensured by adhering to Inland Revenue, CSE and SEC regulations, Industrial and Labour laws of Sri Lanka, the provisions of the Banking Act No.30 of 1998 and its amendments, and the Housing Development Finance Corporation Act No. 7 of 1997 and its amendments. The Annual Reports and the Quarterly Financial Statements published on specified dates by the Bank provide all stakeholders with complete financial and operational information, enabling them to evaluate the performance of the Bank.

VALUE CREATION AND OUR PERFORMANCE IN THE NATIONAL ECONOMY

Value Creation

Value Distribution (Rs. '000)

	2006	2005
To Goods & Services providers	806.39	683.78
To Employees	159.04	145.28
To the Government	140.91	103.82
Shareholders (Dividends)	64.71	30.61
Retentions for Internal Development	114.58	93.73
Total Contribution	1,285.63	1,057.22

Our Performance in the National Economy

In Managing Human Settlement

In general housing is important since it satisfies a basic human need. Human settlement is also considered as one of the several factors used to assess the physical quality of life and economic growth of a country, to meet the Millennium Development Goals (MDGs). The scale of development in Sri Lanka is on par with middle income countries and the Millennium Development Goal timetable for universal primary school enrolment, gender parity in primary and secondary enrolment and universal provision of reproductive health services. Housing conditions too have substantially improved compared to the early 1980s, in particular with respect to housing materials and access to electricity, safe water and sanitation facilities.

In spite of several internal and external obstacles, the Sri Lankan economy expanded by 45% in terms of per capita GDP and 30% in terms of per capita consumption during the past decade.

This indicates a substantial improvement in housing conditions, household lifestyle and in the general quality of life. The growth, however, has not translated into poverty reduction, primarily because it has been concentrated around Colombo and neighbouring districts, which has resulted in widening inequality across the region and across sectors.

(World Bank Poverty Assessment Report - January 2007)

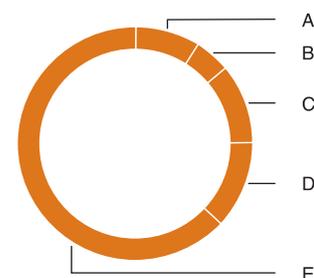
The construction of houses requires enormous amounts of material, labour, energy, water and creates large amount of waste. Therefore, construction involves a significant amount of capital investment.

Thus, the mission of housing, is not only a construction of dwelling units; more broadly it is an employment generator, poverty alleviator, social stabiliser, wealth creator and most importantly an attractive creator of human settlements.

Apart from the natural growth of housing demand, rapid urbanisation and a changing socio-economic scenario, the demand for housing has grown explosively during the last two decades, which encompass a provision of a large amount of national income for housing. Construction is one of the main contributors to GNP growth. Over the last 25 years the construction industry's contribution towards GNP has increased 2.5% - 7.2%. from the employment base around 7.4%, created by the construction industry.

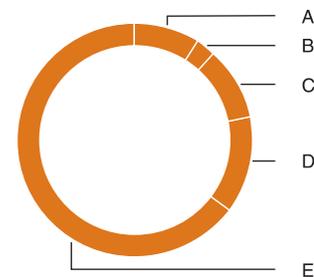
In the year 2006, out of Rs. 826 billion advances of the commercial banks system, Rs. 133.64 billion has been extended to the housing industry which

Value Creation in the Economy - 2006



A Internal Development	9%
B Shareholders	5%
C Government	11%
D Employees	12%
E Suppliers	63%

Value Creation in the Economy - 2005



A Internal Development	8%
B Shareholders	3%
C Government	10%
D Employees	14%
E Suppliers	65%

represents 16.25% of total credits with personal. With personal housing loans granted by housing banks total credit extended for managing human settlement is well above Rs. 146 billion.

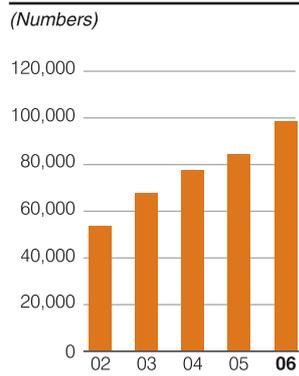
HDFC, with the primary objective of assisting in-home financing for the needy segments of society, has made a significant contribution towards human settlement management in the country, over the last two decades of service.

Aggregate Service

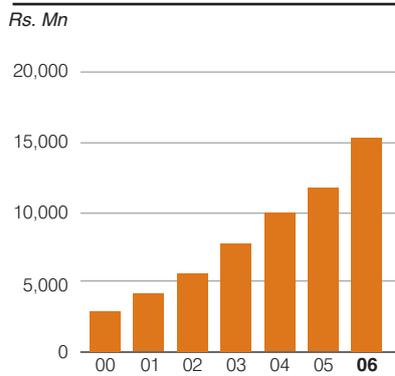
The aggregate volume of loans granted by HDFC is 98,089 as at reporting date and the value of total loans granted, since year 2000 is over Rs. 15 billion.

Out of these advances more than 80% of facilities have been extended for the less privileged segment, whose level of aspiration for achieving a home for settlement is very high.

Aggregate Volume of Loans



Aggregate Value of Loans Granted Since 2000



Towards National Housing Stock & Human Settlement - 2006

In 2006, the Company granted 13,689 facilities with a total value of Rs. 3,476 billion compared to 7,276 loans granted in 2005 for the value of Rs. 1,924 billion. These facilities have been extended for house construction, purchasing, purchasing & construction, redemption of housing loans obtained at high interest rates, renovations & repairs and house extensions, etc.

During the year under review, HDFC has assisted to enhance the national housing stock approximately by 11,750 new houses, with a aggregate square area of 14.1 million at a construction value of Rs. 3.50 billion. Out of this construction value, HDFC has financed approximately for Rs. 2.8 billion, while Rs. 555 million has been extended to purchase constructed houses and dwellings. A. further Rs. 424 million has been extended to meet various housing related other financial commitments including household accessories.

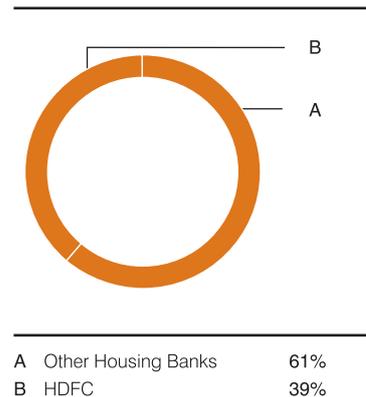
Through these operations, HDFC assisted over 13,600 families islandwide to own the dwelling settlements occupied by them and over 56,000 people to fulfil their pressing need of housing.

We estimated HDFC Banks approximate contribution towards reducing the country's housing backlog is 3.5% during the year 2006.

Strengthening in the Housing Finance Market

All commercial banks that cater mainly to the WIG market, together with the three housing banks namely, State Mortgage & Investment Bank (SMIB), HDFC Bank and National Savings Bank (NSB) have granted 133,120 personal housing loans in 2006, compared to 112,640 loans in 2005, to promote human settlement in Sri Lanka. (CBSL Annual Reports 2005/06)

HDFC Share LIG & MIG Market by Volume of Loans 2006



During the year 2006, three housing banks that basically cater for LIG and MIG market have extended 35,137 loans for the value of Rs. 12,187 million, compared to 23,305 loans granted in 2005. Out of these loans HDFC along has granted 13,689 loans, with a total value of Rs 3.476 million, representing 38% of LIG and MIG segments in the housing finance market, by volume of loans. This share was recorded as 31% in 2005. In terms of loan value, HDFC has catered for 28% of LIG and MIG market in 2006 and 22% in 2005.

Out of the total housing loans granted by the banking system, HDFC has contributed 10% during the year 2006 and 6% in 2005.

CSR & Sustainability Report

Prioritised Service for the Needy Segment

The prime objective of the Bank is to assist the low and middle income groups in society, who need housing finance and allied services. Low & middle income categories are the most affected segments of the population whose income is insufficient to meet the cost of housing.

The demand for housing and urban infrastructure has increased with the continuing population growth and economic development. The population of Sri Lanka in July 2005 was 19.668 million and ranked as the world's 55th largest population with an average density of 298 people per sq.mt. From the total population, 78% of the population is rural and 22% urban. Over the last 10 years, the average mid-year population growth has been recorded as 1.1% whereas urban population is growing at a higher rate of 3%.

(Source: World Fact Book).

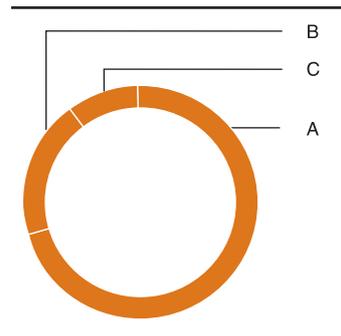
A component as large as 55% of the rural population and 8% of urban population are below poverty level and in average 23% of the total population is within the poverty level and their income is insufficient to meet the cost of housing. (Sri Lanka Development Policy Review 2002 - World Bank).

The majority of the population who fall under this income category also have restricted access to credit facilities offered by the commercial banks or financial institutions. HDFC has been successful in servicing this sector due to its integrated approach with allied services such as legal, technical and valuation, of which the borrowers of this category have little or no knowledge.

HDFC Bank of Sri Lanka being a specialised development bank, has comprehended its national responsibility and has paid emphasis to provide a more productive, efficient and closer service towards this segment which forms a large part of the population.

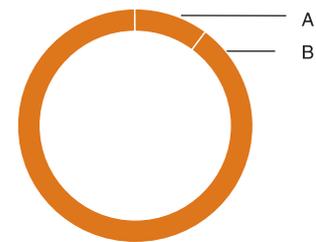
During the year under review, more than 92% of the approved loans were granted to low & middle income groups. Around 70% of approved loans were less than Rs. 200,000/-. Loans between Rs. 200,000/- - Rs. 500,000/- are accounted as 22%. In 2005 and 2004, HDFC focused more than 90% and 89% facilities, respectively towards this segment of the market. The emphasis on this distribution of the loan portfolio reflects our broadened view of social responsibility and the identification of the necessity to service the needy group of the country.

Service to Needy Group -2005



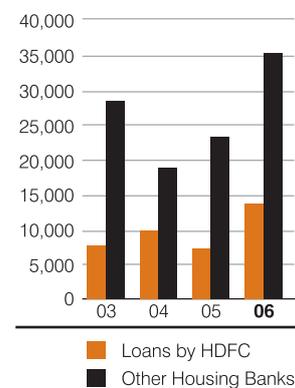
A	LIG	70%
B	MIG	20%
C	WIG	10%

HDFC Contribution towards Promoting Home Ownership 2006



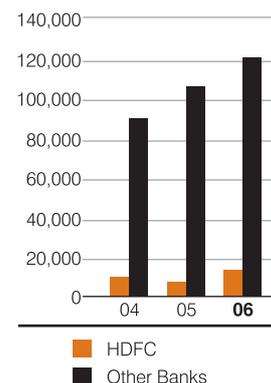
A	Other Housing Banks	10%
B	HDFC	90%

Contribution in LIG & MIG Market

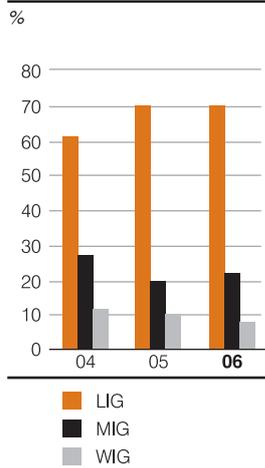


HDFC Contribution Promoting National Home Ownership 2004 - 2006

Numbers



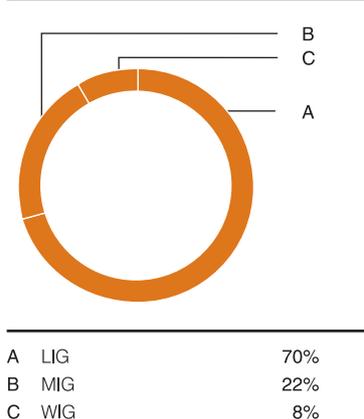
Contribution Towards Needy Group



The LIG segment of the market in general does not possess adequate documents to prove income and often encounters problems with the offered collateral. For this reason, the LIG borrowers seek assistance from HDFC as their last effort.

The greatest lesson we learnt in advancing and managing loans in this segment is to be exercised on a corporate approach rather than on a management approach exercised in typical commercial lending. Experience in lending for LIG is an invaluable strength, which results in sustainable growth of HDFC.

Service towards the Needy Group - 2006



In Promotion of Homeownership

Branch Network

We provide services in all provinces except the Northern, through a fully integrated network of 21 branches. All branches are linked with online system access and are equipped with in-house technical, legal and valuation professionals to provide a one Stop service.

A branch upgrading programme is being implemented since obtaining banking status in 2003, to provide a better working environment to staff and an improved service to customers while also enhancing the image of the Bank. During this period, the Ampara and Ratnapura branches were relocated with a better internal environment and parking facilities, etc.

Apart from the upgrading, a programme is being implemented to increase the number of branches in a scheduled manner.



Ampara Branch relocation

Provincial Distribution of Service

As part of a corporate strategy, HDFC initiated product differentiation to meet the requirements of people in different provinces, in consideration of the following:

- The nature of economic activity involved.
- Nature of income source.
- Income pattern.
- Religious and cultural differentiation.
- Nature of collateral available.

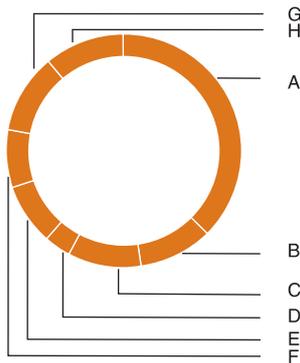
Due to ever increasing urbanisation, the urban population is rising sharply at 3% per annum. This trend is significantly reflected in the Western Province, mainly because of the daily rising number of immigrant families. In the Western Province land prices and rate of construction labour has been increasing sharply making housing unaffordable for many. The demand for individual housing and plots are mainly created by fixed income earning MIG families with influence of many housing credits available from banking system and income from foreign employments. Meanwhile 65% of the condominium market is driven by speculators.

In consideration of these developments in the market, during the financial year 2006, HDFC specially emphasised the Western Province. The total number of loans granted in the Western Province was 5,131 which represents 37% of the volume of loans and 47% of the value of loans granted during the year. Out of these loans 80% were extended to MIG families. Loans for new construction represent 70%, house purchasing 15% and other housing related matters 15%.

CSR & Sustainability Report

A component of 10% of loans were extended in the Southern Province and another 10% in the Central Province. The rests of the facilities were extended to the low & middle income earners in Eastern Wayamba, North Central, Sabaragamuwa and Uva Provinces. A large volume of LIG loans which have been granted in these areas have resulted in a considerable impact on the living standards of the people.

Provincial Distribution of Service - 2006

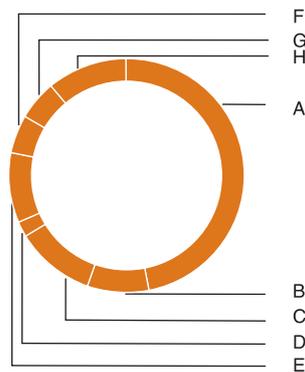


A	Western	38%
B	Central	10%
C	Southern	10%
D	Eastern	4%
E	Wayamba	8%
F	North-Central	8%
G	Uva	11%
H	Sabaragamuwa	11%

Provincial Distribution of Service

Province	2006		2005	
	Loan	Rs mn.	Loan	Rs. mn
Western	5,131	1,634	3,488	1,084
Central	1,361	283	771	150
Southern	1,378	383	642	154
Eastern	531	74	194	23
Wayamba	1,143	340	673	185
North-Central	1,122	185	316	71
Uva	1,520	192	602	81
Sabara-gamuwa	1,503	384	587	176
	13,689	3,475	7,273	1,924

Provincial Distribution of Service by Value - 2006



A	Western	47%
B	Central	8%
C	Southern	11%
D	Eastern	2%
E	Wayamba	10%
F	North-Central	5%
G	Uva	6%
H	Sabaragamuwa	11%

Distribution of Loan

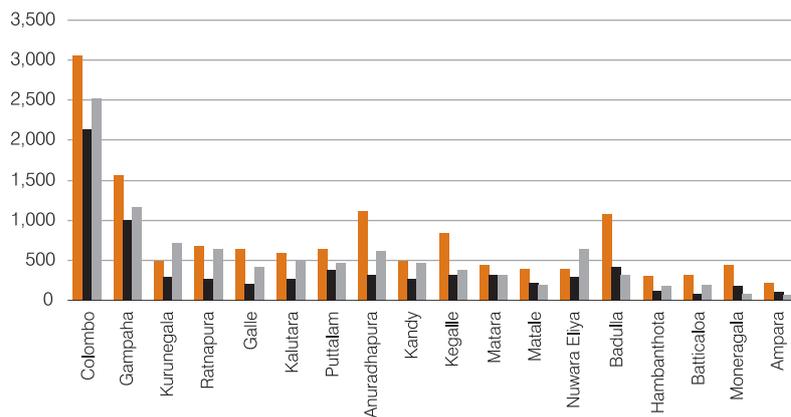
Due to the high growth of population and ever increasing land value, housing has become a tremendous issue particularly in the District of Colombo.

During the year under consideration, HDFC Bank has extended an average 22% of the loan portfolio within the Colombo District. The second highest number of loans were extended in the Gampaha district. HDFC provides services in 20 districts, through the branch network of twenty.

A special programme launched in the North-Central Province, was mobilised through the Anuradhapura District office.

District-wise Distribution of Loans 2004 -2006

Numbers

**Customised Service**

During the year 2005, HDFC granted 4,531 loans worth Rs. 891 million, to EPF members. That accounted for 30% of the total loans extended to EPF members during the year by housing banks. EPF loans account for almost 33% of the volume and 23% of the value of loans extended during the year by HDFC Bank. In total, HDFC Bank has granted 27,674 loans to the members of Employees' Provident Fund.

Customised Service

Customer	2006	2005	2004
General Customers	3,082	2,436	1,735
EPF Members	4,531	2,979	4,114
Government Teachers	3,097	1,348	1,740
Farmers	-	-	110
Doctors	5	2	-
Government Employees Low Interest	856	348	-
Local Government	420	-	-
Existing Customers (Home Loan)	207	-	-
AHF	-	54	1,858
Personal Guaranteed Customers	1,072	-	-
Other	419	109	325
	13,689	7,276	9,882

General mortgage loans account for 22% of the volume of the loans extended during the year. The Bank extended 856 loans worth of Rs. 703 million as special assistance to enable the Government to formulate its housing policies in respect of Government employees. Interest is charged for these loans at 11% per annum, 4% is recovered from the customer and the balance 7% is to be reimbursed by the Government. Private sector employees who are members of the EPF were granted 873 loans at 4% interest per annum; the source of finance was made available from the Employees' Provident Fund at 2% per annum.

During the year 2007 home loans were granted to the existing mortgage customers who were in need of finance, for purchasing furniture, electricity and household items. The amount of these loans is Rs. 45.5 million.

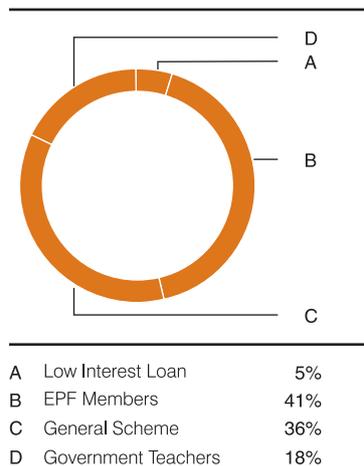
Personal guaranteed loans were granted to customers whose applications were not supported with adequate collaterals and income proof documents. The number of loans granted under guaranteed loans was 1,072 and their value is Rs. 141 million.

Under the 'Gurusevana' Loan Scheme, HDFC granted 3,097 loans to Government teachers that consisted of 22% of the loans extended during the year.

This encompasses identification of the housing needs among different customer segments, particularly in the Government and Corporate sector, middle & lower income group employees who need housing facilities at affordable rates and also have the capacity to obtain housing loans.

CSR & Sustainability Report

Scheme-wise Loans - 2006



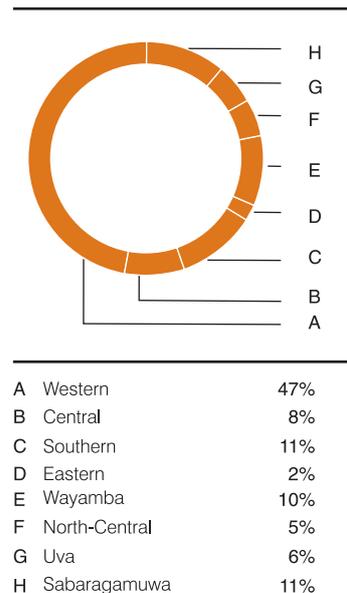
Employment Generation and Poverty Alleviation

In addition to the 298 permanent employees involved in HDFC's operation to enhance the national housing stock, it has generated approximately 2,750 indirect employment opportunities countrywide in related service sectors such as carpentry and masonry.

In terms of the number of induced jobs opportunities created from house construction and related economic activities such as transport, sand mining, bricks & tile manufacturing, quarrying etc. HDFC should have contributed to approximately 12,750 job opportunities in 2006. The total number of direct and indirect employment opportunities created by the HDFC's operation, during the year, represents approximately 2% of the employment opportunities in the construction industry.

The construction industry being one of the main providers of employment has created approximately 527,000 job opportunities countrywide representing 7.4% of the total employment market in 2006. The total advances in 2006, from the banking system accounted for Rs. 146 billion to the construction industry, out of which HDFC contributed Rs. 3,476 billion for personnel housing in nine provinces.

Creation of Job Opportunities



CONTRIBUTION TOWARDS SUSTAINABLE DEVELOPMENT OF THE INDUSTRY

The housing and housing finance industry is facing a challenging situation which inhibits sustainable development of the industry as well as the national economy. These challenges are mainly from the following two impediments:

1. Lack of long-term funding and financial instruments.
2. Lack of sustainable approaches and long-term vision.

Lack of long-term vision on housing finance and development and a sharp rise in land prices, high salaries and wages in the construction industry, high cost of major building materials and the lack of skilled labour also restrain the sustainable growth of the housing sector. (CBSL Report 2005 & 2006)

Being a principal player in the housing finance market in Sri Lanka which caters to approximately 40% of the LIG and MIG segments, it is inevitable; HDFC Bank has to face the above inherited issues in the industry. In comparison to the other two State banks which are involved in housing finance, HDFC deals only with one product which is housing and housing related finance. Therefore, the threats ensuing from the above issues are more material to HDFC than to the other two competitors, in the needy segment of the market.

In consideration of the above threats, HDFC initiated several innovative strategies for the sustainability of the Company and industry.

Searching for Long-Term Funding & Financial Instruments

- In order to facilitate long-term sources of funds, HDFC took an innovative step towards the development of the secondary mortgage market by signing the country's first secondary mortgage securitisation in 2005. The development of secondary mortgage resolved long-term funding needs of the Bank to a greater extent and the amount of funds raised in 2006 to Rs. 750 million. HDFC believes that

primary mortgage lending could be increased by 75% with the help of an efficient secondary mortgage market. At present, the secondary system is being developed by the Central Bank for primary mortgage lenders along with the necessary legal and regulatory framework.

- In order to broad-base ownership and access to the capital market, for raising long-term funds, the Company was listed in the Colombo Stock Exchange (CSE) and the Initial Public Offering (IPO) was launched in 2005 to raise Rs. 500 million. The issue was one of the most successful IPO's, in the CSE, that enriched the image of the Company with a wider recognition.
- In consideration of the mismatch of cash flows and long-term funding needs, HDFC initiated several savings deposits over the last two years.
- The establishment of a research and development department for continuing research on new housing finance instruments.
- HDFC most often encounters the problem of inadequate collateral, in servicing the needy group. In order to facilitate customers, the Bank initiated personnel guarantees and an institutional guarantee loans scheme in 2006.
- In servicing the LIG and MIG segments, HDFC frequently encounters legal problems in collateral offered. An in-house legal department was set-up to offer a comprehensive service to customers to avoid delays and minimise complications.

Addressing on Industry Sustainability

Speculative Demand and Increasing Real Estate Prices

The increased inflow of FDI, increase in foreign currency income from non-resident Sri Lankans, easy access to bank credit, large involvement of informal economy, have recently led to a greater demand for developed residential properties specially in the Western Province. Basically, the condominium market is not driven by credit finance and mostly on informal economy.

While a portion of the current demand is real, at least a 1/5 of this is being driven by speculation. In some residential pockets, as high as one-third of the sale are effected by pure investors. These buyers are unlikely to be the end users and hence, real estate is fast becoming a speculative commodity.

This is an unhealthy trend and has led to unaffordable price levels in some townships. Exceptionally, high prices have locked out the majority of the population that need homes, forcing them to live with their families in indecent dwellings.

As the service provider in this industry, HDFC has always believed that the customer should be the beneficiary of any healthy development in the industry and we therefore ensure that the customer makes informed and critical decisions. It is necessary to question whether the customer is competing with a speculative competitor or a natural competitor, if the customer competes in

a speculative market, it is inevitable, that the customer would pay a speculative price, which is not healthy for the future of the housing finance market.

In the industry we need to exercise caution and verify whether the customer is buying at speculative price or genuine market price. As in every cyclical environment, a downtrend is inevitable. When the speculative dream run comes to an end and prices fall, it leads to a decline in housing equity, borrowings and spending; further widespread defaults could generate a contraction in economic growth.

The demand for housing grows naturally with the increase of population in any country. This is stable and players in housing and the housing finance industry should not rely on the prices driven by speculators and be mindful of the long-term vision sustainability of the industry.

HDFC continues to manage the mix of loan portfolio to minimise risk that may evolve from possible asset price bubbles in the real estate industry.

Affordable Homes

Sri Lanka's housing industry is reaping the benefits of the upswing in its growth cycle. However, as a specialised bank in the industry, HDFC cannot take a look at the current scenario and say that the industry is moving towards sustainable development. The sharp rise in land prices, high salaries and wages in the construction industry and high cost of major building materials has created a situation where housing remains unaffordable for many.

CSR & Sustainability Report

Low & middle income categories are the most affected segments of the population whose income is not sufficient to meet the cost of housing. Affordable housing is a dwelling where the total housing cost is affordable to those living in that housing unit. In Western countries a commonly accepted guideline for housing affordability is a housing cost that does not exceed 30% of a household's gross income. When the monthly carrying cost of a home exceeds 30%-35%, housing is desired as unaffordable. In Sri Lanka the maximum housing cost limits are set as high as 40% of gross income, but that also becomes unaffordable for a large fraction of the population.

Loans granted by the housing banks, declined significantly in 2004, due to the increasing trend of unaffordability of housing cost in LIG and MIG groups. But as a consequence of several strategies followed by the banks and governmental policies, the highest number of loans were granted in 2006. HDFC was able to sustain its market share decline of 31%, by increasing it to 39%.

Over the last two years, HDFC followed several strategies for facilitating the affordability of housing.

- In line with the Government policy of providing houses for government employees at an affordable cost HDFC granted loans to 856 Government servant in 2006, for a value of Rs. 453 million at a subsidised mortgage interest rate of 4%.

- For the private sector low income group, the Bank extended 873 affordable housing loans during the year for EPF members, at the Government subsidised interest rate of 4% p.a. The total value of these loans granted during 2006 was Rs. 225 million.
- The lowest grade employees of the Government and Local Government sectors are not catered to by any structured housing finance scheme or institution. Through the corporation of North-Central Provincial Government, HDFC initiated a programme to assist the lowest grade employees of local authorities in the North-Central Province, granting loans to 420 families for the value of Rs. 41.24 million during the year.
- The Bank launched a special graduated loan scheme for customers whose present income is not sufficient to meet the cost of housing. The loans are arranged on the basis of the future increase in income and monthly instalment housing is increased accordingly.
- HDFC also offered in-house technical, valuation and legal services at lucrative cost to make the initiating cost of the loans affordable.
- HDFC initiated granting project loan facilities for the individual and corporate property developers at an affordable rate, with a view to enhancing the supply of housing and housing plots. HDFC offers a comprehensive support programme for real estate developers as well as

in the areas of valuation, legal, technical, preparation of projects, feasibility reports and obtaining approval from the Condominium Management Authority (CMA) etc. During the year, HDFC granted Rs. 241 million for property development and processed some provisional condominium approvals.

- HDFC continuously sponsors the introduction of innovative construction material and technology in the country. In 2006, the Bank sponsored the promotion of the slip-form low cost housing method in partnership with the Centre for Housing Planning and Building (CHPB), model houses were constructed in Matara, Ampara, Moneragala and Anuradhapura.

Sustainable Living & Environment

Homes are not just houses, they are environments which reflects the aspirations of individual families: clusters of homes form neighbourhoods and clusters of neighbourhoods form towns and cities. Housing construction and real estate developments require enormous amounts of energy and water and create large amount of solid and liquid waste.

Therefore, the manner in which houses are built, affect the ecosystem and the environment in countless ways. Buildings themselves create new indoor environments that presents environmental problems and challenges. As the environmental impact of condominium buildings and housing schemes become

CSR & Sustainability Report

more apparent, a growing field called sustainable design is leading the way to reduce those negative impact sources. The sustainable development approach is the key contributor to mitigating the negative impacts of developments and creating healthier and more resource efficient construction, renovation, operation, maintenance and demolition. Environmental protection is to be emphasised as an integral part of the development process and any breakdown in the environmental stability would have serious implication on the country.

HDFC as a policy follows the concept of "Green Banking" in our operations, emphasising sustainable designing in all housing development projects and providing other property developers and customers with an understanding of the vast potential for integrating environmental solutions into housing and construction decision-making efforts. By this process the customers are always encouraged to emphasis on four areas in house planning and designing and making a housing decision.

- Environmental sustainability; is to be incorporated into the design to reduce greenhouse gas emissions, save water and reduce energy and waste cost.
- Social sustainability; is a characteristic native to the home with built-in safety features to prevent injuries, as well as security features to reduce crime and improve the home owner's sense of security.

- Economic sustainability; is an important feature. The home is designed to save your money when you build or buy it and make money if or when you sell. It avoids the need for major renovations at a later date and reduces the long-term cost of energy consumption, water consumption, and maintenance.
- Quality of life: factors relating to the housing environment which influence people's perception of the quality of life at an affordable price. Affordability is a major factor in building a sustainable home. If the house is not cost effective, it does not offer cost saving technologies and does not suit your current lifestyle and is probably not the right house.

Performance objectives of the above exercise are the following:

- Optimise site potential, including ways that strengthen the neighbourhood, promote opportunity and improve transportation.
- Protect and conserve natural resources, including water and material.
- Expand renewable energy consumption.
- Use material effectively and efficiently.
- Provide a safe, healthy, and productive built environment for inhabitants and users.
- Reduce the facility lifecycle cost and optimise operations and maintenance cost.
- Use green products and services.
- Finally, create a sustainable human settlement at an affordable price.

HDFC, in extending housing finance to particular housing project loans, exercise strict adherence to the above policies. Allocation of proper infrastructure facilities, such as adequate road access, smooth flow of water, assurance of uninterrupted power supply, arrangement for solid waste, waste water and rain water drainage and sewerage systems, are strictly monitored.

In driving HDFC towards its objective, we have been mindful of the requirement to balance environmental needs with human needs. The desire for corporate goals should not override the uniqueness of Sri Lanka, its countryside, its culture and its biodiversity. Our technical staff assesses the environmental impact of each housing loan proposal and educates the clients to meet the environmental regulations of the country. Loan mobilisation strictly follows compliance with the statutory provisions of the Central Environmental Authority, public health and rules and regulations of local authorities etc.

HDFC Bank, which was established with the prime objective of assisting low and middle income groups in housing finance, has contributed extensively towards mitigating this national issue. While being committed toward its corporate objectivity over the past years, HDFC Bank has also been more open and accountable to the economic, environmental and social consequences of the Bank's activity and has had a tremendous impact on national economic development through sustainable human settlement.

CSR & Sustainability Report

SUSTAINABILITY IN OUR OPERATION

Strategic Plan and Achievements

In working towards the prosperity of the national economy, HDFC has been mindful of the long-term sustainability of the Bank, as a body corporate, and its sustainable practices in the context of environment and resource utilisation.

The corporate plan is the master guide for the sustainable growth of the Bank, with quantitative and qualitative strength, that enumerates:

- Corporate vision, mission and objectives.
- Targets, goals.
- Business plan.
- Strategies.

HDFC is passing the five year tenure of its first corporate plan on 31st December 2006 and is proud of its sustainable achievements and growth during this period. The HDFC achieved the status of a Corporation, Licensed Specialised Bank and became a listed company with Rs. 1.2 billion market capitalisation and 40% market share in LIG & MIG and 10% share in the entire housing finance market. These achievements are the results of the visionarised strategies of HDFC's CEO, Mr. C.A. Sarathchandra together with the administrative support of our Chairman, S.M.M. Yaseen and the Board of Directors who were backed by the entire staff.

The corporate plan for the next five years, 2007-2011 is being prepared, with the full participation of all division heads and managers.

Vision & Mission

HDFC is part of an industry with an ever increasing demand and changing tastes caused by the changes in the standard of life. However, its sustainability in the market depends upon the following:

- Its flexibility and dynamism towards daily changing customers tastes.
- How it addresses industry challenges.
- How it competes.

We believe that quantitative development of the Bank could only be achieved by the above qualitative attributes, backed by:

- Operational efficiency (quality).
- Financial stability.

We strongly believe that **Operational Efficiency** is driven by:

- Continuous research & development on products.
- Continuous research & development on operational systems & procedures.
- Continuous development of human resources.
- Continuous development in capacity.
- Efficient utilisation of resources.
- Friendly dealing with the environment.

Meanwhile, HDFC emphasises that 'financial **stability**' is driven by operational profitability and investor confidence that is disciplined by good **corporate governance**, internal controls and procedures.

Operational Efficiency

Research & Development

Research & development is vital to improve operational efficiency with a dynamic approach in the industry. It is a continuous process of identifying ever-changing home needs, lifestyle and industry attributes.

HDFC established its research and development department in 2006.

Researching for new housing finance and savings products, other long-term refinancing instruments and improved systems and procedures is a part of its daily operations.

Market Attributes

LIG	
Rural	Urban
Seasonal income	Aboriginal
Originals	Domestic Violence
Low income	Low Income
Less Education	Mental or physical disability
Large family	Seniors
Low lifestyle quality	Immigrants
	No significant income pattern

MIG	
Rural	Urban
Seasonal income	Good education
Originals	Mostly immigrants
Only one employed	Constant income
More legal issues	Small household
Fairly large lands	Good collaterals
Large family	Both employed
	Small lands

Product Developments

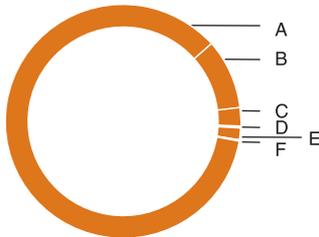
During the year 2006, we successfully launched three products which contributed Rs. 334 million to the turnover in 2006.



1. A low cost slip form house 2. Assisting a Property Developer to obtain CMA Provisional Approval 3. Strategic alliance for Telephone arrangements under home loan 4. Local Government Employees Loan - North-Central Province

Product	No. of Loans	Turnover (Rs. '000)
HDFC Home Loan	207	46
NCP Local Government	420	42
Project Loan	5	246
Total	632	334

Purpose-wise Distribution of Service



A Construction	86%
B Purchase	10%
C Renovation/repair	2%
D Redemption	0%
E Home Loan	2%
F Project Loan	0%

HDFC Home Loan

We identified the difference between a housing loan and a home loan. Housing loan are offered for the physical development of the house and home loans are serviced to convert the house into a home.

We at HDFC, offer assistance to all existing and new mortgage customers to purchase or replace all household items, electrical appliance & accessories, furniture & fittings through Home Finance.

Our vision is **“To improve the physical quality of life with sustainable living and a cultured family”** this we believe would address many domestic, social, cultural and economic issues that constrain the sustainable development of the country. We believe that improvement in the physical quality of life should economically, environmentally and culturally sustainable towards the prosperity of the nation.

During the year, we provided 207 home loans for the value of Rs. 45.52 million.

As part of our strategy, we make strategic alliances with service providers such as telephone service providers and electricity accessory providers to arrange their services for our customers at a cost effective price.

Local Government Employee Loan Scheme

Through the corporation of North-Central Provincial Government, HDFC initiated a programme to assist the lowest grade employees of local authorities in North-Central Province, in housing. Assistance has been provided under this scheme to scavengers, carpenters, drivers and labourers of Local Governments. The target market in the North-Central Provincial Government is 1,400 families and during the year 2006, 420 families were serviced, to the value of Rs. 41.24 million.

The employees of this grade of Government and Local Government sectors are not catered by any structured housing finance scheme or institution. The Bank granted loans under this programme to 420 families.

Housing Project Loan and Developer Assistance Scheme

In terms of encouraging sustainable development in the industry, affordability of housing and maintaining an optimistic product mix, HDFC initiated facilitating property developers, by extending project finance facilities for the individual as well as for corporate property developers at affordable rates.

CSR & Sustainability Report

Through a separate project loan division, HDFC offers a comprehensive support service for real estate developers, in areas such as valuation, legal, technical, preparation of projects and feasibility reports as well as obtaining approval from the Condominium Management Authority (CMA) etc. During the year HDFC granted Rs. 241 million for property development.

Condominium developers are encouraged to obtain provisional condominium approval, before they commence marketing and obtain advances. HDFC does not accept project loan applications prior to CMA provisional approval. This is followed as an ethic to ensure sustainable development.

Subsidiary Operation

The HDFC Bank established its development arm, HDFC Real Estate Development Ltd., in 2005, with a greater vision of:

- Ensuring sustainable development of the industry, within which, the Bank, functions as principal stakeholder
- Enhancing, the Bank's strength and growth to provide a better and diversified service to the following:
 - The segment of the market in which the Bank functions as a principal player; and
 - To its shareholders.

An evaluation of the operations over the last one and half years indicates that the Company has been streamlined to achieve its corporate objectives. The Company is implementing six housing projects in Colombo, Kotikawatta, Avisswella and Ampara and the total investment in these projects up to 31st March 2007 has been Rs. 514 million. The net realisable value of the lands of these projects (having marketable ownership) is Rs. 670 million. The Company has followed corporate strategies in acquiring lands in cost effective ways, from the Government and associated agencies at a low price, on lease or on differed payment basis, in order to minimise the cost of lands for the projects. Furthermore, the Company also plans to finance the construction costs of development projects through local and foreign contractors who undertake construction on one to two year credits.

Improvement in Operational Procedures and Customer Satisfaction

Customer Satisfaction

Quality Policy & Manual

During the year, the HDFC Bank launched a special programme to improve operational efficiency, with a broad based **Quality Policy**, quality objectives and targets for the entire bank and individual service departments and branches. A **Quality Manual**, prepared by a professional quality survey is in place since November 2006 as the master guide.

OUR QUALITY POLICY

HDFC Bank shall constantly strive to innovate and deliver total financial solutions to satisfy the home and lifestyle needs of customers beyond their expectations. This shall be driven by;

- Caring customer service; anticipating requirements and delivering proactive solutions.
- ISO 9001:2000 International Standard based Quality Management System.
- Enhancing the potential of our staff through motivation, development and recognition.
- State-of-the-art information technology and communications systems.
- Continuous improvements based on effective measures and efficient processes.

Internal Customer Satisfaction

Quality **objectives** and **targets** are set in all service departments to improve inter-department operational quality improvement as part of internal customer satisfaction. A periodic internal customer satisfaction survey is conducted by a quality Audit Committee appointed from among members of the staff at all levels of organisation.

The process is planned to study and identify operational bottlenecks, duplications and to suggest corrective measures with quality monitoring and audit techniques. The process also targets to improve office keeping system and documentation flow with a common internal standard.

External Customer Satisfaction

A customer satisfaction survey questionnaire was sent to 6,500 customers representing all branches and market segments, 1,600 of them have responded with their comments and suggestions. Information is being analysed, in order to decide on the customer satisfaction index. The index will be used as the benchmark to develop customer satisfaction in the future.

Branch Performance Recognition

The performance of branches is evaluated on a monthly basis with a uniform performance appraisal system and due consideration on volume and value of loans, recovery ratio, operational cost and budget achievement etc. The branches ranked as the best five performers on overall operation during the last three months are as follows:

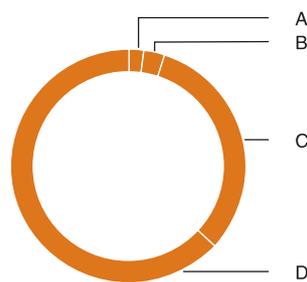
Best Performers	Oct. 06	Nov. 06	Dec. 06
1. Homagama	1	1	1
2. Anuradhapura	2	2	2
3. Matara	2	3	3
4. Galle	4	4	4
5. Ampara	-	5	5
6. Matale	5	-	-

HUMAN RESOURCE DEVELOPMENT & PRODUCTIVITY

Meeting the Challenge

Since its conversion from a Government Corporation to a Licensed Specialised Bank, HDFC has been faced with the challenge of developing its human resources to meet the standards in the competitive banking environment. These challenges were made more acute, in the terms of improving attitude and productivity, in the context of the post conversion scenario, with HR playing the role of a key partner in the task of aligning human resources and business strategies. We record with gratitude, that 75% of staff have adjusted to the needs of the environment that has been partly driven by the improved economy and high career expectations. In general HDFC is proud of having a dedicated and committed human resource.

Staff Strength



A Corporate Management	2%
B Snr. & Exe. Management	3%
C Executive	32%
D Non-Executive	63%

Profile of Human Resource

On average, our employees are 39 years old and have worked at HDFC for an average of 11 years; 52% are women. Out of these employees 58% are professionally qualified in Law, Banking, Accounting and Finance and 27% are graduates.

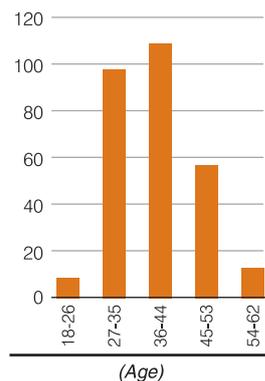
Employee Profile	2006
Average gross salary	349,323
Average other benefits	71,800
Average age (years)	39
Average service period (years)	11
Average absenteeism	10%
Average medical consultation	17,467
Percentage of women	52%
Percentage of graduate	27%
Percentage of professionals (inclusive of banking)	58%
Percentage of employees covered by Collective Agreement	98%
Percentage of employees with disabilities	-
Training days out side workshops	157
Turnover Index	1.7%

An average gross salary of Rs. 349,323/- is far ahead of employees of other State banks.

CSR & Sustainability Report

**HDFC Bank of Sri Lanka
Age Analysis Report**

(Number - Employees)

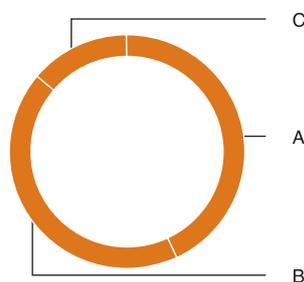


HDFC has achieved constant growth in employee productivity since obtaining banking status. The productivity of our employees in terms of value addition, is far above the service sector employee productivity of Rs. 188,500/- on the same basis.

In terms of the number of loans per employee, labour productivity has increased by 21% over the last three years. This is an important indicator of employee efficiency.

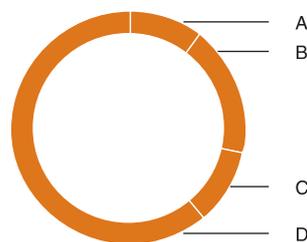
In order to encourage the development of professionals who are prepared to face the competitive environment in which the Company operates, a Competencies Model was introduced for the executive group as part of a Leadership Development Programme. This programme seeks to orient the development of the people who occupy key positions in the Company. The competencies Model, based on the organisation's strategy and current challenges, seeks to assure results (business vision, customer orientation and leadership of people), innovation (doing things differently and development of people) and engagement (influence and communication and the effectiveness of relationships).

Service Analysis of Corporate & Senior Management



A	< 5 years	43%
B	5 < 10 years	43%
C	10 < 15 years	14%

Service Analysis of Executive Management (Branch Managers)



A	< 5 years	10%
B	5 < 8 years	18%
C	8 < 11 years	11%
D	11 < 15 years	61%

HDFC offers financial assistance to employees in all levels of the organisation to obtain recognised professional education in their field of operation especially in Banking and Computers.

Productivity

Productivity Index

	2006	2005	2004
Income per employee (Rs. '000)	4,285	3,641	3,431
Added value per employee	1,490	1,293	1,507
No. of loans per employee	46	25	36

Professional Training and Development

Job enrichment and involvement are two of the areas which HDFC considers as major motivational factors for its employees. We try to create a multi disciplinary workforce by providing both local and foreign training.

Professional Education

	2006	2005
No. of staff registered for Banking Exams	85	14
No. of staff completed Banking Exams	21	1



1. Handing over share certificates under ESOP 2. Nuwara-Eliya Holiday Bungalow 3. Addressing collective agreement signing ceremony by HDFC Branch TU Leader
4. Sustainable Condominium Project financed by HDFC at Wellawatte

Training Offered in Specialised Fields

No. of Employees	Field of Knowledge	Training man-days	
		Local	Foreign
9	New Condominium Property Law	12	–
14	Information Technology	14	10
14	Banking Law	14	–
8	Risk Management	5	–
2	Development of Corporate Bond Market	2	–
10	Low Cost Housing Technology Developments	20	14
3	Innovative Construction	3	–
8	Securitisation	16	–
7	Productivity Development	14	–
4	Reintroduction of Stamp Duty & Applicable Law	4	–
8	Environment Governance	8	–
2	Property Development & Environment	4	–
3	Liquidity Management	3	–
8	Performance Development	8	–
2	Motor Vehicle Maintenance	2	–
101	Total	131	24

a price relatively less than the offered rate, on the basis of the period of service and grade. HDFC's ESOP is the first initiative among State banks toward employee share ownership. The Bank believed that this effort would create a sense of ownership that would enhance dedication and stewardship among employees.

Employee Welfare

Staff welfare is also highly considered by the Bank as a deciding factor in creating a more healthy environment. Medical schemes, death donation and insurance are some of them. During the year Rs. 10.5 million was spent on health, education and other staff welfare activities.

Unitised through Collective Agreement

The management has been improving employee motivation, whilst also maintaining a cordial relationship with the unions to minimise industrial disputes. The **collective agreement** which has been signed **for the first time in 2006** is a major breakthrough in this direction.

There is only one bank union operating in the Bank and almost 98% of the staff are members of the union. During the

signing of the last collective agreement the unity among members was evident through discussions and the final outcome of the agreement.

Motivation through Sharing Ownership

Ownership of the Bank is shared with the employees following the decision to launch the IPO through an organised Employee Share Ownership Programme (ESOP). Under which 5% of the shareholdings were issued to the staff at

Motivation through Participation

The efficient and dedicated staff of the Bank are given equal opportunity to participate in operational committees and sub-committees especially in the process of implementation of the quality manual and preparation of the corporate plan.

The staff also participate voluntarily in marketing and savings promotions.



1. Sacrificing their own time... A promotional campaign by the HDFC staff during their lunch break at Fort Railway Station 2. Educational assistance in North-Central Province
3. Relocation ceremony of Ampara Branch 4. Appreciation of service of an employee who works as a driver 5. Christmas day food distribution by Sports Club

Motivation through Societies

There are number of active sports clubs and welfare associations established by the employees. Annual events are organised on regular basis with the full participation of staff and management. There are cricket, netball and badminton teams in the Bank while 'Banku Puwath' is the quarterly magazine printed by the Welfare Association of the Bank.

Most social welfare events are organised by the staff who have successfully distributed staple food and toys among the needy to commemorate Christmas. At branch level blood donation campaigns are organised.

Service Recognition

As a custom, HDFC appreciates the service of its staff at the time of their retirement and maintains a long-lasting relationship with them.

Capacity Development and Upgrading

Upgrading Work Environment

The HDFC Bank is on the verge of a Rs. 80 million refurbishment plan at its head office building in Colombo 2 to motivate employees, through provision of a better physical environment in the workplace. As at 31st December 2006,

refurbishment of the IT Division was completed at a cost of Rs. 7 million.

During the year, two branch offices were relocated and upgraded with better interior and facilities.

Capacity Upgrading and Enhancing the IT System

We invest a considerable amount of capital on upgrading and developing our IT system to a state-of-the-art uni bank operation during the year, that has put us way ahead among other housing banks. We intend to invest more on ATM and e-commerce application during this year.

CORPORATE SOCIAL PARTICIPATION

- During the year we offered training opportunities in our Bank to 24 under graduates and students of various technical colleges.
- Blood donation campaign organised with NHDA.

In order to create households that lead to the sustainable development of the country, it has been planned to focus on social activities only in the area of good health practices, education and cultural activities. The Company, in the communities where its service is

concentrated, seeks to enhance a more citizen-to-citizen relationship and support local development. Based on this diagnosis, a strategic social investment plan is under development, to be concluded in 2007, the results of which are expected to be more widely felt in 2008.

AWARDS & RECOGNITION

- Winner of National Business Excellence Award in the Financial Services Sector in the year 2004 and 2005, consecutively. The award recognises Sri Lankan enterprises which have demonstrated excellence in business while contributing to the economic progress of the country.
- The Company enjoyed important recognition from the capital market during 2005 at the IPO, where 2,500,000 shares offered to the public were oversubscribed more than 10 times. This reflects the greater recognition and confidence placed by the investors over the corporate sustainability of the Company.
- The achievement of an investment grade classification of A+ from Fitch Lanka Rating Ltd. is an evident of the quality of the Bank's loan portfolio.

- The Brand Finance Lanka Ltd. has after evaluating information available from the Fitch Rating Reports, Annual Reports, Websites, Bloomberg, Central Bank and business sector reports has assessed the brand value at Rs. 127 million and brand power of HDFC Bank as B+. Further, HDFC brand has ranked at 41 among the top 50 brands of listed companies.
(Source: LMD April 2007 issue)
- More positive perception over HDFC is partly reflected in the fact that the capital markets attribute to a market capitalisation (Rs. 1.2 billion) that is nearly two times higher than its equity value (Rs. 640 million).
- Deposit base at HDFC increased from Rs. 1,536 million to Rs. 2,501 million during 2006, a strong indication of the recognition among the players in the financial market.

CHALLENGES

The rapid developments in the housing industry and housing finance sector are challenged by certain impediments which inhibit its growth.

- Absence of long-term sources of funds.
- Mismatch of cash flows in lending institutions for housing.
- Lack of new housing finance instruments.
- Lack of long-term vision on housing development. The housing finance market has concerns about the emergence of new players in the house finance business, such as commercial banks and other financial institutions which have created a dynamic presence in the area of lending, making more options available.

- In addition to the above, a sharp rise in land prices, high salaries and wages in the construction industry, high cost of major building materials and the lack of skilled labour has also restrained the growth of the housing sector.
(CBSL Report 2005 & 2006)

HDFC is mindful of the above threats, and believes that continuous research and the development of new financial instruments, loan products and continuous improvements in productivity and operational efficiency would mitigate these threats to a substantial extent.

However, this needs to be handled with care, with a focus on long-term gain rather than short-term benefits, for sustainable growth in the industry. This is reflected by the fact that most of the housing and condominium projects that have been financed by commercial banks are in the Western Province and other main suburban areas only.

- **The need of governance** is one of the main issues that stakeholders in the industry should address. Real estate forms perhaps the largest asset class in any country and is also the largest source of wealth for families and the nation. It therefore requires a significant amount of governance and needs immediate consideration, in the existing environment of abnormal pricing, competition, accountability, transparency and residents' rights etc. These are the fundamental issues which will ensure long-term sustainability of the industry rather than short-term gains.

LOOKING TO THE FUTURE

Customer Relations

We initiated a further relationship channel with our customers during 2006. An Internet-based tool, the channel offers users, online services and information at a different level to that used for commercial relationships. During 2007, expansion of the customer base with access to this channel is scheduled through ATM and e-commerce facilities and with the implementation of new features designed to simplify the loan approval and disbursement procedure.

New Financial Instruments

New financial instruments are at research level, to raise long-term matching funds. We have no doubt these instruments would be more attractive to investors.

International Grading for Quality Standards

Investment is being made towards overall improvement of operational quality to the best satisfaction of the employees and internal customers as well as our valued home finance seekers as external customers. Our target is to achieve an international recognition for our quality standards for our operation during 2007.

SUSTAINABILITY INDEX 2005 - 2006

		2006	2005
1	Contribution towards Sustainable Development of National Economy		
1.1	In Human Settlement		
1.1.1	Aggregate Service to Enhance Home Ownership		
	Cumulative No. of housing loans (volume since 2000)	98,099	84,410
	Cumulative value of housing Loans (Rs. '000 since 2000)	15,237	11,761
1.1.2	Aggregate Service to increase National Housing Stock		
	Cumulative No. of houses constructed with HDFC assistance	90,300	78,680
	Cumulative Housing Sq. ft. constructed with HDFC assistance	124,210,000	110,011,000
	No. of housing loans granted during the year	13,689	7,276
	Value of housing loans grated during the year (Rs. '000)	3,476	1,824
	No. of houses constructed during the year with HDFC assistance	11,750	6,056
	Sq.ft. of houses constructed during the year with HDFC assistance	14,100,000	7,267,00
1.2	Economic Value Creation (Rs '000)	1,285,642	1,056,423
	Goods & Services purchase	806,386	683,779
	Added value distributed to		
	- Employee (remuneration & benefits)	161,480	144,531
	- Government & community	141,510	103,771
	- Shareholders	64,710	30,612
	- for internal development	109,460	93,730
1.3	Employment Generation	13,050	–
	Direct employments	300	290
	Indirect employment opportunities (calculation based on CBSL)	12,750	–
1.4	Effort to Minimised Development Inequality		
	Percentage of loans granted out of Colombo District	78%	71%
	Percentage of loans granted out of Colombo & Gampaha District	66%	57%
	Percentage of loans granted out of Colombo, Gampaha & kalutara Districts	62%	53%
1.5	Effort to Service the Needy Group		
	Percentage of loans to low income group.	70%	70%
	Percentage of loans to middle income group	22%	20%
	Percentage of loans to wider income group	8%	10%
1.6	Contribution towards Housing Finance Market		
	HDFC contribution towards total housing finance market by volume	10%	7%
	HDFC contribution toards LIG & MIG markets by volume	39%	31%

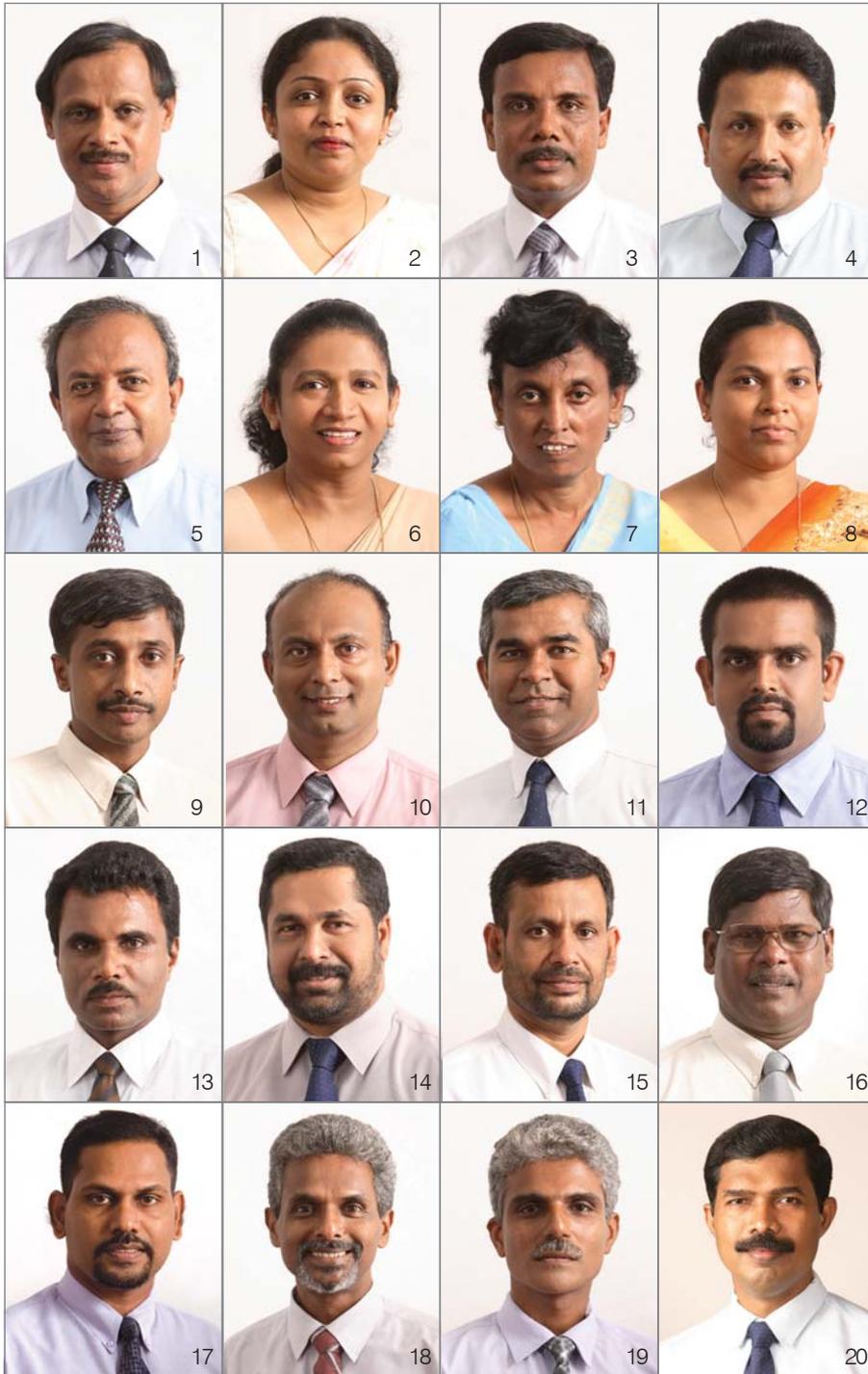
	2006	2005
Contribution towards Sustainable Development of the Industry		
No. of refinancing & savings instruments introduced	1	2
Long-term funds raised from the new instruments (Rs. '000)	750,000	1,000,000
No. new housing loans product introduced	3	2
Additional income from new products (Rs. '000)		241,949
Innovative & cost effective housing products sponsored	1	
Upholding Sustainability Standards In-house		
Productivity & Operational Efficiency		
Added value per employee (Rs 000)	4,285	3,640
No. of loans per employee	45.63	25.09
Average time for processing a loan (days)	20	35
No. of customer complains	* 1,600	–
Employee turnover index	1.7%	3%
Capacity Development		
Total expenses for employee health plan	5,240,092	4,551,591
Average cost per employee for health plan	17,467	15,695
No. of beneficiaries assisted by the health plan	251	269
No. of medical consultations under the health plan	**	**
No. of days spent in hospital covered by the health plan	**	**
Percent of employees covered by collective bargaining agreements	98%	–
Number of permanent employees	300	290
Gross average wage per employee	30,535	28,742
Basic wage per employee	10,517	9,870
Hours dedicated to training and professional development activities	1,256	**
Hours of training and development per employee	4	**
No. of professionally qualified employees (Law, Finance, Banking IT)	166	166
No. of Banking qualified employees	01	01
No. of branches and Service Centres	20	20
No. of Computer terminals per employee	56	55
Capital Expenditure	6,109,086	50,916,735
Environment & Social Participation		
Total commuting KM by fleet vehicles	261,258	359,124
KM commuted per loan	20	49
KM commuted per employee	871	1,238
Cost on social participation	107,592	1,595,648
Percentage of employee participated	40%	25%

Note

* Responses received for the customer satisfaction survey to determine the Customer Satisfaction Index.

** Information is not completed to determine the indexes.

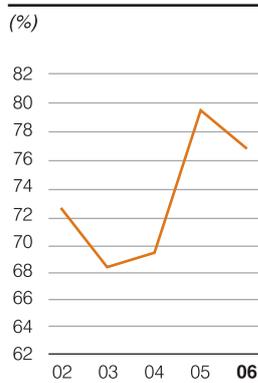
Branch Managers



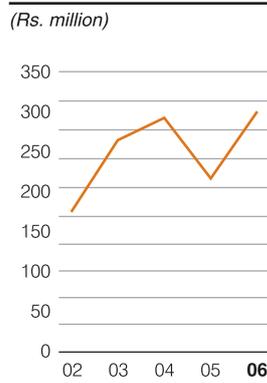
1. Mr. K. Wijesiri
Branch Manager (Chilaw)
2. Ms. I.C. Weerasinghe
Branch Manager (Matara)
3. Mr. N.C. Ranjith
Branch Manager (Galle)
4. Mr. H.M. Thilakaratne
Branch Manager (Matale)
5. Mr. P.L.J. Cooray
Branch Manager (Kalutara)
6. Ms. R.R. Gunawardena
Branch Manager (Colombo)
7. Ms. R.B.E. Uduweriya
Branch Manager (Kurunegala)
8. Ms. N.A.A.N.S. Nissanka
Branch Manager (Kegalle)
9. Mr. U.B.G.P. Balasooriya
Branch Manager (Ampara)
10. Mr. G.D.K.H. Perera
Branch Manager (Anuradhapura)
11. Mr. U.P.A.M.S. Passaperuma
Branch Manager (Nuwara-Eliya)
12. Mr. W.D.K. Senewirathne
Branch Manager (Ratnapura)
13. Mr. G.W.A.N. Kalinda
Branch Manager (Tangalle)
14. Mr. H.M.A.S. Herath
Branch Manager (Kandy)
15. Mr. R.M. Sugathapala
Branch Manager (Badulla)
16. Mr. T. Kandiah
Banking Assistant (Batticaloa)
17. Mr. H.A. Aruna
Branch Manager (Gampaha)
18. Mr. P.V.R.T. Wijerathne
Branch Manager (Monaragala)
19. Mr. W. Gunasinghe
Branch Manager (Homagama)
20. Mr. T.B. Karunabandu
Branch Manager (Ja-Ela)

Financial Review

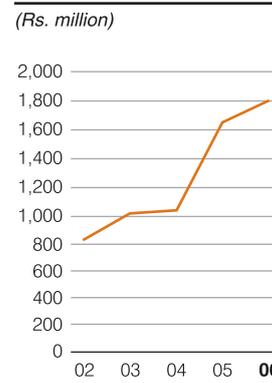
Cost/Income Ratio



Operating Profit



Capital in Hand



INCOME STATEMENT

HDFC Bank showed a significant improvement in profit during the year under review. The net profit before tax rose by 41.9% from Rs. 217.39 million to Rs. 308.6 million. The fee based income of the Bank registered significant increases in contribution to profit increasing by 160% from Rs. 31.61 million in the previous year to Rs. 82.44 million in the year under review. The major part of this increase was attributed to fees derived from legal, technical and valuation services. Thus, the bank was able to increase its profits amidst the diminishing interest spread, by paying more attention to the fee based income as a strategy to mitigate the interest rate risk.

Provision for bad and doubtful debts registered a decrease as the Bank was able to enhance the quality of the loan portfolio.

The dividend quantum was augmented during the year by the enhanced rate of dividend from 5% to 10% by 100% compared to the previous year.

The profit before tax per employee has enhanced to Rs. 1,082,948/- which is an increase of 44% over the previous year figure of Rs. 749,624/-.

VALUE ADDED STATEMENT

The Value Added Statement includes the value added to the banks services by the collective effort of capital, management, employees and Government and thus represents also the reward extended to these factors.

During the year under review, the Bank has provided Rs. 64.71 million to shareholders compared to Rs. 30.61 million in the previous year. This is an increase of 111%, in the form of dividend. The Bank also has transferred Rs. 107.76 million compared to Rs. 86.15 million in the previous year towards the reserves which become a capital gain to which shareholders are entitled.

The funds remitted to the Government as taxes amounted to Rs. 139.72 million in 2006, an increase of 137% over the amount transferred in 2005 amounting

to Rs. 103.77 million. The amount of tax paid during the year is more than 50% of the profits for year.

BALANCE SHEET

The growth in total assets of the Bank was 20.19% and that of the shareholders funds was 9.25%.

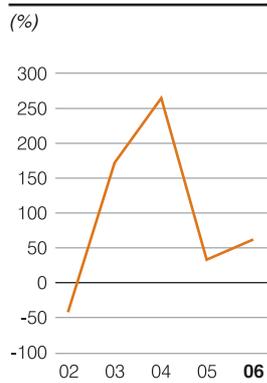
The loans and advances increased by 25% to Rs. 10,133 million the highest portfolio balance among housing finance institutions. The intrinsic value of the Bank's share, based on the net asset value amounts to Rs. 278.16 as at 31st December 2006 which is much higher than the actual market price fetched at the Stock Exchange as at that date.

CAPITAL & LIABILITY STRUCTURE

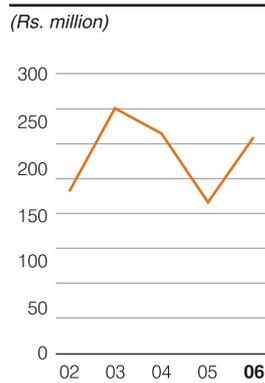
The capital adequacy computation given on page 66 gives the composition of the regulatory capital and risk weighted assets. The regulatory capital of the Bank is significantly above the minimum of 10% and 5% applicable to Tier I and II respectively on 31st December 2006.

Financial Review

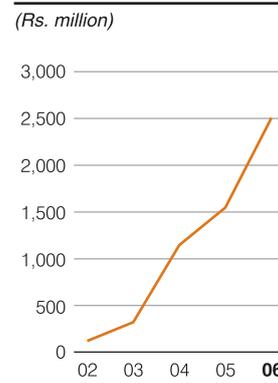
Deposits Growth



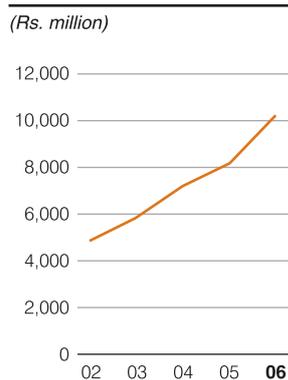
Profit on Ordinary Activities Before Tax



Value of Deposits



Loans & Advances



Interest bearing liabilities accounted for 77.44% of the total liabilities and shareholders' funds on 31st December 2006, as compared to 74.66% one year ago. Deposits from customers have increased by 67% from Rs. 1536 million on 31st December 2005 to Rs. 2,501 million on 31st December 2006.

INVESTORS' RATIOS

	2006	2005
a. Earnings per Share (Rs.)	27.39	26.71
Earnings per share has been slightly reduced due to repayment of shares owned by ETF as per provisions in the HDFC Act.		
b. Dividend per Share (Rs.)	10.00	5.00
Dividend per share was increased during the year as committed at the Annual General Meeting of 2005 and to consider a reasonable dividend yield to shareholders.		
c. Dividend Cover	2.74	3.81
d. Price Earnings Ratio	6.38	7.15
e. Gross Dividend Yield (%)	5.72	2.62
f. Earnings Yield (%)	15.67	13.98
g. Net Assets per Share (NA) (Rs.)	278.16	268.33
h. Return on Average Assets (ROA) (%)	1.77	1.44
i. Return on Equity (ROE) (%)	9.61	7.13

NA, ROA and ROE have increased as a result of increased profits during the year.

Product Portfolio



Home loan schemes for low and middle income families

Attractive Interest Rates (p.a.)

Repayment up to 20 years (Age 70)



Loan for EPF Members. Special Loan within three working days



Value Added Hassle Free Home Loan (with income tax relief)

Ancillary services are provided regarding local authority and land registry matters



Guru Sevana - for Government Teachers

On Personal Guarantees

Repayable in five years



Minors Savings Account with added benefits of loan for the Parent of a concessionary rate of interest for the balance period until the age of maturity

Thilina Children's Savings Intelligent Gift for Children

Thilina Home Loan

A mortgage loan up to 4 times of the balance in Savings Account

Shramoda

4% mortgage loan for EPF members (up to Rs. 300,000/-)



HDFC Bank has innovated a **"Home Loan" on remortgage of a property to purchase furniture, electrical goods, landscaping, curtaining etc.** for existing customers

Loans against Fixed Deposits

Cash Margin Home Loan

Interest Rates (p.a.) 2.5% over the FD rate loan amount 90% of the FD

Guarantor Loan

Personal Guarantors for Employees of selected Organisations

Repayment period 5 years



Vishrama Udana Savings
A Fixed Deposit Scheme for Senior Citizens over 55



Prathilaba Savings
Regular Savings Account

Risk Management

The prime objective of Risk Management is to prepare the background for staff to carry out operations to manage the volatility of return of the Bank in a manner that meets with stakeholder expectations.

CREDIT RISK

Credit risk can be defined as the potential loss arising from the non-repayment of capital or interest in full within the agreed time frame at the agreed rates.

The Bank has a well defined credit policy with clear guidelines and procedures targeted towards maintenance of a quality credit portfolio. The Bank focused its attention on managing credit risk through the development of various risk mitigating practices effective at minimising risks. Comprehensive credit evaluation, sector limits, risk based pricing, and strict maintenance of Loan to Value (LTV) ratio (which reflects the willingness to repay), Instalment to Income (ITI) ratio (which determine the capacity to repay) and the credit reputation of the borrower (which refers to history of fulfilling his financial obligations), are a few of these measures. The table below indicates the success of these processes.

Maturity Profile of Assets & Liabilities (Rs. million)

Months	0-3	3-12	13-36	37-60	61>	Total
Total assets	466	986	2,500	2,401	4,352	10,704
Liabilities	2,630	1,820	1,243	1,447	1,764	8,904
Shareholders	-	-	-	-	1,800	1,800
Total liabilities	2,630	1,820	1,243	1,447	1,762	10,701

Year	2002	2003	2004	2005	2006
NPL Ratio %	24.67	20.95	17.32	17.55	18.13

LEGAL RISK

Legal risks arise from inadequate documentation, inability to meet regulatory requirements, legal or regulatory incapacity and uncertainty in the enforcement of contracts. Such risks are managed through the use of advice obtained from the Bank's Legal Department and from the Compliance Officer. The advice of an external council is obtained in appropriate circumstances.

The Bank has complied with all statutory and other legal requirements and continues to update and maintain a detailed list of these requirements, which it is obliged to fulfil as a bank, taxpayer, employer and listed company.

OPERATIONAL RISK

Operational risk is the potential risk arising as a result of processing errors, systems and procedural failures, human error, fraud, natural disasters and non-compliance with internal policies, external laws and regulations. While operational risk can never be fully eliminated, the Bank endeavours to minimise it by continuously assessing and refining the systems of internal controls. An effective compliance

function has also been designed, and is in place since June 2006, to ensure adherence to both internal policies and regulations as well as external regulatory and statutory requirements.

The internal audit function, which is an integral part of this control framework, assists in identifying, evaluating and mitigating operational risks.

INTEREST RATE RISK

The Bank also incorporates suitable penalty conditions on premature settlement of fixed tenor loans to avoid any likely loss due to difference in interest rates between the current rate and rate lent.

HDFC's financial result is subject to adverse effects for the short-term volatility of market interest rates leading to an uncertainty in the spread earned on the loan portfolio particularly due to its long-term nature. However, the interest rate risk has been reduced to a great extent by obtaining matching long-term funds from long-term debt instruments such as mortgage securitisation to finance the loan portfolio. Cost of funds is reviewed on a monthly basis, and new loans priced accordingly to ensure maintenance of a fair spread.

REPUTATION RISK

An organisation's reputation is its greatest asset. In order to maintain the Bank's reputation and preserve the confidence of its various stakeholders, the Bank has now in place an effective compliance system.

Audit & Management Committee Report

1. CONSTITUTION OF THE AUDIT AND MANAGEMENT COMMITTEE

The Audit and Management Committee consists of three Non-Executive Directors of the Board. The Director who represents the General Treasury acts as the Chairman of the Committee. During the Financial year ended 31st December 2006, the following Board members served on the Audit and Management Committee.

Mr. P. Sumanapala (*Chairman of the Committee*)

Mr. W.A.T. Fernando

Mr. Sunil Kannangara

The General Manager/Chief Executive Officer, Deputy General Manager (Finance) and Deputy General Manager (Credit) attend meetings by invitation. The Chief Internal Auditor functions as the Secretary to the Committee. A representative officer of the Auditor-General's Department attends meetings as external auditor.

2. THE FUNCTIONS OF THE AUDIT AND MANAGEMENT COMMITTEE

The functions of the Audit and Management Committee are to review and monitor the achievement of objectives of the internal audit control systems of the Bank to ensure they are met more effectively and efficiently, and to recommend modifications where necessary.

During the year under review, the Committee focussed on the following matters to achieve the objectives of the Committee.

- a. Review and implementation of Internal controls
- b. Review and approval of Internal Audit Plan
- c. Monitoring of the functions of the Internal Auditor
- d. Periodic review of Internal Audit reports.
- e. Review and comparison of the quarterly performance of the Bank against budget.
- f. Review of compliance procedures with regard to the Laws applicable to bank activities and the policies of the Bank
- g. Compliance of the operational activities of the Bank with statutory requirements.
- h. Review of matters raised by the Auditor-General in the report in terms of Section 14 (2) (c) of Finance Act No. 38 of 1971 for the year 2005.

The Bank adopted new accounting policies, including, in particular, loan loss provision criteria to comply with Sri Lanka Accounting Standards and Central Bank guidelines. The financial statements are now presented in accordance with these standards and best practices in the banking sector.

3. INTERNAL AUDIT DIVISION

Under the guidance of the Audit Committee, the approved Internal Audit work plan was carried out by the Internal Audit Division of the Bank during the year under review. In addition to this, special investigating audits were carried out by the Internal Audit Division of the Bank as required by the Audit and Management Committee and the Chief Executive Officer of the Bank.

Further the Internal Audit Division conducted audits in branches to achieve the following objectives.

- a. Review of Internal controls
- b. Compliance with statutory requirements.
- c. Prevention and detection of frauds and errors

4. MEETINGS

In accordance with the guidelines of the General Treasury Circular No. IAI/2000/I, the Audit and Management Committee of the Bank held its meetings on a quarterly basis. During the financial year ending 31st December 2006, four Audit Committee meetings were held and some deficiencies were observed by the Committee. The Committee had submitted its comments on these deficiencies and remedial measures were taken by the Management, accordingly.

(Sgd.)

P. Sumanapala

Chairman

Audit & Management Committee

Directors' Report

GENERAL

The Directors have pleasure in presenting to the members their Report together with the audited financial statements of the Housing Development Finance Corporation Bank of Sri Lanka, (hereinafter referred to as the HDFC Bank) a licensed specialised Bank incorporated in Sri Lanka under the provisions of Housing Development Finance Corporation Act No. 07 of 1997. The said Act was amended by Act No. 15 of 2003, by which the Bank is empowered to engage in banking business as a licensed specialised bank. The HDFC Bank was quoted in Colombo Stock Exchange in November 2003.

PRINCIPAL ACTIVITIES

The principal activity of the Bank continues to be granting loans and other forms of financial assistance for housing purposes and for the redemption of housing credit facilities obtained from recognised financial institutions.

How ever, the Bank has expanded its business during the last financial year, significantly by entering into the project lending sector through a specially formed unit. The aforesaid project lending unit had further strengthened the Banks performance towards its high volume loan portfolio, enhancing the profitability of the Bank by providing high yield credit facilities to the individuals, firms and companies which engage in housing construction business.

Further, the Bank in the latter part of the respective year started various fund mobilisation campaigns and still in the

process of promoting the savings schemes of the Bank. The aforesaid loan schemes were specifically designed, and would benefit the customers who save with the HDFC Bank to obtain speedy loans at a low rate of interest.

The Bank has further expanded its business by entering into the real estate sector through the HDFC (Real Estate and Development) Ltd. [hereinafter referred to as the HDFC (RED)], which is a subsidiary of the HDFC Bank. The Bank hope to generate excellent profits through HDFC (RED), as the HDFC (RED), during a short period, dealt with highly commercialised properties, which were purchased by the Company for very moderate rates from various private individuals and corporations. The HDFC (RED) is planning to construct condominium apartments equipped with semi-luxury facilities while ensuring new township concept and helping the society to solve the problems created due to the shortfall of housing stocks of the country.

FUTURE DEVELOPMENT

The HDFC Bank is planning to widen the scope of the Bank in order to facilitate the bank to enhance the banking business, by diversifying its business towards various sectors, such as insurance, pawnbroking, Islamic banking and acting as a special purpose vehicle for securitisation, etc.

The HDFC Bank, being the only bank in Sri Lanka incorporated by the Government specifically for the purpose of carrying out the national

policy on housing, is planning to provide consultancy services which are required by its customers to build their dream home.

Therefore the bank has already taken measures to widen the scope of the Bank, up to the extent of a *life style bank*, and is highly keen in providing all types of loans or facilities related to housing or housing needs of the society. However, the final goal of the HDFC Bank is to develop it as a fully fledged bank.

REVIEW OF BUSINESS

The Chairman's Review on page 2 and the Chief Executive Officer/General Manager's Report on page 6 provide an overall assessment on the financial performance and financial position of the Bank. The aforesaid reports describe in detail the affairs of the Bank and important events that had taken place during the year reviewed, forming an essential part of the Directors Report.

SYSTEM OF INTERNAL CONTROLS

The internal control systems setup by the Board of Directors to control the systems of the Bank plays a very vital role, as it helps to safeguard the assets as well as the goodwill of the Bank while securing the accuracy of its records.

The HDFC Bank, being a licensed specialised bank is always highly concerned about the systems adopted by the Bank to control the functions of the Bank, as internal control systems of the Bank directly influence the reputation.

Therefore, the HDFC Bank has set up a separate Compliance Department in order to monitor all the functions of the Bank. The HDFC Bank presently adopts a very comprehensive system of internal control through its several Management/ Board Sub-Committees in addition to the Compliance Department, which are enlisted below.

Human Resource
Audit and Management Committee
Recovery Sub-Committee
Assets and Liability Committee
Valuation Review Committee

VISION, MISSION AND OBJECTIVE

The Bank's Vision, Mission and Objectives are given on Inner Front Cover of this report. The business activities of the Bank are conducted with the highest level of ethical standards in achieving its Vision and Mission.

RISK MANAGEMENT

Specific steps taken by the Bank in managing both banking and non-banking risks associated with the Bank are detailed on page 38 of this report.

PROFITABILITY

The recorded profit and the details compared with the previous year is given in page 48 of this report.

DIVIDEND

The Directors recommended a dividend payment (final) of Rs. 10/- per share for the year 2006.

PROPERTY, PLANT & EQUIPMENT

Capital expenditure on property, plant and equipment amounts to Rs. 84,815,685/- details, of which are given in Note 15 of the financial statements.

RESERVES

The total reserves of the Bank stood at Rs. 1,153,377,906/- as at 31st December 2006, details of which are given in Note 21 to the financial statements.

DIRECTORS

The Board of Directors of HDFC Bank of Sri Lanka consists of nine Directors some of whom are very senior public servants, with wide financial, administration and legal knowledge and experience and private sector exposure.

The following were the Directors of the HDFC Bank during the year:

Mr. S.M.M. Yaseen - *Chairman*
Mr. Sunil Kannangara - *Director*
Mr. K.D. Ranasinghe - *Director*
Mr. L.P. Andrahennadi - *Director*
Mr. W.A.T. Fernando - *Director*
Mr. W.J.L.U. Wijeyaweera - *Director*
Mr. P. Sumanapala - *Director*
Mr. M.I.M. Rafeek - *Director*
Mr. M.M. Abul Kalam - *Director*

The following were the Directors of the HDFC (RED) during the year:

Mr. S.M.M. Yaseen -
The Chairman of the HDFC Bank
Mr. Sunil Kannangara -
Director of the HDFC Bank
Mr. M.I.M. Rafeek
Director of the HDFC Bank
Mr. L.P. Andrahennadi
Director of the HDFC Bank
Mr. C.A. Sarathchandra
The General Manager/CEO of the HDFC Bank

APPOINTMENTS AND RESIGNATIONS

Mr. M.M. Abul Kalam and Mr. M.I.M. Rafeek were appointed to the Board as shareholding Directors of the Bank, at the last Annual General Meeting.

DIRECTORS' RESPONSIBILITY FOR FINANCIAL REPORTING

Directors are responsible for the preparation of the financial statement of the Bank, to reflect a true and fair view of the Bank's affairs. The Directors are of the view that the financial statements have been prepared in conformity with requirements of the Sri Lanka Accounting Standards, Companies Act No. 17 of 1982, Banking Act No. 30 of 1988 (and its amendments) and the listing rules of the Colombo Stock Exchange. The details are given on the Directors' Responsibility for Financial Reporting.

DIRECTORS' INTEREST IN ORDINARY SHARES

As at		01.01.2006	31.12.2006
Mr. S.M.M. Yaseen	Chairman	-	1,000
Mr. Sunil Kannangara	Director	300	300
Mr. K.D. Ranasinghe	Director	-	-
Mr. L.P. Andrahennadi	Director	300	300
Mr. W.A.T. Fernando	Director	100	100
Mr. W.J.L.U. Wijeyaweera	Director	300	300
Mr. P. Sumanapala	Director	-	-
Mr. M.I.M. Rafeek	Director	-	-
Mr. M.M. Abul Kalam	Director	-	-

Directors' shareholdings have not changed subsequent from the date of the Balance Sheet up to 29th May 2007 being one month prior to the date of Notice of the Annual General Meeting.

EMPLOYEE SHARE OPTION PLAN

The Employee Share Ownership Plan which was introduced by the Bank on the approval of the shareholders, benefits permanent employees of the bank. Through the share trust which was set up by the Bank acquiring 5% of the voting ordinary shares at Rs. 143/- per share from the issued capital. The total number of shares issued to the Trustee under the above category is 348,522.

DIRECTORS' INTERESTS IN CONTRACTS

No Directors have any material interest in any transaction or proposed contract involving HDFC Bank of Sri Lanka other than those disclosed in Note 23 of the Accounts on page 61 of this report.

ENVIRONMENTAL PROTECTION

The Bank has not engaged in any activity, which has a direct impact on the environment. Specific measures taken to protect the environment are given in the Social and Environmental Performance Report.

STATUTORY PAYMENTS

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

CONTRIBUTIONS MADE TOWARDS CHARITY

Contributed sum of Rs. 107,592/- towards charity, (For construction of Houses for underprivileged and Disaster Assistance Fund).

DEBENTURE ISSUED

S/No.	Date of issued	No. of Debentures	Consideration Rs.	Class	Purpose
02	18.04.2006	-	25,000,000	Unsecured	For housing finance
03	18.05.2006	-	40,000,000	Unsecured	For housing finance
04	19.05.2006	-	10,000,000	Unsecured	For housing finance
05	16.06.2006	-	10,000,000	Unsecured	For housing finance
06	26.06.2006	-	75,000,000	Unsecured	For housing finance

Total Debentures issued Rs. 160,000,000/- (in 2006)

NEW SHARES ISSUED - 2006

S.No.	Date of Issued	Number of Shares	Consideration Rs.	Class	Remarks
001798	28.06.2006	348,522	49,839,000	Ordinary	Issued to the Trustee [Legalinc Trustee Services (Pvt.) Ltd.] on behalf of employees of HDFC Bank, under the ESOP above mentioned.

EVENTS AFTER THE BALANCE SHEET DATE

There have not been any material events that occurred subsequent to the Balance Sheet date. Those require adjustments to the financial statements other than those disclosed if any, are mentioned in Notes to the financial statements.

GOING CONCERN

The Board of Directors is satisfied that the Bank has adequate resources to continue its operations in the foreseeable future. Accordingly, the financial statements are prepared based on the going concern concept.

APPOINTMENT OF AUDITORS

The Auditor-General continues to be the Auditor of the Bank as stipulated in the HDFC Act No. 07 of 1997.

CORPORATE GOVERNANCE

Systems and procedures are in place to ensure that the corporate governance is properly practised. Specific measures taken in this regard are elaborated in Corporate Governance on page 12 of this report.

NOTICE OF THE MEETING

Notice of the Meeting in respect of the 22nd Annual General Meeting of the HDFC Bank is given on page 67.

By Order of the Board

The Secretary of the Bank

2007 Colombo of the HDFC Bank

Financial Report

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Auditors' Report



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கணக்காய்வாளர் தலைமை அறிப்பதி திணைக்களம்
AUDITOR GENERAL'S DEPARTMENT



මගේ අංකය } TH/F/HDFCB/2006
எனது இல }
My No. }

මගේ අංකය }
உமது இல }
Your No. }

දිනය } 01 June 2007
நிகதி }
Date }

The Chairman
Housing Development Finance
Corporation Bank of Sri Lanka

**Report of the Auditor General on the Financial
Statements of the Housing Development Finance
Corporation Bank of Sri Lanka for the year ended
31st December 2006 in terms of Section 14 (2) (c) of
the Finance Act, No.38 of 1971**

The audit of financial statements of the Housing Development Finance Corporation Bank of Sri Lanka for the year ended 31 December 2006 was carried out under my direction in pursuance of provisions in Article 154 (1) of the Constitution of the Democratic Socialist Republic of Sri Lanka read in conjunction with Section 26 (2) of the Housing Development Finance Corporation of Sri Lanka Act No. 7 of 1997 as amended by the Amendment Act, No.15 of 2003 and Section 13 (1) of the Finance Act, No.38 of 1971. My observations which I consider should be published with the Annual Report of the Bank in terms of Section 14 (2) (c) of the Finance Act appear in this report. A detailed report in terms of Section 13 (7) (a) of the Finance Act will be issued to the Chairman of the Bank in due course.

1.2 Scope of Audit

Audit opinion, comments and findings in this report are based on a review of the financial statements presented to audit and substantive tests of samples of transactions. The scope and the extent of such review and tests were such as to enable as wide an audit coverage as possible within the limitations of staff, other resources and time available to me. The

audit was carried out in accordance with Sri Lanka Auditing Standards, methods and practices to obtain reasonable assurance as to whether the financial statements are free of material misstatements. The audit included examination of evidence supporting the amounts and disclosures in the financial statements and assessment of accounting principles and significant estimates and judgements made in the preparation of financial statements, evaluation of their overall presentation and determining whether accounting policies adopted were appropriate, consistently applied and adequately disclosed. Sub-sections (3) and (4) of Section 13 of the Finance Act, No. 38 of 1971 give discretionary powers to the Auditor General to determine the scope and extent of the audit.

2. Financial Statements

2.1 Opinion

So far as appears from my examination and to the best of my information and according to the explanations given to me, I am of opinion, that the Housing Development Finance Corporation Bank of Sri Lanka had maintained proper books of account for the year ended 31 December 2006 and except for the effects on the financial statements of the matters referred to in paragraph 2.2 of this report, the financial statements which are in agreement with the said books have been prepared and presented in accordance with Sri Lanka Accounting Standards and the stated Accounting Policies and Notes (from Note No. 1 to 21) to the financial statements and give a true and fair view of the financial position of the Housing Development Finance Corporation Bank of Sri Lanka as at 31 December 2006 and the results of its operation and the cash flows for the year then ended.

Consolidated Income Statement

<i>For the year ended 31st December</i>		Bank		Group	
Notes	2006 Rs.	2005 Rs.	2006 Rs.	2005 Rs.	
Income	1,285,642,929	1,056,033,100	1,285,642,929	1,056,147,971	
Interest income	1,203,197,279	1,024,414,755	1,203,197,279	1,024,529,627	
Interest expenses	(699,383,755)	(568,407,324)	(699,782,561)	(568,407,324)	
Net interest income	503,813,524	456,007,431	503,414,718	456,122,302	
Non-interest income	82,445,650	31,618,344	82,445,650	31,618,344	
	586,259,175	487,625,776	585,860,369	487,740,647	
Less: Non-interest expenses					
Personnel costs	133,688,384	126,570,333	135,981,017	127,277,673	
Provision for staff retirement benefits	25,358,523	17,960,861	25,509,637	18,003,146	
Premises equipment & establishment expenses	41,669,791	42,365,190	41,699,991	42,368,036	
Operating expenses	71,650,509	66,334,111	73,875,627	65,325,650	
Provision for loan losses	5,251,556	17,004,204	5,251,556	17,004,204	
	277,618,763	270,234,699	282,317,828	269,978,709	
Operating profit on ordinary activities before Tax	308,640,412	217,391,077	303,542,540	217,761,938	
Less: VAT on financial services	69,689,628	55,033,636	69,689,628	55,033,636	
Operating profit on ordinary activities before corporate tax	238,950,784	162,357,441	233,852,912	162,728,302	
Less: Provision for taxation	66,476,350	45,585,769	66,476,350	45,585,769	
Profit on ordinary activities after tax	172,474,433	116,771,672	167,376,562	117,142,533	
Extraordinary items	–	–	–	–	
Retained profit/(Accumulated losses) b/f	656,286,378	575,965,790	656,657,239	575,965,790	
Profit available for appropriation	828,760,811	692,737,462	824,033,801	693,108,323	
Appropriations	–	–	–	–	
Transfer to special reserve	–	–	–	–	
Transfer to reserve funds	8,623,722	5,838,584	8,623,722	5,838,584	
Dividends	64,710,220	30,612,500	64,710,220	30,612,500	
Retained profit carried forward	755,426,870	656,286,378	750,699,859	656,657,239	
Earnings per share	27.39	26.71	26.58	26.79	

Consolidated Balance Sheet

As at 31st December	Notes	Bank		Group	
		2006 Rs.	2005 Rs.	2006 Rs.	2005 Rs.
Assets					
Cash & short-term funds	9	150,855,715	151,630,493	151,129,002	152,107,160
Investment in Government securities	10	201,641,120	209,408,902	201,641,120	209,408,902
Investment in commercial papers			200,000,000	–	200,000,000
Loans & advances	11	10,133,955,075	8,100,051,815	9,956,655,075	7,922,051,816
Interest receivable	12	21,255,737	27,635,528	21,255,737	27,635,528
Housing projects	13	–	–	434,277,614	332,701,735
Investment in subsidiaries - HDFC RED		25,000,000	25,000,000	–	–
Other assets	14	87,333,651	34,016,427	87,230,421	34,393,425
Property, plant & equipment	15	84,815,685	85,523,480	85,497,576	85,547,080
Total assets		10,704,856,983	8,833,266,645	10,937,686,546	8,963,845,646
Liabilities					
Deposits from customers	16	2,501,242,726	1,536,747,799	2,501,242,726	1,536,747,799
Borrowings	17	5,206,588,689	4,965,666,139	5,406,588,689	4,965,666,139
Taxation payable	18	30,449,114	4,423,991	30,449,114	4,423,991
Other liabilities	19	1,166,096,347	683,551,470	1,203,652,921	813,759,610
Total liabilities		8,904,376,877	7,190,389,399	9,141,933,451	7,320,597,538
Shareholders' Funds					
Share capital	20	647,102,200	612,250,000	647,102,200	612,250,000
Reserves	21	1,153,377,906	1,030,627,246	1,148,650,895	1,030,998,108
		1,800,480,106	1,642,877,246	1,795,753,095	1,643,248,108
Total liabilities & shareholders' funds		10,704,856,983	8,833,266,645	10,937,686,546	8,963,845,646

(Sgd.)
M.M. Yaseen
Chairman

(Sgd.)
M.M. Abdul Kalam
Director

(Sgd.)
C.A. Sarathchandra
CEO/General Manager

(Sgd.)
S. Dissanayake
DGM (Finance)

9th May 2007
Colombo

Consolidated Cash Flow Statement

<i>For the year ended 31st December</i>	2006 Rs.	Bank 2005 Rs.	2006 Rs.	Group 2005 Rs.
Cash Flows from Operating Activities				
Interest received	1,209,577,069	1,015,189,356	1,209,747,469	1,015,304,228
Interest payments	(778,257,526)	(507,318,481)	(778,257,526)	(507,318,481)
Receipt from other operating activities	82,445,650	31,618,344	82,445,650	31,618,344
Cash payments to employees & suppliers	(182,576,312)	(178,396,417)	(185,000,165)	(179,146,042)
Payments on other operating activities	(137,619,208)	(121,367,747)	(138,627,492)	(121,812,132)
Operating profit before changes in operating assets	193,569,674	239,725,056	190,307,937	238,645,917
(Increase)/Decrease in Operating Assets:				
Funds advanced to customers	(2,039,854,815)	(820,162,762)	(2,039,854,815)	(820,162,762)
Housing project	–	–	(64,788,962)	(332,701,735)
HDFC RED loan	700,000	(178,000,000)	–	–
Other assets	(3,478,579)	(10,177,777)	(3,101,579)	(10,554,777)
	(2,042,633,394)	(1,008,340,539)	(2,107,745,356)	(1,163,419,273)
Increase/(Decrease) in Operating Liabilities				
Deposits from customers	964,494,927	396,255,507	964,494,927	396,255,507
Others	34,020,923	43,499,000	34,020,923	175,157,140
	998,515,850	439,754,507	998,515,850	571,412,647
Net cash from operating activities before income tax	(850,547,870)	(328,860,976)	(918,921,569)	(353,360,709)
Income tax & deemed dividend tax paid	(44,172,157)	(55,530,588)	(44,172,157)	(55,530,588)
Net cash from operating activities	(894,720,027)	(384,391,564)	(963,093,726)	(408,891,298)
Cash Flows from Investing Activities				
(Purchase)/Sale of investment securities	200,000,000	(200,000,000)	200,000,000	(200,000,000)
Investment in subsidiaries	–	(25,000,000)	–	–
Acquisition of property, plant & equipment	(6,109,086)	(7,148,825)	(6,773,278)	(7,172,425)
Disposal of Motor vehicles	1,337,965	–	1,337,965	–
Net cash from investing activities	195,228,879	(232,148,825)	194,564,687	(207,172,425)
Cash Flows from Financing activities				
Issue/(Redemption) of shares	–	550,000,000	–	550,000,000
Redemption of shares	–	(50,000,000)	–	(50,000,000)
Repayment of borrowings	(1,343,317,039)	(1,098,696,816)	(1,343,317,039)	(1,098,696,816)
Proceeds from borrowings	1,584,239,590	1,750,554,380	1,652,584,670	1,750,554,380
Dividends paid	(32,762,400)	(18,497,250)	(32,762,400)	(18,497,250)
Net cash from financing activities	208,160,151	1,133,360,314	276,505,231	1,133,360,314
Net increase in cash & cash equivalents	(491,330,998)	516,819,925	(492,023,809)	517,296,592
Cash & cash equivalents at beginning of the period	267,804,310	(249,015,615)	268,280,977	(249,015,615)
Cash & cash equivalents at the end of the period	(223,526,688)	267,804,310	(223,742,832)	268,280,977
Reconciliation of Cash and Cash Equivalents				
Cash & short-term funds	150,855,715	151,630,493	151,129,002	152,107,160
Government of Sri Lanka Treasury bills	201,641,120	209,408,902	201,641,120	209,408,902
Borrowings from banks	(576,023,523)	(93,235,085)	(576,512,954)	(93,235,085)
	(223,526,688)	267,804,310	(223,742,832)	268,280,977

Consolidated Statement of Change in Equity

Bank

For the year ended 31 st December 2006

	Share Capital	Share Premium	Revaluation Reserve	Statutory Reserve Fund	Special Reserves	Profit & Loss Accounts	Total
	Rs. '000	Rs. '000	Rs. '000	Rs. '000	Rs. '000	Rs. '000	Rs. '000
Balance as at 01.01.2005	412,250	—	—	21,283	3,451	575,966	1,012,950
Net profit for the year	—	—	—	—	—	116,772	116,772
Surplus on revaluation	—	—	43,768	—	—	—	43,768
Dividend proposed	—	—	—	—	—	(30,613)	(30,613)
Issue of shares	250,000	300,000	—	—	—	—	550,000
Redemption of share	(50,000)	—	—	—	—	—	(50,000)
Transfer to statutory reserve	—	—	—	5,839	—	(5,839)	—
Balance as at 31.12.2005	612,250	300,000	43,768	27,122	3,451	656,286	1,642,877
Balance as at 01.01.2006	612,250	300,000	43,768	27,122	3,451	656,286	1,642,877
Net profit for the period	—	—	—	—	—	172,474	172,474
Surplus on revaluation	—	—	—	—	—	—	—
Dividend proposed	—	—	—	—	—	(64,710)	(64,710)
Issue of shares	34,852	14,986	—	—	—	—	49,839
Transfer to special reserve fund	—	—	—	8,624	—	(8,624)	—
Balance as at 31.12.2006	647,102	314,986	43,768	35,746	3,451	755,427	1,800,480

Group

For the year ended 31st December 2006

	Share Capital	Share Premium	Revaluation Reserve	Statutory Reserve Fund	Special Reserves	Profit & Loss Accounts	Total
	Rs. '000	Rs. '000	Rs. '000	Rs. '000	Rs. '000	Rs. '000	Rs. '000
Balance as at 01.01.2005	412,250	—	—	21,283	3,451	575,966	1,012,950
Net profit for the period	—	—	—	—	—	117,143	117,143
Surplus on revaluation	—	—	43,768	—	—	—	43,768
Dividend proposed	—	—	—	—	—	(30,613)	(30,613)
Issue of shares	250,000	300,000	—	—	—	—	550,000
Redemption of share	(50,000)	—	—	—	—	—	(50,000)
Transfer to special reserve fund	—	—	—	5,839	—	(5,839)	—
Balance as at 31.12.2005	612,250	300,000	43,768	27,122	3,451	656,657	1,643,248
Balance as at 01.01.2006	612,250	300,000	43,768	27,122	3,451	656,657	1,643,248
Net profit for the period	—	—	—	—	—	167,377	167,377
Dividend proposed	—	—	—	—	—	(64,710)	(64,710)
Issue/(Redemption) of shares	34,852	14,986	—	—	—	—	49,839
Transfer to special reserve fund	—	—	—	8,624	—	(8,624)	—
Balance as at 31.12.2006	647,102	314,986	43,768	35,746	3,451	750,700	1,795,753

Maturity Analysis as at 31st December 2006

An analysis of the interest bearing assets and liabilities based on the remaining period at the Balance Sheet date to the respective contractual maturity date is as follows.

Assets	Up to 3 Months	3 to 12 Months	1 to 3 Years	3 to 5 Years	More than 5 Years	Total
Cash & short-term funds	150,856	–	–	–	–	150,856
Investment in Government securities	500	90,000	111,141	–	–	201,641
Loans & advances	269,702	880,802	2,351,025	2,401,050	4,231,376	10,133,955
Interest receivable	21,256	–	–	–	–	21,256
Investment in subsidiaries	–	–	–	–	25,000	25,000
Other assets	24,073	14,821	37,379	–	11,060	87,334
Property, plant & equipments	–	–	–	–	84,816	84,816
	<u>466,387</u>	<u>985,623</u>	<u>2,499,545</u>	<u>2,401,050</u>	<u>4,352,252</u>	10,704,857
Liabilities						
Bank overdraft	576,024	–	–	–	–	576,024
Deposits	1,455,636	808,091	41,203	31,613	164,700	2,501,243
Borrowings	315,520	773,870	1,201,054	1,408,582	1,507,563	5,206,589
Provision for taxation	30,449	–	–	–	–	30,449
Other liabilities	254,230	238,507	898	7,186	89,252	590,073
	<u>2,631,858</u>	<u>1,820,468</u>	<u>1,243,155</u>	<u>1,447,381</u>	<u>1,761,515</u>	8,904,377
Shareholders' funds						1,800,480
Total liabilities & shareholder's funds						10,704,857

Significant Accounting Policies

General

HDFC Bank of Sri Lanka incorporated in Sri Lanka as a Building Society in 1984 under Section 11 of the National Housing Act of 1956. Subsequently, converted to a Corporation under the Housing development Finance Corporation of Sri Lanka Act No. 7 of 1997 and obtained the status of a specialised bank under Housing Development Finance Corporation of Sri Lanka (Amendment) Act No. 15 of 2003. The principal business activities of HDFC Bank and the Group during the year were granting loans and other forms of financial assistances related to housing purposes and real estate business. HDFC Bank's head office is located at NHDA Secretarial Colombo - 2 Sri Lanka.

1. Accounting Convention

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 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 these accounts. The financial statements are presented in Sri Lanka Rupees, rounded to the nearest thousand.

1.1 Format of Accounts and Prior Year Figures

Financial statements are presented in accordance with the format of accounts prescribed by the Central Bank of Sri Lanka and previous year's figures have been re-arranged wherever necessary to conform to the current presentation.

2. Basis of Consolidation

The Group financial statements comprise the Bank's financial statements consolidated with that of its fully owned subsidiary of HDFC Real Estate Development Ltd. in terms of Sri Lanka Accounting Standard No. 26, Accounting for Investment in Subsidiaries. The accounting policies have been consistently applied by Bank and its Subsidiary.

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 the enterprise so as to obtain benefits from its activities. The financial statements of the subsidiary are included in the consolidated financial statements from the date that control effectively commences until the date that control effectively ceases. The financial statements of the Bank and its subsidiary are combined on line-by-line basis. The consolidated accounts are prepared to a common financial year ends on 31st December.

2.1.1 The total of profit and losses of the subsidiary company is included in the Consolidated Profits & Loss Account.

2.1.2 Intra Group balances and intra group transactions are eliminated in full in the consolidated financial statements.

3. Valuation of Assets

3.1 Loans and Advance 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.

3.1.1 Provision for Loan Losses

Specific provision for possible loan losses are made on base of a continuous review of all advances to customers, in accordance with the applicable accounting standards laid down by the ICAS and the directions issued by the Central Bank of Sri Lanka.

3.1.2 Security - Property Mortgage

Period Outstanding	Classification	Provision made	Net of realisable Value of Security (As per Central Bank Directions)
6 - 12 months	Substandard	25%	
12 - 18 months	Doubtful	50%	
18 months and over	Loss	100%	

Significant Accounting Policies

3.1.3 EPF and Cash Margin Loans

No provision made for the loans granted against the EPF and cash deposit balances.

3.2 Acquired Properties for Sale

Properties mortgaged by HDFC Bank are auctioned if the customers default and the properties which are not disposed at such auctions are recognised as acquired properties in the Balance Sheet. The values of the acquired properties are included in the capital outstanding amount of the loan balances.

3.2.1 General Provision

Bank has provided 0.01% of the general provision for capital outstanding amount of performing loans and overdue loans and advance as per Central Bank requirement.

3.2.2 Provision for Losses on Acquired Property

The Bank has provided 100% specific provision for capital outstanding amount of acquired properties, which were acquired by the Bank five (5) years prior to the Balance Sheet date even if the value of security covers the full or part of interest and capital outstanding.

3.3 Treasury Bills

Investment in Treasury bills is stated at cost.

3.4 Property & Equipment

- a) Fixed assets are recorded at cost or at valuation together with any directly attributable cost of bringing the assets to its working condition. The property and equipment are stated at cost less accumulated depreciation, which is provided for on the basis specified in (b) below.
- b) Depreciation is provided at the following rates on a straight-line basis over the estimated lives of different types of assets:

Office Equipment	12.50% per annum
Furniture & Fittings	10.00% per annum
Motor Vehicles & Bicycles	20.00% per annum
Plant & Machinery	25.00% per annum
Tools & Equipment	12.50% per annum
Computer Equipment	12.50% per annum

Subsidiary

Office Equipment	25.00% per annum
Furniture & Fittings	10.00% per annum

Full annual depreciation is provided on the assets purchased and used during the year and no depreciation is provided in for the year of disposal. Depreciation is not provided for on freehold land.

4. Liabilities and Provisions**Retirement Benefits****4.1 Gratuity**

Provision is made in the Accounts for retirement gratuities payable under the Payment of Gratuities Act No. 12 of 1983 for employees from the time of joining the Bank. The item is grouped under deferred liabilities in the Balance Sheet.

No separate fund is maintained and no actuarial valuation has been carried out for the purpose.

4.2 Defined Contribution Plans – EPF & ETF

All employees are eligible and covered by Employees' Provident Fund and Employees Trust Fund contributions in line with the respective statutes.

5. Revenue Recognition**5.1 Interest Income**

Interest income is recognised on an accrual basis. Interest ceases to be taken to revenue when interest or principal is in arrears for (3) months. And thereafter such income is recognised on a cash basis.

5.2 Default Interest Income

Default charges for late payment of loans instalments are recognised as income on a cash basis.

5.3 Interest Income from other Sources

Interest on Treasury bills and commercial paper is recognised proportionately over the period of instrument.

5.4 Other Income

Other incomes are recognised on a cash basis.

Significant Accounting Policies

5.5 Revenue Recognition on Real Estate Project

Profit on real estate projects would be recognised after the accomplishment of the following:

- a) Signing of the Sales Agreement
- b) Acceptance of the down payment of 25% or more
- c) Completion of 80% of the construction of each unit

The ownership of the properties will be transferred once the sales proceeds are collected in full.

Revenue has not been recognised during the period under review, since there is no Sales Agreements or undertaking of any payment within this period.

6. Expenses

6.1 Interest Expenses

Interest Expenses are recognised on an accrual basis,

6.2 Other Expenses

All expenditures incurred in operations and in maintaining the Property, Plant & Equipment in a state of efficiency are charged to Income Statement in arriving at the profit or loss for the year.

7. Taxation

7.1 Income Tax

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

HDFC Real Estate Development Ltd. has entered into an agreement with the Board of Investment of Sri Lanka under Section 17 of BOI Law No. 4 of 1978 under which the profit and income of the Company is exempted from income tax for the period of five years of assessment subject to the following criteria:

- 1) Initial investment committed to the project within twelve months to be not less than US \$ 500,000/-.
- 2) Minimum of 25 apartments to be constructed within a maximum of four locations.

7.2 Deferred Taxation

Deferred taxation is provided on the liability method. The tax effect of timing differences which occur where items are allowed for income tax purposes in a period different from that when they are recognised in financial statements is included in the provision for deferred taxation at current rate of taxation.

8. Cash Flow Statements

The Cash Flow Statement has been prepared by using the 'Direct Method' of preparing cash flows in accordance with the Sri Lanka Accounting Standard No. 9 on cash Flow Statements. Cash & cash equivalents comprise of cash balance and short-term funds and placements.

9. Statutory Reserve Fund

The amount of Rs. 8.3 million was transferred to the Statutory Reserve Fund in 2006 (5% of the net profit after tax). The balance in the statutory reserve fund as at 31st December 2006 was Rs. 35.4 million.

10. Directors' Responsibility Statement

The Board of Directors of the Bank takes the responsibility for the preparation and presentation of these financial statements. Please refer page for the statement of the Directors' Responsibility.

Notes to the Financial Statements

	2006 Rs.	Bank 2005 Rs.	2006 Rs.	Group 2005 Rs.
1. Income				
Gross income	1,285,642,929	1,056,033,100	1,285,642,929	1,056,147,971
Less: Turnover based taxes	—	—	—	—
Net income	1,285,642,929	1,056,033,100	1,285,642,929	1,056,147,971
Interest income (Note 2)	1,203,197,279	1,024,414,755	1,203,197,279	1,024,529,627
Other income (Note 4)	82,445,650	31,618,345	82,445,650	31,618,344
	1,285,642,929	1,056,033,100	1,285,642,929	1,056,147,971
2. Interest Income				
Loans & advances	1,165,266,250	987,944,223	1,165,266,250	987,944,223
Treasury bills & other banks' placements	37,931,029	36,470,533	37,931,029	36,585,404
	1,203,197,279	1,024,414,756	1,203,197,279	1,024,529,627
3. Interest Expenses				
Long-Term borrowing	381,403,066	398,655,447	381,801,872	398,655,447
Debenture	47,699,355	14,770,377	47,699,355	14,770,377
Deposits	255,232,237	150,706,680	255,232,237	150,706,680
Others	15,049,097	4,274,820	15,049,097	4,274,820
	699,383,755	568,407,324	699,782,561	568,407,324
4. Non-Interest Income				
Dividend income	2,700	—	2,700	—
Fee and commissions income	58,785,993	22,657,811	58,785,993	22,657,811
Others	23,656,957	8,960,533	23,656,957	8,960,533
	82,445,650	31,618,344	82,445,650	31,618,344
5. Other Operating Expenses include the following				
Directors' emoluments	146,795	113,500	146,795	204,500
Auditors' remuneration	230,000	120,000	234,875	170,000
Depreciation	6,816,882	7,177,360	6,836,575	7,177,360
Donations	107,592	1,595,648	107,592	1,825,648
Advertising	7,183,756	9,547,143	7,427,280	9,561,633
Legal expenses	428,137	46,422	428,137	46,422
Professional charges	2,052,067	12,020,251	3,673,344	10,540,501
Others	54,685,281	35,713,787	55,021,030	35,799,586
	71,650,509	66,334,111	73,875,627	65,325,650

Notes to the Financial Statements

	2006 Rs.	Bank 2005 Rs.	2006 Rs.	Group 2005 Rs.
5.1 Retirement Benefits				
EPF contribution	12,122,070	11,438,948	12,242,819	11,473,608
ETF contribution	3,026,496	2,859,738	3,056,861	2,865,363
Gratuity	10,209,957	3,662,175	10,209,957	3,662,175
	25,358,523	17,960,861	25,509,637	18,001,146
6. Taxation on Profits on Ordinary Activities				
Current year income tax	65,979,270	45,523,995	65,979,270	45,523,995
Transfer to/from deferred taxation	(2,044,196)	(1,623,113)	(2,044,196)	(1,623,113)
(Over)/Under provision in previous year	2,541,276	1,684,887	2,541,276	1,684,887
	66,476,350	45,585,769	66,476,350	45,585,769
6.1 Reconciliation of Effective Tax Rate				
Accounting profit	238,950,784	162,357,441	233,852,912	162,728,302
Add: disallowable expenses	95,667,492	43,597,314	95,667,492	43,597,314
Less: Capital allowance & gratuity paid	(4,721,926)	(41,575,844)	(4,721,926)	(41,575,844)
Adjusted profit before tax	329,896,350	164,378,912	324,798,479	164,378,912
Income tax	65,979,270	45,523,995	65,979,270	45,523,995
Effective tax rate	27.61%	28.04%	28.21%	27.98%
7. Dividends				
Net dividends	58,239,198	27,551,250	58,239,198	27,551,250
Tax deducted at source	6,471,022	3,061,250	6,471,022	3,061,250
	64,710,220	30,612,500	64,710,220	30,612,500
Gross dividends	64,710,220	30,612,500	64,710,220	30,612,500
8. Earnings Per Share				
Basic earnings per share is calculated by dividing the net profit after tax by the weighted average number of ordinary shares.				
Annualised net profit after tax	172,474,433	116,771,672	167,376,562	117,142,533
weighted average number of ordinary shares	6,296,761	4,372,500	6,296,761	4,372,500
Basic earnings per share (Rs.)	27.39	26.71	26.58	26.79
9. Cash and Short-Term Funds				
Cash in hand and balances with banks	51,774,530	58,828,026	52,047,817	59,304,693
Money at call and short notice	99,081,185	92,802,467	99,081,185	92,802,467
	150,855,715	151,630,493	151,129,002	152,107,160

Notes to the Financial Statements

	2006 Rs.	Bank 2005 Rs.	2006 Rs.	Group 2005 Rs.
10. Investment in Government Securities				
Treasury bonds	201,141,120	93,177,990	201,141,120	93,177,990
Treasury bills under repurchase agreement	500,000	116,230,912	500,000	116,230,912
	201,641,120	209,408,902	201,641,120	209,408,902
11. Loans & Advances				
Housing loans secured by primary mortgage over residential properties	6,181,881,771	4,763,332,726	6,181,881,771	4,763,332,726
Housing loans against EPF	2,627,876,089	2,255,170,290	2,627,876,089	2,255,170,290
Housing loans on guarantors	730,180,119	685,503,565	730,180,119	685,503,565
Staff loans	149,941,126	154,368,567	149,941,126	154,368,567
- Others	31,264,900	20,114,440	31,264,900	20,114,440
Acquired properties	72,884,838	71,630,495	72,884,838	71,630,495
HDFC RED loan	177,300,000	178,000,000	-	-
Other loans	210,428,569	15,150,518	210,428,569	15,150,518
	10,181,757,411	8,143,270,601	10,004,457,411	7,965,270,601
Less : Loan loss provision	(47,802,336)	(43,218,785)	(47,802,336)	(43,218,785)
	10,133,955,075	8,100,051,815	9,956,655,075	7,922,051,816
I. Movements in the Provisions for Loan Losses				
Balance brought forward	43,218,785	26,886,496	43,218,785	26,886,496
Additional provision/(reversal) made	4,583,551	16,332,289	4,583,551	16,332,289
Balance carry forward	47,802,336	43,218,785	47,802,336	43,218,785
ii. Non-Performing Assets including Loans and Advances				
Loans and advances	1,892,098,807	1,464,598,708	1,892,098,807	1,464,598,708
Less: Loan loss provision	(47,802,336)	(43,218,785)	(47,802,336)	(43,218,785)
	1,844,296,471	1,422,979,923	1,844,296,471	1,421,379,923
12. Interest Receivable				
Interest receivable	245,160,700	237,452,503	219,758,783	237,452,503
Less: Interest in suspense	(223,904,963)	(209,816,975)	(198,503,045)	(209,816,975)
	21,255,737	27,635,528	21,255,737	27,635,528
I. Movements in the Provisions for Loan Losses & Interest in Suspense				
Balance brought forward	209,816,975	159,107,850	209,816,975	159,107,850
Interest suspended/(recovered)	14,087,988	50,709,125	(11,313,930)	50,709,125
Balance carry forward	223,904,963	209,816,975	198,503,045	209,816,975

Notes to the Financial Statements

	2006 Rs.	Group 2005 Rs.
13. Housing Projects		
Avissawella Project	663,607	–
Kotikawatte Project	5,563,637	–
Ampara Project	10,829,283	9,408,581
BMC Project	360,423,584	275,540,800
Wellawatte Project	55,596,282	47,752,354
Edmonton Road Project	1,201,222	–
	434,277,614	332,701,735

	2006 Rs.	Bank 2005 Rs.	2006 Rs.	Group 2005 Rs.
14. Other Assets				
Stationery stock	5,129,707	3,386,585	5,129,707	3,386,585
Deposits and prepayments	3,783,500	3,915,000	3,783,500	3,915,000
Others	78,420,445	26,714,840	78,317,215	27,091,840
	87,333,651	34,016,425	87,230,421	34,393,425

15. Property, Plant & Equipment

	Leasehold Cost/Valuations Buildings	Equipments, Lands & Furniture	Motor Vehicles	Total 2006	Bank Total 2005	Total 2006	Group Total 2005
Balance at the beginning of the period	62,000,000	56,644,154	24,285,142	142,929,297	92,012,562	142,929,297	–
Additions for the period	–	6,109,086	–	6,109,086	7,148,825	6,109,086	–
Revaluation	–	–	–	–	43,767,910	–	–
Less: Disposals during the period	–	–	(1,220,000)	(1,220,000)	–	(1,220,000)	–
Balance at the end of the period	62,000,000	62,753,241	23,065,142	147,818,383	142,929,297	147,818,383	142,929,297
HDFC Real Estate	–	687,792	–	–	–	687,792	23,600
	62,000,000	63,441,032	23,065,142	147,818,383	142,929,297	148,506,175	142,952,897
Accumulated Depreciations							
Balance at the beginning of the period	–	38,588,619	18,817,197	57,405,816	50,228,456	57,405,816	–
Additions for the period	–	4,967,617	1,849,265	6,816,882	7,177,360	6,816,882	–
HDFC Real Estate	–	5,900	–	–	–	5,900	–
Less: Disposal during the period	–	–	(1,220,000)	(1,220,000)	–	(1,220,000)	–
Balance at the end of the period	–	43,562,136	19,446,462	63,002,698	57,405,816	63,008,598	57,405,816
Net book value as at 31.12.2006	62,000,000	19,197,005	3,618,680	84,815,685	–	85,497,576	–
Net book value as at 31.12.2005	62,000,000	18,055,535	5,467,945	85,523,480	85,523,480	–	85,547,081

Notes to the Financial Statements

	2006 Rs.	Bank 2005 Rs.	2006 Rs.	Group 2005 Rs.
16. Deposits from Customers				
Savings deposits	29,183,314	10,815,582	29,183,314	10,815,582
Term deposits	2,276,085,389	1,354,399,928	2,276,085,389	1,354,399,928
Others	195,974,023	171,532,288	195,974,023	171,532,288
	2,501,242,726	1,536,747,798	2,501,242,726	1,536,747,798
17. Borrowings				
Debentures	635,000,000	475,000,000	635,000,000	475,000,000
Government of Sri Lanka	1,445,632,579	1,300,550,646	1,445,632,579	1,300,550,646
GOSL loans under foreign credit lines	1,036,378,740	1,270,990,520	1,036,378,740	1,270,990,520
Refinance borrowings	765,677,540	837,370,080	765,677,540	837,370,080
Other borrowings	1,323,899,830	1,081,754,893	1,523,899,830	1,081,754,893
	5,206,588,689	4,965,666,139	5,406,588,689	4,965,666,139
Due Within One Year	1,089,389,689	860,274,062	1,089,389,689	860,274,062
1 - 5 years	2,609,636,000	2,453,135,378	2,809,636,000	2,453,135,378
After five years	1,507,563,000	1,652,256,699	1,507,563,000	1,652,256,699
	5,206,588,689	4,965,666,139	5,406,588,689	4,965,666,139
18. Provision for Taxation and Deemed Dividend Tax				
Taxation - current	26,747,478	2,399,089	26,747,478	2,399,089
VAT payable	10,987,346	6,731,912	10,987,346	6,731,912
Debit, WHT and PAYE tax	134,736	669,240	134,736	669,240
Deferred tax	(7,420,446)	(5,376,250)	(7,420,446)	(5,376,250)
	30,449,114	4,423,991	30,449,114	4,423,991
19. Other Liabilities				
Bank overdraft	576,023,523	93,235,085	576,512,954	93,235,085
Provision for gratuity (19.1)	44,887,479	35,221,162	44,887,479	35,221,162
Accrued expenditure	262,143,430	339,360,015	299,210,572	339,413,235
Dividend payable	64,729,570	32,781,750	64,729,570	32,781,750
Others	218,312,346	182,953,458	218,312,346	313,108,378
	1,166,096,347	683,551,470	1,203,652,921	813,759,610
19.1 Provision for Gratuity				
Balance brought forward	35,221,162	32,184,750	35,221,162	32,184,750
Provisions made during the year	10,209,957	3,662,175	10,209,957	3,662,175
Payments made during the year	(543,640)	(625,763)	(543,640)	(625,763)
Balance carried forward	44,887,479	35,221,162	44,887,479	35,221,162

Notes to the Financial Statements

	2006 Rs.	Bank 2005 Rs.	2006 Rs.	Group 2005 Rs.
20. Share Capital				
Authorised Capital (20,000,000 ordinary shares of Rs. 100/- each)	2,000,000,000	2,000,000,000	2,000,000,000	2,000,000,000
Issued and Fully Paid (6,471,022 ordinary shares of Rs. 100/- each)	647,102,200	612,250,000	647,102,200	612,250,000
21. Reserves				
Statutory reserve fund	35,745,555	27,121,834	35,745,555	27,121,834
Share premium account	314,986,446	300,000,000	314,986,446	300,000,000
Special reserve	3,451,125	3,451,125	3,451,125	3,451,125
Revaluation reserve	43,767,910	43,767,910	43,767,910	43,767,910
Other reserves	755,426,870	656,286,378	750,699,859	656,657,239
	1,153,377,906	1,030,627,246	1,148,650,895	1,030,998,108

22. Directors' Interests in Contracts with the Bank

No Directors have any material interest in any transaction or proposed contract involving HDFC Bank of Sri Lanka other than those disclosed in Note 24 of the financial statements.

23. Related Party Transactions

The following Directors who held office as Directors of the Bank and some members of the corporate management of the Bank were also Directors of the HDFC Real Estate Development Ltd.

Mr. S.M.M. Yaseen, Chairman of the Bank is also Chairman of the HDFC Real Estate Development Ltd.

Mr. C.A. Sarathchandra is CEO/General Manager of the Bank is also a Director of the HDFC Real Estate Development Ltd.

Mr. L.P. Andrahennadi is a Director of the Bank is also a Director of the HDFC Real Estate Development Ltd.

Mr. S. Kannangara is a Director of the Bank is also a Director of the HDFC Real Estate Development Ltd.

Mr. M.I.M. Rafeek is a Director of the Bank is also a Director of the HDFC Real Estate Development Ltd.

The Bank has contributed Rs. 25 million towards the capital of Real Estate Development Ltd. Further, the Bank has granted Rs. 177.30 million to the subsidiary under normal course of business.

The Bank has guaranteed loan value Rs. 200 million to HNB, on behalf of subsidiary HDFC Real Estate.

24. The Events occurring after the Balance Sheet date

There has been no material event after the Balance Sheet date of 9th May that requires adjustments or disclosure in the financial statements.

25. Assets Pledged

The assets pledged as security for credit facilities obtained are as follows:

Type of Facility	Amount of Facility Rs. million	Nature of Security	Value of security Rs. million	Balance as at 31.12.2006 Rs. million
1) Securitisation II	250.1	Housing loans receivable	456.33	36.7
2) Overdraft (People's Bank)	100.0	Part of loan portfolio	252.58	–
3) Overdraft (Sampath Bank)	50.0	Part of loan portfolio	75.00	50.00
4) Securitisation III	180.0	Housing loans receivable	250.00	60.00
5) Securitisation IV	506.0	Housing loans receivable	750.00	337.8
6) Short-Term Loan (HNB)	200.0	Housing loans receivable	260.00	200.00
7) Securitisation V	200.0	Housing loans receivable	249.5	187.5

26. Commitments and Contingent Liabilities

It has been proposed to build a seven-storied building for the HDFC Bank, Head Office at a cost of Rs. 125 million approximately.

27. Head Office Premises

The Bank occupies premises belonging to the National Housing Development Authority for which a rent is paid. In addition, the office maintenance, renovation and modernisation costs are borne by the Bank.

28. Consolidated Profit/(Loss) Adjustments

	Rs. million
HDFC Bank profit	172.4
Less: Subsidiary (HDFC Red) loss	3.5
	168.9
Fundamental error adjustment	1.5
Consolidated profit	167.4

The subsidiary had recognised Rs. 1.5 million as a management fee from HDFC Bank for the year ended 31st December 2005 which was eliminated during the current year (2006).

Statement of Value Added

<i>For the year ended 31st December</i>	Bank		Group	
	2006 Rs.	2005 Rs.	2006 Rs.	2005 Rs.
Interest income	1,203,197,279	1,024,414,755	1,230,197,279	1,024,529,627
Other income	82,445,650	31,618,344	82,445,650	31,618,344
Gross income	1,285,642,929	1,056,033,100	1,285,642,929	1,056,147,971
Cost of service	806,386,155	683,779,999	808,417,550	682,711,780
	479,256,774	372,253,101	477,225,380	373,436,191
	%	%	%	%
Value Distributed				
To Employees				
(Remuneration & Benefits)	33.2 159,046,907	38.8 144,531,194	33.8 161,490,655	38.9 145,280,819
To Government				
Income Tax	13.9 66,476,350	12.2 45,585,769	13.9 66,476,350	12.2 45,585,769
Value Added Tax	14.5 69,689,628	14.8 55,033,636	14.6 69,689,628	14.7 55,033,636
Debit Tax	1.0 4,752,573	0.8 3,153,470	1.1 5,355,610	0.9 3,216,074
	29.4	27.9	29.7	27.8
To Shareholders (Dividend)	13.5 64,710,220	8.2 30,612,500	13.6 64,710,220	8.2 30,612,500
Retained in the Business				
Retained profit	22.5 107,764,213	23.1 86,159,172	21.5 102,666,342	23.2 86,530,033
Depreciation	1.4 6,816,882	1.9 7,177,360	1.4 6,836,575	1.9 7,177,360
	100.0 479,256,774	100.0 372,253,101	100.0 477,225,380	100.0 373,436,191

Ten Year Summary

Profitability

Using 1997 as the base year, in a decade the loan portfolio has grown by 427.07% from Rs. 1.9 billion in 1997 to Rs. 10.1 billion in 2006. The corresponding income from operations improved from Rs. 307 million to Rs. 1,285 million marking growth of 318%. The bank reported a net profit of Rs. 172 million in 2006 which is growth of 133% from Rs. 71 million in 1997. Shareholders' funds were Rs. 1,800 million in 2006 as against Rs. 221 million in 1997.

Operating Result

	2006	2005	2004	2003	2002	2001	2000	1999	1998	1997
Income Statement										
Total income	1,285	1,056	947	830	654	479	420	456	400	307
Profit before tax	308	217	235	254	174	189	142	117	116	92
Income tax	136	100	53	56	32	64	40	35	31	21
Profit after tax	172	117	183	198	142	125	102	82	85	71
Balance Sheet										
Assets										
Current assets	462	623	216	228	193	81	66	219	298	160
Loans & advances	10,133	8,100	7,118	5,826	4,750	3,591	2,894	2,574	2,291	1,921
Property & equipment	85	85	42	33	53	36	30	17	12	14
Investment in subsidiaries	25	25	—	—	—	—	—	—	—	—
	10,705	8,833	7,376	6,087	4,996	3,708	2,990	2,810	2,601	2,095
Liabilities										
Long-term loans	5,286	5,017	4,363	4,107	3,499	2,256	1,817	1,847	1,892	1,403
Short-term loans	1,090	633	846	761	641	677	560	397	346	460
Deposits	2,501	1,536	1,140	312	41	41	39	37	22	-
Other liabilities	28	5	14	22	12	11	13	10	9	11
Shareholders' funds	1,800	1,642	1,013	885	803	723	561	519	332	221
	10,705	8,833	7,376	6,087	4,996	3,708	2,990	2,810	2,601	2,095
Performance Indicators										
Earning Per Shares (EPS) Rs.	27.39	26.71	44.39	48.03	34.45	34.51	28.16	135.26	140.55	118.50
Net Assets Per Share (NAPS) Rs.	278.16	268.19	245.72	214.68	194.78	199.59	154.87	860.52	551.17	366.18
Return on Average Assets %	1.77	1.44	2.72	3.57	3.26	3.73	3.52	3.03	3.62	3.80
Returns on Equity (ROE) %	9.61	7.13	18.07	22.37	17.68	17.29	18.18	15.80	25.60	32.13

Share Information

Ordinary Shareholders

As at 29th December, 2006

Shareholders	Resident			Non-Resident			Total		
	No. of Shareholders	No. of Shares	%	No. of Shares	No. of Shareholders	%	No. of Shareholders	No. of Shares	%
1 - 1,000 shares	4,146	736,752	11.39	11	2,200	0.03	4,157	738,952	11.42
1,001 - 5,000	166	351,048	5.42	5	14,400	0.22	171	365,448	5.64
5,001 - 10,000	31	211,100	3.26	-	-	-	31	211,100	3.26
10,001 - 50,000	42	920,700	14.23	1	47,700	0.74	43	968,400	14.97
50,001 - 100,000	4	295,600	4.57	-	-	-	4	295,600	4.57
100,001 - 500,000	4	673,522	10.41	-	-	-	4	673,522	10.41
500,001 - 1,000,000	-	-	-	-	-	-	-	-	-
Over 1,000,000	1	3,218,000	49.73	-	-	-	1	3,218,000	49.73
	4,394	6,406,722	96.01	17	64,300	0.99	4,411	6,471,022	100.00

Analysis of Shareholders	No. of Shareholders	No. of Shares
Individual	4,201	1,439,670
Institutional	210	5,031,352
	<u>4,411</u>	<u>6,471,022</u>

As per the Rule No. 8.7 (h) of the Colombo Stock Exchange, percentage of public holding as at 31st December 2006 was 49.19%.

Twenty Major Shareholders 29th December 2006

Name of Shareholder	Shareholding	%
1. National Housing Development Authority	3,218,000	49.73
2. Legalinc Trustee Services Private Ltd.	348,522	5.39
3. DPMC Financial Services (Pvt)Ltd.	112,500	1.74
4. Capital Alliance Holdings Ltd.	112,000	1.73
5. Miss N.T. M.S. Cooray	100,500	1.55
6. Bank of Ceylon	90,900	1.40
7. Seylan Bank Ltd./Jayantha Dewage	78,100	1.21
8. Hongkong & Shanghai Banking Corp - Com Trust Equity Fund	76,300	1.18
9. Phoenix Ventures Ltd.	50,300	0.78
10. Indra Traders (Pvt) Ltd.	50,000	0.77
11. Timex (Garments) Ltd.	50,000	0.77
12. Mr. Y.S.H.I.K. Silva	50,000	0.77
13. Asia Capital Ltd.	48,400	0.75
14. Gold Investment Ltd.	47,700	0.74
15. Lanka Orix Leasing Company Ltd.	45,000	0.70
16. Commercial Bank of Ceylon A/c No. 02	38,000	0.59
17. DFCC Bank A/c No. 01	37,400	0.58
18. Dr. C.P.D.W. Mathew	33,200	0.51
19. Common Amenities Board	30,000	0.46
20. Building Materials Corporation Ltd.	30,000	0.46
Total	4,646,822	71.81

Market Value Per Share - Highest Rs. 235.25
- Lowest Rs. 153.00

Equity - Earnings per Share See financial highlights
- Dividend per Share See financial highlights
- Net Assets per Share See financial highlights

Capital Adequacy

Calculation of Capital Adequacy Ratio for the quarter ended 31st December 2006

On Balance Sheet Items	Principal Amount Rs. '000	Risk Weight (%)	Risk Weighted Assets Amount Rs. '000
1. Cash - local currency	1,508	–	–
2. Sri Lanka Government treasury bills	500	–	–
3. Other securities guaranteed by the Sri Lanka Government	201,141	–	–
7. Loans and advances			
7.1 Loans secured by EPF	2,627,876	–	–
7.2 Staff loans secured by EPF	7,797	–	–
7.3 Secured by primary mortgaged	6,155,896	50	3,077,948
7.4 Over residential property	–	–	–
7.5 Other loans & advances	1,342,385	100	1,342,385
4. Due from local banks including development financial institutions	149,348	20	29,870
5. Fixed assets	84,816	100	84,816
6. Other assets	133,589	100	133,589
	<u>10,704,857</u>		<u>4,668,608</u>

Tier 1 - Core Capital

7. Paid up ordinary shares	647,102
Share premium	314,986
8. Statutory reserve	35,746
9. Published retained profit/(losses)	755,427
10. General & other reserves	3,451
11. Unpublished current year's profit/losses	–
	<u>1,756,712</u>
12. Less: Goodwill	–
	<u>1,756,712</u>

Tier 2 - Supplementary Capital

13. General provisions	8,245
	<u>1,764,957</u>

Capital Adequacy Ratio

Tier I	37.63%
Core capital	1,756,712
Risk weighted assets	4,668,608
Tier I	37.80%
Capital Base	1,746,957
Risk weighted assets	4,668,608

Notice of Meeting

Notice is hereby given that the 22nd Annual General Meeting of the Housing Development Finance Corporation Bank of Sri Lanka will be held on 29th of June 2007 at 2.30 p.m. at Sri Lanka Foundation Institute, No. 100, Independence Square, Colombo 7, for the following purposes:

1. The Chairman's address.
2. To receive and consider and adopt the Report of the Directors and the Audited Accounts of the Bank for the year ended 31st December 2006 together with the Report of the Auditors thereon.
3. To declare a dividend as recommended by the Directors.
4. To elect three shareholding Directors.
5. To appoint Auditors and authorise the Board of Directors to determine their remuneration.
6. To transact any other business of which due notice shall be given.

By Order of the Board

(Sgd.)

Mrs. K. T. D. D. De Silva

The Secretary

HDFC Bank

Colombo

28th February 2007

Form of Proxy

I/We of

Being a member/members of Housing Development Finance Corporation Bank of Sri Lanka hereby appoint.

1. Mr. of whom failing
2. Mr. of whom failing
3. Mr. of whom failing
4. Mr. of whom failing
5. Mr. of whom failing

As my/our proxy to vote for me/us on my/our behalf at the Annual General Meeting of the Bank to be held on at and at any adjournment thereof, and at every poll which any be taken in consequence thereof.

Signed this day of 2007.

.....

Signature

Note: A proxy need not also be a member

The form of proxy should be returned to The Secretary "Housing Development Finance Corporation Bank", P. O. Box 2085, Sir Chittampalam A Gardiner Mawatha, Colombo 2 on or before 27th of June 2007 at 2.30 p.m.

Instruction for Completion

1. To be valid, this form must be filled, signed and deposited with the Secretary, HDFC Bank, P.O. Box 2085, Sir Chittampalam A. Gardiner Mawatha, Colombo 2, not less than 48 hours before the time appointed for holding the meeting.
2. The form of proxy must be signed by the appointer or by Attorney duly authorised in writing.
3. In the case of a corporation, the form of proxy must be either under its common seal or under the hand of an officer or Attorney duly authorised.
4. In the case of joint holder, only one needs to sign. The votes of the senior holder who renders a vote will only be counted.
5. If you wish to appoint any person other than the Chairman as your proxy, please insert the relevant details at 1 to 5.

Corporate Information

Name	The Housing Development Finance Corporation Bank of Sri Lanka.
Legal Form	A licensed specialised bank under the provisions of Housing Development Finance Corporation Act No. 07 of 1997, amended by Act No. 15 of 2003.
Year of Incorporation as a Building Society	1984
Registered Office	Address P.O. Box 2085, Sir Chittampalam A Gardiner Mawatha, Colombo 02. Telephone : 2446241, 2446239, 2447354, 2447314 Fax : 2446392 WebSite : www.hdfc.lk
Company Secretary	Mrs. Dharshani De Silva Attorney-at-Law & Notary Public, Company Secretary, Commissioner of Oaths. Address P.O. Box 2085, Sir Chittampalam A Gardiner Mawatha, Colombo 02. Telephone : 2446241, 2446239, 2447354, 2447314 E-Mail : secretary@hdfc.lk
Registrars	SSP Corporate Services (Pvt.) Ltd. Address No. 101, Inner Flower Road, Colombo 3. Telephone : 2573894, 2576871 Fax : 2573609 E-Mail : sspsec@sltnet.lk
Auditors	Auditor-General - Department of Auditor-General Torrington Square, Colombo 7.
Consultant Lawyers	Attorney-General's Department Hulfdsdorf, Colombo 12.
Bankers	Bank of Ceylon Corporate Branch, Echelon Square, Colombo 01. Sampath Bank No.110, Sir James Pieris Mawatha, Colombo 02. People's Bank No. 75, Sir Chittampalam A Gardiner Mawatha, Colombo 2. Commercial Bank of Ceylon Ltd. Commercial House, Union Place Branch, Colombo 2. Pan Asia Banking Corporation Ltd. Colombo Road, Gampaha Hatton National Bank Head Office Darley Road, Colombo 10.

