

FINANCIAL REVIEW SRI LANKA TELECOM

Revenue increased by 3% in 2007 to Rs. 37.07 billion despite a significant revenue reversal following a court order during the year

FINANCIAL PERFORMANCE

Revenue

The Company's revenue increased by 3.0% in 2007, rising to Rs. 37.07 billion as compared to the previous year. This was despite a significant revenue reversal resulting from a court decision: on 27 August 2007, the Supreme Court delivered judgment on a legal action initiated by an organisation known as 'The Consumer Association of Sri Lanka', according to which SLT customers are entitled to an 8.72% overall rebate on local call charges and rentals for the period 1 January 2007 - 31 October 2007. This rebate appeared as a credit in customers' bills for the month of November, 2007. On 1 November 2007, a new time-based (per second) tariff structure was introduced along with a reduction in rentals and call charges. The overall revenue reduction following from this is approximately 9.03%. For the period 1 January 2007 to 31 October 2007, the revenue reversal is approximately Rs. 1.4 billion.

Domestic Revenue

Domestic revenue decreased by 10% to Rs. 17.04 billion in 2007 as against Rs. 18.85 billion in the previous year mainly because of the above mentioned Supreme Court judgement. Domestic Revenue consists mainly of rentals and domestic call charges and accounted for 45% of total revenue in 2007 as against 53% in 2006.

Additional revenue generated by new CDMA connections has been absorbed by the revenue reversal following from the Supreme Court judgment referred to above, hence the increase in domestic revenue was marginal. However, the Company expects future growth in usage due to the effect of price elasticity.

As at 31 December 2007, SLT had a fixed-line subscriber base of 1.4 million.

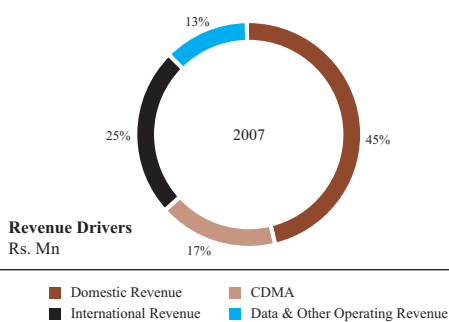
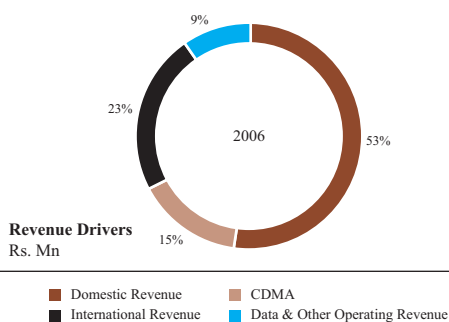
CDMA

CDMA revenue during the year under review was Rs. 6.19 billion, or 17% of total revenue. 227,608 new connections were sold during the course of the year. In May 2008, the connection charge was reduced by 35% and further reduced by 38% in November 2007.

International Revenue

Total international revenues, comprising IDD revenue, receipts from international network operators and international settlements, grew by 10%, to Rs. 9.16 billion. IDD revenue accounted for Rs. 1.76 billion of this, a 13% decrease in comparison to last year's results, while international in-payments increased by Rs. 1.21 billion, a rise of 20% compared with last year.

Revenue from international gateway operations has continued to increase. Growth in international incoming-traffic volumes, mainly through VoIP



operations, has contributed significantly to this increase. The competitive nature of the local market has effected a slight drop in IDD call revenues.

Data & Other Operating Revenue

Data-related revenues have shown healthy growth. Data and Internet-Protocol (IP) services and other sector revenue streams increased by 36%, to Rs. 4.67 billion. This sector is expected to become a significant source of future revenue as IP services open up new opportunities in communications and media, possibly serving as a platform for future convergence. This revenue segment also includes broadband and narrow-band products. By the end of 2007, SLT had approximately 53,500 ADSL connections and approximately 88,000 internet customers. Additionally, the Company provides domestic and international leased services and IP/VPN facilities to corporate customers.

Operating Costs & Depreciation

Operating costs, including International Telecommunication Operators' Levy (ITL) and the Company's Voluntary Retirement Scheme (VRS), rose by 11% to Rs. 20.0 billion year-on-year. An increase in staff costs of 20%, to Rs. 5.48 billion, was the other notable factor.

Despite the high rate of inflation, repair and maintenance costs increased by a modest 4%, to Rs. 1.54 billion.

Depreciation charges amounted to Rs. 8.88 billion for the year under review, as against Rs. 8.81 billion for the previous year.

Third Voluntary Retirement Scheme (VRS)

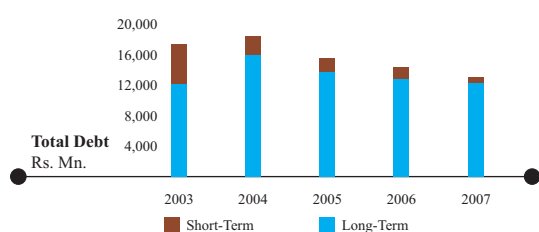
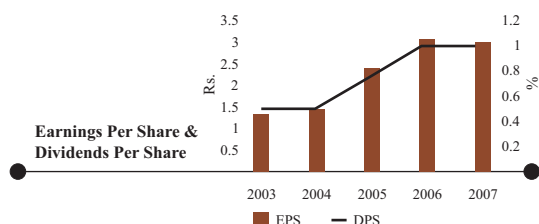
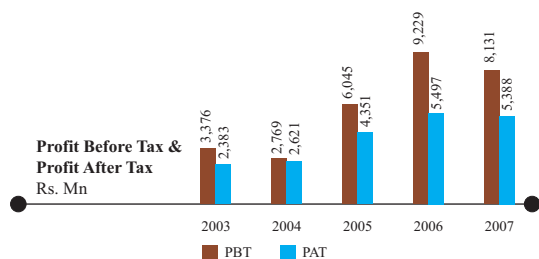
During the third quarter of 2007, SLT introduced its third VRS, incurring a cost of Rs. 43 million. The object of this scheme was to benefit employees who had served the Company well but were troubled by poor health that resulted in stress and other difficulties at work. SLT was the first institution to offer a scheme of this nature, from which 52 employees were benefited.

SLT currently has an employee strength of around 7,000.

International Telecommunication Operators' Levy (ITL)

In terms of the Finance Act No. 11 of 2004, international telecommunications operators are required to make a contribution to the Government of Sri Lanka at the rate of US\$ 0.038 per international incoming-traffic minute. The law is retroactive with effect from 3 March 2003.

MANAGEMENT REPORT



Finance Costs

These consist mainly of interest expenses and include the effects of exchange-rate fluctuations generated by the re-statement of monetary assets and liabilities and the writing-off of realised exchange fluctuations from the hedging reserve. Finance costs decreased by 7% during the year under review, to Rs. 1.36 billion.

Taxation

The quantum of tax payable for the year was Rs. 2.74 billion, down 27% from Rs. 3.73 billion the previous year.

Profitability

Profit before tax, at Rs. 8.13 billion, was 12% below the previous year's achievement of Rs. 9.23 billion. Profits after tax (PAT) decreased by 2%, from Rs. 5,497 million in 2006 to Rs. 5,388 million in 2007. The Company enjoyed a PAT margin of 15%.

Measuring Performance

Earnings per share recorded a decrease of 2%, falling to Rs. 2.99 from Rs.3.05 in the previous year. Return on equity also decreased to 12.1% from 13.5% in 2006.

FINANCIAL POSITION

Balance Sheet

Total assets as at 31 December 2007 were Rs. 78.9 billion, as against Rs. 79.1 billion on 31 December 2006. Total equity increased by Rs. 3.78 billion to Rs. 44.48 billion.

Current liabilities decreased by Rs. 1.26 billion, while non-current liabilities declined by Rs. 2.09 billion.

Non-Current Assets

Total non-current assets of the Company declined to Rs. 50.78 billion, as against Rs. 52.88 billion from the previous year. This was mainly due to a decrease of Rs. 3.28 billion in property, plant and equipment.

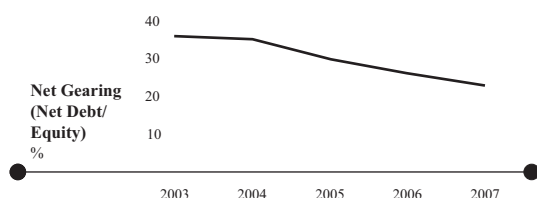
Working Capital

Working capital improved significantly. The figure as at 31 December 2007 was Rs. 16.9 billion, an increase of 23% over 2006. The main contributory factors were a 5% decrease in receivables and pre-payments to Rs. 10.06 billion and an increase in cash and cash equivalents by 16% to Rs. 16.69 billion. The growth in cash and cash equivalents indicates a very strong fund position and includes a sinking fund of US\$ 64.43 million, equivalent to Rs. 7.04 billion, created in 2005 to redeem US\$ 100 million in issued notes by 2009.

Activity and Liquidity Ratios

Asset turnover also improved, from 0.46 in 2006 to 0.47 in 2007. This was the result of better asset utilisation.

The current ratio increased from 2.1 to 2.5 in the year under review. The quick asset ratio also rose marginally, from 2 to 2.4% year on year.

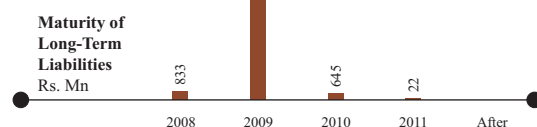


Interest Cover

Interest cover showed a marginal decrease to 6.97. Contributory factors were 9.5% decrease in earnings before interest and tax (EBIT), and an increase in interest expenses of 7.49%.

Capital Structure

The total assets of SLT, amounting to Rs. 78.9 billion, were funded by shareholders' funds (65%), long-term liabilities (21%) and short-term liabilities (14%).



Debt

The total debt of the Company was Rs. 13.2 billion as at balance sheet date, 9% lower than in 2006, demonstrating that SLT has continued successfully to maintain its strategy of reducing debt. The Company's overall debt comprises Rs. 12.37 billion long-term debt (94% of the total) and Rs. 0.83 billion (6%) short-term debt. 85% of the total debt consists of foreign-currency borrowings, while the balance 15% are local-currency borrowings.

Notes for US\$ 100 million issued by the Company and redeemable in 2009 constitute 98% of the foreign-currency debt.

The debt: equity ratio remained at 23% in 2007.

CASH FLOW

Operating Activities

Cash and cash equivalents increased by Rs. 2.2 billion during the year. Net cash flow from operating activities was Rs. 11.7 billion in 2007, reflecting an increase of Rs. 571 million over 2006. This was primarily due to increase in cash generated from operations.

Interest paid during the financial year was Rs. 1.39 billion, as against Rs. 1.47 billion in 2006.

Investment Activities

Net cash outflow from investment activities was Rs. 6.51 billion for the year in review, compared with Rs. 7.13 billion in 2006.

Financing Activities

Net cash outflow from financing activities was Rs. 3.08 billion in the financial year 2007, compared with Rs. 3.17 billion in 2006. Net cash flow from financing activities include the repayment of Rs. 1.27 billion for maturing debt and a dividend payment of Rs. 1.80 billion.

STATEMENT OF CHANGES IN EQUITY

Shareholders' funds as at 31 December 2007 stood at Rs. 44.5 billion, as against Rs. 40.7 billion at 31 December 2006. This constitutes an increase of 9.3%. Changes in equity were primarily impacted by profit after taxation, which was Rs. 5.4 billion.