

RISK MANAGEMENT

Unforeseen consequences can arise from any form of business or operational activity. This is the first principle of risk management and it implies that risk management must cover all operational areas, looking not only to what a recent American Secretary of Defence called the 'known unknowns', but also dealing with ways to manage the unexpected. Nor is this all, for risk management also has a business function related to planning and strategy: every deal, every venture, every new technology introduced, every product or service launched carries its own risk. Good risk management can help identify and evaluate business opportunities by qualifying or even quantifying the potential risk and pointing out possible ways to mitigate it.

SLT has a well-structured risk management system in place, covering the entire company and all its dealings. The Board of Directors receives regular information from the Company's senior management with regard to the implementation and operation of the system and changes to be effected therein. This chapter reviews structure and operation of our risk management process over the course of 2007 with reference to the particular categories of risk we faced in that year, and in many cases continue to face in the present year.

RISKS IN THE OPERATING ENVIRONMENT

Effects of economic growth

Sri Lanka's GDP grew by some 6% in 2007. Telecommunications was again one of the key drivers of the sector, testifying to the still-enormous potential of

the field and thus for SLT. However, such growth lures other operators who may pose a potential threat to us. In a growing economy and competitive environment, such risks are hard to mitigate.

Changing Patterns of Telecom use

Central Bank forecasts for the ICT sector suggest growth at around 35%, driven by services (such as BPO, telemarketing, call centres, data processing and the internet, as well as new technologies like 3G). This shift away from traditional to newer service types and technologies carries risks that SLT is managing by broadening its own product and service portfolio to embody state-of-the-art ICT solutions and disseminating these to a growing client base. Our strategies of diversification, international expansion and convergence also help mitigate this risk.

Time-Consuming Regulatory processes

SLT's licence to operate depends on approval of proposed tariffs by the Telecommunications Regulatory Commission (TRC). Since 2006, we have been engaged in a dialogue with the TRC in order to address the broader policy issues related to the tariffs approval regime.

Licensing Issues

The asymmetrical regulatory regime currently in place favours new entrants. In the long term, this must be addressed by persuading the TRC to level the playing field with a unified licensing regime and more accurate assessments of competing service providers.

Delays in reclaiming TDC

The mandatory International Telecommunication Operators' Levy (ITL) imposed by the State includes a component called the Telecommunication Development Charge (TDC), two-thirds of which may be reclaimed in lieu of unserved and underserved areas, but all such claims are subject to the approval of the TRC. As a mitigatory measure SLT has followed the practice of retaining two-thirds of the TDC whilst submitting to the TRC supporting documentation in proof of network roll-out in unserved and underserved areas.

Product Substitution

Convergence also brings the threat of new technologies developed in parallel processes outside the industry that may overtake and supersede those that telecom operators are familiar with. Other convergence threats come from VoIP (Voice over Internet Protocol), wireless networks and mobile internet. All these are potential risks that SLT must manage. In VoIP, we have overcome the threat and become the current market leader in IP-based solutions, including VoIP, on our extensive IP network. Analogously, we have exploited mobile-like technology to offer customers wireless fixed-line access by means of CDMA technology.

Convergence also brings opportunities. As traditional broadcast television gives way to IP and Mobile TV, a potentially lucrative business area opens up for SLT - as well as for our competitors. Our diversification strategy fully addresses this opportunity while managing the associated risk.

Overall, the Company remains competitive within these developments and risk is mitigated.

INFRASTRUCTURE - RELATED RISK

SLT's Operating Support System and Billing Support System are critical infrastructures to which disruption or outage could seriously affect our operations and inflict lasting damage on customer relationships. This very critical risk field is managed with extreme care. Day-to-day operating risks are mitigated by daily and weekly backups; protecting our systems with intruder-detection programmes, firewalls and anti-virus software; and daily random checks.

Disaster-Recovery

A comprehensive disaster-recovery programme was rolled out in 2007 to manage against this key aspect of infrastructure risk. The purpose of the programme is to ensure data protection and availability at all times, guarding against disaster situations such as fire and terrorist activity as well as data corruption due to operational mistakes or sabotage and 'hard' errors such as prolonged server failure, storage system failure and the like.

The programme also offers a variety of non-disaster-related operating benefits.

Risks arising from terrorist threats can also be mitigated and services maintained through redundancy and alternate routing. The modular nature of our network makes this possible.

Procurement Issues

SLT is a telecommunications/IT product provider as well as a service provider. We depend on a variety of suppliers and a complex inventory of products and services to run this side of our business successfully. Potential threats in this area include supplier delays or defaults, inadequacies in inventory and product obsolescence.

Uncertainties on the demand side could result in either shortages or overstocking. This risk is managed through the use of On-line Material Requirement Planning and Forecasting Software as well as through inventory buffering.

Quality Issues

fundamental risks can arise from materials and equipment that do not conform to the highest quality standards. At SLT, materials quality is managed through an extensive process of checks and balances spanning the whole procurement exercise.

LEGAL RISKS

SLT is party to several court and out-of-court proceedings with Government agencies and other parties. The following is a summary of these proceedings, which could have a material negative impact on the Company.

- Proceedings were initiated under ICC Arbitration application No. I3839/M by Informatics (Private) Limited, claiming US\$ 1,143,630 being the licence upgrade cost and an annual maintenance fee of 15% of the licence fee for the TBR system provided to SLT by Informatics.

- Global Electroteks Limited has initiated legal action under High Court Case No.20/2005 claiming damages of US\$ 12 million from SLT for unlawful disconnection of interconnection services.
- SLT has filed a revision application in the High Court, Anuradhapura, to set aside an order given by Magistrate to hand over the vacant possession of the property at Niwanthaka Chethiya Road, Anuradhapura.
- Under Court of Appeal CA No. 883/2003, SLT is seeking a Writ of Certiorari to quash the award given by the Arbitrator at the Labour Arbitration, increasing the overtime rate from 1.5% to 1.75% and granting of lieu leave with regard to an application made by the Telecommunications Employees Union with effect from 1st February 1998.
- Directories Lanka (Private) Limited (DLPL) filed case No. 2/2006 (3) in Commercial High Court against SLT claiming Rs. 250 million, damages for unfair competition with regard to artwork on the cover page of the SLT Directory Publication.

RISKS ARISING FROM EMPLOYEE ACTIONS

SLT has a highly unionised workforce, with 32 Trade Unions represented.

Risks arising from employee actions remain an ongoing problem for the Company. Our HR Division had in place a system to address key issues, while a cross-functional team of

management and union representatives seeks to improve relationships and address problems.

With trade unions, SLT is seeking a convergence of vision between business objectives and the needs and aspirations of employees. We are building partnerships and promoting dialogue to these ends.

Another vital component here is education: instructing and explaining Company policy and plans to union representatives and employees so as to improve understanding and cooperation.

With employees, the Company is identifying the main causes of grievances to be addressed at Grievance Committee forums. Education on key initiatives will also be provided more efficiently.

OTHER AREAS OF RISK

The challenges of recruitment and maintenance grow with every passing year. As our industry and competitors grow, our best people cannot help but be aware of the widening range of career options becoming available to them. We have responded by conducting a Salary and Benefit Survey with a view to adjusting remuneration to match current market levels, which should help make SLT a more attractive employer overall.

SLT seeks to minimise these costs by putting each employee on the track of continuous learning, optimising each one's value and worth and helping him or her build a lasting career with the Company.

Financial Risks

Given the aggressive strategies being developed by the Company, a significant investment is warranted in the near future. All investments are fraught with a degree of risk, and the Company will carefully examine and assess the attendant risks before embarking on any such initiative.

Exchange Rate Risk

The maintenance of foreign-currency accounts for related inflows by the Company is an automatic hedge against foreign currency exposures. SLT's currency hedging policy requires that cash flows from international revenues be first utilised to service the Company's foreign currency debts. A sinking fund in US Dollars (USD) has also been created for the bullet redemption of the \$100 million notes.

Interest Rate Risk

Debt is maintained in a mix of fixed- and variable-rate instruments to mitigate risks arising from interest rate volatility.

Liquidity Risk

By employing regular financial planning and monitoring systems, the Company ensures that sufficient cash flows are available to meet all financial commitments.

Credit Risk

Comprehensive systems are in place to monitor SLT's debtors and recoveries. Credit risk originating with customers is also mitigated to a large degree by the practice of taking initial deposits, as well as through pre-paid sales.