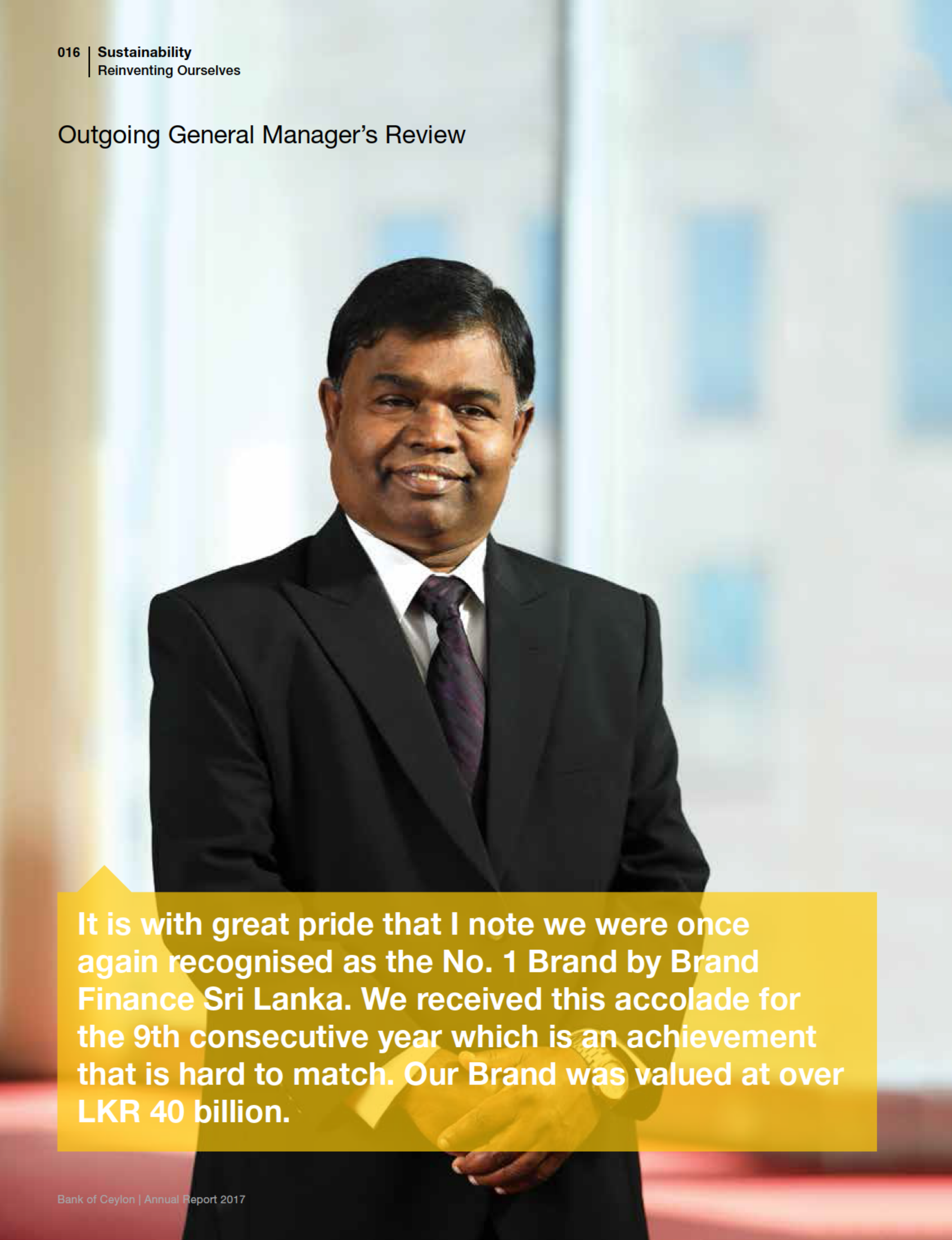
Outgoing General Manager's Review



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Our Business Profile

The Bank of Ceylon is the highest profit earning single entity in Sri Lanka, whether state or private with our pre-tax profit surpassing LKR 30.3 billion in 2017. During the year, the Bank has recorded an impressive 8% growth in Profit Before Tax, when adjusted for the one off gain recorded in 2016. The deposit base of the Bank recorded a 23% "YoY" growth reaching up to LKR 1.5 trillion. Bank of Ceylon has been, for several years, the holder of the largest asset base held by any single entity in the country. This position has been further strengthened as the loans and advances have grown by 16% during the year and has reached LKR 1.2 trillion. During the year assets have grown by 17%. In 2016, we achieved a milestone – we notched the triple trillion in assets, deposits and loans. We have another milestone that is within reach, which is to grow our asset base to LKR 2 trillion. This we hope to achieve by 2018.

The Bank's overseas network constitutes three foreign branches and our subsidiary in the United Kingdom. In addition, we are linked to over 700 correspondent banks worldwide. A 46% share of all inward remittances coming to Sri Lanka, is channelled through the Bank of Ceylon. We take great pride in the service we provide to our expatriate workers who sustain the balance of payments of the country. We have representatives stationed in several overseas locations to canvass remittances. Plans are in the pipeline to increase the number of representatives to 100 in 2018.

Brand and Achievements

As the brand ambassador for the Bank, the brand image and brand value is something I have been concerned with throughout my tenure. It is with great pride that I note that we were once again recognised as the No. 1 Brand by Brand Finance Sri Lanka. We received this accolade for the 9th consecutive year which is an achievement that is hard to match. Our Brand was valued at over LKR 40 billion. It is a tribute to our resilience that we were able to retain this position despite numerous upheavals and changes in the environment. In addition, Bank of Ceylon also received the No. 1 Sri Lankan Brand award at the first "Interbrand Best Sri Lanka Brands" convention. The award reflects not only the financial performance of the brand, but also the recognition given to the brand by the customer and the brand's contribution to the Bank's financial position. These accolades only confirm what is common knowledge; that Bank of Ceylon is a household name and that we have given a helping hand to Sri Lankans from all walks of life to realise their aspirations.

What stands out is that we have notched all these achievements without single-mindedly focusing on the bottom line and without compromising on our social responsibilities. We serve many customer segments such as micro-entrepreneurs, women entrepreneurs, farmers, fishermen, youth and house builders regardless of the inadequacy of a commercial return. However, we fund such clientele due to our commitment to the country's development and the triple bottom line. Our net interest margin is lower than that of any other bank, which reflects our practice of paying high interest to the depositors and charging low interest for loans and advances. In our strategies we have incorporated green banking, sustainability concepts, 5S and climate change concerns. The numerous awards we have won are a tribute to our social conscience.

Operating Environment and Regulation

With the additional demands of Basel III and SLFRS 9 we will face new challenges in carrying out both our commercial and social roles and remaining competitive. However, with the strengths we possess we are confident we can overcome the challenges if we look at the environment around us and leverage the opportunities we have.

In its operating environment, both local and international, the Bank is faced with rapidly evolving developments on many fronts. These include economic, social, technological, regulatory, and environmental changes. While steering the Bank in the midst of these headwinds, we have to also fullfil our social responsibilities as a state bank and the leading Bank of the country.

The Bank scrupulously complies with all laws and regulations of the Central Bank and other regulatory authorities. New demands are constantly being placed on us, mainly due to international developments, on areas such as anti-money laundering, assets and liability management and foreign exchange transactions. Since we are also an internationally linked bank there is additional pressure on us to conform to the requirements of the domiciles of our international partners.

This year saw major regulatory changes being introduced or in the offing. Basel III came into effect from 1 July 2017, which will be phased in with full implementation scheduled for January 2019. IFRS 9 is coming on stream in 2018. These new developments are aimed at enhancing stability of the banking systems worldwide by enlarging the capital and liquidity requirements and improving the asset quality through stringent provisioning. During the past year, we had to tune our operations and procedures with their implications in mind. There were major implications especially regarding management of assets.

Management of Assets

To address the new requirements mentioned above, building our capital and utilising it at an optimum level is a prime concern. To achieve this, we need proper management of our assets and there are three major aspects of this. The first is our physical infrastructure. While we have given a physical facelift to many of our branches what is becoming more vital today is upgrading our technological hardware to keep us on the cutting edge of the digital mode. In doing this, we have to think not just of the needs of the next year, or the year after, but 10-15 years ahead. The model of banking is changing from brick and mortar to digital banking.

Digitisation is progressing with dizzying rapidity globally, even in relatively backward regions such as sub-Saharan Africa. In Sri Lanka, even some of the older generation are moving to the digital platform and carrying out transactions through internet and mobile banking. Our 2018-2020 Corporate Plan has been drawn up with the changes in mind. In 2017, the Bank made major investments in the new technology. We have widened our customer services through more ATMs, CDMs and increased facilities for internet and mobile banking. This necessitated upgrading of our hardware, software and networks.

Our business process re-engineering has automated many processes during 2017.This has eliminated the need for customers to physically be present at the Bank to request for services such as new cheque books, loan applications and standing orders. This has also improved the effectiveness and the efficiency of our operations. In 2017 we launched our new mobile application the "B app". Another landmark event during the year was the launching of the "Smart Passbook". This is another app, freely downloadable, which provides access to transactions, balance history and monthly statements in real time. It permits registration of up to three mobile devices. During the year, the Bank also re-launched its Disaster Recovery Centre (DRC) with upgraded facilities at a new premises. The DRC is now better placed to handle disruptive events that may cause serious interruptions to customer service. It provides for re-establishing IT services at an alternative site following a disaster situation.

The second is the interest earning assets such as loans, advances and investments. Asset quality is assuming more importance in the context of regulatory developments and new accounting treatments. These have had a major impact on our business model. This has changed how we look at our credit evaluation and our investment portfolio. What was formerly based merely on the realisability of assets, has to now be a cash flow-based evaluation and we have to align impairment provisions with the underlying riskiness of the assets we underwrite. Mark-to-market accounting has to be practiced for investments. For the asset quality to be maintained we have to have proper guidance and proper mechanisms for asset acquisition and asset rearrangement. Our various functional units such as credit management, credit evaluation and risk management had to be prepared for the new demands placed on them. From 2018 onwards, the Profit and Loss account and the balance sheet will reflect the impact of these new requirements.

Finally, our human resources remain our most prized asset and we have made major changes to our Human Resources Plan considering our strategic needs. As a consequence of the pattern of recruitment in past periods we have a high proportion of senior staff who retired recently or are now nearing retiring age. New recruitment is taking place in large numbers and the average age of the staff is around 35 years. Around 300 energetic and young professionals were recruited in 2017 as Management Trainees. Further recruitment in large numbers is on the cards for 2018. While we are losing many experienced staff, the upside is that the younger generation whom we are recruiting are technically competent to handle the new modes of transactions and processing. We are thus equipped with the human capital base suited for the current requirements.

Catering to the Evolving Changes in the Economy

In midst of the challenges posted by the regulatory and operating changes in the global space, the economic and social face of Sri Lanka is dynamic and this both opens up opportunities and poses challenges for us. Agriculture is playing an increasingly important role globally due to climatic changes and consequent food scarcities. All indications are that in a decade or so agriculture will be a lucrative area in Sri Lanka. Major opportunities are opening up in areas such as food processing, cut flowers and ornamental fish. Since such areas can be driven by the SME sector, this will increase the significance of the SME sector towards the economic growth of the country. In today's globalised business environment one does not have to be a giant to go global; we can also facilitate the linking of the SME sector to global value chains.

Also with the development of infrastructure in the country the economic landscape is moving away from the former Western Province centric model. Rapid development is taking place in the North and the East as well as other provinces. We have changed our organisational structure in line with these new developments. Further, more focus has been given to cater the SME sector.

We are Investing more resources in the Retail segment to cater the emerging market opportunities in this segment. In view of this, the retail banking has been divided into two ranges injecting more resources to this segment allowing it to expand its business activities. To expedite the credit granting process we have established 14 Regional Loan Centres (RLC) and 15 SME centres; we intend to increase this to having one RLC in each district.

We have well shaped all our internal processes, systems and the capitals to face the future challenges and BoC is well positioned to grab the opportunities offered by the changes happening in the local as well as the global arena. Bank of Ceylon will always be the "Bankers to the Nation".

Appreciations

I wish to express my appreciation for the direction and guidance provided by the Chairman and the Board of Directors; Corporate and the Executive Management and our staff for their dedication and untiring efforts; trade unions for their cooperation; former employees and our customers for their continued loyalty. I also wish to thank the Minister of Public Enterprise and the Minister of Finance as well as the staff of the two ministries for their guidance and cooperation. I also greatly appreciate the regulatory oversight provided by the Central Bank and the officials concerned. My gratitude also goes out to the Auditor General and his staff for the execution of the audit of the Financial Statements enabling the timely publication of this report.

I have full confidence that with our strengths and resources the Bank will go forward in 2018 and beyond to face whatever challenges that arise and take advantage of all opportunities to grow and prosper not only for itself but for all Sri Lankans.

D M Gunasekara
General Manager

21 February 2018
Colombo