

**SRI LANKA
TELECOM**

ALL COUNTRIES

ANNUAL REPORT 2006



SANS FRONTIERES

Ours is an increasingly borderless world - take the EU where individual borders don't exist in terms of a "passport to travel". This report contains seven thematic pictures which illustrate the rich diversity of dress and culture that abounds in this borderless world - a world that holds much diversity of opportunity for Sri Lanka Telecom.

Leaders have the happy advantage of being the first to see the path ahead. With this acumen comes the responsibility of taking industry and enterprise into new worlds of opportunity and growth.

SLT operates within one of the most exciting and fast developing industries in the world today - telecommunications. It is a world where traditional boundaries are ceasing to exist with each passing day. Internet based technology and services are rendering archetypal nomenclature redundant - soon even the word telecommunications will be superseded. The convergence of communications and media will redefine how people communicate and are entertained.

SLT as the unquestioned leader in the communications arena of Sri Lanka stands with both feet firmly planted on this exciting road to tomorrow.

What does this really mean?

We have seen the signs of the times; the direction in which this new 'commedia' world is moving, and we have aligned our business accordingly to remain leaders in this field.

This is being accomplished through our efforts to diversify business, building on the strengths of our technology and infrastructure to push beyond the shores of our motherland, out to the region and the world. This strategy lends relevance therefore, to our investments in key international connectivity initiatives such as the SEA-ME-WE 3 and 4 fibre optic submarine cable systems, the Bharat-Lanka fibre optic submarine cable system and the Dhiraagu-SLT submarine cable system.

Likewise we have begun to establish a presence in key locations in the region as is manifested by our Point of Presence office in Hong Kong - SLT Hong Kong.

These are key factors in the Company's search for 'voice' in the world of regional and global connectivity.

There are those who reflect that viewing the world from outer space, one sees no boundaries or fences - all those demarcations are the work of man. It is encouraging to note that with man's enterprise, innovation and vision, he is able to reverse the trend, as is exemplified by the 'commedia' world we are moving into - no boundaries - just integrated services linking people all over the world - by phone, TV and computer.

This is what SLT has been building up to during 2006 - and it is what we will achieve in the years ahead, giving our local, regional and global customers the benefit of a world with - no frontiers.

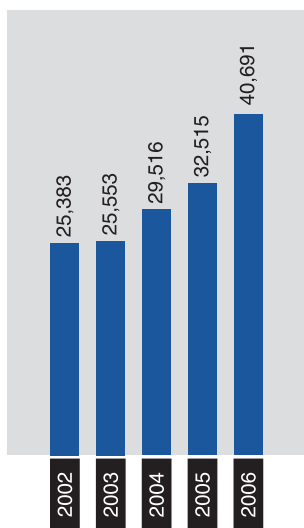
Vision To lead Sri Lanka to become the hub of telecommunications in South Asia

Mission To anticipate and fulfil the communications requirements of all sectors of the nation, in a service oriented work ethic which will provide total customer satisfaction through the most modern telecommunication facilities

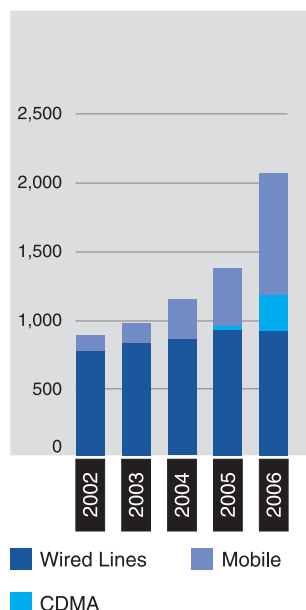
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Highlights

Group Revenue
Rs. million



Group Customer Base
Nos. ('000)



Financial Highlights - Group

Revenue increased 25% to Rs. 40.691 billion

Earnings before Interest & Tax increased 63% to Rs. 10.180 billion

Profit Before Tax increased 92% to Rs. 9.227 billion

Profit After Tax increased 76% to Rs. 5.438 billion

Earnings Per Share increased 76% to Rs. 3.01 per share

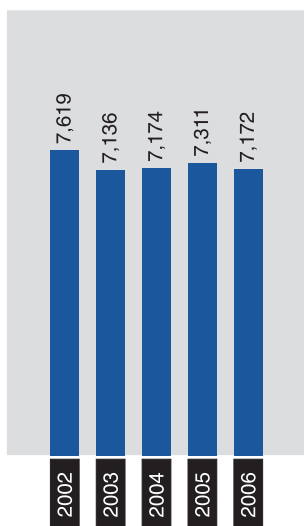
Return on Capital Employed increased from 7.79% to 11.28%

Return on Equity increased from 9.15% to 14.36%

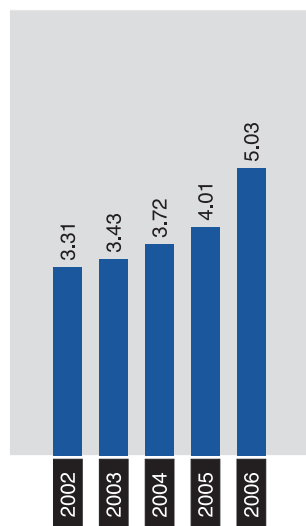
Group Customer Base

	2002	2003	2004	2005	2006
Wired Lines	768,620	822,922	860,468	919,040	909,894
CDMA	-	-	-	35,020	269,338
Mobile	114,009	143,000	284,430	420,062	885,042
Total	882,629	965,922	1,144,898	1,374,122	2,064,274

SLT Employees
Nos.



SLT Revenue Per Employee
Rs. million



Financial Highlights - Sri Lanka Telecom

Revenue increased 23% to Rs. 36.109 billion

Earnings Before Interest & Tax increased 37% to Rs. 9.379 billion

Profit Before Tax increased 53% to Rs. 9.229 billion

Profit After Tax increased 26% to Rs. 5.497 billion

Earnings Per Share increased 27% to Rs. 3.05 per share

Return on Capital Employed increased from 10.31% to 11.46%

Return on Equity increased from 11.90% to 13.50%



The year 2006 has been an extremely successful one for SLT. The progress and strong performance achieved by the Company certainly vindicates the strategies that have been adopted in taking our business forward.

The Economic Landscape

This was a year in which rising oil prices and an uncertain security scenario, both domestic and global, sought to impact adversely on the economic growth of Sri Lanka.

Nevertheless, in the face of these hurdles, the nation's GDP recorded a commendable growth of 8% in the first half of 2006 and is poised to grow above the 7% mark for the full year. For yet another year, the services sector was the main catalyst for this growth with a healthy gain of 9.1% over the previous year, comparing 1st half figures for the two years - the highest growth rate amongst the sectors, which all recorded gains.

The performance of the Services sector was fuelled mainly by the continued growth shown by the Transport, Storage and Telecommunications sub-sector, which expanded by 13% for 1st half 2006. Telecommunications was the highest contributor to this growth rate, expanding by 21.5% for the same period. The positive trends in the industry continued with expansion of coverage and introduction of new technologies and value added services, all of which took place in a very competitive environment. Telecom Service providers recorded a significant revenue growth in the area of Fixed Access - Wireless Loop telephony using CDMA technology. Mobile phone subscribers and revenue also grew.

Projections indicate that the telecommunications sector should close the year 2006 with a healthy growth of 20.2%.

In 2006, SLT made substantial contributions to the National Exchequer through tax payments of Rs. 3.8 billion and Rs. 2.7 billion paid out in other levies

A Great Year

The Group's revenue grew by 25% to reach Rs. 40.7 billion for the year in review. Local telephone services contributed 69% of this revenue, whilst international telephone services accounted for 20% and data and other services contributed 11%. Operating profits increased by 66%. Pre-tax profits stood at Rs. 9.2 billion whilst post-tax profits amounted to Rs. 5.4 billion.

These results have bettered the "best performance since privatisation", which we achieved in 2005 and is testament to Group strategy, its technical prowess and dynamism. It is also a clear indicator of the market potential that exists in the industry for SLT as a forward thinking and proactive player.

To The Nation

Quite apart from SLT's role as the main player in the field of communications in Sri Lanka, it is relevant also to recognise the contribution we make to the economic wealth of the nation.

For the year 2006, SLT contributed Rs. 3.8 billion by way of taxes plus a sum of Rs. 2.7 billion by way of other levies, all of which helps swell the Government's Exchequer.

SLT was Principal Sponsor of one of the region's premier sporting events, the 10th South Asian Games held in Colombo in August 2006. The Company's sponsorship amounted to Rs. 50 million and served to reinforce our commitment to strengthening relations across the region through sports. At the same time, this event identified closely with a goal of the Company, which is to be a major intra-regional communications player in the region.

Along with the Sri Lanka Rupavahini Corporation, SLT created history by deploying for the first time ever, ground breaking technology that enabled high quality live telecasts to be carried via fibre optic linkage.

SLT has invested Rs. 11 billion on new and ongoing projects during the year 2006. Placing this fact in a national perspective, this is equivalent to almost a fifth of the total quantum of Foreign Direct Investment (FDI) expected by the Government by year end 2006, which is forecasted at USD 525 million (Rs. 56.7 billion).

To Our Employees

The Company recognises the requirements and aspirations of employees who have entered into long-term contracts with us and we have taken steps to protect and guarantee their rights.

SLT has also decided to grant salary increases of up to 18.5% to non-executive grades with effect from January 2007

To Society

As this exciting industry continues to spawn ground breaking technology and opportunity that continues to change the face of communication and media across the world, SLT too looks beyond its role of service provider, towards that of a harbinger in bringing this change into homes and offices across the land.

SLT is partnering the Ministry of Education via its Secondary Education Modernization Project (SEMP), in providing broadband network connectivity to schools islandwide. In recognition of the need for more relevant and up to date education for the younger generation,

Chairman's Message

SLT will act as the telecommunications backbone provider for high speed access to data, video and voice communications in schools and libraries who are working in collaboration with SEMP. Initially 1,100 schools will fall within the project. For the future, SLT for its part will seek to expand its CDMA network and provide WiMAX facilities, which is an emerging technology built using radio frequencies for broadband wireless access. SEMP also hopes to widen the scope of this project to embrace 5,000 schools across a wider area of the country.

SLT is also partnering the Ministry of Education in its IRQUE Project (Improving Relevance and Quality of Undergraduate Education) by providing broadband network connectivity to Universities islandwide. This service will power LEARN (Lanka Education & Research Network). LEARN interconnects academic and research institutions across the country.

Under this scheme, SLT will provide connectivity to the University Grants Commission and 13 universities across the country via 10 Mbps IP-VPN links. This network will support various e-learning activities, enhanced video conferencing, video streaming and routing of inter-university voice and broadband internet access for academics and students from respective universities to liaise and improve their educational skills.

SLT is partnering the Government of Sri Lanka in setting up a Local Government Network the aims of which are to establish a Virtual Private Network on IP-VPN technology connecting 325 Government offices in the Western, Central, Southern and Sabaragamuwa Provinces. These offices will consist of Ministries, Departments, District and Divisional Secretariats.

Phase 1 of this project targets connecting 94 offices in the Western Province from mid-January to end-February 2007. Phase 2 will connect 231 offices in the remaining target Provinces between March and November of 2007.

SLT's role in this ground breaking project will involve providing site surveys, LAN and WAN implementation and maintenance of the system.

The Company is engaged in yet another exciting project involving the setting up of a Wide Area Network for the National Distance Education Network (NDEN) which operates under the aegis of the Distance Education Modernization Project of the Ministry of Education.

The NDEN network will provide optical fibre connectivity to all designated NDEN locations and the WAN will be established using Metro Ethernet running on Multi Protocol Label Switching (MPLS) technology.

Phase 1 of the project envisages connecting NDEN's Network Operations Centre with 9 Multi Media Centres (MMCs), all of which will be located in Open Universities. Phase 2 will connect 11 more MMCs to the Operations Centre.

How we Rate

Fitch Ratings reaffirmed SLT's AAA (Ika) domestic rating as well as its BB-International rating.

I am also pleased to inform you that SLT's Internet Data Centre (IDC) has been awarded the highest international information security standard - BS 7799/ISO 27001 certification, making SLT the first Sri Lankan company to achieve this ratification for its Data Centre. This recognition also enables SLT to be featured in the

Chairman's Message

Information Security Management System (ISMS) Registry, which in itself is a landmark achievement for Sri Lanka and opens doors for the country in terms of global competitiveness and standing in search of suitable international trading partners.

For the third year in succession, LMD ranked SLT as Sri Lanka's No. 1 listed company for the year 2005/06. This rating is bestowed after analysis encompassing turnover, payable dividends, stock market reserves and assets and capital reserves of companies listed in the Colombo Stock Exchange.

SLIM and A C Nielsen together conducted the Power of People (PoP) awards where SLT was selected as the winner of the sector 'Telecom Service Brand'.

Thank You

On behalf of shareholders and staff, I wish to thank Mr. Shuhei Anan who has relinquished duties as CEO of the Company, for his invaluable contribution and guidance. He took SLT through the tumultuous and challenging post privatisation years, with great success.

At the same time, on behalf of all, I extend a warm welcome to Mr. Shoji Takahashi who joins the Company as CEO.

I am honoured to recognise and thank employees across the rank and file of the Company. Their efforts and dedication have been the driving factors that have taken the Company to great heights in yet another year.

I thank my colleagues on the Board for their advice and guidance in steering the fortunes of the Company towards success.

SLT is firmly on course for continued success and I look forward to another exciting year of challenge and achievement.

Asoka Weerasinghe de Silva

Chairman

CEO's Message



The decade since privatisation of SLT in 1997 has been a period of great success for the Company. They have been years within which we have developed a world class network, introduced and deployed the latest technology and ushered in a new organisational culture.

The decade that lies before us will bring its own challenges, opportunities and 'excitement' - for the face of communications, particularly telecommunications, is changing so dynamically, as we speak - yet, I believe SLT is very well positioned within this rapidly developing scenario.

I count myself extremely fortunate to be at the helm of SLT at this high point in time. Let me explain in detail our strategic thinking for the future.

A New Culture... A New Way

What SLT needs is an 'evolution'. Thus, continuity will be our overarching theme. Over the decade gone by, we made the critical inputs necessary along the way, to build SLT into what it has become today - investing, creating a desired culture, strengthening infrastructure, building image consistent with market leadership and pursuing leadership in technology and business diversification. Now, we are gearing ourselves to introduce new and far reaching developments, upon the platform of our solid achievements to date.

Our strategic direction will focus on continuing the transformation of SLT from a traditional telecommunications company to that of a provider of an array of integrated services and solutions, shifting focus from being a predominantly infrastructure provider to a provider of services utilising infrastructure. Of course, we will continue to provide infrastructural services necessitated by the unfolding era.

CEO's Message

The key driver of change will be our people. They are truly our most valuable asset. They have achieved great things in the past and are the springboard from which we will launch a new organisational culture. The way we did things in the past will not always be the way in the future. Thus, we will carry forward the virtues of the past and instil in ourselves the new way, befitting the demands of the future.

The mantra underpinning the new culture is represented by 4 Ps: Proactive, Professional, Productive and Profitable. Being the pre-eminent listed company in Sri Lanka as we are, we must feel a great sense of pride in working for the Company and hold our heads high as we live the new mantra.

Every SLT person, across the organisation, will be focussed on the customer. Greater empathy with the customer and a timely sensitivity to customer needs will not only help retain our vast customer base but will also help to anticipate and introduce new and relevant innovative solutions. This unwavering focus on the customer coupled with heightened commercial awareness, creativity, teamwork and fitting business processes will drive our envisaged growth, whilst making life difficult for the competition. And in today's context, competition can arise from a least expected quarter; even from a humble 'start up'.

In this industry of rapid development, it is only natural that the customer has become more demanding than ever before. Corporate customers in particular are themselves challenged to reduce costs, become more efficient, productive and agile. Our capacity to understand our customers' challenges and provide them with innovative solutions will be another key competency that we have to develop further.

Customer retention will feature as prominently as customer acquisition in the scheme of things to evolve.

In our key cycle of processes, whilst business development and sales will play a greater role, they will be developed and bolstered in tandem with delivery and operations and maintenance.



Back office functions that were hitherto considered cost centres would be turned into profit centres where possible. This will afford us greater opportunity to develop a more expansive base of recurring revenue.

Stronger Together now... Convergence

Traditionally, communications and entertainment services fitted neatly into distinct little pigeon-holes - broadcasting, voice and on-line services all had their place, with no overlaps. Their networks were different and they used different platforms - they were regulated by different laws and different regulators.

The advent of Internet Protocol (IP) technology has afforded the facility of transport of traditional as well as new services across a single network, thereby allowing an integration of consumer devices such as telephones, TV and computers.

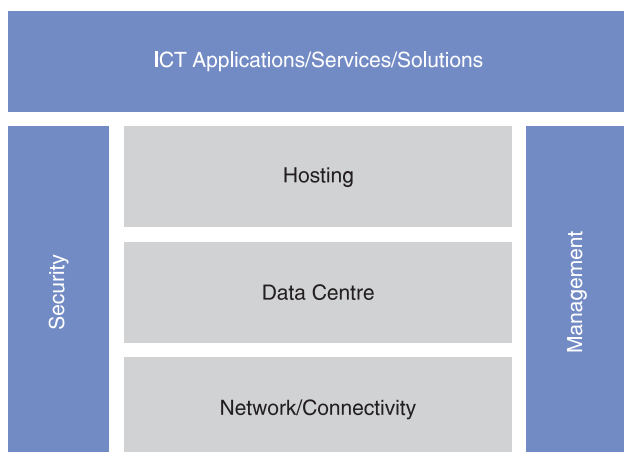
CEO's Message

In broad terms, SLT's three main business areas are: fixed telephony, mobile telephony and Internet. SLT is a clear leader in fixed telephony and the Internet, but lags some way behind, in terms of mobile telephony. One of our goals therefore is to develop our fully-owned subsidiary, Mobitel to achieve leadership in mobile business in the near future. Whilst this is a challenge it is also a great opportunity.

The Internet has opened up vast vistas of opportunity, far beyond traditional concepts of communication and entertainment services. Thus, the cornerstone of our strategy is the convergence of our three key business areas. And in this converged business scenario, mobile telephony, the Internet and fixed telephony would play significant roles, in that order.

Thus, growing our mobile business will be sine qua non to the success of convergence - convergence itself will offer a greater fillip for the growth of the mobile business - a cycle of gain.

We envisage that convergence will lead us to provide the following six areas of service:



SLT will have to be geared to provide all these services. This will be the key to meeting customers' evolving needs and will enable the Company to keep pace with rapidly changing demands and even to lead them.

Global Opportunities

Over the past three to four years, SLT has very aggressively expanded its global business.

The Company's strategic investments in SEA-ME-WE 3 and 4 (South East Asia - Middle East - Western Europe), Bharat-Lanka submarine cable system and Dhiraagu-SLT submarine cable system have significantly increased its international connectivity. SEA-ME-WE 4 is a next generation fibre optic based avenue of connectivity incorporating DWDM (Dense Wavelength Division Multiplexing) technology offering 1.28 terabit per second performance levels. Likewise, the Bharat-Lanka and Dhiraagu-SLT submarine cable systems employ fibre optic technology and have enabled SLT to offer high speed services benefiting both India and Sri Lanka, whilst opening up opportunities for SLT to facilitate communications in the region.

In the year under review, SLT established its first overseas subsidiary in Hong Kong under the name and style of SLT Hong Kong. This initiative signifies an important point of presence of SLT connecting Asia with the rest of the world through Sri Lanka. We intend to maintain this momentum in becoming a key player in the regional telecom industry. More overseas subsidiaries will be established as we go along.

Looking beyond our national borders, India and China are two countries who hold booming opportunities for SLT to tap into. Sri Lanka, sited in the gateway position to India, has a golden opportunity to pursue business in terms of offering main data centre services with backup or the reverse.

SLT's investment of Rs. 11 billion in new and ongoing projects in 2006 is equivalent to 1/5 the total FDI expected by the Government

CEO's Message

In addition, many large organisations have their own requirements of diversity in data handling. Hitherto, organisations mostly only required a submarine overseas cable service, but today, the demand is for end-to-end diversity. There is also the opportunity for SLT to fill the role of an operation centre, providing full and diverse solutions to customer organisations.

Today, alongside most of the top multinationals, a whole host of other international businesses and organisations are storming into India and China. Those that have set up operations in one of these two countries are now setting up operations in the other as well. Thus, data exchange between India and China will see massive increase, and we will have the opportunity to work very proactively with both these countries on this initiative.

In fact, the Chinese Government is eager to create a new business model based on outsourcing. Sri Lanka, India and China can join hands in offering large multinationals these services.

SLT could also consider diversifying into other areas of growth such as BPOs. India has tapped into this market from the West and business is booming. The unfolding scenario in India, however, sees a paucity of IT resources exacerbated particularly by a lack of human resources and attendant non-competitive labour costs. This scenario together with the evolving requirement for diversity of clients, presents a wealth of opportunity for Sri Lanka.

A recently publicised international survey on outsourcing reveals that a great majority of CIOs and CFOs of companies embrace fully the idea of selective IT outsourcing. The survey found the most popular part of an IT function for outsourcing was network/communications infrastructure (50%). In selecting an outsourcing provider for network/communications infrastructure, an overwhelming percentage of CIOs rated telecommunications highest (54%).

The key criteria in going for the specialist is to drive down costs and free themselves up to focus on core business functions.

SLT would consider setting up an IT development centre - a high tech IT Park in Sri Lanka. It would offer much more than infrastructure and will include the six key service areas mentioned earlier. This we envisage would create lucrative employment opportunities in Sri Lanka, which we foresee could lead to reverse migration of IT and related professionals, as has been the experience of other countries similarly placed.

A 'web society' is fast becoming the new global order. As Sri Lankans graduate from dial-up Internet access to broadband Internet access, they will begin to use the Internet for far more than simple web access and e-mail. SLT will lead this change through the provision of greater access to broadband Internet services as well as through the development of a host of other services. Here too, mobile will play a very important role in enabling access to the Internet from anywhere.

I must thank my predecessor, Mr. Shuhei Anan from whom I have taken over the reins, for having spearheaded change within SLT - change that I am eager to continue with the help of all at SLT.

I thank all employees who have stood shoulder to shoulder with management and colleague alike - it is clear that the achievements of SLT would not have come about without the effort and dedication of every single one of them.

My thanks also to members of the Board for their co-operation and prudent guidance over the year gone by.

Shoji Takahashi

Chief Executive Officer/Director

Board of Directors



01. Mr. Asoka Weerasinghe de Silva

Mr. Asoka Weerasinghe de Silva joined the Board of Directors of the Company as Chairman on 28 July 2006 having been nominated by the Government of Sri Lanka. Currently, he also serves as the Chairman of Mobitel (Pvt) Limited, SLT Hong Kong Limited and SLT Publications Limited. He is a Member of the Management Committee of the SLT Provident Fund and a Member of the Remuneration Committee.

Mr. de Silva having enrolled in 1972 as an Attorney-at-Law has an established practice in criminal law in the High Courts. He also serves as the President of the Balapitiya Branch of the Bar Association. From 1993 to 1998, he had served as a Member of the Southern Provincial Council and was a Member of Parliament for the Galle District from 1994 to 2000.

02. Mr. Shoji Takahashi

Mr. Shoji Takahashi was appointed as CEO of the Company on 4 December 2006. He had been a Member of the Board, since August 2005. Mr. Takahashi also holds the position of Director in Mobitel (Pvt) Limited, SLT (Services) Limited, SLT Publications Limited and SLT Hong Kong Limited. He is a Member of the Remuneration Committee.

Prior to his appointment as CEO of SLT, Mr. Takahashi had served NTTCom Asia Limited, HK Net Co. Limited and NTTCom Asia Network Systems (Guang Zhou) Limited as their President and CEO.

Before moving to SLT Mr. Takahashi has been serving NTTCom's overseas business interests for more than 15 years as Director, Arcstar Division - NTTCom, Director, Overseas Carrier Business - NTT and

Senior Manager, Overseas Department of NTT. In 1988, he has been assigned to US West, a US Telecommunications firm to engage in operational research.

He holds a Bachelor's Degree in Mechanical Engineering from the Nihon University, Japan and has completed an international business course at Masters level at the Management Academy of the Japan Productivity Centre.

03. Mr. Shuhei Anan

Mr. Anan was appointed to the Board of Directors of SLT in March 1999 in the capacity of Alternate Director. He became a Principal Director on 5 June 1999. On 21 July 2001 he was appointed Director/CEO of SLT which position he held up to 4 December 2006 when he relinquished the post of CEO. Mr. Anan continues to serve as a Non-Executive Director of the Company. He is the longest serving Director of the Board.

Currently, he serves of the Board of Mobitel (Pvt) Limited. He was also a Director of all the subsidiary companies of SLT until his resignation as CEO.

Mr. Anan holds a Master's Degree in Science from the University of Waseda, Japan. Prior to becoming CEO of SLT, he has held a number of senior management positions at NTTCom and was the Assistant Vice-President in charge of Operations & Maintenance at the Thai Telephone & Telecommunications Company. Whilst at NTT he has been in charge of Mergers and Acquisitions involving Telecom companies such as Philippine Long Distance Telephone Company (PLTD), Starhub in Singapore, Sri Lanka Telecom and Thai Telephone & Telecommunication Public Limited.



04. Mr. S.B. Divaratne

Mr. Divaratne was appointed to the Board of Directors of the Company on 27 May 2004.

Mr. Divaratne holds a Bachelor of Arts Degree from the University of Kelaniya and a Postgraduate Diploma in Economics and Policy Planning from the University of Manchester, United Kingdom.

He has over 30 years experience in the public service and has held a variety of positions, having joined the Sri Lanka Administrative Service in 1971.

He currently serves as the Deputy Secretary to the Treasury as well as Commissioner General of Essential Services. He also serves on the Boards of the Sri Lanka Ports Authority, the Public Enterprises Reform Commission and the Private Sector Infrastructure Development Company.

05. Mrs. Leisha Chandrasena

Mrs. Chandrasena joined the Board on 27 February 2006. She is an Attorney-at-Law & Notary Public by profession who has been in active practice from 1978 to 1987 and has served as a Legal Manager/Company Secretary in private sector enterprises. Currently, she is in active practise in the Civil Courts and serves as a Partner of a family owned Legal Firm.

Mrs. Chandrasena is also on the Board of Mobitel and SLT Hong Kong Limited.

06. Mr. S.N. Kumar

Mr. Kumar was appointed to the Board of Directors of the Company on 27 February 2006. He is also a Member of the Board of Directors of Mobitel.

Mr. Kumar is a businessman involved in the textile and garment sector. He began his career in the garment industry in 1982 holding managerial office in the financial sphere of the industry and thereafter began his own business enterprise in 1983. He currently serves as Advisor to the Minister of Foreign Employment Promotion and is also the Chairman of a reputed company.

07. Mr. Sumith Wijesinghe

Mr. Sumith Wijesinghe was appointed to the Board of Directors of the Company as a Non-Executive Director on 17 April 2006. He is also a Director of Mobitel (Pvt) Limited.

Currently, he serves as a Director of the National Development Trust Fund (Guarantee) Limited and as a Trustee of the National Development Trust Fund.

Prior to his appointment to SLT, Mr. Wijesinghe was a practising lawyer who, from 1993 to 1999 served as a Director of a National NGO which was involved in community development in the dry zone and the northern and eastern provinces.

During the period 1999 to 2004, he held several appointments as Co-ordinating Secretary to the Minister of Fisheries & Aquatic Resources Development, the Minister of Ports, Shipping, Fisheries & Aquatic Resources Development, and to the Leader of the Opposition. From 2004 to 2005 he was the Co-ordinating Secretary to The Hon. Prime Minister and from 2005 onwards he was the Co-ordinating Secretary to HE the President.

Strategic Direction

SLT completes ten years of operations as a privately managed commercial entity, which is unquestionably Sri Lanka's No. 1 Company in the telecommunications industry.

These were a challenging ten years within which the Company had to simultaneously develop in tandem with ultra rapid progress in technology, product and services whilst transforming key areas of business to reflect a dynamic player in a position of market leadership.

SLT's successful progress along this twin path owes much to well laid strategy that broadly fell within five phases.

We began in 1997, where in phase 1 we concentrated on network expansion and capacity building, which required significant investment to meet high demand.

From 1999 to 2001, we worked through phase 2 of our planned strategy, which focussed on creating a strong, competent and highly professional corporate management structure. The Company also strove to deliver higher levels of customer satisfaction, achieve financial stability and improve the quality of our service and maintenance.

Phase 3 was spread over 2002 and 2003 where we began to strengthen structure to take on competition - competition that came from the liberalisation of the market. We concentrated on increasing revenue, and building revenue assurance measures, pursuing revenue diversification, securing investor interest whilst ushering in new products and services, support systems and presenting SLT as a whole new organisation.

Phase 4 ran over the years 2004 and 2005 during which SLT focussed on building an image that befitted our positioning as market leader of the industry. We promoted

regional and global connectivity and continued to push for further avenues of revenue diversification.

As at the time of writing, the Company is firmly on course to accomplish phase 5 of this planned strategic path, which is set to run across the years 2006 to 2008. Within this triennium, SLT will seek to establish itself firmly as a leader in technology with a diversified structure.

To drive success in phase 5, the Company has identified several key areas of initiative.

Global Business

Particularly in the past two years, SLT has concentrated on putting in place adequate international connectivity measures that would assist its drive towards becoming a regional player.

To that end, the SEA-ME-WE 3 and 4 submarine cable systems, the Bharat-Lanka submarine cable system and the Dhiraagu-Lanka submarine cable system have significantly enhanced international connectivity employing fibre optic technology and offering high speed data transfer.

In concise terms, SLT seeks to achieve its vision of being the communication hub of South Asia by leveraging its geographically strategic location, international worldwide connectivity and its existing relationship with other international players.

Diversification

The global telecom industry is fast moving towards convergence. The advent of IP technology now allows for the transport of traditional as well as new services across a single network, leading to exciting possibilities to integrate consumer devices such as telephones, TV and computers.

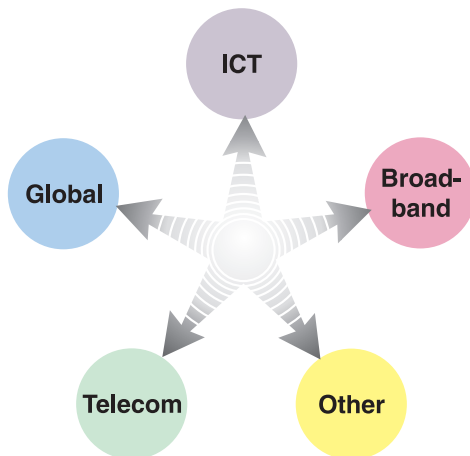
Strategic Direction

These and like developments are putting pressure on telecom companies to reshape conventional business models, which will soon become an absolute requirement for success. The line between 'communications' and 'media' are blurring as we write. The IP based technology of the day, plus wireless technology and other developments are converging the phone, TV and the computer onto one platform.

This is redefining our traditional concepts of telecommunications and moving it far beyond.

These are some of the areas of diversification the Company is actively engaged in:

New Business Development



Market Driven Business Entity

Our strategy is aided by the fact that today's technology is opening up a huge reservoir of customer needs and preferences. In a sense, we are developing our 'listening' qualities; we hear what the market is saying and we then respond with the technologies, products and services to meet these demands. Thus, we concentrate on providing reliable, high speed, high quality solutions with applications to the customer's needs rather than just a basic infrastructure.

Encouraging all our people to think out of the box on behalf of Company and Customer is embodied in one project that is run companywide, called 'Breakthrough Thinking'.

Market & Technology Leadership

Our strategy is to focus on leadership in both areas - where the market is concerned, SLT is a clear leader in terms of fixed line telephony and the Internet, whilst we have some work to do to bring our mobile arm, Mobitel, to a position of leadership.

SLT has begun roll out of its building block technologies which would eventually create fully-fledged NGN (Next Generation Network) based on IP technologies.

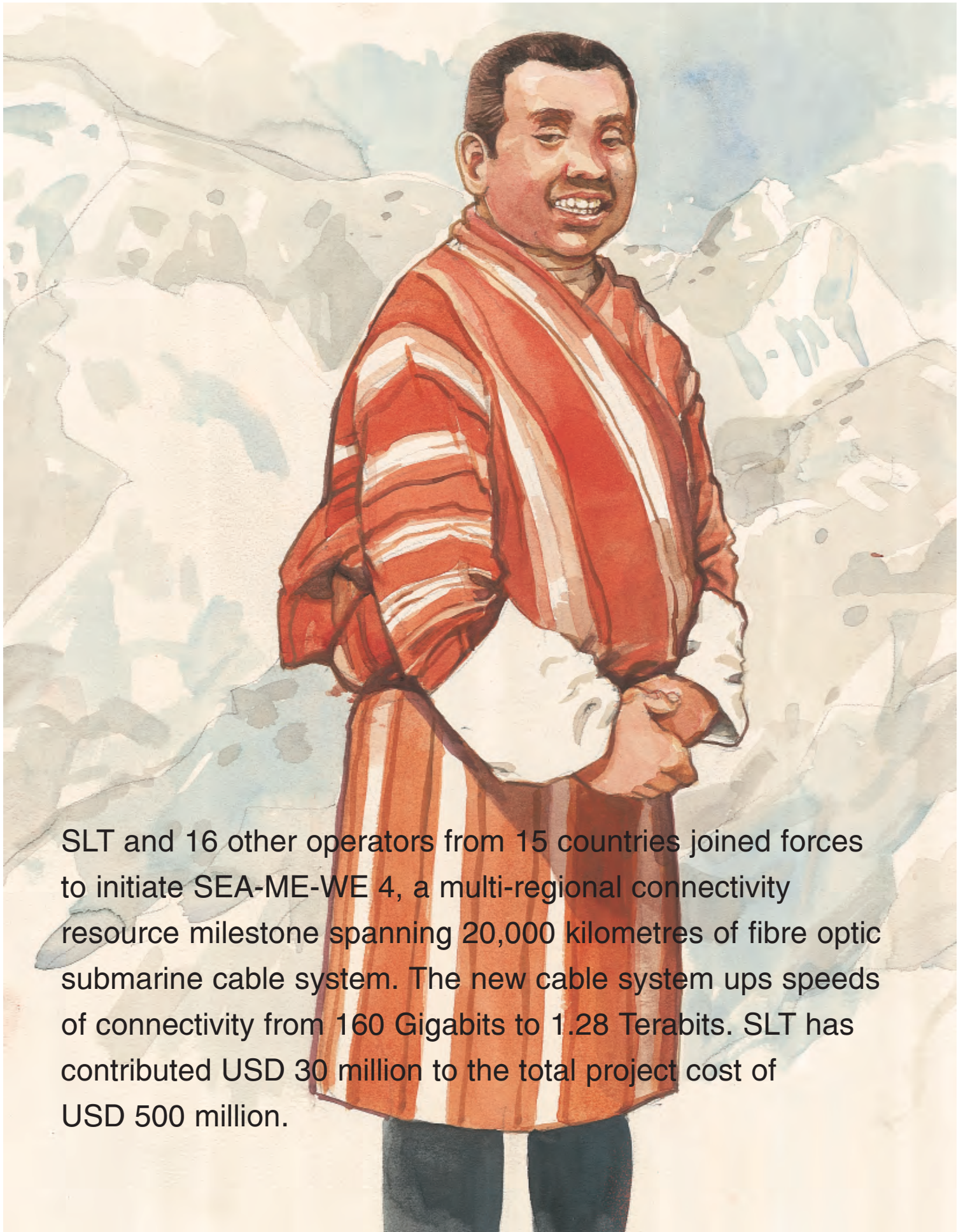
Technologies such as Metro Ethernet, IP-MPLS, IP-VPN, CDMA, WiMAX and ADSL will give SLT a clear edge over its competitors to become the market leader in both consumer and corporate markets.

New Service Development

This aspect of strategy follows a logical course, flowing from the introduction of leading edge technologies.

The Company's aim is to use these technologies to provide a host of services such as IP Voice, Wireless Data and multi-media offerings among others such as iDC, IP-VPN, Web Hosting, IP-TV and IP-transit.

The results achieved by SLT over the past decade certainly vindicate the strategy that has been followed. The Company is confident that forward strategies too are moving SLT in the desired direction towards success.



SLT and 16 other operators from 15 countries joined forces to initiate SEA-ME-WE 4, a multi-regional connectivity resource milestone spanning 20,000 kilometres of fibre optic submarine cable system. The new cable system ups speeds of connectivity from 160 Gigabits to 1.28 Terabits. SLT has contributed USD 30 million to the total project cost of USD 500 million.

In a land where everyone wears the national costume, the art of weaving colourful lengths of the most exquisite handloom fabric is still revered to this day.

Customer Centric Convergence

Over the year 2006, SLT has made steady progress along the path of convergence, where we are on the threshold of bringing the three main elements of business - fixed line, mobile and the Internet, onto one platform moving to multiple services on one network as opposed to the conventional approach of multiple services on multiple networks.

We are envisaging an imminent scenario, where mobile telephony, the Internet and fixed line telephony will be brought onto a single digital delivery platform and brought into homes and offices across the country. What this will do is to effectively offer the customer a composite of communication and media needs from a single source.

In an exciting new “commedia” market-place, it will be the needs of the customer that will drive networks, technologies and services. That day is not far off when services such as voice, data, broadband internet, TV content, video on demand, audio & video streaming and Ethernet services will be delivered via single connectivity to the customer, whether corporate or residential.

The Company's network development, technology deployment and service offering in the year under review were designed to meet the customers needs and demands for communication and access to information any time, any where and on any device. In brief what is envisaged is single connectivity which is capable of quad play: voice, data, video and mobile.

Transforming Networks, Systems and Services

Domestic Networks

Core Network

SLT's current core network comprising of both microwave and optical fibre is a fully digitalised telecommunications transport network consisting of 500 digital switching

nodes with 80 master telecommunication exchanges divided into 29 area codes, each served by a secondary switching centre. The secondary switching centres are in turn, connected to four tertiary switching centres at Colombo, Kandy, Galle and Anuradhapura and routed to the Company's National Switching Centre in Colombo.

High Capacity Optical Fibre Network

Poised to take over from microwave in the near future is our high speed islandwide optical fibre telecommunications infrastructure which will be the foundation for Next Generation Network (NGN). The NGN environment will enable multiple services on one network.

This futuristic infrastructure takes the form of four Metro Rings (504 Mbps), one Central Ring (2016 Mbps), a Southern Ring (504 Mbps), a North-East Central Ring (504 Mbps) and an East-Uva Central Ring (504 Mbps).

Whilst the four Metro Rings and the Central Ring are in full service right now, the other three are scheduled for completion during 2007. On full completion, SLT will command close on 1500 km of optical fibre interconnecting every province in the country.

The Southern Ring is targeted for completion by July 2007 and involves a length of 415 km of cabling covering Kalutara, Galle, Matara, Hambantota, Embilipitiya and Ratnapura.

The North-East Central Ring will be completed in September 2007 and will involve a length of 485 km of cabling covering Kurunegala, Anuradhapura, Trincomalee, Dambulla and Matale.

The East-Uva Central Ring will be in service by November 2007 and will involve a length of 610 km of cabling covering Nuwara Eliya, Bandarawela, Badulla, Moneragala, Ampara, Kalmunai, Batticaloa and Polonnaruwa.

Next Generation Network (NGN)

The Company took steps to evolve existing networks into an NGN which is an IP based service driven network and capable of providing multiple services on a single versatile network. NGN employs open and integrated network architecture. The NGN environment which is able to provide a variety of services: voice, data and multimedia services as an integrated service based on IP technology, will reduce considerably the amount of network components. This will result in less complexity and enhanced cost effectiveness.

In the year under review, the Matara area was identified to effect the migration of the first Master Switching Unit (MSU) and 16 Remote Switching Units (RSU) to NGN switching. This network has created a capacity for 34,325 telephones and 2,832 ADSL connections.

Access Network

Whilst evolving its core network into an NGN, the Company is in the pursuit of developing both wire line and wireless access network. Access network plays a strategic role in the Company's growth strategy. In time to come, the access network should be capable of delivering multiple services to the customer. In the year under review the Company made substantial progress in developing access networks - both wire line and wireless.

Copper

SLT's copper wire line network continued to expand. The primary objective of this expansion was to provide the medium for wire line broadband technologies such as ADSL. 18% of the Company's total capital expenditure was utilised on developing the copper network.

CDMA

The phenomenal growth recorded by SLT Citylink was powered by the continuous expansion of our CDMA network, currently running on 800 MHz frequency.

By the end of 2006, SLT had covered 90% of the geographical area of the island. The number of base stations put into operation rose to 170 in the year under review. This is by far the largest CDMA network with the highest number of base stations in the country.

'Fibre To The Building' Connectivity

SLT has embarked upon and made successful progress in providing optical fibre connectivity to major buildings in the Colombo Metropolitan Area. Fibre To The Building (FTTB) connectivity laid the foundation for promising wide area network technologies such as Metro Ethernet. The ring topology architecture ensures a far greater level of redundancy and greater network availability. In the year under review, the Company laid 70 km of optical fibre comprising of 12 rings in the Colombo Metropolitan Area. 77 important buildings were connected via optical fibre.

Global Networks

Developing a state-of-the-art global network is a strategic initiative. Such a comprehensive and cohesive network is a necessity for SLT to become an effective regional telecommunications player. The global network and domestic network will seamlessly connect with each other bringing in, taking out and redirecting gigantic volumes of telecommunication traffic.

Thanks to these developments, corporate/high capacity users can expect a more competitive tariff regime for global IP-VPN and other IP based solutions.

Sri Lankan customers will also enjoy better connectivity, with added access to multimedia content and broadband services such as movies, music etc. From a national perspective, Sri Lanka's level of international competitiveness will be significantly enhanced, through such service delivered on these networks.

SEA-ME-WE 4 Submarine Cable System

SLT inaugurated local operation of the SEA-ME-WE 4 fibre optic submarine cable system in January 2006. This cable system is a multi-regional connectivity resource of significant proportions spanning 20,000 km in extent.

The cable system is built and managed by a consortium of 16 operators representing 15 countries and will yield a significant increase in regional bandwidth capacity availability.

Benefits to SLT and Sri Lanka in general are plentiful, beginning with another avenue of redundancy, which will further secure existing connections such as the new link's predecessor, SEA-ME-WE 3, plus other on hand line-of-sight microwave links. We will see an upgrade in capacity, with the new cable's ability to support traffic capacities of 1.28 terabits per second. Improved capacity will lead to extension of broadband capabilities of our IP backbone network, allowing for higher speeds and more effective transfers between countries. Likewise levels of reliability and connectivity will also improve.

Bharat Lanka Optical Fibre Submarine Cable System

SLT and Bharat Sanchar Nigam Limited (BSNL) of India inaugurated the Bharat-Lanka cable system, a submarine optical fibre cable system that runs from Tuticorin in India to Mount Lavinia in Sri Lanka, in September 2006.

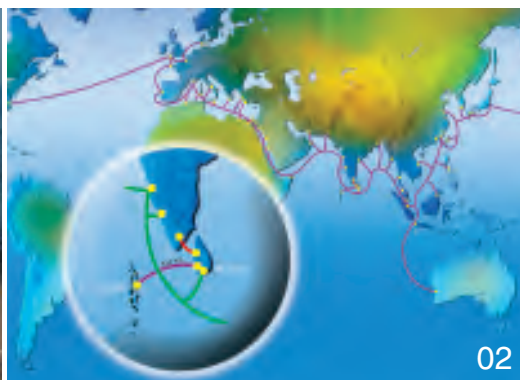
The Bharat-Lanka cable system seamlessly connects to SLT's domestic as well as its international connectivity, the latter including SEA-ME-WE 3 and 4 optical fibre submarine cable systems and multiple satellite channels of connectivity, to propel Sri Lanka into becoming a regional telecommunications facilitator.

The new cable system will benefit both Sri Lankan and Indian customers through provision of services such as highly competitive International Private Leased Circuits (IPLCs), Broadband Internet services, direct and transit IDD traffic, IP backbone networks and multi-media content services.

The cable system will increase BSNL's connectivity and could create substantial bandwidth where both SLT and BSNL could interconnect their IP-MPLS networks to facilitate global VPN services to a valued clientele.

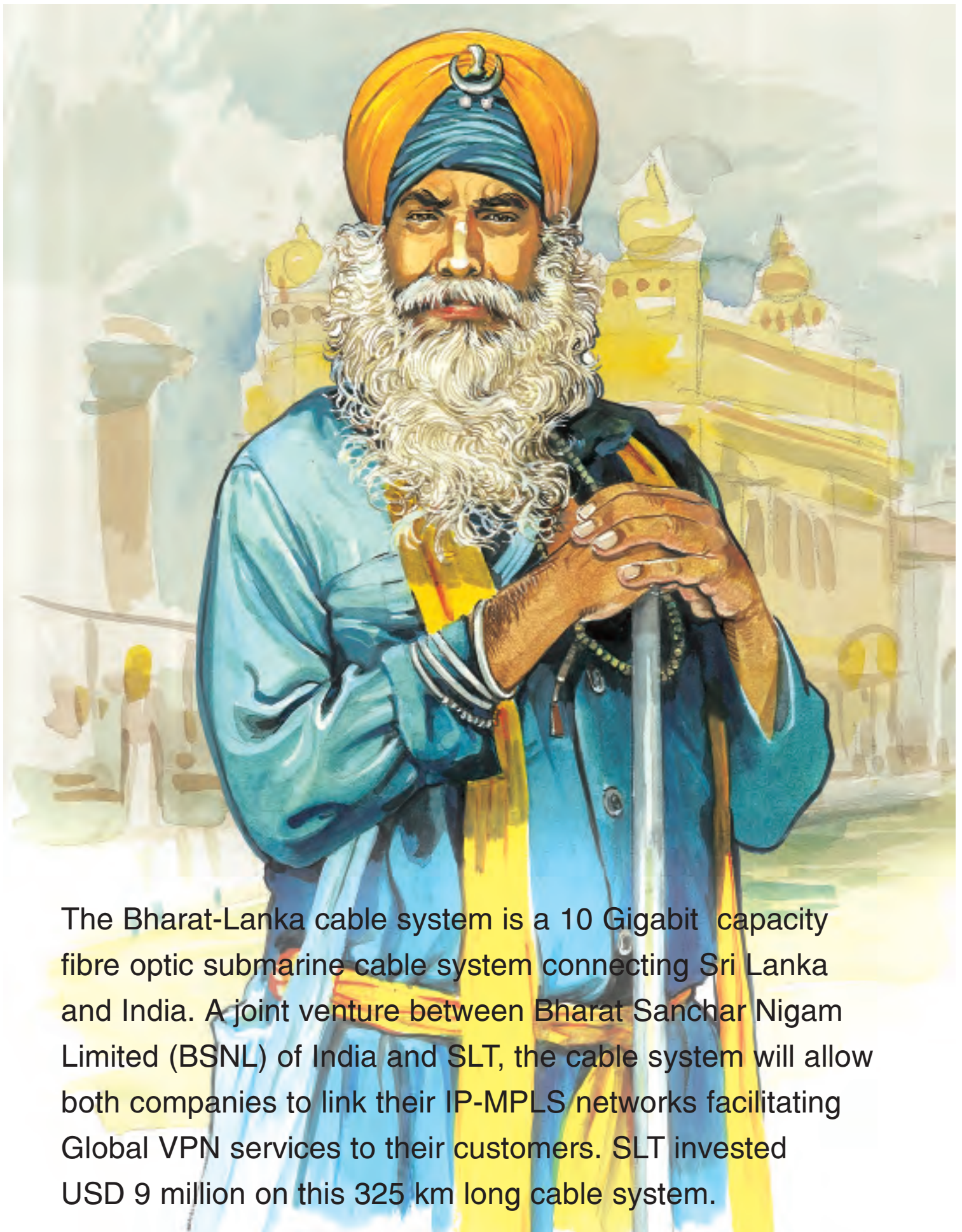
Customers in Sri Lanka will benefit through better connectivity enabling added access to multi-media content and broadband services such as movies and music, among others, whilst actual real time audio and video streaming facilities will be further enhanced.

Historically, this project would constitute the largest joint investment between India and Sri Lanka and stands testimony to the strong links and high level of co-operation that exist between the two countries.



01 The Dhiraagu-SLT fibre optic cable system is laid along its 850 km route creating a high speed connectivity of 10 Gbps per second between Sri Lanka and the Maldives.

02 Expanding its connectivity through fibre optic submarine cable systems, SLT joined operators from 15 other countries to form a multi-regional connection under SEA-ME-WE 4 while connecting with Maldives through the Dhiraagu-SLT cable system and India through the Bharat-Lanka cable system.



The Bharat-Lanka cable system is a 10 Gigabit capacity fibre optic submarine cable system connecting Sri Lanka and India. A joint venture between Bharat Sanchar Nigam Limited (BSNL) of India and SLT, the cable system will allow both companies to link their IP-MPLS networks facilitating Global VPN services to their customers. SLT invested USD 9 million on this 325 km long cable system.

The resplendence of the Sikhs. The majestic turban and other regalia makes a vital contribution to the rich panoply of our giant neighbour, India.

Dhiraagu-SLT Optical Fibre Submarine Cable System

The Company commissioned the Dhiraagu-SLT optical fibre submarine cable system between Sri Lanka and the Maldives on 2006. The project is a collaboration between SLT and Dhiraagu of the Maldives. The new cable system will allow for super highway level bandwidth, with 10 Gbps capacity, between Sri Lanka and the Maldives.

The new cable system, taken in context with Sri Lanka's existing global connectivity through SEA-ME-WE 3 and 4 and the Bharat-Lanka cable systems will afford Dhiraagu and the Maldives with enhanced international connectivity. It will also play a vital role in enhancing economic development between Sri Lanka and the Maldives, through the provision of superior telecommunications facilities in South Asia.

Deployment of Cutting Edge Technologies

The Company gave unprecedented emphasis to the deployment of cutting edge technologies in copper, optical fibre and wireless media. Whilst deploying core technologies to transform our traditional network to an NGN, necessary access networks also have been deployed. As for the core technologies, IP-MPLS deployment took the highest priority. ADSL, CDMA and Metro Ethernet were expanded and introduced as state-of-the-art access technologies.

Core Technologies

One of the the Company's key business objectives was to diversify revenue streams from traditional sources. In fact, customer demand too is for provision of multiple services on single connectivity. The Company stuck to a clear strategy to deploy core technologies that would be the foundation for other technologies and applications/ services to be introduced to make multiple access technologies available.

IP-MPLS Technology

It is a global trend that revenues continue to shift from traditional voice to data at a phenomenal rate. More and more voice is transferred as IP-MPLS. Convergence of services and networks is widely prevalent. IP-MPLS based transport networks are being expanded beyond the 'last mile' up to the customer's premises. Triple play: voice, data and video capability of networks is becoming a mandatory requirement for telecommunications operators.

It was a remarkable achievement for the Company to be able to complete targeted deployment of IP-MPLS technology on fibre network, which is the foundation for multiple service delivery in an NGN environment. Keeping up with global trends and SLT's own growth strategies, several new projects such as a Network Management System for IP-MPLS network, Wireless Data Access Network, strengthening of security, providing management for VoIP network, hosted PABX and IP phone services were successfully implemented.

WiMAX

WiMAX was identified as the future wireless backhauling technology to serve SLT. Therefore, the Company began to explore this exciting new standards-based wireless technology, which provides high-throughput broadband connections over long distances through the use of microwaves. WiMAX also is regarded as a more cost effective option for broadband connectivity. WiMAX is suitable for voice, high speed Internet connectivity, e-mail, fax, data and services such as audio and video streaming. In addition, WiMAX can support other applications including "last mile" broadband connections, hotspots and cellular backhaul and high speed enterprise connectivity for businesses.



SLT and Dhiraagu of the Maldives Islands jointly invested USD 20 million to set up the Dhiraagu-SLT fibre optic submarine cable system running over 850 kilometres between the Maldives and Sri Lanka at a speed of 10 Gbps. It offers high speed connectivity between the two countries fostering better trade relations and telecommunications within the region.

Traditional Belarusian dress originates from the time of Kievan Rus and over time assimilated the cultural influences of the country's neighbours, the Poles, Lithuanians, Latvians, Russians and other European nations.

SLTCitylink CDMA service grew by 693% in 2006 and now covers 90% of the island

Business Review - Sri Lanka Telecom

During the year in review, the Company also signed an agreement with international chip maker, Intel Corporation to deploy a co-marketing programme for WiMAX. Intel Corporation is developing computer chips for WiMAX customers' premises equipment.

The Telecommunications Regulatory Commission (TRC) has granted frequencies on a temporary basis to SLT to conduct testing for which the Company is very grateful.

Access Technologies

CDMA

Entering the market as the last entrant, the Company recorded phenomenal growth in deploying CDMA technology in the year under review. CDMA will continue to be used as a wireless access technology, an alternative to that of copper based wire line. CDMA has brought to the remotest areas of our nation, a system that is based on wireless access technology and delivers a package of state-of-the-art services that truly anticipates and fulfils the needs of customers.

By the end of 2006, SLT Citylink CDMA customers were enjoying facilities such as 16 Party Call Conferencing, Calling Line Identification (CLI), Call Transfer and Forwarding, Do Not Disturb (DND), IDD, Wireless Public Payphones, G3 Fax, Internet Access, Packet Data Services, SMS, and Customised Ring Back Tone (CRBT).

Metro Ethernet

SLT commenced roll out of its Metro Ethernet Services, which provides integrated single port connectivity conveying multiple services such as voice, high speed data, high speed Internet, video conferencing and networking solutions. Alcatel provided the Metro Ethernet solution to SLT that in turn, supported the roll out of the service.

The Company has initially targeted businesses and high-end corporate clients providing them with the end-to-end intelligent solutions they seek, via the Ethernet Service which is based on our state-of-the-art IP-MPLS technology.

SLT Metro Ethernet deployment has completed 12 access rings in Colombo, linking 77 buildings as at year end 2006.

Services offered include high speed/high bandwidth data and Internet services at speeds ranging from 1 Mbps to 1 Gbps. Initially customers are offered the facility of choosing lower speeds such as 1MB or 2MB and later upgrading to any point in the range offered, up to 1 Gbps.

Also offered are new and enhanced services such as Virtual Private LAN services and Local Area Network interconnections.

Basically, SLT's Metro Ethernet is a triple play ready network, where voice, data and video services could be supported.

ADSL

The Company's deployment of its broadband wireline technology ADSL, continued in 2006. SLT's ADSL technology was launched in 2003 and has grown its customer base by 65%, from 13,312 subscribers in 2005 to 21,899 subscribers for 2006.

SLT partnered global giant Huawei Technologies to enable our customers to enjoy broadband facilities at an affordable cost. Under this project SLT customers could tap into exciting value added services such as broadband Internet, VoIP services, IP-TV, Video on Demand, e-Learning and Gaming etc.



SLT established a subsidiary SLT Hong Kong to function as a key point of presence within the Company's growth strategy. Initially, the new office will provide seamless connectivity to traffic generated by SEA-ME-WE 4, Bharat-Lanka and Dhiraagu-SLT cable systems. Initial investment was HKD 2.5 million.

The colourful and elegantly oriental dress styling of the Qing dynastic period of China.

The project will use SLT's existing copper wire line network and enable the Company to provide standard DSL connectivity to many suburban and rural regions of the country, who currently do not enjoy DSL coverage, thus creating a significantly favourable impact on the economy.

Internet Services

SLTNet

SLTNet, the largest Internet service provider in Sri Lanka caters to the entire community in the island, residential or corporate, encompassing all needs, whilst offering the best of packages to suit each individual's need.

Our Internet customer base has been growing since its launch in 1996. In 2000, our service was re-launched as SLTNet in pursuance of a strategy based on competitive pricing, quality of service and access speed. As part of the re-launch, rates were lowered and a help desk was established.

SLT offers a host of facilities and spin offs such as - global Internet connectivity to Asia, Europe and the USA. It allows SLT to connect to the world's Tier 1 operators such as NTT, SingTel and ATT among others. Other benefits include enhanced quality, performance and reliability plus far greater speeds for dial up and ADSL.

This enhanced bandwidth also supports all of SLT's state-of-the-art and futuristic products such as IP-TV, iDC, IP-VPN, VoIP and our Metro Ethernet Services.

Today, SLT is unchallenged as the dominant player with a share of 75% of the Internet market.

SLT currently offers Internet leased lines at 64 kbps, 512 kbps and 2 Mbps. Mail server services, web and Domain Name Server (DNS) hosting are other value added products on offer to business customers.

The Company continues to offer an Internet Pre-paid Card which has proven to be a boon to the traveller who can enjoy access to the Internet at a flat per-minute rate without the inconvenience of application, activation and monthly billing.

Expanding Services to ISPs (B2B2C / Wholesale)

SLT has expanded its Internet Network by establishing Regional PoPs to cover all areas of demand in the Island. The ISP core network has also been upgraded to deliver high quality service.

SLT established the highest International Internet backbone connectivity in Sri Lanka and the Company now offers over 1Gbps International bandwidth.

Thus, the Company operates the largest Internet backbone supporting greater Internet and broadband usage. During the period of the earthquake in Taiwan in 2006, SLT was the only ISP whose services were not disrupted.

By adopting the newest technologies in the IP field, SLT has delivered numerous value added features and services to its Internet customers. SLT's broadband service portfolio includes numerous value additions from Audit Filter Web Service to Online Call Waiting.

Major ISP operators in the country obtain Domestic Internet Exchange Service (SLTIX) from SLT.

IP-Transit Service

The service is targeted at local as well as foreign ISPs in the South East Asian region.

Major Corporates and ISPs who have IP networks not belonging to SLT can obtain direct international IP connectivity from SLT's IP-transit service.

Direct Peering Service

This is a domestic internet service which provides interconnection between SLTNet and other ISP networks thereby enabling mutual exchange of traffic.

Public Peering Service

Public peering allows networks interested in peering, to interconnect with many other networks through a single port. Therefore, any ISP can be connected to any other ISP by SLT's Public Peering Service.

Our efforts to develop the service further goes on apace with the next phase of expansion targeted for the year 2007.

Diversification & Business Convergence

Global Solutions

Points of Presence (PoP)

In 2006, the Company incorporated a fully-owned subsidiary in Hong Kong. SLT Hong Kong Limited, is fully geared to provide services such as IP-transit, IP-VPN, IPSL and international voice traffic transit services to global telecom operators and corporates in Hong Kong.

As part of the ongoing initiatives of SLT to go global, SLT Hong Kong Limited will aim to become an important point of presence for the Company connecting Asia with the rest of the world through Sri Lanka. The initiative of incorporation of SLT Hong Kong Limited will be a considerable step forward for SLT to become a regional telecommunication facilitator.

SLT today enjoys high bandwidth global connectivity via SEA-ME-WE 3 and 4. These cable systems along with multiple satellite connectivities help SLT to harness the

full potential of newly commissioned bilateral projects such as the Bharat-Lanka submarine cable system and the Dhiraagu-SLT submarine cable system.

International submarine cable systems will play a pivotal role in realising SLT's goal to become a global IP company. The Incorporation of SLT Hong Kong Limited will create an important Point of Presence in Hong Kong, a major telecommunications hub in the South-East Asian region. SLT Hong Kong Limited will become a cornerstone of SLT's future global business. Another Point of Presence is planned to be sited in Singapore shortly.

SLT's strategy encapsulates the need for diversification whilst retaining its role of leadership in the telecom market. Herein lies the story of an 'eternal' cycle - leadership comes only when products and services remain on the cutting edge of business; and to remain on the cutting edge requires emancipation of strategy and business to widen focus and embrace the exciting new technology and development that has become the hallmark of the global telecommunication industry.

This report is already replete with the manner in which the Company has gone about upgrading and modernising technology and infrastructure.

Other areas we have concentrated on are - SLT Publications, a fully-owned subsidiary of SLT, which is in operation and focuses on tapping into the publication business opportunities in Sri Lanka whilst producing SLT's own Directories.

The IT sector is also another area of interest in our diversification strategy. SLT plans to commence business in many IT specific areas in the near future.

With MAXtalk, SLT's international calling solution for the price conscious, the Company is truly No. 1 in everyone's book

The diversification strategy of SLT will continuously keep abreast of the current global and local market trends and initiate new business. This, in turn, will grow SLT's business portfolio and keep the Company on the cutting edge of the industry.

Offering Quality Solutions

Business to Customer (B2C) Business Area

The Company recorded a remarkable growth in B2C business. SLT Citylink CDMA was the driver supported by wireline connections, prepaid card business in the domestic market and IDD voice and, internet.

SLT Citylink CDMA

SLT's CDMA roll out plan envisioned three phases each generating 150,000 connections. As at the end of 2006, we have achieved 269,338 connections supported by 175 base stations. When compared with the 35,020 connections achieved for the last quarter of 2005, which was the start up point, SLT Citylink CDMA has posted a growth of 693%, by end 2006.

New Connections for 2006 (CDMA)

Area	Number of Connections
Metro Area	42,485
Central	27,446
North-Central & North-Western	30,408
Western - North	23,257
Western - South	18,662
Sabaragamuwa	21,565
Southern	29,730
Uva	22,374
North & East	18,391
Total	234,318

Wireline Connectivity

The Company continued to expand copper based connectivity, as it remains an important delivery platform for broadband services on ADSL technology. In the year under review, SLT added 25,179 new connections.

SLT Passport

The Company's premier pre-paid card was made more available to the consumer through a tie up between SLT and the Keells Super chain of supermarkets. Hitherto, only available from Teleshops and SLT distributors, the widened availability and convenience of obtaining them from any Keells Super outlet has proved a boon to customers.



01



02

01 The SLT Citylink CDMA campaign launched by SLT resulted in a 693% increase in the CDMA subscriber rate in 2006.

02 The latest SLT pay-phone booth is modern, attractive and facilitates both local and International calls.



A Sami woman - her colourful attire brightens the pristine landscape of Lapland.

SLT MAXtalk

SLT is not just Sri Lanka's No. 1 telecommunications provider, it belongs to everyone in terms of the wide scope of its product portfolio. Nothing illustrates this better than MAXtalk - a pre-paid international calling card that targets the needs of the price conscious consumer.

The card operates on a VoIP platform and offers international calls to over 68 countries around the world at rates of Rs.10 per minute for dialling of fixed lines and Rs.18 per minute for dialling mobile phones. This initial 'footprint' covers countries in Europe, the USA, Japan, Australia and Singapore. Customers can also call countries in the Middle East, South East Asia and 148 other countries for a tariff of Rs. 25 per minute for dialling fixed lines and Rs. 35 for dialling mobile phones. The MAXtalk card is usable on any phone in the country.

SLT Wi-Fi Hotspots

SLT stepped in to provide several local hotels with Wi-Fi (Wireless Fidelity) Mobile Internet Zones, popularly known as Wi-Fi Hotspots. The SLTnet Internet Zone both customers as well as hotel employees can be continuously on-line, accessing up to 2 Mbps dependent on traffic volume handled by the network at the time.

Payphone Booths

With convenience to the public foremost in mind, SLT launched a new telephone booth and payphone with a modern and attractive touch. We envisage providing 750 coin and card payphones in prominent public areas in all major cities in the island, under this project. The phones accept a range of denomination of coins - from 50 cents to Rs.10 and will handle local as well as international calls. Likewise the phones accept SLT Passport cards and MAXtalk cards as well. A new Payphone card is also to be introduced soon. The phones provide charge free access to emergency numbers such as 118 and 119 (the Police), 1241 (faults reporting) and 1242 (billing inquiries).

SLT i-Gateway at the Bandaranaike International Airport (BIA)

The Company inaugurated a communications centre, SLT i-Gateway, at the Transit Lounge of the BIA in February 2006. The new centre provides Internet and voice communication facilities on 24-hour basis to passengers using the Airport.

Business to Business to Customer (B2B2C) Business Area

The year 2006 saw a gigantic growth in provisioning of B2B2C solutions. It is interesting to notice that the Company spread its wings across a broad spectrum of industry verticals.

SLT's dominance in financial, e-governance , manufacturing, diversified and leisure sectors was reinforced whilst making the Company the preferred communications solutions provider to other industry verticals both in private and public sectors.

SLT reinforced its potential as a truly integrated solution provider via its unmatched local and global connectivity to provide triple play services, voice, data and video. SLT's intelligent solutions were a customised blend of different services in the form of MPLS based IP-VPN connectivity, data centre services, high quality premium Internet bandwidth, international leased lines, with an array of value additions such as mobility, managed services and disaster recovery.

During 2006 SLT, through its Metro Ethernet Services commenced connecting key business premises via a high speed, reliable, managed optical fibre network with ring topology. The Company's considerable presence in 2006 by way of provisioning of communications to condominium apartment will be a promising revenue driver in the future.

Bank of Ceylon

SLT is the total voice and data communications solution provider to the Bank and during 2006 SLT completed a project to connect another 150 locations islandwide using IP/VPN technology thus bringing 350 branches online. The Bank's network reliability was enhanced through a disaster recovery solution powered by SLT Metro Ethernet where a high speed fibre connectivity was commissioned to the Bank's backup centre.

People's Bank

During 2006, SLT provided connectivity to another 175 locations using both IP-VPN and Canalised connectivity to power the People's Bank's on-line banking and core banking services. In total, the Bank has over 275 branches and about 100 pawning centres islandwide linked by SLT. Further, SLT commissioned Metro Ethernet connectivity to its HQ and backup centre to facilitate disaster recovery in a seamless manner.

National Savings Bank

The Bank chose SLT to be their total communications solutions provider. Under the agreement, NSB will network their head office, 111 branches, 18 ATMs and 8 savings centres within a IP-VPN. The SLT IP-VPN solution enables the carriage of voice and mission critical data, with utmost reliability and security. In addition, all branch sites are provided with backup systems allowing the countrywide branch and ATM network of NSB to have access to a centralised IT network at any given time, also enabling them to communicate with each other and the head office via phone, video conferencing and data (e-mail, Internet), at a minimal cost.

Commercial Bank of Ceylon

SLT is the main voice and data service provider to Commercial Bank. In 2006, SLT powered the connectivity to its 150th branch, whilst our data network links over 190 locations including ATMs and service centres. The Commercial Bank became the first company to be

provided with the latest Metro Ethernet based Virtual Private Land Services (VPLS) to inter-connect 3 of its main locations at very high speeds. SLT has also proved its capability by linking the Bank's overseas operations in Bangladesh.

Eagle Insurance

During 2006, SLT became the total communications solution provider to Eagle Insurance when it won back its voice services from the competition and commissioned Eagle's islandwide branch network with IP-VPN technology. This network will allow all 24 branches to have access to a centralised IT network, which will enable them to communicate freely with each other and their head office. All main locations of Eagle were connected to SLT Metro Ethernet giving Eagle Insurance immense freedom to expand its operations.

Lanka Orix Leasing Company (LOLC)

During 2006, SLT won back LOLC data services business from the competition, to further strengthen its dominance in the financial sector when the commissioning of an IP-VPN network solution connecting 22 LOLC branches was completed.

MAS Group

In 2006, SLT connected 12 offices of flagship apparel giant, MAS Group using an IP-VPN solution in addition to the voice services provided by the Company. With the launch of SLT Metro Ethernet MAS HQ was provided with high speed Internet connectivity and IP-VPN connectivity to facilitate its high bandwidth requirements. Also SLT is the proud provider of international circuits to MAS Group connecting USA and India.

John Keells Group

SLT is proud to be the preferred telecom service provider of John Keells Group covering its different business streams. Main locations are provided with optical fibre connectivity to link 68 offices by an IP-VPN technology solution.

Ceylinco Group

SLT has been the main telecom service provider to the Ceylinco Group from the inception of that company, covering different business streams such as Banking, Insurance, Real Estate etc. Seylan Bank preferred SLT as their data and voice communications provider and Ceylinco Life grew its IP-VPN network up to 130 branches powered by SLT. During 2006, Ceylinco General also started rolling out with SLT's IP-VPN technology. SLT has been serving this group under the Group Key Account Management concept and is proud to see a steady growth in this account.

Singer (Sri Lanka)

SLT's IP-VPN technology connects 280 branch offices of Singer islandwide, in addition to voice communication services. This network will be one of the largest IP-VPN networks provided by SLT serving a different business sector.

Wijeya Newspapers

SLT entered into an agreement with Wijeya Newspapers Limited under the terms of which SLT has provided them with Voice/PABX for voice communication, IP-VPN for network solution, Internet and iDC/Hosting services. Seamless internal and external communication will help the newspaper group offer enhanced services to their customers whilst also delivering network cost savings.

EDNA Group

The Edna Group has signed up with SLT to receive a total communications solution consisting of 60 new telephone lines, an E 1 link and an inter-branch voice communications solution. SLT will provide a video conferencing network that links more than 30 locations and a data network solution based on the Company's IP-MPLS network.

Colombo Stock Exchange (CSE)

SLT's partnership with the CSE sees the Company putting in place unrivalled and attractive service levels that ensure 100% reliable and uninterrupted data communication between the CSE, its branch offices and stockbrokers, in what is one of Sri Lanka's most mission critical networks.

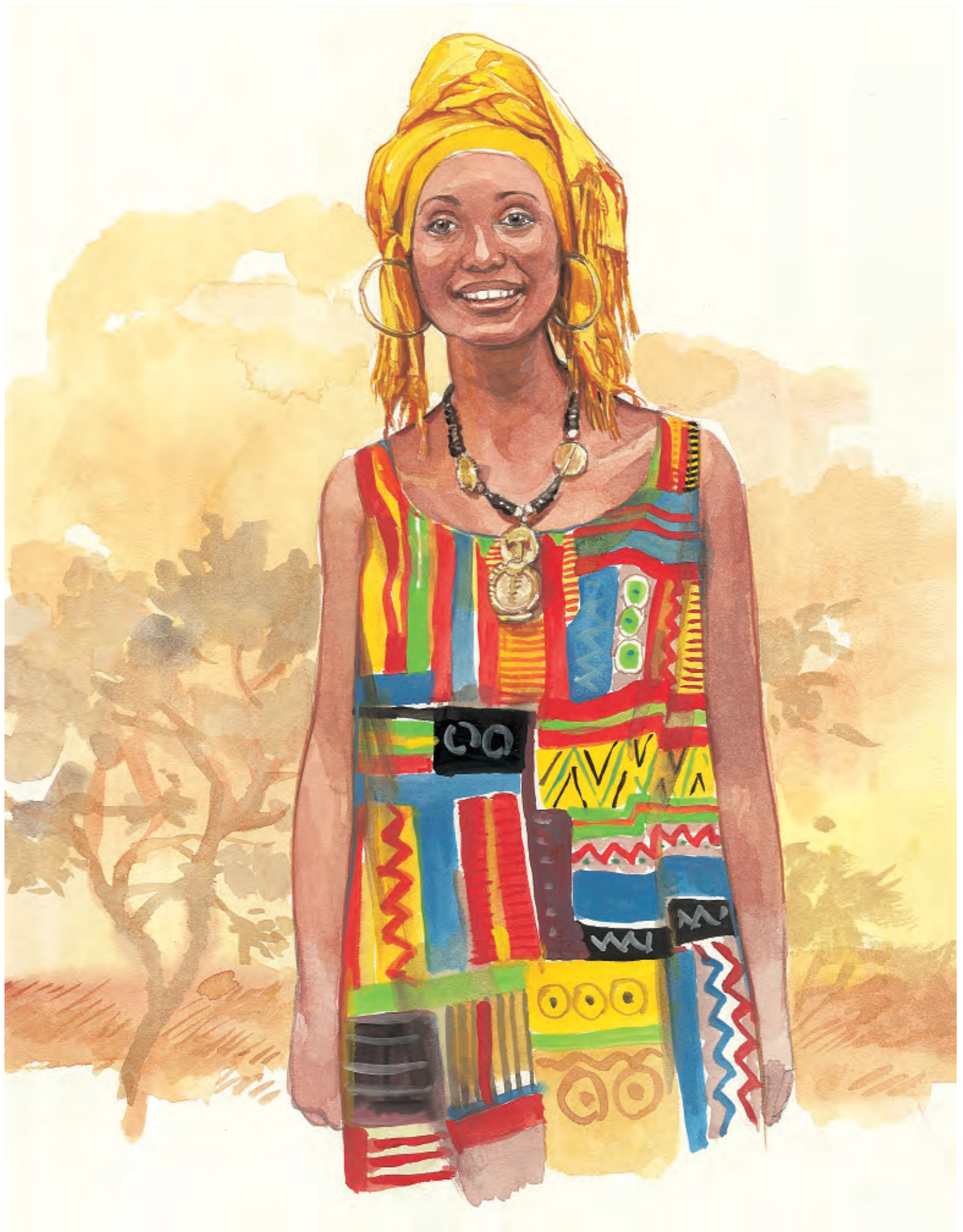
SLT facilitates CSE in providing on-line network connectivity to stockbrokers, desk brokers and its branches to process on-line trading activities, through a network of 30 high bandwidth leased lines.

SLT is the main voice service provider to the CSE and hosts their web, database and application servers at SLT iDC, which connects to the global Internet at unlimited bandwidth. The latter feature enables a large number of investors to get connected simultaneously during trading hours. SLT also provides backup solutions with the requisite hardware to facilitate on-line trading activities.

These services are supported by an MPLS based IP backbone offering a host of services such as IP-VPN, ADSL, voice VPNs and broadband centred hosting.

Other Major Business Tie-ups

2006 was a remarkable year where SLT won many business contracts to provide total communication solutions to the Corporate Sector - Sri Lankan Airlines, Janashakthi Insurance, PABC Bank, Browns Group, Hayleys, Asian Alliance, CIC, Lankem, Mount-Lavinia Hotel, Virtusa and Colombo Dockyard among others.



The face of South Africa - a nation newly emergent in all its richness and diversity, with its own, vibrant indigenous culture.

Trillium Residencies

Under its agreement with Ceylinco Condominiums Limited, SLT becomes the sole communications provider for their flagship BOI approved project, Trillium Residencies. Through its complete solution package, SLT will provide Trillium with 620 telephone lines with capabilities such as broadband Internet, video conferencing, IP-TV, VoD (Video on Demand) and video gaming.

Business to Government to Public (B2G2P) Business Area

Beyond any doubt the Company recorded a remarkable achievement by becoming the network provider to almost all mega projects of the State.

The Company was successful in being awarded each of the mega ICT projects, (which are scalable and would have a longer life-span) by going through competitive tendering processes. These mega networks open the door of tremendous opportunity for the Company to provide integrated solutions which are a composite of network/connectivity, hosting, applications, security and management generating new streams of revenue in the future.

Nenasala - Knowledge Centres

SLT partnered the Information and Communication Technology Agency of Sri Lanka (ICTA) in providing communications solutions for the Agency's Nenasala distance learning and e-learning project across the rural areas of Sri Lanka.

ICTA aims to set up 1,000 such centres and have them fully functional by the end of 2008. The choice of SLT as a partner was based upon competitive pricing and its superior connectivity across the rural and relatively inaccessible areas of the country.

Powered by SLT's guaranteed bandwidth on IP-VPN, 200 Nenasalas, including 100 rural knowledge centres and 100 e-libraries, will enjoy simultaneous access to support multimedia content delivery, across the Internet for web browsing, e-mail and government services.

SLT and ICTA share the vision of an e-Sri Lanka as the way forward for the development of the country.

SchoolNet

SLT and the Ministry of Education have come together to launch SchoolNet, an on-line educational system that seeks to improve efficiency and academic achievement in public schools across the country.

SchoolNet will allow teachers and students from over 1,200 schools islandwide to access reference material, tutorials, e-mails and other educational programmes through the Internet. For the first time ever, teachers would be able to access several lesson plans on their computers.

This initiative is based on a VPN concept. Each school will be connected to SchoolNet VPN by using different access speeds based on current requirements, with the option of increasing to higher data rates on demand. The Network Operation Centre, the hub of SchoolNet will be located at the University of Moratuwa.

In the pipeline are initiatives to expand the Company's CDMA network islandwide and to upgrade services to WiMAX as well as to expand the number of schools covered by this programme to 5,000, by the year 2010, which would amount to 60% of the student population.



A typical Bavarian *fraulein* - just one of so many visual 'flags' for the German nation.

Business Review - Sri Lanka Telecom

This is an initiative well aligned to SLT's own commitment to improvement of the education infrastructure, in line with student needs and as a stepping stone to national development.

LEARN

SLT powered the second phase of LEARN (Lanka Education and Research Network) a project under the auspices of the Ministry of Education's IRQUE (Improve Relevance and Quality of Undergraduate Education) initiative.

The project links the University Grants Commission and 13 universities around the country using the SLT provided 10 Mbps IP-VPN links. We expect to upgrade the initial bandwidth of 10 Mbps to 20 Mbps in the near future. All connections are provided using optical fibre 'last mile' access and all connections can be upgraded to 100 Mbps without any hardware change.

LEARN facilitates various e-learning activities, enhanced video conferencing, video streaming, routing of inter-university voice and broadband Internet access for academics and students in their respective universities to liaise and improve their educational skills and requirements. It also supports the operation of the Higher Education Management Information System (HEMIS).

This initiative is in line with SLT's commitment to meeting the requirements of students and academic bodies with the ultimate goal of nation building and development.

NDEN

The National Distance Education Network (NDEN) is an initiative of the Distance Education Modernisation Project (DEMP) of the Ministry of Education.

SLT signed an agreement with DEMP to provide connectivity solutions for NDEN. The Company provides a WAN operating on fibre optic based VPLS services of our Metro Ethernet. This system connects the Multi-Media Centres of NDEN from across the country, facilitating distance learning.

The aims of NDEN is to strengthen the distance learning infrastructure in Sri Lanka and to bring it to the level where it could support instructional courses leading to Degrees, Master's Level Degrees, Diplomas and Higher Diplomas.

The very real benefits from human resource development that accrue to both enterprise and nation are results SLT strongly identifies with.

LGN (Lanka Government Network)

This programme envisages connecting 325 Government offices in the Western, Central, Southern and Sabaragamuwa Provinces via VPN. The offices will include Ministries, Departments and District and Divisional Secretariats.

Operational Support

Maintenance - OPMCs

SLT added to its growing chain of OPMCs (Outside Plant Maintenance Centres) with an office in Ragama. The OPMCs handle the installation and maintenance of SLT's technical assets in their respective regions. By bringing together a variety of human and material resources, the OPMC concept optimises customer service provision in terms of technical issues and maintenance.

Call Centres

The Company opened a new centre in Anuradhapura augmenting the system which comprises the main centre in Colombo and the regional centres located in Kandy and Galle.

The new centre at Anuradhapura is fully equipped to handle call routing. Customers who call the numbers 1241, 1242, 1231 or 1263 seeking operator assistance and who encounter a busy network, will be automatically routed to Anuradhapura or to whichever centre is not busy at the time.

The Call Centre concept supersedes the former Operator Service. The latter used to assist subscribers make phone calls. This former service has been transformed into a state-of-the-art, customer focussed problem solving centre that fields a variety of customer inquiry for which the call centre staff are geared to respond to and resolve.

Procurement

Implementation of Collaborative Material Forecasting and Replenishment System

SLT has implemented a Collaborative Material Planning Forecasting and Replenishment (CPFR) System which is being broadened to include our suppliers.

CPFR system is an innovative supply chain optimisation technique used by 'best in class' companies worldwide and the software employs mathematical algorithms that forecast the material requirement by using immediate past consumption patterns. The system has been integrated within SLT for requesting materials from main stores warehouse and is also used to determine the required quantity of the materials to be purchased from suppliers.

CPFR system is being extended to SLT's suppliers where standardised material suppliers, in turn, can purchase their material requirement in advance. As a result, SLT expects to shorten the supplier lead time further. Another supplier chain innovation technique which is integrated to the CPFR system is 'Vendor Managed Inventory' where a standardised supply contract supplier can have a 'view' of the inventory level of the materials and replenish the stock level and maintain inventories at a contracted stock level always.

This CPFR system is an extension of the automated material planning system implemented in year 2005. SLT has already greatly reduced the level of inventory it maintains as indicated in the table below and expects to effect further reduction in the coming years thanks to the new measures implemented.

Human Resource Management & Development

Recruitment

Sri Lanka Telecom follows an equal opportunity staffing policy adopting a transparent recruitment and selection process which helps to identify and recruit the best personnel for any given post. This policy enables SLT to build a family, a diverse workforce, which comprises of multi-ethnic, multi-cultural and multi-religious people-drawn from all the regions of the country.

Recruitments are made from two main sources:

1. External recruitment
2. Internal recruitment

For external recruitment, candidates are invited to apply to join the Company through newspaper advertisements whilst internally, opportunities are circularised amongst all employees.

Competency-based tests/examinations are mandatory in all recruitments. Depending on the nature of the job, different modern tools are used; Psychometric Tests, Practical Tests, Voice Tests, IQ Tests, Ability Tests, are some of them. The most successful candidates at the tests/examinations are called for further interviews to assess their behavioural strengths, all of which helps us to select the best for the job.

New recruits are hired on the most competitive and attractive terms in the market. Residential induction training and orientation is given to all of them. As a result

Staff do a GREAT job driving productivity beyond budget

Business Review - Sri Lanka Telecom

of this staffing policy, Sri Lanka Telecom has been able to attract and acquire a multi-skilled staff from diverse backgrounds who all share a real passion for the job.

Employee Information

Staff Strength as at 31 December 2006

Functional Analysis	As at 31 December 2006
Executives	527
Technical Employees	3,254
Non-Technical Employees	2,910
Contract Employees	481
Total	7,172

Training

A host of training opportunities are provided by the Company across every grade, which is key to keeping on track with our business strategies and objectives.

Direct benefits from our training regime accrue in the form of a better equipped and more professional staff who can then face competition and change confidently whilst also keeping pace with rapid technological change. Equally important is the very definite orientation towards better customer care and empathy.

A New High Speed Internet Lab

The Company's Moratuwa Training Centre inaugurated a High Speed Internet Laboratory recently, equipped with the latest facilities. SLT staff benefit from training in a wide variety of subjects such as Oracle, Linux, Broadband services, VoIP, ADSL, MySQL, PHP, CDMA, CPE programming, New Coinbox programming, Internet and E-mail. The Centre will soon expand its subject base to cover DSL Deployment/WiMAX Deployment training. Also on the cards is a Research and Development and NGN Laboratory with HIS links supported by SLT Broadband.

Productivity

SLT's Annual Business Plan for 2006 set an overall target for productivity at 140 (DEL/Employee). Through exemplary effort the staff have driven the Company to far exceed budget to record 166 (DEL/Employee).

Our e-Learning Initiative

The Company launched an e-learning programme to Call Centre officers to help them deliver consistent standards in customer service through the honing of their professional capabilities, competencies and character.

Among other goals, SLT wants to enhance performance throughout the organisational network.

SLT Quality Circle Awards

An annual event, the QC (Quality Circle) and CI (Continuous Improvement) awards reward outstanding performance across the Company.

The Continuous Improvement Team (CIT) of SLT's Call Centre, also known as 'Cutting Edge', won several accolades at the National Convention on Quality and Productivity in September 2006.

'Cutting Edge' won awards in four categories and also won the National Level Overall Championship in CIT.

Underpinning Efficiency and Success

SLT has for many years practised the 5S system that guides the Company's every process and activity. Each year, departments and service outlets are assessed for their compliance.

An internal 5S competition is held annually. Assessments are made for the following awards: Best RTOM Office, Best OPMC, Best Teleshop, Best TTCC, Workshop, Transport, Best Repeater, Best MSU/RISU and Best Division.

Felicitating our First Batch of Retirees

The purpose of our Voluntary Retirement Scheme (VRS) has never been the mere shedding of staff. It has been an extremely carefully wrought initiative that balances the Company's need for retention of a highly productive, skilled and strategic thinking workforce, whilst at the same time providing a means of bridging the gap between age levels and those who wish to retire 'before time' as it were, either due to personal or health reasons.

Two batches of employees availed themselves of the VRS in 2006. The first batch of retirees were felicitated at two events by the senior management of the Company. The VRS seeks to ensure a win-win situation for both retiree and Company in ensuring productivity for both. In an initiative to prepare retirees for life after SLT, the Company offered a carefully formulated training programme for retiring staff.

The four-day training featured experts in the field of entrepreneurship who educated the retirees on how to start their own businesses. A feature of the training was that the retirees were permitted to be accompanied to the training by a relative as a participant. The ultimate goal which the Company wants to attain is to ensure that retirees receive the relevant knowledge and skills that'll help them to create sustainable livelihoods for themselves and their families.

Staff Welfare

The Human Resource Division initiated a key health project named "Suwatha" during 2006, under which every SLT employee undergoes a full annual health check-up, the cost of which is being borne by the Company.

The main objective of this exercise is to enable employees to maintain good health and quality of life not just at the workplace but in general terms. Also, the checks provide valuable forewarning of potential threats

to health, where proper medical advice, exercise, correct diet and other such simple practices could help employees to live a full and healthy life.

Ratings & Accolades

Accreditation Reaffirmed

For the year 2006, Fitch Ratings Lanka reconfirmed its AAA (lka) domestic rating awarded to SLT. They also maintained the BB- foreign currency rating for the same period, in recognition of SLT's market leadership positioning and the Company's strong prospects for further growth.

Standards and Poor's Rating Services also reaffirmed their B+ foreign currency and BB- local currency corporate credit ratings of the Company for yet another year.

Information Security Management at its Highest

Like other important business assets, information and its supporting systems and networks are of immense value and require proper protection from threats such as computer assisted fraud, espionage, sabotage, vandalism, fire and floods - only a few of the security threats that organisations face today.

The international standard BS 7799 (ISO 27001) specifies a model for setting up and managing an effective Information Security Management System (ISMS). SLT-IDC became the first Data Centre in Sri Lanka to receive BS 7799 (ISO 27001) certification, signifying its full compliance with global standards in information security management.

This award also resulted in SLT being listed within the prestigious Information Security Management System Registry.

SLT-iDC - first Sri Lankan Data Centre to receive BS7799 certification for Information Security Management

Business Review - Sri Lanka Telecom

This certification stands testimony to the excellence of the standards maintained by SLT-iDC and relevant departments, whose activities cover hosting clients' data and the provision of other services such as Co-Locating, Dedicated Hosting, Virtual Hosting of Web, Database and E-mail and Managed Services, MPLS based IP-VPN services, ADSL services, Business DSL services and ISDN services.

SLT - Top Telecom Brand - Sri Lanka

After research conducted across the country, SLT received the Power of the People award for Telecom Service Brand of the Year 2006, jointly presented by the Sri Lanka Institute of Marketing (SLIM) and AC Nielsen.

The award further vindicates SLT's commitment to building a first class communications infrastructure providing citizens of Sri Lanka with the most advanced telecom solutions available.

Efficiency and Excellence Rewarded

For the third year in succession, LMD ranked SLT as Sri Lanka's No. 1 listed company for the year 2005/06. This rating is bestowed after analysis encompassing turnover, payable dividends, stock market reserves and assets and capital reserves of companies listed in the share market.

Brand Finance ranked SLT as Sri Lanka's Most Valued Brand and Sri Lanka's third Most Powerful Brand for 2006.

Directory Business

Rainbow Pages

SLT's Rainbow Pages Directory was launched in 2002. Since then, its colour coded indexing and trilingual classifying approach has revolutionised the directory market and it has become the market leader amongst such publications in Sri Lanka.

The sales campaign for its 2007 edition kicked off with a launch function at Cinnamon Grand Hotel, Colombo in May 2006. The event also highlighted the launch of the official website for Rainbow Pages - www.rainbowpages.lk which further enhances accessibility of information to the customer.

Coinciding with the launch, SLT initiated Rainbow Pages Voice for Mobitel customers. This enhanced Directory service permits Mobitel customers to place a call to designated number 1444 and obtain any information contained both in Rainbow Pages and the National Directory, via operator assistance.

During the year, the Company also launched its latest Directory CD incorporating Directory information pertaining to the entire country. This CD is available for purchase at teleshops around the island.

The Rainbow Pages team recognises and honours outstanding achievement through its Annual Achiever's Awards Ceremony, which was held during 2006. The sales team very successfully achieved the targets set for the year 2005 and were rewarded for their sterling efforts.

Mobitel, which started operations in 1994, was one of the early entrants in the market for mobile telephony in Sri Lanka. However, its stature and market performance lagged those of its competitors until October 2002 when it was acquired by SLT and which was followed by the deployment of GSM technology in 2004. A lot of ground has been covered since 2004 and today Mobitel is on par with competition in terms of technology.

The Customer's at our Core

However, technology for its own sake is meaningless to the customer. Mobitel's strategy is one of "value innovation". Technology, distribution, packages, added services and support are only means to an end. And the end is about caring for the customer....always having the customers' best interests at heart.

At Mobitel, value innovation bridges the means and the end. It's not about being first to market but about being right for market, if not being the best for market. It's about anticipating customer needs and coming up with new

value propositions, even before customers could articulate those needs in their own minds. It's about using the means to serve what the customer wants in the flavour he wants it in. It's about simplifying those means to delight the customer and never complicating them and confusing the customer.

Every corner of our business is being geared for value innovation. Thus, customer centricity is not just a fancy cliché at Mobitel. Customer centricity has truly become a way of life.

This strategy has proven to be successful and Mobitel has increased its customer base very significantly from 2004 to-date. The year-on-year growth of our customer base from 2005 to 2006 alone stands in excess of 100%. This represents a growth in excess of industry averages as well as that of all competitors. As of December 31, 2006, the Company commanded a near 20% market share with 885,042 active customers. The emphasis was on pre-paid; this enabled us to keep bad debt to a minimum while acquiring market share profitably. We will be relentless in our efforts in pursuing this aggressive growth strategy to the point of reaching market leadership.



	2003	2004	2005	2006
Subscribers	143,000	284,430	420,062	885,042
Pre-paid	49,816	90,209	194,233	691,650
Post-paid	93,184	194,221	225,829	193,392
YoY Growth	-	99%	48%	111%
Bad Debt (Post paid)	8%	27%	10%	7%
Mobile Market Share	12%	18%	19%	20%
No. of base stations	90	229	370	600
Equipped Capacity	200,000	400,000	1,000,000	1,000,000
<i>Compounded Annual Growth Rate of Subscribers</i>		<i>2001-2003</i>	<i>15%</i>	
<i>Compounded Annual Growth Rate of Subscribers</i>		<i>2003-2006</i>	<i>84%</i>	

Mobitel's Smart 5 - an "any-time-of-day" to "any-number" win-win for customers and shareholders

Business Review - Mobitel

Innovative Product Offerings

The pre-paid package 'Smart 5' launched in the year under review is a classic example of what we mean by value innovation. We simplified the package to a level hitherto unknown to the customer. The package offered calls at Rs. 5/- per minute irrespective of the time of day or whatever number they called; be it mobile or fixed line. Customers could call all 5.8 million phones in the country for the same price. There were no hidden charges by way of daily rentals or any other costs.

The results were phenomenal; we signed up over half a million 'Smart 5' users within the period March to December 2006. 'Smart 5' has been a win-win for both customer and shareholder. The telecommunications industry has over the years 'trained' customers to use their phones in the night owing to the 'peak hours' concept, where operators traditionally charged a premium during those hours. This has resulted in unleashing the retail customer 'after hours', causing congestion of mobile networks at night. Our simple flat rate charge irrespective of the time of day encouraged customers to call during the day. Not only were customers delighted to be able to afford day-time calls, but it also benefited shareholders by enabling us to re-balance network traffic between night and day.

'Smart 5' is a pre-paid service. This was an area in which competitors had firmly entrenched themselves over a period of time. Historically, Mobitel has been a largely post-paid dominant operator. The success of 'Smart 5' not only gave us a tremendous boost in terms of acquiring a large customer base, but it also helped us to better manage working capital in this phase of our growth with high gearing, by virtue of it being a pre-paid service.

A similar innovative package for post-paid customers under the name and style of 'Double M' was also launched towards the end of the year under review. Unlike the traditional two-part tariff having a fixed monthly commitment element and additional entitlements over and above at additional cost, we came up with an innovative three-part tariff where the additional entitlements are broken into two further parts. This enabled us to give the customer double the value for their every rupee. Customers have been quick to see the benefits accruing to them and this is another innovation poised to take off.

Mobitel was the first mobile operator to offer an innovative dual IDD solution to subscribers in 2005. IDD Premier and IDD Buddy offered the choice of making international calls via a high quality service with crystal clear clarity or via a low cost alternative with a more than acceptable



01



02

01 *Mobitel Smart 5 completely eliminated peak hour rates by replacing it with a standard rate of Rs. 5/- per minute throughout the day for both incoming and outgoing calls.*

02 *A tie-up with the Sri Lanka Postal Department now enables customers to buy Mobitel pre-paid cards via the postman.*

service quality, respectively. The two options placed control in the hands of customers, who could choose the best for the desired application - e.g. - making those business calls or chatting informally.

Unique Distribution Channels

Every citizen of this country is a potential customer of ours, irrespective of where they live or how much they earn. The common factor that ties them together is the house...be it a tiny shack in the remotest village hamlet or a sprawling mansion in the heart of the city. And one person unfailingly reaches every one of these houses and enjoys a level of trust like no other. That is the postman. Once again in the spirit of value innovation, we came to a groundbreaking agreement with Sri Lanka Post. The much loved and trusted postman now distributes our pre-paid cards to every nook and corner of the country... taking customer care to a new level through distribution. We have already begun co-branding with Sri Lanka Post in the post offices. We intend delivering more value to customers through this alliance in the future to the point of even accepting payments for post-paid services at their vast island-wide network, which has in excess of 500 post offices and over 3,000 sub/agent post offices.

Another significant innovation of distribution is our tie up with the vast network of Singer Mega Stores. Branded as 'Big M' we now have 15 such retail stores to fully service all pre-paid and post-paid customers. We plan to strengthen this relationship as well and extend our customer care points to cover all 250 Singer outlets in the country. We also plan to make handsets more affordable through Singer's popular hire purchase schemes.

A study of per capita mobile penetration among countries with comparable GDPs revealed that the Philippines have a disproportionately high mobile penetration. It turned out that they were using mobile phones primarily for SMS, due probably to the natural advantage they had in that their native language used the same English Language alphabet. Taking a page from the Philippines experience, Mobitel introduced trilingual SMS enabling customers to send messages in Sinhala and Tamil as well. The system we introduced does not necessitate the recipient of such SMSs to download fonts or other software. We expect this to result in greater use of our messaging services as well as to positively impact new customer acquisitions.

Perceiving our Brand

Marketing research surveys revealed that Mobitel's brand image was lagging the competition. Further, we found that Mobitel's association with our parent company, Sri Lanka Telecom was not widely known. The latter has been corrected through our visual branding as well as joint marketing efforts. And the former issue has been almost turned on its head following the success of our 'Smart 5' package in the market. Latest surveys testify to the fact that the Mobitel brand now endears itself to a wider populace including the 6 million youth of the country.

We now have an entrenched position as the 'National' mobile service provider. This position has been further strengthened by our recent marketing tie ups with Sri Lanka Post and Singer (Sri Lanka) Limited.

In 2006, we made considerable inroads into the pre-paid market. In 2007, we will focus aggressively both the pre-paid and post-paid services. Added services based

Now, Mobitel pre-paid cards available through the post

Business Review - Mobitel

on 3G technology will play a key part in making this happen. The price of 3G handsets keeps dropping and we envisage it reaching a price point below Rs. 20,000/- per handset when we commercially launch our 3G services. This will complement the mass appeal we intend creating with the deployment of 3G technology, which will enable us to offer customers a whole new world of advanced and sophisticated communications. As a result, our mobile services will be able to support video telephony, high speed internet, video streaming, mobile TV, music streaming, on-line music and other non-voice services.

Leveraging the strengths of our parent SLT and offering services together will give a great boost to our quest to make greater in-roads into the corporate sector.

We already have well coordinated account management teams which is further strengthened by the setting up of customer solutions teams. In the spirit of value innovation, we will be able to go into our customers' accounts and identify the problems they wished they had solutions for.

We consider it a fitting acknowledgement of our customer centricity and philosophy of value innovation to have won the prestigious Voice and Data SAARC Innovation Award for the Mobile Operator in Sri Lanka with the "Best Customer Pull". The award was presented to Mobitel at the fifth Voice and Data CEO Conclave held in mid-November 2006. The ensuing years will be exciting and challenging ones. We are now very well positioned to meet them with confidence.

“In our fast paced world, it is essential that we have access to communication tools that are fast and convenient and that help us to respond and problem solve at speed. SLT Mobitel’s e-mail to SMS solution facilitates transmission of vital information via e-mail in the form of SMS directly to a mobile phone, which helps our maintenance executives respond effectively.”

Susantha Ratnayake *Chairman - John Keells Holdings Limited*

“The Fleet Management and Vehicle Tracking solution that SLT Mobitel has developed for CTC is ideally suited to our needs both in terms of optimising our fleet routeing timetables and helping to identify and mitigate instances of vehicle hijacking and theft.”

Andrew O'Regan *Managing Director & CEO - Ceylon Tobacco Company Limited*

Human Resource Management

Mobitel envisions becoming the leader in the Sri Lankan mobile industry by creating and delivering value to the country's mobile subscribers. We have also set out to become the preferred mobile brand thus enriching people's lives whoever they are, wherever they are and whatever they do. Our focus will revolve around customer centricity, which transcends mere customer care.

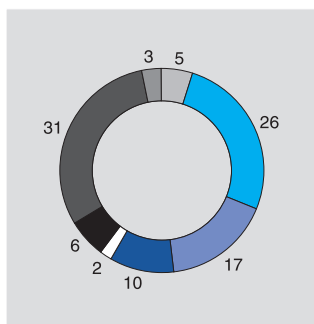
The Company's HR strategies have been crafted to build an organisation, which creates and delivers value to our customers through various innovative solutions.

HR plays a crucial role in ensuring value delivery and securing competitive advantage for the business by acquiring the right competencies and talent. Attracting new staff to meet the challenges of the accelerated expansion programme and introduction of new technology especially in regard to unique techno skills was never a difficulty. We were able to attract some of the best within and outside the industry with exceptional academic and professional qualifications at entry levels.

Our head count increased at a healthy pace whilst leveraging on synergy and cross-functional opportunities through internal job posting. The increase in staffing is geared to be abreast of the expansion and growth of the

%

- Corporate Planning International, VAS and Site Acquisitions
- Customer Care
- Engineering
- Finance
- Human Resources
- Information Systems
- Marketing & Sales
- Other



business. Staff numbers have increased from 634 in December 2005 to 737 as at December 2006.

Employee Service Analysis

The staff composition is an indication of the trends of growth and expansion of our business as evidenced by the greater percentage of staff with one year of service and below and those between two to four years accounting for 43% and 35% respectively.

<i>Service Analysis</i>	
	2006
Less than 1 year	279
2-4 years	322
5-7 years	64
8-10 years	36
Over 10 years	36

Employee Age Analysis

This parameter indicates a predominantly high level of young employees who come within the segment of those below 30 years of age, which is tilted more towards the front-line segment of staff in view of the number of staff required to address growth and expansion of customer base.

<i>Age Analysis</i>	
	2006
19 & Below	19
20-30	485
31-40	160
41-50	59
51 & above	14

Staff Distribution Analysis

The highest staff concentration is in the Customer Care and Sales and Distribution Divisions, which is a clear manifestation of the Company's customer centricity.

Staff Training and Development

The various innovations we have brought about during 2006 were a direct result of the creative thinking and inexorable efforts of our valued employees from every sphere of the organisation.

We have a strong commitment to the long-term training and development of our people. They are a spirited and passionate group of individuals whose diverse talents and capabilities characterise the innovation, tenacity and drive required to achieve corporate objectives and steer the Company towards its vision.

A mix of training opportunities for those with technical background and management skills were provided at overseas facilities whilst some of the soft skills in Customer Care and Sales were imparted locally by recognised trainers. The HR strategies in relation to management development and succession planning play a crucial role in our retention techniques of our staff.

<i>Training Activity</i>	
	2006
Man Days of Training	
Local	805
Foreign	627
No. of Programmes	
Local	60
Foreign	35

The success of our HR initiatives is reflected in the overall performance of the Company. Continuous innovation and introduction of new and revolutionary solutions coupled with high levels of expertise of human skills have brought about an unprecedented growth in our subscriber numbers. The efficiency, effectiveness and productivity of the human asset base of Mobitel is clearly reflected in the number of subscribers per employee, which has almost doubled from 663 to 1,201 during the year under review.

<i>Key Indicators</i>		
	2005	2006
Subscribers per Employee	663	1,201
Revenue per Employee (Rs. million)	5.6	7.2

The strategic initiatives undertaken by Mobitel to build a skilled and professional team have resulted in the Company's brand emerging strong in the market and we are confident that before long they will propel the organisation into a position of leadership in the mobile industry of Sri Lanka.

The financial year 2006 proved to be yet another successful year for SLT.

Financial Performance

Revenue

The Company's revenue increased significantly by 23% to Rs. 36.10 billion as compared to the previous year. This increase in revenue was primarily attributable to the phenomenal growth experienced in the deployment of CDMA services.

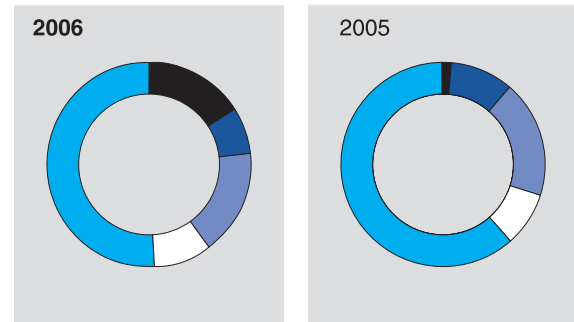
CDMA services were launched in November 2005 and achieved a revenue of Rs. 0.56 billion by end 2005. CDMA connections provided during the year under review contributed Rs. 5.50 billion to the total revenue. This accounts for 15% of the total revenue.

Data, Internet Protocol (IP) services and other sector revenues increased by 32% to Rs. 3.42 billion. This sector is expected to become a significant source of revenue for the Company in the future, as IP services opens up new opportunities in communications and media and becomes the platform for convergence.

Domestic revenue, consisting mainly of rentals and domestic call charges, accounted for 53% of total revenue, while the comparative for 2005 was 62%. The domestic revenue grew by 3% to Rs. 18.85 billion in 2006 as against Rs. 18.28 billion in the previous year.

Total International Revenues grew by 6% to Rs. 8.31 billion. This comprises IDD revenue, receipts from international network operators and International settlements. IDD revenue accounted for Rs. 2.03 billion, a 11% decrease in comparison to last years results, whilst, international inpayments increased by Rs. 0.73 billion an increase of 14% when compared with last year.

Revenue Drivers %



	2006	2005
■ CDMA	15	2
■ IDD	7	9
■ International inpayment	16	18
□ Data, IP & Other	9	9
■ Domestic	53	62

Operating Costs and Depreciation

Operating costs including International Telecommunication Operators' Levy (ITL) and Voluntary Retirement Scheme (VRS) grew by 25% to Rs. 18.06 billion in 2006 as compared to the previous year. The main contributory factor was the cost of CDMA sales which as mentioned above was a start up service in November 2005. An increase in staff costs by 18% to Rs. 4.56 billion was the other notable factor. This was inline with inflation and the Company's remuneration policies. Repairs and Maintenance costs reduced by 18% this year to Rs. 1.48 billion.

Depreciation charges amounted to Rs. 8.85 billion for the year in review as against Rs. 8.14 billion for 2005.

Finance Costs

Finance costs consist mainly of interest expenses and include the effects of exchange rate fluctuations generated by restatement of monetary assets and the writing off of realised exchange fluctuations from the hedging reserve. Finance costs decreased by 8% during the year under review to Rs. 1.32 billion.

International Telecommunication Operators' Levy (ITL)

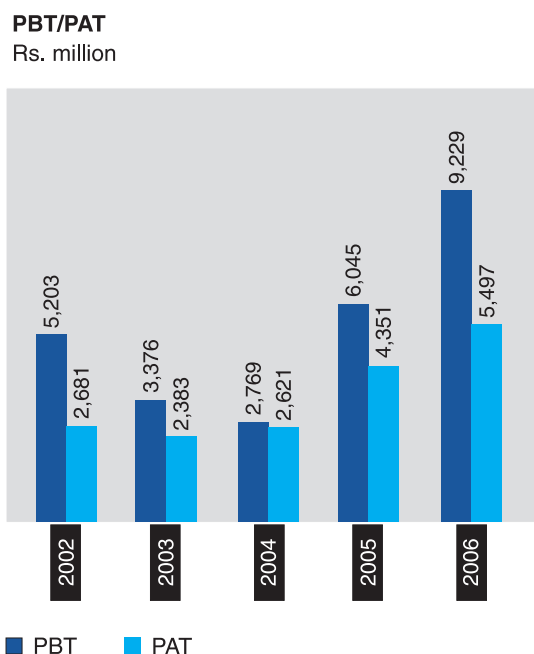
ITL was introduced by the Government of Sri Lanka in late 2004, applicable to all International Telecommunication Operators. Its application was made with retrospective effect, to cover a period from March 2003 onwards. ITL expenditure for the past three years amounted to Rs. 6.30 billion. This includes the provision for 2003. According to gazetted terms, SLT is entitled to reclaim two thirds of the funds expended by the Company in terms of network roll out to unserved and underserved areas in the country from the above ITL expenditure. However, the refund has not been recognised in the financial statements since discussions with the Telecommunications Regulatory Commission (TRC) are still in progress.

Taxation

Taxation was Rs. 3.73 billion, an increase of 120% against Rs. 1.69 billion for the previous year. The increase is mainly attributable to the increase in corporate tax rate from 30% in 2005 to 33 1/3% in 2006 and due to the adjustment to the deferred tax liability arising from the change in tax rate.

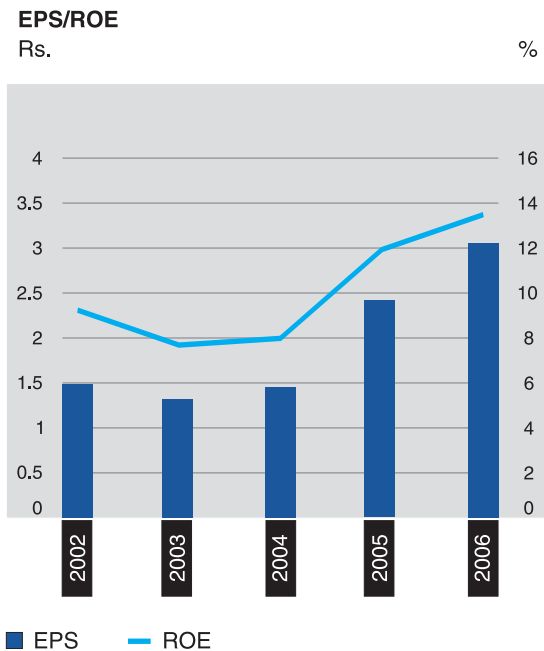
Profitability

SLT posted healthy profits for 2006. Profits Before Taxation (PBT) at Rs. 9.23 billion was 53% above the previous years achievement of Rs. 6.04 billion. However, due to increases in taxation, Profits After Taxation (PAT) increased by 26% - from Rs. 4.35 billion in 2005 to Rs. 5.497 billion in 2006. The Company has successfully maintained PAT margins at 15% during both years.



Measuring Performance

Earnings Per Share (EPS) recorded an increase of 27% to Rs. 3.05 over the Rs. 2.41 recorded in the previous year. Boosted by earnings, Return On Equity (ROE) recorded a healthy increase to 13.5% from 11.9% the previous year.



Financial Position

Balance Sheet

Total assets increased as at 31 December 2006 to Rs. 79.1 billion as against Rs. 75.9 billion the previous year primarily due to an increase of Rs. 4.98 billion in Current Assets.

Total equity increased by Rs. 4.13 billion to Rs. 40.70 billion and Current Liabilities grew by Rs. 1.63 billion while Non-Current Liabilities reduced by Rs. 2.11 billion. Total equity improved on account of increased earnings while Non-Current Liabilities decreased due to reductions in Deferred Tax Liabilities.

Non-Current Assets

The total Non-Current Assets of the Company reduced to Rs. 52.88 billion as against Rs. 54.65 billion from the previous year mainly due to a decrease of Rs. 2.75 billion and Rs. 2.50 billion in property, plant and equipment and non-current receivables respectively. The reductions in the above was over and above the increase of

Rs. 3.53 billion in investments made in subsidiaries, thereby the net reduction in non-current assets. The investments of Rs. 3.5 billion mentioned above related to the investment made in Mobitel.

The Company made an initial investment of Rs. 35 million to set up SLT Hong Kong Limited, a wholly-owned subsidiary company sited in Hong Kong. SLT Hong Kong will operate as a Point of Presence (PoP) enhancing the alignment of the Group's strategic direction in terms of global connectivity.

Working Capital

Working capital improved significantly as at December 31, 2006 to Rs. 13.78 billion, an increase of 32% over the figure for the year 2005. The main contributory factors were the increase in Receivables and Prepayments by 34% to Rs. 10.55 billion and increase in cash and cash equivalents by 13% to Rs. 14.39 billion. The growth in cash and cash equivalents indicates a very strong fund position and includes a sinking fund of USD 40.89 million, equivalent to Rs. 4.43 billion, created in 2005 to redeem the USD 100 million notes by the year 2009.

Activity and Liquidity Ratios

The Asset Turnover for the year has improved to 0.46 times when compared to 0.39 in 2005 as a result of better asset utilisation.

The current ratio increased from 1.96 to 2.1 times in the year under review. The Quick Asset Ratio increased marginally to 2.0 during 2006 as compared with 1.9 of the previous year.

Interest Cover

The Interest Cover has increased remarkably to 62.53 times from 8.52 times in 2005. The increase in Earnings Before Interest and Tax (EBIT) by 36.93%, decrease in interest expenses by 8.42% and increase in interest income by 84% contributed to the above.

Capital Structure

The total assets of SLT amounting Rs. 79.15 billion, were funded by Shareholders' Funds (60%), long-term liabilities (24%) and short-term liabilities (16%).

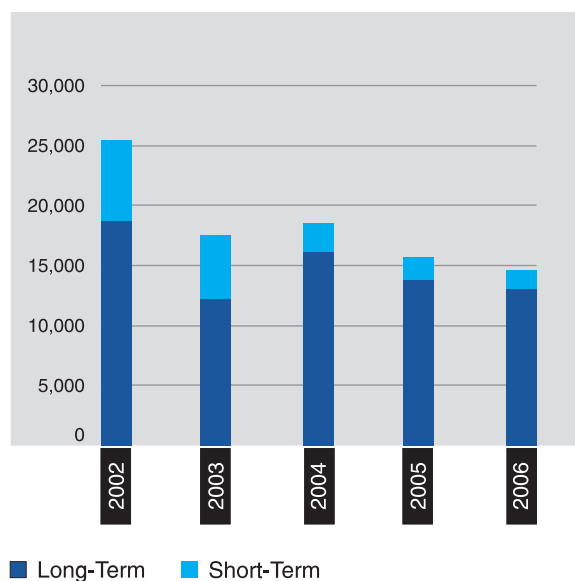
Debt

The total debt of the Company was Rs. 14.52 billion as at Balance Sheet date, 7% lower than that of 2005. The Company has continued to maintain its strategy of reducing debt. The overall debt comprises Rs. 13.07 billion (90%) long-term debt as against Rs. 1.45 billion (10%) of short-term debt. 82% of the total debt is foreign currency borrowings whilst the balance 18% are local currency borrowings.

The USD 100 million notes constitute 90% of the foreign currency debt.

The Debt/Equity ratio declined from 0.30 to 0.26 in 2006 boosted by earnings.

Total Debt
Rs. million



Cash Flow

Operating Activities

Cash and cash equivalents increased by Rs. 0.89 billion during the year. Net cash flow from operating activities at Rs. 11.197 billion in 2006 reflected a decrease of Rs. 5.087 billion over 2005 figures. This was primarily due to increased tax payments of Rs. 4.266 billion compared with Rs. 0.71 billion in 2005.

Interest paid during the financial year 2006 was Rs. 1.47 billion, as against Rs. 1.58 billion in 2005.

Investing Activities

Net cash outflow from Investing Activities was Rs. 7.13 billion for the financial year in review, compared with Rs. 11.07 billion in 2005.

Financing Activities

Net cash outflow from Financing Activities was Rs. 3.17 billion in the financial year 2006 when compared with Rs. 2.997 billion in 2005. Included in the net cash flow from financing activities is the repayment of Rs. 1.82 billion for maturing debt.

Statement of Changes in Equity

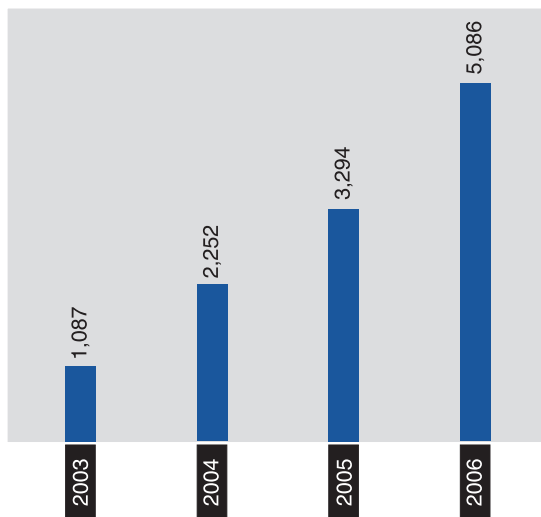
Shareholders' funds stood at Rs. 40.7 billion as at 31 December 2006 as against Rs. 36.5 billion at year end, 2005. This constitutes a growth of 11.3%. Changes in equity were primarily impacted by Profit after Taxation of Rs. 5.50 billion.

Revenue

The Company performed well during the year under review in terms of revenue with an increase of 49% to Rs. 5.3 billion in 2006 as compared to Rs. 3.6 billion in 2005. This increase was mainly attributable to the income from the introduction of the innovative prepaid package “Smart 5” in March 2006.

Revenue Net of Bad Debts

Rs. million

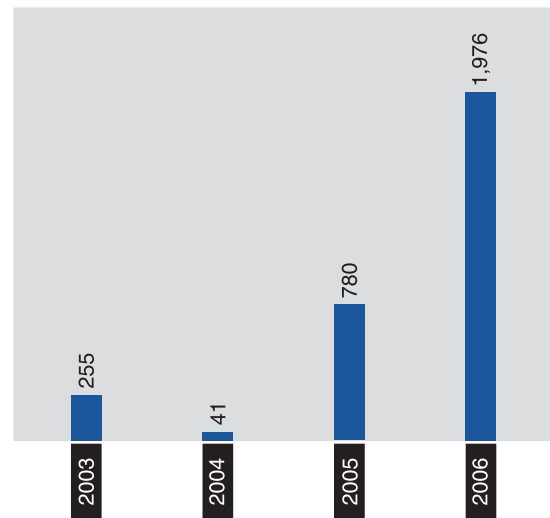


Profitability

Operating profit before depreciation (EBITDA) grew by 153% to Rs. 1.98 billion in 2006 compared to Rs. 780 million in 2005 and Earnings before Interest & Tax (EBIT) increased by 238% to an operating profit of Rs. 0.74 billion as against an operating loss of Rs. 0.54 billion in 2005. This significant growth was mainly on account of increased revenue as mentioned above, controlling of operating costs to 62% of revenue versus 78% in 2005 and a reduction in depreciation charges due to full depreciation of old technologies.

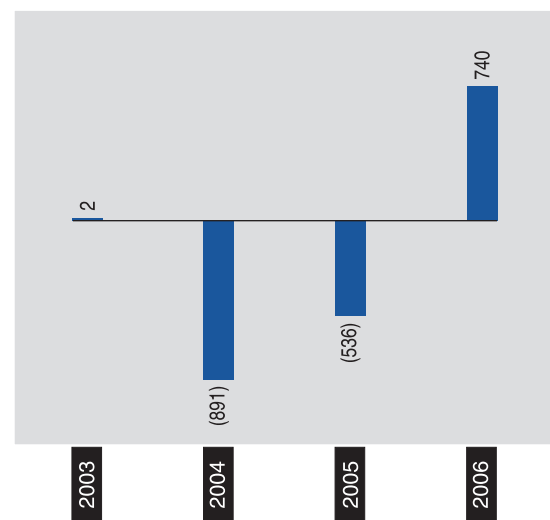
EBITDA

Rs. million



EBIT

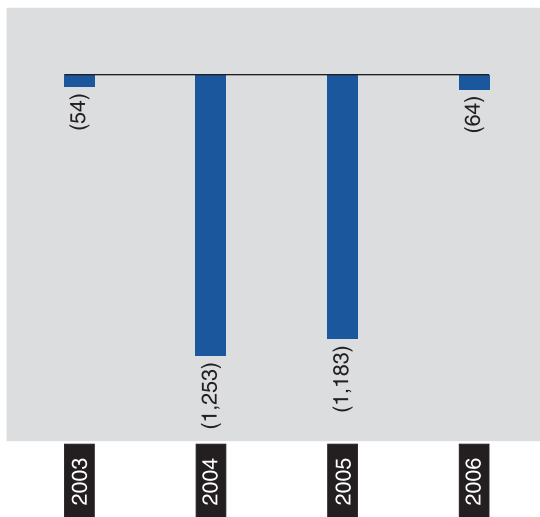
Rs. million



Financial Review - Mobitel

Although the Company ended the year with a net loss of Rs. 64 million it represents a significant improvement considering the net loss margin is only 1% compared to 33% in 2005. Mobitel is rapidly returning to full profitability despite high depreciation and interest charges resulting from considerable investment in technology and network expansion.

NPAT Rs. million



Debt: Equity

The high gearing position of 95% in 2005 was significantly reduced to 60% during last quarter of 2006 through an equity infusion of Rs. 3.5 billion in the form of redeemable cumulative preference shares.

Risk Management

SLT employs an effective Risk Management system whose principles are embedded across every area of the Company. The system necessarily incorporates the elements of risk forecasting, assessment, reporting and mitigation.

Recognising that risk can arise from a variety of sources including the market, credit, liquidity and other factors, the Company's risk management regime, whilst being geared to operate effectively across all risk and operational areas of SLT, also seeks to standardise its risk interpretation procedures.

Risk management, working in tandem with planning and strategy formulation forums also identify areas of opportunity, where the Company may take its business, and in such instances a prudent evaluation of potential risk and mitigation provided through risk management procedures often opens the door to forging new business frontiers. This is of particular value within the dynamic telecommunications industry.

The Board of Directors is kept well informed in a timely manner by the senior management of the Company, as regards the implementation and operation of the system, including any changes that need to be effected.

Areas of risk or individual risks that could have a material negative impact on SLT's net worth, financial position and results are examined below.

Economic Environment

Effects of Increase in GDP

Sri Lanka's GDP grew by 7.5% for the third quarter of 2006. The Services Sector contributed 63% to this growth. Telecommunications drove the performance of this sector yet again and records the highest growth rate amongst component services of the Services Sector.

These year-on-year growth trends testify to the enormous potential for growth that lies within the telecommunications field, and by implication for the growth of SLT.

However, this situation is also associated with risks for SLT from the interests of several new entrants, lured by the attractive potential in the industry.

Central Bank Forecasts for ICT Sector

The Central Bank forecasts that the ICT Sector will grow through services such as BPO Telemarketing Call Centres and data processing as well as growth in Internet based products.

More and more businesses will begin to invest in these services over the traditional telecommunications services, spurring interest and growth in them.

SLT has already recognised the risks coming from this shift away from the traditional to newer services. The Company manages this risk by evolving its own product and service portfolio to embody state-of-the-art ICT solutions and disseminating these to a growing client base.

SLT's strategies of diversification, global business initiatives and convergence also serve to mitigate this risk.

Corporate and individual customers are increasingly seeking these new services and demanding higher standards of quality and service.

The risk here to SLT would be to maintain a strong and dominant brand image in the market.

In mitigation the Company has already begun driving its business from the customer's perspective as opposed to letting technology, networks and services drive down choices. In this way, the Company truly puts the customer's needs up front, letting the rest of our business mix work around them.

Risk Management

Regulation

Tariff Structure Related Approval Process

The current regulatory process governing telecommunications is enshrined in the Telecommunications Act of Parliament.

In accordance with the provisions in this Act as well as those contained under the Licence issued to SLT, the Telecommunications Regulatory Commission of Sri Lanka (TRC) is empowered, in consultation with the Hon. Minister of Telecommunications to approve tariffs for telecommunications services provided by SLT.

SLT's licence requires it to obtain approval from the TRC for its tariffs. This approval process is time consuming. This scenario could have an adverse impact on SLT's ability to respond to market fluctuations and demands as well as threats from competition, in a proactive and business-like manner. We are establishing dialogue with the TRC to address the broader policy issues related to the tariffs approval regime.

Licensing

Sri Lanka still follows a technology dependent licensing regime. Furthermore, there is no valid mechanism or process in place to determine the market powers of individual operators.

Given this background, the continuation of an asymmetrical regulatory regime favouring new entrants, could have a negative impact on the Company's ability to perform in the market-place, especially in view of the need to comply with regulatory directives issued in line with the said asymmetrical regulatory regime in force.

The Company seeks to mitigate the issue in the long-term by commencing a dialogue with the TRC to initiate a process which could ultimately implement a unified licensing regime and a due process to determine the

market powers of operators under a unified licensing regime, thereby rendering the asymmetrical regulatory regime more meaningful.

Claiming TDC and ITL Payments

Payment of the government introduced International Telecommunication Operators' Levy is mandatory. The ITL includes a component termed the Telecommunication Development Charge (TDC). Two-third of the TDC can be reclaimed in lieu of unserved and underserved areas. However, the process is subject to the approval of the TRC.

As a mitigatory measure SLT has followed the practise of retaining two-thirds of TDC whilst submitting to the TRC, supporting documentation in proof of network roll-out in unserved and underserved areas.

Industry, Market and Competition

Convergence Attracts New Entrants

The exciting new world of possibilities that opens up as a consequence of the convergence of fixed line, mobile and Internet operations onto a single platform, is attracting new entrants to the communications field.

SLT expects to face competition from ISP providers and Cable TV providers who may possess converged networks that could offer more comprehensive complete solutions.

The Company has already identified this potential risk and our initiatives in mitigation are embodied in the advances we have made already in laying in the technology and equipment and the continuous offer of new services and products.

There is also the advantage SLT enjoys in terms of a very strong existing infrastructure that is by far the best and most extensive in the country.

Risk Management

Product Substitution due to Convergence

Phenomenal technological progress and the growing trend towards technological convergence is revealing the very real threat of new technologies competing with older ones and even substituting them.

Fixed line telephony is now all but substituted by mobile telephony. With the best fixed line network in the country SLT faced risk. However, through our wholly-owned subsidiary mobile operator Mobitel, the Company is a strong player in this market.

Likewise VoIP (Voice over Internet Protocol) poses a risk as a substitute for traditional voice services. Here, the fact that SLT operates an expanded IP network and is the market leader in IP based solutions including VoIP should negate risk.

Wireless networks are taking over from wired networks - SLT meets this risk through its own portfolio of Wireless Access Systems through CDMA.

Traditional TV is giving way to IP-TV and Mobile TV as a direct result of technical convergence. This is a potential business area for SLT, as it is for several other operators in the market. SLT's strategy for diversification has fully addressed this and the Company will be more than competitive in this area, serving to mitigate any risk.

Again, convergence is already bringing the Internet to mobile telephony - Mobitel already operates off a 3G platform where Internet access is possible. Thus, the Company remains competitive within these developments and risk is mitigated.

IT/Telecommunication Infrastructure - Networks & Systems

The Company's Operating Support System and Billing Support System are two basic avenues through which SLT serves the customer. Disruptions and outages in either system are potentially damaging not just to service standards, but to our relationship with the customer.

Such risks are minimised in the following ways:

- The conduct of daily and weekly backups.
- Protection of the systems by installing intrusion detection programmes, firewalls and anti-virus software.
- The conduct of daily random checks.

Disaster Recovery

The Company hopes to have a fully-fledged disaster recovery programme in place by mid-2007, to meet and mitigate identified risk areas.

Some of the advantages of this programme will be:

The provision of data protection and availability in instances of:

- Failures due to disaster situations such as fire, terrorist activity etc.
- Data corruption due to operational mistakes, sabotage etc.
- Hard errors such as prolonged server failure, storage system failure and the like.

The programme will also yield:

- Enhanced availability of applications.
- Provision of reporting environments.
- Provision of test environments for version/release impact testing.
- Information Lifecycle Management.

Risk Management

Illustrating the rapid response capability of SLT's Disaster Recovery programme, post-tsunami, the Company's network was back in operation within 24 hours.

Risks due to terrorist threat can also be mitigated and services maintained through redundancy and alternate routing. The modular nature of our network makes this possible.

Procurement

SLT is a telecommunications/IT service provider as well as a telecommunications/IT product provider. The Company liaises with a variety of suppliers and manages a complex inventory of products and services that requires meticulous reliability and timeliness.

The potential risk from threats such as supplier default, inadequacies in inventory and product obsolescence to name a few, can be damaging to SLT. Let us examine some of the key issues and initiatives.

Material Requirement/Management

The threat posed by uncertainties of demand resulting in either shortage or excess stock of material purchased by SLT is being addressed and managed through the use of "On-line Material Requirement Planning and Forecasting", which is an MRP Software tool as well as through inventory buffering.

Supplier Unreliability

Potential risk to business through tardy delivery is mitigated through the stringent checking of on time delivery against contractual obligations of suppliers, and where warranted, liquidated damages are applied.

The Company also employs a 'buffer' system of a minimum of two suppliers for each category of material supplied.

SLT is also adopting innovative procurement methodology as adopted by 'best in class' companies which will address these risks. Some of these methods are:

- Vendor Managed Inventory.
- Collaborative Forecasting and Replenishment System - implemented within SLT and being extended to suppliers.

Product Obsolescence

The rate of product obsolescence in the telecommunications industry is one of the highest. This is a consequence of the rapid evolution of technology which leads to an equally rapid turnover of products and services. The basic premise is that, as the 'new' comes in, the 'old' goes out.

This is an inherent risk in relation to the telecommunications industry.

In mitigation, SLT opts where possible to offer scalable solutions, where add ons can be effected without rendering the whole obsolete, and prolonged product/service life can be ensured. It is acknowledged that this solution can only be applied to certain technologies and is not an universal panacea.

An example of a scalable solution is embodied in SLT's Metro Ethernet.

Quality Management

Fundamental risk that could arise from materials and equipment that do not conform to the highest standards or have not been checked through as required is managed as follows.

Risk Management

Material quality is managed through an extensive process of checks and balances that run across the entire procurement exercise. The Material Standardisation process adopted by the Company prevents the purchase of low quality or sub-standard material/equipment. Sample checks are always carried out on non-standardised material before purchase.

Strict acceptance testing is carried out at factory before shipment and likewise testing occurs before and after installation in the case of purchases of new technology items and for turnkey projects.

No item leaves our stores for any user department without being quality assured by our Quality Assurance Unit.

Litigation

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.

The Company is involved in six cases before Courts on a variety of issues concerning implementation of tariff revision, amounts due on interconnection services, seeking of an injunction order against issue of licences to RTN operators and claims arising from the Company's Directory publishing operations.

Out of Court arbitration is proceeding in three cases involving issues such as recovery of dues from a payphone operation, claim for increased overtime rates and recovery of dues consequent to SLT's TBR billing system.

Human Resources

SLT has a highly unionised workforce, who are represented by 32 Trade Unions.

During the year in review, the Company faced many instances of industrial action with a considerable loss of man hours, which had some negative affect across our service. The HR Division had initiated a programme to address key issues which included a Cross Functional Team consisting of management and union representatives to improve relationships and address problems.

This system achieved some success initially but now needs some realignment to deliver desired results.

SLT has decided to address the problem areas to usher in a healthy relationship across the board and mitigate risks that attend unhealthy industrial relations, through focus on activities with three main partners: the management, the Trade Unions and the employees.

Managers are being afforded awareness programmes and instructed on their own HR responsibilities and their responsibilities to their staff and accepting industrial democracy by being open to dialogue with the unions on matters related to the latter's membership, among other matters.

With Trade Unions, the Company seeks to bring about a convergence in terms of the Company's vision and those of the Unions and employees. SLT needs to build partnerships and initiate healthy dialogue towards this. Another vital component will be education - instructing and explaining the Company's direction to the Unions and employees so that there would not be room for miscommunication and misunderstanding on key issues.

Risk Management

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

Other Areas of Risk

Recruitment and maintenance is challenged more each passing year. With the expansion and growth of industry and competitor alike, SLT faces growing challenge to attract and retain competent staff. In mitigation the Company conducts a Salary and Benefit Survey for all staff to identify market levels for the different categories of employee. Thus, salary and benefits can be adjusted to match market levels at least, which in turn, ensures SLT stays a sought after employer.

As efficiencies demanded of telecommunications companies in the new age increase, the Company will face risk from possible increases in personnel cost if we are called onto retain staff who find it difficult to adapt to the new demands and technology, or who are just not on board with the Company's business direction. This could create an unhealthy scenario where high personnel costs could push up operating costs and diminish profitability.

SLT, after much reflection, introduced a Voluntary Retirement Scheme (VRS) in 2006, which provided the means for employees who wished for change, to embark on a life after SLT. The Company built in career guidance benefits in to the package offered with the aim of assisting retirees to live a profitable life after retirement.

Possible obsolescence of technology could lead to redundancies amongst staff. Not all could be absorbed and retrained to fit into new areas. Thus, the Company faces additional costs to retrain those who will remain with us as well as raise the possibility of a need for another VRS in the future.

SLT seeks to minimise fall out from these scenarios by putting each employee on the track of continuous learning thereby optimising the value and worth of each employee and helping them 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 and hence the financial risks have to be managed.

Exchange Rate Risk

The Company maintains foreign currency accounts for related inflows. The maintenance of such accounts 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 USD 100 million notes.

Interest Rate Risk

The Company's debt is maintained in a mix of fixed and variable interest rate instruments to mitigate the volatility of the interest rates.

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, and also by taking initial customer deposits and pre-paid sales the Company manages the credit risk.

Corporate Governance

SLT endeavours to employ a regime that ensures an adherence to transparency, accountability and efficiency as required outcomes in the pursuit of the exercise of the powers of the Board and Management in steering the Company, by encompassing all due processes. Our aim is to achieve exemplary corporate governance practices whilst delivering shareholder value, which is in line with the proposed approach to be mandated in 2007, by the Colombo Stock Exchange.

Independence and Effectiveness of the Board

In terms of the Articles of Association of the Company the Board consists of ten seats. The holders of every 10% of the equity is entitled to one seat on the Board. Accordingly, GOSL is entitled to five seats on the Board in relation to their 49.5% equity holding and NTTCom four seats for their holding of 35.2% and one seat is reserved for the minority shareholders who hold 15% of the equity. In this way the shareholders are responsible for the appointment of Directors even to fill casual vacancies. Additionally, these Directors are subject to retirement by rotation at the Annual General Meetings.

Thus, shareholders are responsible for the appointment of Directors, even to fill casual vacancies. Additionally, these Directors are subject to retirement by rotation at Annual General Meetings.

Whereas the Chairman of the Board is always a nominee Director of the GOSL, the CEO is a Director nominated by NTTCom. All Directors function in the capacity of non-Executive Directors with the exception of the CEO who is an Executive Director. The scope and authority of the CEO's position is laid down in the Articles of Association of the Company. The much needed balance of power is expected to be achieved by the separation of the role of the Chairman from that of the CEO.

The Board provides strategic direction to the Company through the Annual Business Plan. Well ahead of the conclusion of the financial year the management prepares a business plan for the following year and submits it for the consideration of the Board. The Board reviews the plan and the proposed capital and operational expenditure, if necessary, makes amendments or if they think fit grants approval for the management to proceed with the agreed strategic direction. This plan is reviewed quarterly or by mid-year to meet needs of changing environment. Executive responsibility for running the Company's business is with CEO who is supported by the management staff.

Having regard to development in market practice as well as new corporate governance requirements and the guidance notes issued by the Colombo Stock Exchange, the Board implements proposals for best practice to ensure market expectations are delivered.

The Board is committed to best practice in the area of corporate governance as they acknowledge it as a source of competitive advantage.

Board Meetings and Processes

As a practise the Board meets for both scheduled meetings and special meetings - the latter to deal with specific matters that require attention between scheduled meetings.

For the year 2006, fourteen Board meetings were held. Where the NTTCom Directors are unable to be present in person at the Board Meeting they join such meetings via audio-link.

Powers of the Board and Management in steering the Company by encompassing all due processes

Corporate Governance

Certain identified matters that come before the Board are categorised as 'restricted matters' under the Shareholders' Agreement entered into by the two principal shareholders for the management of the Company. The resolution of a 'restricted matter' requires at least one Director from amongst GOSL nominees and one other from amongst NTTCom nominees to agree, in addition to the usual requirement of a simple majority. This provision is a defence against the dominance of a single major shareholder.

Board Committees and Composition

The Board has two sub-committees - the Audit Committee and the Remuneration Committee. Apart from these two sub-committees the Board delegates its authority to ad hoc sub-committee as and when necessary.

The Role of the Company Secretary

The Company Secretary maintains minutes of all Board meetings and in consultation with the CEO and through the Chairman, advises the Board on all matters pertaining to corporate governance. The Board, through the Company Secretary ensures that all capital markets regulatory requirements are complied with and disclosures made in a timely, understandable, full and fair manner.

Audit Committee

The Audit Committee reviews the internal financial controls and the effectiveness of the Company's Internal Audit function. In the past the Audit Committee has been responsible for developing and implementing processes for certain operations with the assistance of the external auditors. If external auditors are required to provide non-audit services, their suitability is also assessed by the Audit Committee.

The Audit Committee comprises of 3 Directors. Two from the GOSL nominee Directors and one from NTTCom nominees. The CFO and the Chief Internal Auditor are invited regularly to attend meetings.

Among other things, the Audit Committee has been working to streamline processes where lapses have been reported by the external auditors.

Remuneration Committee

The Remuneration Committee makes recommendations to the Board in regard to the remuneration of top management grades as well as on the attendance fees for Non-Executive Directors attending Board Meetings. This Committee also recommends the Chairman's emoluments. The Committee is comprised of the Chairman and the CEO of the Company.

Risk Management

In order to ensure a sound system of internal control and to mitigate risk, processes have been put in place.

The Management exercises control over the Company's financial system through the process of the preparation of operational and capital budgets, securing of Board approval and the comparison of actual performance against budget. The Company also has in place a system of safeguards that apply scaled limits on authorisation and approval of all financial transactions, by designation.

The Audit Committee in addition to its usual responsibilities, reviews poor business practices, weak internal process and/or financial management impropriety. The Committee seeks the views of the Company's external auditors on such matters.

Corporate Governance

Where weaknesses are identified, measures are taken to put in place the required checks and balances. A Revenue Assurance Committee headed by an off-line senior manager has been appointed to implement measures to cover identified gaps in revenue recognition and to enforce accountability. Each Chief Officer is responsible for managing the risks pertaining to their area of operations.

Human Resources

Acknowledging that human resources is one of the most valuable assets of the Company the Board ensures that the remuneration policy is fair and equitable across the Company. Salary and benefit packages across all grades are comparable with those of the best corporate entities in the country.

The Board considers health and safety of employees as a matter of paramount importance. In order to reduce absence due to ill-health the Board has authorised a comprehensive medical check-up scheme for all employees with full expenses paid by the Company.

Investor Relations

Continuous dialogue with key shareholders including institutional shareholders are ensured by quarterly investor relations meetings. At these meetings, investors are briefed by the CEO on the Company's progress and its futures plans. The management team is also encouraged to express their views and concerns.

The Way we do Business

The Company has a share dealing code embedded to ensure that senior executives, Directors, relevant employees and 'connected persons' do not abuse price-sensitive information, especially in periods leading up to the announcement of results by the Company.

The Board and the Management always advocate disciplined liberal employment policies and working for the application of responsible business practices.

Corporate Responsibility

Conduct and behaviour have adjudged SLT a responsible company. SLT embodies the spirit of corporate responsibility in every aspect of its business and social life. Some responsibilities are written whilst others are embedded in the Company's culture and tradition.

At SLT, corporate responsibility spreads across a wide area. It varies from serving remote areas, making colossal investments in building the telecommunications infrastructure, the manner in which we do business, selling and procuring, creating value for stakeholders, being engaged in stakeholder dialogues, conserving the environment to supporting initiatives which improve the quality of life of the community within which the Company operates.

A telecommunication infrastructure is one of the backbones necessary for a developing country to grow and prosper in today's world. To help achieve this objective, SLT adopted a philosophy to build a world-class telecommunications infrastructure for local industries to grow and for foreign direct investments (FDI) to come to Sri Lanka by investing colossal sums annually. Recent unprecedented growth in the Communications Sector provides an essential infrastructure for these industries.

Several discussions within different sections of this report cover a great deal of corporate responsibility activity including economic value addition directly pertaining to our value chain. This particular section aims to discuss initiatives and activities pertaining to protection of the environment and community.

SLT, as has been the practise for some years now, focuses its corporate citizenship activities in four broad areas. They are: IT knowledge, Education and English Language skills, nature conservation and upliftment of art and culture.

More than ever, in the year under review, SLT has invested substantially in society, spreading knowledge and introducing modern technology across all strata, particularly in the sphere of education and supporting worthy causes in the areas of conservation and the arts.

Let us however present a cross-section of endeavours that will illustrate the many initiatives that we take besides those related to our value chain.

Asia Foundation's 'Books for Asia' Programme - Spreading the Wealth of Knowledge

Education and knowledge building are two areas close to the SLT heart. The Asia Foundation's 'Books for Asia' programme has been in operation for several decades and was facing difficulty in raising funds for distribution and transportation.

Since the Foundation receives books free of charge from American publishers it is the responsibility of the Foundation's local chapter to bring down books from the USA to Colombo and then to transport them to chosen recipients. By the end of 2006, the number of books distributed amounted to 304,790. SLT recognised the value of this programme for Sri Lanka and took a firm decision to partner the Asia Foundation, Colombo to revive its programme.

By signing an MoU with the Asia Foundation in 2003, SLT began to actively engage in the programme in 2004. The initial target was to bring the number of books distributed to 100,000 per year in total. Playing the role of a catalyst in 'Spreading the wealth of knowledge' was SLT's broader vision for this programme. Between 2004 and end of 2006 the Foundation was able to distribute 304,790 books. 2006 saw the distribution of 104,790 books achieving its distribution target. Beneficiaries of this programme are chiefly universities, affiliated universities, teacher training colleges, primary and secondary schools, professional institutions and public libraries.

Corporate Responsibility

The Asia Foundation, in association with SLT, organises presentation ceremonies to distribute books to schools. Last year eight such presentations were arranged. A cluster of schools in a particular area are invited for each presentation ceremony. The Foundation, SLT and the Education Department jointly organise the ceremony where the schools are invited and the books are handed over. SLT's regional office staff get involved with the activities connected with the ceremony.

The Book Project has become even more meaningful after the introduction of the English medium in schools. With a dearth of books in English, both the teachers and the students will find these books which cover a wide range of subjects, most useful. Books given to libraries, professional and higher education institutions are being used by individuals of all ethnic groups, religions, income levels and social strata. The users range from primary school children to graduate students, professionals, librarians and educators in every field.

It is no doubt that SLT's partnership helped the Asia Foundation distribute 304,790 books worth Rs. 800 million from 2004 to 2006 across the country. Apart from actively being involved in providing logistical support to the Foundation in terms of distribution of books across the island, SLT is also the largest donor by far, to

the project. On the other hand, according to the Asia Foundation, Colombo, SLT's sponsorship has helped stimulate others also to help the programme.

SLT-ACCA HighQ - Broadening the Horizon of Knowledge

SLT- ACCA HighQ, Sri Lanka's Premier Quiz Programme generates a lot of interest and excitement not only among the participants but also among the general public. The programme was conducted by Sri Lanka Telecom in association with ACCA. The quiz programme which is one of the few local TV programmes recommended for viewing by the whole family encompasses education, knowledge and entertainment.

The 62 students, participating in the Challenge Level of the quiz, have qualified to do so as the highest scorers of the initial written test which was offered to all eligible applicants. The winners of each round will automatically qualify for the Semi-Final Level. The quiz programme consists of 12 Challenge Level rounds, 2 Semi-Finals and the grand Final making a total of 15 programmes. The 12 students who qualify for the Semi-Final Level receive a National Savings Bank pass book with a deposit of Rs. 25,000 which is jointly gifted by Sri Lanka Telecom and ACCA. The runners-up of the Semi-Final also receive

01 *Recognising high-flyers: 'High Q' an I.Q. programme jointly sponsored by SLT and ACCA, awards the winner with a grand prize of Rs. 200,000/-.*

02 *Acknowledging the importance of the natural environment, SLT with FOGSL organised several educational tours for students in the Sinharaja forest.*



Corporate Responsibility

prize money of Rs. 25,000 while the winners of this round receive Rs. 50,000. The Finals would see the runner-up receiving Rs. 100,000 and the Champion receiving the Grand Prize Money of Rs. 200,000 as well as the SLT-ACCA HighQ Trophy.

The Quiz has been divided into 4 categories. The first category *Window on the World*: is based on what has been happening in our country and the world during the past few weeks. *Frontiers of Knowledge*: is where science, technology and engineering related topics are covered. The third category *Heritage* as is suggested by the name covers natural and cultural heritage and humanity's exploration and understanding of both, while the final category *Human Endeavours*: concentrates on a range of pursuits from performing arts and literature to commerce and sports. It is also an interesting mix of local and international topics. All questions were prepared in strict confidence with absolute fair play guaranteed.

Popularity of the programme and the vacuum it filled was indicated by the viewership ratings it received of SRL 6.5 on Rupavahini channel. This rating is considered a great achievement for an inaugural series and a programme of this nature.

Popularity of the programme and the vacuum it filled was indicated by the viewership ratings it received.

SLT, FOGSL and Students - Preserving Heritage for Tomorrow

Conservation and protection of nature is a facet of life that is closely interwoven with life of SLT. Accordingly, we seek every avenue to inculcate knowledge and good practice amongst all Sri Lankans, particularly the younger generation who will soon be at the helm of such initiatives themselves.

In this light, SLT has identified its responsibilities in leading a next generation of citizens to be mindful of the country's heritage by launching a nature project together with the Field Ornithology Group (FOGSL) of the University of Colombo. The first programme of the series was held recently involving the students of Gurukula Maha Vidyalaya, Kelaniya.

This programme, gives students the opportunity to visit the Sinharaja Forest and learn/study about forestation and deforestation, endemism of plants, birds and creatures, diversity of the forest and the history and conservation of nature.

SLT believes that through these awareness programmes, future generations will be aware of our rich heritage and help preserve it for tomorrow. We also hope to uplift the capabilities and creativity of students in a multiplicity of directions, while providing awareness on preserving our heritage for tomorrow.

Renowned zoologist, Prof. Sarath Kotagama, together with his team at FOGSL conducts these monthly programmes where 20 students and five teachers are taken on a 3-day field trip through the Sinharaja Rain Forest. Prof. Kotagama has more than 35 years of experience with the Sinharaja Forest, especially on research related to birds in Sinharaja.

The project involves schools islandwide without discrimination or bias. Participants are provided with accommodation, food and a project pack that includes a souvenir t-shirt, cap, stationery and at the end of the programme, with the completion of required case studies, participants will be awarded a certificate of participation.

The SLT Calendar Tells the Story

Each year, the Company's calendar espouses a strong theme in keeping with our ethos of preserving our heritage. SLT spares no pains to make it informative and artistic. In most cases the calendar deals with the topics of environment protection and conservation. In the year under review SLT put out its calendar for 2007 featuring endemic freshwater fish of Sri Lanka. The Company has successfully maintained a strategic balance between introducing global conveniences to discerning customers in Sri Lanka while giving pride of place to all that is culturally, environmentally and socially valuable to the Sri Lankan people. This equilibrium has paved the way for the brand Sri Lanka Telecom to be hailed as a much loved telecommunications brand of the people. SLT's 2007 calendar, which is in the form of artist's impressions in full colour, offers the beholder a magnificent and rare insight into the little known yet absolutely spell binding world of freshwater fish, that are endemic to Sri Lanka.

Sri Lanka is categorised as one of the few countries in the world with a rich diversity of freshwater fish. Artist Shantha Jayaweera who has spent many hours studying their habitats and eco-systems, has illustrated the endemic fish featured in this calendar. The text for the calendar was written by much renowned scholar in

fishery biology Prof. (Ms.) Ruchira Cumaratunga, Dean, Faculty of Fisheries & Marine Sciences, University of Ruhuna, Sri Lanka.

SLT's calendar for 2007 is a privileged journey into their world - a 'preview' that illustrates in detail, their exquisite beauty and the importance of helping to protect them and their habitat for future generations. It is truly an echo of SLT's passion and commitment to preserve nature's heritage for tomorrow.

National ICT Week and Infotel 2006

Sri Lanka Telecom Group, the nation's premier telecommunications solutions provider was the diamond sponsor for the National ICT Week and the INFOTEL 2006 exhibition and ICT Week 2006. INFOTEL is considered to be the most important information and communications event of the year. As the largest telecom organization in the country, SLT's state-of-the-art stall at the BMICH showcased next generation lifestyle in both the corporate and home environment demonstrating access to global connectivity, point of presence, domestic core network and access network as an advanced building block for next generation networks.

01 *Maintaining a link with the country's natural heritage, SLT's 2007 calendar focuses on a theme based on Sri Lanka's rich diversity of freshwater fish.*

02 *Providing the public an opportunity for a hands-on experience with SLT's range of products at Infotel.*



Corporate Responsibility

SLT took this opportunity to engage in synchronising the story of a pioneering technology, strengthening economy and uplifting society. Some of the key technology demonstrations at the stall included NGN and its features involving IP voice and video telephony, fixed wireless convergence, IP networking services and broadband last mile access involving wire and wireless.

SLT demonstrated state-of-the-art IP based services such as IP-TV, Video on demand, IP telephony and extended features. High speed Internet using ADSL 2+ and CDMA EVDO, was also demonstrated at the SLT stall. For business customers, SLT showcased services such as optical fibre based Metro Ethernet Services (Virtual Leased Line & VP LAN Service), Hosted PABX, Call Centre and Fixed Mobile Convergence (FMC).

10th South Asian Games - Empowering Sri Lankan Sports

The Company was honoured to be the Principal Sponsor of this event held in August 2006. SLT's sponsorship of Rs. 50 million is a confirmation of its commitment to develop and strengthen relationships through sports with the sportsmen and women in and around the region. The Games were the biggest multi-sporting event to take place in the country since the first South Asian Games in 1991.

SLT believes that this relationship of merging business and sport is not just about money. At the core of this partnership are complementary values and a uniqueness that drive each other to their absolute best. This was an exciting example of how sport and business can work together and where joint interests can be realised through partnerships such as this. In addition, mutual benefits are created as each partner strives to be the best in their respective competitive environments.

As principal sponsor, SLT contributed telecommunications and ICT services to help stage the Games. SLT technology was used by organisers and the media to record and collate pre-and post-games results from eight different venues in real-time which would then make it possible for journalists and other media to beam the results worldwide on a 24-hour basis.

Starting June 1, 2006 SLT began an islandwide awareness campaign, thereby fostering a nationwide commitment to making these Games a success. This is considered to be the largest campaign ever in the history of Sri Lankan sports. In addition, SLT website provided all the daily highlights and information of the Games as well as souvenirs that could be purchased on-line.



01 As a symbol of its support to sports in Sri Lanka, SLT presented a cheque worth Rs. 50 million to the National Olympic Committee during the 2006 South Asian Games.

Corporate Responsibility

Being the principal sponsor, SLT brought its maximum potential as the technology leader to the Games. Thirteen (13) distributed gaming sites were connected through WiMAX technology and each site was Wi-Fi enabled/Wi-Fi Hotspots owing to the wireless technology backbone provided by SLT.

SLT's technology and service capability was the backbone of television transmissions to the world and to the nation. Sri Lankan Television Industry history was created during the 10th South Asian games as the Sri Lanka Rupavahini Corporation ties up Sri Lanka Telecom (SLT) for live telecast of the 10th South Asian Games. Optical Fibre based Synchronous Digital Interface technology (SDI) provided by SLT was used for this historic transmission run both Worldwide and Islandwide. This was the first time that a Sri Lankan Television station was engaged in a live telecast with the aid of a 'Fibre Optic Cable Link'. During the 10th South Asian Games camera video signals captured were fed into specialised digital video transmission equipment set up at the Games site. These signals were then transmitted as digital signals via a fibre optic cable that links these specialised digital encoding equipment (at the Stadium) to decoding equipment based at the SLRC studios, from which SLRC carried out their special live telecast of the Games locally. SLT also facilitated the international live transmission with microwave links and a special Satellite Uplink to the INSAT satellite from the Padduka Satellite Earth Station. SLT's SDI (Synchronous Digital Interface) technology provided to SLRC for this telecast is the most advanced transmission technology currently available in the world. This technology (although the first of its kind to be used in Sri Lanka) is standard application technology used by major television networks in developed countries for live TV coverage of major global events.

Sport has played an important part in social and cultural role in Sri Lanka bringing together individuals and communities and crossing social boundaries and breaking down barriers. SLT's partnership will reinforce its commitment to the nation.

SME's at Serendib Sri Lanka Trade Exhibition, UK

Sri Lanka Telecom which has always been committed to take Sri Lanka's Small and Medium Enterprises (SME's) to the world, sponsored ten entrepreneurs who came from all parts of the country and were leading names in their respective trades to attend the Serendib Sri Lanka Trade Exhibition in the UK. This event highlighted Sri Lankan handicrafts and the products showcased ranged from recycled hand-made products and jewellery to scented candles and handicrafts.

The ten entrepreneurs were handpicked by the Sri Lanka Export Development Board (EDB) and most of them have been provided with the necessary training and exposure to showcase their products at the Serendib Sri Lanka Trade Exhibition.

Through its state-of-the-art and cost effective communication solutions and services Sri Lanka Telecom is geared up to empower SME's to expand their businesses globally thus, opening up interactive dialogues with the world.

Assisting Sri Lankan Industry

Furthering its corporate philosophy, in a bid to support the local industry, SLT purchased 35 Micro MPV junior vans from Micro Car Ltd. This is the first time SLT purchased such motor vehicles. SLT uses these vehicles in our regional outlets to better facilitate our services to our customers. The outcome was as good as expected.

Financial Reports

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1. The Directors present herewith the audited financial statements for the year ended 31 December 2006.

2. FORMATION

Sri Lanka Telecom (SLT) was established by an Incorporation Order made under Section 2, State Industrial Corporations Act No. 49 of 1957 and published in Gazette Extraordinary No. 596/11 of 6 February 1990. Under an Order made by the Minister of Posts and Telecommunications on 24 July 1991 under Section 23, Sri Lanka Telecommunications Act No. 25 of 1991 and published in Gazette No. 675 of 9 August 1991, all the property, rights and liabilities (other than those excluded by the agreement entered into between the Minister and SLT as per Sub-section 2 of Section 23 of the Sri Lanka Telecommunications Act) to which the Department of Telecommunications (DOT) was entitled or subject to immediately before the transfer date (1 September 1991) were vested in SLT.

As part of the privatisation process SLT was converted to a public limited Company, Sri Lanka Telecom Limited (SLTL), on 25 September 1996 under the Conversion of Public Corporations or Government Owned Business Undertakings into Public Limited Companies Act No. 23 of 1987, vide Gazette Extraordinary No. 942/7 of 25 September 1996. Following the incorporation of SLTL, all of the business and related assets and liabilities of SLT were transferred to SLTL.

Subsequently, on 5 August 1997, the Government as the sole shareholder of SLTL divested 35% of its holding in the issued share capital of SLTL by the sale of 631,701,000 ordinary shares of Rs. 10 each to Nippon Telegraph and Telephone Corporation (NTT) and entered into an agreement with NTT to transfer the management of the Company to NTT. On 2 July 1998, the Government of Sri Lanka divested a further 3.5% of the issued share capital of SLTL by the distribution of 63,170,010 ordinary shares to the employees of SLTL. On 22 March 2000, NTT Corporation transferred the full amount of its shares in the Company to NTT Communications Corporation (NTT Com) on reconstitution of the former.

The Government of Sri Lanka divested a further 12% of its holding to the public through the Colombo Stock Exchange in November 2002, bringing down the Government's holding to 49.5%.

3. RESULTS

The results for the year and the changes in equity are set out in the income statement on page 74 and, the statements of changes in equity on pages 76 and 77 respectively.

4. REVIEW OF BUSINESS

The state of affairs of the Company at 31 December 2006 is set out in the balance sheet on page 75. An assessment of the Company during the financial year is given in the CEO's Review.

5. PROPERTY, PLANT & EQUIPMENT

The movements in property, plant & equipment during the year are set out in Note 12 to the financial statements.

6. GROUP ACTIVITIES

The Group provides a broad portfolio of telecommunication services across the country, the main activity being domestic and international telephone services. The range of services provided by the Company includes, inter alia, internet access, data services, domestic and international leased circuits, frame relay, ISDN, satellite uplink and maritime transmission.

7. SUBSIDIARIES

The wholly-owned subsidiaries of the Company are Mobitel (Private) Limited, Sri Lanka Telecom (Services) Limited, SLT Hong Kong Limited and SLT Publications (Private) Limited. While Mobitel is the mobile phone operation arm of SLT, SLT (Services) engages in providing total network solutions to corporate and small business customers. SLT Hong Kong is a point of presence providing IP transit services and SLT Publications engages in directory publication services.

8. DIVIDEND

During the year a First and Final dividend of 7.5% per share was paid out of the profits of 2005 in May 2006.

The Directors recommend a First and Final dividend of 10% per share for the year ended 31 December 2006 on the issued share capital of Rs. 18,048,600,000.

9. RESERVES

Total reserves of the Group and their composition have been given in the statement of changes in equity on pages 76 and 77 of the financial statements.

10. SUBSTANTIAL SHAREHOLDINGS

As at 31 December 2006 there were 1,804,860,000 ordinary shares of Rs. 10 each in issue, and according to the share register the undernoted held more than a 5% interest therein at the balance sheet date.

	Holding %	No. of Shares
Government of Sri Lanka	49.50	893,405,700
NTT Communications Corporation	35.20	635,076,318

The balance 15.30% is held by the public.

11. SHAREHOLDER RELATIONS

The Board lays emphasis on good investor relations. In addition to the Annual General Meetings at which the Directors have a dialogue with the shareholders, timely financial reports are presented to them on quarterly and annual basis. The Investor Relations Officers together with CEO meet institutional shareholders and Fund Managers on a regular basis. Additionally, shareholders are kept up-to-date on the Company's business endeavours and other activities undertaken to enhance shareholder value, through its quarterly newsletter 'Investor'.

12. DIRECTORS

During the year the Board comprised nine Directors and as at 31 December 2006 the Directors were:

Mr. P. Asoka Weerasinghe de Silva - *Appointed on 28 July 2006 and elected Chairman of the Board*

Mr. Shoji Takahashi - *Appointed CEO on 4 December 2006*

Mr. Shuhei Anan - *Resigned as CEO on 4 December 2006*

Mr. S.B. Divaratne

Mrs. Leisha Chandrasena

Mr. S.N. Kumar

Mr. Jun Sawada

Mr. Sumith Wijesinghe

Report of the Directors

The following who were Directors of the Company at the beginning of the year resigned from the Board on the dates mentioned below:

- Mr. Nigel Hatch - *Resigned on 26 January 2006*
- Mr. Lalith De Mel - *Resigned on 26 January 2006*
- Mr. Kiyoshi Maeda - *Resigned on 13 February 2006*
- Mr. Haruhiko Yamada - *Resigned on 24 July 2006*
- Mr. Anil Obeyesekere - *Resigned on 28 July 2006*
- Mr. Jun Sawada - *Resigned on 16 January 2007*
- Mr. Tadashi Imachi - *Alternate to Mr. Jun Sawada appointed on 29 November 2006 was revoked on 16 January 2007*
- Mr. Kenji Satoh - *Alternate to Mr. Haruhiko Yamada appointed on 30 June 2006 was revoked on 24 July 2006*
Alternate to Mr. Jun Sawada appointed on 30 August 2006 was revoked on 29 November 2006
Alternate to Mr. Shoji Takahashi appointed on 17 May 2006 was revoked on 16 January 2007

Re-election of Directors

The Company's Articles of Association require that one-third of the Directors retire at each Annual General Meeting of the Company.

Accordingly, Mr. Shuhei Anan and Mr. S.B. Divaratne retire in terms of Article 91 and being eligible offer themselves for re-election.

During the year Mr. Sumith Wijesinghe was appointed to fill a casual vacancy by the Board, retires in terms of Article 97, and being eligible offer himself for re-election.

13. DIRECTORS' INTEREST IN CONTRACTS AND PROPOSED CONTRACTS WITH THE COMPANY

The Directors' interests in contracts and proposed contracts with the Company, both direct and indirect, are set out in Note 32 to the financial statements. The Directors have disclosed the nature of their interests in contracts and proposed contracts with the Company at meetings of the Directors.

14. DIRECTORS' INTERESTS IN SHARES OF THE COMPANY

As at the end of the year no Director holding office held shares of the Company.

15. CORPORATE GOVERNANCE

Within the corporate entity, the Company business and affairs are managed and directed with the objective of balancing the attainment of corporate objectives, the alignment of corporate behaviour within the expectation of the law and society and the accountability to shareholders and responsibility to other recognised stakeholders.

Report of the Directors

During the year the Audit Committee comprised of Mrs. Leisha Chandrasena, Mr. S.N. Kumar and Mr. Kenji Satoh.

Mr. P. Asoka Weerasinghe de Silva and Mr. Shuhei Anan were the members of the Remuneration Committee.

16. STATUTORY PAYMENTS

All statutory payments payable to the government and the employees have been made at the balance sheet date.

17. ENVIRONMENTAL PROTECTION

It is the responsibility of the Company to operate in a manner that will not have a detrimental effect on the environment and to provide products and services of the highest quality that have a beneficial effect on our customers and the communities within which we operate.

18. DONATIONS

During the year the Directors have made a donation of Rs. 75,000 to 'Shanthi Foundation' which is a government approved charity.

19. GOING CONCERN

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

20. POST-BALANCE SHEET EVENTS

No events have occurred since the balance sheet date, which would require adjustments to, or disclosure in, the financial statements.

21. APPOINTMENT OF AUDITORS

A resolution to reappoint the present Auditors, Messrs PricewaterhouseCoopers, Chartered Accountants, who have expressed their willingness to continue, will be proposed at the Annual General Meeting.

By Order of the Board

P.G. Dias
Secretary

Colombo
9 February 2007

Statement of the Directors' Responsibilities in Relation to the Financial Statements

The responsibilities of the Directors, in relation to the financial statements of the Group, differ from the responsibilities of the Auditors which are set out in the Report of the Auditors on page 73.

As per the provisions of the Companies Act No. 17 of 1982 the Directors are required to prepare financial statements for each financial year giving a true and fair view of the state of affairs of the Group as at the end of the financial year and of the results of its operations for the financial year.

The Directors consider that, in preparing these financial statements set out on pages 74 to 104, appropriate accounting policies have been selected and applied in a consistent manner and supported by reasonable and prudent judgement and that all applicable Accounting Standards, as relevant, have been followed.

The Directors are also confident that the Group has adequate resources to continue in operation and have applied the going concern basis in preparing these financial statements. Further, the Directors have a responsibility to ensure that the Group maintains sufficient accounting records to disclose with reasonable accuracy, the financial position of the Group, and to ensure that the financial statements presented comply with the requirements of the Companies Act No. 17 of 1982.

The Directors are also responsible for taking reasonable steps to safeguard the assets of the Group and in this regard to give proper consideration to the establishment of appropriate internal control systems to prevent and detect fraud and other irregularities.

The Directors are confident that they have discharged their responsibilities as set out in this statement. The Directors also confirm that to the best of their knowledge, all statutory payments payable by the Group as at the balance sheet date have been paid or where relevant, provided for.

By Order of the Board

P.G. Dias
Secretary

Colombo
9 February 2007



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**TO THE MEMBERS OF SRI LANKA TELECOM LIMITED
FOR THE YEAR ENDED 31 DECEMBER 2006**

We have audited the balance sheet of Sri Lanka Telecom Limited (the Company) and its subsidiaries (the Group) as at 31 December 2006, the Consolidated Balance Sheet of the Group as at that date, and the related Income, Changes in Equity and Cash Flow Statements for the year then ended, together with the Accounting Policies and Notes thereon appearing on pages 74 to 104.

Respective Responsibilities of Directors and Auditors

The Directors are responsible for preparing and presenting these financial statements in accordance with the Sri Lanka Accounting Standards. Our responsibility is to express an opinion on these financial statements, based on our audit.

Basis of Opinion

We conducted our audit in accordance with Sri Lanka Auditing Standards which require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatements. An audit also includes examining, on a test basis, evidence supporting the amounts and disclosures in the said financial statements, assessing the accounting principles used and significant estimates made by the Directors, evaluating the overall presentation of the financial statements and determining whether the said financial statements are prepared and presented in accordance with Sri Lanka Accounting Standards. We have obtained all the information and explanations which, to the best of our knowledge and belief, were necessary for the purposes of our audit. We therefore believe that our audit provides a reasonable basis for our opinion.

Opinion

In our opinion, so far as appears from our examination, the Company maintained proper books of account for the year ended 31 December 2006, and to the best of our

information and according to the explanations given to us, the said Balance Sheet and the related Income, Changes in Equity and Cash Flow Statements and the Accounting Policies and Notes thereto, which are in agreement with the said books and have been properly prepared and presented in accordance with Sri Lanka Accounting Standards, provide the information required by the Companies Act No. 17 of 1982 and give a true and fair view of the Company's state of affairs as at 31 December 2006 and of the results of its operations and its cash flows and changes in equity for the year then ended.

In our opinion, the Consolidated Balance Sheet and related Income, Changes in Equity and Cash Flow Statements and the Accounting Policies and Notes thereto have been properly prepared and presented in accordance with the Sri Lanka Accounting Standards and the Companies Act No. 17 of 1982 and give a true and fair view of the state of affairs as at 31 December 2006 and of the results of the operations and cash flows and changes in equity for the year then ended of the Company and its subsidiaries dealt with thereby, so far as concerns the members of the Company.

Directors' Interests in Contracts

According to the information made available to us, the Directors of the Company were not directly or indirectly interested in contracts with the Group during the year ended 31 December 2006 except as stated in Note 32 to these financial statements.

PricewaterhouseCoopers
Chartered Accountants

Colombo
9 February 2007

Consolidated Income Statement

<i>(All amounts in Sri Lanka Rupees millions)</i>					
<i>For the year ended 31 December 2006</i>					
	Notes	2006	Group 2005	2006	Company 2005
Revenue	3	40,691	32,515	36,109	29,282
Operating costs	4	(17,979)	(15,512)	(15,351)	(12,898)
Operating profit before depreciation and other income		22,712	17,003	20,758	16,384
Depreciation	12	(10,005)	(9,366)	(8,849)	(8,144)
Operating profit		12,707	7,637	11,909	8,240
Voluntary Retirement Scheme (VRS)	7	(425)	–	(425)	–
Other income		180	162	175	158
International Telecommunication Operators' Levy	6	(2,282)	(1,550)	(2,280)	(1,549)
Interest expense and related charges	8	(1,989)	(2,085)	(1,316)	(1,437)
Interest income		1,036	648	1,166	633
Profit before tax		9,227	4,812	9,229	6,045
Tax	9	(3,789)	(1,719)	(3,732)	(1,694)
Net profit		5,438	3,093	5,497	4,351
Earnings per share (Rs.)	10	3.01	1.71	3.05	2.41

All of the Group's activities are continuing activities.

The Notes on pages 79 to 104 form an integral part of these financial statements.

Report of the Auditors on page 73.

Consolidated Balance Sheet

(All amounts in Sri Lanka Rupees millions)
As at 31 December 2006

	Notes	2006	Group 2005	2006	Company 2005
ASSETS					
Non-current assets					
Property, plant & equipment	12	54,425	56,151	44,856	47,607
Intangible assets	13	1,365	612	37	84
Investments in subsidiaries	14	–	–	7,032	3,497
Non-current receivables	15	960	962	960	3,462
		56,750	57,725	52,885	54,650
CURRENT ASSETS					
Inventories	16	1,419	844	1,325	694
Receivables and prepayments	17	10,558	8,483	10,554	7,858
Cash & cash equivalents	18	15,315	14,468	14,390	12,735
		27,292	23,795	26,269	21,287
Total assets		84,042	81,520	79,154	75,937
EQUITY AND LIABILITIES					
Capital and reserves					
Ordinary share capital	26	18,049	18,049	18,049	18,049
Capital reserve		–	188	–	188
Hedging reserve	27	(236)	(208)	(236)	(208)
Insurance reserve	24	183	166	183	166
Retained earnings		19,870	15,598	22,705	18,374
		37,866	33,793	40,701	36,569
Deferred income	21	7,110	7,546	7,110	7,546
Non-current liabilities					
Grants		75	89	75	89
Deferred tax liabilities	20	4,513	6,013	4,513	6,013
Borrowings	19	16,868	19,139	13,065	13,848
Retirement benefit obligations	23	942	751	903	721
Trade and other payables	22	298	297	298	297
		22,696	26,289	18,854	20,968
Current liabilities					
Trade and other payables	22	8,721	7,414	7,330	6,263
Current tax liabilities		3,732	2,777	3,705	2,757
Borrowings	19	3,917	3,701	1,454	1,834
		16,370	13,892	12,489	10,854
Total liabilities		39,066	40,181	31,343	31,822
Total equity and liabilities		84,042	81,520	79,154	75,937

These financial statements were approved by the Board of Directors on 9 February 2007 and were signed on its behalf by:

(Sgd.)

P. Asoka Weerasinghe de Silva
Director

(Sgd.)

Shoji Takahashi
Director

The Notes on pages 79 to 104 form an integral part of these financial statements.

Report of the Auditors on page 73.

Consolidated Statement of Changes in Equity

(All amounts in Sri Lanka Rupees millions)

For the year ended 31 December 2006

	Notes	Insurance reserve	Share capital	Capital reserve	Hedging reserve	Retained earnings	Total
GROUP							
Year ended 31 December 2005							
Balance at 1 January 2005		100	18,049	188	(677)	13,404	31,064
Cash flow hedges							
- foreign currency							
translation difference	27	–	–	–	245	–	245
- charged to income	8	–	–	–	224	–	224
Insurance reserve							
- charged to income	24	66	–	–	–	–	66
Dividend for 2004	11	–	–	–	–	(902)	(902)
Unclaimed dividend written back		–	–	–	–	3	3
Net profit for the year 2005		–	–	–	–	3,093	3,093
Balance at 31 December 2005		166	18,049	188	(208)	15,598	33,793
Year ended 31 December 2006							
Balance at 1 January 2006		166	18,049	188	(208)	15,598	33,793
Cash flow hedges							
- foreign currency							
translation difference	27	–	–	–	(96)	–	(96)
- charged to income	8	–	–	–	68	–	68
Insurance reserve							
- charged to income	24	17	–	–	–	–	17
Capital reserve							
- transferred to retained earnings		–	–	(188)	–	188	–
Dividend for 2005	11	–	–	–	–	(1,354)	(1,354)
Net profit for the year 2006		–	–	–	–	5,438	5,438
Balance at 31 December 2006		183	18,049	–	(236)	19,870	37,866

The Notes on pages 79 to 104 form an integral part of these financial statements.

Report of the Auditors on page 73.

Statement of Changes in Equity

(All amounts in Sri Lanka Rupees millions)

For the year ended 31 December 2006

	Notes	Insurance reserve	Share capital	Capital reserve	Hedging reserve	Retained earnings	Total
COMPANY							
Year ended 31 December 2005							
Balance at 1 January 2005		100	18,049	188	(677)	14,922	32,582
Cash flow hedges							
- foreign currency							
translation difference	27	-	-	-	245	-	245
- charged to income	8	-	-	-	224	-	224
Insurance reserve							
- charged to income	24	66	-	-	-	-	66
Dividend for 2004	11	-	-	-	-	(902)	(902)
Unclaimed dividend written back		-	-	-	-	3	3
Net profit for the year 2005		-	-	-	-	4,351	4,351
Balance at 31 December 2005		166	18,049	188	(208)	18,374	36,569
Year ended 31 December 2006							
Balance at 1 January 2006		166	18,049	188	(208)	18,374	36,569
Cash flow hedges							
- foreign currency							
translation difference	27	-	-	-	(96)	-	(96)
- charged to income	8	-	-	-	68	-	68
Insurance reserve							
- charged to income	24	17	-	-	-	-	17
Capital reserve							
- transferred to retained earnings		-	-	(188)	-	188	-
Dividend for 2005	11	-	-	-	-	(1,354)	(1,354)
Net profit for the year 2006		-	-	-	-	5,497	5,497
Balance at 31 December 2006		183	18,049	-	(236)	22,705	40,701

The Notes on pages 79 to 104 form an integral part of these financial statements.

Report of the Auditors on page 73.

Consolidated Cash Flow Statement

(All amounts in Sri Lanka Rupees millions)
For the year ended 31 December 2006

	Notes	2006	Group 2005	2006	Company 2005
Operating activities					
Cash generated from operations	28	19,322	19,668	16,229	18,049
Interest received		574	541	704	526
Interest paid		(2,142)	(2,294)	(1,470)	(1,581)
Tax paid		(4,320)	(715)	(4,266)	(710)
Net cash generated from operating activities		13,434	17,200	11,197	16,284
Investing activities					
Acquisition of property, plant & equipment		(8,693)	(11,460)	(6,098)	(7,843)
Acquisition of intangible assets		(507)	–	–	–
Disposal of investments		–	762	–	762
Disposal of property, plant & equipment		4	12	4	12
Loan given to subsidiary	15	–	–	(500)	(2,500)
Investments in subsidiary	14	–	–	(535)	(1,500)
Net cash used in investing activities		(9,196)	(10,686)	(7,129)	(11,069)
Financing activities					
Proceeds from borrowings		–	2,041	–	–
Payment on borrowings		(3,739)	(3,338)	(1,821)	(1,723)
Dividends paid	11	(1,354)	(899)	(1,354)	(899)
Redemption of debentures		–	(375)	–	(375)
Net cash used in financing activities		(5,093)	(2,571)	(3,175)	(2,997)
(Decrease)/Increase in cash and cash equivalents		(855)	3,943	893	2,218
Movement in cash and cash equivalents					
Cash and cash equivalents at beginning of the year		15,190	10,485	13,497	10,517
(Decrease)/Increase		(855)	3,943	893	2,218
At end of year	18	14,335	14,428	14,390	12,735

The Notes on pages 79 to 104 form an integral part of these financial statements.

Report of the Auditors on page 73.

1. GENERAL INFORMATION

Sri Lanka Telecom Limited was incorporated under the Companies Act No. 17 of 1982. The registered office of the Company is located at Lotus Road, Colombo 1. The Company is a quoted public company which has its listing on the Colombo Stock Exchange.

The principal activity of the Group is providing domestic and international telephone services. During the year, the Company has formed two fully-owned subsidiaries, namely SLT (Hong Kong) Limited, which has applied for licence to conduct telecommunication related business in Hong Kong and SLT Publications (Private) Limited, engaged in directory publications in Sri Lanka.

These consolidated financial statements have been approved for issue by the Board of Directors on 9 February 2007.

2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

The principal accounting policies applied in the preparation of these consolidated financial statements are set out below. These policies have been consistently applied to all the years presented, unless otherwise stated.

2.1 Basis of preparation

The consolidated financial statements are prepared in accordance and comply with Sri Lanka Accounting Standards. The consolidated financial statements are prepared under the historical cost convention. Where any item is not covered by Sri Lanka Accounting Standards (SLAS), International Accounting Standards (IAS) are followed.

The preparation of financial statements in conformity with SLAS & IAS requires the use of certain critical accounting estimates. It also requires management to exercise its judgement in the process of applying the Company's accounting policies.

2.2 Consolidation

(a) *Subsidiaries*

Subsidiaries are all entities over which the Group has the power to govern the financial and operating policies generally accompanying a shareholding of more than one half of the voting rights. Subsidiaries are fully consolidated from the date on which control is transferred to the Group. They are de-consolidated from the date that control ceases.

(b) *Group accounting*

All inter-company transactions, balances and unrealised surpluses and deficits on transactions between Group companies have been eliminated. The accounting policies of the subsidiaries are the same as those of the Company. No disclosure of minority interest is made as the subsidiaries are wholly owned.

2.3 Foreign currency transactions

(a) *Functional and presentation currency*

Items included in the financial statements of each of the Group's entities are measured using the currency of the primary economic environment in which the entity operates ('the functional currency'). The consolidated financial statements are presented in Sri Lanka Rupees, which is the Company's functional and presentation currency.

2.3 Foreign currency transactions (Contd.)

(b) Transactions and balances

Foreign currency transactions are translated into the functional currency using the exchange rates prevailing at the dates of the transactions. Foreign exchange gains and losses resulting from the settlement of such transactions and from the translation at year-end exchange rates of monetary assets and liabilities denominated in foreign currencies are recognised in the income statements.

Translation differences on non-monetary financial assets and liabilities are reported as part of the fair value gain or loss.

Translation differences on non-monetary financial assets and liabilities such as equities held at fair value through profit or loss are recognised in profit or loss as part of the value gain or loss. Translation differences on non-monetary financial assets such as equities classified as available for sale are included in the fair value reserve in equity.

(c) Group companies

The results and financial position of all the Group entities that have a functional currency different from the presentation currency are translated into the presentation currency as follows:

- (i) assets and liabilities for each balance sheet presented are translated at the closing rate at the date of that balance sheet; and
- (ii) all resulting exchange differences are recognised as a separate component of equity.

On consolidation, exchange differences arising from the translation of the net investment in foreign operations, and of borrowings and other currency instruments designated as hedges of such investments, are taken to shareholders' equity. When a foreign operation is sold, exchange differences that were recorded in equity are recognised in the income statement as part of the gain or loss on sale.

Goodwill and fair value adjustments arising on the acquisition of a foreign entity are treated as assets and liabilities of the foreign entity and translated at the closing rate.

2.4 Intangible Assets

(a) Goodwill

Goodwill represents the excess of the cost of an acquisition over the fair value of the Group's shares of the net identifiable assets of the acquired subsidiary undertakings at the date of acquisition. Separately recognised goodwill is tested annually for impairment and carried at cost less accumulated impairment losses.

(b) Licence and Software

Licence and software will be recorded at cost and amortisation will be charged over the period to which it relates.

(c) Others (Deferred insurance premium)

Insurance premium paid by the Company to secure foreign loans under the 150K Project Scheme has been deferred on the grounds that the benefit of this expenditure is not exhausted in the period in which it is incurred and will be written off to the income statement over the repayment period of the loans.

Notes to the Financial Statements

2.5 Grants

Grants relating to property, plant & equipment are included in non-current liabilities and are credited to the income statement on a straight-line basis over the expected useful lives of the related assets.

2.6 Property, plant & equipment

Property, plant & equipment is stated at historical cost less accumulated depreciation.

Historical cost includes all costs directly attributable to bringing an asset to working condition for its intended use. Cost in the case of the network comprises all expenditure up to and including the cabling within customers' premises, undersea cables, contractors' charges and payments on account of materials, customs duty and borrowing costs. Significant renovations are capitalised only when it is probable that future economic benefits associated with the item will flow to the Group and the cost of the item can be measured reliably. All other repairs and maintenance are charged to the income statement during the financial period in which they are incurred.

Gains and losses on disposals are determined by comparing proceeds with carrying amount. These are included in the income statement.

The basis of valuation used on the transfer of assets from SLT to SLTL is explained in Note 12 (a) to the financial statements.

Depreciation is calculated using the most appropriate method to allocate the cost of each asset to their residual values over their estimated useful lives. The Company depreciates its assets on the straight-line method commencing from

the month of purchase and the useful lives are as follows:

Asset category	Useful life
Freehold land	–
Freehold buildings	40 years
Ducts and other outside plant	10 to 20 years
Undersea cables (ducts, cables and other outside plant)	10 years
Telephone exchanges and transmission equipment	12.5 years
Motor vehicles	5 years
Other fixed assets	4 to 10 years

An asset's carrying amount is written down immediately to its recoverable amount if the asset's carrying amount is greater than its estimated recoverable amount.

Interest costs on borrowings to finance the construction of property, plant & equipment are capitalised, during the period of time that is required to complete and prepare the property for its intended use, as part of the cost of the asset.

2.7 Investments

Long-term investments are shown at cost and provision is only made where, in the opinion of the Directors, there is a permanent diminution in value. Where there has been a permanent diminution in the value of an investment, it is recognised as an expense in the period in which the diminution is identified.

On disposal of an investment, the difference between the net disposal proceeds and the carrying amount is charged or credited to the income statement.

2.8 Inventories

All inventories are held to be used by the Company in providing its services. Inventories are stated at the lower of cost and net realisable value. For this purpose, the cost of inventories is determined using the Weighted Average Cost (WAC). The cost of inventories include all costs of purchase, costs of conversion and other costs incurred in bringing the inventories to their present location and condition. Net realisable value is the estimated selling price in the ordinary course of business, less applicable variable selling expenses. Provision is made for slow-moving and obsolete inventories, which are not expected to be used internally.

2.9 Trade receivables

Trade receivables are carried at original invoice amount less an estimate made for doubtful receivables based on a review of all outstanding amounts at the year end. Bad debts are written off once decided as irrecoverable after due recovery procedures.

2.10 Cash and cash equivalents

Cash and cash equivalents includes cash in hand, deposits held at call with banks, other short-term highly liquid investments with original maturities of three months or less, and bank overdrafts. Bank overdrafts are shown within borrowings in current liabilities on the balance sheet.

2.11 Share capital

Dividends on ordinary shares are recognised in equity in the period in which they are declared.

2.12 Borrowing costs

Borrowing costs are written off to the income statement as incurred, unless they relate to

borrowings which fund significant capital projects, in which case they are capitalised with the relevant qualifying asset up to the date of commissioning, and written off to the income statement over the period during which the asset is depreciated. Borrowing costs include interest charged, commitment fees, guarantee premium and exchange differences on foreign loans to the extent that they are regarded as an adjustment to interest costs.

2.13 Taxation

The current tax charge is based on the results for the year as adjusted for disallowable items.

Deferred income tax is provided in full, using the balance sheet liability method, for all temporary differences arising between the tax bases of assets and liabilities and their carrying values for financial reporting purposes. Currently, enacted tax rates are used to determine deferred income tax.

Under this method the Group is required to make provision for deferred income taxes on revaluations, if any, of non-current assets and, in relation to an acquisition, on the difference between the fair values of the net assets acquired and their tax base. Provision for taxes, mainly withholding taxes, which could arise on the remittance of retained earnings, principally relating to subsidiaries, is only made where there is a current intention to remit such earnings.

The principal temporary differences arise from depreciation on property, plant & equipment, revaluations of certain non-current assets, provisions for retirement benefits, deferred connection charges and tax losses carried forward. Deferred income tax assets relating to the carry forward of unused tax losses are recognised to the extent that it is probable that

future taxable profit will be available against which the deferred tax assets can be utilised.

2.14 Defined benefit plan

SLTL as a matter of policy obtains an actuarial valuation of the retirement benefit liability once a year.

An actuarial valuation was carried out by an independent professional valuer to ascertain the full liability arising in terms of the Payment of Gratuity Act No. 12 of 1983, in respect of all employees of SLTL as at 31 December 2006. The valuation was made adopting the Projected Unit Credit Method as recommended by the Sri Lanka Accounting Standard No. 16, Retirement Benefit Costs.

The assumptions based on which the results of the actuarial valuation was determined, are included in Note 23 to the financial statements.

The liability is not funded externally.

2.15 Defined contribution plan

All employees of the Company are members of the Employees' Provident Fund of SLTL and the Employees' Trust Fund to which SLTL contributes 15% and 3% respectively of such employees' basic salary and allowances.

2.16 Provisions

Provisions are recognised when the Group has a present legal or constructive obligation as a result of past events, it is more likely than not that an outflow of resources will be required to settle the obligation, and the amount has been reliably estimated. Restructuring provisions comprise lease termination penalties and employee termination payments. Provisions are not recognised for future operating losses.

Where there are number of similar obligations, the likelihood that an outflow will be required in settlement is determined by considering the class of obligations as a whole. A provision is recognised even if the likelihood of an outflow with respect to any one item included in the same class of obligation may be small.

Provision are measured at the present value of the expenditures expected to be required to settle the obligation using the pre-tax rate that reflect current market assessment of the time value of money and the risks specific to the obligation. The increase in the provision due to passage of time is recognised as interest expense.

2.17 Revenue recognition

Revenue comprises the fair value of the consideration received or receivable for the rendering of services in the ordinary course of the Group's activities. Revenue is shown net of value added tax, estimated returns, rebates and discounts and after eliminated sales within the Group. Revenue is recognised as follows:

(i) Domestic and international call revenue and rental income

The customers are billed for calls and rental on monthly cycle based on the calendar months. Customers are charged government taxes at the applicable rates but accounted for as a liability. Revenue is recognised net of such taxes based on the amounts billed.

(ii) Revenue from other network operators and international settlements

Revenue is received from other network operators, local and international, for the use of SLTL network for completing connections. These revenues are recognised, net of taxes, based on traffic minutes and stipulated rates.

(iii) Revenue from other telephony services

Revenue is recognised on an accrual basis based on the usage of these services.

(iv) Connection fees

Connection fees relating to Public Subscriber Telephone Network are initially recognised as deferred income and subsequently recognised as revenue by amortising over a period of 15 years.

(v) Equipment sales

Revenue on equipment sales is recognised, net of taxes, on completion of sales transaction.

(vi) Interest income

Interest income is derived from short-term investments of excess funds and is recognised on an accrual basis.

(vii) Dividend income

Dividend income is recognised when the right to receive the payment is established.

2.18 Expenditure

Expenses are recognised on accrual basis. All expenditure incurred in the running of the business and in maintaining property, plant & equipment in a state of efficiency has been charged to income in arriving at the profit for the period.

For the purpose of presentation of the income statement information nature of expense method is used.

2.19 Foreign exchange risk

The Company hedges a portion of exchange risks of loans obtained in foreign currency using future net foreign earnings.

The Company hedges between 50% to 75% of anticipated net foreign earnings for 5 years. Approximately 75% (2005 - 75%) of projected net foreign earnings qualified as 'highly probable' for which hedge accounting was used in 2006.

The Company documents at the inception of the transaction the relationship between hedging instruments and hedged items, as well as its risk management objective and strategies for undertaking various hedge transactions. This process includes linking all derivatives designated as hedges to forecast transactions. The Company also documents its assessment, both at the hedge inception and on an on-going basis, of whether the derivatives that are used in hedging transactions are highly effective in offsetting changes in cash flows of hedged items.

2.20 Dividend distribution

Dividend distribution to the Company's shareholders is recognised as a liability in the Group's financial statements in the period in which the dividends are approved by the Company's shareholders.

2.21 Comparatives

The Company previously disclosed licence fee paid, software and deferred expenses within 'non-current receivable'. Further, the deferred expenses falling within one year was previously disclosed under 'advances and prepayments'. Management believes that their inclusion in 'intangible assets' is a fairer representation.

Notes to the Financial Statements

(All amounts in Sri Lanka Rupees millions)

3. REVENUE

The significant categories under which revenue is recognised are as follows:

	Group		Company	
	2006	2005	2006	2005
Release of deferred connection charges (Note 21)	924	896	924	896
Rental income	7,600	7,687	6,827	6,992
Domestic call revenue	13,902	12,221	10,745	10,096
Receipts from other network operators - domestic	244	215	356	304
International call revenue	2,237	2,430	2,033	2,275
Receipts from other network operators - international	109	291	339	351
International settlements (in payments)	5,940	5,207	5,940	5,207
Telex, data transmission and other telephony services	4,215	3,005	3,425	2,598
CDMA revenue	5,520	563	5,520	563
	40,691	32,515	36,109	29,282

4. OPERATING COSTS

The following items have been included in arriving at operating profit:

	Group		Company	
	2006	2005	2006	2005
Staff costs (Note 5)	4,956	4,144	4,565	3,857
Directors' emoluments	31	32	29	30
Payments to international network operators	1,437	1,755	1,437	1,755
Payments to other network operators - international	451	688	681	662
Payments to other network operators - domestic	306	146	287	237
Auditors' remuneration				
Audit fees	4	4	3	3
Non-Audit fees	0	0	0	0
Repairs and maintenance	1,754	2,024	1,478	1,801
Provision for doubtful debts	844	849	632	577
Provision for fall in value of inventories	242	290	242	109
Net foreign exchange (gains)/losses on operating activities	3	46	(43)	69
Amortisation of goodwill (Note 13)	-	78	-	-
Other operating expenditure	5,651	5,067	3,686	3,493
CDMA expenditure	2,276	305	2,354	305
Write off of inventories	24	84	-	-
	17,979	15,512	15,351	12,898

5. STAFF COSTS

	Group		Company	
	2006	2005	2006	2005
Salaries, wages, allowances and benefits	4,263	3,547	3,921	3,298
Retirement costs - defined contribution plans	407	349	370	318
- defined benefit plans (Note 23)	286	248	274	241
	4,956	4,144	4,565	3,857
Number of employees at the end of the period	7,965	7,995	7,172	7,311

6. INTERNATIONAL TELECOMMUNICATION OPERATORS' LEVY

	Group		Company	
	2006	2005	2006	2005
Charge for the year	2,282	1,691	2,280	1,690
Over provision in respect of previous period	-	(141)	-	(141)
Charge to income statement	2,282	1,550	2,280	1,549

According to Finance Act No. 11 of 2004, International Telecommunications Operators are required to make a contribution to the Government at the rate of US\$ 0.038 per international incoming traffic minute w.e.f. 3 March 2003. The total amount of the levy in respect of SLTL from 1 January 2006 to 31 December 2006 has been estimated at Rs. 2,280 million (2005 - Rs. 1,690 million) and has been recognised as an expense in the current financial year. The corresponding liability has been recognised in the balance sheet.

The Gazette notification of 31 March 2005 provides that each domestic PSTN operator may claim two thirds of the Telecommunications Development Charge (TDC) funds, for the development of their telecommunications network in unserved and underserved areas of Sri Lanka as may be determined by the Telecommunications Regulatory Commission (TRC) within a period of three years.

The documentation supporting the Network roll out in unserved and underserved areas has been submitted to the TRC. The estimated refund of Rs. 3,282 million as at 31 December 2006 has not been recognised in the income statement, since TRC's determination of the refund is yet awaited.

7. VOLUNTARY RETIREMENT SCHEME (VRS)

A VRS has been announced on 6 April 2006 by the Company, accordingly, based on the number of applications and the defined plan identified for each grade of staff, the cost of VRS is estimated at Rs. 425 million.

8. FINANCE COSTS

	Group		Company	
	2006	2005	2006	2005
Interest expense and related charges				
Rupee loans	1,066	944	356	344
Foreign currency loans	135	193	89	155
US\$ 100 million notes	864	691	864	691
Debenture interest	-	12	-	12
Amortisation of deferred costs	105	97	48	87
Other charges [Note (a)]	(109)	(65)	(109)	(76)
Total interest payable	2,061	1,872	1,248	1,213
Interest capitalised	(140)	(11)	-	-
Total interest charged	1,921	1,861	1,248	1,213
Foreign exchange loss (Note 27)	68	224	68	224
Aggregate value of finance costs	1,989	2,085	1,316	1,437

(a) Other charges include exchange gain from US\$ 100 million Bond and other exchange gains and losses on foreign currency deposits, etc.

Notes to the Financial Statements

9. TAX

The charge for taxation is made up as follows:

	Group		Company	
	2006	2005	2006	2005
Income tax charge	5,289	3,195	5,232	3,170
Release of deferred tax liability (Note 20)	(1,500)	(1,476)	(1,500)	(1,476)
	3,789	1,719	3,732	1,694

The tax on the Company's and Group's profit before tax differs from the theoretical amount that would arise using the basic tax rate of the Company and Group as follows:

	Group		Company	
	2006	2005	2006	2005
Profit before tax	9,227	4,812	9,229	6,045
Tax calculated at a tax rate of 33 1/3% (2005 - 30%)	3,076	1,444	3,076	1,813
Tax effect of income not subject to tax	(1,909)	(1,240)	(142)	(153)
Expenses not deductible for tax purposes	1,955	1,515	131	34
Effect of changes in tax rates	667	–	667	–
Tax charge	3,789	1,719	3,732	1,694

10. EARNINGS PER SHARE

Basic earnings per share is calculated by dividing the net profit attributable to shareholders by the weighted average number of ordinary shares in issue during the year.

	Group		Company	
	2006	2005	2006	2005
Net profit attributable to shareholders (Rs. million)	5,438	3,093	5,497	4,351
Weighted average number of ordinary shares in issue (million)	1,805	1,805	1,805	1,805
Basic earnings per share (Rs.)	3.01	1.71	3.05	2.41

All ordinary shares are at a par value of Rs. 10.

11. DIVIDENDS PER SHARE

In respect of 2005, a first and final dividend of 7.5% per share amounting to a total of Rs. 1,353,645,000 has been paid in the current year. (In respect of 2004, a first and final dividend of 5% per share amounting to a total of Rs. 902,430,000 was paid during 2005.)

12. PROPERTY, PLANT & EQUIPMENT

Group	Freehold land and buildings	Ducts, cables and other outside plant	Telephone exchanges	Transmission equipment	Other fixed assets	Contract work-in- progress	Total
At 31 December 2004							
Cost	2,064	61,547	16,845	20,412	6,962	4,459	112,289
Accumulated depreciation	(263)	(36,631)	(8,592)	(8,937)	(3,506)	–	(57,929)
Net book amount	1,801	24,916	8,253	11,475	3,456	4,459	54,360
Year ended 31 December 2005							
Opening net book amount	1,801	24,916	8,253	11,475	3,456	4,459	54,360
Additions	2	272	28	2,590	853	7,794	11,539
Transfers from work-in-progress	31	4,401	1,588	2,086	859	(8,965)	–
Disposals	–	–	–	–	(26)	–	(26)
Adjustment	(107)	(14)	–	1	101	–	(19)
Accumulated depreciation on disposal	–	–	–	–	26	–	26
Write off	(4)	(44)	(227)	(83)	(5)	–	(363)
Depreciation charge	(41)	(4,779)	(1,267)	(2,115)	(1,164)	–	(9,366)
Closing net book amount	1,682	24,752	8,375	13,954	4,100	3,288	56,151
At 31 December 2005							
Cost	1,982	66,008	17,996	24,828	8,744	3,288	122,846
Accumulated depreciation	(300)	(41,256)	(9,621)	(10,874)	(4,644)	–	(66,695)
Net book amount	1,682	24,752	8,375	13,954	4,100	3,288	56,151
Year ended 31 December 2006							
Opening net book amount	1,682	24,752	8,375	13,954	4,100	3,288	56,151
Additions	–	128	13	415	1,300	6,857	8,713
Transfers from work-in-progress	316	2,569	534	2,551	197	(6,167)	–
Disposals	–	–	–	(458)	(5)	–	(463)
Adjustment	(18)	31	(11)	(49)	27	–	(20)
Accumulated depreciation on disposal	–	–	–	44	5	–	49
Depreciation charge	(45)	(5,182)	(1,258)	(2,113)	(1,407)	–	(10,005)
Closing net book amount	1,935	22,298	7,653	14,344	4,217	3,978	54,425
At 31 December 2006							
Cost	2,280	68,736	18,532	27,287	10,263	3,978	131,076
Accumulated depreciation	(345)	(46,438)	(10,879)	(12,943)	(6,046)	–	(76,651)
Net book amount	1,935	22,298	7,653	14,344	4,217	3,978	54,425

Notes to the Financial Statements

Company	Freehold land and buildings	Ducts, cables and other outside plant	Telephone exchanges	Transmission equipment	Other fixed assets	Contract work-in- progress	Total
At 31 December 2004							
Cost	2,064	61,397	16,845	13,455	6,462	3,519	103,742
Accumulated depreciation	(263)	(36,571)	(8,592)	(6,900)	(3,206)	-	(55,532)
Net book amount	1,801	24,826	8,253	6,555	3,256	3,519	48,210
Year ended 31 December 2005							
Opening net book amount	1,801	24,826	8,253	6,555	3,256	3,519	48,210
Additions	2	272	28	84	838	6,698	7,922
Transfers from work-in-progress	31	4,401	1,588	475	824	(7,319)	-
Disposals	-	-	-	-	(25)	-	(25)
Adjustment	(107)	(14)	-	1	102	-	(18)
Accumulated depreciation on disposal	-	-	-	-	25	-	25
Write off	(4)	(44)	(227)	(83)	(5)	-	(363)
Depreciation charge	(41)	(4,707)	(1,267)	(1,025)	(1,104)	-	(8,144)
Closing net book amount	1,682	24,734	8,375	6,007	3,911	2,898	47,607
At 31 December 2005							
Cost	1,982	65,858	17,996	13,754	8,196	2,898	110,684
Accumulated depreciation	(300)	(41,124)	(9,621)	(7,747)	(4,285)	-	(63,077)
Net book amount	1,682	24,734	8,375	6,007	3,911	2,898	47,607
Year ended 31 December 2006							
Opening net book amount	1,682	24,734	8,375	6,007	3,911	2,898	47,607
Additions	-	128	13	117	1,224	4,636	6,118
Transfers from work-in-progress	316	2,569	534	720	197	(4,336)	-
Disposals	-	-	-	-	(5)	-	(5)
Adjustment	(18)	31	(11)	(49)	27	-	(20)
Accumulated depreciation on disposal	-	-	-	-	5	-	5
Depreciation charge	(45)	(5,132)	(1,257)	(1,065)	(1,350)	-	(8,849)
Closing net book amount	1,935	22,330	7,654	5,730	4,009	3,198	44,856
At 31 December 2006							
Cost	2,280	68,586	18,532	14,542	9,639	3,198	116,777
Accumulated depreciation	(345)	(46,256)	(10,878)	(8,812)	(5,630)	-	(71,921)
Net book amount	1,935	22,330	7,654	5,730	4,009	3,198	44,856

- (a) On 1 September 1991 the Department of Telecommunications (DOT) transferred its entire telecommunications business and related assets and liabilities to SLT. A valuation was performed by the Government of the assets and liabilities transferred to SLT. The net amount of those assets and liabilities represents SLT's Contributed Capital on incorporation, and those values were used as the opening cost of fixed assets at 1 September 1991 in the first statutory accounts of SLT.

Further, SLT was converted into a public limited company, Sri Lanka Telecom Limited (SLTL), on 25 September 1996 and on that date all of the business and the related assets and liabilities of SLT were transferred to SLTL as part of the privatisation process.

- (b) The cost of fully depreciated assets as at 31 December 2006 is Rs. 20,030 million (2005 - Rs. 16,118 million).
- (c) No assets have been mortgaged or pledged as security by SLTL.

Notes to the Financial Statements

- (d) The Directors believe SLTL has freehold title to land and buildings transferred from SLT on incorporation (Conversion of SLT to SLTL on 25 September 1996), although it is uncertain whether vesting orders specifying all the demarcations and extents of such land and buildings were issued.
- (e) The property, plant & equipment is not insured except for third party motor vehicle insurance. An insurance reserve has been created together with a sinking fund investment to meet any future loss with regard to uninsured property, plant & equipment. At the balance sheet date, Rs. 183 million (2005 - Rs. 166 million) stood to the credit of the reserve (Note 24). The sinking fund investment of that amount is included under cash and cash equivalents [Note 18 (a)].

13. INTANGIBLE ASSETS

Group	Goodwill	Licence	Software	Others	Total
At 1 January 2005					
Cost	388	102	–	764	1,254
Accumulated amortisation and impairment	(169)	(10)	–	(215)	(394)
Net book amount	219	92	–	549	860
Year ended 31 December 2005					
Opening net book amount	219	92	–	549	860
Additions	–	–	–	–	–
Amortisation charge	(78)	(10)	–	(160)	(248)
Closing net book amount	141	82	–	389	612
At 31 December 2005					
Cost	388	102	–	764	1,254
Accumulated amortisation and impairment	(247)	(20)	–	(375)	(642)
Net book amount	141	82	–	389	612
Year ended 31 December 2006					
Opening net book amount	141	82	–	389	612
Additions	–	500	466	–	966
Amortisation charge	–	(57)	(44)	(112)	(213)
Closing net book amount	141	525	422	277	1,365
At 31 December 2006					
Cost	388	602	466	764	2,220
Accumulated amortisation and impairment	(247)	(77)	(44)	(487)	(855)
Net book amount	141	525	422	277	1,365

Notes to the Financial Statements

Company	Goodwill	Licence	Software	Others	Total
At 1 January 2005					
Cost	-	-	-	330	330
Accumulated amortisation and impairment	-	-	-	(159)	(159)
Net book amount	-	-	-	171	171
Year ended 31 December 2005					
Opening net book amount	-	-	-	171	171
Amortisation charge	-	-	-	(87)	(87)
Closing net book amount	-	-	-	84	84
At 31 December 2005					
Cost	-	-	-	330	330
Accumulated amortisation and impairment	-	-	-	(246)	(246)
Net book amount	-	-	-	84	84
Year ended 31 December 2006					
Opening net book amount	-	-	-	84	84
Amortisation charge	-	-	-	(47)	(47)
Closing net book amount	-	-	-	37	37
At 31 December 2006					
Cost	-	-	-	330	330
Accumulated amortisation and impairment	-	-	-	(293)	(293)
Net book amount	-	-	-	37	37

- (a) As stated in Accounting Policy 2.4, the Company has measured goodwill acquired in business combinations at cost less accumulated impairment losses. Such accounting policy has been prospectively applied with effect from 1 January 2006 in conformity with revised SLAS - 25 - Business Combinations.
- (b) As explained in Accounting Policy 2.4 (c), insurance premium paid by the Company to secure foreign loans under the 150K Project Scheme has been deferred on the grounds that the benefit of this expenditure is not exhausted in the period in which it is incurred and will be written off to the income statement over the repayment period of the loans.

14. INVESTMENTS IN SUBSIDIARIES

	Group		Company	
	2006	2005	2006	2005
Investment in subsidiary [Note (a)]	-	-	25	25
Investment in subsidiary [Note (b)]				
At 1 January	-	-	3,472	1,972
Additions [Note (b)]	-	-	3,500	1,500
At 31 December	-	-	6,972	3,472
Investment in subsidiary [Note (c)]				
At 1 January	-	-	-	-
Addition	-	-	35	-
At 31 December	-	-	35	-
Aggregate cost of investments at 31 December	-	-	7,032	3,497

- (a) The investment in the subsidiary company consists of 2,500,000 ordinary shares, representing a 100% holding in the issued share capital of Sri Lanka Telecom (Services) Limited.
- (b) Additions comprise converting Rs. 3 Billion loan from SLT to redeemable preference shares of Rs. 10 and fresh capital infusion of Rs. 500 million in Mobitel (Private) Limited.
- (c) The investment in the subsidiary company consists of 2,500,000 ordinary shares representing a 100% holding in the issued share capital of Sri Lanka Telecom (Hong Kong) Limited.

15. NON-CURRENT RECEIVABLES

	Group		Company	
	2006	2005	2006	2005
Employee loans [Note (a)]	960	962	960	962
Loan to subsidiary	-	-	-	2,500
Amounts due after one year	960	962	960	3,462

- (a) Employee loans are repayable in equal monthly instalments over five years. The amount shown as a non-current receivable represents staff loan instalments falling due for payment after 1 January 2008.

16. INVENTORIES

Inventories consist of engineering stores and consumables, office equipment and hardware, shown net of provisions for slow moving and obsolete items.

Notes to the Financial Statements

17. RECEIVABLES AND PREPAYMENTS

	Group		Company	
	2006	2005	2006	2005
Domestic trade receivables	7,393	6,474	6,723	5,916
CDMA instalment debtors	709	–	709	–
Foreign trade receivables	1,251	1,078	1,251	1,078
Amount due from related parties [Refer Note 32 (c)]	–	–	1,165	372
Advances and prepayments [Note (a)]	164	180	120	136
Employee loans	333	250	333	250
Other receivables [Note (b)]	708	501	253	106
Amounts due within one year	10,558	8,483	10,554	7,858

- (a) Advances and prepayments mainly consist of advances on purchases Rs. 28 million (2005 - Rs. 51 million) and payments for software maintenance Rs. 75 million (2005 - Rs. 65 million).
- (b) Other receivables mainly consist of interest receivable Rs. 212 million (2005 - Rs. 57 million) refundable deposits Rs. 30 million (2005 - Rs. 20 million) and returned cheques Rs. 10 million (2005 - Rs. 20 million).

18. CASH AND CASH EQUIVALENTS

	Group		Company	
	2006	2005	2006	2005
Cash at bank and in hand	279	756	159	351
Restricted at bank [Note (a)]	4,608	2,205	4,608	2,205
Short-term deposits [Note (b)]	10,428	11,507	9,623	10,179
	15,315	14,468	14,390	12,735

- (a) The restricted cash balance is a bank deposit of Sri Lankan Rupees 182 million (2005 - Rs. 164 million) with the People's Bank which represents the sinking fund investment for the insurance reserve. It also includes a sinking fund maintained to redeem the US\$ 100 million Bond in 2009 amounting to Rs. 4,426 million (2005 - Rs. 2,041 million). The restrictions on these balances are self-imposed.
- (b) These deposits are interest-bearing on commercial terms.

For the purpose of the cash flow statement, the year-end cash and cash equivalents comprise the following:

	Group		Company	
	2006	2005	2006	2005
Cash and cash equivalents	15,315	14,468	14,390	12,735
Bank overdrafts (Note 19)	(980)	(40)	–	–
Cash and cash equivalents as restated	14,335	14,428	14,390	12,735

19. BORROWINGS

	Group		Company	
	2006	2005	2006	2005
Current (due within one year)				
Bank overdrafts	980	40	-	-
Government borrowings	678	696	678	696
Bank borrowings and others	2,257	2,965	774	1,138
Lease liabilities	2	-	2	-
	3,917	3,701	1,454	1,834
Non-current (due after one year)				
Government borrowings	1,994	2,690	1,994	2,690
Bank borrowings and others	4,041	6,244	238	953
US\$ 100 million Notes	10,825	10,205	10,825	10,205
Lease liabilities	8	-	8	-
	16,868	19,139	13,065	13,848
Total borrowings	20,785	22,840	14,519	15,682

(a) The interest rate exposure of the borrowings of the Group and Company were as follows:

	Group		Company	
	2006	2005	2006	2005
Total borrowings				
- at fixed rates	11,851	12,327	11,851	12,327
- at floating rates	8,934	10,513	2,668	3,355
	20,785	22,840	14,519	15,682

The currency exposure of the borrowings of the Group and Company at the Balance Sheet date was as follows:

	Group		Company	
	2006	2005	2006	2005
Foreign currency	12,565	13,182	11,837	12,296
Local currency	8,220	9,658	2,682	3,386
	20,785	22,840	14,519	15,682

Notes to the Financial Statements

Finance lease liabilities - minimum lease payments

	Group		Company	
	2006	2005	2006	2005
Not later than 1 year	3	–	3	–
Later than 1 year and not later than 5 years	11	–	11	–
	14	–	14	–
Less: future finance charges on finance leases	(4)	–	(4)	–
Present value of finance lease liabilities	10	–	10	–

Representing lease liabilities

	Group		Company	
	2006	2005	2006	2005
Current	2	–	2	–
Non-current	8	–	8	–
	10	–	10	–

	Group/Company	
	2006	2005

Average effective interest rates

- Bank overdrafts	13.41%	11.18%
- Foreign bank borrowings	5.21%	6.11%
- Government borrowings	11.10%	9.96%

Debentures

- Fixed (annually)	–	14.50%
- Fixed (quarterly)	–	14.00%
- Floating	–	13%-16%
- US\$ 100 million Notes	6.875%	6.875%

Maturity of non-current borrowings

	Group		Company	
	2006	2005	2006	2005
Between 1 and 2 years	13,839	3,758	12,415	2,241
Between 3 and 5 years	3,029	15,373	650	11,599
Over 5 years	–	8	–	8
	16,868	19,139	13,065	13,848

- (b) The Government borrows amounts in foreign currencies to fund the development of SLTL's network. These amounts have been re-lent to SLTL with shorter repayment periods than the underlying loan. The loan balance as at 31 December 2006 is Rs. 2,672 million (2005 - Rs. 3,386 million). Exchange fluctuations on repayments of these loans are borne by the Government.

Notes to the Financial Statements

- (c) The Government has guaranteed third party loans of SLTL amounting to Rs. 1,012 million (2005 - Rs. 2,091 million). Total value of borrowings that has neither been guaranteed nor secured is Rs. 10,825 million (2005 - Rs. 10,205 million).
- (d) The majority of the loans require SLTL and Mobitel (Private) Limited to submit audited financial statements among other matters to the lenders within the stated periods of the calendar year end, and to maintain adequate accounting records in accordance with generally accepted accounting principles.
- (e) The Directors believe the Company will have sufficient finances available to meet its present commitments.

20. DEFERRED INCOME TAXES

Deferred income taxes are calculated on all temporary differences under the liability method using a principal tax rate of 33 1/3% (2005 - 30%).

The movement in the deferred income tax account is as follows:

	Group		Company	
	2006	2005	2006	2005
At beginning of the year	6,013	7,489	6,013	7,489
Income statement release (Note 9)	(1,500)	(1,476)	(1,500)	(1,476)
At end of the year	4,513	6,013	4,513	6,013

21. DEFERRED INCOME

Deferred income represents the new connection charges, net of amounts amortised to the income statement. Connection charges are initially recognised as deferred income and amortised over a period of 15 years as stated in Accounting Policy 2.17.

	Group/Company	
	2006	2005
Balance at 1 January	7,546	7,272
Connection fees for the year	488	1,170
Amount amortised during the year (Note 3)	(924)	(896)
Balance at 31 December	7,110	7,546

Notes to the Financial Statements

22. TRADE AND OTHER PAYABLES

	Group		Company	
	2006	2005	2006	2005
Amounts due within one year				
Domestic trade payables	921	893	103	170
Foreign trade payables	292	116	292	116
Amount due to related parties [Note 32 (c)]	–	–	158	2
Capital expenditure payables [Note (a)]	1,656	2,391	1,319	2,254
Deferred revenue	181	141	–	–
Social security and other taxes [Note (b)]	407	162	407	162
Interest payable	148	218	148	170
Other payables [Note (c)]	5,116	3,493	4,903	3,389
	8,721	7,414	7,330	6,263
Amounts due after one year				
International Direct Dialling deposits	233	236	233	236
Prepayments on VOIP services	65	61	65	61
	298	297	298	297

(a) Capital expenditure payables mainly consist of contractors' payables Rs. 626 million (2005 - Rs. 1,594 million).

(b) Social security and other taxes mainly consist of Value Added Tax Rs. 267 million (2005 - Rs. 91 million).

(c) Other payables mainly consist of Rs. 244 million (2005 - Rs. 239 million) dividend payable to Government Treasury, Rs. 109 million (2005 - Nil) as provision for Goods Received Notes (GRN), Rs. 3,475 million (2005 - Rs. 2,317 million) as International Telecommunication Operators' Levy and Rs. 165 million as cess (2005 - Rs. 168 million) payable to Director-General of Telecommunications.

23. RETIREMENT BENEFIT OBLIGATIONS

Movement in the liability recognised in the Balance Sheet:

	Group		Company	
	2006	2005	2006	2005
At beginning of the year	751	520	721	497
Current service cost (Note 5)	286	248	274	241
Amount due within a year transferred to other payables	(30)	–	(30)	–
Contributions paid				
- VRS employees	(42)	–	(42)	–
- Other employees	(23)	(17)	(20)	(17)
At end of the year	942	751	903	721

Notes to the Financial Statements

As stated in Accounting Policy 2.14, an actuarial valuation was carried out by an independent actuary in respect of all employees of SLTL as at 31 December 2006.

The principal actuarial assumptions used were as follows:

	Company	
	2006	2005
Discount rate	10%	10%
Future salary increases	9%	9%

In addition to the above, demographic assumptions such as mortality, withdrawal, retirement age were considered for the actuarial valuation. In 2006, 1967/70 Mortality Table issued by the Institute of Actuaries - London (2005 - 1967/70 Mortality Table) was taken as the base for the valuation.

24. INSURANCE RESERVE

	Group/Company	
	2006	2005
At beginning of the year	166	100
Income statement charge	11	10
Interest income on deposit (sinking fund)	6	56
At end of the year	183	166

25. GROUP REPORTING DATES

The financial statements of Sri Lanka Telecom (Services) Limited (SLTSL), SLT (Hong Kong) Limited, SLT Publications (Private) Limited and Mobitel (Private) Limited, wholly owned subsidiaries, are prepared to 31 December each year.

26. ORDINARY SHARES

	Company	
	2006	2005
Authorised		
10,000,000,000 (2005 - 10,000,000,000) ordinary shares of Rs. 10 each	100,000	100,000
Issued and Fully Paid		
1,804,860,000 ordinary shares of Rs. 10 each	18,049	18,049

The issued and fully paid share capital is held as follows:

	2006		2005	
	Holding %	No. of Shares	Holding %	No. of Shares
Government of Sri Lanka (GOSL)	49.50	893,405,700	49.50	893,405,700
NTT Communications Corporation (NTT Com)	35.20	635,076,318	35.20	635,076,318
Employees and others	15.30	276,377,982	15.30	276,377,982
		1,804,860,000		1,804,860,000

Notes to the Financial Statements

27. HEDGING RESERVE

	Group/Company	
	2006	2005
At beginning of the year	(208)	(677)
Cash flow hedges		
- Foreign currency translation difference	(96)	245
- Income statement charge (Note 8)	68	224
At end of the year	(236)	(208)

- (a) The Company's risk management objective is to minimise losses on foreign currency translation relating to the repayment of loans denominated in foreign currency. This is accounted as a cash flow hedge.
- (b) The policy for hedging each type of forecast transaction is stated in Accounting Policy 2.19.
- (c) The future transactions are forecasted for a period of five years.

28. CASH GENERATED FROM OPERATIONS

Reconciliation of profit before tax to cash generated from operations

	Group		Company	
	2006	2005	2006	2005
Profit before tax	9,227	4,812	9,229	6,045
Adjustments for				
Depreciation (Note 12)	10,005	9,366	8,849	8,144
Amortisation of grants	(14)	-	(14)	-
Amortisation of deferred costs (Note 13)	168	166	47	87
Net exchange loss on financing activities (Note 8)	4	125	(41)	148
Interest expense and related charges	2,030	1,937	1,357	1,289
Interest income	(1,036)	(648)	(1,166)	(633)
Connection fees less amortisation (Note 21)	(436)	274	(436)	274
Profit on sale of property, plant & equipment	(4)	(12)	(4)	(12)
Provision for insurance reserve (Note 24)	17	66	17	66
Amortisation of goodwill (Note 13)	-	78	-	-
Retirement benefits (Note 23)	191	231	182	224
Profit on sale of investment	-	(52)	-	(52)
Write off of property, plant & equipment	-	103	-	103
Write off of inventories	24	84	-	-
	20,176	16,530	18,020	15,683
Changes in working capital				
- receivables and prepayments	(1,625)	1,471	(2,245)	1,261
- inventories	(551)	384	(631)	77
- payables	1,322	1,283	1,085	1,028
Cash generated from operations	19,322	19,668	16,229	18,049

29. COMMITMENTS

Capital commitments

The Group/Company has purchase commitments incidental to ordinary course of business as at 31 December 2006 as follows:

	Group		Company	
	2006	2005	2006	2005
Property, plant & equipment				
- approved but not contracted	7,295	766	7,295	766
- approved and contracted	4,217	23,355	2,484	20,326
	11,512	24,121	9,779	21,092

30. Lease commitments

The future minimum lease payments under non-cancellable operating leases are as follows:

	Group		Company	
	2006	2005	2006	2005
Later than one year and not later than five years	244	299	244	299

Financial commitments

Except for the regular maintenance contracts entered into with third parties within the normal course of business there are no other material financial commitments which should require separate disclosure.

31. CONTINGENCIES

- (a) An organisation, styling itself 'The Consumer Association of Lanka', initiated legal action in the Court of Appeal seeking a Writ of Certiorari to quash the approval granted by the Minister of Telecommunications (the Minister) and the Telecommunication Regulatory Commission of Sri Lanka (TRC) for the tariff revision implemented by Sri Lanka Telecom Limited (SLTL) in September 2003, in which the TRC, the Minister, the Secretary to the Treasury and SLT were cited as the respondents to the case.

The judgement delivered in July 2005 by the Court of Appeal granted the Writ of Certiorari quashing the approval granted for the tariff revision by the Minister and the TRC. SLTL filed its application seeking special leave to appeal to the Supreme Court, which was granted on 7 November 2005 and presently case is pending in the Supreme Court.

- (b) Directories Lanka (Private) Limited (DLPL) has instituted action against SLT claiming a sum of Rs. 164 million as damages, in relation to alleged violation of the IP rights of DLPL by SLT and further action was filed by the same party in 2006, by claiming Rs. 250 million from SLT as damages for unfair competition with regard to directory publication.
- (c) The Arbitration proceedings were initiated under ICC Arbitration application No.13839/M by Informatics (Pvt) Limited, claiming US\$ 1,143,630 being the licence upgrade cost with annual maintenance fee of 15% of the licence fee, for the TBR system provided to SLT by Informatics.

Notes to the Financial Statements

- (d) 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.
- (e) Under Court of Appeal CA No. 883/2003 SLT is seeking for 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 1 February 1998.
- (f) With regard to cases detailed under (a), (b), (c), (d) and (e) above, pending the outcome of the appeal, no adjustment has been made in the financial statements up to 31 December 2006. In addition to the above-referred cases, there are more litigation issues in relation to claims by employees and third parties for damages. In the opinion of the Directors none of these actions are likely to result a material liability to the Company.

32. DIRECTORS' INTERESTS IN CONTRACTS

- (a) A Director is considered to have a direct interest in a contract with the Company, if the Director himself is involved in a contract with the Company. A Director has an indirect interest in a contract with the Company, if the Director, through his common Directorships or his dependent family members is involved in a contract with the Company.

The Directors of Sri Lanka Telecom Limited held Directorship in the following organisations during the year:

Director	Company	Position
Mr. Shoji Takahashi	Mobitel (Private) Limited	Director
	NTT Com Asia Limited	Director
	HK Net Co. Limited	Director
	NTT Com Asia Network Systems Limited (Guang Zhou) Limited	Director
	SLT Publications (Private) Limited	Director
Mr. Shuhei Anan	Mobitel (Private) Limited	Director
	Sri Lanka Telecom (Services) Limited	Director
	SLT Hong Kong Limited	Director
Mr. Kiyoshi Maeda	NTT Com Asia Limited	Director
	HK Net Co.Limited	Director
	Milletechno, Inc.	Director
	NTT Singapore Pte Limited	Director
	NTT MSC Sdn Bhd	Director
	NTT Australia Pty. Limited	Director
	NTT America, Inc.	Director
Verio, Inc.	Director	

Notes to the Financial Statements

Director	Company	Position
Mr. Haruhiko Yamada	NTT Communications Corporation	Director
	NTT Resonant Inc.	Internal Auditor
	AutoWeb Communications, Inc.	Director
	NTT Europe Limited	Director
	NTT America, Inc.	Director
	Verio, Inc.	Director
	Philippine Long Distance Telephone Company	Director
Mr. Anil Obeyesekere	Mobitel (Private) Limited	Director
	Sri Lanka Telecom (Services) Limited	Director
Mr. Lalith De Mel	Hemas Holdings Limited	Director
	Serendib Hotels Limited	Director
	Delmege Forsyth and Company Limited	Director
	Serendib Leisure Management Limited	Director
	Mobitel (Private) Limited	Director
Mr. Nigel Hatch	Mobitel (Private) Limited	Director
Mr. Sadao Maki	NTT Europe Limited	Director
	Philippine Long Distance Telephone Company	Director
	NTT Investment Singapore Pte. Limited	Director
	NTT Communications Corporation	Director
Mr. Tadashi Imachi	NTT Worldwide Telecommunications Corporation	Director
	NTT Korea Company Limited	Director
	NTT Communications India (Pvt) Limited	Director
Mr. P. Asoka Weerasinghe de Silva	Mobitel (Private) Limited	Chairman/Director
	SLT Hong Kong Limited	Chairman/Director
	SLT Publications (Pvt) Limited	Director
Mrs. Leisha Chandrasena	Mobitel (Private) Limited	Director
	SLT Hong Kong Limited	Director
Mr. Sumith Wijesinghe	Mobitel (Private) Limited	Director
	National Development Trust (Guarantee) Limited	Director
	National Development Trust Fund	Trustee
Mr. Jun Sawada	EveryD. Com, Inc.	Director
	NTT America, Inc.	Director
	Verio, Inc.	Director
	NTT Europe Limited	Director
	NTT Singapore Pte. Limited	Director
	NTT Communications China Co. Limited	Director
Mr. Kenji Satoh	NTT Urban Development Corporation	Internal Auditor

Notes to the Financial Statements

SLTL had the following transactions with the above companies during the year under review:

(b) Mobitel (Private) Limited

Payments amounting to Rs. 37 million (2005 - Rs. 19 million) have been made during the year on call charges relating to cellular phones purchased for SLTL employees. Further, cellular phones amounting to Rs. 0.1 million (2005 - Rs. 2 million) were purchased from Mobitel (Private) Limited during the year.

Number of new GSM connections granted (special packages with no monthly rental) in 2006 is 1,209 (2005 - 7,783).

Mobitel (Private) Limited has obtained several E1 links from SLTL for which Rs. 15 million (2005 - Rs. 41 million) was paid by Mobitel (Private) Limited during the year.

The Company has guaranteed the following on behalf of Mobitel (Private) Limited:

- (i) Loans amounting to Rs. 6,496 million (2005 - Rs. 7,211 million) and USD 6.7 million (2005 - USD 8.7 million) for GSM roll out and operational expenses.
- (ii) To obtain an investment commitment guarantee amounting to Rs. Nil (2005 - Rs. 250 million) issued by banks in favour of TRC for bidding for a slot in the 1800 MHz band for the GSM rollout.
- (iii) To obtain 3G investment commitment guarantee amounting to Rs. 250 million (2005 - Nil) issued by banks in favour of TRC.

(c) Outstanding balances arising from sale/purchase of services

	2006	2005
Receivable from related party		
Mobitel (Private) Limited - Interconnection charges rental and interest on loan	1,165	397
Payable to related parties		
Mobitel (Private) Limited - Interconnection charges and mobile phone charges	152	-
Sri Lanka Telecom (Services) Limited	6	2
	158	2

NTT Communications Corporation

As per the shareholders' agreement with NTT Com, which owns 35.2% of the issued share capital of SLTL, the following charges have been borne by the Company:

	2006	2005
Fees for secondment of personnel from NTT Com	48	40
Expenditure for personnel from NTT Com	6	7

	Group		Company	
	2006	2005	2006	2005
(d) Compensation for key management personnel	74	52	31	25

33. RELATED PARTY RELATIONSHIPS AND TRANSACTIONS

Parties are considered to be related if one party has the ability to control the other party or exercise significant influence over the other party in making financial and operating decisions. A related party transaction takes place with a transfer of resources or obligations between related parties, regardless of whether a price is charged.

Accordingly, Sri Lanka Telecom (Services) Limited (SLTS) is a related party of SLTL where SLTL has the ability to control. All transactions during the year and balances as at the balance sheet date between the two companies have been eliminated in preparing consolidated financial statements.

Mobitel (Private) Limited, is a related party of SLTL where SLTL has the ability to control. All transactions during the year and balances as at the balance sheet date between the two companies have been eliminated in preparing consolidated financial statements.

SLT Hong Kong Limited is a related party of SLTL where SLTL has the ability to control. During the year under consideration, the only transaction that occurred was the issue of ordinary shares to SLTL for cash.

SLT Publications (Private) Limited, is a related party of SLTL where SLTL has the ability to control. No transactions have occurred during the year between the two companies.

Related party transactions disclosed above should be read in conjunction with Note 32 to the financial statements.

34. POST-BALANCE SHEET EVENTS

No events have arisen since the balance sheet date which would require adjustments to, or disclosure in, the financial statements.

Five Year Progress

	2006 Rs. Mn	2005 Rs. Mn	2004 Rs. Mn	2003 Rs. Mn	2002 Rs. Mn
Financial Position - (Group)					
Property, Plant & Equipment	54,425	56,151	54,360	55,763	56,722
Total Assets	84,042	81,520	78,872	72,373	74,765
Current Assets	27,292	23,843	22,144	14,626	15,963
Current Liabilities	16,370	13,892	11,378	12,440	12,048
Borrowings	20,785	22,840	25,370	21,081	25,926
Equity	37,866	33,793	31,064	30,600	29,024
Performance					
Revenue	40,691	32,515	29,516	25,553	25,383
Operating Profit	10,000	6,087	3,275	5,678	7,953
Finance Cost	1,989	2,085	2,252	2,863	3,377
Earnings before Tax	9,227	4,812	1,441	3,242	5,207
Taxation	3,789	1,719	148	993	2,522
Earnings after Tax	5,438	3,093	1,293	2,249	2,685
Cash Flow					
Net Operating Cash Flows	13,434	17,200	10,402	11,429	13,458
Net Cash used in Investing Activities	9,196	10,686	7,611	7,278	3,722
Net Cash used in/(from) Financing Activities	5,093	2,571	(3,314)	5,525	7,552
Key Financial Indicators					
Earnings per Share (Rs.)	3.0	1.7	0.7	1.3	1.5
Return on Assets (%)	11.9	7.5	4.2	7.8	10.6
Return on Equity (%)	14.4	9.2	4.2	7.3	9.3
Operating Margin (%)	24.6	18.7	11.1	22.2	31.3
Asset Turnover (No. of times)	0.48	0.40	0.37	0.35	0.34
Current Ratio (No. of times C.L.)	1.67	1.72	1.95	1.17	1.32
Quick Asset Ratio (No. of times C.L.)	1.58	1.66	1.83	1.11	1.27
Gearing Ratio (Debt to Rs. 1/- of Equity)	0.35	0.40	0.45	0.41	0.47
Interest Cover (No. of times Interest)	10.68	4.35	1.70	2.27	2.85

Value Addition Statement

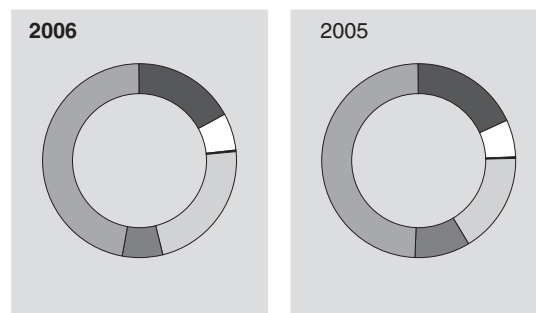
	2006 Rs. Mn	2005 Rs. Mn
Revenue	40,691	32,515
Other income	1,216	810
	41,907	33,325
Goods and Services purchased from other sources	(12,947)	(10,848)
Value creation	28,960	22,477

	2006	%	2005	%
--	------	---	------	---

DISTRIBUTION OF VALUE ADDED

To Employees				
- salaries, wages, & other benefits	4,956	17.11	4,144	18.44
To Providers of Capital				
- dividend to shareholders	1,805	6.23	1,354	6.02
To Management Company NTT				
- Management fees, remuneration & expenditure	54	0.19	47	0.21
To Government				
- taxes & regulatory fees	6,518	22.51	3,742	16.65
To Lenders				
- interest & related charges	1,989	6.87	2,085	9.28
To Business Expansion & Growth				
- depreciation	10,005	34.55	9,366	41.67
- retained income	3,633	12.54	1,739	7.73
	28,960	100.00	22,477	100.00

Value Added %



	2006	2005
■ To Employees	17.11	18.44
□ To Providers of Capital	6.23	6.02
■ To Management Com NTT	0.19	0.21
■ To Government	22.51	16.65
■ To Lenders	6.87	9.28
■ To Business Expansion & Growth	47.09	49.4

Investor Information

1. ANALYSIS OF SHAREHOLDERS ACCORDING TO THE NUMBER OF SHARES AS AT 31.12.2006

Shareholdings	Resident			Non-Resident			Total		
	No. of Share-holders	No. of Shares	%	No. of Share-holders	No. of Shares	%	No. of Share-holders	No. of Shares	%
1 - 1,000	12,510	5,529,531	0.31	22	13,500	-	12,532	5,543,031	0.31
1001 - 5,000	4,351	11,831,489	0.66	22	78,800	-	4,373	11,910,189	0.66
5,001 - 10,000	2,854	22,885,955	1.27	19	162,000	0.01	2,875	23,047,955	1.28
10,001 - 50,000	1,504	26,676,778	1.48	23	637,200	0.04	1,527	27,313,978	1.52
50,001 - 100,000	95	7,557,070	0.42	7	537,900	0.03	102	8,094,970	0.45
100,001 - 500,000	80	17,866,846	0.99	17	3,493,700	0.19	97	21,360,546	1.18
500,001 - 1,000,000	23	17,232,280	0.95	-	-	-	23	17,232,280	0.95
Over 1,000,000	31	987,973,833	54.73	6	702,383,218	38.92	37	1,690,357,051	93.65
	21,448	1,097,553,782	60.81	116	707,306,218	39.19	21,564	1,804,860,000	100.00

2. CATEGORIES OF SHAREHOLDERS

Analysis of Shareholders	31 December 2006			31 December 2005		
	No. of Shareholders	Total Holdings	%	No. of Shareholders	Total Holdings	%
Individual	21,164	91,034,278	5.04	22,922	119,959,686	6.65
Institutional	400	1,713,825,722	94.96	449	1,684,900,314	93.35
	21,564	1,804,860,000	100.00	23,371	1,804,860,000	100.00

3. 20 LARGEST SHAREHOLDERS AS AT THE BALANCE SHEET DATE

Name	Shareholdings	%
Secretary to the Treasury	893,405,709	49.50
NTT Communications Corporation	635,076,318	35.19
Galleon Technology Offshore Limited	35,744,100	1.98
Employees' Provident Fund	24,452,789	1.35
Galleon Diversified Fund Limited	17,732,900	0.98
Sri Lanka Insurance Corporation Limited - Life Fund	9,139,135	0.51
HSBC INTL Nominees Limited - HSBC Bank PLC - CMG First State Global	6,750,600	0.37
Seylan Bank Limited/Mr. Shanker Varadanada Somasundaram	6,042,485	0.33
Bank of New York - Bear Sterns Securities Corporation	5,978,500	0.33
Mr. Somasundaram Shanker Varadananda	4,959,615	0.27
Bank of Ceylon A/C - Ceybank Unit Trust	4,935,900	0.27
DFCC Bank A/C No. 1	4,800,600	0.27
Alchemy Neavy Metals (Pvt) Limited	4,674,700	0.26
MAS Holdings (Private) Limited	2,876,500	0.16
Cargo Boat Development Company Limited	2,550,000	0.14
Hatton National Bank Limited - A/C No. 03	2,286,500	0.13
The Ceylon Investment Company Limited - A/C No. 02	2,213,300	0.12
Timex (Garments) Limited	2,100,000	0.12
Sri Lanka Insurance Corporation Limited - General Fund	2,062,200	0.11
Mr. Esufally Abbasally Nuruddin	1,586,900	0.09
TOTAL	1,669,368,751	92.49

Investor Information

4. MARKET VALUE OF SHARES

Market Value of the ordinary shares of the Company (Rs.) during the year 2006:

	2006	2005
- Highest (Rs.)	29.75	27.00
- Lowest (Rs.)	14.75	15.50
- Last traded price (Rs.)	27.75	16.50

5. RATIOS

31 December	Group		Company	
	2006	2005	2006	2005
Net Assets per Share (Rs.)	20.98	18.72	22.55	20.26
Debt Equity Ratio (Debt Equity) - Number of Times	0.35	0.40	0.26	0.30
Quick Asset Ratio - Number of Times	1.58	1.66	2.00	1.90
<i>For the year</i>	2006	2005	2006	2005
Interest Cover - Number of Times	10.68	4.35	62.53	8.52

6. DIVIDEND PAYMENT

First & Final Dividend - Rs. 0.75 per share paid on 05.05.06.

7. SHARE TRADING INFORMATION

	2006	2005
No. of Transactions	24,392	33,762
No. of Shares traded	294,236,116	253,660,200
Value of Shares traded (Rs.)	6,858,224,712	5,406,140,775

8. DIRECTORS' SHAREHOLDINGS AS AT 31 DECEMBER 2006

Mr. Asoka W. de Silva	-	Nil
Mr. S.B. Divaratne	-	Nil
Mrs. Leisha Chandrasena	-	Nil
Mr. S.N. Kumar	-	Nil
Mr. Sumith Wijesinghe	-	Nil

9. PUBLIC HOLDING - 15.3%

Issued Share Capital		1,804,860,000
Less: Holding over 10%		
Secretary to the Treasury	893,405,709	
NTT Communications Corp.	635,076,318	(1,528,482,027)
		<u>276,377,973</u>

Notice of Meeting

NOTICE IS HEREBY GIVEN that the Tenth Annual General Meeting of Sri Lanka Telecom Limited, will be held in Committee Room A, BMICH, Bauddhaloka Mawatha, Colombo 7 on Friday, 30 March 2007 at 3.00 p.m. for the following purposes:

AGENDA

- 1) To receive and consider the Report of the Directors and Statement of Accounts for the year ended 31 December 2006 with the Report of the Auditors thereon.
- 2) To declare a first and final dividend of 10% per share on the issued share capital of the Company as recommended by the Directors.
- 3)
 - i. To re-elect as a Director, Mr. Shuhei Anan, who retires by rotation in terms of Articles 91 & 92 of the Articles of Association.
 - ii. To re-elect as a Director, Mr. S.B. Divaratne, who retires by rotation in terms of Articles 91 & 92 of the Articles of Association.
 - iii. To re-elect as a Director, Mr. Sumith Wijesinghe, who retires by rotation in terms of Article 97 of the Articles of Association.
- 4) To reappoint M/s. PricewaterhouseCoopers, Chartered Accountants, as Auditors of the Company and authorise the Board of Directors to determine their remuneration.
- 5) To authorise the Directors to determine and make donations to charities.
- 6) To transact such other businesses as may properly be brought before the meeting.

By Order of the Board

Mrs. P.G. Dias

Company Secretary

14 February 2007

Colombo

Notes

1. *A member entitled to attend and vote at the Meeting is entitled to appoint a proxy to attend and vote instead of him/her.*
2. *A proxy need not be a member of the Company.*
3. *A Form of Proxy accompanies this Notice.*

Form of Proxy

I/We
of being a
member/members of SRI LANKA TELECOM LIMITED hereby appoint:
..... of
..... whom failing

- | | |
|--------------------------|--------------|
| Mr. P. Asoka W. de Silva | whom failing |
| Mr. Shoji Takahashi | whom failing |
| Mr. Shuhei Anan | whom failing |
| Mr. S.B. Divaratne | whom failing |
| Mr. S.N. Kumar | whom failing |
| Mrs. Leisha Chandrasena | whom failing |
| Mr. Sumith Wijesinghe | |

as my/our proxy to vote for me/us on my/our behalf as indicated below and/or* at the
10th Annual General Meeting of the Company, to be held on Friday, 30 March 2007 and at any adjournment thereof and at
every poll which may be taken in consequence thereof.

	For	Against
1. To receive and consider the Report of the Directors and Statement of Accounts for the year ended 31 December 2006 with the Report of the Auditors thereon.	<input type="checkbox"/>	<input type="checkbox"/>
2. To declare a first and final dividend of 10% per share on the issued share capital of the Company as recommended by the Directors.	<input type="checkbox"/>	<input type="checkbox"/>
3. (i) To re-elect as a Director, Mr. Shuhei Anan, who retires by rotation in terms of Articles 91 & 92 of the Articles of Association.	<input type="checkbox"/>	<input type="checkbox"/>
(ii) To re-elect as a Director, Mr. S.B. Divaratne, who retires by rotation in terms of Articles 91 & 92 of the Articles of Association.	<input type="checkbox"/>	<input type="checkbox"/>
(iii) To re-elect as a Director, Mr. Sumith Wijesinghe, who retires in terms of Article 97 of the Articles of Association.	<input type="checkbox"/>	<input type="checkbox"/>
4. To reappoint M/s. PricewaterhouseCoopers, Chartered Accountants, as Auditors of the Company and authorise the Board of Directors to determine their remuneration.	<input type="checkbox"/>	<input type="checkbox"/>
5. To authorise the Directors to determine and make donations to charities.	<input type="checkbox"/>	<input type="checkbox"/>

In witness my/our hand/seal given on this day of March, Two Thousand & Seven.

.....

Signature

Please read the instructions on the reverse of the Form of Proxy.

INSTRUCTIONS AS TO COMPLETION OF FORM OF PROXY

1. Kindly perfect the Form of Proxy after filling in legibly your full name and address by signing on the spaces provided and please fill in the date of signature.
2. The persons mentioned above are Directors of the Company and they are willing to represent any shareholder as proxy, and vote as directed by the shareholder. They will not, however, be willing to speak or move or second and amendment to the shareholder to the resolutions or make any statement in regard thereto on behalf of any shareholder.
3. If you wish your proxy holder to speak at the meeting you should insert the words 'to speak' in the space provided with immediately after and/or and initial such insertion.
4. Please indicate with an 'X' in the space provided, how your proxy is to vote on each resolution. If no indication is given the proxy in his/her discretion will vote as he/she thinks fit.
5. If another proxy is perfected, delete the names printed; add the name of the proxy perfected, and initial the alteration.
6. In the case of a corporate member the proxy must be completed under its common seal, which should be affixed and attested in the manner prescribed by its Articles of Association. If the Form of Proxy is signed by an attorney, the relative power of attorney should also accompany the completed Form of Proxy, if it has not already been registered with the Company.
7. The completed Form of Proxy should be deposited with the Company Secretary, Sri Lanka Telecom Limited, Telecom Headquarters, Lotus Road, Colombo 1 not less than 48 hours before the time fixed for the holding of the meeting.

NAME OF THE COMPANY

Sri Lanka Telecom Limited

LEGAL FORM

A Public Limited Liability Company Incorporated in Sri Lanka in September 1996 under the Conversion of Public Corporations or Government Owned Business Undertakings into Public Limited Companies Act No. 23 of 1987 and quoted on the Colombo Stock Exchange in January 2003.

COMPANY REGISTRATION NUMBER

N (PBS/CGB) 172

STOCK EXCHANGE LISTING

The Ordinary Shares of the Company are listed in the Colombo Stock Exchange and the USD 100,000,000 Bonds due in 2009 are listed on the Singapore Stock Exchange.

REGISTERED ADDRESS

Telecom Headquarters
Lotus Road
Colombo 1

BOARD DIRECTORS

Asoka W. de Silva - Chairman
Shoji Takahashi - Chief Executive Officer
Shuhei Anan
S.B. Divaratne
Leisha Chandrasena (Mrs.)
S.N. Kumar
Sumith Wijesinghe

AUDITORS

PricewaterhouseCoopers
Chartered Accountants
100, Braybrooke Place
Colombo 2

COMPANY SECRETARY

Mrs. P.G. Dias, ACIS - UK

CREDIT RATING

The Company has received AAA (lka) Domestic Rating and BB- foreign currency rating from Fitch Rating Lanka.

Standard & Poor's have rated B+ for foreign currency and BB- for local currency corporate credit ratings.

BANKERS

Bank of Ceylon
Commercial Bank of Ceylon Limited
Hatton National Bank Limited
Standard Chartered Bank
Citibank N.A.
Nations Trust Bank
People's Bank
HSBC Bank
Sampath Bank
Seylan Bank
NDB Bank
Deutsche Bank

REGIONAL TELECOM OFFICES

Ampara	Hatton	Matara
Anuradhapura	Havelock Town	Negombo
Avissawella	Jaffna	Nugegoda
Badulla	Kalmunai	Nuwara Eliya
Bandarawela	Kalutara	Panadura
Batticaloa	Kandy	Polonnaruwa
Chilaw	Kegalle	Ratmalana
Colombo Central	Kotte	Ratnapura
Galle	Kurunegala	Trincomalee
Gampaha	Mannar	Vavuniya
Gampola	Maradana	
Hambantota	Matale	

TELESHOPS

Badulla	Kegalle	Ratmalana
Bandarawela	Kotte	Slave Island
Beruwala	Kurunegala	Wattala
Galle	Maharagama	World Trade Centre
Gampaha	Maradana	
Ja-Ela	Matale	
Kalutara	Matara	
Kiribathgoda	Negombo	
Liberty Plaza	Nuwara Eliya	

SUBSIDIARY COMPANIES

Name of Company	Holding	Principal Activity
Mobitel (Pvt) Limited	100%	Mobile telephony
SLT (Services) Limited	100%	Providing total network solutions to corporate and small business customers
SLT Hong Kong Limited (off shore subsidiary)	100%	Point of Presence - Providing IP transit services
SLT Publications (Pvt) Limited	100%	Directory publication services



Sri Lanka Telecom Limited
Lotus Road
Colombo 01
Sri Lanka.

www.slt.lk