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## SLF – Features

### Auditors

KPMG Cayman Islands

### Administrators

Carsons Management Services (Private) Limited

### Lawyers

Maples & Calder, Cayman Islands

### Fee Structure

- Management Fee – 1.5% of NAV
- Incentive – 20% of the amount by which the fund value outperforms the high watermark
- Front End – 1.5% - 2% depending on value, over USD 100,000 negotiable
- Redemption – 0.5% of NAV
- Custodian Cost – An annual fee of 0.15% of NAV or a minimum of USD 6,000 and an administration fee of USD 10,000
- Administrator's fee – 0.2% of NAV
- Legal, audit & other direct expenses borne by Fund

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## Who Can Invest

- International Funds, Institutional Investors, Companies or Individuals not resident in Sri Lanka.
- Sri Lankans holding Foreign Currency Accounts who are not resident in Sri Lanka.

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## Entry/Exit – Sri Lanka Fund

Investment to the fund is by way of subscription to units of the fund

Applications for over USD 10,000 and will carry front end fees:

- USD 10,000 – 50,000 – 2.5%
- USD 50,000 – 100,000 – 1.5%
- Above USD 100,000 – negotiable

Redemption is by way of notification to the Manager within the dealing period and carries a fee of 0.5%

Application forms listed on the web [www.thesrilankafund.com](http://www.thesrilankafund.com)

Forms to be forwarded to Fund Managers or Custodian

KYC details to be submitted along with the application

Money transfer done directly to/from custodian

**Dealing day:** Every Tuesday of the month – subscription/redemption will be accepted on this day price

**Dealing period:** Period within which applications for subscriptions/redemption must be received in order to be dealt with on succeeding dealing day. Subscription/Redemption must be received five business days prior to dealing day

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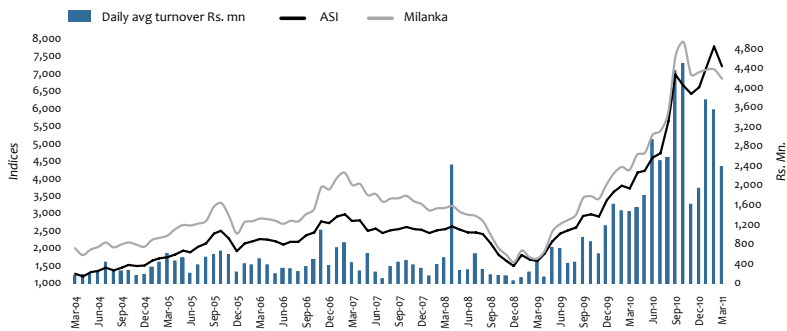
# Managers Review

## Market

The Stock market in Sri Lanka rose 96% for the calendar year 2010, to be the second best performing market in the world. The spectacular performance was due to the post war euphoria continuing with the end of the civil conflict in May 2009, which has seen a resurgence of economic activity in the conflict affected North and East of the country and elsewhere. The All Share Index appreciated 96.0% and the Milanka Index, recognised as the blue chip index, appreciated 83.4% for the calendar year. The index crossed the all time high and peaked at 7147.7 index levels before settling at 6635.8 points at the year end.

The Colombo Bourse was among the top performing markets in the world for the second year running and among the best performing in the region. Equities have had a spectacular run since the dawn of peace in the country regarded as the most important historic event since gaining independence. Investor confidence has gained momentum and corporates & the government have committed to take Sri Lanka to double digit economic growth in the next decade. Thus the risk premium on Sri Lanka has re-rated downwards to represent greater investor confidence. The sovereign risk rating has been upgraded by S&P and Fitch to B<sup>+</sup> with

CSE Indicators

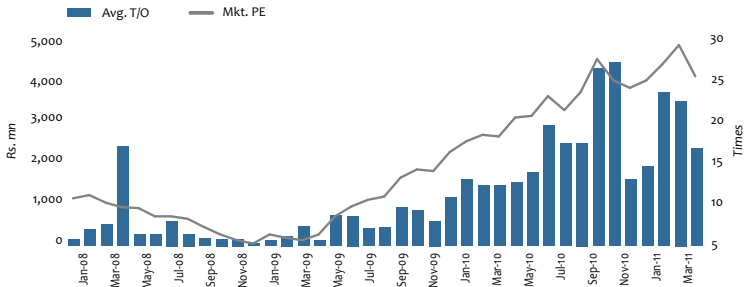


31st Dec 09    31st Mar 10    30th Jun 10    30th Sept 10    31st Dec 10    Movement for 2010

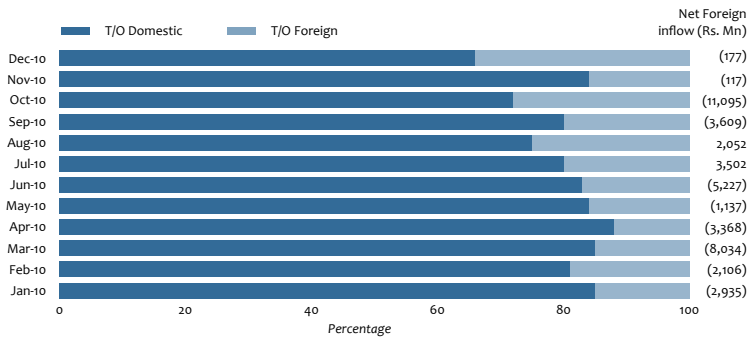
ASPI	3,385.6	3,724.6	4,612.5	6,997.2	6,635.8	96.0%
Milanka	3,849.4	4,270.7	5,278.4	7,552.7	7,061.5	83.4%
Avg.T/O Rs.mn	1,198	1,487	2,954	4,358	1,962	63.8%
Mkt Cap Rs. bn	1,092.14	1,210.84	1,503.91	2,308.75	2,217.81	103.1%
Mkt P/E ratio	16.5	18.4	23.3	27.8	25.25	53.0%

# Managers Review

Daily Avg. T/O Vs Mkt. PE



Turnover - Domestic vs Foreign



a Stable Outlook, a preview of the changing economic scenario.

The depth of the equity market is seen to be improving with the Market Capitalisation of the Colombo Stock Exchange crossing the Rs. 1 trillion mark in 2009 and crossing the Rs. 2 Trillion mark in 2010. The daily average turnover too has seen great improvement to Rs. 1,962 mn in comparison to Rs.1,198 mn at the beginning of the year. However the valuations of the market have gone up tremendously from 16.5 times to P/E

multiples of 25.3 times, and it is therefore looking very expensive on current earnings. In relation to regional markets, the Colombo bourse is still looking over valued. However, we believe that the high P/E multiples are unlikely to deter long term investors from investing in companies with above average growth since a sustained strong growth in corporate earnings is forecast for the next few years.

The market cap to GDP ratio is still at low levels of 42% in 2010 in comparison to 23%

in 2009 and this also points to a relatively immature market with more upside potential. In developed countries the norm is over 100%. Hence we believe that the true potential of the CSE is yet to be harnessed, as more companies list.

The stellar performance at the CSE has been driven by the banking sector, motor sector, oil palms sectors and smaller sectors as highlighted below.

**Sector Movement for 2010**

Banking & Finance	+145.1%
Motors	+239.8%
Oil Palms	+144.2%
Services	+156.2%
Stores & Supplies	+320.6%
Trading	+466.6%
All Share Index	+96.0%

The telecommunication sector which accounts for a larger weight of 21% of market capitalization of the CSE has drastically underperformed, where it has grown by a mere 29.9% for the year. The best performing sectors highlighted above are small contributing sectors other than the banking & finance sector which accounts for 18% of the market capitalization. Thus, we observe that second tier stocks took precedence in the growth of the CSE in 2010.

The CSE has been upheld primarily by its robust domestic activity where domestic participation ratio from 66% at the beginning of the year has increased to 85% by the year end, placing less reliance

on foreign investors at the Colombo Bourse. This has been mainly attributed to selling by foreign investors from the CSE where a net foreign outflow of US\$292mn has been recorded for the calendar year 2010, which highlights the temporary shifting of funds by foreign investors from emerging & frontier markets to mature markets due to cheaper valuations during their economic recovery. Profit taking by foreign investors has not been confined only to Sri Lanka. Foreign fund outflows have been evident in markets such as India and other emerging markets due to fund managers booking record profits when markets have reached peak valuations.

However we are not deterred by temporary foreign selling that has been prompted by factors external to our country, as we feel our market strength has been cemented by fresh domestic investors who have entered the market in the post war scenario. This could be seen in a positive light where volatility attributed to foreign money inflows and outflows is now negligible and therefore greater stability would prevail at the CSE.

Other emerging market economies are likely to be volatile as these markets are not immune from global downturns and capital flight as portfolio managers look for safer options in the more mature markets. Further, some of the more developed markets are seen to be attractively priced due to the over sold positions since 2008 with the global economic crisis caused by the mortgage

# Managers Review

crisis in the USA. Thus we may be in a situation where emerging markets might face an outflow of capital in the short term and hence the strength of domestic investors is vital for market stability.

The market is presently going through a period of correction arising from regulatory changes in the local market and in response to global changes.

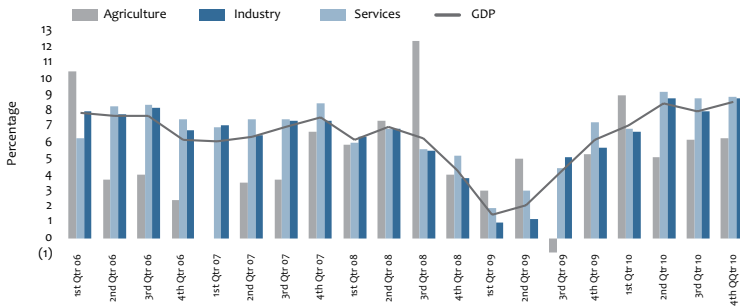
## Outlook for Sri Lanka

Sri Lanka has not yet seen the full benefits of post war economic activity trickling down to the economy by way of high levels of investment, although a resurgence in consumption expenditure is being felt. The opening up of the Northern and Eastern markets will be a positive factor for local corporates due to the construction boom, opening up of new retail markets and agricultural supplies. The Governments priority of investing into infrastructure by way

of highways and ports is likely to lay the foundation for growth in the long term. The Central Bank of Sri Lanka will focus on consolidating the strong growth momentum witnessed in 2010 through committed policies of managing inflation, keeping interest rates in check, reduction of the budget deficit and scaling up investment into infrastructure. The Central Bank has high growth expectations for 2011 against the backdrop of a government budget which encourages investment and a tourism & construction boom driving a GDP growth forecast of 8.5%.

We believe the Sri Lankan economy can achieve an 8.0% growth over the medium term, most importantly by keeping inflation low while ensuring that the pace of infrastructure development accelerates with participation by the public and private sector. It is envisaged that agriculture will play an increasingly

Quarterly Growth Rates



predominant role in the growth of the economy, supported by the significant increase in tourism, construction and consumer sectors. Sri Lanka's policy road map is optimistic in terms of FDI, estimating that it would reach US\$ 1.5bn in 2011 and grow thereafter with the improving investment climate and foreign exchange liberalisation.

Other economic indicators such as inflation are likely to be curtailed at single digit level as we believe the Central Bank would follow appropriate policies to contain inflation caused by pressure

from global commodity price inflation that may put pressure on the Colombo Consumer Price Index (CCPI). We believe that policy rates will be maintained at current rates of 7.00 -8.50%, with some increases coming in however with rising inflation in the second half of the year. On the currency front, the Sri Lankan Rupee is forecasted to marginally appreciate against the US dollar (USD) in 2011 and trade approximately around Rs 110 levels by end 2011. The currency is supported by stronger commodity exports, worker remittances, foreign capital flows for development and foreign borrowings.

	SLRs. Per unit as at 31st Dec 09	SLRs. Per unit as at 31st Mar 10	SLRs. Per unit as at 31st Jun 10	SLRs. Per unit as at 30th Sept 10	SLRs. Per unit as at 31st 31st Dec 10	Appreciation /Depreciation) for calendar yr 2010
US \$	114.38	114.16	113.59	112.04	111.11	+2.86%
STG	181.75	169.78	169.78	176.26	171.69	+5.54%
Euro	163.72	152.10	140.06	153.02	147.78	+9.74%
Yen	1.24	1.24	1.26	1.34	1.36	-9.67%

	Dec 09	Mar 10	Jun 10	Sept 10	Dec 10
Treasury Bill 3M (%)	7.73	8.45	8.07	7.13	7.24
12M (%)	9.33	9.47	9.29	7.10	7.55
Call Money (%)	8.97	9.17	9.10	8.18	8.12
Prime Lending (%)	10.91	10.74	10.38	9.91	9.29

# Managers Review

## Portfolio Review

The year under review has been positive for the company in many respects.

The net asset value increased by 58%, compared to the benchmark All Share Index appreciation of 96% and Milanka Index appreciation of 83%. As at the year end the NAV per share is US\$ 1.06.

The total value of the Sri Lanka Fund amounted to US\$ 3,097,949 as at 31st December 2010, an increase from US\$ 232,766 as at 31st December 2009. The increase in fund value was mainly due to promoters' seeding the fund with US\$2 mn in August 2010 to display their commitment when attracting prospective

Our Top 5 Holdings as at 31st December 2010	Value of the holding US\$ '000	Portfolio Weight %
<b>John Keells Holdings</b> A diversified company with interest in ports & related activities, transportation, property development, tourism, financial services and consumer products in Sri Lanka.	479	16%
<b>Aitken Spence Hotel Holdings</b> A pool of star class hotels situated in Sri Lanka, Maldives and Middle East, accounting for over 1000 rooms.	460	15%
<b>Royal Ceramic</b> A manufacturing company producing Floor Tiles & Sanitary ware products to the local market, which commands a market share of approx. 30%.	343	11%
<b>Commercial Bank of Ceylon</b> One of the largest commercial banks in Sri Lanka with a wide branch network of approx. 200 branches spread island wide.	319	11%
<b>Cargills</b> Leading player in the reatil super market trade, commanding 50% of the market share. Has manufacturing operations in the food sector and operates the KFC franchise in Sri Lanka.	288	10%
Top 5 Holdings	1,889	63%
Other holdings	1,114	37%
<b>Total Portfolio</b>	<b>3,003</b>	<b>100.0%</b>
All Share index movement - 31st Dec 09 to 31st Dec 10		96%

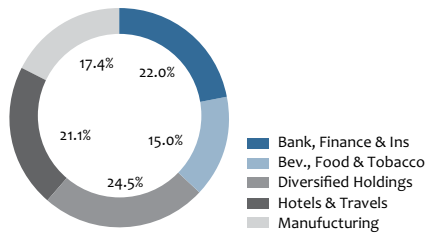
international investors. During the period of review the portfolio has been restructured to represent key growth sectors of the economy in Sri Lanka such as diversified conglomerates, banking & insurance, hotels, manufacturing & construction. Our investment process is driven by fundamental analysis and in depth research. We believe in an aggressive style of bottom up stock selection of companies with good

management, competitive business models and attractive valuations.

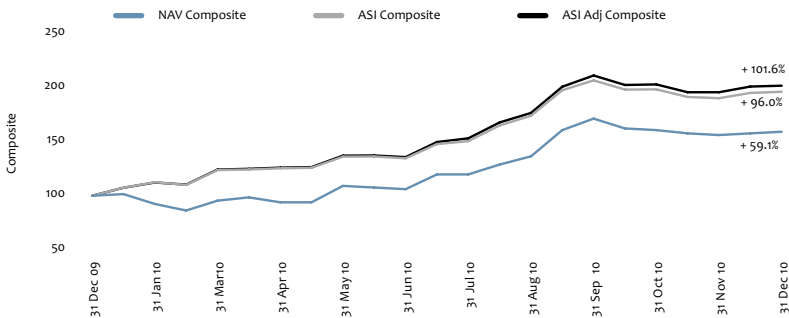
The total participating shares in issue as at end December 2010 was 2,927,131.

	Fund Performance	Index (ASPI)
Last 3 months	(0.9%)	(0.7%)
Since relaunch	33%	30%
YE 2010	59%	96%

Sectorwise exposure as at 31st Dec 2010



Sri Lanka Fund 2010 performance



# Managers Review

## Track record of the Fund Manager

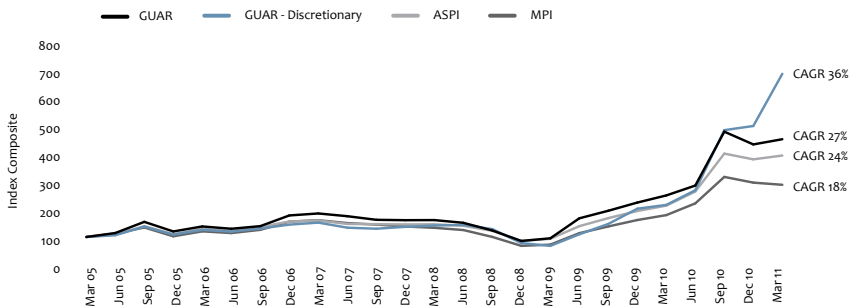
Guardian Fund Management Limited (GFM) and the investment companies it manages (Ceylon Guardian Investment Trust PLC Group and Ceylon Investment PLC) are subsidiaries of Carson Cumberbatch PLC, a diversified conglomerate listed on the Colombo Stock Exchange with business interest in brewing, oil palm plantations and real estate in addition to its investment holdings. Carsons businesses span across Sri Lanka, South Asia and South East Asia. It is among the top 5 listed companies on the Colombo Bourse.

GFM is registered as an Investment Manager with the Securities and Exchange Commission of Sri Lanka since 2006 and registered as underwriters and currently has approx USD 130Mn under

management, inclusive of outsourced client accounts.

The track record of performance of GFM is best illustrated by the performance record of the Guardian Fund given below. CAGR of portfolio taking a five year horizon is +36% (27% based on discretionary Management of Funds) vis-a-vis the benchmark All Share Index of +28%. The bulk of the funds under management is invested in long term listed equities which cover an investment horizon of 3-5 years. The investment style adopted is weighted towards “Value Investing” where a bottom up approach of stock selection is done where individual company valuations are given precedence over asset and sector allocations of the portfolio.

The Manager's Performance



# Directors Profiles

## **Adrian Collins**

Adrian is a Director of The Sri Lanka Fund, Strand Partners Limited, a corporate finance business based in London and serves on the boards of City Natural Resources High Yield Trust Plc, Raven Russia Limited, Windsor Plc and a number of other companies. Adrian has over 30 years' experience in fund management and has served as Managing Director of Gartmore Investment Management and as a director and advisor to several leading investment management businesses in the UK.

## **Chandima Gunawardena**

Chandima is a Director of Carson Cumberbatch PLC. He serves as a Director of the majority of the Carson Cumberbatch Group's companies in Sri Lanka and overseas. He is a member of the Group's Strategic Planning Forum. He also serves as a member of the Audit Committee of the Group, in Sri Lanka and overseas. Chandima has over 30 years' experience in a variety of business and commercial fields and has held senior positions in the corporate sector. He is a Fellow of the Chartered Institute of Management Accountants (UK).

## **Ruvini Fernando**

Director of The Sri Lanka Fund and the CEO of the fund management company which manages the Sri Lanka Fund . She is an Associate Member of the Chartered Institute of Management Accountants, UK and a Fellow of the Association of Chartered Certified Accountants, UK. Has a Masters Degree in Business Administration from the Postgraduate Institute of Management (PIM), University of Sri Jayewardenepura, Sri Lanka. She has over 20 years' experience in management accounting, finance, research analysis, strategic planning and investments. Was a former visiting faculty member of the MBA programme of the Postgraduate Institute of Management. She was a Member of the Regaining Sri Lanka Tourism Steering Committee, a key government policy making forum from January 2002 to January 2004. She also represents the Carsons Group investment companies on the Board of Durdans Medical & Surgical Hospital a leading private healthcare provider in Sri Lanka .

# Our Team

## **Ruvini Fernando**

Refer Directors Profiles.

## **Krishna Selvanathan**

Director of Ceylon Guardian Investment Trust PLC, Ceylon Investment PLC, Lion Brewery Ceylon PLC and Carsons Management Services (Private) Limited. Holds a BA Degree in Accounting & Finance and Business Administration from the University of Kent, UK.

## **Niloo Jayatilake**

Director and Head of Portfolio Management, Guardian Fund Management Limited. Counts over 15 years experience in the investment's field. Prior to joining the Carsons group worked as Fund Manager at The Unit Trust Management Company Limited managers of Ceybank Unit Trust Funds in Sri Lanka. Is an Associate member of the Chartered Institute of Management Accountants, UK and Associate member of the Institute of Chartered Secretaries and Administrators, UK.

## **Vibath Wijesinghe**

Financial Controller of Carsons Management Services (Private) Limited, the Management Company of the Carsons Group. Commenced career at M/s. KPMG Ford Rhodes, Thornton & Company and acquired over five years experience. Joined the Carsons Group in 2004 as the sector Accountant for its Real Estate, Leisure and Investment sectors. Associate Member of the Institute of Chartered Accountants of Sri Lanka, Chartered Institute of Management Accountants, UK and of the Society of Certified Management Accountants of Sri Lanka. Holds a B.Sc. (Special) Degree in commerce from the University of Kelaniya, Sri Lanka.

## **Tharinda Jayawardana**

Head of Research, Guardian Fund Management Ltd. Has over 5 years of experience in investment research. Before joining the Carsons group, worked as a research analyst at JB Securities (Pvt) Ltd. Is a CFA charter holder and an associate member of the Chartered Institute of Management Accountants. Also holds BSc Degree from the University of Sri Jayawardenepura specializing in Finance.

**Sumith Perera**

Fund Manager, Guardian Fund Management Ltd. Has over 6 years experience in the field of Asset Management working as a Fund Manager for CAAM Saudi Fransi LLC (Kingdom of Saudi Arabia) and as an Investment Analyst for Eagle NDB Fund Management (Sri Lanka). Holds a Bsc (Hons) in Economics and Business Finance from Brunel University, UK and an Associate Member of the Chartered Institute of Management Accountants.

**Gayan Karunarathna**

Sector Accountant for the Carsons Group's Investment, Real Estate and Leisure sectors. Commenced career at Ernst & Young, Chartered Accountants and progressed with PricewaterhouseCoopers, Chartered Accountants, prior to joining Carsons Group. Counts over five years of experience in auditing and consulting. An Associate Member of the Institute of Chartered Accountants of Sri Lanka. Holds a BBA (Finance) (Special) Degree from the University of Colombo, Sri Lanka.

# Report of the Directors

The Directors hereby submit their Annual Report together with the audited Financial Statements of The Sri Lanka Fund (the Fund) for the year ended 31st December 2010.

## The Company

The Company is an open-ended investment Company, incorporated as an exempt Company in the Cayman Islands with limited liability. The Sri Lanka Fund was launched by prospectus and currently the Fund is represented by Class A shares of the Company. The Articles of the Company permit the creation of new classes of shares to accommodate subordinated funds, though no such subordinated funds have been created as at 31st December 2010.

The Fund's investment objective is to achieve long-term capital growth by investing in a diversified portfolio of equity securities including convertible bonds and warrants listed on the Colombo Stock Exchange and those issued outside Sri Lanka by any Corporation organised in and under the laws of Sri Lanka and which has its shares listed on the Colombo Stock Exchange and equity securities issued by listed investment companies and funds, wherever established, which invest primarily in equity issued by Sri Lankan Companies listed on the Colombo Stock Exchange.

## Re-launch of the fund

The Net Asset Valuation of the Fund has been suspended from June 2008 due to the substantial redemptions received and the lack of liquidity the Fund has experienced. The suspension was removed in November 2009, once liquidity was restored.

Since then, due to the improvement in the investment climate in Sri Lanka, the Directors have taken steps to re-launch the Fund to international investors in 2010. Ceylon Guardian Investment Trust PLC and Ceylon Investment PLC, being part of the Carsons Group investment sector have infused USD 1 million each to the fund, which represent the promoters' capital.

## Results and Dividends

The results of the Fund for the year ended 31st December 2010 are set out in the Annual Report. The Directors do not recommend the payment of a dividend for the year ended 31st December 2010.

## Share Capital

The details of changes in the issued share capital including subscriptions and redemptions of shares for cash during the year are set out in the statement of changes in ownership equity and Note 4 to the financial statements.

## Directors

The Directors during the year and up to the date of this report were:

- Don Chandima Rajakaruna  
Gunawardena
- Adrian John Reginald Collins
- Mrs. Wedage Yasanthi Ruvini  
Fernando

## Directors' and their interests

Mrs. W.Y.R. Fernando is a Director of Guardian Fund Management Limited, the Investment Manager of the Fund.

Mr. Gunawardena, Director had relinquished his duties and responsibilities from Guardian Fund Management Limited and Carsons Management Services (Private) Limited, the Fund's Administrator with effect from 15th April 2011.

Apart from the above, as at 31st December 2010, none of the Directors had any interest in the share capital of the Company or any interest in any material contracts or contracts for the provision of services during the year significant to the business of the Company.

All Directors are entitled to an annual fee. However, Mr. D.C.R. Gunawardena and Mrs.W.Y.R. Fernando have waived their Directors' fee for the year.

## Auditors

The Company's Auditors during the year under review were Messrs. KPMG Ford, Rhodes, Thornton & Co., Chartered Accountants. The retiring Auditors being eligible, offer themselves for reappointment. A resolution for the reappointment of Messrs. KPMG as Auditors of the Company is to be proposed at the forthcoming Annual General Meeting.

By order of the Board

(Sgd).

**D.C.R. Gunawardena**

Director

23 June 2011.



# Financial Statements

# Report of the Independent Auditors



**KPMG**  
P.O. Box 493  
Century Yard, Cricket Square  
Grand Cayman KY1-1106  
CAYMAN ISLANDS

Telephone +1 345 949 4800  
Fax +1 345 949 7164  
Internet [www.kpmg.ky](http://www.kpmg.ky)

## Independent Auditors' Report to the Shareholders

We have audited the accompanying financial statements of The Sri Lanka Fund ("the Fund"), which comprise the statement of financial position as at 31 December 2010, the statements of comprehensive income, changes in net assets attributable to holders of participating shares and cash flows for the year then ended, and notes, comprising a summary of significant accounting policies and other explanatory information.

### Management's Responsibility for the Financial Statements

Management is responsible for the preparation and fair presentation of these financial statements in accordance with International Financial Reporting Standards and for such internal control as management determines is necessary to enable the preparation of financial statements that are free from material misstatement, whether due to fraud or error.

### Auditors' Responsibility

Our responsibility is to express an opinion on these financial statements based on our audit. We conducted our audit in accordance with International Standards on Auditing. Those standards require that we comply with ethical requirements and plan and perform the audit to obtain reasonable assurance whether the financial statements are free from material misstatement.

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the financial statements. The procedures selected depend on our judgment, including the assessment of the risks of material misstatement of the financial statements, whether due to fraud or error. In making those risk assessments, we consider internal control relevant to the entity's preparation and fair presentation of the financial statements in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the entity's internal control. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of accounting estimates made by management, as well as evaluating the overall presentation of the financial statements.

We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our audit opinion.

### Opinion

In our opinion, the financial statements present fairly, in all material respects, the financial position of the Fund as at 31 December 2010, and its financial performance and its cash flows for the year then ended in accordance with International Financial Reporting Standards.

23 June 2011

KPMG, a Cayman Islands partnership and a member firm of the KPMG network of independent member firms affiliated with KPMG International Cooperative ("KPMG International"), a Swiss entity

# Statement of Comprehensive Income

For the year ended 31 December		2010	2009
	Note	US\$	US\$
<b>Income</b>			
Dividend Income		15,258	-
Interest on Fixed Deposit & Treasury Bond		2,229	5,124
Realized Loss on Sale of Investments		-	(486,043)
Gain on Re-measurement of Investments		918,239	221,264
Foreign Exchange Losses		(30,240)	(16,394)
<b>Net Investment Income/(Loss)</b>		<b>905,486</b>	<b>(276,049)</b>
<b>Expenses</b>			
Investment Manager's Fees	7	(20,751)	(6,256)
Custodian's Fees	8	(14,625)	(20,259)
Administrator's Fee	7	(2,767)	(831)
Legal and Professional Fees		(11,935)	(20,747)
Auditors' Remuneration		(11,993)	(11,928)
Directors' Remuneration	7	(5,000)	(5,000)
Share Transaction Expenses		(21,647)	(7,350)
Sundry Expenses		(385)	(4,223)
<b>Operating Expenses</b>		<b>(89,103)</b>	<b>(76,594)</b>
<b>Change in net assets attributable to holders of participating shares resulting from operations</b>		<b>816,383</b>	<b>(352,643)</b>

*The accompanying notes form an integral part of these financial statements.*

# Statement of Changes in Net Assets Attributable to Holders of Participating Shares

For the year ended 31 December	2010 US\$	2009 US\$
<b>Balance as at 1 January</b>	<b>232,766</b>	585,409
Change in net assets attributable to holders of participating shares resulting from operations for the year	<b>816,383</b>	(352,643)
Redemption of Participating Shares during the year	(450)	-
Issue of Participating Shares during the year	<b>2,049,250</b>	-
<b>Balance as at 31 December</b>	<b>3,097,949</b>	232,766

*The accompanying notes form an integral part of these financial statements.*

# Statement of Financial Position

As at 31 December	Note	2010 US\$	2009 US\$
<b>Assets</b>			
Cash and Cash Equivalents		11,153	431,789
Interest Receivable on Investments		94	2,214
Non Pledged financial assets at fair value through profit or loss	3,6,9	3,174,789	30,965
<b>Total Assets</b>		<b>3,186,036</b>	<b>464,968</b>
<b>Liabilities</b>			
Redemption Payable		(1,498)	(151,735)
Accruals and Other Payables		(86,589)	(80,467)
Total liabilities (excluding net assets attributable to holders of participating shares)		(88,087)	(232,202)
<b>Net assets attributable to holders of participating shares</b>	4, 5	<b>3,097,949</b>	<b>232,766</b>
<b>Net asset value per share, based on 2,927,131 (2009 – 349,054) shares outstanding</b>	4,5	<b>1.06</b>	0.67

The accompanying notes form an integral part of these financial statements.

The financial statements were approved and authorized for issue by the Board of Directors and are signed on their behalf.

(Sgd).  
**D.C.R. Gunawardena**  
 Director  
 23 June 2011.

(Sgd).  
**Ms. W.Y.R. Fernando**  
 Director

# Statement of Cash Flows

For the year ended 31 December	2010 US\$	2009 US\$
<b>Operating Activities</b>		
Dividend Received	15,258	-
Interest Income Received	4,349	7,352
Operating Expenses Paid	(82,981)	(88,931)
Proceeds on Sale of Investments	31,539	510,502
Payments for Purchase of Investments	(2,256,464)	-
Unrealised Exchange Loss from Investments & Liabilities	(30,900)	-
<b>Cash Flows from Operating Activities</b>	<b>(2,319,199)</b>	<b>428,923</b>
<b>Financing Activities</b>		
Payment for Redemption of Participating Shares	(150,687)	-
Proceeds from Issue of Participating Shares	2,049,250	-
<b>Cash Flows from Financing Activities</b>	<b>1,898,563</b>	<b>-</b>
Net (Decrease)/Increase in Cash and Cash Equivalents	(420,636)	428,923
Cash and Cash Equivalents as at 1 January	431,789	2,866
Cash and Cash Equivalents as at 31 December	11,153	431,789

*The accompanying notes form an integral part of these financial statements.*

# Notes to the Financial Statements

For the Year Ended 31 December 2010

## 1. Organization

The Sri Lanka Fund (“the Fund”) is an open-ended investment fund incorporated as an exempt company under the Companies Law (Revised) of the Cayman Islands on 21 October 1993 and registered under the Mutual Funds Law on 26 July 1994.

The objective of the Fund is to provide shareholders with above average returns over the medium to long term through both capital growth and income. The Fund aims to deliver this objective mainly by investing in highly diversified portfolios of equity securities including convertible bonds and warrants listed on the Colombo Stock Exchange and those issued outside Sri Lanka by any corporation organized in and under the laws of Sri Lanka and which has its shares listed on the Colombo Stock Exchange, and equity securities issued by listed investment companies and funds, wherever established, which invest primarily in equity issued by Sri Lankan companies listed on the Colombo Stock Exchange. In doing so, it applies techniques more fully defined in the Fund’s Offering Memorandum.

The investment activities of the Fund are managed by Guardian Fund Management Limited (“the Investment Manager”) and the administration of the Fund is delegated to Carsons Management

Services (Pvt) Limited (“the Administrator”). The registered office of the Fund is located at P.O. Box 309, Ugland House, Grand Cayman KY1-1104, Cayman Islands.

## 2. Significant Accounting Policies

### (a) Statement of Compliance

The financial statements have been prepared in accordance with International Financial Reporting Standards (IFRSs).

### (b) Basis of preparation

The financial statements are presented in United States Dollars and not the local currency of the Cayman Islands reflecting the fact the shares of the Fund are issued and redeemed in United States Dollars. They are prepared on a fair value basis for the financial assets and financial liabilities at fair value through profit or loss. Other financial assets and liabilities are stated at amortized cost or redemption amount (redeemable shares).

The preparation of the financial statements in conformity with IFRSs requires management to make judgments, estimates and assumptions that affect the applications of policies and the reported amounts of the assets and liabilities, income and expense. The estimates and associated assumptions are based on historical experience and various other factors

that are believed to be reasonable under the circumstances, the results of which form the basis of making the judgments about carrying values of assets and liabilities that are not readily apparent from other sources. Actual results may differ from these estimates.

The estimates and underlying assumptions are reviewed on an ongoing basis. Revision to accounting estimates are recognized in the period in which the estimates is revised if the revision affect only that period, or in the period of the revision and the future period if the revision affect both current and future periods.

The accounting policies have been applied consistently by the Fund and are consistent with those used in the prior year.

### (c) Foreign Currencies Translation

Transactions in foreign currencies are translated at the foreign currency exchange rate ruling at the date of the transaction. Monetary assets and liabilities denominated in foreign currencies are translated to United State Dollars at the foreign currency closing exchange rate ruling at the statement of financial position date. Foreign currency exchange differences arising on translation and realized gains and losses on disposal or settlement of monetary assets and liabilities are recognized in the

statement of comprehensive income. Non-monetary assets and liabilities denominated in foreign currencies that are measured at fair value are translated to United States Dollars at the foreign currency exchange rates ruling at the dates that the values were determined. Foreign currency exchange differences relating to investments at fair value through profit or loss are presented separately.

### (d) Financial Instruments

#### (i) Classification

The Fund designates all its equity investments into the financial assets at the fair value through profit or loss category.

Financial instruments are designated at fair value through profit or loss upon initial recognition. These include equity securities listed on the Colombo Stock Exchange and those issued outside Sri Lanka by any corporation organized in and under the laws of Sri Lanka and which has its shares listed on the Colombo Stock Exchange, and equity securities issued by listed investment companies and funds, wherever established, which invest primarily in equity issued by Sri Lankan companies listed on the Colombo Stock Exchange.

Financial liabilities that are not at fair value through profit or loss include accruals and other payables,

# Notes to the Financial Statements

For the Year Ended 31 December 2010

redemption payable and financial liabilities arising on redeemable shares.

## (ii) Recognition

The Fund recognizes financial assets and financial liabilities on the date it becomes a party to the contractual provisions of the instruments.

A regular purchase of financial assets is recognized using trade accounting. From this date any gains and losses arising from changes in fair value of the financial assets or financial liabilities are recorded.

## (iii) Measurement

Financial instruments are measured initially at fair value (transaction price) plus, in case of a financial asset or financial liability not at fair value through profit or loss, transaction costs that are directly attributable to the acquisition or issue of the financial asset or financial liability.

Transaction costs on financial assets and financial liabilities at the fair value through profit or loss are expensed immediately, while on other financial instruments they are amortized.

Subsequent to the initial recognition, all instruments classified at the fair value through profit or loss, are measured at the fair value with changes in their fair value recognized in the statement of comprehensive

income. Other financial assets are measured at amortized cost.

Financial liabilities, other than those at fair value through profit or loss, are measured at amortized cost using the effective interest rate. Financial liabilities arising from the redeemable shares issued by the Fund are carried at the redemption amount representing the investor's right to a residual interest in the Fund's assets.

## (iv) Fair value measurement principles

The fair value of financial instruments is based on their quoted market prices at the statement of financial position date without any deduction for estimated future selling cost. Financial assets are priced at the current bid prices.

If quoted market prices are not available on a recognized stock exchange or from a broker / dealer for non-exchange traded financial instruments, the fair value of the instrument is estimated using valuation techniques, including use of recent arm's length market transactions, reference to the current fair value of another instrument which is substantially the same, and discounted cash flow techniques that provides a reliable estimate of prices obtained in actual market transactions.

(v) Impairment

Financial assets that are stated at cost or amortized cost are reviewed at each statement of financial position date to determine whether there is objective evidence of impairment. If any such indication exists, an impairment loss is recognized in the statement of comprehensive income as the difference between the assets' carrying amount and the present value of estimated future cash flows discounted at the financial assets' original effective interest rate.

If in a subsequent period the amount of impairment loss recognized on a financial asset carried at amortized cost decreases and the decrease can be linked objectively to an event occurring after the write-down, the write-down is reversed through the statement of comprehensive income.

(vi) Derecognition

The Fund derecognizes a financial asset when the contractual rights to the cash flows from the financial asset expire or it transfers the financial asset and the transfer qualifies for derecognition in accordance with IAS 39.

The Fund uses the weighted average method to determine realized gains and losses on derecognition.

A financial liability is derecognized when the obligation specified in the contract is discharged, cancelled or expired.

(vii) Specific Instruments

*Cash and cash equivalents*

Cash comprises current deposits with banks. Cash equivalents are short-term highly liquid investments that are readily convertible to known amount of cash, are subject to an insignificant risk of changes in value, and are held for the purpose of meeting short term cash commitments rather than for investments or other purposes.

(e) Interest Income

Interest income and expenses are recognized in the statement of comprehensive income as they accrue, using the original effective interest rate of the instruments calculated at the acquisition or origination date.

(f) Dividend Income

Dividend income relating to exchange-traded equity investments is recognized in the statement of comprehensive income on the ex-dividend date.

In some cases, the Fund may receive or choose to receive dividends in the form of additional shares rather than cash. In such cases the Fund recognizes the dividend income for the amount of the cash dividend alternative with the corresponding debit treated as an additional investment.

# Notes to the Financial Statements

For the Year Ended 31 December 2010

## (g) Expenses

All expenses, including management fee and custodian fees, are recognized in the statement of comprehensive income on an accrual basis.

Included in sundry expenses are registers fees paid by the Fund, safe custody and bank charges and printing and advertising.

## (h) Foreign Exchange Gains and Losses

Foreign exchange gains and losses on financial assets and financial liabilities at fair value through profit or loss are recognized together with other changes in the fair value.

## (i) Taxation

Under the current system of taxation in Cayman Islands, the Fund is exempt from paying taxes on income, profits or capital gains. The Fund has received an undertaking from Governor in Cabinet of the Cayman Islands authorities exempting it from income tax for a period of 20 years. Accordingly, no tax provision is recorded in these financial statements.

Dividend and interest income received by the Fund may be subject to withholding tax imposed in the country of origin.

## (j) Participating Shares

All participating shares issued by the Fund provide the investors with the right to require redemption for cash at the value proportionate to the investor's share in the Fund's net assets at the redemption date. In accordance with IAS 32 such instruments give rise to a financial liability for a present value of redemption amount.

### 3. Investments

	2010 US\$	2009 US\$
Balance at the beginning of the year	462,503	1,475,441
Additions during the year	2,256,464	-
Disposals during the year	(31,539)	(1,012,938)
Balance at the end of the year	2,666,934	462,503
Unrealized Appreciation / (Depreciation) in value	507,855	(431,538)
Fair value (Note 9)	3,174,789	30,965

### 4. Stated Capital

	2010		2009	
	Number of Shares	Amount US\$	Number of Shares	Amount US\$
<b>Authorized</b>				
Founder shares	100	100	100	100
Participating shares	89,990,000	899,900	89,990,000	899,900
	<b>89,990,100</b>	<b>900,000</b>	<b>89,990,100</b>	<b>900,000</b>
<b>Issued and Fully Paid</b>				
Founder shares	100	100	100	100
<b>Participating Shares</b>				
Balance at the beginning of the year	349,054	3,491	349,054	3,491
Issued during the year	2,578,477	2,049,250	-	-
Redeemed during the year	(400)	(4)	-	-
Balance at the end of the year	2,927,131	2,052,737	349,054	3,491
<b>Total</b>		<b>2,052,837</b>		<b>3,591</b>

# Notes to the Financial Statements

For the Year Ended 31 December 2010

## 4. Stated Capital (Continued)

### Founder Shares

Founder shares confer upon the holders thereof rights in a winding up or repayment of capital in accordance with the Articles of Association of the Fund but confer no other rights to participate in the profits or assets of the Fund. The holder of a founder share has no right to receive notice of or to attend and vote as a shareholder of the Fund at any General Meeting of the Fund. The issued founder shares are held by the Investment Manager. The founder shares are classified as equity.

### Participating Shares

Participating shares may be redeemed on the first and third Tuesday of the month or such other dates as the board of directors shall from time to time determine (Valuation Day) at the net asset value per share based on mid-market prices. The mid-market price is not materially different from the bid/ask price. The shareholder must request such redemption at least 7 days prior to the last business day of each month or such other day as the directors may determine.

Participating shares have the right to receive notice of or to attend and vote as a shareholder of the Fund at any General Meeting of the Fund. Participating shares confer upon the holders of their right of a winding up or repayment of capital in accordance

with the Articles of Association of the Fund. They also have the right to share in all profits or assets of the Fund in excess of the value of the issued share capital of the founder shares. The Fund does not have any externally imposed capital requirements.

## 5. Net Asset Value per Ordinary Share

The calculation of Net Asset Value per participating share is based on the net asset value attributable to participating shareholders of US\$ 3,097,949 (2009: US\$ 232,766) and on the total number of 2,927,131 (2009: 349,054) participating shares in issue at the statement of financial position date.

## 6. Financial Instruments and Associated Risks

Financial assets of the Fund include cash and marketable securities. Financial liabilities include accruals and other payables.

### (a) Market Risk

The Fund's investment activities expose it to various types of market risk, which are associated with the markets in which it invests, to the extent of the amount invested in equity and debt securities. The Fund invests in securities listed on the Colombo Stock Exchange and those issued outside Sri Lanka by any corporation organized in and

under the laws of Sri Lanka, and equity securities issued by listed investment companies and funds, wherever established, which invest primarily in equity issued by Sri Lankan companies listed on the Colombo Stock Exchange, which may experience greater volatility than those of Western companies. The Fund also invests in Sri Lankan Government debt securities.

**(b) Foreign Exchange Risk**

The Fund is exposed to foreign exchange risk from its investments and receivables and payables denominated in currencies other than United States Dollars, to the extent of the amount invested for investments, receivables and payables.

The Fund's total net exposure to fluctuations in foreign currency exchange rates at the statement of financial position date was as follows.

**Sensitivity Analysis**

Since the Fund's investments were not made in domestic currency the returns on the investment depends on the fluctuation of the exchange rate at the time they are traded in the market. As at 31 December 2010, if the US Dollar appreciated by 5%, in relation to the LKR, then the fair value of the portfolio would decline by US \$158,739 (2009: US \$ 1,548). An equal change in the opposite direction would have increased the fair value of the portfolio by the same amount.

There is no value in GBP investment as at 31 December 2010.

All amounts are stated in US\$

Assets	Fair Value 2010	Fair Value 2009
<b>Investments</b>		
Sri Lankan Rupee	3,174,789	30,965
	<b>3,174,789</b>	<b>30,965</b>

**Cash and Cash**

**Equivalents**

British Pounds	-	430,917
Sri Lankan Rupee	3,976	872
US Dollars	7,177	-
	<b>11,153</b>	<b>431,789</b>

**(c) Interest Rate Risk**

Interest bearing financial assets consist mainly of bank deposits and a Sri Lankan Government debt security that mature or re-price in the short-term, no longer than twelve months. As a result, the Fund is not subject to significant interest rate fluctuations and accordingly no interest rate sensitivity is presented.

**(d) Credit Risk**

Financial assets which potentially expose the Fund to credit risk consist principally of marketable securities and cash balances. Investments in Sri Lanka expose the Fund to risk of illiquidity and volatility. The extent of the Fund's exposure to risk in respect of these financial assets approximates their carrying value as recorded in

# Notes to the Financial Statements

For the Year Ended 31 December 2010

the Fund's statement of financial position.

The Fund limits its exposure to credit risk by transacting the majority of its securities and contractual commitment activity with broker-dealers, banks and regulated exchanges with high credit ratings that the Fund considers to be well established.

## (e) Fair Values of Financial Instruments

Investment securities are carried at market values unless the directors have determined that a discount is required to arrive at fair value. The Fund's other assets and liabilities include cash and cash equivalents and amounts due on open transactions which normally settle within a few days and other receivables which are realized or settled within a short period of time. The carrying values of these other assets and liabilities approximate their fair values.

## (f) Price Risk

The Fund's investment portfolio exposes it to the price risk, which is associated with the relevant markets in which the Fund has made its investments. The Fund is in possession of investments for which broker quotes are available (Sri Lankan Government debt securities) and securities which are listed in the Colombo Stock

exchange, from which, based on the market value available for each security, the respective investments are being reflected at fair value. Thus the fluctuation in the fair value in the securities reflected in the Fund's Investment portfolio are caused by factors affecting similar securities traded in each market, such as interest rates, exchange rates, taxation, inflation etc.

## Sensitivity Analysis

As at 31 December 2010, if the price of Sri Lankan debt and equity securities increased by 5%, resulting from the above mentioned general economic factors (except for the impact from the Exchange rate fluctuations mentioned under Foreign Exchange Risk), it would increase the net assets attributable to holders of participating shares by US \$ 158,739 (2009: US \$ 1,548). An equal change in the opposite direction would have decreased the Net Asset value of the Fund by the same amount.

## (g) Liquidity Risk

The financial position of the Fund reflects its ability to meet its accrued expenses and accounts payable due to the availability of the investments made by the Fund in listed securities which are readily realizable since they are being traded in active markets. The financial liabilities of the Fund consist of the accruals and other payables and redemptions payable

as at 31 December 2010. Accruals and other payables have a maturity date of 1 to 3 months except directors' fees, which have maturity date of more than one year. The redemption payable has a maturity date of more than 2 months and liability on participating shares fall due as and when a share holder requests to redeem.

## 7. Related Parties

### Investment Manager

The Fund appointed Guardian Fund Management Limited ("GMFL"), an investment management company incorporated in Sri Lanka, to implement the investment strategy. Under the Investment Management Agreement, the Investment Manager receives a management fee equivalent to 1.5% per annum of the Net Asset Value of the Fund, a fee of 0.5% of the redemption price of each share redeemed, and a performance fee of 20% of the amount at every year end, by which the Fund net asset value exceeds the previous highest net asset value attained at an year end (high watermark). No performance fee was payable for the year ended 31 December 2010 (2009: US\$ Nil). Total Investment Manager's Fee for the year ended 31 December 2010 was US\$ 20,751 (2009: US\$ 6,256).

### Administrator

Carsons Management Services (Pvt) Limited ("CMSL"), the present administrator, and a fellow affiliate of GFML, receives an administrative fee of 0.2% per annum of the average weekly net asset value of the Fund until the termination of its administration agreement with the Fund. Total Administrator's Fee paid to CMSL during the year was US\$ 2,767 (2009: US\$ 831).

### Directors' fee

The directors' fee is disclosed in the statement of comprehensive income.

Mr. Don Chandima Rajakaruna Gunawardena, a Director of the Fund is also a Director of GFML and CMSL. Ms. Wedage Yasanthi Ruvini Fernando a Director of the Fund is also a Director of GFML.

## 8. Custodian

Deutsche Bank AG, as Custodian with effect from 1 April 2009, was paid a fee of 0.15% per annum of the net asset value of the Fund, subject to a minimum annual fee of US\$ 6,000 (2009: US\$6,000). In addition, the custodian was entitled to an annual administration fee of US\$10,000 (2009: US\$10,000).

# Notes to the Financial Statements

For the Year Ended 31 December 2010

## 9. Fair Value Information

The Fund measures fair values using the following fair value hierarchy that reflects the significance of the inputs used in making the measurements:

- Level 1: Quoted market price (unadjusted) in an active market for an identical instrument.
- Level 2: Valuation techniques based on observable inputs, either directly (i.e., as prices) or indirectly (i.e., derived from prices). This category includes instruments valued using: quoted market prices in active markets for similar instruments; quoted prices for identical or similar instruments in markets that are considered less than active; or other valuation techniques where all significant inputs are directly or indirectly observable from market data.
- Level 3: Valuation techniques using significant unobservable

inputs. This category includes all instruments where the valuation technique includes inputs not based on observable data and the unobservable inputs have a significant effect on the instrument's valuation. This category includes instruments that are valued based on quoted prices for similar instruments where significant unobservable adjustments or assumptions are required to reflect differences between the instruments.

The table below analyses financial instruments, measured at fair value at the end of the reporting period, by the level in the fair value hierarchy into which the fair value measurement is categorised:

During the current year, there were no significant transfers between Level 1, Level 2 or Level 3 of the fair value hierarchy. At 31 December 2010, and during the year then ended, the Fund did not hold any Level 3 securities.

31 December 2010	Level 1	Level 2	Total
<b>Financial assets at fair value through Profit or loss</b>			
<b>Equity Securities</b>			
Listed Securities	3,003,330	-	<b>3,003,330</b>
<b>Non Listed Securities</b>	-	-	-
Debt Securities			
Fixed Deposits	171,459	-	<b>171,459</b>
	<b>3,174,789</b>	-	<b>3,174,789</b>

## **10. Events Occurring after the Statement of Financial Position Date**

There have been no material events occurring after the Statement of Financial Position date that require adjustments to or disclosure in the Financial Statements.





