Board Paper No 2024/678/04/A

Board Meeting No 72 **Date 05.04.2024**

DIVIDEND
POLICY & PROCEDURES
MANUAL

Version II

Owner – Assistant General Manager (Finance & Strategic Planning)
Approval. Board of Directors
Date of Approval :- 5th April 2024

DIVIDEND POLICY

1.Objective

This manual is designed to establish a balance outlook between the aspirations of the shareholders to receive a return on their investment and retaining funds in the company to absorb losses, and the need to maintain a sustainable future business growth,

The above strategy will strengthen resilience and capacity of our company to absorb economic shocks that could arise during times of uncertainties and continue to be able to meet the credit needs of our customers, by maintaining sufficient capital.

The dividends decision is an important means by which information about the prospects of a company are conveyed and it resolves uncertainty and improve shareholders confidence, so that the market price of share stabilizes and grows steadily.

The proposed dividend declaration should be carried out in accordance with the requirements stipulated herein and the directions issued by the Director Department of Supervision of Non- Bank Financial Institutions, rules of CSE and prevailing taxation requirements.

2. POLICIES

This Policy is to balance the objectives of rewarding shareholders by providing a reasonable return on their investment and retaining sufficient earnings to support the future growth of the company and to be paid from:-

- **Accumulated retained earnings from previous years and general reserves**
- **Current years distributable profit after tax and as prescribed by regulatory & statutory requirements (Refer paragraph 4 below for more details)**

Utilization of retained earnings:

Where the Board of Directors of the company is of the view that the Company can invest retained earnings to better use and increase the earnings substantially or has the ability to increase earnings, the Board may decide to utilize the retain earnings for the following internal and external parameters prior to approval of declaration of dividends

- **To Secure a durable competitive advantage in the Finance Sector**
- **To expand business by potential acquisition and merger opportunities, as permissible by the regulator, with connected capital expenditure**
- **To invest in technology and applicable modernization and upgrading plans so as to avoid technological obsolescence risks**
- **Such other purposes, as the Board may think appropriate from time to time to maintain / enhance competitive advantage of the company.**

3. FACTORS (INTERNAL AND EXTERNAL) THAT SHOULD BE CONSIDERED WHEN DECLARING DIVIDEND

The decision regarding dividend pay-out is a crucial decision as it determines the amount of profit to be distributed among shareholders and amount of profit to be retained in business. The Board of Directors will endeavor to take a decision with an objective to enhance shareholders wealth and market value of the shares. However, the decision regarding pay-out is subject to several factors and hence, an optimal balance needs to be arrived at when considering the interest of shareholders and that of the Company.

The dividend pay-out decision of the company depends upon certain external and internal factors as follows

Dividend payout ratio

Dividend per share (DPS) = Payout ratio X Earnings per Share ratio (EPR)

a) External Factors:

- **State of Economy**

In case of uncertain or recessionary economic and business conditions, Board will endeavor to retain a part of profits to build up reserves to absorb future shocks.

- **Market Trends**

When the markets are favorable, dividend pay-out can be liberal. However, in case of unfavorable market conditions, the Board may resort to a conservative dividend pay-out in order to conserve cash outflows.

- **Shareholders aspirations**

Return on their investment

- **Taxation policies of the State**

Direct and indirect taxation and levies

b) Internal Factors:

Apart from the external factors he Board could consider various internal factors while declaring dividend, which inter alia will include

- **Profits earned during the year;**
- **Present & future regulatory capital adequacy requirements;**

- **Future requirements involving expansion of Branch network / IT upgrading etc. with related capital expenditure;.**
- **Fresh investments in profitable Financial Instruments**
- **Desire to maintain financial solvency and liquidity .**
- **Any other factor as deemed beneficial to the company..**

4. BASIS OF DIVIDENDS DECLARATIONS

The company has issued ordinary shares with voting rights, Dividends should be declared on a per share basis to the shareholders whose names appear in the Members' Register on the record date after deduction of applicable taxes.

Adequate retention from earnings should be maintained to meet the minimum Core Capital requirement stipulated by the Central Bank of Sri Lanka directions No.02 of 2017 and to maintain Capital Fund with Additional Buffer stipulated in the said direction,

Accordingly, when computing the dividend payout ratio, it should ensured. that the Core Capital Requirement and the Capital Adequacy Ratio with an additional buffer is maintained as per the sighted directive.

Payout Ratio = 1 - Retention Ratio

5. DECLARATION OF DIVIDENDS

Declaration of dividends will be based on a pure residual dividend policy

This policy requires to distribute the profits by way of dividends utilizing earnings that remain after meeting the equity requirement of the capital budget and investments.

Therefore, under this policy whenever there is a fluctuation either in the earnings or capital requirement, dividend amount will also change accordingly. Fluctuations in the dividend may not be acceptable to the shareholders, since shareholders expect stable dividend with growth.

This policy does not create pressure the company to declare dividends under a loss-making scenario as dividends are paid when there are profits as per example given below.

The following table explains the computation of pure residual dividend policy.

Pure Residual Dividend Policy **(Rs.)**

Period	*1*	*2*	*3*	*4*	*5*	*6*	*7*
Earnings	**100**	**200**	**240**	**420**	**580**	**650**	**700**
Investment	**100**	**150**	**180**	**200**	**400**	**600**	**500**
Investment	**50**	**75**	**90**	**100**	**200**	**300**	**250**
Pure Residual Dividend	**50**	**125**	**150**	**320**	**380**	**350**	**450**

When this policy is adopted dividends declared fluctuate gradually in relation the fluctuations in the earnings and capital budget. (In period 1 dividends are Rs.50 in period 2 Rs.125 nd in period 3 Rs.150 and so on.

The company may decide to issue any other class of shares as appropriate from time to time in which case the dividend payments will be determined in accordance with the rules and regulations of the respective terms of the issue of such other class of shares.

6. STOCK DIVIDEND (BONUS SHARES)

The stock dividend is popularly known as bonus shares issue. Under this process, the bonus shares are distributed proportionately to the original shares of the cardholders. Therefore, each shareholder can retain his original proportionate ownership of the company.

Example.

Paid up share capital (shares @ Rs.10/-) ***10Mn***
Reserves and surpluses (retained earnings) ***10Mn***
Total net worth of the company ***20Mn***

If the company declares bonus shares at 1: 2 ratios. That means for every 2 shares held, one bonus share will be issued. That means for bonus shares are issued by converting reserves into paid-up capital.

After bonus issue the Capital structure
Paid up share capital ***15 Mn***
Reserve & surpluses ***. 5 Mn***
Total net worth of the firm ***20.Mn***

Issue of bonus shares does not affect the net worth of the shareholders. Bonus issue represents recapitalization of the share holders' equity portion. It is a transfer of reserves to paid-up capital. Accordingly, the Shareholders' future dividends rise as the number of shares owned by them has increased, because of bonus issue. (A shareholder who originally owned 100 shares, will be the owner of 150 shares `after bonus issue.)

7. REGULATORY PROCEDURES

PRIOR APPROVAL OF CBSL

Approval of the Director, Department of Supervision of Non-Bank Financial Institutions (DSNBFI) should be obtained prior to declaration of either interim or `final dividends.

To obtain the aforesaid approval the following requirements should be fulfilled.

Submit to the Director, Department of Supervision/ of Non- Bank Financial Institutions (D//.SNBFI) a reconciliation on profit before dividends computed under CBSL prudential directions and LKAS/SLFRS . This reconciliation should be approved by the Board of Directors and the audit committee. The reconciliation should be prepared for the period from the beginning of the financial year and presiding calendar month prior to announcement of the proposed dividend

Submit a computation on prudential ratios stated in the Finance Companies (Liquid Assets) and (Risk Weighted Capital Adequacy) Directions after adjusting for the proposed dividend based on the financial information submitted to CBSL under existing prudential directions. The computation should be carried out for the preceding calendar month prior to announcement of the proposed dividend, duly approved by Board of Directors and the Audit committee. The results of this computation should be in compliant with the minimum capital adequacy Directions of CBSL (***Refer Finance Business Act Direction No.02 of 2017 on Minimum Core Capital, or as amended,***

When Conducting stress testing on liquidity and capital adequacy for submission to CBSL among others following aspects should be considered.

- **Market risk**
- **Credit Concentration Risk**
- **Liquidity Risk**
- **Default Risk**
- **Operational Risk**

Stress testing should be conducted considering the impact of prevailing macro-economic conditions and the projected business plan of our company for the next three years and results should be submitted to CBSL together with the supporting assumptions and workings

In addition to the above we should submit to CBSL a statement of Solvency obtained from External auditors of our company

8. COLOMBO STOCK EXCHANGE

On receipt of approval of the Director Department of Supervision of Non- Bank Financial Institutions Notify Colombo stock Exchange (CSE) as per their rules.

9. SHARE HOLDERS' APPROVAL

The Board of Directors when approving the annual financial statement may recommend the final dividend for the approval of the shareholders at the Annual General Meeting, by way of a resolution

8. REVIEW OF MANUAL

This Manual will be reviewed from time to time to ensure conformity with market changes and regulatory changes introduced by CBSL or CSE on the subject, by the Assistant General Manager (Finance and Strategic Planning) with the due approval of the Board of Directors,

9. APPROVAL SOUGHT

We seek the approval of the Board of Directors to adopt this policy and procedures manual on the subject "Declaration of Dividends"

10. RECOMMENDATION

Recommended to the Board of Directors to approve the adoption of this Manual

Assistant General Manager
(Finance & Strategic Planning)

CEO/ Executive Director