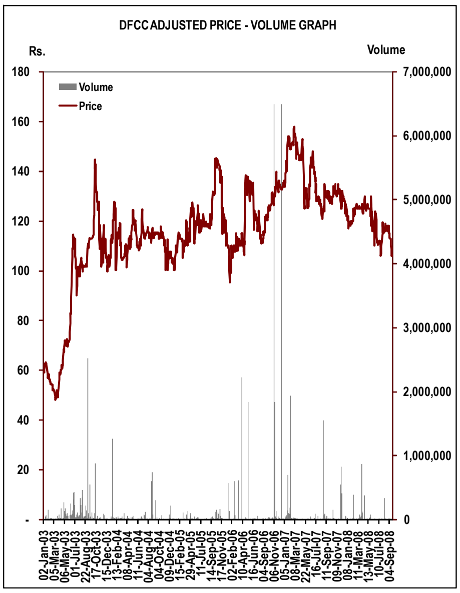
DFCC Bank PLC (DFCC)

Rs. 106.00 **LONG TERM BUY**



Financial Year (Mar)	Net Income	NPAT (Rs.mn)	PAT, MI & Pref Divid	EPS (Rs.)	EPS Growth %	PER (x) Rs.	P/BV	Dividend Yield %	DPS Rs.
2005	1,943	1,419	1,348	10.93	4.72	9.70	1.36	5.2%	5.50
2006	3,614	1,755	1,688	13.51	23.66	7.85	1.18	5.7%	6.00
2007	4,063	1,693	1,586	13.03	(3.54)	8.13	1.10	4.7%	5.00
2008	4,681	2,247	2,168	17.30	32.76	6.13	0.78	4.7%	5.00
2009E	5,849	2,401	2,286	18.48	6.84	5.73	0.72	4.7%	5.00
2010E	6,804	2,772	2,652	21.34	15.47	4.97	0.65	4.7%	5.00

Adjusted for Bonus and Rights Issue

DFCC			
Reuters Code			DFCC.CM
Bloomberg Code			DFCC.SL
Share Price LKR			106.00
Issued Share Capital (Shares)			
Voting			130,732,470
12 mth High/Low (Rs.)			135.00 / 106.00
Average Daily Volume (Shares)			23,640
Market Capitalisation (Voting) Rs. mn			13,858
Price Performance (%)			
	1 mth	6 mth	12 mth
ASPI	(8.78)	(21.89)	(13.49)
DFCC	(9.59)	(15.87)	(19.70)

* Adjusted for bonus and rights issues

- DFCC is a Development Finance Institution and is regulated as a Licensed Specialised Bank. The bank however has acquired a subsidiary, DFCC Vardhana which engages in commercial banking operations. The bank is also engaged in venture capital financing, stock broking and consultancy services and the leasing of land and building for industrial purposes via subsidiary holdings. In addition the bank provides investment banking services via a joint venture with HNB established earlier this year. Contribution to earnings from these businesses apart from DFCC Vardhana is still relatively small. DFCC also has a 27.11% associate stake in Commercial Bank of Ceylon, the largest local private bank in the country.

- Recent guidelines pertaining to ownership restrictions in banks in the country has meant that DFCC is required to reduce its holding in its associate COMB as well as its subsidiary DFCC Vardhana. The Monetary Board has asked DFCC to reduce its holding in COMB to 15% by October 2008, while DFCC has time till 2012 to reduce its holding in DFCC Vardhana. DFCC has appealed against the directive requesting that the central banks direction relating to the Central Bank be quashed or for the time limit for the reduction in ownership to be extended to April 2012. COMB contributed 33.9% of profit before tax for the year ended March 2008. The required reduction in its holding of DFCC Vardhana in April 2012 is likely to result in a merger between the two Banks. Our earnings forecast have assumed that DFCC's stake in COMB remains intact over the next two years. A reduction in DFCC's holding in COMB to 15% would result in a capital gain of approximately Rs. 2.4bn at current market price.

- Moderate loan growth of 8% in FY08 was below the sector average as the bank eased on aggressive loan book expansion given the high interest rate environment. The groups lending portfolio continues to be dominated by project loans and corporate loans although asset growth in DFCC Vardhana has been healthy. Loan growth at DFCC is expected to be conservative at 8% and 20% over the next two years given current high interest rates.

- Deposits accounted for 26% of funding in 2008, with borrowings and funds directed through the government being the primary source of funds. Customer deposits raised via its subsidiary DFCC Vardhana increased by

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55% in FY08 to Rs. 12.1bn while fixed deposits at DFCC Bank declined significantly contributing to a 21% decline in group customer deposits. Deposit growth is expected to grow at 15% and 20% over the next two years. Net Interest margins are expected to remain stable while non interest income is expected to continue to account for approximately 25% of total operating income.

- The bank has reported stable NPL ratios while NPL coverage remains low at just 23.1% in 2008. However the bank adopts prudent provisioning policies like most other large private banks, providing for bad loans in full within 12mths as against central bank guidelines of 18mths while classifying NPLs after 2mths of overdue payments against central bank guidelines of 3 mths. The provision cover is however expected to improve following central bank guidelines on a mandatory general provision.

- The banks cost to income ratio is relatively low as is the case with most Development Finance Institutions although this may rise with an increase in personnel and premises expenses fueled by the branch expansion of DFCC Vardhana, expected to grow at 6 – 7 new branches each year over the next two years.

- The banks Tier 1 and Total CAR is healthy at 20.4% and 19.0% respectively, comfortably above minimum statutory requirements following a 3.03bn rights issue of which Rs. 1.6bn was invested in a rights issue of associate Commercial Bank of Ceylon and a further Rs. 0.86bn invested in a rights issue of subsidiary DFCC Vardhana Bank.

- Forecast earnings growth of 6.8% and 15.5% in FY09 and FY10 correspond to a P/E multiple of 5.73x and 4.97x earnings at a market price of Rs. 106.00. The bank is in the process of evolving from a DFI towards greater exposure into commercial banking operations. The banks sound capital position sound management capability should see the bank derive greater value in the medium to long term as exposure to commercial banking operations increase.

Ratio Analysis	2006	2007	2008	2009E	2010E
PBV	1.2	1.1	0.8	0.7	0.6
EPS	13.0	12.2	16.7	17.6	20.4
PER	8.2	8.7	6.4	6.0	5.2
EPS Growth	25.2%	-6.0%	36.7%	5.4%	16.0%
DVD YLD	5.7%	4.7%	4.7%	4.7%	4.7%
ROE	14.5%	12.6%	12.3%	11.9%	12.5%
ROAE	15.5%	13.1%	14.3%	12.4%	13.1%
ROAA	3.3%	2.4%	2.8%	2.7%	2.8%
NIM	5.2%	4.7%	5.1%	5.9%	5.7%
Fee Income / Operating Income	33%	27%	26%	26%	27%
Cost / Income	44.2%	46.8%	48.7%	45.7%	46.5%
Cost / Income (Excl VAT)	36.0%	36.3%	38.4%	36.1%	36.5%
Cost / Average Assets	3.14%	2.92%	2.94%	3.15%	3.29%
Loan Growth	29.4%	30.6%	3.8%	7.8%	20.6%
Asset Growth	25.3%	30.6%	10.0%	8.9%	17.2%
Loan / Assets	71.6%	71.6%	67.6%	66.9%	68.9%
Deposits / Liabilities	20.0%	34.2%	26.0%	27.4%	27.5%
Equity / Assets	20.6%	17.0%	21.8%	21.7%	20.4%
NPL Ratio	4.95%	4.90%	6.57%	6.00%	6.00%
NPL Coverage	47.0%	27.0%	23.1%	34.0%	38.0%

Income Statement For the Year Ended 31st March	2005 Rs. 'mn	2006 Rs. 'mn	2007 Rs. 'mn	2008 Rs. 'mn	2009E Rs. 'mn	2010E Rs. 'mn
Income	5,167	6,255	8,105	11,724	13,216	15,365
Interest Income	3,936	5,076	7,019	10,497	11,694	13,535
Interest Expense	1,993	2,641	4,042	7,043	7,367	8,561
Net Interest Income	**1,943**	**2,435**	**2,977**	**3,454**	**4,328**	**4,973**
Other Income	1,231	1,179	1,086	1,227	1,521	1,830
Operating Income	**3,174**	**3,614**	**4,063**	**4,681**	**5,849**	**6,804**
Personnel Costs	460	559	673	838	990	1,150
Provision of staff retirement benefits	80	90	94	97	103	108
Premises, equipment & est. expenses	325	330	387	480	570	680
Other overhead Expenses	220	237	306	374	450	545
VAT on Financial Services	228	296	429	485	560	680
Goodwill written off - Associate	2	2	-	-	-	-
Goodwill written off - Subsidiary	57	57	-	-	-	-
Provision forBad and Doubtful Debts	246	177	83	359	375	420
Bad and Doubtful debts - General	(4)	23	42	217	210	225
Investment Securties losses	6	27	15	7	-	-
Operating Expenses	**1,690**	**1,862**	**2,001**	**2,646**	**3,048**	**3,583**
Operating Profit before income tax	**1,550**	**1,839**	**2,077**	**2,042**	**2,801**	**3,221**
Associate Co. Profit before tax	550	882	497	1,049	1,200	1,400
Profit before tax	**2,100**	**2,720**	**2,575**	**3,091**	**4,001**	**4,621**
Income tax expense	680	965	882	843	1,601	1,848
Minority Interest	71	67	107	79	115	120
Profit after tax	**1,348**	**1,688**	**1,586**	**2,168**	**2,286**	**2,652**

Balance Sheet As at 31st March	2005 Rs. 'mn	2006 Rs. 'mn	2007 Rs. 'mn	2008 Rs. 'mn	2009E Rs. 'mn	2010E Rs. 'mn
ASSETS						
Cash and Short Term Funds	1,021	1,469	5,872	3,702	4,083	4,520
Balances with Central Bank	283	694	479	611	672	740
Treasury bills and other securities	2,564	4,521	3,824	7,493	8,504	9,656
Securities purchased under resale agreements	1,460	797	689	753	829	911
Placements with other banks	276	866	996	1,472	1,619	1,781
Dealing Securities	-	14	26	18	26	26
Bills of exchange discounted	77	70	459	493	556	611
Loans	27,072	35,091	44,901	47,961	51,598	61,978
Finance Leases	4,166	5,362	7,546	6,481	7,068	8,857
Interest Receivable	284	338	587	700	1,355	1,705
Investment Securities	2,234	1,808	1,758	2,183	2,293	2,407
Investment in associate companies	3,251	3,749	4,116	6,396	7,008	7,768
Other Assets	1,507	984	1,771	1,974	1,909	1,674
Investment property	144	143	132	137	135	145
Goodwill on consolidation	204	147	147	147	147	147
Property and equipment	607	513	574	749	700	790
Total Assets	**45,150**	**56,566**	**73,878**	**81,270**	**88,499**	**103,717**
Liabilities						
Deposits from customers	6,427	8,885	20,817	16,353	18,806	22,567
Borrowings	24,416	30,931	33,182	38,724	41,478	50,603
Debentures	1,500	2,000	2,000	2,700	2,700	2,700
Interest Accrued	693	720	1,013	1,397	1,585	1,815
Other Liabilities	1,488	1,848	1,770	1,803	1,463	1,566
Subordinated Debentures	-	-	2,000	2,000	2,700	2,700
Total Liabilities	**34,523**	**44,384**	**60,781**	**62,976**	**68,732**	**81,951**
Equity						
Share Capital	574	576	866	1,302	1,298	1,298
Reserve Fund	305	481	549	674	549	549
Other Reserves	7,145	7,894	8,762	10,547	10,545	10,545
Share Premium	918	936	659	3,236	3,239	3,239
Retained Earnings	1,166	1,762	1,707	1,929	3,561	5,560
Shareholders equity	**10,108**	**11,649**	**12,542**	**17,688**	**19,192**	**21,190**
Minority Interest	515	531	555	606	576	576
Total equity and Liabilities	**45,150**	**56,566**	**73,878**	**81,270**	**88,499**	**103,717**