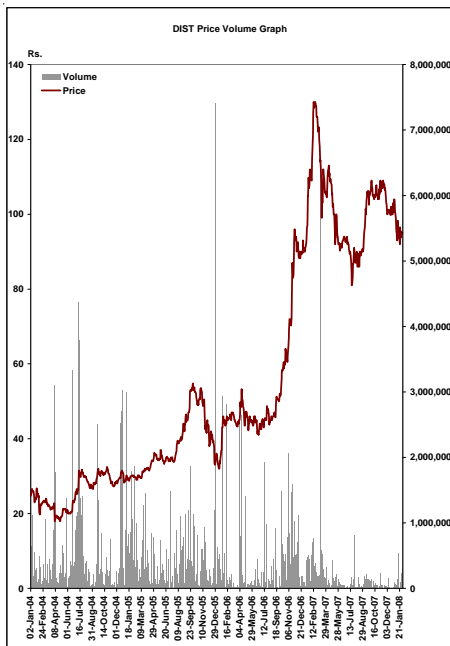




Distilleries Company of Sri Lanka Ltd (DIST)

Rs. 96.00



DIST			
Reuters Code	DIST.CM		
Bloomberg Code	DIST.SL		
Share Price LKR	96.00		
Issued Share Capital			
Voting Shares (Par Value Rs. 1.00)	300.0m		
12 mth High/Low (Rs.)	130.00 / 81.00		
Average Daily Volume (Shares)	113,055		
Market Capitalisation (Voting) Rs. mn	28,800		
Price Performance (%)			
	1 mth	6 mth	12 mth
ASPI	1.19	1.72	(17.70)
DIST	(2.29)	11.63	(26.15)

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February 2008

Financial Year	Turnover (Rs.m)	Net Profit (Rs.m)	EPS (Rs.)	EPS Growth %	PER (x)	Dividend Yield %	DPS (Rs.)
2003	13,454	880	2.93	44.50	32.73	0.47%	0.45
2004	19,729	1,236	4.12	40.42	23.31	0.52%	0.50
2005	26,619	1,596	5.32	29.16	18.05	0.52%	0.50
2006	35,588	2,934	9.78	83.84	9.82	0.63%	0.60
2007	46,769	3,696	12.32	25.98	7.79	0.63%	0.60
2008E	52,907	4,055	13.52	9.71	7.10	0.63%	0.60
2009E	61,565	4,923	16.41	21.39	5.85	0.63%	0.60

* Financial Year End - March

- ✓ The acquisition of fixed line telecom operator Lanka Bell, a 20% stake in Aitken Spence and an 85% stake in Sri Lanka Insurance Corporation (SLIC) has transformed Distilleries from a cash rich Beverage Sector play to a fully fledged Conglomerate with exposure to growth sectors of the economy including Financial Services, Leisure, Telecommunications, Power and Transportation.
- ✓ The cultivation of a loyal, quality conscious customer base has enabled DCSL to earn higher margins via price increases with no significant impact on volumes. Volumes in the beverage sector are expected to grow steadily between 7% - 9% from FY08 – FY09 with margins remaining stable on account of incremental increases in prices to match increases in excise, and increased volumes from sales in supermarkets. The sector continues to be burdened by the insignificant impact of government initiatives to curb the sale of illicit liquor and cheaper imitations of DSL's products. The sale of illicit liquor still accounts for approximately 60% of the hard liquor industry, indicative of the potential available to DCSL should authorities at the Excise Department succeed in cracking down on illicit liquor sales.
- ✓ The beverage sector recorded pre-exceptional earnings Rs. 1.89bn in FY07 and is expected to record flat earnings growth in FY08 and a modest rise of 12% in FY09.
- ✓ Transformation of SLIC under private management following the privatisation of the former state run monopoly insurer has begun to reflect in lower lapse rates and control of management expenses. High lapse rates of 40% in the first year and 70% after three years have declined to just 29% in the first year and 38% by the third year following a more incentivised agent compensation structure. Lapse rates although still high, compare favourably with competitors. In addition staff headcount has declined by 32% in the last three years with 60% of the decline in staff count being due to retirement, leading to further expense savings.
- ✓ Gross tsunami related losses amounted to Rs.2.18bn, however over 92% has been claimed back via reinsurance. Further, reinsurance terms have broadly remained following the tsunami allaying fears of higher reinsurance premiums.

- ✓ Gross Non Life premiums for SLIC are expected to grow annually at 18% to 20% over the next three years while Life Premiums are expected to grow at approximately 15% to 16% over the next 3 years. SLIC has continued to see a decline in market share in terms of Gross Written Premiums but remains the market leader in terms of assets under management. SLIC recorded earnings of Rs.0.56bn in FY07 down from Rs. 1.08bn in FY06. Earnings for FY07 were boosted significantly by foreign exchange gains, with the company's income from investment activities making up for underwriting losses stemming particularly from the motor insurance segment which accounts for 65% of the company's premium income. This has partly been a result of intense price competition that has led to the company's claims ratio rising. We expect SLIC to record lower earnings of Rs. 326mn in FY08. The company has also indicated a desire to float part of the company which we expect in the FY09.
- ✓ The acquisition of a 99% stake in Lanka Bell in June 2005 for approximately Rs. 2.6bn has proved to be a resounding success for the group, with the wireless fixed line operating posting earnings of Rs. 0.6bn in FY06 and Rs. 1.03bn in FY07 stemming from aggressive growth in its fixed line subscriber base following the roll out of its CDMA network. The company had invested significant resources in developing its brand and now commands a very strong nationwide brand presence. Lanka Bell had submitted a bid to the TRC, to enter the mobile segment as the 5th operator, due to the limited potential of a pure fixed line operator. The bid was however unsuccessful with the license being awarded to Bharti Airtel.
- ✓ The company also signed up with FLAG Telecom as the only landing station in Sri Lanka for its international fibre optic network as well as investing in a WiMax data network. Given the lower returns expected from these investments and the anticipated slow down in incremental subscriber growth in the fixed line segment, returns from DISTs' investment in Lanka Bell is expected to slowdown. We expect Lanka Bell to contribute earnings of Rs. 1.4bn in FY08 and Rs. 1.7bn in FY09 stemming from incremental growth in subscribers.
- ✓ Earnings from the plantation sector via the firm's 43% stake in Balangoda Plantations and a 31% stake in Madulsima Plantations are expected to record a significant improvement particularly in Balangoda Plantations despite wage increased with higher revenue stemming from record high tea prices partially fueled by the instability in Kenya. Earnings from its 20% stake in Aitken Spence is also expected to increase significantly in FY07 and FY08 following an increase in earnings from leisure, power and transport sectors.
- ✓ DIST also acquired a controlling interest in Lanka Hospitals Corporation (LHCL - Apollo Hospital) via SLIC's General Fund which now holds a 58% stake in the entity. Heavy operational costs and high borrowing costs has resulted in the Hospital repeatedly recording losses. The hospital posted losses of Rs. 154mn in FY07 and is expected to record losses of Rs. 40mn in FY08. A rights issue late announced in Dec-07 to raise Rs. 1bn would help wipe out debt in the company and should see the hospital recording earnings of Rs. 90mn in FY09.
- ✓ At 7.10x FY08E earnings, the counter is at a steep discount of 33.8% to the market. While in the short term the group's investments in SLIC and LHCL are not generating significant returns, the group still remains a cash rich and asset rich entity with the potential for further acquisitions.

- ✓ The company share price has risen considerably over the last three years reflecting the transition of DCSL from a pure beverage play into a conglomerate. Given potential for earnings growth through its exposure to the Financial Services, Leisure, Telecommunications, Power and Transportation Sectors and healthy cash flows from its Beverage Sector, coupled with its capacity for further acquisitions we believe the counter offers healthy prospects in the medium to long term.

Income Statement	2003	2004	2005	2006	2007	2008E	2009E
Year Ended 31st December	Rs. 'mn	Rs. 'mn	Rs. 'mn	Rs. 'mn	Rs. 'mn	Rs. 'mn	Rs. 'mn
Gross Turnover	13,454	19,729	26,619	35,588	46,769	52,907	61,565
Net Turnover	6,198	11,602	17,261	24,179	27,891	34,316	39,458
Cost of Sales	(4,873)	(8,493)	(13,896)	(18,176)	(20,091)	(22,889)	(27,495)
Gross Profit	1,325	3,109	3,365	6,004	7,800	11,428	11,963
Other Operating Income	111	2,789	4,126	4,682	5,366	5,711	6,506
Distribution Cost	(120)	(114)	(131)	(634)	(1,050)	(1,231)	(1,356)
Administrative Expenses	(442)	(677)	(2,065)	(2,257)	(3,893)	(4,999)	(5,694)
Increase in Life Fund		(2,450)	(2,761)	(2,951)	(3,321)	(5,345)	(4,500)
Other Operating Expenses	(21)	(633)	(369)	(520)	(5)	(61)	(82)
Operating Profit	854	2,024	2,166	4,324	4,898	5,503	6,837
Net Finance (Costs)/Income	129	(355)	(218)	(370)	35	(367)	(384)
Income from Associate	190	408	333	367	466	385	385
Profit Before Tax	1,173	2,077	2,281	4,321	5,399	5,520	6,839
Tax	(370)	(687)	(500)	(1,205)	(1,634)	(1,297)	(1,601)
PAT	803	1,390	1,781	3,117	3,766	4,223	5,238
Minority Interest	77	(155)	(185)	(183)	(69)	(168)	(315)
Profit Attributable to Shareholders	880	1,236	1,596	2,934	3,696	4,055	4,923

Balance Sheet	2003	2004	2005	2006	2007	2008E	2009E
As at 31st March	Rs. 'mn	Rs. 'mn	Rs. 'mn	Rs. 'mn	Rs. 'mn	Rs. 'mn	Rs. 'mn
Non-current Assets	4,413	24,371	26,126	27,913	41,296	43,407	47,557
Investment in Associates	1,315	1,744	1,951	2,261	2,615	2,615	2,615
Current Assets	3,759	20,592	25,246	31,712	29,761	37,281	43,080
Current Liabilities	(3,078)	(9,002)	(7,631)	(12,137)	(12,838)	(12,804)	(12,684)
Net Current Assets	681	11,590	17,614	19,575	16,923	24,477	30,395
Non-current Liabilities	(1,618)	(30,017)	(35,427)	(36,611)	(43,604)	(49,154)	(54,300)
Net Assets	4,790	7,688	10,263	13,139	17,229	21,345	26,268
Ordinary Shares	300	300	300	300	300	300	300
Revenue Reserves	3,346	5,118	6,731	9,092	12,357	16,412	21,335
Capital Reserves	193	378	873	1,492	1,965	1,965	1,965
Shareholders Funds	3,839	5,796	7,904	10,884	14,622	18,677	23,600
Minority Interest	951	1,892	2,359	2,255	2,607	2,668	2,668
Capital Employed	4,790	7,688	10,263	13,139	17,229	21,345	26,268