CHAIRMAN'S STATEMENT

"The widening of the overall tax base as opposed to excessively taxing some sectors, will be a necessary step towards placing the economy on a sounder footing and freeing the financial sector to perform its intermediary development role"

I am pleased to present the Annual Report for the financial year ended 31 March 2007 and welcome you to the Fifty First Annual General Meeting of DFCC Bank.

The year under review saw the Bank celebrating its Golden Jubilee, reminiscing its successes and achievements in a journey of fifty years through many different economic cycles. DFCC Bank can be justifiably proud of its transition from modest and obscure beginnings to one of prominence in Sri Lanka's banking industry today, as a robust, diversified financial services group. This has been made possible by a broader vision the Bank had in extending its scope of operations beyond the narrow confines of its original Charter. While the Bank's primary focus has continued to be long-term project finance, the Bank had over the years redefined itself and diversified into many other areas in response to developments in the external environment characterised by intense competition, narrowing margins and diminishing product differentiation within the banking sector.

The performance of DFCC Bank during the year under review, should be viewed in the context of the wider economic milieu. The financial year 2006/07 was an eventful one for both the Sri Lankan economy and the world economy. Fuelled by the rise of fast developing nations such as China and India, global GDP recorded another year of strong growth. Demand and speculation driven increases in commodity prices, notably the escalation of oil prices during the first half of the year in review, resulted in the emergence of inflationary trends.

The high inflation experienced in Sri Lanka during 2006, has been attributed both to these international supply-side factors and the increase in money demand due to the rapid expansion of credit to both the private sector and the Government. As a result of the Central Bank's efforts to curtail the burgeoning cost of living, policy interest rates were raised by 1.75% during the course of the financial year coupled with several other measures to tighten monetary policy, causing market interest rates to increase.

Notwithstanding the rapid increase in inflation and interest rates, the real sector of the Sri Lankan economy performed remarkably well during 2006. Real economic growth in 2006 registered 7.4%, the highest growth recorded since 1978 in the post-economic liberalisation period. All sectors of the economy contributed positively to this growth, with the services sector leading the way, while per capita GDP has increased appreciably and unemployment has reached its lowest ever level.

As we stride forward, sustaining this growth momentum will depend largely on encouraging investment. Although the Government's emphasis on countrywide infrastructure development and rural development is commendable, the deteriorating security situation is a cause for concern. Since the Ceasefire Agreement is no longer an effective deterrent to the upsurge in violence in many parts of the country and the perceived deterioration of law and order is causing international concern, confidence amongst local and foreign investors will be affected unless these adverse developments are arrested early.

In this respect, the onus is on the political leadership to set in place a stable economic environment and improved governance to facilitate sustained growth. Combating corruption, improving law and order whilst tackling terrorism and reducing the losses in state owned business undertakings, to free funds for infrastructure development will be paramount. Maintaining fiscal discipline and equitable financial policies will also be essential. In particular, the widening of the overall tax base as opposed to excessively taxing some sectors, will be a necessary step towards placing the economy on a sounder footing and freeing the financial sector to perform its intermediary development role.

Let me now comment on some aspects of DFCC Bank's financial performance during the year. Profit before Tax recorded significant growth at both Bank and Group level at 13% and 17.5% respectively. However, this growth is not translated to Profit after Tax where marginal declines were recorded due to considerably higher taxation, both on account of the financial services Value Added Tax (VAT) and the increased rate of Income Tax during the financial year 2006/07.

The subsidiary company, DFCC Vardhana Bank Limited, recorded good growth and contributed significantly to Group profits as did the associate company, Commercial Bank of Ceylon Limited, although the contribution to the Profit after Tax from the latter was somewhat lower than the previous year due to a pension plan restructuring expense.

The recent policy changes affecting ownership limits applicable to banks will require DFCC Bank to consider various options on the best way to provide the full range of banking and financial services in the longer term while preserving the value of the substantial investments in DFCC Vardhana Bank Limited and Commercial Bank of Ceylon Limited. The Board of Directors will formulate and execute appropriate strategies to accomplish these objectives.

In June 2006, a Bonus Issue of one for every two shares was made and an interim dividend of 45% was paid to shareholders in March 2007 on the enhanced capital. The Board also resolved to make a Rights Issue of one ordinary share for every four ordinary shares held at a price of Rs140/- per share and thereafter, to effect a Bonus Issue of one ordinary share for every five ordinary shares. The Board has also recommended a final dividend of 5% to be paid to shareholders on the enhanced capital.

The Rights Issue intended to raise Rs3,030 million of new capital to support the Bank's business expansion plans, Balance Sheet growth, maintain the Capital Adequacy Ratio above 12% in the light of recent and anticipated regulatory requirements and also to fund the subscription in full to the Rights Issue recently concluded by its associate company, Commercial Bank of Ceylon Limited.

The previous occasion on which the Bank sought new capital through a Rights Issue was far back in 1993. I am pleased to report that the Rights Issue was oversubscribed. The Bank also enhanced its regulatory capital by the issue of 5 to 10 year subordinated debentures amounting to Rs2,000 million.

Mr Rienzie T Wijetilleke, Chairman, Hatton National Bank Limited, who served on the Board of DFCC Bank since May 2001, did not seek re-election at the last Annual General Meeting held on 30 June 2006 in view of restrictions imposed by the amended Banking Act. We thank Mr Wijetilleke for his valuable contribution to Board deliberations with his long experience and insights in banking. I welcome to the Board Mr Gamini P Karunaratne, former Senior Deputy General Manager - Treasury of Hatton National Bank Limited, who was elected by the shareholders at the last Annual General Meeting in place of Mr Wijetilleke. I also welcome to the Board, Mr R Dalchow, Country Representative of KfW (German Development Bank), in Sri Lanka, as Alternate Director to Mr T Caglayan of German Investment Development Bank (DEG), Germany.

The Chief Executive Officer, Mr Nihal Fonseka, has once again given very able leadership to the management and staff of the Bank in coming up with a performance that is commendable when considering the context in which it was achieved. We take pride in the appointment of Mr Fonseka as the Chairman of the Colombo Stock Exchange in May 2006.

We are also very proud of our employees who have demonstrated excellent team spirit and exemplary work ethics in enabling a superior performance year after year.

As stated in the Chief Executive's Report and the Financial Review, the Bank was able to grow its total portfolio by 27% without compromising asset quality notwithstanding the high interest rates that prevailed. Thus, the Bank has succeeded in retaining its market share and competitive position though Profit after Tax has not grown due to changes to tax rates that had to be absorbed.

Once again our valuable client base has enabled us to record substantial growth in the grant of loans and leases and thereby, the outstanding portfolio. What is particularly noteworthy is a 21% growth in the number of clients in the year under review. Whilst thanking them for their business, we assure them of our commitment to improving our service standards even further.

I thank the officials of the Ministry of Finance and the Central Bank of Sri Lanka for their support and co-operation in enabling us to continue with our development banking role of assisting and nurturing business and industrial enterprises to prosper and grow.

Let me conclude by thanking you, the shareholders of the Bank, for the trust and confidence you have placed in our ability to guide and direct DFCC Bank to greater heights and in particular, for making our recent Rights Issue a success. On our part, we remain committed at all times to preserve and enhance the value of your shareholding.

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J M S BRITO
Chairman

28 May 2007