Chairman's Statement

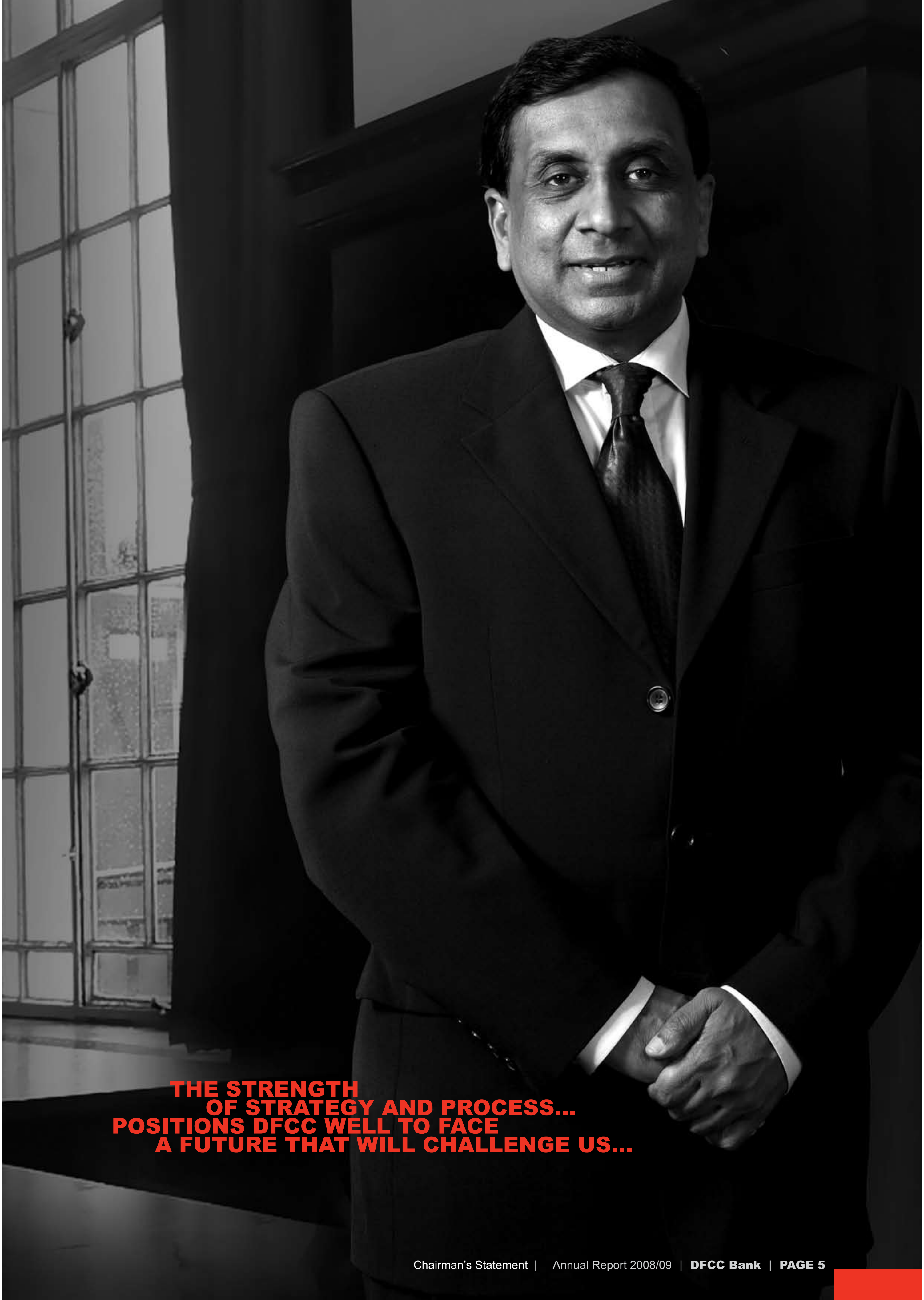
It is my privilege to present the Annual Report of DFCC Bank for the financial year ended 31 March 2009.

Much has been said and written of the worldwide economic crisis and its ramifications for Sri Lanka and I shall not elaborate on what has taken place. Even though the national economy was able to record a laudable 6% growth in the face of adversity, its renowned resilience has yet to experience tougher tests given that the global recession is still to fully impact Sri Lanka. The early effects have been felt with the slowdown in foreign demand stifling export industries and creating a deleterious domino effect that has infected the value and supply chain. Besides a halt in new investment, pay-cuts, work-hour cuts, labour lay-offs and closures have been effected by industries striving to curtail costs and conserve cash flows. Dependence on the global economy means that Sri Lanka's prospects are unlikely to improve in the short-term, given the prognosis for recovery in international markets. At the same time, the unprecedented success of the military action that has paved the way for future peace and prosperity deserves the highest appreciation by all Sri Lankans.

However, any immediate effort to revitalise the economy is likely to be limited by the Government's need to urgently address the financial deficits as well as rebuild cleared areas in the North and East. As such, while the peace dividend will materialise, the near-term outlook is indeed challenging in most respects.

The adverse economic environment also took its toll on the performance of the banking industry. Balance sheet growth was stifled as lending and deposit mobilisation slowed down. This was accompanied by a deterioration in credit quality. Although these developments were not unexpected, the situation was exacerbated by some high profile failures in the local financial services sector. Thankfully, the threatened crisis of confidence in the system was arrested by the swift response of the Central Bank. However, looking ahead, the landscape is likely to be challenging and a fundamental transformation to the financial system has to take place in order to augment and preserve its integrity as well as provide the wherewithal to absorb shocks and weather adverse times. In this context, the case for consolidation is strong, especially in the banking industry. Let us take just two aspects: on the one hand, there is the need for raising additional equity capital to strengthen the base for loan growth and customer support; on the other, there is the need for cost rationalisation and profitability enhancement through scale economy and operational homogeny. All these require a minimum critical mass and cannot be achieved efficiently, if at all, in a fragmented industry space occupied by many players.

I must also make reference to the high levels of taxation to which banks in Sri Lanka are subject to. The combination of Financial VAT and Corporate Tax is approaching 60% and in this scenario the Return on Equity is sub-optimal and not commensurate with the market risk as far as long-term investors are concerned. This means that the raising of equity capital, already a difficult feat under the currently depressed stock market conditions, may only be possible with a steep discount to fair value for most banks, even if the market was to improve substantially. While DFCC Bank and its commercial banking Subsidiary, DFCC Vardhana Bank Limited (DVB) are well positioned in terms of regulatory capital, the difficult outlook implies that the banking industry may be hard pressed to sustain loan growth and weather future shocks. I trust that the concerned authorities will take due heed of the emerging situation.



THE STRENGTH
OF STRATEGY AND PROCESS...
POSITIONS DFCC WELL TO FACE
A FUTURE THAT WILL CHALLENGE US...

Although the outlook is difficult, the opening up of the North and East of the country presents opportunities for the private sector and financial institutions to participate in the development of the North and East. At the initial stages, the activities to be focussed on could be agriculture, fisheries, small and medium industries, and trading. However, given the capacity limitations of the local institutions, larger public undertakings, particularly infrastructure projects, would need to be implemented with financial support from external multilateral agencies. Anyhow, in order to facilitate the involvement of the private sector, the Government's role is vital. As such, the shift of focus from the warfront to the economic front has to be achieved as soon as possible. In this context, the long awaited conclusion of the separatist war will create an environment that should enable all stakeholders to concentrate fully on the urgent development tasks at hand.

I would now like to briefly review the performance of DFCC Bank. Profit after tax at the Bank level was up 3% while that at the Group was down 8%. As could be expected, the adverse macro situation and the resulting slowdown in project investment took its toll on DFCC's core business of financing capital assets. At the same time, the Bank was mindful of the increasing stress on the cash flows and debt servicing capacity of customers, both existing and new, and the focus was proactively shifted from growing the lending portfolio to managing its quality. As part of this strategy, industry assessments were carried out with a view to effecting, where required, sector-wide restructuring of credit facilities in the case of businesses that were experiencing temporary cash flow difficulties. It is notable that DFCC was the first Bank to extend such a programme to the low country tea manufacturing industry. This enabled a much needed breathing space to several factory owners in the aftermath of the collapse of tea prices in late 2008.

DFCC was once again a recipient of an Annual Award by the Association of Development Financing Institutions in Asia & the Pacific. In recognition of its efforts to promote new technologies, DFCC was adjudged winner in the Technology Development Category for assisting a pioneering turbine manufacturing project.

At the Group level, the dip in profits reported by DVB reflected the increased level of provisioning for non-performing assets. Costs were also incurred as part of a strategy to invest in the expansion of its distribution network. This investment will duly bear a commensurate return and enable DFCC Vardhana Bank Limited to increase its future contribution to Group profit. Meanwhile, despite a challenging year, the associate company, Commercial Bank of Ceylon PLC, posted a solid performance and provided a substantial contribution to the Group. Even so, the total profit contribution from the subsidiary and associate companies was impacted by the Bank's share of the post - tax losses reported by Lanka Ventures PLC due to a prior year tax charge and Synapsys Limited, the IT subsidiary, which is in the capacity building phase.

Acuity Partners (Private) Limited, the equally-owned investment banking joint venture with Hatton National Bank PLC (HNB) and the newest member of the Group, formally began operations in July 2008. DFCC's contribution to the venture amounted to Rs250 million, which comprised a transfer of 100% of the shares of DFCC Stockbrokers (Private) Limited and the balance in cash. Acuity Partners (Private) Limited is carrying out the merged corporate finance and capital market businesses of the two Banks, and is the holding company for the stockbroking companies previously owned by DFCC and HNB, and the primary dealer company earlier owned by HNB.

During the year, much effort was directed towards the areas of risk management and corporate governance and further details are given in the relevant sections of the Annual Report.

As you are aware, the ownership limits on banks require DFCC to reduce its ownership in DVB to 15% by 2012. We are regarding this as an opportunity to transform the Bank and recast the Group to be well positioned to meet the challenges ahead while maximising value to shareholders. All available options are being considered and studied with a view to selecting the strategy that would best achieve these objectives. In the meantime, DFCC and DVB would be working closely to develop further synergies in common operational areas such as credit approval and administration, finance and risk management. As regards DFCC's shareholding in Commercial Bank of Ceylon PLC, which DFCC was directed to reduce to 15% by October 2008, the Board is awaiting the outcome of court proceedings seeking time until 2012 to effect the reduction. In the meantime DFCC will abide by the consequential provisions of the Central Bank direction that limits its voting rights to 10% and other restrictions imposed by court on voting arising from other litigation relating to the same matter.

Messrs Gamini Karunaratne (Shareholder Director) and Reinhard Dalchow (alternate Shareholder Director) resigned from the Board in October 2008 and March 2009 respectively. I thank them for their valued contribution and wish them well. I also thank my fellow Directors for their unstinted co-operation, and will count on their support and guidance in taking DFCC Bank forward.

The Chief Executive Officer, Mr. Nihal Fonseka, has once again successfully led DFCC's team in a performance that was creditable given the challenging environment. The commitment from all ranks of employees remains steadfast and I am very confident that this will enable DFCC to prosper as one of the most productive corporate entities in Sri Lanka. My thanks go out to all and my expectations for their future efforts are high.

Our valued clients are a cornerstone of the Bank's success. I thank all for their loyalty and regard for DFCC as the preferred long-term financier. We look forward to extending our support, maintaining a mutually advantageous relationship and facilitating their success.

DFCC has long enjoyed the support of the officials of the Ministry of Finance and the Central Bank of Sri Lanka. We are appreciative of their support and would be relying on their assistance and co-operation in the future.

As Shareholders, you have displayed faith in our ability to guide and direct DFCC and I, together with my fellow Directors, thank you for your conviction. The way ahead for the DFCC Group will be challenging but also full of promise and we assure you that under our stewardship, the enhancement of the value of your shareholding would be a top priority.

JMS Brito

J M S Brito
Chairman
27 May 2009