

19th January 2009

## **DFCC BANK**

## *Valuation Update*

### **Recommendation**

**Buy**

**Ticker  
DFCC**

**Target Price  
Rs.100**

**Current Share  
Price\*  
Rs 63.00**

**Market Cap\*  
Rs 8,497,610,752**

**ASPI\*  
1,628**

**MPI\*  
1,737**

**Analyst  
Varuni de Silva**

\*CSE DATA as at 15<sup>th</sup>  
January 2009

- ◆ As before our buy recommendation on DFCC is based on the valuation mismatch considering DFCC's & Commercial Banks cross ownership.
- ◆ At current market prices the market value of DFCC's holding in COMB amounts to 57% of DFCC's market capitalisation.
- ◆ DFCC's market capitalisation excluding the stake in Commercial Bank is Rs 3.5 billion. Therefore the operations in DFCC are valued at P/E ratio of 2.9 times and P/B ratio of 0.30 times.
- ◆ We believe that even at present depressed market conditions it is irrational for DFCC to trade at such a deep discount
- ◆ Since our last Buy recommendation on DFCC the ASPI has decreased by 36% and the MPI has decreased by 46%. During the same period both DFCC's and Commercial banks share price has declined by 50%.

**Results Review for the six months ended 30<sup>th</sup> September 2008**

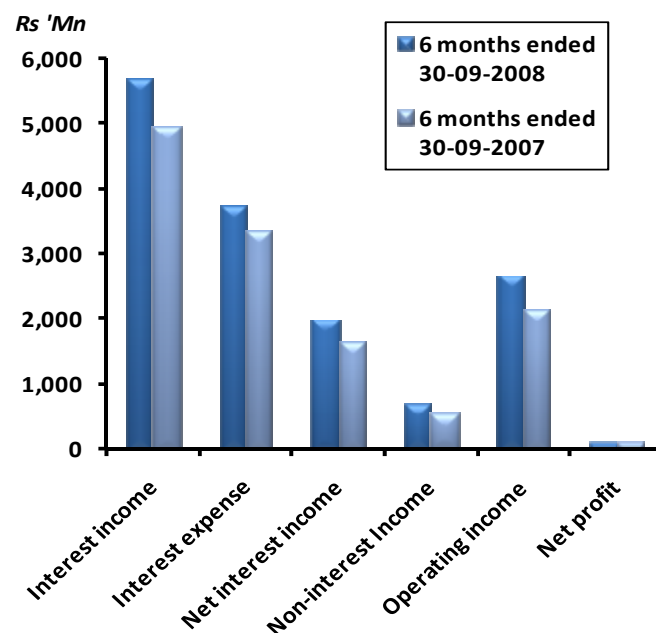
DFCC's interest income grew by 15% YOY and interest expenses grew by 12% YOY during the six months period under review. The net interest income recorded during the period was Rs.1,967 million. This represented a growth of 21% YOY. For the quarter ended 30<sup>th</sup> September 2008 the net interest income recorded was Rs1,049 million. This represented a growth of 14% QOQ.

Non interest income decreased on QOQ basis in the second quarter by 11%. However on YOY basis the non interest income for the quarter ended increased by 5%. For the six month period, non interest income recorded was Rs 696 million. This represented a growth of 34% YOY basis.

The total operating income recorded during the six month period increased by 24% to reach Rs 2,663 million. For the quarter total operating income recorded was Rs.1,378 million. On a QOQ basis this was an increase of 7%.

Operating expenses (non interest expenses) during the six month period was Rs.957million. This represented a growth of 23% YOY.

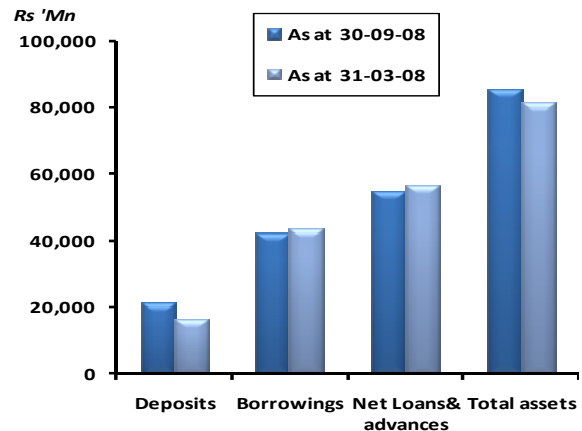
Provisions during the six month period ended increased by 173% YOY. During the same period DFCC's total non performing loans increased by 32% and the gross nonperforming loans ratio increase from 7.3% to 8.5%



<b>Results Summary (Rs' million)</b>	<b>6 months ended 30-09-2008</b>	<b>6 months ended 30-09-2007</b>	<b>YOY Growth</b>
Total interest income	5,698	4,956	15%
Total interest expense	3,730	3,330	12%
<b>Net interest income</b>	<b>1,967</b>	<b>1,626</b>	<b>21%</b>
Non-interest Income	696	520	34%
<b>Operating income</b>	<b>2,663</b>	<b>2,145</b>	<b>24%</b>
Operating expenses	957	779	23%
<b>Profit before provision</b>	<b>1,706</b>	<b>1,366</b>	<b>25%</b>
Provisions	383	140	173%
<b>Profit from operations</b>	<b>1,323</b>	<b>1,226</b>	<b>8%</b>
VAT	324	207	57%
<b>Associate profit</b>	<b>537</b>	<b>514</b>	<b>4%</b>
	1,536	1,533	0%
Less: Income tax expense	562	406	38%
<b>Net Profit</b>	<b>974</b>	<b>1,127</b>	<b>-14%</b>

Mainly due to the increase in provisions net profit for the six month period ended decreased by 14% on YOY basis. For the quarter ended the net profit recorded was Rs 432 million. On a QOQ basis net profits saw a decline of 20%.

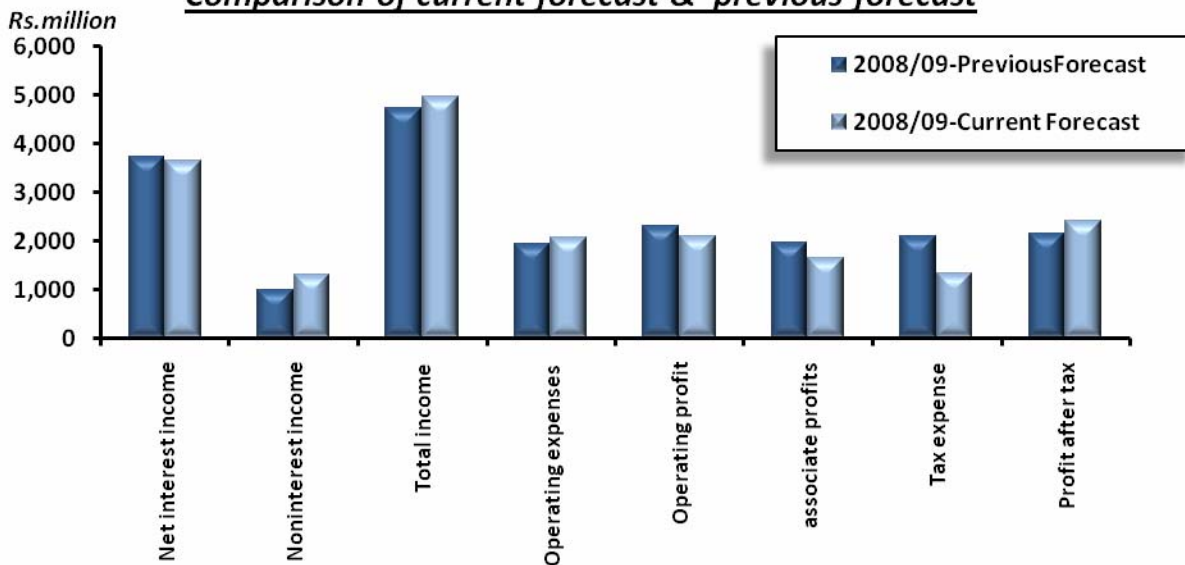
Results Summary (Rs' million)	As at 30-09-08	As at 31-03-08	Growth
Deposits	21,101	16,353	29%
Borrowings	42,239	43,424	-3%
Net Loans & advances	54,973	56,331	-2%
Total assets	85,111	81,270	5%
Non performing loans & advances	6,249	4,731	32%



### Group Forecast – Update

GROUP FORECAST	2005/2006	2006/2007	2007/2008	2008/2009F	2009/2010F	2010/2011F
Total interest income	5,076	7,019	10,497	11,030	11,437	12,737
Total interest expense	2,641	4,042	7,043	7,385	7,689	8,763
<b>Net interest income</b>	<b>2,435</b>	<b>2,977</b>	<b>3,454</b>	<b>3,644</b>	<b>3,748</b>	<b>3,974</b>
Non-interest Income	1,179	1,086	1,226	1,325	1,441	1,656
<b>OPERATING INCOME</b>	<b>3,616</b>	<b>4,063</b>	<b>4,680</b>	<b>4,970</b>	<b>5,189</b>	<b>5,629</b>
	-	12%	15%	6%	4%	8%
<b>OPERATING EXPENSES</b>	<b>1,302</b>	<b>1,474</b>	<b>1,796</b>	<b>2,065</b>	<b>2,375</b>	<b>2,731</b>
Provision for loan losses	177	83	359	790	(104)	134
<b>PROFIT FROM OPERATIONS</b>	<b>2,137</b>	<b>2,506</b>	<b>2,527</b>	<b>2,115</b>	<b>2,919</b>	<b>2,764</b>
		17%	1%	-16%	38%	-5%
<b>Associate profit</b>	<b>882</b>	<b>497</b>	<b>1,049</b>	<b>1,650</b>	<b>1,649</b>	<b>1,890</b>
TAX	1,262	1,311	1,328	1,352	1,677	1,686
<b>PROFIT FOR THE PERIOD</b>	<b>1,757</b>	<b>1,693</b>	<b>2,247</b>	<b>2,414</b>	<b>2,891</b>	<b>2,968</b>
		-4%	33%	7%	20%	3%
GROUP FORECAST	2005/2006	2006/2007	2007/2008	2008/2009F	2009/2010F	2010/2011F
<b>Basic EPS</b>	19.58	18.32	16.65	17.81	21.34	21.90
<b>EPS growth%</b>		-6%	-9%	7%	20%	3%
<b>DPS</b>	6.00	5.00	5.00	5.17	5.75	5.90
<b>Div pay out ratio</b>	20%	26%	29%	28%	26%	26%
Net Loans and Advances	40,791	53,034	56,331	54,903	63,105	72,283
		30%	6%	-3%	15%	15%
<b>Deposits</b>	8,885	20,817	16,353	21,258	24,447	28,114
		134%	-21%	30%	15%	15%
<b>Total assets</b>	56,566	73,878	81,270	85,990	97,127	109,670
		31%	10%	6%	13%	13%
<b>Shareholders' equity</b>	12,180	13,097	18,294	18,525	20,665	22,861
		8%	40%	1%	12%	11%

**Comparison of current forecast & previous forecast**



**Valuation Update**

As before we have valued DFCC by looking at the value of DFCC excluding its stake in COMB

With DFCC's stake in Commercial Bank (COMB) being a dominant driver behind DFCC's value, we have looked at the implied valuation of DFCC excluding the component related to the value of COMB. DFCC's stake in COMB, at the current market price of Rs.75.00, has a value of Rs 4.7 billion. With DFCC at a price of Rs.63.00 and having a market capitalisation of Rs8.2 billion, there is an implied value of Rs 3.5billion placed in DFCC's core operations excluding its stake in COMB.

If we remove the COMB component, DFCC would have recorded a profit after tax and minority interest of Rs1,199 million in 2007/8. Thus the non COMB segment of DFCC operations is trading at an implied historic price earnings multiple of 2.9 times.

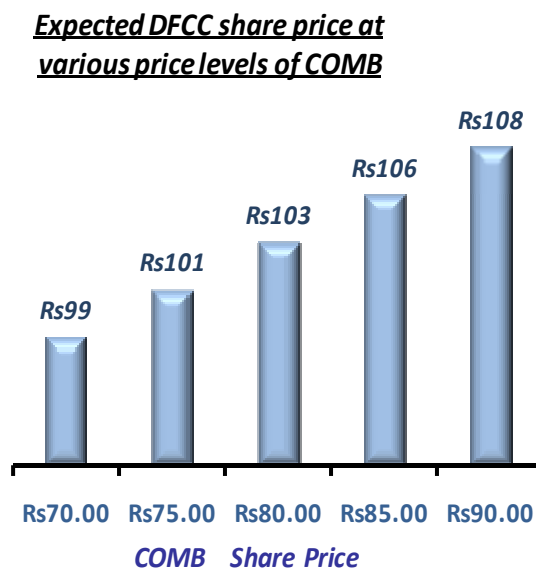
In terms of DFCC's book value, if we subtract the value that the COMB investment is carried in DFCC's accounts from our forecast of DFCC banks total book value , the remaining assets of DFCC have a book value of Rs 12.17 billion .

This suggests an implied historic price to book ratio of 0.29 times for DFCC, excluding its stake in COMB.

<b>COMB Share price (Rs)</b>	<b>Mkt Cap of DFCC excluding COMB @ Rs.75.00 (Rs.million)</b>	<b>Implied share price of DFCC excluding COMB value @ Rs.75.00 (Rs)</b>	<b>Price to Book value Ratio of DFCC excluding COMB</b>
70.00	3,817	29.19	0.31
75.00	3,501	26.78	0.29
80.00	3,185	24.36	0.26
85.00	2,870	21.95	0.24
90.00	2,554	19.54	0.21

Bearing in mind the current market situation, it would be more prudent to consider that DFCC's own operations should at least trade at a discount of 80% to our forecasted book value price for 2008/2009 period plus the current market price of COMB shares market value. Thus the our new target price for DFCC share is Rs.100.

<b>COMB Share price</b>	<b>Expected DFCC Share price</b>
70.00	98.57
75.00	100.98
80.00	103.40
85.00	105.81
90.00	108.23



<b>PBR of DFCC excluding COMB</b>				
<b>COMB Share price</b>	<b>DFCC Share price</b>			
	60.00	63.00	70.00	75.00
70.00	0.28	0.31	0.39	0.44
75.00	0.26	0.29	0.36	0.42
80.00	0.23	0.26	0.34	0.39
85.00	0.20	0.24	0.31	0.36
90.00	0.18	0.21	0.29	0.34

**CAPITAL ALLIANCE**

5<sup>th</sup> Floor, Millennium House, 46/58, Nawam Mawatha, Colombo 2, Sri Lanka

Tel: +94 11 231 7766, Fax: +94 11 231 7788

For further information, please contact:

**Lakshan Algama Perera: +94 777 447 407**

**Harsha Gunawardena: +94 11 231 7716**

**K. H. R. Thilakarathna: +94 11 231 7752**

**W. A Susantha: +94 112 317757**

**Milanka Induruwage: +94 777 261 893**

**Sandeep Fernando: +94 11 231 7716**

**Husna Rafeek: +94 11 231 7722**

**Mangala Perera: +94 11 231 7717**

**Dumindu Silva: +94 11 2317753**

**Milindu Arumawadu: +94 77 359 3044**

**Chanaka Sanoj: +94 11 231 7755**

**Lulith Karunaratne (Matara) : +94 41 439 0610**

**Inok Wijesuriya (Matara):+94 41 439 0610**

**B. Mugundan ( Jaffna ): +94 21 459 1111**

**T. Dananjaya( Negombo) : +94 31 222 7843**

**Sanathana Perera: +94 112 317742**

*The analyst responsible for producing the report does not work for Capital Alliance Securities (Private) Ltd. This report has been produced as part of an outsourced research relationship with a specialized research company engaged by Capital Alliance Securities (Private) Ltd. This document has been prepared and issued on the basis of publicly available information, internally developed data and other sources, believed to be reliable. Capital Alliance Securities (Private) Limited however does not warrant its completeness or accuracy. Opinions and estimates given constitute a judgment as of the date of the material and are subject to change without notice. This report is not intended as an offer or solicitation for the purchase or sale of any financial instrument. The recipient of this report must make their own independent decision regarding any securities, investments or financial instruments mentioned herein. Securities or financial instruments mentioned may not be suitable to all investors. Capital Alliance Securities (Private) Limited it's directors, officers, consultants, employees, outsourced research providers associates or business partner, will not be responsible, for any claims damages, compensation, suits, damages, loss, costs, charges, expenses, outgoing or payments including attorney's fees which recipients of the reports suffers or incurs directly or indirectly arising out actions taken as a result of this report. This report is for the use of the intended recipient only. Access, disclosure, copying, distribution or reliance on any of it by anyone else is prohibited and may be a criminal offence.*