Financial Capital

Financial performance

Overview

DFCC Bank ended the year 2018 with mixed positives. The total asset base of the Bank grew by 13% year-on-year to LKR 374,908 Mn with loans and receivables of LKR 249,734 Mn as at the year end. The deposit base experienced a substantial growth of 25% recording an increase of LKR 48,930 Mn to end the year at LKR 242,238 Mn, while the CASA (Current Accounts and Savings Accounts) ratio slightly improved to 21.8% compared to last year.

As a result of the challenging business environment that prevailed during the year, DFCC Bank's NPL ratio moved up to 3.28% as at 31 December 2018 from 2.77% in December 2017. The ratio was however managed at a level below the industry average of 3.4% as at December 2018.

Profitability

DFCC Bank PLC, the largest entity within the Group, reported a profit before tax of LKR 4,233 Mn and a profit after tax of LKR 2,768 Mn for the year ended 31 December 2018. This compares with a profit before tax of LKR 5,792 Mn and a profit after tax of LKR 4,415 Mn in the previous year. The profit for 2018 however includes a one-off fair value loss on Commercial Bank shares transferred to the trading portfolio and the recently introduced debt repayment levy (DRL) imposed on the value addition on financial services, while the profit for 2017 includes a gain from the sale of Commercial Bank shares. When the loss and gain on account of the Commercial Bank shares and the DRL are eliminated for an equitable comparison, the resultant profit after tax reflects a growth of 10% over 2017 (as detailed in Table 1).

The Group recorded a profit before tax of LKR 4,676 Mn and profit after tax of LKR 3,070 Mn for the year ended 31 December 2018 as compared to LKR 5,891 Mn and LKR 4,434 Mn respectively in 2017. All members of the DFCC Group made positive and improved contributions to this performance.

Net interest income

The Bank's total income for the year 2018 was LKR 39,154 Mn recording an increase of 9%. The interest income consists of 97% of the total income of the Bank. Following a judicious growth strategy which took into consideration the challenging environment faced by the country, DFCC Bank recorded a year-on-year growth of 17% in its net portfolio which when coupled with prudent management of asset and liability pricing, enabled the Bank to achieve this growth.

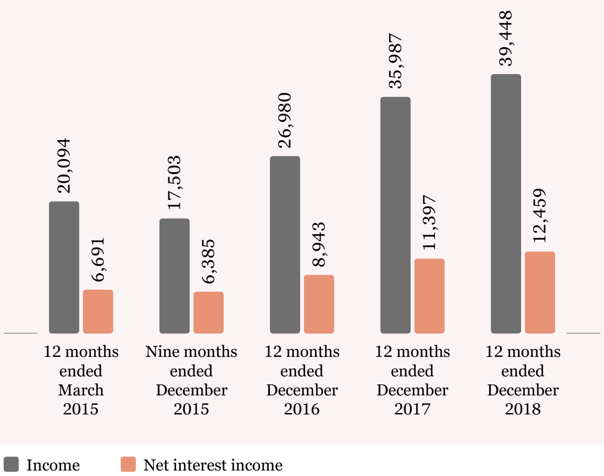
The Bank's net interest income recorded a credible growth of 9% to LKR 12,415 Mn from LKR 11,343 Mn in 2017 in spite of adopting a policy of non-recognition of income on credit impaired loans during the year. The interest income grew by 16% to LKR 38,148 Mn while the total interest expenses increased by 19% to LKR 25,733 Mn due to the significant growth of LKR 48,930 Mn in fixed deposits during the year. As a result, the interest margin decreased marginally to 3.5% from 3.6% in 2017.

Fee and commission income

Growth in overall business segments, introduction of new products based on changing needs of customer profiles and expanding delivery through electronic channels and other means helped the Bank to record a 26% growth in net fee and commission income. Fees generated from loans and advances, and from services provided through customer accounts accounted for the majority of the increase. Fees collected from trade-related services, Remittances, issue of Guarantees and Bancassurance services grew during the year.

The Bank's credit card income recorded a moderate growth. DFCC Bank created history by becoming the first bank in Sri Lanka to be certified for Visa's QR Payment Solution. This move would add more value to the customer convenience and will open up considerable growth in earnings from this important business line.

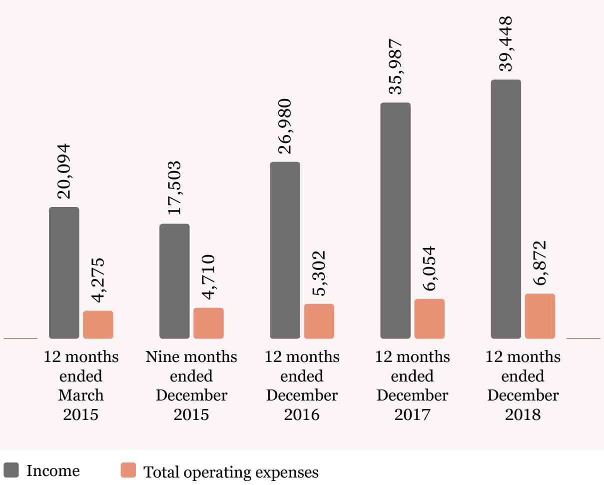
Income (Group)
LKR Mn



Impairment charge on loans and other losses

With the adoption of SLFRS 9 which replaces the "incurred loss" model with the "expected credit loss" model, the Bank recognised LKR 3,700 Mn as the first day impact to its equity base at the beginning of the year. Even though the individual impairment increased to LKR 1,084 Mn from LKR 724 Mn in the year 2017, the overall impairment charge including the collective impairment for the year was LKR 1,056 Mn compared to LKR 1,176 Mn in 2017. Recovery processes are being rigorously pursued to minimise any actual losses that may arise from the specific exposures.

Total income to operating expenses (Group)
LKR Mn

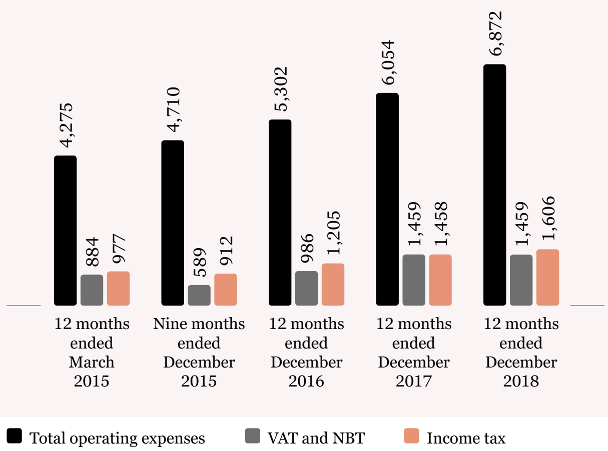


Operating expenses

As part of its growth strategy, DFCC Bank continuously invests in its infrastructure. During the year, the Bank increased its branch network, expanded its product base and created multiple channels for service delivery, which contributed towards an increase in revenue streams, deposit growth and the Bank's customer base.

The incremental cost that was incurred as a result of this growth in business contributed to a 14% increase in operating expenses. However, careful monitoring and effective cost control measures adopted during the year helped to maintain the increase at a moderate level and resulted in a cost to income ratio of 49.7% for 2018.

Expenses (Group)
LKR Mn



Profit after tax (PAT)

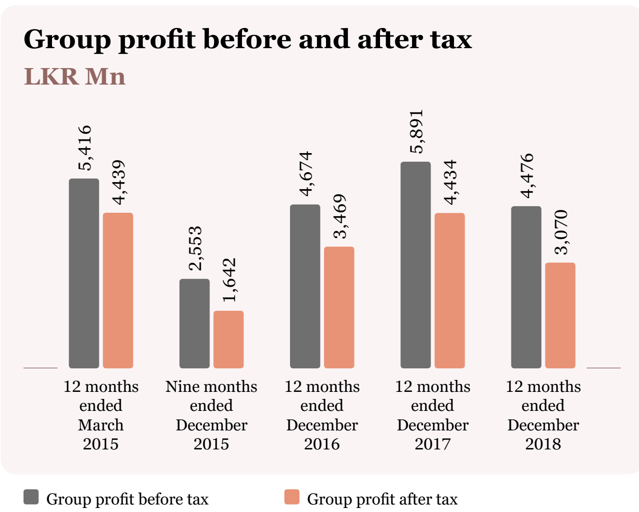
The Bank reported a profit after tax of LKR 2,768 Mn, a decline of 37% from LKR 4,415 Mn in the year 2017. The Group profit after tax attributable to equity holders of the Bank decreased by 31% to LKR 3,011 Mn compared to LKR 4,362 Mn in the year 2017.

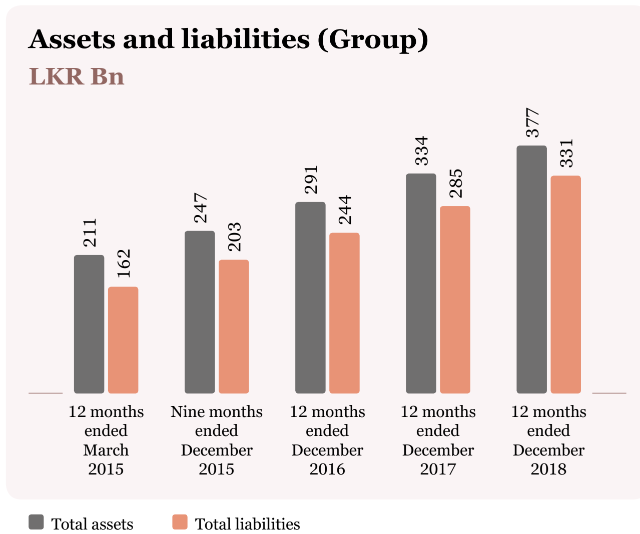
However, when the loss and gain on account of the Commercial Bank of Ceylon shares and the debt repayment levy are eliminated for an equitable comparison as indicated in Table 1 below, the resultant profit after tax of the Bank is LKR 3,851 Mn for 2018 and LKR 3,498 Mn for 2017, reflecting a growth of 10% over last year.

Table 1

For the year ended 31 December	2018 LKR 000	2017 LKR 000	Change %
Profit for the year – reported	**2,768,179**	4,414,964	(37)
Marked to market loss on CBC shares, net of taxes (Note a)	**870,559**	–	–
Gain on sale of CBC shares, net of taxes (Note b)	–	(917,120)	–
Debt repayment levy – effective from 1 October 2018	**212,549**	–	–
Adjusted profit for the year	**3,851,287**	3,497,844	10
(a) Marked-to-market loss on CBC shares, net of taxes			
Net marked-to-market loss on equities (Note 12)	**1,018,554**	–	
Less: VAT and NBT on financial services	**145,995**	–	
	870,559	–	
(b) Gain on sale of equity securities, net of taxes			
Gain on sale of equity securities (Note 15)	–	1,073,030	
Less: VAT and NBT on financial services	–	155,910	
	–	917,120	

CBC – Commercial Bank of Ceylon PLC





Financial position analysis

Assets

The Bank's total asset base as at 31 December 2018 grew by 13% to LKR 374,907 Mn from LKR 333,107 Mn as at 31 December 2017. The growth of the asset base was mainly as a result of the growth of LKR 36,058 Mn in loans to and receivables from other customers.

The term loans recorded the highest growth of LKR 26,064 Mn out of the total growth in loans to and receivables from other customers, followed by trade finance with a growth of LKR 10,164 Mn.

DFCC Bank was the major contributor to the asset base and the Group's total asset base increase was the same as that of the Bank.

Liabilities

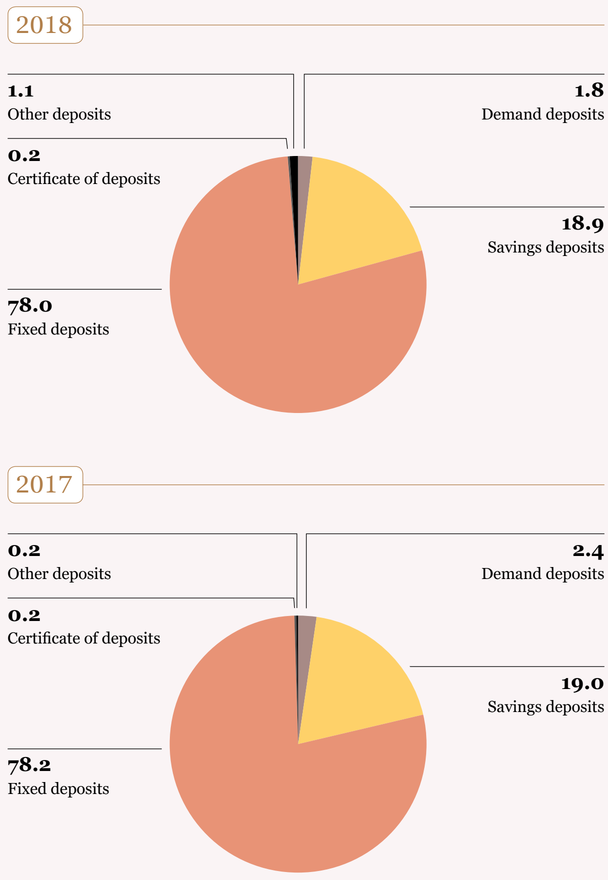
The liabilities increased by 16% over the previous year to LKR 331,061 Mn as at the year end. The main increase was due to the substantial growth of LKR 48,930 Mn in customer deposits and the increase in subordinated term debt of LKR 7,653 Mn. In October 2018. The Bank was also able to successfully repay the International Bond of USD 100 Mn.

With the increased deposit growth, DFCC Bank was able to report an improved loan to deposit ratio of 103% from 110% in December 2017. The Bank's CASA ratio, which represents the proportion of low cost deposits in the total deposits of the Bank, was 21.8% as at 31 December 2018. Funding costs for DFCC Bank were also contained due to access to medium to long-term concessionary credit lines. When these concessionary term borrowings are added to deposits, the ratio improved to 28.6% as at 31 December 2018.

DFCC Bank continued its approach to tap local and foreign currency related, long to medium-term borrowing opportunities. This has increased other borrowings by LKR 6,094 Mn during the year under review.

Deposit mix (Group)

%



Equity and compliance with capital requirements

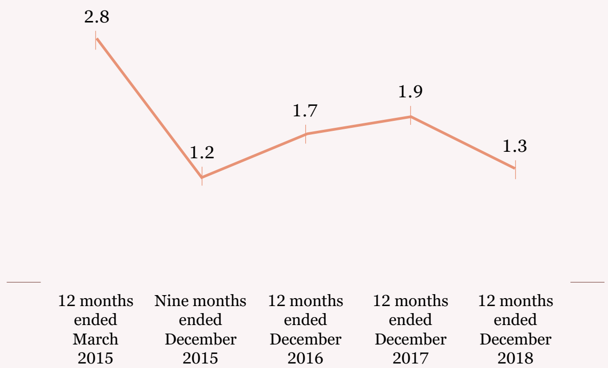
DFCC Bank's total equity decreased to LKR 43,846 Mn as at 31 December 2018 from LKR 47,877 in December 2017. The main contributor to the decrease was the drop in fair value of equity securities and fixed income securities.

The basic earnings per ordinary share of the Bank decreased to LKR 10.44 in 2018 from LKR 16.65 in 2017. The Bank's return on equity (ROE) reduced to 6% in 2018 from 9.4% in 2017. The Bank's return on assets (ROA) before tax was 1.2% compared to 1.9% in the previous year. Furthermore, the Bank's net asset value per share was down by 13% to LKR 165.40 from LKR 180.60 in 2017.

DFCC Bank has consistently maintained a capital ratio above the Basel III minimum capital requirements. As at 31 December 2018, the Group's Tier 1 capital adequacy ratio stood at 10.88% while the total capital adequacy ratio was 16.17%. On a solo basis, as at 31 December 2018, DFCC Bank recorded Tier 1 and total capital adequacy ratios of 10.77% and 16.07% respectively. These ratios are well above the minimum regulatory requirements of 8.5% and 12.5% effective January 2019.

Return on Assets (Group)

%



Return on Equity (Group)

%

Credit quality

During the year, DFCC Bank was successful in growing its loan book covering corporate, retail and small and medium-term business segments. The expansion into new geographical areas and new customer segments increased the challenge to maintain a sustainable risk profile. The Bank continued to improve its pre and post credit monitoring mechanisms through changes to internal processes and timely actions. This has brought positive results in maintaining credit quality.

Dividend policy

The Banking industry faced many challenges during the year; both from business and regulatory fronts. The adverse weather conditions and political upheaval that prevailed during the year became constraints for the growth of returns on equity. The minimum capital requirements became more stringent with the adoption of BASEL III. Other factors which affected were impact on the adoption of the new accounting standards and the introduction of the new tax laws. Based on the medium term projected growth plan, the Bank has projected an asset base of over LKR 500 Bn and above to be achieved by year 2021, with the intention of becoming a systematically important domestic Bank. This will result in the need to maintain an increased Tier 1 ratio of 10% by 2021. The Board of Directors after considering all of the above has approved a dividend of LKR 3.50 per share for the year ended 31 December 2018.

Group performance

The DFCC Group consists of DFCC Bank PLC and its subsidiaries; DFCC Consulting (Pvt) Limited, Lanka Industrial Estates Limited (LINDEL), Synapsys Limited, its joint venture company Acuity Partners (Pvt) Limited (Acuity) and its associate company National Asset Management Limited (NAMAL). LINDEL is a 31 March reporting entity whilst the others are 31 December reporting entities. For the purpose of consolidated financials, 12 months results from 1 January to 31 December 2018 were accounted for in all Group entities. Financials of the 31 March entity was subject to a review by its External Auditor covering the period reported.

The Group made a profit after tax of LKR 3,070 Mn during the year ended 31 December 2018. This is compared to LKR 4,434 Mn made in the year 2017. DFCC Bank accounted for majority of the Group profit with profit after tax of LKR 2,768 Mn while LINDEL (LKR 121.2 Mn), Acuity (LKR 304.7 Mn), Synapsys (LKR 9.5 Mn) and DFCC Consulting (LKR 24.8 Mn) contributed positively by way of profit after tax to the Group. In the previous year, Acuity, DFCC Consulting and LINDEL reported profit after tax of LKR 175.6 Mn, LKR 1.7 Mn and LKR 146.1 Mn respectively. Synapsys reported a loss of LKR 10.2 Mn. The associate company, NAMAL contributed LKR 2.4 Mn to the Group down from LKR 9.4 Mn in the year 2017. An Inter-company dividend of LKR 132 Mn was paid to DFCC Bank by LINDEL (LKR 70.3 Mn), DFCC Consulting (LKR 1.5 Mn) NAMAL (LKR 27 Mn) and Acuity (LKR 33.2 Mn) during the year.

DFCC Bank's business unit performance

Corporate banking

In furtherance to the gradual transition of DFCC Bank from a traditional development bank to a modern dynamic and fully-fledged commercial bank, the Corporate Banking Unit aggressively perused a growth strategy in its commercial banking portfolio during the year. This resulted in a broadening of its commercial banking clientele across a variety of industries and financing needs. The Unit was also successful in converting several traditional term loan customers of the Bank into carrying out commercial banking transactions, resulting in higher non-interest income, whilst providing customers with greater convenience as a one-stop-shop for all its financing needs.

Continuing the drive to build up a sizeable offshore lending portfolio, the Bank granted term loan facilities to two hotel companies in the Maldives during the year-one a greenfield resort project and the other a refurbishment and upgrade of two existing resorts. In addition, the Bank extended a guarantee facility to a contractor engaged in landscape services to world class resort developers in the Maldives. With its footprint already established in the Maldives, DFCC Bank's focus for off-shore lending in 2019 will be in perusing opportunities in other countries in South Asia in addition to East Africa.

Recognising the importance of the dairy sector to the Sri Lankan economy, the Bank extended a loan facility to a 2,000 head dairy project at Ambewela which aims to supply fresh milk both for direct consumption as well as for further processing into other forms of dairy-based products. This project is expected to deliver 20 million liters of fresh milk at its peak capacity and will use the most modern automated dairy farming machinery sourced from Europe. The project will substitute approximately 2,300MT of imported milk powder per annum saving the country valuable foreign exchange.

The Unit strongly believes in maintaining a cordial and mutually beneficial business relationship with its clientele. To this end, several customer functions were held during the year to further the business relationships with its clientele.

Despite the challenging operating environment during the year, corporate banking recorded a portfolio growth of LKR 21,641 Mn during 2018.

As a testament to the prudential measures adopted in granting credit and the stringent continuous monitoring of credit facilities granted, the Unit maintained its non-performing ratio at 0.01%.

With the launch of the DFCC iConnect Payments and Cash Management Solution, the Bank is now in a position to offer a complete banking solution to meet the needs of every customer. The Unit will focus on capitalising on the technological leadership of the iConnect product to attract more customers to carry out commercial banking activities with DFCC Bank, and to support the drive to build a stronger CASA base for the Bank through collection accounts. The Unit will also utilise the corporate contacts as a channel for promoting PFS and card products to the employees of its corporate clientele.

Business banking

A mix of lower-end corporate customers, high-end SME customers and retail customers are served through the Business Banking Unit. The Unit offers a range of comprehensive development banking, commercial banking and retail banking products to customers. The fund based products include greenfield project financing, term loans for construction of buildings/factories, and permanent working capital funding. Fee based products offered by the Unit include Letters of Credit and Guarantees to cover transaction related contingencies. Leasing facilities, housing loans, and personal loans are offered to cater to retail customers.

During the period under review, the business banking assets portfolio grew to LKR 28,544 Mn by 9.6%. The consumer banking assets portfolio grew to LKR 1,436 Mn by 16.5%, with a notable increase in the leasing portfolio. The liability base consisting of Fixed Deposits, Current Accounts and Savings Accounts saw a decline due to the competitive market environment.

The Business Banking Unit will focus on growing the CASA base in 2019 by adopting a strategy of focusing on new relationships whilst strengthening existing relationships. Strategic changes to the Unit have been made in order to improve the overall performance in 2019.

Branch banking

DFCC Bank's branch network offers a wide variety of financial services to Retail, Small and Medium Enterprise (SME) and Micro, Small and Medium Enterprise (MSME) sectors across the country. During 2018, the overall lending portfolio recorded a growth of 11% and the Consumer Banking portfolio achieved a growth of 16%. Branch banking recorded a growth of 12% in deposit portfolio in 2018. The CASA ratio is maintained at 23%.

In spite of adverse changes in the external environment, Branch Banking maintained a healthy credit portfolio as a result of proactive follow up and recovery procedures adopted during the year.

DFCC Bank converted 10 extension offices into fully-fledged branches during the year and will continue to do so, thus enhancing its offering of financial services. In 2019, the Bank expects to further expand the network with new branches in key cities across the country.

Going forward, the Bank will continue to focus on increasing its customer base through aggressive acquisition campaigns targeted at youth and salaried employees. The sales team of the Bank will continue to enhance customer convenience through initiatives such as doorstep banking. The Bank will also expand its digital footprint by increasing self-service terminals both at branches and off-site locations. Alongside its aggressive growth plan for the year ahead, the Bank's focus will remain on maintaining the portfolio quality and offering the highest level of service to all customers.

DFCC Bank's focus on SMEs and MSMEs

DFCC Bank, as the pioneer development bank in Sri Lanka has always played the role of a true partner rather than a mere financier for many SMEs, in developing them into big league businesses.

Branch Banking promotes concessionary loan schemes and has been actively involved in granting facilities under E-friends II (RF), SMILE III (RF), SMELoC, *Saubhagya, Jaya Isuru* and *Ran Aswenna* during 2018. Total loans and leases under these concessionary loan schemes during the year was LKR 3,882 Mn.

Furthermore, DFCC Bank provided financial support to rebuild business ventures of both customers and non-customers of the Bank affected by natural disasters through "*Vardhana Sahanaya*", a DFCC Bank funded concessionary loan scheme.

The MSME Unit was set up in September 2016 to exclusively provide financial services to Small Business Enterprises (SBEs), that eventually become SMEs. The main objective of setting up this unit was to promote and encourage viability based lending and thereby support financially inclusive economic growth.

The MSME Unit offers "*Vardhana Sahaya*" which is a one-stop-shop financial solution that includes loans, leases, bank guarantees, and other commercial facilities below LKR 3 Mn to SBEs catering to key segments of the economy – agriculture, manufacturing, trading, and services.

Using existing value chains of tea, fruits and vegetables, field crops and dairy, DFCC Bank reaches out to micro-level cultivators and smallholders. During the year, the MSME Unit granted facilities and acquired over 2,000 customers.

This Unit also conducts workshops titled "*Sahaya Hamuwa*", a skill enhancing training programme series conducted with the participation of key resource personnel from the Central Bank of Sri Lanka. The primary focus of these programmes is to increase the financial literacy and financial management abilities of MSMEs, in addition to offering financial services. Twenty workshops were held in 2018 across the country.

DFCC Bank received an award for "Outstanding Sustainable Project Financing" at the Global Sustainable Finance Awards 2018 in Germany, in recognising the success in financing MSMEs.

EIB SME and Green Energy Global Loan

The €90 Mn EIB SME and Green Energy Global Loan credit line implemented by DFCC Bank was fully disbursed in 2018. Total disbursements amounted to LKR 14,683 Mn for 163 projects from three participating intermediary banks including DFCC Bank.

SME projects in a variety of sectors island-wide were funded. Prominent sectors were auto services and repair, bakery products, construction, education, healthcare, manufacturing including agro-processing, printing, retailing, tourism, and trading. Under "Green Energy", 18 grid-connected renewable energy power plants using varied sources of energy – hydro, wind, solar and bio-mass, with an aggregate capacity of 56.7MW were funded.

Retail banking

DFCC Bank offers a comprehensive range of financial solutions for its retail customers specially designed to meet individual requirements. These flexible financial solutions include personal loans, overdrafts, housing loans, vehicle loans and leasing, and educational loans. A host of attractive deposit products are also available catering to individuals across target segments.

Within the corporate structure, Retail Banking is divided into two separate units for assets and liabilities in order to optimise performance.

Assets

Housing

DFCC Bank's Housing Loan product is considered an integral part of the Bank's consumer banking offering and is being widely offered to executives, professionals, private sector and public sector employees, and entrepreneurs who look for financing for their new home.

2018 was a significant year for housing loans, where the portfolio witnessed a growth of 19.8%.

The Bank capitalised on the increasing demand for condominium apartments and utilised the same as a tool to achieve desired growth targets. Tripartite agreements were entered into, with several renowned developers (40+ condominium projects) who assisted in attracting customers to obtain home loans from the Bank. Functions were organised in collaboration with property developers to educate customers on the benefits offered by the Bank and each developer. Special housing loan packages with grace periods, flexible payment terms and benefits on early settlements etc. were designed to benefit customers when purchasing their condominium units.

A number of promotional activities were carried out across the island during the year to create awareness among prospective customers as well as existing customers on the home loan offerings of the Bank.

The product's unique selling propositions are attractive interest rates and superior service. The staff of all branches of the Bank and sales teams are fully-geared to serve customers and meet high standards of service.

The strategies will continue in 2019 as well.

Leasing

A pioneer in the industry, DFCC Bank has continued to provide leasing solutions for both SMEs and individuals. Leasing is the strong hand of consumer assets at DFCC Bank and amounts to the largest portfolio among the consumer asset products. Despite challenges faced by the leasing industry during 2018, DFCC Leasing successfully grew by 11% during the year.

Understanding the needs of customers, the Bank also introduced *Waruwen* Leasing, a service that provides a lease within half a day. The Bank also entered into strategic tie-ups with leading brands throughout the year with a focus on the category of commercial vehicles.

Apart from the SME segment, the product caters to the fixed income and professional market segments with special offerings in terms of interest rates, extended tenures as well as structured repayment plans.

A new advertising campaign, *Dan kale hari* (Now's the time) was launched during the year offering several benefits to the customer including zero down payments and guarantor free facilities.

The refinancing arrangements with Asian Development Bank (under the SMELoC credit line) was also a win for DFCC Leasing which provided machinery leases at attractive rates.

DFCC Bank used a two-pronged strategy to market the product. The first being the extended branch network and the next its fleet-on-street. The branch staff and the sales team are fully geared to provide customers with the best services which will further strengthen the Bank's portfolio in 2019.

Personal loans

The year 2018 was significant for personal loans as it was one of the major contributors to the Bank's consumer asset growth. The portfolio recorded a growth of 37%, for the year.

Despite the challenging economic situation in the country and political uncertainty which prevailed during the year, the strategies adopted proved effective and helped to navigate through rough waters.

The Unit successfully optimised market segmentation and employed a strategy of identifying and providing true value to respective segments with tailor-made and flexible solutions. The solutions were structured to cater to the lower middle income, middle income, and higher income brackets of employees in the Government and private sector as well as self-employed professionals.

Varied products were formulated to serve the identified segments. The DFCC Personal loan for lower middle income category, the Speed Loan and Professional Loans for middle income category and the Hiflex loan for the high net-worth employees were a few of the products introduced.

Providing employee banking solutions with tailor-made packages was the key focus to achieve desired results. This approach has been very effective in cross-selling and especially growing CASA. Many tailor-made packages for employees of blue-chip and reputed companies were provided during the year which helped to canvass a significant amount of salary accounts.

Many tie-ups with professional associations and reputed employers have been entered into, which helped to create and explore new markets effectively.

Among the many schemes, the two significant schemes launched were:

Loan scheme for the Government Medical Officers Association (GMOA)

DFCC Bank entered into an exclusive agreement with the GMOA to provide financial solutions for GMOA members. This partnership has been a resounding success which was truly beneficial to the medical officer community of the country.

Loan scheme for the Institute of Engineers of Sri Lanka (IESL)

A special personal loan scheme for the members of The Institute of Engineers was introduced during the year providing value and benefits for the engineering fraternity.

Process efficiencies and delivery has been identified as critical success factors on which the Management has been asserting a special focus. Stringent service level agreements formulated and the deliveries are bench marked and followed up in order to provide a superior customer experience.

A project has been initiated to improve and digitalise the processing work flow. Measures are underway to provide an improved digital experience through web-based applications which is in the pipeline and is expected to materialise in 2019.

Gold-pledged lending

Pawning business recorded a remarkable growth of 26% in 2018. The commendable achievement was a result of aggressive campaigns with attractive rewards for customers pawning with DFCC Bank. Two campaigns were rolled out during the year and were well received by the target segments.

DFCC *Ranwarama* is now a leading competitor in the pawning industry of the country and the Bank has great plans for this product in 2019.

Liabilities and trade business

The Liabilities and Trade Business Development Unit is responsible for driving the growth of deposits and trade business across the branch network. The Unit formulates strategies and key initiatives to achieve its goals by closely engaging with branch staff and the sales team.

Liabilities

A series of key business initiatives were planned and implemented throughout the year to increase the focus on deposits mobilisation. Several campaigns were carried out with the inputs and engagement of all relevant stakeholders, which helped to significantly improve consumer perception that DFCC is a preferred bank for deposits. As a result, the Bank was able to achieve a commendable growth of over 11% on overall Branch Banking liabilities as at 31 December 2018 when compared to 31 December 2017. Overall Branch Banking liabilities grew to LKR 108,316 Mn as at 31 December 2018 from LKR 97,404 Mn as at 31 December 2017. High focus given for CASA mobilisation enabled Branch Banking CASA deposits to grow by LKR 763 Mn during the year, to LKR 25,381 Mn as at 31 December 2018 from LKR 24,618 Mn as at 31 December 2017, recording an overall Bank CASA ratio of 21.8% as at 31 December 2018. Key CASA target consumers such as junior account holders and salaried employees were successfully engaged to generate sustainable CASA deposits.

Trade business

Branch Banking trade business continued on the impressive growth achieved during the previous year in 2018 as well, despite challenging macroeconomic conditions. A team consisting of selected branch staff across the regions were appointed to promote trade business in their geographies. Many training and development programmes were held during the year to upgrade their technical knowledge and business skills. Both internal as well as external resource persons were used for this purpose. Close central monitoring was in place to effectively implement agreed action plans and to achieve the expected outcomes. Growth of over 25% was achieved in Branch Banking import limits during the year, while export limits also recorded a growth of over 36% in 2018. Utilisation remained at high levels due to close follow-up and monitoring.

Card operations

DFCC Bank relaunched its credit cards during the year becoming the first to launch five Visa payWave enabled contactless credit card products in Sri Lanka, in March 2018. The cards range includes Gold, Platinum Signature, Infinite, and the only Visa Corporate credit card in Sri Lanka. It was a significant achievement in the industry to launch all five Visa products after obtaining its primary membership with Visa international in November 2017. DFCC credit cards offer cardholders a unique opportunity, enabling them to save 1% every time they spend, which goes directly into a nominated DFCC savings account.

The unique design of the new range of cards is a significant feature, especially the vertically designed Premier Infinite credit card, another first in the market. The Signature and Infinite credit cards also offer customers a world of exclusive benefits, such as free visits to over 1,000 airport lounges worldwide, travel insurance covering up to USD 75,000, and exclusive Visa offers in many destinations across the globe.

DFCC Bank cardholders were able to enjoy some of the highest discount offers throughout the year at popular merchant locations ranging from supermarkets, clothing outlets, restaurants, electronic and household items, e-commerce sites, and hotels. A special campaign was launched in the month of December namely, "31% CashBack for 31 days", which was well received by customers who received a total of LKR 8 Mn in Cashback value by spending during the season.

The unique offers of the DFCC credit card helped it gain quick popularity and recognition among customers during the year.

DFCC Bank continued to invest in the card business with the introduction of the chip-enabled debit cards, offering more security and benefits to cardholders. Another first from DFCC Bank was the introduction of the interactive credit card e-statement which provides the customer more in depth insight into spending patterns whilst also enabling the customer to convert into flexi-plans and look up promotions at the click of a button.

The credit card portfolio recorded a significant 300% growth adding 8,000 new cards during the year and recorded a total spend of over LKR 1,500 Mn whilst ending the year with an aggregate credit exposure of LKR 500 Mn. Debit cards increased to 160,000 cards with over 36,000 new cards been issued during the year.

The Bank continued the merchant acquiring partnership with a global processor and in return contributed towards LKR 1,000 Mn growth in CASA with over 400 active merchants. DFCC Bank was the first bank to be certified for mVisa QR payments by Visa International in November 2018. The Bank will be introducing innovative solutions in facilitating payments and has focused efforts in 2019 towards continuous growth.

Premier banking

Since 2012, DFCC Premier Banking membership has been offered to clients who maintain deposits over LKR 5 Mn or an equivalent amount in foreign currency.

The dedicated team of professionals at DFCC Premier Banking understand the busy lifestyles of customers within this segment and strive to offer them a seamless banking experience based on the principles of unmatched service quality, professionalism, and utmost care. These customers are served by a dedicated Relationship Manager and are offered comprehensive solutions taking into account their specific needs.

An increase of 27.53% of the client base during the year is a testament to this. Furthermore, DFCC Premier Centre has grown its deposits by 54.33% and its advances by 38.7% during the period under review.

The launch of the Visa Infinite credit card for Premier customers was a key event during the year, offering a host of unmatched benefits such as free lounge access at any airport lounge worldwide and 1% Cashback on the customer's monthly spend. What is also significant is that the Infinite credit card is a lifetime free card.

The Margin trading product was also revamped to enhance service and meet the needs of equity investors.

The revolutionary "Premier Go" app launched in the year 2017 was honoured with a Merit at the prestigious NBQSA Awards. This product enables Premier clients to connect with their relationship managers from anywhere in the world. Furthermore, they can also stay updated on the current promotions and offers, view account balances, schedule appointments, and keep track of their finances.

In terms of events, DFCC Premier Banking continued to provide customers with opportunities to witness internationally acclaimed events. The highlights for the year 2018 included customers being hosted at exclusive events such as the Galle Literary Festival, The Sound of Music Concert, Gaur Gopal Das' CEOs Breakfast Forum, A High Tea with Nigella Lawson, De Lanerolle Brothers Show, SLID Annual Dinner, and the Mamma Mia Concert. During the year, Junior Premier customers were also hosted for an exclusive movie screening of Jurassic World at the Empire Deluxe Theatre, nurturing these relationships at a very young age.

2019 will be an exciting year for DFCC Premier Banking, with the introduction of a new Premier Banking proposition across the branch network. Premier Banking lounges will be introduced at key locations enabling customers to experience the Premier Banking services in their home-towns.

DFCC Premier Banking will also engage with the families of its valued clientele with the launch of a new proposition – DFCC Premier Family.

Treasury

The Treasury Front Office (TFO) of DFCC Bank consists of three main income generating units: the Foreign Exchange and Money Markets Unit, the Fixed Income Unit, and the Treasury Sales Unit that report directly to the Head of Treasury.

The Treasury Middle Office (TMO) functioning independently under the purview of the Chief Risk Officer (CRO) monitors the risks assumed by the Front Office based on Board-approved limits and controls. TMO operations were further enhanced during the period under review in line with the regulatory guidelines.

The Treasury Back Office (TBO) is accountable for the preparation, verification, authorisation, and settlement of all transactions made by the TFO. The TBO independently reports to the Head of Finance/Chief Financial Officer, in compliance with regulatory guidelines.

The year 2018 was a challenging year for the Sri Lankan economy due to the turbulent influence of local developments and global economic factors.

On the domestic front during the period under review, the trade deficit in the trade account expanded significantly as the growth in imports outpaced the increase in exports. This was further aggravated when the US Federal Reserve raised their policy rate four times in 2018, leaving the fed funds rate within the range of 2.25% -2.50%. This increase in US interest rates gradually reduced the risk-return trade-off for foreign nationals to invest in the domestic market, thus resulting in an exodus of foreign funds from the Government Security and Equity Markets. Foreign holdings of Government Securities witnessed a steep decline of 49% in 2018 when compared to 2017.
In absolute terms, LKR 160,000 Mn moved out of the domestic market during the year under review compared to 2017 where there was a LKR 64,200 Mn net inflow. Foreign investment in stock market recorded a net outflow of LKR 22,800 Mn in absolute terms compared to LKR 18,500 Mn inflow in 2017. In this backdrop, the Sri Lankan Rupee depreciated 19.22% in 2018 compared to 2% in 2017.

The depletion of the reserves was mainly due to the effort by CBSL to defend the USD/LKR rate. Gross official reserves increased to a high of USD 9,300 Mn in June 2018 mainly supported by the proceeds of the third tranche from the long lease of Hambantota port amounting to USD 585 Mn and receipts from fifth tranche under IMF Extended Fund Facility programme.

The yields of Government Securities in the primary and secondary market increased during the first quarter of 2018 as a result of the market pricing and the impact of the new tax structure that took effect from 1 April 2018. Considering the low inflation and favourable inflation outlook, as well as lower than expected real GDP growth, the Central Bank reduced the standing lending facility rate by 25 basis points to 8.50% in April. The market rates saw a reversal in the third quarter with market liquidity increasing as a result of less domestic borrowing by the Government as large FDI's and external funding came in. However, foreign investors started exiting from Government security investments towards the end of the third quarter/beginning of the fourth quarter as a result of the US rate hikes, resulting in the rates in the domestic market picking-up again in September. It is noted that the one year Treasury Bill rates stood at 11.20% compared to 8.9%, while five year and ten year Bonds increased to 11.65% from 9.6% and 12.00% from 11.00% respectively by the end of the year 2018 compared to end 2017.

In the month of November 2018, the Monetary Board reduced the Statutory Reserve Ratio (SRR) from 7.50% to 6.00% and increased the policy rates of the Statutory Deposit Facility (SDF) and Statutory Lending Facility (SLF) rates by 0.75% and 0.50% respectively to 8.00% and 9.00% (from 7.25% and 8.50% respectively). The upward move of the policy rates aimed at defending a faltering Rupee as foreign capital outflows picked up amid an escalating political crisis and rising US interest rate. The reduction in SRR was expected to release a substantial amount of Rupee liquidity to the banking system, with the intent of reducing the persistent liquidity deficit in the domestic money market. With the substantial liquidity deficit in the market during the last quarter of the year, the inter-bank money market rates (overnight rates) continued to surge to close the year at 9.00%, compared to 8.15% at the beginning of the year. The closing market deficit was around LKR 148,000 Mn.

Political upheaval in the domestic market deterred investor confidence which resulted in the further depreciation of the Rupee and market liquidity. In this backdrop, Fitch Ratings Sri Lanka downgraded Sri Lanka's Long-Term Foreign-Currency Issuer Default Rating (IDR) to "B" from "B+", with a stable outlook while both S&P and Moody's also downgraded the country's credit rating from "B1" to "B2". Rating agencies said the downgrade reflects heightened external refinancing risks, an uncertain policy outlook, and the risk of a slowdown in fiscal consolidation in the wake of political crisis.

In this context, Treasury has contributed significantly during the period under review to DFCC Bank's bottom line through FX Income, Repo NII, and through efficient management of the funding swap operation.

Treasury grew the liquid asset portfolio by LKR 6,860 Mn during the financial year 2018, closing the position at LKR 62,850 Mn as against the position held at LKR 55,990 Mn in the year ended 2017.

DFCC Bank's Treasury implemented a new state-of-the-art Integrated Treasury Management system, during the first half of the year. The system increases the productivity and efficiency of the operations staff as well as reduces operational risks in the functional areas of foreign exchange, fixed income securities and cash flow management.

Resource mobilisation unit

The Resource Mobilisation Unit falls under the direct purview of the Head of Treasury. It manages all term funding of the Bank, including *inter alia*, credit lines, syndicated loans and local and international debt issuance. The Unit coordinates with rating agencies in their reviews and works to secure ratings for debt issuances. The Unit also manages the Bank's equity and Unit Trust portfolios, related strategic and non-strategic investments, and divestments.

Building upon the relationships the Bank has established over time, the Treasury and Resource Mobilisation Unit actively engages with partner institutions to secure potential funding lines to support the Bank's rapid growth.

Cross Currency SWAP
Breaking new ground in Sri Lanka's banking industry; DFCC Bank successfully executed a Cross Currency SWAP transaction of USD 30 Mn with a Sri Lanka branch of a foreign bank operating locally. Cross Currency SWAP is an over-the-counter (OTC) Interest Rate Derivative (a Quasi Derivative product) with physical exchange of capital and interest amounts between two currencies.

The above derivative transaction executed in March 2018 enabled DFCC Bank to generate Rupees at competitive rates while hedging the interest rate risk and the exchange rate risk of the foreign borrowing of USD 30 Mn from a foreign funding agency. Since the tenor of the SWAP transaction was for a period of three years, this enabled the Bank to hedge the risk exposures for a longer period, compared to conventional avenues such as traditional SWAPs.

DFCC Bank's equity investment portfolio
As per the IFRS 9 guidelines, the equity portfolio is broadly categorised into two categories namely, investments measured at fair value through profit and loss (FVTPL) and fair value through other comprehensive income (FVOCI).

As at 31 December 2018, the combined cost of investments in DFCC Bank's holdings of quoted shares [excluding the investment in the voting shares of Commercial Bank of Ceylon (CBC) PLC], unquoted shares and unit holdings amounted to LKR 1,581.91 Mn and corresponding fair value of the same portfolio stood at LKR 1,776.60 Mn.

The composition of the equity portfolio is as follows:

Equity Portfolio as at 31 December 2018

	Cost* LKR Mn	Fair value LKR Mn
Quoted share portfolio (excluding CBC voting)	**945.12**	**895.84**
Unit Trust portfolio	**630.49**	**691.97**
Unquoted share portfolio	**6.30**	**188.79**
Total	**1,581.91**	**1,776.60**

**Net of provision*

The quoted and unquoted share portfolio mentioned in the above table is carried at fair value through other comprehensive income on the Statement of Financial Position while Unit Trust portfolio has been categorised under fair value through Profit and Loss.

During the period under review, the Bank divested a part of its mature stocks in quoted shares, unquoted shares and Unit Trust investments, thus realising a capital gain of LKR 85.19 Mn. DFCC Bank also made new investments in quoted shares to the value of LKR 227.76 Mn including the subscription to NDB (National Development Bank) rights amounting to LKR 75.2 Mn.

At the beginning of the financial year, DFCC Bank transferred part of its investment portfolio in CBC into investments measured at fair value through profit and loss (FVTPL) and the balance was categorised under fair value through other comprehensive income. At the end of the financial year, corresponding fair value of the investments in CBC categorised under fair value through profit and loss (FVTPL) was LKR 5,386.89 Mn, while the investments categorised under fair value through OCI stood at LKR 9,319.44 Mn against cost of LKR 3,208.87 Mn.

Further, the Bank divested part of CBC shares of trading category and realised LKR 14.39 Mn during the period under review.

Bancassurance

The Bancassurance business commenced mid-2014 with a small portfolio of business and is now stepping into its fifth year of operations.

Starting off from modest beginnings, this "other income" generating business unit has grown in leaps and bounds to where it is today, being a forerunner in service provision for the Bank's Loans, Leases, and Retail clientele.

Being a specialist in insurance services, the Unit provides customers with many products and services which cover long-term insurance needs and short-term asset and liability insurance covers.

Some of the specific benefits of general insurance offered to customers are product customisation to match the specific requirements and secure assets of the individuals and institutions, service customisation for process requirements, hassle-free claim settlements and expansion of bargaining power of all parties, specially designed insurance packages, special marketing promotions, and free-of-charge consultation services.

The Unit's service provision in the area of life insurance has offered customers education on how to live a healthy life via many health events and vitality programmes conducted throughout the year. Campaigns were also done throughout the year to raise awareness on mitigation of risks associated with business and life. In addition, the Unit facilitated programmes on parenting for individual customers. Through customer engagement events, the Unit has also created interest with regard to children's higher education.

In the current banking industry, all banks are pushing the boundaries to add newer fee-based and other income generating sources. This includes mainly the distribution of insurance products, while the insurance service is internally handled through Bank operations. Bancassurance income is not mainly a one-time proposition; it generates income repetitively for the Bank over a long-time period. Hence, the continuous growth will contribute towards the Bank's bottom line in the long term.

The Bank also focuses on value creation in a socially responsible manner, where it ensures customers, their loved ones and assets are secured in the event of an unlikely cause while securing the Bank's interest as well.

International banking

During the year 2018, the Bank witnessed a steady growth in fee and commission income related to Trade Services. A growth of 26% in fee and commission was achieved despite the regulatory changes and the unexpected devaluation of the Sri Lankan Rupee during the last quarter of the year.

Total fee and commission income earned by Trade Services in 2018 was LKR 506.4 Mn compared to LKR 399.9 Mn in 2017. The Bank's import and export business volume grew by LKR 25,041.7 Mn in 2018 compared to 2017.

During the year 2018, as per statistics of the Central Bank of Sri Lanka, the export sector of the country grew by 4.1% (up to November) whilst import sector contracted by 9.1% (up to November). However, the Bank's income from exports business grew by 42% and income from imports business grew by 21%.

Total turnover of inward and outward remittances of the Bank during the year 2018 was LKR 19.7 Bn. This is a 62% increase compared to 2017. This volume increase has contributed to 49.1% of fee and commission income related to remittances during the year compared to 2017.

The aforesaid increase in business was a result of continuous strategic initiatives taken by the Bank to drive the trade business and inward and outward remittance business. Corporate Banking, Business Banking, and Branch Banking Units with the assistance of the Trade Business Development Unit, Trade Services and Remittances departments were able to persuade the existing customers to route more repetitive business through DFCC Bank whilst attracting many new Corporate and SME customers to the Bank.

However, during the last quarter of the year, the Bank witnessed a decline in growth of volume and income in imports as a consequence of cash margin requirements imposed by CBSL for importation of certain vehicles and non-essential goods. Further, CBSL prohibited remitting funds as advance payments for certain non-essential goods by converting Sri Lankan Rupees which negatively affected outward remittance transactions. Furthermore, the unfavourable depreciation of the Sri Lankan Rupee also hampered the growth of import business during the latter part of the year.

During the year, DFCC Bank Trade Services won a prestigious award from the Asian Development Bank as the leading partner bank in Sri Lanka for Trade Finance. This is an annual award and in 2018, 23 leading partner banks were selected from 15 countries with DFCC Bank being the only Bank from Sri Lanka.

On the digitalisation front, the current Trade Finance module was upgraded to improve the efficiency of the services provided to customers.

The competent, knowledgeable, and dedicated teams at trade and remittances continue to improve service levels and provide value added services to build, sustain and improve business in the current competitive environment.