

## **Turk Dis Ticaret Bankasi A S (Disbank)**

**September 2004**

**Bank Report**

**Turk Dis Ticaret Bankasi A S (Disbank)**

**Turkey**

**September 2004**

**Capital Intelligence Ltd**

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**RATING REPORT**

**TURK DIS TICARET BANKASI A S (DISBANK)**

Istanbul, Turkey  
September 2004

| CI RATINGS                        |                  |                    |  |         |
|-----------------------------------|------------------|--------------------|--|---------|
| Sovereign                         | Foreign Currency | Financial Strength | Support  | Outlook |
| L/T: B+ S/T: B                    | L/T: B+ S/T: B   | BBB                | 3  | Stable  |
| <b>ANALYSTS</b>                   |                  | <b>TELEPHONE</b>   | <b>E-MAIL</b>  |         |
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**BALANCES**

| USDmn             | 12/03 | 12/02 |
|-------------------|-------|-------|
| Total Assets      | 4,123 | 3,978 |
| Loans             | 1,774 | 1,872 |
| Contingents       | 1,006 | 1,270 |
| Customer Deposits | 2,465 | 2,094 |
| Total Capital     | 646   | 478   |
| Net Income/loss   | 194   | 35    |

**CI RATIOS**

| %                        | 12/03 | 12/02 |
|--------------------------|-------|-------|
| Return on Average Assets | 4.78  | 0.88  |
| Interest Differential    | 1.96  | 3.23  |
| Expenses/Gross Income    | 51.24 | 61.47 |
| Capital Adequacy Ratio   | 20.39 | 18.50 |
| Liquid Asset Ratio       | 50.09 | 46.24 |
| Loans/Stable Funds       | 68.31 | 67.37 |

**POSITIVE FACTORS**

- Liquid and relatively well-positioned balance sheet supported by good capital base
- Highly-regarded management
- Very high profitability in 2003
- Good asset quality and very well capitalised

**NEGATIVE FACTORS**

- Challenging, although improving, operating environment. Challenges faced in building retail franchise.

**BANK PROFILE** Disbank was established in 1964 as a joint-venture between Bank of America (BoA) and Isbank. In 1981, Isbank bought out BoA and changed the name to Turk Dis Ticaret Bankasi (Turkish Foreign Trade Bank). Isbank sold a majority stake to the Lapis Group in 1993, but the Group ran into problems in 1994 and Isbank regained control in 1994, subsequently selling 65% to the Dogan Group, a large Turkish media, telecommunications, energy, finance and trading group. Isbank retained a 24% stake. In 2003, Isbank finally sold its last remaining shares in Disbank; the current main shareholders are Dogan Group 66.37%, public 16.8% and Disbank Employees Pension Fund 16.56%. Disbank has concentrated on corporate and retail banking, international trade finance, treasury and capital markets activities. In early 1998 the Bank appointed Vural Akisik, previously CEO with Turk Merchant Bank, as CEO. In 2001 Mr Akisik was appointed chairman of state banks. Mr Tayfun Bayazit, previously the Executive Director of Disbank, and Vice Chairman of Dogan Holding, was appointed as the new CEO in April 2001 and, in 2003, as Chairman as well. During the past few years, the Bank has expanded in trade finance, and retail and commercial banking. Disbank is a medium-sized bank in the Turkish banking sector. The Bank has opened branches and invested in alternative distribution channels in order to expand market reach, gather stable deposits and build the customer base. The branch network currently stands at 168. The Bank has an offshore branch in Bahrain, and a subsidiary bank in Malta.

**RATING RATIONALE** Disbank recorded very high profitability in 2003 with strong dealing securities gains. These are unlikely to be repeated in 2004 but nevertheless returns should remain sound. Loan asset quality is very good with a low level of non-performing loans (NPLs) backed up by high provisioning. Liquidity and funding is comfortable. The Bank's capital position is very good and is supported by a high base of free capital. The Bank's market position continues to grow, especially in the area of retail and commercial banking. Disbank's long-term foreign currency rating is upgraded to B+ in line with the sovereign rating. Other ratings are maintained.

## SUMMARY ANALYSIS

**Asset Quality** Disbank's loan asset quality improved in 2003 with non-performing loans (NPLs) to gross loans falling to 3.6% (cf. sector average of 12%). Loan asset quality inevitably deteriorated on the back of the severe economic crisis in 2001 with NPLs to gross loans increasing to 6.6% but this was well below the sector average of 28% at end 2001. Disbank has a strict classification policy and loans and interest more than 30 days overdue (also guaranteed exposure) are placed under legal or administrative follow-up. This compares to the regulatory requirement of 90 days. The provisioning coverage was high at 94% at end 2003.

Approximately 62% of the loan book is denominated in foreign currency. The loan book is well diversified with the main exposure (14%) directed to wholesale and retail trade as well as the textiles sector, followed by retail/consumer at 10% (5% at end 2002). Loan growth fell slightly in 2003, reflecting the fall in the value of the dollar vis-à-vis the lira. Percentage rise the main growth was directed to the retail sector.

Investment securities comprised nearly all available-for-sale securities (TRL1,365 trillion) with TRL29 trillion of held-to-maturity securities. Debt securities comprised mainly government bonds of TRL761 trillion and Eurobonds of TRL525 trillion. Approximately half the investment securities were denominated in US dollar with one-half also over one-year in tenor.

The Dogan Group is a net provider of funds to the Bank. Cash loans at end 2003 stood at USD165mn (2002: USD462mn) and non-cash loans at USD49mn (2002: USD29mn). Legally binding collateralised deposits and treasury bills by group entities amounted to around USD50mn. Further Group deposits (deposits that are not legally binding but could be offset against group risks) amounted to USD231mn at end 2003.

**Capital Adequacy** Disbank's very good capital base was maintained at end 2003, with the capital adequacy ratio standing at 23.6%. Shareholders' equity rose by 35% in 2003 due mainly to the high earnings in the year. Free capital increased sharply, up by 60%, and amounted to USD502mn at the year-end. The Bank's free capital ratio is much higher than the vast majority of Turkish banks.

**Liquidity** Although deposit-based liquidity ratios tightened slightly in 2003, this was due to the 15% fall in deposits. However, this fall was on the back of the rise in the value of the Lira during the year against the US dollar. The majority of deposits are dollar denominated. Disbank displays a very comfortable liquidity position. The liquid assets ratio was a high 50% at end 2003 with net loans to stable funds 68%. Disbank's funding profile changed in 2001 as a result of the crisis with borrowings from foreign banks falling sharply to USD258mn from USD718mn at end 2000. Foreign bank borrowing rose to USD432mn at end 2002 and further to USD747mn at end 2003. The Bank received a syndicated credit facility for USD200mn in July 2003 which had been increased to USD400mn in August 2004. Funding from customer deposits amounted to USD2.1 billion at end 2003. This represented 60% of liabilities. Around 68% of the customer deposit base is denominated in foreign currency. The Bank maintained a neutral foreign currency position throughout 2003. Maturity and interest-rate re-pricing details indicate a well matched position. At one month and three months the negative interest gap represented 12% of total assets. In regards to maturity, the negative gap at one month was 22% of total assets due to the longer-term nature of loans and securities.

**Profitability** Disbank's profitability in 2003 was very high, with net profit up by over 450% to USD194mn. The return on average assets was a very high 4.78%. Net interest income was down by 14% due to the sharp fall in domestic interest rates together with the slight fall in the loan book. However, non-interest income doubled to USD265mn led by dealing securities income of USD191mn. The Bank's treasury department performed extremely well in 2003 and capitalised on falling interest rates connected to the capital markets. Disbank is one of the main dealers in the market in respect to government securities. Fees and commission income also recorded strong growth, up by 120% with the Bank starting to capitalise on its customer base and franchise. Operating expenses were well held, up



by just 4.5%. The provision charge fell to USD14.4mn from USD41mn. The lower net monetary loss reflected the steep fall in inflation during the year.

**Results end-March 2004** Bank only (BRSA accounting standards) figures for 1Q 2004 showed net profit of TRL14.6 trillion against a loss of TRL2.7 trillion in 1Q 2002. Net operating income was down but income from associates and subsidiaries was higher. FX gains also increased but the bottom line was held back by a higher provision charge.

## NON-FINANCIAL FACTORS

### OWNERSHIP AND SUPPORT

*Majority owned by the Dogan Group, a large privately owned Turkish conglomerate with diversified interests.*

Shareholders of Disbank as and 2003 were as follows:

| %  | Ownership     |
|--|---------------|
| Dogan Sirketler Grubu Holding A S (Dogan Group)  | 62.37         |
| Disbank Employees Pension Fund                   | 16.56         |
| Aydin Dogan                                      | 4.00          |
| Publicly held                                    | 16.80         |
| Social Security Foundation for Disbank Employees | 0.22          |
| Social Security Institute of Turkey              | 0.05          |
| <b>Total</b>                                     | <b>100.00</b> |

In 1993, 92% of the shares were owned by Isbank, then the third largest private bank in Turkey (now the first). The holding was put up for sale to the highest bidder, with 85% being sold subsequently on deferred payment terms to the Lapis Group, a tourism and finance group which also owned TYT Bank in Turkey. TYT faced severe liquidity problems at the height of the crisis and was one of the three banks to collapse. Lapis was unable to support the Bank as the group itself experienced extreme cashflow difficulties. As a result, the Lapis Group failed to make payments under the Disbank share purchase agreement, leading to the reversal of ownership of the Bank to Isbank. In October 1994, Isbank agreed to sell 65% of its holding to the Dogan Group for USD94.25mn. The Dogan Group, which is mainly involved in the media sector, owning both the Milliyet and Hurriyet national newspapers, was established in 1958 in transportation and contracting activities. Additionally, the group has interests in the telecommunications, energy, automotive, insurance, tourism, broadcasting, foreign trade and other financial services industries. The group previously owned Alternatif Bank, but sold the bank to the Anadolu Group in early 1996. The Dogan Group is probably among the top five largest groups in Turkey. The media operations have been squeezed over the last two years in line with the economic downturn and its negative affect on advertising. In 2003, Isbank sold its entire remaining stake (9.29%) in Disbank. The Disbank Employees Pension Fund now owns 16.56% of the Bank.

### BACKGROUND

*A medium-sized player founded in 1964 focusing mainly on trade finance, retail banking and capital market activities. Now has a noted retail/commercial presence.*

**History** Disbank was established in 1964 as Amerikan-Turk Dis Ticaret Bankasi (American-Turkish Foreign Trade Bank), a joint-venture between Bank of America (BoA) and Isbank. In 1981, Isbank bought out BoA and changed the name to Turk Dis Ticaret Bankasi (Turkish Foreign Trade Bank) commonly shortened to Disbank. The Bank benefited greatly from its association with BoA. It gained an international reputation, had internationally experienced managers and developed efficient internal systems and controls to manage its business. Disbank had a strong reputation until 1994 but suffered greatly during the crisis year due to its association with Lapis together with the weak state of the economy. Since then the Bank has focused on building its operations, financial profile and performance.

**Profile** The Bank has largely developed its reputation on the financing of international trade, where years of experience had given it a solid competitive advantage. The Bank is strong in capital markets activities. Following the appointment of a new CEO in late 1997 with considerable investment banking experience, treasury and capital markets side of the business has received more emphasis. Other banking activities include corporate and retail banking, with the latter receiving considerable focus over the last five years. Disbank is a medium-sized bank in the Turkish banking sector, ranked tenth out of 50 licensed banks by total assets at end-June 2002 (6<sup>th</sup> largest private commercial bank, fifth on shareholders' equity). Disbank has expanded its branch network briskly over the last three years, with the current network standing at 168.

## MARKET ENVIRONMENT

A broad-based economic recovery is underway and real GDP growth is expected to exceed this year's official projection of 5.0% by a significant margin. At the same time, inflation has fallen to its lowest levels for decades and the central bank's inflation targets of 12% for 2004 and 8% for 2005 appear to be attainable. The turnaround in the economy has been underpinned by the stronger implementation of monetary and fiscal policies, and this has boosted confidence and enabled real interest rates to fall. The government is to negotiate a new programme with the International Monetary Fund (IMF) after the current stand-by arrangement expires in February 2005, and this should help to anchor economic policy and expectations over the coming years.

The fiscal deficit of the public sector continued to decline in 2003, to 9.8% of GDP, while the primary balance (ie. excluding net interest payments) registered a record surplus of 6.1% of GDP. With tax revenues growing well and primary spending generally under control in the first half of 2004, the government is on course to meet its primary surplus target of 6.4% of GDP for the year. Debt dynamics have strengthened, supported by primary budget surpluses, robust GDP growth, declining real interest rates, and a relatively stable exchange rate. The debt ratio dropped to 79% in 2003 and is projected by CI to fall further, to 73%, in 2004.

A pick up in private capital flows has enabled the central bank to substantially increase its stock of official reserves over the past two years, despite a widening of the current account deficit. Official reserves are currently equivalent to over 70% of external debt payments falling due within the next 12 months (the comparable ratio at end-2000 and end-2001 was 49%), suggesting that the authorities would have some room to manoeuvre in the event of an external shock in the near-term.

Nevertheless, Turkey faces some challenges. The ratio of central government debt to GDP stood at 79% at end-2003, with associated debt service costs (principal plus interest) equivalent to over 60% of that amount. Most of the debt is either linked to short-term interest rates or is foreign-currency denominated or indexed. The short maturities and asset price links of the debt stock expose the government to a high level of rollover risk and increase the vulnerability of the public finances and debt dynamics to shifts in investor sentiment. In addition, a high level of public external indebtedness increases the likelihood that domestic fiscal pressures will trigger external volatility and vice versa.

Turkey's gross external financing requirement (current account deficit plus short-term debt at the end of the previous year plus amortisation on medium- and long-term debt) is projected at 161% of official reserves this year and 171% in 2005. Such large financing needs leave little room for policy errors even assuming that all or most of the short-term component – which accounts for about 40% of the total and includes trade credits and non-resident bank deposits – is rolled over. Indeed, sound economic management to prevent a deterioration in market perceptions of Turkish risk may be particularly important as expectations of monetary tightening in the US over the next 12-24 months could put upward pressure on financing costs, and possibly trigger a weakening of capital inflows.

*The economy is growing quickly and inflation is at the lowest levels for decades*

Turkey is recovering strongly from the 2001 currency and banking crisis that caused public indebtedness and inflation to soar and the real economy to contract. Economic activity rebounded in 2002, with real GDP expanding by 7.8%, mainly driven by exports and stock building. Growth became more broadly based in 2003, with private consumption and investment both accelerating in the second half of the year and contributing to an increase in real output of 5.8%. The economic expansion has carried over into 2004, with first quarter GDP growth of 10.1% exceeding market expectations and suggesting that the official growth projection of 5.0% for the full year is very likely to be bettered by a significant margin.

The recovery in the real economy is taking place alongside rapid disinflation, with consumer price inflation falling from 68.5% at end-2001 to 18.4% in 2003 and to 9.6% in July 2004. Inflation is officially targeted at 12% this year and 8% in 2005, and at present the authorities appear to be on course to meet both. Disinflation and improvements in inflation expectations have permitted sizeable reductions in real interest rates, which in turn have stimulated domestic demand. With the economy still operating somewhat below its potential and real unit labour costs at low levels, domestic inflationary pressures are unlikely to be generated in the near future. Confidence in Turkish lira assets has improved but the accompanying de-dollarisation, as well as a pick up in private capital inflows, has contributed to the strengthening of the exchange rate. With the external current account deficit widening, this has raised concerns about international competitiveness. The central bank has, however, taken advantage of the exchange rate position to purchase foreign exchange and boost reserves ahead of an expected increase in public sector external debt-service payments in 2005 (see External Finances).

*Stronger policy implementation has underpinned a reduction in macroeconomic volatility but deeper structural reforms are needed to increase the economy's resilience to shocks*

The turnaround in the economy is underpinned by several factors, including improvements in economic management and the implementation of structural reforms. The election of a popular single-party government in November 2002 appears to have strengthened policymaking and policy delivery, and political stability and economic reform have helped to improve business and consumer confidence.

Economic policy is anchored by an IMF-backed programme and the long-term objective of joining the EU. The focus of policy in recent years has been on restoring the financial health of the banking system; strengthening the public finances and debt dynamics by improving budgetary management and tax administration, and by cutting public sector employment; substantially reducing inflation by tackling its fiscal roots and by controlling base money in order to meet (informal) end-year inflation targets; and increasing the private sector's role in the economy through privatisation.

While the government has not adhered to all aspects of the IMF programme (structural fiscal reforms and privatisation of state enterprises and banks are taking place more slowly than originally anticipated), it has brought about many changes, with generally favourable results. In particular, smaller budget deficits have helped to reduce public debt ratios and inflation, and resulted in lower real interest rates. In addition, the banking sector has been made stronger by the recapitalisation of troubled banks, the introduction of an independent supervisor and regulator, and the tightening of supervisory practices.

Nevertheless, sovereign creditworthiness is still comparatively weak and could easily deteriorate in the event of a shock to economic and political fundamentals or economic and political expectations. The bulk of the government's large debt stock is linked to asset prices and as a result the public finances are vulnerable to exogenous shifts in investor sentiment (see Fiscal Sustainability). Past episodes of political instability, policy reversal and macroeconomic volatility appear to have left investors highly sensitive to news flow and have increased Turkey's susceptibility to self-fulfilling

crises. Changing this will require a sustained and credible commitment to structural reform by the authorities.

Microeconomic reforms have so far lagged macroeconomic stabilisation but given the governing party's strong showing in recent local elections and with parliamentary elections not due until 2007, the government has an opportunity to introduce deeper reforms over the next 18 months. Prospects for a strengthening of policy commitments are reasonably good. The government's recent decision to enter into a new programme with the IMF after the current stand-by arrangement expires in February 2005 is a welcome development that would be expected to ensure that reforms continue to be introduced over the medium term. Reform momentum would also greatly benefit from a positive outcome in December's European Council meeting to decide whether to start entry negotiations with Turkey.

*The primary surplus reached a record high in 2003 and is on course to increase further in 2004*

Fiscal performance has improved since the 2001 crisis but the high sensitivity of debt dynamics to adverse economic events and large gross financing requirements could threaten fiscal sustainability over the medium term.

The central government budget, which accounts for the bulk of fiscal activity, registered a deficit of 11.4% of GDP in 2003 compared to 14.6% in 2002 and 18.8% in 2001. Higher tax revenues and primary spending restraint increased the primary budget surplus (ie excluding interest payments) to 4.8% of GDP from 2.0% in 2002, while the interest bill fell to 16.3% of GDP from 18.7% a year earlier.

The broader public sector borrowing requirement (PSBR), which consolidates the positions of the central government, the extra budgetary funds (EBFs), the state economic enterprises (SEEs), the social security institutions (SSIs), and the unemployment insurance fund, declined to 9.8% of GDP in 2003 from 12.1% in 2002 – the first time the PSBR has been in single digits since 1995.

The government's main fiscal target, and a key performance criterion of its stand-by arrangement with the IMF, is the public sector primary balance. An ambitious primary surplus target of 6.5% of GNP (around 6.3% of GDP) was set for 2002-04. This was missed in 2002 and 2003 but not by much in the latter case, with the improvement in central government performance contributing to a record public sector primary surplus for Turkey of 6.2% of GNP (6.1% of GDP). Overspending by SEEs accounted for most of the shortfall.

The 6.5% target has been retained for 2004. That target appeared to be under serious threat in the Q1 2004 following above-planned hikes in the statutory minimum wage (by 34%) and pensions (by 20%). However, the government took remedial action in March by adopting a supplementary budget that cuts discretionary spending (mainly on capital, which tends to be a less durable form of adjustment) and raises certain excise rates. In its July Letter of Intent to the IMF, the government expressed confidence in its ability to meet, or beat, the 6.5% target and the primary balance is likely to have comfortably exceeded its six-month target level. However, part of the budgetary over-performance in the first half of the year was due to a reduction in the number of corporate tax payment dates, suggesting that the pace of revenue growth may not be sustained in the second half of the year when spending typically increases.

*Rigid primary expenditures and large debt service obligations constrain fiscal flexibility*

The government's ability to respond to economic shocks is constrained by the fiscal structure. Though declining, interest payments continue to absorb a significant proportion of budget revenues (around half) and combined with a high wage bill reduces scope for timely adjustment on the spending side. In addition, the combined deficits of SSIs (around 3.5% of GDP) are providing an increasing drain on government resources. The weak financial position of SSIs and unfavourable demographics suggest that Turkey will face a pensions crisis over the longer term unless social security reforms are

implemented in the near future. The government is due to reveal its pension reform strategy in autumn 2004.

Revenue mobilisation, although improving, is still relatively poor. However, broadening the tax base and improving the efficiency of tax collection/clamping down on tax evasion are key objectives of the government's medium-term fiscal programme.

Large borrowing needs are a key source of potential vulnerability in Turkey and reflect a legacy of fiscal and monetary indiscipline that has resulted in a large stock of unfavourably structured debt. The government's gross financing requirement (budget deficit, including interest costs, plus debt amortisation) averaged about 55% of GDP in 2002-03 and is projected to decline to a still large 47% in 2004, as lower interest rates and a relatively strong exchange rate contribute to a reduction in the local currency cost of debt service (interest and principal).

Despite occasional bouts of turbulence in local financial markets, the Treasury has not faced any serious difficulties meeting its gross financing needs over the past couple of years. Externally, ample liquidity and the search for yield have contributed to increased demand for Turkish government risk (both T/bill and Eurobond) from international investors. Domestically, strong banking sector liquidity and greater public willingness to hold Turkish lira, underpinned by renewed confidence in economic management and falling inflation, have improved financing conditions.

*Debt dynamics and debt structure improve but government still heavily exposed to market risk*

The twin currency and banking crisis of 2001 resulted in the ratio of central government debt to GDP jumping from 51% of GDP in 2000 to 100% in 2001. Massive bond issuance to recapitalise failed banks and to fiscalise the accumulated losses that state banks had incurred from a decade of directed subsidised lending, as well as an adverse valuation effect following the sharp depreciation of the lira were the main reasons for the explosion of the debt ratio.

Debt dynamics have since strengthened, supported by primary budget surpluses, robust GDP growth, declining real interest rates, and a relatively stable exchange rate. The debt ratio dropped to 79% in 2003 and is projected by CI to fall further, to 73.5%, in 2004.

It is not the size of the government debt stock *per se* that is the main concern for Turkey but rather its structure, which generates large, market-sensitive refinancing needs. Fiscal weakness and high inflation have meant that to gain access to financial markets Turkey has generally had to issue instruments with short maturities and/or floating interest rates, or else in foreign currency or indexed to the exchange rate. In so doing, the authorities have increased their exposure to market risk and limited their capacity to monetise the debt stock.

The government has taken advantage of recent favourable market conditions to improve the debt structure by lengthening maturities and reducing the stock of domestic debt indexed to the exchange rate. Helped additionally by the appreciation of the lira, the share of total debt directly affected by the exchange rate has fallen from 58% at end-2002 to about 44% in June 2004. The share is still high, however, and with 42% of domestic debt at floating interest rates government financing and debt dynamics remain vulnerable to changes in investor sentiment and asset prices.

While CI does not expect the government to face any financing problems in the short term, Turkey is prone to political and economic shocks that can trigger sudden changes in creditworthiness. However there are reasons to believe that the government would have room to manoeuvre in the event of a moderate shock in the near term.

The (budgetary) central government has a small financing buffer in the form of local- and foreign-currency deposits worth about 3% of GDP which it can use to offset temporary declines in the rollover rate in domestic debt auctions. Moreover, 40% of central government domestic debt is held by other public sector institutions (mainly the central bank and state banks) and that debt could conceivably be

rolled over if so required. Of the domestic debt held by the private sector, around 50% is held by local banks and claims on the central government account for 43% of banks' total assets. Private banks' large exposure to sovereign risk suggests that they too would be willing to rollover debt in a stress situation (although not necessarily on the same terms). Finally, the government has negotiated a USD8.5 billion (about 3.5% of GDP) low-cost loan package with the US government which it could draw on to meet external financing needs.

*A growing current account deficit has renewed concerns about competitiveness and financing*

Gross external debt has fallen significantly relative to GDP in recent years, although less so against current account receipts, indicating an improvement in the country's solvency. However, a widening of the current account deficit, partly financed by strong increase in short-term capital, and a heavy debt amortisation schedule leave the country (and government) vulnerable to 'sudden stops' in capital flows.

The current account deficit increased from 0.8% of GDP in 2002 to 2.9% in 2003, and with the trade deficit more than doubling in the first half of 2004, is on course to reach 3.5-4.0% this year. At present the current account does not appear to be on an unsustainable path. External imbalances are largely the result of high oil prices (a temporary factor) and the recovery in domestic activity, which has increased demand for imported capital and intermediate goods. Export performance is strong, despite a relatively high exchange rate, as producers are benefiting from rising labour productivity, fairly low real unit labour costs, and greater access to trade finance. Merchandise exports increased by 27% in 2003 and 32% year-on-year in the first half of 2004. Tourism receipts have recovered following a temporary dip in 2003 related to the war in Iraq, and is expected to make a strong contribution to the current account in the second half of the year.

Turkey's flexible exchange rate regime should curb the extent to which external imbalances can build up, and enhances the country's capacity to adjust to adverse external developments. However, currency depreciation, particularly if associated with a hike in domestic interest rates, could temporarily weaken the public finances and debt dynamics.

*External financing needs are large but manageable provided policy discipline is maintained*

Gross external debt stood at 197% of current account receipts or 61% of GDP at end-2003. The public sector (including the central bank) accounts for over 60% of total external debt, and about 45% of public external debt is owed to official creditors, particularly the IMF. The share of short-term external debt (by original maturity) in total debt increased from 12.5% in 2002 to 15.6% in 2003, and stood at 16.4% in March 2004. This change in the composition of the debt stock is not yet a cause for concern as it is attributable to an increase in deposits at the central bank (which tend to be rolled over), the re-opening of foreign trade credit lines to Turkish companies, and greater access for some private banks to the cross-border interbank market.

Turkey has large external financing needs. The country's gross external financing requirement (current account deficit plus short-term debt at the end of the previous year plus amortisation on medium- and long-term debt) is projected to fall from an average of 220% of official reserves in 2000 and 2001 to around 161% this year and 171% in 2005. Such large financing needs leave little room for policy errors even assuming that all or most of the short-term component – which includes trade credits and non-resident bank deposits and accounts for about 40% of the total – is rolled over. Indeed, sound economic management to prevent a deterioration in market perceptions of Turkish risk may be particularly important as expectations of monetary tightening in the US over the next 12-24 months could put upward pressure on financing costs, and possibly trigger a weakening of capital inflows.

External financing (inclusive of IMF credits) was easily secured in 2003 and the first half of 2004 and international reserves increased as a result. The composition of financial flows has, however, shifted towards what are generally perceived to be more volatile forms of capital and as such are a source of

potential vulnerability. Unidentified capital flows (captured in the errors and omissions component of the balance of payments) and non-resident purchases of government domestic securities have increased in importance over the past 18 months, meeting almost 25% of gross external financing needs (excluding short-term debt). The former appears to be due to residents substituting lira assets for foreign currency assets (including banknotes) held overseas or outside of the domestic financial system. The strength of both types of capital flows is probably susceptible to short-term swings in investor confidence and yield considerations. The government continues to enjoy good access to international capital markets and by June 2004 had met around two-thirds of its programmed sovereign issuance for the whole year.

Macroeconomic stability and improvements to the business environment would help to encourage less risky financial flows, notably foreign direct investment (FDI). Net FDI has been poor in recent years but was expected to pick up this year in line with an acceleration of the government's privatisation programme. However legal and administrative problems have delayed the sales process (especially for oil refiner TUPRAS), but the government intends to launch the tender process for Turk Telekom by the end of the year. The government receiving a start-date for EU accession negotiations would also be a catalyst for long-term inward investment,

Public sector external debt service (interest plus principal but excluding deposits at the central bank) is scheduled to increase annually in 2004-06, to a peak of around USD23 billion, and to fall sharply thereafter. The increase in the payments profile is mainly due to the expected repayment of IMF loans of USD7.8 billion in 2005 and USD10.7 billion in 2006. However, the government intends to begin a new programme with the IMF after the current stand-by arrangement expires in February 2005 and this would probably enable Turkey to draw additional funds from the IMF over the coming years. Repayments to the Fund would be lower in net terms as a result. Also, with a new arrangement the government would probably be able to negotiate a short extension to its financial obligations to the IMF should financial market concerns about government financing increase.

Funding from the IMF and other international financial institutions is likely to continue to play an important role in enabling Turkey to meet its external financing needs in the coming years. In the event of a temporary shock, the government's short-term repayment capacity could be supported by the drawdown of the USD8.5 billion loan facility with the US government, and/or the realisation of official reserves, which in June 2004 stood at USD33.9 billion. Indeed the latter are currently more than twice as large as the level of public sector external debt service due within a year (excluding deposits at the central bank).

## STRATEGIES

*Disbank/Dogan Group is actively looking to expand and, over the longer-term, the Bank aims to become a leading private bank group through expanding the asset base into commercial and retail banking.*

In the current environment, Disbank is aiming to remain as liquid as possible, keeping balance sheet risk to a minimum while endeavouring to maintain good loan asset quality. In an attempt to aid earnings, cost cutting has occurred while expansion plans have been revised. This has largely been the strategy over the past couple of years.

Disbank's ultimate aim is to become a large Turkish banking group competing head-on with the leading private banks such as Isbank, Akbank, Yapi Kredi and Garanti. The Bank has increased its branch network in order to focus on retail and commercial services through a relationship approach and market segmentation. Through diversifying the business and product breadth, management believe it will be able to prosper in the new low interest and low inflation environment. Disbank will also aim at exploiting Dogan Group synergies, particularly within the energy, media businesses and retail banking activities. Initial emphasis has been given on Petrol Ofisi (POAS). Dogan Group jointly with Isbank acquired POAS in July 2000 in a privatisation process. POAS is the largest fuel distributor in the country with more than USD 4 billion turnover and has more than 4,500 retail outlets. Technology remains a core part of this new development with focus on alternative distribution channels and centralising operations.

The restructuring programme was initiated at Disbank in December 1997. The strategic change is based on several interrelated principles. The Bank has focused on raising the value and effectiveness of branches, human resources and technology. The concepts of customer focus and segmentation have been implemented across all business lines. Management has focused on the bottom line through restructuring the loan portfolio, revising trading activities and applying effective expense management policies.

A strategic plan for retail expansion was later introduced in 1999. Management strategy concentrates on developing Disbank's core business areas in corporate and personal banking, international trade finance and capital markets activities to establish uncorrelated business lines and strengthen advisory and intermediation skills. Disbank aims to deepen customer relationships by structuring complex, custom-made products and services that create added value.

The operational strategy centres on restructuring Disbank in order to create internal customers, profit centres, strategic planning, communication and teamwork. Much emphasis is placed on information technology and a strong MIS database and CRM capabilities.

Disbank has a greater degree of flexibility in formulating operational and market strategy due to its size. Disbank's management recognise this and plan to continue to exploit opportunities in all areas of operation, but see greater potential profits coming from a more innovative approach to capital markets operations and trade finance.

Disbank/Dogan Group has looked at acquisitions in the local market. After an unsuccessful bidding process of Vakifbank, the Bank/Group was selected as one of four financial groups to enter the bidding process for Pamukbank but subsequently withdrew its interest.

## OPERATIONS

*Niche market operator driven by profit centres and product and customer profitability. Product range continues to expand. Integrated financial services group.*

### Domestic

**Network** Disbank's domestic network currently numbers 168 branches (159 commercial and retail branches, 7 corporate branches, 1 private banking branch, 1 branch in Bahrain), supported by 260 ATMs (its target is 270 ATMs by end 2004) plus 97 Direct Access Points (DAPs) in shopping malls and airports. It is also a member of Golden Point (ATM sharing Programme) with 4,200 ATMs (Akbank, Disbank, Garanti, Kocbank, Vakifbank). The Bank has aggressively expanded its branch network over the years, with the number of branches rising from 21 at the end of 1995. The reasons have largely been two-fold. On the liabilities side, the Banks has been trying to build its base of core customer deposits in order to have a good stock of stable and cheap funding in place. In tandem, Disbank recognised the need to build the customer base and market reach, to widen and diversify its income stream, especially as easy money from high yielding government securities diminishes. Disbank selectively acquired 23 branches from banks under the SDIF (7 branches from former Iktisat, 2 branches of former Kentbank, 4 branches from former Etibank and 10 branches from Toprakbank).

**Business focus** Marketing strategy for retail clients was formed around expanding the branch network, including satellite branches. The operation will be technology and product driven with relationship based marketing. Disbank has also established a private banking operation. Overall, product and customer profitability will be key.

Retail operations have expanded quite rapidly over the last couple of years. Credit cards issued at the end 2003 stood at 713,000, giving the Bank a share of 3.6% (up sharply from just 0.2% two years ago and 2% a year ago). Active credit cards total 363,000. Credit card turnover is currently USD330mn. The number of debit cards issued is 965,000 at end 2003. The Bank currently has 62,000 operative POS terminals, where the market share (quantity) has risen to 7.3% (turnover 6.1%). The number of accounts stood at 2.3mn at end 2003 with 1.2mn customers.

Disbank had 150,000 active internet customers as of 2003. The Bank has over 200,000 active phone-banking customers.

The Bank was one of the first Turkish banks to specialise in trade finance. Foreign trade has historically received differing degrees of political support in Turkey. By 1981, reforms had led to a sharp increase in exports and many banks began to recognise the profit potential in providing export finance. The foreign banks in Turkey were initially the leaders in this business, as they had better access to foreign currency. Local banks also became active in export finance but Disbank's years of experience gave it a strong competitive advantage at that time. The current market share in international trade is 6.2% at end 2003.

In 2000/2001, the emphasis moved to capital markets activities. Proprietary trading in the Treasury bill and government bond markets and in repos, together with the investment and management of funds on behalf of clients is undertaken by the Bank's capital markets division and has become a very profitable activity in recent years. Corporate banking activities are concentrated on the finance of international trade and taking participations in local syndications for longer-term projects. Disbank has traditionally focused on leading Turkish companies within the top 500 including export trading firms, subsidiaries of large industrial groups, and multinationals. The credit policy incorporates a sector diversification strategy. The retail business has three key components: card operations; deposits and insurance; and consumer loans. The Bank is a member of Visa International and issues Classic and Gold credit cards. Corporate banking operations are driven by relationship banking, but Disbank hopes to penetrate the market further through its cash management products. A small number of branches will concentrate purely on corporate banking for prime clients.

## **International**

**Network** The Bank has an offshore branch in Bahrain, and subsidiary banks in Malta and, until August 2003, the Netherlands. The latter was sold to Demir-Halk Bank in August 2003 for €46.9mn. Correspondent relationships are important to the Bank and are maintained in numerous countries, especially concentrating on those undertaking significant trade with Turkey. The Bank's correspondent banking division is responsible for initiating and maintaining correspondent relationships. Disbank successfully raised USD200mn in August 2003 from syndicated loan markets with 19 banks from Europe, US and Japan taking part in the deal. In August 2004 the syndication was renewed for USD400mn with participation of 60 banks and overall cost was 70bp lower than the previous deal.

**Business focus** The Bank channels the international business of its customer base through its growing correspondent network. International transaction volumes are mainly made up of confirmed and non-confirmed letters of credit to exporters and importers, pre- and post-financing credits to exporters, the discounting of export letters of credit and import credits from international institutions. Due to the volatility of the TRL, currency substitution is common in Turkey, with many domestic depositors preferring to place foreign currency (FCY), especially US dollars and DEM with banks. Together with foreign borrowings in FCY, the banks place a large proportion of these funds in FCY denominated investments/loans. Hence, the proportion of the balance sheet, both assets and liabilities denominated in FCY tends to be high in Turkey.

## **BUSINESS PROSPECTS**

*Strong year earnings wise in 2003. Disbank is supported by a good level of both liquidity and capital which will support its growth. The outlook over the medium-term will remain tough due to competitive pressures. However, Disbank's franchise continues to grow and should provide the base for future returns.*

Disbank recorded very high profitability in 2003. Management continues to focus on maintaining liquidity, restricting risk positions, reducing costs and preserving shareholders' equity. However, the Bank is also emphasising growth, aiming to build its retail/commercial franchise and gain market share through product development. The banking sector has recorded improvement over the last two years on the back of a more stable operating environment.

The Bank is looking to expand its market share in the domestic banking sector, possibly through acquiring a bank if the right opportunity arises. However, the Bank has been able to grow largely organically, raising its market share in the areas of retail and commercial business. The customer base is now fairly sizeable and this should provide the impetus for future revenue growth once the environment stabilises. Disbank's balance sheet is supported by a good level of capital.

## **AUTOMATION AND INFORMATION TECHNOLOGY**

### **Strong focus on technology and information systems.**

Automation and information technology systems form a key part of Disbank's operations and are given significant investment and attention. The Bank has always taken advantage of new technology to improve services and the flow of management information. The Bank has upgraded both hardware and software. Mainframe computing has been replaced with networks in which 900 terminals are operational and each branch operates on-line real-time. The Bank has introduced various new systems in the last few years, including securities and funds services, electronic funds transfer, dealing systems, management information systems. Communication, both external and internal, with the introduction of a web site and use of the internet and an intranet, connecting head office and all branches. In 1998, Disbank migrated from a proprietary to an open enterprise server, creating a new platform for management information systems. The Bank also took the decision to migrate banking systems to a new open system platform.

## MANAGEMENT QUALITY

*Very good management profile and culture.*

In November 1997, Dr Vural Akisik, an experienced, well-known and successful Turkish banker, previously managing Turk Merchant Bank was appointed as the new CEO to formulate a new strategy and improve financial performance. Along with the appointment of Mr Akisik, management depth at the top level improved and deepened, while staff rationalisation has occurred across all levels. The culture of the Bank changed noticeably in this period. Mr Akisik was appointed to head Ziraat/Halk Bank in April 2001, to implement much needed reforms in state banking. Mr Tayfun Bayazit another experienced and well-respected banker, was appointed as the new CEO in April 2001. He held executive positions for 13 years at the Cukurova Group (Yapi Kredi as SEVP, Interbank and BCP, Switzerland as CEO). Mr Bayazit had been with Dogan Group (vice chairman of the holding company and VC of POAS) for the previous three years. Mr Bayazit was appointed Chairman and CEO at the General Assembly in 2003. He also serves as Chairman of all the financial subsidiaries of the bank. The top management team is capable, experienced and stable, having been intact over the past three years during the Bank's successful retail expansion phase under Mr Bayazit's leadership.

## SYSTEMS AND CONTROLS

All credit decisions are taken either at the Credit Committee, which comprises deputy general managers, president, and the CEO or the board of directors depending on the size of the credit in question. A decentralised approach for commercial and consumer loans was implemented in 2000 based on a scoring system. All credit risk for corporate, commercial and consumer assets is monitored by the Head Office Credit Department. Lending authority is centralised for corporate credits. Lending authority up to an aggregate of USD1.5mn is extended to the branches for commercial and consumer loans, each loan amount not exceeding USD100,000. Risk in any one sector may not exceed 15% of total risk. The total credit risk of any one corporation or financial group cannot be taken on by the Bank. Risk of any one corporation or financial group may take up a maximum of 10% of the total risk of the Bank. Loans are classified under four categories: standard, closely monitored, renewed and rescheduled, and loans under legal follow-up. Loans are classified under 'loans under legal follow-up' if interest due is not collected within 30 days from the due date. The Bank also has in place tight controls related to both market and liquidity risks.

The Bank has completed a number of major risk management projects over the last two years. Its market risk management project was completed in March 2002, its counterparty credit risk measurement project in May 2002 and its asset-liability risk management system in August 2002. In July 2003, the Bank segregated its banking and trading books and implemented forward and back office software. Market risk is measured by VaR and Extreme Value Theory with daily VaR reporting, scenario reports and yield curve generation. Credit risk is managed through Monte Carlo methods and KMW for counterparty credit risk. Around 54% of market risk is represented by securities, 26% in the credit portfolio and 13% in placements. Interest rate modelling is conducted through CIR and Hull and White models. Basle II requirements should be fully achieved by end 2004.

## Subsidiaries

**Dis Yatirim**, the investment banking subsidiary, was set up in late 1996 in line with new capital market directives, and is ranked ninth largest in Turkey. Dis Yatirim manages three of the biggest mutual funds in the market. Its main business lines are proprietary trading and client base trading. It is also placing more attention on M&A, venture capital and project finance. **Dis Leasing** has a well-diversified portfolio and is the sixth largest leasing company in Turkey in terms of business volume and market share. On the back of limited funding sources and slow demand, Dis Leasing is maintaining business volume and profit margins by working with medium-size companies, concentrating on industrial machinery and equipment. The market share of Dis Leasing is 5.6%. **Dis Factoring** is the seventh biggest factoring company in Turkey with a market share of approximately 3.6% in domestic factoring and 2.2% in export factoring conducted in Turkey. All the financial subsidiaries returned to profitability in 2002 following a

difficult year in 2001. Year 2003 was also good. Other subsidiaries include Ray Sigorta, Dogan Emeklilik (pension) Sigorta. Foreign affiliates Disbank Hollanda and Disbank Malta have capital of €40mn and €33mn respectively. Disbank Malta has total assets of USD580mn at end 2003. Ray Sigorta, a significant subsidiary of Disbank, subject to full consolidation ranks ninth based on premium generation. The subsidiary has improved its market share to 4.6%.

## FINANCIAL ANALYSIS

### AUDITORS AND DISCLOSURE

Disbank's accounts (audited by PricewaterhouseCoopers) are consolidated and inflationary adjusted.

### ASSET QUALITY

*Very good loan asset quality backed up by high level of provisioning. .*

| %                                  | 12/03 | 12/02 | 12/01 |
|------------------------------------|-------|-------|-------|
| NPLs/Total Loans                   | 3.57  | 4.20  | 6.61  |
| Provisions/Total Loans             | 3.35  | 4.04  | 4.60  |
| Loan Loss Provisions/NPLs          | 93.95 | 96.29 | 69.58 |
| Net Loans/Total Assets             | 43.02 | 47.05 | 35.93 |
| Government Securities/Total Assets | 32.33 | 29.19 | 19.11 |

**Asset Composition** The asset composition profile was broadly in line with that of 2002 although loans as a percentage of the balance sheet fell slightly. On the back of improved economic and trading conditions in 2002, the Bank directed funds to government securities which comprised 29% of total assets at the year-end against 19% at end 2001. This rose slightly, to 32% in 2003. During 2000-01, the Bank's focus was heavily on liquidity, particularly bank placements. Although experiencing very challenging conditions throughout 2001, as was the case for the sector, Disbank was less affected than most peer banks during the year. This was due to the conservative positioning of the balance sheet, particularly high liquidity. At end 2000, the main asset category was bank placements, forming 36% of total assets, thereby shielding it to some extent from the crisis of February 2001. During 2001, the Bank again focused on liquidity and at the year-end, 31% of assets were in bank placements. Bank placements were 13% of total assets at end 2003 (2002: 10%).

**Securities** Investment securities comprised nearly all available-for-sale securities (TRL1,365trillion) with TRL29 trillion of held-to-maturity securities. Debt securities comprised mainly government bonds of TRL761 trillion and Eurobonds of TRL525 trillion. Approximately half the investment securities were denominated in US dollar with one-half also over one-year in tenor.

**Loans** Approximately 62% of the loan book is denominated in foreign currency. The loan book is well diversified with the main exposure (14%) directed to wholesale and retail trade as well as the textiles sector, followed by retail/consumer at 10% (5% at end 2002). Loan growth fell slightly in 2003, reflecting the fall in the value of the dollar vis-à-vis the lira. Percentage rise the main growth was directed to the retail sector.

A small percentage of the Turkish lira loans are foreign currency index linked, where the original TRL value is maintained in the books and exchange gains are booked as interest and other income accruals. Disbank collects interest on all loans on a quarterly basis. This provides a strong tool to monitor the financial strength of the Bank's clients as well as improving the liquidity of the Bank.

**Related-party lending** The Dogan Group is a net provider of funds to the Bank. Cash loans at end 2003 stood at USD165mn (2002: USD462mn) and non-cash loans at USD49mn (2002: USD29mn). Legally binding collateralised deposits and treasury bills by group entities amounted to around USD50mn. Further Group deposits (deposits that are not legally binding but could be offset against group risks) amounted to USD231mn at end 2003.

**Non-performing loans** Disbank's loan asset quality improved in 2003 with NPLs to gross loans falling to 3.6% (cf. sector average of 12%). Loan asset quality inevitably deteriorated on the back of the severe economic crisis in 2001 with NPLs to gross loans increasing to 6.6% but this was well below the sector average of 28% at end 2001. Disbank has a strict classification policy and loans and interest more than 30 days overdue (also guaranteed exposure) are placed under legal or administrative follow-up. This compares to the regulatory requirement of 90 days. The provisioning coverage was high at 94% at end 2003.

**Contingents** Relative to other Turkish banks, contingent accounts and off balance sheet commitments were quite small, representing an equivalent of 24% of the balance sheet. The bulk of the USD1 billion of commitments and contingencies were local and foreign currency letters of guarantees.

## CAPITAL ADEQUACY

*Very good level of risk-weighted capital.*

| %                            | 12/03 | 12/02 | 12/01 |
|------------------------------|-------|-------|-------|
| Actual Capital Ratio – Local | 21.36 | 20.39 | 18.50 |
| Capital to Total Assets      | 15.66 | 12.01 | 14.56 |

**BIS risk asset ratio** Disbank's very good capital base was maintained at end 2003, with the capital adequacy ratio standing at 21.3%. Shareholders' equity rose by 35% in 2003 due mainly to the high earnings in the year. Free capital increased sharply, up by 60%, and amounted to USD502mn at the year-end. The Bank's free capital ratio is much higher than the vast majority of Turkish banks.

## LIQUIDITY

*Good liquidity and funding profile.*

| %   | 12/03 | 12/02 | 12/01  |
|---|-------|-------|--------|
| Net Loans/Total Deposits                    | 73.68 | 67.60 | 46.71  |
| Net Loans/Stable Funds                      | 68.31 | 65.32 | 51.33  |
| Liquid Asset Ratio                          | 50.09 | 46.24 | 56.43  |
| Customer Deposits/Total Liabilities+Capital | 50.79 | 61.96 | 57.438 |

**Funding mix** Although deposit-based liquidity ratios tightened slightly in 2003, this was due to the 15% fall in deposits. However, this fall was on the back of the rise in the value of the Lira during the year against the US dollar. The majority of deposits are dollar denominated. Disbank displays a very comfortable liquidity position. The liquid assets ratio was a high 50% at end 2003 with net loans to stable funds 68%. Disbank's funding profile changed in 2001 as a result of the crisis with borrowings from foreign banks falling sharply to USD258mn from USD718mn at end 2000. Foreign bank borrowing rose to USD432mn at end 2002 and further to USD747mn at end 2003. The Bank received a syndicated credit facility for USD200mn in July 2003 which had been renewed. Funding from customer deposits amounted to USD2.1 billion at end 2003. This represented 60% of liabilities. Around 57% of the customer deposit base is denominated in foreign currency.

**Liquidity position** Liquidity ratios were mainly stable in 2003. The key net loans to stable funds ratio was only 68%. Liquid assets were 50% against 46% the previous year. Customer deposits still exceed the loan book.

**Maturity, interest-rate and FX Risk** The Bank maintained a neutral foreign currency position throughout 2003. Maturity and interest-rate re-pricing details indicate a well matched position. At one month and three months the negative interest gap represented 12% of total assets. In regards to

maturity, the negative gap at one month was 22% of total assets due to the longer-term nature of loans and securities.

## PROFITABILITY

*Strong trading profitability in 2003*

| %                                  | 12/03 | 12/02 | 12/01  |
|------------------------------------|-------|-------|--------|
| Interest Differential              | 1.96  | 3.23  | 11.62  |
| Operating Expenses/Gross Income    | 51.24 | 61.47 | 60.09  |
| Return on Average Assets           | 4.78  | 0.88  | -2.89  |
| Return on Average Equity           | 34.46 | 7.31  | -19.52 |
| Operating Profit on Average Assets | 5.68  | 3.65  | 4.53   |

**Profit and Loss** Disbank's profitability in 2003 was very high, with net profit up by over 450% to USD194mn. Disbank recorded net profit of USD35mn in 2002 against a loss of USD67mn in 2001. The return on average assets was a very high 4.78% in 2003. Net interest income was down by 14% due to the sharp fall in domestic interest rates together with the slight fall in the loan book. However, non-interest income doubled to USD265mnl led by dealing securities income of USD191mn. The Bank's treasury department performed extremely well in 2003 and capitalised on falling interest rates connected to the capital markets. Disbank is one of the main dealers in the market in respect to government securities. Fees and commission income also recorded strong growth, up by 120% with the Bank starting to capitalise on its customer base and franchise. Operating expenses were well held, up by just 4.5%. The provision charge fell to USD14.4mn from USD41mn. The lower net monetary loss reflected the steep fall in inflation during the year.

**Cost base** Operating expenses rose by 4.5% in 2003 with the Bank continuing to focus on cost control. In previous years costs rose appreciably on the back of branch expansion, personnel growth and investment in technology and infrastructure. Total expenses however remain high as a percentage of average total assets, at 6%. Depreciation expenses continued to rise sharply on account of new branches and systems upgrading over the previous few years. Operating expenses to gross income fell to a respectable 51% at end 2003 (2002: 61%) on account of the high income.

**Results end-March 2004** Bank only (BRSA accounting standards) figures for 1Q 2004 showed net profit of TRL14.6 trillion against a loss of TRL2.7 trillion in 1Q 2002. Net operating income was down but income from associates and subsidiaries was higher. FX gains also increased but the bottom line was held back by a higher provision charge.

| PERFORMANCE RATIOS  | External Audit | AUD<br>12/2003 | AUD<br>12/2002 |
|---|----------------|----------------|----------------|
| <b>A . SIZE FACTORS</b>   |                |                |                |
| 1 . Total Assets (USD 000)  |                | 4,122,871      | 3,977,843      |
| 2 . Total Capital (USD 000)   |                | 645,696        | 477,881        |
| <b>B . ASSET QUALITY</b>  |                |                |                |
| 3 . Total Assets Growth Rate (Year on Year %)                           |                | 3.65           |                |
| 4 . Loan-Loss Reserve to Gross Loans (%)                                |                | 3.35           | 4.04           |
| 5 . Non-Performing Loans to Gross Loans (%)                             |                | 3.57           | 4.20           |
| 6 . Loan-Loss Reserve to Non-Performing Loans (%)                       |                | 93.95          | 96.29          |
| 7 . Unprovided Non-Performing Loans to Free Capital (%)                 |                | 0.79           | 0.97           |
| 8 . Loan-Loss Provision Charge on Gross Loans (%)                       |                | 0.79           | 2.10           |
| 9 . Reserve for Dimin. of Investments to Total Investments (%)          |                |                |                |
| 10 . Related Party Loans to Total Capital (%)                           |                |                | 96.64          |
| 11 . Total Contingents on Total Assets (%)                              |                | 24.39          | 31.93          |
| <b>C . CAPITAL ADEQUACY</b>   |                |                |                |
| 12 . Cl Risk Asset Ratio (%)  |                | 16.60          | 9.55           |
| 13 . Estimated BIS Risk Asset Ratio (%)                                 |                | 20.24          | 13.65          |
| 14 . Estimated BIS RAR on Tier One Capital (%)                          |                | 20.24          | 13.65          |
| 15 . Actual Risk Asset Ratio to Local Standards (%)                     |                | 20.39          | 18.50          |
| 16 . Internal Capital Generation (%)                                    |                | 33.89          | 18.21          |
| 17 . Total Capital Growth Rate (Year on Year %)                         |                | 35.12          |                |
| 18 . Total Capital to Total Assets (%)                                  |                | 15.66          | 12.01          |
| 19 . Total Capital to Gross Loans (%)                                   |                | 35.18          | 24.50          |
| 20 . Free Capital Funds (TRL mn)  |                | 701,684,000    | 437,937,000    |
| 21 . Estimated BIS RAR Shortfall (TRL mn)                               |                | 0              | 0              |
| 22 . Risk Weighted Assets on Total Footings (%)                         |                | 61.69          | 65.51          |
| <b>D . LIQUIDITY</b>  |                |                |                |
| 23 . Net Loans to Total Deposits (%)                                    |                | 73.68          | 67.59          |
| 24 . Net Loans to Total Customer Deposits (%)                           |                | 84.71          | 75.94          |
| 25 . Net Loans to Stable Funds (%)                                      |                | 68.31          | 67.37          |
| 26 . Customer Deposits to Total Deposits (%)                            |                | 86.98          | 89.01          |
| 27 . Liquid Asset Ratio (%)   |                | 50.09          | 46.24          |
| 28 . Quasi-Liquid Asset Ratio (%)                                       |                | 50.47          | 46.34          |
| 29 . FX Currency Assets to FX Currency Liabilities (%)                  |                | 97.39          | 107.46         |
| 30 . FX Currency Loans to FX Currency Deposits (%)                      |                | 55.57          | 59.77          |
| 31 . Interbank Assets to Interbank Liabilities (%)                      |                | 169.57         | 137.06         |
| 32 . Net Interbank Assets (TRL mn)                                      |                | 304,487,000.00 | 157,556,000.00 |
| <b>E . PROFITABILITY</b>  |                |                |                |
| 33 . Return on Average Assets (%)                                       |                | 4.78           | 0.88           |
| 34 . Return on Average Equity (%)                                       |                | 34.46          | 7.31           |
| 35 . Underlying Profits on Average Assets (%)                           |                | 0.15           | 1.78           |
| 36 . Underlying Profits on Average Equity (%)                           |                | 1.11           | 14.78          |
| 37 . Funding Cost (%)   |                | 13.54          | 17.63          |
| 38 . Interest on Average Earning Assets (%)                             |                | 15.51          | 20.86          |
| 39 . Interest Differential (%)  |                | 1.96           | 3.23           |
| 40 . Non-Interest Income to Gross Income (%)                            |                | 56.21          | 35.88          |
| 41 . Operating Expenses to Gross Income (%)                             |                | 51.24          | 61.47          |
| 42 . Operating Profit Growth Rate (%)                                   |                | 58.58          |                |
| 43 . Operating Profit on Average Assets (%)                             |                | 5.68           | 3.65           |
| 44 . Risk Provisioning Charge to Operating Profit (%)                   |                | 6.27           | 28.15          |
| 45 . Dividend Payout Ratio (%)  |                | 0.00           | 0.00           |
| <b>RATES</b>  |                |                |                |
| Exchange Rate (Units per USD)   |                | 1,396,638      | 1,396,638      |
| Inflation Rate (%)  |                | 14.50          | 30.80          |
| Imputed Interest Rate on Free Capital (%)<br>(Average Government Bonds) |                | 29.95          | 47.56          |

NOTES:

| BALANCE SHEET - ASSETS (TRL mn) |  |                  |                      |                      |                         |         |   |               |               |   |
|---------------------------------|--|------------------|----------------------|----------------------|-------------------------|---------|---|---------------|---------------|---|
| RISK                            | External Audit                             | 12/2003          | AUD                  | AUD                  | Growth (%)              |         |   | Breakdown (%) |               |   |
| WGHT                            |  | USD 000          | 12/2003              | 12/2002              | 12/2003                 | 12/2002 | 0 | 12/2003       | 12/2002       | 0 |
| <b>LIQUID ASSETS:</b>           |  |                  |                      |                      |                         |         |   |               |               |   |
| 0%                              | Cash & 7 Day                               | 36,790           | 51,382,000           | 62,556,000           | -17.86                  |         |   | 0.89          | 1.13          |   |
| 0%                              | Central Bank                               | 164,139          | 229,243,000          | 301,917,000          | -24.07                  |         |   | 3.98          | 5.43          |   |
| 10%                             | Treasury Bills                             | 975,467          | 1,362,374,000        | 279,653,000          | 387.17                  |         |   | 23.66         | 5.03          |   |
| 20%                             | Government Bonds                           | 357,249          | 498,948,000          | 1,342,268,000        | -62.83                  |         |   | 8.67          | 24.16         |   |
| 20%                             | Profit Sharing Notes                       |                  |                      |                      |                         |         |   |               |               |   |
|                                 | <b>TOTAL LIQUID ASSETS</b>                 | <b>1,533,645</b> | <b>2,141,947,000</b> | <b>1,986,394,000</b> | <b>7.83</b>             |         |   | <b>37.20</b>  | <b>35.75</b>  |   |
| <b>DEPOSITS WITH BANKS:</b>     |  |                  |                      |                      |                         |         |   |               |               |   |
| 20%                             | Short - Up to 1 Year                       | 147,312          | 205,741,000          | 284,845,000          | -27.77                  |         |   | 3.57          | 5.13          |   |
| 20%                             | Short - Interbank Funds                    | 384,067          | 536,403,000          | 297,859,000          | 80.09                   |         |   | 9.32          | 5.36          |   |
| 100%                            | Non - OECD Medium Term                     |                  |                      |                      |                         |         |   |               |               |   |
|                                 | <b>TOTAL DEPOSITS WITH BANKS</b>           | <b>531,379</b>   | <b>742,144,000</b>   | <b>582,704,000</b>   | <b>27.36</b>            |         |   | <b>12.89</b>  | <b>10.49</b>  |   |
|                                 | <b>MARKETABLE SECURITIES</b>               | <b>15,594</b>    | <b>21,779,000</b>    | <b>5,385,000</b>     | <b>&lt;&lt;&lt;&lt;</b> |         |   | <b>0.38</b>   | <b>0.10</b>   |   |
| <b>LOANS AND ADVANCES:</b>      |  |                  |                      |                      |                         |         |   |               |               |   |
| 20%                             | Government Guaranteed                      | 30,753           | 42,951,000           | 54,786,000           | -21.60                  |         |   | 0.75          | 0.99          |   |
| 50%                             | First Mortgage Loans                       |                  |                      |                      |                         |         |   |               |               |   |
| 100%                            | Bills Disc. & Short Term                   | 1,655,743        | 2,312,473,000        | 2,466,245,000        | -6.24                   |         |   | 40.16         | 44.39         |   |
| 100%                            | Medium/Long Term                           |                  |                      |                      |                         |         |   |               |               |   |
| 100%                            | Other - Finance Leases                     | 83,223           | 116,232,000          | 88,858,000           | 30.81                   |         |   | 2.02          | 1.60          |   |
| 100%                            | Non-Performing Loans                       | 65,428           | 91,379,000           | 114,438,000          | -20.15                  |         |   | 1.59          | 2.06          |   |
| 100%                            | Loan-Loss Reserve                          | -61,470          | -85,851,000          | -110,189,000         | -22.09                  |         |   | -1.49         | -1.98         |   |
|                                 | <b>NET LOANS AND ADVANCES</b>              | <b>1,773,677</b> | <b>2,477,184,000</b> | <b>2,614,138,000</b> | <b>-5.24</b>            |         |   | <b>43.02</b>  | <b>47.05</b>  |   |
| 100%                            | <b>UNQUOTED INVESTMENTS</b>                | <b>5,528</b>     | <b>7,721,000</b>     | <b>7,007,000</b>     | <b>10.19</b>            |         |   | <b>0.13</b>   | <b>0.13</b>   |   |
| 100%                            | <b>NON-FINANCIAL SUBS &amp; AFFILIATES</b> |                  |                      |                      |                         |         |   |               |               |   |
|                                 | <b>FINANCIAL SUBS &amp; AFFILIATES</b>     | <b>5,478</b>     | <b>7,651,000</b>     | <b>12,125,000</b>    | <b>-36.90</b>           |         |   | <b>0.13</b>   | <b>0.22</b>   |   |
| 100%                            | <b>FIXED ASSETS</b>                        | <b>137,808</b>   | <b>192,468,000</b>   | <b>217,365,000</b>   | <b>-11.45</b>           |         |   | <b>3.34</b>   | <b>3.91</b>   |   |
| 100%                            | <b>OTHER ASSETS</b>                        | <b>119,763</b>   | <b>167,265,000</b>   | <b>130,488,000</b>   | <b>28.18</b>            |         |   | <b>2.90</b>   | <b>2.35</b>   |   |
|                                 | <b>TOTAL ASSETS</b>                        | <b>4,122,871</b> | <b>5,758,159,000</b> | <b>5,555,606,000</b> | <b>3.65</b>             |         |   | <b>100.00</b> | <b>100.00</b> |   |
| <b>CONTINGENT ACCOUNTS:</b>     |  |                  |                      |                      |                         |         |   |               |               |   |
| 100%                            | Fin. Gtees/SLCs/Acceptances                | 824,550          | 1,151,598,000        | 1,378,677,000        | -16.47                  |         |   | 81.99         | 77.72         |   |
| 50%                             | Bid & Performance Bonds                    |                  |                      |                      |                         |         |   |               |               |   |
| 20%                             | LCS/Bank & Govt Guarantees                 | 181,111          | 252,947,000          | 395,276,000          | -36.01                  |         |   | 18.01         | 22.28         |   |
| 10%                             | Bonding for Banks & Govts                  |                  |                      |                      |                         |         |   |               |               |   |
| 5%                              | IR Swaps/Bank & Govt LCs                   |                  |                      |                      |                         |         |   |               |               |   |
|                                 | <b>TOTAL CONTINGENT ACCOUNTS</b>           | <b>1,005,661</b> | <b>1,404,545,000</b> | <b>1,773,953,000</b> | <b>-20.82</b>           |         |   | <b>100.00</b> | <b>100.00</b> |   |
|                                 | <b>TOTAL FOOTINGS</b>                      | <b>5,128,533</b> | <b>7,162,704,000</b> | <b>7,329,559,000</b> | <b>-2.28</b>            |         |   |               |               |   |
|                                 | <b>RISK WEIGHTED ASSETS</b>                | <b>3,163,812</b> | <b>4,418,699,400</b> | <b>4,801,246,100</b> | <b>-7.97</b>            |         |   |               |               |   |

| BALANCE SHEET - LIABILITIES (TRL mn) |                                      |                  |                      |                      |               |         |   |               |               |   |
|--------------------------------------|--------------------------------------|------------------|----------------------|----------------------|---------------|---------|---|---------------|---------------|---|
|                                      |                                      | USD 000          | 12/2003              | 12/2002              | Growth (%)    |         |   | Breakdown (%) |               |   |
|                                      |                                      |                  |                      |                      | 12/2003       | 12/2002 | 0 | 12/2003       | 12/2002       | 0 |
| <b>INTERBANK LIABILITIES:</b>        |                                      |                  |                      |                      |               |         |   |               |               |   |
|                                      | Current & 7 Day                      | 25,475           | 35,580,000           | 61,599,000           | -42.24        |         |   | 0.62          | 1.11          |   |
|                                      | Short - Borrowings & Deposits        | 49,625           | 69,308,000           | 230,989,000          | -70.00        |         |   | 1.20          | 4.16          |   |
|                                      | Other - Interbank Funds              | 238,264          | 332,769,000          | 132,560,000          | 151.03        |         |   | 5.78          | 2.39          |   |
|                                      | <b>TOTAL INTERBANK LIABILITIES</b>   | <b>313,365</b>   | <b>437,657,000</b>   | <b>425,148,000</b>   | <b>2.94</b>   |         |   | <b>7.60</b>   | <b>7.65</b>   |   |
| <b>CUSTOMER DEPOSITS:</b>            |                                      |                  |                      |                      |               |         |   |               |               |   |
|                                      | Demand                               | 352,028          | 491,655,000          | 592,856,000          | -17.07        |         |   | 8.54          | 10.67         |   |
|                                      | Savings                              |                  |                      |                      |               |         |   |               |               |   |
|                                      | Time                                 | 1,741,889        | 2,432,788,000        | 2,849,379,000        | -14.62        |         |   | 42.25         | 51.29         |   |
|                                      | Other                                |                  |                      |                      |               |         |   |               |               |   |
|                                      | <b>TOTAL CUSTOMER DEPOSITS</b>       | <b>2,093,916</b> | <b>2,924,443,000</b> | <b>3,442,235,000</b> | <b>-15.04</b> |         |   | <b>50.79</b>  | <b>61.96</b>  |   |
| <b>OFFICIAL DEPOSITS</b>             |                                      |                  |                      |                      |               |         |   |               |               |   |
|                                      | <b>TOTAL DEPOSITS + INTERBANK</b>    | <b>2,407,281</b> | <b>3,362,100,000</b> | <b>3,867,383,000</b> | <b>-13.07</b> |         |   | <b>58.39</b>  | <b>69.61</b>  |   |
|                                      | <b>OTHER LIABILITIES</b>             | <b>1,069,895</b> | <b>1,494,256,000</b> | <b>1,020,796,000</b> | <b>46.38</b>  |         |   | <b>25.95</b>  | <b>18.37</b>  |   |
| <b>MEDIUM/LONG TERM LIABILITIES</b>  |                                      |                  |                      |                      |               |         |   |               |               |   |
| <b>TIER TWO CAPITAL:</b>             |                                      |                  |                      |                      |               |         |   |               |               |   |
|                                      | Asset Revaluation Reserve            | 0                | 0                    | 0                    | -             |         |   | 0.00          | 0.00          |   |
|                                      | Hybrid Capital Instruments           | 0                | 0                    | 0                    | -             |         |   | 0.00          | 0.00          |   |
|                                      | Subordinated Term Debt               | 0                | 0                    | 0                    | -             |         |   | 0.00          | 0.00          |   |
|                                      | <b>TOTAL TIER TWO CAPITAL</b>        | <b>0</b>         | <b>0</b>             | <b>0</b>             | <b>-</b>      |         |   | <b>0.00</b>   | <b>0.00</b>   |   |
| <b>TIER ONE CAPITAL:</b>             |                                      |                  |                      |                      |               |         |   |               |               |   |
|                                      | Paid Up Capital                      | 421,673          | 588,925,000          | 509,179,000          | 15.66         |         |   | 10.23         | 9.17          |   |
|                                      | Minority Interests                   | 8,994            | 12,562,000           | 15,169,000           | <<<<          |         |   | 0.22          | 0.27          |   |
|                                      | Reserves                             | 215,028          | 300,316,000          | 143,079,000          | 109.90        |         |   | 5.22          | 2.58          |   |
|                                      | <b>TOTAL TIER ONE CAPITAL</b>        | <b>645,696</b>   | <b>901,803,000</b>   | <b>667,427,000</b>   | <b>35.12</b>  |         |   | <b>15.66</b>  | <b>12.01</b>  |   |
|                                      | <b>TOTAL CAPITAL</b>                 | <b>645,696</b>   | <b>901,803,000</b>   | <b>667,427,000</b>   | <b>35.12</b>  |         |   | <b>15.66</b>  | <b>12.01</b>  |   |
|                                      | <b>TOTAL LIABILITIES AND CAPITAL</b> | <b>4,122,871</b> | <b>5,758,159,000</b> | <b>5,555,606,000</b> | <b>3.65</b>   |         |   | <b>100.00</b> | <b>100.00</b> |   |

| PROFIT AND LOSS ACCOUNT (TRL mn) |                                 |                |                    |                    |               |         |   |                           |              |   |
|----------------------------------|---------------------------------|----------------|--------------------|--------------------|---------------|---------|---|---------------------------|--------------|---|
|                                  |                                 | USD 000        | 12/2003            | 12/2002            | Growth (%)    |         |   | % of Average Total Assets |              |   |
|                                  |                                 |                |                    |                    | 12/2003       | 12/2002 | 0 | 12/2003                   | 12/2002      | 0 |
|                                  | Interest Income                 | 557,347        | 778,412,000        | 1,019,225,000      | -23.63        |         |   | 13.76                     | 18.35        |   |
|                                  | Interest Expense                | -350,545       | -489,585,000       | -681,772,000       | -28.19        |         |   | -8.65                     | -12.27       |   |
|                                  | <b>Net Interest</b>             | <b>206,802</b> | <b>288,827,000</b> | <b>337,453,000</b> | <b>-14.41</b> |         |   | <b>5.11</b>               | <b>6.07</b>  |   |
|                                  | Fees and Commissions            | 50,458         | 70,472,000         | 31,974,000         | 120.40        |         |   | 1.25                      | 0.58         |   |
|                                  | FX Translation Loss             | 3,029          | 4,230,000          | -10,625,000        | 139.81        |         |   | 0.07                      | -0.19        |   |
|                                  | Dealing Securities Income       | 191,481        | 267,429,000        | 78,541,000         | 240.50        |         |   | 4.73                      | 1.41         |   |
|                                  | Other Investment Income         | 1,635          | 2,284,000          | 34,055,000         | -93.29        |         |   | 0.04                      | 0.61         |   |
|                                  | Other Income                    | 18,848         | 26,324,000         | 54,852,000         | -52.01        |         |   | 0.47                      | 0.99         |   |
|                                  | <b>Non Interest Income</b>      | <b>265,451</b> | <b>370,739,000</b> | <b>188,797,000</b> | <b>96.37</b>  |         |   | <b>6.55</b>               | <b>3.40</b>  |   |
|                                  | <b>GROSS INCOME</b>             | <b>472,253</b> | <b>659,566,000</b> | <b>526,250,000</b> | <b>25.33</b>  |         |   | <b>11.66</b>              | <b>9.47</b>  |   |
|                                  | Administrative Expenses         | 169,990        | 237,414,000        | 270,269,000        | -12.16        |         |   | 4.20                      | 4.86         |   |
|                                  | Depreciation                    | 55,483         | 77,489,000         | 49,619,000         | 56.17         |         |   | 1.37                      | 0.89         |   |
|                                  | Other Expenses                  | 16,530         | 23,086,000         | 3,572,000          | 546.30        |         |   | 0.41                      | 0.06         |   |
|                                  | <b>OPERATING EXPENSES</b>       | <b>242,002</b> | <b>337,989,000</b> | <b>323,460,000</b> | <b>4.49</b>   |         |   | <b>5.97</b>               | <b>5.82</b>  |   |
|                                  | <b>OPERATING PROFIT</b>         | <b>230,251</b> | <b>321,577,000</b> | <b>202,790,000</b> | <b>58.58</b>  |         |   | <b>5.68</b>               | <b>3.65</b>  |   |
|                                  | Provisions for Doubtful Debts   | -14,433        | -20,158,000        | -57,094,000        | -64.69        |         |   | -0.36                     | -1.03        |   |
|                                  | Prov. for Dimin. of Investments |                |                    |                    |               |         |   |                           |              |   |
|                                  | <b>GROSS PROFIT (or -LOSS)</b>  | <b>215,818</b> | <b>301,419,000</b> | <b>145,696,000</b> | <b>106.88</b> |         |   | <b>5.33</b>               | <b>2.62</b>  |   |
|                                  | Loss on net monetary position   | -25,254        | -35,271,000        | -72,725,000        | 51.50         |         |   | -0.62                     | -1.31        |   |
|                                  | Tax & Equivalent                | 3,017          | 4,213,000          | -24,151,000        | -117.44       |         |   | 0.07                      | -0.43        |   |
|                                  | <b>NET PROFIT (or -LOSS)</b>    | <b>193,580</b> | <b>270,361,000</b> | <b>48,820,000</b>  | <b>453.79</b> |         |   | <b>4.78</b>               | <b>-2.89</b> |   |
|                                  | Transfers/Adjustments           | -80,156        | -111,949,000       | 97,348,000         | -215.00       |         |   | -1.98                     | 1.75         |   |
| <b>APPROPRIATION:</b>            |                                 |                |                    |                    |               |         |   |                           |              |   |
|                                  | Minority Interests              | 841            | 1,175,000          | 3,089,000          | -61.96        |         |   | 0.02                      | 0.06         |   |
|                                  | Bonus Shares Issued             | 0              | 0                  | 0                  | -             |         |   | 0.00                      | 0.00         |   |
|                                  | Dividends                       | 0              | 0                  | 0                  | -             |         |   | 0.00                      | 0.00         |   |
|                                  | Movement in Reserves            | 112,583        | 157,237,000        | 143,079,000        | 9.90          |         |   | 2.78                      | 2.58         |   |
|                                  | <b>TOTAL</b>                    | <b>113,424</b> | <b>158,412,000</b> | <b>146,168,000</b> | <b>8.38</b>   |         |   | <b>2.80</b>               | <b>2.63</b>  |   |

## RATIO FORMULAE

| <b>A. Size Factors</b>  |   |
|---|---|
| 1. TOTAL ASSETS (USD 000)   |   |
| 2. TOTAL CAPITAL (USD 000)  |   |
| <b>B. Asset Quality Ratios</b>                                    |   |
| 3. TOTAL ASSETS GROWTH RATE (YEAR ON YEAR %)                      | $\frac{(\text{CURRENT YEAR TOTAL ASSETS} - \text{LAST YEAR TOTAL ASSETS}) \times 100}{\text{LAST YEAR TOTAL ASSETS}}$                           |
| 4. LOAN-LOSS RESERVE TO GROSS LOANS (%)                           | $\frac{\text{LOAN-LOSS RESERVE} \times 100}{\text{GROSS LOANS}}$  |
| 5. NON-PERFORMING LOANS TO GROSS LOANS (%)                        | $\frac{\text{NON-PERFORMING LOANS} \times 100}{\text{GROSS LOANS}}$   |
| 6. LOAN-LOSS RESERVE TO NON-PERFORMING LOANS (%)                  | $\frac{\text{LOAN-LOSS RESERVE} \times 100}{\text{NON-PERFORMING LOANS}}$   |
| 7. UNPROVIDED NON-PERFORMING LOANS TO FREE CAPITAL (%)            | $\frac{\text{NON-PERFORMING LOANS} - \text{LOAN LOSS RESERVE} \times 100}{\text{FREE CAPITAL}}$   |
| 8. LOAN-LOSS PROVISION CHARGE ON GROSS LOANS (%)                  | $\frac{\text{PROVISIONS FOR DOUBTFUL DEBTS CHARGE} \times 100}{\text{GROSS LOANS}}$   |
| 9. RESERVE FOR DIMINUTION OF INVESTMENTS TO TOTAL INVESTMENTS (%) | $\frac{\text{RESERVE FOR DIMINUTION OF INVESTMENTS} \times 100}{\text{TOTAL INVESTMENTS}}$  |
| 10. RELATED PARTY LOANS TO TOTAL CAPITAL (%)                      | $\frac{\text{RELATED PARTY LOANS} \times 100}{\text{TIER ONE} + \text{TIER TWO CAPITAL}}$   |
| 11. TOTAL CONTINGENTS ON TOTAL ASSETS (%)                         | $\frac{\text{TOTAL CONTINGENTS} \times 100}{\text{TOTAL ASSETS}}$   |
| <b>C. Capital Adequacy Ratios</b>                                 |   |
| 12. CI RISK ASSET RATIO (%)                                       | $\frac{\text{FREE CAPITAL FUNDS} \times 100}{\text{RISK WEIGHTED ASSETS} - \text{NON-FINANCIAL SUBS.} - \text{FIXED ASSETS}}$                   |
| 13. ESTIMATED BIS RISK ASSET RATIO (%)                            | $\frac{(\text{TOTAL CAPITAL} - \text{FINANCIAL SUBSIDIARIES}) \times 100}{\text{RISK WEIGHTED ASSETS}}$   |
| 14. ESTIMATED BIS RAR ON TIER ONE CAPITAL (%)                     | $\frac{\text{TIER ONE CAPITAL} - \text{FINANCIAL SUBSIDIARIES} \times 100}{\text{RISK WEIGHTED ASSETS}}$  |
| 15. ACTUAL RISK ASSET RATIO TO LOCAL STANDARDS (%)                | AS REPORTED BY LOCAL CENTRAL OR COMMERCIAL BANKS  |
| 16. INTERNAL CAPITAL GENERATION (%).                              | $\frac{(\text{NET PROFIT} - \text{DIVIDENDS} - \text{EXTRAORDINARY ITEMS}) \times 100}{\text{TIER ONE CAPITAL}}$                                |
| 17. TOTAL CAPITAL GROWTH RATE (YEAR ON YEAR %)                    | $\frac{(\text{CURRENT YEAR TOTAL CAPITAL} - \text{LAST YEAR TOTAL CAPITAL}) \times 100}{\text{LAST YEAR TOTAL CAPITAL}}$                        |
| 18. TOTAL CAPITAL TO TOTAL ASSETS (%)                             | $\frac{\text{TOTAL CAPITAL} \times 100}{\text{TOTAL ASSETS}}$   |
| 19. TOTAL CAPITAL TO GROSS LOANS (%)                              | $\frac{\text{TOTAL CAPITAL} \times 100}{\text{GROSS LOANS}}$  |
| 20. FREE CAPITAL FUNDS (LOCAL CURRENCY)                           | TOTAL CAPITAL - FINANCIAL & NON FINANCIAL SUBSIDIARIES - FIXED ASSETS   |
| 21. ESTIMATED BIS RAR SHORTFALL (LOCAL CURRENCY)                  | IF BIS RISK ASSET RATIO IS LESS THAN 8%<br>$(0.08 \times \text{RISK WEIGHTED ASSETS}) - (\text{TOTAL CAPITAL} - \text{FINANCIAL SUBSIDIARIES})$ |
| 22. RISK WEIGHTED ASSETS ON TOTAL FOOTINGS (%)                    | $\frac{\text{RISK WEIGHTED ASSETS} \times 100}{\text{TOTAL FOOTINGS}}$  |
| <b>D. Liquidity Ratios</b>  |   |
| 23. NET LOANS TO TOTAL DEPOSITS (%)                               | $\frac{\text{NET LOANS} \times 100}{\text{TOTAL CUSTOMER DEPOSITS} + \text{INTERBANK}}$   |
| 24. NET LOANS TO TOTAL CUSTOMER DEPOSITS (%)                      | $\frac{\text{NET LOANS} \times 100}{\text{TOTAL CUSTOMER DEPOSITS}}$  |
| 25. NET LOANS TO STABLE FUNDS (%)                                 | $\frac{\text{NET LOANS} \times 100}{\text{STABLE FUNDS}}$   |
| 26. CUSTOMER DEPOSITS TO TOTAL DEPOSITS (%)                       | $\frac{\text{TOTAL CUSTOMER DEPOSITS} \times 100}{\text{TOTAL DEPOSITS} + \text{INTERBANK}}$  |
| 27. LIQUID ASSET RATIO (%)  | $\frac{(\text{TOTAL LIQUID ASSETS} + \text{TOTAL DEPOSITS WITH BANKS}) \times 100}{\text{TOTAL ASSETS}}$  |
| 28. QUASI-LIQUID ASSET RATIO (%)                                  | $\frac{\text{QUASI-LIQUID ASSETS} \times 100}{\text{TOTAL ASSETS}}$   |
| 29. FOREIGN CURRENCY ASSETS TO FOREIGN CURRENCY LIABILITIES (%)   | $\frac{\text{FOREIGN CURRENCY ASSETS} \times 100}{\text{FOREIGN CURRENCY LIABILITIES}}$   |
| 30. FOREIGN CURRENCY LOANS TO FOREIGN CURRENCY DEPOSITS (%)       | $\frac{\text{FOREIGN CURRENCY LOANS} \times 100}{\text{FOREIGN CURRENCY BORROWINGS} + \text{FOREIGN CURRENCY DEPOSITS}}$                        |
| 31. INTERBANK ASSETS TO INTERBANK LIABILITIES (%)                 | $\frac{\text{TOTAL DEPOSITS WITH BANKS} \times 100}{\text{TOTAL INTERBANK LIABILITIES}}$  |
| 32. NET INTERBANK ASSETS (LOCAL CURRENCY)                         | TOTAL DEPOSITS WITH BANKS - TOTAL INTERBANK LIABILITIES   |

| <b>E. Profitability Ratios</b>                       |  |
|--|--|
| 33. RETURN ON AVERAGE ASSETS (%)                     | $\frac{\text{NET PROFIT (or LOSS)} \times 100}{\text{AVERAGE TOTAL ASSETS}}$   |
| 34. RETURN ON AVERAGE EQUITY (%)                     | $\frac{\text{NET PROFIT (or LOSS)} \times 100}{\text{AVERAGE TIER ONE CAPITAL} + \text{AVERAGE REVALUATION RESERVE}}$  |
| 35. UNDERLYING PROFITS ON AVERAGE ASSETS (%)         | $\frac{(\text{OPERATING PROFIT} - \text{INTEREST ON AVERAGE FREE CAPITAL}) \times 100}{\text{AVERAGE TOTAL ASSETS}}$   |
| 36. UNDERLYING PROFITS ON AVERAGE EQUITY (%)         | $\frac{(\text{OPERATING PROFIT} - \text{INTEREST ON AVERAGE FREE CAPITAL}) \times 100}{\text{AVERAGE TIER ONE CAPITAL} + \text{AVERAGE REVALUATION RESERVE}}$  |
| 37. FUNDING COST (%)                                 | $\frac{\text{INTEREST EXPENSE} \times 100}{\text{AVERAGE TOTAL DEPOSITS \& INTERBANK} + \text{AVERAGE MEDIUM/LONG TERM LIABILITIES} + \text{AVERAGE HYBRID CAPITAL INSTRUMENTS} + \text{AVERAGE SUBORDINATED TERM DEBT}}$  |
| 38. INTEREST ON AVERAGE EARNING ASSETS (%)           | $\frac{\text{INTEREST INCOME} \times 100}{\text{AVERAGE CASH \& 7 DAY} + \text{AVERAGE T-BILLS} + \text{AVERAGE GOVERNMENT SECURITIES} + \text{AVERAGE OTHER LIQUID ASSETS} + \text{AVERAGE TOTAL DEPOSITS WITH BANKS} + \text{AVERAGE MARKETABLE SECURITIES} + \text{AVERAGE NET LOANS}}$   |
| 39. INTEREST DIFFERENTIAL (%)                        | INTEREST ON AVERAGE EARNING ASSETS (%) - FUNDING COST (%)  |
| 40. NON-INTEREST INCOME TO GROSS INCOME (%)          | $\frac{(\text{GROSS INCOME} - \text{NET INTEREST}) \times 100}{\text{GROSS INCOME}}$   |
| 41. OPERATING EXPENSES TO GROSS INCOME (%)           | $\frac{\text{OPERATING EXPENSES} \times 100}{\text{GROSS INCOME}}$   |
| 42. OPERATING PROFIT GROWTH RATE (YEAR ON YEAR %)    | $\frac{(\text{CURRENT YEAR OPERATING PROFIT} - \text{LAST YEAR OPERATING PROFIT}) \times 100}{\text{LAST YEAR OPERATING PROFIT}}$  |
| 43. OPERATING PROFIT ON AVERAGE ASSETS (%)           | $\frac{\text{OPERATING PROFIT} \times 100}{\text{AVERAGE TOTAL ASSETS}}$   |
| 44. RISK PROVISIONING CHARGE TO OPERATING PROFIT (%) | $\frac{\text{PROV. CHARGE FOR DOUBTFUL DEBTS \& DIM. OF INVESTMENTS} \times 100}{\text{OPERATING PROFIT}}$   |
| 45. DIVIDEND PAYOUT RATIO (%)                        | $\frac{\text{DIVIDENDS} \times 100}{\text{NET PROFIT (or LOSS)}}$  |
| <b>DEFINITIONS:</b>                                  |  |
| <b>FREE CAPITAL:-</b>                                | FREE CAPITAL FUNDS - TIER TWO CAPITAL  |
| <b>STABLE FUNDS:-</b>                                | TOTAL CUSTOMER DEPOSITS + OFFICIAL DEPOSITS + MEDIUM/LONG TERM LIABILITIES + FREE CAPITAL FUNDS.   |
| <b>QUASI LIQUID ASSETS:-</b>                         | TOTAL LIQUID ASSETS + TOTAL DEPOSITS WITH BANKS + MARKETABLE SECURITIES.   |
| <b>TOTAL INVESTMENTS:-</b>                           | MARKETABLE SECURITIES + UNQUOTED INVESTMENTS + NON-FINANCIAL SUBSIDIARIES & AFFILIATES + FINANCIAL SUBSIDIARIES & AFFILIATES.  |
| <b>RISK WEIGHTED ASSETS:-</b>                        | WEIGHTED TOTAL OF ASSETS APPLYING THE FOLLOWING PERCENTAGES:-<br><br>100% Non-OECD medium term deposits, marketable securities, bills discounted & short term loans, medium/long term loans, other loans, non-performing loans, loan-loss provisions, unquoted investments, non-financial subsidiaries & affiliates, fixed assets, other assets, financial guarantees / standby LCs / acceptances.<br><br>50% First mortgage loans, bid & performance bonds.<br><br>20% Government securities, other liquid assets, up to 1 year deposits with banks, short/other deposits with banks, government guaranteed / collateralised loans, LCs / bank & government guarantees.<br><br>10% T-Bills, bonding for banks & governments.<br><br>5% Interest rate swaps/bank & government LCs. |
| <b>GROSS LOANS:-</b>                                 | GOVERNMENT GUARANTEED, FIRST MORTGAGE LOANS, BILLS DISC. & SHORT TERM, MEDIUM/LONG TERM LOANS, OTHER LOANS, NON-PERFORMING LOANS.  |
| <b>EQUITY:-</b>                                      | TIER ONE CAPITAL + ASSET REVALUATION RESERVE   |

# RATINGS DEFINITIONS

## Foreign & Local Currency Ratings

CI's international credit ratings assess the likelihood that an entity (*sovereign, bank or corporate*) will repay its foreign currency or local currency financial obligations in a timely manner. Both foreign currency and local currency ratings are internationally comparable assessments.

For banks and corporates, foreign currency ratings take into account sovereign-related risks including transfer and convertibility risk and the risk that the sovereign may be unable or unwilling to service its foreign currency obligations. Local currency ratings assess the likelihood of payment in local currency and unlike foreign currency ratings exclude transfer and convertibility risk. Foreign and local currency ratings take into account economic, financial and country risks that may affect an entity's creditworthiness. For banks and corporates, both types of ratings take into account the likelihood of external support in the event of financial difficulties.

Ratings assigned to banks and corporates are generally not higher than the local and foreign currency ratings assigned by CI to the relevant sovereign government. However, it may be possible for an issuer with particular strengths and attributes such as inherent financial strength, geographically diversified cash flow, significant foreign assets, and guaranteed external support, to be rated above the sovereign.

The following rating scale applies to both foreign currency and local currency ratings. Short-term ratings assess the time period up to one year.

## Long-Term Issuer Ratings

### ***Investment Grade***

- AAA The highest credit quality. Exceptional capacity for timely fulfilment of financial obligations and most unlikely to be affected by any foreseeable adversity. Extremely strong financial condition and very positive non-financial factors.
- AA Very high credit quality. Very strong capacity for timely fulfilment of financial obligations. Unlikely to have repayment problems over the long term and unquestioned over the short and medium terms. Adverse changes in business, economic and financial conditions unlikely to affect the institution significantly.
- A High credit quality. Strong capacity for timely fulfilment of financial obligations. Possesses many favourable credit characteristics but may be vulnerable slightly to adverse changes in business, economic and financial conditions.
- BBB Good credit quality. Satisfactory capacity for timely fulfilment of financial obligations. Acceptable credit characteristics but some vulnerability to adverse changes in business, economic and financial conditions. Medium grade credit characteristics and the lowest investment grade category.

- Speculative Grade**
- BB Speculative credit quality. Capacity for timely fulfilment of financial obligations vulnerable to adverse changes in internal or external circumstances. Financial and/or non-financial factors do not provide significant safeguard and the possibility of investment risk may develop.
  - B Significant credit risk. Capacity for timely fulfilment of financial obligations very vulnerable to adverse changes in internal or external circumstances. Financial and/or non-financial factors provide weak protection; high probability for investment risk exists.
  - C Substantial credit risk is apparent and the likelihood of default is high. Considerable uncertainty as to timely repayment of financial obligations. Credit is of poor standing with financial and/or non-financial factors providing little protection.
  - D Obligations are currently in default.

### Short-Term Issuer Ratings

- Investment Grade**
- A1 Superior credit quality. Highest capacity for timely repayment of short-term financial obligations that is extremely unlikely to be affected by unexpected adversities. Institutions with a particularly strong credit profile have a "+" affixed to the rating.
  - A2 Very strong capacity for timely repayment but may be affected slightly by unexpected adversities.
  - A3 Strong capacity for timely repayment that may be affected by unexpected adversities.
- Speculative Grade**
- B Adequate capacity for timely repayment that could be seriously affected by unexpected adversities.
  - C Inadequate capacity for timely repayment if unexpected adversities are encountered in the short term.
  - D May be in an untenable position and is likely to default if it does not receive immediate external support.

Capital Intelligence uses "+" and "-" signs appended to an institution's foreign and local currency **long term** ratings in the categories from "AA" to "C" to indicate that the strength of a particular institution is, respectively, slightly greater or less than that of similarly rated peers.

**Outlook** - expectations of improvement, no change or deterioration in a bank or corporate rating over the 12 months following its publication are denoted Positive, Stable or Negative. The time horizon for a sovereign rating outlook is longer, at 12-24 months.

**Qualified** - in cases where data and/or co-operation are such that it is not possible to formulate ratings to CI's high standards of robustness and reliability the letter "q" is appended to the ratings.

## Financial Strength Ratings

CI's financial strength ratings provide an opinion of a bank's inherent financial strength, soundness and risk profile. These ratings do not address sovereign risk factors, including transfer risk, which may affect an institution's capacity to honour its financial obligations, be they local or foreign currency. Financial strength ratings also exclude support factors, which are addressed by foreign and local currency ratings, as well as CI's support ratings. However, financial strength ratings do take into account the bank's operating environment including the economy, the structure, strength and stability of the financial system, the legal system, and the quality of banking regulation and supervision. Financial strength ratings do not assess the likelihood that specific obligations will be repaid in a timely manner.

The following rating scale applies to the financial strength rating.

- AAA Financially in extremely strong condition with positive financial trends; significant strengths in other non-financial areas. Operating environment likely to be highly attractive and stable.
- AA Financially in very strong condition and significant strengths in other non-financial areas. Operating environment likely to be very attractive and stable.
- A Strong financial fundamentals and very favourable non-financial considerations. Operating environment may be unstable but institution's market position and/or financial strength more than compensate.
- BBB Basically sound overall; slight weaknesses in financial or other factors could be remedied fairly easily. May be limited by unstable operating environment.
- BB One or two significant weaknesses in the bank's financial makeup could cause problems. May be characterised by a limited franchise; other factors may not be sufficient to avoid a need for some degree of temporary external support in cases of extraordinary adversity. Unstable operating environment likely.
- B Fundamental weaknesses are present in the bank's financial condition or trends, and other factors are unlikely to provide strong protection from unexpected adversities; in such an event, the need for external support is likely. Bank may be constrained by weak market position and/or volatile operating environment.
- C In a very weak financial condition, either with immediate problems or with limited capacity to withstand adversities. May be operating in a highly volatile operating environment.
- D Extremely weak financial condition and may be in an untenable position.

Capital Intelligence uses "+" and "-" signs appended to an institution's financial strength ratings in the categories from "AA" to "C" to indicate that the strength of a particular institution is, respectively, slightly greater or less than that of similarly rated peers.

**Outlook** - expectations of improvement, no change or deterioration in a rating over the 12 months following its publication are denoted Positive, Stable or Negative.

**Qualified** - in cases where data and/or co-operation are such that it is not possible to formulate ratings to CI's high standards of robustness and reliability the letter "q" is appended to the ratings.



## Support Ratings

CI's support ratings assess the likelihood that a bank would receive support in case of difficulties. Although subjective, these ratings are based on a thorough assessment of a bank's ownership, market position and importance within the sector and economy, as well as the country's regulatory and supervisory framework. Support ratings do not address the financial soundness of an institution. CI's support ratings also do not specifically address transfer risk as a result of economic and/or political events.

The following rating scale applies to support ratings.

- 1 Government-owned or clear legal guarantee on part of the state, or of such importance to the country, that the state would provide support in case of need. The state must clearly be able, and willing, to provide support.
- 2 Government support extremely likely despite absence of written guarantee. There may be some uncertainty regarding the state's willingness or ability to provide support. A private bank which has extremely strong ownership.
- 3 Owners of very good reputation and resources, and which can provide clear support.
- 4 Support is likely but not certain.
- 5 No clear support and/or support cannot be relied upon.