

## Report of the President Director

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**Sebastian Paredes, President Director**



Dear Shareholder,

I am pleased to report that, Bank Danamon has recorded a creditable financial performance despite challenging market conditions and produced healthy growth in both lending and deposit taking activity. Normalised earnings grew 7% to Rp 1,195 billion and Net Profit after tax was Rp 2,003 billion or Rp 407.71 per share.

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### **Ahead of the times**

In presenting these results I believe Bank Danamon has assumed a market-leading role through the development of a very forward-looking strategy. The Bank has been a pioneer, the first private sector bank to research and build an extensive and direct presence in the micro finance sector in Indonesia. We have invested to develop leadership in the fast growing consumer finance sector via our subsidiary, Adira Finance and we lead among local banks with our innovative treasury and corporate banking services.

Our high yield asset businesses and our ability to use multiple business models to diversify earnings distinguish us from the competition. We continually develop, test and refine new business models as part of our overall approach as a universal bank with a comprehensive financial services offer and an active presence in financial markets.

Our key performance indicator is the level of net interest margin (NIM). We have been able to sustain NIM despite the upward pressure of rising interest rates in the past year. The Bank's high yield asset base is funded substantially from a stable mix of customer deposits, as well as structured funding in local currency. We believe this gives us greater earnings potential and a substantial improvement in our asset/liability strategy.

### **How do we stand in our market at the end of 2005?**

Among Indonesia's 131 commercial banks we closed the year second largest in terms of branch network and fifth largest in loans and deposits. We are second in return on average assets (ROAA) and net interest margin (NIM). Our capital position is strong having the second highest capital adequacy among all banks at 23.5% compared with the central bank minimum requirement of 8%, and we are unsurpassed in terms of equity to assets ratio. Our enterprise risk management is clearly working with non-performing loans (NPL) just 2.6% of total lending and fully covered by provisions.

## **Our strategic priorities**

Drawing on our current competitive position, the attractive fundamentals and long term growth potential of our market, we are focusing our efforts in five strategic priorities.

### **1. To maximise our net interest margin by continuing to invest in high margin businesses and products.**

DSP, our micro finance business, and Adira Finance, our consumer finance operations grew exponentially during 2005. DSP now represents 10% of our total lending activity. In the last two years we have hired and trained approximately 6,600 employees for this business alone and during 2005 we expanded its presence by a further 475 units. In the year ahead the pace of physical expansion will slow to around 72 new units, however, we are adding new products and building new models to leverage this significant franchise. Consumer auto financing grew in 2005 by 40% in terms of receivables and 25% in volume to a new record of more than 728,000 vehicles financed, mainly motorcycles. We are planning to expand our non-auto consumer finance business further in 2006. After the initial period of slowdown, following the fuel price and interest rate hikes, we are confirming that the acquisition of Adira Finance by Danamon has proven as a key success factor in times of tight monetary policy.



## **2. To enhance our funding franchise by diversifying sources of funding and improving our entire delivery platform in terms of distribution, products and marketing**

Strong demand for credit in recent years has in turn raised competition for deposit gathering to sustain future expansion. Bank Danamon's substantial network and recognised service standards have ensured we were able to maintain a significant share in the deposit market in 2005. We benefited from the massive redemption in mutual funds, triggered by the rise in interest rates. To build further momentum a complete review of our branch presence was completed including selected closures and relocations of a number of offices and we are in the midst of hiring a further 1,000 sales people. At the close of the year our physical presence included 441 branches and a shared network of over 8,000 ATMs (ATM Bersama) including 779 of our own ATMs in 192 towns and cities across Indonesia. We are completing arrangements to obtain long-term funding through the International Finance Corporation (IFC) and other foreign institutions to fund future growth across all our businesses. Bank Danamon carries a rating by Standard and Poor's above sovereign risk which supports our efforts to obtain funding.

## **3. To be a low cost producer by substantially reducing unit transaction costs**

Our ability to grow rapidly over the last two years to keep pace with demand has been a function of detailed planning and sustained investment and this was the reason our normalised cost to income ratio increased from 41.5% to 48.8% in 2005. In the course of the year we continued to invest in technology, a strategic priority in itself but also a source of potential economies both in installation and operation. Our IT costs benchmarked against selected international peers are substantially lower. We have a designated committee looking at every aspect of cost control and we were able to reduce costs on a per transaction basis by 22% in 2005.

### **The Board of Management**

From left to right: Lam Kun Kin, Muliadi Rahardja, Tejpal Singh Hora, Ali Yong, Jerry Ng, Vera Eve Lim, Sebastian Paredes, Rene Burger, Anika Faisal, Hendarin Sukarmadji, Kanchan Nijasure



#### **4. To build world-class technology by investing in reliable, scalable and flexible systems**

Our approach is to apply technology at a level of sophistication and cost suited to the requirements of the underlying business, utilising world class systems as appropriate. An excellent example of this was the full implementation of our new Treasury and Capital markets system featuring end to end processing and in June a new transaction processing system went live for our Trade Finance operations. A collections and remedial loan management system for consumer and SME businesses was also completed in the first half along with a valuable review of our disaster recovery capability.

#### **5. To become an employer of choice by building the right attributes that will attract and retain the best talent.**

We recruited over 4,500 new employees in 2005 and completed the year with over 18,500 employees. We established an Employee Service Centre including call centre and internet access to ensure we raise the level of care and service to those upon whom we rely to deliver the promise of the Bank Danamon brand every working day. We tested the working climate with an opinion survey conducted among employees nationwide and we were pleased to score highly on job satisfaction, teamwork and corporate values. We learned that employees are keen to participate more in the development of new ideas and welcomed more training, which we view as a healthy sign of a motivated and engaged attitude. Recruitment and training is ongoing and the significant investment made during 2005 in engaging additional employees is expected to deliver commensurate returns in the year ahead as market conditions improve.

#### **Corporate Social Responsibility**

Danamon Peduli (Danamon Cares) continued to build momentum across a number of different social responsibility programmes in 2005 with an emphasis on direct participation by volunteer employees in furthering good causes.

We have been closely involved in helping the people of Aceh, from the first few days of the natural disaster occurring and onward. We supplied immediate volunteer disaster relief and financial donations in educational and self help programmes for 1,000 households through the phases of reconstruction and rehabilitation. A total of 200 houses were completed within a joint project with Bank Indonesia and Citibank committing to build 500 houses in 2005.

## **A positive outlook**

After a challenging year, the consensus view on Indonesia in 2006 suggests a rebound for the economy, but opinions vary on how soon. An interesting dichotomy has emerged. On the one hand, financial markets are bullish on the policies of a new cabinet, on Indonesia's fundamentals, a stock market rally and the rapid strengthening of the Rupiah in the first few months of 2006. On the other hand, the real economy is under strain from high fuel prices, the effects of inflation and high interest rates and in need of stimulus in the form of Government spending. A reduction of interest rates seems likely given the decision not to raise electricity prices, which in turn will ease the task of bringing down inflation. Irrespective of the final outcome of events in 2006, the bank is well positioned for several reasons:

- Given the significant level of loans in our portfolio with fixed interest terms, we will benefit from any decline in interest rates during 2006 and beyond.
- Sixty per cent of national GDP is reliant upon household spending and a large and growing portion of our business is linked directly to household consumption and indirectly, via consumer-led businesses.
- Many Indonesians do not yet have a bank account. Our DSP models and community activities are breaking through traditional barriers, building better understanding and access to the world of financial services.
- Indonesia's fundamentals, in the form of substantial natural resources, strong commodity prices (including oil and gas) and vital infrastructure development to support future economic growth, represent highly attractive inward investment opportunities. Our commercial and corporate banking teams offer valuable linkages in the commercialization, trade and downstream business associated with these opportunities. The added jobs and commercial activity for surrounding communities is a source of further business for DSP.

Bank Danamon has the skills and capacity to capitalise on these trends and your Board of Directors and I take an optimistic view for the Bank's prospects in the year ahead.

I close by taking the opportunity to express my thanks to our customers, to our employees for continuing to differentiate Bank Danamon in service, products and customer care, and to our shareholders and stakeholders for their ongoing support.

For and on behalf of the Board of Directors



**Sebastian Paredes, President Director**