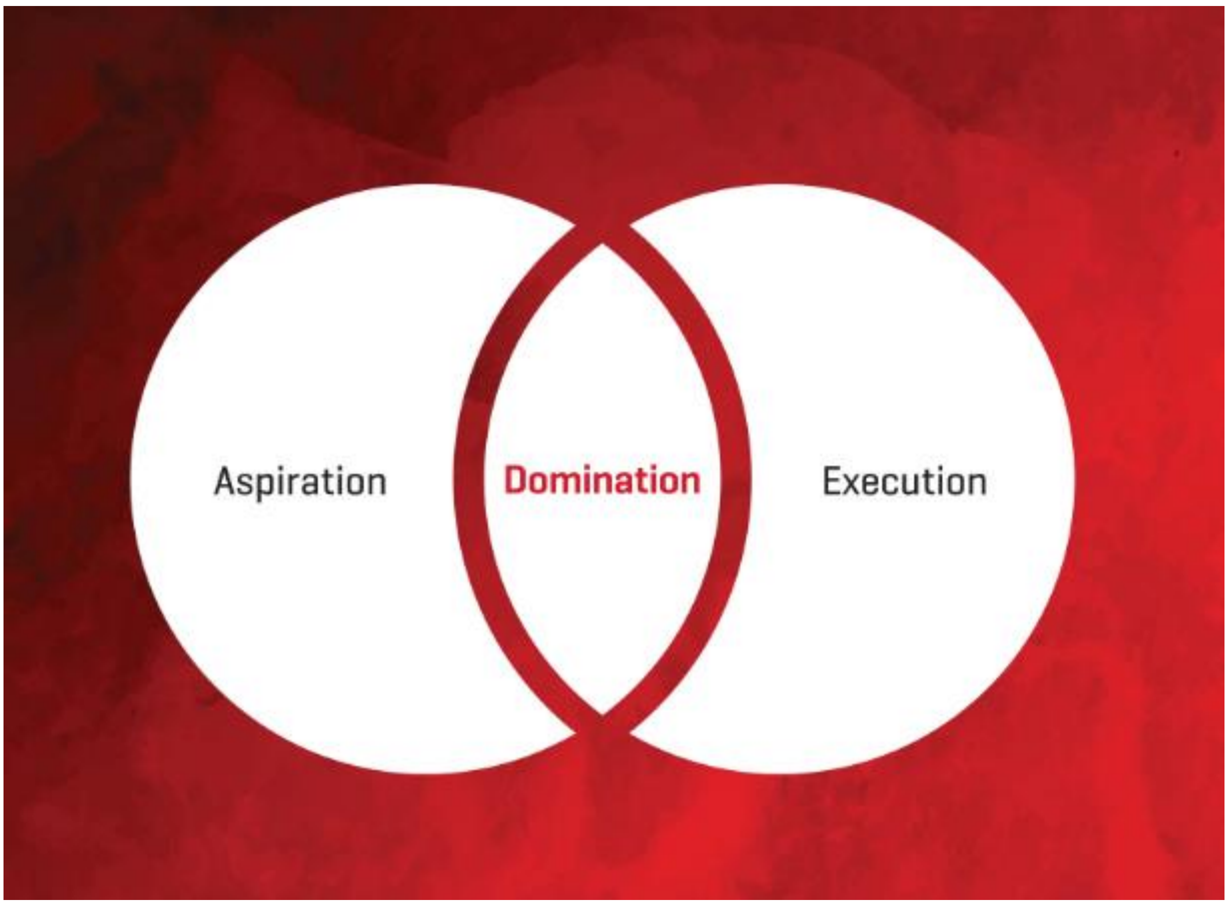
Edited Transcript

Webinar with investors and analysts

Quarterly financial results – Q1 2019
16 May 2019 – 10.00 am

National Development Bank PLC
NDB.N0000



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Contents

Corporate Participants

Presented by Dimantha Seneviratne - Director/ Group Chief Executive Officer

Panelists

- Buwaneka Perera – Senior Vice President - Corporate Banking
- Sanjaya Perera – Senior Vice President – Personal Banking & Branch Network
- Deepal Akuratiyagama – Chief Operating Officer
- Niran Mahawatte – Vice President – Treasury
- Indika Ranaweera – Vice President – SME, Middle Market & Business Banking
- Suvendrini Muthukumarana - Vice President –Finance
- Shanka Abeywardene - Assistant Vice President - Corporate Planning & Business Intelligence

Investor Presentation

GCEO - Dimantha Seneviratne

Opening Remarks

Good morning everyone and welcome to the first webinar for the year. With me I have some of our Senior Leadership team members.

Moving on to the presentation, the structure is, we have the Business Overview, the financial performance and the Q&A forum.

Slide 06 - Business Overview - Fast Facts

NDB is completing 40 years this year, of which as a commercial bank 14 years, so less than 15 years in commercial banking.

Extracted from the Presentation [with additional comments from the GCEO]

- 4 decades of banking excellence with 14 years of commercial banking specialization
- Approximately 2,500 competent NDBers delivering universal banking services – Last year alone, there was more than 300 added to the team.
- 110 branches, 122 ATM & Cash Recycle Machine [CRM] touch-points
- Strong digital financial capabilities
    - Bank2U, the Branch-less Banking proposition reaching out to niches
    - 35 CRMs with the capability in cash withdrawals as well as cash deposits
    - Mobile Banking App
    - On-line banking solution
    - Phygital branch – NDB NEOS – Our first phygital branch
- Only financial services group in the country, which provides seamless products in banking and capital markets services – Including investment banking, wealth management, securities trading and private equity management
- First and only Sri Lankan entity to obtain EDGE Certification, the only global certification for gender equality at workplace – As at 31 December 2018 we had 40% female representation at the senior management level and 39% female representation across the team
- Driven on a clear strategy called Transformation 2020 for the near term to become a systemically important bank and a five year strategy up to 2023 for the medium term

Slide 07 - Business Overview – Key Awards

Some of the key awards we won during the year are as appearing in the slide no 7.

- AsiaMoney Magazine - Country Best Bank Awards 2019
    - Best Domestic Bank Sri Lanka – This was for the first time. This is something that we consider as a top achievement. This award is on the back of the Bank emerging as The Bank of the Year Sri Lanka by The Banker Magazine UK and the Best Bank Sri Lanka as adjudged by the Global Finance Magazine USA in 2018.
    - Best for Premium Banking Services Sri Lanka
    - Best Corporate and Investment Bank Sri Lanka [Third consecutive year]
- Global Banking & Finance Review UK - 2019
    - Best SME Bank Sri Lanka [Third consecutive year]
    - Best financial services Group Sri Lanka [Second consecutive year]
    - Most Innovative Digital Transformation Sri Lanka – This is for our efforts in launching NDB NEOS as well as the other digital transformation that we have achieved over the years
    - Best Bank for Project Financing Sri Lanka [Second consecutive year]
    - Best Automobile Lending Initiative Sri Lanka
- International Business Magazine – UAE
    - Best Corporate Bank Sri Lanka 2019
- LMD Brands Annual 2019
    - NDB brand ranked 19th with a brand rating of A+. Brand value LKR 8,155 Mn

Slide 09 – Movement in KPIs - Snapshot

Moving on to the financial performance, as you all are aware, it was quite a difficult/ subdued industry we faced. Compared to most of the other financial institutions NDB had done relatively well.

Our Net Interest Income [NII] grew by 39% to LKR 4.6 Bn in the first three months. Net fee & commission income a 22% growth to LKR 864 Mn. Pre-tax core banking profit had a 22% growth to LKR 2.5 Bn. Total operating expenses increased by 16% to LKR 2.2 Bn. We will later discuss some of the reasons behind this. All in all we had a 9% growth in profit before tax YoY to LKR 2.9 Bn. However, profit after tax had a YoY reduction of 12% to LKR 1.37 Bn. This is mainly driven by high tax charges including the newly introduced Debt Repayment Levy plus some of the exchange losses due to the appreciation of the Rupee this year.

In terms of the balance sheet – From Dec 2018 to March 2019; Total assets grew by 2% to close at LKR 483 Bn. Gross loans also grew by 2% to LKR 361 Bn. Deposits at 351 Bn, and equity - we remained at LKR 35 Bn with a growth of 1%.

In terms of key ratios; I think we maintained our net interest margin [NIM] at 3.4%. Cost to income ratio has improved to 37%, one of the best in the industry. ROE for the three months annualized is 11%. I think compared to some of the other numbers that came up, we have done better. NPL ratio of 3.37% when the industry average is around 4.2 – 4.3%, again I would consider it better, but it is a challenge to maintain these numbers given the industry situation.

Of course, Tier I and Total capital adequacy ratios, relatively good in terms of capitalization – We had 9.34% in Tier I and 14.40% in total capital ratios.

What we did actually was, we were rapidly growing last year, more than 27% growth last year. But this year what we did was we recalibrated the business model to suit the environment and also given the conditions. That is why the growth in the loan book is not that big – it was around 2% for three months. During this period, we also strengthened our risk management practices and underwriting standards plus also, this year we are going to use it for a lot of housekeeping work, such as upgrading our core banking system, enhancing processes – lot of things are there to ensure that in a subdued market situation, internally we are strengthening our capabilities, so that when things improve we will be in a better footing to take up new challenges later on.

So with that, we are moving on to the Financials.

Slide 10 – Income Statement [Bank]

Gross income – we had an 18% growth to LKR 14.1 Bn in Q1 2019 from LKR 11.9 Bn in Q1 2018. So that is a LKR 2.1 Bn growth. Interest income – 29% growth, from LKR 9.8 Bn to LKR 12.77 Bn, whereas interest expenses increased from LKR 6.5 Bn to LKR 8.1 Bn – a 24% growth. So as a result, the Net Interest Income [NII] had a 39% growth, equal to LKR 1.3 Bn. This is mainly driven by the growth in our asset book.

Our loan book from Q1 2018 to Q1 2019 - YoY - we had LKR 73 Bn growth in loans and advances. Deposits YoY grew by 67 Bn. So although our Q1 YTD quantum growth is limited, the YoY growth – the growths we had last year, helped us book in more interest income.

Non-fund income, there was a drop from LKR 2 Bn in Q1 2018 to LKR 1.3 Bn in Q1 2019. This is mainly driven by the foreign exchange side. The other one is in last year first quarter, we had some substantial capital gains from financial investments. So that is the main reason why you see a drop in the first quarter.

Impairment charges YoY remains almost the same – LKR 800 Mn vs. LKR 842 Mn [Q1 2018 vs. Q1 2019]

Net operating income as a result, we had a 12% growth from Q1 2018 – from LKR 4.6 Bn to LKR 5.1 Bn.

Operating expenses, the increase is about 16% from LKR 1.9 Bn to LKR 2.2 Bn. This will be discussed further later on. So as a result, operating profit before tax, as I mentioned earlier was a 9% growth from LKR 2.6 Bn to LKR 2.9 Bn.

The main issue here is after tax profit, the tax expenses has grown by 38% from LKR 1.1 Bn last year to LKR 1.5 Bn in Q1 2019 – a LKR 430 Mn increase, mainly coming from the Debt

Repayment Levy [DRL]. So Profit After Tax [PAT] – there was a 12% drop, from LKR 1.5 Bn to LKR 1.3 Bn. Group Profit Attributable to Shareholders [PAS] was also a drop of 13% from LKR 1.15 Bn to LKR 1 Bn.

Slide 11 – Non Fund Based Revenue Analysis

Further break up of non fund income; Net fee and commission income - we had a 22% growth YoY, whereas net gains from trading were almost at the same levels [LKR 355 Mn in Q1 2018 to LKR 356 Mn in Q1 2019].

Net gains from de-recognition of financial assets, there was a drop of 77% - LKR 272 Mn to LKR 62 Mn.

Other operating income, this is where I explained; the exchange losses or the revaluation of the foreign currency reserves is recorded. There is a substantial drop there. The total non-fund income had a drop of 35% from LKR 2 Bn to LKR 1.3 Bn.

Slide 12 – Operating Expenses [Bank]

Operating expenses, overall there was a 16% increase, coming mainly from personnel expenses which was an increase of 14%. On depreciation, there was about 30% increase. Quantum wise, this is about LKR 32 Mn. This is mainly driven by the expansion in our branch network [we opened 3 branches over Q1 2018 to Q1 2019]. Also the digital offering enhancements, the opening of the NEOS branch plus we had 31 new cash recycle machines [CRMs] deployed over Q1 2018 to Q1 2019. Altogether we have 35 CRMs right now. So that was a growth of the CRM network from 4 to 35. The depreciation is coming from these expenses.

Other expenses had a 15% increase.

All in all, 16% increase in operating expenses. But if you look at the Cost to Income ratio [CIR], still we have better managed the CIR, where in Q1 2018 it was 39.3%. So far, Q1 2019, it is 37%. So we have been managing g our costs quite well compared to the industry.

Slide 13 – Balance Sheet [Bank]

Moving on to the balance Sheet, not a big growth. 2% overall growth from LKR 473 Bn to LKR 483 Bn – LKR 396 Bn in Q1 2018. That is about LKR 10 Bn in Q1 YTD.

Gross loans have grown by about LKR 7.5 Bn, from LKR 353 Bn to LKR 361 Bn. Total deposits – LKR 3.5 Bn growth. Actually there is a reason as well where loans have grown higher. Of course we had funding coming from the debenture issue. We raised LKR 5.5 Bn in March 2019, so there was funding from that source as well.

So that is how the Balance Sheet has grown.

Moving on to total group assets, this was LKR 488 Bn.

Talking about impairment, impairment charges for Q1 2018 to Q1 2019 you would see a substantial increase in the individual impairment from LKR 330 Mn in Q1 2018 to LKR 1,039 Mn in Q1 2019. This is of course reflective of the industry situation with high NPLs coming up. Apart from that, some of the few large exposures as well. However, in the collective impairment side, you would see a reduction from LKR 456 Mn in Q1 2018 to a write-back of LKR 243 Mn in Q1 2019. This is mainly due to the more granular impairment assessment. We went for a more granular model. So that is why you would see a higher quantum in individual impairment level. Apart from that, we re-assessed the models, and there again we went in to the product level model assessment. That also helped us to release some unnecessary provisions that were there.

But all in all, still the individual impairment has grown from LKR 330 Mn to LKR 1 Bn in Q1 2019 – roughly LKR 800 Mn.

Slide 14 – Loans and Receivables & Customer Deposits

Moving on to the balance sheet, Gross loans – there is a currency wise comparison, LCY to FCY. There has been an improvement. This is one of our key strategic imperatives to move the focus from foreign currency to local currency. So as a results from 78% local currency last year, we have improved to 80% in Q1 2019. So that is one positive development in terms of our Balance Sheet.

Long term and medium term loans, credit cards – they recorded sound growth during this quarter. Especially our credit cards did well, so did our other retails products. There are also a lot of assets coming from the Project Finance side.

Overall, all business segments contributed i.e. retail, SME/ business banking, corporate banking and project financing. Although the growth was small, it was a quality growth with good margins. The segmental composition of the loan book – now it remains at around 58: 42 between corporate and retail & SME.

Talking about the deposits side, overall there is a drop in the CASA level. From 2018 to 2019 there is about a LKR 6 Bn drop. The CASA ratio remains at almost 20% level. Growing this CASA remains a challenge, of course naturally with the current economic conditions, low GDP growth rates – people's savings capacity is thinning. In this challenging circumstances, growing CASA remains a challenge. We have seen the industry CASA ratios also steadily coming down. In that situation maintaining the CASA ratio is an achievement. We are working hard on bringing this CASA further up, and this where we are looking at certain digital initiatives to support CASA/ low cost funding base.

Slide 15 – Capital Management and Liquidity

Capital management and liquidity – Bank level Tier 1 capital adequacy ratio [CAR], we are well above the minimum requirement of 8.5%. We are at 9.34%. The total CAR, the minimum is 12.5% and the Bank is at 14.4%. If you take the Group level it is 15.39%.

Liquidity coverage is also well above the minimum – both Rupee and All Currency ratios. So we are well ahead of the minimum requirement there. Some of the capital fund raisings we did was, we raised Basel III complaint rated, unsecured, subordinated, redeemable debentures, and we raised LKR 5.561 Bn which is coming in to Tier II capital. These are five year debentures. Of course we are in the threshold of reaching the LKR 500 Bn mark so that the capital requirement is going up. So right now we are working on several capital expansion plans.

Slide 16 – Investor Ratios

This is the last slide on investor ratios. Of course, the price does not reflect any good. It has come down further, naturally reflecting the current market conditions. At quarter end the share price was LKR 94.20. However it has come down further. Earnings per share [annualized] was LKR 17.52. ROE was 11.06% from 17.41% last year, mainly due to the increase in the capital base, with the Rights Issue that took place last year. ROA has come down to 0.81%.

Book value per share again is LKR 159.17. This is mainly due to the higher number of shares issued in the latter part of last year. However the Price to Book Value is still 0.6, which makes the NDB share an attractive share for investors.

So this basically ends the prepared presentation. Now the forum is open for questions.

Questions and Answers Session

(Answered by the GCEO, unless specifically mentioned)

Q1 - What is your target loan book growth this year?

I think, given the current market situation, we do not have that aggressive plans. Most likely, we hope to grow above the industry average growth rate. But we do not want to grow aggressively, given the current market conditions.

Q2 - Can you please elaborate on the Tier I capital raising plans?

Of course, we are working on different areas in raising capital, as we will reach LKR 500 Bn in total assets. We are working with couple of fronts, discussing with the Board's direction. It is too early for me to give directions. But we have made some very good headway there. Very soon we will be able to make a market announcement on same.

Q3: Recently the Central Bank issued a circular, allowing banks not to migrate non performing SME loans below LKR 25 Mn to stage II impairment until 2020.Can you please add more colour on to this?

The regulator has realized the current economic situation and that is why they have come-up with more regulations, which is also supported by the Institute of Chartered Accountants. So in line with Sri Lanka Financial Reporting Standards, this relief was introduced. We have not adjusted our numbers yet. This is not reflective in our Q1 numbers. We have not taken the benefit of certain reduction in impairment this quarter. So there can be a certain reduction on the impairment initially. The industry is still having cash flow, liquidity and collection issues. So the industry would naturally continue to have the pressures in the coming months as well till we see some improvement.

So right now what we are doing is, we have quite a substantial SME portfolio. So we would help them. This is not due to their own fault. It is a market situation. So wherever possible what we have done is we try and help them. We have strengthened our underwriting standards, and we have strengthened our SME Credit Team and we have a separate project team as well, looking at these customers proactively, and if needed we will provide further funding, otherwise we will support them with some restructuring. We will support them in this challenging period. I think for us, hopefully the worst situation is over. But it all depends on how the economy will perform in the coming months. From our side, what is needed is strengthening the credit underwriting standards, and on the other side, the recoveries, and we have been doing that.

Indika Ranaweera: We already started on understanding the business issues and providing financial support wherever possible. It is not only restructuring, in today's context but sometimes they need some funding as well due to so many cash flow constraints, which with our Team, we are closely monitoring and following up.

Q4: Will there be some consolation with the low deposit rates?

Few months back, the rates were quite exorbitantly high. Some financial institutions were offering exorbitant rates. But with the regulator introducing a cap on the deposit rates, not only for banks but also NBF institutions, I think the rates are not going to be any market driver going forward, so it is going to be a level playing field. Overall the market rates have come down. So it is a matter of how you maintain and improve your relationships with your customers. And also the credibility of your Bank and the risk rating of the Bank hopefully should come in to light, in a situation like this where the interest rates are at an equal level.

So I would say that is a consolation in terms of margins. Naturally, we need to pass that benefit on to our borrowers. We are reviewing these rates. So when rates are up for maturity and rate reviews, we will be passing this benefit to our borrowing clients. So overall the industry should also get this benefit. Because the overall rates were quite high. In a country where the inflation rate is 3.5 – 4%, the real interest rate gap was quite high. The regulator also realized this high gap. Since the market is not adjusting on its own, the regulator came in to reduce the high rates. So that should get reflected in the overall reduction in the interest rates as well.

Q5: What are your exposures to the tourism sector, in terms of the Loan Book and NPLs?

Our exposure is very less in terms of the portfolio, very much below 5%, around 3.5%. We also do not have major concerns on the NPLs at the moment. But there again, the regulator came up with certain offerings in terms of debt moratoriums starting from mid-April to next year July. So we will assess our customers, whoever who needs that. Certainly we will go and help them. But overall for the Bank book, our exposure to the tourism sector is not significant at around 3.5%.

Q6: Can you give a bit more colour on NPLs. What were the sectors under stresses in Q1 2019?

I would say some of the construction driven sectors are still under stress.

Buwaneka Perera: Apart from that, few local manufacturing and also trading sector is under stress and we are monitoring them carefully and closely. Construction sector on a project by project basis, and others more closely than that.

Q7: After the Easter attack, what are the sectors that you see are stressed?

Of course the tourism sector is the major one. Apart from the tourism sector, there are various industries that are supporting the tourism sector, for example tour operators, vehicle fleet operators providing transportation, even large suppliers to the sector. So it is not only the tourism sector that will get affected. There are other support sectors. Plus even the employees of these companies, especially those who are earning service charges as a relatively higher part of their income naturally get affected.

In terms of our loan assessments, we have not taken that as a criteria for assessment, so we did not have an issue like that compared to some of the other banks, where when you evaluate personal loans, you consider fee based income also as a part of income. However, wherever they have issues, we are willing to support. Even the circular that was issued, by the regulator also covers the employees of tourism related companies.

Q8: There were significant loan book write-offs in Q1 2019 in a number of banks? What was your Bank's figure?

We did not have a large write-off. Ours was quite small. Not material.

Q9: How will the relief package introduced to the tourism industry affect you future cash flows? Does your lending portfolio include a considerable percentage in tourism industry?

I think I answered that. Our exposure is about 3.5%. But of course, cash flow-wise the impact would be that 3.5% being impacted if the entire sector asked for concessions, the interest income coming from that 3.5% would be impacted. But very unlikely that this situation would come in, because most of our customers are well off. May be few customers would come in. Right now, the referrals that we are getting are not that significant. But as things move on, there could be some more clients.

Q10: Are you planning to bring down the loan rates in response to the cap introduced by the Central Bank of Sri Lanka on the deposit rates?

I answered this before also. The reason why a deposit rate cap was introduced was to bring the borrowing rates also down. So we will also gradually bring our rates down. Especially for the floating rate clients, there is an element of fixed rate in lending that has already been booked. So for those we cannot make any changes. But for the floating rates, naturally as and when the loan matures and for all the new customers, there will be a reduction in the rates.

Q11: Do you think the regulator will introduce a credit ceiling, and if yes how will the industry be impacted?

I think at the moment, there are no plans which we are aware of. I do not think there is a credit ceiling requirement at this type of a subdued economic condition. Unlikely that the regulator will impose such an initiative. The regulator will monitor the situation and if needed, they will come up with such a thing. But at the moment I do not think there is a necessity.

Q12: Why are the market rates are not adjusting on its own?

Niran Mahawatte: I assume you are referring to the interest rates.

It is too early to the market rates to adjust. There will be a time lag. With the deposits rates ceiling coming down, especially on the assets side for the rates to come down, it will take a little bit of time, with maturities. But at the same time, the liquidity position of the market will also play a role there. Because for us to grow, any incremental growth, there has to be sufficient liquidity in the market for the rates to come down.

Q13: Are there plans for any branch expansions this year?

Sanjaya Perera: We have some approvals we have received from the CBSL for expansion. As you already know, we have already opened two new branches so far. We have also finalized on two more branches, which will start operations before Q3 this year. Those are the plans for now. We are also looking for some locations which we have not finalized.

Q14: What is your fixed and floating mix in the lending book?

It is quite well balanced, at around 50:50. So there again we have been managing that element rather than having overly exposure to either aspect. I think it is a well balanced portfolio.

Q15: Given all the stresses you spoke of, curious to know what kind of a change you did to see a reversal in the collective impairment. Was there a major change in the assumptions, or was there a major over impairment to offset deterioration?

Suvendrini Muthukumarana: From a collective provision point of view, it is model based, and we looked at more granular level - product wise. Within a product also we identified different asset quality types and stresses and we used a detailed model computation. In terms of the stresses we identified on a specific loan basis, and we have increased our specific provision impairment charges. So these reversals will not continue for the next quarters.

It was actually a model improvement with the implementation of the SLFRS 9. Last year we revalidated our models and looked at the product based more granular level and made some improvement.

GCEO: So it is product based modelling. So even if you take short term loans, earlier it would have been on that. But now we have gone to the next level of Dream Maker Loans, SME loans, corporate, project loans, etc. So we have segregated them and naturally there is an improvement. As a result the collective charge has come down, however you would note that individual impairment has gone up.

Q16: How is the liquidity position? Can you quantify?

Niran Mahawatte: I assume that this is on market liquidity. The market liquidity has improved. Soon after the statutory reserve requirements cut. With that the market liquidity improved to about LKR 80 Bn. But right now the liquidity position has come down to about LKR 30 Bn. So we believe that with the interest rates at the current levels, Central Bank will take necessary steps to maintain an adequate liquidity position in the market.

Q17: What are your leverage plans? From this quarter onwards the leverage has to be more than 3% as per regulator?

Suvendrini Muthukumarana: The Leverage Ratio is now mandated by the CBSL, so there is mandatory compliance required. The minimum requirement is 3%. Our ratio is well above. We are actually well above 5%. That is disclosed in our published financial statements.

End of Q&A.

Closing Remarks

With that we come to the end of the Q&A session.

Just to recap and also to give a brief update on what is happening;

The market is quite subdued. Based on this, we recalibrated our growth plans. That is why a low growth rate. However you would see that we maintained our margins. Overall profitability YoY improved. Our cost to income ratio has improved. This is all due to some of the hard work we did last year in terms of streamlining our operations, looking at our cost base, and also gradually improving our margin and the growth in our asset book last year. So these are reaping benefits in this difficult time. We will continue to re-asses the market as we move on. So we do not expect significant growth this year.

However, when there is an opportunity, we will take them because we have a very good clientele. We will go out and help them. We will be looking out for new business opportunities as well. That will continue, especially on the corporate side, as well as the retail side.

Other thing that we are doing this year is, looking at all our processes. There is a very comprehensive business review process that is happening, which will streamline our operations, so that we will be more nimble and efficient in providing our services.

On the other side there is some good training happening on the customer service side to improve our customer service aspects among all our staff. On the other side on capital, we will work on this very hard and we are hopeful that we can disclose on this soon.

With all these, we are lining up for a more stable, efficient and well capitalized banking institution, as we move on to the state of being a systemically important bank by H 1 2019. So that is the plan.

With that we would like to conclude the webinar.

Thank you very much for connecting, the questions and active participation.

End of edited transcript.