Edited Transcript

Webinar with investors and analysts
National Development Bank PLC
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Forward Looking Statements

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Investor Presentation

Dimantha Seneviratne

Opening Remarks

Good morning, welcome to NDB's Investor Webinar where we will be sharing the Q3 results for 2018.

With me I have some of the top team members, Senior Vice President - Corporate Banking, Group CFO, Vice President - Treasury, Assistant Vice President - Retail Banking and also the Assistant Vice President - Finn ace. As usual we will take you through the Presentation and thereafter, there will be an opportunity to ask Questions.

Slide 06 – Business Overview

About the history of the Bank - Now we are almost 40 years in operation. Initially started as a Development Bank and now we have moved on to be a commercial bank. We converted to a fully-fledged commercial bank in 2005 so, over the last 13 years, we have evolved a lot, and have become a fully-fledged commercial bank. But we have also left the development bank roots. As you see we have a very good Project Finance Team and also a very good SME and Business Banking support base. Apart from that, we have made quite a good progression in the digital banking sphere. This is actually quite a good opportunity for a mid-sized bank like ours, to move in to that area, and we see very good results in that space as well.

Our staff strength has gone up from 2,100 in last year, now we are almost 2,400. Also, Group asset base as at September 2018, you would note that we have crossed LKR 460 bn - At Bank level 458 bn. Our rating was affirmed as A+ by Fitch Ratings.

Slide 07 - Business Overview

Moving on to some of the recent awards that we achieved - the top one is the Global Finance of USA awarding us the Best Bank in Sri Lanka title for 2018. This is the second time that we won this award, earlier in 2015.So we are really happy about it and thanks to all the hard work that the Team has out in, and also the customer - their trust on us.

From the Group companies, that is where NDB has quite a good advantage in terms of our subsidiaries in NDB Investment Bank, NDB Wealth Management, NDB Securities and NDB Zephyr for private equity management. So what we have done is, to these Group entities to work together with the Bank and ensure that the Group synergies are at work, and lot of things are underway. We can see a lot of progress as we go forward as a Group, as we move on to the next year. There are a lot of things planned.

[Please refer the slide for the full list of awards of the Bank and the Group companies].

Slide 08 - Business Overview – Strategic Focus – Update

The Bank - we had tremendous progress over the last one and a half years, especially in the last nine months, thanks to the new strategic plan we introduced, which is called Transformation 2020. Here the key strategic imperative is by 2020 for NDB to become a systemically important bank, by way of assets growth and also in terms of the contribution and taking our services to a larger clientele. We have made very good progress in the strategic planning and achieving strategic objectives. We have taken key strategic decisions which are all now in place. So the progress we have shared up to 9 months confirms that the strategy we have applied has worked quite well.

Slide 10 – Q3 2018 – Key Performance Indicators [Bank]

Now we move in to the key performance indicators. In terms of profitability - Q3 - the pre-tax ore banking profits have grown by 43%. This is a key achievement, this is without the equity income, which is core banking income. This has grown to 6.4 bn under challenging circumstances. This was helped by a quite a good Net Interest Income [NII] growth and fee income growth. NII was up by 39% YoY to LKR 10.6 bn. Net fee & commission income was up by 25% to LKR 2.3 bn. These are quite sizable growth numbers when you are looking at the market conditions right now.

All in all the total operating income grew by 30% to LKR 15.6 bn. On the other hand, the operating expenses - the increase was only 13% to LKR 6.2 bn. So in that too, we had a very good cost management arrangement despite our investments in the digital banking sphere and some of the branch expansions. As a result of well managed costs, the Cost to Income ratio [CIR] actually improved to 39.4% from 45% last year. So this is again a key achievement amidst all these growth. Our income has also growth, hence the CIR has improved to 39.4%.

Profit after tax [PAT] grew by 22% to LKR 4 bn after nine months. I think this is the first time the Bank recorded LKR 4 bn in nine months. Group Profit attributable to shareholders [PAS] grew by 42% to LKR 3.6 bn.

In terms of the Balance Sheet, total assets of the Bank grew by an impressive 20% for the nine months to close at LKR 458 bn. Net loans and receivables grew by again 20% to LKR 328 bn. Customer deposits also grew by 20% to LKR 463 bn. So all loans, total assets and deposits grew by 20% over the nine months. We consciously grew our deposits base as well, to support the lending growth. The deposits base closed at LKR 329 bn as at the end of nine months. Total assets at the Group level now is at LKR 463 bn.

In terms of efficiency, as I mentioned, the key improvement was in the CIR to 39.4%. Net interest margin [NIM] also has improved from 3% to 3.36% in Q3 2018. Return on average equity [ROE] has improved from 16.27% to 16.95% of almost 17%. Return on assets [ROA] has improved from 1.21% to 1.23%.

Business capacity ratios - Mainly the Loans to Deposits ratio [LDR] improved to 102% - this is something that we were working on quite closely, getting our branch network and all the other business units to work on the liability base- deposits drive. So as a result - 102% LDR. I initially mentioned our commercial banking operations started in 2005 so within a period of 13 years, because as a development banking entity, we did not have any deposits to support the growth, but when we moved in to the commercial banking operations this is where we started growing our branch network, growing our deposits base. So within a span of less than 15 years or 13 years growing our deposits base, and achieving a LDR of almost 100% is I would say is a great achievement. So that is something we would continue to focus on going forwards as well.

Tier 1 capital ratio - we are comfortably above the minimum threshold. Tier I is 8.37% and Tier II 12.13% as at September. This is prior to the infusion of Rights Issue funds that were received only in October.

Liquidity coverage ratio is well above the statutory minimum requirement.

Slide 11 – Income Statement [Bank]

Now on to more detailed analysis, the Income Statement - The Gross income, we had 16% growth in Gross Income by LKR 5 bn to LKR 36.8 bn. As I mentioned earlier, the NII had quite a good growth - 39% from LKR 7.7 bn to LKR 10.63 bn. I will explain in more detail in the next line, how the composition of the NII came. Net fee and commission income increased by 25% to LKR 2.2 bn. So all in all, Total operating income we had 30% increase from LKR 12 bn to LKR 15.6 bn over the nine months - YoY comparison.

Net operating income of course - one area that we had significant impairment charges compared to what we had last year. All in all, up to September - LKR 2.4 bn in terms of impairment. We will discuss this more in future. But we have seen a stress in the industry. Naturally that has moved on to our Balance Sheet as well. But we have done a lot of work in managing proactively these accounts and helping wherever helping these clients to support. Some of these impairment numbers are also based on very prudent and conservative base as well. So we had been very conservative in getting the impairment numbers. All in all despite our NPL numbers going up from 1.8 to 2.57%, compared to the industry average of 3.6%, I think our impairment is quite prudent.

With that impairment, the overall net operating income we had 19% growth despite a significant impairment charge, from LKR 11.1 bn to LKR 13.3 bn. Total operating expenses, this is where I earlier mentioned how we managed our CIR. From LKR 5.4 bn to LKR 6.2 bn - only LKR 690 mn or 13% increase. So operating profits after all the impairment charges and expenses grew by 25%, at Bank level from LKR 5.6 bn to LKR 7.1 bn.

Taxes, we had a 30% tax. So far, we have paid over LKR 3 bn taxes from LKR 2.3 bn to LKR 3 bn growth in taxes. SO PAT is 22% growth, from LKR 3.3 bn to LKR 4 bn. Group PAS - 42% growth in terms of quantum - LKR 1 bn growth YoY to reach LKR 3.5 bn.

Slide 12 – Revenue Analysis - Fund Based Income

The interest income from loans and advances grew by 17% from LKR 27 bn to LKR 31 bn YoY. On the other side interest expenses, the growth was only 8%, from LKR 19 bn to LKR 21 bn. SO this where the real contributory factor came in. You would note that the deposit growth was 20%. But the interest expense growth was 8%, which shows that we had been working quite well on getting some low cost deposits and are managing our liability base, to give that contribution in terms of lower interest expenses. As a result by quite active ALCO management and pricing, we have managed to get a NII growth of 30% from LKR 7.6 bn to LKR 10.6 bn. The NIM again has improved from 2.9% in Q3 last year to 3.36% in Q3 2018 which is a 50 bps increase in NIM.

Slide 13 – Revenue Analysis - Other Income

The other area that we have worked quite well is the Other Income side. Especially on the fee and commission structure. We have been focusing quite well on the fee structure, the trade side and also the fee revenue is there. As a result of the focused approach, we got about 25% growth in fee and commission income, which grew from LKR 1.8 bn to LKR 2.3 bn. In the trading side, we had 9% growth from LKR 793 mn to LKR 861 mn. Net gains from financial investments was a negative 17% growth, from LKR 545 mn LKR 455 mn which is due to interest rate movement. But other income all in all, we had quite a sizable other income growth, excluding the equity investments from LKR 160 mn to LKR 857 mn. So non-interest income from core banking activities - we had 34% growth from LKR 3.3 bn to LKR 4.4bn. Other operating income - there is drop you would note, that is from LKR 1,056 mn to LKR 562 mn. Last year we got a sizable dividend from our Group companies close to LKR 1 bn. Whereas this time, it is around LKR 500 mn. Apart from that our equity investment also has given us certain income. But compared to last year, it is almost half of that.

Despite all of that the non-interest income side, we had 15% growth from LKR 4.4 bn to LKR 5 bn.

Slide 14 – Operating Expenses [Bank]

This is again a good story. Personal expenses of course, with the increase in staff numbers, increase in other benefits, etc., overall there was a 24% increase here from LKR 2.6 bn to LKR 3.3 bn. Depreciation saw a marginal increase, but I would say the major improvement is in the other expenses. We have managed other expenses. It is almost static at LKR 2.5 bn. Just a 2% growth. Despite all cost escalations, the expansions in to digital banking side, branch expansion, we have deployed 12 cash recycle machines, we have also launched branch-less banking - "Bank2U" proposition, getting more branches added to this, and we have opened 5 new Privilege Centres, during the year, 4 branch relocation, new branch openings and also a dedicated Business Banking Unit was opened. With all those expenses we still managed to curtail those expenses increase to 2%. That really shows how much we have focused on managing unnecessary costs and improving our efficiency levels through more digitalized arrangements such as work-flow arrangements. So there is more fat that we can cut and there is further potential to work on this area.

All in all CIR improved to 39.4% - we are targeting to manage this at 40%.

Slide 15 – Balance Sheet [Bank]

Moving on to the Balance Sheet, as I mentioned, again all the aspects, total assets, loans, deposits all grew by 20% and the equity side, about 12% growth, with retained earnings. This equity position is prior to the Rights Issue funds. All in all the total growth in assets - 20% for nine months is quite significant despite challenging market conditions, and this is in line with our Transformation 2020 strategy as well, because we believe in scale advantage and the opportunities of more benefits in terms of efficiency in terms to Cost to Income, would come based on the size of the Balance Sheet. That was the reason for us to go on this growth trajectory. That has really worked well. So quite a good growth. So in the process we have seen that in terms of our imperative to become one of the top 5 banks, we have already reached that stage much earlier than we envisaged. We planned to reach that by 2020 but even by now, we have reached that. So that is something good to achieve. But we will be retaining that and growing on this platform going forward.

Slide 16 – Loans & Receivables [Bank]

The loan growth - we have achieved considerable improvement in the currency composition. This - you may recall, is one of our targets to bring our local currency to foreign currency mix to a particular level. So that has improved [LCY: FCY] from 75% in Q3 2017 to 77% to now. So that is something that we are working on. The loan growth has come from all sectors - corporate banking, project financing, retail banking and also SME. They have all exceeded the budgeted growth numbers. So we are very happy to see quite a good spread, it is very well mixed in terms of the asset growth with the growth coming from all sectors. So that growth is coming from all sectors. That is actually a key note that I want to share with the investor community.

Slide 17 – Asset Quality

Asset quality and impairment - now this is where I would like to spend some more time as well, as it would be a key area of interest from any analyst. The NPL numbers, the NPL ratio it has increased from 1.83% in December 2017 to 2.57% in Q3 2018. But 2.57% is I would say is relatively much better, compared to the industry average of 3.6%. We had seen stresses in the market, naturally coming out from an economic growth rate 3.5% rate last year due to various impacts, the weather impact, the drought in one side, and the floods in another side, the agriculture contribution was quite low.

All this has contributed to low growth rate and we see certain stress levels in our portfolio, which is the industry situation as well. But despite that I would say we have curtailed quite well in terms of managing our non-performing loan ratio. Our underwriting standards have been upgraded. We have strengthened our recovery and collection staff, the way that we approach them, prior to issue- proactively managing them. So all that have been strengthened and we are conformable that we can actually manage this further as we move along, because we are quite on top of the ball basically managing these aspects. But we have made some precautionary provisions in terms of individual impairment as well as collective impairment.

Collective impairment is mainly as a result of the growth in the Balance Sheet. Collective impairment has grown from LKR 439 mn to LKR 934 mn and the individual impairment - where a sizable growth was seen - so far up to the nine months it was LKR 1,479 mn. So composition of the entire LKR 2.4 bn impairment charge for the year, it is basically out of LKR 2.4 bn, LKR 1.479 bn on individual basis and LKR 934 mn in collective basis.

On individual again, we have been assessing the cash flows looking at the recoverability and also the cash flows, I think we have taken quite a prudent approach in looking at the impairments. As a result, naturally the impairment numbers have gone up and it compares to LKR 872 mn in the first nine months of 2017, and in the nine months of 2018 it is LKR 2.4 bn.

I think, going forward as I mentioned, the prudent strategies that we have deployed in strengthening our recovery, proactive account management, watch list monitoring for early signs, all those mechanisms are now in place. We can identify early and help these clients early in a stress situation. Apart from that, we have also improved our underwriting standards so that is why I said we are comfortable that this can be managed as we move along.

Slide 18 – Customer Deposits

In terms of deposits - Again quite a good story - quite a significant quantum increase in deposits - YTD - 56 bn, YoY - LKR 74 bn. The other important thing is the CASA growth - over the 9 months, we had LKR 12 bn growth in CASA. This is something that we have been consciously building up. You would note that the CASA ratio was well maintained despite the growth in the deposits, especially on the term deposits side, but we still managed to maintain the CASA ratio at 21.4% which was 21.3% last year. Slight improvement I would say despite the industry CASA ratio coming down and now it is hovering around 31%. So there is upside potential for NDB. The industry CASA ratio us 31% - ours is 21.4%. There is a huge upside potential in 10% that we can really achieve if we work on it.

So this is where we have been working quite hard with our branch network, having our liability sales team, we have re-launched the *Ithuru Karana Maga [Path to Save]* campaign very recently, this is something NDB had few years back taking the savings habit, taking the meaning of savings, educating the clients how to save even with a limited income. All our branch staff and front line staff have been trained how to provide that savings skill to the customers. So we are taking this campaign to a different level and we are quite confident that with all these measures taken, we can continue to manage the CASA growth going forward. So all in all, the deposits growth was LKR 56 bn for the year. There again, the FCY and LCY mix is there. Bulk of the deposits growth has naturally come from the LKR side, LKR 256 bn, and in terms of FCY deposits we have LKR 73 bn.

Slide 19 – Capital Management

In terms of capital management, equity capital - Tier I the minimum Tier I is 7.875% - Bank level we have 8.37%, Group level we have 9.62% Total capital ratio the minimum is 11.875% for which the Bank level ratio us 12.13% and we are about 50 bps above the minimum level. This is prior to the Rights Issue proceeds so the ratios have to improve since then.

In terms of Rights Issue - we declared a Rights Issue of 1 for each 3 shares held and of course we went for the Rights Issue and you would also note that the market price also came down. But all in all, what we achieved was about 60% subscription because of the market price reduction. Also the Bank has announced to the Stock Exchange and we have made it public that we are exploring opportunities with strategic investors for the subscription of the remaining portion. So that discussion is going on and that has been announced to the Stock Exchange as well.

Slide 20 - Investor Ratios

So investor ratios, this is where always we have a problem. Despite the Bank doing so well, the price of the share would not reflect that. As at yesterday [31 October] it closed at LKR 105/-. The Earnings per share [annualized] has improved from LKR 24.52 to LKR 29.09. ROE again it is close to 17%, it has improved from 16.27%. ROA 1.23%. Book value per share, it is now LKR 181 .27. Now whereas the price is LKR 105/-. When you do the math, price earning time it is 3.8 times, and the Price to Book value 0.57.

So share price traded in the range of LKR 102.20 [low] and LKR 116/- [high] during the third quarter.

Questions and Answers Session

(Answered by the CEO, unless specifically mentioned)

Q1: What is included in the other operating income for the quarter amounting to LKR 525 mn?

Bulk of that is in revaluation of the foreign currency income as sizable portion of the Balance Sheet was in in foreign currency. With the depreciation of the Rupee close to 10%, this has resulted in quite a sizable operating income.

Q2: Can you please explain how your depreciation expenses will move with spending in digital IT infrastructure?

Lalith T Fernando: – Here we are thinking of a depreciation for an over a period of 5 years. There won't be a significant impact as such. We are investing very carefully.

Q3: How would staff expenses evolve to grow in terms of the plans to grow Business?

Yes we had closer to 350-400 new staff getting on board to the Bank with the intention of growing our deposit and advances base. Most of these staff are at entry level in front line. Because of this we are comfortable the return that is going to be deployed by these sales forces will be higher when compared to the investment. There was a 24% growth in personal expenses. This is due to the changes to the staff benefits and the other is the increase to the number. Despite all of that cost to income ratio has been curtailed below the 40% mark.

Q4: What percentage of loans are rescheduled in the loan book for the September quarter and June quarter?

I don't think we had many accounts rescheduled. Only a handful of accounts were rescheduled. In this environment we have seen many ups and downs in the economy and this is not quite unique to any country. What is important is to identify these signals early and structuring our facilities improving our situation. So that is what I meant and in terms of the re-schedulements I would say our number is very few.

Q5: What percentage of NPL in September quarter is in 3 months category and more than 1 year?

I think we don't have that kind of breakdown with us available now with us to share in detail.

Impairment chargers don't directly correlate to NPL. NPL is only a trigger that whatever impairment charge we have made now can get reversed with the improvement in the asset quality and proactive recovery actions and greater focus.

Q6: What is the expected loan growth for this year and next couple of years?

Of course this year we have seen already 20% growth rate so most likely we would maintain similar trend in the last quarter but in terms of the next year we are to see what's going on as well but overall we would say roughly around 18% growth in terms of the loan book which would be slightly above the industry growth rate which is expected around 15%. We will watch the market and take appropriate calls on what growth rate we should have in next year.

Q7: When do you expect the NPL ratio to peak and when can we expect the improvement to start?

It is very difficult to predict that, we are hopeful that it's at peak level but industry numbers are bit different to us so it's very difficult to give an answer to that question.

Q8: Could you explain how the IFRS impact would be for 2018 as per the explanation in the notes?

Lalith T Fernando: As we have calculated it's going to be in the range of 40% to 50% that was worked out with the auditors but at the yearend we will adjust accordingly and publish the actual numbers. Right now it's in the range of 40% -50%.

GCEO: I think we are in line with the industry numbers as well.

Q9: When it comes to NPL, which sector was most stressed and comparatively NDB was able to control NPLs much better in quarter -quarter. What did NDB do differently compared to other Banks?

Indika Ranaweera: There is no specific sector as such. If you look at the SME sector we have formed a separate recovery unit. Actually they start follow ups before NPLs are in minus seven days onwards as they are starting calling with robust recovery process. As a result we were able to manage very proactively. Also for us to give a solution as a remedial action before them going to NPL by restructuring and proper solutions what I think we have managed these NPLs.

Buwaneka Perera - From Corporate Banking side especially on working capital area I would say generally the stressed and challenging sector was the construction sector. With the past experience in handling this sector from a long time, we have been handling each construction company on project by project basis and closely monitoring the progress, the performance and payment on those projects.

GCEO: On the second part of the question where NDB did differently to other Banks. One example was what was shared by Buwaneka earlier on the construction sector. We have been funding project by project basis which required very close monitoring. RMs are working very closely with these clients especially on the stressed accounts.

Apart from that I would say that credit understanding that we have is a source of strength. Having Development Banking exposure, project finance and SME exposure has helped all levels of staff to be quite credit savvy. I would say that in situations like this these are the skills that will come in handy and that's the other reason that I would say why we are in top of the under witting standards.

In terms of the retail portfolio we are quite comfortable, as the retail NPL ratios are much lower than the average ratios. There again we have got a very strong collection team. So early stage proactive management have contribute to improve our NPL management.

Q10: What percentage is in the special mention category?

Special mention category is as per CBSL categorization. This cannot be disclosed as we go based on impairment classification either collective or specific. Numbers on special mention category is provided only for regulatory purposes.

Q11: How does the Bank address the capital issue with its plan to become a systemically important Bank crossing LKR 500 bn?

That was actually the reason we went for a Rights Issue, our original plan was to raise slightly over LKR 6 bn. However due to price reduction in the market situation the level of subscription was only 60%.

There again we have announced to the stock exchange that we are working with few strategic investors to ensure short-fall is met. That's the current plan and that would also be in a short period of time. In terms of supporting beyond when the Bank crosses the LKR 500 Bn, there will be a higher capital requirement as well. So these Rights Issue numbers were based on that higher capital requirement. However we will be raising on Tier 11 funding, which is in nature very capital intensive operations in terms of the Banking industry. Also we have to ensure fair return to the shareholder is given. So far we have achieved 17% and we have to manage it closely. This means at the appropriate time based on our asset growth we will be looking at supporting equity raising measures.

So at the moment it's a Right Issue but later on we may approach for Tier 11 and other means of capital raising.

Q12: What is the number of customers in digital banking?

I would answer this in different ways as all our customers are somehow digitally connected with us. In terms of our revenue from the retail customer base I would say more than 75% is coming from digital channels. This is something quite nice to see and something we are quite focusing as well. We have made some key progress as well in digital sphere so far, we have 134 ATMs and 18 cash recycling machines. All those cash recycle machines were deployed during this year so that is a sizable deployment in that space.

Apart from that our initiatives towards branch-less banking, taking banking to support broader client base with deposit taking and many more other activities have also contributed a lot towards being digital.

We have much more plans in getting our mobile banking app to a different level which is already an award winning mobile app. So like that so many new activities are happening in the digital space and as we progress we would see more. The intention is to be more digitally savvy providing customer convenience from all aspects. Rather than growing our revenue merely through branch banking we are quite conscious of developing our digital approach because that is the future and we are quite well progressing in that sphere.

Q13: The Bank having LKR 460Bn assets is now coming close to systemically important bank. The capital ratio would be 14% by 2019. Even if the 40% unsubscribed rights get subscribed it won't be enough for the BASEL requirement?

Apart from the Right issue naturally we would go for Tier 11 and other means of raising capital. The plus factor is we see quite a good progress in terms of asset growth and profitability of the Bank, so naturally when we tap the market for investors Tier 1 or Tier 11 or any other different capital instruments I think we are comfortable that we can get required funding at the appropriate time. But we are careful when to reach, when to approach because as I mentioned we have to manage ROE numbers as well.

Q14: From which sectors did you grow the loan book?

Actually the growth came from all sectors. Corporate Banking & Project Financing we have 55% of the Book. So significant growth has come from that side as well. Apart from that a much focused approach on the business banking side is the middle market, SMEs and the retail space which we have Dream Maker loan being the market leader, also leasing portfolio which gained quite a good growth. Card base had a quite a good growth and home loans as well. So I can say all business segments performed beyond the budgeted numbers and all have contributed to the 20% growth in advances.

Q15: Will the next Right issue also be at LKR 105/- as mentioned in the announcement?

Actually we have not announced anything as such. That's a wrong perception.

Q16: Could you please explain what your focus areas are for 2019 & beyond for loan growth?

We have a very strong corporate and project finance platform and an area we believe we have more space to grow is the Business Banking side or the middle market. That's where the 108 branches that we have (with more than 50% branch less than 5 years) and these branches will also get more opportunities in future in terms of Business Banking. So SME would be a focus area along with that retail banking side as we have various new products that have come up. We are also looking at banking on women initiatives, which will have a more focused approach towards Retail & SME while growing our Corporate and Project Finance base.

End of Q&A.

Closing Remarks

Thank You very much for taking part and for raising some good questions in our webinar Thank you again for your active participation. If you have any more questions, please feel free to reach us through our email investor.relations@ndbbank.com and from our contact numbers given.

End of edited transcript.