Edited Transcript

Webinar with investors and analysts

Quarterly financial results – H1 2019
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National Development Bank PLC
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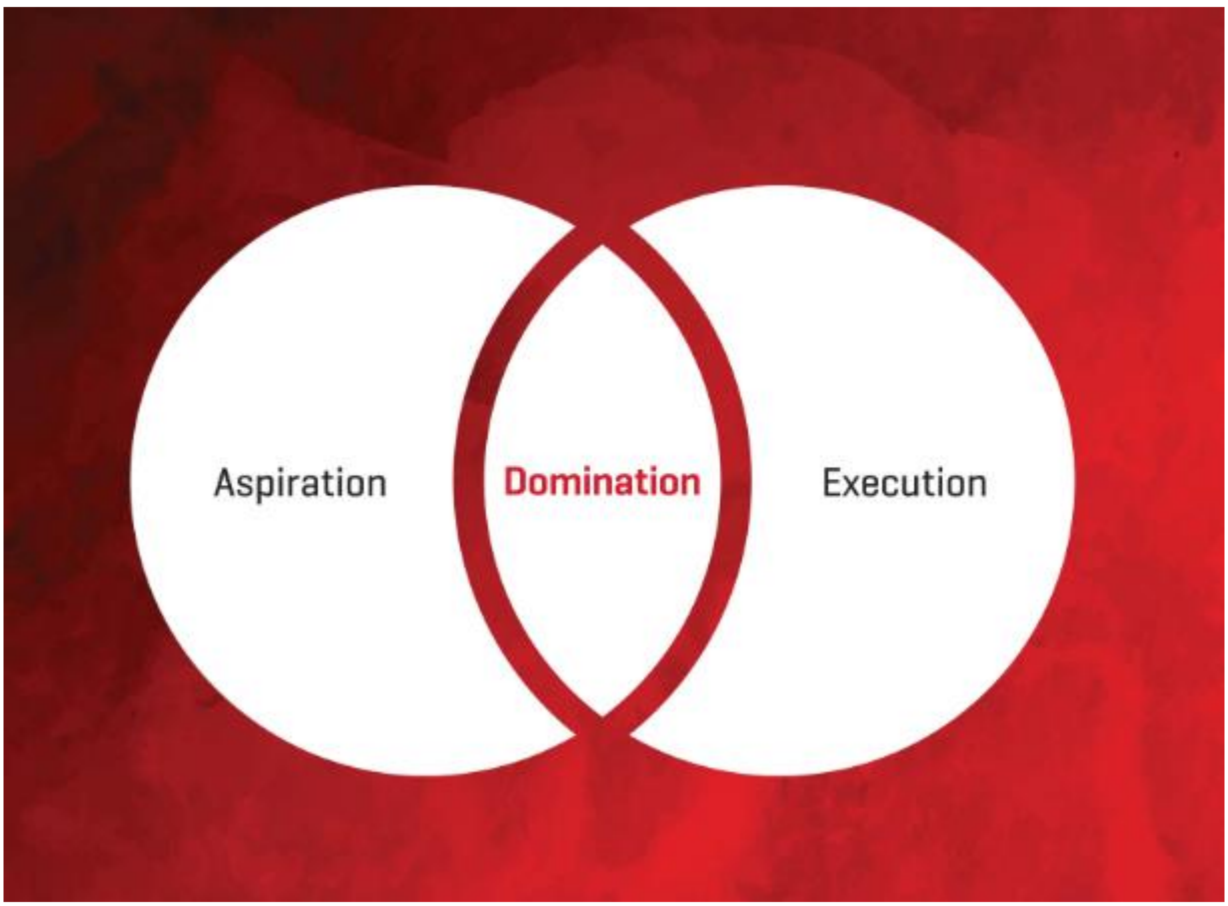

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Contents

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
- Indika Ranaweera – Vice President – SME, Middle Market & Business Banking
- Shanka Abeywardene - Assistant Vice President - Corporate Planning & Business Intelligence

Investor Presentation

GCEO - Dimantha Seneviratne

Opening Remarks

Good morning ladies and gentlemen. Welcome to the investor webinar to discuss the second half results for 2019 of National Development Bank PLC.
With me I have the panelists,

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

Slide 06 - Business Overview

Moving on to the business overview,

Actually NDB is celebrating 40 years. We commenced our operations in 1979 as a development bank, and we became a commercial bank in 2005.This month, we are planning a number of 40 year celebration activities. Over the years, we have been serving the clients. Now we have 111 branches. We also have various on and off-site ATMs, and a branchless banking proposition, where over 80 branches are delivering this service.

All in all, there are about 230 customer touch points serving the customers, along with our digital branch, NDB NEOS. We have been servings the clients via these modes.

Our Total staff strength is 2,700 plus, of that more than 40% are female. We are the first and the only EDGE certified work place where gender equality at work place is assessed. EDGE stands for Economic Dividends for Gender Equality.

In terms of our digital solutions, almost 70% of our transactions are covered by digital means. We have a very strong governance framework and a very competent management team, which is reflected in our results and the awards we have won over the years.

Slide 07 Business Overview – Key Awards 2019

Talking about the awards, we have so far won 32 awards, of which 7 are by the Group Companies and 25 by the Bank.

We have been rated as the Best Bank in Sri Lanka by AsiaMoney.

Refer slide 7 for more details on the Bank’s awards.

Slide 09 – Movement in KPIs – Snapshot

Moving on to the financial, this is a snapshot at a very high level. We will get in to the details later on.

Year on Year [YoY], we had a 22% growth in Gross income – to LKR 28.9 Bn. Net interest income had a 27% growth, relatively a very high growth compared to the YoY assets growth, which was around 20%.

Net fee and commission income had a 22% YoY growth to LKR 1.8 Bn. Pre-tax core banking profit recorded a 14% growth to LKR 4.6 Bn. Total operating expenses increased by 18% to LKR 4.6 Bn. Profit before tax, we saw an 8% growth to cross LKR 5 Bn for the six months.

Profit after tax had a 15% YoY decline, mainly as a result of high taxes and the introduction of the Debt Repayment Levy [DRL]. So as a results, YoY PAT shows a negative growth.

Key ratios, I would like to highlight the Net Interest Margin [NIM] has improved to 3.36%.

Cost to income ratio [CIR] was 39.4% in H1 2018, and now is 40.3%. Slight decline in CIR but is still around 40%.

Return on Equity [ROE], end of last year we recorded 17.41%, the highest ROE on the Banking industry. H1 2019, it has come down to 10.91%. One reason is the increase in our capital level, apart from that, PAT was a decline given the high tax charges we had to incur.

Return on Assets [ROA], moved from 2.22% to 1.88%. There again, ROA reduction was mainly due to the exchange losses we incurred due to the appreciation of currency. And also the asset growth, so the denominator has grown up. YoY asset growth was LKR 74 Bn.

NPL was 2.85% last year, and in H1 2019 it has gone up to 4.56%, which is a situation that we have observed across the industry, even the industry average for NPL has gone up.

On the Balance Sheet, the Balance Sheet crossed LKR 490 Bn, a 4% growth Year to Date [YTD]. Gross loans had a 5% growth – LKR 19 Bn growth. Deposits had a 2% growth to LKR 355 Bn.

Slide 10 – Income Statement [Bank]

Moving on to the Income Statement, Gross income had a 22% growth i.e. LKR 5.2 Bn growth to cross LKR 28.8 Bn. Of that, interest income showed a 28% growth to LKR 26 Bn, quantum growth of LKR 5.6 Bn. Interest expenses also had a 28% increase, from LKR 13 Bn to LKR 17 Bn. So interest income and interest expenses both increased at 28%.

Net interest income, which is an important figure had a 27% growth YoY from LKR 6.8 Bn to LKR 8.7 bn.

Non fund based income also had a drop YoY, which we will discuss later. This was mainly due to the exchange impact – movement; from LKR 3.3 Bn to LKR 2.9 Bn.

Impairment charges, again in H1 2018, we had LKR 1.5 Bn. It has gone up to LKR 1.9 Bn in H1 2019.

All in all, net operating income has grown from LKR 8.6 Bn in H1 2018 to LKR 9.7 Bn in H1 2019, i.e. LKR 1 Bn or 13% growth. Operating expenses has gone up from LKR 3.9 Bn to LKR 4.7 Bn, by 18%.

Operating profit before tax, as I mentioned earlier, is an 8% growth from LKR 4.6 Bn to LKR 5 Bn.

Taxes, you would see a substantial increase, from LKR 2 Bn to LKR 2.8 Bn, almost a LKR 800 Mn increase which is a 39% increase.

As a result, the Profit after Tax [PAT] showed a negative 15% growth from LKR 2.6 Bn to LKR 2.2 Bn. And then, the Group Profit Attributable to the Shareholders [PAS] was a drop from LKR 2.3 Bn to LKR 1.8 Bn.

I think the more important points here are the growth in the core banking income. That is where we have been working hard. As a result, there has been a good coordination amongst interest income. We have been managing our Balance Sheet quite well. So that is shown in the impressive net interest income growth of 27%. Impairment had a 24% increase from LKR 1.5 Bn to LKR 1.9 Bn, which is reflected in the growth in the NPL side, along the current economic situation.

However, when we look at the industry growth in the impairment numbers, where we are seeing some other banks showing substantial increase in impairment, the 24% increase in NDB – I would attribute that to the strong risk management practices that we have developed last year and also the recovery process and the model improvements that we have done continuously.

Over 50% of our PBT was paid out as taxes. Actually, our effective tax rate is about 56%.

Slide 11 – Non Fund Based Revenue Analysis

More analysis on the non-fund based income.

There again, a very good improvement in net fee and commission income, that is where we were working hard on, from LKR 1.4 Bn to LKR 1.8 Bn which is a 22% growth.

Net gains from trading activity also showed a 15% growth from LKR 588 Mn to LKR 676 Mn. Net gains from de-recognition of financial assets was almost at same levels from LKR 344 Mn to LKR 353 Mn.

The total non-fund based income has come down from LKR 3.3 Bn to LKR 2.9 Bn. That is where the other operating income, where the exchange loss is shown. Almost LKR 600 Mn is incurred in that. Other operating income in H1 2018 was LKR 921 Mn. This year it is only LKR 101 Mn. In H1 2018, we had an exchange gain, where as in H1 2019, it is an exchange loss. So almost LKR 600 Mn YoY gap which is reflected in the LKR 819 Mn drop in other operating income. Also, there is about a LKR 150 Mn drop in the dividends from H1 2018 to H1 2019.

The major reason for the fee based income increase would be, increase in volumes in corporate and retail banking. We have been growing our card base, and on the corporate banking side we have been growing trade related fee based income. Those two have contributed to the fee based income.

And also the steep increase in digital based financial solutions. As I mentioned earlier, our digital foot print has been expanding and as a result, that has also contributed to the fee based income. The mobile app and the branchless banking activities that we have been carrying out, have helped us to get the fee based income from digital financial solutions.

Slide 12 – Operating Expenses & Taxation [Bank]

There is an overall 18% increase in operating expenses. If we go in to the details, the personal expenses had a 13% increase. The head count also increased. From 2,381 in H1 2018, to 2,766 in H1 2019, over 300 staff being added. Of course this staff has been recruited; one is for branch expansion, and the other one is new customer support, and new business development on retail and business banking side. We see the contribution coming from the enhanced number of staff, especially on the retail and the business banking segments. Despite the increase in the staff numbers, the increase in the staff expenses is 13% YoY.

The other expenses, has gone up by 24%, from LKR 1.6 Bn to LKR 2 Bn. Of course this has the Value Added Tax [VAT] impact and the increase in certain fixed costs. So these are the reasons for the overall increase in the operating expenses.

Depreciation increase is due to the large investments in the digital and physical infrastructure we have been incurring over the year.

Moving on to taxes, so there you see from H1 2018, 43% was the effective tax rate. That is where we see a substantial increase where the effective tax rate has gone up to 56% in H1 2019. It is mainly coming from the DRL which was not there in the H1 last year. We have paid out almost LKR 500 Mn as DRL which is a substantial element in H1 2019. Apart from that, income tax element of LKR 1 Bn last year has increased to LKR 1.3 Bn in H1 2019. This is due to the increase in the PBT. All in all from LKR 2 Bn tax impact last year, it has gone up to LKR 2.8 Bn in H1 2019.

Slide 13 – Balance Sheet [Bank]

Moving on to the Balance Sheet, we had quite a good growth, compared to the industry, we had a good growth in the Balance Sheet. In the first half, the industry had a negative growth of almost LKR 40 Bn, where as NDB had a LKR 17 Bn growth YTD – 4%. If you look at the YoY growth, it is LKR 74 Bn, and this is the reason I explained earlier as the drop in the ROA. So YoY Balance Sheet growth is 18%.

Gross loans, we had a LKR 19 Bn growth for the first half this year, from LKR 353 bn to LKR 372 Bn. That is a 5% growth. YoY growth was LKR 66 Bn – 21%.

Total deposits, we had a quantum growth of LKR 7 bn, which was a percentage growth of 2% YTD. YoY quantum growth was LKR 57 Bn – 19%. The deposits growth rate is comparatively low, compared to the assets growth. But we matched this funding, as you may recall by the Debenture Issuance we had in Q1 this year. So that also partly supported our funding arrangements apart from the Rights Issue funds we received from the latter part of last year.

Borrowings has moved from LKR 75 Bn to LKR 87 Bn. That is again a 16% growth. YoY it is about 13%. Total equity grew by LKR 1 Bn, which is basically the accumulated profit. So YTD growth is about 4%.

All in all, that is basically the highlight on the Balance Sheet side. So we are at LKR 490 Bn in total assets, at the threshold of the LKR 500 Bn benchmark that the regulator has set up as a systemically important bank. So that is where the capital raising activities that we are working on come in.

Moving on to the impairment analysis, overall, individual impairment has come up to LKR 1.9 Bn from LKR 749 Mn in H1 2018. Of course this is reflected in the NPL ratio as well, which has moved from 2.85% last year to 4.56%. But you would also note, collective impairment, there is a release of provisions. This is mainly due to granular level provisions that we took as well as the model improvements that we have been doing, over the years. So as a result, there was a collective provision release. The other provisions - LKR 115 Mn that is shown, is certain debentures that we hold, in the investments side. So overall, total provisions, there is a movement from LKR 1.5 Bn to LKR 1.9 Bn.

Slide 14 – Loan Book Analysis

This is an analysis of the loan book. You would see that the pie chart shows quite a well spread kind of exposure, there is no major concentration on any particular industry. Tourism sector is highlighted in yellow, because of the recent concessions granted to the industry, and also the industry that got affected after the April Easter Sunday incident. Our exposure is only 4%. There again, out of that 4%, Sri Lanka exposure is about 3%.

Currency composition of the Loan Book, as you would see, this is one of our strategic goals that we have been working on, which was to move towards a more Rupee based Balance Sheet. So the FCY exposure from 22%, has come down to 20%. So the Rupee based exposure has improved from 78% to 80% in terms of the currency composition.

Slide 15 – Funding Sources

This is a more detailed analysis of how we have funded our assets in H1. You would see the demand deposits have improved from LKR 19 Bn to LKR 20 Bn – almost LKR 1 Bn in current accounts. Savings, there is a decline from LKR 36 Bn to LKR 33 Bn. You see the same trend in FCY savings, from some of the FCY deposits we had at the end of the year, which have moved out.

The time deposits have grown by LKR 20 Bn, from LKR 206 Bn to LKR 227 Bn.

So overall, the deposit increase is on the LKR side, a LKR 17.7 Bn increase. This is mainly due to the retail banking side, where we have been very active through our branch network, in getting the deposits. That shows the growth in the Rupee based deposits side, whereas in the FCY side, the growth is only LKR 7 Bn.

Apart from the deposits, we also used the debenture proceeds for funding, so that is why there was not much of a pressure in gaining deposits in the first half of 2019. But moving on, for the second half, naturally we have to have our deposits growth also to match our lending growth.

CASA is actually 19%. Mainly due to the increase in the exchange rates and also because some of the FCY deposits moved out, CASA dropped. So that is the other reason for the drop in the CASA percentage from 21% to 19%.

Slide 16 – Capital and Liquidity

Moving on to the capital and liquidity levels, the Bank continued to maintain above minimum requirements as follows. Liquidity coverage ratios are also very much above the minimum requirements for Rupee and All Currency as follows. So the Bank is very well within the Liquidity Ratios.

BASEL III - H1 2019	BANK	GROUP
Common Equity Tier 1 Capital Ratio % [Minimum Requirement -7.0%]	9.02	10.21
Tier 1 Capital Ratio % [Minimum Requirement – 8.5%]	9.02	10.21
Total Capital Ratio % [Minimum Requirement – 12.5%]	13.64	14.56
Liquidity Coverage Ratio [%] – Rupee [Minimum Requirement - 100%]	211.85	211.85
Liquidity Coverage Ratio [%] – All Currency [Minimum Requirement - 100%]	156.40	156.40

In capital ratios, there is a certain cushion, but as we move on to the next level, naturally we are working on some capital raising activities.

Slide 17 – Investor Ratios

Some of the investor ratios,

The share price as at the end of 2018 was LKR 106.80 and as at end H1 2019 it has come down to LKR 89.90. But we have seen that picking up early this week about to LKR 112. Earnings per Share [EPS] has mainly come down due to the growth in the capital base as well – to LKR 17.52.

The book value of the share remains around LKR 163.40. In December 2018, it was LKR 166.41. That is where the Price Earning [times] is 5.13 vs. 3.53. So more importantly, the Price to Book Value – I think we are one of those shares trading at much below the book value at 0.55 times. That is as at June. But with the recent price increase, this has improved slightly. But still it is a good opportunity to get in to NDB at these rates.

With that we come to the end of the presentation, and we move on to the questions and answers session.

Questions and Answers Session

(Answered by the GCEO, unless specifically mentioned)

Q1: Are there NPLs in the construction industry. Is it across the sectors, or are there any other specific areas from which NPL is stemming, in the second quarter of 2019?

I do not think it is construction related itself. It is across all sectors, construction also was a part of that. But the other sectors also saw stresses, hence not only limited to the constructions sector.

Q2: Can you explain the Easter Moratoriums granted by the Government.

Most of these customers are Business Banking customers. What the Government came up with was, the Central Bank, along with the Tourism Ministry agreed that concessions be provided to those registered with the Tourism Development Authority, who have genuine reasons, and provide them with a one year moratorium. That is how it has worked out, and Indika can provide more details.

Indika Ranaweera: Closer to over LKR 1 Bn is there, which is eligible for the moratorium in our books. There, there is a requirement for the Tourist Board approval. So with that approval, we give a one year moratorium and then after that, repayment starts from 2020 June onwards. So at that time, by looking at the cash flows available then, we will provide a repayment plan based on the existing cash flows. So already we have given the moratorium for over LKR 1 Bn as per the Central Bank and Tourist Board directions.

Q3: Can you explain the digital uptake in the non fund based income segment.

So as I mentioned earlier, we have over 80 branchless banking touchpoints where we go to the customer and collect funds. Apart from that our mobile app has been highly rated. That is where the digital aspect is coming, other than for CEFT and other transfer income.

Apart from that, more importantly, on the Cards side, and also on the Trade side, fee based income has improved. Though the volumes have not grown as much, we have some sizable exposures where we managed to make some fee based income.

Card side, we have seen a tremendous growth, the portfolio is doing very well, and that also has helped us to get some good fee income.

Q4: Can you elaborate on the time lines to raise additional capital.

So we are working on a couple of fronts to raise capital. It is too early to give you a timeline, but we are mindful of the total assets reaching the LKR 500 Bn mark, so in line with that, various plans are there. So we are quite confident that we should be able to make some disclosures once certain things have materialized. It won't be that far, certainly within this year.

Q5: How does the increase in the staff number by 270 in the six months link with the digital strategy, and what is the long term impact on the cost to income ratio, as the full impact of this is not reflected in the first half?

Actually this increase is YoY, June last year to June this year. That is reflected in the CIR also, the CIR was 39.42% which has moved to 40.38%, slight increase. You would have seen that personnel expenses have grown by about 13%. What is important is that, the increase in the staff is coming from the Retail segment. Most of them are on contract basis, on customer interfacing activities, growing the retail base. You would have seen quite a good progress on the retail side especially on the cards and the Dream Maker personal loans growth and also the leasing growth. In leasing also we consciously set up 10 Leasing Centres across the country.

Sanjaya Perera: [On the Retail growth] - Looking at expanding the Leasing base, we have already opened dedicated leasing centres with our branches. We have also had significant growth on the persona loan side. We have expanded our "feet on street" sales force. Then on the Housing Loans side also, we have significant growth this year. So we continue to have that momentum throughout the year.

GCEO: So to answer the question whether the growth in staff numbers have any impact on the Cost to Income, may be in the initial few months you may see that. But the volume of growth we are seeing, for example in July, we had substantial volume coming on the retail side itself, so these volumes that have been deployed at quite a good margin would help us to cover these temporary increases in the staff.

Another area that we have grown our staff is in the support functions. Especially with the higher volumes, naturally more requirements arise in the support functions, especially on the credit approval side. Those also have helped us but more importantly, moving in to the digital side, for example, the Robotic processing that we have implemented since early this year – that is where we are trying to reduce the head count on the support function, so going forward, we are comfortable that we should be able to manage CIR below the 40% level.

Q6: What is your revised asset growth projection for the year, given the business climate?

As I mentioned, in July, we have seen some substantial growth coming from the Retail sector. We are mindful of the industry developments as well and the political developments coming up in the last quarter of this year. So whatever the growth that should come naturally should come in the third quarter. So we need to make some judgmental call on that side. However, with our existing customers, good profitable business, we want to take them. But we would have a cautious approach, keeping these industry developments in mind. So it is very difficult to predict, because we do not want to have those accelerated growth plans that we have had in the previous years. I think we shared these in our earlier webinars as well, and we continue to share this view, that this year, what we did was, we concentrated on the internal arrangement in terms of our efficiency improvements and all of that. That is actually helping us, so once stability comes in, especially from next year onwards, we are comfortable that we can really propel our growth because we have done our internal work very well and we are ready for that kind of growth.

Q7: Which industries are driving the higher NPLs currently? Do you anticipate the NPLS to pick up further in the next quarter?

My personal opinion is, I do not think we will see large upticks.

Buwaneka Perera: You cannot say that there are specific sectors. When we spoke in the Q1 webinar, there was a specific sector that we mentioned, but coming forward since then, it is a wide variety of industries, but we are managing the NPLs very carefully on a case by case basis, of course in relation to the overall economic situation that we have in hand.

Indika Ranaweera: On the SME side, as Buwaneka says, earlier, it was tourism, construction, etc., but now it is not any particular industry but across many that we are managing the NPLs. We have a separate team within the Business Line itself, mainly to monitor and follow up these very closely and give the solutions such as restructuring. So we are closely following up, with central recoveries as well as within the Business Line.

Q8: Can you please shed some light on the tourism sector NPLs, if you were to look at the tourism sector in isolation.

There again, the Bank's overall exposure to the Tourism sector was 4%, not the NPLs, but the loan book. Out of that the overseas exposure is about 1%. So the Bank's local exposure is about 3%. But if you look at the NPLs, in the total NPLs roughly 2 – 3% is from tourism. So that basically reflects well with the Bank's overall asset book, and also it is not concentrated on the tourism sector.

Q9: Who bears the cost of the moratorium?

The banks have to bear the cost of the moratorium. So it is a one year deferred arrangement, where the interest is accrued at a lower rate, but definitely above our cost of funds, so it is also a contribution that the Bank is doing to the industry, knowing that it is beyond the control of the customers. So we are positively looking at it. As Indika explained, our exposure in terms of restructuring is not significant. Even the NPL, what I mentioned was around 2–3 % is for tourism sector. The other good news is that we have seen that these customers are coming up saying that their bookings for the second half is picking up. So we are quite confident that we should be able to manage with this moratorium, especially the payments are due from April next year. So right now, the cost is basically managed through the interest that has been accrued.

Q10: In deposit growth, what are the levers of differentiation that NDB is following now that the rates are largely uniform across the industry?

I think that is where our relationship banking is really working. We have a very good private wealth management entity which took to the branch level last year. That is creating results especially on the retail side. On the corporate banking side also we have very well established relationships. So this is where the relationship banking comes in and helps us. We have been banking with these clients for many years so that is the other area that we are working on very closely to ensure that in a market where the rates are capped, the differentiator is going to be the service and also the relationships that we have built. That is where I think we are going to do well whilst capitalizing on these long established relationships in getting the deposits to grow.

Q11: can you clarify if the tourism NPLs are 2-3% of the NPL book?

Yes, out of the NPL book, 2-3% is in tourism.

End of Q&A.

Closing remarks

Thank you very much for your participation. I think I would like to summarize, we have been building up the internal processes and we are very actively engaged in them, at a time that NDB is celebrating 40 years. The 40 years anniversary celebration activities are also starting from next week.

Apart from that we have seen quite a good momentum in the Group staff as well as the bank staff working together. That is another aspect that I could not talk much on earlier. The group synergies are working very well. For example, NDB Bank's corporate banking and project financing departments are working with NDB Investment Bank. So is the NDB Bank retail banking department and NDB Wealth Management, where we just launched the product, NDB One Account where a client can have a current or savings account and also have the luxury of having wealth funds, which provide higher rates. So these are unique products that only NDB can offer because of our presence. So is the NDB project financing unit and NDB Investment bank working together, showcasing our stature as the premier project financing bank in the country. So a lot more are planned along these lines. We are working hard on these lines, as you will see more improvements.

There are also the internal processes that we are working on, the process automations that we have done – BPR exercise and the six sigma exercises that we are carrying out. We have managed our processes very well for leaner processes. So when the market picks up, we are well geared to meet that challenge and provide more efficient customer service to our loyal customers.

We are hopeful that we should be able to show some progress in the next couple of quarters.

So with that, thank you very much for all your attention, and thank you for my team as well as the Finance Team for organizing this webinar.

Looking forward to the next webinar in the next quarter.

End of edited transcript.