Edited Transcript

Webinar with investors and analysts

Quarterly financial results – Q3 2019
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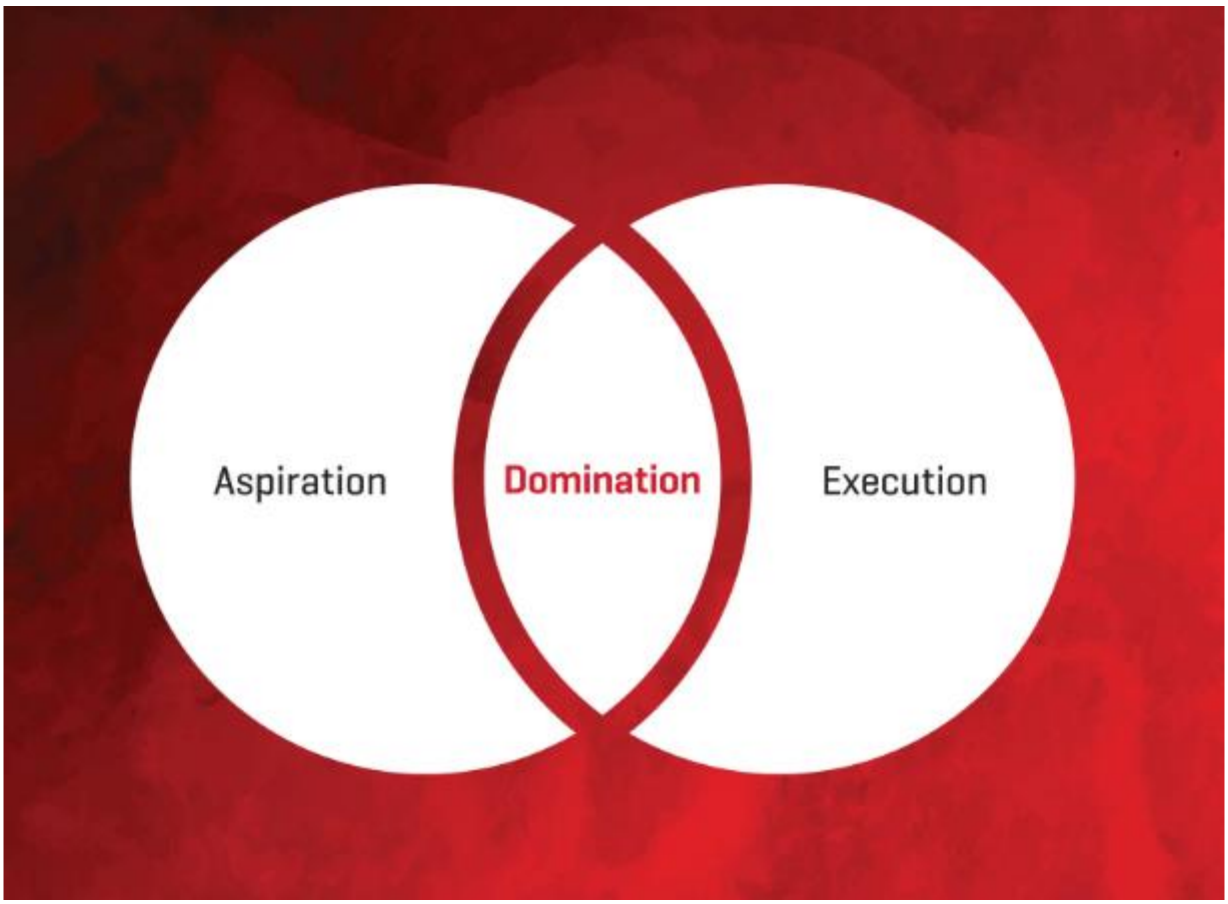

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Contents

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
- 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 third 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

This year NDB celebrated 40 years of service to the nation since 1979. With the presence of 112 branches, 101 ATMs, 22 Off-site ATMs and 53 cash recycle machines and 80 plus branchless banking network NDB is a fully fledged Bank.

Our reach has been widening over the last couple of years. Also we opened our second digital branch last week at Shangri-La. So now we have two NEOS branches with us. Also through the mobile app, we have been able to have more presence through the digital channels to reach our clients. With this, total Staff strength is around 2800. We had almost 400 increases from last year to this year. Out of that female representation is around 39% and we are the only EDGE Certified Corporate in Sri Lanka providing equal opportunity to gender equality.

This year we won closer to 50 awards, both internationally and locally, Couple of key highlights are the best domestic bank award from Asia Money. Also last week we were awarded the best digital bank by global finance USA.

The bank is very much strengthened in its corporate governance with independent chairman and highly expertise management team. We have young and energetic team to grow the Bank.

Slide 07 – Movement in KPIs – Snapshot

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

Overall KPIs for the 3rd quarter in a snapshot

- 19% YoY growth in gross income resulting to LKR 43.9 Billion
- With that Net Interest Income (NII) grew by 23% YoY
- Fee and commission income 21% growth crossed LKR 2.7 Billion.

So as a result pretax core banking profit had 16% growth from third quarter last year to this year 3rd quarter. Then the total operating expenses again grew by 16% growth to LKR 7.1 Billion. So the Profit before Tax crossed LKR 3.3 Billion. Of course, there is a negative growth in Profit After Tax mainly due to the debt service levy introduced. Profit attributable to Shareholders was LKR 2.9 Billion.

More importantly on the Balance sheet we see significant growth. We crossed LKR 500 Billion which was a key strategic goal we set for ourselves and now we are at LKR 505 Billion. So that is a 7% growth from December last year to this year September. We saw 10% growth in gross loans and 8% growth in deposits to LKR 374 Billion.

The other key ratios, Net Interest Margin (NIM) we have maintained 3.4% and cost income ratio around 40.7%. Last year it was 39.4%. Mainly due to the investments in branch expansions and for some of the digital expansions which we arranged during the year.

In terms of the performance ratios, the Return on Equity has come down from 17.4% from end of last year to 11.8 %. But still we are better than the performance of the industry which has been released so far.

With the capital raising activities carried out in last quarter of the year 2018 the ROE has come down. This is due to the denometer which has gone up as a result of the increase capital.

Return on Assets stands at 1.99, which is almost at 2. This has come down from 2.22 as at FY 2018.

NPL ratio from 2.85 to last year December has gone up to 4.93, which is very similar to the industry figure of 4.99 as at September.

Of course the performance compared to last year was impacted by the low growth scenario. Economic activities were curtailed. GDP was very low. Then the industry wide deterioration in the credit quality was observed. We also took precautionary actions for underwriting arrangements and concentrated on certain other sectors to improve our sevice quality standards.

Also higher taxes were imposed on the banking industry with an effective tax rate of 58%. All of that have contributed to relatively low performance than last year.

Despite of all this challenges Core income has grown by around 16% when PBT reflects a 11% growth.

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

Slide 08 – Fund and Non Fund Based Revenue Analysis

The Fund based revenue comprises Interest income with 24% growth and interest expense with 24% growth. As a result Net Interest Income grew by 23% from LKR 10.6 Billion to LKR 13 Billion. This is a quarter to quarter comparison up to 3rd quarter of 2019.

Under Non-fund based revenue in fee & commission income we saw 21% growth. Despite this being a challenging area we managed to get a positive growth on fee and commission income.

Net gains from trading remains almost the same figure as LKR 767 Million. Net gains from de-recognition of financial assets has LKR 243 Million growth to 58% .

Other operating income has come down from LKR 1.4 Billion to LKR 304 Million. This is mainly due to the exchange gain impact. Last year we had quite a substantial exchange gain. Whereas this year with the appreciation of the Sri lankan Rupee there was actually a small exchange gain loss. We are comparing a large exchange gain last year with a small exchange loss this year. So the total Non fund based income there is a 10% decline which is from LKR 5 Billion to LKR 4.4 Billion.

Interest income and the NII growth was mainly due to the 10% expansion of the loan book in the Balance Sheet.

Slide 09 – Operating Expenses and Taxation (Bank)

Moving on to the expense side of the financial results again the personal expenses grew from about 14%. One reason is the intake of almost 400 new staff with increments. I would say its still manageable with cost to income around 40%.

Depreciation remands almost the same about 23% growth mainly due to the investments in IT side, digital platforms. There can be more depreciation coming in with the investments that took place in the second half of this year. And overall the operating cost has gone up by 16% .

Cost income ratio remains at 40.7% slightly above the 39.4 % of the last year.

In terms of taxation. VAT on financials there is 12% increase From 1.2 Billion to LKR 1.3 billion. NBT at 185 Million. The Debt service levy is the new tax which amounts to LKR 757 Million for the past three quarters.

Income tax has gone up to LKR 1.89 Billion. Taxes paid so far amounts to LKR 4.2 Billion compared to LKR 2.9 Billion of the last year. Effective tax rate from last year 43% has gone up to 56%. This is not only NDB bank but entire industry is faced with this tax increase. That's something that we need to work on since delivering our ROE is a challenge ahead of us.

Slide 10 – Balance Sheet and Asset Quality (Bank)

Moving on to the Balance Sheet and Asset quality side

Total assets were passed LKR 500 Billion milestone. We have YTD growth of 32 Billion and the percentage growth amounts to 7%.Compared to September last year to September this year YoY is around 10%.

Gross Loans crossed LKR 390 Billion, with a volume growth of LKR 37 Billion for the year. Substantial growth came in the last quarter .Total deposits reached LKR 374 Billion and Borrowings roughly to 81 Billion compared to 84 Billion in Q3 2018.

Total equity crossed LKR 37 Billion. If you compare the industry growth with our Balance sheet growth, we have recorded very much above the industry growth rates. When you look at the relative growth numbers, NDB has maintained average growth in both deposits and advances.

There is a significant increase in impairment numbers. Last year quarter impairment was only LKR 1.4 Billion when this quarter has reached LKR 2.1 Billion. That was on individual impairment side but on collective impairment side it has come down to LKR 561 Billion .

So what you can see is that we are taking more critical assessment on accounts at individual level. Total impairment for last year three quarters was at LKR 2.6 Billion when this quarter has reached to LKR 2.8 Billion.

NPL ratio we have maintained it around 4.9% We have seen in the industry NPL ratio also moving up. However, we have managed our NPLs in the third quarter compared to the growth we saw in first two quarters. So that is some positive trend which we have seen.

Slide 11 – Loan Book Analysis

This is some further analysis in loan book. Currency wise roughly 78% of the book is in LCY. 22% in foreign currency. So that ratio has remain same compared to last year and the sectorial composition there again you see a quite a well-balanced pie chart in exposure in all sectors with a well-diversified portfolio in terms of the exposures. Agriculture is one of the regulatory requirements.

Tourism which was impacted recently, exposure is only around 3%. On that 3% roughly 1% is with Maldives. So there again NDB has quite a diversified portfolio in terms of the exposure.

Slide 12 – Funding Sources

Moving on to the funding sources, the key Balance Sheet growth was funded by increasing deposits. And also the listed debenture issuance were made in march where we raised closer to five and a half Billion. So the current accounts and the savings accounts exposure remains the same with total CASA base of about LKR 76 Billion. Time deposits have grown up from LKR 271 to LKR 297 Billion.

The overall deposit growth reached LKR 374 Billion. Of course there is a high growth in deposits for first nine months, but these are three months deposits .However, recently we have taken more one tear tenor deposits taking advantage on deposit ceiling ,Interest rate Cap that was introduced recently.

Most importantly, we have observed growth in granular deposits and CASA. Retail network has contributed quite well for this growth in deposits. That is one positive thing that we have seen. Maybe from Corporate side large deposits would have moved out but that was filled in by the significant growth in retail side. You may not see a big change in the CASA deposits because overall the figures are almost the same. However the retail side growth is quite significant.

Strengthening our tier 11 capital debenture was raised which was oversubscribed and we raised LKR 5.5 Billion in March 2019.

Slide 13 – Capital and Liquidity

The common equity tier 1 ratio minimum requirement is 7% and the Bank is maintaining 9.5%. Group level we have 10.6% .

Tier 1 ratio again minimum requirement is 8.5% , and we maintain 9.5 %.

Total capital ratio the minimum is 12.5% where as we maintain 14%.

Liquidity coverage is at 200%, when all currency liquidity ratio is at 155% which again very much above the minimum ratios.

Net stable funding ratio is 108%.

With regard to becoming a domestic systemically important bank, earlier requirement of the regulator was when we cross LKR 500 Billion the capital requirements are to go up. Tier 1 ratio up to 10% and Tier 2 to 14%.

However, regulator made some adjustments to this categorization where in addition to crossing the LKR 500 Billion exposure the regulator also looking at the multiple factors such as the connectedness, substitutability, Complexity and interconnection of an organization. Given that they have confirmed that higher capital requirements are not adequate to NDB we have some head room to make capital requirements for NDB.

That's where we stand in terms of the capital and now moving on to investor ratios

Slide 14 – Investor Ratios

Closing price of the share as at September was 97.8 and as at yesterday it has gone up to 105. EPS 19.27 when the ROE was at 11.83 compared to 17.41, ROA was almost 2% compared to 2.2% of last year.

Book value of the share is slightly above last year 167.9 Rupees .where the price to book value is 5.08 which still remains as an attractive place for investors to invest at.

Basically that covers the prepared presentation and now the webinar is open for your questions and answers.

Questions and Answers Session

(Answered by the GCEO, unless specifically mentioned)

Q1 - In the third quarter individual impairment drop sharply both on YoY and Quarter to Quarter basis, but the collective impairment increased. Pls comment on this

Individual impairment for last year three quarters stands at 1.4 Billion when this year individual impairment was LKR 2.1 Billion. Individual impairment was much lower in the third quarter when there was substantial higher rates were taken up in first half. As I mentioned we saw some improvement in the NPL side and also the flow of accounts moving to NPLs especially in the third quarter declines. Overall YTD terms still its higher than the last year.

Q2 - What's the current composition on the loan book from Corporate SME Retail and Project Finance side and what the bank wants to be at end of 2020 ?

In terms of the Compositions we have seen some significant growth in retail side. Especially on first three quarters. There are reasons as well. We have strengthen the sales force. Underwriting standards were also streamlined on the way that we book our loans especially on the efficiency side we have improved specially on Credit Cards side we see significant growth by crossing LKR 5.3 Billion on Cards asset. As a result we have seen a significant growth in retail side. These are more into granular levels touching several Sri Lankans by widening the risk base .

The Corporate side growth is not quite significant, but in Project Finance side there is a significant growth. So we have seen some shift towards retail and SME

Q3 :To what sectors the growth of the Term Loans have gone to

It's mainly from Project Financing. Plus we had some good growth in the retail exposures as well for personal loans given for 5 year plus housing.

Q4: YTD loan growth is around LKR 37 Billion while other Banks have been sluggish' where is this loan growth coming from to NDB ?

Partly retail partly Project Finance. NDB also made some exposure to oversees where our Project Finance and Corporate Banking made some headway, so when opportunities in Sri Lanka is limited, specially taking advantage in expertise in Project Financing we moved in to East African Region which also helped us to grow our portfolio.

Plus in the retail banking side we have the largest Personal loan portfolio. That is the portfolio we have been growing quite carefully and that's where we have seen quite good opportunity to grow with the support of the sales staff and improve in our underwriting standards.

Q5 : When do you expect the increase capital requirement will be imposed to NDB ?

So we are working on several funds growing our capital base which we started early this year. The process is bit lengthy; of course the political developments are also not helping when working with foreign investors. We are working on several funds and we are quite confidant to make this capital infusion before the end of the first quarter next year. So that's the time plan that we are currently planning to work on. If a thing goes well as planned most likely there will be some market announcements soon. But we have made some very good progress in terms of working with prospective investors to raise more capital.

Q6 : Do you think NPL and provision cycles have peaked out

When you look at our portfolio its look like that we have reached the peak of the portfolio. I don't know about the industry but I can talk about NDB looking at the portfolio quality and the flow of NPLs with the recovery figures we are achieving I think NDB has reached its peak and now kind of managing it down.

Q7: Digital branches what sort of services are provided by NDB NEOS, How many employees are working in NEOS branches and how many branches your planning to open in next year

Sanjaya Perera - We have two branches already. It's paperless. Starting from account opening, deposit withdrawals can be enable without a paper being signed. Also there is 24 x 7 access through the cash deposit machine as well. This has been very successful .In terms of the expansion we have to look at this strategically and identify where we want to go with this. If you look at the first branch in Fort and then the opportunity to came up to open in one gall face we thought that this technology should be taken in to consideration.

So If we get opportunities like such we will be long at in selectively and will use it. In terms of the branch staff 4 people are working in the branch whereas in normal branch 7/8 staff is attached.

Our digital branches were first opened in Fort and now the second in Galle face. We see a significant headway. There are separate set of clients who patronizing that. We have carefully selected these locations based on that and since we are catering the customers who are digitally savvy.

We see lot of opportunities not only for digital branch but for all digital channels like Cash recycle machines which we have been installing, Bank to you proposition. We have seen quite a good growth in both. So its not only installing these machines its about how you get and reach to this clients. This is one of the area which NDB has done quite well

Even though you get all good machines its all about attracting the clients and how our staff go and speak to them and get them in. NDB has very well motivated staff who are very passionate about delivering the results. That is the key advantage we have

Q8 : NIMs have been steadily increasing compared to other Banks. What is the strategy the Bank is using? Is it cutting down the previous high cost deposits or by moving towards Retail & SME sector

Again, I would say NIM remains same at 3.4%. But its a slight improvement from last year when industry figure has come down or remains same. I would say Its more on the cost management side and utilizing unutilized funds. If you look at the Corporate Banking side look at the ones that margins are better. So we look at the holistic picture but some time the NIM may be lower but the Commission and Fee Income of overall basket of the income is good enough we apply the RORAc model, Return on risk adjusted capital model.

So sometimes we may have to cut down on our NIM and work on other Fee based Income .That is why there is 24% growth in NII and 21% growth in Fee Income. Our staff look at these opportunities, providing them to get the best out of these relationships

That's one side. The other one is the focus on retail side with more focus on cards which fees are relatively with higher margins. We have one of the best card products in the market which we have been investing in a new card system and in couple of months we will be moving on to a new platform. Right now we are working only with VISA. We are looking at working with Master and other card platforms as well. So there is a good growth and a good plan to come in which will be in placed by next year.

Q9 : Please explain how you managed your NII and in future over the reduction in interest rates is it only through cost reduction

Niran Mahawatthe : With the rate reductions introduced by the Central Bank in April 2019, definitely we had to bring our costs down. This had a lag effect also which will have a Positive effect for all Banks going up to somewhere around end of this quarter. What we see is that we don't think rates to go up but it will remain the same with the current economic situation. We will continuously monitor our cost of funds which will remain at current levels and even though the rate CAPS introduced in the Assets side we feel a growth in the Balance sheet will offset the yields that which we can earn.

Also we have very robust ALCO, which we continuously monitor which we meet on weekly basis. So with proper Asset and Liability Management we feel our NIMs can be protected and improved in next year

Q10 : Was retail loan portfolio focused on any particular sector

There was no particular sector. As I mentioned earlier personal loan portfolio is quite significant so that has helped on top up arrangements and all. Our sales team has been focusing on approved companies and professionals with salaries.

The other side is on the leasing side which is asset backed. We opened around 10 leasing centers over the year. Actually that is a reason for cost escalation as well. However, we are reaping the benefits of such investments by getting more volumes in terms of leasing.

Then the Housing loan process was simplified and we get lot applications coming from branches with real granular level housing loans not just apartment financing loans.

Also as I mentioned Cards have contributed a lot for Retail portfolio too.

Q11: Based on your discussions with Corporates do you expect corporate credit demand to pick up in next year , all will the wait and see sentiment continue till the general elections.

Buwanaka Perera :In 2019 corporate business segment was very much lower than last year 2018. Three factors affected this such as Political Uncertainty and the confusion which prevailed, second thing was the Easter Sunday attack which affected most of the Business Colombo and around, and the third factor is the current political environment with the current presidential elections. Almost entire year was affected with these unforeseen issues. Going forward with the elections being concluded in this month we are expecting the environment to be more stabilized and with that the corporate segment to grow compared to 2019.

Q12 :With the rate cap in placed is NDB comfortable to lend given that the rate cap does not justify the risk premium to lend

Niran Mahawattha :What was told at the Central Bank was that this is going to be a very temporarily measure. Probable towards the end of first quarter we may see the rates CAPs being taken out. At the same time given the position, if we keep our rates low since there is no significant increase in cost of funds and in the liquidity position of the market and the availability of other source of funds, we are quite comfortable we can maintain the same margin. Still we have little bit of room to improve the margins even though the AWPLR is low

Q12 : What's the target ratio you're looking at getting for the mentioned fund raisings

We are looking at somewhere around 11 / 11.5 leaving for ample push for future growth with target fund raising.

Q13: To Which sectors you have allocated your newly recruited staff

It's mainly on the front line. We have been maintaining very tight tab on support functions because several efficiency improvement measures were taken like six sigma studies, Robotic automations in several process related areas. So as a result we have curtailed the growth in support functions and most of these staff has been deployed to business functions especially on Retail Banking Business banking which generate new business developments.

Deepal Akuratiyagama : As Chief Operating Officer my responsibility is to manage the operational areas. So we basically worked on two areas. One is the automation and the other is Reengineering of the Process improvement side.

On automation side we used Robotic Operations and also hard core systems like workflow systems were deployed. roughly 10 work flows and 6 RPA systems.

And on the other hand, process efficiency areas we have introduced lean six sigma to the Bank. At the moment we have 30 lean six sigma certified staff in the Bank. So they are working on continuous basis to support the bank and the business.

Q14: Loan Quality - What is the percentage in stage three now

As at December it was 7.5%. Since we are not required by the regulators to disclose the quarterly numbers, however, since the question was asked I will disclosed that we are around 10%.

Q15: Bank did not moved to DSBI category due to changes in the assessment criteria's. How does they assess the other criteria's which seems to be more qualitative? Is this coming out in new Banking Act

Information from regulator is that It's not only crossing of a certain figure (Earlier threshold was LKR 500 Billion) . There are five Banks including the two state banks above this threshold at the moment

What I think regulator looking at is managing few systematically important banks. And if you look at India they have only three DSBIs and if you look at Thailand its only 4 DSBIs. So those countries have come up with different measures for example the interconnectedness of this particular Bank to the system, or else the substitutability or the complexity. So various elements are there and regulators are working on this.

I don't think we have to wait for the banking act. The regulator has informed that it will be enacted by the end of 2020 and before that the guidelines on DSBIs will be released. By that time we would have much more clear understanding. Right now our understanding is regulator wants to put down the number so that the regulator will have closer understanding and monitoring

Q16: What is the sense of the cost income of the NEOs branch Vs the Normal Branch

As Sanjaya explained earlier, the staff count is more than 50% less than the normal branch which has around 7-8 staff when matured branch its around 10. In NEOS we manage around 4 staff. So there is a cost reduction in HR side. However, the initial investments are quite significant. So over the first three four years amortization of such investments could have an effect on these branches.

What we are looking at is not short-term but at long term investments, so that is why we have been very much selective where we going to have NEOs branches with enough potential .Even though initial cost is relatively higher it's a long term investment.

Q17: What proposition does the tourism sector NPLs account for

That cost is insignificant as our tourism portfolio is less than 3%

Q18: Could you share some insights on capital raising for DSIBs, will it be case by case or applicable for all new entrants ?Any time lines for staggered basis proposed for capital raising ?

Of course the regulator has mentioned the staggered timelines; most likely 1 year timeliness will be given even If the Bank is identified as a DSBI.

We are waiting for the guidelines but I think it's not a problem as other counties too have gone for a similar model where there is staggered basis step by step timeliness have been given for capital raising.

Q19 : What is the outlook on NIM given the mandatory rate reduction on NIM, couple with the attraction of the Fixed Deposits at higher rates post the renewal of the deposit CAP

We still feel that market rates are continue to be around this level or probably little low given the current economic situation. We don't expect our Cost of funds to rise significantly and also given that the focus on our Balance Sheet is mainly for Retail and SME side we feel that we will continue to keep our margins and with proper Assets and Liability management we feel that the NIMs can be defended improved further.

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;

I think we have seen NDB growing in a very strong with increase in portfolio quality .Lot of investments will be done in digital side, with a core banking upgrade and on IT front there is so much to come in. Best is yet to come in NDB and we are looking forward for that and would like to thank everybody for your participation.

With that we would like to conclude the webinar.

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

End of edited transcript.