

# Edited Transcript

Webinar with investors and analysts

Results for the first quarter ended 31 March 2022

National Development Bank PLC

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# INSIDE INSIGHT



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## Corporate Participants

Presented by Dimantha Seneviratne - Director/Chief Executive Officer

### Panelists

- Sanjaya Perera - Senior Vice President - Personal Banking & Customer Experience
- Deepal Akuratiyagama - Chief Operating Officer
- Suvendrini Muthukumarana - Vice President - Finance
- Niran Mahawatte - Vice President - Treasury
- Indika Ranaweera - Vice President - SME, Middle Market & Business Banking
- Ishani Palliyaguru - Vice President - Project Finance and Corporate Credit Control
- K V Vinoj - Vice President - Wholesale Banking
- Zeyan Hameed - Vice President - Branch Network Management & Product Development
- Damitha Silva - Assistant Vice President - Digital Financial Services
- Shanka Abeywardene - Assistant Vice President - Corporate Planning & Business Intelligence

## Investor Presentation

### Opening Remarks - Kumudari Peiries

Good Afternoon to All of you who have joined with us to discuss NDB results of Q1 2022. As usual we will have our Director/CEO Mr.Dimantha Senevirathne who will take you through the prepared presentation and towards the end of the session the forum will be open for questions and answers. All questions should be posted with the chat option to our panel. With this note let me now handover the session to our CEO

### Opening Remarks - CEO - Dimantha Seneviratne

Welcome all of you for our quarterly investor webinar and with me I have my leadership team who will join me in answering all your questions later on after my presentation.

## PART I - Corporate Profile

### Slide 05 - Corporate Profile

Over 40 years of service to the nation with the presence of 113 branches, NDB was recognized by the Best Bank in Sri Lanka 2022 - Global Finance USA, this is the fourth time we were recognized by this prestige award.

## PART II - Operating Environment

### Slide 06 - Operating Environment

First quarter of 2022 was certainly the most difficult time we have experienced. During the quarter we saw 150 basis points increase in SDFR and SLFR and in the Bank rate. Subsequently in April this was further tightened by increase in policy rates so our foreign reserves depleted rapidly. LKR 200 peg for USD was removed by the Central Bank, and decision made the rupee depreciation rapidly and now addressed to a certain extent where we saw the restrictions on imports. This of course affected importers.

Movement towards the informal market made the dollars not being routed through the banking system and also we saw the power crisis and the full price increase in the first quarter putting a lot of pressure on day to day life of all of us, and then the political environment was highly volatile leading to social unrest. Also we saw the sovereign rating downgrade, a very steep downgrade in first quarter and now of course with the government announced our inability to make the sovereign commitments which resulted the rating to be rated to restrictive default category.

With all of the above the inflationary pressure was considerably higher to around 21.5% but we all know that the current official inflation as at April has gone up to 33% and I'm sure it's much higher than what is being seen there. So we basically operated in a very challenging environment and banking industry who is in the forefront in the economic activities have to basically bear all that challenges and managing that is the major challenge.

Below graph shows how the rates have basically increased to a very tightening situation. Year ago in SDF was 5 % now it has gone up to 13.5% and SLF is for 14.5%. Most importantly, what is reflected in the market is through the treasury bills and bonds which are now going around 23% despite the policy rates are at 14.5% which also shows the market liquidity constraints that we have where all the banks are quite tight with the liquid situation.

## **PART III - Financial Performance Q1 2022**

### **Slide 07 - Overview**

During the first quarter NDB saw about 9% growth in the total asset base to LKR 765 Bn and of that loans had about 10% growth to LKR 580 Bn. Of course partly due to the depreciation of the rupee leading to the loans denominated in foreign currency highlighted high, however there was a slight growth in the book as well.

In deposits we saw 9% growth and in terms of profitability, our total operating income saw 22% Y-o-Y growth. So at the top-line NDB, had been delivering based on our run rate which is a very good achievement under these circumstances. However, due to significantly high impairments both from the loan book and also on our investment book we were compelled to have a substantial impairment which I will describe later on. Our post tax profitability had a 74% reduction leading to LKR 605 Mn.

In terms of other KPIs which have also improved where NIM was improved to 3.43 from 3.25 in 2021. CASA ratio also despite the interest rates going up has improved from 27% to 28% and the impaired loan stage 3 ratios also to 4.4 from 4.5. In terms of group profitability the group profit attribute to the shareholders was LKR 539 Mn.

Group ROE has come down substantially because of these provision hit from 12.4% to 6.8% and the total group assets now stands at LKR 771 Bn which is about 8% growth.

Capital ratios still remain well that Tier 1 capital ratio as of march is at 8.69% and the total capital ratio of 13.36% thanks to the retention of profits and also the capital raising activities that we did last year where we raised more than LKR 9.5 Bn and also with the prevailing rates there is a clear benefit on the debenture we issued during the latter part of last year.

### **Slide 08 - Financial Performance - Income**

In Q1 2022 we see a growth in gross income level to 22% growth from LKR 15.7 Bn last year first quarter versus LKR 19.16 Bn. So that's a LKR 3.4 Bn in quantum or 22% in growth. This actually confirms the strategies that were in place ensuring our loan book margins are contributing positively

Total Net interest income reflects 21% growth when LKR 2.7 Bn growth was recorded for interest income. Quantum growth of Interest Expense is LKR 1.6 Mn due to the increase in the interest rates. All of this resulted NII growth of LKR 1 Bn or 21% growth. Fee base income is one of the areas that we have been working through our V25 strategy concentrating on more transactional business. This has shown results as you can see from LKR 1.3 Bn to LKR 1.7 Bn which shows a 30% growth and also the non-fund based income growing up by 20%. Operating income reflected 22% resulted to LKR 31 Bn.

All of this reflects 22% top line performance which was manageable with all the strategic imperatives we worked in.

### **Slide 09 - Financial Performance - Impairment**

However, now we all face a major issue in terms of the profitability due to the impairment charges. We have basically taken LKR 6.3 Bn impairment charge for the quarter compared to LKR 2.1 Bn in first quarter 2021 which is a substantial growth of about LKR 4 Bn increase. One key reason is of course the escalation of stress levels and the Post COVID stress of the

customers coming out from moratorium and significant deterioration in the market conditions with the interest rates rise.

Through the collective environment models we have taken a higher impairment and also through the individually significant impairments also we have seen a certain stress due to some customers got affected. Due to all of these we have taken adequate impairments and also this includes portion of foreign currency denominated Government securities and SLDB's which we have taken quite a sizeable impairment

This is also impacted by the currency devaluation where the value of that in rupee terms have gone up substantially resulting a combined impairment of LKR 6.3 Bn. So the KPIs on the asset quality which are, impaired loans ratio has improved from what it was last year to 4.4% whereas the impairment to stage 3 has improved to 34.02% from 32.81%.

All of this shows that we have been building impairments as a very conservative bank.

### **Slide 10 - Financial Performance - Operating Expenses**

With regard to the operating expenses, here again I would say we have done a quite a remarkable good job in containing the growth in operating expenses to 6% when the official inflation of march is at 21% despite all of that YoY increase is only 6 % to LKR 2.6 Bn for the quarter.

The personal expenses almost are on par with what was paid last year, where the increase is mainly on the other expenses side with 23% increase which is slightly in line with the inflation rate. So overall still we see only 6% growth in operating expenses thanks to the cost management strategies and the benefit that we have derived from the automation and improvements on the internal processes and digitalization of customer journeys where customer solutions moving on to more digital channels. All of these have basically contributed despite the Balance Sheet growth is substantial.

As I mentioned earlier the profit after deducting all the impairments has actually come down substantially by about 72% for the quarter from LKR 3.4 Bn in the previous year first quarter to LKR 962 Mn before tax when after tax profit has come down to LKR 605 Mn. Profit attributable to shareholders deducting all the subsidy company's contribution has come down to LKR 539 Bn.

### **Slide 11 - Financial Performance - Balance Sheet**

Total assets of the Balance Sheet grew by 9% to LKR 765 Bn, when investments remained same and then the loan book also had a 10% growth and deposits had 9% growth. So total gross loans to total deposits still stand below 100% close to about 95% which shows that our lending is being supported by our own deposits confirming the level of liquidity to support the loan book.

Equity was around LKR 55 Bn. As I mentioned earlier Tier I equity capital infusion of LKR 9.5 Bn in 2021 and debentures of LKR 8 Bn raised in November 2021 have helped to ensure that the equity level remains strong.

### Slide 12 - Financial Performance - Investor Ratios

With all the market sentiments as at March end the share price was 55 rupees compared to 68 rupees last year. Since March 2022 this has unexpectedly come down mainly because of the drop in profitability. Group ROE stood at 7.80% when last year end it was at 12.27%.

### Slide 13 - Financial Performance - Capital & Liquidity Position

In terms of capital and the liquidity position, the common tier one capital at group level stands at 9.19% at bank level 8.7% when total capital ratios are at 13.78% for Group and 13.36% in Bank level. Liquidity Coverage Ratio is much above the minimum requirements of 206.32% when the net stable funding ratio also at 118.43% compared to 100% minimum requirement.

I must mention that the central bank recently came up with a certain leeway due to the substantial increase in Balance Sheet due to the rupee depreciation all banks faced this constraint in terms of capital because the capital is based in rupee whereas part of the Balance Sheet is in dollars leading to a substantial increase in the asset base leading to a lower capital ratio.

Due to the impact coupled with the potential impairment due to the steep increase in interest rates and the valuation of government holdings central bank has come up with the release of capital conservation buffer up to 250 basis points.

The direction was issued early last week, but anyway we have not reached that level to make use of the capital conservation buffer. However, as we move forward sometimes we may have to use that but the entire industry is expected to make use of it and that is one cushion available.

Capital conservation buffers are usually built up in good times when the industry is doing well. We put aside a certain reserves for that and build it up and when a challenging situation comes make use of them. So we are glad to see regulator releasing that and allowing the banks to make use of in case of a need.

### PART IV - Way Forward

I think compared to the first quarter the situation has further deteriorated and I would like to mention that the rate increase has resulted severe liquidity challenge in the banking system plus in the foreign currency side there's a substantial liquidity stress.

Unfortunately some of the foreign currency commitments by two state banks been defaulted. State banks have been funding the country's essential imports in the earlier quarters but I think when the country dry off the reserves they have been unable to commit. This resulted quite a level of stress in the foreign currency liquidity market that has affected almost all banks.

This is one challenge that we have to manage day to day and NDB has been doing it very well in managing that by ensuring that our foreign currency liquidity simulation is supported.

We had to prioritize of things in terms of new import volumes, limiting it to the essential imports which the country is in need at this time and so unfortunately we were unable to do any other non-essential imports.



This is the requirement of the regulator as well to support the real requirements to ensure that countries essentials are kept going. With this, all banks are expected to contribute a certain level of percentage of our export revenue to the central bank.

So going forward we'll be prioritizing on preserving the asset quality, it's very important in an economic downturn which we are proactively working on our credit portfolio. Even the retail banking portfolio where customers have difficulties are monitored so that more proactive monitoring helping the clients. We can't support all the requests, but however giving a new consideration for the stress level that the customers are in and trying to support them while preserving the asset quality of the bank is one of the key priorities at the moment.

Discussing about the liquidity challenges, when the market liquidity is also short by a substantial figure NDB has been very successful in managing that ensuring the bank is always liquid though there is a stress in the market. NDB has been doing very well to ensure that we remain strong in terms of our rupee liquidity and also on foreign currency which we have been managing with certain challenges. Still I must say that compared to the industry we have been managing it very well.

On enhancing the deposit base, I would say basically across the bank it should not be hot money deposits where you pay a rate and get them but we need to have more granular deposits. Thanks to all efforts of the retail banking and our sales team we have seen quite a good growth there and also supporting our clients to maintain resilience in these challenging times while also trying to give the best return to the shareholders.

Certainly we won't be able to deliver what we have been delivering in the past, we have been delivering one of the highest ROEs in the past. I'm sure the shareholders are also aware of the challenges as we are trying our best in this situation while preserving all our resources

Since our groundwork is very strong and our base is strong with a strong experience team very well connected, when the revival happened we will be one of the first to make use of that and then do well when we bounce back.

Also we have to work on capital augmentation plan, now that the regulator has given certain levy on the capital ratios. However, when we make use of those capital conservation buffers we need to have a capital augmentation plan for the next 3 years to ensure that we get back to the minimum previous levels of capital requirements.

So that basically ends the prepared presentation and I leave it open to all the participants to raise your questions and along with me the panelists here representing the leadership team are here to take any questions.

## **PART V - Q & A**

(Answered by the CEO, unless specifically mentioned)

### **Q 01 - Given the liquidity constraints have you started cutting down on loan growth?**

I think in this significant challenging economic concern environment, probably growing the loan book is a least priority at the moment because we had to secure our exposure rather than blindly taking potential bad accounts. Also loan book was partly affected due to liquidity and potential capital constraint as well. So I would say, Yes, we have curtailed the loan growth.

### **Q 02 - Does tier one capital ratio of 9.9% of NDB group include the capital conservation buffer?**

Yes, it is including the total tier 1 capital ratio

### **Q 03 - How much impairments have been provided for foreign currency loans as a percentage up to now?**

Suvendrini Muthukumara : With the country downgrade in first quarter we have increased our impairment cover, and I think we are adequately covered as of 31st march. We had an impairment cover of approximately 7% as of December and on a consistent base across all the banks we took it up to a range of around 10% to 12% in the first quarter

### **Q 04 - What is the last reported NPL ratio?**

Suvendrini Muthukumara: Now with the new regulation banks are disclosing only the stage 3 ratios.

### **Q 05 - Given the capital preservation what are the plans on NDB having a lower capital buffer, would you go ahead and add up the MTM losses?**

Suvendrini Muthukumara: The direction was issued about 2 or 3 days back. Definitely yes, we will, if there is a need to take mark to market. There is a relief for staggering mark to market losses. We will be certainly evaluating it. At this moment I think it's too early to provide any plans on how we obtain the release.

### **Q 06- Any plans on raising equity in the near term with all the negative impacts like debt restructuring?**

Regulator has come up with a capital release from capital conservation buffer up to 250 basis points. We also very well know that this is not the time for any bank to go and raise capital specially at a time that the price to book value of all the banks are at the lowest because that would also dilute the existing shareholders and raise the desired result so we have to defer the capital raising activities.

Actually during this year we are prioritizing on three things and it would be in ensuring how much would be the impact on SLDBs and ISBs that each bank is holding and look at what would be the level of retirement and assess that, then the impact of the depreciation and what would be the impact of the Balance Sheet and take stock of that and then later on when the IMF program is clear we know the direction. Also we expect some policy changes which will remain for several years so there is a proper plan for the country's revival when that

situation improves I'm sure that is the time for any bank to reach the equity market to tap new funds.

**Q 07 - How is other comprehensive income treated currently and what is the relaxation provided by the recent direction?**

Suvendrini Muthukumarana : Currently any MTM losses are considered as a deduction for tier one capital and the relief offered by the direction is for MTM losses which arose with the sharp increase in the rates. Such impact to be deferred over a period of 2 years and of course there are certain conditions given where dividends cannot be distributed as such, so banks will have to evaluate and get the relief.

**Q 08 - How much of the loan book is towards SOEs?**

This is not a significant amount and I would say it's less than 5 %

**Q 09 - What is the level of haircuts assumed for ISBs and SLDBs?**

Suvendrini Muthukumarana : Under the expected loss rate NDB and most of the other banks are also in line with 12% covers of 31st march. In terms of the level of haircuts we have not assumed anything or accounted for a haircut in our accounts but we have made these provisions based on the PDs and the LGDs and that's how impairment cover of 12% has been considered. The industry took a view from the external auditors as well on this.

**Q 10 - What is the impact to capital after adjusting to exchange rate of LKR 365?**

We are above the minimum capital requirement of 8 % so there is no need for us to get into the capital conservation buffer as of now.

**Q 11 - How does the bank perceive NPLs in the next couple of quarters?**

Okay I would say that is a concern for all banks because the productivity of the country got affected with the power cuts and the non-availability of the foreign currency to continue. So it's basically would come from all sectors I would say even retail exposed clients would have lower spending capacity with the inflations going up to around 35% -40% servicing debt would be a challenge.

So as the corporates because of the productivity challenges they have faced and whoever who's in the trading activity would also get impacted because restrictions in import-driven businesses naturally with 100 cash margin implemented, which are all for right reasons that have been introduced but looking at corporates or the customer level certainly that would have severe challenges and severe stresses.

NPLs is an area that all banks and all finance companies have to be very watchful and that's why I did mention earlier our top priority is to ensure that these customers are proactively managed and looked into their requirements, understand their availability to bounce back and provide them solutions now rather than wait for few more months and then when they are really stressed when they have taken use of all the available resources

This was something which we have been doing quite well over the years and proactively managing these accounts but naturally there will be stress that would get reflected in the industry very soon.

**Q 12 - Has there been any inquiry from potential overseas investors looking to inject new capital into the bank?**

One good thing is our key shareholders have shown their commitment in the event that NDB is required to raise capital they would support and there are recent Central bank discussions also and I hope that would also materialize. In terms of the minimum shareholding requirements there are some relaxations.

NDB holds a positive track record in raising dollar funds, even in the past we raised DFC and IFC loans. Having driven the digital capabilities and the cost income ratios there's certainly a chance for investment in NDB. However, what restricts foreign investors is the current country rating and also the political stability. Probably towards the first quarter next year we will see the situation improving and the country move forward with the IMF corrections with required policies in place.

When the first stage or the second stage of the IMF funds are released that is the time for us to approach these overseas investors but they all are closely watching and have given us assurances that when the right time comes certainly they will be one of the first to come and support us and invest in the bank.

**Q 13 - What is the FOREX exposure to state banks?**

We don't want to disclose the numbers, but I think all banks have some exposure towards state banks.

**Q 14 - What is the expected loan growth for 2022?**

Going forward our loan growth for 2022 would be very slow. If we are growing we would be looking at less riskier assets and also based on the need and what sort of contribution that the corporate can bring into the bank all that would be considered. So as a result it would be a very minimal loan that we are expecting for 2022

**Q 15 - What are the exchange rates used for recognizing impairment of 12% on foreign currency loans?**

Suvendrini Muthukumarana : It was in the range of 295 as of 31st march

**Q 16 - ISBs and SLDBs were treated similar or different to provisioning?**

Suvendrini Muthukumarana : If you take ISBs it was treated differently because the impairment cover was higher there and SLDBs were treated differently. These were in line with the industry practices which was consistency applied by all the Banks.

**Q 17 : Question on the expectation on rates**

Niran Mahawatte : There were signs of moving further up during the auction which held one week before. In the last auction we saw it was very much oversubscribed and the whole thing was taken at a much lower level.

Secondary market was trading even lower than that so that is a good indication to see that the rates are also coming towards a little bit lower levels but we may not see an immediate adjustment. It will be a better movement if we can at least stabilize or stop it from moving further up. We will get to see the trend from Monday's auction. Also we have not seen exorbitant rates in the secondary market as well. With all of this I can say that interest rates

also stabilize around the current level and also as long as we curtail the government expenses or the SOE expenses I think we should be able to manage until the IMF works out.

### **General update on market liquidity by Niran Mahawatte**

More than the liquidity side I think I should mention little bit on the exchange rate. I think there is some stability coming in after certain steps taken by the central bank with the new Governor. This was very much welcome by all the banks and I think all the market parties are also committed to somehow to stabilize the exchange rate at the current level and even try bring it down a little bit since with the escalation of costs it will be very difficult for the country to move forward.

Restrictions came on these open account transactions for the importers were very much welcome which were also in our agenda during the last week in certain forums and these conversations which were brought in are now has come into operation, so that definitely will reflect some positives.

Also we saw certain steps were taken to restrict the gray and the black market which will enable some of the remittances to come through the banking sector. So I would say lot of positives are happening and market parties are also working together so we can bring the most want stability and also to get the exchange rate under control.

From the liquidity side, hopefully with the IMF coming in and with the political stability which is very much important at the current junction, will support the market liquidity levels as well. Because we have seen certain investors checking on certain opportunities because interest rates are very high and we have seen the exchange rate stabilizing around 360- 375 range, so they feel that it may be an opportunity for them to come in but it will be too soon to say.

Certainly any positives coming from IMF will definitely be triggered so that will be the trigger point for the country. Somehow if the political stability comes in and we move forward with the recommendations of the IMF then I think that would be a trigger point for some of these foreign investors to come in, of course initially it will probably be short term but we can look at some positives for the medium term as well.

**End of Q&A.**

## Closing Remarks

These are the questions that we have and we will close our investor webinar today with this, Thank you very much for your active participation and also asking some valid questions. One assurance that we can give is that NDB is quite actively involved in managing these challenges and we have a good team and also a good Board also to support us with all these challenges, we have been on top of managing the liquidity and other challenges and we should be able to confidentially manage the current challenges from all fronts.

Sri Lanka Bank's association is also working together with us to support and face the challenges. We as active participants in the economic revival have a big role to play in. So I think going forward, NDB would be involved in ensuring that our required commitment and contribution for the economic revival is there. Also thank you very much for all the participants being part of that and being with us today. With that we will conclude our investor webinar.

Thank You

**End of edited transcript.**