Classification: Public

Edited Transcript

Webinar with investors and analysts

Results for the first quarter ended 30 June 2022
National Development Bank PLC

CSE stock code: NDB.N0000 | Bloomberg: NDB SL | Reuter's: NDB.CM
25 August 2022 – 11.00 am

Forward Looking Statements

This document has been prepared by National Development Bank PLC ("NDB", "Bank" or the "Group") solely for use at its presentation to potential & current investors. By accepting this document, you agree to maintain absolute confidentiality regarding the information disclosed in this document.

The information contained in this document should be considered in the context of the circumstances prevailing at the time and has not been, and will not be, updated to reflect material developments, which may occur after the date of the presentation. Neither the Bank nor any of its respective affiliates, advisers or representatives shall have any liability whatsoever (in negligence or otherwise) for any loss howsoever arising from any use of this document or its contents or otherwise arising in connection with this document.

This document contains proprietary information and no part of it may be reproduced, redistributed or passed on, directly or indirectly, to any other person (whether within or outside your organization/firm) or published, in whole or in part, for any purpose.

This presentation and subsequent discussion may contain certain forward-looking statements with respect to the financial condition, results of operations, capital position and business of the Group. These forward-looking statements represent the Group's expectations or beliefs concerning future events and involve known and unknown risks and uncertainties that could cause actual results, performance or events to differ materially from those expressed or implied in such statements.

Forward-looking statements speak only as of the date they are made. The Group makes no commitment to revise or update any forward-looking statements to reflect events or circumstances occurring or existing after the date of any forward-looking statements.

Contents

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 Peiris

Good morning ladies & Gentlemen, Welcome to NDB's investor update for the first half 2022 and a very good afternoon to those who are joining from the Far East. 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 after the presentation.

PART I – Corporate Profile

Slide 05 – Corporate Profile

NDB Bank in the banking industry with 40 plus years of existence is now the fourth largest listed Bank in Sri Lanka operating with 113 branches, 150 plus CRM and 80 machines. Also we bring in Group synergies through the NDB Investment Banking, Wealth Management and Stock broking arms and provide the best customer-centric solutions to our customers. Recently we have been winning some prestigious awards the latest being Euromoney Best Bank in Sri Lanka award for 2022 and also the global Finance USA for the last four years consequently. All these achievements are from the services that we deliver thanks to our stakeholders customers and staff members who work very hard.

PART II – Operating Environment

Slide 06 – Operating Environment

I must say we are facing the most challenging environment that a banking sector has ever faced. As you all are aware the monetary policy tightening happened in the second first half and there was more than 8.5% or 850 basis point increases in SDFR rates. Also the rupee that has been pegged to dollars for almost 10 months artificially at about 200 level was allowed to be free floated moved the rupee from 200 to 360 rupees which was stabilized around 363.65. So actually two things that impacted the entire Banking sector and the economy saw a sharp hike in interest rates and on the other side the exchange rate movement resulted from significant depreciation of the rupee. We also saw restrictions on importing Goods that affected the importing customers and also the exporters to a certain extent as they were reliant on some of the import raw materials. Also the power outages, world shortages that all continued to a level that people couldn't tolerate anymore.

Apart from that in August the Government also announced our inability to make the international debt payments on time, so as a result the sovereign rating also downgraded by the international rating agencies. Then we also saw the inflation picking up very sharply especially the food inflation around 80 plus range and even inflation is more than 50%. All the bad or diverse situations that we can expect all that happen within the last six months so the bank operated in that circumstances in that environment which we should all be aware of.

Further, Bank rates from last year August 2021,9% went up to 18.5%, SDF rate from a 5% to 14.5% from August 2021 to July 2022.

PART III - Financial Performance Q1 2022

Slide 07 – Overview

This is the financial summary at very high level. In spite of all the challenges, operating profit of NDB manages to record a 46% YoY growth of LKR 22.4 Bn. I would say this is a tremendous achievement in this environment whilst maintaining the service level ensuring that the operating income grow year on year. However, on the other side the impairment charges substantially increased by LKR 13.9 Bn recorded a 235% growth in impairment in year-on-year basis that led to 56% YoY drop in profit before tax which recorded at LKR 2.7 Bn and the profit after tax at LKR 1.7 Bn. Naturally, the profits are moderated mainly because of the impairment charges, otherwise the top line level recorded close to 50% YoY growth. Balance Sheet also had substantial growth of 16% for the first half where we had LKR 816 Bn, asset growth partly due to the steep depreciation of Sri Lankan rupee as well. There was some growth in the first quarter in the loans. Loan book grew by 16% to record LKR 609 Bn and deposits grew by a higher percentage of 17% to LKR 645 Bn. Deposits are more than adequate to support the loan growth as indicated LKR 645 Bn deposits versus LKR 609 Bn loans.

In terms of group performance group Profit after tax was LKR 1.7 Bn year on year and as I mentioned earlier it's a 58% drop. Group ROE significantly dropped again from what it was last year from 12.47% to 5.3%. Group total assets are at LKR 822 Bn, and we also saw the margins improving thanks to the rating hikes. NIMs are at 3.77% compared to 3.25% in 2021. In terms of credit quality impaired loan stage 3 ratio was at 5.7%. In terms of capital ratios,we managed to keep above the minimum requirement of 8.5% at 8.63% and this is without capitalizing the retained profits as most banks didn't had interim audit in June to take the reserves, however we have not taken that into our Capital so this 8.63% is without taking the retained earnings of LKR 1.7 Bn to the capital but if this is considered capital ratio would have been 9% and the total Capital ratio at 14%.

Slide 08 - Financial Performance - Income

You would see 46% increase in the gross income from LKR 30 Bn to LKR 44 B mainly coming from interest income which grew by 46% from LKR 25 Bn to LKR 37 Bn. Interest expenses are also in similar levels. However the Net Interest Income was LKR 14.9 Bn or almost LKR 15 Bn compared to LKR 10 Bn in the first half last year so there is about 45% growth. We also had good growth in Net Fee and commission income year on year again close to 19% growth from LKR 2.5 Bn to LKR 3 Bn. This is despite the import restrictions that we saw in the first half

We saw positive growth in fee income thanks to our trade income and in addition to that the digital strategy that we deployed and also the cards and some other retail products also contributed to get the fee income growing despite the restrictions of imports.

Other non-fund based income also saw 77% growth from 2.4 to 4.3 and overall total operating income we had 46% growth from LKR 15.3 Bn to LKR 22.3 Bn.

Slide 09 – Financial Performance – Impairment

The reason to reduce the profitability was the impairment charges and we were compelled to take high impairment charges especially after the country rating was downgraded. From LKR 4 Bn last year first half we ended up in taking LKR 13.9 or almost LKR 14 Bn impairment charges which is about 235% increase mainly coming from both the investment in government securities both foreign currency denominated and also the loan book precautionary provisions that we took and we continue to ensure that the impairment cover is built up especially in environment like this where we see credit side also getting affected, naturally with high interest environments some of the SME sector and even some of the corporate sector also find it difficult to manage that and also consider the business as they used to do when the economy has also contracted. So that would be an area that we would be focusing even in future to build up that adequate impairment cushion.

Impaired loan stage 3 ratio has moved up to 5.7% from 4.5% last year and impairment cover remains same almost at 32% compared to last year.

Slide 10 – Financial Performance – Operating Expenses

With regard to operating expenses despite the inflationary pressure we saw, I think the team has done a wonderful job in containing the growth to 13%. Compared to last year operating expenses of LKR 5.1 Bn growth was 13% to LKR 5.7 Bn. In the personal expenses side we have more than 3,000 staff with us but managed to contain the personal expenses at 5%. I would like to thank the staff also for supporting our efforts in controlling the expenses wherever possible by trying to manage our controllable costs. The other expenses of course saw a steep increase from LKR 1.8 Bn to LKR 2.4 mainly due to the depreciated rupee related expenditure and some IT commitments which are paid in dollars, especially for the co-banking systems and the licenses paid in dollars. Despite all that since we recorded only 13% increase in operating expenses which I think we have done a reasonably good job which leads into a cost income ratio of below 30% which reflects both the cost efficiencies and the revenue enhancements. I think that's a remarkable achievement despite all these challenges in terms of how we manage our cost and how nimble and how efficient and how adaptable we are to a situation. This is where NDB would score even in future.

In terms of profitability, as I mentioned the profit before all taxes because of the high impairment charges dropped by 56% from LKR 6 Bn last year to LKR 2.6 Bn. Of course with a vat component and all the profit after tax dropped from LKR 3.9 Bn last year to LKR 1.7 Bn. Profit attributable to the shareholders at group level dropped from LKR 4 Bn to LKR 1.7 Bn.

Slide 11 – Financial Performance – Balance Sheet

We had 16% growth in total assets from LKR 704 Bn to LKR 816 Bn and even in investment, similar growth of 12% growth from 146 to 164 mainly due to depreciation of the rupee that also contributed that the devaluation also continued to have some impact in terms of investment growth. Gross loan book for the six months we had LKR 83 Bn growth again partly contributed by the rupee depreciation. Deposits recorded LKR 93 Bn growth. I would say that the growth in the deposits also helped to support our equity position and the total Equity increased from LKR 59 Bn to LKR 64 Bn.

You may recall that the total shareholder Equity last year was arrived by the tier one Capital infusion of LKR 9.5 Bn in 2021 second quarter and we also raised Basel 3 compliant tier two debentures of LKR 8 Bn in November 2021. I think the timing was perfect since we raised that at a very lower cost than what we are seeing now.

Slide 12 – Financial Performance - Investor Ratios

Closing price per share substantial dropped from 68.9 rupees in the first half last year to 35. I think the price is moving around 36 rupees. EPS also dropped from 20 to 9 rupees. Market also reflects the country's challenging economic situation especially with the default situation. ROE also recorded a substantial drop from 12.27 to 5.6 when Book value per share is at 167.62 last year versus 165.02. Group Book value per share is 177.83 rupees. P/E ratio is 3.86 and Price to Book value dropped from 40 cents last year to around 20 cents in this quarter. Almost all the bank shares recorded a drop in prices and we are no different to the market.

Slide 13 – Financial Performance – Capital & Liquidity Position

Capital and the liquidity position are two important ratios in the current context. The common equity tier one Capital ratio last year was 10.01%. However in this year it has come down to 8.63 mainly due to the growth in our asset book due to the steep depreciation of Sri Lankan rupee but I must say here that the minimum Capital ratio is for the tier one is 7%.

Tier one capital ratio minimum requirement is 8.5 where we are above the minimum requirement. There was no need for us to go and tap the capital conservation buffer which the Central Bank announced technically where bank can go and tap up 2% more in terms of capital conservation buffer. Even with the current challenges so far there was no need for NDB to go and tap that and this Capital ratio is also without capitalizing the retain earnings up to the first half as we didn't go for an interim profit certification. Depending on the requirements as we move forward during second half we might go for certification, but I think we are comfortable as we should be able to manage the capital level. As of now total Capital ratio is 13.02% compared to 15.42% last year. In terms of statutory liquid assets we have been maintaining a good liquidity level at 21.57 and then statutory liquid asset ratio is at 24.49%. In terms of liquid ratios we are very much above the minimum requirement of 100% at 241% that has improved from the last year's 193%. All currency liquid ratios also at a good level of 156% compared to minimum required of 90%. In fact Central bank brought the minimum requirement from 100 to 90 but despite that we are quite well above at 156%. Net stable funding ratio again minimum required is 90% when we're at 117%. So liquidity wise we are quite liquid and we are comfortable of that stance and even in capital as of now we are quite comfortable. However, if we have to take further impairments from the investment side we may have to look at getting into the capital conservation buffer but that addition would be taken after the profit certification most likely in September.

PART IV – Way Forward

The challenges are enormous in terms of managing the current high interest situations and also the liquid challenges that the banks are having and I think we have overcome the foreign currency liquid challenge that we saw in the first half especially in April, May and June time.

Almost all banks in the country faced with quite a significant foreign currency liquidity challenge and some banks defaulting on the foreign currency. As a result there was an artificially created liquidity issue but I think we have also come out along with all the other

Banks and I must say we have come out from that challenges and we are quite comfortable in terms of having met all our commitments.

The next challenge is basically managing the rupee liquidity. We are comfortable in managing that but most importantly the greater challenge would come in terms of credit quality because at this high interest rate scenario for Corporates and SMEs. On the other side economy is having a contraction and a lesser demand would lead to a significant impact on the serviceability of the debt and that's why we are very closely monitoring and helping the clients.

On the other side in leases we had seen the value of the assets improving. Which means even the recoverability also has improved especially in the vehicle leases the values have gone up and customers also do come and cooperate when there is additional cash available after disposing and settling the value since there will be some excess cash given to the customer as well.

Other priority would be in ensuring the asset quality is well managed in these circumstances and then more importantly supporting our customers to maintain their resilience in these challenging times. NDB is a customer-centric bank. All our facilities are provided with the intention of customer at the highest level so whenever they have difficulties we ensure that they maintain their resilience that would take certainly involved hard decisions as well. We would also continue to focus on keeping more liquidity in this circumstance so deposit mobilization is also a key area that we are focusing. With the external factors we have shifted some of these priorities, earlier where we used our staff to grow our asset book and now our focus is providing either deposit mobilization or providing greater service or even use good credit knowledgeable staff into supporting the distressed customers in terms of restructuring and working with them closely in providing worthy solutions.

Our priority is preserving the capital, wherever possible rather than going for the high risk weighted assets we move towards low risk weighted assets and maintain the risk weighted asset portfolio so that our Capital ratio would not be burdened with a greater asset growth.

Whilst all that is done we ensure wherever possible to give a reasonable return to the shareholders which is a challenge that we all are having, but I think we are comfortable and we have very understanding shareholders who are supporting us at the right time to support and grow the balance sheet. Once the country agrees with the IMF that we are working and how we agree on sustainable debt re-structuring arrangements. We do understand there are various DFIs are also willing to support the banking sector and I think they're all waiting for this successful structuring.

PART V – Q & A

(Answered by the CEO, unless specifically mentioned)

Q 01: There is LKR 28.6 Bn loan growth for second quarter. From which customer segments are these loans coming from? Is it from working capital or CAPEX related?

I must say that the bulk of the loan growth is due to the exchange impact from the depreciation of the rupee specially the dollar denominator loans once it's revalued at the rupee rate. Despite that in the first quarter we had a slight loan growth mainly coming from the corporate side and also from the retail side. There are no CAPEX actually we were not making any commitment on the CAPEX and its mainly on the working capital side.

Q 02: How is the variable and fixed rate loan proportions change? I think in the first half there was no major change between the variable and fixed rate so there was no change there.

Q 03: What's the bank's policy on credit card issuance for the future period? any restrictions for the demand?

We don't want to go and expand as we used to do but certainly there's demand from the upper segment where we would continue to support. We made certain adjustments in terms of new issuance especially in challenging times easiest way is to use a credit card.

We are careful in identifying the right plans where we would still continue to grow on the right customers but not an aggressive growth that we used to have about a year ago.

Q 04: What are the customer segments, corporate retail SME that are mostly impacted by current economic condition when 8% NPL ratio is forecasted by Central Bank for the year 2022?

Mostly impacted customer segment is the SME sector because they are basically at the grassroots level of the economic growth and when the economy is showing negative growth naturally they would be the first to get impacted and for most of the SME customers the borrowing rates are relatively high. So then when the interest rate goes up they would be the first to get impacted.

In Retail, we have not seen much impact similar to SMEs and Corporate also not much because for most of our cooperates we have funded working capital, so when the business comes down the level of working capital quantum would also come down. Our exposure in the corporate sector and for certain extent even in SME sector our funding is working capital and not the term loan components. We have gradually seen their exposure coming down especially when they are unable to import as they used to do.

If you monitor them properly and structure the facilities to ensure that they won't divert these funding to other segments like a free overdraft. NDB has scored quite well in this as whenever there's a drop-in demand we had seen a drop in the loan book as well but with regard to NPLs yes, the Central Bank have indicated their expectations naturally because most of these customers were in moratorium are coming out from their moratorium at a high interest rates environment.

So for them to continue prepaying that in a high interest rate regime that could be the key challenge so there'll be a lower effect of those in the moratorium moving some of them to NPL so that is by the regulator has also indicated some high NPL percentages and we can't rule that out especially in a negative growth kind of a situation with high interest rates there can be a situation so that's why I did mention that we also are bracing for this situation we are also certain that our remedial unit will prevent the clients going to NPLs and try to support them.

Most of our high-end resources are now deployed in the remedial unit to ensure that we address it early rather than wait for the situation to get worse.

Q 05: What are the initiatives taken to manage the impairments?

Setting up the remedial unit is the key initiative that we have taken. The remedial unit is now in force for the entire Bank both corporate SME and Project Finance. Also in the retail side identifying the potential customers who can go into more deteriorated credit situations and Identifying them early having our most experienced RMs managing them, assisting them is a key initiative that we have taken.

Q 06: Reclassification of OCI debt portfolio to amortized cost portfolio that was taken in second quarter, how much of OCI portfolio was reclassified or to amortize costs?

Suvendrini Muthukumarana : All your queries are addressed in the public financial note number 6 in the interim financial statements. The bank classified approximately LKR 38 Bn of the portfolio as a onetime re-classification to amortize costs and with that the impact to equity or the upside to equity was LKR 6.6 Mn. So as per financial statement disclosure requirements we have disclosed all the information and you can refer the note for further information.

Q 07: What is the haircut you are expecting from ISBs when arriving at the provisions?

None of the banks are expecting any haircut as that's the stance taken by all the local banks holding on to ISBs and usually these ISBs restructuring negotiations will ensure the protection of the local banking entities. IMF would also get involved in such and trying to see the local banking entities are supported without having a major impact. So we are not expecting any haircut. However, as precautionary provisioning entire banking industry has agreed on certain percentages. This has been agreed even with the CA Sri Lanka the regulator so I think even NDB provisioning buildup is in line with the industry and what we have agreed.

Q 08: How has the activity on the loan restructuring picked up given the economic environment and how much of the current loan portfolio would represent restructured loans.

We are heightening that activity to be more proactive and restructuring them and supporting them and that's why I mentioned earlier also by setting up this remedial unit we continue to do that by proactively supporting these clients.

Q 09: What is the variable Vs fixed loan composition at the moment and also the Corporate, SME and retail breakdown

All three are equally distributed when SME is slightly lower, all corporate and the SME exposures are at variable rates. The fixed exposure may be around 50% of the Project Finance exposure which would be roughly about 10% to 15% of the book.

Q 10: Has there been any provision made for potential local debt restructure?

I don't think we have considered that and I think the central bank is very clear on that and you would have seen the Governor also making those statements. So we have not taken any provision for any local debt restructuring.

Q 11: What is the moratorium percentage now versus beginning of 2022 and also are you'll expecting the moratorium percentage increase with the new extensions

Certainly not. We had seen the moratorium exposure coming down and you would note that the moratoriums are also completed by end of June so there are no moratoriums now, even for tourism sector there are no moratoriums, so that the exposure on the moratorium would certainly has come down . However, for those still having difficulties would get re-structured which we are doing now

Q 12: Whether the ISB Investments are at market value which means a big part of the impairment is already taken

Yes, ISB Investments are recorded at market value but when we buy these ISBs they have been bought at a discount compared to some of those others who have bought at the nominal price. So there is an advantage of having them at having bought it at a discount.

Q 13: Are there any plans to modify the product mix to mitigate the risk of the volatile interest rate environment?

Wherever possible, yes we do modify the product mix especially moving towards better Risk weighted asset products in challenging times and wherever possible the interest rates are also moving towards flexible interest rates.

Some of the ALCO related adjustments are already made in terms of how we look at the business but most importantly rather than growing the asset book it would be more curtailing where necessary. We support export driven entities, SMEs who are suppliers to the export driven Industries. We have picked these industries where it would make a positive contribution to the economy rather than import driven businesses. Even these controls introduced by the government in terms of issuing temporary ban on certain imports also going to help in managing the exchange rate and country's total expenditure on imports in challenging times. Our product mix also has been adjusted in line with these good intentions.

Q 14: How do you tackle with the reduction in the equity position when SLAR reduce to 21% which was 27% in second quarter 2021 and what is the plan on growing deposit rates?

Certainly that's why our focus would be to be liquid in the market and when you want to be liquid in the market naturally we may have to pay higher price but on the other hand we had seen so many State Banks are paying quite a big high rates. So this is where the investment that we made in terms of digital channels and also the investment we made in terms of deploying our privileged banking clientele at most of the branches, has helped us to get more granular deposits, rather than going for big numbers our strategy has been to go for more granular retail deposits though it takes time to get them, I think we have a very good loyal customer base and this is where again the family banking concept that we have deployed focusing the customer centricity comes into play. In the Group, the investment options that are available in terms of wealth plan as well.

Customers are also having the ability to move their funds within the different options and all these available options would help to be liquid in a situation like this rather than simply going behind term deposits and getting them.

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.

Thank You

End of edited transcript.