Edited Transcript

Webinar with investors and analysts

Results for the third quarter ended 30 September 2022
National Development Bank PLC

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Forward Looking Statements

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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

Investor Presentation

Opening Remarks - Kumudari Peiris

Good Morning Ladies and Gentlemen and a good afternoon to the participants joining from Thailand and Far East countries. Welcome to NDB's investor update for the 3rd quarter of the year 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 are requested to 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 is present in the banking industry with 40 plus years of existence offering fully fledged commercial banking services in collaboration with the NDB Group presence in the finance industry. The Bank has been continuously winning many prestigious awards and the 'Best Bank Award from Euro Money Asia', 'Best Bank from Global Finance USA' and the 'Best Bank Award from Banker UK' are some of the highlights in the journey of been the most awarded Bank.

PART II - Operating Environment

Slide 06 – Operating Environment

The operating environment was extremely challenging during the last nine months with noticeable fluctuations of the policy rates. The rates have changed from the month of January 2022 from SDF rate of 5.5 and within a short span of seven months the SDF rate was increased to 14.5% and therefore, the SLF Rate to 15.5% which is a significant increase of 900 basis points.

The Sri Lankan Ruppee depreciated to an unprecedented level and the inflation increased up to 80% during the month of September. I am relieved and pleased to see the inflation decreasing up to 73.7% during the month of October. Although we had reached a tip of inflation level there would be a downward trend especially as a result of reduction in prices of food and energy which are the major cost elements.

Another bottleneck was overcoming the COVID-19 pandemic challenges. In the months of April and May the country experienced a series of challenges subsequent to the deceleration on inability service the debt obligation of the country. The country was downgraded to SD which lead the funding lines to be curtailed.

Simultaneously the inflow of foreign currency was disturbed weakening the reserves of the Country. These circumstances lead to unrest in the political grounds and interruptions from the general public in terms of managing the daily routine with the prevailed constraints to source essential foods, medicine, etc.

The brunt of the prevailed circumstances had to be absorbed by the sector and our prime responsibility was to ensure supporting the essentials. The Banks continued to support the central fund by selling approximately 25% of all export earnings and remittances to ensure the creation of a pool to ensure the essential imports of the country being facilitated.

We are hopeful that the IMF relief program would be rolled out soon. With the prevailing high interest rates getting further extended the problems would create a bigger impact and in that light the Board level agreement is expected in December and especially the credit level agreement is expected to be signed in the short run in order to expedite the restructure.

However, some improvements in the operating environment could be witnessed and we are witnessing controlling measures been put on place for increasing interest rates with the intervention of the Central Bank. Subsequent to the increased deposit rates, lending and liquidity rates increased as well. Based on the circular issued recently, the pressure on liquidity that the system is going through could be eased to certain extent.

PART III - Financial Performance Q3 2022

Slide 07 - Overview

The Bank reflected a 35% YoY growth and the top line operating income for LKR 31.5 Bn which is 35% YoY increase was offset by significant impairment charges which increased by LKR 22 Bn or a 234% increase as a result of deteriorated credit quality of the loan book including precautionary provisions.

Our Asset book both in LKR and Dollar terms inclusive of precautionary provisions were made with the indications of the country been downgraded to selected default situation and the discussion of structuring the rates which is ongoing. As a result the pre-tax profitability for the nine months sharply decreased by 91% to 790 Mn YoY and the post-tax profitability was recorded LKR 561 Mn which is a 90% drop compared to last year's nine months performance.

Some other positively critical highlights are the growth in gross income by 62% which also reflects the strong fundamentals and the ability of the Bank to drive midst all the challenges. Only the impairments have been a hit which is believed to be a temporary situation until coming out of the uncertainties in the present.

The net interest income grew by 39% although there were constraints for trading business during the first six months. The Exchange income which is a key driver was also crunched with the shortage of liquidity in terms of foreign currency and despite the same the fee and commission income grew by 10%. However, profitability got moderated due to the significant provisioning of impairment that required being absorbed. In terms of the Balance Sheet, the total assets grew by 16% and are in the boundary line of LKR 820 Bn.

By the month of September we are partly driven by depreciation of the LKR. The assets in terms of dollars were converted to domestic currency resulted in a depreciated impact. The gross loans and receivables crossed LKR 600 Bn which is a 14% increase and also more importantly the deposits that cost approximately LKR 650 Bn, resulting the deposit to grow by 18% which is higher than the 14% growth in the loan book. Therefore, the impact in the Balance Sheet is around 82%. The referred numbers were mainly driven by Depreciation and the Balance Sheet was held and wasn't grown much during the second and third quarters in a row considering the environment and the circumstances which were beyond our control.

The Group Companies contributed a profit for LKR 641 Mn and the YoY growth is approximately 89% and the total Group Assets now stands at LKR 825 Bn. In terms of key performance indicators the net interest margin improved from 3.25% in 2021 to 3.78% which is more than 50 basis points. The impaired stage III loan ratio has increased from 4.55% in December 2021 to 5.75% which reflects the actual downturn of the economy, negative GDP growth.

The minimum requirement of Capital is 8.5% and tier one Capital as of September was recorded to be at 9.42% and there was no requirement for us to top up the capital by converting the buffers although the regulator has given the option for all the Banks. The total Capital ratio for the year is a minimum of 12.5% % and NDB has achieved 13.6 %.

The 'Advanced Deposit Ratio (ADR)' was improved to 94% and especially in the LKR side we were maintaining more than 100% ADR ratio. However, during the month of September the same got reversed and now we are below 100% in terms of the LKR and the ADR as well.

Both in liquidity and capital fronts NDB has reflected to be well capitalized and we were relieved not to proceed with the conversion of Capital buffer compared to the minimum requirement despite the current challenges. The improvement of the liquidity ratios also reflect the strength to manage the unforeseeable challenging situations similar to the circumstances undergone at the present in terms of the financial position that cumulated the first nine months ending September 2022 versus nine months last year.

Slide 08 - Financial Performance - Income

The growth in income level by 62% or recorded LKR 28 Bn growth , interest income by 68% or by LKR 26 Bn and the interest expenses by 89% mainly driven by steep increases mentioned earlier. Almost 900 basis points increase in the Policy Rates were reflected in the deposits rates and the entire market had liquidity constraints which lead the market rates to fluctuate in quick time as a whole compared to the adjustments to the loan book. Naturally any Bank would undergo a mix of variable interest rates and fixed interest rates and the changes to the fixed rates naturally is a challenge. The net interest income grew by 39% to 40% from LKR15 Bn in 2021 to LKR 22 Bn during this year.

In terms of fee based income, as I mentioned before, the growth was 10% where it is worth noting the period from nine months six to seven months actual were quite challenging with the liquidity challenges of dollars which the entire Country faced. This was also supported by the curtailed policy decisions to deal with restricted imports. Hence, the usual trade instruments which support the trade income to any Bank got impacted but still NDB achieved a growth of10%. The other non-funded based income was grown by 47% and the total non-funded based income in terms of fee revenue was increased to LKR 9.3 Bn from LKR 7.3 Bn for the past nine months. The operating income has improved by 35% from LKR 23 Bn to LKR 31 Bn and the improved interest margin despite the re-pricing of assets.

Slide 09 – Financial Performance – Impairment

The Bank had a huge impact due to impairment charges for the quarter which is a more than 03 times growth or a 234% increase or an increase up to LKR 22 Bn from last year's LKR 6.6 Bn which is substantial. These impairment charges are inclusive of foreign currency denominated to the government securities that we held and also the loans to the customers, especially the largest portion arriving from foreign currency nominated government securities.

We have basically impaired based on the industry Norms that we have agreed along with the Chartered Institute, Banking Sector and the Regulator. In line with the market, the prudent provisioning were made, especially with the interest rates going up to 30%. Certain other customers are coming out from the moratorium and the natural tendency for elevated non-performing loans are high. Hence, the Bank proactively building provisions which is part of the business in such economic cycles and managing the same. The Bank can overcome this situation with the strength of the key performance indicators denoting asset quality impaired ratio increase from 4.55% last year to 5.75% this year reflecting the negative growth rate in the Country which results from the credit quality.

The impaired stage 03 to the stage 03 loan ratio, which is basically how much of your stage 3 loans have been impaired has improved from 32% in December last year to 34.66 %.This is a ratio that we have been consciously building up to ensure that the impairment cover would be sufficient for any eventual credit losses later on

Slide 10 – Financial Performance – Operating Expenses

Another key element is how we managed our operating costs and that's where I think NDB has scored quite well. The overall increase in operating expenses is only 10% despite the inflation hitting 70% plus and all our costs going up. Despite the height of the crisis we have been providing transport services to our staff members and more than 12 buses were deployed.

On the personal expenses, only 3% increase from LKR 4.2 Bn to LKR 4.3 Bn. The cost comparison as % from 55 % last year, has come down to 51%. Admin expenses, depreciation and Investments recorded 23% increase with a 10% growth in operating expenses, we have recorded one of the best cost to income ratios which is less than 30%. The credit is to be extended to the efficiency level on how we operate and also the digital technology that we have deployed in the process of automation, productivity and enhancements that we did and also optimizing the staff through redeployment in a challenging year to manage the cost. These sustainable cost savings and sustainable arrangements would continue as key areas even in going forward. NDB has the ability to get the best out and that's one area that we have been focusing over the past one year or even prior to that and we would continue to do that to manage our costs and be more efficient.

Slide 11 – Financial Performance – Balance Sheet

With reference to the Balance Sheet, there was 16% growth in overall assets mainly driven by the depreciation from LKR 700 Bn to LKR 819 Bn. Investments reflect a 21% growth with consciously investing in the treasury bills and funds. Whenever, the loan growth is curtailed the excess funds are deployed there and the gross loans recorded 14% growth and gross deposits 18% growth. The marginal growth of total equity improved by LKR 3 Bn about 5% growth YoY and the Balance Sheet remains strong with the liquidity position being quite strong.

The cost of funds are relatively good where we have seen the Net interest margins improving and most likely going forward we would ensure that Balance Sheet is protected and we may not grow as we used to grow in the past because the environment is not conducive for that .

We have to be cautious and protective of where we hold our assets. We would be adapting a conscious growth that we would have even during the next year.

Slide 12 – Financial Performance – Investor Ratios

Closing price per share has come down substantially by LKR 43 in September, when EPS dropped to LKR 1.97. The ROE of 1.24% and the ROA of 0.14%. These are extremely low numbers compared to what it was mainly driven by the huge impairment charge that we had to take. The book value remains around LKR 162.17 and the price to book again is 0.3 times reflecting the market sentiments. One of the reasons for the drop in the book value is basically the increase in the stock issue through the script dividend in March this year.

Slide 13 – Financial Performance – Capital & Liquidity Position

In terms of capital and liquidity position the regulatory minimum tier one requirement is 7% and we are at 9.42%. In the total Capital ratio the minimum requirement is 12.5% and we are at 13.6% without drawing the capital conservation buffer as I mentioned earlier. The statutory liquidity ratio remains at 22.80%.

Liquidity coverage ratio stood at 208% when the regulatory minimum is 90%. All currency liquidity ratios is at158% compared to minimum of 90% and Net stable funding ratio stood at 123.19% versus 90% regulatory requirement. We have been always maintaining high liquidity and has kept all the regulatory ratios at a level above the minimum requirement.

PART IV – Way Forward

With reference to the last slide the way forward, there are couple of things that the industry is looking forward in terms of debt structuring and the level of debt structuring along with the IMF release package. We are hopeful that the Creditor level agreement can be finalized soon.

The Paris club and the non-paris club bilateral creditors to obtain IMF Board level approval and with that to obtain IMF approvals. There are some bilateral lenders who have been lined up with some funding. Our second quarter next year is about the level of debt structure that needs to be agreed with the commercial creditors. Although that is something that we are looking forward the impairments were in line with expectations on these discussions which still has a lot of uncertainties. In that light the industry has taken a cautious approach without knowing what this debt structuring would ultimately. We would have a much clearer picture hopefully by second quarter and until such time the banks would be building up these impairments as a precaution.

The impairment provision building is critical for any potential loss coming from the debt restructuring. Because most of these customers have fallen not because of their fault but naturally because of the economic downturn and the condition that we all had. We have to actually protect them, support them

Another key area that we are covering is the preserving the credit quality of the lending book that's where we had to be proactive. Some of the customers are coming out from the moratorium in December but more importantly we need to understand what their challenges and problems are and provide solutions. Some of them are not financially literate and that's where the education from rather experienced Bankers coming and helping them. The Bank already set up a Remedial Management Unit within our Business Lines to take care of these customers who needs more assistance and guidance and that's proactively what we can do as a Banks.

The other key area is cost rationalization and revenue management to preserve the profitability in a challenging year ahead. Especially on impairment charges we all know that taxes have been raised which is their need for the country.

We would be concentrating more on Capital efficient products and our key priorities would be naturally preserving the asset quality in a challenging environment supporting customers to maintain the resilience. That's where the Remedial Management Unit, more relationship Banking and holding all that comes into place here. Also being liquid all the time being above the minimum liquidity ratios is a key area for any bank to concentrate. We will be concentrating on that and also preserving the capital and have a capital augmentation plan when the market conditions improve.

Hopefully after the IMF restructuring program is announced, it would be a time that bank should go and also tap capital for the next phase. The Country needs stronger banking systems and we are getting ready to ensure that the country picks up the power growth momentum from the middle of next year. We are strong enough to support the nation on this.

With that we have could wind up the prepared presentation. Myself and my team now would now be open for the posted questions. We would be looking that those questions and answer them.

PART V – Q & A

(Answered by the CEO, unless specifically mentioned)

Q 01: From industry we are hearing many are leaving NDB now. Was NDB able to retain and grow employees? What are you seeing from the staff? What steps the bank has taken to manage this

Yes we see the staff turnover increasing. I think this not only us but the entire industry is faced with. Young staff members are always looking for their career opportunities and most of them are moving overseas as well. We are also impacted by that but how we manage is basically, we always had a pool of staff. There may be staff in some of the areas that we are not growing our Business and probably they will be allocated to areas that we want to grow so it's a matter of how you manage.

Q 02 : The foreign balances the bank holds with foreign counterparts and are there any unpaid dollar debts of the bank?

No, we don't have any unpaid dollar debts. We have settled all our dollar debts We have very few loan settlements that are coming up in next year. This year we don't have any loan settlements.

Q 03: Tier I capital of the bank has increased by around LKR 3.6 Bn. Why the total equity on the Balance Sheet has come down?

Due to loss on the quarter

Q 04: What are the reasons for your Tier I Capital increase?

Usually the profit and loss will be recognized on tier I Capital. We have basically revalued our assets and auditors have confirmed this capital revaluation reserves. That's why the capital ratio has improved

Q 05: What is the bank's exposure to the condominium sector? Can you get a sense of the level of distress in that sector?

We don't have a significant exposure

Ishani Palliaguru : There are one or two facilities stressed. If you look as a proportion of the sector I don't think we have much exposure. So that's not a considerable stress in as a sector for us.

Q 06: The staff cost was only increased by 3% while the inflation is about 60%. Is this demotivating the staff and leading for higher staff turnover.

I would say that the Bank has realized that the stress level especially the inflation going up starting from end of July. We have made certain adjustments as allowances which has also helped to support in some way but certainly not the level of impatience. Staff is affected from both sides. One is the inflation and the other is the high tax rates that are coming up from December where the total tax rates going up from 18% to 36%. We are working with the HR teams among all the banks to work on a level of increments. Only 3% increase in staff cost is mainly due to the cost efficiency that I spoke earlier.

We have given so many other benefits for the staff to manage their time in terms of working from home, flexi -hours, transport arrangement. Some of the overtime costs and the level of engagement activities been curtailed has resulted a natural decline in such costs and those are the reasons for the staff related cost not to be high as the inflation cost.

Q 07: Plans to raise capital and another question about the ISB positions and expected recovery price, expected losses.

In terms of plans for raising Capital as I mentioned the Capital Ratio has improved to 9.5%. There's no plan for us to use the capital conservation buffer as the regulator has announced. I think this question has come from Tony Watson, an Investment Management Hong Kong one of our shareholders.

There is no plan for us to raise capital at the moment. However, when the situation improves, the IMF approval is in place the market situation gets better we would certainly go for a Capital raise.

I did mention in my presentation that right now the challenge is to preserve the quality of the capital and also the Balance Sheet. There would be a time that we need to grow the Balance Sheet and the time, most likely the second half of next year. We may have to track the market for the capital raising.

Niran Mahawatte : As per the current situation I think all the banks will wait for the understanding of the IMF and Central Bank for restructuring to take place and what sort of hair cut the Banks may have be take. We have also given our solutions where the local banks can be treated differently from the international markets. If there is going to be any cuts we can absorb that proportion in rupees because we have the vacuum to take certain amounts in Rupees.

If you look at the markers there is some kind of an improvement in the prices over the last one week and we have seen the prices increasing to about 30% to 29% from the 20% to 82% which also looks little positive from what it was.

Q 08: What is Banks plan with regards to the tourism sector?

We have seen the tourism companies are coming out from their moratorium now. Some good positive news is that almost all of our customers have indicated that their level of booked orders has improved. They're expecting a good turnaround; some are even good till April next year. That's one good positive thing. Overall NDB's exposure to tourism is around 4.5% of including Maldives which is doing very well. So we are talking about 3.5% exposure to tourism which are under management. Most of them are in the corporate side where we had seen the customers are coming out from the challenges. Some minor business banking or the semi sized Businesses also have shown improvement but some of them need some support. This is supported through the Remedial Management Unit that we have set up.

Q 09: Would the Bank looking in to converting its debt into equity

I think there is no need for us to look at it

Q 10: What's the Bank's opinion on Treasury Bill Rate

I think we have seen some easing off over the last week and also even from yesterday to today the rates have come off. So let's wait and see of the tomorrow's auction and also the continuity at least such high rates also will be very detriment to the country's economy. We feel that the rates may drop in the coming weeks. Probably we have seen the field as the inflation.

Q 11:What is bank's intentions on increasing its liquidity?

The Bank has looked at the recent direction combining both the Dollar Assets and the Rupee Assets combined together and have it in Rupees, which would ease off some of the liquidity pressures that the banking system is going through right now which is a good development. Reduction in the interest rates could also help the current liquidity to improve. We increase our liquidity mainly through more granular deposits. Our retail network is quite strong and has the Transactional Banking Unit who is working on more transactional accounts to be with us at the same time our supplier financing or the dealer financing is a combined solution that we give. The Branches and the entire network operations have been given directions about how we get more Transactional accounts into the bank and that is an approach that is working well. We would continue to go focused on that to improve on our liquidity.

Q 12 : Would it be possible to get an idea of the exposure of lending related to state owned Banks

We don't have, it's basically Zero. We don't have any lending to the state banks

Q 13: How the Treasury Bills and Treasury Bonds changes from 2021 levels and how many Bonds and Bills is the Bank

Niran Mahawatte : Though the loans are not going as fast as we used to see in the bank the deposit popularization is continuing ,There are investments in the interested Bills and Treasury Bonds.

Q 14: What is including the denominator in calculating SLAR

Suvendrini Muthukumarana :How much of liquid assets the bank has over its total liability base. Total liabilities will include the deposits and borrowings. There's a clear guideline. So in summary it's your total liquid assets excluding the loan book over your total Liabilities.

There was a question earlier about the level of impairment for the ISBs and SLDBs. I just want to clear that we are in line with the impairment charges banks are taking in line with the discussions we had with the chartered Institute. Also we are in line with all the banks in the industry that has taken of course a lower impairment for SLDBs because the treasury has started settling. They sell SDBS in LKR so most of the banks have received in Sri Lankan Rupees. Our maturities of SLDBs are very less next year. In terms of the ISBS we are in line with the industry and the impairments that we have agreed with.

Q 15: How has the inter bank lending markets changed in the last few weeks?

The Governor was looking to improve the liquidity levels in the market. If you look at today, we have seen a TB yields dropped by about 150 basis points. We might see some improvements going forward as continuation of high rates are very detrimental to countries economy with connection to inflation rates as well.

Q 16: Does Central Bank pay SLDB outstanding's without a delay ?

They do pay without a long delay

Q 17: What are the OBO liquid assets for the latest reported quarters?

Suvendrini Muthukumara : Its 25% and that is in published financials

Q 18: Are you doing any advisory services for the sale of distressed assets and how much will the Mount Lavinia hotel can be priced

We are unable to comment on that. However this is where NDB Investment Bank would be paying an active role. The government has announced several SOEs that are being restructured. This is part and parcel of what NDB Investment Bank is doing so we would also get involved in those. I'm not sure there'll be other players as well but I would say this is an opportunity for the investment banking community to work on these distress assets and the restructuring programs.

End of Q&A.

Closing Remarks

I think we have no other question so with that we will conclude our webinar. Thank you very much for your participation as always it's quite good to have interactive sessions and we have been doing it every quarter without fail. So thank you very much for your presence and also asking so many questions and thank you for my team and the finance team who have been putting this together

I am looking forward to meet you all again through a webinar like this in the next quarter. We would be working very closely with the Central Bank and our customers. Especially we need to take care of our customers. There's a huge set of customers who we have to look after, depositors as well as the borrowers. As a responsible Bank we have to ensure that they all are heard and provided with solutions. That's a role for us while ensuring that a bank delivers a good result for shareholders which are what the investment Community is looking at.

Thank you very much for all your questions and please be with us even in the next quarter and follow us in your analysis and continue to have these interactions

Thank you so much.

End of edited transcript.