EDITED TRANSCRIPT

WEBINAR WITH INVESTORS AND ANALYSTS

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NDB bank

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Forward Looking Statements

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Corporate Participants

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Sanjaya Perera - Senior Vice President - Personal Banking & Customer Experience
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Suvendrini Muthukumarana – Vice President/ Chief Financial Officer
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Investor Presentation

Opening Remarks - CEO - Dimantha Seneviratne

Welcome all of you for our quarterly investor webinar and with me I have my leadership team.

PART I - Corporate Profile

Slide 06 – Corporate Profile

At a very high level, the corporate profile, 42 years in operations and NDB has 113 branches, we provide the full gamut of commercial banking activities. Staff strength now less than 3,000. Key area that we are focusing on is our digital drive, where 85% of our transactions are routed via digital modes. That is one area we have been investing in. That has also helped us to get our cost to income ratios down and provide more holistic solutions to our customers through digital platforms. The other key advantage NDB has is the NDB Group companies engaged in capital market activities, including investment banking, wealth management, and stock broking making it a well-covered financial proposition that we offer to our customers. We are also highly rated in people management, we are a Great Place TO Work, in terms of diversity 41% of our staff is female, and we are the first EDGE certified corporation in Sri Lanka where gender equality is maintained well.

PART II - Operating Environment

Slide 08 – Operating Environment

Now coming to the Operating Environment, to recap the scenario – we were operating in a tremendously volatile environment last year and this year. But things are getting better having financial sanity. One key area is inflation where we have seen inflation coming down from a high level of 75% in September 2022 and coming down to a level of 33% in April 2023 the latest available numbers. The expectations are for this to come further down and hopefully to single digit levels by the year end, of course at a higher base. But I think that is a good sign that we are out of the peak level.

Then on the exchange rate, we have seen the Rupee appreciating against the dollar which is again a good sign. We saw in the first quarter itself a 10% appreciation of the Rupee from a high level of LKR 367/- in December 2022. Now if you see the appreciation to date (23 May 2023) it is over 15%, from LKR 367/-, which is now hovering around LKR 306/-. This is a good development in bringing down the cost of living for the Sri Lankans, and also ensuring those sometimes over heated exchange situations are getting corrected. We all had foreign currency liquidity challenges last year, but we were one of the first banks to come out of it and we were helping the customers. Now the liquidity situation has considerably enhanced. This is due to few reasons, one the demand for imports have come down with certain controls introduced. But now certain of these controls are being lifted. The Government also has indicated that by June there will be further relaxations. The cash margin requirement was taken out very recently, so that is one reason. Overall people’s spending capacity has also come down, so as a result, we being an import dependent country, which demand has come down.

But on the other hand, the export side kept on supporting the country with much needed dollars. There could be impacts, with global demand coming down so we see exporters also experiencing gradual cut downs on their demand. We hope that is temporary. As of now the foreign currency situation and the exchange rates have improved. This is also supported by the worker remittances that have improved YoY and the recent improvement in our tourist arrivals.

During the first quarter, the Central Bank of Sri Lanka (CBSL) also increased the policy rates so that the gap between the market rates and policy rates narrow. We saw a 100 bps increase in Q1. We also saw a gradual decline of the interest rates along with inflation and risk premia connected to debt restructuring concerns. As you can see, the policy rates – The SDFR, SLFR and SRR are at 15.5%, 16.5% and 4.0%. The improvements in the market rates are quite volatile as you can see/ The table on the bottom right hand corner – in Q1 2022 365 T-Bills were at 12.28%, which, which peaked at financial year end to 29.27% and the in Q1 2023, reduced by about 500 bps to 24.3 and now further reduced to 22.79% as of end April 2023.

Similar trend was noted in the AWPLR. One of the lowest in Q1 2022 at 9.47%, this is before the announcement of the country's debt default. This went up to 28.19% in the end of 2022. Now it is at 21.80%.

So these basically reflect the volatile environment that we have operated in. NII is a key source of income for the Bank. Overall the industry has seen an improvement in NIM. Another area we are keen on is the debt restructuring and the finalization of creditor arrangements. Of course, the IFC relief programme was approved and Sri Lanka received the first tranche of USD 333 Mn under the Extended Fund Facility (EFF). The next one is due in September 2023 and prior to that we have to ensure all the creditor level support is there in place for us to go to the second tranche. But that has stabilized, we also have seen a lot of queries from potential investors and financiers, now that Sri Lanka has entered the IMF programme, knowing that there will be discipline, and we see on the political support as well, to ensure the deliverables are met, so that the targets are met.

Slide 09 – Banking Sector Highlights

So moving to banking sector highlights in Q1 2023, we had seen marginal growth in total assets in industry level and most banks were recording decline in loans and receivables. One reason is the lack of demand due to high rates and other key reason probably is the capital pressure for the banking sector with the Rupee depreciating steeply last year. The capital ratios got impacted. Different banks have varying levels of foreign currency denominated assets, FCY: Rupee composition. Dollar based assets get revalued when the Rupee depreciates whereas you capital is in Rupees. The other key reason is all the impairment the industry has taken one on the investments in foreign currency denominated G-Secs, plus deterioration in credit quality for over four years, specially the tourism industry, they have been on moratorium since the Easter attack, and other sectors were also under moratorium for 2 to 2.5 years. For all of them, the moratoriums were relaxed only in December 2022. Now we see interest taken by customers to negotiate and get in to debt structuring arrangements, still the credit quality is stressed and this has impacted capital.

Deposits – we saw a moderate growth trend again naturally with inflation going up, people's capacity to invest/ save was affected. We saw CASA ratio also coming down substantially industry-wide, now at about 29%, where as last year same time this was at around 38%. A significant drop. That also reflects people' capacity to save. But still a moderate growth in the deposits was seen. In the Q1 capital levels have improved across the sector thanks to the appreciation of the exchange rate so there is a reversal impact on what I explained before.

Also the banks have consciously reduced the asset book – that means the loan book, which is risk weighted at a higher rate that the G-Secs. So all that has helped improve the capital ratios.

Credit quality of the loan book – We still see this deteriorating at the industry, may be at about 13% in April, this is a situation we need to work closely with customers and understand their pain points and support them. On the other hand liquidity has improved both Rupee and foreign currencies, industry wide we have seen good improvement.

The profitability - we have seen profitability coming down due to high impairment and thinning NIMS due to interest rate volatility.

The industry is awaiting direction on how Government will restructure debt in foreign and local currency. There is some clarity provided by the CBSL and also Ministry of Finance earlier. But as we get in to the discussions with creditors these will be finalized, hopefully by end of June. We hope there would be clarity how debt would be optimized particularly debt with banks. Such clarity would cut down high interest rates that are going especially for bonds, typically there is a premium. So if there is clarity that would bring down debt holding cost.

PART III - Financial Performance Q1 2023

Slide 11 – Financial Performance Overview

Moving on to the Bank's performance at a very high level, for Q1 2023, gross income has grown year-on-year (YoY) by 75% this is Q1 2022 vs Q1 2023 that is commendable, given all the challenges. We have also grown NII by 38% to LKR 8.5 Bn. Here again despite the significant growth in deposits costs with timely re-pricing of the book; we have been able to manage a NII growth of 38%. Net operating income also had a YoY growth of 24% to LKR 4.5 Bn. Pre-tax profitability was LKR 1.4 Bn, a YoY growth of 45%. Post tax profitability was LKR 805 Mn with a YoY growth of 33%.

In terms of the Balance sheet position of Q1 2023 compared to year end of 2022 (YTD), total assets reduced by 6% and we locked in a LKR 781.9 Bn, mainly driven by a reduction in the loan book, a conscious reduction which are repayments of customers mainly, but we were not growing the book, because one thing the demand was lacking with high rate. It would be a challenge for us to grow the book so therefore, we were concentrating on managing the quality of the book. Therefore the entire Balance Sheet, including loans and deposits had a negative growth. Loans declined by 7% even deposits had a negative growth of 6%. Partly the appreciation of the Rupee also contributed to this. There was a 10% appreciation from December 2022 to March 2023.

In terms of KPIS, net interest margin – 4.01% a slight improvement over 4.00% in 2022. But still there is room for us to improve on this which we are working on. Impaired Loans (Stage 3) Ratio 7.30% (2022: 6.24%), slight deterioration, all the banks ensure this aspect is addressed. Cost to Income Ratio is 33%. This is an area that we have been working on very hard. The digital platforms helped and we are relatively better here. Tier I CAR has moved to 10.08% when the regulatory minimum is 8.5%. Total CAR is almost 14% at 13.99% (Reg. minimum – 12.5%). LAR 27.76% (Reg. minimum – 20.0%), actually it is slightly higher than that.

Slide 12 - Financial Performance - Income

Now we move on to further discussion on the Income Statement. Again 75% growth in gross income. As you can see, we had a 113% increase in interest income, from LKR 15 Bn in Q1 2022 to LKR 32 Bn in Q1 2023. We also had a substantial increase in our interest expenses from LKR 9 B to LKR 24 Bn that is a 165% growth. In terms of quantum it is LKR 15 Bn. NII is 38% up from LKR 6.2 Bn to 8.5 Bn. The areas that we should focus and control is the interest expense side where we have seen 165% growth. We are working on it. There was a reason for us also to have taken more deposits especially on the liquidity side. Because the Bank always took a very conservative approach in a very volatile environment to be liquid. This is an area we focused on with an impact on our profitability, stability and liquidity was important to us as I emphasized in the previous two webinars as well.

In terms of non-fund income, net fee, we had seen quite a good growth LKR 1.7 Bn in Q1 2022 growing to LKR 1.9 Bn. This is where things would improve further going forward because Q1 2022 was a usual quarter before the Government announced their inability to service debt in April. So fees on imports were normal, but in the subsequent quarters we saw a significant drop there. So when you compare with Q1 2022, I would say we are coming to normalcy now. Still there is a 13% increase in net fee and commission income. Other non-fund income, this is where the exchange impact has had a negative impact. It is a negative of LKR 1.2 Bn in Q1 2023 versus LKR 2.0 Bn in Q1 2022. So total non-fund based income is LKR 760 Mn there is a significant drop there. In Q1 2022 exchange based gains are recorded. If you look at Q1 2022, one is the revaluation gain, then exchange side quite a substantial contribution for the first quarter. But this year we do not have it, still the operating income we have maintained at LKR 9.3 Bn compared to LKR 9.9 Bn in Q1 2022.

Slide 12 – Financial Performance - Impairment Charges

Impairment charges, since this is a substantial figure, we thought we will discuss this in detail, of course there is a YoY reduction from LKR 6.4 Bn to LKR 4.8 Bn. Now though we see a reduction, actually last year in Q1 mainly this impairment has come from building up of impairment for Government securities in foreign currency. That was substantial. However this year the Bank has made adequate impairment for that which is in line with the industry expectation and also in line with auditors' expectations. There was no pressure for us to buildup impairment in relation to foreign currency government securities. The appreciation of the Rupee also helped us in having this impairment available so that we can basically use that cushion to build up impairments on the loan book. But still there is a YoY reduction there.

Then on KPIS denoting asset quality, Impaired Loans (Stage 3) Ratio from 6.24% in December 2022 it has gone up to 7.30% reflecting the industry trend of credit quality. But importantly, Impairment (Stage 3) to Stage 3 loans Ratio has slightly improved from 37.44% to 37.60%. Total Impairment Cover, this is irrespective of which stage the loan is in, compared to the loan book, movement from 5.81% in 2022 to 7.27% in Q1 2023. Within three months it has improved to 7.27%.

This gives you some indication of the level of impairment we have been building up.

The resultant net operating income was managed at LKR 4.5 Bn up by 24% YoY.

Slide 14 – Financial Performance – Operating Expenses

Analysis of operating expenses, there again, from Q1 2022 to Q1 2023, 9 % increase in the personnel expenses. I would say this is well managed despite us offering sizable market driven increments for the staff. Efficiency of staff and head count all have been managed to contain this increase. Depreciation and amortization are beyond our control and are relatively small compared. Other expenses 23% increase from LKR 1.1 Bn to LKR 1.4 Bn. Now that is where we would continue to focus, going for sustainable savings. We had seen good progress there. That is why despite the inflation rates going so high and with the impact of the exchange, certain of our expenses such as IT related ones are billed in foreign currency. But despite all that us containing the operating expenses are commendable. So YoY increase in total operating expenses was 16%, to LKR 3 Bn. So all in all as I mentioned the cost to income ratio was managed at 33%. This was as low as 25-26% last year but because of the depreciation impact and the reduction in the overall income levels, CIR deteriorated but compared to the industry NDB is at a better place.

Slide 15 – Financial Performance – Balance Sheet

Moving on to the Balance Sheet, again reduction the Balance Sheet as I explained earlier. Total assets LKR 833 Mn to LKR 782 Bn, a LKR 51 Bn drop in three months alone, mainly coming from the appreciation of the Sri Lankan rupee plus the reduction in the loan book. However, investments remain LKR 10 Bn more than the year end, a 6% growth. The reduction in the loan book is LKR 580 Bn to LKR 526 Bn, this is a LKR 44 Bn reduction. Similarly the deposits also we saw a LKR 43 Bn reduction from LKR 672 Bn to LKR 629 Bn. Borrowing also recorded a drop from LKR 81 Bn to LKR 72 Bn. Total equity has improved from LKR 64 Bn to LKR 65 Bn. So you can see that balance sheet management is one of the key focuses here. No longer is it a balance sheet growth, because one has to preserve the capital and how efficient you can manage the balance sheet and how efficiently you can get returns from this balance sheet is key. Also the reduced economic activity, reduced customer appetite due to high interest rates all that impacted. So the key here is how you manage the Balance Sheet well in a volatile environment. I think we have been doing that well. We have seen decline in loan book even in last year second half, and we continue to do that but deploying our assets in more return generating assets, and may be curtailing growth in some of the areas and proper balance sheet management, especially the interest margin management that would basically be the focus going forward for this year, to improve on our efficiencies.

Slide 16 – Financial Performance – Investor Ratios

The investor perspective Closing Price per Share [LKR] from 32 in December 2022, it has improved to 44.90. Today it is hovering around 42-43. Earnings per share are 8.59%, whilst at Group level it is 9.11%. ROE has improved from 4.75% to 5.07%. ROA (pre-tax) has improved from 0.26% to 0.70%. Book value also has improved from LKR 167.16 to LKR 172.02. P/E [times] from 4.18 to 5.23. Naturally the price to book value still remains low, and similar to all other stocks in the market, specially banking stocks. It has slightly improved from 0.19 to 0.26, due to the increase in the share price.

Slide 17 – Financial Performance – Capital & Liquidity Position

This is on the capital ratios. This is an area we have been working on having our capital ratios improved. Tier 1 Capital Ratio has improved from 9.34% to 10.08%. Total Capital Ratio from 13.35% to 13.99%. Group level it is 14.46%. Statutory Liquid Assets Ratio again despite challenges, minimum is 20%, and we have been maintaining close to 28%. Liquidity Coverage Ratios are very much above the minimum requirements. So I think not only NDB the entire Bank have been maintaining liquidity levels, may be with one or two exceptions. But we have been quite liquid and capital is also another area that we have been focusing on.

PART IV – Way Forward

Now I will share some of our ideas on the way forward. One of the key strategic priorities is how to optimize the balance sheet. So we are relooking at the margins, because when you compare with the industry, still our NIMs are relatively lower. One reason probably is the foreign currency to rupee mix. But we feel there is still enough room to improve the cost of funding. On the fee based income, we are focusing on enhancing the revenue mix from fee based income. Cost rationalization is also another area to enhance shareholder returns. We have managed our head count, substantial reduction there as well tanks to digital processes that we have deployed. We have 14 RPAs plus workflows. Digital platforms are used to drive efficiencies and manage costs. We will continue to focus here. Loan book growth will be very cautious. Our underwriting standards have been further improved. We would always look at total margins. Not only interest income, but how risk efficient the asset is so the RORAC model will be adopted (Return in Risk Adjusted Capital). We will ensure whatever the loan book growth will be profitable and above a certain threshold we have internally set, whilst doing those customers being supported is one of the key areas we have been focusing on. During Q1 we also migrated to a new core banking system after almost 10 plus years. So we are now in the new platform and the couple of initial months were spent on ironing out teething issues, but now we are ready to provide that next level of customer service and support in a holistic manner. We also want to maintain the liquidity position and serve capital needs. We have already announced our intention to raise Basel III compliant Tier II Listed Rated Unsecured Subordinated Redeemable debentures up to LKR10 Bn. We will be coming to the market; we are waiting for the right interest scenario. We think once this debt restructuring discussions are over; hopefully by end of June specially on the rupee side, on how the domestic debt would be optimized, already the CBSL has indicated some of the plans. Whatever the level of that domestic debt optimization we need clarity and hopefully that clarity will be available by end June 2022 especially if we are going for the second tranche of the IMF relief package. We need to have all the creditor level agreements in place. So once that clarity is provided, I think the current high premium that is driven on the government bonds should come down. So we are hopeful that once that clarity is provided there will be a reduction in the interest rates as well. I think that is where we can provide better returns to our shareholders.

PART V – Q & A

(Answered by the CEO, unless specifically mentioned)

Q 01: Any comments to shed on the DDR.

We are also awaiting clarity on this. The GoSL has given an indication on their holding of T bonds, apart from that T bills may not have any DDR concern. It's good to follow what is happening. I am unable to comment anything further.

Niran Mahawatte: We are also going by the comments of the CBSL Governor.

Q2: How much has NDB provisioned for ISBs and SLDBs?

We have covered that in the presentation as well. In line with the market expectations, and also based on what external auditors agree, the entire banking system has agreed on a certain level of provisions. NDB is well within that provision, slightly excess as well. Appreciation of the Rupee also helps on the provision.

Q3: Is it correct that the total banking sector capitalization need is in the range of USD 4 Bn?

I am not sure of the source of that figure. It all depends on the level of haircuts the GoSL would finally agree with the sovereign bond holders and to meet the debt to GDP targets, what level of GoSL spending has to be curtailed. So it is a lot of uncertainty as of now. But one thing, once all this debt restructuring is over, the economy has to pick up. To support that economic revival, a strong banking balance sheet is required. The banks as of now have about a LKR 19 Tn asset base, right now well capitalized. But the impact of these debt restructuring measures like Day 1 impact and that is where the regulatory forbearance is needed. But more importantly, in terms of capital ratios, there will be forbearance. However, to grow, you need to have capital. And that is where the entire system will need capital to support the next level of growth. Capital raising is priority for all banks. All banks going out and raising capital, whether it is a right one and whether there is room for consolidation all that are some of the questions. Certainly, capital is needed for the sector to grow going forward.

Q4: There is around LKR 8 Bn increase in Tier I for this quarter. Is this coming only from profits, or are there any additions/ deductions?

Suvendrini Muthukumarana: We did not consider the profits for the quarter, as we have to get it audited. How we have improved our ratio is through balance sheet management, with the Rupee appreciation this has benefited the Bank. So it is mainly through asset management.

Q5: There is a question on SLDBs, a sizable maturity in Q1 2023. Has this been guaranteed to be paid in LKR or via bonds, what is the stance there? What sort of an impairment has been taken on this if defaulted?

Niran Mahawatte: This has not been paid yet. CBSL has indicated to us that the settlement would be in either LKR or T bonds. They have obtained consent of all banks for this. Currently with the DDO under consideration, they may not have any T bills auctions for the time being. So there will be a delay in settling the SLDB outstanding. They have not given us a time plan. As per the impairment, as the CEO mentioned we have followed the industry norm and the external auditors' advice on the percentage, so that has been taken for the quarter end.

Q6: What is the loan growth rate for 2023 for NDB?

So far there is a reduction in the loan book. We are not expecting much growth for 2023. Still the GDP growth is in the negative territory. Hopefully things will improve in Q4. One is the approach, we have to be conservative. Other one is the lack of demand at high rates.

Q7: Is there any provision for local debt, if not any potential for same?

I think the industry so far has not taken any local debt impairment. The position is the sovereign can service local debt. So far none of the local players have taken local debt related impairment, as far as I am aware.

Q8: How has profitability targets been set in a declining loan growth scenario. What is the PAT target?

I am unable to share the PAT target. But it will be substantially higher than last year. But how we manage the profitability targets upwards despite the loan book not growing, is about how you efficiently manage your balance sheet. So that is why I mentioned, Interest margins is a key area. And there is huge potential. When you look at market players, there is a good gap of our pricing. So that is something that we would work on. Other one is on the fee based and exchange based income that we are working on. Plus also the investment on the bond portfolio, I think the holding cost – our average returns are much higher than the industry. So these are some of the areas that we can really work on, getting higher profitability targets set despite the balance sheet not growing.

Q9: What is the based used in calculating NIM? Is it the average of total assets?

Suvendrini Muthukumarana: This is what all the banks follow, and there are guidelines on this, so NIM is calculated by taking the average of total assets, so the entire balance sheet – NIM of total assets.

Q10: What is the investment mix between T bills and bonds as at 31 Mar 2023?

We do not have that much of an exposure on bonds. But more on bills.

Q11: From which sections are the loan book and deposits contraction coming from?

Loan book contraction: Probably construction is one key area naturally, corporate and business banking side, that is where we see contraction. And also some of the exporters – the level of usage of the export lines – we see these gradually coming down, naturally due to lack of demand in global markets. Now these are some of the economic cycles that anyone would go through. I think the industry is quite used to this kind of troughs. We have managed it in the past and I think that is where the reduction in the loan book is coming from.

Q12: Was there a reversal on other impairment, foreign currency bond related impairment for the quarter due to currency appreciation.

Yes, that is the main reason, however, despite foreign currency appreciation some of the impairments, we consciously build up these impairments.

Q13: (Non-financial) How has resignations of staff affected NDB? Is it severe or manageable?

It is manageable. The entire industry saw high turnover. People going overseas, or as a result vacancies being created locally. So far we have managed quite well, we have seen a reduction in staff numbers. We continue to invest in people in terms of training so that that would give opportunities for the others to move up to higher positions. Our training side is quite strong.

End of Q&A.

End of edited transcript.