EDITED TRANSCRIPT

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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/ Chief Financial Officer
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K V Vinoj - Vice President -Wholesale Banking
Bimal Perera - Vice President - Strategy & Business Intelligence

Investor Presentation

Opening Remarks - CEO - Dimantha Seneviratne

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

PART I –Operating Environment

Slide 06 – Operating Environment

Just to give you a context to the operating environment, it is a very turbulent time that we have been going through over the last year and even the six months. Things are getting better, still a lot of changes we saw. So that is the background we operated.

To elaborate more on the economic conditions and how it impacted the banking sector, of course we saw the monetary policy being relaxed. We saw 450 bps reduction in the policy rates, since 01 June. Of course earlier the tightening measures had increase in in rates, all of which helped reduce the inflation and as a result every month we saw a steep reduction in the inflation and as at July it has come to a mid-single digit level of 6.3%, which is also in line with CBSL/ GoSL expectations to maintain mid-single-digit level inflation. It is good to see these improvements, and also with the lag effect how the policy measures taken by the GoSL has resulted in curtailing the inflation. We also saw improvement in domestic supply conditions and with the exchange stabilizing we saw some relaxation of import restrictions that were imposed. The gradual enhancement in business and investor sentiments was also observed. As banks we saw business activities picking up during the first half. In terms of external sector performance – we have been resilient amidst all the challenges. We saw a good improvement in worker remittances, which is a very good thing to see. Compared to last year's full figure of USD 3,789 Mn up to June of 2023 we received USD 2,823 Mn. One good thing is the informal market is now virtually not in existence. We saw even in July, even in July worker remittances had cross USD 530 Mn. We also saw tourism picking up, tourist arrivals crossing 819,507 as of 10 Aug 2023 versus 719,978 of 2022. Gross official reserves have also improved to USD 3.8 Bn. Exchange rate is also stabilizing to some extent. We saw it from high Rs. 360 in end 2022 improving to the current level of Rs. 322 range. Then the country also saw some inflow of foreign currency. World Bank funds, IMF funds and we are looking forward to the release of the second tranche in September. From ADB there was USD 350 Mn. So all these inflows and the external measures we have taken helped us to improve on the external sector performance.

The other thing is on the policy rates. We saw policy rates reducing by 450 bps since 01 June 2023. We saw the first reduction from 15.5% to 13.0% and in July another 2% reduction. The current SDLR stands at 11.0% and SLFR at 12.0%. More importantly, recently, the Statutory Reserves Requirement was also reduced from 4.0% to 2.0% effectively improving liquidity in the market again signaling opportunities to grow and improve liquidity. Market rates as a result substantially reduced from very high levels in 2022 – where one year T bills were almost touching 30%, now has come down to 13.94%. We even saw the 91 days bill rate steeply coming down. The AWPLR which was around 28% in end of 2022, currently reduced to around 9.47%. AWDR also at 14.67% now.

The other key important announcement was the Domestic Debt Optimization. That actually helped to reduce the risk premia assigned to interest rates of T bills and bonds, and also the uncertainties revolving around banking sector were all clarified through that announcement. So that also helped reduce the interest rate.

With regards to the banking sector, very broadly, we saw the sector wide assets declining in the first half. Industry-wide there has been a decline in total assets. Also loans had a negative growth. One was the exchange impact from Rs. 360 to the Rs. 320 level. But the other reason was consciously, given the high interest rate and credit environment, banks has been reluctant to grow, and there was lesser demand also from customers due to low GDP situation. Instead of a loan growth, we saw an increase in investments in GoSL bills and bonds. The other thing is credit quality continue to deteriorate – industry average was around 13.5%. The entire industry saw the decline in the credit quality. Then on the deposits side, we saw a moderate growth of deposits. Naturally, the inflation reduced people's savings ability resulting in lower deposits – steep increase in personal taxes also contributed to this. CASA deposits saw a substantial decline mainly due to the high interest rate disparity between fixed deposits and savings. Even a three months FD was priced high so there was tendency to move to FDs to get the advantage, which had an impact on the CASA. Liquidity wise, there was an improvement in the market. Again because of lack of demand, and the biggest borrow, GoSL borrowings was also curtailed. Liquidity in terms of both local and foreign currency tremendously improved. The entire banking sector is now well liquid in foreign currency and this is the tendency we saw.

The other thing we are awaiting is, now that the DDO is over, the outcome of the ISB restructuring. The discussions are ongoing, local banks also have substantial stake in ISBs. We saw all the outstanding SLDBs were settle by CBSL – total settlements netting around USD 788 Mn. The funds were injected in Rupees. We are awaiting the next step on ISBs. All the banks have made sufficient provisions for potential haircuts that have been indicated in the Domestic Restructuring paper, so looking forward to that.

PART II – FINANCIAL PERFORMANCE REVIEW

Slide 07

It is a transformative journey that we have been going through. Initially we were going at a pace to grow our balance sheet, but last two years with the COVID impact, the huge exchange impact and all, we have transformed our strategies to more balance sheet focused growth.

Slide 08 – Financial Performance Overview

If you look at the financial performance for the first half, compared to last year, we had gross income YoY increase of 50% going up to Rs. 66.7 Bn. PBT we had 55% YoY growth going up to Rs.4.2Bn. PAT, Rs. 2.3 Bn a 37% YoY growth. Of course tax rates were revised during this year making a slower increase in PAT than the increase in PBT. In terms of balance sheet – total assets of the Bank recorded a 5% decline to Rs. 739 Bn. This is mainly due to the exchange impact. Roughly about 25% of our book is in foreign currency. So that could have impacted when the exchange reduced. That is one reason but also we saw the loan book on the Rupee side shrinking because the lesser appetite for credit and the Bank not wanting to take exposure in an uncertain environment. All that resulted in a 5% reduction in the balance sheet. Loans and advances – we saw a 14% negative growth to Rs. 470 Bn. On deposits, we saw a 7% decline to Rs. 628 Bn. Deposits of course the main impact was the exchange impact where the USD denominated deposits were converted at a lower rate.

With regards to KPIs, Net interest margin was 3.7%; relative to industry this is lower. There are reasons as well, but this is something we are working on. Return on equity has improved to 7.2% from what it was last year. Cost to income ratio I would say is one of the better ratios in industry – 35% compared to the industry. Impaired loans stage 3 ratio is 9.2% that has gone slightly above the industry; we are hoping to improve this by the end of the year. In terms of capital ratios, Tier I has improved to 11.04% - there is a separate slide on capital ratios over the period. When we come to that I will elaborate more. Total capital adequacy ratio has improved to 14.78%.

Slide 09 - Financial Performance – Income

Moving on to the income statement, we had gross income growing by 50% as I mentioned, from Rs. 44.5 Bn to Rs. 66.7 Bn. That came out mainly from interest income growth of 70% from Rs. 37 Bn to Rs. 63 Bn. Interest expenses were quite steep, so from Rs. 22 Bn to Rs. 48 Bn – which is about a 117% increase mainly because of the high interest rates that were prevailing. Now this would get corrected going forward, the rate revisions that we saw in June – however the first half naturally because of the high rates the deposits have been re-priced. So the entire industry saw a similar situation. If you look at the net interest income, in NDB's case, it is a small increase 0.3%, or Rs. 40 Bn. Small increase mainly because of the re-pricing of the deposits at a high rate. But this would get corrected as we see every month a substantial base of deposits are getting re-priced at a low rate so this should get improved in the NIM.

With regards to non-fund based income this is where the Bank has done considerably well, when you compare to the industry as well. Net fee and commission income we had a 19% growth, in a challenging period where the demand for imports also became less with the exchange going up from Rs. 3 Bn to Rs. 3.7 Bn – a Rs. 589 Mn growth for the six month which is good. With regards to other non-fund based income this was a negative Rs. 144 Mn from Rs. 4.3 Bn. This is mainly due to the exchange rate impact. With regard to total non-fund based income it has reduced from Rs. 7.4 Bn to Rs. 3.5 Bn. Though the net fee and commission income had a good growth, because of the exchange impact there was a negative contribution. All in all, operating income reduced from Rs. 22 Bn to Rs. 18 Bn, a 17% reduction.

Slide 10 – Financial Performance – Impairment Charges

In terms of impairment, it is another key element – a substantial figure in our P&L. Impairment charges have come down substantially from Rs. 13.9 Bn last year first half to Rs. 7.9 Bn this year first half. So a total of about Rs. 6 Bn. We have been improving our loans and advances related impairment. However, the Bank had certain impairment releases on ISBs due to the exchange rate improvement. This benefit was used to build on impairment for loans and advances. In terms of KPIs with regards to asset quality the Impaired loans (Stage 3) ratio has increased to 9.2% from 6.2%. This is due to a couple of large facilities which we are comfortable that we will be able to recover by the year end. Then on the Impairment cover (Stage 3) to Stage 3 loans ratio 37.44% of H1 2022 has come down to 34% again because of the movement of a few large exposures which are very well secured – so that is where the impairment cover is. Total impairment cover from 5.81% in H1 2022 has increased to 7.84%.

Net operating income has been up by 27% to Rs. 10.7 Bn.

Slide 11 – Financial Performance – Operating Expenses

We now move on to the expenses side. So here, total operating expenses have gone up only by 13% - Rs. 5.7 Bn to Rs. 6.5 Bn. This is where NDB's focus on the digital aspects has well paid off. Despite substantial increases in the cost side, substantial inflation, we have curtailed our expenses and managed the increase at 13%. This is one of the best among the industry when you review the comparator numbers. The composition of the expenses is as shown in the slide in the pie chart.

Slide 12 – Financial Performance – Taxes and profitability

Here, profit for the period, first half – profit before tax was Rs. 4.1 Bn, a 55% increase. However, taxes on financial services was Rs. 1.2 Bn, a 43% increase from Rs. 841 Mn. Income tax expenses has substantially increased from Rs. 132 Mn to Rs. 613 Mn. So all in all profit after tax of Rs. 2.3 Bn – a 37% increase from previous year. Effective tax rate has increased from 36% to 44%. That is about 8% increase. The breakup is also given here, the movement in the regulatory tax rates. FSVAT has been at 18%. Income tax was increased from 24% to 30% a 6% increase there. And SSCL was introduced in this year which was 2.5%.

Slide 13 – Financial Performance – Balance Sheet

In terms of Balance Sheet, as I mentioned total assets reduced by 5%. The break-up is given here – mainly the gross loans have come down by Rs. 70 Bn to Rs. 510 Bn. This is reflected in the deposits as well. There is also a substantial reduction in the borrowings from Rs. 81 Bn to Rs. 28 Bn. Almost all our foreign currency borrowings are settled. On equity we saw a 6% improvement from Rs. 64 Bn to Rs. 67 Bn – which is basically the retained profits.

The financials have been profit certified by our external auditors.

In terms of the currency-wise composition of our loan book, it is 22% in foreign currency (FCY) and 78% in local currency (LCY). In terms of deposits 27% is in FCY and 73% in LCY. So FCY exposure is relatively high around 25% of the book.

The balance sheet movement was largely in line with the industry trends. Total reduction in assets, as I mentioned was due to the Rupee depreciation and lack of demand for loans. All in line with the industry.

Slide 14 – Financial Performance – Investor Ratios

We closed the first half at Rs. 50/-. It has improved from Rs. 32/- in 2022. It has improved since then substantially to about Rs. 84/- and yesterday it was around Rs. 79/-. Earnings per share has also improved to Rs. 11.80. ROE has improved from 4.75% to Rs. 7.20%. ROA (pre-tax) has improved from 0.26% to 1.03%. These are some of the improvements we have seen compared to last year. Last year was a very challenging year. We see a recovery, and we see more improvement as we move along with interest rates stabilizing.

Slide 15 – Financial Performance – Capitals & Liquidity Position

Again we saw quite substantial improvement here, Tier I ratio from 9.34% in 2022 to 11.04% Total capital ratio has also improved from Rs. 13.35% to 14.77%, over 100 bps improvement. Statutory liquid assets ratio – whilst the minimum was 20%, the bank is quite liquid with 34.35%. One is the adequate deposits that we have and also the lack of demand for credit. In the foreign currency side also, there is enough liquidity. All that has been demonstrated in very high liquid asset ratios. Even the liquidity coverage ratios are very much above the regulatory requirement as you can see from the below right graphs. With regards to capital adequacy, the graph on the bottom left, I want to elaborate more on this. You would see that in 2021 our total capital ratio moved up to 15.42% and Tier I ratio improved to 10%. This was the time that we raised fresh capital through the Rights Issue and where Norfund came in as an anchor investor. However in 2022 with the steep depreciation of the Rupee from Rs.200 to Rs. 300 plus, the entire USD book got inflated, plus we also had substantial impact from tax, about Rs. 2 Bn in terms of Super Gain tax. All that impacted our capital and Tier I ratio came down to 9.34%, total capital ratio to 13.35%. So since then, we have been improving to 10% in Tier I in Q1 2023 and now 11%. Even the tier II ratio has improved to 14.77%, partly due to the reduction in the asset book and also the inbuilt profit retention we have been doing. In terms of dividends, cash dividend was lower, to reboot and capture capital adequacy after the shocks we had in 2022.

PART III – Way Forward – Slide 17

On to way forward, of course we have been responsive and agile. That is the advantage of being a mid-sized bank. Our agility is one of the key strengths. So we have recovered quite soon, and now it is about how we move forward. So we have a couple of strategic priorities. If we look at our net interest margins comparatively, that is low. So that is something we are focusing really hard on going forward. Especially in a low interest environment, managing NIM is a key focus area. Then in terms of fee based income, we have been doing above average, despite the challenges it has been growing as you in the previous slide. We will be focusing on that to enhance the revenue mix coming from the fee based income in the low interest rate regime. Then the cost rationalization – again, we saw that the overall cost increase for H1 was only 13% in a very high inflationary situation. That would help preserve profitability and enhance shareholder returns. Another key area is preserving asset quality. There was deterioration that has been gradually restored, we have already setup the Remedial Management Unit to support the customers in the distressed situation, our recovery strategies – all this has seen quite a good improvement in our recovery front. Month on month we see quite an improvement and also since we have not grown the asset book, naturally what we see as a ratio the impacted loan as a percentage of total assets, would go up when you are not growing the balance sheet, so in an area where interest rates are coming to acceptable levels, there is credit and that is picking up. So we will be cautious in the loan book growth. Whatever the new loans that we book in it would be risk efficient in terms of lending where we use the RORAC base to ensure that certain minimum RORAC thresholds are met and also the transactional accounts that are coming in, that should also help manage our NIM. We would also look at supporting our customers maintain their resilience. We are thankful to all the customers who have been banking with us. Also the customers who we have on-boarded recently through all our channels including digital channels to bank with us. We have been helping as a true local commercial bank fully supporting them whenever they went through challenges – so that has been one of the key elements of NDB. Even during the height of the foreign currency crisis and the economic crisis, we have maintained good relationships.

We continue to manage our liquidity position soundly. Highly liquid but that would be the case going forward as well. We will be preserving the capital in current conditions by not growing at a higher pace – may be managing the growth of the balance sheet. But going forward it would be more on managing margins. From a lower balance sheet but how you maximize on using the efficiencies of the balance sheet to get the best in terms of profitability to our shareholders. So preserving capital is one of the key elements. We have also announced a Tier II Basel III complaint debenture issue that would be raised this year. We will continue to provide best possible returns to shareholders and support all our stakeholders - staff and all who are contributing in this challenging market environment. In doing so digital drive will continue to be a priority. We have completed our core banking upgrade successfully and is in operation. We have been empowering the women's market segment and that would continue. And also our ESG related initiatives will continue as we move forward.

PART V – Q & A

(Answered by the CEO, unless specifically mentioned)

Q 01: What is the update on the debenture issuance? We saw Fitch withdrawing the rating for the Debenture.

We did not want to raise the funds at the high rates. We were in a book building process as well. However with the steep reduction in rates and improvement in the liquidity we thought we should differ this issue. Fitch withdrew their rating accordingly. We will be making announcements in this regard when we come to the right price. This will enhance our total capital ratio as well.

Q 02: With the reduction in the SRR, how much more will the interest rates fall?

Here about Rs. 200 Bn liquidity was injected. By how much the interest rate will fall – Niran will comment.

Niran Mahawatte: We currently see a gap between the policy rates and the Treasury bill rates that is mainly compared to the three months rate. What we will see is these rates converging. The t bill rates will come to policy rate levels, and the CBSL might take a policy decision once again on whether they want to reduce their rates further in the coming months.

Q3: Since you are looking to increase your loan book will you look in to factoring state receivables, for example will you discount receivables owed by CEB.

By the way, we do not have that much of exposure to CEB, but we have seen with the utility prices going up, the cash flows of these state entities who have been borrowing from us improving, but some of these payments which were overdue have been settled. So that is a good improvement. In terms of factoring state receivables we need to find out who is willing to take the state risk and do the factoring. If that is the case we will be looking at it, but right now I think things are improving.

Q4: How much impairment has been taken to foreign currency bonds in this quarter?

So I think with the exchange rate improvement, etc., we are in line with the required ISB impairment. There is no major change there because the provision that we made at the beginning of the year was also sufficient to cover the ISB provision which is in line with the industry.

Q5: With the current rate volatility, what is the strategy of the Bank?

We are not keen on growing the Balance Sheet right now, but we will ensure that the current balance sheet would give the maximum returns in terms of improving on the margin, and also build on our CASA base and more on the fee based revenue. I elaborated on this before as well, how when the balance sheet is not growing, how you improve on the margins, fee based income and other revenue bases, whilst of course managing cost.

Q6: Stage 01 has taken a write-back whereas Stage 02 and 03 impairment have increased QoQ. What is the reason for this movement?

Suvendrini Muthukumarana: So I think we reviewed our Stage 01 portfolio and as you can see, across the industry there is a risk element in terms of asset quality so certain facilities, we conservatively and proactively downgraded where we felt that we need to buffer up our impairment provisions. That is the reason why at Stage 02 and 03 level we have increased the impairment provision. So these will actually not be really losses but we have accounted for any expected credit loss that we see.

Q7: There is around Rs. 3 Bn increase in Tier I capital. What drove this?

Suvendrini Muthukumarana: What has really driven this is profitability. We reported Rs. 2.3 Bn PAT so that has been capitalized, and also we hold a bills and bonds portfolio. And the bond portfolio, with the interest rates movement we have a fair value gain. All this has been certified by E&Y, and we have capitalized it in to Tier I capital.

Q8: How has the T bills and bonds mix changed from 2022 levels and how much is the Bank holding now?

Of course the mix has remained the same, there is no change to that. Since these bonds are at relatively higher rates, I think there can be some capital gains going forward as the rates have come down.

Q9: What is the composition of fixed and variable rate loans?

So this is something we have been working on, reducing our fixed rate exposure. Whatever the new loans that we are giving would be mostly on variable loans.

Q10: Expectation for loan growth for coming quarters.

We are not having high targets. Demand is gradually picking up, but it would be more cautious approach in terms of loan growth. We would naturally look at the RORACs we have mentioned when we book additional assets. So it would be a cautious growth.

Q11: Has loan demand picked up in recent weeks? Have you done any import financing for any vehicles?

Loan demand is coming up. It is improving. We have not done any import financing for vehicles. But on the import side, other imports – commodities, we have been supporting, and that is how our fee based income has been improved.

Q12: What is your ISB provisions figure?

Our provisions are in line with the industry. As I mentioned we had a half yearly profit review and profit certification by external auditors.

Q13: What is the outlook of the asset quality review?

We are not privy to that information.

Q14: Have you been hiring in the recent months? We see that other banks are expanding their work force.

I think we also continue to ire, because of the economic situation and all, we have seen staff turnover mostly pursuing overseas opportunities and as a result that creates a vacuum and them all the banks have started advertising. This is an industry-wide situation that we are seeing.

Q15: Will there be further provisions reversal once the ISB debt restructuring is announced?

The provisions that we have made are based on what the Government has indicated, potential haircuts, etc. But that is an initial proposal from the Government. But when it comes to final negotiations with the external ISB holders there can be changes so either additional provisions or reversals will come based on that.

Q16: What is the state of delinquencies of credit cards in the past quarter and recent months?

Our credit card portfolio is much better. So we have been catering to the upper end, but of course people had challenges in terms of income especially with tax increases and all. It is slightly increased but that is managed. We have seen the floor rates reduced – when I say floor rates from one bucket to the other bucket. We have been improving in terms of collections also. So gradually its improving, it did go up in the first half, particularly the first quarter with the tax impact, etc. But now it is gradually coming to a level that is manageable.

Q17: What is your exposure to the hotel and tourism sector?

There is no increase in exposure to this sector. If at all it should be due to the exchange impact.

Q18: What is the plan on capital raising?

Tier II level we have announced plans to raise debentures during this year and make use of the current low interest rate opportunity. In terms of Tier I level, once the economic situation is stabilized, and we are clear even on the ISB side, what is the impact, etc., most likely next year from second half onwards there may be some equity raising plans that the Bank may be looking at.

Q19: What sort of a dividend policy is the bank intending?

That is up to the Board also to decide. But we have been having a dividend policy of about 25-30% of profits, but how you pay that whether cash or scrip is something that the Board has to decide.

Q20: What segments is the loan demand coming from, for the reported quarter? Also in terms of geography, provinces where is the demand coming from?

Sanjaya Perera: There is little bit of demand especially on the leasing side with the interest rates coming down, and also on the housing side. These are the sectors that have improved based on the rates.

Q21: Is the stock brokerage operating at a profit?

We have a subsidiary are here. In line with the market improvements our stock brokering arm is doing quite well.

Q22: What is the provision on ISBs?

Suvendrini Muthukumarana: It is slightly above 35%. So actually we have done our computation based on the indications given in the DDO proposal as well, and based on our portfolio, we are maintaining 35% and above, this is quite adequate based on the direction that has been given.

There is no 5% reversal here. 30% hair cut we need to have, and there will be a Day 01 impact for all banks we have computed the impact based on our portfolio and the price at which we have purchased at the time maturities. So basically we are quite confident that based on the directions that they have given, the provisions that we carry is adequate.

End of Q&A.

End of edited transcript.