Edited Transcript

Webinar with investors and analysts
National Development Bank PLC
Quarterly financial results – H1 2017

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Forward Looking Statements

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Investor Presentation

Dimantha Seneviratne

Opening Remarks

Good morning ladies and gentlemen. Welcome to National Development Bank's Investor Webinar to discuss the financial performance of the Bank for the first six months of 2017. We released our results to the Colombo Stock Exchange on the 25th of July.

As usual, I will take you through the Investor PPT, and after the PPT we will entertain questions and answers. I have with me, representatives from the Management Team who will help clarify questions raised by you.

Slide 05 – Business Overview (A unique banking and capital markets group structure)

NDB is one of the unique banks, where we have the investment banking, wealth management, stock broking and fund management arms coming under NDB Capital Holdings Limited (NCAP). We also have DHPL in property management, in a 58% ownership along with Export Development Board (EDB). The major development during the first half of the year in relation to NCAP was the relocation of NCAP to a new location at Baudhdhaloka Mawatha, where NDB Investment Bank, NDB Securities and NDB Wealth have been relocated. We have also received the CBSL approval to open our own branch there, which should happen shortly. This new location is a one stop shop where all capital market needs are catered to in one location.

Slide 06 – Business Overview (Strong presence in both physical and digital channels)

We have 106 branches. During the first half, two new branches were added on to the network, Kottawa and Katana. We have 118 ATMs. The other way of reaching to the customers, is our award winning mobile banking app. We just crossed LKR 2 billion transactions in July for six months, transacted through the mobile app, in closer to 200,000 transactions. This shows our reach to the customers through digital channels as well. LKR 2 billion in six months is a substantial volume of transactions.

In terms of social media presence, we are quite active in a number of interactive social media platforms. In Facebook alone, we have over 400,000 followers. So we continue to capitalize on the branch network, and the other is the digital channels.

Slide 07 – Recognition Awards that the Bank & the Group Companies have won (April – June 2017)

We have received quite a number of awards during the first half of 2017. The Asian Banking and Finance Magazine of Singapore, under the Retail Banking Awards 2017 has recognized us with three awards, namely, the Domestic Retail Bank of the Year (for the fifth consecutive year), SME bank of the year Sri Lanka (for the fifth consecutive year) and the Mobile Banking Application of the year Sri Lanka.

The same magazine under their Wholesale banking awards recognized us with two awards, Domestic Project Finance Bank of the Year (for the third consecutive year) and the Cash Management Bank of the Year (for the second time).

In terms of local awards, we won SLT ZeroOne award for the mobile banking app. Our mobile banking app was the runners up at the LankaPay Technovision Awards 2017. But amongst the banks, I would say ours was the best mobile banking app. The Women in Management Organization recognized the Bank's contribution in empowering women, developing their credit skills and also their contribution to their society.

Slide 08 – Recognition Awards that the Bank & the Group Companies have won (Jan – Mar 2017)

Global Banking & Finance recognized us with three awards for best mobile banking app, best SME bank and the best investor relations. We will continue to conduct these types of investor forums and discussions with investors and analysts, which are recognized by such investor awards.

In the marketing side, CMO Golden Globe Awards held in Kuala Lampur recognized the Bank with two awards, Award for branding excellence within the banking & finance sector and award for excellence in social media marketing.

The NDB Group (NDBIB) was recognized by the Global Brands Magazine with the Most Trusted Investment Banking Brand in Sri Lanka title, and by the Asiamoney Banking Awards with the Best Corporate and Investment Bank in Sri Lanka title.

In addition, Euromoney recently has recognized our investment banking operations in both Sri Lanka and Bangladesh as the best investment bank in both these countries. So these are some of the awards that I thought that we thought we should share with you. The Bank and its staff are highly motivated by these awards to deliver best services to our customers.

Slide 09 – Macro Economic and Industry Analysis

The global economy is still slowing down. The growth shown was 3.5% for 2017 and the prediction for 2018 is 3.6%. We are seeing monetary policy normalization in some advanced economies, especially the US which can cause some unanticipated tightening in the global financial conditions.

In the Sri Lankan economy, we saw the growth rates coming down. In Q1 growth rate was 3.8%. Naturally the second quarter would be much lower, due to the floods and the droughts that we are experiencing. Headline inflation and core inflation have gone up slightly, to 6.1% and 5.1% respectively. Inflation is projected to be in mid-single digits by end 2017, then stabilize thereafter. We take these assumptions in to consideration in our decisions, in our pricing of deposits, in particular the longer term deposits.

We have seen a gradual depreciation of the Sri Lankan Rupee, roughly from LKR 149 to LKR 154, about 2% depreciation in the first half. In terms of market interest rates, we have seen a slight reduction in the rates for deposits. We would expect this trend to continue for the second half as well.

Talking about the banking sector, the SDFR and the SLFR remained at 7.25% and 8.75% respectively. YoY assets growth of the industry, up to May 2017 is around 14.9%. The growth in deposits has been 20%. You would see that our numbers are slightly higher than the industry average rates. In terms of interest rates, the recent development is the removal of the cap on the interest rates of 24% and the cap on the penal rate of 2%f or overdue or unauthorized excesses. So now it is a more market driven approach that is in effect from 01 of July.

Slide 11 – H1 2017 Financial Performance Summary

To discuss our financial performance in summary, under profitability, the Net Operating Income of the Bank has grown by 32% YoY, i.e. the first half of 2017 vs. first half of 2016. This is a growth from LKR 5.4 billion to LKR 7.1 billion in terms of net operating income. Operating expenses have grown up by only 5%. We have been able to manage it quite well, the movement is from LKR 3.1 billion to LKR 3.3 billion. As a result, the profit after tax figure has improved by 81%, from LKR 1.2 billion to LKR 2.3 billion. This is almost LKR 1.1 billion in quantum.

In terms of the Balance Sheet, we had a 9% growth in total assets, which is a comparison from the December 2016 position to June 2017 position – LKR 335 billion to LKR 365 billion, around LKR 30 billion increase in assets. Loans have shown a substantial improvement from LKR 228 to LKR 252 billion. That is a 11% growth and a LKR 25 billion growth. In terms of deposits, it has grown by about LKR 35 billion from LKR 204 billion to LKR 239 billion – 17% growth.

In terms of our efficiency ratios, Cost to Income ratio has improved, from 49% previous year to 43%. This is one area we are focusing on. The other major improvement is in the NIM from 2.64% in December 2016 to 2.74% in June 2017. This is a roughly about 10 basis points increase in NIM. This is one area that we are focusing on, so this would improve further.

Return on equity, has again improved by about more than 150 basis points from 13.36% to 14.63%. This is still below the industry average and we have to keep on improving. This is one area that we are focusing on, and is a part of our strategic plan. One key improvement is in the NPL ratio, from 2.63% to 2.22% which demonstrates the credit quality, and a ratio which is below the industry average.

In terms of business capacity ratios, the Loans to Deposits Ratio have shown a quite good improvement from 115% last year to 108% in June 2017. We will continue to improve this ratio and finance our book by our own finances. In terms of Capital Adequacy, we are at 12.76%, well above both regulatory requirements and our internal capital adequacy measurements. Liquidity ratio is maintained well above the regulatory minimum requirement. It is currently at 22.3%.

Slide 12 – Income Statement

This slide shows some details about the income statement. Out of the total income – net interest income, we had a 17% from H1 2016 to H1 2017, in terms of quantum, LKR 706 million growth – from LKR 4 billion to LKR 4.7 billion. In Other income, we had a 62% growth from LKR 1.1 billion to LKR 1.85 billion, a growth of LKR 711 million. Operating income has grown from LKR 6.3 billion to LKR 7.7 billion.

Impairment, which was LKR 829 million in H1 2016, has seen around a LKR 200 million reductions this time to LKR 581 million. This was mainly due to the portfolio quality improvement and last year of course, there was substantial specific impairment that we made as well, on one particular account last year.

In terms of operating expenses, we have made good progress with a growth of only 5% from LKR 3.1 billion to LKR 3.3 billion. We will discuss more on this in the next slide. As a result, the operating profit level saw a 70% improvement from LKR 2.2 billion to LKR 3.8 billion. So that is about LKR 1.5 billion increase in the operating profit level.

There is naturally a 55% growth in tax with the improvement in the profits. Last year we paid roughly a billion – LKR 965 million. Now it has gone up to LKR 1.5 billion. So PAT has recorded an 81% growth. Profit attributable to the shareholders at a Group level has recorded a 37% growth from LKR 1 billion last year to LKR 1.486 billion in H1 2017. This is a 403 million increase in PAS level.

You would see that in PBT and PAT, overall operating profit has seen a 70% growth. This is partly due to dividends earned from the Group companies. But even if you take out the dividend income, the growth in both PBT and PAT YoY is 56% and 63% respectively, which shows that even without the Group dividend, the core banking operations have made substantial contribution to the growth in the PAT level.

Slide 13 – Revenue Analysis – Net Interest Income

This is a more detailed analysis of the revenue, and in interest income. You would see a 36% increase in the interest income. This is a LKR 4.7 billion quantum growth in interest income, partly due to the substantial growth in the advances. Interest expenses have moved from LKR 9 billion to LKR 13 billion. This is again a LKR 4 billion .increase in the interest expenses. As a result, the NII has grown by about LKR 700 million from LKR 4 billion to LKR 4.7 billion – a 17% in NII. 44% increase in the interest expenses is due to the change in the composition of the CASA deposits portfolio, where the CASA ratio now remains at around 22%.

In terms of NIM, you would note that there has been a 10 basis point improvement in the NIM from 2.64% to 2.74%. Main contributor is volume growth. NIM has also gone up due to the re-pricing of the assets book and also due to the shift to more retail and SME loans. We look at the overall return to the Bank when disbursing funds. All these three measures have contributed in improving NIM.

Slide 14 – Revenue Analysis – Non interest income

In fee and commission income, we had a 6% growth from LKR 1 billion to LKR 1.1 billion. Net gains from trading grew by 17% from LKR 456 million to LKR 533 million. Net gains from financial investments saw a slight drop of 5% from LKR 128 million to LKR 122 million. Other operating income saw a quite substantial increase from LKR 556 million to LKR 1,197 million. This includes the group dividend that we received, LKR 556 of last year compared to LKR 1.1. billion this year. That is where the growth is.

Growth in total non-interest income is 35%, from LKR 2.2 billion to LKR 2.99 billion. In terms of non-interest income growth excluding the Group dividend is about 12%. Net fee and commission income growth is about 6%. This is a key area that we are working on heavily, in achieving the ratio of NII to net fee and commission income ratio of 70:30, improving our fee based income further.

Slide 15 – Operating expenses

We see only a 5% overall growth. We see a reduction of about 2% in personnel expenses. I would say that there are two major reasons that contributed to this drop despite we increasing the overall staff benefits. One is the number of staff reduction from 2,100 to 2,070. Plus, the movement or turnover of some of the senior management staff that happened during the latter part of last year. Therefore the movement in personnel costs is a 2% reduction. But going forward, for the second half, we are looking at salary revisions based on some market survey numbers we are expecting. Therefore, we would be expecting a 5-7% increase in the expense in the year end.

In terms of other expenses, there has been a 16% growth from LKR 1.2 billion to LKR 1.4 billion which is roughly a LKR 200 million increase. That is mainly due to the VAT increase from 11% to 15% plus the substantial growth in our deposits – actually by LKR 48 billion from June 2017 to June 2017. There is deposit insurance cost entailed to it, which we had to bear like all the other banks. So this is also a part of the other expenses.

During this period, 4 new branches were added on to the network. We also had two product launched during first half we will discuss more, later on. All in all we have managed to keep the cost increase to 5%.

Slide 16 – Balance Sheet

Talking about the Balance Sheet, we had an overall 9% increase in the Balance Sheet from LKR 335 billion to LKR 365 billion. This is end 2016 versus June 2017. This growth is mainly coming from the loans and advances from LKR 228 billion to LKR 253 billion. This is a 11% growth. In terms of liability side, the growth is coming from deposits, from LKR 203 to LKR 239 billion. So a LKR 36 billion growth in deposits. We have been consciously concentrating on CASA as well. CASA ratio remains around 22%. There will be more details in the next slide.

Overall there has been a total assets growth of LKR 30 billion, loans growth of LKR 25 billion and deposits growth of LKR 35 billion.

Slide 17 – Loans and advances

This is more about the loans and advances, the composition between the corporate, retail and SME and also project finance. The retail and SME has now moved to around 39%. That is an area that we would be focusing more on, in gradually increasing this retail and SME focus by making the use of our presence – that is 106 branches, throughout the island. So that is one area that we are strategically focusing on.

The other area that we are focusing on is the LKR to FCY mix of the loans and advances. Right now it is at 76:24 and we target to improve to more LKR lending. Therefore we are looking at a 85:15 mix in the next 3-4 years. The 5 year cumulative growth rate has been 20% in loans and advances. This year the rate has been slightly above that.

Slide 18 - Asset Quality

You would see that our portfolio is well diversified in to all sectors. Manufacturing has the largest exposure with 22% but it is a quite well spread pie chart. The NPL ratio, you would see that the ratio has improved from 2.63% in December 2016 to 2.22% in June 2017. There are no any major stresses in the portfolio, we are quite happy with portfolio quality. Whatever the individual impairments that have gone up have been due to specific accounts that we have looked at. On an overall note on asset quality, we are quite comfortable with it.

Slide 19 – Customer Deposits

We have seen substantial growth here. Year-to-date growth has been 17%. Annualized of same is roughly 34%, whereas the CAGR for the last five years have been 20%. This growth is coming from both LKR and FCY deposits and also from CASA as well. We did introduce two new CASA products during the latter part of the first half and in early July – Investment Planner and Araliya the women's savings product. We see quite a good progress on those two products. All in all, the CASA growth alone – in terms of absolute numbers for the six months is about LKR 6 billion. That is an area that we would continue to focus on, on improving the low cost deposits base all in all to improve our NIM.

Slide 20 – Capital Adequacy

In terms of capital adequacy, we are well above the regulatory requirements. We are also compliant with the new Basel III regulations which came in to effect from the 01st of July. As per those requirements, the pillar I & total capital adequacy requirements are 7.25% and 11.25%.

We are at the moment at 9.4% and 12.8%. So we are quite well above the minimum requirements. We are naturally working on our capital planning exercise with our growth plan, so that would continue as and when it seems fit to contribute to capital, we would ensure that the capital would be brought in. Right now what we are focusing on is improving the ROE numbers.

Slide 21 – Investor Ratios

The market price of the share has unfortunately come down, which reflects the market conditions as well. It is currently trading at around LKR 144 (26 July). The earnings per share (EPS) have improved, from LKR 19.19 to LKR 22.82. ROE has improved by more than 100 basis points from 13.36% to 14.63%. ROA has improved from 0.99 to 1.09%. Book value of the share has increased by about LKR 10 from 149.80 to 159.53. Price to book value is around 0.9 times. So that is where one has to really work on, that is actually the market perception, currently the share is traded at LKR 144 against a book value of LKR 159/.

So with that we come to the end of the presentation. It is now time for questions.

Questions and answers session

(Answered by the CEO, unless specifically mentioned).

Q 1: What portion of your lending book is on floating rates, and what portion is on fixed rate?

Niran Mahawatte: A significant portion of the loan book is in floating rate. The larger portion of the Balance Sheet, which is in the retail segment, is in variable rates.

Q2: Do you see any further scope for re-pricing the current loan book, or will any NIM gains come from new loans.

We have revised the pricing structure. So there is definitely still more scope for improvement in NIM. Also, the new growth that is coming in, most of it from retail and SME will benefit the NIMs – there the margins are higher. So, there is still scope for improvement in NIMs in the existing book, plus the new loans we are booking will come at higher prices.

Q3: What is the strategy in growing your SME book from the current size, and what is the target composition of the loan book?

As I mentioned earlier, we have 106 branches, and more than 55 branches have been added to the network in the last five years. That's where we see significant opportunity in growing our SME portfolio. Our origins being in development banking, naturally, the credit skills of our relationship managers and the regional network is quite high. So we need to capitalize on that in-built talent.

We will continue to focus on making use of our presence and our talent in assessing credit. So most of the credit will come from the regional network in terms of SME, plus a focused approach on the retail side, we have a good sales team and I think we have the largest personal loan portfolio in the market. So we would continue to make use of that strength to grow our retail book as well.

Q4: How much of the deposits book is maturing under 12 months?

Niran Mahawatte: Around 75% of our deposits book is skewed towards less than one year, which is fairly a large portion. It is more or less aligned with the industry, our savings accounts growth, as per the budgeted numbers and as per our strategy/ way forward; then of course the duration of our liability portfolio will go beyond one year.

Q5: What explains the big drop in the NPL ratio?

Two reasons contributed to this. One reason is the natural reason of the growth in denominator, which is the loans and advances. When the denominator or the loans and advances go up, the rate comes down. But on the quantum side, there is substantial improvement in terms of one, in recovery side. The other one is the long overdues or the recognized NPLs about eight years back, fully impaired were taken out of the book. So a combination of all these three has contributed to a lower NPL ratio, compared to December numbers.

Q6: What are the NPLs with respect to SME and with respect to Retail?

These are wide sectors and the risks are very well spread and we do not see any stresses. On the retail side NPLs are much lower than our overall 2.22%. Same is with SME. I would say that they are all in line with the average NPL ratio, and the risks are well spread amongst all sectors. There is no particular stressed sector as such in the portfolio.

Q7: To what extend will you use digital products to grow your business?

This is one key area that we are focusing on. When we did our assessment, we realized that about 60%of our transactions are through digital channels. What we should do is to have a more focused approach in this channel. In our strategy too, we have a key area looking at the digital channels. Of course, the mobile App as I mentioned is one of the great ways to reach the customer, and as I mentioned, more than 2 billion transactions have been routed through the mobile App. I would say this is one of the best mobile Apps available in the country. We would like to continue to look at digital means. We are a part of CEFT, the common ATM switch. So many areas are available, that we can work on, using the technology. So this is one area that we are focusing heavily, to improve further in the digital channels.

Q8: What is the split between retail and SME within your book? Last quarter was 50:50.Has it changed material in this quarter?

No, it is still around 50:50, retail and SME. These are two areas that we want to continue growing. Sanjaya, do you want to add anything?

Sanjaya Perera: We are aggressively focusing on both sides. At the moment it is more or less, 50:50.

Q9: What is the Bank's exposure to property development segment and what is the Bank's exposure to home/ mortgage loan segment?

Buwaneka Perera: We are very selective on the property sector. We consider the location, the promoter and the salability or the price of it. We have been progressing on a very selective basis.

Even the exposure to home loans is within the retail book, and the overall exposure is less than 10% within the overall book. The NPLs on this sector is also very much under control.

Q10: Do you have any plans to expand your branch network, if so, how much would be capex per branch, and how many would be employees per branch?

We have a model for branches, based on the model and based on the potential; we have a minimum number of staff to ensure service quality. So, we basically deploy staff based on this model. As and when the transactions increase, and as the volumes of the particular branch increase and as the branch upgrades to a different level, naturally, more number of staff would be allocated.

In terms of the growth in network, we do have plans to grow. We also need to get the regulatory approval for same. Apart from branch growth, we are looking at growth from other channels such as the digital channel, which we will focus on, as we mentioned earlier.

Q 11: Have you already met Leverage Ratio and Liquidity Coverage Ratio under Basel III guidelines?

Suvendrini Muthukumarana: We are well above the minimum requirements. LCR is 80% and we are well above this currently. On the leverage ratio, we are required to maintain a maximum of 5%, and we are well below the ratio. We are monitoring it comprehensively.

Q12: What the KPIs of your new 2020 strategy, devised with IFC?

I take this opportunity to discuss this broadly. We have looked at our position last year and then compared same to the market. Having reviewed our book and our transactions for the last three months, we realized that we have a lot of areas that we can further improve on. So based on that, we have worked on a strategy. Right now, we are working on more than ten work streams. For some of those streams there are dedicated product champions. We monitor the progress of the strategy, through a much centered approach. All in all, by 2020, what we aspire is substantial growth in assets, and naturally to be a systemically important bank by 2020.

In terms of Balance Sheet mix, I would say, we are shifting towards more LKR exposures compared to FCY exposures. That would naturally happen as our focus would be on the retail and SME space. In terms of ROE, we have high numbers to achieve, to come to the industry average or the above. Naturally, it is a more than 18% ROE. In terms of NIM, we aspire for a better NIM. In terms of the NII and fee and commission income composition, we aspire for a better composition. All in all, we have addressed all key areas that we need to work on. That strategic plan is now in force, which we have shared with the staff and there is a lot more development taking place in the next six months.

The real benefits of these new strategy initiatives would be seen next year onwards.

Q13: How much did the two new deposits products contribute to the CASA growth in the months that they were available?

One of these products was introduced in late June, and the other product was introduced during this month (July). It is too early to talk about the contribution to the CASA numbers from these two products. Current numbers that we are seeing from the branches show that they are quite actively working on those products. The branches now have a set of products to reach the clients. That is a vacuum that we addressed through these products, as a response to needs that were in place for a long time.

Q14: What is included in the manufacturing sector NPLs, other than textile? Are there any material sectors?

Buwaneka Perera: Under manufacturing, it is the plantation sector, which is controlled and very well monitored.

Q15: What is the foreign currency loans mostly constituted of?

Buwaneka Perera: About 80-85% of this segment is in export import loans.

Q16: Does the Bank intend to grow its pawning portfolio in the second half?

Naturally, it should be a cautious growth. Pawning is a part of our product portfolio. The branches are equipped with that product. This is not a significant portfolio, and we would grow it cautiously. Some of the customers in some of the branches do require this product. So, in such localities, we will selectively grow the product.

Q17: What are the key contributors to other operating income?

Suvendrini Muthukumarana: Apart from our normal fee, trading and forex income, we also had group dividends. If you eliminate those, there is still a 12% growth from our core banking operations.

Q18: Which sectors of loan growth will benefit in the future? Has there been an impact to the leasing portfolio with the LTV ratio reduced for motor vehicles and trishaws?

Trishaws are not in our loan book. We would look at the middle-income category. We have not seen a big impact from the LTV ratio in general. Our leasing portfolio is quite healthy and it would continue to grow. We have not seen much of an effect due to that.

Q19: Although the impairment reduced on a half year basis, we saw an increase in the quarter by 32% from LKR 333 mn to LKR 440 mn. What was the reason for quarterly impairment growth?

One reason is, we looked at more granular level specific impairment. As we move forward in focusing on retail and SME space, we need to look at granular level specific impairment. So, we brought the threshold levels down to lower levels, so that we can actually consider larger sector of accounts under specific impairment. That was the reason that specific impairment was relatively high. But on the other hand, the collective impairment, naturally with the growth in advances – LKR 25 billion in advances, when you apply the model, there is also a growth in the impairment numbers.

Q20: Tax rates have been above 50% in the last two years. Why does NDB have a higher effective tax rate than the peer banks?

Suvendrini Muthukumarana: As per the reported numbers, our effective tax rate is 39% for the six months. There is Group dividend, which is exempt from income tax. If you remove that, it was a 52% effective tax rate, with FSVAT, income tax, altogether, as per the industry, it is about 55%. I think we are on par with the industry.

Q 21: What is your view on interest rates?

Niran Mahawatte: We have seen a decline in the government bond yields. There is quite a bit of liquidity in the market. The perception is that interest rates will either come down or stabilize in the next two quarters. That is the Bank's view also. Based on that, we are taking certain re-pricing decisions. So basically, we expect the rates to decline a little bit, from the present levels going for the next six months.

Q 22: What is your expectation on LKR depreciations?

Niran Mahawatte: It has been very clearly mentioned by the CBSL and the Governor, that the exchange rates will be determined by the market forces, and that they will not intervene in the exchange rate determination, especially by selling exchange. So, currently the exchange rate has depreciated by about 2.25 – 2.5%. I think the same trend will continue. We have seen a lot of inflows coming in. Even during the last couple of weeks, certain inflows have come in to the bond markets. Certain other remittances, infrastructure related inflows, for larger development projects are expected to be here. We see that the market will not be much volatile.

Q23: Are there any plans for a capital issuance this year?

We will closely watch the growth in the advances book. We will then take a decision. Right now, we are quite above the Basel III requirement. In terms of numbers, we should be able to manage. But however, if the growth continues and if we see more growth levels, especially in the next year, we would look at a capital infusion. One must balance the optimum level of capital and the growth. So, we would continue to focus on same.

Q24: Have mix between working capital loans and capital expenditure loan have varied largely over the year?

There is no major variation compared to last year.

Q25: What was the source of loan growth between existing customers and new customers?

It has come from both sources. We have quite a good set of customers. With an NPL level below the industry. Those clients also have plans to expand. Our first preference is to support our existing clients. Then with the opening of new branches and all, there are opportunities for us to look at new customers. So, it comes from both sources.

Q26: In your loan book of SMEs, what percentage of the loan book is asset backed vs. non asset backed? What sectors have these been extended to?

Wherever possible, we would assess the working capital cycle of the SME customers. We will work on our facilities based on the working capital cycle. So there can be situations where if the customer is unable to substantiate it with their financials or with their cash flows, naturally, that is where we have to rely on some sort of a secondary repayment source, which is some kind of n assets mortgage. So we always look at the cash flow based lending. So that is the primary source of recovery. The security will come only as a secondary source. There is no hard and fast rule of what percentage of loans should be backed by assets. Because as we grow our book, naturally we need to look at the cash flows. But in case of a distressed situation, that is where security comes and helps us in the recovery process. It is a very balanced and scientific way of evaluating credit. I would say quite a significant number of small accounts are quite well secured in terms of our exposure to smaller branch level customers.

Q 27: How much of your loan book was capped at 24%?

We are yet to review that. Thank you for that question. I would say, the entire book is capped at 24%. If you look at LKR to FCY – the 75% was capped at 24%. Now it is a market based situation. One has to be very careful not to go and whack the customers when they cannot pay. One has to be very careful. Otherwise it will come in as a potential NPL. I think all banks are taking a very practical approach here. Just because the cap is removed, I do not think any bank will take that as a license to go and charge higher rates. We are very responsible in that manner.

So we would continuously look at who has to be priced appropriately and take a call. That is where even the CBSL is monitoring to ensure that all banks adhere to a very practical approach. Now that the cap is removed we will also follow very strictly, how to handle this. But of course there have been cases of deliberate intentions to withhold payments or delay payments. I think that is where we have to make use of a penal interest rate to pressurize such clients who are intentionally differing payments, to get their payments faster.

Q28: Do you have plans to go for further foreign borrowings?

One of the core areas that we are focusing on is the LKR FCY mix of the loan book. Our focus is to increase the LKR side. I do not think there is a need for us to consider more FCY borrowings. In fact we are looking at some of the existing borrowings that we already have, whether it justifies to have some of them in our books, or whether we can look at re-pricing them. So that is the assessment that is currently taking place. Not really to go for fresh foreign borrowings.

Q29: What will be the impact of IFRS 9, is there a change in NPL recognition? Have you done an assessment?

NPL assessments will be as per the CBSL guidelines. On IFRS 9, we have engaged and they are currently in detail.so the impacts will be known accurately by the latter part of the year.

Q30: Is there a difference for NPL in your book, as per IFRS 9 and the CBSL guidelines?

As was explained before, NPLs is a time based classification as per the current CBSL guidelines. IFRS 9 provisioning is on the total exposure based on the sectorial behavior and the performance of the sector, and how the loans are settled. So therefore, we cannot relate the NPL classifications and IFRS accounting for impairment. However, currently since the CBSL guidelines are in effect, we have to follow both methods so we are complying with both regulations.

Q31: Your current ROE is around 14.5%. Given you plan to achieve a ROE of 18%by 2020, what is the average loan growth rate you anticipate from 2018 - 2020?

We are looking at average industry growth rate. This is in line with what the regulator is also expecting. Main improvement will come from the NIM, which is currently 2.7%. So that is where significant improvement is coming from. Even with industry growth rates, we are comfortable that we will be able to deliver those numbers.

Business mix is the other segment that the improvement in NIM will come from. From higher end corporate market to the retail and SME sector where you spread your risk and at the same time make use of our reach to work on more SME and retail based lending.

Q32: What is your target NIM by 2020?

This would be the industry average at 3 – 3.5%.

End of Q&A.

Closing remarks

Thank you ladies and gentlemen for your participation.

End of edited transcript.