Edited Transcript

Webinar with investors and analysts
National Development Bank PLC
Quarterly financial results – Q1 2017

NDB bank
Our Commitment. Your Success.

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Investor Presentation

Dimantha Seneviratne

Opening Remarks

Good afternoon ladies and gentlemen, a warm welcome to all of you who are joining us for the Bank's Investor Webinar on the Q1 2017 results.

If I may take you through the presentation,

Slide 05 - Business Overview - A unique banking and capital markets group structure

This is the Group structure of NDB. This Webinar mainly covers the performance of the Bank. But of course, the Group contribution is also covered in that.

Slide 06 - Business Overview - An equitable mix of physical and virtual channels

In fact, yesterday, we opened our 106th branch at Kottawa. So now we have 106 branches and 118 ATMs. We also have internet banking access. One key area that I want to highlight is the NDB Mobile Banking App which has been quite a success. I thought of sharing with investors, that since the launch in February 2016, over LKR 1 billion transactions were routed through our NDB Mobile App. For a mobile app, I think that is one of the key drivers. Also, the Global Banking & Finance Review has recognized our Mobile App as the Best Mobile App in Sri Lanka. We'll share some more details later during the presentation.

Slide 07 - Recognition

These are the awards that we won during the quarter, and soon after the quarter in April and May 2017. The Global Banking & Finance Review of UK has awarded our Mobile Banking App the best Mobile Banking Application award. We were also rated as the Best SME Bank for 2017. This is actually in line with our strategy in moving towards a more SME/ Retail driven strategy. Also, we were recognized as the Best Investor Relations Bank. I am sure, the webinars like this on a quarterly basis, and the press conferences that we had earlier helped us to maintain this momentum as the most investor friendly bank in Sri Lanka.

In addition to these three awards, CMO Golden Globe Brand Excellence Awards in Malaysia recognized us with two awards, one for the brand excellence within the banking and finance sector 2017. We also won the award for excellence in social media marketing.

Plus, from our NDB Group, NDB Investment Bank was recognized by the Global Brands Magazine as the Most Trusted Investment Banking Brand in Sri Lanka. The Asiamoney Awards recognized us with the title, Best Corporate and Investment Bank in Sri Lanka.

So, these are some of the recognition and awards that we are quite pleased with, which we thought we should share with our investor community.

Slide 08 - Macro Economic and Industry Analysis

Very quickly on the macro-economy and the industry analysis, during the quarter, the global economic activities picked up and this was something long awaited. This is a cyclical recovery that we are seeing in investments, manufacturing and trade side. World economic growth is expected to rise from 3.1% in last year to around 3.5% in 2017.

Talking about the Sri Lankan economy, there was an upward trend in inflation. This is something we noted in March 2017. CCPI core inflation for March 2017 moved up to 7.3% in March. However, in April this trend was reversed. The Rupee also saw a slight depreciation. The market rates saw some increase, with the AWPLR moving up in Q1 2017.Probably on the Rupee Dollar side, with today's conclusion of Sri Lanka's issuance of bonds up to 1.5 billion, which is around 6.25%. With over 11 billion demand shown, this is actually quite a good reflection of the country's standing, and also the appetite for our bonds. This will auger well for Sri Lanka going forward.

In terms of the banking sector, the Monetary Board increased the SDFR and the SLFR by 25 basis points each up to 7.25% and 8.75% respectively. The banking sector total assets, as per the CBSL numbers grew by a 13.5% in the first quarter.

Prior to moving to the Bank's financial performance, I thought I should explain our theme from last year's Annual Report "Unlocking our potential to unleash yours". NDB as a Group has a huge potential. What we are trying to do is unlocking that potential, not only of the Bank, but also our Group companies, and unlock those potentials thereby unleash our customers' potential.

Slide 10 - Q1 2017 Performance Summary

Moving to the numbers, this is our performance summary. The quarter had a very good growth in terms of net operating income. We are comparing Q1 of 2017 with Q1 of 2016. There has been a 28% growth from LKR 2,846 million to LKR 3,631 million. Operating expenses of course grew, but it was quite a controlled growth in terms of 10% growth from LKR 1.57 billion to LKR 1.72 billion. Couple of things contributed to the increase in the expenses, though we are trying to manage our costs down. One major contributing factor was the deposit insurance premium. You would note later, in the Balance Sheet, that we had a significant increase in the deposits. The VAT increases also caused an increase in the operating expenses of around 10%. But still, compared to the operating income growth of 28%, it is quite well managed.

In terms of after tax profit, we have recorded an increase of 45%, from LKR 797 million last year to LKR 1,159 million.

In terms of Balance sheet growth, we compare same for Q1 2017 with the year-end Balance Sheet of 2016, so it is a three months progress. Total assets have grown by 4%. Total loans are a 6% growth, which in terms of the quantum is roughly around LKR 13 billion for three months. The biggest growth came from deposits which is an LKR 24 billion growth. It is a 12% growth for a quarter. This is quite a sizable growth. We are happy that within that growth, there has been sizable growth in CASA. We had a net growth of about LKR 3 billion in CASA within the said increase of LKR 24 billion.

In terms of efficiency, Cost to Income has improved significantly, from 49% last year to 46% in Q1 2017. Net interest margins (NIMs), is an area that we are focusing quite hard on, through re-pricing and also through bringing down the cost of funds. CASA also contributed to NIMs along with the re-pricing of the book, which is reflected in the improvement in the NIM from 2.64% to 2.78%. Although it is a 14 basis points margin, this is an increase in NIM which for three months I believe is a sizable increase and that is an area that we continue to focus on going forward.

Return on equity improved from 13.36% last year to almost 14%, to 13.96%. On the Balance Sheet again, Loans to Deposits Ratio, this is a ratio which we are concentrating on, has improved from 115% to 108%. You may recall at the last Investor Update, we were saying that we focus in growing/ self-funding our advances book. That is one of the key priorities that we are working towards. One indicator of this is the LKR 24 billion growth in deposits. The other one is the improvement in Loans to Deposits Ratio (LDR) from 115% to 108%.

Capital adequacy of 12.95% last December has moved down to 12.76%. We are still above the minimum requirements. But this is an area that we are also working on, especially towards the second half of the year, in improving the capital base. Liquidity ratio wise, we are well above the minimum liquidity of 20%. In fact liquidity, has improved from 21.5% to 22%.

Slide 11 - Income Statement

Talking about the Income Statement, a more detailed break-up is given here. Net interest income (NII) had a LKR 355 million growth quarter to quarter, an 18% increase to LKR 2.3 billion. Other income was a marginal growth – from LKR 1.4 billion to LKR 1.431 billion - roughly a 2% growth. This again is quarter to quarter. Of course, the last year in first quarter, we had some high commission income due to some of the larger corporate deals that we entered in to. But without those significant deals we have slightly improved the income this quarter. But on an overall note, the core income - the fee income; is an area that we are focusing on, in which we have also seen some good progress.

In terms of impairment, that is where one of the considerable improvements is seen. Compared to LKR 537 million in Q1 2016, this year (Q1 2017) the charge is LKR 134 million. There again, some of the unusual high impairment charges were made last year for few accounts which were not seen in this year. Those one-off specific impairments were made on prudence basis.

Operating expenses as we discussed earlier, saw a 10% increase from LKR 1,568 million to LKR 1,718 million.

The biggest improvement is in operating profits. As you would see, there is a 50% growth in operating profits prior to tax from LKR 1.2 billion to LKR 1.9 billion. The tax component increased from LKR 481 million in Q1 2016 to LKR 753 million in Q1 2017.

Profit after tax, saw a 45% growth from LKR 797 million to LKR 1,159 million.

Slide 12 - Revenue Analysis

Moving on to revenue analysis, some more details are given here on revenue. The NII as you would see has moved from LKR 1,979 million to LKR 2,334 million. Fee income has recorded a growth of around 3%. Now this is where, as I mentioned, the last year's LKR 539 million included some of the one off large fee income that we received from some of the corporate deals. Without those in Q1 2017, we managed to have a 3% increase in fee based income.

Other income moved from LKR 864 million to LKR 877 million.

With regard to the composition of total operating income, the graph here shows that the core operations have contributed to our performance. This is one of the key highlights of this slide.

Slide 13 - Operational Expenses

Talking of operating expenses, the overall operating expenses have grown by 10%. There again, the break-up is, personnel expenses recorded a 7% QoQ increase. This is in line with inflation. Then the depreciation is 4%. Other expenses have grown by 14%. This is where the VAT and also the branch expansion had an impact. We also have added about 6 branches since first quarter of 2016 up to first quarter of 2017. Apart from those new openings, 3-4 relocation of branches took place. There again the cost of relocation is similar to opening a new branch. So altogether I would say around 10 new branches plus relocations were seen. So that is another reason for the increase in expenses.

Slide 14 - Balance Sheet

On the Balance Sheet, 4% increase in the Balance Sheet from Dec 2016 to March 2017, from LKR 334.5 billion to LKR 347 billion was seen.

There again the biggest increase is on the assets side, on loans and advances which was a 6% growth from LKR 227Bn to LKR 241bn. This is a LKR 14 billion growth. There again we were quite focused on ensuring that the loan growth is coming from high margin assets as well as through re-pricing of the loan book.

In terms of liabilities, the major increase is on the deposits from LKR 203 billion to LKR 227 billion. This is a LKR 24 billion growth in deposits.

Slide 15 - Loans and Advances

This is a segment mix of our loan book. Roughly, corporate banking accounts for 34% of our lending book. Then Project Financing - 23%, the Retail and SME space 40% of the core lending book. In terms of currency-wise break up, you would see, roughly LKR 188 billion in local currency and LKR 59 billion in foreign currency.

That roughly is 24% of the lending book in foreign currency. Over the last five years, we have grown our loan book by a CAGR of 20%. But you would see, year to date growth is 6%. If you annualized it, this is roughly around 24%. So we are quite keen to continue this growth momentum. Also, the currency mix, currently 24% of foreign currency loans, we are thinking of reducing the foreign currency exposure and move in towards a more LKR based Balance Sheet.

Slide 16 - Asset Quality

Quality of assets; quite a well-diversified portfolio as you would see from the pie chart. It is quite well spread. The largest exposure of 20% is on retail, which is basically reflecting the economy. Our agriculture exposure is 10%, which is in line with the regulatory minimum requirement. Gross NPL ratio stood at 2.87% which is in line with the industry ratio. Net NPL ratio is 1.56%. So NDB continues to focus on ensuring a quality lending book. So we are working on improving these ratios further as we move along.

Slide 17 - Customer Deposits

Customer deposits, there again, YTD growth of 12% was shown and a CAGR of 20%. So out of the total deposits, LKR 179 billion is in LKR deposits. LKR 49 billion is in FCY deposits. As I mentioned earlier, out of this LKR 24 billion impressive growth, roughly LKR 3.3 billion has come from CASA balances, which is an area that we continue to focus using our branches. We are trying to reap the benefits of the investments that we have already made on these branches, which is 106 branches.

The CASA ratio is roughly around 21%. You may not see that growth because of the significant growth in overall deposits, but as a quantum the CASA has grown by LKR 3.3 billion.

Slide 18 - Capital Adequacy

Capital adequacy ratio wise, we are quite well above the minimum regulatory requirements. The Bank is quite well capitalized as per current Basel guidelines. We are also geared towards Basel III. From July 2017 onward, total tier I ratio under Pillar I is going up to 7.25%. Total capital adequacy ratio is going up to 11.25%. So at the moment, we are quite above that. We are 9.2% and 12.8% for Tier I and II respectively. But as we go along, as we grow our book and as Sri Lanka moves towards Basel III, this Tier I, Tier II ratios are moving up, and the Bank is working on strengthening the capital base to support this growth as well as to ensure that the minimum capital requirements are maintained. But we want to keep an optimum level of capital, rather than going for significant capital increases to ensure that the ROE is maintained at or above industry ROE levels. We are right now, a bit low on that, which is where we are targeting at working on.

Slide 19 - Investor Ratios

The share price has come down from LKR 156/- in Dec 2016 to LKR 139.60 by end of Q1 2017. As at now, it is about LKR 143/-. Still it is one of the shares which is traded below the book value. Book value of our share is LKR 149.35. So we are trading slightly below the book value. This is something one has to look at, especially the investors. ROE is 14%. ROA has improved, from 0.99%to 1.03%.

Earnings per share have improved from LKR 19.19 in end December 2016 to LKR 21.25 as at quarter end. This is probably the reflection of the low share prices which reflects the current market trend. But still I believe there is enough scope for improvement in the share price as it is currently trading below the book value.

These are the financial highlights as per the first quarter.

We are now ready to take up your questions, along with the rest of the panelists.

Questions and answers session

(Answered by the CEO, unless specifically mentioned).

Q1: What is the number of branches to be opened this year?

VP-Branch Network Management

We have already opened two branches during the year. We are looking at opening around four more branches during this year. Our focus on branch expansion remains the same. What we will do is stabilize the existing branches, whilst conservatively expanding the network. That would be our focus.

Q2: Apart from the capital ratios, what are the leverage and liquidity ratios that need to be met by the Bank by July 2017?

AVP-Finance & Planning

The Bank should maintain a Liquidity Coverage Ratio with a minimum of 80% for the year 2017. We are well above the ratio currently. It is more than 100%, so we are maintaining it. On liquidity ratio for DBU and FCBU, we are very much above the required ratios. On the leverage, also, we are quite confident on this ratio. From 01st of July 2017, we will be able to maintain this ratio as per regulations.

Q3: What is the expected loan growth for this year and next year? What will the focus be for loan expansion, whether it is from Corporate or SME?

I think it is in line with the country's growth rate, and the way that the Bank is growing. Roughly around 57% of our book is corporate and project finance as you would have seen in the pie chart before. Retail and SME is 40%. But we would be focusing more on the retail and SME space. We have a network of 106 branches, we have the reach and there is potential. We are upskilling the credit skills of the branch staff. As a development financial institution, which is our forte, we possess good credit skills. We should make sure, that we make use of those credit skills. By making use of that we are actually increasing our exposure to retail and SME space, whilst growing our corporate and project finance business. As such, the focus would be more on growing the retail and SME book.

As per the numbers, you would have seen about 6% growth in the first quarter. We would like to continue with a similar momentum in growing our lending book.

Q4: Why is your impairment reducing on QoQ, despite increases in the NPL?

VP-Corporate Banking

In Q1 2016, the increase was due to some specific customers for which we made one-off specific provisions. But if you take the corporate banking book, we currently have around 75-80% of the book impaired. With adequate security covering and with impairment being looked at on a quarterly basis, we are quite comfortable during this year.

Q5: How are you planning to improve your fee income? Is it by increasing the fees or expanding the range of products?

This is again an area that we are focused on. We have quite a good corporate banking portfolio and a very good trade finance book. Our fee based income compared to interest income as a ratio is relatively high compared to most of the banks. Because we have a history, we have good resources and also a very good correspondent banking network, which we have invested and built up over the years. So we will continue to focus on the trade side, expanding in to even branches which will have trade desks.

The other one is, as we move on to a more retail space, and actually with personal loans, there is a fee/ revenue that is available. Then on our card business, that is again an area where we are growing. There are more opportunities here to grow our fee income through the card business. So there are various areas that we are working on.

Reviewing the fee structure is another area and how we apply the fees. Various strategies are there which we are working on to improve the structure.

Q6: What is the loan book spread between Retail and SME?

This is around 50:50. 40% of the total loan book is Retail and SME. So 50:50 of that which means out of the total loan book of the Bank, 20% is retail and 20% is SME. Both these are focus areas for us.

Q7: Any comments on the proposed transactions levy?

AVP-Finance & Planning

The industry is awaiting more clarity on the details. So at this moment, we cannot comment on it. We need some more clarity on the basis, and the method of collecting, whether it is a direct transaction levy, we need to see once the Act is enacted.

Q8: What is the NIM expectation? What is the expectation for the interest rates for the rest of the year?

(Also in consideration of the long term sovereign bond issue by the Government).

I will comment on NIMs. The Treasury VP Niran Mahawatte will comment on the interest rates afterwards.

Of course there is improvement in the NIMs. But that is an area where we can improve - one is the repricing of the book. The other one is moving on to more LKR based lending. As you would have seen, 24% of our book is on foreign currency, so when it moves towards more LKR, the margins are higher. We also will move more on to the Retail and SME space, where again the margins are better.

Furthermore, reducing the cost side will be focused on. We will focus on the CASA base so that we can improve our cost of funds. So it is a two pronged arrangement. One is improving on the margins, other one is bringing our cost down. So we are expecting this NIM to improve further as we move along.

With regard to the interest rate expectation, Niran will now add his comments.

VP-Treasury

With the current placing of sovereign bonds by the Government, immediately, the pressure on the interest rates in the shorter run will also ease. Because the liquidity pressure will ease. It has been already taken in the bond market, if you look at the long term bond yield; it is coming down by about 150 basis points. So there is a very strong possibility, with the pressure on the liquidity easing, there will be a reduction in rates, particularly in the second half of the year.

Q9: In growing your loan book, which products are you focusing on?

It will be growth from all fronts. We can’t say we will be focusing on one particular area. From the industry dispersion of our portfolio, you would have seen quite a well spread portfolio. When it comes to products, I think it will be all products, as they have equal opportunity to grow. So, we have product leaders. We also have quite a good sales team. Plus, the branch network. There again as we mentioned, the credit skills of our branch managers, and the credit approval structure is quite impressive. So, this is what we want to make use of in growing our lending book. It is actually a well spread growth in all products.

Q10: Do you see a slowdown in your deposits with the indirect taxes imposed last year?

VP-Branch Network Management

Well we have not seen that, when you look at our deposits, you can see a significant growth. As such, we do not see such an impact on our deposits.

Q11: Will you opt for a rights issue soon?

As we mentioned before, we have to raise capital. One reason is to support this growth momentum, the other one is to be line with the regulatory requirements, BASEL III coming in. So naturally, we are looking at few options, rights issue can be one of those. Most likely in the second half of the year, we have to approach the market in raising capital.

Q12: On an overall sense, can you please tell us what the strategy for the Bank is, and in what direction you will drive the Bank.

Actually, we are in the process of finalizing our strategic plan for the next 3-4 years. We are looking at 2020 - T20 and we are working on this strategic plan. Couple of things, that I think I highlighted earlier, one was shifting our focus more towards retail - SME. So the Balance Sheet mix will shift from corporate-project finance lending to retail-SME.

Next one is on our liability side. We are still 108% in terms of LDR. But we want to bring it down so that we are self-financed in terms of deposits. There again, we want to get more low cost deposits in improving our CASA ratio. Then the Balance Sheet currency structure, in which we want to move from 25% foreign currency to more Rupee based Balance Sheet structure. We are working on the interest margins.

Also, we are working on the process improvements. That is an area that we see enough room in NDB to improve. We have started streamlining the processes. We have a core team to look at what processes need improvement. Some of them may be automation, or may be simplifying the processes. We are trying to improve the SLAs thereby, the efficiency.

Naturally, the strategy would cover the growth in the entire asset book. Furthermore, we are looking at how we can integrate and get more outcomes from our Group investments. We are the only bank with significant investments in investment banking, wealth management and also, our investment in Bangladesh. So with regard to all those investments, we are trying to make more out of those investments, in terms of integration, and getting them to deliver the optimum on the capital investments. So there are various opportunities and various strategies that we are working on at the Group level.

So all that is covered in our strategic plan which we are planning to finalize within the next one to two months. Thereafter we will be on a strong footing to grow the Bank.

Q13: What is your plan regarding the investment in Seylan Bank shares as it is capital inefficient as per BASEL III?

This investment is held as Available for Sale (AFS). We will look at various strategies with regard to this. There are lots of options. One is to continue this holding. Other one is disposing. We are looking at various options at the moment. So it will continue to be reflected in AFS category for the time being.

Q 14: Can you tell us, what percentage of your branches is breaking even.

I think it depends from bank to bank, how you apportion your cost. Some banks apportion all of their Head Office cost. Some banks do not do so. You cannot compare break even number of branches because various banks are applying various mechanisms to apportion costs. We are working on a number of branches, as you would see; about 35% of the branches have been opened in the last three years.

Naturally it takes some time for some of those branches to break-even. At the same time, we have seen several branches opened during latter part of last year and during this first quarter, moving towards profitability. Now one good example is, yesterday at our Kottawa branch opening, we had a good base of first day deposits coming in. A lot of clients came in and over LKR 100 million deposits were taken on the first day. It is a matter of how you market, how you apply the leadership of different branches. Also, how we have our deposits and lending mix. We also need to make sure that each of these branches contributes to the bottom line. That is a point that at the centre, we are focusing on, in improving all these branches to ensure that all the branches are making sizable profits.

By the way, we have also decided and have already implemented in classifying the branches in to Super Grade Branches, category A, Category B, etc. based on their Balance Sheet size and also their profitability. So each branch manager also has certain targets to achieve so that he/she can aspire to be moving towards the next level of the branch category. We are looking at various ways of incentivizing and ensuring that the entire branch network contributes at its optimum from their investments.

Q15: In expanding the retail side, what is the Balance Sheet mix you are pushing towards? Also, if you look at all banks, they are saying that they are expanding retail and SME. What is that you are going to do different on this, given your Balance Sheet size and your funding cost relative to other banks?

The potential for NDB is in our people, the resources. We have well trained, quite a good, well educated, very skilled staff. As a development finance institution over the years, credit skills are inbuilt in our culture. About 10 years back, with the acquisition of ABN AMRO, with that came corporate banking experience/ expertise and also a very good corporate banking portfolio that we have groomed and grown.

We have an entire gamut of very good corporate portfolio under Buwaneka's leadership. In the trade side, thanks to long years of developing our trade book, and also correspondent banking relationships, some of them coming from ABN Amro days, we have a very good trade potential. Plus, the 106 branches located at very good locations, led by very experienced people, and also led by a very experienced Vice President, and also the branch staffs are coming from various commercial banks, are our strengths.

Some of the staff is original NDBiers who have been here for many years. It is a mix of those who join as high caliber staff from various other commercial banks. So potential wise, people’s quality wise, we have all the resources to grow our branch banking, SME and retail space. If one asks what we are doing differently, I think we do not do different things. I think we have the caliber; we have the in house built quality and capacity of the staff to reap the benefits, which we have probably not done in the past.

This is one area we are trying to focus and improve and contribute from getting the best out of our existing investments. That is why we say, "Unlocking our potential" - we have a lot of potential, that itself would help us to improve in our move towards retail and SME space.

End of Questions and Answers session.

Closing remarks

Thank you ladies and gentlemen for your participation. There were quite a lot of participants today. Thank you for your time, and also for raising some very important and interactive questions. We are looking forward to addressing you in a similar webinar after we end our next quarter, hopefully with much better results and with continued growth momentum.

Thank you again.

End of edited transcript.