Edited Transcript
National Development Bank PLC
Quarterly financial results - Q1 2016
Webinar with investors and analysts

12 May 2016, 2.00 pm (GMT +0530hrs)

Corporate participants
Rajendra Theagarajah – Director/Chief Executive Officer
Faizan Ozman – Group Chief Financial Officer
Dhanan Senathirajah - Vice President - Finance & Planning
Ms. Suvendrini Muthukumarana – Assistant Vice President - Finance & Planning
Forward Looking Statements

This document has been prepared by National Development Bank PLC ("NDB", “Bank" or the “Group”) solely for the use at its presentation to potential & current investors. By accepting this document, you agree to maintain absolute confidentiality regarding the information disclosed in this document.

The information contained in this document should be considered in the context of the circumstances prevailing at the time and has not been, and will not be, updated to reflect material developments which may occur after the date of the presentation. None of the Bank nor any of its respective affiliates, advisers or representatives shall have any liability whatsoever (in negligence or otherwise) for any loss howsoever arising from any use of this document or its contents or otherwise arising in connection with this document.

This document contains proprietary information and no part of it may be reproduced, redistributed or passed on, directly or indirectly, to any other person (whether within or outside your organization/firm) or published, in whole or in part, for any purpose.

This presentation and subsequent discussions may contain certain forward-looking statements with respect to the financial condition, results of operations, capital position and business of the Group. These forward-looking statements represent the Group’s expectations or beliefs concerning future events and involve known and unknown risks and uncertainty that could cause actual results, performance or events to differ materially from those expressed or implied in such statements.

Forward-looking statements speak only as of the date they are made. The Group makes no commitment to revise or update any forward-looking statements to reflect events or circumstances occurring or existing after the date of any forward-looking statements.
Hello and good afternoon to all of our friends who have dialed in for the NDB’s 2016 first quarter investor Webinar. I am Rajendra Theagarajah, Group CEO of the Bank and along with me I have a few of my colleagues, Ozman Faizan the Group CFO, and a few of the other colleagues from the Finance Team, who will be here to help me during the Q&A time if there are any questions and clarifications.

What we have ladies and gentlemen is, an investor pack which has already been uploaded for your information, so rather than going through all the slides, what I would like to do is, to take you through a fewer specific slides of relevance, and then spend a bit more time to have an interactive Q&A session which will help you to better understand how the Bank has performed in this environment.

So if I can move directly in to the macroeconomic overview (Slide 6), on an overall note, I think the country itself, whilst still on a positive upwardly moving trajectory, has had a few challenges in this quarter. We have certainly seen a tightening of the monetary policy. This has been due to the excessive demand pressure on inflation, leading to a negative impact on credit and monetary expansion. We have also seen the Balance of Payment being vulnerable given the poor export performance and seen some net outflows in terms of foreign investments.

On that particular aspect, I would like to say, this morning, I had the opportunity of sitting at the Sri Lankan - Austrian business forum, where one of the key policy makers from the Government made an announcement that, last night the Government together with the European Union has made a joint communiqué which gives the positive thumbs up for the GSP Plus, which I guess on this point in time, once it becomes implemented through the approval of the Parliament, will certainly send positive vibrations opening a completely new trade zone available for Sri Lankan Exports. This is a very welcoming move.

So we are very optimistic. Of course during the last few months, you have seen the Fitch ratings downgrading Sri Lanka from BB- to B+ with a negative outlook, given the gradual increase in the national re-financing which was perceived as a risk and also the perception regarding the weaker public finances.

Now in that context I would like to pause and also make a few brief comments on the recently announced upward revision on the Value Added Tax, the VAT regime. This has certainly come in to some domestic discussion. I will take a step back and put this into perspective. If I can quote from a reason survey which was done by KPMG world over on VAT, some 110 countries embrace VAT as a taxation tool, and the survey highlights that the typical VAT percentages range from 15% to around 23%, with the average slab being between 15% to around 20 - 21%.

So increasing ours to 15% still brings us at the lower end of regional/comparable international rates, which is something we should understand. Secondly I think what we are now doing is to shift the taxation policy from what used to be a partially enforced VAT regime to a near full enforced VAT regime, which means that there are going to be fewer, literally no sectors exempt, so that the entire country's
economy gets plugged into one slab. Given that along with the corporate tax which has now come down to 28%, and in overall personal income tax coming down to something like 16%, which is comparable to Singapore at 16% and Hong Kong at 17%, we still today as a country have one of the most modest and moderate income tax regimes in the world.

So this I guess really poses significant challenge to the Government to make sure that tax compliance and a revenue leakage from tax collection is addressed. And I guess that is the challenge and that is the opportunity for the regime to get in to institutional reforms in collecting and improving the collection process and I guess the launch of RAMIS, the new automated MIS system at a national level will certainly go a long way, in helping to plug any possible revenue leakages from this collection process which will help to create a more stable and a robust taxation regime under which we will all operate. So I think from a Bank's point of view we believe in strict tax compliance and we do not really see an issue there.

(Slide 6) In terms of inflation, we have seen a gradual rising in both the CCPI as well as the core inflation, which against our comparable Q1 2015 has grown by almost 200 bps. If I can look at the bottom left graph and co-relate that to the bottom right hand side graph which is the credit to the private sector, you can also see a co-relation between the creeping or rising inflation against the suppression or the moderation of the credit to the private sector. So those are two features against which we as banks are operating.

On the top right hand side we see the interest rate curves over the last 12 months. PLR since around January 2015 has seen a gradual but a steady rise with the average weighted deposit rate showing a more moderated rise. What this means is for banks like us when we have a quarterly or a half yearly re-pricing on our fixed term book, the re-pricing has a lagging effect, so it is a slower re-pricing for a book like ours. But we have recognized that there is a rising interest rate regime to live with. One thing which this graph does not show, in addition to PLR and the average deposit rate, is that the short term overnight domestic money market rate has moved by almost 170 bps in the last quarter, and as at date it has actually gone up by about 190 bps. So that also demonstrates the need to be mindful of money market funding as a tool and the potential volatility on our cost of funding. And I will touch on that as we get more towards the cost of the Bank's funding structure.

(Slide 7) This is the typical seven pillar strategy which we have consistently articulated for the last two years. There is no shift in the Bank's strategy regarding the overall profitable balance sheet which gives overall roof to a very strong foundation of corporate governance, compliance and risk management, amidst which you have the five pillars of a strong operational commitment to excellence, strong sales culture, higher than average fee income, management of cost in an optimization manner and a best in class engaged and inspired team to support the business. So those five pillars continue unabated.

I would like, before I get in to the detailed Bank's numbers, to bring to your attention a couple of the levers which we brought to your attention towards the end of the last year, which remain our key priority for the next four quarters. (Slide 8) On fee to net interest income, you could see the steady increase during the last 15 months from the top left had graph. The importance of fees, every additional percentage point, continues to add to the overall journey, and I think we are in the right trajectory.

Cost to income, demonstrates a steady downward progress. I think as at the end of March 2016, for the Group as a whole, we are at around 51% and for the Bank, I think we are below 50% at around 47-48%.
So again we will touch more on operational expenses at a further slide. But from a commitment, it is looking south going towards the mid 40%s, which is the overall growth for the year.

The bottom graph shows four circles which talks about the vintage of our branches and their CASA. If I look at this - and as at the end of the first quarter, the newer branches as we said in the previous presentation; we have opened 6 for the first three months, we have almost 20 branches with a period of less than 2 years, the CASA there is around 42%.

The overall strategy is while the more older branches which are beyond 6 years continue to improve their existing CASA, and as I said the newer branches are actually continuing to deliver improved CASA as and when they open, because their focus is on CASA, our attention continues to be on the middle two clusters, which are those branches with a heritage of 2-6 years.

So our attention is really to work with them and get them to improve continuously month after month their contribution to CASA. Of course the dual challenge for this year in the midst of a steadily rising money market regime, is not only to focus on the CASA, but to also, at the same time, drive the growth of the overall deposit base because every billion in deposits means less reliance on money market. So it is a challenge to balance not just the CASA KPI but the overall growth in deposits and less reliance on money market and overnight funding. So on these drivers; I think we are very clear in our focus and, consistency in attention.

(Slide 9) This slide talks about few of the awards which we got in the last six months but I think that's of less relevance and we need to focus on the numbers. So with your permission I will move on to the overall performance.

(Slide 11) This shows a snapshot of the performance summary for the first quarter vis-a-vis the similar period for 2015. Operating income has grown by 7% with the operating expenses growing at a faster pace of 10%. With your permission, I will take to you to the next slide and bring you back to this slide.

(Slide 13) The gross income has increased by 20%. The asset re-pricing has helped us, along with volumes to achieve this and I guess the re-pricing of the assets, in all categories continue month after month from around mid-January to bring in those results.

From the overall gross basis, if we take the three elements, interest income itself has grown by 22%. Net fee and commission income has increased by 13%. If you take the elements of fees and commission income, Corporate and Retail banking continue to show good growth in the fee and commission income. Project Finance which tends to be more structured, whilst growing the book very intelligently, continues to have a challenge in the type of fee they are able to generate.

So the focus is really in leveraging the fees and commission from Corporate and Retail banking. And we will come to more details as we go on. On the other income itself, we have seen a growth of 7%. If we look at the three clusters you see on the slide, LKR 44 million YoY increase on the gain from financial investments were mainly from the realization of some bond trading/ bond sales which took place during the quarter.

The LKR 187 million net gain from trading, which comes from the trading portfolio is from forex income. In the first quarter we had from our own point of view, within our risk framework, a fairly challenging
quarter given the amount of flexibility the Bank was given by the regulatory framework to maneuver in terms of Forex trading. So that was a challenge, which I guess was also a challenge for the industry. But it moderated us as to what we could do and what we could not do.

(Slide 11) Then if I go back to the overall expenses slide, the operating expenses have increased by 10%. Now this has two components. We have the administrative cost and we have the payroll. The payroll has increased by a modest 8.4%, despite the salary revisions for 2016, which shows that the cost under payroll has been contained. The other expenses which relate to administrative expenses including the cost of opening new branches have increased by 12.4% during this period. That is despite opening six new branches for the first quarter. So I think we are pleased with the manner in which our cost structure has been optimized for the first quarter. The focus on that particular attribute will continue to be as intense as possible.

Profits to shareholders have reduced by 37% in relation to the first quarter of 2015. Let me take your attention to the next slide (Slide 12) and look at the dip of 37% and segment that to the four elements which make up that.

Net interest income has grown by 4%. Operating income including other income has grown by 7%. The operating expense base has been contained to 10%, with the two elements which I just described. What has dragged us down there is impairment. We are seeing impairment grow during this quarter to LKR 546 million against a reversal of LKR 64 million in the first quarter of last year.

This LKR 546 million has two elements ladies and gentlemen. It has LKR 350 million of specific individual impairments and LKR 196 million of collective impairment. Collective impairment is a factor of portfolio growth as well as various multitudes of factors which are internal and external to the organization, in accordance with the Board approved collective impairment policy. I guess if I look at the collective factor, I guess the indicators, especially some of the external indicators given the moderation in GDP growth, given the moderation in terms of the country downward rating and a few other ratings which also had a composite impact on the overall LGD factor. This would have also necessitated an improvement or increase in the overall collective impairment despite a modest 3% in the loan growth. So that was one aspect. But if we go back to the more specific item of the LKR 350 million, we have one item, one single group which gave rise to a specific impairment of LKR 388 million.

That was in the textile and apparel sector. It is not systemic or reflective of that sector as a whole. Because if I take your attention very briefly to a slide ahead of us (Slide 17), if you look at this particular slide, the bottom chart shows that our exposure to the textile and the garment sector represents just 9% of the loan book. On the bottom right had side, the last bar of the bar chart shows a 6.9% of NPLs to this sector, which was mainly spiked with this LKR 388 million single impairment.

If we take that single item out of the NPL for that particular sector, the 6.9% is actually 3.2%, which is well comparable to agriculture or trading which gives right to us to believe that this is not systematic or symptomatic of that sector. It is a single loan which went bad, which we have with objective evidence chosen to provide for and certainly the recovery efforts will continue. We will as times goes by, give you an update as to where we think and what we can salvage out of it.

But what we are very clear of is that the particular loan as a group has been fully provided for and there is nothing else to take forward. So we have cleaned that particular item up. And the point that I am
trying to say is that it is a single item which is not reflective of an emerging trend. So if we take that and look at the overall operating profit, we saw a dip of 37% in PAS - Profit attributable to shareholders against Q1 2015. And if I may articulate that if we exclude that single item of LKR 388 million which was a one off, non-sector specific impairment, is that, the 37% dip would actually come down to 5%, which is a reflection of where we are comparing apples with apples. I think in terms of levers and KPIs, we are very focused on where we think the Group is going, where the Bank is going and how we are managing the portfolio and impairment in relation to growth.

We believe that this particular impairment which we took head-on in Q1 will tail off and it will not be symptomatic or be a sign of continuity for the next three quarters. Because we have something projected for the full year, and this takes the brunt of that in Q1 2016.

(Slide 12) In terms of taxation, it is much higher than the previous year. During the last investor webinar too, there was a question on taxation, so we would like to take that question upfront as it is a probable question. Our effective tax rate for this quarter is 47%, in terms of the taxation regime. But in December 2015, it was 19.87%. That is because in the last quarter of the last year, there was a bulk of, higher amount of specific provisions which were claimed against the overall taxation remitted. And also we had a much larger component of exempt income which resulted in the effective tax coming down to 20%. But this year on Q1 we have gone back to normalization at the 47%. So I hope that clarifies the taxation element.

(Slide 14) On the expenses, we have discussed the key elements on operating expenses and staff cost. Again to reiterate, staff cost increase is 8.4% YoY and the increase in other costs, which is mainly administration cost including the cost of opening new branches, which is moderated below 13% at 12.4%. This is something that we are very pleased about.

(Slide 15) When we get to the Balance Sheet, and analyze the asset mix, we see 68% of the asset composition being loans, of which 76% is LKR loans and 24% is foreign currency loans. Again as a strategy, this bank works on an Opex model with a minimal investment in fixed asset unlike some of the larger and legacy banks. So we see fixed assets representing a mere 1%. Cash and cash equivalent is 7% along with investments representing 22% which are asset pools which we believe are controllable within our management ability.

In term of 68% in loans, this particular number has not shifted materially in the last quarter, and is consistent with our strategy.

On the liability side, we see deposits accounting for 62% of the liability pool with a 75% - 25% combination of local currency and foreign currency deposits. Couple of comments here, 68% of the asset book, which is loans, is funded 62% by deposits, indicates a good sign. What is a not so good sign which is a challenge but also an opportunity for us is, 20% of the liability mix coming from debt securities and borrowings.

Of this 20%, 5% reflects money market borrowings, and that is where we see the threat of spikes which are beyond our control. The challenge as well as the opportunity to us is, to as much as possible minimize the reliance on money market borrowings during the next three quarters. This means we need to grow our deposits at a much faster rate. During the first three months, our deposits book has grown...
by 6% which is much faster than loans but our overall year aspiration is to grow the deposits in excess of 25%.

I think we are on track, but we need to hopefully exacerbate that projection, so that month on month, we reduce the reliance on money market borrowings. We are highly conscious and mindful of this.

(Slide 16) - Loans and advances on a 5 year CAGR basis have showed a 26% growth. YoY growth is 23%. I think this is fairly reflective of the industry. So we are very pleased on that. What is noteworthy is when we look at the bottom left pie chart, we see Corporate banking accounting for 37% of the book which is a reduction of 5% from the previous full year, and that 5% of the pie has shifted 4% to Project Financing and 1% to Retail banking. So retail has gone up to 40% from 39%, and Project Finance has gone in to 23% from 19%.

This is a good movement in the mix, because as we always say, the positioning of the Bank today is to become the country's premier development oriented licensed commercial bank. So we are blending commercial banking with a very strong development pillar. This demonstrates that we have not moved away from development banking. We recognize the importance of Project Financing, which is medium to long term in tenor. We have seen that shift in the mix of our loan book. With the shift of course the opportunity is the medium to long term tailing of the asset base. But the challenge is the funding, to make sure that we fund and strike the right pricing. This is something which we are working on.

(Slide 17) It gives us a good sustainable pool of business to support our assets. On the asset quality, I already spoke about the key spike on the bottom right hand side, which was on textile and garment sector, which tells you that once we take away that one-off item, it is normalized to the other two bars at the bottom right hand side. What is pleasing to note is our retail book which accounts for around 21% of the book has a mere 1.9% in NPLs. We have got a sound risk management and a collection mechanism and our strategy is making sense. In terms of the gross NPL ratio, yes, two years ago, we had a clear gap of almost a one-on-one between the industry and NDB NPL ratio. We have seen the industry steadily coming down to just over 300 bps, whilst ours have remained literally flat from 2.5% in 2013 to 2.5% in 2016.

We can read it two ways that the industry has done better than us in terms of the NPLs. Another way of looking at it is, while being cognizant of the industry, our strategy which was spelt in the summer of 2013 was to improve our aggression on lending but to manage a tolerance of NPL around 200 bps, which remains unshaken. So I think from a strategic direction point of view, we have committed to our strategy, despite turbulences in the market. I think it is very important to demonstrate a commitment to a strategy.

(Slide 18) Customer deposits recorded a 5 year CGAR of 25%, with a YoY growth of 21%. The growth in Q1 has been 6%. When we look at the YoY 21% growth in deposits, against a 23% growth in assets, it is fairly balanced, but I would like to see it slightly flipped in favor of deposits. Ideally we would like to see a 4-5% gap between the deposit growth and loan growth. Because that will make a clear and marked difference in our reliance on money market borrowings and will definitely have a clear positive impact on the overall net interest income as well as bottom line, during the rest of the year. So it is something we have recognized as important to us.
The bottom right hand graph is the LCR - the liquidity coverage ratio. Over the last 15-16 months we have been consistently and well above the regulatory requirement of 100%. It is being monitored on a regular basis. Of course when we look at the deposit composition, the current accounts are at 9% which is well above the 7.5% once we look at the statutory reserve we kept with the regulator. Saying that, I would like to see the current accounts from 9% to perhaps beyond double digits, so it is an opportunity for us. CASA 9% plus 15% is 24%. I think we need to get to anything north of 30%. This is not something we are happy about. We are living with it, but we need to increase our CASA.

I think in 2016 if I look at the five levers, the top most lever for us, a top most priority for everybody at NDB is CASA, CASA and CASA. Everything else takes shelter under CASA and it is something which everyone is pushing for.

But I would like to, for the benefit of all of you, segment that 24% into two elements. The bulk of CASA comes from the branch network and the retail banking. If we look at the retail-SME CASA pool, this has two components, the branch network, as well as the privilege banking network. If we look at the 99 branches, they collectively account for a CASA pool of just under 30%. This means that they are projecting in the right upwards direction. But we have also got a priority privilege banking pool of around LKR 45 billion, which has a CASA contribution of 12%.

The positive thing was, this was around 2% two years ago, so again, the priority is also cross selling, and inch by inch increasing their contribution to CASA. So I think the positive thing we are taking is the overall contribution inch by inch moving up, towards that end goal to increase it to 30%. This is something, which in a rising interest rate regime will continue to be the top most challenge for NDB.

(Slide 19) Capital adequacy, from an overall total, we are at 14.9%, and well above the minimum requirement of 10%. In terms of Tier I we are at 10.8% on a Group basis against 5% minimum regulatory requirement. Our Tier I ratio has come down. We are mindful of that, which is mainly attributable to the asset growth achieved over the last perhaps two years.

This is something that is being looked at. We recognize that sometime during 2016, there will be a requirement to top up Tier I capital. I think the Bank has taken steps and engaged the target solution providers almost 6-9 months ago. We are in the tail end of discussions to come to a conclusion, which will help to boost the Tier I, which will hopefully take us to a medium term strategy of defending a 12% Tier I at group level.

We have taken 6 months to engage a multi-pronged level of discussion with potential stakeholders, who will be committed to a medium to long term pool of Tier I and make sure we derive the best value in that solution. Key thing ladies and gentlemen is, we identified this as a gap in 2014 summer and we have been working towards realizing a sustainable solution.

(Slide 20) The last slide on investor ratios shows you the EPS again as a reflection of the dip of 37% in PAS against Q1 of 2015. So we are very realistic about that. But the key point I want to drive home to you is, once we take off the one-off item, that 37% is about 5%. So we know that it is within our grasping and our reach.

One other thing I would like to bring to your attention is when we look at the book value per share, the LKR 168.80 which is a dip from the LKR 172/- of 2015 is attributable to two factors. In Q1, we paid out
around LKR 655 million as final dividend, resulting on an overall dividend payout for the year of LKR 11/- per share. That was one component. Secondly, the marked to market impact of the AFS book net of tax, was around LKR 638 million. So those two, cumulatively accounted for that LKR 4/- or so dip in the book value.

What I would like to focus is that, the marked to market gross impact in Q1 2016 was around LKR 820 million, that is now down to around LKR 300 odd million, as at April 2016. The second thing is our investment in Seylan Bank, which is reflected as AFS showed a marked to market dip of LKR 138 million in Q1. This has also reduced reasonably in April and May 2016. But we will come back to you in that, as we talk about Q2. So the key thing, those two items which come below the bottom line under comprehensive income certainly have an up and down, but I think as the conditions get better, you see the positive turn. But the key thing is, once you sit on a LKR 316 billion asset base, the Bank has the resilience and the risk appetite to ring-fence that and manage the process.

So I guess that concludes the commentary in terms of the performance and the numbers. I would like to leave a couple of important points with you. When we came to you as a management team towards the end of last year, we recognized four or five levers which were important for the success of the Bank for the next 1-2 year, given a margin compressing regime. They were asset re-pricing, better managing the cost of funding, containing and optimizing our cost structure and managing portfolio and making sure that our fees continue to increase its contribution to the overall bottom line. So if we look at those overall five leavers, I think we have got four of the five right, in terms of upward progression.

Asset re-pricing, containment of overall NPLs despite that one-off rise, cost management (not cost cutting), fee as a percentage of NII, on the upward trajectory are in place. Key challenge is CASA as well as our reliance or less reliance on money market borrowings. So I think we have identified that lever as one single lever which will remain as the top most among those five levers while we push those up again. While the positive momentum is on, we will continue to push those four, but the top most priority is the deposit growth and CASA.

So with those remarks, I would on behalf of the team, like to thank you ladies and gentlemen for joining with us today. More importantly as the medium to long term stakeholders of the Bank, for your understanding as to how we have understood these levers, and how we articulate as to how we manage those levers in the medium to long term interest of the Bank. We as a management team, with the support of the Board, have demonstrated the resilience in being able to keep our head above shoulders in challenging times and focusing on the end game. The end game was a 3-5 year strategy, with five levers, and our focus is relentlessly on addressing those levers. We will continue to keep you updated on how we progress in each of those five levers.

Thank you very much for your attention, and now I would like to take on any questions.
Questions and Answers session

Rajendra Theagarajah – Director/ Chief Executive Officer

Question 01 - What percentage of NDB’s loan book is at variable rates and what percentage of NDB’s funding is at variable rates?

The variable component is around 60% or more in terms of the loan book. In terms of the funding book, as I said the CASA overall is 24% funding. In terms of the deposits, you have 76% which is term, the bulk of it is between 3 months and 12 months, to give you some perspective.

Question 02 - What if the tax rate we should use for 2016?

I guess we have been consistent, I guess we should use the 47% which we have demonstrated in Q1. Anything as an improvement on that is what we call the icing on the cake, but I think we will continue to use the 47%, which is comparable to the industry.

Question 03 - To grow your deposits aggressively, you will need to raise the deposits rates, resulting in net interest margin compression. Please comment.

Yes, but also not yes. What as a bank we have done so far is, we have grown our deposit book in the last 12 months by 21%, which is reasonably comparable to the industry. But if my colleagues will endorse, we have not gone out and paid something more than what we should pay, because we also are a firm believer in service quality and product innovation. Similarly, if we look at what has been published so far, numbers are a bit early, but if we look at some of the banks which have come out, our 6% growth in deposits against 0.65% of the one of the larger banks, and I guess another bank which has again grown by a single digit, it shows that we are not immune or doing something completely different from the industry.

Of course our appetite and challenge is to try and grow the book slightly above the industry average, because we are smaller than some of the larger banks, and I think the opportunity is to get a larger share of the pie. But I think what we will not do is go relentlessly and pay an unusually high price. To do that, that will have a marked impact on our margins. We do recognize the importance of managing margins, by growing the asset book. That is the excitement to be able to manage a growing asset book, whilst also defending the margins. That is something which is done on a day to day basis.

Question 04 - Can you please comment on the expected increase in salaries?

As I said we have factored in, it is already taken in to account and the overall increase in average is around 10% for the year, and as already been factored in the April numbers, you can take that as done. It is very systemic with what we projected towards last year.
Question 05 - Did the Bank’s higher exposure in foreign deposits and loans contribute to lower NIMs?

Not really, if we looked at the last three months, our NIMs from the foreign loans have actually shown a steady increase, by may be 30 - 40 bps. But I think where the challenge has been in the first quarter has been on the corporate banking side, we have seen on the working capital a steady increase in asset re-pricing. Where we have seen some challenge is the Project Financing book, we have achieved around 17% overall, of the expected growth. And I think with that we would have seen some challenges. Of course of the retail banking book, if we strip the book to credit cards, the personal loan product which is the Dream Maker loan, Housing and Auto-financing, you will see that when you take away credit cards, the other four, when you have a 4-5 year tenor, and you start to re-price reflecting the upwards cost of funding, it has a slightly lag effect, in the pricing to actually blend in with the overall pool.

So we are mindful that that will take some time, to actually get factored into the overall pool. So we know that the off-take in the asset re-pricing in the retail book will take slightly longer than the corporate as well as the SME. On the other hand, the SMEs, where the overdraft is the main product, we have seen the re-pricing in the month of March alone growing up by almost 50 bps. So that is the positive side and also a challenge that we are managing intensively.

Question 06 - Again somebody is on taxation. Why 47%, should it not be 45%?

That is inclusive of 28% on Corporate tax and 15% on VAT and 2% on NBT. I am told that the 15% of VAT becomes effectively close to 17% once we factor in the adding back of the emoluments/ salaries. So on a gross per cent, it is 15, but when you have the effect, it works to around 17%. So I guess that clarifies it.

Question 07 - Do you expect to maintain your dividend pay-out ratio or will you maintain your dividends at LKR 11/-?

See, our biggest strength is our shareholders. Internally it is our staff. And our shareholders in particular, our medium to long term shareholders have stood by us and tested the impact of time. The minimum we can do to respect that commitment is to reward them. I think internally the management and I within the Board, is also of the belief that if we are consistent on our dividend payout, and if we continue to demonstrate and articulate our story in terms of strategic direction, if and when we need a top up and a commitment from the shareholders, you as a shareholder pool will reciprocate and oblige. So I do not think as a team, we believe that suppressing dividend payout is a good thing for investor management. And I am seeing the nods all around the table which tells us that. If there is a good story - a good medium term story, and a commitment to reward shareholders, we can always come back and ask. So I hope that answers the question.

Question 08 - Most of the banks have recorded significant trading income, and your trading income has declined. Please comment.

I guess if we are to be very consistent, trading has two components. Forex and trading in securities. If we look at forex, I guess NDB strategy has always - if you look at that slide on Governance structure and strategy (Slide 7), the house/ home has a very strong foundation on risk management, governance and compliance. We have always believed that when we look at trading, trading as much as possible must be backed by fundamental. There should be an underlying fundamental to trade and not speculation. Secondly, our core banking lending and providing customer solutions to a core group of customers
mainly funded by deposits. That trading part is a nice to have thing but remember that we have almost 700,000 retail customers, to whom we have our first priority is safety and security. So I think as a strategy, whilst trading is a component of our overall P&L, I do not think it is the most important component, given that we have a more important contribution and commitment for the safety and security of our customers. So it is nice to have in moderation, but I do not think as a strategy we go to maximize trading business. Core is very important to us.

**Question 09 - How many branches are we expected to add in the next three years?**

As I said, we added six new branches for the first three months. We hope to open our 100th branch hopefully, in the last week of this month and we will probably have about another 12 branches for the remainder of this year. And I guess, organically we will look at anything between 10 -15 branches per year in the next two years for 2017 & 2018. So it will be a consistent growth.

**Question 10 - The bank's potential capacity is more than LKR 1 billion per quarter. What do you think are the key issues that the bank needs to address to reach this level, in terms of profit?**

We are very mindful of that sir. Even for the Q2 we are very mindful of the billion per quarter. Because I think it is a LKR 4 billion plus profit organization. Of course, the plan for the year was to have a scaling up or a tapering up. For whatever reason we took, and I think for the right reason we took, that one off impairment head-on. And I think we have reasonable grounds to believe that during the rest of the year, there are no surprises in terms of the planned impairment. So I think with the Group also contributing in a manner which they are contributing, I think you are right, this bank has the potential of delivering anything north of 4 million. On average a billion per quarter.

So in terms of the key issues, throughout my remarks, I was very focused on those five attributes, and I think in conclusion, I reiterated those five, but I will reiterate it for your benefit. Upward step by step re-pricing of assets to reflect the rising interest rate regime, the importance of the deposit growth to minimize the impact of money market borrowings, and within that framework to step by step increase the contribution to CASA. The steadfast increase in fee income as a percentage of total net income, which has been happening but we have to continue.

Grow the book but also contain the NPLs. I think at 2.49% - 2.5%, in that direction. And then with all these four, to make sure that we do not lose focus on squeezing and getting a better extraction on the return on overall assets from an asset pool. Growing the asset book by another 20% or so is the aspiration for the year. But remember, we made some tremendous strides in the last two years. By growing that asset book from around the high 100 to more than 300 billion (LKR) at the end of last year, and we ended up last year with a ROA of around 1.1%. I think we have the capacity to get through anything north of 150 bps. So every additional 10 bps, even with the existing asset base, makes a significant improvement. We are, like you sir, very mindful of that not only as a challenge but more increasingly as an opportunity.
Question 11 - Most of the variable loan book is re-priced semi-annually and what is the share of semi-annually priced share in the variable book?

No sir, I would say, because the variable book of that 60 or so per cent, has two components. It has the long term book, and it has the working capital book. The working capital book in terms of overdrafts can get re-priced on a monthly basis. In terms of the variable book, some of the long term loans get even re-priced on a quarterly basis. Not necessarily six months basis, so it is a combination of the two. But we are mindful when the money market rises, or the PLR rises steadily, literally every week, even if the asset book is re-priced on a quarterly basis, there is still a lag. So we are very mindful of that.

Question 12 - What are the lending rates in the each segment of retail, SME, corporate and project finance?

See that is proprietary information which I would like to refrain from commenting. All I can tell you is on each of these elements, the Bank has an internal policy, which is debated, discussed and arrived at, at the ALCO. And we have put together, an internal structure, supported by Finance, but also championed by the Chief Credit Officer of the Bank that there is a complete shut, or the window is closed on any potential revenue leakages from special pricing. So any special pricing gets captured or escalated to the highest level of the organization. And there is a business justification to do that. So I think that is an operational initiative which contributes to the strategic direction, in terms of NIMs management.

Question 13 - What is your future market outlook on interest rates for the banking sector?

So as I said earlier on a macro outlook, when we look at what we are currently seeing, it is currently looking northwards, because you are seeing both the PLR & the inter-bank money market rates going up. My comment on this for NDB is, if at all if we see any moderation, there will have to be a couple of things. One is whether the Government’s overall revenue collection initiative will continue to improve to reduce public sector financial burden is one thing. Overall as you and I both know, there is publicly available information regarding the IMF program which is scheduled to come in Q3. And there are some discussions about complementary financing on commercial terms. If that comes, certainly it will reduce the impact on perhaps the foreign exchange strain on the country. It may also have some positive impact on the domestic liquidity which will certainly help to ease out interest rates.

But at this point in time, NDB is not factoring any downward revision in rates as part of our strategy for the next three months. It is looking at rates which will be marginally above what it is today.

Question 14 - Any further rate hikes expected?

I think I have just answered that. As bank itself, our pricing will be reflective of where we see the market going.

Contd.
Question 15 - What are the NIMs expected for the next two years?

If I recollect, I think we ended up the year at 2.6%. Our strategy for 2016 is to steadily increase that contribution towards the 300 bps. So before we talk about 2017 or 2018, I think we need to see the reflection of these four initiatives translating from 2.6 to 2.8 to 3.0. And that is what we like to see in the next three quarters. And we are pulling the right levers. And once we get to that, we will then look at 2017.

Question 16 - What is the expectation for the loan growth for 2016?

As we said earlier in the year, I think we project something like 23-24% for this year, against the deposit growth of around 26%. That is the expectation for the full year.

End of Q&A session.

So I guess we have had some very robust and meaningful questions, which tells me that you as a group have been very cognizant and engaging with the story. So we thank you for your patience and understanding. And I hope that the better understanding of the strategy will improve your understanding and your engagement with the bank. We look forward to have your continuous engagement. Have a very pleasant afternoon folks.

If there are any further individual questions, please feel free to send them to our investor team. We will be more than happy to continue this engagement. And I believe the more detailed presentation of this is already uploaded to our corporate website. And for those of you, who have not been able to dial in, it’s available - there will be a transcript and it will be hosted on our website as well.

Thank you very much again.

End of transcript.