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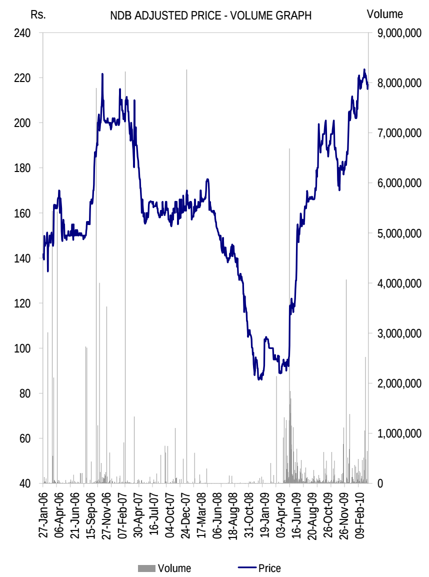
NDB Bank PLC (NDB)

Rs 217 .00 **BUY**

Financial Year (Dec)	Net Income	PAT (Rs.mn)	PAT& MI (Rs.mn)	EPS (Rs.)	EPS Growth	PER (x) Rs.	P/BV	Dividend Yield %	DPS Rs.	NAV Rs.	ROE
2007	4,746	1,387	1,272	15.54	25.43	13.97	1.52	2.76%	6.00	142.75	10.9%
2008	5,449	1,708	1,605	19.61	26.17	11.07	1.40	2.76%	6.00	154.69	12.7%
2009	6,793	2,121	2,085	25.47	29.91	8.52	1.25	2.76%	6.00	173.44	14.7%
2010E	7,455	2,508	2,307	28.18	10.66	7.70	1.08	2.76%	6.00	201.62	14.0%
2011E	8,786	2,969	2,731	33.37	18.40	6.50	0.92	2.76%	6.00	234.99	14.2%
2012E	10,344	3,506	3,225	39.40	18.08	5.51	0.79	2.76%	6.00	274.39	14.4%
2013E	12,256	4,178	3,843	46.95	19.17	4.62	0.68	2.76%	6.00	321.35	14.6%

NDB			
Reuters Code	NDB.CM		
Bloomberg Code	NDB.SL		
Issued Share Capital (Shares)			
Voting	81,855,385		
12 mth High/Low (Rs.)	225.00 / 88.25		
Average Daily Volume (Shares)	240,910		
Market Capitalisation Rs. mn	17,763		
Price Performance (%)			
	1 mth	6 mth	12 mth
ASPI	1.76	33.29	133.53
NDB	0.00	14.36	128.42



Profile

The National Development Bank was established through an act of Parliament in 1979 as one of two state owned Development Finance Institutions to provide project funding to the private sector and distribute credit lines received from multilateral agencies.

The bank was privatized in 1993 with the bank recording impressive growth in the mid to late '90s with total assets growing at a CAGR of 20.25% from 1995 to 2000.

The banks' main source of funding in the nineties was the concessionary credit lines obtained from multilateral agencies. However realizing that credit lines from such sources are likely to reduce with the country achieving certain benchmarks of development, the bank sought to enter the commercial banking arena via the merger with NDB Bank (formerly ABN AMRO, Sri Lanka) giving it access to low cost retail deposits. NDB Bank was incorporated in 2001 as a separate commercial banking entity and was consequently merged with NDB to form NDB Bank in mid 2005 under the Companys Act.

NDB has over the last 8 years transformed its operations from a one-product project lending operation to a more diversified 'Universal Bank' offering retail banking, corporate banking, leasing, investment banking, stock broking and insurance in addition to its project finance division.

Financial Performance

The bank recorded a 29.91% yoy growth in earnings for FY09 to Rs. 2.1bn assisted by a 54% increase in other income which included capital gains on bond trading amounting to Rs. 733mn compared to a Rs. 1mn loss the previous year as well as capital gains on the sale of quoted and non quoted equities. The sale of non quoted investments were part of compliance with a directive of the Central Bank encouraging NDB to reduce exposure to non quoted securities it acquired in the past as part of project financing. Earnngs growth was also assisted by a modest 12% growth in net interest income as a result of a favourable rate variance despite negative loan book growth. Operating expense continued to be kept in check increasing by just 12% for the year while provision expense increased by 66% off a small base of just Rs. 172mn in FY08.

Loan Growth and Asset Quality

Total net loans and advances contracted by 1% in FY09 after declining by 7% in the first nine months of the year as the bank undertook a portfolio rebalancing exercise reducing exposure to certain sectors perceived to be under stress. Measures announced by the government in late FY09 to bring down interest rates at state banks has resulted in prime lending rates fuel some credit growth in the 4QFY09. Conclusion of Parliamentary elections in April and a likely reduction in import duties going forward should spur further demand for credit.

... increase in domestic and external trade in FY10 should see steady credit demand for its commercial lending portfolio with new branches in the North and Eastern provinces being set up by the bank in the 2H FY09. The bank is expected to benefit from credit demand from infrastructure projects for which it leverages on a comprehensive array of project financing skills that the bank has consciously sought to retain and develop over the last 30 years.

Loan growth in the bank for FY10 is expected at 15.2% next year while increasing to 20% in FY11 and beyond. The bank has diversified its loan book over the years from being a 100% long term project lender in 2001 to having a corporate lending portfolio accounting for 47% of its loan book with project finance and retail banking now accounting for approximately 30% and 23% respectively. Despite the contraction of the loan book in FY09, the banks retail lending portfolio increased by 12%

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The bank also rolled out credit cards in FY09 which should benefit from an anticipated upturn in retail consumer credit demand. Retail lending however will continue to be driven by focused segments of housing loans leasing, and personal loans including mortgage backed education loans and personal consumption loans.

The banks asset quality continues to remain the best among local private commercial banks with a reported gross and net NPL ratio of 2.58% and 0.62% respectively as at end FY09.

Funding and Capital

Customer deposits now account for over 59% of total funding as at end FY09 from being almost entirely funded by government and multilateral sources in 2001. The bank has been competitive in its deposit rates which have enabled the bank to out pace peers in its deposit growth in recent years. The banks cost of funds are however higher than more peers such as COMB, HNB and SAMP which enjoy a larger proportion of low cost savings deposits to total deposits. Time deposits at NDB account for 77% of total customer deposits with demand and low cost savings deposits accounting for 9.5% and 13.5% respectively.

Deposit growth for FY09 was 61% with the commercial banking sector benefiting from a loss of consumer confidence over the safety of deposits in non banking financial institutions since mid 2008. Deposit growth FY10 onwards is expected at 20%. New branches opened in the north and east as well as the role out of competitively priced savings products will attract an increasing amount of low cost savings deposits but we do not envisage a significant shift in the deposit mix in the short term.

The banks Tier 1 and Total capital stood at 14.80% and 17.37% respectively as at 31st December 2009, well above minimum statutory requirements of 5% and 10% respectively.

Interest Income

The bank has as with other peer banks managed to hold onto and marginally widen its net interest margins with a sharp decline in yields on government securities enabling the banks to re-price its liabilities downward ahead of a more significant downward revision in lending rates in the 4Q FY09. Net interest margins are expected to remain around 4.0% given competitive pressures in lending and attracting of deposits.

Non-Interest Income

Other income has increased significantly in FY09 on the back of gains on bond trading portfolios helping to offset lower interest income from negative loan growth. Trade finance activities are expected to increase with a reduction in lending rates, the withdrawal of additional credit margin requirements for import of goods as well as the likely reduction in import duties. A stable SLR to the US$ is expected to result in muted foreign exchange income while active treasury operations and fee based commissions should see non interest income continuing to account for approximately a 35% - 40% of total net income.

Operating Expenses

NDB continues to record a relatively low cost to income ratio in comparison to peers.

NDB continues to record a relatively low cost to income ratio in comparison to peers. Centralisation of processes and increased use of technology across all operations has enabled the bank to steadily curtail operating expenditure. Further centralization of support functions in the bank is expected to result in further modest improvements in the cost to income ratio.

Outlook

Insurance Business: The bank holds 41.14% of Eagle Insurance PLC, with Aviva PLC having controlling interest of the entity. Eagle insurance PLC is the 3rd and 5th largest insurance company in the Life and Non Life insurance business in Sri Lanka respectively with a market share of 18.39% in Life and 5.97% in Non Life. The company contributed Rs. 526mn in associate company earnings in FY09 and is expected to contribute Rs. 578m in FY10.

Consolidation: The bank has repeatedly voiced the need for consolidation in the banking sector; a position that we also subscribe to along with most players in the banking sector. Rationalisation of costs as a result of a merger or acquisition will be substantial improving ROE levels from the present muted 12% - 13% levels at the bank. In addition NDB being a well managed highly capitalized bank with a modest branch network of about 42 branches makes it an attractive entity to partner with.

NDB Bank has been actively looking for M & A opportunities in the sector and has repeatedly voiced its desire for inorganic growth While we feel consolidation in the banking sector is inevitable given the value that can be unlocked from an ROE perspective; issues pertaining to ownership restrictions on banks, strong employee trade unions have among others issues discouraged consolidation thus far.

Valuations

Earnings growth forecasts of 10.66% in FY10 and 18.4% in FY11 correspond to a PER of 7.70x and 6.50x respectively at a market price of Rs. 217.00 and a corresponding P/BV of 1.25x based on the NAV as of 31st December 2009. The counter currently trades at a 9.6% discount to the sector and a 34% discount to the market.

Income Statement For the Year Ended 31st December	2006 Rs. 'mn	2007 Rs. 'mn	2008 Rs. 'mn	2009 Rs. 'mn	2010E Rs. 'mn	2011E Rs. 'mn	2012E Rs. 'mn	2013E Rs. 'mn	2014E Rs. 'mn
Income	8,204	9,822	12,522	14,167	15,303	17,188	19,547	22,647	26,531
Interest Income	6,076	8,599	10,860	11,607	12,487	13,724	15,390	17,659	20,545
Less: Interest Expense	3,223	5,076	7,073	7,374	7,848	8,402	9,203	10,391	11,994
Net Interest Income	**2,853**	**3,522**	**3,787**	**4,233**	**4,639**	**5,322**	**6,188**	**7,268**	**8,551**
Income Operatiing Leases	7	-	-	-	-	-	-	-	-
Depreciation - Operating Leases	(6)	-	-	-	-	-	-	-	-
Other Income	2,127	1,224	1,662	2,560	2,816	3,464	4,156	4,988	5,985
Net Income	**4,979**	**4,746**	**5,449**	**6,793**	**7,455**	**8,786**	**10,344**	**12,256**	**14,536**
Less Operating Expenses									
Personnel Costs	817	932	1,129	1,281	1,435	1,636	1,881	2,163	2,488
Provision for staff retirement benefits	13	17	22	19	24	32	41	53	69
VAT on Financial Services	466	476	558	847	930	1,096	1,290	1,528	1,813
Loan losses and Provisions	13	65	116	286	111	159	189	212	223
Other Overhead expenses	923	1,102	1,237	1,457	1,676	1,944	2,275	2,684	3,167
Total Expenses	**2,233**	**2,593**	**3,062**	**3,891**	**4,176**	**4,866**	**5,676**	**6,641**	**7,760**
Profit from Operations	**2,747**	**2,153**	**2,388**	**2,903**	**3,279**	**3,920**	**4,668**	**5,615**	**6,776**
Add: Share of PBT of Assoc.	214	179	172	526	578	648	726	813	910
Profit before Tax	**2,961**	**2,333**	**2,560**	**3,428**	**3,858**	**4,568**	**5,394**	**6,427**	**7,686**
Less: Provision for Taxation	754	945	852	1,307	1,350	1,599	1,888	2,250	2,690
Profit after taxation	**2,207**	**1,387**	**1,708**	**2,121**	**2,508**	**2,969**	**3,506**	**4,178**	**4,996**
Less: Minority Interest	176	115	103	37	201	238	280	334	400
Net profit for the year	**2,030**	**1,272**	**1,605**	**2,085**	**2,307**	**2,731**	**3,225**	**3,843**	**4,596**

Balance Sheet As at 31st December	2006 Rs. 'mn	2007 Rs. 'mn	2008 Rs. 'mn	2009 Rs. 'mn	2010E Rs. 'mn	2011E Rs. 'mn	2012E Rs. 'mn	2013E Rs. 'mn	2014E Rs. 'mn
ASSETS									
Cash and short-term funds	6,042	7,758	5,900	8,243	8,375	9,945	11,829	14,090	16,803
Government Securities	5,933	4,843	9,476	11,429	16,914	17,760	19,358	21,294	22,784
Commercial paper	605	414	-	-	-	-	-	-	-
Investment and Dealing Securities	6,237	9,848	9,016	20,699	28,564	33,706	38,425	43,804	50,375
Bills of Exchange	1,592	2,121	2,247	2,689	3,093	3,650	4,306	5,082	5,996
Loans and Advances	38,957	45,373	50,431	48,579	55,865	67,038	80,446	96,535	115,842
Lease Rentals Receivable	1,449	1,820	1,910	1,949	2,339	2,807	3,425	4,212	5,181
Group Balances receiveable	-	-	-	-	-	-	-	-	-
Investment in Assoc.	1,184	1,210	1,393	1,724	1,724	1,724	1,724	1,724	1,724
Interest and Fees receivables	420	504	-	889	-	-	-	-	-
Other Assets	1,691	1,165	925	2,033	(2,272)	(2,171)	(1,382)	(580)	699
Property, Plant and Equipment	1,892	2,004	1,981	1,937	2,228	2,562	2,946	3,388	3,896
TOTAL ASSETS	**64,977**	**76,143**	**83,280**	**99,286**	**116,830**	**137,020**	**161,077**	**189,549**	**223,301**
Financed By :									
Deposits form customers	21,161	25,624	31,091	49,948	59,556	71,040	84,769	101,187	120,825
Dividends Payable	108	170	250	344	181	181	181	181	181
Borrowings	29,204	34,147	34,993	29,591	34,326	39,818	46,189	53,579	62,151
Other Liabilties	2,624	3,102	3,716	4,550	5,696	6,178	6,909	7,729	8,675
Tax Payable	640	522	352	560	1,307	1,350	1,599	1,888	2,250
TOTAL LIABILITIES	53,097	63,043	70,050	84,433	99,758	117,216	138,048	162,676	191,832
Minority Interest	**1,314**	**1,415**	**568**	**687**	**568**	**568**	**568**	**568**	**568**
SHAREHOLDERS FUNDS									
Stated Capital	1,033	1,033	1,033	1,033	1,033	1,033	1,033	1,033	1,033
Statutory Reserve Fund	819	819	819	819	819	819	819	819	819
Reserves	8,715	9,833	10,811	12,345	14,652	17,384	20,609	24,452	29,049
Shareholders Funds	10,567	11,685	12,662	14,197	16,504	19,235	22,460	26,304	30,900
TOTAL LIABILITIES & CAPITAL	**64,977**	**76,143**	**83,280**	**99,316**	**116,830**	**137,020**	**161,077**	**189,549**	**223,301**

Ratio Analysis	2007	2008	2009	2010E	2011E	2012E	2013E
Price / Book Value	1.5	1.4	1.3	1.1	0.9	0.8	0.7
EPS	15.5	19.6	25.5	28.2	33.4	39.4	47.0
PER	14.0	11.1	8.5	7.7	6.5	5.5	4.6
EPS Growth	25.4%	26.2%	29.9%	10.7%	18.4%	18.1%	19.2%
DVD YLD	2.3%	2.3%	2.3%	2.3%	2.3%	2.3%	2.3%
ROE	10.9%	12.7%	14.68%	14.0%	14.2%	14.4%	14.6%
ROAE	11.4%	13.2%	15.5%	15.0%	15.3%	15.5%	15.8%
ROAA	1.8%	2.0%	2.3%	2.1%	2.2%	2.2%	2.2%
NIM	5.03%	5.07%	4.66%	4.11%	4.03%	4.00%	4.01%
Fee Income / Operating Income	26%	30%	38%	38%	39%	40%	41%
Cost / Income	53.3%	54.1%	53.1%	54.5%	53.6%	53.0%	52.5%
Cost / Income (Excl VAT)	43.8%	44.6%	43.6%	45.0%	44.1%	43.5%	43.0%
Cost / Average Assets	3.58%	3.70%	3.95%	3.76%	3.71%	3.68%	3.67%
Loan Growth	17.4%	10.7%	-2.5%	15.2%	19.9%	20.0%	20.0%
Asset Growth	17.2%	9.4%	19.2%	17.7%	17.3%	17.6%	17.7%
RWA Growth	20.4%	8.1%	19.2%	17.7%	17.3%	17.6%	17.7%
Loan/ Deposits	192.5%	175.6%	106.5%	102.9%	103.5%	104.0%	104.6%
Loan / Assets	64.8%	65.5%	53.6%	52.5%	53.6%	54.7%	55.8%
Deposit / Liabilities	48.3%	49.3%	71.3%	70.5%	71.2%	72.3%	73.3%
Equity / Assets	15.3%	15.2%	14.3%	14.1%	14.0%	13.9%	13.9%
NPL Ratio	1.67%	2.34%	2.58%	3.25%	3.00%	2.75%	2.50%
NPL Coverage	213.1%	146.7%	137.8%	110.0%	115.0%	120.0%	125.0%