

**NATIONAL DEVELOPMENT BANK PLC [NDB.N0000]****MAINTAIN BUY****EARNINGS SLIP ON ASSET QUALITY...****Fair Value: 2022E - LKR 85.0 [+39%]**

Total Return with DPS: 2022E - 42% [AER 55%]

NDB's earnings saw a drop of 25.0%YoY in the 4Q2021 to LKR 0.9Bn while the decline was led by significant rise in impairment by 82.2%YoY to LKR 3.6Bn in the midst of a strong loan growth and also in response to elevated risks caused by the pandemic. In addition, income tax expense increased by 161.4%YoY to LKR 437.1Mn further impacting the earnings. Considering the stress stemming from the macroeconomic landscape and expiry of moratoriums in 2022E we have increased our impairment expectations for 2022E while earnings were downgraded by 16.0% to LKR 7.5Bn. Consequently, fair value was also downgraded to LKR 85.0 for 2022E from LKR 110.0 considering the potential negative impact to earnings from higher impairment. However, at the current market price of LKR 61.0, 2022E fair value imply an upside of 39.0% **MAINTAIN BUY**

LKR (Mn)	4Q2020	4Q2021	YoY	2020	2021	YoY
<b>Earnings (LKR 'Mn)</b>						
Net Interest Income	4,114	5,724	+39%	17,925	21,741	+21%
Total Operating Income	6,481	8,411	+30%	26,404	32,996	+25%
Post Impairment Income	4,501	4,803	+7%	19,610	22,743	+16%
Pre Tax Profit	1,469	1,448	-1%	7,390	9,214	+25%
Net Profit	1,248	936	-25%	5,117	6,904	+35%
<b>Balance Sheet (LKR 'Mn)</b>						
Loans	425,682	502,345	+18%	425,682	502,345	+18%
Shareholders' Equity	47,976	62,727	+31%	47,976	62,727	+31%
NAVPS	206.2	175.7	-15%	206	175.7	-15%

**Earnings skid by 25.0%YoY led by higher impairment**

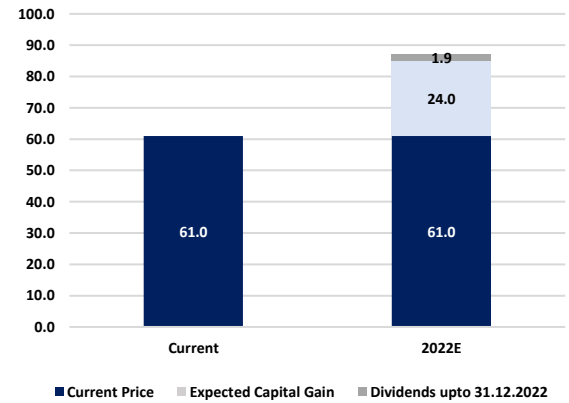
NDB recorded a decline of 25.0%YoY owing to the significant rise in impairment by 82.2%YoY to LKR 3.6Bn and rise in income tax expense by 161.4%YoY to LKR 437.1Mn. NDB saw a considerable increase in its impairment charges for the 4Q2021 compared to similar charges in 2020 as the bank consciously reviewed the stress levels of the customers in lights of the prevailing economic conditions and accounted for impairment charges on an individually significant basis as well as on a collective portfolio level basis. With regards to impairment provisions on foreign currency denominated government instruments, NDB increased such provisions up to LKR 2.0Bn, factoring in the revisions of the sovereign rating of the country. Despite the rise in impairment, core income grew by 30.0%YoY to LKR 8.4Bn amidst the surge in NII and net fee and commission income. NII grew to LKR 5.7Bn (39.1%YoY) benefitted by the enhancement in interest income up to LKR 14.0Bn (14.6%YoY) while net fee and commission income grew to LKR 2.0Bn (16.0%YoY) with exports related trade services becoming a key contributor in this aspect, while digital financial services and other asset products also contributing to the growth.

**NDB recorded a loan growth of 18.6% for 2021E in line with our expectations**

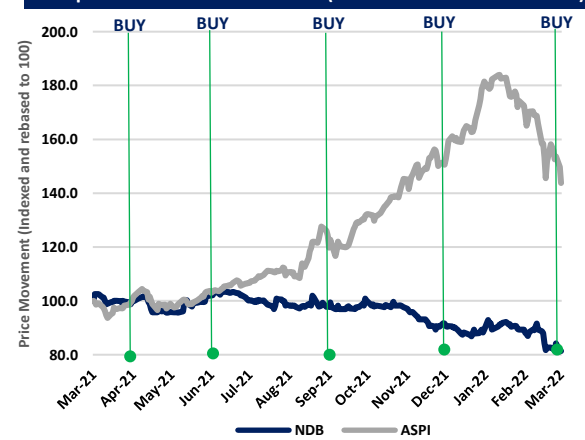
With its aggressive plans of increasing the market share, NDB clocked a loan growth of 18.6% as forecasted in the previous report while our estimated loan growth for 2022E is 15.0% which is above the private sector credit growth expectation of c.10.0%. Hence, we expect NII to improve amidst the strong loan book growth and potential rise in interest rates and thereby NII for 2022E and 2023E are expected to record a growth of 17.0%YoY and 15.0%YoY respectively. However, considering the expiry of moratoriums in 2022E, (nearly 15.0%-16.0% of NDB's loan book were under the moratorium as at Feb-22), its higher exposure to SME sector and foreign currency denominated government securities (as at end 2021 NDB had an exposure of nearly LKR 28.0Bn for sovereign bonds) we have increased our impairment estimate for 2022E by 34.2%YoY to LKR 12.4Bn.

**Fair value for 2022E was further downgraded to LKR 85.0- MAINTAIN BUY**

We have adjusted for the proposed surcharge tax of 25% (LKR 1.8Bn) in retained earnings of 2022E and VAT increase through 2022E earnings. Considering macro-economic headwinds and resultant negative impact, 2022E earnings were revised down to LKR 7.5Bn from previous estimates, while NDB's fair value was further downgraded to LKR 85.0 for 2022E. However, at the current market price of LKR 61.0, 2022E fair value imply an upside of 39% and trades well below its current book value of LKR 175.7 with a PBV of 0.4x. **MAINTAIN BUY**

**FIRST CAPITAL RESEARCH**

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[hiruni@firstcapital.lk](mailto:hiruni@firstcapital.lk)**Price performance of NDB vs ASPI (Indexed and rebased to 100)**

Source: CSE

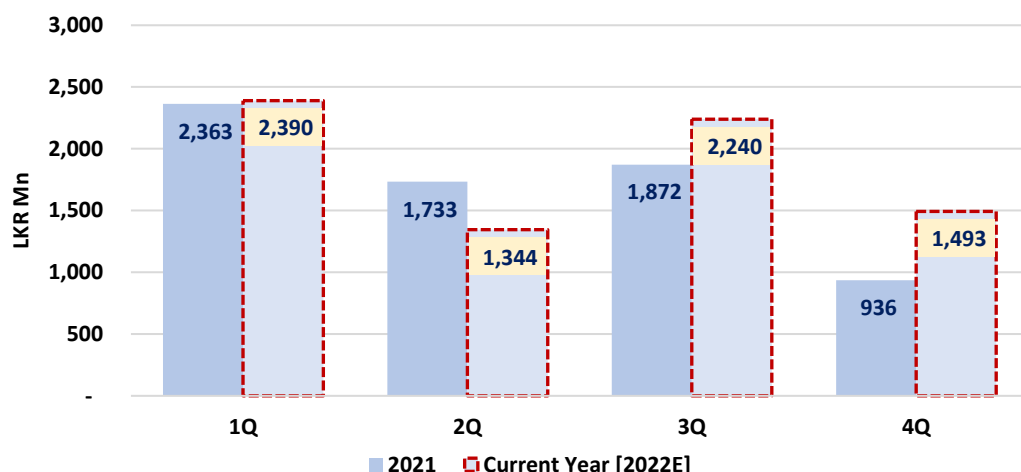
**Minimum Return for BUY:**

**Buy Below for 2022E [AER of 15.0% with DPS]: LKR 78.0**  
NDB categorized as 'Grade A' counter

**Disclosure on Shareholding:**

First Capital Group or the covering analyst did not hold 1% or more of the total outstanding share capital of NDB during the five trading days prior to the issuance of this document.

## Quarterly Earnings



## Estimate Revision

In LKR Mn	2022E - O	2022E - R	% Change	2023E - O	2023E - R	% Change
<b>Earnings Estimate</b>						
Net Interest Income	25,251	25,439	+1%	28,249	29,207	+3%
Total Operating Income	37,892	38,095	+1%	42,510	43,119	+1%
Post Impairment Income	28,635	25,670	-10%	34,209	31,176	-9%
Pre Tax Profit	11,914	9,933	-17%	16,129	13,916	-14%
Net Profit	8,880	7,467	-16%	12,022	10,461	-13%
Adjusted EPS	24.9	20.9	-16%	33.7	29.3	-13%
Net Profit Growth YoY	17%	8%		35%	40%	
<b>Balance Sheet Estimate</b>						
Loans & Advances	565,406	569,817	1%	617,304	618,361	+0%
Shareholders' Equity	69,046	67,657	-2%	78,181	76,998	-2%
<b>NAVPS (adjusted)</b>	<b>193.3</b>	<b>189.4</b>		<b>218.9</b>	<b>215.6</b>	
<b>Ratio Estimate</b>						
<b>ROE (%)</b>	<b>13.5%</b>	<b>11.5%</b>		<b>16.3%</b>	<b>14.5%</b>	
<b>PER (x)</b>	<b>2.8</b>	<b>2.9</b>		<b>2.1</b>	<b>2.1</b>	
<b>PBV (x)</b>	<b>0.4</b>	<b>0.3</b>		<b>0.3</b>	<b>0.3</b>	

## Valuation Table

P/E 31 December	2018	2019	2020	2021	2022E	2023E	2024E
<b>Estimates (LKR 'Mn)</b>							
Net Interest Income	15,104	17,971	17,925	21,741	25,439	29,207	32,223
Total Operating Income	22,553	24,806	26,404	32,996	38,095	43,119	47,406
<b>Net Profit</b>	<b>5,136</b>	<b>4,776</b>	<b>5,117</b>	<b>6,904</b>	<b>7,467</b>	<b>10,461</b>	<b>12,257</b>
Adjusted EPS (LKR)	14.4	13.4	14.3	19.3	20.9	29.3	34.3
Net Profit YoY Growth (%)	47%	-7%	7%	35%	8%	40%	17%
<b>Valuations</b>							
PER (x)	4.2x	4.6x	4.3x	3.2x	2.9x	2.1x	1.8x
PBV (x)	0.6x	0.5x	0.5x	0.3x	0.3x	0.3x	0.2x
DY (%)	13.1%	11.5%	2.5%	3.2%	5.1%	9.6%	11.3%
NAVPS	109.5	121.5	134.3	175.6	189.4	215.6	244.1
Adjusted DPS	4.7	4.3	1.0	1.9	3.1	5.9	6.9
Dividend Payout	33%	33%	7%	10%	15%	20%	20%

## Valuation Summary

Expected NDB price	2022E
Justified PBV based target price	79.0
PER Valuation based target price	83.6
RI Valuation based target price	93.2
<b>Average Target Price</b>	<b>85.3</b>
<b>Target Price after Rounding off</b>	<b>85.0</b>

Return	2022E
Target Price	85.0
Current Price	61.0
Capital Gain (LKR)	24.0
Dividends upto 31st Dec (LKR)	1.9
Capital Gain %	39%
Dividend Yield %	3%
<b>Total Return %</b>	<b>42%</b>
<b>Annualized Return %</b>	<b>55%</b>

## Residual Income Valuation

Residual Income based Valuation	2022E
PV of Residual Income	-29,438
No. of Shares ('Mn)	357
RI per Share	-82.4
Opening Book value per Share	175.6
<b>Value per Share</b>	<b>93.2</b>

COE	2022E
Rf	10.0%
Rm	18.0%
Growth %	3.0%
$\beta$	1.66
<b><math>K_e = R_f + \beta(R_m - R_f)</math></b>	<b>23.3%</b>

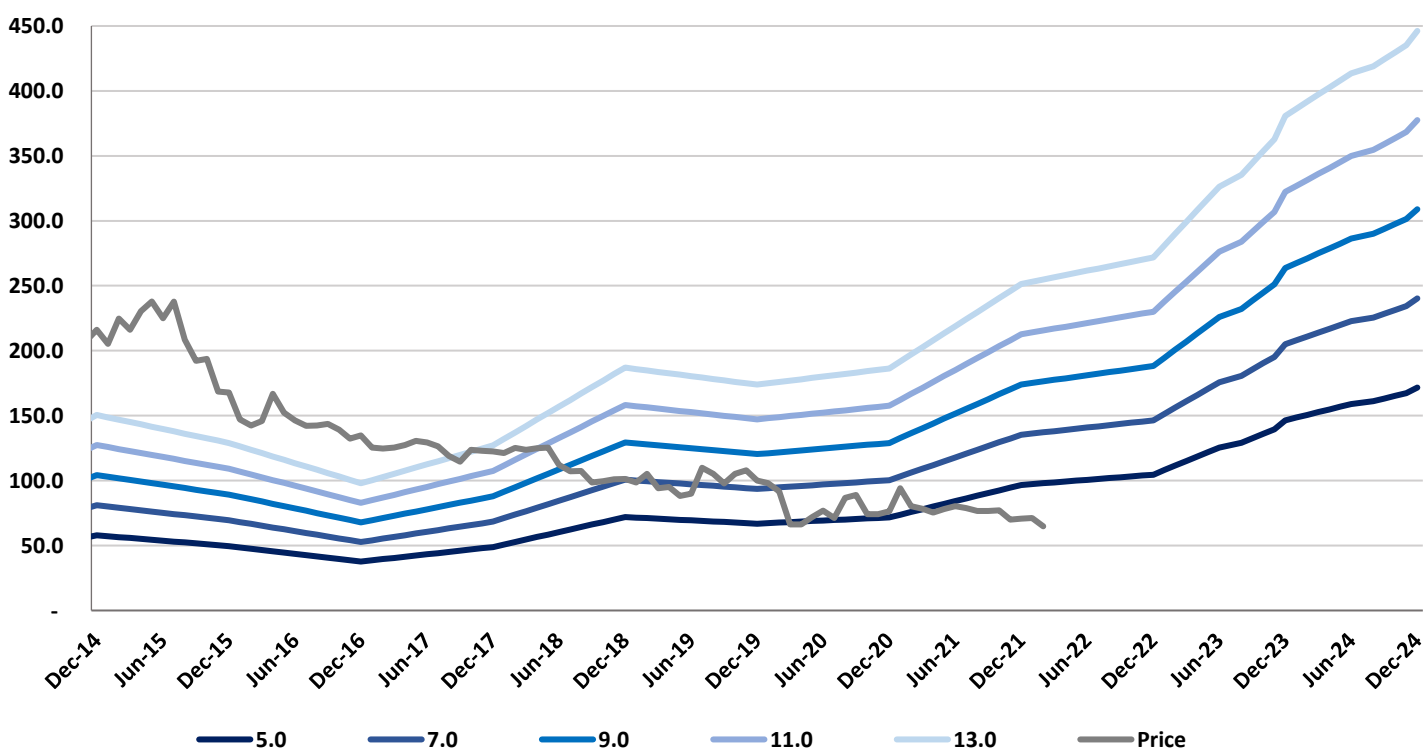
## Justified PBV Valuation

Justified PBV based Valuation	2022E
ROAE	11.5%
Growth	3.0%
COE	23.3%
PBV	0.42
NAVPS	189.4
<b>Target Price</b>	<b>79.0</b>

## PER Valuation

PER based Valuation	2022E
Earnings (LKR 'Mn)	7,467
No. of Shares ('Mn)	357
EPS	20.9
Expected PER	4.0x
<b>Price at 4.0x of Earnings</b>	<b>83.6</b>

## PER Chart



## Appendix I: Statement of Income and Expenses

Statement of Financial Performance (LKR Mn)	2018	2019	2020	2021	2022E	2023E	2024E
<b>P/E 31st Dec</b>							
<b>Gross Income</b>	<b>51,621</b>	<b>60,237</b>	<b>61,632</b>	<b>64,050</b>	<b>75,584</b>	<b>85,723</b>	<b>95,893</b>
Interest Income	44,622	53,402	53,153	52,795	62,928	71,811	80,710
Interest Expenses	-29,518	-35,431	-35,228	-31,053	-37,489	-42,604	-48,487
<b>Net Interest Income</b>	<b>15,104</b>	<b>17,971</b>	<b>17,925</b>	<b>21,741</b>	<b>25,439</b>	<b>29,207</b>	<b>32,223</b>
Fee & Other Income	7,450	6,836	8,479	11,255	12,656	13,911	15,183
<b>Total Operating Income</b>	<b>22,553</b>	<b>24,806</b>	<b>26,404</b>	<b>32,996</b>	<b>38,095</b>	<b>43,119</b>	<b>47,406</b>
Impairment (Charges)/ Reversal	-3,765	-4,405	-6,794	-10,253	-12,425	-11,942	-10,988
<b>Net Operating Income</b>	<b>18,788</b>	<b>20,401</b>	<b>19,610</b>	<b>22,743</b>	<b>25,670</b>	<b>31,176</b>	<b>36,419</b>
Less : Operating expenses							
Personal Expenses	-4,898	-5,460	-5,748	-6,323	-7,452	-8,313	-10,028
Depreciation and Amortization	-509	-883	-932	-914	-636	-685	-738
Other Operating Expenses	-3,959	-4,065	-3,721	-4,278	-4,706	-5,174	-5,689
<b>Op. profit before value added tax</b>	<b>9,422</b>	<b>9,992</b>	<b>9,209</b>	<b>11,229</b>	<b>12,877</b>	<b>17,005</b>	<b>19,964</b>
VAT on financial services	-1,938	-2,068	-1,819	-2,015	-2,943	-3,089	-3,659
Debt Repayment Levy	-235	-1,003	0	0	0	0	0
<b>Op. profit after value added tax</b>	<b>7,248</b>	<b>6,921</b>	<b>7,390</b>	<b>9,214</b>	<b>9,933</b>	<b>13,916</b>	<b>16,305</b>
Share of associate companies' profit	0	0	0	0	0	0	0
<b>Profit Before Tax</b>	<b>7,248</b>	<b>6,921</b>	<b>7,390</b>	<b>9,214</b>	<b>9,933</b>	<b>13,916</b>	<b>16,305</b>
Income Tax Expense	-1,972	-2,036	-2,173	-2,151	-2,319	-3,249	-3,807
<b>Profit for the Year</b>	<b>5,276</b>	<b>4,885</b>	<b>5,217</b>	<b>7,063</b>	<b>7,614</b>	<b>10,667</b>	<b>12,498</b>
Minority Interest	140	109	101	158	147	206	241
<b>Profit attributable to Equity Holders</b>	<b>5,136</b>	<b>4,776</b>	<b>5,117</b>	<b>6,904</b>	<b>7,467</b>	<b>10,461</b>	<b>12,257</b>
<b>Adjusted EPS</b>	<b>14.4</b>	<b>13.4</b>	<b>14.3</b>	<b>19.3</b>	<b>20.9</b>	<b>29.3</b>	<b>34.3</b>

## Appendix II: Statement of Financial Position

Balance Sheet (LKR Mn)	2018	2019	2020	2021	2022E	2023E	2024E
<b>As at 31st December</b>							
<b>ASSETS</b>							
Cash and cash equivalents	7,170	6,081	10,779	13,772	30,008	43,927	43,308
Balances with Central Bank	15,546	13,887	6,812	16,403	23,373	25,931	28,524
Placements with banks	15,237	6,291	12,402	8,299	9,879	5,433	5,977
Derivative financial instruments	3,938	1,596	1,429	1,338	1,499	1,649	1,814
Financial assets recognised through profit or loss	4,052	3,489	7,713	4,784	5,358	5,894	6,483
Loans and advances to customers	344,276	396,672	425,682	502,345	569,817	618,361	673,910
Financial assets at amortised costs	24,175	27,486	44,712	54,263	37,044	37,353	41,088
Financial assets measured at Fair value through OCI	54,487	68,430	108,763	89,717	92,611	101,872	112,059
Other assets	2,933	3,228	3,595	5,671	6,351	6,986	7,685
Intangible assets	397	701	1,062	1,217	1,007	969	922
Deferred tax	1,101	647	1,946	3,443	3,443	3,443	3,443
Property, plant & equipment	3,144	3,565	3,541	3,735	3,814	3,911	4,028
Investment properties	2,111	2,273	2,362	2,528	2,528	2,528	2,528
<b>Total assets</b>	<b>478,596</b>	<b>535,600</b>	<b>632,132</b>	<b>708,802</b>	<b>788,018</b>	<b>859,543</b>	<b>933,055</b>
<b>LIABILITIES</b>							
Due to Banks	15,047	18,380	24,173	24,821	26,488	29,354	31,926
Derivative financial instruments	2,907	729	1,017	1,049	1,189	1,291	1,407
Due to customers	347,170	404,668	489,659	551,257	617,407	679,148	747,063
Debt securities issued and other borrowed funds	43,423	30,740	35,784	26,570	31,327	30,227	29,257
Tax liabilities	3,175	2,342	2,563	2,586	2,788	3,906	0
Other liabilities	8,838	9,807	8,435	9,094	10,315	11,194	12,199
Subordinated term debts	16,812	23,109	19,881	27,961	27,961	24,335	20,708
Deferred Tax	513	567	596	569	569	569	569
Employee benefit liabilities	502	719	820	830	830	830	830
<b>Total liabilities</b>	<b>438,386</b>	<b>491,061</b>	<b>582,928</b>	<b>644,736</b>	<b>718,875</b>	<b>780,854</b>	<b>843,960</b>
<b>EQUITY ATTRIBUTABLE TO PARENT</b>							
Stated capital	6,469	7,685	8,794	18,264	18,264	18,264	18,264
Statutory reserve fund	1,636	1,896	2,196	2,571	2,571	2,571	2,571
Investment Fund	337	571	842	-839	-839	-839	-839
Retained Earnings	30,668	33,230	36,143	42,731	47,660	57,002	67,167
<b>Equity attributable to parent</b>	<b>39,111</b>	<b>43,383</b>	<b>47,976</b>	<b>62,727</b>	<b>67,657</b>	<b>76,998</b>	<b>87,163</b>
Non-controlling interests	1,099	1,155	1,227	1,339	1,486	1,692	1,933
<b>Total Equity</b>	<b>40,210</b>	<b>44,539</b>	<b>49,203</b>	<b>64,067</b>	<b>69,143</b>	<b>78,690</b>	<b>89,095</b>
<b>Total liabilities and total equity</b>	<b>478,596</b>	<b>535,600</b>	<b>632,132</b>	<b>708,802</b>	<b>788,018</b>	<b>859,543</b>	<b>933,055</b>
<b>Adjusted NAVPS</b>	<b>109.5</b>	<b>121.5</b>	<b>134.3</b>	<b>175.6</b>	<b>189.4</b>	<b>215.6</b>	<b>244.1</b>



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