

**NATIONAL DEVELOPMENT BANK PLC [NDB.N0000]****MAINTAIN BUY****“EXCEPTIONAL GAINS IN THE WAKE OF RECOVERY”****Fair Value: 2024E - LKR 150.0 [+129%]**

Total Return with DPS: 2024E - 138% [AER 130%]

NDB's earnings surged by over threefold in 3Q2023 to LKR 3.0Bn (+385.2%YoY and +95.8%QoQ) underpinned by a substantial expansion in the non-fund based income category soaring by 527.8%YoY and 313.5%QoQ to reach LKR 4.0Bn. The increase was primarily driven by variations in exchange rates and interest rates compared to 2022. Notably, 3Q2023 performance exceeded expectations, and with improving certainty and business confidence stemming from macroeconomic factors such as interest rates, exchange rates and inflation stabilizing over the year, we have upgraded the bottom-line by 34.4% to LKR 8.5Bn for 2024E. Consequently, we have slightly upgraded the fair value to LKR 150.0 for 2024E to reflect the anticipated increase in earnings. However, at the current market price of LKR 65.6, 2024E fair value implies an upside of 128.7%. **MAINTAIN BUY**

LKR (Mn)	3Q2022	3Q2023	YoY	9M2022	9M2023	YoY
Earnings (LKR 'Mn)						
NII	7,323	9,501	+30%	22,413	24,834	+11%
Total Operating Income	9,607	15,693	+63%	32,662	35,085	+7%
Net Operating income	1,313	9,631	+634%	10,446	21,130	+102%
PBT	-1,643	4,436	+370%	394	7,576	+1824%
Net Profit	-1,083	3,030	+380%	641	5,421	+745%
Balance Sheet (LKR 'Mn)						
Shareholders' Equity	67,505	76,074	+13%	67,505	76,074	+13%
Loans	545,920	473,299	-13%	545,920	473,299	-13%
NAVPS	177.6	190.4		177.6	190.4	

Earnings skyrocket by 385.2%YoY defying tax challenges

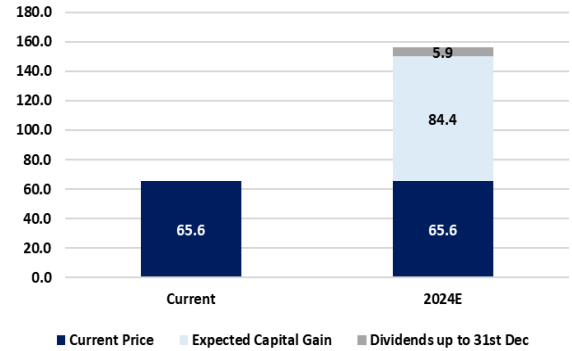
In the face of escalating tax expenses, NDB achieved a significant 385.2%YoY increase in the bottom-line, driven by a noteworthy 20.9%YoY rise in core income, amounting to LKR 36.8Bn. This growth was propelled by a surge in NII, net fee and commission income, and non-fund based income. NII expanded to LKR 9.5Bn, marking a 29.7%YoY increase, primarily attributed to a rise in interest income reaching LKR 30.6Bn (8.7%YoY). Concurrently, the bank repriced its deposit book, achieving a NIM of 4.03%, and concluded with customer deposits at LKR 627.3Bn, reflecting a reduction of 6.6%YoY, partly influenced by LKR appreciation on foreign currency denominated deposit book. Consequently, the NDB's CASA ratio stood at 21.6% for 9M2023, increasing from 19.5% reported during 6M2023. Furthermore, net fee and commission income also played a pivotal role in boosting the bottom line, exhibiting improvement to LKR 2.1Bn (+30.9%YoY). This enhancement was propelled by the bank's concerted efforts in transactional activities, aligning with a broader objective of supporting the economy, particularly in trade-related services that augmented fee income amid a moderate expansion of the loan book. Non-fund based income categories, including net gains from trading, net gains from financial assets at FVTPL, and net gains on derecognition of financial assets, experienced an exponential increase of 527.8%YoY. This surge was attributed to variations in exchange rates and interest rates compared to 2022. However, we expect NIMs to contract in 2024E by 4.2%YoY due to the downward re-pricing of the lending rates reflecting the cumulative reduction of 550bps in key policy rates during 2023.

Impairment plunges by 26.9%YoY amidst credit quality headwinds

In 3Q2023, NDB demonstrated a continued gradual reduction in impairment charges, decreasing by 26.9%YoY to LKR 6.1Bn. This reduction was primarily due to the base effect of higher impairment provisions made for foreign currency investments during the corresponding period in 2022. However, NDB maintained provisions on investments in foreign currency bonds in anticipation of the expected announcement regarding the ISB restructuring later in the year. Despite recording a notable NPL ratio of 9.2% in 3Q2023, comparatively higher than its peers, NDB accounts for an impairment provisioning of 36.6%, reflecting industry-wide concerns about credit quality.

Loan growth dips by over 11.0%YoY due to higher interest rates and diminished demand

As of Sep-23, NDB witnessed a reduction of 11.2%YoY in gross loans, totaling LKR 514.5Bn. This decline was attributed to the combined impact of LKR appreciation, elevated interest rates and diminished demand for loans, influenced by the country's sluggish economic activity, persistent negative GDP growth, and declining consumer confidence in the preceding quarters. However, there has been a slight recovery in credit to the private sector, particularly after mid-year, driven in part by significant reductions in loan interest rates. With the gradual improvement in the overall economic situation (with GDP recording the first growth in 3Q2023 after the debt default, IMF approval of the 2nd tranche, etc.) there is an anticipation that the industry-wide decline in gross loans will shift into positive territory in the near future. Therefore, we project a loan growth of 12% for 2024E, below NDB's 10-year average loan growth of 17.0%. Furthermore, the expansion of economic activities and the easing of import restrictions is poised to stimulate trade and credit card operations which can also potentially increase NDB's fee-based income by 12% in 2024E.

**FIRST CAPITAL RESEARCH**

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Source: CSE

Minimum Return for BUY:

Buy Below 2024E [AER of 22.0% with DPS]: LKR 135.0
NDB.N categorized as 'Grade B' counter

Disclosure on Shareholding:

First Capital Group do not hold shares in NDB and will not trade in this share for three trading days following the issue of this document.



NDB remains well capitalized

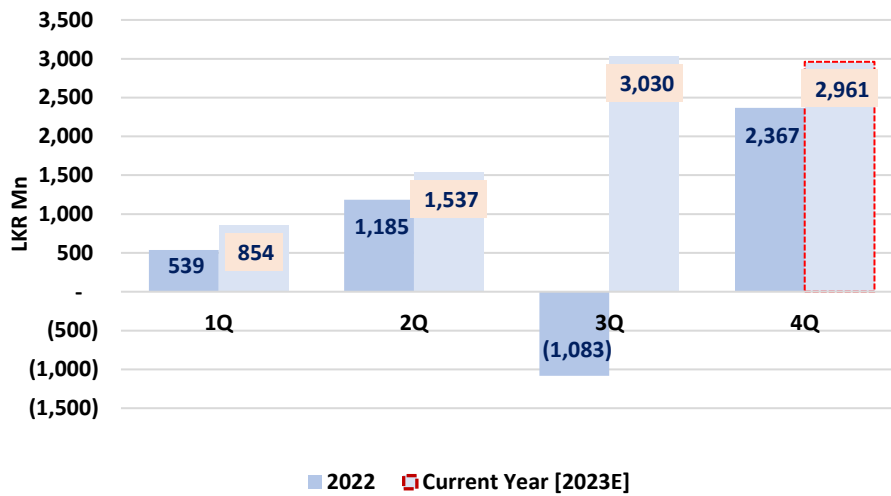
NDB reported a Tier 1 and Total Capital Adequacy Ratio of 11.54% and 14.87%, respectively, which is well above the minimum levels of 8.50% and 12.50% as of Sep-23. Furthermore, NDB has also announced plans to raise tier 2 capital via a debenture issue of up to LKR 10.0Bn by the end of Dec-23, to further strengthen its capital position.

Fair value for 2024E was further upgraded to LKR 150.0– MAINTAIN BUY

With the sustained recovery in GDP and the expansion of economic activities, we anticipate NDB to trade at 0.8x its PBV, translating to a fair value estimate of LKR 150.0 for 2024E, signifying a significant 129% upside from the present market price of LKR 65.6. **MAINTAIN BUY**



Quarterly Earnings



Estimate Revision

In LKR Mn	2023E - O	2023E - R	% Change	2024E - O	2024E - R	% Change
Earnings Estimate						
Net Interest Income	27,956	30,991	+11%	29,119	27,023	-7%
Total Operating Income	36,437	49,638	+36%	37,195	47,385	+27%
Net Operating Income	22,461	30,426	+35%	26,437	31,678	+20%
Profit before Tax	6,677	11,879	+78%	8,582	10,813	+26%
Net Profit	4,908	8,382	+71%	6,308	8,477	+34%
Adjusted EPS	12.3	21.0	+71%	15.8	21.2	+34%
Balance Sheet Estimate						
Loans & Advances	604,311	466,468	-23%	675,452	524,134	-22%
Shareholders' Equity	72,526	73,737	2%	77,249	79,943	+3%
NAVPS (adjusted)	181.6	184.6		193.4	200.1	
Ratio Estimate						
ROE (%)	7.0%	11.9%		8.4%	11.0%	
PER (x)	5.0	3.1		3.9	3.1	
PBV (x)	0.3	0.4		0.3	0.3	

Valuation Table

P/E 31 December	2020	2021	2022	2023E	2024E	2025E
Estimates (LKR 'Mn)						
Net Interest Income	17,925	21,741	31,130	30,991	27,023	29,940
Total Operating Income	26,404	32,996	44,448	49,638	47,385	50,274
Net Profit	5,117	6,904	3,009	8,382	8,477	9,637
Adjusted EPS (LKR)	12.8	17.3	7.5	21.0	21.2	24.1
Net Profit YoY Growth (%)	7%	35%	-56%	179%	1%	14%
Valuations						
PER (x)	5.1x	3.8x	8.7x	3.1x	3.1x	2.7x
PBV (x)	0.5x	0.4x	0.4x	0.4x	0.3x	0.3x
DY (%)	2.3%	8.4%	0.0%	9.0%	9.1%	10.3%
NAVPS	120.1	157.0	169.0	184.6	200.1	218.5
Adjusted DPS	1.0	5.5	0.0	5.9	5.9	6.8
Dividend Payout	8%	32%	0%	28%	28%	28%



Valuation Summary

Expected NDB price	2024E	Return	2024E
Justified PBV based target price	160.1	Target Price	150.0
Residual Income based Valuation	148.3	Current Price	65.6
PER Valuation based target price	148.6	Capital Gain (LKR)	84.4
Average Target Price	152.3	Dividends upto 31st Dec (LKR)	5.9
Target Price after Rounding off	150.0	Capital Gain %	129%
		Dividend Yield %	9%
		Total Return %	138%
		Annualized Return %	130%

Residual Income Valuation

Residual Income based Valuation	2024E	COE	
PV of Residual Income	-14,486	Rf	11.0%
No. of Shares ('Mn)	399	Rm	19.0%
RI per Share	-36.3	Growth %	3.0%
Opening Book value per Share	184.6	β	1.20
Value per Share	148.3	$Ke=Rf+\beta(Rm-Rf)$	20.6%

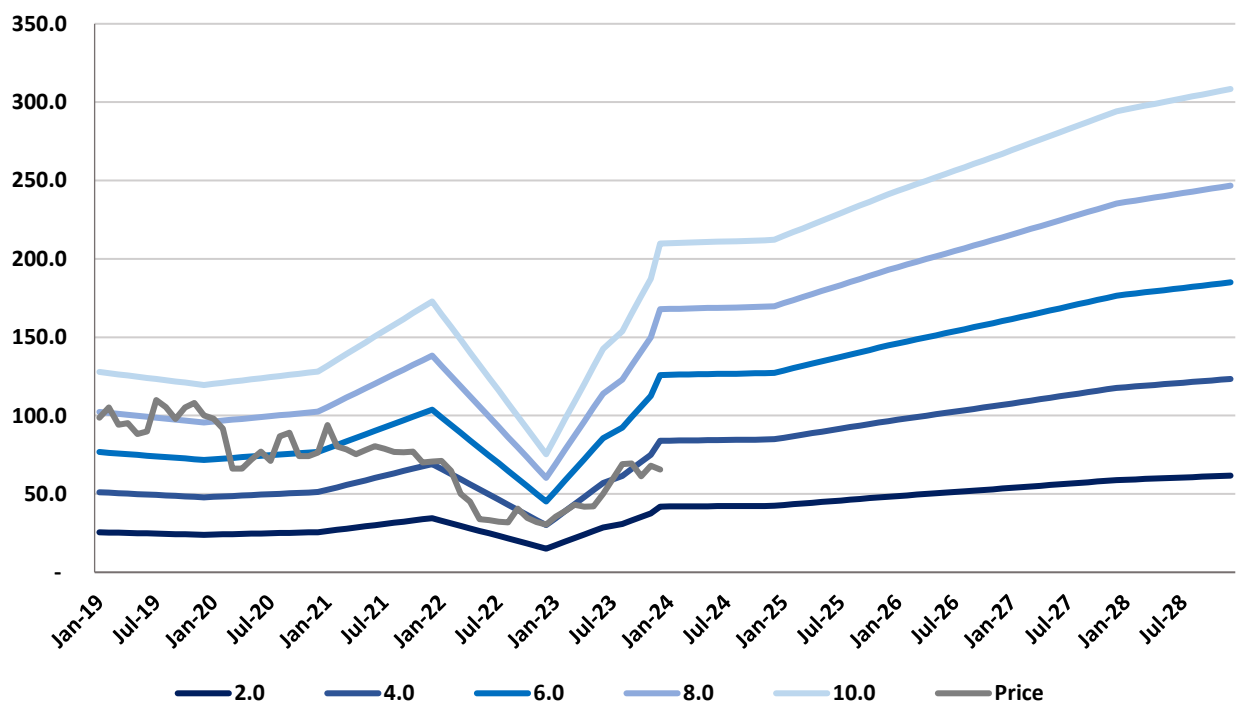
Justified PBV Valuation

Justified PBV based Valuation	2024E
ROAE	11.0%
Growth	3.0%
COE	20.6%
PBV	0.80
NAVPS	200.1
Target Price	160.1

PER Valuation

PER based Valuation	2024E
Earnings (LKR 'Mn)	8,477
No. of Shares ('Mn)	399
EPS	21.2
Expected PER	7.0x
Price at 7.0x of Earnings	148.6

PER Chart





Appendix I: Statement of Income and Expenses

Statement of Profit or Loss (LKR Mn)	2018	2019	2020	2021	2022E	2023E	2024E	2025E
As at 31st December								
Gross Income	51,621	60,237	61,632	64,050	111,552	136,733	136,638	141,883
Interest Income	44,622	53,402	53,153	52,795	98,217	118,086	116,277	121,549
Interest Expenses	-29,518	-35,431	-35,228	-31,053	-67,087	-87,095	-89,254	-91,610
Net Interest Income	15,104	17,971	17,925	21,741	31,130	30,991	27,023	29,940
Fee & Other Income	7,450	6,836	8,479	11,255	13,317	18,647	20,361	20,334
Total Operating Income	22,553	24,806	26,404	32,996	44,448	49,638	47,385	50,274
Impairment (Charges)/ Reversal	-3,765	-4,405	-6,794	-10,253	-29,277	-19,213	-15,707	-13,140
Net Operating Income	18,788	20,401	19,610	22,743	15,171	30,426	31,678	37,134
Less : Operating expenses								
Personal Expenses	-4,898	-5,460	-5,748	-6,323	-6,363	-7,856	-9,668	-12,356
Depreciation and Amortization	-509	-883	-932	-914	-926	-1,066	-1,070	-1,099
Other Operating Expenses	-3,959	-4,065	-3,721	-4,278	-5,210	-6,412	-6,792	-7,193
Op. profit before value added tax	9,422	9,992	9,209	11,229	2,672	15,092	14,147	16,486
VAT on financial services	-1,938	-2,068	-1,819	-2,015	-1,203	-3,213	-3,334	-4,038
Debt Repayment Levy	-235	-1,003	0	0	0	0	0	0
Op. profit after value added tax	7,248	6,921	7,390	9,214	1,469	11,879	10,813	12,448
Share of associate companies' profit	0	0	0	0	0	0	0	0
Profit Before Tax	7,248	6,921	7,390	9,214	1,469	11,879	10,813	12,448
Income Tax Expense	-1,972	-2,036	-2,173	-2,151	1,607	-3,326	-2,163	-2,614
Profit for the Year	5,276	4,885	5,217	7,063	3,076	8,553	8,650	9,834
Minority Interest	140	109	101	158	67	171	173	197
Profit attributable to Equity Holders	5,136	4,776	5,117	6,904	3,009	8,382	8,477	9,637
Adjusted EPS	12.9	12.0	12.8	17.3	7.5	21.0	21.2	24.1

Appendix II: Statement of Financial Position

Statement of Financial Position (LKR Mn)	2018	2019	2020	2021	2022E	2023E	2024E	2025E
As at 31st December								
ASSETS								
Cash and cash equivalents	7,071	6,081	10,779	13,765	35,728	38,796	41,627	48,606
Balances with Central Bank	15,546	13,887	6,812	16,403	18,188	8,448	8,903	9,373
Placements with banks	15,237	6,291	12,402	8,299	4,109	20,098	20,726	20,933
Derivative financial instruments	3,938	1,596	1,429	1,338	7,909	3,140	4,836	4,884
Financial assets recognised through profit or loss	4,052	3,489	7,713	4,784	20,789	25,122	27,634	27,911
Loans and advances to customers	344,276	396,672	425,682	504,374	545,920	466,468	524,134	524,680
Financial assets at amortised costs	24,175	27,486	44,712	54,263	135,048	119,330	127,809	125,598
Financial assets measured at Fair value through OCI	54,487	68,430	108,763	89,697	45,454	80,391	84,285	90,710
Other assets	2,933	3,228	3,595	5,671	7,038	6,909	7,599	8,373
Intangible assets	397	701	1,062	1,217	1,813	1,769	1,501	1,521
Deferred tax	1,101	647	1,946	3,443	9,049	9,255	9,255	9,255
Property, plant & equipment	3,144	3,565	3,541	3,735	3,908	3,226	2,772	2,014
Investment properties	2,111	2,273	2,362	2,528	2,879	2,879	2,879	2,879
Total assets	478,497	535,600	632,132	710,832	839,198	787,114	865,243	878,020
LIABILITIES								
Due to Banks	15,047	18,380	24,173	24,821	20,299	4,050	4,953	4,982
Derivative financial instruments	2,907	729	1,017	1,049	96	154	173	173
Due to customers	347,170	404,668	489,659	551,257	671,713	628,052	690,857	697,766
Debt securities issued and other borrowed funds	43,423	30,740	35,784	26,570	32,503	37,515	45,752	43,774
Tax liabilities	3,175	2,342	2,563	2,586	6,635	4,657	3,893	3,660
Other liabilities	8,838	9,807	8,435	11,123	9,183	6,764	6,814	6,821
Subordinated term debts	16,812	23,109	19,881	27,961	27,980	28,714	29,214	29,714
Deferred Tax	513	567	596	569	873	854	854	854
Retirement benefit obligations	502	719	820	830	1,019	1,056	1,056	1,056
Total liabilities	438,386	491,061	582,928	646,765	770,302	711,815	783,565	788,799
EQUITY ATTRIBUTABLE TO PARENT								
Stated capital	6,469	7,685	8,794	18,264	19,871	20,738	20,738	20,738
Statutory reserve fund	1,636	1,896	2,196	2,571	2,746	2,746	2,916	3,109
Investment Fund	239	571	842	-839	3,772	754	830	913
Retained Earnings	30,668	33,230	36,143	42,731	41,116	49,498	55,459	62,530
Equity attributable to parent	39,012	43,383	47,976	62,727	67,505	73,737	79,943	87,290
Non-controlling interests	1,099	1,155	1,227	1,339	1,391	1,562	1,735	1,932
Total Equity	40,111	44,539	49,203	64,067	68,896	75,299	81,678	89,222
Total liabilities and total equity	478,497	535,600	632,132	710,832	839,198	787,114	865,243	878,020
Adjusted NAVPS	97.7	108.6	120.1	157.0	169.0	184.6	200.1	218.5



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