

“In a challenging year with multiple distractions and strong headwinds we have reported solid profits and positioned the business for our second decade. With our customer first policy anchored to a strong capital base and a concerted effort in managing risks and costs, we are now on a growth curve to realise the expected upside.”



It is with great pleasure and a sense of pride that I present my 3rd review as CEO of Nations Trust Bank PLC. The third quarter of 2009, during which I commenced my stewardship, sees it stabilised and positioned to take advantage of the next 12 months - the first year of a new decade after the completion of its first decade of operation.

We commenced the year under review facing multiple challenges of stunted private sector credit growth, deteriorating credit quality and several economic sectors struggling to survive in a stressed post-global crisis scenario. To compound matters, competition among the local banks was severe with each trying to enhance market share resulting in a price war, threatening the erosion of core revenues and margins. The end of the civil war and the Government stimulus, however, provided much needed respite and a positive impact to the financial sector during the latter part of 2009.

Amidst these challenges we have delivered a creditable performance during the year with the core businesses not only intact but also continuing to develop strongly. We strengthened our internal capabilities to serve our core-customer segments through application of best practices, leveraged on people and technology and pursued a path of smart costs to generate the best results possible in a period where revenue generation, margin maintenance and provisioning for bad debt posed significant challenge.

ECONOMY

The global economic and financial crisis saw a domino effect across the globe. The world economy has yet to recover from the resulting meltdown in demand. Like so many developing economies, we were not spared of the battering, but the fall out equally was perhaps less damaging and the effects on our economy were somewhat muted as a result of tight regulatory controls with no direct exposure to the infamous ‘toxic assets’ that were at the core of the issue. During the early part of the year, our economy performed well for a country that was at war coupled to a global economy in recession that had resulted in a substantial overhang of inventory. The Government’s strong focus on development resulted in a considerable improvement in the country’s infrastructure laying the foundation for future economic activity. Last year also marked one of the most dramatic moments in our country’s long history. The end of the war in May, will undoubtedly remain in our

memories for many years to come. With the end of the war, the deceleration of the economy bottomed out and is now awaiting the ignition of activity to a level higher than the recently announced annual GDP growth of 4% for 2009. The much expected post-war economic boom, i.e., the so-called ‘peace dividend’ is likely to translate into considerably reduced levels of unemployment and improve production across all areas of the economy.



Market Position further Strengthened

Healthy Growth Yields Profit, Builds Trust and Generates Resources for Further Growth

Deposits Portfolio grew by a CAGR of 33% over the past 5 years.

Loans and Advances Portfolio grew by a CAGR of 25% over the past 5 years.

Customer Base grew from 44,000 in 2004 to 142,000 by 2009.

Branch Network grew by 12 branches - 26 branches in 2004 to 38 branches in 2009.

14 new ATM Points were added to the network over the past 5 years.

Staff Strength grew by 1,053 from 2004 to 2009, and stood at 1,532 as at December 31.

(For definitions, please refer the Glossary on page 128.)

Banking sector showed mixed signals with deposits increasing by Rs. 348 bn or 18.5%, loans and advances contracting by Rs. 65 bn or by 4.0% due to a combination of reasons - a lack of positive investment sentiment, high interest rates, cautious lending by banks, etc., with the mismatch being absorbed by investment in Government securities. Reflecting deteriorating credit quality, non-performing loans increased by Rs. 22 bn with the ratio increasing to 8.0% from 6.3% in 2008. The specific provision cover came down from 47.6% to 39.3% which is the lowest coverage since 1998, perhaps reflecting over provisioning in previous years.

FINANCIAL PERFORMANCE

For 2009, we report profit before tax of Rs. 1,381 mn - an increase of 34% over the previous year with post-tax profits of Rs. 686 mn growing by 16%. Increase in the effective tax rate by 8% over 2008, restricted post-tax profit growth to a rate lower than the growth in pre-tax profits. Showing resilience and strength in core activities, the Group reported increased volumes and improved margins across all its business lines. The growth was broad based with all core-business segments reflecting good momentum in each area. The margin of net interest income to gross interest income increased from 24% to 31% in the year. Other operating income also showed a sizeable increase of 8%. Capital gains arising from our fixed income-trading portfolio contributed significantly to bridge the vacuum created by the foreign exchange loss that was recognised during the year. Net income grew by 22% over the previous year with operating expenses increasing by 10%. Conservative provisioning in response to tough economic conditions moderated earnings with specific provisioning rising from Rs. 436 mn in 2008 to Rs. 847 mn for the current year. Despite such constraints, PBT Margins remained healthy moving from 22% to 24% as focus on managing expenses also paid dividends. Expenses increased at a lower rate (18%) than net income (22%) thereby lowering the operating cost: income ratio from 68% to 62% for the year.

In an intensely competitive market, our deposit base grew by 30% to Rs. 44.2 bn with low cost funds contributing a healthy 26%. The adverse economic environment and conservative lending policies contributed respectively to increased NPLs and a contracting loan portfolio. For the year under review, NPLs increased from Rs. 2.4 bn to Rs. 3.8 bn and the Loan Portfolio decreased from Rs. 38.6 bn to Rs. 35.3 bn. As a result, although the net NPL Ratio deteriorated from 4.8% to 8.5%, it reflects both industry trends and management desire not to expand business under weak economic conditions. In the second half of 2009, as a result of a number of management actions, flows into delinquencies decreased and balances in arrears declined across the consumer unsecured loan and credit card portfolios. Hence, we believe that we have passed the worst in provisioning in the second half of 2009. In terms of Balance Sheet footings, our asset base increased by 4% to an aggregate Rs. 70.5 bn, while our capital position strengthened to Rs. 4.8 bn enabling the reporting of a healthy Capital Adequacy Ratio of 16.1%.

The results are equally pleasing for the enhanced productivity in the use of capital, risk and costs. Profits grew much faster than inflation, risk-weighted assets and the associated consumption of capital and most importantly the growth of income exceeded the growth of expenses by 4%. Equally the value of the NTB brand as recorded by Brand Finance Sri Lanka moved position from 41 to 21.

PERFORMANCE IN CORE SEGMENTS

Consumer Banking

Consumer banking continued to launch and refine several initiatives to build on its brand value of delivering 'simplicity and convenience' to its customers through innovative and flexible banking solutions. Our customer centric approach and strategies were well-executed during the year to this segment resulting in a 13% growth in the customer base and 43% growth in deposits mobilised. To our comprehensive suite of consumer-banking products, we added Nations Gold Advances together with Kidz Investment Planner and Auto Sweep Account bringing novelty and value addition to our customers. Our private banking product offering was relaunched with the opening of a new exclusive private banking centre.

Our branch network which is the backbone of our service infrastructure and the face of our Bank to all our customers was upgraded and geographic presence strengthened. We declared open our refurbished flagship Head Office Branch located at Union Place which is designed to provide customers with simple and convenient access to our full range of products and services. During the year, we also embarked on a strategy to establish our presence in the North and East Provinces not only to capitalise on the unique economic prospects available there but also accomplish island-wide coverage at a much faster pace. We believe all these initiatives have aided us to affirm our position as a long-term partner in the consumer banking segment.

Corporate Banking

Our competitive strength in this area is the result of our ability to understand closely the business needs of our customers and the reputation built as a reliable and strong partner. We worked relentlessly to maintain and strengthen our relationships with corporate customers offering packages that fit their individual needs. Solutions such as International Banking At Your Door Step and E-mailing of Transactional Advices were introduced during the year providing simplicity and convenience to our customers. We continued to maintain a well-diversified portfolio of customers covering key areas of business activity and sectors of the

economy with a view to maintaining a healthy advances portfolio by managing exposure on a well Balanced risk-reward trade-off. Special vigilance was placed this year on facilities to corporate business entities that were considered vulnerable to the economic downturn of both local and international markets.

SME Banking

Our SME banking business performed commendably during the year. The landscape for SME sector during the year has been very challenging with cash flows drying up and NPLs escalating. Economic pull back in the vehicle market posed a number of challenges in the leasing segment. Despite these, our winning formula for sourcing new customers in selected market segments and focused approach worked well. We also enhanced our product suite by launching Nations Business First, an exclusive package designed to help businesses handle their banking conveniently and efficiently.

Treasury

It was a testing year for the Treasury. With the subdued economic activity and resultant poor customer volumes, foreign exchange profits recorded were low during the early part of the year. We were successful, however, in managing our liquidity and fixed income securities portfolio which resulted in significant trading gains for the year. Fresh challenges emerged due to the detection of operational lapses within the Treasury which resulted in a sizeable foreign exchange loss. The Board reacted quickly to stem and manage the issues. These developments resulted in enhanced treasury policies and processes, the establishment of fresh risk parameters, tightening of reconciliations and more importantly the establishment of an expertly skilled treasury middle office. As the treasury business undergoes rapid transformation having to operate in a more regulated environment, steps are underway to building a clear market position demonstrating our commitment to delivering sustainable treasury profits within a sound risk framework.

Risk Management

We are exposed to a galaxy of risks on a daily basis in the pursuit of our business objectives, chief among them being credit, market, operational, compliance and strategic. Failure to adequately manage these risks exposes us not only to losses threatening our own survival as a business entity but also endangering the stability of the financial system. During the year, we took several steps to ensure that adequate policies are put in place to manage and mitigate the adverse effects of these risk elements across our operations. We also reviewed, developed and implemented appropriate and effective systems and procedures to manage and control such risks in line with policies set out by the Integrated Risk Management Committee of the Board. We believe that strengthening our risk management framework will generate competitive advantage leading to enhanced longer term sustainable shareholder value.

Human Capital

We would not have navigated a year filled with many challenges if not for the commitment and sheer hard work of our staff, who embraced all these ups and downs to better anchor the institution they have come to love. We believe that as a Financial Institution our value creation and credibility lies with developing a pool of focused professionals with integrity, intent and capabilities, all of which play a vital role in today's business world. We have made a strong commitment to the continuous learning of our staff, to support them in their ability to change, adapt and flex with the changing demands of their tasks and responsibilities and become truly equipped to perform in their job roles.

The year was filled with more than 9,000 trainee days being completed with a leadership programme for our senior managers facilitated by Hewitt International. We also launched initiatives to groom our staff whilst fostering cross-functional interaction with initiatives such as Nations Mastermind, Inter Cluster Quiz, Nations Best Speaker Contest and an Inter Departmental Debating Championship. The enthusiasm and commitment shown by our staff at these events is commendable and the competitions were of high standard. The sporting prowess of our staff should also not go unmentioned. They competed across many activities to achieve widespread success. Their generosity also should be commended in supporting our Bank CSR efforts. Without doubt I will have to call on their many talents, expertise, advice and energy as we move forward into 2010.

FUTURE

The dawn of peace has brought with it many exciting possibilities for Sri Lanka's entire economy. We are in the cusp of a future that offers significant upside if focused and managed well. To the banking sector, 2009 was a year filled with anxiety and challenges which we have faced successfully whilst consolidating our position in the market. The trends that lie behind our strong operating performance in core-business segments will be strengthened in the future. We are doing more business with more customers than at any time in our ten-year history. Hence, the platform for a launch that will take-off is now set.

Our plans for the future will focus on recognising that we are a regulated business aiming to deliver sustainable profits over the longer term within a sound risk management framework. In doing so, given the intense competition we need to demonstrate agility and balance in all our dealings. To our customers, we offer fulsome service and products second to none. To our employees, we offer ample avenues to grow to their full potential. To the regulators, we offer an undertaking to play according to the rules and finally to our shareholders, we offer better than average returns sustained over the longer term.

APPRECIATIONS

Although, it is only a short period of some three months, I am indebted to many. Among them, I would like to record and acknowledge the support and guidance provided by the Governor of the Central Bank of Sri Lanka and his officials. No less important was the focus and assistance of the Chairman and unstinting time and expertise of the Board Members.

I would also like to express my sincere thanks for the yeoman service rendered by Mr. Zulfiqar Zawahir, my predecessor as CEO. My thanks also to the corporate management team who underwent a challenging year by my side in its latter part. I also take this opportunity to thank all of our employees for their dynamism, loyalty and support for the organisation they serve.

I also thank Messrs Ernst & Young, our External Auditors for their professionalism. The time and effort is indeed much appreciated.

CONCLUSION

All those involved with NTB from its start in 1999, can look back with satisfaction and pride to what it has evolved today. Born to a war-torn economy it has withstood the ravages of an unprecedented global economic recession. Having survived by any reckoning, the most challenging decade, we are now ready to embark on the next, based on a strong foundation, a tested and modernised business model and a resilient and trained workforce. Although filled with fresh challenges, the resolve to overcome them as in the past, I am confident, remains intact.

In this period of sustained uncertainty, the strength of our brand, commitment of our people, quality of our portfolios and management processes are tell-tale signs of our ability to perform at greater heights in the future and provide sustainable returns to our shareholders.

We are fully committed to our disciplined strategy of balancing risk and return and look forward to playing a full role in the much anticipated economic recovery. Taking both the country and the Bank into consideration, we are in the threshold of a historical growth curve that needs careful nurturing and management.

I have engaged widely since my arrival at NTB. I am heartened by the knowledge that I can count on the support of our stakeholders.

I look forward to 2010 with confidence.

Saliya Rajakaruna
Director/Chief Executive Officer

18th February 2010