Dear Shareholder,

Cargills Bank positive on future outlook despite temporary challenges

Performance and profitability

The Bank experienced increased Non Performing Assets (NPA), lower than anticipated business volumes and the impact of weaker macroeconomic conditions resulting in a loss after taxes of Rs. 196.5 million during the quarter ended 31 March 2019, as compared with a Profit After Tax of Rs. 18.3 million in the corresponding period of the previous year.

During the quarter in review, the Bank recorded NPAs on a few large ticket loans. A large facility in the construction sector was classified as NPA, impacting the bottom line of the Bank. Provision for this group has been made according to the classification directed by the Central Bank in a general directive to all banks. In respect of a few other large customers who are in NPA, the Bank is foreclosing on the mortgages and pursuing other restructuring and recovery measures. We remain confident of recovering a substantial part of the amounts due from these customers within a year.

Impairment for the quarter in review amounted to Rs. 323.3 million as compared to the previous year's quarter of Rs. 79.2 million. The adoption of SLFRS 9 resulted in more stringent impairment provisioning and also contributed to the increase.

Interest income reflected a 13% YoY increase and grew to Rs. 990.8 million. Net interest income contracted by 7% Year-on-Year (YoY) down to Rs. 429.4 million. The percentage growth was marginally impacted by changes in the impairment mechanism. Interest expense reflected a 35% YoY increase and grew to Rs. 561.4 million.

Net fees and commission income rose to Rs. 53.5 million, reflecting a growth of 61% YoY during the quarter. This improvement was primarily attributable to a 70% YoY expansion in fees and commission income which grew from Rs. 47.2 million to Rs. 80.4 million whilst the fee and commission expense increased only by Rs. 13 Mn. The Bank launched its credit cards subsequent to first quarter last year hence the current year had the benefit of a new stream of income in cards fee and commission. While commendable, the growth in fee and commission income from cards was constrained by the delayed commencement of the credit card merchant acquiring business and lower than anticipated card volumes during the quarter. YoY Growth was also seen in fees on loans and inward remittances but at a rate that was lower than expected. Over the quarter, the Bank also entered into an agreement with WorldRemit - a leading digital money transfer service – with a view to strengthening cross-border inward remittance services offered by the Bank. This partnership is anticipated to help the Bank increase its share of the remittances business in the months ahead.

The Bank's total other income recorded a 71% YoY contraction to close the quarter at Rs. 12.5 million, reflecting the absence of one-off capital gain secured by the Bank in the previous year, arising from one-off sales of Treasury Bills and Bonds, as well as rupee depreciation. By contrast, during the quarter in review, the rupee began to appreciate in value, resulting in a reduction in value of the Bank's foreign currency holdings. The Bank also incurred a one off exchange loss Rs. 13.8 Mn on conversion of the medium term borrowing.

During this period, operating expenses increased by 27% YoY to Rs. 478 million with a major component of this increase arising from the higher cost in information technology and communication. The increase of cadre from 475 to 586 was also reflected in higher personnel expenses. The increase in the workforce was mainly in the Card Centre, sales force Retail Banking, and recoveries.

As evidenced by our performance, the quarter in review was challenging.

Financial position

Given these challenges, the Bank's loan portfolio growth was subdued and expanded to Rs. 25.7 billion at quarter ended compared with Rs. 23.9 billion as at 31 December 2018, with loans to the SME sector accounting for the highest growth rate, while corporate and retail lending represented the majority of the Bank's loan book in terms of value.

The Bank's total deposit base recorded a modest growth, closing the quarter with Rs. 21.7 billion, as compared with Rs. 19.9 billion as at 31 December 2018. The Bank was mindful of increasing the deposit base given the higher associated interest cost.

Capital Management
The Bank's regulatory capital ratios were maintained well above the statutory minimum requirements. The Common Equity Tier 1 Capital Ratio and Tier 1 capital Ratio both stood at 28.5% at the end of the quarter while the Bank's Total Capital Ratio was held steady at 28.8%, as compared with minimum regulatory requirements of 7%, 8.5%, and 12.5% respectively.

Rating
During the quarter in review, Cargills Bank secured a multi-notch upgrade from Fitch to A-(lka) with stable outlook. Fitch Rating attributed the upgrade to its "assessment of support from its ultimate parent, CT Holdings PLC (CTH), and our expectation that the Bank is likely to receive extraordinary support from its ultimate parent, if needed"

For Cargills Bank to have secured an A-(lka) stable rating from Fitch just four years into our journey is a testament to the unique value and model brought to the Sri Lankan banking industry. Backed by the support of our parent, Cargills Bank is working to redefine several aspects of banking in Sri Lanka.

The Future
Given the prevailing monetary conditions which resulted in a volatile and largely higher interest rate environment, growth was stifled across key sectors of the Sri Lankan economy, resulting in delayed settlements by some large customers, recovery of these outstanding will be the Bank's immediate priorities.

The Bank continues to support the Agrarian Microfinance network of 14,000 farmers, including dairy farmers. This is a segment which is considered a national priority and lending to the sector to meet demand for essential agricultural inputs like purchase seeds, fertilizer and other Agri related assets. In that regard, Cargills Bank is working in partnership with the National Agri Development Program (NADEP) and the Central Bank of Sri Lanka to support the needs of farmers mostly from the Monaragala and Anuradhapura districts.

The coming months will see the Bank increase its marketing and promotional initiatives – including promotions campaigns exclusively designed to build engagement across new media platforms and with a particular emphasis on cards and retail banking.

Cargills Bank's expansion into the credit card market has been well received by a wide spectrum of customers and we are excited by the opportunities available in this sphere and confident of establishing a leadership position within identified segments, particularly amongst shoppers patronizing Cargills Food City's retail network.

The Bank is also confident that its early initiatives in the Retail, SME and Agri segments will develop strongly; combined with technological innovation, the future augurs well.

The Bank's unique FMCG centric banking model leverages on parent company's extensive supplier eco system which also provides fast and convenience access to markets, while the existing relationship between the parent and its supplier network serves as an additional buffer against risk to the Bank. Moving forward, a substantial thrust will be directed towards the further development and enhancement of this unique model.

(Sgd.)
Louis R Page
Chairman

31 May 2019
*Please access www.cargillsbank.com for the financial statements for the three months ended 31 Mar 2019