

Engaging with today's realities

Managing Director's Review



Dear Stakeholder,

It gives me great pleasure to share with you an extraordinary performance by your Bank, with many of the key performance indicators surpassing previous highs to establish new milestones in the industry.

Performance

The Group's Operating Profit Before VAT and Tax grew by a record 41.3% to Rs 27.1 Bn whilst Group Profit After Tax grew by 41.2%, to Rs 15.7 Bn during the year. The Profit Before Tax for the Bank recorded an impressive growth of 33.9% to reach Rs 20.1Bn while the Bank's Profit After Tax improved by 35.4% to Rs 14.1Bn.

Bank's loan portfolio grew by 17.3% during the year, in an environment of rising interest rates, which saw rates increasing by nearly 400 basis points by year end. The higher interest rates contributed to an improvement in interest margins with loans being re-priced. However, it also spurred a movement of funds from capital savings to Fixed Deposits. Despite intense competition in the industry to attract deposits the Bank's deposit base grew by 18.3% year on year. HNB's Minor Savings, proposition 'Singithi' also contributed significantly towards this growth in deposits, with an impressive growth which included mobilisation of a record breaking Rs 900 Mn in minor savings during the national Savings month of October alone.

The Bank's ROA improved to an outstanding 1.8% while the ROE improved to nearly 20% for the year 2016.

Following the Bank's strategic focus on increasing fee income to reduce the dependency on interest income, it continued to enhance fee income by 22.0% during the year under review; mainly supported by trade finance, cards business and guarantee commissions, as well as the offer of new value added services and products which were facilitated by the Bank's technological advancements.

HNB's Asset Quality improved once again, recording its lowest NPL ratio ever, to close at 1.8% as at year end. The improvements to credit screening and evaluation helped

improve approval and monitoring across the branch network. Credit quality was also enhanced by maintaining stringent limits on risk concentration and diversifying our portfolio across the Corporate, SME, Micro Finance and Personal Banking segments. During the year, we also implemented significant enhancements to the Bank's Risk dashboards and initiated improvements in skill levels through appropriate training. Furthermore, our persistent efforts into recovering overdue loans also enabled this outstanding improvement. Asset quality will continue to be a key focus area and the measures we have undertaken would further augment our Risk management framework and processes to continue enhancing the Bank's asset quality.

A Digitally driven journey

HNB continues to drive technology led banking and will provide industry leadership in the digital banking space. The electronic banking upgrade completed during the year, enabled the launch of a state of the art payment and Cash Management solution - a trail blazer in the industry; a distributor and supplier financing solution amongst other value added features and benefits offered to retail customers. HNB also initiated the launch of its digital branches - the first of which will be opened during the first quarter of next year, becoming another first in the industry. HNB also continued to increase the number of cash recyclers and cash deposit machines across the network.

Moreover, it is most heartening to see that the micro and small scale sectors of the economy have begun to adopt technology, with many in the sector starting to use Debit and Credit cards and POS machines to conduct micro finance transactions. Even more significantly, micro entrepreneurial

Game Changer

Group

PBT
Rs **22.5 Bn**

PAT
Rs **15.7 Bn**

Bank

ROA **1.8%** ROE **19.9%**

Cost to Income **42.5%** NPA **1.8%**

artisans and farmers have begun to reach export markets through many web portals, with local handmade sarees now being purchased in Europe via the internet and vegetables being ordered through the web.

Globally, the trend amongst most organisations is towards convergence of their digital strategy with their corporate strategy. In this evolving environment and in line with the Bank's strategic plan and vision to be the most future ready bank in Sri Lanka, we created a new vertical during the year, with the appointment of a "Chief Digital Officer" (CDO) to drive the digital transformation across our entire value chain. Digitalisation as we know is breaking down boundaries and becoming the foundation for entirely new ways of doing business as well as creating new business.

Customers

Whilst HNB pursues a digital banking led strategy to enhance value creation and convenience to customers, we are always mindful that the raison d'etre of any business is satisfying customer needs, and as articulated by our mission, "to constantly exceed stakeholder expectations". Sustaining a competitive advantage in banking at HNB has been about "banking beyond transactions", about long term

Game Changer Digital

- Launching Digital Branches
- Appointment of a Chief Digital Officer to drive the digital transformation
- Payment and Cash Management
- Distributor Financing

Managing Director's Review

relationships and “partnering people’s progress”.

Reflecting our strategic focus on customer service, the year under review saw the Bank recruit a Customer Experience Officer to give leadership to enhance customer experience, to meet the highest standards and set new industry benchmarks. This new role will also enable us to incorporate customers perspectives and experience to every aspect of our business, such as at each stage of product development, launch and delivery.

Following a market research study commissioned by us, the Bank re-launched its new proposition for high net worth customers re-branded as “Priority Circle” replacing HNB’s Crystal Circle. The new proposition aims to meet changing customer needs and intensifying competition with the offer of an exclusive service and a plethora of benefits to our loyal high net worth customers.

Game Changer
Customer

- Recruitment of a Customer Experience Officer
- First to market innovative products such as MoMo, WallyE
- Re-launching the Priority Circle proposition

Enhancing productivity and efficiency

Our commitment to look at things anew and do things differently for win-win impacts has enabled us to keep innovating the ways in which we play the Game.

As I enumerated last year, following an in-depth analysis of the internal processes and operations, the Bank launched a reengineering of its business processes in 2013. To drive initiatives for the Bank’s sustained leadership in evolving market conditions, we established a dedicated change management unit, the only local bank to have a fully dedicated and

Game Changer
Productivity & Efficiency

- Centralisation of Retail credit
- Regionalisation of SME credit
- Creating a culture of continuous improvement through six sigma

empowered team to initiate and implement change. These BPR initiatives in 2013-2016 have created new pathways for our Game Changing journey, and contributed tremendously to the excellent results of the past two years. The initiatives include the establishment of centres of operational excellence, automation and streamlining of processes which have yielded significant improvements to the Bank’s Cost to Income ratio, to 42.5% as at the year end; whilst helping grow the topline through service excellence and enhanced value creation for all our stakeholders. The lean management initiatives have enabled our Profits per employee to increase to Rs 3.4 Mn in 2016 compared with Rs 2.4 Mn in 2015. During the year under review, we focused on expanding these initiatives to other aspects, as well as on ensuring that a culture of continuous innovation and reengineering is embraced by the different departments in order to sustain the competitive advantages thus harnessed. Towards this end the Bank introduced training in tools such as Six Sigma Yellow belt, Lean Management and 5 S.

Our People

The talents, passion and commitment of our people have been at the heart of our strategy - in adding new perspectives and in the passionate drive to re-engineer our business processes; in being nimble enough to adapt and drive change in our business model to adopting a mindset of continuous improvement and rising up to the challenges of greater responsibilities and for nurturing win-win partnerships with our stakeholders. It is thus most heartening that our HR efforts have been recognized during the year by several international accolades. These include the award for “Best HR Strategy in Line with Business” by the Asia

Best Employer Brand; overall award for Best Results Based Training at the Asia’s Training & Development Excellence Awards 2016.

The Bank’s strategic initiatives to harness technology, streamline operations and establish centres of excellence have energised and empowered our people by relieving them of mundane responsibilities to engage in more value adding activities. This has yielded the anticipated dividends in terms of improved productivity, and has also been win-win in driving sales whilst also enabling greater focus on building relationships with our existing clients and attracting new ones. In addition, flexible hiring is being introduced to support the Bank’s strategic objectives and to cater to a future workforce which would largely be made up of Generation Z. Aligning our HR Management practices with the Bank’s strategic objectives of driving sales and marketing, the Bank increased the rewards for achievement of targets and introduced a performance based variable pay to support a sales and marketing driven culture.

A focus on “Experience” is a growing trend in the market. Whilst many companies the world over have verticals dedicated to Customer experience, a few have also begun to focus on enriching the Employee Experience. Hence, appreciating that service must begin at home, HNB became the first bank in Sri Lanka to create the position of Chief Employee Experience Officer – to serve as a single point of contact for the entire HATNA family, for all experience related matters which could range from a need for resources or information or two way communication, a breaking down of barriers and silos to share ideas, opinions and criticisms to improve the work place.

The Bank’s Talent Development Model introduced in 2014, is a key platform for future growth and was further expanded during this year with the management development programme designed for branch managers in collaboration with the Post Graduate Institute of Management.

In line with the Bank’s strategy of a digital transformation, our HR efforts will also focus on recruiting as well as developing and

nurturing a tech savvy workforce. During the year we increased our investments into virtual learning. Reflecting a lean and technologically driven model, the future employees of the HATNA family will also be groomed to be members of cross functional teams who are provided opportunities to enrich and enlarge their job roles.

Game Changer People

- Appointment of Employee Experience Officer to drive a happy organisation
- Performance related pay

A Sustainable Approach

The role we play in the nation's development agenda is one we hold high and which is intrinsic to our triple bottom line approach in business. HNB's involvement with the SME and Micro Finance sectors of the country dates back to the Bank's origins in the small hillside town of Hatton. Our engagement with the SME sector has since then expanded across the length and breadth of the country from the rural hinterlands to the big cities. Our Micro Finance programme "Gami Pubuduwa" - the first ever micro finance initiative in the country by a Bank, is in its 28th year and continues to enrich diverse communities across rural Sri Lanka.

During the year, the Bank expanded its value addition to the SME sector via the launch of Distributor Financing, to benefit small scale distributors of large corporates.

In line with our triple bottom line objectives, the Bank invested over Rs 350 Mn on Solar energy systems for 69 of its branches during the year. These have enabled us to reduce our dependence on the national grid for electricity and hence reduce energy bills whilst contributing to green energy. Furthermore, our green focus also prompted us to encourage green initiatives by our employees, by introducing a concessionary loan scheme to purchase solar energy systems for their homes.

In addition to our business integrated social and environmental sustainability initiatives, the Bank also continued its on-going initiatives under the categories of children and education, health and environment.

Looking ahead

We anticipate that the moderate growth in GDP experienced in the past two years will pick up to a faster pace, as the economy regains the vibrancy that better reflects its potential. We expect new development projects, planned infrastructure projects and new investments to begin in the year ahead.

E-Commerce is likely to continue to see exponential growth going forward. With HNB's game changing presence in the digital space, it stands well poised to grow in this business space and harness the opportunities that would arise from the proliferation of E-Commerce.

Following our strategic planning exercise involving the top 100 of the Bank's executives, a number of priorities for the year ahead have been established and we will take initiatives to achieve them in 2017. Amongst them is a need to drive low cost deposits important for sustainable balance sheet growth.

The Bank will continue to expand its centralisation initiatives (which began with the centralisation of credit processing in 2015) in 2017, by centralising the disbursement of credit, thus minimizing risks and enhancing customer service. Moreover, we also plan to centralise the repository of all security documentation, thereby enhancing protection, consistency and accuracy of documentation and efficiency of retrieval.

The past two years has seen us harness the unique opportunities and advantages of utilising technology across the board. We foresee boundless possibilities ahead of us, and we look to serve generations more with added vigour, continuing on our trail blazing journey - to develop new propositions and products, to adopt new business models and attract new customers and reduce costs, whilst standing firm on a sound platform of

a strong brand promise - of "Safety, Stability and Strength", which spans over a century.

Appreciation

I would like to convey my sincere appreciation to our Chairman and my colleagues on the Board for their guidance, constant support and the confidence placed in me. My gratitude also to the Governor of the Central Bank of Sri Lanka and other regulatory bodies for the vital role they play and their contributions to the industry; and to all our stakeholders and customers for their loyalty and inspiration and the opportunity to be a "partner in their progress".

My heartfelt thanks to my corporate and senior management teams who provide leadership and their boundless energy to drive our strategies for growth and business excellence and each and every member of our team that make up HNB, who continue to be the ambassadors of a legacy and bolster the Bank's stature whilst staying nimble and energized enough, to not merely respond to changing market environments but to *keep Changing the Game*.

Jonathan Alles
Managing Director /CEO

Colombo, Sri Lanka
23rd February 2017