

# COMMERCIAL BANK OF CEYLON PLC [COMB.N0000]

**MAINTAIN BUY**

## SAVERS' CHOICE

**Fair Value [2018E]: LKR 163.0 [+39%]**

**Buy Below: LKR 153.0**

*COMB's earnings grew by 14% in the 1Q2018 driven by high NIIs and stronger NIMs though partially offset by heavy impairment. Earnings are broadly in line with our expectations as we maintain earnings growth at 18% for 2018E and thereby we maintain TP at LKR 163.0. Maintain BUY.*

LKR (Mn)	1Q2017	1Q2018	YoY	2016	2017	YoY
NII	8,787	11,728	+33%	33,128	39,567	+19%
NII + Other Income	10,848	14,175	+31%	40,217	48,492	+21%
Post Impairment Income	11,693	14,890	+27%	44,398	50,774	+14%
Pre Tax Profit	6,432	7,669	+19%	23,824	28,173	+18%
Net Profit	3,820	4,341	+14%	14,511	16,606	+14%
Loans	646,839	784,976	+21%	620,129	742,444	+20%
Shareholders' Equity	80,429	110,263	+37%	78,992	107,995	+37%
NAVPS	89.0	108.3	+22%	88.7	107.7	+21%

### Earnings continue steady growth through improved topline

COMB recorded a 14%YoY growth in earnings of LKR 4.3Bn for 1Q2018 with NII surging by 33% supported by high loan growth and improved NIMs (56bpYoY to 3.97%) as COMB utilizes interest free rights issue cash. Gains were primarily offset by the 544% jump in impairment. Thanks to the heavy impairment, the underlying earnings fell broadly in line with our expectations despite the heavy surge in interest income. We maintain our profit target for 2018E (LKR 20Bn – 17%YoY) and 2019E (LKR 24Bn – 20%YoY) amidst expectations of high impairment provisioning in the coming quarters as well.

### NII up +33% as loan growth comes in higher

COMB's NII increase was mainly driven by 20.5%YoY surge in interest income which was supported by 5.7%QoQ & 21.1%YoY growth in the COMB's loan book. Interest expenses grew much slower at 13.0%YoY on the back of COMB's less preference to deposits having already obtained cash through the rights issue. Bank's CASA dipped YoY to 40.0% from 41.5% in 1Q2017 but improved from 39.5% in 4Q2017.

### Improvement in C/I ratio

COMB recorded an improvement in its' Cost to Income (C/I) ratio largely attributable to the improved NII stemming from growing trade related and SME sector borrowing and the continued digitalization drive. C/I dipped to 37.6% in 1Q2018 compared to 42.8% in 1Q2017 and 37.7% in 4Q2017.

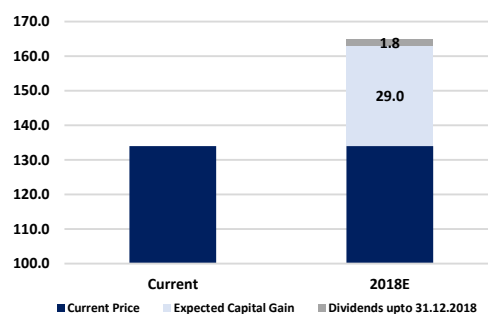
### IFRS 9 pushed higher Impairment Provision

COMB provided LKR1.6Bn in 1Q2018 as total impairment for the quarter was up by LKR1.0Bn or 544% from LKR 0.3Bn 1Q2017 and LKR 0.6Bn in 4Q2017. The jump was primarily stemming from the implementation of IFRS 9/SLFRS 9 which came into effect on 01.01.2018.

### We maintain BUY on both voting and Non-Voting

Earnings are broadly in line with our expectations as we maintain earnings growth at 17% for 2018E and thereby we maintain TP at LKR 163.0. COMB.X is valued at LKR 130.0 anticipating 22% discount to the voting share. Maintain BUY for COMB.N and COMB.X.

**ANALYST CERTIFICATIONS AND REQUIRED DISCLOSURES BEGIN ON PAGE 8**



## FIRST CAPITAL RESEARCH

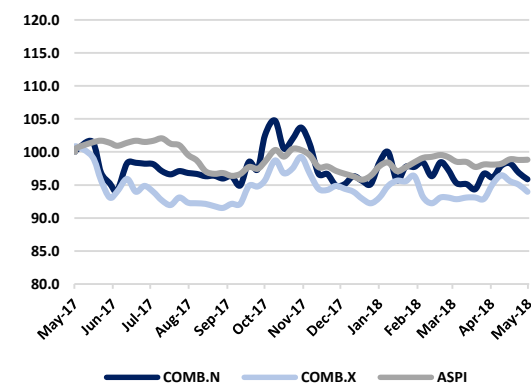
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### KEY DATA

	COMB.N0000	COMB.X0000
CSE Ticker	COMB.N0000	COMB.X0000
Bloomberg Ticker	COMB SL	COMB X SL
Share Price (LKR)	134.00	104.00
52w High (LKR)	147.80	113.21
52w Low (LKR)	132.20	100.79
Avg. Daily Volume (Shares)	237,670	26,998
Avg. Daily Turnover (LKR)	32,660,037	2,884,380
Issued Share Capital (Shares 'Mn)	945,206	65,013
Market Cap (LKR 'Mn)	126,657,661	6,761,370
Market Cap (USD 'Mn)	806,737	43,066

\*1 USD = LKR 157

Price Performance (%)	1 mth	3 mths	12mths
COMB - Voting	0%	-3%	-6%
COMB - Non-Voting	-1%	-3%	-8%
ASPI	1%	-1%	-3%



### Disclosure on Shareholding:

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

**Estimate Revision**

In LKR Mn	2018E - O	2018E - R	% Change	2019E - O	2019E - R	% Change
<b>Earnings Estimate</b>						
Net Interest Income	44,375	45,895	+3%	52,580	52,430	-0%
NII + Other Income	55,096	56,616	+3%	65,446	65,295	-0%
Post Impairment Income	58,914	60,556	+3%	69,438	69,276	-0%
Pre Tax Profit	32,989	32,955	-0%	25,364	25,364	0%
Net Profit	19,524	19,503	-0%	23,510	23,497	-0%
Adjusted EPS	19.4	19.4		23.4	14.5	
Growth YoY	17%	17%		20%	20%	
<b>Balance Sheet Estimate</b>						
Loans & Advances	858,838	858,838	0%	995,639	995,639	0%
Shareholders' Equity	122,078	122,063	-0%	138,974	138,950	-0%
<b>Adjusted NAVPS</b>	<b>107.7</b>	<b>107.7</b>		<b>119.6</b>	<b>119.6</b>	
<b>Ratio Estimate</b>						
<b>ROE (%)</b>	<b>17.0%</b>	<b>17.0%</b>		<b>18.0%</b>	<b>18.0%</b>	
<b>PER (x)</b>	<b>6.9</b>	<b>6.9</b>		<b>5.7</b>	<b>5.7</b>	
<b>PBV (x)</b>	<b>1.1</b>	<b>1.1</b>		<b>1.0</b>	<b>1.0</b>	

**Valuation Table**

P/E 31 December	2014	2015	2016	2017	2018E	2019E	2020E
<b>Estimates (LKR 'Mn)</b>							
Net Interest Income	27,320	30,567	33,128	39,567	45,895	52,430	63,650
Total Operating Income	39,160	26,742	33,957	42,473	51,020	57,432	64,928
<b>Net Profit</b>	<b>11,239</b>	<b>11,855</b>	<b>14,511</b>	<b>16,606</b>	<b>19,503</b>	<b>23,497</b>	<b>29,783</b>
Adjusted EPS (LKR)	11.2	11.8	14.5	16.6	19.4	23.4	29.7
YoY Growth (%)	6%	5%	22%	14%	17%	20%	27%
<b>Valuations</b>							
<b>PER (x)</b>	<b>12.0x</b>	<b>11.3x</b>	<b>9.3x</b>	<b>8.1x</b>	<b>6.9x</b>	<b>5.7x</b>	<b>4.5x</b>
<b>PBV (x)</b>	<b>1.7x</b>	<b>1.9x</b>	<b>1.7x</b>	<b>1.2x</b>	<b>1.1x</b>	<b>1.0x</b>	<b>0.9x</b>
<b>DY (%)</b>	<b>4.9%</b>	<b>4.2%</b>	<b>4.2%</b>	<b>4.8%</b>	<b>5.6%</b>	<b>6.6%</b>	<b>8.1%</b>

**Valuation Summary**

<b>Expected COMB.N price for 2018E</b>	
Justified PBV based target price	146.0
PER Valuation based target price	159.5
RI Valuation based target price	183.7
<b>Average Target Price</b>	<b>163.1</b>
<b>Target Price after Rounding off</b>	<b>163.0</b>
<b>Expected COMB.X price for 2018E</b>	
Target Price for COMB.N	163.0
Average 12 month discount	-20%
Target Price for COMB.X	130.4
<b>Target Price after Rounding off</b>	<b>130.0</b>

<b>Return</b>	
<b>Target Price</b>	<b>163.0</b>
<b>Current Price</b>	<b>134.0</b>
<b>Capital Gain (LKR)</b>	<b>29.0</b>
<b>Dividends upto 31.12.2018 (LKR)</b>	<b>1.8</b>
<b>Capital Gain %</b>	<b>22%</b>
<b>Dividend Yield %</b>	<b>1%</b>
<b>Total Return %</b>	<b>23%</b>
<b>Annualized Return %</b>	<b>39%</b>

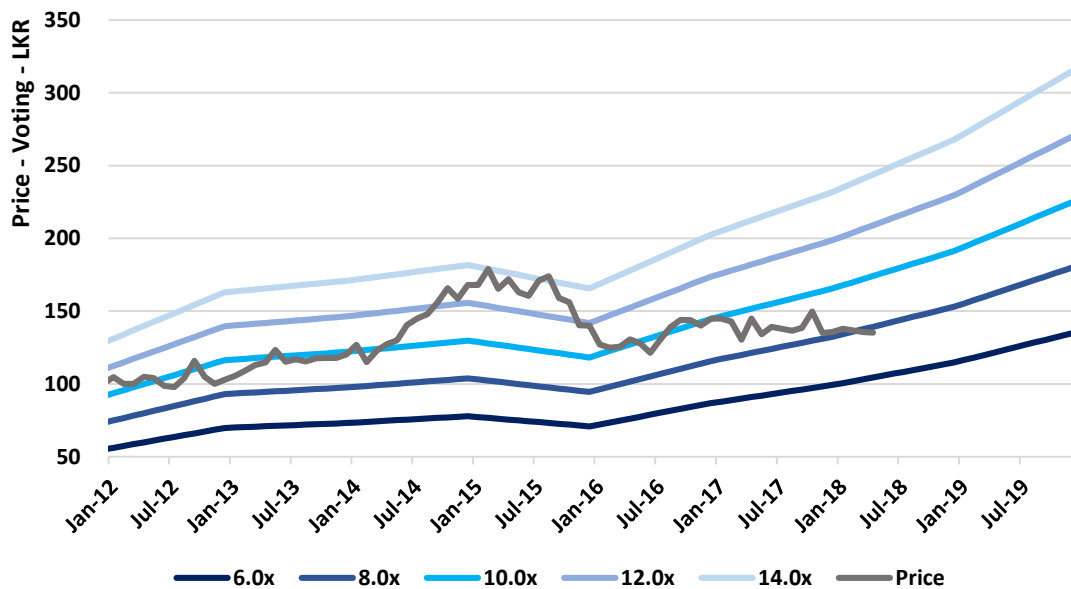
### Residual Income Valuation

Residual Income based Valuation	
PV of Residual Income	76,911
No. of Shares ('Mn)	1,003
RI per Share	76.7
Opening Book value per Share	107.7
Value per Share	184.4

### Justified PBV Valuation

Justified PBV based Valuation		COE	
ROAE	17.0%	Rf	9.1%
Growth	3.0%	Rm	16.1%
COE	14.4%	Growth %	3.0%
PBV	1.2	$\beta$	0.64
NAVPS	119.6	Adjusted $\beta$	0.76
Target Price	146.2	$Ke=Rf+\beta(Rm-Rf)$	14.4%

### PER Valuation



Source: First Capital Research Estimates

PER based Valuation	
2018E Earnings (LKR 'Mn)	19,502,532
No. of Shares ('Mn)	1,003
2018E EPS	19.45
Expected PER	8.2x
Price at 8.2x 2018E Earnings	159.5

**Appendix I: Key Ratios**

COMB P/E 31 December	2014	2015	2016	2017	2018E	2019E	2020E
<b>Capital</b>							
Tier 1 (5%)	13.07%	11.55%	11.55%				
Tier 2 (10%)	16.22%	14.3%	14.3%				
Equity / Assets	8.5%	8.0%	7.7%	9.3%	9.1%	9.0%	9.0%
<b>Earnings</b>							
Return on Average Equity	17.43%	17.12%	19.35%	17.76%	16.95%	18.00%	19.90%
Return on Average Assets	1.60%	1.41%	1.52%	1.53%	1.57%	1.63%	1.79%
Avg. yield on earning assets	10.35%	8.59%	9.80%	11.42%	10.87%	10.22%	9.88%
Avg. cost of funds	6.25%	5.70%	6.31%	7.11%	6.74%	6.32%	5.79%
Net Interest Spread	4.10%	2.90%	3.48%	4.32%	4.13%	3.90%	4.09%
Net Interest Margin	4.57%	3.97%	4.00%	4.35%	4.33%	4.21%	4.40%
<b>Efficiency</b>							
Cost / Income	40%	42%	43%	40%	37%	37%	34%
Cost/ Core Income	49%	48.4%	47.2%	42.0%	39%	39%	36%
Cost / Average Assets	1.4%	1.4%	1.3%	1.2%	1.2%	1.1%	1.1%
Cost / Branch (Rs.'Mn)	61.2	66.0	69.3	72.8	78.3	87.2	94.1
Rev. / Employee (Rs.'Mn)	8.1	8.4	8.9	10.2	11.8	12.5	14.7
<b>Asset Quality</b>							
Asset Growth	31%	11%	16%	13%	16%	16%	16%
Deposit Growth	17%	18%	19%	15%	16%	16%	16%
Borrowings Growth	-65%	-4%	55%	43%	29%	10%	11%
Loan Growth	19%	16%	17%	18%	16%	16%	16%
<b>Liquidity</b>							
Loan / Deposits	76.8%	82%	83%	87%	86.4%	86.3%	86.3%
Loan / Total Assets	51%	58%	61%	64%	64%	64%	65%
Deposit / Liabilities	73%	76.9%	79.0%	81.9%	82%	82%	82%
CASA	48.4%	49.7%	41.9%	39.5%	41.0%	43.0%	43.0%

*Source : Company Annual Reports and First Capital Research Estimates*

**Appendix II: Statement of Income & Expenses**

Income Statement P/E 31 December	2014	2015	2016	2017	2018E	2019E	2020E
<b>Gross Income</b>	<b>72,571</b>	<b>78,225</b>	<b>93,726</b>	<b>116,842</b>	<b>132,097</b>	<b>146,584</b>	<b>165,370</b>
Interest Income	61,933	66,339	81,315	104,049	115,544	127,467	143,147
Less: Interest Expenses	34,613	35,772	48,186	64,482	69,649	75,037	79,497
<b>Net Interest Income</b>	<b>27,320</b>	<b>30,567</b>	<b>33,128</b>	<b>39,567</b>	<b>45,895</b>	<b>52,430</b>	<b>63,650</b>
Fee and Commission Income	5,614	6,330	8,230	10,511	12,613	15,136	17,406
Fees and Commission Expense	764	920	1,141	1,586	1,892	2,270	2,611
<b>Net Fee and Commission Income</b>	<b>4,849</b>	<b>5,410</b>	<b>7,089</b>	<b>8,924</b>	<b>10,721</b>	<b>12,865</b>	<b>14,795</b>
Net Gain from Trading	(305)	813	(1,467)	234	268	311	361
Net Gain from Financial Investments	2,273	694	111	129	1,377	1,049	1,273
Other Operating Income	5,024	4,049	5,537	1,919	2,295	2,621	3,183
<b>Total Operating Income</b>	<b>39,160</b>	<b>41,534</b>	<b>44,398</b>	<b>50,774</b>	<b>60,556</b>	<b>69,276</b>	<b>83,262</b>
and other Losses	4,898	4,100	1,583	2,226	5,278	4,340	3,946
<b>Net Operating Income</b>	<b>34,262</b>	<b>37,434</b>	<b>42,815</b>	<b>48,548</b>	<b>55,278</b>	<b>64,936</b>	<b>79,316</b>
<b>Operating Expenses</b>							
Personnel Expenses	8,956	10,261	10,913	11,339	12,142	13,741	14,775
Other Operating Expenses	6,764	7,161	8,078	9,036	10,180	11,623	13,256
<b>Total Operating Expenses</b>	<b>15,720</b>	<b>17,421</b>	<b>18,991</b>	<b>20,374</b>	<b>22,323</b>	<b>25,364</b>	<b>28,032</b>
<b>Operating Profit before Value Added Tax (VAT)</b>	<b>18,542</b>	<b>20,013</b>	<b>23,824</b>	<b>28,173</b>	<b>32,955</b>	<b>39,573</b>	<b>51,285</b>
Less: Value Added tax (VAT) on Financial Service:	2,689	2,890	3,716	4,897	5,863	6,931	9,909
<b>Operating profit after value added tax (VAT)</b>	<b>15,853</b>	<b>17,122</b>	<b>20,108</b>	<b>23,277</b>	<b>27,092</b>	<b>32,642</b>	<b>41,376</b>
Share of Profit/(Loss) of Associates (Net of Incon	7	14	6	4	4	4	4
<b>Profit before Income Tax</b>	<b>15,860</b>	<b>17,136</b>	<b>20,115</b>	<b>23,280</b>	<b>27,096</b>	<b>32,646</b>	<b>41,380</b>
Less: Income Tax Expense	4,617	5,277	5,648	6,654	7,587	9,141	11,586
<b>Profit for the Year</b>	<b>11,243</b>	<b>11,859</b>	<b>14,466</b>	<b>16,627</b>	<b>19,509</b>	<b>23,505</b>	<b>29,793</b>
Profit Attributable to Equity Holders of the Bank	11,239	11,855	14,511	16,606	19,503	23,497	29,783
Non-Controlling Interest	4	4	(45)	21	7	8	10
<b>PROFIT FOR THE YEAR</b>	<b>11,243</b>	<b>11,859</b>	<b>14,466</b>	<b>16,627</b>	<b>19,509</b>	<b>23,505</b>	<b>29,793</b>
<b>EPS</b>	<b>13.0</b>	<b>11.8</b>	<b>14.5</b>	<b>16.6</b>	<b>19.4</b>	<b>23.4</b>	<b>29.7</b>

Source : Company Annual Reports and First Capital Research Estimates

**Appendix III: Statement of Financial Position**

Statement of Financial Position P/E 31 December	2014	2015	2016	2017	2018E	2019E	2020E
<b>ASSETS</b>							
Cash and Cash Equivalents	20,622	20,107	32,924	34,645	16,670	26,134	36,603
Balances with Central Banks	19,634	28,221	43,935	45,546	58,031	66,276	76,880
Placements with Banks	14,508	17,194	11,718	17,633	19,749	22,119	24,773
Derivative Financial Instruments	460	4,118	1,053	2,335	2,148	2,492	2,890
Other Financial Assets Held-For-Trading	6,327	7,656	4,988	4,411	14,916	17,303	20,072
Loans and Receivables to Banks	551	601	624	641	1,193	1,384	1,606
Loans and Receivables to Other Customers	406,531	509,923	620,129	742,444	858,838	995,639	1,155,416
Financial Investments - Available-for-sale	214,225	204,262	160,093	154,914	198,887	230,708	267,622
Financial Investments - Loan and Receivables	50,436	57,724	51,824	48,712	58,455	70,146	84,175
Property, Plant & Equipment	11,135	11,181	11,570	16,317	16,562	17,353	18,773
Intangible Assets	856	884	1,133	1,251	1,537	1,891	2,330
Other Assets	10,560	12,097	16,483	17,363	19,889	23,071	26,762
<b>Total assets</b>	<b>797,258</b>	<b>882,183</b>	<b>1,020,984</b>	<b>1,155,792</b>	<b>1,336,455</b>	<b>1,544,095</b>	<b>1,787,482</b>
<b>LIABILITIES</b>							
Due to Banks	25,669	31,789	71,098	60,245	42,942	49,782	57,771
Derivative Financial Instruments	1,193	1,891	1,515	3,678	2,577	2,987	3,466
Securities sold under repurchase agreements	124,391	112,250	69,629	49,532	85,884	99,564	115,542
Due to Other Customers	529,267	624,021	743,311	857,270	994,433	1,153,542	1,338,109
Other Borrowings	11,637	9,986	9,270	23,786	34,338	37,074	40,270
Current Tax Liabilities	5,711	3,026	3,465	4,203	3,793	4,570	5,793
Deferred Tax Liabilities	2,876	468	-	3,565	3,793	4,570	5,793
Other Liabilities	17,670	15,749	18,029	19,508	17,177	19,913	23,108
Subordinated Term Debts	11,263	11,988	24,850	25,166	28,583	32,262	36,424
<b>Total liabilities</b>	<b>729,678</b>	<b>811,169</b>	<b>941,168</b>	<b>1,046,954</b>	<b>1,213,521</b>	<b>1,404,265</b>	<b>1,626,276</b>
<b>EQUITY</b>							
Stated Capital	21,458	23,255	24,978	37,144	39,681	42,677	46,434
Statutory Reserves	4,327	4,922	5,648	6,493	7,468	8,643	10,133
Retained Earnings	4,418	4,468	4,554	5,087	8,741	15,124	23,215
Other Reserves	37,330	38,319	43,813	59,272	66,172	72,505	80,533
<b>Total Equity to Equity Owners of the Bank</b>	<b>67,533</b>	<b>70,964</b>	<b>78,992</b>	<b>107,995</b>	<b>122,063</b>	<b>138,950</b>	<b>160,315</b>
Non-Controlling Interest	48	50	823	844	872	880	890
<b>Total Equity</b>	<b>67,580</b>	<b>71,014</b>	<b>79,815</b>	<b>108,838</b>	<b>122,934</b>	<b>139,830</b>	<b>161,205</b>
	<b>797,258</b>	<b>882,183</b>	<b>1,020,984</b>	<b>1,155,792</b>	<b>1,336,455</b>	<b>1,544,095</b>	<b>1,787,482</b>
<b>NAVPS</b>	<b>78.0</b>	<b>70.8</b>	<b>78.8</b>	<b>107.7</b>	<b>119.6</b>	<b>133.5</b>	<b>150.6</b>

*Source : Company Annual Reports and First Capital Research Estimates*

Appendix IV: Top 20 Shareholders

Top 20 shareholders - (% held) - COMB.N	1Q2018	4Q2017	QoQ	1Q2017	YoY
DFCC Bank A/C 1	13.6%	13.6%	0.0%	14.7%	-
Employees Provident Fund	9.6%	9.7%	0.0%	9.7%	-
Mr.Y.S. H. I. Silva	8.1%	7.6%	0.5%	9.9%	-
Deutsche Bank AG Singapore - DSS A/C Ntasian Discovery Master Fund	5.7%	5.7%	0.0%	0.0%	5.7%
Sri Lanka Insurance Corporation Ltd. - Life Fund	4.5%	5.0%	-0.5%	5.0%	-0.5%
Melstacorp PLC	4.5%	4.5%	-	3.4%	1.1%
CB NY S/A International Finance Corporation	4.4%	4.5%	0.0%	4.5%	0.0%
Sri Lanka Insurance Corporation Ltd. - General Fund	3.9%	4.3%	-0.4%	4.3%	-0.4%
Mrs. L. E. M. Yaseen	1.8%	1.8%	0.0%	1.8%	0.0%
BNYMSANV RE-CF Ruffer Absolute Return Fund	1.8%	1.8%	-	1.0%	0.8%
Employees Trust Fund Board	1.7%	1.7%	0.1%	1.3%	0.4%
HSBC Intl. Nominees Ltd. - JPMCB - T Rowe New Asia Fund	1.6%	1.6%	-	0.0%	1.6%
HSBC Intl. Nominees Ltd. - JPMLU- Franklin Templeton Investment Fu	1.6%	1.8%	-0.2%	1.8%	-0.2%
HSBC Intl. Nominees Ltd. - SSBT-Morgan Stanley Asset Management S	1.5%	1.5%	-	1.5%	0.0%
HSBC Intl. Nominees Ltd. - SSBT-Morgan Stanley Institutional Fund, In	1.4%	1.5%	-0.1%	1.5%	-0.1%
BNYMSANV RE - First State Investments ICVC - Stewart Investors Indi	1.2%	1.1%	0.1%	0.0%	1.2%
HSBC Intl. Nominees Ltd. - SSBT - BMO Investments II (Ireland) Public	1.1%	1.1%	-	1.0%	0.0%
HSBC Intl. Nominees Ltd. - BPSS LUX - Aberdeen Global Asia Pacific Eq	1.0%	1.0%	-	1.3%	-
HSBC Intl. Nominees Ltd. - JPMLU-T Rowe Price Funds SICAV	1.0%	1.0%	-0.1%	0.0%	1.0%
CITY Bank Newyork S/A Norges Bank Account 02	0.8%	0.0%	0.8%	0.0%	-

Top 20 shareholders - (% held) - COMB.X	1Q2018	4Q2017	QoQ	1Q2017	YoY
CITY Bank Newyork S/A Norges Bank Account 02	15.4%	10.1%	5.3%	6.9%	-
Employees Trust Fund Board	7.5%	7.3%	0.2%	7.3%	-
Akbar Brothers (Pvt) Ltd. A/C No.01	2.7%	1.1%	1.6%	1.0%	-
GF Capital Global Limited	2.6%	2.6%	-	2.8%	-0.2%
BNYMSANV RE-Butterfield Trust (Bermuda) Limited	2.3%	2.3%	-	2.5%	-0.2%
CB NY S/A Salient International Dividend Signal Fund	2.1%	2.1%	-	2.3%	-0.2%
M.J.F.Exports (Pvt) Ltd	1.7%	1.7%	-	1.7%	0.0%
Northern Trust Company S/A Polar Capital Funds PLC	1.7%	1.1%	0.6%	0.0%	1.7%
Mr. M. F. Hashim	1.4%	1.4%	-	1.4%	0.0%
Saboor Chatoor (Pvt) Ltd	1.4%	1.4%	-	1.4%	0.0%
Mrs. L. V. C. Samarasinha	1.3%	1.2%	0.1%	1.1%	0.1%
Union Assurance PLC/No - 01A/C	1.0%	1.0%	-	1.0%	0.0%
Mr. J. D. Bandaranayake , Dr. V. Bandaranayake & Ms. I. Bandaranayak	1.0%	0.0%	1.0%	0.0%	1.0%
Mr. J. D. Bandaranayake , Ms. N. Bandaranayake & Dr. V. Bandaranaya	1.0%	0.0%	1.0%	0.0%	1.0%
Mr. T.W.A. Wickramasinghe	0.8%	0.8%	0.0%	0.8%	0.1%
Mr. G. R. Mallawaarachy & Mrs. B. G. P. Mallawaarachy (Joint)	0.8%	0.8%	-	0.8%	0.0%
Mr. A.L. Gooneratne	0.7%	0.7%	-	0.0%	0.7%
Bank of Ceylon A/C Ceybank Century Growth Fund	0.7%	0.7%	-	0.0%	-
Mr. J. G. de Mel	0.6%	0.0%	0.6%	0.9%	-0.3%
Mr. K.B. de Vos	0.6%	0.0%	0.6%	0.0%	-

## Research Disclosure

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