



COMMERCIAL BANK OF CEYLON PLC [COMB.N0000]

MAINTAIN BUY

FX GAINS EQUIPOISE IMPAIRMENT

Fair Value: 2018E - LKR 137.0 [+21%], 2019E - LKR 152.0 [+35%]

Total Return with DPS: 2018E - 21% [AER 645%] 2019E – 41% [AER 36%]

COMB's earnings grew by 24% in the 3Q2018 driven by high NIIs, stronger NIMs and a mammoth forex gain though partly offset by heavy impairment. We downgrade the earnings outlook to LKR 19.0Bn (-2%) for 2018E and to LKR 21.0Bn (-10%) for 2019E due to rising impairment and proposed debt repayment levy. We roll over our Target Price (TP) to 2019E, revising the fair value downwards to LKR 152.0 from previous LKR 183.0 providing an annualised return of 36%. **Maintain BUY.**

LKR (Mn)	3Q2017	3Q2018	YoY	9M2017	9M2018	YoY
NII	10,554	12,290	+16%	28,644	36,161	+26%
NII + Other Income	12,733	18,279	+44%	36,517	49,301	+35%
Post Impairment Income	12,074	14,874	+23%	34,898	41,868	+20%
Pre Tax Profit	7,018	8,702	+24%	19,904	24,305	+22%
Net Profit	4,112	5,119	+24%	11,769	13,678	+16%

Loans	712,066	840,068	+18%	712,066	840,068	+18%
Shareholders' Equity	103,281	121,502	+18%	103,281	121,502	+18%
NAVPS	103.8	119.2	+15%	103.8	119.2	+15%

Earnings growth through improved top line and significant FX gains

COMB recorded 24%YoY growth in earnings to reach LKR 5.1Bn for 3Q2018 with NII surging by 16% to LKR 12.2Bn and Other Income rising by 362%YoY to LKR 3.5Bn through foreign exchange gains. Earnings fell in-line with our expectation for 3Q2018 as heavy surge in impairment provisioning of LKR 3.4Bn (up by 417%YoY) was offset by the foreign exchange gain. However, we downgrade our profit target for 2018E to LKR 19.0Bn and 2019E to LKR 21.0Bn due to rising impairment and possible implementation of the proposed debt repayment Levy.

NII up +16%YoY on the back of loan growth and expansion of NIMs

COMB's NII increase was mainly driven by 14.6%YoY surge in interest income which was supported by 3.2%QoQ & 18.0%YoY growth in the COMB's loan book to LKR 840.0Bn and 42bps expansion in NIMs. Interest expenses grew at a much slower pace at 13.4%YoY on the back of COMB's less preference to deposits.

Improvement in C/I ratio

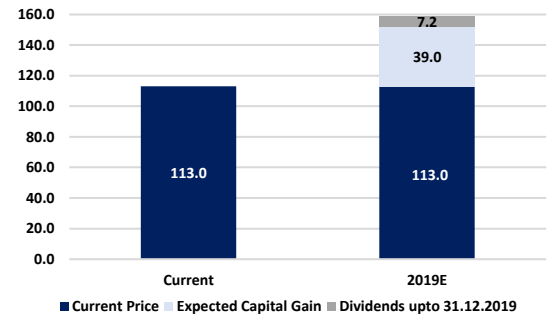
COMB recorded an improvement in its' Cost to Income (C/I) ratio largely attributable to the improved NII, stemming from growing trade related and SME sector borrowings and the continued digitalization drive. C/I improved to 33.8% in 3Q2018 compared to 39.7% in 3Q2017.

Sharp increase in impairment

Impairment continued to pick up sharply with a four-fold increase YoY and 41.5% increase QoQ, with the largest impact arising from individual impairment mainly driven by SME. Overall, 9M2018 impairment also picked up four-fold. COMB's exposure to troubled sectors such as Construction and Agri drove the impairment, while the bank has already taken some level of prudent impairment provisioning given the impending IFRS 9/SLFRS 9 implementation.

We maintain BUY on both voting and Non-Voting

We downgrade the earnings outlook to LKR 19.0Bn (-2%) for 2018E and to LKR 21.0Bn (-10%) for 2019E due to rising impairment and proposed debt repayment levy, thereby we downgrade TP to LKR 152.0 for 2019E. COMB.X is valued at LKR 122.0 anticipating 20% discount to the voting share. **BUY for COMB.N and COMB.X.**



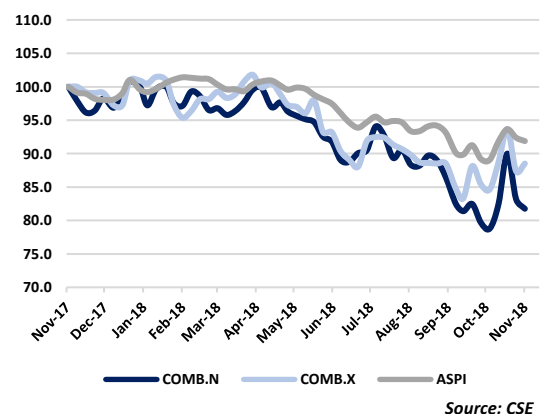
FIRST CAPITAL RESEARCH

Atchuthan Srirangan +94 11 263 9863
atchuthan@firstcapital.lk

KEY DATA	COMB.N0000	COMB.X0000
CSE Ticker	COMB.N0000	COMB.X0000
Bloomberg Ticker	COMB SL	COMB X SL
Share Price (LKR)	113.0	94.0
52w High (LKR)	140.4	108.5
52w Low (LKR)	107.8	88.3
Avg. Daily Volume (Shares)	234,549	27,628
Avg. Daily Turnover (LKR)	30,659,984	2,780,394
Issued Share Capital (Shares 'Mn)	945	65
Market Cap (LKR 'Mn)	106,808	6,111
Market Cap (USD 'Mn)	610	35

*1 USD = LKR 175

Price Performance (%)	1 mth	3 mths	12mths
COMB - Voting	4%	-7%	-20%
COMB - Non-Voting	6%	-1%	-13%
ASPI	3%	-2%	-9%



Minimum Return for BUY:

Buy Below [AER of 14% with DPS]: LKR 137.0
 COMB categorized as 'Grade A' counter (Refer page 08 for Recommendation criteria of Grade A, B & C Stocks)

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
Earnings Estimate						
Net Interest Income	44,375	44,840	+1%	52,580	49,213	-6%
NII + Other Income	55,096	55,561	+1%	65,446	62,078	-5%
Post Impairment Income	58,914	64,798	+10%	69,438	65,834	-5%
Pre Tax Profit	32,989	33,139	+0%	25,364	25,364	0%
Net Profit	19,524	19,047	-2%	23,510	21,096	-10%
Adjusted EPS	19.4	18.7		23.4	20.7	
Growth YoY	17%	15%		20%	11%	
Balance Sheet Estimate						
Loans & Advances	858,838	854,781	-0%	995,639	994,206	-0%
Shareholders' Equity	122,078	121,738	-0%	138,974	136,916	-1%
Adjusted NAVPS	119.6	119.3		133.5	131.8	
Ratio Estimate						
ROE (%)	17.0%	16.6%		18.0%	16.3%	
PER (x)	6.9	6.1		5.7	5.5	
PBV (x)	1.1	0.9		1.0	0.9	

Valuation Table

P/E 31 December	2014	2015	2016	2017	2018E	2019E	2020E
Estimates (LKR 'Mn)							
Net Interest Income	27,320	30,567	33,128	39,567	44,840	49,213	56,394
Total Operating Income	39,160	41,534	44,398	50,774	64,798	65,834	75,497
Net Profit	11,239	11,855	14,511	16,606	19,047	21,096	23,760
Adjusted EPS (LKR)	11.0	11.6	14.2	16.3	18.7	20.7	23.3
YoY Growth (%)	6%	5%	22%	14%	15%	11%	13%
Valuations							
PER (x)	10.3x	9.7x	7.9x	6.9x	6.1x	5.5x	4.9x
PBV (x)	1.4x	1.6x	1.4x	1.0x	0.9x	0.9x	0.8x
DY (%)	5.8%	5.0%	5.0%	5.7%	6.4%	7.0%	7.7%

Valuation Summary

Expected COMB.N price for 2019E	
Justified PBV based target price	164.6
PER Valuation based target price	144.7
RI Valuation based target price	147.3
Average Target Price	152.2
Target Price after Rounding off	152.0

Expected COMB.X price for 2019E	
Target Price for COMB.N	152.0
Average 12 month discount	-20%
Target Price for COMB.X	121.6
Target Price after Rounding off	122.0

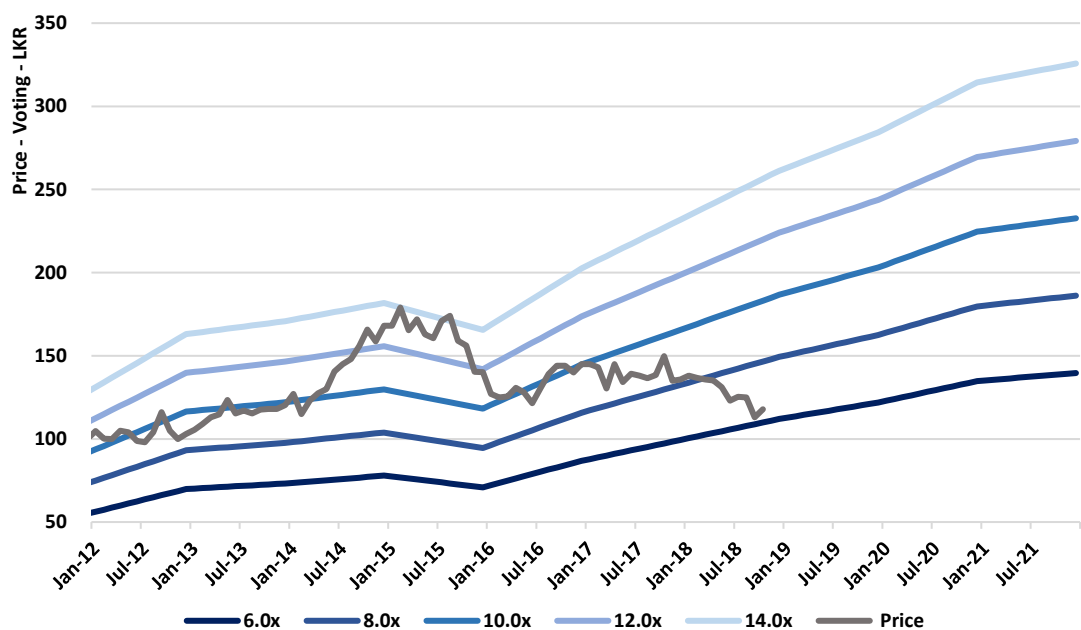
Return	
Target Price	152.0
Current Price	113.0
Capital Gain (LKR)	39.0
Dividends upto 31.12.2019 (LKR)	7.2
Capital Gain %	35%
Dividend Yield %	6%
Total Return %	41%
Annualized Return %	36%

Residual Income Valuation

Residual Income based Valuation	
PV of Residual Income	28,569
No. of Shares ('Mn)	1,020
RI per Share	28.0
Opening Book value per Share	119.3
Value per Share	147.3

Justified PBV Valuation

COE		Justified PBV based Valuation	
Rf	9.5%	ROAE	16.3%
Rm	16.5%	Growth	3.0%
Growth %	3.0%	COE	13.7%
β	0.60	PBV	1.2
$Ke=Rf+\beta(Rm-Rf)$	13.7%	NAVPS	131.8
		Target Price	164.6

PER Valuation


PER based Valuation	
2019E Earnings (LKR 'Mn)	21,096
No. of Shares ('Mn)	1,020
2019E EPS	20.67
Expected PER	7.0x
Price at 7x 2019E Earnings	144.7

Appendix I: Key Ratios

COMB P/E 31 December	2014	2015	2016	2017	2018E	2019E	2020E
Capital							
Tier 1 (5%)	13.1%	11.6%	11.6%	12.1%			
Tier 2 (10%)	16.2%	14.3%	16.0%	15.7%			
Equity / Assets	8.5%	8.0%	7.7%	9.3%	9.1%	8.9%	8.7%
Earnings							
Return on Average Equity	17.43%	17.12%	19.35%	17.76%	16.58%	16.31%	16.33%
Return on Average Assets	1.60%	1.41%	1.52%	1.53%	1.53%	1.47%	1.43%
Avg. yield on earning assets	10.35%	8.59%	9.80%	11.42%	11.26%	10.82%	10.57%
Avg. cost of funds	6.25%	5.70%	6.31%	7.11%	7.22%	7.20%	7.04%
Net Interest Spread	4.10%	2.90%	3.48%	4.32%	4.04%	3.62%	3.53%
Net Interest Margin	4.57%	3.97%	4.00%	4.35%	4.24%	3.96%	3.90%
Efficiency							
Cost / Income	40%	42%	43%	40%	34%	39%	37%
Cost/ Core Income	49%	48.4%	47.2%	42.0%	40%	41%	39%
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	12.6	11.9	13.3
Asset Quality							
Asset Growth	31%	11%	16%	13%	16%	15%	15%
Deposit Growth	17%	18%	19%	15%	16%	16%	16%
Borrowings Growth	-65%	-4%	55%	43%	28%	10%	11%
Loan Growth	19%	16%	17%	18%	15%	17%	16%
Liquidity							
Loan / Deposits	76.8%	82%	83%	87%	86.0%	86.2%	86.3%
Loan / Total Assets	51%	58%	61%	64%	64%	65%	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
Gross Income	72,571	78,225	93,726	116,842	141,317	153,575	174,766
Interest Income	61,933	66,339	81,315	104,049	119,468	134,683	153,051
Less: Interest Expenses	34,613	35,772	48,186	64,482	74,628	85,470	96,657
Net Interest Income	27,320	30,567	33,128	39,567	44,840	49,213	56,394
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
Net Fee and Commission Income	4,849	5,410	7,089	8,924	10,721	12,865	14,795
Net Gain from Trading	-305	813	-1,467	234	268	311	361
Net Gain from Financial Investments	2,273	694	111	129	1,345	984	1,128
Other Operating Income	5,024	4,049	5,537	1,919	7,623	2,461	2,820
Total Operating Income	39,160	41,534	44,398	50,774	64,798	65,834	75,497
and other Losses	4,898	4,100	1,583	2,226	9,336	1,715	2,513
Net Operating Income	34,262	37,434	42,815	48,548	55,462	64,119	72,984
Operating Expenses							
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
Total Operating Expenses	15,720	17,421	18,991	20,374	22,323	25,364	28,032
Operating Profit before Value Added Tax (VAT)	18,542	20,013	23,824	28,173	33,139	38,756	44,953
Less: Value Added tax (VAT) on Financial Services:	2,689	2,890	3,716	4,897	5,887	6,825	8,959
Operating profit after value added tax (VAT)	15,853	17,122	20,108	23,277	26,460	29,306	33,007
Share of Profit/(Loss) of Associates	7	14	6	4	4	4	4
Profit before Income Tax	15,860	17,136	20,115	23,280	26,464	29,310	33,011
Less: Income Tax Expense	4,617	5,277	5,648	6,654	7,410	8,207	9,243
Profit for the Year	11,243	11,859	14,466	16,627	19,054	21,103	23,768
Profit Attributable to Equity Holders of the Bank	11,239	11,855	14,511	16,606	19,047	21,096	23,760
Non-Controlling Interest	4	4	-45	21	7	7	8
PROFIT FOR THE YEAR	11,243	11,859	14,466	16,627	19,054	21,103	23,768
EPS	13.0	11.8	14.5	16.6	18.7	20.7	23.3

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
ASSETS							
Cash and Cash Equivalents	20,622	20,107	32,924	34,645	19,980	24,944	28,657
Balances with Central Banks	19,634	28,221	43,935	45,546	57,494	65,653	76,157
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	854,781	994,206	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
Total assets	797,258	882,183	1,020,984	1,155,792	1,335,171	1,540,850	1,778,813
LIABILITIES							
Due to Banks	25,669	31,789	71,098	60,245	42,739	49,710	57,771
Derivative Financial Instruments	1,193	1,891	1,515	3,678	2,564	2,983	3,466
Securities sold under repurchase agreements	124,391	112,250	69,629	49,532	85,478	99,421	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	34,257	37,045	40,270
Current Tax Liabilities	5,711	3,026	3,465	4,203	3,705	4,103	4,622
Deferred Tax Liabilities	2,876	468	-	3,565	3,705	4,103	4,622
Other Liabilities	17,670	15,749	18,029	19,508	17,096	19,884	23,108
Subordinated Term Debts	11,263	11,988	24,850	25,166	28,583	32,262	36,424
Total liabilities	729,678	811,169	941,168	1,046,954	1,212,560	1,403,054	1,623,933
EQUITY							
Stated Capital	21,458	23,255	24,978	37,144	39,626	42,332	45,362
Statutory Reserves	4,327	4,922	5,648	6,493	7,445	8,500	9,689
Retained Earnings	4,418	4,468	4,554	5,087	8,618	14,348	20,803
Other Reserves	37,330	38,319	43,813	59,272	66,049	71,735	78,140
Total Equity to Equity Owners of the Bank	67,533	70,964	78,992	107,995	121,738	136,916	153,993
Non-Controlling Interest	48	50	823	844	872	879	887
Total Equity	67,580	71,014	79,815	108,838	122,610	137,796	154,880
NAVPS	78.0	70.8	78.8	107.7	119.3	131.8	145.6

Source : Company Annual Reports and First Capital Research Estimates

Appendix IV: Top 20 Shareholders

Top 20 shareholders - (% held) - COMB	3Q2018	2Q2018	QoQ	3QFY17	YoY
DFCC Bank A/C 1	13.6%	13.6%	-	13.6%	-0.1%
Employees Provident Fund	9.6%	9.6%	-	9.7%	0.0%
Mr.Y.S. H. I. Silva	8.1%	8.1%	-	7.9%	0.2%
Deutsche Bank AG Singapore - DSS A/C Ntasian Discovery Master Fund	5.7%	5.7%	-	4.4%	1.3%
Sri Lanka Insurance Corporation Ltd. - Life Fund	4.5%	4.5%	-	5.0%	-0.5%
Melstacorp Limited	4.5%	4.5%	0.1%	4.5%	0.0%
CB NY S/A International Finance Corporation	4.4%	4.4%	-	4.5%	0.0%
Sri Lanka Insurance Corporation Ltd. - General Fund	3.9%	3.9%	-	4.3%	-0.4%
Employees Trust Fund Board	1.8%	1.8%	-	1.6%	0.2%
BNYMSANV RE-LF Ruffer Absolute Return Fund	1.8%	1.8%	-	0.0%	1.8%
Mrs. L. E. M. Yaseen	1.7%	1.8%	-0.1%	1.8%	-0.2%
JPMCB - T Rowe New Asia Fund	1.6%	1.6%	-	1.6%	-
BNYMSANV RE - First State Investments ICVC - Stewart Investors Indiar	1.3%	1.3%	-	1.1%	0.2%
Morgan Stanley Asset Management SA Acting on behalf of Morgan Star	1.2%	1.3%	-0.1%	1.5%	-0.3%
Citi Bank Newyork S/A Norges Bank Account 2	1.2%	1.1%	0.1%	0.0%	1.2%
BMO Invetments 11 (Ireland) Public Limited Company	1.1%	1.1%	-	1.1%	-
BPSS LUX -Aberdeen Global Asia Pacific Equity Fund	1.0%	1.0%	-	1.3%	-0.3%
Mr. M. J. Fernando	1.0%	0.0%	1.0%	0.0%	1.0%
JPMLU-T Rowe Price Funds SICAV	1.0%	1.0%	-0.1%	0.0%	1.0%
Morgan Stanley Institutional Fund, Inc. - Frontier Emerging Markets Po	0.8%	1.2%	-0.4%	1.5%	-0.6%

Appendix V: Recommendation criteria

Categorization	Company Category	Buy	Hold	Sell
Grade A	S&P SL20 Companies	T.Bill + 5% & Above	T.Bill + 1% & Above	Below T.Bill + 1%
Grade B	Rest of the Companies	T.Bill + 8% & Above	T.Bill + 3% & Above	Below T.Bill + 3%
Grade C	Companies less than LKR 1Bn Market Cap	T.Bill + 11% & Above	T.Bill + 6% & Above	Below T.Bill + 6%

Weighted Average 1-year T-bill rate during Jun 2018: 9.46%

Categorization	Company Category	Buy	Hold	Sell
Grade A	S&P SL20 Companies	14.46%	10.46%	10.46%
Grade B	Rest of the Companies	17.46%	12.46%	12.46%
Grade C	Companies less than LKR 1Bn Market Cap	20.46%	15.46%	15.46%



First Capital

First Capital Holdings PLC

No.2, Deal Place,
Colombo 3

Tel: +94 11 2145 000

Fax: +94 11 2145 050

RESEARCH

Dimantha Mathew	+94 11 2639 853	Hiruni Perera	+94 11 2639 864
Atchuthan Srirangan	+94 11 2639 863	Nisansala Kuruppumudali	+94 11 2639 866
Amanda Lokugamage	+94 11 2639 868		

GOVERNMENT SECURITIES SALES

Anjelo Simmons	+94 77 3031 636	Neminda Jayawardena	+94 76 6644 080
Anushka Dissanayake	+94 77 2220 021	Arun Kandasamy	+94 75 4861 506
Anushi Ranawaka	+94 77 3876 819		

CORPORATE DEBT SALES

Sewwandi Kathriarachchi	+94 77 3461 734	Mahesh Amarasinghe	+94 77 0073 684
Nethalie De Mel	+94 11 2639 854	Dharshanie Vasanthajothy	+94 77 9159 878

EQUITY SALES

CEO	Jaliya Wijeratne	+94 70 2910 042	Negombo	
			Priyanka Anuruddha	+94 70 2910 035
Colombo			Priyantha Wijesiri	+94 70 2910 036
Damian Le Grand		+94 70 2910 032		
Nishantha Mudalige		+94 70 2910 041		
Isuru Jayawardana		+94 70 2910 034		
Ifadh Marikar		+94 77 9625 679		
Thushara Pathiraja		+94 70 2910 037		
Anushka Buddhika		+94 70 2910 030		
Gamini Hettiarachchi		+94 70 2910 039		

UNIT TRUST SALES

Kavin Karunamoorthy	+94 77 0328 060	Thiruni Gooneratne	+94 77 5077 695
Imali Abeygunawardena	+94 77 1764 799	Deepal Pathmaperuma	+94 77 9159 878

BRANCHES

Kandy	Kurunegala	Matara	Negombo
2nd Floor, No.121 Kotugodella Veediya (E L Senanayake Veediya) Kandy 20000.	Ground Floor No. 42, Mihindu Mawatha, Kurunegala 60000.	2nd Floor, E.H. Cooray Building No: 24, 1/3, Anagrika Dharmapala Mawatha, Matara 81000.	1st Floor No: 163B, Colombo Road, Negombo 11500.
Manager: Salinda Samarakoon	Manager:	Manager: Rohana Jayakody	Manager: Buddhika Edirisinghe
Tel: +94 81 2236 010	Tel: +94 37 2222 930	Tel: +94 41 2222 988	Tel: +94 31 2233 299

Disclaimer:

This Review is prepared and issued by First Capital Holdings PLC based on information in the public domain, internally developed and other sources, believed to be correct. Although all reasonable care has been taken to ensure the contents of the Review are accurate, First Capital Holdings PLC and/or its Directors, employees, are not responsible for the correctness, usefulness, reliability of same. First Capital Holdings PLC may act as a Broker in the investments which are the subject of this document or related investments and may have acted on or used the information contained in this document, or the research or analysis on which it is based, before its publication. First Capital Holdings PLC and/or its principal, their respective Directors, or Employees may also have a position or be otherwise interested in the investments referred to in this document. This is not an offer to sell or buy the investments referred to in this document. This Review may contain data which are inaccurate and unreliable. You hereby waive irrevocably any rights or remedies in law or equity you have or may have against First Capital Holdings PLC with respect to the Review and agree to indemnify and hold First Capital Holdings PLC and/or its principal, their respective directors and employees harmless to the fullest extent allowed by law regarding all matters related to your use of this Review. No part of this document may be reproduced, distributed or published in whole or in part by any means to any other person for any purpose without prior permission.

About us:

This report providing a snapshot of fixed income, equity and unit trust is composed and circulated by First Capital Holdings PLC an investment bank in Sri Lanka. The company operates in the capital market of Sri Lanka with operations in government securities - treasury bills and bonds, stock brokering and share market investments, asset management, private wealth management, retirement planning, personal financial planning, unit trust, margin trading, capital market research, trustee services, corporate finance advisory services including corporate debt structuring (debentures, trust certificates, commercial papers), valuations, restructuring, mergers and acquisitions, initial public offerings (IPOs) and project advisory. The First Capital Group consists of First Capital Treasuries PLC, First Capital Limited, First Capital Markets Limited, First Capital Asset Management Limited and First Capital Equities (Private) Limited covering Colombo, Negombo, Matara, Kandy and Kurunegala.