



First Capital

Phoenix; Rise from the Ashes

Banking Sector – 31st Jan 2021

FIRST CAPITAL RESEARCH

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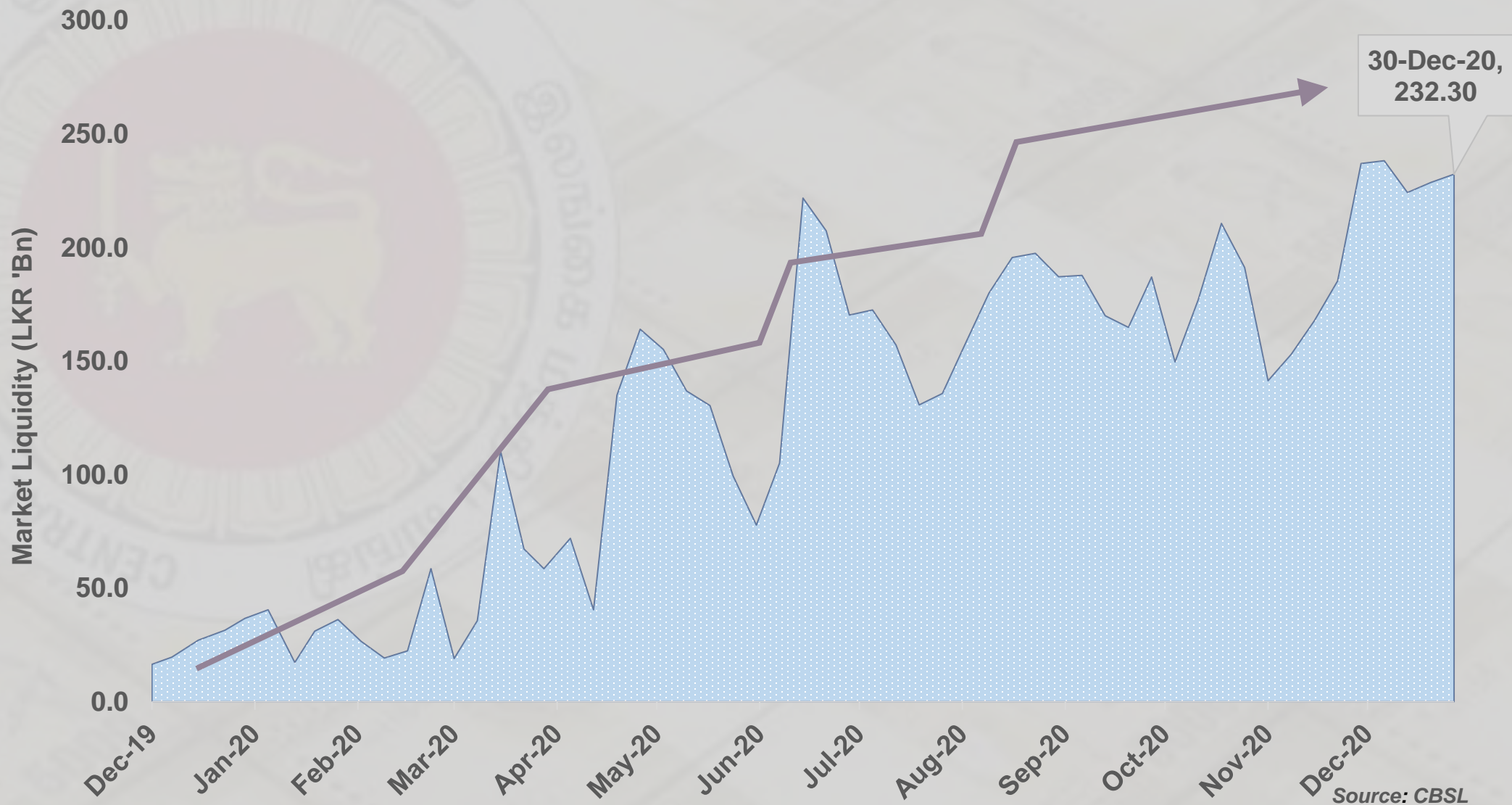
- 1.0 Banking system resilience in the time of Covid-19
- 2.0 Digitalization saves banking sector from Covid-19
- 3.0 Economy in transition and poised for renewed growth
- 4.0 Impairment to soften
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1.0 Banking system resilience in the time of Covid-19

CBSL continuously injected liquidity supporting the financial system throughout...



Source: CBSL

...and announced multiple Moratoriums to provide breathing space for businesses

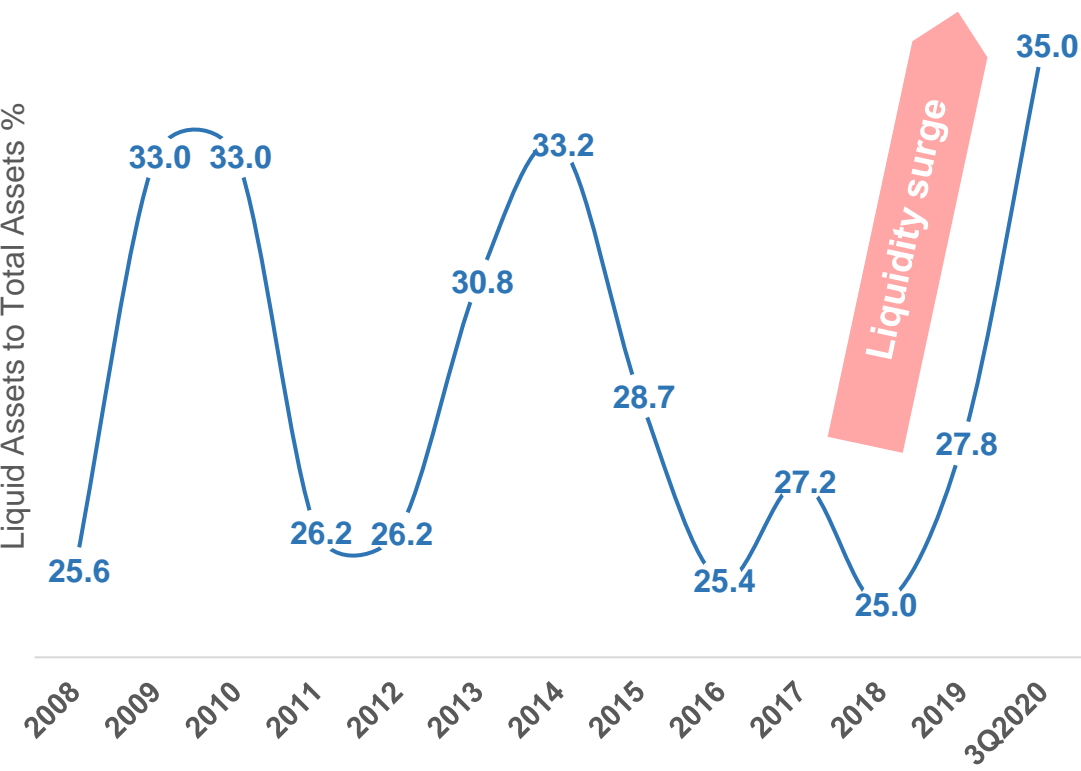
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Source: CBSL

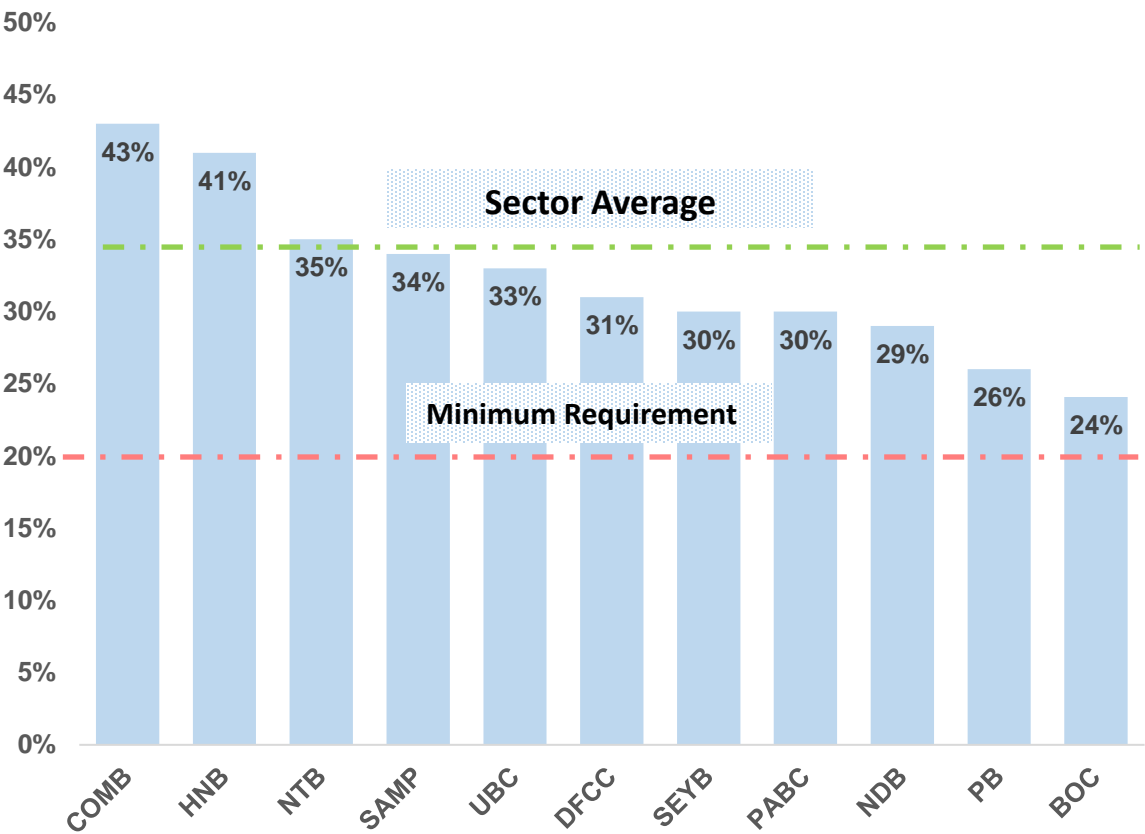
Despite moratoriums, liquidity is abundant, with cash being hoarded

Liquid Asset ratio surges to 35%



Source: CBSL

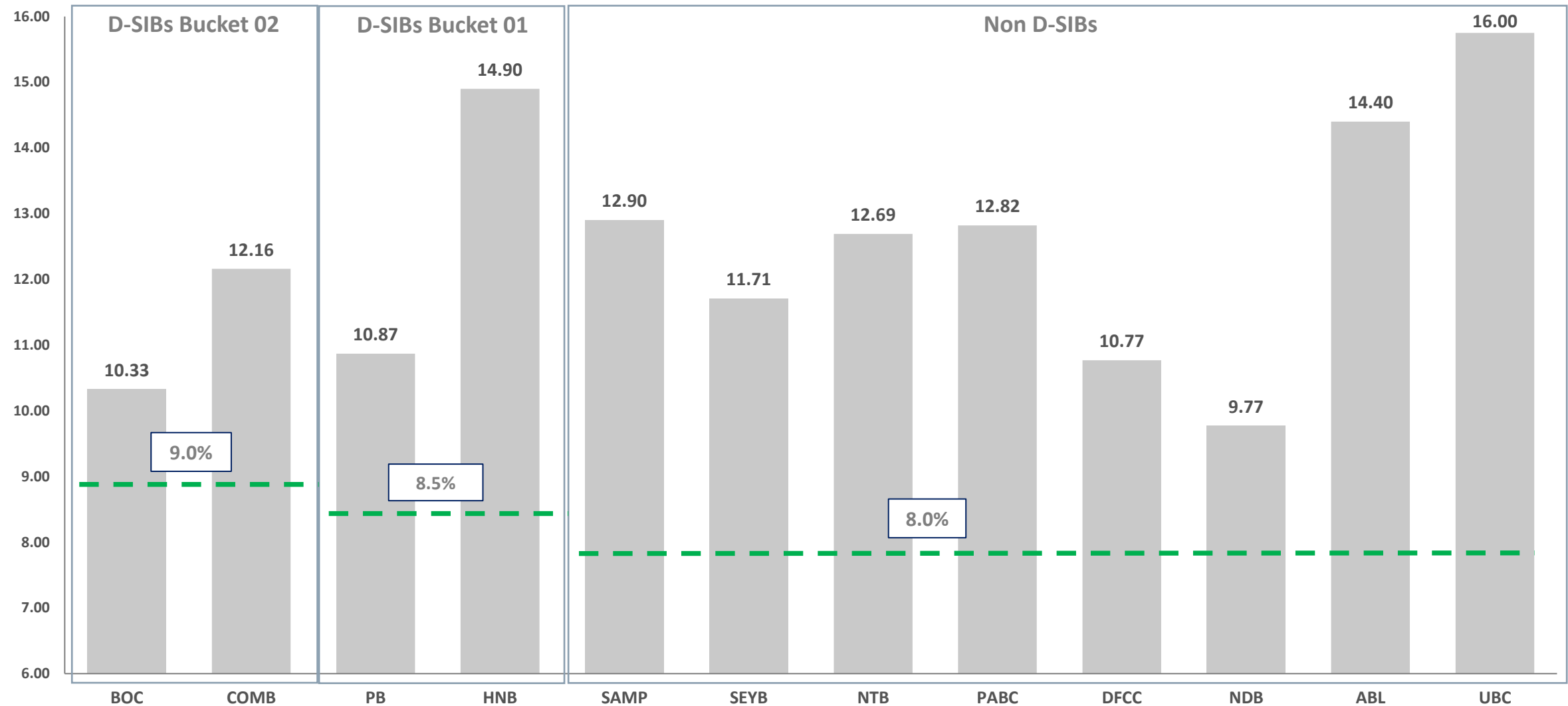
Most banks are well above regulatory liquidity requirement



Source: CBSL, Company Reports

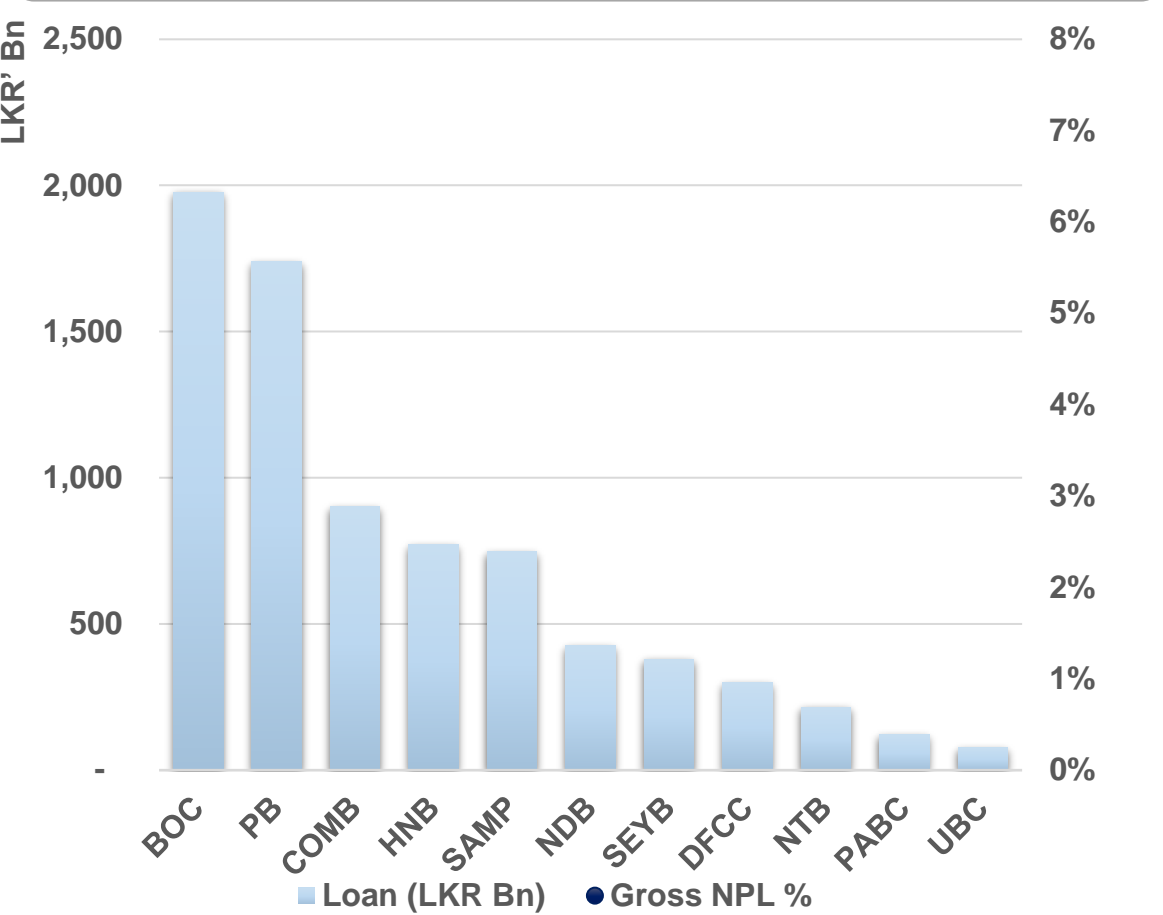
Capital cushions steady: “Bent-but-don’t-break”

Source: CBSL, Company reports



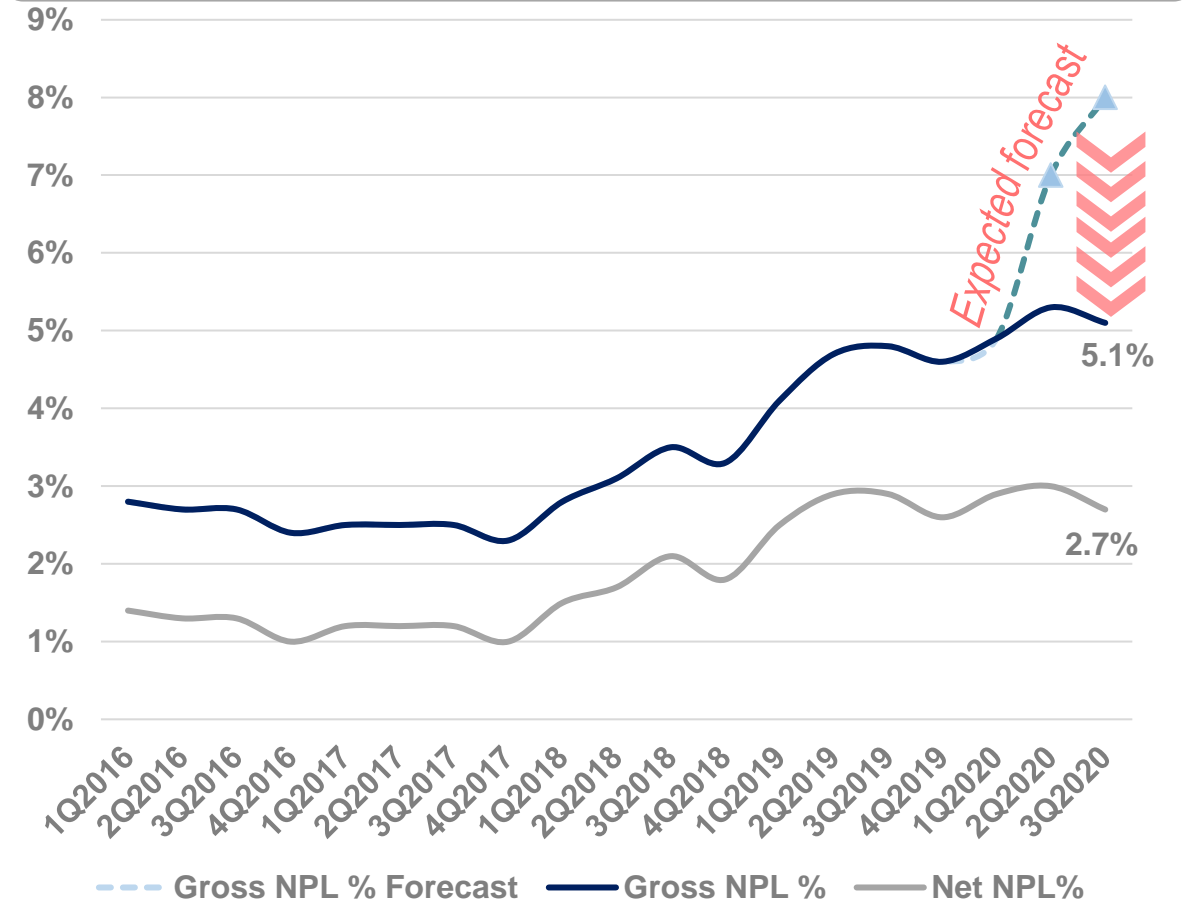
Back-to-back moratoriums limit NPLs shocks, recording NPLs below expectations...

Banks with higher NPLs ratios are under pressure



Source: Company reports

Moratorium reduces surge in NPLs

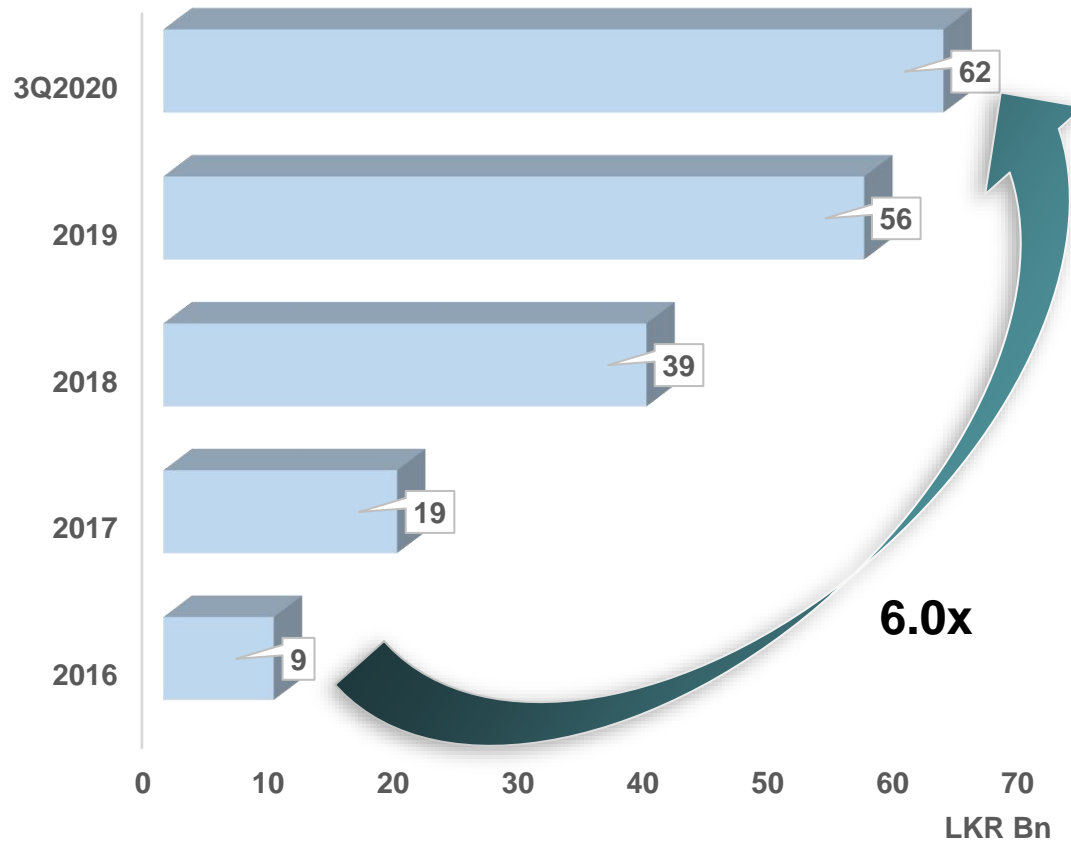


Source: CBSL, First Capital Research

...But banks take the safe zone with massive provisioning

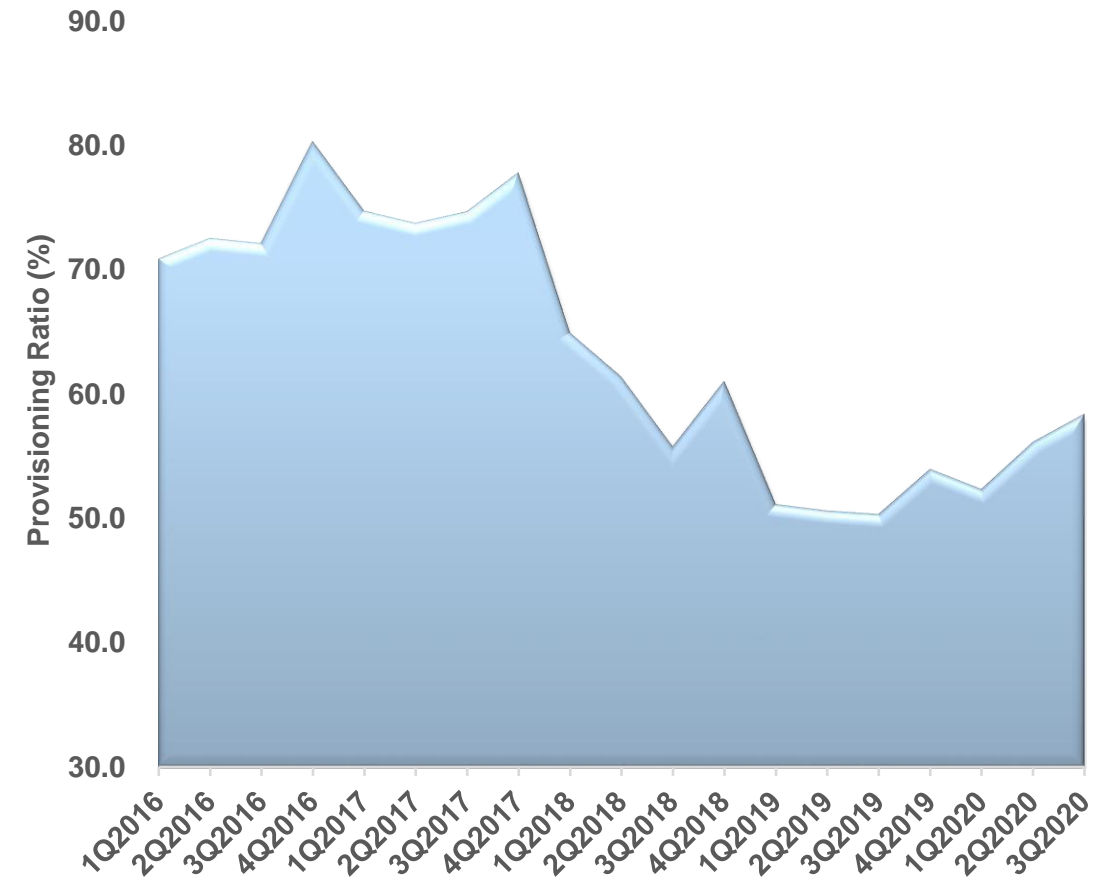
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Banks's impairment provisioning increased to 6.0x in 5 years.



Source: CBSL

Provisioning ratio improves despite higher impairment charge



Source: CBSL

2.0 Digitalization saves banking sector from Covid-19

Covid-19 shapes up banking megatrends with digitalization taking centre stage...

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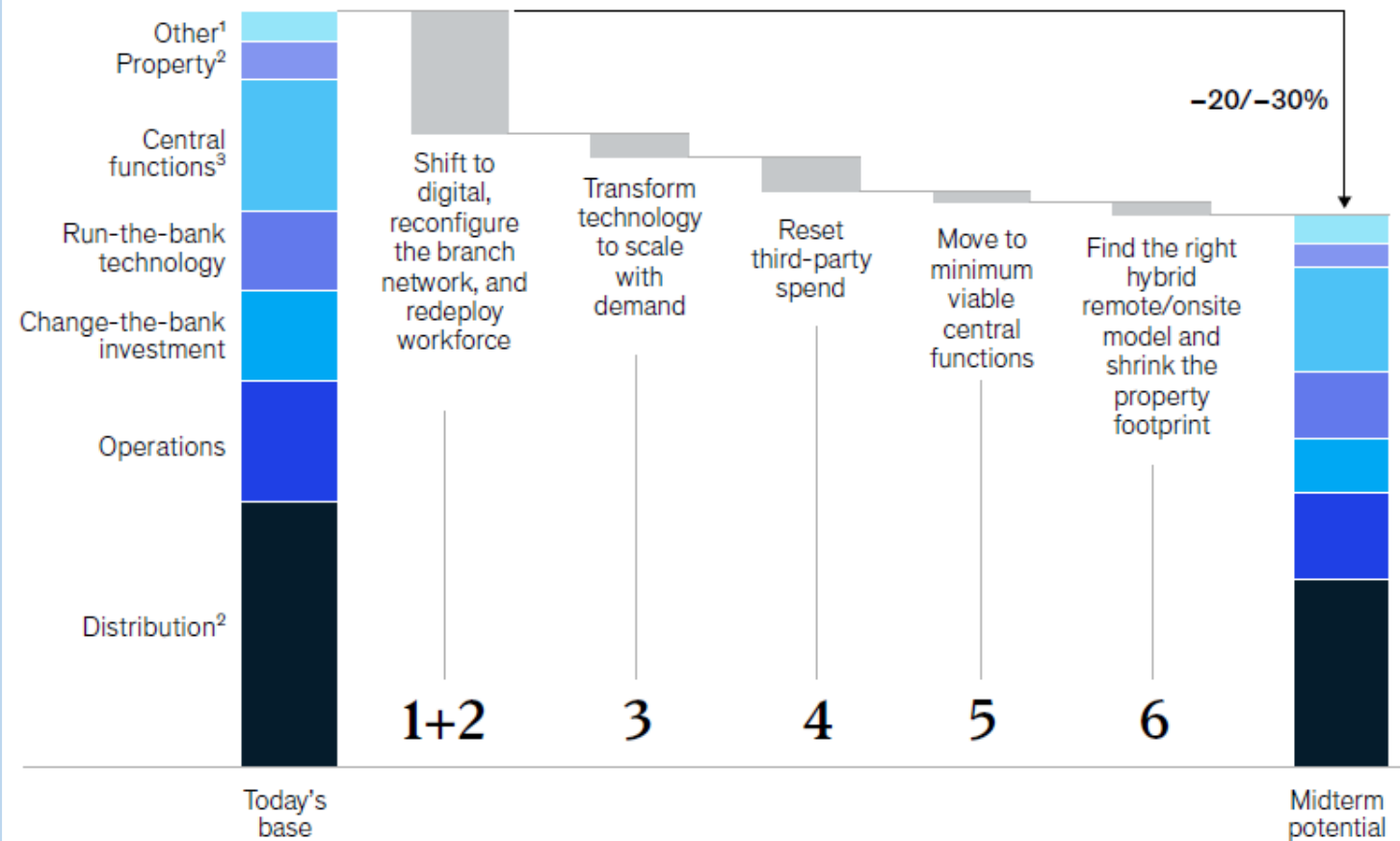
Source: McKinsey

...while the digitalization drive saved the banks to get through Covid-19 lockdowns...

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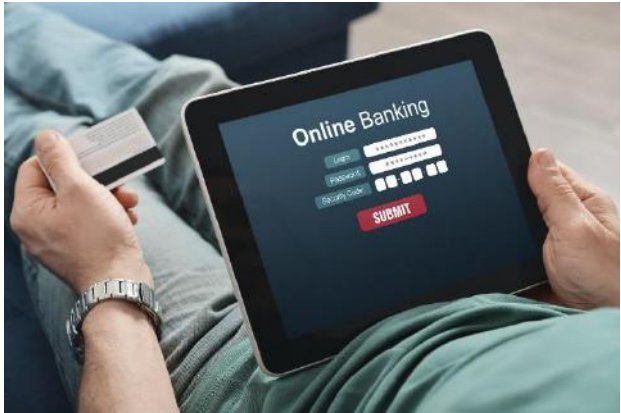
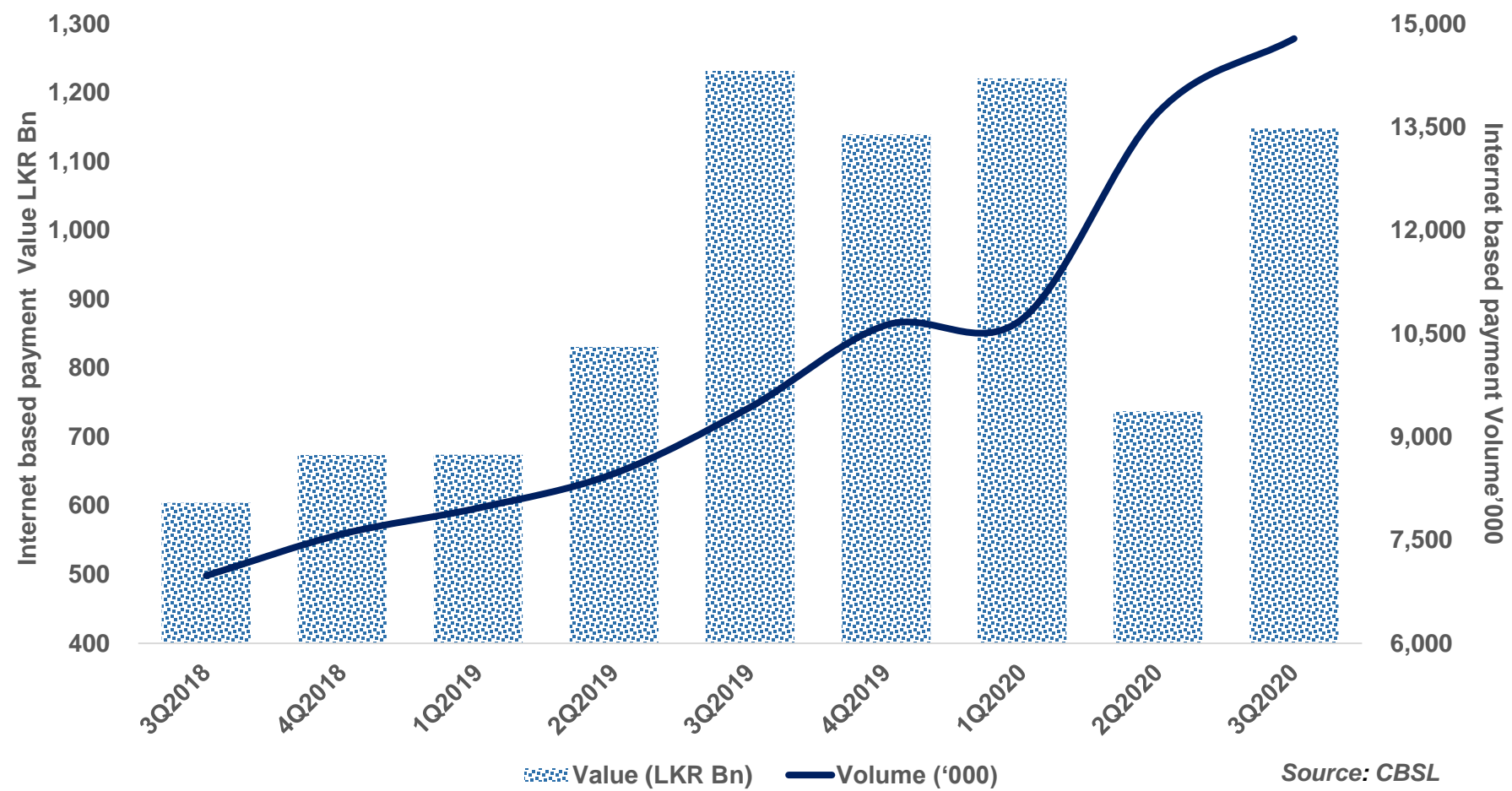
...building
long-term
resilience and
using
technology for
strategic cost
transformation



Source: McKinsey

Access to banking surged via the digital channels...

Internet based payment volume increased 56.8%YoY 3Q2020 despite reduction in value of transaction



...allowing banks to keep their C/I under check

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Digital operations and products efficient cost management through scale advantages and process



Source: CBSL, First Capital Research

46%

60%



Cost/Income Ratio

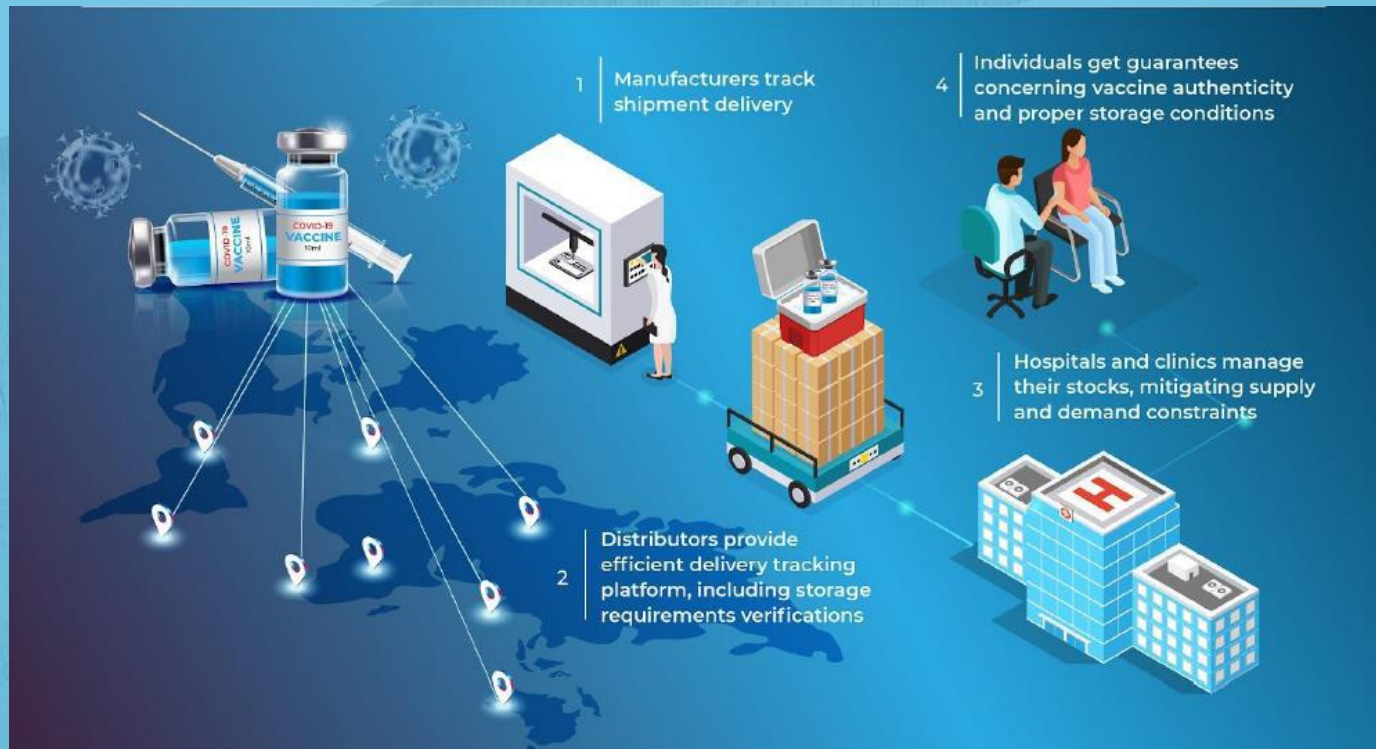


Cost/Core Income Ratio



3.0 Economy in transition and poised for renewed growth

Vaccine hope amplifies...



Company	Type	Doses	How effective*	Storage	Cost per dose
Oxford Uni-AstraZeneca	Viral vector (genetically modified virus)	x2	62-90%	Regular fridge temperature	£3 (\$4)
Moderna	RNA (part of virus genetic code)	x2	95%	-20C up to 6 months	£25 (\$33)
Pfizer-BioNTech	RNA	x2	95%	-70C	£15 (\$20)
Gamaleya (Sputnik V)	Viral vector	x2	92%	Regular fridge temperature (in dry form)	£7.50 (\$10)

Source: BBC

REFERENCES

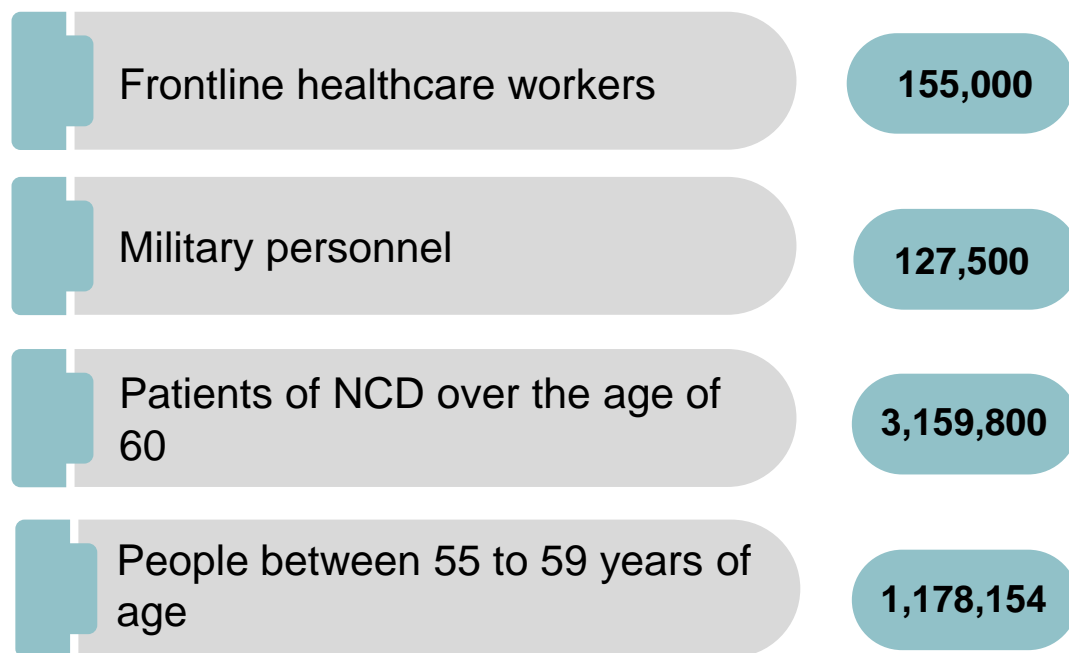
ELIOT BROWN
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Jan 2021

...with Sri Lanka also getting its first shipment by last week of Jan 2021...



SL Covid-19 vaccine eligibility groups



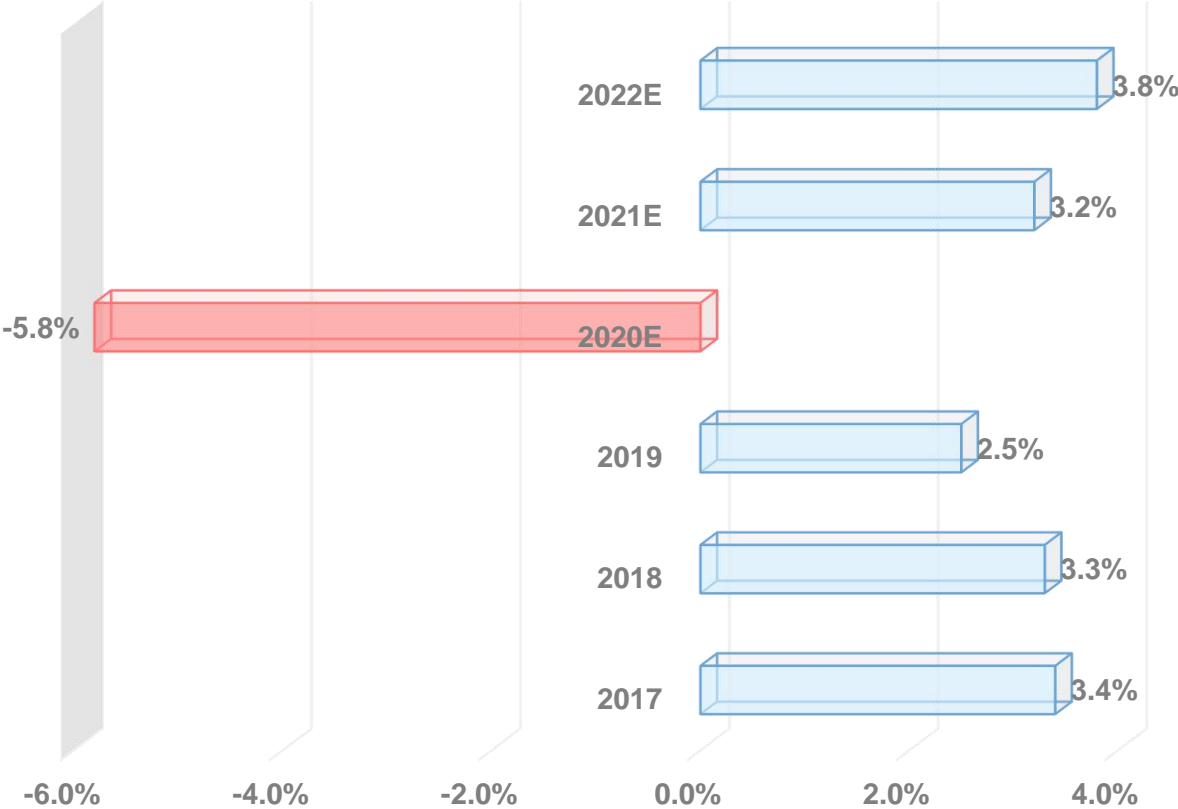
...providing confidence for Government to accelerate the relaxing of control measures

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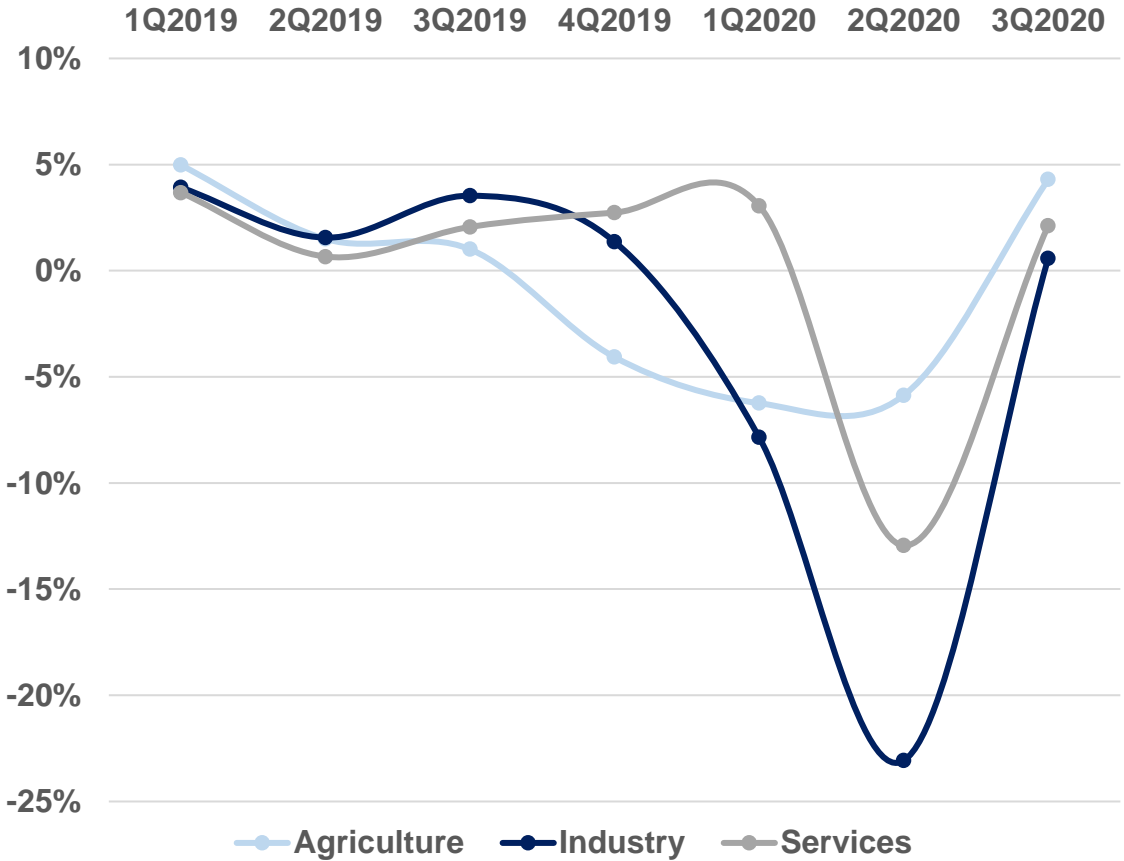
GDP to recover back to 3.2% growth supported by the recommencement tourism activities

GDP bouncing from Covid-19 pandemic crash



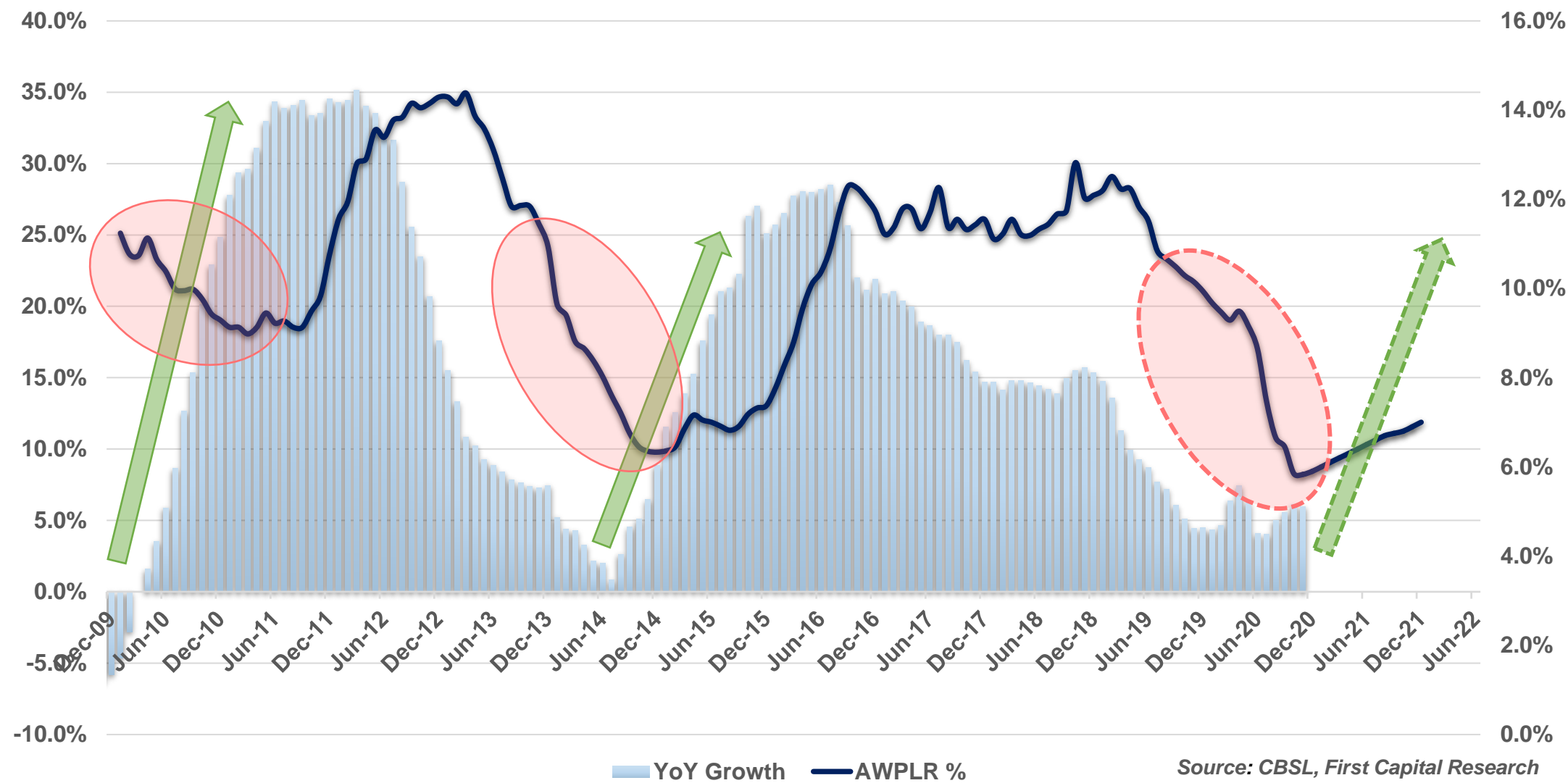
Source: First Capital Research, Dept. Census and Statistics

Faster resumption in main sectors



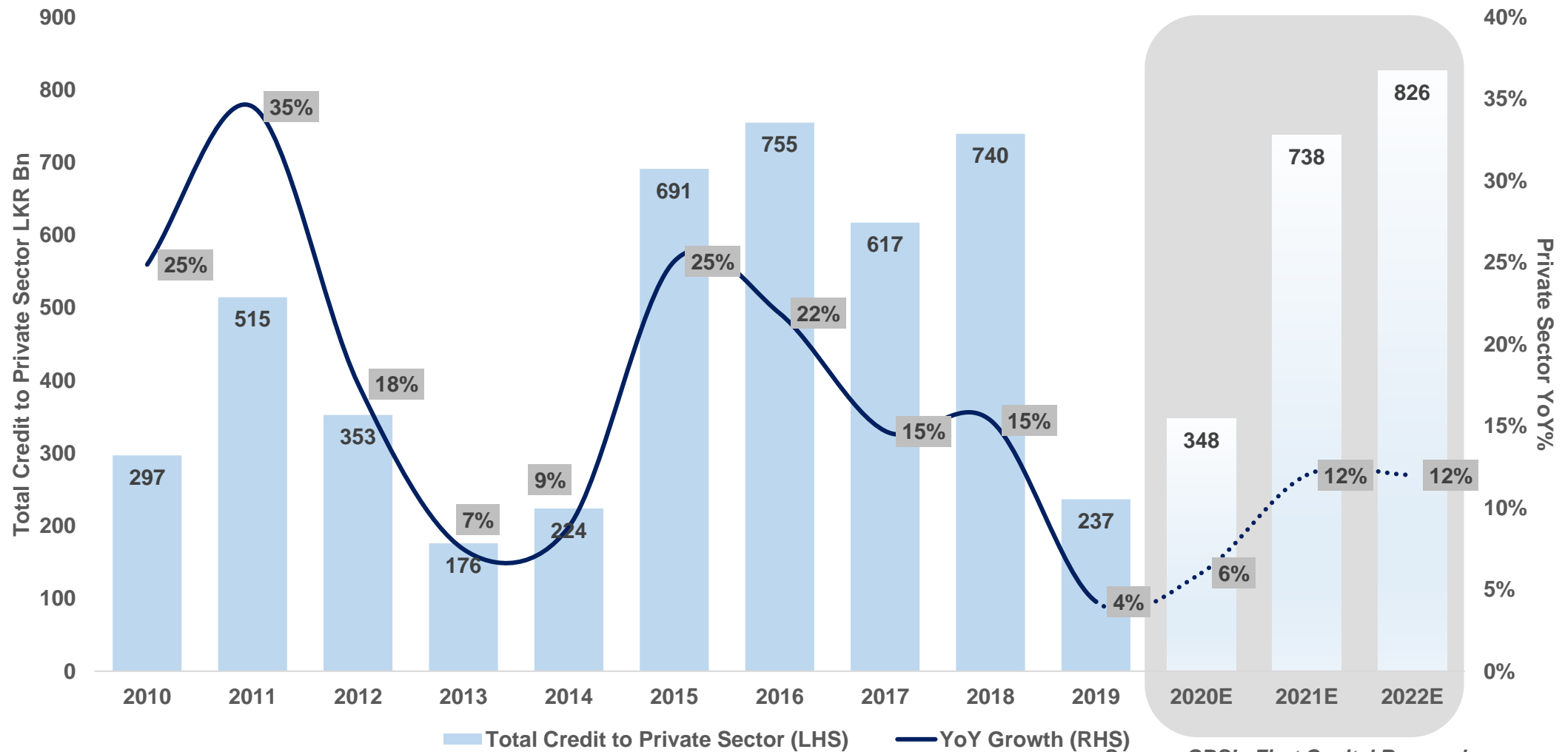
Source: Dept. Census and Statistics

Prolonged low-rate environment may provide ample space for credit...



...spiking private sector credit growth back to double digits

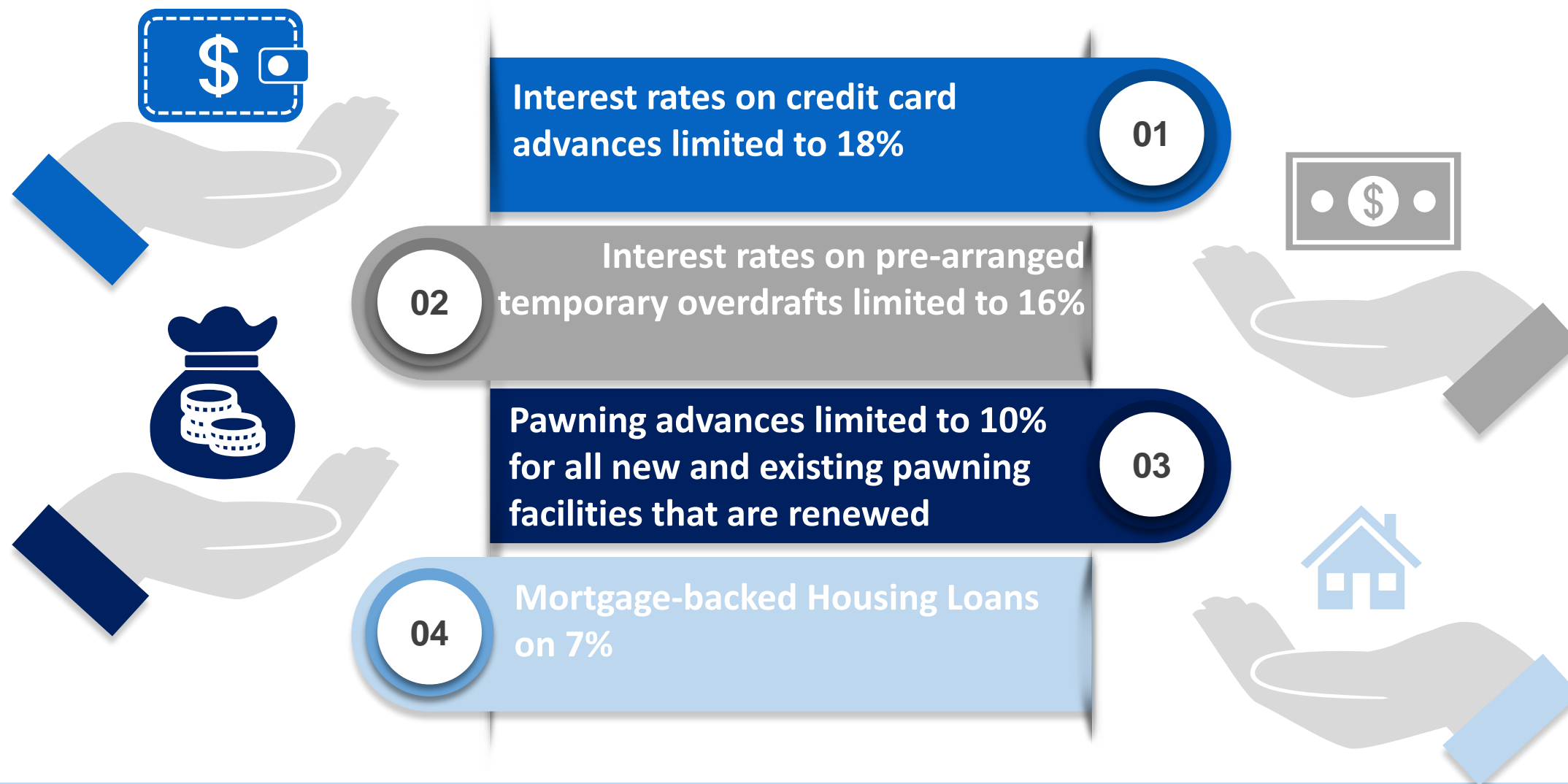
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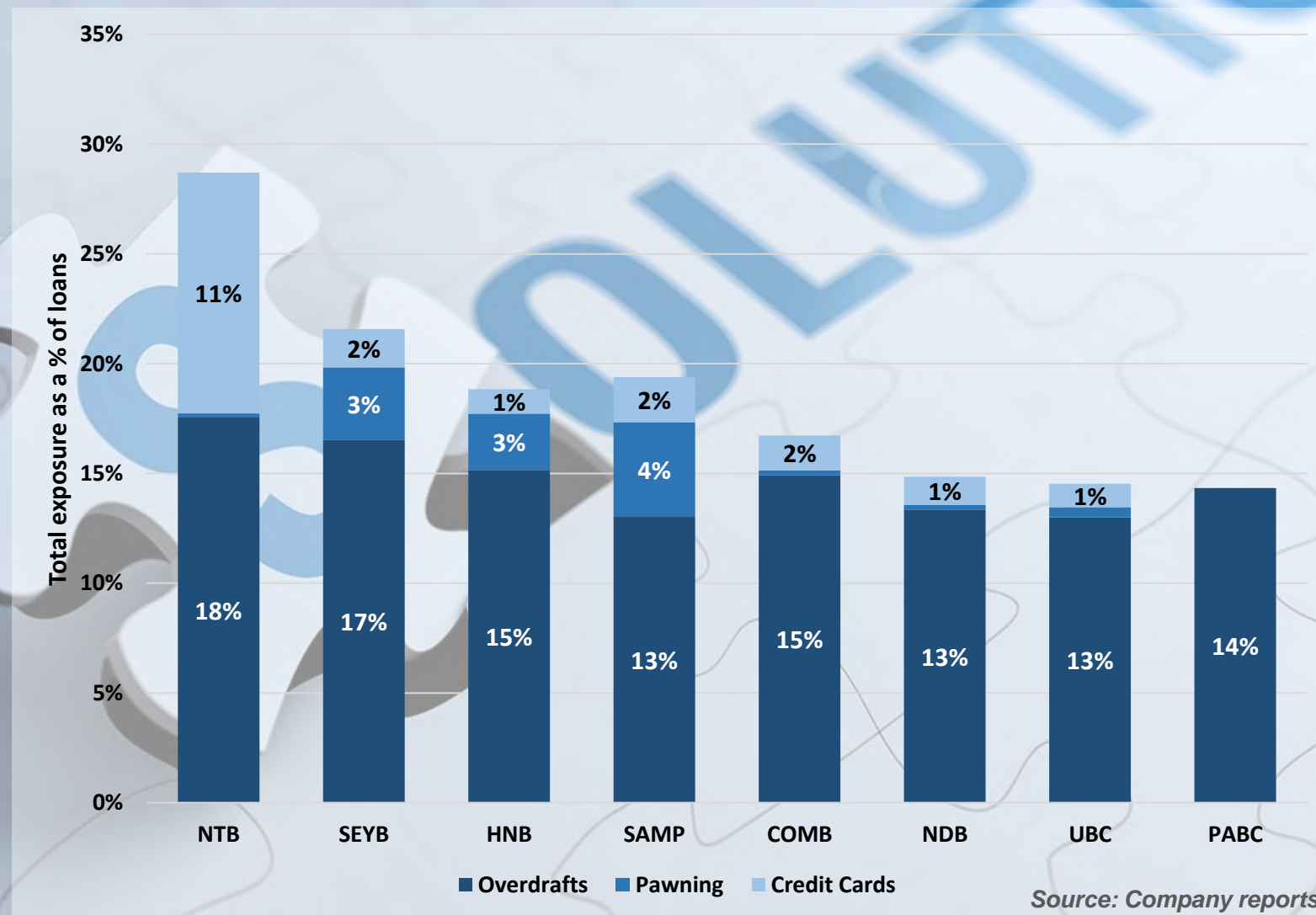
Source: CBSL, First Capital Research

However, lending caps may take a heavy toll...

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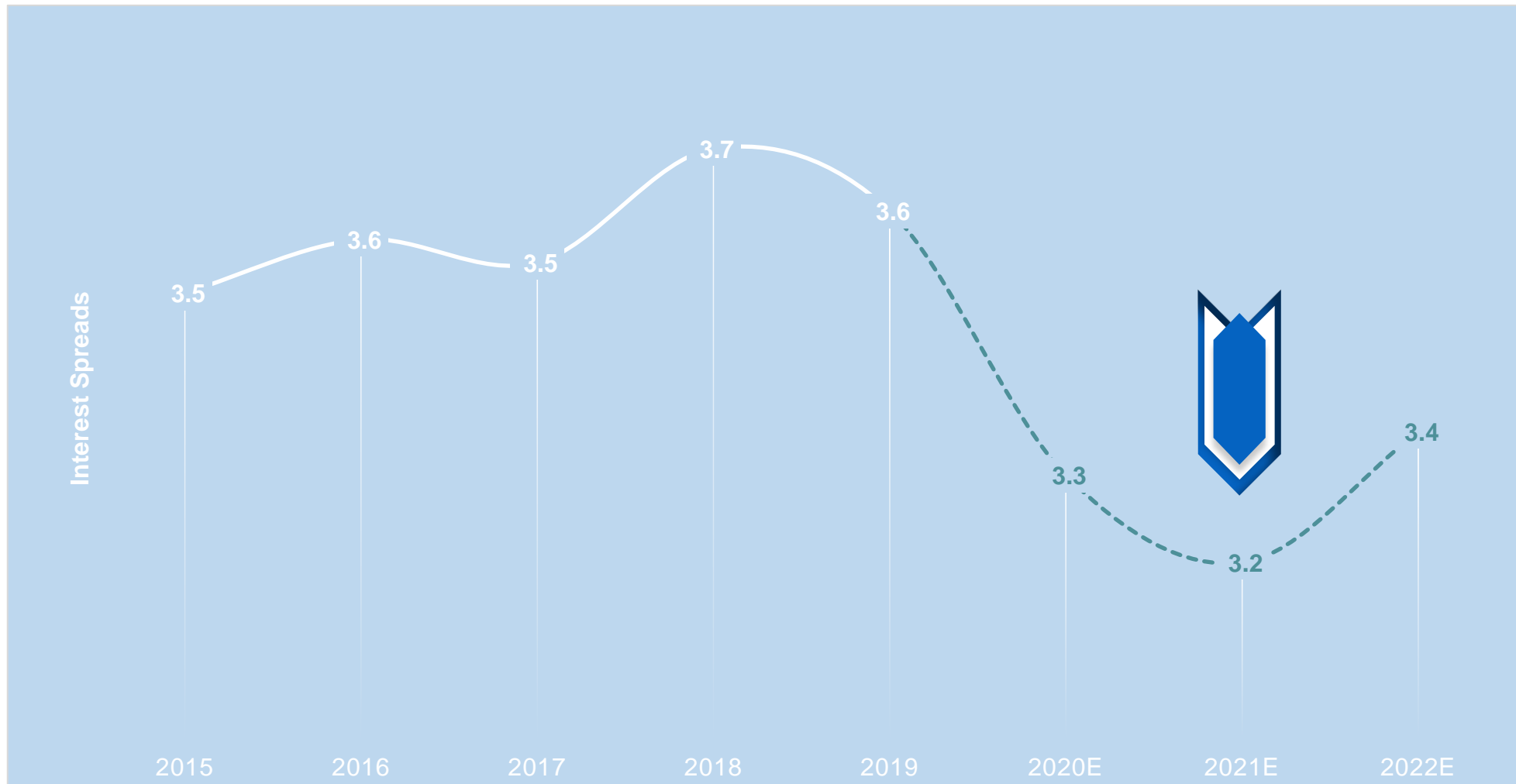
...on bank's SME and retail portfolios...



We estimate a single digit growth in SME and retail portfolio due to lending caps lowering our private sector credit growth resulting in lower spreads during 2021

...resulting in lower spreads in the lending portfolio

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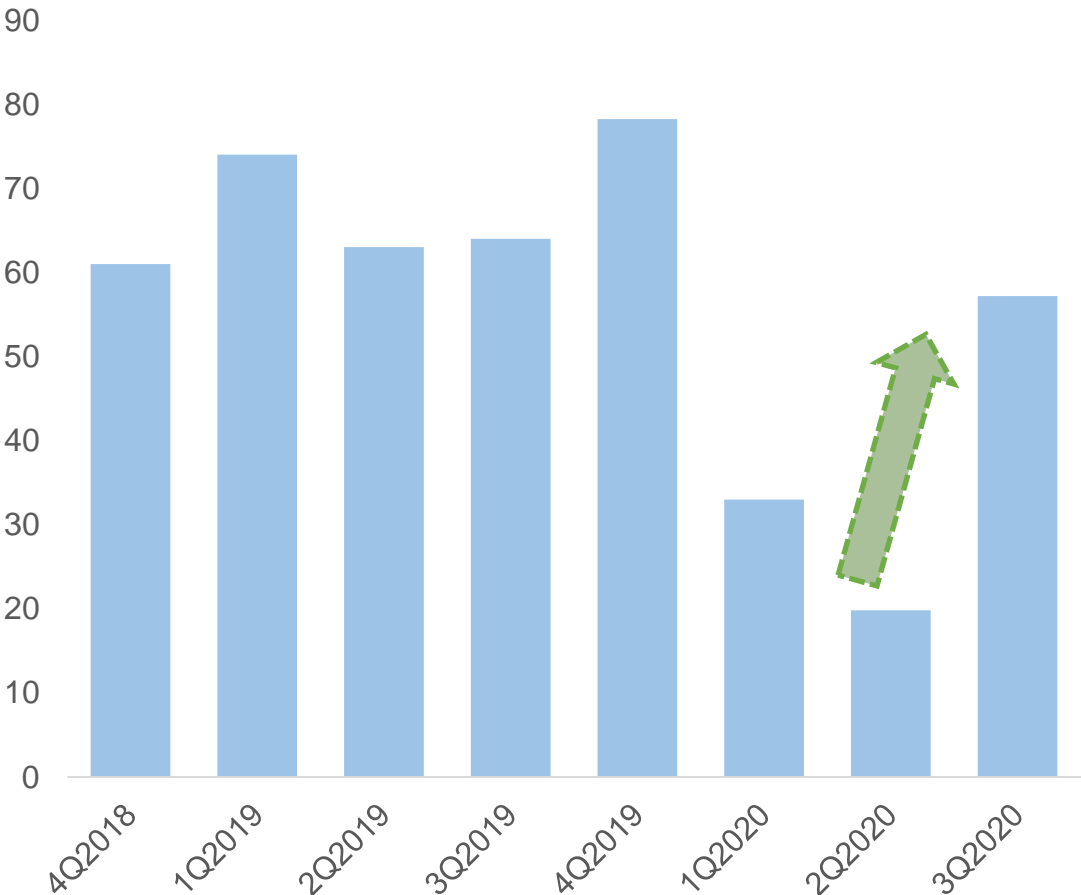


4.0 Impairment to soften



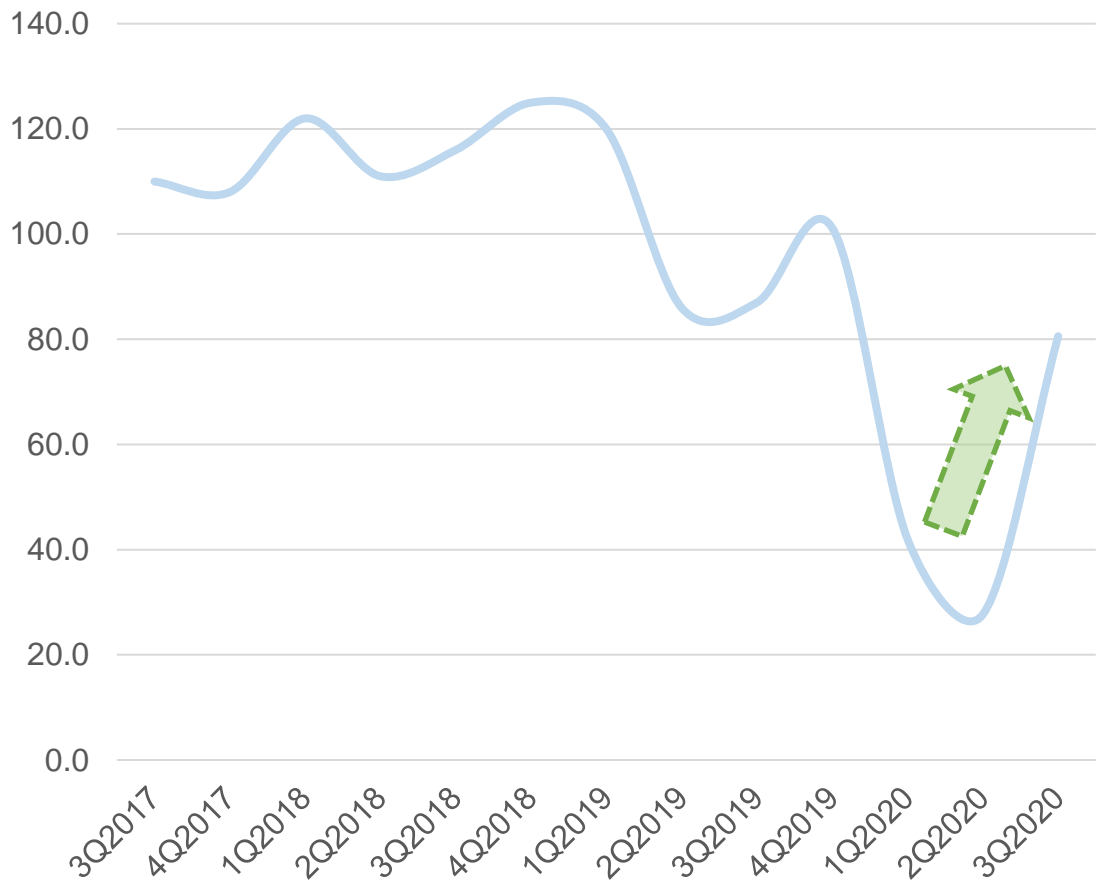
Economic activity bounce back...

Business Condition Index reverts to pre-Covid level...



Source: CBSL, First Capital Research

...while Business Demand Index recovers



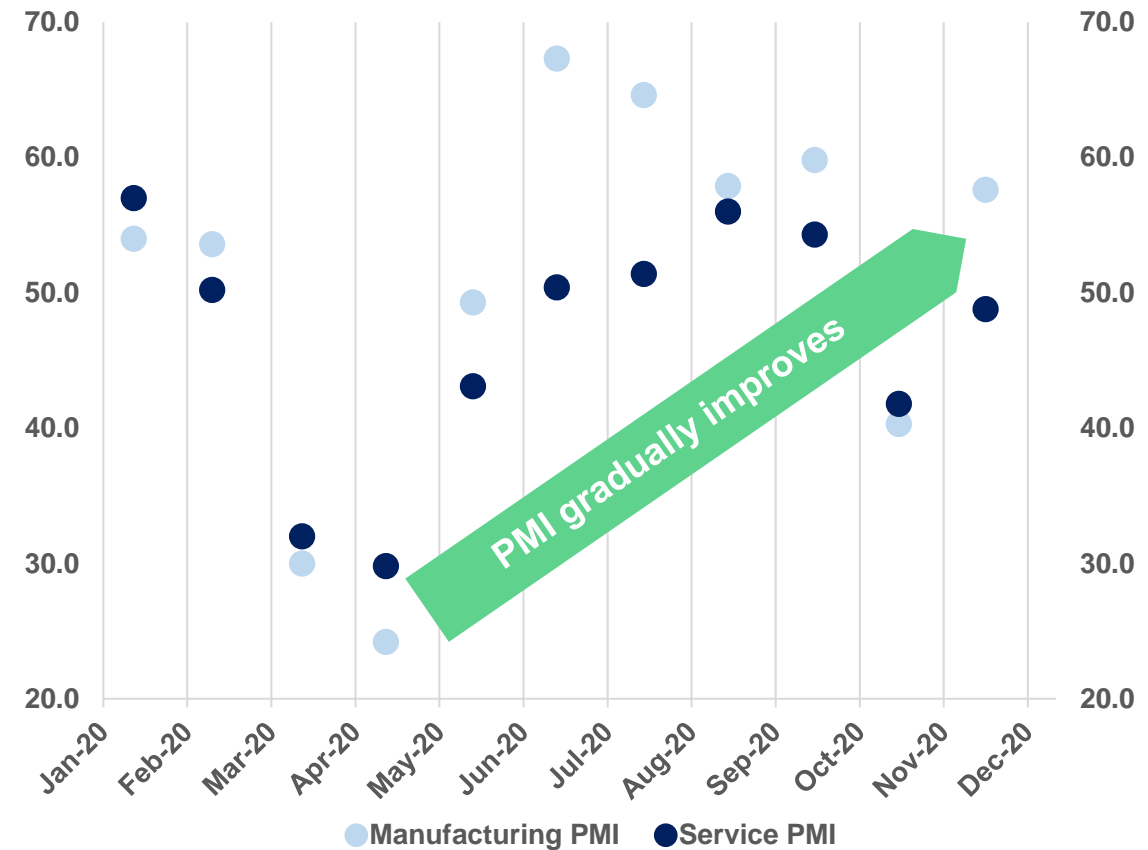
Source: CBSL, First Capital Research

...with normalizing SME business cycle...

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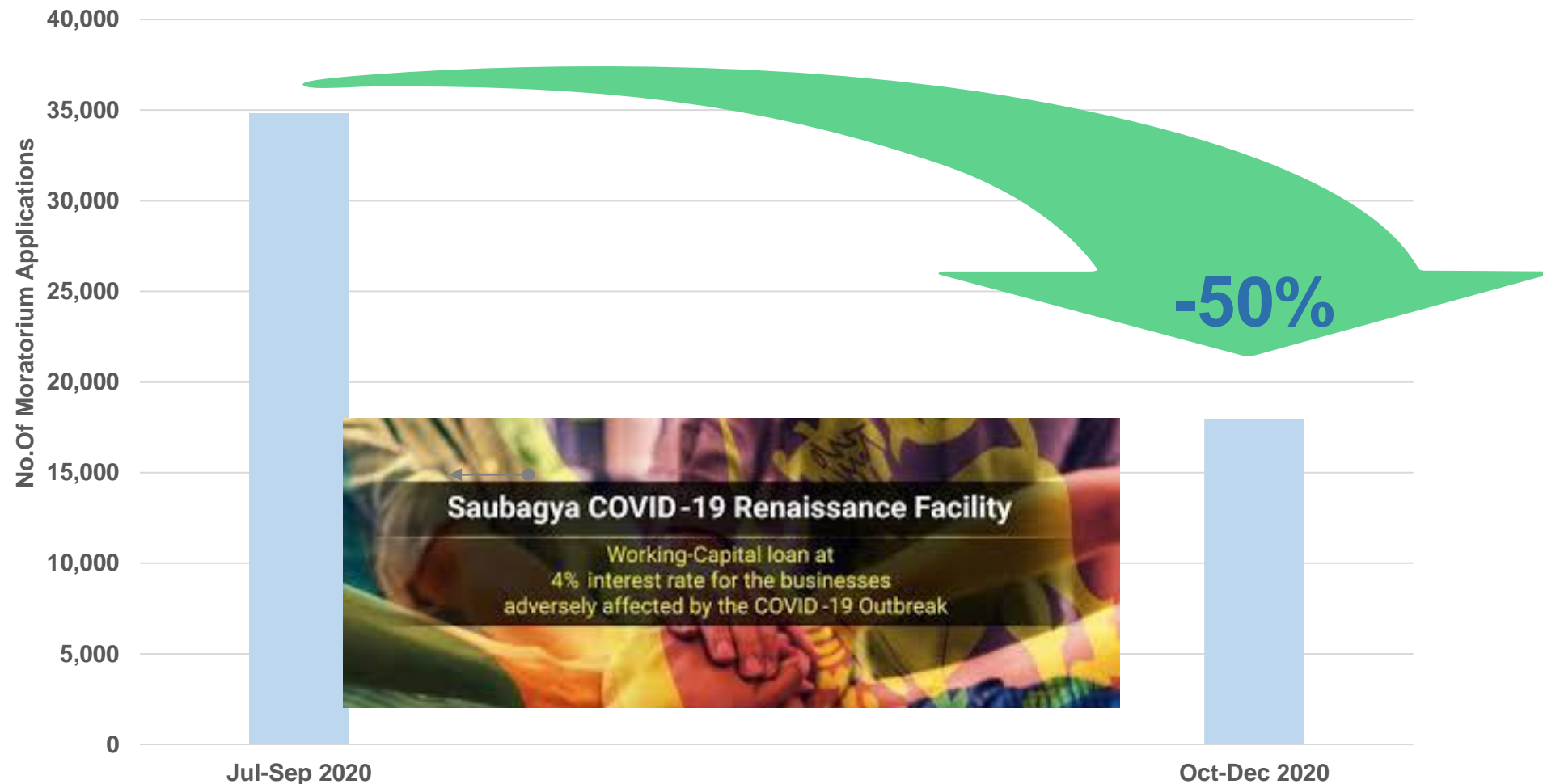
Manufacturing and Service PMI recover to pre-Covid-19 levels



Source: CBSL, First Capital Research

...illustrated by the 50% drop in moratorium applications during the final moratorium extension in Oct-Nov 2020

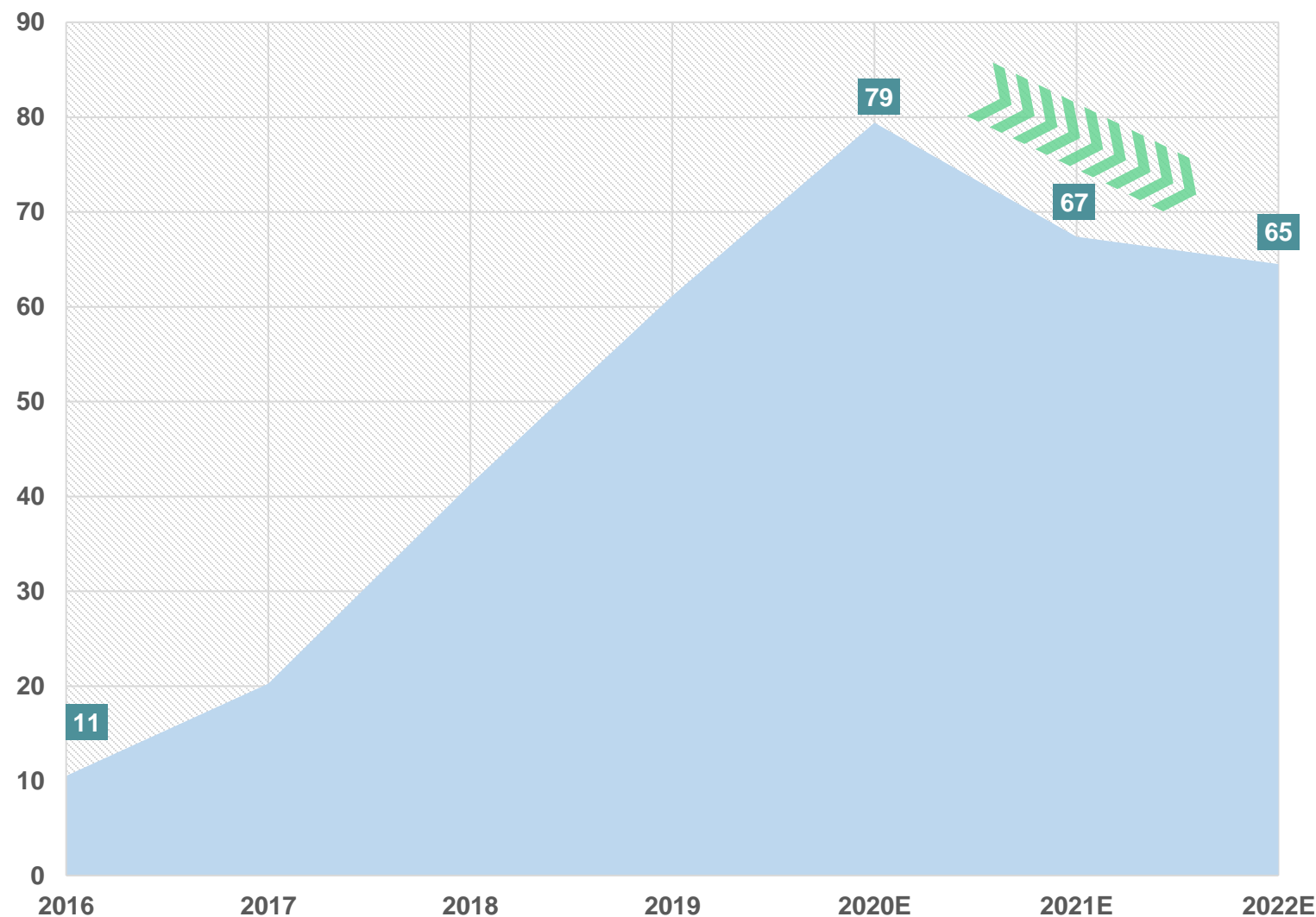
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Source: CBSL, First Capital Research

Improved
business
climate may
lower
impairment
provisioning...

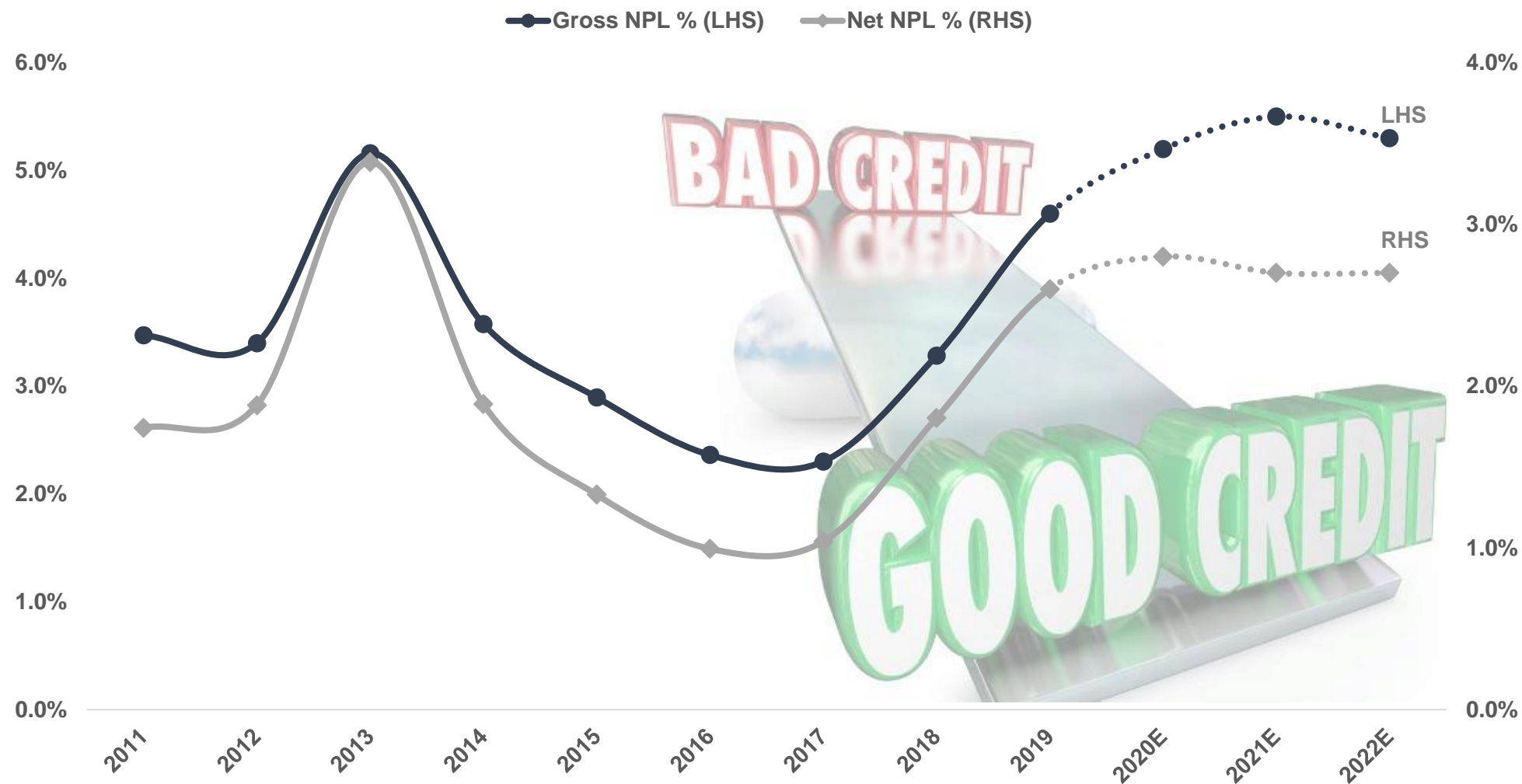
Impairment provisioning easing in 2021E onward after 2020 peak



Source: CBSL, First Capital Research Jan 2021

...reducing NPLs to 5.3% by 2023

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Source: CBSL, First Capital Research

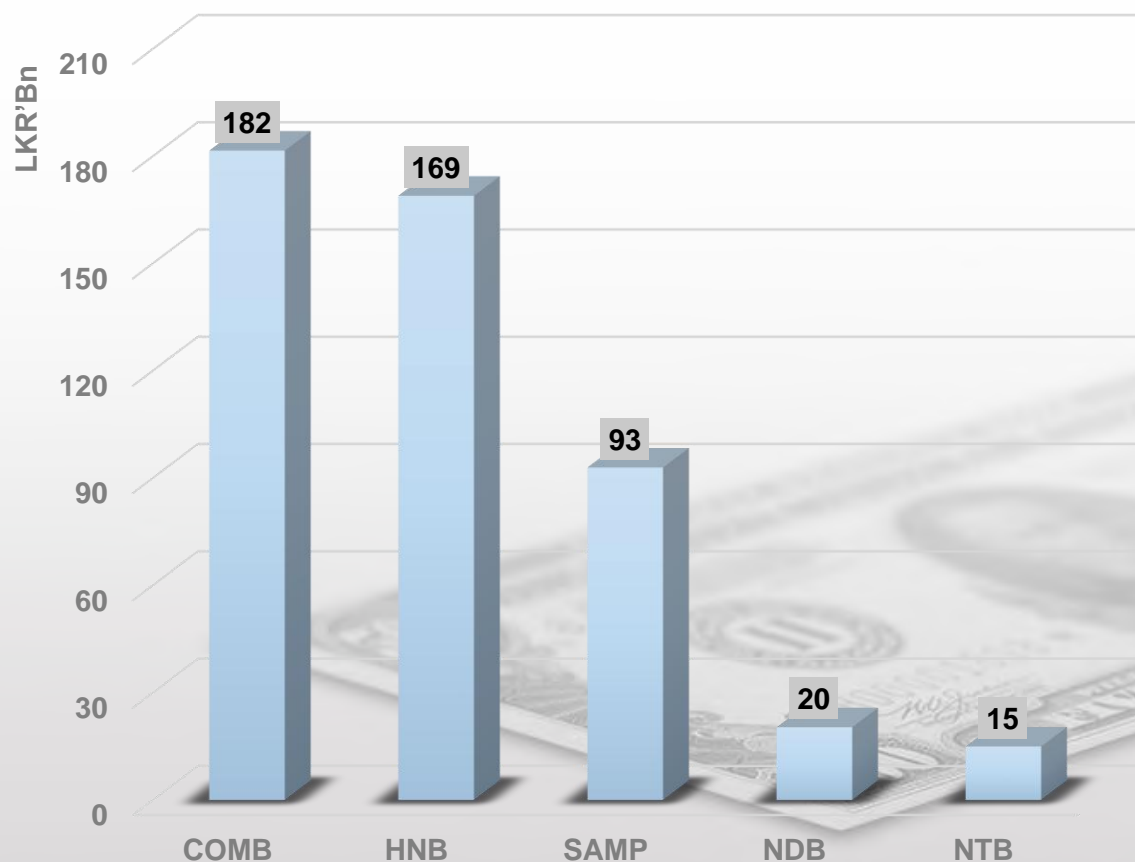
5.0 Other Income may surge in 2021E



Banks adopt the challenging playbook with Sovereign Bonds...

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Banks with highest foreign assets may benefit the most



Source: Company Report

5 Yr Sovereign yield at 16.93%



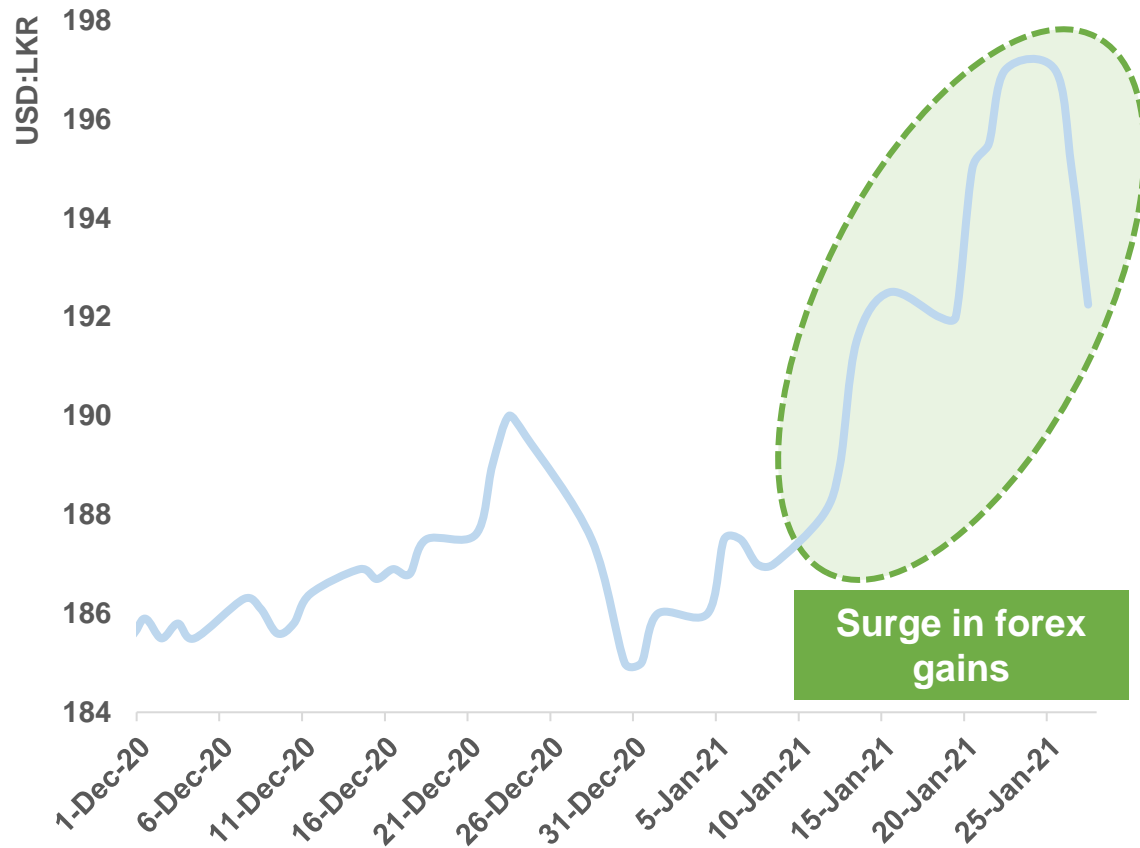
10 Yr Sovereign yield at 14.99%



...with Forex Gains; The Sweetener

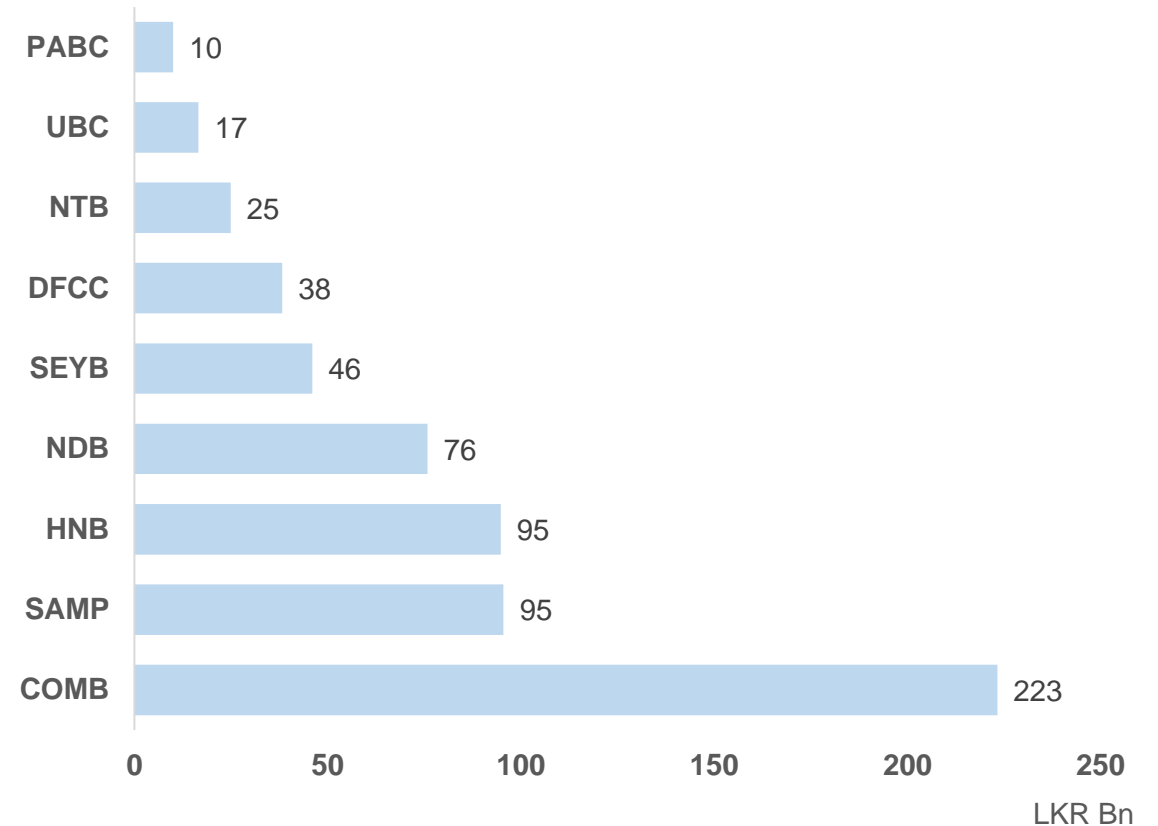
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Volatile USD:LKR favour Banks



Source: CBSL, First Capital Research

Banks with highest foreign asset to benefits amidst currency depreciation



Source: Company Report

...while expanded digital banking volumes may accelerate fee and Commission income by a CAGR of 12% for 2021-23E

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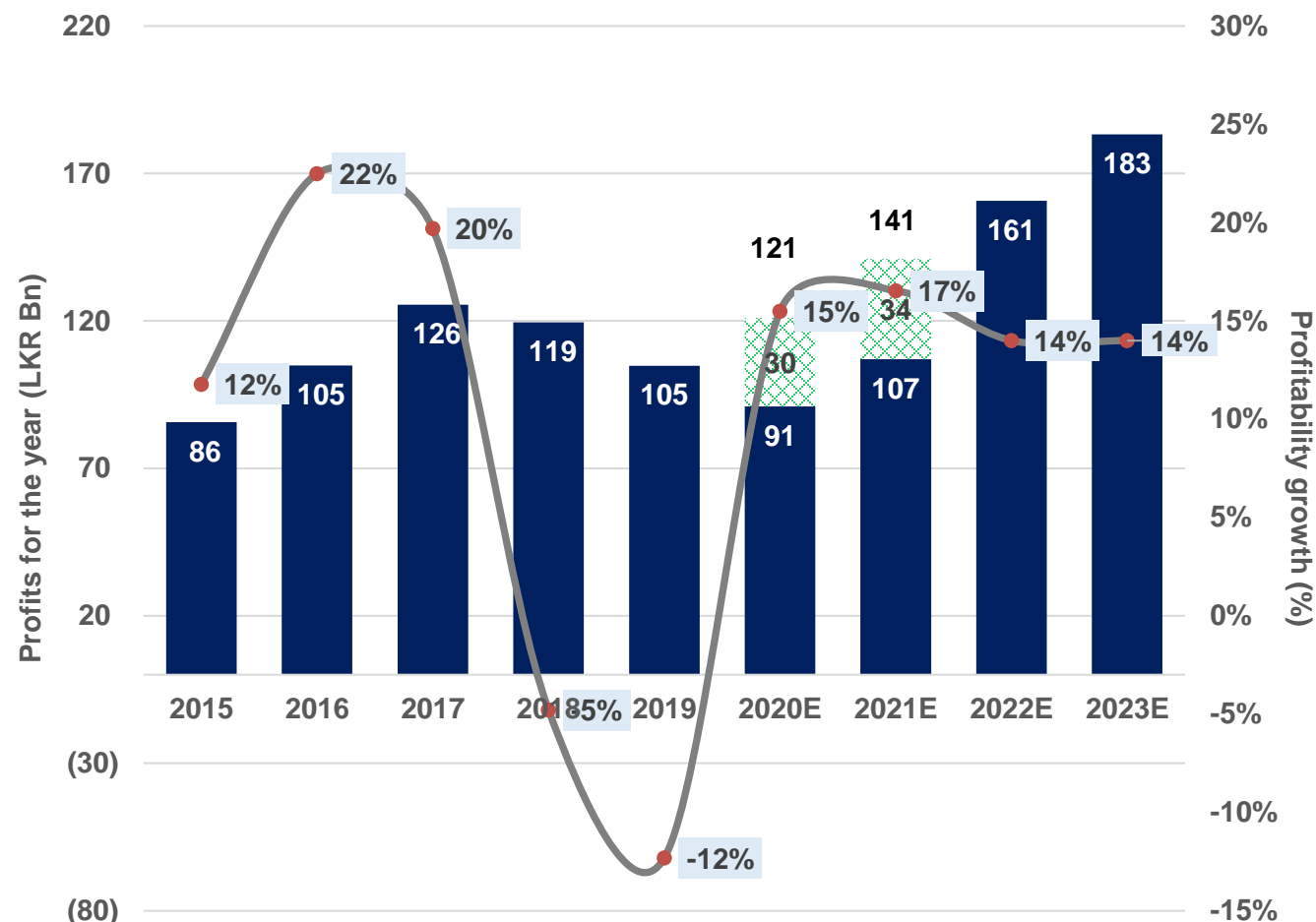
Source: CBSL, First Capital Research

6.0 Valuation



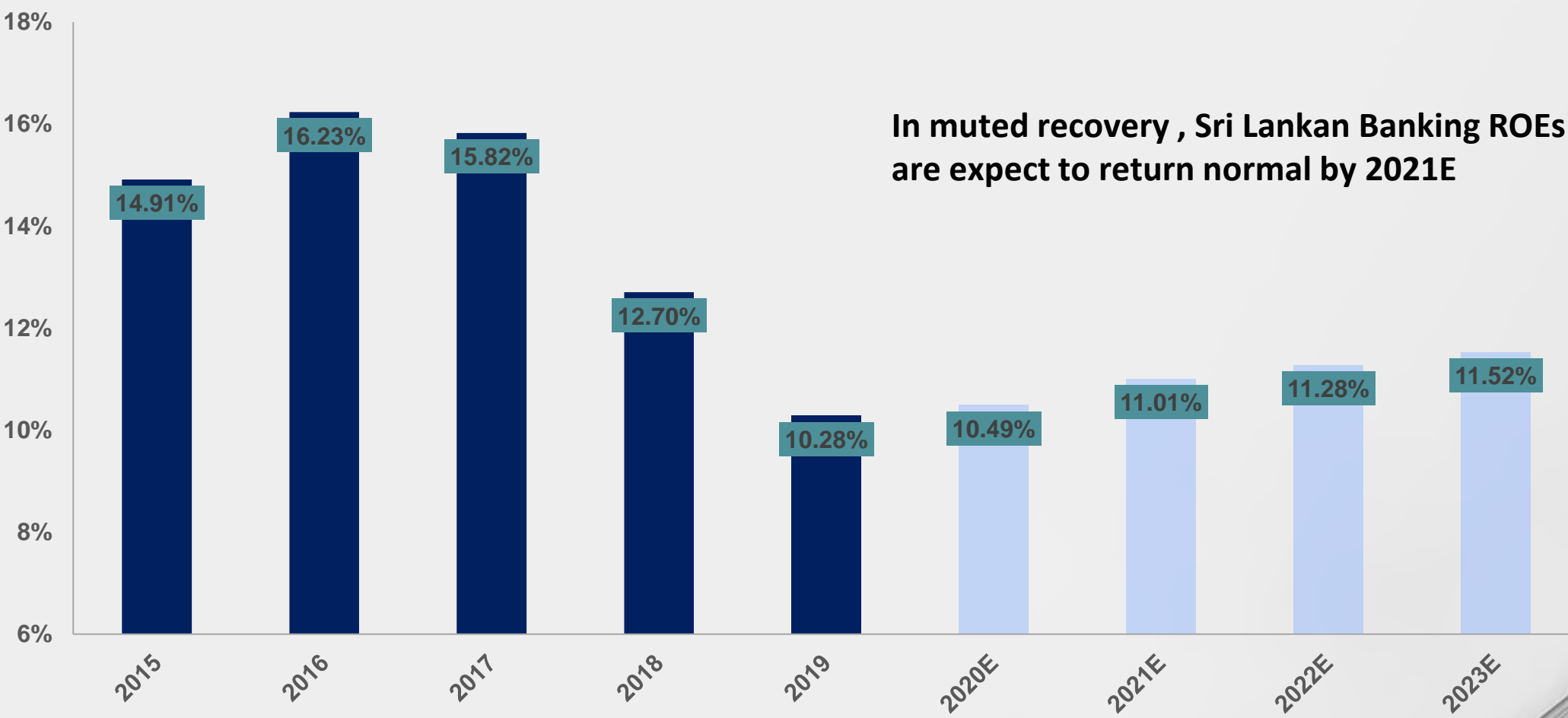
Economic rebound to spur growth amidst banking sector Profitability

Sector Profitability to bounce back to near 2018 levels amidst easing of NPLs pressure



Source: CBSL, Company Reports, First Capital Research

RoE will begin to recover in 2021

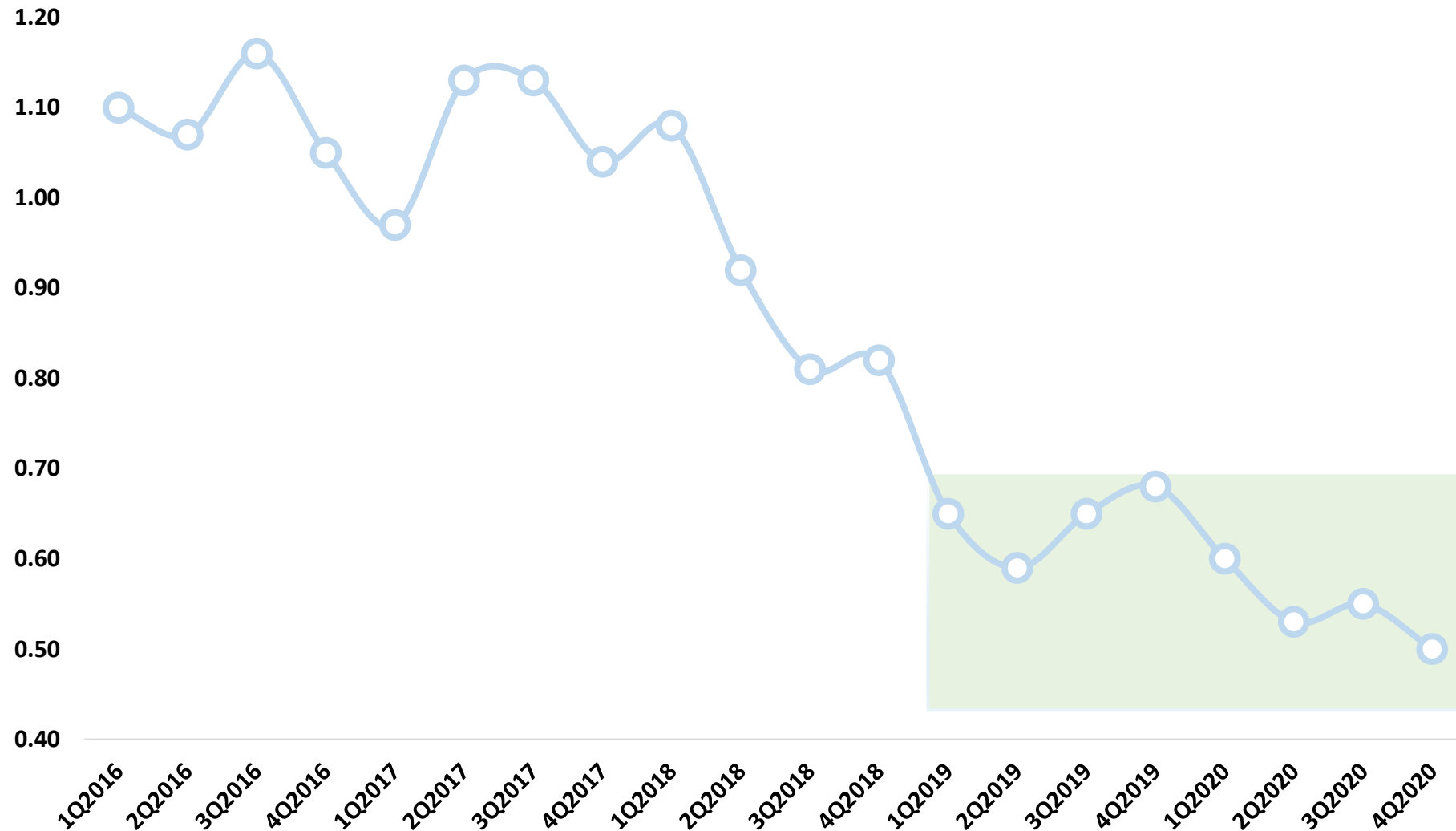


Source: CBSL, First Capital Research



The banking sector trades at a 70% below book value for more than 8 Quarters

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Source: CBSL, First Capital Research

A Long Recovery Road Ahead

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Stock	Stock	Mkt. Cap (LKR mn)	Price	Target Price	Upside (%)	PER (x)		PBV (x)	
	Code					2021E	2022E	2021E	2022E
Commercial Bank - Voting	COMB.N	102,201	93.0	125.0	34%	5.6x	4.7x	0.7x	0.7x
Hatton National Bank - Voting	HNB.N	59,291	144.5	180.0	25%	5.2x	4.5x	0.4x	0.4x
Sampath Bank	SAMP.N	68,567	179.8	185.0	3%	5.7x	4.4x	0.6x	0.5x
National Development Bank	NDB.N	21,542	92.6	115.0	24%	4.6x	3.7x	0.5x	0.5x
Seylan Bank - Voting	SEYB.N	14,710	57.3	70.0	22%	5.2x	4.4x	0.6x	0.6x
Nations Trust Bank - Voting	NTB.N	17,174	61.9	75.0	21%	4.4x	4.1x	0.6x	0.5x
Banking Sector Universe					22%				
<u>Non-Voting Shares</u>									
Commercial Bank - Non-Voting	COMB.X	5,560	81.8	100.0	22%	5.0x	4.1x	0.6x	0.6x
Hatton National Bank - Non Voting	HNB.X	11,843	116.5	144.0	24%	4.2x	3.7x	0.4x	0.3x
Seylan Bank - Non-Voting	SEYB.X	12,885	49.5	56.0	13%	4.5x	3.8x	0.5x	0.5x
Nations Trust Bank - Non-Voting	NTB.X	2,915	75.3	75.0	0%	5.3x	5.0x	0.7x	0.6x

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Thank You

“Successful Investment Is About Managing Risk...”