



# HATTON NATIONAL BANK PLC [HNB.N0000]

**MAINTAIN BUY**

## “UNLEASHING POTENTIAL WITH SOLID CREDIT GROWTH”

**Fair Value: 2022E - LKR 180.0 [+33%]**

Total Return with DPS: 2022E - 40% [AER 40%]

HNB's earnings marginally improved by 1.8%YoY in 3Q2021 to LKR 3.5Bn compared to LKR 3.4Bn recorded in 3Q2020. The subdued earnings were largely attributable to the increase in impairment provision by 78.5%YoY to LKR 5.0Bn owing to the additional impairment provisioning made after considering the effect of sovereign downgrade by Moody's in Oct 2021. However, HNB recorded a gross loan growth of 10.3% to LKR 934.1Bn for 9M2021 while recording YoY growth of 14.7%. HNB's intensive focus on digitalisation is also expected to boost the bottom-line via cutting down the operational costs significantly. Thus, we are upgrading our earnings forecast for 2021E and 2022E to LKR 16.9Bn and LKR 19.2Bn, respectively. Moreover, considering the higher risk-free rate stemming from the increased interest rates, we are downgrading our fair value target for HNB.N for 2022E to LKR 180.0 with a total upside potential of 40.0%.

**MAINTAIN BUY**

LKR (Mn)	3Q2020	3Q2021	YoY	9M2020	9M2021	YoY
<b>Earnings (LKR 'Mn)</b>						
NII	12,568	14,142	+13%	38,430	40,830	+6%
Total Operating Income	17,725	20,687	+17%	53,100	61,087	+15%
Net Operating Income	14,903	15,649	+5%	40,997	49,255	+20%
Pre Tax Profit	4,585	4,429	-3%	11,974	16,443	+37%
Net Profit : Equity Holders	3,436	3,497	+2%	8,605	12,973	+51%
<b>Balance Sheet (LKR 'Mn)</b>						
Loans	770,388	878,356	+14%	770,388	878,356	+14%
Shareholder's Equity	153,032	163,769	+7%	153,032	163,769	+7%
NAVPS	298.9	311.4	+4%	298.9	311.4	+4%

### Earnings posted a marginal growth of 1.8%YoY striking a higher impairment provisioning

HNB earnings for 3Q2021 recorded a marginal growth of 1.8%YoY to LKR 3.5Bn compared to LKR 3.4Bn recorded in 3Q2020, despite witnessing a substantial improvement in both NII and Total Operating Income which recorded a growth of 12.5%YoY and 16.7%YoY, respectively. The subdued earnings were largely attributable to the massive increase in impairment provisioning by 78.5%YoY to LKR 5.0Bn owing to the additional impairment provision made after considering the sovereign downgrade by Moody's in Oct 2021 along with other macro-economic factors in order to prudently weather any weighty negative effects on future profitability. Fee and Commission income expanded by 9.4%YoY to LKR 2.4Bn amidst continuous disruptions to business activities caused by Covid-19 pandemic. Growth in Fee and Commission Income was primarily supported by the notable improvement in Cards and Trade Businesses along with the increased use of digital platforms induced by the adoption of new normal lifestyle. Considering both the positive and negative effects on banking activities, we restated our NII target for 2021E to LKR 59.7Bn (+2% from the previous target) and for 2022E to LKR 70.7Bn (+9% from the previous target). We have also restated our earnings targets for 2021E and 2022E to LKR 16.9Bn and LKR 19.2Bn, respectively.

### Gross Loan Book registered a substantial growth of 10.3% for 9M2021

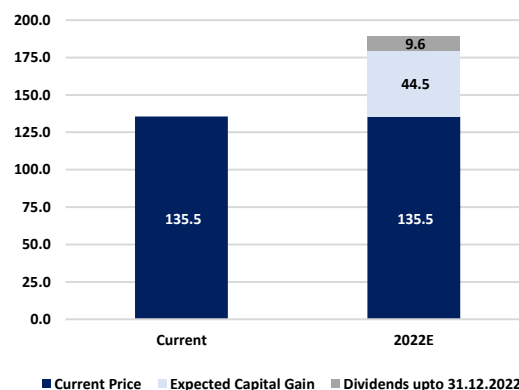
HNB recorded a gross loan growth of 10.3% to LKR 934.1Bn for 9M2021 while recording a growth of 14.7%YoY vis-à-vis 3Q2020. Higher loan growth and timely repricing for higher interest rates coupled with slow moving FD rates may enable HNB to enjoy a substantial interest spread in the coming years. We expect HNB to sustain a solid loan growth of c.12% during 2022E in par with our private sector credit growth expectations.

### Relentless investment in e-commerce and digital platforms propels cost reduction

HNB's effort in driving through its digitalisation road map and the implementation of major IT projects are positioning them well within the digital transformation and thereby we expect HNB to experience significant reduction in operational costs. Accordingly, process automation for customer acquisition and robotic process automation are some of the key initiatives on the digitalisation spectrum of HNB which is expected to come into the radar in the coming years in order to embrace well within the new normal world.

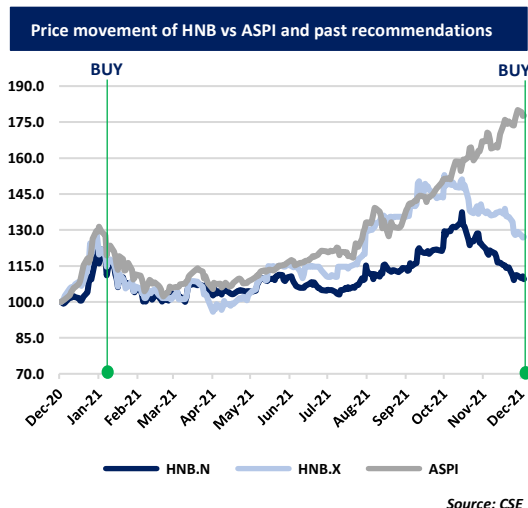
### FV is estimated for HNB.N at LKR 180.0 and HNB.X at LKR 145.0 for 2022E - MAINTAIN BUY

We have accounted for proposed surcharge tax of 25% (3.4Bn) through the retained earnings while no adjustment made in terms of the turnover levy of 2.5% (Social Security Contribution), assuming it can be passed on to the customers. Thus, we have estimated the fair value of HNB.N to reach LKR 180.0 by 2022E generating a total return of 40.0% at its current market price of LKR 135.5, and the share is trading well below its current book value of LKR 311.4 with a PBV of 0.4x. HNB.X is valued at LKR 145.0 by 2022E anticipating a 20% discount to the voting share. **MAINTAIN BUY.**



### FIRST CAPITAL RESEARCH

Vidushika Perera +94 11 263 9864  
[vidushika@firstcapital.lk](mailto:vidushika@firstcapital.lk)



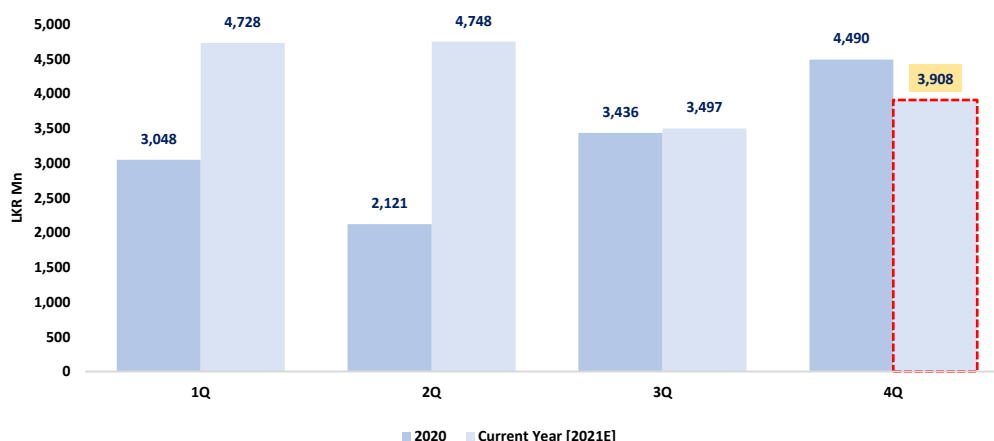
#### Minimum Return for BUY:

**Buy Below 2022E - [AER of 15% with DPS]: LKR 165.0**  
HNB.N categorized as 'Grade A' counter

#### Disclosure on Shareholding:

First Capital Group or the covering analyst did not hold 1% or more of the total outstanding share capital of HNB during the five trading days prior to the issuance of this document.

## Quarterly Earnings



## Estimate Revision

In LKR Mn	2021E-O	2021E-R	% Change	2022E-O	2022E-R	% Change
<b>Earnings Estimate</b>						
Net Interest Income	58,517	59,726	+2%	65,160	70,713	+9%
Total Operating Income	78,829	80,608	+2%	85,716	91,508	+7%
Net Operating Income	66,302	63,924	-4%	74,130	74,438	+0%
Pre Tax Profit	19,105	21,509	+13%	22,088	26,637	+21%
Net Profit : Equity Holders	14,173	16,882	+19%	16,386	19,232	+17%
Adjusted EPS	27.6	33.0		31.9	37.6	
Net Profit Growth YoY	12%	29%		16%	14%	
<b>Balance Sheet Estimate</b>						
Loans & Advances	840,745	885,738	+5%	928,228	982,467	+6%
Shareholders' Equity	167,072	163,274	-2%	179,028	170,369	-5%
<b>Adjusted NAVPS</b>	<b>325.7</b>	<b>309.7</b>		<b>349.0</b>	<b>323.2</b>	
<b>Ratio Estimate</b>						
<b>ROE (%)</b>	<b>8.5%</b>	<b>10.3%</b>		<b>9.2%</b>	<b>11.3%</b>	
<b>PER (x)</b>	<b>4.7</b>	<b>4.1</b>		<b>3.5</b>	<b>3.6</b>	
<b>PBV (x)</b>	<b>0.5</b>	<b>0.4</b>		<b>0.6</b>	<b>0.4</b>	

## Valuation Table

P/E 31st December	2017	2018	2019	2020	2021E	2022E	2023E
<b>Estimates (LKR 'Mn)</b>							
Net Interest Income	45,461	53,636	56,356	50,837	59,726	70,713	80,256
Total Operating Income	61,099	75,114	76,511	72,074	80,608	91,508	101,924
<b>Net Profit: Equity Holders</b>	<b>15,947</b>	<b>17,636</b>	<b>14,670</b>	<b>13,095</b>	<b>16,882</b>	<b>19,232</b>	<b>27,207</b>
Adjusted EPS (LKR)	31.1	34.4	28.7	25.6	33.0	37.6	53.1
YoY Growth (%)	8%	11%	-17%	-11%	29%	14%	41%
<b>Valuations</b>							
PER (x)	4.4x	3.9x	4.7x	5.3x	4.1x	3.6x	2.5x
PBV (x)	0.6x	0.5x	0.5x	0.5x	0.4x	0.4x	0.4x
Dividend Yield (%)	6.3%	6.3%	5.9%	5.9%	7.1%	7.8%	9.6%
NAVPS (LKR)	231.5	251.7	276.0	292.6	309.7	323.2	357.4
DPS (LKR)	8.5	8.5	8.0	8.0	9.6	10.6	13.0
Dividend Payout (%)	27.3%	24.7%	27.9%	31.3%	29.1%	28.2%	24.4%



### Valuation Summary

Expected HNB.N price	2022E
Justified PBV Based Target Price	174.5
PER Valuation Based Target Price	187.8
RI Valuation Based Target Price	191.3
Average Target Price	184.5
Target Price After Rounding Off	180.0

Return	2022E
Target Price	180.0
Current Price	135.5
Capital Gain (LKR)	44.5
Dividends upto 31st Dec (LKR)	9.6
Capital Gain %	33%
Dividend Yield %	7%
<b>Total Return %</b>	<b>40%</b>
<b>Annualized Return %</b>	<b>40%</b>

### Residual Income Valuation

Residual Income based Valuation	2022E
PV of Residual Income	-60,630
No. of Shares ('Mn)	512
RI per Share	-118.4
Opening Book Value per Share	309.7
Value per Share	191.3

COE	2022E
Rf	10.0%
Rm	18.0%
Growth %	3.0%
$\beta$	1.10
$Ke=Rf+\beta(Rm-Rf)$	18.8%

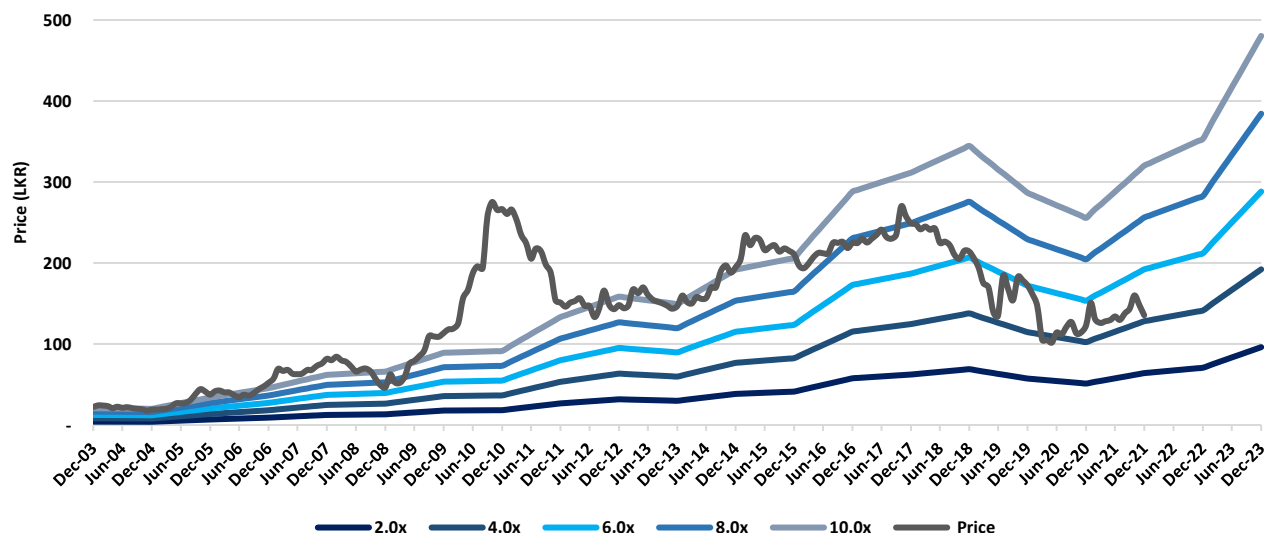
### Justified PBV Valuation

Justified PBV based Valuation	2022E
ROAE	11.5%
Growth	3.0%
COE	18.8%
PBV	0.5
NAVPS	323.2
Target Price	174.5

### PER Valuation

PER based Valuation	2022E
Earnings (LKR 'Mn)	19,232
No. of Shares ('Mn)	512
EPS	37.6
Expected PER	5.0x
Price at 5.0x of Earnings	187.8

### PER Chart



## Appendix I: Statement of Income and Expenses

Income Statement P/E 31 December	2017	2018	2019	2020	2021E	2022E	2023E
Interest income	103,908	116,489	124,889	112,825	124,401	150,729	170,415
Interest expenses	58,447	62,852	68,533	61,988	64,676	80,016	90,159
<b>Net interest income</b>	<b>45,461</b>	<b>53,636</b>	<b>56,356</b>	<b>50,837</b>	<b>59,726</b>	<b>70,713</b>	<b>80,256</b>
<b>Net fee and commission income</b>	<b>9,014</b>	<b>10,098</b>	<b>9,977</b>	<b>8,026</b>	<b>8,423</b>	<b>8,760</b>	<b>9,110</b>
Net loss from trading	-3,696	-397	-2,263	-55	-1,022	-2,048	-2,052
Other operating income	10,072	11,559	12,251	13,057	13,272	13,872	14,397
<b>Total Operating income</b>	<b>61,099</b>	<b>75,114</b>	<b>76,511</b>	<b>72,074</b>	<b>80,608</b>	<b>91,508</b>	<b>101,924</b>
Less: Impairment charge/(reversal) for loans	-3,926	-9,784	-11,427	-16,047	-16,685	-17,070	-9,400
<b>Net operating income</b>	<b>57,173</b>	<b>65,330</b>	<b>65,084</b>	<b>56,027</b>	<b>63,924</b>	<b>74,438</b>	<b>92,524</b>
<b>Operating Expenses</b>							
Personnel expenses	10,916	13,009	14,026	13,903	14,881	16,302	18,128
Other expenses	12,408	13,636	15,311	13,527	15,015	16,817	18,835
	<b>28,810</b>	<b>32,324</b>	<b>36,428</b>	<b>34,806</b>	<b>38,156</b>	<b>42,700</b>	<b>48,078</b>
Operating profit before value added tax (VAT)	28,363	33,006	28,656	21,222	25,768	31,737	44,446
Value Added Tax (VAT) on Financial Services	5,436	6,843	8,398	4,048	4,675	5,525	7,196
<b>Operating profit after value added tax (VAT)</b>	<b>22,927</b>	<b>26,163</b>	<b>20,258</b>	<b>17,173</b>	<b>21,093</b>	<b>26,213</b>	<b>37,250</b>
<b>Profit before income tax</b>	<b>23,103</b>	<b>26,466</b>	<b>20,445</b>	<b>17,580</b>	<b>21,509</b>	<b>26,637</b>	<b>37,682</b>
Income Tax Expense	6,362	7,317	5,416	3,918	4,194	6,393	9,044
<b>Profit for the Year</b>	<b>16,741</b>	<b>19,149</b>	<b>15,029</b>	<b>13,662</b>	<b>17,314</b>	<b>20,244</b>	<b>28,639</b>
<b>Profit attributable to Equity holders of the Bank</b>	<b>15,947</b>	<b>17,636</b>	<b>14,670</b>	<b>13,095</b>	<b>16,882</b>	<b>19,232</b>	<b>27,207</b>
Adjusted EPS	31.1	34.4	28.7	25.6	33.0	37.6	53.1

## Appendix II: Statement of Financial Position

Balance Sheet (LKR Mn) As at 31st December	2017	2018	2019	2020	2021E	2022E	2023E
<b>Assets</b>							
Cash and Cash Equivalents	21,214	24,967	30,264	34,899	43,019	39,970	55,969
Balances with Central Bank of Sri Lanka	38,611	33,907	22,795	7,212	25,304	36,292	38,804
Placements with Banks	9,670	8,506	15,490	12,126	16,417	12,039	19,503
Reverse Repurchase Agreements	772	1,169	2,072	2,827	6,643	6,877	5,264
Financial Assets Measured at FVTPL	267	264	1,155	1,095	985	1,083	1,040
Financial Assets Measured at Amortised Cost - Loans & Advances	656,323	770,263	769,392	800,816	885,738	982,467	1,052,727
Financial investments - FVOCI	101,743	76,005	133,953	256,395	229,833	240,778	260,040
Financial Assets Measured at Amortised Cost - Debt & Other Instruments	125,032	165,822	156,511	193,349	197,000	210,680	208,032
Property, Plant and Equipment	34,635	42,417	42,453	41,827	41,111	40,344	39,613
Other Assets	13,038	16,274	15,468	11,045	18,606	20,466	22,103
<b>Total assets</b>	<b>1,007,560</b>	<b>1,148,614</b>	<b>1,197,635</b>	<b>1,371,483</b>	<b>1,474,817</b>	<b>1,601,682</b>	<b>1,714,286</b>
<b>Liabilities</b>							
Due to Banks	62,464	77,976	87,213	89,747	85,854	87,908	89,441
Due to Other Customers	718,770	818,042	835,060	994,949	1,094,444	1,203,888	1,300,199
Dividends Payable	987	1,009	1,467	981	1,418	1,615	2,057
Other Borrowings	27,258	24,894	22,604	30,526	19,929	22,106	27,371
Other Liabilities	7,359	8,945	12,495	15,452	16,225	17,036	17,547
<b>Total Liabilities</b>	<b>881,902</b>	<b>1,011,280</b>	<b>1,047,165</b>	<b>1,211,823</b>	<b>1,305,700</b>	<b>1,424,459</b>	<b>1,517,581</b>
<b>Equity</b>							
Stated Capital	31,409	32,338	33,821	35,572	36,284	37,009	37,750
Retained Earnings	18,082	20,181	23,073	29,361	37,147	42,898	59,335
<b>Total Equity Attributable to Equity Holders of the Bank</b>	<b>122,009</b>	<b>132,661</b>	<b>145,508</b>	<b>154,249</b>	<b>163,274</b>	<b>170,369</b>	<b>188,419</b>
Non-controlling Interests	3,649	4,673	4,962	5,410	5,843	6,855	8,287
<b>Total Equity</b>	<b>125,658</b>	<b>137,335</b>	<b>150,471</b>	<b>159,659</b>	<b>169,117</b>	<b>177,224</b>	<b>196,706</b>
<b>Total Liabilities and Equity</b>	<b>1,007,560</b>	<b>1,148,614</b>	<b>1,197,635</b>	<b>1,371,483</b>	<b>1,474,817</b>	<b>1,601,682</b>	<b>1,714,286</b>
<b>NAVPS</b>	<b>231.5</b>	<b>251.7</b>	<b>276.0</b>	<b>292.6</b>	<b>309.7</b>	<b>323.2</b>	<b>357.4</b>



**First Capital**  
A Janashakthi Group Company

# 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	Vidushika Perera	+94 11 2639 864
Hiruni Perera	+94 11 2639 864	Tharusha Ashokgar	+94 11 2639 864

## 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

Nethalie De Mel	+94 11 2639 854
-----------------	-----------------

## EQUITY SALES

<b>CEO</b>	Jaliya Wijeratne	+94 70 2910 042	<b>Negombo</b>	
<b>Colombo</b>			Priyanka Anuruddha	+94 70 2910 035
Rasika Indra Kumara	+94 77 7072 698		Priyantha Wijesiri	+94 70 2910 036
Isuru Jayawardena	+94 76 7084 953			
Nishantha Mudalige	+94 70 2910 041			
Ifadh Marikar	+94 77 9625 679			
Anushka Buddhika	+94 71 4310 600			
Thushara Pathiraja	+94 70 2910 037			
Chandika Jayawardana	+94 77 3940 070			

## UNIT TRUST SALES

Kavin Karunamoorthy	+94 77 0328 060	Imali Abeygunawardena	+94 77 1764 799
---------------------	-----------------	-----------------------	-----------------

## BRANCHES

<b>Kandy</b>	<b>Kurunegala</b>	<b>Matara</b>	<b>Negombo</b>
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, Anagarika Dharmapala Mawatha, Matara 81000.	Colombo Stock Exchange - Negombo Branch Office, No. 72A, 2/1, Old Chilaw Road, Negombo 11500.
<b>Manager: Salinda Samarakoon</b>	<b>Manager:</b>	<b>Manager: Rohana Jayakody</b>	<b>Manager:</b>
Tel: +94 81 2236 010	Tel: +94 37 2222 930	Tel: +94 41 2222 988	Tel: +94 31 4937 072

## 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 accuracy, 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 a connected person or associated person 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.