



First Capital
A Janashakthi Group Company

BANKS, THE NEXT BIG THING...

EQUITY | SRI LANKA | BANKING SECTOR

FIRST CAPITAL RESEARCH

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SECTOR REPORT | 18 OCT 2023

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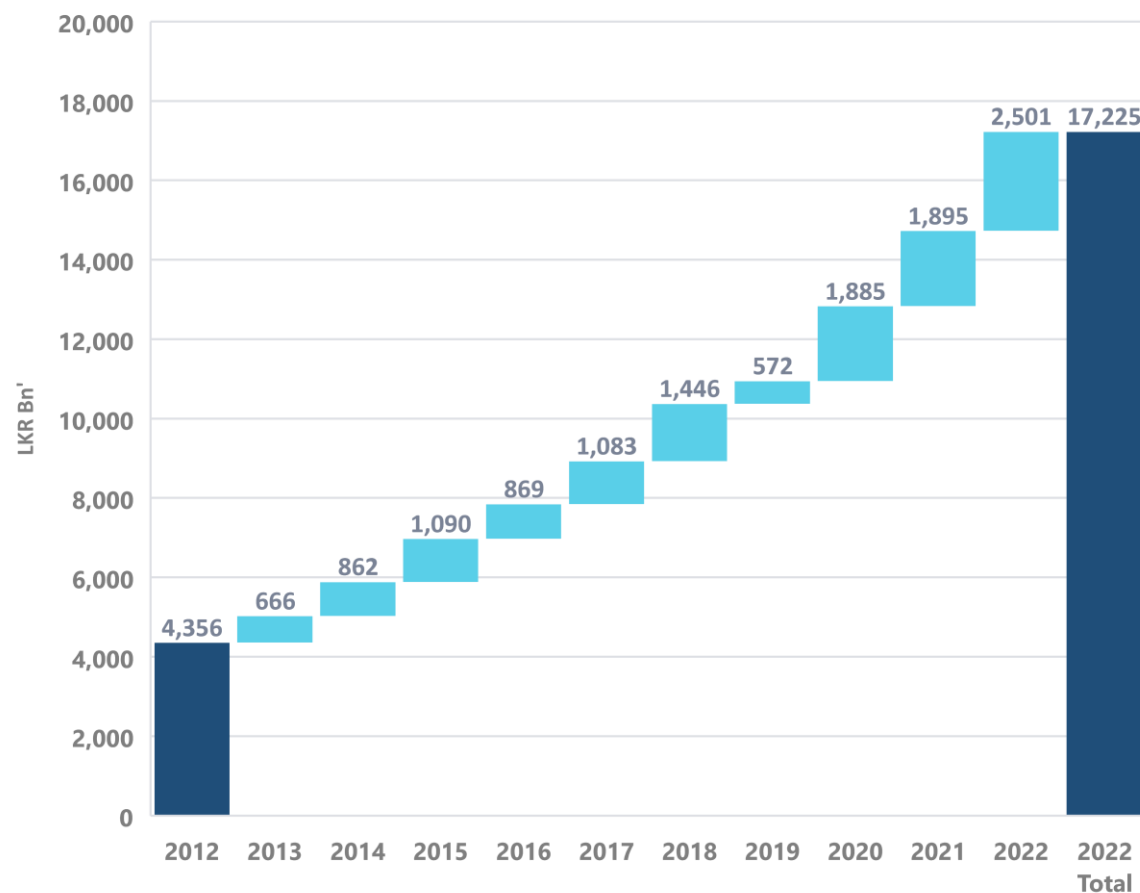
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Executive Summary

- Sri Lankan banking sector has struggled during post-covid period, impacted by slowdown in business volumes, rising impairments and GoSL defaulting on outstanding debt. This resulted in banking sector trading at a steep discount of 50% to the past 10yr historical multiple of 1.0x.
- However, FCR believes that the Sri Lankan banking sector is ready to unlock the next chapter in banking benefitted by declining interest rates and pick up in economic activity, which is expected to boost banking sector via expansion in loan book, and fee & commission incomes.
- Furthermore, with minimum capital expenditure allocations of 25.0% across all banks, commercial banks in Sri Lanka are preparing themselves for the next phase of digitalization. This is expected to drive down operating costs of banks in the medium term, increasing profitability during the coming years.
- Given the favorable outlook for banks in the coming months, we expect the overall banking sector to reiterate up and trade at its past 10Yr PBV multiple of 1.0x by 2024E.

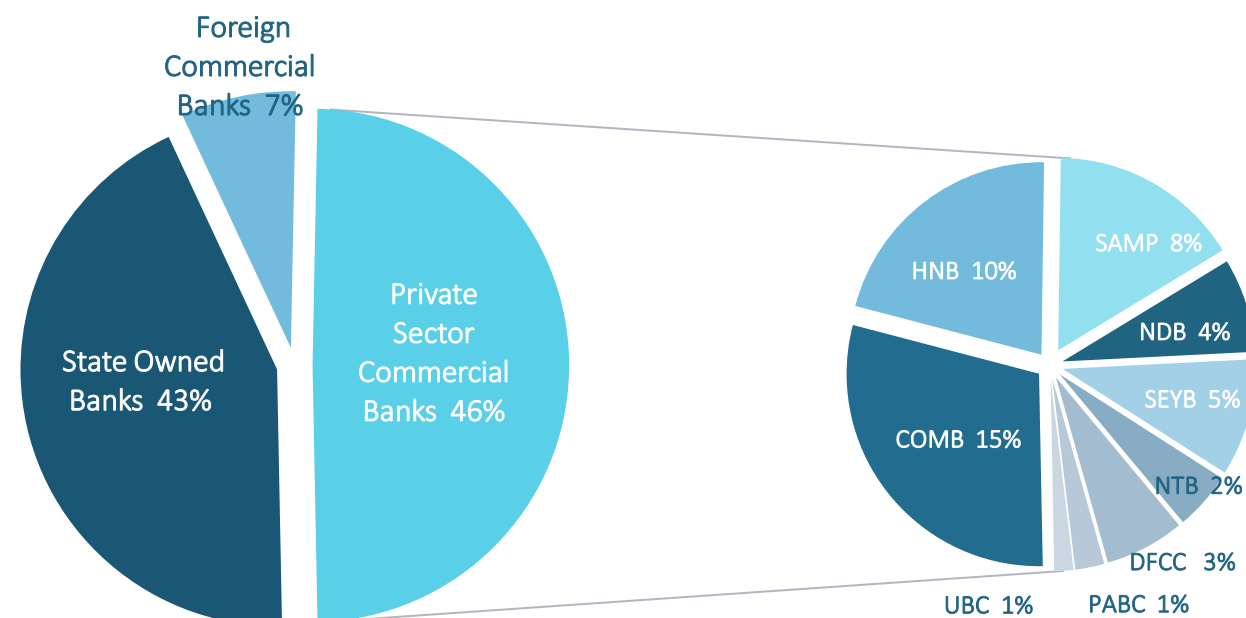
Banking Sector assets in a glance...

Banking Sector Assets



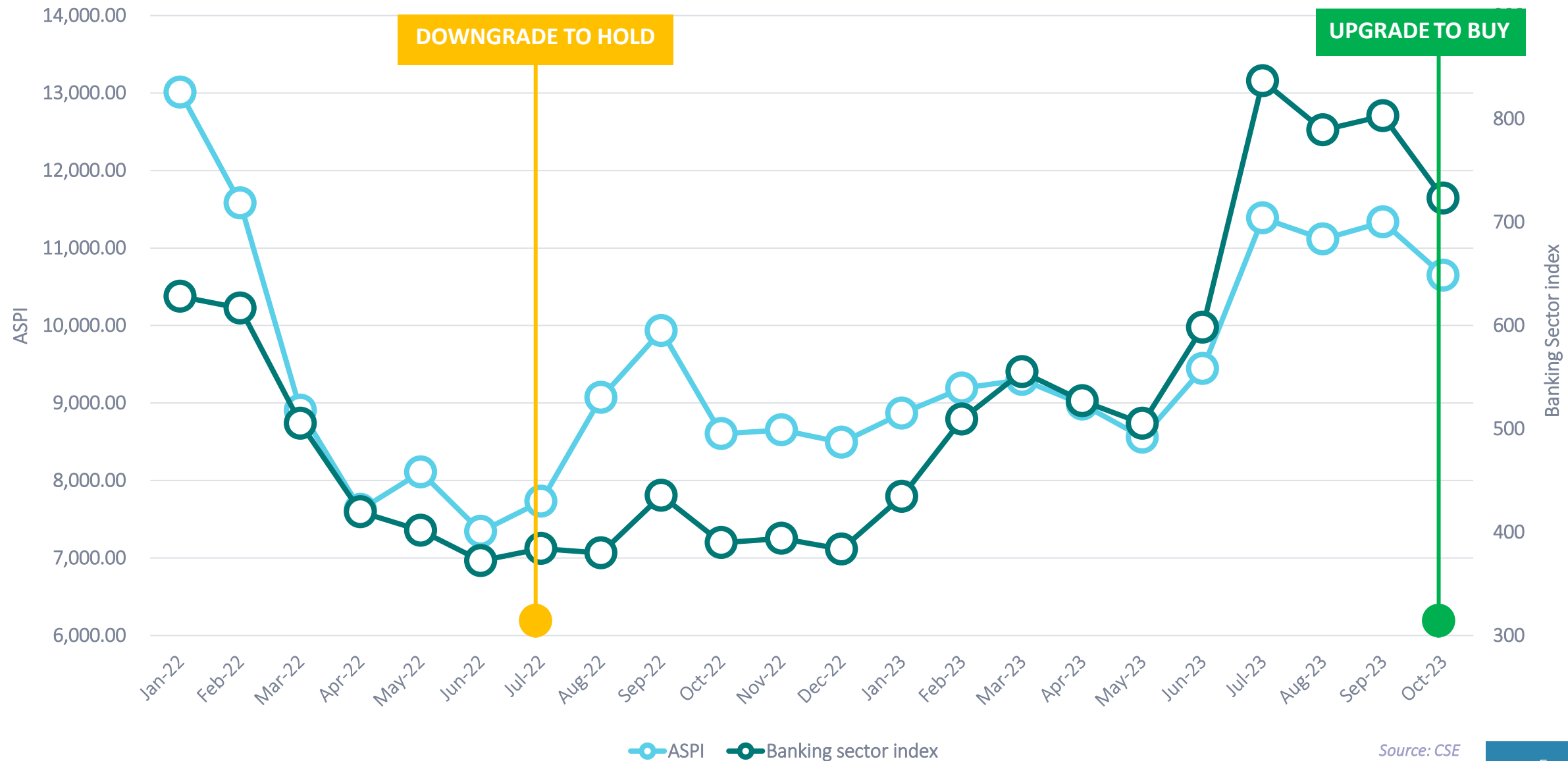
Source: CBSL, First Capital Research

Banking Asset Segmentation



Source: CBSL, First Capital Research

ASPI vs Banking Sector Index





1.0 INVESTMENT THESIS

1.0 Investment Thesis



1.1 Unlocking the next chapter in Banking



1.2 Reduction in impairment provisions to aid bottom-line growth

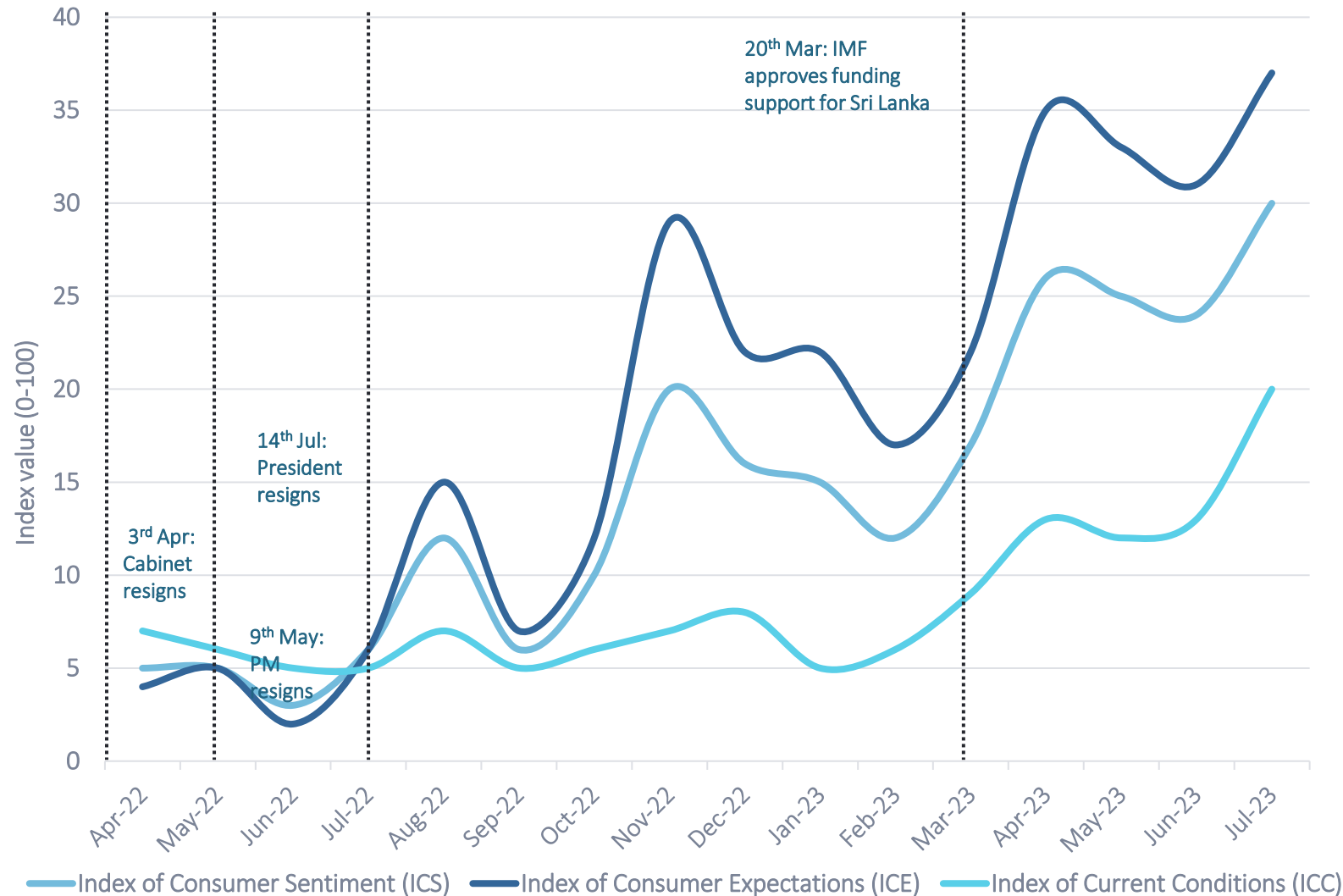


1.3 Digitalization and Resumption of business activities to mitigate cost pressures



1.1 Unlocking the next chapter in Banking

Economy signals signs of recovery amidst rising consumer confidence as economic worries ease...



Index of Consumer Sentiment (ICS) improved to the highest level since Oct-21, by 6 points for Jul-23 based on the views of consumers on their personal economic status and national economy.

Index of Consumer Expectation (ICE) also showed improvement as it peaked to a new high of 37 points indicating less pessimism on the long-term future of the country.

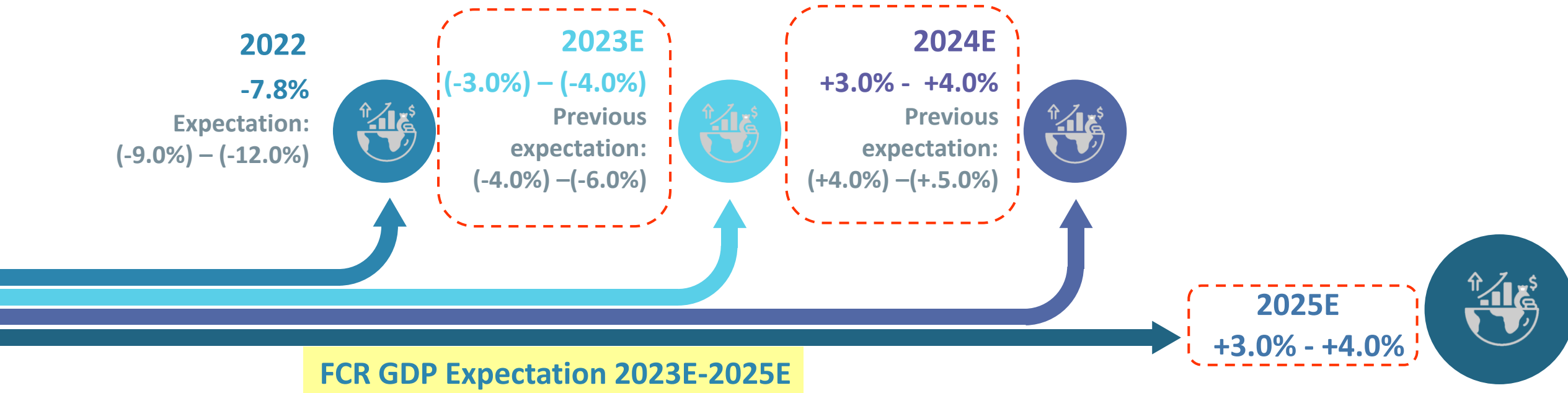
(The index ranges from zero to a potential maximum of 100, with levels below 50 indicating net pessimism)

...with First Capital expecting a turnaround in GDP from 4Q2023 onwards

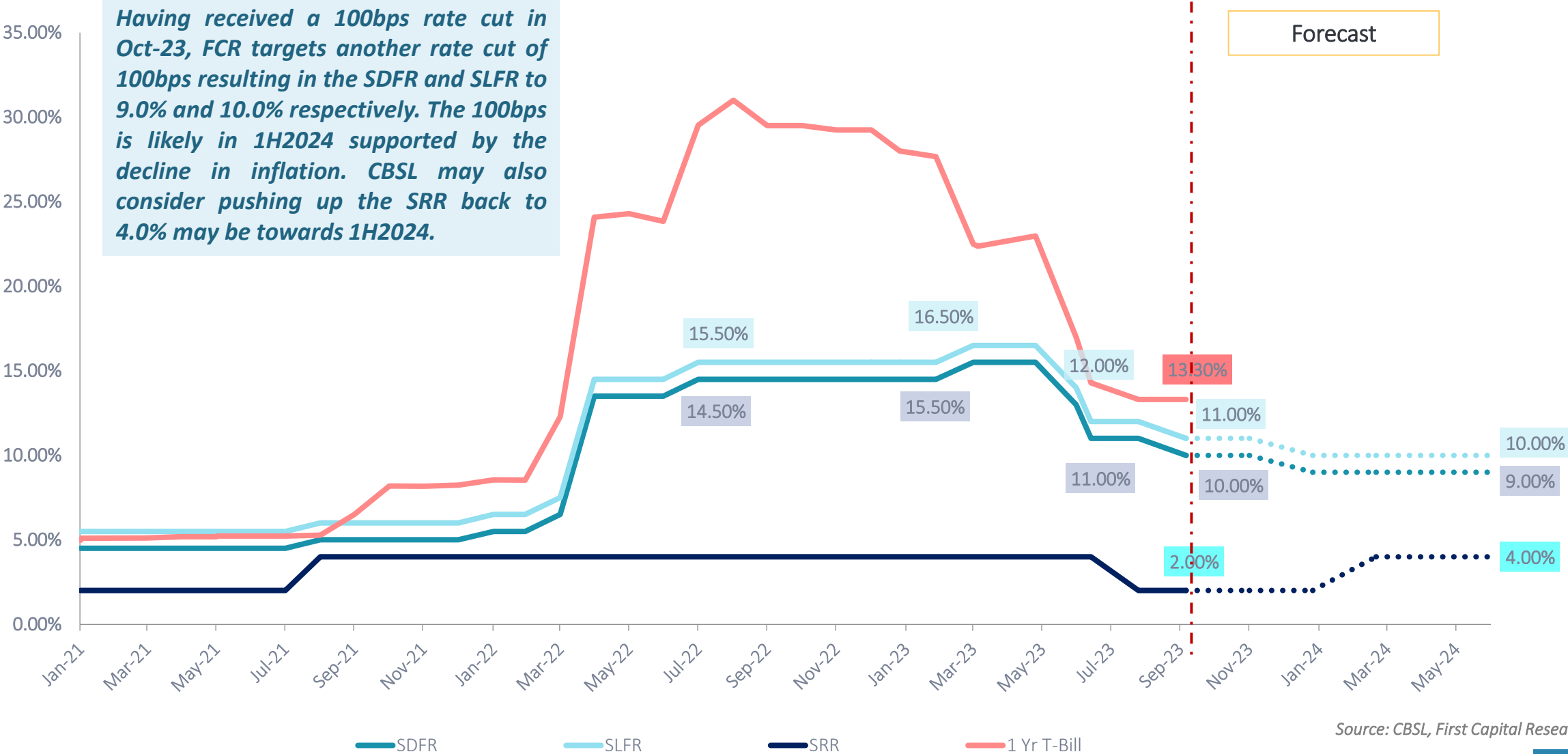
With major economic indicators showing promising signs of recovery, we expect 2023E to be better than 2022, yet with a minor contraction whilst 2024E is expected to record a growth between 3.0%-4.0%.

The Banking sector performance, which is a proxy to the economic performance, recorded a 27.0%YoY decline in profitability while the economy contracted by 7.8%YoY in 2022.

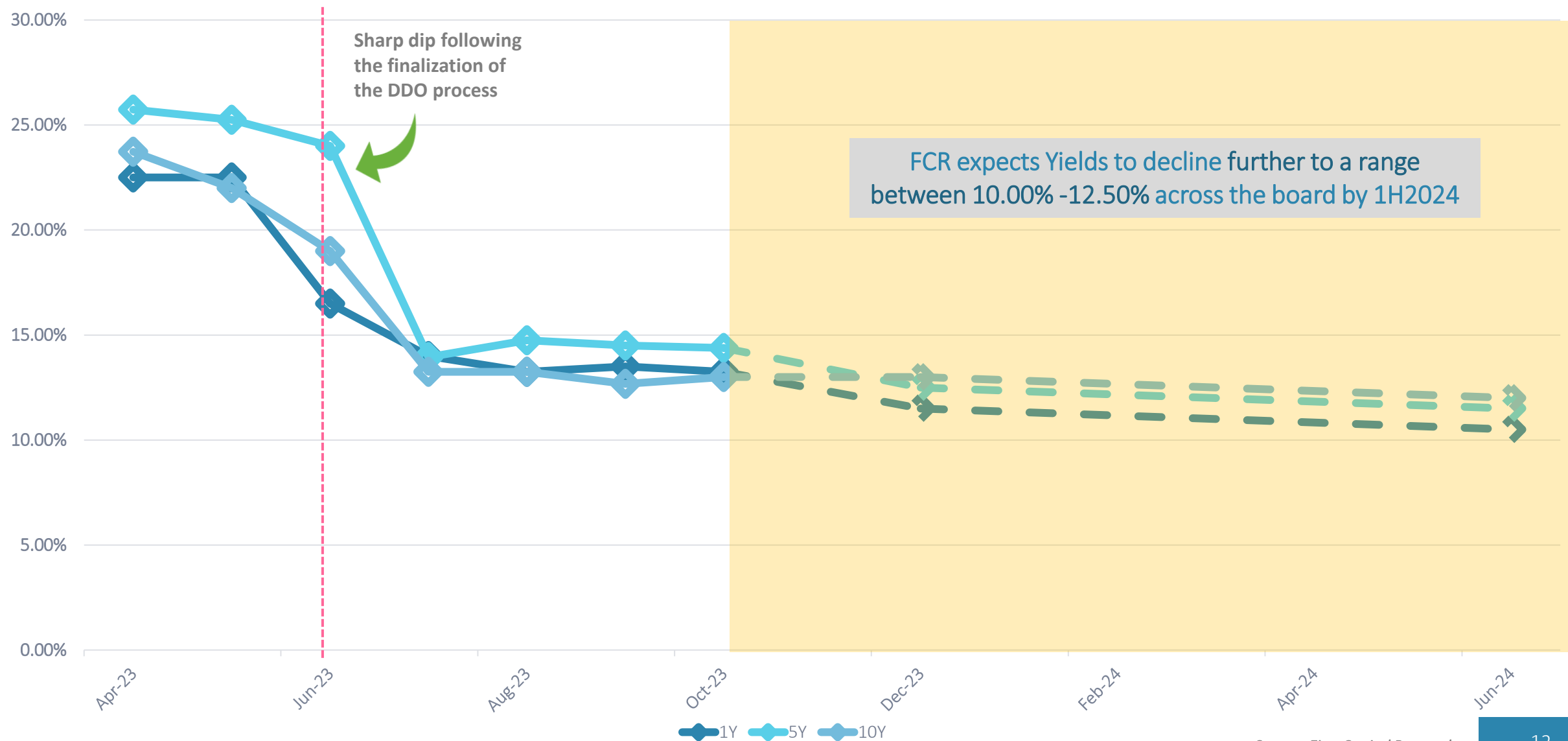
The recovery in the economy is expected to boost the outlook for the listed banking sector, targeting profits to grow at 40% in 2023E and 60% in 2024E.



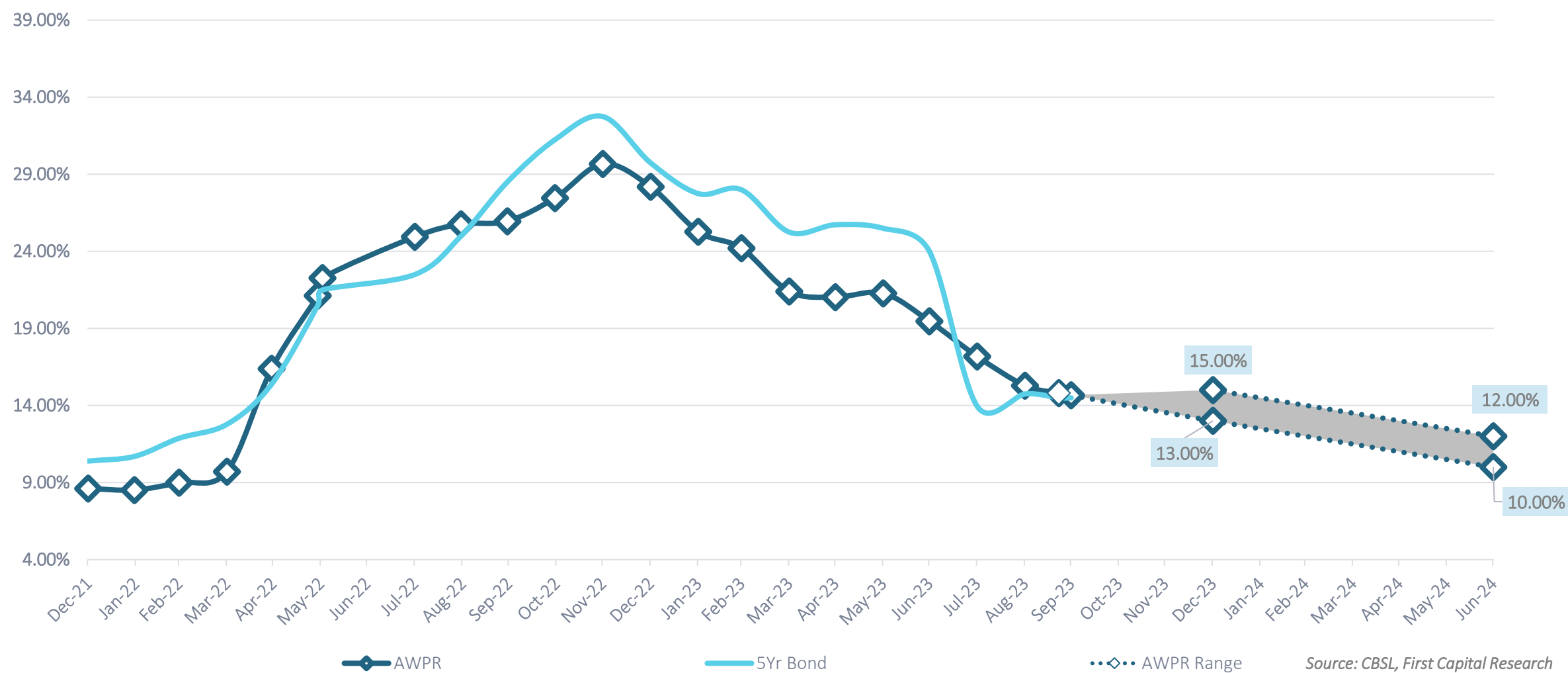
CBSL pushes down policy rates further, accounting for a cumulative dip of 550bps so far in 2023...



...influencing overall decline in G-Sec yields...

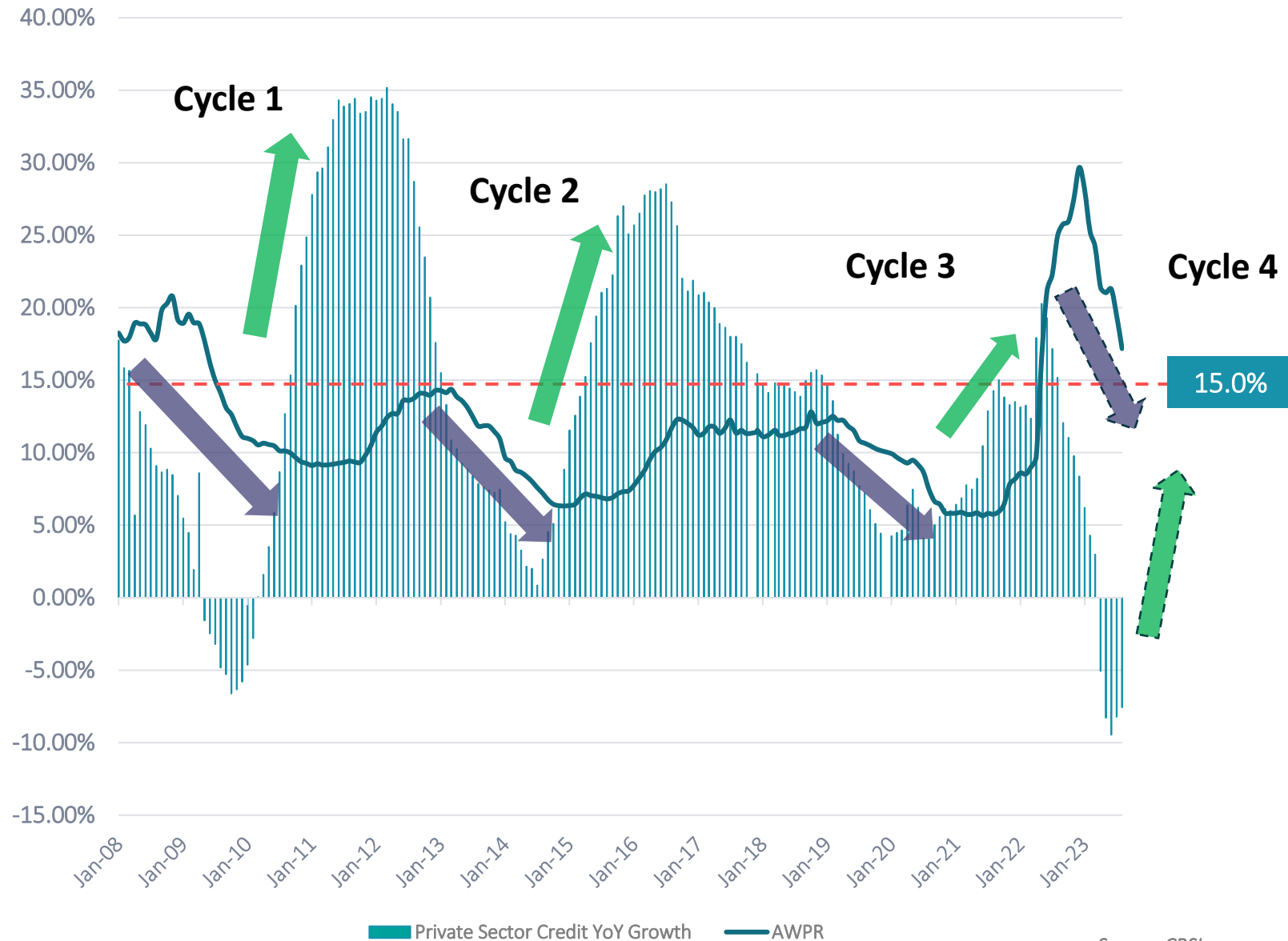


... while stirring an accelerated dip in AWPLR, as FCR expects AWPR to further dip to 10.0%-12.0% by Jun-24



Source: CBSL, First Capital Research

Dip in yields is expected to reinforce interest in private credit as business activity recovers...

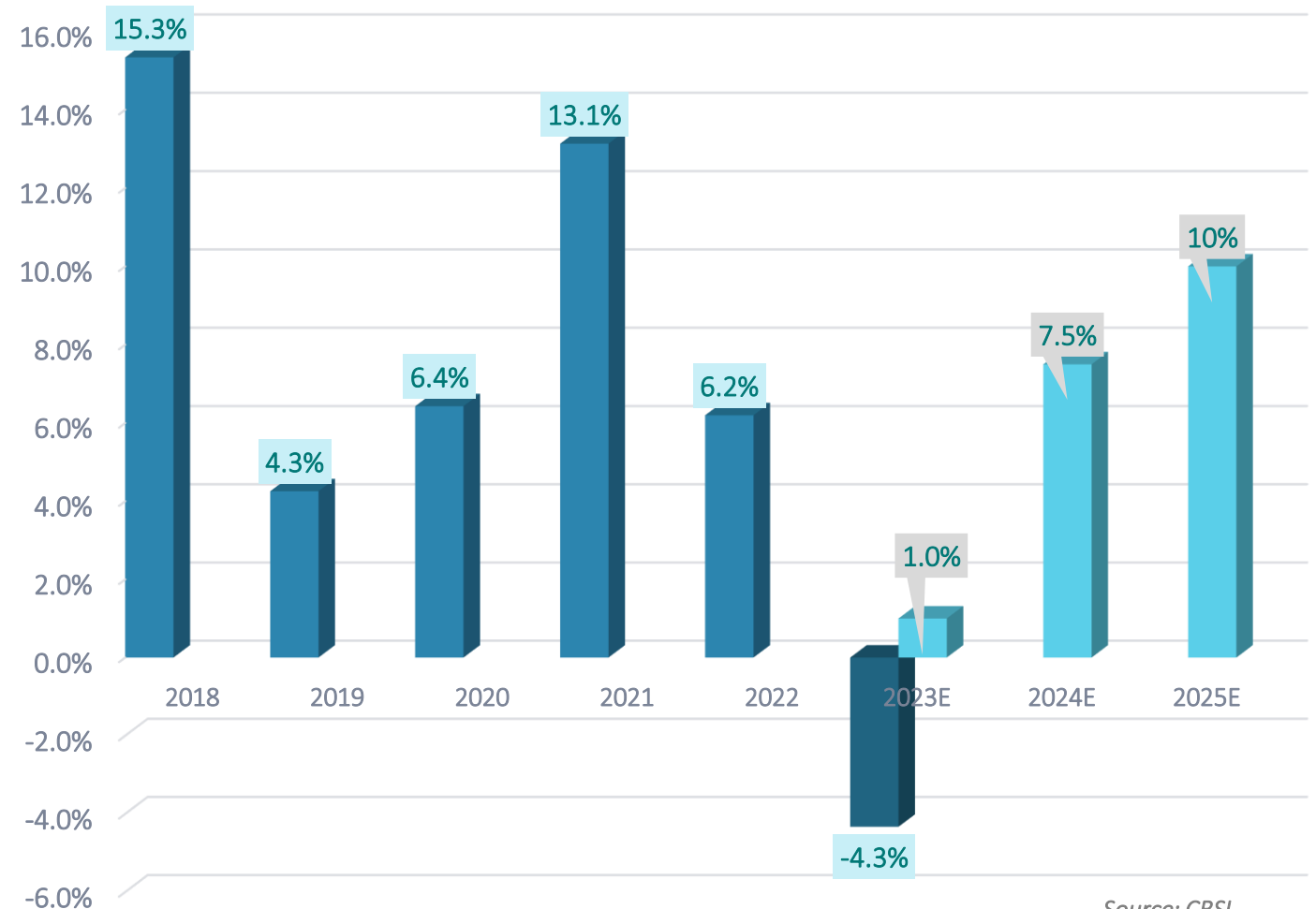


Economic activity spikes with stronger credit growth when interest rates drop below 15%

Source: CBSL

...enabling private sector credit growth to expand by 7.5% in 2024E and 10.0% in 2025E...

Aggressive policy actions undertaken by the CBSL via three rate cuts totaling to 550bps have prompted private sector credit to grow consecutively for 3 months to Aug-23. FCR expects private sector credit to rebound enabling loan book expansion during 2H2023.



Source: CBSL

...facilitating banking sector loan growth to recover...



Between 2013-23 period, Sri Lankan interest rates behaved with greater volatility and with inconsistent direction, with AWLR touching the lowest of 9.4% by 3Q2021 and highest of 18.7% by 4Q2022.



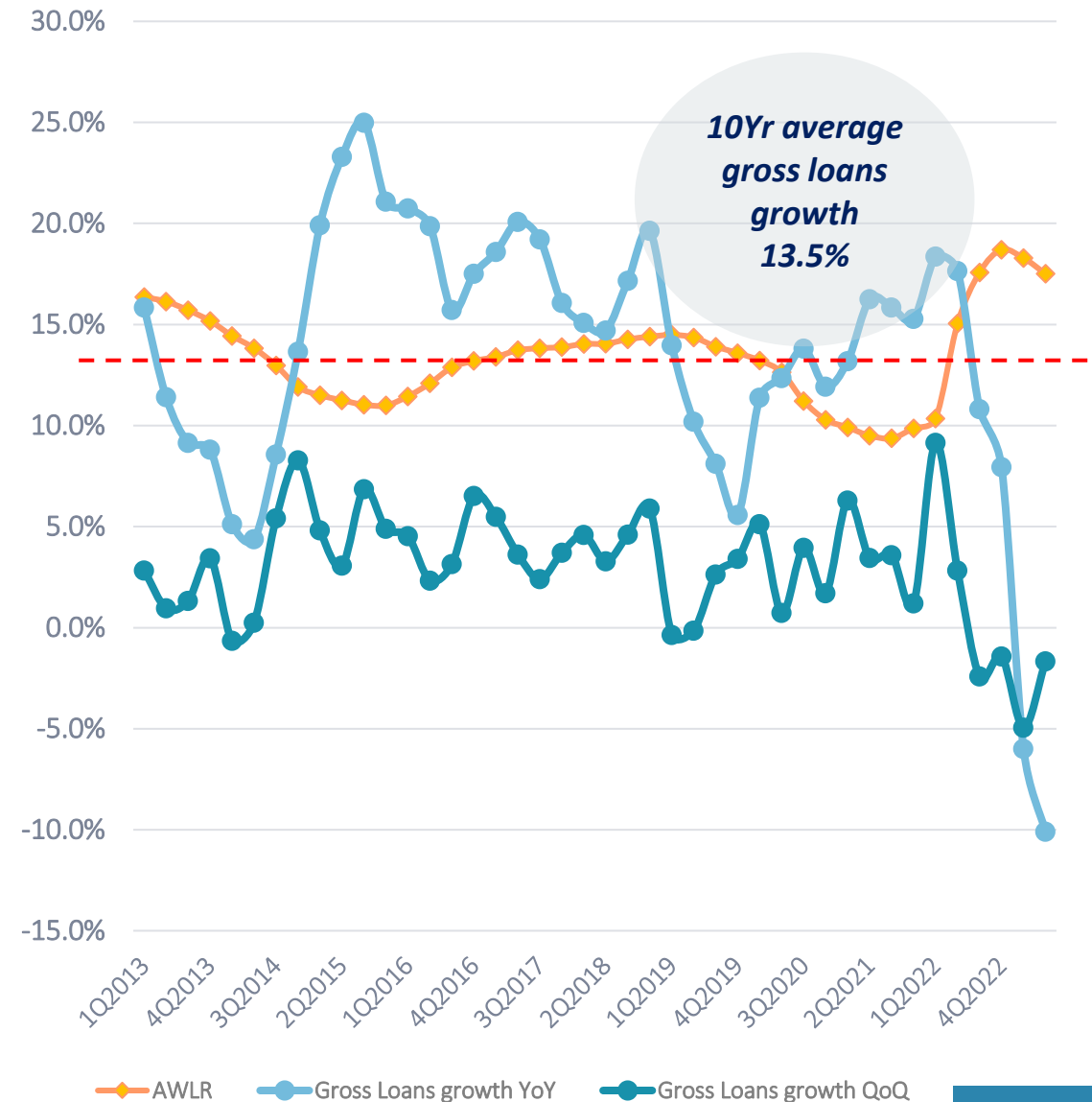
Despite the significant volatility in the AWLR movement, the banking industry gross loan book grew at a 10yr average of 13.5%.



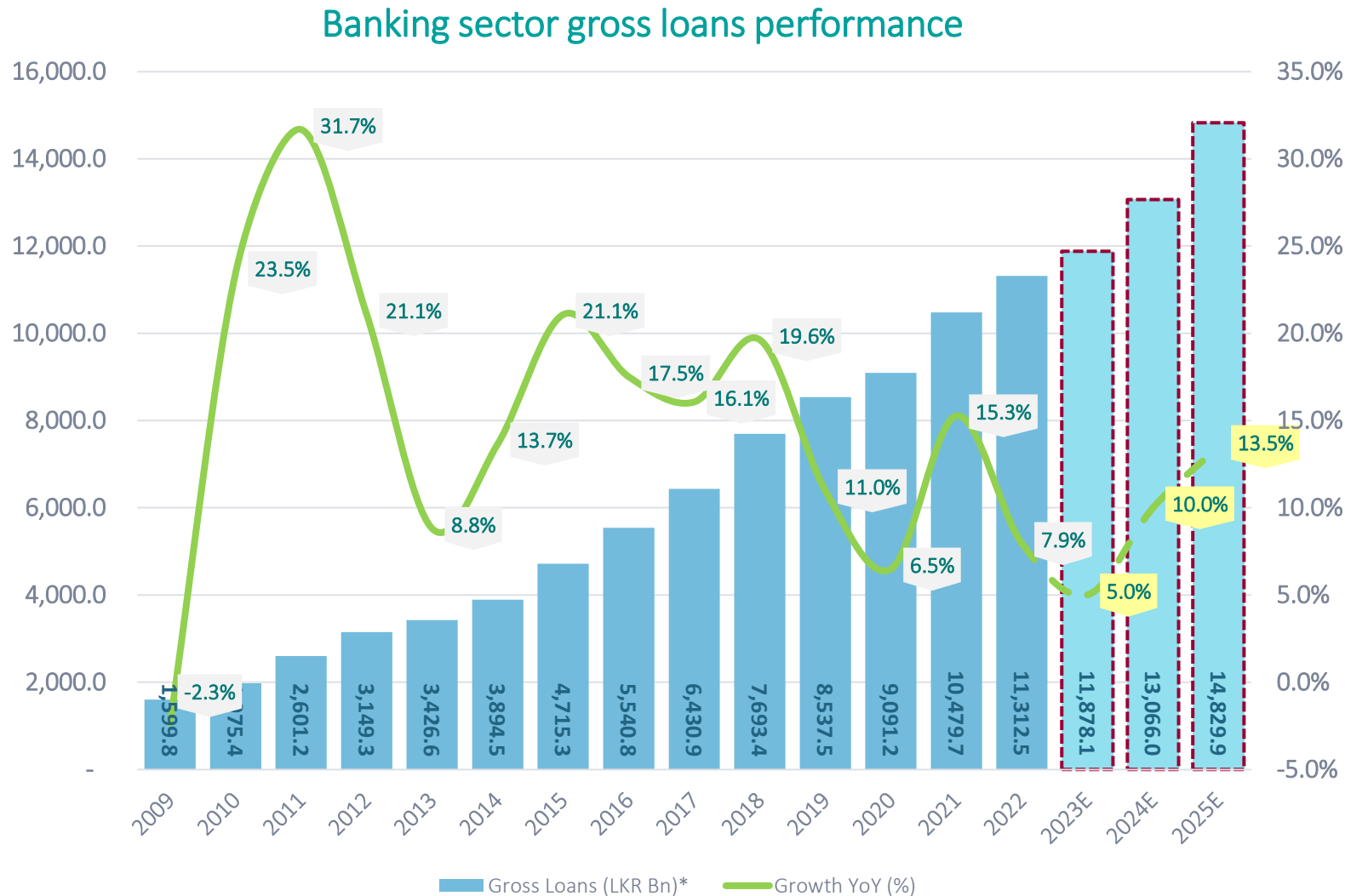
With AWLR peaking at 18.7% in 4Q2022, gross loan book of the banking industry slumped by 10.1% in 2Q2023.



On the back of the anticipated recovery in the 2H2023E supported by the bottoming out interest rates (towards 1H2024E), we expect the banking sector gross loans to grow near its past year 10-yr average of 13.5%.



...reaching 10% in 2024E and growing to its 10Yr average in 2025E to 13.5%



Gross loans in the banking sector is expected to record a tepid growth of 5.0% in 2023E, with growth largely driven during 2H2023E.

Meanwhile, gross loan book is expected to grow at 10.0% in 2024E, benefitted by the lenient monetary policy.

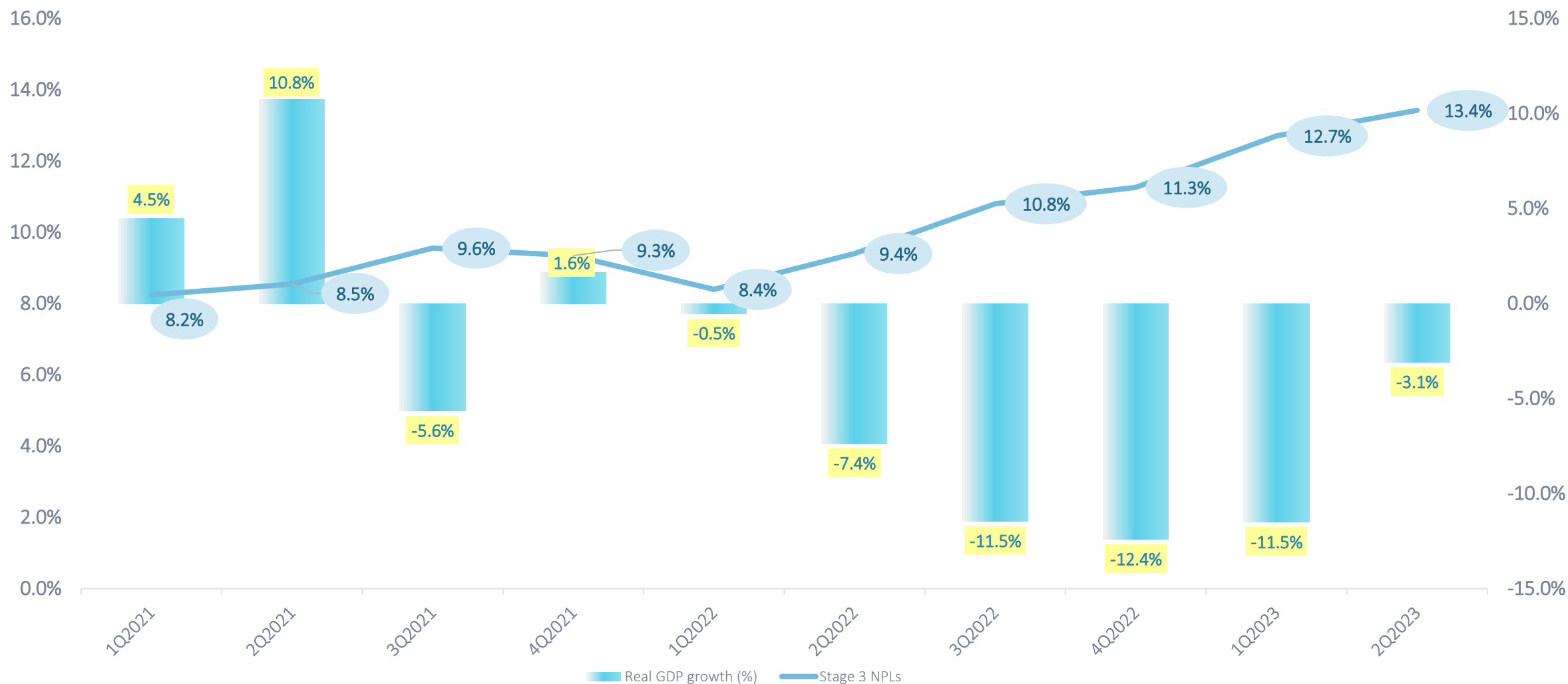
However, we believe that the 10yr growth of +13.5% growth in the banking sector gross loan book is possible only in 2025E, with expectations that the CBSL will stick with the current monetary policy and IMF targets whilst Sri Lanka records a robust growth in GDP.

*Gross Loans = State Credit + Pvt. Sector credit



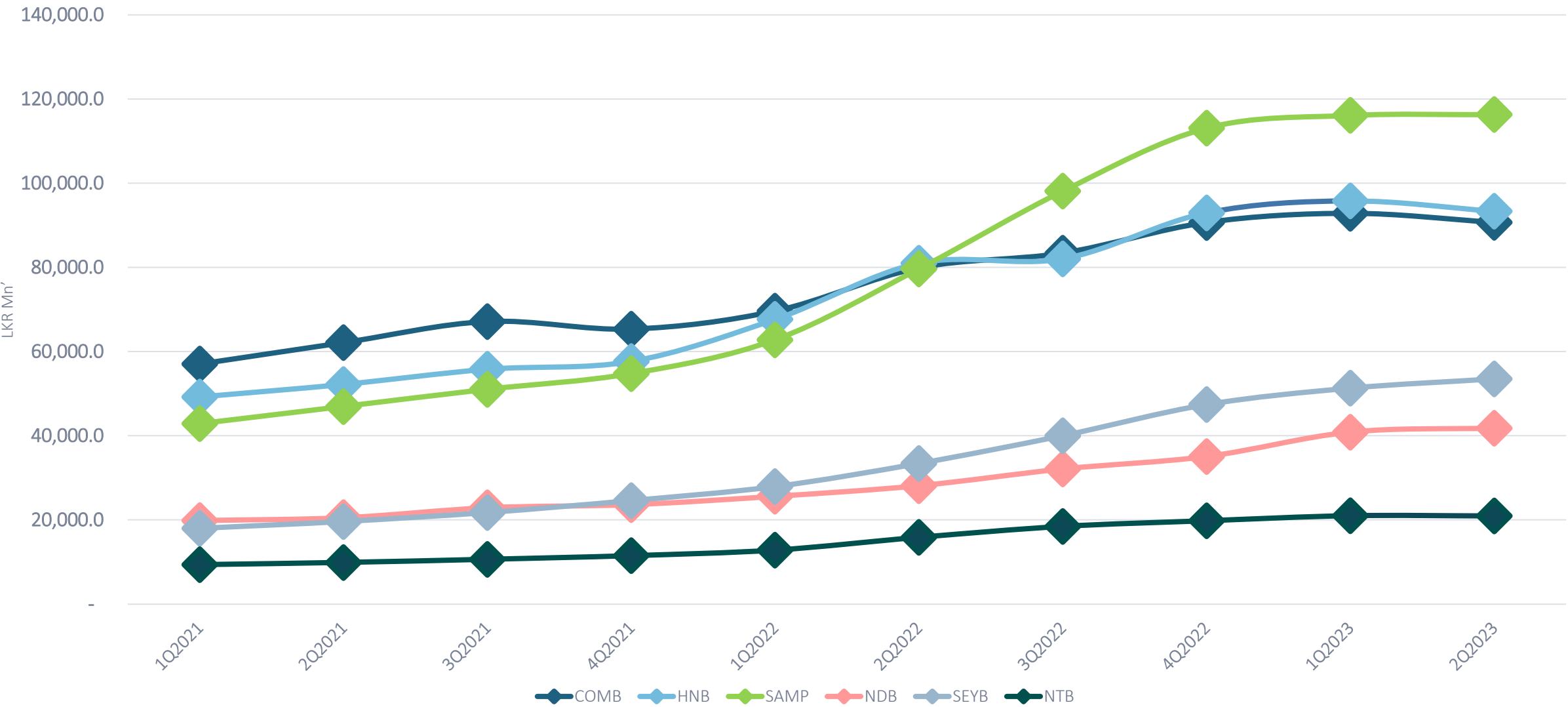
1.2 Reduction in impairment provisions to aid bottom-line growth

NPLs continued to surge amidst the economic contraction...

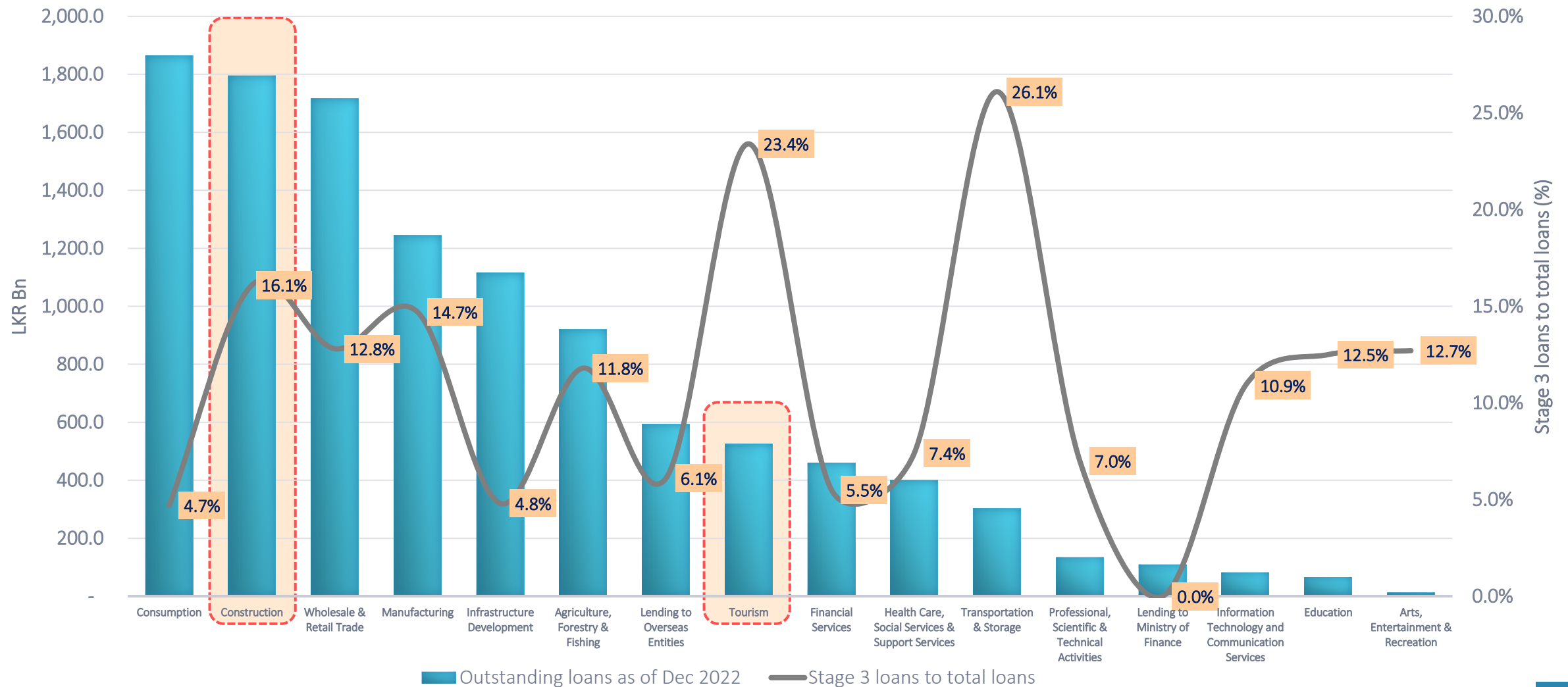


Source: CBSL

...however, impairment provisioning has already seen its peak and is on the decelerating trend



Construction and Tourism are primary sectors of concern with cumulative exposure near 40.0%...



...But the LCBs burden is expected to lighten with Govt making payments to construction sector after significant delays...

Government to settle Rs.175bn construction industry outstanding payments from capital allocations

1 February 2023 06:53 am 1 - 2858



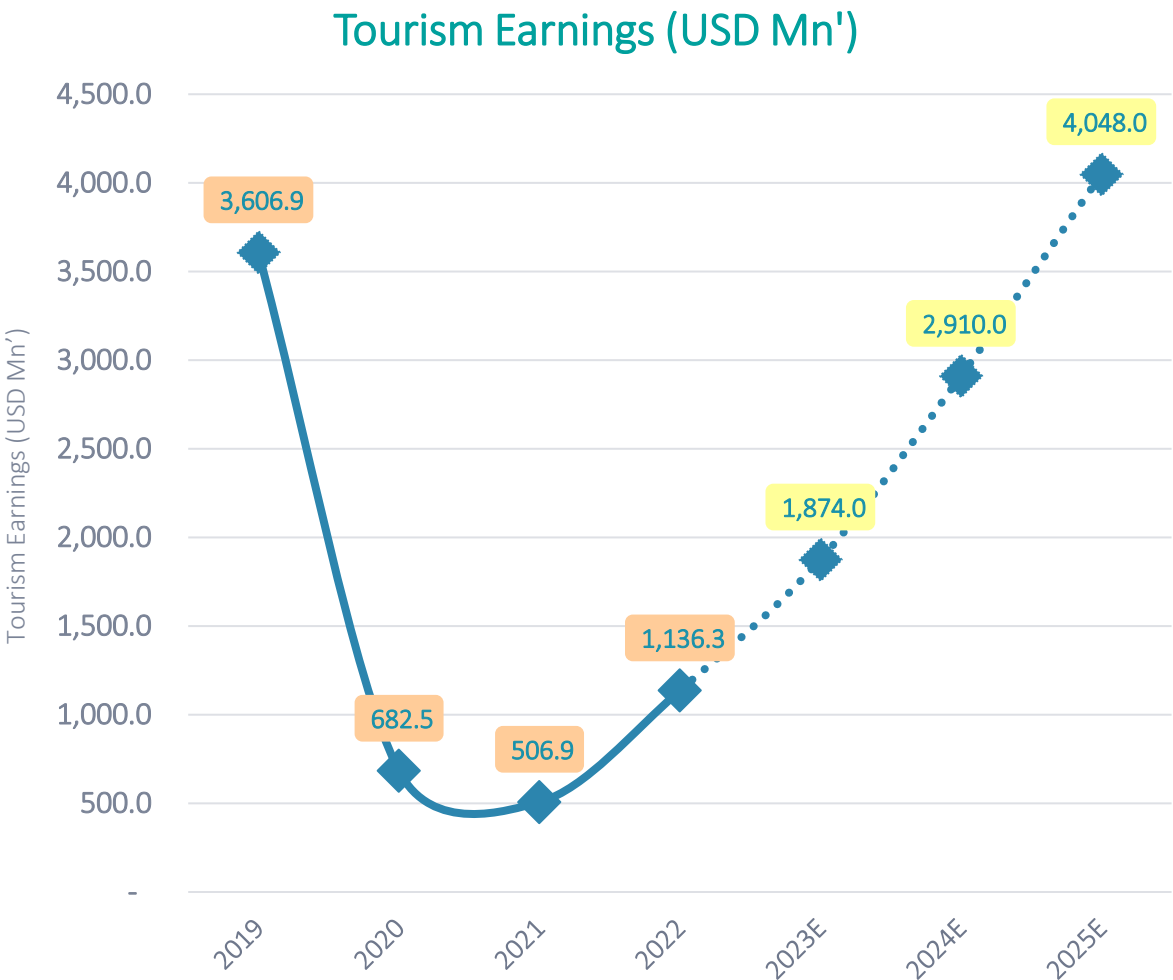
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The industry's unpaid balance was initially at LKR 200.0Bn, but it has **since reduced to approximately LKR 175.0Bn**. The government is gradually addressing these outstanding payments as funds become available to the ministry.

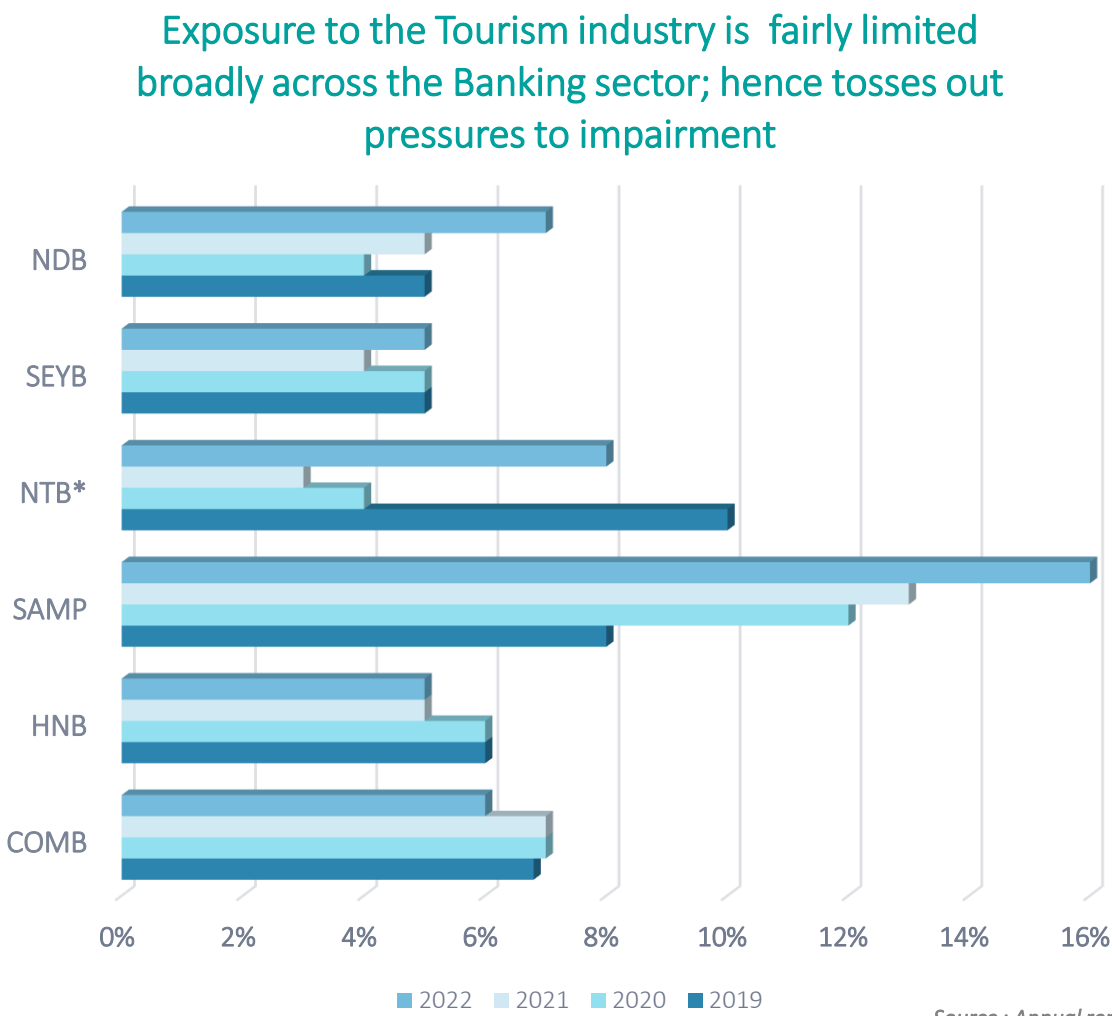
In accordance with a previous decision, the government **paid back a portion of the debt via bonds** with a 2.5-year maturity and a 22.5% interest rate.

Meanwhile, The **construction industry's outlook** for the next three months largely remains optimistic. This positivity is driven by **anticipated economic recovery**, lower interest rates and material costs, and ongoing discussions regarding the **resumption of government-funded projects**.

...while tourism sector earnings spike with the resurgence of tourist arrivals...



Source : CBSL



Source : Annual report

*NTB exposure includes Transportation segment too. Tourism exposure alone as of 2022 is between 4%-5%

...and ending 3Yr long Tourism moratoriums

the morning

⚡ Colpetty tragedy: Death toll rises to five ⚡ Ruhuna Uni. say

Over three-year-old tourism moratoriums come to end

30 Jun 2022



- Banks, finance companies turn down industry requests for a six-month extension
- Extension refused, citing impact on banking system, says SLTDA Chair
- Notes will continue to lobby authorities for an extension

the SUNDAY TIMES

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Sunday, July 03, 2022

BUSINESS TIMES

Debt moratorium looms over tourism industry

By Sunimalee Dias
View(s):

Sri Lanka's tourism industry is bracing for a good winter but the debt moratoriums have come to a screeching halt as the banks feel they will collapse if this continues.

The government is facing a catch-22 situation unable to allow banks to go ahead and obtain the claims and neither give-in to the hotels and as a result the authorities are now considering looking at taking up each on a case by case basis.

CBSL Governor snubs tourism industry calls for moratorium

Wednesday, 25 January 2023 00:00 - 1058

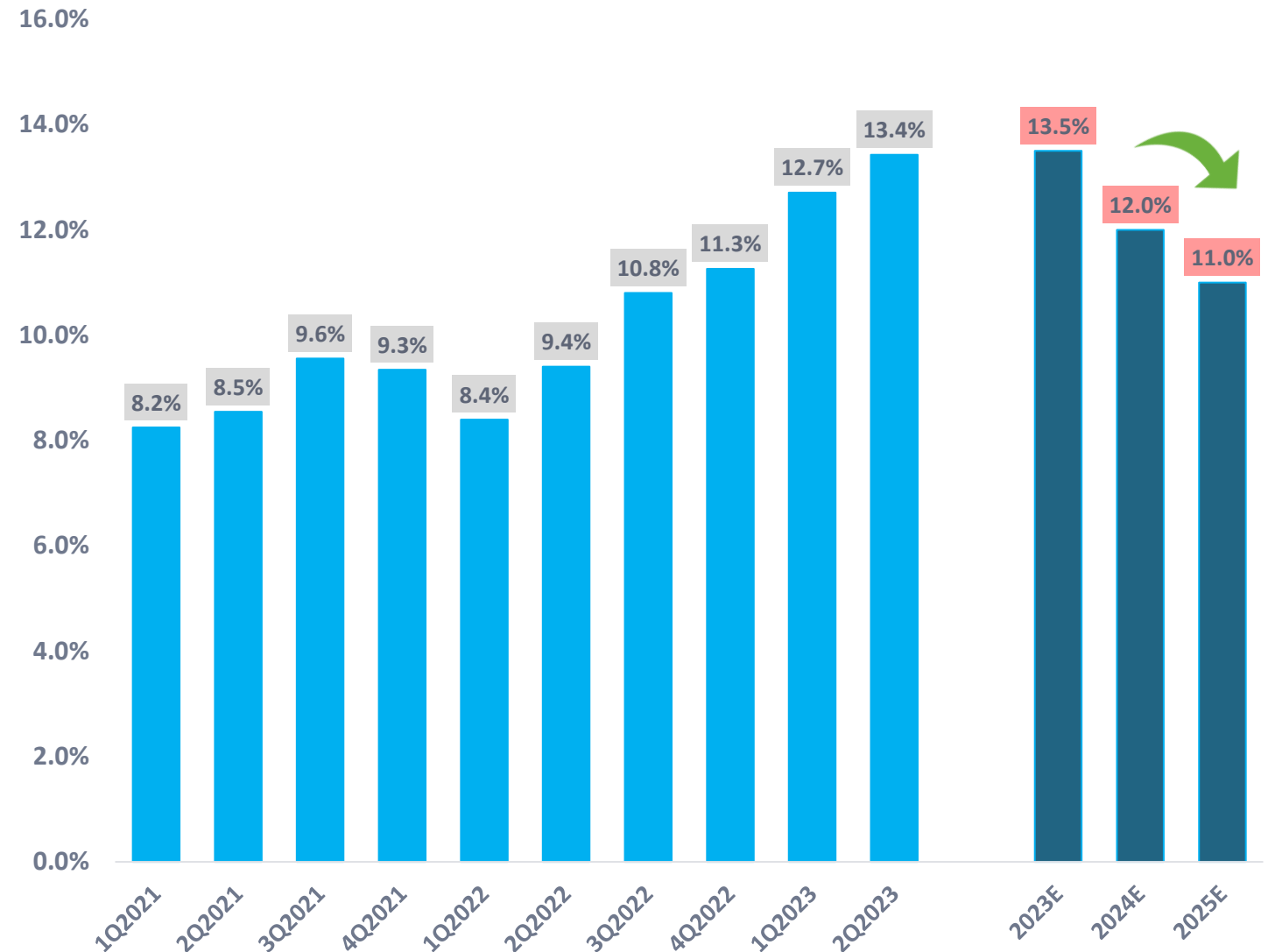


- Opines moratoria are not the solution for tourism but recovery via promotion of luring more tourists
- Stresses even after successive moratoria if tourism sector has not been able to recover CBSL can't ask banks to extend debt moratorium anymore
- CBSL Chief's reluctance comes after President Wickremesinghe's remarks that Govt. will explore possibility of extension
- The Hotels Association President recently requested Govt. to think 'out of the box' as crisis in tourism is unprecedented and SMEs impacted most
- Tourism sector outstanding capital and interest estimated at Rs. 500 b; overall banking sector credit to private sector at Rs. 7,499 b

First Capital expects impairment provisioning to ease reducing NPL ratios at a gradual scale.

Stage 3 non-performing loans in the banking sector is expected to decline from current high levels to 13.5%-11.0% between 4Q2023E-2025E.

The improvement in NPL ratio is largely attributable to the improved recoveries as well as the broadening of the loan base, due to the expected recovery of the economy.

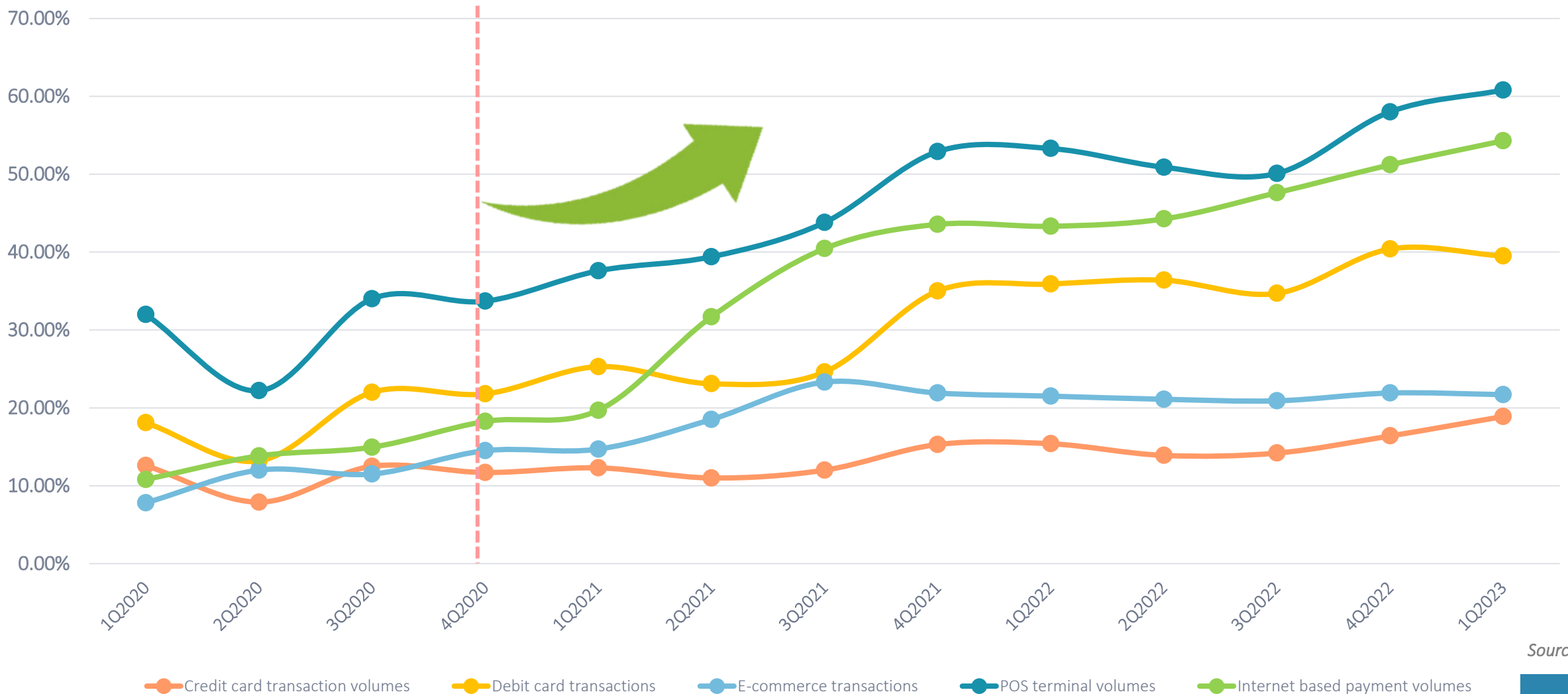




1.3

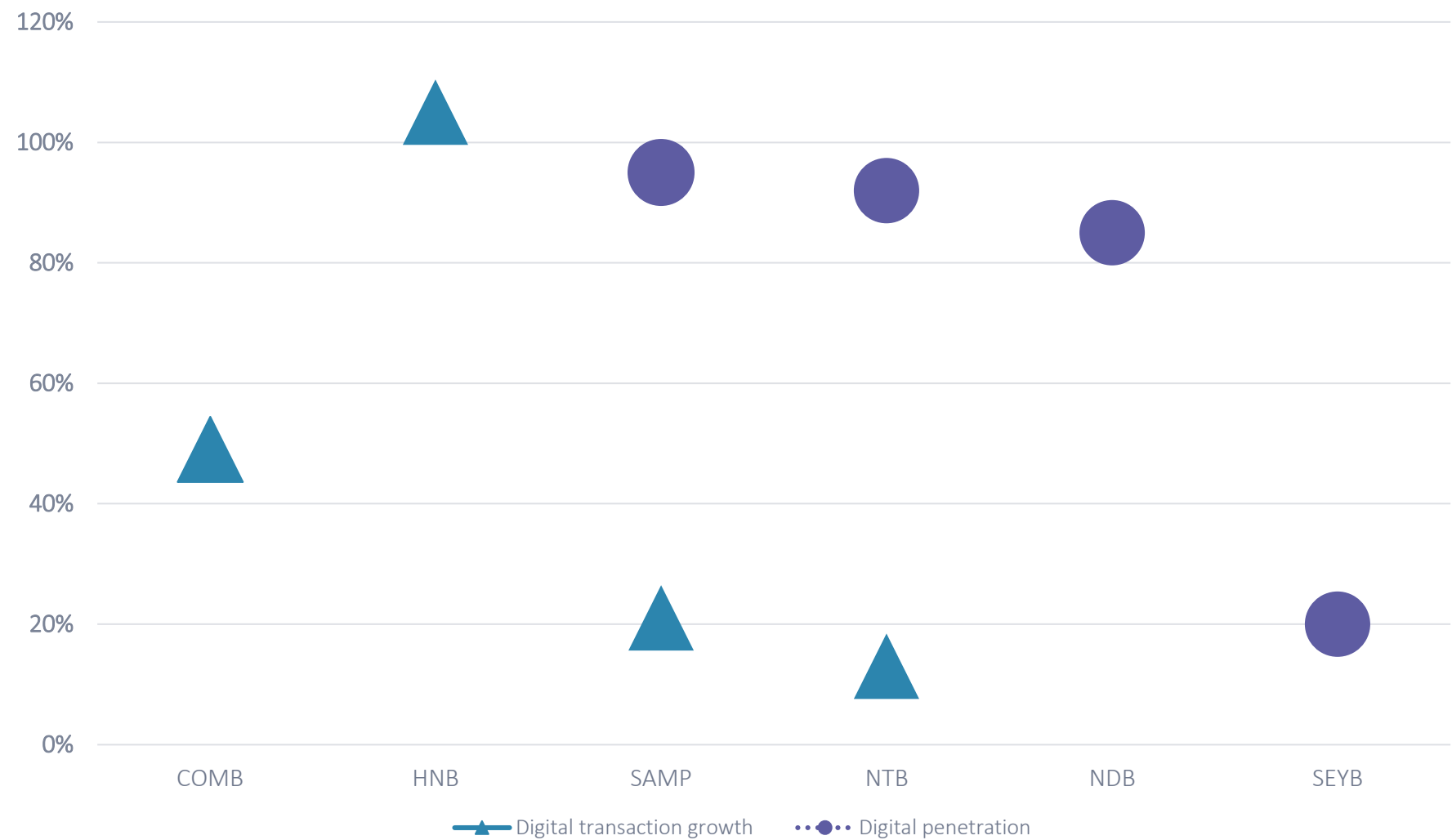
Digitalization and Resumption of business activities to mitigate cost pressures

Post COVID-19 outbreak, Internet based payment volumes in the Banking sector displayed exponential growth...



Source: CBSL

...with surging digital transaction volumes and improving digital penetration of the LCBs...



Source: Company meetings, Annual report

...while Digital wallets too have gained popularity over time, deviating from traditional financial products...

Global market size of digital wallets estimated to grow at 60%



COMB - Flash



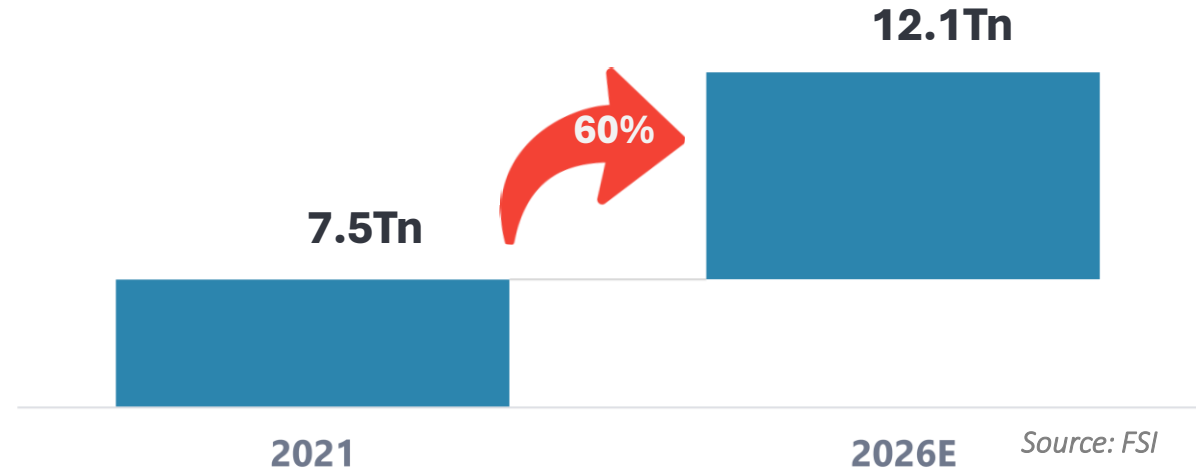
SAMP - WEPAY



HNB - SOLO



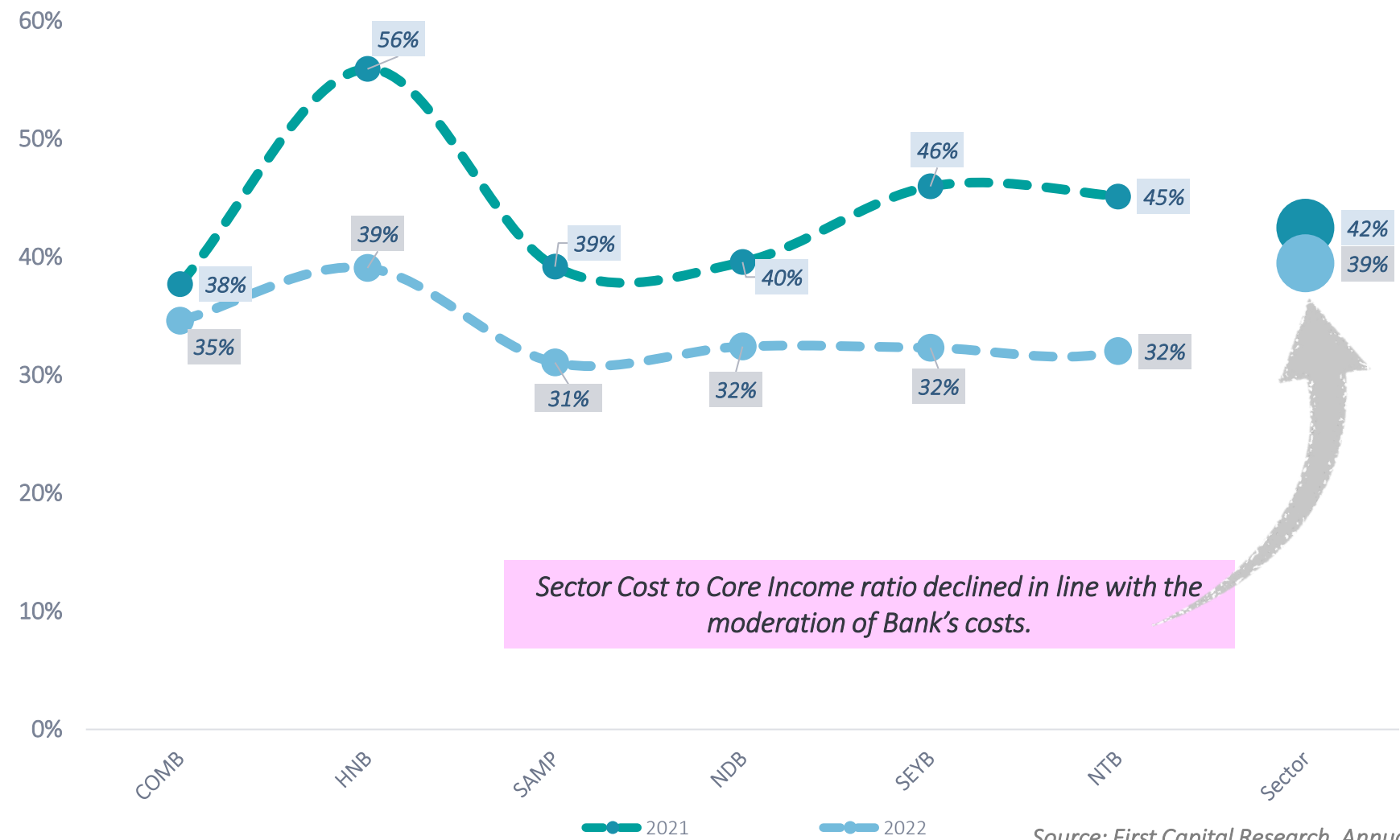
NTB - FriMi



Prominent international players like Alipay, PayPal, and Apple Pay have established their dominance in the global digital wallet sector. Nevertheless, local digital wallets such as **FriMi**, **SOLO**, **Flash** and **WePay** have risen to become market leaders in Sri Lanka.

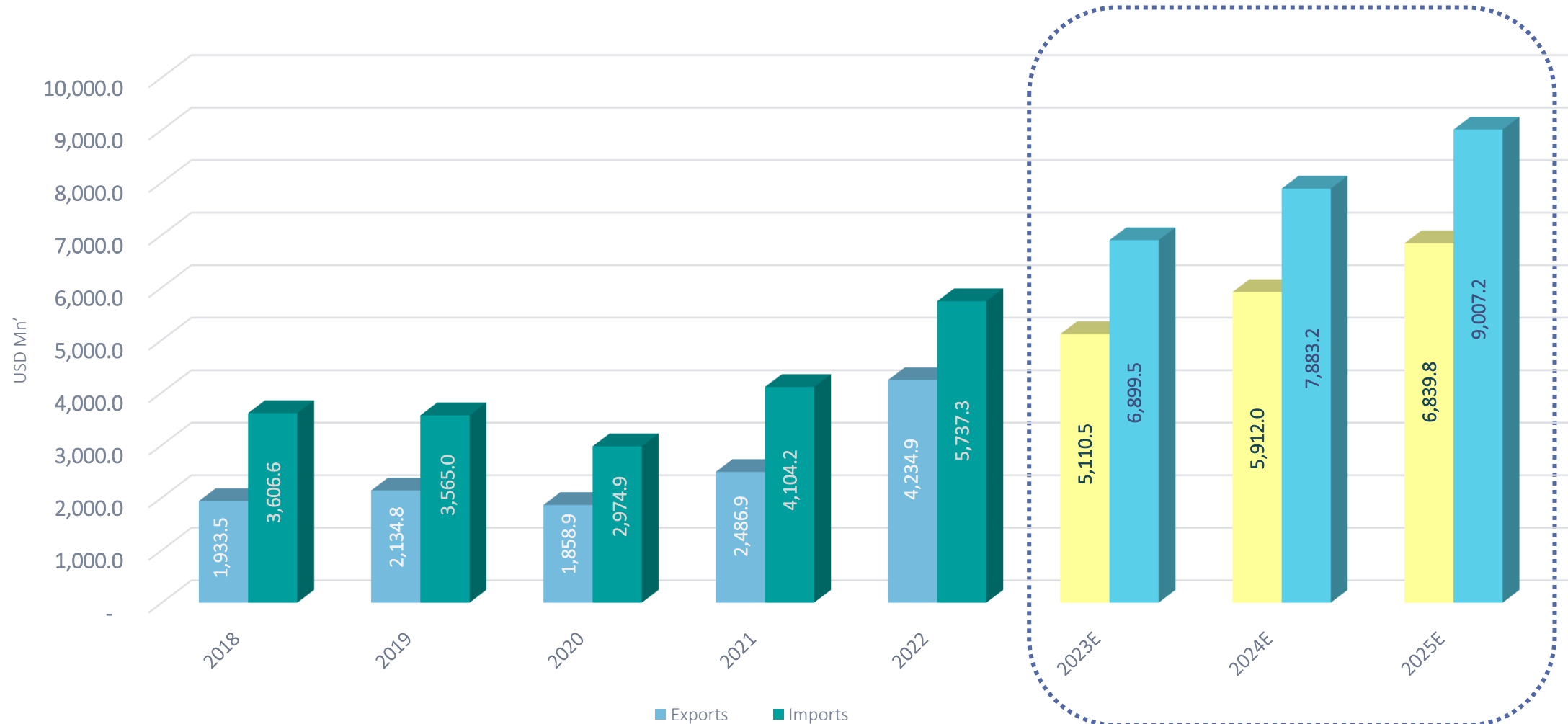
COVID-19 pandemic expedited the shift towards contactless transactions, solidifying digital wallets' relevance while high mobile phone penetration facilitated easy access to secure and convenient digital wallets via smartphones.

...aiding banks to overcome cost pressures while experiencing a reasonable dip in Cost to Income margins

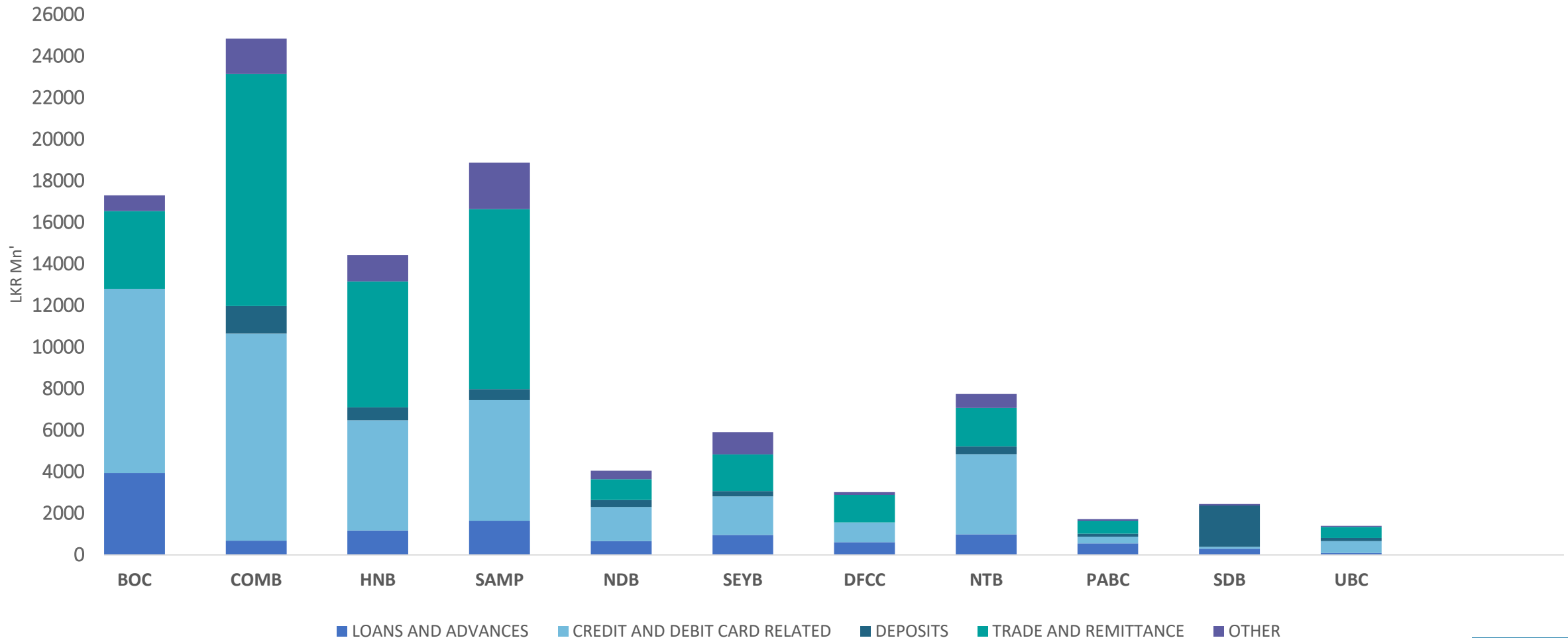


Source: First Capital Research, Annual reports

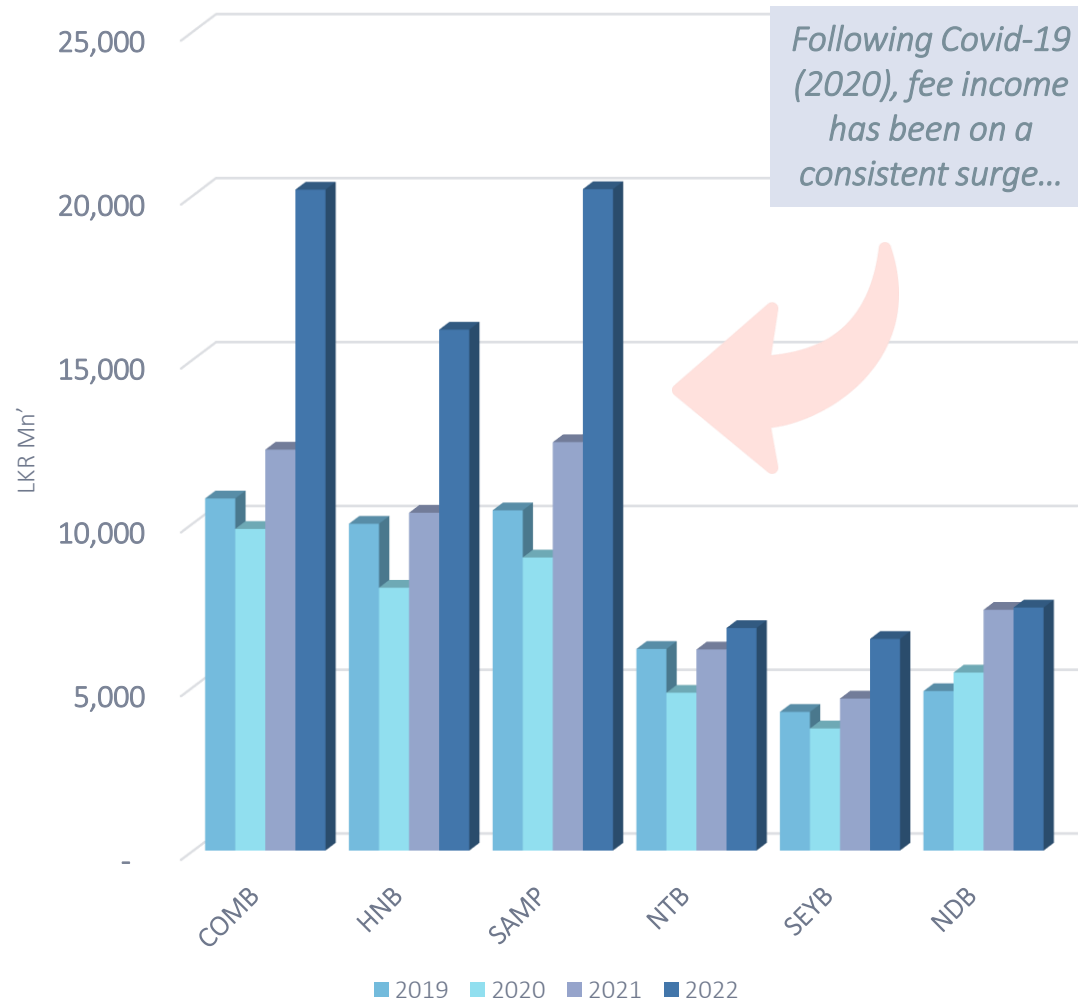
Meanwhile, resumption in business activities are expected as import bans ease while export volumes are anticipated to grow



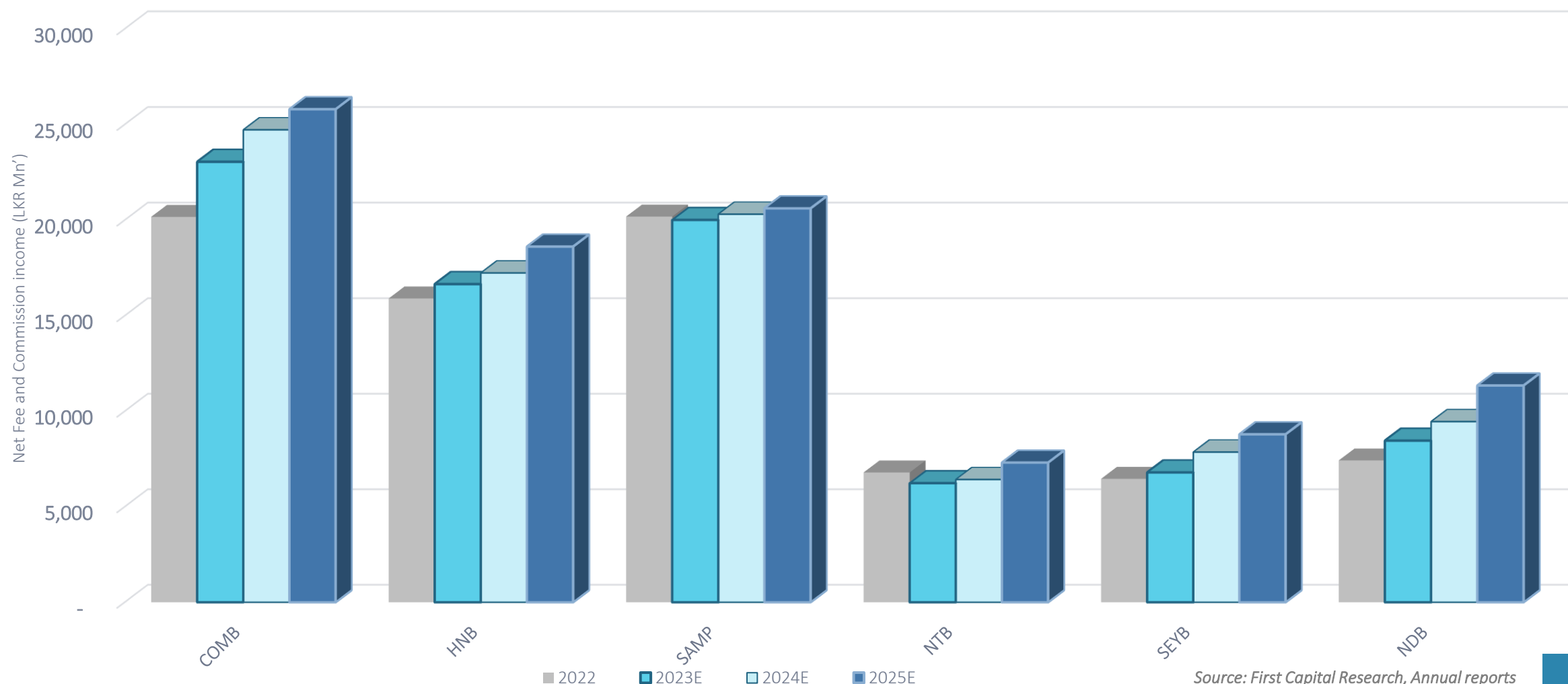
With trade activities (export/import) and card related payments accounting for a sizeable portion of overall Fee based income...



...Net Fee and Commission incomes of LCBs are expected to leap higher, supporting the earnings potential of banks



Accordingly, Net Fee & Commission income is expected to grow at an average CAGR of 6% from 2022-2025E across FCR Banking universe





2.0 Banking sector trading at a steep discount to book value

The successful completion of domestic debt optimization,...



Offers for 37% of the total outstanding principal amount of Eligible Bonds were accepted which amounts to LKR 3.2Tn out of LKR 8.7Tn worth of T-Bonds.



Valid Offers had been accepted for almost 84% of the total outstanding principal amount of Eligible Bonds as of the end of June 2023, among the Superannuation Funds.



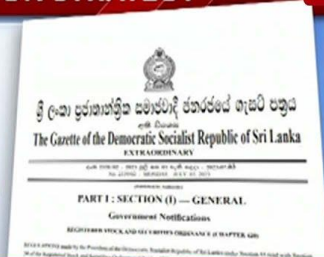
EPF participates in DDO after channeling alternative options of “debt Exchange” and “Non-Exchange” and opted to exchange where EPF has offered LKR 2,667.5Bn in face value of Treasury bonds for debt exchange, including an additional LKR 149.0Bn above the minimum participation requirement.



Sri Lanka Parliament Passes Resolution on Domestic Debt Optimization with Amendments

DOMESTIC DEBT OPTIMISATION STRATEGY

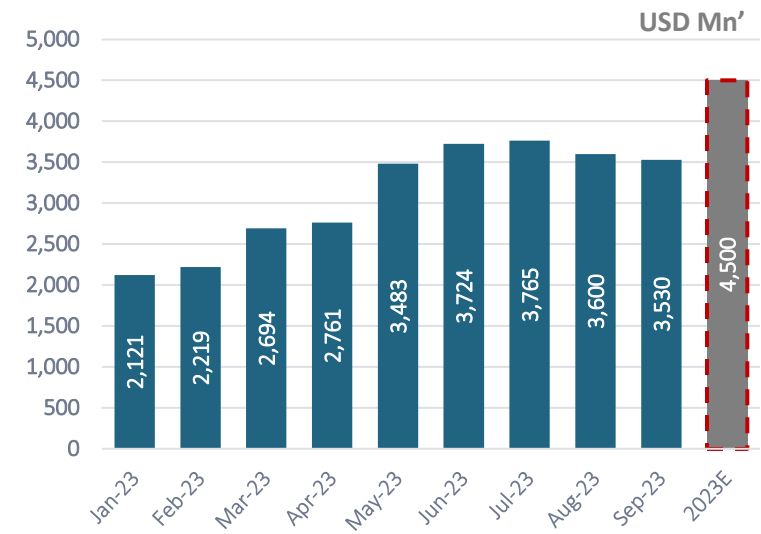
THE TREASURY SECRETARY AND
THE REGISTRAR OF PUBLIC DEBT
TO OFFER TO ANY HOLDER OF
ANY STOCK OR SECURITIES ISSUED
IN SRI LANKA, THE OPTION OF
CONVERTING OR EXCHANGING



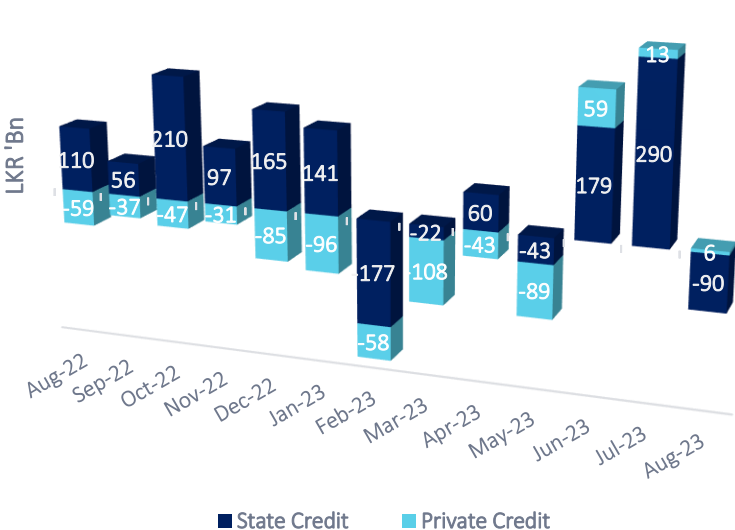
**Special gazette issued on domestic
debt optimization**

...improvement in major economic indicators...

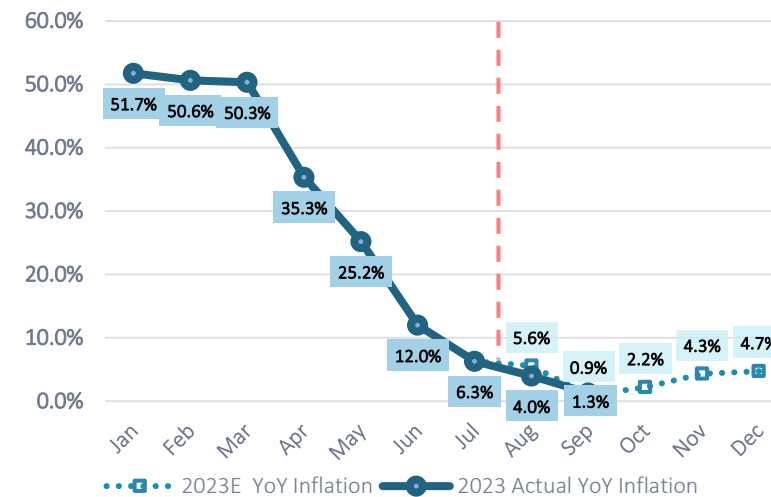
FCR targets reserves to reach USD 4.5Bn By 2023E



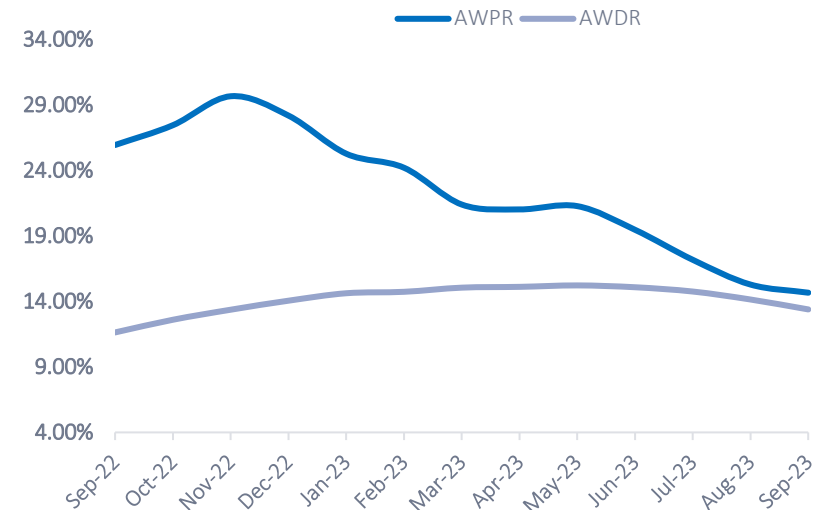
Private sector credit improves for the 1st time in 12 months in Jun-23



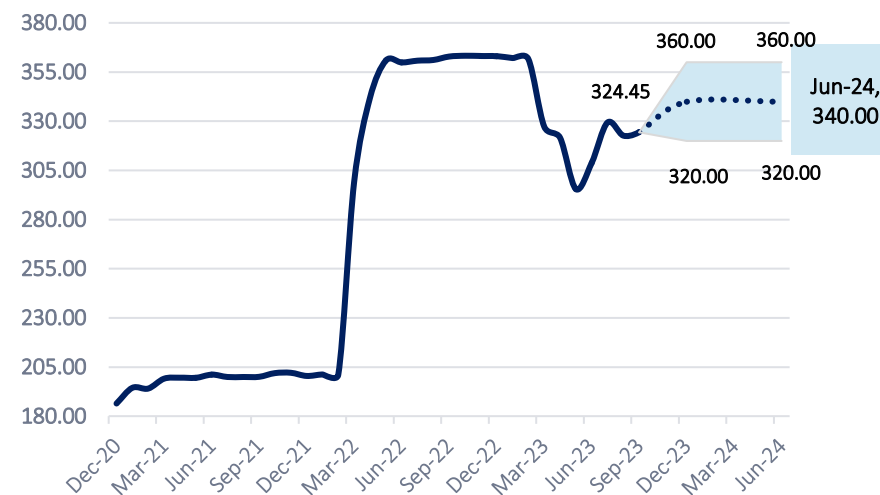
CCPI shows consistent deceleration and eases beyond projections



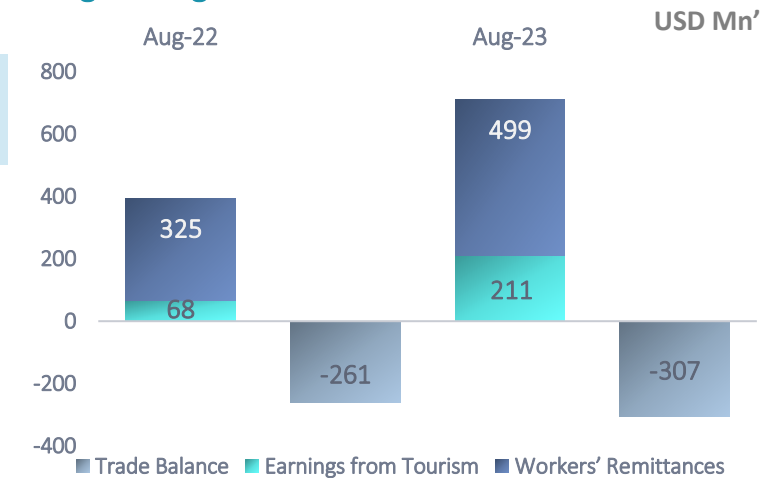
AWPR and AWDR shifts momentum in line with declining interest rates



USD/LKR remains volatile, hence FCR revises target for 2023



Remittance and tourism earnings scale high strengthening BoP



...and a possible foreign currency rating upgrade upon completion of external debt restructuring, may further boost prospects of the banking sector

**economynext**

ECONOMY

Sri Lanka local currency rating upgraded to CCC- by Fitch

Thursday September 28, 2023 7:54 pm

Having successfully completed domestic debt optimization, multiple credit agencies have already raised both Sri Lanka's and banks local currency ratings.

With the successful completion of the next step of debt restructuring, which is the external debt restructure, FCR believes that foreign currency rating upgrades are on the cards, which we believe that banking sector will benefit with access to cheaper funding lines from DFI and multilateral funds.



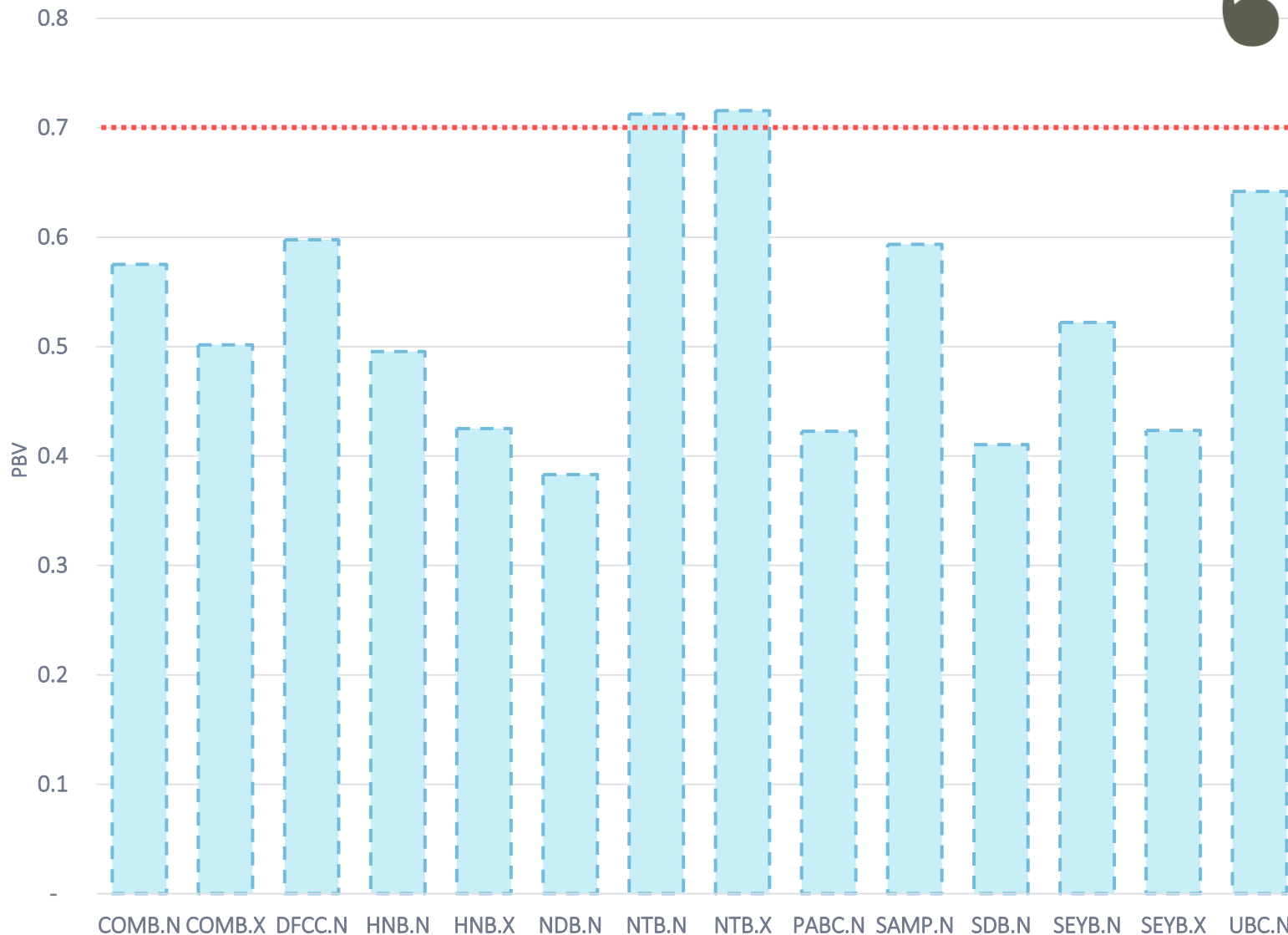
**economynext**

ECONOMY

Sri Lanka local currency rating upgraded to CCC+ by S&P

Tuesday September 26, 2023 7:11 am

Addition of multiple factors caused banks to trade at a steep discount...



Source: First Capital Research, CSE

“

Sri Lankan banking sector slumped to its lowest valuation during the past decade due to risk of restructuring government debt, including bank holdings of T-bills and T-bonds.

However, with government and CBSL successfully completing domestic debt restructuring, the risk of default on G-sec have considerably declined. Thus, we believe the current trading multiples of banks are not justified and expect the overall banking sector to re-rate and trade at its historical trading multiple of 1.0x book value.

”

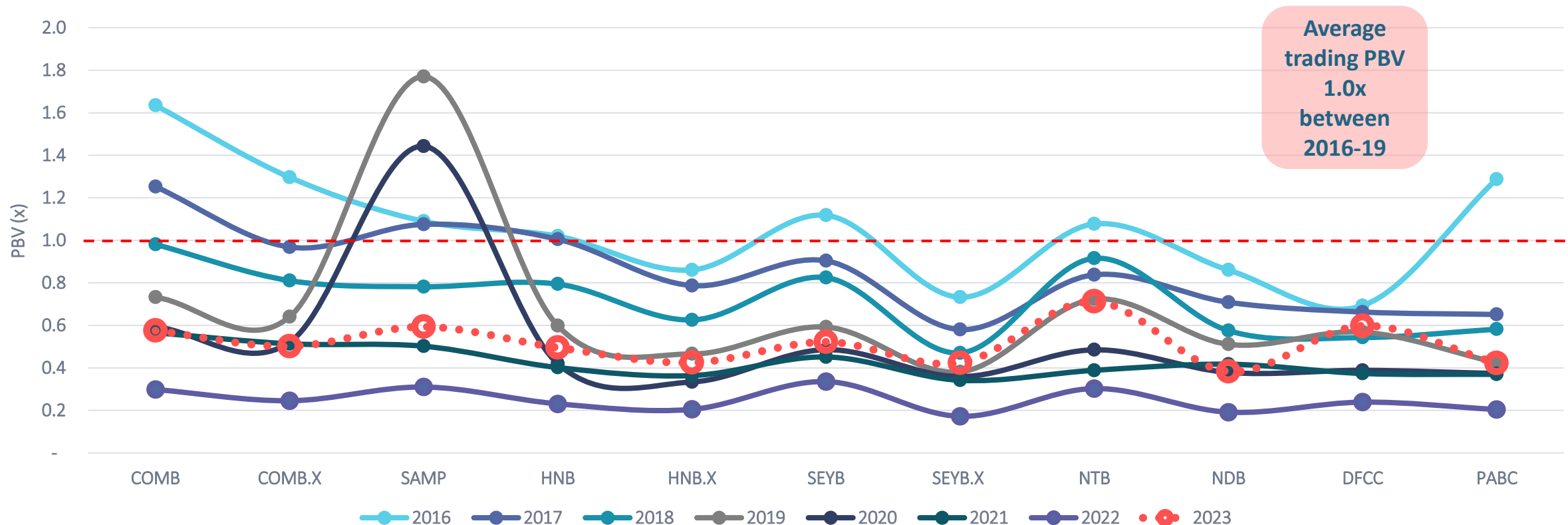
...pushing down banking sector trading multiples to a historic low

The Sri Lankan listed banking space have traded at an average of 1.0x book value between 2016-2019 period.

Having affected by multiple blows from the pandemic, Sri Lanka announcing default and rating downgrade from all three credit agencies, banking sector have plummeted and traded at a 60% discount between 2020-22 period.

With the expectation of economic recovery from 2H2023 whilst DDO concerns almost near completion, we believe the banking sector currently trading currently at 0.5x is unwarranted.

We expect the listed banking space to reiterate and trade up at its pre-pandemic 4-yr average of 1.0x.



Moreover, Sri Lanka also offers the cheapest valuations on banking sector compared to its regional peers



Vietnam



Market Cap – LKR 22.8Tn



PER (x) – 9.6x



PBV (x) – 1.2x



Bangladesh



Market Cap – LKR 1.9Tn



PER (x) – 8.0x



PBV (x) – 1.1x



Thailand



Market Cap – LKR 45.9Tn



PER (x) – 9.0x



PBV (x) – 0.9x



Pakistan



Market Cap – LKR 1.4Tn



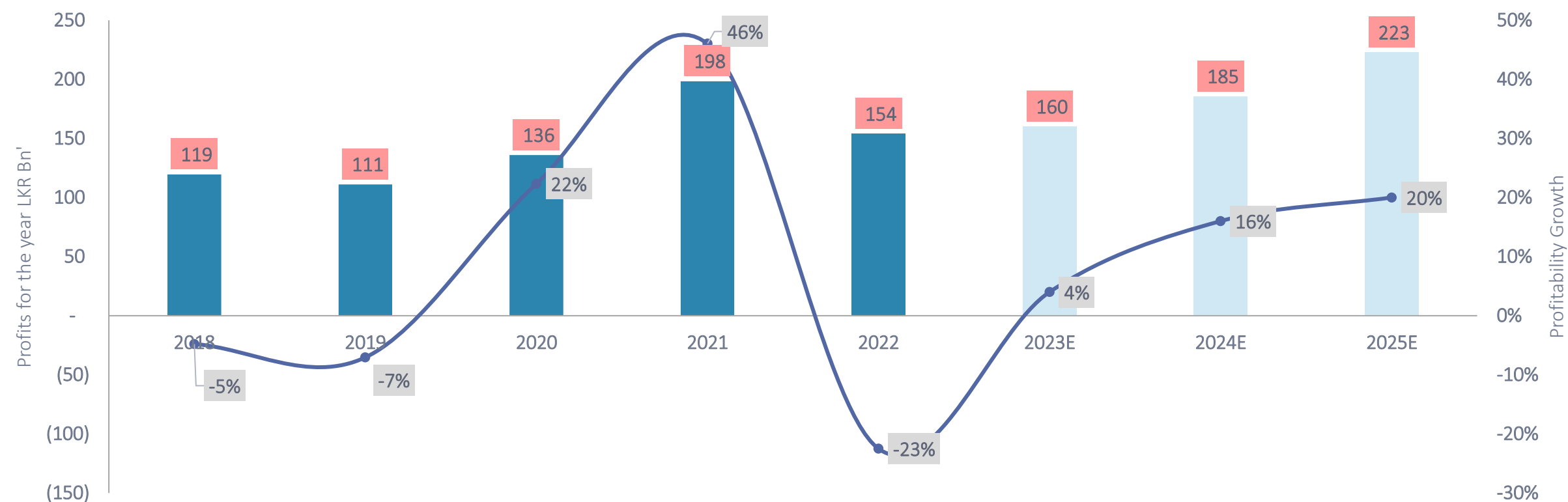
PER (x) – 7.1x



PBV (x) – 0.8x

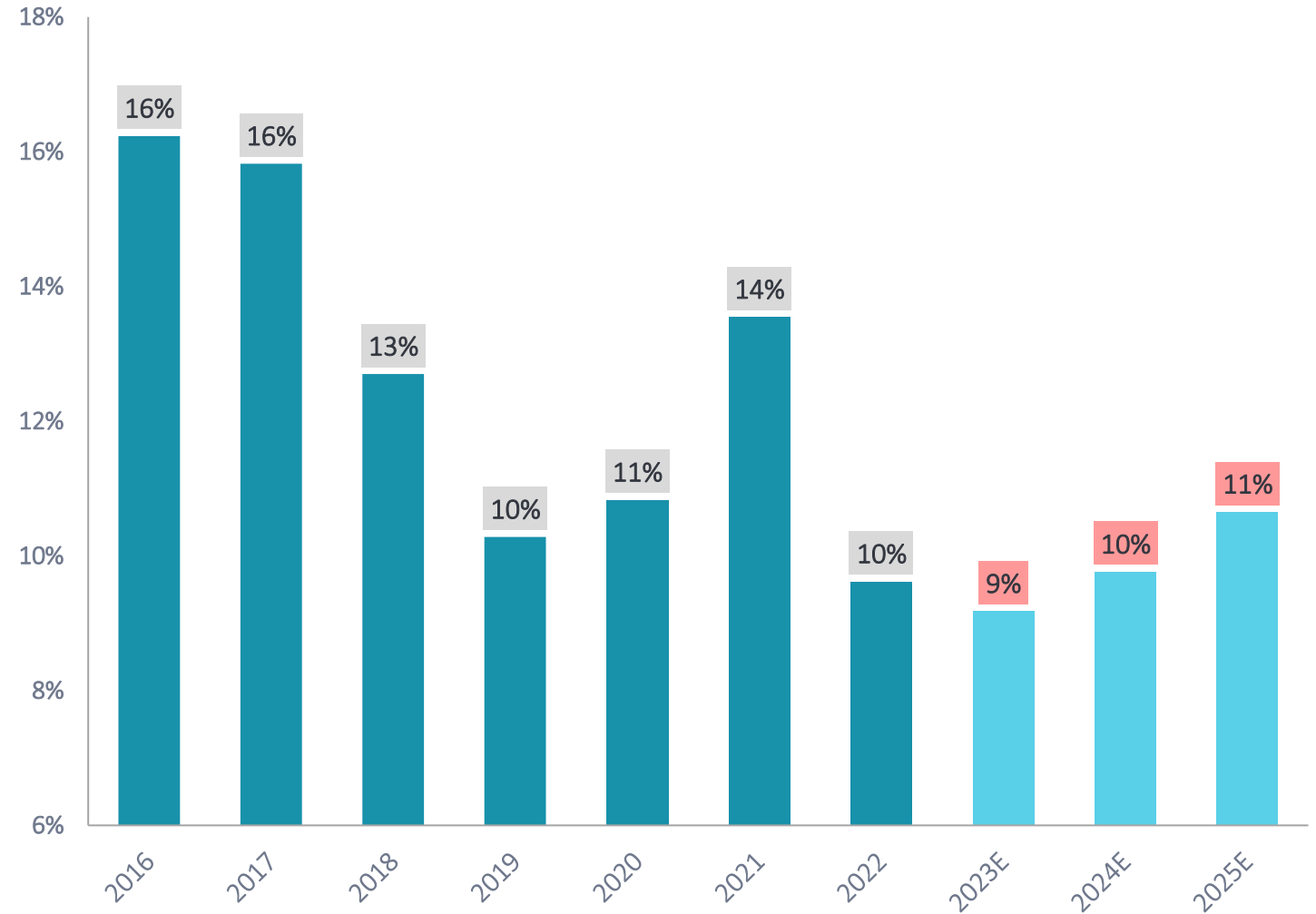
However, with expectations of a boost in profitability....

With the economy expected to rebound, we expect impairment provisioning to significantly slowdown while recovery in loan growth may support NII. Thereby, we expect banking sector earnings to recover during the 2H2023 erasing the declines in the 1H2023. Moreover, we expect earnings to grow by 16% to reach LKR 185.0Bn in 2024E and 20%YoY to LKR 223.0Bn in 2025E.



We expect ROE to improve and post double digit returns after 2024E...

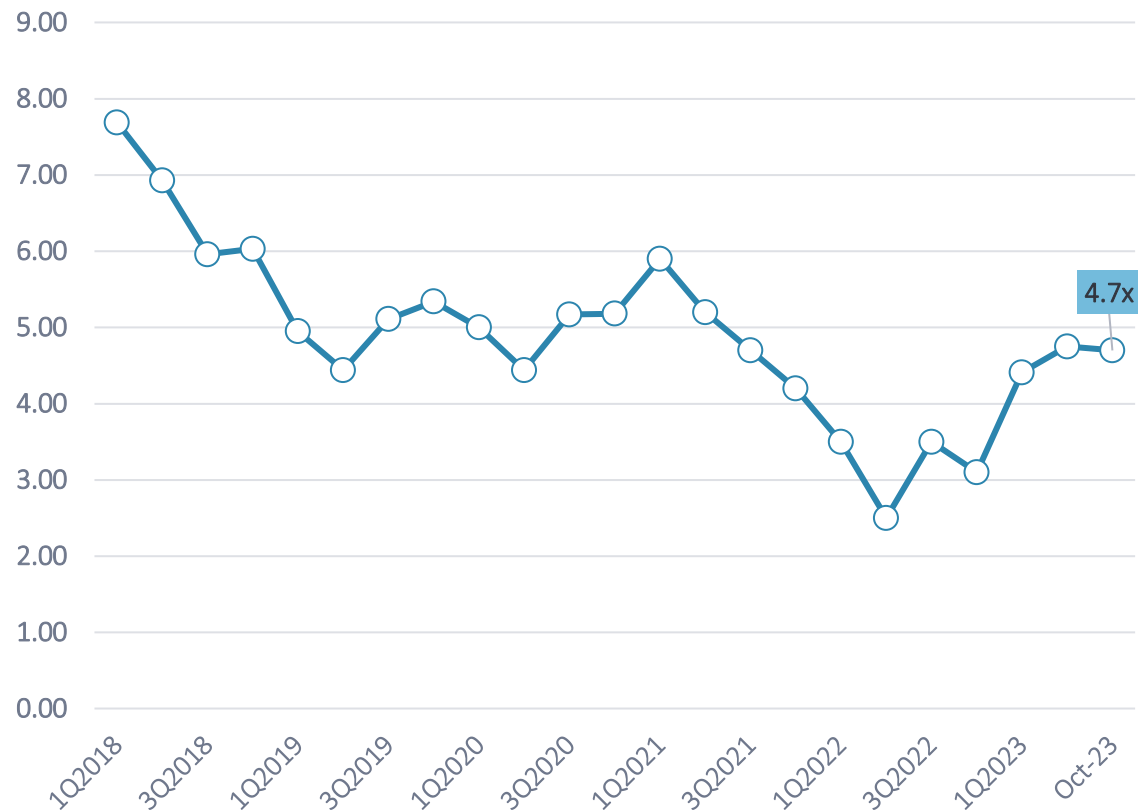
Poor returns in the banking sector post 2022, led returns on the banking sector to decline and fall below 10% levels, which we believe will **recover with the GDP** whilst **reduction in impairment provisions and growth in commission incomes** are expected to aid sector ROE to surpass 10% after 2024E.



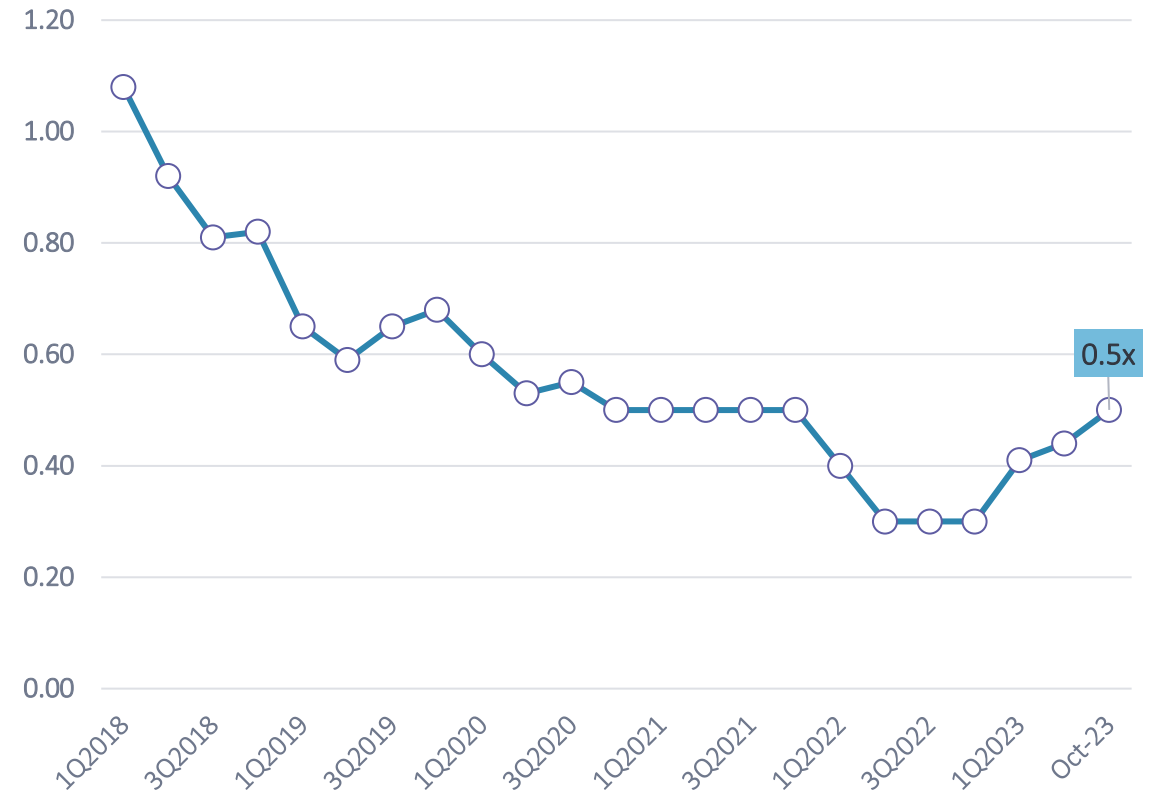
Source: First Capital Research, CBSL

...making the current multiples of banking sector amongst the cheapest in CSE

Banking Sector PER stands at a low level of 4.7x...



...while PBV stands at 0.5x with potential to re-rate


















Banking sector valuations snapshot

Stock	Stock Code	Market Cap (LKR Mn)	Price	Target price	Upside (%)	PER (x)		PBV (x)	
						2024E	2025E	2024E	2025E
<u>Voting shares</u>									
Commercial Bank PLC	COMB.N	101,024.0	81.70	170.00	108.1%	4.4	4.2	0.5	0.4
Hatton National Bank PLC	HNB.N	72,358.0	162.00	310.00	91.4%	4.0	3.7	0.4	0.4
Sampath Bank PLC	SAMP.N	70,948.0	60.50	120.00	98.3%	4.1	3.8	0.5	0.5
Seylan Bank PLC	SEYB.N	13,382.0	45.10	96.40	113.7%	3.7	3.6	0.4	0.3
Nations Trust Bank PLC	NTB.N	27,625.0	100.00	175.00	75.0%	2.8	2.6	0.5	0.4
NDB Banks PLC	NDB.N	24,567.0	61.50	145.00	135.8%	2.1	1.7	0.3	0.3
<u>Non-voting shares</u>									
Commercial Bank PLC	COMB.X	5,432.0	70.00	150.00	114.3%	3.8	3.6	0.4	0.4
Hatton National Bank PLC	HNB.X	15,210.0	134.50	240.00	78.4%	3.3	3.1	0.4	0.4
Seylan Bank PLC	SEYB.X	10,996.0	34.50	60.00	73.9%	2.8	2.8	0.3	0.3
Nations Trust Bank PLC	NTB.X	4,348.0	100.25	170.00	69.6%	2.8	2.6	0.5	0.4



BANKING SECTOR

Stock	Stock Code	18-Oct-23	PE	PBV	DY	52-Week High	52-Week Low
LKR							
 AMANA BANK	ABL.N0000	2.20	7.5	0.4	0.0%	3.30	2.20
 COMMERCIAL BANK OF CEYLON	COMB.N0000	80.50	4.6	0.5	5.6%	107.50	48.70
 COMMERCIAL BANK OF CEYLON	COMB.X0000	70.50	4.1	0.5	6.4%	89.00	39.60
 DFCC BANK	DFCC.N0000	78.00	5.5	0.5	0.0%	95.50	30.00
 HDFC BANK OF SRI LANKA	HDFC.N0000	33.70	27.3	0.3	0.0%	39.00	24.00
 HATTON NATIONAL BANK	HNB.N0000	161.75	4.7	0.5	4.0%	203.50	72.00
 HATTON NATIONAL BANK	HNB.X0000	132.00	3.9	0.4	4.9%	169.75	64.90
 NATIONAL DEVELOPMENT BANK	NDB.N0000	60.40	6.6	0.3	1.7%	85.00	31.30
 NATIONS TRUST BANK	NTB.N0000	100.25	3.0	0.7	0.0%	125.00	45.00
 NATIONS TRUST BANK	NTB.X0000	100.25	3.0	0.7	0.0%	121.50	44.60
 PAN ASIA BANKING CORPORATION	PABC.N0000	17.70	3.0	0.4	0.0%	23.50	8.60
 SAMPATH BANK	SAMP.N0000	60.30	4.9	0.5	7.0%	79.20	30.00
 SANASA DEVELOPMENT BANK	SDB.N0000	31.20	43.1	0.4	4.8%	38.90	20.00
 SEYLAN BANK	SEYB.N0000	43.80	4.8	0.5	0.0%	60.50	25.00
 SEYLAN BANK	SEYB.X0000	35.00	3.8	0.4	0.0%	48.20	15.20
 UNION BANK OF COLOMBO	UBC.N0000	10.00	18.6	0.6	0.0%	12.40	6.50

* Target price under review

N/A- Not under active coverage

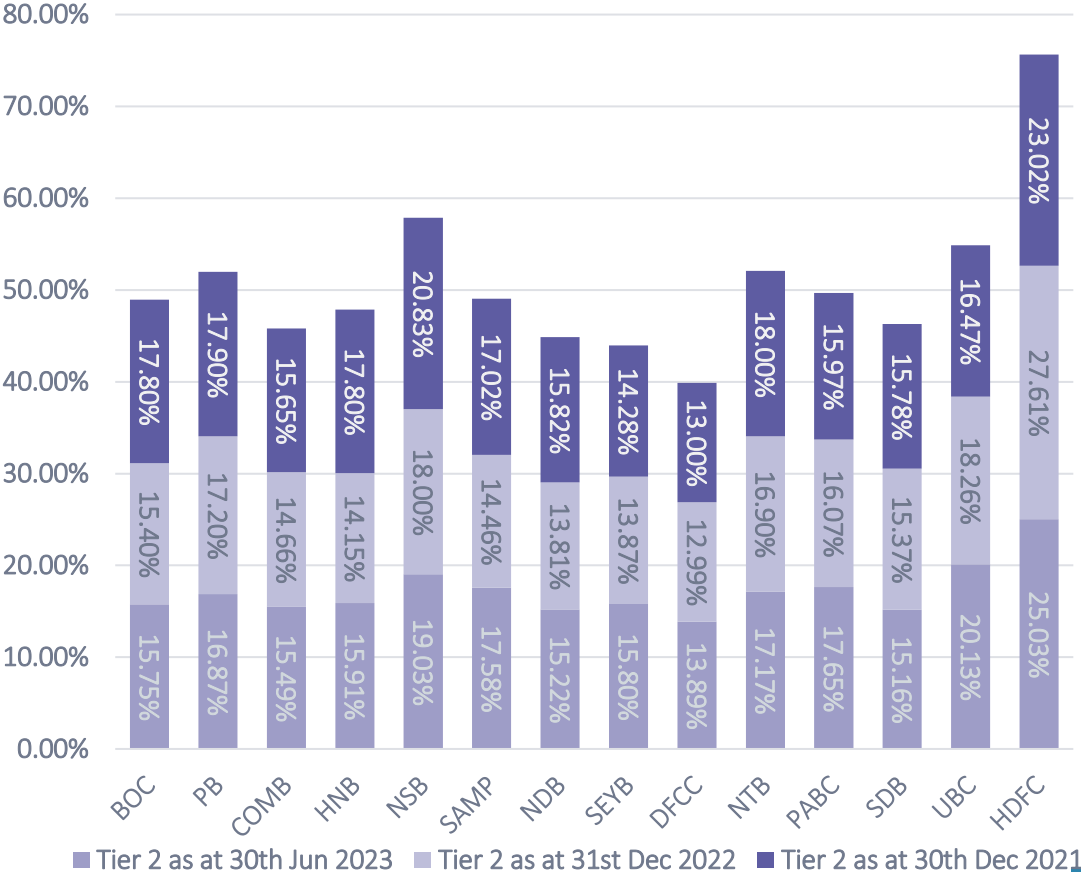
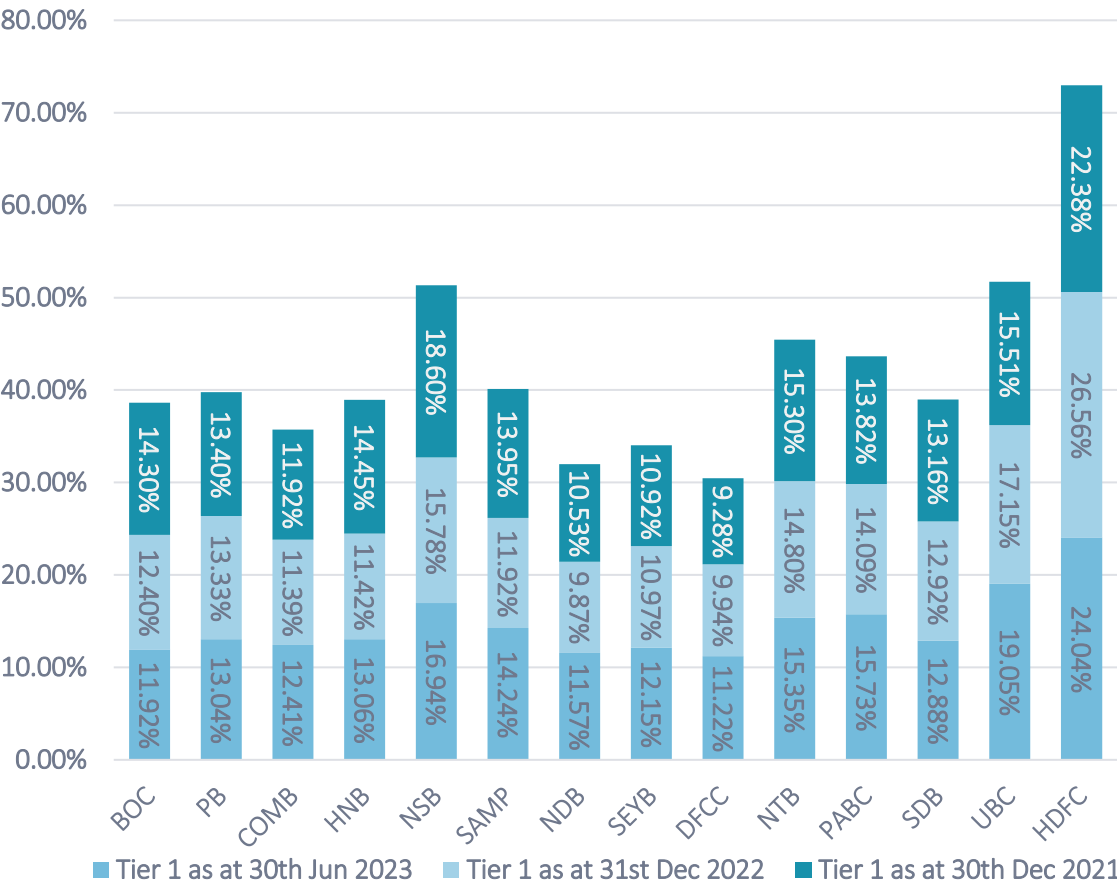


3.0 Key Risks for the next 12-months

Possibility of debentures in the horizon to recapitalize capital buffers

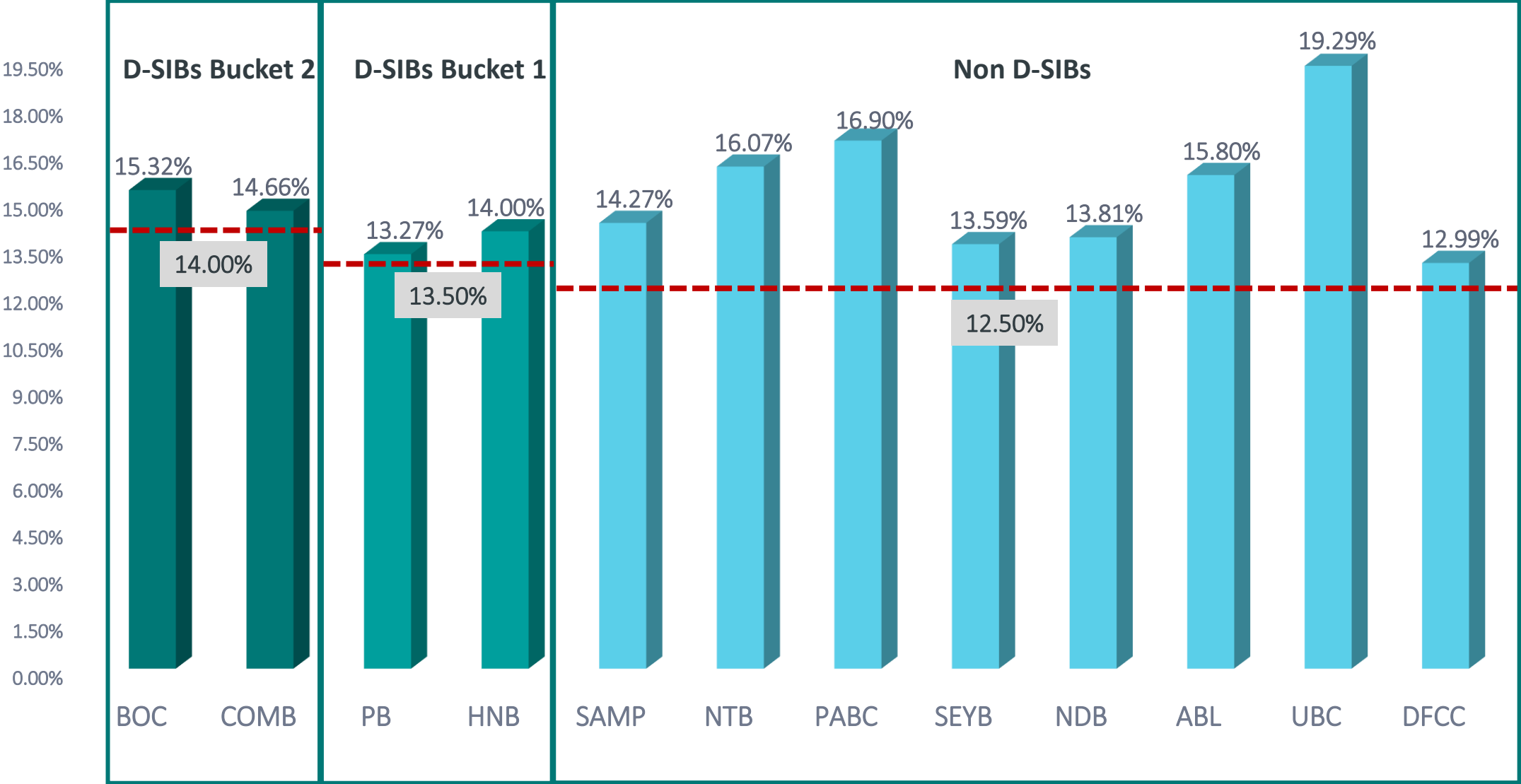
The banking sector was subjected to multiple shocks during 2022, which resulted in continuous shocks to capitalization buffers.

However, given the limited capitalization and liquidity available at the banking sectors, we believe banks may look to improve their liquidity and buff up their capital adequacy levels in the coming months. However, given the high interest rates prevailing in the country, banks may look to recapitalize using debenture issues rather than opt for right issues in the coming months.



Source: First Capital Research, Company Annual reports

While impairment provisions creates pressure on sourcing capital adequacy...



Source: CBSL, First Capital Research

...upcoming elections brings in uncertainty...

Historically, Sri Lankan politics and economy goes hand in hand, with monetary policy and economic policy decisions inconsistent with change of every political regime. From a very relaxed monetary policy stance to a highly tightened policy stance, Sri Lanka has seen everything during the past 2 years. Furthermore, with the expectations of Presidential elections in Mid-24, the risk arises if Sri Lanka will follow the same strategy to gain the favor of the common man.



Sri Lanka's United National Party Announces
Presidential Election by Mid-2024

...Yet IMF expected keep Sri Lanka on a tight leash

The past track record of Sri Lanka does not offer investors any guarantee that past will not repeat. However, having entered an Extended Fund Facility (EFF) with the IMF, the governing body is expected to keep a close eye on Sri Lanka with presidential elections on the horizon. This will be largely done through strict fiscal targets and reforms set by the IMF with future disbursements depending on the completion of targets set by the IMF.





4.0 Top picks on the banking sector

COMMERCIAL BANK OF CEYLON

COMB.N0000/COMB.X0000

Current Price: LKR 84.60/ LKR 74.00

Fair Value: LKR 170.00/ LKR 150.00 (2024E)

BUY

Largest private bank in Sri Lanka, Operating with an asset base of +LKR 2.4Bn and a loan book and deposit base surpassing LKR 1.0Bn, COMB stands tall as the only Sri Lankan bank to be ranked in the 'Top 1000 World Banks', for the 11th consecutive year. Furthermore, COMB also operates with the widest reach in the country (289 branches and 934 ATM) and is ranked as the 1st in the banking sector with a market capitalization of LKR 104.0Bn.

Earnings to bounce back to normalcy in 2024E. Despite the poor performance during the 1H2023 (net earnings down 10.9%YoY to LKR 8.0Bn), which was affected by record high impairment provisioning and overall slowdown in business volumes, coming months looks less gloomy for COMB as the expected pick up in economic activity from 3Q2023 is believed to offset the lingering challenges from impairments.

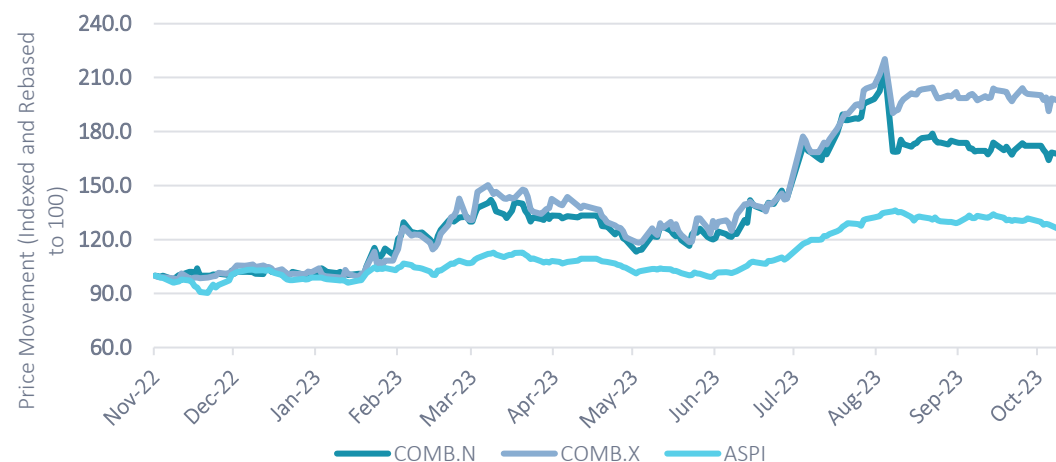
Digitalization to drive down COMB cost base. With LKR 2.0-3.0Bn spending targeted annually for digitalization led capital expenditure for front and mid end infrastructure development, we believe COMB is perfectly in place to take advantage as the industry leader to cater to the expected growth in digital transaction volumes as Sri Lanka gears up for the next phase of the digitalization. Hence, we expect COMB's fee & commission income to operating income ratio to improve from current 14.0-15.0% levels to 20.0%-21.0% levels between 2023E-2026E period.

CASA to improve whilst the pickup in economic activity to boost loan growth. Amidst declining interest rates, we expect COMB's CASA mix to somewhat normalize and hover between 40.0%-42.0% between 2023E-2026E whilst the loan growth is expected to be moderate at 5Yr FWD CAGR of 8.2%. Coming off from a degrowth of 10.1% during 1H2023, we expect the coming 12-months to be bright for COMB, with private sector credit growth already showing promising signs of recovery.

COMB remains well capitalized. COMB reported a tier 1 and a tier 2 capital adequacy ratio of 12.41% and 15.49%, respectively, which is well above the required rate of 8.50% and 14.00%. Furthermore, as a conservative operator, COMB has also announced a debenture issue for LKR 60.0Bn to further strengthen the tier 2 capital of the bank.

COMB trades well below the 2024E TP of 170.0/share. Impacted by multiple hits, the banking sector currently trades at 0.5x book value, which is at a 50.0% discount to the 5Yr average industry PBV of 1.0x and the regional peer average of 0.9x. With successful completion of debt restructuring around the corner together with the evident recovery in GDP, we expect COMB to trade at its 5Yr average PBV of 1.0x, offering a TP of LKR 170.0/share and an annualized return of 82.5%. Thus, we rate and initiate coverage on the COMB share with a **BUY**.

P/E 31st December	2020	2021	2022	2023E	2024E	2025E
Estimates (LKR 'Mn)						
Net Interest Income	48,640	66,416	84,665	71,157	78,354	84,331
Total Operating Income	74,500	93,598	136,637	102,197	113,319	121,203
Net Profit: Equity Holders	16,940	24,062	23,812	17,946	24,991	27,498
Adjusted EPS (LKR)	14.2	20.1	19.9	14.0	18.6	19.5
YoY Growth (%)	-2%	42%	-1%	-30%	33%	5%
Valuations						
PER (x)	6.4x	4.5x	4.5x	6.5x	4.9x	4.6x
PBV (x)	0.7x	0.6x	0.5x	0.5x	0.5x	0.5x
DY (%)	7.2%	8.3%	5.0%	5.5%	7.3%	7.6%
Adjusted NAVPS (LKR)	132.9	140.2	174.9	167.3	175.9	186.1
DPS (LKR)	6.5	7.5	4.5	4.9	6.6	6.9
Dividend Payout (%)	45.8%	37.2%	22.6%	35.4%	35.4%	35.4%



HATTON NATIONAL BANK PLC

HNB.N0000/HNB.X0000

Current Price: LKR 160.25/132.25

Fair Value: LKR 310.00/LKR 240.00 (2024E)

BUY

Leading the financial frontier with 2.6Mn+ customers: Hatton National Bank is one of the largest private sector commercial banks in Sri Lanka catering to over 2.6Mn customers across 255 branches. With a workforce of 5,156 and 314 ATMs, 312 CRMs, and 161 CDMs, HNB extends its services across 8 business segments of which 5 are part of the bank encompassing the retail banking, corporate banking, SME, micro and treasury segments.

Driving digitalization through Robotic Process Automation: In 2022, HNB's digital transaction volumes surged by 105%, onboarding more than 80% of customers. The bank invested LKR 682.0Mn towards CAPEX in 2022, and they are poised for further expansion with a CAPEX budget of around LKR 1.0Bn-2.0Bn for 2024E, which is expected to reduce their cost base and improve their bottom-line.

Downward interest rate cycle to fuel loan growth and narrow NIMs: HNB demonstrated a 10-year average loan growth of 13.1% marginally below the banking sector's average growth rate of 13.5%. In 1H2023, HNB's loan book contracted by 9.0% to LKR 934.7Bn primarily due to the appreciation of the LKR against the USD and exceptionally high interest rates. However, we anticipate HNB's loan book to expand by 7.8% in 2024E, below its historical average, as there is potential for interest rates to further decrease, considering the 10-year average of the AWPLR at 11.24%. Furthermore, as lending rates are gradually adjusting downwards and the spread is narrowing, we anticipate a contraction in NIMs, projecting it to reach 6.9% in 2023E (c.f. 7.8% in 2022). Additionally, the bank's CASA ratio is forecasted to reach 40% in 2024E, providing the bank with a stable source of funds to underpin future lending expansion.

Impairment reduction to boost the bottom-line: HNB has increased its provisions to 45% due to significant impairment provisioning for dollar-denominated assets linked to investments in ISBs. However, in 1H2023, HNB displayed a 27.7%YoY reduction in total impairment charges amidst industry-wide concerns about credit quality. As HNB expects the SME and micro segments to drive economic growth, there might be a slight element of risk, and the reversal in impairment is expected to be relatively moderate when compared to other banks. Looking ahead, impairments will be influenced by loan loss provisioning considering the prevailing economic conditions including tax increases that might impact consumer purchasing power.

Expanding revenue stream through fee-based income: In 2022, HNB's net fee and commission demonstrated a 10Yr CAGR growth of 15.5% and experienced a 54.1% growth in 2022, surpassing the industry's average growth rate of 38.6%. Looking ahead, the easing of import restrictions, expansion of economic activities and increase in consumer purchasing power is poised to stimulate activities in cards, remittances, trade and digital platforms, which can potentially increase HNB's fee-based income.

FV for 2024E derives at LKR 310.0: Based on HNB's strong loan book, positive sector outlook and the possibility of a potential re-rating, we anticipate HNB to trade at a 0.8x PBV, translating to a fair value of LKR 310.0 for 2024E, which represents a 93% upside from the current market price of LKR 160.3. **BUY**

P/E 31st December	2020	2021	2022	2023E	2024E	2025E
Estimates (LKR 'Mn)						
Net Interest Income	50,837	56,462	111,567	110,976	117,982	124,162
Total Operating Income	72,074	84,404	160,875	142,341	156,716	164,806
Net Profit: Equity Holders	13,095	19,025	15,329	19,520	22,940	24,286
Adjusted EPS (LKR)	23.4	34.0	27.4	34.9	41.0	43.4
YoY Growth (%)	-11%	45%	-19%	27%	18%	6%
Valuations						
PER (x)	6.8x	4.7x	5.9x	4.6x	3.9x	3.7x
PBV (x)	0.5x	0.5x	0.5x	0.5x	0.4x	0.4x
Dividend Yield (%)	5.0%	5.6%	3.0%	2.6%	3.7%	5.1%
Adjusted NAVPS (LKR)	293.3	335.9	342.2	347.0	360.9	374.8
DPS (LKR)	8.0	9.0	4.8	4.1	5.9	8.2
Dividend Payout (%)	34.2%	26.5%	17.5%	11.8%	14.5%	18.9%



SAMPATH BANK PLC

SAMP.N0000

Current Price: LKR 65.20

Fair Value: LKR 120.00 (2024E)

BUY

Digital pioneer serving 3.4Mn+ customer base: SAMP stands as the third-largest private bank in Sri Lanka with an extensive network of 229 branches throughout the country. Notably, it boasts the largest agent banking network in the nation and takes pride in its industry-leading digital presence. With total assets worth LKR 1.4Tn, SAMP contributed approximately 8.1% to the Banking Sector's loans and advances in 2022.

Persistent loan book growth to aid by further decline in interest rates: SAMP consistently outperformed with a 10-year average loan growth of 14%, exceeding the sector's 13.5% average. In 1H2023, total loans decreased by 3.5% to LKR 810.8Bn due to LKR's appreciation against the USD. However, LKR-denominated loans increased by LKR 4.6Bn amidst the YTD drop in AWPLR by 872bps to 19.47%. Hence, we expect SAMP's loan book to grow at 10%, below its historical average, as interest rates still have room to ease (AWPLR 10-year average: 11.24%). With 40% of SAMP's loans tied to Trade, Manufacturing, and Tourism sectors in 2022 (compared to 37% in 2021), gradual growth is likely in line with these sectors' recovery.

Impairment reduction paves the way for profitability growth: In 1H2023, SAMP saw a significant 74.8%YoY decrease in total impairment charges due to proactive provisioning made in 1H2022 amid external uncertainties. Going forward, we expect SAMP impairment provisions to reduce, largely on the back of the pickup in tourism sector (SAMP has the highest exposure to tourism), which is expected to enable timely repayments and thus resulting in a possible reduction in impairment provisions in the coming years.

Easing of economic activities expands non fund based income: In 2022, net fee and commission showed a remarkable 10Yr CAGR growth of 24.8%, surging by 61.9% in 2022 alone, far exceeding the industry's 38.6% average growth. Going forward, the relaxation of import bans is expected to boost trade and credit card businesses, potentially increasing non-fund-based income. With over 90% of transactions being digital, electronic channels are likely to boost the bank's income further. Meanwhile, SAMP's CASA ratio for 1H2023 stands at 31.3%, providing a cost-effective source of funds compared to peers.

FV for 2024E derives at LKR 120.0: Anticipating a positive sector outlook and a potential re-rating, we expect SAMP to trade at a 1.0x PBV, resulting in a fair value of LKR 120.0 for 2024E, which represents a substantial 84.1% upside from the current market price of LKR 65.20. Notably, the share currently trades well below its book value of LKR 120.3 with a PBV of 0.5x. **BUY**

P/E 31 December	2020	2021	2022	2023E	2024E	2025E
Estimates (LKR 'Mn)						
Net Interest Income	36,827	45,518	76,042	67,846	68,061	78,059
Total Operating Income	50,066	64,399	114,768	92,606	92,623	103,221
Net Profit	8,443	13,856	14,061	15,521	17,046	18,314
Adjusted EPS (LKR)	7.4	12.1	12.3	13.6	14.9	16.0
YoY Growth (%)	-28%	64%	1%	10%	10%	7%
Valuations						
PER (x)	8.8x	5.4x	5.3x	4.8x	4.4x	4.1x
PBV (x)	0.7x	0.6x	0.6x	0.5x	0.5x	0.5x
DY (%)	4.2%	6.5%	7.1%	7.7%	8.5%	9.1%
NAVPS	100.0	111.1	118.4	122.1	127.4	133.3
DPS (LKR)	2.7	4.2	4.6	5.0	5.5	5.9
Dividend Payout	37.3%	35.1%	37.4%	37.0%	37.0%	37.0%



SEYLAN BANK PLC

SEYB.N0000/SEYB.X0000

Current Price: LKR 45.60/ LKR 35.60

Fair Value: LKR 96.40/ LKR 60.00 (2024E)

BUY

SEYB, 5th largest private bank in Sri Lanka. Incorporated in 1987, Seylan Bank PLC is listed commercial bank in the Colombo bourse with a market capitalization of +LKR 13.5Bn. SEYB is also the 5th largest private bank in Sri Lanka with a total asset base of LKR 672.8Bn. Furthermore, SEYB also has a wide network spread throughout the island with 171 branches and 215 ATMs.

Net earnings up 71.8%YoY to LKR 2.5Bn in 1H2023. SEYB reported profit growth during 1H2023 came from across the board with net operating income reporting a growth of 44.8%YoY to LKR 15.2Bn. Expansion in net interest income by 21.2%YoY to LKR 20.7Bn amidst a high interest environment, net fee and commission income by 26.8%YoY to LKR 3.5Bn and reduction in impairment provisions by 15.9%YoY to LKR 9.6Bn collectively resulted towards the higher profitability during 1H2023.

New account opening via digital platforms to touch 100.0%. SEYB reported that digital penetration at the bank is currently at 20.0% and as an initiative to drive up digitalization the bank have pledged 1/4th of its CAPEX on digitalization initiatives, whilst targeting new account opening via digital platforms to increase to 100.0% from current 70.0%. As a result of the increased penetration in new account opening, SEYB is adapting a similar approach to the other shares for expansion with 2 new branches planned for 2024E, on a hybrid model with limited employment at branches.

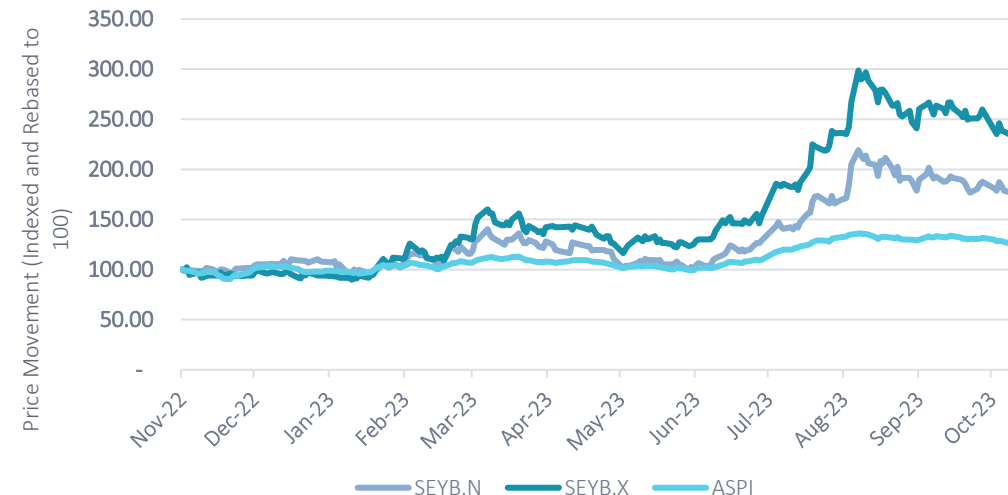
SEYB loan book to grow at a CAGR of 8.7% between 2022-2026E. As a mid tier bank mainly targeting the mid-size corporates and SME, we believe SEYB loan book may grow at a relatively lower rate than the last 10Yr banking sector loan book CAGR of 13.5%. The below average growth targeting for the bank is largely on the expectation of a slower recovery in the SME sector, which's recovery is expected to take place during 1H2024E. However, recovering from a poor CASA base of 23.8% in 2022, we expect the CASA to recover and hover between 32.0%-34.0% between 2023E-2026E, boosting the NIMs in the coming years.

Impairment charges reversals to boost profitability. SEYB has already shown promising recovery in impairments (-15.9%YoY in 1H2023) after customers opted to refinance and settle existing loans taking advantage of the declining interest rates. Going forward, we expect more reversals to come from customer impairments as NPL ratio declines to 2.0% in 2024E from 4.32% recorded in 2022. Meanwhile, with GoSL successfully completing the DDR and with SLDB not subjected to a haircut, SEYB management have indicated that the bank will move its existing provisioning to support ISB provisioning, which will increase up to 45%-50% of the ISB exposure. However, in an event a lower-than-expected loss is incurred on ISB, we may see a reversal in existing provisions made for ISBs translating positively to the books of SEYB.

SEYB remains well capitalized. SEYB reported a tier 1 and a tier 2 capital adequacy ratio of 12.15% and 15.80%, respectively, which is well above the required rate of 8.50% and 12.50%. Furthermore, as a conservative operator, SEYB has also successfully completed a debenture issue for LKR 7.0Bn to further strengthen the tier 2 capital of the bank.

SEYB trades well below the 2024E TP of 96.40/share. Impacted by multiple hits, the banking sector currently trades 0.5x book value, which at a 50.0% discount to the 10Yr average industry PBV of 1.0x and the regional peer average of 0.9x. With gloomy outlook subsiding, we expect SEYB share to reiterate up and trade at 0.8x book value, offering a TP of LKR 96.40/share for 2024E and an annualized return of 91.2%. Thus, we rate and initiate our coverage on SEYB share with a **BUY**.

Y/E 31 December	2020	2021	2022	2023E	2024E	2025E
Estimates (LKR 'Mn)						
Net Interest Income	19,811	23,904	40,887	43,178	33,194	35,957
Total Operating Income	25,723	31,729	51,381	51,129	43,129	46,801
Net Profit	3,039	4,653	4,574	6,665	7,082	7,204
Adjusted EPS (LKR)	5.3	8.1	7.9	11.5	12.3	12.5
YoY Growth (%)	-19%	53%	-2%	46%	6%	2%
Valuations						
PER (x)	8.7x	5.7x	5.8x	4.0x	3.7x	3.7x
PBV (x)	0.6x	0.5x	0.5x	0.4x	0.4x	0.3x
DY (%)	3.3%	6.6%	4.4%	6.6%	6.6%	6.6%
NAVPS	82.7	93.4	97.3	109.2	118.5	130.9



NATIONS TRUST BANK PLC

NTB.N0000/NTB.X0000

Current Price: LKR 103.0/101.0

Fair Value: LKR 175.0/170.0 (2024E)

BUY

Tailored for niche banking needs - Nations Trust Bank is a prominent and innovative player in Sri Lanka's competitive banking sector. With a strong emphasis on customer service, innovation, and convenience, NTB has grown its network to include 96 branches, 83 ATMs, and 85 CRMs, serving its clients with a workforce of 2,479 employees.

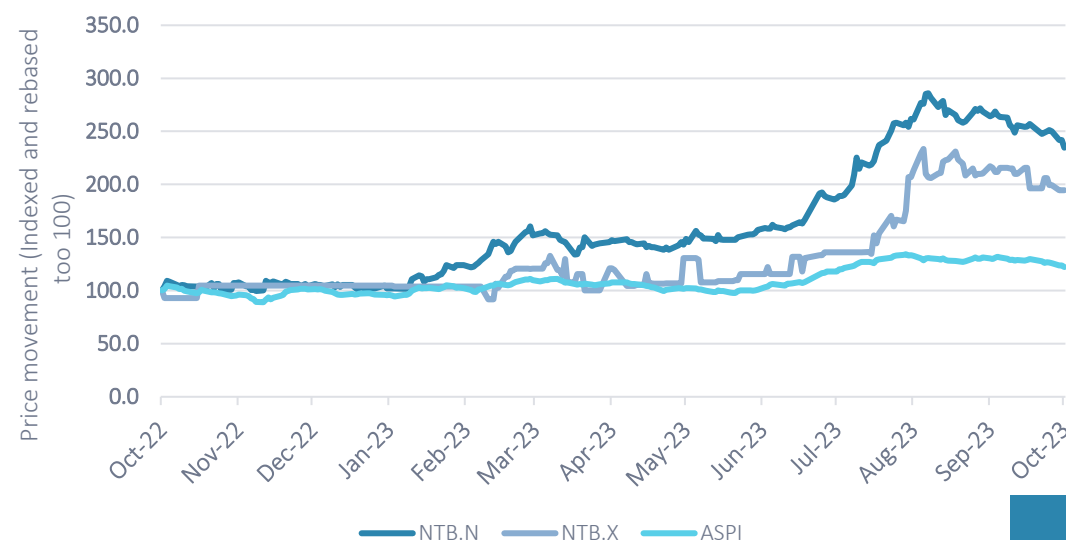
Slow and steady pickup in loan book - NTB loan book slightly shrunk during 2022 by 2.5%YoY amidst limited demand for credit. However, in the 2Q2023 loans & advances poised a narrow uptick of 2.6%QoQ on the back of plunging AWPLR. Considering NTBs cautious approach in the area of lending, we expect NTB to record a marginal growth of 3% in the 2023E period and scale higher to its 10yr average loan growth of 14% in 2024E with lending mostly centered on middle market players and Export based businesses. In line with the improving credit demand, credit card business of NTB too is seeing pre-pandemic levels of transactions while inflation and pent-up demand too has contributed to the same.

Impairments to come off; strengthening bottomline - Impairment charges of NTB saw a notable decline in 2Q2023 by 80.8%YoY (-59.4%QoQ) reflecting the positive impact of the banking sector exclusion from the DDO. NTB also has the lowest NPL ratio registered at 3.4% in 2Q2023; lowest in the industry while it accounts for an impairment provisioning of 50.3%. Conclusion of moratoriums to the tourism industry and bank's limited exposure to risky business segments (Construction) shall further reduce pressure on impairments. Hence, we expect impairment charges to decline going forward given the cautious provisioning and the bank's ability to maintain a low NPL.

Fee income to upturn positively in the period ahead - Fee based income during 2022 showed a growth of 10.7%YoY despite low levels of imports as NTB was positioned with a healthy dollar liquidity level. We expect fee-based income to further improve in the period ahead predominantly from trade finance activities with NTB's increasing penetration in the export segment while import ban relaxations too shall contribute to the improvement. Moreover with 92% of transaction being digitalized and the continuous growth in digital transactions, fee-based income has high potential to further grow. Meanwhile, NTB has registered a CASA of 30% as at 2Q2023, aiding the bank to lower its cost of funds.

FV of LKR 175.0 for 2024E: Expecting a favorable outlook for the sector and the potential re-rating, we project that NTB will trade at 0.8x PBV for a fair value of LKR 175.0 in 2024E suggesting a significant upside of 70% from the current market price of LKR 103.0. **BUY**

P/E 31 December	2018	2019	2020	2021	2022	2023E	2024E	2025E
Estimates (LKR 'Mn)								
Net Interest Income	15,164	16,134	13,672	14,078	29,301	25,618	30,572	32,608
Total Operating Income	21,310	22,552	21,241	23,269	38,867	34,302	39,527	42,428
Net Profit	3,702	3,714	4,055	6,694	7,228	7,833	11,569	12,230
Adjusted EPS (LKR)	11.6	11.6	12.7	20.9	22.6	24.5	36.2	38.3
YoY Growth (%)	10%	0%	9%	65%	8%	8%	48%	6%
Valuations								
PER (x)	8.9x	8.9x	8.1x	4.9x	4.6x	4.2x	2.8x	2.7x
PBV (x)	1.2x	1.0x	0.9x	0.8x	0.7x	0.6x	0.5x	0.4x
DY (%)	1.7%	1.8%	2.0%	1.7%	3.0%	1.9%	2.8%	3.0%
NAVPS	84.7	98.3	109.9	125.7	144.1	173.7	207.1	242.3
DPS (LKR)	2.10	3.10	4.10	5.10	6.10	7.10	8.10	9.10
Payout ratio	18.1%	26.7%	32.3%	24.4%	27.0%	29.0%	22.4%	23.8%



NATIONAL DEVELOPMENT BANK PLC

NDB.N0000

Current Price: LKR 61.20

Fair Value: LKR 145.00 (2024E)

BUY

Leveraging investments in automation and process streamlining: National Development Bank is one of the growing private sector commercial banks serving the retail, SME, corporate and government sectors in Sri Lanka. NDB comprises a workforce of 2,929 employees, with 85 ATMs and 84 CRMs, and operates primarily in Sri Lanka with limited operations in Bangladesh and Mauritius.

LKR appreciation affects deposit growth: NDB demonstrated a 5Yr CAGR growth of 20% in customer deposits in 2022. However, in 1H2023, customer deposits reduced by 6.6% over 2022 primarily owing to appreciation of the LKR on foreign currency denominated deposit book.

Loan book expansion amidst additional rate cuts: NDB demonstrated a 10-year average loan growth of 17.0%, significantly above the banking sector's average growth rate of 13.5%. In 1H2023, NDB's loan book contracted by 19.4%YoY due to the appreciation of the LKR against the USD, exceptionally high interest rates and reduced lending to the private sector. Consequently, we anticipate NDB's loan book to expand by 11.8% in 2024E, below its historical average, as there is still potential for interest rates to further decrease, considering the 10-year average of the AWPLR at 11.24%. Furthermore, the downward re-pricing of the lending rates with the reducing market rates trend, is expected to contract NIMs, which is projected to reach 4.0% in 2023E (c.f. 4.9% in 2022).

Fee-based income to enhance the top-line: In 2022, NDB's net fee and commission demonstrated a 10Yr CAGR growth of 15.7% and experienced a 15.2%YoY increase in 1H2023, driven mainly by trade activities, digital transactions and card transactions amidst reduced business volumes in a negative GDP growth scenario. Looking ahead, the expansion of economic activities, increase in consumer purchasing power and the easing of import restrictions is poised to stimulate trade and credit card operations which can potentially increase NDB's fee-based income. With over 80% of transactions conducted digitally, electronic channels are also likely to further contribute significantly to NDB's topline.

NDB remains well capitalized: NDB reported a tier 1 and total capital adequacy ratio of 11.57% and 15.22%, respectively, which is well above the minimum levels of 8.50% and 12.50% in 1H2023. Furthermore, NDB has also announced plans to raise tier 2 capital via a debenture issue of up to LKR 10.0Bn within 30th Mar 2024, to further strengthen its capital position.

FV for 2024E derives at LKR 145.0: With the expected recovery in GDP and the possibility of a potential re-rating, we anticipate NDB to trade at a 0.8x PBV, translating to a fair value of LKR 145.0 for 2024E, which represents a substantial 137% upside from the current market price of LKR 61.2. **BUY**

P/E 31 December	2020	2021	2022	2023E	2024E	2025E
Estimates (LKR 'Mn)						
Net Interest Income	17,925	21,741	31,130	27,956	29,119	32,276
Total Operating Income	26,404	32,996	44,448	36,437	37,195	40,331
Net Profit	5,117	6,904	3,009	4,908	6,308	7,381
Adjusted EPS (LKR)	12.8	17.3	7.5	12.3	15.8	18.5
Net Profit YoY Growth (%)	7%	35%	-56%	63%	29%	17%
Valuations						
PER (x)	4.8x	3.5x	8.1x	5.0x	3.9x	3.3x
PBV (x)	0.5x	0.4x	0.4x	0.3x	0.3x	0.3x
DY (%)	2.5%	9.0%	0.0%	4.0%	5.2%	6.0%
NAVPS	120.1	157.0	169.0	181.6	193.4	207.5
Adjusted DPS	1.0	5.5	0.0	2.5	3.2	3.7
Dividend Payout	8%	32%	0%	20%	20%	20%



Glossary

AWPLR – Average Weighted Primary Lending Rate

CASA – Current Account Savings Account

CBSL – Central Bank of Sri Lanka

CCPI – Colombo Consumer Price Index

DDO – Domestic Debt Optimization

DFI – Development Finance Institutions

D-SIB – Domestic Systemically Important Banks

EFF – Extended Fund Facility

GDP – Gross Domestic Product

GoSL – Government of Sri Lanka

GS – Government Securities

IMF – International Monetary Fund

ISB – International Sovereign Bonds

LCB – Licensed Commercial Banks

PBV – Price to Book Value

SDFR – Standard Deposit Facility Rate

SLDB – Sri Lanka Development Bonds

SLFR – Standard Lending Facility Rate

SRR – Statutory Reserves Ratio

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Thank you!

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