



First Capital
A Janashakthi Group Company

EQUITY | SRI LANKA | BANKS

EARNINGS UPDATE | 05 JUN 2024

HATTON NATIONAL BANK PLC [HNB.N0000]

MAINTAIN BUY

“CUTTING IMPAIRMENTS, GROWING PROFITS”

Fair Value: 2024E - LKR 315.0 [+56%] 2025E – LKR 350.0 [+73%]
Total Return with DPS: 2024E - 59% [AER 126%] 2025E – 78% [AER 44%]

HNB witnessed a remarkable surge in its bottom line, soaring by 62.4%QoQ (+1.7%YoY), surpassing our estimate by 29.2% in 1Q2024. This was primarily attributed to a significant reduction in impairment charges, which plummeted by 81.2%QoQ (-86.0%YoY). Looking ahead, HNB is optimistic about further decreases in impairment levels throughout the year, which is projected to enhance the bottom line by 22.6%YoY, reaching LKR 27.9Bn in 2024E. Moreover, during the quarter, there was a modest 2.9%QoQ rise in net interest income (NII), mainly attributed to the lag effect in repricing deposit rates. However, despite these positive trends, HNB's NPL ratio slightly deteriorated, increasing to 4.0% in Mar-24 from 3.8% in Dec-23. The gross loan book also contracted by 2.4%QoQ, mainly due to the appreciation of the LKR and the settlement of facilities by borrowers. However, with expected decreases in lending rates, growth in private sector credit is anticipated, with a projected 10.0% loan growth for HNB this year. Consequently, based on HNB's strong loan book growth and a positive sector outlook, we anticipate HNB to trade at 0.9x its PBV during 2025E, amidst the current discounted trading multiples. We maintain the FV at LKR 350.0 for HNB.N and LKR 270.0 for HNB.X. **MAINTAIN BUY**

LKR (Mn)	1Q2024	1Q2023	YoY	2023	2022	YoY
Earnings (LKR 'Mn)						
NII	25,334	34,820	-27%	118,075	111,567	+6%
Total Operating Income	32,605	41,200	-21%	149,500	160,875	-7%
Net Operating Income	30,971	29,490	+5%	106,976	69,139	+55%
Pre Tax Profit	11,242	11,325	-1%	37,218	14,420	+158%
Net Profit : Equity Holders	7,209	7,088	+2%	22,771	15,329	+49%
Balance Sheet (LKR 'Mn)						
Loans	964,081	966,339	-0%	988,601	1,014,519	-3%
Shareholder's Equity	218,641	190,929	+15%	212,240	183,292	+16%
Adjusted NAVPS	382.4	333.9	+15%	371.2	320.5	+16%

Bottom-line soars 62.4%QoQ as impairment charge plummets by 81.2%QoQ

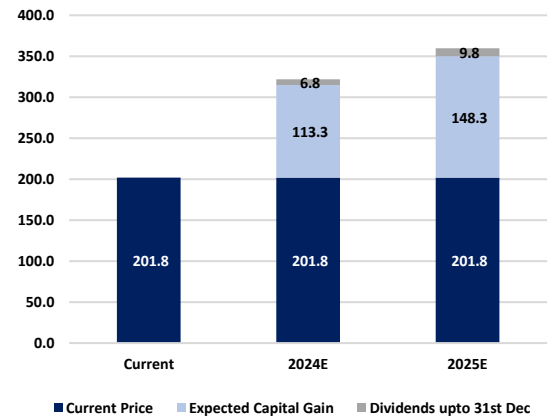
HNB's bottom line surged by 62.4%QoQ (+1.7%YoY) to LKR 7.2Bn in 1Q2024, 29.2% higher than our estimate for the quarter. This was primarily driven by a significant reduction in impairment charges, which fell by 81.2%QoQ (-86.0%YoY) to LKR 1.6Bn. This reduction can be attributed to the base effect from provisions made for ISBs in 1Q2023 and an improvement in economic conditions. However, HNB's NPL ratio slightly deteriorated to 4.0% in Mar-24 from 3.8% in Dec-23, accounting for a net stage 3 impairment provisioning of 55.5%. Looking ahead, HNB is optimistic about a further decrease in impairment levels throughout the year, expecting a significant reduction in impairments in 2024E, which is projected to boost the bottom line by 22.6%YoY to LKR 27.9Bn.

Interest, fee and commission income gently steers bottom-line growth

While impairment charges played a significant role in driving the bottom-line up for the quarter, NII marginally increased by 2.9%QoQ (-27.2%YoY) to LKR 25.3Bn in 1Q2024. This was primarily driven by a slower decline in interest expenses by 10.2%QoQ (-14.8%YoY), primarily attributed to the lag effect in repricing deposit rates. However, interest income declined by 5.5%QoQ (-20.2%YoY), driven by the AWPR decline of around 144bps and the contraction of NIM to 4.5% (4Q2023: 5.7%) during the quarter. HNB also provided substantial interest rebates to support vulnerable sectors, contributing to a decline in NII on a YoY basis. Looking ahead, with expectations for AWPR to average around 11.0%-13.0% by Dec-24, we anticipate HNB's net interest margin (NIM) to average around 4.8% in 2024E (compared to 7.0% in 2023), potentially resulting in an NII of LKR 91.2Bn. Net fee and commission income also experienced a marginal increase of 2.4%QoQ (-4.5%YoY) to LKR 4.3Bn during the quarter, driven by robust growth in retail and corporate digital channels, signaling a shift towards cashless transactions. With expectations for economic activities to expand, there's a positive outlook for trade and credit card operations, which could further enhance HNB's fee-based income by 11.6% in 2024E. Nevertheless, total operating income declined by 4.4%QoQ (-20.9%YoY) to LKR 32.6Bn primarily influenced by LKR appreciation and the reversion of trade tariffs to pre-crisis levels. Meanwhile, all categories under total operating expenses increased by 16.8%QoQ (+13.7%YoY) to LKR 17.3Bn, as inflation averaged around 4.4% in 1Q2024 compared to 3.0% in 4Q2023. This rise in operating expenses was notably driven by a surge in insurance claims and underwriting expenses, which rose by 62.5%QoQ (+7.4%YoY) to LKR 4.7Bn.

Loan book dips by 2.4%QoQ with LKR's ascent

Amidst an appreciation of the LKR and the post-season settlement of facilities by the borrowers, private sector credit contracted in Jan-24 and saw a slight increase in Feb-24. Against this backdrop, HNB's gross loan book contracted by 2.4%QoQ to LKR 1.1Tn in 1Q2024, primarily due to HNB holding approximately 13.8% of its loans in foreign currency. However, with the AWPLR currently being under 10.0%, further growth in private sector credit is anticipated and we project a 10.0% loan growth for HNB in 2024E, which is below its 10-year average of 11.6% but higher than the projected 7.5% average increase for private credit this year. HNB anticipates that loan growth will be driven by increased lending to the manufacturing, healthcare, education, and agricultural sectors in Sri Lanka. Meanwhile, HNB's total deposits in 1Q2024 declined by 1.3%QoQ to LKR 1.6Tn, marking the first decline in almost five years since 2019. Furthermore, HNB's CASA ratio increased to 30.4% in 1Q2024, up from 29.4% in 2023, and we expect it to improve to around 40.0% by the end of 2024E, fueled by the reduction of HNB's fixed deposit rates and the rollout of its payment and cash management solution.



FIRST CAPITAL RESEARCH

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Price performance of HNB vs ASPI (Indexed and rebased to 100)



Source: CSE

Minimum Return for BUY:

Buy Below 2024E [AER of 19.0% with DPS]: LKR 291.3
HNB.N categorized as 'Grade A' counter

Disclosure on Shareholding:

First Capital Group holds 1.1% of the outstanding voting share capital of HNB.



Capital adequacy holds strong above regulatory minimums

HNB experienced a significant rise in both its Tier 1 and Total Capital Adequacy Ratio, reaching 15.48% and 18.81%, respectively, surpassing the minimum thresholds of 9.50% and 13.50% as of Mar-24. Additionally, HNB has the option to decrease the capital conservation buffer by a maximum of 250bps, aligning with the concessions granted by the CBSL.

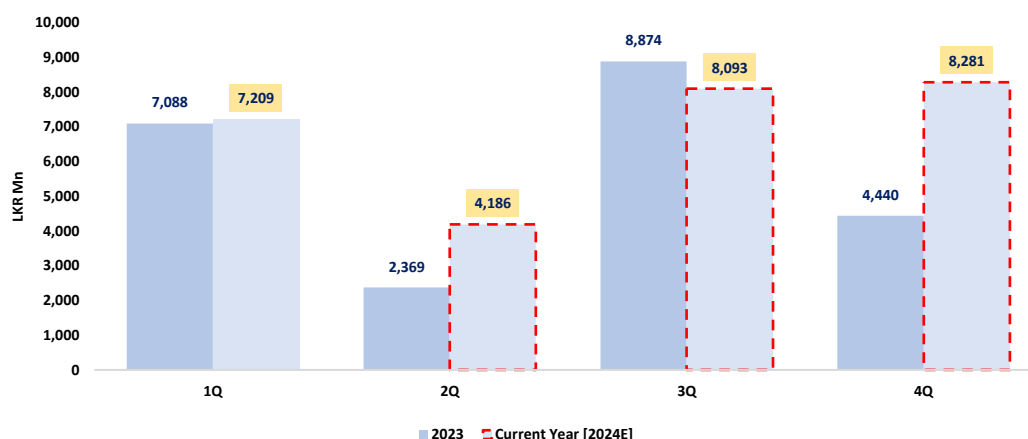
FV for FY25E is maintained at LKR 350.0 for HNB.N and LKR 270.0 for HNB.X – MAINTAIN BUY

With the anticipated conclusion of the external debt restructuring program, HNB’s strong loan book growth and a recovery in macro-economic indicators, we anticipate HNB to trade at 0.9x its PBV during 2025E, amidst the current discounted trading multiples, maintaining the FV at LKR 350.0 for HNB.N and LKR 270.0 for HNB.X.

MAINTAIN BUY



Quarterly Earnings



Estimate Revision

In LKR Mn	2024E-O	2024E-R	% Change	2025E-O	2025E-R	% Change
Earnings Estimate						
Net Interest Income	91,162	91,162	0%	100,361	100,361	0%
Total Operating Income	135,514	135,514	0%	147,203	147,203	0%
Net Operating Income	123,441	123,441	0%	131,980	131,980	0%
Pre Tax Profit	46,980	46,980	0%	51,164	51,164	0%
Net Profit : Equity Holders	27,906	27,906	0%	30,392	30,392	0%
Adjusted EPS	48.8	48.8	0%	53.1	53.1	0%
Net Profit Growth YoY	23%	23%		9%	9%	
Balance Sheet Estimate						
Loans & Advances	1,084,646	1,084,646	0%	1,212,139	1,212,139	0%
Shareholders' Equity	223,280	223,280	0%	233,277	233,277	0%
Adjusted NAVPS	390.5	390.5	0%	408.0	408.0	0%
Ratio Estimate						
ROE (%)	12.8%	12.8%		13.3%	13.3%	
PER (x)	4.1	4.1		3.8	3.8	
PBV (x)	0.5	0.5		0.5	0.5	

Valuation Table

P/E 31st December	2020	2021	2022	2023	2024E	2025E	2026E
Estimates (LKR 'Mn)							
Net Interest Income	50,837	56,462	111,567	118,075	91,162	100,361	111,538
Total Operating Income	72,074	84,404	160,875	149,500	135,514	147,203	160,841
Net Profit: Equity Holders	13,095	19,025	15,329	22,771	27,906	30,392	34,497
Adjusted EPS (LKR)	22.9	33.3	26.8	39.8	48.8	53.1	60.3
YoY Growth (%)	-11%	45%	-19%	49%	23%	9%	14%
Valuations							
PER (x)	8.8x	6.1x	7.5x	5.1x	4.1x	3.8x	3.3x
PBV (x)	0.7x	0.7x	0.6x	0.5x	0.5x	0.5x	0.5x
Dividend Yield (%)	4.0%	4.5%	2.4%	2.0%	3.4%	4.8%	5.3%
Adjusted NAVPS (LKR)	269.8	309.0	320.5	371.2	390.5	408.0	425.4
DPS (LKR)	8.0	9.0	4.8	4.0	6.8	9.8	10.6
Dividend Payout (%)	34.9%	27.1%	17.8%	10.1%	13.9%	18.4%	17.6%



Valuation Summary

Expected HNB.N Price	2024E	2025E
Justified PBV Based Target Price	331.9	367.2
Residual Income Valuation	304.3	337.5
PER Valuation Based Target Price	317.2	345.5
Average Target Price	317.8	350.0
Target Price After Rounding Off	315.0	350.0

Return	2024E	2025E
Target Price	315.0	350.0
Current Price	201.8	201.8
Capital Gain (LKR)	113.3	148.3
Dividends upto 31st Dec (LKR)	6.8	9.8
Capital Gain %	56%	73%
Dividend Yield %	3%	5%
Total Return %	59%	78%
Annualized Return %	126%	44%

Justified PBV Valuation

Justified PBV Based Valuation	2024E	2025E
ROAE	12.8%	13.3%
Growth	3.0%	3.0%
COE	16.6%	15.6%
PBV	0.9	0.9
NAVPS	390.5	408.0
Value per Share	331.9	367.2

PER Valuation

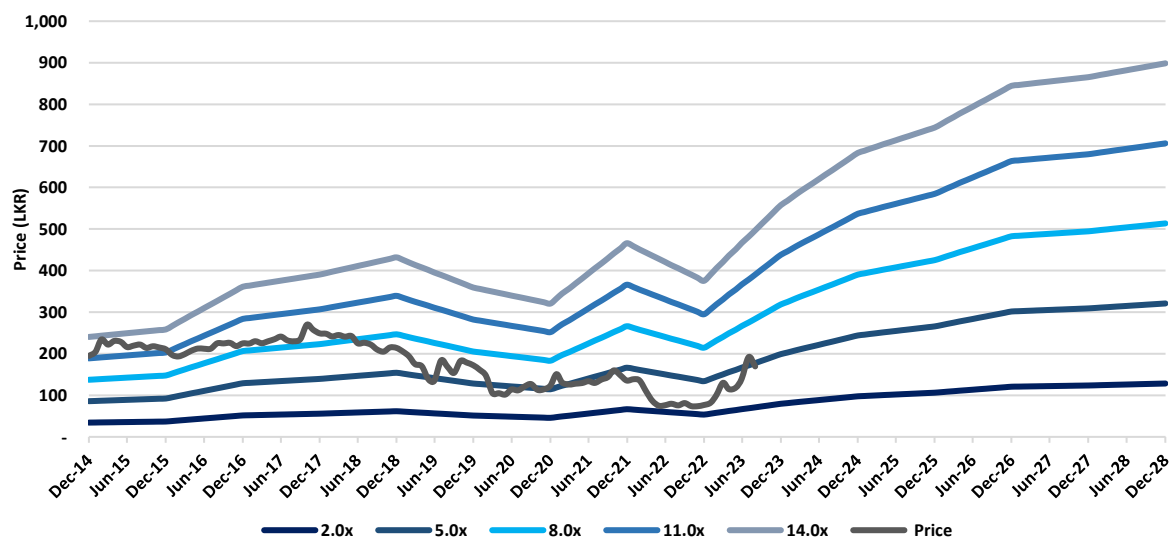
PER Based Valuation	2024E	2025E
Earnings (LKR 'Mn)	27,906	30,392
No. of Shares ('Mn)	572	572
EPS	48.8	53.1
Expected PER	6.5x	6.5x
Value per Share	317.2	345.5

Residual Income Valuation

Residual Income Based Valuation	2024E	2025E
PV of Residual Income	-38,207	-30,304
No. of Shares ('Mn)	572	572
RI per Share	-66.8	-53.0
Opening Book Value per Share	371.2	390.5
Value per Share	304.3	337.5

COE	2024E	2025E
Rf	11.0%	10.0%
Rm	19.0%	18.0%
Growth %	3.0%	3.0%
β	0.70	0.70
$K_e = R_f + \beta(R_m - R_f)$	16.6%	15.6%

PER Chart





Appendix I: Statement of Income and Expenses

Income Statement	2020	2021	2022	2023	2024E	2025E	2026E
P/E 31 December							
Interest income	112,825	107,408	220,581	304,578	226,880	246,229	266,726
Interest expenses	61,988	50,945	109,015	186,504	135,719	145,868	155,188
Net interest income	50,837	56,462	111,567	118,075	91,162	100,361	111,538
Net fee and commission income	8,026	10,316	15,902	16,573	18,436	19,910	21,304
Net loss from trading	-817	-384	4,826	-11,851	-2,647	-2,817	-2,987
Other operating income	13,819	17,813	28,558	26,393	28,252	29,435	30,670
Total Operating income	72,074	84,404	160,875	149,500	135,514	147,203	160,841
Less: Impairment charge/(reversal) for loans	-16,047	-19,534	-91,736	-42,524	-12,074	-15,223	-18,606
Net operating income	56,027	64,870	69,139	106,976	123,441	131,980	142,235
Personnel expenses	13,903	13,676	18,491	20,934	22,238	23,792	24,243
Other expenses	13,527	14,718	19,598	24,222	24,707	25,201	25,705
Total operating expenses	34,806	37,349	49,804	60,375	63,685	66,571	68,404
Operating profit before value added tax (VAT)	21,222	27,521	19,336	46,601	59,756	65,409	73,831
Value Added Tax (VAT) on Financial Services	4,048	4,760	5,248	10,523	13,939	15,432	16,967
Operating profit after value added tax (VAT)	17,173	22,761	14,088	36,077	45,817	49,977	56,864
Profit before income tax	17,580	23,054	14,420	37,218	46,980	51,164	58,075
Income Tax Expense	3,918	2,969	-1,328	13,612	18,792	20,466	23,230
Profit for the Year	13,662	20,084	15,748	23,606	28,188	30,699	34,845
Profit attributable to Equity holders of the Bank	13,095	19,025	15,329	22,771	27,906	30,392	34,497
Adjusted EPS	22.9	33.3	26.8	39.8	48.8	53.1	60.3

Appendix II: Statement of Financial Position

Balance Sheet (LKR Mn)	2020	2021	2022E	2023	2024E	2025E	2026E
As at 31st December							
Assets							
Cash and Cash Equivalents	34,899	41,712	80,630	73,759	79,452	83,019	84,523
Balances with Central Bank of Sri Lanka	7,212	25,820	32,344	12,234	12,834	14,127	16,147
Placements with Banks	12,126	6,371	58,172	61,836	62,564	71,010	81,662
Reverse Repurchase Agreements	2,827	6,246	1,381	1,830	1,957	2,187	2,490
Financial Assets Measured at FVTPL	1,095	863	236	801	865	982	1,129
Financial Assets Measured at Amortised Cost - Loans & Advances	800,816	911,253	1,014,519	988,601	1,084,646	1,212,139	1,380,017
Financial investments - FVOCI	256,395	210,804	6,062	195,975	199,857	226,838	260,863
Financial Assets Measured at Amortised Cost - Debt & Other Instruments	193,349	171,931	479,787	584,131	630,862	725,880	839,299
Property, Plant and Equipment	41,827	49,724	49,616	50,165	51,503	52,828	54,140
Other Assets	11,045	15,047	30,573	33,415	34,758	39,450	45,368
Total assets	1,371,483	1,453,651	1,798,275	2,047,040	2,205,574	2,476,744	2,815,985
Liabilities							
Due to Banks	89,747	17,076	6,105	9,020	9,155	10,090	11,267
Due to Other Customers	994,949	1,107,066	1,443,179	1,609,154	1,737,886	1,972,501	2,268,376
Dividends Payable	981	1,014	1,039	991	1,006	1,451	1,580
Other Borrowings	30,526	25,556	33,386	25,032	30,483	34,067	38,785
Other Liabilities	15,452	14,597	18,042	20,696	23,076	25,730	28,689
Total Liabilities	1,211,823	1,270,383	1,608,188	1,827,484	1,974,696	2,235,562	2,564,457
Equity							
Stated Capital	35,572	37,364	38,679	40,955	43,394	46,910	50,739
Retained Earnings	29,361	43,644	50,247	68,252	74,324	78,051	81,094
Total Equity Attributable to Equity Holders of the Bank	154,249	176,668	183,292	212,240	223,280	233,277	243,274
Non-controlling Interests	5,410	6,599	6,795	7,317	7,599	7,906	8,254
Total Equity	159,659	183,267	190,087	219,557	230,878	241,182	251,528
Total Liabilities and Equity	1,371,483	1,453,651	1,798,275	2,047,040	2,205,574	2,476,744	2,815,985
Adjusted NAVPS	269.8	309.0	320.5	371.2	390.5	408.0	425.4



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