



First Capital
A Janashakthi Group Company

EQUITY | SRI LANKA | BANKS

EARNINGS UPDATE | 26 SEP 2025

HATTON NATIONAL BANK PLC [HNB.N0000]

DOWNGRADE TO HOLD

“MOMENTUM MEETS VALUATION CEILING”

Fair Value: 2025E - LKR 400.0 [+2%]

Total Return with DPS: 2025E - 7% [AER 30%]

2026E - LKR 425.0 [+8%]

2026E - 14% [AER 11%]

HNB reported a 37.0% YoY increase in earnings for 2Q2025, primarily driven by impairment reversals, which significantly strengthened bottom-line performance. However, core banking operations reflected some softness, with Net Interest Income (NII) declining by 3.5% YoY to LKR 26.3Bn, despite a notable 23.5% YoY expansion in the loan book. This decline in NII was largely attributable to the lower interest rate environment, which led to a 4.4% YoY reduction in interest income. On the cost side, interest expenses fell by 5.1% YoY, supported by initiatives to enhance the CASA base. Nevertheless, the pressure on NII contributed to a contraction in Net Interest Margins (NIMs), which declined to 4.20% in 2Q2025, compared to 4.70% in 2Q2024 and 4.48% in 1Q2025. Non-interest income provided a strong offset to the weakness in NII. Net Fee and Commission Income grew by 20.0% YoY, underpinned by higher card usage and increased volumes of digital transactions. Other operating income, primarily comprising exchange income, also improved substantially, reaching LKR 2.5Bn in 2Q2025, compared to a loss of LKR 2.0Bn in 2Q2024, driven by currency depreciation. In light of stronger-than-anticipated loan book growth, we have revised our 2025E earnings forecast upward to LKR 39.0Bn (previously LKR 36.4Bn). This is expected to be followed by a more measured earnings growth of 5.9% in 2026E, with revised projections at LKR 41.3Bn (from LKR 38.7Bn). The upward revision in earnings forecasts has led to a corresponding increase in our fair value estimates, with the 2025E fair value now set at LKR 400.0 and the 2026E fair value at LKR 425.0. HNB's fundamentals remain robust, underpinned by prudent asset quality management and a well-diversified income base. Nevertheless, given the significant appreciation in the share price in recent months, the stock currently presents limited upside potential relative to our 2026E fair value estimate of LKR 425.0. Therefore, while HNB's long-term prospects remain favourable, FCR recommends investors retain the stock and issues a **DOWNGRADE TO HOLD** from our previous BUY.

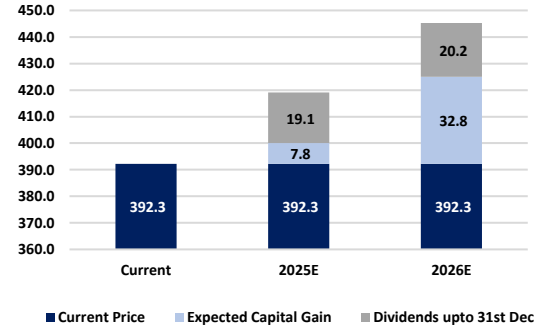
LKR (Mn)	2Q2024	2Q2025	YoY	1H2024	1H2025	YoY
Earnings (LKR 'Mn)						
NII	27,252	26,301	-3%	52,586	54,212	+3%
Total Operating Income	37,745	40,448	+7%	70,350	81,900	+16%
Net Operating Income	36,930	45,097	+22%	67,901	86,743	+28%
Pre Tax Profit	15,766	19,416	+23%	27,008	36,483	+35%
Net Profit : Equity Holders	8,570	11,743	+37%	15,778	22,441	+42%
Balance Sheet (LKR 'Mn)						
Loans	1,084,138	1,338,919	+24%	1,084,138	1,338,919	+24%
Shareholder's Equity	227,540	276,695	+22%	227,540	276,695	+22%
Adjusted NAVPS	397.9	483.9	+22%	397.9	483.9	+22%

HNB earnings up by 37.0% YoY during 2Q2025

HNB reported a 37.0% YoY growth in earnings for 2Q2025, primarily driven by impairment reversals recorded during the period. However, core banking operations reflected some pressure, with NII declining by 3.5% YoY to LKR 26.3Bn, largely due to the prevailing low-interest rate environment compared to the same quarter in 2024. Despite a 23.5% YoY expansion in the loan book, interest income declined by 4.4% YoY, underscoring the impact of reduced lending rates. This was partially offset by a 5.1% YoY decline in interest expenses, supported by strategic efforts to enhance the CASA base. Nevertheless, the pressure on NII contributed to a contraction in NIMs, which declined to 4.20% in 2Q2025, compared to 4.70% in 2Q2024 and 4.48% in 1Q2025. Non-interest income showed strong growth, with Net Fee and Commission Income increasing by 20.0% YoY, driven by higher card transaction volumes and increased adoption of digital banking platforms. Furthermore, other operating income, which primarily includes exchange income rose significantly to LKR 2.5Bn, reversing a loss of LKR 2.0Bn in the corresponding quarter of 2024. This was largely attributable to the depreciation of the LKR against the USD. In terms of asset quality, HNB recorded a net impairment reversal of LKR 4.6Mn, in contrast to an impairment charge of LKR 815.0Mn in 2Q2024, indicating an improvement in the Stage 3 loan portfolio. Accordingly, the Net Stage 3 ratio improved to 1.59%, compared to 1.82% in 1Q2025 and 4.09% in 2Q2024. Nevertheless, profitability was partially constrained by rising cost pressures. Operating expenses increased by 21.6% YoY, while tax-related expenses also rose, with VAT on financial services up 18.6% YoY and corporate income tax higher by 5.4% YoY. Overall, HNB delivered a resilient performance in 2Q2025, supported by improved asset quality and a more diversified income base, despite headwinds from a lower interest rate environment and elevated cost pressures.

Loan book expands as private credit gains momentum

Amid the prevailing low-interest rate environment, private sector credit growth accelerated to 17.9% YoY as of June 2025, up from 14.0% YoY in March 2025. Within this backdrop, HNB's gross loan portfolio recorded a robust 23.5% YoY increase, reaching LKR 1.3Tn as at 2Q2025. On an annual basis, domestic currency lending rose by 23.1%, largely driven by increased volumes in term loans. Foreign currency loans also expanded significantly, growing by 26.1% YoY, supported by the depreciation of the LKR against the USD during the quarter as well as higher term loan disbursements. The downward trajectory in interest rates, reflected in the decline of the Average Weighted Lending Rate (AWLR) to 11.56% at end-2Q2025 from 11.80% in 1Q2025, alongside broad-based economic recovery, is expected to continue supporting credit expansion in the near term, although a gradual moderation may occur over time. On the funding front, HNB's total deposits rose by 17.5% YoY to LKR 1.9Tn in 2Q2025. Consequently, the loan-to-deposit ratio increased to 70.1% in 2Q2025, compared to 63.9% in 1Q2025 and 66.7% in 2Q2024. The CASA ratio improved to 34.8%, up from 33.4% in 1Q2025 and 32.4% in 2Q2024, reflecting continued efforts to strengthen the Bank's low-cost funding base.

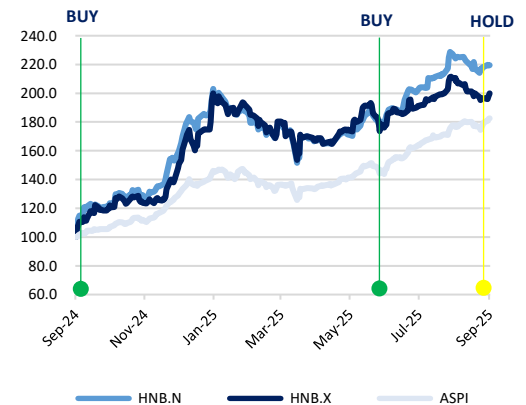


FIRST CAPITAL RESEARCH

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



Source: CSE

Minimum Return for BUY:

Buy Below 2026E [AER of 14.0% with DPS]: LKR 377.4
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.



Capital adequacy soars past regulatory hurdles

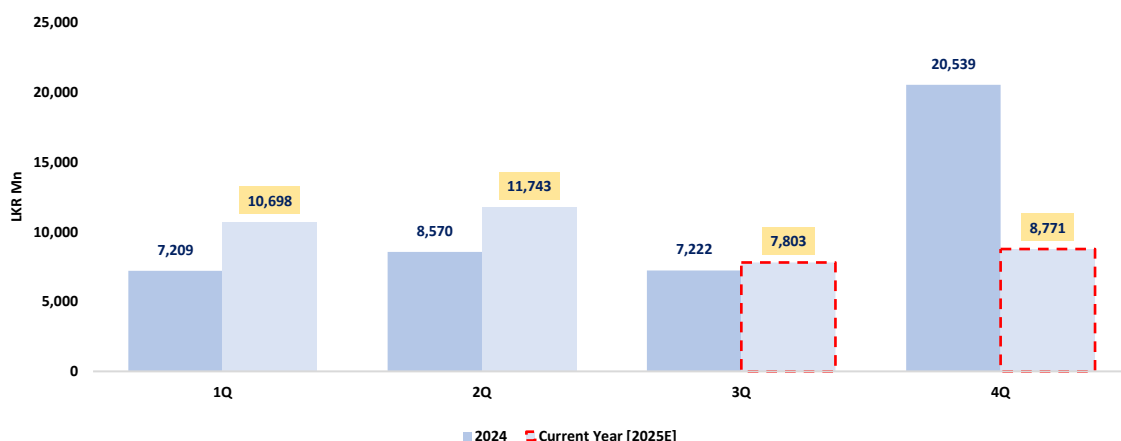
During the period, HNB continued to maintain strong capital buffers, with Tier I and Total Capital Adequacy Ratios at 18.42% and 22.46%, respectively, well above the regulatory minimum requirements of 9.5% and 13.5%. The Bank also sustained a strong liquidity position, evidenced by an all currency Liquidity Coverage Ratio of 271.54%, significantly exceeding the minimum regulatory threshold of 100%.

FV for 2026E revised upwards – Time to pause

Given the stronger-than-expected expansion in the loan book, we have upwardly revised our earnings forecast for 2025E to LKR 39.0Bn (previously LKR 36.4Bn). For 2026E, we project a more moderate earnings growth of 5.9%, with earnings expected to reach LKR 41.3Bn (previously LKR 38.7Bn). The upward revision in earnings projections has resulted in a corresponding adjustment to our fair value estimates. The fair value for HNB.N is now set at LKR 400.0 for 2025E and LKR 425.0 for 2026E, while the fair value for HNB.X has been revised to LKR 320.0 for 2025E and LKR 340.0 for 2026E. HNB's fundamentals remain robust, underpinned by prudent asset quality management and a well-diversified income base. Nevertheless, given the significant appreciation in the share price in recent months, the stock currently presents limited upside potential relative to our 2026E fair value estimate of LKR 425.0. Accordingly, while the long-term outlook remains constructive, FCR recommends investors retain the stock and issues a **DOWNGRADE TO HOLD** from our previous BUY.



Quarterly Earnings



Note: 4Q2024 earnings include the impact of impairment reversals on ISB holdings

Estimate Revision

In LKR Mn	2025E-O	2025E-R	% Change	2026E-O	2026E-R	% Change
Earnings Estimate						
Net Interest Income	113,666	114,572	+1%	128,067	127,459	-0%
Total Operating Income	160,635	161,540	+1%	176,705	176,097	-0%
Net Operating Income	151,595	154,884	+2%	161,841	164,801	+2%
Pre Tax Profit	62,660	67,208	+7%	66,722	71,147	+7%
Net Profit : Equity Holders	36,375	39,015	+7%	38,733	41,302	+7%
Adjusted EPS	63.6	68.2	+7%	67.7	72.2	+7%
Net Profit Growth YoY	143%	161%		6%	6%	
Balance Sheet Estimate						
Loans & Advances	1,203,584	1,302,510	+8%	1,280,798	1,488,886	+16%
Shareholders' Equity	273,091	274,564	+1%	284,528	286,697	+1%
Adjusted NAVPS	487.9	490.5	+1%	508.3	512.2	+1%
Ratio Estimate						
ROE (%)	13.6%	14.6%		13.9%	14.7%	
PER (x)	5.0	5.7		4.7	5.4	
PBV (x)	0.7	0.8		0.6	0.8	



Valuation Table

P/E 31st December	2021	2022	2023	2024	2025E	2026E	2027E
Estimates (LKR 'Mn)							
Net Interest Income	56,462	111,567	118,075	109,765	114,572	127,459	141,200
Total Operating Income	84,404	160,875	149,500	97,593	161,540	176,097	192,212
Net Profit: Equity Holders	19,025	15,329	22,771	43,539	39,015	41,302	44,007
Recurring Net Profit: Equity Holders	19,025	15,329	22,771	14,974	39,015	41,302	44,007
Adjusted EPS (LKR)	33.3	26.8	39.8	26.2	68.2	72.2	77.0
YoY Growth (%)	45%	-19%	49%	-34%	161%	6%	7%
Valuations							
PER (x)	11.8x	14.6x	9.9x	15.0x	5.7x	5.4x	5.1x
PBV (x)	1.2x	1.2x	1.0x	0.8x	0.8x	0.8x	0.7x
Dividend Yield (%)	2.3%	1.2%	2.0%	3.8%	4.9%	5.2%	5.5%
Adjusted NAVPS (LKR)	315.6	327.5	379.2	466.9	490.5	512.2	535.4
DPS (LKR)	9.0	4.8	8.0	15.0	19.1	20.2	21.5
Dividend Payout (%)	27.1%	17.8%	20.1%	57.3%	28.0%	28.0%	28.0%

Note: Recurring net profit for 2024 indicates reported net profit adjusted for impairment reversal on ISB holdings and net losses from derecognition of financial assets.

Ratio Analysis

		2021	2022	2023	2024	2025E	2026E	2027E
Growth	Asset	6.0%	23.7%	13.8%	7.9%	11.9%	11.7%	11.9%
	Deposit	11.3%	30.4%	11.5%	8.8%	12.5%	12.5%	12.7%
	Net Loans	13.8%	11.3%	-2.6%	11.7%	18.0%	14.3%	12.0%
Profitability	Return on Equity	11.5%	8.5%	11.5%	18.4%	14.6%	14.7%	15.0%
	Return on Average Assets	1.3%	0.9%	1.2%	2.0%	1.7%	1.6%	1.5%
	Net Interest Spread	4.0%	7.4%	6.4%	5.0%	4.6%	4.6%	4.6%
	Net Interest Margin	4.4%	7.8%	6.9%	5.7%	5.3%	5.2%	5.2%
Funding & Liquidity	Loan/ Deposits	82.3%	70.3%	61.4%	63.1%	66.2%	67.2%	66.9%
	Loan/ Assets	62.7%	56.4%	48.3%	50.0%	52.7%	53.9%	54.0%
	Deposit/ Liabilities	87.1%	89.7%	88.1%	90.2%	90.0%	89.9%	89.8%
	CASA	40.0%	30.4%	29.4%	33.5%	45.0%	43.0%	43.0%



Valuation Summary

Expected HNB.N Price	2025E	2026E
Justified PBV Based Target Price	416.9	435.4
Residual Income Valuation	376.0	404.3
PER Valuation Based Target Price	409.4	433.4
Average Target Price	400.8	424.4
Target Price After Rounding Off	400.0	425.0

Return	2025E	2026E
Target Price	400.0	425.0
Current Price	392.3	392.3
Capital Gain (LKR)	7.8	32.8
Dividends upto 31st Dec (LKR)	19.1	20.2
Capital Gain %	2%	8%
Dividend Yield %	5%	5%
Total Return %	7%	14%
Annualized Return %	30%	11%

Justified PBV Valuation

Justified PBV Based Valuation	2025E	2026E
ROAE	14.6%	14.7%
Growth	3.0%	3.0%
COE	19.4%	19.4%
PBV	0.9	0.9
NAVPS	490.5	512.2
Value per Share	416.9	435.4

PER Valuation

PER Based Valuation	2025E	2026E
Earnings (LKR 'Mn)	39,015	41,302
No. of Shares ('Mn)	572	572
EPS	68.2	72.2
Expected PER	6.0x	6.0x
Value per Share	409.4	433.4

Residual Income Valuation

Residual Income Based Valuation	2025E	2026E
PV of Residual Income	-51,986	-49,299
No. of Shares ('Mn)	572	572
RI per Share	-90.9	-86.2
Opening Book Value per Share	466.9	490.5
Value per Share	376.0	404.3

COE	2025E	2026E
Rf	9.0%	9.0%
Rm	17.0%	17.0%
Growth %	3.0%	3.0%
β	1.30	1.30
$K_e = R_f + \beta(R_m - R_f)$	19.4%	19.4%

Recommendation Criteria

Categorization	Company Category	Buy	Hold	Sell
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Grade A	S&P SL20 Companies	T.Bill + 5% & Above	T.Bill + 1% & Above	Below T.Bill + 1%
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Grade B	Rest of the Companies	T.Bill + 8% & Above	T.Bill + 3% & Above	Below T.Bill + 3%
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Grade C	Companies less than LKR 1Bn Market Cap	T.Bill + 11% & Above	T.Bill + 6% & Above	Below T.Bill + 6%
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Categorization	Company Category	Buy	Hold	Sell
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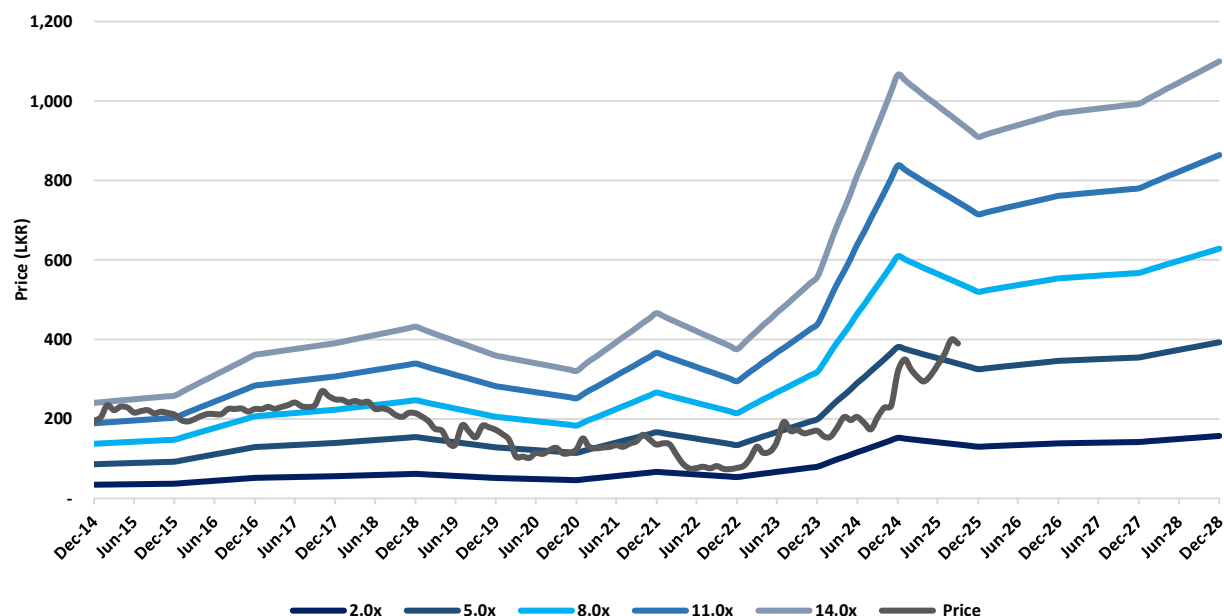
Grade A	S&P SL20 Companies	14.00%	10.00%	10.00%
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Grade B	Rest of the Companies	17.00%	12.00%	12.00%
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Grade C	Companies less than LKR 1Bn Market Cap	20.00%	15.00%	15.00%
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PER Chart



Appendix I: Statement of Income and Expenses

Income Statement	2021	2022	2023	2024	2025E	2026E	2027E
P/E 31 December							
Interest income	107,408	220,581	304,578	240,244	235,268	263,229	300,529
Interest expenses	50,945	109,015	186,504	130,479	120,696	135,770	159,329
Net interest income	56,462	111,567	118,075	109,765	114,572	127,459	141,200
Net fee and commission income	10,316	15,902	16,573	19,149	22,181	24,177	26,353
Net loss from trading	-384	4,826	-11,851	-3,966	2,278	1,645	1,518
Other operating income	17,813	28,558	26,393	-27,862	21,978	22,364	22,757
Total Operating income	84,404	160,875	149,500	97,593	161,540	176,097	192,212
Less: Impairment charge/(reversal) for loans	-19,534	-91,736	-42,524	77,406	-6,656	-11,295	-14,486
Net operating income	64,870	69,139	106,976	174,998	154,884	164,801	177,726
Personnel expenses	13,676	18,491	20,934	26,329	27,050	29,057	32,699
Other expenses	14,718	19,598	24,222	27,486	27,898	30,409	33,146
Total operating expenses	37,349	49,804	60,375	71,129	72,696	77,657	84,490
Operating profit before value added tax (VAT)	27,521	19,336	46,601	103,869	82,189	87,144	93,235
Value Added Tax (VAT) on Financial Services	4,760	5,248	10,523	21,148	16,386	17,430	18,890
Operating profit after value added tax (VAT)	22,761	14,088	36,077	82,722	65,803	69,714	74,345
Profit before income tax	23,054	14,420	37,218	84,099	67,208	71,147	75,807
Income Tax Expense	2,969	-1,328	13,612	39,260	26,986	28,568	30,439
Profit for the Year	20,084	15,748	23,606	44,840	40,222	42,579	45,368
Profit attributable to equity holders of the Bank	19,025	15,329	22,771	43,539	39,015	41,302	44,007
Recurring profit attributable to equity holders of the Bank	19,025	15,329	22,771	14,974	39,015	41,302	44,007
Adjusted EPS	33.3	26.8	39.8	26.2	68.2	72.2	77.0



Appendix II: Statement of Financial Position

Balance Sheet (LKR Mn)	2021	2022	2023	2024	2025E	2026E	2027E
As at 31st December							
Assets							
Cash and Cash Equivalents	41,712	80,630	73,759	64,065	55,419	68,581	70,609
Balances with Central Bank of Sri Lanka	25,820	32,344	12,234	6,913	7,755	8,641	9,728
Placements with Banks	6,371	58,172	61,836	48,656	59,045	66,426	74,828
Reverse Repurchase Agreements	6,246	1,381	1,830	5,281	6,957	7,953	8,907
Financial Assets Measured at FVTPL	863	236	801	2,963	3,331	3,748	4,222
Financial Assets Measured at Amortised Cost - Loans & Advances	911,253	1,014,519	988,601	1,104,013	1,302,510	1,488,886	1,667,552
Financial investments - FVOCI	210,804	6,062	195,975	112,407	147,612	276,773	361,671
Financial Assets Measured at Amortised Cost - Debt & Other Instruments	171,931	479,787	584,131	770,021	787,267	730,682	773,227
Property, Plant and Equipment	49,724	49,616	50,165	55,468	58,092	60,714	63,335
Other Assets	15,047	30,573	33,415	24,538	27,593	31,042	34,968
Total assets	1,453,651	1,798,275	2,047,040	2,209,174	2,471,517	2,760,970	3,088,188
Liabilities							
Due to Banks	17,076	6,105	9,020	6,596	9,502	10,500	11,451
Due to Other Customers	1,107,066	1,443,179	1,609,154	1,750,259	1,968,167	2,214,187	2,494,282
Dividends Payable	1,014	1,039	991	994	3,277	3,469	3,697
Other Borrowings	25,556	33,386	25,032	19,742	24,543	28,055	31,421
Other Liabilities	14,597	18,042	20,696	21,549	22,436	22,997	23,572
Total Liabilities	1,270,383	1,608,188	1,827,484	1,939,424	2,187,357	2,463,400	2,776,255
Equity							
Stated Capital	37,364	38,679	40,955	42,858	49,741	57,026	64,789
Retained Earnings	43,644	50,247	68,252	91,385	94,513	95,979	97,616
Total Equity Attributable to Equity Holders of the Bank	176,668	183,292	212,240	261,361	274,564	286,697	299,700
Non-controlling Interests	6,599	6,795	7,317	8,389	9,595	10,873	12,234
Total Equity	183,267	190,087	219,557	269,749	284,160	297,570	311,934
Total Liabilities and Equity	1,453,651	1,798,275	2,047,040	2,209,174	2,471,517	2,760,970	3,088,188
Adjusted NAVPS	315.6	327.5	379.2	466.9	490.5	512.2	535.4



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