

Hatton National Bank PLC

*Strong balance sheet with
proven track record*

21st December 2020

BUY : LKR 124.40 (voting) | 96.00 (nonvoting)

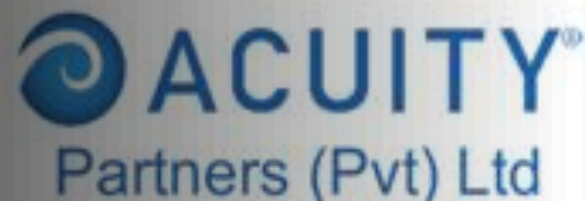


**HNB
ASSURANCE**

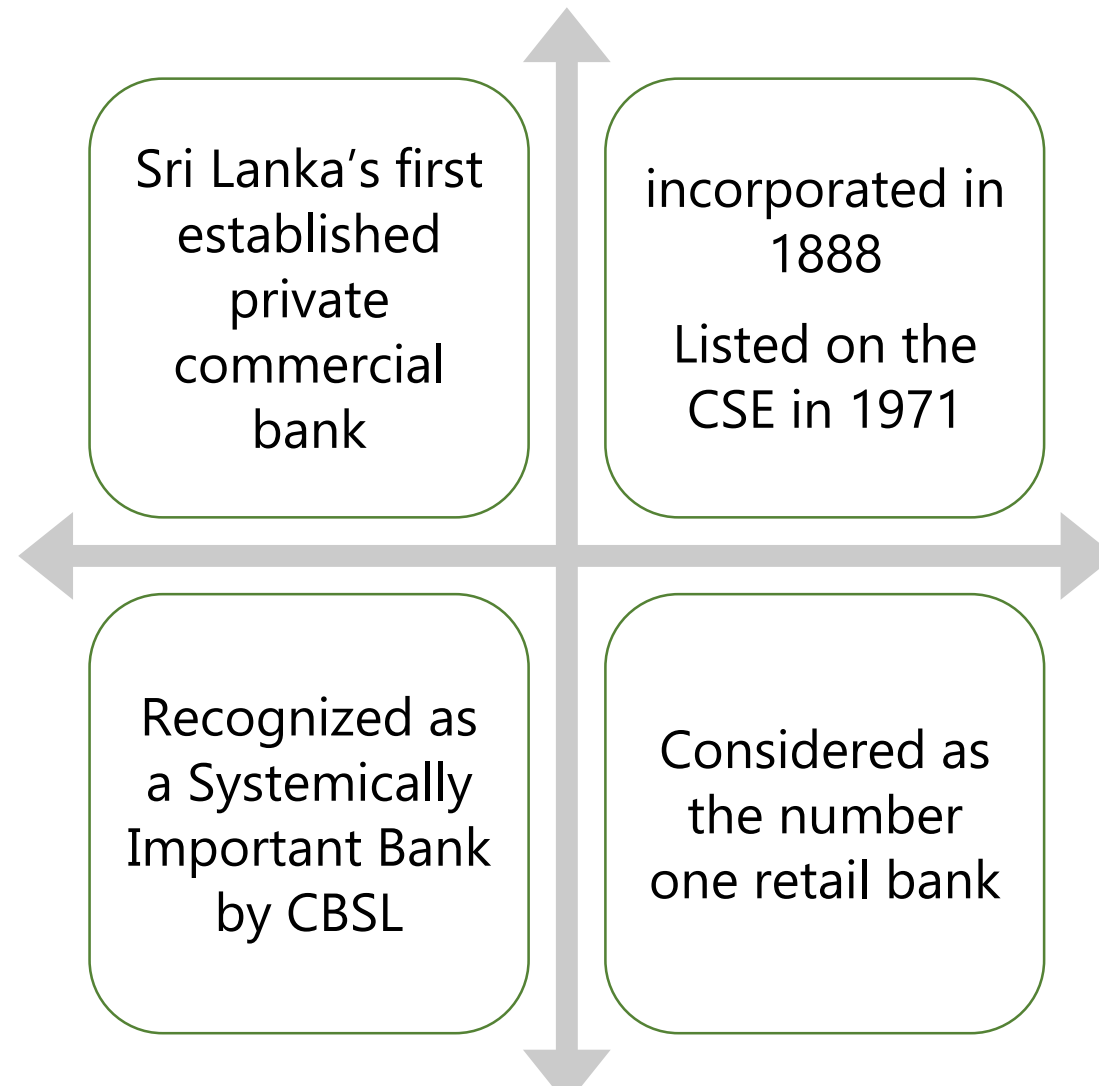
HNB FINANCE

Sithma

Development



About Hatton National Bank PLC



Hatton National Bank Group



Industry Position

	Total Assets 30-Sep-2020	Net Profit 30-Sep-2020	Market Cap: 15-Dec-2020
Financial Perspectives			
Value (LKR)	1,324 billion	8.61 billion	62 billion
Rank (among PCBs)	2	2	2

	As at 31 st Dec 2019	Branches	SSMs	Customers
Other Perspectives				
Number of :		252	780	~ 2.6 million
Rank (among PCBs)		2	2	3

Source: HNB Annual Report, SC Securities Research Division

Case for Investment

-
- **Trading at a discount:** Based on 2020E earnings HNB voting share is trading at PE and PBV multiples of 5.14x and 0.40x (2021E: 4.10x and 0.36x) which are below the market and sector multiples. While the nonvoting share is trading at 21.6% discount to the voting share price.
 - **12 month target price yields 30% upside:** 12 month target: Voting LKR.161.00 | Nonvoting LKR 126.40
 - **Relatively high Net Interest Margin (NIM) :** Compared to peers and industry HNB has a higher NIM due to prudent asset and liability management
 - **Adequately capitalized to fund future growth:** HNB continues to be among the best capitalized banks; complementing its strong liquidity position.
 - **Balanced exposure to high yield SBU's:** HNB is having high exposure to higher yielding retail and SME customer segment and 54% of the loan book comprised higher yielding segments.

Case for Investment

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- **New funding line:** HNB obtained USD 60Mn long tenor funding from the French Development Agency PROPARCO to fund the SME sector. This is a resounding endorsement of Bank's financial position and business model despite the volatility in local and macro economic fundamentals.
 - **Removal of Debt Repayment Levy and NBT:** Banks are not subject to 2% NBT w.e.f. 01 Dec 2019, and 7% DRL w.e.f. 01 Jan 2020. (During FY2019 HNB group paid LKR.3,391mn as DRL and NBT)
 - **Digital integration :** Digital transformation will improve the efficiencies and user experience while witnessing a sustainable growth and improved cost efficiencies.
 - **Stable insurance contribution to total operating income :** Insurance arm would positively contribute towards the performance of HNB.



Operational Overview



Investor's Guide

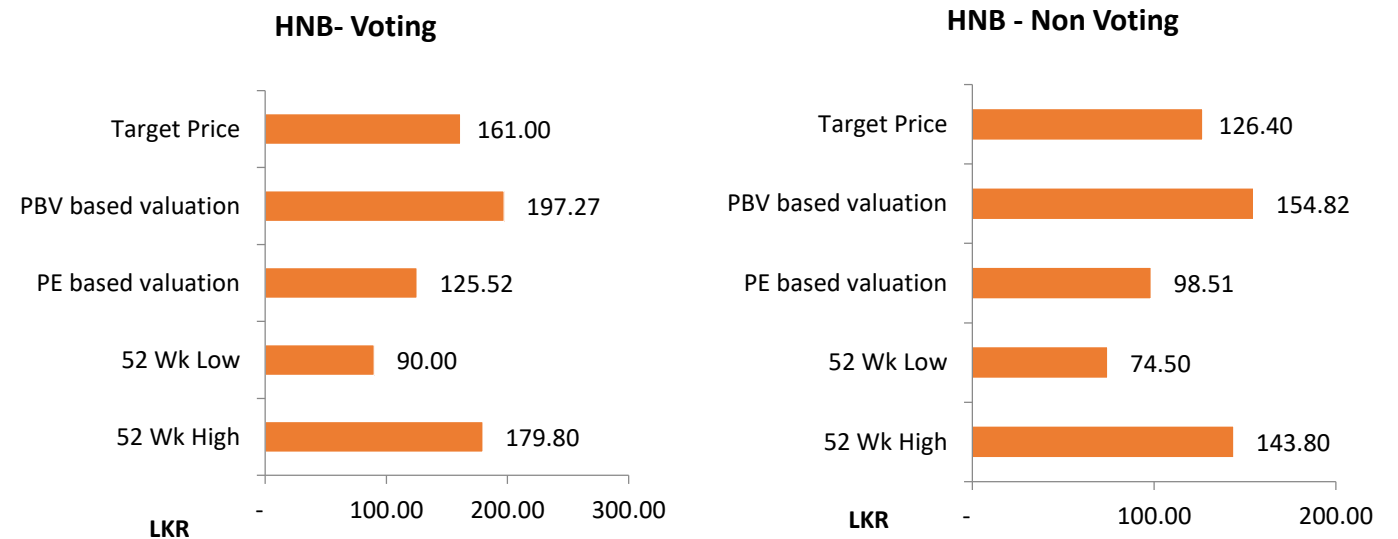
YE 31st December	2017	2018	2019	2020F	2021F
Net Profit (LKR.Mn)	15,947	17,636	14,670	12,053	15,096
+/- Growth	8%	11%	-17%	-18%	25%
EPS (LKR)	32.64	35.80	29.32	24.09	30.17
PE (x) - HNB.N	7.63	5.98	5.87	5.16	4.12
PE (x) - HNB.X	5.97	4.71	4.62	3.99	3.18
NAV (LKR)	249.74	269.28	290.78	313.01	341.62
PBV (x) - HNB.N	1.00	0.79	0.59	0.40	0.36
PBV (x) - HNB.X	0.78	0.63	0.47	0.31	0.28
DPS (LKR)	8.50	8.50	8.50	8.50	8.50
DY (%) HNB.N	3.4%	4.0%	4.9%	6.8%	6.8%
DY (%) - HNB.X	4.4%	5.0%	6.3%	8.9%	8.9%
ROE (%)	15.0%	13.8%	10.5%	8.0%	9.2%
ROA (%)	1.7%	1.6%	1.3%	0.9%	1.1%
MPS HNB.N- (LKR)	249.00	214.00	172.00	124.40	124.40
MPS HNB.X - (LKR)	195.00	168.50	135.50	96.00	96.00

Source: HNB Financials, SC Securities

Blended valuation yields a 29.4% upside. Recommendation: **STRONG BUY**

- A blended valuation approach was implemented. We looked at local listed banking sector companies and computed the average PER and PBV multiples and applied it to HNB's FY20E profit figure and FY20E NAVPS.
- Our approach yielded us a target price of LKR 161.00 which gives a 29.4% upside. Therefore, we recommend a BUY over medium to long term investment horizon.

HNB - Voting	FY20E values
EPS (LKR)	24.09
NAVPS (LKR)	313.01
PER multiple	5.18
PBV multiple	0.63
PE based valuation (LKR)	124.77
PBV based valuation (LKR)	197.20
Blended Valuation (LKR)	161.00
Upside	29.4%



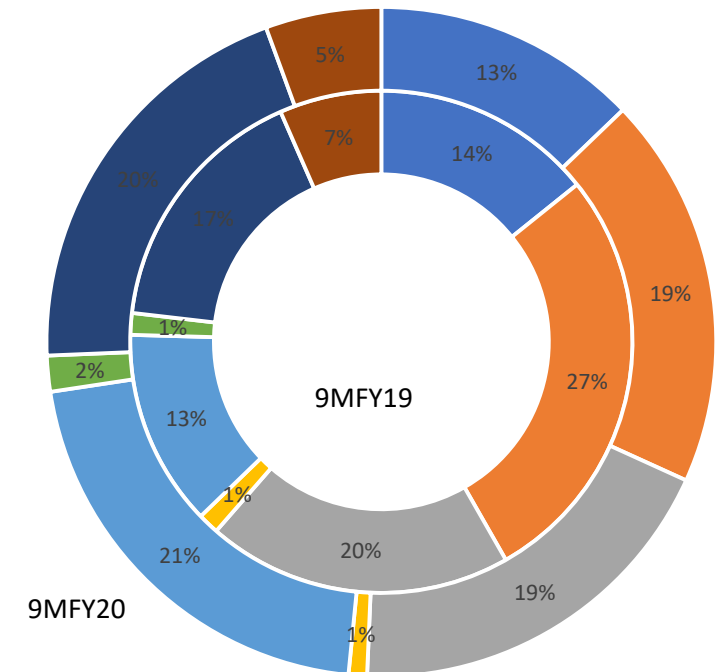
Source: HNB Financials, SC Securities

9M Profit Marginally Up amid Monetary Easing

- 9MFY20 interest income contracted 8% YoY to LKR 86 billion compared to corresponding period of FY19 in line with the drop in interest rates.
- Interest expense declined 6% YoY to LKR 47 billion compared to the previous financial year, resulting a net interest income of LKR 38 billion; 10% lower compared to 9MFY2019.
- Net fee and commission income dampen by 22% YoY to LKR 5.8 billion as a result of the restrictions placed on imports, removal of certain charges and low volume of foreign card transactions.
- Bottom line of HNB grew by 2% YoY, on the back of lower trading losses and lower tax due to removal of DRL and NBT.

Segmental Net Operating Income

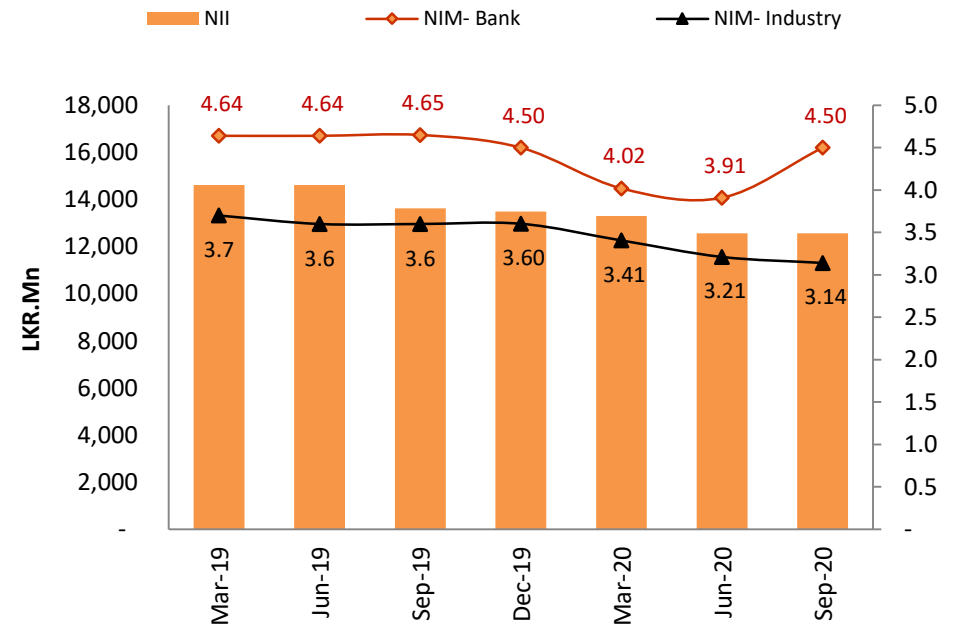
■ Corporate ■ Retail ■ SME ■ Micro ■ Treasury ■ Real Estate ■ Insurance ■ NBFI*



Source: HNB Financials

3Q Profit flat with lower tax expenses

- NII drop by 8% YoY to reach LKR 12.5 billion due to the low interest rate regime. The monetary easing adopted post pandemic has led to a 400 basis points (bps) drop in AWPLR since the beginning of the year.
- Net operating income declined by 14% YoY due to the reduction in fee and commission income, and higher impairment charges.
- Tax savings from the removing of NBT and DRL supported the bottom line despite the lower interest income and the higher impairment charges, 3Q profit stood at LKR 3.4 billion witnessing marginal 1% YoY decline compared to the 3QFY19.



Source: HNB Financials



Future Outlook



Future Outlook

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- We expect a decline of 6.5% YoY in NII during FY20 on the back of lackluster economic environment and lower interest rate regime.
 - Impairment provisioning at healthy level with outstanding exposure (LKR11.5 Bn) to SOE recovered in October 2020 and expect NPA to reflect recovery. Accordingly, after adjusting for this recovery, the NPA ratio for the Bank would have decreased to 5.06% from the NPA ratio of 6.51% reported for September 2020.
 - We expect a strong credit growth in FY21 with improved investor confidence and low interest rate environment; thus we expect loan book to grow by 6% YoY in FY21.
 - Budget 2021 introduced 50% treasury guarantee on tourism related moratoriums, thus reduced risk exposure.

Future Outlook

- Interest and capital gains earned by LCBs through Sri Lanka International Sovereign Bonds were made tax free subject to a minimum investment of USD 100mn (budget 2021).
- CBSL during 1H2020 issued an directive preventing LCB's paying any cash dividend during 2020. Thus, we expect the dividend payment to be only in the form of scrip dividend.
- We have estimated net profit of LKR 12.1 Bn, with a profit decline of 18% YoY with low interest rate regime and recover bottom line in FY21 with 25% YoY growth underpinned by loan growth.

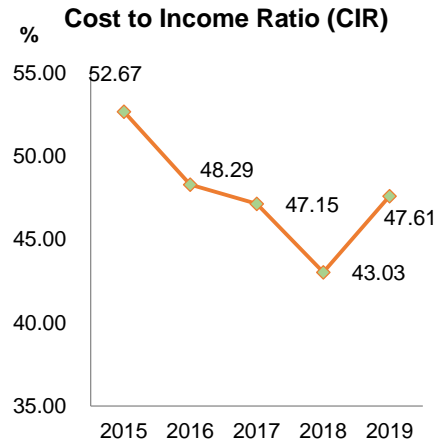


Appendix

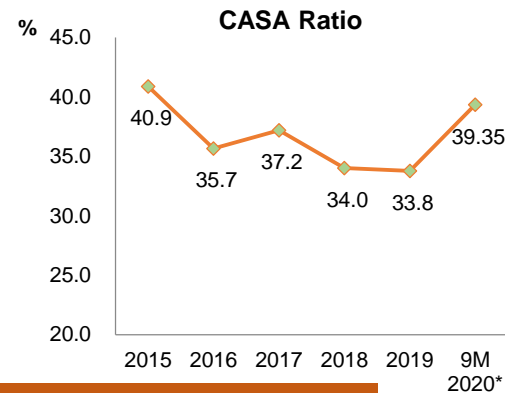


Financial Performance Dashboard

Cost to Income



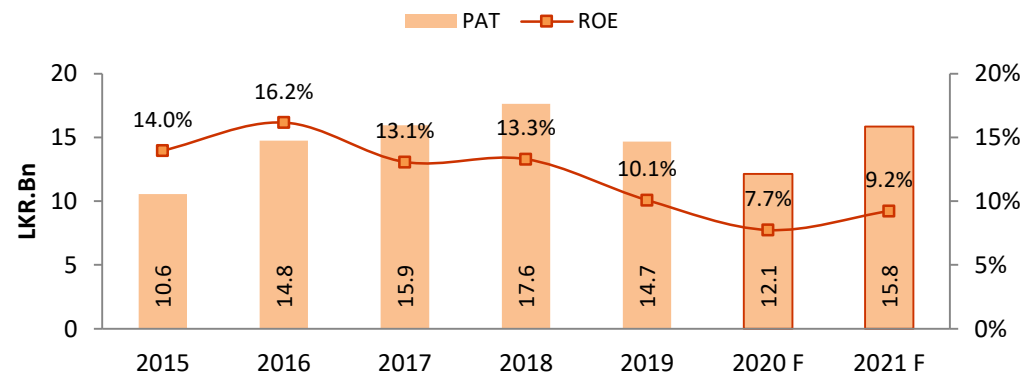
CASA



Relative Stock Performance

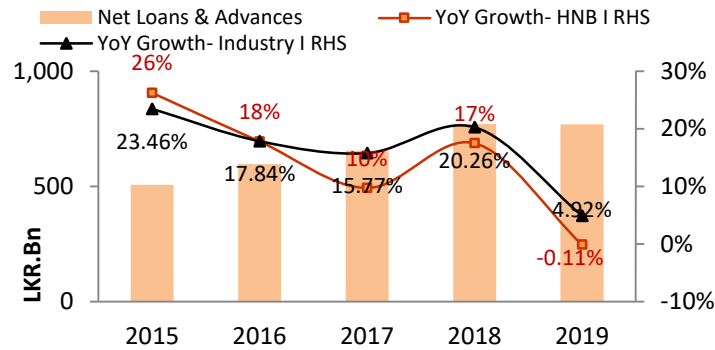


PAT Vs ROE

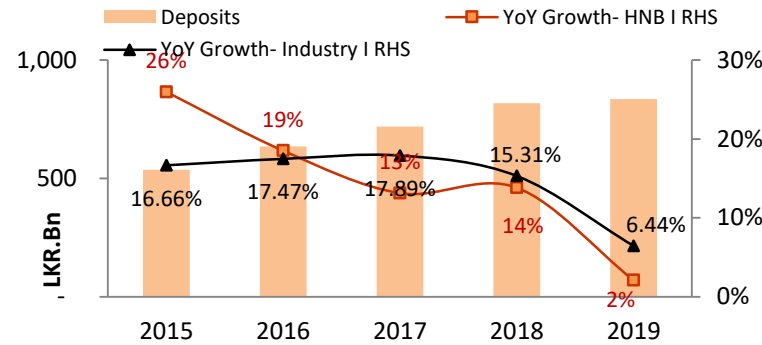


Financial Performance Dashboard

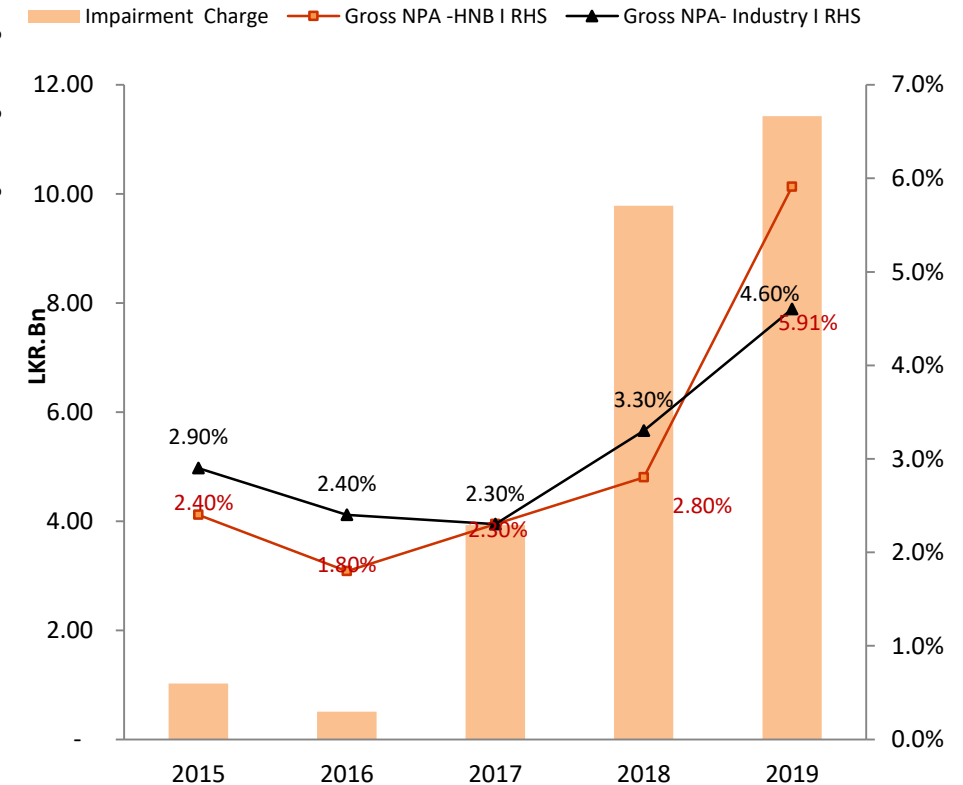
Net Loans & Advances



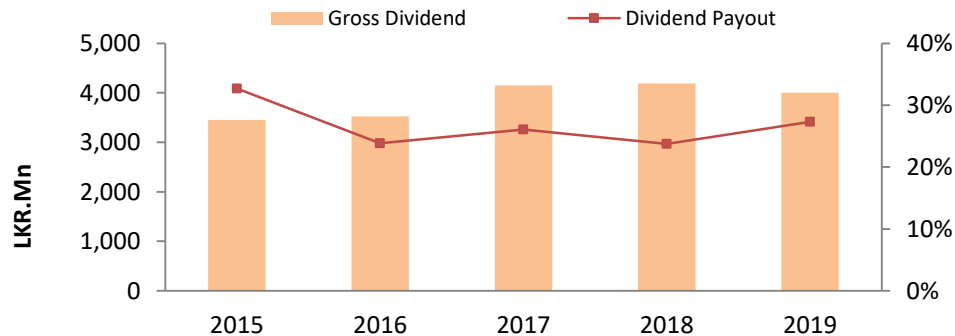
Deposits



Impairment Charge Vs Gross NPA

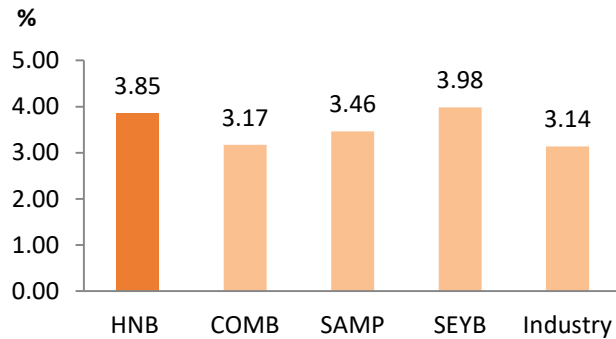


Gross Dividend Vs Dividend Payout

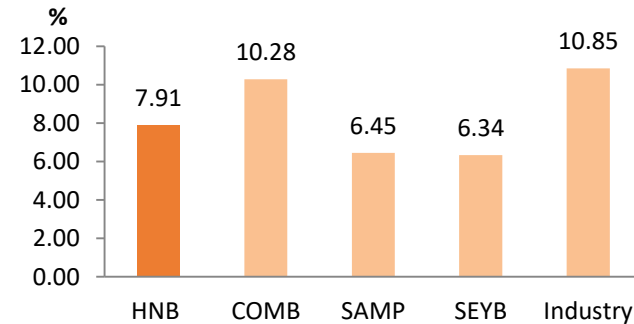


Peer Comparison – Key Ratios

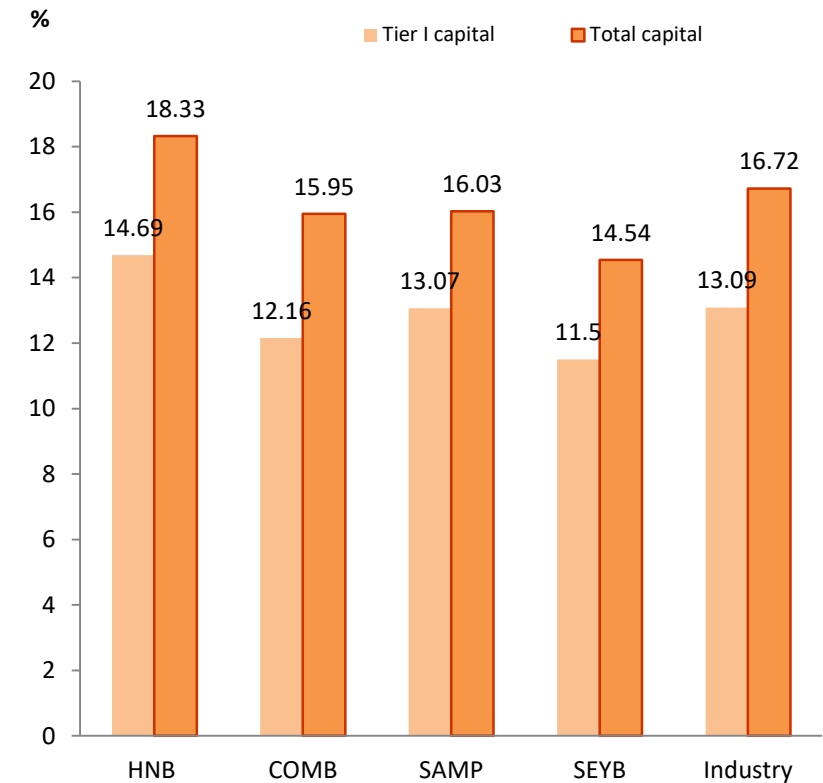
Net Interest Margin



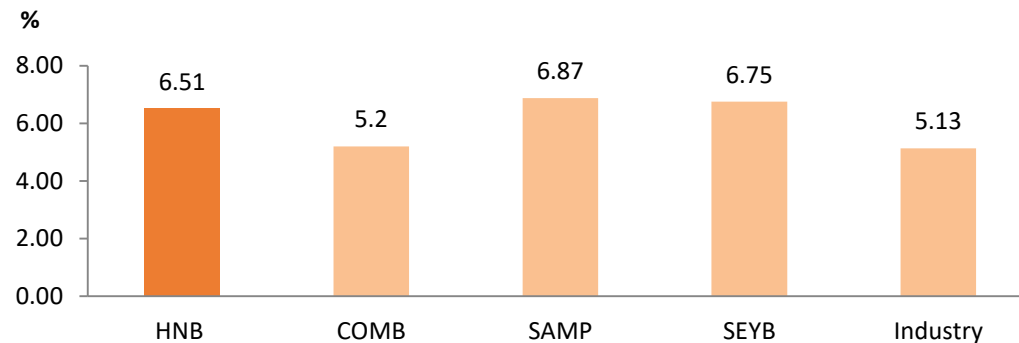
ROE



Capital Adequacy Ratios



Gross NPL Ratio



Financials: Condensed Income Statement

Year Ended 31st December	2017	2018	2019	2020 F	2021 F
Net interest income	45,461	53,636	56,356	51,162	49,472
Net fee and commission income	9,014	10,098	9,977	7,872	7,047
Total Operating income	61,099	75,114	76,511	71,261	69,427
Net operating income after impairment charge	57,173	65,330	65,084	55,717	61,147
Operating Expenses	28,810	32,324	36,428	36,603	37,252
Operating profit before value added tax (VAT)	28,363	33,006	28,656	19,115	23,895
Value Added Tax (VAT) on Financial Services	5,436	6,843	8,398	2,867	3,584
Operating profit after value added tax (VAT)	22,927	26,163	20,258	16,247	20,310
Share of profit of joint venture (net of income tax)	176	303	187	273	380
Profit before income tax	23,103	26,466	20,445	16,520	20,691
Income Tax Expense	6,362	7,317	5,416	3,965	4,966
Profit for the Year	16,741	19,149	15,029	12,555	15,725
Profit attributable to Equity holders of the Bank	15,947	17,636	14,670	12,053	15,096
Profit attributable to Non-controlling interests	794	1,514	359	502	629
Profit for the Year	15,947	17,636	14,670	12,555	15,725

Financials (Interim Performance)

LKR Mn	1QFY20	2QFY20	3QFY20	9MFY20	9MFY19
Net interest income	13,304	12,559	12,568	38,430	42,866
Net fee and commission income	2,226	1,430	2,149	5,804	7,417
Total Operating income	18,849	16,526	17,725	53,100	57,442
Less: Impairment charge/(reversal) for loans and other losses	4,655	4,625	2,822	12,103	9,116
Net operating income	14,194	11,901	14,903	40,997	48,327
Operating Expenses	8,880	8,218	9,242	26,340	27,552
Operating profit before value added tax (VAT)	5,314	3,683	5,660	14,657	20,775
VAT on Financial Services, DRL& NBT	1,036	822	1,103	2,961	6,320.86
Operating profit after VAT,NBT &DRL	4,278	2,861	4,557	11,696	14,454
Share of profit of joint venture (net of income tax)	36	215	28	278	145
Profit before income tax	4,313	3,076	4,585	11,974	14,598
Income Tax Expense	1,037	875	1,262	3,174	5,904
Profit for the Year	3,277	2,200	3,323	8,800	8,694
Profit attributable to Equity holders of the Bank	3,048	2,121	3,436	8,605	8,406
Profit attributable to Non-controlling interests	229	79	(113)	195	288
Profit for the Year	3,277	2,200	3,323	8,800	8,694

Source: HNB Financials, SC Securities

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