



Sanasa DevelopmentBank PLC

Earnings Review: **STRONG BUY**

Price LKR 56.10

Target Price LKR 70.20

Upside+ 25%

Member of the Colombo Stock Exchange

October 2020

Trading Snapshot

Sector	Banks
CSE Code	SDB.N0000
Bloomberg Ticker	SDB SL
Shares in Issue (Mn)	56
52W High (LKR)	65.80
52W Low (LKR)	43.80
Market Cap (LKR.Mn)	3,142
Market Cap (USD.Mn)	17
LKR:USD	185.5224
Market Price (LKR)	56.10

Case for Investment

Dominant player in SME segment: SDB managed to strengthen its position as a dominant player in the SME segment, uplifting SME customer base through new savings and wealth creation efforts right through the **COVID-19** pandemic affected period.

Rights issue proceeds will drive loan book growth: We expect SDB to expand its loan book through untapped “Sanasa” societies and new SME customers under the lower interest rate regime.

Net Interest Income: Declining interest rates add pressure on interest margins, and we expect 4% YoY decline in NII in FY2020; however the reduction of Statutory Reserve Ratio (SRR) would facilitate loan book growth.

Removal of Debt Repayment Levy (DRL) and NBT: Banks are no longer subject to 2% NBT w.e.f. 01 Dec 2019, and 7% DRL w.e.f. 01 Jan 2020. Compared to FY19 estimated tax saving is approximately LKR 128 Mn.

Lower Income Tax from 2020: Income Tax rate reduced from 28% to 24% w.e.f. 01st April 2020. This will improve the Net Profit.

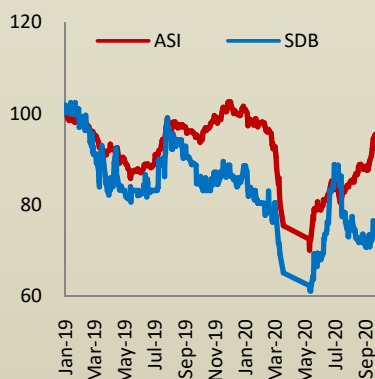
Adequately Capitalized to fund future growth: LKR 1.5bn rights issue proceeds would further strengthen the equity base and capital adequacy.

Digital Integration: Digital transformation will improve the efficiencies and user experience while witnessing a sustainable growth.

Investor Guide

YE 31st December	2017	2018	2019	2020F	2021F
NII (LKR.Mn)	3,887	4,723	5,697	5,458	5,268
+/- Growth	17%	21%	21%	-4%	-3%
Net Profit (LKR.Mn)	508	357	253	783	917
+/- Growth	26%	-30%	-29%	209%	17%
Adj. EPS (LKR)	9.87	6.34	4.50	12.76	10.56
PE (x)	10.32	11.83	14.20	4.40	5.31
NAV (LKR)	133.83	132.28	136.20	114.92	121.25
PBV (x)	0.76	0.57	0.47	0.49	0.46
Dividend/Share (LKR)	6.00	-	7.00	-	4.22
Dividend Yield (%)	5.89%	0.00%	-	0.00%	7.53%
ROE (%)	7.90%	4.83%	3.35%	8.88%	8.94%
Share Price (LKR)	101.90	75.00	63.90	56.10	56.10

Relative Stock Performance



SC Securities (Pvt) Ltd

5th Floor,
26B, Alwis Place, Colombo 3,
Sri Lanka.

Hotline +94 11 4711000

Fax +94 11 2394405

research@sampathsecurities.lk

<https://sampathsecurities.lk>

Brief Introduction to Sanasa Development Bank PLC

- SDB was formed to provide financial facilities to Sanasa Movement
- Bank was established on 1997 as a licensed specialized bank.
- SDB listed on CSE in 2012
- Leading MSME bank in Sri Lanka and awarded the “The fastest growing MSME bank in Sri Lanka” by the Global Banking and Financial Review.
- SDB acquired ‘Upay’ digital payment platform in 2019
- SDB launched its mobile banking facility called “SDB Mobile”
- Network comprises 94 branches with 1,475 employees
- Customer base includes retail, SME and Corporative Societies
- Fitch Ratings affirmed credit rating of BB+ (lka) ; Outlook stable

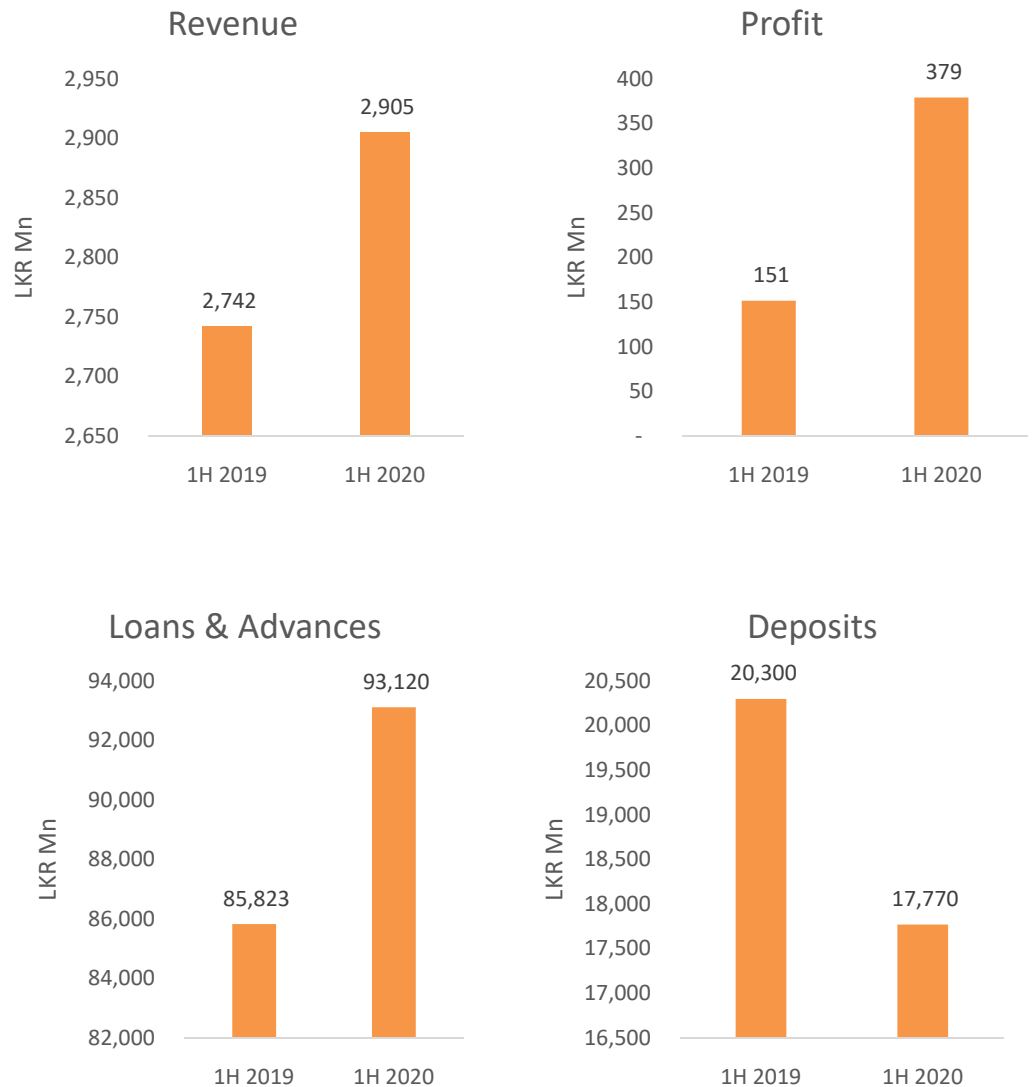
Recent Awards & Recognition

- National Business Excellence Award in Banking Sector (Merit Award) by the National Chamber of Commerce of Sri Lanka (NCCSL).
- Three outstanding awards at Asian Banking and Finance Awards 2019
 - Financial Inclusion Initiative of the Year
 - Advertising Campaign of the Year
 - Rural/Co-operative Bank of the Year
- UPay recognized at the SLASSCOM Innovation Awards 2019

SWOT Analysis

<p style="text-align: center;">STRENGTHS</p> <ul style="list-style-type: none">▪ Support by the Sanasa Movement▪ Access to active Sanasa Societies▪ Very Low NPLs▪ New rebranding	<p style="text-align: center;">WEAKNESSES</p> <ul style="list-style-type: none">▪ Highly depend on Sanasa Movement
<p style="text-align: center;">OPPORTUNITIES</p> <ul style="list-style-type: none">▪ Digitalization▪ Potential in the retail segment▪ Cheap foreign funding▪ Low interest rates	<p style="text-align: center;">THREATS</p> <ul style="list-style-type: none">▪ Slow economic growth due to COVID-19▪ Increase competition from the finance companies

1H2020 Financial Performance



During 1H2020 total interest income of the bank increased by 5% YoY to LKR 7.7 Bn while loans and advances of SDB grew by 9% YoY to LKR 93.1 Bn. Interest expenses during the same period increased by only 5% YoY to LKR 4.8 Bn, thus NII witnessed a 6% growth to reach LKR 2.9 Bn compared to LKR 2.7 Bn in 1HFY2019. Interest margin stood at 6.09% in 1H2020; relatively high compared to its peers.

1H2020 observed a rapid increase in fee and commission income by 47% YoY to LKR 141 Mn compared to LKR 96 Mn in 1H2019, thus operating profit witnessed a strong growth of 33% during this period.

Since banks are no longer liable to pay DRL (7%) and NBT (2%) during 2020, SDB made a significant saving; thus profit before tax increased by 88% to reach LKR 587Mn during 1HFY20.

Corporate tax rate for banks was reduced from 28% to 24% w.e.f 01st April 2020; hence Profit after tax in 1HFY20 amounted to LKR 379Mn compared to LKR 151 Mn in 1HFY2019.

Rights Issue

SDB has announced a rights issue in the proportion of 1 new share at LKR.50.00 for every 2 existing shares (30,525,344 new shares to be issued) to raise LKR 1.5 bn.

The main purpose of this rights issue is to:

- further strengthen the equity base of the bank and thereby improve the capital adequacy
- part finance the growth in the loan portfolio of the bank

Future Outlook

- Rights issue proceeds to strengthen the equity base and improve capital adequacy.
- SDB plans to utilize rights issue proceeds to grow its loan book. We expect the loan book to grow by 25% in FY2020 despite the impact of COVID -19.
- Digitalization coupled with mobile banking would improve the customer confidence.
- We expect SDB to post LKR 783 Mn in FY 2020 with strong loan book growth and introducing novel savings to MSME customer segment.
- High growth rate coupled with brand value enhancement would increase the customer base of SDB.
- Reduction in corporate income tax and the tax saving on DRL and NBT would improve the profit after tax of SDB and we expect to post strong growth in profit in FY2020.

Valuation



We have utilized the relative valuation method in order to derive the target price of SDB. According to the forecasted PE multiples of 6.04x SDB is valued at LKR 77.07. Based on the target PBV multiple of 0.55x, company is valued at LKR 63.32. Using the blended valuation approach by giving equal weight to both PE and PBV approach we derived price target of LKR 70.20, which is **25% upside** to the current market price of LKR 56.10. Considering the attractive price multiples, liquidity position and the upside potential we recommend investors to BUY shares of SDB.

Top 20 Shareholder List as at 30th June 2020

Name	No. of shares	%
Ayenka Holdings Private Limited	7,028,043	12.48%
Seylan Bank PLC /Senthilverl Holdings (Pvt) Ltd	6,952,168	12.35%
CB NY S/A International Finance Corporation	4,991,644	8.86%
Nederlandse Financierings-Maatschappij Voor Ontwikkelingslanden N.V.	4,627,714	8.22%
SBI Emerging Asia Financial Sector Fund PTE. LTD	2,660,426	4.72%
People's Leasing & Finance PLC	2,094,012	3.72%
Kegalle SANASA Shareholders Trust Company Limited	1,039,330	1.85%
SANASA General Insurance Company Ltd	1,036,669	1.84%
SANASA Life Insurance Company Ltd (LIFE)	910,708	1.62%
Sampath Bank PLC/ Dr. T.Senthilverl	871,885	1.55%
Sanasa Federation Limited	720,024	1.28%
Polgahawela Sanasa Societies Union Ltd	387,314	0.69%
Hambanthota DTCCS Union Ltd	384,257	0.68%
Dr. T.Senthilverl	373,598	0.66%
Mr. D.P. Pieris	257,067	0.46%
Kotikawatta Thrift and Credit Co-operative Society Limited	253,896	0.45%
Polgahawela SANASA Shareholders Trust Company Limited	240,836	0.43%
Sampath Bank PLC/ Mr. Arunasalam Sithampalam	224,333	0.40%
Dr. S. Yaddehige	205,653	0.37%
Mr. W.P.G.H.S. De Silva	193,000	0.34%
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	35,452,577	62.96%
Shares held by other shareholders	20,855,675	37.04%
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Total	56,308,252	100.00%

Summarized Financial Statements

Income Statement

LKR. Mn/ Year Ended 31 Dec	2017	2018	2019	2020 (F)	2021 (F)
Interest income	10,829	13,147	15,079	14,108	14,848
Interest expenses	(6,942)	(8,424)	(9,383)	(8,650)	(9,580)
Net interest income	3,887	4,723	5,697	5,458	5,268
Fee and commission income	279	197	238	259	283
Fee and commission expenses	(4)	(4)	(7)	(6)	(7)
Net fee and commission income	275	192	231	253	276
Net gains/(losses) from trading	-	-	1	-	-
Net fair value gains/(losses) of financial assets at fair value through profit or loss	212	280	115	172	259
Net other operating income	51	21	91	100	110
Total operating income	4,425	5,216	6,135	5,983	5,912
Impairment for loans and other losses	(294)	(526)	(917)	(816)	(544)
Net operating income	4,132	4,691	5,218	5,167	5,368
Personnel expenses	(1,474)	(1,827)	(2,116)	(2,107)	(2,323)
Depreciation and amortisation expenses	(192)	(224)	(431)	(302)	(361)
Other expenses	(1,364)	(1,526)	(1,420)	(1,341)	(1,372)
Operating profit before VAT, NBT& DRL	1,102	1,113	1,250	1,418	1,312
Value added tax (VAT) on financial services	(301)	(363)	(387)	(213)	(105)
Nation building tax (NBT) on financial services	(48)	(53)	(51)	-	-
Debt repayment levy (DRL)	-	(53)	(227)	-	-
Operating profit/(loss) after VAT, NBT & DRL	753	644	586	1,205	1,207
Profit before tax	753	644	586	1,205	1,207
Tax expenses	(245)	(287)	(332)	(422)	(290)
Profit for the year	508	357	253	783	917

Source: SDB Financials, SC Securities Research

Statement of Financial Position

LKR. Mn/ Year Ended 31 Dec	2017	2018	2019	2020 (F)	2021 (F)
Assets					
Cash and cash equivalents	1,190	4,172	2,430	1,659	2,890
Placements with banks	6,015	9,528	5,628	6,754	7,429
Financial assets fair value through profit or loss	4,474	146	3,527	4,233	4,656
Financial assets at amortised cost	-	-	-	-	-
– loans and receivables to other customers	66,687	77,507	85,823	107,557	118,211
– debt and other instruments	-	3,406	6,999	7,318	7,651
Other financial asset classified under loans and receivable	1,480	-	-	-	-
Financial assets measured at fair value through other comprehensive income	-	60	57	57	57
Financial investments – Available for sale	64	-	-	-	-
Financial investments – Held to maturity	600	-	-	-	-
Asset classified as held for sale	37	-	-	-	-
Property, plant and equipment	726	705	645	778	936
Right of use assets	-	-	651	651	651
Investment properties	23	22	21	21	21
Intangible assets	8	4	308	479	642
Deferred tax assets	-	69	232	232	232
Other assets	1,070	1,198	1,461	1,607	1,767
Total assets	82,375	96,818	107,784	131,346	145,144
Liabilities					
Due to other customers	59,905	67,475	72,432	91,386	102,519
Other borrowings	8,828	15,421	20,300	23,345	26,846
Debt securities issued	4,190	4,199	1,014	1,014	-
Subordinated term debts	1,004	1,008	4,211	4,211	4,211
Retirement benefit obligation	-	355	480	480	480
Current tax liabilities	32	144	187	187	187
Deferred tax liabilities	58	-	-	-	-
Other liabilities	1,027	768	1,492	746	373
Total liabilities	75,044	89,369	100,115	121,367	134,616
Equity					
Stated capital	5,759	5,922	5,922	7,448	7,448
Statutory reserve fund	198	216	228	273	325
Retained earnings	1,341	1,281	1,492	2,231	2,729
Other reserves	34	31	28	28	28
Total equity	7,331	7,449	7,669	9,979	10,529
Total equity and liabilities	82,375	96,818	107,784	131,346	145,144

Source: SDB Financials, SC Securities Research

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Strong Buy: FV more than 20% above Current Trading Price
Buy: FV between 10% and 20% above Current Trading Price
Hold: FV between -10% and 10% around Current Trading Price
Sell: FV more than 10% below Current Trading Price

CONTACT



Hotline +94 11 4711000

Fax +94 11 2394405

<https://sampathsecurities.lk>

Board Of Directors

Sunil Wijesinha

Chairman

Seedantha Kulatilake

Director

Ranjith Samaranayake

Director

Roshantha Fernando

CEO

Prasanth Lal de Alwis

Director

Trading Division

Roshantha Fernando

CEO

0777-736623

ceo@sampathsecurities.lk

Anuradha Chandramohan

Assistant General Manager Sales

0777-414660

anuradha@sampathsecurities.lk

Indika Jayaratna

Manager Sales

0777-369084

indika@sampathsecurities.lk

Nimal Liyanagamage

Assistant Manager Sales

0773-493868

nimal@sampathsecurities.lk

Muhammadhu Farook

Assistant Manager Sales

0772-253730

miflal@sampathsecurities.lk

Kumara Pooddwala

Assistant Manager Sales

0773-956769

kumara@sampathsecurities.lk

Prabath Jayarathna

Senior Investment Advisor

0773-047056

prabath@sampathsecurities.lk

Sajee Perera

Senior Investment Advisor

0778-088993

sajee@sampathsecurities.lk

Chamesh Harsha

Investment Advisor

0776-677606

harsha.c@sampathsecurities.lk

Channa De Silva

Investment Advisor

0773-370894

channa@sampathsecurities.lk

Agranath Umayanga

Investment Advisor

0770-181283

agranath@sampathsecurities.lk

Chalalochana Yapa (Kandy)

Senior Investment Advisor

0773-243374

chala.yapa1978@gmail.com

Research Division

Charitha Gunasekera

Head of Research

0775-253508

charitha@sampathsecurities.lk

Ruvini Kaushalya

Senior Research Analyst

0779-732377

ruvini@sampathsecurities.lk

Harin Sarathchandra

Technical Analyst

0774-694341

harin@sampathsecurities.lk