

Commercial Bank of Ceylon PLC [COMB.N: LKR 85.20, COMB.X: LKR 77.00]
COMB to sustain above average returns, stands at an attractive entry point for investors

Recommendation: BUY

Target Price: LKR 107.80/LKR 97.20

Sector: Banking

Incorporated in 1969, Commercial Bank (COMB) remains the 3rd largest commercial bank and the largest private commercial bank in Sri Lanka. COMB is also the largest listed Commercial Bank in the country, currently stands as the 8th largest market capitalization on the CSE while also remaining a premier blue-chip stock with a ~20% foreign exposure. With a branch network of 268 in Sri Lanka and 19 branches in Bangladesh, COMB is crowned as the only domestic bank which has successfully penetrated to overseas markets. COMB commands a market share of ~12% in gross loans and 13% in deposit market share in the LCB space and is the first private commercial bank to cross the LKR1Tn mark in assets.

COMB's ability to sustain above average returns consistently with best-in-class efficiency is expected to continue specially on the back of strong performance by its overseas ventures. The solid affirmation received by IFC through its investment via both debt and equity is a testament of the confidence placed on the bank and is also a confidence booster for the foreign investors. Sri Lanka's likely bailout by IMF to tame the inflation and weaker currency will help regain the macroeconomic stability and debt sustainability of the country, paving the way for investors to relook at value stocks like COMB.

Performance Consistency to Continue: Sri Lanka's largest private commercial bank, COMB has been one of the only banks to consistently outperform the average industry profitability over the past few years. COMB's effective and prudent portfolio management strategy and successful ventures in overseas specially in Bangladesh helped achieved these milestones.

COMB's Bangladesh operations where Commercial Bank of Ceylon PLC (CBC) commenced by acquiring the banking business of Crédit Agricole Indosuez in 2003, became the first private sector bank to establish a branch operation outside the country. Bangladesh operations currently has 11 Branches, 6 SME Centers and 2 Offshore Banking Units, contributing to ~12% of group assets and 20.4% of profits in 2020. Since then, COMB established three subsidiaries in Italy (serves the fund-transfer needs of Sri Lankan expatriates in Italy), the Maldives (fully-fledged Tier 1 bank under the license issued by the Maldives Monetary Authority offering an extensive range of financial services) and Myanmar (offering microfinancing services.) where overseas operations cumulatively contributing to a substantial 11.79% of consolidated assets and 20.46% of consolidated profit before taxes.

Due to efficient operations in domestic front (specially prudent and effective portfolio management in the SME and retail segment) and effective operations in Bangladesh (BGD cost to income ratio is as low as 25%, NIMS -4%, NPL-1.04%, ROE -13.3% in 2020) COMB had consistently been able to record (i) lower Cost to Income Ratio (CIR) (ii) higher Current Account Savings Account (CASA) ratios (iii) higher capital adequacy ratios and (iv) higher returns which we believe to continue given that there is no other listed bank operating in such a diversified space.

COMB has consistently outperformed the industry over the years

	COMB			Industry		
	2018	2019	2020	2018	2019	2020
NIMS	3.7%	3.5%	3.2%	3.7%	3.5%	3.1%
CASA	38.0%	37.6%	42.9%	33.1%	32.8%	36.3%
Cost to Income Ratio	36.8%	38.6%	34.2%	45.1%	46.2%	43.8%
ROE	15.6%	13.6%	11.5%	13.8%	10.6%	10.9%
ROA	1.4%	1.3%	1.1%	1.2%	1.0%	1.1%
Loan loss coverage	104.3%	79.9%	105.9%	45.7%	54.1%	65.2%
Tier 01	11.3%	12.3%	13.2%	11.9%	13.0%	13.1%
Total capital adequacy ratio	15.6%	16.1%	16.8%	15.0%	16.6%	16.7%
Liquid Asset Ratio	24.5%	30.4%	45.0%	25.0%	27.8%	33.8%

Source: CBSL & Company Reports

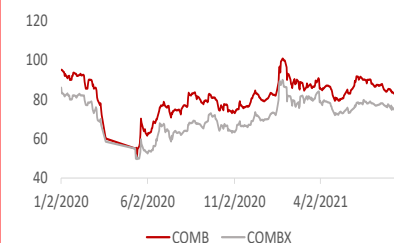
Key Statistics

Market Cap (LKR Bn) - Voting	95.9
Market Cap (LKR Bn) - Non Voting	5.4
Market Cap (USD Mn) - Voting	481.9
Market Cap (USD Mn) - Non Voting	27.2
Issued Quantity (Mn) - Voting	1124.5
Issued Quantity (Mn) - Non Voting	69.7
Current Trading Range - Voting	85.00-86.00
Current Trading Range - Non Voting	77.00-79.30
52 week High/Low - Voting	73.00/100.75
52 week High/Low - Non Voting	63.10/89.90
YTD High/Low - Voting	79.30/100.75
YTD High/Low - Non Voting	72.00/89.90
Valuation	
Market PE (x)	10.5
Market PBV (x)	1.2
PE (x) - Voting	4.7
PE (x) - Non Voting	4.2
PBV (x) - Voting	0.6
PBV (x) - Non Voting	0.5
Bloomberg Ticker	COMB SL
GICS Industry Group	Banks

Main shareholders as at 30.06.2021

	%
DFCC Bank PLC A/C 1	12.02
Mr.Y. S. H. I. Silva	9.88
Employees' Provident Fund	8.62
CB NY S/A International Finance Corporation	7.11
Sri Lanka Insurance Corporation Ltd - Life Fund	5.55

Share Price Performance



Analyst: Anjula Nawarathna

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COMB has performed well above industry peers in many key indicators too

As at 2H'21

	Details (USD 'Mns)				Other Key Indicators									
	Total Operating Inome	Total Assets	Net Loans	Deposit base	YTD		NIMS	CASA	NPA	Tier 01	Total cap			
					loan growth	deposit growth					adequacy	Coverage	Branches	ROE
COMB	228.3	9,530.7	4,787.7	6,921.4	7.5%	9.2%	3.3%	45.5%	5.0%	13.5%	16.9%	121%	287	14.9%
HNB	199.0	6,978.8	4,035.9	5,204.2	2.9%	6.2%	3.8%	38.6%	4.3%	15.3%	18.4%	141%	253	11.9%
SAMP	150.0	5,967.7	3,859.9	4,730.9	4.6%	6.4%	3.5%	42.4%	5.8%	12.5%	15.8%	98%	229	12.7%
NDB	79.8	3,295.0	2,297.2	2,535.3	9.7%	5.1%	3.2%	26.3%	5.6%	10.4%	14.7%	75%	113	14.8%
SEYB	72.7	2,835.9	2,027.8	2,241.9	5.2%	3.4%	3.9%	34.1%	6.5%	10.3%	13.8%	68%	171	8.2%
NTB	55.3	1,780.1	1,164.0	1,231.3	12.2%	3.9%	3.6%	37.0%	5.7%	13.1%	16.1%	71%	96	18.1%
PABC	26.9	923.2	639.1	723.6	5.6%	4.1%	4.7%	26.1%	6.6%	12.6%	15.0%	92%	85	16.4%
UBC	17.4	627.4	377.8	441.8	4.3%	3.0%	3.9%	26.9%	5.8%	15.6%	15.9%	75%	67	5.4%
DFCC	46.6	2,425.8	1,634.9	1,604.6	10.0%	5.2%	2.4%	34.6%	5.5%	9.9%	14.2%	89%	139	8.2%

Note: COMB- Commercial Bank, HNB- Hattton National Bank, SAMP- Sampath Bank, NDB- National Development Bank, SEYB- Seylan Bank, NTB- Nation Trust Bank, PABC- Pan Asia Bank, UBC- Union Bank, DFCC- DFCC bank

Source: Company Reports

Interest by IFC, an added boost to foreign investors: COMB received a strong affirmation with the completion of a private placement of shares with the IFC (International Finance Corporation, a long-standing partner of bank which has supported COMB through multiple investments and advisory) amounting to USD 50Mn. (LKR 9.216 Bn.) in 2020. The investment was the first foreign equity placement of shares by the Bank and also the first post-pandemic equity placement by one of the largest foreign investments into Sri Lanka since the start of the pandemic, which is clear indication of the trust and confidence placed by an institution such as IFC on COMB.

With this commitment, IFC and related parties now holds 14.45% of COMB and together accounts to nearly 20% of foreign ownership, one of the highest of this magnitude in Colombo Stock Exchange. The transaction helped bank to increase its tier 01 capital ratio to 13.2% from 12% levels to meet the new Basel III requirement quite comfortably (IFRS 9 was replaced the Incurred Credit Loss (ICL) model of IAS 39 wef 1 Jan 2018, with a forward-looking Expected Credit Loss (ECL) model) while IFC also helped to boost the total capital adequacy ratio of the Bank by committing another LKR 10Bn funded via a loan of USD 50 Mn.

Likely IMF bail out to add multiple benefits to the banking sector. Macro stability & confidence to draw much awaited investor interest, COMB to be amongst the key beneficiaries: Sri Lanka has already showed some early indication of a possible IMF programme after becoming the first in Asia to raise interest rates since the pandemic began, in order to tame the inflationary pressure and to support the weaker LKR. We believe this could be one of the key adjustments by IMF, as Sri Lanka has been under severe pressure in recently with LKR depreciating to nearly LKR 220 per USD in the formal market, despite CBSL keeping its official exchange rate within LKR 198.00–202.00 levels (>8% YTD).

Sri Lanka started losing the grip on both the exchange rate and interest rates amidst market tensions, decided to increase its Standing Deposit Facility Rate (SDFR) and the Standing Lending Facility Rate (SLFR) by 50bps each, to 5% and 6%, respectively last week while also increasing the Statutory Reserve Ratio (SRR) applicable on all rupee deposit liabilities of licensed commercial banks by 200bps to 4% after a lapse of 18 months. This could help ease external payments imbalances (Sri Lanka's reserves fell to USD2.8Bn Bn by July'21 covering 1.8 months of imports after settling all due external liabilities on time) of the country and mitigate any excessive inflationary pressures over the medium term. Banking sector would benefit from this move with assets getting repriced faster than liabilities, improving NIMS and COMB particularly been benefited from monetary tightening of both Sri Lanka and Bangladesh.

IMF setup would also manage to restore the much-awaited macroeconomic stability and debt sustainability of the country while also strengthening the post COVID-19 recovery in our view. This could be a great platform for foreigners to invest back in Sri Lankan equity markets (during the IMF set up in 2016 foreign holding stood at >26% in CSE, however tumbled to ~24% with constitutional coup in 2018 and now stands at 22%) and especially in counters like COMB where it already commands a high foreign participation (19% cf HNB- 11%, SAMP-4% NDB, 14%, DFCC -6%).

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Moreover, a likely IMF program would also recommence the import activities in our view after Sri Lanka halting the importation of non essential items at the onset of the pandemic to mitigate the external pressure. This would manage to revive the trade book which was hampered (COMB however managed to grow its trade book due to its scale) during last year and address the NPL issue due to stability and likely revival in economic activities.

Average PBV multiple indicates BUY: On the basis of COMB's (i) consistency in delivering above average performance (industry best CIR, CASA, profit Margins and above average NIMs, ROE), (ii) Potential increases in NII amid higher NIMs and fee income, (iii) long term prospects from its regional presence and (iv) market leadership among the local private banks, we forecast COMB's bottom-line reaching LKR 22.1Bn by FY2021E, resulting in an EPS of LKR 18.60. Beyond FY2021E, we estimate a forward EPS of LKR 22.30, a 20%YoY rise in profits to LKR 26.6Bn. Due to the above, COMB had been consistently trading at a higher multiple relative to its peers. At peak valuations, COMB traded at a PBV of 2.7x (FY2010) and, although multiples have declined since then, COMB's PBV has still ranged between 1.0x-1.7x in 2015-2018. However due to constitutional coup that took place in 2018 followed by Easter attacks in April 2019 and Covid impact thereafter, caused a free fall in prices of the banking sector counters despite banks recording commendable performance.

COMB has consistently traded at a higher multiple relative to its peers

	PBV (X)							PE (x)							
	2015	2016	2017	2018	2019	2020	Current	2015	2016	2017	2018	2019	2020	Current	
COMB	1.7	1.6	1.3	1.0	0.7	0.6	0.6	COMB	10.4	8.9	7.9	6.6	5.7	5.2	4.7
HNB	1.1	1.0	1.0	0.8	0.6	0.4	0.4	HNB	8.1	6.3	7.0	6.0	5.9	4.9	4.0
SAMP	1.1	0.9	0.8	0.7	0.6	0.5	0.5	SAMP	6.6	4.9	4.9	5.0	5.3	6.1	4.8
NDB	1.1	0.9	0.7	0.6	0.5	0.4	0.4	NDB	9.0	9.6	6.7	4.1	4.9	3.6	4.0
NTB	1.3	1.1	0.8	0.8	0.6	0.4	0.4	NTB	7.6	6.5	5.7	6.8	6.1	4.2	2.8
SEYB	1.2	1.1	0.9	0.8	0.6	0.5	0.5	SEYB	8.5	7.7	6.4	9.1	5.8	7.8	6.9
DFCC	1.0	0.7	0.7	0.5	0.6	0.4	0.3	DFCC	18.4	9.5	7.5	8.2	12.1	7.3	5.8

Based on our earnings growth and on a more stable economic environment, we believe COMB should trade least at an implied PBV of 0.71x. We expect COMB to trade at LKR 107.80, an upside of 26% by FY2021E. We believe COMB (X) should trade at LKR 97.20 on average, representing a 26% upside to the current trading price of LKR 77.00. We thus recommend a BUY.

Earnings Forecast

YE Dec	2017	2018	2019	2020	2021E	2022E
Net Profit (LKR mn)	16,606	17,735	17,263	16,940	22,169	26,629
YoY Growth (%)	14.4%	6.8%	-2.7%	-1.9%	30.9%	20.1%
EPS (LKR)	13.9	14.9	14.5	14.2	18.6	22.3
YoY Growth (%)	14.4%	6.8%	-2.7%	-1.9%	30.9%	20.1%
DPS (LKR)	6.5	6.5	6.5	6.5	0.0	6.5
BVPS (LKR)	90.4	100.0	112.6	133.3	151.9	167.7
Dividend Payout	37.6%	37.6%	38.7%	41.4%	0.0%	29.0%
ROE (%)	17.8%	15.6%	13.6%	11.5%	13.0%	0.0%
Voting - PER (x)	6.1	5.8	5.9	6.0	4.6	3.8
Voting- PBV (x)	0.9	0.9	0.76	0.64	0.6	0.5
Div Yield (%)	7.6%	7.6%	7.6%	7.6%	0.0%	7.6%
Non Voting - PER (x)	5.5	5.2	5.3	5.4	4.1	3.5
Non Voting - PBV (x)	0.9	0.8	0.7	0.6	0.5	0.5
Div Yield (%)	7.6%	7.6%	7.6%	7.6%	0.0%	7.6%

Source: Company Annual Reports & NLE Research

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