

## **Sri Lanka to announce domestic debt restructuring plan**

## Sri Lanka to announce Domestic Debt Restructuring plan

- Sri Lanka is to announce the domestic debt restructuring plan this week , a critical step towards striking a deal with the domestic creditors. The country also must meet targets set by the IMF where debt restructuring process should be completed by the first review planned in September. We also believe that its important that Sri Lanka find the right balance between the foreign bond holders, domestic creditors and bilateral creditors in order to achieve country's ambitious debt targets and maintain sustainability.*
- Sri Lanka has a total of USD 81.8Bn worth of public debt by 2022, of which USD 45.5Bn (55%) is denominated in foreign currency debt. Of USD 45.5Bn, only USD 30.9Bn is up for restructuring which includes private creditors worth of USD 20Bn and bilateral creditors and export credit agency backlogs of USD 10.6Bn. Out of the total debt of USD 81.8Bn, the remaining USD 36.3Bn accounts for local currency debt (44.5% of total loans), of which only USD 7.1Bn held in T bills under CBSL is proposed for restructuring. Therefore, when domestic and foreign currency debts put together, total debt that is proposed for restructuring accounts to USD 38.0Bn, 46% of the total public debt.*
- Meanwhile, of the USD 36.3Bn local debt, USD 24Bn worth of t-bonds held by domestic investors are proposed for a voluntary domestic debt optimization process. Of this, USD 10.7Bn ( 44.5%) belongs to deposit taking institutions while USD 10.2Bn ( 42.7% ) belongs to superannuation funds, where we believe would have found just few takers for voluntary debt optimization proposed earlier in March'23. We hence think the proposed DDR plan that is likely to be announced this week could possibly look at more of a maturity extension rather than any significant haircuts.*
- President as well as the Governor have repeatedly assured the financial system stability despite DDR, where President also assured that any restructuring would not affect the stability of any private or public bank or member balance of any provident fund including EPF.*
- When analyzing the listed commercial banks, Commercial Bank ( 23% of total assets) , Sampath Bank ( 16% of total assets) followed by Nations Trust Bank ( 14%) and Seylan Bank ( 13% of total assets) have highest exposures for T bonds while HNB's exposure stands at 3%.*
- The plan is expected to be debated in the parliament during the weekend (1<sup>st</sup> and 2<sup>nd</sup> July) after been presented to the cabinet on June 28<sup>th</sup>.*

Total public debt amounts to USD 81.8Bn, of which 46% ( USD 38Bn) considered for restructuring. T bonds held by local investors were considered for debt optimization before.

## Total foreign debt stock

	USD Bn
<b>Foreign currency creditors</b>	<b>45.5</b>
<b>Debt proposed for treatment</b>	<b>30.9</b>
Bilateral official loans & ECA backed loans	10.6
Private creditors ( ISB's, SLDB's etc.)	20.3
<b>Debt excluded from treatment</b>	<b>14.6</b>
Multilateral Creditors	11.5
Emergency assistance Credit lines	0.8
Bilateral SWAP Lines	2.0
CPC and CEB Fx Payables	0.3

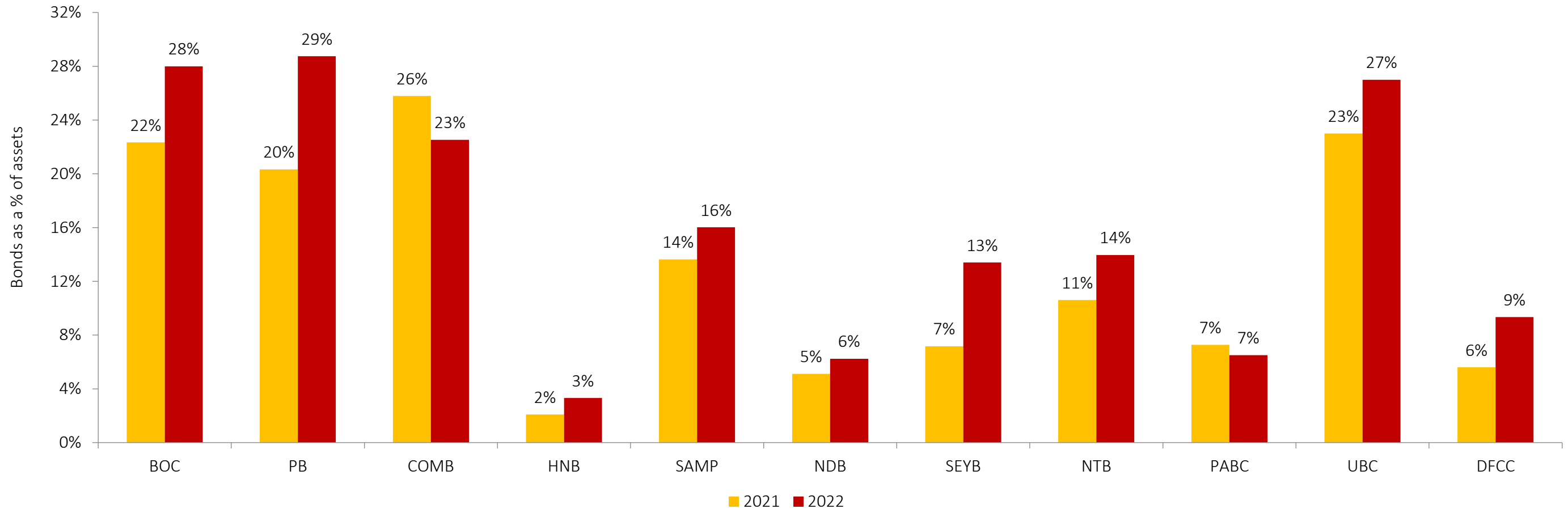
## Total local debt stock

	USD Bn
<b>Local currency creditors</b>	<b>36.3</b>
<b>T-bills</b>	<b>11.4</b>
Owned by CBSL – proposed for restructuring	7.1
Deposit taking Institutions <sup>1</sup>	2.1
Non deposit taking Institutions <sup>2</sup>	2.0
<b>T– bonds ( proposed for debt optimization)</b>	<b>24.0</b>
Superannuation funds	10.2
Deposit taking institution	10.7
Other Non deposit taking financial institutions	2.2
Other <sup>3</sup>	0.8
<b>Other Loans</b>	<b>0.3</b>
<b>CBSL Advances</b>	<b>0.6</b>

Source: MOF/CBSL

Note 01-Including Licensed Commercial Banks, Licensed Specialized Banks and Registered Finance Companies, Note 02-Notes: (1) Including Licensed Commercial Banks, Licensed Specialized Banks and Registered Finance Companies, Note 02- Including superannuation funds (if not specified elsewhere), corporations, insurance companies,, government institutions, funds and SOEs, local individuals and others. Note 03-Including Treasury securities used for repurchase transaction allocations

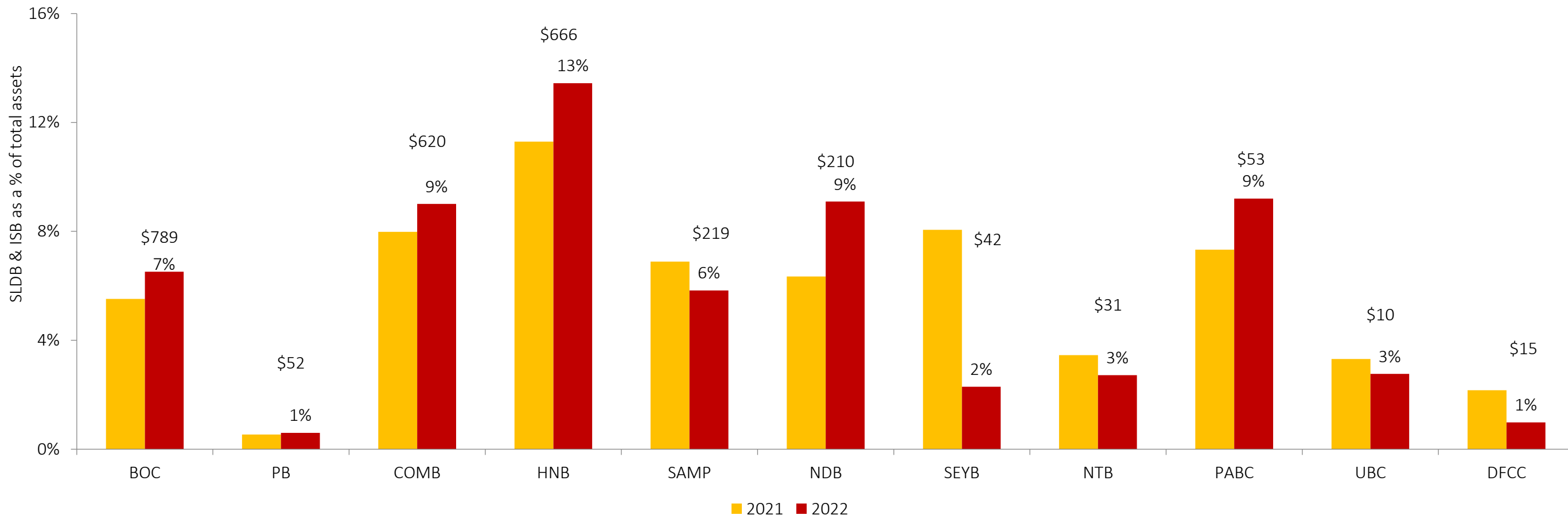
Of the listed counters, COMB holds the highest percentage of T-bonds on their total assets followed by SAMP, NTB and SEYB. HNB's exposure however is minimal.



*BOC- Bank of Ceylon, PB- People's Bank, COMB- Commercial Bank, HNB- Hatton National Bank, SAMP- Sampath Bank, NDB- National Development Bank, SEYB- Seylan Bank, NTB- Nations Trust Bank, PABC- Pan Asia Bank, UBC- Union Bank, DFCC- DFCC Bank,*

*Sources: Company annual reports*

Of the ISB and SLDB exposures, HNB, COMB and NDB accounts the highest exposure on total assets. Significant provisions (~40%) however have been made to cover the impending haircut. There could be substantial reversals if private commercial creditors negotiates a lower haircut than what is been already provided.



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Exchange rate taken as at 30.12.2022 @ LKR 363.00, USD figures are in millions  
Sources: Company annual reports

Of the listed space, SAMP, NTB, SEYB and DFCC have comparatively lower concentration of SLDB and SLISB's. The banks were able to significantly reduce provisions made against SLDBs by exercising the option to convert maturing SLDBs into LKR denominated bonds/bills. However, there could be substantial reversals once again for the SLDB's maturing in 2023E, if CBSL starts issuing bonds to convert the maturing SLDB's ( Issuance of T bonds were suspended from Jan '23 due to negotiations)

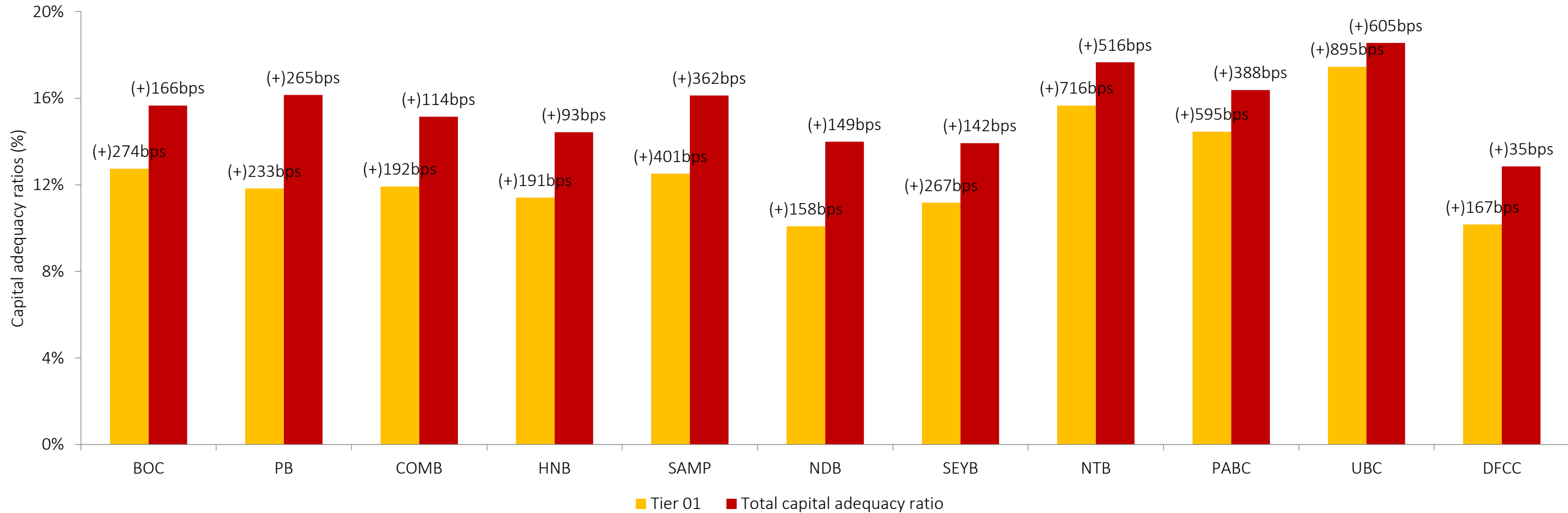
Counter	SLDB (LKR Mns)		ISB (LKR Mns)		SLDB (USD Mns)		ISB (USD Mns)		SLDB & ISB as a % of total assets		T-bonds as a % of assets	
	2021	2022	2021	2022	2021	2022	2021	2022	2021	2022	2021	2022
BOC	162,627	193,631	49,623	92,610	813.1	533.4	248.1	255.1	5.5%	6.5%	22.3%	28.2%
PB	-	-	15,184	18,810	-	-	75.9	51.8	0.5%	0.6%	20.3%	28.7%
COMB	61,573	28,335	96,736	196,889	307.9	78.1	483.7	542.4	8.0%	9.0%	25.8%	22.5%
HNB	51,547	32,110	112,666	209,641	257.7	88.5	563.3	577.5	11.3%	13.4%	2.1%	3.3%
SAMP	66,073	43,849	19,493	35,818	330.4	120.8	97.5	98.7	6.9%	5.8%	13.6%	16.0%
NDB	18,356	22,207	26,576	54,105	91.8	61.2	132.9	149.1	6.3%	9.1%	5.1%	6.2%
SEYB	7,756	2,584	7,855	12,842	205.5	7.1	39.3	35.4	8.1%	2.3%	12.7%	13.4%
NTB	8,524	1,882	4,579	9,405	42.6	5.2	22.9	25.9	3.5%	2.7%	10.6%	14.0%
PABC	5,559	5,602	8,330	13,547	27.8	15.4	41.6	37.3	7.3%	9.2%	7.3%	6.5%
UBC	4,110	3,776	-	-	20.5	10.4	-	-	3.3%	2.8%	23.0%	27.0%
DFCC	4,903	371	5,647	5,216	24.5	1.0	28.2	14.4	2.2%	1.0%	5.6%	9.3%

BOC- Bank of Ceylon, PB- People's Bank, COMB- Commercial Bank, HNB-Hatton National Bank, SAMP- Sampath Bank, NDB- National Development Bank, SEYB- Seylan Bank, NTB- Nations Trust Bank, PABC- Pan Asia Bank, UBC- Union Bank, DFCC- DFCC Bank,

Note : Exchange rate taken as at 31.03.2021 @ LKR 200.00 & 30.12.2022 @ LKR 363.00,

Sources: Company annual reports

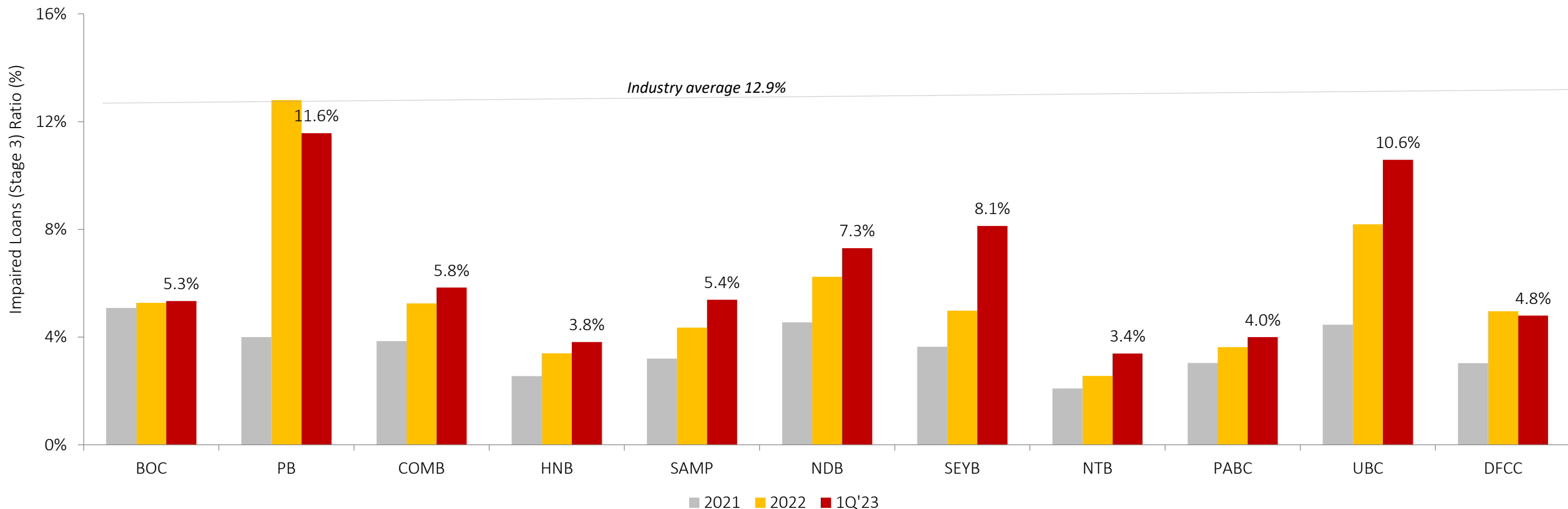
Of the bigger banks, SAMP has the highest tier 01 capital buffer (+400bps) compared to its minimum requirement, implying its high capacity to absorb additional losses even at an event of a DDR/DDO.



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Sources: Company annual reports,

Of the bigger listed banks, HNB accounts to the lowest impaired loans (when the borrower becomes 90 days past due on its contractual payments) followed by NTB, DFCC and SAMP. Pace in which impaired loans increased should now slow down with the pickup in economic activities. The trend should reverse possibly from 3Q'23 specially with rates falling post DDR and CBSL's dovish monetary policy stance which is now more focused towards stimulating economic activities.

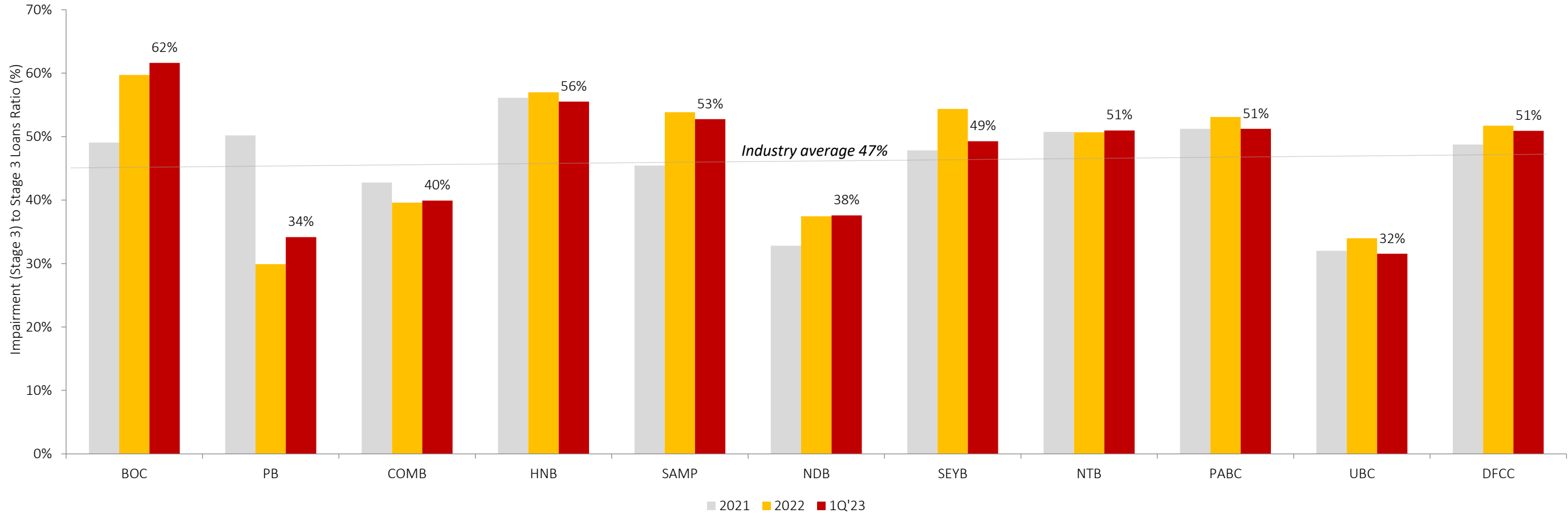


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*Sources: Company annual reports, CBSL  
Industry data as at 31.03.2023*



Of the listed counters HNB and SAMP commands the highest provision coverage on stage 3 loans, which will not only help neutralize the risks of the banks but will also reflect positively in an event of a recovery/reversal.



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Sources: Company annual reports, CBSL  
Industry data as at 31.03.2023

## Key indicators of banking sector counters for 2022

	NIMS	Fee Income as a % of Total Banking Income	Cost to income	CASA	ROE	10Yr loan growth	10 Yr deposit growth	Tie 01	Impaired loans	Impairment (Stage 3) to Stage 3 Loans Ratio (%)	SLDB & ISB as a % of total assets	T-bonds as a % of total assets
BOC	3.2%	9%	28%	29%	13.2%	13.6%	17.0%	11.3%	5.3%	60%	6.5%	28%
PB	3.1%	13%	45%	30%	11.5%	10.8%	13.2%	11.9%	12.8%	30%	0.6%	29%
COMB	3.8%	15%	27%	39%	12.7%	13.7%	17.6%	11.4%	5.3%	40%	9.0%	23%
HNB	6.9%	10%	31%	30%	8.5%	13.6%	15.5%	11.4%	3.4%	57%	13.4%	3%
SAMP	5.8%	18%	26%	32%	10.7%	15.7%	16.5%	12.2%	4.4%	54%	5.8%	16%
NDB	4.0%	17%	28%	21%	4.6%	17.2%	20.1%	9.3%	6.2%	37%	9.1%	6%
SEYB	6.4%	13%	30%	30%	8.3%	13.9%	14.1%	10.7%	5.0%	54%	2.3%	13%
NTB	7.4%	17%	30%	32%	16.8%	13.1%	13.2%	14.2%	2.6%	51%	2.7%	14%
PABC	4.8%	20%	54%	19%	10.2%	13.1%	13.0%	14.1%	3.6%	53%	9.2%	7%
UBC	5.2%	14%	55%	22%	2.4%	14.1%	15.2%	17.2%	8.2%	34%	2.8%	27%
DFCC	4.9%	9%	33%	18%	5.6%	14.5%	19.4%	10.1%	5.0%	52%	1.0%	9%
Industry LCB	4.1%	NA	29%	33%	11.0%	14.0%	16.0%	13.0%	10.9%	45%	NA	NA

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Sources: Company annual reports, CBSL. Note: Cells highlighted in green are the counters which have overperformed the industry in their specific KPI's  
Industry data and company data is as at 31.12.2022

### Medium term prospects looks promising despite short term setbacks

- Dynamics of the banking sector changed since of 2017, from the introduction of Basel III, implementation of Debt repayment levy, rising NPL caused by weak economic conditions, Easter attacks in 2019, pandemic, economic crisis, higher taxes followed by recent suspension of external debt payments causing higher provisions, thus resulting in steep losses in market prices.
- Counters in banking sector which traded above 1.2x of book value during 2015-2017, now is heavily undervalued, trading at less than half of the book, placing as the lowest valuations compared to frontier and emerging markets.
- Banking sector although may see some temporary setbacks due to the current restructuring process, we believe should reverse its course specially with recovery in economic activities that should come about by 2H'23. Gradual recovery in economic activities should improve the asset quality while gradual fall in rates should push the loan books back on track, making way for a significant rerating of the banking sector.

Banking sector valuations looks extremely attractive. Market prices of most banks trades than half of their NAVPS giving ample space to rerate the valuations of the industry.

Counter	Ticker	MPS (LKR)	No. of Shares (Mn)	Market Cap (LKR Mn)	DPS (4 Qr)	DY%	PE TTM(x)	PBV(x)	BVPS (LKR)	ROE(%)
<b>Banking Sector</b>				<b>333,706.3</b>			<b>4.7</b>	<b>0.4</b>		<b>8.4</b>
Commercial Bank	COMB-N-0000	67.7	1,236	83,672.0	4.5	6.6	5.4	0.4	156.2	8.0
Sampath Bank	SAMP-N-0000	55.2	1,173	64,733.1	4.6	8.3	5.3	0.5	114.8	9.1
Hatton National Bank	HNB -N-0000	137.75	447	61,526.3	5.0	3.6	4.4	0.4	341.1	9.3
National Development Bank	NDB -N-0000	49.4	399	19,733.5	5.5	11.1	5.9	0.3	173.6	4.8
Nations Trust Bank	NTB -N-0000	69.5	276	19,199.2	4.0	5.8	2.6	0.5	153.7	17.2
DFCC Bank	DFCC-N-0000	44.9	422	18,945.5	2.0	4.5	4.2	0.3	144.1	7.3
Union Bank	UBC -N-0000	9.7	1,084	10,510.5	0.0	na	28.5	0.6	17.5	2.0
Seylan Bank	SEYB-N-0000	34.2	297	10,147.7	2.0	5.8	4.5	0.4	93.3	8.1
Amana Bank	ABL -N-0000	2.5	2,784	6,959.9	5.3	212.0	9.2	0.5	5.2	5.2
Pan Asia Bank	PABC-N-0000	13	443	5,753.3	0.0	na	2.7	0.3	47.3	10.1
Sanasa Development Bank	SDB -N-0000	29.9	161	4,804.9	0.0	na	na	0.4	85.3	na
HDFC	HDFC-N-0000	26.3	65	1,701.9	0.0	na	11.1	0.3	102.7	2.3

Sources: Company annual reports  
Prices as at 27.06.2023

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