

# COMMERCIAL BANK OF CEYLON PLC | COMB.N | COMB.X BANKS (GICS) | SRI LANKA | CSE “Unlocking value”

Report date: 16.01.2024

Commercial Bank of Ceylon PLC (COMB) is one of the leading private Licensed Commercial Banks (LCBs) in Sri Lanka which has the largest asset base among the listed private LCBs. We initiate coverage at a time when the share is trading at an attractive discount to its fair value, providing an upside of 38.88% (COMB.N) and 41.03% (COMB.X). **BUY**

**Loan book growth is expected to pick up while loan quality is expected to improve:** Anticipated rebound in private sector credit and economic recovery suggests a double-digit loan book growth for COMB between 2024-2026. The bank's diverse loan portfolio, especially with 32% in foreign currency, aligns with the potential surge in private credit. Foreseen improvements in loan quality, with impaired loan ratios projected to drop to 4%-5% by 2026 from the current 6.11%, further strengthen the bank's position. COMB's lending predominantly centers on term loans, particularly in sectors like retail, wholesale trade, and manufacturing. Anticipated economic recovery is likely to fuel lending in these segments, providing potential growth opportunities. The declining interest rates, supported by Central Bank measures, have narrowed interest rate spreads. Despite an expected stabilization in rates by mid-2024, a slight uptick later in the year is plausible. This trend could impact lending and borrowing dynamics.

**Higher CASA ratios and capital adequacy to provide cushion:** COMB boasts industry-leading CASA ratios, providing cost-efficient funds and sufficient liquidity for loan portfolio expansion. With a manageable cost-to-income ratio and technology investments, the bank sustains operational efficiency. Strong capital ratios and liquidity coverage further fortify its ability to grow and fund its operations. Despite declining interest rate spreads, high CASA ratios are expected to maintain stable Net Interest Margins around 3.0%. Adequate Tier I and Tier II capital ratios, along with robust liquidity coverage and stable funding ratios, position the bank favorably in the face of regulatory requirements.

**Valuation upside:** The estimated fair values for COMB.N and COMB.X stand at LKR 126.38 and LKR 107.61, respectively. These valuations suggest a potential upside of 38.88% and 41.03% based on current market prices, signaling an attractive investment proposition for investors. Historical data from 2018 to 2023 reveals an average discount of approximately 14.85% for COMB.X against COMB.N. COMB.N has consistently traded below its book value since 2019. A blended strategy combines absolute and relative valuation methodologies to gauge both fundamental value and market sentiment.

Refer to page 14 for an important disclaimer.  
Abbreviations are explained on page 13.

## BUY

### COMB.N

Current price LKR 91.00  
Fair value LKR 126.38 (+38.88%)

### COMB.X

Current price LKR 76.30  
Fair value LKR 107.61 (+41.03%)

Key data	COMB.N	COMB.X
<b>Historical returns</b>		
1-year capital gain	79.84%	90.27%
1-year dividend yield	7.56%	9.54%
1-year total return	87.40%	99.81%
Beta	0.78	0.78
1-year high	105.00	88.80
1-year low	50.20	40.10
<b>Valuation multiples</b>		
PE ratio	5.21x	4.36x
PB ratio	0.56x	0.47x
<b>Per share data</b>		
EPS (TTM) (LKR)	17.48	17.48
NAVPS (Sep23) (LKR)	162.70	162.70
DPS (2023)	3.82	3.82
<b>Shareholding details</b>		
No of shares (Mn)-voting	1,237	
No of shares (Mn)-non voting	78	
Total no of shares (Mn)	1,314	
MCAP (Mn)-voting	113,884	
MCAP (Mn)-non voting	6,161	
Public holding-voting	99.81%	
Public holding-non voting	99.88%	
<b>Top 5 shareholders - COMB.N</b>		
DFCC Bank PLC A/C 1	12.11%	
Mr.Y. S. H. I. Silva	9.89%	
Employees' Provident Fund	8.61%	
Mr. D. P. Pieris	7.71%	
Int. Finance Corporation	7.11%	
<b>Top 5 shareholders - COMB.X</b>		
Employees' Trust Fund Board	7.78%	
Akbar Brothers (Pvt) Ltd.	4.85%	
GF Capital Global Limited	2.59%	
Mr. M. F. Hashim	1.80%	
M. J. F. Exports (Pvt) Ltd	1.71%	

Key financials (LKR Mn)	2020	2021	2022	2023F	2024F	2025F
Gross income	151,966	163,675	280,387	348,709	362,865	412,721
Net interest income	50,869	66,416	84,665	83,162	63,119	71,691
Profit for the year	17,087	24,290	24,399	20,622	26,844	28,593
Loans and advances	910,609	1,029,584	1,155,493	1,214,949	1,426,353	1,651,208
Total assets	1,762,496	1,983,491	2,499,554	2,662,322	2,953,070	3,368,903
EPS (LKR)	15.70	19.41	19.21	15.06	19.61	20.89
NAVPS (LKR)	136.42	140.24	168.47	174.69	193.31	211.23
Net margin	11.24%	14.84%	8.70%	5.91%	7.40%	6.93%
ROE	10.62%	14.33%	11.46%	8.79%	10.32%	10.04%
ROA	0.97%	1.22%	0.98%	0.77%	0.91%	0.85%

COMB.N - Price and Volume



COMB.X - Price and Volume



Source: CSE

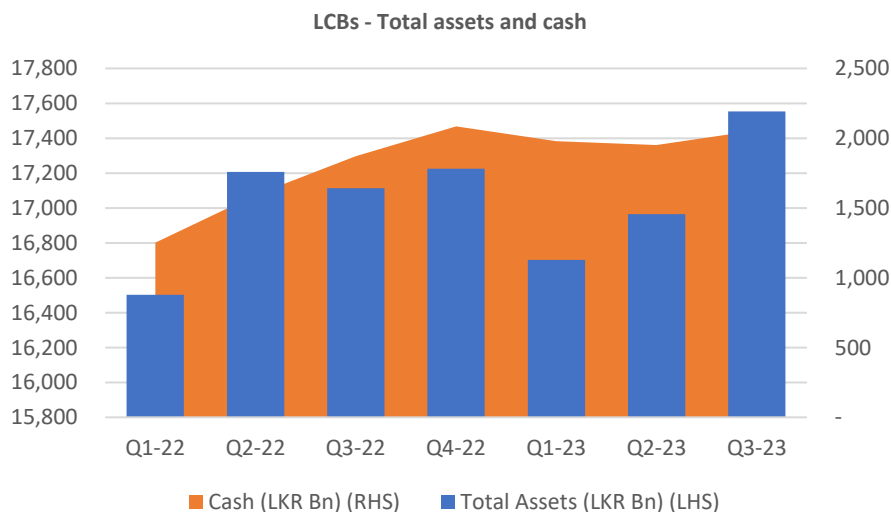
## 1. Company description

Commercial Bank of Ceylon PLC (COMB) was established in 1969. The company serves over 3.5M customers with 289 branches and 934 ATMS employing over 5,000 staff. In addition to its presence in Sri Lanka, COMB has also operations in Bangladesh where it has expanded up to 20 branches. COMB has further expanded its geographical footprint to Maldives and Myanmar. The bank has a credit rating of A (Ika) by Fitch Ratings. It operates in four main segments: personal banking, corporate banking, treasury, and international operations. COMB has won numerous awards and accolades including the Best Bank Sri Lanka – Bank of the Year award by the Banker (UK) in 2022. The bank continues to invest in its digital platforms and IT infrastructure to offer a better customer experience.

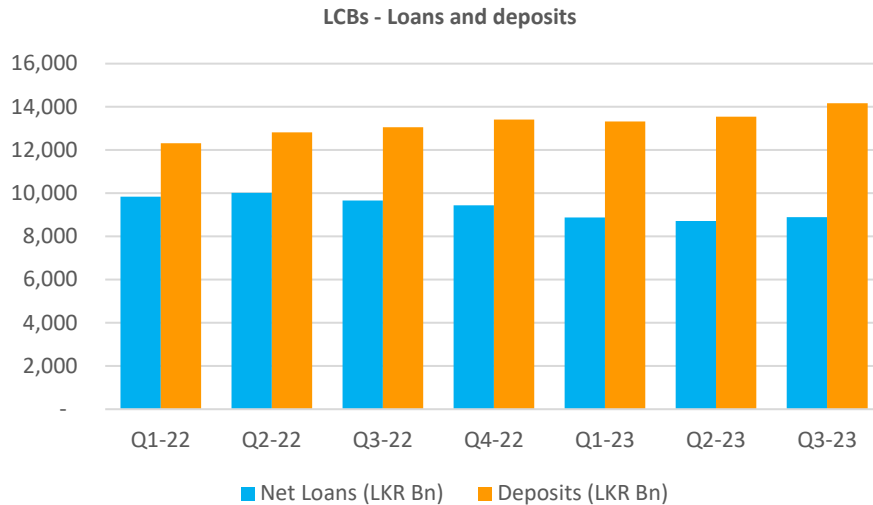
## 2. Industry overview – Licensed Commercial Banks (LCBs)

Sri Lankan Licensed Commercial Banking space comprises 24 banks, of which 10 are listed on the CSE. COMB is the largest listed private LCB in terms of asset base, among the listed private LCBs.

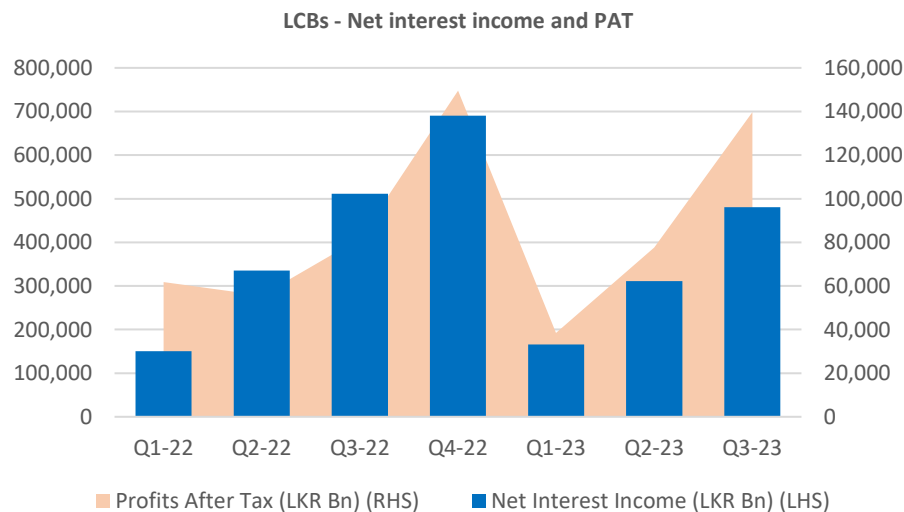
Among LCBs, the performance in the third quarter of 2023 compared to the same period in 2022 witnessed fluctuations across various aspects. Total assets increased by 2.7% YoY to LKR 17.5 trillion in 3Q2023, showcasing a moderate upward trajectory. Notably, cash and due from banks saw a modest increase of 10.0% YoY, reaching LKR 2.06 trillion in 3Q2023.



Net loans and receivables experienced a decline of 8.07% YoY, dropping to LKR 8.88 trillion in 3Q2023. Furthermore, the total impairment on loans increased marginally by 10.9% YoY to LKR 910.4 billion in 3Q2023, signifying amplified challenges in loan quality management. Overall, while certain sectors within LCBs displayed growth, the decline in net loans and the uptick in loan impairments highlight challenges the sector faced amidst deteriorating economic conditions.



In 3Q2023, LCBs experienced substantial growth in earnings and profits compared to 3Q2022. Total income surged by 31.8% to LKR 1.89 trillion in 3Q2022. Interest income notably increased by 42.4% to LKR 1.74 trillion, while interest expenses rose by 77.5% to LKR 1.26 trillion, impacting net interest income. Operating expenses grew by 20.6% to LKR 238.7 billion, mainly driven by rises in staff costs and impairment for loans and other losses. Profit before VAT and taxes increased by 82.6% to LKR 284.5 billion, while the profits after corporate tax witnessed an increase of 70.9% to LKR 139.7 billion in 3Q 2023. The fiscal budget for 2024 allocated LKR 450 billion to recapitalize banks which will strengthen the banks' capital base.

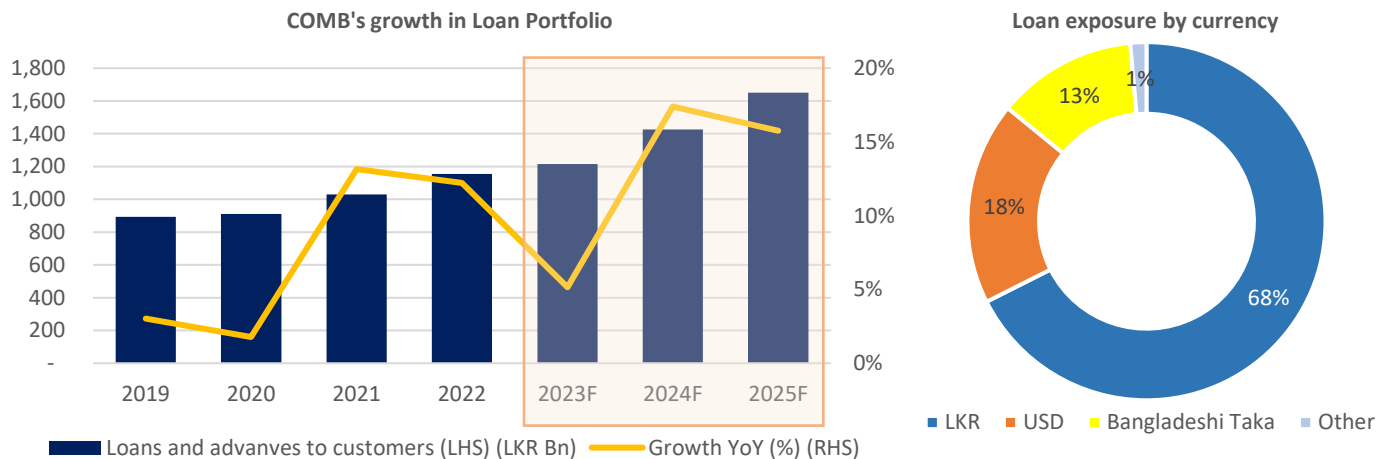


Source: Company reports, CBSL, Ambeon Estimates

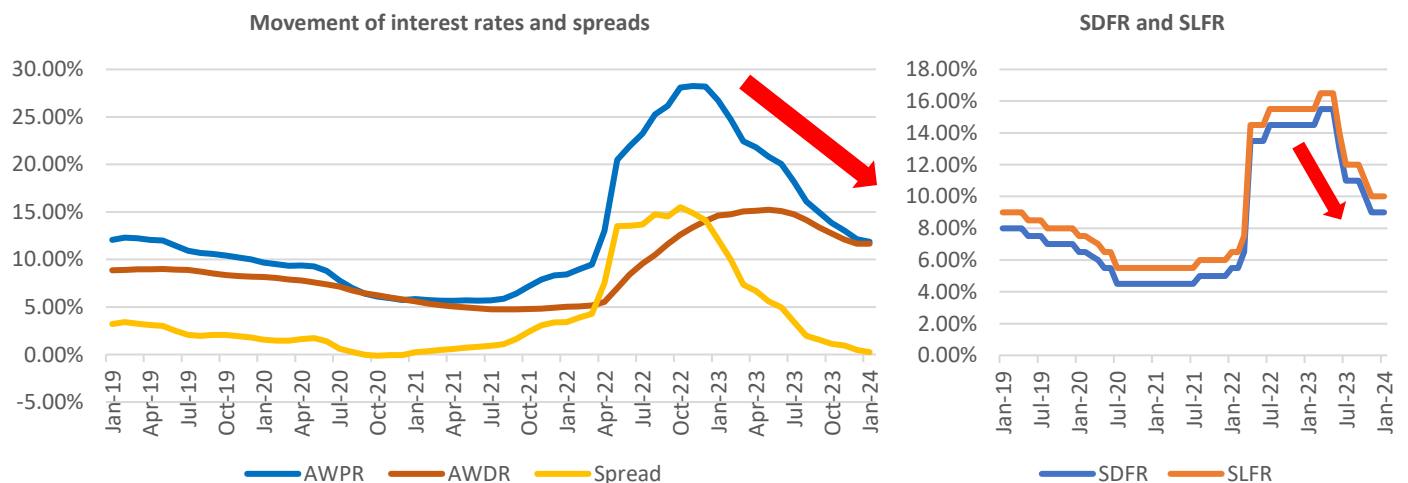
### 3. Investment highlights

#### Loan book growth is expected to pick up while loan quality is expected to improve

The credit to the private sector marginally increased in November 2023, reversing a negative trend. Further rebound in private sector credit towards a positive growth rate is anticipated in 2024. As the country progresses toward meeting IMF debt sustainability targets, the economy shows signs of recovery, a pivotal factor driving anticipated growth in private sector credit. COMB's loan book is expected to grow at double-digit levels in 2024-2026. The loan book is diversified with 32% of the loans being foreign currency denominated.



The interest rates are on a downtrend which provides strong support for the expansion of private credit. The average AWPLR at the beginning of 2023 was ~28% which has now reduced to ~12% in line with the reduction in policy rates and monetary easing measures by the Central Bank that took place towards the latter part of 2023. As the AWPLR and AWDR declined, the interest rate spreads also have largely narrowed. While we foresee a stabilization of interest rates in the first half of 2024, a potential slight uptick toward the second half of the year remains plausible.



Source: Company reports, CBSL, Ambeon Estimates

Presently, COMB's lending primarily focuses on term loans, constituting approximately 63% of its loan book. Notably, the bank holds the highest loan exposure in sectors such as retail and wholesale trade (21%), overseas entities (17%), and manufacturing (12%). The expected surge in private credit and consumer spending is likely to augment lending activities in these segments, benefiting retail, wholesale trade, and manufacturing. Moreover, COMB has the potential to further diversify its lending exposure.

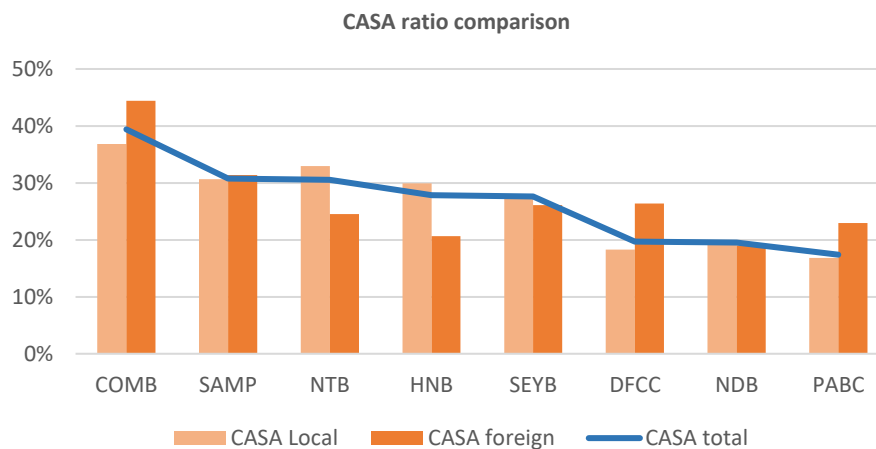
It is also expected that the loan quality would improve, and the bottom line would be significantly benefited due to declining impairments and stage 3 loans. COMB's current impaired loans ratio is 6.11% and impairments to stage 3 loans are 39.85%. We expect the impaired loan ratio to drop to 4%-5% by 2026. Historical average impairment ratio was 4.68% between 2018-2021.

At the start of 2023, COMB was proactive and had already made provisions for its Treasury and ISB portfolio holdings, anticipating the Domestic Debt Optimization (DDO). The DDO for which the terms were announced in June 2023 exempted the treasury portfolios held by commercial banks, offering relief for the banking sector. COMB has the option to reverse some of the provisions made in this regard if deemed necessary.

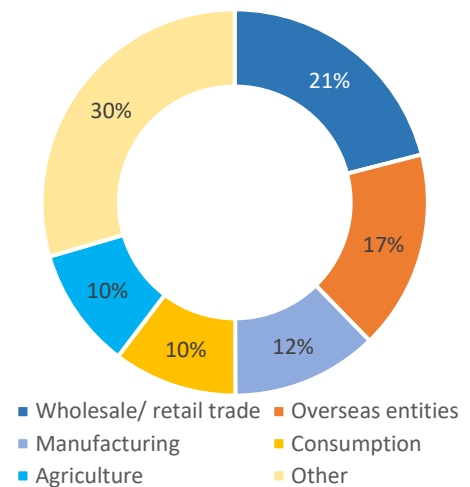
COMB's operations in Bangladesh and Maldives have contributed to its bottom line. Looking ahead, we anticipate that COMB's continued presence and activities in Bangladesh, Maldives, and Myanmar will further bolster and enhance its bottom-line profits. Additionally, the bank can anticipate value addition in revenue through fee-based income.

### Higher CASA ratios and capital adequacy to provide cushion

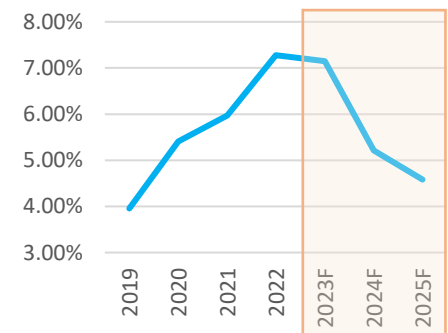
COMB has the highest CASA ratios in the industry. Based on local deposits, the CASA ratio was 37% while the foreign deposits indicate a CASA ratio of 44%. The total CASA ratio is 39%. Higher CASA ratios provide the ability to reduce the cost of funds for the bank. It also enables the bank to manage its liquidity by providing enough cushion when expanding the funding base to support the loan portfolio growth.



Loan exposure by economic sector



Impairments/ Gross loans

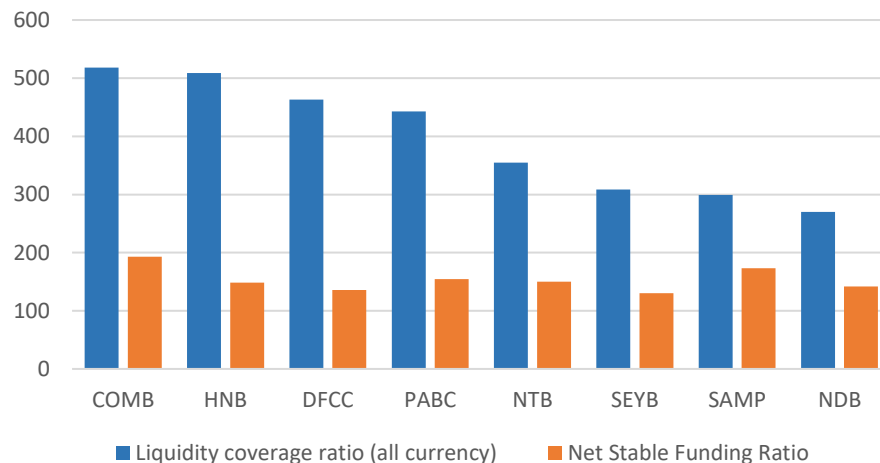


COMB's cost-to-income ratio before taxes on financial services was 26.29% in 2023 and we expect that the bank can manage the cost-to-income ratio with efficient operations. The number of staff and customer service centers have remained flat since 2019 and COMB does not see a need to majorly expand the staff as it has the capacity to handle the increasing number of customers. COMB's investment in technology is also helping it to keep the cost-to-income ratio at current levels without a major increase.

Current NIMs of COMB stand at 3.21%. Given the high CASA ratios, we expect the NIMs to remain stable at 3.0% levels despite the declining interest rates. While the interest rate spreads have declined we expect a slight increase in rates beyond 2024 as inflation is expected to pick up along with the expansionary monetary policies.

COMB's Tier I capital ratio stands at 11.53% against the requirement of 8.5%-10%. The total capital ratio stands at 14.5% against the minimum required 14%. The adequate capital base provides enough cushion to expand its loan book and external funding. We believe the impact from the Single borrower limit would be minimal on COMB as it is adequately capitalized which enables to grow the loan book. The bank further strengthened its Tier II capital through a debenture issue in 2023. Compared to its peers, COMB has the highest Liquidity Coverage Ratio (all currency) of 518.33% against a requirement of 100%. It also has the highest Net Stable Funding Ratio of 193.13% against a requirement of 100%.

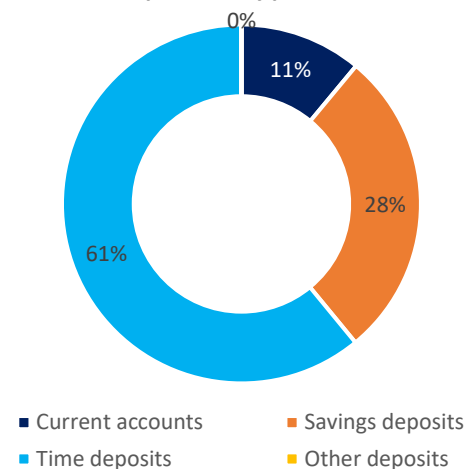
Liquidity coverage and Net Stable Funding Ratio



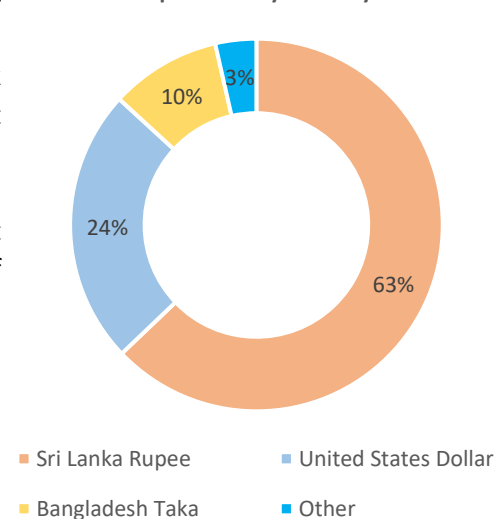
### Valuation upside

We have estimated the weighted average fair values COMB.N and COMB.X at LKR 126.38 and LKR 107.61 respectively. COMB.N and COMB.X provide an upside of 38.88% and 41.03% respectively based on the current market price.

Deposit mix by product



Deposit mix by currency



With anticipated dividends, the returns on COMB.N and COMB.X can go up to 46.42% and 50.03% respectively.

#### 4. Valuation summary

For 2024E, COMB.N and COMB.X are valued at LKR 126.38 and LKR 107.61 respectively, based on the weighted average value derived from four valuation methods.

Weighted average intrinsic value	(LKR)
Residual Income method	161.59
Justified Price to book value	52.55
Forward PE	98.05
Net Asset Value Per Share (NAVPS - 2024E)	193.31
Weighted average value per share - COMB.N	126.38
Weighted average value per share - COMB.X	107.61

It's important to acknowledge the historical trading patterns of COMB.X relative to COMB.N, spanning from 2018 to 2023, which revealed an average discount of approximately 14.85% for COMB.X against COMB.N. Notably, since 2019, COMB.N has consistently traded below its book value.

Our valuation strategy encompasses a blend of absolute and relative valuation methodologies to holistically gauge the stock's intrinsic value considering both fundamental value and market sentiment. Absolute valuation techniques, including the Residual Income model and Net Asset Value, have contributed to establishing an upper threshold for valuation. The market-based multiples such as Forward PE and Justified Price to Book have moderated the valuation estimates downward, influenced by prevailing market sentiments.

Given below are key assumptions used for each of the valuation methods.

Residual Income (RI) Valuation	(LKR '000)
Present Value of Residual Income	(1,452,750)
No of shares ('000)	1,314,121
Residual Income per share	(1.11)
Net Asset Value Per Share (current)	162.70
Value per share	161.59

Cost of equity	
Risk Free rate	12.00%
Equity Risk Premium	23%
Beta	0.78
Cost of Equity	29.94%



**Justified Price to Book Valuation**

ROE (2024E)	10.32%
Growth rate (g)	3%
Cost of equity (r)	29.9%
Justified PBV = (ROE - g) / (r - g)	0.27
Net Asset Value Per Share (2024E)	193.31
Value per share	52.55

It should be noted that the peer average price-to-book ratio is 0.45.

**Forward PE Valuation**

Peer average PE	3.66
Expected forward PE	5.00
EPS (2024E)	19.61
Value per share	98.05

The company's Trailing Twelve Month (TTM) EPS was LKR 17.48 as of Sep 2023.

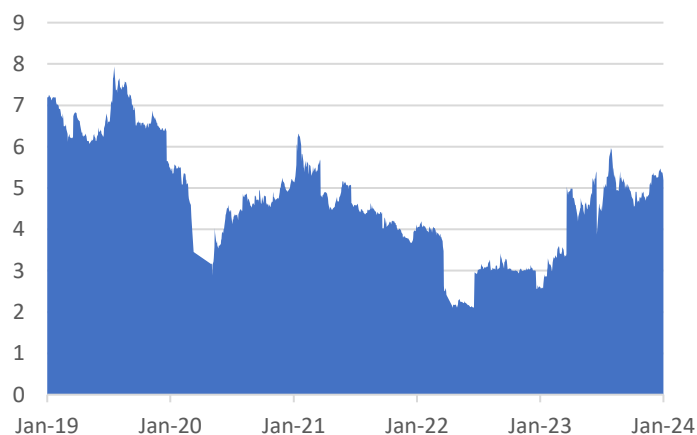
**Net Asset Value Based Valuation**

Net Asset Value per share (Sep 2023)	162.70
Net Asset Value per share (2024E)	193.31

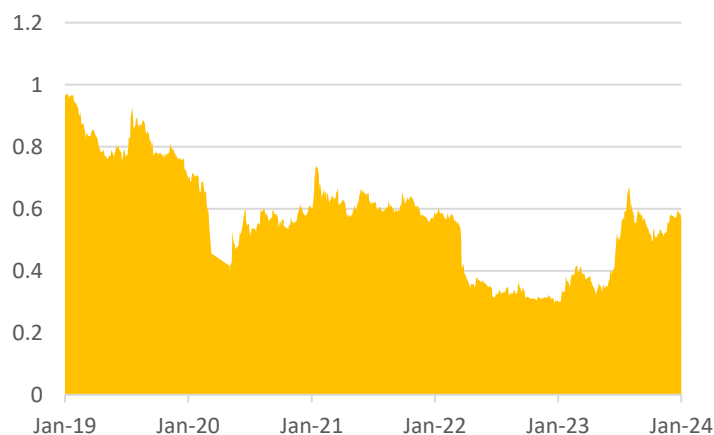
Given below are peer Price Earnings (PER) and Price to Book (PBV) ratios. These have not been directly considered in the valuation, however used as guidance in the valuation process.

Peer valuation multiples	PE	PBV
HNB.N	4.18	0.46
SAMP.N	4.31	0.54
NTB.N	2.94	0.49
NDB.N	3.33	0.34
SEYB.N	4.10	0.44
DFCC.N	3.75	0.48
PABC.N	3.00	0.39
Peer average	3.66	0.45

COMB.N - Historical PE ratio



COMB.N - Historical Price to Book ratio



Source: Company reports, Bloomberg, Ambeon Estimates

## 5. Investment risks

Interest rate risk shadows the bank's earnings. The interest rates are on the downtrend, and this would lead to reduced Net Interest Margins (NIMs) for the bank.

Macroeconomic and geopolitical risks also weigh on the bank's performance. Sri Lanka is recovering from one of the worst crises in its history and any delays in the recovery process would affect the growth potential of the bank. The upcoming election also may create tension in the macroeconomic and social environment in which the bank operates.

The stock returns are also exposed to market risk where a general market downtrend could adversely affect the share price. A general loss of confidence in the market could lead to actual market prices significantly deviating from the fair values for prolonged periods.

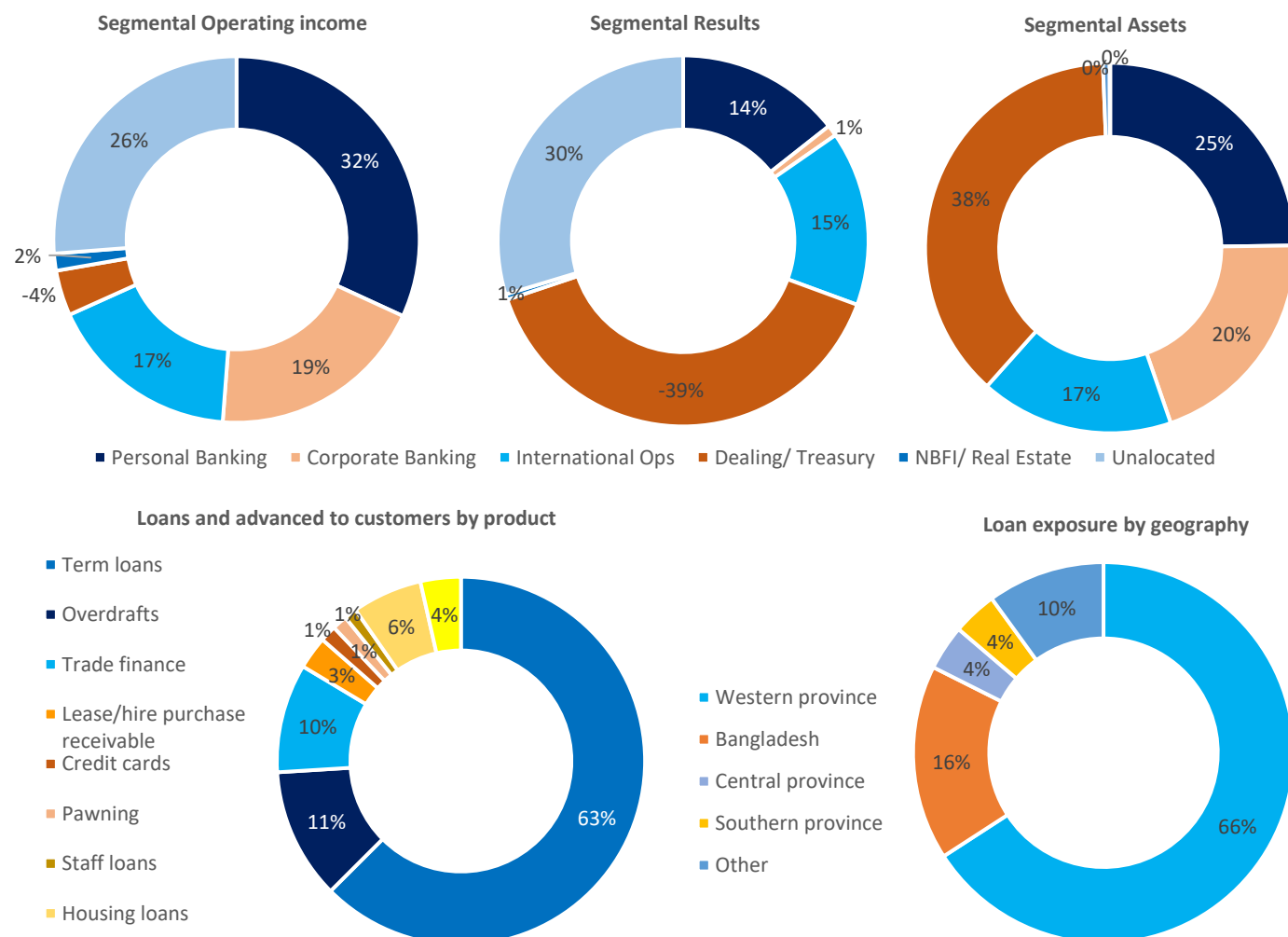
## Annexure I: Financial Statements

INCOME STATEMENT (LKR Mn)	2020	2021	2022	2023F	2024F	2025F
Gross income	151,966	163,675	280,387	348,709	362,865	412,721
Interest income	124,088	132,818	222,393	305,857	295,139	337,849
Less: Interest expense	73,219	66,402	137,728	222,695	232,020	266,158
Net interest income	50,869	66,416	84,665	83,162	63,119	71,691
Fee and commission income	11,840	15,917	26,192	30,374	35,659	41,280
Less: Fee and commission expense	2,018	3,675	6,022	7,593	8,202	9,494
Net fee and commission income	9,822	12,242	20,169	22,780	27,457	31,786
Net gains/(losses) from trading	1,878	1,936	35,297	(16,200)	1,955	1,975
Net gains/(losses) from derecognition of financial assets	6,390	3,002	277	3,518	3,694	3,878
Net other operating income	7,771	10,002	(3,772)	25,160	26,418	27,739
Total operating income	76,729	93,598	136,637	118,421	122,643	137,069
Less: Impairment charges and other losses	21,420	25,140	71,924	35,329	30,095	34,609
Net operating income	55,310	68,458	64,712	83,092	92,548	102,459
Less: Expenses						
Personnel expenses	14,993	16,799	19,788	21,767	23,944	26,338
Depreciation and amortisation	3,103	3,220	3,598	4,117	4,240	4,382
Other operating expenses	8,167	9,638	12,896	16,764	20,117	24,141
Total operating expenses	26,263	29,658	36,282	42,648	48,301	54,861
Operating profit before taxes on financial services	29,047	38,801	28,430	40,443	44,247	47,599
Less: Taxes on financial services	4,531	5,845	3,921	4,894	5,903	6,757
Operating profit after taxes on financial services	24,516	32,955	24,509	35,550	38,344	40,842
Share of profit/(loss) of associate, net of tax	4	2	(4)	5	5	5
Profit before tax	24,520	32,957	24,505	35,555	38,349	40,847
Less: Income tax expense/(reversal)	7,433	8,667	106	14,933	11,505	12,254
Profit for the year	17,087	24,290	24,399	20,622	26,844	28,593
Profit attributable to: Equity holders of the Bank	16,940	24,062	23,812	19,797	25,771	27,449
Non-controlling interest	147	228	588	825	1,074	1,144
Profit for the year	17,087	24,290	24,399	20,622	26,844	28,593
Earnings Per Share (LKR)	15.70	19.41	19.21	15.06	19.61	20.89
BALANCE SHEET (LKR Mn)	2020	2021	2022	2023F	2024F	2025F
Assets						
Cash and cash equivalents	51,255	69,335	151,109	105,916	109,690	159,084
Balances with banks and derivatives	134,417	75,522	184,542	135,654	182,280	200,874
Financial assets through profit or loss (fair value)	35,189	23,436	24,873	98,933	155,960	171,556
Loans and advances to other customers	910,609	1,029,584	1,155,493	1,214,949	1,426,353	1,651,208
Debt and other financial instruments	302,060	385,391	761,650	709,291	668,358	737,754
Financial assets through other comprehensive income	278,717	335,954	118,652	296,955	326,650	359,315
Investment in associate	64	60	55	55	55	55
PPE and intangible assets	27,254	27,090	31,640	33,002	34,329	38,182
Deferred tax and other assets	22,931	37,119	71,538	67,568	49,394	50,875
Total assets	1,762,496	1,983,491	2,499,554	2,662,322	2,953,070	3,368,903
Liabilities						
Liabilities Due to banks and derivatives	181,161	227,318	165,578	148,644	179,897	205,072
Financial liabilities at amortised cost – due to depositors	1,286,616	1,472,640	1,977,744	2,158,990	2,362,458	2,682,218
Financial liabilities at amortised cost – other borrowings	54,556	32,587	16,150	23,481	35,222	52,833
Tax and other liabilities	79,214	81,393	127,109	96,710	115,452	144,054
Total liabilities	1,601,547	1,813,939	2,286,581	2,427,825	2,693,029	3,084,176
Equity						
Stated capital	52,188	54,567	58,150	62,948	69,243	72,705
Reserves and non-controlling interest	108,761	114,986	154,823	171,549	190,798	212,022
Total equity	160,949	169,553	212,973	234,497	260,041	284,727
Total liabilities and equity	1,762,496	1,983,491	2,499,554	2,662,322	2,953,070	3,368,903
Net Asset Value Per Share (LKR)	136.42	140.24	168.47	174.69	193.31	211.23

## Annexure III: Key ratios

	2020	2021	2022	2023F	2024F	2025F
Avg. yield on interest earning assets	8.11%	7.47%	10.75%	13.15%	11.42%	11.55%
Avg. cost on interest bearing funds	4.81%	3.83%	6.38%	9.55%	9.00%	9.05%
Net interest margin	3.33%	3.74%	4.09%	3.58%	2.44%	2.45%
Interest rate spread	3.30%	3.64%	4.37%	3.60%	2.42%	2.49%
Cost to income (operating)	34.23%	31.69%	26.55%	36.01%	39.38%	40.02%
Cost to income (with impairments)	31.38%	33.48%	38.59%	12.23%	13.31%	13.29%
Impairments/ Gross loans	5.41%	5.97%	7.28%	7.15%	5.21%	4.58%
Net margin	11.24%	14.84%	8.70%	5.91%	7.40%	6.93%
ROE	10.62%	14.33%	11.46%	8.79%	10.32%	10.04%
ROA	0.97%	1.22%	0.98%	0.77%	0.91%	0.85%
Equity/ total assets	9.13%	8.55%	8.52%	8.81%	8.81%	8.45%
Deposits / total assets	73.00%	74.24%	79.12%	81.09%	80.00%	79.62%
Cash / total assets	2.91%	3.50%	6.05%	3.98%	3.71%	4.72%
Gross income per employee	30,051	32,270	54,752	67,420	69,462	78,224
Dividend payout	41.40%	38.64%	23.43%	25.39%	35.00%	35.00%

## Annexure I: Segmental information



**Annexure III: Recommendation criteria**

The recommendations are based on the stock returns compared against the 1-year Treasury bill rate as a benchmark.

BUY	Return of the stock > 1-year T bill rate plus 5%
HOLD	1-year T bill rate plus 5% > Return of the stock > 1-year T bill rate
SELL	Return of the stock < 1-year T bill rate

1-year T bill rate used for comparison = 12.93%

**Abbreviations**

1H.../2H...	First half of...(year)/ Second half of...(year)
1Q/2Q..	1 <sup>st</sup> quarter/ 2 <sup>nd</sup> quarter..
Bn	Billions
CBSL	Central Bank of Sri Lanka
CSE	Colombo Stock Exchange
DDO	Domestic Debt Optimization
DPS	Dividend Per Share
EPS	Earnings Per Share
FY	Financial Year
LKR	Sri Lanka Rupees
MCAP	Market Capitalization
MPS	Market Price per Share
Mn	Millions
NIM	Net Interest Margin
NAVPS	Net Asset Value Per Share
PBV	Price to Book Value
PE	Price Earnings Ratio
ROA	Return on Assets
ROE	Return on Equity
TTM	Trailing Twelve Months
YoY	Year on Year
YTD	Year to date (Jan to date)

**AMBEON SECURITIES (PVT) LIMITED**

No: 10, 2nd Floor  
 Gothami Road,  
 Colombo 08,  
 Sri Lanka.  
 T : +94 11 532 8 100  
 F : +94 11 532 8 177



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 regular updates](#)

**Sales Team**

Charith Kamaladasa	Director/CEO	<a href="mailto:charithk@ambeonsecurities.lk">charithk@ambeonsecurities.lk</a>
Niranjana Niles	Executive Director	<a href="mailto:niles@ambeonsecurities.lk">niles@ambeonsecurities.lk</a>
Romesh Kenny	Senior Manager Institutional Sales	<a href="mailto:romesh@ambeonsecurities.lk">romesh@ambeonsecurities.lk</a>
Chinthaka Weeraratna	Senior Investment Advisor	<a href="mailto:chinthaka@ambeonsecurities.lk">chinthaka@ambeonsecurities.lk</a>
Pasindu Yatawara	Senior Investment Advisor	<a href="mailto:pasindu@ambeonsecurities.lk">pasindu@ambeonsecurities.lk</a>

**Research Team**

Hansinee Beddage	Manager Investment Research	<a href="mailto:hansinee@ambeonsecurities.lk">hansinee@ambeonsecurities.lk</a>
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