



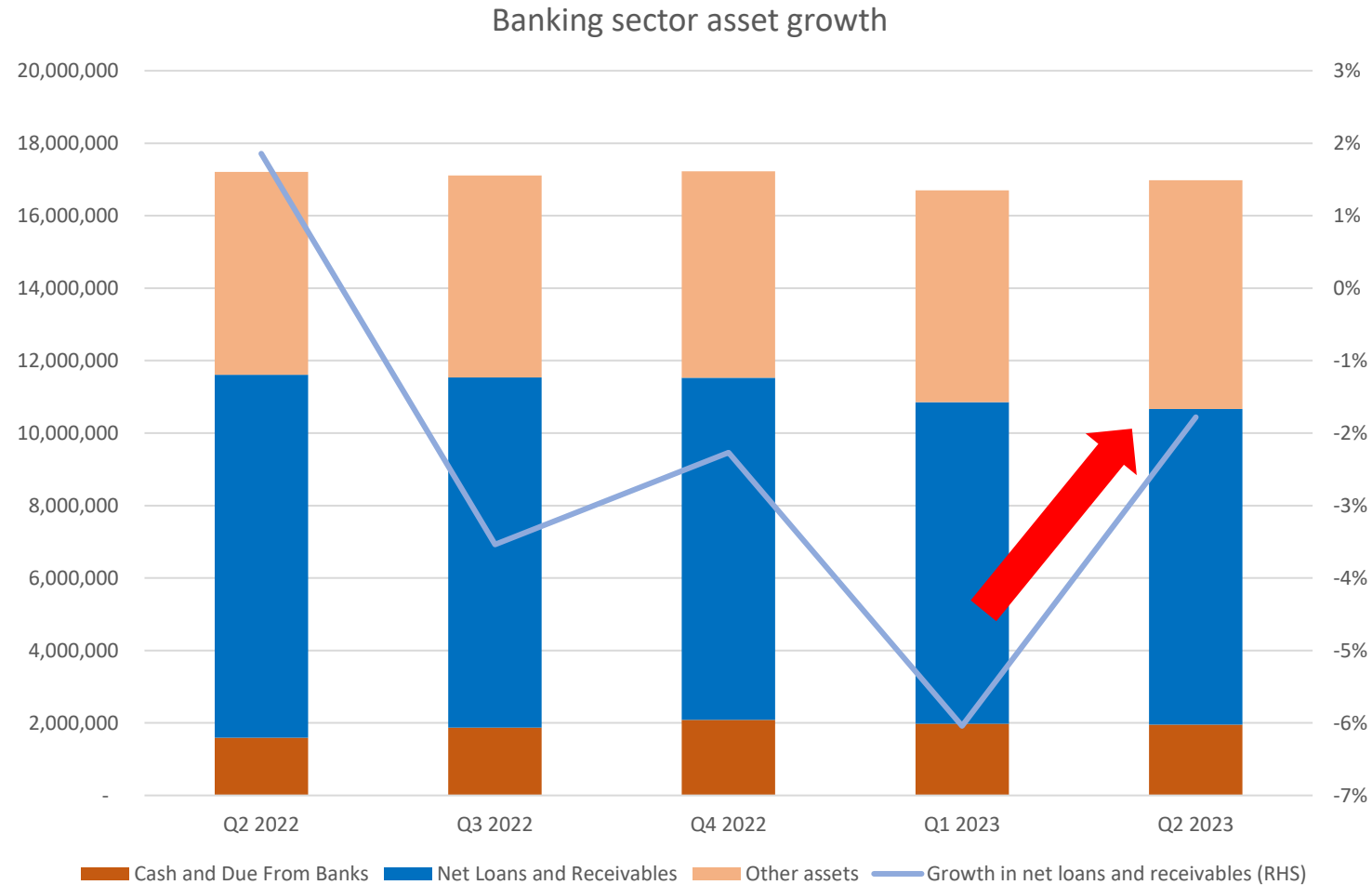
## RAPID INSIGHT REPORT | BANKING

**AMBEON**  
SECURITIES

25.10.2023



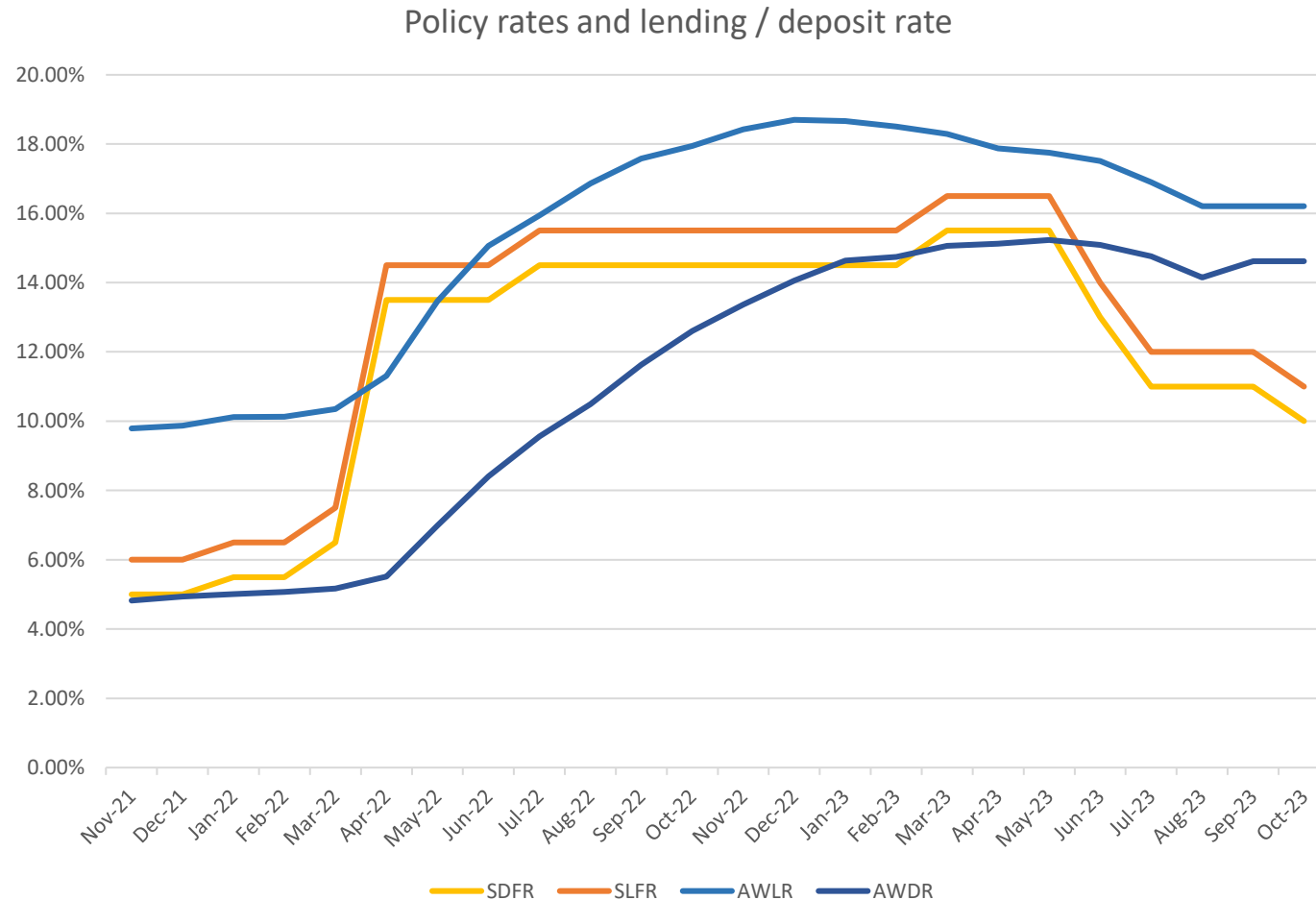
## Banking sector loan portfolios are reversing the negative growth trend



- A period of sluggish private sector credit expansion had taken its toll, compelling banks to prioritize loan recoveries rather than new disbursements.
- Now, with the **decline in interest rates and a corresponding anticipation of reduced impairments**, a more optimistic outlook emerges. The expected outcome is a shift towards positive portfolio growth.
- Projections indicate that loans and advances will experience a gradual resurgence, initially in the single-digit range in 2024, followed by a robust double-digit expansion in 2025.

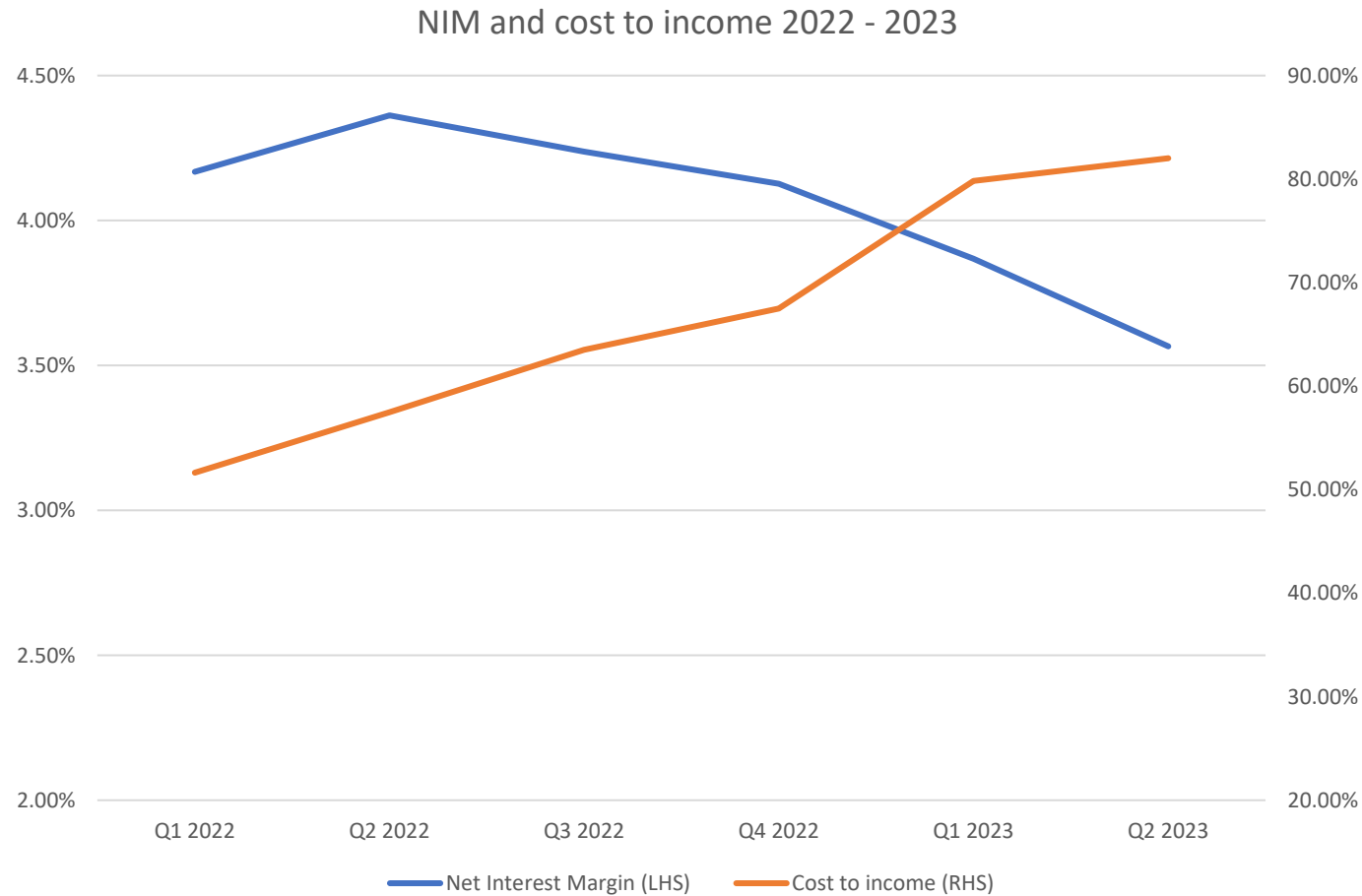
Source: CBSL, Ambeon estimates

## Interest rates have declined in 1H23 along with the policy rate revisions



- Sri Lanka's Central Bank took a series of upward policy rate revisions to Standard Deposit Facility Rate (SDFR) and Standard Lending Facility Rate (SLFR) in 2022 to tighten its monetary policy.
- However, starting from May 2022, the Central Bank embarked on a policy shift by gradually reducing the policy rates, given the effective control over inflation.
- Consequently, in the latter half of 2023, both the Average Weighted Lending Rates (AWLR) and Average Weighted Deposit Rates (AWDR) have observed a decline, aligning with the revisions made to the policy rates.

## NIMs of Licensed Commercial Banks have declined while cost to income has escalated



- NIMs of the banking sector increased as the interest rates declined in the 1H23 from higher levels prevailed in 2022
- Cost to income also have seen an increase as the costs have not declined in line with declining interest income

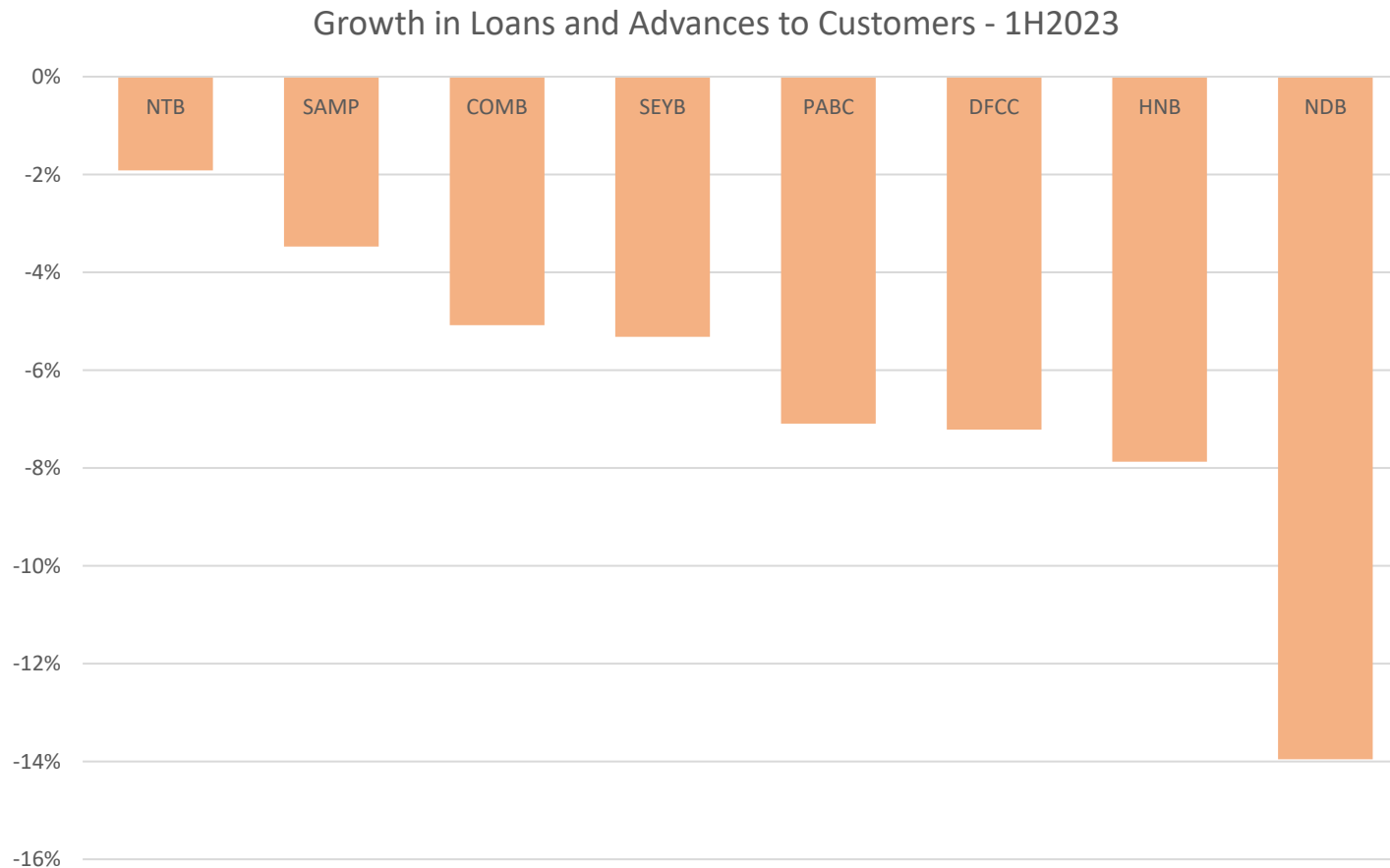
Source: CBSL, Ambeon estimates



## SELECTED COUNTERS



## Private sector credit growth of 9.1% in 1H23 beckons reversing the negative growth in Loans and Advances to customers

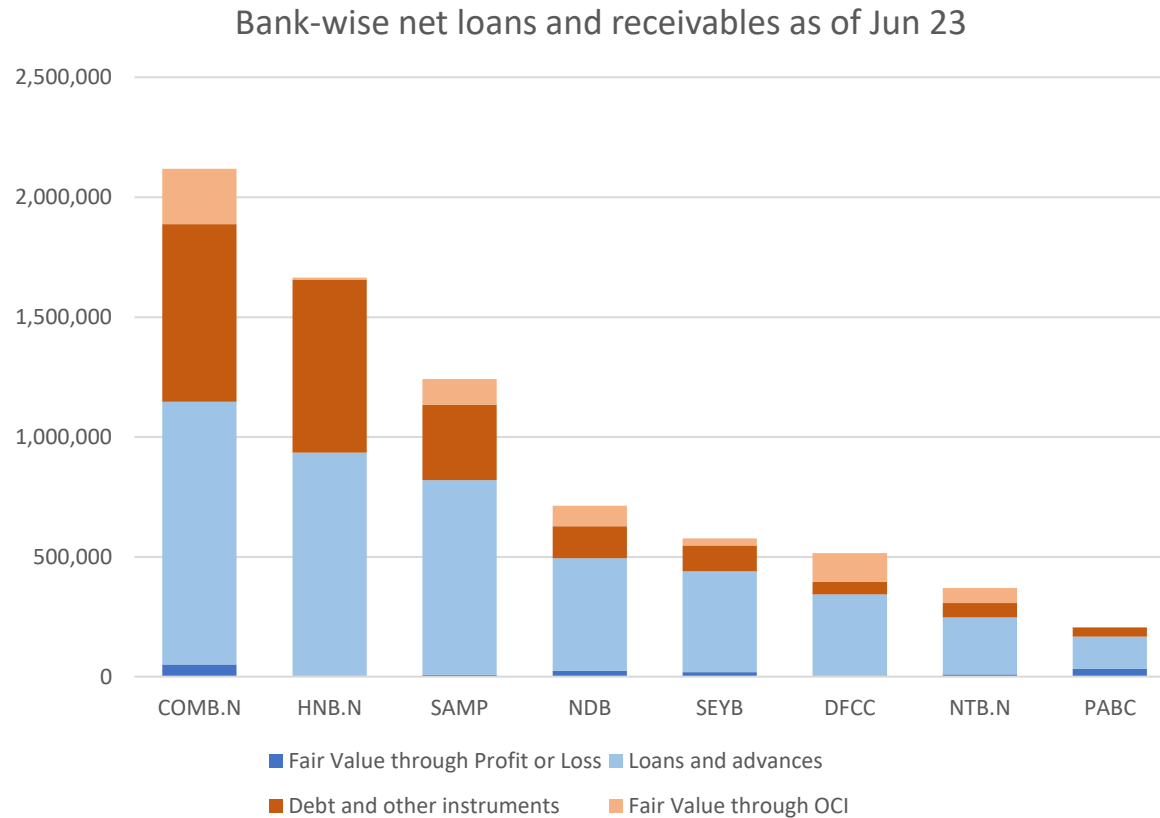


- Private credit growth in 2022 exhibited a notable weakness, primarily attributable to the high-interest rates resulting from a stringent monetary policy.
- The tight monetary policy coupled with weak consumer demand had a profound impact on the lending environment and borrowing activities within the private sector.
- All banks were affected by the weak economic conditions while NTB and SAMP were among the least affected.
- Given that the private sector credit growth has turned positive to 9.1% in 1H23, we can anticipate expansion of the loan book in 2H23 - 2024

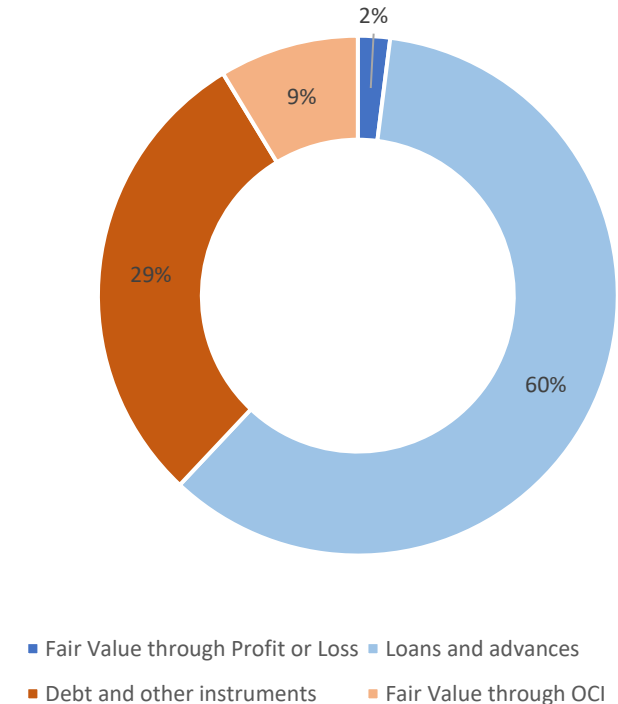
Source: Company reports, CBSL, Ambeon estimates



## COMB and HNB stands out with the largest portfolios of financial assets



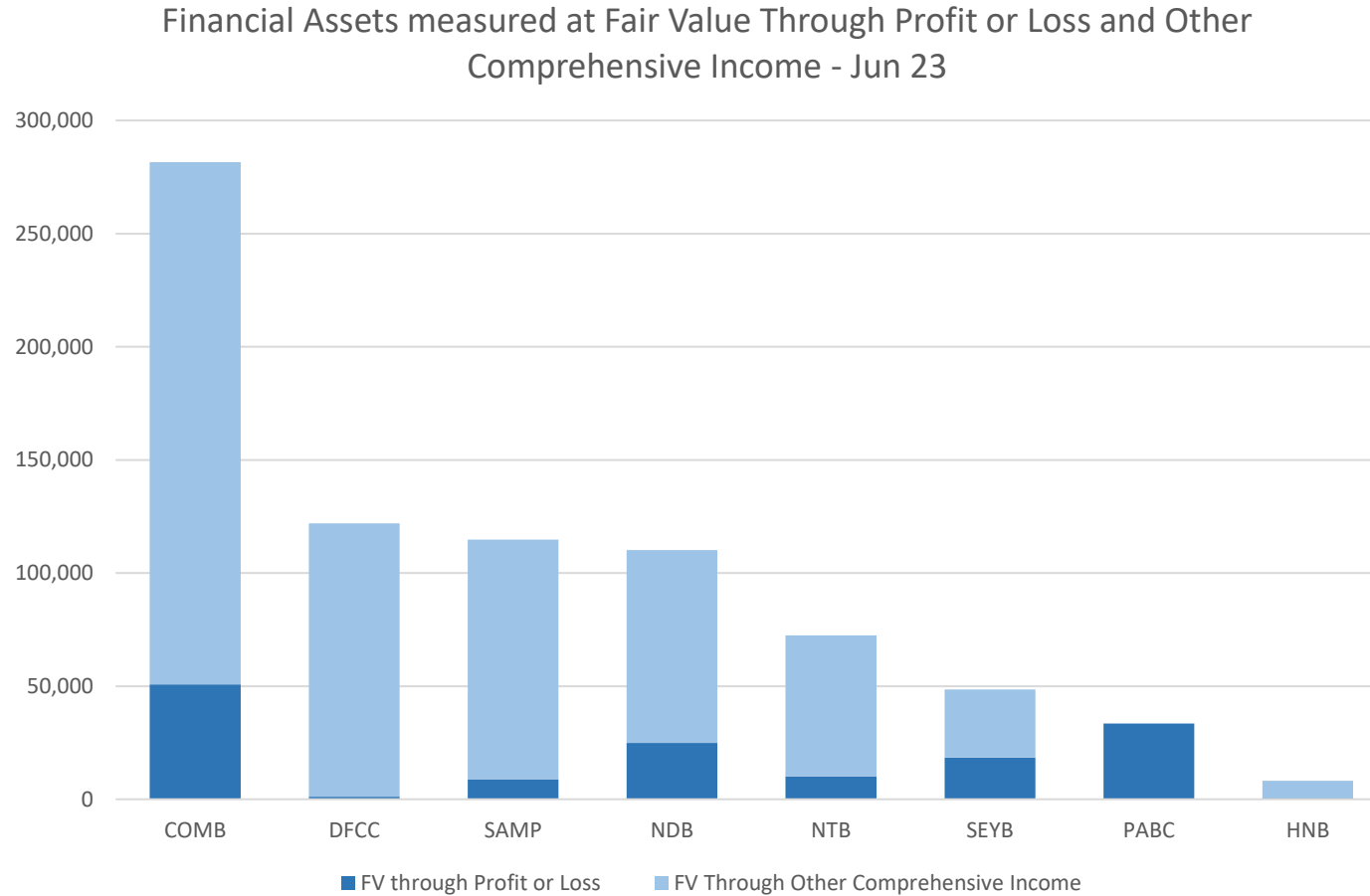
Total portfolio composition - Jun 23



- Financial assets encompass a wide range of assets, including those measured at fair value and those measured at amortized cost.
- The core of these portfolios primarily consists of loans and advances extended to customers (60%), while also encompassing holdings of treasury bills and bonds.

Source: Company reports, Ambeon estimates

## COMB and PABC has the largest portfolios measured at Fair Value Through Profit or Loss

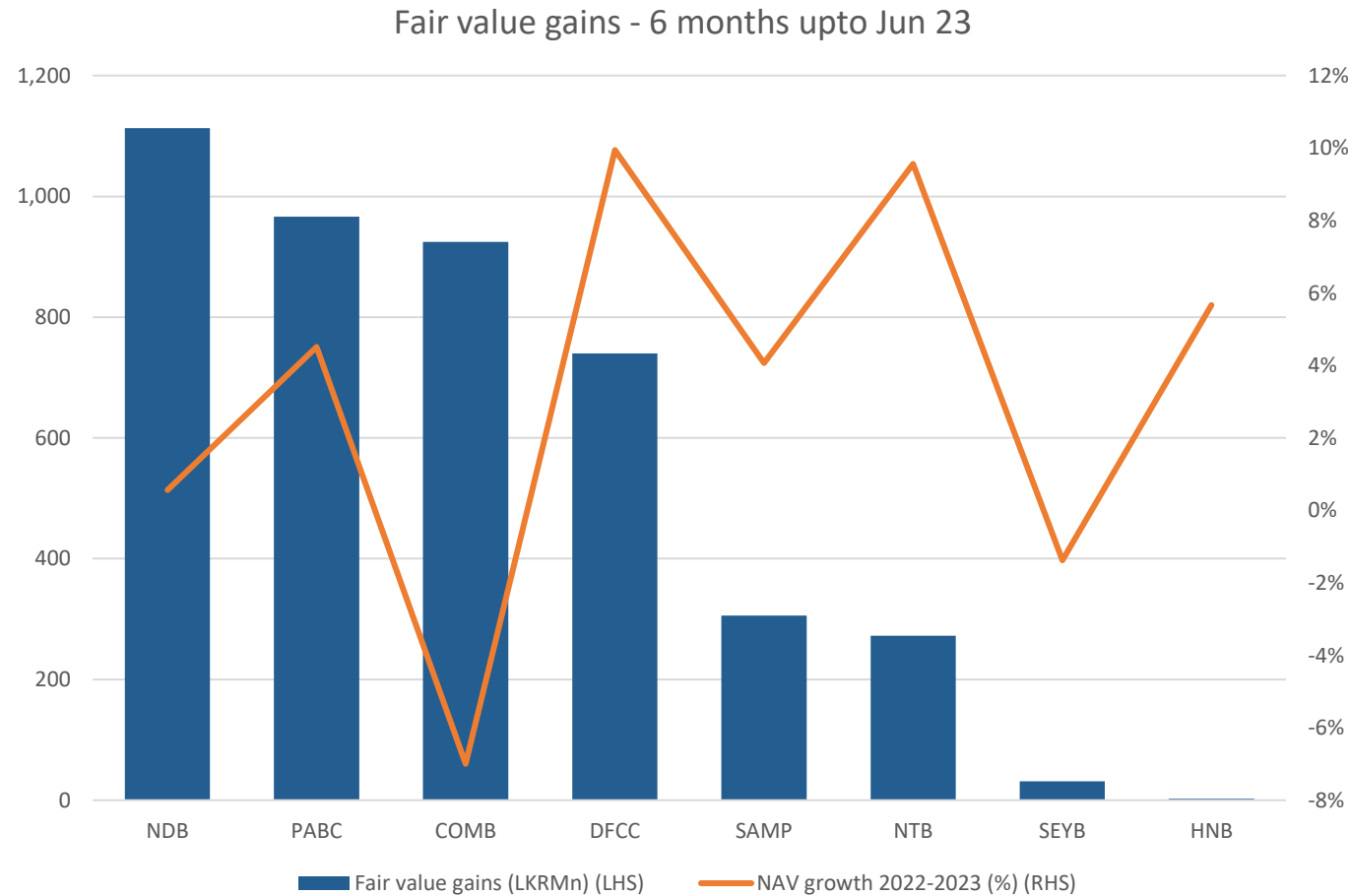


- The decrease in interest rates in 1H23 has led to a surge in the value of financial assets.
- It's important to note that the **gains on Financial Assets at Fair Value Through Profit or Loss (FVTPL) can be acknowledged and reported directly in the income statement.**
- However, gains on debt instruments measured at amortized cost are not recognized in the income statement but rather reflected in the net asset value.

Source: Company reports, Ambeon estimates



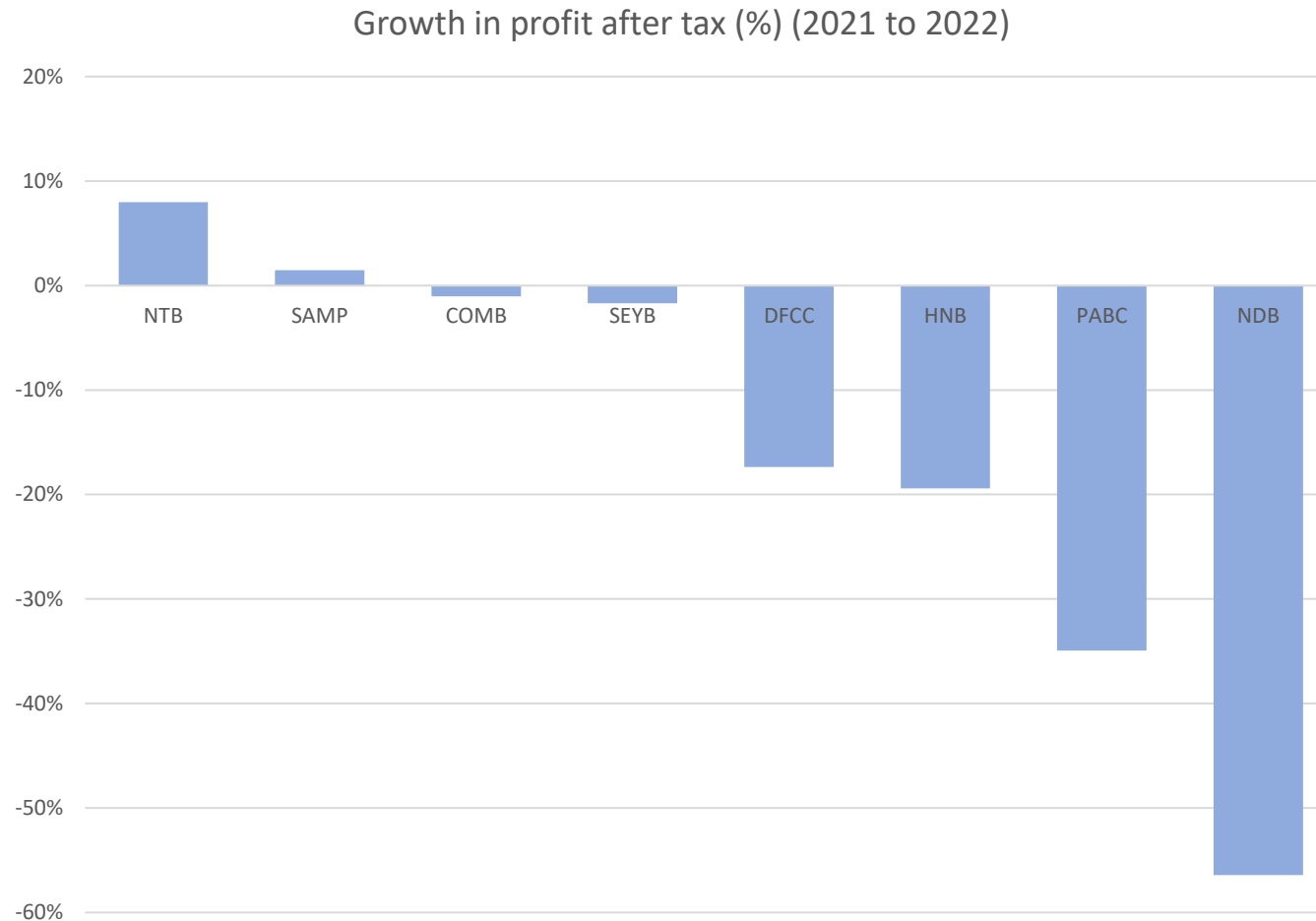
## Many banks recorded fair value gains in 1H23 while most have seen a growth in NAV from 2022



- While some banks have already reported gains in their portfolio resulting from declining interest rates on their income statements, there are other banks that have yet to record these portfolio gains.
- Interestingly, certain banks recorded an increase in Fair Value through Other Comprehensive Income (OCI) also on their income statements
- DFCC and NTB recorded the largest gains in fair value

Source: Company reports, Ambeon estimates

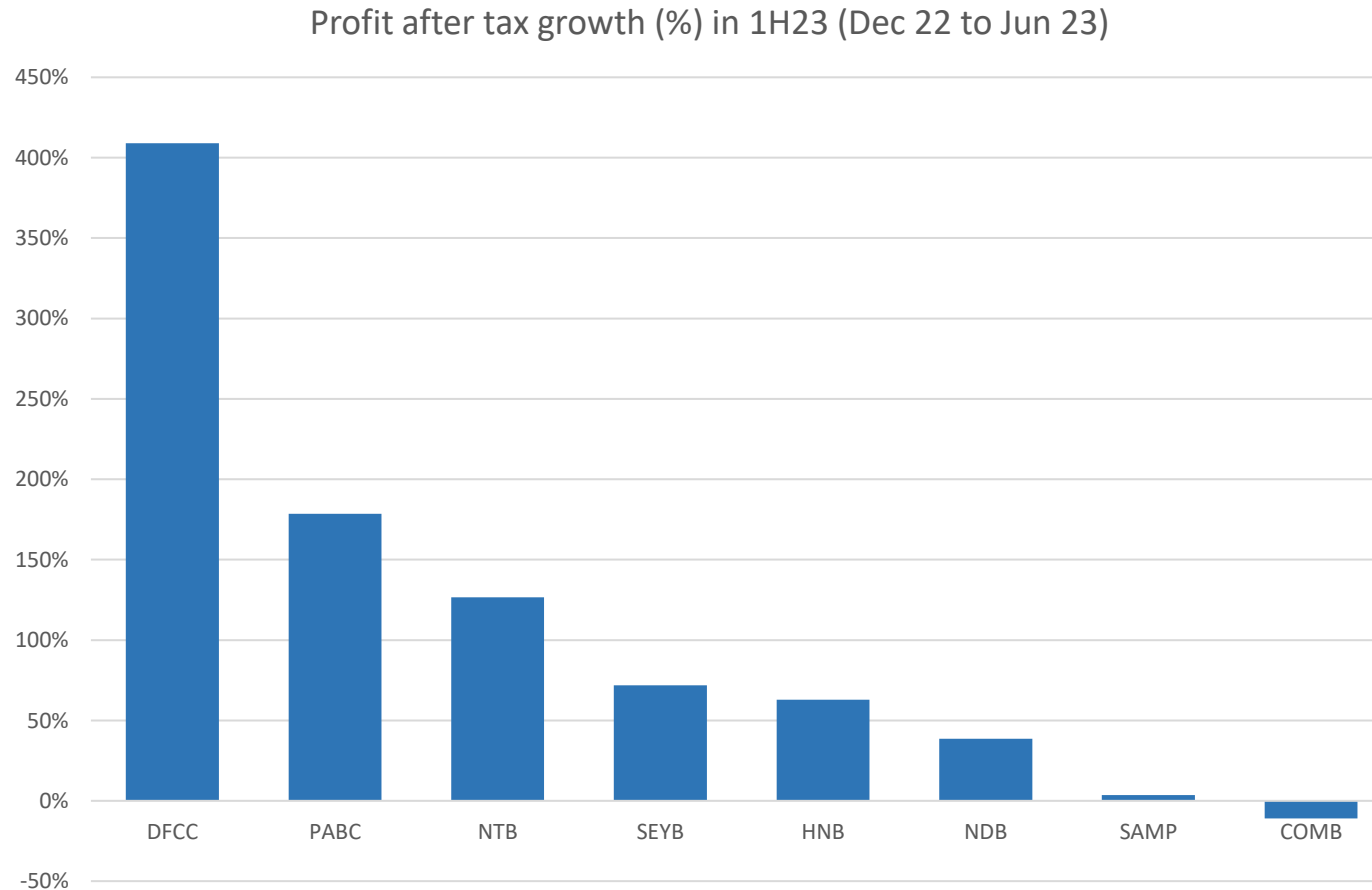
## Except NTB and SAMP, most banks saw negative profit growth in 2022



- Many banks witnessed an expansion in net interest income during 2022, primarily driven by higher interest rates.
- Several banks also reported gains on trading derivative assets attributed to the depreciation of the rupee.
- However, higher impairment charges both on loans and advances to customers as well as to Treasury securities in anticipation of the DDO had a dampening effect on their earnings.
- Banks such as NTB managed to achieve increase in profits by effectively managing their impairment expenses due to less exposure to government securities.

Source: Company reports, Ambeon estimates

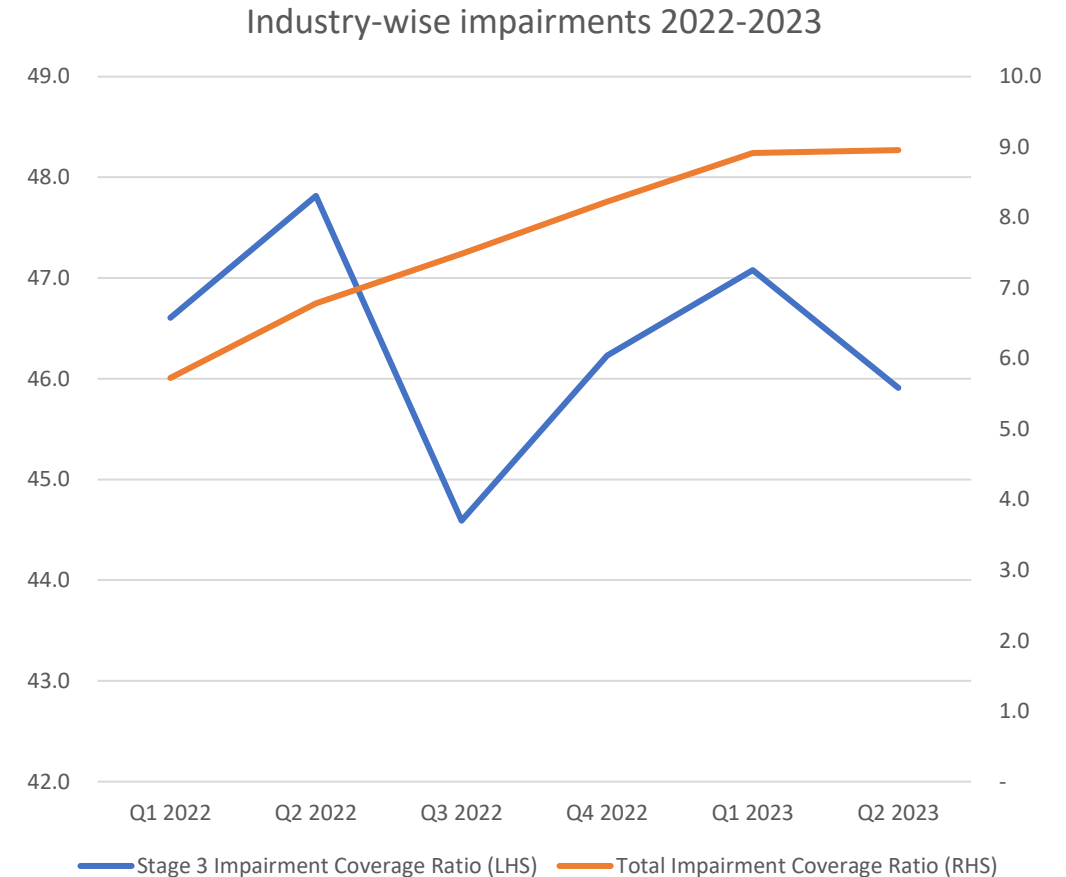
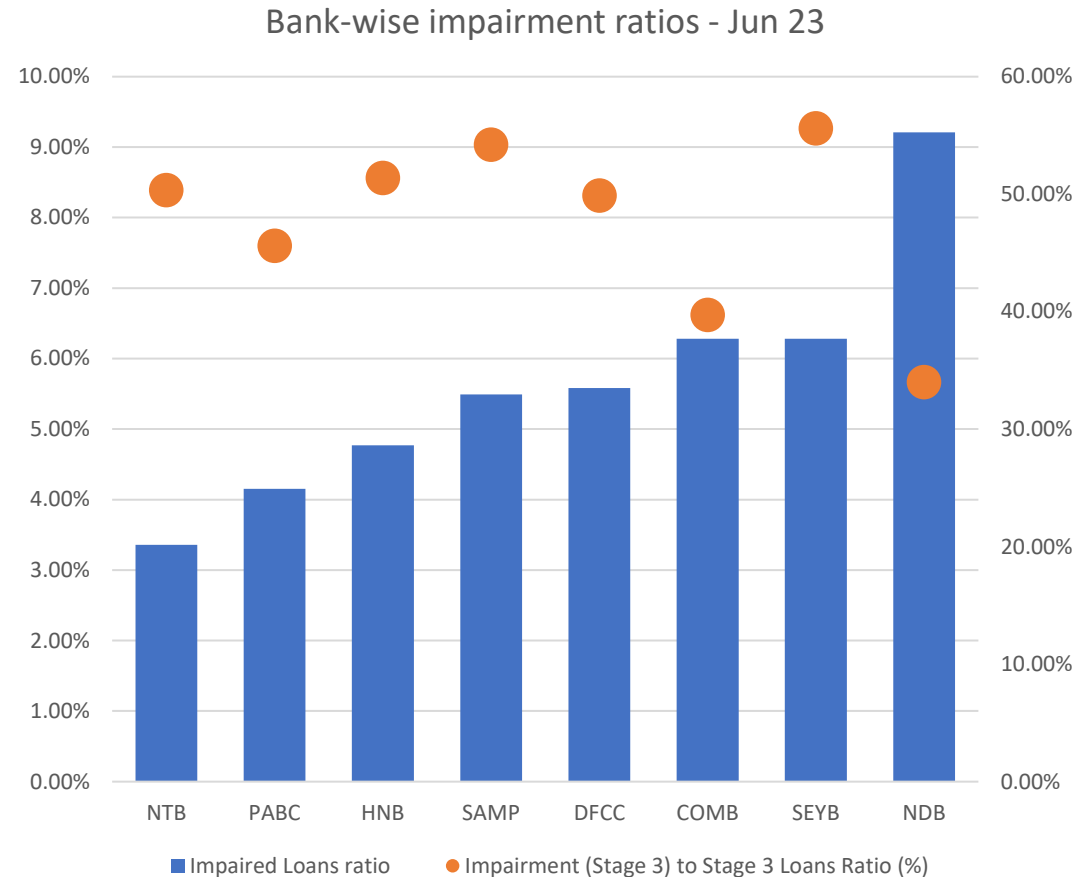
## Profit growth is returning in 1H23; DFCC and PABC experienced the highest growth in profits



- Net interest income remained on an upward trajectory in the first half of 2023, primarily due to the lag in reducing lending rates, which continued to favor banks.
- Trading gains were however lower for some banks as the currency appreciated in 2H23.
- On a positive note, **impairment charges saw a substantial reduction, significantly bolstering the bottom line** and contributing to a more favorable financial outlook.

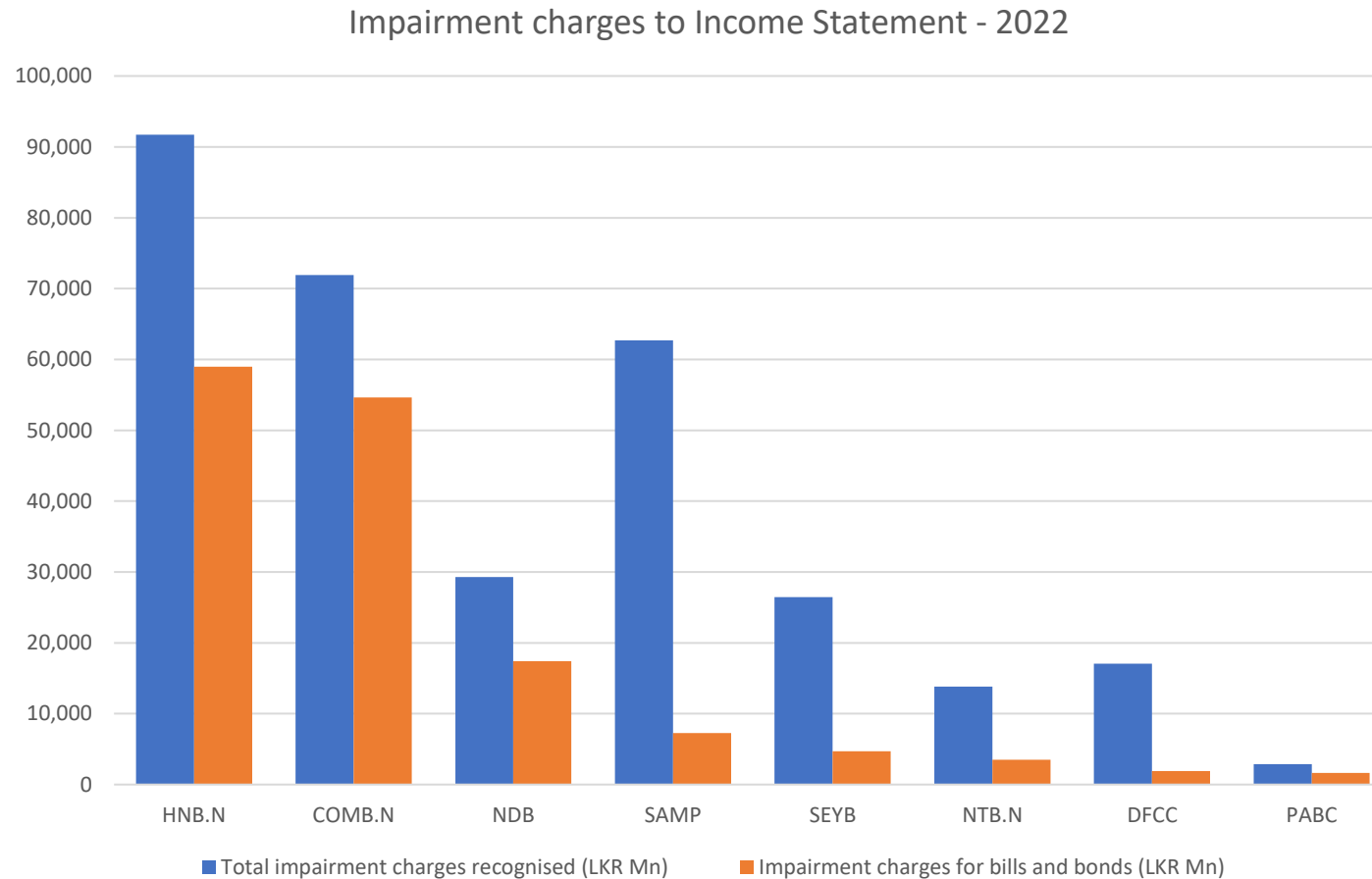
Source: Company reports, Ambeon estimates

## NTB and PABC recorded the lowest Impaired Loans ratios and NDB recorded the lowest Stage 03 Impairment coverage in 1H23



Source: Company reports, Ambeon estimates

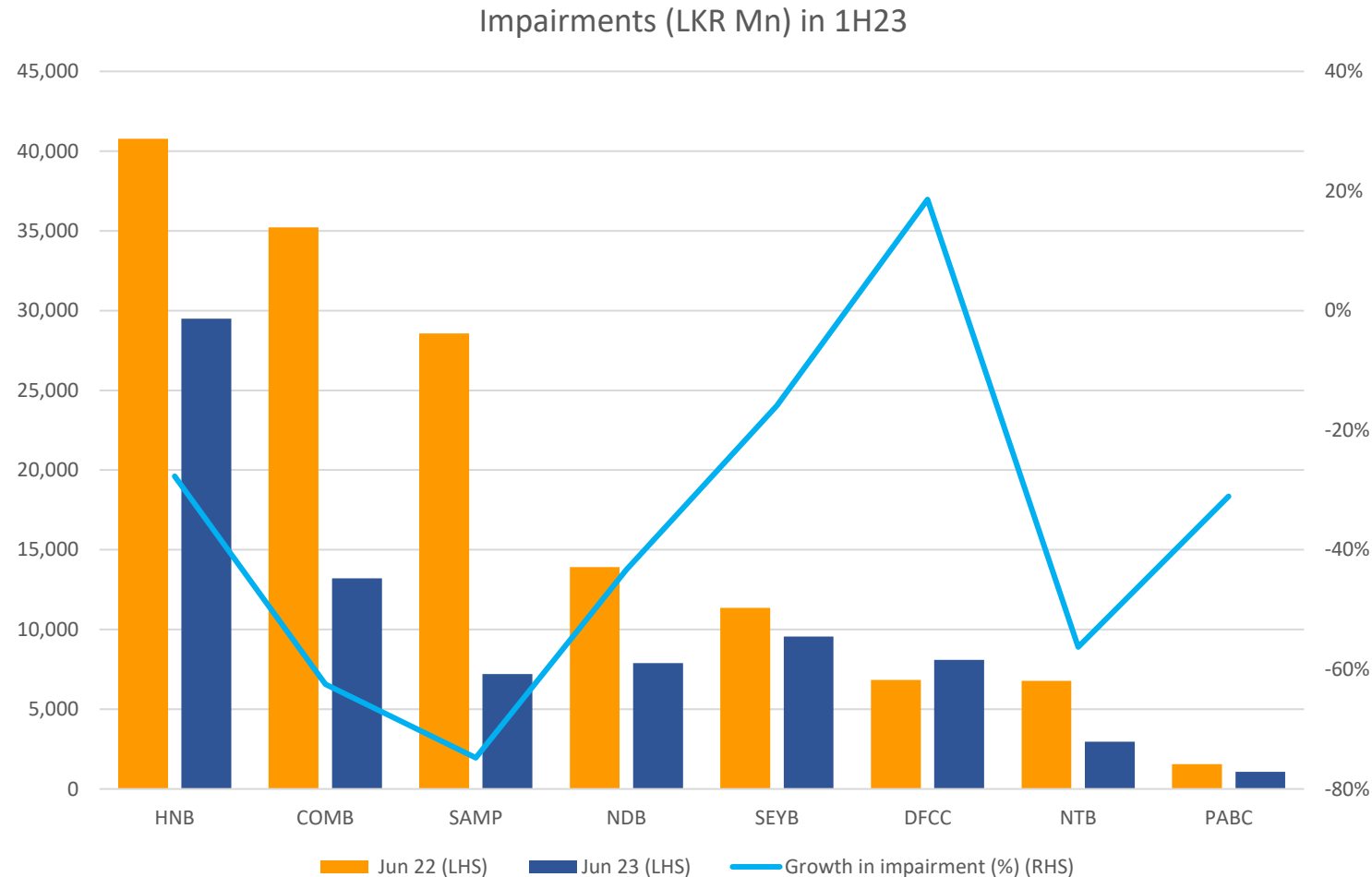
## HNB and COMB recognized the highest impairment charges in 2022, part of which could potentially be reversed



- Impairments have risen due to the weakened economic conditions, which have eroded the repayment capacity of our customers thereby reducing credit quality.
- Additionally, uncertainties loomed over the treasury securities due to the anticipated Domestic Debt Restructuring (DDO), leading to higher impairment charges.
- It's noteworthy that the bank's treasury bill and bond holdings are exempt from the DDO, and therefore, some of the impairment charges related to these holdings could potentially be reversed.

Source: Company reports, Ambeon estimates

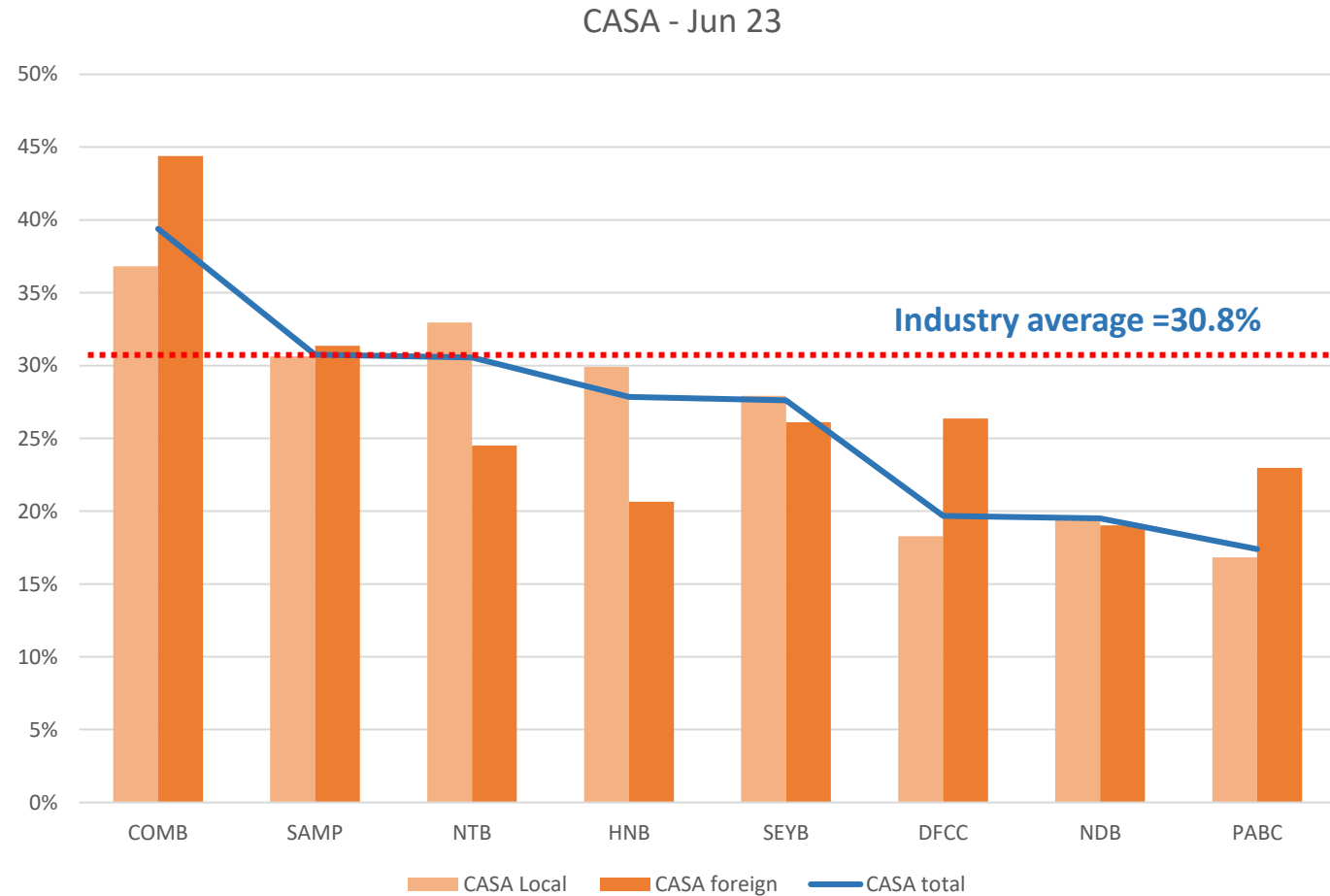
## Impairments in 1H23 declined from 1H22



- HNB and COMB have seen their impairments declining significantly in 1H23
- SAMP recorded an impairment reversal of LKR 1.4Bn in 1H23 in relation to its SLDB portfolio as it opted for the LKR conversion option given to SLDBs
- The exemptions of banking sector treasury bills and bond holdings from the DDO, and the option to convert SLDBs to LKR bonds could encourage banks to reverse some of the impairment provisions already made in 2022
- Further reduction in impairments can be expected as the credit quality improves as the economic conditions improve

Source: Company reports, Ambeon estimates

## COMB, SAMP, and NTB have CASA ratios above industry average

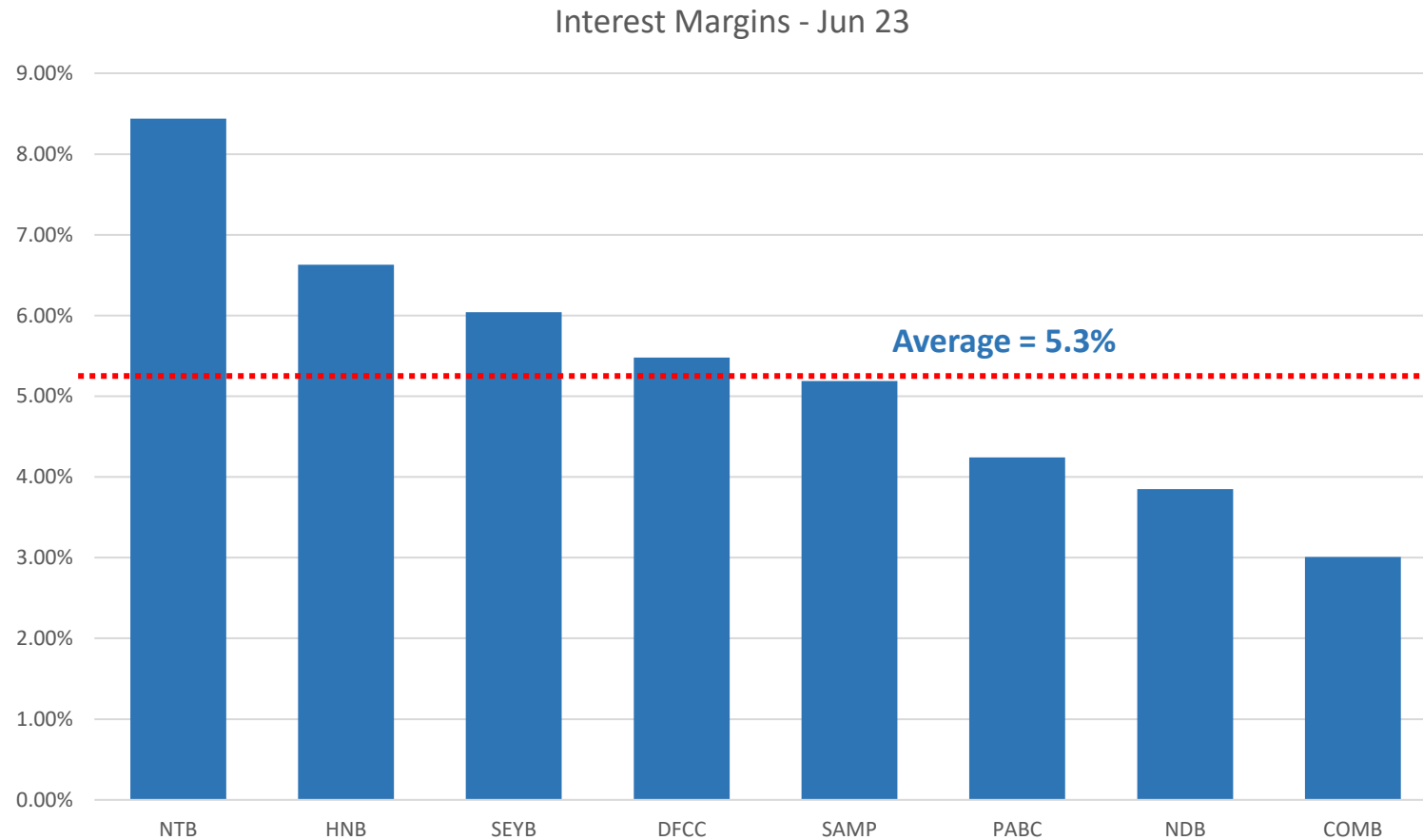


- A higher CASA ratio suggests that a greater proportion of the banks' funding comes from current and savings accounts, which are considered more stable and lower-cost sources of funding.
- This can enhance the bank's overall stability, especially in terms of liquidity as well as expansion of net interest income.
- The average CASA ratio of the banks remained 31%
- It is notable that several banks such as COMB, SAMP, DFCC, and PABC indicated higher CASA ratios for their foreign currency-denominated deposits.

Source: Company reports, CBSL, Ambeon estimates



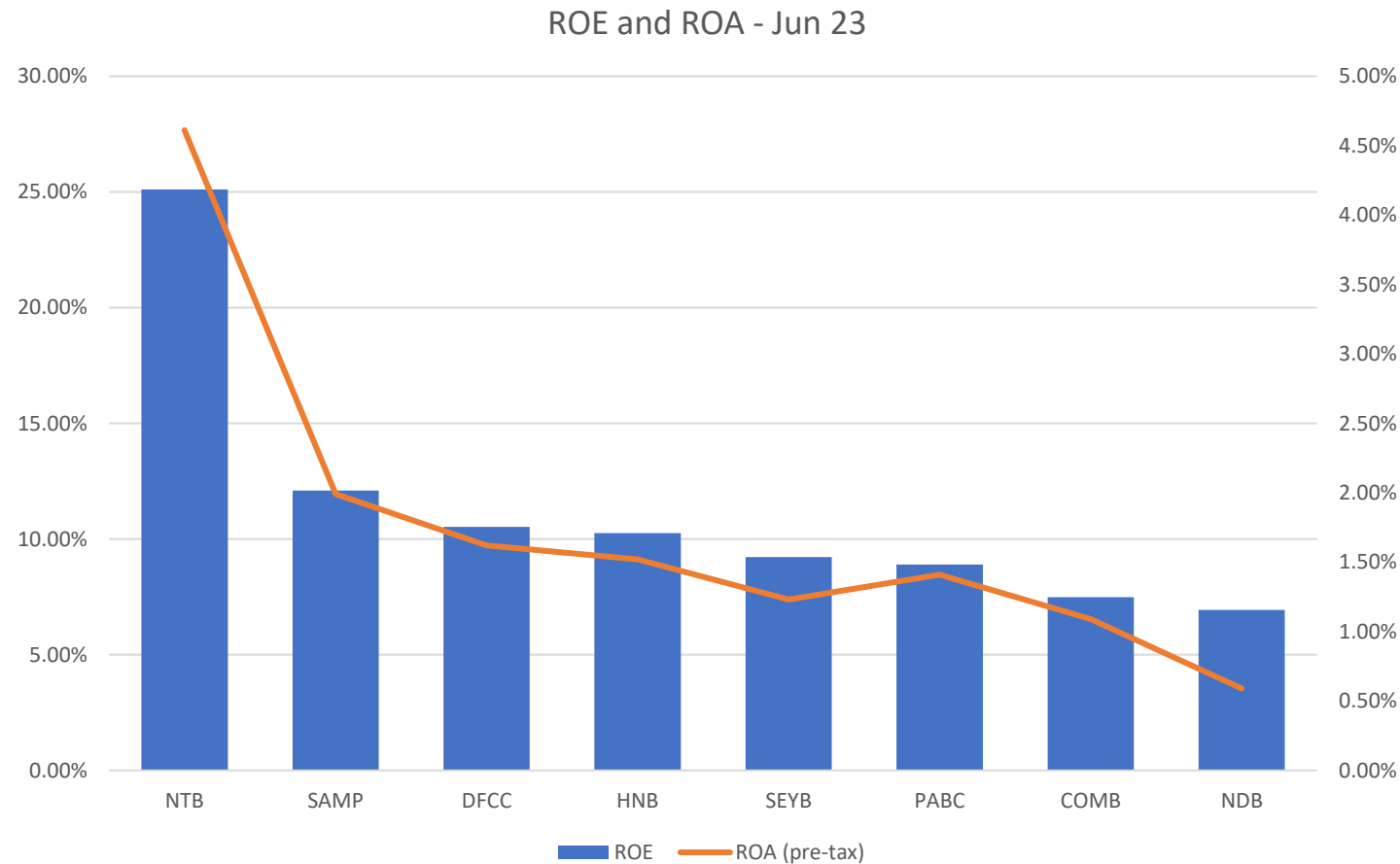
## NTB and HNB recorded the highest Interest Margins in 1H23



- A higher NIM can also reflect operational efficiency, indicating that the bank is managing its operations in a cost-effective manner.
- A higher NIM can be achieved by optimizing the loan portfolio by focusing on higher-yielding assets while managing risk.
- Attracting more low-cost deposits, such as current and savings accounts (CASA) help expanding the NIMs

Source: Company reports, Ambeon estimates

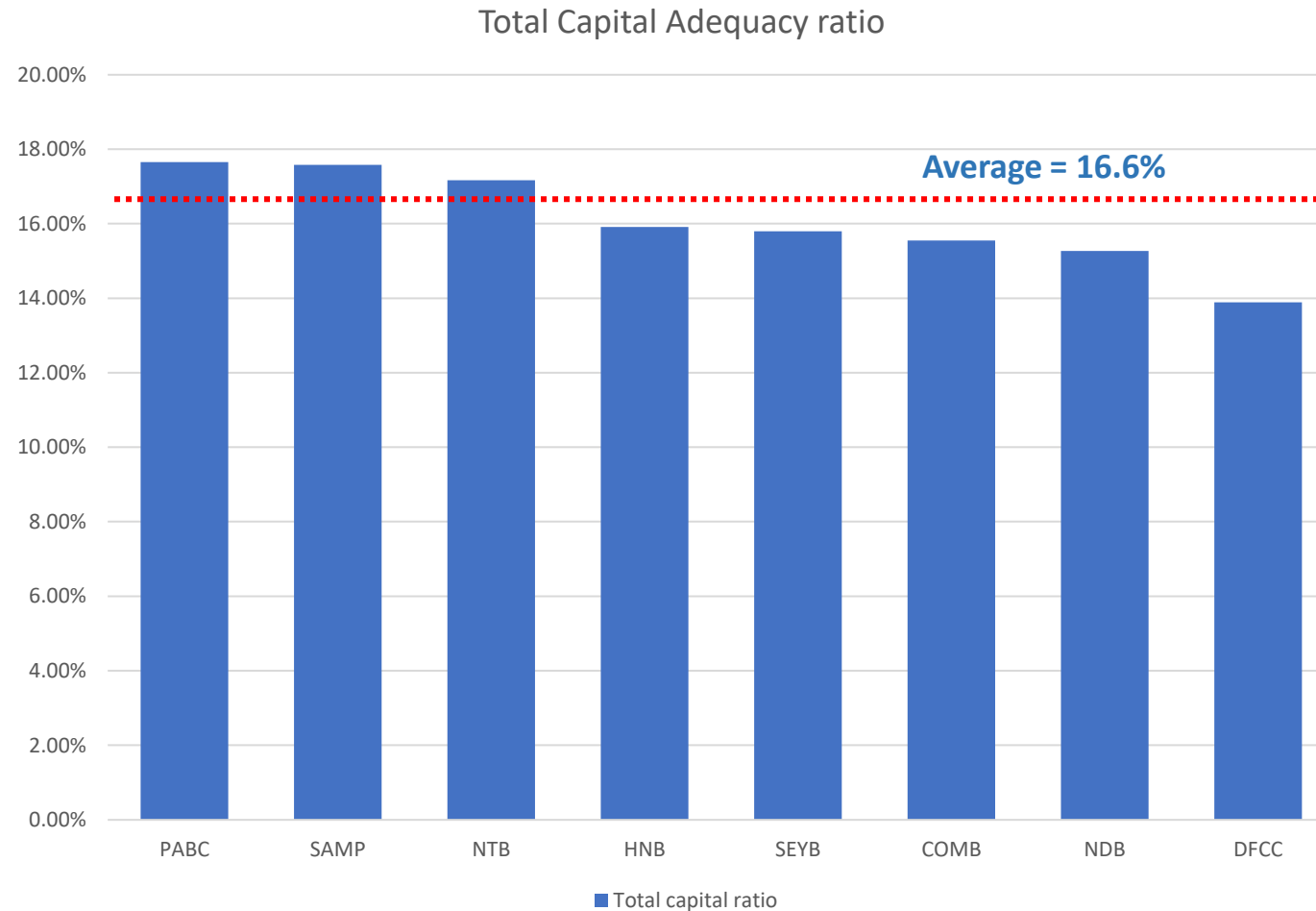
## NTB and SAMP recorded the highest ROEs and ROAs in 1H23



- Industry average ROE was 12% and ROA (pre-tax) was 1.6% in Jun 23
- Expansion in NIMs and optimizing the capital allocation by attracting more deposits help enhance the ROE
- Higher asset quality and lower funding cost also help enhance the ROAs of banks
- Streamlining operations and efficient use of physical assets by deploying online banking channels also contribute to improving ROAs

Source: Company reports, CBSL, Ambeon estimates

## PABC, SAMP and NTB has Capital Adequacy Ratios (CAR) above industry average



- Average Capital Adequacy ratio of the banking sector was 16.6% as of Jun 23
- Tier I Capital consists primarily of common equity, while Tier II Capital includes various forms of subordinated debt and other hybrid instruments.
- A high CAR indicates that a bank has a substantial capital buffer, making it more resilient to financial shocks, economic downturns, and unexpected losses. It can withstand adverse conditions without jeopardizing its solvency.
- A bank with a strong CAR is more likely to continue lending during economic downturns, supporting the broader economy by providing access to credit for businesses and consumers.

Source: Company reports, Ambeon estimates

## Top picks

Ticker	Key financials (LKR)			Valuations			Price appreciation		
	EPS (TTM)	NAVPS (Jun 23)	MPS	PE	PBV	Discount to NAVPS	2-Year	1-Year	Post-DDO
COMB.N	18.07	156.68	84.9	4.7x	0.5x	-46%	-4%	70%	25%
COMB.X	18.07	156.68	74.9	4.1x	0.5x	-52%	-5%	88%	38%
HNB.N	35.13	346.02	165.0	4.7x	0.5x	-52%	10%	114%	19%
HNB.X	35.13	346.02	140.0	4.0x	0.4x	-60%	1%	103%	159%
SAMP	12.55	120.29	65.0	5.2x	0.5x	-46%	16%	85%	16%
NTB.N	33.3	167.33	101.5	3.0x	0.6x	-39%	73%	118%	44%
NTB.X	33.3	167.33	102.3	3.1x	0.6x	-39%	66%	100%	51%
DFCC	14.95	147.48	82.4	5.5x	0.6x	-44%	29%	139%	77%
PABC	5.86	48.68	18.6	3.2x	0.4x	-62%	8%	94%	44%
SEYB.N	9.62	95.93	46.0	4.8x	0.5x	-52%	-1%	63%	32%
SEYB.X	9.62	95.93	36.4	3.8x	0.4x	-62%	-2%	117%	51%
NDB	9.37	178.6	62.0	6.6x	0.3x	-65%	-19%	71%	24%

**Top picks**

- All selected counters are currently trading at a substantial discount to their Net Asset Value Per Share (NAVPS).
- Post-DDO announcement in July 2023, all banks have seen a significant price increase

Source: Company reports, Ambeon estimates

## 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

E: [research@ambeonsecurities.lk](mailto:research@ambeonsecurities.lk)

## Sales Team

Charith Kamaladasa

Niranjan Niles

Romesh Kenny

Chinthaka Weeraratna

Pasindu Yatawara

Director/CEO

Executive Director

Senior Manager Institutional Sales

Senior Investment Advisor

Senior Investment Advisor

[charithk@ambeonsecurities.lk](mailto:charithk@ambeonsecurities.lk)

[niles@ambeonsecurities.lk](mailto:niles@ambeonsecurities.lk)

[romesh@ambeonsecurities.lk](mailto:romesh@ambeonsecurities.lk)

[chinthaka@ambeonsecurities.lk](mailto:chinthaka@ambeonsecurities.lk)

[pasindu@ambeonsecurities.lk](mailto:pasindu@ambeonsecurities.lk)

## Research Team

Hansinee Beddage

Manager Investment Research

[hansinee@ambeonsecurities.lk](mailto:hansinee@ambeonsecurities.lk)

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## Abbreviations

1H23	First half of 2023
Bn	Billions
CBSL	Central Bank of Sri Lanka
CSE	Colombo Stock Exchange
DDO	Domestic Debt Optimization
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)