



Commercial Bank of Ceylon PLC (COMB)

Rs 179.00

BUY

Financial Year (Dec)	Net Income (Rs.mn)	NPAT (Rs. mn)	PAT, MI & Pref Divid (Rs.mn)	EPS (Rs.)	EPS Growth %	PER (x)	P/BV	Dividend Yield %	DPS Rs.	NAV / Share	ROE
2005	8,769	2,360	2,128	5.65	42.32	31.67	4.22	2.5%	4.50	42.4	13%
2006	11,473	2,951	2,718	7.22	27.73	24.79	4.21	2.8%	5.00	42.5	17%
2007	16,273	4,152	4,037	10.72	48.52	16.69	2.77	3.9%	7.00	64.7	17%
2008	19,642	4,120	4,119	10.94	2.04	16.36	2.57	3.9%	7.00	69.7	16%
2009	18,812	4,193	4,192	11.14	1.77	16.07	2.35	3.9%	7.00	76.3	15%
2010E	22,096	4,993	4,988	13.25	19.00	13.51	2.00	3.9%	7.00	89.6	15%
2011E	25,783	5,784	5,778	15.35	15.83	11.66	1.71	3.9%	7.00	104.9	15%
2012E	30,735	6,976	6,969	18.51	20.61	9.67	1.45	3.9%	7.00	123.4	15%
2013E	36,699	8,291	8,283	22.00	18.86	8.13	1.23	3.9%	7.00	145.4	15%

COMB

Reuters Code	COMB.CM
Bloomberg Code	COMB.SL
Share Price LKR	179.00
Issued Share Capital (Shares)	
*Voting	352,242,689
*Non Voting	24,181,195
12 mth High/Low (Rs.) - Voting	194.75 / 85.47
Average Daily Volume (Voting Shares)	392,664
Market Capitalisation (Voting) Rs. mn	63,051
Price Performance (%)	1 mth 6 mth 12 mth
ASPI	0.21 28.20 90.67
COMB (Voting)	(4.11) 35.78 106.53

* Adjusted for bonus and rights issues

Profile

>> Commercial Bank of Ceylon PLC (COMB) remains Sri Lanka's leading private sector bank accounting for 13% of the country's LCB assets and deposits and has gained a reputation of being one of the best managed banks in the country. The bank having historically started as a corporate bank with established relationships with large firms and trading establishments is now reaping the benefits of its decision to go nationwide in the 1980's. Approximately 44% of the banks lending portfolio in Sri Lanka arises from the corporate sector while the growing retail and SME segment now accounts for 56% of advances. The bank operates 184 branches in Sri Lanka along with 333 ATM machines across the island with total assets of the bank currently amounting to Rs. 322bn.

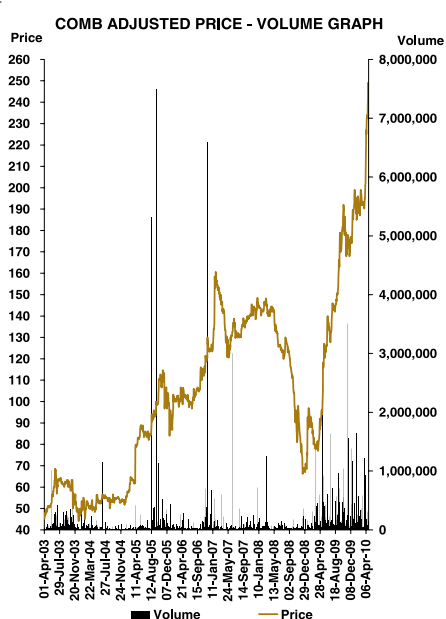
>> COMB has also successfully established a presence in Bangladesh following the acquisition of the Bangladesh branch of Credit Agricole Indosuez in 2003. The bank has since expanded its network to 9 banking centres with a predominant corporate lending portfolio with assets accounting for 8.3% of COMB's total assets and 6.54% of gross income in the group. The quality of its loan book in Bangladesh is reflected in the fact that it

recorded zero NPL's in the first 5 years of operations.

>> COMB being the largest local private bank in the country with 8 branches in the North East region is well positioned to reap the benefits of the anticipated boom in economic activity in the country following the end of the 3 decade long conflict. The central bank announced that approvals have been granted for the opening of 67 new branches in the Northern Province alone in the 3 weeks that followed the end of the conflict in mid May, in comparison to 136 branches opened across the entire country during the whole of last year. This is indicative of the untapped potential for the Banking sector given the unprecedented scope for development and growth in investment in the country across all sectors in a post war era, not withstanding the immediate investments required in reconstruction and infrastructure development in the North and East provinces.

Financial Performance

>> The past 18 months prior to the end of the war in May 2009 has been a challenge for the banking sector which witnessed a high interest rate environment, high inflation and



weakening economic conditions as the war intensified resulting in a reduction in new business volumes and a contraction of its lending portfolio as seen across the sector. The bank nevertheless posted group earnings of Rs. 4.19bn in FY09 marginally up from Rs. 4.12bn in FY08 which included a capital gain of Rs. 405.5mn on its sale of a 30% stake it had in Commercial Leasing CO. PLC as well as a charge of Rs. 692.16mn to its income statement on account of oil hedging contracts for which it is yet to receive payment

>> The group ROAA stood at 1.4% for FY09 while ROAE for the group was 15.3%. We do anticipate a reversal on the provisions made against the oil hedging contracts in mid FY10 although we have not factored this into our forecasts.

>> Net interest income for the bank declined marginally as the bank's loan book contracted and net interest margins declined on an adverse volume variance. Non interest income increased by 5.4% for FY09 on the back of foreign exchange gains earlier in the year and a pick up on fees and commission income stemming from trade finance activities in the last quarter. Gross NPL's that peaked at 8.85% in June '09 declined to 6.84% by the year end.

Loan Growth and Asset Quality

>> Asset growth in the bank has recorded a 20.07% CAGR over the last five years prior to FY09 while its loan book has grown at a CAGR of 22.10% over the same period marginally above a 21.35% CAGR witnessed in the Sri Lankan banking sector over the same period. Asset growth in FY09 was 14.6% while the bank registered negative loan growth of 4.70% for the year with much of deposits invested in government securities in the last year as demand for credit dried up. The banking sector did however witness signs of credit demand picking up in the 4Q of FY09.

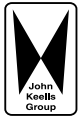
>> The bank's personal banking division now accounts for 56% of total advances with the bank evolving from being an almost exclusive corporate lender in the 1980's. The bank's retail lending portfolio consists mainly of consumption and housing loans while the bank's corporate loan portfolio is spread across key growth sectors of the economy without any significant over exposure in any segment.

>> We expect loan book growth of 14.8% in FY10 increasing incrementally to 24.5% by 2013 which is similar to asset growth rates witnessed during the 2002 – 2005 ceasefire period.

>> The bank anticipates giving greater focus toward the high yield SME and micro enterprise sector in the medium term while also commencing activities in the pawning business in 2008 which is zero rated for capital adequacy purposes. We expect the bank's NPL ratio to decline to 6.5% in FY10 and provision cover to improve significantly going forward.

Funding and Capital

>> Deposit growth for the bank has grown at a CAGR of 21.63% over the last 5 years. Low cost current and savings deposits which accounted for 53% of the bank's deposit base in 2006 declined to 45% in 2008 as rising interest rates resulted in a migration from savings and current deposits to high cost time deposits. Low



cost deposits currently account for 48% of the bank's deposit base with savings and demand deposits accounting for 39.7% and 8.3% of total deposits respectively.

>> The bank however continues to have a superior low cost deposit to total deposit ratio in comparison to other private commercial banks. A healthy surplus of low cost retail deposits over retail lending continues to help fund the banks corporate lending portfolio having a positive impact on cumulative interest margins.

>> The bank has a portfolio of longstanding branded savings products targeted at children, teens, seniors as well as working professionals which have helped the bank to cultivate its strong retail deposit base. The bank does have 8 branches in the North and East provinces and is expected to increase its presence in these regions giving a further boost to its savings deposit base.

>> The banks Tier 1 and Total capital adequacy ratios currently stand at 11.68% and 13.64% respectively as at 31st March 2010. The bank has always successfully attracted funds via attractively priced rights issues over the years during periods when asset growth consistently exceeded ROE of the bank. Furthermore the bank has regularly raised funds via subordinated debt for Tier 2 capital. The banks capital adequacy is presently well above minimum requirements of 5% and 10% for Tier 1 and Total capital respectively.

Net Interest Income

>> The sharp decline in yields on government securities has enabled banks to re-price its liabilities enabling banks to offset the negative impact on net interest margins caused by the adverse volume variance in the sector. One year treasury bills have fallen from 19.12% in early FY08 to a current rate of 9.47% which has spurred a downward revision on deposit rates. Commercial lending rates have also declined with prime lending rates at 10.52%.

>> Low interest rates offered by state banks to certain sectors will create added competitive pressures; however a time lag in re-pricing liabilities ahead of assets should ensure the bank retains margins. A high budget deficit and an up tick in inflation is expected to result in a 150bps increase in prime lending rates in the current year with net interest margins expected to range between 4.3% to 4.5% over the next two years. The resilience of the banks margin's should continue given its active promotion of its low cost savings deposits as well as its increased exposure to retail lending.

Non Interest Income

>> Non interest income has consistently accounted for one third of total net income of the bank over the last 5 years and is expected to continue to do so over the next few years on the back of foreign gains and fees and commissions from trade finance activities. The bank has aggressively pursued channeling the flow of worker remittances into the country and it has increased its share of inward remittances to 13% from 9% in 2007. Remittance houses established in Europe and the Far East as well as expansion of activities in the Middle East under the brand 'Commex' is expected to contribute to further gains on foreign exchange income.

Operating Expenses

>> COMB continues to record one of the lowest cost to income ratios among the local banks. Scale benefits from its size as well as constant re-engineering and rationalization of internal processes with the increased adoption of technology in its processes is expected to continue to register an incremental decline in costs going forward. The cost to income ratio in 2009 was higher as expected largely as a function of lower net interest income as apposed to a sharp rise in operating costs.

Valuations

>> The sector would also benefit considerably from the phasing out of the existing 20% VAT on financial services over the next few years as per representations made by the sector to the government. This would curtail current excessive effective tax rates in the banking sector amounting to 55% - 60%, permitting capital accumulation in banks to fund future loan growth and increase credit penetration in the country.

>> Earnings growth forecasts of 19% in FY10 correspond to a PER of 13.51x at Rs. 179.00. The counter trades at a P/BV 2.25x the NAV as of 31st March 2010. The counter trades at a 8% premium to the sector. Given that the bank has consistently exhibited sound fundamentals and is well positioned to further consolidate its market position in Sri Lanka while having strong medium to long term prospects in the region, it is our view that the counter ought to continue to trade at a premium to the sector. We recommend BUY.

COMB	2005	2006	2007	2008	2009	2010E	2011E	2012E	2013E
Price / Book Value	4.2	4.2	2.8	2.6	2.3	2.0	1.7	1.5	1.2
EPS	5.7	7.2	10.7	10.9	11.1	13.3	15.3	18.5	22.0
PER	31.7	24.8	16.7	16.4	16.1	13.5	11.7	9.7	8.1
EPS Growth	42.3%	27.7%	48.5%	2.0%	1.8%	19.0%	15.8%	20.6%	18.9%
DVD YLD	3.4%	3.4%	3.4%	3.4%	3.4%	3.4%	3.4%	3.4%	3.4%
ROE	13.3%	17.0%	16.6%	15.7%	14.6%	14.8%	14.6%	15.0%	15.1%
ROAE	14.2%	17.0%	20.0%	16.3%	15.3%	16.0%	15.8%	16.2%	16.4%
ROAA	1.3%	1.3%	1.6%	1.5%	1.4%	1.5%	1.5%	1.6%	1.6%
NIM	3.6%	3.7%	4.6%	5.0%	4.30%	4.31%	4.3%	4.3%	4.4%
Fee Income / Operating Income	33%	36%	29%	34%	34%	36%	37%	38%	38%
Cost / Income	54.6%	50.4%	47.5%	50.7%	61.0%	59.2%	58.7%	57.6%	56.3%
Cost / Income (Excl VAT)	47.4%	41.9%	38.0%	40.0%	48.9%	47.4%	47.0%	46.0%	45.1%
Cost / Average Assets	2.97%	2.86%	3.14%	3.62%	3.80%	3.83%	3.94%	4.00%	3.99%
Tier 1	9.68%	7.62%	10.00%	10.55%	11.92				
Loan Growth	30.9%	26.8%	15.8%	3.5%	-7.0%	12.1%	22.3%	23.4%	24.5%
Asset Growth	27.0%	24.4%	19.8%	4.9%	14.6%	11.6%	13.6%	16.3%	17.9%
RWA Growth	29%	33%	21%	5%	15%	12%	14%	16%	18%
Loan/ Deposits	93.1%	95.5%	95.1%	90.2%	71.4%	71.8%	77.2%	81.2%	84.8%
Loan / Assets	65.9%	67.1%	64.9%	64.0%	52.0%	52.2%	56.2%	59.7%	63.0%
Deposit / Liabilities	77.6%	75.7%	75.0%	78.3%	79.9%	80.3%	80.6%	81.4%	82.3%
Equity / Assets	8.9%	7.1%	9.1%	9.3%	8.9%	9.4%	9.7%	9.8%	9.8%
NPL Ratio	3.43%	2.79%	3.02%	5.33%	6.86%	6.00%	5.50%	5.00%	4.60%
NPL Coverage	53.9%	60.4%	67.5%	51.5%	44.0%	62.5%	65.0%	70.0%	77.5%
% Change in NPL's	-0.9%	3.1%	25.5%	82.5%	43.9%	-18.5%	12.1%	12.1%	14.5%
Personnel Cost / Average Assets	1.3%	1.3%	1.3%	1.3%	1.5%	1.6%	1.6%	1.7%	1.7%



Income Statement	2004	2005	2006	2007	2008	2009	2010E	2011E	2012E	2013E
For the Year Ended 31st December	Rs. 'mn	Rs. 'mn	Rs. 'mn	Rs. 'mn	Rs. 'mn	Rs. 'mn	Rs. 'mn	Rs. 'mn	Rs. 'mn	Rs. 'mn
Income	12,437	16,226	23,418	35,207	43,960	42,305	43,819	49,456	58,005	69,335
Foreign exchange profit	874	587	1,439	1,545	2,633	2,962	3,644	4,409	5,379	6,347
Fee and commision income	1,377	1,760	2,011	2,382	2,715	2,228	2,785	3,398	4,078	4,893
Other Income	409	586	665	760	1,398	1,200	1,500	1,830	2,196	2,635
Net Income	7,397	8,769	11,473	16,273	19,642	18,812	22,096	25,783	30,735	36,699
Less Operating Expenses										
Personnel Costs	1,820	2,144	2,566	3,284	3,665	4,664	5,410	6,276	7,343	8,591
Premises and Equipment expenses	1,019	1,146	1,384	1,600	1,996	2,176	2,503	2,878	3,367	3,940
Provision for staff retirement benefits	326	236	-	269	293	450	362	405	454	509
Loan losses and Provisions	699	415	655	1,777	2,278	214	963	1,169	1,707	2,657
Total Expenses	(4,879)	(5,199)	(6,435)	(9,507)	(12,235)	(11,686)	(14,047)	(16,307)	(19,399)	(23,333)
Profit from Operations	2,518	3,570	5,038	6,766	7,407	7,126	8,049	9,476	11,336	13,366
Add: Share of PBT of Assoc.	76	100	62	25	9	4	5	6	6	7
Profit before Tax	2,594	3,670	5,101	6,791	7,416	7,130	8,054	9,481	11,343	13,373
Less: Provision for Taxation	867	1,311	2,150	2,638	3,296	2,937	3,060	3,698	4,367	5,082
Profit after taxation	1,727	2,360	2,951	4,152	4,120	4,193	4,993	5,784	6,976	8,291
Less: Minority Interest	2	-	3	3	2	1	5	6	7	8
Net profit for the year	1,725	2,358	2,948	4,149	4,119	4,192	4,988	5,778	6,969	8,283
Cum. Red. Pref. Shares 13%	117.78	117.78	117.78							
Cum. Red. Pref. Shares 11.25%	112.50	112.50	112.50	112.50						
NPAT, MI & Pref. Dividend	1,495	2,128	2,718	4,037	4,119	4,192	4,988	5,778	6,969	8,283



Balance Sheet	2004	2005	2006	2007	2008	2009	2010E	2011E	2012E	2013E
As at 31st December	Rs. 'mn	Rs. 'mn	Rs. 'mn	Rs. 'mn	Rs. 'mn	Rs. 'mn	Rs. 'mn	Rs. 'mn	Rs. 'mn	Rs. 'mn
ASSETS										
Cash and short-term funds	12,136	18,657	13,731	16,208	24,115	29,260	28,688	31,557	34,712	38,184
Balances with Central Banks	6,320	9,045	12,574	11,576	10,322	11,795	15,548	13,500	15,530	17,732
Government Treasury Bills and Bonds	6,647	19,160	12,222	41,266	35,598	70,518	70,347	75,974	82,812	91,921
Commercial paper	560	408	423	-	-	-	-	-	-	-
Sec. purchased under re-sale agreements	2,087	808	4,593	3,804	3,400	8,523	8,949	9,397	9,866	10,360
Dealing Securities	110	182	145	207	58	81	350	385	424	466
Investment securities	2,940	3,691	1,795	1,756	1,197	1,025	1,798	2,068	2,378	2,735
Treasury Bonds Maturing after one year	14,379	1,714	20,025	8,795	16,270	17,630	33,439	31,767	30,178	28,670
Bills of Exchange	2,799	2,790	3,288	3,195	3,059	2,964	3,112	3,175	3,238	3,303
Loans and Advances	82,605	108,917	137,720	160,177	167,795	158,036	177,395	218,196	270,563	338,204
Lease rec. within one year	2,004	2,676	3,007	3,562	3,009	2,653	2,979	3,396	3,905	4,569
Lease rec. from one to five years	3,243	4,295	6,415	7,238	6,335	3,980	4,468	5,093	5,857	6,853
	135,828	172,345	215,938	258,164	271,159	306,465	347,073	394,507	459,463	542,995
Investment in Assoc.	243	283	41	63	71	73	96	96	96	96
Interest and Fees receivables	1,143	1,199	1,639	2,120	2,341	4,093	3,266	3,658	4,097	4,588
Other Assets	1,445	2,944	3,006	4,041	3,654	6,802	4,256	4,596	4,964	5,361
Property, Plant and Equipment	3,134	3,365	3,438	3,997	4,343	5,113	5,365	6,009	6,730	7,537
TOTAL ASSETS	141,792	180,135	224,061	268,385	281,567	322,546	360,056	408,866	475,350	560,579
Financed By :	-	-	-	-	-	-	-	-	-	-
Deposits form customers	98,622	127,491	157,532	183,088	199,865	234,731	261,932	297,792	349,086	416,302
Dividends Payable	232	230	113	113	-	-	-	-	-	-
Borrowings	9,090	13,453	18,944	18,752	13,620	11,639	14,898	18,175	21,810	26,172
Sec. sold under repurchase agreements	12,261	11,386	14,317	23,238	24,960	29,773	33,048	36,684	40,719	45,198
Other Liabilities	3,491	6,070	8,402	9,741	10,094	12,242	12,609	12,987	13,377	13,778
Tax Payable	484	773	1,420	1,679	1,663	1,211	2	3	3	-
Deferred Taxation	251	239	625	712	676	767	1,074	1,504	2,105	2,947
Debentures	3,244	4,553	6,680	6,680	4,436	3,436	2,749	2,199	1,759	1,407
	127,676	164,168	208,033	244,004	255,314	293,799	326,311	369,343	428,859	505,804
Minority Interest	12	13	11	24	27	26	36	36	36	36
SHAREHOLDERS FUNDS										
Ordinary Shares - Voting	650	1,328	1,335	2,329	2,363	2,363	2,363	2,363	2,363	2,363
Ordinary Shares - Non Voting	47	93	93	161	161	161	161	161	161	161
13% Cum. Pref. shares	907	907	-	-	-	-	-	-	-	-
11.25% Cum. Red. Pref. Shares	1,000	1,000	1,000	1,000	-	-	-	-	-	-
Share Capital	2,603	3,327	2,428	3,491	2,524	2,524	2,524	2,524	2,524	2,524
Statutory Reserve Fund	1,010	1,422	1,429	1,634	1,848	2,062	2,162	2,278	2,417	2,583
Reserves	10,491	11,205	12,159	19,233	21,854	24,135	29,023	34,685	41,515	49,632
Shareholders Funds	14,105	15,954	16,016	24,358	26,226	28,721	33,709	39,487	46,456	54,739
	141,792	180,135	224,061	268,385	281,567	322,546	360,056	408,866	475,350	560,579

