



Hatton National Bank PLC (HNB)

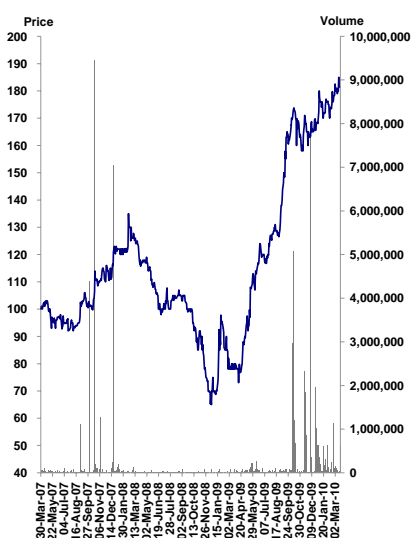
Rs 181.25 (Voting); Rs. 135.25 (Non Voting)

BUY

Financial Year (Dec)	Net Income (Rs.mn)	PAT (Rs.mn)	EPS (Rs.)	EPS Growth %	PER (x) Rs. (Voting)	PER (x) Rs. (Non Voting)	P/BV	Dividend Yield % (Voting)	DPS Rs.
2006	12,425	2,239	9.61	26.47	18.86	14.07	3.27	3%	5.00
2007	15,946	3,150	13.52	40.70	13.40	10.00	1.98	3%	5.00
2008	18,438	2,831	12.15	(10.16)	14.92	11.13	1.84	2%	4.00
2009	21,036	4,483	19.24	58.39	9.42	7.03	1.60	4%	6.50
2010E	23,108	4,885	20.97	8.95	8.64	6.45	1.42	4%	6.50
2011E	27,087	5,921	25.41	21.21	7.13	5.32	1.23	4%	6.50
2012E	31,734	7,092	30.44	19.79	5.95	4.44	1.06	4%	6.50
2013E	37,334	8,606	36.94	21.34	4.91	3.66	0.91	4%	6.50

HNB			
Reuters Code	HNB.CM		
Bloomberg Code	HNB.SL		
Share Price LKR (Voting)	181.25		
Issued Share Capital (Shares)			
*Voting	186,717,435		
*Non Voting	46,249,532		
12 mth High/Low (Rs.) - Voting	185 / 72.00		
Average Daily Volume (Shares) - Voting	176,143		
Market Capitalisation (Voting) Rs. mn	33,843		
Price Performance (%)			
	1 mth	6 mth	12 mth
ASPI	1.76	33.29	133.53
HNB	4.47	11.20	132.37

HNB ADJUSTED PRICE - VOLUME GRAPH



Profile

Hatton National Bank PLC is the second largest private bank in the country ranked closely to its peer Commercial Bank of Ceylon PLC in terms of banking assets and branch network. The bank has 186 banking centres across the island providing corporate and retail banking, along with trade and project finance services. The bank's subsidiaries include Insurance, and a Joint Venture investment in a Stock broking and Investment Banking firm while also functioning as a Primary Dealer for Government Securities. Contributions from these entities are relatively small. HNB is also the third largest issuer of credit cards in the country behind the two foreign banks HSBC and Standard Chartered Bank.

Financial Performance

The bank recorded a 58% increase in group post tax earnings in FY09 with sound improvements recorded on all key fundamentals. A 16% increase in net interest income driven by a favourable rate variance despite the negative growth in its lending portfolio. Non interest income increased by a modest 12% for FY09, while the bank continued to rationalize costs with operating expenses increasing by just 11% in FY09. A sharp rise in recoveries as a result of write backs on two fully provided non performing advances resulted in total provision expenses amounting to just 2.04mn in FY09 as against Rs. 259mn in the previous year.

The bank continued to benefit from tax losses which resulted in an effective corporate tax rate of just 26.16%. Our estimates assume that this will not recur going forward.

Loan Book and Asset Quality

HNB witnessed a 4% contraction in the bank's loan portfolio stemming from high interest rates and depressed economic conditions in early FY09. While the sector is just beginning to witness signs of credit demand picking up, it is widely expected that the conclusion of the General Elections in April would spur credit demand by corporates. Loan growth expansion is already evident on retail consumption loans including housing and pawning loans.

We anticipate loan growth of 16.9% in FY10 increasing to 20% and over post FY11 for HNB. The bank added 9 branches in the last year and is expected to add a further 10 to 12 branches in FY10 a bulk of which would be added to boost its network in the North and East provinces which already has 21 HNB branches.

Investments made in integrating its' systems across its network of banking centres has strengthened follow up and credit risk monitoring over the past two years. In addition more resources and greater proficiency has been brought into credit risk management over the last 4 years which has contributed to a healthier loan book.



Emphasis on recoveries, follow up and rescheduling of bad debts has led to a decline in Non Performing Loans and a subsequent decline in provisioning expense. The banks' gross NPL ration declined to 6.15% from 8.73% in Jun FY09 and is likely to improve further to 5.25% in FY10 along with incremental improvements in provision cover.

Funding and capital

Customer deposits are principally HNBs' core source of funding with approximately 91% of interest bearing liabilities being customer deposits in FY09. Low cost demand and savings deposits account for 7.6% and 37.8% of total deposits in FY09. Customer deposits grew 13% in FY09 and are expected to grow by 16.5% in FY10 and 16.6% in FY11. We do not foresee a significant change in the banks deposit mix over the medium term.

The banks Tier 1 and Total capital stood at 11.1% and 13.16% respectively as at 31st December 2009, well above minimum statutory requirements of 5% and 10% respectively.

Interest Income

The bank maintained healthy net interest margins of 5.4% in FY09 largely due to its significant exposure to low cost deposits as well as a sound maturity match of assets and liabilities. We expect Net interest margins to remain fairly stable at current levels over the next few years given the banks strong low cost retail deposit base.

Non-Interest Income

Non-interest income has consistently contributed over $\frac{1}{3}$ of total income over the past few years, arising primarily out of fees and commissions for trade finance activities. The bank witnessed a moderate growth of just 9% in non interest income. Increase in exposure to consumer lending as well as an upturn in general economic activity is expected to boost external trade which would filter down to increased fees and commissions. The bank is also expected to record an increase in foreign exchange income via its inward remittance business following the opening of exchange houses in Canada and the Middle East. The bank estimated to have a 17% market share in the formal remittance market in the country the highest among private commercial banks.

Operating Expenses

HNB's Cost to Income ratio declined sharply over the last 4 years. The bank has added nearly 40 branches over the last 4-5 years whilst retaining if not marginally reducing its staff cadre. The bank's branch expansion model going forward will have an average of just 7 personnel. The operational efficiencies have been complemented by the launch of a core banking software solution, which has integrated the banks entire network facilitating the roll out of new branches as well as improving credit monitoring and follow up. Operating expenses increased by just 11% in FY09 while the banks cost to income ratio is expected to record further improvement over the next few years.

Valuations

HNB has shown exhibited strong fundamentals over the last three years with a healthier loan book, improved provision cover and enhanced profitability. Earnings growth of 8.95% in FY09 and 21.21% in FY10 excluding exceptional items such as large recoveries and write backs, correspond to a forecast PER of 8.64x and 7.13x FY10 and FY11 earnings at a market price of Rs. 181.25. The counter currently trades at a P/BV of 1.60x as at end December 2009. We believe the counter ought to continue to trade at a premium to sector. We recommend **BUY**.



Income Statement	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
Income	23,214	32,076	38,725	41,317	42,933	50,406	59,120	70,284
Interest Income	19,321	27,127	32,830	34,836	35,042	40,647	47,470	56,459
Less: Interest Expense	10,788	16,130	20,287	20,281	19,379	22,949	26,964	32,281
Net Interest Income	8,533	10,996	12,542	14,555	15,662	17,699	20,507	24,179
Foreign exchange profit	773	1,115	1,169	920	1,058	1,217	1,399	1,609
Fee and commision income	1,861	2,122	2,435	2,355	2,827	3,533	4,240	5,003
Other Income	1,258	1,712	2,292	3,206	4,007	5,009	6,010	7,212
Net Income	12,425	15,946	18,438	21,036	23,554	27,457	32,156	38,003
Less Operating Expenses	3,892							
Personnel Costs	2,895	3,430	3,831	4,446	5,113	5,880	6,879	8,049
Premises and Equipment expenses	1,752	1,859	2,184	2,649	2,967	3,353	3,788	4,357
Provision for staff retirement benefits	3,344	4,740	5,717	6,243	7,180	8,257	9,495	10,919
Loan losses and Provisions	401	457	795	823	865	908	953	1,144
Other Overhead expenses	932	908	1,159	709	275	248	476	515
Total Expenses	(9,344)	(11,396)	(13,947)	(14,877)	(16,414)	(18,661)	(21,609)	(25,000)
Profit from Operations	3,082	4,550	4,492	6,159	7,139	8,796	10,547	13,003
Add: Share of PBT of Assoc.	14	14	(6)	8	17	17	17	17
Profit before Tax	3,095	4,565	4,485	6,167	7,156	8,813	10,564	13,020
Less: Provision for Taxation	820	1,365	1,599	1,613	2,362	3,085	3,698	4,557
Profit after taxation	2,276	3,200	2,886	4,553	4,795	5,729	6,867	8,463
Less: Minority Interest	37	49	55	70	5	6	7	8
Net profit for the year	2,239	3,150	2,831	4,483	4,790	5,723	6,860	8,454

Balance Sheet	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
ASSETS								
Cash and short-term funds	23,856	19,275	23,560	27,489	32,987	39,584	47,501	57,001
Balances with Central Banks	12,017	13,406	11,862	11,079	12,170	13,387	14,726	16,199
Government Treasury Bills and Bonds	2,452	1,156	759	306	352	404	465	535
Commercial paper	291	236	236	283	325	374	430	495
Sec. purchased under re-sale agreements	4,393	5,859	2,539	951	1,093	1,257	1,446	1,663
Dealing Securities	976	712	81	688	770	863	966	1,082
Investment securities	22,214	20,978	26,971	55,848	58,082	55,758	55,201	54,649
Bills of Exchange	1,911	2,069	1,959	1,476	1,506	1,536	1,566	1,598
Loans and Advances	113,929	143,415	159,462	156,392	182,978	219,574	263,489	321,456
Lease receivable within one year	3,796	4,396	4,392	3,931	4,599	5,519	6,734	8,215
Lease receiveable from one to five years	7,756	8,894	7,097	5,013	5,865	7,038	8,587	10,476
Investment in Assoc.	165	165	144	226	271	326	391	469
Other Assets	5,035	7,048	8,274	8,788	9,289	10,208	10,678	10,361
Property, Plant and Equipment	7,571	13,182	13,901	14,333	15,050	15,802	16,592	17,422
TOTAL ASSETS	206,620	241,003	261,990	287,511	325,977	372,207	429,289	502,085
Financed By :								
Deposits form customers	147,463	175,567	186,615	210,363	240,753	276,847	321,996	380,370
Dividends Payable	38	30	127	216	-	-	-	-
Borrowings	25,359	18,257	25,050	17,998	20,158	22,576	25,286	28,320
Non Life Ins. reserves & Long Term Ins. Fund	827	1,221	1,831	2,453	2,747	3,077	3,446	3,860
Other Liabilities	11,661	16,606	18,074	23,139	25,916	29,026	32,509	36,410
Tax Payable	774	1,605	2,416	2,977	3,335	3,735	4,183	4,685
Deferred Taxation	318	608	873	938	1,051	1,177	1,318	1,477
Debentures	7,083	5,589	3,735	2,653	1,990	1,492	1,119	839
	193,524	219,483	238,721	260,738	295,949	337,930	389,857	455,961
Minority Interest	180	220	348	400	348	348	348	348
SHAREHOLDERS FUNDS								
Ordinary Shares - Voting	947	1,893	1,893	1,893	1,893	1,893	1,893	1,893
Ordinary Shares - Non Voting	231	462	462	462	462	462	462	462
Share Capital	1,178	2,355	5,059	5,084	5,084	5,084	5,084	5,084
Statutory Reserve Fund	670	822	983	1,260	1,546	1,889	2,058	2,250
Reserves	11,068	18,123	16,879	20,030	23,049	26,955	31,941	38,442
Shareholders Funds	12,916	21,300	22,921	26,374	29,679	33,928	39,084	45,776
	206,620	241,003	261,990	287,511	325,977	372,207	429,289	502,085



	2006	2007	2008	2009	2010E	2011E	2012E	2013E
Price / Book Value	3.3	2.0	1.8	1.6	1.4	1.2	1.1	0.9
EPS	9.6	13.5	12.1	19.2	21.0	25.4	30.4	36.9
PER	18.9	13.4	14.9	9.4	8.6	7.1	6.0	4.9
EPS Growth	26.5%	40.7%	-10.2%	58.4%	9.0%	21.2%	19.8%	21.3%
DVD YLD	2.8%	2.8%	2.8%	2.8%	2.8%	2.8%	2.8%	2.8%
ROE	17.3%	14.8%	12.3%	17.0%	16.4%	17.3%	17.9%	18.5%
ROAE	18.6%	18.4%	12.8%	18.2%	17.4%	18.5%	19.2%	20.0%
ROAA	1.2%	1.4%	1.1%	1.6%	1.6%	1.7%	1.8%	1.8%
NIM	4.81%	5.18%	5.51%	5.94%	5.42%	5.39%	5.39%	5.35%
Fee Income / Operating Income	31%	31%	32%	31%	35%	37%	37%	38%
Cost / Income	67.7%	65.8%	69.4%	67.4%	67.3%	65.5%	64.1%	63.2%
Cost / Income (Excl VAT)	59.9%	57.8%	61.4%	56.0%	58.1%	56.6%	54.6%	53.8%
Cost / Average Assets	4.41%	4.69%	5.08%	5.16%	5.07%	5.08%	5.07%	5.06%
Loan Growth	19.5%	24.6%	8.9%	-3.5%	16.9%	19.9%	20.0%	21.9%
Asset Growth	18.1%	16.6%	8.7%	9.7%	13.4%	14.2%	15.4%	17.0%
RWA Growth	30%	23%	14%	10%	13%	14%	15%	17%
Loan/ Deposits	86.4%	90.4%	92.7%	79.3%	81.0%	84.4%	87.1%	89.8%
Loan / Assets	61.7%	65.9%	66.0%	58.0%	59.8%	62.7%	65.2%	68.0%
Deposit / Liabilities	76.2%	80.0%	78.2%	80.7%	81.3%	81.9%	82.6%	83.4%
Equity / Assets	6.3%	8.8%	8.7%	9.2%	9.1%	9.2%	9.2%	9.3%
NPL Ratio	7.48%	6.11%	7.12%	6.47%	5.25%	4.50%	4.00%	3.50%
NPL Coverage	64.7%	67.4%	59.7%	45.8%	51.0%	52.0%	53.0%	54.0%

