



CITIZENS DEVELOPMENT BUSINESS FINANCE PLC [CDB.N0000]

INITIATING WITH BUY

STEADY GROWTH, RISING STRONGER

Fair Value [FY19E]: LKR 120.0 [+38%]

Buy Below: LKR 108.5

*CDB, a mid-sized finance company with an asset base of LKR 68Bn is likely to retain a steady growth momentum with an earnings CAGR of 18% FY18E-20E. Company's innovative fintech led cost management strategy improves its digital footprint and allows early identification of potential clients. Company's plans to increase exposure to high margins products such as gold loans and credit cards is expected to support a rise in NIMs. CDB fair value is at LKR 120.0 for FY19E (after liquidity discount) providing an annualized return of 51%. **BUY***

P/E 31 March	FY14	FY15	FY16	FY17	FY18E	FY19E	FY20E
Estimates (LKR 'Mn)							
Net Interest Income	2,342	2,896	3,111	2,978	3,733	4,622	5,653
Total Operating Income	372	452	846	1,017	1,623	1,852	2,104
Net Profit	561	709	1,019	1,023	1,267	1,423	1,695
EPS (LKR)	10.3	13.1	18.8	18.8	23.3	26.2	31.2
YoY Growth (%)	15%	26%	44%	0%	24%	12%	19%
Valuations							
PER (x)	8.4x	6.7x	4.6x	4.6x	3.7x	3.3x	2.8x
PBV (x)	1.3x	1.1x	0.9x	0.8x	0.6x	0.6x	0.5x
DY (%)	0.0%	0.0%	4.0%	4.0%	5.4%	6.0%	7.2%

Digitalized Marketing and Early Client Identification

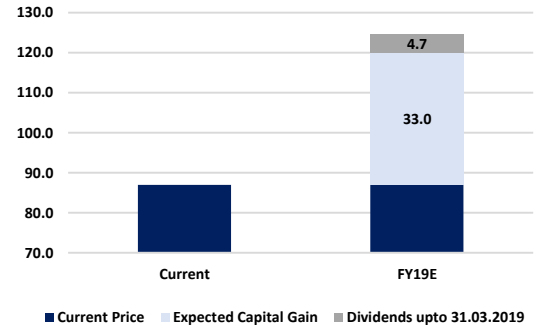
CDB has implemented a radical cost management strategy with the company investing heavily into a digital platform known as patpat.lk. With the support of the digital marketing strategy, we expect CDB cost to income to improve to ratio to 53% by FY19E and 52% by FY20E. With the investment, company manages its marketing costs amidst a strong focus on digital marketing allowing CDB to expand its digital footprint. The platform also allows CDB to identify potential clients early which is a major saving and a key advantage for the company.

Introduction of high margin products

CDB IR spreads which are estimated at 5.6% in FY18E is likely to improve to 5.8% by FY19E and 6.0% by FY20E (6.7% - FY17) with the aggressive expansion of its gold loans portfolio and the new credit card business. CDB has invested heavily to specially recruitment and train staff to handle gold loans and is currently rolling out the gold loan products in all 70 branches.

CDB.N & CDB.X are both rated BUY

CDB earnings are likely to grow at a CAGR of 18% FY18E-20E with earnings growing by 24% in FY18E and 12% in FY19E. CDB has in the past been a conservative company with steady growth and its new strategies are providing a competitive advantage strengthening its ability to manage cost. The story on CDB is more a steady growth and attractive valuations, where the company, due to the new strategies may result in re-rating of the stock. However, considering the low liquidity of the stock and the fact that the counter usually trades at a discount to the market, we have factored in a 10% discount to our original fair value. With CDB.N valued at LKR 120.0, despite the recent uptick, we expect further upside of 38% plus DY of 5%. CDB.X is valued at LKR 105.0 anticipating a 12% discount to the voting share. **BUY for CDB.N and CDB.X**



FIRST CAPITAL RESEARCH

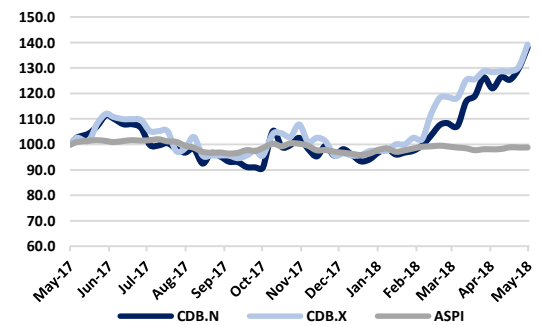
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KEY DATA	Voting	Non-Voting
CSE Ticker	CDB.N0000	CDB.X0000
Bloomberg Ticker	CDB SL	CDBX SL
Share Price (LKR)	87.00	78.00
52w High (LKR)	92.80	80.00
52w Low (LKR)	60.20	54.20
Avg. Daily Volume (Shares)	29,451	4,799
Avg. Daily Turnover (LKR)	2,062,325	293,684
Issued Share Capital (Shares 'Mn)	46.3	8.0
Market Cap (LKR 'Mn)		4,652
Market Cap (USD 'Mn)		30

*1 USD = LKR 157

Price Performance (%)	1 mth	3 mths	12mths
CDB - Voting	13%	42%	43%
CDB - Non-Voting	25%	57%	66%
ASPI	1%	0%	-1%



Disclosure on Shareholding:

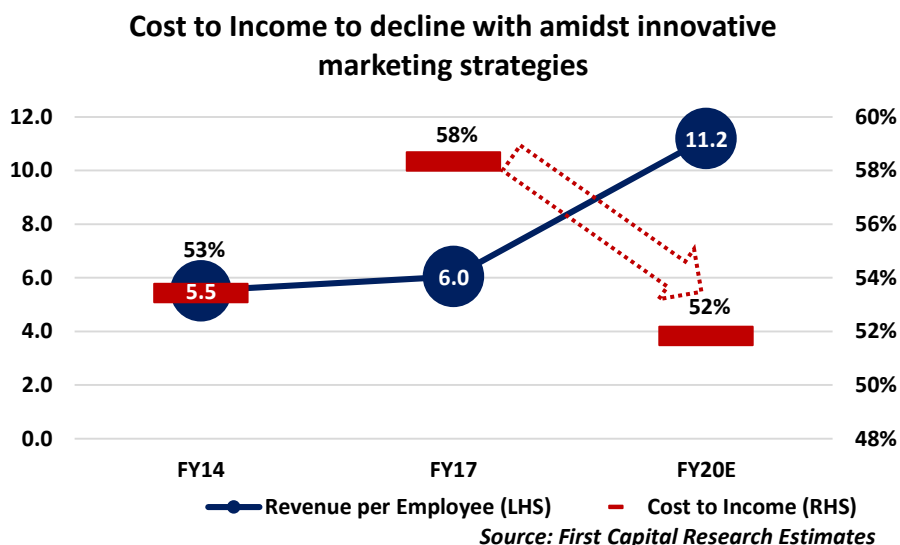
First Capital Group hold 570,247 shares in CDB. First Capital Group has not traded in the shares in the three trading days prior to this document, and will not trade in the shares for three trading days following the issue of this document.

1.0 Digitalized Marketing and Early Client Identification

Digitalized Marketing to dominate marketing: CDB has made major strides in investing in fintech over the last couple of years and developing a strong digital marketing platform. Currently the platform patpat.lk which acts as a facilitator for vehicle market is paying dividends with visitors and active users improving considerably. CDB’s marketing is now more focused towards the digital platform which allows the company to manage its marketing cost as the digital channels are comparatively cheaper compared to other media channels.

Supports early client identification: With CDB’s new digital platform facilitating the vehicle market, it provides a key advantage for CDB to identify its potential clientele early, before its competitors, thus overall reducing the cost of generating leads. The platform is popular among buyers and sellers of second hand vehicles, which is exact target market of CDB’s lending business, thus providing opportunity to directly identify clients at a much early stage. The strategy provides an edge built on relationships with the customer at an early stage. Some of these relationships at a later stage get converted to leads for CDB’s core lending business. Overall marketing cost required for lead generation would reduce due to the digital platform.

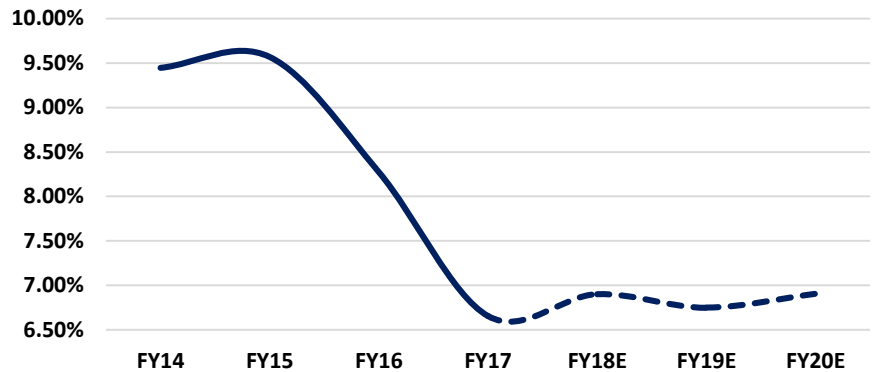
Figure 1: Cost to Income vs Revenue per employee



2.0 Introduction of high margin products

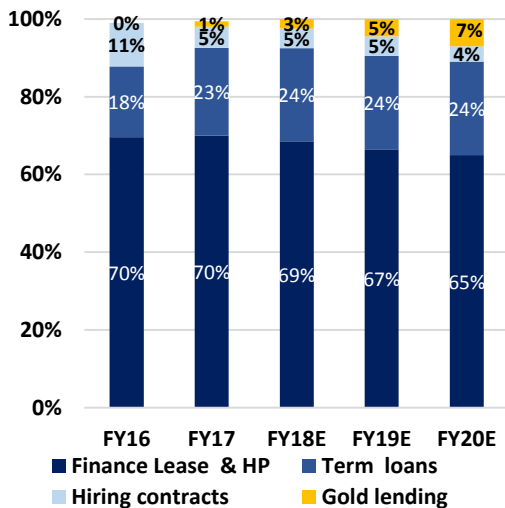
Re-entering to high margin products: CDB is introducing high margin products such as gold loans and credit cards with the intension of boosting their NIMs in the near term. According to our estimates, CDB's spreads are expected to increase to 5.8% by FY19E and 6.0% by FY20E respectively supported by rising NIMs, which is estimated to be at 6.8% by FY19E and 6.9% by FY20E.

Figure 2: Net Interest Income to bottoming out



Source: First Capital Research Estimates

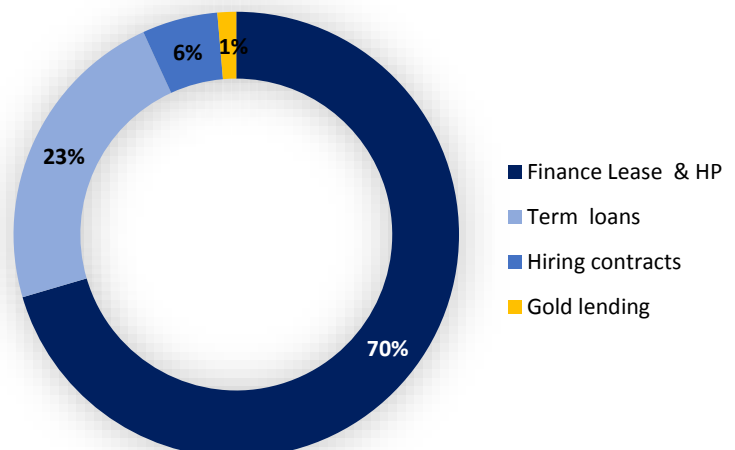
Figure 3: Gold Loan to grow to 7%



Source: First Capital Research Estimates

More focus on Gold loans: CDB plans on increasing its allocation to gold loans with the intension of diversifying the portfolio and also increasing the overall yield of the lending portfolio. CDB has recruited and trained staff specifically for gold lending and has already placed them in all 69 branches which will allow CDB to accelerate disbursements into this segment and also reduce risk in assessment of value. The company targets to gradually increase gold loan portfolio to about 10% of the loan book over the medium term. Currently 60% of gold loans are 1-3 months maturity period, while less than 10% loans have a maturity period over 1 years. We expect gold loan to reach 4.0% of total loans in FY18E and 6.0% in FY19E and less aggressive than company's expectations.

Figure 4: Finance Lease & HP 70% of loan mix



Source: Company Annual Reports

Reducing maturity mismatches: We expect the CDB to record improve NIMs in FY19E and FY20E through introduction of credit card which will provide strong fee base income and offset maturity mismatches.

3.0 Future Outlook

CDB Earnings CAGR of 18% FY18E-20E: We expect earnings to rise 24% to LKR 1.2Bn in FY18E (CDB has already done LKR 846Mn up +35% for the 9 months of FY18) while a further 12% and 19% growth is expected in FY19E and FY20E resulting in an 18% CAGR for FY18E-20E.

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YoY Growth (%)	15%	26%	44%	0%	24%	12%	19%
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PBV (x)	1.3x	1.1x	0.9x	0.8x	0.6x	0.6x	0.5x
DY (%)	0.0%	0.0%	4.0%	4.0%	5.4%	6.0%	7.2%

CDB TP at LKR 120.0: First Capital Research used 3 valuation methods to determine the value of CDB. The average of the 3 valuation methods provide a target price of LKR 131.9 which will well below its expected net asset value of LKR 153.3. However, the low return on equity and the historical trend of the counter trading well below its peers results in a lower valuation for the counter. Despite the lower valuation, a further liquidity discount of 10% has been applied due to the lower liquidity factor of the stock resulting in a target price of LKR 120.0. For the target price of LKR 120.0, the counter provides 51% annualized return. For CDB.X, our target price stands at 105.0, considering the 12 month average 12% discount which the counter usually trades at to its voting share.

Return	
Target Price	120.0
Current Price	87.0
Capital Gain (LKR)	33.0
Dividends upto 31.03.2019 (LKR)	4.7
Capital Gain %	38%
Dividend Yield %	5%
Total Return %	43%
Annualized Return %	51%

Expected CDB.N price for FY19E	
Justified PBV based target price	138.0
PER Valuation based target price	131.0
RI Valuation based target price	126.1
Average Target Price	131.7
Liquidity Discount (10%)	-13.2
Target Price after Discount	118.5
Target Price after Rounding off	120.0

Expected CDB.X price for FY19E	
Target Price for CDB.N	120.0
Average 12 month discount	-12%
Target Price for CDB.X	105.6
Target Price after Rounding off	105.0

4.1 Justified PBV valuation

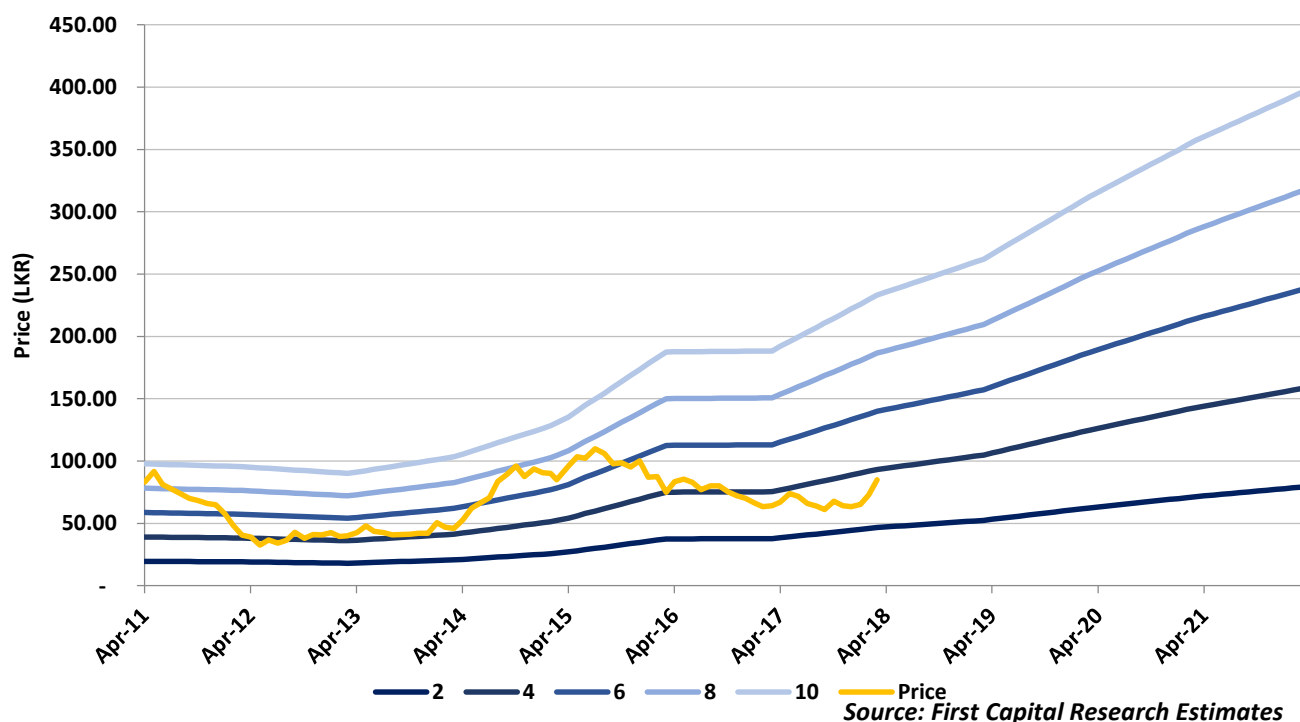
Cost of Equity (K_e)	
R_f	9%
R_m	17%
β	1.54
Adjusted β	1.36
Growth (%)	3%
$K_e = R_f + \beta (R_m - R_f)$	20%

Justified PBV		FY19E
ROAE		18.1%
Growth rate (g)		3.0%
Cost of Equity (K_e)		20.0%
Justified PBV		0.9
NAVPS		155.3
Fair Value		138.0

4.2 PER based valuation

PER based Valuation		FY19E
FY19E Earnings (LKR 'Mn)		1,423
No. of Shares ('Mn)		54.3
FY19E EPS		26.20
Expected PER		5.0x
Price at 5.0x FY19E Earnings		131.0

Figure 5: CDB.N PER Band Chart



4.3 Residual Income based valuation

RI Valuation		FY19E
PV of Residual Income		-448
No. of Shares		54.3
RI per share		-8.2
Opening book value		134.3
Fair Value		126.1

4.0 Company Profile

CDB Asset Base LKR 68Bn: CDB is the 7th largest listed entity in the financial sector in Sri Lanka with an asset base of LKR 68Bn by the end of December 2017. During FY14-17 the total asset base of CDB grew by a CAGR of 19%. CDB’s lending portfolio accounts for 80% of the total asset base of the company leading to a Return on Assets of 1.95% as of FY17.

Branch Network of 69 Branches: More than 1,400 workforce of CDB has spread across 69 branches located island wide services the company’s large clientele, offering long tenure products ranging from lease, personal loans to short term financing.

Share Price Performance: Over the past 12 months CDB’s share price outperformed the market where CDB.N and CDB.X has seen a hike of 42.5% and 65.7% respectively. CDB.N had been trading between LKR 60.20- LKR 92.80 and CDB.X had been trading between LKR 52.00 – LKR 80.00.

Figure 6: CDB.N Price Volume Chart

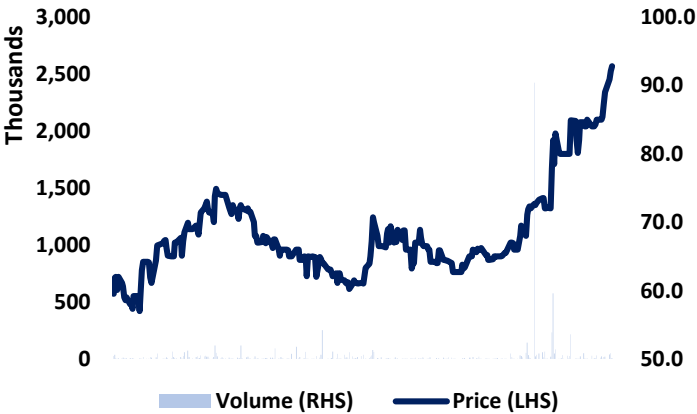
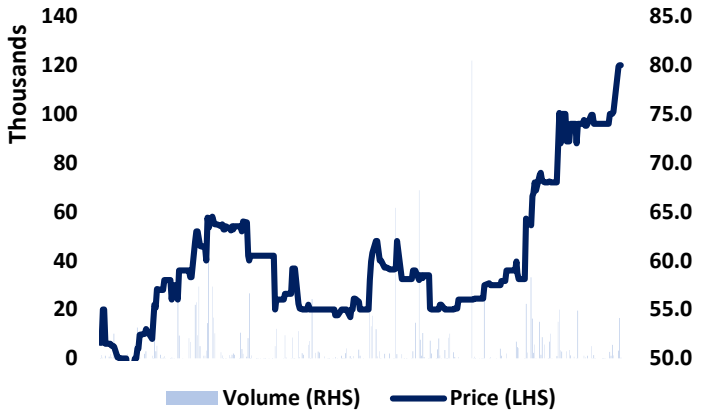


Figure 7: CDB.X Price Volume Chart



5.0 Investment Risks

5.1 Default risk dominates Credit risk: Given the nature of the business of being the financial intermediary, CDB is exposed to credit risk which is the uncertainty that a borrower may not repay a loan and that the lender may lose the principal of the loan or the interest associated with it. Credit risk is inherent due to the nature of business thus can only be mitigated or transferred but not avoided.

5.2 Market risk primarily attributable to interest rate risk: CDB is exposed to the market risk that is resultant to the uncertainty arising from the volatility in interest rates, exchange rate, equity price, commodity prices (e.g.: vehicle, gold, etc...). CDB cannot eliminate Market risk but can be managed through hedging given it is considered a systematic risk.

5.3 Changes in regulations to impact the sectors' performance: Banking and finance sector of Sri Lanka is one of the most highly regulated segments in the economy, governed by the Central Bank of Sri Lanka acting as the Regulator. The uncertainty CDB is exposed to as a result of adhering to laws, regulations and regulatory guidelines as well as internal controls and approved policies. CDB is exposed to Regulatory risk which can only be managed through lobbying or compliance mechanisms.

6.0 Key Ratios

CDB	FY14	FY15	FY16	FY17	FY18E	FY19E	FY20E
Tier 1 (5%)	12.61%	12.79%	11.72%	12.32%			
Tier 2 (10%)	16.00%	15.57%	11.74%	14.12%			
Return on Average Equity	17%	18%	22%	18%	19%	18%	19%
Return on Average Assets	1.93%	1.97%	2.29%	1.95%	2.00%	1.79%	1.78%
Net Interest Spread	7.68%	7.80%	6.85%	5.35%	5.60%	5.75%	6.00%
Net Interest Margin	9.45%	9.57%	8.27%	6.66%	6.90%	6.75%	6.91%
Non-Core Income / Net Income	14%	14%	21%	25%	30%	29%	27%
Cost / Income	53%	54%	53%	58%	54%	53%	52%
Cost / Average Assets	5%	5%	5%	4%	5%	4%	4%
Asset Growth	38%	13%	33%	7%	33%	20%	20%
Deposit Growth	38%	10%	14%	6%	45%	20%	18%
Borrowings Growth	56%	13%	153%	7%	15%	22%	25%
Lending Growth	32%	15%	31%	13%	35%	21%	17%
Avg. yield on earning assets	22%	19%	16%	16%	19%	18%	18%
Avg. cost of funds	14%	11%	10%	11%	13%	12%	12%
Loan / Deposits	105%	109%	126%	134%	124%	125%	125%
Loan / Total Assets	76%	78%	77%	80%	81%	82%	80%
Deposit / Liabilities	81%	80%	68%	68%	73%	72%	71%
Equity / Assets	11%	11%	10%	12%	10%	10%	9%
Cost / Branch (Rs.'Mn)	24.6	30.7	33.9	33.8	41.5	48.1	54.3
Rev. / Employee (Rs.'Mn)	5.5	5.8	6.6	6.0	8.3	9.5	11.2

Source : Company Annual Reports and First Capital Research Estimates

7.0 Shareholding of CDB

Top 20 shareholders - (% held) - CDB.N	1Q2018	4Q2017	QoQ	1Q2017	YoY
Ceylinco Life Insurance Limited Account No.1	33.5%	33.5%	-	33.5%	-
Janashakthi General Insurance Limited	5.2%	5.2%	-	5.2%	-
Janashakthi Insurance Plc (Policy Holders)	5.0%	5.0%	-	5.0%	-
Ceylinco General Insurance Limited	4.0%	4.0%	-	4.0%	-
People's Leasing & Finance Plc / Mr.W.P.C.M.Nanayakkara	3.9%	3.9%	-	3.6%	0.3%
Citizens Development Business Finance Plc A/C 02 (CDB Employee Gratuity Fund)	3.7%	3.7%	-	3.7%	-
People's Leasing & Finance PLC/Asia Management Consultancy (Private) Limited	3.5%	2.7%	0.8%	1.5%	1.9%
People's Leasing & Finance PLC/Mr.S.V.Munasinghe	2.2%	2.2%	-	2.1%	0.1%
Seylan Bank PLC/Tennakoon Mudiyansele Damith Prasanna Tennakoon	2.0%	2.0%	-	2.0%	-
Peoples's Leasing & Finance PLC/ Mr. R.H. & Mrs. V.F. Abeygoonewardena	2.0%	2.0%	-	2.0%	-
Ceylinco Life Insurance Limited Account No.3	1.9%	1.9%	-	1.9%	-
Mr. Warnakula Weerasooriya Kingsly Malcom Weerasooriya	1.1%	1.1%	-	1.0%	0.0%
Mr. Heenkenda Mudiyansele Lucksri Maduranga Bandara Heenkenda	1.0%	1.0%	-	1.0%	-
Mr. Elangovan Karthik	0.9%	0.9%	-	0.9%	-
People's Leasing & Finance PLC/Mrs.N.D.Kodagoda	0.9%	0.9%	-	0.8%	0.1%
Mr.Hasitha Kaushalya Dassanayake	0.6%	0.6%	-	0.6%	0.1%
Mr.Isanka Madhawa Kotigala	0.6%	0.6%	-	0.6%	-
People's Leasing & Finance PLC/Mr.M.N.M.Imdaad	0.5%	0.5%	-	0.0%	-
Mr. Kuruppu Arachchige Don Ranjith Gunasinghe	0.5%	0.5%	-	0.5%	0.0%
Mr. Pilana Vitharama Ravindra Surain Abeysekera	0.5%	0.0%	0.5%	0.0%	-

Top 20 shareholders - (% held) - CDB.X	1Q2018	4Q2017	QoQ	1Q2017	YoY
Deutsche Bank Ag As Trustee For Jb Vantage Value Equity Fund	16.7%	16.7%	-	16.7%	-
J.B. Cocoshell (Pvt) Ltd	13.0%	13.0%	-	13.0%	-
Mr.Amarakoon Mudiyansele Weerasinghe	7.7%	7.7%	-	7.7%	-
People's Leasing & Finance Plc/Mr.H.M. Abdulhussein	3.8%	3.0%	0.8%	2.2%	1.5%
Askold (Private) Limited	3.0%	3.0%	-	3.0%	-
Mr.Malik Joseph Fernando	2.6%	2.6%	-	2.6%	-
Mr.Husein Nuruddin Esufally	2.6%	2.6%	-	2.6%	-
Mr.Yusuf Husseinally Abdulhussein	2.2%	2.0%	0.2%	1.8%	0.4%
Mr.Murtazaali Abidhussen Hassanaly Esufally	2.0%	2.0%	-	2.0%	-
Mr.Abbasally Nuruddin Esufally	2.0%	2.0%	-	2.0%	-
Mr.Gulzar Hussein Ibrahim Jafferjee (Deceased)	2.0%	2.0%	-	2.0%	-
Miss.Rukaiya Husseinally Abdulhussein	2.0%	1.8%	0.2%	0.0%	2.0%
Seylan Bank Plc/S.R. Fernando	1.6%	1.6%	0.0%	1.6%	0.0%
E.W. Balasuriya & Co. (Pvt) Ltd	1.5%	2.6%	-1.0%	2.6%	-1.0%
Essajee Carimjee Insurance Brokers (Pvt) Ltd	1.5%	1.5%	-	1.4%	0.0%
Jafferjees Investments (Pvt) Ltd	1.3%	1.3%	-	1.3%	-
Gold Investment Limited.	1.3%	1.3%	-	1.3%	-
Mr.Mukesh Abhaykumar Valabhji	1.3%	1.3%	-	1.3%	-
Commercial Bank of Ceylon Plc A/C No. 04	1.3%	1.3%	-	1.3%	-
Lakdhanavi Limited	1.3%	1.3%	-	1.3%	-

Appendix I: Income Statement

Profit & Loss Statement (LKR mn)	FY14	FY15	FY16	FY17	FY18E	FY19E	FY20E
P/E 31st March							
Gross Income	6,268	6,737	7,549	8,703	12,525	14,561	17,261
Interest Income	5,896	6,285	6,703	7,686	10,902	12,709	15,156
Interest Expenses	-3,553	-3,389	-3,591	-4,708	-7,169	-8,087	-9,503
Net Interest Income	2,342	2,896	3,111	2,978	3,733	4,622	5,653
Fee & Other Income	372	452	846	1,017	1,623	1,852	2,104
Total Operating Income	2,714	3,348	3,958	3,995	5,356	6,474	7,758
Impairment (Charges)/ Reversal	-481	-475	-405	-232	-355	-447	-694
Net Operating Income	2,233	2,873	3,553	3,763	5,001	6,027	7,064
Less : Operating expenses							
Staff Cost	-523	-603	-754	-902	-1,136	-1,320	-1,493
Depreciation of PPE	-643	-901	-992	-1,113	-1,392	-1,724	-2,069
Other Operating Expenses	-285	-306	-356	-316	-379	-417	-459
	-1,450	-1,810	-2,102	-2,331	-2,908	-3,461	-4,021
Profit from operations	783	1,063	1,451	1,432	2,092	2,566	3,043
VAT on Financial Services	-53	-95	-173	-173	-420	-583	-680
Profit Before Tax	730	968	1,278	1,260	1,673	1,983	2,363
Income Tax Expense	-169	-258	-258	-235	-401	-555	-662
Profit for the Year	561	710	1,021	1,025	1,271	1,428	1,701
Minority Interest	0	-1	-2	-2	-5	-5	-6
Profit attributable to Equity Holders	561	709	1,019	1,023	1,267	1,423	1,695
EPS	10.3	13.1	18.8	18.8	23.3	26.2	31.2

Source : Company Annual Reports and First Capital Research Estimates

Appendix II: Balance Sheet

Balance Sheet (LKR mn) as at 31st March	FY14	FY15	FY16	FY17	FY18E	FY19E	FY20E
Assets							
Cash and cash equivalents	466	334	730	507	1,670	1,871	3,290
Financial instruments held-for-trading	0	56	122	163	163	163	163
Loans to & Deposits with Banks	2,934	2,245	4,589	2,549	3,190	3,970	5,353
Loans and Receivables to Customers	25,725	29,620	38,754	43,605	58,829	71,001	83,395
Investments	2,644	3,167	3,326	3,657	3,840	4,416	5,079
Property, plant & equipment	1,004	1,426	1,611	1,842	2,210	2,652	3,183
Other Assets	995	1,276	1,515	1,910	2,483	2,855	3,426
Total Assets	33,769	38,125	50,646	54,233	72,385	86,929	103,889
Liabilities							
Deposits	24,518	27,079	30,804	32,590	47,256	56,707	66,915
Borrowings	4,314	4,882	12,354	13,193	15,172	18,510	23,138
Current tax liabilities	49	117	111	179	179	179	179
Other liabilities	1,311	1,707	2,272	1,956	2,445	3,056	3,820
Total Liabilities	30,192	33,786	45,540	47,919	65,052	78,452	94,051
Shareholders Funds							
Stated Capital	1,185	1,185	1,185	1,185	1,185	1,185	1,185
Reserves	1,408	1,664	1,804	2,406	2,660	2,944	3,283
Retained earnings	983	1,460	2,086	2,691	3,451	4,304	5,322
Shareholders Funds	3,577	4,310	5,075	6,282	7,295	8,434	9,790
Minority Interest	0	30	30	33	37	42	48
	3,577	4,339	5,106	6,315	7,333	8,476	9,838
Total Liabilities & Shareholders' Funds	33,769	38,125	50,646	54,233	72,385	86,929	103,889
NAVPS	65.9	79.4	93.5	115.7	134.3	155.3	180.3

Source : Company Annual Reports and First Capital Research Estimates

Research Disclosure

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