Fitch Ratings

11 Feb 2019 | Rating Changed Outlook to Negative

Fitch Revises National Development Bank's Outlook to Negative; Rates Basel III Sub-Debt 'A(lka)(EXP)'

Fitch Ratings-Colombo-12 February 2019: Fitch Ratings has revised the Outlook on National Development Bank PLC's (NDB) National Long-Term Rating to Negative from Stable and has affirmed the National Long-Term Rating at A+(lka). At the same time, Fitch has assigned the bank's proposed Basel III-compliant subordinated unsecured debentures an expected National Long-Term Rating of 'A(lka)(EXP)'.

The proposed debentures will total up to LKR6.5 billion with maturities of five years and will be listed on the Colombo Stock Exchange. They will qualify as Basel III-compliant regulatory Tier 2 capital for the bank and include a non-viability clause whereby they will convert to ordinary shares if so determined by the Monetary Board of Sri Lanka. The bank plans to use the proceeds to strengthen its Tier 2 capital base and support loan-book expansion. The final rating is subject to the receipt of final documentation conforming to information already received.

Key Rating Drivers

NDB's National Long-Term Rating reflects its developing franchise and satisfactory asset quality relative to peers, balanced against declining capitalisation and above-sector loan growth.

The revision in the Outlook reflects our expectation of continued pressure on NDB's capitalisation stemming from its rising risk appetite in terms of high loan growth and increasing exposure to riskier retail and SME customer segments. Fitch believes the bank could remain challenged in the medium term to maintain capital buffers that are commensure with its risk appetite, even with capital raising, due to its above-sector growth aspirations - loan growth has averaged at 18% annually since 2014 - and probable higher regulatory requirements as a domestic systemically important bank (D-SIBs). Capitalisation has been weakening, with the group's Tier 1 capital ratio declining to 9.6% at end-September 2018 (end-2014:12.9%), while the bank's ratio stood at 8.4% (2014: 10.0%).

Fitch expects NDB to face greater capital pressure as its asset base is likely to cross the LKR500.0 billion threshold in 2019 (end-2018: LKR473 billion). This will require the bank to maintain minimum Tier 1 and total capital ratios of 10.0% and 14.0%, respectively, which include an additional regulatory capital buffer of 1.5% imposed on D-SIBs. The bank raised only LKR3.4 billion from its LKR6.2 billion rights issue in 4Q18, subsequent to which the Tier 1 ratio for the group and bank rose to 10.4% and 9.2% respectively at end-2018.

NDB expects to increase its exposure to the retail and SME segments, which Fitch regards as more vulnerable to deteriorating domestic economic conditions. The bank remains mostly exposed to corporates and its reported gross non-performing loan ratio (2.85% at end- 2018) compares well against peers, but its rising exposure to riskier customer segments could pressure asset quality, especially in light of rapid loan growth and Fitch's expectation that the overall operating environment will remain challenging.

The bank's near-term profitability has improved and its increased focus on retail and SME segments, as well as a higher share of rupee-based lending, could support better net-interest margins. However, the potential upside to the bank's profitability is likely to be constrained by the bank's relatively weak deposit franchise and potentially higher impairment charges.

Fitch rates the proposed Tier II instrument one notch below the bank's National Long-Term Rating to reflect the notes' subordinated status and higher loss-severity risks relative to senior unsecured instruments. The notes would convert to equity upon the occurrence of a trigger event, as determined by the Monetary Board of Sri Lanka. The bank's legacy Basel II Sri Lanka rupee-denominated subordinated debt is also rated one notch below its National Long-Term Rating to reflect similar subordination to senior unsecured creditors. NDB's National Long-Term Rating is used as the anchor rating for these instruments, as it reflects its standalone financial strength and best indicates the risk of the bank becoming non-viable. Fitch has not applied additional notching to the proposed notes for non-performance risk, as they have no going-concern loss-absorption features, in line with the agency's criteria.

Rating Sensitivities

NDB's National Long-Term Rating could be downgraded if the bank cannot sustain its capitalisation at a level that is commensurate with its rising risk appetite. Fitch would revise the Outlook to Stable if the bank maintains sufficient capital buffers that are commensurate with its risk profile and similarly rated peers.

The rating of NDB's Basel II and proposed Basel III compliant notes will move in tandem with its National Long-Term Rating.

Sources of Information

Note to editors: Fitch's National ratings provide a relative measure of creditworthiness for rated entities in countries with relatively low international sovereign ratings and where there is demand for such ratings. The best risk within a country is rated 'AAA' and other credits are rated only relative to this risk. National ratings are designed for use mainly by local investors in local markets and are signified by the addition of an identifier for the country concerned, such as 'AAA(lka)' for National ratings in Sri Lanka. Specific letter grades are not therefore internationally comparable.

National Development Bank PLC; National Long Term Rating; Affirmed; A+(lka); RO:Neg
----subordinated; National Long Term Rating; Affirmed; A
----junior subordinated; National Long Term Rating; Expected Rating; A(EXP)(lka)

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Applicable Criteria

Bank Rating Criteria (pub. 12 Oct 2018)

National Scale Ratings Criteria (pub. 18 Jul 2018)

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