



RATING ACTION COMMENTARY

Fitch Revises Outlook on National Development Bank to Stable; Affirms at 'A+'(Ika)

Wed 10 Jun, 2020 - 10:50 AM ET

Fitch Ratings - Colombo - 10 Jun 2020: Fitch Ratings Lanka has revised the Outlook on National Development Bank PLC's (NDB) National Long-Term Rating to Stable from Negative and affirmed the rating at 'A+(Ika)', following the recalibration of our Sri Lankan National Ratings scale. At the same time, Fitch downgraded NDB's subordinated debt ratings by one notch to 'A-(Ika)' from 'A(Ika)', in alignment with our recovery expectations under our updated Bank Rating Criteria.

The recalibration of the National Ratings scale reflects changes in the relative creditworthiness among Sri Lankan issuers following Fitch's downgrade of the country's sovereign rating to 'B-/Negative' from 'B'/Negative on 24 April 2020.

KEY RATING DRIVERS

NATIONAL RATING

NDB's National Long-Term Rating reflects its modest franchise and more balanced business model but thinner capitalisation relative to similar rated peers.

The revision of the Outlook to Stable reflects our expectation of reduced pressure on NDB's capitalisation relative to its risk appetite. Exposure to corporates has continued to dominate its loan book and this is likely to remain in the medium term, amid increased challenges in the operating environment, despite its plan to increase exposure to SME and retail customer segments. NDB's common equity Tier 1 (CET1) ratio stood at 9.9% at end-1Q20 and could remain lower than similar rated peers that are likely to sustain riskier business models in the medium term.

NDB has been expanding its franchise as a commercial bank but project lending (24% of total loans at end-2019) is likely to remain an integral component of its loan book. This exposure, and NDB's appetite for growth, has kept its loans/deposit ratio at over 100%, although the ratio improved to 105% across 2016-2019, from 114% across 2012-2015, alongside the expansion in its deposit base. NDB accounted for 4.2% of banking sector assets and 4.4% of deposits at end-2019.

SUBORDINATED DEBT

Fitch has downgraded NDB's Basel II and Basel III compliant Sri Lankan rupee-denominated subordinated debt to 'A-(Ika)' from 'A(Ika)', two notches below the National Long-Term Rating anchor. This is driven by the change in Fitch's baseline notching for loss severity to two notches (from one) for this type of debt and our expectations of poor recoveries. There is no additional notching for non-performance risks, as the notes do not incorporate going-concern loss-absorption features.

RATING SENSITIVITIES

Factors that could, individually or collectively, lead to positive rating action/upgrade:

The prospect of an upgrade appears unlikely in the near term because of the pressure on the operating environment. In the medium term, an upgrade of NDB's rating could stem from a much stronger franchise and financial profile, in particular higher capital buffers that can absorb risks related to the operating environment.

NDB's subordinated debt would be upgraded if the bank's National Long-Term Rating is upgraded.

Factors that could, individually or collectively, lead to negative rating action/downgrade:

NDB's rating would be downgraded if there were deterioration in its financial profile relative to the universe of rated entities in Sri Lanka, in particular its capital buffers, or increased risk appetite through aggressive loan growth or increased exposure to riskier customer segments.

NDB's subordinated debt would be downgraded if the bank's National Long-Term Rating is downgraded.

BEST/WORST CASE RATING SCENARIO

International scale credit ratings of Financial Institutions issuers have a best-case rating upgrade scenario (defined as the 99th percentile of rating transitions, measured in a positive direction) of three notches over a three-year rating horizon; and a worst-case rating downgrade scenario (defined as the 99th percentile of rating transitions, measured in a negative direction) of four notches over three years. The complete span of best- and worst-case scenario credit ratings for all rating categories ranges from 'AAA' to 'D'. Best- and worst-case scenario credit ratings are based on historical performance. For more information about the methodology used to determine sector-specific best- and worst-case scenario credit ratings, visit <https://www.fitchratings.com/site/re/10111579>.

REFERENCES FOR SUBSTANTIALLY MATERIAL SOURCE CITED AS KEY DRIVER OF RATING

The principal sources of information used in the analysis are described in the Applicable Criteria.

RATING ACTIONS

ENTITY/DEBT

RATING

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ENTITY/DEBT	RATING			F
National Development Bank PLC	Natl	A+(Ika) Rating Outlook Stable	Affirmed	/
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				↑
● subordinated	Natl	A-(Ika)	Downgrade	/
	LT			

[VIEW ADDITIONAL RATING DETAILS](#)

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APPLICABLE CRITERIA

[Bank Rating Criteria \(pub. 29 Feb 2020\) \(including rating assumption sensitivity\)](#)

[National Scale Rating Criteria \(pub. 08 Jun 2020\)](#)

ADDITIONAL DISCLOSURES

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National Development Bank PLC

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Banks Asia-Pacific Sri Lanka

