FitchRatings

Fitch Publishes Cargills Bank's First-Time 'BB(lka)' Rating; Outlook Stable

Fitch Ratings-Colombo-18 October 2018: Fitch has published Sri Lanka-based Cargills Bank Ltd's (CBL) National Long-Term Rating of 'BB(lka)' with a Stable Outlook.

KEY RATING DRIVERS
NATIONAL RATINGS

CBL's rating reflects its small and developing domestic franchise, evolving business model and limited operating history in Sri Lanka's banking sector. The rating also captures its high risk appetite and pressures on its financial profile, particularly asset quality and funding and liquidity, due to the bank's aggressive growth aspirations in the medium term. CBL began its operations in July 2014, and had only an insignificant share of system assets at end-June 2018.

We expect the bank to remain focused on the retail, SME and agricultural segments (1H18: 58% of gross loans, 2017: 39%) as it diversifies away from the corporate sector. Corporate loans remain dominant, constituting about 42% of gross loans, but the proportion is likely to shrink in the medium term.

CBL's reported gross non-performing loan (NPL) ratio jumped to 3% at end-June 2018 from 1% at end-2016, due to two large corporate NPLs. The bank's NPL ratio is likely to be higher than that of the industry in the short to medium term, as it expands rapidly into the more economically vulnerable segments.

We foresee pressures on CBL's funding and liquidity as it pursues an aggressive growth plan in the medium term, as its deposit franchise is still developing and competition for deposits is high. To address this, we believe the bank may supplement its funding mix with wholesale funding and equity.

We expect CBL's pre-impairment profitability to improve further in the medium term, although higher credit costs from asset quality pressures and the implementation of SLFRS 9 could limit the gains. The bank's core profitability improved in 2017 but it remained weaker than peers'.

We expect CBL's capital ratios to decline from the current Tier 1 capital ratio of 34%, weighed down by rapid loan growth that exceeds internal capital generation. The regulator in October 2017 increased the minimum capital requirement for licensed commercial banks to LKR20 billion to be met by end-2020, which we believe CBL will require capital injections to meet as internal capital generation will be insufficient.

The Cargills Group, which owns supermarket chain Cargills Food City, has a 53% effective stake in CBL (voting rights restricted to 30% by the regulator), which gives the bank benefits of the strong "Cargills" brand and group synergies. Fitch has not factored in any extraordinary support in CBL's rating, although ordinary support has been incorporated.

RATING SENSITIVITIES
NATIONAL RATINGS

A rating upgrade could be triggered if CBL is able to build a sustainable business model through the execution of its medium-term strategy. A sustained improvement in its financial profile, particularly in profitability and funding, could also lead to a positive rating action.

Deterioration in loss-absorption buffers, either through aggressive loan expansion or greater share of unprovisioned NPLs, could place downward pressure on the rating. Failure to support growth through more diversified funding sources would be negative for the rating.

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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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