



Fitch Downgrades Sri Lanka's HDFC Bank to 'BB+(lka)'; Outlook Stable

Fitch Ratings-Colombo-23 January 2019: Fitch Ratings has downgraded the National Long-Term Rating and senior unsecured debentures of Housing Development Finance Corporation Bank of Sri Lanka (HDFC Bank) to 'BB+(lka)' from 'BBB-(lka)'. All ratings have been removed from Rating Watch Negative, and the Outlook is Stable.

Key Rating Drivers

NATIONAL RATINGS

The downgrade reflects Fitch's assessment of HDFC Bank's standalone strength, as we believe timely support from the sovereign cannot be relied upon. Our assessment takes into consideration that the state, as a major shareholder, has not injected new capital into HDFC that the bank would need to meet the minimum regulatory capital requirement of LKR5 billion that came into force in 1 January 2016. Our view also reflects the weakening of the sovereign's ability to provide support following the downgrade of the sovereign rating to 'B'/Stable from 'B+'/Stable on 3 December 2018.

HDFC Bank's current rating reflects its high risk appetite and potential challenges in accessing capital, when required. The rating also captures asset quality and profitability which is weaker than its peers. This reflects a large exposure to low- and middle-income customers, who are particularly susceptible to economic and interest-rate cycles.

HDFC Bank's reported non-performing loan (NPL) ratio has been increasing over the past few years - standing at 20.5% at end-3Q18, well above the industry average. This has been due mainly to defaults from housing finance backed by the Employees' Provident Fund (EPF), which contributed more than half of the bank's total housing NPLs at end-3Q18. Nevertheless, the Central Bank of Sri Lanka reimburses HDFC Bank annually for EPF-backed loans in arrears for more than three months. The bank's NPL ratio remained high even without the EPF-backed housing loans, at 10.0% (9.0% at end-2017), which reflects the concentration of its credit risk in the low- and middle-income housing-finance market.

The bank's Fitch Core Capital ratio improved marginally in 3Q18 to 17.3% owing to muted balance-sheet expansion. Nevertheless, we see capitalisation as weak because of its substantial unreserved NPLs. Profitability is likely to remain soft in light of its high cost structure and rising credit costs.

Fitch expects HDFC Bank's asset and liability mismatches to persist due to its longer-tenor loan book and short-tenor deposit base, exerting pressure on liquidity. Dependence on high-cost term deposits also weighs on the net interest margin and profitability.

SENIOR DEBT RATINGS

The bank's outstanding senior unsecured debentures are rated in line with its National Long-Term Rating, and rank equally with the claims of other senior unsecured creditors.

Rating Sensitivities

NATIONAL RATINGS AND SENIOR DEBT

HDFC Bank's rating could be downgraded if there is a sustained deterioration in capitalisation, either through aggressive loan growth or higher unprovisioned NPLs. An upgrade would be contingent on moderation of its risk appetite and a sustained improvement in asset quality and profitability.

The ratings of the senior unsecured debentures will move in tandem with HDFC Bank's National Long-Term Ratings.

Housing Development Finance Corporation Bank of Sri Lanka; National Long Term Rating; Downgrade; BB+(lka); RO:Sta
----senior unsecured; National Long Term Rating; Downgrade; BB+(lka); RW: Off

Contacts:

Primary Rating Analyst
Sugath Alwis,
Analyst
+94 11 2541 900
Fitch Ratings Lanka Ltd.
15-04 East Tower World Trade Center
Colombo 00100

Secondary Rating Analyst
Rukshana Thalgodapitiya,
Director
+94 11 2541 900
Fitch Ratings Lanka Ltd.
15-04 East Tower World Trade Center
Colombo 00100

Committee Chairperson
Wee Siang Ng,
Senior Director
+65 6796 7230

Media Relations: Leslie Tan, Singapore, Tel: +65 6796 7234, Email: leslie.tan@thefitchgroup.com

Additional information is available on www.fitchratings.com

Applicable Criteria

Bank Rating Criteria (pub. 12 Oct 2018)
National Scale Ratings Criteria (pub. 18 Jul 2018)

Additional Disclosures

Solicitation Status
Endorsement Policy

ALL FITCH CREDIT RATINGS ARE SUBJECT TO CERTAIN LIMITATIONS AND DISCLAIMERS. PLEASE READ THESE LIMITATIONS AND DISCLAIMERS BY FOLLOWING THIS LINK: [HTTPS://WWW.FITCHRATINGS.COM/UNDERSTANDINGCREDITRATINGS](https://www.fitchratings.com/understandingcreditratings). IN ADDITION, RATING DEFINITIONS AND THE TERMS OF USE OF SUCH RATINGS ARE AVAILABLE ON THE AGENCY'S PUBLIC WEB SITE AT WWW.FITCHRATINGS.COM. PUBLISHED RATINGS, CRITERIA, AND METHODOLOGIES ARE AVAILABLE FROM THIS SITE AT ALL TIMES. FITCH'S CODE OF CONDUCT, CONFIDENTIALITY, CONFLICTS OF INTEREST, AFFILIATE FIREWALL, COMPLIANCE, AND OTHER RELEVANT POLICIES AND PROCEDURES ARE ALSO AVAILABLE FROM THE CODE OF CONDUCT SECTION OF THIS SITE. DIRECTORS AND SHAREHOLDERS RELEVANT INTERESTS ARE AVAILABLE AT [HTTPS://WWW.FITCHRATINGS.COM/SITE/REGULATORY](https://www.fitchratings.com/site/regulatory). FITCH MAY HAVE PROVIDED ANOTHER PERMISSIBLE SERVICE TO THE RATED ENTITY OR ITS RELATED THIRD PARTIES. DETAILS OF THIS SERVICE FOR RATINGS FOR WHICH THE LEAD ANALYST IS BASED IN AN EU-REGISTERED ENTITY CAN BE FOUND ON THE ENTITY SUMMARY PAGE FOR THIS ISSUER ON THE FITCH WEBSITE.

Copyright © 2018 by Fitch Ratings, Inc., Fitch Ratings Ltd. and its subsidiaries. 33 Whitehall Street, NY, NY 10004. Telephone: 1-800-753-4824, (212) 908-0500. Fax: (212) 480-4435.

Reproduction or retransmission in whole or in part is prohibited except by permission. All rights reserved. In issuing and maintaining its ratings and in making other reports (including forecast information), Fitch relies on factual information it receives from issuers and underwriters and from other sources Fitch believes to be credible. Fitch conducts a reasonable investigation of the factual information relied upon by it in accordance with its ratings methodology, and obtains reasonable verification of that information from independent sources, to the extent such sources are available for a given security or in a given jurisdiction. The manner of Fitch's factual investigation and the scope of the third-party verification it obtains will vary depending on the nature of the rated security and its issuer, the requirements and practices in the jurisdiction in which the rated security is offered and sold and/or the issuer is located, the availability and nature of relevant public information, access to the management of the issuer and its advisers, the availability of pre-existing third-party verifications such as audit reports, agreed-upon procedures letters, appraisals, actuarial reports, engineering reports, legal opinions and other reports provided by third parties, the availability of independent and competent third-party verification sources with respect to the particular security or in the particular jurisdiction of the issuer, and a variety of other factors. Users of Fitch's ratings and reports should understand that neither an enhanced factual investigation nor any third-party verification can ensure that all of the information Fitch relies on in connection with a rating or a report will be accurate and complete. Ultimately, the issuer and its advisers are responsible for the accuracy of the information they provide to Fitch and to the market in offering documents and other reports. In issuing its ratings and its reports, Fitch must rely on the work of experts, including independent auditors with respect to financial statements and attorneys with respect to legal and tax matters. Further, ratings and forecasts of financial and other information are inherently forward-looking and embody assumptions and predictions about future events that by their nature cannot be verified as facts. As a result, despite any verification of current facts, ratings and forecasts can be affected by future events or conditions that were not anticipated at the time a rating or forecast was issued or affirmed.

The information in this report is provided "as is" without any representation or warranty of any kind, and Fitch does not represent or warrant that the report or any of its contents will meet any of the requirements of a recipient of the report. A Fitch rating is an opinion as to the creditworthiness of a security. This opinion and reports made by Fitch are based on established criteria and methodologies that Fitch is continuously evaluating and updating. Therefore, ratings and reports are the collective work product of Fitch and no individual, or group of individuals, is solely responsible for a rating or a report. The rating does not address the risk of loss due to risks other than credit risk, unless such risk is specifically mentioned. Fitch is not engaged in the offer or sale of any security. All Fitch reports have shared authorship. Individuals identified in a Fitch report were involved in, but are not solely responsible for, the opinions stated therein. The individuals are named for contact purposes only. A report providing a Fitch rating is neither a prospectus nor a substitute for the information assembled, verified and presented to investors by the issuer and its agents in connection with the sale of the securities. Ratings may be changed or withdrawn at any time for any reason in the sole discretion of Fitch. Fitch does not provide investment advice of any sort. Ratings are not a recommendation to buy, sell, or hold any security. Ratings do not comment on the adequacy of market price, the suitability of any security for a particular investor, or the tax-exempt nature or taxability of payments made in respect to any security. Fitch receives fees from issuers, insurers, guarantors, other obligors, and underwriters for rating securities. Such fees generally vary from US\$1,000 to US\$750,000 (or the applicable currency equivalent) per issue. In certain cases, Fitch will rate all or a number of issues issued by a particular issuer, or insured or guaranteed by a particular insurer or guarantor, for a single annual fee. Such fees are expected to vary from US\$10,000 to US\$1,500,000 (or the applicable currency equivalent). The assignment, publication, or dissemination of a rating by Fitch shall not constitute a consent by Fitch to use its name as an expert in connection with any registration statement filed under the United States securities laws, the Financial Services and Markets Act of 2000 of the United Kingdom, or the securities laws of any particular jurisdiction. Due to the relative efficiency of electronic publishing and distribution, Fitch research may be available to electronic subscribers up to three days earlier than to print subscribers.

For Australia, New Zealand, Taiwan and South Korea only: Fitch Australia Pty Ltd holds an Australian financial services license (AFS license no. 337123) which authorizes it to provide credit ratings to wholesale clients only. Credit ratings information published by Fitch is not

intended to be used by persons who are retail clients within the meaning of the Corporations Act 2001

Fitch Ratings, Inc. is registered with the U.S. Securities and Exchange Commission as a Nationally Recognized Statistical Rating Organization (the "NRSRO"). While certain of the NRSRO's credit rating subsidiaries are listed on Item 3 of Form NRSRO and as such are authorized to issue credit ratings on behalf of the NRSRO (see <https://www.fitchratings.com/site/regulatory>), other credit rating subsidiaries are not listed on Form NRSRO (the "non-NRSROs") and therefore credit ratings issued by those subsidiaries are not issued on behalf of the NRSRO. However, non-NRSRO personnel may participate in determining credit ratings issued by or on behalf of the NRSRO.

ENDORSEMENT POLICY - Fitch's approach to ratings endorsement so that ratings produced outside the EU may be used by regulated entities within the EU for regulatory purposes, pursuant to the terms of the EU Regulation with respect to credit rating agencies, can be found on the EU Regulatory Disclosures page. The endorsement status of all International ratings is provided within the entity summary page for each rated entity and in the transaction detail pages for all structured finance transactions on the Fitch website. These disclosures are updated on a daily basis.