FitchRatings

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

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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