



## Fitch Affirms HNB Finance at 'A(lka)'; Outlook Stable

Fitch Ratings-Colombo-22 February 2019: Fitch Ratings Lanka has affirmed HNB Finance Limited's (HFL) National Long-Term Rating at 'A(lka)'. The Outlook is Stable.

### Key Rating Drivers

HFL's rating reflects Fitch's expectation of support from its parent, Hatton National Bank PLC (HNB; AA-(lka)/Stable), Sri Lanka's fourth-largest domestic commercial bank. This view is based on HNB's majority 51% shareholding, its involvement in HFL's strategic direction through board representation, and the common HNB brand. The two-notch differential reflects HFL's limited role in the group. HFL is engaged mainly in microfinance, which is not a major product for HNB. Furthermore, there is limited operational integration between the entities.

HFL has been diversifying its loan book away from high-yielding microfinance (end-September 2018: 62% of gross loans, end-March 2017: 81%) to low-yielding vehicle financing which accounts for 29% of gross loans. We expect this trend to continue in light of the regulatory cap on interest rates on microfinancing alongside the pressure on asset quality - given this segment's greater susceptibility to economic cycles. HFL's loan growth slowed to 14% in 1HFY19 (FY18: 42%, FY17: 52%) due primarily to asset-quality weakness in its microfinance portfolio. However, we expect growth to pick up from FY20 at a faster pace than the industry average.

HFL's regulatory six-month non-performing loan (NPL) ratio had increased sharply to 4.9% by end-September 2018 from 2.8% at end-March 2018. We expect asset quality to deteriorate in the medium term due to stresses on its microfinance portfolio amid difficult operating conditions. HFL's aggressive expansion into vehicle financing could also pose a risk as these loans season.

We expect HFL's capital ratios to come under pressure in the medium term from the planned aggressive growth that is likely to outpace earnings retention. Its regulatory Tier 1 capital ratio had declined sharply to 9.5% by end-September 2018 due to the new capital-adequacy computation which has a 125% risk weight for microfinance exposure, along with an operational risk charge which is now in place. HFL's core capitalisation and leverage metric - debt/tangible equity of 5 times - is broadly comparable with that of its peers.

### Rating Sensitivities

HFL's ratings are sensitive to changes in Fitch's assessment of HNB's ability and propensity to provide support.

HNB Finance Limited; National Long Term Rating; Affirmed; A(lka); RO:Sta

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Applicable Criteria  
Bank Rating Criteria (pub. 12 Oct 2018)  
National Scale Ratings Criteria (pub. 18 Jul 2018)  
Non-Bank Financial Institutions Rating Criteria (pub. 12 Oct 2018)

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