

10 Sep 2019 | Affirmation

Fitch Affirms DFCC Bank PLC at 'B' and 'AA-(lka)'; Outlook Stable

Fitch Ratings-Hong Kong/Colombo-10 September 2019:

Fitch Ratings has affirmed Sri Lanka-based DFCC Bank PLC's Long-Term Foreign- and Local-Currency Issuer Default Ratings (IDRs) at 'B' and National Long-Term Rating at 'AA-(lka)'. The Outlook is Stable.

Key Rating Drivers

IDRS, VIABILITY RATING, NATIONAL RATING AND SENIOR DEBT RATING

DFCC's IDRs are driven by its intrinsic strength. DFCC's Viability Rating and National Long-Term Rating reflect DFCC's above-average capitalisation, which compensates for the risks stemming from its developing commercial bank franchise, deteriorating asset quality and weak earnings.

DFCC's Fitch Core Capital ratio of 15.9% at end-June 2019 remains one of the highest among its large peers. The ratio continues to be affected by mark-to-market losses associated with its stake in Commercial Bank of Ceylon PLC (AA(lka)/Stable), of which a part is categorised as available-for-sale. We expect DFCC's capital buffers to converge with that of larger peers in the medium term, as the bank's business model, via expansion in commercial banking, becomes broadly similar to that of the large peers. DFCC could only raise LKR2.8 billion in April 2019, well below its planned LKR7.6 billion, because some shareholders, including the state, which had a 35% stake in DFCC at end-2018, did not subscribe to their rights entitlements.

We expect asset-quality pressure to continue to weigh on DFCC's ratings, with incremental risks stemming from an increase in commercial loans. Fitch believes the risk associated with its project financing book has been somewhat managed by focusing on corporate customers rather than SMEs. DFCC's regulatory non-performing loan (NPL) ratio rose to 4.6% by end-June 2019, from 3.3% at end-2018 (end-2017: 2.8%), bumped up by the SME segment. The bank's stressed NPL ratio (including rescheduled and restructured loans) continues to be high.

We expect DFCC's profitability to remain weak in the short to medium term on account of slower

loan growth, higher impairment costs and a higher effective tax rate. DFCC's profitability has been weakening in recent years, especially after its merger with DFCC Vardhana Bank PLC in October 2015. The bank's earnings over 2018-1H19 were also weighed down by mark-to-market losses on the remainder of its stake in Commercial Bank of Ceylon that is classified as held-for-trading. DFCC has one of the weakest earnings and profitability profiles among Fitch-rated large private banks.

The Sri Lanka rupee-denominated senior debt of DFCC is rated at the same level as its National Long-Term Rating as the debentures rank equally with other senior unsecured obligations.

SUPPORT RATING AND SUPPORT RATING FLOOR

The Support Rating of '5' and Support Rating Floor of 'No Floor' reflect Fitch's assessment that state support may be possible but timely sovereign support cannot be relied upon in light of the sovereign's weakened financial ability. Furthermore, the bank's franchise is small with market share of around 3% of system assets against 8%-11% for the larger private banks.

SUBORDINATED DEBT

The Basel II- and Basel III-compliant Sri Lanka rupee-denominated subordinated debt of DFCC is rated one notch below its National Long-Term Rating to reflect the subordination to senior unsecured creditors. The Basel III-compliant debentures include a non-viability trigger upon the occurrence of a trigger event, as determined by the Monetary Board of Sri Lanka.

RATING SENSITIVITIES

IDRS, VIABILITY RATING, NATIONAL RATING AND SENIOR DEBT RATING

An inability to sustain capital buffers at a level that is commensurate with its risk profile could pressure the bank's IDRs, Viability Rating and National Long-Term Rating. Fitch sees limited upside for the bank's ratings due to its weak franchise.

The assigned senior and subordinated debt ratings are primarily sensitive to changes in DFCC's National Long-Term Rating.

SUPPORT RATING AND SUPPORT RATING FLOOR

DFCC's Support Rating and Support Rating Floor are sensitive to the sovereign's ability to provide support.

SUBORDINATED DEBT

The ratings on DFCC's subordinated debt will move in tandem with the bank's National Long-Term Rating.

ESG Considerations

Unless otherwise disclosed in this section, the highest level of ESG credit relevance is a score of 3 - ESG issues are credit neutral or have only a minimal credit impact on the entity, either due to their nature or the way in which they are being managed by the entity.

For more information on our ESG Relevance Scores, visit www.fitchratings.com/esg

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DFCC Bank PLC; Long Term Issuer Default Rating; Affirmed; B; RO:Sta
; Local Currency Long Term Issuer Default Rating; Affirmed; B; RO:Sta
; National Long Term Rating; Affirmed; AA-(lka); RO:Sta
; Short Term Issuer Default Rating; Affirmed; B
; Viability Rating; Affirmed; b
; Support Rating; Affirmed; 5
; Support Rating Floor; Affirmed; NF
----senior unsecured; National Long Term Rating; Affirmed; AA-(lka)
----subordinated; National Long Term Rating; Affirmed; A+(lka)

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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 \(pub. 18 Jul 2018\)](#)

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