10 Sep 2019 | Affirmation

Fitch Affirms National Development Bank at 'A+'(lka); Outlook Negative

Fitch Ratings-Colombo-10 September 2019:

Fitch Ratings has affirmed National Development Bank PLC's (NDB) National Long-Term Rating at 'A+(lka)'. The Outlook remains Negative.

Key Rating Drivers

NATIONAL LONG-TERM RATING

The rating reflects a modest franchise, balanced against declining capitalisation and rising risk appetite.

The Negative Outlook reflects our expectation of continued pressure on NDB's capitalisation, which has been on a decreasing trend. This is even after a LKR3.4 billion capital-raising in 4Q18, with the group's Tier 1 capital ratio falling to 10.2% by end-June 2019, from 12.9% at end-2014, while the bank's Tier 1 capital ratio is lower at 9.0% (2014: 10.1%).

Fitch believes the bank could continue to face difficulty in maintaining its medium-term capital buffers that are commensurate with its risk appetite. This is in light of strong growth aspirations and potentially higher exposure to the more susceptible retail and SME segments, which collectively constituted 42% of total loans at end-2018. Furthermore, NDB could face higher capital requirements as a domestic systemically important bank (D-SIB), when its asset base crosses the LKR500 billion threshold (end-June 2019: LKR490billion (bank); LKR496 billion (group)). This will require the bank to maintain minimum Tier 1 and total capital ratios of 10.0% and 14.0%, respectively, which include a capital surcharge of 1.5% for D-SIBs.

We expect asset quality to remain under pressure as long as the operating environment stays challenging. This is especially on the heels of years of rapid loan growth, especially in the riskier customer segments. Weakness in loan quality has started to be reflected in the reported gross non-performing loan (NPL) ratio rising to 4.6% by end-June 2019, from 2.9% at end-2018 and 1.8% at end-2017.

Potential upside to NDB's profitability from an increased focus on the higher-margin retail and

SME segments, as well as a higher share of Sri Lanka rupee-based lending, could be offset by higher impairment charges.

Fitch maintains a negative outlook on the Sri Lankan banking sector, as difficult operating conditions - including macroeconomic risks - are likely to prevail in the short- to medium-term, placing persistent pressure on banks' financial profiles, particularly asset quality and earnings and profitability.

SUBORDINATED DEBT

NDB's Basel II- and Basel III-compliant rupee-denominated subordinated debt 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

NATIONAL LONG-TERM RATING

The rating could be downgraded if the high risk appetite is sustained at the expense of capitalisation. The rating outlook would be revised to Stable if the bank maintains sufficient capital buffers that are commensurate with its risk profile.

SUBORDINATED DEBT

NDB's subordinated debt ratings will move in tandem with the National Long-Term Rating.

National Development Bank PLC; National Long Term Rating; Affirmed; A+(lka); RO:Neg
----subordinated; National Long Term Rating; Affirmed; A(lka)

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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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