



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

Fitch Ratings - Colombo - 12 February 2020:

Fitch Ratings Lanka has affirmed HNB Finance Limited's (HFL) National Long-Term Rating at 'A(lka)'. The Outlook is Stable. The agency has also affirmed the National Long-Term Rating on HFL's subordinated debentures at 'BBB+(lka)'

### **KEY RATING DRIVERS**

HFL's rating reflects Fitch's expectation of support from 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, we believe there is limited operational integration between the entities.

We expect HFL's exposure to vehicle financing to increase in the medium-term away from the high-risk microfinance segment, which now accounts for less than half of its loan book (financial year ending March 2017 (FY17): 73% of gross loans). HFL's loan growth slowed to just 9.7% in 1HFY20 (CAGR of 44% during FY16-FY19), as the company focused on tackling asset-quality pressure stemming from a challenging operating environment. We expect HFL's loan growth to pick up in the medium-term at a faster pace than the industry, but to remain lower than its historical growth rate.

HFL's regulatory six-month non-performing loan ratio increased sharply to 11.6% in September 2019, from 8.9% in FY19 (FY18: 2.8%), driven by defaults in the microfinance portfolio. We believe HFL's aggressive expansion into vehicle financing could pose a risk as these loans season.

HFL concluded Tier 2 issuance of LKR1.2 billion in December 2019, which improved its regulatory Tier 2 capital ratio, which stood at 10.2% at end-September 2019. This was lower than the regulatory requirement of 10.5%

effective 1 July 2019. HFL's core capitalisation and leverage metric - debt/tangible equity of 6.3x - is broadly comparable with that of peers.

HFL's subordinated debentures are rated two notches below its National Long-Term Rating, in line with Fitch's Exposure Draft: Non-Bank Financial Institutions Rating Criteria and Exposure Draft: Bank Rating Criteria. This reflects Fitch's expectation of poor recoveries arising from the debentures' subordinated status. Furthermore, we do not expect any regulatory action that would reduce losses on subordinated instruments.

#### **RATING SENSITIVITIES**

HFL's National Long-Term Rating could be downgraded if HNB's ability to support HFL were to weaken, as signalled through a downgrade of HNB's National Long-Term Rating or any perceived weakening in HNB's propensity to support HFL. This could arise from weakening links with the parent that results in wider notching and may be in the form of a material reduction in HNB's ownership stake in HFL or weak performance at HFL that raises questions over the business's long-term viability.

An upgrade would most likely result from an upgrade of HNB or HFL becoming strategically important to its parent through an increase in its role, product alignment as well as integration within the group.

The rating of the subordinated debt will move in tandem with HFL's National Long-Term Rating. The rating is also sensitive to Fitch's expectations for potential recoveries and the finalisation of the Exposure Draft: Bank Rating Criteria.

#### **PUBLIC RATINGS WITH CREDIT LINKAGE TO OTHER RATINGS**

The ratings of HFL are driven by institutional support from HNB. A change in Fitch's assessment of HNB's ratings would automatically result in a change in the ratings of HFL.

## RATING ACTIONS

ENTITY/DEBT	RATING	PRIOR
<b>HIDE RATING ACTIONS</b>		
HNB Finance Limited	Natl LT A(Ika) Affirmed	A(Ika)
subordinated	Natl LT BBB+(Ika) Affirmed	BBB+(Ika)

### VIEW ADDITIONAL RATING DETAILS

Additional information is available on [www.fitchratings.com](http://www.fitchratings.com)

#### APPLICABLE CRITERIA

[National Scale Ratings Criteria \(pub. 18 Jul 2018\)](#)  
[Non-Bank Financial Institutions Rating Criteria \(pub. 12 Oct 2018\)](#)  
[Exposure Draft: Non-Bank Financial Institutions Rating Criteria \(pub. 15 Nov 2019\)](#)  
[Exposure Draft: Bank Rating Criteria \(pub. 15 Nov 2019\)](#)

#### ADDITIONAL DISCLOSURES

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