FitchRatings

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

Fitch Ratings - Colombo - 05 Feb 2021: Fitch Ratings Lanka has affirmed HNB Finance PLC's (HNBF) National Long-Term Rating at 'A(lka)'. The Outlook is Stable. The agency has also affirmed the National Long-Term Rating on HNBF's subordinated debentures at 'BBB+(lka)'.

KEY RATING DRIVERS

HNBF'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 HNBF's strategic direction through board representation and the common HNB brand. The two-notch differential reflects HNBF's limited role in the group - HNBF's loan book accounts for just 3.8% of group gross loans, with a focus on vehicle financing and microfinance. We do not regard these as core products for HNB. Furthermore, there is limited operational integration between the entities.

Fitch regards HNBF's intrinsic financial strength as materially weaker than its support-driven rating due to its weak financial profile, small franchise, at around 3% market share, more limited operating history, evolving business model and high risk appetite. HNBF's high risk appetite stems from its still large exposure to microfinance as well as its recent entry and rapid growth in vehicle financing, where ticket sizes are larger.

HNBF's lease portfolio accounted for a third of gross loans at end-March 2020 (FY20), compared with 12% in FY17, recording a CAGR of 83% during the period. Its microfinance lending is mostly targeted at customers without formal access to finance or the necessary collateral to pledge, making it riskier than collateralised lending.

HNBF's six-month regulatory non-performing loan ratio rose to 16.9% in 1HFY21, from 11.6% in FY20, despite a moratorium on loan repayments for customers affected by the coronavirus pandemic. We expect the deterioration in asset quality to become more evident once the ongoing moratorium ceases in March 2021, given the high vulnerability of these customer segments to deteriorating economic conditions.

HNBF's debt (including deposits)/tangible equity ratio rose to 8.1x in 1HFY21, from 6.9x in FY20, on account of lower tangible equity due to interim losses as well as increased funding, but remains broadly comparable with smaller peers. In the absence of an equity injection, we expect HNBF's capital buffers to come under significant pressure from the anticipated deterioration in asset quality and weaker profitability, although its current regulatory Tier 1 capital ratio of 10.2% is still above the regulatory minimum of 6.5%.

SUBORDINATED DEBT

HNBF's subordinated debentures are rated two notches below its National Long-Term Rating, in line with Fitch's Bank Rating Criteria. Fitch's baseline notching of two notches for loss severity reflects our expectation of poor recovery. We have not applied additional notching for non-performance risk, as the notes do not have going-concern loss-absorption features, in line with Fitch criteria.

RATING SENSITIVITIES

Factors that could, individually or collectively, lead to positive rating action/upgrade:

An upgrade would most likely result from an upgrade of HNB or HNBF 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 HNBF's National Long-Term Rating.

Factors that could, individually or collectively, lead to negative rating action/downgrade:

HNBF's National Long-Term Rating could be downgraded if HNB's ability to support HNBF 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 HNBF. This could arise from weakening links with the parent that result in wider notching and may be in the form of a material reduction in HNB's ownership stake in HNBF or persistently weak performance at HNBF that raises questions over the business's long-term viability.

The rating of the subordinated debt will move in tandem with HNBF's National Long-Term Rating.

REFERENCES FOR SUBSTANTIALLY MATERIAL SOURCE CITED AS KEY DRIVER OF RATING

The principal sources of information used in the analysis are described in the Applicable Criteria.

PUBLIC RATINGS WITH CREDIT LINKAGE TO OTHER RATINGS

HNB Finance's rating is driven by Hatton National Bank PLC's National Rating

RATING ACTIONS

ENTITY/DEBT	RATING			PRIOR
HNB Finance PLC	Natl LT	A(lka) ●	Affirmed	A(lka) ●
• subordinated	Natl LT	BBB+(lka)	Affirmed	BBB+ (lka)

VIEW ADDITIONAL RATING DETAILS

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APPLICABLE CRITERIA

- Non-Bank Financial Institutions Rating Criteria (pub. 29 Feb 2020) (including rating assumption sensitivity)
- Bank Rating Criteria (pub. 29 Feb 2020) (including rating assumption sensitivity)
- National Scale Rating Criteria (pub. 22 Dec 2020)

ADDITIONAL DISCLOSURES

- Solicitation Status
- Endorsement Policy

ENDORSEMENT STATUS

HNB Finance PLC -

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