FitchRatings

RATING ACTION COMMENTARY

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

Mon 31 Jan, 2022 - 1:30 AM ET

Fitch Ratings - Colombo - 31 Jan 2022: Fitch Ratings Lanka has affirmed CBC Finance LTD's (CBCF) National Long-Term Rating at 'A(lka)'. The Outlook is Stable.

KEY RATING DRIVERS

The rating is driven by Fitch's view that CBCF's parent, Commercial Bank of Ceylon PLC (CB, AA-(lka)/Stable) would provide extraordinary support to CBCF, if required. CB's ability to support CBCF is reflected in its credit profile, underpinned by its standalone strength and CBCF's relatively small size. The support assessment also takes into account CB's full ownership of CBCF, a record of ordinary support via multiple equity infusions, CBCF's management and operational integration with CB and closer alignment of branding since 2020.

The Stable Outlook on CBCF reflects the Stable Outlook on CB.

CBCF is rated two notches below its parent to reflect our assessment of its limited importance to the CB group. This stems from its limited role in the group's core business, reflected in CBCF's negligible share of CB's consolidated gross loans (0.9% at end-September 2021). It also reflects CBCF's still-weak performance, despite some improvement since CB's acquisition of the company in 2014.

We see CBCF's intrinsic credit profile as being considerably weaker than its support-driven rating. This due to its small franchise - with CBCF accounting for only 0.7% of Sri Lanka's

total finance and leasing sector assets at end-September 2021 - high risk appetite and weak financial profile, particularly in terms of asset quality and profitability.

CBCF's reported gross non-performing loan ratio of 15.1% at end-September 2021 was down from previous levels (end-September 2020: 19.7%, end-September 2018: 37.8%), but remained above 12.8% for the sector. Its pre-tax return on assets has improved since the financial year ending March 2020 (FY20), but continued to be weighed down by high impairment charges, which completely eroded improved pre -impairment operating profitability in 1HFY22. Funding diversity has improved alongside strong deposit growth following the commencement of acceptance of deposits, which accounted for 97% of total funding at 1HFY22 (FYE20: 4%). CBCF's capital position remains supported by capital from the parent, which has enabled it to meet minimum capital requirements and maintain lower leverage relative to bank-held peers.

RATING SENSITIVITIES

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

An upgrade would most likely result from an upgrade of CB's National Long-Term Rating, which would reflect the parent's increased ability to support the subsidiary. However, near-term upside to CB's National Long-Term Rating is limited due to our assessment of the sovereign credit profile and the operating environment.

An upgrade could also stem from CB's greater propensity to support CBCF through a significant increase in CBCF's strategic importance to CB, although we regard this as unlikely in the near term. This could be driven by a wider role within the group through a substantial increase in its scale of operations, contribution to the consolidated group and a longer record of successful operations.

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

CBCF's National Long-Term Rating could be downgraded if CB's ability to support CBCF were to weaken, as signalled through a downgrade of CB's National Long-Term Rating. Any perceived weakening in CB's propensity to provide support to CBCF could also drive a downgrade. 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 CB's ownership stake in CBCF or persistently weak performance at CBCF.

A deterioration in CBCF's intrinsic credit profile is unlikely to affect its National Rating due to the support-driven nature of the 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

CBCF's rating is driven by the rating on its parent, CB.

RATING ACTIONS

ENTITY / DEBT	RATING		PRIOR
CBC Finance LTD	Natl LT Affirmed	A(lka) Rating Outlook Stable	A(lka) Rating Outlook Stable

VIEW ADDITIONAL RATING DETAILS

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APPLICABLE CRITERIA

Non-Bank Financial Institutions Rating Criteria— Effective Feb. 28, 2020-Jan. 31, 2022 (pub. 29 Feb 2020) (including rating assumption sensitivity)

National Scale Rating Criteria (pub. 22 Dec 2020)

ADDITIONAL DISCLOSURES

Solicitation Status

Endorsement Policy

ENDORSEMENT STATUS

CBC Finance LTD	-

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Non-Bank Financial Institutions Asia-Pacific Sri Lanka