



## RATING ACTION COMMENTARY

# Fitch Maintains CBC Finance's National Long-Term Rating of 'BBB+(lka)' on Watch Negative

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Fitch Ratings - Colombo/Singapore - 10 Apr 2023: Fitch Ratings has maintained the Rating Watch Negative (RWN) on CBC Finance LTD's (CBCF) National Long-Term Rating of 'BBB+(lka)'.

## KEY RATING DRIVERS

**RWN Reflects Parent's Rating:** The RWN on CBCF's ratings reflects that on its parent, Commercial Bank of Ceylon PLC (CB: A(lka)/RWN). The Watch Negative also takes into consideration the potential for further deterioration in CBCF's creditworthiness relative to other entities on the Sri Lankan National Ratings scale, amid sustained pressure on the domestic operating environment arising from the stressed sovereign credit profile (Long-Term Local Currency Issuer Default Rating: CC).

We see the funding and liquidity conditions of domestic finance and leasing companies (FLC) as tied to those of the banks, and any signs of funding or liquidity stress in the banking sector would carry contagion risk for FLCs. The RWN reflects our view that CBCF is not immune to these system-wide stresses, which will continue to exert pressure on the prospects for parental support.

**Shareholder Support-Driven Rating:** The National Long-Term Rating is driven by our view that the parent would provide extraordinary support to CBCF, if required. CB's ability to support CBCF is reflected in its credit profile, which is underpinned by its standalone strength. We believe that any required support for CBCF would be manageable relative to CB's financial capacity. The support assessment also takes into consideration CB's full ownership of CBCF, a record of ordinary support, CBCF's moderate management and operational integration, and close branding alignment.

**Limited Importance to CB group:** CBCF is rated two notches below its parent to reflect our assessment of its limited importance to the CB group. The financing subsidiary's core business line caters mainly to high-yielding, under-banked customer segments that have limited overlap with the parent bank's core customer base. CBCF also accounts for a minimal share of CB's consolidated gross loans, at 0.9% at end-2022, and its contribution to group profitability remains negligible.

**Weak Standalone Profile:** We assess CBCF's standalone credit profile as weaker than its support-driven rating because of its small franchise (asset market share of 0.7% as of end-2022), evolving business model, high risk appetite, and weak financial profile - as reflected in its poor asset-quality metrics, weak profitability and highly concentrated deposit base.

**Continued Asset-Quality Deterioration:** We expect CBCF's asset-quality metrics to deteriorate in the near- to medium-term as economic conditions remain challenging. The company's over six months regulatory non-performing loans ratio edged up to 17.0% by end-2022 compared with 13.1% at end-2021, but its stage 3 loans, which includes over six months dues as well as those with elevated credit risk, increased to 27.3% of loans (2021: 19.5%), signalling rising risks to asset quality.

**Profitability Weaker than Peers:** CBCF's pre-tax profit/average assets ratio declined to 0.5% in 2022 from 1.2% in 2021, due primarily to the sharp increase in operating costs which outweighed the substantial bad debt recoveries. We expect CBCF's profitability to improve in the near to medium term, but still remain weaker than peers, as the company ventures into high-yielding loan products along with its increased focus on recoveries.

## **RATING SENSITIVITIES**

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

CBCF's rating is sensitive to changes in CB's credit profile, as reflected in CB's National Long-Term Rating as well as Fitch's opinion around CB's ability and propensity to extend timely extraordinary support.

Developments that could lead to a downgrade include:

- insufficient or delayed liquidity support from CB relative to CBCF's needs, which hinders CBCF's ability to meet its obligations in a timely manner
- intervention by the authorities that constrain CBCF's ability to service its obligations

- increased size relative to the parent that makes extraordinary support more onerous for the parent

The ratings may also be downgraded if we perceive a weakening in the parent's propensity to support its finance subsidiary due to weakening links.

The resolution of the RWN is contingent upon developments in the operating environment, the parent's credit profile, and the evolution of the finance company's funding and liquidity position, which may take more than six months to emerge.

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

There is limited scope for upward rating action given the RWN.

### **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 CB's National Long-Term Rating.

### **RATING ACTIONS**

ENTITY / DEBT ⚡	RATING ⚡	PRIOR ⚡
CBC Finance LTD	Natl LT	BBB+
	BBB+(Ika) Rating Watch Negative	(Ika) Rating Watch
	Rating Watch Maintained	Negative

[VIEW ADDITIONAL RATING DETAILS](#)

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## APPLICABLE CRITERIA

[National Scale Rating Criteria \(pub. 22 Dec 2020\)](#)

[Non-Bank Financial Institutions Rating Criteria - Effective from 31 January 2022 to 5 May 2023 \(pub. 01 Feb 2022\) \(including rating assumption sensitivity\)](#)

## ADDITIONAL DISCLOSURES

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CBC Finance LTD

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