

RATING ACTION COMMENTARY

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

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Fitch Ratings - Colombo - 26 Apr 2024: Fitch Ratings has affirmed CBC Finance LTD's (CBCF) National Long-Term Rating at 'BBB+(lka)'. The Outlook is Stable.

KEY RATING DRIVERS

Shareholder Support Drives Rating: CBCF's rating is driven by our view that the parent, Commercial Bank of Ceylon PLC (CB: A(lka)/Stable), 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. The support assessment also considers CB's full ownership of CBCF, a record of ordinary support through multiple equity infusions and close brand 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. CBCF mainly caters to high-yielding, under-banked customer segments that have limited overlap with the parent bank's core customer base. CBCF also accounts for a negligible share of CB's group gross loans and its contribution to the group's profitability remains miniscule, worsened by its net loss in 2023. Furthermore, CBCF has significant management independence and limited operational integration with the CB group.

Weak Standalone Profile: We believe CBCF's intrinsic credit profile is considerably weaker than its support-driven rating due to its small franchise, with a loan market share of 0.8% as of end-2023, evolving business model, high risk appetite and weak financial profile as reflected in its poor asset-quality metrics, weakened profitability and concentrated deposit

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profit/average assets of 0.4%). We expect the company's earnings to improve in the near-to-medium term on its aggressive growth plans, declining funding costs and lower credit costs relative to 2023.

Capital Ratios to Narrow: Fitch expects CBCF's leverage ratio and regulatory capital ratios to be under pressure from its growth plan, which exceeds the pace of internal capital generation. That said, we expect the ratios to remain above regulatory minimums. Reported net losses and asset growth in 2023 caused the company's leverage ratio to increase to 3.5x (2022: 2.6x) and the regulatory Tier 1 capital ratio to fall to 19.6% (end-2022: 24.9%).

Asset-Quality Stresses to Linger: CBCF's gross stage 3 loan (over 120 days past due) ratio remained high at 29.4% at end-2023 mainly due to its legacy non-performing loans (NPLs), but has gradually declined due to enhanced recovery measures and loan growth. CBCF's planned asset growth should help moderate the NPL ratio in the near-to-medium term but asset-quality risk could rise as new loans season.

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 of CB's ability and propensity to extend timely extraordinary support. Developments that could lead to negative rating action include:

- a meaningful reduction in the parent's ownership, control or influence that could weaken its propensity to support CBCF;
- sustained weak performance of CBCF that we believe will weaken the parent's propensity to support the subsidiary;
- a notable decline in CBCF's capital buffers, indicating reduced timeliness in financial support to back growth or meet regulatory norms;
- a material increase in size relative to the parent that makes extraordinary support more onerous for the parent;

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These developments could significantly reduce shareholder support prospects and, if severe, may lead to a multi-notch downgrade.

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 indicate the parent's strengthened ability to support the subsidiary.

An upgrade could also stem from a greater propensity to support CBCF due to a significant increase in its strategic importance to CB and integration with the group, although we regard this as unlikely in the near term.

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 ratings are driven by CB's National Long-Term Rating.

RATING ACTIONS

ENTITY / DEBT ⚡	RATING ⚡	PRIOR ⚡
CBC Finance LTD	Natl LT BBB+(Ika) Rating Outlook Stable Affirmed	BBB+ (Ika) Rating Outlook Stable

[VIEW ADDITIONAL RATING DETAILS](#)

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APPLICABLE CRITERIA

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

[Non-Bank Financial Institutions Rating Criteria \(pub. 18 Jan 2024\) \(including rating assumption sensitivity\)](#)

ADDITIONAL DISCLOSURES

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CBC Finance LTD

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