



Fitch Affirms Commercial Bank of Ceylon at 'A(lka)'; Outlook Stable

Fitch Ratings - Colombo - 06 Jun 2024: Fitch Ratings has affirmed Commercial Bank of Ceylon PLC's (COMB) National Long-Term Rating of 'A(lka)'. The Outlook is Stable. At the same time, Fitch has affirmed the bank's subordinated debt at 'BBB+(lka)' and proposed subordinated debt at 'BBB+(EXP)(lka)'.

KEY RATING DRIVERS

Intrinsic Profile Drives Rating: COMB's rating is driven by its intrinsic credit strength and is highly influenced by the bank's exposure to the weak credit profile of the Sri Lankan sovereign (Long-Term Foreign-Currency Issuer Default Rating: RD (Restricted Default), Long-Term Local-Currency Issuer Default Rating: CCC-). In addition, the ongoing sovereign debt restructuring has exerted pressure on COMB's risk and financial profiles, particularly capitalisation and funding. Nonetheless, the rating is supported by the bank's superior domestic franchise as Sri Lanka's third-largest commercial bank.

Restructuring Delays Hinder Progress: The operating environment for Sri Lanka's banks continues to show signs of stabilisation, supporting a recovery in banks' operational flexibility. There are sustained improvements in reported headline macro variables, but we believe persistent delays in the completion of the sovereign debt restructuring exercise could impede the progress made thus far.

Sovereign Risks Still High: Our assessment of COMB's risk profile factors in its exposure to defaulted foreign-currency government securities, to which COMB has the second-highest exposure among domestic banks, at 7% of total assets at end-2023. A further 30% exposure stems from its local-currency denominated treasury securities, making the bank vulnerable to the sovereign's repayment capacity and liquidity position. COMB recognised impairments of 52% on its sovereign bond exposure by end-2023. However, its adequacy remains uncertain as negotiations are ongoing.

Funding and Liquidity Challenges Persist: We believe COMB's funding and liquidity stress has eased on both the foreign- and local-currency fronts relative to the crisis period, given favourable external sector flows and the bank's focus on liquidity preservation, as reflected in its higher liquidity coverage ratio. However, improvements in foreign-currency liquidity remains susceptible to sudden changes in creditor sentiment. The bank's ability to access foreign-currency wholesale funding remains constrained by the sovereign's weak credit profile, similar to peers.

Gradual Loan-Quality Improvement: We expect COMB's impaired (stage 3) loan ratio to fall as the repayment capacity of borrowers gradually improves. This follows the notable decline in interest rates, but a slow pick-up in economic activity and loan growth. This is despite the adverse impact on recoveries from the parate suspension that is in effect till 15 December 2024, in our view. COMB's impaired loan ratio broadly remained unchanged in 1Q24 from 11.4% at end-2023. Its large holdings of local- and foreign-currency government securities exacerbate risks to asset quality.

Risks to Profitability Manageable: We expect risk to COMB's profitability to be manageable, despite the potential for one-off losses from a restructuring of sovereign bonds, should these exceed the provisions already factored in. Barring this, profitability should improve in line with net interest margin stabilisation, envisaged lending growth and a moderation in impairments. COMB's operating profit/risk-weighted assets ratio improved to 5.2% in 1Q24, from 2.7% at end-2023, on higher operating income and lower impairments that outweighed the increase in risk-weighted assets.

Continued Risks to Capital: COMB's large exposure to the sovereign's weak credit profile through its holdings in defaulted sovereign bonds and treasuries weigh on its capitalisation metrics. We believe the bank's proposed capital augmentation plans should uplift its group level common equity Tier 1 (CET1) ratio by 1.5pp. However, this maybe counteracted in the medium-term by a sustained rise in risk density amid envisaged growth, which could pressure the capital ratios. COMB's regulatory CET1 ratio stood at 11.4% at end-1Q24, below the Fitch-rated Sri Lanka bank peer average of 15.4%.

Economic Conditions Support Business Profile: We believe the stabilisation in economic conditions should bode well for COMB's ability to generate and defend business volume, despite constraints from the vulnerable and weak operating environment. Resumption in lending alongside the economic recovery led to a slight uptick in the share of net loans in total assets to 47% in 1Q24 (end-1H23: 45%) - a trend that we expect to continue in the near to medium term, similar to peers.

RATING SENSITIVITIES

Factors that Could, Individually or Collectively, Lead to Negative Rating Action/Downgrade

The National Long-Term Rating is sensitive to a change in the bank's creditworthiness relative to other Sri Lankan issuers. A deterioration in COMB's key credit metrics beyond our base-case expectations relative to peers would increase pressure on the bank's rating, which is driven by its intrinsic financial strength.

Factors that Could, Individually or Collectively, Lead to Positive Rating Action/Upgrade

Positive rating action on the sovereign may lead to an upgrade in the bank's rating. A sustained improvement in the bank's key credit metrics beyond our base-case expectations relative to peers could also lead to an upgrade.

OTHER DEBT AND ISSUER RATINGS: KEY RATING DRIVERS

COMB's Sri Lankan rupee-denominated outstanding and proposed subordinated debt is rated two notches below its National Long-Term Rating anchor. This reflects our baseline notching for loss severity for this type of debt and expectations of poor recovery. There is no additional notching for non-performance risk, as the notes do not incorporate going-concern loss-absorption features.

OTHER DEBT AND ISSUER RATINGS: RATING SENSITIVITIES

The subordinated debt ratings move in tandem with the 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.

RATING ACTIONS

ENTITY / DEBT ↕	RATING ↕			PRIOR ↕
<input type="text"/>	<input type="text"/>			<input type="text"/>
Commercial Bank of Ceylon PLC	Natl LT	A(Ika) ●	Affirmed	A(Ika) ●
subordinated	Natl LT	BBB+(Ika)	Affirmed	BBB+(Ika)
subordinated	Natl LT	BBB+(Ika)	Affirmed	BBB+(Ika)
subordinated	Natl LT	BBB+(EXP)(Ika)	Affirmed	BBB+(EXP)(Ika)

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[VIEW ADDITIONAL RATING DETAILS](#)

Additional information is available on www.fitchratings.com

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APPLICABLE CRITERIA

- [National Scale Rating Criteria \(pub. 22 Dec 2020\)](#)
- [Bank Rating Criteria \(pub. 16 Mar 2024\) \(including rating assumption sensitivity\)](#)

ADDITIONAL DISCLOSURES

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Commercial Bank of Ceylon PLC -

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