

Rating Action & Commentary

Fitch Affirms Hatton National Bank's National Rating

Fitch Ratings-Colombo/Singapore-01 July 2008: Fitch Ratings Lanka has today affirmed Sri Lanka-based Hatton National Bank Plc's (HNB) National Long-term rating at 'AA-(lka)' (AA minus (lka)), reflecting the bank's good profitability, asset quality and solvency. At the same time, Fitch has also affirmed the 'A+(lka)' rating of the bank's subordinated debentures. The Outlook remains Stable.

HNB maintained a loan growth of 19.8% in FY07 above the banking system's average loan growth of 18.9%, although this level of growth is not expected to be sustained in the current economic environment. Focus for the bank has remained primarily on the consumer segment, which comprised 49% of loans at FYE07. Meanwhile, credit concentrations remained high at FYE07, as the five largest total exposures accounted for 11% of HNB's loans and 84% of its equity, including related party exposures at 5% of loans and 35% of equity at FYE07.

The bank's profitability as measured by ROA increased to 1.43% in FY07 and compared favourably against most of its peers, due to an expansion in interest margins (5.51% in FY07 against 4.99% in FY06) arising from higher yields that reflected HNB's aforementioned customer segment exposures. However, its ROA dipped to 1.24% at Q108 owing to increased operating costs, and could come under further pressure as a result of reduced margins due to the potential difficulties in passing on high funding costs, rising operating costs and increased provision charges.

Following the implementation of the Basel II framework in FY08, HNB's core and total capital adequacy ratios declined by 230bps and 172bps to 7.9% and 10.3%, respectively, at Q108, largely due to the additional charge for operational risk. Significant revaluation surpluses arising from the revaluation of its land and buildings constituted 26% of equity at FYE07. Nonetheless, capitalisation remained adequate, as indicated by equity/assets (excluding revaluation surpluses) of 6.8% at FYE07 (8.9% unadjusted), and is supported by strong profitability and profit retention.

HNB's gross NPL ratio has continued to improve from 14% at FYE03, and decreased to 6.0% at FYE07 from 7.1% at FYE06, due to greater focus on recoveries. However, by Q108, the ratio declined to 6.8%, a deterioration also observed across its peers, stemming from the challenging macroeconomic environment. Specific provision coverage rose to 67.2% at FYE07 from 66.8% at FYE06, while general provisions (including mandatory regulatory provisions) accounted for 0.5% of loans at FYE07. Consequently, the net NPL/equity ratio (excluding revaluation surpluses) improved to 18.7% at FYE07 (14.1% unadjusted) from 23.2% at FYE06 but deteriorated to 26.8% at Q108. Fitch expects these ratios to deteriorate further on account of more stringent regulatory classification of NPLs and a probable decline in asset quality.

HNB is Sri Lanka's second-largest private bank and the fourth-largest Licensed Commercial Bank in Sri Lanka, accounting for 9.6% of banking system assets at FYE07. Entities related to the Stassens group and the Browns Group held 24% and 15% of the bank's voting equity as at FYE07.

HNB has a 1.78% shareholding in Fitch Ratings Lanka but is not involved in either the day-to-day operations or credit rating reviews undertaken by Fitch Ratings Lanka.

A credit update will be made available shortly on Fitch's websites, www.fitchratings.com and www.fitchratings.lk.

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Note to editors: Fitch's National ratings provide a relative measure of creditworthiness for rated entities in countries with relatively low international sovereign ratings and where there is demand for such ratings. The best risk within a country is rated 'AAA' and other credits are rated only relative to this risk. National ratings are designed for use mainly by local investors in local markets and are signified by the addition of an identifier for the country concerned, such as 'AAA(lka)' for National ratings in Sri Lanka. Specific letter grades are not therefore internationally comparable.

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