

**Rating Action: Moody's affirms ratings of three Sri Lankan banks; revises outlooks to negative from stable**

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Global Credit Research - 21 Jun 2016

Singapore, June 21, 2016 -- Moody's Investors Service has affirmed the long-term ratings of three banks in Sri Lanka (B1 negative).

Moody's has also revised their ratings outlooks to negative from stable.

The rating actions follow the affirmation of Sri Lanka's B1 sovereign rating, and the change in outlook on the sovereign rating to negative from stable on 20 June 2016.

The affected banks are: (1) Bank of Ceylon; (2) Hatton National Bank Ltd.; and (3) Sampath Bank PLC.

The baseline credit assessments (BCAs) and Adjusted BCAs of the three banks were affirmed at b1.

The counterparty risk assessments (CRAs) of the three banks were affirmed at Ba3(cr)/NP(cr).

In Moody's view, the operating conditions for Sri Lanka's banks have weakened because of lower-than-expected policy effectiveness. As a result, Moody's has changed Sri Lanka's Macro Profile to "Moderate -" from "Moderate".

The full list of ratings and assessments affected by this rating action can be found at the end of this press-release.

**RATINGS RATIONALE**

The credit ratings on the three banks were affirmed and their outlooks changed to negative because Moody's affirmed Sri Lanka's B1 sovereign rating and changed its outlook to negative from stable on 20 June 2016.

The ratings and outlooks of banks typically follow the ratings and outlooks of their respective governments if the banks' ratings are positioned at the same level as capped by the sovereign rating, which is the case for Bank of Ceylon, Hatton National Bank Ltd. and Sampath Bank PLC.

Typically, such linkages between the sovereign credit profile and the credit metrics of the domestic banks are driven by the banks' large investments in sovereign bonds.

The key drivers of Sri Lanka's sovereign outlook change to negative from stable are: (1) Moody's expectation of a further weakening in some of Sri Lanka's fiscal metrics in an environment of subdued GDP growth; and (2) the possibility that the effectiveness of the fiscal reforms envisaged by the government may be lower than we currently expect, which could further weaken fiscal and economic performance.

More details on the sovereign rating action are available at the issuer page of the Government of Sri Lanka on [www.moody's.com](http://www.moody's.com).

Moody's has also changed its Macro Profile for Sri Lanka to "Moderate -" from "Moderate", reflecting our view that operating conditions have weakened for Sri Lankan banks. In particular, Moody's has lowered its "institutional strength" score for Sri Lanka's Macro Profile. The fiscal consolidation path targeted by the authorities and outlined in the IMF program is ambitious; sustaining such efforts will challenge the government's institutional capacities and might affect GDP growth over the short term. The decrease in score for Sri Lanka's Macro Profile has had no impact on the BCAs of the three Sri Lankan banks.

**RATIONALE BEHIND THE AFFIRMATION OF BANKS' BCAs, ADJUSTED BCAs, AND CRAs**

Moody's has affirmed the b1 BCAs and b1 Adjusted BCAs of the three banks.

For Bank of Ceylon, its b1 BCA was affirmed owing to the bank's broadly stable asset quality with a 3.8% problem loans ratio at end-March 2016, as well as Moody's expectation that its profitability will increase

because of lower loan loss provisions and improved margins. Moody's also expects that the bank's capital buffer will remain stable, albeit low, at 6.05%, calculated as tangible common equity / adjusted risk weighted assets (TCE ratio) as of the same date.

For Hatton National Bank Ltd., its BCA was affirmed because of the bank's moderate capital adequacy position with a TCE ratio of 10.3% at end-March 2016. In addition, it has healthy profitability with a return on average assets of 1.8% for 1Q 2016. The BCA also captures the bank's tight liquidity profile as seen in the high loans-to-deposits ratio of 98% at end-March. The bank's asset quality improved in 2015 and early 2016, with problem loans of 2.4% as of the same date. Moody's notes that the bank's rapid credit growth of 26% in 2015 could mask asset quality challenges because a large proportion of loans is unseasoned.

The BCA of Sampath Bank PLC was affirmed because of the bank's healthy asset quality; a problem loans ratio of 1.64% at end-2015 and problem loans coverage of 111%. Similar to Hatton National Bank, Sampath Bank reported very high loan growth of 24% in 2015, which could mask asset quality challenges. Profitability remains a key credit strength of the bank, with its return on average assets over the last three years averaging at 1.23%. The bank's capital levels are low, with a TCE ratio of 6.9% end-2015.

The Counterparty Risk Assessments of the three banks were affirmed because of the respective affirmation of these banks' Adjusted BCAs.

#### WHAT COULD MOVE THE RATING UP/DOWN

Given the revision of the sovereign rating outlook to negative from stable, there is no potential for an upward revision of the long-term credit ratings of the three Sri Lankan banks. This is because the banks' long-term ratings are positioned at the same level as Sri Lanka's sovereign B1 rating.

A downgrade of Sri Lanka's sovereign rating will result in a downgrade of the long-term credit ratings of the three Sri Lankan banks.

The BCAs of the three banks could be lowered if there is a material deterioration in solvency factors, such as asset quality, profitability and capital. Tighter liquidity and an increased reliance on market funding will also be negative for the BCAs.

#### LIST OF AFFECTED RATINGS AND ASSESSMENTS

##### Bank of Ceylon

Long-term local currency deposit rating affirmed at B1, outlook revised to negative

Long-term foreign currency deposit rating affirmed at B2, outlook revised to negative

Long-term foreign currency issuer and senior unsecured ratings affirmed at B1, outlook revised to negative

Short-term domestic and foreign currency deposit ratings remain unchanged at NP

BCA and Adjusted BCA affirmed at b1

Counterparty Risk Assessments (CRA) affirmed at Ba3(cr)/NP(cr)

##### Sampath Bank PLC

Long-term local currency deposit rating affirmed at B1, outlook revised to negative

Long-term foreign currency deposit rating affirmed at B2, outlook revised to negative

Long-term foreign currency issuer rating affirmed at B1, outlook revised to negative

Short-term domestic and foreign currency deposit ratings remain unchanged at NP

BCA and Adjusted BCA affirmed at b1

Counterparty Risk Assessments (CRA) affirmed at Ba3(cr)/NP(cr)

##### Hatton National Bank Ltd.

Long-term local currency deposit rating affirmed at B1, outlook revised to negative

Long-term foreign currency deposit rating affirmed at B2, outlook revised to negative

Long-term foreign currency issuer rating affirmed at B1, outlook revised to negative

Short-term domestic and foreign currency deposit ratings remain unchanged at NP

BCA and Adjusted BCA affirmed at b1

The principal methodology used in these ratings was Banks published in January 2016. Please see the Ratings Methodologies page on [www.moody.com](http://www.moody.com) for a copy of this methodology.

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Eugene Tarzimanov  
VP - Senior Credit Officer  
Financial Institutions Group  
Moody's Investors Service Singapore Pte. Ltd.  
50 Raffles Place #23-06  
Singapore Land Tower  
Singapore 48623  
Singapore  
JOURNALISTS: (852) 3758 -1350  
SUBSCRIBERS: (852) 3551-3077

Stephen Long  
MD - Financial Institutions  
Financial Institutions Group  
JOURNALISTS: (852) 3758 -1350  
SUBSCRIBERS: (852) 3551-3077

Releasing Office:  
Moody's Investors Service Singapore Pte. Ltd.  
50 Raffles Place #23-06  
Singapore Land Tower  
Singapore 48623  
Singapore  
JOURNALISTS: (852) 3758 -1350  
SUBSCRIBERS: (852) 3551-3077



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