ICRA Lanka reaffirms [SL]AAA rating with stable outlook to Bank of Ceylon

November 05, 2015

Instrument	Amount	Rating Action
Issuer Rating	N/A	[SL]AAA Reaffirmed (Outlook-Stable)

ICRA Lanka has reaffirmed the Issuer Rating of Bank of Ceylon (BOC or the Bank) at [SL]AAA (pronounced SL Triple A) with stable outlook. The highest credit quality rating continue to factor in the 100% Government of Sri Lanka (GOSL) ownership, which provides a strong likelihood of sovereign support to the bank; coupled with BOC's leading position in the Sri Lankan banking industry, its established franchise, healthy deposit profile and comfortable liquidity profile. ICRA Lanka notes the LKR 5 Billion fresh equity infusion by GOSL in 2014 and another LKR 5 Billion equity infusion which is expected in the current year, is likely to support the overall capitalization profile in the near term. The bank however would require regular capital support from GoSL to maintain a conservative capitalization profile, with Core Tier-I at 10%, going forward. The rating takes note the bank's systemic importance and GoSL ownership, which provides visibility on the capital support when required. Asset quality of the bank deteriorated during H12015 (GNPA at 5.4% in June 2015 vis a vis 3.8% in December 2014) as the bank moderated the recoveries and auctioning processes of its pawing NPAs, following the special concession announced by the GoSL for pawning customers. However, the bank has commenced the normal auction/recoveries on these exposures from post June 2015, which is likely to result in the decline in the pawning NPAs and support the overall asset quality indicators.

The Bank accounts for 22% of the aggregate advances and about 22% of the aggregate deposits of the Licensed Commercial Banks(LCBs) in Sri Lanka as on December 2014. The Bank also operated about 570 branches and 540 ATM access points around the country as of December 2014. BOC's total advances in FY2014 grew by a moderate 3% (6% in FY2013) compared to the 12% growth reported by the LCBs during the same period. During H12015, net advances grew by 7.1% over December 2014 levels. The rating factors in the Bank's position as the key lender to GOSL and the State Owned Entities (SOEs), which accounted for over 40% of the overall advances as of December 2014; credit risk on this exposure, notwithstanding the concentration, is expected to be quite minimal due to the sovereign guarantee on these exposures. BOC has been able to maintain a balanced corporate to retail mix of about 54:46. The Proportion of pawning advances, the largest category under the Bank's retail book, which is quite vulnerable to the adverse movement in the gold prices declined to about 10% in December 2014, as compared to 17% in December 2013

The Bank reported a healthy deposit profile with a comfortable mix of both foreign and local deposits aided by the bank's well established branch network, dominant position in the remittance business and a strong franchise, being the largest government bank in the country. BOC's deposit base grew by 11% during FY2014. The Bank reported a healthy CASA Ratio of 43% as of December 2014, above the industry average of 42%. BOC's overall liquidity profile was comfortable, assisted by the moderation of loan growth in FY2014 leading to the decline in Gross advances to Deposit Ratio to about 83% as of

December 2014, as compared to 90% as of December 2013 and its ability to secure long term borrowings.

BOC's Tier I Capital improved to 9.5% and a total CAR to 13.6% as of December 2014 (Tier 1 – 8.4%, total CAR 12.1% as for FY2013) supported by the capital infusion by GoSL and modest advances growth of about 3% during 2014, the same however was weaker as compared to the industry average of Tier I – 12.6% and total CAR of 15.6% as of December 2014 (Tier I - 13%, total CAR – 16.1% as of December 2013). The Bank's Core Tier-I stood at 8.4% in June 2015. The expected LKR 5 Billion equity infusion from GOSL in the current year is expected to positively impact the Bank's overall capitalization profile to support the near term growth.

BOC has been reporting a stable Return on Average Assets (ROAA, net of taxes) of above 1.1% over the last two financial years. The bank's NIMs moderated from about 3.3% in FY2013 to 3.0% in FY2014, due to modest advances growth during the period; the same is expected to witness some uptick from the current levels, with the revival in the business volumes, moderation in the cost of deposits along with improvement in the share of low cost CASA deposits; although the lending rates may witness some decline due to low systemic rates. BOC's Return on average net worth, notwithstanding some moderation due to the equity infusion, was good at 20.5% for FY2014 compared to 22.2% in FY2013. Going forward, expected improvements in operating expenses matrices in line with the increase in the scale of operations and lower credit provisions owing to a decline in the incremental NPA formation and losses on existing NPAs is likely to support the overall profitability.

Bank Profile

Bank of Ceylon is a Licensed Commercial Bank, 100% owned by the Government of Sri Lanka. The Bank was incorporated in August 1939 under Bank of Ceylon Ordinance No. 53 of 1938. Bank of Ceylon is currently the largest financial institution in the country with about LKR 1.3 trillion in assets accounting for approximately 23% of the total LCB assets as at December 2014. Currently, BOC operates about 570 branches including 3 overseas branches in Maldives, Chennai and Seychelles. The bank also operates a subsidiary in the UK – Bank of Ceylon (UK) Limited. The BOC group has 12 subsidiaries and five associate companies which together accounts for 5% of the Groups earnings and accounts for 3% of the group's total assets as of December 2014.

During FY2014 BOC reported PAT of LKR 13,574 Mn on a total assets base of LKR 1,329 Bn as against a PAT of LKR 12,087 Mn on a total assets base of LKR 1,194 Bn during FY2013. For H1FY2015 BOC reported a PAT of LKR 6,667 Mn on a total assets base of LKR 1,406 Bn. As on June 30, 2015, the bank reported capital adequacy of 11.9% (Tier 1: 8.4%) and Gross NPA of 5.4%.

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For further details please contact:

Analyst Contacts:
Mr. Karthik Srinivasan, (Tel No. +91-22-6114 3444)
karthiks@icraindia.com

Relationship Contacts:
Mr. W. Don Barnabas, (Tel. No. +94-11-4339907)
wdbarnabas@icralanka.com

Subsidiary of

ICRA Limited

A Group Company of Moody's Investors Service

CORPORATE OFFICE
Level 10, East Tower, World Trade Center, Colombo 01, Sri Lanka
Tel: +94 11 4339907; Fax: +94 11 2333307
Email: info@icralanka.com; Website: www.icralanka.com