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RATING ACTION COMMENTARY

Fitch Affirms Dialog Finance at 'AA(lka)'; Outlook Stable

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Fitch Ratings - Colombo - 01 Mar 2021: Fitch Ratings has affirmed Dialog Finance PLC's (DF) National Long-Term Rating of 'AA(lka)'. The Outlook is Stable.

KEY RATING DRIVERS

DF's rating reflects Fitch's expectation of support from parent, Dialog Axiata PLC (Dialog, AAA(lka)/Stable), Sri Lanka's largest mobile telecommunication and pay-TV operator. This is based on Dialog's 99.05% equity stake in the subsidiary, DF's high operational and management integration with the parent and the common Dialog brand. The two-notch differential reflects our view that DF is of limited importance to Dialog's core business, given its evolving fintech business model as well as modest size and financial contribution to the group.

Dialog's credit profile and ability to support DF is reflected in its rating, which is underpinned by its standalone strength. DF was acquired in 2017 to support Dialog's aspiration to expand in digital financial services in Sri Lanka via the fintech business model. The company has made some progress in executing its intended role, but we do not expect it to be a significant contributor to the group's core business in the near to medium term.

We believe DF's intrinsic financial strength is materially weaker than its support-driven rating due to its weak financial profile, small franchise - with market share of around 1% - short operating history and high-risk appetite. Its weak financial profile primarily stems from the company being structurally unprofitable due to its inability to execute its planned business model and its highly concentrated deposit base, which is mostly made up of related-party deposits.

The transfer of DF's device financing portfolio, which accounted for a substantial share of non-performing loans, to a sister company during 4Q20 helped the company's regulatory six-month non-performing loan ratio to improve significantly to 8.3% by end-2020 from 47.6% at end-September 2020. We expect DF to

increasingly tap the group's ecosystem for lending opportunities where credit risk is lower while also launching its planned fintech services in a meaningful way.

Regular capital infusions to comply with regulatory capital requirements kept DF's debt/tangible equity low at 0.6x at end-2020. That said, we expect DF's leverage to increase in the medium term as the company embarks on its growth plans, which we expect to be funded by deposits and borrowings, but leverage will still remain lower than that of similar-sized peers. Fitch expects Dialog to inject an amount necessary to help DF to comply with the regulatory core capital level of LKR2.5 billion by end-2021.

RATING SENSITIVITIES

Factors that could, individually or collectively, lead to positive rating action/upgrade:

An upgrade of the National Long-Term Rating would most likely result from a significant increase in DF's strategic importance to its parent through an increase in its role and financial contribution within the Dialog group.

Factors that could, individually or collectively, lead to negative rating action/downgrade:

DF's National Long-Term Rating could be downgraded if Dialog's ability to support DF were to weaken, as signalled through a downgrade of Dialog's National Long-Term Rating - but we believe such a scenario is unlikely to occur in the medium term. Any perceived weakening in Dialog's propensity to support DF could also be negative for DF's rating. This could arise from weakening links with the parent that results in wider notching and may be in the form of a meaningful reduction in parental control or influence, or reduced importance to the group because DF is unable to establish a meaningful role in the group.

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

DF's rating is driven by support from its parent, Dialog Axiata PLC.

ENTITY/DEBT	RATING ACTIONS		PRIOR
		RATING	
Dialog Finance PLC	Natl LT	AA(lka) Affirmed	AA(lka)

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