RAM
RATINGS

Media Release

RAM Ratings affirms Sabah Development Bank's AA_1 ratings on firm commitment of support from state government

RAM Ratings has affirmed the AA_1/Stable/P1 ratings of Sabah Development Bank Berhad's (SDB or the Bank) debt instruments (Table 1) on the expectation that the Sabah state government (the State) will readily extend support if required.

In our rating assessment of SDB, RAM is well cognisant of the Bank's very weak standalone credit profile, accentuated by the significant underprovisioning of legacy credit exposures, thin capital buffers and previously lax impaired loan classification. However, the ratings continue to be anchored by Sabah state's very strong likelihood of support for the Bank and its debt borrowings – a commitment firmly articulated to RAM and SDB's investors. The State's financial capacity is underpinned by its robust fiscal position and cash reserves, estimated at over RM6 bil as at end-December 2023 (end-December 2022: RM5.4 bil).

Following a major revamp in August 2023, new board members and senior management personnel were appointed to turn around SDB. Management topped up much-needed provisions on impaired accounts, which brought provision practices closer to banking norms. This resulted in a steep RM480 mil pre-tax loss in FY Dec 2023 (FY Dec 2022: RM84 mil pre-tax profit). Consequently, the Bank's tier-1 capital ratio fell to 10.5% as at end-2023 (end-2022: 14.7%). We caution that more provisioning is expected this year to enhance buffers, which will inevitably lead to similarly large pre-tax losses and further deterioration in the Bank's tier-1 capital ratio.

To address the capital erosion, the State has committed to convert RM660 mil of its deposits in the Bank to redeemable preference shares (RPS) and set off another RM650 mil against non-performing government-linked loans. Although the conversion of these deposits to RPS will be spread over a few years, they will be pledged as security until full conversion and will be subordinated to senior borrowings. Pending RPS conversion (the terms of which are still being finalised), SDB's tier-1 capital ratio may fall to low-to-mid single digits before improving gradually. Assuming these deposits qualify as tier-2 capital, SDB's total capital ratio is anticipated to stay above 10%. Cash injections from the State (2023: RM40 mil; 2024: RM50 mil approved) will also help in restoring capital.

The State has affirmed vide a public statement on 12 July 2024 its support for the Bank in ensuring bond obligations and repayments will be kept whole. SDB has RM1.6 bil in bond obligations due over the next 12 months. The Bank intends to use its available cash reserves to fully repay an upcoming RM390 mil bond obligation due on 30 July 2024. Expected deposit placements from other state agencies will help provide additional liquidity in the coming months.

Since taking office, the new management team has summarily strengthened the Bank's governance and credit underwriting, while also intensifying recovery efforts for distressed assets. SDB's gross impaired loan ratio jumped to 72% as at end-2023 (end-2022: 47%) due to a smaller loan base and impairment of a large exposure. While the Bank ceased lending to new peninsula borrowers in 2019 – a key source of impairments in the past and contrary to its developmental mandate – these legacy borrowings still comprise a significant 45% of total loans and will require time to be resolved.

A development financial institution wholly owned by the State, SDB is now refocused on its mandate of funding socially and economically meaningful and environmentally responsible development projects originated in Sabah. As part of our surveillance, we will continue to maintain close engagements with SDB and the State government on the progress of the Bank's transformation.

Table 1: Ratings of SDB's debt programmes

Instrument	Rating action	Ratings
RM3.0 bil Commercial Papers (CP) (2021/2028)/Medium-Term Notes (MTN) Programme (2021/2046)^	Affirmed	AA_1/Stable/P1
RM3.0 bil MTN Programme (2011/2036)	Affirmed	AA_1/Stable
RM1.0 bil MTN Programme (2008/2028)	Affirmed	AA_1/Stable
^ The aggregate outstanding CP and MTN cannot exceed RM3.0 bil at any time.		

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