Silk Bank Limited

RATING REPORT

REPORT DATE:
July 04, 2017

RATING ANALYSTS:
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RATING DETAILS				
	Latest Rating		Previous Rating	
Rating Category	**Long-term**	**Short-term**	**Long-term**	**Short-term**
Entity Rating	A-	A-2	A-	A-2
Outlook	Stable		Stable	
Date	*June 30, '17*		*June 30, '16*	

COMPANY INFORMATION	
Year of Establishment: 1994	**External auditors:** Deloitte Yousuf Adil, Chartered Accountants
Type of Company: Public Limited Company	**Chairman of the Board:** Mr. Munnawar Hamid, OBE
Key Shareholders (with stake 5% or more):	**President & CEO:** Mr. Azmat Tarin
Arif Habib Limited (32.87%)	
Shaukat Tarin (13.5%)	
International Finance Corporation (9.01%)	
Zulqarnain Nawaz Chattha (8.69%)	

APPLICABLE METHODOLOGY(IES)
PRIMER - Commercial Banks (December 2001): ***http://jcrvis.com.pk/images/primercb.pdf***

Silk Bank Limited

OVERVIEW OF THE INSTITUTION

Silk Bank Limited (Silk) was incorporated as a public listed company in 1994. Ownership of the bank is shared by Arif Habib Corporation, Mr. Shaukat Tarin, Gourmet Group and International Finance Corporation.

Silk operates out of 88 branches (2015: 88) including 10 Islamic branches (2015: 10) in Pakistan.

Profile of Chairman

Mr. Munnawar Hamid OBE serves as the Chairman of the Board; he has held this position since 2008. Mr. Hamid's experience spans over 45 years in business & corporate management and operations. He has been associated with various educational institutions, consultative bodies and organizations.

Profile of President & CEO

Mr. Azmat Tarin's experience spans over three decades. Mr. Tarin has been serving the bank in his current position since 2008.

RATING RATIONALE

Silk Bank Limited (Silk) had an asset base of Rs. 135.0b (2015: Rs. 133.1b) at year-end'2016. Financing and investment portfolio represented 48% and 28% of total assets, respectively. While declining on a timeline basis, Non-Earning Assets (NEAs) remain sizeable in relation to total assets and bank's own equity. Two major NEAs amounting to Rs. 5.8b were converted into earning assets by entering into an agreement to sell within a period of 5 years with annual rental income. The arrangement is expected to result in a profitability impact of Rs. 352m for full year 2017. Share issuance process against rights issue of Rs. 10b was also completed in January'2017.

Silk plans to expand branch network during the ongoing year through opening of 20 Islamic branches. And additional 15 conventional branches and 20 booths are also planned to be opened subject to SBP approval. Branch expansion strategy entails opening of low cost (smaller & efficient branches) & current account centric branches. Surplus employees from existing pool are planned to be deployed in new branches. The bank also plans to venture into the digital banking space and has received approvals for branchless banking license from SBP. Pilot launch is targeted in August'2017.

Rating Drivers

Credit Risk: Reported asset quality indicators (Gross Infection: 1Q17: 7.6%; 2016: 8.4%; 2015: 12.7%) of the bank have witnessed noticeable improvement on account of recoveries, conversion to OREO and write-offs. Moreover, provisioning coverage has increased to 78.1%% (2016: 77.5%%; 2015: 70.1%) at end-March'2017. Corporate portfolio continues to represent the major portion of financing portfolio with noticeable growth witnessed in the ongoing year. Going forward, short term and trade related (LCs, guarantees) exposures are planned to be undertaken while gradual run-off of term loans is planned. Select corporate clients from sugar, leather and rice sectors may result in asset quality pressures while restructured clients may also require close monitoring. Consumer portfolio continued its growth momentum; albeit at a slower pace than budgeted levels. Contribution to bank's overall profitability of the consumer segment is sizeable with asset quality indictors continuing to be maintained at sound levels. SME portfolio is also targeted to grow with focus on supply chain and vendor financing.

Liquidity: At end-March'2017, deposit base of the bank increased to Rs. 94.3b (2016: Rs. 86.8b; 2015: Rs. 81.1b) with increase in proportion of saving and current accounts in deposit mix to 28% (2016: 27%; 2015: 25%) and 26% (2016: 24%, 2015: 26%), respectively. However, CASA ratio of the bank is on the lower side at 55% vis-à-vis peer group median of 72%. Depositor concentration is sizeable and has increased on a timeline basis (Top 50 depositors represent 40% of total deposits). Focus on new-to-bank and CASA will continue to drive deposit strategy, going forward. Besides opening of new branches, initiatives including employee & digital banking and opening of booths is planned to further improve depositor profile. Liquidity coverage ratio (86.2%) and liquid assets in relation to deposits & borrowings were on the lower side at around 23% of total deposits & borrowings.

Capitalization: Tier-1 and overall Capital Adequacy Ratio (CAR) of the bank was reported at 9.46% (Regulatory Requirement: 8.15%) and 10.67% (Regulatory Requirement: 10.65%), respectively, at year-end'2016. The bank is in the process of issuing a Basel 3 compliant Tier-2 instrument in the ongoing year which the management expects will allow the bank to comply with increasing regulatory requirement and higher deduction for deferred tax assets from tier-1 capital. Quantum of future profits and quality of exposures will be important determinants for compliance with future capital requirements. Net-NPLs in relation to tier-1 equity improved to 18.3% (2015: 25.3%) attributable to reduction in net-NPLs.

Profitability: The bank posted an operating profit in 2016 vis-à-vis an operating loss in 2015. Improvement in operating profitability was supported by increase in spreads (reduction in deposit cost), volumetric growth in earning assets and higher fee based income while increase in administrative expenses remained within manageable levels. Overall profitability was also supported by provision reversals, rental income on Non-Banking Assets and capital gains. Going forward, operating profitability is projected to increase with growth in earning assets and reduction in OREO. However, quantum of overall profits may vary with capital gains on OREO and provisioning charges on financing portfolio.

Silk Bank Limited

FINANCIAL SUMMARY *(Rs. in Millions)*			Appendix I
BALANCE SHEET	**31-Dec-16**	**31-Dec-15**	**31-Dec-14**
Total Investments	37,488	35,513	18,105
Advances	64,803	61,074	58,966
Total Assets	135,034	133,103	102,736
Borrowings	30,195	33,230	21,742
Deposits & other accounts	86,787	81,098	68,770
Subordinated Loans	-	-	-
Tier-1 Equity	9,279	11,607	5,312
Net Worth	12,055	14,577	8,501
INCOME STATEMENT	**31-Dec-16**	**31-Dec-15**	**31-Dec-14**
Net Mark-up Income	4,349	3,099	3,460
Net Provisioning	-49	724	368
Non-Markup Income	2,213	1,894	1,720
Operating Expenses	5,326	6,109	4,681
(Loss) / Profit Before Tax	1,285	-1,839	131
(Loss) / Profit After Tax	739	-1,712	87
RATIO ANALYSIS	**31-Dec-16**	**31-Dec-15**	**31-Dec-14**
Market Share (Advances) (%)	1.20%	1.40%	1.40%
Market Share (Deposits) (%)	0.80%	0.80%	0.80%
Gross Infection (%)	8.40%	12.70%	12.80%
Total Provisioning Coverage (%)	77.50%	70.10%	66.30%
Net Infection (%)	2.70%	5.00%	5.40%
Net NPLs to Tier-1 Capital (%)	18.30%	25.30%	55.70%
Capital Adequacy Ratio (C.A.R (%))	10.70%	13.80%	9.10%
Efficiency (%)	94.80%	122.60%	102.60%
ROAA (%)	0.50%	-1.50%	0.10%
ROAE (%)	6.00%	-17.50%	1.30%
Liquid Assets to Deposits & Borrowings (%) *	23.00%	26.70%	18.10%
****Adjusted for Repo*			

ISSUE/ISSUER RATING SCALE & DEFINITIONS — Appendix II

Medium to Long-Term

AAA
Highest credit quality; the risk factors are negligible, being only slightly more than for risk-free Government of Pakistan's debt.

AA+, AA, AA-
High credit quality; Protection factors are strong. Risk is modest but may vary slightly from time to time because of economic conditions.

A+, A, A-
Good credit quality; Protection factors are adequate. Risk factors may vary with possible changes in the economy.

BBB+, BBB, BBB-
Adequate credit quality; Protection factors are reasonable and sufficient. Risk factors are considered variable if changes occur in the economy.

BB+, BB, BB-
Obligations deemed likely to be met. Protection factors are capable of weakening if changes occur in the economy. Overall quality may move up or down frequently within this category.

B+, B, B-
Obligations deemed less likely to be met. Protection factors are capable of fluctuating widely if changes occur in the economy. Overall quality may move up or down frequently within this category or into higher or lower rating grade.

CCC
Considerable uncertainty exists towards meeting the obligations. Protection factors are scarce and risk may be substantial.

CC
A high default risk

C
A very high default risk

D
Defaulted obligations

Short-Term

A-1+
Highest certainty of timely payment; Short-term liquidity, including internal operating factors and /or access to alternative sources of funds, is outstanding and safety is just below risk free Government of Pakistan's short-term obligations.

A-1
High certainty of timely payment; Liquidity factors are excellent and supported by good fundamental protection factors. Risk factors are minor.

A-2
Good certainty of timely payment. Liquidity factors and company fundamentals are sound. Access to capital markets is good. Risk factors are small.

A-3
Satisfactory liquidity and other protection factors qualify entities / issues as to investment grade. Risk factors are larger and subject to more variation. Nevertheless, timely payment is expected.

B
Speculative investment characteristics; Liquidity may not be sufficient to ensure timely payment of obligations.

C
Capacity for timely payment of obligations is doubtful.

Rating Watch: JCR-VIS places entities and issues on 'Rating Watch' when it deems that there are conditions present that necessitate re-evaluation of the assigned rating(s). Refer to our 'Criteria for Rating Watch' for details. www.jcrvis.com.pk/images/criteria_watch.pdf

Rating Outlooks: The three outlooks 'Positive', 'Stable' and 'Negative' qualify the potential direction of the assigned rating(s). An outlook is not necessarily a precursor of a rating change. Refer to our 'Criteria for Rating Outlook' for details. www.jcrvis.com.pk/images/criteria_outlook.pdf

(SO) Rating: A suffix (SO) is added to the ratings of 'structured' securities where the servicing of debt and related obligations is backed by some sort of financial assets and/or credit support from a third party to the transaction. The suffix (SO), abbreviated for 'structured obligation', denotes that the rating has been achieved on grounds of the structure backing the transaction that enhanced the credit quality of the securities and not on the basis of the credit quality of the issuing entity alone.

'p' Rating: A 'p' rating is assigned to entities, where the management has not requested a rating, however, agrees to provide informational support. A 'p' rating is shown with a 'p' subscript and is publicly disclosed. It is not modified by a plus (+) or a minus (-) sign which indicates relative standing within a rating category. Outlook is not assigned to these ratings. Refer to our 'Policy for Private Ratings' for details. www.jcrvis.com.pk/images/policy_ratings.pdf

'SD' Rating: An 'SD' rating is assigned when JCR-VIS believes that the ratee has selectively defaulted on a specific issue or obligation but it will continue to meet its payment obligations on other issues or obligations in a timely manner.

REGULATORY DISCLOSURES — Appendix III

Name of Rated Entity	Silk Bank Limited
Sector	Commercial Banks
Type of Relationship	Solicited
Purpose of Rating	Entity Rating

Rating History

Rating Date	Medium to Long Term	Outlook	Short Term	Rating Action
RATING TYPE: ENTITY				
30-Jun-17	A-	Stable	A-2	Reaffirmed
30-Jun-16	A-	Stable	A-2	Reaffirmed
30-Jun-15	A-	Stable	A-2	Reaffirmed
18-Dec-14	A-	Stable	A-2	Rating Watch Removed
30-Jun-14	A-	Rating Watch – Developing	A-2	Rating Watch – Developing
29-Jun-13	A-	Stable	A-2	Maintained
22-Oct-12	A-	Rating Watch – Developing	A-3	Maintained
18-Aug-11	A-	Rating Watch – Developing	A-2	Reaffirmed
25-Feb-11	A-	Rating Watch – Developing	A-2	Maintained
05-Aug-13	A-		A-2	Rating Watch - Positive

TFC	Basel 3 compliant unsecured, subordinated privately placed Tier 2 TFC amounting to Rs. 2.0billion (inclusive of Green Shoe Option of Rs. 500million). The TFC has a tenor of 8 years with semi-annual profit payment frequency. TFC instrument carries a guarantee for a period of one year of an amount equivalent to two interest payments as well as investment of 50% of the issue size in liquid government securities.
Statement by the Rating Team	JCR-VIS, the analysts involved in the rating process and members of its rating committee do not have any conflict of interest relating to the credit rating(s) mentioned herein. This rating is an opinion on credit quality only and is not a recommendation to buy or sell any securities.
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