The Pakistan Credit Rating Agency Limited

SONERI BANK LIMITED
RATING REPORT

	NEW [JUNE-17]	PREVIOUS [JUNE-16]
Entity		
Long Term	AA-	AA-
Short Term	A1+	A1+
Outlook	Stable	Stable

REPORT CONTENTS

JUNE 2017

Profile & Ownership

- Soneri Bank Limited (SBL), incorporated in Sep91, has a deposit share of 1.8%. The bank has maintained its share.
- At end-Mar17, bank is operating with a network of 282 branches (CY16: 288, CY15: 266) and 304 ATMs (CY16: 306) across the country.
- Feerasta Family – sponsors of Rupali Group – holds controlling stake (58%), followed by NIT (~10%), while rest is spread across general public and others.

Governance & Management

- Eight member board including the CEO; two directors represent Feerasta Family, two are NIT nominees, while three are independent members
- The President and CEO, Mr. Aftab Manzoor, carries over three decades of international banking experience. The COO, Mr. Amin A. Feerasta, has been associated with the bank since 2000.
- Operations divided into sixteen functions

Risk Management

- SBL is at an advanced stage in implementing T24 as core banking software (to be online by Sep17).
- During CY16, lending portfolio registered 11% growth, mainly financed through deposits; corporate segment dominated the portfolio (60%); exposure to top-3 sectors witnessed a meager decline (CY16: 58%, CY15: 59%).
- The bank's advances to deposit ratio rationalized to 59% at end-Dec16 - higher than industry average of 46%.
- Top-20 performing exposure's concentration witnessed improvement (CY16: 23%, CY15: 27%); still considered high when compared with AA rated banks.
- During CY16, infection ratio declined to 8% (CY15: 10%) on back of significant increase in gross advances and recoveries/ reclassification in NPLs
- During CY16, investment portfolio, comprising 46% of earning assets, witnessed 7% YoY growth; dominated by government securities (96%); mix tilted towards PIBs; unrealized capital gains as of Feb17: PKR 1.6bln.

Business Risk

- During CY16, net interest income witnessed decline of 10% YoY, despite significant rise in earning assets (~12%); mark-up expenses also inched up. Hence, spread reduced to 2.9% (CY15: 3.8%).
- Non-markup income also witnessed decline (13%) – mainly due to decline in gain on sale of investments and income from foreign currencies
- Operating expenses (cost to total net revenue) increased to 68% in CY16 (CY15: 57%) – a factor of increase in number of branches.
- Despite significant decrease in provisioning expense, the profit after tax deteriorated to PKR ~1.9bln, down 15% YoY.
- Going forward, management is focused on low cost deposit mobilization and capitalizing on CPEC opportunities through participation in consortiums

Financial Risk

- Deposits witnessed addition of PKR 25bln – though system share remain intact YoY; CASA largely maintained (end-Dec16: ~70%, end-Dec15: 69%).
- Top-20 depositors' concentration significantly increased to 25% (CY15: 19%); considered very high when compared with AA rating benchmarks.
- Overall liquidity position marginally declined though remained adequate (end-Dec16: 47%, end-Dec15: 50%).
- CAR stood at 14.1% (Tier-I: end-Dec16: 10.8%, end-Dec15: 11.7%) declined YoY; owing to decrease in profitability and increase in risk weighted assets

TFC Issue:

- SBL issued 2nd subordinated, unsecured, and listed TFC of PKR 3,000mln in Jul15 (Tenor 8 years). Profit rate is 6MK plus 135bps p.a. payable semi-annually in arrears. Principal repayment (99.7%) would be in bullet form at maturity (2023). SBL retains call option; exercisable in Jul20.
- The issue carries a lock-in and loss absorbency clauses.
- Cushion to loss absorbency ranges from ~3% to 8%, incorporating the projections.

RATING RATIONALE

The ratings reflect Soneri Bank's sustained business profile; system share remained intact YoY. The bank expanded its deposit base in line with the industry growth, while maintaining the contribution of low cost deposits. The bank continues to make fresh deployment in advances, hence sustaining its ADR - which is comparatively higher than industry average. The reduction in net interest revenue translated into reduced profitability YoY, a factor of squeeze in spreads – an industry wide phenomenon. Going forward, the bank, while focusing to improve asset quality, intends to follow a prudent strategy in terms of advances growth. Enhancing non-fund based exposure, in turn fee income, would be targeted while capitalizing on potential business opportunities expected from China-Pakistan Economic Corridor. At the same time, the strategy would be to mobilize low-cost deposits with an increase in branch network. The bank's CAR reduced with decline in Tier-I YoY (end-Dec16: 10.8%, end-Dec15: 11.7%) on account of hit on profitability and increase in risk weighted assets; warrants management attention going forward.

KEY RATING DRIVERS

The rating is dependent on the bank's ability to maintain its market position in banking industry while strengthening its overall risk profile. Bringing efficiency in overall operational structure is important to rationalize costs. In comparative landscape, adding granularity to core operations - deposits and advances - is critical. Meanwhile, sustainable increase in system share and consequent profitability would be ratings positive.

INDUSTRY

The banking sector experienced substantial expansion in its deposit base (2016: 14%). Building on the uptick in the economy, advances also grew by a sizeable margin after a lag of many years. Given GDP growth in FY17 and other macro-economic fundamentals, credit expansion is foreseen. Hence, CAR is going to be a challenge, as profits would also suffer due to PIBs maturities.

Soneri Bank Limited

PKR mln

BALANCE SHEET	31-Mar-17 1QFY17	31-Dec-16 Annual	31-Dec-15 Annual	31-Dec-14 Annual
Earning Assets				
Advances (Net of NPL)	130,698	123,333	109,033	105,389
Debt Instruments	3,917	3,989	2,304	1,471
Total Finances	134,615	127,322	111,337	106,861
Investments	117,767	113,895	106,542	74,244
Others	13,109	5,678	4,514	905
	265,491	**246,894**	**222,393**	**182,010**
Non Earning Assets				
Non-Earning Cash	16,168	18,960	16,932	16,050
Deferred Tax	-	-	-	-
Net Non-Performing Finances	1,898	1,972	2,969	2,579
Fixed Assets & Others	9,764	10,693	11,047	12,536
	27,830	**31,625**	**30,948**	**31,165**
TOTAL ASSETS	**293,321**	**278,520**	**253,342**	**213,175**
Interest Bearing Liabilities				
Deposits	216,285	210,840	185,222	163,250
Borrowings	50,701	41,903	42,876	25,825
	266,986	252,743	228,098	189,075
Non Interest Bearing Liabilities	8,508	7,488	7,052	7,061
TOTAL LIABILITIES	**275,493**	**260,230**	**235,150**	**196,136**
EQUITY (including revaluation surplus)	**17,214**	**18,289**	**18,192**	**17,039**
Total Liabilities & Equity	**292,707**	**278,520**	**253,342**	**213,175**

INCOME STATEMENT	31-Mar-17 1QFY17	31-Dec-16 Annual	31-Dec-15 Annual	31-Dec-14 Annual
Interest / Mark up Earned	4,257	17,524	18,320	16,906
Interest / Mark up Expensed	(2,647)	(10,680)	(10,722)	(10,626)
Net Interest / Markup revenue	**1,610**	**6,844**	**7,597**	**6,280**
Other Income	1,184	2,736	3,150	2,509
Total Revenue	**2,794**	**9,580**	**10,748**	**8,789**
Non-Interest / Non-Mark up Expensed	(1,701)	(6,479)	(6,123)	(5,798)
Pre-provision operating profit	1,092	3,102	4,625	2,991
Provisions	(176)	(24)	(1,029)	(549)
Pre-tax profit	916	3,077	3,596	2,442
Taxes	(321)	(1,198)	(1,383)	(860)
Net Income	**596**	**1,879**	**2,213**	**1,582**

Ratio Analysis	31-Mar-17	31-Dec-16	31-Dec-15	31-Dec-14
Performance				
ROE	15.3%	12.0%	15.0%	11.9%
Cost-to-Total Net Revenue	61.1%	67.8%	57.3%	66.2%
Provision Expense / Pre Provision Profit	16.1%	0.8%	22.3%	18.4%
Capital Adequacy				
Equity/Total Assets	5.2%	5.7%	6.1%	6.6%
Capital Adequacy Ratio as per SBP	12.8%	14.1%	15.4%	12.5%
Funding & Liquidity				
Liquid Assets / Deposits and Borrowings	44.6%	47.5%	50.0%	44.4%
Advances / Deposits	61.3%	59.4%	60.5%	66.1%
CASA deposits / Total Customer Deposits	71.9%	69.9%	69.2%	67.2%
Intermediation Efficiency				
Asset Yield	6.7%	7.6%	9.2%	10.5%
Cost of Funds [Interest Expensed / Average (Deposits + Borrowings)]	4.3%	4.7%	5.4%	6.3%
Spread	2.4%	2.9%	3.8%	4.2%
Outreach				
Branches	282	288	266	246

CREDIT RATING
SCALE & DEFINITIONS

Credit rating reflects forward-looking opinion on credit worthiness of underlying entity or instrument; more specifically it covers relative ability to honor financial obligations. The primary factor being captured on the rating scale is relative likelihood of default.

LONG TERM RATINGS

AAA	**Highest credit quality.** Lowest expectation of credit risk. Indicate exceptionally strong capacity for timely payment of financial commitments.
AA+ **AA** **AA-**	**Very high credit quality.** Very low expectation of credit risk. Indicate very strong capacity for timely payment of financial commitments. This capacity is not significantly vulnerable to foreseeable events.
A+ **A** **A-**	**High credit quality.** Low expectation of credit risk. The capacity for timely payment of financial commitments is considered strong. This capacity may, nevertheless, be vulnerable to changes in circumstances or in economic conditions.
BBB+ **BBB** **BBB-**	**Good credit quality.** Currently a low expectation of credit risk. The capacity for timely payment of financial commitments is considered adequate, but adverse changes in circumstances and in economic conditions are more likely to impair this capacity.
BB+ **BB** **BB-**	**Moderate risk.** Possibility of credit risk developing. There is a possibility of credit risk developing, particularly as a result of adverse economic or business changes over time; however, business or financial alternatives may be available to allow financial commitments to be met.
B+ **B** **B-**	**High credit risk.** A limited margin of safety remains against credit risk. Financial commitments are currently being met; however, capacity for continued payment is contingent upon a sustained, favorable business and economic environment.
CCC **CC** **C**	**Very high credit risk.** Substantial credit risk "CCC" Default is a real possibility. Capacity for meeting financial commitments is solely reliant upon sustained, favorable business or economic developments. "CC" Rating indicates that default of some kind appears probable. "C" Ratings signal imminent default.
D	Obligations are currently in default.

SHORT TERM RATINGS

A1+: The highest capacity for timely repayment.

A1:. A strong capacity for timely repayment.

A2: A satisfactory capacity for timely repayment. This may be susceptible to adverse changes in business, economic, or financial conditions.

A3: An adequate capacity for timely repayment. Such capacity is susceptible to adverse changes in business, economic, or financial conditions.

B: The capacity for timely repayment is more susceptible to adverse changes in business, economic, or financial conditions.

C: An inadequate capacity to ensure timely repayment.

Outlook (Stable, Positive, Negative, Developing)
Indicates the potential and direction of a rating over the intermediate term in response to trends in economic and/or fundamental business/financial conditions. It is not necessarily a precursor to a rating change. 'Stable' outlook means a rating is not likely to change. 'Positive' means it may be raised. 'Negative' means it may be lowered. Where the trends have conflicting elements, the outlook may be described as 'Developing'.

Rating Watch
Alerts to the possibility of a rating change subsequent to, or in anticipation of, a) some material identifiable event and/or b) deviation from expected trend. But it does not mean that a rating change is inevitable. A watch should be resolved within foreseeable future, but may continue if underlying circumstances are not settled. Rating Watch may accompany Outlook of the respective opinion.

Suspension
It is not possible to update an opinion due to lack of requisite information. Opinion should be resumed in foreseeable future. However, if this does not happen within six (6) months, the rating should be considered withdrawn.

Withdrawn
A rating is withdrawn on a) termination of rating mandate, b) cessation of underlying entity, c) the debt instrument is redeemed, d) the rating remains suspended for six months, e) the entity/issuer defaults., or/and f) PACRA finds it impractical to surveill the opinion due to lack of requisite information

Regulatory and Supplementary Disclosure

Name of Issuer	Soneri Bank Limited (SBL)
Sector	Banking
Type of Relationship	Solicited
Purpose of the Rating	Independent Risk Assessment Regulatory Requirement

Rating History

Dissemination Date	Long Term	Short Term	Outlook	Action
17-Jun-17	AA-	A1+	Stable	Maintain
17-Jun-16	AA-	A1+	Stable	Maintain
17-Jun-15	AA-	A1+	Stable	Maintain
17-Jun-14	AA-	A1+	Stable	Maintain
26-Jun-13	AA-	A1+	Stable	Maintain
22-Jun-12	AA-	A1+	Stable	Maintain
27-Jun-11	AA-	A1+	Stable	Maintain

Related Criteria and Research

Rating Methodology	Bank Rating Methodology
Sector Research	Banking Sector - Viewpoint | Jun-17

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Rating Team Statement

Rating Procedure

Rating is an opinion on relative credit worthiness of an entity or debt instrument. It does not constitute recommendation to buy, hold or sell any security. The rating team for this assignment does not have any beneficial interest, direct or indirect in the rated entity/instrument.

Disclaimer

Rating Shopping

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Surveillance

PACRA monitors all the outstanding ratings continuously and any potential change therein due to any event associated with the rated entity/ issuer, the security arrangement, the industry etc, is disseminated to the market, in a timely and effective manner, after appropriate consultation with the entity/issuer

PACRA reviews all the outstanding ratings on annual basis or as and when required by any stakeholder (including creditor) or upon the occurrence of such an event which requires to do so

PACRA initiates immediate review of the outstanding rating(s) upon becoming aware of any information that may be reasonable be expected to result in any change (including downgrade) in the rating

Reporting of Misconduct

PACRA has framed and implemented whistle-blower policy encouraging all employees to intimate the compliance officer any unethical practice or misconduct relating to the credit rating by another employees of the company that came to his/her knowledge. The Compliance Officer reports to the BoD and SECP

Confidentiality

PACRA has framed a confidentiality policy to prevent abuse of the non-public information by its employees and other persons involved in the rating process, sharing and dissemination of the non-public information by such persons to outside parties

Where feasible and appropriate, prior to issuing or revising a rating, PACRA informs the issuer of the critical information and principal considerations upon which a rating will be based and provide the opportunity to clarify any likely factual misperception or other matter that PACRA would wish to be made aware of in order to produce a fair rating. PACRA duly evaluates the response. Where in a particular circumstance PACRA has not informed the entity/issuer prior to issuing or revising a rating, it informs the entity/issuer as soon as practical thereafter

Prohibition

Probability of Default (PD)

PACRA's Rating Scale reflects the expectation of credit risk. The highest rating has the lowest relative likelihood of default (i.e, probability). PACRA's transition studies capture the historical performance behavior of a specific rating notch. Transition behavior of the assigned rating can be obtained from PACRA's Transition Study available at our website. (www.pacra.com). However, actual transition of rating may not follow the pattern observed in the past