The Pakistan Credit Rating Agency Limited

Rating Report

Soneri Bank Limited | TFC II | Jul-15

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Rating History

Dissemination Date	Long Term Rating	Short Term Rating	Outlook	Action	Rating Watch
	A+	-	Stable	Maintain	-
15-Dec-2017	A+	-	Stable	Maintain	-
16-Jun-2017	A+	-	Stable	Maintain	YES
16-Dec-2016	A+	-	Stable	Maintain	-
17-Jun-2016	A+	-	Stable	Maintain	-

Rating Rationale and Key Rating Drivers

The ratings reflect Soneri Bank's sustained business profile; system share slightly improved YoY. The bank expanded its deposit base in line with the industry growth, while maintaining the contribution of low cost deposits. The bank witnessed a rise in ADR subsequent to fresh deployment in advances. The cost structure (cost to total net revenue) has increased. 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 on improving asset quality, intends to follow a prudent strategy in terms of advances growth. Continued enhancement in non-fund based exposure, delivering higher fee income, focusing on low cost deposit mobilization and to capitalize on various business opportunities including those which are a part of CPEC. 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-Dec17: 9.9%, end-Dec16: 10.8%) with lower profitability and increase in risk weighted assets. The bank is issuing Tier-1 TFC (PKR 4,000mln), which is expected to boost its total eligible capital. The bank's CET-1 ratio stands at 9.86% as at end-Dec17.

The rating is a function of bank's ability to maintain its market position in the banking industry while strengthening its overall risk profile. Bringing efficiency in overall operational structure is important for long term growth. In the comparative landscape, adding granularity to deposits and advances is critical. Meanwhile, a sustainable increase in system share and consequent profitability would be ratings positive.

Disclosure

Name of Rated Entity	Soneri Bank Limited | TFC II | Jul-15
Type of Relationship	Solicited
Purpose of the Rating	Debt Instrument Rating
Applicable Criteria	Methodology | Debt Instruments Rating Methodology(Jun-17)
Related Research	Sector Study | Commercial Bank(Jun-17)
Rating Analysts	Sehar Fatima | sehar.fatima@pacra.com | +92-42-35869504 Jhangeer Hanif | jhangeer@pacra.com | +92-42-35869504

Soneri Bank Limited (SBL) Profile	
Incorporated	1991
Major Business	Commercial Banking
Legal Status	Listed
Head Office	Lahore

Additional Tier-I TFC Issue

SBL is in the process of issuing Unsecured, Subordinated, Listed (to be listed on the OTC Market), Perpetual and Non-Cumulative Term Finance Certificates of up to PKR 4,000mln, inclusive of a green shoe option of PKR 1,000mln. The instrument will be perpetual in nature with no fixed redemption date. Profit payments will be subject to the condition that such payments will not result in breach of Soneri's MCR or CAR requirements. The Instrument will be subject to loss absorption upon the occurrence of a Pre-Specified Trigger. Additional Tier 1 instruments are subject to loss absorption clause whereby these instruments will be permanently converted to common shares in case the bank's CET1 ratio falls to or below 6.625% of RWA.

Ownership & Group Profile

- Soneri Bank Limited (SBL), incorporated in Sep'91, has a sustained deposit system share of 1.8%. At end-Dec17, bank is operating with a network of 290 branches (CY16: 288, CY15: 266) across the country.
- Feerasta Family holds a controlling stake (61%), followed by NIT (~10%), while rest is spread across general public and others.
- The Feerasta Family is one of the leading business groups in Pakistan with diverse commercial interests ranging from manufacturing, exporting, banking and trade financing.

Governance

- The control is vested with an eight member board including the CEO; three nominees of the Feerasta Family, one NIT representative along with three independent members.
- The President and CEO, Mr. Aftab Manzoor, carries over three decades of international banking experience. Executive Director and COO, Mr. Amin A. Feerasta, has been associated with the bank since 2000.
- The auditors of the company M/s. A.F. Ferguson & Co., Chartered Accountants, issued an unqualified audit opinion pertaining to annual financial statements for FY17.

Risk Management

- During CY17, lending portfolio registered a 32% growth with Corporate and SME segments dominating the portfolio.
- The bank's net advances to deposit ratio increased to 72.3% (CY16: 59.7%, CY15: 60.6%) on account of a greater emphasis on lending.
- Top-20 performing exposures' concentration witnessed marginal improvement to 19% in CY17 (CY16: 23%).
- During CY17, infection ratio declined to 5.9% (CY16: ~8%) on the back of significant increase in gross advances while NPLs remained flat.
- Investment portfolio, comprising ~40% of earning assets, witnessed a marginal increase during the year and continued to be primarily comprised of government securities (97%); mix tilted towards T-bills.

Business Risk

- During CY17, net interest income witnessed a decline (-3%), despite rise of 16% in earning assets; mark-up expenses also increased by 11% YoY. Hence, spread reduced to 2.4% (CY16: 2.9%). This however remained an industry vide phenomenon.
- Non-markup income increased to PKR 3.2bln (CY16: PKR 2.7bln), up 19% YoY.
- Driven by an increase in branches and technology upgrades operating expenses (cost to total net revenue) increased to ~71% in CY17 (CY16: ~68%).
- During CY17, the provisioning expense witnessed a reduction. The profit after tax stood at PKR 1.6bln, down 13% YoY.
- Going forward, management while focusing on low cost deposit mobilization will capitalize on various business opportunities including those which are a part of CPEC.

Capital & Funding

- At end-Dec'17, customer deposits stood at PKR 211bln with an increase of 6.8% against industry growth of 9%; CASA remained stable at 70.3% (end-Dec'16: ~70%, end-Dec'15: 69%).
- Top-20 depositors' concentration remained at 25% during CY17 (CY16: 25%); considered high when compared with AA rating benchmarks.
- Overall liquidity position declined significantly to ~38% (end-Dec'16: ~48%, end-Dec'15: 50%).
- CAR stood at 12.8% (Tier-I: end-Dec'17: 9.9%, end-Dec'16: 10.8%) declined YoY; owing to lower profitability and significant rise in risk weighted assets (driven by growth in advances). However, CAR is expected to rise after issuance of Tier-1 TFC.

TFC Issue

- SBL issued its 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 Jul'20. The issue carries lock-in and loss absorbency clauses.
- SBL is in the process of issuing Unsecured, Subordinated, Listed (to be listed on OTC Market), Perpetual and Non-Cumulative Term Finance Certificates of up to PKR 4,000mln, inclusive of a green shoe option of PKR 1,000mln. The instrument will be perpetual in nature with no fixed redemption date. Profit payments will be subject to the condition that such payments will not result in breach of Soneri's MCR or CAR requirements. The Instrument will be subject to loss absorption upon the occurrence of a Pre-Specified Trigger.

Soneri Bank Limited

Financials [Summary]

PKR mln

BALANCE SHEET	31-Mar-18 *Annual*	31-Dec-17 *Annual*	31-Dec-16 *Annual*	31-Dec-15 *Annual*
Earning Assets				
Advances (Net of NPL)	160,164	162,528	123,333	109,033
Debt Instruments	2,765	2,956	3,989	2,304
Total Finances	162,929	165,484	127,322	111,337
Investments	92,206	114,472	113,895	106,542
Others	8,233	6,751	5,678	3,276
	263,368	**286,707**	**246,894**	**221,155**
Non Earning Assets				
Non-Earning Cash	20,190	20,376	18,960	18,170
Deferred Tax	-	-	-	-
Net Non-Performing Finances	1,440	1,765	1,972	2,969
Fixed Assets & Others	12,330	13,286	10,693	11,047
	33,959	**35,427**	**31,625**	**32,186**
TOTAL ASSETS	**297,327**	**322,134**	**278,520**	**253,342**
Interest Bearing Liabilities				
Deposits	215,188	227,348	209,925	184,847
Borrowings	54,056	67,582	41,903	42,876
	269,244	294,930	251,828	227,722
Non Interest Bearing Liabilities	9,852	8,699	8,403	7,427
TOTAL LIABILITIES	**279,095**	**303,629**	**260,230**	**235,149**
EQUITY (including revaluation surplus)	**18,231**	**18,505**	**18,289**	**18,193**
Total Liabilities & Equity	**297,327**	**322,134**	**278,520**	**253,342**

INCOME STATEMENT	31-Mar-18 Annual	31-Dec-17 Annual	31-Dec-16 Annual	31-Dec-15 Annual
Interest / Mark up Earned	4,658	18,505	17,524	18,320
Interest / Mark up Expensed	(2,922)	(11,846)	(10,680)	(10,722)
Net Interest / Markup revenue	**1,736**	**6,659**	**6,844**	**7,597**
Other Income	876	3,269	2,736	3,150
Total Revenue	**2,612**	**9,928**	**9,580**	**10,748**
Non-Interest / Non-Mark up Expensed	(1,806)	(7,031)	(6,479)	(6,123)
Pre-provision operating profit	806	2,897	3,102	4,625
Provisions	211	(66)	(24)	(1,029)
Pre-tax profit	1,017	2,831	3,077	3,596
Taxes	(356)	(1,188)	(1,198)	(1,383)
Net Income	**661**	**1,643**	**1,879**	**2,213**

Ratio Analysis	31-Mar-18	31-Dec-17	31-Dec-16	31-Dec-15
Performance				
ROE	16.1%	10.1%	12.0%	15.0%
Cost-to-Total Net Revenue	69.4%	71.1%	67.8%	57.3%
Provision Expense / Pre Provision Profit	-26.2%	2.3%	0.8%	22.3%
Capital Adequacy				
Equity/Total Assets	5.5%	5.1%	5.7%	6.1%
Capital Adequacy Ratio as per SBP	12.1%	12.8%	14.1%	15.4%
Funding & Liquidity				
Liquid Assets / Deposits and Borrowings	38.3%	38.5%	47.7%	50.0%
Advances / Deposits	75.1%	72.3%	59.7%	60.5%
CASA deposits / Total Customer Deposits	72.1%	70.3%	69.7%	69.2%
Intermediation Efficiency				
Asset Yield	6.9%	7.0%	7.6%	9.2%
Cost of Funds [Interest Expensed / Average (Deposits	4.4%	4.6%	4.7%	5.4%
Spread	2.5%	2.5%	2.9%	3.8%
Outreach				
Branches	290	290	288	266

Regulatory and Supplementary Disclosure
Annexure I

Loan Amount (PKR)	3,000,000,000	
Tenor (Years)	8 years	
Rate	6MK + 1.35%	(Kibor assumed 6.5%)

PKR mln

Installment	Post Issuance	Principal	Mark Up	Total Installment	Outstanding
					3,000
1	Jan-16	0.6	127	128	2,999
2	Jul-16	0.6	118	118	2,999
3	Jan-17	0.6	118	118	2,998
4	Jul-17	0.6	118	118	2,998
5	Jan-18	0.6	118	118	2,997
6	Jul-18	0.6	118	118	2,996
7	Jan-19	0.6	118	118	2,996
8	Jul-19	0.6	118	118	2,995
9	Jan-20	0.6	118	118	2,995
10	Jul-20	0.6	118	118	2,994
11	Jan-21	0.6	118	118	2,993
12	Jul-21	0.6	117	118	2,993
13	Jan-22	0.6	117	118	2,992
14	Jul-22	0.6	117	118	2,992
15	Jan-23	0.6	117	118	2,991
16	Jul-23	2,991	0	2,991	0

Call option exercisable date

DEBT INSTRUMENT RATING SCALE & DEFINITIONS

The instrument rating reflects forward-looking opinion on credit worthiness of underlying debt 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) the debt instrument is redeemed, c) the rating remains suspended for six months, d) the entity/issuer defaults., or/and e) PACRA finds it impractical to surveill the opinion due to lack of requisite information

Rating Team Statements
(1) Rating is just an opinion about the creditworthiness of the entity and does not constitute recommendation to buy, hold or sell any security of the entity rated or to buy, hold or sell the security rated, as the case may be | Chapter III; 14-3-(x)

2) **Conflict of Interest**
i. The Rating Team or any of their family members have no interest in this rating | Chapter III; 12-2-(j)
ii. PACRA, the analysts involved in the rating process and members of its rating committee, and their family members, do not have any conflict of interest relating to the rating done by them | Chapter III; 12-2-(e) & (k)
iii. The analyst is not a substantial shareholder of the customer being rated by PACRA [Annexure F; d-(ii)] Explanation: for the purpose of above clause, the term "family members" shall include only those family members who are dependent on the analyst and members of the rating committee

Restrictions
(3) No director, officer or employee of PACRA communicates the information, acquired by him for use for rating purposes, to any other person except where required under law to do so. | Chapter III; 10-(5)
(4) PACRA does not disclose or discuss with outside parties or make improper use of the non-public information which has come to its knowledge during business relationship with the customer | Chapter III; 10-7-(d)
(5) PACRA does not make proposals or recommendations regarding the activities of rated entities that could impact a credit rating of entity subject to rating | Chapter III; 10-7-(k)

Conduct of Business
(6) PACRA fulfills its obligations in a fair, efficient, transparent and ethical manner and renders high standards of services in performing its functions and obligations; | Chapter III; 11-A-(a)
(7) PACRA uses due care in preparation of this Rating Report. Our information has been obtained from sources we consider to be reliable but its accuracy or completeness is not guaranteed. PACRA does not, in every instance, independently verifies or validates information received in the rating process or in preparing this Rating Report.
(8) PACRA prohibits its employees and analysts from soliciting money, gifts or favors from anyone with whom PACRA conducts business | Chapter III; 11-A-(q)
(9) PACRA ensures before commencement of the rating process that an analyst or employee has not had a recent employment or other significant business or personal relationship with the rated entity that may cause or may be perceived as causing a conflict of interest; | Chapter III; 11-A-(r)
(10) PACRA maintains principal of integrity in seeking rating business | Chapter III; 11-A-(u)
(11) PACRA promptly investigates, in the event of a misconduct or a breach of the policies, procedures and controls, and takes appropriate steps to rectify any weaknesses to prevent any recurrence along with suitable punitive action against the responsible employee(s) | Chapter III; 11-B-(m)

Independence & Conflict of interest
(12) PACRA receives compensation from the entity being rated or any third party for the rating services it offers. The receipt of this compensation has no influence on PACRA´s opinions or other analytical processes. In all instances, PACRA is committed to preserving the objectivity, integrity and independence of its ratings. Our relationship is governed by two distinct mandates i) rating mandate - signed with the entity being rated or issuer of the debt instrument, and fee mandate - signed with the payer, which can be different from the entity
(13) PACRA does not provide consultancy/advisory services or other services to any of its customers or to any of its customers' associated companies and associated undertakings that is being rated or has been rated by it during the preceding three years unless it has adequate mechanism in place ensuring that provision of such services does not lead to a conflict of interest situation with its rating activities; | Chapter III; 12-2-(d)
(14) PACRA discloses that no shareholder directly or indirectly holding 10% or more of the share capital of PACRA also holds directly or indirectly 10% or more of the share capital of the entity which is subject to rating or the entity which issued the instrument subject to rating by PACRA; | Reference Chapter III; 12-2-(f)
(15) PACRA ensures that the rating assigned to an entity or instrument is not be affected by the existence of a business relationship between PACRA and the entity or any other party, or the non-existence of such a relationship | Chapter III; 12-2-(i)
(16) PACRA ensures that the analysts or any of their family members shall not buy or sell or engage in any transaction in any security which falls in the analyst's area of primary analytical responsibility. This clause shall, however, not be applicable on investment in securities through collective investment schemes. | Chapter III; 12-2-(l)
(17) PACRA has established policies and procedure governing investments and trading in securities by its employees and for monitoring the same to prevent insider trading, market manipulation or any other market abuse | Chapter III; 11-B-(g)

Monitoring and review
(18) PACRA monitors all the outstanding ratings continuously and any potential change therein due to any event associated with the issuer, the security arrangement, the industry etc., is disseminated to the market, immediately and in effective manner, after appropriate consultation with the entity/issuer; | Chapter III | 18-(a)
(19) PACRA reviews all the outstanding ratings on semi-annual basis or as and when required by any creditor or upon the occurrence of such an event which requires to do so; | Chapter III | 18-(b)
(20) PACRA initiates immediate review of the outstanding rating upon becoming aware of any information that may reasonably be expected to result in downgrading of the rating; | Chapter III | 18-(c)
(21) PACRA engages with the issuer and the debt securities trustee, to remain updated on all information pertaining to the rating of the entity/instrument; | Chapter III | 18-(d)
Probability of Default
(22) 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 | Chapter III | 14-(f-VII)
Proprietary Information