Silk Bank Limited

RATING REPORT

REPORT DATE:
July 7, 2015

RATING ANALYSTS:
Talha Iqbal
talha.iqbal@jcrvis.com.pk

Mohammad Arsal Ayub
arsal.ayub@jcrvis.com.pk

RATING DETAILS

Rating Category	Latest Rating		Previous Rating	
	Long-term	Short-term	Long-term	Short-term
Entity Rating	A-	A-2	A-	A-2
Outlook	Stable		Stable	
Date	*June 30, '15*		*Dec 18, '14*	

COMPANY INFORMATION

Year of Establishment: 1994	**External auditors:** M. Yousuf Adil Saleem & Co. 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
Mr. Shaukat Tarin (26.3%)	
International Finance Corporation (26.3%)	
Nomura European Investment Limited (13.4%)	
Bank Muscat S.A.O.G. (11.8%)	

APPLICABLE METHODOLOGY(IES)

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

Silk Bank Limited

OVERVIEW OF THE INSTITUITION

Silk is listed on all three stock exchanges of Pakistan. International Finance Corporation, Nomura European Investment Limited, Bank Muscat S.A.O.G and executives of Sinthos Capital Advisors Limited had aggregate holding of 82.4% in the bank at end-2014. External auditors of the bank for 2014 were M/s Deloitte Yousuf Adil Saleem & Co. Chartered Accountants. The same auditors have been appointed for 2015.

RATING RATIONALE

During the outgoing year, Silk Bank Limited (Silk) received Rs. 2b as advance against shares subscription. However, the bank continues to be short of Minimum Capital Requirement (MCR) and Capital Adequacy Ratio (CAR) regulatory requirements. In order to meet regulatory capital requirements sponsors are in the process of issuing rights shares to the tune of Rs. 10b (including advance against rights shares of Rs. 2b). Of the amount of Rs. 8b, underwriting agreement has been signed for Rs. 6b while commitment to Securities and Exchange Commission of Pakistan has been given for subscription of the remaining amount. Besides meeting capital requirements, enhancing capital buffers will support the bank in the backdrop of increased capital requirements under Basel 3, deduction of Deferred Tax Asset from Common Equity Tier-1, higher risk charge on unrated exposures and the quality of assets. Subsequent to equity injection, shareholding of the bank is expected to change. Shift in business strategy, if any, will be tracked by JCR-VIS.

Liquidity profile of the Bank requires further strengthening. Silk's liquid assets coverage of deposits and borrowings (adjusted for repo) is considered low at 18.5% (2013: 24.3%) while deposit concentration (largest 10 depositors represent 11% of the deposit base) continues to be on the higher side. In the backdrop of moratorium imposed on another bank, deposit base of Silk witnessed significant attrition. Accordingly, Silk had to enhance reliance on high cost fixed deposits & borrowings to bridge the liquidity shortfall. Cost of funds of the bank is on the higher side in relation to peer banks. There were several instances noted in November and December where the Bank was short of SBP's CRR and SLR requirements. With growth in deposit base and equity injection, liquidity profile of the bank is expected to showcase some improvement, although liquid assets coverage of deposits & borrowings will continue to remain below peer group median.

Given the strong focus on recoveries, there has been a reduction in reported NPLs from Rs. 12.8b at end 2008 to Rs. 8.2b by end 2014. However, given that assets acquired in satisfaction of claims have increased from Rs. 0.4b to Rs. 5.2b over the same period, there has been a net addition of Rs. 0.2b in non-earning assets (NEAs). Although NEAs in relation to total assets have declined over this period. The management expects capital gains from sale of these properties to be generated over time. Progress against the same will be tracked by JCR-VIS. Aggregate non-earning assets (including deferred tax asset and operating fixed assets) continue to remain sizeable in relation to the bank's own equity, creating a significant drag on the bank's earnings profile.

Growth in financing portfolio has been witnessed in the consumer segment in the outgoing year with aggressive growth targets also planned for the ongoing year. Infection in the consumer portfolio has been recorded well below industry norms. Corporate portfolio continues to be the largest financing segment for the bank. Given the reduction in NPLs, reported asset quality indicators have depicted improvement but remain weak in comparison to peers. Median gross impairment ratio for the peer group is about 10.0% vis-à-vis 12.8% for Silk. Moreover, risk profile of watchlist clients needs to be closely monitored to avoid fresh accretion in NPLs from performing portfolio.

The bank reported profit after tax of Rs. 86.9m and Rs. 49.9m during 2014 and 1Q15, respectively. Excluding capital gains, operating profits reported during 9M14 reversed with an operating loss registered in 4Q14 and 1Q15. This can be attributable to higher cost of funds and non-accrual of income on Musharkah transactions executed on non-banking assets. Going forward, spreads may come under pressure in the backdrop of decline in interest rates. Moreover, provisioning expense will continue to be a drag on the bottom line as additional FSV benefit expires. Management believes that diversification into consumer assets alongwith re-pricing of deposits will help mitigate pressure on spreads. Additionally, focus on recoveries of NPLs and sale of non-banking assets is planned to enhance profitability in the ongoing year.

Silk Bank Limited

FINANCIAL SUMMARY *(All figures in PKR millions unless stated otherwise)*			Appendix I
BALANCE SHEET	**DEC 31, 2014**	**DEC 31, 2013**	**DEC 31, 2012**
Total Investments	18,105	14,853	12,735
Advances	58,966	56,038	49,060
Total Assets	102,649	91,770	89,080
Borrowings	21,759	11,382	11,377
Deposits & other accounts	68,770	69,433	69,050
Subordinated Loans	-	-	-
Tier-1 Equity	8,367	6,267	5,213
Net Worth	8,501	6,675	5,373
INCOME STATEMENT	**DEC 31, 2014**	**DEC 31, 2013**	**DEC 31, 2012**
Net Mark-up Income	3,460	2,160	1,902
Net Provisioning	368	633	580
Non-Markup Income	1,720	1,325	1,065
Operating Expenses	4,681	4,379	4,077
Profit Before Tax	131	(1,528)	(529)
Profit After Tax	87	(1,157)	(344)
RATIO ANALYSIS	**DEC 31, 2014**	**DEC 31, 2013**	**DEC 31, 2012**
Market Share (Advances) (%)	1.3%	1.4%	1.3%
Market Share (Deposits) (%)	0.8%	0.9%	1.0%
Gross Infection (%)	12.8%	16.1%	20.0%
Provisioning Coverage (%)	61.1%	52.0%	44.9%
Net Infection (%)	5.4%	8.4%	12.1%
Cost of deposits (%)	6.27%	5.94%	7.46%
Net NPLs to Tier-1 Capital* (%)	55.7%	128.7%	158.4%
Capital Adequacy Ratio (C.A.R (%))	9.14%	7.65%	5.69%
Markup Spreads (%)	3.42%	2.24%	2.03%
Efficiency (%)	102.6%	141.0%	158.0%
Basic ROAA (%)**	-	-	-
ROAA (%)	0.09%	-	-
ROAE (%)	1.1%	-	-
Liquid Assets to Deposits & Borrowings (%)***	18.4%	24.3%	21.4%

**Tier 1 Capital = CET1+AT1+General Provisioning*
** *Recurring Income – Administration Expenses*
****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-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

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.
Probability of Default	JCR-VIS' ratings opinions express ordinal ranking of risk, from strongest to weakest, within a universe of credit risk. Ratings are not intended as guarantees of credit quality or as exact measures of the probability that a particular issuer or particular debt issue will default.
Disclaimer	Information herein was obtained from sources believed to be accurate and reliable; however, JCR-VIS does not guarantee the accuracy, adequacy or completeness of any information and is not responsible for any errors or omissions or for the results obtained from the use of such information. JCR-VIS is not an NRSRO and its ratings are not NRSRO credit ratings. Copyright 2015 JCR-VIS Credit Rating Company Limited. All rights reserved. Contents may be used by news media with credit to JCR-VIS.