Silk Bank Limited

RATING REPORT

REPORT DATE:
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RATING ANALYSTS:
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RATING DETAILS

Rating Category	Latest Rating Long-term	Latest Rating Short-term	Previous Rating Long-term	Previous Rating Short-term
Entity Rating	A-	A-2	A-	A-2
Outlook	Positive		Stable	
Date	*June 29, '18*		*June 30, '17*	

COMPANY INFORMATION

Year of Establishment: 1994	**External auditors (2017):** Deloitte Yousuf Adil, Chartered Accountants **External auditors (2018):** Grant Thornton Anjum Rahman 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 (28.2%)	
Shaukat Tarin (11.6%)	
International Finance Corporation (7.7%)	
Zulqarnain Nawaz Chattha (7.5%)	

APPLICABLE METHODOLOGY(IES)

JCR-VIS Commercial Banks Rating Methodology (March 2018) : ***http://jcrvis.com.pk/docs/Meth-CommercialBanks201803.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 123 branches (2016: 88) including 30 Islamic branches (2016: 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) is a commercial bank listed on Pakistan Stock Exchange with its central office located in Karachi. The bank is engaged in providing financial services and offers a range of retail, consumer, corporate and Islamic products. Silk expanded its branch network in 2017 through opening of 35 new branches including 20 Islamic branches. The bank plans to venture into the digital banking space and has received approvals for branchless banking license from SBP.

Sizeable growth in advances with limited accretion of fresh Non-Performing Loans (NPLs); Select corporate clients may result in asset quality pressures

While NPLs have depicted only a slight increase, asset quality indicators have witnessed improvement on account of recoveries, write offs and sizeable growth in advances. After pursuing consolidation strategy in 2016, the management pursued growth strategy during the outgoing year despite plans to reduce the size of the corporate portfolio. As per management, growth was attributable to financing requirement of select clients where timely repayment was expected. Resultantly, gross advances were higher by 30% to Rs. 90.1b (2016: Rs. 69.3b) at end-2017 while counterparty and group portfolio concentration has also increased. Majority of financing facilities have been extended to sole proprietors operating business of general trading. Select corporate clients from trading, sugar, leather and rice sectors may result in asset quality pressures while restructured clients may also require close monitoring. Focus of corporate segment is expected to remain on short term and trade related (LCs, guarantees) exposures while gradual run-off of term loans is envisaged while service quality is planned to be a key differentiating factor as compared to other banks. Consumer portfolio continued its growth momentum with double digit increase in portfolio across all three products (PIL, ready line and credit cards). Contribution to bank's overall profitability of the consumer segment is sizeable with asset quality indictors continuing to be maintained at sound levels. Despite regulatory requirements, increase in consumer assets will be the key growth driver in the financing portfolio in 2018. Going forward, the bank plans to reduce quantum of overall advances. As per management, this will be achieved by shedding exposure against some large customers while focusing on increasing non-fund based business including guarantee/import/LC business.

Deposit base witnessed growth with sizeable increase in core deposits; cost of deposits depicted decline. Liquidity buffer carried on balance sheet remains on the lower side and below rating benchmarks

Deposit base increased by 27% in 2017, and further by 10% over 1Q2018. Current and Saving Accounts (CASA) ratio of the bank increased to 54% (2016: 52%) by end-2017. Moreover, the bank reported higher average CA balance of Rs. 1.75b in 2017 vis-à-vis Rs. 0.8b in preceding year. CASA is on the lower side at 54% vis-à-vis peer group median. Growth in CASA has continued in 1Q2018, increasing to 57%, on the back of 33% growth in core deposits. Depositor concentration is sizeable and has increased on a timeline basis (Top 50 depositors represent 44% of total deposits). Going forward, Silk plans to reduce its cost of deposits by shedding high cost deposits and replacing them with low cost deposits (focus will primarily be on CA). Moreover, depositor profile is planned to be enhanced with focus on core deposit growth, through opening of banking booths, digital banking, employee banking initiatives and launch of new products. Silk's liquid assets coverage of deposits and borrowings (adjusted for repo) is considered low at 27.0% (2016: 23.0%) while liquidity coverage ratio remains below the regulatory requirement of 90%. Reduction in corporate portfolio as planned by the management will result in increase in liquidity buffer carried on the balance sheet and allow the Bank to comply with increasing regulatory requirements. Going forward, reducing depositor concentration levels and increasing liquidity buffer is considered important from a ratings perspective.

Profitability on growth trajectory. Achieving targeted decline in cost of funds while restricting administrative expenses growth and provisioning charges will allow in achieving budgeted profitability. Materialization of planned sale in OREO if realized will also benefit earnings growth.

Profitability of the bank depicted sizeable increase in 1Q2018 and 2017 vis-à-vis the corresponding periods in the preceding year. This increase can be primarily attributed to volumetric growth in average earning assets along with capital gain and rental income on OREO assets resulting in higher earnings. In contrast to industry trend, spreads were also reported higher during the outgoing year due to increase in yield on financing portfolio. Going forward, management is targeting reduction in financing portfolio and increasing quantum of investments, while also pursuing selective growth in high yielding consumer and SME segments. Given that yields on investments are lower than advances, significant increase in yield on earning assets is not expected. However, since the bank is also targeting in reducing its cost of funds, this may also translate into higher net profit, provided growth in administrative expenses and fresh NPLs is controlled. Materialization of planned sale in OREO if realized will also positively impact profitability.

Capitalization indicators have weakened on a timeline basis and are below regulatory requirements as well as JCR-VIS's benchmark for the assigned ratings.
Capital Adequacy Ratio (CAR) of the bank was 11.04% as at March 31, 2018, against the minimum requirement of 11.275% on account of high capital consumption given the sizeable growth in advances portfolio. The bank has exemption from SBP, for meeting the Tier-1 and overall CAR requirements till June 30, 2018. While declining on a timeline basis, Non-Earning Assets (NEAs) remain sizeable in relation to total assets and bank's own equity. For ongoing year, management has intimated that it plans to complete sale of three properties.

Timely achievement of planned reduction in RWAs, disposals of non-banking assets, quantum of future profits and quality of exposures will be important determinants for achieving capitalization indicators in line with benchmarks for the assigned ratings.

Credit risk on investment portfolio is manageable; market risk has declined post divestment of equity portfolio.
Investment portfolio primarily comprises investment in government securities. Around 71% and 25% of the investment portfolio comprises investment in T-bills and PIBs, respectively. Given the decline in duration on PIB portfolio and divestment of equity portfolio, exposure to market risk has declined. During the outgoing year, the bank sold equity securities having market value of Rs. 798m through off-market transaction at a price equivalent to the bank's average cost of Rs. 1.05b.

Silk Bank Limited

FINANCIAL SUMMARY *(Rs. in Millions)*			Appendix I
BALANCE SHEET	**31-Dec-17**	**31-Dec-16**	**31-Dec-15**
Total Investments	38,267	37,488	35,513
Advances	85,851	64,803	61,074
Total Assets	166,855	135,034	133,103
Borrowings	35,582	30,195	33,230
Deposits & other accounts	110,278	86,787	81,098
Subordinated Loans	-	-	-
Tier-1 Equity	10,177	9,279	11,607
Net Worth	13,181	12,055	14,577
INCOME STATEMENT	**31-Dec-17**	**31-Dec-16**	**31-Dec-15**
Net Mark-up Income	5,486	4,349	3,099
Net Provisioning	288.575	-49	724
Non-Markup Income	2,943	2,213	1,894
Operating Expenses	6,754	5,326	6,109
(Loss) / Profit Before Tax	1,387	1,285	-1,839
(Loss) / Profit After Tax	1135	739	-1,712
RATIO ANALYSIS	**31-Dec-17**	**31-Dec-16**	**31-Dec-15**
Market Share (Advances) (%)	1.4%	1.20%	1.40%
Market Share (Deposits) (%)	27.1%	0.80%	0.80%
Gross Infection (%)	6.50%	8.40%	12.70%
Total Provisioning Coverage (%)	73.16%	77.50%	70.10%
Net Infection (%)	2.46%	2.70%	5.00%
Net NPLs to Tier-1 Capital (%)	19.84%	18.30%	25.30%
Capital Adequacy Ratio (C.A.R (%))	10.94%	10.670%	13.84%
Efficiency (%)	87.55%	94.80%	122.60%
ROAA (%)	0.75%	0.50%	-1.50%
ROAE (%)	9.04%	6.00%	-17.50%
Liquid Assets to Deposits & Borrowings (%) *	27.03%	23.00%	26.70%
*****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	Short term	Outlook	Rating Action
		RATING TYPE: ENTITY			
29-Jun-18	A-	A-2	Positive	Maintained
30-Jun-17	A-	A-2	Stable	Reaffirmed
30-Jun-16	A-	A-2	Stable	Reaffirmed
30-Jun-15	A-	A-2	Stable	Reaffirmed
18-Dec-14	A-	A-2	Stable	Rating Watch Removed
30-Jun-14	A-	A-2	Rating Watch – Developing	Rating Watch – Developing
29-Jun-13	A-	A-2	Stable	Maintained
22-Oct-12	A-	A-3	Rating Watch – Developing	Maintained
18-Aug-11	A-	A-2	Rating Watch – Developing	Reaffirmed
25-Feb-11	A-	A-2	Rating Watch – Developing	Maintained

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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