RATING REPORT

Sindh Bank Limited

REPORT DATE:
July 05, 2018

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

Sidra Ahsan Qureshi
sidra.qureshi@jcrvis.com.pk

RATING DETAILS

	Latest Rating		Previous Rating	
Rating Category	**Long-term**	**Short-term**	**Long-term**	**Short-term**
Entity	AA	A-1+	AA	A-1+
Outlook	Rating Watch-Developing		Rating Watch-Developing	
Date	*June 28, '18*		*June 30, '17*	

COMPANY INFORMATION

Incorporated in 2010	External auditors (2017): **EY Ford Rhodes, Chartered Accountants**
Public Unlisted Company	Chairman of the Board: **Mr. Afzal Ghani**
Key Shareholders (with stake 5% or more):	Chief Executive Officer: **Mr. Tariq Ahsan**
Government of Sindh, Finance Department – 99.9%	

APPLICABLE METHODOLOGY(IES)

JCR-VIS Commercial Banks Rating **http://jcrvis.com.pk/docs/Meth-CommercialBanks201803.pdf**

Sindh Bank Limited

OVERVIEW OF THE INSTITUTION

Sindh Bank Limited was incorporated as a public limited unlisted company in October 2010. Government of Sindh has 99.9% shareholding in the bank. The bank was operating with a network of 300 branches at end-2017.

Profile of the Chairman

Mr. Afzal Ghani is the Chairman of the Board of Directors. He is a Senior Chartered Accountant and a Business Executive, having vast experience as a Professional Business Executive and Corporate Expert.

Profile of the CEO

Mr. Tariq Ahsan is the CEO of the bank. He joined the bank in December 2010. He has over 28 years of experience in the financial sector.

RATING RATIONALE

Sindh Bank Limited (SNDB) is a majority owned entity of the Government of Sindh (GoS). Ratings assigned to SNDB derive support from shareholding structure of the Bank. SNDB had total network of 300 (2016: 260) branches at year-end'2017. Out of the total branches, 14 branches are dedicated to Islamic banking. The bank now has presence in 151 (2016: 130) cities across Pakistan.

During 2016, SNDB and major shareholders of Summit Bank Limited decided to merge the two banks. After the completion of due diligence exercise, both the banks agreed to a swap ratio. However, as per Scheme of Amalgamation, given the un-expected delay in completing the merger exercise, a fresh due diligence exercise to determine a new swap ratio based on the financials of Dec'2017 was agreed to by the parties. Once the swap ratio is determined and other legal & regulatory requirements are completed, Sindh Bank being the surviving entity will eventually be listed on PSX.

Exposure to credit risk is on the higher side given the significant sector and counterparty concentration. Asset quality indicators have weakened on a timeline basis; comfort is drawn from sizeable general provision made.

Gross advances registered growth of 23% during 2017 with increase witnessed in food, sugar and steel sectors. Over nine-tenth of the financing portfolio comprises corporate exposures with remaining loan book featuring SME, agriculture and consumer portfolio. Sectoral concentration in the sugar sector continues to be on the higher side with increase in NPLs primarily comprising sugar sector clients. As per management, classification has been undertaken on the instruction of the regulator while these counterparties continue to make timely payments. Given the weak sector dynamics of the sugar sector, performing exposures against the same may need to be closely monitored. Of the total sugar sector exposure of Rs. 20.8b at end-Dec'2017, Rs. 3.7b (17.8%) is secured against cash collateral and Rs. 6.4b (30.8%) is secured against pledge of sugar with 20% margin and the remaining against mortgage of fixed assets. As per management, given the collaterals in place, risk of eventual loss to the Bank is limited.

Client concentration in the portfolio has also depicted an increase with top 10 clients comprising over 40% of the advances portfolio. With growth in NPLs, gross infection in the portfolio increased to 7.4% (2017: 7.9%; 2016: 2.8%) at end-1Q18 while FSV benefit availed stood at Rs. 2.8b (2017: Rs. 2.4b). The bank also carries general provisions to the tune of Rs. 4b at end-1Q18. Given the mid-term economic scenario and policy rate regime, maintaining asset quality indicators in line with benchmarks for the assigned ratings is considered important.

High duration of PIBs resulting in sizeable exposure to market risk

Investment portfolio stood at Rs. 99.8b at end-1Q18. Given the sizeable investment in sovereign instruments, exposure to credit risk is considered minimal. While average yield on PIB portfolio compares favorably vis-à-vis peer Banks, exposure to market risk is on the higher side given the duration of the PIB portfolio (6.3 years at end-Dec'2017) and in the backdrop of further increase expected in benchmark rates. Investment in equities represented 16.8% (2016: 13.5%) of the bank's own equity at year-end'2017. Given the decline in benchmark index, there is a sizeable deficit on equity and equity related mutual fund holdings.

While cost of deposits has declined, the same is on the higher side vis-à-vis peer Banks. Depositor concentration is sizeable and has increased on a timeline basis. Liquidity profile draws support from sizeable liquid assets carried on the balance sheet as evident from LCR and NSFR being well above regulatory requirement.

Deposits base increased to Rs. 134.2b (2016: Rs. 119.0b) at end-2017. Proportion of GoS deposits has continued to decline on a timeline basis and represented 14% (2016: 17%) of total deposits at year-end'2017. However, deposit concentration remains sizeable with top 50 depositors comprising over half of the Bank's deposit base. As per management, concentration in deposits is partly attributable to sizeable GoS deposits. Proportion of current accounts in deposit mix has depicted an increase resulting in a decline in cost of deposits; the same still compares less favorably vis-à-vis peer Banks. Assessment of liquidity profile draws support from sizeable liquid assets carried on the balance sheet. Liquid assets in relation to deposits and borrowing stood at 53.6% at end-2017. Strong liquidity buffer is also reflected by liquidity coverage ratio (917% vs. regulatory requirement of 90%) and net stability funding ratio (126% vs. regulatory requirement of 100%) being well above regulatory requirements.

While declining on a timeline basis, capitalization indicators remain commensurate with the benchmarks for the assigned ratings.

Net equity base of the Bank stood at Rs. 16.1b (2016: Rs. 15.5b) at end-2017 and has grown over the years on account of retained profits. While declining on a timeline basis, Capital Adequacy Ratio (CAR) stood above the regulatory requirement at 15.67% (2016: 17.5%) at end-2017. In the backdrop of increasing regulatory requirements, maintaining buffer over regulatory requirement in line with benchmark for the assigned ratings is considered important. In case, the ongoing merger with another Bank goes through without any equity injection, capitalization indicators of the merged entity will not remain commensurate with the benchmarks for the assigned ratings.

Volumetric growth in earning assets and controlled administrative expenses translated into significant increase in operating profitability. Overall profitability declined due to absence of capital gains.

Despite pressure on spreads (declined by 15bps), operating profitability increased by 67% and 66% during 2017 and 1Q18, respectively, due to volumetric growth in earning assets and limited escalation in administrative expenses. Given the improvement in operating profitability, cost to income ratio improved to 69.4% (2016: 78%) in 2017. Despite lower general provisions, profit before tax declined due to significantly lower capital gain on sale of investments. Going forward, operating profitability is projected to increase on the back of volumetric growth in earning assets. However, overall profitability will depend on quantum of provisioning charges on financing portfolio.

Sindh Bank Limited

Appendix I

FINANCIAL SUMMARY			*(amounts in PKR millions)*
BALANCE SHEET	**DEC 31, 2017**	**DEC 31, 2016**	**DEC 31, 2015**
Total Investments	114,259	71,539	70,394
Advances	64,713	51,833	44,169
Total Assets	204,482	146,355	128,242
Borrowings	50,971	8,910	27,160
Deposits & other accounts	134,207	119,022	84,076
Tier-1 Equity	14,913	14,493	13,459
Net Worth	16,067	15,530	14,758
INCOME STATEMENT	**DEC 31, 2017**	**DEC 31, 2016**	**DEC 31, 2015**
Net Mark-up Income	5,264	4,404	4,442
Net Provisioning	252	1,607	2,516
Non-Markup Income	1,327	3,495	3,491
Operating Expenses	4,157	3,864	3362
Profit Before Tax	2,182	2,427	2,051
Profit After Tax	1,255	1,390	1,230
RATIO ANALYSIS	**DEC 31, 2017**	**DEC 31, 2016**	**DEC 31, 2015**
Market Share (Advances) (%)	1.1%	1.0%	1.0%
Market Share (Deposits) (%)	1.1%	1.1%	0.9%
Gross Infection (%)	7.9%	2.8%	0.6%
Net Infection (%)	7.4%	2.6%	0.5%
Cost of deposits (%)	4.1%	4.5%	5.2%
Net NPLs to Tier-1 Capital (%)	26.8%	7.5%	1.6%
Capital Adequacy Ratio (C.A.R (%))	15.7%	17.5%	20.1%
Markup Spreads (%)	3.3%	3.5%	4.4%
Efficiency (%)	69%	78%	69%
ROAA (%)	0.7%	1.0%	1.0%
ROAE (%)	7.8%	9.5%	9.2%
Liquid Assets to Deposits & Borrowings (%)	53.6%	68.9%	59.4%

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	Sindh Bank Limited
Sector	Commercial Banks
Type of Relationship	Solicited
Purpose of Rating	Entity Rating
Rating History	

Rating Date	Medium to Long Term	Short Term	Rating Outlook	Rating Action
RATING TYPE: ENTITY				
6/28/2018	AA	A-1+	Rating Watch-Developing	Re-affirmed
6/30/2017	AA	A-1+	Rating Watch-Developing	Maintained
6/28/2016	AA	A-1+	Stable	Re-affirmed
6/30/2015	AA	A-1+	Stable	Re-affirmed
12/23/2014	AA	A-1+	Stable	Upgrade
6/30/2014	AA-	A-1+	Positive	Maintained
6/28/2013	AA-	A-1+	Stable	Maintained
5/21/2012	AA-	A-1	Stable	Reaffirmed

Instrument Structure	N/A
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 2018 JCR-VIS Credit Rating Company Limited. All rights reserved. Contents may be used by news media with credit to JCR-VIS.