RATING REPORT

Sindh Bank Limited

REPORT DATE:
July 05, 2019

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

Muhammad Tabish
muhammad.tabish@vis.com.pk

RATING DETAILS				
	Latest Rating		Previous Rating	
Rating Category	**Long-term**	**Short-term**	**Long-term**	**Short-term**
Entity	A+	A-1	AA	A-1+
Outlook	Stable		Rating Watch-Developing	
Date	*June 21, '19*		*June 28, '18*	

COMPANY INFORMATION	
Incorporated in 2010	External auditors (2019): **Naveed Zafar Ashfaq Jaffery & Co. Chartered Accountants**
Public Unlisted Company	Chairman of the Board: **Mr. Tajammal Husain Bokharee**
Key Shareholders (with stake 5% or more):	Chief Executive Officer: **Mr. Tariq Ahsan**
Government of Sindh, Finance Department – 99.9%	

APPLICABLE METHODOLOGY(IES)
VIS Commercial Banks Rating **http://vis.com.pk/docs/Meth-CommercialBanks201803.pdf**

Sindh Bank Limited (SNDB)

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 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). SNDB had total network of 330 (2017: 300; 2016: 260) branches at year-end'2018. Out of the total branches, 14 branches are dedicated to Islamic banking.

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 had agreed to a revised swap ratio in 2018. However, the board decided that the merger is not advisable and has informed State Bank of Pakistan of the same.

Given the high exposure to credit risk as already highlighted in earlier reviews, asset quality indicators have depicted significant deterioration on a timeline basis primarily due to classification of exposures against a single group.

Gross advances registered growth of 14.5% during 2018. Corporate loan book remains the mainstay of the Bank's lending operations. Lending to the public sector represents around 12% of gross advances while largest sectoral exposures are to the sugar, food and power sectors. Overall client and sectoral concentration in the financing portfolio remains on the higher side and is a source of credit risk. Asset quality indicators have depicted significant weakening on a timeline basis due to classification of exposures against a single group. Security against the said group exposure has also weakened due to unauthorized removal of pledged stocks.

With growth in NPLs, gross infection in the portfolio increased to 31.4% (2017: 7.9%; 2016: 2.8%) at end-2018. FSV benefit availed stood at Rs. 8.57b (2017: Rs. 2.45b). Higher provisioning charges were met through transfer of general provision buffer created in the preceding years and additional provisioning charge undertaken in FY18. Provisioning charges are expected to remain elevated over the rating horizon due to change in classification of NPLs, expiry of FSV benefit undertaken and fresh NPL accretion in the backdrop of weak macroeconomic environment.

Strategy of maintaining sizeable medium to long tenor PIB holdings has translated into significant revaluation deficit. Further revaluation deficit is expected on PIB portfolio.

Given the attrition in deposit base, lower repo borrowings, revaluation deficit on PIBs and sale of government securities, net investment portfolio of the Bank reduced by half and stood at Rs. 55.35b (2017: Rs. 114.3b) at end-2018. Investment portfolio primarily includes fixed rate PIBs. Total deficit on AFS investment portfolio stood at Rs. 6.43b at end-Dec'2018. Deficit on revaluation of PIB portfolio is expected to have increased further given additional increase in interest rates post December. Average duration of PIB portfolio stood at 4.098 years. Overall exposure to market risk is on the higher side given the sizeable exposure to equities in relation to bank's own equity which stood at 17.3% at end-2018.

Deposit base witnessed significant attrition in the outgoing year. Liquidity profile has weakened given the sizeable and increasing depositor concentration and decline in liquidity buffer carried on the balance sheet. Liquidity Coverage Ratio and Net Stability Funding Ratio remain above regulatory requirement.

Deposit base of the bank declined to Rs. 113.6b (2017: Rs. 134.2b) at end-Dec'2018. Decline was witnessed in private sector corporate deposits. Deposits from government (federal and provincial) represent around 64% of total deposits at end-Dec'2018. Moreover, top 50 depositor concentration continues to increase and remain sizeable. Given the decline in deposits and higher gross advances, advances to deposit ratio of the Bank increased to 68.6% (2017: 50.6%) at end-2018. Liquidity Coverage Ratio and Net Stability Funding Ratio were reported at 156% (2017: 917%) and 124% (2017: 126%) at end-2018 vis-à-vis regulatory requirement of 100%.

Capital Adequacy Ratio of the Bank remains below regulatory requirements as at end-March'2019. Aggregate equity injection of Rs. 14.7b over the next 1 year is planned to allow the Bank to achieve cushion over regulatory CAR requirements. Timely implementation of the same is considered important.

Net equity base of the Bank declined to Rs. 11.2b (2017: Rs. 16.1b) at end-2018 on account of losses incurred and revaluation deficit on PIB portfolio. Given the losses, Capital Adequacy Ratio (CAR) declined to 8.02% (2017: 15.67%) at end-2018. Sizeable equity injection has been approved and budgeted by the GoS which entails fresh equity injection, merger with an associate leasing company and divestment from its subsidiary, a microfinance bank to allow the Bank to achieve cushion over regulatory CAR requirements. Timely implementation of the capitalization plan is considered important. VIS expects the Bank to achieve adequate cushion over regulatory requirements once the capitalization plan is implemented. However, net-NPLs in relation to Tier-1 equity will remain on the higher side given that provisioning will be staggered over a number of years.

Trend in operating losses to reverse once equity injection materializes

During 2018, SNDB posted an operating profit of Rs. 938.4m (2017: Rs. 1.8b) in 2018. However, the Bank incurred a loss before tax of Rs. 1.4b in 2018 on account of realized losses on PIB portfolio and equities and provisioning charges on advances portfolio. Going forward, VIS expects trend of operating losses in the ongoing year to reverse once equity injection materializes. Overall profitability will depend on provisioning for non-performing exposures.

Existing Internal Audit and IT infrastructure is a rating constraint

During the ongoing year, the previous external auditors excused from undertaking the audit for calendar year 2018 and Naveed Zafar Ashfaq Jaffery & Co. Chartered Accountants were appointed as external auditors. The auditors are in the 'A' category on SBP's. Overall staff strength and capacity of the internal audit function requires strengthening IT infrastructure also needs to be upgraded. Board of Directors has also witnessed a number of changes since last review.

Strong sponsor support is a key rating driver.

Ratings assigned to SNDB derive support from shareholding structure of the Bank. Support from GoS will be critical for the Bank to achieve compliance with regulatory requirements.

ANNEXURE-I

Committee Names	Members
Risk Management Committee	- Mr. Javaid Bashir Sheikh (Chairman) - Mrs. Masooma Hussain (Member) - President/CEO (Member) - Head of Risk Management (Secretary)
Procurement, Information Technology & Security Committee	- Mr. Tajammal Husain Bokharee (Chairman) - Mr. Anis A. Khan (Member) - Mrs. Masooma Hussain (Member) - President/CEO (Member) - Finance Secretary (GoS) (By Invitation) - Head of IT / Head of Admin. (Secretary)
Human Resource & Remuneration Committee	- Mr. Anis A. Khan (Chairman) - Mr. Muhammad Bilal Sheikh (Member) - Mr. Sami ul Haq Khilji (Member) - Finance Secretary (GoS) (Member) - President/CEO (By Invitation) - Head of HR (Secretary)
Audit Committee	- Mr. Sami ul Haq Khilji (Chairman) - Finance Secretary (GoS) (Member) - Mr. Muhammad Bilal Sheikh (Member) - Mr. Javaid Bashir Sheikh (Member) - Head of Internal Audit (Secretary)
Nomination Committee	- Mr. Tajammal Husain Bokharee (Chairman) - Finance Secretary (GoS) (Member) - Mr. Muhammad Bilal Sheikh (Member) - Company Secretary (Secretary)

Sindh Bank Limited **Appendix I**

FINANCIAL SUMMARY				*(amounts in PKR millions)*
BALANCE SHEET	**DEC 31, 2018**	**DEC 31, 2017**	**DEC 31, 2016**	**DEC 31, 2015**
Total Investments	55,351	114,260	71,539	70,394
Advances	73,632	64,713	51,833	44,169
Total Assets	155,561	204,876	146,355	128,242
Borrowings	26,772	50,971	8,910	27,160
Deposits & other accounts	113,594	134,207	119,022	84,076
Tier-1 Equity	7,093	14,914	14,493	13,459
Net Worth	11,238	16,068	15,530	14,758
INCOME STATEMENT	**DEC 31, 2018**	**DEC 31, 2017**	**DEC 31, 2016**	**DEC 31, 2015**
Net Mark-up Income	4,875	5,265	4,404	4,442
Net Provisioning	(1,378)	252	1,607	2,516
Non-Markup Income	(389)	1,328	3,495	3,491
Operating Expenses	4,527	4,157	3,864	3362
Loss/Profit Before Tax	(1,419)	2,182	2,427	2,051
Loss/Profit After Tax	(1,205)	1,255	1,390	1,230
RATIO ANALYSIS	**DEC 31, 2018**	**DEC 31, 2017**	**DEC 31, 2016**	**DEC 31, 2015**
Market Share (Advances) (%)	1.0%	1.1%	1.0%	1.0%
Market Share (Deposits) (%)	0.9%	1.1%	1.1%	0.9%
Gross Infection (%)	31.4%	7.9%	2.8%	0.6%
Net Infection (%)	26.3%	7.4%	2.6%	0.5%
Cost of deposits (%)	4.2%	4.1%	4.5%	5.2%
Net NPLs to Tier-1 Capital (%)	272.4%	26.8%	7.5%	1.6%
Capital Adequacy Ratio (C.A.R (%))	8.0%	15.7%	17.5%	20.1%
Markup Spreads (%)	2.9%	3.3%	3.5%	4.4%
Efficiency (%)	83%	69%	78%	69%
ROAA (%)	-0.7%	0.7%	1.0%	1.0%
ROAE (%)	-7.5%	7.8%	9.5%	9.2%
Liquid Assets to Deposits & Borrowings (%)	37.2%	53.8%	68.9%	59.4%

ISSUE/ISSUER RATING SCALE & DEFINITIONS Appendix II

VIS Credit Rating Company Limited

RATING SCALE & DEFINITIONS: ISSUES / ISSUERS

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: 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.vis.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.vis.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.

(blr) Rating: A suffix (blr) is added to the ratings of a particular banking facility obtained by the borrower from a financial institution. The suffix (blr), abbreviated for 'bank loan rating' denotes that the rating is based on the credit quality of the entity and security structure of the facility.

'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.vis.com.pk/images/policy_ratings.pdf

'SD' Rating: An 'SD' rating is assigned when 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		
6/28/2019	A+	A-1	Stable	Downgrade
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	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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