October 2016

JCR-VIS

# SECTOR UPDATE

# Commercial Banks

*This report covers 26 commercial banks and has been developed given the current industry stratification...*

*The banking sector assets in Pakistan have grown at a CAGR of 14.7% over the last 5 years reaching Rs. 14.1t (2010: Rs. 7.1t)*

**Recent Developments**

- The banking sector assets in Pakistan have grown at a Compound Annual Growth Rate (CAGR) of 14.7% over the last 5 years (2010-2015) reaching Rs. 14.1t (2010: Rs. 7.1t). Asset base of the banking sector stood at Rs. 15.4 tr at end-June 2016.
- Growth in asset base has been funded by increase in deposits which have posted a CAGR of 13.8% over the last 5 years (2010-2015) reaching Rs. 10.4t (2010: Rs. 5.4t). Deposits of the banking sector increased to Rs. 11.0 tr at end-June 2016.
- Despite healthy growth over the last few years, financial inclusion indicators of Pakistan remain on the lower side vis-à-vis regional counterparts with only 13% of the population (age 15 and above) having a formal bank account, indicating significant room for growth for commercial banks to increase the deposit base.

| Table 01: Financial Inclusion Indicators 2015 | People with Bank Accounts (%) | People with Formal Savings (%) | People with Formal Borrowings (%) |
|---|---|---|---|
| Pakistan | 13 | 3 | 2 |
| Sri Lanka | 83 | 31 | 18 |
| India | 53 | 14 | 6 |
| Bangladesh | 31 | 7 | 10 |
| China | 79 | 41 | 10 |
| Kazakhstan | 54 | 8 | 16 |
| Iran | 92 | 22 | 32 |

** People implies the entire adult population of a country i.e. aged 15 and above. Source: World Bank*

- During May'2015, the State Bank of Pakistan (SBP) introduced various regulatory measures for the sector in an effort to reduce the volatility of overnight repo rate including i) introduction of a target/policy rate (50 basis points below discount rate, ii) contraction of interest rate corridor (spread between ceiling/discount rate & floor/SBP repo rate) by 50bps to 2%. In view of the adjustment in the interest rate corridor, the downward adjustment in cost of saving deposits was less than the re-pricing of loans and contributed to decline in net interest income.
- Imposition of super tax of 4% on bank's income for tax year 2015 and 2016 and flat tax of 35 % on all sources of bank's income has exerted

pressure on profitability during 2015 and expected to continue to do so in 2016, while tax rate on business income of the corporate sector has been rationalized to 31%.

- In order to increase number of people in the tax net and encourage people to file tax returns, the advance tax on cash withdrawals and banking transactions of Rs 50,000 and above by a non-filer in a day was imposed initially at 0.6% (federal budget 2015-16). It was later reduced to 0.3% and then revised up to 0.4%. Consequently, growth in deposit base was slower at 4.2% in 2H15 vis-à-vis 8% in 1H15. As per federal budget 2016-17, advance tax on cash withdrawals from each account of Rs 50,000 and above per day has been widened to cover cash withdrawal of Rs 50,000 and above per day from all banks.
- China Pakistan Economic Corridor (CPEC) worth $45.6b is expected to result in financing and deposit mobilization opportunities for commercial banks. Work on projects has already started with timeline of all projects being 15 years. CPEC involves:
    - 24 energy projects (US$34.4bn).
    - 4 infrastructure projects (US$9.8bn).
    - Development of Gwadar port (US$800mn).
    - Formation of over 30 Special Economic Zones.
- Reduction in policy rate by 375bps since the monetary easing cycle commenced has translated into average 6M-KIBOR (Karachi Inter Bank Offer) declining by 275bps during 2015 decreasing from 10.09% (2014 annual average) to 7.34% (2015 annual average). 6M-KIBOR has declined further to 6.05% as of 8th September, 2016. Maturity of PIBs and low interest rates is expected to impact profitability growth of the sector.
- In order to reduce refinancing/rollover risk on domestic debt given the sizeable concentration in short maturities (around two-third of domestic debt had maturities within one year at end-FY13), GoP started issuing high yielding medium to long-tenor domestic debt (PIBs). Banking sector exposure to PIBs increased by over 4.5x to Rs. 3.37trillion at year-end'2015. Increase in exposure to high yielding PIBs has resulted in significant jump in profitability of the sector in the form of higher net interest income and capital gains. Reinvestment risk on maturing PIBs (large chunk of PIBs had a tenor of 3 years) will continue to be a drag on sector profitability. Around 27% of the outstanding PIBs matured in July'2016.
- The significant drop in commodity prices have reduced quantum of working capital facilities that majority of banks provide to their corporate clientele. Non-fund based financing has also declined resulting in lower fee based income for banks. Reduction in rebate on remittance[1] business will also impact fee based revenues of banks. Effective July 1, 2015, rebates were reduced to 20 Saudi riyal per transaction (previously 25 Saudi riyal per transaction) on a minimum remittance of $200 (previously $100).

**Industry Classification**

- The State Bank of Pakistan (SBP) includes in their quarterly compendium 26 local commercial banks split between the private (21) and public (5) sector. Besides local commercial bank, there are four foreign banks with the number of foreign banks having decreased by 1 with the merger of HSBC Bank Oman S.A.O.G. with Meezan Bank Limited.
- The JCR-VIS Banking Sector Overview covers 26 local commercial banks and has been developed given the current industry stratification whereby top 6 banks account for 59.8% of banking sector deposits, including presence in various overseas markets. Besides these large banks, the industry is composed of a few medium sized banks and several small sized banks.

[1] *Under Pakistan Remittance Initiative scheme, the government pays the remittance fee charges against home remittances to encourage remittances through legal channels.*

Given that risk profile of banks in different classifications varies widely, we have accordingly split the industry analysis on the basis of market share in deposits.

- Banks have been classified into 3 groups: Large banks (market share > than 6%), Medium banks (market share ranging between 3-6%) and Small banks (market share < than 3%). For each risk area, JCR-VIS has commented on the issues of the sector, as a whole, followed by specific comments for strong and weak banks in each classification.

**Table 02: Banking Industry Classification**
*(in order of market share provided in [] paranthesis)*

| Large Banks | Medium Banks | Small Banks |
|---|---|---|
| Habib Bank Limited (HBL) - *[14.1%]* | Meezan Bank Limited (Meezan) - *[4.9%]* | Soneri Bank Limited (Soneri) - *[1.9%]* |
| National Bank of Pakistan (NBP) - *[13.1%]* | Bank Al-Habib (Al-Habib) - *[4.7%]* | BankIslami Pakistan Limited (BankIslami) - *[1.6%]* |
| United Bank Limited (UBL) - *[8.6%]* | Askari Bank Limited (Askari) - *[4.1%]* | JS Bank Limited (JS Bank) - *[1.5%]* |
| Allied Bank Limited (ABL) - *[7.6%]* | Bank of Punjab (BoP) - *[3.9%]* | Dubai Islamic Bank Pak. Limited (DIB) - *[1.4%]* |
| MCB Bank Limited (MCB) - *[7.3%]* | Habib Metropolitan Bank Limited (HabibMetro) - *[3.6%]* | NIB Bank Limited (NIB) - *[1.3%]* |
| Bank Alfalah Limited (Alfalah) - *[6.6%]* | Standard Chartered Bank Limited (SCB) - *[3.4%]* | The Bank of Khyber (BoK) - *[1.2%]* |
| | Faysal Bank Limited (Faysal) - *[3.0%]* | Summit Bank Limited (Summit) - *[1.2%]* |
| | | Sindh Bank Limited (Sindh) - *[0.9%]* |
| | | Silk Bank Limited (SILK) - *[0.8%]* |
| | | Bank Albaraka (Pakistan) Limited (Albaraka) - *[0.7%]* |
| | | Samba Bank Limited (Samba) - *[0.4%]* |
| | | Burj Bank Limited (Burj) - *[0.3%]* |
| | | First Women Bank Limited (First Women) - *[0.2%]* |

# Commercial Banks

### Concentration

- The banking industry is characterized by significant concentration with large banks (top 6 banks) accounting for around 60% of assets, deposit base and branches. However, contribution to profitability is significantly higher at 71.1%. Accounting for profitability of medium sized banks, large and medium sized banks cumulatively represent 95.1% of banking sector's after tax profits. The remaining 13 banks contribute only 5% of profit after tax.

**Table 03: Concentration**

| | Large Banks | Medium Banks | Small Banks | Total (Rs. M) |
|---|---|---|---|---|
| Asset Base | 60.0% | 26.2% | 13.8% | 13,562,504 |
| Deposits | 59.8% | 27.5% | 12.7% | 10,243,268 |
| Profit After Tax | 71.1% | 24.0% | 4.9% | 180,877 |
| Advances | 56.1% | 27.0% | 16.9% | 4,631,453 |
| Non-performing Loans | 52.5% | 30.1% | 17.4% | 578,702 |
| Branches | 60.8% | 21.2% | 18.0% | 12,102 |

### Credit Risk

- Overall advances portfolio of banking sector has witnessed growth of 8.1% and 7% during 2015 and 1H16, respectively. Gross advances of the sector stood at Rs. 5.7trillion at end-June'2016.

**Table 04: Sector-wise Industry Analysis**

| *In Rs. b* | HY16 | | | 2015 | | | 2014 | | |
|---|---|---|---|---|---|---|---|---|---|
| | Advances | NPLs | Infection | Advances | NPLs | Infection | Advances | NPLs | Infection |
| Textile | 749<br>*13.1%* | 197 | 26.30% | 762<br>*14.3%* | 198 | 26.00% | 792<br>*16.1%* | 198 | 25.00% |
| Production/ Transmission of Energy | 789<br>*13.8%* | 38 | 4.90% | 681<br>*12.8%* | 41 | 6.00% | 621<br>*12.6%* | 29 | 4.70% |
| Agribusiness | 504<br>*8.8%* | 58 | 11.50% | 474<br>*8.9%* | 40 | 8.50% | 394<br>*8.0%* | 37 | 9.40% |
| **Total** | **5,703** | **634** | **11.10%** | **5,330** | **605** | **11.40%** | **4,930** | **604** | **12.30%** |

- Private sector credit growth witnessed growth of 3.9% during 1H16 as compared to a slight decline during 1H15. However, growth in lending to government and public sector enterprises has outpaced private sector, indicating bank's preference for low risk exposures. Lending to government and public sector enterprises increased by 21% and 13%, respectively during 1H16.

**Table 05: Segment-wise Industry Analysis**

| *In Rs. b* | HY16 | | | 2015 | | | 2014 | | |
|---|---|---|---|---|---|---|---|---|---|
| | Advances | NPLs | Gross Infection | Advances | NPLs | Gross Infection | Advances | NPLs | Gross Infection |
| Corporate | 3,794 | 448 | 11.8% | 3,534 | 434 | 12.3% | 3,289 | 429 | 13.0% |
| SME | 310 | 82 | 26.5% | 318 | 83 | 26.1% | 299 | 91 | 30.5% |
| Agriculture | 297 | 46 | 15.5% | 291 | 38 | 13.0% | 264 | 33 | 12.4% |
| **Consumer** | **350** | **34** | **9.8%** | **336** | **29** | **8.7%** | **294** | **34** | **11.6%** |
| **Commodity** | **698** | **4** | **0.6%** | **594** | **7** | **1.2%** | **549** | **5** | **1.0%** |
| **Others** | **254** | **20** | **7.9%** | **257** | **15** | **5.7%** | **234** | **11** | **4.8%** |
| **Total** | **5,703** | **634** | **11.1%** | **5,330** | **605** | **11.4%** | **4,930** | **604** | **12.3%** |

- In terms of sectoral exposures, growth in financing has been driven by energy, power and infrastructure projects. Production and transmission of energy is now the largest sectoral exposure for banks. Lending to textile sector has witnessed a decline as a consequence of cautious approach adopted by banks given the weak sectoral dynamics.
- Corporate lending continues to remain the mainstay of bank's lending operations representing two-third of gross advances.
- Regulatory concerns have impacted credit disbursement in some large private sector power and infrastructure projects (largely owing to currency concerns). SBP has been mandating companies to arrange foreign currency financing for projects to limit dollar outflow. Similarly, local banks are expected to face challenges in financing CPEC projects in foreign currency.
- With decline in interest rates, consumer financing has witnessed noticeable increase as banks re-focus on high margin segments. Within consumer financing, growth has been manifested in auto, mortgage and personal loans.
- Large power, infrastructure and CPEC related projects are expected to result in higher credit off-take going forward. Supporting industries that will make CPEC's execution possible including cement, steel and contracting will be other sectors where the banks will look to increase financing portfolio.

**Asset Quality**

**Table 06: Banking Industry Credit Portfolio**

| | 6M16 | 2015 | 2014 | 2013 |
|---|---|---|---|---|
| Gross Infection | 11.1% | 11.4% | 12.3% | 13.3% |
| Net Infection | 2.2% | 1.9% | 2.7% | 3.4% |
| Provisioning Coverage (Total) | 82.4% | 84.9% | 79.8% | 77.1% |

- While overall NPLs have increased, growth in gross advances has been faster with the same increasing from Rs. 4.9trillion at end-2014 to Rs. 5.7trillion at end-HY16, therefore resulting in a lower gross infection indicator
- Asset quality of domestic loan book is improving on the back of recoveries and growth in loan book while overseas asset quality indicators have weakened.

**Table 07: Overseas Performance NBP vs. HBL vs. UBL**

| *In Rs. m* | NBP | | | HBL | | | UBL | | |
|---|---|---|---|---|---|---|---|---|---|
| | HY16 | CY15 | CY14 | HY16 | CY15 | CY14 | HY16 | CY15 | CY14 |
| Profit | n/a | (3,662) | (11,227) | n/a | 423 | 4,633 | n/a | 4,266 | 5,198 |
| Total Assets | n/a | 142,993 | 97,757 | n/a | 305,274 | 286,853 | n/a | 292,884 | 254,160 |
| Overseas NPLs | 31,718 | 31,896 | 30,186 | 16,802 | 14,092 | 9,289 | 11,842 | 10,910 | 9,268 |
| **Overseas Provisioning** | **n/a** | **30,033** | **21,557** | **13,914** | **13,355** | **9,080** | **7,978** | **6,719** | **5,968** |

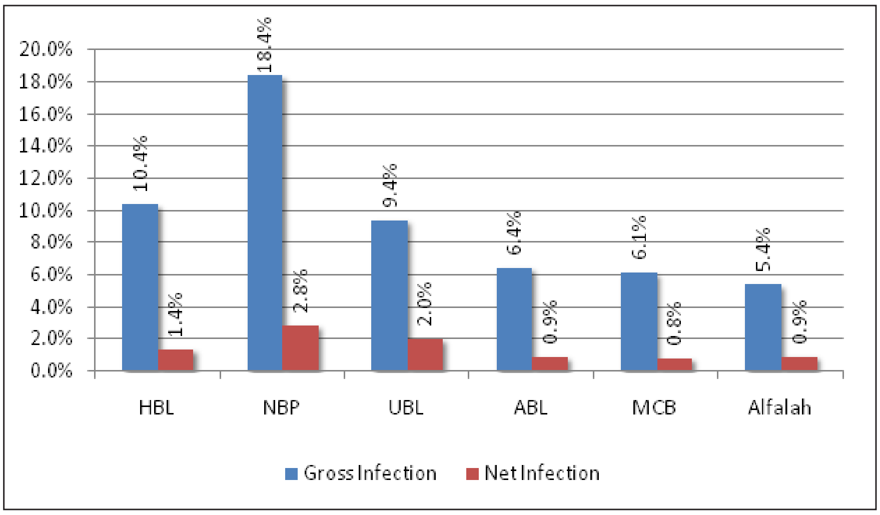
- Increase in overseas NPLs of large banks has been noted during 2015 and in the ongoing year. Risk of further non-performing loans in the overseas portfolio remains (particularly in MENA region) given the backdrop of lower oil prices and increased political uncertainty.

| Table 08: Banking Industry Credit Portfolio | Large Banks | | Medium Banks | | Small Banks | | Total | |
|---|---|---|---|---|---|---|---|---|
| | 2015 | 2014 | 2015 | 2014 | 2015 | 2014 | 2015 | 2014 |
| Advances as a % of Assets | 32.4% | 37.7% | 27.1% | 38.2% | 40.0% | 44.8% | 34.1% | 36.7% |
| Gross Infection | 7.9% | 9.1% | 13.8% | 14.3% | 9.6% | 9.0% | 11.4% | 12.3% |
| Net Infection | 1.1% | 1.9% | 1.7% | 2.1% | 2.6% | 2.4% | 1.9% | 2.7% |

- With additional liquidity generated by way of an increasing deposit base deployed in government paper, advances as a proportion of total assets has witnessed a decline for large, medium and small banks. Advances as a proportion of total assets is highest for small banks and lowest for medium banks. Within medium sized banks, SCB and HabibMetro have the lowest advances to total asset ratio while BoP and Faysal have the highest advances to total asset ratio.
- Large banks particularly HBL and UBL are well positioned to benefit from advances growth from infrastructure projects given large per party limits, presence in China & collaboration with international banks to tap lending opportunities arising from CPEC.

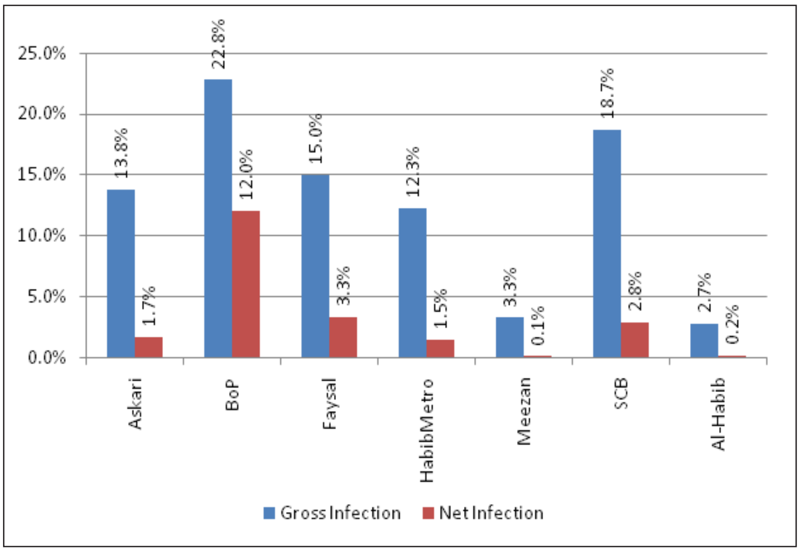
- **Large Banks**: Asset quality indicators of Alfalah, MCB and ABL compare favorably vis-à-vis peers.

**Fig. 1: Large Banks Infection levels 2015**



- **Medium Banks**: Asset quality indicators of Meezan Bank and Bank Al Habib compare favorably to other peers with remaining banks in the medium sized category reporting double digit gross infection as at year-end'2015.

**Fig. 2: Medium Banks Infection levels 2015**




- **Small Banks**: Banks with limited operating history and recent growth in financing portfolio have asset quality indicators that compare favorably to other small banks (JS Bank, Sindh, Samba & DIB). Infection levels in the portfolio will be evident as portfolio matures. Asset quality indicators of Summit, NIB, First Women and BankIslami are weaker vis-à-vis other small banks.

**Table 09: Small Banks Infection levels 2015**

| Bank | Gross Infection | Net Infection |
|---|---|---|
| Albaraka | 8.0% | 2.4% |
| BoK | 12.8% | 4.0% |
| BankIslami | 18.3% | 2.6% |
| Burj | 7.5% | 0.2% |
| DIB | 2.1% | 0.6% |
| First Women | 20.5% | 7.7% |
| JS Bank | 3.8% | 0.4% |
| NIB | 20.9% | 3.6% |
| Samba | 7.5% | 0.2% |
| SILK | 12.7% | 5.0% |
| Sindh | 0.6% | 0.5% |
| Soneri | 9.6% | 2.7% |
| Summit | 20.7% | 6.6% |

**Capitalization**

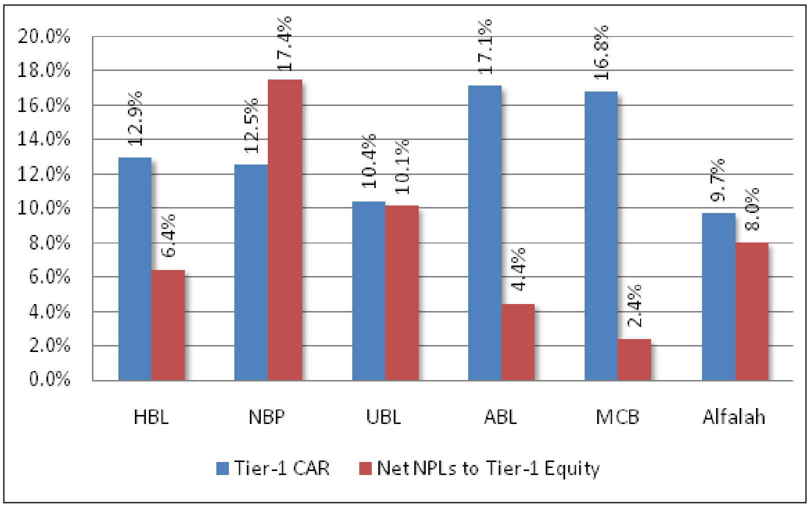
- Overall capitalization indicators of the banking sector are healthy with a Tier-1 Capital to RWAs reported at 13% (2015: 14.4%; 2014: 14.3%) while overall CAR was reported at 12.5% (2015: 13.1%; 2014: 12.9%) at end-June'2016.
- Tier-1 and CAR requirement for end-Dec'2015 was 7.75% and 10.25%, respectively and will increase to 10% and 12.5% at end-2019.
- Decline in Tier-1 and overall CAR at end-June'2016 vis-à-vis end-December'2015 is on account of growth in risk weighted assets (due to increase in private sector lending) being higher than internal capital generation.
- In the backdrop of increasing capital requirements, a number of banks have already issued Basel 3 Tier 2 instruments while a number of other banks also plan to issue the same in the ongoing year and 2017. JCR-VIS expects increased issuances of Basel 3 Tier 2 capital instruments in the backdrop of additional regulatory CAR requirements and higher risk charge on unrated exposures.

| Table 10: Classification-wise Capitalization Indicators | SBP Benchmarks | Large Banks | | Medium Banks | | Small Banks | |
|---|---|---|---|---|---|---|---|
| | 2016 | 2015 | 2014 | 2015 | 2014 | 2015 | 2014 |
| Tier-1 CAR | 8.15% | 12.7% | 12.4% | 10.7% | 10.9% | 11.7% | 11.8% |
| CAR | 10.65% | 16.8% | 16.2% | 13.9% | 13.0% | 14.5% | 14.2% |
| Net NPLs to Tier-1 Equity | NA | 7.2% | 10.8% | 8.6% | 12.2% | 16.4% | 12.7% |
| Leverage | 3.0% | 4.75% | 5.31% | 4.18% | 3.99% | 6.19% | 5.50% |

***Large Banks***

- Median capitalization of large banks compares favorably to that of medium and small banks. Within large banks, capitalization indicators of UBL and Alfalah compare less favorably to other Banks while MCB and ABL are the most well capitalized Banks.

**Fig. 03: Large Banks 2015 Tier-1 CAR and Net NPLs to Tier-1 Equity**

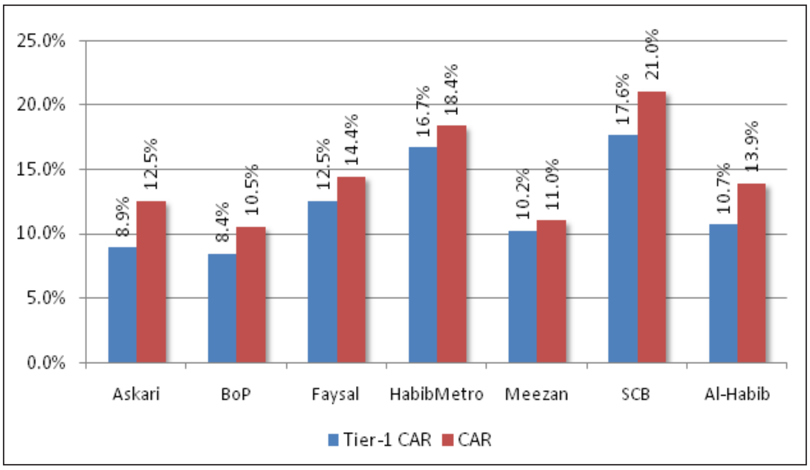



- A number of large banks may face additional capital requirements if surcharge is imposed on systematically important financial institutions (SIFIs). Internationally, SIFI surcharge has ranged from 0.8% to 3%. State Bank of Pakistan is in the process of identification of SIFIs.

***Medium Banks***

- Given the healthy internal capital generation during 2015, capitalization indicators of medium banks have improved on a timeline basis as reflected in a higher CAR and leverage ratio and reduction in net NPLs to tier-1 equity.
- Increased provisions and higher tier-1 equity has translated into significantly lower median net NPLs to Tier-1 equity for medium sized banks. Net NPLs to Tier-1 Equity of BoP is significantly high within medium-sized banks at 147.9% at end-December'2015.
- While currently being compliant with regulatory requirement, two banks (Askari and BoP) within medium sized peer group are currently short of the Tier-1 CAR requirement for end-December'2019. Capitalization indicators of SCB and HabibMetro compare favorably vis-à-vis other banks in the peer group.

**Fig. 04: Medium Banks 2015 Tier-1 CAR vs. Total CAR**




- With rapid branch expansion being pursued by a number of medium sized banks, capitalization indicators may need to be monitored closely given the limited growth in profitability (low spreads and high overheads) and increase in RWAs on account of volumetric growth and lending to unrated clients.

## Commercial Banks

***Small Banks***

- For small banks, capitalization indicators vary across different banks. Banks with relatively shorter history and limited lending portfolios have healthy capitalization levels. These banks include Samba, Sindh and BoK.
- However, a number of small banks are facing challenges on the capitalization front. These banks include Summit, NIB, BankIslami and DIB.

**Table 11: Small Banks 2015 Tier-1 CAR vs. Total CAR**

| Bank | Tier-1 CAR | Total CAR |
|---|---|---|
| Al-Baraka | 11.7% | 14.5% |
| BoK | 21.6% | 23.7% |
| BankIslami | 9.2% | 12.3% |
| Burj | 17.9% | 18.1% |
| DIB | 9.7% | 11.1% |
| First Women | 39.8% | 41.2% |
| JS Bank | 11.5% | 12.5% |
| NIB | 9.1% | 11.9% |
| Samba | 29.7% | 30.3% |
| SILK | 12.6% | 13.8% |
| Sindh | 18.5% | 20.1% |
| Soneri | 11.7% | 15.4% |
| Summit | 8.7% | 10.0% |

- Challenges on the capitalization front are on account of rapid growth in financing portfolio, deduction of Deferred Tax Asset from Common Equity Tier-1, reduction in eligible amount of sub-ordinated debt to be counted as Tier-2 capital, higher risk charge on unrated exposures and weak asset quality of performing portfolio.

**Profitability**

- Profit before tax of the banking sector has doubled over the last two years increasing to Rs. 329b (2014: Rs. 247b; 2013: Rs. 162b) in 2015.
- Growth in sector profitability was on account of volumetric growth in earning assets and increase in exposure to high yielding PIBs by around 4.5x over the last two years (2013-2015) to Rs. 3.37trillion at end-December'2015.
- Reduction in policy rate by 375bps since the monetary easing cycle commenced has exerted pressure on spreads of the sector. Average banking sector spread declined to 5.56% in 2015 versus 5.99% in CY14, down 43bps and is the lowest average in last 11-years.
- With declining benchmark rates, average spreads during 7MCY16 declined to 5.17% versus 5.71% in 7MCY15. Resultantly, profit before tax has witnessed a decline to Rs. 162b (1HCY15: Rs. 171b) despite volumetric growth in earning assets and lower provisioning charges.
- Significant high yielding PIBs have matured in July'2016. Maturity of PIBs is expected to result in further pressure on spreads if the low interest rate environment persists. Volumetric growth in earning assets, further reduction in cost of deposits and focus on non-core income is being targeted by most banks to offset the impact on profitability.

| Table 12: Classification-wise Profitability Indicators | Large Banks | | Medium Banks | | Small Banks | |
|---|---|---|---|---|---|---|
| | 2015 | 2014 | 2015 | 2014 | 2015 | 2014 |
| Efficiency | 44.5% | 47.7% | 60.4% | 61.4% | 91.9% | 91.8% |
| ROAA | 1.7% | 1.9% | 1.1% | 1.2% | 0.6% | 0.5% |
| ROAE | 23.2% | 22.9% | 24.6% | 20.2% | 5.6% | 3.9% |

***Large Banks***

- Large banks posted significant increase in profitability due to increase in exposure to PIBs, volumetric growth in earning assets, reduction in cost of deposits and capital gain on sale of securities.
- Impact of decline in spreads will vary across large banks and will depend on reinvestment risk on maturing PIB portfolio, ability to reduce cost of deposits, rationalize expense base and enhance ancillary sources of income.
- MCB, ABL and Alfalah have witnessed a decline in operating profit during 1H16 vis-à-vis 1H15. MCB, despite expansion in their asset base, was the only bank in the peer group to witness a decline in net interest income during 1H16 as compared to the corresponding period last year. In terms of re-investment risk, UBL is the most well positioned amongst large banks with most sizeable PIB portfolio (well-structured maturities) having the highest average yield while MCB and ABL had significant PIB portfolios (outstanding at end-December'2015) maturing in the ongoing year.

| Table 13: Large Banks Net Interest Income & Operating Profit comparison *(Rs. M)* | Net Interest | | | Operating Profit | | |
|---|---|---|---|---|---|---|
| | 6M16 | 6M15 | % change | 6M16 | 6M15 | % change |
| HBL | 40,456 | 38,197 | 5.90% | 26,789 | 26,335 | 1.70% |
| UBL | 29,330 | 27,287 | 7.50% | 21,915 | 21,903 | 0.10% |
| NBP | 28,127 | 25,250 | 11.40% | 15,053 | 13,168 | 14.30% |
| MCB | 23,397 | 24,934 | -6.20% | 17,790 | 19,547 | -9.00% |
| ABL | 17,705 | 17,385 | 1.80% | 12,857 | 13,130 | -2.10% |
| Alfalah | 14,654 | 13,907 | 5.40% | 6,412 | 6,752 | -5.00% |

- MCB has the highest CASA in deposit mix at 94% at end-June'2016 and hence the lowest cost of deposit. With declining interest rates (resulting in re-pricing of saving deposits) and increasing proportion of current accounts in deposit mix, cost of deposits for large banks (particularly UBL and HBL) has reduced significantly in the ongoing year.
- Large banks also benefit in terms of diversified revenue stream with significant contribution of trade, bancassurance, remittance and branchless banking to overall revenues. UBL, HBL and NBP standout in this regard.

- Efficiency ratio (cost to income ratio) of large banks compare favorably to medium and small banks on account of lower cost of deposit and diversified revenue streams.

| Table 14: Large Banks Fee & Commission Income as a % of Recurring Income comparison | | |
|---|---|---|
| **Bank** | **6M16** | **6M15** |
| HBL | 17.0% | 16.0% |
| UBL | 16.7% | 17.1% |
| NBP | 19.3% | 17.8% |
| MCB | 13.6% | 13.6% |
| ABL | 9.7% | 9.5% |
| Alfalah | 13.2% | 12.9% |

- Some challenges around maintaining historical growth rates in fees and commissions would be due to lower rebates from remittance business and decline in trade related fee income due to lower commodity prices. This is however expected to be offset by higher investment banking and Financial Institution Group fee due to participation in various large public sector and CPEC projects.

***Medium Banks***

- Median profitability indicators of medium sized banks have shown significant improvement due to sizeable increase in capital gains. Jump in ROAE during 2015 was most notable for Askari, BoP and HabibMetro.
- SCB has the best efficiency ratio at 43.1% while Askari has the weakest efficiency ratio at 67.6%.

| Table 15: Medium Banks Efficiency ratio comparison | | |
|---|---|---|
| **Bank** | **2015** | **2014** |
| Askari | 67.6% | 74.8% |
| BoP | 61.3% | 61.4% |
| Faysal | 60.4% | 70.6% |
| Habib Metro | 45.8% | 50.1% |
| Meezan | 60.8% | 62.1% |
| SCB | 43.1% | 45.1% |
| Al-Habib | 51.7% | 54.8% |

- With a number of banks in this category having already realized gains on PIB portfolio and also undergoing aggressive branch expansion, profitability pressures for medium sized banks will be more pronounced as compared to large banks.

***Small Banks***

- Median profitability indicators of small sized banks compare less favorably to medium and large sized banks. Given the smaller branch network and hence lower market share, cost of deposits and spreads are lower for small sized banks. Resultantly, median efficiency ratio is very high.

- Efficiency ratio varies significantly in the group with BoK having the best efficiency ratio at 57.3% while Burj Bank had the weakest efficiency ratio of 151.6%

| Table 16: Small Banks Efficiency ratio comparison | | |
|---|---|---|
| **Bank** | **2015** | **2014** |
| Albaraka | 91.9% | 91.8% |
| BoK | 57.3% | 60.0% |
| Bank Islami | 119.7% | 119.7% |
| Burj | 151.6% | 146.1% |
| DIB | 84.7% | 79.2% |
| First Women’s | 106.9% | 106.9% |
| JS Bank | 68.1% | 77.5% |
| NIB | 93.9% | 91.9% |
| Samba | 87.1% | 83.6% |
| SILK | 122.6% | 102.6% |
| Sindh | 68.9% | 70.9% |
| Soneri | 62.4% | 66.8% |
| Summit | 105.3% | 119.8% |

- Weaker asset quality as reflected in a higher gross and net infection has also created drag on profitability of small sized banks in terms of higher provisioning requirements.

**Liquidity**

- The liquidity of the banking industry is driven by enhanced deposit taking potential across the sector as banks target systematic branch network growth and penetration in the branchless banking segment.
- Total banking sector branches increased from 11,174 branches at end-2014 (including sub-branches / windows etc.) to 12,102 at end-2015.
- Total deposits held by commercial banks grew by 9.3% from Rs. 9,375b at end-2014 to Rs. 10,243b. The same amounted to Rs. 11,024b at end-HY16.
- CASA growth which is a key driver for profitability of banks will be challenging in the backdrop of advance tax imposed on banking transactions.

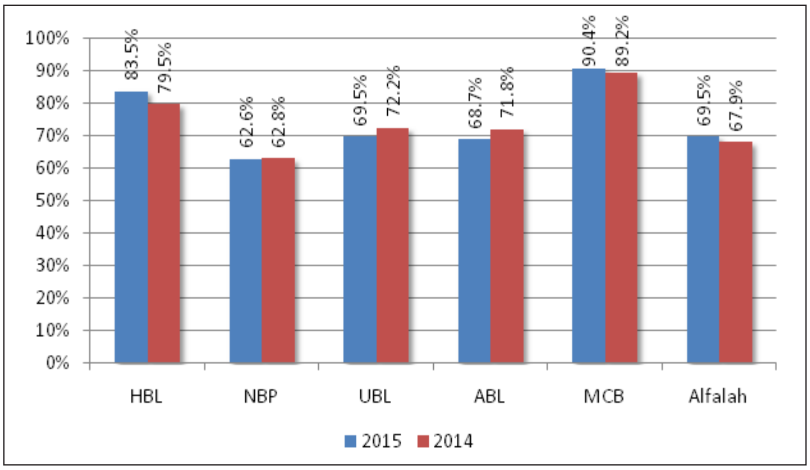
| Table 17: Classification-wise Liquidity Indicators | Large Banks | | Medium Banks | | Small Banks | |
|---|---|---|---|---|---|---|
| | **2015** | **2014** | **2015** | **2014** | **2015** | **2014** |
| CASA* | 69.5% | 72.0% | 70.6% | 70.3% | 59.3% | 61.0% |
| Individual Deposits | 39.8% | 41.5% | 38.3% | 36.4% | 46.7% | 45.8% |
| ADR | 45.6% | 47.5% | 42.9% | 45.3% | 62.6% | 67.7% |
| Liquid Assets to Deposits & Borrowings | 65.3% | 57.7% | 57.1% | 56.6% | 40.7% | 43.6% |
| Investments as a % of Assets | 52.9% | 47.7% | 50.0% | 46.8% | 39.3% | 31.0% |

** Includes Overseas deposits*

*Large Banks*

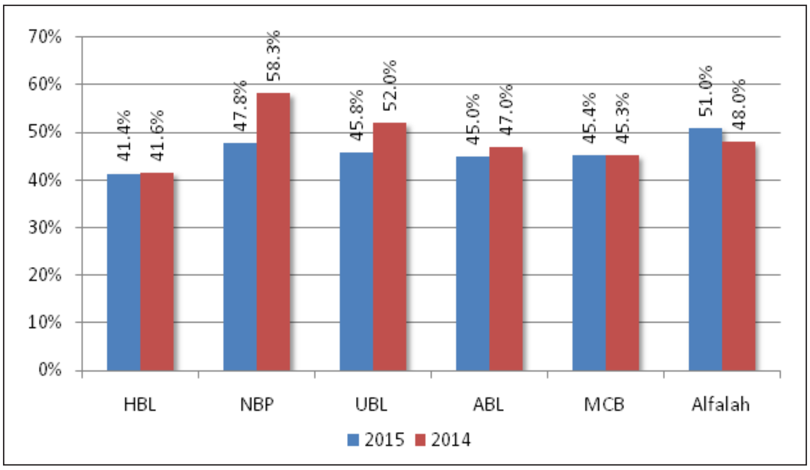
- Growth in the deposit base of large banks accounted for the lion share, 67% growth, in total deposits held by commercial banks. HBL and NBP account for around 27.3% of the market share in domestic deposits while UBL has been pursuing a market share acquisition strategy with the same increasing to over 8.8% at end-HY16. JCR-VIS considers market share to be a key rating driver.
- MCB continues to remain the strongest performer amongst large banks maintaining an impressive CASA ratio of 90.4% (2014: 89.2%) at end-2015. However, HBL and UBL stand out in terms of CASA growth during 2015 and in the ongoing year. Overall CASA ratio of banks with overseas operations tend to be lower given the wholesale banking model adopted by most banks. At end-2015, domestic CASA of HBL and UBL was sizeable at 86% and 84%, respectively.

**Fig. 05: Large Banks CASA 2015 vs. 2014**




- Apart from Alfalah, Gross Advances to Deposits ratio (ADR) has remained stable or declined for remaining large banks. With low ADRs for most large banks, liquid assets in relation to deposits and borrowings is sizeable. This along with granular deposit base (low depositor concentration) has resulted in strong liquidity profile for most large banks.

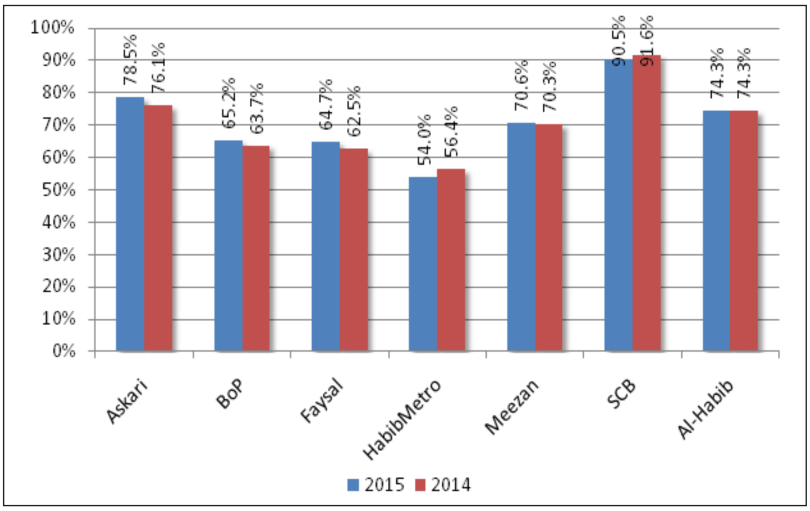
**Fig. 06: Large Banks ADR 2015 vs. 2014**



***Medium Banks***

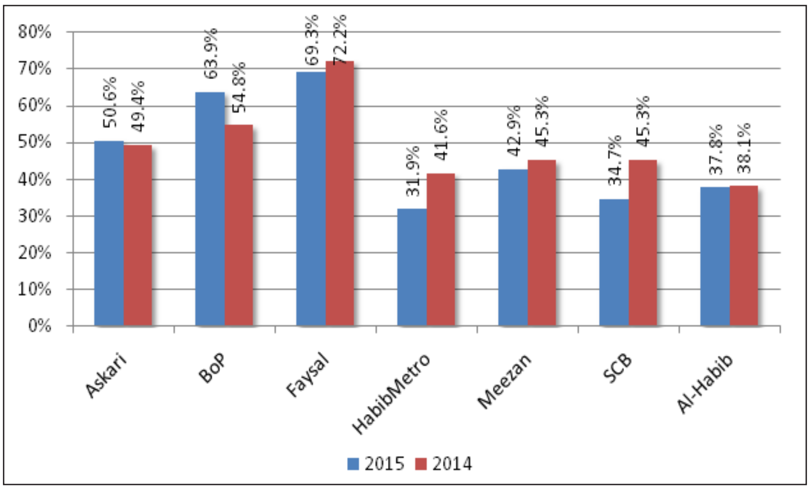
- Within medium sized banks, MBL, SCB and Al-Habib stand out in terms of deposit profile. Strong domestic operations and franchise has allowed these banks to build a sizeable CASA base with low deposit concentration and significant proportion of retail deposits. Proportion of CASA is lowest for HabibMetro within medium sized banks.
- A number of medium sized banks are pursuing aggressive branch expansion to further strengthen proportion of CASA in deposit mix.

**Fig. 07: Medium Banks CASA 2015 vs. 2014**




- While lower vis-à-vis large banks, median liquid assets to deposits and borrowings is sizeable at 57.1% (2014: 56.6%) at end-2015. Liquidity profile of BoP is weakest within medium sized banks with high depositor concentration and lowest liquid assets carried on the balance sheet in relation to peers.
- ADR varies significantly within medium sized banks with BoP, Faysal and Askari having higher Gross ADR vis-à-vis other medium sized banks.

**Fig. 08: Medium Banks ADR 2015 vs. 2014**




***Small Banks***

- Depositor profile of most small banks remains weak with significant depositor concentration and low proportion of retail deposits. Resultantly, cost of deposits is high as compared to most large and medium sized banks. JCR-VIS is of the view that liquidity cushion, in the form of liquid assets carried on the balance sheet, for banks with significant depositor concentration should be higher.

- Small banks were the most impacted by the moratorium imposed on KASB Bank with significant deposit withdrawals noted by JCR-VIS.
- Proportion of CASA for Albaraka, Summit and First Women compares favorably to other peer banks.

**Table 18: Small Banks CASA 2015 vs. 2014**

| Bank | 2015 | 2014 |
|---|---|---|
| Albaraka | 71.0% | 54.7% |
| BoK | 59.2% | 65.4% |
| BankIslami | 63.0% | 61.9% |
| Burj | 48.8% | 56.9% |
| DIB | 58.8% | 64.2% |
| First Women | 86.7% | 75.6% |
| JS Bank | 48.5% | 49.2% |
| NIB | 59.4% | 60.1% |
| Samba | 47.8% | 54.9% |
| SILK | 52.7% | 53.6% |
| Sindh | 65.6% | 77.9% |
| Soneri | 63.7% | 65.3% |
| Summit | 69.6% | 66.9% |

- Gross ADR of small banks is higher vis-à-vis medium and large sized banks. Given the cost of deposits, lending to high yielding clients & segments is being pursued by a number of small banks in order to manage spreads. Asset quality implications vary with underwriting guidelines being followed by individual banks.

**Table 19: Small Banks ADR 2015 vs. 2014**

| Bank | 2015 | 2014 |
|---|---|---|
| Albaraka | 67.7% | 59.6% |
| BoK | 32.9% | 45.1% |
| BankIslami | 53.6% | 45.5% |
| Burj | 71.4% | 77.7% |
| DIB | 74.7% | 68.7% |
| First Women | 60.7% | 69.4% |
| JS Bank | 52.3% | 55.9% |
| NIB | 103.5% | 111.9% |
| Samba | 62.6% | 67.7% |
| SILK | 80.1% | 89.0% |
| Sindh | 55.6% | 66.6% |
| Soneri | 60.5% | 65.8% |
| Summit | 64.9% | 69.3% |

**Conclusion**

- Given the increasing capital requirements, higher risk charge on unrated exposures and in order to facilitate planned growth, JCR-VIS expects capitalization challenges for a number of medium and small banks. Increased issuances of Basel 3 Tier 2 instruments, rights issue and higher profit retention is expected in order to meet challenges on the capitalization front.
- A number of large banks may face additional capital requirements if surcharge is imposed on systematically important financial institutions (SIFIs). Internationally, SIFI surcharge has ranged from 0.8% to 3%. State Bank of Pakistan is in the process of identification of SIFIs.
- Significant reduction in discount rate along with maturity of PIBs is expected to result in pressure on profitability growth of the sector if the current low interest rate environment persists. With a number of small and medium sized banks having already realized gains on PIB portfolio and also undergoing aggressive branch expansion, profitability pressures for small and medium sized banks will be more pronounced as compared to large banks.
- While even some large banks have reported decline in operating profits, large banks with high yielding PIB portfolios, diversified income streams (high fee commission in relation to NII/ diversified overseas operations) and low cost of deposits are expected to maintain healthy profitability growth.
- Consumer financing has shown an uptick during 2015 and in the ongoing year with growth expected to continue as banks look to mitigate pressure on spreads through increase in exposure to high yielding segments.
- Increase in trade related fee income is expected due to increased opportunities arising from CPEC and large infrastructure projects.
- Bank's exposure to credit risk is expected to increase on account of expected increase in credit off-take from large power and infrastructure projects. Rapid growth in financing particularly in high yielding segments (unsecured consumer financing) may have asset quality implications.
- Increase in overseas NPLs of large banks has been noted during 2015 and in the ongoing year. Risk of further non-performing loans in the overseas portfolio remains (particularly in MENA region) in the backdrop of lower oil prices and increased political uncertainty.
- Overall liquidity profile of the sector is healthy with sizeable liquid assets in relation to deposits and borrowings. Depositor profile of a number of small banks features significant concentration with low proportion of retail deposits. JCR-VIS is of the view that liquidity cushion, in the form of liquid assets carried on the balance sheet, for banks with significant depositor concentration should be higher.

**Ratings of Commercial Banks by JCR-VIS Credit Rating Company Limited**

| Large Banks | | Medium Banks | | Small Banks | |
|---|---|---|---|---|---|
| **Name** | **Rating** | **Name** | **Rating** | **Name** | **Rating** |
| Habib Bank Limited | AAA/A-1+ | Meezan Bank Limited | AA/A-1+ | Dubai Islamic Bank Pakistan Limited | A+/A-1 |
| National Bank of Pakistan | AAA/A-1+ | Askari Bank Limited | AA/A-1+ | The Bank of Khyber | A/A-1 |
| United Bank Limited | AAA/A-1+ | Faysal Bank Limited | AA/A-1+ | Summit Bank Limited | A-/A-1 |
| | | | | Sindh Bank Limited | AA/A-1+ |
| | | | | Silk Bank Limited | A-/A-2 |
| | | | | Bank Albaraka (Pakistan) Limited | A/A-1 |
| | | | | Samba Bank Limited | AA/A-1 |
| | | | | Burj Bank Limited | BBB+/A-2 |

**Analysts Contacts**

**Talha Iqbal Chhoangalia**
Senior Manager
talha.iqbal@jcrvis.com.pk

**Moiz Badshah**
Assistant Manager
moiz.badshah@jcrvis.com.pk