The Pakistan Credit Rating Agency Limited

SONERI BANK LIMITED

	NEW [JUNE-16]	PREVIOUS [JUNE-15]
Entity		
Long Term	AA-	AA-
Short Term	A1+	A1+
Outlook	Stable	Stable

REPORT CONTENTS

JUNE 2016

Profile & Ownership

- Soneri Bank Limited (SBL), incorporated in Sep91, is a small size commercial bank having 1.8% deposit share in the system
- Operating with a network of 266 branches and 274 ATMs across the country
- Feerasta Family – sponsors of Rupali Group – holds controlling stake (58%), followed by NIT (13%), while rest is spread across general public and others

Governance

- Eight member board including the CEO; two directors represent Feerasta Family, two are NIT nominees, while three are independent members

Management

- Experienced management team
- The President and CEO, Mr. Aftab Manzoor, carries over three decades of international banking experience; supported by COO, Mr. Amin A. Feerasta
- Operations divided into thirteen functions

Risk Management

- SBL is implementing T24 as core banking software (to be online by Jul17)
- During CY15, lending portfolio registered ~4% growth, mainly financed through deposits; corporate segment dominated the portfolio (73%); exposure to top-3 sectors witnessed a meager decline (CY15: 59%)
- The bank's advances to deposit ratio rationalized to 60% at end-Dec15; though higher than industry average; expected to remain range bound in medium term
- Top-20 private performing clients' concentration inched up (CY15: 27%, CY14: 26%); considered high when compared with AA rated banks
- During CY15, despite significant cash recovery, asset quality weakened; infection ratio increased to 10% (CY14: 9%); though subjectively classified as NPL
- During CY15, investment portfolio, comprising 48% of earning assets, witnessed ~44% YoY growth; dominated by government securities (98%); mix tilted towards T-bills; unrealized capital gains as of Mar16: PKR 3.1bln

Business Risk

- Performance trend maintained; net interest income registered 21% YoY growth on the back of volumetric increase in earning assets coupled with curtailed markup expense; however, spread reduced to 3.6% (CY14: 3.9%)
- Support from non-markup income (25% increase) a facet of gain on sale of investments augmented the revenue base
- Operating expenses (cost to total net revenue) reduced to 57% in CY15 (CY14: 66%) – a factor of one-off capital gains
- Despite significant increase in provisioning expense, the benefit of healthy revenue base helped the bank in posting healthy profits (PKR 2.2bln; up 40%)
- Going forward, management is focused on capitalizing CPEC opportunities through participation in consortiums. At the same time, low cost deposit mobilization drive will continue (branches target at end-CY16: 300)

Financial Risk

- Deposits increased by ~8% YoY with an addition of PKR 12bln; CASA slightly improved (end-Dec15: 69%, end-Dec14: 67%)
- Top-20 depositors' concentration marginally increased to 19% (CY14: 18%); still good in comparison to peer banks
- Overall liquidity position strengthened due to rise in risk free investments
- Capitalization remained healthy with CAR standing at 15.4% at end-Dec15; though declined at end-Mar16 – a factor of dividend payout

TFC Issue:

- SBL issued 2nd subordinated, unsecured, and listed TFC of PKR 3,000mln in Jul15 having a tenor of eight years. Profit rate is 6MK plus 135bps p.a. payable semi-annually in arrears. Principal repayment (99.7%) would be in bullet form at maturity (2023). SBL retains call option; exercisable in Jul20
- The issue carries a lock-in clause that stops payment if SBL falls below MCR. The instrument is also subject to loss absorbency
- Cushion to loss absorbency ranges from ~4% to 9%, incorporating the projections

RATING RATIONALE

The ratings reflect Soneri Bank's sustained business profile; system share in terms of deposits maintained. The bank's earning assets registered a growth – mainly in government securities – funded by money market borrowings and deposits. ADR rationalized, yet remained healthy versus industry average. With sizeable government securities exposure, capital gains augmented the bottom-line. Thus the bank's profitability maintained its upward trajectory; however, spreads came down – an industry wide phenomenon. Going forward, the bank, while focusing to improve asset quality, intends to follow a conservative strategy in terms of advances growth. Enhancing non-fund based exposure, in turn fee income, would be focused while capitalizing on potential business opportunities expected from China-Pakistan Economic Corridor. At the same time, the strategy would be to mobilize low-cost deposits; branch network is targeted to increase to 300 by end-Dec16. The bank maintained sound liquidity and good risk absorption capacity. However, dividend pay-out declined the capital adequacy ratio (15% at end-Dec15) at end-Mar16; this needs effective monitoring going forward.

KEY RATING DRIVERS

The rating is dependent on the bank's ability to maintain its market position in banking industry while strengthening its overall risk profile. Bringing efficiency in overall operational structure is important to rationalize costs. In comparative landscape, adding granularity to core operations - deposits and advances - is critical. Meanwhile, increase in system share would be ratings positive.

STANDARD RATING SCALE & DEFINITIONS

Credit rating reflects forward-looking opinion on credit worthiness of underlying entity or instrument; more specifically it covers relative ability to honor financial obligations. The primary factor being captured on the rating scale is relative likelihood of default.

Long Term Ratings

AAA	**Highest credit quality.** Lowest expectation of credit risk. Indicate exceptionally strong capacity for timely payment of financial commitments. This capacity is highly unlikely to be adversely affected by foreseeable events.
AA+ **AA** **AA-**	**Very high credit quality.** Very low expectation of credit risk. Indicate very strong capacity for timely payment of financial commitments. This capacity is not significantly vulnerable to foreseeable events.
A+ **A** **A-**	**High credit quality.** Low expectation of credit risk. The capacity for timely payment of financial commitments is considered strong. This capacity may, nevertheless, be vulnerable to changes in circumstances or in economic conditions.
BBB+ **BBB** **BBB-**	**Good credit quality.** Currently a low expectation of credit risk. The capacity for timely payment of financial commitments is considered adequate, but adverse changes in circumstances and in economic conditions are more likely to impair this capacity.
BB+ **BB** **BB-**	**Speculative.** Possibility of credit risk developing. There is a possibility of credit risk developing, particularly as a result of adverse economic change over time; however, business or financial alternatives may be available to allow financial commitments to be met.
B+ **B** **B-**	**Highly speculative.** Significant credit risk. A limited margin of safety remains against credit risk. Financial commitments are currently being met; however, capacity for continued payment is contingent upon a sustained, favorable business and economic environment.
CCC **CC** **C**	**High default risk**. Substantial credit risk "CCC" Default is a real possibility. Capacity for meeting financial commitments is solely reliant upon sustained, favorable business or economic developments. "CC" Rating indicates that default of some kind appears probable. "C" Ratings signal imminent default.
D	Obligations are currently in default.

Short Term Ratings

A1+: The highest capacity for timely repayment.

A1:. A strong capacity for timely repayment.

A2: A satisfactory capacity for timely repayment. This may be susceptible to adverse changes in business, economic, or financial conditions.

A3: An adequate capacity for timely repayment. Such capacity is susceptible to adverse changes in business, economic, or financial conditions.

B: The capacity for timely repayment is more susceptible to adverse changes in business, economic, or financial conditions.

C: An inadequate capacity to ensure timely repayment.

Rating Watch
Alerts to the possibility of a rating change subsequent to, or in anticipation of, a) some material identifiable event and/or b) deviation from expected trend. But it does not mean that a rating change is inevitable. Rating Watch may carry designation – Positive (rating may be raised, negative (lowered), or developing (direction is unclear). A watch should be resolved with in foreseeable future, but may continue if underlying circumstances are not settled.

Outlook (Stable, Positive, Negative, Developing)
Indicates the potential and direction of a rating over the intermediate term in response to trends in economic and/or fundamental business/financial conditions. It is not necessarily a precursor to a rating change. 'Stable' outlook means a rating is not likely to change. 'Positive' means it may be raised. 'Negative' means it may be lowered. Where the trends have conflicting elements, the outlook may be described as 'Developing'.

Suspension
It is not possible to update an opinion due to lack of requisite information. Opinion should be resumed in foreseeable future. However, if this does not happen within six (6) months, the rating should be considered withdrawn.

Withdrawn
A rating is withdrawn on a) termination of rating mandate, b) cessation of underlying entity, c) the debt instrument is redeemed, d) the rating remains suspended for six months, or e) the entity/issuer defaults.

Name of Issuer	SONERI BANK LIMITED (SBL)
Sector	Banking
Type of Relationship	Solicited
Purpose of the Rating	Independent Risk Assessment Regulatory Requirement

Rating History

Dissemination Date	Long Term	Short Term	Outlook	Action
17-Jun-16	AA-	A1+	Stable	Maintain
17-Jun-15	AA-	A1+	Stable	Maintain
17-Jun-14	AA-	A1+	Stable	Maintain
26-Jun-13	AA-	A1+	Stable	Maintain
22-Jun-12	AA-	A1+	Stable	Maintain
27-Jun-11	AA-	A1+	Stable	Maintain

Related Criteria and Research

Rating Methodology	Bank Rating Methodology
Sector Research	Banking Sector - Viewpoint | Dec-15

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Rating Team Statement

Rating Procedure

Rating is an opinion on relative credit worthiness of an entity or debt instrument. It does not constitute recommendation to buy, hold or sell any security. The rating team for this assignment does not have any beneficial interest, direct or indirect in the rated entity/instrument.

Disclaimer

Rating Shopping

PACRA maintains principle of integrity in seeking rating business.

PACRA has used due care in preparation of this document. Our information has been obtained directly from the underlying entity and public sources we consider to be reliable but its accuracy or completeness is not guaranteed. PACRA shall owe no liability whatsoever to any loss or damage caused by or resulting from any error in such information.

Conflict of Interest

PACRA, 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 done by them

The analysts involved in the rating process do not have any interest in a credit rating or any of its family members has any such interest

The analysts and members of the rating committees including the external member members have disclosed all the conflict of interest, including those of their family members, if any, to the Compliance Officer PACRA

The analysts or any of its family members do not buy or sell or engage in any transaction in any security which falls in the analyst's area of primary analytical responsibility. This is, however, not applicable on investment in securities through collective investment schemes. PACRA has established appropriate policies governing investments and trading in securities by its employees

PACRA may provide consultancy/advisory services or other services to any of its clients or to any of its clients' associated companies and associated undertakings that is being rated or has been rated by it. In such cases, PACRA has adequate mechanism in place ensuring that provision of such services does not lead to a conflict of interest situation with its rating activities

PACRA receives compensation from the entity being rated or any third party for the rating services it offers. The receipt of this compensation has no influence on PACRA's opinions or other analytical processes. In all instances, PACRA is committed to preserving the objectivity, integrity and independence of its ratings. Our relationship is governed by two distinct mandates i) rating mandate - signed with the entity being rated or issuer of the debt instrument, and ii) fee mandate - signed with the payer, which can be different from the entity

PACRA ensures that the credit rating assigned to an entity or instrument should not be affected by the existence of a business relationship between PACRA and the entity or any other party, or the non-existence of such a relationship

Surveillance

PACRA monitors all the outstanding ratings continuously and any potential change therein due to any event associated with the rated entity/ issuer, the security arrangement, the industry etc, is disseminated to the market, in a timely and effective manner, after appropriate consultation with the entity/issuer

PACRA reviews all the outstanding ratings on annual basis or as and when required by any stakeholder (including creditor) or upon the occurrence of such an event which requires to do so

PACRA initiates immediate review of the outstanding rating(s) upon becoming aware of any information that may be reasonable be expected to result in any change (including downgrade) in the rating

Reporting of Misconduct

PACRA has framed and implemented whistle-blower policy encouraging all employees to intimate the compliance officer any unethical practice or misconduct relating to the credit rating by another employees of the company that came to his/her knowledge. The Compliance Officer reports to the BoD and SECP

Confidentiality

PACRA has framed a confidentiality policy to prevent abuse of the non-public information by its employees and other persons involved in the rating process, sharing and dissemination of the non-public information by such persons to outside parties

Where feasible and appropriate, prior to issuing or revising a rating, PACRA informs the issuer of the critical information and principal considerations upon which a rating will be based and provide the opportunity to clarify any likely factual misperception or other matter that PACRA would wish to be made aware of in order to produce a fair rating. PACRA duly evaluates the response. Where in a particular circumstance PACRA has not informed the entity/issuer prior to issuing or revising a rating, it informs the entity/issuer as soon as practical thereafter

Prohibition

Probability of Default (PD)

PACRA's Rating Scale reflects the expectation of credit risk. The highest rating has the lowest relative likelihood of default (i.e, probability). PACRA's transition studies capture the historical performance behavior of a specific rating notch. Transition behavior of the assigned rating can be obtained from PACRA's Transition Study available at our website. (www.pacra.com). However, actual transition of rating may not follow the pattern observed in the past