Silk Bank Limited

RATING REPORT

REPORT DATE:
July 1, 2016

RATING ANALYSTS:
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RATING DETAILS

Rating Category	Latest Rating		Previous Rating	
	Long-term	Short-term	Long-term	Short-term
Entity Rating	A-	A-2	A-	A-2
Outlook	Stable		Stable	
Date	*June 30, '16*		*June 30, '15*	

COMPANY INFORMATION

Year of Establishment: 1994	**External auditors:** Deloitte Yousuf Adil, 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 (32.87%)	
Shaukat Tarin (14.18%)	
International Finance Corporation (9.01%)	
Zulqarnain Nawaz Chattha (8.69%)	
Zubair Nawaz Chattha (5.33%)	

APPLICABLE METHODOLOGY(IES)

PRIMER - Commercial Banks (December 2001):*http://jcrvis.com.pk/images/primercb.pdf*

Silk Bank Limited

OVERVIEW OF THE INSTITUITION

Arif Habib Corporation Limited (AHCL) is the largest sponsor of the bank with 32.87% shareholding of Silk. Mr. Zulqarnain Nawaz Chattha and Zubair Nawaz Chattha, representatives of Gourmet Group, have a combined shareholding of 14.02%. Mr. Shaukat Tarin, Advisor to the Chairman is the other primary sponsor of the Bank.

At year-end'2015, Silk had a branch network of 88 branches (2014: 88 branches), which includes 10 (2014: 10) Islamic branches.

RATING RATIONALE

Silk Bank Limited (Silk) raised Rs. 8b through issuance of rights shares (Rs. 2b had already been received as advanced against shares from potential investors in 2014) in 2015. Resultantly, shareholding pattern has witnessed change. During 2015 and 1Q16, additional liquidity generated by way of equity injection and increasing deposits & borrowing has largely been deployed towards government securities. Resultantly, proportion of investments has increased to 29% (2014: 18%) at end-1Q16. Risk emanating from investment portfolio is considered manageable given the sizeable investment in government securities. Financing portfolio still represents the largest component of the asset base at 42% at end-1Q16. Non-banking assets (NBAs) acquired in lieu of settlement against non-performing loans doubled to Rs. 11.9b (2014: Rs. 5.2b) at end-2015. Resultantly, non-earning assets in relation to total assets and equity is sizeable at 10.8% and 130.9%, respectively at end-1Q16.

Going forward, Silk plans to expand branch network through 60 new branches during 2016 while another 60 are targeted to be opened during 2017. Branch expansion strategy entails opening of low cost (smaller & efficient branches) & current account centric branches. Surplus employees from existing pool are planned to be deployed in new branches with limited increase in administrative expenses (6% increase) projected on account of branch expansion.

Rating Drivers

Asset Quality

Corporate: Largest sectoral exposures of the bank were against real estate, sugar and textile sectors. Lending to the textile sector declined as part of a deliberate strategy to curtail exposure to export oriented sectors. Despite sizeable recoveries, non-performing financing have increased indicating fresh classification. Less than one-tenth of the performing portfolio comprises clients with weak risk profiles and requiring close monitoring. In order to improve portfolio quality, management intends to reduce exposure against weak Obligor Risk Rating clients and cultivate new relationships with relatively better ORR. Going forward, management intends to pursue a conservative lending strategy and consolidate the corporate portfolio with reduction in portfolio size targeted by end-2016. Corporate advances product mix is targeted to shift towards trade loans/self-liquidating credit lines.

Consumer & SME: Consumer portfolio depicted healthy growth across all products during 2015 and now represents around one-fifth of the financing portfolio. Net infection levels have been maintained at manageable levels at 1.2%. The segment has contributed significantly to the bank's profitability. Fresh lending in the SME portfolio has remained limited with increase in infection largely a function of reduction in portfolio.

Liquidity: Deposit mobilization has picked pace during 2015 and in the ongoing year; proportion of CASA has remained around prior year level at 54%. However, deposit concentration has increased on a timeline basis and continues to be on the higher side. Equity injection and lower advances to deposit ratio (ADR) has translated into liquid assets in relation to deposits and borrowings (adjusted for repo) increasing to 27% at end-2015 (2014: 18%). Given the high depositor concentration levels and ADR, liquidity cushion in the form of higher liquid assets may need to be maintained on the balance sheet. Achievement of plan submitted to SBP for realization of NBA of Rs. 5.8b in 2016 will facilitate in achieving the same.

Capitalization: Reported capitalization indicators of the bank have improved on a timeline basis with the Bank now being MCR and CAR compliant. MCR and CAR was reported at Rs. 11.3b and 10.83%, respectively at end-1Q16. The bank intends to manage growth in risk weighted assets through limited increase in corporate portfolio and has projected internal profitability to be sufficient to meet increasing capital requirements.

Profitability: Operating loss of the bank witnessed a significant increase to Rs. 970m (2014: loss of Rs. 120m) during 2015. Higher operating loss is attributable to decline in mark-up income (due to reversal of income booked on musharaka transactions and declining interest rates) and increase in administrative expenses. Accounting for provisions against financing and NBAs, the bank incurred a loss of Rs. 1.8b. Trend in operating losses has reversed during 1Q16 primarily on account of higher net interest (due to declining cost of deposit & reversal of suspended mark-up) and fee based income. Trend in operating profitability in the backdrop of aggressive branch expansion, declining banking sector spreads and asset quality indicators will be tracked by JCR-VIS.

Silk Bank Limited

FINANCIAL SUMMARY *(All figures in PKR millions unless stated otherwise)*			Appendix I
BALANCE SHEET	**DEC 31, 2015**	**DEC 31, 2014**	**DEC 31, 2013**
Total Investments	34,999	18,105	14,853
Advances	61,074	58,966	56,038
Total Assets	133,137	102,736	91,770
Borrowings	33,230	21,742	11,382
Deposits & other accounts	81,098	68,770	69,433
Subordinated Loans	-	-	-
Tier-1 Equity	11,607	5,312	3,384
Net Worth	14,577	8,501	6,675
INCOME STATEMENT	**DEC 31, 2015**	**DEC 31, 2014**	**DEC 31, 2013**
Net Mark-up Income	3,099	3,460	2,160
Net Provisioning	724	368	633
Non-Markup Income	1,894	1,720	1,325
Operating Expenses	6,109	4,681	4,379
(Loss) / Profit Before Tax	(1,839)	131	(1,528)
(Loss) / Profit After Tax	(1,712)	87	(1,157)
RATIO ANALYSIS	**DEC 31, 2015**	**DEC 31, 2014**	**DEC 31, 2013**
Market Share (Advances) (%)	1.4%	1.4%	1.5%
Market Share (Deposits) (%)	0.8%	0.8%	0.9%
Gross Infection (%)	12.7%	12.8%	16.1%
Total Provisioning Coverage (%)	70.1%	66.3%	55.0%
Net Infection (%)	5.0%	5.4%	8.4%
Cost of deposits (%)	5.51%	6.27%	5.94%
Net NPLs to Tier-1 Capital (%)	25.3%	55.7%	128.7%
Capital Adequacy Ratio (C.A.R (%))	13.84%	9.14%	6.93%
Markup Spreads (%)	3.79%	3.42%	2.24%
Efficiency (%)	122.6%	102.6%	141.0%
ROAA (%)	(1.5)%	0.09%	-
ROAE (%)	(17.5)%	1.3%	-
Liquid Assets to Deposits & Borrowings (%) *	27.1%	18.5%	24.3%
***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	Outlook	Short Term	Rating Action
RATING TYPE: ENTITY				
30-Jun-16	A-	Stable	A-2	Reaffirmed
30-Jun-15	A-	Stable	A-2	Reaffirmed
18-Dec-14	A-	Stable	A-2	Rating Watch Removed
30-Jun-14	A-	Rating Watch – Developing	A-2	Rating Watch – Developing
29-Jun-13	A-	Stable	A-2	Maintained
22-Oct-12	A-	Rating Watch – Developing	A-3	Maintained
18-Aug-11	A-	Rating Watch – Developing	A-2	Reaffirmed
25-Feb-11	A-	Rating Watch – Developing	A-2	Maintained
05-Aug-13	A-		A-2	Rating Watch - Positive

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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