

ASKARI COMMERCIAL BANK LIMITED (ACBL)

RATINGS (JUNE 2006)

ASKARI COMMERCIAL BANK LIMITED

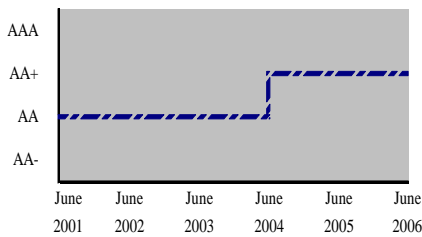
	NEW	PREVIOUS
ENTITY		
Long Term	AA+	AA+
Short Term	A1+	A1+

TFCs

Unsecured, subordinated

1 st Issue (PKR 1,500mln)	AA	AA
2 nd Issue (PKR 1,500mln)	AA	AA

LT ENTITY RATING - HISTORY



FINANCIAL DATA

PKR (mln)

	31-Dec-05	31-Dec-04
Total Assets	145,099.9	107,167.5
Equity	7,369.1	5,573.1
Net Income	2,022.0	1,923.0
ROA %	1.60	2.00
ROE %	31.25	40.59
Equity/ Total Assets %	5.08	5.20
SBP CAR	11.00	8.53

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TFC ISSUE

Askari bank has issued unsecured subordinated TFCs of PKR 1,500mln each for a tenor of 8 years in February 2005 and October 2005. The profit payment is made semi-annually, based on 6-month KIBOR plus 150bps. The principal will be redeemed in a bullet payment at the maturity of the instrument. The TFC holders are exposed to a relatively higher risk, as the obligations towards the TFC holders are subordinate to those of other creditors including depositors of the bank.

RATING RATIONALE

ASSESSMENT

- The ratings reflect the bank's largely sustained core performance and very good asset quality, which despite experiencing certain deterioration lately was preserved owing to sizeable general provision for potential loan losses. The bank, while maintaining its cautious stance towards entering new avenues, intends to strengthen its position within the retail banking segment – low cost deposit mobilization and high margin consumer financing – to improve its competitiveness. The ratings also recognize the management's efforts of continuously strengthening the risk management systems.
- ACBL expanded its network mainly in the last quarter of 2005 to 99 branches (end-04: 75). The bank, at the same time, maintained consistent growth during the year (Total assets ↑: 35.4%), which helped in improving its system share. Meanwhile, in contrast to some of its peers, the bank reduced its credit-to-deposit ratio (net of export refinance: end-05: 66%, end-04: 75%). For credit expansion, ACBL maintained its focus on SMEs and consumer finance, which while providing volume growth, also helped in spread management. Although increasing concentration in consumer financing entails higher risk, the continuing focus on personal loans to corporate employees and increasing focus on mortgage loans has enabled the bank to keep delinquencies in consumer portfolio at relatively lower levels. Meanwhile, a relatively higher proportion of trade finance in the total working capital also translates into low credit risk.
- The bank's performance, in terms of both ROA and ROE, declined during 2005 primarily in the absence of one off sizeable capital gains realized during the previous year. However, the performance based on core operations showed a marginal improvement. NIMR increased in line with rising spreads and volume growth. The bank's spreads, though increasing modestly YoY, could not match some of its peers primarily due to higher cost of funds, mainly an outcome of declining proportion of demand deposits. At the same time, there was almost a threefold increase in time deposits, which otherwise are benefiting the bank as a stable source of funding. The non-fund based income (net of capital gains) also exhibited growth mainly on the back of foreign trade business on account of enhanced trade volume. The bank, with increased focus on the treasury function, also achieved significantly higher income from dealing in foreign currencies. This resulted in a moderate YoY increase in pre provision operating profit despite a marginal increase in cost-to-total net revenue. Although there was a decrease in effective tax rate, emanating from 3pp reduction in statutory tax rate and a positive adjustment relating to prior years, the bottom line was subdued due to significantly higher specific provisioning during the year. Performance trends in 1Q06 do not indicate any buoyancy given the limited increase in NIMR and higher provisioning.
- Going forward, the management, while maintaining measured growth through branch expansion including Islamic branches plans to lower its relatively higher cost of funds mainly by focusing on small individual accounts, which were not targeted previously. For the expansion of its loan book, the bank's primary reliance would remain on self-liquidating trade financing mainly for second tier clients. Meanwhile, the bank is also planning to launch auto finance, a relatively low risk segment in consumer finance. These initiatives are likely to ease some pressure on spreads and help in achieving growth in profitability.
- The bank's asset quality deteriorated on YoY basis in terms of NPLs to finances 2.6% (end-04: 1.5%). This was mainly due to three clients classified during the year. The bank made prudential provisioning against these accounts in 2005. In addition to the existing sizable general provision, specific provision will also be enhanced to meet the potential loss on these accounts. The overall quality of the asset portfolio remains good as reflected in the nominal net NPLs as a proportion of equity ratio at end-March06. Meanwhile, the bank, in accordance with the BASEL II requirements, is developing a risk management strategy that would expand into a comprehensive formulation of risk management policies and procedures for assessing, and monitoring potential risks. The process involves detailed study of the existing risk review and risk management functions within the bank and is being jointly carried out with a consultant. An independent Risk Management Division has already been established to oversee the whole exercise and implement the recommendations. The bank is also taking IT initiatives in terms of acquiring a new customized system particularly for consumer and Islamic operations, which is likely to be implemented by the end-07.
- The bank's equity in total assets experienced minor deterioration with significant increase in assets base during 2005. However, the Capital Adequacy Ratio exhibited substantial improvement due to issuance of unsecured subordinated TFCs during the year and considerable revaluation surplus on listed equities at end-05 – tier II capital. Going forward, the bank, with higher level of CAR, retains sufficient cushion for future growth.

BACKGROUND

- ACBL, operating with a countrywide network of 98 branches plus one offshore banking unit at end-2005, commenced its operations in 1992. Army Welfare Trust (AWT) remains its principal shareholder controlling the Board of Directors through its nominees. AWT has business interests spread across a wide range of economic and industrial sectors.
- ACBL offers a full range of commercial banking services to the corporate, middle market and retail segments. The bank has established an image of efficiency and professionalism, attributable in part to its policy of maximum technology utilization – offering facilities such as online real-time banking, ATMs, internet and telephone banking, and cash management services. Offshore banking unit in Bahrain, established with the primary objective of capacity building of the bank, has started generating profits, though the contribution is modest. The asset base of the bank has grown steadily over the years and ACBL has emerged as one of the ten local banks with asset base of over one billion rupees. While the bank continues to rely on organic growth, the management continues to explore the options of an acquisition that would lead to a quantum leap in the bank's size
- The new president, subsequent to the completion of term of the previous one, assumed the office in March06. However, except this change, the senior management – comprising experienced and distinguished bankers – has remained the same. While the new president has extensive banking experience – including two years in ACBL – he faces a daunting task of preserving the bank's relative positioning in the fast changing sector dynamics.