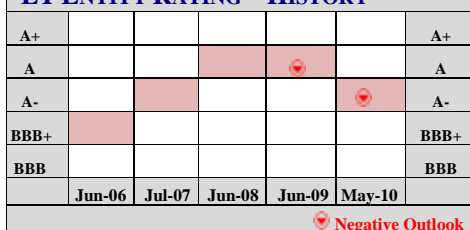


**RATINGS (JUNE 2010)**
**KASB BANK LIMITED (KBL)**

	New	Previous
<b>Entity</b>		
Long Term	A-	A
Short Term	A2	A1
<b>Proposed TFC Issue (PKR 1,000mln)</b>	BBB+	A-
<i>unsecured, subordinated.</i>		
<b>Outlook</b>	Negative	Negative

**LT ENTITY RATING - HISTORY**

A+					A+
A					A
A-					A-
BBB+					BBB+
BBB					BBB
	Jun-06	Jul-07	Jun-08	Jun-09	May-10
					

 **Negative Outlook**
**FINANCIAL DATA**
**(PKR IN MLN)**

	31-Mar-10 <sup>^</sup>	31-Dec-09	31-Dec-08
Total Assets	60,070	59,223	51,799
Equity	4,150	4,504	8,813
Net Income (Loss)	(360)	(4,228)	(973)
ROA (%)	(2.4)*	(7.6)	(2.1)
ROE (%)	(33.3)*	(63.5)	(15.0)
Equity / Total Assets (%)	6.9	7.6	17.0
SBP CAR(%)	2.5	3.5	9.1

<sup>^</sup> Based on un-audited results for 3 months ended Mar 31, 2010

\* ROE and ROA are simple annualized

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**PROFILE**

- KASB Bank Limited, incorporated in October 1994 and listed on all three stock exchanges, was acquired by KASB group in October 2002. The KASB Group, established by Khadim Ali Shah Bukhari in 1958, has a sizeable portfolio of investments in financial sector. However, the financial profile of most of group companies has come under stress in recent periods owing to difficult market conditions.
- Mr. Mr. Nasir Ali Shah Bukhari, the chairman of the board, has an experience of around three decades in financial markets. Lately, the group has signed an agreement with Asia International Finance, a china based group for an initial investment of US\$40mln in KASB group, of which major portion would flow into KASB Bank. The transaction, on timely completion is expected to help revive the bank's financial profile.
- The chief executive, Mr. Muneer Kamal is an experienced banker with a distinguished profile. He is assisted by a core team of experienced professionals, which has been recently fortified by induction of Mr. Masood Karim Shaikh, a seasoned banker, as COO. The bank is operating with a branch network of 100 (CY08:73; CY07: 35).

**RATING RATIONALE AND KEY DRIVERS**

- The ratings of the bank reflect substantially weakened risk absorption capacity – a consequence of significant business losses and deterioration in asset quality. Moreover, high level of non earning assets, mainly NPLs and strategic equity investments, reflect subdued performance prospects. Cognizant of this, the management is in the process of bringing fresh capital in the bank through issuance of right shares. The restructuring of group investments is also expected to be finalized over the near term. However, timely execution of the management's initiatives seems challenging. The ratings draw comfort from the vigilance and pro-activeness of the apex regulator – SBP.
- The outlook on the ratings remains negative and is dependent upon ability of the bank to revive its risk absorption capacity and bring it to an adequate level, while meeting regulatory capital requirements. At the same time, success in building up the bank's franchise and returning to profitable core operations would be critical.

**ASSESSMENT**

- Although most of the banking industry managed to sustain its risk profile in the backdrop of subdued socio-economic environment barring few small banks, CY09 proved to be quite challenging for KASB Bank Limited. The growth in loan book remained limited. The bank also suffered significant business losses owing to relatively higher level of provisioning against i) loan losses, ii) impairment of goodwill, and iii) diminution in value of strategic investments.
- On account of significant deterioration in quality of loan book and other wise bank's relatively higher cost of funding, the earning capacity of the bank was negatively impacted. The weighted average spreads were negligible (CY09: 0.24%; CY08: 0.26%). Though the average cost of deposits has decreased in 1Q10, a continuous improvement in spreads remains to be seen. Meanwhile, the other operating income provided cushion to total net revenues. However, the bank incurred a pre provisioning operating loss as operating expenses increased significantly mainly owing to branch expansion costs. Provisioning expense remained high, despite the bank availing 40% FSV benefit against provisioning amounting to PKR 608mln and another relaxation from SBP for provisioning against Dewan Mushtaq Group of around PKR243mln in CY09.
- The asset quality has remained critical issue for the whole banking sector, particularly for medium to small banks in recent periods. KBL has witnessed significant deterioration in its asset quality (Non Performing Loans (NPL) as percentage of Gross Finances: 20.0% at end Mar-10; 21.9% at end Dec-09; 17.7% at end Dec-08). Majority of impaired loan book is constituted by textile, real estate and trading related businesses, which were most hit during recent economic crises. Nevertheless, the bank is actively pursuing the infected portfolio and has booked a reversal of PKR 448mln in provisioning in 1QCY10 [Provisioning expense net of reversal: PKR 60.8 mln] and PKR 864mln in CY09 [Provisioning expense net of reversal: PKR 1,295mln]. While the concentration in top twenty exposures, mainly corporates, reduced to 31% of the loan book in CY09 (CY08: 42%), it is primarily dominated by more vulnerable sectors interalia, textile and construction.
- Going forward, the management, while improving the quality of service, intends to fully leverage its lately expanded branch network to mobilize fresh deposits and retain existing ones at low cost. The bank has also started fresh disbursements in 1QCY10 and targeting a rather optimistic growth in advances. In the near future, major focus of the bank would remain on, a) recovery of infected loans, b) low-cost deposit mobilization, and c) improvement in other income through transactional banking.
- During CY09, the bank successfully increased the deposit base to PKR 44bln (1QFY10: PKR 47 bln). However, high proportion of time deposits still remains a concern for the bank. Deposit concentration has increased, as top 20 depositors constitute 36% (CY08: 24%) of total deposits.
- The equity of the bank is tied up in financing the sizeable non-earning assets, which essentially reflects minimal cushion against any shock arising from the bank's core operations. The delays in plan to migrate the non-earning investments to the holding company structure has not only impacted the capital adequacy of the bank (CAR at end Mar-10: 2.5%; at end Dec-09: 3.5%), but also put a constraint on free earning resources of the bank. Similarly the bank is also non compliant to minimum capital requirement. At the same time, the net NPL to Equity stands at 79% at end Mar10, reflecting potential drag on KBL's weakening risk absorption capacity.
- The management of the bank, cognizant of deteriorating risk absorption capacity is working on a capital injection plan wherein the bank's capital base would be enhanced through i) fresh equity injection by issuance of right shares of around PKR 3,000mln, ii) divestment of few subsidiaries by Dec-10 - this would also free up certain capital that would support CAR, and iii) issuance of a subordinated TFC to strengthen its CAR. However, timely execution of these plans remains a challenging task.

**TFC ISSUE**

- The bank plans to issue, unsecured and subordinated TFCs of PKR 1,000mln for a period of 5.5 years with an interest of KIBOR plus 3.5% payable semi-annually. The TFC is expected to be issued after completion of right issue. The TFC holders would be exposed to relatively higher risk due to subordinate nature of the instrument.