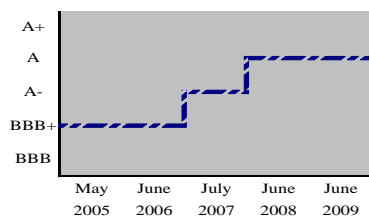


**RATINGS (SEPTEMBER 2009)**
**KASB BANK LIMITED (KBL)**

	New	Previous
<b>Entity</b>		
Long Term	A	A
Short Term	A1	A1
<b>Proposed TFC</b>		
<b>Issue (PKR 1,250mln)</b> <i>unsecured, subordinated, and privately placed</i>	A-	-
<b>Outlook</b>	Negative	-

**LT ENTITY RATING – HISTORY**

**FINANCIAL DATA**
*(Amounts in PKR mln)*

	31-Jun-09*	31-Dec-08	31-Dec-07
Total Assets	60,287	51,799	40,891
Equity	7,926	8,813	4,172
Net Income (Loss)	(898)	(973)	198
ROA (%)	(3.2)*	(2.1)	0.6
ROE (%)	(21.5)*	(15.0)	6.2
Equity / Total Assets (%)	13.1	17.0	10.2
SBP CAR(%)	7.5	9.0	12.3

*\* Based on un-audited results for 6 months ended Jun 30, 2009*
*\* 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. The bank's seven member Board of Directors (BOD) has diverse experience and background and is involved in the development of the bank's strategy and monitors its execution. The chief executive, Mr. Muneer Kamal is an experienced banker with a distinguished profile. A core team of experienced professionals assists him. The bank is operating with a branch network of 73 (CY07: 35).

**RATING RATIONALE AND KEY DRIVERS**

- The ratings recognize the bank's quality management team, improving systems and controls, and expanding outreach. Cognizant of the bank's inherent limitations – moderate size, emergent network, and high funding costs – the management is in the process of developing a workable strategy in view of changing business dynamics while actively focusing on preserving its asset quality.
- The outlook on the ratings is negative, which highlights the possible deterioration in the bank's risk absorption capacity due to infection in its loan book. Moreover, as the sizeable investment portfolio, inherited on merger is non-earning, timely completion of ongoing restructuring activity at group level is important to free up bank's resources and focus on core business operations. At the same time, success in building up the bank's franchise and controlling respective costs so as to overcome constraints and translate balance sheet consolidation into higher profitability remains to be seen.

**ASSESSMENT**

- KBL underwent a major merger activity with KASB Capital Limited (KCL) – a group company with expertise in investment banking and private equity deals – and Network Leasing Corporation in 2008, accumulating additional assets of PKR 4.8 bln for the bank. This merger was primarily driven by increasingly challenging operating environment and higher regulatory capital requirements. Given the current economic environment and relatively gestation phase of most of acquired investments, the earning ability is minimal.
- The loan book of KBL witnessed significant growth in 2008, mainly on account of increase in lending to wholesale and retail trade sector. The segment wise composition of the loan portfolio remained largely the same (corporate sector: 81%; SME: 10%; Consumer: 6%). While the concentration in top twenty exposures, mainly corporates, remained high (42% of the loan book), it is primarily dominated by more vulnerable sectors interalia, textile and construction.
- Lately, asset quality has emerged as the key issue for the whole banking sector, particularly for medium to small banks. KBL has witnessed significant deterioration in its asset quality (Non Performing Loans (NPL) as percentage of Gross Finances: 19.3% at end-Jun09; 17.7% at-end-Dec08). Majority of impaired loan book is constituted by textile, real estate and trading related businesses, which were most hit during recent economic crises. Meanwhile, sizeable amount of watch list accounts, if turned bad, may further drag the risk absorption capacity of the bank.
- KBL's core performance is dragged down by its weak spreads, attributable to high cost of deposits. At the same time, continuous deterioration in KBL's loan book is also negatively impacting the earning capacity of the bank (NIMR: -286.9mln at endJun09). Given, the bank's reliance on high cost deposits, spreads are expected to further weaken in the near term
- In this regard, the management, while improving the quality of service, intends to fully leverage its lately expanded geographically diversified network to mobilize fresh deposits and retain existing ones at low cost. In the medium to short term, the management of the bank is targeting minimal growth in advances. Currently, KBL has put on hold its core lending business. Going forward, major focus would remain on, a) recovery of infected loans, and b) low-cost deposit mobilization.
- Risk management framework of KBL follows an enterprise-level approach underpinned by centralization of operations and sophisticated IT solutions. The bank is using Misys Equation as its core software, which is completely implemented in all the branches and the head office. Risk rating of the entire Wholesale Banking portfolio is complete.
- KBL was impacted by the liquidity crunch experienced in the financial sector in 4Q08. Its deposit base reduced to PKR35bln in Dec08 from PKR 47bn in Sep08. As a result it faced difficulties managing its liquidity (ADR at end-08: 92%). However, the bank has successfully increased the deposit base to PKR 43bln at end-Jun09 and its ADR now stands at 73%. Deposit concentration is moderate, as top 20 depositors constitute 24% of total deposits. Liquidity has improved as reflected by Liquid Assets to Funding ratio (30% at end-Jun09; 11.8% at-end Dec08).
- The bank's capital has increased following the merger. However, this has not benefited the CAR. The sponsoring group is working on establishing financial holding company structure, wherein the bank would spin off strategic investments (asset management company, brokerage house, Modaraba management, and non-financial corporates) to the holding company, KASB Finance Limited. This would also free up certain capital that would support CAR. Meanwhile, the bank is planning to issue a subordinated TFC to strengthen its CAR, while supporting the liquidity. At the same time, the net NPL to Equity stands at 38% at end-Jun09, reflecting potential drag on KBL's risk absorption capacity.

**TFC ISSUE**

- The bank plans to issue privately placed, unsecured and subordinated TFCs of PKR1,250 mln, to support its business operations and maintain its capital adequacy ratio at statutory level.(CAR at end-Jun09: 7.48%; after incorporating the proposed issue: 10.11%) for a period of 5.5 years. The interest would be payable semi-annually at the rate of 6-month KIBOR plus 3.5% without any cap or floor. Major portion of principal would be redeemed in the form of a bullet payment at maturity.