

RATINGS (JUNE 2011)
KASB BANK LIMITED (KBL)

	New	Previous
Entity		
Long Term	BBB	A-
Short Term	A3	A2
Proposed TFC Issue(PKR 1,500mln)	BBB-	BBB+
<i>Listed, rated, unsecured, and subordinated.</i>		

LT ENTITY RATING - HISTORY					
A+					A+
A					A
A-					A-
BBB+					BBB+
BBB					BBB
	Jun-07	Jun-08	Jun-09	May-10	Jun-11

Outlook Negative Negative

FINANCIAL DATA (PKR IN MLN)

	31-Mar-11*	31-Dec-10	31-Dec-09
Total Assets	57,512	56,429	59,223
Equity	1,287	1,830	4,504
Net Income (Loss)	(549)	(2,711)	(4,228)
ROA (%)	(3.9)*	(4.7)	(7.6)
ROE (%)	(141.0)*	(85.6)	(63.5)
Equity / Total Assets (%)	2.2	3.2	7.6
SBP CAR(%)	(6.2)	(3.6)	3.5

* Based on un-audited results for 3 months ended Mar 31, 2011

* ROE and ROA are simple annualized

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PROFILE

- KASB Bank Limited, incorporated in October 1994, was acquired by KASB group in October 2002. The KASB Group, established by (Late) Khadim Ali Shah Bukhari in 1958, has a sizeable portfolio of investments in financial sector. However, most group companies could not cope well with prevalent difficult market conditions and their financial profile are under stress.
- Mr. Nasir Ali Shah Bukhari, the chairman of the board, has an experience of around three decades in financial markets. Lately, the group has received US\$40mln from Asia International Finance (AIF), a China based group. The money would mainly flow into KASB Bank. Post completion of the proposed right issue, KASB Bank would be 82% owned by KASB Finance, which in turn is equally owned by KASB Family and AIF. The sponsors are making efforts to introduce other foreign investors to the bank.
- The acting Chief Executive, Mr. Munir Saleem, is an experienced banker with a distinguished profile. He is assisted by a core team of experienced professionals. The bank is operating with a network of 104 branches.

RATING RATIONALE AND KEY DRIVERS

- The ratings reflect significant deterioration in bank's risk absorption capacity, a consequence of less than adequate level of capitalization, and high level of infected loans. Moreover, drag of non-earning assets (NPLs and strategic equity investments) coupled with low spreads led to continuous business losses of the bank. Nevertheless, the bank carries an adequate liquidity profile and its deposit mix is changing in favor of stable current and saving accounts.
- The ratings incorporate recently announced right issue (~PKR 3,000mln), which would support the bank's financial profile, though the impact would be limited. Cognizant of this, the bank has devised a detailed plan which interalia includes a) bringing additional equity of US\$50mln, b) reduction in infected portfolio by accelerating the recovery process, c) mobilizing low cost deposits, and d) divestment of non-earning investments. In PACRA's opinion timely materialization of bank's efforts to bring further equity (US\$ 50mln) - which is an imminent need of the bank - would be most critical factor. Nevertheless, 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 through immediate fresh capital injection while meeting regulatory capital requirements. Meanwhile, garnishing the bank's franchise and achieving profitability from core business operations remain critical.

ASSESSMENT

- The recent years are marked by continuous deterioration in KBL's business and financial profile. On one side, bank's non earning assets continue to pile up (Non earning investments-net: PKR 3,883mln; Net NPLs: PKR 4,662mln; Deferred tax asset: PKR 3,879mln at end Mar-11), while on the other side the bank suffered significant business losses emanating from lower revenues and relatively higher level of provisioning despite availing 40% FSV benefit of PKR 1,637 (CY09: PKR 1,329mln) in CY10. 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 (CY10: -0.1%; CY09: 0.2%). Though the average cost of deposits has decreased in 1Q11, a continuous improvement in spreads remains to be seen.
- KBL has witnessed significant deterioration in its asset quality (Non Performing Loans (NPL) as percentage of Gross Finances: 28% at end Mar-11; 27% at end Dec-10; 21% at end Dec-09). Majority of impaired loan book is constituted by textile, real estate and trading related businesses, which were most hit during economic crises. Nevertheless, the bank is actively pursuing the infected portfolio and is expecting a sizeable portfolio of infected loans to be recovered by end Dec-11. While the concentration in top twenty exposures, mainly corporate, constitutes 31% of the loan book, it is primarily dominated by more vulnerable sectors interalia, textile and construction. Concentration of top twenty NPLs also resides in similar sectors.
- 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. Additionally, the management targets improvement in other income through transactional banking.
- During CY10, the bank increased the deposit base to PKR 46bln (1QFY11: PKR 47 bln). However, high proportion of time deposits still remains a concern for the bank. Deposit concentration has decreased, as deposit from customers exceeding 1% each of total deposits stands at 17% (CY09: 36%). Though the bank is currently compliant with statutory liquidity requirements, the cushion to handle any major withdrawal remains limited.
- A major portion of equity of the bank is exhausted and the rest 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. 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-11: -6.2%; at end Dec-10: 3.5%), but also put a constraint on free earning resources of the bank. Similarly the bank is non compliant to minimum capital requirement. At the same time, the net NPL to Equity stands at 362% at end Mar-11, reflecting potential drag on KBL's deteriorating 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 and further injection of US\$50 mln, ii) divestment of few subsidiaries by Dec-11 - 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, listed, rated, unsecured and subordinated TFCs of PKR 1,500mln (Inclusive of PKR 500mln green shoe option) for a period of 5.5 years at an annual fixed rate of 15.3%. The profit payment would be made on monthly basis in arrears. 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.