

UNION BANK LIMITED (UNBL)

**Ratings (June 2006)
Union Bank Limited**

	New	Previous
*Entity		
Long-Term	AA-	AA-
Short-Term	A1+	A1+

** Pending the outcome of the negotiations regarding the acquisition of UnBL by Standard Chartered Bank, the ratings have been placed on a RatingWatch with positive implications.*

TFCs

Unsecured, Subordinated

1st Issue PKR 750mln	A+	A+
2nd Issue PKR 750mln	A+	A+
3rd Issue PKR 1000mln	A+	A+

Financial Data

PKR (mln)

	31-Dec-05	31-Dec-04
Total Assets	117,100.7	77,710.7
Equity	5,074.6	3,335.6
Net Income	1,744.7	829.7
ROA %	1.79	1.14
ROE %	41.49	28.40
Equity/ Total Assets %	4.33	4.29
SBP CAR	8.92	8.17

Analysts

Muhammad Usman Majeed

+92 42 5869504

usman@pacra.com

Shahzad Saleem

+92 42 5869504

shahzad@pacra.com

TFC Issues

UnBL issued its first unsecured subordinated TFC during December 2002 for a tenor of 5 1/2 years at a floating rate of latest cut-off yield on 5 year PIB plus 225bps with a floor of 11.00% and a cap of 15.50%. Principal redemption will be in three instalments, commencing from the 54th month of the issue. The bank issued second unsecured subordinate TFC for a tenor of 7 years during January 2004. The profit payment is at a floating rate of 5% and cap of 10.75%. Major principal redemption will be in six unequal instalments, commencing from the 54th month of issue. The third TFC of PKR 1000 million was issued in January 2006, including an IPO of PKR 250mln. The TFC has a 7-year tenor, with profit payable at a floating interest rate of 6-months KIBOR + 2%. The TFC holders are exposed to a relatively higher risk, as the obligations towards the TFC holders are subordinate to those of senior unsecured creditors (depositors) of the bank.

Rating Rationale

Assessment

- The ratings reflect the sustained success of the bank in consolidating its competitive edge in consumer banking while continuing to expand the corporate finance and SME segments. Increasing exposure to consumer banking suggests a relatively high risk appetite. Nevertheless, effective risk management through stringent credit evaluation and monitoring supported by a strong I.T. structure and systems are expected to largely mitigate the potential risk of loss. However, the asset quality continues to be weighed down by the legacy of NPLs inherited from the acquired banks, and consequently, the historical infection ratios remain higher than peer banks. Given its established niche in the consumer segment, and backed by a strong human and physical infrastructure, the bank is well positioned to meet the challenges of the emerging competitive banking environment.
- UnBL sustained the healthy performance trend both in terms of growth and profitability during 2005, with a slight increase in the system share. Owing to a higher emphasis on deposit mobilization as against credit expansion during 2005, the bank's credit-to-deposit ratio declined slightly in contrast to the sector trend. Nevertheless, improved spreads on the back of an enhanced exposure in the consumer segment, alongwith increased volumes enabled the bank to register a substantial increase in the NIMR. With an increased focus on services and consumer lending, income from fee, commission and brokerage (bulk of which is generated by the credit cards segment) registered a considerable YoY increase. The bank's non-interest costs decreased as a percentage to total revenue on a YoY basis. However, it remains higher when compared to its peers, owing mainly to the continued network expansion and higher cost associated with consumer financing.
- Going forward, the management intends to further strengthen the bank's foothold in consumer segment with focus on specialized and high-margin products, and targets a portfolio size of 40% of the total assets. Meanwhile, the bank also targets continued growth in both the corporate and SME portfolios by introducing new products and improving turn-around time. UnBL primarily targets larger non-remunerative deposits in order to meet the incremental funding requirements. The bank plans to open another eight branches during 2006. At the same time, conscious of the challenges ahead in terms of maintaining the high growth trends of recent years, the bank is working on a proactive strategy of continuous improvement in the quality as well as the range of services, while targeting a steady improvement in the intermediation costs.
- The asset quality of the bank continues to be weighed down by the legacy of NPLs inherited from the acquired banks. Nevertheless, owing to the substantially increased equity base of the bank, the overall net exposure to equity stands substantially reduced. Furthermore, as a result of the additional general provisioning on account of consumer financing, the overall provision coverage has also improved, while efforts continue to be in hand for recoveries and settlement. Meanwhile, the risk of potential loss on account of NPLs stands further mitigated owing to the increase in real estate prices, the underlying collateral against the bulk of the NPLs.
- A major part of the investment portfolio comprises exposure is in short-term MTBs on which there is minimal interest rate risk. With the equity portfolio constituting only 0.6% of the total assets, the market risk remains negligible.
- The year-end figure for CAR witnessed a modest YoY improvement on the back of pre-IPO subscriptions received against the third TFC issue. Going forward, the bank plans to support the capital structure by means of retention of profits, alongwith incremental tier-II capital in the shape of TFCs as and when required, in order to support the targeted expansion.
- The Standard Chartered Bank (SCB) has recently initialled an agreement with the bank's sponsoring shareholders to acquire 66% shares of UnBL. Should the deal go through, the surviving entity is expected to emerge as a stronger player in the banking sector, combining the strong niche enjoyed by SCB in the corporate sector with UnBL's strong consumer market niche. SBP has granted both banks the permission to undertake a due diligence exercise, which if completed to mutual satisfaction is expected to culminate in a sale-purchase agreement (SPA). In view of the development, the ratings have been placed on RatingWatch with positive implications.

Background

- UnBL commenced operations in 1991 under the management of a local business group. However, the management changed subsequently in 1999, as the controlling interest in the bank was acquired by a Saudi investor. UnBL has in recent years emerged as one of the fastest growing banks with commensurate strengthening of its performance indicators. The bank has also expanded into the international arena by operating two branches in Sri Lanka. The bank's vision under its dedicated management is to expand to a full range of banking services while consolidating the original niche in the area of consumer banking and financing small and medium businesses. UnBL has a branch network of 67 (65 local and 2 foreign branches) as of 1QE2006. The success in implementation of strategic initiatives is, inter-alia, due to the close and effective monitoring by the Board, with members having a distinguished record of public service and corporate exposure.