The Pakistan Credit Rating Agency Limited

Rating Report

Soneri Bank Limited | Tier 1 TFC

Report Contents

Rating History

Dissemination Date	Long Term Rating	Short Term Rating	Outlook	Action	Rating Watch
20-Dec-2018	A	-	Stable	Maintain	-
26-Sep-2018	A	-	Stable	Initial	-
27-Apr-2018	A	-	Stable	Preliminary	-

Rating Rationale and Key Rating Drivers

The ratings reflect Soneri Bank’s sustained business profile as reflected in slightly higher net interest margin. The bank’s funding base comprise of deposits and borrowings. During 9MCY18, customer deposits witnessed growth of 3% against industry growth of 6% - customer deposit system share inched down to 1.7% as at end-Sep18 (end-Dec17: 1.8%). Contribution of low costs deposits witnessed marginal decline. The lending portfolio recorded growth of ~6% (against industry growth of 14%). Non-Performing Loans witnessed a slight increase. Fee based income also witnessed some growth and needs to seek a higher stimulant. With a largely maintained cost structure, the bank’s profitability got additional support from reversal in provisioning. Hence, spread was largely maintained. Continued enhancement in non-fund based exposure and sustainable growth in fee income is important for future years. At the same time, the strategy would be to mobilize low cost deposits with an increase in branch network. The bank’s CET-I stands at 10.04% as at end-Sep18. Total CAR stands at 12.60%. The bank has issued additional Tier-1 TFC (PKR 4,000mln), which will enhance its total eligible capital further.

The rating is a function of bank's ability to maintain its market position in the banking industry while strengthening its overall risk profile. Bringing efficiency in operational structure is important for long term growth. In the comparative landscape, adding granularity to deposits and advances is critical. Meanwhile, a sustainable increase in system share and consequent profitability would be ratings positive.

Disclosure

Name of Rated Entity	Soneri Bank Limited | Tier 1 TFC
Type of Relationship	Solicited
Purpose of the Rating	Debt Instrument Rating
Applicable Criteria	Methodology | Financial Institution(Jun-18),Methodology | Basel III Compliant - Debt Instrument(Jun-18)
Related Research	Sector Study | Commercial Bank(Jun-18)
Rating Analysts	Sehar Fatima | sehar.fatima@pacra.com | +92-42-35869504

Profile

Structure Soneri Bank Limited (SBL), incorporated as a public limited company, commenced operations as a Scheduled Commercial Bank in 1991. The bank is quoted on Pakistan stock exchange under the category of commercial banks.

Background Soneri Bank's registered office is situated at Upper Mall Scheme, Anand Road, Lahore while it's central office is located in Karachi.

Operations The Bank is engaged in banking services as described in the Banking Companies Ordinance, 1962 and operates with 291 branches including 21 Islamic banking branches (31 December 2017: 290 branches including 19 Islamic banking branches) in Pakistan.

Ownership

Ownership Structure The current sponsors Feerasta Family own 61% stake of the Bank, followed by NIT (~10%). The remaining stake (~29%) is widely spread among financial institutions, and general public.

Stability Ownership structure of the Company is seen as stable as no ownership changes are expected in near future. Majority stake rests with the Feerasta family.

Business Acumen The Feerasta Family has been associated with diverse set of businesses, since last few decades and has been successfully managing them. Some of the key businesses that the group owns include Rupali Polyester Limited, Rupali Foods Limited, Rupafil Limited and Soneri Bank Limited. Hence, sponsor's business acumen is considered good.

Financial Strength Given that Soneri is the flagship business of sponsors, willingness to support the Bank in case the need arises is considered high.

Governance

Board Structure The overall control of the bank vests with eight-member board of directors (BoD), including the CEO. Three of the board members are nominees of Feerasta family including one executive director; three are non executive directors while one is NIT representative.

Members' Profile The board members carry extensive professional experience in banking and other sectors. The BoD provides an overall guideline in managing risks associated with the bank's operations and strategic direction.

Board Effectiveness There are six board committees; i) Audit ii) Risk management iii) Human Resource and Remuneration, iv) Credit, v) Independent Directors and vi) Information Technology committee,which assist the board in effective oversight of the bank's overall operations on relevant matters.

Financial Transparency A.F Ferguson & Co, Chartered Accountants, classified in category 'A' by SBP and having a satisfactory QCR rating are the external auditors for SBL. They expressed an unqualified opinion for the financials of end-Dec17 and end-Jun18. SBL has an Internal Audit function which reports to Board Audit Committee in line with the Code of Corporate Governance.

Management

Organizational Structure Overall operations have been divided into thirteen functions and organized into Northern, Central and Southern regions for effective management and control. Ten functions report directly to the CEO, whereas, remaining three – Risk Management, Operations and Information Technology – report to the Executive Director (former COO).

Management Team SBL's management team comprises of experienced individuals. Mr. Aftab Manzoor, the President and CEO since Apr11, is a seasoned banker and carries over three decades of international banking experience. He is supported by Executive Director since Mar15, Mr. Amin A. Feerasta – member of Feerasta family – who has been associated with the bank since 2000.

Effectiveness SBL has nine management committees in place; all headed by the CEO. The committees are i) Management, ii) Executive Credit, iii) Assets & Liability, iv) Investment, v) I.T Steering, vi) Credit Risk Management, vii) Business Continuity Plan Steering, viii) Operational Risk Management Committee and ix) Market and Liquidity Risk Management Committee.

MIS Comprehensive MIS reports are generated on daily, weekly and monthly basis which are viewed by management on regular basis.

Risk Management Framework SBL has an integrated risk management framework. The risk management policy covers all major types of risks and is formulated in line with regulatory guidelines. Furthermore, the Risk Management Committee ensures that risk exposures are maintained within acceptable levels.

Business Risk

Industry Dynamics Pakistan's economy is at an important juncture, whereby the need of the hour is timely materialization of financial inflows and continued reduction in the import bill. For the 9MCY18, the banking sector experienced a slower growth in its deposit base 6% (CY17: 10%) due to slowdown in economy. Increasing policy rate is positive for the banking industry. CAR is expected to remain a challenge as vigilant management is required in future years.

Relative Position SBL, a medium sized bank, holds a customer deposit base of PKR 217bln at end-Sep18. The deposit share of the bank inched down to 1.7% in 9MCY18 (CY17: 1.8%).

Revenues During 9MCY18, SBL's NIMR witnessed an increase of 5% YOY to stand at PKR 5.1bln (9MCY17: PKR 4.9bln), with Markup income witnessing an increase of 11% YOY to stand at PKR 15bln (9MCY17: PKR 13bln), driven by volumetric increase in lending portfolio. Markup expenses also increased by 14% YOY. Hence, Bank's spread inched down (9MCY18: 2.3%; CY17: 2.5%; 9MCY17: 2.4%).

Performance During 9MCY18, Non-markup income recorded a decline to stand at PKR 2.1bln, down 14% YOY, mainly due to lower capital gains booked in the current period. Non-markup expenses increased by 5% YOY standing at PKR 5,485mln (9MCY17: PKR 5,236mln). Provisions reversal of PKR 317mln supported the bottom line to stand at PKR 1.29bln (9MCY17: PKR 1.23bln).

Sustainability Going forward, the management is focused on mobilizing low cost deposits to channel growth in lending as the bank's Advances-to-Deposits ratio (9MCY18: 72%) is at a higher end than industry average (9MCY18: 56.7%). The management's focus is to have secured exposures which will ultimately have a positive impact on the bottom-line.

Financial Risk

Credit Risk During 9MCY18, SBL's advances have grown by 6% (9MCY18: PKR 174bln; CY17: PKR 165bln). However, growth in advances was below of industry average (9MCY18:15%). The Bank's ADR remained at 72% (end-Dec17: 72%). As a result, infection ratio remained at ~6% end-Sep18 (end-Dec17: ~6%). Indeed, the bank needs to create room in its CAR to expand advances book.

Market Risk During 9MCY18, SBL invested majorly in Government securities (92%) which are Government of Pakistan (GoP) Sukuks, whereas rest of the book (8%) is invested in non-strategic equity investments. SBL's exposure in Tbills has increased to 54% at end-Sep18 (end-Dec17: 48%, end-Dec16: 41%), while exposure in PIBs reduced to 37% at end-Sep18 (end-Dec17: 50%, end-Dec16: 57%). This trend has been witnessed throughout the industry in the wake of rising interest rate environment in upcoming years. Going forward, interest rate regime would shape industry's trajectory and balance towards government papers.

Liquidity And Funding During 9MCY18, SBL's customer deposits increased to PKR 217bln, up 3% against 6% growth achieved by the industry in nine months. Nevertheless, the bank's deposit share in the system reported at 1.7%. CASA proportion inched down to 66% at end-Sep18 (end-Dec17: ~70%). Going forward, deposit mobilization is likely to increase deposit per branch which was reported at PKR 746mln at end-Sep18 (end-Dec17: PKR 727mln). However, mobilization of CA deposits remains important for further improvement in cost structure.

Capitalization At end-Sep18, the bank reported CAR of 12.6%, comprising of Tier I capital (10%), remaining at par with the minimum requirement by SBP; owing to significant rise in risk weighted assets (driven by growth in advances). SBL issued its 2nd subordinated, unsecured, and listed TFC of PKR 3,000mln in Jul15 (Tenor 8 years). Profit rate is 6MK plus 135bps p.a. payable semi-annually in arrears. Principal repayment (99.7%) would be in bullet form at maturity (2023). SBL retains call option; exercisable in Jul'20. The issue carries lock-in and loss absorbency clauses. SBL has recently issued Unsecured, Subordinated, Listed, Perpetual and Non-Cumulative Term Finance Certificates of PKR 4,000mln as additional Tier-I ADTI. The instrument is perpetual in nature with no fixed redemption date. Profit payments are subject to the condition that such payments will not result in breach of Soneri's MCR or CAR requirements. The Instrument is subject to loss absorption upon the occurrence of a Pre-Specified Trigger. CAR is expected to rise after incorporation of ADT-I TFC.

Soneri Bank Limited

Financials [Summary]

PKR mln

BALANCE SHEET	30-Sep-18	31-Dec-17	31-Dec-16	31-Dec-15
	9M	*Annual*	*Annual*	*Annual*
Earning Assets				
Advances (Net of NPL)	171,080	162,528	123,333	109,033
Debt Instruments	3,331	2,956	3,989	2,304
Total Finances	174,411	165,484	127,322	111,337
Investments	103,807	114,472	113,895	106,542
Others	5,470	6,751	5,678	3,276
	283,689	**286,707**	**246,894**	**221,155**
Non Earning Assets				
Non-Earning Cash	23,909	20,376	18,960	18,170
Deferred Tax	-	-	-	-
Net Non-Performing Finances	2,586	1,765	1,972	2,969
Fixed Assets & Others	13,089	13,286	10,693	11,047
	39,584	**35,427**	**31,625**	**32,186**
TOTAL ASSETS	**323,273**	**322,134**	**278,520**	**253,342**
Interest Bearing Liabilities				
Deposits	241,229	227,348	209,925	185,222
Borrowings	51,812	67,582	41,903	42,876
	293,041	294,930	251,828	228,098
Non Interest Bearing Liabilities	12,060	8,699	8,403	7,052
TOTAL LIABILITIES	**305,100**	**303,629**	**260,230**	**235,150**
EQUITY (including revaluation surplus)	**18,172**	**18,505**	**18,289**	**18,192**
Total Liabilities & Equity	**323,273**	**322,134**	**278,520**	**253,342**

INCOME STATEMENT	30-Sep-18	31-Dec-17	31-Dec-16	31-Dec-15
	9M	Annual	Annual	Annual
Interest / Mark up Earned	15,114	18,505	17,524	18,320
Interest / Mark up Expensed	(9,972)	(11,846)	(10,680)	(10,722)
Net Interest / Markup revenue	**5,142**	**6,659**	**6,844**	**7,597**
Other Income	2,192	3,269	2,736	3,150
Total Revenue	**7,334**	**9,928**	**9,580**	**10,748**
Non-Interest / Non-Mark up Expensed	(5,485)	(7,017)	(6,479)	(6,123)
Pre-provision operating profit	1,850	2,911	3,102	4,625
Provisions	317	(66)	(24)	(1,029)
Pre-tax profit	**2,167**	**2,845**	**3,077**	**3,596**
Taxes	(874)	(1,188)	(1,198)	(1,383)
Net Income	**1,294**	**1,657**	**1,879**	**2,213**

Ratio Analysis	30-Sep-18	31-Dec-17	31-Dec-16	31-Dec-15
Performance				
ROE	10.3%	10.2%	12.0%	15.0%
Cost-to-Total Net Revenue	75.1%	71.0%	67.8%	57.3%
Provision Expense / Pre Provision Profit	-17.2%	2.3%	0.8%	22.3%
Capital Adequacy				
Equity/Total Assets	5.2%	5.1%	5.7%	6.1%
Capital Adequacy Ratio as per SBP	12.6%	12.8%	14.1%	15.4%
Funding & Liquidity				
Liquid Assets / Deposits and Borrowings	41.3%	38.1%	47.7%	50.0%
Advances / Deposits	72.0%	72.3%	59.7%	60.5%
CASA deposits / Total Customer Deposits	66.2%	70.3%	69.7%	69.2%
Intermediation Efficiency				
Asset Yield	7.2%	7.0%	7.6%	9.2%
Cost of Funds [Interest Expensed / Average (Deposits + Borrowings)]	4.8%	4.6%	4.7%	5.4%
Spread	2.3%	2.5%	2.9%	3.8%
Outreach				
Branches	291	290	288	266

DEBT INSTRUMENT RATING SCALE & DEFINITIONS

The instrument rating reflects forward-looking opinion on credit worthiness of underlying debt instrument; more specifically it covers relative ability to honor financial obligations. The primary factor being captured on the rating scale is relative likelihood of default.

LONG TERM RATINGS

AAA	Highest credit quality. Lowest expectation of credit risk. Indicate exceptionally strong capacity for timely payment of financial commitments.
AA+ AA AA-	Very high credit quality. Very low expectation of credit risk. Indicate very strong capacity for timely payment of financial commitments. This capacity is not significantly vulnerable to foreseeable events.
A+ A A-	High credit quality. Low expectation of credit risk. The capacity for timely payment of financial commitments is considered strong. This capacity may, nevertheless, be vulnerable to changes in circumstances or in economic conditions.
BBB+ BBB BBB-	Good credit quality. Currently a low expectation of credit risk. The capacity for timely payment of financial commitments is considered adequate, but adverse changes in circumstances and in economic conditions are more likely to impair this capacity.
BB+ BB BB-	Moderate risk. Possibility of credit risk developing. There is a possibility of credit risk developing, particularly as a result of adverse economic or business changes over time; however, business or financial alternatives may be available to allow financial commitments to be met.
B+ B B-	High credit risk. A limited margin of safety remains against credit risk. Financial commitments are currently being met; however, capacity for continued payment is contingent upon a sustained, favorable business and economic environment.
CCC CC C	Very high credit risk. Substantial credit risk “CCC” Default is a real possibility. Capacity for meeting financial commitments is solely reliant upon sustained, favorable business or economic developments. “CC” Rating indicates that default of some kind appears probable. “C” Ratings signal imminent default.
D	Obligations are currently in default.

SHORT TERM RATINGS

A1+: The highest capacity for timely repayment.

A1:. A strong capacity for timely repayment.

A2: A satisfactory capacity for timely repayment. This may be susceptible to adverse changes in business, economic, or financial conditions.

A3: An adequate capacity for timely repayment. Such capacity is susceptible to adverse changes in business, economic, or financial conditions.

B: The capacity for timely repayment is more susceptible to adverse changes in business, economic, or financial conditions.

C: An inadequate capacity to ensure timely repayment.

Outlook (Stable, Positive, Negative, Developing)
Indicates the potential and direction of a rating over the intermediate term in response to trends in economic and/or fundamental business/financial conditions. It is not necessarily a precursor to a rating change. ‘Stable’ outlook means a rating is not likely to change. ‘Positive’ means it may be raised. ‘Negative’ means it may be lowered. Where the trends have conflicting elements, the outlook may be described as ‘Developing’.

Rating Watch
Alerts to the possibility of a rating change subsequent to, or in anticipation of, a) some material identifiable event and/or b) deviation from expected trend. But it does not mean that a rating change is inevitable. A watch should be resolved within foreseeable future, but may continue if underlying circumstances are not settled. Rating Watch may accompany Outlook of the respective opinion.

Suspension
It is not possible to update an opinion due to lack of requisite information. Opinion should be resumed in foreseeable future. However, if this does not happen within six (6) months, the rating should be considered withdrawn.

Withdrawn
A rating is withdrawn on a) termination of rating mandate, b) the debt instrument is redeemed, c) the rating remains suspended for six months, d) the entity/issuer defaults., or/and e) PACRA finds it impractical to surveill the opinion due to lack of requisite information

Regulatory and Supplementary Disclosure
(Credit Rating Companies Regulations,2016)

Rating Team Statements
(1) Rating is just an opinion about the creditworthiness of the entity and does not constitute recommendation to buy, hold or sell any security of the entity rated or to buy, hold or sell the security rated, as the case may be | Chapter III; 14-3-(x)

2) **Conflict of Interest**
i. The Rating Team or any of their family members have no interest in this rating | Chapter III; 12-2-(j)
ii. PACRA, the analysts involved in the rating process and members of its rating committee, and their family members, do not have any conflict of interest relating to the rating done by them | Chapter III; 12-2-(e) & (k)
iii. The analyst is not a substantial shareholder of the customer being rated by PACRA [Annexure F; d-(ii)] Explanation: for the purpose of above clause, the term "family members" shall include only those family members who are dependent on the analyst and members of the rating committee

Restrictions
(3) No director, officer or employee of PACRA communicates the information, acquired by him for use for rating purposes, to any other person except where required under law to do so. | Chapter III; 10-(5)
(4) PACRA does not disclose or discuss with outside parties or make improper use of the non-public information which has come to its knowledge during business relationship with the customer | Chapter III; 10-7-(d)
(5) PACRA does not make proposals or recommendations regarding the activities of rated entities that could impact a credit rating of entity subject to rating | Chapter III; 10-7-(k)

Conduct of Business
(6) PACRA fulfills its obligations in a fair, efficient, transparent and ethical manner and renders high standards of services in performing its functions and obligations; | Chapter III; 11-A-(a)
(7) PACRA uses due care in preparation of this Rating Report. Our information has been obtained from sources we consider to be reliable but its accuracy or completeness is not guaranteed. PACRA does not, in every instance, independently verifies or validates information received in the rating process or in preparing this Rating Report.
(8) PACRA prohibits its employees and analysts from soliciting money, gifts or favors from anyone with whom PACRA conducts business | Chapter III; 11-A-(q)
(9) PACRA ensures before commencement of the rating process that an analyst or employee has not had a recent employment or other significant business or personal relationship with the rated entity that may cause or may be perceived as causing a conflict of interest; | Chapter III; 11-A-(r)
(10) PACRA maintains principal of integrity in seeking rating business | Chapter III; 11-A-(u)
(11) PACRA promptly investigates, in the event of a misconduct or a breach of the policies, procedures and controls, and takes appropriate steps to rectify any weaknesses to prevent any recurrence along with suitable punitive action against the responsible employee(s) | Chapter III; 11-B-(m)

Independence & Conflict of interest
(12) PACRA receives compensation from the entity being rated or any third party for the rating services it offers. The receipt of this compensation has no influence on PACRA´s opinions or other analytical processes. In all instances, PACRA is committed to preserving the objectivity, integrity and independence of its ratings. Our relationship is governed by two distinct mandates i) rating mandate - signed with the entity being rated or issuer of the debt instrument, and fee mandate - signed with the payer, which can be different from the entity
(13) PACRA does not provide consultancy/advisory services or other services to any of its customers or to any of its customers' associated companies and associated undertakings that is being rated or has been rated by it during the preceding three years unless it has adequate mechanism in place ensuring that provision of such services does not lead to a conflict of interest situation with its rating activities; | Chapter III; 12-2-(d)
(14) PACRA discloses that no shareholder directly or indirectly holding 10% or more of the share capital of PACRA also holds directly or indirectly 10% or more of the share capital of the entity which is subject to rating or the entity which issued the instrument subject to rating by PACRA; | Reference Chapter III; 12-2-(f)
(15) PACRA ensures that the rating assigned to an entity or instrument is not be affected by the existence of a business relationship between PACRA and the entity or any other party, or the non-existence of such a relationship | Chapter III; 12-2-(i)
(16) PACRA ensures that the analysts or any of their family members shall not buy or sell or engage in any transaction in any security which falls in the analyst's area of primary analytical responsibility. This clause shall, however, not be applicable on investment in securities through collective investment schemes. | Chapter III; 12-2-(l)
(17) PACRA has established policies and procedure governing investments and trading in securities by its employees and for monitoring the same to prevent insider trading, market manipulation or any other market abuse | Chapter III; 11-B-(g)

Monitoring and review
(18) PACRA monitors all the outstanding ratings continuously and any potential change therein due to any event associated with the issuer, the security arrangement, the industry etc., is disseminated to the market, immediately and in effective manner, after appropriate consultation with the entity/issuer; | Chapter III | 18-(a)
(19) PACRA reviews all the outstanding ratings on semi-annual basis or as and when required by any creditor or upon the occurrence of such an event which requires to do so; | Chapter III | 18-(b)
(20) PACRA initiates immediate review of the outstanding rating upon becoming aware of any information that may reasonably be expected to result in downgrading of the rating; | Chapter III | 18-(c)
(21) PACRA engages with the issuer and the debt securities trustee, to remain updated on all information pertaining to the rating of the entity/instrument; | Chapter III | 18-(d)
Probability of Default
(22) PACRA´s Rating Scale reflects the expectation of credit risk. The highest rating has the lowest relative likelihood of default (i.e, probability). PACRA´s transition studies capture the historical performance behavior of a specific rating notch. Transition behavior of the assigned rating can be obtained from PACRA´s Transition Study available at our website. (www.pacra.com). However, actual transition of rating may not follow the pattern observed in the past | Chapter III | 14-(f-VII)
Proprietary Information

Regulatory and Supplementary Disclosure

Nature of Instrument	Size of Issue (PKR)	Tenor	Security	Quantum of Security	Nature of Assets	Trustee	Book Value of Assets (PKR mln)
Listed, Unsecured, Subordinated Tier - I TFC	4 Bn (Inclusive of Green Shoe Option of PKR 1 Bn)	Perpetual	N/A	N/A	N/A	Pak Brunei Investment Company Limited	N/A

Soneri Bank Limited | Tier-I TFC | Jun-18	
Name of Issuer	Soneri Bank Limited
Issue size	PKR 4 Bn (Inclusive of Green Shoe Option of PKR 1 Bn)
Tenor	Perpetual
Maturity	Perpetual (unless Call Option is exercised)
Profit Rate	6 MK + 2.0%
Repayment	Payable semi-annually in arrears on a non-cumulative basis on the outstanding principal amount of the Issue. The first such payment will be due six months from the Issue Date and subsequently every six months thereafter.
Security	N/A