

## ICRA Lanka has reaffirmed the ratings of Pan Asia Banking Corporation PLC; outlook revised to negative

March 15, 2017

Instrument	Amount (in LKR)	Revised Rating Action
Issuer Rating	-	[SL]BBB reaffirmed; outlook revised from stable to negative
Issue Rating -Subordinated unsecured redeemable listed debenture (2014/2019)	3.0 Billion	[SL]BBB- reaffirmed; outlook revised from stable to negative

ICRA Lanka Limited, subsidiary of ICRA Limited, a group company of Moody's Investors Service, while reaffirming the issuer rating of Pan Asia Banking Corporation PLC (PABC or "the Bank") at [SL]BBB (pronounced SL triple B), has revised the outlook of the rating from stable to negative. ICRA Lanka has also reaffirmed the [SL]BBB- (pronounced SL triple B minus) rating for the LKR 3.0 Billion subordinated unsecured redeemable listed debenture programme of the bank, while revising the outlook from stable to negative.

The revision of the outlook factors in the expected pressure on the capital profile of the bank going forward to achieve the envisaged portfolio growth and, because of the higher capital requirement under Basel-III. The ratings take cognizance of the sharp moderation in the CASA base of the bank, over the recent past, which is expected to impact the liquidity and profitability profile of the bank going forward. The ratings take note of the improvement in the asset quality profile (GNPA 4.74% in Dec-16 vis a vis 4.84% in Dec-15 and 5.73% in Dec-14), however, the same continues to be weaker than most peers. The ratings factor in PABC's current moderate size and its evolving franchise, especially in the urban and semi urban segments. The bank's profitability was moderate with a ROAA of 1.06% in CY2016 vis a vis 1.10% in CY2015.

As the the bank was unable to meet the interim minimum capital requirement of LKR 7.50 Bn on the stipulated date (Jan 01, 2017), an extension was granted till March 31, 2017 by CBSL. ICRA Lanka takes note of the successful conclusion of the rights issue by the bank in Feb 2017, which has enabled the bank to increase the core capital to LKR 8.67 Bn. However, the bank will need to meet the minimum capital requirement of LKR 10 Bn applicable for Licensed Commercial Banks by Jan 01, 2018. The bank expects to meet this requirement, through profits generated from operations. The ability to generate adequate internal profits during CY2017 to meet the minimum capital requirement would be a key near term rating sensitivity. ICRA Lanka would also monitor the bank's ability to maintain a comfortable capital position to meet the Basel-III capital requirements, without adversely affecting business growth (25-30% per annum) over the medium term. The core capital ratio as at Dec-16 stood at 11.11% (post rights issue) while the overall ratio was 14.14%.

The bank's funding profile is largely characterized by fixed deposits, which accounted for about 53% of the total debt (deposits + borrowings) of the bank as in Sep-16 (Dec-15: 50%), while the proportion of current account-savings account (CASA) deposits moderated from 28.7% in Dec-15 to 20.7% in Dec-16 because of severe competition faced from the larger banks. Borrowings from other funding sources and debentures accounted for the remaining. PABC's Credit-Deposit ratio<sup>1</sup> moderated to 94% in Dec-16 vis a vis 95% in Dec-15 and 93% in Dec-14, as the credit portfolio grew at a higher rate than deposits and funding was supported by incremental borrowings from other banks, institutions and via debt securities issued. PABC's ALM profile is characterized by sizeable mismatches in the <1-year bucket due to the short-term nature of the fixed deposits.

<sup>1</sup> Net Loans and Advances/ Total Deposits

PABC's net loans and advances grew at a robust pace of 25%<sup>2</sup> in CY2015 and, moderated to 15% in CY2016. PABC's portfolio largely consists of loans to retail borrowers, small and lower end medium enterprises and mid-sized corporates. The retail sector accounted for 76% of total advances in Sep-16 increasing from 70% in Dec-15. The bank's main credit products were term loans (51%), overdrafts (22%) and leasing (10%) as at end Sep-16. Pawning Gold Loans which in 2011 accounted for 19% of the lending portfolio has steadily reduced to 3.0% of the portfolio in Sep-2016.

The bank's asset quality ratio has improved over the recent past, with GNPA's moderating to 4.74% in Dec-16 compared to 4.84% in Dec-15 and 5.73% in Dec-14, supported by the recovery initiatives taken by the bank. The incremental NPA generation rate in 9MCY2016 improved to about 6% (annualized) as compared to 8% in CY 2015 (10% in CY 2014); the same is still high indicating the inherent risk in PABC's target segment. PABC is exposed to the inherent risks associated with its key target customer segments, i.e. retail borrowers and SME traders, due to the modest credit profile of the borrowers in these segments and their vulnerability to adverse macroeconomic changes. Additionally, ICRA Lanka notes that the top-10 delinquent borrowers accounted for about 39% of the total NPAs as in Sep-16 indicating a high level of NPA concentration within the portfolio. Effective recoveries from the same and limiting incremental slippages to a reasonable level would be crucial for the asset quality profile going forward. Meanwhile, the provision cover ratio continued to be below average at 37% in Sep-16.

PABC has recorded a NIM of about 3.9% (4.2% in CY2015) for the CY2016; the moderation in the NIMs was largely due to the increase in the systemic interest rates and reduction in the share of low cost CASA, however some improvement in the operating efficiencies supported the ROAA, which stood at 1.06% for CY2016 (1.11% in CY2015). PABC experienced higher credit costs in 2013, due to the write off of pawning exposures resulting in lower profitability for that period. While credit losses have moderated in the recent past, going forward, PABC would require increased credit provisioning to improve its NPA provision coverage ratios (37% in September 2016). Ability to further improve operating efficiencies (Operating Expenses excluding VAT/Average Total Assets at 2.9% for Dec-16 vis a vis 3.2% in Dec-15) by maintaining optimal growth and keeping credit costs (0.45% in Dec-16 vis a vis 0.80% in Dec-15) at reasonable levels would be critical for incremental profitability.

### ***Company Profile***

PABC was incorporated in 1995 as a Licensed Commercial Bank (LCB) under the Banking Act No. 30 of 1988. It is listed on the Colombo Stock Exchange (CSE). PABC remains one of the small players in the domestic LCB industry, with an asset base of LKR 127 Bn and a net loan book of LKR 85 Bn as at 9MCY2016. This accounted for about 1.7% of the sector assets and 2.0% of sector loans. The bank has been consolidating its presence in the local arena while improving its franchise during the past 5 years. As at end of Sep-16, the bank operated with 80 branches and 1,447 staff members.

### ***Recent Results***

For the CY2016, PABC reported a profit after tax of LKR 1,252 Mn (CY2015: LKR 1,041Mn) with a total asset base of LKR 129.5 Bn (CY2015: 107.8 Bn). The bank had a net worth of LKR 6,872 Mn in Dec-16 as compared with LKR 5,773 Mn in Dec-15.

*March 2017*

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<sup>2</sup> Gross Loan Portfolio grew at 41% in CY2015

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