

ICRA Lanka Assigns [SL]BBB (Stable) issuer rating to Pan Asia Banking Corporation PLC; Subordinated Debt rated [SL]BBB- (Stable)

February 26, 2016

Instrument	Amount(in LKR)	Rating Action
Issuer Rating	N/A	[SL]BBB(Stable) Assigned
Issue Rating –Subordinated unsecured redeemable listed debenture (2014/2019)	3.0 billion	[SL] BBB-(Stable) Assigned

ICRA Lanka Limited, subsidiary of ICRA Limited, a group company of Moody's Investors Service has assigned the Issuer rating of [SL]BBB (pronounced SL triple B) with a Stable outlook to Pan Asia Banking Corporation PLC (PABC or "the Bank"). ICRA Lanka has also assigned the [SL]BBB- (pronounced SL triple B minus) rating with stable outlook to the LKR 3.0 billion Subordinated unsecured redeemable listed debenture programme of the bank.

The rating takes note of the bank's improving profitability (ROAA 1.2% in 9M 2015 vis a vis 0.6% in 2014), asset quality profile (GNPA 5.4% in Sep-2015 vis a vis 5.7% in Dec-2014) and deposit profile (CASA of 27.6% in Sep-2015 and 30.5% in Dec 2014 vis a vis 19.3% in Dec-2013) over the recent past; the same however continues to be weaker than most peers. The rating factors in PABC's current modest size and its evolving franchise, especially in the urban and semi urban segments. The rating takes cognisance of PABC's aggressive growth during 2014 and in 9M 2015, notwithstanding the moderation in the capital profile. ICRA Lanka takes note of the high asset growth of 25-30% going forward also, this along with the regulatory requirement to increase PABC's core capital to LKR 10 billion by Jan 2018 (eligible core capital of LKR 4.6 billion in Sep-2015) would require sizeable external equity as internal generation is expected to remain modest. Ability of the bank to secure external capital in a timely manner would be a key rating sensitivity in the near to medium term. ICRA Lanka would continue to monitor the performance of the bank in this regard.

PABC's gross lending portfolio grew at a robust pace of about 27% in 2014 and at about 30% in 9M 2015. 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 66% of total advances in Sep-2015 increasing from 61% in Dec-2014. The bank's main credit products were Term Loans (56%), Overdrafts (20%) and Leasing (10%) as at end-Sep 2015. Pawning which, in 2011 accounted for 19% of the lending portfolio of PABC has steadily reduced to about 2% of the portfolio in 2014 and 9M 2015. Going forward, PABC is expected to continue its focus on retail, SME and mid-sized corporate lending especially in the manufacturing, trading, services, tourism, housing and consumption segments.

The bank's asset quality has improved over the recent past, with GNPA's moderating to 5.36% in Sep-2015 compared to 5.73% in Dec-2014 and 8.01 % in Dec-2013, supported to an extent by the robust portfolio growth and the recovery initiatives by the bank. The incremental NPA generation rate in 9M 2015 moderated to about 8% (annualised) as compared to 10% in 2014 (15% in 2013); 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 40% of the total NPAs as in Dec-2015 indicating a high level of NPA concentration within the portfolio. Effective recoveries from the same and limiting incremental slippages to reasonable levels would be crucial for the asset quality profile going forward, as the bank has an aggressive business growth plan going forward. Meanwhile, the provision cover ratio continued to be below average at 32% in Sep-2015 and 34% in Dec-2014.

PABC's capitalization is currently modest with the bank unable to meet CBSL guidelines on minimum capital requirement of LKR 10 billion for Licensed Commercial Banks as at 1st January 2016. In July 2015, the management had obtained an extension on the capital requirement by agreeing to an action plan, whereby PABC would maintain LKR 5 billion by 1st of January 2016, LKR 7.5 billion by 1st January 2017 and LKR 10 billion by 1st of January 2018. The Core Capital Ratio as at end-Sep 2015 stood at 7.14% while the overall ratio was 11.66% marginally above the regulatory requirement of 10%. The internal generation rate was about 9% in 2014 and 18% in 9M 2015. ICRA Lanka expects additional capital of about LKR 1.5- 2.0 billion assuming an internal capital generation of about 16-18% per annum and 25-30% CAGR for the risk weighted assets during the period 2015-2017.

Meanwhile, the bank's funding profile is largely characterized by fixed deposits, which accounted for about 59% of the total debt (deposits + borrowings) of the bank as in Sep-2015 (2013: 73%), while the proportion of current account-savings account (CASA) deposits increased from 16% in 2013 to 25% in Sep-2015. Borrowings from other funding sources and Debentures accounted for the remaining. PABC's Credit-Deposit (CD) ratio increased to 82% in December 2014, as compared to 77% in December 2013, as the credit portfolio grew at a higher rate than deposits and funding was supported by incremental borrowings.

PABC's ALM profile is characterized by sizeable mismatches in the <1 year bucket due to the short term nature of the fixed deposits. ICRA Lanka takes note of the initiatives by PABC to diversify its funding profile by raising long term debentures, which moderates the liquidity related risks to an extent.

PABC has enjoyed a good NIM of about 4.5% (3.8% in 2014) for the period 9M2015; the improvement in the NIMs in the recent past was largely supported by the moderation in the systemic interest rates which resulted in the improvement in the ROAA to 1.2% for 9M 2015 from about 0.6% in 2014. 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 coverage ratios. Ability to improve operating efficiencies (Operating Expenses/Average Total Assets at 2.66% for 9M2015 vis a vis 3.70% in Dec-2014) by maintaining optimal growth and keeping credit costs (0.75% in 9M 2015 vis a vis 1.13% in Dec-2014) 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 79.61 billion and a net loan book of LKR 67.94 billion as at FYE Dec 2014. This accounted for about 1.35% of the sector assets and 1.79% 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-Dec 2010, PABC operated 41 branches with 670 staff members while as at end of Sep-2015, the bank operated with 79 branches and 1382 staff members.

Recent Results

In 9M 2015, PABC reported a Profit after tax of LKR 751 million (2014: LKR 415 million) with a total asset base of LKR 103.06 billion (2014:79.61 billion). The Bank had a net worth of LKR 5,486 Million in Sep-15, increasing from LKR 4,735 Million in Dec-14.

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