ICRA Lanka has revised the long term ratings of Pan Asia Banking Corporation PLC

August 28, 2017

Instrument	Amount (in LKR)	Revised Rating Action
Issuer Rating	-	Issuer rating revised to [SL] BBB- (Negative) from [SL] BBB (Negative)
Issue Rating -subordinated unsecured redeemable listed debenture (2014/2019)	3,000 million	Issue rating revised to [SL] BB+ (Negative) from [SL] BBB- (Negative)

ICRA Lanka Limited, subsidiary of ICRA Limited, a group company of Moody's Investors Service, has revised the issuer rating of Pan Asia Banking Corporation PLC (PABC or "the Bank") to [SL]BBB- (pronounced S L triple B minus) with Negative outlook from [SL]BBB (pronounced S L triple B) with Negative outlook. ICRA Lanka has also revised the issue rating to [SL] BB+ (pronounced S L double B plus) with Negative outlook from [SL]BBB- (pronounced S L triple B minus) with Negative outlook for the bank's subordinated unsecured redeemable listed debenture programme of LKR 3,000 Mn.

The revision of the ratings and continuation of the negative outlook factor in the expected pressure on the profitability profile of the bank due to deteriorating asset quality and escalating interest cost which may hinder the internal generation to achieve the minimum capital requirement of LKR 10,000 Mn by January 1,2018 set by the Central Bank of Sri Lanka. The ratings take cognizance of the impact on bank's performance following the suspension of Primary Dealer License based on an investigation carried out by CBSL. The ratings take note of the sharp moderation in the CASA base of the bank, over the recent past, which is expected to impact both profitability and the liquidity. ICRA Lanka takes note of the currently comfortable capital adequacy ratios and liquidity coverage ratios of PABC under Basel-III enhaced requirements.The ratings factor in PABC's current moderate size and its evolving franchise, especially in the urban and semi urban segments.

The bank will need to meet the minimum capital requirement of LKR 10,000 Mn applicale for Licensed Commercial Banks by Jan 01, 2018. The bank expects to meet this requirement, through profits generated from operations. The bank has recorded a PAT of LKR 617 Mn for H1CY2017, the estimated core capital (including H1CY2017 profits) is estimated to be about LKR 9,290 as of June 2017. The ability to generate about LKR 700 Mn in PAT during H2CY2017 to meet the minimum capital requirement would be crucial in the near term. In terms of Basel-III requirement, the core capital ratio as on June 30, 2017 stood at 11.67%[1] while the overall ratio was 14.19%[1]. The rupee liquidity coverage ratio and all currency liquidity coverage ratio stood at 150.01% and 213.28% as on June 30, 2017 respectively. ICRA Lanka would continue to monitor the bank's capital position to meet the Basel-III capital adequacy and liquidity coverage requirements, without adversely affecting business growth over the medium term.

The bank's funding profile is largely characterized by fixed deposits, which accounted for about 64% of the total debt (deposits + borrowings) of the bank as on June 30, 2017 (December 31, 2016: 56%), Borrowings from other funding sources and debentures accounted for the remaining. The proportion of current account-savings account (CASA) deposits moderated from 20.3% as on December 31, 2016 to 18.6% as on June 30, 2017 because of severe competition faced from the larger banks. PABC's credit-deposit ratio[2] moderated to 89% in June 2017 vis a vis 94% in December 2016 and 95% in December 2015, with the capital infusion from the rights issue and the moderate growth in the credit portfolio witnessed

[1] Including draft PAT for H1CY2017
[2] Net Loans and Advances/ Total Deposits

during H1CY2017. PABC's ALM profile is characterized by sizeable mismatches (15%) in the <1-year bucket due to the short-term nature of the fixed deposits.

PABC's net loans and advances grew at a robust pace of 25%[3] in CY2015 before moderating to 15% in CY2016 and 1% during H1CY2017. 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 50% of total advances in June 2017, while SME sector and corporate sector accounted for 29% and 21% respectively. The bank's main credit products were term loans (44%), overdrafts (19%) and short term loans (10%) as at end of June 2017.

The bank's asset quality ratio has deteriorated over the last six months, with GNPAs increasing to 6.27% in June 2017 compared to 4.74% in December 2016 and 4.84% in December 2015, because of the new slippages recorded in corporate and SME portfolios. The incremental NPA generation rate in H1CY2017 has moderated to about 8.9% (annualized) as compared to 6.2% in CY2016 (8.0% in CY2015). PABC is exposed to the inherent risks associated with its key target customer segments due to the modest credit profile of the borrowers and their vulnerability to adverse macroeconomic changes. Additionally, ICRA Lanka notes that the top-10 delinquent borrowers accounted for about 30% of the total NPAs as on June 30, 2017 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 33% in June 2017 (38% in December 2016).

PABC has recorded a NIM of about 3.7% (annualized) in H1CY2017 vis a vis 3.9% in CY2016 (4.2% in CY2015); 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 0.96% for H1CY2017 (1.06% in CY2016). 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 been moderating since then, during H1CY2017 the new slippages resulted in an increase of the same to 0.53% vis a vis 0.45% in CY2016. Going forward, effective monitoring and controlling on the NPA portfolio would be cruitial for PABC to lower its credit costs. Ability to further improve operating efficiencies (Operating expenses excluding VAT/Average Total Assets at 2.74% for H1CY2017 via a via 2.97% for CY2016 and 3.18% in CY2015) by maintaining optimal growth and keeping credit costs 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 128 Bn and a net loan book of LKR 87 Bn as at the end of H1CY2017. As of December 2016, the bank 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 June 2017, the bank operated with 83 branches and 1,433 staff members.

Recent Results

For the H1CY2017, PABC reported a profit after tax of LKR 617 Mn (1,252 Mn in CY2016 and LKR 1,041Mn in CY2015) with a total asset base of LKR 128.1 Bn (LKR 129.5 Bn in CY2016 and 107.8 Bn in CY2015). The bank had a net worth of LKR 9,554 Bn in June 2017 as compared to 6,872 Mn in December 2016 and LKR 5,773 Mn in December 2015.

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[3] Gross Loan Portfolio grew at 41% in CY2015

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