VIS Credit Rating Company Limited

International Affiliates: Islamic International Rating Agency - **Bahrain,** Credit Rating Information & Services Ltd. - **Bangladesh,** Borhan Credit Rating Company Ltd. - **Iran**

Ref: SBL/0030
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Confidential

Mr. Imran Sarmad
President & CEO
Sindh Bank Limited
3rd Floor, Federation House
Abdullah Shah Ghazi Road
Clifton, Karachi.

Ratings of Sindh Bank Limited

Dear Mr. Sarmad,

VIS Credit Rating Company Ltd. (VIS) has reaffirmed the entity ratings of Sindh Bank Limited (SNDB) at 'A+/A-1' (Single A Plus/A-One). Outlook on the assigned ratings is 'Stable'. The previous rating action was announced on June 28, 2019.

The assigned ratings incorporate SNDB being a wholly owned subsidiary of Government of Sindh (GoS). Explicit support of the Bank's sponsor is a key rating consideration. Ratings incorporate sizeable capital injection to the tune of Rs. 11.7billion in 2019 which has allowed the Bank to achieve compliance with Capital Adequacy Ratio requirement. Moreover, an additional Rs. 3billion is expected to be added to Tier-1 capital post-merger with Sindh Leasing which has been approved by the cabinet on 25th June 2020. Strong sponsor support is also evident from sizeable deposits by GoS and related entities. VIS expects strong support to continue in future in order to ensure compliance with regulatory requirements whenever the need arises. In line with its methodology, VIS uses a bottom-up approach for rating entities owned and having explicit support of sub-sovereigns where standalone ratings can be notched up to 3-4 notches which has been factored into the rating to incorporate for strong sponsor support.

On a standalone basis, liquidity and capitalization indicators have witnessed improvement on a timeline basis. Nevertheless, asset quality and profitability profile remain weak. Liquidity buffers are adequate as evident from sizeable liquid assets in relation to deposits and borrowings and significant cushion in terms of LCR and NSFR. However, given the sizeable deposit concentration liquidity buffers remain exposed to external shocks as had been witnessed in 2019. Deposit base after recovering in the last quarter of 2019 has continued growth momentum in the ongoing year. Nevertheless, reducing depositor concentration levels and improving deposit mix is considered important. During the outgoing year, we have noted that senior management team has been strengthened with hiring undertaken at key positions. Ratings incorporate efforts to strengthen governance and risk management framework which is considered important from a ratings perspective.

We have noted that gross financing portfolio depicted a slight decline in the outgoing year. Overall client and sectoral concentration in financing portfolio remain on the higher side signifying sizeable exposure to credit risk. Going forward, management plans to cautiously grow in the consumer and SME segment while quality of underwriting will be crucial as credit risk is higher in these segments. We have been given to understand that restriction on corporate lending remains in place and whenever lifted, will augment the Bank's business plan. Net infection is considerably on the higher side vis-à-vis rating benchmark while provisioning coverage is low due to sizeable FSV benefit realized by the Bank. Regulatory relief measures undertaken by SBP to promote financial stability, ensure continued credit supply to the economy and maintain confidence in the banking system have been received positively and are expected to delay the impact of prevailing headwinds on portfolio asset quality indicators. However, exposure of banking sector to credit risk is elevated due to significant impact of Covid-19 on already weak macroeconomic indicators. Our credit impairment expectations are conservative, albeit there is a probability of deviation from expectations; downside risk is elevated, amidst an uncertain economic environment.

We have noted that investments represented the largest component of SNDB's balance sheet at around 41% of the asset base. Credit risk emanating from investment portfolio is considered limited as ~92% of investments are deployed in GoP securities. Sharp decline in interest rates has resulted in revaluation surplus on PIB portfolio from a significant deficit position. Given the current low level of spreads due to non-performing exposures, SNDB incurred sizeable operating loss in 2019 while higher provisioning charges resulted in SNDB incurring a significant loss. Although quantum of operating losses is expected to decline, VIS expects trend in operating losses to persist in 2020. VIS will continue to closely monitor the bank's performance metrics where compliance with communicated rating benchmarks for asset quality (net infection), capitalization (net-NPLs to Tier-1 equity), profitability (cost to income ratio) and liquidity (deposit concentration) benchmarks while continued sponsor support would remain critical. Any material deterioration in asset quality or continuity of losses will result in weakening in capital buffers and may need to be incorporated in the assigned ratings. Going forward, ratings would remain dependent on qualitative factors delineated in the methodology and adherence to following quantitative benchmarks:

Key ratios (%)	**Benchmarks**
Total CAR	RR+2.75%
Tier-1 CAR	RR+2.75%
Net Infection	2-3%
Net NPLs / Tier-1 equity	15-20%
Liquid Assets / Deposits & Borrowings	In excess of 40%
Top 50 Deposits / Total Domestic Deposits	15-25%
Operational Efficiency	70-80%
ROAA	0.75-1%
Market share (Deposits)	3%
Leverage	Over 4%

***RR: Regulatory Requirement including Capital Conservation Buffer**

Please note that ratings continue to be under surveillance during the period of the contract. Moreover, please note that in terms of the regulatory requirements, ratings would require a mid-term review. In view of this, mid-term review of the assigned rating would fall due in December 2020. Accordingly we would seek your cooperation for updating information available on the system. Furthermore, please notify VIS of any material development that may impact the risk profile of the institution.

We would also like to take this opportunity to place on record our gratitude for the cooperation and courtesy extended to us during the course of the rating assignment.

With kind regards,

Faryal Ahmad Faheem
Deputy CEO