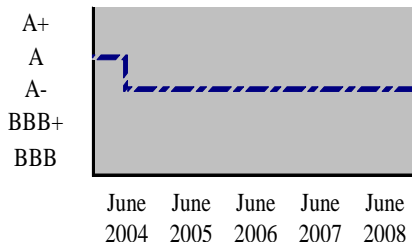


**ALBARAKA ISLAMIC BANK B.S.C. (E.C.) [PAKISTAN BRANCHES] (ABIB)****RATINGS (JUNE 2008)**ALBARAKA ISLAMIC BANK B.S.C. (E.C.)  
[PAKISTAN BRANCHES]

|                | NEW             | PREVIOUS |
|----------------|-----------------|----------|
| <b>ENTITY</b>  |                 |          |
| LONG TERM      | A-              | A-       |
| SHORT TERM     | A1              | A1       |
| <b>OUTLOOK</b> | <i>Positive</i> | -        |

**L.T. ENTITY RATING – HISTORY****FINANCIAL DATA**

PKR (MLN)

|                        | 31-Dec-07 | 31-Dec-06 |
|------------------------|-----------|-----------|
| Total Assets           | 22,077.1  | 18,868.3  |
| Equity                 | 2,446.5   | 2,191.2   |
| Net Income             | 245.5     | 143.9     |
| ROA %                  | 1.20      | 0.86      |
| ROE %                  | 10.59     | 6.34      |
| Equity/ Total Assets % | 11.08     | 11.61     |
| SBP CAR %              | 14.69     | 16.76     |

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AlBaraka Islamic Bank (ABIB), incorporated in Bahrain, is a majority owned (91%) subsidiary of AlBaraka Banking Group (ABG) and it operates four commercial branches in Bahrain and eighteen branches in Pakistan. ABG is a part of Dallah AlBaraka Group (DBG) – a Saudi-based corporate conglomerate and one of the leading privately owned enterprises in the Middle East. ABG, established in June 2002, and listed on Bahrain Stock Exchange and Dubai International Financial Exchange, has an equity base of about US\$ 1.5bln. During the year, ABG successfully completed the merger of its Bahrain based investment unit, Al Amin Bank with and into AlBaraka Islamic Bank resulting in an amalgamated assets base of US\$ 1bln and equity of around US\$ 185mln. ABG has BBB-international rating by S&P.

ABIB commenced branch operations in Pakistan in 1991 and was granted Islamic banking license in 2004. Mr. Shafqaat Ahmed - country head - is a professional banker with over three decades of experience and has been holding the position since the start of the bank's operations in Pakistan.

**RATING RATIONALE AND KEY DRIVERS**

- The ratings reflect ABIB's prudent risk management as reflected by its sound asset quality. Recognising the changing landscape of the banking industry and taking cognizance of the bank's constrained performance in the past, the management has planned various initiatives aiming to improve the bank's relative standing and performance prospects. However, given the intensifying competition, the success of these initiatives remains to be seen. At the same time, affiliation with a strong banking group – AlBaraka Banking Group (ABG) – remains a key rating factor.
- ABIB's ratings have been assigned a positive outlook recognising the benefits to accrue from the proposed local incorporation in improving ABIB's profile and implementation of management's growth strategy. Meanwhile, any material deterioration in the asset quality and/or inability to strengthen its relative positioning among peers could have negative implications for ratings.

**ASSESSMENT**

During 2007, the bank achieved a modest growth in its size. The expansion in advances, together with a slight improvement in spreads led to increase in net revenue. However, ABIB's spreads still remain on lower side among peers owing to higher funding costs. The contribution of fee, commission and foreign currency dealing income towards the total revenue, remained healthy. Meanwhile, the income from stock market operations increased on YoY basis. Resultantly, despite rise in operating costs due to network expansion, the bank experienced improvement in the bottom line. During 1Q08, the overall profitability declined due to increasing operating cost – an outcome of ongoing network expansion, six branches in 4Q07– and provision expense against NPLs.

Going forward, the bank intends to further expand its network by opening 12 more branches during 2008. To achieve the planned credit growth, the bank plans to offer new modes of Islamic financing for the trade, manufacturing and agriculture sector, while planning to increase diversification in SME segment, which currently has modest contribution in the overall finances. Meanwhile, considering the recent trend of rising NPLs in consumer segment, the management intends not to pursue this segment aggressively in the near future. The proposed local incorporation in Pakistan, and consequent increase in equity (more than doubling from current levels) would help the management in effectively pursuing the overall strategy. The capital, currently placed with the SBP due to branch status, would be released for onward deployment in earning avenues. This together with additional capital injection of PKR 3bln to meet SBP capital requirement would provide substantial surplus funds. While in the absence of an active Sharia-compliant money market, the deployment of excess liquidity would remain a challenge, the management has planned various strategies to step up deployment in advances. ABG is pursuing an increasing focus on knowledge and resource sharing among its various subsidiaries, an area neglected in the past. The areas under focus of ABG at present are product development, branding and IT infrastructure. The group is in the process of acquiring globally recognized software – Mysis – and plans to implement it gradually at the group level, including ABIB, in 2009. ABIB's operations are expected to benefit from these initiatives at the group level.

ABIB, through its effective credit evaluation and approval systems, has managed a good asset quality (NPLs to gross advances: end-Mar08: 2.1%; end-Dec06: 2.5%). Meanwhile, due to adequate provisioning the proportion of net impaired lending to equity remains negligible (07: 1.4%; 06: 2.9%). Although individual concentration in the loan book remains on the higher side, the bank's policy of dealing only with well performing clients, having satisfactory credit history and adequate collateralization of the exposure, has so far insulated the bank from any material loss arising out of sectoral and client concentration. Nevertheless, with plans to expand its loan book relatively aggressively, the bank is required to further strengthen its risk management framework making it more comprehensive to effectively assess risks across various sectors, segments, clients and higher volumes.

The main source of ABIB's funding is its deposit base, reflecting around 76% of total assets. The deposit base is highly concentrated, with top 20 depositors constituting 51% of the total. Going forward, the targeted branch expansion would help the management in mobilizing funds from the more stable retail segment.

As per regulatory capital requirements for branch operations, ABIB was insulated from phased increase in capital as its parent has capital more than US\$ 100mln, a condition by SBP to continue its operations. With respect to ABIB's local incorporation plans, the bank has acquired the necessary approvals from SBP and SECP and the management expects the completion of the said process during 2008. In this regard, the sponsors of ABIB have agreed to inject further equity of PKR 3bln to meet the minimum capital requirement. This enhanced equity base would bring the capital of the bank in line with its peers, providing ample cushion for future growth.