The Pakistan Credit Rating Agency Limited

BANKING

ALLIED BANK LIMITED (ABL)

RATINGS (JUNE 2008)
ALLIED BANK LIMITED (ABL)

RATINGS	NEW	PREVIOUS
Entity		
Long Term	AA	AA
Short Term	A1+	A1+
Instrument (TFCs)		
(Unsecured, Subordinated) PKR 5,000mln	AA-	n.a.

FINANCIAL DATA
PKR (mln)

	31-Dec-07	31-Dec-06
Total Assets	320,109.7	252,026.8
Equity	18,408.4	16,229.6
Net Income	4,076.1	4,397.2
ROA %	1.42	1.98
ROE %	23.54	30.18
Equity/Total Assets %	5.75	6.44
SBP CAR	9.29	12.80

ANALYSTS

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TFC Issue

ABL plans to issue listed, unsecured, subordinated TFCs of upto PKR 5,000mln, for a tenor of 10 years. The profit payment, to be made semi-annually in arrears, will be based on 6 months KIBOR plus 85bps for the first 5 years of the TFC Issue, and 6 months KIBOR plus 130bps from the start of the 6th year. The instrument is structured to redeem 0.02% of the principal at every repayment date, with the remaining principal to be redeemed at maturity through a bullet payment. The TFCs have a call option, in whole or in part, exercisable on any profit payment date starting 60th month from the issue date.

RATING RATIONALE AND KEY DRIVERS

- The ratings reflect ABL's good performance prospects emanating from its extensive outreach, sound capital structure and an improving asset quality. While seeking to strengthen its infrastructure and control environment, the management intends to withstand in an increasingly competitive environment through achieving diversification in loan book and leveraging the extensive outreach to expand its retail universe – both for credit expansion and low cost deposit mobilization.
- The ratings are dependent on the bank's effective execution of its business strategy to improve its competitive position. Meanwhile retention and cohesiveness of senior management is critical to ensure consistency in policies and strategy. Although the bank is working in a structured manner to strengthen its risk management framework and IT infrastructure, any inordinate delay in implementation would impact its ability to effectively tap emerging opportunities. Meanwhile, any material deterioration in the asset quality of the bank leading to weakening of its risk absorption capacity, could also adversely affect the ratings.

ASSESSMENT

- ABL is a large sized bank, with a network of 757 branches at end-Mar08. The bank, since its acquisition by the new sponsors, has been improving its system share of advances and deposits with finances-to-deposits ratio leaping from 50% at end-04 to around 71% at end-Mar08. The loan book is currently concentrated in the corporate sector (76%), with remaining major portion being deployed in SME sector and commodity financing. Consumer financing is currently negligible.
- The bank's net interest revenue increased during 2007 on the back of substantial growth in earning assets. The growth helped the bank to manage the impact of increasing proportion of high cost deposits, mobilized to fund aggressive growth in advances, which led to a more than proportionate increase in cost of funds. The contribution of fee-based income towards total net revenue increased appreciably during the year. Meanwhile, higher income from capital market operations supported net revenue. The bank's cost-to-net revenue, though on a higher side, was maintained in 07. However, the bank's YoY performance, in terms of ROE and ROA, declined mainly due to higher impact of provisioning expense on account of change in regulation by SBP.
- ABL is undertaking a number of initiatives to tap the growth potential. These include (i) renovation of branches, (ii) induction of management trainees, (iii) launching of bancassurance products, (iv) aggressive mobilization of deposits with a focus on reducing cost and (v) commencement of asset management operations through a wholly owned subsidiary. While maintaining the finances-to-deposit ratio at around 71%, the management plans to diversify the loan book by increasing the combined share of SME and commercial segment to around one-fourth of the total in the medium term. The bank is targeting overseas operations in Dubai and Bahrain during the year. These initiatives, alongwith ABL's increasing participation in corporate/investment banking and trade-related activities, would help in enhancing fee-based income, and hence profitability.
- ABL witnessed a modest growth in NPLs in 07. However, the bank's net NPLs as a percentage of gross advances declined to 6.4% at end-07 (06: 6.7%, 05: 10.3%). Going forward, though the management is targeting further reduction in NPLs through expected cash recovery and regularization, given the relative weakening of the macroeconomic environment, there would be pressure on asset quality, necessitating strengthening of monitoring systems. Concentration of top-20 borrowers is relatively high, but the risk is mitigated as most of them are public sector entities and reputable private groups.
- Implementation of core banking software, Temenos, has been delayed by about a year and as per revised timeline the first branch is expected to go live by June 2009. Meanwhile other technological initiatives at the front end have enabled the bank to improve upon its service quality. However as most of the technological initiatives are Temenos dependent, much of it depends upon effective and timely implementation of the core banking software.
- ABL maintains adequate liquidity with a major proportion of investment portfolio deployed in T Bills. This also largely mitigates interest rate risk, as ABL has modest investments in PIBs. Investment in low risk fixed income funds increased significantly during the year. Although equity investment increased significantly over the previous year, mainly in 1Q08, potential risks are mitigated owing to the portfolio's diversified, liquid and dividend-yielding characteristics. Nevertheless, equity investments, as a percentage of the bank's equity, were close to the maximum limits stipulated by SBP.
- The bank's capitalization declined due to aggressive expansion in funded as well as non-funded exposure during the year. The strength of CAR is primarily derived from Tier-I capital. The bank plans to issue TFCs of PKR5bln in near future to strengthen Tier-II capital. This would provide the requisite capital for planned growth.

PROFILE

- Ibrahim Group (IG), through its different companies and family members, owns 76% of shareholding in ABL. Apart from interest in the financial sector, the IG is engaged in manufacturing of yarn and polyester staple fibre, trading, and generation of electric energy. SBP is also a shareholder with around 10% holding.
- The eleven member BoD is dominated by nominees of IG and also includes 2 government nominees. The board is actively involved in providing strategic input to management on a regular basis. Board oversight of the management ensures effective implementation of its policy directives in line with its strategic vision to promote a risk culture in the bank.
- The bank recently appointed Mr. Aftab Manzoor as CEO. He is a seasoned banker with almost 25 years of banking experience. Before joining ABL in November 2007, he served MCB Bank for 7 years as President & CEO. He is assisted by an experienced senior management team.

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