Bank Alfalah Limited (BAL)

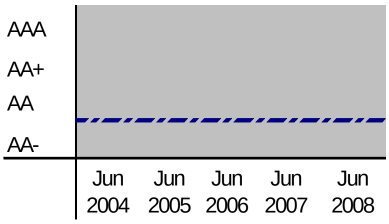
RATINGS (JUNE 2008)

BANK ALFALAH LIMITED (BAL)

	New	Previous
Entity		
Long Term	AA	AA
Short Term	A1+	A1+
TFC Issues		
Unsecured, Subordinated		
1st *(PKR 650mln)*	A1+^	AA-
2nd *(PKR 1,250mln)*	AA-	AA-
3rd *(PKR 1,325mln)*	AA-	AA-
4th *(PKR 2,500mln)*	AA-	-

^ Short-term rating

LT-RATING HISTORY



FINANCIAL DATA

PKR (mln)	31-Dec-07	31-Dec-06
Total Assets	328,895	275,686
Pure Equity	13,767	10,573
Adjusted Equity**	16,220	12,242
Net Income /(Loss)	3,130	1,763
ROA (%)	1.0	0.7
ROE (%)	25.7	20.4
Equity/ Assets (%)	4.2	3.8
SBP CAR (%)	9.6	9.5

* Based on first three months reviewed results
** Includes revaluation surplus on assets

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TFC ISSUES

BAL issued first unsecured subordinated TFC during December 2002 for a tenor of 6 years. Given its full redemption in Dec08, the instrument is assigned short term rating of A1+. The bank issued second unsecured subordinate TFC during December 2004 for a tenor of 8 years carrying mark-up at a floating rate of latest 6-month KIBOR plus 1.5%. Major principal redemption will be in three equal semi-annual installments commencing from the 84th month of the issue (i.e. December 2011). The bank issued its third TFC in November 2005 for 8 years at terms similar to the second issue. Major principal redemption, in three equal semi-annual installments, will commence from November 2012. The bank is considering to issue its fourth subordinated instrument in the near term for a tenor of 8 years.

RATING RATIONALE AND KEY DRIVERS

- The ratings reflect BAL's demonstrated ability to maintain its established position in spite of intensified competition in the banking industry. The ratings also recognize the bank's improved performance prospects emanating from its expanding franchise value that has started yielding benefits in terms of effective deposit mobilization. At the same time, BAL has a higher degree of diversity in its loan book. The relatively stressed capital structure of the bank is unlikely to change, though the management has demonstrated the capacity to raise its capital, both Tier 1 & 2, to cater for its growth targets. Meanwhile, the ratings recognize the continuing support of financially robust sponsors as a key factor.
- The ratings are dependent on the bank's success to sustain its relative standing in an increasingly competitive banking environment, while improving its risk management systems in tandem with its expansion. Meanwhile, any material deterioration in its asset quality, in turn diluting its profitability and weakening the risk absorption capacity, would have negative implications for the ratings.

ASSESSMENT

- The bank maintained its position as the fifth largest bank of Pakistan in terms of total assets. BAL's advances witnessed sizeable growth (around 14%) funded by healthy deposit mobilization. The growth was above the industry, further strengthening BAL's system share. However, the bank's share in the industry's deposit base experienced a marginal squeeze, attributable to its cautious approach towards deposit mobilization to achieve a favorable deposit mix for augmenting spreads. In addition, BAL continued expanding its consumer base with main focus on credit cards, followed by mortgage business.
- The non-fund based income registered impressive growth on YoY basis. While fee income grew mainly on the back of expansive credit card base (above 380K), continued expansion in volume of trade business (07: US$ 4.3bln, 06: US$ 3.2bln) supported the growing commission income. BAL had to make provisions of PKR 2.3bln in 2007. However, its likely negative impact on the bottomline was mitigated by one-off capital gains of PKR 1.8bln on sale of Warid Telecom shares. This enabled BAL to report healthy bottomline during 2007 despite its relatively higher operating cost structure among peers.
- Going forward, the bank intends to maintain the growth trend with targeted advances (net of export refinance)-to-deposit ratio in the range of 65%-70%. While preserving diversification in the credit portfolio, the management intends to deploy additional funds in risk free avenues including direct/indirect sovereign lending. Growth in consumer financing is expected to be fuelled mainly by the credit card business. Meanwhile, BAL plans to add 49 new branches to its network in the near-term with primary focus to build low cost deposit base. Though BAL's profitability is likely to improve, it is expected to remain under pressure on account of rapid network expansion. Meanwhile, the bank, in addition to exploring prospects of entry into other regional countries, intends to fortify its existing overseas operations with expansion in branch network and deployment of complete suite of all financial products.
- BAL is undergoing a revamping of its organizational structure with an aim to improving the efficiency of decision making at all levels and enhancing the quality and timeliness of its services. Besides, instilling a risk conscious culture is also a key objective. BAL's Risk Management Division (RMD) has developed Credit Initiation and Internal Rating System (CIIRS) in accordance with Basel II for generating obligor internal ratings. CIIRS provides technological platform for assessing credit worthiness of new and existing customers and enables structured analysis of customer data for decision making. The system is currently in validation phase. Moreover, the bank is implementing Economic Capital Framework (ECF) across the bank, which is expected to enable BAL to quantify and attribute cost to various material risks besides facilitating in calculating the risk adjusted profitability of each business line.
- BAL experienced sizeable increase in non-performing loans during 2007, which further increased to PKR 5.3bln in 1Q08 (NPLs/gross advances: 3%). Nonetheless, the bank continues to have better asset quality among peers. In spite of sizeable growth in consumer portfolio, NPLs arising from this portfolio, as a percentage of gross advances-to-consumers, were only 5% at end-Mar08. The bank, in addition to having a special assets management division for regularly monitoring NPLs, has initiated Significant Non-Performing Loan Analysis with a view to identifying reasons for delinquencies. This is likely to help manage any adverse developments in the advances portfolio on a pre-emptive basis. Nevertheless, the management's ability to maintain its asset quality remains critical.
- BAL, with its relatively low advances-to-deposit ratio, maintains a sizeable investment portfolio at end-07: PKR 85bln of which the major portion is represented by Market Treasury bills (c. 80%). Given their short-term nature, BAL's exposure to the interest rate risk remains limited. BAL's equity portfolio is around PKR 6bln, with larger proportion being represented by strategic investments.
- To improve the timeliness of its activities and the quality of services and to support risk management, the bank is in the process of installing a new comprehensive core banking software – Temenos T24. Although there have been delays in the implementation process, the system is expected to be fully operational across the branch network by end-09.
- BAL has one of the lowest equity-to-assets ratio amongst peers. To support its growth initiatives, the bank is contemplating either to have a right issue in 3Q08 or raise Tier II capital.

PROFILE

- The Abu Dhabi Group (ADG), comprising some of the prominent members of UAE's ruling family, leading businessmen of UAE and their associates, owns the majority shareholding in BAL since its privatisation in 1997. The bank is listed on the Karachi and Lahore Stock Exchange. The bank has a leading position in consumer, trade finance and working capital finance.
- The seven member BoD comprises four members from ADG and three other professionals including the CEO. The chairman of the board, H.E. Sheikh Hamdan Bin Mubarak Al Nahayan, is Federal Minister of Public Works, United Arab Emirates. The current CEO, an MBA with above three decades banking experience, joined BAL in 2001 and elevated to the current position in mid 2007. BAL, with a domestic network of 223, has operations in Bangladesh (5 branches) and Afghanistan (2 branches), and is on the lookout for further regional expansion. The bank also entered into communication sector and other dimensions of financial services – brokerage, asset management, and insurance – through its subsidiaries and associates, which are in their gestation phase and would require sometime before emerging as material contributors to BAL's revenue stream.