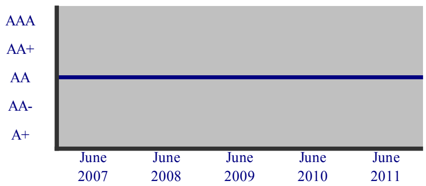
BANKING

The Pakistan Credit Rating Agency Limited

RATINGS (JUNE 2011)

BANK ALFALAH LIMITED (BAL)

	New	Previous
Entity		
Long Term	AA	AA
Short Term	A1+	A1+
TFCs Issues		
Unsecured, Subordinated		
2nd *(PKR 1,250mln)*	AA-	AA-
3rd *(PKR 1,325mln)*	AA-	AA-
4th *(PKR 5,000mln)*	AA-	AA-



FINANCIAL DATA

PKR (mln)

	Mar-11*	Dec-10	Dec-09
Total Assets	407,781	411,483	389,070
Equity	20,587	19,726	19,770
Net Income	929.7	968	897
ROA %	0.91**	0.24	0.24
ROE %	18.4**	4.9	5.2
Equity / Assets (%)	5.1	4.8	5.1
SBP CAR %	11.4	10.5	12.5

**Based on unaudited results for three months*
*** Annualized*

ANALYSTS

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PROFILE

- The bank, listed on all the bourses of the country, has a network of 386 branches. 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 the bank. The bank has strategic investments in communication sector and other dimensions of financial sector – asset management, brokerage, and insurance. However, the investments, particularly non-financial, are still far from reaching sustainable strength.
- The seven member BoD comprises four members from ADG, two independent directors and 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 CEO, Mr. Sirajuddin Aziz, has over three decades of banking experience and is supported by a seasoned management team.

RATING RATIONALE AND KEY RATING DRIVERS

- The ratings reflect BAL's sustained market positioning despite increasingly tough operating environment in the country. The bank's asset quality has been impacted, attributable to continuing pressure on the socio-economic landscape, though infection largely remains concentrated in few segments and is aligned with the peer group. Moreover, the bank's twofold strategy – low-cost deposit mobilization and cautious advances deployment – is expected to yield better profitability. Meanwhile, the ratings recognize the demonstrated support of Abu Dhabi group as a key factor.
- The ratings are dependent on the bank's ability to sustain through continuing depressed macro-economic fundamentals, while improving its risk management systems inline with its expansion. In the meantime, cohesiveness of the management team would be critical. Meanwhile, material deterioration in the asset quality, impacting both BAL's profitability and risk absorption capacity, would have negative implications for the ratings.

ASSESSMENT

- The macroeconomic landscape of Pakistan remains uncertain. Although a few indicators have improved as reflected in current account surplus of the country, prolonged energy crisis, stubborn inflationary pressure and burgeoning fiscal imbalance continue to pose major challenges to economic growth. This is also reflected in continuing weakening in the asset quality of the banks. The pace of accumulation of NPLs has stalled lately, but it would be challenging for the banks to maintain asset quality amidst subdued business sentiments .
- During 2010, BAL slightly enhanced its system share in advances. BAL's exposure in terms of sectoral distribution remained unchanged except moderate increase in power and textile. The top 20 concentration in advances went significantly higher (10: ~37%, 09:25%), attributed to lending to government for commodity operations and circular debt; excluding this top 10 advances had modest concentration of 10% (09: 8%). Meanwhile, the bank's deposit mix observed a significant change during the last quarter of 2010 with a substantial rise in CASA, which reached 70% at end-1Q11 (end-1Q10: 59%). Nevertheless, the bank, at end-Dec10, had six depositors, with more than 1% contribution towards deposits (cumulative 10%), signifying room for improvement.
- During 2010, BAL experienced significant enhancement in its net interest revenue. Although the bank's asset yield slightly declined, the spread of the bank observed nominal improvement (2010: 4.4%, 2009: ~4.0%) due to increased low-cost deposits. Owing to low transaction volume on credit cards, the bank witnessed a dip in related income, though it was cushioned by hike in commission income and other service charges. BAL largely maintained its cost-to-total net revenue ratio, despite branch expansion. Meanwhile, the bank recognized PKR 1.7bln on account of diminution in value of its investment in Warid. Moreover, the classified portfolio exerted pressure in the form of provisioning expenses though lower on YoY basis. Nevertheless, BAL's Islamic banking business continued a healthy before tax contribution ((Dec10: 70%; Dec09: 69%) to BAL's earnings. During 1Q11, the improving trend in performance has continued mainly on the back of success in retaining low cost deposits.
- BAL has experienced considerable increase in its non-performing loans in the recent years. Consequently, its NPLs as a percentage of gross advances increased to 8.7% at end-Mar11 (end-08: 4.5%). The unprovided portion still continues to remain on higher side. Although fresh infection is anticipated, net addition in NPLs would remain limited, given higher probability of recovery in some accounts.
- Going forward, the bank plans to follow its cautious lending approach while aiming higher CASA mobilization. Given limited market size and increasing competition, the extent of the bank's success in this regard remains to be seen. The implementation of Temenos (T24) as core banking software has faced delays and the system is expected to be fully operational across the entire network by end-1Q12.
- BAL's investment portfolio constitutes 23% of the assets at end-Mar11 (end-Mar10: 22%). A significant portion of it comprises government securities – T-Bills (~51%), SBP ijarah and WAPDA sukuks (23%), and PIBs (14%) – signifying low credit and interest rate risk. The remaining portion includes equity investments mainly strategic in nature (6%), overseas government bonds (4%) and income based mutual funds (2%).
- The bank, with its low advances-to-deposit ratio, maintains adequate liquidity. Its CAR – lower on YoY basis due to higher risk-weighted assets – remains above regulatory requirement.

TFCs ISSUES

- The bank issued its second unsecured subordinate TFCs 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. Dec-11). The bank issued its third TFCs in November 2005 for 8 years tenor at terms similar to the second issue. Major principal redemption, in three equal semi-annual installments, will commence from Nov-12. The fourth TFCs of the bank, with a tenor of 8 years, was issued in December 2009. Major portion of the TFCs will be repaid in three equal semi-annual installments commencing from Dec-16.