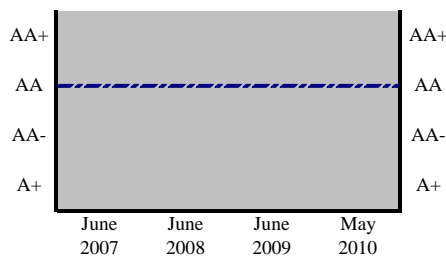


RATINGS (JUNE 2010)
FAYSAL BANK LIMITED (FBL)

	NEW*	PREVIOUS
ENTITY		
Long Term	AA	AA
Short Term	A1+	A1+
Outlook	-	Negative

*Placed on Rating Watch

RATING HISTORY

FINANCIAL DATA

PKR (mln)

	Mar-10*	Dec-09	Dec-08
Total Assets	168,747	180,865	138,241
Equity	13,022	11,336	10,136
Net Income	1,685.7	1,200.3	1,115.0
ROA%	3.86 [^]	0.75	0.80
ROE%	55.36 [^]	11.18	10.89
Equity/Assets %	7.72	6.27	7.33
SBP CAR%	11.80	11.89	10.84

*Based on unaudited results for 3 Months ended March10

[^]Annualized

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RATING RATIONALE AND KEY DRIVERS

- The ratings reflect FBL's ability to withstand tough operating environment and maintain its market standing. This is reflected in increasing earning asset base and improving liquidity position. Meanwhile, the bank has achieved progress in arresting infection in its asset quality by streamlining monitoring/recovery efforts and tightening of risk management controls, though with subdued economic conditions, asset quality would remain a concern. The ratings recognize FBL's association with a financially sound business group (Dar Al Maal Al-Islami Trust).
- The ratings are dependant on the bank's ability to effectively execute its medium-term business strategy to fortify its competitive position within the sector. Meanwhile, cohesiveness and stability in the senior management to ensure continuity of business plan remains critical. Any material deterioration in the asset quality, with dual impact upon FBL's profitability and hence risk absorption capacity, would adversely impact the ratings.
- FBL has recently signed a Share Purchase Agreement for acquiring 99.37% shares of Pakistan Operations of Royal Bank of Scotland. In view of this, the ratings of the bank have been placed upon Rating Watch. With the completion of the acquisition, PACRA will review its ratings taking into account the impact on FBL's strategy, capital structure and integration of the two entities.

ASSESSMENT

- Despite achieving robust growth in deposits (20% YoY), the bank had a moderate growth in finances (14%) during 2009, owing to a conservative lending strategy. Holding back its branch expansion strategy, FBL focused on expanding its product slate to cater a diverse clientele besides launching Barkat Islamic Banking and Solitaire Wealth Management. The finances book of FBL is dominated by the corporate segment (64%), followed by SME (14%) and consumer (13%). FBL's top 20 exposures remain on the higher side (end-09: 28%, end-08:27%). Furthermore, the deposit expansion is skewed towards increased reliance on top 20 depositors (end-09: 24%, end-08: 15%).
- During 2009, FBL's interest revenue registered a healthy growth, on the back of increase in finances and higher asset yield. However, sizeable increase in interest expense, due to higher cost of deposits (up by around 130bps), led to squeezed spreads and relatively flat growth in net interest revenue. Non-interest income continued to support the bank's overall revenues, despite lower final dividend from investment in NI(U)T-LoC. Meanwhile, higher operating costs and increased quantum of provisions against NPLs precluded expansion in net income of the bank on a comparative basis. During 1QCY10, FBL witnessed significant upturn in its reported profitability, attributed to recognition of revaluation gain on investments (PKR 1.7bln). Otherwise, the performance experienced limited improvement, mainly led by lower provisioning expense.
- Going forward, FBL's philosophy is that finances growth should be pursued without compromising the risk profile of the bank. In this regard, FBL is targeting non-cyclical sectors including infrastructure, fertilizers, and energy. Meanwhile, the bank aims to pursue selective growth strategy with reference to its SME and consumer portfolio.
- Rising trend in non-performing loans (NPLs) continued in 2009, but curtailed in 1QCY10. NPLs as a percentage of gross advances rose to 10.9% by end-09, while settling at 10.3% in Mar10 (Mar09: 8.6%). While some large exposures have high contribution towards the NPLs, the trend is more broad based among different sectors and borrowers' profile. The bank's provisioning against rising NPLs has remained sufficient through internally generated funds, with net NPLs-to-equity intact at around 24% (end-Dec08: 23%). The management has intensified its efforts to arrest the trend by expediting the recovery efforts and vigilant monitoring of watch-list accounts. Given continuing depressed socio-economic environment, probability of fresh infections may not be ruled out.
- The bank continued to operate at a high finances-to-deposit ratio (2009: 83%; 2008: 88%), which has further increased to 95% in 1QCY10 as the bank retired a significant portion of high cost time-deposits to rationalize its deposit mix. However, the bank maintains adequate liquidity as it carries significant inventory of government securities in the form of T-bills and PIBs.
- FBL's investments of PKR 44.8bln form ~27% of total assets at end-Mar10. The portfolio is dominated by T-bills (70.8%), signifying low credit and market risk, and PIBs (11.2%). The remaining portion is deployed in fixed-income funds/preference shares (2.2%) and equities (15.4%).
- The capital of the bank primarily constitutes Tier-1 capital that provides significant cushion to absorb the impact of any adverse macroeconomic shocks. Recognition of revaluation gain on investments has provided further room for growth. Meanwhile, retention of profits has supplemented FBL's capital structure.

PROFILE

- The bank started operations in Pakistan in 1987, first as a branch set up of Shamil Bank of Bahrain and since 1994, as a locally incorporated bank under the present name of Faysal Bank Limited. FBL is a medium sized bank, with a network of 133 branches at present.
- Ithmaar Bank, a 45% owned associate of Dar Al-Maal Al-Islami Trust (DMI), holds the majority shareholding (67%) of FBL. The DMI group owns and operates an international network of Islamic Banks, and Investment and Insurance companies.
- The seven-member BoD includes three nominees of DMI, the CEO, and three renowned professional from Pakistan, including the Chairman. The BoD exercises close monitoring of the bank's operations through its three committees, namely i) Board Risk Management Committee (BRMC); ii) Recruitment Nomination and Remuneration Committee (RNRC); and iii) Audit Committee (AC). The CEO, Mr. Naved A. Khan, joined FBL in Mar08 and has extensive local and international banking experience.