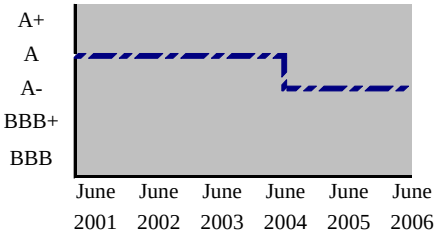
ALBARAKA ISLAMIC BANK B.S.C. (E.C.) [PAKISTAN BRANCHES] (ABIB)

Ratings (June 2006)

AlBaraka Islamic Bank B.S.C. (E.C.) [Pakistan Branches]

	New	Previous
Entity		
Long Term	A-	A-
Short Term	A1	A1
Outlook	***Positive***	***Positive***

L.T Entity Rating – History



Financial Data

PKR (mln)

	31-Dec-05	31-Dec-04
Total Assets	14,618.6	11,939.5
Equity	2,352.5	1,656.8
Net Income	345.6	126.9
ROA %	2.60	1.17
ROE %	17.24	9.08
Equity/ Total Assets %	16.09	13.88
SBP CAR %	23.22	18.77

Analysts

Sumaira Fazal
+92 42 5869504
sumaira@pacra.com
Shahzad Saleem
+92 42 5869504
shahzad@pacra.com

Background

- AlBaraka Islamic Bank (ABIB), incorporated in Bahrain as an offshore bank, is a subsidiary of AlBaraka Banking Group (ABG). ABG is part of Dallah AlBaraka Group (DBG) – a Saudi-based corporate conglomerate, which has emerged as one of the top privately owned enterprises in the Middle East. ABG was established in June 2002 with an objective to consolidate the financial areas of DBG into a cohesive organization pursuing a uniform strategy. ABG carries out commercial and corporate banking, treasury and fund management activities through its ten subsidiaries operating in various countries. The bank, through a recently completed IPO, got listed on Bahrain Stock Exchange and Dubai International Financial Exchange. Through this issue, ABG has become one of the largest *Islamic* banking institutions in terms of capital (US$ 630mln).
- ABIB commenced commercial operations in Pakistan in 1991 and currently operates from nine branches in the country. The present country head – a professional banker with over three decades of experience – has been holding the position since the start of the bank's branch operations in Pakistan. The bank has been granted Islamic banking license during 2004, and is in the process of conversion into a locally incorporated *Islamic* bank.

Rating Rationale

Assessment

- The ratings reflect ABIB's maintained good asset quality and strong capitalization. At the same time, ratings factor in the bank's somewhat constrained performance and prospects relative to some other banks. This emanates from ABIB's competitive disadvantage of limited geographical outreach, which raises difficulties in fund mobilization as well as credit expansion. Meanwhile, the management's efforts to explore new credit avenues while enhancing return and potential benefits in the wake of its move towards incorporation as a local Islamic bank are considered positive.
- During 2005, ABIB achieved substantial deposit growth but could not deploy these funds in credit avenues effectively, resulting in a decline in credit-to-deposit ratio. The bank opened only two new branches, as against the target of five, making a network of 9 branches at end-05. With the modest target for network expansion during the current year, volume growth is expected to remain low. While ABIB's cost of funds increased substantially, higher proportionate increase in mark-up revenue – on the back of better margins on *morabah* financing – resulted in a slight improvement in spreads. This coupled with hefty capital gains mainly on account of disposal of NIT units led to a substantial increase in the bottom line, thereby improving performance indicators to a record high level. However, the overall profitability without the impact of non-recurring income, capital gains, remained lower on YoY basis owing to higher operating cost and provisions.
- Going forward, the sustainability of profitability will largely depend on the bank's ability to expand its credit portfolio in a highly competitive operating environment. ABIB, while maintaining growth in corporate credit exposure, is increasing focus on higher yielding consumer financing. As part of this, the management plans to market the bank's consumer finance product Car*Ijarah* aggressively. On the medium-term horizon, credit growth would be accelerated through approaching untapped areas by introducing innovative *shari'a* compliant products.
- During 2005, ABIB sold a major part of its holding of NIT units, thereby reducing the total portfolio to 4% of equity as against 22% at end-04. Though the overall investments increased during 1Q06 mainly on account of investment in sukuk bonds, the bank's exposure to stock market still remains as low as 5% of the total equity. Going forward, the bank continues to follow its policy to limit the equity securities portfolio to the maximum of US$ 3mln, which currently represents 8% of equity.
- The bank has been able to maintain its good asset quality, with net impairment to equity being less than 4%. Though the ratio of impairment to gross finances increased due to a few fresh infections, the management is pursuing recovery thereagainst. Going forward, in order to manage the risk arising from higher growth stance mainly in consumer financing, the bank is strengthening its risk management framework. A separate risk management department has been established to further tighten the controls, and a revised risk management policy is being implemented, thereby mitigating the potential credit risk. Meanwhile, the bank has done foundation work for the implementation of Basel-II framework, and the revamp process is in the finalization stage.
- ABIB is fairly well capitalized and its equity-to-total assets ratio has remained stronger than most banks. Though the bank's risk weighted assets increased during 2005, this did not impact CAR which improved further owing to additional capital injection and remains among the highest in the sector. Going forward, the management plans to maintain its strong capital structure through a combination of profit retention and issuance of right shares in the post localization scenario.

Rating Outlook & Key Rating Drivers

- The Positive Outlook, assigned last year, to ABIB's ratings has been maintained based on the increasing strength of the ABG and expected benefits in the post localization scenario, such as availability of the capital to the bank due to freeing of the same from SBP and independence of the management leading to strategic decision making more in tune with the local market. However, as these developments are still in the implementation phase, the expected benefits in quantitative terms are expected to be realised with a time lag. Additionally, considering the intensifying competition, the extent of the impact remains to be seen.

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