The Pakistan Credit Rating Agency Limited

FAYSAL BANK LIMITED (FBL)

RATING REPORT

	NEW [JUN-17]	PREVIOUS [JUN-16]
Long Term	AA	AA
Short Term	A1+	A1+
Outlook	Stable	Stable

REPORT CONTENTS

JUNE 2017

Assets:

- During CY16, the banks total earning assets grew marginally by 2%. Nearly 86% of FBL's assets are earning assets mainly comprising finances (49%) and investments (37%).
- The bank's advances increased by ~13% during CY16
- The sectoral concentration remained inclined towards the energy sector (17%) and agriculture (15%).
- Top 20 client concentration, which comprises a mix of high rated corporates, declined to 21% of the total exposure (CY15: 25%).

Funding

- The main source of FBL's funding – deposit base – witnessed 16% growth largely due to increase in customer deposits.
- The advances-to-deposits ratio (ADR) continued a similar trend at 61% (CY15: 61%).

Credit Risk

- The NPLs of the bank remained stagnant during the period. Herein, the coverage ratio also remained steady (CY16: 83%, CY15:81%) on the back of provisions booked by the bank.
- Due to increased advances book, the bank's infection ratio decreased to 14% during CY16 (CY15: 17%).

Market Risk

- The investments book forms ~38% of total assets at end-Dec16 (CY15: 46%).
- FBL observed a decrease of ~13% (CY16: PKR 170bln, CY15: 195bln) in its investment portfolio mainly due to a reduction in Pakistan Investment Bonds (PIB).
- The portfolio is dominated by T-bills (53%), followed by PIBs (32%) and equity (3%).
- The bank has been consistently increasing its exposure towards T-Bills as a percentage of investment book.

Performance

- The bank's net interest revenue decreased by 13% on the back of decreased interest income from customer financing coupled with reduction in PIB's.
- The higher contribution from a realization of gain on sale of investments coupled with increase in fee, commission and brokerage helped in augmenting the bank's non-mark up income, in turn positively impacting the total revenue stream on a YoY basis.
- The dip in the overall provisioning expenses supported a moderate growth in the bank's profitability on a YoY basis (CY16: PKR 4,302mln, CY15: 4,222mln).
- The spreads decreased by 130bps (CY16: 2.9%, CY15: 4.2%) on account of a greater dip in the asset yield as compared to the rationalization in cost of funds

Capital

- FBL's paid-up capital stands at PKR 11,998mln (CY15: 11,998mln), thus safely meeting the MCR of PKR 10,000mln for end-Dec16.
- During CY16, the bank achieved a CAR of 14.6% (CY15: 14.4%)

Business Strategy

- FBL plans to focus on mobilizing low cost core deposits and enhancing business volume via branch outreach while bringing cost efficiencies.
- The Bank intends to convert its operations to Shariah compliant by 2020

Profile

- Faysal Bank Limited (FBL) 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. The bank has a nationwide network of 355 branches at end-Dec16

Governance and management

- The overall control of the bank vests in the ten-member Board of Directors (BoD) including the CEO. Mr. Farooq Rahmatullah, the Chairman, is a professional carrying extensive experience in diverse roles related to the oil and gas industry.
- Mr. Yousaf Hussain, is the designated acting CEO.

RATING RATIONALE

Faysal Bank Limited (FBL) continued its focus on cautious growth and consolidation of its relative positioning among peer banks. The bank has enduring emphasis on low cost CASA deposits, prudent deployment of assets for better yields and carefully planned loan book growth. FBL is targeting reduction in Non-Performing Loans through various measures including recoveries and settlements under the approved policy. The bank has a continued focus on operational efficiency and was able to keep its costs under control and improve its efficiency ratio. These initiatives have supported the bank's profitability and provided cushion against risk absorption capacity. The management is cognizant of dynamic competition in the industry and is taking steps to strengthen FBL's positioning amongst medium-sized banks operating in Pakistan. FBL's conversion into Islamic banking is a medium-term plan, which is being rolled out as envisaged. Meanwhile, the ratings recognize FBL's association with a foreign business group (Dar Al Maal Al-Islami Trust).

KEY RATING DRIVERS

The ratings are dependent on bank's ability to sustain improvement in its financial profile. This is important since most peer banks have gained in terms of their size and profitability matrix in recent years. Any material weakening in asset quality, in turn, putting pressure on bank's profitability and risk absorption capacity may have negative implications for the ratings

INDUSTRY SNAPSHOT

The banking sector experienced substantial expansion in its deposit base (2016: 14%). Building on the uptick in the economy, advances also grew by a sizeable margin after a lag of many years. Given GDP growth in FY17 and other macro-economic fundamentals, credit expansion is foreseen. Hence, CAR is going to be a challenge, as profits would also suffer due to PIBs maturities.

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Faysal Bank Limited

BALANCE SHEET	30-Mar-17	30-Dec-16	30-Dec-15	31-Dec-14
	3M	Annual	Annual	Annual
Earning Assets				
Advances	194,265	199,789	175,154	175,383
Debt Instruments	17,177	17,982	7,969	7,737
Total Finances	211,443	217,771	183,123	183,120
Investments	170,516	154,322	189,669	149,299
Others	3,064	8,431	3,663	3,672
	385,022	**380,524**	**376,455**	**336,091**
Non Earning Assets				
Non-Earning Cash	31,211	34,948	23,739	18,036
Deferred Tax	2,552	2,264	3,087	2,429
Net Non-Performing Finances	2,658	2,948	3,813	4,017
Fixed Assets & Others	22,069	23,781	22,979	27,553
	58,490	**63,941**	**53,618**	**52,035**
TOTAL ASSETS	**443,512**	**444,465**	**430,073**	**388,126**
Interest Bearning Liabilities				
Deposits	337,643	340,306	292,130	283,346
Borrowings	54,944	54,303	93,559	63,922
	392,586	394,609	385,690	347,268
Non Interest Bearing Liabilities	14,588	14,847	14,031	14,555
TOTAL LIABILITIES	**407,174**	**409,456**	**399,720**	**361,823**
EQUITY (including revaluation surplus)	**36,337**	**35,008**	**30,353**	**26,303**
Total Liabilities & Equity	**443,512**	**444,465**	**430,073**	**388,126**

INCOME STATEMENT	30-Mar-17	30-Dec-16	30-Dec-15	31-Dec-14
	3M	Annual	Annual	Annual
Interest / Mark up Earned	6,909	26,201	32,313	32,313
Interest / Mark up Expensed	(3,396)	(14,134)	(18,358)	(18,480)
Net Interest / Markup revenue	**3,513**	**12,066**	**13,955**	**13,832**
Other Income	1,996	6,746	5,557	4,373
Total Revenue	**5,509**	**18,812**	**19,512**	**18,206**
Non-Interest / Non-Mark up Expensed	(2,855)	(11,474)	(11,198)	(12,295)
Pre-provision operating profit	2,653	7,338	8,314	5,911
Provisions	277	(679)	(1,393)	(2,359)
Pre-tax profit	2,930	6,659	6,920	3,552
Taxes	(1,063)	(2,357)	(2,698)	(1,075)
Net Income	**1,868**	**4,302**	**4,222**	**2,477**

Ratio Analysis	30-Mar-17	30-Dec-16	30-Dec-15	31-Dec-14
	3M	Annual	Annual	Annual
Performance				
ROE	25.1%	14.9%	17.6%	11.7%
Cost-to-Total Net Revenue	51.8%	62.6%	58.2%	69.6%
Provision Expense / Pre Provision Profit	-10.4%	9.3%	16.8%	39.9%
Capital Adequacy				
Equity/Total Assets	7.0%	6.6%	6.1%	5.6%
Capital Adequacy Ratio as per SBP	15.9%	14.6%	14.4%	12.2%
Funding & Liquidity				
Liquid Assets / Deposits and Borrowings	56.8%	52.7%	57.6%	44.1%
Advances / Deposits	59.0%	60.2%	62.0%	64.0%
CASA deposits / Total Customer Deposits	70.8%	68.6%	67.6%	64.9%
Intermediation Efficiency				
Asset Yield	7.3%	6.9%	9.1%	10.3%
Cost of Funds	3.8%	4.0%	5.0%	5.5%
Spread	3.5%	2.9%	4.1%	4.8%
Outreach				
Branches	355	355	280	274

CREDIT RATING SCALE & DEFINITIONS

Credit rating reflects forward-looking opinion on credit worthiness of underlying entity or instrument; more specifically it covers relative ability to honor financial obligations. The primary factor being captured on the rating scale is relative likelihood of default.

LONG TERM RATINGS

AAA	**Highest credit quality.** Lowest expectation of credit risk. Indicate exceptionally strong capacity for timely payment of financial commitments.
AA+ AA AA-	**Very high credit quality.** Very low expectation of credit risk. Indicate very strong capacity for timely payment of financial commitments. This capacity is not significantly vulnerable to foreseeable events.
A+ A A-	**High credit quality.** Low expectation of credit risk. The capacity for timely payment of financial commitments is considered strong. This capacity may, nevertheless, be vulnerable to changes in circumstances or in economic conditions.
BBB+ BBB BBB-	**Good credit quality.** Currently a low expectation of credit risk. The capacity for timely payment of financial commitments is considered adequate, but adverse changes in circumstances and in economic conditions are more likely to impair this capacity.
BB+ BB BB-	**Moderate risk.** Possibility of credit risk developing. There is a possibility of credit risk developing, particularly as a result of adverse economic or business changes over time; however, business or financial alternatives may be available to allow financial commitments to be met.
B+ B B-	**High credit risk.** A limited margin of safety remains against credit risk. Financial commitments are currently being met; however, capacity for continued payment is contingent upon a sustained, favorable business and economic environment.
CCC CC C	**Very high credit risk**. Substantial credit risk "CCC" Default is a real possibility. Capacity for meeting financial commitments is solely reliant upon sustained, favorable business or economic developments. "CC" Rating indicates that default of some kind appears probable. "C" Ratings signal imminent default.
D	Obligations are currently in default.

SHORT TERM RATINGS

A1+: The highest capacity for timely repayment.

A1:. A strong capacity for timely repayment.

A2: A satisfactory capacity for timely repayment. This may be susceptible to adverse changes in business, economic, or financial conditions.

A3: An adequate capacity for timely repayment. Such capacity is susceptible to adverse changes in business, economic, or financial conditions.

B: The capacity for timely repayment is more susceptible to adverse changes in business, economic, or financial conditions.

C: An inadequate capacity to ensure timely repayment.

Outlook (Stable, Positive, Negative, Developing)
Indicates the potential and direction of a rating over the intermediate term in response to trends in economic and/or fundamental business/financial conditions. It is not necessarily a precursor to a rating change. 'Stable' outlook means a rating is not likely to change. 'Positive' means it may be raised. 'Negative' means it may be lowered. Where the trends have conflicting elements, the outlook may be described as 'Developing'.

Rating Watch
Alerts to the possibility of a rating change subsequent to, or in anticipation of, a) some material identifiable event and/or b) deviation from expected trend. But it does not mean that a rating change is inevitable. A watch should be resolved within foreseeable future, but may continue if underlying circumstances are not settled. Rating Watch may accompany Outlook of the respective opinion.

Suspension
It is not possible to update an opinion due to lack of requisite information. Opinion should be resumed in foreseeable future. However, if this does not happen within six (6) months, the rating should be considered withdrawn.

Withdrawn
A rating is withdrawn on a) termination of rating mandate, b) cessation of underlying entity, c) the debt instrument is redeemed, d) the rating remains suspended for six months, e) the entity/issuer defaults., or/and f) PACRA finds it impractical to surveill the opinion due to lack of requisite information

Regulatory and Supplementary Disclosure

Name of Issuer FAYSAL BANK LIMITED (FBL)
Sector Banking
Type of Relationship Solicited

Purpose of the Rating Independent Risk Assessment
Regulatory Requirement

Rating History

Dissemination Date	Long Term	Short Term	Outlook	Action
22-Jun-17	AA	A1+	Stable	Maintain
22-Jun-16	AA	A1+	Stable	Maintain
22-Jun-15	AA	A1+	Stable	Maintain
23-Jun-14	AA	A1+	Stable	Maintain
26-Jun-13	AA	A1+	Stable	Maintain
30-Jun-12	AA	A1+	Stable	Maintain
30-Jun-11	AA	A1+	Stable	Maintain

Related Criteria and Research

Rating Methodology Bank Rating Methodology
Sector Research Banking Sector - Viewpoint | Jun-17

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Rating Team Statement

Rating Procedure
Rating is an opinion on relative credit worthiness of an entity or debt instrument. It does not constitute recommendation to buy, hold or sell any security. The rating team for this assignment does not have any beneficial interest, direct or indirect in the rated entity/instrument.

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PACRA initiates immediate review of the outstanding rating(s) upon becoming aware of any information that may be reasonable be expected to result in any change (including downgrade) in the rating

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Probability of Default (PD)

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