The Pakistan Credit Rating Agency Limited

MCB ISLAMIC BANK LIMITED

	NEW OCT-17	PREVIOUS FEB-17
Long-Term	A	A
Short-Term	A1	A1
Outlook	Stable	Stable

REPORT CONTENTS

OCTOBER 2017

Profile &Ownership

- MCB Islamic Bank Limited (MCBIBL) –wholly owned subsidiary of MCB Bank Limited - was formed as a banking company in May, 2014. It started commercial operations in November 2015.
- In April, 2016, Lahore High Court approved the demerger of Islamic Banking Group (IBG) of MCB Bank Limited (MCB) and its subsequent merger with MCBIBL.
- Resultantly, all the domestic Islamic banking operations of MCB IBG were merged into MCB IBL w.e.f September 30, 2015.
- MCBIBL currently has 68 branches network (as at end Dec16: new 26 plus acquired through IBG: 34, end-Dec15: 6).
- The bank has sought permission from SBP to open another 10 branches till Dec17.
- Flexcube, the core banking software, is completely implemented in all branches.
- The Bank provides a wide range of Islamic products including Ijarah, Murabha, Diminishing Musharkah, and Istisna.
- Strong presence of MCB in financial sector is likely to support MCBIBL in establishing its islamic Banking franchise

Governance

- BoD currently comprises seven members including two independent directors.
- Mr. Raza Mansha became the chairman of the board in Mar17.
- BoD closely monitors the management's policies and the bank's operations through its four committees, namely a) Audit Committee, b) Risk Management & Portfolio Review Committee (RM&PR) and c) Human Resource Committee and d) Business Strategy & Service Quality Control Committee.
- There is another committee Board Evaluation Committee; responsible to assess board's collective knowledge and commitment in fulfilling corporate governance responsibilities.
- M/s A.F. Ferguson & C. Chartered Accountants are the auditors of the bank.

Management

- Mr. Ali Muhammad Mahoon, President of MCBIBL, has over 20 years of experience with local and international financial institutions.
- The experienced top mangemnet team heads different departments.

Risk Managemnt

- Well established risk management function is placed in the bank. Credit risk management policies cover the qualitative and quantitative aspects of credit evaluation and monitoring. Exposure limits are adopted as per the prudential regulations.
- Designated Risk Managemnt Group (RMG), reporting directly to RM&PR committee, takes care of risk review and adherence to the policies.
- Annual review of performance against designed metrics by RM&PR committee. Good quality morabha dominated financing portfolio (end-Jun17: 55%) followed by diminishing musharkah (end- Jun17: 38%), Ijarah (end- Jun17: 5%) and Istisna (end-Jun17: 2%) with only one non performing client.
- Cautious lending strategy is followed, with focus on corporate clients. However, management is heading towards other business segmets including consumer financing, SME, microfinancing etc.

Performance

- During CY16, MCBIBL registered a spread of 2.69%. The Bank managed to absorb its administrative costs through net revenue, while gain on sale of securities and revision in general provisioning led to a profit of PKR 80mln (end-Dec15: PKR 52mln).
- During 1HCY17, by earning spread of 2.67% and on the back of gain on sale of investments, its bottom line rests at PKR 30mln.
- Going forward, while exploring key sectors including Cement, Fertilizer, Power, Steel, Poultry, and Sugar Industries bank is also aiming to explore new business segments including consumer financing, Microfinancing and digital banking etc.

Funding & Capital

- Post merger deposits size exhibited a growth of 49% (end-Sep16: PKR 14,099mln; end Dec15 (merged): PKR 9,450mln). MCBIBL's management is targeting to grow its deposit base to ~PKR 21 bln by end-Dec17.
- CASA remained at 89%as at end-Jun17.
- The bank has already met the Minimum Capital Requirement (MCR) of PKR 6bln through capital injection worth PKR 10bln from the parent - MCB.

RATING RATIONALE

MCB Islamic Bank is a wholly owned subsidiary of MCB Bank Limited. MCB Bank has long term rating of "AAA" reflecting its robust profile duly supplemented by its strong market position in local banking landscape, established brand equity, and sound financial profile. As per envisaged strategy to consolidate Islamic banking operations, Islamic Banking Group (IBG) operations of MCB were merged with MCBIBL. This gave a boost to standalone operational profile of MCBIBL. During 1HCY17, the management continued to follow its business strategy, while gradually building a sound assets book and a diversified deposit base. The bank is in the process of advancing its operational infrastructure including branch network. Technological implementation and setting governance structure were mile stones achieved by bank in past half year. The ratings incorporate inherent constraints faced by MCBIBL, mainly limited branch network, small deposit base and high cost structure particularly in early years.

KEY RATING DRIVERS

Islamic banking industry offers healthy growth opportunities. However, MCBIBL's prospects are dependent upon the management's ability to promote its positioning in the relative universe. Effective implementation of business strategy is important.

MCB Islamic Bank Limited

BALANCE SHEET	30-Jun-17	31-Dec-16	31-Dec-15	31-Dec-15
			(Restated after merger)	(Change of Y/E to Dec)
	1HCY17	CY16	CY15	CY15
Earning Assets				
Financing	24,974	16,174	12,568	973
Private Sukuks	2,433	2,035	2,052	(39)
Total Financing	27,407	18,209	14,620	933
Investments	5,338	3,734	3,962	664
Others	3,687	2,751	6,277	8,132
	36,432	**24,695**	**24,859**	**9,729**
Non Earning Assets				
Non-Earning Cash	3,045	1,510	769	76
Deferred Tax	10	-	-	9
Net Non-Performing Financing	(1)	(1)	(113)	-
Fixed Assets & Others	2,781	2,365	1,364	294
	5,835	**3,874**	**2,020**	**379**
TOTAL ASSETS	**42,267**	**28,569**	**26,879**	**10,108**
Remunerative Liabilities				
Deposits	22,728	14,279	9,450	38
Borrowings	8,079	2,786	632	-
	30,807	17,065	10,082	38
Non-remunerative Liabilities	1,247	1,238	6,839	86
TOTAL LIABILITIES	**32,054**	**18,303**	**16,921**	**124**
EQUITY (including revaluation surplus)	**10,213**	**10,266**	**9,958**	**9,984**
Total Liabilities & Equity	**42,267**	**28,569**	**26,879**	**10,108**

INCOME STATEMENT	30-Jun-17	31-Dec-16	31-Dec-15	31-Dec-15
	1HCY17	CY16	CY15	CY15
Profit / Return Earned	818	1,527	376	155
Return Expensed	(370)	(577)	(101)	(0)
Net Revenue	**448**	**950**	**275**	**155**
Other Income	375	259	25	11
Total Revenue	**823**	**1,209**	**300**	**166**
Admin and Other Expenses	(778)	(1,190)	(203)	(113)
Pre-provision operating profit	45	20	98	53
Provisions	0	94	(40)	-
Pre-tax profit	45	114	58	53
Taxes	(15)	(34)	(5)	(5)
Net Income	**30**	**80**	**52**	**48**

Note: Dec15 Profit and Loss Statement is not available.

Ratio Analysis				
Performance				
ROE	0.6%	0.8%	2.1%	1.9%
Cost-to-Total Net Revenue	95.2%	99.3%	67.7%	68.1%
Provision Expense / Pre Provision Profit	-0.8%	-474.6%	40.9%	0.0%
Capital Adequacy				
Equity/Total Assets	24.0%	35.3%	37.2%	99.0%
Capital Adequacy Ratio as per SBP	29.7%	39.7%	46.4%	182.4%
Funding & Liquidity				
Liquid Assets / Deposits and Borrowings	40.6%	46.9%	109.0%	na
Advances / Deposits	109.9%	113.3%	132.0%	na
CASA deposits / Total Customer Deposits	88.9%	67.3%	55.6%	100.0%
Intermediation Efficiency				
Asset Yield	11.1%	31.4%	6.2%	6.8%
Cost of Funds	3.3%	8.4%	2.0%	0.6%
Spread	7.8%	23.0%	4.2%	6.2%
Outreach				
Branches	66	66	40	6

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

Rating	Definition
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

Disclaimer: PACRA's ratings are an assessment of the credit standing of entities/issue in Pakistan. They do not take into account the potential transfer / convertibility risk that may exist for foreign currency creditors. PACRA's opinion is not a recommendation to purchase, sell or hold a security, in as much as it does not comment on the security's market price or suitability for a particular investor.