The Pakistan Credit Rating Agency Limited

Rating Report

Bank Alfalah Limited | TFC V | Feb-13

Report Contents

Rating History

Dissemination Date	Long Term Rating	Short Term Rating	Outlook	Action	Rating Watch
	AA	-	Stable	Maintain	-
29-Dec-2017	AA	-	Stable	Maintain	-
22-Jun-2017	AA	-	Stable	Upgrade	-
30-Jun-2016	AA-	-	Positive	Maintain	-
30-Jun-2015	AA-	-	Positive	Maintain	-

Rating Rationale and Key Rating Drivers

The ratings reflect relative positioning of the bank among large banks of the country. The bank has a stronger position in advances - sustained by fresh deployments. The deposit system share has witnessed dilution as the bank embarked upon a strategy to sustain-ably rationalize its cost of funding with enduring focus on low cost deposits. Resultantly, BAFL's cost of fund is comparable to some of the large banks. The bank enjoys extended outreach across the country which has augmented its deposit base. Operating cost structure, though still higher than peers, has improved on YoY basis on account of cost rationalization. The asset quality of the bank has sustained over the past three years on account of prudent risk management. The bank witnessed changes in the key management positions. Cohesion and effectiveness of the new team is essential for the sustained growth of the bank. Declining asset yield is being offset by cost efficiency hence, enabling spreads to be maintained at current levels. Despite consistent improvement in the bank's profitability, capital augmentation remained limited. Cognizant of the fact, the management recently issued Tier-I instrument to improve its capital, whereas, enhancing Tier-II capital through issue of a new instrument is also an option, which the bank may continue to avail from time to time.

The ratings are dependent on the management's ability to uphold its business profile; effective implementation of strategy is important. Sustaining spreads at current levels is a challenge, which needs to be effectively managed. Strengthening of the bank's capitalization and adding granularity to its advances and deposits book are essential.

Disclosure

Name of Rated Entity	Bank Alfalah Limited | TFC V | Feb-13
Type of Relationship	Solicited
Purpose of the Rating	Debt Instrument Rating
Applicable Criteria	Rating Methodology | Basel III Instruments(Mar-18)
Related Research	Sector Study | Commercial Bank(Jun-18)
Rating Analysts	Nauman Mustafa | nauman.mustafa@pacra.com | +92-42-35869504 Jhangeer Hanif | jhangeer@pacra.com | +92-42-35869504

BANK ALFALAH LIMITED (BAFL) PROFILE	
Incorporated	1992
Major Business	Banking
Legal Status	Listed Company
Head Office	Karachi

INDUSTRY SNAPSHOT

The banking sector has experienced highest growth in terms of advances in 2017 over the last decade. As a consequence, there is mounting pressure on capital adequacy ratio of the banks. The challenge is exacerbated as the internal generation of capital (profits) are witnessing a dip. Some relief on income side is expected with recent uptick in interest rates.

OWNERSHIP

- Bank Alfalah Limited (BAFL), incorporated as a public limited company in 1992, commenced banking operations in 1997, and is listed on Pakistan Stock Exchange.
- Majority owned by Abu Dhabi Group (49.5%), rest is owned by IFC (14.8%), Mutual Funds and Other NBFs, FIs (26.2%) and General Public (9.5%).
- The bank has a widespread network of 630 branches, including 477 conventional and 153 Islamic at end-Mar18. The bank has a network of more than 720 ATMs, covering 150 cities.

GOVERNANCE

- The control of the bank vests in the eight-member board of directors (BoD). The board comprises President / CEO and seven non-executive directors, four of whom are representatives of ADG, one is an IFC nominee, while two members are independent.
- Chairman of the board – H.H Sheikh Nahayan Mabarak Al Nahayan - is associated with ADG since long, and is a well-known and seasoned businessman.
- The board actively participates in strategy formulation and effectively monitors the managerial affairs of the bank. The BoD has constituted four committees to ensure rigorous monitoring of the management's policies and bank's operations.

MANAGEMENT

- BAFL's senior management team comprises experienced bankers having national and international exposure. Mr. Nauman Ansari is the CEO of the bank. He carries extensive experience in the banking industry.
- The bank formulated three key management committees, Central Management Committee (CMC), Central Credit Committee (CCC), and Asset-Liability Committee (ALCO). These committees are headed by the President and include senior executives.
- Core management team comprises experienced professionals.

BUSINESS RISK

- The bank's market share has declined from 6.1% at end-Dec15 to 5.6% at end-Dec16 and to 5.2% at end-Dec17.
- Total deposits growth remained flat at 1.1% on a YoY basis as the bank followed its strategy of shredding high cost deposits in order to improve cost of funding. Yet the, the portion of CASA decreased to 78% (end-Dec16: 85%). Net advances grew by a mere 3%, much lower than the industry average (18%) and peer banks. The growth was mainly financed through borrowings followed by deposits. Advances-to-deposits ratio increased to ~61% at end-Dec17 (end-Dec16: 59%); better than industry average of ~51%.
- During CY17, BAFL's NPLs decreased by PKR 1.5bln and stood at PKR 17.6bln. However, loan loss coverage stands at a high 94% at end-Dec17 (end-Dec15: 90%), better than industry average. As gross advances grew sizably, infection ratio declined (end-Dec17: 4.2%, end-Dec16: 4.8%).
- During CY17, BAFL's interest revenue witnessed a minor dip of 0.4% on a YoY basis on account of lower asset yield amidst maturity of high yielding book (CY17: PKR 56,919mln; CY16: PKR 57,245mln). Non markup income increased as compared to last year (CY17: PKR 9,894mln; CY16: PKR 8,907mln).
- During CY17, the spreads were further squeezed to (CY17: ~3.48%; CY16: 3.52%).
- Going forward, BAFL is to foster its competitive position. This is reflected in lower system share in deposits. The business strategy mainly focuses on bringing down cost of deposits. Key initiative includes: (i) introducing technology led products – mobile wallet – mainly to tap current account, (ii) focus on SME through transactional banking, and (iii) shift from conventional to digital banking model; setting up of 'smart branches' is on cards, aiming to improve cost structure. On the lending side, the bank is geared to target double digit growth in SME and consumer book (mainly auto), with sustained focus towards corporate clientele.

FINANCIAL RISK

- Investment portfolio, representing 45% of the bank's earning assets at end-Dec17, witnessed a dip from (46% in CY16) YoY, on account of shrinkage of investment book due to maturity of government papers. Investments continued to remain concentrated in government securities (93%). Mix of (PIBs: 37%, T-Bills: 50%) at end-Dec17 changed over the year (end-Dec16: PIBs: 63%, T-Bills: 15%); unrealized gains on PIBs government securities is ~PKR 3.5bln.
- The bank's liquidity profile remained steady as reflected in its liquid assets-to-deposits-and-borrowings ratio which stood to 46.8% at end-Dec17 (2016: 46.6%).
- BAFL's deposit base witnessed an increase of ~ 1.1% in CY17 (PKR 653bln, CY16: 641bln) as against industry growth of 10%; Deposits continues to dominate its total liabilities (Dec17: 71%, Dec16: 75%).
- The portion of CASA decreased to 78% (end-Dec16: 85%).
- The bank's capital adequacy – mainly comprising Tier-1 (11.2%) – increased slightly to 13.7% at end-Dec17 (end-Dec16: 13.2%). Despite consistent improvement in the bank's profitability, capital augmentation remained limited. Hence, BAFL's equity-to-assets ratio remained low amongst other large banks (end-Dec17: ~5.9%, end-Dec16: ~5.4%). The equity capital of the bank stands at PKR 65,800mln at end CY17 (CY16: 60,125mln).
- BAFL has one unsecured and subordinated TFCs in issue. TFC V of PKR 5,000mln, issued in Feb-13. With 8yrs of tenure, principal repayment of TFC-V would be repaid in bullet form at the time of maturity (Feb-21). The outstanding TFC issue amounts to PKR 4,991mln at end-Dec17.
- The bank has lately issued a Tier I Instrument.

Bank Alfalah Limited

BALANCE SHEET	31-Mar-18	31-Dec-17	31-Dec-16	31-Dec-15
Earning Assets				
Advances (Net of NPL)	412,034	399,603	376,845	331,896
Debt Instruments	10,229	14,260	12,505	10,826
Total Finances	422,263	413,863	389,350	342,722
Investments	277,289	386,553	376,683	412,329
Others	45,707	60,439	45,867	51,443
	745,259	**860,854**	**811,900**	**806,494**
Non Earning Assets				
Non-Earning Cash	58,574	63,348	67,726	55,104
Deferred Tax	-	-	-	-
Net Non-Performing Finances	993	973	1,781	2,207
Fixed Assets & Others	59,050	63,654	36,051	38,802
	118,616	**127,975**	**105,558**	**96,113**
TOTAL ASSETS	**863,876**	**988,829**	**917,457**	**902,608**
Funding				
Deposits	644,511	653,406	640,944	640,189
Borrowings	96,661	211,215	186,629	182,376
	741,172	864,621	827,573	822,565
Non Interest Bearing Liabilities	56,053	58,408	29,759	26,689
TOTAL LIABILITIES	**797,225**	**923,029**	**857,332**	**849,254**
EQUITY (including revaluation surplus)	**66,650**	**65,800**	**60,125**	**53,353**
Total Liabilities & Equity	**863,876**	**988,829**	**917,457**	**902,608**

INCOME STATEMENT	31-Mar-18	31-Dec-17	31-Dec-16	31-Dec-15
Interest / Mark up Earned	14,269	56,919	57,245	61,458
Interest / Mark up Expensed	(6,715)	(27,639)	(28,474)	(32,811)
Net Interest / Markup revenue	**7,554**	**29,281**	**28,770**	**28,648**
Other Income	2,865	9,894	8,868	8,841
Total Revenue	**10,419**	**39,175**	**37,638**	**37,489**
Non-Interest / Non-Mark up Expensed	(5,631)	(25,389)	(23,432)	(22,598)
Pre-provision operating profit	4,788	13,785	14,206	14,891
Provisions	287	260	(1,183)	(2,287)
Pre-tax profit	5,075	14,045	13,023	12,604
Taxes	(1,811)	(5,678)	(5,123)	(5,081)
Net Income	**3,264**	**8,367**	**7,900**	**7,523**

Ratio Analysis	31-Mar-18	31-Dec-17	31-Dec-16	31-Dec-15
Performance				
ROE	22%	16%	17%	19%
Cost-to-Total Net Revenue	54%	65%	62%	60%
Provision Expense / Pre Provision Profit	6%	-2%	8%	15%
Capital Adequacy				
Equity/Total Assets	7%	6%	5%	5%
Capital Adequacy Ratio as per SBP		14%	13%	13%
Funding & Liquidity				
Liquid Assets / Deposits and Borrowings	48%	47%	47%	52%
Advances / Deposits	64%	61%	59%	52%
CASA deposits / Total Customer Deposits	82%	79%	85%	77%
Intermediation Efficiency				
Asset Yield	7%	7%	7%	9%
Cost of Funds	3%	3%	4%	5%
Spread	4%	3%	4%	4%
Outreach				
Branches	640	639	639	653

The Pakistan Credit Rating Agency Limited

ENTITY CREDIT RATING SCALE & DEFINITIONS

Credit rating reflects forward-looking opinion on credit worthiness of underlying entity; 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 or 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.** "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.

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. Rating Watch may carry designation – Positive (rating may be raised, negative (lowered), or developing (direction is unclear). A watch should be resolved within foreseeable future, but may continue if underlying circumstances are not settled.

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 or 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'.

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, a suspended 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, or e) the entity/issuer defaults.

Disclaimer: PACRA's rating is an assessment of the credit standing of an entity/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.

DEBT INSTRUMENT RATING SCALE & DEFINITIONS

The instrument rating reflects forward-looking opinion on credit worthiness of underlying debt 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.

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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) the debt instrument is redeemed, c) the rating remains suspended for six months, d) the entity/issuer defaults., or/and e) PACRA finds it impractical to surveill the opinion due to lack of requisite information

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(1) Rating is just an opinion about the creditworthiness of the entity and does not constitute recommendation to buy, hold or sell any security of the entity rated or to buy, hold or sell the security rated, as the case may be | Chapter III; 14-3-(x)

2) **Conflict of Interest**
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ii. PACRA, the analysts involved in the rating process and members of its rating committee, and their family members, do not have any conflict of interest relating to the rating done by them | Chapter III; 12-2-(e) & (k)
iii. The analyst is not a substantial shareholder of the customer being rated by PACRA [Annexure F; d-(ii)] Explanation: for the purpose of above clause, the term "family members" shall include only those family members who are dependent on the analyst and members of the rating committee

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(7) PACRA uses due care in preparation of this Rating Report. Our information has been obtained from sources we consider to be reliable but its accuracy or completeness is not guaranteed. PACRA does not, in every instance, independently verifies or validates information received in the rating process or in preparing this Rating Report.
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(19) PACRA reviews all the outstanding ratings on semi-annual basis or as and when required by any creditor or upon the occurrence of such an event which requires to do so; | Chapter III | 18-(b)
(20) PACRA initiates immediate review of the outstanding rating upon becoming aware of any information that may reasonably be expected to result in downgrading of the rating; | Chapter III | 18-(c)
(21) PACRA engages with the issuer and the debt securities trustee, to remain updated on all information pertaining to the rating of the entity/instrument; | Chapter III | 18-(d)
Probability of Default
(22) PACRA´s Rating Scale reflects the expectation of credit risk. The highest rating has the lowest relative likelihood of default (i.e, probability). PACRA´s transition studies capture the historical performance behavior of a specific rating notch. Transition behavior of the assigned rating can be obtained from PACRA´s Transition Study available at our website. (www.pacra.com). However, actual transition of rating may not follow the pattern observed in the past | Chapter III | 14-(f-VII)
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