The Pakistan Credit Rating Agency Limited

Rating Report

MCB Islamic Bank Limited

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Rating History

Dissemination Date	Long Term Rating	Short Term Rating	Outlook	Action	Rating Watch
23-Jun-2022	A	A1	Stable	Maintain	-
23-Jun-2021	A	A1	Stable	Maintain	-
25-Jun-2020	A	A1	Stable	Maintain	-
27-Dec-2019	A	A1	Stable	Maintain	-
27-Jun-2019	A	A1	Stable	Maintain	-
26-Dec-2018	A	A1	Positive	Maintain	-
29-Jun-2018	A	A1	Positive	Maintain	-
16-Oct-2017	A	A1	Stable	Maintain	-
01-Feb-2017	A	A1	Stable	Maintain	-

Rating Rationale and Key Rating Drivers

MCB Islamic Bank Limited (MCB Islamic) is a wholly owned subsidiary of MCB Bank Limited (MCB). MCB has a long-term rating of "AAA" reflecting its robust profile, duly supplemented by its strong market position in the local banking landscape, established brand equity, and sound financial profile. MCB Islamic has embarked upon a journey of focused growth after the induction of new leadership. The area of growth is the supply chain vendors, where the group has good understanding and also a presence in one form or the other. The deposit expansion is expected to be exacerbated with renewed emphasis of Islamic banking and optimal use of network. Advances recorded an increase YoY whilst infection remained under check. MCB Islamic is a small-sized bank and has witnessed an increase of 27.8% in its customers' deposits. During CY21, it maintained its system share. The Bank’s continuous focus on the accumulation of low-cost deposits has resulted in a healthy current and savings (CASA) deposit mix. However, deposit mix and concentration need further improvement. Capitalization remains adequate as reflected by Tier I and overall capital adequacy ratio (CAR) of 11.7% and 12.1%, respectively, as on Dec’21. Going forward, the Bank’s equity base will increase after a capital injection of PKR 4bln. This is a great comfort to the ratings. The additional capital will be utilized for lending in several avenues. The management is positive under the new leadership about the growth strategy being crafted. The envisaged strategy will encompass a documented vision for the bank. The Bank’s CAR will record a sizable increase in Jun-22.

Pakistan’s economy has gone through several varied phases in last two years. It was deeply impacted by the magnitude of the COVID19 pandemic. Banking sector continues to flourish with high profitability. Total banking assets posted good growth with sizable increase in investments. Advances posted double digit growth where infection displayed only slight increase. Going forward, increasing interest rate and tightening of demand may have implications on asset quality.

The ratings are dependent on Bank's ability to hold its risk profile, while maintaining its relative market position in the banking industry. Any weakening in asset quality will in turn put pressure on the Bank's profitability and risk absorption capacity.

Disclosure

Name of Rated Entity	MCB Islamic Bank Limited
Type of Relationship	Solicited
Purpose of the Rating	Entity Rating
Applicable Criteria	Methodology | Financial Institution Rating(Jun-21),Criteria | Correlation Between Long-term & Short-term Rating Scales(Jun-21),Criteria | Rating Modifiers(Jun-21)
Related Research	Sector Study | Commercial Bank(Jun-22)
Rating Analysts	Iram Shahzadi | iram.shahzadi@pacra.com | +92-42-35869504

Profile

Structure MCB Islamic Bank Limited (MCB Islamic) was incorporated in Pakistan as an unlisted Public Limited Company on May 15, 2014.

Background After issuance of Certificate of Commencement of Banking Business by the State Bank of Pakistan (SBP) in Sep'15, MCB Islamic started its commercial operations as an Islamic Bank in Oct'15. In Mar'16, Lahore High Court approved demerger of Islamic Banking Group (IBG) of MCB Bank Limited from MCB and its merger with and into MCB Islamic. Resultantly, all domestic Islamic banking operations of MCB-IBG were incorporated into MCB Islamic w.e.f September 30, 2015 for PKR 7.9bln.

Operations The Bank is engaged in corporate, commercial, consumer, micro finance, investment and retail banking activities. The Bank is operating through 180 branches including one sub branch in Pakistan as at Mar22 (Dec21: 177 branches) branches including one sub branch in Pakistan.

Ownership

Ownership Structure MCB Islamic is a wholly owned subsidiary of MCB Bank Limited (MCB).

Stability The stability of the Bank will stay intact with strong sponsor support.

Business Acumen Nishat Group (the sponsor group), including individual holdings and holding through group corporates, is a premier business house of Pakistan. The Group is one of the leading and most diversified in South East Asia, having presence in numerous industries and sectors.

Financial Strength Apart from MCB Islamic Bank Limited, MCB Bank Limited has five more subsidiaries. MCB is the country's 4th largest bank in terms of customer deposits (CY21: 1,383bln) and operates a branch network of 1,426 spread across Pakistan. The bank is rated "AAA/A1+" by PACRA, the bank recorded net income of PKR 30.8bln in CY21 (CY20 PKR 29.0bln).

Governance

Board Structure The overall control of the Bank vests with eight-member Board of Directors (BoD) including the CEO/ President.

Members' Profile Mr. Raza Mansha is the Chairman of the Board. He is accompanied with over 2 decades of diversified experience in various business sectors. Majority of the Board members possess extensive national and international banking and financial services industry experience.

Board Effectiveness The Board exercises close monitoring of the management's policies and the Bank's operations through its Committees. While participating in all Board and Committee meetings, active decision making was ensured.

Financial Transparency The External Auditors, A. F. Ferguson & Co., Chartered Accountants, issued an unqualified audit opinion pertaining to annual financial statements for CY21. Furthermore, the Board has set up an effective internal audit function that reports independently to the Audit Committee.

Management

Organizational Structure MCB Islamic follows functional structure, where Bank's operations are grouped under thirteen departments.

Management Team Muhammad Afaq Khan has in his possession experience of over 33 years as an Islamic banking professional. He has been bestowed with several Islamic Banker of the Year awards owing to his proven track record of building global businesses

Effectiveness The Bank has five committees in place at the management level to oversee its day-to-day operational matters and take decisions to implement the strategy outlined by the board.

MIS MCB Islamic has adopted Oracle's solution of financing appraisal management system (FAMS). FAMS is fully integrated with Core Banking System Flexcube. There are nine stages of appraisal process, culminating in auto data handshake with liability management system.

Risk Management Framework Operations of the Bank are monitored by Risk Management Group (RMG). Four units are working under RMG i) Credit Risk Review, ii) Market and Liquidity Risk Management, iii) Operational Risk and Business Continuity Planning and iv) IT Security risk. The Bank, has developed Operational Risk Management Framework. Operations Risk & Internal Control Unit has been working to strengthen the internal control environment of the Bank.

Business Risk

Industry Dynamics Pakistan's economy has gone through several varied phases in last two years. It was deeply impacted by the magnitude of the COVID19 pandemic. The economic activity revived afterwards and Pakistan posted a GDP growth rate of ~4.0% in FY21 after a contraction in economy of -0.4% in FY20 (GDP growth figures were revised after base year was changed from FY05-06 to FY15-16). Banking sector continues to flourish with high profitability. Banking sector weightage is approximately ~25% of the KSE 100 index. Total banking assets posted growth of ~19% YoY whilst investments surged by 21% YoY to PKR ~14.4trln (end-Dec20: PKR ~11.9trln). Gross Advances of the sector recorded growth (23%) to stand at PKR ~10.9trln (end-Dec20: PKR ~8.8trln). Non-performing loans witnessed slight uptick of 4% to PKR ~860bln. Capital Adequacy Ratio stood at 16.7% (regulatory requirement of 11.5%). During CY21, banking sector deposits enhanced to PKR ~21.6trln (grew by ~17%). Hence, ADR rationalized to 47% (end-Dec20: ~45%). Net profitability of the sector recorded at PKR ~267bln (CY20: PKR ~244bln); up 9% YoY. However, growth of equity base of the sector recorded meagre uptick of 0.8% YoY attributable to handsome dividend payout.

Relative Position MCB Islamic is a small-sized bank with sustainable growth and has witnessed an increase of 27.8% in its customer's deposit to PKR 119bln (CY20: PKR 93.1bln). During 3MCY22, customer deposits of the Bank further increased to PKR 122bln.

Revenues During CY21, gross mark-up income of the Bank witnessed a marginal contraction of 4.9% to PKR 9,203mln (CY20: PKR 9,676mln); on account of decrease in markup earned on advances owing to steep decline in policy rate. The bank's asset yields also decreased and stood at 7.6% (CY20: 10.3%). Cost of funds stood at 3.9% (CY20: 5.1%). Hence, Bank's spread declined (CY21: 3.7%; CY20: 5.2%). The bank's net markup income inched up to PKR 1.1bln (CY20: PKR 1.0bln) whilst non-mark up income also remained largely same. During 1QCY22, net markup income figure witnessed similar inclining trend as per previous periods and stood at PKR 1,192mln (3MCY21: PKR 1,021mln). Non markup income stood at PKR 96mln (PKR 112mln).

Performance Despite high inflationary pressures, the Bank was largely able to manage its non-markup expenses, inched up by 3.2%. Hence, the bank's pre-provision operating loss stood at PKR 422mln for the year CY21. Furthermore, reversal of PKR 130mln was booked. Resultantly, profit for the year booked at PKR 100mln (CY20: PKR 208mln); down by 52% YoY. In 1QCY22, profit after tax of the Bank stood at PKR 128mln (1QCY21: PKR 55mln).

Sustainability Going forward, under the new leadership, the management is positive regarding securing growth. Capital injection, by parent company, of PKR 4bln is at an advanced stage. This will provide positive impetus to manage growth in upcoming year.

Financial Risk

Credit Risk During CY21, the Bank witnessed decent growth of 13.8% to PKR 95.8bln (CY20: PKR 84.9bln; CY19: PKR 51.3bln) in net advances. MCB Islamic's non-performing loans (NPLs) recorded attrition by 7.14% to PKR 702mln (CY20: PKR 756mln; CY19: PKR 381mln) during CY21. Hence, infection ratio remained below 1%. Coverage ratio, on the other hand, improved to 27% (CY20: 9%).

Market Risk The Bank's investment portfolio constituted 20.1% of the total earning assets at end-Dec21 (end-Dec: 23.3%). However, a significant increase of 23.8% in investments was seen during CY21. Moreover, the mix of government securities in overall investments also enhanced to 98.8%; hence, the Bank is exposed to relatively low market risk.

Liquidity And Funding Bank's liquidity position remained largely same as reflected in the liquidity ratio at 34.1% (CY21: 34.3%). Meanwhile, top-20 deposits concentration increased by 32.2% at end-Dec21 (end-Dec20: 28.0%). During CY21, the Bank was able to maintain its CA at 30.7% (CY20: 31.1%) and SA ratio decreased to 39.8% (CY20: 44.6%).

Capitalization The Paid-up Capital of the Bank stands at PKR11.55bln CAR stands at 12.1%, is in compliance with the required CAR of 11.5% as at end-Mar'22. Going forward, the bank's equity base will increase after capital injection of PKR 4bln. The bank's CAR will be record sizable increase in Jun-22. However, going forward, will record dilution after growth in advances. The Bank's equity base stood at PKR 10.7bln in 3MCY22. Equity to total asset ratio of MCB Islamic decreased to 6.6% at CY21 (CY20: 7.6%; CY19: 10.0%).

PKR mln

MCB Islamic Bank Limited Un-Listed Public Limited	Mar-22 3M	Dec-21 12M	Dec-20 12M	Dec-19 12M
A BALANCE SHEET				
1 Total Finances - net	97,849	96,819	85,609	52,658
2 Investments	30,830	32,450	26,214	14,617
3 Other Earning Assets	6,841	1,717	830	10,230
4 Non-Earning Assets	28,077	29,766	27,826	27,173
5 Non-Performing Finances-net	521	515	690	345
Total Assets	164,118	161,267	141,171	105,022
6 Deposits	124,900	122,748	99,253	81,854
7 Borrowings	18,209	16,473	20,597	4,128
8 Other Liabilities (Non-Interest Bearing)	10,237	11,442	10,593	8,575
Total Liabilities	153,346	150,663	130,443	94,556
Equity	10,772	10,605	10,728	10,467
B INCOME STATEMENT				
1 Mark Up Earned	3,050	9,203	9,676	9,849
2 Mark Up Expensed	(1,858)	(5,009)	(5,281)	(5,855)
3 Non Mark Up Income	96	199	678	343
Total Income	1,288	4,393	5,074	4,337
4 Non-Mark Up Expenses	(1,206)	(4,815)	(4,665)	(4,503)
5 Provisions/Write offs/Reversals	129	647	(15)	(200)
Pre-Tax Profit	210	225	393	(366)
6 Taxes	(83)	(125)	(185)	122
Profit After Tax	128	100	208	(244)
C RATIO ANALYSIS				
1 Performance				
Net Mark Up Income / Avg. Assets	2.9%	2.8%	3.6%	4.0%
Non-Mark Up Expenses / Total Income	93.7%	109.6%	92.0%	103.8%
ROE	4.8%	0.9%	2.0%	-2.4%
2 Capital Adequacy				
Equity / Total Assets (D+E+F)	6.6%	6.6%	7.6%	10.0%
Capital Adequacy Ratio	11.6%	12.1%	12.0%	13.8%
3 Funding & Liquidity				
Liquid Assets / (Deposits + Borrowings Net of Repo)	32.5%	34.1%	34.3%	39.2%
(Advances + Net Non-Performing Advances) / Deposits	78.0%	78.5%	85.5%	62.7%
CA Deposits / Deposits	33.5%	30.7%	31.1%	27.2%
SA Deposits / Deposits	36.3%	39.8%	44.6%	43.6%
4 Credit Risk				
Non-Performing Advances / Gross Advances	0.7%	0.7%	0.9%	0.7%
Non-Performing Finances-net / Equity	4.8%	4.9%	6.4%	3.3%

Credit Rating

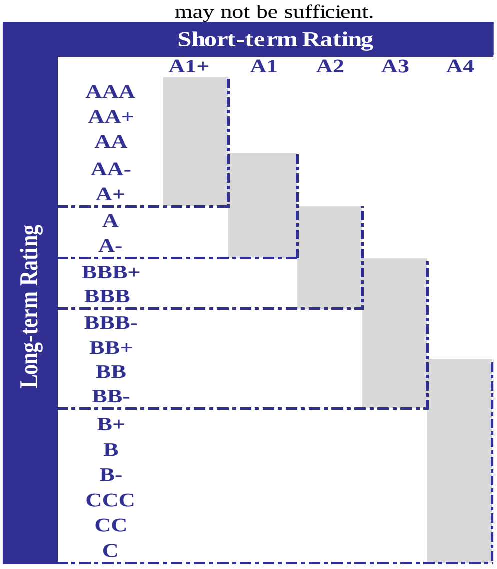
Credit rating reflects forward-looking opinion on credit worthiness of underlying entity or instrument; more specifically it covers relative ability to honor financial obligations. The primary factor being captured on the rating scale is relative likelihood of default.

Long-term Rating

Scale	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 Rating

Scale	Definition
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
A4	The capacity for timely repayment is more susceptible to adverse changes in business, economic, or financial conditions. Liquidity may not be sufficient.



**The correlation shown is indicative and, in certain cases, may not hold.*

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 some material identifiable event with indeterminable rating implications. 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 rating 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.

Harmonization A change in rating due to revision in applicable methodology or underlying scale.

Surveillance. Surveillance on a publicly disseminated rating opinion is carried out on an ongoing basis till it is formally suspended or withdrawn. A comprehensive surveillance of rating opinion is carried out at least once every six months. However, a rating opinion may be reviewed in the intervening period if it is necessitated by any material happening.

Note. This scale is applicable to the following methodology(s):

Entities

a) Broker Entity Rating
b) Corporate Rating
c) Financial Institution Rating
d) Holding Company Rating
e) Independent Power Producer Rating
f) Microfinance Institution Rating
g) Non-Banking Finance Companies (NBFCs) Rating

Instruments

a) Basel III Compliant Debt Instrument Rating
b) Debt Instrument Rating
c) Sukuk Rating

Regulatory and Supplementary Disclosure

(Credit Rating Companies Regulations,2016)

Rating Team Statements

(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**

i. The Rating Team or any of their family members have no interest in this rating | Chapter III; 12-2-(j)
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

Restrictions

(3) No director, officer or employee of PACRA communicates the information, acquired by him for use for rating purposes, to any other person except where required under law to do so. | Chapter III; 10-(5)
(4) PACRA does not disclose or discuss with outside parties or make improper use of the non-public information which has come to its knowledge during business relationship with the customer | Chapter III; 10-7-(d)
(5) PACRA does not make proposals or recommendations regarding the activities of rated entities that could impact a credit rating of entity subject to rating | Chapter III; 10-7-(k)

Conduct of Business

(6) PACRA fulfills its obligations in a fair, efficient, transparent and ethical manner and renders high standards of services in performing its functions and obligations; | Chapter III; 11-A-(a)
(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 | Clause 11-(A)(p).
(8) PACRA prohibits its employees and analysts from soliciting money, gifts or favors from anyone with whom PACRA conducts business | Chapter III; 11-A-(q)
(9) PACRA ensures before commencement of the rating process that an analyst or employee has not had a recent employment or other significant business or personal relationship with the rated entity that may cause or may be perceived as causing a conflict of interest; | Chapter III; 11-A-(r)
(10) PACRA maintains principal of integrity in seeking rating business | Chapter III; 11-A-(u)
(11) PACRA promptly investigates, in the event of a misconduct or a breach of the policies, procedures and controls, and takes appropriate steps to rectify any weaknesses to prevent any recurrence along with suitable punitive action against the responsible employee(s) | Chapter III; 11-B-(m)

Independence & Conflict of interest

(12) PACRA receives compensation from the entity being rated or any third party for the rating services it offers. The receipt of this compensation has no influence on PACRA´s opinions or other analytical processes. In all instances, PACRA is committed to preserving the objectivity, integrity and independence of its ratings. Our relationship is governed by two distinct mandates i) rating mandate - signed with the entity being rated or issuer of the debt instrument, and fee mandate - signed with the payer, which can be different from the entity
(13) PACRA does not provide consultancy/advisory services or other services to any of its customers or to any of its customers' associated companies and associated undertakings that is being rated or has been rated by it during the preceding three years unless it has adequate mechanism in place ensuring that provision of such services does not lead to a conflict of interest situation with its rating activities; | Chapter III; 12-2-(d)
(14) PACRA discloses that no shareholder directly or indirectly holding 10% or more of the share capital of PACRA also holds directly or indirectly 10% or more of the share capital of the entity which is subject to rating or the entity which issued the instrument subject to rating by PACRA; | Reference Chapter III; 12-2-(f)
(15) PACRA ensures that the rating assigned to an entity or instrument is not be affected by the existence of a business relationship between PACRA and the entity or any other party, or the non-existence of such a relationship | Chapter III; 12-2-(i)
(16) PACRA ensures that the analysts or any of their family members shall not buy or sell or engage in any transaction in any security which falls in the analyst's area of primary analytical responsibility. This clause shall, however, not be applicable on investment in securities through collective investment schemes. | Chapter III; 12-2-(l)
(17) PACRA has established policies and procedure governing investments and trading in securities by its employees and for monitoring the same to prevent insider trading, market manipulation or any other market abuse | Chapter III; 11-B-(g)

Monitoring and review

(18) PACRA monitors all the outstanding ratings continuously and any potential change therein due to any event associated with the issuer, the security arrangement, the industry etc., is disseminated to the market, immediately and in effective manner, after appropriate consultation with the entity/issuer; | Chapter III | 18-(a)
(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)

Proprietary Information