



The Pakistan Credit Rating Agency Limited

Rating Report

MCB Islamic Bank Limited

Report Contents

1. Rating Analysis
2. Financial Information
3. Rating Scale
4. Regulatory and Supplementary Disclosure

Rating History

Dissemination Date	Long Term Rating	Short Term Rating	Outlook	Action	Rating Watch
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	-
01-Feb-2016	A	A1	Stable	Initial	-

Rating Rationale and Key Rating Drivers

MIB is a wholly owned subsidiary of MCB Bank Limited (MCB). MCB 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. MIB's standalone risk profile is improving. The management's strategy is to focus primarily on high-rated, blue chip corporate clients. Meanwhile, undertaking new business lines including Micro, SME and Consumer financing are also on the horizon. MIB has set relatively high targets for deposit growth and plans to focus on maintaining its financing book quality. The thrust of the business plan is to achieve breakeven. 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 the last year. The ratings incorporate inherent constraints faced by MIB, mainly limited branch network, small deposit base and high cost structure particularly in early years. Lately, the bank's branch network and deposit base witnessed improvement which may bode well for achieving break even in upcoming year. Going forward, monitoring of CAR is important while expanding lending portfolio.

The positive outlook captures the continued improvement in the MIB's relative positioning in the growing Islamic banking industry.

Disclosure

Name of Rated Entity	MCB Islamic Bank Limited
Type of Relationship	Solicited
Purpose of the Rating	Entity Rating
Applicable Criteria	Methodology Financial Institution(Jun-18),Methodology Criteria Rating Modifier(Jun-18),Methodology Correlation Between Long-Term And Short-Term Rating Scale(Jun-18)
Related Research	Sector Study Islamic Banking(Jun-18)
Rating Analysts	Sehar Fatima sehar.fatima@pacra.com +92-42-35869504



Profile

Structure MCB Islamic Bank Limited (MIB) was formed as a banking Company in May, 2014 with its head office in Lahore. After issuance of Certificate of Commencement of Banking Business by the State Bank of Pakistan (SBP) in September, 2015, it started its commercial operations as an Islamic Bank in November, 2015.

Background Initially, in 2015 MIB had 6 branches, whereas after merging 34 branches of MCB IBG and opening of new 26 branches, its branch network grew to 76 as at end-Dec17. Recently, the demerger of 90 branches of MCB into or within MIB was approved and executed. According to which assets other than advances, liabilities, operations systems, staff, assets of back office functions and obligations of the bank related to business operations will be transferred and vested in MIB.

Operations MCB Islamic is a small sized bank islamic bank, currently operating with 173 branches including migration of 90 branches into/within MIB.

Ownership

Ownership Structure MIB is a wholly owned subsidiary of MCB Bank Limited. MCB is the country's fourth largest bank in terms of system share-deposits and operates with branch network of 1,356 spread across Pakistan.

Stability The ownership structure is likely to remain with MCB in foreseeable future.

Business Acumen The Mansha Family – primary sponsors behind MCB – is one of renowned business families with diversified business interests in various sectors. The sponsor's business acumen is considered strong on account of long association with the banking sector.

Financial Strength The financial strength of the sponsor is considered strong as MCB Bank is one of the leading commercial banks of Pakistan. The willingness of sponsor may vary from time to time.

Governance

Board Structure The overall control of the bank vests with eight members of the Board of Directors (BoD) including the CEO. The Board currently comprises of seven members (one position is vacant). Majority of the Board constitutes representatives of sponsoring group. Board consist of one independent director and five non-executive members.

Members' Profile Mr. Raza Mansha (son of Mian Mansha) is the Chairman of the Board. He is accompanied with ~ 2 decades of diversified experience in various business sectors including Banking, Textile, Power, Cement, Insurance, Hotels, Properties, Natural Gas, Agriculture, Dairy etc.

Board Effectiveness The board exercises close monitoring of the management 's policies and the Bank's operations through its Committees, namely i) Audit Committee, ii) Risk Management & Portfolio Review Committee (RM&PR Committee), iii) Human Resource Committee and iv) Business Strategy & Service Quality Control Committee.

Financial Transparency During the year, A.F Ferguson & CO, Chartered Accountants, external auditor, a SBP panel member, expressed an unqualified opinion for the financials of December 31, 2017. An interim review was conducted by new auditor KPMG Taseer Hadi & Co. for six months to June 30th, 2018.

Management

Organizational Structure MIB follows functional structure, where bank's operations are grouped under eleven departments i) Distribution, ii) Treasury iii) Risk Management, iv) Operations, v) Human Resource & General Services & Security, vi) IT & Information System, vii) Compliance, viii) Shariah Compliance, ix) Internal Audit, x) Finance, xi) Service Quality, xii) Research & Product Development, xiii) Microfinance & Digital Banking, xiv) Legal affairs.

Management Team Mr. Ali Muhammad Mahoon, President of MCBIBL, carrying with himself more than 25 years of experience of local and international financial institutions. The experienced top management team heads different functions of the bank; all reporting to the CEO of the bank.

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 MIB 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 Risk is monitored by Risk Management Group. Three units are working under this group i) Operational Risk & Internal Controls, ii) Business Continuity Planning and iii) Fraud Risk Management. 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 The banking industry witnessed significant expansion in the loan book. Last year and YTD (2018) both witnessed huge deployments. This is expected to slow down. New projects require gestation period and additionally crowding-out effect may take place. Rising interest rates mean profitability of the sector would take support. Yet NPLs, as a result, may also transpire. CAR is reaching the maximum requirement by December 2018 (11.9%). This will create a challenge for some of the players.

Relative Position MIB is small tier bank, holding a deposit system share of 0.5% (Dec-17: 0.2%).

Revenues During 9MCY18, MIB's profit earned stood at PKR 2.6bln (9MCY17: PKR 1.4bln) driven by sizable increase witnessed in lending portfolio (84%). Mark-up expenses also significantly increased to PKR 1.5bln (9MCY17: PKR 667mln) driven by surge in number of branches. Whereby, net revenue recorded at PKR 1.1bln (9MCY17: PKR 775mln). Bank's spread inched down to 2.6% (CY17: 2.7%; 9MCY17: 2.5%).

Performance Non-markup income declined on YOY basis by 37% owing to lesser realized and unrealized gain on sale of investments (9MCY18: PKR 18mln; 9MCY17: PKR 300mln). Non-markup expenses witnessed upward trend (71%) to stand at PKR 2.1bln (9MCY17: PKR 1.2bln). Hence, the bank's pre-provision operating loss increased to PKR 699mln (9MCY17: PKR 51mln) primarily on account of surged administrative expenses. After deduction of provisioning expense, the bank's net loss for the period is PKR 780mln (9MCY17: PKR 33mln). The bank is planning to achieve breakeven by 4QCY19.

Sustainability The management's strategy is to focus primarily on high-rated, blue chip corporate clients. Meanwhile, undertaking new business lines including Micro, SME and Consumer financing are also on the horizon.

Financial Risk

Credit Risk MIB's gross advances have grown significantly by 84% (end-Sep18: PKR 57bln; end-Dec17: PKR 31mln) driven by addition of branches. The Bank's ADR rationalized to 90.3% as at end-Sep18 (end-Dec17: 96.3%). MIB's financing book is dominated by Diminishing Musharikhah and running Musharikhah (end-Dec17: 60%), followed by Murabaha financing (end-Dec17: 32%) and others including Ijarah Istisna etc. (end-Dec17: 8%). Top-13 private performing client's concentration remained high at 30% during CY17. The new management, after asset cleansing, has focused on quality lending. Currently, MIB has only one non-performing financing amounting ~PKR 8mln. Hence, infection ratio remained at ~0% end-Sep18 (end-Dec17: ~0%). MIB has set relatively high targets for deposit growth for period ending CY18 and is planning to focus on improving its lending book quality.

Market Risk In line with industry, MIB invested majorly in Government securities (92%) which are Government of Pakistan (GoP) Sukuks, whereas rest of the book (8%) is invested in non-strategic equity investments. Going forward, MIB is planning to invest further in GoP Sukuks.

Liquidity And Funding Deposit mobilization remained the key source of funding. During 9MCY18, MIB's customer deposits increased to PKR 58bln (CY17: PKR 27bln), up 114% YoY. Nevertheless, the bank's deposit share in the system increase slightly at 0.5% (Dec-17: 0.2%). CASA proportion in total customer deposits witnessed sizable increase to stand at 94% at end-Sep18 (end-Dec17: ~83%) driven by sizeable increase in CA. Top-20 depositors' concentration remained same on YOY basis but still higher at 46% at end-Dec17 (end-Dec16: 46%). Going forward, deposit mobilization is likely to increase; deposit per branch projected to be PKR 568mln by CY18 but the achievement of target remains vital.

Capitalization The bank has lately met the Minimum Capital Requirement (MCR) of PKR 10bln due to equity injection by sponsor of PKR 1.2bln. The bank reported CAR as of end-Sep18 is 14.3%. Going forward, given the targeted growth in financing disbursements, the bank's CAR is likely to face pressure.



BALANCE SHEET	30-Sep-18	31-Dec-17	31-Dec-16	31-Dec-15	31-Dec-15
	9M	CY17	CY16	(Restated after merger) CY15	(Change of Y/E to Dec) CY15
Earning Assets					
Financing	57,849	31,473	16,174	12,568	973
Private Sukuks	2,411	2,088	2,035	2,052	(39)
Total Financing	60,260	33,561	18,209	14,620	933
Investments	10,044	7,098	3,734	3,962	664
Others	2,189	4,103	2,751	6,277	8,132
	72,493	44,763	24,695	24,859	9,729
Non Earning Assets					
Non-Earning Cash	6,565	3,391	1,510	769	76
Deferred Tax	688	289	-	-	9
Provision for Loan Losses - Prudential General	(8)	(0)	(1)	(113)	-
Fixed Assets & Others	4,386	3,328	2,365	1,364	294
	11,632	7,008	3,874	2,020	379
TOTAL ASSETS	84,125	51,771	28,569	26,879	10,108
Remunerative Liabilities					
Deposits	64,084	32,691	14,279	9,450	38
Borrowings	7,131	7,927	2,786	632	-
	71,215	40,618	17,065	10,082	38
Non-remunerative Liabilities	2,761	1,522	1,238	6,839	86
TOTAL LIABILITIES	73,976	42,140	18,303	16,921	124
EQUITY (including revaluation surplus)	10,149	9,631	10,266	9,958	9,984
Total Liabilities & Equity	84,125	51,771	28,569	26,879	10,108
INCOME STATEMENT	30-Sep-18	31-Dec-17	31-Dec-16	31-Dec-15	31-Dec-15
	9M	CY17	CY16	CY15	CY15
Profit / Return Earned	2,660	2,061	1,527	376	155
Return Expensed	(1,498)	(1,006)	(577)	(101)	(0)
Net Revenue	1,162	1,055	950	275	155
Other Income	260	439	259	25	11
Total Revenue	1,422	1,494	1,209	300	166
Admin and Other Expenses	(2,121)	(1,845)	(1,190)	(203)	(113)
Pre-provision operating profit	(699)	(351)	20	98	53
Provisions	(495)	0	94	(40)	-
Pre-tax profit	(1,195)	(351)	114	58	53
Taxes	415	88	(34)	(5)	(5)
Net Income	(780)	(263)	80	52	48
Ratio Analysis					
Performance					
ROE	-10.3% *	-2.6%	0.8%	2.1%	1.9%
Cost-to-Total Net Revenue	150.1%	124.4%	99.3%	67.7%	68.1%
Provision Expense / Pre Provision Profit	-70.8%	0.0%	-474.6%	40.9%	0.0%
Capital Adequacy					
Equity/Total Assets	12.2%	19.0%	35.3%	37.2%	99.0%
Capital Adequacy Ratio as per SBP	14.3%	23.8%	39.7%	46.4%	182.4%
Funding & Liquidity					
Liquid Assets / Deposits and Borrowings	28.0%	37.5%	58.7%	109.0%	na
Advances / Deposits	90.3%	96.3%	113.3%	132.0%	na
CASA deposits / Total Customer Deposits	93.9%	83.0%	67.3%	55.6%	100.0%
Intermediation Efficiency					
Asset Yield	6.1% *	6.1%	6.4%	6.2%	6.8%
Cost of Funds	3.6% *	3.5%	4.2%	2.0%	0.6%
Spread	2.6% *	2.7%	2.1%	4.2%	6.2%
Outreach					
Branches	166	76	66	40	6
Annualized*					
Jun-18					

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		Short Term Ratings	
AAA	Highest credit quality. Lowest expectation of credit risk. Indicate exceptionally strong capacity for timely payment of financial commitments	A1+	The highest capacity for timely repayment.
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.	A1	A strong capacity for timely repayment.
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.	A2	A satisfactory capacity for timely repayment. This may be susceptible to adverse changes in business, economic, or financial 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.	A3	An adequate capacity for timely repayment. Such capacity is susceptible to adverse changes in business, economic, or financial conditions.
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	The capacity for timely repayment is more susceptible to adverse changes in business, economic, or financial conditions.
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.	C	An inadequate capacity to ensure timely repayment.
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.		



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 surveil the opinion due to lack of requisite information.

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

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.

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.
- (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

(23) All information contained herein is considered proprietary by PACRA. Hence, none of the information in this document can be copied or, otherwise reproduced, stored or disseminated in whole or in part in any form or by any means whatsoever by any person without PACRA's prior written consent