



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-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	-
01-Feb-2016	A	A1	Stable	Initial	-

Rating Rationale and Key Rating Drivers

MCB Islamic Bank Limited (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 consolidate the financing book of corporate clients; curtailed financing book in CY19 to support the same. MIB has set relatively high targets for deposit growth and plans to focus on maintaining its financing book quality. MIB is a small-sized bank with sustainable growth and has witnessed an increase of 22.6% in its customer's deposit, improving its system share. The Bank's continuous focus on the accumulation of low-cost deposit has resulted in a healthy current and savings (CASA) deposit mix. Despite many economic challenges owing to the pandemic, the Bank witnessed a robust growth in its loan book. Moreover, borrowers, having aggregate outstanding exposure of PKR 5,052mln, have availed regulatory relief; the risk of increase in credit losses persists. During CY20, the earnings marked significant improvement this time after incurring losses over the past many years. Capitalization remains comfortable as reflected by Tier I and overall capital adequacy ratio (CAR) of 11.32% and 12.01%, respectively, as on Dec'20. The ratings incorporate the sponsor's willingness to support MIB in the time of need. COVID-19 is an ongoing challenge. While it has taken a toll on many businesses, its ramifications are still unfolding. The proactive measures taken by the regulators and other concerning bodies have mitigated the potential damages much anticipated from this pandemic. As a result, the banking industry remained protected and in fact posted record profits. Vigilance is required as the loan repayment cycle remains amid variants of the pandemic continue to re-emerge.

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 FI (Jun-20),Methodology Correlation Between Long-Term And Short-Term Rating Scale(Jun-20),Criteria Rating Modifier(Jun-20)
Related Research	Sector Study Commercial Bank(Jun-21)
Rating Analysts	Muhammad Noor Ul Haq noorulhaq@pacra.com +92-42-35869504



Profile

Structure MCB Islamic Bank Limited (MIB) 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, MIB 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 MIB. Resultantly, all domestic Islamic banking operations of MCB-IBG were incorporated into MIB w.e.f September 30, 2015 for PKR 7.9bln.

Operations Currently, the Bank is engaged in corporate, commercial, consumer, micro finance, investment and retail banking activities. The Bank is operating through 183 branches in Pakistan (end-Dec20:187). The registered office of the Bank is situated at 59 Block T, Phase II, DHA, Lahore Cantt.

Ownership

Ownership Structure MIB 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 (CY20: 1,258bln) and operates a branch network of 1,429 spread across Pakistan. The Bank rated "AAA/A1+" by PACRA, had a net income of PKR 29.0bln during CY20 (CY19: 24.0bln).

Governance

Board Structure The overall control of the Bank vests with eight-member Board of Directors (BoD) including the CEO/ President. Currently, one position is vacant after resignation of an independent director in Mar'21.

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, KPMG Taseer Hadi & Co, Chartered Accountants, issued an unqualified audit opinion pertaining to annual financial statements for CY20. Furthermore, the Board has set up an effective internal audit function that reports independently to the Audit Committee.

Management

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

Management Team Mr. Muhammad Azfar Alam Nomani joined MCB Islamic Bank Limited as president, has over twenty-eight years of professional experience in the banking sector. He holds a master's degree in Business Administration from LUMS and engineering from UET Lahore. He is supported by experienced team members.

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 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 The indicators of the banking sector reflected mixed trend where economy is recovering from the effects of COVID-19 pandemic. Despite challenging economic conditions prevailing in CY20 due to COVID-19 outbreak, the banking sector managed to grow by a decent pace. Deposits of the banking sector grew by 16.1% to PKR 18,519bln (CY19: PKR 15,953bln) as compared to 11.9% growth in CY19. The surge in deposits provided the necessary funding support to finance the robust rise in investments (CY20: PKR 11,935bln; CY19: PKR 8,939bln) and particularly towards government instruments. During CY20, advances witnessed a mild contraction owing to slackness amid COVID-19 pandemic outbreak. The policy measures rolled out by the SBP enabled the sector to enhance profitability, improve resilience and limit the credit risk. With the completion of deferment period allowed, the aftermath is yet to be comprehended by the industry.

Relative Position MIB is a small-sized bank with sustainable growth and has witnessed an increase of 22.6% in its customer's deposit to PKR 93.1bln, improving its system share at 0.6% (CY19: 0.5%).

Revenues During CY20, the gross mark-up income of the Bank witnessed a marginal contraction of 1.8% to PKR 9,676mln (CY19: PKR 9,849mln), on account of a decrease in income of advances owing to steep decline in policy rate. The non-markup income of the Bank accelerated by 97.7% YoY, clocking in at PKR 678mln (CY19: PKR 343mln), mainly on account of increase in fee & commission income along with a substantial increase in foreign exchange income. Ultimately, the total revenue of the Bank grew by 17.0% to PKR 5,074mln (CY19: PKR 4,337mln) as at end-Dec20. The Bank's core spread adversely impacted with the reduced interest rates during 3MCY21 to 4.5% (3MCY20: 7.0%), dominated by investment and advances yields of 8.2% and 8.0% respectively.

Performance During CY20, the Bank's yield on assets deteriorated to 10.3% as compared to the last year of 12.6%. This contraction was a manifestation of curtail in key policy rate. The Bank's cost of funds revealed an improvement to 5.1% (CY19: 7.0%) due to the low cost borrowed funds. Despite high inflationary pressures, the Bank was largely able to manage its non markup expenses, inched up by 3.6% to PKR 4,665mln as compared to a significant increase of 45.8% in CY19. This improvement was driven by an effective management control in order to sustain profitability levels. Which is ultimately, translated into operational profitability this time after incurring losses as PAT clocked in at PKR 208mln as compared to loss of PKR 244mln in CY19. During 3MCY21, the Bank witnessed a significant increase in its PAT, reported at PKR 55mln (3MCY20: PKR 6.2mln). The effective management of portfolio mix enabled the Bank to improve its profitability.

Sustainability The management intends to continue with its strategy of long-term sustainable profitability by focusing on mobilizing no and low cost deposits along with high earning assets and containment of operating costs. However, the ability to manage the asset quality will be critical for the Bank under the current situation.

Financial Risk

Credit Risk During CY20, the Bank witnessed decent growth of 65.5% YoY in net advances and customer's deposit registered impressive growth of 22.6% YoY. This led to ADR at a level of 94.1%; significantly higher than the industry average. Top sector concentration stood at 64.0%, reflecting high dependence on a single sector. Moreover, borrowers, having aggregate outstanding exposure of PKR 5,052mln, have availed regulatory relief; the risk of increase in credit losses persists. During 3MCY21, net advances remained stagnant at PKR 84,547mln (CY20: 84,896mln) due to weak demand.

Market Risk The Bank's investment portfolio constituting 23.3% of the total earning assets at end-CY20 (end-CY19: 18.9%). However, a significant increase of 79.3% in investments was seen during CY20. Moreover, the mix of government securities in overall investments also enhanced to 95.9%; hence, the Bank is exposed to relatively low market risk.

Liquidity And Funding Bank's liquidity position deteriorated as reflected in the liquidity ratio at 34.3% (CY19: 39.2%) on account of decline in deposits with banks. Meanwhile, top-20 deposits concentration remained stagnant at 28.0% at end-CY20 (end-CY19: 27.0%). During CY20, the Bank was able to attract deposits with similar proportion of current and saving accounts, thus almost maintaining its CA and SA ratio at 31.1% and 44.6% respectively. During 3MCY21, the composition indicates that current and savings account deposits (CASA) together explain 74.9% of the total deposits.

Capitalization The Paid-up Capital of the Bank stands at PKR10.2bln and the Capital Adequacy Ratio (CAR) stands at 12.3%, is in compliance with the required CAR of 11.5% as at end-Mar'21. Moreover, the Bank's equity base stood at PKR 10.7bln in 3MCY21.



PKR mln

MCB Islamic Bank Limited
Unlisted Public Limited

Mar-21	Dec-20	Dec-19	Dec-18
3M	12M	12M	12M

A BALANCE SHEET

1 Total Finances - net	85,887	85,609	52,658	65,148
2 Investments	26,080	26,214	14,617	10,477
3 Other Earning Assets	4,552	830	10,230	5,654
4 Non-Earning Assets	24,905	27,826	27,168	13,619
5 Non-Performing Finances-net	12	690	345	(4)
Total Assets	141,436	141,171	105,017	94,894
6 Deposits	100,842	99,253	81,854	73,307
7 Borrowings	19,654	20,597	4,128	7,801
8 Other Liabilities (Non-Interest Bearing)	10,223	10,593	8,569	3,717
Total Liabilities	130,719	130,443	94,550	84,825
Equity	10,717	10,728	10,467	10,070

B INCOME STATEMENT

1 Mark Up Earned	2,247	9,676	9,849	4,209
2 Mark Up Expensed	(1,211)	(5,281)	(5,855)	(2,305)
3 Non Mark Up Income	98	678	343	399
Total Income	1,133	5,074	4,337	2,303
4 Non-Mark Up Expenses	(1,077)	(4,665)	(4,503)	(3,088)
5 Provisions/Write offs/Reversals	36	(15)	(200)	(896)
Pre-Tax Profit	92	393	(366)	(1,680)
6 Taxes	(37)	(185)	122	584
Profit After Tax	55	208	(244)	(1,096)

C RATIO ANALYSIS

1 Performance

Net Mark Up Income / Avg. Assets	2.9%	3.6%	4.0%	2.6%
Non-Mark Up Expenses / Total Income	95.1%	92.0%	103.8%	134.1%
ROE	2.0%	2.0%	-2.4%	-11.1%

2 Capital Adequacy

Equity / Total Assets (D+E+F)	7.6%	7.6%	10.0%	10.6%
Capital Adequacy Ratio	12.3%	12.0%	13.8%	13.2%

3 Funding & Liquidity

Liquid Assets / (Deposits + Borrowings Net of Repo)	31.9%	34.3%	39.2%	23.3%
(Advances + Net Non-Performing Advances) / Deposits	83.8%	85.5%	62.7%	85.8%
CA Deposits / Deposits	30.7%	31.1%	27.2%	30.2%
SA Deposits / Deposits	44.2%	44.6%	43.6%	50.8%

4 Credit Risk

Non-Performing Advances / Gross Advances	0.1%	0.9%	0.7%	0.0%
Non-Performing Finances-net / Equity	0.1%	6.4%	3.3%	0.0%

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.

Scale	Long-term Rating Definition
AAA	Highest credit quality. Lowest expectation of credit risk. Indicate exceptionally strong capacity for timely payment of financial commitments
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.
AA-	
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.
A-	
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.
BBB-	
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.
BB	
BB-	
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.
B-	
CCC	
CC	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.
C	
D	Obligations are currently in default.

Scale	Short-term Rating 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 conditions.
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 surveil 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):

<p>Entities</p> <ul style="list-style-type: none"> 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 	<p>Instruments</p> <ul style="list-style-type: none"> a) Basel III Compliant Debt Instrument Rating b) Debt Instrument Rating c) Sukuk Rating
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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

- 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

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- (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)
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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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- (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)

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- (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)

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