The Pakistan Credit Rating Agency Limited

Rating Report

Faysal Bank Limited

Report Contents

Rating History

Dissemination Date	Long Term Rating	Short Term Rating	Outlook	Action	Rating Watch
27-Dec-2018	AA	A1+	Stable	Maintain	-
28-Jun-2018	AA	A1+	Stable	Maintain	-
30-Dec-2017	AA	A1+	Stable	Maintain	-
22-Jun-2017	AA	A1+	Stable	Maintain	-
22-Jun-2016	AA	A1+	Stable	Maintain	-

Rating Rationale and Key Rating Drivers

Faysal Bank Limited (FBL) continued its focus on growth and on strengthening its relative positioning among peer banks. The bank has enduring emphasis on low cost CASA deposits, prudent deployment of assets for better yields and carefully planned loan book growth. FBL reduced its Non-Performing Loans and is targeting further reduction in NPLs through various measures including recoveries and settlements under the approved policy. The bank has a continued focus on operational efficiency and despite increase in its branch network, the bank was able to keep costs under control. These initiatives have supported the bank’s profitability and provided cushion against risk absorption capacity. The management is cognizant of dynamic competition in the industry and is taking steps to strengthen FBL's positioning amongst medium-sized banks operating in Pakistan. FBL's conversion into Islamic banking is a medium-term plan, which is being rolled out as envisaged. The banks’ capital adequacy has seen a substantial improvement, gradually over the years. Meanwhile, the ratings recognize FBL's association with a foreign business group (Dar Al Maal Al-Islami Trust).

The ratings are dependent on bank's ability to sustain improvement in its financial profile. This is important since most peer banks have gained in terms of their size and profitability matrix in recent years. Any material weakening in asset quality, in turn, putting pressure on bank's profitability and risk absorption capacity may have negative implications for the ratings.

Disclosure

Name of Rated Entity	Faysal 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 | Commercial Bank(Jun-18)
Rating Analysts	Muhammad Noor ul Haq | muhammad.noorulhaq@pacra.com | +92-42-35869504

Profile

Structure Faysal Bank Limited (hereinafter referred as "FABL" or "the Bank") was incorporated on October 3, 1994. Its shares are listed on Pakistan Stock Exchange Limited (PSX).

Background FABL started operations in Pakistan in 1987, first as a branch set up of Shamil Bank of Bahrain and since 1994, as a locally incorporated bank under the present name. During 2002, Al-Faysal Investment Bank, another group entity, merged into FABL. During 2010, FABL acquired 99.37% shareholding of Royal Bank of Scotland (Pakistan) Limited (RBS). The bank has equity of PKR 37.2bln as at end-Sep18.

Operations The Bank is mainly engaged in corporate, commercial and consumer banking activities. The Bank has a network of 410 branches at end-Sep18 (December 31, 2017: 405); including 204 Islamic banking branches (December 31, 2017: 197) and 1 Islamic sub-branch (December 31, 2017: 1) in Pakistan.

Ownership

Ownership Structure Ithmaar Bank B.S.C (closed), a fully owned subsidiary of Ithmaar Holdings B.S.C is the parent company of the Bank, holding directly and indirectly 66.78% (December 31, 2017: 66.78%) of the shareholding of the Bank. Dar Al-Maal AlIslami. Trust (DMIT), (ultimate parent of the Bank) is the holding company of Ithmaar Holdings B.S.C.

Stability HR committee designs succession planning policies for the CEO, key executives and General Managers. Internal successors were highlighted in addition to earmarking key potential external resources to ensure a robust pipeline across all levels at the Bank.

Business Acumen Ithmaar Holding B.S.C. (Ithmaar Holding) is a Bahrain-based holding company that is licensed and regulated as an investment company and is listed on the Bahrain Bourse, Boursa Kuwait and Dubai Financial Market. Ithmaar Holding has a paid-up capital of US$757.69 million.

Financial Strength Ithmaar Holding B.S.C has an asset base of USD 8.6 bln and equity of USD 0.35 bln as at Dec-17. Ithmaar Holding B.S.C and its subsidiaries are engaged in a wide range of financial services including retail, commercial, investment banking, private banking, takaful and real estate development.

Governance

Board Structure The overall control of the bank vests in the ten-member Board of Directors (BoD) including the CEO. Ithmaar Bank, the key shareholder, is represented by six non-executive directors on the board who are nominees of the bank. The remaining three are independent directors.

Members' Profile Mr. Farooq Rahmatullah, the Chairman, is a professional carrying extensive experience in diverse roles related to the oil and gas industry.

Board Effectiveness The BoD exercises close monitoring of the management's policies and the Bank's operations through its five committees.

Financial Transparency The present auditors, A F Ferguson & Co., Chartered Accountants, will retire on the date of next AGM and are eligible for re-appointment for the financial year 2019. Further, an independent and objective internal audit function is in place covering all activities of the bank with an emphasis on risk management and internal controls.

Management

Organizational Structure Well-defined organizational structure exists. Operations are segregated into various departments wherein clear lines of responsibility are defined for each cadre.

Management Team Mr. Yousaf Hussain is the President & CEO since May-2017. Mr. Hussain has been associated with Faysal Bank since 2008 and has banking experience of worth over two decades. He has held senior positions at ABN Amro, Samba and Mashreq Bank. He is supported by a management team of well experienced and qualified individuals.

Effectiveness A Management Committee (MANCOM), comprising group heads, meets on a quarterly basis to review the performance of each division vis-à-vis set targets. The MANCOM also provides strategic input for setting the direction of the bank vis-à-vis economic environment and decides on the implications of new business initiatives for the bank. Other committees include (ALCO), (IC), (ITSC) and (CCC) headed by CEO of FBL.

MIS The bank has developed Obligor Risk Rating (ORR) models for corporate, commercial, ME, small enterprise (CBSME), Agriculture, Insurance & Financial Institutions and facility rating model.

Risk Management Framework RMF's primary objective is to ensure that risk-taking activities are in line with the guidelines approved by the BoD and to protect the interests of the Bank's depositors and shareholders. RMG headed by CRO has been expanded and entrusted to monitor the risk areas across the organization, including adoption & convergence towards Regulatory & Basel guidelines on Risk Management.

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 the profitability of the sector would take support. Yet NPLs, as a result, may also transpire. CAR is reaching the requirement of 11.9% by December 2018. This will create a challenge for some of the players.

Relative Position With a sustainable growth, FABL is a medium-sized bank, has witnessed an increase in its system share (Deposits: 9MCY18: 3.1%, CY17: 3 %; Advances: 9MCY18: 4.2%CY17: 3.7%).

Revenues During 9MCY18, FABL's Net interest revenue stood at 3.0% (CY17: 3.0%; CY16: 2.8%). The sizeable (PKR 3,581) dip in the overall provisioning expenses supported a healthy growth in the bank's profitability at 9MCY18 (CY17: PKR 4,515mln, CY16: 4,302mln).

Performance During 9MCY18, the realized gain on sale of investments coupled with a low provisioning expense continued to provide support to the bank's performance. Nearly 87% of FABL's assets are earning assets mainly comprising finances (47%) and investments (35%). During 9MCY18, the spreads increased to 3.8% (CY17: 3.6%) on account of an increase in asset yields as compared to a slight dip in the cost of funds.

Sustainability Going forward, FABL plans to focus on mobilizing low-cost core deposits and enhancing business volume via branch outreach. As per the plans of the parent institution, FABL intends to convert its operations to Shariah compliant over the medium term. In this respect, FABL's management is following a 5-year plan (2016-2020) working in consultation with Shariah Board to convert its operations into shariah compliant.

Financial Risk

Credit Risk The bank's credit risk is managed by the RMG via sub-divisions. The portfolio is dominated by the private sector (83%) whereas the government/public sector stood at 17%. The sectorial concentration remained inclined towards the energy sector (17%) and textile (11%). Other contributors include individuals, agriculture and transportation.With the increased advances book, the bank's infection ratio decreased to 8% during 9MCY18 (CY17:11%, CY16:13%). During 9MCY18. The Bank has managed to considerably decrease its NPLs resulting in improvement of coverage ratio of 88% (CY17: 89%, CY16:83%).

Market Risk FABL observed an increase of ~5.6 % (CY17: PKR 180bln, CY16: 170bln) in its investment portfolio mainly due to an increase in investment in GOP and Private Sukuk Bonds. The investments book forms ~37% of total assets at end-Dec17 (CY16: 38%). The portfolio is dominated by T-bills (69%), Sukuk Bonds (15%) and PIBs (13%).

Liquidity And Funding Bank's liquidity position declined marginally on a YoY basis as reflected in liquid assets as a percentage of total deposits and borrowings (CY17: 51%, CY16: 53%). The main source of FBL's funding – deposit base – witnessed 10% growth largely due to an increase in customer deposits. ADR continued a similar trend at 62% (CY16: 60%). The overall deposit mix remained alike during the period.

Capitalization FABL's paid-up capital stands at PKR 15bln at end-Sep18 (CY17: 13blnCY16: 12bln), thus safely meeting the MCR requirement of PKR 10bln for CY17. During 9MCY18, the bank achieved a CAR of 16.3% (CY17: 15.9%) with contribution from Tier-1 capital (14.5%) and Tier-II (1.8%).

Faysal Bank Limited

BALANCE SHEET	30-Sep-18	31-Dec-17	31-Dec-16	31-Dec-15
	9M	Annual	Annual	Annual
Earning Assets				
Advances	293,412	228,506	199,789	175,154
Debt Instruments	25,232	23,528	17,982	7,969
Total Finances	318,644	252,034	217,771	183,123
Investments	107,519	158,296	154,322	189,669
Others	5,092	13,084	8,431	3,663
	431,255	**423,414**	**380,524**	**376,455**
Non Earning Assets				
Non-Earning Cash	35,500	35,661	34,948	23,739
Deferred Tax	643	1,608	2,264	3,087
Net Non-Performing Finances	929	908	2,948	3,813
Fixed Assets & Others	28,077	26,436	23,781	22,979
	65,148	**64,613**	**63,941**	**53,618**
TOTAL ASSETS	**496,403**	**488,027**	**444,465**	**430,073**
Interest Bearning Liabilities				
Deposits	399,424	373,081	340,306	292,130
Borrowings	37,800	54,789	54,303	93,559
	437,223	427,870	394,609	385,690
Non Interest Bearing Liabilities	16,765	20,925	14,847	14,031
TOTAL LIABILITIES	**453,989**	**448,795**	**409,456**	**399,720**
EQUITY (including revaluation surplus)	**42,414**	**39,232**	**35,008**	**30,353**
Total Liabilities & Equity	**496,403**	**488,027**	**444,465**	**430,073**

INCOME STATEMENT	30-Sep-18	31-Dec-17	31-Dec-16	31-Dec-15
	9M	Annual	Annual	Annual
Interest / Mark up Earned	24,019	28,791	26,201	32,313
Interest / Mark up Expensed	(12,970)	(14,831)	(14,134)	(18,358)
Net Interest / Markup revenue	**11,050**	**13,960**	**12,066**	**13,955**
Other Income	4,671	5,591	6,932	5,557
Total Revenue	**15,721**	**19,552**	**18,998**	**19,512**
Non-Interest / Non-Mark up Expensed	(10,316)	(12,779)	(11,776)	(11,166)
Pre-provision operating profit	5,405	6,773	7,222	8,346
Provisions	825	496	(564)	(1,426)
Pre-tax profit	6,230	7,269	6,658	6,920
Taxes	(2,648)	(2,755)	(2,357)	(2,698)
Net Income	**3,581**	**4,515**	**4,301**	**4,222**

Ratio Analysis	30-Sep-18	31-Dec-17	31-Dec-16	31-Dec-15
	9M	Annual	Annual	Annual
Performance				
ROE	13.5%	14.4%	15.6%	17.6%
Cost-to-Total Net Revenue	67.6%	65.8%	63.6%	58.2%
Capital Adequacy				
Equity/Total Assets	7.5%	6.9%	6.6%	6.1%
Capital Adequacy Ratio as per SBP	16.2%	15.9%	14.6%	14.4%
Funding & Liquidity				
Liquid Assets / Deposits and Borrowings	39.2%	51.4%	52.7%	57.6%
Advances / Deposits	74.3%	62.1%	60.2%	62.0%
CASA deposits / Total Customer Deposits	66.8%	70.7%	67.1%	67.3%
Intermediation Efficiency				
Asset Yield	7.6%	7.2%	7.0%	9.1%
Cost of Funds	4.0%	3.6%	3.6%	5.0%
Spread	3.6%	3.6%	3.4%	4.1%
Outreach				
Branches	410	405	355	280

Rating Scale

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.

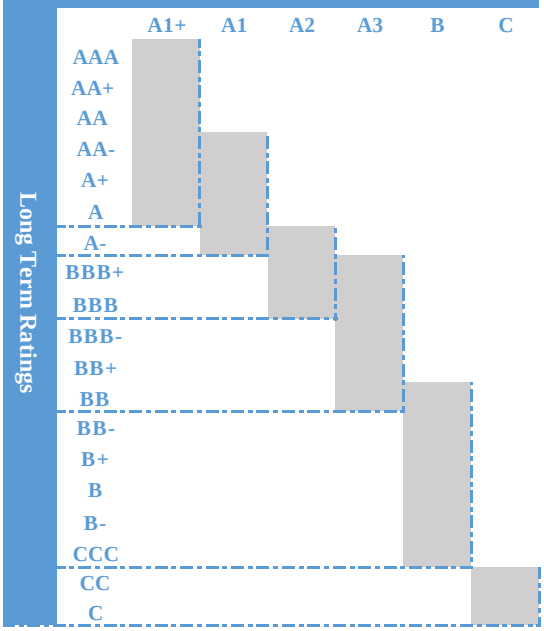
Long Term Ratings

AAA	**Highest credit quality.** Lowest expectation of credit risk. Indicate exceptionally strong capacity for timely payment of financial commitments
AA+ AA AA-	**Very high credit quality.** Very low expectation of credit risk. Indicate very strong capacity for timely payment of financial commitments. This capacity is not significantly vulnerable to foreseeable events.
A+ A A-	**High credit quality.** Low expectation of credit risk. The capacity for timely payment of financial commitments is considered strong. This capacity may, nevertheless, be vulnerable to changes in circumstances or in economic conditions.
BBB+ BBB BBB-	**Good credit quality.** Currently a low expectation of credit risk. The capacity for timely payment of financial commitments is considered adequate, but adverse changes in circumstances and in economic conditions are more likely to impair this capacity.
BB+ BB BB-	**Moderate risk.** Possibility of credit risk developing. There is a possibility of credit risk developing, particularly as a result of adverse economic or business changes over time; however, business or financial alternatives may be available to allow financial commitments to be met.
B+ B B-	**High credit risk.** A limited margin of safety remains against credit risk. Financial commitments are currently being met; however, capacity for continued payment is contingent upon a sustained, favorable business and economic environment.
CCC CC C	**Very high credit risk.** Substantial credit risk "CCC" Default is a real possibility. Capacity for meeting financial commitments is solely reliant upon sustained, favorable business or economic developments. "CC" Rating indicates that default of some kind appears probable. "C" Ratings signal imminent default.
D	Obligations are currently in default.

Short Term Ratings

A1+	The highest capacity for timely repayment.
A1	A strong capacity for timely repayment.
A2	A satisfactory capacity for timely repayment. This may be susceptible to adverse changes in business, economic, or financial conditions.
A3	An adequate capacity for timely repayment. Such capacity is susceptible to adverse changes in business, economic, or financial conditions.
B	The capacity for timely repayment is more susceptible to adverse changes in business, economic, or financial conditions.
C	An inadequate capacity to ensure timely repayment.

Short Term Ratings



Outlook (Stable, Positive, Negative, Developing) Indicates the potential and direction of a rating over the intermediate term in response to trends in economic and/or fundamental business/financial conditions. It is not necessarily a precursor to a rating change. 'Stable' outlook means a rating is not likely to change. 'Positive' means it may be raised. 'Negative' means it may be lowered. Where the trends have conflicting elements, the outlook may be described as 'Developing'.

Rating Watch Alerts to the possibility of a rating change subsequent to, or in anticipation of, a) some material identifiable event and/or b) deviation from expected trend. But it does not mean that a rating change is inevitable. A watch should be resolved within foreseeable future, but may continue if underlying circumstances are not settled. Rating Watch may accompany Outlook of the respective opinion.

Suspension It is not possible to update an opinion due to lack of requisite information. Opinion should be resumed in foreseeable future. However, if this does not happen within six (6) months, the rating should be considered withdrawn.

Withdrawn A rating is withdrawn on a) termination of rating mandate, b) cessation of underlying entity, c) the debt instrument is redeemed, d) the rating remains suspended for six months, e) the entity/issuer defaults., or/and f) PACRA finds it impractical to surveill the opinion due to lack of requisite information.

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

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