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-Jun-2019	AA	A1+	Stable	Maintain	-
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	-

Rating Rationale and Key Rating Drivers

Faysal Bank Limited (FABL) continued its focus on growth while maintaining 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. 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 FABL's positioning amongst medium-sized banks operating in Pakistan. FABL'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 FABL's association with a foreign business group (Dar Al Maal Al-Islami Trust).FABL has been successfully managing its asset quality despite ongoing stress in the system. FABL reduced its Non-Performing Loans and is targeting further reduction in NPLs. FABL remains one of the most capitalised commercial bank with a common equity tier 1 (CET1) ratio of 14.81% in CY18 (CY17: 14.00%).

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-19)
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 as a public limited company under the provisions of the Companies Ordinance 1984. Its shares are listed on Pakistan Stock Exchange (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).

Operations The Bank is mainly engaged in Conventional and Islamic Corporate, Commercial and Consumer banking activities. During 2018, FABL opened 57 new Islamic branches increasing the Islamic branch network to 254 branches, making it the biggest network of dedicated Islamic Branches amongst all conventional banks in Pakistan. With a presence of 455 conventional and Islamic branches and 1 Islamic sub-branch (2017:1), it expanded its footprint in to 124 cities across Pakistan.

Ownership

Ownership Structure Ithmaar Bank B.S.C, 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 are 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$757.69mln.

Financial Strength Ithmaar Holding B.S.C has an asset base of USD 8.3 bln and equity of USD 0.23 bln as at Dec-18. 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. Mr. Farooq Rahmatullah, the Chairman, is a professional carrying extensive experience in diverse roles related to the oil and gas industry. Ithmaar Bank, the key shareholder, is represented by six non-executive directors on the board who are nominees of the bank.

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. i) Audit, ii) Board Risk Management, iii) Recruitment, Nomination and Remuneration iv) Board Strategy and v) Board IT.

Financial Transparency The external auditors of the company, A F Ferguson & & Co., Chartered Accountants, issued an unqualified audit opinion pertaining to annual financial statements for CY18. Furthermore, the Board has set up an effective internal audit function that reports independently to the Audit Committee regularly on compliance with critical policies and procedures and recommends on amendments to these policies in line with the industry best practices.

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 experience 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 direction of the bank vis-à-vis economic environment and decides on implications of new business initiatives for the bank.

MIS FABL 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 Risk Management Framework'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. The Bank has developed and implemented a governance and management structure, processes surrounding each risk area, including credit risk, market risk, capital management, operational risk and information security risk.

Business Risk

Industry Dynamics The year 2018 was a marked year as the industry saw an expansion of ~22% in advances, although the deposit growth rate stayed in single digit. As a result the industry saw a rise in the ADR ratio from 50% to 55%. Corporate sector claimed the major portion of the borrowings with small amounts going into commodity, consumer and SME sectors. Profitability of the banks has taken a hit due to incremental costs and provisioning on account of NPLs. After a lapse of few years the industry NPLs have seen a accretion which is a concern going forward.

Relative Position FABL is a medium-sized bank with sustainable growth, and has witnessed an increase of 7.7% in its customer's deposit to PKR 380bln as against the sector's growth of 10.7% which resulted in slight dilution in its system share (customer deposits: CY18: 2.9%, CY17: 3.0 %).

Revenues During CY18, FABL continued its growth momentum showing an increase of over 20% in total assets mainly led by 28% growth in financing and 19% in investments. Resultantly, the total revenue increased by 15% to PKR 2.9bln. During 1QCY19, Bank reported an increase of PKR 1.5bln in markup income over same period last year and non-markup income was reported at PKR 0.2bln – increasing by 13% YoY.

Performance During CY18, the spreads slightly decreased by 20bps (CY18: 3.4%, CY17: 3.6%) on account of increase in cost of funds as compared to a slight dip in asset yield. On the provision side, recovery trend in the classified portfolio continued to reflect profitably with a PKR 421mln reversal. During 1QCY19 Profit before tax of the Bank grew by 49.5% over the same period last year and was reported at PKR 3.0bln.

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 has managed to slightly decrease its NPLs and has sustained its coverage ratio (CY18: 89%, CY17: 89%). With the increased advances book, the bank's infection ratio decreased to 8% during CY18 (CY17: 11%). During 1QCY19, advances of the Bank constitute 56% of the total assets increasing ~0.3%. The coverage and infection ratios of the Bank were reported at 87% and 8% respectively.

Market Risk FABL observed an increase of ~19 % (CY18: PKR 214bln, CY17: 180bln) in its investment portfolio mainly due to an increase in investment in Government Securities. However, during 1QCY19, after maturity of MTB's, net investments have decreased by PKR 89bln (-58%) with a corresponding increase in Lending to Financial Institutions by PKR 26bln to capitalize on the anticipated interest rate hike in the month of March 2019.

Liquidity And Funding Bank's liquidity position declined marginally on YoY basis as reflected in liquid assets to total deposits and borrowings ratio (end-Dec17: 47.6%, end-Dec17: 48%). The main source of FABL's funding – deposit base – witnessed 7.7% growth largely due to increase in customer deposits. The advances-to-deposits ratio (ADR) saw a sharp increase to 72% (CY17: 62%). The top 20 depositor concentration clocked in at 20% in CY18 (CY17: 11%) with rise in high amount deposits.

Capitalization FABL's paid-up capital stands at PKR 15,177mln (CY17: 13,197mln), thus safely meeting the MCR requirement of PKR 10,000mln for end-Dec18. During CY18, the bank achieved a CAR of 16.8% (CY17: 15.9%) with contribution from Tier-1 capital (14.8%) and Tier-II (2.0%).

Faysal Bank Limited

BALANCE SHEET	31-Mar-19	31-Dec-18	31-Dec-17	31-Dec-16
	3M	Annual	Annual	Annual
Earning Assets				
Advances	294,431	293,571	228,506	199,789
Debt Instruments	14,100	24,000	23,588	17,982
Total Finances	308,532	317,571	252,094	217,771
Investments	112,977	192,298	158,258	154,322
Others	38,663	7,975	13,084	8,431
	460,171	**517,844**	**423,436**	**380,524**
Non Earning Assets				
Non-Earning Cash	38,439	40,044	35,661	34,948
Deferred Tax	169	183	1,600	2,264
Net Non-Performing Finances	2,177	762	908	2,948
Fixed Assets & Others	44,712	41,081	33,329	23,781
	85,497	**82,070**	**71,498**	**63,941**
TOTAL ASSETS	**545,669**	**599,914**	**494,934**	**444,465**
Interest Bearning Liabilities				
Deposits	422,133	409,384	371,624	340,306
Borrowings	40,387	98,352	54,789	54,303
	462,520	507,736	426,413	394,609
Non Interest Bearing Liabilities	37,880	48,680	29,275	14,847
TOTAL LIABILITIES	**500,400**	**556,416**	**455,687**	**409,456**
EQUITY (including revaluation surplus)	**45,269**	**43,499**	**39,246**	**35,008**
Total Liabilities & Equity	**545,669**	**599,914**	**494,934**	**444,465**

INCOME STATEMENT	31-Mar-19	31-Dec-18	31-Dec-17	31-Dec-16
	3M	Annual	Annual	Annual
Interest / Mark up Earned	12,205	35,200	28,766	26,201
Interest / Mark up Expensed	(7,261)	(18,925)	(14,831)	(14,134)
Net Interest / Markup revenue	**4,944**	**16,275**	**13,935**	**12,066**
Other Income	1,705	6,260	5,639	6,746
Total Revenue	**6,650**	**22,535**	**19,574**	**18,812**
Non-Interest / Non-Mark up Expensed	(3,859)	(14,755)	(12,774)	(11,590)
Pre-provision operating profit	2,791	7,780	6,800	7,223
Provisions	206	422	492	(564)
Pre-tax profit	2,997	8,202	7,292	6,659
Taxes	(1,388)	(3,365)	(2,763)	(2,357)
Net Income	**1,609**	**4,837**	**4,530**	**4,302**

Ratio Analysis	31-Mar-19	31-Dec-18	31-Dec-17	31-Dec-16
	3M	Annual	Annual	Annual
Performance				
ROE	17.2% *	13.4%	14.4%	15.6%
Cost-to-Total Net Revenue	58.4%	66.7%	66.1%	63.3%
Capital Adequacy				
Equity/Total Assets	7.3%	6.4%	6.8%	6.5%
Capital Adequacy Ratio as per SBP	16.2%	16.2%	15.9%	14.6%
Funding & Liquidity				
Liquid Assets / Deposits and Borrowings	40.4%	47.6%	48.0%	52.7%
Advances / Deposits	70.6%	72.4%	62.3%	60.2%
CASA deposits / Total Customer Deposits	70.0%	68.3%	70.6%	67.1%
Intermediation Efficiency				
Asset Yield	11.1% *	7.5%	7.2%	7.0%
Cost of Funds	6.6% *	4.1%	3.6%	3.6%
Spread	4.5% *	3.4%	3.6%	3.4%
Outreach				
Branches	455	455	405	355

*Annualized

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.

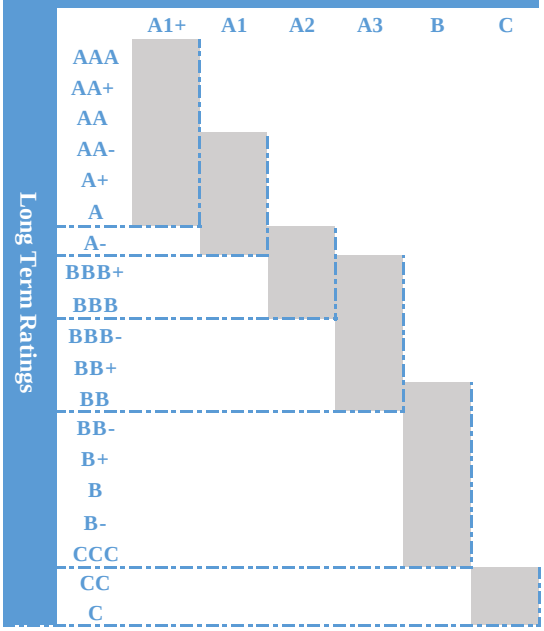
Long Term Ratings

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