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
26-Jun-2020	AA	A1+	Stable	Maintain	-
27-Dec-2019	AA	A1+	Stable	Maintain	-
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	-
22-Jun-2016	AA	A1+	Stable	Maintain	-
22-Jun-2015	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 an enduring emphasis on 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 an increase in its branch network, the bank was able to keep costs under control. These initiatives have supported the bank's profitability and provided a 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. FABL opened 100 new Islamic branches during FY19 increasing the Islamic branch network to 413 branches including 1 Islamic sub-branch, making it the biggest network of dedicated Islamic Branches amongst all conventional banks in Pakistan. The banks' capital adequacy has seen 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 remains a highly capitalized commercial bank with a common equity tier 1 (CET1) ratio of 15.5% as at Dec-19. Covid-19 has posed challenges to the banking sector, as almost all segments of the economy, worldwide and domestically, are getting negatively impacted. The ramifications would continue to unfold, warranting vigilance and timely actions where needed.

The ratings are dependent on the 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 the 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	PACRA_Methodology_FI(Jun-19),Methodology | Correlation Between Long-Term And Short-Term Rating Scale(Jun-19),Criteria | Rating Modifier(Jun-19)
Related Research	Sector Study | Commercial Bank(Jun-20)
Rating Analysts	Kanwal Ejaz | kanwal.ejaz@pacra.com | +92-42-35869504

Profile

Structure Faysal Bank Limited (hereinafter referred to 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 the Royal Bank of Scotland (Pakistan) Limited (RBS).

Operations The Bank is mainly engaged in Conventional and Islamic Corporate, Commercial and Consumer banking activities. During CY19, FABL opened 100 new Islamic branches increasing the Islamic branch network to 413 branches, making it the biggest network of dedicated Islamic Branches amongst all conventional banks in Pakistan. With a presence of 141 conventional and 413 Islamic branches and 1 Islamic sub-branch (2017:1), it expanded its footprint into 200 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% 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-19. 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 & corporate Governance ii) Risk Management, iii) Recruitment, Nomination and Remuneration iv) Strategy and v) 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 CY19. 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 amendments to these policies in line with the industry's 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 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.

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 As a result of general economic slowdown most indicators of the banking sector reflected mixed trend. Deposits of the banking sector stood at (CY19: PKR 15,953bln; CY18: PKR 14,254bln), showing a growth of ~12% as compared to 9.5% growth in CY18. Deployment of funds was largely skewed towards investments and particularly towards government instruments due to favorable interest rate dynamics (CY19: PKR 8,939bln; CY18: PKR 7,914bln). Meanwhile, advances witnessed a slowdown owing to subdued demand, cautious lending approach and monetary tightening .There was only a growth of 3.7% as compared to expansion of 22.2% in CY18. Asset quality saw deterioration – increased NPLs (CY19: PKR 761bln; CY18: PKR 680bln). The profitability of the banking sector improved due to an increase in Net Interest Income, which translated positively in other profitability indicators. The overall risk profile of the banking sector remained satisfactory.

Relative Position FABL is a medium-sized bank with sustainable growth and has witnessed an increase of 12% in its customer's deposit to PKR 458mln, maintaining its system share at 3.0%. (customer deposits: CY18: 2.9%, CY17: 3.0 %).

Revenues The bank's return on advances stood at 13.1% (CY18: 9.2%), whereas the cost of deposits increased to 6.7% from 3.7% YoY basis. During CY19, Bank showed significant growth of 66% to PKR 58bln (CY18: PKR 35bln) in gross markup income and non-markup income was reported at PKR 7bln up by 11% YoY.

Performance During CY19, the non-markup expenses have been increased to 15%. Profit before tax of the bank grew by 24% over the same period last year and was reported at PKR 10.19bln (CY18: PKR 8.2bln).

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 working in consultation with the Shariah Board to convert its operations into shariah compliant by 2023.

Financial Risk

Credit Risk Against a slight increase of 4.7% in advances book, the NPLs of the bank increased by 13% to PKR 30bln due to classification of certain customers in review period. During CY19 advances of the Bank constitute 49% of the total assets.

Market Risk FABL observed a decrease of ~4.6 % to PKR 204bln (CY18: PKR 214bln, CY17: 180bln) in its investment portfolio. However, during CY19, after maturity of MTB's, net investments have decreased by PKR 10bln.

Liquidity And Funding Bank's liquidity position declined marginally as reflected in liquid assets to total deposits and borrowings ratio 36.5% (Dec-18: 39.6%, Dec-17: 42.9%). The main source of FABL's funding – deposit base – witnessed a 5.9% growth largely due to an increase in customer deposits. The advances-to-deposits ratio (ADR) saw a slight decrease to 67.6% (CY18: 72%). The top 20 depositor concentration clocked in at ~17% in CY19 (CY18: ~19%).

Capitalization FABL's paid-up capital stands at PKR 15,177mln (CY18: 15,177mln), thus safely meeting the MCR requirement of PKR 10,000mln for the ongoing year CY20. During CY19, the bank achieved a CAR of 19.14% (CY18: 16.8%) with contribution from Tier-1 capital (15.53%) and Tier-II (3.61%).

PKR mln

Faysal Bank Limited	Dec-19	Dec-18	Dec-17
Listed Public Limited	12M	12M	12M
A BALANCE SHEET			
1 Total Finances - net	364,582	317,571	252,094
2 Investments	144,992	192,298	158,258
3 Other Earning Assets	5,381	7,975	13,084
4 Non-Earning Assets	110,829	81,309	70,590
5 Non-Performing Finances-net	4,068	762	908
Total Assets	629,853	599,914	494,934
6 Deposits	457,789	409,384	371,624
7 Borrowings	72,747	98,352	54,789
8 Other Liabilities (Non-Interest Bearing)	44,053	48,680	29,275
Total Liabilities	574,589	556,415	455,687
Equity	55,264	43,499	39,246
B INCOME STATEMENT			
1 Mark Up Earned	58,398	35,200	28,766
2 Mark Up Expensed	(37,278)	(18,925)	(14,831)
3 Non Mark Up Income	7,247	6,584	5,639
Total Income	28,367	22,859	19,574
4 Non-Mark Up Expenses	(17,333)	(15,079)	(12,774)
5 Provisions/Write offs/Reversals	(843)	422	492
Pre-Tax Profit	10,192	8,202	7,292
6 Taxes	(4,151)	(3,365)	(2,763)
Profit After Tax	6,041	4,837	4,530
C RATIO ANALYSIS			
1 Performance			
Net Mark Up Income / Avg. Assets	3.4%	3.0%	2.9%
Non-Mark Up Expenses / Total Income	61.1%	66.0%	65.3%
ROE	12.2%	11.7%	12.2%
2 Capital Adequacy			
Equity / Total Assets (D+E+F)	8.8%	7.3%	7.9%
Capital Adequacy Ratio	19.1%	16.8%	15.9%
3 Funding & Liquidity			
Liquid Assets / (Deposits + Borrowings Net of Repo)	36.5%	39.6%	42.9%
(Advances + Net Non-Performing Advances) / Deposits	67.6%	72.4%	62.3%
CA Deposits / Deposits	32.3%	32.3%	33.8%
SA Deposits / Deposits	37.7%	35.9%	35.4%
4 Credit Risk			
Non-Performing Advances / Gross Advances	9.1%	8.3%	10.7%
Non-Performing Finances-net / Equity	7.4%	1.8%	2.3%

Rating Scale | Corporate

2019

Credit Rating Scale & Definitions

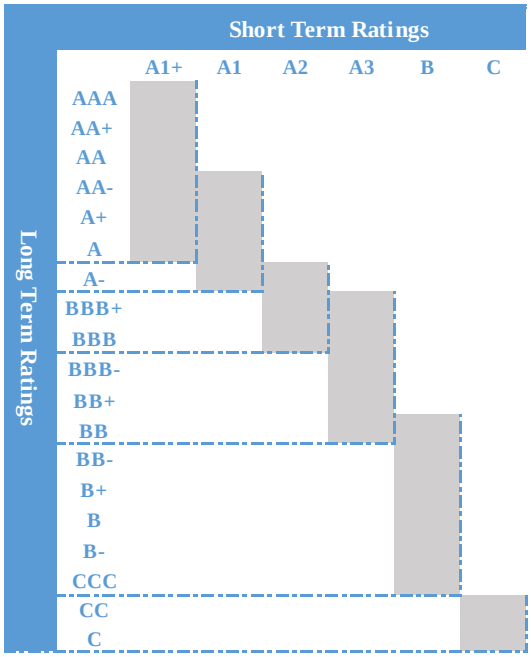
Credit rating reflects forward-looking opinion on credit worthiness of underlying entity or instrument; more specifically it covers relative ability to honor financial obligations. The primary factor being captured on the rating scale is relative likelihood of default.

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.



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