The Pakistan Credit Rating Agency Limited

Rating Report

Askari Bank Limited | TFC VI (Additional Tier I) | Jul-18

Report Contents

Rating History

Dissemination Date	Long Term Rating	Short Term Rating	Outlook	Action	Rating Watch
28-Jun-2019	AA-	-	Stable	Maintain	-
01-Jan-2019	AA-	-	Stable	Maintain	-
06-Dec-2018	AA-	-	Stable	Initial	-
19-Apr-2018	AA-	-	Stable	Preliminary	-

Rating Rationale and Key Rating Drivers

Askari Bank has shown stable growth rate over the years. This has ensured its relative profitability to remain intact. The bank has a strong brand image, flanked by its affiliation with one of the strongest conglomerate, Fauji Foundation Group. The ownership structure has proven itself a strong backing, as reflected by Askari Bank's history. The Bank has continued the growth trajectory during 2018. The net spread has improved on the back of significant improvement in asset yield amidst slightly higher cost of funds. Volumetric increase in earning assets, led by loan portfolio augmentation, provided support to profitability; but was negatively impacted due to higher provisioning expense on mark-to market loss of investment and NPL provisioning. The bank had a sizeable reversal in specific charge NPL provisioning during 2018, yet the positive impact was diluted by a higher incidence of provisioning expense. This also impacted the profitability for 2018.
The Bank's CAR is 12.5% at end-Dec18. The Tier 1 capital increased from 9.31% in 2017 to 10.92% in 2018 while the overall CAR improved by 40 basis points. With minimum CAR requirement of 12.5% by next year, the Bank would need to tread ahead with a cautious approach while lending in order to maintain sustainability with growth. The deposit growth was sizeable, enabling the bank to hold its relative position.

The ratings are dependent upon sustainability of the bank 's relative positioning and continuous improvement in capital adequacy, whereas, effective management of spreads remains important. Meanwhile, holding the asset quality is a pre-requisite.

Disclosure	
Name of Rated Entity	Askari Bank Limited | TFC VI (Additional Tier I) | Jul-18
Type of Relationship	Solicited
Purpose of the Rating	Debt Instrument Rating
Applicable Criteria	Methodology | Financial Institution(Jun-18),Methodology | Basel III Compliant - Debt Instrument(Jun-18)
Related Research	Sector Study | Commercial Bank(Jun-19)
Rating Analysts	Muhammad Obaid | muhammad.obaid@pacra.com | +92-42-35869504

Profile

Structure Askari Bank Limited (AKBL), incorporated as a public limited company, commenced operations as a Scheduled Commercial Bank in 1992.

Background The bank has a steady presence in Islamic banking as well. Started in 2006, the bank provides a range of shariah compliant products under its Islamic brand name 'Ikhlas'.

Operations The Bank, with its head office in Islamabad, operates with a network of 516 branches at end-Mar19. The bank has a widespread ATM network of over 583, covering all major cities. The Bank's market share in terms of customer deposits stood at 4.4% (CY17: 4.4%).

Ownership

Ownership Structure The current sponsors, Fauji Foundation Group, own 71.9% stake of the Bank. The remaining stake (28.1%) is widely spread among financial institutions, and general public.

Stability Fauji Foundation (FF) is a Charitable Trust and is exclusively devoted to the welfare of ex-servicemen of the Pakistan Armed Forces and their dependents. Over the years, FF has emerged as one of the leading conglomerates of the country with established business interests in numerous sectors and industries.

Business Acumen The Fauji Foundation Group comprising several industrial/commercial projects in various sectors including energy, gas supply, fertilizer, cement, food etc, includes wholly owned as well as partly owned ventures. The group, with its increased penetration in the major facets of the economy, has garnered expertise and knowledge of various sectors which provides it with a holistic view of the macro economy and a strategic viewpoint.

Financial Strength Fauji Foundation is one of the leading and most diversified groups in Pakistan. The group has a strong equity and asset base. Over the years the group has stretched its business profile by entering into new industries, providing it with diversity in revenue streams, strong brand image and an increased hands-on knowledge of the various sectors of the economy.

Governance

Board Structure Overall control of the Bank vests in the eleven-member Board of Directors (BoD) including the President & CE. Chairman of the BoD is Lt. Gen Syed Tariq Nadeem Gilani. Five of the board members are Fauji Foundation nominees; four are independent members, while one represents NIT. The board composition and membership reflects diversified experience with sound business acumen of the nominated directors.

Members' Profile The members carry diversified experience in Financial Institutions (Banking, AMCs), public sector entities, Oil and Gas, Power, Fertilizer, IT etc. Most of the directors have completed their trainings as part of Code of Corporate Governance and meet the criteria specified by SECP.

Board Effectiveness During the year, seven board meetings were held. Attendance of board members in these meetings remained good. There are four board committees in place; i) Board Audit, ii) Board Risk Management, iii) Board Human Resource and Remuneration, and iv) Board Information Technology.

Financial Transparency The audit committee comprises five members, all of whom are non-executive directors while three of them are independent directors including the chairman. A.F. Ferguson & Co. Chartered Accountants, the external auditors of the bank, expressed an unqualified opinion on the bank's financial statements for the year ended December 31, 2018.

Management

Organizational Structure The Board appointed Mr. Abid Sattar in Jun-18 as President and CE. He has extensive expertise, both locally and overseas, in the financial services industry.

Management Team The Bank has eight management committees in place to oversee its day-to-day operational matters; seven of them are headed by the President. The committees ensure, that the bank is aligned with its current strategy. Going forward, sustainability and cohesiveness of the team would remain important to continue the growth trend.

Effectiveness AKBL's operations are currently divided in 23 functions, out of which 14 are directly reporting to the President. Chief Internal Auditor reports to the Board Audit Committee.

MIS The bank has implemented Flexcube (developed by Oracle financial services and installed at over 750 sites worldwide), as its core banking software.

Risk Management Framework The Bank has a robust Risk Management Framework driven by the Board Risk Management Committee and managed by Risk Management Group. Risk Management Group is headed by the Chief Risk Officer (CRO), who is overseeing independent divisions for management of Credit, Market/Liquidity, Information Security, policy and Operational 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%. In terms of advances expansion, a predominant portion went in to energy sector followed by textile, individuals and agriculture. 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 During CY18, Bank's customer deposits (PKR 570bln) increased by ~9% in line with the sector's growth of ~9.5%. AKBL maintained its system share in terms of total deposits at 4.4% (CY17: 4.4%).

Revenues On the gross markup income side, Bank reported a 20% increase amounting to PKR 7.4bln. Of this increase, income on advances constituted the major chunk increasing 40% to PKR 23.8bln (CY17: PKR 17.0bln). Non-markup income of the Bank saw a decline of ~10% YoY, clocking in at PKR 5.6bln (CY17: PKR 6.2bln) with major contributions coming in from fee and commission income and income from dealing in foreign currencies. During first quarter ending March 2019, Bank reported a massive increase of 56% in gross markup income clocking in at PKR 14.2bln (3MCY18: PKR 9.1bln) whereas non-markup income of the Bank was reported at ~PKR 1.4bln (3MCY18: ~PKR 1.2bln).

Performance Profit before tax of the Bank shrunk by 19% over the last year and was reported at PKR 6.88bln (CY17: PKR 8.49bln). Provisioning expense saw a 2x increase over the previous year (CY18: PKR 1.4bln, CY17: PKR -1.3bln). The bank's yield on advances was impacted positively by increasing interest rates environment and stood at 7.4% (CY17: 6.5%). The bank's cost of deposits increased less than proportionately (CY18: 4.0%, CY17: 3.4%) compared to the asset yield.

Sustainability The budgeted forecasts and actual numbers of AKBL have strong correlation. Increasing interest rate environment helped the bank in increasing its spread and earning higher profitability.

Financial Risk

Credit Risk During CY18, AKBL's gross advances registered a massive growth of ~32% YoY. ADR on the back of higher credit off-take by the bank saw a massive improvement to 60% at end-Dec18 (end-Dec17: 49%). At end CY18, the Non-performing loan base of the Bank almost remained static with marginal decrease of PKR 96mln and was reported at PKR 26.6bln. The coverage and infection ratios of the Bank improved and were reported at 98.1% (CY17: 95.9%) and 7.2% (CY17: 9.4%) respectively.

Market Risk The investment portfolio showed a contraction of 17% to PKR 260bln during CY18 (CY17: PKR 315bln), primarily due to loss incurred on fixed income securities, especially PIBs amidst rising interest rates. The bank's investment portfolio constitutes 37% of total asset base and government securities continue to dominate the overall investment book (96%).

Liquidity And Funding The Bank was able to attract deposits with similar proportion of current and saving accounts, thus maintaining its CASA ratio at 84.7% (CY17: 84.4%). The deposit base of the Bank registered an increase of PKR 47bln (9% YoY) over Dec-17. AKBL issued a perpetual, unsecured, unlisted TFC (ADT1) of PKR 6,000mln in July 2018. AKBL continued to fund major portion of its assets through deposits (81%).

Capitalization AKBL is an adequately capitalized institution with an equity base and CAR above the regulatory requirements. However, higher provisioning expense of PKR 2.8bln put a dent in Bank's CAR on Dec18 to 12.51% (Dec17: 12.09%), despite a PKR 6bln TFC issued in Jul-18.

Askari Bank Limited

BALANCE SHEET	31-Dec-18	31-Dec-17	31-Dec-16
Earning Assets			
Advances (Net of NPL)	342,602	257,587	233,589
Debt Instruments	5,417	7,153	4,569
Total Finances	348,019	264,739	238,158
Investments	254,818	308,916	292,339
Others	10,639	11,253	16,666
	613,475	**584,908**	**547,162**
Non Earning Assets			
Non-Earning Cash	42,642	38,430	38,585
Deferred Tax	3,774	101	-
Net Non-Performing Finances	339	444	963
Fixed Assets & Others	46,136	33,275	32,879
	92,891	**72,250**	**72,427**
TOTAL ASSETS	**706,532**	**662,691**	**619,589**
Interest Bearing Liabilities			
Deposits	573,636	525,808	472,811
Borrowings	62,696	76,580	94,257
	636,332	602,388	567,068
Non Interest Bearing Liabilities	36,691	21,884	19,494
		(1,919)	
TOTAL LIABILITIES	**673,023**	**624,273**	**586,562**
EQUITY (including revaluation surplus)	**33,509**	**38,418**	**33,027**
Total Liabilities & Equity	**706,532**	**662,691**	**619,589**

INCOME STATEMENT	31-Dec-18	31-Dec-17	31-Dec-16
Interest / Mark up Earned	43,670	36,267	35,512
Interest / Mark up Expensed	(25,060)	(20,072)	(20,497)
Net Interest / Markup revenue	**18,610**	**16,195**	**15,016**
Other Income	5,622	6,255	7,106
Total Revenue	**24,232**	**22,450**	**22,122**
Non-Interest / Non-Mark up Expensed	(15,892)	(15,164)	(14,304)
Pre-provision operating profit	8,340	7,161	7,818
Provisions	(1,461)	1,205	659
Pre-tax profit	6,879	8,491	8,477
Taxes	(2,448)	(3,224)	(3,256)
Net Income	**4,431**	**5,267**	**5,221**

Ratio Analysis	31-Dec-18	31-Dec-17	31-Dec-16
Performance			
ROE	19.9%	20.0%	22.1%
Cost-to-Total Net Revenue	65.6%	67.5%	64.7%
Provision Expense / Pre Provision Profit	17.5%	16.5%	8.4%
Capital Adequacy			
Equity/Total Assets	4.5%	4.2%	4.1%
Capital Adequacy Ratio as per SBP	12.5%	12.1%	12.5%
Funding & Liquidity			
Liquid Assets / Deposits and Borrowings	47.0%	55.9%	55.1%
Advances / Deposits	59.8%	49.2%	49.7%
CASA deposits / Total Customer Deposits	84.9%	84.4%	81.4%
Intermediation Efficiency			
Asset Yield	7.3%	6.5%	7.0%
Cost of Funds	4.0%	3.4%	3.9%
Spread	3.3%	3.1%	3.1%
Outreach			
Branches	516	516	501

Nature of Instrument	Size of Issue (PKR)	Tenor	Security	Quantum of Security	Nature of Assets	Trustee	Book Value of Assets (PKR mln)
TFC - ADT 1	6,000 mln	Perpetual	Unsecured and subordinated to all other obligations of the bank	N/A	N/A	Pak Oman Investment Company Limited	N/A

Askari Bank Limited | Tier 1 - TFC | CY18	
Name of Issuer	Askari Bank Limited
Issue size	PKR 6,000mln (Inclusive of Green Shoe option of PKR 1,500mln)
Tenor	Perpetual
Maturity	Perpetual (unless call option is excercised)
Profit Rate	6 MK + 1.5%
Principal Repayment	Payable semi-annually in arrears on a non-cumulative basis on the outstanding principal amount of the issue. The first such payment will be in six months from the issue date and subsequently every six months thereafter.
Security	N/A

Askari Bank Limited | Tier-I TFC | CY-18

Due Date Principle	Opening Principal	Principal Repayment	Due Date Markup/ Profit	Markup/Profit Rate	6M Kibor	Markup Payment	Installment Payable	Principal Outstanding
	PKR in mln					*PKR in mln*		
Issuance								
6 months from issuance	Redemption Schedule not applicable since its a perpetual TFC whereby there is no fixed or final redemption date. Profit (if declared) will be payable semi-annually in arrears, on a non-cumulative basis, on the outstanding TFC amount. The first such profit payment will fall due six months from the Issue Date and subsequently every six months thereafter subject to complying with regulatory requirements as stipulated in State Bank of Pakistan BPRD Circular No. 6 dated August 15, 2013.							
12 months from issuance								
18 months from issuance								
24 months from issuance								
30 months from issuance								
36 months from issuance								
42 months from issuance								
48 months from issuance								
54 months from issuance								
60 months from issuance								
66 months from issuance								
72 months from issuance								
78 months from issuance								
84 months from issuance								
90 months from issuance								
96 months from issuance								
102 months from issuance								
108 months from issuance								
114 months from issuance								
120 months from issuance								
		-				-	-	

DEBT INSTRUMENT RATING SCALE & DEFINITIONS

The instrument rating reflects forward-looking opinion on credit worthiness of underlying debt 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) 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 surveill the opinion due to lack of requisite information

Regulatory and Supplementary Disclosure
(Credit Rating Companies Regulations,2016)

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)
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