The Pakistan Credit Rating Agency Limited

Rating Report

Bank Alfalah Limited

Report Contents

Rating History

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

Rating Rationale and Key Rating Drivers

The ratings reflect relative positioning of the bank among large banks of the country. The bank has a stronger position in advances - sustained by fresh deployments. BAFL embarked upon a strategy to sustainably rationalize its cost of funding with enduring focus on low cost deposits. Resultantly, BAFL's cost of fund is comparable to some of the large banks. The bank enjoys extended outreach across the country which has augmented its deposit base. Operating cost structure has improved on YoY basis on account of cost rationalization. The asset quality of the bank has sustained over the past three years on account of prudent risk management. Effective implementation of the envisaged business strategy is important. The increasing asset yield and cost efficiency enabled spreads to increase slightly. The bank issued Tier-I instrument to improve its capital, whereas, enhancing Tier-II capital through issue of a new instrument is also an option, which the bank can continue to avail from time to time.

The ratings are dependent on the improved positioning of the bank. Improvement in spreads is essential to profitability. Strengthening of the bank's capitalization backed by strong sponsors support and adding granularity to its advances and deposits book are essential.

Disclosure

Name of Rated Entity	Bank Alfalah 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 Obaid | muhammad.obaid@pacra.com | +92-42-35869504

Profile

Structure Bank Alfalah Limited (hereinafter referred as "BAFL" or "the bank") was incorporated as a public limited company, in 1992, and is listed on Pakistan Stock Exchange (PSX).

Background Bank commenced operations in 1992. Since its inception, Bank Alfalah has grown rapidly to become Pakistan's one of the largest private bank, the largest issuer and acquirer of credit cards, and one of the largest Islamic Banking businesses in the country. The Bank has a network of 640 branches spanning in more than 200 cities in Pakistan and a presence in Afghanistan, Bangladesh, Bahrain and the UAE.

Operations Bank provides financial solutions to consumers, corporations, institutions and governments through a broad spectrum of products and services, including corporate and investment banking, consumer banking and credit, commercial, SME, agri-finance, Islamic and asset financing. The Bank currently serves more than 1.7 million customers.

Ownership

Ownership Structure BAFL is majority owned by the Abu Dhabi Group (ADG) (50.23%), rest is owned by IFC (14.76%), Mutual funds and other NBFIs (26.18%) and General public (8.82%) at Sep18 end.

Stability HR committee designs succession planning policies for the CEO and Key executives. 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 ADG consists of some of the prominent members of UAE's ruling family and leading businessmen of UAE. ADG, being a distinguished business group, maintains substantial presence in the country's financial sector, and strong foothold in telecommunication sector.

Financial Strength Sponsors, being ruling family of UAE, possess strong financial ability to support BAFL in case of need. Furthermore, direct and indirect business interests of the sponsor group is spread throughout various industry sectors including banking, telecom, insurance, project financing and investment management.

Governance

Board Structure Subsequent to the elections of BAFL directors, held in May 18, the board comprises of nine members including President/CEO and eight non-executive directors, four of whom are representatives of ADG, one is an IFC nominee, while three members are independent.

Members' Profile Chairman of the board, H.H. Sheikh Nahayan Mabarak Al Nahayan, is a well-known and seasoned businessman having direct and indirect business interests through various industry sectors in numerous countries.

Board Effectiveness The board actively participates in strategy formulation and effectively monitors the managerial affairs of the bank. The BoD has constituted six committees to ensure rigorous monitoring of the management's policies and bank's operations.

Financial Transparency M/s. EY Ford Rhodes, Chartered Accountants, expressed an unmodified conclusion vide their review report for the half year ended June 30, 2018. The retiring auditors M/s KPMG Taseer Hadi & Co., Chartered Accountants, completed the period of five years and therefore, were not eligible for re-appointment. Further, an independent and objective internal audit function is in place covering all activities of the bank with emphasis on risk management and internal controls.

Management

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

Management Team BAFL's senior management team comprises experienced bankers having national and international exposure. Nauman Ansari, CEO, is reputed to be a seasoned banker with strong professional acumen with 24 year professional career in commercial banking.

Effectiveness The bank has formulated two key management committees, Central Management Committee (CMC) and Central Credit Committee (CCC). These committees are headed by the President and include senior executives. Furthermore, BAFL has various sub-committees of CMC, with defined areas of oversight. Functions of the management committees are clear and well-defined to effectively achieve its underlying goals and objectives.

MIS The bank uses Temenos (T-24) as its core banking software across all branches. With implementation of T-24 and other support systems, all banking processes conducted across the entire branch network of the bank, have been centralized resulting in manifold benefits like extended control, time efficiency, reduction in staff costs, and improved MIS.

Risk Management Framework Bank has a framework for effective identification, measurement, monitoring, integration and management of different financial and non-financial risks that are constantly evolving as business activities change in response to concurrent internal and external developments. The Board Risk Management Committee (BRMC) is appointed to assist in design, regular evaluation and timely updating of the risk management framework of the Bank.

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

Relative Position BAFL is ranked amongst top 5 banks on the basis of its strong growth trajectory in advances and profitability. BAFL's customer deposits (Sep18: PKR 649 bln) increased by ~5% inline with the sector's growth of 6%. Bank's share in total deposits of the sector remained at 5.2%.

Revenues Total net revenue for the nine months improved 5% YoY and stands at PKR 31.4 Bln. The growth in Net Interest Income was primarily due to improved volumes and spreads, despite maturity of high yielding PIBs. The predominant elements in non-markup income are higher foreign exchange, core fee and commission earnings which are offset by lower capital gains being a market phenomenon.

Performance ROE of the Bank increased 60bps from 18.1% in Sep17 to 18.7% in Sep18 owing to surge in markup and non-markup income. Further, during nine months period an overall specific provision net reversal of PKR 603 mln was recorded (Dec17: PKR 510 mln).

Sustainability Going forward, fresh perspectives, innovative ideas and renewed commitment should be given importance. BAFL is successfully working towards achieving its ambition of becoming a truly digital bank and an innovative financial institution in Pakistan.

Financial Risk

Credit Risk Advances book continued to remain concentrated in Corporate (Sep18: 48% Dec17: 48%) and Commercial (Sep18: 26% Dec17: 29%) borrowers. Recoveries against non-performing advances continued to outpace fresh charge booked against delinquent loans, as NPLs decreased from PKR 17.6 bln at Dec17 to PKR 17 bln at Sep18. Bank's coverage ratio stands at 93%, while the Bank's NPL ratio stands at 3.5%, and remains one of the lowest in the industry.

Market Risk Market risk, in terms of BAFL's exposure of investment book, is now representing 26% of total earning assets as at Sep18 witnessed a dip from 45% at Dec17, owing to shrinkage of investment book due to maturity of government securities. Investments continued to remain concentrated in government securities (Sep18: 94%; Dec17: 97%).

Liquidity And Funding Total customer deposits grew by mere 4.9% to PKR 649 bln which is inline industry growth of 6.2%. It was due to classification of Afghanistan operations as held for sale. Further, the Bank is focusing more on low/ no cost deposits, high cost deposits were shed to reduce the cost of deposits. The portion of CASA stood at 76.5% (Dec17: 78.8%). Advances-to-deposits ratio increased to 69.5% at Sep18 (Dec17: 61.3%).

Capitalization Bank remains adequately capitalized, with CAR for Sep18, reported at 15% (Dec17: 13.7%). During the period, the Bank issued fully paid up, rated, listed, perpetual, unsecured, subordinated, non-cumulative and contingent convertible debt instruments in the nature of TFCs, which qualify as Additional Tier I. The Bank's monthly average Liquidity Coverage Ratio (LCR) for the nine months period ended Sep 18 is 156%, while the Bank's Net Stable Funding Ratio (NSFR) as at Sep 18 is 141%, which are both well in excess of SBP prescribed minimum requirement.

Bank Alfalah Limited

BALANCE SHEET	30-Sep-18	31-Dec-17	31-Dec-16	31-Dec-15
Earning Assets				
Advances-Performing	471,618	399,603	376,845	331,896
Debt Instruments	13,057	14,260	12,505	10,826
Total Finances	484,674	413,863	389,350	342,722
Investments	199,046	386,553	376,683	412,329
Others	86,456	60,439	45,867	51,443
	770,176	**860,854**	**811,900**	**806,494**
Non Earning Assets				
Non-Earning Cash	66,236	63,348	67,726	55,104
Deferred Tax	-	-	-	-
Net Non-Performing Finances	892	973	1,781	2,207
Fixed Assets & Others	57,066	63,654	36,051	38,802
	124,194	**127,975**	**105,558**	**96,113**
TOTAL ASSETS	**894,371**	**988,829**	**917,457**	**902,608**
Funding				
Deposits	680,497	653,406	640,944	640,189
Borrowings	88,683	211,215	186,629	182,376
	769,179	864,621	827,573	822,565
Non Interest Bearing Liabilities	55,606	58,408	29,759	26,689
TOTAL LIABILITIES	**824,785**	**923,029**	**857,332**	**849,254**
EQUITY (including revaluation surplus)	**69,585**	**65,800**	**60,125**	**53,353**
Total Liabilities & Equity	**894,371**	**988,829**	**917,457**	**902,608**

INCOME STATEMENT	30-Sep-18	31-Dec-17	31-Dec-16	31-Dec-15
Interest / Mark up Earned	42,904	56,919	57,245	61,458
Interest / Mark up Expensed	(19,662)	(27,639)	(28,474)	(32,811)
Net Interest / Markup revenue	**23,242**	**29,281**	**28,770**	**28,648**
Other Income	8,159	9,894	8,868	8,841
Total Revenue	**31,401**	**39,175**	**37,638**	**37,489**
Non-Interest / Non-Mark up Expensed	(17,763)	(25,389)	(23,432)	(22,598)
Pre-provision operating profit	13,638	13,785	14,206	14,891
Provisions	623	260	(1,183)	(2,287)
Pre-tax profit	14,261	14,045	13,023	12,604
Taxes	(5,632)	(5,678)	(5,123)	(5,081)
Net Income	**8,629**	**8,367**	**7,900**	**7,523**

Ratio Analysis	30-Sep-18	31-Dec-17	31-Dec-16	31-Dec-15
Performance				
ROE	19% *	16%	17%	19%
Cost-to-Total Net Revenue	57%	65%	62%	60%
Provision Expense / Pre Provision Profit	-5%	-2%	8%	15%
Capital Adequacy				
Equity/Total Assets	7%	6%	5%	5%
Capital Adequacy Ratio as per SBP	15%	14%	13%	13%
Funding & Liquidity				
Liquid Assets / Deposits and Borrowings	41%	47%	47%	52%
Advances / Deposits	69%	61%	59%	52%
CASA deposits / Total Customer Deposits	79%	79%	85%	77%
Intermediation Efficiency				
Asset Yield	7% *	7%	7%	9%
Cost of Funds	3% *	3%	4%	5%
Spread	4% *	3%	4%	4%
Outreach				
Branches	640	637	639	653

**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.

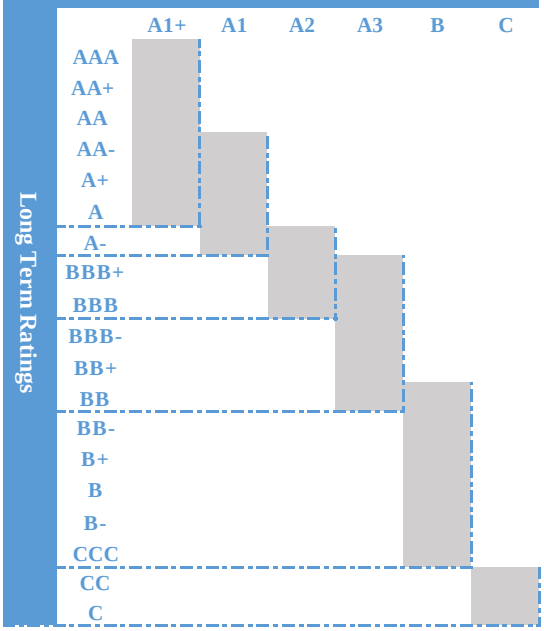
Long Term Ratings

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