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 |
|---|---|---|---|---|---|
| 26-Jun-2021 | AA+ | A1+ | Stable | Maintain | - |
| 26-Jun-2020 | AA+ | A1+ | Stable | Maintain | - |
| 28-Dec-2019 | AA+ | A1+ | Stable | Maintain | - |
| 28-Jun-2019 | AA+ | A1+ | Stable | Maintain | - |
| 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 | - |
| 30-Jun-2015 | AA | A1+ | Positive | Maintain | - |

**Rating Rationale and Key Rating Drivers**

The ratings reflect the bank's sustained performance, good asset quality, strong financial profile and healthy liquidity. The bank has maintained its position as one of the large banks, in terms of market share. The bank's advances have been maintained at a notable level, resulting in a distinguished ADR of 65.5%, which is the highest among the universe of large banks. This reflects the bank’s overall strategic philosophy and its growth trajectory. The bank has a balanced presence in various segments and intends to further fortify its position in SME and consumer markets. The bank has a forthcoming strategy towards SME and has made headwinds in this arena. Overall infection ratio has largely remained the same. The mix of deposits improved as the bank added a few percentage points in the CASA mix; both CA and SA witnessed improvement. In terms of CA, the bank already has a distinct position among the leading banks. In line with the industry, BAFL's cost of funds also declined during 2020, which is attributed to the re-alignment of interest rate regime in Pakistan. Being customer centric Bank with focus towards technological advancement, BAFL has a sound foothold with a considerable presence across the country - enabling its deposit base growth. PAT of the bank witnessed a decline of 17.5% in CY20, on the back of general provision recorded against restructured loans for COVID-19 relief scheme to mitigate credit risk. Effective implementation of the envisaged long term business strategy has played an important role in business growth. The rating draws comfort from the bank's stable ownership, experienced management team, prudent risk management policies and distinct emphasis on sustaining the position. COVID-19 is an ongoing challenge. While it has taken a toll on many businesses, its ramifications are still unfolding. The proactive measures taken by the regulators and other concerning bodies have mitigated the potential damages much anticipated from this pandemic. As a result, the banking industry remained protected and in fact posted record profits. Vigilance is required as the loan repayment cycle remains amid variants of the pandemic continue to re-emerge. The bank has also formed a board level Corona Crisis Management Committee in order to formulate future strategies for diminishing the financial and business risks.

The rating is dependent on the bank's sustained risk profile. The equity base of the bank and CAR are satisfactory and expected to remain the same in view of the uncertainties prevailing due to COVID-19. Augmentation of the Bank's capitalization supported by strong sponsors and adding granularity to its advances and deposits book are essential. Continued effective management of spreads remains important, meanwhile, holding the asset quality is a pre-requisite.

**Disclosure**

| | |
|---|---|
| **Name of Rated Entity** | Bank Alfalah Limited |
| **Type of Relationship** | Solicited |
| **Purpose of the Rating** | Entity Rating |
| **Applicable Criteria** | Methodology \| FI (Jun-20),Methodology \| Correlation Between Long-Term And Short-Term Rating Scale(Jun-20),Criteria \| Rating Modifier(Jun-20) |
| **Related Research** | Sector Study \| Commercial Bank(Jun-20) |
| **Rating Analysts** | Ahmad Saad Siddiqi \| ahmad.saad@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 730 branches spanning in more than 200 cities in Pakistan.

**Operations** In collaboration with International Finance Corporation (IFC) - a member of the World Bank Group - the bank altered its model from only offering credit services to providing a complete range of banking services to SME customers.

## Ownership

**Ownership Structure** BAFL is majority owned by the Abu Dhabi Group (ADG) (49.03%), rest is owned by IFC (14.74%), Mutual funds, other NBFIs (25.39%), general public (10.78%) and directors (0.06%).

**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.

**Financial Strength** Sponsors, being prominent ruling family of UAE, possess strong financial ability to support BAFL in case of need.

## Governance

**Board Structure** At present, BAFL's board comprises of 8 members including President/CEO and seven non-executive directors, out of which four are representatives of ADG, while three members are independent.

**Members' Profile** Chairman of the board, H.H. Sheikh Nahayan Mabarak Al Nahayan, is a prominent member of the ruling family of Abu Dhabi, UAE. He owns substantial business interests, hotels and other investments in the UAE, Pakistan, Africa, USA and Central Asia.

**Board Effectiveness** The board actively participates in strategy formulation and effectively monitors the managerial affairs of the bank. To ensure effective and independent oversight of the bank's overall operations, the Bank has constituted seven committees.

**Financial Transparency** The external auditors of the Bank, EY Ford Rhodes, Chartered Accountants, issued an unqualified audit opinion pertaining to annual financial statements for 2020.

## Management

**Organizational Structure** BAFL has a lean organizational structure that clearly defines responsibilities, authority and reporting lines with proper monitoring and compliance mechanism.

**Management Team** Bank's senior management team comprises experienced bankers having national and international exposure. Mr Atif Bajwa has been at the Bank's Board as President & CEO of Bank Alfalah since 2020.

**Effectiveness** Bank Alfalah has three main management committees for the purpose of strategic planning and decision-making under the Chairmanship of the CEO.

**MIS** The Bank uses Temenos (T-24) as its core banking software across all branches. The Bank's core banking system is well recognized for its high stability and efficiency; a result of carefully planned performance-enhancements, architectural redesigning, optimization along with a large number of successfully in-house developed T-24 new products.

**Risk Management Framework** The Board Risk Management Committee (BRMC) is appointed and authorized by the Board of Directors (BOD) to assist in design, regular evaluation and timely updating of the risk management framework of the Bank.

## Business Risk

**Industry Dynamics** The indicators of the banking sector reflected mixed trend where economy is recovering from the effects of COVID-19 pandemic. Despite challenging economic conditions prevailing in CY20 due to COVID-19 outbreak, the banking sector managed to grow by a decent pace. Deposits of the banking sector grew by 16.1% to PKR 18,519bln (CY19: PKR 15,953bln) as compared to 11.9% growth in CY19. The surge in deposits provided the necessary funding support to finance the robust rise in investments (CY20: PKR 11,935bln; CY19: PKR 8,939bln) and particularly towards government instruments. During CY20, advances witnessed a mild contraction owing to slackness amid COVID-19 pandemic outbreak. The policy measures rolled out by the SBP enabled the sector to enhance profitability, improve resilience and limit the credit risk. With the completion of deferment period allowed, the aftermath is yet to be comprehended by the industry.

**Relative Position** BAFL is ranked among the large banks of the country, on the basis of its strong growth trajectory in net advances and deposits. During CY20, Bank's customer deposits increased by 14% to PKR 840bln (CY19: PKR 734bln). BAFL upheld its position in the banking sector with share in customer deposits of the sector at 5.0%.

**Revenues** On the revenue front, net markup income for CY20 showed a subtle drop of 0.4% to PKR 44.7bln (CY19: PKR 44.9bln). Non markup income showed an increase of 23.5% compared to last year, standing at PKR 12.8bln (CY19: PKR 10.4bln). During 1QCY21, the bank reported a decline of 12.3% in net markup income to PKR 10.3bln (1QCY20: 11.8bln), due to decrease in discount rate.

**Performance** The Bank recorded a decline of 17.5% during CY20 in profit after tax, which stood at PKR 10.5bln as against PKR 12.7bln during CY19, due to additional COVID-19 related general provisioning. The Bank's PBT for the year stands at PKR 17.9bln as against PKR 22.4bln during CY19, showing a drop of 20.1%. Average cost of funding decreased to 4.6% (CY19: 5.5%). During 1QCY21, the Bank showed signs of improvement, as it reported net profit of PKR 3.5bln as against PKR 2.8bln in 1QCY20.

**Sustainability** Looking ahead, Bank Alfalah is well-positioned for strong growth and building long-term shareholder value. The Bank will continue to focus on building a low-cost deposit base, improving the return on capital on risk assets, optimizing returns from the banking book and enforcing a strong cost discipline across the Bank. The Bank is focusing on expanding its outreach with increased number of branches. Focus on recoveries from the infected portfolio will be a foreground for the Bank.

## Financial Risk

**Credit Risk** As of CY20, performing advances (including non-government debt securities) of the Bank were reported at PKR 596bln constituting around 43.0% of the Bank's total assets; showing an increase of 15.7% on YoY basis as compared to performing advances (including non-government debt securities) of PKR 515Bln for CY19. The non-performing loan base of the Bank witnessed an increase of PKR 3.4bln, on the basis of subjective classification and prudence, and was reported at PKR 26bln. Additionally, the infection ratio was recorded at 4.3% as compared to CY19 ratio of 4.2%; yet continuing to remain one of the lowest infection ratios in the industry. The Bank's coverage ratio stands at 91.2% which includes general provision against restructured loan for COVID-19 relief scheme to mitigate credit risk. The Bank continued to increase its advances exposure as it reported performing advances (including non-government debt securities) of PKR 603bln in 1QCY21.

**Market Risk** Following the significant investment in PIBs and T-Bills, the investment portfolio depicted an increase of 80.5%, amounting to PKR 526bln during CY20 (CY19: PKR 292bln). The government securities continue to dominate the overall investment book (86.1%). Similar trend followed in 1QCY21, as the bank reported total investments (excluding non-government debt securities) of PKR 568bln.

**Liquidity And Funding** Bank's focus has been on improving deposit profile and managing spreads throughout, total deposits were reported at PKR 882bln as of CY20 against PKR 782bln in CY19; growth is mainly driven by surge in current account part of CASA mix. ADR ratio showed no change compared to last year as it stood at 65.5% in CY20 (CY19: 65.4%). During CY20, with a prudent approach BAFL has built a fair liquidity position: Liquidity coverage ratio: 187.0% (CY19: 163.0%) and Net stable funding ratio of 136.0% (CY19: 138.0%).

**Capitalization** Bank's CAR as at end-CY20 stood at 16.53% (CY19: 16.88%), which is well-above the regulatory requirement of 11.50%. Higher Quality of capital is evident from Bank's ratio; Common Equity Tier-I (CET-I) to Total Risk Weighted Assets (RWA), which comes to 11.55% against the regulatory requirement of 6.00%.

PKR mln

| Bank Alfalah Limited<br>Listed Public Limited | Mar-21<br>3M | Dec-20<br>12M | Dec-19<br>12M | Dec-18<br>12M |
|---|---|---|---|---|
| **A BALANCE SHEET** | | | | |
| 1 Total Finances - net | 602,788 | 595,856 | 515,092 | 508,254 |
| 2 Investments | 568,401 | 526,274 | 291,560 | 268,977 |
| 3 Other Earning Assets | 49,062 | 101,387 | 87,143 | 75,107 |
| 4 Non-Earning Assets | 166,220 | 159,080 | 167,834 | 151,814 |
| 5 Non-Performing Finances-net | 1,521 | 2,276 | 3,682 | 2,066 |
| **Total Assets** | 1,387,992 | 1,384,874 | 1,065,311 | 1,006,218 |
| 6 Deposits | 913,213 | 881,767 | 782,284 | 702,895 |
| 7 Borrowings | 294,063 | 321,960 | 114,829 | 135,727 |
| 8 Other Liabilities (Non-Interest Bearing) | 92,673 | 90,129 | 80,170 | 91,948 |
| **Total Liabilities** | 1,299,949 | 1,293,856 | 977,284 | 930,571 |
| **Equity** | 88,043 | 91,017 | 88,028 | 75,647 |
| **B INCOME STATEMENT** | | | | |
| 1 Mark Up Earned | 21,388 | 92,616 | 92,519 | 59,672 |
| 2 Mark Up Expensed | (11,061) | (47,911) | (47,623) | (27,746) |
| 3 Non Mark Up Income | 3,833 | 12,795 | 10,357 | 10,431 |
| **Total Income** | 14,160 | 57,499 | 55,253 | 42,357 |
| 4 Non-Mark Up Expenses | (8,574) | (32,032) | (29,843) | (24,713) |
| 5 Provisions/Write offs/Reversals | (216) | (7,589) | (3,029) | (27) |
| **Pre-Tax Profit** | 5,370 | 17,878 | 22,382 | 17,618 |
| 6 Taxes | (1,899) | (7,403) | (9,686) | (6,993) |
| **Profit After Tax** | 3,471 | 10,475 | 12,696 | 10,625 |
| **C RATIO ANALYSIS** | | | | |
| **1 Performance** | | | | |
| Net Mark Up Income / Avg. Assets | 3.0% | 3.6% | 4.3% | 3.2% |
| Non-Mark Up Expenses / Total Income | 60.6% | 55.7% | 54.0% | 58.3% |
| ROE | 15.5% | 11.7% | 15.5% | 15.0% |
| **2 Capital Adequacy** | | | | |
| Equity / Total Assets (D+E+F) | 6.3% | 6.6% | 8.3% | 7.5% |
| Capital Adequacy Ratio | 15.6% | 16.5% | 16.9% | 15.0% |
| **3 Funding & Liquidity** | | | | |
| Liquid Assets / (Deposits + Borrowings Net of Repo) | 50.3% | 46.3% | 42.6% | 39.5% |
| (Advances + Net Non-Performing Advances) / Deposits | 63.8% | 65.5% | 65.4% | 71.4% |
| CA Deposits / Deposits | 45.8% | 44.7% | 43.4% | 40.9% |
| SA Deposits / Deposits | 32.4% | 33.2% | 32.4% | 34.5% |
| **4 Credit Risk** | | | | |
| Non-Performing Advances / Gross Advances | 4.2% | 4.3% | 4.2% | 3.6% |
| Non-Performing Finances-net / Equity | 1.7% | 2.5% | 4.2% | 2.7% |

| # | Notes |
|---|---|
| A1 | Total Finances-net: The line includes non-government debt securities |

## Credit Rating

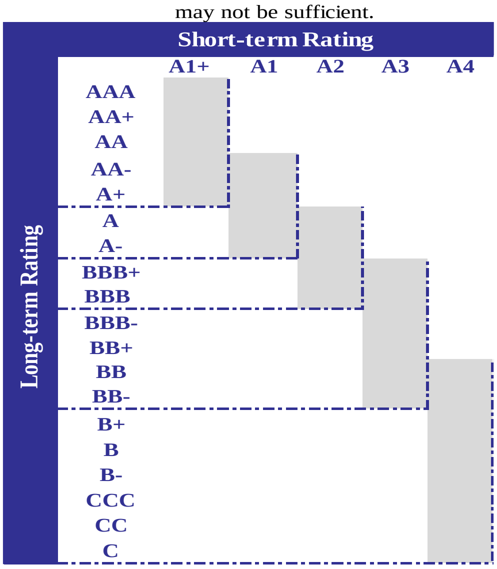
Credit rating reflects forward-looking opinion on credit worthiness of underlying entity or instrument; more specifically it covers relative ability to honor financial obligations. The primary factor being captured on the rating scale is relative likelihood of default.

### Long-term Rating

| Scale | Definition |
|---|---|
| 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 Rating

| Scale | Definition |
|---|---|
| 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 |
| A4 | The capacity for timely repayment is more susceptible to adverse changes in business, economic, or financial conditions. Liquidity may not be sufficient. |




*The correlation shown is indicative and, in certain cases, may not hold.*

**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 some material identifiable event with indeterminable rating implications. 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 rating 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.

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

**Surveillance.** Surveillance on a publicly disseminated rating opinion is carried out on an ongoing basis till it is formally suspended or withdrawn. A comprehensive surveillance of rating opinion is carried out at least once every six months. However, a rating opinion may be reviewed in the intervening period if it is necessitated by any material happening.

**Note.** This scale is applicable to the following methodology(s):

**Entities**
a) Broker Entity Rating
b) Corporate Rating
c) Financial Institution Rating
d) Holding Company Rating
e) Independent Power Producer Rating
f) Microfinance Institution Rating
g) Non-Banking Finance Companies (NBFCs) Rating

**Instruments**
a) Basel III Compliant Debt Instrument Rating
b) Debt Instrument Rating
c) Sukuk Rating

## 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

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(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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