



The Pakistan Credit Rating Agency Limited

Rating Report

BankIslami Pakistan Limited

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Rating History

Dissemination Date	Long Term Rating	Short Term Rating	Outlook	Action	Rating Watch
27-Dec-2018	A+	A1	Stable	Maintain	YES
22-Jun-2018	A+	A1	Stable	Maintain	-
13-Dec-2017	A+	A1	Developing	Maintain	YES
22-Jun-2017	A+	A1	Developing	Maintain	-
25-Oct-2016	A+	A1	Rating Watch- Developing	Maintain	-

Rating Rationale and Key Rating Drivers

The ratings reflect Bank Islami's sustained risk profile. During 9MCY18, the bank's lending portfolio has slimmed down while NPLs has witnessed an upward trend. The NPLs are a concern, especially the borderline cases. Investment book has increased; mix remained tilted towards government securities. Asset yield inched up driven by increase in policy rate. The funding base comprise of deposits and borrowings. The bank also restrained the quantum of high cost of deposits, rationalizing its cost of funds. Consequently, the bank's spread inched up. The significant milestone achieved by the bank is pre-provisioning operational break-even. It is a good omen and will reflect positively on its future profitability. Going forward, some structural changes are expected as key positions are filled with the experience individuals. The bank management is positive about achieving cost efficiency and has started pursuing new business plan under leadership of new CEO. The focus would be on the risk management side which will help bank to smooth line its business.

The rating watch captures the bank's resolve to deal with the aftermath of the recent cyber attack including its financial ramifications. Also the need to be a sustainable profitable institution. At the same time maintaining a strong capital adequacy while pursuing growth is important. Any downward spiral in profits, or incidence of non-performing assets with consequent impact on equity may negatively impact the ratings.

Disclosure

Name of Rated Entity	BankIslami Pakistan 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 Islamic Banking(Jun-18)
Rating Analysts	Sehar Fatima sehar.fatima@pacra.com +92-42-35869504



Profile

Structure BankIslami Pakistan Limited (BIPL), incorporated in Oct-04, was the first bank in Pakistan to receive the Islamic Banking license, in Mar-05, under the Islamic Banking Policy of 2003. The bank, after being declared a scheduled Islamic bank by the State Bank of Pakistan in Mar-05, commenced its operations from April 07, 2006.

Background The bank has been following organic growth since its inception. Furthermore, in May 07, 2015, BIPL acquired defunct bank "KASB Bank Limited" under "Scheme of amalgamation of defunct KASB Bank Limited with and into BankIslami Pakistan Limited under Section 47 of Banking Companies Ordinance, 1962".

Operations BankIslami is a small sized Islamic bank with a network of 330 branches.

Ownership

Ownership Structure BIPL has four prominent sponsors namely JS Group (through Jahangir Siddiqui & Company Limited (JSCL), Mr. Ali Hussain and SAJ Capital Management Limited, Emirates NBD (through Dubai Bank PJSC), and Randeree family. All these have a collective holding of ~76% in the bank and predominantly direct the affairs of the BIPL's board.

Stability All sponsors are renowned business groups with stakes in various sectors. The sponsors have national and international presence.

Business Acumen The business acumen of sponsors is considered strong as sponsors have diversified interest and long association with the markets.

Financial Strength The ability to support in case of financial need is considered strong.

Governance

Board Structure BIPL's seven member board of directors (BoD) including CEO constitutes representatives of sponsoring groups. Currently, one from DCD group, two are independent directors and four are non-executive (including DCD representation). BIPL's shariah board comprises three leading Islamic scholars of the country, namely (i) Mufti Irshad Ahmad Aijaz, ii) Mufti Muhammad Husain, and iii) Mufti Javed Ahmed.

Members' Profile Mr. Ali Hussain, MD SAJ Capital Limited, is the Chairman of the Board. All the board members are highly experienced professionals with the different sector background.

Board Effectiveness The BoD exercises close monitoring of the management's policies and governs the bank's operations through its five committees namely i) Audit Committee, ii) Board Remuneration Committee iii) Human Resource & Management Committee, (iv) Risk Management Committee, and (v) Executive Committee.

Financial Transparency During the year, EY Ford Rhodes, Chartered Accountants, the external auditor, SBP panel member, expressed an unqualified opinion for the financial statements for the year ending December 30th, 2017. An interim review was conducted for the six months period of June 30th, 2018.

Management

Organizational Structure BIPL's organizational structure is divided into thirteen functional departments i) Product Development, ii) Corporate & SME, iii) Consumer, iv) Retail/Distribution, v) Risk Management, vi) Treasury and Financial Institutions, vii) Information Systems, viii) Human Resource, ix) Service Quality & Phone Banking, x) Finance, xi) Operations, xii) Administration and xiii) Compliance.

Management Team Mr. Syed Amir Ali has joined the bank as Deputy CEO in Apr-18. He has taken up the position of 'President & CEO' in Oct-18. He is a Chartered Accountant & CFA Chartered holder by qualification, carrying with himself more than one decade experience mainly of Meezan Bank.

Effectiveness The bank has eight committees at the management level for the effective and smooth functioning of each business segment: (i) Management Credit Committee (MCC), (ii) IT Steering Committee (ITSC), (iii) Asset & Liability Committee (ALCO), (iv) Compliance Committee (CC), (v) Operations Reengineering Committee (ORC), (vi) Human Resource (HRC), (vii) Shariah Review and Coordination Committee (SRCC), and (viii) Management Committee (MANCOM).

MIS The management has selected a comprehensive Islamic Banking application that has inbuilt Shariah compliance features – iMal, a core banking software, which has been developed by Path Solutions, a software house in the Middle East.

Risk Management Framework Risk Rating Module, Vista Plus, is being used by the bank. The module supports the bank in its internal Obligor Risk Rating (ORR) process by adding more objectivity to the credit appraisal process.

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 The BIPL is small tier bank with with the deposit system share of 1.3% (Dec-17: 1.3%).

Revenues During 9MCY18, the bank earned profit of PKR 8.5bln (9MCY17: PKR 7.6bln) primarily driven by increase in asset yield as lending portfolio witnessed decline during this period. The bank recorded NIMR at PKR 4.2bln (9MCY17: PKR 3.7bln), up 12% YoY.

Performance Fee and brokerage income increased during the year. The company also booked a net gain of PKR 99mln on the sale of Agritech shares which also supported the bank's profitability. Other operating expenses surged to PKR 4.9bln (9MCY17: PKR 4.5bln), up 8% YoY. The bank reported net income of PKR 99mln (9MCY17: PKR 107mln), down 7% YoY.

Sustainability Going forward, the bank aims to expand its lending portfolio by funding through low cost deposits. The bank is prioritizing the rated client lending in future. Recovery from non-performing loans transferred from KASB is also a priority. Going forward, meeting capital requirements and defending market share by achieving sustainable growth is vital for the management.

Financial Risk

Credit Risk The bank NPL's increased to PKR 16.3bln as at end-Sep18 (end-Dec17: PKR 15.8bln) which led to higher NPLs to Gross Advances ratio (end-Sep18: 13.6%; end-Dec17: 12.1%; end-Dec16: 14.6%). Whereby, drag on equity is increasing (Net NPLs/Equity: end-Sep18: 37.7%; end-Dec17: 33.6%; end-Dec16: 22.2%), over last few years. Advances' concentration in terms of top-20 increased significantly to 49% during CY17 (CY16: 28%; CY15: 58%), mainly comprise of Government guaranteed finances. Whereas, during CY17, advances mix was dominated by corporate sector (76%) followed by consumer banking (15%) and SME sector (4%). During 9MCY18, the bank's ADR rationalized to 62% (CY17: 66.5%; CY16: 50.4%; CY15: 46%).

Market Risk BIPL's investment portfolio witnessed marginal increase to PKR 46bln (end-Dec17: PKR 41bln) funded by deposits. The investment composition remained tilted towards government securities (end-Sep18: 94%; end-Dec17: 95%; end-Dec16: 94%). During 9MCY18, portfolio was mainly skewed towards GoP Ijarah sukuk.

Liquidity And Funding During 9MCY18, BIPL's customer deposits increased to PKR 162bln (end-Dec17: PKR 158bln), up 3%. Nevertheless, the bank's deposit share in the system remained intact (1.3%). CASA ratio improved marginally (end-Sep18: 74%; end-Dec17: 73%; end-Dec16: 70%), which bodes well for cost rationalization. Concentration in top 20 deposits decreased in CY17 to 29% (CY16: 39%). The bank's liquidity position improved as evident by Liquid assets to Deposits & Borrowing ratio (end-Sep18: 30%; end-Dec17: 26%; end-Dec16: 32%), primarily driven by increased investment in government securities.

Capitalization The bank has equity base of PKR ~13bln which is above the minimum capital requirement. At end-Sep18, CAR is largely maintained at 15.1% with Tier I at 11.5%. In future, the bank will have to manage CAR while increasing its lending portfolio.



	30-Sep-18	31-Dec-17	31-Dec-16	31-Dec-15
	9M	CY17	CY16	CY15
<i>PKR mln</i>				
BALANCE SHEET				
Earning Assets				
Advances	104,052	114,992	75,415	67,215
Debt Instruments	409	309	1,018	1,100
Total Finances	104,461	115,301	76,433	68,315
Investments	46,081	41,783	45,300	34,786
Others	17,573	22,174	28,359	39,824
	168,115	179,258	150,091	142,925
Non Earning Assets				
Non-Earning Cash	11,752	11,784	8,921	10,817
Deferred Tax	7,963	7,702	5,918	6,591
Net Non-Performing Finances	4,715	4,163	2,402	1,579
Fixed Assets & Others	14,236	13,258	13,514	12,319
	38,666	36,907	30,755	31,306
TOTAL ASSETS	206,780	216,165	180,846	174,231
Interest Bearing Liabilities				
Deposits	175,427	179,249	154,400	153,058
Borrowings	10,623	15,570	6,066	3,198
	186,050	194,819	160,466	156,256
Non Interest Bearing Liabilities	7,338	7,669	7,936	6,789
TOTAL LIABILITIES	193,387	202,488	168,402	163,044
EQUITY (including revaluation surplus)	13,393	13,676	12,445	11,186
TOTAL LIABILITIES & EQUITY	206,780	216,165	180,846	174,231
INCOME STATEMENT				
	30-Sep-18	31-Dec-17	31-Dec-16	31-Dec-15
	9M	CY17	CY16	CY15
Profit / Return Earned	8,579	10,354	10,128	8,834
Return Expensed	(4,376)	(5,249)	(5,791)	(5,119)
NIMR	4,203	5,105	4,336	3,715
Other Income	455	964	638	570
Total Revenue	4,658	6,069	4,974	4,285
Other Expenses	(4,971)	(6,178)	(6,160)	(5,188)
Pre-provision operating profit	(312)	(110)	(1,186)	(903)
(Provisions)/ Reversal	473	267	2,030	631
Pre-tax profit / (Loss)	161	157	844	(272)
Taxes	(62)	1,406	(391)	76
Net Income/ (Loss)	99	1,563	452	(196)
RATIO ANALYSIS				
	30-Sep-18	31-Dec-17	31-Dec-16	31-Dec-15
	9M	CY17	CY16	CY15
Performance				
ROE	1.1% *	13.5%	4.3%	-2.4%
Cost-to-Total Net Revenue	108.3%	103.1%	126.7%	122.9%
Provision Expense / Pre Provision Profit	151.6%	243.4%	171.1%	69.8%
Capital Adequacy				
Equity/Total Assets	6.0%	5.7%	6.0%	5.9%
Capital Adequacy Ratio as per SBP	15.0%	14.5%	13.4%	12.3%
Funding & Liquidity				
Liquid Assets / Deposits and Borrowings	30.3%	26.1%	32.7%	27.1%
Advances / Deposits	62.0%	66.5%	50.4%	44.9%
CASA deposits / Total Customer Deposits	74.0%	73.1%	70.2%	67.1%
Intermediation Efficiency				
Asset Yield	6.6% *	6.3%	7.0%	7.6%
Cost of Funds	3.1% *	3.0%	3.7%	4.1%
Spread	3.6% *	3.4%	3.3%	3.5%
Outreach				
Branches	330	330	321	317

Annualized*

BankIslami Pakistan Limited

Dec-18

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		Short Term Ratings	
AAA	Highest credit quality. Lowest expectation of credit risk. Indicate exceptionally strong capacity for timely payment of financial commitments	A1+	The highest capacity for timely repayment.
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.	A1	A strong capacity for timely repayment.
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.	A2	A satisfactory capacity for timely repayment. This may be susceptible to adverse changes in business, economic, or financial 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.	A3	An adequate capacity for timely repayment. Such capacity is susceptible to adverse changes in business, economic, or financial conditions.
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	The capacity for timely repayment is more susceptible to adverse changes in business, economic, or financial conditions.
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.	C	An inadequate capacity to ensure timely repayment.
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.		



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 surveil the opinion due to lack of requisite information.

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

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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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- (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)

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- (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)

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- (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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