The Pakistan Credit Rating Agency Limited

# Rating Report

## AlBaraka Bank (Pakistan) Limited

**Report Contents**



**Rating History**

| Dissemination Date | Long Term Rating | Short Term Rating | Outlook | Action | Rating Watch |
|---|---|---|---|---|---|
| 31-Dec-2018 | A | A1 | Stable | Maintain | YES |
| 29-Jun-2018 | A | A1 | Stable | Maintain | - |
| 29-Dec-2017 | A | A1 | Positive | Maintain | - |
| 30-Jun-2017 | A | A1 | Positive | Maintain | - |
| 22-Sep-2016 | A | A1 | Developing | Rating Watch | - |

### Rating Rationale and Key Rating Drivers

The ratings reflect ABPL's association with AlBaraka Banking Group – a strong Middle Eastern banking institution. ABPL witnessed improvement in net spread on account of increasing interest rate environment and enhanced contribution of CASA. A sizeable book of GoP securities in the investment portfolio helped in maintaining adequate liquidity. Going forward, the management aims low cost deposit mix and cautious credit growth, in turn, better profits. Success in planned initiatives is crucial.

Effective implementation of business strategy, particularly in the back drop of challenging operating environment and competitive banking landscape, is important. Pivotal to this strategy is achieving profitability and hence generation of internal capital. As at Sep-18, overall CAR of the Bank is reported at 10.03% which is below the regulatory requirement, and to address this sponsors are willing to inject $10mln as ADT-I. This is expected to provide breathing space to the Bank. Moreover, improving diversification in revenue streams, particularly from non-fund based avenues and maintaining healthy asset quality are important for bottom-line performance.

**Disclosure**

| | |
|---|---|
| **Name of Rated Entity** | AlBaraka Bank (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 \| Commercial Bank(Jun-18) |
| **Rating Analysts** | Muhammad Obaid \| muhammad.obaid@pacra.com \| +92-42-35869504 |

## Profile

**Structure** Al Baraka Bank (Pakistan) Limited (ABPL), incorporated as a public limited company, commenced operations as a Scheduled Commercial Bank in 2010.

**Background** AlBaraka Islamic Bank B.S.C. (c) (ABIB), through its Pakistan branches started its operations in Pakistan in 1991. However, after acquisition of ~50% shares of Emirates Global Islamic Bank Limited (EGIBL) by ABIB, Pakistan Branches of ABIB were merged with and into EGIBL during October 2010 to form ABPL.

**Operations** The Bank, with its head office in Karachi, operates with a network of 188 branches as at end-Sep18.

## Ownership

**Ownership Structure** Major shareholders of ABPL are ABIB (~59%), Islamic Corporation for the development of the Private Sector (ICD) (12%), Mal Al Khaleej group (~12%), Sheikh Tariq Bin Faisal Khalid Al Qassem (~8%) and Mr. Muhammad Umar Ijaz (3%).

**Stability** AlBaraka Islamic Bank B.S.C (c) (ABIB) – a 91% owned subsidiary of AlBaraka Banking Group (ABG), is a member of Dallah AlBaraka Group (DBG). DBG – a Saudi-based conglomerate - is one of the leading privately owned enterprises in the Middle East.

**Business Acumen** ABG has a wide geographical presence in the form of subsidiary banking units and representative offices in 16 countries. The Group provides ABPL with international expertise and strategic direction through its presence on the Board.

**Financial Strength** DBG has business interests in wide array of industries in Middle East including real estate, transportation, healthcare, media, and food industry, etc. ABIB, a subsidiary of DBG, is continuing to provide support and expertise to the Bank.

## Governance

**Board Structure** Overall control of the Bank vests in the ten-member Board of Directors (BoD). Four of the board members are ABG nominees, one each from ICD and Mal Al Khaleej Investments, whereas the other four are independent members.

**Members' Profile** Mr Adnan Ahmed Yousif – CEO ABG – is the Chairman of the board. The current CEO, Mr. Ahmed Shuja Kidwai is a professional banker with many decades of experience. He has been associated with AlBaraka Group since the start of the bank's branch operations in Pakistan. Most of the members are seasoned bankers and are also nominated on boards of respective groups' companies.

**Board Effectiveness** During the year, three board meetings were held. Attendance of board members in these meetings remained adequate. There are five board committees in place which help the board in effective oversight of the Bank's overall operations on relevant matters.

**Financial Transparency** The audit committee reports directly to the board. EY Ford Rhodes Chartered Accountants are the external auditors of the bank who expressed an unqualified opinion on the bank's financial statements for the year ended Dec 31, 2017.

## Management

**Organizational Structure** The bank has a well-defined organizational structure in place, incorporating redundancy planning. All the revenue segments report to the Chief Operating Officer while the service segments report to the Chief Executive Officer.

**Management Team** The CEO, Mr. Ahmed Shuja Kidwai, is a seasoned banker with rich banking experience. He is supported by a team of experienced professionals.

**Effectiveness** The bank has formed, besides the shariah committee, nine committees at the management level for effective and smooth functioning of each business segment.

**MIS** ABPL has implemented a state of the art ERP system, as its core banking software in all conventional branches. A disaster recovery site is in place to ensure uninterrupted banking operations in the event of disaster.

**Risk Management Framework** The bank has established risk management systems, considering the growth targets of the bank. The management has designed a risk management manual, policies and risk appetite statement. Moreover, efforts are underway to build a strong risk management framework, to be monitored on an on-going basis by its risk management department. The board's risk management committee is responsible for overall oversight of design and implementation of different policies and procedures to manage multiple risks.

## 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** ABPL, a small sized bank, has a customer deposit base of PKR 99bln at end-Sep18, holding 0.8% share of the industry.

**Revenues** For the 9MCY18, the bank's interest revenue witnessed an increase of ~12% on a YoY basis to PKR 3.1bln (9MCY17: PKR 2.7bln), on the back of volumetric growth as well as rising interest rate environment. Increase in revenue was supported by income from dealing in foreign currencies which saw a huge jump of 1.1x (9MCY18: PKR 284mln; 9MCY17: PKR 136mln) on account of prudent FX management amid depreciating PKR while in the period under review, the capital gains dipped to PKR 24mln (9MCY17: PKR 121mln).

**Performance** For the 9MCY18, the bank's yield on advances improved slightly with rising interest rates and stood at *8.4% compared to last years' 7.2% (*annualized). Consequently, the bank's cost of deposits also increased in this period (9MCY17: *3.4%, CY17: 2.9%). Higher volumetric growth coupled with improvement on the asset yield side overshadowed the higher cost of funds, bringing the NIMR ratio to *3.4% (CY17: 2.9%). The spread for 9MCY18 stood at 5.0% (CY17: 4.4%). The bank was able to curtail its non-markup expenses (9MCY18: PKR 3.6bln; CY17: PKR 5.0bln) bringing down the cost to total net revenue (9MCY18: ~92%, CY17: ~112%). However during the 9MCY18, although there was additional provisioning, the bank was able to lower its losses on a YoY basis as net loss clocked in at PKR 279mln (9MCY17: PKR 600mln).

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

## Financial Risk

**Credit Risk** During the 9MCY18, ABPLs' gross advances registered a growth of 2.8%, mainly financed through deposits. Growth in advances was below industry average of 6%. Advances-to-Deposits ratio decreased slightly, as there has been pressure on CAR, coming down to 70% at end-Sep18 (end-Dec17: 72%).

**Market Risk** ABPL's investment portfolio comprises ~21% of total earning assets. At end-Sep18, investments stood at PKR 21.3bln, registering ~10% increase for the period. The investment portfolio remained dominated in government securities (~53%).

**Liquidity And Funding** ABPL's customer deposit base stood at PKR 99bln at end-Sep18, thereby registering ~6% growth during the year. The top 20 depositors' concentration has slightly increased in the recent years (end-Dec17: 19%; end-Dec16: 18%). The liquidity of the bank measured in terms of Liquid Assets / Deposits and Borrowings remained low at 33% (CY17: 31%) as compared to A category banks with an increase during the period.

**Capitalization** ABPL's capitalization stood at 10.03% at end-Sep18 (end-Dec17: 10.17%, end-Dec16: 10.30%), which is below the regulatory requirement. In order to meet the increasing regulatory requirement of CAR, ABG is willing to inject $10mln, modality of which is in approval stage. This injection of ADT1 would somewhat relieve pressure from the current CAR of 10.03 as at end-Sep18 but meeting further SBP requirements of minimum 12.5% till end-Dec19 with constrained bottom-line would become increasingly difficult.

## AlBaraka Bank (Pakistan) Limited

| BALANCE SHEET | 30-Sep-18 9MCY18 | 31-Dec-17 CY17 | 31-Dec-16 CY16 |
|---|---|---|---|
| **Earning Assets** | | | |
| Advances | 70,132 | 67,841 | 63,944 |
| Debt Instruments | 2,767 | 2,514 | 2,227 |
| Total Finances | 72,900 | 70,355 | 66,171 |
| Investments | 18,579 | 16,879 | 22,375 |
| Others | 2,458 | 8,028 | 3,677 |
| | **93,936** | **95,262** | **92,223** |
| **Non Earning Assets** | | | |
| Non-Earning Cash | 13,447 | 8,916 | 18,725 |
| Deferred Tax | 3,472 | 3,239 | 2,873 |
| Net Non-Performing Finances | 2,603 | 3,362 | 2,841 |
| Fixed Assets & Others | 9,695 | 9,882 | 10,137 |
| | **29,217** | **25,399** | **34,576** |
| **TOTAL ASSETS** | **123,154** | **120,661** | **126,799** |
| **Interest Bearing Liabilities** | | | |
| Deposits | 103,748 | 98,590 | 105,843 |
| Borrowings | 4,351 | 5,852 | 4,652 |
| | 108,099 | 104,442 | 110,495 |
| **Non Interest Bearing Liabilities** | 4,597 | 5,456 | 4,914 |
| **TOTAL LIABILITIES** | **112,697** | **109,898** | **115,409** |
| **EQUITY (including revaluation surplus)** | **10,457** | **10,762** | **11,390** |
| **Total Liabilities & Equity** | **123,154** | **120,661** | **126,799** |

| INCOME STATEMENT | 30-Sep-18 9MCY18 | 31-Dec-17 CY17 | 31-Dec-16 CY16 |
|---|---|---|---|
| Profit / Return Earned | 5,720 | 6,718 | 5,158 |
| Return Expensed | (2,667) | (3,078) | (2,795) |
| **Net Revenue** | **3,053** | **3,640** | **2,363** |
| Other Income | 855 | 967 | 874 |
| **Total Revenue** | **3,908** | **4,607** | **3,237** |
| Admin and Other Expenses | (3,585) | (5,040) | (3,502) |
| Pre-provision Operating Profit | 323 | (433) | (265) |
| Provisions | (738) | (98) | 164 |
| Pre-tax profit | (415) | (531) | (101) |
| Taxes | 137 | 142 | (55) |
| **Net Income / (Loss)** | **(279)** | **(389)** | **(156)** |

| Ratio Analysis | 30-Sep-18 9MCY18 | 31-Dec-17 CY17 | 31-Dec-16 CY16 |
|---|---|---|---|
| Performance | | | |
| ROE | -3.6% | -3.5% | -1.8% |
| Cost-to-Total Net Revenue | 92.3% | 111.6% | 108.3% |
| Provision Expense / Pre Provision Profit | 228.5% | -22.7% | 62.0% |
| Capital Adequacy | | | |
| Equity/Total Assets | 8.4% | 8.8% | 8.7% |
| Capital Adequacy Ratio as per SBP | 10.0% | 10.2% | 10.3% |
| Funding & Liquidity | | | |
| Liquid Assets / Deposits and Borrowings | 33.4% | 31.4% | 43.6% |
| Advances / Deposits | 70.1% | 72.2% | 63.1% |
| CASA deposits / Total Customer Deposits | 83.3% | 80.1% | 74.7% |
| Intermediation Efficiency | | | |
| Asset Yield | 8.4% | 7.2% | 6.5% |
| Cost of Funds | 3.4% | 2.9% | 3.0% |
| Spread | 5.0% | 4.3% | 3.5% |
| Outreach | | | |
| Branches | 188 | 188 | 224 |

**9MCY18 figures have been annualized and pro-rated with respect to Dec17 numbers*

# Rating Scale

## Credit Rating Scale & Definitions

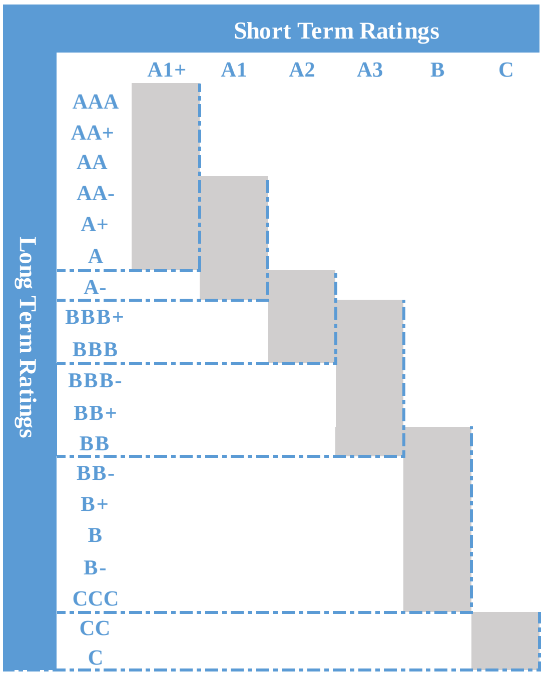
Credit rating reflects forward-looking opinion on credit worthiness of underlying entity or instrument; more specifically it covers relative ability to honor financial obligations. The primary factor being captured on the rating scale is relative likelihood of default.

### Long Term Ratings

| | |
|---|---|
| AAA | **Highest credit quality.** Lowest expectation of credit risk. Indicate exceptionally strong capacity for timely payment of financial commitments |
| AA+<br>AA<br>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+<br>A<br>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+<br>BBB<br>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+<br>BB<br>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+<br>B<br>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<br>CC<br>C | **Very high credit risk.** Substantial credit risk "CCC" Default is a real possibility. Capacity for meeting financial commitments is solely reliant upon sustained, favorable business or economic developments. "CC" Rating indicates that default of some kind appears probable. "C" Ratings signal imminent default. |
| D | Obligations are currently in default. |

### Short Term Ratings

| | |
|---|---|
| A1+ | The highest capacity for timely repayment. |
| A1 | A strong capacity for timely repayment. |
| A2 | A satisfactory capacity for timely repayment. This may be susceptible to adverse changes in business, economic, or financial conditions. |
| A3 | An adequate capacity for timely repayment. Such capacity is susceptible to adverse changes in business, economic, or financial conditions. |
| B | The capacity for timely repayment is more susceptible to adverse changes in business, economic, or financial conditions. |
| C | An inadequate capacity to ensure timely repayment. |




**Outlook (Stable, Positive, Negative, Developing)** Indicates the potential and direction of a rating over the intermediate term in response to trends in economic and/or fundamental business/financial conditions. It is not necessarily a precursor to a rating change. 'Stable' outlook means a rating is not likely to change. 'Positive' means it may be raised. 'Negative' means it may be lowered. Where the trends have conflicting elements, the outlook may be described as 'Developing'.

**Rating Watch** Alerts to the possibility of a rating change subsequent to, or in anticipation of, a) some material identifiable event and/or b) deviation from expected trend. But it does not mean that a rating change is inevitable. A watch should be resolved within foreseeable future, but may continue if underlying circumstances are not settled. Rating Watch may accompany Outlook of the respective opinion.

**Suspension** It is not possible to update an opinion due to lack of requisite information. Opinion should be resumed in foreseeable future. However, if this does not happen within six (6) months, the rating should be considered withdrawn.

**Withdrawn** A rating is withdrawn on a) termination of rating mandate, b) cessation of underlying entity, c) the debt instrument is redeemed, d) the rating remains suspended for six months, e) the entity/issuer defaults., or/and f) PACRA finds it impractical to surveill the opinion due to lack of requisite information.

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

## 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)
**Proprietary Information**