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
27-Dec-2019	A	A1	Stable	Maintain	YES
28-Jun-2019	A	A1	Stable	Maintain	YES
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	-
25-Jun-2016	A	A1	Stable	Maintain	-
26-Jun-2015	A	A1	Positive	Maintain	-
27-Jun-2014	A	A1	Positive	Maintain	-

Rating Rationale and Key Rating Drivers

The ratings reflect ABPL's association with AlBaraka Banking Group – a strong Middle Eastern banking institution. ABPL has largely managed to improve in spreads on account of increasing interest rate environment along with the high-cost deposits. 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. Post merger, increased operational efficiency and branch level synergies are starting to pay dividends in the form of increasing profitability.

Effective implementation of business strategy, particularly in the backdrop of a challenging operating environment and competitive banking landscape, is important. Pivotal to this strategy is maintaining profitability and hence generation of internal capital. As of Sep-19, overall CAR of the Bank is reported at 11.93% which needs to reach 12.50% as on December 31,2019. Internal profit generation has improved, sponsors had injected USD 10mln in Dec-18 to support CAR requirement with a commitment to inject further amount on need basis. Improving diversification in revenue streams, particularly from non-fund based avenues and maintaining healthy asset quality are important for bottom-line performance. A recent accretion of NPL's is a concern.

Disclosure	
Name of Rated Entity	AlBaraka Bank (Pakistan) Limited
Type of Relationship	Solicited
Purpose of the Rating	Entity Rating
Applicable Criteria	PACRA_Methodology_FI_FY19(Jun-19),Methodology | Correlation Between Long-Term And Short-Term Rating Scale(Jun-19),Criteria | Rating Modifier(Jun-19)
Related Research	Sector Study | Commercial Bank(Jun-19)
Rating Analysts	Muhammad Noor ul Haq | muhammad.noorulhaq@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 the 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 192 branches including 8 sub-branches as at end-Sep19.

Ownership

Ownership Structure Major shareholders of ABPL are ABIB (59.13%), Islamic Corporation for the development of the Private Sector (ICD) (11.85%), Mal Al Khaleej group (11.53%), Sheikh Tariq Bin Faisal Khalid Al Qassem (7.5%) and Mr Muhammad Umar Ijaz (3.06%).
Stability AlBaraka Islamic Bank B.S.C (c) (ABIB) – a 92% owned subsidiary of AlBaraka Banking Group (ABG), is a member of Dallah AlBaraka Group (DBG) – a Saudi-based conglomerate - 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 nine-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 three 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 CY18, four board meetings were held. Attendance of board members in these meetings remained adequate. There are five board committees in place which help the board ineffective 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, 2018.

Management

Organizational Structure The bank has a well-defined organizational structure in place, incorporating redundancy planning. All the revenue segments report to the Chief Executive Officer while the service segments report to the Deputy 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, 9 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 branches. A disaster recovery site is in place to ensure uninterrupted banking operations in the event of a 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 the design and implementation of different policies and procedures to manage multiple risks.

Business Risk

Industry Dynamics Despite challenging macroeconomic environment, banking sector maintained its growth trajectory during 9MCY19, backed by decent growth in deposits (9MCY19: PKR 14,945bln; 9MCY18: 13,603bln). However, lending was largely skewed towards investments and particularly towards government instruments due to favorable interest rate dynamics (9MCY19: PKR 9,641bln; 9MCY18: 6,942bln). Meanwhile, advances witnessed a slowdown owing to subdued economic activity, cautious lending approach and monetary tightening (9MCY19: PKR 8,014bln; 9MCY18: 7,422bln). Asset quality saw some deterioration – increased NPLs, particularly in sugar and energy sectors (9MCY19: PKR 758 bln; 9MCY18: 637bln). The profitability of the banking sector improved due to an increase in Net Interest Income, which translated positively in other profitability indicators. The overall risk profile of the banking sector remained satisfactory.
Relative Position ABPL, a small-sized bank, has a customer deposit base of PKR 112bln at end-Sep19, holding less than 1% share of the industry. During 9MCY19, customer deposits showed a growth of 21%.
Revenues On the gross markup income side, Bank reported markup of PKR 9bln as of Sep-19 with the growth of 56.6% as compared to the corresponding period of last year. Of this increase, income on Islamic finances and related assets constituted the major chunk increasing 46% to PKR 6.6bln (9MCY18: PKR 4.6bln). The non-markup income of the Bank increased by ~14% YoY, clocking in at PKR 1bln (9MCY18: PKR 901mln) with major contributions coming in from fee and commission income amounting to PKR 556mln.
Performance The bank's yield on assets saw an improvement with rising interest rates and stood at 12.4% compared to the same period last year at 8.1%. The bank's cost of funds significantly increased in this period (9MCY19: 6.2%; 9MCY18: 3.4%). but with a smaller proportion compared to the asset yield, it brings the spread up to 6.2% (9MCY18: 4.8%). Despite increasing footprint, the bank was able to manage its non-markup expenses (9MCY19: PKR 3.9bln; 9MCY18: PKR 3.6bln) on the back of increased efficiency, improving the cost to total net revenue (9MCY19:0 83.1%, 9MCY18: 91.7%). Although there was additional provisioning during the year, the bank was able to achieve operational profitability this time after incurring losses for the past couple of years as PBT clocked in at PKR 230mln (9MCY18: PKR -415mln).
Sustainability The budgeted forecasts and actual numbers of ABPL have an adequate correlation. Increasing the interest rate environment helped the bank in increasing its spread and earning higher profitability.

Financial Risk

Credit Risk During 9MCY19, ABPLs' gross Islamic financing and related assets registered a negative growth of 2.3%, due to the current economic environment. However, ADR increased to 65.1%, as some pressure abated from the CAR and the Bank was able to lend more. At the end-Sep19, the Non-performing loan base of the Bank saw an increase of PKR 1.5bln and was reported at PKR 8.6bln. Resultantly, the coverage and infection ratios of the Bank deteriorated as well, reporting at 59.2% (CY18: 67.8%) and 11.7% (CY18: 8.8%) respectively.
Market Risk ABPL's investment portfolio comprises 20.8% of total earning assets. At end-Sep19, investments stood at PKR 20.6bln, registering a 15.0% increase for the nine-month period of CY19. The investment portfolio remained dominated in government securities (96.6%).
Liquidity And Funding ABPL's customer deposit base stood at PKR 112bln at end-Sep19, thereby registering a remarkable growth of 21.2% during the period. The bank saw a significant decrease in the overall CASA ratio at 60.9% (CY18: 76.0%). The liquidity of the bank, measured in terms of Liquid Assets / Deposits and Borrowings, improved slightly but remained low at 35.7% (CY18: 31.3%) as compared to A-rated category banks with an increase during the period.
Capitalization Bank's CAR stands at 11.93% as at end-Sep19 (Dec18: 11.77%), which is barely meets the regulatory requirement. Previously, to bridge the regulatory shortfall, the major sponsor of the bank – Al Baraka Islamic Bank B.S.C (c) – had sanctioned USD 20mln, of which to ABPL has utilized USD 10mln last year to bridge the gap. Internal cash generation has improved, which the management is hopeful would be enough to meet the Dec-end 2019 CAR requirement; but if need be, ABPL still has the option to avail USD 10mln funding from the sponsor.

PKR mln

AlBaraka Bank (Pakistan) Limited	Sep-19	Dec-18	Dec-17	Dec-16
Unlisted Public Limited	9M	12M	12M	12M
A BALANCE SHEET				
1 Total Finances - net	74,347	76,144	70,355	66,171
2 Investments	20,640	17,953	16,879	22,375
3 Other Earning Assets	4,199	854	8,028	3,677
4 Non-Earning Assets	39,281	31,602	24,028	31,735
5 Non-Performing Finances-net	3,489	2,261	3,362	2,841
Total Assets	141,956	128,813	122,652	126,799
6 Deposits	114,572	99,915	96,623	105,843
7 Borrowings	5,917	7,582	5,852	4,652
8 Other Liabilities (Non-Interest Bearing)	10,714	10,611	9,415	4,914
Total Liabilities	131,204	118,108	111,890	115,409
Equity	10,752	10,705	10,762	11,390
B INCOME STATEMENT				
1 Mark Up Earned	8,957	8,032	6,718	5,158
2 Mark Up Expensed	(5,275)	(3,815)	(3,078)	(2,795)
3 Non Mark Up Income	1,027	1,097	968	874
Total Income	4,709	5,314	4,608	3,237
4 Non-Mark Up Expenses	(3,912)	(4,789)	(4,953)	(3,502)
5 Provisions/Write offs/Reversals	(567)	(770)	(185)	164
Pre-Tax Profit	230	(245)	(531)	(101)
6 Taxes	(130)	(9)	142	(55)
Profit After Tax	100	(254)	(389)	(156)
C RATIO ANALYSIS				
1 Performance				
Net Mark Up Income / Avg. Assets	3.6%	3.4%	2.9%	2.2%
Non-Mark Up Expenses / Total Income	83.1%	90.1%	107.5%	108.2%
ROE	1.2%	-2.4%	-3.5%	-1.8%
2 Capital Adequacy				
Equity / Total Assets (D+E+F)	7.6%	8.3%	8.8%	9.0%
Capital Adequacy Ratio	11.9%	11.8%	10.2%	10.3%
3 Funding & Liquidity				
Liquid Assets / (Deposits + Borrowings Net of Repo)	35.7%	31.3%	28.0%	38.0%
(Advances + Net Non-Performing Advances) / Deposits	65.1%	75.1%	73.7%	63.1%
CA Deposits / Deposits	21.7%	24.1%	23.0%	23.4%
SA Deposits / Deposits	39.2%	51.9%	56.4%	53.2%
4 Credit Risk				
Non-Performing Advances / Gross Advances	10.7%	8.8%	10.1%	10.1%
Non-Performing Finances-net / Equity	32.4%	21.1%	31.2%	24.9%

Rating Scale | Corporate

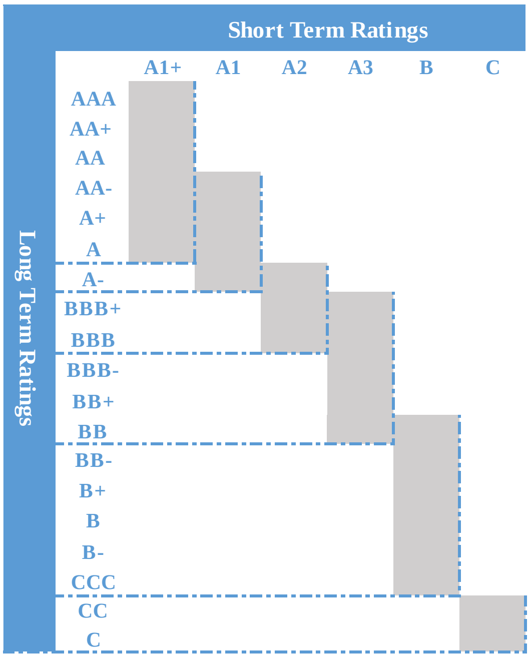
2019

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.



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