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
26-Jun-2020	A	A1	Stable	Maintain	-
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 and a continued strong support from the major sponsor of the bank. ABPL has largely managed to improve in spreads despite of increasing interest rate environment which creates pressure on cost of deposits. A sizeable book of GoP securities in the investment portfolio and a remarkable growth in the customer deposit base of the Bank 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. There was sizeable improvement in the pre-provision profits of the bank during 2019. This was a good omen. The bank has achieved before and after tax profitability in 1Q2020 and is fully compliant with the capital adequacy regime. From the start of current year 2020, Covid-19 has posed challenges to the banking sector, almost all segments of the economy, worldwide and domestically, are getting negatively impacted. The ramifications would continue to unfold, warranting vigilance and timely actions where needed.The central bank has taken well-tailored and comprehensive actions including reduction in key policy rates (~525bps down since January 2020) and deferment of repayment obligations for a defined period. While reduction in interest rates would determine the Bank's profitability, these measures have cushioned the allied risks surrounding the credit exposures.

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. To bridge the regulatory shortfall, the major sponsor of the bank – Al Baraka Islamic Bank B.S.C (c) – has injected USD 9mln as Capital Support Fund, resulting in increase in the Bank’s CAR at 12.87% as on Mar 31, 2020. 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(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-20)
Rating Analysts	Muhammad Noor ul Haq | 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-Mar20.

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 eleven-member Board of Directors (BoD), including the CEO. Five 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 CY19, 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, 2019.

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 As a result of general economic slowdown most indicators of the banking sector reflected mixed trend. Deposits of the banking sector stood at (CY19: PKR 15,953bln; CY18: PKR 14,254bln), showing a growth of ~12% as compared to 9.5% growth in CY18. Deployment of funds was largely skewed towards investments and particularly towards government instruments due to favorable interest rate dynamics (CY19: PKR 8,939bln; CY18: PKR 7,914bln). Meanwhile, advances witnessed a slowdown owing to subdued demand, cautious lending approach and monetary tightening .This was only a growth of 3.7% as compared to expansion of 22.2% in CY18. Asset quality saw deterioration – increased NPLs (CY19: PKR 761bln; CY18: PKR 680bln). 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 deposits base of PKR 123bln at end-Dec19, holding less than 1% share of the industry. During CY19, customer deposits showed a significant growth of 33.9%.
Revenues During CY19, the gross mark-up income of the Bank witnessed a magnificent increase and was recorded at PKR 12.9bln (CY18: 8.0bln) mainly due to the major chunk increasing by 46.4% to PKR 9.4bln (CY18: PKR 6.4bln) in income on Islamic finances and related assets. The non-markup income of the Bank increased by 23.9% YoY, clocking in at PKR 1.4bln (CY18: PKR 1.2bln) mainly on account of increase in income from dealing in foreign currencies. However, during 3MCY20, the Bank witnessed a significant growth of 59.3% YoY in its gross mark-up/ interest income. This growth is attributed to higher policy rates.
Performance The bank's yield on assets saw an improvement with rising interest rates and marked at 12.5% compared to the last year at 8.5%. The bank's cost of funds significantly increased to 6.5% (CY18: 3.7%) due to the high cost deposit. Despite the high inflation and increasing footprint, the bank was largely able to manage its non-markup expenses (CY19: PKR 5.2bln; CY18: PKR 4.9bln) on the back of increased efficiency, improving the cost to total net revenue (CY19: 81.4%; CY18: 90.1%) which is translated into operational profitability this time after incurring losses for the past couple of years as PBT clocked in at PKR 7.6mln as compared to the last year loss of PKR 245mln. During 3MCY20, given the tough market condition due to adverse impact of COVID-19 coupled with inflationary pressure, the Bank's operating expenses remain on higher side.
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. The ability to manage the asset quality of trade finance will be critical for ABPL's profitability .

Financial Risk

Credit Risk The Bank continue to follow cautious approach in growing financing portfolio and registered a negative growth in its gross finances, due to the current economic environment over the year. ADR decreased to 58.2%, as some pressure abated from the CAR and the Bank was able to lend more. ABPL has high geographical concentration in the central region, which accounted for 52.9% of the portfolio. Asset quality of the bank remains weak as reflected in the increasing trend of NPLs, which are increased by 31.8% to PKR PKR 9.3bln. Resultantly, the coverage and infection ratios of the Bank deteriorated as well, reporting at 63.2% and 11.4% respectively.
Market Risk ABPL's investment portfolio comprises 17.8% of total earning assets and stood at PKR 20.2bln, registering a 12.5% increase for CY19. The investment portfolio remained dominated in government securities (96.8%). Hence, increasing the exposure towards market risk.
Liquidity And Funding Bank's liquidity position improved marginally as reflected in the liquidity ratio at 35.9%. ABPL's customer deposit base registered a remarkable growth of 33.9%, supported by low-cost current account and savings account (CASA) deposits and average CASA ratio was 56.5% for CY19. ABPL has high geographical concentration of in the south and central region, which accounted for 79.2% of the deposits.
Capitalization To bridge the regulatory shortfall, the major sponsor of the bank – Al Baraka Islamic Bank B.S.C (c) – has injected USD 9mln as Capital Support Fund during CY19, resulting in increase in the Bank's MCR to PKR 11.4bln and CAR at 13.3%.

PKR mln

AlBaraka Bank (Pakistan) Limited Unlisted Public Limited	Mar-20 3M	Dec-19 12M	Dec-18 12M	Dec-17 12M
A BALANCE SHEET				
1 Total Finances - net	76,406	76,036	76,144	70,355
2 Investments	19,341	20,199	17,953	16,879
3 Other Earning Assets	30,517	16,968	1,102	8,028
4 Non-Earning Assets	35,105	45,376	31,354	24,028
5 Non-Performing Finances-net	3,820	3,404	2,261	3,362
Total Assets	165,189	161,982	128,813	122,652
6 Deposits	132,847	129,654	99,915	96,623
7 Borrowings	7,529	7,739	7,582	5,852
8 Other Liabilities (Non-Interest Bearing)	12,156	11,858	10,611	9,415
Total Liabilities	152,532	149,251	118,108	111,890
Equity	12,657	12,732	10,705	10,762
B INCOME STATEMENT				
1 Mark Up Earned	4,050	12,923	8,032	6,718
2 Mark Up Expensed	(2,776)	(7,912)	(3,872)	(3,078)
3 Non Mark Up Income	683	1,430	1,154	968
Total Income	1,958	6,441	5,314	4,608
4 Non-Mark Up Expenses	(1,393)	(5,243)	(4,789)	(4,953)
5 Provisions/Write offs/Reversals	(193)	(1,190)	(770)	(185)
Pre-Tax Profit	372	8	(245)	(531)
6 Taxes	(149)	(199)	(9)	142
Profit After Tax	223	(192)	(254)	(389)
C RATIO ANALYSIS				
1 Performance				
Net Mark Up Income / Avg. Assets	3.1%	3.4%	3.3%	2.9%
Non-Mark Up Expenses / Total Income	71.1%	81.4%	90.1%	107.5%
ROE	7.0%	-1.6%	-2.4%	-3.5%
2 Capital Adequacy				
Equity / Total Assets (D+E+F)	7.7%	7.9%	8.3%	8.8%
Capital Adequacy Ratio	12.9%	13.3%	11.8%	10.2%
3 Funding & Liquidity				
Liquid Assets / (Deposits + Borrowings Net of Repo)	27.7%	35.9%	31.3%	28.0%
(Advances + Net Non-Performing Advances) / Deposits	57.3%	58.2%	75.1%	73.7%
CA Deposits / Deposits	21.1%	20.4%	24.1%	23.0%
SA Deposits / Deposits	44.7%	43.7%	51.9%	56.4%
4 Credit Risk				
Non-Performing Advances / Gross Advances	12.0%	11.4%	8.8%	10.1%
Non-Performing Finances-net / Equity	30.2%	26.7%	21.1%	31.2%

Rating Scale | Corporate

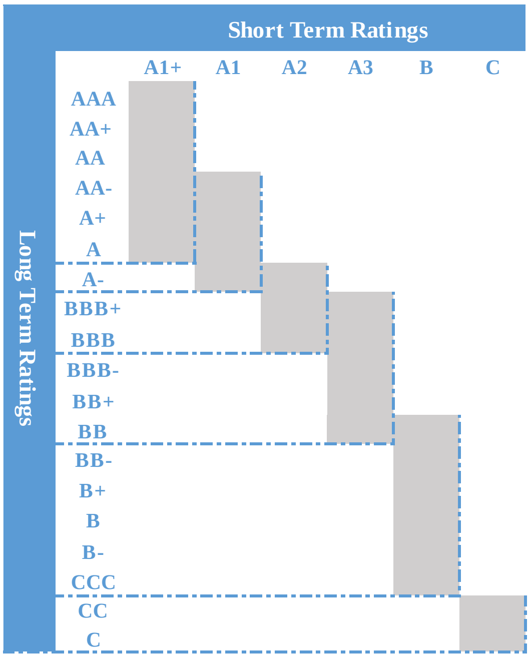
2019

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