The Pakistan Credit Rating Agency Limited

Rating Report

Bank Alfalah Limited | TFC V | Feb-13

Report Contents

Rating History

Dissemination Date	Long Term Rating	Short Term Rating	Outlook	Action	Rating Watch
28-Jun-2019	AA	-	Stable	Maintain	-
28-Dec-2018	AA	-	Stable	Maintain	-
14-Jun-2018	AA	-	Stable	Maintain	-
29-Dec-2017	AA	-	Stable	Maintain	-
22-Jun-2017	AA	-	Stable	Upgrade	-
30-Jun-2016	AA-	-	Positive	Maintain	-
30-Jun-2015	AA-	-	Positive	Maintain	-
30-Jun-2014	AA-	-	Stable	Maintain	-
28-Jun-2013	AA-	-	Stable	Maintain	-
14-Nov-2012	AA-	-	Stable	Initial	-

Rating Rationale and Key Rating Drivers

The ratings reflect relative positioning of the bank among large banks of the country. Advances grew faster than the industry average, resulting in a very high ADR of ~71%, highest amongst its peers. Another reason for the hike in ADR was less than average growth in deposit base, though the mix of which improved. The Bank shed high cost deposits and added a few percentage points to the CA part of the CASA mix. Resultantly, BAFL's cost of funds is comparable to some of the large banks. The Bank has a sound foothold with a considerable presence across the country which has enabled its deposit base to increase. Operating cost structure has improved on YoY basis on account of cost rationalization. The Bank saw healthy uptick in its profitability. Overall infection ratio has reduced due to an expanded loan book, while the Bank has maintained its asset quality. Effective implementation of the envisaged business strategy is important. The increasing asset yield and cost efficiency enabled spreads to increase. The bank issued Tier-I instrument to improve its capital, whereas, enhancing Tier-II capital through issue of a new instrument is also an option, which the Bank can continue to avail from time to time.

The Bank has continued its growth stride; continuation of the same is considered positive. Herein, augmentation of the Bank's capitalization backed by strong sponsors and adding granularity to its advances and deposits book are essential.

Disclosure

Name of Rated Entity	Bank Alfalah Limited | TFC V | Feb-13
Type of Relationship	Solicited
Purpose of the Rating	Debt Instrument Rating
Applicable Criteria	Methodology | Financial Institution(Jun-18),Methodology | Basel III Compliant - Debt Instrument(Jun-18)
Related Research	Sector Study | Commercial Bank(Jun-19)
Rating Analysts	Muhammad Obaid | muhammad.obaid@pacra.com | +92-42-35869504

Profile

Structure Bank Alfalah Limited (hereinafter referred as "BAFL" or "the bank") was incorporated as a public limited company, in 1992, and is listed on Pakistan Stock Exchange (PSX).

Background Bank commenced operations in 1992. Since its inception, Bank Alfalah has grown rapidly to become Pakistan's one of the largest private bank, the largest issuer and acquirer of credit cards, and one of the largest Islamic Banking businesses in the country. The Bank has a network of 649 branches spanning in more than 200 cities in Pakistan.

Operations The Bank currently serves more than 1.9 million customers. In collaboration with International Finance Corporation (IFC) - a member of the World Bank Group - the bank altered its model from only offering credit services to providing a complete range of banking services to SME customers.

Ownership

Ownership Structure BAFL is majority owned by the Abu Dhabi Group (ADG) (49.32%), rest is owned by IFC (14.76%), Mutual funds, other NBFIs (27.31%) and General public (8.61%).

Stability HR committee designs succession planning policies for the CEO and Key executives. Internal successors were highlighted in addition to earmarking key potential external resources to ensure a robust pipeline across all levels at the Bank.

Business Acumen ADG consists of some of the prominent members of UAE's ruling family and leading businessmen of UAE.

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

Governance

Board Structure The board comprises of nine members including President/CEO and eight non-executive directors, four of whom are representatives of ADG, one is an IFC nominee, while three members are independent.

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

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

Financial Transparency The external auditors of the Bank, EY Ford Rhodes, Chartered Accountants, issued an unqualified audit opinion pertaining to annual financial statements for CY18.

Management

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

Management Team Bank's senior management team comprises experienced bankers having national and international exposure. Mr. Nauman Ansari, CEO, joined Bank Alfalah as President and CEO in July 2017 and has served various banks during his 25-year professional career,including leading institutions like SCB, Bank of America, ABN AMRO, Fortis Bank and Samba.

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

MIS The bank uses Temenos (T-24) as its core banking software across all branches. The Bank's core banking system is well recognized for its high stability and efficiency; a result of carefully planned performance-enhancements, architectural redesigning, optimization along with a large number of successfully in-house developed T24 new products.

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

Business Risk

Industry Dynamics The year 2018 was a marked year as the industry saw an expansion of ~22% in advances, although the deposit growth rate stayed in single digit. As a result the industry saw a rise in the ADR ratio from 50% to 55%. In terms of advances expansion, a predominant portion went in to energy sector followed by textile, individuals and agriculture. Corporate sector claimed the major portion of the borrowings with small amounts going into commodity, consumer and SME sectors. Profitability of the banks has taken a hit due to incremental costs and provisioning on account of NPLs. After a lapse of few years the industry NPLs have seen a accretion which is a concern going forward.

Relative Position BAFL is ranked 6th amongst banks on the basis of its strong growth trajectory in net advances and profitability. During CY18, Bank's customer deposits (PKR 654 bln, excluding Afghanistan branches being discontinued operations) increased by ~5.7% as against the sector's growth of 10.7%. BAFL retained its position in top 8 banks with share in customer deposits of the sector at 5.0% (Dec17: 5.2%).

Revenues On the revenue front, net markup income and non-markup income showed combined growth of 9.8% YoY. Non-markup income was reported at PKR 10.2bln, an increase of 12.4% over corresponding period last year, led by strong growth in foreign exchange income, fee business as well as dividend income.

Performance The Bank recorded an impressive growth of 27% YoY in profit after tax despite a challenging operating environment. The Bank's PBT (from continued operations) for the year stands at PKR 16.84bln as against PKR 13.71bln last year, showing improvement of 22.9%. PAT (from continued operations) of PKR 10.15bln as against PKR 8.17bln last year, saw improvement of 24.3%. The total profit after tax of the bank stands at PKR 10.63bln against PKR 8.37bln, improving by 27% (Dec18 audited figures i.e. without Afghanistan). For 1QCY19, The Bank's PAT stood at PKR 3.12bln due to higher taxation as a result of Super Tax charge for 2017 levied through the mini budget.

Sustainability Looking ahead, Bank Alfalah is well-positioned for sustainable growth and building long-term shareholder value. The Bank will continue to focus on building a low-cost deposit base, improving the return on capital on risk assets, optimizing returns from the banking book and enforcing a strong cost discipline across the Bank.

Financial Risk

Credit Risk Net advances of the Bank constitute ~50% of the total assets at end Dec18 – increasing 25% YoY (CY18: PKR 501.6bln, CY17: PKR 400.6bln). Out of total performing advances, only 19.0% are lent to government sector while remaining 81.0% is lent to private sector. At end CY18, the Non-performing loan base of the Bank witnessed an increase of PKR 1,243mln, on the basis of subjective classification and prudence, and was reported at PKR 18.8bln. NPL ratio has improved to 3.6% as compared to 4.2% last year and continues to remain one of the lowest infection ratios in the industry.

Market Risk Following the significant maturity of PIBs, the investment portfolio showed a decline of 23% to PKR 259bln during CY18 (CY17: PKR 387bln). The bank's investment portfolio constitutes 26% of total asset base and government securities continue to dominate the overall investment book (95%). During first quarter CY19, net investments have decreased by PKR 135bln (-49%) with a corresponding increase in Lending to Financial Institutions by PKR 120bln (193%) to capitalize the anticipated interest rate hike in the month of March 2019.

Liquidity And Funding Bank's focus throughout the year remained on improving deposit profile and managing spreads. Total Deposits were reported at PKR 703bln as against PKR 645bln last year – mainly led by growth in current accounts at 11%. At the year end, ADR ratio stood at 73.8%, an indicator of aggressive growth.

Capitalization Bank's CAR on Dec18 stands at 14.95% (Dec17: 13.39%), which is well-above the regulatory requirement of 11.90%. Quality of capital is evident from Bank's Common Equity Tier-I (CET-I) to Total Risk Weighted Assets (RWA) ratio, which comes to 10.90% against the requirement of 6.00%.

Financials [Summary]

Bank Alfalah Limited

BALANCE SHEET	31-Dec-18	31-Dec-17	31-Dec-16
Earning Assets			
Advances-Performing	499,571	399,603	376,845
Debt Instruments	18,298	14,260	12,505
Total Finances	517,869	413,863	389,350
Investments	259,363	386,553	376,683
Others	75,107	60,439	45,867
	852,339	**860,854**	**811,900**
Non Earning Assets			
Non-Earning Cash	73,347	63,348	67,726
Deferred Tax	-	-	-
Net Non-Performing Finances	2,066	973	1,781
Fixed Assets & Others	78,466	74,408	36,051
	153,879	**138,729**	**105,558**
TOTAL ASSETS	**1,006,218**	**999,583**	**917,457**
Funding			
Deposits	702,895	644,985	640,944
Borrowings	135,727	212,185	186,629
	838,623	857,170	827,573
Non Interest Bearing Liabilities	91,948	75,859	29,759
TOTAL LIABILITIES	**930,571**	**933,028**	**857,332**
EQUITY (including revaluation surplus)	**75,647**	**65,800**	**60,125**
Total Liabilities & Equity	**1,006,218**	**998,828**	**917,457**

INCOME STATEMENT	31-Dec-18	31-Dec-17	31-Dec-16
Interest / Mark up Earned	59,318	56,176	57,245
Interest / Mark up Expensed	(27,727)	(27,199)	(28,474)
Net Interest / Markup revenue	**31,591**	**28,976**	**28,770**
Other Income	10,200	9,076	8,868
Total Revenue	**41,791**	**38,052**	**37,638**
Non-Interest / Non-Mark up Expensed	(24,365)	(24,964)	(23,432)
Pre-provision operating profit	17,426	13,089	14,206
Provisions	(588)	616	(1,183)
Pre-tax profit	16,838	13,705	13,023
Taxes	(6,687)	(5,539)	(5,123)
Net Income	**10,150**	**8,166**	**7,900**

Ratio Analysis	31-Dec-18	31-Dec-17	31-Dec-16
Performance			
ROE	16%	15%	17%
Cost-to-Total Net Revenue	59%	66%	62%
Provision Expense / Pre Provision Profit	3%	-5%	8%
Capital Adequacy			
Equity/Total Assets	7%	6%	5%
Capital Adequacy Ratio as per SBP	15%	14%	13%
Funding & Liquidity			
Liquid Assets / Deposits and Borrowings	43%	44%	47%
Advances / Deposits	71%	62%	59%
CASA deposits / Total Customer Deposits	78%	79%	85%
Intermediation Efficiency			
Asset Yield	7%	7%	7%
Cost of Funds	3%	3%	4%
Spread	4%	3%	4%
Outreach			
Branches	640	637	639

**annualized*

Regulatory and Supplementary Disclosure

Nature of Instrument	Size of Issue (PKR)	Tenor	Security	Quantum of Security	Nature of Assets	Trustee	Book Value of Assets
Term Finance Certificate (TFC)	5,000 mln	8 years	Unsecured (subordinated as to the payments of principal and profit to all other indebtedness of BAFL)	N/A	N/A	Pak Brunei Investment Company	N/A

Bank Alfalah Limited | TFC | Feb' 13	
Name of Issuer	Bank Alfalah Limited
Issue size	PKR 5,000 mln
Issue Date	20-Feb-13
Tenor	8 years
Maturity	20-Feb-21
Profit Rate	6 MK + 1.25%
Principal Repayment	0.30% of the principal will be redeemed in the first 90 months and remaining principal of 99.70% at maturity in the 96th month.
Security	Unsecured (subordinated as to the payments of principal and profit to all other indebtedness of BAFL)

Bank Alfalah Limited | TFC | Feb' 13 | Redemption Schedule

Due Date Principle	Opening Principal	Principal Repayment	Due Date Markup/ Profit	Markup/ Profit Rate	6M Kibor	Markup/Profit Payment	Installment Payable	Principal Outstanding
	PKR in mln					PKR in mln		
20-Feb-13	5,000	-						5,000
20-Aug-13	5,000	1	20-Aug-13	6 MK + 1.25%	9.44%	265	266	4,999
20-Feb-14	4,999	1	20-Feb-14	6 MK + 1.25%	9.11%	261	262	4,998
20-Aug-14	4,998	1	20-Aug-14	6 MK + 1.25%	10.16%	283	284	4,997
20-Feb-15	4,997	1	20-Feb-15	6 MK + 1.25%	10.18%	288	289	4,996
20-Aug-15	4,996	1	20-Aug-15	6 MK + 1.25%	8.47%	241	242	4,995
20-Feb-16	4,995	1	20-Feb-16	6 MK + 1.25%	7.06%	209	210	4,994
20-Aug-16	4,994	1	20-Aug-16	6 MK + 1.25%	6.35%	190	191	4,993
20-Feb-17	4,993	1	20-Feb-17	6 MK + 1.25%	6.01%	183	184	4,992
20-Aug-17	4,992	1	20-Aug-17	6 MK + 1.25%	6.14%	183	184	4,991
20-Feb-18	4,991	1	20-Feb-18	6 MK + 1.25%	6.15%	186	187	4,990
20-Aug-18	4,990	1	20-Aug-18	6 MK + 1.25%	6.43%	190	191	4,989
20-Feb-19	4,989	1	20-Feb-19	6 MK + 1.25%	8.05%	231	232	4,988
20-Aug-19	4,988	1	20-Aug-19	6 MK + 1.25%	10.86%	297	298	4,987
20-Feb-20	4,987	1	20-Feb-20	6 MK + 1.25%	10.86%	302	303	4,986
20-Aug-20	4,986	1	20-Aug-20	6 MK + 1.25%	10.86%	299	300	4,985
20-Feb-21	4,985	4,985	20-Feb-21	6 MK + 1.25%	10.86%	302	5,287	-
		5,000				**3,909**	**8,909**	

Debt Instrument Rating Scale & Definitions

Credit rating reflects forward-looking opinion on credit worthiness of underlying 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