# RATING REPORT

# Faysal Bank Limited

**REPORT DATE:**
July 05, 2017

**RATING ANALYSTS:**
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**RATING DETAILS**

| Rating Category | Latest Rating Long-term | Latest Rating Short-term | Previous Rating Long-term | Previous Rating Short-term |
|---|---|---|---|---|
| **Entity Rating** | AA | A-1+ | AA | A-1+ |
| **TFC-II** | AA- | | AA- | |
| **Outlook** | Stable | | Stable | |
| ***Date*** | *June 30, '17* | | *June 28, '16* | |

**COMPANY INFORMATION**

| | |
|---|---|
| **Established in 1994** | External auditors: **A.F. Ferguson & Co. Chartered Accountants** |
| **Public Limited Company** | Chairman of the Board: **Mr. Farooq Rahmatullah** |
| **Key Shareholders (with stake 5% or more):** | Acting CEO: **Mr. Yousaf Hussain** |
| Ithmaar Bank & Subsidiaries – 66.8% | |
| General Public – 14.9% | |
| Foreign Investors – 6.4% | |
| Public Sector Companies & Corporations – 5.4% | |

**APPLICABLE METHODOLOGY(IES)**

**PRIMER - Commercial Banks (December 2001):**http://jcrvis.com.pk/images/primercb.pdf
**Rating the Issue (September 2014):** http://jcrvis.com.pk/Images/criteria_instrument.pdf

# Faysal Bank Limited

## OVERVIEW OF THE INSTITUTION

Ithmaar Bank B.S.C (IB), a Islamic Retail Bank in Bahrain and Kuwait, is the parent bank of Faysal Bank Limited, holding directly and indirectly, 66.78% of FBL's shares. As a result of restructuring in Ithmaar Bank in 2017, shares of FBL are transferred to IB Bank B.S.C, a wholly owned subsidiary of Ithmaar Holding Company B.S.C.

FBL was operating through a network of 355 (2014: 280) branches at year-end'2016. Islamic banking has 146 (2015: 68) branches. In terms of branch network, the bank was the 11th largest bank in the country at end-December'2016.

## RATING RATIONALE

Faysal bank is considered as a mid-tier bank operating in Pakistan, with a market share of 3% (2015: 3%) in terms of domestic deposits and 4.1% in terms of advances (2015: 4.2%). Long term strategic vision of the Board of Directors and shareholders involves transformation of the business model of the bank from a Conventional bank with an Islamic banking window to a full-fledged Islamic Bank. In this regard, a comprehensive business transformation process has been established; the same is currently in the implementation phase.

**Rating Factors**

**Advances:** In order to mitigate the impact of decrease in spreads due to lower interest rates, considerable growth was undertaken in the gross advances portfolio during the outgoing year. Corporate financing portfolio constituted more than three-fourth of the total advances at end-2016. Going forward, growth is envisioned in financing portfolio pertaining to corporate, consumer and commercial & Small and Medium Enterprise segment (CBSME) in 2017, and will be achieved primarily through acquisition of new clients (inorganic sources). In order to achieve the targeted growth, the bank plans to leverage its relationship with existing clients in order to target the corporate value chain; the same will aid growth in advances. Expansion in branch network, with addition of 50 branches in 2017, will facilitate growth in consumer portfolio. Concentration of top-20 customers in the advances portfolio witnessed an increase during the outgoing year. As per management, growth through acquisition of new customers will also help in improving the concentration in portfolio.

**Asset quality:** Despite improving on yearly basis, gross and net infection ratios compare less favorably in relation to its peers, with the bank utilizing considerable Forced Sale Value (FSV) benefit. However, declining trend is being witnessed in the FSV benefit being availed by the bank on yearly basis. Yearly improvement in infection ratio can be attributed to lower infection ratios in the corporate portfolio. On the other hand, declining commodity prices have adversely impacted infection ratios in agricultural financing. Going forward, management has projected higher recoveries in relation to the provisioning expense, on the back of strong recovery drives. Credit and market risk emanating from investment portfolio is considered manageable given the sizeable proportion of government securities and further reduction in duration of PIBs portfolio held by the bank. Going forward, the sound underwriting policies must be maintained by the bank in pursuing growth in financing portfolio.

**Liquidity:** Concentration in deposits increased during the outgoing year; however, liquidity profile of the bank is supported by presence of sizeable liquid assets in relation to deposits and borrowings. At end-Q1'17, Liquidity Coverage Ratio (LCR) on the bank was above the minimum regulatory requirement. Moreover, expansion in branch network is expected to improve the granularity in deposits. Financing to Deposits Ratio (ADR) exhibited minimal decrease to 63.5% (2015: 64.6%) in the outgoing year. However, the same remains higher vis-à-vis peers.

**Capitalization:** Capitalization indicators, including Tier I capital, Capital Adequacy Ratio (CAR) and leverage ratio, have depicted improvement on the back of retention in profits and controlled growth in risk weighted assets. Net NPL to Tier-I ratio of the bank depicted considerable improvement on the back of sizeable recoveries; however, the same remains higher vis-à-vis peers. Accounting for projected growth in advances and branch network, capitalization indicators of the bank are expected to remain comfortable in 2017.

**Profitability:** Operating profit and profit before tax decreased in the outgoing year on account of lower spreads and higher administrative expenses. Spreads declined on account of low interest rate environment, while expansion in branch network translated into higher administrative expenses. Resultantly, efficiency (cost to income) ratio worsened to 70.7% (2015: 60.4%) in 2016. Profitability in Q1'17 was higher vis-a-vis the corresponding period in previous year on account of realization of suspended markup income pertaining to a client and sizeable capital gains on PIBs. Going forward, profitability of the bank is expected to remain under pressure given the presence of low interest scenario – in line with the overall banking industry, high competition and aggressive branch expansion of the bank. Management aims to mitigate the effect of these factors by targeting volumetric growth in portfolio and ensuring that costs are kept at a minimal level.

| FINANCIAL SUMMARY | | | Appendix I |
|---|---|---|---|
| **BALANCE SHEET** *(Figures in PKR Billions unless stated otherwise)* | **DEC 31, 2016** | **DEC 31, 2015** | **DEC 31, 2014** |
| **Total Investments** | 170 | 196 | 155 |
| **Advances** | 205 | 181 | 183 |
| **Total Assets** | 444 | 430 | 388 |
| **Borrowings** | 53 | 91 | 61 |
| **Deposits & other accounts** | 340 | 292 | 283 |
| **Subordinated Loans** *(in PKR millions)* | 1,497 | 2,994 | 2,995 |
| **Tier-1 Equity** | 28 | 24 | 19 |
| **Net Worth** | 35 | 30 | 26 |
| | | | |
| **INCOME STATEMENT** *(Figures in PKR millions)* | **DEC 31, 2016** | **DEC 31, 2015** | **DEC 31, 2014** |
| **Net Mark-up Income** | 12,066 | 13,955 | 13,832 |
| **Net Provisioning/(Reversal)** | 564 | 1,426 | 2,359 |
| **Non-Markup Income** | 6,768 | 5,564 | 4,374 |
| **Operating Expenses** | 11,590 | 11,166 | 12,295 |
| **Profit Before Tax** | 6,659 | 6,920 | 3,552 |
| **Profit After Tax** | 4,302 | 4,222 | 2,477 |
| | | | |
| **RATIO ANALYSIS** | **DEC 31, 2016** | **DEC 31, 2015** | **DEC 31, 2014** |
| **Market Share (Advances) (%)** | 4.1% | 4.2% | 4.6% |
| **Market Share (Deposits) (%)** | 3.0% | 3.0% | 3.3% |
| **Gross Infection (%)** | 13.1% | 14.8% | 14.3% |
| **Provisioning Coverage (%)** | 83.2% | 80.7% | 80.1% |
| **Net Infection (%)** | 2.7% | 3.5% | 3.5% |
| **Cost of deposits (%)** | 3.6% | 4.3% | 5.3% |
| **Net NPLs to Tier-1 Capital (%)** | 19.4% | 26.2% | 31.6% |
| **Capital Adequacy Ratio (C.A.R (%))** | 14.6% | 14.4% | 12.2% |
| **Markup Spreads (%)** | 2.5% | 3.0% | 3.5% |
| **Efficiency (%)** | 70.7% | 60.4% | 70.6% |
| **Basic* ROAA (%)** | 1.1% | 1.7% | 1.5% |
| **ROAA (%)** | 1.0% | 1.0% | 0.7% |
| **ROAE (%)** | 15.6% | 17.6% | 11.7% |
| **Liquid Assets to Deposits & Borrowings (%)** | 45.7% | 46.3% | 42.5% |
| ** Recurring Income – Administration Expenses* | | | |

## ISSUE/ISSUER RATING SCALE &DEFINITIONS

**Appendix II**

**Medium to Long-Term**

**AAA**
Highest credit quality; the risk factors are negligible, being only slightly more than for risk-free Government of Pakistan's debt.

**AA+, AA, AA-**
High credit quality; Protection factors are strong. Risk is modest but may vary slightly from time to time because of economic conditions.

**A+, A, A-**
Good credit quality; Protection factors are adequate. Risk factors may vary with possible changes in the economy.

**BBB+, BBB, BBB-**
Adequate credit quality; Protection factors are reasonable and sufficient. Risk factors are considered variable if changes occur in the economy.

**BB+, BB, BB-**
Obligations deemed likely to be met. Protection factors are capable of weakening if changes occur in the economy. Overall quality may move up or down frequently within this category.

**B+, B, B-**
Obligations deemed less likely to be met. Protection factors are capable of fluctuating widely if changes occur in the economy. Overall quality may move up or down frequently within this category or into higher or lower rating grade.

**CCC**
Considerable uncertainty exists towards meeting the obligations. Protection factors are scarce and risk may be substantial.

**CC**
A high default risk

**C**
A very high default risk

**D**
Defaulted obligations

**Short-Term**

**A-1+**
Highest certainty of timely payment; Short-term liquidity, including internal operating factors and /or access to alternative sources of funds, is outstanding and safety is just below risk free Government of Pakistan's short-term obligations.

**A-1**
High certainty of timely payment; Liquidity factors are excellent and supported by good fundamental protection factors. Risk factors are minor.

**A-2**
Good certainty of timely payment. Liquidity factors and company fundamentals are sound. Access to capital markets is good. Risk factors are small.

**A-3**
Satisfactory liquidity and other protection factors qualify entities / issues as to investment grade. Risk factors are larger and subject to more variation. Nevertheless, timely payment is expected.

**B**
Speculative investment characteristics; Liquidity may not be sufficient to ensure timely payment of obligations.

**C**
Capacity for timely payment of obligations is doubtful.

**Rating Watch:** JCR-VIS places entities and issues on 'Rating Watch' when it deems that there are conditions present that necessitate re-evaluation of the assigned rating(s). Refer to our 'Criteria for Rating Watch' for details. www.jcrvis.com.pk/images/criteria_watch.pdf

**Rating Outlooks:** The three outlooks 'Positive', 'Stable' and 'Negative' qualify the potential direction of the assigned rating(s). An outlook is not necessarily a precursor of a rating change. Refer to our 'Criteria for Rating Outlook' for details. www.jcrvis.com.pk/images/criteria_outlook.pdf

**(SO) Rating:** A suffix (SO) is added to the ratings of 'structured' securities where the servicing of debt and related obligations is backed by some sort of financial assets and/or credit support from a third party to the transaction. The suffix (SO), abbreviated for 'structured obligation', denotes that the rating has been achieved on grounds of the structure backing the transaction that enhanced the credit quality of the securities and not on the basis of the credit quality of the issuing entity alone.

**'p' Rating:** A 'p' rating is assigned to entities, where the management has not requested a rating, however, agrees to provide informational support. A 'p' rating is shown with a 'p' subscript and is publicly disclosed. It is not modified by a plus (+) or a minus (-) sign which indicates relative standing within a rating category. Outlook is not assigned to these ratings. Refer to our 'Policy for Private Ratings' for details. www.jcrvis.com.pk/images/policy_ratings.pdf

**'SD' Rating:** An 'SD' rating is assigned when JCR-VIS believes that the ratee has selectively defaulted on a specific issue or obligation but it will continue to meet its payment obligations on other issues or obligations in a timely manner.

| **REGULATORY DISCLOSURES** | **Appendix III** |
|---|---|
| **Name of Rated Entity** | Faysal Bank Limited |
| **Sector** | Commercial Banks |
| **Type of Relationship** | Solicited |
| **Purpose of Rating** | Entity & TFC Rating |
| **Rating History** | (see table below) |

**Rating History**

| Rating Date | Medium to Long Term | Short Term | Rating Outlook | Rating Action |
|---|---|---|---|---|
| | | **RATING TYPE: Entity** | | |
| **30-Jun-17** | AA | Stable | A-1+ | Re-affirmed |
| **28-Jun-16** | AA | Stable | A-1+ | Re-affirmed |
| **30-Jun-15** | AA | Stable | A-1+ | Reaffirmed |
| **30-Jun-14** | AA | Stable | A-1+ | Reaffirmed |
| **26-Jun-13** | AA | Stable | A-1+ | Reaffirmed |
| **02-Jul-12** | AA | Stable | A-1+ | Reaffirmed |
| **28-Jun-11** | AA | Stable | A-1+ | Reaffirmed |
| **24-Feb-11** | AA | Stable | A-1+ | Rating Watch Removed |
| **01-Jun-10** | AA | | A-1+ | Rating Watch - Developing |
| | | **RATING TYPE: TFC - 2** | | |
| **30-Jun-17** | AA- | Stable | | Re-affirmed |
| **28-Jun-16** | AA- | Stable | | Re-affirmed |
| **30-Jun-15** | AA- | Stable | | Reaffirmed |
| **30-Jun-14** | AA- | Stable | | Reaffirmed |
| **26-Jun-13** | AA- | Stable | | Reaffirmed |
| **02-Jul-12** | AA- | Stable | | Reaffirmed |
| **28-Jun-11** | AA- | Stable | | Reaffirmed |
| **24-Feb-11** | AA- | Stable | | Rating Watch Removed |
| **27-Sep-10** | AA- | Rating Watch – Developing | | Final |
| **24-Jun-10** | AA- | Rating Watch – Developing | | Preliminary |

| | |
|---|---|
| **Instrument Structure** | TFC-2 is an unsecured instrument, sub-ordinated to all other indebtedness of the bank including deposits. The TFC features payments of 0.20% of principle of Rs. 3b in first 60 months and remaining principal in 4 semi-annual installments of 24.95% starting from 66$^{th}$ month. Applicable coupon rate is KIBOR +2.25%. The instrument was issued in December 2010 and is due to mature in December 2017. |
| **Statement by the Rating Team** | JCR-VIS, the analysts involved in the rating process and members of its rating committee do not have any conflict of interest relating to the credit rating(s) mentioned herein. This rating is an opinion on credit quality only and is not a recommendation to buy or sell any securities. |
| **Probability of Default** | JCR-VIS' ratings opinions express ordinal ranking of risk, from strongest to weakest, within a universe of credit risk. Ratings are not intended as guarantees of credit quality or as exact measures of the probability that a particular issuer or particular debt issue will default. |
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