RATING REPORT

Faysal Bank Limited

REPORT DATE:
July 4, 2019

RATING ANALYSTS:

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RATING DETAILS				
	Latest Rating		Previous Rating	
Rating Category	Long-term	Short-term	Long-term	Short-term
Entity Rating	AA	A-1+	AA	A-1+
Outlook	Stable		Stable	
Date	*June 27, '19*		*June 29, '18*	

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):	**CEO:** Mr. Yousaf Hussain
Ithmaar Bank B.S.C – 48.06%	
Faisal Finance (Luxemborg) S.A. – 8.55%	
MFAI (Jersey) Limited – 5. 89%	
State Life Insurance Corporation of Pakistan – 5.30%	
General Public – 14.12%	

APPLICABLE METHODOLOGY(IES)
Commercial Banks (March 2018): https://www.vis.com.pk/kc-meth.aspx

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, 66.8% of FBL's shares.

FBL has a branch network of 455 (2017: 405) branches, including 254 (2017: 197) Islamic branches and one Islamic sub-branch

Profile of Chairman

Mr. Farooq Rahmatullah is a seasoned professional with a diverse experience in several roles in different organizations. He is a Law graduate and is currently serving on Board of three other organizations.

Profile of CEO

Mr. Yousaf Hussain has over 26 years of professional experience, primarily at ABN AMRO Bank where he held multiple senior managerial positions including those within the Corporate / Credit and Transaction Banking functions. He has been affiliated with Faysal Bank since August 2008, with a significant contribution to the franchise in his previous positions as Chief Risk Officer.

RATING RATIONALE

Faysal Bank Limited (FBL) is engaged in provision of conventional and Islamic Corporate, Commercial and Consumer banking services. FBL is a mid-sized bank with a market share of 3.1% (2017: 3.0%) in domestic deposits and 4.1% (2017: 3.9%) in domestic advances. Long term strategic vision of the bank entails transformation of the business model from a Conventional bank offering Islamic banking services to a full-fledged Islamic bank. The timeline for completion of transformation is 2022. An asset led conversion model has been adopted by the management in this regard. At end-Q1'19, 29.1% of the bank's gross advances portfolio comprised Islamic financing.

Rating Rationale:

Gross financing portfolio witnessed healthy double digit growth. Assets quality indicators continue to depict improvement on timeline basis, while total provisioning coverage remains sound at 89%.

Gross financing portfolio of FBL depicted sizeable growth of 25.2% to increase to Rs. 320.3b (2017: Rs. 255.8b) at end-2018. With conversion of conventional loans to Islamic loans and booking of new loans under Islamic mode of financing, Islamic financing and related assets registered increase to Rs. 79.0b (2017: Rs. 45.9b) at end-2018. Corporate advances continue to remain the forte of the bank as the same constituted more than three-fourth of the total advances portfolio. Going forward, focus will continue to remain on corporate sector with selective growth in commercial, SME and consumer segments. Client wise concentration in advances witnessed an increase as top-20 funded exposures clients accounted for 39.0% (2017: 36.8%) of total portfolio. Gross advances portfolio was reported at Rs. 321.5b at end-Q1'19.

Asset quality indicators of the bank improved during the reviewed period due to decrease in quantum of NPLs (2018: Rs. 26.7b; 2017: Rs. 27.3b) on account of recoveries, and increase in portfolio size. Gross and net infection ratios of the bank were reported lower at 8.3% (2017: 10.7%) and 1.2% (2017: 1.5%), respectively. Despite improving on timeline basis, asset quality indicators remain on the higher side vis-à-vis peers primarily due to sizeable NPLs pertaining to legacy portfolio. While VIS expects some increase in NPLs in the domestic portfolio in view of the macroeconomic situation going forward, asset quality indicators are expected to remain sound on the back of adequate quality of exposures undertaken. In view of the mid-term economic scenario and policy rate regime, maintaining asset quality indicators is considered important from ratings perspective.

Credit and market risk emanating from the investment portfolio is considered low

Net investment portfolio of the bank was reported at Rs. 125.8b (2018: Rs. 214.8b; 2017: Rs. 179.7b). Credit risk of the portfolio is considered low as majority of the investment portfolio comprised exposure to government securities at end-Q1'19. Exposure in PIBs as a percentage of total investment has witnessed a noticeable decline since 2017 which bodes well from a market risk perspective.

Overall liquidity profile of the bank remains comfortable in view of adequate liquid assets in relation to deposits and borrowings. However, room for further improvement exists in liquidity buffer and granularity in deposit base when compared with peers

Deposit base of the bank depicted healthy growth in 2018 primarily on account of increase in saving accounts and term deposits. Given the increasing interest rate scenario, management opted to increase the quantum of term deposits in order to lock rates for a fixed period of time. Concentration in deposit base continues to trend upwards with top-20 and top-50 depositors representing 18.8% (2017: 17.0%) and 27.1% (2017: 24.6%) of total deposit base at end-2018. While granularity in deposit base continued to decrease, presence of adequate liquid assets amounting to 40.5% (2017: 45.1%) of total deposits and borrowings provide comfort to overall liquidity profile. However, room for further improvement in liquidity buffer along with concentration in deposits exists when compared with peers. Going forward, expansion in branch network and implementation of a branch led SME model is expected to aid growth in deposit base and facilitate improvement in depositor granularity.

Profitability indicators have depicted healthy growth on account of increase in topline revenue of the bank. Going forward, profitability is expected to depict an increasing trend due to volumetric growth in advances and increasing interest rate scenario.

Profit after tax was reported higher at Rs. 4.8b (2017: Rs. 4.5b) in 2018. Profitability of the bank registered sizeable growth during the outgoing year on the back of improvement in markup income along with controlled growth in expenses. Net markup income increased owing to volumetric increase in average earning assets. Spreads of the bank remained at a similar level vis-à-vis the preceding year as higher yield on advances due to rising interest rates was offset by increase in the cost of funds. Administrative expenses registered double digit growth on account of growth registered in compensation related expenses primarily due to branch expansion. However, with greater increase in recurring income vis-à-vis the growth in operating expenses, efficiency ratio of the bank improved to 66.0% (2017: 67.9%). Going forward, VIS expects operating profitability of the bank to depict an increasing trend owing to balance sheet growth along with improvement in spreads on account of rising interest rates. Growth in overall profitability will depend on quantum of impairment charges as client repayment capacity may be affected due to rise in interest rates. Moreover, imposition of super tax will also constrain growth in profitability.

Profit retention strengthens capitalization indicators, which are expected to maintain sizeable cushion over the regulatory requirements.

Capitalization indicators, including Capital Adequacy Ratio (CAR) and leverage ratio, have depicted improvement to 16.8% (2017: 15.9%) and 4.9% (2017: 5.2%) respectively. Improvement in the same was brought about by increase in capital on the back of retention in profits. Going forward, capitalization indicators of the bank are expected to remain comfortable over the regulatory requirement after accounting for projected growth in advances.

Faysal Bank Limited

FINANCIAL SUMMARY			Appendix I
BALANCE SHEET *(Figures in PKR Billions unless stated otherwise)*	**DEC 31, 2016**	**DEC 31, 2017**	**DEC 31, 2018**
Investments	170	180	214
Advances	205	232	296
Total Assets	452	495	600
Borrowings	53	55	98
Deposits & other accounts	340	372	409
Subordinated Loans *(in PKR millions)*	1,497	-	-
Tier-1 Equity	28	33	37
Net Worth	35	39	43
INCOME STATEMENT *(Figures in PKR millions)*	**DEC 31, 2016**	**DEC 31, 2017**	**DEC 31, 2018**
Net Mark-up Income	12,066	13,935	16,275
Net Provisioning/(Reversal)	564	(492)	(422)
Non-Markup Income	6,954	5,639	6,260
Operating Expenses	11,661	12,608	14,492
Profit Before Tax	6,659	7,292	8,202
Profit After Tax	4,302	4,530	4,837
RATIO ANALYSIS	**DEC 31, 2016**	**DEC 31, 2017**	**DEC 31, 2018**
Market Share (Advances) (%)	4.1%	3.9%	4.1%
Market Share (Deposits) (%)	3.0%	3.0%	3.1%
Gross Infection (%)	13.1%	10.7%	8.3%
Provisioning Coverage (%)	83.2%	88.9%	89.2%
Net Infection (%)	2.7%	1.5%	1.2%
Cost of funds (%)	3.9%	3.6%	4.1%
Net NPLs to Tier-1 Capital (%)	19.4%	10.8%	9.5%
Capital Adequacy Ratio (C.A.R (%))	14.6%	15.9%	16.8%
Markup Spreads (%)	2.7%	2.8%	2.8%
Efficiency (%)	71.0%	67.9%	66.0%
Basic* ROAA (%)	1.1%	1.3%	1.4%
ROAA (%)	1.0%	1.0%	0.9%
ROAE (%)	15.6%	14.2%	13.4%
Liquid Assets to Deposits & Borrowings (%)	45.9%	45.1%	40.5%

** 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: 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.vis.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.vis.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.

(blr) Rating: A suffix (blr) is added to the ratings of a particular banking facility obtained by the borrower from a financial institution. The suffix (blr), abbreviated for 'bank loan rating' denotes that the rating is based on the credit quality of the entity and security structure of the facility.

'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.vis.com.pk/images/policy_ratings.pdf

'SD' Rating: An 'SD' rating is assigned when 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 Rating

Rating History

Rating Date	Medium to Long Term	Short Term	Rating Outlook	Rating Action
RATING TYPE: Entity				
27-Jun-19	AA	Stable	A-1+	Reaffirmed
29-Jun-18	AA	Stable	A-1+	Reaffirmed
30-Jun-17	AA	Stable	A-1+	Reaffirmed
28-Jun-16	AA	Stable	A-1+	Reaffirmed
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

Instrument Structure	N/A
Statement by the Rating Team	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.
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