RATING REPORT

Faysal Bank Limited

REPORT DATE:
June 29, 2020

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 29, '20*		*June 27, '19*	

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 – 14.6%	

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

Faysal Bank Limited

OVERVIEW OF THE INSTITUTION	RATING RATIONALE

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 555 branches (2018: 455); including 413 Islamic branches (2018: 254) and 1 Islamic sub-branch (2018: 1) in Pakistan.

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 25 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

FBL is a mid-sized bank engaged in provision of conventional and Islamic Corporate, Commercial and Consumer banking services. The bank has a market share of 4.1% (2018: 4.1%) and 3.1% (2018: 3.1%) in domestic advances and domestic deposits, respectively. 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. An asset led conversion model has been adopted by the management in this regard. At end Q1'20, total Sharia compliant deposits as proportion of total deposits were reported at 27.5%, while Islamic advances represented 41.1% of total financing portfolio. Management expects to completely transform into an Islamic bank by end-2023.

Rating Rationale

Gross financing portfolio witnessed moderate growth but asset quality indicators declined slightly during 2019 (due to industry-wide defaults of a few borrowers). In the long run, asset quality indicators are expected to decrease further in line with the banking sector given the negative impact of COVID-19 on repayment capacity of many borrowers

Gross financing portfolio of FBL depicted modest growth of 4.2% to increase to Rs. 333.8b (2018: Rs. 320.3b) at end-2019. 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. 116.1b (2018: Rs. 79.0b) at end-2019. Corporate advances continue to remain the mainstay 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 segment with selective growth in commercial, SME and consumer segments. Government's decision to enhance limits of SME borrowers in the wake of COVID-19 pandemic provides additional incentive to the bank to cater to this segment. Client wise concentration in advances witnessed slight decrease as funded exposures of top-20 clients accounted for 37.4% (2018: 39.0%) of total portfolio. Gross advances portfolio was reported at Rs. 331.7b at end-Q1'20.

Asset quality indicators of the bank declined slightly due to greater increase in quantum of NPLs vis-à-vis the increase in gross financing portfolio. Resultantly, gross and net infection ratios were reported higher at 9.1% (2018: 8.3%) and 2.2% (2018: 1.2%), respectively. Recent economic slowdown due to COVID-19 is expected to negatively impact repayment capacity of many borrowers; hence, asset quality indicators may witness pressure in the long run in line with the overall banking industry. In 2020, minimum impact will be observed on fresh NPLs as SBP has allowed banks to defer clients' payment of principal on loan obligations by one year and also relaxed regulatory criteria for restructured/rescheduled loans for borrowers who require relief beyond the extension of principal repayment for one year. Maintaining assets quality indicators in line with rating benchmarks is considered an important rating driver going forward.

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

Value of the investment portfolio was reported at Rs. 215.9b (2019: Rs. 204.1b; 2018: Rs. 214.2b) at end-Q1'20. Credit risk emanating from the portfolio is considered low as approximately 70% of the investment portfolio was deployed in government portfolio. Market risk is also considered low as investment in equity securities constituted less than 5%

of overall investment portfolio during 2019 and Q1'20.

Overall liquidity profile of the bank is considered adequate in view of sizeable liquid assets in relation to deposits and borrowings; however, room for improvement in deposit granularity exists

Deposit base of the bank depicted double digit growth during 2019. CASA of the bank was reported higher at 70.1% (2018 67.4%). In terms of total quantum, saving accounts registered the largest growth as management offered special rates in both conventional and Islamic saving accounts to mobilize deposits and maintain Advances to Deposits (ADR) ratio of the bank. However, the management has converted these special rate saving accounts to rack rate accounts during 2020 in a bid to rationalize cost of deposits. Concentration in deposit base observed slight decrease vis-à-vis the preceding year, with top 20 and top 50 depositors accounting for 17.2% (2018: 18.8%) and 25.2% (2018: 27.1%) of total deposits at end-2019. However, further room for improvement exists in this regard. Growth in liquid assets was greater than growth observed in deposits and borrowings. Consequently, liquid assets in relation to deposits and borrowings were reported higher at 45.1% (2018: 40.8%). Going forward, management's strategy is to focus on attracting low cost deposits rather than aiming for higher volume. However, economic slowdown due to COVID-19 is expected to present challenges in mobilizing low cost deposits.

Increasing interest rates contributed to improvement in profitability profile during the period under review; however, profitability is expected to remain under pressure in medium to long term in view of decreasing interest rate scenario and client repayment capacity being affected due to economic slowdown

Profit after tax of FBL was reported higher at Rs. 6.0b (2018: Rs. 4.8b) in 2019. 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. Increasing interest rates were a key factor contributing to higher profitability. Net markup income increased owing to volumetric increase in average earning assets and improvement in spreads. Administrative expenses registered double digit growth on account of increase 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 (cost to income) of the bank improved to 59.9% (2018: 66.0%). Going forward, the COVID-19 crisis and its impact on the economy and the financial sector would make the operating dynamics of the banks in general challenging. SBP has announced regulatory relaxations to manage the asset quality of the banks' portfolio which along with the relief package provided by the Federal Government is expected to provide certain respite to the banks in the short term. Profitability of FBL will be further supported during 2020 on account of lag in re-pricing of loan portfolio and efforts by the management to reduce the cost of deposits by mobilizing low cost deposits and reducing operational expenses to compensate for decrease in interest rates. However, the impact of curtailment of economic activity due to COVID-19 and lower lending rate scenario may cause NIM compression, thereby impacting the profitability of the bank in the medium to long term. Moreover, impairment charges due to adverse impact of economic slowdown on client's repayment capacity are expected to put further downward pressure on profitability. Maintaining conservative lending strategy to maintain asset quality and cost efficiencies would be important rating drivers going forward.

Capitalization indicators are expected to remain sound

Equity (excluding revaluation surplus) depicted increase on timeline basis due to profit retention. Capital Adequacy Ratio (CAR) and leverage ratio were reported at 19.1% (2018: 16.8%) and 5.9% (2018: 4.9%) respectively. Going forward, capitalization indicators of the bank are expected to demonstrate comfortable cushion over the regulatory requirements after accounting for projected growth in advances.

FINANCIAL SUMMARY			Appendix I
BALANCE SHEET *(Figures in PKR Billions unless stated otherwise)*	**DEC 31, 2017**	**DEC 31, 2018**	**DEC 31, 2019**
Investments	180	214	204
Advances	232	296	310
Total Assets	495	600	630
Borrowings	55	98	73
Deposits & other accounts	372	409	458
Subordinated Loans *(in PKR millions)*	-	-	-
Issued, subscribed and paid up capital	13	15	15
Tier-1 Equity	33	37	43
Net Worth	39	43	55
INCOME STATEMENT *(Figures in PKR millions)*	**DEC 31, 2017**	**DEC 31, 2018**	**DEC 31, 2019**
Net Mark-up Income	13,935	16,275	21,120
Net Provisioning/(Reversal)	(492)	(422)	843
Non-Markup Income	5,639	6,584	7,247
Operating Expenses	12,608	14,816	17,068
Profit Before Tax	7,292	8,202	10,192
Profit After Tax	4,530	4,837	6,041
RATIO ANALYSIS	**DEC 31, 2017**	**DEC 31, 2018**	**DEC 31, 2019**
Market Share (Advances) (%)	3.9%	4.1%	4.1%
Market Share (Deposits) (%)	3.0%	3.1%	3.1%
Gross Infection (%)	10.7%	8.3%	9.1%
Provisioning Coverage (%)	88.9%	89.2%	79.7%
Net Infection (%)	1.5%	1.2%	2.2%
Cost of funds (%)	3.6%	4.4%	7.9%
Net NPLs to Tier-1 Capital (%)	10.8%	9.5%	15.8%
Capital Adequacy Ratio (C.A.R (%))	15.9%	16.8%	19.1%
Markup Spreads (%)	2.8%	3.3%	3.9%
Efficiency (%)	67.9%	66.5%	59.9%
Basic* ROAA (%)	1.3%	1.4%	1.9%
ROAA (%)	1.0%	0.9%	1.0%
ROAE (%)	14.2%	13.4%	14.6%
Liquid Assets to Deposits & Borrowings (%)	45.1%	40.8%	45.1%
** 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		
29-Jun-20	AA	Stable	A-1+	Reaffirmed
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.
Probability of Default	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.
Disclaimer	Information herein was obtained from sources believed to be accurate and reliable; however, VIS does not guarantee the accuracy, adequacy or completeness of any information and is not responsible for any errors or omissions or for the results obtained from the use of such information. VIS is not an NRSRO and its ratings are not NRSRO credit ratings. For conducting this assignment, analyst did not deem necessary to contact external auditors or creditors given the unqualified nature of audited accounts and diversified creditor profile.

Due Diligence Meetings Conducted

S.No	Name	Designation	Date
1	Mr. Tahir Yaqoob Bhatti	Head of Retail Banking	May 21, 2020
2	Mian Salman Ali	Chief Risk Officer	May 21, 2020
3	Syed Majid Ali	CFO	May 21, 2020