# RATING REPORT

# Meezan Bank Limited

**REPORT DATE:**
July 3, 2015

**RATING ANALYSTS:**
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## RATING DETAILS

| | Latest Rating | | Previous Rating | |
|---|---|---|---|---|
| **Rating Category** | **Long-term** | **Short-term** | **Long-term** | **Short-term** |
| **Entity** | AA | A-1+ | AA | A-1+ |
| **Outlook** | Stable | | Stable | |
| ***Date*** | *June 29, '15* | | *June 24, '14* | |

## COMPANY INFORMATION

| | |
|---|---|
| **Incorporated in 1997** | External auditors: **A.F. Ferguson & Co.** |
| **Public Limited Company** | Chairman of the Board: **H.E. Sheikh Ebrahim Bin Khalifa Al-Khalifa** |
| **Key Shareholders (with stake 5% or more):** | Chief Executive Officer: **Mr. Irfan Siddiqui** |
| Noor Financial Investment Co, Kuwait – 49.1% | |
| Pakistan Kuwait Investment Co. (Pvt.) Ltd. – 30.0% | |
| Islamic Development Bank, Jeddah – 9.3% | |

## APPLICABLE METHODOLOGY(IES)

**JCR-VIS Entity Rating Criteria: PRIMER – Commercial Banks (December 2001)**
***http://www.jcrvis.com.pk/images/primercb.pdf***

# Meezan Bank Limited

## OVERVIEW OF THE INSTITUTION

Meezan Bank Limited is the largest Islamic commercial bank in Pakistan. Sponsors of the bank include Noor Financial Investment Company Limited, Pakistan Kuwait Investment Company (Pvt.) Limited and Islamic Development Bank.

## RATING RATIONALE

The assigned ratings incorporate Meezan Bank Limited (MBL's) well-established domestic franchise, solid funding base, healthy profitability, sound liquidity profile and strong Shariah Governance Infrastructure. Over the last few years, MBL has pursued an aggressive branch expansion strategy which has allowed the bank to increase its market share in Islamic and domestic banking sector deposits to 35.6% (2013: 31%) and 4.56% (2013: 3.85%), respectively by year-end 2014. Deposit base features granularity; MBL has the one of the highest proportion of retail deposits while deposit concentration is low and has declined further on a timeline basis.

While net equity of the bank has increased in absolute terms due to internal capital generation, overall Capital Adequacy Ratio (CAR) of the bank declined due to sizeable growth in Risk Weighted Assets (RWAs). CAR of MBL at 11.88% at year-end 2014 was lower than the 12.75% median for peer group. Given the growth plans of the bank and in the backdrop of increased capital requirements under Basel 3 & higher risk charge on unrated exposures of over Rs. 3b (effective Dec'15), enhancing retention levels will facilitate the bank in maintaining a healthy CAR.

Financing portfolio of the bank witnessed healthy growth in 2014. Corporate portfolio continues to remain the mainstay of MBL's lending operations comprising over four-fifths of the bank's financing portfolio while growth was also recorded in consumer and commercial segments. Concentration in financing portfolio continues to be on the higher side and may result in asset quality pressures in case of impairment in large financings. Asset quality indicators currently compare favorably to peers with provisioning coverage being highest amongst peer banks. MBL plans to increase the proportion of consumer and commercial segments in financing mix while adding new clients in the corporate portfolio to reduce concentration risk.

Despite increase in expense base on account of aggressive branch expansion being pursued by the bank, operating profitability of MBL increased by 42% during 2014 on the bank of significant growth in earning assets and higher income from dealing in foreign currencies. Going forward, spreads & profitability are expected to come under pressure in the backdrop of decline in market benchmark rates and increase in expenses due to branch expansion. Introduction of Sukuk backed OMOs has partly allowed the bank to offset the impact of decline in interest rates given that exposure has been locked with SBP for a year. Management is focusing on volumetric growth in earning assets and enhancing income from ancillary sources in order to mitigate the impact of declining spreads and increasing expense base.

MBL's strong access to cost effective deposits and growing branch network is a significant advantage, providing comfort to the bank's liquidity position. Moreover, liquid assets carried on the balance sheet are sizeable in relation to deposits and borrowing. While liquidity profile of the bank is strong it is not easy to manage because of lack of avenues for deployment. Introduction of Sukuk backed open market operations based on Bai Muajjal in October'2014 is expected to provide support to bank's liquidity profile; however recurring GoP Ijarah Sukuk issuances is a requirement for the same. Almost the entire maturity of MBL's holding of GoP Ijarah Sukuk falls due in the ongoing year. Deployment of the same may be a challenge for the bank.

As part of the bank's vision 2020, MBL plans to expand branch network to 800 while deposit base is targeted to grow to 1 trillion. Aggressive branch expansion is planned to continue with the addition of 122 branches in the ongoing year. During 2014, MBL completed the acquisition of HSBC Pakistan Operations. The acquisition was undertaken at a discount resulting in a bargain purchase gain which supported the Bank's CAR. Moreover, 10 branches were added to MBL's branch network while the bank also gained access to top-tier customers.

## Meezan Bank Limited Appendix I

| FINANCIAL SUMMARY | | | (amounts in PKR billions) |
|---|---|---|---|
| **BALANCE SHEET** | **DEC 31, 2014** | **DEC 31, 2013** | **DEC 31, 2012** |
| Total Investments | 114.1 | 151.6 | 152.5 |
| Advances | 175.7 | 127.6 | 88.7 |
| Total Assets | 437.4 | 329.7 | 274.4 |
| Borrowings | 15.5 | 11.4 | 18.5 |
| Deposits & other accounts | 380.4 | 289.8 | 230.4 |
| Subordinated Loans | 0 | 0 | 0 |
| Equity (excluding surplus) | 23.3 | 17.9 | 15.5 |
| Net Worth | 23.9 | 18.9 | 16.6 |
| | | | |
| **INCOME STATEMENT** | **DEC 31, 2014** | **DEC 31, 2013** | **DEC 31, 2012** |
| Net Mark-up Income | **13.4** | **10.6** | **10.5** |
| Net Provisioning | -0.5 | -0.09 | -0.45 |
| Non-Markup Income | 4.8 | 3.5 | 2.4 |
| Operating Expenses | 10.5 | 8.3 | 7.2 |
| Profit Before Tax | 6.9 | 5.6 | 5.2 |
| Profit After Tax | 4.6 | 4.0 | 3.5 |
| | | | |
| **RATIO ANALYSIS** | **DEC 31, 2014** | **DEC 31, 2013** | **DEC 31, 2012** |
| Market Share (Advances) (%) | 3.94% | 3.13% | 2.30% |
| Market Share (Deposits) (%) | 4.56% | 3.85% | 3.45% |
| Gross Infection (%) | 3.77% | 3.63% | 5.30% |
| Provisioning Coverage - Overall (%) | 109.57% | 120.89% | 114.5% |
| Net Infection (%) | 0.36% | 0.18% | 0.55% |
| Cost of deposits (%) | 4.57% | 4.52% | 5.58% |
| Net NPLs to Tier-1 Capital (%) | 2.56% | 1.21% | 2.99% |
| Capital Adequacy Ratio (C.A.R (%)) | 11.88% | 12.31% | 13.75% |
| Markup Spreads (%) | 5.1% | 5.1% | 6.1% |
| Efficiency (%) | 62.11% | 64.66% | 58.70% |
| Basic ROAA (%) | 1.66% | 1.50% | 2.13% |
| ROAA (%) | 1.19% | 1.32% | 1.91% |
| ROAE (%) | 21.36% | 22.59% | 23.11% |
| Liquid Assets to Deposits & Borrowings (%) | 59.70% | 61.11% | 70.79% |
| | | | |
| | | | |

## 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.

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**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** | Meezan Bank Limited |
| **Sector** | Commercial Banks |
| **Type of Relationship** | Solicited |
| **Purpose of Rating** | Entity Rating |
| **Rating History** | see table below |
| **Instrument Structure** | N/A |
| **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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**Rating History**

| Rating Date | Medium to Long Term | Short Term | Rating Outlook | Rating Action |
|---|---|---|---|---|
| **RATING TYPE: ENTITY** | | | | |
| **6/29/2015** | AA | A-1+ | Stable | Reaffirmed |
| **6/24/2014** | AA | A-1+ | Stable | Reaffirmed |
| **6/26/2013** | AA | A-1+ | Stable | Upgrade |
| **6/1/2012** | AA- | A-1+ | Stable | Reaffirmed |
| **6/1/2011** | AA- | A-1+ | Stable | Maintained |