RATING REPORT

Meezan Bank Limited (MBL)

REPORT DATE:
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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+
Sukuk (Tier-2)	AA		AA-	
Sukuk (Tier-1)	AA- (Preliminary Rating)			
Rating Outlook	Stable		Stable	
Rating Date	*May 30, '18*		*Jun 22, '17*	

COMPANY INFORMATION	
Incorporated in 1997	External auditors: **M/sEY Ford Rhodes**
Public Limited Company	Chairman of the Board: **Mr. Riyadh S.A.A. Edrees**
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)
PRIMER - Commercial Banks (November 2015):[*http://www.jcrvis.com.pk/Images/Meth-CommercialBanks201511.pdf*](http://www.jcrvis.com.pk/Images/Meth-CommercialBanks201511.pdf)

OVERVIEW OF THE INSTITUTION

Meezan Bank Limited is the largest Islamic commercial bank in Pakistan, which commenced operations in March'2002, after being issued the first ever Islamic commercial banking license by the State Bank of Pakistan (SBP)

Noor Financial Investment Company Limited, Pakistan Kuwait Investment Company (Pvt.) Limited and Islamic Development Bank are the primary shareholders of the bank

Profile of Chairman

Mr. Riyadh Edrees serves as Chairman of the Board. Mr. Edrees holds more than 23 years of experience at various organizations

Profile of CEO

Mr. Irfan Siddiqui is the founding President and CEO of the Bank. Mr. Siddiqui is a qualified Chartered Accountant from the Institute of Chartered Accountants of England & Wales.

RATING RATIONALE

Meezan Bank Limited (MBL) is the largest Islamic Bank in the country having a market share of around 36% in total Islamic banking deposits. With aggressive branch expansion pursued over the last 5 years, branch network increased to 601 (2012: 310) branches at end-Dec'2017. Strong growth posted by the bank is reflected in deposits and advances recording a 5 year CAGR of 23.9% (Industry deposit growth of 13.1%) and 36.5% (Industry advances growth 11.1%), respectively. With growth in deposit base outpacing increase in industry deposits, market share of MBL increased to 5.4% (2016: 5.0%) at year-end'2017. Based on historical growth in deposits and branch expansion plans, market share of MBL is projected to cross 6% by 2020. Apart from growth in deposits and financing portfolio, non-fund based business (import, export and guarantee business) of the Bank has depicted healthy growth. Overall trade business of the Bank recorded an increase of 29% and crossed Rs. 700b in 2017 having a market share of 8.5% in Pakistan's trade business.

Net investment portfolio of the Bank represents around 15% of the total asset base. Investments include strategic stake in Al Meezan Investment Management Limited (AMIML). AMIML is a leading player in the asset management industry enjoying strong franchise and financial profile. We have been given to understand that the market value of this investment in AMIML is substantially higher than currently being carried by MBL in its financial statements.

Financing portfolio: Gross financing portfolio of the bank witnessed a growth of 34% during 2017. Broad based growth in financing portfolio was witnessed in the outgoing year with Corporate, Commercial & SME (CBSME) and Consumer financing portfolio increasing by 29%, 53% and 48%, respectively, during 2017. Credit risk emanating from the performing corporate portfolio is considered manageable with around one-third of financing comprising public sector/government guaranteed exposures with remaining large counterparties comprising top-tier clients with sound financial risk profile. MBL's CBSME portfolio includes financing to Wheat, Edible Oil & Seed, Cotton Ginning, Fertilizer, Coal, Sugar, Rice, Feed and Steel sectors. As per management, clients primarily include short-term self-liquidating exposures. Lending to clients in the sugar sector (due to weak sector dynamics) and flat steel importers (due to expansion by both local players and imposition of duty) may need to be monitored closely. Moreover, given that a large chunk of the portfolio comprises commodity related exposures, the portfolio may be exposed to sharp movement in commodity prices. Increase in consumer financing has been driven by auto and home loans with infection in the portfolio being well below industry norms. Overall asset quality indicators compare favorably to peer banks with gross infection ratio at 1.54% and provisioning coverage at 133%. Given the aggressive growth in financing portfolio, mid-term economic scenario and policy rate regime, maintaining asset quality indicators in line with benchmarks for the assigned ratings is considered important.

Liquidity: Liquidity profile of the bank draws support from a healthy customer franchise and a solid funding base, largely comprising cost effective retail deposits. Total number of depositors increased by 20% during 2017 while proportion of non-remunerative current accounts witnessed a slight increase to 35.1% (2016: 34.8%) at year-end'2017. Moreover, proportion of individual depositors is sizeable at around 70%. While depositor concentration levels have witnessed an increasing trend over the last two years, depositor concentration levels at end-December'2017 compare favorably to peer banks. With growth in advances portfolio, liquid assets in relation to deposits and borrowings declined to 43.8% (2016: 51.2%) while liquidity coverage ratio (LCR) was reported at 126% at end-Dec'2017. While LCR is well above regulatory requirement, the same compares less favorably to peers due to lending to FIs (one-fifth of asset base) not qualifying as high quality liquidity assets. Liquidity management continues to remain a challenge for MBL given the limited avenues for deploying surplus liquidity (particularly SLR eligible GoP Ijarah Sukuk). Given the sizeable maturity of GoP Ijarah Sukuk in the last quarter of 2018, overall yield may be impacted slightly if MBL has to deploy the excess liquidity with SBP in cash balances to comply with SLR requirement in the absence of GoP Ijarah Sukuk.

Profitability: Operating profit increased by 38% during 2017 and amounted to Rs. 10.7b (2016: Rs. 7.7b). With spreads being slightly lower as compared to prior year level, growth in operating profit was a function of volumetric growth in earning assets and higher fee based income. Fee based income recorded an increase of 59% due to growth in trade business and higher income from alternate delivery channel. Higher administrative expenses were offset by increase in income resulting in an improvement in efficiency ratio to 60.7% (2016: 65.4%). Despite higher general provisions and provisions on investment portfolio, profit before tax increased to Rs. 10.2b (2016: Rs. 8.9b) during 2017. Going forward, profitability is projected to depict double digit growth in FY18 due to higher spreads, volumetric growth in earning assets and sizeable jump in fee based income.

Capitalization: In 2017, the bank completed a 6% Right Issue of shares to the existing shareholders resulting in an equity injection of Rs. 3b. This alongwith retained profits resulted in growth in net equity base of the Bank to Rs. 34.3b (2016: Rs. 28.2b) at year-end'2017. Tier-1 Capital Adequacy Ratio (CAR) and leverage ratio were reported higher at 9.94% (2016: 9.41%) and 3.85% (2016: 3.68%); however, overall CAR was reported lower at 12.89% (2016: 12.91%) due to decline in revaluation surplus on AFS portfolio. Going forward, planned issuance of additional Tier-1 Capital in the ongoing year is projected to support growth plans of the Bank. Maintaining cushion over regulatory CAR requirement in line with benchmarks for the assigned ratings is considered important from a ratings perspective.

Corporate Governance: Overall corporate governance framework is supported by strong board composition and oversight, stable and professional management team and adequate control infrastructure. During the outgoing year, core banking system deployed at MBL, Temenos 24 (T-24), was upgraded to its new release of R-16.

<u>Proposed Additional Tier 1 Sukuk</u>

Instrument: MBL is in the process of issuing a privately placed/OTC listed, perpetual, unsecured, subordinated, non-cumulative and contingent convertible debt instruments amounting up to Rs. 7.0b. The issue proceeds will contribute towards the bank's additional Tier-1 capital and will be utilized towards enhancement of the bank's business operations.

Priority: In terms of priority of claims, MBL's Tier-1 instrument will rank ahead of claims of ordinary shareholders but below the bank's senior creditors, including depositors and holders of Tier 2 TFC.

Non-performance risk: Tier-1 instruments are characterized by higher non-performance risk vis-à-vis Tier-2 instruments on account of issuer having full discretion on profit payments, coupon servicing from only profits for the year and conversion feature in the event of pre-specified trigger events in terms of regulatory requirements. Tier-1 instruments also include lock-in-clause stipulating that neither profit nor principal may be paid (even at maturity) if such payments will result in shortfall in MCR or CAR or increase any existing shortfall. While the regulatory framework may not consider a missed coupon payment as a default; the credit rating methodology employed by JCR-VIS would treat such missed payments as a default like situation given the investors' need for focus on the certainty of full and timely payments. Despite existence of full coupon discretion, exercising the feature is not considered likely in normal course of business as it will hamper future fund raising ability of the Bank.

Meezan Bank Limited Appendix I

FINANCIAL SUMMARY			*(amounts in PKR billions)*
BALANCE SHEET	**DEC 31, 2017**	**DEC 31, 2016**	**DEC 31, 2015**
Total Investments	119.2	130.2	146.3
Gross Advances	428.8	319.6	215.8
Total Assets	781.7	657.8	531.8
Borrowings	36.8	32	13.6
Deposits & other accounts	673.2	564	471.8
Subordinated Sukuk (Tier II)	7	7	-
Tier-1 Equity	33.6	27.5	24.8
Net Worth	35.0	30.5	26.3
INCOME STATEMENT	**DEC 31, 2017**	**DEC 31, 2016**	**DEC 31, 2015**
Net Mark-up Income	20.8	17.8	17.7
Net (reversal) Provisioning	1.3	(0.18)	0.56
Non-Markup Income	7.6	5.6	4.6
Administrative Expenses	16.6	14.7	13.1
Profit Before Tax	10.2	8.9	8.5
Profit After Tax	6.3	5.6	5.0
RATIO ANALYSIS	**DEC 31, 2017**	**DEC 31, 2016**	**DEC 31, 2015**
Market Share (Advances) (%)	6.6%	5.7%	4.5%
Market Share (Deposits) (%)	5.4%	5.0%	5.1%
Gross Infection (%)	1.5%	2.1%	3.3%
Provisioning Coverage (%)	133.3%	118.1%	116.2%
Net Infection (%)	0.04%	0.08%	0.1%
Cost of deposits (%)	2.3%	2.4%	3.5%
Net NPLs to Tier-1 Capital (%)	0.50%	0.88%	0.86%
Capital Adequacy Ratio (C.A.R (%)	12.9%	12.9%	11.0%
Markup Spreads (%)	3.93%	3.97%	4.8%
Efficiency (%)	60.7%	65.4%	59.9%
ROAA (%)	0.9%	0.9%	1.0%
ROAE (%)	20.2%	20.7%	20.6%
Liquid Assets to Deposits & Borrowings (%)	43.8%	51.2%	58.6%

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	Meezan Bank Limited
Sector	Commercial Banks
Type of Relationship	Solicited
Purpose of Rating	Entity and Sukuk Rating

Rating History

Rating Date	Medium to Long Term	Short Term	Rating Outlook	Rating Action
RATING TYPE: ENTITY				
5/30/2018	AA+	A-1+	Stable	Upgrade
6/22/2017	AA	A-1+	Stable	Reaffirmed
6/2/2016	AA	A-1+	Stable	Reaffirmed
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	Reaffirmed

Rating Date	Medium to Long Term	Rating Outlook	Rating Action
RATING TYPE: SUKUK (Tier 2)			
5/30/18	AA	Stable	Upgrade
6/22/17	AA-	Stable	Reaffirmed
8/31/16	AA-	Stable	Preliminary
6/29/16	AA-	Stable	Preliminary

Rating Date	Medium to Long Term	Rating Outlook	Rating Action
RATING TYPE: SUKUK (Tier 1)			
6/5/18	AA-	Stable	Preliminary

Instrument Structure

Basel III compliant Tier 2, privately placed, unsecured & subordinated Sukuk amounting to Rs. 7.0b and has a tenor of 10 years.

Basel III compliant Tier 1 privately placed/OTC listed, perpetual, unsecured, subordinated, non-cumulative and contingent convertible debt instruments amounting up to Rs. 7.0b.

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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