RATING REPORT

Meezan Bank Limited (MBL)

REPORT DATE:
January 21, 2020

RATING ANALYSTS:
Talha Iqbal
talha.iqbal@vis.com.pk

Asfia Aziz
asfia.aziz@vis.com.pk

RATING DETAILS

Rating Category	Latest Rating Long-term	Latest Rating Short-term	Previous Rating Long-term	Previous Rating Short-term
Entity	AA+	A-1+	AA+	A-1+
Sukuk (Tier-2 Rs. 7b)	AA		AA	
Sukuk (Tier-1 Rs. 7b)	AA-		AA-	
Sukuk (Tier-2 Rs. 4b)	AA (Final)		AA (Preliminary)	
Rating Outlook	Stable		Stable	
Rating Date	*January 21, 2020*		*November 19, 2019*	

COMPANY INFORMATION

Incorporated in 1997	External auditors: **M/S EY 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 – 35.25%	
Pakistan Kuwait Investment Co. (Pvt.) Ltd. – 30.0%	
Islamic Development Bank, Jeddah – 9.3%	
***as of the report date**	

APPLICABLE METHODOLOGY(IES)

VIS Commercial Banks Rating ***https://s3-us-west-2.amazonaws.com/backupsqlvis/docs/Meth-CommercialBanks201803.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 24years 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 first and largest Islamic commercial bank of the country, accounting for 35% of total Islamic banking sector assets as at end-June 2019. Over the last decade, MBL has significantly expanded its operations and improved the Bank's market position; presently, MBL's distribution network is spread across 689 branches (2018: 660 branches) as at end-September 2019. Consequently, the bank is positioned as the seventh largest bank in Pakistan.

Major shareholding of the bank rests with Noor Financial Investment Company (NFIC), Pakistan Kuwait Investment Company (Pvt.) Ltd (PKICL) and Islamic Development Bank, Jeddah (IDB).

Industry Dynamics

Banking sector profitability after declining for 3 consecutive years (2016 to 2018) owing to pressure on spreads and one-off expenses & settlement payments and regulatory actions (transaction tax on deposits, super tax and deposit insurance), has depicted an increase in the ongoing year. During 1HCY19, profit before tax and profit after tax witnessed an increase of 21% and 7.8%, respectively. VIS expects profitability to improve over the next 12 months as full impact of increase in discount rate on spreads materializes with a lag given that liabilities re-price faster than assets do. Over the medium term, balance sheet growth along with improvement in spreads, is expected to off-set higher credit cost, and translate into healthy growth in profitability. Extent of improvement in profitability will depend on timing and quantum of discount rate reversal and impact of implementation of IFRS-9. Other key risk to profitability may emerge from implementation of treasury single account which may result in liquidity and profitability challenges for banks. The impact may be significant for select public sector and provincial government owned banks. Impact for large and medium sized private sector banks is expected to be manageable given that deposits represent a smaller proportion of overall deposits and cost of funds for government is significantly higher vis-à-vis Bank's average cost of funds.

Given the structural reforms being undertaken by the government, GDP growth is expected to remain slow over the next 18 months. Resultantly private sector credit growth is expected to remain slower vis-à-vis preceding years with working capital financing and BMR and expansion in the textile being the key contributors. With decline in private sector credit growth, ADR ratios of banks which have increased over the last 2 years (ADR Ratio of the sector has increased from 46.6% at end-Dec'2016 to 55.8% at end-Dec'2018) are expected to decline again. Resultantly, liquidity buffers are expected to increase.

Maintaining asset quality indicators will be the biggest challenge for the banking sector where VIS expects weakening in asset quality indicators of Banks in general. Increase would be more pronounced for Banks where ADR is on the higher side and where exposure to the SME segment is sizeable. This is already evident from increase in NPLs of the banking sector at end-June 2019 vis-à-vis December 2017 (NPLs have increased by around Rs. 175b during the period), although some increase is attributable to higher overseas NPLs and non-performance by a single sugar sector group. Capital adequacy ratio of commercial banks has slightly improved from 15.3% at end-Dec'2017 to 15.9% at end-June 2019. Given the increasing profitability and conservative lending strategy expected to be pursued by most banks, capitalization indicators for most large and medium sized banks are expected to remain sound.

After aggressive growth in financing portfolio over the last two years, management is pursuing a prudent asset deployment strategy given current macroeconomic scenario. Despite slight increase in NPLs, asset quality indicators remain sound and compare favorably to peer banks. Provisioning coverage remains strong at 136% at end-Sep'2019.

After aggressive growth in financing portfolio over the last two years (28% CAGR over the last 2 years), management is pursuing a prudent asset deployment strategy given current macroeconomic scenario and expects growth in financing portfolio to be in single digits in 2019. Lower growth in financing portfolio during 2019 is also partly attributable to aggressive deployment in Pakistan Energy Sukuk, guaranteed by the Federal Government during the first half of the ongoing calendar year. While corporate segment comprises the major portion of financing portfolio, other segments have also depicted healthy growth during 2017 and 2018.

Non-performing exposures have depicted some increase in the ongoing year with NPLs reported at Rs. 8b (CY18: Rs. 7b) as at end-September 2019. Accretion in NPLs is primarily against a client from the edible oil sector while select increase in NPLs has been witnessed against retail and SME clients. Despite the increase in NPLs, asset quality indicators remain sound and compare favorably to peer banks. At end-Sep'2019, gross infection was reported at 1.65% (CY18: 1.34%). Despite higher NPLs, overall provisioning remains strong at 136% (CY18: 139%) at end-Sep'2019 reflecting prudent approach being pursued by management. Moreover, MBL does not expect material provisioning requirements post implementation of IFRS-9. In line with slower GDP growth and rising finance cost expected for FY20, VIS expects NPLs to continue to increase. Given the mid-term economic scenario and policy rate regime, maintaining asset quality indicators in line with benchmarks for the assigned ratings is considered important.

Credit and market risk emanating from investment portfolio is considered manageable
Investment in sovereign instruments represented 91% of the total portfolio. Resultantly, credit risk emanating from the investment portfolio is low. In absolute terms, the bank invested Rs. 85b in Pakistan Energy Sukuk in 1QCY19 while the bank also plans to participate in the second tranche once it is issued. In line with performance of the benchmark equity index, MBL realized a loss of Rs. 155.2m on equity portfolio during 9MCY19. Nevertheless, overall exposure to market risk is considered manageable given the size of equity portfolio in relation to Bank's own equity.

Strong liquidity profile as evident from sizeable, granular and cost effective deposit base. Customer base has depicted healthy growth with depositor concentration levels comparing favorably to medium and large sized banks. Liquidity buffer has increased on a timeline basis.

Deposit base of MBL recorded an increase of 6.8% during 9MCY19 higher than industry growth of 5% during the period. Resultantly, market share increased to 5.98% at end-Sep'2019 as compared to 5.88% at end-Dec'2018. Growth has been witnessed in low cost deposit with proportion of CASA in total deposits increasing to 74% (2018: 72%). MBL has a sizeable retail customer base with over 2 million customers while depositor concentration levels are amongst the lowest in the banking sector. Given the sizeable investment in Pakistan Energy Sukuk, liquid assets in relation to deposit and borrowings have witnessed an increase. Similarly, LCR and NSFR have depicted an increase and were reported at 184% (2018: 147%) and 151% (2018: 130%), respectively.

Capitalization indicators supported by healthy internal capital generation and decline in risk weighted assets. Issuance of second tranche of Basel 3 compliant Tier-II Sukuk to further strengthen capitalization buffers.

Equity base of the Bank increased to Rs. 46.8b (2018: Rs. 40.3b) as at end-Sep'2019 due to healthy internal capital generation. Cash Dividend payout ratio for 2018 was reported at 45.6%. In 2018, MBL also completed issuance of additional Tier 1 Sukuk (ADT-1) issue amounting to Rs. 7b which along with healthy profitability in the ongoing year has resulted in significant increase in total eligible capital. Focused management of risk weighted assets (RWAs) and prudent financing growth strategy in the ongoing year has resulted in a decline in RWAs (primarily credit risk weighted assets) by 7% during 9MCY19. Higher eligible capital and lower RWAs has translated into an improvement in Tier 1 and overall CAR which were reported at 14.67% (2018: 12%) and 17.63% (2018: 14.6%), respectively as at end-Sep'2019. Going forward, capitalization indicators of the Bank is expected to further strengthen due to strong profitability, prudent financing growth strategy being pursued by the management and issuance of second tranche of Basel 3 compliant Tier-II Sukuk in the ongoing year.

Despite continuous branch expansion, volumetric growth in earning assets, higher fee based income and spread improvement has translated into 84% increase in profit before tax and 75% increase in profit after tax during 9MCY19. Profitability growth was highest in the banking sector while cost to income ratio has improved from last year is comparable to efficient large banks.

Net spread earned increased by 74% during 9MCY19. Increase is attributable to volumetric growth in earning assets and 188bps spread improvement (facilitated by re-pricing of assets and cost effective deposit base). Fee and commission income increased by 24% with trade and debit card related fees being major contributors to growth. Despite increase in administrative expenses due to branch expansion and higher employee related cost, cost to income ratio witnessed noticeable improvement due to higher recurring revenue. Cost to income ratio improved to 44.93% during 9MCY19 vis-à-vis 54.6% for full year 2018. Provisioning charges depicted an increase due an increase in NPLs and diminution in value of investments. Accounting for taxes, MBL reported profit after tax of Rs. 10.9b (9MCY18: Rs. 6.24b) during 9MCY18, an increase of 75%. Going forward, volumetric growth in earning assets are expected to be the key profitability driver provided provisioning charges are contained.

Tier II Instrument

The Instrument: MBL is in the process of issuing second tranche of a regulatory compliant unsecured, subordinated privately placed Tier 2 Sukuk amounting up to Rs. 4.0b. Tenor of the instrument shall be 10 years with bullet repayment at the end of the tenor. Profit will be payable semi-annually in arrears on the outstanding investment amount. Expected profit rate on the instrument is 6M KIBOR + margin to be decided via a Reverse Dutch Auction.

Priority: In terms of priority of claims, MBL's Tier II Sukuk will rank superior to the claims of ordinary shareholders.

Non-performance risk: Non-performance risk for the instrument is characterized by presence of point of lock-in and loss absorbency clause. While the regulatory framework may not consider a missed coupon payment as a default; the credit rating methodology employed by VIS would treat such missed payments as an event of default. In normal course of business, VIS believes that chances of non-performance risk are considered remote given healthy capital buffers which will be enhanced further post issuance of the Tier II instrument.

Meezan Bank Limited Appendix I

FINANCIAL SUMMARY	*(amounts in PKR billions)*			
BALANCE SHEET	**31-Dec-16**	**31-Dec-17**	**31-Dec-18**	**30-Sep-19**
Total Investments	130.2	119.2	123.7	214.4
Gross Advances	319.6	428.8	522.2	483.7
Total Assets	662.1	788.8	937.9	1004
Borrowings	32	36.8	36.4	41.2
Deposits & other accounts	559.4	667.2	785.5	838.9
Subordinated Sukuk (Tier II)	7	7	7	7
Subordinated Sukuk (Tier I)	0	0	7	7
Paid Up Capital	10.0	10.6	11.7	12.9
Tier-1 Equity	27.5	33.6	46.6	52.8
Net Worth	30.4	35	40.3	46.5
INCOME STATEMENT	**31-Dec-16**	**31-Dec-17**	**31-Dec-18**	**30-Sep-19**
Net Mark-up Income	17.8	20.8	28.1	33.2
Net (reversal) Provisioning	-0.2	1.3	1.1	2.5
Non-Markup Income	5.6	7.6	7.4	6.7
Administrative Expenses	14.7	16.6	19.2	17.9
Profit Before Tax	8.9	10.2	14.7	19
Profit After Tax	5.6	6.3	8.9	10.9
RATIO ANALYSIS	**31-Dec-16**	**31-Dec-17**	**31-Dec-18**	**30-Sep-19**
Market Share (Advances) (%)	5.70%	6.60%	6.60%	NA
Market Share (Deposits) (%)	5.00%	5.40%	5.90%	NA
Cash Flow Position	-	-	-	-
Current Ratio	-	-	-	-
Debt to Equity	-	-	-	-
NPLs	6.8	6.6	7	8
Gross Infection (%)	2.10%	1.50%	1.34%	1.65%
Provisioning Coverage (%)	118.10%	133.30%	138.90%	135.70%
Cost of deposits (%)	2.40%	2.30%	2.60%	4.48%
Tier-1 CAR (%)	9.41%	9.94%	12.00%	14.67%
Capital Adequacy Ratio (C.A.R) (%)	12.90%	12.90%	14.60%	17.63%
LCR (%)	NA	126.00%	147.00%	184.00%
NSFR (%)	NA	133.00%	130.00%	151.00%
Markup Spreads (%)	3.97%	3.93%	4.41%	6.08%
Efficiency (%)	65.40%	60.70%	54.60%	44.93%
ROAA (%)	0.93%	0.87%	1.04%	1.50%
ROAE (%)	19.53%	19.26%	23.77%	33.51%
Advances to Deposits Ratio (%)*	54.70%	61.00%	63.40%	53.40%
Liquid Assets to Deposits & Borrowings (%)	51.50%	45.00%	44.40%	51.76%
*For ADR calculation, Financings are net off SBP Islamic Export Refinance Scheme and other SBP Financings				

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	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		
6/28/2019	AA+	A-1+	Stable	Reaffirmed
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	Maintained

Rating Date	Medium to Long Term	Rating Outlook	Rating Action
	RATING TYPE: SUKUK-3		
01/21/20	AA	Stable	Final
11/19/19	AA	Stable	Preliminary

Rating Date	Medium to Long Term	Rating Outlook	Rating Action
	RATING TYPE: SUKUK-1		
6/28/19	AA	Stable	Reaffirmed
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-2		
6/28/19	AA-	Stable	Reaffirmed
8/20/18	AA-	Stable	Final
6/5/18	AA-	Stable	Preliminary

Instrument Structure

Sukuk 1: Shariah compliant, privately placed, unsecured & subordinated Tier 2 Sukuk amounting to Rs. 7.0b and has a tenor of 10 years.

Sukuk 2: Shariah compliant, privately placed, unsecured & subordinated Additional Tier I Sukuk Rs. 7b having a perpetual tenor with monthly profit payments.

Sukuk 3: Second tranche of Shariah compliant privately placed, unsecured & subordinated Tier 2 Sukuk amounting Rs. 4b and has a tenor of 10 years.

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.
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