

RATING REPORT

Meezan Bank Limited (MEBL)

REPORT DATE:

November 24, 2021

RATING ANALYSTS:

Arsal Ayub, CFA

arsal.ayub@vis.com.pk

RATING DETAILS

| Rating Category | Latest Rating | | Previous Rating | |
|----------------------|--------------------------|------------|----------------------|------------|
| | Long-term | Short-term | Long-term | Short-term |
| Sukuk 4 (Tier-II) | AAA * | | NA | |
| Sukuk 1 (Tier-II) | AAA | | AA+ | |
| Sukuk 3 (Tier-II) | AAA | | AA+ | |
| Sukuk 2 (ADT-I) | AA+ | | AA | |
| Rating Outlook | Stable | | Stable | |
| <i>Rating Date</i> | <i>November 24' 2021</i> | | <i>June 30' 2021</i> | |
| <i>* Preliminary</i> | | | | |

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. – 30.00%

Islamic Development Bank, Jeddah – 9.32%

*as of the report date

APPLICABLE METHODOLOGY(IES)

Rating Methodology - Commercial Banks - June 2020

<https://s3-us-west-2.amazonaws.com/backupsqvis/docs/Meth-CommercialBanks202006.pdf>

Rating the Issue - July 2020

<https://docs.vis.com.pk/docs/Notchingtheissue202007.pdf>

OVERVIEW OF THE INSTITUTION

RATING RATIONALE

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 MEBL

Profile of Chairman

Mr. Riyadh Edrees serves as Chairman of the Board. Mr. Edrees holds more than 26 years of experience at various organizations

Profile of CEO

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

Meezan Bank Limited ('MEBL' or 'the Bank') is the first and largest Islamic commercial bank of the country. Over the last decade, MEBL has significantly expanded its operations. In terms of domestic deposits and financings, MEBL was the 4th largest bank in the country, as of Dec'20. As of Sep'21, MEBL's distribution network is spread across 849 branches, operating in more than 265 cities across Pakistan.

Major shareholding of MEBL rests with Noor Financial Investment Company (NFIC) (35.25%), Pakistan Kuwait Investment Company (Pvt.) Ltd (PKICL) (30.00%) and Islamic Development Bank, Jeddah (IDB) (9.32%).

Entity Ratings – Rating Rationale

In terms of market positioning, MEBL has transformed from a medium-sized to large-sized category

As of Sep'21, MEBL held market share of 6.71% and 6.78% in terms of financings & deposits respectively (Dec'19: 6.21% & 6.37%). During 2020, in terms of domestic deposits and financings, MEBL was the 4th largest Bank in the country, as of Dec'20. Subsequently, the classification of MEBL has been revised from a medium-sized bank to a large-sized bank.

Assets quality indicators remain comfortable and compare favorably to other large-sized banks.. Deferments, under SBP's Covid relief measures, were also limited.

Corporate financing remains the mainstay of the Bank's financings operations. Amidst a heightened credit risk environment, MEBL's infection ratio remained low, faring notably better than the industry. As a Mar'21, MEBL's gross infection of 2.7% was lower than industry gross infection by 3.4x. Overall gross infection also compares favorably to other large-sized banks.

Given the onset of the pandemic in 2020, SBP rolled out relief measures, which allowed deferment of profit payments. As per management, total deferments under Covid relief, was availed on only 6% of the financing portfolio. Majority of these customers have already repaid the deferred amount. As per management, the outstanding deferred financing portfolio is almost entirely performing and amounts to only 1.7% of the total financing portfolio as of Mar'21.

Rating derives support from strong deposit generation ability

MEBL's liquidity profile is considered strong, as reflected by the Bank's ability to post strong growth in deposits along with an improvement in deposit composition whilst maintaining the lowest cost of funding amongst peers. During the outgoing year, the Bank's deposit base posted a growth of 35%, eclipsing the industry growth rate by about 2x. Of the growth, 72% emanated from retail deposits, which constituted 69% of the deposits as of Dec'20 (Dec'19: 67%). Deposit composition has also depicted notable improvement, as reflected by the proportionate increase in both current and saving accounts, which increased by 49% and 30% respectively. Deposit granularity has improved on a timeline.

With the diversion of excess liquidity towards investment portfolio, liquid assets to deposits and borrowings has risen, from 54.5% as of Dec'19, to 66.2% as of Sep'21. The LCR and NSFR also stand comfortable at 222% and 170% respectively. These measures are aligned with similar-sized banks in the industry.

Profitability indicators compare favorably to peers.

MEBL's profitability indicators, like RoAA & RoAE, depicted growth and these compare favorably to peers. As the branch expansion slowed down during 2020 and on the back of strong volumetric growth in deposits, particularly current deposits, which positively affected the net spread income, the efficiency ratio depicted notable improvement during 2020. At 39.2%, for 2020, the Bank's efficiency ratio was only inferior to 2 banks in the large to medium-sized banks category. Overall provisioning coverage of the NPLs stands higher than 1x. Any material increase in provisioning burden going forward is unlikely. As per management, current provisioning coverage is adequate to cover any additional IFRS 9 related provisions.

Capitalization is comfortable & adequate, albeit CAR lags the large-sized banks

MEBL's capitalization metrics have continued to depict improvement on the back of strong profitability, adequate profit retention, and deployment of excess liquidity in low risk weight assets. The Bank's CAR has continued to increase on a timeline, and is considered to be strong. As of Sep'21, the Bank was maintaining a comfortable cushion over the minimum CAR requirement, set by SBP for D-SIBs.

Existing ADT I and Tier II: The outstanding entity ratings of MBL were upgraded on June 30, 2021, to 'AAA/A-1+'. Based on the revision of ratings, the outstanding ratings of Tier II Sukuk (Sukuk 1 and Sukuk 3) and ADT I Sukuk (Sukuk 2) are being reassessed at 'AAA' (Triple A) and 'AA+' (Double A Plus) respectively.

Planned Tier II Sukuk – Sukuk 4

The Instrument: The Bank is planning to raise its third Shariah Compliant Tier II Capital of upto Rs. 10b (inclusive of a Rs. 3b green shoe option) by way of issuing Mudarabah based Sukuk Certificates. The Issue will be unsecured & sub-ordinated. Tenor of the issue is 10 years and repayment structure is bullet payment at the end of the tenor.

The arrangement involves recalling the Sukuk issued previously on September 22, 2016 amounting to Rs. 7b, and issuing fresh Sukuk with a face value of Rs. 10b (Inclusive of Rs. 3b green shoe option). The Issue shall contribute towards MBL's Tier II Capital for complying with the Capital Adequacy Ratio (CAR) requirements prescribed by SBP under its Basel III framework. The Issue proceeds will contribute towards the Bank's Tier-2 capital and will be utilized towards enhancement of the bank's business operations.

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 (Rs. in billions) | | | | |
|--|------------------|------------------|------------------|------------------|
| BALANCE SHEET | 31-Dec-18 | 31-Dec-19 | 31-Dec-20 | 30-Sep-21 |
| Total Investments | 123.7 | 225.6 | 434.2 | 476.4 |
| Gross Financings | 522.2 | 506.5 | 531.6 | 623.1 |
| Total Assets | 937.9 | 1,121.3 | 1,521.6 | 1,697.7 |
| Borrowings | 36.4 | 42.0 | 94.5 | 139.3 |
| Deposits & other accounts | 785.5 | 932.6 | 1,254.4 | 1,344.2 |
| Subordinated Sukuk (Tier II) | 7.0 | 7.0 | 11.0 | 11.0 |
| Subordinated Sukuk (Tier I) | 7.0 | 7.0 | 7.0 | 7.0 |
| Share Capital | 11.7 | 12.9 | 14.1 | 16.3 |
| Tier-1 Equity | 46.6 | 55.8 | 69.4 | 81.4 |
| Net Worth | 40.3 | 59.0 | 69.2 | 81.8 |
| INCOME STATEMENT | 2019 | 2020 | 9M'2020 | 9M'2021 |
| Net Spread Earned | 46.5 | 64.8 | 49.8 | 48.5 |
| Net Provisioning charge | 4.2 | 8.2 | 4.2 | 0.5 |
| Non-Markup Income | 9.3 | 10.1 | 7.2 | 10.3 |
| Administrative Expenses | 24.8 | 28.8 | 21.9 | 24.9 |
| Profit Before Tax | 26.2 | 36.9 | 30.1 | 32.6 |
| Profit After Tax | 15.2 | 22.2 | 18.1 | 19.6 |
| RATIO ANALYSIS | 31-Dec-18 | 31-Dec-19 | 31-Dec-20 | 30-Sep-21 |
| Market Share (Advances) (%) | 6.62% | 6.21% | 6.26% | 6.71% |
| Market Share (Deposits) (%) | 5.88% | 6.37% | 7.02% | 6.78% |
| Advances to Deposits Ratio (%) | 66.5% | 54.3% | 42.4% | 46.4% |
| Liquid Assets to Deposits & Borrowings (%) | 43.0% | 54.5% | 67.0% | 66.2% |
| NPLs | 7.0 | 9.0 | 14.9 | 14.4 |
| Gross Infection (%) | 1.34% | 1.78% | 2.81% | 2.32% |
| Provisioning Coverage (%) (incl. general prov) | 138.9% | 141.6% | 127.6% | 131.4% |
| Net Infection (%) | 0.04% | 0.14% | 0.26% | 0.21% |
| Cost of deposits (%) | 2.48% | 5.04% | 3.68% | NA |
| Net NPLs to Tier-1 Capital (%) | 0.43% | 1.27% | 1.78% | 1.49% |
| Tier-1 CAR (%) | 12.00% | 12.92% | 13.63% | 15.16% |
| Capital Adequacy Ratio (C.A.R) (%) | 14.55% | 16.58% | 17.82% | 18.98% |
| LCR (%) | 147.0% | 192.0% | 263.0% | 222.0% |
| NSFR (%) | 130.0% | 163.0% | 180.0% | 170.0% |
| Markup Spreads (%) | 4.55% | 6.32% | 6.16% | NA |
| Efficiency (%) | 54.6% | 44.5% | 39.2% | 43.0% |
| ROAA (%) | 1.0% | 1.5% | 1.7% | 1.6%* |
| ROAE (%) | 23.8% | 30.7% | 34.6% | 34.5%* |
| * Annualized | | | | |

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 moderate 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 |
| <u>RATING TYPE: ENTITY</u> | | | | | |
| | 6/30/2021 | AAA | A-1+ | Stable | Upgrade |
| | 6/30/2020 | AA+ | A-1+ | Stable | Reaffirmed |
| | 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 |
| <u>RATING TYPE: Sukuk 4 (Planned Tier II of Rs. 10b)</u> | | | | | |
| | 11/24/2021 | AAA | | Stable | Preliminary |
| | Rating Date | Medium to Long Term | | Rating Outlook | Rating Action |
| <u>RATING TYPE: Sukuk 1 (Tier II Sukuk of Rs. 7b)</u> | | | | | |
| | 11/24/2021 | AAA | | Stable | Upgrade |
| | 6/30/2021 | AA+ | | Stable | Upgrade |
| | 6/30/2020 | AA | | Stable | Reaffirmed |
| | 6/28/2019 | AA | | Stable | Reaffirmed |
| | 5/30/2018 | AA | | Stable | Upgrade |
| | 6/22/2017 | AA- | | Stable | Reaffirmed |
| | 8/31/2016 | AA- | | Stable | Preliminary |
| | 6/29/2016 | AA- | | Stable | Preliminary |
| | Rating Date | Medium to Long Term | | Rating Outlook | Rating Action |
| <u>RATING TYPE: Sukuk 3 (Tier II Sukuk of Rs. 4b)</u> | | | | | |
| | 11/24/2021 | AAA | | Stable | Upgrade |
| | 6/30/2021 | AA+ | | Stable | Upgrade |
| | 6/30/2020 | AA | | Stable | Upgrade |
| | 1/21/2020 | AA | | Stable | Reaffirmed |
| | 11/19/2019 | AA | | Stable | Reaffirmed |
| | Rating Date | Medium to Long Term | | Rating Outlook | Rating Action |
| <u>RATING TYPE: Sukuk 2 (ADT-I Sukuk of Rs. 7b)</u> | | | | | |
| | 11/24/2021 | AA+ | | Stable | Upgrade |
| | 6/30/2021 | AA | | Stable | Upgrade |

| | | | | |
|---|--|-----|--------|-------------|
| | 6/30/2020 | AA- | Stable | Reaffirmed |
| | 6/28/2019 | AA- | Stable | Reaffirmed |
| | 8/20/2018 | AA- | Stable | Final |
| | 6/5/2018 | AA- | Stable | Preliminary |
| Instrument Structures | <p><u>Existing</u> Additional Tier I Sukuk - Unsecured Basel III compliant Tier I Sukuk, subordinated privately placed based on Mudaraba of Rs. 7b as instrument of redeemable capital under section 66 of the Companies Act, 2017. Tier II Sukuk: Basel III compliant Tier 2, privately placed, unsecured & subordinated Sukuk amounting to Rs. 7.0b and Rs. 4b issued in Sep'16 and Jan'20 respectively featuring maturity of 10 years from issue date.</p> <p><u>Planned</u> The Bank is planning to raise its third Shariah Compliant Tier II Capital of upto Rs. 10b (inclusive of a Rs. 3b green shoe option) by way of issuing Mudarabah based Sukuk Certificates. The Issue will be unsecured & sub-ordinated. Tenor of the issue is 10 years and repayment structure is bullet payment at the end of the tenor.</p> <p>The arrangement involves recalling the Sukuk issued previously on September 22, 2016 amounting to Rs. 7b, and issuing fresh Sukuk with a face value of Rs. 10b (Inclusive of Rs. 3b green shoe option).</p> | | | |
| 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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| Due Diligence Meetings Conducted | NA | | | |