

DRAFT RATING REPORT

Meezan Bank Limited (MEBL)

REPORT DATE:

June 27, 2023

RATING ANALYSTS:Musaddeq Ahmed Khan
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RATING DETAILS

Rating Category	Latest Rating		Previous Rating	
	Long-term	Short-term	Long-term	Short-term
Entity	AAA	A-1+	AAA	A-1+
	<i>June 27' 2023</i>		<i>June 29' 2022</i>	
Sukuk 4 (Tier-II)	AAA		AAA	
	<i>June 27' 2023</i>		<i>June 29' 2022</i>	
Sukuk 3 (Tier-II)	AAA		AAA	
Sukuk 2 (ADT-I)	AA+		AA+	
Rating Outlook	Stable		Stable	
Rating Date	<i>June 27' 2023</i>		<i>June 29' 2022</i>	

COMPANY INFORMATION

Incorporated in 1997

External auditors: M/S A.F. Ferguson & Co.,
Chartered Accountants

Listed 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 – Financial Institution (June 2023)

<https://docs.vis.com.pk/docs/FinancialInstitution.pdf>VIS Rating Scale: <https://docs.vis.com.pk/docs/VISRatingScales.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 28 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.

Economic Review

The economy is currently facing several challenges, including a decrease in foreign reserves, a devaluing currency, and high inflation levels. To combat rising inflation, caused by the commodity super cycle and effects of Ukraine war, the central bank has implemented stricter monetary policies, resulting in a significant increase in the policy rate. This has led to higher funding costs for banks and impacted borrowers' debt servicing ability. As a result, banks are adjusting by increasing provisions for potential loan losses and writing off non-performing loans. The economic slowdown will likely prompt stricter lending standards with banks continuing to remain heavily invested in sovereign exposures. Counterbalancing this, rising interest rates should help banks maintain their margins, partially offsetting the decline in earnings and allowing for improved profitability. However, there is increased credit risk and market risk vulnerability, especially in the face of any potential interest rate or currency fluctuations, which could impact the capitalization levels of banks. Looking ahead, the medium to long-term outlook for the fiscal account is challenging because the government is struggling to expand its revenue base. Public debt accumulation is accelerating, crowding out private sector credit. This trend also increases the risk of potential sovereign debt restructuring. Given banking sector balance sheets highly skewed towards Government paper, this could lead to liquidity and profitability challenges, particularly for small and medium-sized banks in the future.

Key Rating Drivers

The assigned rating is underpinned by the strong market position and franchise of MEBL

Meezan Bank Limited ('MEBL' or 'the Bank') is the first and largest Islamic commercial bank in Pakistan. Over the last decade, MEBL has significantly expanded its operations and was the 4th largest bank of Pakistan in terms of deposits and the 3rd largest in terms of financings as of Mar'23, with a market share of 8.87% and 7.60% in terms of financings & deposits respectively (Dec'21: 7.66% & 6.94%). MEBL's network is spread across 972 branches (2021: 902 branches), operating in 324 cities (2021: 290 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%).

MEBL experienced significant changes in asset allocation and deposit composition, showcasing strong growth in business assets and deposits, while maintaining a robust liquidity profile.

The balance sheet depicts significant changes in the asset allocation structure. The financing and investment portfolio dominates, with the combined asset allocation increasing progressively from 72.4% as of Dec'21 to 85.2% as of Mar'23. The Gross Financing to Deposit Ratio (FDR) of the

Bank has increased from 53.4% as at Dec'21 to 58.6% as at Mar'23. However, Liquid Assets to Deposits and Borrowings (LADB) was at 61.7% as of Mar'23 from 60.6% as of Dec'21.

MEBL demonstrates a strong liquidity profile, as evidenced by its ability to achieve significant growth in core deposits, resulting in improved deposit composition and reflected in the lowest cost of funding compared to its peers. As of Mar'23, the Bank's Liquidity Coverage Ratio (LCR) and Net Stable Funding Ratio (NSFR) were comfortably high.

Overall, MEBL has demonstrated positive trends in its asset allocation, deposit base, and market share. The Bank's liquidity profile remains strong.

MEBL demonstrates improved asset quality and maintains favorable position compared to peers, with effective NPL management and high provisioning coverage

Asset quality indicators have improved further on a YoY basis, due to the growth in the portfolio. As of Mar'23, MEBL's gross infection rate of 1.47% was the lowest compared to other 'Large Banks'. The Bank's credit quality is reflective of effective NPL management and strong provisioning coverage, reaching 160.1% as of Mar'23. The unfunded portfolio has experienced significant growth; client concentration remains stable. With the recent rise in the State Bank of Pakistan's (SBP) policy rate, concerns about credit risk are emerging; MEBL appears to be well-positioned in this regard compared to its peers, supported by its higher exposure to blue chip clients and substantial provisioning coverage as of Mar'23.

Healthy financial performance in 2022 was backed by wider spreads, and reflected in an improved Return on Average Assets (RoAA) despite prudent provision taking.

MEBL demonstrates strong financial performance in 2022, with significant growth in spread income driven by higher deployed assets, low cost deposits and underlying benchmark rates. Non-markup income also grew, primarily attributed to fee and commission income. The Bank's efficiency ratio improved as expense growth lagged inflation and given enhanced revenues. As a result, profit before provisions and taxes (PBPT) increased substantially. The provisioning charge also saw a significant rise, but remained lower than the industry average. MEBL's superior asset quality indicators and high provisioning coverage is likely to limit additional provisioning costs in future periods, indicating further increase in earnings in 2023.

Strong capital adequacy aligns with the VIS benchmark for the assigned rating.

Strong capitalization buffers are evident, with strong profitability and a restricted dividend payout of 33.8% in 2022. The Bank's Capital Adequacy Ratio (CAR) surpasses the minimum requirement set by the State Bank of Pakistan (SBP) and meets the benchmark for a 'AAA' rating by VIS. CAR is expected to remain comfortable, supported by strong internal capital generation potential, robust credit quality indicators, and lower exposure to market risk compared to peers.

Meezan Bank Limited
Appendix I

FINANCIAL SUMMARY (Rs. in billions)				
<u>BALANCE SHEET</u>				
	31-Dec-21	31-Dec-22	31-Mar-23	
Total Investments	620.1	1,283.2	1,281.9	
Gross Advances	777.3	1,018.1	1,049.2	
Net Advances	758.1	995.5	1,024.5	
Total Assets	1,903.0	2,577.4	2,707.9	
Borrowings	220.4	573.3	601.3	
Deposits & other accounts	1,455.9	1,658.5	1,791.2	
Subordinated Sukuk (Tier II)	14.0	14.0	14.0	
Subordinated Sukuk (Tier I)	7.0	7.0	7.0	
Paid-up Capital	16.3	17.9	17.9	
Tier-1 Equity	87.9	120.3	127.5	
Net Shareholder Equity (excl. revaluation)	82.5	116.0	126.1	
<u>INCOME STATEMENT</u>				
	2021	2022	1Q22	1Q23
Net Mark-up Income	68.9	121.7	21.4	41.0
Net Provisioning charge	1.0	4.2	0.2	2.1
Non-Markup Income	14.9	19.1	4.3	3.9
Operating Expenses	34.4	46.2	10.0	14.3
Profit Before Tax	47.5	88.4	15.1	27.8
Profit After Tax	28.4	45.0	9.2	15.4
<u>RATIO ANALYSIS</u>				
	31-Dec-21	31-Dec-22	31-Mar-23	
Market Share (Advances) (%)	7.7%	8.5%	8.9%	
Market Share (Deposits) (%)	6.9%	7.4%	7.6%	
Non-Performing Loans (NPLs)	14.4	13.6	15.4	
Gross Infection (%)	1.9%	1.3%	1.5%	
Total Provisioning Coverage (%) (incl. general prov.)	132.9%	165.8%	160.6%	
Net Infection (%)	0.1%	0.1%	0.2%	
Cost of deposits (%)	2.33%	3.58%	4.12%	
Net NPLs to Tier-1 Capital (%)	1.2%	0.6%	1.4%	
Gross Financings to Deposits Ratio (%)	53.4%	61.4%	58.6%	
Tier-1 CAR (%)	14.00%	15.69%	16.19%	
Capital Adequacy Ratio (C.A.R) (%)	17.81%	18.42%	18.89%	
Markup Spreads (%)	5.04%	6.47%	7.80%	
Efficiency (%)	41.6%	33.1%	32.1%	
Liquidity Coverage Ratio (LCR) (%)	222.0%	284%	208%	
Net Stable Funding Ratio (NSFR) (%)	165.0%	157%	163%	
ROAA (%)	1.7%	2.0%	2.3%*	
ROAE (excl. revaluation) (%)	38.8%	45.4%	51.0%*	
Liquid Assets to Deposits & Borrowings (%)	60.6%	63.8%	61.7%	
* Annualized				

REGULATORY DISCLOSURES					Appendix II
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>					
	6/27/2023	AAA	A-1+	Stable	Reaffirmed
	6/29/2022	AAA	A-1+	Stable	Reaffirmed
	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</u>					
	6/27/2023	AAA		Stable	Reaffirmed
	6/29/2022	AAA		Stable	Reaffirmed
	12/31/2021	AAA		Stable	Final
	6/30/2021	AAA		Stable	Preliminary
	Rating Date	Medium to Long Term		Rating Outlook	Rating Action
<u>RATING TYPE: Sukuk 3</u>					
	6/27/2023	AAA		Stable	Reaffirmed
	6/29/2022	AAA		Stable	Reaffirmed
	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 2</u>					
	6/27/2023	AA+		Stable	Reaffirmed
	6/29/2022	AA+		Stable	Reaffirmed
	11/24/2022	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>Sukuk 2: Additional Tier I Sukuk - Unsecured Basel III compliant Tier I Sukuk, sub-ordinated privately placed based on Mudaraba of Rs. 7b as instrument of redeemable capital under section 66 of the Companies Act, 2017.</p> <p>Sukuk 3: Basel III compliant Tier 2, privately placed, unsecured & subordinated Sukuk amounting to Rs. Rs. 4b issued Jan'20 respectively featuring maturity of 10 years from issue date.</p> <p>Sukuk 4: Tier II Capital of Rs. 10b (inclusive of a Rs. 3b green shoe option). The Issue is unsecured & sub-ordinated. Tenor of the issue is 10 years and repayment structure is bullet payment at the end of the tenor.</p>			
Statement by the Rating Team	<p>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.</p>			
Probability of Default	<p>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.</p>			
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Due Diligence Meetings Conducted	Name	Designation	Date	
	Mr. Muhammad Abdullah Ahmed	Group Head Corporate & Institutional Banking	May 23, 2023	
	Mr. Syed Tariq Hassan	Chief Risk Officer		
	Mr. Syed Imran Ali Shah	Chief Financial Officer		