RATING REPORT

Al-Baraka Bank (Pakistan) Limited

REPORT DATE:
July 05, 2018

RATING ANALYSTS:
Talha Iqbal Chhoangalia
talha.iqbal@jcrvis.com.pk

Asfia Aziz
asfia.aziz@jcrvis.com.pk

RATING DETAILS

Rating Category	Latest Rating		Previous Rating	
	Long-term	Short-term	Long-term	Short-term
Entity	A+	A-1	A+	A-1
Sukuk (Rs. 2b)	A		A (Preliminary)	
Outlook	Negative		Stable	
Date	*June 29, 2018*		*May 17, 2017*	

COMPANY INFORMATION

Incorporated in December 2004	**External auditors:** Ernst & Young Ford Rhodes Chartered Accountants
Key Shareholders (with stake 5% or more):	**Chairman of the Board:** Mr. Adnan Ahmed Yousif
Al Baraka Islamic Bank B.S.C: 59.1%	**Chief Executive Officer:** Mr. Ahmed Shuja Kidwai
Islamic Corporation for the Development of the private Sector: 11.9%	
Mal Al Khaleej Investment LLC: 11.5%	

APPLICABLE METHODOLOGY

JCR-VIS Commercial Banks Rating *http://jcrvis.com.pk/docs/Meth-CommercialBanks201803.pdf*

Al-Baraka Bank (Pakistan) Limited

OVERVIEW OF THE INSTITUTION

Owned in majority by Al Baraka Islamic Bank B.S.C. Bahrain, a member of Al-Baraka Banking Group (ABG), Al-Baraka Bank (Pakistan) Limited (ABPL) has presence in more than 16 countries and has a strong franchise in the area of Islamic banking.

Profile of Chairman

Mr. Adnan Ahmed Yousif, serves as the Chairman of the Board. Mr. Yousif's experience spans over 39 years in international banking and is also currently serving as chairman of several Islamic Banks in Middle East.

Profile of CEO

Mr. Ahmed Shuja Kidwai, possesses around 39 years of banking experience in the domestic and international banking industry. He was appointed as the CEO in March'2018 in place of Mr. Shafqaat Ahmed.

RATING RATIONALE

Al-Baraka Bank (Pakistan) Limited (ABPL) was incorporated as a subsidiary of Al-Baraka Islamic Bank B.S.C, which is domiciled in the Kingdom of Bahrain. The parent is part of Al-Baraka Banking Group B.S.C (ABG). In Nov'2016, Burj Bank Limited (BBL) merged its operations with ABPL under the name of Al Baraka Bank (Pakistan) Limited.

Strong Sponsor Support

A key rating driver to the assigned ratings is ABPL's association with the Al-Baraka Banking Group (ABG); a prominent Islamic Banking Group having diversified operations in 16 countries. The Islamic International Rating Agency (IIRA) and Dagong Global Credit Rating Company Limited have jointly assigned ratings of BBB+/A3 (Triple B Plus/A Three) to ABG on the international scale. IIRA has also assigned ratings of BBB-/A3 (Triple B Minus/A Three) to Al Baraka Islamic Bank B.S.C., the major sponsor, on the international scale.

Diversification in financing mix noted through growth in high yielding CBSME and consumer portfolio. Asset quality indicators have room for improvement while some recoveries have been noted in the ongoing year.

Financing portfolio increased by 6% during 2017. Growth in financing portfolio was witnessed in high yielding consumer and CBSME segment; proportion of both segments in financing mix has increased to 43% (2016: 39%; 2015: 32%) at end-2017. Overall exposures are diversified with the largest sectoral exposure being to food & beverage, textiles and chemical and pharmaceutical segment. However, asset quality indicators compare less favorably vis-à-vis JCR-VIS's benchmark for the assigned ratings. Moreover, significant increase in infection in the CBSME portfolio has been noted. Given the sizeable overdue portfolio, risk of fresh accretion in NPFs remains. ABPL has also realized sizeable forced sale value benefit (FSV) amounting to Rs. 2.6b (2016: Rs. 2.25b) at end-2017. Management intends to minimize the provisioning expense arising on account of FSV benefit withdrawal through recoveries from NPFs.

Credit risk emanating from investment portfolio is considered manageable; exposure to market risk has increased on a timeline basis.

Net investments stood lower at Rs. 19.4b (2016: Rs. 24.6b) at end-Dec'2017 on account of maturity of GoP Ijarah Sukuk of around Rs. 14b. Proceeds of maturing GIS was deployed in higher yielding fixed rate GIS and Bai Muajjal with SBP. Credit risk emanating from the investment portfolio is considered manageable given the sizeable exposure in sovereign/government guaranteed investments and provisions undertaken for non-performing Sukuk. Exposure to market risk has increased on a timeline basis given the higher investment in fixed rate GIS (expectation of further increase in benchmark rates) and increase in equity exposure. Given the significant decline in benchmark index due to political uncertainty, market value of equity portfolio is significantly below cost.

Deposit base witnessed attrition as part of a deliberate strategy to improve deposit mix; cost of deposits depicted a noticeable decline. While remaining within regulatory requirements, liquidity buffers have weakened.

Deposit base of the Bank declined to Rs. 98.6b (2016: Rs. 105.8b) at year-end'2017. Decline in deposit base is attributable to a deliberate strategy to reduce deposit cost through improving deposit mix. Resultantly, proportion of CASA in deposit mix increased to 76% (2016: 67%) while cost of deposits decreased to 2.95% (2016: 3.4%). Given the decline in deposit base and increase in advances portfolio, ADR ratio increased to 75% (2017: 73%; 2016: 64%) at end-1Q18. Liquid assets in relation to deposits and borrowings declined to 33% (2017: 35%; 2016: 43%) at end-1Q18 while net stable funding ratio declined to 108% (2016: 118%).

After concerted efforts on spread improvement and rationalization of expenses in 2017, ABPL achieved operational breakeven in 1Q18. Provisioning expense continue to be a drag on overall profitability profile.

Quantum of operating losses witnessed a declining trend during 2017 due to improvement in spread (increase in return on earning assets and reduction in cost of deposits), rationalization of administrative expenses (cost reduction initiatives including closure/consolidation of loss making branches along with synergies from the merger) and increase in fee based income. ABPL achieved operational break even during 1Q18 with efficiency (cost to income) ratio being reported at 100%. Given the volumetric growth in earning assets, expected increase in spreads due to hike in benchmark rates and limited increase in administrative expenses, efficiency ratio is projected to reduce to 95% during 2018. Further reduction in the same in line with JCR-VIS's benchmark for the assigned ratings is considered important. Quantum of overall profitability would depend on materialization of planned recoveries.

Tier-1 CAR has weakened on a timeline basis and are below regulatory requirements. Proposed Tier-1 Sukuk issuance in the ongoing year is planned to allow ABPL to achieve compliance with regulatory requirements.

At end-1Q18, net equity of ABPL was slightly above the minimum regulatory capital requirement of Rs. 10b. Tier-1 and overall CAR of the Bank were reported below regulatory requirement at 7.72% (2017: 7.82%; 2016: 8.75%) and 10.02% (2017: 10.17%; 2016: 10.26%), respectively at end-1Q18. Weak capitalization indicators are evident from net-NPLs in relation to Tier-1 equity being significantly higher vis-à-vis JCR-VIS benchmark for the assigned ratings at 44% (2017: 53%; 2016: 39%) at end-1Q18. ABPL is in the process of issuing a Basel 3 compliant Tier 1 instrument which will allow the Bank to comply with regulatory requirements. In the backdrop of increasing regulatory CAR requirements, higher deduction of deferred tax from Tier-1 capital and growth plans of ABPL, maintaining buffer over regulatory requirements in line with benchmarks for the assigned ratings through internal capital generation will be challenging.

FINANCIAL SUMMARY *(amounts in PKR millions) – Annexure I*

BALANCE SHEET	**2015**	**2016**	**2017**	**1Q18***
Investments	17,358	24,602	19,393	19,710
Islamic Financing & Other Assets	47,645	66,785	71,203	72,012
Total Assets	86,933	126,799	120,661	118,783
Borrowings	5,865	4,652	5,852	6,094
Deposits & other accounts	71,644	105,843	98,590	96,974
Subordinated Loans	3,757	1,429	2,643	2,500
Tier-1 Equity	6,288	10,985	10,590	10,369
Net Worth	6,273	11,390	10,762	10,513
INCOME STATEMENT	**2015**	**2016**	**2017**	**1Q18***
Net Spread Earned	2,478	3,189	3,640	3,769
Net Provisioning / (Reversal)	125	31	(98)	(1,479)
Non-Markup Income	656	1,224	968	1,059
Operating Expenses	(2,849)	(5,150)	(4,929)	(4,739)
Profit/ (Loss) Before Tax	407	(856)	(531)	(1,390)
Profit / (Loss) After Tax	240	(718)	(389)	(885)
RATIO ANALYSIS	**2015**	**2016**	**2017**	**1Q18***
Market Share (Advances)	1.1%	1.3%	1.2%	NA
Market Share (Deposits)	0.8%	0.9%	0.8%	NA
Gross Infection	8.00%	10.05%	10.14%	9.59%
Provisioning Coverage	72%	60%	56%	63%
Net Infection	2.45%	4.38%	4.84%	3.92%
Cost of deposits	4.59%	3.40%	2.95%	3.03%
Gross Advances to Deposits Ratio	68%	64%	73%	75%
Net NPLs to Tier-1 Capital	16%	39%	53%	44%
Capital Adequacy Ratio (CAR)	14.54%	10.26%	10.17%	10.02%
Markup Spreads	3.62%	3.29%	3.97%	4.05%
Efficiency	92%	128%	109%	100%
ROAA	0.3%	-0.7%	-0.3%	-0.7%
ROAE	3.9%	-8.3%	-3.6%	-8.4%
Liquid Assets to Deposits & Borrowings	41%	43%	35%	33%

** 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 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	Al-Baraka Bank (Pakistan) Limited
Sector	Commercial Banks
Type of Relationship	Solicited
Purpose of Rating	Entity Rating/Sukuk

Rating History

Rating Date	Medium to Long Term	Short Term	Rating Outlook	Rating Action
RATING TYPE: ENTITY				
29- June-18	A+	A-1	Negative	Maintained
17-May-17	A+	A-1	Stable	Upgrade
30-Jun-16	A	A-1	Rating Watch Developing	Maintained
29-Jun-15	A	A-1	Positive	Maintained
30-Jun-14	A	A-1	Stable	Reaffirmed
28-Jun-13	A	A-1	Stable	Reaffirmed
29-Jun-12	A	A-1	Stable	Reaffirmed
04-Jul-11	A	A-1	Stable	Initial
RATING TYPE: Tier 2 Sukuk				
29- June-18	A		Negative	Maintained
5-Sept-17	A		Stable	Final
17-May-17	A		Stable	Preliminary

Instrument Structure	Basel 3 compliant Tier 2 unsecured, subordinated, and privately placed Sukuk to the tune of Rs. 1.5b. The tenor of the Sukuk is seven years maturing in 2024. Profit is payable on a semi-annual basis @ 6M KIBOR+0.75%.
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.
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