

RATING REPORT

Al Baraka Bank (Pakistan) Limited

REPORT DATE:

June 30, 2024

RATING ANALYST:

Basel Ali Assad

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RATING DETAILS				
Rating Category	Latest Rating		Previous Rating	
	Long-term	Short-term	Long-term	Short-term
Entity	A+	A-1	A+	A-1
Sukuk – 2 nd Issue	A		A	
Sukuk – 3 rd Issue	A		A	
Outlook/Rating Watch	Positive		Stable	
Date	June 30, 2024		June 27, 2023	
Rating Action (Entity)	Maintained		Reaffirmed	
Rating Action (Sukuk – 2 nd Issue)	Maintained		Reaffirmed	
Rating Action (Sukuk – 3 rd Issue)	Maintained		Reaffirmed	

COMPANY INFORMATION

Incorporated in December 2004

External auditors: A. F. Ferguson & Co.

Key Shareholders (with stake 5% or more):

Chief Executive Officer: Mr. Muhammad Atif Hanif

Al Baraka Islamic Bank B.S.C: 59.13%

Islamic Corporation for the Development of the private Sector: 11.85%

Mal Al Khaleej Investment LLC: 11.53%

Sheikh Tariq Bin Faisal Khalid Al Qassemi: 7.50%

APPLICABLE METHODOLOGY

Rating Methodology – Financial Institution

<https://docs.vis.com.pk/Methodologies%202024/Financial-Institution-v2.pdf>

Rating The Issue

<https://docs.vis.com.pk/docs/Rating-the-Issue-Aug-2023.pdf>

VIS Rating Scale

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

Al Baraka Bank (Pakistan) Limited

OVERVIEW OF
THE INSTITUTION

Majority owned by Al Baraka Islamic Bank B.S.C. Bahrain, a member of Al Baraka Group (ABG), Al Baraka Bank (Pakistan) Limited (ABPL) has a network of 170 branches across Pakistan and has sound franchise in the area of Islamic banking.

Profile of CEO

Muhammad Atif Hanif has amassed 24 years of banking experience, with 17 of those years spent in Islamic Banking. He has worked in various capacities within retail and corporate banking in both Islamic and conventional banking sectors, including positions at The Bank of Khyber, HBL Islamic, Dubai Islamic Bank, and Bank Alfalah. Prior to his banking career, he has experience of 4 years in Capital markets.

RATING RATIONALE

Al Baraka Bank (Pakistan) Limited ('ABPL' or 'the Bank') was incorporated as a subsidiary of Al Baraka Islamic Bank B.S.C, which is domiciled in the Kingdom of Bahrain. The parent company is part of Al Baraka Group (ABG).

Banking Sector

The banking sector in Pakistan has been navigating a challenging macroeconomic landscape. Despite facing headwinds such as high inflation, elevated interest rates, and geopolitical uncertainties, the sector has demonstrated resilience and adaptability in supporting economic stability.

One of the important factors contributing to the sector's resilience has been its strong capitalization and liquidity. Banks in Pakistan remain well-capitalized, with an industry-wide CAR of 19.7%. This ensures that banks are equipped to absorb potential shocks and maintain financial stability. Moreover, profitability metrics remain healthy, with a return on equity (ROE) of 27.1% based on CY-23 results, underscoring the sector's ability to generate sustained returns amidst challenging operating conditions.

The government's successful negotiation of the IMF's Stand-By Arrangement (SBA) program, culminating in a Staff-Level Agreement and disbursement of funds, has provided additional support to market confidence and exchange rate stability, with positive implications for the banking sector. In terms of monetary policy dynamics, the State Bank of Pakistan (SBP) has maintained a cautious stance, balancing the imperative of containing inflationary pressures while supporting economic growth. As the headline inflation has moderated from peak levels, though remains elevated, prompting the SBP to decrease the policy rate by 150bps to 20.5% in its latest monetary policy statement. This stance reflects the central bank's commitment to anchoring inflation expectations and safeguarding macroeconomic stability.

Looking ahead, the banking sector faces both challenges and opportunities. Continued vigilance in managing credit quality and liquidity risks will be vital, especially amidst evolving macroeconomic dynamics and policy uncertainties. Moreover, the sector's role in supporting the government's reform agenda, particularly in areas such as taxation, energy, and privatization of state-owned enterprises, will be critical in fostering sustainable economic growth and financial stability.

Key Rating Drivers**Sponsor support and management change**

A key rating driver to the assigned ratings is ABPL's association with the Al Baraka Group (ABG); a prominent Islamic Financial Group having diversified operations in 13 countries offering Retail, Corporate, Investment Banking and Treasury Services strictly in accordance with the principles of Islamic Shariah. The asset base of ABG is around USD 25.3b (CY22: 25b), and it has a total equity of USD 2.0b (CY22: 2.0b) at end-Dec'23.

The Islamic International Rating Agency (IIRA) has assigned ratings of BBB+/A3 (Triple B Plus/A Three) to ABG on the international scale. IIRA has also assigned ratings of BB/A3 (Double B/A Three) with stable outlook to Al Baraka Islamic Bank B.S.C., the major sponsor, on the international scale. Support from the parent has been witnessed in the past and VIS expects this support to continue, going forward.

The management has taken certain initiatives including induction of senior human resource, enhancement of IT infrastructure and security, improvement in risk management policies and procedures, launching of comprehensive training programs, revamping of branch network, and hiring of a consultant for the implementation of ESG framework and onboarding of the new team to take the bank forward.

ABPL maintained a cautious approach to financing due to the high policy rate and challenging macroeconomic conditions

ABPL's gross financing portfolio witnessed a decline of 5.9% by end-Mar'24 vis-a-vis end-Dec'22 whereas the overall industry depicted a marginal 0.4% growth in financing. Consequently, the Bank's market share in financing also decreased to 0.7% at end-Mar'24 compared to 0.8% at end-Dec'22. Going forward, the management intends to expand its gross financing portfolio to avoid potential additional tax liabilities imposed on banks with an Advances to Deposit ratio (ADR) of less than 50%. However, the overall financing strategy will remain cautious by focusing largely on well-established corporate entities owing to the ongoing macroeconomic challenges and high benchmark rates.

Some deterioration in asset quality indicators was witnessed during CY23 amid challenging macroeconomic environment

In tandem with decline in the gross financing portfolio and increase in Non-Performing Financing (NPFs) due to the challenging macroeconomic conditions, gross infection increased to 13.9% (CY22: 12.2%; CY21: 11.6%) and remained at 14% by end-Mar'24. Additionally, given that rise in NPFs outstripped specific provisioning taking into account eligible FSV benefit on collateral, Net infection also increased to 2.8% (FY22: 2.3%) at end-Dec'23. Nevertheless, with timeline decrease in Net NPLs to Tier-1 Equity, the overall credit risk related to financing portfolio is considered manageable. However, compared to small-sized banking peers, asset quality indicators still have room for improvement.

The overall provision coverage (specific plus general) has been increasing on a timeline basis to 103.2% (FY23: 91.2%; FY22: 86.4%; FY21: 77.1%) by end-Mar'24. Going forward, given that the macroeconomic environment is likely to remain stressed in the foreseeable future, some build up in infection rates may be expected. However, with planned increase in corporate lending to well-established entities and some recoveries are expected by the management against NPFs, asset quality indicators may depict some improvement. Nonetheless, the overall credit risk is likely to remain manageable.

Investments

ABPL's investments increased over the rating review period as excess liquidity was channeled primarily into Ijarah Sukuks and to some extent into foreign securities amidst the high policy rate environment. Given that the overall investment portfolio comprises largely of government securities, the associated credit risk is also considered minimal. Additionally, despite the majority of portfolio being categorized as securities at fair value through other comprehensive income (FVOCI), the overall weighted average duration amounts to less than a year and floating rate instruments comprise around 90% of the portfolio which provides protection against Mark-to-Market (MTM) losses. Going forward, the management aims to continue its conservative investing approach. Moreover, the risks related to investment in companies through capital market and non-government debt instruments is considered minimal as the quantum of these investment is modest in the overall investment portfolio.

Improving trend in liquidity and increasing proportion of low-cost deposits

ABPL's deposit base expanded during CY23 largely owing to uptick in retail current deposits; with trailing industry deposit expansion, the Bank's market share is decreasing slightly on a timeline basis. Moreover, with a higher proportion of Current Account Saving Account (CASA), the Bank's mobilization of low-cost funding improved. The overall deposit composition, while diversified, depicted increase in concentration on a timeline basis. Given higher liquid assets, the ratio of liquid assets relative to deposits and borrowings improved further by end-Dec'23. Going forward, the planned network expansion is viewed positively in terms of deposit growth.

ABPL's profitability improved during CY23 due to uptick in net markup income driven by mobilization of low-cost deposits and high profit rates with a focus on efficiency measures and prudent provisioning

ABPL's profitability performance depicted a marked improvement over the rating review period on the back of mobilization of low-cost deposits and monetary tightening implemented by the SBP to curb rising inflation, with benchmark profit rates rising by 600 bps in CY23 vis-à-vis SPLY. Consequently, with expansion of net spreads, the Bank's net markup income augmented during CY23. Additionally, non-markup income increased owing to higher foreign exchange earnings and fees & commission income. Resultantly, despite increase in operating expenses, the efficiency ratio depicted marked improvement with sizeable uptick in recurring income. Thereby, despite higher provision charge, profit before tax increased significantly to Rs. 6.1b (CY22: Rs. 2.6b; CY21: Rs. 674m) in CY23. With higher incidence of taxation, bottom-line increased to Rs. 3.1b (CY22: Rs. 1.5b) in CY23. Despite some pressure on spreads, increase in operating expenses and higher effective taxation, net profit stood higher on the back of higher non-fund based income and reversal in loan loss provisions during 1QCY24. The positive trend in operating performance is being tracked for further improvement in ratings, going forward.

Going forward, with recent decrease in policy rates and further decrease expected during 2HCY24 alongside the Bank's competitive loan pricing strategy to build up its financing portfolio, pressure on net spreads is expected which are likely to affect profitability performance; however, the management's focus on mobilization of low-cost funding may help in alleviating pressure on spread to a certain extent. Moreover, further reversal in provisions is projected which may support profitability.

Timeline improvement in capitalization indicators

As of Mar'24, ABPL remained fully compliant with all regulatory requirements related to its capital structure. The Bank's Capital Adequacy Ratio (CAR) has shown a positive trajectory on a timeline basis to 20.9% (CY23: 19.3%, CY22: 15.8%) in March 2024, despite taking into account impact of IFRS 9; the same is mainly attributable to uptick in Tier-I Capital on the back of higher profit retention. Additionally, Risk-Weighted Assets (RWA) also declined over the rating review period largely on account of lower credit risk due to contraction in financing. However, going forward, moderation in CAR is expected owing to planned expansion of the financing portfolio coupled with expected tightening in net spreads; nonetheless, the same is expected to remain comfortably above regulatory requirements.

The capital structure of the Bank entails a Capital Support Fund (CSF) to the tune of Rs. 1.4b which was injected by the parent Bank. These funds can only be remitted after prior approval of SBP. In case capital of the Bank is not increased through alternate plans, the said capital support fund will be converted into Share Capital of the Bank. Presently, SBP has allowed the Bank, extension for the conversion process of CSF into Share capital till June 30, 2024; the management has applied for further extension of the same.

Al Baraka Bank (Pakistan) Limited
Appendix I

FINANCIAL SUMMARY (amounts in PKR mln)				
BALANCE SHEET	2021	2022	2023	1QCY24
Investments	76,552	109,900	122,881	117,576
Due from Financial Institutions	403	-	8,099	4,876
Net Islamic Advances and Related Assets	96,202	86,057	79,756	77,461
Cash and balances	27,372	16,691	23,560	21,532
Other Assets	17,588	19,927	21,078	23,763
Total Assets	218,117	232,575	255,374	245,208
Due to Financial Institutions	8,969	12,950	7,650	7,162
Deposits & other accounts	178,917	185,049	207,338	199,108
Subordinated Loans	4,624	4,624	4,624	4,624
Other Liabilities	12,193	15,347	17,508	16,095
Total Liabilities	204,703	217,970	237,120	226,989
Paid-Up Capital (net)	14,500	14,500	14,500	14,500
Tier-1 Equity	12,934	14,428	17,460	17,518
Net Worth	13,415	14,605	18,253	18,219
INCOME STATEMENT	2021	2022	2023	1QCY24
Net Spread Earned	6,530	8,446	13,363	3,007
Net (Provisioning) / Reversal	(2,208)	(1,057)	(1,567)	280
Non-Markup Income	1,982	1,791	2,117	704
Operating Expenses	(5,615)	(6,435)	(7,646)	(2,105)
Profit/ (Loss) Before Tax	674	2,636	6,124	1,849
Profit / (Loss) After Tax	631	1,510	3,104	954
RATIO ANALYSIS	2021	2022	2023	1QCY24
Market Share (Advances)	1.0%	0.8%	0.7%	0.8%
Market Share (Deposits)	0.9%	0.8%	0.7%	0.7%
Liquid Assets to Deposits & Borrowings	53.5%	61.6%	69.6%	67.5%
Gross Infection	11.6%	12.2%	13.9%	14.0%
Provisioning Coverage (specific & general)	77.1%	86.4%	91.2%	103.2%
Net Infection (based on specific provision)	3.2%	2.3%	2.8%	2.4%
Cost of deposits	3.8%	7.3%	10.0%	10.8%
Markup Spreads	4.3%	5.0%	7.4%	6.4%
Gross Advances to Deposits Ratio*	54.0%	45.8%	40.4%	41.9%
Net NPLs to Tier-1 Capital	27.7%	15.2%	13.1%	9.7%
Tier-I CAR	10.5%	13.3%	16.4%	18.0%
Capital Adequacy Ratio (CAR)	13.0%	15.8%	19.3%	20.9%
LCR	186.3%	184.1%	213.9%	205.5%
NSFR	168.2%	180.0%	216.6%	203.5%
Efficiency	67.2%	63.1%	49.7%	57.0%
ROAA	0.3%	0.7%	1.3%	1.5%**
ROAE	5.0%	11.0%	19.5%	21.8%**

*Adjusted for SBP Borrowings

**Annualized

REGULATORY DISCLOSURES					Appendix II
Name of Rated Entity	Al Baraka Bank (Pakistan) Limited				
Sector	Commercial Banks				
Type of Relationship	Solicited				
Purpose of Rating	Entity & Instrument Ratings				
Rating History	Rating Date	Medium to Long Term	Short Term	Outlook/Rating Watch	Rating Action
	<u>RATING TYPE: ENTITY</u>				
	30-June-24	A+	A-1	Positive	Maintained
	27-June-23	A+	A-1	Stable	Reaffirmed
	29-June-22	A+	A-1	Stable	Reaffirmed
	23-June-21	A+	A-1	Stable	Reaffirmed
	27-June-20	A+	A-1	Stable	Reaffirmed
	28-June-19	A+	A-1	Stable	Maintained
	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
	<u>RATING TYPE: Tier II Sukuk – 2nd Issue</u>				
	30-June-24	A		Positive	Maintained
	27-June-23	A		Stable	Reaffirmed
	29-June-22	A		Stable	Reaffirmed
	23-June-21	A		Stable	Maintained
	27-June-20	A		Stable	Maintained
	28-June-19	A		Stable	Maintained
	29-June-18	A		Negative	Maintained
	5-Sept-17	A		Stable	Final
	17-May-17	A		Stable	Preliminary
	<u>RATING TYPE: Tier II Sukuk – 3rd Issue</u>				
30-June-24	A		Positive	Maintained	
27-June-23	A		Stable	Reaffirmed	
29-June-22	A		Stable	Final	
23-June-21	A		Stable	Preliminary	
Instrument Structure	<p>Sukuk – 3rd Issue: Basel 3 compliant Tier 2 unsecured, subordinated, and privately placed Sukuk to the tune of Rs. 1.735b. The tenor of the Sukuk is ten years maturing in 2031. Profit is payable on a semi-annual basis @ 6M KIBOR+1.5%.</p> <p>Sukuk – 2nd Issue: 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%.</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		Name	Designation	Date
	1	Mr. Tamim Shabbir	Chief Financial Officer	10-May-2024
	2	Mr. Sayed Nasir Ahmed Khizer Pasha	Chief Risk Officer	
	3	Mr. Syed Asad Hasan	Head of Credit	
	4	Mr. Khurram Shahzad	Head of Enterprise Risk Management	
	5	Mr. Asim Asif	Head of Commercial Banking & SME	