RATING REPORT

Al-Baraka Bank (Pakistan) Limited

REPORT DATE:
July 2, 2019

RATING ANALYSTS:
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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 (Rs. 2b)	A		A	
Outlook	Stable		Negative	
Date	*June 28, 2019*		*June 29, 2018*	

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

VIS Commercial Banks Rating *https://s3-us-west-2.amazonaws.com/backupsqlvis/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 a wide network of over 190 branches in 97 cities and towns across Pakistan 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 40 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 40 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 is a key rating driver

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 17 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.

Financing portfolio is diversified. Given the legacy non-performing exposures, infection in the portfolio is on the higher side. Credit growth is expected to remain muted in the ongoing year while enhanced focus on recoveries is planned to improve asset quality indicators. Given the high ADR and weak macro-economic conditions, close monitoring of exposures is warranted.

Gross financing portfolio increased to Rs. 79.7b (2017: Rs. 75.5b) at end-Dec'2018 depicting a growth of 6% on year-on-year basis. Growth in financing base was largely manifested by the consumer portfolio (increase of 27% in 2018) followed by CBSME segment increasing by 12% in 2018. Consequently, proportion of consumer and commercial portfolio increased to 21% (2017: 20%) and 25% (2017: 23%), respectively at end-2018 while proportion of corporate portfolio declined to 54% (2017: 57%). Sectoral exposures are diversified with lending to textile sector representing the largest exposure at around 12.2% (2017: 11.9%) at end-2018. Other large sectoral exposures include food products, beverages and chemical & pharmaceutical segment. Gross and net infection in the portfolio was reported at 9.8% and 4.1%, respectively at end-1Q19. Higher net infection and lower provisioning coverage is a function of cash collaterals and sizeable FSV benefit held by the Bank. However, provisioning coverage is projected to increase. Going forward, credit growth is expected to remain prudent in the ongoing year while enhanced focus on recoveries is planned to improve asset quality indicators. Given the high ADR and weak macro-economic conditions, close monitoring of exposures is warranted.

Credit risk emanating from investment portfolio is considered low; exposure to market risk is considered manageable

Net investments stood higher at Rs. 24.9b (2017: Rs. 19.4b) at end-1Q19. Increase was manifested in higher investment in Pakistan Energy Sukuk issued by the Government. The Bank plans to build further exposure in this segment, going forward. Credit risk emanating from the investment portfolio is considered low given sizeable exposure in sovereign/government guaranteed investments and complete provisions made for non-performing Sukuk. Given the limited investment in fixed rate GoP Ijarah Sukuk and listed equities, overall exposure to market risk is considered manageable. Market value of equity portfolio is significantly below cost.

Deposit profile has witnessed improvement with reduction in depositor concentration levels. Overall growth in deposit base remained below budgeted levels. ADR ratio is on the higher side but is projected to decline from current levels. Overall liquidity profile is adequate.

Deposit base of the Bank increased to Rs. 98b (2018: Rs. 99.9b; 2017: Rs. 96.6b) at end-Mar'2019.

Deposit base of the bank witnessed a high of Rs. 107.4b at end-June'2018; however the same witnessed attrition at end-Dec'18. Contribution of CASA in deposit mix witnessed a decline to 72% (2017: 75%) at end-2018. However, depositor concentration levels witnessed improvement in 2018. For 2019, management has targeted to grow deposit base to Rs. 123b with focus on low cost core deposits. Liquidity buffer carried on the balance sheet is adequate with liquid assets in relation to deposits and borrowings reported at 34% at end-Mar'2019. Basel III liquidity coverage ratio (LCR) and net stability funding ratio (NSFR) were in compliance with regulatory requirements and were reported at 110% and 122%, respectively at end-Mar'2019.

Given the concerted efforts on spread improvement and rationalization of expenses, ABPL posted significant jump in operating profits in 2018 vis-à-vis operating loss in 2017. Improvement in profitability profile will continue with VIS expecting operating profitability to double in 2019 as compared to 2018 driven by spread improvement and volumetric growth in earning assets. Quantum of overall profitability will depend on provisioning charges on financing portfolio

The bank reported operating profitability in 2018 due to improvement in spreads, higher fee and FX income, rationalization of administrative expenses (completion of consolidation of loss making branches and merger synergies). Consequently, efficiency ratio of the bank noted sizeable improvement to 90% (2017: 109%) while operating profit amounted to Rs. 538m (2017: operating loss of Rs. 404m) in 2018. Going forward, improvement in spreads, volumetric growth in financings and focused management of administrative expenses is expected to result in operating profits being almost double in 2019 vis-à-vis 2018. During 2018, the Bank incurred a loss of Rs. 254m due to higher provisioning charges. Quantum of overall profitability would continue to depend on provisioning charges and materialization of planned recoveries.

Capitalization indicators were compliant with regulatory requirements at end-March'2019. Internal capital generation along with issuance of Basel 3 capital instrument and management of risk weighted assets is planned to comply with regulatory requirements

At end-1Q19, net equity of ABPL was above the minimum regulatory capital requirement of Rs. 10b. Tier-1 and overall CAR of the Bank were reported at par with regulatory requirement at 9.44% (2017: 7.82%) and 11.95% (2017: 10.17%), respectively. Improvement in capitalization indicators was a function of reduction in risk weighted assets and issuance of Basel 3 compliant Tier-1 instrument in the outgoing year to the tune of Rs. 1.4b. Leverage ratio of the Bank was reported at 5.21% (2018: 5.35%) vis-à-vis regulatory requirement of 3%. While improving on a timeline basis, net NPLs in relation to tier-1 equity continued to remain on the higher side at 40% (2017: 53%) at end-Mar'2019. Internal capital generation along with issuance of Basel 3 capital instrument and management of risk weighted assets is planned to allow the Bank to achieve compliance with regulatory requirements.

Strengthening IT infrastructure and foray into digital banking remain key focus areas

Since last review, management has taken a number of initiatives for strengthening IT infrastructure including up-gradation of main servers, establishing independent & dedicated IT security function, activation of a DR site and dual connectivity link for all branches. On the digital banking front, the bank is working on digitizing the account opening process while revamping the mobile banking app and launch of mobile wallet and e-commerce transactions are also planned for the ongoing year.

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

BALANCE SHEET	**2015**	**2016**	**2017**	**2018**	**1Q19***
Investments	17,358	24,602	19,393	21,345	24,975
Islamic Financing & Related Assets	47,645	66,785	71,203	75,012	73,869
Total Assets	86,933	128,712	122,652	128,813	129,361
Borrowings	5,865	4,652	5,852	7,582	9,182
Deposits & other accounts	71,644	103,320	96,623	99,915	98,024
Subordinated Loans	3,757	1,429	2,643	3,746	3,604
Tier-1 Equity	6,288	10,985	10,590	10,352	10,422
Net Worth	6,273	11,390	10,762	10,705	10,700
INCOME STATEMENT	**2015**	**2016**	**2017**	**2018**	**1Q19***
Net Spread Earned	2,478	3,189	3,640	4,217	1,254
Net (Provisioning) / Reversal	125	31	(98)	(766)	(160)
Non-Markup Income	656	1,224	968	1,097	292
Operating Expenses	(2,849)	(5,150)	(4,929)	(4,783)	(1,246)
Profit/ (Loss) Before Tax	407	(856)	(531)	(245)	139
Profit / (Loss) After Tax	240	(718)	(389)	(254)	70
RATIO ANALYSIS	**2015**	**2016**	**2017**	**2018**	**1Q19***
Market Share (Advances)	1.1%	1.3%	1.2%	1.0%	NA
Market Share (Deposits)	0.8%	0.9%	0.8%	0.7%	NA
Gross Infection	8.00%	10.05%	10.14%	8.80%	9.82%
Provisioning Coverage	72%	60%	56%	68%	63%
Net Infection	2.45%	4.38%	4.84%	3.20%	4.08%
Cost of deposits	4.59%	3.40%	2.95%	3.47%	4.72%
Gross Advances to Deposits Ratio**	68%	66%	75%	76%	77%
Net NPLs to Tier-1 Capital	16%	39%	53%	32%	40%
Capital Adequacy Ratio (CAR)	14.54%	10.26%	10.17%	11.77%	11.95%
Markup Spreads	3.62%	3.29%	3.97%	4.42%	5.33%
Efficiency**	92%	128%	109%	90%	82%
ROAA	0.3%	-0.7%	-0.3%	-0.2%	0.2%
ROAE	3.9%	-8.3%	-3.6%	-2.4%	2.7%
Liquid Assets to Deposits & Borrowings**	41%	44%	35%	33%	34%

** Annualized*
*** Calculated as per VIS's internal criteria*

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	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				
	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
	RATING TYPE: Tier 2 Sukuk				
	28-June-19	A		Stable	Maintained
	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	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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