RATING REPORT

Al-Baraka Bank (Pakistan) Limited

REPORT DATE:
July 03, 2020

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		Stable	
Date	*June 27, 2020*		*June 28, 2019*	

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 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) has 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) with negative outlook to Al Baraka Islamic Bank B.S.C., the major sponsor, on the international scale.

Exposure of banking sector to credit risk is elevated due to significant impact of Covid-19 on already weak macroeconomic indicators. Financing portfolio is diversified. Asset quality indicators have weakened due to fresh NPL accretion from legacy portfolio while provisioning coverage is on the lower side due to sizeable FSV benefit availed by the Bank.

Given the challenging macroeconomic environment, ABPL pursued a conservative lending strategy with limited growth in financing portfolio in 2019. Gross financing portfolio increased to Rs. 81.3b (2018: Rs. 79.8b) at end-Dec'2019 depicting a growth of 1.9% on year-on-year basis. Growth in financing base was largely manifested in corporate (sovereign, low risk weight and cash backed exposures) and consumer segment while CBSME portfolio declined. Going forward, management would continue to pursue a prudent strategy with fresh lending comprising exposure to sovereigns, lending under SBP's payroll financing scheme and some growth in consumer financing. However, given the maturities from existing portfolio and sharp decline in fresh disbursements (due to Covid-19) maintaining growth momentum from the consumer segment would be a challenge; although declining interest rates may provide support to auto volumes once Covid-19 situation improves.

Overall asset quality indicators have weakened due to addition of fresh NPLs during 2019 and 1Q20. Net infection is considerably on the higher side vis-à-vis rating benchmark while provisioning coverage is low due to sizeable FSV benefit realized by the Bank. Infection is highest in the CBSME portfolio followed by Corporate segment while asset quality of the consumer portfolio compares favorably to peers. While fresh NPL accretion is expected to remain limited due to 1 year principal extension by SBP and other regulatory relief measures issued by the government, provisioning charges are expected to remain elevated primarily due to FSV benefit expiry and also partly due to due to change in classification of NPLs. Overall exposure to credit risk from the performing portfolio is considered high given the quality of exposures (particularly for CBSME portfolio), weak macroeconomic indicators and sizeable slowdown expected in GDP growth due to impact of Covid-19. VIS expects already weak asset quality indicators to remain under pressure post expiry of principal extension period by SBP.

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

Net investments stood higher at Rs. 24.2b (2018: Rs. 21.3b) at end-2019. Increase was manifested in higher investment in Pakistan Energy Sukuk (PES) issued by the Government. With issuance of 2nd tranche of PES in May 2020 exposure in this segment has increased further. Fund deployment will be towards liquid sovereign investments. In contrast to preceding years, sizeable fresh Shariah compliant sovereign instrument issuances planned are expected to remain sufficient to cater to liquidity requirements of the Islamic banking sector. 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 as at end-March 2020.

Deposit base witnessed healthy growth in 2019 while liquidity buffers have improved. However, deposit profile in terms of depositor concentration and deposit mix has room for improvement.

Deposit base of the Bank increased to Rs. 132.8b (2019: Rs. 129.7b; 2018: Rs. 99.9b) at end-Mar'2020. Proportion of current and saving account deposits in deposit mix declined to 20% (2018: 24%) and 40% (2018: 46%), respectively, with growth in deposits primarily emanating from term deposits. Contribution of CASA in deposit mix witnessed a decline to 60% (2018: 70%) at end-2019. Moreover, depositor concentration increased and is on the higher side vis-à-vis rating benchmarks. Given the decline in ADR, liquidity buffer carried on the balance sheet has witnessed a noticeable increase with liquid assets in relation to deposits and borrowings reported at 50% (2019: 48%; 2018: 33%) at end-Mar'2020. Basel III liquidity coverage ratio (LCR) and net stability funding ratio (NSFR) also increased and were reported at 218.8% (2019: 124.3%; 2018: 110.9%) and 162.26% (2019: 162.38%; 2018: 122.11%), respectively at end-Mar'2020. Given the current liquidity buffers and future fund deployment planned in liquid sovereign instruments, ABPL is adequately positioned to deal with liquidity pressures that may arise in the current challenging operating environment and sizeable deferment of principal by clients.

Operating profitability depicted strong growth on the back of spread improvement and higher fee based income. While overall profitability profile has improved, sizeable provisioning charges continued to be a drag on overall profitability. Ratings remain dependent on improvement in overall profitability levels.

Operating profit posted by ABPL more than doubled to Rs. 1.3b (2018: Rs. 538m) on the back of spread improvement (68bps), higher fee income (broad based growth across all key areas including branch banking, trade and consumer finance; however investment banking income declined) and significant jump in forex income (due to currency volatility). Strong focus on cost controls alongwith consolidation of loss making branches and merger synergies has resulted in administrative expenses growing at a CAGR of less than 1% over the last 3 years. Resultantly, efficiency ratio improved to 80% (2018: 90%) during 2019. However, translation of improved operating profitability did not translate into significant jump in net profit due to higher provisioning charges with the Bank posting a meager profit before tax of Rs. 7.5m (2018: loss before tax of Rs. 245m). Going forward, VIS expects operating profitability improvement to sustain in the ongoing year (despite immediate repricing of consumer loans) due to aggressive focus on deposit cost rationalization and volumetric growth in earning assets. However, repricing of assets at lower rates is expected to result in pressure on spreads from 2021 as has been witnessed historically. Ratings remain dependent on sustaining operating profitability profile over the medium term while continuous improvement in quantum of overall profits is warranted.

Equity injection by sponsors facilitated the Bank in achieving compliance with regulatory requirement. VIS expects CAR to remain above regulatory requirement over the rating horizon.

At end-1Q20, net equity of ABPL was above the minimum regulatory capital requirement of Rs. 10b. Equity base increased by Rs. 1.39b due to capital injection by the sponsor in 2019. Tier-1 and overall CAR of the Bank were reported above regulatory requirement at 10.49% (2019: 10.6%; 2018: 9.27%) and 12.87% (2019: 13.3%; 2018: 11.77%), respectively. Improvement in capitalization indicators was a function of capitalization support from the sponsor. While declining on a timeline basis, leverage ratio of the Bank was reported at 4.3% (2019: 4.3%; 2018: 5.35%) well above the regulatory requirement of 3%. However, net-NPL to Tier-1 equity is on significantly on the higher side vis-à-vis rating benchmark and also as compared to peer Banks. VIS expects CAR to remain above regulatory requirement over the rating horizon given the conservative lending strategy planned to be pursued by the management. As per management, reduction in CCB requirement by 1% alongwith internal capital generation and further equity injection is projected to allow ABPL some room to grow when the operating environment improves.

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

BALANCE SHEET	2015	2016	2017	2018	2019	Q1'20
Investments	17,358	24,602	19,393	21,345	24,195	23,392
Islamic Financing & Other Assets	47,645	66,785	71,203	75,012	75,444	76,175
Total Assets	86,933	128,712	122,652	128,813	161,982	165,189
Borrowings	5,865	4,652	5,852	7,582	7,739	7,529
Deposits & other accounts	71,644	103,320	96,623	99,915	129,654	132,847
Subordinated Loans	3,757	1,429	2,643	3,746	3,461	3,318
Share Capital	13,740	13,107	13,107	13,107	14,500	14,500
Tier-1 Equity	6,288	10,985	10,590	10,352	11,546	13,837
Net Worth	6,273	11,390	10,762	10,705	12,732	12,657

INCOME STATEMENT	2015	2016	2017	2018	2019	Q1'20
Net Spread Earned	2,478	3,189	3,640	4,217	5,350	1,304
Net (Provisioning) / Reversal	125	31	(98)	(766)	(1,188)	(192)
Non-Markup Income	656	1,224	968	1,097	1,091	654
Operating Expenses	(2,849)	(5,150)	(4,929)	(4,783)	(5,215)	(1,366)
Profit/ (Loss) Before Tax	407	(856)	(531)	(245)	8	373
Profit / (Loss) After Tax	240	(718)	(389)	(254)	(192)	224

RATIO ANALYSIS	2015	2016	2017	2018	2019	Q1'20
Market Share (Advances)	1.1%	1.3%	1.2%	1.0%	1.0%	
Market Share (Deposits)	0.8%	0.9%	0.8%	0.7%	0.9%	
Gross Infection	8.00%	10.05%	10.14%	8.80%	11.38%	11.98%
Provisioning Coverage	72%	60%	56%	68%	63%	61%
Net Infection	2.45%	4.38%	4.84%	3.20%	4.73%	5%
Cost of deposits	4.59%	3.40%	2.95%	3.47%	6.28%	
Gross Advances to Deposits Ratio	68%	66%	70%	71%	55%	54%
Net NPLs to Tier-1 Capital	16%	39%	53%	32%	40%	43%
Capital Adequacy Ratio (CAR)	14.54%	10.26%	10.17%	11.77%	13.30%	12.87%
Markup Spreads	3.62%	3.29%	3.97%	4.38%	5.05%	
Efficiency	92%	128%	109%	90%	80%	76%
ROAA	0.3%	-0.7%	-0.3%	-0.2%	-0.1%	0.5%
ROAE	3.9%	-8.3%	-3.6%	-2.4%	-1.8%	8%
Liquid Assets to Deposits & Borrowings	41%	44%	35%	33%	48%	50%

** 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: 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				
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
RATING TYPE: Tier 2 Sukuk				
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

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.
Disclaimer	Information herein was obtained from sources believed to be accurate and reliable; however, VIS does not guarantee the accuracy, adequacy or completeness of any information and is not responsible for any errors or omissions or for the results obtained from the use of such information. VIS is not an NRSRO and its ratings are not NRSRO credit ratings.

Due Diligence Meetings Conducted

	Name	Designation	Date
1	Mr. Kazim Raza	Group Head Retail Banking	7th May 2020
2	Mr. Abdullah Ghaffar	Group Head Corporate & Investment Banking	7th May 2020
3	Mr. Tamim Shabbir	Chief Financial Officer	7th May 2020