RATING REPORT

Al-Baraka Bank (Pakistan) Limited

REPORT DATE:
09 July, 2021

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	
Sukuk (Rs. 2b)- Preliminary	A		-	
Outlook	Stable		Stable	
Date	*June 23, 2021*		*June 27, 2020*	

COMPANY INFORMATION

Incorporated in December 2004	**External auditors:** EY Ford Rhodes Chartered Accountants
Key Shareholders (with stake 5% or more):	**Chairman of the Board:** Tariq Mahmood Kazim (Acting)
Al Baraka Islamic Bank B.S.C: 59.13%	**Chief Executive Officer:** Mr. Ahmed Shuja Kidwai
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

VIS Commercial Banks Rating
https://s3-us-west-2.amazonaws.com/backupsqlvis/docs/Meth-CommercialBanks202006.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 90 cities and towns across Pakistan and has a strong franchise in the area of Islamic banking.

Profile of Chairman

Deputy Chairman, Mr. Tariq Mahmood Kazim is now the Acting Chairman, after the resignation of Adnan Ahmed Yousif after a longtime association with Al Baraka Group. Mr. Tariq has over 36 years of industry experience and currently serves as the General Manager of Business Group of Al Baraka Islamic Bank B.S.C.

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 company is part of Al-Baraka Banking Group B.S.C (ABG). In November 2016, Burj Bank Limited (BBL) merged its operations with ABPL under the name of Al Baraka Bank (Pakistan) Limited.

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 BB/A3 (Double B/A Three) with negative 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.

Portfolio growth picked up on the back of capital support from sponsors. Focus remained on cautious lending. Asset quality indicators improved amid limited growth in Non-Performing Financing's (NPF's) and higher provisioning, albeit remaining higher than rating benchmarks.

On the back of capital support extended by sponsors towards end-FY19; gross advances grew by 19.8% to Rs. 97b by end-2020, and Rs. 107bn by Q1'FY21. Consequently, ADR increased to 61% during Q1'FY21 (FY20: 53%; FY19: 55%). The bank continued to pursue a selective growth strategy given the challenging macro-economic environment and capital limitations. Growth was largely manifested in Corporate and Consumer segments, while exposure in Commercial segment was reduced noting higher infection in the segment in the past. Fresh lending has been concentrated in sovereign, low risk and cash based exposures. Consumer portfolio prime focus has been on auto loans. The loan book remains fairly diversified, with food sector reflecting some concentration in 2020 on account of Government backed commodity exposures booked during the year. However, given the strong focus on corporate segment, counterparty concentration has increased over time, although comfort can be derived from the fact that exposures comprise of government clientele. Going forward, ABPL is planning to issue a Tier II instrument in 2021 for Rs. 2b, including a green shoe option of Rs. 500m. With this planned issue, management aims to continue to pursue a prudent growth strategy with a focus on sovereign lending, refinance schemes and low risk weight industries such as pharma and auto segment in consumer financing.

Asset quality indicators recorded improvement in FY20 amid largely intact NPF's and higher provisioning. Gross and net infection reduced to 9.1% (FY20: 9.8%; FY19: 11.4%) and

3.1% (FY20: 3.3%; FY19: 4.7%) respectively during Q1FY'21; albeit remaining higher than rating benchmark. Provisioning coverage recorded a significant improvement from 63% in FY19 to 75% during Q1'FY21. However, NPF accretion in FY20 remained limited due to COVID deferments allowed by SBP, the outcome of which is yet to be seen. Overall credit risk remains elevated. Further weakening expected on account of new NPF addition in the pipeline. Maintaining asset quality indicators in line with rating benchmarks is considered an important rating driver going forward.

Low credit risk emanating from investment portfolio

Investments have more than doubled during FY20 to Rs. 57b (FY19: Rs. 24b) with higher investment in 2nd tranche of Pakistan Energy Sukuk (PES) issued by the Government in 2020. Credit risk emanating from the investment portfolio is considered low given sizeable exposure in sovereign/government guaranteed investments. Given no sizable Shariah compliant sovereign instrument issuances in the pipeline, Islamic banking sector may face constraints in deploying liquidity in the long run.

Momentum in deposit growth continued. Liquidity buffers remain adequate. Deposit mix and concentration needs further improvement.

The momentum in deposit growth continued in FY20, in line with industry recording an increase of 23% to Rs. 159.3b (2019: Rs. 129.7b; 2018: Rs. 99.9b). Deposits at end-Q1'FY21 stands at Rs. 154.7b. Market share was maintained at ~1%. Proportion of current and saving account deposits in deposit mix at end-Q1'FY21 was at 23% (2020: 25%; 2019: 21%; 2018: 26%) and 45% (2020: 43%; 2019: 44%; 2018: 52%), respectively. On a timeline basis, while the composition has fluctuated slightly, the mix has not recorded any significant change since 2018. Moreover, depositor concentration has been deteriorating over the years and remains on the higher side vis-à-vis rating benchmarks.

Liquidity buffers remain adequate with liquid assets in relation to deposits and borrowings reported at 46% (2020: 50%; 2019: 48%; 2018: 33%) at end-Q1'FY21. Basel III liquidity coverage ratio (LCR) and net stability funding ratio (NSFR) have also increased on a timeline basis and were reported at 161.3% (FY20: 185.3%; FY19: 124.3%; FY18: 110.9%) and 164.3% (FY20: 174.7%; FY19: 162.4%; FY18: 122.1%), respectively at end-Q1'FY21. Given current liquidity levels and future deployment of funds to remain vested in sovereign instruments, ABPL is adequately positioned to deal with liquidity pressures that may arise in the future.

Profitability posted on the back of higher earning assets together with contained expenses. However, sizable provisioning coverage continue to be a drag on overall profitability.

Volumetric growth in earning assets improved profitability in FY20, which was the first year after four years the bank returned to profitability. Spreads slightly declined in FY20, however, the impact was more pronounced in Q1'FY21, with repricing of deposits and deployment of funds in low yielding sovereign exposures. Fee income growth was constrained across all areas with the exception of trade fees due to branch closures and SBP restrictions on service fees under COVID relief. An uptick in forex income (FY20: Rs. 966m; FY19: Rs. 735m) also provided support to the bottom line. Strong focus on cost rationalization continued including streamlining of loss making branches. Resultantly, efficiency ratio improved to 67% in FY20 (FY19: 80%; FY18: 90%). Notable improvement has been noted in efficiency levels over the years. The increase in operating profitability, however, did not fully trickle down due to higher provisioning charges. Going forward, as per management, targeted volumetric growth and focus on trade and remittance business for higher fee income together with cost containment is expected to sustain and enhance profitability although provisioning burden will continue to be a drag.

Capitalization indicators remain compliant with regulatory requirements.

Tier-1 and Capital Adequacy Ratio (CAR) of the Bank were in compliance with regulatory requirements at 11.22% (FY19: 10.60%; FY18: 9.27%) and 12.90% (FY19: 13.30%; FY18: 11.77%), respectively, during FY20. However, the cushion in CAR is low given provisioning coverage stands at 75%. Leverage ratio, while declining on a timeline basis, was reported at 4.12% (2019: 4.3%; 2018: 5.35%) during FY20 well above the regulatory requirement of 3%. However, net-NPF to Tier-1 capital at 27% remained significantly higher than rating benchmark. The planned Tier II instrument in 2021 is expected to provide some cushion in CAR to absorb any adverse movement in credit risk till such time planned portfolio growth is materialized. VIS expects capitalization indicators to remain compliant with regulatory requirements over the rating horizon, however prudent lending strategy as planned by the management and improvement in profitability will remain an important factor.

Tier II Instrument:

Al Baraka Bank is in the process of issuing an unsecured, subordinated, privately placed Mudarba Sukuk amounting up to Rs. 2b (inclusive of green shoe option of Rs. 500m). The tenor of the instrument would be ten years with bullet payment on maturity in 2031. The proceeds shall be invested in the General Pool of the Bank and will be used to support future growth, while remaining compliant with the CAR prescribed by the SBP under its Basel III framework. Profit will be payable semi-annually in arrears on the outstanding investment amount.

Priority: In terms of priority of claims, Al Baraka Tier II Sukuk will rank superior to the claims of ordinary shareholders.

Non-performance risk: Non-performance risk for the instrument is characterized by presence of point of lock-in and loss absorbency clause. While the regulatory framework may not consider a missed coupon payment as a default; the credit rating methodology employed by VIS would treat such missed payments as an event of default. In normal course of business, VIS believes that chances of non-performance risk are considered remote given adequate capital buffers which will be enhanced further post issuance of the Tier II instrument.

FINANCIAL SUMMARY ***(amounts in PKR millions)***				***Annexure I***	
BALANCE SHEET	2017	2018	2019	2020	Q1'21
Investments	19,393	21,345	24,195	57,117	59,772
Islamic Financing & Other Assets	71,203	75,012	75,444	90,279	99,418
Total Assets	122,652	128,813	161,982	192,814	196,891
Borrowings & Subordinated Loans	5,852	7,582	7,739	8,897	16,167
Deposits & other accounts	96,623	99,915	129,654	159,364	154,685
Subordinated Loans	2,643	3,746	3,461	3,175	3,032
Share Capital	13,107	13,107	14,500	14,500	14,500
Shareholder's Equity	10,590	10,352	11,546	12,306	12,679
Net Worth	10,762	10,705	12,732	13,029	13,337
INCOME STATEMENT	**2017**	**2018**	**2019**	**2020**	**Q1'21**
Net Spread Earned	3,640	4,159	5,011	6,376	1,602
Net (Provisioning) / Reversal	(98)	(766)	(1,188)	(1,198)	(168)
Non-Markup Income	968	1,154	1,430	1,886	565
Operating Expenses	(4,929)	(4,783)	(5,215)	(5,394)	(1,357)
Profit/ (Loss) Before Tax	(531)	(245)	8	1,538	618
Profit / (Loss) After Tax	(389)	(254)	(192)	764	373
RATIO ANALYSIS	**2017**	**2018**	**2019**	**2020**	**Q1'21**
Market Share (Advances)	1.2%	1.0%	1.0%	1.1%	1.2%
Market Share (Deposits)	0.8%	0.7%	0.9%	0.9%	0.9%
Gross Infection	10.14%	8.80%	11.38%	9.77%	9.11%
Provisioning Coverage	56%	68%	63%	74%	75%
Net Infection	4.84%	3.20%	4.73%	3.25%	3.05%
Cost of deposits	2.95%	5.82%	9.74%	4.45%	NA
Gross Advances to Deposits Ratio	70%	71%	55%	53%	61%
Net NPFs to Tier-1 capital	53%	32%	40%	27%	27%
Capital Adequacy Ratio (CAR)	10.17%	11.77%	13.30%	12.90%	12.71%
Markup Spreads	3.97%	4.09%	4.09%	4.21%	NA
Efficiency	109%	90%	80%	67%	67%
ROAA	-0.3%	-0.2%	-0.1%	0.4%	0.8%*
ROAE	-3.6%	-2.4%	-1.8%	6.4%	11.9%*
Liquid Assets to Deposits & Borrowings	35%	34%	49%	50%	46%
**** 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				
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
RATING TYPE: Tier 2 Sukuk				
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
RATING TYPE: Tier 2 Sukuk (Preliminary)				
23-June-21	A		Stable	Preliminary

Instrument Structure	**Sukuk (Rs. 2b) - Preliminary:** Basel 3 compliant Tier 2 unsecured, subordinated, and privately placed Sukuk to the tune of Rs. 2b. The tenor of the Sukuk is ten years maturing in 2031. Profit is payable on a semi-annual basis @ 6M KIBOR+1.5%. **Sukuk (Rs. 2b):** 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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Due Diligence Meetings Conducted

	Name	Designation	Date
1	Mr. Ahmed Shuja Kidwai	Chief Executive Officer	May 3, 2021
2	Mr. Abdullah Ghaffar	Group Head Corporate & Investment Banking	May 3, 2021
3	Mr. Tamim Shabbir	Chief Financial Officer	May 3, 2021
4	Mr. Akif Imtiaz	Group Head Retail Banking	May 3, 2021
5	Mr. Muhammad Raza Dyer	Head of Operations	May 3, 2021
6	Mr. Masroor Hussain Rao	Chief Internal Auditor	May 3, 2021
7	Mr. Javed Husain Siddiqi	Chief Risk Officer	May 3, 2021
8	Mr. Shahid Sumar	Chief Information Officer	May 3, 2021