

RATING REPORT

Al-Baraka Bank (Pakistan) Limited

REPORT DATE:

June 27, 2023

RATING ANALYSTS:

Musaddeq Ahmed Khan

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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	Stable		Stable	
Date	June 27, 2023		June 29, 2022	
Rating Action (Entity)	Reaffirmed		Reaffirmed	
Rating Action (Sukuk – 2 nd Issue)	Reaffirmed		Reaffirmed	
Rating Action (Sukuk – 3 rd Issue)	Reaffirmed		Final	

COMPANY INFORMATION

Incorporated in December 2004

External auditors: A. F. Ferguson & Co.

Key Shareholders (with stake 5% or more):

Chairman of the Board: Dr. Jehad El-Nakla

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

Chief Executive Officer: Mr. Muhammad Atif Hanif

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 (June 2023)

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

VIS Rating Scale

<https://docs.vis.com.pk/docs/VISRatingScales.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 Group (ABG), Al-Baraka Bank (Pakistan) Limited (ABPL) has a wide network of 170 branches across Pakistan and has a strong franchise in the area of Islamic banking.

Profile of Chairman

Dr. Jihad El-Nakla is the Chairman of BoD. In addition to that, he is a Senior Advisor at Acreditus Partners and has previously served at Moody's Investors Service Middle East and had been a member of Board Committees for a number of institutions around the globe. He has over thirty five years of experience in commercial banking and credit rating agency at senior levels as well as possessing strong credit, risk management and financial analysis skills.

Profile of CEO

Muhammad Atif Hanif has amassed an 23 years of banking experience, with 16 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

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 economy is currently facing several challenges, including a decrease in foreign reserves, a devaluing currency, and high inflation levels. To combat rising inflation, caused by the commodity super cycle and effects of Ukraine war, the central bank has implemented stricter monetary policies, resulting in a significant increase in the policy rate. This has led to higher funding costs for banks and impacted borrowers' debt servicing ability. As a result, banks are adjusting by increasing provisions for potential loan losses and writing off non-performing loans. The economic slowdown will likely prompt stricter lending standards with banks continuing to remain heavily invested in sovereign exposures. Counterbalancing this, rising interest rates should help banks maintain their margins, partially offsetting the decline in earnings and allowing for improved profitability. However, there is increased credit risk and market risk vulnerability, especially in the face of any potential interest rate or currency fluctuations, which could impact the capitalization levels of banks. Looking ahead, the medium to long-term outlook for the fiscal account is challenging because the government is struggling to expand its revenue base. Public debt accumulation is accelerating, crowding out private sector credit. This trend also increases the risk of potential sovereign debt restructuring. Given banking sector balance sheets highly skewed towards Government paper, this could lead to liquidity and profitability challenges, particularly for small and medium-sized banks in the future.

Key Rating Drivers

Sponsor Support is a key rating driver

A key rating driver to the assigned ratings is ABPL's association with the Al-Baraka Group (ABG); a prominent Islamic Banking Group having diversified operations in 15 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 25.0b (2021: 27.8b), and it has a total equity of USD 2.0b (2021: 2.0b) at end-Dec'22.

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.

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.

ABPL maintained a cautious approach to financing due to rising policy rates and deteriorating economic situation

ABPL's gross financing portfolio witnessed a decline of 14.2% as of Mar'23 when compared to Dec'21, which is in contrast with industry trend of 16.6% growth in financings. Consequently, the Bank's market share in financing also decreased from 1.04% in Dec'21 to 0.77% in Mar'23. Additionally, considering the current scenario of rising policy rates and deteriorating economic conditions, the management plans to adopt cautious approach in financing to all segments.

Gross non-performing financing ratio was on a higher side as compared to Dec'21, however net infection level was on the lower side as a result of the higher provisioning coverage.

ABPL's gross financing portfolio witnessed a decline of 14.2% as of Mar'23 when compared to Dec'21, resultantly gross infection increased to 13.6% (Dec'22: 12.2%; Dec'21: 11.6%). Gross infection ratio has constantly been increasing on a timeline basis. With increased specific and general provisioning, net infection is on the lower side, however remains more than peers in terms of Teir-1 Equity. The specific provision coverage ratio has increased from 74.8% as of Dec'21 to 79.0% as of Mar'23, while the total provisioning coverage ratio also increased from 77.1% to 84.7% over the same period.

ABPL's portfolio depicts high, although reducing counterparty concentration as of Dec'22.

Improved Liquidity Position and Stable Deposit Base

Deposit base of the Bank grew by 6.1% during Jan'22-Mar'23 and was below the industry growth rate. Accordingly, the Bank's market share slightly declined from 0.85% as of Dec'21 to 0.80% as of Mar'23. Moreover, concentration in the deposit base remains on the higher side. However, the Bank has witnessed an improvement in its liquidity position, with a significant 29.6% growth in liquid assets as of Mar'23. Higher liquidity at hand has been channeled into increased investments in GoP Ijarah Sukuk. Consequently, Liquid Assets to Deposits and Borrowings (LADB) increased to 63.5% (Dec'22: 62.5%; Dec'21: 53.5%) by the end of Mar'23. Liquidity indicators, including liquidity coverage ratio (LCR) and net stable funding ratio (NSFR), also remained at satisfactory levels and exceed regulatory requirements as of Mar'23.

ABPL's profitability improved in 2022 due to higher net markup income, driven by monetary tightening, with a focus on efficiency measures and prudent provisioning for future stability.

In 2022, the State Bank of Pakistan (SBP) implemented a monetary tightening policy, which resulted in high benchmark rates for most of the year. The average benchmark rate in 2022 was approximately 550 basis points higher than in 2021. Consequently, ABPL, like other banks in the industry, witnessed an increase in its spread in 2022. As a result, ABPL's net markup income saw a significant rise of 29.4% in 2022. However, the Bank's non-markup income experienced a decline of 9.6% during the same period. Due to increase in markup income, the efficiency ratio of the Bank also improved to 63.2% in 2022 from 67.2% in 2021. Accordingly, in 2022, ABPL reported higher profit after tax of Rs. 1.5b compared to Rs. 631m in 2021.

In 1Q'23, the Bank reported profit after tax of Rs. 744m (1Q'22: Rs. 324m) driven by growth in current account deposit in 1Q'23. Going forward, the Bank aims to boost profitability by implementing efficiency measures and capitalizing on higher spreads, while remaining cautious on the business front, in view of inflationary pressures and a challenging macroeconomic environment, and potentially higher provisioning requirements.

Capitalization indicators remain compliant with regulatory requirements.

As of Mar'23, ABPL remained fully compliant with all regulatory requirements related to its capital structure. The Bank's net equity increased notably due to significant growth in profitability. The Capital Adequacy Ratio (CAR) at the end of Mar'23 was reported to be 16.98%, which was comfortably above the required level of 11.5%. The Tier I CAR and Common Equity Tier I (CET I) also shows an increasing trend over the years.

Capital structure of the Bank entails a Capital Support Fund 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.

Al-Baraka Bank (Pakistan) Limited

Appendix I

FINANCIAL SUMMARY (amounts in PKR millions)			Annexure I
BALANCE SHEET	Dec'21	Dec'22	Mar'23
Investments	76,552	109,900	110,011
Islamic Financing & related assets - net	96,202	86,057	80,206
Total Assets	218,117	233,668	240,488
Due to Financial Institutions	8,969	12,950	15,783
Deposits & other accounts	178,917	185,049	189,793
Subordinated Loans	4,624	4,624	4,624
Paid up Capital	13,740	13,740	13,740
Tier-1 Equity	10,861	12,816	13,639
Net Worth	13,415	14,605	15,099
INCOME STATEMENT	2021	2022	1Q2023
Net Spread Earned	6,530	8,446	2,802
Net Provisioning	(2,208)	(1,057)	(285)
Non-Markup Income	1,982	1,791	588
Operating Expenses	(5,615)	(6,435)	(1,755)
Profit Before Tax	674	2,636	1,314
Profit After Tax	631	1,510	744
RATIO ANALYSIS	Dec'21	Dec'22	Mar'23
Market Share (Advances)	1.0%	0.8%	0.8%
Market Share (Deposits)	0.9%	0.8%	0.8%
Gross Infection	11.6%	12.2%	13.6%
Total Provisioning Coverage (incl. general prov.)	77.1%	86.4%	84.7%
Net Infection	3.2%	2.3%	3.2%
Cost of deposits	3.8%	7.3%	9.5%
Gross Financing to Deposits Ratio*	54.0%	45.8%	41.9%
Net NPLs to Tier-1 Capital (adj. for General Prov.)	27.7%	15.2%	18.0%
Capital Adequacy Ratio (CAR)	12.97%	15.80%	16.98%
Markup Spreads	4.3%	5.0%	6.5%
Efficiency	67.2%	63.2%	51.8%
LCR	186.3%	184.1%	196.2%
NSFR	168.2%	180.0%	182.8%
ROAA	0.3%	0.7%	1.3%**
ROAE (shareholder's equity)	5.0%	11.0%	20.1%**
Liquid Assets to Deposits & Borrowings	53.5%	62.5%	63.5%

*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 Rating/Sukuk				
Rating History	Rating Date	Medium to Long Term	Short Term	Rating Outlook	Rating Action
	<u>RATING TYPE: ENTITY</u>				
	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>				
	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>				
	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	08-May-2023
	2	Mr. Asim Asif	Group Head CBSME and Acting Group Head CIBG	
	3	Mr. Jawaid Iqbal	Acting Head of Risk Management	
	4	Mr. Syed Farhan Ahmed	Acting Head of Credit	