# RATING REPORT

# Bank Alfalah Limited

**REPORT DATE:**
June 30, 2018

**RATING ANALYSTS:**
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## RATING DETAILS

| | Latest Rating | | Previous Rating | |
|---|---|---|---|---|
| **Rating Category** | **Long-term** | **Short-term** | **Long-term** | **Short-term** |
| **Entity** | AA+ | A-1+ | AA+ | A-1+ |
| **Rating Outlook** | Stable | | Stable | |
| ***Rating Date*** | *29th June, '18* | | *31st August, '17* | |
| **TFC (Tier-1)** | AA- | | AA- | |
| **Rating Outlook** | Stable | | Stable | |
| ***Rating Date*** | *29th June, '18* | | *17th January, '18* | |

## COMPANY INFORMATION

| | |
|---|---|
| **Incorporated in 1992** | **External auditors:**<br>**2017:** KPMG Taseer Hadi & Co. Chartered Accountants<br>**2018:** EY Ford Rhodes & Co. Chartered Accountants |
| **Public Limited Company** | **Chairman of the Board:** H.H. Sheikh Nahayan Mabarak Al Nahayan |
| **Key Shareholders (with stake 5% or more):** | **Chief Executive Officer:** Mr. Nauman Ansari |
| H.H. Sheikh Nahayan Al Nahayan, Chairman – 10.72% | |
| H.H. Sheikh Hamdan Bin Mubarak Al Nahayan – 8.42% | |
| H.E. Sheikh Suroor Bin Mohammad Al Nahyan – 7.16% | |
| M/S. Electro Mechanical Company LLC – 5.47% | |
| M/S. International Finance Corporation – 14.81% | |

## APPLICABLE METHODOLOGY

**JCR-VIS Commercial Banks Rating – March 2018**
**http://jcrvis.com.pk/docs/Meth-CommercialBanks201803.pdf**

# Bank Alfalah Limited

## OVERVIEW OF THE INSTITUTION

Bank Alfalah Limited (BAFL) was established as a privately held bank in 1992. Currently the bank operates as a public limited company with majority shareholding held by Abu Dhabi Group.

**Awards & Recognition**

**Best Bank Award - Pakistan Banking Awards (PBA) 2017**
*Best Debit and Credit Cards*
*Best Innovative Card*
*Diversity and Inclusion Award*
*Best Customer Franchise*

**Profile of CEO**

Mr. Nauman Ansari served various banks during his 24-year professional career, including leading institutions like Standard Chartered Bank, Bank of America, ABN Amro, Fortis Bank and Samba. He is a business graduate of Miami University, USA.

**Profile of Chairman**

His Highness Sheikh Nahayan Mabarak Al Nahayan is a prominent member of the ruling family of Abu Dhabi, United Arab Emirates. Currently, His Highness is UAE Cabinet Member and Minister of State for Tolerance. Prior to his current responsibility, he served as Minister of Culture and Knowledge Development; Minister of Culture, Youth, and Social Development, and Minister of Higher Education and Scientific Research.

## RATING RATIONALE

**Strong sponsors, diversified operations and established franchise.**

Ranked eighth largest in the commercial banking sector in terms of domestic deposits, Bank Alfalah Limited (BAFL) is sponsored by the Abu Dhabi Group (ADG), comprising some of the prominent members of UAE's ruling family and leading businessmen. Market share of the bank in terms of domestic deposits decreased to 5.1% (2016: 5.7%; 2015: 6.2%) at end-2017. As on December 31, 2017, the bank had a network of 638 (2016: 639) branches and over 700 ATMs. Along with overseas presence in Bahrain, Afghanistan and Bangladesh, BAFL has recently set up operations in Dubai. The bank is in process of exit from Afghanistan; accordingly, the segment has been classified as held for sale. BAFL enjoys a significant Islamic footprint with 14.1% (2016: 15.2%) contribution to total assets. The bank has continued to focus on broadening its already extensive portfolio of services through product innovation while leveraging information technology for customer experience enhancement. BAFL also has presence in Asset Management (Alfalah GHP Investment Management), Insurance (Alfalah Insurance) and Brokerage (Alfalah Securities).

**Strong board composition and experienced management team. Cost control and digital transformation continue to be important pillars in the bank's overall strategy.**

Overall corporate governance framework is supported by strong board composition and oversight, professional management team and adequate control infrastructure. Well-structured strategic planning process is in place. Several changes were witnessed at key management positions since last review (Chief Executive Officer, Chief Financial Officer, Group Head Corporate & Investment Banking Group and International Business and Head of Human Resources). The bank underwent an internal re-organization in 2017 with existing structures & responsibilities being gradually streamlined to bring in synergy and enhance efficiencies while significant emphasis continues on branch transformation program. Cost control remains a fundamental point of BAFL's strategy and accordingly, significant initiatives undertaken included closures of loss making branches, headcount rationalization, centralization of various expenses and regular revisits to expenditure approval authorities. Going forward, key strategic areas include building customer base, Small & Medium Enterprise (SME) lending, transaction banking and shift towards digital banking (introduction of digital products such as mobile wallet and set up of smart branches). Effective implementation of the envisaged business strategy will be a key rating sensitivity.

**Growth in loan book primarily driven by high-yielding consumer and SME segments while asset quality has improved. Focus on consumer and SME financing to continue in the ongoing year.**

Aggregate exposure to sovereign/public sector by way of advances and investments represented almost half of the balance sheet. Growth in BAFL's loan book in 2017 was primarily driven by high yielding consumer and SME financing while focus on these segments is expected to continue over the ongoing year along with enhancing return on capital on corporate loans. Overall sector-wise exposures are diversified with largest sector representing less than 15% of financing portfolio. Although counterparty concentration risk in advances portfolio remains, the same is mitigated by financing to government guaranteed exposures and well-established lending relationship with most clients. Supported by one-shop solutions and cross-sell initiatives, trade business volumes depicted sizeable growth in the outgoing year with further increase projected in 2018. Overall credit risk profile of the bank has improved overtime with reduction in infection levels and increase in provisioning coverage. Given the mid-term economic scenario and policy rate regime, maintaining asset quality indicators in line with benchmarks for the assigned ratings is considered important.

**Stable liquidity profile as evident from steady increase in low-cost funding. Depositor concentration levels depicted slight increase on timeline basis. Sizeable liquid assets carried on balance sheet also support assessment of bank's liquidity profile.**

During 2017, average domestic deposit and current account deposit base depicted growth of 2.5% and 10.7%, respectively. Overall growth in deposit base has been subdued on account of bank's strategy to rationalize its cost of funding with focus on low cost deposits and reclassification of Afghanistan deposits under liabilities held for sale at end-2017, without retrospective adjustment for 2016 figures. Proportion of current account deposit remains sizeable. New to bank relationships added in 2017 was reported at 172,033 (2016: 180,433).

While depositor concentration has increased slightly, presence of sizeable liquid assets in relation to deposits and borrowings (2017: 46.8%; 2016: 50.7%) provides comfort to liquidity profile of the bank. The bank also maintains adequate cushion over the regulatory requirements of Liquidity Coverage Ratio (LCR) and Net Stable Funding Ratio (NSFR).

**Market risk emanating from the investment portfolio has reduced while credit risk is considered manageable.**

Around nine-tenth of the investment portfolio as at end-2017 comprises exposure to government securities. Overall investment mix has witnessed shift from PIBs to T-Bills with the latter representing half of government paper holdings. Since majority of the investment portfolio constitutes government securities, credit risk emanating from the same is considered to be limited. Given the reduction in PIB exposure in relation to deposits and decline in duration, market risk emanating from the same has reduced. In the backdrop of further increase expected in benchmark rates, reduction in PIB exposure is expected to bode well from a market risk perspective.

**With spreads under pressure, profitability was sustained by volumetric growth in earning assets, higher non-markup income, including fee-based earnings, which continue to be sizeable vis-à-vis peer banks and recoveries from non-performing loans. Cost control to be a key driver of profitability in 2018.**

Operating profit increased by 3% during 2017 and amounted to Rs. 12,538m (2016: 12,135m). Given re-pricing and deposit re-profiling, the bank was able to reduce its cost of deposits significantly. With spreads under pressure, profitability was sustained by volumetric growth in earning assets, higher non-markup income, including fee-based earnings, which continue to be sizeable vis-à-vis peer banks and recoveries from non-performing loans. Despite growth in administrative expenses which in absolute terms are on the higher side vis-à-vis peer banks, increase in recurring income resulted in efficiency ratio being maintained around prior year level at 66.7% (2016: 66.1%). Increase in administrative expenses during the outgoing year is partially attributed to one-off expenses, including staff restructuring cost due to organizational changes. Efficiency ratio of the bank remains on the higher side and compares less favorably to peers. Profit before tax increased to Rs. 14.0b (2016: Rs. 13.0b) in 2017.

In 1Q18, the bank posted higher profit before tax (1Q18: Rs. 5.1b; 1Q17: Rs. 4.3b). This increase was primarily attributable to improvement in spreads, growth in fee income and recoveries against NPLs. This is reflected in improved efficiency ratio of 62.2% over the quarter. Going forward, future trend in profitability is likely to be a function of spreads (improvement in CASA), volumetric growth in earning assets, non-funded income and materialization of cost control initiatives.

**Comfortable capitalization levels supported by internal capital generation and recent issuance of Tier 1 instrument.**

The bank's Capital Adequacy Ratio (CAR) increased slightly to 13.74% (2016: 13.18%) while leverage ratio increased to 4.06% (2016: 3.45%) at end-2017. During 1Q2018, the bank successfully closed its additional Tier-1 capital issuance amounting to Rs. 7.0b in the form of listed, perpetual, unsecured, subordinated, non-cumulative and contingent convertible debt instruments. With stagnant growth in Risk Weighted Assets (RWAs) and increase in capital primarily through issuance of Tier 1 capital instrument, Tier-1 and overall CAR increased to 12.72% and 15.13% at end-1Q2018.

Ratings going forward would remain dependent upon continued maintenance of strong asset quality and capitalization indicators along with improvement in operational efficiency.

**Bank Alfalah Limited** **Appendix I**

| FINANCIAL SUMMARY | | | *(Rupees in millions)* |
|---|---|---|---|
| **BALANCE SHEET** | **1Q2018** | **2017** | **2016** |
| **Investments - Net** | 287,461.0 | 400,733.3 | 389,092.6 |
| **Advances - Net** | 413,083.6 | 400,655.4 | 378,720.3 |
| **Total Assets** | 863,875.8 | 988,828.8 | 917,457.1 |
| **Borrowings** | 84,671.3 | 206,223.6 | 178,311.0 |
| **Deposits & other accounts** | 644,511.1 | 653,406.1 | 640,944.3 |
| **Subordinated Loans** | 11,990.0 | 4,991.0 | 8,317.7 |
| **Tier-1 Capital** | 60,725.8 | 53,260.3 | 42,549.9 |
| **Net Worth (excluding deficit on revaluation of assets)** | 59,690.4 | 58,544.6 | 49,185.2 |
| | | | |
| **INCOME STATEMENT** | **1Q2018** | **2017** | **2016** |
| **Net Mark-up Income** | 7,554.1 | 29,280.6 | 28,991.3 |
| **Net Provisioning** | (287.5) | (259.7) | 1,183.3 |
| **Non-Markup Income** | 2,864.7 | 9,894.0 | 8,907.3 |
| **Administrative Expenses** | 5,952.6 | 25,116.1 | 23,683.6 |
| **Profit Before Tax** | 5,075.2 | 14,045.0 | 13,023.2 |
| **Profit After Tax** | 3,263.8 | 8,367.3 | 7,899.9 |
| | | | |
| **RATIO ANALYSIS** | **1Q2018** | **2017** | **2016** |
| **Gross Infection (%)** | 4.0% | 4.2% | 4.8% |
| **Total Provisioning Coverage (%)** | 94.0% | 94.0% | 90.1% |
| **Net Infection (%)** | 0.5% | 0.5% | 0.7% |
| **Cost of deposits (%)** | 2.7% | 2.60% | 3.04% |
| **Net NPLs to Tier-1 Capital (%)** | 3.1% | 3.5% | 6.1% |
| **CET 1 Capital Adequacy Ratio (CAR) (%)** | 11.26% | 11.20% | 9.85% |
| **Tier 1 CAR (%)** | 12.72% | 11.20% | 9.85% |
| **CAR (%)** | 15.13% | 13.74% | 13.17% |
| **Markup Spreads (%)** | 3.06% | 2.96% | 3.48% |
| **Efficiency (%)** | 62.2% | 66.7% | 66.1% |
| **ROAA (%)** | 0.4% | 0.9% | 0.9% |
| **ROAE (%)** | 22.1% | 15.5% | 16.1% |
| **Liquid Assets to Deposits & Borrowings (%)** | 41.9% | 46.8% | 50.7% |

## 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.

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**Rating Watch:** JCR-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.jcrvis.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.jcrvis.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.

**'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.jcrvis.com.pk/images/policy_ratings.pdf

**'SD' Rating:** An 'SD' rating is assigned when JCR-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** | Bank Alfalah Limited (BAFL) |
| **Sector** | Commercial Bank |
| **Type of Relationship** | Solicited |
| **Purpose of Rating** | Entity and TFC Rating |
| **Rating History** | |

| Rating Date | Medium to Long Term | Short Term | Rating Outlook | Rating Action |
|---|---|---|---|---|
| | | RATING TYPE: ENTITY | | |
| 06/29/2018 | AA+ | A-1+ | Stable | Reaffirmed |
| 08/31/2017 | AA+ | A-1+ | Stable | Reaffirmed |
| 02/14/2017 | AA+ | A-1+ | Stable | Initial |

| Rating Date | Medium to Long Term | Rating Outlook | Rating Action |
|---|---|---|---|
| | RATING TYPE: TFC (Tier 1) | | |
| 06/29/2018 | AA- | Stable | Reaffirmed |
| 1/17/2018 | AA- | Stable | Final |
| 11/8/2017 | AA- | Stable | Preliminary |

| | |
|---|---|
| **Instrument Structure** | Basel III compliant Tier 1, listed, perpetual, unsecured, subordinated, non-cumulative and contingent convertible debt instruments amounting up to Rs. 7.0b (inclusive of Green Shoe Option of Rs. 2.0b). |
| **Statement by the Rating Team** | JCR-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** | JCR-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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