The Pakistan Credit Rating Agency Limited

BANK ALFALAH LIMITED (BAFL) RATINGS REPORT

	NEW [JUNE-17]	PREVIOUS [JUNE-16]
Long Term	AA+	AA
Short Term	A1+	A1+
TFC IV & V of PKR 5bln	AA	AA-
Outlook	Stable	Positive

REPORT CONTENTS

JUNE 2017

Profile & Ownership

- BAFL commenced operations in 1997, is listed on the Pakistan Stock Exchange and has a network of 640 branches at end-Mar17 including 153 Islamic banking branches - the biggest network by any conventional bank
- The bank holds ~5.6% share in the total customer deposits as at end-Dec16; making it sixth largest bank
- Abu Dhabi Group (ADG), comprising some of the prominent members of UAE's ruling family and leading businessmen, continues to own majority stake (~52% at end-Dec16) in the bank; IFC has 15% stake

Governance & Management

- Control of the bank vests in the eight-member board of directors (BoD)
- Board comprises President & CEO and seven non-executive directors, four are representatives of ADG, one represents IFC, while two are independent
- Induction of IFC representative along with independent members on board has strengthened the board structure
- Mr. Atif Bajwa has submitted his resignation as a director and CEO of the bank, which the BoD has accepted, subject to the approval of SBP
- The BoD has further resolved to coopt Mr. Nauman Ansari as a director of the bank in Place of Mr. Bajwa for the remainder of the term and appointed him as CEO of the bank, subject to SBP approval

Risk Management

- Earning assets – largely comprising advances and investments – constituted 88% of total assets at end-Dec16, whereas, 47% of the funds have been parked in liquid avenues largely comprising government securities
- Advances-to-deposits ratio increased to ~59% at end-Dec16 (end-Dec15: 52%); better than industry average of 46%; this bodes well for the bank
- Top-20 performing private sector exposures' concentration slightly increased to ~25% (end-Dec15: ~23%)
- Gross advances grew sizably; resultantly, infection ratio declined to 4.8%
- During CY16, investment portfolio increased significantly (~31%) YoY. Investments continued to remain concentrated in government securities (~95%); mix (PIBs: 63%, T-Bills: 15%) was largely maintained

Business Risk

- Interest revenue witnessed a dip of 7% on a YoY basis on account of lower asset yield amidst maturity of high yielding PIBs. The spreads were also squeezed YoY (CY16: ~3.5%, CY15: ~3.9%)
- Cost to total net revenue ratio slightly inched up (CY16: ~62%, CY15: ~60%); still higher than peers
- Notable decline (48%) in provisioning, enabled the bank to earn higher profit before tax as it registered an increase of 3%)
- Performance trend continued during 1QCY17 as profit before tax of the bank increased by 13% on a YoY basis and clocked in at PKR 4.2bln
- BAFL plans to grow prudently; this implies consolidating its position on the competitive banking landscape. The business strategy mainly focuses on rationalizing cost structure
- On the lending side, the bank is geared to target double digit growth in SME and consumer book (mainly auto), with sustained focus towards corporate clientele

Financial Risk

- Customer deposits remained the key source of funding for the bank; contributing 74% to the total funding base at end-Dec16 (end-Dec15: 72%)
- Total deposits growth remained flat on a YoY basis as the bank followed its strategy of shredding high cost deposits in order to improve cost of funding
- CASA increased to 85% (end-Dec15: 77%). The top-20 deposit concentration improved to (11%) at end-Dec16
- CAR declined to 13.2% at end-Mar-17, lowest amongst peer group

RATING RATIONALE

The ratings reflect relative positioning of the bank among large banks of the country. The bank has a stronger position in advances - sustained by fresh deployments. The deposit system share has witnessed dilution as the bank embarked upon a strategy to sustainably rationalize its cost of funding with enduring focus on low cost deposits. Resultantly, BAFL's cost of fund is comparable to some of the large banks. The bank enjoys extended outreach across the country which has augmented its deposit base. Operating cost structure, though still higher than peers, has improved on YoY basis on account of cost rationalization. The asset quality of the bank has sustained over the past three years on account of prudent risk management. Going forward, the management is focused to grow prudently; this implies consolidating its position on the competitive banking landscape as against merely focusing on system share. Key initiatives include: (i) introducing technology led products - mobile banking - mainly to tap current account, (ii) focus on SME & transactional banking, and (iii) shift from conventional to digital banking model; setting up of 'smart branches' is on cards, aiming to improve cost structure. Declining asset yield is being offset by cost efficiency hence, enabling spreads to be maintained at current levels. Despite consistent improvement in the bank's profitability, capital augmentation remained limited. Cognizant of the fact, the management intends to improve its Tier-I capital through multiple options, whereas, enhancing Tier-II capital through issue of a new instrument is also being considered, thereby creating cushion to regulatory capital. The ratings recognize demonstrated support of Abu Dhabi group (ADG) as a key factor.

KEY RATING DRIVERS

The ratings are dependent on the management's ability to uphold its business profile; effective implementation of strategy is important. Sustaining spreads at current levels is a challenge, which needs to be effectively managed. Strengthening of the bank's capitalization and adding granularity to its advances and deposits book are critical for ratings improvement.

TFCs ISSUE

BAFL has two unsecured and subordinated TFCs in issue. TFC IV and V of PKR 5bln each, were issued in Dec09 and Feb13, respectively. Both TFCs are for a tenor of 8 years each. The principal repayment of TFC-IV would be in three equal installments commencing from Dec16 while principal repayment of TFC-V would be in bullet form at the time of maturity (Feb21)

INDUSTRY SNAPSHOT

The banking sector experienced substantial expansion in its deposit base (2016: 14%). Building on the uptick in the economy, advances also grew by a sizeable margin after a lag of many years. Given GDP growth in FY17 and other macro-economic fundamentals, credit expansion is foreseen. Hence, CAR is going to be a challenge, as profits would also suffer due to PIBs maturities.

Bank Alfalah Limited

PKR mln

BALANCE SHEET	31-Mar-17	31-Dec-16	30-Dec-15	31-Dec-14
Earning Assets				
Advances (Net of NPL)	376,159	376,845	331,896	285,436
Debt Instruments	12,368	12,505	10,826	10,012
Total Finances	388,527	389,350	342,722	295,448
Investments	372,576	376,683	412,329	314,269
Others	50,317	45,867	51,443	36,661
	811,419	**811,900**	**806,494**	**646,378**
Non Earning Assets				
Non-Earning Cash	57,448	67,726	55,104	44,500
Deferred Tax	-	-	-	-
Net Non-Performing Finances	1,276	1,781	2,207	5,200
Fixed Assets & Others	34,610	36,051	38,802	47,051
	93,335	**105,558**	**96,113**	**96,750**
TOTAL ASSETS	**904,754**	**917,457**	**902,608**	**743,128**
Funding				
Deposits	600,215	640,944	640,189	605,963
Borrowings	212,854	186,629	182,376	65,220
	813,068	827,573	822,565	671,183
Non Interest Bearing Liabilities	29,463	29,759	26,689	27,126
TOTAL LIABILITIES	**842,531**	**857,332**	**849,254**	**698,309**
EQUITY (including revaluation surplus)	**62,223**	**60,125**	**53,353**	**44,819**
Total Liabilities & Equity	**904,754**	**917,457**	**902,608**	**743,128**

INCOME STATEMENT	31-Mar-17	31-Dec-16	30-Dec-15	31-Dec-14
Interest / Mark up Earned	13,862	57,245	61,458	55,378
Interest / Mark up Expensed	(6,600)	(28,474)	(32,811)	(33,505)
Net Interest / Markup revenue	**7,262**	**28,770**	**28,648**	**21,873**
Other Income	2,553	8,868	8,841	9,036
Total Revenue	**9,815**	**37,638**	**37,489**	**30,910**
Non-Interest / Non-Mark up Expensed	(5,607)	(23,432)	(22,598)	(20,863)
Pre-provision operating profit	4,208	14,206	14,891	10,047
Provisions	82	(1,183)	(2,287)	(1,534)
Pre-tax profit	4,290	13,023	12,604	8,514
Taxes	(1,502)	(5,123)	(5,081)	(2,873)
Net Income	**2,788**	**7,900**	**7,523**	**5,641**

Ratio Analysis	31-Mar-17	31-Dec-16	30-Dec-15	31-Dec-14
Performance				
ROE	22%	17%	19%	17%
Cost-to-Total Net Revenue	57%	62%	60%	68%
Provision Expense / Pre Provision Profit	2%	8%	15%	15%
Capital Adequacy				
Equity/Total Assets	6%	5%	5%	5%
Capital Adequacy Ratio as per SBP	13%	13%	13%	13%
Funding & Liquidity				
Liquid Assets / Deposits and Borrowings	46%	47%	52%	54%
Advances / Deposits	63%	59%	52%	48%
CASA deposits / Total Customer Deposits	87%	85%	77%	73%
Intermediation Efficiency				
Asset Yield	7%	7%	9%	10%
Cost of Funds	3%	4%	5%	6%
Spread	4%	4%	4%	4%
Outreach				
Branches	640	639	653	648

** Numbers are actual when published first and not restated.*

CREDIT RATING
SCALE & DEFINITIONS

Credit rating reflects forward-looking opinion on credit worthiness of underlying entity or instrument; more specifically it covers relative ability to honor financial obligations. The primary factor being captured on the rating scale is relative likelihood of default.

LONG TERM RATINGS

AAA	**Highest credit quality.** Lowest expectation of credit risk. Indicate exceptionally strong capacity for timely payment of financial commitments.
AA+ AA AA-	**Very high credit quality.** Very low expectation of credit risk. Indicate very strong capacity for timely payment of financial commitments. This capacity is not significantly vulnerable to foreseeable events.
A+ A A-	**High credit quality.** Low expectation of credit risk. The capacity for timely payment of financial commitments is considered strong. This capacity may, nevertheless, be vulnerable to changes in circumstances or in economic conditions.
BBB+ BBB BBB-	**Good credit quality.** Currently a low expectation of credit risk. The capacity for timely payment of financial commitments is considered adequate, but adverse changes in circumstances and in economic conditions are more likely to impair this capacity.
BB+ BB BB-	**Moderate risk.** Possibility of credit risk developing. There is a possibility of credit risk developing, particularly as a result of adverse economic or business changes over time; however, business or financial alternatives may be available to allow financial commitments to be met.
B+ B B-	**High credit risk.** A limited margin of safety remains against credit risk. Financial commitments are currently being met; however, capacity for continued payment is contingent upon a sustained, favorable business and economic environment.
CCC CC C	**Very high credit risk.** Substantial credit risk "CCC" Default is a real possibility. Capacity for meeting financial commitments is solely reliant upon sustained, favorable business or economic developments. "CC" Rating indicates that default of some kind appears probable. "C" Ratings signal imminent default.
D	Obligations are currently in default.

SHORT TERM RATINGS

A1+: The highest capacity for timely repayment.

A1:. A strong capacity for timely repayment.

A2: A satisfactory capacity for timely repayment. This may be susceptible to adverse changes in business, economic, or financial conditions.

A3: An adequate capacity for timely repayment. Such capacity is susceptible to adverse changes in business, economic, or financial conditions.

B: The capacity for timely repayment is more susceptible to adverse changes in business, economic, or financial conditions.

C: An inadequate capacity to ensure timely repayment.

Outlook (Stable, Positive, Negative, Developing)
Indicates the potential and direction of a rating over the intermediate term in response to trends in economic and/or fundamental business/financial conditions. It is not necessarily a precursor to a rating change. 'Stable' outlook means a rating is not likely to change. 'Positive' means it may be raised. 'Negative' means it may be lowered. Where the trends have conflicting elements, the outlook may be described as 'Developing'.

Rating Watch
Alerts to the possibility of a rating change subsequent to, or in anticipation of, a) some material identifiable event and/or b) deviation from expected trend. But it does not mean that a rating change is inevitable. A watch should be resolved within foreseeable future, but may continue if underlying circumstances are not settled. Rating Watch may accompany Outlook of the respective opinion.

Suspension
It is not possible to update an opinion due to lack of requisite information. Opinion should be resumed in foreseeable future. However, if this does not happen within six (6) months, the rating should be considered withdrawn.

Withdrawn
A rating is withdrawn on a) termination of rating mandate, b) cessation of underlying entity, c) the debt instrument is redeemed, d) the rating remains suspended for six months, e) the entity/issuer defaults., or/and f) PACRA finds it impractical to surveill the opinion due to lack of requisite information

Name of Issuer Bank Alfalah Limited
Sector Banking
Type of Relationship Solicited

Purpose of the Rating Independent Risk Assessment
Regulatory Requirement

Rating History

Dissemination Date	Long Term	Short Term	Outlook	Action
-	AA+	A1+	Stable	Upgrade
30-Jun-16	AA	A1+	Positive	Maintain
30-Jun-15	AA	A1+	Positive	Maintain
30-Jun-14	AA	A1+	Stable	Maintain
28-Jun-13	AA	A1+	Stable	Maintain

Related Criteria and Research

Rating Methodology — Bank Rating Methodology
Sector Research — Banking Sector - Viewpoint | Jun-17

Rating Analysts

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Rating Team Statement

Rating Procedure
Rating is an opinion on relative credit worthiness of an entity or debt instrument. It does not constitute recommendation to buy, hold or sell any security. The rating team for this assignment does not have any beneficial interest, direct or indirect in the rated entity/instrument.

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PACRA reviews all the outstanding ratings on annual basis or as and when required by any stakeholder (including creditor) or upon the occurrence of such an event which requires to do so
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Reporting of Misconduct
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Prohibition

Probability of Default (PD)

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Regulatory and Supplementary Disclosure

Rated Entity

Name of Issuer: Bank Alfalah Limited
Name of Issue: Bank Alfalah | TFC IV
Sector: Banking
Type of Relationship: Solicited

Purpose of the Rating: Regulatory Requirement
Independent Risk Assessment

Rating History

Dissemination Date	TFC	Rating Action
-	AA	Upgrade
30-Jun-16	AA-	Maintain
30-Jun-15	AA-	Maintain
30-Jun-14	AA-	Maintain
28-Jun-13	AA-	Maintain

Instrument Details

Nature of Instrument	Size of Issue	Tenor	Trustee	Security
TFC (Sub-ordianted, Un-Listed)	PKR 5,000mln	8 years	Pak Brunei Investment Company	Unsecured

Amortization Schedule: See Annexure A

Related Criteria and Research

Specific Methodology: Banks Methdology [2005]
Research: Banking Sector - Viewpoint | Jun-17

Rating Analysts: Muneeb Rashid
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Loan Amount (PKR)	5,000,000,000
Tenor (Years)	8 years
Rate	6MK + 2.5% (for 53% of TFC Holders) & 15% (for 47% of TFC Holder)

PKR mln

Installment	Due Date	Principal	Mark Up	Total Installment	Outstanding
	Dec-09				5,000
1	Jun-10	1	548	549	4,999
2	Dec-10	1	564	565	4,998
3	Jun-11	1	566	567	4,997
4	Dec-11	1	542	543	4,996
5	Jun-12	1	543	544	4,995
6	Dec-12	1	509	510	4,994
7	Jun-13	1	509	510	4,993
8	Dec-13	1	514	515	4,992
9	Jun-14	1	519	520	4,991
10	Dec-14	1	519	520	4,990
11	Jun-15	1	490	491	4,989
12	Dec-15	1	474	475	4,988
13	Jun-16	1	469	470	4,987
14	Dec-16	1,662	466	2,129	3,325
15	Jun-17	1,662	311	1,973	1,662
16	Dec-17	1,662	155	1,818	0

Regulatory and Supplementary Disclosure

Rated Entity

Name of Issuer	Bank Alfalah Limited
Name of Issue	Bank Alfalah | TFC V
Sector	Banking
Type of Relationship	Solicited

Purpose of the Rating

Regulatory Requirement
Independent Risk Assessment

Rating History

Dissemination Date	TFC	Rating Action
-	AA	Upgrade
30-Jun-15	AA-	Maintain
30-Jun-14	AA-	Maintain
28-Jun-13	AA-	Maintain
14-Nov-12	AA-	Initial

Instrument Details

Nature of Instrument	Size of Issue	Tenor	Trustee	Security
TFC (Unsecured, Sub-ordianted, Listed)	PKR 5,000mln	8 years	Pak Brunei Investment Company	Unsecured

Amortization Schedule

See Annexure B

Related Criteria and Research

Specific Methodology: Banks Methdology [2005]
Research: Banking Sector - Viewpoint | Jun-17

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Loan Amount (PKR)	5,000,000,000
Tenor (Years)	8 years
Rate	6MK + 1.25%

PKR mln

Installment	Due Date	Principal	Mark Up	Total Installment	Outstanding
	Feb-13				5,000
1	Aug-13	1	267	268	4,999
2	Feb-14	1	275	276	4,998
3	Aug-14	1	285	286	4,997
4	Feb-15	1	273	274	4,996
5	Aug-15	1	215	216	4,995
6	Feb-16	1	194	195	4,994
7	Aug-16	1	185	186	4,993
8	Feb-17	1	185	186	4,992
9	Aug-17	1	185	186	4,991
10	Feb-18	1	185	186	4,990
11	Aug-18	1	185	186	4,989
12	Feb-19	1	185	186	4,988
13	Aug-19	1	185	186	4,987
14	Feb-20	1	185	186	4,986
15	Aug-20	1	185	186	4,985
16	Feb-21	4,985	185	5,170	0