The Pakistan Credit Rating Agency Limited

FAYSAL BANK LIMITED (FBL)

	NEW [DEC-17]	PREVIOUS [JUN-17]
Long Term	AA	AA
Short Term	A1+	A1+
Outlook	Stable	Stable

DECEMBER 2017

Assets:

- The bank's liquidity, in terms of its Liquid Assets-to-Deposits and Borrowings ratio, remained steady YoY basis, to 51% at end-Sep17 (end-Sep16: 52%), comprising pre-dominantly government entities.
- FBL's advances portfolio constitutes 45% of total assets at end-Sep17 (end-Sep'16: 47%).
- The bank's advances increased by ~19% during end-Sep17 to PKR 211.02bln (end-Sep16: PKR 175.55bln).

Funding

- The main source of FBL's funding – deposit base – witnessed 14% growth largely due to increase in customer deposits.
- The advances-to-deposits ratio (ADR) continued a similar trend at 60% (end-Sep16: 57%).

Credit Risk

- The NPLs of the bank decreased during the period (end-Sep17: PKR 27.455bln, end-Sep16: PKR 30.067bln). Herein, the coverage ratio witnessed a steady rise (end-Sep17: 88%, end-Sep16: 83%).
- Subsequently, the bank's infection ratio decreased to 12% during end-Sep17 (end-Sep16: 15%).

Market Risk

- The investments book forms ~40% of total assets at end-Sep17 (end-Sep16: 39%).
- FBL observed a decrease of ~22% (end-Sep17: PKR 170.298bln, end-Sep16: PKR 139.899bln) in its investment book.
- The bank has been consistently increasing its exposure towards T-Bills as a percentage of investment book.

Performance

- The asset yield declined by 0.2% (end-Sep17: 7.4%, end-Sep16: 7.2%) Similarly, cost of funds witnessed a decrease (end-Sep17: 3.6%, end-Sep16: 3.9%). Subsequently, the spread increased by 10bps (end-Sep17: 3.6%, end-Sep16: 3.5%).
- The bank's interest revenue increased (end-Sep17: PKR 21.307bln, end-Sep16: PKR 19.56bln) as the bank improved its margin by reducing cost of deposits.
- The non-markup/interest income decreased (end-Sep17 PKR 4.326bln, end-Sep16: PKR 5.612bln), mainly due a decrease in the gain on sale of securities.
- Recoveries of non-performing loans resulted in net provisions of PKR 765mln.
- Net income profit increased marginally to PKR 3.82bln (end-Sep16: 3.75bln).

Capital

- FBL's paid-up capital stands at PKR 13,197mln thus safely meeting the MCR of PKR 10,000mln for end-Dec16.
- During end-Sep17, the bank achieved a CAR of 15.9%.

Business Strategy

- FBL plans to focus on mobilizing low cost core deposits and enhancing business volume via branch outreach while bringing cost efficiencies.
- The Bank intends to convert its operations to Shariah compliant by 2020.

Profile

- Faysal Bank Limited (FBL) started operations in Pakistan in 1987, first as a branch set up of Shamil Bank of Bahrain and since 1994, as a locally incorporated bank under the present name. The bank has a nationwide network of 376 branches at end-Sep17.

Governance and management

- The overall control of the bank vests in the ten-member Board of Directors (BoD) including the CEO. Mr. Farooq Rahmatullah, the Chairman, is a professional carrying extensive experience in diverse roles related to the oil and gas industry.
- Mr. Yousaf Hussain, the CEO was appointed in July 2017. He is assisted by a team of experienced banking professionals.

RATING RATIONALE

Faysal Bank Limited (FBL) continued its focus on cautious growth and consolidation of its relative positioning among peer banks. The bank has enduring emphasis on low cost CASA deposits, prudent deployment of assets for better yields and carefully planned loan book growth. FBL is targeting reduction in Non-Performing Loans through various measures including recoveries and settlements under the approved policy. The bank has a continued focus on operational efficiency and was able to keep its costs under control and improve its efficiency ratio. These initiatives have supported the bank's profitability and provided cushion against risk absorption capacity. The management is cognizant of dynamic competition in the industry and is taking steps to strengthen FBL's positioning amongst medium-sized banks operating in Pakistan. FBL's conversion into Islamic banking is a medium-term plan, which is being rolled out as envisaged. Meanwhile, the ratings recognize FBL's association with a foreign business group (Dar Al Maal Al-Islami Trust).

KEY RATING DRIVERS

The ratings are dependent on bank's ability to sustain improvement in its financial profile. This is important since most peer banks have gained in terms of their size and profitability matrix in recent years. Any material weakening in asset quality, in turn, putting pressure on bank's profitability and risk absorption capacity may have negative implications for the ratings

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.

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Faysal Bank Limited

BALANCE SHEET	30-Sep-17 9MCY17	30-Dec-16 Annual	30-Dec-15 Annual
Earning Assets			
Advances (Net of NPL)	211,023	199,789	175,154
Debt Instruments	22,457	17,982	7,969
Total Finances	233,480	217,771	183,123
Investments	170,298	154,322	189,669
Others	11,579	8,431	3,663
	415,357	**380,524**	**376,455**
Non Earning Assets			
Non-Earning Cash	30,588	34,948	23,739
Deferred Tax	2,133	2,264	3,087
Net Non-Performing Finances	1,159	2,948	3,813
Fixed Assets & Others	23,476	23,781	22,979
	57,355	**63,941**	**53,618**
TOTAL ASSETS	**472,712**	**444,465**	**430,073**
Interest Bearning Liabilities			
Deposits	358,826	340,306	292,130
Borrowings	58,378	54,303	93,559
	417,204	394,609	385,690
Non Interest Bearing Liabilities	17,521	14,847	14,031
TOTAL LIABILITIES	**434,726**	**409,456**	**399,720**
EQUITY (including revaluation surplus)	**37,987**	**35,008**	**30,353**
Total Liabilities & Equity	**472,712**	**444,465**	**430,073**

INCOME STATEMENT	30-Sep-17 9MCY17	30-Dec-16 Annual	30-Dec-15 Annual
Interest / Mark up Earned	21,307	26,201	32,313
Interest / Mark up Expensed	(10,947)	(14,134)	(18,358)
Net Interest / Markup revenue	**10,359**	**12,066**	**13,955**
Other Income	4,306	6,746	5,557
Total Revenue	**14,666**	**18,812**	**19,512**
Non-Interest / Non-Mark up Expensed	(9,080)	(11,590)	(11,198)
Pre-provision operating profit	5,586	7,222	8,314
Provisions	765	(564)	(1,393)
Pre-tax profit	6,350	6,658	6,920
Taxes	(2,525)	(2,357)	(2,698)
Net Income	**3,825**	**4,302**	**4,222**

Ratio Analysis	30-Sep-17 9MCY17	30-Dec-16 Annual	30-Dec-15 Annual
Performance			
ROE	16.4%	15.6%	17.6%
Cost-to-Total Net Revenue	61.8%	62.6%	58.2%
Capital Adequacy			
Equity/Total Assets	7.0%	6.6%	6.1%
Capital Adequacy Ratio as per SBP	15.9%	14.6%	14.4%
Funding & Liquidity			
Liquid Assets / Deposits and Borrowings	50.5%	52.7%	57.6%
Advances / Deposits	59.7%	60.2%	62.0%
CASA deposits / Total Customer Deposits	69.6%	67.1%	67.3%
Intermediation Efficiency			
Asset Yield	7.2%	7.0%	9.1%
Cost of Funds	3.6%	3.6%	5.0%
Spread	3.6%	3.4%	4.1%
Outreach			
Branches	376	355	280

STANDARD RATING SCALES & 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 or 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**. "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.

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. Rating Watch may carry designation – Positive (rating may be raised, negative (lowered), or developing (direction is unclear). A watch should be resolved within foreseeable future, but may continue if underlying circumstances are not settled.

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'.

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, a suspended 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, or e) the entity/issuer defaults.

Disclaimer: PACRA's rating is an assessment of the credit standing of an entity/issue in Pakistan. They do not take into account the potential transfer / convertibility risk that may exist for foreign currency creditors. PACRA's opinion is not a recommendation to purchase, sell or hold a security, in as much as it does not comment on the security's market price or suitability for a particular investor.