The Pakistan Credit Rating Agency Limited

BANK ALFALAH LIMITED

	NEW [JUNE-16]	PREVIOUS [JUNE-15]
Unlisted, Unsecured Term Finance Certificate (TFC IV; PKR 5bln)	AA-	AA-
Outlook	Positive	Positive

REPORT CONTENTS

1. RATING ANALYSES
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JUNE 2016

Profile & Ownership

- BAFL has a network of 653 branches at end-Mar16 including 158 Islamic banking branches - the biggest network by any conventional bank. The bank holds ~6% share in the total banking deposits as at end-Dec15
- 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-Dec15) in the bank; IFC has 15% stake

Governance & Management

- With addition of one member (IFC representative) on the board, in May15, control of the bank vests in the eight-member 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, the President, has over thirty years of banking experience. He is supported by a seasoned management team

Risk Management

- Earning assets grew (~25%) mainly on the back of government securities followed by performing advances. The growth was mainly financed through borrowings followed by deposits
- Advances-to-deposits ratio increased to ~52% at end-Dec15 (end-Dec14: ~48%); this is aligned with industry. Top-20 performing private sector exposures' concentration slightly increased to ~23% (end-Dec14: ~21%)
- Net NPLs decreased by ~PKR 1bln. Gross advances grew sizably. Resultantly, infection ratio declined to 5.3%
- During CY15, investment portfolio increased significantly (~31%) YoY. Investments continued to remain concentrated in government securities (~98%); mix (PIBs: 58%, T-Bills: 23%) was largely maintained

Business Risk

- During CY15, net markup income witness a ~31% increase YoY mainly on account of sizable increase in earning assets. The spreads were largely maintained (CY15: ~3.9%)
- Cost to total net revenue ratio declined significantly (CY15: ~60%, CY14: ~68%); still higher than peers
- Despite notable increase (~49%) in provisioning, the bank earned higher profit before tax (CY15: ~PKR 13bln; CY14: PKR 8.5bln)
- During 1QCY16, performance trend continued; profitability improved vis-à-vis same period last year (profit before taxation; 1QCY16: PKR 3.8bln, up 25%)
- BAFL plans to grow prudently; this implies consolidating its position on the competitive banking landscape. The business strategy mainly focuses on rationalizing cost structure

Financial Risk

- Customer deposits remained the key source of funding for the bank (end-Dec15: ~72%, end-Dec14: ~85%); proportion of borrowings increased on YoY basis
- Borrowings increased by ~PKR 117bln (up ~180%) while, total deposits grew by ~6% (~PKR 34bln); portion of CASA increased to ~77% (end-Dec14: ~73%). Top-20 deposit concentration remained constant (~15%) at end-Dec15
- The liquidity ratio (end-Dec15: ~52%, end-Dec14: ~54%) remained healthy
- CAR improved to ~13.9% at end-Mar16

TFC 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)

RATING RATIONALE

Ratings reflect BAFL's sound business profile emanating from its established market position (sixth largest bank with ~6% system share in deposits) and healthy profitability. The bank enjoys extended outreach across the country which has augmented its deposit base over the years. Operating cost structure, though still higher than peers, has improved on YoY basis on account of cost rationalization and steady revenue growth. Despite accretion in gross infected portfolio, success in recoveries benefitted BAFL's asset quality. 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. The strategy has a focus on bringing down cost of deposits. Key initiatives include: (i) introducing technology led products - mobile wallet - mainly to tap current account, (ii) focus on SME through transactional banking, and (iii) shift from conventional to digital banking model; setting up of 'smart branches' is on cards, aiming to improve cost structure. Despite consistent improvement in the bank's profitability, capital augmentation remained limited - a factor of dividend payout. Cognizant of the fact, the management intends to improve its Tier-I capital through profit retention, 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. Strengthening of the bank's capitalization and adding granularity to its advances and deposits book are critical for ratings improvement.

Financials [Summary]

The Pakistan Credit Rating Agency Limited

Bank Alfalah Limited

PKR mln

BALANCE SHEET	31-Mar-16	30-Dec-15	31-Dec-14	31-Dec-13
Earning Assets				
Advances (Net of NPL)	320,451	331,896	285,436	255,881
Debt Instruments	10,530	10,826	10,012	4,202
Total Finances	330,981	342,722	295,448	260,083
Investments	424,496	412,329	314,269	215,374
Others	30,046	51,443	36,661	25,346
	785,524	**806,494**	**646,378**	**500,804**
Non Earning Assets				
Non-Earning Cash	40,519	55,104	44,500	73,560
Deferred Tax	-	-	-	1,204
Net Non-Performing Finances	2,963	2,207	5,200	5,013
Fixed Assets & Others	32,273	38,802	47,051	30,033
	75,755	**96,113**	**96,750**	**109,811**
TOTAL ASSETS	**861,278**	**902,608**	**743,128**	**610,614**
Funding				
Deposits	623,359	640,189	605,963	525,526
Borrowings	152,988	182,376	65,220	33,106
	776,347	822,565	671,183	558,632
Non Interest Bearing Liabilities	29,888	26,689	27,126	20,081
TOTAL LIABILITIES	**806,235**	**849,254**	**698,309**	**578,713**
EQUITY (including revaluation surplus)	**55,043**	**53,353**	**44,819**	**31,902**
Total Liabilities & Equity	**861,278**	**902,608**	**743,128**	**610,614**

INCOME STATEMENT	31-Mar-16 Quarterly	30-Dec-15 Annual	31-Dec-14 Annual	31-Dec-13 Annual
Interest / Mark up Earned	14,944	61,458	55,378	43,961
Interest / Mark up Expensed	(7,850)	(32,811)	(33,505)	(27,066)
Net Interest / Markup revenue	**7,095**	**28,648**	**21,873**	**16,895**
Other Income	2,362	8,841	9,036	8,279
Total Revenue	**9,456**	**37,489**	**30,910**	**25,174**
Non-Interest / Non-Mark up Expensed	(5,422)	(22,598)	(20,863)	(17,313)
Pre-provision operating profit	4,034	14,891	10,047	7,861
Provisions	(240)	(2,287)	(1,534)	(1,054)
Pre-tax profit	3,794	12,604	8,514	6,807
Taxes	(1,327)	(5,081)	(2,873)	(2,131)
Net Income	**2,467**	**7,523**	**5,641**	**4,676**

Ratio Analysis	31-Mar-16 Quarterly	30-Dec-15 Annual	31-Dec-14 Annual	31-Dec-13 Annual
Performance				
ROE	23%	25%	23%	17%
Cost-to-Total Net Revenue	57%	60%	68%	69%
Provision Expense / Pre Provision Profit	6%	15%	15%	13%
Capital Adequacy				
Equity/Total Assets	5%	5%	5%	5%
Capital Adequacy Ratio as per SBP	14%	13%	13%	12%
Funding & Liquidity				
Liquid Assets / Deposits and Borrowings	56%	52%	54%	55%
Advances / Deposits	52%	52%	48%	50%
CASA deposits / Total Customer Deposits	78%	77%	73%	75%
Intermediation Efficiency				
Asset Yield	8%	9%	10%	9%
Cost of Funds	4%	5%	6%	6%
Spread	3%	4%	4%	4%
Outreach				
Branches	653	653	648	574

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STANDARD 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. This capacity is highly unlikely to be adversely affected by foreseeable events.
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-	**Speculative.** Possibility of credit risk developing. There is a possibility of credit risk developing, particularly as a result of adverse economic change over time; however, business or financial alternatives may be available to allow financial commitments to be met.
B+ B B-	**Highly speculative.** Significant 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	**High default 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.

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 with in 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, 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, or e) the entity/issuer defaults.

Disclaimer: PACRA's ratings are an assessment of the credit standing of entities/issues 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.

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
30-Jun-16	AA-	Maintain
30-Jun-15	AA-	Maintain
30-Jun-14	AA-	Maintain
28-Jun-13	AA-	Maintain
30-Jun-12	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 | Dec-15

Rating Analysts

Rida Zahoor
rida.zahoor@pacra.com
(92-42-35869504)

Saira Rizwan
saira.rizwan@pacra.com
(92-42-35869504)

Rating Team Statement

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

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Prohibition

Probability of Default (PD)

PACRA's Rating Scale reflects the expectation of credit risk. The highest rating have the lowest relative likelihood of default (i.e, probability). PACRA's transition studies capture the historical performance behavior of a specific rating notch. Transition behavior of the assigned rating can be obtained from PACRA's Transition Study available at our website. (www.pacra.com). However, actual transition of rating may not follow the pattern observed in the past.

Regulatory and Supplementary Disclosure Annexure A

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