RATING REPORT

Bank Alfalah Limited

REPORT DATE:
July 08, 2020

RATING ANALYSTS:
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RATING DETAILS

Rating Category	Latest Rating		Previous Rating	
	Long-term	Short-term	Long-term	Short-term
Entity	AA+	A-1+	AA+	A-1+
Rating Outlook	Stable		Stable	
Rating Date	*30th June 2020*		*2nd July, '19*	
TFC (Tier-1)	AA-		AA-	
Rating Outlook	Stable		Stable	
Rating Date	*30th June 2020*		*2nd July, '19*	

COMPANY INFORMATION

Incorporated in 1992	**External auditors:** 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. Atif Bajwa.
H.H. Sheikh Nahayan Mabarak Al Nahayan, Chairman – 10.67%	
H.H. Sheikh Hamdan Bin Mubarak Al Nahayan – 8.38%	
H.E. Sheikh Suroor Bin Mohammad Al Nahyan – 7.12%	
M/s. Electro Mechanical Company LLC – 5.44%	
M/s. International Finance Corporation – 14.74%	

APPLICABLE METHODOLOGY

VIS Commercial Banks Rating – March 2018
https://s3-us-west-2.amazonaws.com/backupsqlvis/docs/Meth-CommercialBanks201803.pdf

*2017 and 2018 balance sheet numbers do not include Bank's Afghanistan Operation, which was held for sale, whereas 2019 numbers include the same as it has been declassified.

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.

Profile of CEO

Mr. Atif Bajwa was appointed as the President and CEO of Bank Alfalah in February 2020. Mr. Bajwa has diversified and rich experience in Banking and has held various senior positions. He has been the President of the Abu Dhabi Group, President of MCB Bank and Soneri Bank in Pakistan, Regional Head for Citigroup for the Central and Eastern Europe region, Head of Consumer Banking for ABN AMRO's Asia Pacific region as well as Country Manager for ABN AMRO. Mr. Bajwa received his education at Columbia University, New York.

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, Bank Alfalah Limited ('BAFL' or 'the bank') is sponsored by the Abu Dhabi Group (ADG), comprising some of the prominent members of UAE's ruling family and leading businessmen. Over the years, the bank has developed a strong franchise recall, and diversified its operations across various business areas such as Asset Management (Alfalah GHP Investment Management), Insurance (Alfalah Insurance) and Brokerage (Alfalah CLSA Securities). BAFL also has overseas operations in Bahrain, Afghanistan, Bangladesh and United Arab Emirates; these overseas operations cumulatively contributed 8.3% of the bank's pre-tax profits for 2019 (2018: 8.6%).

Asset growth has picked up on the back of resumption in ranch expansion; ADR has been reduced, albeit continues to trend above the peer median.

BAFL posted asset growth of 5.8% in 2019, exceeding prior year's growth of 0.7%. Historically, the bank's asset growth has lagged the growth in sector assets, with its 4-year CAGR standing at 4.2% vis-à-vis sector's 11.7%. This can mainly be attributed to its slower branch growth and a cost of fund rationalization strategy. In 2019, BAFL resumed branch expansion, growing its branch network to 698, including 24 sub-branches (Dec'18: 649 branches, including 25 sub-branches). However, in the ongoing year, further plans of new branches have been revisited and limited branch opening is planed due to the novel coronavirus outbreak.

BAFL's asset mix has depicted slight change, as growth in lending operations remained relatively muted; resultantly asset base composition depicts a higher tilt towards liquid assets. Consequently, BAFL's ADR has dropped from 68.4% in Dec'18 to 61.2%, as of Mar'20, albeit it sill continues to trend higher than the 'AA+' rated peer median

Lending operations remained relatively muted during 2019. Portfolio infection has risen on a timeline; as per management, this was mainly driven by subjective provisions prudently taken by the management.

Akin to the industry, BAFL's lending operations remained relatively muted in 2019. In terms of segment exposures, corporate financing remains the mainstay of the bank's lending operations. Trade business grew by 1.2%, significantly lower than the growth witnessed in 2018 (15%). Given a heightened credit risk environment, on the back of high interest rates and prevailing macroeconomic adjustments during the period, the bank's non-performing portfolio grew by 25% during the period Dec'18-Mar'20; as per management, this was mainly driven by subjective provisions prudently taken by the management. Resultantly portfolio (gross) infection has risen. However provisioning coverage is adequate and net infection is considered to be low, at 1%.

Going forward, the oncoming pandemic-induced headwinds are expected to test the portfolio asset quality. So far, SBP has taken notable measures to ease the expected credit crisis, resulting from the pandemic. However, the SBP-mandated relaxations are expected to delay the impact of prevailing headwinds on the portfolio asset quality indicators. The operating environment remains precarious, amidst intermittent lock downs with no definite deadline. In view of the same, the full impact of the pandemic on the industry is uncertain.

Overall liquidity risk of the institution, is considered manageable, in view of the sizable liquidity buffers

Given a slowdown in lending, liquidity indicators have depicted notable improvement. The bank's LCR and NSFR have been maintained well above the regulatory requirement. As branch expansion resumed in the preceding year, the bank was able to sustain its market share at 5.3%, unlike prior years when the bank was losing market share. In 2019, improvement was noted in BAFL's deposit mix, which was partly on account of reclassification of Afghanistan Operations as 'continuing operations'. As of Dec'19, the bank's CA & CASA proportion compared favorably to peers. The overall liquidity risk of the institution is considered manageable, in view of the sizable liquidity buffers.

Profitability indicators compare favorably to peers; however, akin to the industry, profitability is expected to weaken going forward

The bank's profitability indicators compare favorably to peers, with the banking spread and the overall RoAA comfortably standing in excess of peer median. Conversely, the bank does not fare as well in the area of intermediation cost, which is the highest amongst peers. As per management, this is partly due to full menu of consumer & SME products and services being offered at branches, unlike peers; focus on low-cost current & saving accounts; and partly on account of the ongoing branch expansion, investment in IT & digital channels, the cost of which will be recovered over subsequent years.

In 2019, growth in profitability was driven by the net spread income. Amidst depressed growth in lending operations, better spread mainly emanated from the increase in benchmark rates. The cost of funding of the bank has also trended up, albeit the increase was not as marked. For 2019, BAFL's cost of funding was the lowest amongst peers. At 52.8%, the bank's efficiency ratio compares favorably to peers.

Going forward, the sector profitability is expected to weaken on account of the following; i) So far, the interest rate has already dropped by 625 basis points; this sharp drop in interest rates and narrowing of the interest rate corridor is expected to negatively affect banking spread. A review of historical banking spread in low interest regime indicates that spread shrinkage is likely going to be ~50 basis points; however, in the near term (Q2 & Q3), the spreads may post short term improvement, as a result of faster re-pricing on liabilities vis-à-vis assets. This short-term spread improvement will likely keep the spreads intact for the ongoing year; ii) the adverse credit risk environment – on account of the novel coronavirus outbreak – is expected to translate in increased provisioning burden. However, the charge of the same is expected to be rolled forward as a result of the SBP relief measures; iii) in view of the reduced economic activity, fee-related income and overall ancillary income will shrink; this, along with projected spread shrinkage, will likely have an adverse impact on efficiency ratios across the industry and iv) the SBP maintains its deadline for IFRS 9 implementation at January 1 2021, with deadline for pro-forma accounts preparation being Oct'20. The full provisioning impact of the same is expected to be sizable.

Capitalization metrics remain strong vis-à-vis peers; capitalization buffers are likely to experience some weakening in the short to medium term

The bank's capitalization metrics remain strong vis-à-vis peers, as reflected by the comfortable capital adequacy buffer wherein both tier I and total CAR exceed the peer median. However, the bank's net-NPLs to net equity ratio has increased on a timeline.

Given higher loan loss projections, on account of pandemic-induced heightened credit risk environment, and additional IFRS 9-related provisioning, the bank's capital adequacy buffer is expected slightly recede going forward. However, capitalization buffers, built up over the past few years, are expected to provide adequate cushion to absorb projected credit impairment. Our credit impairment expectations are conservative, albeit there is significant degree of deviation from expectations, amidst an uncertain economic environment. VIS will continue to closely monitor the capitalization ratios on quarterly basis.

FINANCIAL SUMMARY (Appendix I)					*(Rupees in millions)*
BALANCE SHEET		**Dec'17**	**Dec'18**	**Dec'19**	**Mar'20**
Investments - Net		400,733	277,660	299,098	366,830
Advances - Net		400,655	501,636	511,236	500,865
Total Assets		998,828	1,006,218	1064,672	1,081,803
Borrowings		207,194	123,738	102,842	146,893
Deposits & other accounts		644,985	702,895	782,284	755,135
Subordinated Loans		4,991	11,989	11,987	11,986
Tier-1 Capital		53,662	66,810	73,650	72,614
Paid-up Capital		16,076	17,744	17,772	17,772
Net Equity (excluding deficit on revaluation of assets)		58,514	68,264	76,661	77,474
INCOME STATEMENT	**2017**	**2018**	**2019**	**Q1'19**	**Q1'20**
Net Mark-up Income	28,976	31,926	44,857	11,165	11,781
Net Provisioning/ (Reversal)	(616)	27	3,029	446	1,528
Non-Markup Income	9,076	10,431	10,396	2,290	2,709
Administrative Expenses	24,672	24,313	29,066	6,742	8,054
Profit Before Tax	14,045	17,618	22,382	6,134	4,757
Profit After Tax	8,367	10,625	12,696	3,122	2,821
RATIO ANALYSIS		**Dec'17**	**Dec'18**	**Dec'19**	**Mar'20**
Gross Infection (%)		4.2%	3.6%	4.2%	4.5%
Total Provisioning Coverage (%)		94.0%	89.0%	82.2%	83.3%
Net Infection (%)		0.5%	0.6%	1.0%	1.0%
Cost of Deposits (%)		2.70%	3.10%	5.00%	5.80%
Net NPLs to Tier-1 Capital (%)		3.5%	4.4%	6.8%	6.7%
CET 1 Capital Adequacy Ratio (CAR) (%)		10.92%	10.90%	12.01%	12.25%
Tier 1 CAR (%)		10.92%	12.17%	13.27%	13.56%
CAR (%)		13.39%	14.94%	16.88%	17.25%
Markup Spreads (%)		3.20%	4.00%	5.40%	5.30%
Efficiency (%)		66.9%	59.1%	52.8%	55.3%
ROAA (%)		0.8%	1.1%	1.2%	1.1%
ROAE (%)		14.1%	16.8%	17.5%	14.6%
Liquid Assets to Deposits & Borrowings (%)		41.0%	41.7%	48.6%	48.1%

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.

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 DISCLOSURE	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		
06/30/2020	AA+	A-1+	Stable	Reaffirmed
07/02/2019	AA+	A-1+	Stable	Reaffirmed
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)		
06/30/2020	AA-	Stable	Reaffirmed
07/02/2019	AA-	Stable	Reaffirmed
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	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
Ms. Anjum Hai	CFO	June 5, 2020
Mr. Faisal Rabbani	CRO	June 5, 2020
Mr. Bilal Asghar	Head of Corporate, Investment Banking and International Business	June 8, 2020