The Pakistan Credit Rating Agency Limited

Rating Report

Askari Bank Limited

Report Contents

Rating History

Dissemination Date	Long Term Rating	Short Term Rating	Outlook	Action	Rating Watch
28-Dec-2019	AA+	A1+	Stable	Maintain	-
28-Jun-2019	AA+	A1+	Stable	Maintain	-
27-Dec-2018	AA+	A1+	Stable	Maintain	-
20-Jun-2018	AA+	A1+	Stable	Maintain	-
29-Dec-2017	AA+	A1+	Stable	Maintain	-
22-Jun-2017	AA+	A1+	Stable	Maintain	-
25-Jun-2016	AA+	A1+	Stable	Initial	-

Rating Rationale and Key Rating Drivers

Askari Bank has shown stable growth rate over the years. This has ensured its relative profitability to remain intact. The bank has a strong brand image, aided by its affiliation with one of the strongest conglomerate, Fauji Foundation Group. The ownership structure has proven itself a strong support, as reflected by Askari Bank's history. The Bank has continued the growth trajectory during 9MCY19. The net spread has inched up on the back of significant improvement in asset yield amidst higher cost of funds leading to enhanced profitability for 9MCY19. Volumetric increase in earning assets, led by loan portfolio augmentation, provided support to profitability; but was impacted due to higher provisioning expense on mark-to market loss of investment. The bank recorded reversal in specific charge NPL provisioning during CY18 and 9MCY19 which supported bottom-line.
The Bank's CAR is 12.73% at end-Sep19. The Tier 1 capital increased from 10.92% in 2018 to 11.25% in 9MCY19 while the overall CAR improved by 22 basis points. The Bank is issuing tier II TFC of PKR 7bln inclusive of PKR 2bln green shoe option which will enhance its capital base, thereby boosting its lending capacity. Additionally, the Bank will comfortably comply with statutory requirement of 12.5% CAR as at end-Dec19. The deposit growth was sizeable, enabling the bank to hold its relative position.

The ratings are dependent upon sustainability of the bank's relative positioning and continuous improvement in capital adequacy, whereas, effective management of spreads remains important. Meanwhile, holding the asset quality is a pre-requisite.

Disclosure

Name of Rated Entity	Askari Bank Limited
Type of Relationship	Solicited
Purpose of the Rating	Entity Rating
Applicable Criteria	PACRA_Methodology_FI(Jun-19),Methodology | Correlation Between Long-Term And Short-Term Rating Scale(Jun-19),Criteria | Rating Modifier(Jun-19)
Related Research	Sector Study | Commercial Bank(Jun-19)
Rating Analysts	Usama Liaquat | usama.liaquat@pacra.com | +92-42-35869504

Profile

Structure Askari Bank Limited (AKBL), incorporated as a public limited company, commenced operations as a Scheduled Commercial Bank in 1992.

Background The bank has a steady presence in Islamic banking as well. Started in 2006, the bank provides a range of shariah compliant products under its Islamic brand name 'Ikhlas'

Operations The Bank, with its head office in Islamabad, operates with a network of 535 branches including Wholesale Banking Branch (WBB) in the Kingdom of Bahrain at end-Dec19. The bank has a widespread ATM network of over 617, covering all major cities. The Bank's market share in terms of customer deposits stood at 4.6% as at Sep-19 (CY18: 4.4%).

Ownership

Ownership Structure The current sponsors, Fauji Foundation Group, own 71.9% stake of the Bank. The remaining stake (28.1%) is widely spread among financial institutions, and general public.

Stability Fauji Foundation (FF) is a Charitable Trust and is exclusively devoted to the welfare of ex-servicemen of the Pakistan Armed Forces and their dependents. Over the years, FF has emerged as one of the leading conglomerates of the country with established business interests in numerous sectors and industries.

Business Acumen The Fauji Foundation Group comprising several industrial/commercial projects in various sectors including energy, gas supply, fertilizer, cement, food etc, includes wholly owned as well as partly owned ventures. The group, with its increased penetration in the major facets of the economy, has garnered expertise and knowledge of various sectors which provides it with a holistic view of the macro economy and a strategic viewpoint.

Financial Strength Fauji Foundation is one of the leading and most diversified groups in Pakistan. The group has a strong equity and asset base. Over the years the group has stretched its business profile by entering into new industries, providing it with diversity in revenue streams, strong brand image and an increased hands-on knowledge of the various sectors of the economy.

Governance

Board Structure Overall control of the Bank vests in the eleven-member Board of Directors (BoD) including the President & CE. Chairman of the BoD is Lt. Gen Syed Tariq Nadeem Gilani. Five of the board members are Fauji Foundation nominees; four are independent members, while one represents NIT. The board composition and membership reflects diversified experience with sound business acumen of the nominated directors.

Members' Profile The members carry diversified experience in Financial Institutions (Banking, AMCs), public sector entities, Oil and Gas, Power, Fertilizer, IT etc. Most of the directors have completed their trainings as part of Code of Corporate Governance and meet the criteria specified by SECP.

Board Effectiveness During 9MCY19 attendance of board members in board meetings remained good. There are four board committees in place; i) Board Audit, ii) Board Risk Management, iii) Board Human Resource and Remuneration, and iv) Board Information Technology.

Financial Transparency The audit committee comprises four members, all of whom are non-executive directors while chairman of the committee is an independent director. A.F. Ferguson & Co. Chartered Accountants, the external auditors of the bank, expressed an unqualified opinion on the bank's financial statements for half year ended June 30, 2019.

Management

Organizational Structure Mr. Abid Sattar is President and CE of the Bank. He has extensive expertise, both locally and overseas, in the financial services industry.

Management Team The Bank has eight management committees in place to oversee its day-to-day operational matters; seven of them are headed by the President. The committees ensure, that the bank is aligned with its current strategy. Going forward, sustainability and cohesiveness of the team would remain important to continue the growth trend.

Effectiveness AKBL's operations are currently divided in 23 functions, out of which 14 are directly reporting to the President. Chief Internal Auditor reports to the Board Audit Committee.

MIS The bank has implemented Flexcube (developed by Oracle financial services and installed at over 750 sites worldwide), as its core banking software.

Risk Management Framework The Bank has a robust Risk Management Framework driven by the Board Risk Management Committee and managed by Risk Management Group. Risk Management Group is headed by the Chief Risk Officer (CRO), who is overseeing independent functions for management of Credit, Market/Liquidity, Information Security, policy and Operational Risk.

Business Risk

Industry Dynamics Despite challenging macroeconomic environment, banking sector maintained its growth trajectory during 9MCY19, backed by decent growth in deposits (9MCY19: PKR 14,945bln; 9MCY18: 13,603bln). However, lending was largely skewed towards investments and particularly towards government instruments due to favorable interest rate dynamics (9MCY19: PKR 9,641bln; 9MCY18: 6,942bln). Meanwhile, advances witnessed a slowdown owing to subdued economic activity, cautious lending approach and monetary tightening (9MCY19: PKR 8,014bln; 9MCY18: 7,422bln). Asset quality saw some deterioration – increased NPLs, particularly in sugar and energy sectors (9MCY19: PKR 758 bln; 9MCY18: 637bln). The profitability of the banking sector improved due to increase in Net Interest Income, which translated positively in other profitability indicators. The overall risk profile of the banking sector remained satisfactory.

Relative Position During 9MCY19, Bank's customer deposits (PKR 642bln) increased by ~12.67% which is way better than sector's growth of ~5.1%. AKBL slightly improved its system share in terms of customer deposits at 4.6% in 9MCY19 (CY18: 4.4%).

Revenues On the gross markup income side, Bank reported markup of PKR 51bln as at Sep-19 with growth of 64% as compared to corresponding period of last year. Of this increase, income on advances constituted the major chunk increasing 82% to PKR 30.2bln (9MCY18: PKR 16.6bln). Non-markup income of the Bank increased by ~21% YoY, clocking in at PKR 5bln (9MCY18: PKR 4.16bln) with major contributions coming in from fee and commission income and income from dealing in foreign currencies amounting to PKR 2.6bln and PKR 1.87bln respectively.

Performance Profit before tax of the Bank increased by 16% over the same period of last year and was reported at PKR 7.2bln (9MCY18: PKR 6.2bln). Provisioning expense saw a ~76%x increase over the same period of previous year (9MCY19: PKR 731mln, 9MCY18: PKR 416mln). The bank's yield on assets was impacted positively by increasing interest rates environment and stood at 10.3% (9MCY18: 7%). The bank's cost of funds increased to 6.7% (9MCY18: 3.7%) hence spread inched up to 3.6% (9MCY18: 3.3%).

Sustainability Increasing interest rate environment helped the bank in increasing its spread and earning higher profitability.

Financial Risk

Credit Risk During 9MCY19, AKBL's gross advances registered a growth of ~8.25% as compared to CY18. ADR declined by 2% to 57.7% at end-Sep19 (end-Dec18: 59.8%). At end 9MCY19, the Non-performing loan base of the Bank increased by PKR 2.15bln and was reported at PKR 28.8bln (CY18: 26.65bln). The coverage ratio of the Bank decreased by 8.2% and was reported at 89.9% (CY18: 98.1%) and infection ratio of the Bank remained stagnant and was reported at 7.2% (CY18: 7.2).

Market Risk The investment portfolio showed an expansion of 26.5% to PKR 329bln during 9MCY19 (CY18: PKR 260bln). The bank's investment portfolio constitutes 40% of total asset base and government securities continue to dominate the overall investment book (98.4%).

Liquidity And Funding The Bank was able to attract deposits with similar proportion of current and saving accounts, thus almost maintaining its CA and SA ratio at 27.7% and 55.3% (CY18: 28.7% and 55.2%) respectively. The deposit base of the Bank registered an increase of PKR 74bln in 9MCY19 (13%) over Dec18. AKBL issued a perpetual, unsecured, unlisted TFC (ADT1) of PKR 6bln in July 2018. AKBL continued to fund major portion of its assets through deposits (79%).

Capitalization AKBL is an adequately capitalized institution with a sufficient equity base and CAR above the regulatory requirements. However, due to uptake in total eligible capital a slight improvement in Bank's CAR was noted as at Sep19 to 12.73% (Dec18: 12.5%).

PACRA

PKR mln

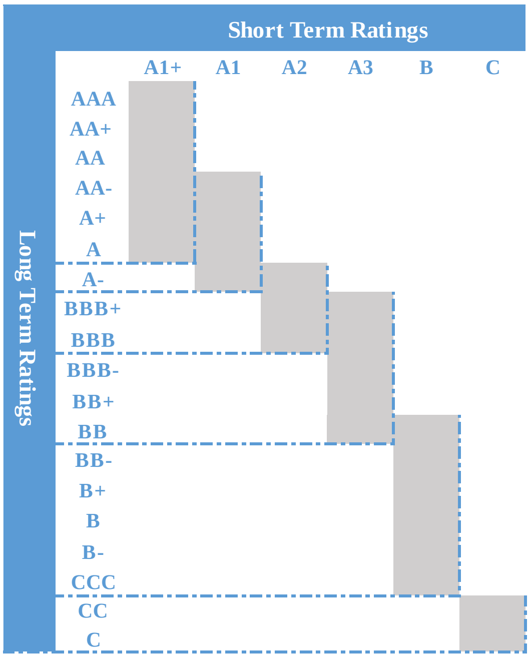
Askari Bank Limited Listed Public Limited	Sep-19 9M	Dec-18 12M	Dec-17 12M	Dec-16 12M
A BALANCE SHEET				
1 Total Finances - net	378,550	348,018	264,105	238,158
2 Investments	321,533	254,818	308,439	291,889
3 Other Earning Assets	12,331	10,639	11,253	16,666
4 Non-Earning Assets	108,847	92,552	77,789	71,463
5 Non-Performing Finances-net	2,892	505	1,106	963
Total Assets	824,153	706,532	662,691	619,139
6 Deposits	647,887	573,636	525,808	472,811
7 Borrowings	97,401	62,696	76,580	94,257
8 Other Liabilities (Non-Interest Bearing)	41,010	36,691	27,867	19,494
Total Liabilities	786,298	673,023	630,256	586,562
Equity	37,855	33,509	32,435	32,577
B INCOME STATEMENT				
1 Mark Up Earned	50,737	43,670	36,267	35,408
2 Mark Up Expensed	(34,510)	(25,060)	(20,072)	(20,497)
3 Non Mark Up Income	5,033	5,622	6,108	7,148
Total Income	21,260	24,232	22,304	22,060
4 Non-Mark Up Expenses	(13,316)	(15,892)	(15,142)	(14,301)
5 Provisions/Write offs/Reversals	(731)	(1,461)	1,330	718
Pre-Tax Profit	7,213	6,879	8,492	8,477
6 Taxes	(2,834)	(2,448)	(3,224)	(3,256)
Profit After Tax	4,379	4,431	5,268	5,221
C RATIO ANALYSIS				
1 Performance				
Net Mark Up Income / Avg. Assets	2.8%	2.7%	2.5%	2.6%
Non-Mark Up Expenses / Total Income	62.6%	65.6%	67.9%	64.8%
ROE	16.4%	13.4%	16.2%	17.6%
2 Capital Adequacy				
Equity / Total Assets (D+E+F)	4.6%	4.7%	4.9%	5.3%
Capital Adequacy Ratio	12.7%	12.5%	12.1%	12.5%
3 Funding & Liquidity				
Liquid Assets / (Deposits + Borrowings Net of Repo)	46.8%	46.6%	55.4%	54.1%
(Advances + Net Non-Performing Advances) / Deposits	57.7%	59.8%	49.2%	49.7%
CA Deposits / Deposits	27.7%	28.7%	27.6%	26.7%
SA Deposits / Deposits	55.3%	55.2%	55.7%	54.0%
4 Credit Risk				
Non-Performing Advances / Gross Advances	7.2%	7.2%	9.4%	10.9%
Non-Performing Finances-net / Equity	7.6%	1.5%	3.4%	3.0%

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.

Harmonization A change in rating due to revision in applicable methodology or underlying scale.

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Rating Team Statements
(1) Rating is just an opinion about the creditworthiness of the entity and does not constitute recommendation to buy, hold or sell any security of the entity rated or to buy, hold or sell the security rated, as the case may be | Chapter III; 14-3-(x)

2) **Conflict of Interest**
i. The Rating Team or any of their family members have no interest in this rating | Chapter III; 12-2-(j)
ii. PACRA, the analysts involved in the rating process and members of its rating committee, and their family members, do not have any conflict of interest relating to the rating done by them | Chapter III; 12-2-(e) & (k)
iii. The analyst is not a substantial shareholder of the customer being rated by PACRA [Annexure F; d-(ii)] Explanation: for the purpose of above clause, the term “family members” shall include only those family members who are dependent on the analyst and members of the rating committee

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(3) No director, officer or employee of PACRA communicates the information, acquired by him for use for rating purposes, to any other person except where required under law to do so. | Chapter III; 10-(5)
(4) PACRA does not disclose or discuss with outside parties or make improper use of the non-public information which has come to its knowledge during business relationship with the customer | Chapter III; 10-7-(d)
(5) PACRA does not make proposals or recommendations regarding the activities of rated entities that could impact a credit rating of entity subject to rating | Chapter III; 10-7-(k)

Conduct of Business
(6) PACRA fulfills its obligations in a fair, efficient, transparent and ethical manner and renders high standards of services in performing its functions and obligations; | Chapter III; 11-A-(a)
(7) PACRA uses due care in preparation of this Rating Report. Our information has been obtained from sources we consider to be reliable but its accuracy or completeness is not guaranteed. PACRA does not, in every instance, independently verifies or validates information received in the rating process or in preparing this Rating Report.
(8) PACRA prohibits its employees and analysts from soliciting money, gifts or favors from anyone with whom PACRA conducts business | Chapter III; 11-A-(q)
(9) PACRA ensures before commencement of the rating process that an analyst or employee has not had a recent employment or other significant business or personal relationship with the rated entity that may cause or may be perceived as causing a conflict of interest; | Chapter III; 11-A-(r)
(10) PACRA maintains principal of integrity in seeking rating business | Chapter III; 11-A-(u)
(11) PACRA promptly investigates, in the event of a misconduct or a breach of the policies, procedures and controls, and takes appropriate steps to rectify any weaknesses to prevent any recurrence along with suitable punitive action against the responsible employee(s) | Chapter III; 11-B-(m)

Independence & Conflict of interest
(12) PACRA receives compensation from the entity being rated or any third party for the rating services it offers. The receipt of this compensation has no influence on PACRA´s opinions or other analytical processes. In all instances, PACRA is committed to preserving the objectivity, integrity and independence of its ratings. Our relationship is governed by two distinct mandates i) rating mandate - signed with the entity being rated or issuer of the debt instrument, and fee mandate - signed with the payer, which can be different from the entity
(13) PACRA does not provide consultancy/advisory services or other services to any of its customers or to any of its customers’ associated companies and associated undertakings that is being rated or has been rated by it during the preceding three years unless it has adequate mechanism in place ensuring that provision of such services does not lead to a conflict of interest situation with its rating activities; | Chapter III; 12-2-(d)
(14) PACRA discloses that no shareholder directly or indirectly holding 10% or more of the share capital of PACRA also holds directly or indirectly 10% or more of the share capital of the entity which is subject to rating or the entity which issued the instrument subject to rating by PACRA; | Reference Chapter III; 12-2-(f)
(15) PACRA ensures that the rating assigned to an entity or instrument is not be affected by the existence of a business relationship between PACRA and the entity or any other party, or the non-existence of such a relationship | Chapter III; 12-2-(i)
(16) PACRA ensures that the analysts or any of their family members shall not buy or sell or engage in any transaction in any security which falls in the analyst’s area of primary analytical responsibility. This clause shall, however, not be applicable on investment in securities through collective investment schemes. | Chapter III; 12-2-(l)
(17) PACRA has established policies and procedure governing investments and trading in securities by its employees and for monitoring the same to prevent insider trading, market manipulation or any other market abuse | Chapter III; 11-B-(g)

Monitoring and review
(18) PACRA monitors all the outstanding ratings continuously and any potential change therein due to any event associated with the issuer, the security arrangement, the industry etc., is disseminated to the market, immediately and in effective manner, after appropriate consultation with the entity/issuer; | Chapter III | 18-(a)
(19) PACRA reviews all the outstanding ratings on semi-annual basis or as and when required by any creditor or upon the occurrence of such an event which requires to do so; | Chapter III | 18-(b)
(20) PACRA initiates immediate review of the outstanding rating upon becoming aware of any information that may reasonably be expected to result in downgrading of the rating; | Chapter III | 18-(c)
(21) PACRA engages with the issuer and the debt securities trustee, to remain updated on all information pertaining to the rating of the entity/instrument; | Chapter III | 18-(d)
Probability of Default
(22) PACRA´s Rating Scale reflects the expectation of credit risk. The highest rating has 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 | Chapter III | 14-(f-VII)
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