The Pakistan Credit Rating Agency Limited

Rating Report

Bank Alfalah Limited | Additional Tier 1 TFC | 7bln

Report Contents

Rating History

Dissemination Date	Long Term Rating	Short Term Rating	Outlook	Action	Rating Watch
14-Feb-2024	AA-	-	Stable	Maintain	-
27-Jun-2023	AA-	-	Stable	Maintain	-
29-Jun-2022	AA-	-	Stable	Initial	-

Rating Rationale and Key Rating Drivers

The ratings highlight the bank's improved performance, strong financial profile, good asset quality, and healthy liquidity. As a customer-centric bank with a focus on technological advancement, the Bank has a strong nationwide presence, enabling it to capture a significant share in ADC and digital transactions. With lower advances base and increase in subjective non-performing loans, the infection ratio stood at 5.4% at end-Sep’23 (CY22: 4%). While maintaining regular dividend payouts, the bank CAR improved to 15.50% (compared to 13.83% in CY22). The Bank has achieved a notable level of deposits, resulting in a Net advance to deposit ratio (ADR) of 49.3% as of end-Dec’22. The Net ADR declined to 36.5% at end Sep’23 due to reduction in advances. The cost of funds increased in line with industry trends due to the prevailing high policy rate for the year. The bank's profitability has reflected significant growth, with a 93.4% increase in profit after tax (PAT) in 9MCY23 as compared to the corresponding previous period. The effective implementation of the long-term business strategy, coupled with stable ownership, an experienced management team, prudent risk management policies, and improving its market position, provides confidence in the bank's performance.

The bank's growth trajectory, particularly in terms of nurturing its deposit base while enhancing granularity, is viewed positively.

Disclosure

Name of Rated Entity	Bank Alfalah Limited | Additional Tier 1 TFC | 7bln
Type of Relationship	Solicited
Purpose of the Rating	Debt Instrument Rating
Applicable Criteria	Methodology | Rating Modifiers(Apr-23),Methodology | Debt Instrument Rating(Aug-23),Methodology | Financial Institution Rating(Oct-23)
Related Research	Sector Study | Commercial Bank(Jun-23)
Rating Analysts	Uswa Sikandar | uswa.sikandar@pacra.com | +92-42-35869504

Issuer Profile

Profile Bank Alfalah Limited (hereinafter referred as “BAFL” or “the Bank”) was incorporated as a public limited company, in 1992, and is listed on Pakistan Stock Exchange (PSX). Bank Alfalah, established in 1992, has experienced remarkable growth to become a prominent private commercial bank in Pakistan. It holds a significant position in credit card issuance and acquisition, SME, digital banking, and remittances and is recognized as one of the major players in Islamic Banking in the country. With an extensive network of 942 branches (including conventional, corporate, Islamic, and foreign branches), as well as ATMs and CDMs/CCDMs, the bank operates across more than 225 cities in Pakistan as at end-Sep'23. Bank provides financial solutions to consumers, corporations, institutions, and governments through a broad spectrum of products and services, including corporate and investment banking, consumer banking, digital banking and credit, commercial, SME, agri-finance, Islamic, and asset financing.

Ownership Ownership Bank Alfalah (BAFL) is majority-owned by the Abu Dhabi Group (The Group), with a stake of 56.16%. Other stakeholders include Mutual Funds, NBFCs, FIs, DFIs, individuals (43.70%), and executives (0.14%). The Group has retained the majority shareholding, for the last many years and is expected to remain the same in the foreseeable future. The Group consists of some of the prominent members of UAE’s ruling family and leading businessmen of UAE. The group has investments in countries including Pakistan, Bangladesh, and the Middle East. Sponsors, having close ties with the ruling family of UAE, possess strong financial ability to support BAFL in case of need.

Governance Currently, BAFL's board consists of eight members, including the President/CEO and seven non-executive directors. Out of the seven non-executive directors, four represent the Abu Dhabi Group, while the remaining three members serve as independent directors. The chairman of the board, H.H. Sheikh Nahayan Mabarak Al Nahayan, is a prominent member of the ruling family, UAE. Currently, he is a UAE Cabinet Member and Minister of State for Tolerance and Coexistence. To ensure effective and independent oversight of the Bank’s overall operations, the Bank has constituted eight committees namely, i) Audit Committee, ii) Human Resource, Remuneration & Nomination Committee, iii) Risk Management Committee, iv) IT Committee, v) Strategy and Finance Committee, vi) Compensation Committee, vii) Real Estate Committee, and viii) Crisis Management Committee. The retiring external auditors of the Bank, EY Ford Rhodes, Chartered Accountants, issued an unqualified audit opinion on annual financial statements for CY22. Furthermore, the Board has an effective internal audit function that reports independently to the Audit Committee.

Management BAFL has a lean organizational structure that clearly defines responsibilities, authority, and reporting lines with proper monitoring and compliance mechanisms. The Bank’s senior management team comprises experienced bankers having national and international exposure. Mr. Atif Bajwa joined Bank Alfalah as President and CEO in 2020. Mr. Bajwa has held numerous senior positions in large local and multinational banks, which include: President/CEO of Bank Alfalah, previously President/CEO of MCB Bank and Soneri Bank. Bank Alfalah has three main management committees for the purpose of strategic planning and decision-making under the Chairmanship of the CEO; (a) Central Management Committee; (b) Central Credit Committee; and (c) Digital Council. The Bank uses Temenos (T-24) as its core banking software across all branches and head office operations. The Board Risk Management Committee (BRMC) is appointed and authorized by the Board of Directors (BOD) to assist in the design, regular evaluation, and timely updating of the risk management framework of the Bank. The Board has further authorized management committees i.e., Central Management Committee (CMC) and Central Credit Committee (CCC) to supervise risk management activities within their respective scopes.

Business Risk Pakistan's economy experienced a notable decline in FY23, witnessing a sharp drop in its real GDP growth to a mere 0.3%. However, despite this, the banking sector has been thriving primarily due to higher net interest income, driven by increased interest rates. For the period ended 3QCY23, Pakistan's banking sector's total assets posted growth of ~25% YoY whilst investments surged by 29% to PKR ~23.26trln (end-Dec22: PKR ~18.4trln). Gross Advances of the sector recorded growth (6%) to stand at PKR ~12.596trln (end-Dec22: PKR ~12.645trln). Non-performing loans witnessed a slight uptick of 7% YoY to PKR ~965bln. The capital Adequacy Ratio stood at 19.1% (regulatory requirement of 11.5%). In CY22, BAFL's markup earned increased to PKR 213.9bln (CY21: PKR 100.4bln). Net markup income surged by 66.9% to PKR 77.3bln (CY21: PKR 46.3bln). The asset yield rose to 12.2% (CY21: 7.3%), resulting in a spread of 4.5% (CY21: 3.3%). In 3QCY23, markup earned reached PKR 286.2bln, marking a 98.6% increase from 3QCY22 (PKR 144.10bln), and net markup income stood at PKR 91bln (3QCY22: PKR 54bln). In CY22, the Bank witnessed a 33.7% increase in non-markup income to PKR 21.8bln (CY21: PKR 16.3bln). Non-markup expenses rose by 37.2% YoY to PKR 50.5bln (CY21: PKR 36.8bln). Profit Before Tax at end-Dec'22 increased by 54.7% to stand at PKR 36.2bln (end-Dec'21: PKR 23.4bln) and further inclined to PKR 52.8bln in 3QCY23, while profit after tax increased to PKR 18.2bln in CY22 (CY21: PKR 14.2bln), and to PKR 27.3bln in 3QCY23. Bank Alfalah is poised for sustainable growth and value creation in a challenging economic environment. The Bank will continue to invest in Digital banking, Technology, Human Capital, and Strong Governance. The focus will be on expanding its network, building a low-cost deposit base, optimizing returns, and maintaining cost discipline. Prudent risk management practices will be followed amidst elevated interest rates and potential credit challenges.

Financial Risk In CY22, Bank Alfalah's net advances grew by 8.7% to PKR 732.4bln (CY21: PKR 673.9bln), and dropped to PKR 665.6bln as at 3QCY23. The non-performing loan base in CY22 increased to PKR 30.9bln (CY21: 24.7bln), resulting in an infection ratio of 4% (CY21: 3.5%). The non-performing loans and infection ratio increased to PKR 37.9bln and 5.4% respectively as at 3QCY23. The coverage ratio, including general reserve and subjective provisioning, improved to 107.6% in CY22 (CY21: 101.9%), and to 112.5% as at 3QCY23. The bank's investment portfolio (excluding non-government debt) surged by 38.8% to PKR 1,092.5bln in CY22 (CY21: PKR 787.1bln) where PIBs reached PKR 896.1bln (CY21: PKR 510.7bln). The bank's investment portfolio surged to PKR 1,482.6bln in 3QCY23. The Total deposits of the Bank increased to PKR 1,821.3bln in 3QCY23 (CY22: PKR 1,486.8bln, CY21: PKR 1,139.0bln). The Net Advances to Deposit Ratio (ADR) was recorded at 36.5% in 3QCY23 (CY22: 49.3%, CY21: 59.2%). In 3QCY23, the CASA ratio slightly decreased to 70.6% (CY22: 71.7%, CY21: 76.9%). Total borrowings (including subordinated debt) increased to PKR 519.8 in 3QCY23 (PKR 505.2bln in CY22 & PKR 390.8bln in CY21). As at CY22, Bank Alfalah maintained a Tier 1 capital of 11.09%, resulting in a CAR of 13.83% (CY21: 14.43%) exceeding the regulatory requirement of 11.50%. As at 3QCY23, the CAR further improved to 15.50%.

Instrument Rating Considerations

About The Instrument The Bank issued an Additional Tier-I Term Finance certificate amounting to PKR 7bln. The instrument is listed, unsecured, perpetual, non-cumulative and contingent convertible. The issue contributes towards supporting the Bank’s Capital Adequacy Ratio (CAR) by strengthening additional Tier-I Capital as per guidelines set by SBP. Mark-up is payable semiannually in arrears on outstanding principal amount @6MK+1.5%. The TFCs may be recalled and replaced with similar or better-quality capital, subject to SBP approval, after five years from the issue date on principal redemption date or thereafter, subject to call option condition. As per lock-in clause requirement, neither profit nor principal would be payable (even at maturity), if such payment will result in a shortfall in Bank's minimum capital requirement (MCR), leverage ratio (LR) or CAR or results in an increase in any existing shortfall in MCR, LR or CAR. The TFC is subject to a loss absorbency clause, which upon the occurrence of Non-Viability event, SBP may fully or permanently convert the TFCs into common shares of the Bank.

Relative Seniority/Subordination Of Instrument The TFCs will be subordinated to the payment of principal and profit, to all other indebtedness of the Bank, including deposits.

Credit Enhancement The instrument is unsecured.

PKR mln

Bank AlFalah Listed Public Limited	Sep-23 9M	Dec-22 12M	Dec-21 12M	Dec-20 12M
A BALANCE SHEET				
1 Total Finances - net	693,811	756,661	696,483	595,856
2 Investments	1,482,594	1,092,467	787,094	526,274
3 Other Earning Assets	73,894	117,750	48,064	101,387
4 Non-Earning Assets	430,015	288,665	203,163	159,080
5 Non-Performing Finances-net	(4,725)	(2,347)	(483)	2,276
Total Assets	2,675,589	2,253,197	1,734,321	1,384,874
6 Deposits	1,821,313	1,486,845	1,139,045	881,767
7 Borrowings	519,793	505,180	390,809	321,960
8 Other Liabilities (Non-Interest Bearing)	214,741	161,157	104,465	90,129
Total Liabilities	2,555,847	2,153,182	1,634,319	1,293,856
Equity	119,742	100,015	100,003	91,017
B INCOME STATEMENT				
1 Mark Up Earned	286,233	213,897	100,402	92,616
2 Mark Up Expensed	(195,247)	(136,558)	(54,134)	(47,911)
3 Non Mark Up Income	18,519	21,786	16,254	12,795
Total Income	109,504	99,126	62,522	57,499
4 Non-Mark Up Expenses	(47,587)	(50,497)	(36,840)	(32,032)
5 Provisions/Write offs/Reversals	(9,164)	(12,468)	(2,312)	(7,589)
Pre-Tax Profit	52,753	36,160	23,370	17,878
6 Taxes	(25,501)	(17,954)	(9,154)	(7,403)
Profit After Tax	27,252	18,206	14,217	10,475
C RATIO ANALYSIS				
1 Performance				
Net Mark Up Income / Avg. Assets	4.9%	3.9%	3.0%	3.6%
Non-Mark Up Expenses / Total Income	43.5%	50.9%	58.9%	55.7%
ROE	33.1%	18.2%	14.9%	11.7%
2 Capital Adequacy				
Equity / Total Assets (D+E+F)	4.5%	4.4%	5.8%	6.6%
Capital Adequacy Ratio	15.5%	13.8%	14.4%	16.5%
3 Funding & Liquidity				
Liquid Assets / (Deposits + Borrowings Net of Repo)	68.7%	56.6%	54.4%	46.3%
(Advances + Net Non-Performing Advances) / Deposits	36.5%	49.3%	59.2%	65.5%
CA Deposits / Deposits	41.0%	44.5%	44.0%	44.7%
SA Deposits / Deposits	29.6%	27.2%	32.9%	33.2%
4 Credit Risk				
Non-Performing Advances / Gross Advances	5.4%	4.0%	3.5%	4.3%
Non-Performing Finances-net / Equity	-3.9%	-2.3%	-0.5%	2.5%

Credit Rating

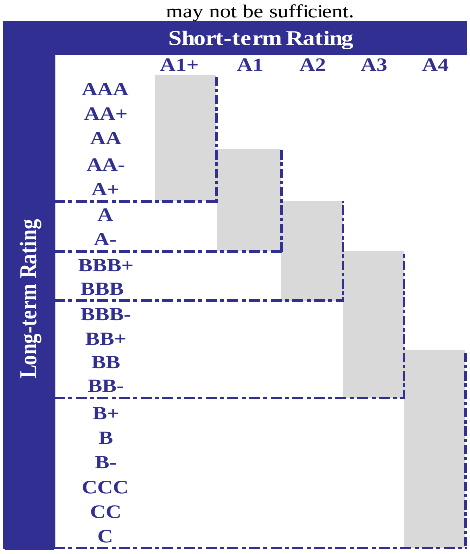
Credit rating reflects forward-looking opinion on credit worthiness of underlying entity or instrument; more specifically it covers relative ability to honor financial obligations. The primary factor being captured on the rating scale is relative likelihood of default.

Long-term Rating

Scale	Definition
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 Rating

Scale	Definition
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
A4	The capacity for timely repayment is more susceptible to adverse changes in business, economic, or financial conditions. Liquidity may not be sufficient.



**The correlation shown is indicative and, in certain cases, may not hold.*

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 some material identifiable event with indeterminable rating implications. 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 rating 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) the debt instrument is redeemed, c) the rating remains suspended for six months, d) the entity/issuer defaults., or/and e) 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.

Surveillance. Surveillance on a publicly disseminated rating opinion is carried out on an ongoing basis till it is formally suspended or withdrawn. A comprehensive surveillance of rating opinion is carried out at least once every six months. However, a rating opinion may be reviewed in the intervening period if it is necessitated by any material happening.

Note. This scale is applicable to the following methodology(s):

a) Broker Entity Rating
b) Corporate Rating
c) Debt Instrument Rating
d) Financial Institution Rating
e) Holding Company Rating
f) Independent Power Producer Rating
g) Microfinance Institution Rating
h) Non-Banking Finance Companies Rating

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

Restrictions
(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 | Clause 11-(A)(p).
(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 | 17-(a)
(19) PACRA reviews all the outstanding ratings periodically, on annual basis; Provided that public dissemination of annual review and, in an instance of change in rating will be made; | Chapter III | 17-(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 | 17-(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 | 17-(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 | 14-3(f)(vii)
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Regulatory and supplementary Disclosure

Nature of Instrument	Size of Issue (PKR)	Tenor	Security	Nature of Assets	Trustee
TFC - ADT 1	7 Bln	Perpetual	Unsecured and subordinated to all other obligations of the bank.	N/A	Pak Brunei Investements Limited

Bank Alfalah Limited | TFC | Additional Tier I | Mar-18	
Name of Issuer	Bank Alfalah Limited
Maturity	Perpetual (unless Call Option is exercised)
Profit Rate	6 months KIBOR + 1.5%
Call Option	Exercisable after Mar-23 (5 years)
Principal Repayment	N/A
Security	Instrument is unsecured and subordinated as to payment of principal and profit to all other claims except common shares.

Repayment Schedule

Opening Principal	Principal Repayment	Due Date Markup/ Profit	6M Kibor + 1.5%	Markup/Profit Payment	Installment Payable	Principal Outstanding
PKR in mln						*PKR in mln*

Redemption Schedule not applicable since its a perpetual TFC whereby there is no fixed or final redemption date. Profit (if declared) will be payable semi-annually in arrears, on a non-cumulative basis, on the outstanding TFC amount. The first such profit payment will fall due six months from the Issue Date and subsequently every six months thereafter subject to complying with regulatory requirements. The instrument carries a call option which may be exercised after Mar-23 (5 years), subject to approval of the SBP.