The Pakistan Credit Rating Agency Limited

Rating Report

MCB Bank Limited

Report Contents

Rating History

Dissemination Date	Long Term Rating	Short Term Rating	Outlook	Action	Rating Watch
27-Jun-2018	AAA	A1+	Stable	Maintain	-
29-Dec-2017	AAA	A1+	Stable	Maintain	-
19-Jun-2017	AAA	A1+	Stable	Maintain	-
24-Jun-2016	AAA	A1+	Stable	Maintain	-
24-Jun-2015	AAA	A1+	Stable	Maintain	-

Rating Rationale and Key Rating Drivers

The ratings take note of MCB's sustained financial profile, reflected in very strong capitalization, sound liquidity and diverse deposit base. This has been enabled by the bank's able parentage, wherein a diverse mix of sponsors - mainly led by Nishat Group - have been providing an effective oversight. The ratings factor in MCB's strong market positioning, supported by its well established brand name and substantial out-reach. MCB has the highest CASA in the industry, with lowest cost of funds amongst all players. The bank has added a sizeable chunk to its deposit base. The bank continues with its current strategy of lending to premier corporates with sustained focus on government exposure. Lately, the bank has added momentum to its growth trajectory. At the same time, beefing up of the consumer and SME book is also anticipated amidst improving fundamentals. The bank has established an Islamic Banking subsidiary, thereby, becoming the first conventional bank to do so. NIB Bank Limited was merged with and into MCB in July-17. Post-merger, MCB's risk profile has sustained - which bodes well for the bank.

The ratings are dependent on the bank's ability to hold its existing position in the banking sector. Any deterioration in the perceived strength of the bank or ownership with consequent impact upon its governance efficacy would have negative implication. Further strengthening of human resource would be vital.

Disclosure	
Name of Rated Entity	MCB Bank Limited
Type of Relationship	Solicited
Purpose of the Rating	Entity Rating
Applicable Criteria	Methodology | Bank Rating(Jun-17)
Related Research	Sector Study | Commercial Bank(Jun-18)
Rating Analysts	Muhammad Obaid | muhammad.obaid@pacra.com | +92-42-35869504 Jhangeer Hanif | jhangeer@pacra.com | +92-42-35869504

MCB BANK LIMITED PROFILE	
Incorporated	1947
Major Business	Commercial Bank
Legal Status	Listed
Head Office	Lahore

PROFILE AND OWNERSHIP

- MCB Bank Limited (MCB), incorporated in 1947, is listed and is the fourth largest bank in terms of its share in total customer deposits (8%) as at end-Dec17.
- The bank has one of the largest branch networks with a distinct franchise (1,433 domestic online branches at end-Dec17).
- MCB Bank is majority owned by Nishat group (~36%), a prominent business conglomerate, followed by Malayan Banking Berhad (Maybank) of Malaysia, has 19% stake in MCB.

GOVERNANCE AND MANAGEMENT

- Mian Mohammad Mansha – one of the leading businessman and the man behind Nishat Group – is the chairman of MCB's thirteen-member board of directors.
- President and CEO Mr. Imran Maqbool is an executive director while others are non-executive directors including two representatives of Maybank.

RISK MANAGEMENT

- Top twenty funded exposure dropped by 4% on YoY basis to 28% (CY16: 32%), although in line with peers, remains high.
- Proportion of short term loans including working capital and trade finance loans in total advances declined to 41% (CY16: 44%).
- The bank's gross NPLs witnessed a rise in CY17 owing to transfer of NPLs from NIB under the merger. Consequently, the infection ratio of the bank has deteriorated (CY17: 9.5%, CY16: 5.9%).
- The investment portfolio showed a robust growth of 18% to PKR 657bln during CY17 (CY16: PKR 556bln). The bank's investment portfolio constitutes 49% of the asset base and govt. securities continue to dominate the overall investment book (92%).
- The liquidity ratio remained robust at 66% (CY16: 73%) with a slight decline on a YoY basis.

BUSINESS RISK

- During CY17, the banks total earning assets grew by a whopping 25%. Nearly 86% of total assets are earning assets mainly comprising finances (36%) and investments (49%).
- The bank's interest revenue increased by ~10% on a YoY basis (CY16: -16%), primarily due to increasing business volume and shifting investment mix from PIBs to shorter maturity T-Bills.
- The banks yield on advances was impacted by declining interest rates as it dropped to 6.81% (CY16: 7.26%).
- The portfolio is dominated by T-bills (59%), followed by PIBs (34%) and Equity Securities (6%).
- The bank's cost of deposits remained stagnant at 2.49% in CY17 (CY16: 2.49%). With stagnant cost of funds side coupled with lower revenue spreads, resulted in deterioration of NIMR. Resultantly the net spread for CY17 dropped to 3.52% (CY16: 4.62%). Non-markup expenses witnessed a sharp increase of 23%, driven primarily by increasing personnel expenses. The decline in revenue stream resulted in increase in the cost to total net revenue on a YoY basis (CY17: 48%, CY16: 39%).

FINANCIAL RISK

- The bank's net interest revenue decreased by ~3%.
- During CY17, the spreads decreased by 110bps (CY17: 3.5%, CY16: 4.6%) on account of decrease in asset yields.
- In comparison with the corresponding period last year, Profit Before Tax has decreased by 14.0% whereas Profit After Tax has increased by 2.6%.

CAPITAL RISK

- The bank added customer deposits worth PKR 183bln, (CY17: PKR 947bln, CY16: PKR 764bln) which led to a stellar growth of 24%. The gross advances (net of NPLs) to deposit ratio increased by 4% (CY17:49%, CY16: 45%).
- MCB has one of the highest reported capitalization level in the banking sector, with capital adequacy ratio (CAR) at 16.44%.

MCB Bank Limited

PKR mln

BALANCE SHEET	31-Dec-17	31-Dec-16	31-Dec-15	31-Dec-14
	Annual	Annual	Annual	Annual
Earning Assets				
Advances (Net of NPLs)	466,305	346,126	312,258	300,410
Debt Instruments	7,797	5,899	9,927	8,246
Total Finances	474,102	352,025	322,185	308,656
Investments	649,166	550,030	558,875	502,891
Others	15,507	10,063	12,651	8,083
	1,138,776	**912,118**	**893,711**	**819,630**
Non Earning Assets				
Non-Earning Cash	99,542	71,313	57,372	43,105
Deferred Tax	-	-	-	-
Net Non-Performing Finances	3,051	1,990	1,867	3,149
Fixed Assets & Others	85,942	66,393	63,679	68,747
	188,535	**139,696**	**122,918**	**115,001**
TOTAL ASSETS	**1,327,311**	**1,051,814**	**1,016,630**	**934,632**
Interest Bearning Liabilities				
Deposits	580,223	472,924	435,435	444,709
Borrowings	136,962	74,515	118,459	59,543
	717,185	547,439	553,894	504,252
Non Interest Bearing Liabilities	456,559	362,748	324,935	300,276
TOTAL LIABILITIES	**1,173,745**	**910,187**	**878,829**	**804,527**
EQUITY (including revaluation surplus)	**153,566**	**141,627**	**137,800**	**130,104**
Total Liabilities & Equity	**1,327,311**	**1,051,814**	**1,016,630**	**934,632**

INCOME STATEMENT	31-Dec-17	31-Dec-16	31-Dec-15	31-Dec-14
	Annual	Annual	Annual	Annual
Interest / Mark up Earned	74,091	67,422	80,532	77,269
Interest / Mark up Expensed	(31,684)	(23,655)	(31,210)	(33,757)
Net Interest / Markup revenue	**42,407**	**43,767**	**49,322**	**43,512**
Other Operating Income	17,674	15,901	16,705	12,747
Total Revenue	**60,081**	**59,668**	**66,027**	**56,259**
Other Income / (Loss)	286	320	410	197
Non-Interest / Non-Mark up Expensed	(28,679)	(23,260)	(23,560)	(21,668)
Pre-provision operating profit	31,688	36,728	42,877	34,788
Provisions	(673)	(654)	(544)	1,941
Pre-tax profit	31,014	36,075	42,333	36,729
Taxes	(8,555)	(14,184)	(16,782)	(12,405)
Net Income	**22,459**	**21,891**	**25,550**	**24,325**

Ratio Analysis	31-Dec-17	31-Dec-16	31-Dec-15	31-Dec-14
	Annual	Annual	Annual	Annual
Performance				
ROE	17.7%	19.0%	23.2%	23.8%
Cost-to-Total Net Revenue	48.0%	39.0%	35.7%	38.5%
Provision Expense / Pre Provision Profit	2.1%	1.8%	1.3%	5.6%
Equity/Total Assets	10.3%	11.2%	11.1%	11.4%
Funding & Liquidity				
Liquid Assets / Deposits and Borrowings	66.1%	73.1%	74.9%	75.5%
Advances / Deposits	48.5%	44.5%	44.4%	44.1%
CASA deposits / Total Customer Deposits	92.9%	94.1%	92.9%	90.8%
Intermediation Efficiency				
Asset Yield	7.4%	7.7%	9.6%	10.3%
Cost of Funds	3.2%	2.8%	4.0%	4.8%
Spread	4.1%	4.9%	5.7%	5.6%
Outreach				
Branches	1,444	1,238	1,246	1,232

The Pakistan Credit Rating Agency Limited

ENTITY CREDIT RATING SCALE & DEFINITIONS

Credit rating reflects forward-looking opinion on credit worthiness of underlying entity; 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

Rating	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 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 or 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.

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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(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.
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(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)

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(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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