



The Pakistan Credit Rating Agency Limited

## Rating Report

### MCB Islamic Bank Limited

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#### Rating History

Dissemination Date	Long Term Rating	Short Term Rating	Outlook	Action	Rating Watch
23-Jun-2023	A	A1	Stable	Maintain	-
23-Jun-2022	A	A1	Stable	Maintain	-
23-Jun-2021	A	A1	Stable	Maintain	-
25-Jun-2020	A	A1	Stable	Maintain	-
27-Dec-2019	A	A1	Stable	Maintain	-
27-Jun-2019	A	A1	Stable	Maintain	-
26-Dec-2018	A	A1	Positive	Maintain	-
29-Jun-2018	A	A1	Positive	Maintain	-
16-Oct-2017	A	A1	Stable	Maintain	-

#### Rating Rationale and Key Rating Drivers

MCB Islamic Bank Limited (MCB Islamic) is a wholly owned subsidiary of MCB Bank Limited (MCB). MCB has a long-term rating of "AAA" reflecting its robust profile, duly supplemented by its strong market position in the local banking landscape, established brand equity, and sound financial profile. The area of growth is the supply chain vendors, where the group has a good understanding and also a presence in one form or the other. The deposit expansion is expected to be exacerbated with a renewed emphasis on Islamic banking and optimal use of the network. MCB Islamic is a small-sized bank and has witnessed an increase of 20.3% in its customers' deposits. During CY22, recorded an inched uptick in its system share (Dec: 0.7%; Dec21: 0.6%). There is heightened focus on deposit mobilization, wherein the parent's footprints would help. The continuous focus on the accumulation of low-cost deposits has resulted in a healthy current and savings (CASA) deposit mix. However, the deposit mix and concentration need further improvement. Advances to Deposit Ratio (ADR) remain on the higher side, relative to peers. The financing portfolio in CY22 grew slightly lower than the industry, leading to a nominal change in market share. Exposures comprise largely private sector, mid-tier clients, concentrated in the Transportation, Textiles, Food & Beverages, and Services sectors. Asset quality indicators have recorded a decline over time, although they remain better than the peer average. The Bank's equity base increased after a capital injection of PKR 4bln. The bank's CAR recorded a sizable increase in Dec-22 and stood at 20.4%, which has a sizable cushion in place above the required limit of CAR at 11.5%. Profitability in CY22 was supported by growth in non-markup income. Going forward, under the new leadership, the management is positive regarding securing growth. The management intends to continue with its strategy of long-term sustainable profitability by focusing on mobilizing no and low-cost deposits along with high-earning assets and containment of operating costs. However, the ability to manage the asset quality will be critical for the Bank. The envisaged strategy will encompass a documented vision for the bank.

The ratings are dependent on Bank's ability to hold its risk profile while maintaining its relative market position in the banking industry. Any weakening in asset quality will in turn put pressure on the Bank's profitability and risk absorption capacity.

#### Disclosure

<b>Name of Rated Entity</b>	MCB Islamic Bank Limited
<b>Type of Relationship</b>	Solicited
<b>Purpose of the Rating</b>	Entity Rating
<b>Applicable Criteria</b>	Methodology   Financial Institution Rating(Jun-22),Methodology   Correlation Between Long-term & Short-term Rating Scales(Jun-22),Methodology   Rating Modifiers(Jun-22)
<b>Related Research</b>	Sector Study   Commercial Bank(Jun-23)
<b>Rating Analysts</b>	Sehar Fatima   sehar.fatima@pacra.com   +92-42-35869504



## Profile

**Structure** MCB Islamic Bank Limited (MCB Islamic) was incorporated in Pakistan as an unlisted Public Limited Company on May 15, 2014.

**Background** After issuance of Certificate of Commencement of Banking Business by the State Bank of Pakistan (SBP) in Sep'15, MCB Islamic started its commercial operations as an Islamic Bank in Oct'15. In Mar'16, Lahore High Court approved demerger of Islamic Banking Group (IBG) of MCB Bank Limited from MCB and its merger with and into MCB Islamic. Resultantly, all domestic Islamic banking operations of MCB-IBG were incorporated into MCB Islamic w.e.f September 30, 2015 for PKR 7.9bln.

**Operations** The Bank is engaged in corporate, commercial, consumer, microfinance, investment and retail banking activities. The Bank is operating through 201 branches including one sub-branch in Pakistan as at Mar23 (Dec 22: 198 branches; Dec 21: 177 branches) branches including one sub-branch in Pakistan.

## Ownership

**Ownership Structure** MCB Islamic is a wholly owned subsidiary of MCB Bank Limited (MCB).

**Stability** The stability of the Bank will stay intact with strong sponsor support.

**Business Acumen** Nishat Group (the sponsor group), including individual holdings and holding through group corporates, is a premier business house of Pakistan. The Group is one of the leading and most diversified in South East Asia, having presence in numerous industries and sectors.

**Financial Strength** Apart from MCB Islamic Bank Limited, MCB Bank Limited has five more subsidiaries. MCB is one of the largest banks in terms of deposits and operates a branch network of 1,448 spread across Pakistan. The bank is rated "AAA/A1+" by PACRA, the bank recorded a net income of PKR 32.7bln in CY22 (CY21 PKR 30.8bln).

## Governance

**Board Structure** The overall control of the Bank vests with eight-member Board of Directors (BoD) including the CEO/ President.

**Members' Profile** Mr. Raza Mansha is the Chairman of the Board. He is accompanied with over 2 decades of diversified experience in various business sectors. Majority of the Board members possess extensive national and international banking and financial services industry experience.

**Board Effectiveness** The Board exercises close monitoring of the management's policies and the Bank's operations through its Committees. While participating in all Board and Committee meetings, active decision making was ensured.

**Financial Transparency** The External Auditors, PWC A.F. Ferguson, Chartered Accountants, issued an unqualified audit opinion about the annual financial statement for CY22. Furthermore, the Board has set up an effective internal audit function that reports independently to the Audit Committee.

## Management

**Organizational Structure** MCB Islamic follows functional structure, where Bank's operations are grouped under thirteen departments.

**Management Team** Mr. Zargham Khan Durrani, the CEO, has an extensive banking career spanning over 27 years. Before joining MCB Islamic Bank, he was the Group Head of Retail Banking (SEVP) at MCB Bank. He is an experienced banking professional having hands-on experience in branch banking, digital banking, and SME / Commercial lending, and the transformation of MCB Bank's retail franchise over the last 15 years is a testament to his success.

**Effectiveness** The Bank has five committees in place at the management level to oversee its day-to-day operational matters and take decisions to implement the strategy outlined by the board.

**MIS** The Bank is operating manual system.

**Risk Management Framework** Five units are working under RMG i) Credit Risk Review, ii) Market and Liquidity Risk Management, iii) Operational Risk and Business Continuity Planning, iv) Fraud Risk, and v) IT Security risk. The Bank, has developed Operational Risk Management Framework. Operations Risk & Internal Control Unit has been working to strengthen the internal control environment of the Bank.

## Business Risk

**Industry Dynamics** The country's economy has gone through several varied phases in the last few years. Looking ahead, the macroeconomic landscape is fraught with numerous challenges, including political instability, elevated interest rates, demand tightening, sizable rupee depreciation, and heightened inflation, all of which reverberate across all sectors of the economy. Pakistan posted a GDP growth rate of 1.69% in 9MFY23 and 4.71% in FY22 (GDP growth figures were revised after the base year was changed from FY05-06 to FY15-16). The banking sector continues to flourish with high profitability. Total banking assets posted growth of 18.5% YoY whilst investments surged by 25% YoY to PKR 18.0trln (end-Dec21: PKR 14.4trln). Gross Advances of the sector recorded growth (16%) to stand at PKR 12.6trln (end-Dec21: PKR 10.9trln). Non-performing loans witnessed an increase to PKR 924bln. The Capital Adequacy Ratio remained intact at 17% (regulatory requirement of 11.5%). However, declined in Mar-23 to 15%. During CY22, banking sector deposits enhanced to PKR 23.4trln. Hence, ADR rationalized to 50% (end-Dec21: 47%). CASA average, for the industry, stood at 74%. Net profitability of the sector was recorded at PKR 331bln (CY21: PKR 267bln); up 23% YoY. However, the growth of the equity base of the sector recorded a meager uptick of 7% YoY attributable to a handsome dividend payout.

**Relative Position** MCB Islamic is a small-sized bank with slow, however sustainable growth and has witnessed an increase of 20.2% in its customer deposit to PKR 143bln (1QCY23: PKR 152bln; CY21: PKR 119bln), with a slight increase in market share of 0.7% (CY21: 0.6%, CY20: 0.6%).

**Revenues** During CY22, the gross markup income of the Bank witnessed an increase of 4.9% to PKR 18.6bln (CY21: PKR 9.2bln) on account of an increase in markup earned on advances. The increase in markup earned was mainly due to the increase in key policy rates during CY22. Consequently, the Bank's net-markup income inclined to PKR 8.5bln (CY21: PKR 4.2bln). The Bank's spread inclined and stood at 5.9% (CY21: 3.7%). During 1QCY23, the Bank markup earned PKR 2.9bln (1QCY22: PKR 1.2bln), reflecting an uptick of 142%. Hence, total income recorded a good improvement to PKR 3.2bln (1QCY22: PKR 1.3bln).

**Performance** The Bank's non-markup income witnessed improvement, clocking in at PKR 868mln (CY21: PKR 199mln), primarily attributable to enhanced foreign exchange income (CY22: PKR 429mln; CY21: PKR 114mln). The increased foreign exchange has remained an industry-wide trend, not considered a sustainable source, due to fluctuation in the exchange rate. The bank's pre-provision operating profit stood at PKR 3.3bln for the year CY22 (CY21: loss of PKR 422mln). A reversal of PKR 403mln was booked. Resultantly, profit for the year was booked at PKR 1.5bln (1QCY23: PKR 840mln; CY21: PKR 101mln).

**Sustainability** Going forward, under the new leadership, the management is positive regarding securing growth. The management intends to continue with its strategy of long-term sustainable profitability by focusing on mobilizing no and low-cost deposits along with high-earning assets and containment of operating costs. However, the ability to manage the asset quality will be critical for the Bank under the current situation.

## Financial Risk

**Credit Risk** During CY22, the net advances of the Bank declined 6% to PKR 89bln (CY21: PKR 95bln), This led to advances in the ratio of the deposit (ADR) at a level of 58.6%. The non-performing loans (NPLs) recorded a sizable increase to PKR 1.7bln (CY21: PKR 702mln) during CY22. Hence, the infection ratio was also affected and posted at 1.8%. On the other hand, the coverage ratio improved to 34.9% (CY21: 26.6%).

**Market Risk** The Bank's investment portfolio constituted 43% of the total earning assets at end-Dec22 (end-Dec21: 37%). However, a significant increase of 116% in investments was seen during CY22. Moreover, the mix of government securities in overall investments also enhanced to 99.9%; hence, the Bank is exposed to relatively low market risk.

**Liquidity And Funding** Bank's liquidity position has seen decent growth as reflected in the liquidity ratio at 51.6% (CY21: 34.1%). During CY22, the Bank was able to maintain its CA at 27.7% (CY21: 30.7%) and the SA ratio slightly increased to 40.0% (CY21: 39.8%). During 1QCY23, the composition indicates that CASA secures 69.8% of the total deposits.

**Capitalization** The Bank's equity base increased after a capital injection of PKR 4bln. The bank's CAR recorded a sizable increase in Dec-22 and stood at 20.4%, which has a sizable cushion in place above the required limit of CAR at 11.5%. The bank's CAR in Mar-23 was recorded at 19.4%. The equity to total asset ratio of MCB Islamic increased to 8.2% in CY22. (CY21: 6.6%).



PKR mln

**MCB Islamic Bank Limited**  
**Un-Listed Public Limited**

Mar-23	Dec-22	Dec-21	Dec-20
3M	12M	12M	12M

**A BALANCE SHEET**

1 Total Finances - net	93,506	89,978	96,819	85,609
2 Investments	71,674	71,899	32,450	26,214
3 Other Earning Assets	4,916	6,172	1,717	830
4 Non-Earning Assets	38,512	29,897	29,766	27,826
5 Non-Performing Finances-net	972	1,094	515	690
<b>Total Assets</b>	<b>209,581</b>	<b>199,040</b>	<b>161,267</b>	<b>141,171</b>
6 Deposits	163,007	154,001	122,748	99,253
7 Borrowings	16,587	14,671	16,473	20,597
8 Other Liabilities (Non-Interest Bearing)	12,933	14,020	11,442	10,593
<b>Total Liabilities</b>	<b>192,527</b>	<b>182,693</b>	<b>150,663</b>	<b>130,443</b>
<b>Equity</b>	<b>17,054</b>	<b>16,347</b>	<b>10,605</b>	<b>10,728</b>

**B INCOME STATEMENT**

1 Mark Up Earned	6,297	18,553	9,203	9,676
2 Mark Up Expensed	(3,410)	(10,032)	(5,009)	(5,281)
3 Non Mark Up Income	271	868	199	678
<b>Total Income</b>	<b>3,157</b>	<b>9,390</b>	<b>4,393</b>	<b>5,074</b>
4 Non-Mark Up Expenses	(1,590)	(6,046)	(4,815)	(4,665)
5 Provisions/Write offs/Reversals	(116)	(141)	647	(15)
<b>Pre-Tax Profit</b>	<b>1,452</b>	<b>3,203</b>	<b>225</b>	<b>393</b>
6 Taxes	(612)	(1,654)	(125)	(185)
<b>Profit After Tax</b>	<b>840</b>	<b>1,548</b>	<b>101</b>	<b>208</b>

**C RATIO ANALYSIS**

**1 Performance**

Net Mark Up Income / Avg. Assets	5.7%	4.7%	2.8%	3.6%
Non-Mark Up Expenses / Total Income	50.4%	64.4%	109.6%	92.0%
ROE	20.1%	11.5%	0.9%	2.0%

**2 Capital Adequacy**

Equity / Total Assets (D+E+F)	8.1%	8.2%	6.6%	7.6%
Capital Adequacy Ratio	19.4%	20.4%	12.1%	12.0%

**3 Funding & Liquidity**

Liquid Assets / (Deposits + Borrowings Net of Repo)	51.3%	51.6%	34.1%	34.3%
(Advances + Net Non-Performing Advances) / Deposits	57.5%	58.6%	78.5%	85.5%
CA Deposits / Deposits	31.3%	27.7%	30.7%	31.1%
SA Deposits / Deposits	38.7%	40.0%	39.8%	44.6%

**4 Credit Risk**

Non-Performing Advances / Gross Advances	1.8%	1.8%	0.7%	0.9%
Non-Performing Finances-net / Equity	5.7%	6.7%	4.9%	6.4%

### 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.

Scale	Long-term Rating Definition
AAA	<b>Highest credit quality.</b> Lowest expectation of credit risk. Indicate exceptionally strong capacity for timely payment of financial commitments
AA+	
AA	<b>Very high credit quality.</b> 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.
AA-	
A+	
A	<b>High credit quality.</b> 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.
A-	
BBB+	<b>Good credit quality.</b> 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.
BBB	
BBB-	
BB+	<b>Moderate risk.</b> 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.
BB	
BB-	
B+	
B	<b>High credit risk.</b> 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.
B-	
CCC	<b>Very high credit risk.</b> 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.
CC	
C	
D	Obligations are currently in default.

Scale	Short-term Rating 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 conditions.
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 surveil 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

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(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 | 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 | 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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