



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
22-Jun-2024	A+	A1	Stable	Upgrade	-
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	-

Rating Rationale and Key Rating Drivers

MCB Islamic Bank Limited (MCB Islamic) is a wholly owned subsidiary of MCB Bank Limited (MCB). The parent Bank, 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. MCB Islamic is a small-sized bank and has witnessed an increase of ~28.7% in its customers' deposits during CY23. While the system share in terms of deposits was reported at 0.7% at the end of Dec'23 (Dec 22: 0.65%). There is an increased emphasis on deposit mobilization, with strong support from the parent company aiding the expansion of Islamic branches nationwide. This support includes a plan to convert 39 conventional branches of MCB Bank into Islamic branches. Additionally, MCB Islamic banking customers can now utilize MCB Bank's counters, cash management services, POS machines, and e-payment services. The continuous focus on the accumulation of low-cost deposits has resulted in a healthy current and savings (CASA) deposit mix. In CY23, the Advances to Deposit Ratio (ADR) aligned with peers, showing improvement in 1QCY24. The financing portfolio in CY23 declined slightly, however, increased by 21% during 1QCY24 leading to a slight increase in market share. The financing portfolio is largely comprised of private sector, mid-tier clients, with concentrations in the Transportation, Textiles, Food & Beverages, and Services sectors. The Asset quality indicators remain above the peer average. The bank's equity base grew following a PKR 4 billion capital injection, reaching PKR 22 billion at the end of Dec'23 on the back of significant growth in profitability. The Capital Adequacy Ratio (CAR) saw a significant increase in Dec'23, standing at 23.8%, well above the required limit of 11.5%. Profitability in CY23 increased by 2.32 times, driven by a significant rise in net markup income, influenced by a high interest rate environment and lower deposit costs compared to the MDR for Islamic banking. The management aims for long-term sustainable profitability by focusing on mobilizing no and low-cost deposits, acquiring high-earning assets, and controlling operating costs. However, managing asset quality will be crucial. The bank's strategy includes a documented vision for its future.

The rating upgrade reflects the strong support from the ultimate sponsor for increased deposit mobilization, growing and sustainable profitability, an improved cost structure leading to better net interest margins (NIM), enhanced market risk management, a sufficient cushion in the Capital Adequacy Ratio (CAR), and a stable equity base.

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

Name of Rated Entity	MCB Islamic Bank Limited
Type of Relationship	Solicited
Purpose of the Rating	Entity Rating
Applicable Criteria	Methodology Correlation Between Long-term & Short-term Rating Scales(Jul-23),Methodology Financial Institution Rating(Oct-23),Methodology Rating Modifiers(Apr-24)
Related Research	Sector Study Commercial Banks(Jun-24)
Rating Analysts	Madiha Sohail madiha.sohail@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 the issuance of a 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, the Lahore High Court approved the 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 226 branches as of Dec 23 (Dec 22: 198 branches) branches including two sub-branches 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) is a premier business house in Pakistan, including individual holdings and holdings through group corporates. The group is one of the leading and most diversified in South East Asia, having a 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 1,438 spread across Pakistan. The bank is rated "AAA/A1+" by PACRA, and the bank recorded a net income of PKR 59.6bln in CY23 (CY22 PKR 32.7bln).

Governance

Board Structure The overall control of the Bank vests with an 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 CY23. Furthermore, the Board has set up an effective internal audit function that reports independently to the Audit Committee.

Management

Organizational Structure MCB Islamic follows a 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 28 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 make decisions to implement the strategy outlined by the board.

MIS The Bank is operating a 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 an 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 CY23 remained a challenging year for the economy inclusive of a drop in exchange reserves, currency devaluation, and peak inflation. To combat inflation and curb aggregate demand, the Central Bank maintained a tight monetary policy stance. Despite these challenges, CY23 was a remarkably successful year for the banking industry. The sector outperformed historical statistics, with two-thirds of net markup income coming from investments in government securities and the remainder from advances. During the year, Pakistan's banking sector's total assets posted growth of ~30% YoY whilst investments surged by ~42% to PKR ~25.6trln (end-Dec22: PKR ~18trln). Gross Advances of the sector recorded growth of ~4% to stand at PKR ~13.101trln (end-Dec22: PKR ~12.645trln). Non-performing loans witnessed an increase of 8.3% YoY to PKR ~881bln (end-Dec22: ~812bln). The CAR averaged at 18.5% (end-Dec22: 15.5%). Looking ahead, with the expected monetary rate cut, banks are likely to sustain some dilution in profitability by CY24.

Relative Position MCB Islamic is a small-sized bank with slow, however sustainable growth and has witnessed an increase of 28.2% in its customer deposit to PKR 183bln (CY22: PKR 143bln), with a slight increase in market share of 0.7% (CY22: 0.6%, CY21: 0.6%).

Revenues During CY23, the gross markup income of the Bank witnessed an increase of 93.7% to PKR 35.9bln (CY22: PKR 18.6bln) 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 CY23. Consequently, the Bank's net-markup income inclined to PKR 17.1bln (CY22: PKR 8.5bln). The Bank's spread inclined and stood at 9.0% (CY22: 5.9%). During CY23, the Bank's net markup income increased to PKR 17.1bln (CY22: PKR 8.5bln). Hence, total income recorded a good improvement to PKR 18.9bln (CY22: PKR 9.3bln).

Performance The Bank's non-markup income witnessed improvement, clocking in at PKR 1737mln (CY22: PKR 868mln), primarily attributable to enhanced foreign exchange income (CY23: PKR 735mln; CY22: PKR 429mln). 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 11.2bln for the year CY23 (CY22: PKR 3.3bln).

Sustainability Going forward, 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 CY23, the net advances of the Bank declined 0.6% to PKR 88.6bln (CY22: PKR 89bln), This led to advances in the ratio of the deposit (ADR) at a level of 44%. The non-performing loans (NPLs) were increased to PKR 1.95bln (CY22: PKR 1.67bln) during CY23. Hence, the infection ratio was also affected and posted at 2.2%. On the other hand, the coverage ratio improved to 65.8% (CY22: 34.9%).

Market Risk The Bank's investment portfolio constituted 59.2% of the total earning assets at end-Dec23 (end-Dec22: 53.5%). However, a significant increase of 83.3% in investments was seen during CY23 from last year. Moreover, the mix of government securities in overall investments also enhanced to 100%; 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 66.9% (CY22: 51.6%). During CY23, the CA of the bank was recorded at 27.6% (CY22: 27.7%) and the SA ratio slightly increased to 43% (CY22: 40%).

Capitalization The bank's CAR recorded a sizable increase in Dec-23 and stood at 23.8%, which has a sizable cushion in place above the required limit of CAR at 11.5%. The equity to total asset ratio of MCB Islamic was slightly increased to 8.3% in CY23. (CY22: 8.2%).



MCB Islamic Bank Limited
Un-Listed Public Limited

PKR mln **PKR mln**

Dec-23 **Dec-22** **Dec-21** **Dec-20**
12M **12M** **12M** **12M**

A BALANCE SHEET

1 Total Finances - net	89,441	89,978	96,819	85,609
2 Investments	131,781	71,899	32,450	26,214
3 Other Earning Assets	2,502	6,172	1,717	830
4 Non-Earning Assets	42,606	29,897	29,766	27,826
5 Non-Performing Finances-net	670	1,094	515	690
Total Assets	267,000	199,040	161,267	141,171
6 Deposits	204,460	154,001	122,748	99,253
7 Borrowings	25,814	14,671	16,473	20,597
8 Other Liabilities (Non-Interest Bearing)	14,690	14,020	11,442	10,593
Total Liabilities	244,963	182,693	150,663	130,443
Equity	22,036	16,347	10,605	10,728

B INCOME STATEMENT

1 Mark Up Earned	35,942	18,553	9,203	9,616
2 Mark Up Expensed	(18,759)	(10,032)	(5,009)	(5,281)
3 Non Mark Up Income	1,737	868	199	764
Total Income	18,921	9,390	4,393	5,099
4 Non-Mark Up Expenses	(7,649)	(6,046)	(4,815)	(4,691)
5 Provisions/Write offs/Reversals	(704)	(141)	647	(15)
Pre-Tax Profit	10,568	3,203	225	393
6 Taxes	(5,414)	(1,654)	(125)	(185)
Profit After Tax	5,153	1,548	101	208

C RATIO ANALYSIS

1 Performance

Net Mark Up Income / Avg. Assets	7.4%	4.7%	2.8%	3.5%
Non-Mark Up Expenses / Total Income	40.4%	64.4%	109.6%	92.0%
ROE	26.9%	11.5%	0.9%	2.0%

2 Capital Adequacy

Equity / Total Assets (D+E+F)	8.3%	8.2%	6.6%	7.6%
Capital Adequacy Ratio	23.8%	20.4%	12.1%	12.0%

3 Funding & Liquidity

Liquid Assets / (Deposits + Borrowings Net of Repo)	66.9%	51.6%	34.1%	34.3%
(Advances + Net Non-Performing Advances) / Deposits	43.7%	58.6%	78.5%	85.5%
CA Deposits / Deposits	27.6%	27.7%	30.7%	31.1%
SA Deposits / Deposits	43.1%	40.0%	39.8%	44.6%

4 Credit Risk

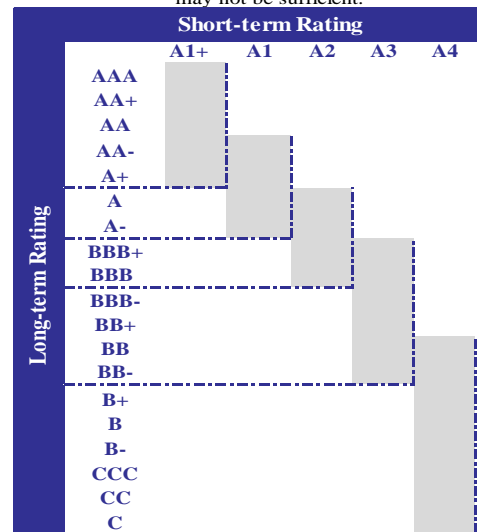
Non-Performing Advances / Gross Advances	2.2%	1.8%	0.7%	0.9%
Non-Performing Finances-net / Equity	3.0%	6.7%	4.9%	6.4%

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	Highest credit quality. Lowest expectation of credit risk. Indicate exceptionally strong capacity for timely payment of financial commitments
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.
AA-	
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.
A-	
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.
BBB	
BBB-	
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.
BB	
BB-	
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.
B	
B-	
CCC	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.
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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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 | 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)

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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 | 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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