



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
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	-
01-Feb-2017	A	A1	Stable	Maintain	-
01-Feb-2016	A	A1	Stable	Initial	-

Rating Rationale and Key Rating Drivers

MIB is a wholly owned subsidiary of MCB Bank Limited (MCB). MCB has long term rating of "AAA" reflecting its robust profile duly supplemented by its strong market position in local banking landscape, established brand equity, and sound financial profile. MIB's standalone risk profile is improving. The management's strategy is to consolidate the financing book of corporate clients; curtailed financing book in 9MCY19 to support the same. MIB has set relatively high targets for deposit growth and plans to focus on maintaining its financing book quality. Technological implementation and setting governance structure were mile stones achieved by bank in the last years. The thrust of the business plan is to achieve break-even. During 9MCY19, NIMR witnessed significant improvement attributable to increase in key policy rate. The fee commission income witnessed good jump but was negated with the loss on securities. The bank added branches from parent company resulting in bank's expanded outreach; enhanced costs from new branches is yet to be absorbed. Enhanced provisioning expense has further increased the loss. However, MIB's losses has began to shrink in 9MCY19 where the bank closed 3QCY19 in profits. As at end-Sep19, the bank's CAR is at 13.5%. The ratings incorporate the sponsor's willingness to support MIB evident from capital injection of PKR 350mln in 9MCY19.

The ratings are dependent on bank's ability to hold its risk profile, while maintaining its relative market position in the banking industry.

Disclosure

Name of Rated Entity	MCB Islamic Bank Limited
Type of Relationship	Solicited
Purpose of the Rating	Entity Rating
Applicable Criteria	PACRA_Methodology_FI_FY19(Jun-19),Methodology Correlation Between Long-Term And Short-Term Rating Scale(Jun-19),Criteria Rating Modifier(Jun-19)
Related Research	Sector Study Commercial Bank(Jun-19)
Rating Analysts	Sehar Fatima sehar.fatima@pacra.com +92-42-35869504



Profile

Structure MCB Islamic Bank Limited (MIB) was incorporated in Pakistan as an unlisted Public Limited Company in May 2014 with its head office in Lahore. After issuance of Certificate of Commencement of Banking Business by the State Bank of Pakistan (SBP) in September 2015, it started its commercial operations as an Islamic Bank in November 2015.

Background In March 2016, Lahore High Court approved demerger of Islamic Banking Group (IBG) of MCB Bank Limited from MCB and its merger with and into MIB. Resultantly, all domestic Islamic banking operations of MCB-IBG were incorporated into MIB w.e.f September 30, 2015 for PKR 7.9bln.

Operations The Bank is operating as an Islamic Bank in Pakistan with its head office in Lahore. During CY18, the demerger of 90 branches of MCB into MIB took place. The Bank provides financing through shariah compliant financing products including, Ijarah, Murabaha, Diminishing Musharaka, Istisna, Running Musharaka and Export Refinance through Export Refinance Scheme to different segments of its customers.

Ownership

Ownership Structure MIB is a wholly owned subsidiary of MCB Bank Limited. MCB is the country's fourth largest bank in terms of deposit and operates a branch network of 1,376 spread across Pakistan

Stability Lately, bank has raised PKR 1.2bln (120mln shares @ 10/ share) through right issue which was fully subscribed which shows the sponsor support. So, the stability of the bank will stay intact.

Business Acumen The business acumen of the bank's sponsor is considered strong. Nishat Group has vested interests in various sectors; all companies are successful business models.

Financial Strength The sponsor's financial muscle is considered strong. Apart from MCB Islamic Bank Limited, MCB Bank Limited has five more subsidiaries. The bank rated "AAA/A1+" by PACRA, had a net income of PKR 16,287mln in September, 2019 (end-Dec18: PKR 21,360mln).

Governance

Board Structure The overall control of the bank vests with eight members of the Board of Directors (BoD) including the CEO. Board consist of two independent director and five non-executive members.

Members' Profile Mr. Raza Mansha is the Chairman of the Board. He is accompanied with ~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. So, the overall board profile considered good.

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 M/s KPMG Taseer Hadi & Co, Chartered Accountants (listed as A category of SBP) was appointed as external auditor and has given an unqualified view on the financials of the bank for the year ended December 31, 2018. An interim review was conducted for the six months ended June 30th, 2019.

Management

Organizational Structure MIB follows functional structure, where bank's operations are grouped under thirteen departments.

Management Team Mr. Muhtashim Ahmad Ashai joined MCB Islamic Bank Limited as CEO, has over twenty-five years of professional experience in the banking sector. He holds a master's degree in Business Administration from LUMS followed by the International Management Program at McGill University, Montreal. He is supported by experienced team members.

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 MIB has adopted Oracle's solution of financing appraisal management system (FAMS). FAMS is fully integrated with Core Banking System Flexcube. There are nine stages of appraisal process, culminating in auto data handshake with liability management system.

Risk Management Framework Operations Risk is monitored by Risk Management Group. Four units are working under this group i) Credit Risk Review, ii) Market and Liquidity Risk Management, iii) Operational Risk and Business Continuity Planning and iv) 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 Despite challenging macroeconomic environment, banking sector maintained its growth trajectory during 9MCY19, backed by decent growth in deposits (9MCY19: PKR 14,945bln; 9MCY18: 13,603bln). However, lending was largely skewed towards investments and particularly towards government instruments due to favorable interest rate dynamics (9MCY19: PKR 9,641bln; 9MCY18: 6,942bln). Meanwhile, financing witnessed a slowdown owing to subdued economic activity, cautious lending approach and monetary tightening (9MCY19: PKR 9,014bln; 9MCY18: 4,422bln). Asset quality saw some deterioration – increased NPLs, particularly in sugar and energy sectors (9MCY19: PKR 758 bln; 9MCY18: 637bln). The profitability of the banking sector improved due to increase in Net Interest Income, which translated positively in other profitability indicators. The overall risk profile of the banking sector remained satisfactory.

Relative Position MIB is small tier bank, holding a deposit system share of 0.5% (Dec-18: 0.5%).

Revenues During 9MCY19, the Bank reported profit earned of PKR 7,154mln (9MCY18: PKR 2,660mln) significant jump attributable to rise in key policy rate whilst net advances witnessed decline. Of this increase, profit earned from finances stood at PKR 5,462mln (9MCY18: PKR 2,096mln). The bank's asset yield impacted positively by increasing interest rates environment and stood at 11.7% (9MCY18: 6.3%). Cost of funds also increased (9MCY19: 6.6%, 9MCY18: 3.6%).

Performance Fee, Commission income witnessed significant jump but was negated with loss on securities (9MCY19: PKR decline113mln, 9MCY18: PKR 18mln). Hence, other operating income decreased by ~28% YoY, clocking in at PKR 186mln (9MCY18: PKR 260mln). Provisioning expense witnessed declining trend (9MCY19: PKR 212mln, 9MCY18: PKR 495mln) but impacted the loss further. Hence, the bank's net loss for the period is PKR 274mln (9MCY18: PKR 780mln), declined YoY.

Sustainability The management's strategy is to focus primarily on high-rated, blue chip corporate clients; curtailed financing book in 9MCY19 to support the same. The major focus is on achieving break even.

Financial Risk

Credit Risk During 9MCY19, MIB's finances declined by ~8.98% (end-Sep19: PKR 57,260mln; end-Dec18: PKR 62,911mln) following management's strategy of prudent lending. ADR declined to 71% (end-Dec18: 85.8%) mainly due to the increase in time deposit (end-Sep19: PKR 9,116mln; end-Dec18: PKR 5,144mln). The bank's ADR is higher when compared with industry's average at 53.6% as at end-Sep19. At end-Sep19, the non-performing loan base of the Bank increased by PKR 363mln (CY18: 11mln). However, the management is positive about recovery.

Market Risk The bank's investment to deposit ratio increased significantly at 18% (CY18: 14%) due to increase in government securities. MIB's net investments of PKR 14,502mln constitute ~13% of total assets base.

Liquidity And Funding During 9MCY19, MIB's customer deposits increased to PKR 70,841mln (CY18: PKR 62,273mln), up 13.76%. The Bank was able to attract deposits with similar proportion of current and saving accounts, thus almost maintaining its CA and SA ratio at 43.7% and 45.1% (CY18: 50.2%; 42.8%) respectively. Term deposits over deposits increased by 4.2% (9MCY19: 11.2%; CY18: 7.0%). The liquidity of the bank, measured in terms of Liquid Assets / Deposits and Borrowings, improved slightly but remained low at 30.7% (CY18: 23.3%).

Capitalization MIB is an adequately capitalized institution with CAR above the regulatory requirements. As at end-Sep19, the Bank's CAR was noted at 13.5% (CY19: 12.5%). As at end-Sep19, the bank's equity base stood at PKR 9.7bln which is below the minimum capital requirements. However, sponsor has injected further capital of PKR 350mln which will enhance the equity base for end-CY19 to remain compliant with the minimum regulatory requirements.



PKR mln

Financial Institution
MCB Islamic Bank

Sep-19	Dec-18	Dec-17	Dec-16
9M	12M	12M	12M

A BALANCE SHEET

1 Total Finances - net	59,111	65,148	33,401	18,209
2 Investments	14,502	10,477	7,100	3,734
3 Other Earning Assets	10,474	5,654	3,561	2,751
4 Non-Earning Assets	23,585	13,619	7,685	3,875
5 Non-Performing Finances-net	332	(4)	(0)	(1)
Total Assets	108,003	94,894	51,746	28,569
6 Deposits	81,134	73,307	32,691	14,279
7 Borrowings	8,743	7,801	7,927	2,786
8 Other Liabilities (Non-Interest Bearing)	8,334	3,717	1,498	1,381
Total Liabilities	98,210	84,825	42,115	18,446
Equity	9,793	10,070	9,631	10,266

B INCOME STATEMENT

1 Mark Up Earned	7,154	4,209	2,061	1,527
2 Mark Up Expensed	(4,200)	(2,305)	(1,006)	(577)
3 Non Mark Up Income	186	399	439	259
Total Income	3,140	2,303	1,494	1,209
4 Non-Mark Up Expenses	(3,336)	(3,088)	(1,845)	(1,190)
5 Provisions/Write offs/Reversals	(212)	(896)	0	94
Pre-Tax Profit	(408)	(1,680)	(351)	114
6 Taxes	134	584	88	(34)
Profit After Tax	(274)	(1,096)	(263)	80

C RATIO ANALYSIS

1 Performance

Net Mark Up Income / Avg. Assets	3.9%	2.6%	2.6%	3.4%
Non-Mark Up Expenses / Total Income	106.2%	134.1%	123.5%	98.4%
ROE	-3.7%	-11.1%	-2.6%	0.8%

2 Capital Adequacy

Equity / Total Assets (D+E+F)	9.1%	10.6%	18.6%	35.9%
Capital Adequacy Ratio	13.5%	13.3%	23.8%	39.7%

3 Funding & Liquidity

Liquid Assets / (Deposits + Borrowings Net of Repo)	30.7%	23.3%	32.5%	46.9%
(Total Finances - net + Net Non-Performing Advances + Net Non-Performing Debt Instruments) / Deposits	73.3%	88.9%	102.2%	127.5%
CA Deposits / Deposits	43.7%	50.2%	43.7%	37.9%
SA Deposits / Deposits	45.1%	42.8%	42.1%	34.5%

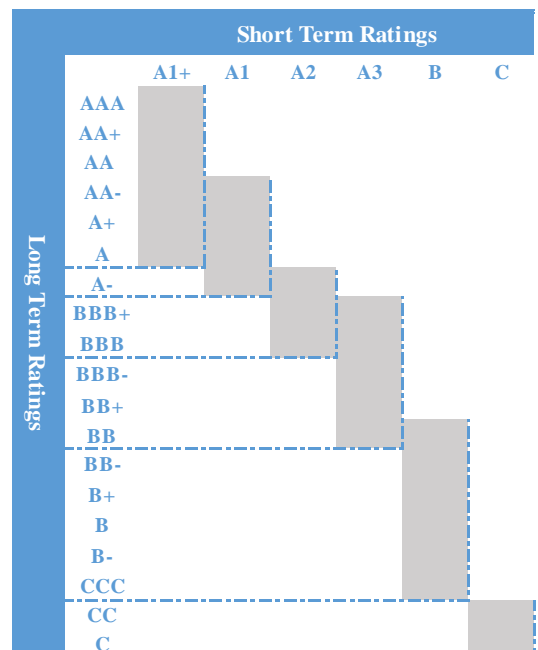
4 Credit Risk

Non-Performing Advances / Gross Advances	0.6%	0.0%	0.0%	0.0%
Non-Performing Finances-net / Equity	3.4%	0.0%	0.0%	0.0%

Credit Rating Scale & Definitions

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

Long Term Ratings		Short Term Ratings	
AAA	Highest credit quality. Lowest expectation of credit risk. Indicate exceptionally strong capacity for timely payment of financial commitments	A1+	The highest capacity for timely repayment.
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.	A1	A strong capacity for timely repayment.
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.	A2	A satisfactory capacity for timely repayment. This may be susceptible to adverse changes in business, economic, or financial 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.	A3	An adequate capacity for timely repayment. Such capacity is susceptible to adverse changes in business, economic, or financial conditions.
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	The capacity for timely repayment is more susceptible to adverse changes in business, economic, or financial conditions.
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.	C	An inadequate capacity to ensure timely repayment.
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.		



Outlook (Stable, Positive, Negative, Developing) Indicates the potential and direction of a rating over the intermediate term in response to trends in economic and/or fundamental business/financial conditions. It is not necessarily a precursor to a rating change. ‘Stable’ outlook means a rating is not likely to change. ‘Positive’ means it may be raised. ‘Negative’ means it may be lowered. Where the trends have conflicting elements, the outlook may be described as ‘Developing’.

Rating Watch Alerts to the possibility of a rating change subsequent to, or in anticipation of, a) some material identifiable event and/or b) deviation from expected trend. But it does not mean that a rating change is inevitable. A watch should be resolved within foreseeable future, but may continue if underlying circumstances are not settled. Rating Watch may accompany Outlook of the respective opinion.

Suspension It is not possible to update an opinion due to lack of requisite information. Opinion should be resumed in foreseeable future. However, if this does not happen within six (6) months, the rating should be considered withdrawn.

Withdrawn A rating is withdrawn on a) termination of rating mandate, b) cessation of underlying entity, c) the debt instrument is redeemed, d) the rating remains suspended for six months, e) the entity/issuer defaults, or/and f) PACRA finds it impractical to surveil the opinion due to lack of requisite information.

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

Disclaimer: PACRA's ratings are an assessment of the credit standing of entities/issue in Pakistan. They do not take into account the potential transfer / convertibility risk that may exist for foreign currency creditors. PACRA's opinion is not a recommendation to purchase, sell or hold a security, in as much as it does not comment on the security's market price or suitability for a particular investor.

Rating Team Statements

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

2) Conflict of Interest

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

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

Conduct of Business

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

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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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