The Pakistan Credit Rating Agency Limited

Rating Report

Faysal Bank Limited

Report Contents

Rating History

Dissemination Date	Long Term Rating	Short Term Rating	Outlook	Action	Rating Watch
24-Jun-2024	AA	A1+	Stable	Maintain	-
23-Jun-2023	AA	A1+	Stable	Maintain	-
25-Jun-2022	AA	A1+	Stable	Maintain	-
26-Jun-2021	AA	A1+	Stable	Maintain	-
26-Jun-2020	AA	A1+	Stable	Maintain	-
27-Dec-2019	AA	A1+	Stable	Maintain	-
27-Jun-2019	AA	A1+	Stable	Maintain	-
27-Dec-2018	AA	A1+	Stable	Maintain	-
28-Jun-2018	AA	A1+	Stable	Maintain	-

Rating Rationale and Key Rating Drivers

Ithmaar Bank B.S.C (closed), a banking entity regulated by the Central Bank of Bahrain, is the parent company holding directly and indirectly 66.78% (2022: 66.78%) of the Faysal Bank Limited ("FBL" or the "Bank") shares. Ithmaar Bank B.S.C. (closed) is a wholly owned subsidiary of Ithmaar Holdings B.S.C. Dar Al- Maal Al-Islami Trust (DMIT) is the holding entity of Ithmaar Holding B.S.C. and the ultimate parent of the Bank. During CY23, Faysal Bank Limited made history in Pakistan by converting a full-fledged Conventional Bank into a Shariah Compliant Bank. The transition took place smoothly and FBL got an Islamic Banking license from the regulator after surrendering the Conventional Banking license. This strategic move aligns with broader trends in the banking industry, where Islamic banking continues to gain prominence globally. The bank is committed to digital transformation, promoting eco-friendly practices such as Green Banking, e-banking etc. FBL is a medium-sized bank with a market share of ~3.7% (CY22: 3.5%) driven by an increase of ~30% in deposit growth. During CY23, the total deposits crossed PKR 1 trln however, the CASA mix due to growth in Term Deposits, decreased from 80.0% to 75.0%. While several new products were added to the suite to cater to diverse market segments: contributing PKR 5.9bln in deposit growth. The bank's gross financing grew by 26.8%, reaching PKR 600bln, showcasing expansion in lending activities majorly in power, gas, pharma and chemical. The NPA coverage ratio decreased slightly to 87% (CY22: 89%). The bank's investment portfolio grew by 25.5% to PKR 589bln, with a significant majority (89%) allocated to government securities. This concentration highlights the bank's conservative investment strategy, prioritizing stability and liquidity. Diversifying the investment mix could optimize returns while balancing risk in the bank's portfolio. The Bank reported a PAT of PKR ~ 20bln (CY:22 PKR ~ 11.2bln) driven by an increase in net spreads influenced by a high interest rate environment and lower deposit costs compared to the MDR for Islamic banking. The bank's total expenses have risen by 48.4% over 2022. However, the cost-to-income ratio has improved from 56.2% in 2022 to 49.1% in 2023. The equity of the Bank stood at PKR 90bln, while CAR is reported at 17.5% (CY22: 15.5%) well above the required limit of 12.5% (with a 1% relaxation due to Covid-19). Under the recent development, the shareholders of Ihtmaar proposed to sell 75% of Ihtmaar's stake in FBL to GFH Financial Group B.S.C (GFH). This would bring the Ihtmaar holding to 16.67%. Post acquisition, FBL plans to continue its current strategy including continuity of leadership/senior management team, translating into FBL's mission of Islamic banking.

Going forward, adeptness in preserving profitability while safeguarding the profit rate spreads and maintaining asset quality would bode well.

Disclosure

Name of Rated Entity	Faysal 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 Faysal Bank Limited (FABL) was incorporated on October 3, 1994, as a public limited company under the provisions of the Companies Ordinance 1984. Its shares are listed on the Pakistan Stock Exchange (PSX).

Background FABL started operations in Pakistan in 1987, first as a branch set up of Shamil Bank of Bahrain and since 1994, as a locally incorporated bank under the present name. In the year of 2002, Al-Faysal Investment Bank, another group entity, merged into Faysal Bank Limited.

Operations The Bank is engaged in Shariah-compliant modern corporate, commercial and Consumer banking activities. During CY23, the Bank opened new branches, taking its branch network to 722 branches. The registered office of the Bank is located at Faysal House, St-02, Shahrah-e-Faysal, Karachi, Pakistan.

Ownership

Ownership Structure Ithmaar Bank B.S.C, a wholly owned subsidiary of Ithmaar Holdings B.S.C. is the parent company of the Bank, holding directly and indirectly 66.78% of the shareholding of the Bank. Dar Al-Maal Al-Islami Trust (DMIT), (ultimate parent of the Bank) is the holding company of Ithmaar Holdings B.S.C.

Stability The Recruitment Nomination & Remuneration Committee designs succession planning policies for the CEO and key executives. Internal successors are highlighted in addition to earmarking key potential external resources to ensure a robust pipeline across all levels at the Bank.

Business Acumen Ithmaar Holdings B.S.C. (Ithmaar Holdings) is a Bahrain-based holding company that is licensed and regulated as an investment company and is listed on the Bahrain Bourse, Boursa Kuwait and Dubai Financial Market.

Financial Strength Ithmaar Holdings B.S.C. and its subsidiaries are engaged in a wide range of financial services including retail, commercial, investment banking, private banking, takaful and real estate development.

Governance

Board Structure The overall control of the Bank vests in the eleven-member Board of Directors (BoD) including the CEO. Ithmaar Bank, the key shareholder, is represented by six non-executive directors on the board who are nominees of the Bank. The remaining four are independent directors.

Members' Profile Mr. Mian Muhammad Younis, the Chairman, has done a Masters in Economics and has served in the Civil service of Pakistan. He has vast experience in the financial industry of Pakistan.

Board Effectiveness Board meetings are conducted at regular intervals and minutes of the meetings are documented adequately. The BoD exercises close monitoring of the management's policies and the Bank's operations through board committees.

Financial Transparency The External Auditors of the Bank, KPMG Taseer Hadi & Co., Chartered Accountants, issued an unqualified audit opinion pertaining to annual financial statements for CY23. Furthermore, the Board has set up an effective internal audit function that reports independently to the Board Audit & Corporate Governance Committee regularly on compliance with critical policies and procedures and recommends amendments to these policies in line with the industry's best practices.

Management

Organizational Structure The Bank has a well-defined organizational structure. Operations are segregated into various departments wherein clear lines of responsibility are defined for each cadre.

Management Team Mr. Yousaf Hussain is the President & CEO since May-2017. Mr. Hussain has been associated with Faysal Bank since 2008 and has banking experience over two decades. He is supported by a management team of well-experienced and qualified individuals.

Effectiveness A Management Committee (MANCOM), comprising group heads, meets on a quarterly basis to review the performance of each division vis-à-vis set targets. The MANCOM also provides strategic input for setting the direction of the Bank vis-à-vis the economic environment and decides on the implications of new business initiatives for the Bank.

MIS The Bank has a comprehensive reporting system for the management to keep track of activities. The Bank is using business intelligence software namely QlikView.

Risk Management Framework Risk Management Framework's primary objective is to ensure that risk-taking activities are in line with the guidelines approved by the BoD and to protect the interests of the Bank's depositors and shareholders.

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 19.7% (end-Dec22: 16.7%). Looking ahead, with the expected monetary rate cut, banks are likely to sustain some dilution in profitability by CY24.

Relative Position FABL is a medium-sized bank with sustainable growth and has witnessed an increase in its total deposit base to PKR 1018.3bln (CY22: PKR 782bln).

Revenues During CY23, the profit/return earned by the Bank witnessed a significant increase and was reported at PKR 189.4bln (CY22: 105bln), mainly due to a surge in income from Investments and Islamic finances and Related assets.

Performance During CY23, the Bank's yield on assets recorded an incline, owing to an increased key policy rate The Bank's cost of funds also grew to 11.2% (CY22: 7.1%) due to increase in policy rate. This was accompanied by an increase in spreads. The operating cost of the Bank increased to PKR 40.8bln (CY22: PKR 27.5bln). The Bank has earned a pre-provision profit of PKR 42.3bln (CY22: PKR 21.5bln). Bank has charged a net provision of PKR 913.9mln as compared to reversal of PKR 940mln in CY22. The Bank's profit after tax (PAT) grew to PKR 20bln in CY23 (CY22: PKR 11.2bln).

Sustainability Going forward, FABL plans to focus on mobilizing low-cost core deposits and enhancing business volume via branch outreach.

Financial Risk

Credit Risk In CY23, FABL showcased a strong performance, with its advances portfolio growing by 26.9% YoY to PKR 600.8bln from PKR 473.6bln in CY22. This significant increase highlights the bank's effective strategies in expanding its lending activities, predominantly financed through deposits, Despite this impressive growth in advances, the Advances to Deposit Ratio (ADR) slightly decreased to 57% from 58.1% in the previous year. On the asset quality front, Non-Performing Loans (NPLs) increased marginally to PKR 23bln from PKR 21.7bln in CY22, The increase is relatively modest compared to the substantial growth in the advances portfolio. Overall, FABL's financial health appears strong, with a growing advances portfolio supported by a solid deposit base and manageable levels of non-performing assets.

Market Risk In CY23, FABL's investment portfolio demonstrated significant growth, expanding by 25.6% YoY to PKR 589.5bln from PKR 469bln in CY22. A notable aspect of FABL's investment strategy is its strong concentration in government securities, which constitute 98% of the total portfolio, The majority of the funds generated from deposits were invested primarily in Ijara Sukuks it reflects FABL's commitment to adhering to Sharia-compliant financial principles. Overall Bank focus on stability, low-risk investments.

Liquidity And Funding In CY23, FABL's liquidity position improved, with the liquidity ratio rising to 52.1% from 50.4% in CY22. This increase reflects the bank's enhanced ability to meet short-term obligations, supported by a 32.2% growth in liquid assets to PKR 617.7bln from PKR 467.1bln. However, the CASA (Current Account Savings Account) mix declined to 78% from 84.9%. This decrease indicates a shift in the deposit base composition, possibly towards higher-cost term deposits. Overall, FABL's strategy in CY23 highlights a strengthened liquidity position and a dynamic approach to managing its deposit base, ensuring financial stability and flexibility.

Capitalization During CY23, the Bank achieved a CAR of 17.46% (CY22: 15.5%) with contributions from Tier-1 capital (14.6%) and Tier-II (2.8%).

PKR mln

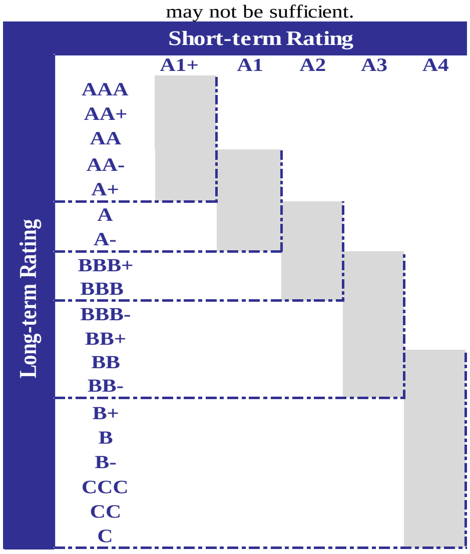
Faysal Bank Limited	Dec-23	Dec-22	Dec-21	Dec-20
Listed Public Limited	12M	12M	12M	12M
A BALANCE SHEET				
1 Total Finances - net	634,238	506,619	453,011	377,426
2 Investments	533,009	414,724	297,839	213,024
3 Other Earning Assets	4,324	12,177	4,415	6,846
4 Non-Earning Assets	195,494	138,464	111,430	108,002
5 Non-Performing Finances-net	3,009	2,369	2,917	4,660
Total Assets	1,370,074	1,074,353	869,612	709,958
6 Deposits	1,018,276	781,571	644,089	540,636
7 Borrowings	166,887	150,134	111,190	58,447
8 Other Liabilities (Non-Interest Bearing)	94,713	72,564	48,510	50,768
Total Liabilities	1,279,875	1,004,269	803,789	649,851
Equity	90,198	70,083	65,823	60,107
B INCOME STATEMENT				
1 Mark Up Earned	189,448	104,521	53,869	55,922
2 Mark Up Expensed	(118,395)	(64,533)	(28,035)	(31,388)
3 Non Mark Up Income	12,089	8,959	8,509	8,231
Total Income	83,142	48,947	34,343	32,765
4 Non-Mark Up Expenses	(40,807)	(27,494)	(20,887)	(19,740)
5 Provisions/Write offs/Reversals	(914)	940	(48)	(2,254)
Pre-Tax Profit	41,422	22,393	13,409	10,770
6 Taxes	(21,376)	(11,160)	(5,256)	(4,260)
Profit After Tax	20,046	11,233	8,153	6,511
C RATIO ANALYSIS				
1 Performance				
Net Mark Up Income / Avg. Assets	5.8%	4.1%	3.3%	3.5%
Non-Mark Up Expenses / Total Income	49.1%	56.2%	60.8%	60.2%
ROE	25.0%	16.5%	12.9%	10.8%
2 Capital Adequacy				
Equity / Total Assets (D+E+F)	6.6%	6.5%	7.6%	8.5%
Capital Adequacy Ratio	17.5%	15.5%	17.5%	18.7%
3 Funding & Liquidity				
Liquid Assets / (Deposits + Borrowings Net of Repo)	52.1%	50.4%	46.1%	45.8%
(Advances + Net Non-Performing Advances) / Deposits	57.0%	58.1%	61.5%	58.9%
CA Deposits / Deposits	30.9%	34.5%	32.8%	30.7%
SA Deposits / Deposits	43.0%	44.6%	42.1%	40.4%
4 Credit Risk				
Non-Performing Advances / Gross Advances	3.8%	4.6%	5.6%	7.7%
Non-Performing Finances-net / Equity	3.3%	3.4%	4.4%	7.8%

Credit Rating

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

Long-term Rating	
Scale	**Definition**
AAA	**Highest credit quality.** Lowest expectation of credit risk. Indicate exceptionally strong capacity for timely payment of financial commitments
AA+ AA AA-	**Very high credit quality.** Very low expectation of credit risk. Indicate very strong capacity for timely payment of financial commitments. This capacity is not significantly vulnerable to foreseeable events.
A+ A A-	**High credit quality.** Low expectation of credit risk. The capacity for timely payment of financial commitments is considered strong. This capacity may, nevertheless, be vulnerable to changes in circumstances or in economic conditions.
BBB+ BBB BBB-	**Good credit quality.** Currently a low expectation of credit risk. The capacity for timely payment of financial commitments is considered adequate, but adverse changes in circumstances and in economic conditions are more likely to impair this capacity.
BB+ BB BB-	**Moderate risk.** Possibility of credit risk developing. There is a possibility of credit risk developing, particularly as a result of adverse economic or business changes over time; however, business or financial alternatives may be available to allow financial commitments to be met.
B+ B B-	**High credit risk.** A limited margin of safety remains against credit risk. Financial commitments are currently being met; however, capacity for continued payment is contingent upon a sustained, favorable business and economic environment.
CCC CC C	**Very high credit risk.** Substantial credit risk “CCC” Default is a real possibility. Capacity for meeting financial commitments is solely reliant upon sustained, favorable business or economic developments. “CC” Rating indicates that default of some kind appears probable. “C” Ratings signal imminent default.
D	Obligations are currently in default.

Short-term Rating	
Scale	**Definition**
A1+	The highest capacity for timely repayment.
A1	A strong capacity for timely repayment.
A2	A satisfactory capacity for timely repayment. This may be susceptible to adverse changes in business, economic, or financial conditions.
A3	An adequate capacity for timely repayment. Such capacity is susceptible to adverse changes in business, economic, or financial
A4	The capacity for timely repayment is more susceptible to adverse changes in business, economic, or financial conditions. Liquidity may not be sufficient.



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

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

Rating Watch Alerts to the possibility of a rating change subsequent to, or, in anticipation of some material identifiable event with indeterminable rating implications. But it does not mean that a rating change is inevitable. A watch should be resolved within foreseeable future, but may continue if underlying circumstances are not settled. Rating watch may accompany rating outlook of the respective opinion.

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

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

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

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

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

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

Regulatory and Supplementary Disclosure
(Credit Rating Companies Regulations,2016)

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

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

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

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

Independence & Conflict of interest
(12) PACRA receives compensation from the entity being rated or any third party for the rating services it offers. The receipt of this compensation has no influence on PACRA´s opinions or other analytical processes. In all instances, PACRA is committed to preserving the objectivity, integrity and independence of its ratings. Our relationship is governed by two distinct mandates i) rating mandate - signed with the entity being rated or issuer of the debt instrument, and fee mandate - signed with the payer, which can be different from the entity
(13) PACRA does not provide consultancy/advisory services or other services to any of its customers or to any of its customers’ associated companies and associated undertakings that is being rated or has been rated by it during the preceding three years unless it has adequate mechanism in place ensuring that provision of such services does not lead to a conflict of interest situation with its rating activities; | Chapter III; 12-2-(d)
(14) PACRA discloses that no shareholder directly or indirectly holding 10% or more of the share capital of PACRA also holds directly or indirectly 10% or more of the share capital of the entity which is subject to rating or the entity which issued the instrument subject to rating by PACRA; | Reference Chapter III; 12-2-(f)
(15) PACRA ensures that the rating assigned to an entity or instrument is not be affected by the existence of a business relationship between PACRA and the entity or any other party, or the non-existence of such a relationship | Chapter III; 12-2-(i)
(16) PACRA ensures that the analysts or any of their family members shall not buy or sell or engage in any transaction in any security which falls in the analyst’s area of primary analytical responsibility. This clause shall, however, not be applicable on investment in securities through collective investment schemes. | Chapter III; 12-2-(l)
(17) PACRA has established policies and procedure governing investments and trading in securities by its employees and for monitoring the same to prevent insider trading, market manipulation or any other market abuse | Chapter III; 11-B-(g)

Monitoring and review
(18) PACRA monitors all the outstanding ratings continuously and any potential change therein due to any event associated with the issuer, the security arrangement, the industry etc., is disseminated to the market, immediately and in effective manner, after appropriate consultation with the entity/issuer; | Chapter III | 17-(a)
(19) PACRA reviews all the outstanding ratings periodically, on annual basis; Provided that public dissemination of annual review and, in an instance of change in rating will be made; | Chapter III | 17-(b)
(20) PACRA initiates immediate review of the outstanding rating upon becoming aware of any information that may reasonably be expected to result in downgrading of the rating; | Chapter III | 17-(c)
(21) PACRA engages with the issuer and the debt securities trustee, to remain updated on all information pertaining to the rating of the entity/instrument;| Chapter III | 17-(d)
Probability of Default
(22) PACRA´s Rating Scale reflects the expectation of credit risk. The highest rating has the lowest relative likelihood of default (i.e., probability). PACRA´s transition studies capture the historical performance behavior of a specific rating notch. Transition behavior of the assigned rating can be obtained from PACRA´s Transition Study available at our website. (www.pacra.com). However, actual transition of rating may not follow the pattern observed in the past; | Chapter III | 14-3(f)(vii)
Proprietary Information