



The Pakistan Credit Rating Agency Limited

Rating Report

BankIslami Pakistan Limited | Modaraba Sukuk

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Rating History

Dissemination Date	Long Term Rating	Short Term Rating	Outlook	Action	Rating Watch
30-Jun-2020	A-	-	Stable	Initial	-
08-Oct-2019	A-	-	Stable	Maintain	-
30-Apr-2019	A-	-	Stable	Preliminary	YES

Rating Rationale and Key Rating Drivers

The ratings reflect BankIslami's sustained risk profile. The bank's profitability enhanced owing to asset yield driven by peaked policy rates and volumetric increase in financing and instruments. Higher increase in asset yield than cost of funds - resulting in increase in spreads. The bank was able to achieve good operating profits; trend should continue. The management is emphatically pursuing for recovery of NPLs, leading to improvement in impairment ratio. Covid-19 has posed challenges to all segments of the economy, worldwide and domestically, most sectors are getting negatively impacted. The ramifications would continue to unfold, warranting vigilance and timely actions where needed. The central bank has taken well-tailored and comprehensive actions including reduction in key policy rates (625bps down since Jan-20) and deferment of repayment obligations. While reduction in interest rates would determine the bank's profitability, these measures have cushioned the allied risks surrounding the credit exposures. The bank's deposit base recorded significant addition tilted towards term deposits leading to decline in CASA (end-Dec19: 58.5%, end-Dec18: 68.8%) with focus to increase stability and liquidity. Increased term deposits may effect cost of funds in CY20. Key positions are headed by experienced individuals. The bank's management is positive about performance and achieving cost efficiency, pursuing the new business plan under leadership of the CEO. The focus is on risk management, IT infrastructure, workforce strengthening and customer facilitation which will help bank to achieve operational efficiency. The bank has taken steps to strengthen its fortress against cyber risks; provision needed was created in CY19. Going forward, primary focus is to consolidate CAR as the relaxations given by central bank will be withdrawn in CY21. The management is current on the planned steps to enhance capital of the bank which will assist in inching up CAR.

The bank's ability to raise its capital base in order to pursue its growth plan is important. In this regard, BIPL made a right issue of PKR 1bln along with the issuance ADT-1 Sukuk of Rs. 2 billion.

Disclosure

Name of Rated Entity	BankIslami Pakistan Limited Modaraba Sukuk
Type of Relationship	Solicited
Purpose of the Rating	Entity Rating
Applicable Criteria	PACRA_Methodology_FI(Jun-19),PACRA_Methodology_DI Basel III_FY19(Jun-19),Methodology Sukuk(Jun-19),Criteria Rating Modifier(Jun-19)
Related Research	Sector Study Commercial Bank(Jun-20)
Rating Analysts	Usama Zubair usama.zubair@pacra.com +92-42-35869504



Profile

Structure BankIslami Pakistan Limited (BIPL), incorporated in Oct-04, was the first bank in Pakistan to receive the Islamic Banking license, in Mar-05, under the Islamic Banking Policy of 2003. The bank, after being declared a scheduled Islamic bank by the State Bank of Pakistan in Mar-05, commenced its operations from April 07, 2006.

Background The bank has been following organic growth since its inception. Furthermore, on May 7th, 2015, BIPL acquired defunct bank “KASB Bank Limited” under “Scheme of amalgamation of defunct KASB Bank Limited with and into BankIslami Pakistan Limited under Section 47 of Banking Companies Ordinance, 1962”.

Operations BIPL is currently operating with 340 branches as at March 31, 2020 (CY19: 334 branches) across the country. The bank is engaged in corporate, commercial, consumer, retail banking and investment activities by offering wide range of Shariah compliant products and services.

Ownership

Ownership Structure BIPL has four prominent sponsors namely the JS Group (through Jahangir Siddiqui & Company Limited (JSCL), Mr. Ali Hussain and SAJ Capital Management Limited, Emirates NBD (through Dubai Bank PJSC), and Randeree family. All these have a collective holding of 72.89% in the bank and predominantly direct the affairs of the BIPL’s board.

Stability BIPL ownership is backed by strong sponsors and has been same for many years. It is expected to remain same in the foreseeable future.

Business Acumen All sponsors are renowned business groups with stakes in various sectors with national and international presence. The business acumen of sponsors is considered strong as sponsors have diversified interest and long association with the markets.

Financial Strength The ability to support in case of financial need is considered good.

Governance

Board Structure BIPL’s eight-member board of directors (BoD) including CEO constitutes representatives of sponsoring groups. Currently, four are independent directors, three are non-executive and one Executive director (CEO - Bank Islami). BIPL’s Shariah board comprises three leading Islamic scholars of the country, namely (i) Mufti Irshad Ahmad Aijaz, ii) Mufti Muhammad Hussain, and iii) Mufti Javed Ahmad. The election were conducted in April 2020 and new Board is awaiting SBP approval.

Members’ Profile Mr. Ali Hussain, MD SAJ Capital Limited, was the Chairman of the previous Board, had ~38 years of experience. All the other board members have different educational and work experience background.

Board Effectiveness The BoD exercises close monitoring of the management’s policies and governs the bank’s operations through its Six committees namely i) Audit Committee, ii) Board Remuneration Committee iii) Human Resource & Management Committee, (iv) Risk Management Committee, (v) Executive Committee, (vi) IT Committee.

Financial Transparency During the year, EY Ford Rhodes Chartered Accountants the external auditor are SBP panel member, expressed an unqualified opinion for the financial statements for the year ended December 31st, 2019.

Management

Organizational Structure BIPL’s organizational structure is divided into twelve functional departments i) Distribution, ii) Corporate Banking, iii) Consumer, iv) Treasury/ FIs, v) Risk Management, vi) Product and Shariah Structuring, vii) Human Resource, viii) Legal, ix) Finance, x) Operations, xi) Security and Govt. Relations and xii) Compliance.

Management Team Mr. Syed Amir Ali has joined the bank as Deputy CEO in Apr-18. He has taken up the position of 'President & CEO' in Oct-18. He is Chartered Accountant by qualification, carried more than decade experience mainly with Meezan Bank. The BIPL is focusing on the improvement of team efficiency.

Effectiveness The bank has eight committees at the management level: (i) Business Strategy & Review Committee (BSRC), (ii) IT Steering Committee (ITSC), (iii) Asset & Liability Committee (ALCO), (iv) Compliance & Controls Committee (CCM), (v) Service Excellence Committee (SEC), (vi) Management Credit Committee (MCC), (vii) Disciplinary Action Committee (DAC), and (viii) Procurement & Disposal Committee (PDC).

MIS The management has selected a comprehensive Islamic Banking application that has inbuilt Shariah compliance features – iMal, a core banking software, which has been developed by Path Solutions, a software house in the Middle East.

Risk Management Framework Since Oct 2019, Bank is using its new internally developed Rating Model for ORR. The module supports the bank in its internal Obligor Risk Rating (ORR) process by adding more objectivity to the credit appraisal process.

Business Risk

Industry Dynamics As a result of general economic slowdown most indicators of the banking sector reflected mixed trend. Deposits of the banking sector stood at (CY19: PKR 15,953bln; CY18: PKR 14,254bln), showing a growth of ~12% as compared to 9.5% growth in CY18. Deployment of funds was largely skewed towards investments and particularly towards government instruments due to favorable interest rate dynamics (CY19: PKR 8,939bln; CY18: PKR 7,914bln). Meanwhile, advances witnessed a slowdown owing to subdued demand, cautious lending approach and monetary tightening. This was only a growth of 3.7% as compared to expansion of 22.2% in CY18. Asset quality saw deterioration – increased NPLs (CY19: PKR 761bln; CY18: PKR 680bln). The profitability of the banking sector improved due to an increase in Net Interest Income, which translated positively in other profitability indicators. The overall risk profile of the banking sector remained satisfactory.

Relative Position The BIPL is small tier bank and was able to maintain its deposit system share of 1.5% (Dec-18: 1.3%).

Revenues During period CY19, the bank earned mark-up of PKR 23.7bln (CY18: PKR 12.2bln; CY17: PKR 10.4bln). The increase of 94% YoY is due to the earnings from consolidation in financing book and new investments in sovereign guaranteed papers. The bank recorded NIMR at PKR 10.8bln (CY19: PKR 6.0bln), up only by 80% YoY. As at CY19, bank’s financing book increased which led to improvement in spread which stood at 6.0% (CY18: 3.8%) - a positive factor.

Performance Other operating income of the bank inched up to stand at PKR 1.63bln (CY18: PKR 1.20bln) primarily due to gain on sales of investment and improvement in spread. Pre-provision operating profit significantly increased to PKR 4.6bln (CY18: PKR 439mln) attributable to robust total income. Owing to the provisioning, charged, the bank’s profitability stood at PKR 1.08bln (CY18: PKR 213mln).

Sustainability Going forward, the bank aims to expand its financing portfolio by funding through low cost deposits. The bank is prioritizing the rated client financing in future which will assist in CAR measures. Recovery from non-performing financing transferred from KASB is also a priority. Going forward, risk management framework improvement will be focused by the bank.

Financial Risk

Credit Risk During CY19, The bank NPL’s inched down to PKR 15.50bln as at end-Dec19 (end-Dec18: PKR 15.56bln) as some NPLs were settled or restructured, which led to decline in NPLs to Gross Advances ratio (end-Dec19: 10.7%; end-Dec18: 12%). Further, drag on equity (Net NPLs/Equity: end-Dec19: 13.8%; end-Dec18: 32.2%) is reduced.

Market Risk BIPL’s investment portfolio increased to PKR 46.9bln (end-Dec18: PKR 28.8bln). Portfolio increased mainly due to increase in Government Securities of PKR 45.4bln. The investment composition remained tilted towards government securities (end- Dec19: ~97%) excluding debt instruments.

Liquidity And Funding As at end-Dec19, BIPL’s customer deposits increased to PKR 228.8bln (end-Dec18: PKR 184.7bln), up 23.8% owing to greater increase witnessed in term deposits. CA and SA ratios decline slightly (end-Dec19: 29.6%; end-Dec18: 32.1%) & (end-Dec19: 28.9%; end-Dec18: 36.7%) respectively, which may increase cost of funding in the upcoming year. The bank’s liquidity position has improved evident by Liquid assets to Deposits & Borrowing ratio (end-Dec19: 24.6%; end- Dec18: 21.0%), primarily driven by the increase in government securities.

Capitalization The bank has equity base of PKR 19.69bln. At end-Dec19, CAR is largely maintained at 14.9% with Tier I at 11.6%. To support Tier-I capital, Bank issued Additional Tier-I Sukuk of PKR 2.0bln on 21st April 2020.



PKR mln

BankIslami Pakistan Limited
Listed Public Limited

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

A BALANCE SHEET

1 Total Finances - net	137,361	123,942	120,232	76,433
2 Investments	46,890	28,788	36,543	45,299
3 Other Earning Assets	44,789	19,006	22,174	28,359
4 Non-Earning Assets	51,338	39,334	34,372	29,981
5 Non-Performing Finances-net	2,718	4,673	4,472	2,402
Total Assets	283,096	215,743	217,792	182,473
6 Deposits	228,827	184,693	178,310	153,736
7 Borrowings	16,804	7,820	15,570	6,066
8 Other Liabilities (Non-Interest Bearing)	17,770	8,716	10,236	10,227
Total Liabilities	263,400	201,228	204,116	170,029
Equity	19,696	14,515	13,676	12,445

B INCOME STATEMENT

1 Mark Up Earned	23,650	12,204	10,354	10,128
2 Mark Up Expensed	(12,860)	(6,170)	(5,250)	(5,791)
3 Non Mark Up Income	1,633	1,264	965	637
Total Income	12,424	7,298	6,069	4,973
4 Non-Mark Up Expenses	(7,794)	(6,858)	(6,303)	(6,160)
5 Provisions/Write offs/Reversals	(2,799)	(36)	392	2,030
Pre-Tax Profit	1,831	404	157	843
6 Taxes	(744)	(190)	1,406	(391)
Profit After Tax	1,087	214	1,563	451

C RATIO ANALYSIS

1 Performance

Net Mark Up Income / Avg. Assets	4.3%	2.8%	2.6%	2.4%
Non-Mark Up Expenses / Total Income	62.7%	94.0%	103.9%	123.9%
ROE	6.4%	1.5%	12.0%	3.8%

2 Capital Adequacy

Equity / Total Assets (D+E+F)	7.0%	6.7%	6.3%	6.8%
Capital Adequacy Ratio	14.9%	15.1%	14.5%	13.4%

3 Funding & Liquidity

Liquid Assets / (Deposits + Borrowings Net of Repo)	24.6%	21.0%	23.7%	32.8%
(Advances + Net Non-Performing Advances) / Deposits	57.6%	64.2%	66.8%	50.6%
CA Deposits / Deposits	29.6%	32.1%	32.1%	37.0%
SA Deposits / Deposits	28.9%	36.7%	43.4%	31.1%

4 Credit Risk

Non-Performing Advances / Gross Advances	10.7%	12.0%	12.1%	16.2%
Non-Performing Finances-net / Equity	13.8%	32.2%	32.7%	19.3%

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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- (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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