The Pakistan Credit Rating Agency Limited

Rating Report

MCB Bank Limited

Report Contents

Rating History

Dissemination Date	Long Term Rating	Short Term Rating	Outlook	Action	Rating Watch
27-Jun-2019	AAA	A1+	Stable	Maintain	-
27-Dec-2018	AAA	A1+	Stable	Maintain	-
27-Jun-2018	AAA	A1+	Stable	Maintain	-
29-Dec-2017	AAA	A1+	Stable	Maintain	-
19-Jun-2017	AAA	A1+	Stable	Maintain	-

Rating Rationale and Key Rating Drivers

The ratings take note of MCB's sustained financial profile, reflected in very strong capitalization, sound liquidity and diverse deposit base. This has been enabled by the bank's able parentage, wherein a diverse mix of sponsors - mainly led by Nishat Group - have been providing an effective oversight. The ratings factor in MCB's strong market positioning, supported by its well established brand name and substantial out-reach. MCB has one of the highest CASA in the industry, with lowest cost of funds amongst all players. The bank deposit base grew almost with the industry average and crossed one trillion mark.The bank continues with its current strategy of lending to premier corporates with sustained focus on government exposure. MCB was marked as the bank with the highest profitability numbers for the year 2018. The Bank took a cautious approach with advances this time. ADR has stayed the same. The bank has established an Islamic Banking subsidiary, thereby, becoming the first conventional bank to do so. The risk absorption capacity of the bank, measured in terms of CAR, has increased from 16.4% 2017 to 18.1% in 2018.

The ratings are dependent on the bank's ability to hold its existing position in the banking sector. Any deterioration in the perceived strength of the bank or ownership with consequent impact upon its governance efficacy would have negative implication. Further strengthening of human resource would be vital.

Disclosure	
Name of Rated Entity	MCB Bank Limited
Type of Relationship	Solicited
Purpose of the Rating	Entity Rating
Applicable Criteria	Methodology | Financial Institution(Jun-18),Methodology | Criteria | Rating Modifier(Jun-18),Methodology | Correlation Between Long-Term And Short-Term Rating Scale(Jun-18)
Related Research	Sector Study | Commercial Bank(Jun-19)
Rating Analysts	Muhammad Obaid | muhammad.obaid@pacra.com | +92-42-35869504

Profile

Structure MCB Bank Limited (hereinafter referred as "MCB" or "the bank") was incorporated as a public limited company, in 1947, and is listed on Pakistan Stock Exchange (PSX).

Background Bank commenced operations in 1947 and was privatized in 1991. In 2008, the Bank entered into a strategic partnership with Maybank, Malaysia, which owns 18.78% stake in MCB through Maybank International Trust (Labuan) Berhad. Further in 2017, MCB has expanded its domestic footprint by acquisition of NIB Bank Limited and 170 branches have been merged with and into MCB Bank Limited. Subsequently in 2018, 90 branches have been transferred to MCB Islamic Bank, a wholly owned subsidiary company.

Operations MCB offers a wide range of products and services hence ensuring ease and freedom for the customer to bank from any of the 1350+ branches across the country and a wide array of digital channels.

Ownership

Ownership Structure MCB Bank is majority owned (~36%) by Nishat group, through individuals of Mansha family and corporates of the group.

Stability The Bank ensures development and retention of high potential employees to create a talent pool to fill key positions in the organization. This is a continuous process, which in turn ensures that the organization's management can keep up with the changing business environment.

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

Financial Strength The group has a strong equity and asset base, with its foothold in numerous sectors and industries in Pakistan. Further, Maybank holds ~18.78% stake in MCB through Maybank International Trust (Labuan) Berhad and 5.49% shares are held by Bugis Investment (Mauritius) PTE Limited.

Governance

Board Structure Apart from CEO, the Board includes two independent directors and eight non-executive directors as at end-Dec18.

Members' Profile Chairman of the board, Mr. Mian M Mansha, is a well-known and seasoned businessperson with over 45 years' experience. The board of directors (BoD) includes prominent industrialists and financial sector specialists, who have a plethora of rich experience in the business world by demonstrating outstanding entrepreneurial ability.

Board Effectiveness To ensure effective and independent oversight of the bank's overall operations, the Bank has constituted eight committees. During the year, five board meetings were held. Attendance of board members in these meetings remained high.

Financial Transparency The external auditors of the company, KPMG Taseer Hadi & Co., Chartered Accountants, issued an unqualified audit opinion pertaining to annual financial statements for CY18.

Management

Organizational Structure The bank, with a largely horizontal organizational structure, has fifteen groups & divisions reporting to the CEO, except Internal Audit and Corporate Affairs which report to the Board's Audit Committee and the Board respectively.

Management Team MCB's senior management team comprises experienced bankers having national and international exposure. Mr. Imran Maqbool, CEO, is a seasoned banker with over three decades of diverse, international banking experience.

Effectiveness The Bank has fourteen management committees in place each with defined terms of reference. Comprising of senior officials including the President, meetings are held on a regular basis and agenda items include developing business plans, reviewing the performance of the Bank on standalone basis as well as compared to the sector.

MIS MCB management has centralized the authority, direction, management, and monitoring of Information Security activities for the entire organization in the Information Technology Group (ITG) under the umbrella of Information Security (IS) Team. ITG is headed by CIO, who in turn reports functionally and administratively to the CEO.

Risk Management Framework Risk Management & Portfolio Review Committee remains responsible to ensure that appropriate risk management policies are developed and implemented to mitigate the key risks to which the bank is exposed.

Business Risk

Industry Dynamics The year 2018 was a marked year as the industry saw an expansion of ~22% in advances, although the deposit growth rate stayed in single digit. As a result the industry saw a rise in the ADR ratio from 50% to 55%. In terms of advances expansion, a predominant portion went in to energy sector followed by textile, individuals and agriculture. Corporate sector claimed the major portion of the borrowings with small amounts going into commodity, consumer and SME sectors. Profitability of the banks has taken a hit due to incremental costs and provisioning on account of NPLs. After a lapse of few years the industry NPLs have seen a accretion which is a concern going forward.

Relative Position MCB was marked as the bank with the highest profitability numbers for the year 2018. During CY18, Bank's customer deposits (PKR 1,021 bln) increased by ~7.8% as against the sector's growth of 10.7%. MCB retained its position in top 5 banks based on advances, deposits and profitability with share in total deposits of the sector at 7.8% (Dec17: 8.0%).

Revenues On the net markup income side, bank reported an increase of PKR 3.3bln. Non-markup income block of the Bank was reported at PKR 17.2bln with major contributions coming in from fee and commission income and income from dealing in foreign currencies. During first quarter ending March 2019, Bank reported an increase of PKR 2.4bln in net markup income over same period last year and non-markup income block of the Bank was reported at PKR 3.5bln – decreasing by 20% YoY.

Performance PBT of the Bank grew by 3% over last year and was reported at PKR 32.06bln. Past service cost of PKR 1.04bln, because of revision in monthly pension, further added to the cost. PBT for the three months period ended March 31, 2019 increased by 24% and was reported at PKR 9.08bln.

Sustainability Despite fragile economic conditions resulting in subdued business activity, the Bank delivered exceptional results to its shareholders in 2019. MCB has the history of paying highest dividend per share to its shareholders. MCB is continually expanding its network of branches to meet customer's expectations with parallel investment on the digital infrastructure. Recovery from infected portfolio remains one of the key concerns.

Financial Risk

Credit Risk Net advances of the Bank constitute ~34% of the total assets at end Dec18. Out of total performing advances, only 16.5% are lent to government sector while remaining 83.5% is lent to private sector. The coverage and infection ratios of the Bank were reported at 88.26% (CY17: 93.74%) and 8.95% (CY17: 9.47%) respectively. The Bank's top 10 exposures on the basis of total funded and non-funded exposure aggregated to PKR 233.5bln (CY17: PKR 205.3bln).

Market Risk The investment portfolio showed a robust growth of 14% to PKR 749bln during CY18 (CY17: PKR 657bln). The bank's investment portfolio constitutes 50% of total asset base and government securities continue to dominate the overall investment book (95%). Investment mix continued to shift from long-term PIBs to the short-term T-Bills during the year in the wake of rising interest rate scenario. Resultantly, investment in T-Bills increased by PKR 194bln whereas investment in PIBs decreased by PKR 95bln.

Liquidity And Funding The deposit base of the Bank registered a significant increase of PKR 81bln (8% YoY), net of deposits amounting PKR 22bln transferred to MCBIL under the scheme of demerger. The Bank reported a high CASA ratio of 91% at end CY18 (CY17: 93%), second highest in the industry. MCB's average cost of funding has remained stable at 3.20% (CY17: 3.20%), which is considered relatively low compared to the industry.

Capitalization Banks's total CAR is 18.13% against the requirement of 11.90%. Quality of the capital is evident from Bank's Common Equity Tier-1 to total risk weighted assets ratio which comes to 16.02% against requirement of 6%. Bank reported Liquidity Coverage Ratio of 178.7% and Net Stable Funding Ratio of 130.6% against requirement of 100%.

MCB Bank Limited

BALANCE SHEET	31-Dec-18 Annual	31-Dec-17 Annual	31-Dec-16 Annual	31-Dec-15 Annual
Earning Assets				
Advances (Net of NPLs)	497,836	466,305	346,126	312,258
Debt Instruments	9,280	7,573	5,899	9,927
Total Finances	507,116	473,878	352,025	322,185
Investments	740,089	649,391	550,030	558,875
Others	50,375	15,507	10,063	12,651
	1,297,580	**1,138,776**	**912,118**	**893,711**
Non Earning Assets				
Non-Earning Cash	99,785	99,542	71,313	57,372
Net Non-Performing Finances	5,745	3,051	1,990	1,867
Fixed Assets & Others	95,020	101,869	66,393	63,679
	200,550	**204,462**	**139,696**	**122,918**
TOTAL ASSETS	**1,498,130**	**1,343,238**	**1,051,814**	**1,016,630**
Interest Bearing Liabilities				
Deposits	629,150	580,223	472,924	435,435
Borrowings	219,910	136,962	74,515	118,459
	849,059	717,185	547,439	553,894
Non Interest Bearing Liabilities	499,793	472,486	362,748	324,935
TOTAL LIABILITIES	**1,348,852**	**1,189,672**	**910,187**	**878,829**
EQUITY (including revaluation surplus)	**149,278**	**153,566**	**141,627**	**137,800**
Total Liabilities & Equity	**1,498,130**	**1,343,238**	**1,051,814**	**1,016,630**

INCOME STATEMENT	31-Dec-18 Annual	31-Dec-17 Annual	31-Dec-16 Annual	31-Dec-15 Annual
Interest / Mark up Earned	83,319	74,091	67,422	80,532
Interest / Mark up Expensed	(37,305)	(31,429)	(23,655)	(31,210)
Net Interest / Markup revenue	**46,014**	**42,662**	**43,767**	**49,322**
Other Operating Income	16,823	18,076	15,901	16,705
Total Revenue	**62,837**	**60,738**	**59,668**	**66,027**
Other Income / (Loss)	375	42	320	410
Non-Interest / Non-Mark up Expensed	(32,902)	(28,721)	(23,260)	(23,560)
Pre-provision operating profit	30,310	32,059	36,728	42,877
Provisions	1,753	(1,045)	(654)	(544)
Pre-tax profit	32,064	31,014	36,075	42,333
Taxes	(10,704)	(8,555)	(14,184)	(16,782)
Net Income	**21,360**	**22,459**	**21,891**	**25,550**

Ratio Analysis	31-Dec-18 Annual	31-Dec-17 Annual	31-Dec-16 Annual	31-Dec-15 Annual
Performance				
ROE	15.5%	17.7%	19.0%	23.2%
Cost-to-Total Net Revenue	52.4%	47.3%	39.0%	35.7%
Provision Expense / Pre Provision Profit	-5.8%	3.3%	1.8%	1.3%
Equity/Total Assets	9.3%	10.2%	11.2%	11.1%
Funding & Liquidity				
Liquid Assets / Deposits and Borrowings	64.8%	66.1%	73.1%	74.9%
Advances / Deposits	48.0%	48.5%	44.5%	44.4%
CASA deposits / Total Customer Deposits	91.5%	93.0%	94.1%	92.9%
Intermediation Efficiency				
Asset Yield	7.1%	7.4%	7.7%	9.6%
Cost of Funds	3.2%	3.2%	2.8%	4.0%
Spread	3.9%	4.2%	4.9%	5.7%
Outreach				
Branches	1,387	1,444	1,238	1,246

Rating Scale

Credit Rating Scale & Definitions

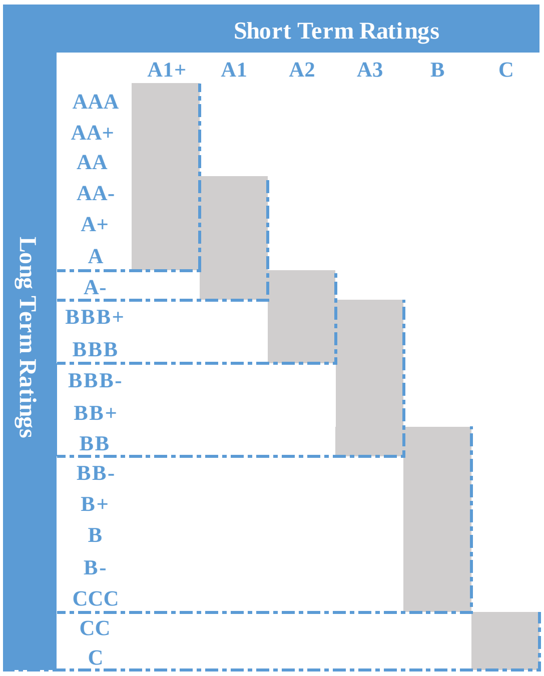
Credit rating reflects forward-looking opinion on credit worthiness of underlying entity or instrument; more specifically it covers relative ability to honor financial obligations. The primary factor being captured on the rating scale is relative likelihood of default.

Long Term Ratings

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 Ratings

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.
B	The capacity for timely repayment is more susceptible to adverse changes in business, economic, or financial conditions.
C	An inadequate capacity to ensure timely repayment.



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 surveill the opinion due to lack of requisite information.

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

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.
(8) PACRA prohibits its employees and analysts from soliciting money, gifts or favors from anyone with whom PACRA conducts business | Chapter III; 11-A-(q)
(9) PACRA ensures before commencement of the rating process that an analyst or employee has not had a recent employment or other significant business or personal relationship with the rated entity that may cause or may be perceived as causing a conflict of interest; | Chapter III; 11-A-(r)
(10) PACRA maintains principal of integrity in seeking rating business | Chapter III; 11-A-(u)
(11) PACRA promptly investigates, in the event of a misconduct or a breach of the policies, procedures and controls, and takes appropriate steps to rectify any weaknesses to prevent any recurrence along with suitable punitive action against the responsible employee(s) | Chapter III; 11-B-(m)

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

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