

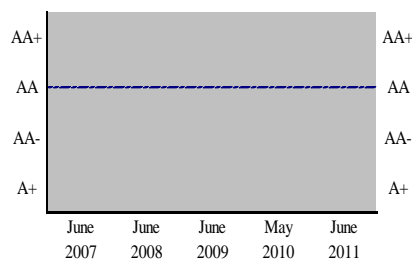
The Pakistan Credit Rating Agency Limited

RATINGS (JUNE 2011)

FAYSAL BANK LIMITED (FBL)

| | NEW | PREVIOUS |
|---------------------------------------------------|-----|----------|
| ENTITY | | |
| Long Term | AA | AA |
| Short Term | A1+ | A1+ |
| TFCs (UNSECURED, SUBORDINATED, AND LISTED) | | |
| PKR 800MLN | AA- | AA- |

RATING HISTORY



FINANCIAL DATA

PKR (mln)

| | Mar-11* | Dec-10 | Dec-09 |
|-----------------|---------|---------|---------|
| Total Assets | 246,594 | 267,321 | 180,865 |
| Equity | 16,848 | 16,643 | 11,336 |
| Net Income | 241 | 1,190 | 1,200 |
| ROA% | 0.38^ | 0.53 | 0.75 |
| ROE% | 5.76^ | 8.51 | 11.18 |
| Equity/Assets % | 6.83 | 6.23 | 6.27 |
| SBP CAR% | 10.36 | 10.31 | 11.93 |

*Based on unaudited results for 3 Months ended March11

^Annualized

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TFC ISSUE

- FBL has inherited on acquisition of Royal Bank of Scotland (Pakistan) Limited an outstanding unsecured subordinated TFC, issued in February 2005 for a tenor of 8 years. The instrument carries mark-up at a floating rate of latest 6-month KIBOR plus 1.9%, payable semi-annually. Principal redemption is in four equal annual installments, and has commenced from Feb-10.

RATING RATIONALE AND KEY DRIVERS

- The ratings reflect FBL's ability to withstand tough operating environment and maintain its market standing. The recent merger of Royal Bank of Scotland (Pakistan) Limited (RBS) with and into FBL has ushered a new era of opportunities and challenges. While earning assets of the bank has witnessed substantial rise with simultaneous expansion in deposit base, FBL's infected portfolio as well as operating cost structure has increased. Cognizant of the situation, the management is focusing on operational integration and consolidation with an aim to reduce infection and rationalize cost structure. FBL's association with a financially sound business group (Dar Al Maal Al-Islami Trust) remains a key rating factor.
- The ratings are dependant on the bank's ability to effectively execute its medium-term business strategy while capitalizing on the potential of the combined entity in terms of its operating platform and extended market outreach. Cohesiveness and stability in the senior management and swift reduction in expanded cost structure while holding profitable business streams would be critical. The efficacy of the risk management framework aimed at improving the overall asset quality of the bank also remains important.

ASSESSMENT

- Prior to acquisition of 99.4% shareholding of RBS, FBL had a major focus on corporate segment with limited presence in consumer financing. Even within small consumer book, the bank was reliant on collateralized lending as evidenced from its consumer portfolio being dominated by auto and mortgage loans. The bank's loan book was skewed towards fixed investment, followed by working capital funding. In terms of sectoral mix, the bank's strategy was to target non-cyclical segments like energy, fertilizer and infrastructure though textile still remained a major contributor. The bank had experienced hike in classified portfolio though accretion in the same slowed down during 2010 (end-3QCY10: 11.9%)
- RBS, a small sized bank with a network of around 80 branches, had a sizeable consumer book though the major chunk was represented by corporate lending. The consumer portfolio was dominated by non-collateralized lending in the form of personal loans and credit cards. Much before the takeover, RBS had started shedding of high cost time deposit to rationalize its cost structure. This resulted in the bank having major proportion in CASA almost similar to the mix of FBL. The infection ratio was significantly high with NPLs as a percentage of gross advances rising to ~ 18% by end-3QCY10. Moreover, the bank had a high operating cost structure.
- Following the acquisition (effective October2010), the combined entity has remained focused on the operational integration of both entities. The objective is to create a single IT and operational platform for achieving efficiency, while ensuring seamless customer service. Branch network would be optimized with the aim of using vacated space for setting up Islamic branches. This would rationalize the cost structure and help the bank build capacity for further growth. FBL's success in its cost rationalization efforts remains critical. The bank, capitalizing on the acquired consumer portfolio, intends to enhance revenue from this segment. This would be done under strict risk parameters to avoid infection in asset quality. Moreover, the management plans to augment the agri portfolio besides increasing the cross selling efforts in the large corporate customer base of the combined entity.
- During 2010, FBL's interest revenue registered a decent growth on the back of the expanded finances portfolio. Resultantly, there was considerable increase in net interest revenue. Non-interest income continued to support the bank's overall revenues, supplemented by one-off gain of PKR 1.5bln on settlement of NI(U)T units. Meanwhile, a sizeable increase in the company's operating costs alongwith substantial provisioning expense negatively impacted the bank's profitability and resulted in largely maintained net income on a comparative basis. During 1Q11, despite a healthy increase in the revenue stream, the bank showed limited improvement in performance on account of high costs structure.
- The NPLs as a proportion of total advances are considerably high (1Q11: 16%, 2010: 16%, 2009: 11%), mainly due to the infected portfolio inherited from RBS. However, the loss coverage ratio is strong (1Q11:70%), given the significant provisioning made on a continuous basis. The management's plan to stall further additions in the NPLs on account of vigilant monitoring of stressed exposures and strengthened recovery efforts remains a challenge.
- FBL's investments of PKR 60.2bln form ~24% of total assets at end-Mar11. The portfolio is dominated by T-bills (68%), signifying low credit and market risk, and PIBs (19%). The remaining portion is deployed in fixed-income funds/preference shares (1.4%) and equities (11.4%). FBL's stock market exposure represents 40% of the bank's equity and signifies high market risk. This necessitates rationalization.
- The bank was unable to meet its CAR requirement of 10% at end-Dec10 due to deduction of exempted provisioning from Tier 1 Capital against some large non-performing exposures. Subsequently, FBL has been granted relaxation in provisioning against these exposures and has been allowed to use it for CAR purpose as well. As a result, the bank's CAR has restated its capital adequacy ratio for December10 and March10 and its CAR stands at 10.31% and 10.36%, respectively. Going forward, the bank plans to increase its CAR gradually through retention of profits. With the issuance of TFC II of PKR 3,000 bln during 2010, the room for Tier II capital has squeezed. [CAR-Mar11: Tier I: 8.14%, Tier II: 2.2%].

PROFILE

- The bank 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 of Faysal Bank Limited. Ithmaar Bank, a subsidiary of Dar Al-Maal Al-Islami Trust (DMI), holds the majority shareholding (67%) of FBL.
- The eight-member BoD includes the CEO, one nominee of DMI, and four non-executive directors, including the Chairman and two independent directors. The CEO, Mr. Naved A. Khan, joined FBL in Mar08 and has extensive local and international banking experience.