

AL BARAKA BANK (PAKISTAN) LIMITED DIRECTORS' REPORT TO MEMBERS

On behalf of the Board of Directors of the Al Baraka Bank (Pakistan) Limited (the Bank), we are pleased to present the 13th annual report along with the audited financial statements of the Bank and Auditors' report for the year ended 31 December 2018.

Economic Overview

The country's annual GDP growth reached 5.8% in the financial year ending June-2018, from 5.4% in FY17. The government had set a high GDP growth target for FY19, however impacts of changes in commodity producing sectors and the services sector, is likely to reduce real GDP growth for FY19 to around 4.5 percent, well below both the annual target of 6.2% and the 5.8% growth realized in the FY18.

The CPI inflation which has been on the rise during FY19 reached at 6.2% YoY as of December 2018, higher than 4.6% YoY in December 2017. The same is expected to further increase during 2019, due to the exchange rate movements, upward adjustments in gas and electricity tariffs, and higher government borrowings from SBP. However, the increase is likely to be offset to a certain extent by lagged impact of the increase in policy rate and fall in international oil prices.

The economic uncertainty has started to fade out after Government received commitments for financial assistance from various allies. This will ease the pressure of immediate need for financial stability and to settle the looming foreign debt payments. The deferred oil payment facilities will further release pressure on widening current account deficit and depleting forex reserves.

Pakistan's current account deficit has improved to USD 7.9 billion as of December 2018 as compared to USD 8.3 billion in the last year corresponding period. However, it has yet to reach sustainable level. If the current lower crude oil prices continue and exports show double digit improvement, the current account deficit can be brought at manageable level. The country's exports were stagnant at USD 11.83 billion during Jul-Dec FY 19 as compared to USD 11.82 billion during the corresponding period last year. Imports were also recorded at USD 27.45 billion during Jul-Dec FY 19 as compared to USD 26.6 billion corresponding period last year.

Despite stagnant exports and increase in imports, current account deficit showed some improvements mainly from a 9.9% increase in foreign remittances. The SBP net liquid reserves were US\$ 7.2 billion by the end of December 2018.

The Pak Rupee was under stress during Jan-Dec 2018 due to current fiscal situation resulting in devaluation of Pak Rupee by 26% reaching to Rs 139 to 1 US\$ as of 31 December 2018.

The State Bank of Pakistan (SBP) in its monetary policy statement issued in November 2018 raised the policy rate by 150 bps to 10% and consequently taking discount rate to 10.5%. Rates have been raised by 425 bps during the year 2018, and are now at their highest level since 2015.



Financial highlights of the Bank

The key business numbers for 2018 are as under:

	2018	2017	Growth
Financing (net)	Rs. 75 Billion	Rs. 71 Billion	5.6%↑
Investments	Rs. 21 Billion	Rs. 19 Billion	10.5%↑
Total assets	Rs. 129 Billion	Rs. 123 Billion	4.9%↑
Deposits	Rs. 100 Billion	Rs. 97 Billion	3% ↑
Equity	Rs. 10.7 Billion	Rs. 10.8 Billion	0.9%↓
Branch Network	191 Branches	188 Branches	3 branches ↑

Financial performance

PROFIT AND LOSS ACCOUNT	2018	2017	%
	<i>Rs. In millions</i>		
Profit/return on financing, investments and placements	8,032	6,718	20%
Return on deposits and other dues expensed	(3,815)	(3,078)	24%
Net spread earned	4,217	3,640	16%
Fee, commission and brokerage income	683	668	2%
Income from dealing in foreign currencies	384	173	122%
Dividend income and Capital (loss) / gain on investments	5	33	(85%)
Other income	25	93	(73%)
Income before expenses	5,314	4,607	15%
Administrative expenses and other charges	(4,789)	(4,953)	(3%)
Operating profit	525	(346)	252%
(Provision) / reversal against non performing financing, investments, other assets and write off	(770)	(185)	316%
Loss before tax	(245)	(531)	(54%)
Taxation	(9)	142	(106%)
Loss after tax	(254)	(389)	(35%)

Financial Performance

The deposit of the Bank was closed at Rs 100 billion as at 31 December 2018 as compared to Rs 97 billion at 31 December 2017. The Bank continued its focus on mobilizing low cost saving accounts. As of 31 December 2018, the Bank's CASA deposit mix was 78%. The Bank is managing its cost of deposit prudently by increasing its focus on mobilization of current accounts.



The Bank continued to follow cautious approach in growing financing portfolio and closed its net financing at Rs 75 billion as compared to Rs 71 billion reported at 31 December 2017. The focus of the Bank is to build a high quality and well-diversified financing portfolio. The Bank's ADR stood at 75.1% as on 31 December 2018.

In profit and loss account, the net spread earned by the Bank increased significantly by 16% at Rs 4,217 million as compared to Rs 3,640 million reported last year. Other income increased to Rs 1,097 million as compared to Rs 968 million recorded in the last year. The increase is mainly attributable to income from dealing in foreign currencies. The Bank is focusing on increasing its non-funded income from trade and advisory business.

Administrative expenses and other charges have decreased to Rs 4,789 million from Rs 4,953 million. The Bank had planned various cost optimization strategies last year which are now resulting in substantial cost savings to the Bank. The Bank continues to follow disciplined cost management strategy and enhancing business synergies.

Despite of challenging conditions, the Bank recorded operating profit of Rs 525 million during the year ended 31 December 2018 as compared to operating loss of Rs 346 million last year.

During the year, the Bank recorded additional provision on non performing financing amounting to Rs 471 million. Significant provisions were booked on non-performing accounts recorded as industry wide defaults. The Bank also booked capital loss of Rs 31 million and impairment on equity market portfolio of Rs 295 million during the year due to stressed performance of Pakistan Stock Exchange. The Bank is making concrete efforts to regularize certain old chronic accounts and we expect the reversals to be recorded in near future.

Earnings per share

Loss per share of the Bank for 2018 was Re 0.18 (2017: Loss per share Re 0.28) based on the paid-up share capital for the year ended 31 December 2018.

Minimum Capital Requirements (MCR)

During the year, the sponsor of the Bank has injected the Additional Tier I Capital. As at 31 December 2018, the Minimum Capital Requirements (MCR) and Capital Adequacy Ratio (CAR) stood at Rs. 10.19 billion and 11.77% respectively.

Human Resources

We believe that trainings play a significant role in the personal development of our staff. Hence; as part of our ongoing initiatives we are in constant endeavor to provide enhanced learning experience that's not only engaging but also effectively meets their training needs. In 2018, 348 in-house training sessions were arranged in which large number of Bank employees had participated. Similarly; in addition to these staff was also nominated for 294 trainings sessions and workshops organized through outsourced vendors.



Information Technology

The Bank is committed to developing and operating high end technology platforms which helps in better performance and achieving high efficiencies. The Bank is focused on the use of technology in line with Albaraka Group guidelines to provide quality services to its customers.

During the year 2018, the Bank achieved following ventures in the field of Information Technology:

- Acquisition of new data center Servers & Storage Solution for primary and Disaster Recovery (DR) site. The new servers are in process of implementation and will be live in first quarter of 2019. This change will significantly improve our banking services.
- Launching of EMV / Chip debit Mastercard for its customers. The new Al Baraka debit Mastercard comes with an improved card design and an embedded EMV /Chip which ensure utmost security of the debit card thus minimizing the risk of card skimming and related frauds.
- Launching of Al Baraka Masterpass QR (Quick Response) facility for its customers. The launch made Al Baraka Bank the first Islamic Bank in Pakistan to have a dedicated QR Payments within its own Mobile Banking Application.
- Launching of “OTC (Over the counter) - Bill Payment Services” allowing customers to make payments electronically from our branches.
- Acquisition of advance IT solution for compliance function.

Corporate Awards and Recognition

During the year ended 31 December 2018, the Bank won two CSR awards at the “7th International CSR Summit Awards & Gallery 2018” for “Collaboration & Partnership” and “Education/Scholarship Program”.

Corporate Social Responsibility

During the year, Al Baraka Tree Plantation Drive 2018 was held under the slogan of Al Baraka Goes Green in coordination with Urban Forest which is one of its kind in Pakistan, working in and around urban cities to make Pakistan green and pollution free.

Corporate and Financial Reporting Framework

The Board of Directors is fully cognizant of its responsibility under the Code of Corporate Governance issued by the Securities and Exchange Commission of Pakistan (SECP) and adopted by the State Bank of Pakistan (SBP) and related regulations issued by SBP.

The following statements are manifestation of its commitment towards high standards of Corporate Governance and continuous organizational improvement:

1. The financial statements prepared by the management of the Bank present fairly its state of affairs, the results of its operations, cash flows and changes in equity.



2. Proper books of account of the Bank have been maintained.
3. Appropriate accounting policies as stated in notes to the financial statements have been consistently applied in preparation of financial statements and accounting estimates are based on reasonable and prudent judgment.
4. International Financial Reporting Standards and such other standards as applicable in Pakistan have been followed in preparation of financial statements and any departure from these has been adequately disclosed.
5. The system of internal control is sound and has been effectively implemented and monitored.
6. There are no doubts upon Bank's ability to continue as going concern.
7. There has been no material departure from the best practices of corporate governance.
8. Investments of the Bank's recognized Provident Fund and Gratuity Fund based on un-audited accounts as at 31 December 2018 amounted to Rs 792 (2017: Rs 767) million and Rs 262 (2017: Rs 273) million respectively.

During the year ended 31 December 2018, four (04) Board meetings were held which were attended by the Directors as under:

Name of Director	No. of Meetings	
	Held	Attended
Mr. Adnan Ahmed Yousif, Chairman	4	4
Mr. Tareq Mahmood Kazim, Deputy Chairman	4	4
Mr. Abdulrahman Shehab, Director	4	4
Mr. Salman Ahmed, Director	4	4
Mr. Najmul Hassan, Director	4	4
Mr. Azhar Hamid, Director	4	4
Mr. Ahmed Rehman, Director	4	4
Mr. Shafqaat Ahmed, Director	3	3
Mr. Asaf Mohyuddin, Director (ceased on 01-10-2018)	3	3
Mr. Zahid Rahim, Director (Appointed on 28-02-2018)	3	3

Committee Meetings

During the year, five (05) meetings of the Board Executive Committee (BEC) and four (04) meetings of the Board Risk Committee (BRC), Board Audit Committee (BAC), Board Human Resource Committee (BHRC) and Board Social Responsibility Committee (BSRC) were held by each committee. The attendance of the members was as follows:



Board Risk Committee (BRC)			Board Audit Committee (BAC)		
Name of Director	Meetings Held	Meetings Attended	Name of Director	Meetings Held	Meetings Attended
Mr. Salman Ahmed	4	4	Mr. Abdulrahman Shehab	4	4
Mr. Ahmed Rehman	4	4	Mr. Asaf Mohyuddin	3	3
Mr. Zahid Rahim	3	3	Mr. Azhar Hamid	4	4

Board Human Resource Committee (BHRC)			Board Executive Committee (BEC)		
Name of Director	Meetings Held	Meetings Attended	Name of Director	Meetings Held	Meetings Attended
Mr. Tariq Mahmood Kazim	4	4	Mr. Tariq Mahmood Kazim	5	5
Mr. Abdulrahman Shehab	4	4	Mr. Salman Ahmed	5	5
Mr. Asaf Mohyuddin	3	3	Mr. Najmul Hassan	5	4
Mr. Najmul Hassan	4	3	Mr. Zahid Rahim	4	4

Board Social Responsibility Committee (BSRC)		
Name of Director	Meetings Held	Meetings Attended
Mr. Tariq Mahmood Kazim	4	4
Mr. Azhar Hamid	4	4
Mr. Shafqaat Ahmed	3	3

Shareholding Pattern as on 31 December 2018

Share holders category	No. of share holders	Shares held	%age
Directors			
Mr. Adnan Ahmed Yousif	1	500	0.00%
Mr. Tariq Mahmood Kazim	1	500	0.00%
Mr. Salman Ahmed	1	500	0.00%
Mr. Abdulrahman Shehab	1	500	0.00%
Mr. Azhar Hamid	1	500	0.00%
Mr. Ahmed Rehman	1	500	0.00%
Mr. Shafqaat Ahmed	1	500	0.00%
Associated companies, undertakings and related parties			
Al Baraka Islamic Bank, Bahrain B.S.C (c)	1	812,446,082	59.13%
Islamic Corporation For The Development of The private Sector	1	162,847,717	11.85%
Mal Al Khaleej Investments LLC	1	158,360,039	11.53%



Public Sector Companies, Corporations, Banks, Development Financial Institutions and Non-Banking Financial Institutions, Mutual Funds & Other Organizations			
Gargash Enterprises L.L.C	1	5,882,352	0.43%
State Life Insurance Corporation of Pakistan	1	4,941,176	0.36%
Amanah Investment Limited	1	2,938,823	0.21%
Bank of Punjab	1	2,000,000	0.15%
Al-Hoqani Securities & Investment Corporation (Pvt) Ltd.	1	1,470,588	0.11%
Dossa Cotton & General Trading (Pvt) Ltd.	1	788,235	0.06%
Orix Leasing Pakistan Ltd	1	705,882	0.05%
Descon Holding (Private) Limited	1	588,235	0.04%
B.R.R Guardian Modaraba	1	100,000	0.01%
Dawood Capital Management Ltd.	1	2,961	0.00%
Shareholding ex-Directors and others			
Sheikh Tariq Bin Faisal Khalid Al Qassem	1	103,018,177	7.50%
Mr. Muhammad Umar Ejaz	1	42,000,000	3.06%
Mr. Mubarak Bulaswaad	1	4,860,000	0.35%
Mr. Syed Tariq Husain	1	3,300,284	0.24%
Mr. Abdul Ghaffar Faney	1	978,468	0.07%
Other (Shareholders with less than 10% Shareholding)	58	66,730,241	4.86%
Total Shareholding	83	1,373,962,760	100%

Shareholders with 10% or more voting interest:

Name of Share holders	No. of share holders	Shares held	%age
Al Baraka Islamic Bank, Bahrain B.S.C (c)	1	812,446,082	59.13%
Islamic Corporation For The Development of The Private Sector	1	162,847,717	11.85%
Mal Al Khaleej Investments LLC	1	158,360,039	11.53%

Except as disclosed above, no Executive of the Bank or their spouses / minor children was shareholder of the Bank as of 31 December 2018.



Risk Management Framework

The Bank's Risk Management Framework encompasses culture, policies, processes & structure and is directed towards the effective management of potential opportunities and threats that the Bank might face. The range of business activities undertaken by the Bank requires effective identification, measurement, monitoring, integration and management of different financial and non-financial risks that are constantly evolving as business activities change in response to concurrent internal and external developments. The Board keeps an oversight on Bank-wide risk management framework and approves the risk management strategies, policies and risk appetite. The Board Risk Committee (BRC) has been mandated by the Board of Directors (BOD) to assist in the design, regular evaluation and timely updation of the risk management framework of the Bank. The BRC aims to ensure that the Bank maintains a complete and prudent integrated risk management framework at all times and exposures are maintained within acceptable levels. The Board approved risk management policy has been developed strictly in line with the principles of Shariah and covers all major types of risks that the Bank may be exposed to.

The authority to monitor and manage different risks has been further delegated to the specialized committees comprising of senior members of management with relevant experience and expertise. The committees include:

1. Asset and Liability Management Committee (ALCO)
2. Credit Committee (CC)

The Bank has setup functions of asset booking and credit approval in which financing exposures and their related risks are analyzed in the light of credit limits, applicable controls and segment exposures.

Credit Committee has been established for oversight and management of overall credit risk faced by the Bank. Credit Administration Department (CAD) ensures compliance of all the activities with respect to policies and procedures and applicable laws and regulations, financing documentation and adherence to financing covenants. A Special Asset Management (SAM) function handles stressed assets to ensure a focused remedial strategy in compliance with the regulatory requirements.

The primary objective of this architecture is to inculcate risk management culture into the organization to ensure that risks are appropriately identified and assessed, properly documented, approved and adequately monitored; and managed in order to enhance long term earnings and to protect the interests of the Bank's depositors and shareholders.

For effective implementation, the Risk Management function operates independently within the Bank. The function is also responsible for development and oversight of risk policies and plays a pivotal role in monitoring the risks associated with various activities of the Bank. Risk Management function is headed by the Chief Risk Officer (CRO), who administratively reports to the President with an independent functional reporting line to the BRC.

To ensure the independence of this position, following areas are critical to the Bank's sustainability & profitability and are placed under the umbrella of RM function:

- Risk Policies and Industry Analysis
- Credit Risk Review (CRR)



- Credit Portfolio Risk Management, Basel & IFRS 9
- Market and Liquidity Risk Management

Risk policies and Industry Analysis Unit of RMG formulates and updates credit and risk policies of the Bank besides preparing comprehensive industry analysis and its updates from time to time.

Credit Risk under Risk Management Group (RMG) is playing its due role in conducting credit risk reviews of Corporate/Commercial, SME, Agri and Consumer credit applications and presents its observations to CC/respective approving authorities of the Bank. CRR adds value to the approval process by validation and assurance to the affect that the financing/investment proposals are in compliance with different policy parameters, regulatory instructions and adherence to the risk appetite of the Bank. Besides, CRR also conducts assessment of credit proposals on concentration levels of the Bank in terms of large exposures, industry limits, and impact on CAR and also identify/record if there are exceptions. Independent validation is helpful for the Credit Committee/ approving authorities in decision making process. The structure of the CRR is designed in view of the nature, complexity of business activities of the Bank.

Credit Portfolio Risk Management function performs periodic analysis on credit portfolio to provide Credit Committee/approving authorities an objective assessment of the portfolio health. This function is also responsible for the implementation of Basel Capital Adequacy Standards as per SBP's requirements as well as adoption of IFRS 9 - Financial Instruments in line with best industry practices and Group's initiatives. Currently, the Bank is using Standardized Approach for capital requirements for credit and market risks while Basic Indicator Approach has been adopted for Operational Risk.

During the year under review the Bank made significant progress in terms of transition to Internal Rating Based Approach for Credit Risk. In this contest, Expected Credit Loss (ECL) assessment has been made under IFRS 9 through implementation of Moody's Risk Analyst, a world's renowned internal credit rating system. The Moody's Risk Analyst system takes into consideration qualitative and quantitative factors of the counter-party, transaction structure and collaterals and generates ratings at Obligor and Facility levels as required by Internal Rating Based (IRB) approach under Basel regulations. The facility rating system, developed in line with SBP's guidelines, also provides estimated Loss Given Default (LGD) and Obligor rating provides Probability of Default (PD). The system is backed by secured database with backup support and is capable of generating MIS reports providing snapshot of the entire portfolio for strategizing and decision making.

The Market and Liquidity Risk manages the market and liquidity risks and reviews liquidity requirements under the supervision of ALCO. As part of market risk management, Treasury Middle Office (TMO) manages risks relating to treasury operations and reports its findings to senior management for prompt remedial actions. The Bank ensures that any liquidity mismatch and gaps are proactively managed by keeping liquidity under control and closely monitored. Sources of liquidity are regularly reviewed / monitored by the ALCO keeping view the prevailing economic indicators, projected cash flows and asset / liability mix, and approve strategy for managing liquidity appropriately. The Liquidity Risk Management Policy of the bank encompasses contingency funding plan for actions to be taken in case of liquidity stress conditions.

The Bank has well established structure of internal limits with respect to its treasury and investment operations. TMO monitors risk limits, assess market risk in investment of Sukuk and



foreign exchange transactions and also monitors each and every transaction executed through treasury.

For effective management of Operational Risk, the Bank has established an exhaustive operational risk management framework across all business lines and support units/departments as well as those arising from external events like natural disasters, outsourcing etc.

The Bank has been conducting Risk Control and Self-Assessment (RCSA's) exercises for each business line and key control functions of the Bank. Through the RCSA exercise, the Bank has been able to develop inventory of risks, controls and key risk indicators (KRI) and has identified gaps in its operating activities which are rectified on a priority basis.

The Bank has successfully completed transition to an outsourced Operational Risk Management suite i.e. Risk Nucleus to fully automate operational loss data collection, RCSAs and KRIs. The system keeps a detailed track of all operational loss events with complete audit trail. Furthermore, Bank wide training plan is being imparted to create awareness of operational risk management and significance of operational loss incident reporting.

The Bank has adopted Basel III guidelines issued by SBP and relevant disclosures are made in the financial statement for the year ended 31 December 2018.

The Bank has aligned its strategy and all the relevant policies & procedures with FATF recommendations and regulatory requirements. The Bank has implemented screening solutions for exercising efficient controls over any possible provision of services to proscribed persons / entities and Transactions Monitoring Solution (TMS) for generation of quality alerts to hedge the Bank from ML/FT risks.

Statement of Compliance with the Code of Corporate Governance

The Bank has adopted the requirements of the Code of Corporate Governance as issued by the SECP and adopted by SBP. A statement to this effect is annexed to this report.

Statement of Internal Controls

The management of the Bank is responsible for establishing and maintaining adequate controls and procedures and fully recognizes this responsibility and appreciates its value and significance. The placement of staff within and other integration such as IT systems, policies, procedures and processes have been streamlined. The Board is pleased to endorse the management's statement relating to Internal Controls as annexed to this report.

Future Outlook

The SBP has further increased the discount rate by 25 BPS in its monetary policy announced in January 2019 resulting in a total increase in discount rate by 450 BPS from January 2018. As the country enters into an IMF program, along with rising inflation, SBP may further tighten monetary policy in months ahead. The increase in discount rate will have a positive effect on the banking industry as a whole in 2019. Our focus will be on maintaining the growth momentum without compromising on net spreads and asset quality. Efforts will also be made to target new market segments, widening of customer base and improving efficiency and productivity by leveraging on the investment in technology made by the Bank in recent years.



The Bank will take following new initiatives in 2019:

- Improved mobilisation of low cost deposits.
- Deepening in SME, Agricultural and Consumer Finance including Auto Financing, Home Mortgage and Debit Cards.
- Focus on IT driven products to increase business volumes and customer satisfaction.
- Recovering old and stuck up financings.
- Fresh Investment Banking mandates and advisory services to increase revenues.

We are confident that all of above mentioned initiatives cumulatively will add more value to the Bank's services and contribute to the overall growth of the Bank.

Credit Rating

Based on the financial statements of the Bank for the year ended 31 December 2017, JCR-VIS, has maintained the long-term rating to 'A+' and the short-term rating at 'A1'. Pakistan Credit Rating Agency Limited (PACRA) has maintained the Bank's long-term rating at 'A' and short term rating at 'A1'.

External Auditors

Our existing auditors M/s EY Ford Rhodes (EYFR), Chartered Accountants, is eligible to offer themselves for reappointment for accounting year ending 31 December 2019 and we have received their consent to continue to act as auditors of the Bank.

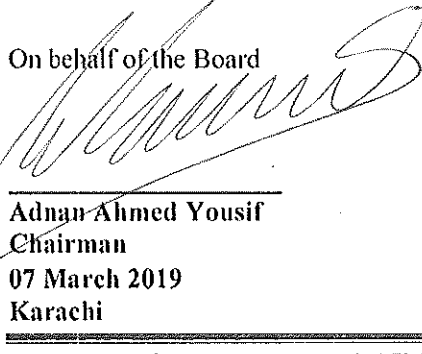
The external auditors have confirmed that they have been given a satisfactory rating under the Quality Control Review program of the Institute of Chartered Accountants of Pakistan, and that the firm and all their partners are compliant with the International Federation of Accountants' Guidelines on Code of Ethics, as adopted by the Institute of Chartered Accountants of Pakistan, and meet the requirements for appointment under all applicable laws.

The external auditor's re-appointment shall be subject to approval in the forthcoming Annual General Meeting.

Acknowledgement

The Board wish to place on records its sincere thanks and gratitude to the State Bank of Pakistan, the Securities and Exchange Commission of Pakistan and the Shariah Board for their continued guidance and support. We would also like to thank our valued customers, shareholders and business partners for their continued patronage and confidence as well as staff members for their commitment and devotion.

On behalf of the Board


Adnan Ahmed Yousif
Chairman
07 March 2019
Karachi

