**Camel Analysis for Meezan Bank Limited**

**BSAF 7B**

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Capital Adequacy:

The capital adequacy ratio (CAR) is a measurement of a bank's available capital expressed as a percentage of a bank's risk-weighted credit exposures. The capital adequacy ratio, also known as capital-to-risk weighted assets ratio (CRAR), is used to protect depositors and promote the stability and efficiency of financial systems around the world. Two types of capital are measured: tier-1 capital, which can absorb losses without a bank being required to cease trading, and tier-2 capital, which can absorb losses in the event of a winding-up and so provides a lesser degree of protection to depositors.

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| Capital Adequacy Ratio |  |  |  |  |  |  |
| Capital to Assets Ratios | Total Equity/Total Assets | 5.3% | 4.3% | 4.5% | 4.6% | 5.0% |
| Common equity to Total capital | Common equity/Total capital | 5.26% | 4.30% | 4.49% | 4.63% | 4.95% |
| Debt to Equity Ratio | Debt/Equity | 71.2% | 90.3% | 105% | 105% | 52% |

The reason minimum capital adequacy ratios (CARs) are critical is to make sure that banks have enough cushion to absorb a reasonable amount of losses before they become insolvent and consequently lose depositors’ funds. The capital adequacy ratios ensure the efficiency and stability of a nation’s financial system by lowering the risk of banks becoming insolvent. Generally, a bank with a high capital adequacy ratio is considered safe and likely to meet its financial obligations.

During the process of winding-up, funds belonging to depositors are given a higher priority than the bank’s capital, so depositors can only lose their savings if a bank registers a loss exceeding the amount of capital it possesses. Thus the higher the bank’s capital adequacy ratio, the higher the degree of protection of depositor's assets.

Off-balance sheet agreements, such as foreign exchange contracts and guarantees, also have credit risks. Such exposures are converted to their credit equivalent figures and then weighted in a similar fashion to that of on-balance sheet credit exposures. The off-balance sheet and on-balance sheet credit exposures are then lumped together to obtain the total risk-weighted credit exposures.

Asset Quality:

An asset quality rating refers to the assessment of credit risk associated with a particular asset, such as a bond or stock portfolio. The level of efficiency in which an investment manager controls and monitors credit risk heavily influences the rating bestowed. And because asset quality is an important determinant of risk that profoundly impacts liquidity and costs, analysts go to great lengths to make sure they issue the most accurate evaluations possible. After all, their pronouncements can greatly affect the overall condition of a business, bank, or portfolio for years to come.

Analysts consider a multitude of factors when issuing asset quality ratings, including portfolio diversification, operational efficiency, and how existing regulatory frameworks may or may not limit credit risk. A rating of “one” signals that an asset possesses high quality with little credit risk. Such a rating would likely be assigned to ultra-secure government Treasury bills (T-Bills). At the other end of the spectrum, a rating of “five” would likely be given to assets with significant credit deficits, such as high-risk corporate-issued junk bonds.

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| Asset quality |  |  |  |  |  |  |
| Non performing financing to Total financing |  | 2.58% | 1.89% | 2.10% | 2.60% | 3.95% |
| Non performing financing to Total assets |  | 1.14% | 1.03% | 1.13% | 1.23% | 1.54% |

Management

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| --- | --- | --- | --- | --- | --- | --- |
| Operating expenses to net income | Operating expenses/Net income | 163% | 215% | 260% | 268% | 267% |
| ROE Growth rate last 5 years |  | 8% | 16% | 22.1% | 1.1% | -6.6% |
| ROA Growth rate last 5 years |  | 11% | 42.2% | 17.0% | -2.1% | -12.7% |

Earnings:

Return on equity (ROE) is a measure of financial performance calculated by dividing net income by shareholders' equity. Because shareholders' equity is equal to a company’s assets minus its debt, ROE is considered the return on net assets. ROE is considered a measure of the profitability of a corporation in relation to stockholders’ equity.

Whether ROE is deemed good or bad will depend on what is normal among a stock’s peers. For example, utilities have many assets and debt on the balance sheet compared to a relatively small amount of net income. A normal ROE in the utility sector could be 10% or less. A technology or retail firm with smaller balance sheet accounts relative to net income may have normal ROE levels of 18% or more.

A good rule of thumb is to target an ROE that is equal to or just above the average for the peer group. For example, assume a company, TechCo, has maintained a steady ROE of 18% over the last few years compared to the average of its peers, which was 15%. An investor could conclude that TechCo’s management is above average at using the company’s assets to create profits. Relatively high or low ROE ratios will vary significantly from one industry group or sector to another. When used to evaluate one company to another similar company, the comparison will be more meaningful. A common shortcut for investors is to consider a return on equity near the long-term average of the S&P 500 (14%) as an acceptable ratio and anything less than 10% as poor.

Return on assets (ROA) is an indicator of how profitable a company is relative to its total assets. ROA gives a manager, investor, or analyst an idea as to how efficient a company's management is at using its assets to generate earnings. Return on assets is displayed as a percentage

Return on assets (ROA), in basic terms, tells you what earnings were generated from invested capital (assets). ROA for public companies can vary substantially and will be highly dependent on the industry. This is why when using ROA as a comparative measure, it is best to compare it against a company's previous ROA numbers or against a similar company's ROA.

The ROA figure gives investors an idea of how effective the company is in converting the money it invests into net income. The higher the ROA number, the better, because the company is earning more money on less investment.

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| Earnings |  |  |  |  |  |  |
| Return On Equity | Net income/share holders equity | 26% | 22% | 18% | 18% | 19% |
| Net interest Mark up/Total Assets | Net Interest Mark up/Total Assets | 4.15% | 3.00% | 2.66% | 2.72% | 3.43% |
| Return On Assets | Profit/loss after taxation/ Total Assets | 1.36% | 0.96% | 0.82% | 1% | 1% |

Liquidity:

The loan-to-deposit ratio (LDR) is used to assess a bank's liquidity by comparing a bank's total loans to its total deposits for the same period. The LDR is expressed as a percentage. If the ratio is too high, it means that the bank may not have enough liquidity to cover any unforeseen fund requirements. Conversely, if the ratio is too low, the bank may not be earning as much as it could be.

A loan-to-deposit ratio shows a bank's ability to cover loan losses and withdrawals by its customers. Investors monitor the LDR of banks to make sure there's adequate liquidity to cover loans in the event of an economic downturn resulting in loan defaults.

Also, the LDR helps to show how well a bank is attracting and retaining customers. If a bank's deposits are increasing, new money and new clients are being on-boarded. As a result, the bank will likely have more money to lend, which should increase earnings. Although it's counterintuitive, loans are an asset for a bank since banks earn interest income from lending. Deposits, on the other hand, are liabilities because banks must pay an interest rate on those deposits, albeit at a low rate.

Investment to Deposit Ratio Interpretation: Investment to deposit ratio shows that which amount of deposit is used to as investment. If investment to deposit ratio is increasing year by year .That means, Bank is properly using their deposits in different profitable sectors in the domestic and foreign arena.

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| Liquidity |  |  |  |  |  |  |
| Finance to Deposit | Finances/Deposits | 52.95% | 65.26% | 62.39% | 55.2% | 43.99% |
| Investment to Deposits | Investment/Deposits | 24.20% | 15.75% | 17.71% | 23.1% | 16.30% |
| (Current account+Saving account) to total deposits |  | 73.27% | 72.3% | 74.2% | 74.5% | 71.85% |