MCB Islamic Bank Ltd.

Directors' Report to the Members

On behalf of the Board of Directors of MCB Islamic Bank Limited (the Bank), we are pleased to present the Annual Report for the year ended December 31, 2022

Rs. in Million

Statement of Financial Position	31-Dec-22	31-Dec-21	Growth
Deposits	154,001	122,748	25%
Total Assets	199,040	161,267	23%
Investments – *net*	72,669	33,476	117%
Islamic Financing – *net*	90,302	96,309	-6%
Shareholders' Equity *(including revaluations)*	16,347	10,605	54%

Profit & Loss Account	YTD Dec 2022	YTD Dec 2021	Growth
Operating income	9,390	4,393	114%
Operating and other expenses	6,046	4,815	26%
Provisions against financing and investments	(141)	647	-1.22 Times
Profit before taxation	3,203	225	13.2 Times
Profit after taxation	1,548	100	14.48 Times
Basic / diluted earnings per share - *Rs.*	1.125	0.073	14.41 Times

Performance Review

Banking industry remains encouraging and performed well despite the downward economic growth, soaring inflation, recent floods disaster and external pressures.

Despite these challenges our Bank remained fully aware of the high downside risks to the economic and operating environment and pursued its strategy of consistent growth through low cost deposit mobilization and prudent financing practices, supported by an optimal organizational structure, robust risk management framework and effective compliance with regulatory instructions, helping the Bank to attain **a profit before tax of Rs. 3,203 billion for the year ended December 31, 2022, Alhamdulillah.**

The Bank's Deposits reached at Rs. 154 billion as of December 31, 2022 as compared to Rs. 122.75 billion as at December 31, 2021, registering an excellent growth of 25% while accumulation of no and low-cost deposits remained a key objective of the Bank during the period under review. The Bank's Current and Saving Account (CASA) mix stands at a healthy rate of 72% with non-remunerative Deposits constituting 32% of total deposit mix of the Bank as of December 31, 2022. The bank achieved a significant growth in Current Accounts by Rs. 7.51 billion (18%) during the year. The Bank continues to emphasize on promoting Islamic Banking amongst potential non-banked customers through offering a variety of Islamic Banking products and ensuring service excellence.

Total assets of the Bank increased by 23% to reach at Rs. 199.04 billion as of December 31, 2022 as compared to Rs. 161.27 billion as at December 31, 2021. The net Financing was closed at Rs. 90.30 billion against the December 31, 2021 position of Rs. 96.31 billion whereas the investments were at Rs. 72.67 billion against Rs. 33.48 billion at December 31, 2021, showing management sagacious approach to gear up the banks' profitability without compromising its Capital Adequacy which increase by 8.32% points to close at 20.41%. The management has its continuous focus on efficient capital management, better asset quality and high yielding portfolio.

During the year under review, the Bank earned operating income of Rs. 9.39 billion, while return on earning assets stood at a level of 11.62% with the cost of funds at 6.24% resulting in a net spread of 5.38% for the year under review. On the other side due to the exorbitant rise in the general price level and the Rupee devaluation, the operating and other expenses were increased by 26% as compared to last year, being monitored closely to be contained through effective management controls in order to sustain profitability levels.

In view of the above developments, gradually increasing Balance Sheet spreads through effective portfolio mix management enabled the Bank's profit and loss statement to maintain an after-tax profit of Rs.1.548 billion for the year against Rs.100 million for the last year. The improvement in the Bank's profitability is also evident from earnings per share after tax of Rs. 1.125 for the year under review, against Rs. 0.073 for the last year.

Credit Rating

Pakistan Credit Rating Agency (PACRA) has maintained the Bank's medium to long-term rating as "A" and the short-term rating as 'A-1' with positive outlook.

Economic Review

The global economy is going through a number of disordered challenges. Constantly mounting inflation has increased the cost of living crisis across the globe especially for the lower income segments. The successive shocks have combined to keep uncertainty elevated from Brexit and US-China trade tensions to the Covid-19 and Russia Ukraine war issues resulting in supply chain issues, rising commodity prices, unexpectedly rapid and synchronous monetary policy tightening measures. International Monetary Fund (IMF) estimates global inflation of 8.8% in year 2022 against 4.7% in 2021, whereas the global growth of 3.4% in year 2022 against 6.2% in 2021.

During 2022, Pakistan witnessed significant economic headwinds. The rising inflation, increasing fuel prices, depleting foreign exchange reserves, massive devaluation of the Pakistani rupee, political instability, increasing policy rates, and high budget deficit made the year more challenging. Resultantly Fitch, Moody's and S&P Global dropped the country's sovereign credit rating. In June 2022, Pakistan was hit with a natural catastrophe in the shape of worst ever floods in the history of the country which has badly affected the economic outlook and its prospects especially for agriculture sector. Macroeconomic risks have further widened due to market sentiment deterioration. The external sector remains under stress due to delay in realization of financial inflows and debt repayments. IMF's growth estimation for Fiscal Year (FY) 2022 is 6.0% against 5.7% of 2021.

National Consumer Price Index (CPI) was recorded at 24.5% on year-on-year basis in December 2022 against the same level of 12.3% during the last year. Headline inflation remained on higher side, however, decline of 2.10% is observed from 26.6% in October 2022. State Bank of Pakistan (SBP) increased the policy rate by a cumulative 625 basis point to 16% during the year 2022 which has further enhanced to 17% in January 2023. This steep increase is aimed at reducing aggregate demand in the economy and also to counter high inflation. This led to a steep uptick in domestic food prices.

Large Scale Manufacturing (LSM), during Jul-Oct FY 2023, witnessed the contraction of 2.9% against 7.6% growth in same period of last year, mainly driven by food, beverages, tobacco, textile, coke & petroleum products, pharmaceuticals, wood products, paper & paperboard, rubber products, non-metallic mineral products, fabricated metal, electrical equipment, machinery & equipment, automobiles and other transport equipment.

On the external front, the Current Account posted a deficit of USD 3.7 billion for the period July-December of FY 2023 as against deficit of USD 9.1 billion during the same period last year. The substantial reduction is due to the tightening the import policy and other related administrative measures.

Exports declined by 6.8% during the period July-December of FY 2023 and reached USD 14.2 billion (USD 15.2 billion last year). Imports declined by 18.2% during the period July-December of FY 2023 and reached USD 29.5 billion (USD 36.1 billion last year). Resultantly, the trade deficit reached USD 15.3 billion as against USD 20.9 billion last year. The workers' remittances stood at USD 14.1 billion in the July-December FY 2023 against the USD 15.8 billion during the corresponding period of last year, decreased by 11.1%. FX reserves stood at USD 10.8 billion as at December 2022 closing, with exchange rate depreciated by more than 27% year-on-year basis.

On the fiscal front, the overall deficit widened during the period July-October of FY 2023 is recorded at 1.5% of GDP (Rs. 1,266 billion) against 0.9% of GDP (Rs.587 billion) in the same period of last year.

The KSE-100 Index closed at 40,420.45 points on December 31, 2022 a downward shift by 4,176 points from December 31, 2021, mainly attributable to uncertainty on both the economic and political fronts.

Assets and Deposit of Islamic banking industry grew by Rs. 1,325 billion and Rs. 810 billion respectively during period January-September of 2022. The total assets and deposits increased by 24% and 19% closed at Rs. 6,902 billion (market share of 20%) and Rs. 5,021 billion (market share of 21.1%) respectively, whereas the Branch network closed at 4,191 branches by the end of September 2022.

Risk Management

Risk Management Framework comprises governance and organizational structure, policies & procedures, risk assessment techniques, systems, early warning indicators, reporting and escalation mechanism aligned with the Bank's strategy set by the Board of Directors. It commensurate with size and scope of the Bank to ensure the independence of Risk Management Function in measuring, analysing, controlling and monitoring the risks from the frontline business soliciting groups, in line with the international best practices and the guidelines of SBP.

Risk Management & Portfolio Review Committee (RM&PRC), a subcommittee of Board, provides guidance and directions on credit, market, operational and fraud risks based on the quarterly updates. Whereas at management level, the Management Finance Committee is another platform to regularly the key risks of the portfolio. The Bank is confident that it has more than sufficient risk bearing capacity to with stand the challenging business environment where the borrowers are most likely to be affected.

Market risk management function is responsible for management of Basel ratios, annual Internal Capital Adequacy Assessment, annual behavioural study and quarterly stress testing for various risks as part of regulatory regime. Value at Risk is being calculated for various market risk parameters assessment. Further, the Bank is actively engaged to ensure the compliance with smooth transition towards SBP's instructions for implementation of International Financial Reporting Standard 9, "Financial Instruments" (IFRS-9). The Bank has been timely submitting the impact of Expected Credit Loss under IFRS-9 to SBP.

Asset Liability Management Framework, Liquidity Strategy and Contingency Funding Plan are in place, to ensure that the Bank can meet its liquidity needs on a timely basis while optimizing contribution towards the profitability of the Bank. Asset Liability Committee at management level, is responsible for oversight of the assets and liabilities management function.

Operational risk is managed through diversified data collection mechanism through in-house system, which includes but not limited to data for operational losses, near miss events, control breach data, internal / external / compliance / regulatory observations and Risk Control & Self-Assessment exercise. Business continuity and disaster recovery planning is in place and being reviewed on regular basis. Trainings are conducted to create risk awareness among the staff on various aspects of associated risks.

Fraud risk is managed by a dedicated department and serves as a focal point. Fraud risk department also operates a '24x7 fraud detection unit', to proactively track fraudulent usage of digital banking transactions.

Information Technology (IT) security risks are being mitigated through various means like automated solutions, risk assessment, access review (privilege users), employee awareness along with the annual internal and external vulnerability assessment and penetration testing. The Bank has now in place a 24x7 Security Operations Centre for continuous monitoring. The Bank aims to further strengthen the related risk mitigating measures in the coming year under the guidelines by SBP.

The Bank is fully acquainted with Shari'ah Non-Compliance Risk and its potential implications of business and reputational risks for which adequate measures are being taken to ensure conformity of its operations with Shari'ah principles. The Shari'ah Board, Shari'ah Compliance Department, Shari'ah Audit Department and the

Shari'ah Non-Compliance Risk Management Committee are exclusively overseeing and monitoring the associated risks.

Statement on Internal Control

The Board of Directors is pleased to endorse the statement made by management relating to internal controls including management's evaluation of ICFR. The Management's Statement on Internal Control is included in the Annual Report.

Statement under Code of Corporate Governance and section 227 of the Companies Act, 2017

The Board of Directors is committed to ensure that the requirements of Corporate Governance set by the Securities and Exchange Commission of Pakistan are fully met. The Bank has adopted good Corporate Governance practices and the Directors are pleased to report that:

- The financial statements prepared by the management of the Bank present its state of affairs fairly, the result of its operations, cash flows and changes in equity.
- Proper books of accounts of the Bank have been maintained.
- Appropriate accounting policies have been consistently applied in preparation of financial statements. Accounting estimates are based on reasonable and prudent judgment.
- International Financial Reporting Standards, as applicable to banks in Pakistan, have been followed in preparation of financial statements and any departure there-from has been adequately disclosed and explained.
- There has been no material departure from the best practices of Corporate Governance.
- There are no significant doubts upon the Bank's ability to continue as a going concern.
- Profit amounting to Rs.309.6 million has been transferred to Statutory Reserve for the year 2022.
- The System of Internal Control is sound in design and has been effectively implemented and monitored.
- As of December 31, 2022, MCB Bank Limited (parent company) holds 1,554,999,993 shares of the Bank, non-executive directors hold 05 shares one each and others hold 02 shares one each. The Pattern of Shareholding has been separately disclosed in Annual Report.
- Statement of Compliance with Code of Corporate Governance is included in the Annual Report.
- Composition of the Board is given in the Corporate Governance Section of the Annual Report.
- The Committees of Board of Directors along with their Terms of Reference (TORs) have been separately disclosed in the Corporate Governance Section of the Annual Report.
- The number of Board and committees' meetings held during the year and attendance by each Director has been separately disclosed in the Corporate Governance Section of the Annual Report.
- The names of the persons who, at any time during the financial year, were directors of the Bank have been separately disclosed in the Corporate Governance Section of the Annual Report.
- Detail of remuneration of Chairman, President / Chief Executive Officer (CEO) and Non-Executive Directors, including independent Directors, is disclosed in note 37 of the financial statements. Non-executive directors are paid a reasonable and appropriate remuneration for attending the Board and/or its committee meetings which is not at a level that could be perceived to compromise independence. No fee is paid to the Directors who do not attend a meeting. Similarly, fee is not paid for the resolution considered through circulation.
- Details of directors' training programs are given in the Statement of Compliance with the Code of Corporate Governance.
- Key operating and financial data for the last 05 years is presented in the Annual Report.
- The value of investments of the Bank's Provident Fund based on unaudited accounts at December 31, 2022 amounted to Rs. 469.9 million.
- There is no overdue statutory payment on account of taxes, duties, levies and charges.

Charity Funds Management

Charity is one of the most important pillars of a healthy society. The Bank remains committed to its objective of paying back to the society, but in line with the Islamic principles of Ihsan - both directly and indirectly.

In order to dis-incentivise misuse of the system, customers have to contribute towards a charity account in case of late payment. Also, if during a Shari'ah audit, a transaction is identified where the process defined to ensure Shari'ah compliance is not followed, income of such a transaction is transferred to charity account. During 2022, a total of Rs. 17.5 million was paid from the charity account on behalf of the customers to purify the Shari'ah non-compliant income to different charitable organizations as detailed in Note 19.2 to the Financial Statements.

Trading of Shares of the Bank

The Bank is currently a non-listed concern; hence no trades in the shares of the Bank were carried out by the Directors, executives and their spouses and minor children during the year 2022.

Auditors

The retiring auditors M/s. A. F. Ferguson & Co., Chartered Accountants, being eligible for the next term have offered themselves for reappointment. Upon suggestions of the Audit Committee, the Board of Directors recommends M/s. A. F. Ferguson & Co., Chartered Accountants, as the statutory auditors for the year ending December 31, 2023.

Future Outlook

World economic outlook will continue to face downside risks and uncertainties. The aggressive monetary measures to fight inflation and Russia's war in Ukraine continue to weigh on economic activity. The rapid spread of COVID-19 in China reduced growth in 2022, but the recent reopening has cleared the way for a faster than anticipated recovery. IMF expects the global inflation to fall from 8.8% of 2022 to 6.6% and 4.3% in 2023 and 2024 respectively, still above pre-pandemic (2017–19) levels of about 3.5%. These implications translate in growth projected by IMF to 2.9% and 3.1% in 2023 and 2024 respectively and World Bank of 1.7% in 2023 and 2.75% in 2024. This could be the third weakest pace in latest three decades or even global recession in 2023.

On the Domestic front, headline inflation will continue to be dominated by supply shocks, Pak-rupee devaluation and hike in commodity and petroleum prices in the near future. However, if the continued and broad based inflationary pressures remains the same then they could led into higher inflation expectations over a longer than anticipated period. SBP expects slowdown in the overall economic activity and reduction in imports which can reflect the downside risk of achieving the tax collection target also. The IMF's 9th review is in process for extended funding facility which is critical to reduce uncertainty and survival, given the scale of the other external financing needs which are majorly linked to IMF endorsement. IMF projects the country's GDP growth down to 2.0% in 2023 and 4.4% in 2024, whereas, World Bank forecasts 2.0% in 2023 and 3.2% in 2024.

The Banking industry will continue to be critically challenged by credit, operation and information security risks in coming days. Now is the time to shift the business models strategically from traditional banking service provider towards technology driven dynamic banks.

The Bank is determined to continue with its strategy of long-term sustainable growth especially after the fresh capital injection during the year which will pave ways for new business avenues and boost the future profitability in line with its objective to become the Most Relevant Player in the Islamic industry. The key focus will be on generating no and low-cost deposits, high earning assets and containment of operating costs along with the investment in automation of processes, building new product platforms and digitization.

Acknowledgment

On behalf of the Board of Directors and management, we wish to express our sincere gratitude to our customers, business partners and shareholders for their continued patronage and trust. We would also like to thank the State Bank of Pakistan, Securities & Exchange Commission of Pakistan and other regulatory authorities for their continuous guidance and support. The Board of Directors sincerely appreciates the

significant contribution by all its staff members to the growth of this franchise under challenging business conditions.

For and on behalf of the Board of Directors

Khawaja Khalil Shah	**Raza Mansha**
Acting President / CEO	**Chairman**