The Pakistan Credit Rating Agency Limited

Rating Report

The Bank of Punjab

Report Contents

Rating History

Dissemination Date	Long Term Rating	Short Term Rating	Outlook	Action	Rating Watch
27-Jun-2018	AA	A1+	Stable	Maintain	-
30-Dec-2017	AA	A1+	Stable	Maintain	-
22-Jun-2017	AA	A1+	Stable	Maintain	-
23-Sep-2016	AA	A1+	Stable	Upgrade	-
29-Jun-2016	AA-	A1+	Positive	Maintain	-

Rating Rationale and Key Rating Drivers

The ratings reflect the sustained risk profile of Bank of Punjab (BoP) with an appreciable improvement in profitability and asset quality over the last few years which supplemented the equity base. During current year, the bank has recorded commendable uptick in revenue base – both interest earned and income from fee, commission. However, the bank recorded loss for the year on account of providing for certain infected exposures which were previously secured by Letter of Comfort (LoCs) by the sponsor. Hence, the bank’s recorded significant improvement in its coverage ratio. The bank’s bottom-line again turned green in 1QCY18. The bank witnessed reduction in the non-performing loans inherited by the current management. The bank's Capital Adequacy Ratio (CAR) clocks in at 9.73% at Dec’17 which improved to 10.53% in 1QCY18. Tier-I CAR declined to 7.61% (Dec’16: 9.40%) due to provisioning against NPLs earlier covered under LOCs. The bank enjoys relaxation from the applicable CAR till Jun’18 granted by the State Bank of Pakistan. Timely re-couping the CAR is essential to ratings. The bank envisages growth in advances wherein the criteria is higher margins with sustained risk profile. Meanwhile, expansion in deposit base with low cost focus, while attracting a wide customer range, is on the cards.

The ratings are dependent on the financial risk profile of the bank, mainly emanating from sustenance of capital adequacy and continued healthy profitability trend in line with the management's plans. Meanwhile, improvement in asset quality and upholding better governance standards remain imperative.

Disclosure	
Name of Rated Entity	The Bank of Punjab
Type of Relationship	Solicited
Purpose of the Rating	Entity Rating
Applicable Criteria	Methodology | Debt Instruments Rating Methodology(Jun-17),Methodology | Bank Rating(Jun-17),Rating Methodology | Basel III Instruments(Mar-18)
Related Research	Sector Study | Commercial Bank(Jun-18)
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BANK OF PUNJAB (BOP)
PROFILE

Established	1989
Major Business	Commercial Banking
Legal Status	Listed
Head Office	Lahore

INDUSTRY

The banking sector has experienced highest growth in terms of advances in 2017 over the last decade. As a consequence, there is mounting pressure on capital adequacy ratio of the banks. The challenge is exacerbated as the internal generation of capital (profits) are witnessing a dip. Some relief on income side is expected with recent uptick in interest rates.

OWNERSHIP

- The Bank of Punjab, established under the BoP Act 1989, is listed on Pakistan Stock Exchange (PSX). The bank operates with network of 536 branches, mainly concentrated in Punjab. The Government of Punjab (GoPb) holds majority stake in BOP (58%), whereas the rest is widely dispersed.

GOVERNANCE & MANAGEMENT

- The control of the bank vests with ten-member Board of Directors, including the President. Six members, including the Chairman, are representing GoPb on the board. Three are independent members representing minority shareholder while the President is an executive member.
- Mr. Naeemuddin Khan, the President of the Bank since Sep'08, has four decades of diversified banking experience and has been associated with reputed international and domestic banks during his career. The senior management consists of seasoned bankers.
- He is backed by a team of experienced professionals, most of whom have long association with the bank.

RISK MANAGEMENT

- As at end-Dec'17, BoP's advances portfolio constitutes 45% of total assets (end-Dec16: ~44%)
- During CY17, advances (net) witnessed growth of 13% (against 18% of average industry growth)
- The sectoral concentration inclines towards government (~25%), textile and ginning (~19%) and individuals (~12%). Further analysis reveals that 71% lies with the corporate sector, followed by 13% to the commodity financing.
- The Bank's ADR rationalized to 53.2% (end-Dec'16: 58%)
- NPLs-to-Gross advances improved to ~15% (end-Dec'16: ~19%) primarily on account of increase in lending.
- Loan loss coverage ratio improved to 90% (end-Dec'16: 58%) as the bank provided for some significant exposures during the year. Hence, the drag on equity declined to 18.5% (end-Dec'16: 95%).
- The bank's liquidity, in terms of its Liquid Assets-to-Deposits and Borrowings ratio, strengthened on YoY basis, to ~50% at end-Dec'17 (end-Dec'16: 47%), comprising pre-dominantly government securities.

PERFORMANCE

- During CY17, interest earned stood at PKR 34bln (CY16: PKR ~30bln) primarily on account of 22% and 25% growth witnessed in advances and earning assets respectively. Hence, NIMR clocked in at PKR 15.5bln (CY16: PKR 12.2bln), up 27% YoY.
- Non-Markup income recorded a dip mainly on account of decline in gain on sale of investments. However, improved fee, commission and brokerage income (up 26% YoY) is considered a positive. On the provisioning front, the bank has provided for PKR 12.3bln against certain infected exposures previously secured by Letter of Comfort (LoC) from sponsors. Hence, the bank posted loss of PKR 3.3bln (CY16: PKR 4.8bln profit).
- During CY17, asset yield declined to 6.8% (CY16: 7.2%), in line with industry trend. Cost of funds stood at 3.5% (CY16: 3.8%). Hence, the bank's spread stood at 3.3%, marginally declined from last year of 3.4%.

CAPITAL AND FUNDING

- The main source of BoP's funding is its deposit base, constituting around 89% of the total liabilities at end-Dec'17. The bank witnessed a sizeable growth (23%) in its deposit base mainly driven by customer deposits
- As at end-Dec'17 the bank's Capital Adequacy Ratio reduced to 9.73% (below minimum required level) (Dec'16: 12.28%). However, as at end-Mar18, the Capital Adequacy Ratio improved to 10.53% (previous: 9.73%) with the Tier I ratio improving to 8.44% (previously 7.61%). The bank has been given time till Jun'18 to get compliant with SBP's enlisted CAR requirements.

TFC ISSUES

- In 2016, BoP issued term finance certificates in the amount of PKR 2.5bln to raise Tier-II capital. This privately placed, rated, unsecured and subordinated issue was raised to comply with State Bank of Pakistan's (SBP) regulation to maintain the Capital Adequacy Ratio (CAR). The tenor of the instrument is 10 years from the date of issue. Profit is based on 6M-KIBOR plus a spread. The issue carries lock-in and loss absorbency clauses, as per Basel III capital regulations.
- BoP has issued second TFC of amount PKR 4.3bln. The tenor of the instrument is ten years from the date of the issue (April 2018) whereas the profit is based on 6M-KIBOR plus 125 bps per annum. TFC is unsecured and subordinated as to the payment of principal and profit to all other indebtedness of the bank, including deposits and is not redeemable before maturity without prior approval of the SBP. The TFC is structured to redeem 0.02% of the issue amount, per semi-annual period, in first nine years and the remaining issue in two equal; semi-annual installments of 49.82%, in the tenth (10th) year.

The Bank of Punjab (BoP)

BALANCE SHEET	31-Mar-18	31-Dec-17	31-Dec-16	31-Dec-15
	Annual	*Annual*	*Annual*	*Annual*
Earning Assets				
Advances (Net of NPL)	306,619	290,784	238,968	193,272
Debt Instruments	7,770	7,560	4,695	7,098
Total Finances	314,389	298,344	243,664	200,370
Investments	207,743	237,184	194,712	168,610
Others	52,686	28,732	14,646	7,911
	574,818	**564,260**	**453,022**	**376,891**
Non Earning Assets				
Non-Earning Cash	40,097	44,394	36,438	28,905
Deferred Tax	10,524	10,725	6,480	7,906
Net Non-Performing Finances	2,514	2,731	23,434	26,461
Fixed Assets & Others	27,344	27,438	25,840	32,120
	80,479	**85,287**	**92,192**	**95,392**
TOTAL ASSETS	**655,296**	**649,547**	**545,214**	**472,284**
Interest Bearing Liabilities				
Deposits	569,600	556,281	453,220	374,961
Borrowings	33,457	43,448	44,329	57,236
	603,057	599,730	497,549	432,198
Non Interest Bearing Liabilities	20,653	20,086	19,811	17,408
TOTAL LIABILITIES	**623,710**	**619,815**	**517,360**	**449,605**
EQUITY (including revaluation surplus)	**31,586**	**29,732**	**27,855**	**22,678**
Total Liabilities & Equity	**655,296**	**649,547**	**545,214**	**472,284**

INCOME STATEMENT	31-Mar-18	31-Dec-17	31-Dec-16	31-Dec-15
Interest / Mark up Earned	9,692	34,451	29,674	31,266
Interest / Mark up Expensed	(5,019)	(18,877)	(17,430)	(20,199)
Net Interest / Markup revenue	**4,673**	**15,574**	**12,244**	**11,068**
Other Income	917	4,591	5,294	7,624
Total Revenue	**5,591**	**20,165**	**17,539**	**18,692**
Non-Interest / Non-Mark up Expensed	(2,761)	(10,646)	(8,464)	(7,666)
Pre-provision operating profit	**2,830**	**9,519**	**9,075**	**11,026**
Provisions	179	(14,217)	(1,025)	(3,496)
Pre-tax profit	**3,009**	**(4,698)**	**8,050**	**7,529**
Taxes	(1,069)	1,376	(3,192)	(2,781)
Net Income	**1,940**	**(3,322)**	**4,858**	**4,748**

Ratio Analysis	31-Mar-18	31-Dec-17	31-Dec-16	31-Dec-15
Performance				
ROE	27.9%	13.0%	22.3%	27.4%
Cost-to-Total Net Revenue	54.5%	58.1%	53.3%	44.9%
Provision Expense / Pre Provision Profit	-6.3%	149.4%	11.3%	31.7%
Capital Adequacy				
Equity/Total Assets	4.4%	4.1%	4.4%	4.1%
Capital Adequacy Ratio as per SBP	10.5%	9.7%	12.3%	10.5%
Funding & Liquidity				
Liquid Assets / Deposits and Borrowings	48.0%	49.5%	47.0%	41.9%
Advances / Deposits	54.7%	53.2%	57.8%	58.5%
CASA deposits / Total Customer Deposits	70.4%	71.4%	71.0%	65.9%
Intermediation Efficiency				
Asset Yield	6.8%	6.8%	7.2%	8.9%
Cost of Funds	3.4%	3.5%	3.8%	5.0%
Spread	3.5%	3.3%	3.4%	3.9%

ENTITY CREDIT RATING SCALE & DEFINITIONS

Credit rating reflects forward-looking opinion on credit worthiness of underlying entity; 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 or 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.** “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.

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. Rating Watch may carry designation – Positive (rating may be raised, negative (lowered), or developing (direction is unclear). A watch should be resolved within foreseeable future, but may continue if underlying circumstances are not settled.

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 or 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’.

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, a suspended 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, or e) the entity/issuer defaults.

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)
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