The Pakistan Credit Rating Agency Limited

Rating Report

National Bank of Pakistan

Report Contents

Rating History

Dissemination Date	Long Term Rating	Short Term Rating	Outlook	Action	Rating Watch
30-Jun-2018	AAA	A1+	Stable	Maintain	-
30-Dec-2017	AAA	A1+	Stable	Maintain	-
23-Jun-2017	AAA	A1+	Stable	Maintain	-
30-Jun-2016	AAA	A1+	Stable	Maintain	-
30-Jun-2015	AAA	A1+	Stable	Initial	-

Rating Rationale and Key Rating Drivers

The ratings are driven by strong ownership structure (Government of Pakistan (GoP) holds majority stake). The bank's strong financial risk profile, characterized by firm risk absorption capacity, provides strength to the ratings. NBP's renowned franchise along with extended outreach aids the bank in deposit mobilization; public-private deposit mix remained intact. NBP fortified its position as the second largest bank in the country in terms of customer deposits. During CY17, the bank's deposits growth was sluggish as the management embarked upon a strategy to shed high cost deposits. This yielded results as CASA mix improved; optimizing cost of funding. Bank withstood pressure on NIMR in 2017, though with PIBs maturity, this was inevitable. High cost structure of the bank is limiting profitability. As against historical trend, NBP's asset quality improved during CY17, though it is still considered weak as compared to peer banks. Overseas operations and domestic private credit are key contributors to overall infection. Thus strengthening of related risk management systems is important. Going forward, the bank is keen to strengthen its lending portfolio; entering into profitable avenues seems a challenge. With focused efforts, NBP has managed to bring volumes in Islamic banking (Aitemaad) though limited; it is targeted to contribute towards growth.

The ratings are dependent upon the management's ability maintain relative standing of the bank in the industry in all key parameters. Banks (Nationalization) Act, 1974 (clause 4 of section 5) provides for the safety of all deposits in the banks. Depositor Protection Act 2016 (clause 39) has removed the protection clauses of the referred Act. Which law is to prevail, should any dispute arise, is a legal matter. Moreover, the bank in a case related to pensioner benefits to retired employees has filed a review petition against the Supreme Court judgment and has also moved an application for constitution of larger bench which has been accepted.

Disclosure	
Name of Rated Entity	National Bank of Pakistan
Type of Relationship	Solicited
Purpose of the Rating	Entity Rating
Applicable Criteria	Methodology | Correlation between long-term and short-term rating scale(Jun-17),Methodology | Criteria Modifiers(Jun-17),Methodology | Bank Rating(Jun-17)
Related Research	Sector Study | Commercial Bank(Jun-18)
Rating Analysts	Muhammad Noor ul Haq | muhammad.noorulhaq@pacra.com | +92-42-35869504 Jhangeer Hanif | jhangeer@pacra.com | +92-42-35869504

National Bank of Pakistan (NBP) Profile	
Incorporated	1949
Profile	▪ National Bank Limited (NBP) is incorporated under National Bank of Pakistan Ordinance ▪ NBP is second largest commercial bank – system share: ~12% at end-Dec17. ▪ Operating with a network of 1,501 branches including 170 Islamic branches at end-Mar18. It also has one of the largest overseas network amongst local banks.
Legal Status	Listed
Head Office	Karachi

Industry Snapshot

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

- Majority owned by Government of Pakistan (GoP), through SBP (~75%), followed by Financial Institutions (20%)

Governance

- GoP nominated seven-member board of directors including the President & CEO; one executive, six non-executive including one independent director
- With directors nominated by the GoP, the risk of political intervention remains

Management

- Mr. Saeed Ahmad assumed the seat of President and CEO in Mar-17. He is a seasoned banker having over three decades of experience of domestic and international markets
- The President is assisted by an experienced team of professionals

Risk Management

- During CY17, the bank witnessed decent growth in advances portfolio (up 10% YoY; industry growth ~17% YoY), however, on the other hand, customer deposits registered nominal growth of ~2%, underperforming as compared to industry (up ~10% YoY)
- ADR posted improved to ~43% at end Dec-17 (end-Dec16: ~40%); still below industry average of 50%; but in line with peer group of large banks. Public sector lending represented ~33% of the total book at end-CY17, down by ~2% on YoY basis
- Top-20 borrowers' concentration stood at 33%
- NBP's asset quality remained suppressed during CY17, it is still considered weak as compared to peer banks
- New classifications nullified the impact of stringent recoveries and as a result total delinquencies increased by PKR ~1.3bln, as NPLs stood at (end-CY17: PKR ~121bln, end-CY16: PKR ~119bln)
- As per historical trend, due to seasonality impact of agri business in 1QCY17, delinquencies increased to PKR ~128bln; requiring management's attention
- Mix of government securities in overall investments increased to (94.5%); hence the bank is exposed to relatively low market risk

Business Risk

- Asset yield dropped from 7.6% to 6.7% in CY17 – a factor of low benchmark lending rates, cost of funds further rationalized to 4.2% (CY16: 4.4%); still higher than AAA rated banks
- Spreads recorded a decline of 70bps and stood at 2.5% at end-CY17. As the spreads were squeezed, the bank witnessed nominal decline in its NIMR of 1%
- Contribution from non- markup income registered improvement during CY17 by 4% – a factor of higher business in fee related segments; although capital gains were suppressed during the year by 23%
- Cost to total net revenue on the back of lower revenue base increased marginally to 60% in CY17 (CY16: 58%), highest amongst peer banks
- The bank was able to achieve nominal growth in profitability of 1% also getting support of reversal in provisioning expense
- Unrealized gains on government securities stood at PKR 953mln at end-Dec17 (PKR 4.3bln at end-Dec16)
- Going forward, NBP's key focus would be to enhance its lending book mainly through infrastructure lending; though it remains a challenge. Asset quality remains a challenge; needs management attention
- NBP aims to target major LSM sectors mainly automobile, cement and steel. The bank is also focusing on establishing alternative delivery channels through digitization; herein success remains to be seen

Capital & Funding

- Customer deposits with 70% contribution remained the key source of funding for the bank. CASA mix improved by a fair margin to 77%; lower than other large banks
- Top-20 deposits concentration remained stagnant at 17% at end-CY17 (end-CY16: 17%); considered good
- Overall liquidity position remained strong on account of relatively high growth in govt. securities as against deposits
- CAR is strong (end-Mar18: 16.3%) and predominantly comprises Tier-I capital (11.9%)

National Bank of Pakistan (NBP)

PKR mln

BALANCE SHEET	31-Mar-18	31-Dec-17	31-Dec-16	31-Dec-15
	3M	Annual	Annual	Annual
Earning Assets				
Advances (Net of NPL)	741,908	736,140	662,060	564,572
Debt Instruments	60,543	54,310	56,275	20,204
Total Finances	802,451	790,451	718,335	584,776
Investments	1,012,502	1,247,759	850,742	806,287
Others	64,710	46,263	134,459	24,266
	1,879,663	**2,084,473**	**1,703,536**	**1,415,328**
Non Earning Assets				
Non-Earning Cash	138,482	166,822	160,915	154,457
Deferred Tax	6,954	7,317	5,136	9,669
Net Non-Performing Finances	2,666	(2,718)	(4,557)	16,306
Fixed Assets & Others	117,890	113,992	110,676	110,601
	265,992	**285,412**	**272,170**	**291,033**
TOTAL ASSETS	**2,145,655**	**2,369,885**	**1,975,706**	**1,706,361**
Interest Bearning Liabilities				
Deposits	1,668,545	1,727,102	1,657,312	1,431,037
Borrowings	187,515	360,120	44,890	21,947
	1,856,060	2,087,222	1,702,202	1,452,984
Non Interest Bearing Liabilities	108,386	107,281	96,771	85,026
TOTAL LIABILITIES	**1,964,446**	**2,194,503**	**1,798,973**	**1,538,010**
EQUITY (including revaluation surplus)	**181,210**	**175,382**	**176,733**	**168,351**
Total Liabilities & Equity	**2,145,655**	**2,369,885**	**1,975,706**	**1,706,361**

INCOME STATEMENT	31-Mar-18	31-Dec-17	31-Dec-16	31-Dec-15
Interest / Mark up Earned	31,390	123,073	114,403	113,662
Interest / Mark up Expensed	(17,266)	(68,820)	(59,578)	(59,941)
Net Interest / Markup revenue	**14,124**	**54,253**	**54,824**	**53,721**
Other Income	5,895	31,066	29,967	34,983
Total Revenue	**20,019**	**85,319**	**84,791**	**88,704**
Non-Interest / Non-Mark up Expensed	(12,634)	(50,395)	(48,351)	(43,667)
Pre-provision operating profit	7,385	34,924	36,440	45,037
Provisions	184	675	701	(11,821)
Pre-tax profit	7,569	35,599	37,141	33,216
Taxes	(2,675)	(12,571)	(14,389)	(13,997)
Net Income	**4,894**	**23,028**	**22,752**	**19,219**

Ratio Analysis	31-Mar-18	31-Dec-17	31-Dec-16	31-Dec-15
Performance				
ROE	15%	19%	19%	17%
Cost-to-Total Net Revenue	65%	60%	58%	50%
Provision Expense / Pre Provision Profit	-2%	-2%	-2%	26%
Capital Adequacy				
Equity/Total Assets	6%	5%	6%	7%
Capital Adequacy Ratio as per SBP	16%	16%	17%	18%
Funding & Liquidity				
Liquid Assets / Deposits and Borrowings	62%	64%	67%	67%
Advances / Deposits	45%	43%	40%	40%
CASA deposits / Total Customer Deposits	80%	77%	69%	73%
Intermediation Efficiency				
Asset Yield	6%	7%	8%	9%
Cost of Funds	4%	4%	4%	5%
Spread	3%	2%	3%	4%
Outreach				
Branches	1,501	1,498	1,448	1,403

Rating Scale

Credit Rating Scale & Definitions

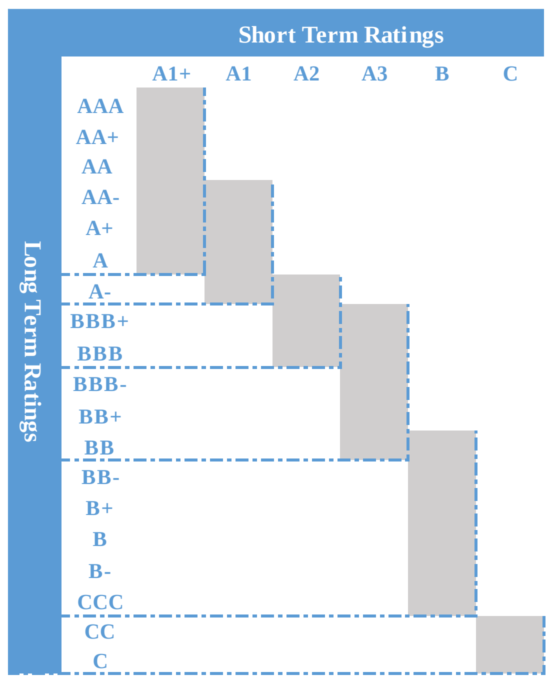
Credit rating reflects forward-looking opinion on credit worthiness of underlying entity or instrument; more specifically it covers relative ability to honor financial obligations. The primary factor being captured on the rating scale is relative likelihood of default.

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 and in 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.** Substantial 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.



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/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'.

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. A watch should be resolved within foreseeable future, but may continue if underlying circumstances are not settled. Rating Watch may accompany Outlook of the respective opinion.

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, the 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, e) the entity/issuer defaults., or/and f) PACRA finds it impractical to surveill the opinion due to lack of requisite information.

Harmonization A change in rating due to revision in applicable methodology or underlying scale.

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

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(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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