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
26-Jun-2023	AA+	A1+	Stable	Maintain	-
18-Jun-2022	AA+	A1+	Stable	Maintain	-
18-Jun-2021	AA+	A1+	Stable	Upgrade	-
30-Jun-2020	AA	A1+	Stable	Maintain	-
28-Dec-2019	AA	A1+	Stable	Maintain	-
28-Jun-2019	AA	A1+	Stable	Maintain	-
27-Dec-2018	AA	A1+	Stable	Maintain	-
27-Jun-2018	AA	A1+	Stable	Maintain	-
30-Dec-2017	AA	A1+	Stable	Maintain	-

Rating Rationale and Key Rating Drivers

The Bank of Punjab has built a franchise around its name, which itself is a reflection of strong parentage. The bank enjoys a respectable position in its peer universe, also reflected by its system share. The parentage of the bank has provided associated benefits to the institution. The management, led by sound leadership, is poised to strengthen the profile of the bank. The incumbent management has revamped and strengthened the governance and compliance structure in place, over the last three years, which is essential for oversight and dynamic operations of the Bank. The leadership is cognizant of the challenge areas and has a well-designed strategy to address the challenges and steer the bank towards a growth journey. Customer focus and geographical diversification and expansion are the key elements. The Bank grew its deposit base by 22% to stand at PKR 1,227bln - higher than the industry's growth where deposits remained tilted towards saving. The system share of the Bank has taken a positive contribution from the growth, which would lead the bank towards being classified as a large bank. However, the expensive funding avenues pose a challenge which is an area of focus for the current management of the bank. During CY22, the Bank maintained its PBT equal to CY21, taking benefit from the reversals. However, PAT declined by 13% to stand at PKR 10.8bln on account of the difference in taxation rate (CY21: PKR 12.4bln). The management has represented that future profitability is going to take benefit from asset repricing among other things. Asset quality improved along with growth in advances. Coverage of non-performing loans has declined YoY, attributed to the benefit of collateral. The investment book mainly comprises government securities. At end-Mar23, the equity base is affected by a deficit in the investments. The mark-to-market losses of the investment book have caused a decrease in the equity base of the bank. Consequently, the capital adequacy ratio of the bank weakened to 11.7% (12.91% including advance subscription money for Tier-II Capital), which is expected to improve by end-Jun23 by a 2% to 3% margin, as projected by the management. For this, the prudent management of CAR remains essential. The risk absorption capacity of the bank is being augmented by a successive issuance of ADT-I and Tier-II bonds. The parental association has again benefited the bank by way of raising money from investors. During 1QFY23, the spread of the bank remained under pressure due to gaps in the durations of liabilities and assets of the Bank.

The ratings are dependent on the financial risk profile of the bank, mainly emanating from volumetric increases in core operations and continued healthy profitability trends in line with the management's plans. Any weakening in asset quality will in turn put pressure on the bank's profitability and risk absorption capacity. Going forward, ample management of the CAR above the regulatory threshold remains necessary.

Disclosure

Name of Rated Entity	The Bank of Punjab
Type of Relationship	Solicited
Purpose of the Rating	Entity Rating
Applicable Criteria	Methodology | Financial Institution Rating(Jun-22),Methodology | Correlation Between Long-term & Short-term Rating Scales(Jun-22),Methodology | Rating Modifiers(Jun-22)
Related Research	Sector Study | Commercial Bank(Jun-23)
Rating Analysts	Sehar Fatima | sehar.fatima@pacra.com | +92-42-35869504

Profile

Structure The Bank of Punjab (BoP) was established under the BoP Act 1989 (the Act), as a non-scheduled bank and was subsequently converted into a scheduled bank in 1994.

Background With its Head Office in Lahore, the Bank operates a network of 780 branches at end-Mar23 (end-Dec22: 780 branches) and employs 13,047 employees at end-Dec22 (end-Dec21: 11,257).

Operations The bank's principal activities are to provide commercial and Islamic banking services to individuals and institutional clients. BoP entered Islamic Banking Operations in 2013, under the brand name "Taqwa Islamic Banking". At end-Mar23, there are 140 (end-Dec22: 140) fully functional online Islamic Banking Branches.

Ownership

Ownership Structure The Government of Punjab (GoPb) holds a controlling stake of 57.5% in the Bank of Punjab. The rest of the shareholding is by individuals 30.1% and institutions at 12.4%.

Stability The ownership structure of the bank is seen as stable as no ownership changes are expected in the future. The majority stake will rest with The Government of Punjab.

Business Acumen Sponsor's business acumen is considered good as BoP has been achieving milestones by successfully making the right business decisions. Over the last few years, it has sustained being a profitable institution.

Financial Strength BoP, being one of the flagship entities under the umbrella of the Government of Punjab, willingness to support the Bank in case the need arise is considered high; also supplemented by access to the capital markets.

Governance

Board Structure The control of the bank vests with an eight-member Board of Directors comprising three non-executive directors, three independent directors, and two executive directors. four members are representing the Government of Punjab. Mr Zafar Masud – President of BoP is an executive director.

Members' Profile Members of BoD are also distinguished professionals including seasoned bankers and civil servants. However, owing to the institutional framework of BoP, the key shareholder can exert influence over the BoD which may potentially compromise its independence.

Board Effectiveness The BoD exercises close monitoring of the management's policies and the bank's operations via five sub-committees. Meetings for all these five committees are held quarterly. The Board members' attendance and participation are considered good and effective.

Financial Transparency The Audit Committee comprises three members; Mr. Muhammad Mudassir Amray is the chairman. The external auditors – A.F Ferguson & Co. Chartered Accountants, have expressed an unqualified opinion on the financial statements of the bank for CY22.

Management

Organizational Structure The bank has a lean organizational structure with experienced senior management heading each function and/or unit and relevant segregation of duties in place.

Management Team Mr. Zafar Masud is the President and CEO of the Bank. He has been associated with reputed international and domestic banks during his career. The senior management consists of seasoned bankers having diversified experience.

Effectiveness The bank has various committees in place at the management level to oversee its day-to-day operational matters and take decisions to implement the strategy outlined for it by the board. The committee, responsible for overseeing the operational matters of the bank, including human resources, different lines of business, compliance, and administration, meets fortnightly to review these areas.

MIS A comprehensive IT security policy has been put in place along with risk mitigation protocols. The bank has successfully implemented an internationally renowned Oracle-based core banking system 'Flexcube" and all branches have been migrated to the new CBS.

Risk Management Framework The Risk Management Division (RMD), headed by Chief Risk Officer (CRO) – Mr. Arsalan Muhammad Iqbal manages different facets of risk including credit, market, operational, liquidity, reputation, and country risk. Heads of Credit Risk Units – Corporate, Commercial, Consumer, Special Assets Management (SAM), and Agri – report to the head of credit risk, while heads of Operational, Market, and Risk Policy report directly to the CRO.

Business Risk

Industry Dynamics The country's economy has gone through several varied phases in the last few years. Pakistan posted a GDP growth rate of 1.69% in 9MFY23 and 4.71% in FY22 (GDP growth figures were revised after the base year was changed from FY05-06 to FY15-16). The banking sector continues to flourish with high profitability. Total banking assets posted growth of 18.5% YoY whilst investments surged by 25% YoY to PKR 18.0trln (end-Dec21: PKR 14.4trln). Gross Advances of the sector recorded growth (16%) to stand at PKR 12.6trln (end-Dec21: PKR 10.9trln). Non-performing loans witnessed an increase to PKR 924bln. The Capital Adequacy Ratio remained intact at 17% (regulatory requirement of 11.5%). However, declined in Mar-23 to 15%.

Relative Position At end-Dec22, BOP, a medium-sized bank, secures a good position in the industry of 5.4% (end-Dec21: 5%) market share in terms of deposits. The customer deposit base stands at PKR 1,181bln as of end-Dec22 (end-Dec21: PKR 982bln).

Revenues During CY22, BOP's NIMR witnessed an incline of 3% on a YoY basis to stand at PKR 30.7bln (CY21: PKR 29.8bln) primarily attributable to increased mark-up earnings amounting to PKR 137.2bln (CY21: PKR 81.6bln) up by 68% on a YoY basis. Whereas, the markup expenses increased to stand at PKR 106.4bln (CY21: PKR 51.7bln). Bank's asset yield is inclined to stand at 11.7% (CY21 8.1%). The cost of funds increased to 8.8% (CY21: 5.0%). During 1QCY23, NIMR decreased by 4% YoY to stand at PKR 7.7bln (1QCY22; PKR 8.1bln) due to increased markup expenses clocking in at PKR 42.9bln (1QCY22: PKR 18.6bln). Consequently, Spread declined to 2.7% (1QCY22: 3.2%).

Performance During CY22, non-markup income inclined by 34% YoY to stand at PKR 10.6bln (CY21: PKR 7.9bln), attributable to higher foreign exchange income clocking in at PKR 1.8bln (CY21: PKR 577mln) and increased fee & commission income clocking in at PKR 7.3bln (CY21: PKR 5.1bln). The non-markup expenses also grew by 32% to stand at PKR 27.7bln (CY21: PKR 21bln). The total provisioning reversals of the bank were recorded at PKR 4.8bln (CY21: PKR 1.6bln). The net profitability declined by 13% to stand at PKR 10.8bln (CY21: PKR 12.4bln). During 1QCY23, the Net markup income of the bank decreased to PKR 7.7bln (1QCY22: PKR 8.1bln). The net profit of the bank decreased by 44% to stand at PKR 1.2bln (1QCY22: 2.1bln).

Sustainability The management envisages growth in the deposit base while bringing granularity to the customer base through further private-sector deposits. Growth in advances is also on the cards, wherein the criteria are higher margins and a sustainable risk profile. Implementation of modern technological tools would help in improving the control regime and bringing efficiency to the operation.

Financial Risk

Credit Risk At end-Dec22, BOP's net advances have grown by 22% YoY to stand at PKR 589.5bln (end-Dec21: PKR 484bln). ADR was reported at 48% (end-Dec21: 48.3%). NPLs have decreased to stand at PKR 51.6bln (end-Dec21: 52bln). Therefore, the infection ratio improved to 8.1% (end-Dec21: 9.7%) which is reflecting positively on asset quality. At end-Mar23, net advances of the bank clocked in at PKR 567.5bln. Consequently, the infection ratio of the bank inched up to 8.3%.

Market Risk At end-Dec22, the investment portfolio of the bank has increased by 21% to stand at PKR 626bln, excluding debt instruments (end-Dec21: PKR 517bln). Government securities constitute 98.3% of total investments (end-Dec21: 98.7%). At end-Mar23, the investment portfolio of the bank recorded at PKR 790.8bln.

Liquidity And Funding At end-Dec22, customer deposits increased by 20% to stand at PKR 1,181bln (end-Dec21: PKR 982bln). CA and SA proportion rationalized to 20.9% (end-Dec21: 19.4%) and 45.8% (end-Dec21: 46.5%) respectively. The bank's liquidity, in terms of Liquid Assets-to-Deposits and borrowing ratio, declined to 53.1% (end-Dec21: 55.2%). At end-Mar23, customer deposits increased to PKR 1,177bln with CA and SA proportions clocked in at 20.4% and 46.5% respectively.

Capitalization At end-Dec22, the bank reported CAR of 13.1% (end-Dec21: 12.3%), comprising of Tier I capital (11.9%), remaining compliant with the minimum requirement by SBP. At end-Mar23, the bank reported CAR of 11.7% (12.91% inclusive of advance subscription TFC-III) The maintenance of a cushion, over and above the regulatory requirement, remains essential for the bank.

PKR mln

The Bank of Punjab Listed Public Limited	Mar-23 3M	Dec-22 12M	Dec-21 12M	Dec-20 12M
A BALANCE SHEET				
1 Total Finances - net	579,764	597,697	499,255	402,885
2 Investments	787,565	625,817	517,084	552,948
3 Other Earning Assets	36,069	76,065	40,207	18,807
4 Non-Earning Assets	197,538	177,985	140,656	117,690
5 Non-Performing Finances-net	3,427	4,326	(251)	3,116
Total Assets	1,604,362	1,481,890	1,196,952	1,095,446
6 Deposits	1,189,219	1,227,339	1,002,955	835,068
7 Borrowings	256,683	98,024	79,112	161,633
8 Other Liabilities (Non-Interest Bearing)	96,243	91,475	60,052	46,484
Total Liabilities	1,542,145	1,416,838	1,142,119	1,043,185
Equity	62,217	65,052	54,833	52,262
B INCOME STATEMENT				
1 Mark Up Earned	50,676	137,168	81,651	86,019
2 Mark Up Expensed	(42,908)	(106,410)	(51,775)	(62,694)
3 Non Mark Up Income	2,741	10,576	7,904	13,046
Total Income	10,508	41,335	37,780	36,371
4 Non-Mark Up Expenses	(8,380)	(27,705)	(21,014)	(17,519)
5 Provisions/Write offs/Reversals	(20)	4,878	1,642	(6,862)
Pre-Tax Profit	2,109	18,508	18,408	11,989
6 Taxes	(907)	(7,673)	(5,968)	(5,046)
Profit After Tax	1,202	10,834	12,440	6,944
C RATIO ANALYSIS				
1 Performance				
Net Mark Up Income / Avg. Assets	2.0%	2.3%	2.6%	2.4%
Non-Mark Up Expenses / Total Income	79.7%	67.0%	55.6%	48.2%
ROE	7.6%	18.1%	23.2%	14.0%
2 Capital Adequacy				
Equity / Total Assets (D+E+F)	3.9%	4.4%	4.6%	4.8%
Capital Adequacy Ratio	11.7%	13.1%	12.3%	16.2%
3 Funding & Liquidity				
Liquid Assets / (Deposits + Borrowings Net of Repo)	55.7%	53.1%	55.2%	61.2%
(Advances + Net Non-Performing Advances) / Deposits	47.7%	48.0%	48.3%	46.8%
CA Deposits / Deposits	20.4%	20.9%	19.4%	20.3%
SA Deposits / Deposits	46.5%	45.8%	46.5%	47.3%
4 Credit Risk				
Non-Performing Advances / Gross Advances	8.3%	8.1%	9.7%	12.9%
Non-Performing Finances-net / Equity	5.5%	6.6%	-0.5%	6.0%

Credit Rating

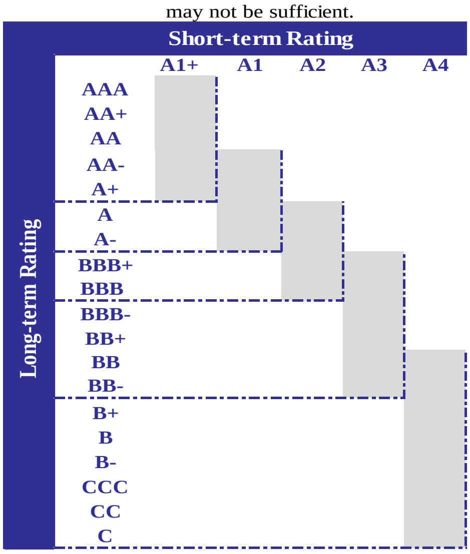
Credit rating reflects forward-looking opinion on credit worthiness of underlying entity or instrument; more specifically it covers relative ability to honor financial obligations. The primary factor being captured on the rating scale is relative likelihood of default.

Long-term Rating

Scale	Definition
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 Rating

Scale	Definition
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
A4	The capacity for timely repayment is more susceptible to adverse changes in business, economic, or financial conditions. Liquidity may not be sufficient.



**The correlation shown is indicative and, in certain cases, may not hold.*

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 some material identifiable event with indeterminable rating implications. 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 rating 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) the debt instrument is redeemed, c) the rating remains suspended for six months, d) the entity/issuer defaults., or/and e) 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.

Surveillance. Surveillance on a publicly disseminated rating opinion is carried out on an ongoing basis till it is formally suspended or withdrawn. A comprehensive surveillance of rating opinion is carried out at least once every six months. However, a rating opinion may be reviewed in the intervening period if it is necessitated by any material happening.

Note. This scale is applicable to the following methodology(s):

a) Broker Entity Rating
b) Corporate Rating
c) Debt Instrument Rating
d) Financial Institution Rating
e) Holding Company Rating
f) Independent Power Producer Rating
g) Microfinance Institution Rating
h) Non-Banking Finance Companies Rating

Regulatory and Supplementary Disclosure

(Credit Rating Companies Regulations,2016)

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 | Clause 11-(A)(p).
(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)

Proprietary Information