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 |
| 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 | - |
| 22-Jun-2017 | AA | A1+ | Stable | Maintain | - |
| 23-Sep-2016 | AA | A1+ | Stable | Upgrade | - |
| 29-Jun-2016 | AA- | A1+ | Positive | Maintain | - |
| 29-Jun-2015 | AA- | A1+ | Positive | Maintain | - |

### Rating Rationale and Key Rating Drivers

The ratings reflect improved risk profile of Bank of Punjab (BoP) with an appreciable enhancement in profitability and asset quality over the last few years which supplemented the equity base. During CY19, the bank has recorded commendable uptick in revenue base – interest earned. Largely attributable to hike in key policy rate as advances witnessed marginal growth slightly improved non-mark up income supplemented the profitability. Hence, a rise was witnessed in asset yield. There is significant dilution in the bank's net interest and operating margins during 1QCY20. Growth in advances was subdued when compared with the medium industry average growth of 3.7%. Hike in NPLs led to net provisioning expense being recorded; maintaining asset quality intact remains essential. The Bank grew its customers deposit base higher than the sector’s growth, with particular importance to saving deposit. The concentration of government and public sector deposits remain high. The bank's Capital Adequacy Ratio (CAR) clocked in at 14.8% as at end-Dec19 (end-Dec18: 13.17%), which is a healthy sign for BoP. Covid-19 has posed challenges to the banking sector, as almost all segments of the economy, worldwide and domestically, are getting negatively impacted. The ramifications would continue to unfold, warranting vigilance and timely actions where needed.

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. Any weakening in asset quality will in turn put pressure on the bank's profitability and risk absorption capacity

| Disclosure | |
|---|---|
| **Name of Rated Entity** | The Bank of Punjab |
| **Type of Relationship** | Solicited |
| **Purpose of the Rating** | Entity Rating |
| **Applicable Criteria** | PACRA_Methodology_FI(Jun-19),Methodology \| Correlation Between Long-Term And Short-Term Rating Scale(Jun-19),Criteria \| Rating Modifier(Jun-19) |
| **Related Research** | Sector Study \| Commercial Bank(Jun-20) |
| **Rating Analysts** | Abdul Wahab \| abdul.wahab@pacra.com \| +92-42-35869504 |

## Profile

**Structure** BoP was established under the BoP Act 1989, as a non-scheduled bank and was subsequently converted into a scheduled bank in 1994. The bank is quoted on PSX.

**Background** With its Head Office in Lahore, the bank operates a network of 624 branches at end-Dec19 and employs more than 9,640 employees (end-Dec18: 8,634).

**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 of "Taqwa Islamic Banking". At end-Dec19, there are 100 (end-Dec18: 72) fully functional online Islamic Banking Branches, offering a range of Shariah Compliant products and services to its clients. Besides offering deposits products, the Bank is also financing under Murabaha, Diminishing Musharaka and Ijarah.

## Ownership

**Ownership Structure** The Government of Punjab (GoPb) holds controlling stake of ~57.5% in bank of Punjab. The rest of shareholding is by local individuals (23.2%) and institutions (~19.3%).

**Stability** Ownership structure of the Company is seen as stable as no ownership changes are expected in near future. 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 become a profitable institution.

**Financial Strength** Given that BoP is the flagship business of sponsors, 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 seven-member Board of Directors, including the President. Three members, including the deputy chairman, are representing Government of Punjab while one member 'Mr. Mohammad Abdullah Khan Sumbal' represents Government of Pakistan on the board. Mr. Saeed Anwar and Khawaja Farooq Saeed are independent members representing minority shareholders. Mr Zafar Masud – President of BoP is an executive member.

**Members' Profile** The bank's 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 that may potentially compromise its independence.

**Board Effectiveness** The BoD exercises close monitoring of the management's policies and the bank's operations via sub-committees, namely i) Board Risk Management (BRMC), ii) Human Resource & Remuneration Committee (HR&RC), iii) Central Audit Committee (CAC) and iv) Islamic Banking Review Committee (IBRC). The Board members' attendance and participation is considered good and effective.

**Financial Transparency** The Central Audit Committee comprises of three members; Mr. Khawaja Farooq Saeed is the chairman. The auditors – M/s EY Ford Rhodes, Chartered Accountants, have expressed unqualified opinion on the financial statements of the bank for CY19. The retiring auditors (EY Ford Rhodes) have been reappointed as statutory auditors of the bank for year 2020.

## Management

**Organizational Structure** The bank has assembled an experienced top management team to spearhead its restructuring initiatives and streamlining key functions.

**Management Team** Mr Zafar Masud was appointed as President & CEO after Mr. Ijaz Ur Rehman Qureshi, Acting President. 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.

**MIS** The bank has successfully implemented an internationally renowned Oracle based core banking system 'Flexcube" and all branches have been migrated to new CBS.

**Risk Management Framework** The bank continued to strengthen its capacity to manage its risks and risk management environment. In addition to that the bank has put in place a standardized approval processes for all credit proposals to minimize the credit risk. Training sessions for various risk takers across the bank has been carried out by RMG.

## Business Risk

**Industry Dynamics** As a result of general economic slowdown most indicators of the banking sector reflected mixed trend. Deposits of the banking sector stood at (CY19: PKR 15,953bln; CY18: PKR 14,254bln), showing a growth of ~12% as compared to 9.5% growth in CY18. Deployment of funds was largely skewed towards investments and particularly towards government instruments due to favorable interest rate dynamics (CY19: PKR 8,939bln; CY18: PKR 7,914bln). Meanwhile, advances witnessed a slowdown owing to subdued demand, cautious lending approach and monetary tightening. This was only a growth of 3.7% as compared to expansion of 22.2% in CY18. Asset quality saw deterioration – increased NPLs (CY19: PKR 761bln; CY18: PKR 680bln). The profitability of the banking sector improved due to an increase in Net Interest Income, which translated positively in other profitability indicators. The overall risk profile of the banking sector remained satisfactory.

**Relative Position** BOP, a medium sized bank, holds a good position in the industry; 4.7% deposit system share and customer deposit base of PKR 681bln as at end-Dec19. There is a 0.2% YoY meager incline in its market share (Market share; Dec18: 4.5%).

**Revenues** During CY19, BOP's NIMR witnessed an increase of 33% on YOY basis to stand at PKR 27bln (CY18: PKR 20bln) primarily attributable to peaked key policy rate. On the contrary markup expenses also increased by a drastic 102% YOY (CY19: PKR ~54bln; CY18: PKR 27bln). The bank's asset yield inched up 11.8% (end-Dec18: 7.9%). Cost of funds also increased to 7.6% (CY18: 4.3%). Hence, bank's spread inched up (CY19: 4.2%; CY18: 3.6%).

**Performance** During CY19, non-markup income recorded a slight growth of 7.5% YoY (CY18: PKR 3.9bln; CY18: PKR 3.6bln), mainly emanating from fees and commission income (CY19: PKR 3.5bln; CY18: PKR 3.2bln). The rise in non-markup expense (17% YoY) stood at PKR 14.8bln (CY18: PKR 12.6bln). Majorly due to ~15% increase in total compensation expenses (CY19: PKR 7.2 bln; CY18: PKR 6.2 bln) Despite of the provisioning expense of PKR 1.8bln (Reversal Provision: CY18: PKR 1.1bln) the bottom-line to stood at an impressive PKR 8.3bln (CY18: PKR 7.6bln).

**Sustainability** Going forward, the management envisages growth in deposit base while bringing granularity in customer base through penetrating private sector deposits. To achieve this, the bank envisages increased outreach, focusing on service excellence and launch of new products. Growth in advances is also on the cards, wherein the criteria is higher margins and sustainable risk profile.

## Financial Risk

**Credit Risk** During CY19, BOP's advances have grown by ~0.5% (CY19: PKR 383bln; CY18: PKR 382bln). Growth in advances was subdued when compared with the medium industry average growth of 3.7%. The Bank's ADR, on the back of lower credit off-take decreased to 56% YOY (end-Dec18: 64%). BoP has a high infection ratio in comparison to its peers; stood at ~12% end-Dec19 (end-Dec18: ~11.6%). Optimism was witnessed as earning assets increased by 21% YoY (CY19: PKR 749bln, CY18: PKR 619bln).

**Market Risk** During CY19, the investment portfolio of the bank has grown by 72% to stand at PKR 354bln, excluding debt instrument (end-Dec18: PKR 204bln).

**Liquidity And Funding** The main source of BoP's funding is its deposit base, constituting around 84% of the total liabilities as at end-Dec19 (end-Dec18: 88%). The bank witnessed growth of 16% YoY in its customer deposit base (CY19: PKR 681bln, CY18: PKR 589bln). The system share in customer deposits inched up to 4.7% at end-Dec19 (end-Dec18: 4.5%). CA deposits stood PKR 154bln (end-Dec18: PKR 151bln) and SA deposits stood PKR 334bln (end-Dec18: PKR 258bln) with CA and SA ratio of ~22 and ~48% respectively (CY18: 25% and 43%); whereas term Deposits was 29% (CY18: 31%).

**Capitalization** The capitalization level of the bank was improving in last few years. As at end-Dec19 the bank's Capital Adequacy Ratio raised to 14.8% (Dec18: 13.2%) with the Tier I ratio improving to 11.3% (previously 9.86%). Hence, BoP remains compliant with SBP's enlisted CAR requirements.

PKR mln

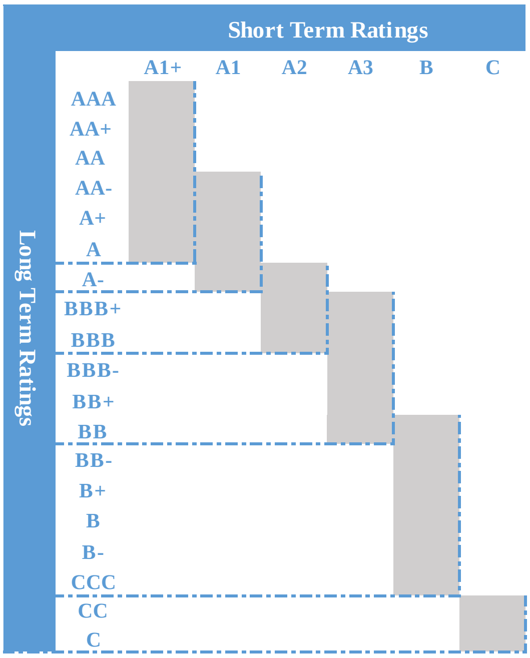
| The Bank of Punjab<br>Listed Public Limited | Dec-19<br>12M | Dec-18<br>12M | Dec-17<br>12M |
|---|---|---|---|
| **A BALANCE SHEET** | | | |
| 1 Total Finances - net | 387,240 | 384,492 | 298,344 |
| 2 Investments | 354,056 | 204,187 | 237,183 |
| 3 Other Earning Assets | 8,491 | 30,746 | 28,732 |
| 4 Non-Earning Assets | 115,671 | 91,685 | 90,747 |
| 5 Non-Performing Finances-net | 3,470 | 3,270 | 2,731 |
| **Total Assets** | 868,928 | 714,380 | 657,737 |
| 6 Deposits | 691,017 | 595,582 | 556,281 |
| 7 Borrowings | 85,839 | 50,590 | 43,448 |
| 8 Other Liabilities (Non-Interest Bearing) | 45,389 | 30,487 | 28,276 |
| **Total Liabilities** | 822,245 | 676,659 | 628,005 |
| **Equity** | 46,682 | 37,720 | 29,732 |
| **B INCOME STATEMENT** | | | |
| 1 Mark Up Earned | 80,867 | 46,908 | 34,668 |
| 2 Mark Up Expensed | (54,110) | (26,845) | (19,095) |
| 3 Non Mark Up Income | 3,940 | 3,663 | 4,591 |
| **Total Income** | 30,696 | 23,726 | 20,165 |
| 4 Non-Mark Up Expenses | (14,876) | (12,666) | (10,132) |
| 5 Provisions/Write offs/Reversals | (1,776) | 1,148 | (14,731) |
| **Pre-Tax Profit** | 14,044 | 12,208 | (4,698) |
| 6 Taxes | (5,795) | (4,645) | 1,376 |
| **Profit After Tax** | 8,249 | 7,564 | (3,322) |
| **C RATIO ANALYSIS** | | | |
| **1 Performance** | | | |
| Net Mark Up Income / Avg. Assets | 3.4% | 2.9% | 2.6% |
| Non-Mark Up Expenses / Total Income | 48.5% | 53.4% | 50.2% |
| ROE | 19.5% | 22.4% | -11.5% |
| **2 Capital Adequacy** | | | |
| Equity / Total Assets (D+E+F) | 5.4% | 5.3% | 4.5% |
| Capital Adequacy Ratio | 14.8% | 13.2% | 9.7% |
| **3 Funding & Liquidity** | | | |
| Liquid Assets / (Deposits + Borrowings Net of Repo) | 53.1% | 39.0% | 47.6% |
| (Advances + Net Non-Performing Advances) / Deposits | 55.5% | 64.1% | 53.2% |
| CA Deposits / Deposits | 22.2% | 25.4% | 28.4% |
| SA Deposits / Deposits | 48.4% | 43.3% | 43.3% |
| **4 Credit Risk** | | | |
| Non-Performing Advances / Gross Advances | 12.0% | 11.6% | 14.9% |
| Non-Performing Finances-net / Equity | 7.4% | 8.7% | 9.2% |

## 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+<br>AA<br>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+<br>A<br>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+<br>BBB<br>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+<br>BB<br>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+<br>B<br>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<br>CC<br>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

**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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