



The Pakistan Credit Rating Agency Limited

Rating Report

National Bank of Pakistan

Report Contents

1. Rating Analysis
2. Financial Information
3. Rating Scale
4. Regulatory and Supplementary Disclosure

Rating History

Dissemination Date	Long Term Rating	Short Term Rating	Outlook	Action	Rating Watch
27-Dec-2019	AAA	A1+	Stable	Maintain	YES
28-Jun-2019	AAA	A1+	Stable	Maintain	YES
28-Dec-2018	AAA	A1+	Stable	Maintain	-
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 reflect the formidable strength of the Bank in the domestic commercial banking industry. The Bank's strong financial risk profile, characterized by firm risk absorption capacity and systemic importance provides strength to the ratings. NBP's renowned domestic franchise along with extended outreach and high customer confidence aids the bank in sustaining its position. NBP fortified its position as the second-largest bank in the country in terms of advances, investments as well as deposits. During 9MCY19, NBP's performance remained better than its peers in the country. Additionally, CASA mix improved; especially the CA side of it; benefiting in the spreads. However, the high administration cost and a higher taxation charge of 44% is limiting profitability. There was deterioration in the asset quality as NBP booked PKR 19.13bln of NPLs. Although, the Bank has developed a system for early warning pertaining to the risks of NPLs, wherein some refinement may also be beneficial. 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 driven by strong ownership structure (Government of Pakistan (GoP) holds majority stake) also.

The ratings are dependent upon the management's ability to maintain the 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 pension benefits to retired employees has filed a review petition against the Supreme Court judgment and has also moved an application for the constitution of the 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	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-19)
Rating Analysts	Muhammad Noor ul Haq muhammad.noorulhaq@pacra .com +92-42-35869504



Profile

Structure National Bank of Pakistan (hereinafter referred to as “NBP” or “the Bank”) was incorporated as a public limited company, under NBP Ordinance 1949, and is listed on Pakistan Stock Exchange (PSX).

Background The primary objective of the Bank was to give credit to the agricultural sector. NBP is authorized to act as an agent of State Bank of Pakistan (SBP) and handles treasury operations for the Government of Pakistan (GoP). At the same time, the Bank acts as a trustee of public funds.

Operations NBP maintained its position as a second-largest commercial bank in the country in terms of customer deposit with 1,508 branches – including 189 Islamic branches. NBP also operates 21 overseas branches in 19 countries to cater the needs of locals as well as expatriates.

Ownership

Ownership Structure NBP is majorly owned (75.6%) by the Government of Pakistan (GoP), mainly through the SBP (75.2%). The remaining shareholding is widely spread.

Stability Being the largest public sector commercial bank, NBP is of strategic importance to the GoP. An implicit guarantee is provided against liabilities (deposits) of NBP under The Bank’s (Nationalization) Act, 1974.

Business Acumen SBP, which has a major stake in NBP on behalf of GoP, stands to provide it with the industry-specific working knowledge and strategic thinking capability as it has a holistic view of the entire industry.

Financial Strength The GoP has provided assistance to the Bank in the past and shall continue to support it as an implicit guarantee is provided against liabilities (deposits) of NBP under The Bank’s (Nationalization) Act, 1974.

Governance

Board Structure According to BNA, 1974, the Bank is required to have a minimum of five members BoD at any point in time. During CY18, the overall control of the Bank vested in GoP nominated nine-member Board of Directors (BoD).

Members’ Profile The board carries diversified experience including the financial sector, particularly banking, civil services, and other businesses. The majority of the directors have above two decades of experience. The directors having requisite experience and education are exempt from, SECP’s Code of Corporate Governance. During the year four directors completed training as part of CCG requirements.

Board Effectiveness During CY18, 12 board meetings (CY17: 10) were held; attendance of directors remained high. Relatively, a large number of meetings reflect continuous monitoring of affairs pertaining to oversee operations. The high attendance of members reflects active oversight.

Financial Transparency The Audit & Compliance Committee comprises three members, all of whom are non-executive directors while two of them are independent directors including the chairman. This ensures effective, transparent and independent oversight. The Bank has joint external auditors; Deloitte Yousaf Adil Chartered accountants and Grant Thornton Anjum Rahman Chartered accountants. Joint auditors expressed an unqualified opinion on the Bank’s financial statements for the year ended December 31, 2018.

Management

Organizational Structure NBP has a lean organizational structure that clearly defines responsibilities, authority and reporting lines with proper monitoring and compliance mechanism.

Management Team NBP’s senior management team comprises experienced bankers. The CEO/ President, Mr. Arif Usmani is a seasoned banker having over three decades of experience in domestic and international markets. He has been serving at Mashreq Bank and his previous experience includes stints as global head of wholesale banking at Abu Dhabi Islamic Bank PJSC, managing director and country officer of Citibank Pakistan.

Effectiveness NBP has an effective mix of management committees that are established to monitor performance and assure the adherence to the policies and procedures.

MIS NBP uses “Profile” as its core banking application (CBA). The Bank is using Misys Kondor for Treasury function while SAP is used for Financial General Ledger and Human Resources Management. The Bank has established a new division – Payment Services and Digital Banking Group. This is in line with management’s strategy of adopting digitization.

Risk Management Framework NBP’s risk management framework resides with the Risk Management Group (RMG). RMG develops risk management policies and tools in line with SBP guidelines while ensuring implementation by respective departments. RMG has 8 functions; i) Credit Risk Architecture, ii) Enterprise Risk Management, iii) E-CIB and Data Management, iv) Operational Risk Management, v) Market & Liquidity Risk Management, vi) Business Process Review & COSO Project, vii) Information Security Division and viii) Credit Administration.

Business Risk

Industry Dynamics Despite challenging macroeconomic environment, banking sector maintained its growth trajectory during 9MCY19, backed by decent growth in deposits (9MCY19: PKR 14,945bln; 9MCY18: 13,603bln). However, lending was largely skewed towards investments and particularly towards government instruments due to favorable interest rate dynamics (9MCY19: PKR 9,641bln; 9MCY18: 6,942bln). Meanwhile, advances witnessed a slowdown owing to subdued economic activity, cautious lending approach and monetary tightening (9MCY19: PKR 8,014bln; 9MCY18: 7,422bln). Asset quality saw some deterioration – increased NPLs, particularly in sugar and energy sectors (9MCY19: PKR 758 bln; 9MCY18: 637bln). The profitability of the banking sector improved due to increase in Net Interest Income, which translated positively in other profitability indicators. The overall risk profile of the banking sector remained satisfactory.

Relative Position NBP was marked as the bank with the second highest profitability numbers for the 9MCY19. NBP retained its position in top 3 (Extra Large) banks based on advances, deposits and profitability.

Revenues Based on the anticipated interest rate movement, the Bank focused on asset base with shorter maturities, resulting in a ~24% increase in net interest income over the year. However, during 9MCY19 gross markup income reported a significant increase of PKR ~62bln. Income on advances increased by 68% to PKR ~31bln whereas, on the investment side, gross markup income increased by 46% to PKR ~26bln.

Performance During 9MCY19, NBP’s asset yield increased from 6.9% to 9.1% – a factor of high benchmark lending rates. There was also a slight increase in the cost of funding to 6.0% as against 4.0%, during 9MCY19. Also, the bank was unable to curtail its operational expenses as it posted an increase of ~8.7% as against the same period last year. The non-markup expenses to total income decreased to 52% (9MCY18: 57%), still high.

Sustainability The budgeted forecasts and actual numbers of NBP have a strong correlation. Increasing interest rate environment helped the Bank in increasing its spread and earning higher profitability. However, recovery from infected portfolio would remain one of the key targets in 2019.

Financial Risk

Credit Risk NBP is the second-largest lender in the country with a ~11% share in the commercial banking industry’s advances at end-Sep19. During 9MCY19, the Bank witnessed decent growth in net advances (~2.5%; industry growth less than 1%), this led to ADR at a level of ~49%; below the industry average of 53.6%. Although, the NPLs of the Bank were increased by 14% to PKR 152bln (CY18: PKR 133bln).

Market Risk During the period, all the borrowed funds are parked in Govt. securities, hence, increasing the exposure towards market risk. The Bank’s investment portfolio constituting 57.6% of the total earning assets at end-Sep19 (end-CY18: 51.8%). The mix of government securities in overall investments increased from (CY18: 92.3%) to (9MCY19: 95.8%).

Liquidity And Funding During 9MCY19, NBP has mobilized mostly all funds via borrowings from FI’s through Repo. The Bank’s liquid assets to deposits & borrowings ratio remained high at 55.7% on account of relatively high growth in govt. securities in comparison to the deposits and borrowings. The customer deposit base of the Bank increased by PKR 1.2%; amongst industry average of 5.1%. Meanwhile, top-20 deposits concentration remained unchanged at 20.9% at end-Sep19; considered good.

Capitalization The Bank’s capitalization though declined on YoY basis yet remained healthy with equity to total assets at 7.3% at end-Sep19 (end-Dec18: 7.4%); in line with peers. NBP’s Capital Adequacy Ratio (CAR) is strong (end-Sep19: 17.1%) and predominantly comprises Tier-I capital 13.1%.



PKR mln

**National Bank of Pakistan
Listed Public Limited**

Sep-19	Dec-18	Dec-17	Dec-16
9M	12M	12M	12M

A BALANCE SHEET

1 Total Finances - net	1,004,393	987,845	790,451	718,335
2 Investments	1,502,219	1,227,769	1,247,759	850,742
3 Other Earning Assets	102,424	155,051	46,263	134,459
4 Non-Earning Assets	410,965	433,189	423,566	276,727
5 Non-Performing Finances-net	5,370	(5,287)	(2,718)	(4,557)
Total Assets	3,025,372	2,798,566	2,505,321	1,975,706
6 Deposits	1,938,036	2,011,385	1,727,102	1,657,312
7 Borrowings	680,683	392,739	360,120	44,890
8 Other Liabilities (Non-Interest Bearing)	185,796	187,573	242,717	96,771
Total Liabilities	2,804,514	2,591,698	2,329,939	1,798,973
Equity	220,857	206,869	175,382	176,733

B INCOME STATEMENT

1 Mark Up Earned	167,388	149,969	123,073	114,403
2 Mark Up Expensed	(113,525)	(89,302)	(68,820)	(59,578)
3 Non Mark Up Income	25,573	36,249	31,066	29,967
Total Income	79,436	96,915	85,319	84,791
4 Non-Mark Up Expenses	(41,362)	(55,931)	(50,395)	(48,351)
5 Provisions/Write offs/Reversals	(8,892)	(11,300)	675	701
Pre-Tax Profit	29,182	29,683	35,599	37,141
6 Taxes	(12,852)	(9,668)	(12,571)	(14,389)
Profit After Tax	16,331	20,015	23,028	22,752

C RATIO ANALYSIS

1 Performance

Net Mark Up Income / Avg. Assets	2.5%	2.3%	2.4%	3.0%
Non-Mark Up Expenses / Total Income	52.1%	57.7%	59.1%	57.0%
ROE	10.2%	10.5%	13.1%	13.2%

2 Capital Adequacy

Equity / Total Assets (D+E+F)	7.3%	7.4%	7.0%	8.9%
Capital Adequacy Ratio	17.1%	16.3%	15.9%	16.5%

3 Funding & Liquidity

Liquid Assets / (Deposits + Borrowings Net of Repo)	55.7%	55.4%	62.5%	59.4%
(Advances + Net Non-Performing Advances) / Deposits	49.1%	46.0%	42.8%	40.3%
CA Deposits / Deposits	42.1%	39.3%	52.9%	47.6%
SA Deposits / Deposits	41.6%	42.2%	27.6%	25.9%

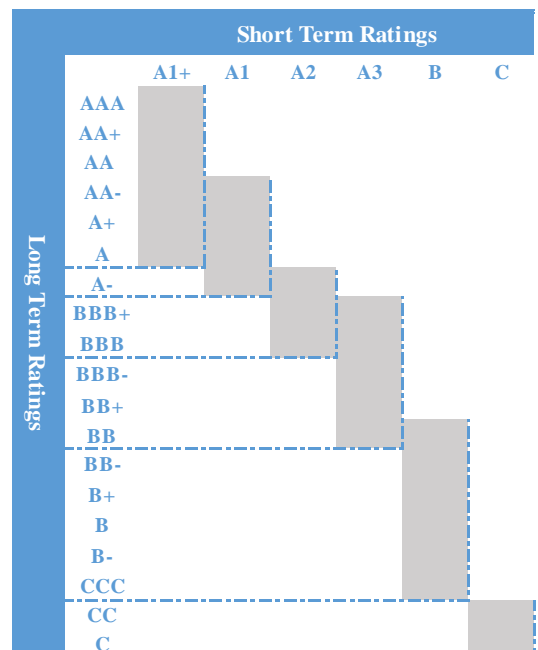
4 Credit Risk

Non-Performing Advances / Gross Advances	13.9%	12.6%	14.1%	15.3%
Non-Performing Finances-net / Equity	2.4%	-2.6%	-1.5%	-2.6%

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		Short Term Ratings	
AAA	Highest credit quality. Lowest expectation of credit risk. Indicate exceptionally strong capacity for timely payment of financial commitments	A1+	The highest capacity for timely repayment.
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.	A1	A strong capacity for timely repayment.
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.	A2	A satisfactory capacity for timely repayment. This may be susceptible to adverse changes in business, economic, or financial 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.	A3	An adequate capacity for timely repayment. Such capacity is susceptible to adverse changes in business, economic, or financial conditions.
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	The capacity for timely repayment is more susceptible to adverse changes in business, economic, or financial conditions.
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.	C	An inadequate capacity to ensure timely repayment.
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.		



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 surveil the opinion due to lack of requisite information.

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

Disclaimer: PACRA’s ratings are an assessment of the credit standing of entities/issue in Pakistan. They do not take into account the potential transfer / convertibility risk that may exist for foreign currency creditors. PACRA’s opinion is not a recommendation to purchase, sell or hold a security, in as much as it does not comment on the security’s market price or suitability for a particular investor.

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)

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- (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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