The Pakistan Credit Rating Agency Limited

THE BANK OF PUNJAB (BOP)

INSTRUMENT RATING REPORT

	PRELIMINARY [SEP-16]
Unlisted Term Finance Certificates (PKR 2,500mln)	AA-
Outlook	Stable

REPORT CONTENTS

SEPTEMBER 2016

RATING ANALYSES (SEPTEMBER 2016)
THE BANK OF PUNJAB (BOP)

RATING RATIONALE

The rating reflects the improved risk profile of BOP. The bank's capitalization and, hence, risk absorption capacity has witnessed sizeable uptick. Capital Adequacy Ratio (CAR) of the bank clocks in at 12%, which would be further beefed up with the issue of proposed TFCs. There has been an appreciable improvement in the bank's profitability, over the years, on the back of improved interest income and capital gains, supplementing its equity base. The bank witnessed reduction in the non-performing loans inherited by the current management, though further recovery is taking time. Moreover, continued support from the sponsors - the Government of Punjab (GoPb) – provides requisite fiscal space; fresh capital injection and Letters of Comfort (LOCs) against provisioning for certain infected exposures are valid till 2018. Association with GoPb has benefited the bank in terms of a sustainable deposit base. Further synergies with GoPb are being unfolded. The bank envisages growth in advances wherein the criteria is higher margins with sustained risk profile. Meanwhile, expansion in deposit base with low cost focus, while attracting a wide customer range, is on the cards.

KEY RATING DRIVERS

The rating of TFCs is dependent upon compliance with all major covenants.

- **About the TFCs:** BOP intends to issue unlisted TFCs of PKR 2,500mln to contribute towards Tier II Capital. The tenor of the instrument is 10 years from the date of issue. Profit would be based on 6M-KIBOR plus a spread. The funds raised would be used in normal operations.
- **Security Structure:** The proposed instrument will be unsecured, subordinated as to the payment of principal and interest to all other indebtedness of the bank, including deposits. The issue is subject to lock-in clause – no instalment may be paid (even at maturity) if it results in a shortfall in MCR or CAR, and a loss absorbency clause – full and permanent conversion of TFCs into ordinary shares of the bank, upon occurrence of Point of Non-Viability (PONV).
- **Funding:** The main source of BOP's funding is its deposit base, constituting around 93% of the total liabilities at end-Jun16. The bank witnessed a sizeable growth in its deposit base in recent years (end-Jun16: PKR 430bln, end-Dec10: PKR 204bln); system share in customer deposits stands at 4% at end-Dec15. Herein the CASA deposits have been the lynchpin. Top 20 deposit concentration, though improved, is on the higher side (25%).
- **Credit Risk:** The major issue of the bank is its infected portfolio (end-Dec15: PKR 57bln) representing 23% of gross advances. A predominant portion of NPLs (PKR 31bln) is covered by two Letters of Comfort (LOCs) by the GoPb till 2018 – a guarantee by GoPb. This gives relaxation in provisioning requirements for up to PKR 22bln (70% of required provisioning). An increase in NPLs (non-LOCs) of PKR 2.8bln in CY15 requires management attention. At end-Jun16, the bank's total NPLs stood at PKR 57bln.
- **Market Risk:** The investment portfolio (PKR 159bln) at end-Jun16 comprises mainly government securities (99%), followed by a nominal proportion of equity investments and mutual funds (1%). Noticing the declining interest rate environment, BOP increased exposure in PIBs of longer-term maturity in CY14 and realized capital gains of PKR 3.9bln from sale of PIBs in CY15, and PKR 1.6bln in 1H16.
- **Performance:** The bank has achieved sustained growth in NIMR in recent years, largely driven by higher interest earned. Asset yield declined by 1.2%, but improved cost of funds (CY15: 5.0%, CY14: 5.8%) on account of higher proportion of CASA deposits, salvaged the spread as it reduced by 34bps only (CY15: 3.9%, CY14: 4.2%). Pre-provision profits doubled (CY15: PKR 11bln, CY14: PKR 5.5bln) on support provided by high capital gains from PIBs (PKR 4bln). In effect, profit after tax grew by 70% (CY15: PKR 4.8bln, CY14: PKR 2.8bln). During 1H16, the bank continued healthy profitability though investment income decreased; changing interest rate scenario led to decreased capital gain on PIBs. At the same time, decrease in provisions for loan losses helped in sustaining pre-tax profit (1H16: PKR 4,245mln, 1H15: PKR 4,213mln).
- **Business Strategy:** Going forward, the management envisages growth in deposit base by targeting low cost CASA deposits 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 also on the cards, wherein the criteria is higher margins and sustainable risk profile. Benefit derived from association with GoPb shall continue. BOP is in the process of issuing proposed TFCs of PKR 2.5bln, which would further augment the CAR to 13% and above. The management envisages maintaining CAR above the target via healthy profitability.
- **Capital Structure:** The capitalization level of the bank has substantially improved over the years as a result of continued profitability as well as better management of Risk Weighted Assets (RWA); exposure towards GoPb (0% risk weight) increased. The Capital Adequacy Ratio (CAR) of the bank is 12% (Dec15: 10.49%, Dec14: 10.2%). CAR is envisaged to increase after issuing proposed TFCs of PKR 2.5bln, supplementing Tier II Capital. The equity base of the bank has been strengthened through significant reduction in accumulated losses (Jun16: PKR 0.4bln, Dec15: PKR 5.2bln, Dec14: PKR 9.1bln). The demonstrated support of GoPb – the sponsors – augments the financial risk; (i) LOCs (PKR 22bln) to meet CAR, (ii) Capital injection (PKR 10bln) and (iii) Advance subscription money (PKR 7bln) to meet MCR, and (iv) subordinated loan (CY14: PKR 2bln) to meet CAR. Moreover, the Board had approved (i) a subordinated debt from GoPb up to PKR 4bln – of which PKR 2bln had been received by end-Dec14 but remainder is not yet received, and (ii) a refund, from GoPb, of markup (PKR 2.13bln) on share deposit money, which is also pending.
- **About the Issuer:** The Bank of Punjab, established under the BOP Act 1989, is listed on Pakistan Stock Exchange (PSX). The bank operates a vast network of 408 branches, mainly concentrated in Punjab (87%). The Government of Punjab (GoPb) holds majority stake in BOP (58%), whereas the rest is widely dispersed.

Financials [Summary]

The Pakistan Credit Rating Agency Limited

The Bank of Punjab (BOP)

PKR mln

BALANCE SHEET	30-Jun-16	31-Dec-15	31-Dec-14	31-Dec-13
	1H16	Annual	Annual	Annual
Earning Assets				
Advances (Net of NPL)	222,015	193,272	141,472	123,000
Debt Instruments	8,168	7,098	1,583	1,476
Total Finances	230,183	200,370	143,055	124,476
Investments	159,018	168,610	152,671	121,977
Others	6,825	7,911	34,057	14,090
	396,027	**376,891**	**329,783**	**260,544**
Non Earning Assets				
Non-Earning Cash	36,581	28,905	24,553	25,403
Deferred Tax	6,359	7,906	9,845	12,627
Net Non-Performing Finances	24,817	26,461	29,461	34,788
Fixed Assets & Others	25,768	32,120	26,727	19,335
	93,525	**95,392**	**90,587**	**92,154**
TOTAL ASSETS	**489,552**	**472,284**	**420,370**	**352,698**
Interest Bearning Liabilities				
Deposits	429,983	374,961	342,291	306,561
Borrowings	13,538	57,236	46,744	22,805
	443,521	432,198	389,035	329,366
Non Interest Bearing Liabilities	19,774	17,408	12,009	9,851
TOTAL LIABILITIES	**463,295**	**449,605**	**401,043**	**339,217**
EQUITY (including revaluation surplus)	**26,257**	**22,678**	**19,327**	**13,481**
Total Liabilities & Equity	**489,552**	**472,284**	**420,370**	**352,698**

INCOME STATEMENT	30-Jun-16	31-Dec-15	31-Dec-14	31-Dec-13
Interest / Mark up Earned	14,603	31,266	29,522	24,228
Interest / Mark up Expensed	(8,654)	(20,199)	(20,526)	(20,209)
Net Interest / Markup revenue	**5,949**	**11,068**	**8,996**	**4,019**
Other Income	2,344	5,989	1,790	2,448
Total Revenue	**8,293**	**17,057**	**10,786**	**6,467**
Non-Interest / Non-Mark up Expensed	(3,701)	(7,666)	(6,250)	(5,280)
Pre-provision operating profit	**5,479**	**11,026**	**5,536**	**2,335**
Provisions	(1,234)	(3,496)	(1,229)	666
Pre-tax profit	4,245	7,529	4,307	3,001
Taxes	(1,477)	(2,781)	(1,519)	(1,063)
Net Income	**2,767**	**4,748**	**2,787**	**1,938**

Ratio Analysis	30-Jun-16	31-Dec-15	31-Dec-14	31-Dec-13
Performance				
ROE	28%	27%	20%	17%
Cost-to-Total Net Revenue	45%	45%	58%	82%
Provision Expense / Pre Provision Profit	23%	32%	22%	-29%
Capital Adequacy				
Equity/Total Assets	5%	4%	4%	4%
Capital Adequacy Ratio as per SBP	12.0%	10.5%	10.2%	9.0%
Funding & Liquidity				
Liquid Assets / Deposits and Borrowings	46%	42%	49%	47%
Advances / Deposits	57%	59%	50%	51%
CASA deposits / Total Customer Deposits	71%	66%	64%	58%
Intermediation Efficiency				
Asset Yield	8%	9%	10%	10%
Cost of Funds	4%	5%	6%	6%
Spread	4%	4%	4%	3%
Outreach				
Branches	408	406	364	334

STANDARD RATING SCALES & 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 or economic conditions are more likely to impair this capacity.
BB+ **BB** **BB-**	**Moderate risk.** Possibility of credit risk developing. There is a possibility of credit risk developing, particularly as a result of adverse economic or business changes over time; however, business or financial alternatives may be available to allow financial commitments to be met.
B+ **B** **B-**	**High credit risk.** A limited margin of safety remains against credit risk. Financial commitments are currently being met; however, capacity for continued payment is contingent upon a sustained, favorable business, and economic environment.
CCC **CC** **C**	**Very high credit risk.** "CCC" Default is a real possibility. Capacity for meeting financial commitments is solely reliant upon sustained, favorable business or economic developments. "CC" Rating indicates that default of some kind appears probable. "C" Ratings signal imminent default.
D	Obligations are currently in default.

Short Term Ratings

A1+: The highest capacity for timely repayment.

A1:. A strong capacity for timely repayment.

A2: A satisfactory capacity for timely repayment. This may be susceptible to adverse changes in business, economic, or financial conditions.

A3: An adequate capacity for timely repayment. Such capacity is susceptible to adverse changes in business, economic, or financial conditions.

B: The capacity for timely repayment is more susceptible to adverse changes in business, economic, or financial conditions.

C: An inadequate capacity to ensure timely repayment.

Rating Watch
Alerts to the possibility of a rating change subsequent to, or in anticipation of, a) some material identifiable event and/or b) deviation from expected trend. But it does not mean that a rating change is inevitable. Rating Watch may carry designation – Positive (rating may be raised, negative (lowered), or developing (direction is unclear). A watch should be resolved within foreseeable future, but may continue if underlying circumstances are not settled.

Outlook (Stable, Positive, Negative, Developing)
Indicates the potential and direction of a rating over the intermediate term in response to trends in economic and/or fundamental business/financial conditions. It is not necessarily a precursor to a rating change. 'Stable' outlook means a rating is not likely to change. 'Positive' means it may be raised. 'Negative' means it may be lowered. Where the trends have conflicting elements, the outlook may be described as 'Developing'.

Suspension
It is not possible to update an opinion due to lack of requisite information. Opinion should be resumed in foreseeable future. However, if this does not happen within six (6) months, a suspended rating should be considered withdrawn.

Withdrawn
A rating is withdrawn on a) termination of rating mandate, b) cessation of underlying entity, c) the debt instrument is redeemed, d) the rating remains suspended for six months, or e) the entity/issuer defaults.

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Regulatory and Supplementary Disclosure

Name of Issuer	The Bank of Punjab (BOP)
Sector	Banking | Commercial
Type of Relationship	Solicited
Purpose of the Rating	Independent Risk Assessment Regulatory Requirement

Rating History

Dissemination Date	Long Term	Outlook	Action
23-Sep-16	AA-	Stable	Preliminary

Instrument Details

Nature of Instrument	Size of Issue (PKR mln)	Tenor (yrs)	Security	Trustee
TFCs	PKR 2,500mln	10	Unsecured, subordinated as to the payment of principal and profit to all other indebtedness of the Bank, including deposits, and will not be redeemable before maturity without prior approval of SBP. Also subject to lock-in and loss absorbency clauses.	?

Related Criteria and Research

Rating Methodology — Bank Rating Methodology
Sector Research — Banking Sector - Viewpoint | Dec-15

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Rating Team Statement

Rating Procedure
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