



The Pakistan Credit Rating Agency Limited

THE BANK OF PUNJAB (BOP)

INSTRUMENT RATING REPORT

	INITIAL PRELIMINARY [DEC-16] [SEP-16]		REPORT CONTENTS
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DECEMBER 2016

RATING ANALYSES

(DECEMBER 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% (end-Sep16), which would be further beefed up with the issue of 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 is in the process of issuing unlisted TFCs of PKR 2,500mln (subscription received on 23-Dec-16) 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 100bps. The funds raised would be used in normal operations.
- **Security Structure:** The 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-Sep16. The bank witnessed a sizeable growth in its deposit base in recent years (end-Sep16: PKR 420bln, end-Dec10: PKR 204bln); system share in customer deposits stands at 4% at end-Sep16. 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-Sep16, the bank's total NPLs stood at PKR 56bln.
- **Market Risk:** The investment portfolio (PKR 201bln) at end-Sep16 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 2bln in 9M16.
- **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 9M16, 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 (9M16: PKR 6,036mln, 9M15: PKR 5,639mln).
- **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 (subscription received on 23-Dec-16), which would further augment the CAR. 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 to profitability (Sep16: PKR 0.75bln, 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 453 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-Sep-16	31-Dec-15	31-Dec-14	31-Dec-13
	9M16	Annual	Annual	Annual
Earning Assets				
Advances (Net of NPL)	217,014	193,272	141,472	123,000
Debt Instruments	8,206	7,098	1,583	1,476
Total Finances	225,221	200,370	143,055	124,476
Investments	200,583	168,610	152,671	121,977
Others	10,517	7,911	34,057	14,090
	436,320	376,891	329,783	260,544
Non Earning Assets				
Non-Earning Cash	33,636	28,905	24,553	25,403
Deferred Tax	6,243	7,906	9,845	12,627
Net Non-Performing Finances	24,801	26,461	29,461	34,788
Fixed Assets & Others	25,573	32,120	26,727	19,335
	90,253	95,392	90,587	92,154
TOTAL ASSETS	526,573	472,284	420,370	352,698
Interest Bearing Liabilities				
Deposits	420,464	374,961	342,291	306,561
Borrowings	59,833	57,236	46,744	22,805
	480,298	432,198	389,035	329,366
Non Interest Bearing Liabilities	19,165	17,408	12,009	9,851
TOTAL LIABILITIES	499,463	449,605	401,043	339,217
EQUITY (including revaluation surplus)	27,110	22,678	19,327	13,481
Total Liabilities & Equity	526,573	472,284	420,370	352,698

INCOME STATEMENT	30-Sep-16	31-Dec-15	31-Dec-14	31-Dec-13
Interest / Mark up Earned	21,931	31,266	29,522	24,228
Interest / Mark up Expensed	(13,025)	(20,199)	(20,526)	(20,209)
Net Interest / Markup revenue	8,905	11,068	8,996	4,019
Other Income	2,828	5,989	1,790	2,448
Total Revenue	11,733	17,057	10,786	6,467
Non-Interest / Non-Mark up Expensed	(5,853)	(7,666)	(6,250)	(5,280)
Pre-provision operating profit	7,018	11,026	5,536	2,335
Provisions	(982)	(3,496)	(1,229)	666
Pre-tax profit	6,036	7,529	4,307	3,001
Taxes	(2,105)	(2,781)	(1,519)	(1,063)
Net Income	3,931	4,748	2,787	1,938

Ratio Analysis	30-Sep-16	31-Dec-15	31-Dec-14	31-Dec-13
Performance				
ROE	25%	27%	20%	17%
Cost-to-Total Net Revenue	50%	45%	58%	82%
Provision Expense / Pre Provision Profit	14%	32%	22%	-29%
Capital Adequacy				
Equity/Total Assets	4%	4%	4%	4%
Capital Adequacy Ratio as per SBP	12.0%	10.5%	10.2%	9.0%
Funding & Liquidity				
Liquid Assets / Deposits and Borrowings	45%	42%	49%	47%
Advances / Deposits	57%	59%	50%	51%
CASA deposits / Total Customer Deposits	70%	66%	64%	58%
Intermediation Efficiency				
Asset Yield	7%	9%	10%	10%
Cost of Funds	4%	5%	6%	6%
Spread	3%	4%	4%	3%
Outreach				
Branches	453	406	364	334

The Bank of Punjab (BOP)
December 2016



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		SHORT TERM RATINGS
AAA	<p>Highest credit quality. Lowest expectation of credit risk.</p> <p>Indicate exceptionally strong capacity for timely payment of financial commitments.</p>	<p>A1+: The highest capacity for timely repayment.</p> <p>A1: A strong capacity for timely repayment.</p> <p>A2: A satisfactory capacity for timely repayment. This may be susceptible to adverse changes in business, economic, or financial conditions.</p> <p>A3: An adequate capacity for timely repayment. Such capacity is susceptible to adverse changes in business, economic, or financial conditions.</p> <p>B: The capacity for timely repayment is more susceptible to adverse changes in business, economic, or financial conditions.</p> <p>C: An inadequate capacity to ensure timely repayment.</p>
AA+ AA AA-	<p>Very high credit quality. Very low expectation of credit risk.</p> <p>Indicate very strong capacity for timely payment of financial commitments. This capacity is not significantly vulnerable to foreseeable events.</p>	
A+ A A-	<p>High credit quality. Low expectation of credit risk.</p> <p>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.</p>	
BBB+ BBB BBB-	<p>Good credit quality. Currently a low expectation of credit risk.</p> <p>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.</p>	
BB+ BB BB-	<p>Moderate risk. Possibility of credit risk developing.</p> <p>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.</p>	
B+ B B-	<p>High credit risk.</p> <p>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.</p>	
CCC CC C	<p>Very high credit risk.</p> <p>“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.</p>	
D	<p>Obligations are currently in default.</p>	

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.

Disclaimer: PACRA's rating is an assessment of the credit standing of an entity/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.



Name of Issuer
Sector
Type of Relationship

The Bank of Punjab (BOP)
Banking | Commercial
Solicited

Purpose of the Rating

Independent Risk Assessment
Regulatory Requirement

Rating History

Dissemination Date	Long Term	Outlook	Action
27-Dec-16	AA-	Stable	Initial
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.	Pak Brunei Investment Company Limited

Related Criteria and Research

Rating Methodology
Sector Research

Bank Rating Methodology
Banking Sector - Viewpoint | Dec-15

Rating Analysts

Muneeb Rashid
muneeb.rashid@pacra.com
(92-42-35869504)

Amara S. Gondal
amara.gondal@pacra.com
(92-42-35869504)

[Rating Team Statement](#)

Rating Procedure

Rating is an opinion on relative credit worthiness of an entity or debt instrument. It does not constitute recommendation to buy, hold or sell any security. The rating team for this assignment does not have any beneficial interest, direct or indirect in the rated entity/instrument.

[Disclaimer](#)

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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 ii) fee mandate - signed with the payer, which can be different from the entity

PACRA ensures that the credit rating assigned to an entity or instrument should 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

Surveillance

PACRA monitors all the outstanding ratings continuously and any potential change therein due to any event associated with the rated entity/ issuer, the security arrangement, the industry etc, is disseminated to the market, in a timely and effective manner, after appropriate consultation with the entity/issuer

PACRA reviews all the outstanding ratings on annual basis or as and when required by any stakeholder (including creditor) or upon the occurrence of such an event which requires to do so

PACRA initiates immediate review of the outstanding rating(s) upon becoming aware of any information that may be reasonable be expected to result in any change (including downgrade) in the rating

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PACRA has framed and implemented whistle-blower policy encouraging all employees to intimate the compliance officer any unethical practice or misconduct relating to the credit rating by another employees of the company that came to his/her knowledge. The Compliance Officer reports to the BoD and SECP

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circumstance PACRA has not informed the entity/issuer prior to issuing or revising a rating, it informs the entity/issuer as soon as practical thereafter

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[Probability of Default \(PD\)](#)

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



Month	Issue Price Component of Redemption Amount	Maximum Expected Profit	Total Redemption Amount	Maximum Prompt Payment Bonus	Principal Amount Outstanding
0					100,000
6	20	9,500.0	9,520.0	9,500.0	99,980
12	20	9,498.1	9,518.1	9,498.1	99,960
18	20	9,496.2	9,516.2	9,496.2	99,940
24	20	9,494.3	9,514.3	9,494.3	99,920
30	20	9,492.4	9,512.4	9,492.4	99,900
36	20	9,490.5	9,510.5	9,490.5	99,880
42	20	9,488.6	9,508.6	9,488.6	99,860
48	20	9,486.7	9,506.7	9,486.7	99,840
54	20	9,484.8	9,504.8	9,484.8	99,820
60	20	9,482.9	9,502.9	9,482.9	99,800
66	20	9,481.0	9,501.0	9,481.0	99,780
72	20	9,479.1	9,499.1	9,479.1	99,760
78	20	9,477.2	9,497.2	9,477.2	99,740
84	20	9,475.3	9,495.3	9,475.3	99,720
90	20	9,473.4	9,493.4	9,473.4	99,700
96	20	9,471.5	9,491.5	9,471.5	99,680
102	20	9,469.6	9,489.6	9,469.6	99,660
108	20	9,467.7	9,487.7	9,467.7	99,640
114	20	9,465.8	59,285.8	9,465.8	49,820
120	20	4,732.9	54,552.9	4,732.9	-
Total	100,000.0	184,908.0	284,908.0	184,908.0	