The Pakistan Credit Rating Agency Limited

THE BANK OF PUNJAB (BOP)

RATING REPORT

	NEW [JUN-17]	PREVIOUS [SEP-16]
Long Term Ratings	AA	AA
Short Term Ratings	A1+	A1+
Unlisted Term Finance Certificates (PKR 2,500mln)	AA-	AA-
Outlook	Stable	Stable

REPORT CONTENTS

JUNE 2017

Assets:

- The bank's liquidity, in terms of its Liquid Assets-to-Deposits and Borrowings ratio, strengthened on YoY basis: to 47% at end-Dec16 (end-Dec15: 41%)
- BOP's advances portfolio constitutes 48% of total assets at end-Dec'16 (end-Dec'15: 46%)
- The ADR remained steady at 58% (CY15:58%).

Funding

- The main source of BOP's funding is its deposit base, constituting around 88% of the total liabilities at end-Mar 17.
- The bank witnessed a sizeable growth in its deposit base in recent years (end-Dec 16: PKR 453bln, end-Dec15: PKR 375bln)
- Top 20 deposit concentration, though improved, is on the higher side (28%).

Credit Risk

- One major issue of the bank is its infected portfolio (end-Dec16: PKR 55bln) representing 19% of gross advances. A predominant portion of NPLs is covered by two Letters of Comfort (LOCs) by the GoPb till 2018
- This gives relaxation in provisioning requirements for up to 70% of required provisioning. At end-Mar17, the bank's total NPLs stood at PKR 55bln.

Market Risk

- The investment portfolio (PKR 199bln) at end-Mar17 comprises mainly government securities (99%), followed by a nominal proportion of equity investments and mutual funds (1%).
- Bop increased its exposure towards T-bills on the back of reducing interest emanating from high yield PIBs.

Performance

- During CY16, assets yield declined by 1.7%. However, improved cost of funds (CY16: 3.8%, CY15: 5%) on account of higher proportion of CASA deposits, salvaged the spread as it reduced by 50bps (CY16: 3.4%, CY15: 3.9%)
- Interest income, in absolute amount, diminished by 5% due to low volumes. Interest expense also decreased by 14%.
- Pre-provision operating profit declined to PKR 9bln (CY15:11bln), majorly due to decrease in capital gains on PIBs.

Capital

- The Capital Adequacy Ratio (CAR) of the bank is 12% (Dec15: 10.49%, Dec14: 10.2%) due to retained profits and issuing of TFCs of PKR 2.5bln, supplementing Tier II Capital.
- The equity base of the bank has been strengthened through the elimination of significant accumulated losses (Dec15: PKR 5.2bln, Dec14: PKR 9.1bln).
- Moreover, in March 2017, the board of directors approved issue of right shares for PKR 12 per share at a premium of PKR 2 per share. This equates to PKR 13bln. The management expects to complete the process till July 2107.
- PKR 7bln has already been received from GoPb

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.
- Benefit derived from association with GoPb shall continue.

Profile

- 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..

Governance and management

- Mr. Naeemuddin Khan, the President of the Bank since Sep'08, has four decades of diversified banking experience and has been associated with reputed international and domestic banks during his career. The senior management consists of seasoned bankers twenty years.
- He is backed by a team of experienced professionals, most of whom have long association with the bank.

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 12.28% at end – Dec 16. 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 also in terms of a sustainable deposit base. The bank is in process of raising capital through right issue. This, along with projected profits, would provide cushion against LOC's. 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 ratings are dependent on the financial risk profile of the bank, mainly emanating from sustenance of capital adequacy and continued healthy profitability trend inline with the management's plans. Meanwhile, improvement in asset quality and upholding better governance standards remain imperative.

DEBT INSTRUMENT

The tenor of the instrument is 10 years from the date of issue. Profit is based on 6M-KIBOR plus 100 bps p.a . The issue carries lock-in and loss absorbency clauses, as per Basel III capital regulations.

INDUSTRY SNAPSHOT

The banking sector experienced substantial expansion in its deposit base (2016: 14%). Building on the uptick in the economy, advances also grew by a sizeable margin after a lag of many years. Given GDP growth in FY17 and other macro-economic fundamentals, credit expansion is foreseen. Hence, CAR is going to be a challenge, as profits would also suffer due to PIBs maturities.

BALANCE SHEET	31-Mar-17	31-Dec-16	31-Dec-15	31-Dec-14
	3M	Annual	Annual	Annual
Earning Assets				
Advances (Net of NPL)	248,696	238,968	193,272	141,472
Debt Instruments	7,945	4,695	7,098	1,583
Total Finances	256,641	243,664	200,370	143,055
Investments	199,466	194,712	168,610	152,671
Others	9,587	14,646	9,017	34,057
	465,694	**453,022**	**377,998**	**329,783**
Non Earning Assets				
Non-Earning Cash	31,129	36,438	27,798	24,553
Deferred Tax	6,235	6,480	7,906	9,845
Net Non-Performing Finances	23,664	23,434	26,461	29,461
Fixed Assets & Others	25,135	25,840	32,121	26,727
	86,163	**92,192**	**94,286**	**90,587**
TOTAL ASSETS	**551,857**	**545,214**	**472,284**	**420,370**
Interest Bearning Liabilities				
Deposits	459,820	453,220	374,961	342,291
Borrowings	42,547	44,329	57,236	46,744
	502,367	497,549	432,198	389,035
Non Interest Bearing Liabilities	19,994	19,811	17,408	12,009
TOTAL LIABILITIES	**522,361**	**517,360**	**449,605**	**401,043**
EQUITY (including revaluation surplus)	**29,496**	**27,855**	**22,679**	**19,327**
Total Liabilities & Equity	**551,857**	**545,214**	**472,284**	**420,370**

INCOME STATEMENT	31-Mar-17	31-Dec-16	31-Dec-15	31-Dec-14
Interest / Mark up Earned	7,642	29,674	31,266	29,522
Interest / Mark up Expensed	(4,364)	(17,430)	(20,199)	(20,526)
Net Interest / Markup revenue	**3,278**	**12,244**	**11,068**	**8,996**
Other Income	402	3,636	5,989	1,790
Total Revenue	**3,680**	**15,880**	**17,057**	**10,786**
Non-Interest / Non-Mark up Expensed	(2,254)	(8,464)	(7,666)	(6,250)
Pre-provision operating profit	**1,948**	**9,075**	**11,026**	**5,536**
Provisions	452	(1,025)	(3,496)	(1,229)
Pre-tax profit	2,401	8,050	7,529	4,307
Taxes	(839)	(3,192)	(2,781)	(1,519)
Net Income	**1,562**	**4,858**	**4,748**	**2,787**

Ratio Analysis	31-Mar-17	31-Dec-16	31-Dec-15	31-Dec-14
Performance				
ROE	27%	22%	27%	20%
Cost-to-Total Net Revenue	61%	53%	45%	58%
Provision Expense / Pre Provision Profit	-23%	11%	32%	22%
Capital Adequacy				
Equity/Total Assets	5%	4%	4%	4%
Capital Adequacy Ratio as per SBP	13.0%	12.3%	10.5%	10.2%
Funding & Liquidity				
Liquid Assets / Deposits and Borrowings	47%	47%	42%	49%
Advances / Deposits	59%	58%	59%	50%
CASA deposits / Total Customer Deposits	72%	71%	66%	64%
Intermediation Efficiency				
Asset Yield	7%	7%	9%	10%
Cost of Funds	4%	4%	5%	6%
Spread	3%	3%	4%	4%
Outreach				
Branches	453	453	406	364

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+ 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 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

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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	Short Term	Outlook	Action
22-Jun-17	AA	A1+	Stable	Maintain
23-Sep-16	AA	A1+	Stable	Upgrade
29-Jun-16	AA-	A1+	Positive	Maintain
29-Jun-15	AA-	A1+	Positive	Maintain
30-Jun-14	AA-	A1+	Stable	Maintain
30-Jun-13	AA-	A1+	Stable	Maintain

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 Bank Rating Methodology
Sector Research Banking Sector - Viewpoint | Jun-17

Rating Analysts

Faraan Taimoor
faraan.taimoor@pacra.com
(92-42-35869504)

Jhangeer Hanif
jhangeer.hanif@pacra.com
(92-42-35869504)

Rating Team Statement

Rating Procedure
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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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