The Pakistan Credit Rating Agency Limited

Rating Report

The Bank of Punjab | TFC II | April-18

Report Contents

Rating History

Dissemination Date	Long Term Rating	Short Term Rating	Outlook	Action	Rating Watch
28-Dec-2019	AA-	-	Stable	Maintain	-
28-Jun-2019	AA-	-	Stable	Maintain	-
27-Dec-2018	AA-	-	Stable	Maintain	-
27-Jun-2018	AA-	-	-	Initial	-
26-Oct-2017	AA-	-	-	Preliminary	-

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. Last few years are reflective of this, during 9MCY19, the bank has recorded commendable uptick in revenue base – both interest earned and income from fee and commission. The former is largely attributable to hike in key policy rate as advances witnessed marginal growth. Hence, a rise was witnessed in asset yield. Resultantly, spread inched up to 5.1% (end-Dec18: 4.6%). Although, the bank performed well, but on the other hand, hike in NPLs led to net provisioning expense being recorded. On the funding side, saving deposits witnessed significant jump. The concentration of government and public sector deposits remain high. The bank's Capital Adequacy Ratio (CAR) clocked in at 14.66% as at end-Sep19, which is a healthy sign for BoP. Going forward, 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.

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. Meanwhile, improvement in asset quality and upholding better governance standards remain imperative.

Disclosure

Name of Rated Entity	The Bank of Punjab | TFC II | April-18
Type of Relationship	Solicited
Purpose of the Rating	Debt Instrument Rating
Applicable Criteria	PACRA_Methodology_FI(Jun-19),PACRA_Methodology_DI Basel III_FY19(Jun-19),Criteria | Rating Modifier(Jun-19)
Related Research	Sector Study | Commercial Bank(Jun-19)
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 with a network of 611 branches as at end-Sep19 and employs more than 9,227 employees (end-Dec18: 9,400).

Operations The bank's principal activities are to provide commercial and Islamic banking services to individuals and institutional clients.

Ownership

Ownership Structure The Government of Punjab (GoPb) holds controlling stake of ~57% in BoP. The rest of the shareholding is by local individuals (~20%) and institutions (~23%).

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 the 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 BoP has a seven-member Board. Four members, including the Chairman, are representing GoPb on the Board while three are independent members.

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. The Board members' attendance and participation is considered good and effective

Financial Transparency The auditors – M/s EY Ford Rhodes, Chartered Accountants, have expressed unqualified opinion on the financial statements of the bank for CY18. The retiring auditors (EY Ford Rhodes) have been re-appointed as statutory auditors of the bank for year 2019.

Management

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

Management Team Mr. Khalid Tirmizey, Deputy CEO, has become Acting President / CEO in Dec-18. 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 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 BOP, a medium sized bank, holds a good position in the industry; 4.6% system share and deposit base of PKR 640.5bln as at end Sep-19.

Revenues During 9MCY19, BoP's NIMR witnessed an increase of ~40% on YOY basis to stand at PKR ~19.8bln (CY18: PKR ~15bln; 9MCY18: PKR ~14bln) on the back of volumetric growth as well as rise in key policy rate. The bank's asset yield inched up ~10.9% (end-Dec18: ~7.9%; end Sep-18: ~7.5%). Cost of funds also increased to 4.2% (end-Dec18: ~4.6%; end Sep-18: ~4%). Hence, bank's spread inched up (9MCY19: 5.1%; CY18: 3.6%).

Performance During 9MCY19, Non-markup income almost remained same YoY (9MCY19: PKR 2.8bln; 9MCY18: PKR 2.8bln). Bank recorded a provision expense of PKR 1.47bln (Provision Reversal: CY18: PKR ~1.15bln; 9MCY18: PKR ~948mln) all the above factors contributed to the bottom-line to stand at an impressive PKR 6.1bln (CY18: PKR ~7.5bln; 9MCY18: PKR ~5.4bln).

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. The Bank is also keen to take benefit of (CPEC) and play its role in national development.

Financial Risk

Credit Risk During 9MCY19, BOP's advances have shrunk by ~2.7% (9MCY19: PKR 371bln; CY18: PKR 381bln). The Bank's ADR decreased to 58% (end-Dec18: 64%). Infection ratio increased to ~12.5% end-Sep19 (end-Dec18: ~11.6%). Cumulatively, The total provision coverage ratio is 12.3% (end Sep-19: 10.4%). All of the above factors make the bank least vulnerable to credit risk.

Market Risk During 9MCY19, the investment portfolio of the bank has grown by ~73% to stand at PKR 362.5bln (end-Dec18: PKR 210bln).

Liquidity And Funding The main source of BoP's funding is its deposit base, constituting around ~80% of the total liabilities as at end-Sep19 (end-Dec18: ~88%). The bank witnessed growth of ~7.7% in its deposit (9MCY19: PKR 640bln, CY18: PKR 595bln). The bank was able to attract deposits with similar proportion of current and savings account, thus slightly decrease in its CA/ deposit ratio at 22.2% and SA/ Deposit ratio slightly increased to 48% in Sep-19 from 43% in Dec-18. The bank's deposits posted a growth of 7.7%, against average industry decline of 2.8%. The bank's liquidity, in terms of its Liquid Assets-to-Deposits and Borrowings net of repo, ratio stands at ~50.4% (CY18: ~39%).

Capitalization The capitalization level of the bank was improving since the last few years. As at end-Sep19 the bank's Capital Adequacy Ratio raised to 14.66% (Dec18: 13.17%) with the Tier I ratio improving to 11.23% (previously 9.86%). As of today, BoP is compliant with SBP's enlisted CAR requirements.

PKR mln

The Bank of Punjab Listed Public Limited	Sep-19 9M	Dec-18 12M	Dec-17 12M	Dec-16 12M
A BALANCE SHEET				
1 Total Finances - net	374,300	384,492	298,344	246,188
2 Investments	354,852	204,187	237,183	194,712
3 Other Earning Assets	9,547	30,746	28,732	14,646
4 Non-Earning Assets	100,458	91,685	90,747	68,758
5 Non-Performing Finances-net	4,973	3,270	2,731	20,910
Total Assets	844,129	714,380	657,737	545,214
6 Deposits	640,525	595,582	556,281	453,220
7 Borrowings	123,262	50,590	43,448	44,329
8 Other Liabilities (Non-Interest Bearing)	37,760	30,487	28,276	19,811
Total Liabilities	801,547	676,659	628,005	517,360
Equity	42,582	37,720	29,732	27,854
B INCOME STATEMENT				
1 Mark Up Earned	57,135	46,893	34,668	29,674
2 Mark Up Expensed	(37,303)	(26,840)	(19,095)	(17,430)
3 Non Mark Up Income	2,801	3,673	4,591	5,294
Total Income	22,633	23,726	20,165	17,539
4 Non-Mark Up Expenses	(10,645)	(12,666)	(10,132)	(8,464)
5 Provisions/Write offs/Reversals	(1,473)	1,148	(14,731)	(1,025)
Pre-Tax Profit	10,515	12,208	(4,698)	8,050
6 Taxes	(4,335)	(4,645)	1,376	(3,192)
Profit After Tax	6,180	7,564	(3,322)	4,858
C RATIO ANALYSIS				
1 Performance				
Net Mark Up Income / Avg. Assets	3.4%	2.9%	2.6%	2.4%
Non-Mark Up Expenses / Total Income	47.0%	53.4%	50.2%	48.3%
ROE	20.5%	22.4%	-11.5%	19.2%
2 Capital Adequacy				
Equity / Total Assets (D+E+F)	5.0%	5.3%	4.5%	5.1%
Capital Adequacy Ratio	14.7%	13.2%	9.7%	12.3%
3 Funding & Liquidity				
Liquid Assets / (Deposits + Borrowings Net of Repo)	50.4%	39.0%	47.6%	45.3%
(Advances + Net Non-Performing Advances) / Deposits	58.0%	64.1%	53.2%	57.8%
CA Deposits / Deposits	22.2%	25.4%	28.4%	28.8%
SA Deposits / Deposits	48.2%	43.3%	43.3%	42.7%
4 Credit Risk				
Non-Performing Advances / Gross Advances	12.5%	11.6%	14.9%	18.7%
Non-Performing Finances-net / Equity	11.7%	8.7%	9.2%	75.1%

Debt Instrument Rating Scale & Definitions

Credit rating reflects forward-looking opinion on credit worthiness of underlying 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.

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)
Proprietary Information
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Nature of Instrument	Size of Issue (PKR Bln)	Tenor	Security	Quantum of Security	Nature of Assets	Trustee	Book Value of Assets (PKR mln)
TFC II (Tier-II)	4.3	10 years	Instrument will be unsecured and subordinated as to 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	N/A	N/A	Pak Brunei Investment Company Limited	N/A

The Bank of Punjab | Tier-II TFC | Apr-18	
Name of Issuer	The Bank of Punjab
Issue size	PKR 4.3 Bn
Tenor	10 Years
Maturity	10 years from the date of issuance (unless Call Option is exercised)
Profit Rate	6 MK + 1.25%
Call Option	Exercisable in Apr-23
Principal Repayment	The TFC is structured to redeem 0.02% of the issue amount, per semi-annual period, in the first 09 years and the remaining issue amount in two equal semi-annual installments of 49.82% each, in the 10th year.
Security	TFC is unsecured and subordinated as to the payment of principal and profit to all other indebtedness of the bank, including deposits and is not redeemable before maturity without prior approval of the SBP.

The Bank of Punjab | TFC II | Redemption Schedule

Due Date Principle	Opening Principal	Principal Repayment	Due Date Markup/ Profit	Markup/Profit Rate	6M Kibor (Assumed at 10.60%)	Markup/Profit Payment	Installment Payable	Principal Outstanding
		PKR in mln						*PKR in mln*
								4,300.00
6 months from issuance	4,300.00	0.86	6 months from issuance	6 Month Kibor + 1.25%				4,299.14
12 months from issuance	4,299.14	0.86	12 months from issuance	6 Month Kibor + 1.25%		Already Paid		4,298.28
18 months from issuance	4,298.28	0.86	18 months from issuance	6 Month Kibor + 1.25%				4,297.42
24 months from issuance	4,297.42	0.86	24 months from issuance	6 Month Kibor + 1.25%				4,296.56
30 months from issuance	4,296.56	0.86	30 months from issuance	6 Month Kibor + 1.25%				4,295.70
36 months from issuance	4,295.70	0.86	36 months from issuance	6 Month Kibor + 1.25%				4,294.84
42 months from issuance	4,294.84	0.86	42 months from issuance	6 Month Kibor + 1.25%				4,293.98
48 months from issuance	4,293.98	0.86	48 months from issuance	6 Month Kibor + 1.25%				4,293.12
54 months from issuance	4,293.12	0.86	54 months from issuance	6 Month Kibor + 1.25%				4,292.26
60 months from issuance	4,292.26	0.86	60 months from issuance	6 Month Kibor + 1.25%				4,291.40
66 months from issuance	4,291.40	0.86	66 months from issuance	6 Month Kibor + 1.25%				4,290.54
72 months from issuance	4,290.54	0.86	72 months from issuance	6 Month Kibor + 1.25%				4,289.68
78 months from issuance	4,289.68	0.86	78 months from issuance	6 Month Kibor + 1.25%				4,288.82
84 months from issuance	4,288.82	0.86	84 months from issuance	6 Month Kibor + 1.25%				4,287.96
90 months from issuance	4,287.96	0.86	90 months from issuance	6 Month Kibor + 1.25%				4,287.10
96 months from issuance	4,287.10	0.86	96 months from issuance	6 Month Kibor + 1.25%				4,286.24
102 months from issuance	4,286.24	0.86	102 months from issuance	6 Month Kibor + 1.25%				4,285.38
108 months from issuance	4,285.38	0.86	108 months from issuance	6 Month Kibor + 1.25%				4,284.52
114 months from issuance	4,284.52	2,142.26	114 months from issuance	6 Month Kibor + 1.25%				2,142.26
120 months from issuance	2,142.26	2,142.26	120 months from issuance	6 Month Kibor + 1.25%				-
		4,300.00				-	-	