The Pakistan Credit Rating Agency Limited

Rating Report

The Bank of Punjab | Additional Tier 1 Capital TFC | TBI

Report Contents

Rating History

Dissemination Date	Long Term Rating	Short Term Rating	Outlook	Action	Rating Watch
07-Jan-2022	AA-	-	Stable	Preliminary	-

Rating Rationale and Key Rating Drivers

The Bank of Punjab has built a franchise around its name, which itself is a reflection of strong parentage. It took a long period which witnessed concerted efforts by the management duly backed by the sponsors' support to reinvigorate the Bank. The incumbent management, under the new leadership, has revamped and strengthened the governance and compliance structure in place which is essential for oversight and dynamic operations of the Bank. The areas of focus envision three phases (control, consolidation & growth), which help lead the bank from an augmented control environment to a growth arena. Customer focus and geographical diversification and expansion are the key elements. The Bank grew its deposit's base to stand at PKR 884bln as at end-Sep21. The system share of the Bank has taken a positive contribution from the growth, which would lead the bank towards being classified as a large bank. During 9MCY21, asset quality witnessed improvement attributable to decline in absolute NPLs. However, on a prudence basis, subjective classification and general provisioning were done to ensure that asset quality remains unimpaired going forth. The bank's Capital Adequacy Ratio (CAR) clocked in at 14.5% as at end-Sep21 (end-Dec20: 16.2%), CET1 to TRWA's stand at 11.66%, providing BOP with a healthy cushion to expand its advances' book in line with its stated strategy, whereby the growth in risk assets will be covered through insurance and first-loss guarantees wherever available. COVID-19 is an ongoing challenge. The proactive measures taken by the regulators and other concerning bodies, alongside the measures taken by the banks, have mitigated the potential damages much anticipated from this pandemic. As a result, the banking industry remained protected and in fact posted record profits.

The ratings are dependent on the financial risk profile of the bank, mainly emanating from the sustenance of capital adequacy and continued healthy profitability trend in line with the management's plans. Any weakening in asset quality will in turn put pressure on the bank's profitability and risk absorption capacity.

Disclosure

Name of Rated Entity	The Bank of Punjab	Additional Tier 1 Capital TFC	TBI
Type of Relationship	Solicited
Purpose of the Rating	Debt Instrument Rating
Applicable Criteria	Methodology	Debt Instrument Rating(Jun-21)
Related Research	Sector Study	Commercial Bank(Jun-21)
Rating Analysts	Sehar Fatima	sehar.fatima@pacra.com	+92-42-35869504

Issuer Profile

Profile The Bank of Punjab (BoP) was established under the BoP Act 1989 (the Act), as a non-scheduled bank and was subsequently converted into a scheduled bank in 1994 with its Head Office in Lahore, the bank operates a network of 640 branches at end-Dec20 and employs 9,967 employees (endDec19: 9,640). The bank's principal activities are to provide commercial and Islamic banking services to individuals and institutional clients. BoP entered Islamic Banking Operations in 2013, under the brand name of “Taqwa Islamic Banking”. At end-Dec20, there are 105 (end-Dec19: 100) fully functional online Islamic Banking Branches.

Ownership The Government of Punjab (GoPb) holds controlling stake of 57.5% in bank of Punjab. The rest of shareholding is by local individuals (26.5%) and institutions (~16.0%). Ownership structure of the bank is seen as stable as no ownership changes are expected in near future. Majority stake will rest with The Government of Punjab. 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 sustained being a profitable institution. BoP, being one of the flagship entities under umbrella of Government of Punjab, willingness to support the Bank in case the need arise is considered high; also supplemented by access to the capital markets.

Governance The control of the bank vests with eight-member Board of Directors comprising five non-executive directors, two independent directors and one executive director. Six members are representing Government of Punjab. Mr Zafar Masud – President of BoP is an executive director. 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. The BoD exercises close monitoring of the management’s policies and the bank’s operations via five sub-committees. Meetings for all these five committees are held quarterly. The Board members’ attendance and participation is considered good and effective. The Audit Committee comprises four members; Mr. Saeed Anwar is the chairman. The external auditors – M/s EY Ford Rhodes, Chartered Accountants, have expressed unqualified opinion on the financial statements of the bank for CY20.

Management The bank has long organizational structure with experienced senior management heading each function and/or unit and relevant segregation of duties in place. Mr Zafar Masud has been appointed as President and CEO. He has been associated with reputed international and domestic banks during his career. The senior management consists of seasoned bankers having diversified experience. 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. The committee, responsible for overseeing the operational matters of the bank, including human resource, different lines of business, compliance, and administration, meets fortnightly to review these areas. A comprehensive IT security policy has been put in place along with risk mitigation protocols. 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 Division (RMD), headed by Chief Risk Officer (CRO) – Mr. Arsalan Muhammad Iqbal manages different facets of risk including credit, market, operational, liquidity, reputation and country risk. Heads of Credit Risk Units – Corporate, Commercial, Consumer, Special Assets Management (SAM), and Agri – reports to head of credit risk, while heads of Operational, Market and Risk Policy reports directly to CRO.

Business Risk During 1HCY21, the indicators of the banking sector reflected signs of recovery and resilience. Deposits of the banking sector grew by 12% to PKR 20,441bln (CY20: PKR 18,519bln) as compared to 16.1% growth in CY20. The surge in deposits provided the necessary funding support to finance the robust rise in investments (1HCY21: PKR 14,162bln, CY20: PKR 11,935bln) which remained tilted towards government instruments. On the advances front, during 1HCY21, after recording slight uptick advances stood at PKR 8,808bln (CY20: PKR 8,292bln) where mild contraction was observed in CY20 owing to slackness amid COVID-19 pandemic outbreak. The policy measures rolled out by the SBP (during CY20) enabled the sector to enhance profitability, improve resilience and limit the credit risk. With the completion of deferment period allowed, the aftermath is yet to be comprehended by the industry. BOP, a medium sized bank, holds a good position in the industry; 4.6% (end-Dec20: 4.5%) market share in term of deposits. The deposit base stands at PKR 884bln as at end-Sept21 (end-Dec20: PKR 835bln). During 9MCY21, the bank’s NIMR witnessed an increase of 29.4% on YOY basis to stand at PKR 22bln (9MCY20: PKR 17bln). Spread inched down to 3.1% (9MCY20: 2.9%). Non-markup income declined by 48% (9MCY21: PKR 6bln, 9MCY20: PKR 11.6bln) driven by decline in gain recorded on sale of securities (9MCY21: PKR 1.6bln; 9MCY20: PKR 8.3bln). Profit after tax, increased by 50% YOY, amounted to PKR 8.7bln (9MCY20: PKR 5.8bln). Going forward, the incumbent management has revamped and strengthened governance and compliance structure in-place which is essential for oversight and dynamic operations of the Bank. The areas of focus envision three phases (control, consolidation & growth), which help lead the bank from augmented control environment to growth arena. Customer focus and geographical diversification and expansion are the key elements.

Financial Risk During 9MCY21, BOP's net advances grew by 13.5% to stand at PKR 444bln (end-Dec20: PKR 391bln). ADR rationalized to 50.2% (CY20: 46.8%). Infection ratio marginally improved to 11% (CY20: 12.9%). Investment portfolio of the bank decreased by 4.1% to stand at PKR 530bln, excluding debt instruments (end-Dec20: PKR 553bln). As at end-Dec20, investment portfolio’s composition remained as 58% of T-Bills, 37% of PIBs and 5% of other government securities and investments. The deposit base stands at PKR 884bln as at end-Sept21 (end-Dec20: PKR 835bln). The bank’s liquidity, in terms of Liquid Assets-to-Deposits and Borrowings ratio decreased to 58.9% (CY20: 61.2%). Herein, the bank’s leverage ratio (4.8%) safely complies with SBP’s requirement i.e., 3%. The bank reported CAR of 14.5%, comprising of Tier I capital (11.7%), remaining compliant with the minimum requirement by SBP. The CET1 to TRWA's stand at 11.66%. The equity base of the bank increased by 2.5% clocking in at PKR 54bln (CY20: PKR 52.2bln).

Instrument Rating Considerations

About The Instrument BoP is planning to issue Rated, Unsecured, Perpetual and Non-Cumulative Debt Instruments in the nature of Additional Tier I Capital Term Finance Certificates TFC of the amount PKR 10bln (Inclusive of green shoe option of PKR 5bln). The Issue Amount will contribute towards BOP’s Additional Tier I Capital for Capital Adequacy Requirement as per guidelines set by SBP. Mark-up (If declared) will be payable semi-annually in arrears on the outstanding principal amount, based on 365 days a year basis and on a non-cumulative basis. Applied laws are Banking Companies Ordinance, 1962; SBP Circular No. 6 of 2013 dated August 15, 2013 and other SBP circulars, notifications and Prudential Regulations issued from time to time; Companies Act, 2017, Securities Act, 2015 and rules and regulations issued thereunder by the Securities and Exchange Commission of Pakistan; and rules of the Pakistan Stock Exchange Limited.

Relative Seniority/Subordination Of Instrument In event of default, the settlement of claims will be ranked as, first; who are superior to the claims of ordinary shareholders, second; junior to all other claims (including depositors and general creditors) and Third; Pari passu without preference amongst themselves. The lock-in clause states that mark-up will only be paid from the Issuer’s current year’s earning and if the Issuer is in compliance with regulatory Minimum Capital Requirement, Capital Adequacy Ratio and Leverage Ratio requirements set by SBP from time to time (“Regulatory Capital Requirements”). Payment of profit will be subject to the condition that such payment will not result in breach of the Bank’s regulatory Minimum Capital Requirement (“MCR”) or Capital Adequacy Ratio (“CAR”) set by SBP from time to time, as per Clause iii (g) of Annexure 2 of the Circular. It being clarified that the profit rate for such period shall effectively be 0% (i.e., no profit)

Credit Enhancement The TFCs will be unsecured and subordinated as to payment of principal and profit to all other claims except common shares.

PKR mln

The Bank of Punjab Listed Public Limited	Sep-21	Dec-20	Dec-19	Dec-18
	9M	12M	12M	12M

A BALANCE SHEET

	Sep-21	Dec-20	Dec-19	Dec-18
1 Total Finances - net	457,347	402,885	387,240	384,492
2 Investments	529,864	552,948	354,056	204,187
3 Other Earning Assets	17,770	18,807	8,491	30,746
4 Non-Earning Assets	115,873	117,690	115,671	91,685
5 Non-Performing Finances-net	693	3,116	3,470	3,270
Total Assets	1,121,546	1,095,446	868,928	714,380
6 Deposits	884,393	835,068	691,017	595,582
7 Borrowings	134,075	161,633	85,839	50,590
8 Other Liabilities (Non-Interest Bearing)	49,492	46,484	45,389	30,487
Total Liabilities	1,067,960	1,043,185	822,245	676,659
Equity	53,586	52,262	46,682	37,720

B INCOME STATEMENT

	Sep-21	Dec-20	Dec-19	Dec-18
1 Mark Up Earned	59,804	86,019	80,867	46,908
2 Mark Up Expensed	(37,892)	(62,694)	(54,110)	(26,845)
3 Non Mark Up Income	6,044	13,046	3,940	3,663
Total Income	27,956	36,371	30,696	23,726
4 Non-Mark Up Expenses	(15,496)	(17,519)	(14,876)	(12,666)
5 Provisions/Write offs/Reversals	(97)	(6,862)	(1,776)	1,148
Pre-Tax Profit	12,362	11,989	14,044	12,208
6 Taxes	(3,645)	(5,046)	(5,795)	(4,645)
Profit After Tax	8,717	6,944	8,249	7,564

C RATIO ANALYSIS

	Sep-21	Dec-20	Dec-19	Dec-18
1 Performance				
Net Mark Up Income / Avg. Assets	2.6%	2.4%	3.4%	2.9%
Non-Mark Up Expenses / Total Income	55.4%	48.2%	48.5%	53.4%
ROE	22.0%	14.0%	19.5%	22.4%
2 Capital Adequacy				
Equity / Total Assets (D+E+F)	4.8%	4.8%	5.4%	5.3%
Capital Adequacy Ratio	14.5%	16.2%	14.8%	13.2%
3 Funding & Liquidity				
Liquid Assets / (Deposits + Borrowings Net of Repo)	58.9%	61.2%	53.1%	39.0%
(Advances + Net Non-Performing Advances) / Deposits	50.2%	46.8%	55.5%	64.1%
CA Deposits / Deposits	20.2%	20.4%	22.2%	25.4%
SA Deposits / Deposits	50.6%	47.2%	48.4%	43.3%
4 Credit Risk				
Non-Performing Advances / Gross Advances	11.0%	12.9%	12.0%	11.6%
Non-Performing Finances-net / Equity	1.3%	6.0%	7.4%	8.7%

Credit Rating

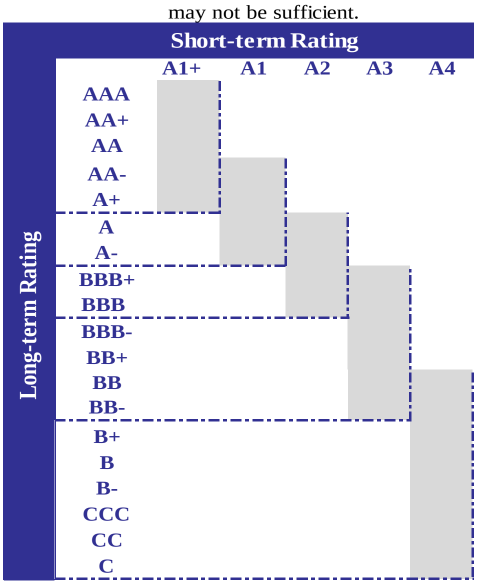
Credit rating reflects forward-looking opinion on credit worthiness of underlying entity or instrument; more specifically it covers relative ability to honor financial obligations. The primary factor being captured on the rating scale is relative likelihood of default.

Long-term Rating

Scale	Definition
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 Rating

Scale	Definition
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
A4	The capacity for timely repayment is more susceptible to adverse changes in business, economic, or financial conditions. Liquidity may not be sufficient.



**The correlation shown is indicative and, in certain cases, may not hold.*

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 some material identifiable event with indeterminable rating implications. 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 rating 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) the debt instrument is redeemed, c) the rating remains suspended for six months, d) the entity/issuer defaults., or/and e) 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.

Surveillance. Surveillance on a publicly disseminated rating opinion is carried out on an ongoing basis till it is formally suspended or withdrawn. A comprehensive surveillance of rating opinion is carried out at least once every six months. However, a rating opinion may be reviewed in the intervening period if it is necessitated by any material happening.

Note. This scale is applicable to the following methodology(s):

a) Broker Entity Rating
b) Corporate Rating
c) Debt Instrument Rating
d) Financial Institution Rating
e) Holding Company Rating
f) Independent Power Producer Rating
g) Microfinance Institution Rating
h) Non-Banking Finance Companies Rating

Regulatory and Supplementary Disclosure

(Credit Rating Companies Regulations,2016)

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)

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Regulatory and Supplementary Disclosure

The Bank of Punjab | Additional Tier 1 Capital TFC | TBI

Nature of Instrument	Size of Issue (PKR)	Years	Security	Quantum of Security	Nature of Assets	Book Value of Assets (PKR mln)	Trustee	
Additional Tier 1 Capital TFC	PKR 10,000mln	Perpetual (i.e. no fixed or final redemption date); Coupon Payment Payment of	Instrument will be unsecured and subordinated	N/A				

6 Months KIBOR Ask Rate (assumed "0" for calculation purpose)	0.00%
Spread:	
Effective Rate	6-Month KIBOR (Ask Side) + Indicative Spread of 1.9%.
Maximum Rate	
Maximum Rate + Spread	
Issue Amount	PKR 10,000mln

The Bank of Punjab | Additional Tier 1 Capital TFC | TBI | Tentative Redemption Schedule

Years	Months	Tentative Dates	No. of Days	Principal Redemption Schedule	Issue price Component of Redemption	Maximum Expected Profit 22%	Total Redemption	Prompt Payment Bonus	Principal Outstanding
Not Applicable, as the instrument is of perpetual nature.									
Total				0%	-	-	-	-	