The Pakistan Credit Rating Agency Limited

Rating Report

The Bank of Punjab

Report Contents

Rating History

Dissemination Date	Long Term Rating	Short Term Rating	Outlook	Action	Rating Watch
27-Dec-2018	AA	A1+	Stable	Maintain	-
27-Jun-2018	AA	A1+	Stable	Maintain	-
30-Dec-2017	AA	A1+	Stable	Maintain	-
22-Jun-2017	AA	A1+	Stable	Maintain	-
23-Sep-2016	AA	A1+	Stable	Upgrade	-

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. During the current year, the bank has recorded commendable uptick in revenue base – both interest earned and income from fee, commission. Hence, an uptick witnessed in asset yield. NPLs inched down; trend needs to continue in future. Customer deposits – part of funding base – witnessed increase; contribution of CA deposits declined. During 9MCY18, the bank recorded sizable improvement in profitability which was further supplemented by reversal in provisioning. The bank's Capital Adequacy Ratio (CAR) clocked in at 13.29% for the period ending-Sep18. 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
Type of Relationship	Solicited
Purpose of the Rating	Entity Rating
Applicable Criteria	Methodology | Financial Institution(Jun-18),Methodology | Criteria | Rating Modifier(Jun-18),Methodology | Correlation Between Long-Term And Short-Term Rating Scale(Jun-18)
Related Research	Sector Study | Commercial Bank(Jun-18)
Rating Analysts	Sehar Fatima | sehar.fatima@pacra.com | +92-42-35869504

Profile

Structure 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. The bank is quoted on Pakistan stock exchange under the category of commercial banks.

Background BoP entered into Islamic Banking Operations in 2013, under the brand name of "Taqwa Islamic Banking". BOP's head office is located in lahore.

Operations BOP is principally engaged in commercial banking and related services. At end-Sep18, the Bank has 545 branches including 07 sub branches and 68 islamic banking branches (end-Dec17: 536 branches including 06 sub branches and 64 islamic branches)

Ownership

Ownership Structure The Government of Punjab (GoPb) holds controlling stake of ~58% in bank of Punjab. The rest of shareholding is by local individuals (~22%) and institutions (20%).

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.

Financial Strength Given that BOP is the flagship business of sponsors, willingness to support the Bank in case the need arises is considered high; also supplemented by access to capital markets.

Governance

Board Structure The control of the bank vests with nine-member Board of Directors, including the President. Six members, including the Chairman, are representing GoPb on the board. Mr. Saeed Anwar is an independent member representing minority shareholder while the President is an executive member. During 9MCY18, Mr. Syed Muratib ali- a non executive member, resigned from the board.

Members' Profile The bank's chairman, Dr. Pervaiz Tahir, took office w.e.f. end-Aug'16. He is a senior economist, having held key positions in GoP's Ministry of Finance as well as Planning Commission. The other 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, namely i) Board Risk Management (BRMC), ii) Human Resource & Remuneration Committee (HR&RC), iii) Central Audit Committee (CAC) and iv) Islamic Banking Review Committee (IBRC).

Financial Transparency The auditors – M/s EY Ford Rhodes, Chartered Accountants, have expressed unqualified opinion on the financial statements of the bank for CY17.

Management

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

Management Team Mr. Naeemuddin Khan, President of the Bank since Sep-08, has lately resigned. Mr. Khalid Tirmizey, former deputy CEO, has become Acting-CEO in Dec-18. The senior management consists of seasoned bankers.

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 A comprehensive IT security policy has been put in place along with risk mitigation protocols. The bank is in the process of implementing an internationally renowned Oracle based core banking system 'Flexcube". Currently, over 50 branches are functioning at new core banking system and complete migration is expected in 2018.

Risk Management Framework Risk Management Division (RMD), headed by Chief Risk Officer (CRO) manages different facets of risk including credit, market, operational, liquidity, reputation and country risk.

Business Risk

Industry Dynamics The banking industry witnessed significant expansion in the loan book. Last year and YTD (2018) both witnessed huge deployments. This is expected to slow down. New projects require gestation period and additionally crowding-out effect may take place. Rising interest rates mean profitability of the sector would take support. Yet NPLs, as a result, may also transpire. CAR is reaching the maximum requirement by December 2018 (11.9%). This will create a challenge for some of the players.

Relative Position BOP, a medium sized bank, holds a good position in the industry with a 4.5% customer deposit base of PKR 563bln at end-Sep18.

Revenues During 9MCY18, BOP NIMR witnessed an increase of 27% on YOY basis to stand at PKR 14bln (9MCY17: PKR 11bln) on the back of volumetric growth as well as rise in key policy rate. On the other hand markup expenses also increased by 33% YOY. The bank's asset yield marginally inched up 7.5% (end-Dec17: 6.8%). Cost of funds also increased to 4.1% (FY17: 3.5%). Hence, bank's spread inched up (9MCY18: 3.5%; FY17: 3.3%; 9MFY17: 3.2%).

Performance During 9MCY18, Non-markup income recorded a decay of 35% YOY, mainly emanating from a significant decrease in unrealized gain on sale of investments (9MCY18: PKR 27mln; 9MFY17: PKR 1,303mln). The rise in non-markup expense (21%) stood at PKR 9bln (9MCY17: PKR 7bln). Bank recorded a net reversal of PKR 1,011mln (Provision: 9MFY17: PKR 1,990mln) which contributed to the bottom-line to stand at PKR 5,443mln (9MCY17: PKR 3,161mln).

Sustainability 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.

Financial Risk

Credit Risk During 9MCY18, BOP's advances have grown by 26% (9MCY18: PKR 371bln; CY17: PKR 295bln). Growth in advances was above industry average (9MCY17: 15%). The sectoral concentration inclines towards government (~25%), textile and ginning (~19%) and individuals (~12%). Further analysis reveals that 71% lies with the corporate sector, followed by 13% to the commodity financing. The bank is continuing its focus of expanding advances through a diversified portfolio. The Bank's ADR, on the back of higher credit off-take by the bank increased to 65% (end-Dec17: 53%) driven by increased lending. BOP has a high infection ratio when compared with peers; however improved to ~12% end-Sep18 (end-Dec17: ~15%). Earning assets increased by 3% (9MCY18: PKR 581bln, FY17: PKR 564bln).

Market Risk During 9MCY17, the investment portfolio of the bank has shrunken by 16% to stand at PKR 202bln (end-Dec17: PKR 242bln). As at end-Sep18, the composition of investment portfolio comprises 93% of T-Bills (end-Dec17: 83%) and 7% of other government securities and investments. The significant tilt towards T-Bills is the industry vide trend in the wake of increasing interest rate environment of the country.

Liquidity And Funding The main source of BoP's funding is its deposit base, constituting around 91% of the total liabilities as at end-Sep18 (end-Dec17: 89%). The bank witnessed growth of 2% in its customer deposit (9MCY18: PKR 563bln, FY17 PKR 550bln). The system share in customer deposits stands at 4.5% at end-Sep18 (end-Dec17: 3.8%). CASA deposits stood PKR 380bln (end-Dec17: PKR 393bln) with CASA ratio of ~68% (CY17: 71%) driven by increase in time deposits. The bank's liquidity, in terms of its Liquid Assets-to-Deposits and Borrowings ratio stands at 39% (CY16: ~50%).

Capitalization The capitalization level of the bank was improving in last few years. However, as at end-Dec17 the bank's Capital Adequacy Ratio reduced to 9.73% (below minimum required level) (Dec16: 12.28%). However, as at end-Mar18, the Capital Adequacy Ratio improved to 10.53% (previous: 9.73%) with the Tier I ratio improving to 8.44% (previously 7.61%). The bank has been given time till Jun-18 to get compliant with SBP's enlisted CAR requirements.

Financial Summary

The Bank of Punjab (BoP)

PKR Mln

BALANCE SHEET	30-Sep-18	31-Dec-17	31-Dec-16	31-Dec-15
	9M	*Annual*	*Annual*	*Annual*
Earning Assets				
Advances (Net of NPL)	366,670	290,784	238,968	193,272
Debt Instruments	8,523	7,560	4,695	7,098
Total Finances	375,193	298,344	243,664	200,370
Investments	196,229	237,184	194,712	168,610
Others	10,408	28,732	14,646	7,911
	581,831	**564,260**	**453,022**	**376,891**
Non Earning Assets				
Non-Earning Cash	39,453	44,394	36,438	28,905
Deferred Tax	8,937	10,725	6,480	7,906
Net Non-Performing Finances	2,984	2,731	23,434	26,461
Fixed Assets & Others	29,825	27,438	25,840	32,120
	81,199	**85,287**	**92,192**	**95,392**
TOTAL ASSETS	**663,030**	**649,547**	**545,214**	**472,284**
Interest Bearning Liabilities				
Deposits	568,343	556,281	453,220	374,961
Borrowings	38,333	43,448	44,329	57,236
	606,676	599,730	497,549	432,198
Non Interest Bearing Liabilities	21,256	20,086	19,811	17,408
TOTAL LIABILITIES	**627,932**	**619,815**	**517,360**	**449,605**
EQUITY (including revaluation surplus)	**35,098**	**29,732**	**27,855**	**22,678**
Total Liabilities & Equity	**663,030**	**649,547**	**545,214**	**472,284**

INCOME STATEMENT	30-Sep-18	31-Dec-17	31-Dec-16	31-Dec-15
Interest / Mark up Earned	32,309	34,451	29,674	31,266
Interest / Mark up Expensed	(18,256)	(18,877)	(17,430)	(20,199)
Net Interest / Markup revenue	**14,053**	**15,574**	**12,244**	**11,068**
Other Income	2,855	4,591	5,294	7,624
Total Revenue	**16,908**	**20,165**	**17,539**	**18,692**
Non-Interest / Non-Mark up Expensed	(9,067)	(10,646)	(8,464)	(7,666)
Pre-provision operating profit	**7,841**	**9,519**	**9,075**	**11,026**
Provisions	1,011	(14,217)	(1,025)	(3,496)
Pre-tax profit	**8,851**	**(4,698)**	**8,050**	**7,529**
Taxes	(3,408)	1,376	(3,192)	(2,781)
Net Income	**5,443**	**(3,322)**	**4,858**	**4,748**

Ratio Analysis	30-Sep-18	31-Dec-17	31-Dec-16	31-Dec-15
Performance				
ROE	24.4%	13.0%	22.3%	27.4%
Cost-to-Total Net Revenue	58.5%	58.1%	53.3%	44.9%
Provision Expense / Pre Provision Profit	-12.9%	149.4%	11.3%	31.7%
Capital Adequacy				
Equity/Total Assets	4.9%	4.1%	4.4%	4.1%
Capital Adequacy Ratio as per SBP	13.3%	9.7%	12.3%	10.5%
Funding & Liquidity				
Liquid Assets / Deposits and Borrowings	39.1%	49.5%	47.0%	41.9%
Advances / Deposits	65.4%	53.2%	57.8%	58.5%
CASA deposits / Total Customer Deposits	67.6%	71.4%	71.0%	65.9%
Intermediation Efficiency				
Asset Yield	7.5%	6.8%	7.2%	8.9%
Cost of Funds	4.1%	3.5%	3.8%	5.0%
Spread	3.5%	3.3%	3.4%	3.9%

Rating Scale

Credit Rating Scale & Definitions

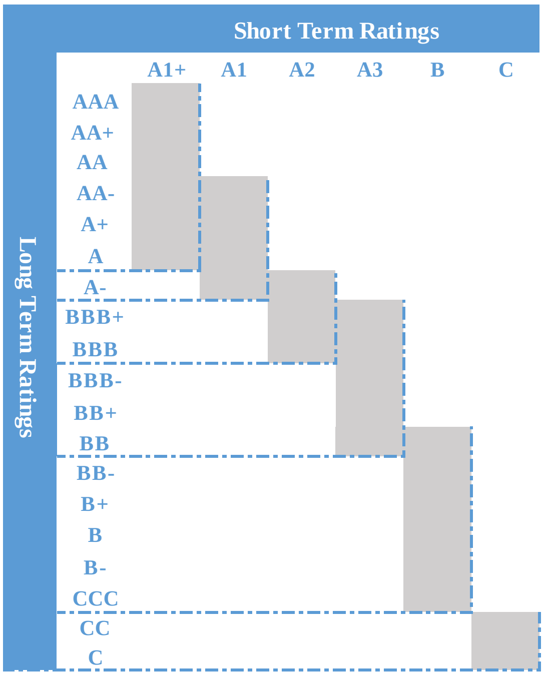
Credit rating reflects forward-looking opinion on credit worthiness of underlying entity or instrument; more specifically it covers relative ability to honor financial obligations. The primary factor being captured on the rating scale is relative likelihood of default.

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.

Harmonization A change in rating due to revision in applicable methodology or underlying scale.

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)
Proprietary Information