RATING REPORT

Zarai Taraqiati Bank Limited

REPORT DATE:
June 27, 2019

RATING ANALYSTS:
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RATING DETAILS

Rating Category	Latest Rating		Previous Rating	
	Long-term	Short-term	Long-term	Short-term
Entity	AAA	A-1+	AAA	A-1+
Outlook	Stable		Stable	
Government Debt Obligations	AAA		AAA	A-1+
Outlook	Stable		Stable	
Date	*Jun 26,'19*		*Jun 28,'18*	

COMPANY INFORMATION

Incorporated in 2002	**External Auditors:** Horwath Hussain Chaudhary& Co & BDO Ebrahim & Co, Chartered Accountants
Public Limited Company	**Chairman of the Board:** Mr. Syed Yawar Ali (till July'17) **Chief Executive Officer:** Mr. Sheikh AmanUllah
Key Shareholders (with stake 5% or more):	
State Bank of Pakistan : 76.23% Government of Pakistan : 23.75% Other Provinces : 0.02%	

APPLICABLE METHODOLOGY(IES)

VIS Entity Rating Criteria: Government Supported Entities (June2016);
http://www.vis.com.pk/kc-meth.aspx

Zarai Taraqiati Bank Limited

OVERVIEW OF THE INSTITUTION

ZTBL, formerly Agricultural Development Bank of Pakistan (ADBP), was formed through the repeal of ADB Ordinance 1961. ADBP was established following the merger of Agricultural Development Finance Corporation and Agricultural Bank of Pakistan. ZTBL took over all assets, business, contracts and liabilities of ADBP and started its countrywide operations as a public limited banking company on December 14, 2002. The bank has the mandate to provide finance and credit facilities to small farmers and low-income households.

Profile of CEO

ZTBL's management team has been headed by Sheikh AmanUllah since October, 2018. Mr. AmanUllah carries thirty one years of banking experience

Financial Snapshot

Total Equity: FY18: Rs.73.9b, FY17: Rs.76.1b.

Net Loss: FY18: Rs. 668m; FY17: Rs. 6.4b.

RATING RATIONALE

The assigned ratings take into account the implicit support of Government of Pakistan (GoP) being provided to Zarai Taraqiati Bank Limited (ZTBL). ZTBL plays a pivotal role in the development of agriculture sector of the country since it's the principal financial institution of GoP for the mobilization of agricultural credit. However, the financial risk profile of the bank has been affected by deterioration in asset quality coupled with decline in liquidity indicators. Moreover, decline in investment portfolio was witnessed along with a slight decrease in gross advances portfolio due to lower disbursements, and some erosion in equity base. The profitability has also weakened mainly on account of downward pressure on markup spreads, increase in administration expenses, and higher provision charge against non-performing advances. Given the government's support to the agriculture sector, the bank remains exposed to downward pressure on mark-up rates on advances.

Advances: Gross advances portfolio of the bank decreased slightly on account of considerable reduction in credit disbursement of Rs. 76.3b (FY17: Rs. 97.1b) during FY18. Kissan Dost Scheme (KDS) and Sada Bahar Scheme (SBS) remained the flagship products of the bank with disbursements of Rs. 7.3b and Rs. 41.1b, respectively. The bank has defined per acre loan ceilings for major crops while maintained the overall loan ceiling at Rs. 1.5m. The advances portfolio concentration in Punjab remained largely the same during FY18, which is in line with the highest population and agricultural related activity. Assets quality indicators deteriorated considerably during FY18 partially due to increase in NPLs related to sugarcane and potato crops. Resultantly, gross infection increased to 29.1% by end-FY18 (FY17: 16.6%) and net infection to 26% (FY17: 14.6%).The extended rain spell in Punjab and KPK may result in further NPLs mainly related to wheat crop during FY19. Going forward, the management plans to adopt corrective recovery mechanism; encouraging clients to clear their dues; failure to do so will lead to auction of their properties secured as collateral with the bank and/or encashment of post-dated cheques taken as collateral.

Going forward, the bank intends to launch a loan product to encourage local farming of import substitution products such as soybean seed to diversify its portfolio. Moreover, the bank plans to increase exposure to value-added crops and disburse loans for the establishment of fruits dehydration units in the KPK region. As per the management, e-Credit scheme is working well with 98% recovery rate, and more provinces are expected to join the said scheme in the upcoming budget. ZTBL is also working with the SBP to expand insurance coverage for more loan products to mitigate the losses.

Investments: ZTBL registered a significant reduction in investment portfolio during FY18, mainly on account of divesture in government securities. The investment portfolio mainly consisted of government securities, and hence the overall credit risk emanating from the same is considered minimal. Despite some increase in exposure to PIBs, the interest rate risk arising from PIBs portfolio is still considered manageable as it represents less than 4% of total assets and a weighted average modified duration of 1.06% years. The equity portfolio comprises investment in a blue chip stock, which carries sizeable unrealized surplus. ZTBL also receives regular dividend from the said investment. Going forward, the management plans to maintain the current investment mix with majority investment in risk-free government securities with no additional investment to be made in the stock market.

Profitability: The bank earned a lower markup income on account of a combination of decline in average advances and investment portfolio and an overall decrease in yield on markup bearing assets during FY18.Yield on mark-up bearing assets decreased mainly on account of lower yield on advances. Disbursement proportion of lower yielding KDS and agri e-Credit scheme production loans increased to 60% (FY17:51%) during FY18. The cost of funds stood slightly higher in line with increase in interest rates. Resultantly, markup spreads stood lower at 4.3% (FY17: 5.9%) during FY18.Non-markup based income also decreased mainly owing to lower credit related fee income, an outcome of lower disbursements. Operating expenses increased by 12.2% on a YoY basis. The bank reported a nominal loss before provisions of Rs. 108.5m (FY17: Rs. 5.45b profit before provision). The bank recorded a higher net provision and write-offs of Rs. 3.26b (FY17: Rs. 957.6m) mainly against loans & advances. Resultantly, ZTBL reported a loss before tax of Rs. 3.4b during FY18. Accounting for deferred taxation, the net loss reduced to Rs. 668m during FY18; the bank had incurred a net loss of Rs. 6.4b in FY17 mainly due to occurrence of hefty extraordinary/unusual expense – charged in respect of pension liability.

Liquidity: The liquidity profile of the bank weakened on account of notable decrease in adjusted (against collateral) liquid assets during FY18 mainly with the divestiture of short-term government securities. Resultantly, the liquid assets in relation to adjusted deposits and borrowings decreased to 29% by end-FY18 (FY17: 51%). Total deposit base of the bank stood lower at Rs. 40.4b by end-FY18 (FY17: Rs. 70.5b; FY16: Rs. 59.9b), which is considerably lower than the target of Rs. 71.9b. According to the management, the bank deliberately shed high cost deposit to curtail increasing cost of funds. Resultantly, proportion of fixed and saving deposits decreased to 79% (end-FY17: 85%) by end-FY18. However, the concentration of deposits among top 10 customers decreased slightly to 60% by end-FY18 (FY17: 63%; FY16: 63%), including 21% deposits related to ZTBL pension fund. Until the required granularity in deposits is achieved, the institution requires maintaining a sizeable liquidity cushion. ZTBL commenced Islamic banking operations on December 17, 2018. Islamic banking division is currently operating 5 branches with focus on deposit taking only, as asset side products are under Shariah and regulatory consideration for approval. The bank also plans to open Islamic banking windows at key conventional branches in major cities. The management attained Rs. 42.5 million benchmark in Islamic deposits by end-FY18. The focus on conventional and Islamic retail deposits will bode well for the bank.

Capitalization: The paid-up capital of the bank remained unchanged during FY18. However, total equity base decreased slightly as the bank reported net loss during FY18. With increase in NPLs and decrease in equity base, net NPLs in relation to the bank's Tier-I equity increased significantly to 50.4% by end-FY18 (FY17: 28.7%). The Risk Weighted Assets (RWA) were recorded at Rs.206.2b at end-FY18 (FY17: Rs. 194.5b) as the impact of lower market and operational risks was offset by the elevation of credit risk. Thereby, with a slightly decrease in total eligible capital, the Capital Adequacy Ratio (CAR) of the bank was recorded lower at 36.8% at end-FY18 (FY17: 39.9%), though still considerably higher than the minimum regulatory requirement.

Governance and Digitalization: The BoD at ZTBL consists of four members, of which two members are independent and one is the nominee of the Ministry of Finance. The BoD is non-functional since June'17. The management is currently headed by Mr. Sheikh AmanUllah, who has been serving as the acting President of the bank since October, 2018. Apart from a few changes, the senior management depicted stability.

ZTBL has officially launched 03 ATMs after getting 1-link approval certification and plans to add another 100 by end-FY19. In addition, more than 1,500 ATMs cards have been issued to the bank employees while issuance of the same to customers is expected to begin from June, 2019. The state-of-the-art core banking system (CBS) for conventional, commercial, and Islamic Banking has been approved, and acquisition of CBS along IT security software & hardware infrastructure is expected in the 4th quarter of FY19. The implementation of CBS is expected to be completed within 2 years subsequent to acquisition. In addition, the bank plans to make various enhancements in cDMS, CBAS, and the overall IT network infrastructure during FY19.

Zarai Taraqiati Bank Limited — Annexure I

FINANCIAL SUMMARY *(amounts in PKR billions)*			
BALANCE SHEET	**31-Dec-16**	**31-Dec-17**	**31-Dec-18**
Total Investments	37.1	70.2	28.5
Advances	135.8	140.9	135.7
Balances with other Banks	20.1	18.2	6.9
Cash and bank balances	3.5	4.9	3.8
Operating Fixed Assets	2.1	2.2	2.3
Other Assets	17.0	19.9	25.3
Total Assets	215.6	256.3	202.5
Borrowings	55.9	86.8	65.3
Deposits & other accounts	59.9	70.5	40.4
Other Liabilities	14.2	22.9	22.9
Subordinated Loans	3.2	-	-
Tier-1 Equity	80	72.9	71.6
Net Worth	82.4	76.1	73.9
INCOME STATEMENT	**31-Dec-16**	**31-Dec-17**	**31-Dec-18**
Net Mark-up Income	14.2	14.0	10.4
Net Provisioning/ (reversal)	2	2.9	4.7
Non-Markup Income	4.4	2.5	1.9
Operating Expenses	10.1	11.0	12.3
Profit Before Tax	6.5	-6.1	-3.4
Profit After Tax	3.3	-6.4	-0.7
RATIO ANALYSIS	**31-Dec-16**	**31-Dec-17**	**31-Dec-18**
Gross Infection (%)	15.8%	16.6%	29.1%
Provisioning Coverage (%)	11.2%	14.6%	14.2%
Net Infection (%)	14.3%	14.5%	26.0%
Cost of Funds (%)	5.5%	6.3%	6.5%
Net NPLs to Tier-1 Capital (%)	24.8%	28.7%	50.4%
Capital Adequacy Ratio (C.A.R (%))	46.7%	39.9%	36.8%
Markup Spreads (%)	7.2%	5.9%	4.3%
ROAA (%)	1.6%	-2.7%	-0.3%
Liquid Assets to Deposit & Borrowings (%)	48.9%	50.9%	29.3%

ISSUE/ISSUER RATING SCALE & DEFINITIONS Annexure II

VIS Credit Rating Company Limited

RATING SCALE & DEFINITIONS: ISSUES / ISSUERS

Medium to Long-Term

AAA
Highest credit quality; the risk factors are negligible, being only slightly more than for risk-free Government of Pakistan's debt.

AA+, AA, AA-
High credit quality; Protection factors are strong. Risk is modest but may vary slightly from time to time because of economic conditions.

A+, A, A-
Good credit quality; Protection factors are adequate. Risk factors may vary with possible changes in the economy.

BBB+, BBB, BBB-
Adequate credit quality; Protection factors are reasonable and sufficient. Risk factors are considered variable if changes occur in the economy.

BB+, BB, BB-
Obligations deemed likely to be met. Protection factors are capable of weakening if changes occur in the economy. Overall quality may move up or down frequently within this category.

B+, B, B-
Obligations deemed less likely to be met. Protection factors are capable of fluctuating widely if changes occur in the economy. Overall quality may move up or down frequently within this category or into higher or lower rating grade.

CCC
Considerable uncertainty exists towards meeting the obligations. Protection factors are scarce and risk may be substantial.

CC
A high default risk

C
A very high default risk

D
Defaulted obligations

Short-Term

A-1+
Highest certainty of timely payment; Short-term liquidity, including internal operating factors and /or access to alternative sources of funds, is outstanding and safety is just below risk free Government of Pakistan's short-term obligations.

A-1
High certainty of timely payment; Liquidity factors are excellent and supported by good fundamental protection factors. Risk factors are minor.

A-2
Good certainty of timely payment. Liquidity factors and company fundamentals are sound. Access to capital markets is good. Risk factors are small.

A-3
Satisfactory liquidity and other protection factors qualify entities / issues as to investment grade. Risk factors are larger and subject to more variation. Nevertheless, timely payment is expected.

B
Speculative investment characteristics; Liquidity may not be sufficient to ensure timely payment of obligations.

C
Capacity for timely payment of obligations is doubtful.

Rating Watch: VIS places entities and issues on 'Rating Watch' when it deems that there are conditions present that necessitate re-evaluation of the assigned rating(s). Refer to our 'Criteria for Rating Watch' for details. www.vis.com.pk/images/criteria_watch.pdf

Rating Outlooks: The three outlooks 'Positive', 'Stable' and 'Negative' qualify the potential direction of the assigned rating(s). An outlook is not necessarily a precursor of a rating change. Refer to our 'Criteria for Rating Outlook' for details.www.vis.com.pk/images/criteria_outlook.pdf

(SO) Rating: A suffix (SO) is added to the ratings of 'structured' securities where the servicing of debt and related obligations is backed by some sort of financial assets and/or credit support from a third party to the transaction. The suffix (SO), abbreviated for 'structured obligation', denotes that the rating has been achieved on grounds of the structure backing the transaction that enhanced the credit quality of the securities and not on the basis of the credit quality of the issuing entity alone.

(blr) Rating: A suffix (blr) is added to the ratings of a particular banking facility obtained by the borrower from a financial institution. The suffix (blr), abbreviated for 'bank loan rating' denotes that the rating is based on the credit quality of the entity and security structure of the facility.

'p' Rating: A 'p' rating is assigned to entities, where the management has not requested a rating, however, agrees to provide informational support. A 'p' rating is shown with a 'p' subscript and is publicly disclosed. It is not modified by a plus (+) or a minus (-) sign which indicates relative standing within a rating category. Outlook is not assigned to these ratings. Refer to our 'Policy for Private Ratings' for details. www.vis.com.pk/images/policy_ratings.pdf

'SD' Rating: An 'SD' rating is assigned when VIS believes that the ratee has selectively defaulted on a specific issue or obligation but it will continue to meet its payment obligations on other issues or obligations in a timely manner.

REGULATORY DISCLOSURES Annexure III

Name of Rated Entity	Zarai Taraqiati Bank Limited (ZTBL)
Sector	Specialized Bank
Type of Relationship	Solicited
Purpose of Rating	Entity Rating

Rating History

Rating Date	Medium to Long Term	Short Term	Rating Outlook	Rating Action
RATING TYPE: ENTITY				
26-June-19	AAA	A-1+	Stable	Reaffirmed
28-June-18	AAA	A-1+	Stable	Reaffirmed
20-June-17	AAA	A-1+	Stable	Reaffirmed
16-June-16	AAA	A-1+	Stable	Reaffirmed
18-Jun-15	AAA	A-1+	Stable	Reaffirmed
08-Aug-14	AAA	A-1+	Stable	Upgrade
17-Dec-13	A	A-2	Stable	Initial
30-May-13	-	-	-	Withdrawn
12-July-12	B+	B	Stable	Reaffirmed
05-Apr-12	B+	B	Stable	Reaffirmed
21-Dec-11	B+	B	Rating Watch Developing	Rating Watch Developing
RATING TYPE: GOVERNMENT GUARANTEED OBLIGATIONS				
26-June-19	AAA	A-1+	Stable	Reaffirmed
28-June-18	AAA	A-1+	Stable	Reaffirmed
20-June-17	AAA	A-1+	Stable	Reaffirmed
16-Jun-16	AAA	A-1+	Stable	Reaffirmed
18-Jun-15	AAA	A-1+	Stable	Reaffirmed
17-Dec-13	AAA	A-1+	Stable	Reaffirmed
29-Aug-13	AAA	A-1+	Stable	Reaffirmed
12-July-12	AAA	A-1+	Stable	Reaffirmed
5-Apr-12	AAA	A-1+	Stable	Initial

Instrument Structure	N/A
Statement by the Rating Team	VIS, the analysts involved in the rating process and members of its rating committee do not have any conflict of interest relating to the credit rating(s) mentioned herein. This rating is an opinion on credit quality only and is not a recommendation to buy or sell any securities.
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