RATING REPORT

Zarai Taraqiati Bank Limited

REPORT DATE:
July 02, 2020

RATING ANALYSTS:
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RATING DETAILS				
	Latest Rating		Previous Rating	
Rating Category	Long-term	Short-term	Long-term	Short-term
Entity	AAA	A-1+	AAA	A-1+
Outlook	Stable		Stable	
Date	*Jun 30,'20*		*Jun 26,'19*	

COMPANY INFORMATION	
Incorporated in 2002	**External Auditors:** Horwath Hussain Chaudhary& Co & BDO Ebrahim& Co, Chartered Accountants
Public Limited Company	**Chief Executive Officer:** Mr. Muhammad Shahbaz Jameel
Key Shareholders (with stake 5% or more): State Bank of Pakistan: 76.23% Government of Pakistan:23.75**%**	

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

Zarai Taraqiati Bank Limited

RATING RATIONALE

The ratings assigned to Zarai Taraqiati Bank Limited (ZTBL) take into account the implicit support of Government of Pakistan (GoP) being the sole shareholder of the bank. The ratings incorporate the fundamental role of ZTBL in the overall ecosystem of the country since the bank remains the principal development financial institution used as an agricultural financing arm by GoP. However, the financial risk profile of the bank has been adversely impacted during the outgoing year owing incidence of sizable non-performing loans (npls) leading to substantial equity erosion. The bank's profitability has also been severely affected by increasing provision requirement primary as an outcome of progression of npls to subsequent loss categories. The ratings factor in improvement in liquidity profile and increasing trend in spreads; the latter is a function of change in loan pricing strategy, which now pertains to floating pricing regime as opposed to fixed pricing in previous years.

With the advent of global corona virus pandemic and the following lockdown, the small to medium agri-credit borrowers and especially those in urban areas will have a further reduced capacity of meeting obligations. The ratings take into account SBP's relaxation on repayment terms for borrowers by giving a blanket extension of one year; however, VIS expects that the same will only stagger the infection ratios, which will eventually come forth by end-FY21. Also the liquidity management may pose challenges in the backdrop of collections being reduced due to loans payment deferment and outstanding deposit liability. Going forward, ratings are dependent on meeting recovery targets, improving asset quality indicators, strengthening deposit profile and retaining buffer over regulatory capital requirement.

Advances: ZTBL disbursed Rs. 82.6b duringFY19 as compared to Rs. 76.3b in the preceding year, however the same is still slightly lower than the target of Rs. 86.4b. Although this year around the disbursement surpassed previous year's figures; however, on timeline basis the disbursement targets and the disbursement against the target have declined sizably in the past three consecutive fiscal years. However, given the market share is based on gross outstanding portfolio of the bank, ZTBL's market share in agriculture credit increased to 48% during FY19 as compared to 42% in preceding year. The decline in disbursement made by the bank has been a function of higher incidence of npls as a result of which the management had to revert to the strategy of portfolio consolidation in contrast to portfolio growth. The bank has also fallen short on current year's pro-rata disbursement target; representing a decline of 44% from amount disbursed in the corresponding period last year. The financial impact in the remaining months of FY20 will aggravate drastically as a result of COVID-19 as well as locust attack in southern Punjab and bordering areas of Sindh. Further, loan disbursement activities may also be hit due to hailstorm, heavy rain and flood during monsoon period, which is expected to begin in July'20.

Kissan Dost Scheme (KDS) and Sada Bahar Scheme (SBS) remained the flagship products of the bank. 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 FY19, which is in line with the highest population and agricultural related activity. The average loan size has decreased during FY19 as an outcome of adjustment made by bank to realign borrower's repayment capacity with loan installment. As per the management has focused on disbursement of small ticket size loans resulting in an increase of only 1% in development loans during the outgoing year. Given the bank has fallen short of meeting its target average loan size at end-FY19, it is highly unlikely the management would be able to meet its targets for FY20 given disbursements depict a downward trend from FY19 coupled with significant quantum of non-performing loans booked reflecting lower recovery from outstanding portfolio making cash available for disbursements limited.

Going forward, the bank intends to launch a loan product for 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. In addition, a new scheme namely Kissan Sahulat Scheme (loan against salary) is expected to be launched during the ongoing year. As per the management, e-Credit scheme maintained its effectiveness 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; however the same has suffered delays.

Asset Quality: Total npls of bank soared to Rs. 60.3b by end-FY19 (FY18: Rs. 42.1b) due to slower

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 is headed by Mr. Muhammad Shahbaz Jameel. Mr. Jameel has an extensive experience of over 28 years of working with different financial institutions He has served as various positions including Acting Managing Director/ Group Head at Bank of Kyber and Pak Oman Investment Company and Regional Head-North at UBL.

Financial Snapshot

Total Equity:

FY19:Rs.57.6b, FY18: Rs.73.9b, FY17: Rs.76.1b.

Net Loss: FY19: Rs. 17.6b FY18: Rs. 668m; FY17: Rs. 6.4b.

recoveries and incremental NPLs emanating from the short-term and dairy sector loans. The troublesome increase in NPL's was an outcome of poor client cash flow assessment, complacent monitoring practices and inefficient recovery strategies. As a result on a timeline basis, the asset quality indicators of the bank have worsened severely. Moreover, on account of inability of the bank to recover loans appearing in OAEM category last year, the proportion of NPL's in progressive loss categories has deteriorated during FY19, the same is a key rating concern for VIS. Although as per the management, ZTBL's will be able to recover half of the existing non-performing portfolio given increased focus and resources have been deployed for recovery targets. To expedite recovery, the bank has appointed four provincial chiefs for each province who are solely responsible for loan recoveries both from performing and non-performing portfolio. In addition, to keep a check on NPL's emanating from a particular region, the disbursement to be made in that region is capped at 90% of recovery made from that region. Given the bank is not able to achieve its recovery target, the same incident might result in revision of ZTBL's ratings.

Investments:

ZTBL registered reduction in investment portfolio during the outgoing, mainly on account of divesture in government securities. The investment portfolio is predominantly vested with government securities, hence the overall credit risk emanating from the same is considered minimal. Further, owing to declining interest rate scenario prevalent after the onset of COVID-19, market risk emanating from PIBs portfolio has decreased accordingly and is considered manageable on account of relatively smaller quantum of the same in relation to total assets. 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, in line with conservative investment strategy followed by the bank, the current investment mix with majority investment in risk-free government securities with no additional investment to be made in the stock market is to be retained. In addition, the bank considers investment in shares of Nestle as a strategic investment with no immediate plan on liquidating the same; however if the situation in terms of liquidity position becomes critical going forward, ZTBL can liquidate the share to alleviate pressure on liquidity.

Liquidity: The liquidity position of the bank has improved during FY19 largely on account of excess liquidity being parked in deposit accounts with different commercial banks. With substantial increase in balances with banks, the collateral adjusted liquid assets increased at end-FY19. Resultantly, liquid assets in relation to collateral adjusted deposits and borrowings increased to 41% by end-FY19 (FY18: 29%). Given pressure on profitability indicators owing to higher incidence of NPLs, the management plans to keep the bank afloat and comfortable in terms of liquidity position with majority excess balances kept in liquid avenues. In addition, owing to lower loan disbursements made during FY19 coupled with same trend being replicated in the current year on account of increased focus on recovery and ongoing pandemic, the liquidity position of the bank is expected to remain adequate going forward. However, the impact of the same on the spreads of the institution is yet to be ascertained.

Total deposit base of the bank stood higher at Rs. 46.0b at end-FY19 (FY18: Rs. 40.4b), which is in sync with the target set for FY19. The largest increase was manifested in term deposits, given owing to higher profit offered the procurement of fixed deposits is relatively easier compared to growth in current and saving accounts (CASA) for which commercial banks are preferred by customers in line with variety of online national and international services rendered. The deposit mix by customer type titled even further towards contribution of corporate customers as the proportion of retail deposits reduced considerably during FY19 as compared to preceding year. Subsequently, share of corporate deposits stood higher. On the other hand, the concentration of deposits among top 10 customers decreased considerably to 40% by end-FY19 (FY18: 60%), including 19% (FY18: 21%) deposits related to ZTBL pension fund. The concentration risk has improved in a timeline basis but still depicts room for improvement. However, overall the concentration risk is manageable given top deposits seem sticky in nature as depicted by largely stable concentration ratio. Further, the management had planned to convert another five branches from convectional to Islamic during FY19; however, the same could not be put into action. In addition, the target to build a portfolio of Rs. 1.0b Islamic deposits could not be achieved as ZTBL reaped a deposit of Rs. 380m at end-FY19. The bank also plans to open Islamic banking windows at key conventional branches in major cities. The focus on conventional and Islamic retail deposits will bode well for the bank.

Profitability: Despite increase in markup spreads and no exponential increase in operating expenses; the profitability of the bank dipped to a critical level primarily as an outcome of significant provisioning expense booked against non-performing loans during FY19. ZTBL's profitability took a sharp hit with the bank's net loss amounting to Rs. 17.6b during FY19 as compared to loss of Rs. 668m in the previous year.

Further, the quantum decline in the advances portfolio also contributed to reduced revenue generation. In line with the decline in the average advances and investment portfolio, ZTBL markup income was reported lower during FY19 as compared to preceding year. However, markup expense exhibited increase on account of increased composition of high cost term deposits in the deposit mix, the combined impact of both resulted in considerably lower net markup income of Rs. 8.6b (FY18: Rs. 10.4b). The yield on the advances portfolio increased in line with change in the pricing strategy of the bank; initially ZTBL followed fixed pricing for its entire portfolio however from FY19 onwards the pricing is pegged with 6M-Kibor + 5% for the complete product range. The change has positively reflected on yield on advances owing to prevalent high market interest rate scenario. In addition, the improvement in yield on advances and in return on spreads has been more profound on account of majority of ZTBL's borrowings, around two-thirds of total, having fixed interest cost of 7.5%. However, despite increase in markup yield on advances by almost 200bps, markup earned on advances decreased as a result of reduction in portfolio size.

Capitalization: The paid-up capital of the bank remained unchanged during FY18. However, total equity base decreased significantly as the bank incurred sizable loss during FY19. With the decrease in Tier-I equity, net NPLs in relation to the bank's Tier-I equity increased noticeably to 59.1% by end-FY19 (FY18: 50.4%). The considerable equity erosion during the outgoing year has weakened the risk profile of the bank; the same remains a key rating sensitivity. The management needs to stringently monitor and rescue the infection ratios going forward, given if the same trend continues in the medium term. The Risk Weighted Assets (RWA) stood lower as the impact of lower credit risk related assets; meanwhile, total eligible capital of the bank was reported lower. Resultantly, the Capital Adequacy Ratio (CAR) decreased to 35.3% by end-FY19 (FY18: 36.8%), though still is considerably higher than the minimum regulatory requirement. CAR represents room for growth; however the rectification of asset quality indicators is a pre-requisite for the same.

Governance and Digitalization: The BoD is non-functional since June'17, as per the management, after finalization of Fiscal Budget FY20-21; GOP's committee looking into the issue of ZTBL's Board formulation will finalize the board composition. Apart from a few changes, the senior management depicted stability. During FY19, a change in the scope involved complete digitalization of Credit Administration Department as a result of which all information pertaining to loan approval, sanctioning and monitoring is available at click of the button. The same is likely to improve loan turnaround time along with a meticulous check on incremental disbursement of loan over and above customer's requirement and credit repayment capacity. The change is expected to assist in bringing the infection ratios in line.

The bank established disaster recovery facility and a call center during FY19. ZTBL has expended its ATM footprint to 42 branches along with issuance of over 2500 Pay Pak debit cards. In addition, compliance with enterprise governance and risk management framework was achieved through hiring of consultants along with system integration made with Punjab Land Revenue Authority. Moreover, on the IT front, ZTBL has introduced policies and strategies to counter anti-money laundering and to combat terrorist financing. Further, on account of integration with NADRA through biometric verification of customers on real time basis, ZTBL has improved its KYC guidelines and implementation. 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 to be procured in FY20; meanwhile the implementation of CBS is expected to be completed within the next 2 years.

ZaraiTaraqiati Bank LimitedAnnexure I

FINANCIAL SUMMARY *(amounts in PKR billions)*				
BALANCE SHEET	**31-Dec-16**	**31-Dec-17**	**31-Dec-18**	**31-Dec-19**
Total Investments	37.1	70.2	28.5	24.1
Advances	135.8	140.9	135.7	109.7
Balances with other Banks	20.1	18.2	6.9	30.1
Cash and bank balances	3.5	4.9	3.8	2.4
Operating Fixed Assets	2.1	2.2	2.3	2.7
Other Assets	17.0	19.9	25.3	30.7
Total Assets	215.6	256.3	202.5	199.9
Borrowings	55.9	86.8	65.3	72.5
Deposits & other accounts	59.9	70.5	40.4	46.0
Other Liabilities	14.2	22.9	22.9	23.8
Subordinated Loans	3.2	-	-	-
Tier-1 Equity	80	72.9	71.6	55.5
Paid Up Capital	13	53	53	53
Net Worth	82.4	76.1	73.9	57.6
INCOME STATEMENT	**31-Dec-16**	**31-Dec-17**	**31-Dec-18**	**31-Dec-19**
Net Mark-up Income	14.2	14.0	10.4	8.6
Net Provisioning/ (reversal)	2	2.9	4.7	25.3
Non-Markup Income	4.4	2.5	1.9	1.8
Operating Expenses	10.1	11.0	12.3	12.7
Profit Before Tax	6.5	-6.1	-3.4	-26.3
Profit After Tax	3.3	-6.4	-0.7	-17.6
RATIO ANALYSIS	**31-Dec-16**	**31-Dec-17**	**31-Dec-18**	**31-Dec-19**
Gross Infection (%)	15.8%	16.6%	29.1%	43.00%
Provisioning Coverage (%)	11.2%	14.6%	14.2%	45.60%
Net Infection (%)	14.3%	14.5%	26.0%	29.10%
Cost of Funds (%)	5.5%	6.3%	6.5%	8.73%
Net NPLs to Tier-1 Capital (%)	24.8%	28.7%	50.4%	59.10%
Capital Adequacy Ratio (C.A.R (%))	46.7%	39.9%	36.8%	35.29%
Markup Spreads (%)	7.2%	5.9%	4.3%	4.99%
ROAA (%)	1.6%	-2.7%	-0.3%	-
Liquid Assets to Deposit & Borrowings (%)	48.9%	50.9%	29.3%	41.40%

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				
30-June-20	AAA	A-1+	Stable	Reaffirmed
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.
Probability of Default	VIS' ratings opinions express ordinal ranking of risk, from strongest to weakest, within a universe of credit risk. Ratings are not intended as guarantees of credit quality or as exact measures of the probability that a particular issuer or particular debt issue will default.
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Due Diligence Meetings Conducted

Name	Designation	Date
Muhammad Shahbaz Jameel	CEO	11th June'20

	Muhammad Arif	CFO	11thJune'20
	Muhammad Hafeez	Chief Credit and Risk	11thJune'20
	Waqas Ahmad	Division Head Finance	11thJune'20