RATING REPORT

Zarai Taraqiati Bank Limited

REPORT DATE:
June 30, 2021

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	Rating Watch-Developing		Stable	
Rating Date	*Jun 30,'21*		*Jun 30,'20*	

COMPANY INFORMATION

Incorporated in 2002	**External Auditors:** Crowe Hussain Chaudhary & Co Chartered Accountants
Public Limited Company	**Chairman of the Board:** Mr. Nadeem Lodhi
Key Shareholders (with stake 5% or more)	**Chief Executive Officer:** Mr. Muhammad Shahbaz Jameel
State Bank of Pakistan: 76.23% Government of Pakistan: 23.75%	

APPLICABLE METHODOLOGY(IES)

VIS Entity Rating Criteria: Government Supported Entities (July 2020); 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 Chairman

Mr. Nadeem Lodhi was appointed as Chairman of the Board in Dec'20 by Government of Pakistan. Mr. Lodhi has more than three decades of experience as emerging markets banker. He has served as Managing Director at ANZ Gindlays Bank P.I.C, Abraj Capital and DIB Capital Ltd. He also held positions of Citi Country Officer at Citi Bank, Uganda; Business & Governance Head at Citi Bank, Afghanistan; and as Citi Country Officer & Corporate Bank Head at Citi Bank, Pakistan).

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 at various positions including Acting Managing Director / Group Head at The Bank of Khyber and Pak Oman Investment Company and Regional Head-North at HBL.

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 the GoP. Gross loan portfolio has been depleting on a timeline basis on account of lower disbursements vis-à-vis recoveries. The bank's risk profile on a standalone basis has remained dismal given high infection ratios. Performance has remained weak for the last three years mainly on account of decreasing trend in net mark-up income and incidence of provision against infected portfolio. Liquidity has remained adequate with higher investments in liquid government securities. Capital Adequacy Ratio has remained sound at 30.4% (FY19: 30%). Regular Board of Directors (BoD) meetings have started recently after a gap of almost four years which is considered a positive development.

The management is projecting relatively better performance in the ongoing year. Meanwhile, improvement in recoveries due to various measures taken and curtailment of Non-Performing Loans (NPLs) on back of centralizing the loan approval system is expected to augur well for the bank. Amount received from GoP against fiscal package for markup subsidy also provides some comfort. Amount of loans rescheduled under the SBP Covid relief scheme as proportion of net advance portfolio was 2.6%, the same is expected to have controlled impact on asset quality over the rating horizon. Going forward, ratings would remain dependent on meeting recovery targets, improving asset quality indicators and strengthening deposit base. Meanwhile, ZTBL is in the process of seeking clarity from Ministry of Finance (MoF) regarding current applicability of Section 5(4) of the Bank Nationalization Act 1974 (BNA) providing government guarantee to its depositors, given that ZTBL is a member institution of Deposit Protection Corporation (DPC). Rating would be reevaluated upon receiving further clarity on the matter from MoF.

Advances: The bank fell short of the disbursement target of Rs. 86 b and disbursed Rs. 62.1b (FY19: Rs. 82.6b) during FY20. Disbursements were lower mainly on account of conservative strategy adopted by the bank amid pandemic to curb already high infection ratios and also due to transition from decentralized to centralized loan approval system. Disbursements were also affected from locust attack in southern Punjab and bordering areas of Sindh and hailstorm, and heavy rains during monsoon period. Market share of the bank also decreased to 38% by end-FY20 vis-à-vis 42% in the preceding year mainly on account of decease in outstanding gross loan portfolio to Rs. 129.9b (FY19: Rs. 140.2b) by end-FY20. In the backdrop of high infection, the Agricultural Credit Advisory Committee (ACAC) has set a lower disbursement target of Rs. 71.0b for ZTBL for the ongoing year, against which the bank has disbursed Rs. 18.5b in 1QFY21.

Loan portfolio mix remained largely unchanged as production loans accounted for 76% (FY19: 73%) of the total disbursements in FY20 whereas the rest constituted development loans. Sada Bahar Scheme (SBS) remained the flagship product of the bank. The bank rescheduled loans amounting Rs. 2.7b under the relief provided by the SBP regarding Covid-19 during FY20. In order to curtail the impact of pandemic and facilitate borrowers, the GoP approved allocation of markup subsidy amounting to Rs. 6.8b specified to ZTBL effective from July 01, 2020. Under this relief package, new and existing regular borrowers with landholdings up to 12.5 acres are eligible for markup subsidy at the rate of 10% valid up till June 30, 2021. Markup subsidy of around Rs. 5b has been availed by over one hundred thousand borrowers as of now. Certain borrowers did not opt for rescheduling of their loans to remain regular in order to avail the said initiative.

The portfolio concentration in Punjab remained largely the same during FY20, which is in line with the highest population and agricultural related activity. During the ongoing year, the bank plans to increase proportion of development loans with higher focus on regions other than Punjab. For this purpose, the bank has also launched new financing product to facilitate the farming community in GB for "Establishment of Agri Tourist Outlet/Orchard" where tourist may purchase agricultural produce of farmers thereby eliminating the role of intermediaries. The bank has also launched five Green Banking Products under 'Green Banking Guidelines of SBP' and 'Green Banking Policy of ZTBL'. A financing scheme for 'Dairy Value Chain' has also been initiated in Mar'21 to provide credit to dairy farming community. Each of these schemes have maximum financing limit upto Rs. 1.5m per borrower/party. Two other schemes are in the pipeline namely Kissan Khushhal Scheme and financing for Agri Land Development through

Alternate/Renewable Energy. The above mentioned products may require time to make significant inroads in the bank's portfolio.

Asset Quality: Total NPLs of the bank stood slightly lower at Rs. 59.2b (FY19: Rs. 60.3b) on account of regularization of some accounts. Incremental NPLs were mainly an outcome of economic slowdown impacting the repayment capacity of borrowers along with locust attack, heavy rains and white fly attacks on cotton crop which adversely impacted farmers' earnings. In Sindh province, most of the branches of four major zones were declared under calamity. The management largely met recovery target of Rs. 30b for NPLs during the outgoing year. Despite slight decrease in NPLs, gross infection increased to 45.6% (FY19: 43.0%) by end-FY20 due to lower gross advances portfolio. Net infection also increased to 33.1% (FY19: 29.1%) with lower provisioning charge against NPLs. As per management, infection ratios are expected to improve going forward with centralization of loan approval system and enhanced digitization, resulting in prudent lending, transparency and better controls. Involvement of senior executives with field staff to expedite recoveries would also bode well to curb infection.

Investments: Net investments of the bank increased to Rs. 39.8b (FY19: Rs. 24.1b) by end-FY20; the increase was mainly manifested in Pakistan Investment Bonds (PIBs) which accounted for nearly two-third of the total investments. The proportion of government securities in overall investment portfolio increased to 85% (FY19: 72%) by end-FY20. The credit risk emanating from investment portfolio is considered low. Given around 45% of the PIBs are floating rate, market risk arising from the same is also considered low. However, fixed rate PIBs having weighted average maturity of 3 years exposes the bank to relatively higher interest rate risk. The equity portfolio comprises investment in a blue chip stock, which carries sizeable unrealized surplus; the bank also receives regular dividend from the said investment. Investment portfolio augmented further to Rs. 53.1b by end-1QFY21; the increase was manifested in market T-bills. Meanwhile, mark to market deficit on government securities has increased to Rs. 447m (FY20: Rs. 195m) by end-1QFY21 primarily due to higher deficit on PIBs. Going forward, in line with conservative investment strategy, the bank plans to largely maintain the current investment mix.

Liquidity: Liquidity position of the bank has improved slightly as reflected by higher liquid assets to total deposits and borrowing ratio to 44.0% (FY19: 41.4%) by end-FY20. Total deposit increased to Rs. 49.2b (FY19: Rs. 46.0b) to end-FY20. The increase was largely manifested in current and saving accounts, the proportion of which in total deposit mix increased to 30% (FY19: 26%). Meanwhile, the proportion of corporate deposits contributed three-fourth to the total deposit. The concentration of deposits increased notably as top 10 depositors accounted for 63% (FY19: 40%) of total deposit base by end-FY20. However, the concentration risk is considered manageable given 31% (FY19: 19%) of the deposits pertained to ZTBL Pension Fund. Moreover, majority of other large deposits have exhibited stickiness over time. Around two-third of funding (excluding deposits) comprised redeemable preference shares issued to SBP carrying a fixed rate of 7.5% while the rest constituted repo borrowings, secured against market T-bills and PIBs.

Profitability: Profitability has remained dismal for the last few years mainly on account of decreasing trend in net mark-up income and incidence of provision against infected portfolio. The bank has sustained its topline during the outgoing year, despite decreasing trend in business volumes, mainly on back of higher investment income. Overall markup yield on interest bearing assets decreased owing to lower markup rates. Cost of funds also decreased with lower interest rates on deposits and borrowings, except for fixed rate SBP redeemable preference shares. Resultantly, markup spread was largely sustained in the outgoing year. Despite lower net mark-up and fee based income, the bank recorded lower net loss of Rs. 2.5b (FY19: Rs. 17.6b) on account of lower net provisioning charge and decrease in operating expenses, an outcome of rationalization of employee related expenses and strict cost control measures.

Capitalization: The paid-up capital of the bank remained unchanged during FY20. Total equity base has been depleting on account of continuing losses. Net NPLs in relation to Tier-I equity increased to 63.7% (FY19: 59.1%) by end-FY20. Total eligible capital of the bank was reported lower at end-FY20. The Risk Weighted Assets (RWA) stood lower primarily due to lower operational risk assets along with some decrease in credit risk and market risk related assets. Resultantly, the Capital Adequacy Ratio (CAR) increased slightly to 30.40% (FY19: 30.01%) by end-FY20, that is considerably higher than the minimum regulatory requirement of 11.50% (FY19: 12.50%).

Governance and Digitization: Seven-member Board of Directors (BoD) including three ex-officio members has been formed in Dec'20. The board had been non-functional since June'17. Meeting of the BoD was held on April 7, 2021. Meanwhile, the bank filled some vacant management positions during FY20 thereby terminating additional monetary benefits admissible to executives' having acting or dual charge.

M/s Ernst & Young has been appointed in FY20 as HR consultant to recommend a new organizational chart along with market-based compensation package to attract quality staff.

During the review period, loan approval system was completely centralized at the Head Office (HO) level, effective from Mar'20. Loan sanctioning methodology has been revised by establishing an E-Sanctioning system and Central Loan Sanctioning Department (CLSD) at the HO under the administration of Enterprise Risk Management Division (ERMD). CAD is also planned to be centralized by end-1QFY22. Acquisition of Core Banking System (CBS) is in process; full implementation of CBS is planned to be achieved by FY22. ZTBL has also launched Deposit Protection Mechanism for its depositors as per the directives of SBP. The Pool Management System has been deployed in production in June, 2020 which would help in enhancing operational efficiency of the CBAS. Moreover, on the IT front, ZTBL has taken various initiatives which include the development of Sanction Compliance Management System which has the ability to freeze/defreeze account of absconders who were found in ATA (Anti-Terrorism Act) block list and Transaction Monitoring System (TMS) was developed in which alerts are generated at different points of transactions in case of some unusual activity. In order to reduce error and comply with FATF, the process of account opening was centralized during the year.

Zarai Taraqiati Bank Limited Annexure I

FINANCIAL SUMMARY				*(amounts in PKR billions)*
BALANCE SHEET	**31-Dec-18**	**31-Dec-19**	**31-Dec-20**	**31-Mar-21**
Total Investments	28.5	24.1	39.8	53.1
Advances	135.7	109.7	102.7	95.2
Balances with other Banks	6.9	30.1	19.4	16.9
Cash and bank balances	3.8	2.4	2.7	1.8
Lending to Financial Institutions	-	-	11.0	17.7
Operating Fixed Assets	2.3	2.7	2.8	2.7
Deferred Tax Assets		13.0	13.3	15.1
Other Assets	25.3	17.8	19.0	18.4
Total Assets	202.5	199.9	210.7	220.8
Borrowings	65.3	72.5	81.2	95.1
Deposits & other accounts	40.4	46.0	49.2	49.9
Other Liabilities	22.9	23.8	23.2	21.6
Subordinated Loans	-	-	-	-
Tier-1 Equity	71.6	55.5	55.0	52.5
Paid Up Capital	52.7	52.7	52.7	52.7
Net Worth	73.9	57.6	56.7	53.8
INCOME STATEMENT	**31-Dec-18**	**31-Dec-19**	**31-Dec-20**	**31-Mar-21**
Net Mark-up Income	10.4	8.6	8.3	3.0
Net Provisioning/ (reversal)	4.7	25.3	1.3	4.7
Non-Markup Income	1.9	1.8	1.3	0.3
Operating Expenses	12.3	12.7	11.5	2.7
Profit Before Tax	-3.4	-26.3	-3.2	-4.0
Profit After Tax	-0.7	-17.6	-2.5	-2.5
RATIO ANALYSIS	**31-Dec-18**	**31-Dec-19**	**31-Dec-20**	**31-Mar-21**
Gross Infection (%)	29.1%	43.0%	45.6%	40.1%
Provisioning Coverage (%)	14.2%	45.6%	40.9%	47.6%
Net Infection (%)	26.0%	29.1%	33.1%	26.0%
Cost of Funds (%)	6.5%	8.7%	8.4%	N/A
Net NPLs to Tier-1 Capital (%)	50.4%	59.1%	63.7%	48.5%
Capital Adequacy Ratio (CAR (%))	36.8%	30.0%	30.4%	N/A
Markup Spreads (%)	4.3%	4.99%	4.88%	N/A
ROAA (%)	-	-	-	-
Liquid Assets to Deposit & Borrowings (%)	29.3%	41.4%	44.0%	48.5%

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 Ratings
Rating History	

Rating Date	Medium to Long Term	Short Term	Rating Outlook	Rating Action
RATING TYPE: ENTITY				
30-June-21	AAA	A-1+	Rating Watch Developing	Maintained
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

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
Mr. Muhammad Arif	CFO	4th May'21
Mr. Arshad Hassan Awan	Head Credit Division	4th May'21
Mr. Qasim Mehmood Chishti	Head Enterprise Risk Management Division	4th May'21
Rana Mujahid Ali Khan	Head Recovery & SAM Division	4th May'21
Mr. Waqas Ahmad	Head Internal audit & Inspection Division	4th May'21
Mr. Amir Zafar	Group Head IS Division, Digital Banking Division & Service Division.	4th May'21