RATING REPORT

National Bank of Pakistan

REPORT DATE:
July 6, 2020

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+
Rating Outlook	Stable		Stable	
Rating Date	*June 29, 2020*		*June 30, 2019*	

COMPANY INFORMATION

Incorporated in 1949	**External auditors:** Deloitte Yousuf Adil Chartered Accountants and Grant Thornton Anjum Rahman Chartered Accountants
Public Limited Company	**Chairman of the Board:** Mr. Zubyr Soomro
Key Shareholders (with stake 5% or more):	**President:** Mr. Arif Usmani
State Bank of Pakistan – 75.2%	
Foreign Companies – 9.6%	

APPLICABLE METHODOLOGY(IES)

Commercial Banks Methodology – March 2018
https://s3-us-west-2.amazonaws.com/backupsqlvis/docs/Meth-CommercialBanks201803.pdf

National Bank of Pakistan

OVERVIEW OF THE INSTITUTION

Incorporated in Pakistan under the National Bank of Pakistan Ordinance, 1949, National Bank of Pakistan (NBP) is the largest public sector bank in the country. Shares of the bank are listed and traded on Pakistan Stock Exchange (PSX).

Profile of CEO

Mr. Usmani is a seasoned professional with over 35 years of professional experience encompassing financial institutions in various geographical locations. Prior to joining NBP, he served as CEO at CitiBank Pakistan.

RATING RATIONALE

Industry Update

As a result of the novel coronavirus outbreak, both macro and micro financial stability indicators have been impacted. Pakistan's economy, which was already undergoing a phase of adjustment, has been dented by the resultant intermittent lockdowns and depressed economic activity. As of the date of this report, with new virus cases touching new peaks, the pandemic may stretch into Q2'2021, when potentially an effective vaccine is expected to be developed.

In view of weak macroeconomic environment, credit risk across the sector is considered to be heightened, beyond pre-coronavirus credit risk levels, which were more aligned with usual macroeconomic cycle-based volatility. Accordingly, there is a credit risk driven downward pressure on all bank ratings. SBP, in an effort to promote financial stability, ensure continued credit supply to the economy and to maintain confidence in the banking system, has taken certain measures, which include allowance to defer principal payments for up to a year, while also allowing other clients facing major liquidity constraints, a full restructuring of their existing loan facilities; the policy rate has been reduced by 625 basis points to 7% (Dec'19: 13.25%); capital conservation buffer (CCB) has been waived by 100 basis points to 1.5%; for SMEs, the regulatory limit for extension of credit has been increased to Rs. 180m (up 44%) and allowed debt burden ratio for consumer loans has been enhanced from 50% to 60%.

These measures are expected to provide short-term relief to counterparties, with several of them facing liquidity constraints. Nevertheless, at the same time, these will also delay the materialization of increased credit risk level on asset impairment ratios. The waiver in CCB should allow the banks additional room to meet financing requirements of liquidity-strained counterparties. - The adverse credit risk environment – on account of the COVID-19 outbreak – is expected to translate in increased provisioning burden. VIS expects differences between banks in the way they book provisioning charges against expected NPLs. Banks that have strong profitability profile and capitalization indicators are expected to start booking provisions (in the form of general provisions) in the ongoing year while other smaller banks will undertake provisions as they fall due as per regulatory requirement starting from last quarter of 2021.

Collectively, sector financial risk indicators have significantly strengthened since the last financial crises of 2008. In terms of capitalization, the industry boasts a CAR of 17%, ADR of 51% and about 50% of the asset base is liquid (Mar'20). These ratios are indicative of strong loss absorption buffers, while the excess liquidity available with the banks should allow them navigate through the crises.

While impact on profitability will vary across industry, overall profitability indicators for 2021 are expected to be impacted by the followings; i) So far, the interest rate has already dropped by 625 basis points; this sharp drop in interest rates and narrowing of the interest rate corridor is expected to negatively affect banking spread. A review of historical banking spread in low interest regime indicates that spread shrinkage is likely going to be ~50 basis points. However, in the near term (Q2 & Q3), the spreads may post short term improvement, as a result of faster re-pricing on liabilities vis-à-vis assets. This short-term spread improvement will likely keep the spreads intact for the ongoing year; ii) higher provisioning iii) in view of the reduced economic activity and lower trade volumes, fee-related income and overall ancillary income will shrink. This, along with projected spread shrinkage, will likely have an adverse impact on efficiency ratios across the industry; SBP maintains its deadline for IFRS 9 implementation at January 1 2021, with deadline for pro-forma accounts preparation being Oct'20; full provisioning impact of this is expected to be sizable.

In 2019, continuous tightening of monetary policy with rising interest rate and weakening in currency resulted in sluggish lending growth in the banking industry. While asset quality indicators remain sound, exposure of the banking sector to credit risk remains heightened.

Owing to the macroeconomic dynamics, NBP also adopted a conservative lending stance and registered a growth of ~9% in gross financing portfolio. Nevertheless, the same stood higher vis-à-vis industry growth of ~3%. Gross loan portfolio of the bank increased steadily from Rs. 1,059.5b at end-2018 to Rs. 1,151.3b at end-2019. Of total advances, a large chunk of the bank constitutes private credit while the remaining belongs to the public sector. Credit risk on advances is considered manageable given a significant proportion of around one-third is maintained in the public sector, on a timeline basis. Domestic advances have been maintained at almost 91% of total gross advances given modest growth in the international portfolio. Growth in domestic advances outpaced the industry growth resulting in a market share in terms of domestic advances increased to 12.9% (2018: 12.3%), at end-December 2019. Furthermore, management plans to consolidate its international operations by closing loss making branches which are creating a drag on the bank's overall profitability. The Board has decided on the closure of about one third of these operations with another one third targeted for review within the ongoing year.

Given the impact of COVID 19 on various industries, the management is targeting cautious growth in gross advances for the year 2020. Achievement of the same depends upon duration and breadth of the pandemic. Going forward, management also anticipates a consolidation approach towards lending in order to keep infection levels at manageable levels. Asset quality indicators remain sound while provisioning coverage has been consistently maintained on the higher side. However, exposure of the banking sector to credit risk remains heightened. Regulatory relief measures undertaken by SBP to promote financial stability, support businesses, ensure continued credit supply to the economy and maintain confidence in the financial system have been received positively and are expected to delay the impact of prevailing headwinds on portfolio asset quality indicators. Our credit impairment expectations are conservative, albeit there is a probability of deviation from expectations; downside risk is elevated, amidst an uncertain economic environment.

Credit and market risk emanating from investment portfolio is considered manageable.

Investment portfolio of the bank increased to Rs. 1.4tr (2018: Rs. 1.3tr) at end-December 2019. Growth in investment portfolio was largely tilted towards building its long term government paper, during 2019. Investment mix witnessed a shift towards PIBs in view of the expectation that rates have peaked out during the year. While T-bills portfolio of the bank declined to Rs. 735.9b (2018: Rs. 742.0b), quantum of PIBs increased to Rs. 514.3b (2018: Rs. 354.9b) at end-2019. The bank also holds exposure in GoP foreign currency bonds amounting to Rs. 26.6b along with GoP Ijarah Sukuk of Rs. 2.0b (2018: Rs. 9.7b) at end-2019. Credit risk emanating from the portfolio is considered low as majority of investments are deployed in government securities including international sovereign securities.

Liquidity profile is considered healthy as evident from its cost effective & strong retail deposit mix. Significant liquidity buffer carried on the balance sheet also supports assessment of liquidity profile of the Bank.

Total deposit base of the bank witnessed an increase to Rs. 2.2tr (2018: Rs. 2.0tr) at end-2019 with the growth emanating from both domestic and international businesses. Core focus of the bank entailed a strategy of growing low cost deposits. Current account mix (excluding deposits from FIs) of the bank stands at 39% (2017: 33%) and CASA increased to 81.8% (2018: 81.5%) at end-2019. Domestic deposit base grew at a modest pace in comparison to average industry growth, given that market share of NBP in domestic deposits was 14.4% (2018: 15.0%) at end-2019. Overseas deposit base of the bank were reported lower at Rs. 85.5b at end-2019. Liquidity profile of the bank is supported by the presence of sizeable liquid assets in relation to deposits and borrowings. Proportion of liquid assets in relation to deposits and borrowings (adjusted for repo borrowings) stood at 67.4% (2018: 65.8%) at end-2019. Furthermore, adequate liquidity is available through Liquidity Coverage Ratio and Net Stable Funding Ratio over the regulatory requirements as the same amounted to 148% and 233% at end-2019, respectively vis-à-vis regulatory requirement of 100% for each.
VIS expects liquidity pressures, if any, emanating from deferment/extension in principal as per SBP relaxation scheme to be limited given the strong liquidity buffers in place.

National Bank of Pakistan Appendix I

National Bank Of Pakistan				
(Amounts in Rs. m)	**2016**	**2017**	**2018**	**2019**
Total Assets	2,008,855	2,505,321	2,798,566	3,124,389
Growth	16.00%	25.00%	12.00%	11.60%
Gross Advances	781,476	856,938	926,007	1,151,315
Growth	13.00%	10.00%	8.00%	8.70%
Market Share - Advances (Domestic Only)	13.00%	12.00%	12.00%	12.90%
Total Investments	897,131	1,295,720	1,284,319	1,439,160
PIBs (at market value)	317,458	305,666	354,943	514,283
PIBs as a % of Deposits	19.00%	18.00%	18.00%	23.40%
PIBs as a % of Total Investments	35.00%	24.00%	28.00%	35.70%
Asset Quality				
NPLs	119,416	120,797	133,360	148,752
Gross Infection	15.00%	14.00%	14.00%	12.90%
Specific Provisioning Coverage	92.00%	92.00%	95.00%	90.20%
Total Provisioning Coverage	96.00%	97.00%	100.00%	90.20%
Net Infection	2.00%	1.00%	1.00%	1.40%
Funding & Liquidity				
Deposits	1,657,312	1,727,102	2,011,385	2,198,049
Growth	16.00%	4.00%	16.50%	9.30%
Market Share - Domestic Deposits	14.00%	13.00%	15.00%	14.40%
Current Account % (CA)	31.00%	33.00%	39.00%	40.20%
Current Account Savings Account % (CASA)	74.00%	77.00%	81.50%	81.80%
Gross Advances to Deposit Ratio	47.00%	50.00%	46.00%	52.40%
Cost of Deposits	4.00%	4.00%	4.00%	6.30%
Cost of Funding	4.00%	3.90%	5.00%	7.50%
LCR		170.00%	169.00%	147.60%
NSFR		365.00%	321.00%	233.20%
Liquid Assets to Total Deposits & Borrowings	64.00%	59.00%	50.00%	67.40%
Capitalization				
Paid-up Capital	21,275	21,275	21,275	21,275
Tier-1 Equity	95,540	101,303	124,818	162,370
Shareholder's Equity	120,015	125,693	146,882	232,614
Revaluation Surplus on Investments	56,718	49,689	59,986	70,244
Net NPLs to Tier 1 capital	10.00%	9.00%	5.00%	9.00%

Tier-1 CAR	12.00%	12.00%	12.00%	12.10%
CAR	17.00%	16.00%	16.00%	15.50%
Leverage	4.00%	3.00%	3.00%	3.40%
Total Shareholders' Equity/ Total Assets	6.00%	5.00%	5.00%	7.40%
Profitability Indicators				
Net Interest Income	54,824	54,253	60,666	71,907
Return on Earning Assets	8.00%	7.00%	6.00%	10.80%
Spreads	4.00%	2.70%	2.40%	3.30%
Administrative Expenses	46,943	48,225	55,687	65,705
Efficiency	63.00%	63.00%	62.00%	65.60%
Overheads	3.00%	2.00%	2.00%	2.20%
ROAA	1.00%	1.00%	1.00%	0.50%
ROAE	19.00%	19.00%	14.00%	7.20%
Operating Profit / (Loss)	27,893	28,875	34,608	34,522
Profit/ (loss) after Tax	22,752	23,028	20,015	15,810
Other Indicators				
Staff Strength (including outsourced)	15,793	16,590	16,876	15,188
Branches	1,469	1,519	1,525	1,530
Employee related costs	31,430	31,043	37,270	45,285
Per branch deposit	1,128	1,137	1,189	1,437
Per employee cost	2	2	2.2	3
Employees per branch	11	10	10	10
Industry Deposits	11,202,886	12,361,806	13,353,916	14,631,875
Industry Advances	5,571,985	6,529,968	7,888,024	8,157,816

ISSUE/ISSUER RATING SCALE & DEFINITIONS Appendix II

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: JCR-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.jcrvis.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.jcrvis.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.

'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.jcrvis.com.pk/images/policy_ratings.pdf

'SD' Rating: An 'SD' rating is assigned when JCR-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 — Appendix III

Name of Rated Entity	National Bank of Pakistan
Sector	Public Sector Banks
Type of Relationship	Solicited
Purpose of Rating	Entity Rating
Rating History	See table below
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	See table below

Rating History

Rating Date	Medium to Long Term	Short Term	Rating Outlook	Rating Action
RATING TYPE: ENTITY				
29-Jun-20	AAA	A-1+	Stable	Reaffirmed
28-Jun-19	AAA	A-1+	Stable	Reaffirmed
29-Jun-18	AAA	A-1+	Stable	Reaffirmed
30-Jun-17	AAA	A-1+	Stable	Reaffirmed

Due Diligence Meetings Conducted

	Name	Designation	Meeting Date
1	Mr. Abdul Wahid Sethi	SEVP & CFO, Financial Control Group	June 15, 2020
2	Mr. Syed Jamal Baquar	SEVP & Group Chief, Corporate & Investment Banking Group	June 15, 2020
3	Mr. Saad ur Rahman Khan	SEVP & Group Chief, International, Financial Institutions & Remittances Group	June 15, 2020