RATING REPORT

Zarai Taraqiati Bank Limited

REPORT DATE:
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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	
Government Debt Obligations	AAA	A-1+	AAA	A-1+
Outlook	Stable		Stable	
Date	*Jun 28,'18*		*Jun 20,'17*	

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)
Key Shareholders (with stake 5% or more):	**Chief Executive Officer:** Mr. Syed Talat Mehmood
State Bank of Pakistan : 76.23% Government of Pakistan : 23.75% Other Provinces : 0.02%	

APPLICABLE METHODOLOGY(IES)

JCR-VIS Entity Rating Criteria: Government Supported Entities (June 2016);
http://jcrvis.com.pk/docs/Meth-GSEs201606.pdf

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 spearheaded by Syed Talat Mehmood since April, 2014. Mr. Mehmood carries more than three decades of domestic and international banking experience.

Financial Snapshot

Total equity: FY17: Rs.76.1b, FY16: Rs.82.4b

Net profit / (Loss): FY17– (Rs.6.4b); FY16: Rs. 3.3b

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 also derive strength from the prominent role of ZTBL in the overall economic dynamics of the country since the bank remains the principal agriculture sector development financial institution which is used as a financing arm by the GoP. However, the financial risk profile of the bank has been adversely impacted during FY17 owing to a large one time provision against staff retirement benefits amounting Rs. 10.6b, leading to some erosion in equity. The bank's profitability has also been affected by increasing provision requirement primary due to lower category of classification of non-performing loans in FY17 and 1QFY18. Pressure on spreads has also been witnessed on a timeline basis. Given the government's support to the agriculture sector, the bank remains exposed to downward pressure on mark-up rates on loans.

Advances: The gross advances portfolio exhibited steady increase owing to favorable environment in the agro based economy since the sector posted highest growth rate of 3.8% in over a decade as per economic survey of Pakistan FY17/18. Subsequently, commercial banks improved their penetration in the sector as a result of which ZTBL's share in agriculture lending slightly declined during the outgoing year. The bank remained short of agri disbursement target allocated by State Bank of Pakistan; however, it still remains the primary player in agriculture lending with highest disbursement amounting to Rs. 97b. Kisan Dost Scheme (KDS) and Sada Bahar Scheme (SBS) continue to be the flagship products of the bank. The management has defined per acre loan ceilings for major crops while overall loan ceiling is maintained at Rs. 1.5m. Province-wise concentration of advances remained sizeable, which is in line with the Punjab's population and highest agricultural related activity nationwide. Asset quality indicators exhibited nominal deterioration during FY17 with gross infection increasing during the outgoing year; however the same was somewhat curtailed by end-1QFY18. Net infection also trended downwards during the ongoing year as a result of higher provisioning coverage owing to progression of non-performing loans to subsequent loss category. Going forward, the management projects downward trend in infection ratios by adopting 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.

Investments: Given ZTBL's investment portfolio is largely concentrated in government securities; overall credit risk originating from the same is considered minimal. Exposure in PIBs declined; given size of investment in PIBs in relation to total assets, interest rate risk is considered manageable. The equity portfolio comprises investment in a blue chip stock which carries sizeable unrealized surplus; the bank also receives regular dividend from the said company. 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.

Liquidity: Liquidity profile remains underpinned with sizeable investment in government securities carried on balance sheet. Moreover, deposit base posted growth of around 18% during the outgoing year. In addition, the deposit concentration in terms of top 10 depositors, corporate deposit base and geographical breakdown remains on a higher side. Until the required granularity in deposits is achieved, the institution requires maintaining a sizeable liquidity cushion.

Profitability & Capitalization: Before tax profit decreased in the outgoing year mainly on account of lower spreads and higher administrative expenses. Spreads declined on account of shift in investment mix entailing low yielding securities and high cost of funds, while annual increments including provision against staff related benefits, and expansion in branch network mainly translated into higher administrative expenses. Markup expense increased on account of higher interest pertaining to preference shares and high expense related to fixed and saving deposits. The bank also reported higher provision charge against non-performing loans during FY17. The non-markup also remained muted in line with lower gain on sale of instruments during FY17. Moreover, a hefty expense amounting Rs. 10.6b related to extraordinary / unusual item was incurred during the outgoing year. Therefore, as a function of the said expense coupled with higher provision charge and depressed spreads, the bank posted a significant loss of Rs. 6.4b during FY17. During 1QFY18, provision against non performing advances increased to Rs. 3.5b on account of progression of NPLs to lower category of classification. The administrative expenses stood higher at Rs. 3.0b on account of higher rate on defined employee pension plan. Accounting for taxation, the bank reported a loss of Rs. 1.4b during 1QFY18. Resultantly, the bank's core capital plummeted; however, CAR remained well above regulatory requirement exhibiting sufficient loss absorption capacity of the institution. The management has devised a 3-year disposal plan whereby a portion of properties will be sold every year to compensate against increasing infection levels; contributing positively to the bottom line with reversal in provisioning. During FY18, the management has projected to auction around 100 properties.

Board, Management & IT Infrastructure: ZTBL's BoD has not been functional since August 17 however now the Government of Pakistan has nominated Board of Directors of the Bank vide notification dated June 6, 2018; FPT Clearance of the same is under process through State Bank of Pakistan. On account of this, no Board or Board Committee meetings were convened after August'17. Barring Chief Operating Officer, the senior management depicted stability; timely appointment of COO is considered critical for effective implementation of the business strategy. ZTBL is in the process of acquisition of Core Banking Software with the help of a consultant.

Corporate Profile

On August 28, 2002, Agriculture Development Bank of Pakistan (ADBP) was converted into a public limited company as the Federal Government of Pakistan (GoP) converted all assets, liabilities, contacts, proceedings and undertakings of ADBP into Zarai Taraqiati Bank Limited (ZTBL). Consequently, ZTBL was incorporated as a public limited company in 2002 under the Companies Ordinance, 1984. The bank's registered and principal office is situated at 1-Faisal Avenue, Islamabad.

The bank provides agriculture credit and banking services to farmers across the country. The bank remains the largest public sector agriculture development financial institution in the country. ZTBL has a limited banking license which restricts the institution from undertaking broad range of banking business. The bank has applied for commercial banking license to the State Bank of Pakistan (SBP); however no final decision has yet been taken with regards to the same since it is subject to achievement of some milestones.

Kissan Support Services Limited (KSSL) is a wholly owned subsidiary of the bank. KSSL was incorporated in 2005 and provides advisory, consultancy and other support services including security and janitorial services to ZTBL.

Board of Directors comprised 4 members at end-FY17 including the CEO. Currently, two of the Board members are independent directors and one is a nominee director of Ministry of Finance. ZTBL's BoD has not been functional since Aug'17 however now Government of Pakistan has nominated Board of Directors of the Bank vide notification dated June 6, 2018; FPT Clearance of the same is under process through State Bank of Pakistan. On account of this, no Board or Board Committee meetings were convened after August'17. In normal course of operations, Board has formed nine committees including Board Audit Committee (BAC), Human Resource Management Committee, Risk Management Committee, Nomination Committee, Procurement Committee, Investment Committee, Committee on Information Technology, Agriculture Technology Committee and Committee on Non-Performing Loans and Special Assets Management.

The bank's management team has been spearheaded by Syed Talat Mehmood since April, 2014. Mr. Mehmood carries more than three decades of domestic and international banking experience. As per the organogram, some departments report into the Chief Operating Officer (COO) who reports to the CEO. In the absence of COO, the Division/departmental heads report directly to the CEO. As COO is a critical position, the bank may expedite the hiring process to fill in the vacant position. The bank operates through 15 divisions and 61 departments.

During FY17, few internal promotions took place owing to retirement of divisional heads. Rana Mujahid Ali Khan was promoted as the Head of Human Resource Division after the retirement of Mr. Khalid Mahmood Gill. Moreover, Mr. Hakeem Khan replaced Mr. Mohammad Shah Zaman as the Head of Credit Administration and Risk Management Division. Mr. Hakeem had previously served as the Head of Risk Management Department. Moreover, the previously vacant position of Head Islamic Banking Division has been filled after recruitment of Mr. Fiaz Hussain. Mr. Fiaz has a diverse commercial banking experience spanning over sixteen years. The brief profile of the incoming employee is attached as Appendix-I to the report. Barring the office of COO, the senior management team depicted stability. Total staff strength of the bank including contractual employees was reported at 5,799 (FY16: 5,700) at end-FY17.

Branch Network

As per the annual branch expansion plan, 28 new branches were opened during FY17 comprising 17 conventional/Agri. branches and 11 Deposit taking branches. Subsequently, ZTBL's branch network expanded to 488 (FY16: 460) locations by end-FY17. Around 56% of the branches are located in Punjab followed by Sindh (20%), KPK (13%), Baluchistan (7%), AJK (2%) and GBC (2%). Going forward, the management has projected to enhance network to 502 branches by end-FY18. The additional 14 branches will include 12 conventional/agri. branches and 2 deposit taking branches. Province-wise breakup of branch network is tabulated below:

Province	Number of Branches	
	FY16	**FY17**
Punjab	221	274
Sindh	89	95
KPK	53	65
Baluchistan	33	32
AJK	11	11
GBC	9	11
Total	**416**	**488**

The bank operates through 32 zonal offices and 4 area offices distributed across the country. Staff strength at the branch level varies between 10 to 15 depending on the branch size. Each branch is headed by a Branch Manager (BM) while other branch staff includes operation officer, Mobile Credit Officers (MCO), branch accountant and teller. There was no change in the branch reporting structure during the period under review; BM reports to the Zonal Chief who in turns reports to the COO. BM's are given targets for both asset and liability sales.

In addition, on account of initiation of deposit mobilization by the bank, Business Development Officers (BDOs) are also deployed at major branches of major zones; the bank plans to gradually deploy BDO at all branches. BDOs report to the Regional Sales Manager (RSM), who would report to the Zonal Sales Manager (Cluster Head); Zonal Sales Manager reports to the National Sales Manager; National Sales Manager heads the Liability Marketing Division at ZTBL.

Number of loss making branches increased to 164 (FY16: 152) at end-FY17. As per the management, loss making branches include recently established units and the branches with weak portfolio quality. The average turnaround time of a conventional branch is around 3 years; however high volume branches achieve breakeven in half the average time. Moreover, turnaround time for deposit taking branches is recorded at about 2 years.

Loan Approval Mechanism

During the period under review, there was no change in the loan approval mechanism. Loan approval process continues to be decentralized. Initial client screening involving cash flow analysis is conducted by MCOs after which documents are forwarded to the CAD officer for verification. The loan sanctioning limit varies from scheme to scheme; however the same remain unchanged during the review period. BM can sanction loan upto to Rs. 1.0m whereas loan amounts ranging between Rs. 1.0m to Rs. 1.2m are sanctioned by Zonal Chief. Loan amounts exceeding Rs. 1.2m are sanctioned by zonal credit committee. Moreover, BM can only sanction up to Rs. 0.5m. under Sada Bahar Sceme (SMS) and development loans.

Credit Worthiness Report (CWR) is generated for all cases irrespective of loan amount or loan cycle. Moreover, borrower's basic fact sheet is a part of loan application form. Track record of borrowers is also verified through market intelligence. As per bank's internal policy, delinquent clients with write-off or overdue history are not extended loans. In addition, client with delayed repayment can only avail 90% of the existing loan amount.

Overall loan ceiling is maintained at Rs. 1.5m. The management has defined loan ceilings for major crops based on different factors including cost of seed, pesticide, fertilizer, tractor and labor charges which are updated on a periodic basis. Per acre loan amount for major crops is tabulated below.

Crop	Per acre loan amount
Cotton	Rs. 39,000
Sugarcane	Rs. 53,000
Rice	Rs. 34,000

Maize	Rs. 34,000
Potato	Rs. 51,000
Wheat	Rs. 29,000
Tobacco	Rs. 35,000

MCOs are responsible for conducting post disbursement utilization check for entire population. For development loans, utilization is checked within one month while for production loans, meanwhile utilization check for development loans is conducted after 2 months of disbursement. Post disbursement utilization checks are also conducted by BMs (25%), zonal recovery managers (10%), zonal chiefs (5%) and Internal Audit Department (25%). During FY17, the bank introduced mobile wallet scheme in collaboration with Ufone. The acquisition of own mobile wallet application will be initiated by end-FY18.

Credit Administration and Risk Management Division

Credit Administration & Risk Management Department (CA&RMD) is headed by Mr. Hakeem Khan. The division is divided into four areas namely Credit Administration Department (CAD), Risk Management Department (RMD), Internal Control over Financing Reporting Department (ICFR) and IT Security department. The total staff strength was recorded at 14 employees. The scope of the department involves managing the overall risk profile of the institution. As per best practices, CA&RMD works independently of operations and reports directly to the CEO. A Board Risk Committee and two separate management level committees on credit risk and operational risk are formulated at the HO level to address the concerned issues.

RMD has implemented an Obligor Risk Rating (ORR) model which takes into account both quantitative and qualitative data with a higher weightage of latter. MCO initially assigns ORR for all loans which is subsequently verified by the RMD. As per policy, the bank does not lend to watch-list clients; customers with ORR between 1-4 are only eligible for loans. The average ORR of the institution was recorded around 2. If the ORR of a particular client exceeds 5, the case is transferred to Zonal Chief for corrective action.

During FY17, Operational Risk Model (ORM) was rolled out in all the branches with Key Risk Indicators (KRIs) identified based on business processes. Changes in the ORM include inclusion of KPIs related to consumer protection, corporate governance and self-assessment. The data in this regard is collected and assessed on a quarterly basis. Overall risk profile of the credit portfolio is discussed during the Business Risk Review (BRR) meetings which are held on a regular basis. BRR meetings include update of operational risk on a holistic bank vide level. Moreover, credit risk related metrics are discussed at product, sector, branch and zone levels. The department also assigns risk rating to all the new products developed. Moreover, stress testing is performed on a quarterly basis.

For monitoring of liquidity risk, liquidity gap reports are discussed during ALCO meetings. The department also conducts new product risk assessments.

Role and responsibilities of front, middle and treasury back office are defined in Treasury & Investment policy. Middle office reports to RMD while front office reports directly to COO. Going forward, CA&RMD's MIS is planned to be fully integrated with Centralized Branch Automation System (CBAS) during FY18.

Internal Audit

The Internal Audit Division (IAD) is headed by Mr. Abdul Ghaffar Bhatti who has been associated with the bank since the last 25 years. IAD is functionally divided into three departments namely:

- Field Audit Department.
- Corporate Audit Department
- Information Systems Audit Department (ISD)

Overall scope of IA includes conducting audit of all the branches, HO, information system, and fraud and financial irregularity inspection. Moreover, IAD assures that business operations and procedures are in accordance with regulatory guidelines and internal policies of the bank. IAD operates through nine audit zones located in major cities across the country with each zonal office having around 20-25 resources. The total department staff strength stood at 300 at end-FY17.

All branches are audited twice every year, irrespective of their risk profile. Areas covered under branch audit include loan disbursement, recovery process, branch operations and cash management. During the audit exercise, 100% of loan portfolio is examined. In addition, 25% of the cases are also examined for loan utilization. All departments at the HO and zonal offices are audited once a year. Audit Management System has been developed in-house enabling the IAD to audit the operations from their own desk including CNIC verifications, credit worthiness reports, loan transactions/examining vouchers and security documents. The total headcount of IT audit function was 6 employees.

During FY17, IAD developed Audit Risk Rating Framework which will be evaluated by an external evaluator during the ongoing year. Moreover, the management plans to introduce Internal Audit Facilitation System whereby audit officers will be provided laptops to improve effectiveness of audit activity. The branch related audit observations are communicated to the BM on a daily basis. Moreover, after two days, all unresolved observations are escalated to the zonal chief. The branch rating scores are projected to be linked to performance appraisal during the ongoing year.

Financial Statements for FY17 were jointly audited by Horwath Hussain Chaudhary & Co Chartered Accountants and BDO Ebrahim & Co. Chartered Accountants. Both auditors have been re-appointed for FY18.

Information Technology

The IT infrastructure at ZTBL comprises following major applications

- cDMS (centralized Deposit Management System)
- CBAS (centralized Branch Automation Computerized)
- Oracle ERP-EBS (Oracle Enterprise Resource Planning; e-Business Suite)
- Di-MIS (Dynamic Integrated Management Information System)

cDMS is a oracle based real time application providing all liability side information system of the bank. The branch operations requirements are now met by in-house developed CBAS which provides flexibility for new product development. CBAS is an interactive system with inbuilt improved reporting system. Anti-Money Laundering application is also implemented which generates alert for transactions amounting over Rs. 1m. For KYC requirements, the system has been integrated with NADRA to carryout biometric verification of customers on a real time basis.

Implementation of Oracle ERP-EBS was completed during FY17. Oracle ERP-EBS is a real time oracle based application involving automation of back office operations. Different modules of the ERP- EBS system include cash management, consolidated GL, Treasury, Accounts Payable, Accounts Receivables, Inter-Bank Transfer, Fixed Asset Management, Human Resource, Treasury, Strategic Planning and Budgeting.

Di-MIS is an oracle based centralized application catering to the reporting requirements of the bank. The bank plans to conduct an external audit of all in-house developed systems during the ongoing year.

ZTBL plans to acquire state-of-the-art core banking system (CBS) for conventional and Islamic Banking products. E&Y Ford Rhodes – Chartered Accountants have been inducted as consultants for the selection and acquisition of the new CBS. According to the management, acquisition and implementation of new CBS was initiated during FY17. The required infrastructure compatible with CBS would also be procured accordingly. Implementation of CBS is expected to be completed within the next 2 years.

As per the management, the bank has applied for 1-link approval certification; once the certification is received, the official launch of ATMs will be carried out. The management intends to launch 50 ATMs by end-FY18. Moreover, the bank plans to introduce Europay, Mastercard and Visa (EMV) based biometric ATM card for customers.

The entire branch network is connected to a centralized data center, located at the HO. For data transmission, the bandwidth of the Wide Area Network (WAN) between the HO and field offices is maintained at 2 Mbps. For Business Continuity Plan (BCP), a failover site is in place at Staff College, Islamabad. Back-up of data is run daily according to standard operating procedures both onsite and offsite. BCP drills are conducted on a periodic basis. At head office, a backup policy is in place for data security.

Financial Analysis

Asset base of the bank expanded by around 19% to Rs. 256.3b by end-FY17 (FY16: Rs. 215.6b) with increase primarily manifested in investments. Advances portfolio amounted to Rs. 140.9b (FY16: 135.8b) and constituted 55% (FY16: 63%) of the asset base while investments amounting to Rs. 70.2b (FY16: Rs. 37.1b) represented 27% (FY16: 17%) of the asset base. Cash and bank balances remained almost at prior year's level at Rs. 23.1b (FY16: Rs. 23.6b) and reflected 9% of the asset base at end-FY17 (FY16: 11%).

Asset base decreased to Rs. 233.9b at end-1QFY18 primarily on account of decline in investments and balances held with other banks. The net advances and investments comprised 60% and 26% of the asset base, respectively. The asset mix is presented in the table below:

	FY16	FY17	1QFY18
Cash & Balances	10.9%	9.0%	4.2%
Lending to FIs	0.0%	0.46%	0.0%
Investments	17.2%	27.4%	25.5%
Advances (net)	63.0%	55.0%	59.8%
Operating Assets	1.0%	0.9%	0.9%
Other Assets	7.9%	7.7%	9.6%
Total *(Rs. in Billions)*	**215.6**	**256.3**	**233.9**

Credit Risk

Disbursement target to ZTBL is allocated by the Agriculture Credit Advisory Committee (ACAC) of SBP. Against the disbursement target of Rs. 103b for FY17, ZTBL disbursed Rs. 97.1b, which was higher than the previous year's disbursement of Rs. 92.8b. During FY17, disbursements made towards production and development loans represented 77% (FY16: 78%) and 23% (FY16: 22%), respectively, of total disbursements. Overall banking sector agriculture disbursement amounted to Rs. 704.5b during FY17 (FY16: Rs. 598.3b) against the target of Rs. 700b. ZTBL's share in agriculture lending declined to 13.8% (FY16: 15.5%), however continues to remained highest among all financial institutions.

For FY18, ACAC has set disbursement target of Rs. 114b for ZTBL. The bank's disbursements were reported at Rs. 40.0b till end-May'18.

Gross loan portfolio of the bank increased to Rs. 147.5b (FY16: Rs. 141.3b) at end-FY17, exhibiting a growth of 4.4%; gross loan portfolio amounted to Rs. 148.7b. ZTBL's lending portfolio comprises production and development loans with a higher proportion of former. Production loans, pertain to financing for working capital requirements, represented 58% (FY16: 58%) while development loans comprises 42% (FY16: 42%) of the net loan portfolio at end-FY17. Regarding development loans, principal and interest is collected bi-annually. The average loan size was recorded around Rs. 210,000 during FY17. The management plans to introduce three new products during the ongoing year catering to agri storage, alternative energy and women empowerment.

The geographical breakup of gross portfolio largely remained unchanged with Punjab comprising 82.3% (FY16: 82.6%) of the total portfolio, followed by Sindh FY17: 13.4%; (FY16: 12.9%) and KPK FY17: 3.2%; (FY16: 3.4%). The highest disbursements were made in Punjab (81.3%) followed by Sindh (12.8%) and KPK (4.9%). Kissan Dost Scheme (KDS) and Sada Bahar Scheme (SBS) continue to be the flagship products of the bank. KDS provides financing for agriculture inputs for seasonal crop production at concessional rates. SBS entails financing for working capital requirements as well as production need on annual revolving.

Recoveries made against the performing portfolio amounted to Rs. 107.6b (FY16: Rs. 102.0b) during FY17. Recoveries related to Special Asset Management (SAM) were recorded at 2.0b (FY16: Rs. 1.9b) during the outgoing year; the management has projected recovery of Rs. 1.9b for FY18. The management projects a declining trend in the SAM portfolio to the tune of Rs. 2b approximately every year.

In absolute terms, NPLs increased to Rs. 24.5b (FY16: Rs. 22.7b) while declined to Rs. 23b by end-1QFY18. Amounts charged off amounted to Rs. 1.5b (FY16: Rs. 1.4b) during FY17. The same stood at Rs. 1.7b during 1QFY18. Advances are charge off in accordance with prudential regulations after a period of three years from the date of default. For production loans, the classification is made in accordance to the actual amount of default; meanwhile, for development loans the entire principal is classified as NPL even if the overdue payment is 5% of the total amount.

At end-FY17, NPLs mainly pertained to OAEM and substandard category with low migration towards higher risk categories. In agriculture credit, migration to loss categories is slower, after 2 to 3 years, in comparison to commercial banks whereby a loan is classified in loss category after one year. The management may require to remain cognizant as considerable amount is moving towards lower category of classification entailing higher provisioning. The table below depicts the distribution of NPLs among various categories.

	FY15	FY16	FY17	1QFY18
OAEM	71%	74%	65%	34%
Substandard	14%	14%	18%	42%
Doubtful	11%	9%	12%	15%
Loss	4%	3%	5%	9%

Asset quality indicators exhibited deterioration on timeline basis with gross infection increased to 16.6% by end-FY17 (FY16: 15.8%%; FY15: 12.2%) on account of increasing trend in NPLs. However, the gross infection was recorded lower at 15.5% during 1QFY18. Net infection has also trended downwards to 12.1% (FY17:14.5%; FY16: 14.3%) at end-1Q18. The provisioning coverage stood higher at 14.6% (FY16: 11.2%) on account of progression of NPLs to subsequent classification categories whereby regulatory provisioning requirements are higher. The bank maintains general provision of Rs. 3b. As a matter of prudence, ZTBL has not availed the benefit of value of mortgaged lands and buildings allowed while computing provision against NPLs. For FY18, the management has projected the gross infection ratio to decline to 13.6%. The asset quality indicators are presented in the table below:

	FY15	FY16	FY17	1QFY18
Gross Infection (excluding charge-offs)	12.3%	15.8%	17.4%	15.5%
Gross infection (including charge-offs)	13.1%	16.6%	17.6%	16.6%
Net Infection	10.9%	14.3%	14.5%	12.1%

At end-FY17, major contingent liabilities declined to Rs. 659.5m (FY16: Rs. 10.9b) on account of realization of pension/gratuity payment to be made to the employees against numerous cases filed against the bank.

Investments

The bank's investment portfolio is primarily concentrated in government securities representing 91.5% of the total investments at end-FY17 (FY16: 89.2%); credit risk emanating from the investment portfolio is therefore considered limited. T-bills constitute 82.2% (FY16: 67.4%) of the investment portfolio at end-FY17; market risk arising from the same is considered minimal on account of short-term maturity of the instruments. Exposure in PIBs declined to 9.3% of total investment portfolio (FY16: 21.8%); hence interest rate risk inherent in PIB portfolio is considered manageable on account of relatively smaller quantum of the same in relation to total assets. The weighted average modified duration of PIB portfolio was recorded at 0.28 years (FY16: 2.9 years) at end-FY17. During ALCO meetings, it was decided to maintain treasury assets at 80% of the total deposit base during the ongoing year. The spread on government securities was recorded at 0.15% during FY17 compared to 0.57% in the preceding year. Moreover, the capital gain on sale of securities was lower at Rs. 41m (FY16: Rs. 179m) during FY17.

Investment portfolio of the bank stood higher at Rs. 70.2b (FY16: Rs. 37.1b) by end-FY17 owing to investment made in T-bills during the review period. However, the same declined to Rs. 59.6b by end-1QFY18. The table below presents the investment portfolio mix:

Investments (at market value in billions)	FY16	%	FY17	%
Government securities	33.1	89.2%	64.2	91.5%
PIBs	*8.1*	*21.8%*	*6.5*	*9.3%*
T-Bills	*25*	*67.4%*	*57.7*	*82.2%*
Shares – Listed	3.9	10%	5	7.1%
TFCs – Listed	0.04	<1%	0.07	0.1%
Other	0.1	<1%	0.9	1.3%
Total	**37.1**		**70.2**	

Composition of listed and unlisted equity portfolio remained unchanged during FY17. Listed equity portfolio comprises investment in Nestle Pakistan Limited (Nestle) representing 7.1% (FY16: 10.0%) of total investments; the bank received dividend income amounting to Rs. 176.5m (FY16: Rs. 148.5m) from the aforementioned company during FY17. In addition, there is sizeable unrealized revaluation gain to the tune of Rs. 4.9b (FY16: Rs. 3.8b) on investment in Nestle. Investment in unlisted companies comprising Pakistan Merchantile Exchange Limited amounting to Rs. 10.5m has been fully provided for. Average return on equities portfolio was recorded at 27% during FY17. Going forward, the bank intend to remain shy of any further investment equities.

ZTBL has made investment in TFCs of commercial banks with instrument ratings of 'AA' and above exhibiting sound credit risk profile. ZTBL's investment in wholly owned subsidiary, Kissan Support Services Limited (KSSL), amounted to Rs. 100m (FY16: Rs. 100m) at end-FY17.

Liquidity & Deposits

Overall liquidity profile of the bank improved during the outgoing year on the back of sizeable investment in government securities carried on the balance sheet. Liquid assets in terms of deposit and borrowings increased to 50.9% (FY16: 48.9%) at end-FY17. In absolute terms, liquid assets (adjusted for collateral) were recorded higher at Rs. 66.1b (FY16: 55.9b) by end-FY17.

During FY17, total deposit base of the bank increased by around 18% to Rs. 70.5b (FY16: Rs. 59.9b). Growth was largely manifested in the last quarter of the outgoing year; in view of this, deposit trends have to depict maturity. At end-1QFY18, deposit base stood at Rs. 62.0b. Share of term deposits decreased slightly to 63.4% (FY16: 64.4%) of the overall deposit base while share of current and saving deposits increased to about 36.6% (FY16: 35.6%). Proportion of current deposits have declined to 15.2% (FY16: 20.5%). The total deposit base of the institution is projected to reach Rs. 71.9b by end-FY18. Composition of the deposit mix is presented in table below:

Rs. Millions	FY16		FY17	
	Amount	%	Amount	%
Term Deposits	38,552	64%	44,744	63%
Saving Deposits	8,687	15%	15,082	22%
Current Deposits	12,632	21%	10,722	15%
Total (inc unclaimed)	59,871	100%	70,548	100%

Deposit mix profile, in terms of retail and institutional deposits, depicted a change with corporate deposits representing 79.5% (FY16: 60.2%) of total deposits at end-FY17. Concentration in the deposit base remains high with top 10 depositors comprising 62.6% of total deposits at end-FY17 (end-FY16: 62.5%). Moreover, largest depositor represented 16% of total deposits and pertained to a government entity. Given high concentration levels, the bank has yet to develop a broad base access to deposit.

Deposits feature geographic concentration with around 62% of deposits mobilized from Punjab. Geographic concentration of deposits is presented in the table below:

Region	FY16	FY17
Punjab	77.6%	62.2%
Sindh	14.1%	29.5%
KPK	3.3%	3.8%
Baluchistan	0.9%	0.9%
GBC & AJK	4.1%	3.6%

The bank is also engaged in money market activities with repo borrowings amounting to Rs. 27.4b at end-FY17 (FY16: Rs. 4.6m) and call borrowings of Rs. 5b (FY16: Nil). Redeemable preference shares worth Rs. 54.5b were issued to SBP in March'17 carrying mark-up rate of 7.5% per annum, redeemable in one bullet payment on December 31, 2025. ZTBL has sent a proposal to SBP to stagger the redemption of its preference shares to Rs. 10b each year till FY23 in return of provision of a long-term funding facility. If the proposal is approved by SBP, mark-up rate will be reduced by 135bps, and is expected to have cumulative positive impact on mark-up expense of around Rs. 2.2b over the next 5 years.

Going forward, to enhance CASA deposit collection to fund growth targets the management plans to deploy KSSL teams. The management has projected to increase CASA deposits to Rs. 35.4b by end-FY18.

Profitability

Despite increase in lending and investment portfolio in absolute terms, the core income of the bank remained largely stagnant at Rs. 14.2b (FY16: Rs. 14.4) during FY17 owing to decline in yield on investments and higher markup expense on borrowings. The higher markup cost was a function of conversion of SBP debt into redeemable preference shares carrying higher markup charge vis-à-vis previous SBP loan coupled with higher cost of deposits.

Income from advances portfolio increased to Rs. 18.5b (FY16: Rs. 17.5b) on account of volumetric growth in the portfolio and represented 83.6% of total markup income (FY16: 89.0%). Yield on performing advances was reported higher at 15.7% (FY16: 15.0%) on account of higher disbursement made in production loan schemes entailing the highest markup rate. In line with lower proportion of high yielding PIB portfolio, return on investment portfolio decreased to 6.3% (FY16: 6.9%). Given increase in lower yielding investment portfolio in comparison to advances portfolio, yield on overall markup bearing assets decreased to 12.2% (FY16: 12.6%) during FY17.

With higher proportion of saving deposits in the deposit mix, cost of deposits increased to 5.3% (FY16: 4.5%). Overall cost of funding increased to 6.3% (FY16: 5.5%) in line with higher procurement of repurchase financing and also relatively high cost related to preference shares.

With lower yield on mark-up bearing assets and higher cost of funding, spreads of the bank declined to 5.9% (FY16: 7.2%) during FY17. Given the government's support to the agriculture sector, the bank may experience further reduction in the pricing of loan products, going forward.

Non-markup income decreased slightly to Rs. 4.3b (FY16: Rs. 4.4b) during FY17 primarily on account of lower gain on sale of securities. The gain on sale of securities was recorded at Rs. 40.8m (FY16: Rs. 179.3m).

Administrative expenses increased by around 12% and amounted to Rs. 11.0b (FY16: Rs. 9.8b) with employee related expenses representing 71% of the total administrative expenses (FY16: 75%). However on account of increase in the bank's asset base, overheads declined to 4.7% (FY16: 4.9%) during FY17. During FY17, the bank realized net reversal in provision against other assets to the tune of Rs. 30.3m vis-à-vis a provision charge of Rs. 3.3m in the preceding year.

Net provisioning against non-performing portfolio was reported higher at Rs 2.6b (FY16: Rs. 1.8b) during FY17. In addition, an extraordinary expense amounting to Rs. 10.6b was recorded during the outgoing year. Subsequently, on account of this extraordinary item coupled with reduced spreads and high provisioning charge, the bank reported loss before tax amounting to Rs. 6.1b compared to profit of Rs. 6.5b in the preceding year. Accounting for taxation, net loss stood at Rs. 6.4b during FY17 in comparison to profit after tax of Rs. 3.3b in FY16. The provisioning charge against NPLs is projected at Rs. 1.4b for FY18.

Net interest income amounted to Rs. 3.4b during 1QFY18. Provision against non performing advances increased to Rs. 3.5b on account of progression of NPLs to lower category of classification. The administrative expenses stood higher at Rs. 3.0b on account of higher rate on defined pension plan. Accounting for taxation, the bank reported a loss of Rs. 1.4b during 1QFY18.

The profit before tax for FY18 is projected at Rs. 4.5b for FY18. To compensate for NPLs, ZTBL intends to dispose-off acquired properties; there are around 400 properties in the bank's possession. The management has devised a 3-year disposal plan whereby a portion of properties will be sold every year; hence contributing positively to the bottom line with reversal in provisioning. During FY18, the management has projected to auction around 100 properties.

Capitalization

Given conversion of share deposit money into paid-up capital, total share capital of the bank augmented to Rs. 52.7b (FY16: Rs. 12.5b) by end-FY17. However, total equity of the bank was reported lower at Rs. 76.1b (FY16: Rs. 82.4) on account of loss incurred during FY17. With further loss during first quarter of the ongoing year, the bank's tier-1 equity decreased to Rs. 71.6b (FY17: Rs. 72.9b) by end-1QFY18. Net NPLs as a percentage of the bank's tier-1 capital were reported at 24.1% at end-1QFY18 (FY17: 28.7%; FY16: 24.8%); improvement in this regard is considered critical for strengthening of the bank's risk profile.

Risk Weighted Assets (RWA) were reported higher at Rs. 194.9b (FY16: Rs. 183.8b) by end-FY17 with increase manifested in RWA pertaining to credit and market risk. Moreover, admissible capital declined to Rs. 77.6b by end-FY17 as compared to Rs. 85.8b in preceding year. Resultantly, Capital Adequacy Ratio (CAR) decreased to 39.9% (FY16: 46.7%) by end-FY17; the same is still well above the minimum regulatory requirement.

Mr. Fiaz Hussain	Mr. Fiaz Hussain has a diverse commercial banking of over two decades. He has previously served in Citibank, Standard Chartered Bank (Pakistan) Limited and Meezan Bank Limited. He did his Masters in Business administration from Preston University, Karachi.

FINANCIAL SUMMARY *(amounts in PKR billions)*				Appendix-II
BALANCE SHEET	**31-Dec-15**	**31-Dec-16**	**31-Dec-17**	**31-Mar-18**
Total Investments	19.8	37.1	70.2	59.6
Advances	129.6	135.8	140.9	139.9
Balances with other Banks	16.4	20.1	18.2	7.2
Cash and bank balances	2.5	3.5	4.9	2.6
Operating Fixed Assets	2.1	2.1	2.2	2.2
Other Assets	17.2	17.0	19.9	22.4
Total Assets	187.6	215.6	256.3	233.9
Borrowings	57.1	55.9	86.8	73.6
Deposits & other accounts	35.9	59.9	70.5	62.0
Other Liabilities	12.2	14.2	22.9	23.3
Subordinated Loans	3.2	3.2	-	-
Tier-1 Equity	76.9	80	72.9	71.6
Net Worth	79.2	82.4	76.1	75.0
INCOME STATEMENT	**31-Dec-15**	**31-Dec-16**	**31-Dec-17**	**31-Mar-18**
Net Mark-up Income	12.2	14.2	14.0	3.4
Net Provisioning/ (reversal)	-0.4	2	2.9	3.5
Non-Markup Income	5.6	4.4	4.3	1.1
Operating Expenses	9.9	10.1	11.0	3.0
Profit Before Tax	8.4	6.5	-6.1	-2.0
Profit After Tax	5.3	3.3	-6.4	-1.4
RATIO ANALYSIS	**31-Dec-15**	**31-Dec-16**	**31-Dec-17**	**31-Mar-18**
Gross Infection (%)	12.2%	15.8%	16.6%	15.5%
Provisioning Coverage (%)	12.7%	11.2%	14.6%	25.1%
Net Infection (%)	10.9%	14.3%	14.5%	12.1%
Cost of deposits (%)	3.1%	4.5%	5.3%	-
Net NPLs to Tier-1 Capital (%)	18.7%	24.8%	28.7%	24.1%
Capital Adequacy Ratio (C.A.R (%))	49.7%	46.7%	39.9%	-
Markup Spreads (%)	6.5%	7.2%	5.9%	-
Efficiency (%)	79.5%	68.2%	77.3%	87.6%
Basic ROAA (%)	5.2%	4.1%	6.0%	0.2%
ROAA (%)	3.0%	1.6%	-2.7%	-0.6%
Liquid Assets to Deposit & Borrowings (%)	36.3%	48.9%	50.9%	43.1%

ISSUE/ISSUER RATING SCALE & DEFINITIONS Appendix III

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 IV

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				
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				
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	JCR-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	JCR-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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