RATING REPORT

Zarai Taraqiati Bank Limited

REPORT DATE:
June 22, 2023

RATING ANALYSTS:

Tayyaba Ijaz, CFA
tayyaba.ijaz@vis.com.pk

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	
Rating Action	*Reaffirmed*		*Maintained*	
Rating Date	*Jun 22,'23*		*Jun 30,'22*	

COMPANY INFORMATION

Incorporated in 2002	**External Auditors:** BDO Ebrahim & Co Chartered Accountants
Public Limited Company	**Chairman of the Board:** Vacant
Key Shareholders (with stake 5% or more)	**Chief Executive Officer (Acting):** Mr. Asad Ullah Habib
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
Rating Scales & Definitions:
https://docs.vis.com.pk/docs/VISRatingScales.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.

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. The Bank operates through 501 (2021: 501), which are governed by 31 zonal offices. Out of total branch network, the number of Islamic branches stood at 15 (2021: 5), as of June 20, 2023. After the Federal Government's directives last year to end the Riba-based banking and financial system within the next five year, ZTBL has also embarked upon converting into Islamic Banking. The management contemplates to convert 20 branches into full-fledged Islamic branches by the end of this year as per timeline provided by SBP and at least 50 branches would be converted by the end of following year.

Gross loan portfolio has been depleting on a timeline basis on account of subdued disbursements amid portfolio consolidation. During 2022, there has been a huge turnaround in the Bank's net profitability after being in loss for the last consecutive five years on the back of considerably higher risk adjusted returns from treasury operations and sizable net reversals in provisioning vis-à-vis provisioning charge in the preceding year. Liquidity has remained adequate with sizable investments in government securities. Capital Adequacy Ratio has remained sound and well above regulatory requirement. The management projects further growth in earning profile in full year on the back of improvement in asset quality along with higher profitability from treasury operations. Going forward, the ratings would remain dependent on meeting recovery targets, improving asset quality indicators and strengthening deposit base.

The economy is currently facing several challenges, including a decrease in foreign reserves, a devaluing currency, and high inflation levels. To combat rising inflation, caused by the commodity super cycle and effects of Ukraine war, the central bank has implemented stricter monetary policies, resulting in a significant increase in the policy rate. This has led to higher funding costs for banks and impacted borrowers' debt servicing ability. As a result, banks are adjusting by increasing provisions for potential loan losses and writing off non-performing loans. The economic slowdown will likely prompt stricter lending standards with banks continuing to remain heavily invested in sovereign exposures. Counterbalancing this, rising interest rates should help banks maintain their margins, partially offsetting the decline in earnings and allowing for improved profitability. However, there is increased credit risk and market risk vulnerability, especially in the face of any potential interest rate or currency fluctuations, which could impact the capitalization levels of banks. Looking ahead, the medium to long-term outlook for the fiscal account is challenging because the government is struggling to expand its revenue base. Public debt accumulation is accelerating, crowding out private sector credit. This trend also increases the risk of potential sovereign debt restructuring. Given banking sector balance sheets highly skewed towards Government paper, this could lead to liquidity and profitability challenges, particularly for small and medium-sized banks in the future.

Key Rating Drivers:

Advances: During CY22, the Bank disbursed Rs. 69.6b in advances, which was slightly higher than the previous year's disbursements. However, the disbursements have remained lower than the budgeted amount as the Bank remained conservative amid deteriorating economic conditions. To diversify its lending portfolio, the Bank focussed on increasing the proportion of development loans during 2022, which resulted in a shift in the loan portfolio mix. As a result, the proportion of development loans increased to 47.4% of the total disbursements, up from 31.0% in the preceding year.

The portfolio concentration in Punjab remained largely the same during the outgoing year, which is in line with the highest population and agricultural related activity. The Bank is currently offering 32 products under the Development loan category while production loans are being disbursed under Kissan Khushhal Scheme (KKS), which is a revolving scheme to support farmers to have easy access to the credit, with the facility of one-time documentation for three years period with one-year clean-up; withdrawal of loan amount as per their credit requirement and deposit the same as and when funds are available. Agriculture land in shape of pass book or Fard Jamabani (record of right (ROR), document containing entries regarding ownership, cultivation and up to date of various rights in land) owned by borrowers is held as collateral, and in case of its non-availability, parents' or family members' property can also be accepted as co-applicant. The loans under development category are offered to cater various needs of the farming community. The tenure of these long-term loans is upto 10 years with six months to one year of grace period. Loan under these schemes will be sanctioned by Central Loan Sanctioning Department (CLSD) upto the amount of Rs. 2.5m and over and above this amount, Head Office Credit Committee will sanction the loan. The borrowers are required to provide security/collateral of the loan as per Bank's policy. Certain percentage (5 to 10%) of the loan amount will also be contributed by the borrowers, which will be adjusted towards the asset price.

Subsidized Financing Schemes by GoP

The government pro-Agri initiatives are playing key role in the revival of agriculture sector productivity. Currently following Government schemes are available to ZTBL (allocated targets of Rs.22.5 billion for 04 loans schemes for year 2023 that contain subsidies of mark-up for agri financing;

i. ZTBL received the largest share of Rs. 6b in Prime Minister Youth Business and Agriculture subsidized lending scheme entailing concessionary rate of 7%.

ii. GOP Markup Subsidy Scheme for Revival of Agriculture/Livestock Sectors in Flood Affected Areas against loans of up to Rs 500,000/- to subsistence farmers with budgeted amount of Rs. 6b. No markup shall be paid by the borrowers of flood affected areas, whereas Government of Pakistan will pay markup @ KIBOR+3% to the Bank

ii. Interest Free Loans and Risk Sharing Scheme for Landless Farmers up to Rs 200,000 in flood affected areas with credit limit of Rs. 0.5b to ZTBL. No markup shall be paid by the borrowers of flood affected areas, whereas Government of Pakistan will pay markup @ KIBOR+3% to the Bank upon lodging of claim on quarterly basis with SBP. This scheme is valid up to June 30, 2023.

v. Markup Subsidy and Risk Sharing Scheme for Farm Mechanization across the country with credit limit of Rs. 10 billion allocated to ZTBL. The markup rate for this scheme is KIBOR+3%; whereby 7% markup shall be paid by borrowers and differential markup shall be paid by GoP.

In addition, in the outgoing year, ZTBL rescheduled loans amounting Rs. 3.95b under the relief provided by State Bank of Pakistan (SBP) for flood affected areas.

In the recent budget 2023-24, the federal Govt. has increased the annual target for agri financing limit from Rs. 1,800b to Rs. 2,250b. Furthermore, to support rural economy, the budget allocated an amount of Rs. 5b for provision of concessionary loan to agro-based industry. Under PM Youth Business and Agricultural loan scheme, small and medium scale easy loans will be continued and for this purpose Rs. 10b will be provided for markup subsidy in the next financial year. Lastly, to increase productivity, small farmers will be provided with loans at low markup with the participation of provincial governments. A sum of Rs. 10b has been allocated in this regard.

Asset Quality: Despite dwindling socio-political and economic situation in the country, the improvement in asset quality indicators is a reflection of strong internal control measures. The Bank's non-performing loans (NPLs) have also exhibited a declining trend on a timeline basis in line with reversals in provisioning (CY22: Rs. 5.3b; CY21: Rs. 7.7b) and loans charged off the portfolio amounting (CY22: Rs. 10.1b; CY21: Rs. 11.0b). Therefore, despite nominal decrease in value of performing advances, gross advances portfolio decreased by 6.6% as on Dec'22. Advances are charged 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 while for development loans the entire principal is classified as NPL even if the overdue payment is a trivial amount. In addition to the time based criteria, the Bank also classifies loans and advances on the basis of credit worthiness of the borrowers in accordance with the subjective criteria of the Prudential Regulations for Agriculture Financing.

Specific provisions also stood lower at Rs. 14.1b (Dec'21: Rs. 20.4b) while general provisions remained unchanged at Rs. 3b at end-Dec'22. Resultantly, provisioning coverage has decreased relative to preceding year. As a matter of prudence, ZTBL has not availed the benefit of allowed value of mortgaged lands and buildings while computing the provision against nonperforming loans. Meanwhile, infection ratios have depicted an improving trend in line with decrease in NPLs. Gross and net infection ratios have decreased to 31.3% (CY21: 35.4%) and 21.0% (CY21: 21.5%), respectively by end-CY22. As per management, infection ratios are expected to improve going forward on account of strengthened internal controls, resulting in prudent lending and transparency. In addition, the expected approval from Ministry of Finance (MoF) in the ongoing year, regarding recourse to recovery of loans under relevant provision of Loans for Agricultural, Commercial and Industrial Purpose Act, 1973 (LACIP Act), is expected to bode well in terms of improvement in asset quality indicators.

Investments: The Bank's net investments exhibited multifold growth (CY22: Rs. 306.8b; CY21: Rs. 82.4b), led by higher investments in Market Treasury Bills (T-bills), which constituted ~80% (CY21: 51%) of the investment portfolio as of Dec'22. Overall exposure of Government securities increased to 98.3% (CY20: 93.6%). Therefore, credit risk emanating from investment portfolio is considered low. Given fixed rate PIBs accounted for only around 13% of the PIBs portfolio, market risk arising from the same is also limited. Net deficit on the Govt. securities portfolio amounted to Rs. 840.5m (CY21: Rs. 873.0m) as of Dec'22. 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.

Net investment portfolio further augmented to Rs. 485.9b, with growth entirely manifested in T-bills. The deficit has increased to Rs. 2.2b by end-Mar'23 due to mark to mark losses, which has largely been settled subsequently after re-pricing. The Bank has been participating in open market operations (OMO) initiated by SBP to manage system's liquidity. Given the Bank's leverage ratio stood at 7.87% (CY22: 10.09%; CY21: 13.55%) against SBP requirement of 3%, ZTBL still has enough cushion to enhance its investment portfolio.

Liquidity: The liquidity position of the bank is underpinned by sizeable coverage of deposits and borrowing via liquid assets (CY22: 62.2%; CY21: 54.9%). The proportion of Current Account Savings Account (CASA) in the total deposit mix increased to 31.2% (CY21: 29.6%) by end-Dec'22. Overall the deposit base of the Bank increased by 8.6% leading to some improvement in ADR ratio. Top 10 deposits constituted 66.5% (CY21: 65.7%) of the total deposit base while ZTBL Pension Funds alone contributed around 27% (CY21: 35%) to the mix. Meanwhile, the Bank has offloaded a few high cost large deposits in 1Q'23. Resultantly, the deposit base has reduced to Rs. 37.9b as of March 31, 2023. The management intends to build its deposit book this year with main focus on obtaining small size deposits. The Bank plans to achieve a target of increasing its deposit base to Rs. 60b. The funding mix (excluding deposits) includes preference shares amounting Rs. 54.5b issued to SBP carrying markup rate of 7.5% per annum, the same are redeemable in one bullet payment on March 07, 2027. The Bank has also devised a plan to counter the liquidity risk that may arise due to maturity gap in 3 to 5 year plus bucket owing to bullet repayment of SBP preference shares. The rest of the borrowings largely comprised repo borrowings, secured against T-bills and PIBs. The Bank's liquidity coverage ratio (LCR) and net stable funding ratio (NSFR) have remained comfortable on a timeline basis.

Profitability: During the outgoing year, there was a huge turnaround in the profitability of the Bank primarily on account of sizable risk adjusted returns from treasury operations along with reversals in provisioning against advances. The markup income of the Bank exhibited sizable growth of ~75% primarily driven by higher returns earned on its investment portfolio (CY22: Rs. 19.0b; CY21: Rs. 4.6b). Weighted average return on advances portfolio also increased to 21.95% (CY21: 20.95%) in CY22 mainly on account of regularization of some loans. Markup income suspended on NPLs also decreased to Rs. 8.7b (CY21: Rs. 10.4b). Overall yield on markup earning assets increased by ~402 bps whereas cost of funding increased by ~431 bps. Resultantly, markup spread reduced by ~29 bps. Efficiency ratio of the Bank also improved notably on account of higher total recurring income despite some increase in operating expenses. The bank recorded sizable net provisioning reversals to the tune of Rs. 3.7b vis-à-vis provisioning charge of Rs. 777.7m in the preceding year. Resultantly, profit after tax was reported substantially higher at Rs. 5.1b as compared to loss of Rs. 1.7b in the preceding year. In the backdrop of sharp hike in benchmark interest rates in 1Q'23, the mark-up spreads remained under pressure. However, there was still a considerable improvement in net interest income primarily on account of higher return on investment portfolio as compared to the SPLY. In addition, strict cost control measures and digitization has led to marginal increase in operating expenses despite substantially higher inflation rate. The management projects further growth in earning profile in full year on the back of improvement in asset quality along with higher profitability from treasury operations.

Capitalization: The Bank's Tier-1 capital augmented to Rs. 49.6b (CY21: Rs. 45.0b) due to the reduction in accumulated losses by end-Dec'22. This, along with decrease in NPLs led to improvement in net NPLs in relation to Tier-I equity (adjusted for general provisioning). However, the same has much room for improvement in relation to the benchmarks for the assigned ratings. Total CAR of the Bank has remained well above the regulatory requirement. CAR represents room for growth; however, the rectification of asset quality indicators is considered critical for the same.

Digitization: Over the last three years, the Bank has improved internal control systems through digitization. This majorly encompasses digitization and centralization of Credit Administration Department (CAD), centralization of loan approval system and creation of CLSD at HO under the administration of Enterprise Risk Management Division (ERMD). In addition, the Bank has deployed various information system tools in compliance and risk divisions. For MCOs tablet applications have been launched in 7 zones and is expected to be rolled out completely by end-Jun'23. The deployment of Managed Network Infrastructure has been reached to 462 sites as of now and is expected to complete by end-3Q'CY23. A network operations centre has been set up to supervise the monitoring of IT-network equipment and services. The Information System Department has completed the first phase of RAAST, which includes the Micro Payment Gateway, with success. The vendor is working on the second phase which is expected to complete by end-Sep'23. To ensure efficient and seamless services to internal customers, an integrated helpdesk solution called HaloITSM has been implemented. This solution allows for centralized recording of all complaints and utilizes an escalation process that aligns with advanced enterprise standards in the industry. Moreover, efforts have been made to streamline the lending process, including the validation of e-stamp paper and the implementation of a digital land record system.

Internet banking is currently in pilot phase. For acquisition of mobile phone application, vendor has been finalized. In addition, USSD channel platform, a global system for mobile communications (GSM) protocols is contemplated to kick off in 1Q'CY24. The number of ATMs installed have reached 50 as of now while another 50 ATMs would be installed by end-CY23. The Bank is pursuing to get approval for branchless banking license, which will further lead to increase in financial inclusion. Meanwhile, acquisition of core banking system has suffered delays. Acquisition of core banking system is expected by end-Dec'23 while implementation is contemplated over the following three years.

Corporate Governance: Bank (Nationalization) Act, 1974 states that the Chairman, the President, and other members of the Board, representing Federal Government's direct and indirect shareholding, shall be appointed by the Federal Government in consultation with the State Bank of Pakistan (SBP), for a term of three years, on such terms and conditions as may be fixed by the General Meeting of the Bank. Further the Bank has setup a Nomination Committee as per Public Sector Companies (Corporate Governance) Rules, 2013 to identify, evaluate and recommend candidates for vacant positions. At present, the Board comprised six members, including Acting President/ Chief Executive Officer (CEO), two independent directors and three non-executive directors. There is currently a vacancy for the positions of Chairman and President/CEO, following the retirement of Mr. Muhammad Shahbaz Jameel as President/CEO in November 2022. Mr. Asad Ullah Habib is currently serving as Acting President/CEO. With respect to Chairman of the Board, it should be noted that while constituting ZTBL Board by Federal Government in Dec, 2020, Mr. Nadeem Lodhi was appointed as Chairman Board, however, he resigned from the position in Mar'22 and since then the position has remained vacant despite several requests to Federal Govt. In the absence of Chairman Board, Mr. Muhammad Shahbaz Jameel was just chairing the Board meetings as per provisions of Banks (Nationalization) Act, 1974. During 2022, nine meetings of the Board of Directors (BoD) were convened with satisfactory attendance level.

The restrictions imposed by SBP on new hiring or appointments due to non-functional Board in previous years have been lifted in August, 2022. The Bank had been facing various issues leading to subdued performance at multiple facets. In 2022, 118 Bank employees of various cadres above OG-III have left due to retirement, exit policy or resignations. In addition, the Bank is facing acute shortage of field functionaries (Mobile Credit Officers (MCOs) and branch managers). The shortage of field functionaries/MCOs has been obstructing the contact level with borrowers. The Board Human Resource Committee (BHRC) has approved a batch of 300 MCOs for deployment in the ongoing year. For CY23, the BHRC has proposed to hire an additional 300 MCOs and 300 cash officers while 176 employees are intended to be hired in OG-III cadre. In 2021, the Bank hired the services of M/s E&Y, consultants firm for restructuring/re-organization and revision of the employees' compensation packages. The Bank also hired the services of a head hunting firm for recruitment of key executives. The Financial Statements for 2022 were audited by BDO Ebrahim & Co Chartered Accountants, who have been reappointed for 2023.

Zarai Taraqiati Bank Limited — Annexure I

FINANCIAL SUMMARY (in billion Rs.)				
BALANCE SHEET	**Dec'20**	**Dec'21**	**Dec'22**	**Mar'23**
Total Investments	39.8	82.4	306.8	485.9
Gross Advances	129.9	115.3	107.6	106.4
Advances - net	102.7	91.8	90.5	90.4
Total Assets	**210.7**	**254.8**	**491.1**	**646.8**
Borrowings	81.2	132.3	354.9	519.5
Deposits & other accounts	49.2	43.6	47.3	37.9
Paid up Capital	52.7	52.7	52.7	52.7
Tier-1 Equity	46.9	45.0	49.6	51.0
Net Shareholders Equity (excl. revaluation surplus)	56.7	53.9	59.7	60.0
INCOME STATEMENT	**Dec'20**	**Dec'21**	**Dec'22**	**Mar'23**
Net Mark-up Income	8.3	12.2	14.5	4.7
Net Provisioning/ (reversal)	1.3	0.8	(3.6)	(1.0)
Non-Markup Income	1.3	1.3	1.4	0.4
Operating Expenses	11.5	10.9	12.1	3.2
Profit/(Loss) Before Tax	(3.2)	1.8	7.5	3.0
Profit/(Loss) After Tax	(2.5)	(1.7)	5.1	1.4
RATIO ANALYSIS	**Dec'20**	**Dec'21**	**Dec'22**	**Mar'23**
NPLs	59,225	40,800	33,739	30,381
Gross Infection (%)	45.6%	35.4%	31.3%	28.5%
Provisioning Coverage (Specific) (%)				
Provisioning Coverage (total) (%)	46.0%	57.5%	50.9%	52.8%
Net Infection (%)	33.1%	21.5%	21.0%	18.6%
Cost of Funds (%)	8.43%	7.14%	11.45%	16.02%
Net NPLs to Tier-1 Capital (%)	70.1%	42.5%	37.3%	32.2%
Advances to Deposit Ratio (%)*	153%	139%	112%	137%
Tier-1 Capital Adequacy Ratio (CAR (%))	28.3%	30.7%	32.09%	32.18%
Total CAR (%)	30.4%	32.7%	33.69%	33.16%
Markup Spreads (%)	4.89%	6.06%	5.77%	2.56%
LCR (%)	784%	728%	728%	896%
NSFR (%)	128%	127%	129%	116%
Efficiency (%)	120.3%	81.0%	76.5%	62.0%
ROAA (%)	-1.2%	-0.7%	1.4%	1.0%**
ROAE (%)	-4.5%	-3.2%	9.2%	9.1%**
Liquid Assets to Deposits & Borrowings* (%)**	44.0%	54.1%	62.2%	52.4

**Adjusted for SBP subsidized borrowings*
***Annualized*
****Adjusted for Collateral*

REGULATORY DISCLOSURES — Annexure II

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				
22-June-23	AAA	A-1+	Stable	Reaffirmed
30-June-22	AAA	A-1+	Stable	Maintained
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-June-15	AAA	A-1+	Stable	Reaffirmed
08-August-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.
Disclaimer	Information herein was obtained from sources believed to be accurate and reliable; however, VIS does not guarantee the accuracy, adequacy or completeness of any information and is not responsible for any errors or omissions or for the results obtained from the use of such information. Copyright 2023 VIS Credit Rating Company Limited. All rights reserved. Contents may be used by news media with credit to VIS.
Due Diligence Meetings Conducted	

Name	Designation	Date
Mr. Muhammad Arif	CFO	June 01, 2023
Mr. Arshad Hassan Awan	Head Credit Division	
Mr. Shah Miftah ul Azim	Head Treasury Division	
Mr. Salman Arshad	Head Enterprise Risk Management Division	
Mr. Mustansar Billah	Head Recovery & SAM Division	
Zahid Hussain	SEVP/Group-Head (Operations , PR&MSD and LM&MD)	
Zeeshan Mazhar	EVP/Divisional Head Information System Division	