

RATINGS (JUNE 2010)

BANK OF KHYBER (BoK)

	New	Previous
Entity		
Long-Term	BBB+	BBB
Short-Term	A2	A2
Outlook	Positive	-

FINANCIAL DATA

PKR (mln)

	1Q10[^]	Dec-09	Dec-08
Total Assets	36,576	38,811	31,339
Equity	5,372	5,265	5,677
Net Income	107	(637)	137
ROA %	1.1	(1.8)	0.4
ROE %	8.1	(11.7)	2.4
Equity / Assets (%)	14.7	13.6	18.1

[^] Based on unaudited accounts for 3 months ended March 31, 2010

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RATING RATIONALE AND KEY RATING DRIVERS

- The ratings of BoK reflect its strong patronage with the government of Khyber Pakhtunkhwa – a majority shareholder (51%) of the bank. Meanwhile, the ratings acknowledge increased focus on more formalized policies and procedures and strengthening of operating platform, following the changes in top management. Nonetheless, the bank’s limited institutional profile in terms of small size, lack of brand equity, pressure on risk absorption capacity due to potential provisioning and constrained operating environment are key challenges.
- The ratings have been assigned a positive outlook based on sponsor’s plan to inject equity to the tune of PKR 3bln in the bank. Timely completion of this transaction will be a key rating driver. At the same time, management’s ability to effectively implement its overall business strategy and strengthening of the systems and processes will remain crucial.

ASSESSMENT

- BoK is undergoing a strategic shift whereby it envisages establishing itself as a geographically diversified bank with operations spread across the country. However, main focus would be areas having business relations with entities in Khyber Pakhtunkhwa. The bank plans to enhance its earning avenues through lending to large corporates, while continuing to cater SMEs. Furthermore, development and implementation of risk management policies and guidelines remains a core area of focus for the management during the year.
- BoK’s performance was subdued during 2009. Consistent with industry trend, its financing portfolio remained largely stagnant, despite a reasonable increase in deposits. The bank’s spreads came under pressure owing to lack of high-yielding deployment avenues and its inherently high cost of funding. Other operating income witnessed modest improvement on back of capital gains resulting from improvement in stock market performance during 2009 and slightly better non-fund revenues. However, a significant rise in provisions (2009: PKR 1,261mln, 2008: 239mln) owing to increasing NPLs and recognizing of deferred provisions against available for sale (AFS) investment portfolio (PKR 558mln) rendered the bottom-line into red. During 1Q10, BoK posted a profit of PKR 107mln, mainly attributable to capital gain (PKR 162mln) recognized on transfer of NIT units.
- Going forward, the management, following a cautious stance, plans to explore new growth opportunities while aiming to tighten the control environment and lending criteria to avoid further drag on its asset quality. The bank’s strategy to establish its presence in Punjab and Sindh is expected to fuel the targeted growth in advances. However, the short-term profitability remains vulnerable to further provisioning against NPLs.
- BoK’s asset quality has deteriorated significantly over the year (NPLs to total advances Dec09: 30%, Dec08: 22%), owing mainly to adverse socio-economic conditions, high exposure to relatively less resilient SME segment, and weakness in risk management framework. Meanwhile, concentration in the loan book remained high (Top 20 exposures > 50% of loan book). However, the bank has managed to arrest the trend through aggressive recovery efforts during 2Q10. Going forward, timely execution of formulated credit policies would remain important.
- The bank’s investment policies and procedures and in-house resources have been strengthened during the year. BoK’s investment portfolio as a percentage of total assets increased over the year (2009: 39% 2008: 24%), a shift largely consistent with the industry. These investments are concentrated in government securities (84% of total investments at end-Dec09), mainly treasury bills, hedging BoK against market risks. The remaining portfolio comprises investments in stock market and mutual funds.
- BoK’s equity base, in turn its risk absorption capacity, has depleted (2009: PKR 5,264mln, 2008: PKR 5,678mln) over the year following sizeable losses suffered by the bank. BoK is currently non-compliant with SBP’s regulatory minimum capital requirement (MCR). Cognizant of this situation, the provincial government plans to inject PKR 3bln in the bank. This amount will be transferred from ‘Federal Credit Guarantee Scheme’ of SBP. This equity injection will remain critical for the bank, given the mounting pressure on its equity base in shape of unprovided NPLs (2009: 28%, 2008: 19%).
- Deposits from Khyber Pakhtunkhwa government comprise 48% of the deposit base at end-Dec09. Although, mobilized largely at competitive market rate, these deposits lend stability to the overall funding base. Going forward, BoK’s plan to enhance its presence across the country will have positive implications for its deposit base.

PROFILE

- Bank of Khyber (BoK) was established in 1991 under the BoK Act, passed by the Provincial Legislative Assembly of Khyber Pakhtunkhwa (formerly N.W.F.P). It was awarded status of a scheduled bank in September 1994. The provincial government has majority stake in BoK (51%), whereas, Ismail Industries and AKD with 14.15% and 4.53% holdings, respectively, are other major shareholders.
- The board comprises eight members, including the CEO, Mr. Bilal Mustafa. The remaining members include four nominees of government of Khyber Pakhtunkhwa, including two ex-officio members. One member represents Ismail Industries, while two are independent.

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