The Pakistan Credit Rating Agency Limited

THE BANK OF KHYBER
RATING REPORT

	NEW [DEC-17]	PREVIOUS [JUN-17]
Long-Term	A	A
Short-Term	A1	A1
Outlook	Stable	Stable

REPORT CONTENTS

DECEMBER 2017

Profile &Ownership

- The Bank of Khyber (BoK) was established in 1991 under the BoK Act and was awarded status of a scheduled bank in September 1994.
- BoK was established with a vision to gradually promote Islamic banking. At present, 83 of its branches function as dedicated Islamic banking branches, whereas 82 cater conventional banking.
- The Government of Khyber Pakhtunkhwa (GoKP) has majority stake in BoK (70%), whereas, Ismail Industries significantly increased its stake (24%) in BoK in CY16.

Governance & Management

- Board composition is in line with the parameters set in the BoK Act.
- The board comprises seven members, out of which four are GoKP nominees, including two ex-officio members and a Managing Director. The remaining includes one member of Ismail Industries and two independent members.
- The risk of government intervention remains as it may impact the objectivity as well as consistency in policy making and oversight process by the board.
- Dr. Shahzad Khan Bangash is elected as the new chairman of the board as he took the charge in Nov-17.
- The senior management team at BoK comprises seasoned professionals; majority having long term association with the bank.
- Current Acting Managing Director– Mr. Muhammad Shahbaz Jameel – was appointed by the government in Oct-17. He is a seasoned banker with twenty four (24) years of diverse experience at leading multinational financial institutions.

Risk Management and Asset Quality

- During 9MCY17 BoK's earning assets grew by ~28%; a facet of increased advances book by PKR 42bln.
- At end-Sep17, gross advances increased to PKR 70,610mln (CY16: PKR 36,054mln). These are mainly concentrated in corporate segment.
- Banks' investment increased slightly by 12% majory contribution by government securities.
- BoK's asset quality slightly improved as reflected by NPLs to Gross Advances ratio (9MCY17: 7%; CY16: ~14%CY15: 13%).
- FSV benefit availed by BoK has limited the bank's provisioning expense as depicted by loan loss coverage (9MCY17: 85%; CY16: 80%; CY15: 72%; CY14: 71%).

Business Risk

- During 9MCY17, the bank net interest margin slightly improved by ~3.69% on YOY basis as the bank revenue increased (19.5%), but the net intesest expense increased with the higher ratio 29.9%.
- Decreased other income, a factor of decrease from gain on sale of investments – total net revenue stands at PKR 5,026mln ((9MCY16: PKR 5,152mln).
- Pesonnel expenses increased slightly PKR 1,612mln (9MCY16: 1,461mln); on account of increased number of branches.
- As aresult the bank posted a profit YoY (9MCY17: PKR 1,375mln; CY16: PKR 2,020mln; 9MCY16: PKR 1,470mln).
- Going forward, BoK, while expanding its branch network, has identified Islamabad and Lahore, as Hubs to expand its operations. Meanwhile, the bank intends to efficiently utilize its existing network, mainly out of KPK. The bank while having cautious approach, intends to increase its advances especially in power, infrastructure and cement sector amongst others.
- **Capital & Funding**
- Deposit base persisted sloping towards interest rate sensitive (saving and time) deposits which constitute ~79%.
- Top-20 depositors' concentration slightly increased to 55% at end- Dec16(end-CY15: 50%).
- Banks's borrowing increased – especially from other financial institution by PKR 58bln (CY16: PKR 27bln).
- BoK mainatained its CAR at 21.1% during 9MCY17 (21.3% at end-Dec16).

RATING RATIONALE

The ratings reflect BOK's strong fundamentals. This includes sound liquidity and high capital adequacy, accompanied by improving profitability. Spreads remained low, showed a downward trend. NPLs has seen slight rise hence require management attention though provision coverage is adequate. The bank has dependence on large ticket deposits from Government of Khyber Pakhtunkhwa (GoKP) and its related agencies. However, stability is observed in such deposits over time. The bank is expanding its branch network with high focus on KPK and Punjab; However, slightly establishing footprints in other provinces may be needed to better compete with established banks. The management plans to increase advances book with higher focus preferably on power, cement and infrastructure. With desired credit growth, nurturing strength of management team is essential. The ratings incorporate association of the bank with the Government of Khyber Pakhtunkhwa (GoKP).

KEY RATING DRIVERS

The ratings are dependent on bank's ability to hold its risk profile, while maintaining its relative market position. Improvement in the technology platform is critical to foster the control environment including reporting framework. Meanwhile, any significant infection in asset quality, thereby weakening the bank's risk absorption capacity, and/or any intervention compromising the governance standards would impact negatively.

BANKING SECTOR

The banking sector experienced substantial expansion in its deposit base (2016: 14%). Building on the uptick in the economy, advances also grew by a sizeable margin after a lag of many years. Given GDP growth in FY17 and other macro-economic fundamentals, credit expansion is foreseen. Hence, CAR is going to be a challenge, as profits would also suffer due to PIBs maturities.

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The Bank of Khyber

BALANCE SHEET	30-Sep-17	31-Dec-16	31-Dec-15	31-Dec-14
Earning Assets				
Advances (Net of NPL)	65,296	30,598	35,004	38,733
Debt Instruments	4,008	3,604	1,002	1,645
Total Finances	69,305	34,202	36,006	40,378
Investments	154,276	138,286	87,221	70,689
Others	6,065	16,393	17,686	2,659
	229,646	**188,881**	**140,913**	**113,726**
Non Earning Assets				
Non-Earning Cash	5,826	11,052	7,579	6,061
Deferred Tax	304	-	-	-
Net Non-Performing Finances	516	758	1,523	1,422
Fixed Assets & Others	5,729	5,709	5,144	4,897
	12,376	**17,519**	**14,245**	**12,380**
TOTAL ASSETS	**242,022**	**206,400**	**155,159**	**126,106**
Interest Bearning Liabilities				
Deposits	161,546	157,020	117,292	92,264
Borrowings	59,933	28,701	17,130	14,192
	221,479	185,721	134,422	106,456
Non Interest Bearing Liabilities	5,373	4,537	4,819	4,731
TOTAL LIABILITIES	**226,852**	**190,258**	**139,241**	**111,187**
EQUITY (including revaluation surplus)	**15,169**	**16,143**	**15,918**	**14,920**
Total Liabilities & Equity	**242,022**	**206,400**	**155,159**	**126,106**

INCOME STATEMENT	30-Sep-17	31-Dec-16	31-Dec-15	31-Dec-14
	9M	Annual	Annual	Annual
Interest / Mark up Earned	10,602	12,049	10,869	9,751
Interest / Mark up Expensed	(7,136)	(7,643)	(6,442)	(6,210)
Net Interest / Markup revenue	**3,465**	**4,406**	**4,428**	**3,541**
Other Income	1,472	2,584	1,680	995
Total Revenue	**4,937**	**6,990**	**6,108**	**4,536**
Non-Interest / Non-Mark up Expensed	(2,727)	(3,209)	(2,688)	(2,471)
Pre-provision operating profit	2,299	3,871	3,539	2,135
Provisions	87	631	581	235
Pre-tax profit	2,213	3,240	2,959	1,901
Taxes	(837)	(1,219)	(1,169)	(591)
Net Income	**1,375**	**2,020**	**1,789**	**1,309**

Ratio Analysis	30-Sep-17	31-Dec-16	31-Dec-15	31-Dec-14
	9M	Annual	Annual	Annual
Performance				
ROE	13%	14%	13%	10%
Cost-to-Total Net Revenue	55%	46%	44%	54%
Other operating income/ Total net revenue	30%	37%	28%	22%
Capital Adequacy				
Equity/Total Assets	6%	7%	9%	10%
Capital Adequacy Ratio as per SBP	21%	21%	24%	23%
Funding & Liquidity				
Liquid Assets / Deposits and Borrowings	67%	83%	73%	71%
Advances / Deposits	41%	20%	31%	43%
CASA deposits / Total Customer Deposits	52%	61%	59%	66%
Intermediation Efficiency				
Asset Yield	7%	7%	9%	9%
Cost of Funds	-5%	-5%	-5%	-6%
Spread	2%	3%	3%	3%
Outreach				
Branches	165	150	130	116

CREDIT RATING SCALE & DEFINITIONS

Credit rating reflects forward-looking opinion on credit worthiness of underlying entity or instrument; more specifically it covers relative ability to honor financial obligations. The primary factor being captured on the rating scale is relative likelihood of default.

LONG TERM RATINGS

AAA	**Highest credit quality.** Lowest expectation of credit risk. Indicate exceptionally strong capacity for timely payment of financial commitments.
AA+ AA AA-	**Very high credit quality.** Very low expectation of credit risk. Indicate very strong capacity for timely payment of financial commitments. This capacity is not significantly vulnerable to foreseeable events.
A+ A A-	**High credit quality.** Low expectation of credit risk. The capacity for timely payment of financial commitments is considered strong. This capacity may, nevertheless, be vulnerable to changes in circumstances or in economic conditions.
BBB+ BBB BBB-	**Good credit quality.** Currently a low expectation of credit risk. The capacity for timely payment of financial commitments is considered adequate, but adverse changes in circumstances and in economic conditions are more likely to impair this capacity.
BB+ BB BB-	**Moderate risk.** Possibility of credit risk developing. There is a possibility of credit risk developing, particularly as a result of adverse economic or business changes over time; however, business or financial alternatives may be available to allow financial commitments to be met.
B+ B B-	**High credit risk.** A limited margin of safety remains against credit risk. Financial commitments are currently being met; however, capacity for continued payment is contingent upon a sustained, favorable business and economic environment.
CCC CC C	**Very high credit risk**. Substantial credit risk "CCC" Default is a real possibility. Capacity for meeting financial commitments is solely reliant upon sustained, favorable business or economic developments. "CC" Rating indicates that default of some kind appears probable. "C" Ratings signal imminent default.
D	Obligations are currently in default.

SHORT TERM RATINGS

A1+: The highest capacity for timely repayment.

A1:. A strong capacity for timely repayment.

A2: A satisfactory capacity for timely repayment. This may be susceptible to adverse changes in business, economic, or financial conditions.

A3: An adequate capacity for timely repayment. Such capacity is susceptible to adverse changes in business, economic, or financial conditions.

B: The capacity for timely repayment is more susceptible to adverse changes in business, economic, or financial conditions.

C: An inadequate capacity to ensure timely repayment.

Outlook (Stable, Positive, Negative, Developing)
Indicates the potential and direction of a rating over the intermediate term in response to trends in economic and/or fundamental business/financial conditions. It is not necessarily a precursor to a rating change. 'Stable' outlook means a rating is not likely to change. 'Positive' means it may be raised. 'Negative' means it may be lowered. Where the trends have conflicting elements, the outlook may be described as 'Developing'.

Rating Watch
Alerts to the possibility of a rating change subsequent to, or in anticipation of, a) some material identifiable event and/or b) deviation from expected trend. But it does not mean that a rating change is inevitable. A watch should be resolved within foreseeable future, but may continue if underlying circumstances are not settled. Rating Watch may accompany Outlook of the respective opinion.

Suspension
It is not possible to update an opinion due to lack of requisite information. Opinion should be resumed in foreseeable future. However, if this does not happen within six (6) months, the rating should be considered withdrawn.

Withdrawn
A rating is withdrawn on a) termination of rating mandate, b) cessation of underlying entity, c) the debt instrument is redeemed, d) the rating remains suspended for six months, e) the entity/issuer defaults., or/and f) PACRA finds it impractical to surveill the opinion due to lack of requisite information

Regulatory and Supplementary Disclosure

Name of Rated Entity The Bank of Khyber
Sector Banking
Type of Relationship Solicited

Purpose of the Rating Independent Risk Assessment

Rating History

Dissemination Date	Long Term	Short Term	Outlook	Action
29-Dec-17	A	A1	Stable	Maintain
21-Jun-17	A	A1	Stable	Maintain
30-Jun-16	A	A1	Stable	Maintain
30-Jun-15	A	A1	Stable	Maintain
30-Jun-14	A	A1	Stable	Maintain
28-Jun-13	A	A1	Stable	Upgrade
30-Jun-12	A-	A2	Positive	Maintain
30-Jun-11	A-	A2	Positive	Maintain
30-Dec-10	A-	A2	Stable	Upgrade

Related Criteria and Research Banking Sector - Viewpoint | Jun-17

Rating Methodology Bank Rating Methodology

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Rating Team Statement

Rating Procedure
Rating is an opinion on relative credit worthiness of an entity or debt instrument. It does not constitute recommendation to buy, hold or sell any security. The rating team for this assignment does not have any beneficial interest, direct or indirect in the rated entity/instrument.

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PACRA initiates immediate review of the outstanding rating(s) upon becoming aware of any information that may be reasonable be expected to result in any change (including downgrade) in the rating

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