The Pakistan Credit Rating Agency Limited

# Rating Report

# The Bank of Khyber

**Report Contents**



**Rating History**

| Dissemination Date | Long Term Rating | Short Term Rating | Outlook | Action | Rating Watch |
|---|---|---|---|---|---|
| 25-Jun-2022 | A | A1 | Stable | Maintain | - |
| 26-Jun-2021 | A | A1 | Stable | Maintain | - |
| 26-Jun-2020 | A | A1 | Stable | Maintain | - |
| 24-Dec-2019 | A | A1 | Stable | Maintain | - |
| 25-Jun-2019 | A | A1 | Stable | Maintain | - |
| 24-Dec-2018 | A | A1 | Stable | Maintain | - |
| 25-Jun-2018 | A | A1 | Stable | Maintain | - |
| 29-Dec-2017 | A | A1 | Stable | Maintain | - |
| 21-Jun-2017 | A | A1 | Stable | Maintain | - |
| 30-Jun-2016 | A | A1 | Stable | Maintain | - |

## Rating Rationale and Key Rating Drivers

The ratings reflect Bank of Khyber’s sustained business profile, on an overall basis, as reflected by largely intact customer deposit system share (end-Dec21: 1.1%, end-Dec20: 1.2%). The incumbent leadership assumed the stewardship of the Bank and has devised a clear and prudent strategy for growth and performance improvement of the Bank. The management team is fully cognizant of the prevailing micro and macro challenges and aligned on the strategy to bring improvement in all the key indicators of the Bank. The deposit mix remained tilted towards saving deposits, while the CASA ratio witnessed improvement (CY21: 65.2%; CY20: 61.1%). Net markup income registered slight increase during the period. Further, Non-mark-up income recorded a downfall primarily due to loss on securities as against sizeable gains realized last year. Moreover, an enhancement in branch network has been a major dimension for the Bank in CY21 (CY21: 216; CY20: 179). Sustainability in net-mark up income continued enhancement in non-fund-based exposure and strengthened treasury operations are important for future years. The dividend payouts in the past had led to limited growth in the equity base of the Bank, however, the Bank prudently opted to only issue bonus shares for FY-2021 to shore up the capital. The Bank while having a cautious approach, intends to increase its exposure to Private Sector Advances. It remains vital for Bank to properly manage the credit risk, if any, arising from lending through government schemes. The Bank has further embarked upon improving efficiency and effectiveness in operating system through the implementation of widely used Core Banking Software T-24. Asset quality declined as reflected by NPLs to Gross Advances ratio (CY21:8.0%; CY20: 5.4%) whilst coverage diluted (end-Dec21: 62.9%, endDec20: 80.3%). The management has developed and started implementation of a well thought out strategy for reduction of NPLs and improvement of portfolio quality. The Investment book increased tilted towards Govt. papers. The Bank’s total CAR stands at 14.7% as of end-Dec21. Pakistan’s economy has gone through several varied phases in the last two years due to the COVID19 pandemic. The banking sector continued to flourish with high profitability. Going forward, the macro-economic environment is beset with myriad challenges due to heightened interest rates, tightening of demand, rupee depreciation, and higher inflation. This has repercussions for the several segments of the economy.

The ratings are dependent on the bank's ability to hold its risk profile while maintaining its relative market position. Moreover, the Bank enjoys continued support of its strong sponsors that can have a positive impact on Bank’s rating going forward.

**Disclosure**

| | |
|---|---|
| **Name of Rated Entity** | The Bank of Khyber |
| **Type of Relationship** | Solicited |
| **Purpose of the Rating** | Entity Rating |
| **Applicable Criteria** | Methodology \| Financial Institution Rating(Jun-21),Criteria \| Correlation Between Long-term & Short-term Rating Scales(Jun-21),Criteria \| Rating Modifiers(Jun-21) |
| **Related Research** | Sector Study \| Commercial Bank(Jun-21) |
| **Rating Analysts** | Sehar Fatima \| sehar.fatima@pacra.com \| +92-42-35869504 |

## Profile

**Structure** The Bank of Khyber (BoK) was established in 1991 under the BoK Act, passed by the Provincial Legislative Assembly of the province of Khyber Pakhtunkhwa (KPK)

**Background** BoK was established with a vision to gradually promote Islamic banking. At present, the Bank operates 216 branches including 110 Islamic banking branches (2020: 179 branches including 91 Islamic banking branches).

**Operations** Bank of Khyber is operating as a scheduled bank. The bank registered office is located at The Mall – Peshawar Cantt. Further, It operates with 1,433 employees. The branch network is mainly concentrated in the province of KP and also increasing in Punjab while having a limited presence in all other provinces of Pakistan.

## Ownership

**Ownership Structure** The Government of Khyber Pakhtunkhwa (GoKP) has a majority stake in BoK (70%), whereas, Ismail Industries owns 24.2%. The remaining shareholding is widely dispersed.

**Stability** As the major shareholding remains with the Government of Pakhtunkhwa, and bank is looking to grow market share in low-cost deposit. And in future, the bank's shareholding pattern is expected to remain stable in the foreseeable future.

**Business Acumen** The Khyber Pakhtunkhwa is one of the biggest provinces of Pakistan. The Government of Khyber Pakhtunkhwa will maintain its 70% stake in the bank but will not influence the day-to-day management affairs.

**Financial Strength** The bank is backed by the Government of Khyber Pakhtunkhwa which adds to the financial muscle. Also, Ismail Industries is one of the leading confectioneries, snacks, and biscuit manufacturing company

## Governance

**Board Structure** Currently, there are four independent directors and two non- executive directors including chairman and one executive director. Board composition is in line with the parameters set in the BoK Act.

**Members' Profile** The profile of the members is considered strong where majority members are representing government on board. Shahab Ali Shah has been appointed as the Chairman of the board since May-21. During the year 2021, three directors resigned from the Board of Director of the Bank whereas two new directors having strong professional background were co-opted by the Board

**Board Effectiveness** The board monitors the key functional and risk areas through its five committees; i) Audit Committee, ii) Human Resource & Remuneration Committee, iii) Risk Management Committee and iv) Board IT Steering Committee v) Compliance Committee

**Financial Transparency** The auditors of the bank, M/S EY Ford Rhodes, Chartered Accountants have expressed an unqualified opinion on the bank's financial statements for the year ended December 31, 2021

## Management

**Organizational Structure** The bank's overall functions are currently segregated into twelve divisions, including: (I) Business Management Group, (ii) Remedial Asset Management Division, (iii) Islamic Banking, (iv) Treasury & Investment, (v) Operations & Support, (vi) SAM & CAD, (vii) IT, (viii) Finance, (ix) Risk Management, (x) Compliance, (xi) Conventional banking & Human Resource, and (xii) Internal Audit.

**Management Team** Mr. Muhammad Ali Gulfaraz took the charge as Managing Director on August 12, 2021. Mr. Ali Gulfaraz brings with him an extensive experience of 25 years in global corporate and investment banking. Other senior management consists of seasoned professionals.

**Effectiveness** The bank has 10 committees in place at the management level with well-defined terms of reference to oversee its day-to-day operational matters and to take decisions to implement the strategy outlined by the board.

**MIS** The frequency of reports generated are daily, weekly, and monthly. The quality of the reports is considered adequate. Islamic Banking deposits are accepted on a Musharakah basis and the Bank has acquired software "Al-Qist" for Profit Distribution and Pool Management

**Risk Management Framework** BoK has established separate risk management, credit management, and compliance and internal control divisions. The IRMC and ALCO of management operate within the established framework to monitor the bank's activities and maintain the risk level within predefined limits. Market, Liquidity, Operational, Environmental, and Country risks are being looked after by the Enterprise Risk Management Division (ERMD).

## Business Risk

**Industry Dynamics** Pakistan's economy has gone through several varied phases in last two years. It was deeply impacted by the magnitude of the COVID19 pandemic. The economic activity revived afterwards and Pakistan posted a GDP growth rate of ~4.0% in FY21 after a contraction in economy of -0.4% in FY20 (GDP growth figures were revised after base year was changed from FY05-06 to FY15-16). Banking sector continues to flourish with high profitability. Banking sector weightage is approximately ~25% of the KSE 100 index. Total banking assets posted growth of ~19% YoY whilst investments surged by 21% YoY to PKR ~14.4trln (end-Dec20: PKR ~11.9trln). Gross Advances of the sector recorded growth (23%) to stand at PKR ~10.9trln (end-Dec20: PKR ~8.8trln). Non-performing loans witnessed slight uptick of 4% to PKR ~860bln. Capital Adequacy Ratio stood at 16.7% (regulatory requirement of 11.5%). During CY21, banking sector deposits enhanced to PKR ~21.6trln (grew by ~17%). Hence, ADR rationalized to 47% (end-Dec20: ~45%). Net profitability of the sector recorded at PKR ~267bln (CY20: PKR ~244bln); up 9% YoY. However, growth of equity base of the sector recorded meagre uptick of 0.8% YoY attributable to handsome dividend payou

**Relative Position** : The Bank of Khyber - a small-sized bank with the system share, (Deposits: End-Dec21: 1.1%, End-Dec20: 1.2%) during recent years. During CY21, the bank was able to record growth by 8.4% against average growth reflected by small banks of around 12.7%.

**Revenues** During CY21, markup income reported an attrition by 14.4% on a YOY basis to stand at PKR 22bln from PKR 25.7bln (CY20), attributable to decline in both mark up earned from advances and investments. Further, analysis reveals that since last two years, greater reliance is on mark up earned from investments (CY21: PKR 12.4bln, CY20: PKR 14.4bln).

**Performance** The bank's non-markup expenses increased to PKR 5.3bln (CY20: PKR 4.2bln), up 25.5%. attributable to surge in compensation expenses

**Sustainability** Going forward, BoK, is aiming to generate deposit through CASA from the private sector, and the bank intends to diversify financing portfolio by gradually moving from Government backed lending to private sector for fresh loans with potential of ancillary business and trade finance opportunities. Besides, other target areas remain Consumer Financing, Agriculture and SMEs to foster development and generate economic activity. The Bank has further embarked on improving efficiency and effectiveness of internal controls through the implementation of widely used Core Banking Software T-24

## Financial Risk

**Credit Risk** The client concentration remained high with the top 10 customers demonstrating 56.05% of BoK's overall advances (CY20: 59.4%); considered high. Advances to deposits declined to 56.1% (end-Dec20: 63.6%). And NPLs to Gross Advances ratio stand at (CY21:8.0%; CY20: 5.4%) – mainly due sizable increase in NPLs (end-Dec21: PKR 10.5bln, end-Dec20: PKR 7.2bln).

**Market Risk** Government securities consist of 99.0% of the total investment (CY20: 99.1%). BoK's investments significantly increased and clocked in at PKR 175.1bln (CY20: PKR 94.2bln).

**Liquidity And Funding** The bank's deposit base enhanced to PKR 221.8bln (end-Dec20: PKR 203.0bln). CASA increased to 65.2% (end-Dec20: 61.1%) primarily attributable to increase in SA deposits

**Capitalization** The bank's total equity stands at PKR 16.6bln in CY21 (CY20: PKR 17.7bln). The equity over total assets declined further and reported at only 4.6% in CY21 (CY20: 6.2%).

PACRA

PKR mln

| Bank of Khyber<br>Listed Public Limited | Dec-21<br>12M | Dec-20<br>12M | Dec-19<br>12M | Dec-18<br>12M |
|---|---|---|---|---|
| **A BALANCE SHEET** | | | | |
| 1 Total Finances - net | 130,121 | 146,828 | 120,511 | 105,717 |
| 2 Investments | 175,089 | 94,282 | 135,350 | 83,025 |
| 3 Other Earning Assets | 17,226 | 16,475 | 21,823 | 8,456 |
| 4 Non-Earning Assets | 32,432 | 29,283 | 27,829 | 25,394 |
| 5 Non-Performing Finances-net | 3,739 | 1,432 | 793 | 503 |
| **Total Assets** | 358,606 | 288,300 | 306,305 | 223,095 |
| 6 Deposits | 221,876 | 203,072 | 182,168 | 171,168 |
| 7 Borrowings | 110,069 | 57,063 | 94,656 | 34,842 |
| 8 Other Liabilities (Non-Interest Bearing) | 10,091 | 10,394 | 15,280 | 5,381 |
| **Total Liabilities** | 342,036 | 270,528 | 292,104 | 211,390 |
| **Equity** | 16,570 | 17,772 | 14,201 | 11,705 |
| **B INCOME STATEMENT** | | | | |
| 1 Mark Up Earned | 21,939 | 25,673 | 24,657 | 14,686 |
| 2 Mark Up Expensed | (15,150) | (18,911) | (19,891) | (9,547) |
| 3 Non Mark Up Income | 1,023 | 2,878 | 1,112 | (526) |
| **Total Income** | 7,812 | 9,640 | 5,878 | 4,613 |
| 4 Non-Mark Up Expenses | (5,300) | (4,223) | (3,638) | (4,077) |
| 5 Provisions/Write offs/Reversals | (832) | (1,610) | 21 | 171 |
| **Pre-Tax Profit** | 1,680 | 3,806 | 2,261 | 707 |
| 6 Taxes | (577) | (1,655) | (955) | (241) |
| **Profit After Tax** | 1,104 | 2,152 | 1,306 | 466 |
| **C RATIO ANALYSIS** | | | | |
| **1 Performance** | | | | |
| Net Mark Up Income / Avg. Assets | 2.1% | 2.3% | 1.8% | 2.2% |
| Non-Mark Up Expenses / Total Income | 67.8% | 43.8% | 61.9% | 88.4% |
| ROE | 6.4% | 13.5% | 10.1% | 3.4% |
| **2 Capital Adequacy** | | | | |
| Equity / Total Assets (D+E+F) | 4.6% | 6.2% | 4.6% | 5.2% |
| Capital Adequacy Ratio | 14.7% | 19.3% | 15.3% | 12.3% |
| **3 Funding & Liquidity** | | | | |
| Liquid Assets / (Deposits + Borrowings Net of Repo) | 50.0% | 44.2% | 43.9% | 42.9% |
| (Advances + Net Non-Performing Advances) / Deposits | 56.1% | 63.6% | 60.2% | 55.5% |
| CA Deposits / Deposits | 16.0% | 16.7% | 19.2% | 23.4% |
| SA Deposits / Deposits | 49.2% | 44.4% | 39.1% | 33.0% |
| **4 Credit Risk** | | | | |
| Non-Performing Advances / Gross Advances | 8.0% | 5.4% | 4.4% | 4.7% |
| Non-Performing Finances-net / Equity | 22.6% | 8.1% | 5.6% | 4.3% |

## Credit Rating

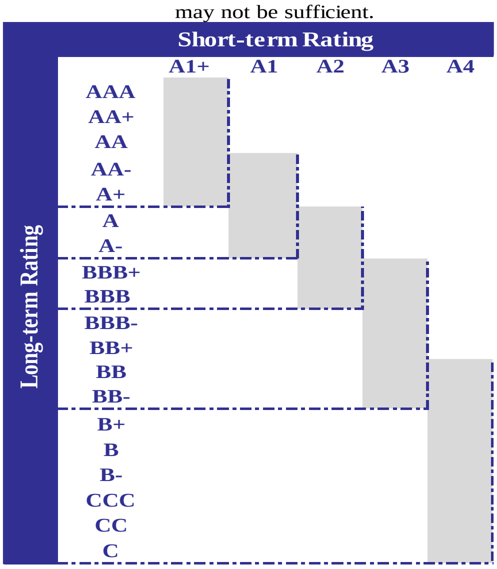
Credit rating reflects forward-looking opinion on credit worthiness of underlying entity or instrument; more specifically it covers relative ability to honor financial obligations. The primary factor being captured on the rating scale is relative likelihood of default.

**Long-term Rating**

| Scale | Definition |
|---|---|
| AAA | **Highest credit quality.** Lowest expectation of credit risk. Indicate exceptionally strong capacity for timely payment of financial commitments |
| AA+<br>AA<br>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+<br>A<br>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+<br>BBB<br>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+<br>BB<br>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+<br>B<br>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<br>CC<br>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 Rating**

| Scale | Definition |
|---|---|
| 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 |
| A4 | The capacity for timely repayment is more susceptible to adverse changes in business, economic, or financial conditions. Liquidity may not be sufficient. |




**The correlation shown is indicative and, in certain cases, may not hold.*

**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 some material identifiable event with indeterminable rating implications. 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 rating 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) the debt instrument is redeemed, c) the rating remains suspended for six months, d) the entity/issuer defaults., or/and e) PACRA finds it impractical to surveill the opinion due to lack of requisite information.

**Harmonization** A change in rating due to revision in applicable methodology or underlying scale.

**Surveillance.** Surveillance on a publicly disseminated rating opinion is carried out on an ongoing basis till it is formally suspended or withdrawn. A comprehensive surveillance of rating opinion is carried out at least once every six months. However, a rating opinion may be reviewed in the intervening period if it is necessitated by any material happening.

**Note.** This scale is applicable to the following methodology(s):

**Entities**

a) Broker Entity Rating
b) Corporate Rating
c) Financial Institution Rating
d) Holding Company Rating
e) Independent Power Producer Rating
f) Microfinance Institution Rating
g) Non-Banking Finance Companies (NBFCs) Rating

**Instruments**

a) Basel III Compliant Debt Instrument Rating
b) Debt Instrument Rating
c) Sukuk Rating

## Regulatory and Supplementary Disclosure

(Credit Rating Companies Regulations,2016)

**Rating Team Statements**

(1) Rating is just an opinion about the creditworthiness of the entity and does not constitute recommendation to buy, hold or sell any security of the entity rated or to buy, hold or sell the security rated, as the case may be | Chapter III; 14-3-(x)

2) **Conflict of Interest**

i. The Rating Team or any of their family members have no interest in this rating | Chapter III; 12-2-(j)

ii. PACRA, the analysts involved in the rating process and members of its rating committee, and their family members, do not have any conflict of interest relating to the rating done by them | Chapter III; 12-2-(e) & (k)

iii. The analyst is not a substantial shareholder of the customer being rated by PACRA [Annexure F; d-(ii)] Explanation: for the purpose of above clause, the term “family members” shall include only those family members who are dependent on the analyst and members of the rating committee

**Restrictions**

(3) No director, officer or employee of PACRA communicates the information, acquired by him for use for rating purposes, to any other person except where required under law to do so. | Chapter III; 10-(5)

(4) PACRA does not disclose or discuss with outside parties or make improper use of the non-public information which has come to its knowledge during business relationship with the customer | Chapter III; 10-7-(d)

(5) PACRA does not make proposals or recommendations regarding the activities of rated entities that could impact a credit rating of entity subject to rating | Chapter III; 10-7-(k)

**Conduct of Business**

(6) PACRA fulfills its obligations in a fair, efficient, transparent and ethical manner and renders high standards of services in performing its functions and obligations; | Chapter III; 11-A-(a)

(7) PACRA uses due care in preparation of this Rating Report. Our information has been obtained from sources we consider to be reliable but its accuracy or completeness is not guaranteed. PACRA does not, in every instance, independently verifies or validates information received in the rating process or in preparing this Rating Report | Clause 11-(A)(p).

(8) PACRA prohibits its employees and analysts from soliciting money, gifts or favors from anyone with whom PACRA conducts business | Chapter III; 11-A-(q)

(9) PACRA ensures before commencement of the rating process that an analyst or employee has not had a recent employment or other significant business or personal relationship with the rated entity that may cause or may be perceived as causing a conflict of interest; | Chapter III; 11-A-(r)

(10) PACRA maintains principal of integrity in seeking rating business | Chapter III; 11-A-(u)

(11) PACRA promptly investigates, in the event of a misconduct or a breach of the policies, procedures and controls, and takes appropriate steps to rectify any weaknesses to prevent any recurrence along with suitable punitive action against the responsible employee(s) | Chapter III; 11-B-(m)

**Independence & Conflict of interest**

(12) PACRA receives compensation from the entity being rated or any third party for the rating services it offers. The receipt of this compensation has no influence on PACRA´s opinions or other analytical processes. In all instances, PACRA is committed to preserving the objectivity, integrity and independence of its ratings. Our relationship is governed by two distinct mandates i) rating mandate - signed with the entity being rated or issuer of the debt instrument, and fee mandate - signed with the payer, which can be different from the entity

(13) PACRA does not provide consultancy/advisory services or other services to any of its customers or to any of its customers’ associated companies and associated undertakings that is being rated or has been rated by it during the preceding three years unless it has adequate mechanism in place ensuring that provision of such services does not lead to a conflict of interest situation with its rating activities; | Chapter III; 12-2-(d)

(14) PACRA discloses that no shareholder directly or indirectly holding 10% or more of the share capital of PACRA also holds directly or indirectly 10% or more of the share capital of the entity which is subject to rating or the entity which issued the instrument subject to rating by PACRA; | Reference Chapter III; 12-2-(f)

(15) PACRA ensures that the rating assigned to an entity or instrument is not be affected by the existence of a business relationship between PACRA and the entity or any other party, or the non-existence of such a relationship | Chapter III; 12-2-(i)

(16) PACRA ensures that the analysts or any of their family members shall not buy or sell or engage in any transaction in any security which falls in the analyst’s area of primary analytical responsibility. This clause shall, however, not be applicable on investment in securities through collective investment schemes. | Chapter III; 12-2-(l)

(17) PACRA has established policies and procedure governing investments and trading in securities by its employees and for monitoring the same to prevent insider trading, market manipulation or any other market abuse | Chapter III; 11-B-(g)

**Monitoring and review**

(18) PACRA monitors all the outstanding ratings continuously and any potential change therein due to any event associated with the issuer, the security arrangement, the industry etc., is disseminated to the market, immediately and in effective manner, after appropriate consultation with the entity/issuer; | Chapter III | 18-(a)

(19) PACRA reviews all the outstanding ratings on semi-annual basis or as and when required by any creditor or upon the occurrence of such an event which requires to do so; | Chapter III | 18-(b)

(20) PACRA initiates immediate review of the outstanding rating upon becoming aware of any information that may reasonably be expected to result in downgrading of the rating; | Chapter III | 18-(c)

(21) PACRA engages with the issuer and the debt securities trustee, to remain updated on all information pertaining to the rating of the entity/instrument; | Chapter III | 18-(d)

**Probability of Default**

(22) PACRA´s Rating Scale reflects the expectation of credit risk. The highest rating has the lowest relative likelihood of default (i.e, probability). PACRA´s transition studies capture the historical performance behavior of a specific rating notch. Transition behavior of the assigned rating can be obtained from PACRA´s Transition Study available at our website. (www.pacra.com). However, actual transition of rating may not follow the pattern observed in the past | Chapter III | 14-(f-VII)

**Proprietary Information**