



The Pakistan Credit Rating Agency Limited

## THE BANK OF KHYBER

|            | <b>NEW<br/>[JUN-16]</b> | <b>PREVIOUS<br/>[JUN-15]</b> |
|------------|-------------------------|------------------------------|
| Long-Term  | A                       | A                            |
| Short-Term | A1                      | A1                           |
| Outlook    | Stable                  | Stable                       |

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|--|
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JUNE 2016

**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, 66 of its branches function as dedicated Islamic banking branches, whereas 64 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 CY15.

**Governance**

- 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.
- Mr. Muhammad Azam Khan is the new chairman of the board as he assumed the charge as additional chief secretary – KPK in Jan-16.

**Management**

- The senior management team at BoK comprises seasoned professionals; majority having long term association with the bank.
- Current Managing Director – Mr. Shams-ul-Qayyum – was appointed by the government in Oct-14. He has over 41 years of diversified experience in the banking industry.

**Risk Management and Asset Quality**

- BoK’s earning assets grew by ~24%; a facet of increased investments in government securities.
- At end-Dec15, advances declined. These were mainly concentrated in corporate segment, which constituted 44% (CY14: 47%) of the total advances book.
- The sectoral mix improved slightly with top 3 private sectors comprising ~30% of advances (CY14: 27%).
- Client concentration remained adequate with top 20 customers comprising 27% of BoK’s overall advances (Dec14: 24%).
- BoK’s asset quality deteriorated as reflected by NPLs to Gross Advances ratio (CY15: 13%; CY14: 10%).
- FSV benefit availed by BoK has limited the bank’s provisioning expense as depicted by loan loss coverage (CY15: 72%; CY14: 71%).

**Business Risk**

- During CY15, the bank posted a growth of 25% in its net interest margin on the back of higher earning assets and better spreads.
- Proportionately lesser decline in asset yield helped the bank in registering better spread.
- Significant growth in other income – a facet of gains from sale of investments – further strengthened the total net revenue.
- BoK posted a healthy profit (CY15: PKR 1,789mln; CY14: PKR 1,309mln).
- During 1QCY16, the bank witnessed considerable growth in bottom-line
- Going forward, BoK, while expanding its branch network by adding 20 branches in CY16, 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. In this regard, focus would be on SME & Consumer financing. Meanwhile, implementation of core banking software, which is critical to enhance operational efficiency, is management’s priority.

**Capital & Funding**

- Deposit base remained tilted towards interest rate sensitive (saving and time) deposits which constitute ~77%.
- Top-20 depositors’ concentration increased to 50% (end-CY14: 28%).
- Increased investment in government securities has improved the overall liquidity position.
- BoK has a strong capitalization as registered in CAR of 23.7% at end-Dec15.

**RATING RATIONALE**

The ratings reflect association of the bank with the Government of Khyber Pakhtunkhwa (GoKP). The bank's standalone profile exhibits strengths. These include sound liquidity and high capital adequacy, supplemented by improving profitability. Spreads remained low, though showed stability. Although potential drag on equity is being contained, weakening in asset quality is a concern and needs management attention. Beefed-up treasury operations has helped the bank in registering significant capital gain. Resultantly, rise in total revenue has rationalized the Cost to Total Net Revenue ratio as compared to the peers. The bank still has reliance 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; however, establishing footprints in other provinces is may be needed better compete with established banks. The management plans to increase advances book with higher focus in SME and recently launched consumer financing. With desired credit growth, strengthening management information systems remains critical.

**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.



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The Bank of Khyber

|   | PKR mln          |                  |                  |                  |
|---|------------------|------------------|------------------|------------------|
| <b>BALANCE SHEET</b>                          | <b>31-Mar-16</b> | <b>31-Dec-15</b> | <b>31-Dec-14</b> | <b>31-Dec-13</b> |
| <b>Earning Assets</b>                         |                  |                  |                  |                  |
| Advances (Net of NPL)                         | 34,171           | 35,004           | 38,733           | 34,482           |
| Debt Instruments                              | 944              | 1,002            | 1,645            | 1,854            |
| Total Finances                                | 35,114           | 36,006           | 40,378           | 36,337           |
| Investments                                   | 106,897          | 87,221           | 70,689           | 51,439           |
| Others  | 19,054           | 17,686           | 2,659            | 9,720            |
|   | <b>161,066</b>   | <b>140,913</b>   | <b>113,726</b>   | <b>97,496</b>    |
| <b>Non Earning Assets</b>                     |                  |                  |                  |                  |
| Non-Earning Cash                              | 5,201            | 7,579            | 6,061            | 5,662            |
| Deferred Tax                                  | -                | -                | -                | 299              |
| Net Non-Performing Finances                   | 1,402            | 1,523            | 1,422            | 1,037            |
| Fixed Assets & Others                         | 4,559            | 5,144            | 4,897            | 3,675            |
|   | <b>11,161</b>    | <b>14,245</b>    | <b>12,380</b>    | <b>10,674</b>    |
| <b>TOTAL ASSETS</b>                           | <b>172,227</b>   | <b>155,159</b>   | <b>126,106</b>   | <b>108,170</b>   |
| <b>Interest Bearing Liabilities</b>           |                  |                  |                  |                  |
| Deposits                                      | 132,957          | 117,292          | 92,264           | 77,218           |
| Borrowings                                    | 16,318           | 17,130           | 14,192           | 15,158           |
|   | 149,275          | 134,422          | 106,456          | 92,376           |
| <b>Non Interest Bearing Liabilities</b>       | 5,285            | 4,819            | 4,731            | 3,238            |
| <b>TOTAL LIABILITIES</b>                      | <b>154,559</b>   | <b>139,241</b>   | <b>111,187</b>   | <b>95,613</b>    |
| <b>EQUITY (including revaluation surplus)</b> | <b>17,667</b>    | <b>15,918</b>    | <b>14,920</b>    | <b>12,557</b>    |
| <b>Total Liabilities &amp; Equity</b>         | <b>172,227</b>   | <b>155,159</b>   | <b>126,106</b>   | <b>108,170</b>   |

|                                      | PKR mln          |                  |                  |                  |
|--------------------------------------|------------------|------------------|------------------|------------------|
| <b>INCOME STATEMENT</b>              | <b>31-Mar-16</b> | <b>31-Dec-15</b> | <b>31-Dec-14</b> | <b>31-Dec-13</b> |
|                                      | 1Q               | Annual           | Annual           | Annual           |
| Interest / Mark up Earned            | 2,795            | 10,869           | 9,751            | 7,407            |
| Interest / Mark up Expensed          | (1,711)          | (6,442)          | (6,210)          | (4,336)          |
| <b>Net Interest / Markup revenue</b> | <b>1,084</b>     | <b>4,428</b>     | <b>3,541</b>     | <b>3,071</b>     |
| Other Income                         | 534              | 1,680            | 995              | 604              |
| <b>Total Revenue</b>                 | <b>1,618</b>     | <b>6,108</b>     | <b>4,536</b>     | <b>3,675</b>     |
| Non-Interest / Non-Mark up Expensed  | (716)            | (2,688)          | (2,471)          | (2,011)          |
| Pre-provision operating profit       | 927              | 3,539            | 2,135            | 1,752            |
| Provisions                           | (14)             | 581              | 235              | 82               |
| Pre-tax profit                       | 941              | 2,959            | 1,901            | 1,669            |
| Taxes                                | (336)            | (1,169)          | (591)            | (515)            |
| <b>Net Income</b>                    | <b>605</b>       | <b>1,789</b>     | <b>1,309</b>     | <b>1,154</b>     |

| <b>Ratio Analysis</b>                     | <b>31-Mar-16</b> | <b>31-Dec-15</b> | <b>31-Dec-14</b> | <b>31-Dec-13</b> |
|---|------------------|------------------|------------------|------------------|
|   | 1Q               | Annual           | Annual           | Annual           |
| <b>Performance</b>                        |                  |                  |                  |                  |
| ROE                                       | 17%              | 13%              | 10%              | 10%              |
| Cost-to-Total Net Revenue                 | 44%              | 44%              | 54%              | 55%              |
| Other operating income/ Total net revenue | 33%              | 28%              | 22%              | 16%              |
| <b>Capital Adequacy</b>                   |                  |                  |                  |                  |
| Equity/Total Assets                       | 8%               | 9%               | 10%              | 11%              |
| Capital Adequacy Ratio as per SBP         | 24%              | 24%              | 23%              | 24%              |
| <b>Funding &amp; Liquidity</b>            |                  |                  |                  |                  |
| Liquid Assets / Deposits and Borrowings   | 78%              | 73%              | 71%              | 64%              |
| Advances / Deposits                       | 27%              | 31%              | 43%              | 46%              |
| CASA deposits / Total Customer Deposits   | 62%              | 59%              | 66%              | 58%              |
| <b>Intermediation Efficiency</b>          |                  |                  |                  |                  |
| Asset Yield                               | 7%               | 9%               | 9%               | 9%               |
| Cost of Funds                             | -5%              | -5%              | -6%              | -5%              |
| Spread                                    | 3%               | 3%               | 3%               | 3%               |
| <b>Outreach</b>                           |                  |                  |                  |                  |
| Branches                                  | 130              | 130              | 116              | 100              |



## STANDARD RATING SCALES & 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.

| <b>LONG TERM RATINGS</b>                 |   | <b>SHORT TERM RATINGS</b>   |
|--|---|---|
| <b>AAA</b>                               | <p><b>Highest credit quality.</b> Lowest expectation of credit risk.</p> <p>Indicate exceptionally strong capacity for timely payment of financial commitments.</p>   | <p><b>A1+:</b> The highest capacity for timely repayment.</p> <p><b>A1:</b> A strong capacity for timely repayment.</p> <p><b>A2:</b> A satisfactory capacity for timely repayment. This may be susceptible to adverse changes in business, economic, or financial conditions.</p> <p><b>A3:</b> An adequate capacity for timely repayment. Such capacity is susceptible to adverse changes in business, economic, or financial conditions.</p> <p><b>B:</b> The capacity for timely repayment is more susceptible to adverse changes in business, economic, or financial conditions.</p> <p><b>C:</b> An inadequate capacity to ensure timely repayment.</p> |
| <b>AA+</b><br><b>AA</b><br><b>AA-</b>    | <p><b>Very high credit quality.</b> Very low expectation of credit risk.</p> <p>Indicate very strong capacity for timely payment of financial commitments. This capacity is not significantly vulnerable to foreseeable events.</p>   |   |
| <b>A+</b><br><b>A</b><br><b>A-</b>       | <p><b>High credit quality.</b> Low expectation of credit risk.</p> <p>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.</p>  |   |
| <b>BBB+</b><br><b>BBB</b><br><b>BBB-</b> | <p><b>Good credit quality.</b> Currently a low expectation of credit risk.</p> <p>The capacity for timely payment of financial commitments is considered adequate, but adverse changes in circumstances or economic conditions are more likely to impair this capacity.</p>                                       |   |
| <b>BB+</b><br><b>BB</b><br><b>BB-</b>    | <p><b>Moderate risk.</b> Possibility of credit risk developing.</p> <p>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.</p>   |   |
| <b>B+</b><br><b>B</b><br><b>B-</b>       | <p><b>High credit risk.</b></p> <p>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.</p>   |   |
| <b>CCC</b><br><b>CC</b><br><b>C</b>      | <p><b>Very high credit risk.</b></p> <p>“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.</p> |   |
| <b>D</b>                                 | Obligations are currently in default.   |   |

### 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. Rating Watch may carry designation – Positive (rating may be raised, negative (lowered), or developing (direction is unclear). A watch should be resolved within foreseeable future, but may continue if underlying circumstances are not settled.

### 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’.

### 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, a suspended 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, or e) the entity/issuer defaults.

**Disclaimer:** PACRA's rating is an assessment of the credit standing of an entity/issue in Pakistan. They do not take into account the potential transfer / convertibility risk that may exist for foreign currency creditors. PACRA's opinion is not a recommendation to purchase, sell or hold a security, in as much as it does not comment on the security's market price or suitability for a particular investor.



**Name of Rated Entity**  
**Sector**  
**Type of Relationship**

The Bank of Khyber  
 Banking  
 Solicited

**Purpose of the Rating**

Independent Risk Assessment  
 Regulatory Requirement

**Rating History**

| Dissemination Date | Long Term | Short Term | Outlook  | Action   |
|--------------------|-----------|------------|----------|----------|
| 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 |

**Related Criteria and Research**

Banking Sector - Viewpoint | Dec-15

**Rating Methodology**

Bank Rating Methodology

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[Rating Team Statement](#)

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[Probability of Default \(PD\)](#)

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