RATING REPORT

The Bank of Khyber

REPORT DATE:
July 3, 2015

RATING ANALYSTS:
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RATING DETAILS

	Latest Rating		Previous Rating	
Rating Category	**Long-term**	**Short-term**	**Long-term**	**Short-term**
Entity	A	A-1	A	A-1
Rating Outlook	Stable		Stable	
Rating Date	*June 30, '15*		*June 30, '14*	

COMPANY INFORMATION

Incorporated in 1991; scheduled in 1994	External auditors: **Anjum Asim Shahid Rahman, Chartered Accountants**
Public Listed Company	Chairman of the Board: **Dr. Hammad Uwais Agha**
Key Shareholders (with stake 5% or more):	Managing Director: **Mr. Shams-Ul-Qayyum**
Government of Khyber Pakhtunkhwa – 70.2%	
Ismail Industries Ltd – 24.2%	
Others (including general public) – 5.6%	

APPLICABLE METHODOLOGY(IES)

JCR-VIS Entity Rating Criteria: Commercial Banks ***http://jcrvis.com.pk/Images/primercb.pdf***

OVERVIEW OF THE INSTITUTION

BoK is one of the three provincial government owned banks in the country. The government of KPK holds around 70% stake in the bank, followed by Ismail Industries Ltd holding 24.2% shares.

RATING RATIONALE

With additional shares purchased from the market, Ismail Industries Limited (IIL) enhanced its shareholding in The Bank of Khyber (BoK) to 24.2% while the Government of Khyber Pakhtunkhwa (KPK) continues to be the major shareholder. In addition to being the primary shareholder, KPK has also placed sizeable deposits with the bank. While this has resulted in high concentration, given the quantum of individual deposits, these have remained relatively stable over the years. Moreover, the bank carries sizeable liquid assets on its balance sheet, which provides cushion to manage withdrawals. Capitalization indicators of the bank are considered sound, providing room for growth in future.

BoK offers both conventional and Islamic banking products; some of the indicators such as asset quality, liquidity and cost of funding of the two are notably distinct, with Islamic banking operations featuring superior numbers.

The bank expanded its network to 116 (end-FY13: 100) branches with 54 Islamic banking branches operational by end-Dec-14. Growth will primarily be pursued in Islamic banking operations with plans to set up 12 additional Islamic banking branches in FY15 and only 2 conventional branches. By end FY18, the management plans to achieve a network of 200 branches. Given that most banks have expanded their outreach in recent years, this is considered necessary to maintain the bank's positioning in the market.

Total deposits increased to Rs. 92.3b (end-FY13: Rs. 77.2b) by end-FY14. Islamic Banking Group (IBG) deposits grew by 22% to Rs. 20.3b (FY13: Rs. 16.6b) with major portion in current and saving accounts. Deposit mix of IBG features lower concentration vis-à-vis conventional banking; moreover, cost of deposits of IBG also compares favorably on the back of sizeable proportion of CASA. Overall concentration in deposits has trended upwards over time; the management plans to rationalize its deposit mix by increasing share of retail segment. Moreover, the bank's access to private sector deposits remains limited, with the same representing 40% of total deposits at end FY14.

Growth in lending operations in the outgoing year was primarily manifested in seasonal commodity Islamic financing. A larger portion of loan portfolio though still comprises corporate book. Concentration in the loan book continues to be high with top 10 funded exposures constituting more than 1/3rd of gross advances including the seasonal impact of commodity financing at end-FY14. With increase in NPLs, asset quality indicators weakened slightly by end-FY14; however, the same continue to be within manageable limits. The capital adequacy ratio of the bank provides considerable cushion for growth.

Investment portfolio of the bank continued to be dominated by government securities which represent 95% of the portfolio. In line with general expectations regarding interest rates, BoK also accumulated PIBs. To the extent of the bank's holding of long term government paper with fixed rates, the bank may be able to sustain the impact of current low interest rate environment on earnings. However, once the existing PIB holdings begin to mature, the bank may encounter pressure on spreads if the low interest rate environment persists, unless any meaningful reduction in cost of deposits is achieved. Continued momentum in deposits from Islamic banking operations, which features much lower cost of deposits, may allow the bank to reduce its overall cost of deposits.

In order to improve service delivery, the bank is in the process of replacing its existing management information system with state-of-the-art Core Banking System (CBS). Previously, delays have been witnessed in the implementation of the said system. However, the management is hopeful that CBS will go live by end of FY15. With the induction of new MD, strategic plan and course of action for network expansion and business growth will be evident over time.

FINANCIAL SUMMARY			*(amounts in PKR billions)*
BALANCE SHEET	**DEC 31, 2014**	**DEC 31, 2013**	**DEC 31, 2012**
Total Investments	72.4	53.4	45.7
Advances	40.1	35.5	26.7
Total Assets	126.1	108.2	82.2
Borrowings	14.2	15.2	7.4
Deposits & other accounts	92.3	77.2	60.0
Subordinated Loans	-	-	-
Tier-1 Equity	13.2	11.9	10.8
Net Worth	14.9	12.6	11.7
INCOME STATEMENT	**DEC 31, 2014**	**DEC 31, 2013**	**DEC 31, 2012**
Net Mark-up Income	3.5	3.1	2.6
Net Provisioning	0.3	0.1	0.04
Non-Markup Income	1.1	0.7	1.0
Operating Expenses	2.4	2.0	1.7
Profit Before Tax	1.9	1.7	1.6
Profit After Tax	1.3	1.2	1.1
RATIO ANALYSIS	**DEC 31, 2014**	**DEC 31, 2013**	**DEC 31, 2012**
Market Share (Advances) (%)	0.9	0.9	0.7
Market Share (Deposits) (%)	1.1	1.0	0.9
Gross Infection (%)	10.4	10.1	14.6
Provisioning Coverage (%)	69.7	74.3	69.4
Net Infection (%)	3.4	2.8	5.0
Cost of deposits (%)	6.5	6.2	7.9
Net NPLs to Tier-1 Capital (%)	10.3	8.3	12.3
Capital Adequacy Ratio (C.A.R (%))	22.7	24	25.1
Markup Spreads (%)	3.3	3.4	3.6
Efficiency (%)	58.9	54.2	50.6
Basic ROAA (%)	1.8	1.9	2.6
ROAA (%)	1.1	1.2	1.5
ROAE (%)	10.5	10.2	9.5
Liquid Assets to Deposits & Borrowings (%)	70.4	58.4	71.6

ISSUE/ISSUER RATING SCALE & DEFINITIONS Appendix II

Medium to Long-Term

AAA
Highest credit quality; the risk factors are negligible, being only slightly more than for risk-free Government of Pakistan's debt.

AA+, AA, AA-
High credit quality; Protection factors are strong. Risk is modest but may vary slightly from time to time because of economic conditions.

A+, A, A-
Good credit quality; Protection factors are adequate. Risk factors may vary with possible changes in the economy.

BBB+, BBB, BBB-
Adequate credit quality; Protection factors are reasonable and sufficient. Risk factors are considered variable if changes occur in the economy.

BB+, BB, BB-
Obligations deemed likely to be met. Protection factors are capable of weakening if changes occur in the economy. Overall quality may move up or down frequently within this category.

B+, B, B-
Obligations deemed less likely to be met. Protection factors are capable of fluctuating widely if changes occur in the economy. Overall quality may move up or down frequently within this category or into higher or lower rating grade.

CCC
Considerable uncertainty exists towards meeting the obligations. Protection factors are scarce and risk may be substantial.

CC
A high default risk

C
A very high default risk

D
Defaulted obligations

Short-Term

A-1+
Highest certainty of timely payment; Short-term liquidity, including internal operating factors and /or access to alternative sources of funds, is outstanding and safety is just below risk free Government of Pakistan's short-term obligations.

A-1
High certainty of timely payment; Liquidity factors are excellent and supported by good fundamental protection factors. Risk factors are minor.

A-2
Good certainty of timely payment. Liquidity factors and company fundamentals are sound. Access to capital markets is good. Risk factors are small.

A-3
Satisfactory liquidity and other protection factors qualify entities / issues as to investment grade. Risk factors are larger and subject to more variation. Nevertheless, timely payment is expected.

B
Speculative investment characteristics; Liquidity may not be sufficient to ensure timely payment of obligations.

C
Capacity for timely payment of obligations is doubtful.

Rating Watch: JCR-VIS places entities and issues on 'Rating Watch' when it deems that there are conditions present that necessitate re-evaluation of the assigned rating(s). Refer to our 'Criteria for Rating Watch' for details. www.jcrvis.com.pk/images/criteria_watch.pdf

Rating Outlooks: The three outlooks 'Positive', 'Stable' and 'Negative' qualify the potential direction of the assigned rating(s). An outlook is not necessarily a precursor of a rating change. Refer to our 'Criteria for Rating Outlook' for details. www.jcrvis.com.pk/images/criteria_outlook.pdf

(SO) Rating: A suffix (SO) is added to the ratings of 'structured' securities where the servicing of debt and related obligations is backed by some sort of financial assets and/or credit support from a third party to the transaction. The suffix (SO), abbreviated for 'structured obligation', denotes that the rating has been achieved on grounds of the structure backing the transaction that enhanced the credit quality of the securities and not on the basis of the credit quality of the issuing entity alone.

'p' Rating: A 'p' rating is assigned to entities, where the management has not requested a rating, however, agrees to provide informational support. A 'p' rating is shown with a 'p' subscript and is publicly disclosed. It is not modified by a plus (+) or a minus (-) sign which indicates relative standing within a rating category. Outlook is not assigned to these ratings. Refer to our 'Policy for Private Ratings' for details. www.jcrvis.com.pk/images/policy_ratings.pdf

'SD' Rating: An 'SD' rating is assigned when JCR-VIS believes that the ratee has selectively defaulted on a specific issue or obligation but it will continue to meet its payment obligations on other issues or obligations in a timely manner.

REGULATORY DISCLOSURES	Appendix III
Name of Rated Entity	The Bank of Khyber
Sector	Commercial Banks
Type of Relationship	Solicited
Purpose of Rating	Entity Rating
Rating History	see table below
Instrument Structure	N/A
Statement by the Rating Team	JCR-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	JCR-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.
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Rating History

Rating Date	Medium to Long Term	Short Term	Rating Outlook	Rating Action
RATING TYPE: ENTITY				
30-Jun-15	A	A-1	Stable	Reaffirmed
30-Jun-14	A	A-1	Stable	Reaffirmed
28-Jun-13	A	A-1	Stable	Maintained
29-Jun-12	A	A-1	Stable	Upgrade
08-Feb-12	A-	A-2	Rating Watch-Developing	Rating Watch-Developing
02-Jul-11	A-	A-2	Positive	Upgrade
24-Dec-10	A-	A-2	Stable	Maintained