RATING REPORT

The Bank of Khyber

REPORT DATE:
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RATING ANALYSTS:

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RATING DETAILS

Rating Category	Latest Rating Long-term	Latest Rating Short-term	Previous Rating Long-term	Previous Rating Short-term
Entity	A	A-1	A	A-1
Rating Outlook	Stable		Stable	
Rating Date	*June 28, '16*		*June 30, '15*	

COMPANY INFORMATION

Incorporated in 1991; scheduled in 1994	External auditors: **Grant Thornton Anjum Rahman, Chartered Accountants**
Public Listed Company	Chairman of the Board: **Muhammad Azam Khan**
Key Shareholders (with stake 5% or more):	Managing Director: **Mr. Shams-Ul-Qayyum**
Government of Khyber Pakhtunkhwa – 70.2%	
Ismail Industries Ltd – 24.4%	
Others (including general public) – 5.4%	

APPLICABLE METHODOLOGY(IES)

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

The Bank of Khyber

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% shares.

RATING RATIONALE

The ratings assigned to Bank of Khyber (BoK) take into account its shareholding structure with the bank being majority owned by Government of KPK. In addition to being the primary shareholder, Government of KPK has also placed sizeable deposits with the bank; these have remained relatively stable over the years. Ratings also take into account sound capitalization indicators of the bank. Given the declining interest rate regime, the bank intends to focus on increasing its advances portfolio in order to support spreads.

Advances: With additional funding channelized into investments, share of advances portfolio in the overall asset base has trended downward. Around three-fourth of the advances pertained to conventional banking. Corporate financing reflected 47% of gross advances followed by commodity financing (26%), SME financing (14%), agriculture (6%) and consumer (2%). Internal per party and group limits set by the bank are considerably lower than the limits allowed under prudential regulations; while this reduces concentration in the lending portfolio to some extent, the bank may not be able to meet the funding requirements of some of large tier corporate clients. Asset quality indicators have weakened on a timeline basis. With a provisioning coverage of 73.4% at end-1QFY16 (FY15: 71.2%; FY14: 69.7%), the bank has availed sizeable FSV benefit. Among corporate portfolio, management aims to increase exposure in infrastructure related projects mainly energy and power while proportion of consumer lending is also projected to increase.

Investments: Inline with overall banking sector trend, the bank has made sizeable investment in government securities in the recent years; the same represented around 55% of the asset base at end-FY15 (FY14: 54%). Credit risk arising from the investment is considered to be minimal in the local context; however the same is exposed to interest rate risk reflected by a high modified duration of the PIB portfolio. Size of equities portfolio in relation to assets is low; the associated risk is considered manageable. Barring non-performing TFCs against which bank maintains adequate provisioning, the exposure in TFCs is limited to banking sector instruments carrying sound risk profile.

Liquidity: Deposit base posted healthy growth during FY15 and in the ongoing year. However deposit mix witnessed less than desirable changes with share of CASA declining to 58.0% by end-FY15 (FY14: 63.9%); some improvement in CASA share was noted during the 1QFY16. Moreover, concentration related indicators have also trended upwards. Around two-third of the deposit base pertains to deposit from KPK government. Liquidity profile draws strength from the sizeable investment in government securities carried on balance sheet.

Profitability: While core earnings of the bank increased marginally to Rs. 1.5b during FY15 (FY14: Rs. 1.4b) bottom line received impetus from gain on sale of securities, mainly government securities, which amounted to Rs. 1.2b (FY14: Rs. 469.6m) with profit after tax reported at Rs. 1.8b (FY14: Rs. 1.3b). Overall cost of deposit declined owing to dip in benchmark rates and shedding of high cost deposits during the period. Cost of deposits of Islamic Banking Group (IBG) compares favorably with conventional banking on account of higher proportion of CASA in IBG deposits. BoK's fee based income in relation to net markup revenue is relatively on the lower side. The management plans to enhance the proportion of fee based income by enhancing ancillary business.

Capitalization: The bank maintains a high payout ratio (FY15: 69.9%; FY14: 76.3%). Resultantly, pace of internal capital generation has been slow. Nonetheless, Capital Adequacy Ratio (CAR) is comfortably above the minimum regulatory requirement and provides ample room for growth. CAR is also highest among peer commercial banks. Net NPLs as a percentage of tier-1 equity are on the higher side; further improvement in this area is however warranted.

Management & IT Infrastructure Various positions are vacant at the senior management level; timely appointment of resources for these positions is considered important in achieving long term business strategy of the bank. The Bank is in the process of replacing its existing software with a new Core Banking System (CBS) 'Bank Essential' (BE). Effective implementation of BE will enable real time connectivity across all branches, strengthen controls and enable introduction of new services.

The Bank of Khyber — Annexure III

FINANCIAL SUMMARY *(amounts in PKR billions)*

BALANCE SHEET	MAR 31, 2016	DEC 31, 2015	DEC 31, 2014
Total Investments	107.9	88.3	72.4
Advances	35.5	36.5	40.1
Total Assets	172.2	155.2	126.1
Borrowings	16.3	17.1	14.2
Deposits & other accounts	133	117.3	92.3
Subordinated Loans	-	-	-
Tier-1 Equity	14.6	14	13.2
Net Worth	17.7	15.9	14.9

INCOME STATEMENT	MAR 31, 2016	DEC 31, 2015	DEC 31, 2014
Net Mark-up Income	1.1	4.4	3.5
Net Provisioning	0.002	0.6	0.2
Non-Markup Income	0.6	1.8	1.1
Operating Expenses	0.7	2.8	2.4
Profit Before Tax	0.9	2.9	1.9
Profit After Tax	0.6	1.8	1.3

RATIO ANALYSIS	MAR 31, 2016	DEC 31, 2015	DEC 31, 2014
Market Share (Advances) (%)	-	0.8	0.9
Market Share (Deposits) (%)	-	1.3	1.1
Gross Infection (%)	13.0	12.8	10.4
Provisioning Coverage (%)	73.4	71.2	69.7
Net Infection (%)	3.8	4.0	3.4
Cost of deposits (%)	4.6	5.3	6.5
Net NPLs to Tier-1 Capital (%)	9.3	10.6	10.3
Capital Adequacy Ratio (C.A.R (%))	23.3	23.8	22.7
Markup Spreads (%)	2.9	3.2	3.3
Efficiency (%)	56.5	55.9	58.9
ROAA (%)	0.4	1.3	1.1
ROAE (%)	4.4	13.8	10.8
Liquid Assets to Deposits & Borrowings (%)	-	79.5	70.4

ISSUE/ISSUER RATING SCALE & DEFINITIONS Annexure IV

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 — Annexure V

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				
28-Jun-16	A	A-1	Stable	Reaffirmed
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