RATING REPORT

The Bank of Khyber

REPORT DATE:
July 11, 2017

RATING ANALYSTS:

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RATING DETAILS

Rating Category	Latest Rating		Previous Rating	
	Long-term	Short-term	Long-term	Short-term
Entity	A	A-1	A	A-1
Rating Outlook	Stable		Stable	
Rating Date	*June 29, '17*		*June 28, '16*	

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 – 24.16%	
Others (including general public) – 5.6%	

APPLICABLE METHODOLOGY(IES)

JCR-VIS Entity Rating Criteria: Commercial Banks (Nov, 2015)
http://www.jcrvis.com.pk/kc-meth.aspx

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.

CEO

Mr. Shams-ul-Qayyum has been associated with banking profession for the last 40 years. Prior to joining BoK, he has held senior management positions at Habib Bank limited.

Chairman

Mr. Muhammad Azam Khan is a senior civil servant. He has diverse management experience having held positions in district administration and headed important Government Departments.

Financial analysis

Net profit:1QFY17: Rs. 0.36b; FY16: Rs. 2b

Equity:1QFY17: Rs. 13.5b; FY16: Rs. 14.7b

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 which have remained stable over the years. In the recent years, profitability of the bank remained dependent on treasury income as advances portfolio growth remained subdued; management aims to aggressively increase advances portfolio, going forward. Meanwhile, strengthening of senior management team bodes well to achieve the strategic objectives of the bank.

Advances: Aggregate gross advances of the bank increased to Rs. 56.7b at end-1QFY17 (FY16: 36.1b; FY15: Rs. 40.1b). With sizeable increase in finances under IBG pertaining to commodity financing, share of the same increased to around 44% by end-1QFY17. Advances to deposit ratio of the bank continue to remain lower in comparison to industry trends. The bank aims to aggressively increase its advances portfolio by focusing on infrastructure related projects while proportion of consumer lending is also projected to increase. Inview of this, branch network is projected to increase to 200 by end-FY18. In absolute terms, Non-Performing loans (NPLs) amounted to Rs. 5.4b by end-1QFY17 (FY16: Rs 5.5b; FY15: Rs. 5.1b). With higher advances portfolio, asset quality indicators improved with gross infection declining to 9.6% at end-1QFY17 (FY16: 15.1%; FY15: 12.8%).

Investments: Share of Government Securities represented around 97% in overall investment portfolio; credit risk arising from the same is considered to be minimal in the local context; however the same is exposed to interest rate risk. Considering the size of the equity portfolio, the associated risk is considered manageable.

Liquidity: Liquidity profile of the bank draws comfort from the sizeable investment in government securities carried on the balance sheet. Liquid assets as a proportion of total deposits and borrowings (adjusted for repo borrowings) remained healthy and stood at 80.8% (FY15: 79.3%). Total deposits increased to Rs. 157b at end-FY16 (FY15: Rs.117.3b); at end-1QFY17 the same amounted to Rs. 150.3b. Deposit mix reflected less than desirable changes with share of CASA declining to 47.2% at end-1QFY17 (FY16: 59.7%). The high level of liquidity carried on balance sheet mitigates the risk associated with high deposit concentration.

Profitability: Core earnings of the bank decreased to Rs. 1b during FY16 (FY15: Rs. 1.5b) on account of higher administrative expenses attributable to network expansion and annual salary adjustment. Meanwhile, income from treasury operations continues to support the bottom line. BoK's cost of deposits stood at 4.7% during FY16 (FY15: 5.1%); cost of deposits of Islamic Banking Group (IBG) compares favorably with conventional banking on account of higher proportion of CASA in IBG deposits. Inline with banking industry trend, spreads of BoK continue to remain under pressure owing to lower benchmark rates.

Capitalization: The bank continues to maintain a high payout ratio. Resultantly, pace of internal generation has remained slow. Capital Adequacy Ratio (CAR) stood at 21.34 % (FY15: 23.75%) depicting ample room for further growth. Net NPLs as a percentage of tier-1 equity was reported at 7.5% at end-1QFY17 (FY16: 7.3%; FY15: 10.4%).

Management and IT Infrastructure: During the period under review, some of the key senior management positions have been filled including head of conventional banking and investment banking. The process of replacing banks existing software with a new Core Banking System (CBS) 'Bank Essential' (BE) has witnessed delays; management expects major rollout of the system by end-2017. 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 I**

FINANCIAL SUMMARY	*(amounts in PKR billions)*		
BALANCE SHEET	**1QFY17**	**FY16**	**FY15**
Total Investments	121.4	141.6	95.5
Advances	52.3	31.6	36.5
Total Assets	191.1	206.4	155.2
Borrowings	19	28.7	17.1
Deposits & other accounts	150.3	157.0	117.3
Tier-1 Equity	13.5	14.7	14
Net Worth	15.2	16.1	15.9
INCOME STATEMENT	**1QFY17**	**FY16**	**FY15**
Net Mark-up Income	1.03	4.4	4.4
Net Provisioning	0.019	0.6	0.6
Non-Markup Income	0.37	2.7	1.8
Operating Expenses	0.83	3.2	2.8
Profit Before Tax	0.55	3.2	2.9
Profit After Tax	0.36	2.0	1.8
RATIO ANALYSIS	**1QFY17**	**FY16**	**FY15**
Gross Infection (%)	9.6	15.1	12.8
Provisioning Coverage (%)	81.2	80.3	71.2
Net Infection (%)	2.0	3.4	4.0
Cost of deposits (%)	4.7	5.1	5.3
Net NPLs to Tier-1 Capital (%)	7.5	7.3	10.4
Capital Adequacy Ratio (C.A.R (%))	23.2	21.3	23.8
Markup Spreads (%)	1.7	1.8	2.5
Efficiency (%)	33.9	31.4	54.0
ROAA (%)	0.7	1.1	1.3
ROAE (%)	9.1	12.6	13.8
Liquid Assets to Deposits & Borrowings (%)	-	80.8	79.3

ISSUE/ISSUER RATING SCALE & DEFINITION
Annexure 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 — Annexure III

Name of Rated Entity	The Bank of Khyber
Sector	Commercial Banks
Type of Relationship	Solicited
Purpose of Rating	Entity Rating

Rating History

Rating Date	Medium to Long Term	Short Term	Rating Outlook	Rating Action
		RATING TYPE: ENTITY		
29-Jun-17	A	A-1	Stable	Reaffirmed
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

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.
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