RATING REPORT

The Bank of Khyber

REPORT DATE:
June 29, 2018

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 29, 2018*		*June 29, '17*	

COMPANY INFORMATION	
Incorporated in 1991; scheduled in 1994	**External auditors**: M/s Grant Thornton Anjum Rahman Chartered Accountants
Public Listed Company	**Chairman of the Board**: Dr. Shahzad Khan Bangash
Key Shareholders (with stake 5% or more):	**Managing Director/Chief Executive Officer (Acting)**: Muhammad Shahbaz Jameel
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 (March, 2018) *http://jcrvis.com.pk/docs/Meth-CommercialBanks201803.pdf*

OVERVIEW OF THE INSTITUTION

The Bank of Khyber (BoK) was established under the Bank of Khyber Act, 1991 and acquired the status of a schedule bank in 1994. BoK is listed on Pakistan Stock Exchange Limited (PSX) and is one of the three provincial-government owned commercial banks operating in Pakistan.

MD/CEO (Acting)

Mr. Muhammad Shahbaz Jameel is a seasoned banker with 24 years of diverse experience various multinational financial institutions. Mr. Shahbaz has done Masters in Internal Business & Management from Manchester Business School, University of Manchester (former UMIST), UK.

Chairman

Dr. Shahzad Khan Bangash is a senior civil servant with extensive national and international experience. Dr. Bangash has also served at various positions abroad.

Financial analysis

Net Profit: 1QFY18: Rs.477.7m; FY17: Rs. 1.79b; FY16: Rs. 2.02b

Net Equity: 1QFY18: Rs. 14.1b; FY17: Rs. 15.4b; FY16: Rs. 16.1b

RATING RATIONALE

The assigned ratings of Bank of Khyber (BoK) reflect its shareholding structure with the bank being majorly owned by the Government of KPK. The ratings also take into account improved asset quality, adequate capitalization and sound profitability of the bank.

Advances: By end-1QFY18, gross advances increased significantly to Rs. 101.8b (FY17: Rs. 87.7b; FY16: Rs. 36.1b) mainly as a result of commodity and corporate lending to the public sector. During FY17, total disbursements amounted to Rs. 62.3b of which Rs. 48.8b entailed public sector financing; public sector disbursements amounted to Rs. 16.2b during 1QFY18. In absolute terms, non-performing loans (NPLs) declined on a timeline basis owing to higher recoveries against classified portfolio, thereby mitigating the impact of incremental infection. As a result, asset quality indicators exhibited considerable improvement by end-1QFY18. Gross advances are projected to grow to Rs. 119.0b by end-FY18 with focus to remain in corporate lending.

Investments: By end-FY17, investments (at market value) stood slightly lower mainly due to deficit on revaluation of available for sale (AFS) securities. Share of government securities represented around 96.3% (FY16: 96.9%) of the overall investment portfolio at end-FY17; credit risk from the same is considered to be minimal in the local context, however the same is exposed to interest rate risk. Unlike most peers, the bank made further investment in PIBs during FY17; keeping in view the increasing interest scenario, deficit on revaluation of available-for-sale securities has increased further by end-1QFY18. Remaining investment portfolio comprises listed/unlisted TFCs/Sukuks and exposure in equities. Barring non-performing TFCs/Sukuks against which the bank maintains adequate provisioning, net exposure in TFCs/sukuks pertain to counterparties carrying sound credit risk profile, while considering the size of equity portfolio, associated risk from the same is considered manageable.

Liquidity: Liquidity profile of the bank weakened on a timeline basis underpinned by decrease in liquid assets as a proportion of total deposits & borrowings (adjusted for collateral). Liquid assets (adjusted for collateral) declined as investments were liquidated to fund growth in advances, while fresh investments were financed mainly through repo borrowings. As a result, Advances-to-Deposit (ADR) ratio increased to 69.6% (FY17: 55.1%; FY16: 23.0%) by end-1QFY18. The deposit concentration decreased, though still remained high, as top 10 deposits were 45.0% (FY16: 50.1%) of total deposit base at end-FY17; comfort can be drawn by the fact that most of these are related to the government of KPK. Based on contractual maturity, there is a cumulative Assets & Liability mismatch up to 5-year period. However, comfort can be drawn on the back of considerable liquid government securities available with the bank.

Profitability: During FY17, spreads declined mainly due to lower yield on mark-up bearing assets as a result of lending to public sector at a lower rate and relatively recent addition of PIBs in the portfolio that have lower rate vis-à-vis previous one. Moreover, yield on deposits declined mainly due to re-pricing of fixed deposits in FY17. However, despite decline in spreads, net mark-up income augmented on the back of higher business volumes. Non mark-up income stood lower due to lower net gain on sale of securities, while administrative expenses increased on the back of higher staff salaries and voluntary separation scheme. As a result of higher administrative expenses and lower non mark-up income, net profit declined in FY17. During 1QFY18, profitability improved mainly on the back of higher net mark-up income vis-à-vis corresponding period last year. Given The bank has projected lower net profit for the ongoing year vis-à-vis FY17.

Capitalization: The bank continues to maintain a high payout ratio; resultantly, pace of internal capital generation has remained low. Despite significant increase in advances portfolio, Capital Adequacy Ratio (CAR) decreased slightly by end-FY17 as disbursements were primarily related to the public sector. With disbursement to private sector, CAR declined to 16.5% by end-1QFY18. CAR of the bank depicts ample room for growth. By end-1QFY18, net NPLs as a percentage of tier-1 equity stood at 3.9% (FY17: 3.5%; FY16: 7.3%).

The Bank of Khyber (BoK) — Annexure I

FINANCIAL SUMMARY *(amounts in PKR millions)*

BALANCE SHEET	FY16	FY17	1QFY18
Total Investments	141,602.4	140,473.8	105,120.3
Advances (net)	31,643.9	83,369.1	97,578.5
Lending to FIs	8,827.3	1,529.1	1,879.1
Cash & Balances	18,617.4	12,173.3	9,473.9
Operating Fixed Assets	2,070.6	2,370.1	2,375.5
Other Assets	3,638.7	5,217.0	5,164.2
Total Assets	**206,400.3**	**245,132.4**	**221,591.5**
Borrowings	28,700.8	64,189.6	54,058.0
Deposits & other accounts	157,020.4	159,247.0	146,169.1
Other Liabilities	3,608.9	5,166.5	6,382.3
Bills Payable & Others	927.7	1,131.2	900.1
Tier-1 Equity	14,685.2	14,943.3	13,890.4
Net Worth	16,142.5	15,398.1	14,082.0

INCOME STATEMENT	FY16	FY17	1QFY18
Net Mark-up Income	4,406.5	4,799.0	1,396.9
Net Provisioning	630.8	(103.8)	(101.3)
Non-Markup Income	2,672.9	1,650.8	168.5
Operating Expenses	3,208.7	3,758.2	977.9
Profit Before Tax	3,240.0	2,795.4	688.9
Profit After Tax	2,020.5	1,790.5	447.7

RATIO ANALYSIS	FY16	FY17	1QFY18
Gross Infection (%)	15.1	5.5	4.6
Provisioning Coverage (%)	80.3	89.0	88.3
Net Infection (%)	3.4	0.6	0.6
Cost of Deposits (%)	4.8	4.6	-
Net NPLs to Tier-1 Capital (%)	7.3	3.5	3.9
Capital Adequacy Ratio (C.A.R (%))	21.3	20.0	16.5
Markup Spreads (%)	2.7	2.3	-
Efficiency (%)	66.2	71.6	64.5
ROAA (%)	1.1	0.8	0.8
ROAE (%)	12.6	11.4	12.1
Liquid Assets to Deposits & Borrowings (%)	84.3	56.2	43.4

ISSUE/ISSUER RATING SCALE &DEFINITIONS 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-18	A	A-1	Stable	Reaffirmed
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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