RATING REPORT

Bank of Khyber

REPORT DATE:
June 28, 2024

RATING ANALYSTS:
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RATING DETAILS				
Rating Category	**Latest Rating**		**Previous Rating**	
	Long-term	**Short-term**	**Long-term**	**Short-term**
Entity Rating	A+	A-1	A+	A-1
Outlook/Rating Watch	Stable		Stable	
Rating Action	*Reaffirmed*		*Reaffirmed*	
Date	*June 28, 2024*		*June 27, 2023*	

COMPANY INFORMATION	
Incorporated in 1991; scheduled in 1994	**External auditors:** M/s A.F. Ferguson & Co.
Public Limited Company	**Chairman of the Board:** Syed Imtiaz Hussain Shah
Key Shareholders (with stake 5% or more):	**Managing Director/Chief Executive Officer (Acting):** Mr. Irfan Saleem Awan
Government of Khyber Pakhtunkhwa – 70.2%	
Ismail Industries Ltd – 24.4%	

APPLICABLE METHODOLOGY
VIS Financial Institution https://docs.vis.com.pk/Methodologies%202024/Financial-Institution-v2.pdf
VIS Rating Scale https://docs.vis.com.pk/docs/VISRatingScales.pdf

Bank of Khyber

OVERVIEW OF THE INSTITUTION

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.

Profile of Chairman

Syed Imtiaz Hussain Shah is a Civil Servant of the Pakistan Administrative Service (PAS) group. He has been appointed as Chairman on the Board of the Bank by virtue of his position as Additional Chief Secretary, Government of Khyber Pakhtunkhwa. Syed Imtiaz Hussain Shah is M.Sc. Agricultural Development Economics, MA Economics and B.Sc. Engineering. He has remained on different administrative positions and has also attended various national and international courses.

Profile of CEO (Acting)

Mr. Irfan Saleem Awan is currently serving as CFO & Managing Director/CEO (Acting). He is a fellow member of the Institute of Chartered Accountants of Pakistan and a Certified Director from Pakistan Institute of Corporate Governance. He also holds Advanced Certificate in AAOIFI Shariah Standards from the Institute of Business

RATING RATIONALE

Banking Sector

The banking sector in Pakistan has been navigating a challenging macroeconomic landscape. Despite facing headwinds such as high inflation, elevated interest rates, and geopolitical uncertainties, the sector has demonstrated resilience and adaptability in supporting economic stability.

One of the important factors contributing to the sector's resilience has been its strong capitalization and liquidity. Banks in Pakistan remain well-capitalized, with an industry-wide CAR of 19.7%. This ensures that banks are equipped to absorb potential shocks and maintain financial stability. Moreover, profitability metrics remain healthy, with a return on equity (ROE) of 27.1% based on CY-23 results, underscoring the sector's ability to generate sustained returns amidst challenging operating conditions.

The government's successful negotiation of the IMF's Stand-By Arrangement (SBA) program, culminating in a Staff-Level Agreement and disbursement of funds, has provided additional support to market confidence and exchange rate stability, with positive implications for the banking sector. In terms of monetary policy dynamics, the State Bank of Pakistan (SBP) has maintained a cautious stance, balancing the imperative of containing inflationary pressures while supporting economic growth. Even as headline inflation has moderated from peak levels, it remains elevated, hence SBP has reduced the policy rate by 150bps to 20.5% in its latest monetary policy statement. This stance reflects the central bank's commitment to anchoring inflation expectations and safeguarding macroeconomic stability.

Looking ahead, the banking sector faces both challenges and opportunities. Continued vigilance in managing credit quality and liquidity risks will be vital, especially amidst evolving macroeconomic dynamics and policy uncertainties. Moreover, the sector's role in supporting the government's reform agenda, particularly in areas such as taxation, energy, and privatization of state-owned enterprises, will be critical in fostering sustainable economic growth and financial stability.

Rating Drivers:

Sponsor Support is evident

The ratings assigned to BOK reflect its shareholding structure as the majority stake (70.2%) is held by the sub-sovereign, the Government of KPK followed by Ismail Industries Limited (24.4%).

Asset quality indicators are weak although IFRS-9 adoption has increased reserves held; market risk is low in the present benchmark rate scenario and given the high proportion of floating rate securities

Administration (IBA-CEIF), Karachi. His professional career spans over two decades with experience of working in various areas, including finance, compliance, enterprise risk management, strategic planning, company secretarial, and external audit. He has worked in the financial industry with various organizations including Prime Commercial Bank Limited, Askari Commercial Bank Limited, Askari Investment Management Limited, KASB Funds Limited, Pak-Libya Holding Company (Pvt.) Limited and Summit Bank Limited.

As of Dec'23, BoK's asset base grew, funded by a rise in deposits, although it lagged behind the industry's 29.5% asset base expansion. This growth was primarily reflected in a significant increase in investments, which primarily comprise government securities and therefore represent minimal credit risk. On the other hand, BoK experienced a reduction in Gross Advances (GA), contrasting with the industry's average growth of 3.7%. Sector-wise reduction was notably in the Commodity Financing, Power, and Trade sectors. The Gross Infection (GI) ratio increased significantly in sectors such as construction, miscellaneous, manufacturing, trade, agriculture, and sugar. The public sector's proportion of advances decreased to 39.5% from 48.9% in 2022. Despite this, most large exposures (over 5% of common equity) are still extended to government entities, contributing to limiting the otherwise high credit risk in the portfolio.

Non-Performing Loans (NPLs) rose in 2023, increasing the GI ratio by Dec'23. Starting in 2024, BoK transitioned to IFRS-9 as directed by the State Bank of Pakistan (SBP). Stage 3 assets were largely comparable to NPLs reported as at December'23. However, specific coverage for Stage 3 assets increased to 75.6%, while general coverage for Stage 1 and Stage 2 assets also increased reserves set aside by a further Rs. 2.2bn, significantly raising loss buffers held by the bank against potential asset losses in future. Net NPLs to Tier 1 Equity was reported at a much lower 16.7% at the end of Mar'24.

Approximately 85% of the investment portfolio consists of floating-rate securities, reducing market risk. The weighted average duration of fixed-rate government securities was 0.96 years, while the entire portfolio's duration was 0.25 years as of March 2024.

Excess Liquidity is available

In 2023, BoK saw significant deposit growth, mainly in term deposits from customers. This growth continued in the first quarter of 2024, driven by an increase in saving accounts. As of Dec'23, the deposit composition remained stable, with government deposits representing a significant portion. Some concentration is evident, however the related party nature of government deposits may render these sticky. By Mar'24, total borrowings had significantly reduced, mainly due to a decrease in Repo Borrowings.

BoK's liquidity profile improved, as evidenced by a substantial LADB coverage at the end of the first quarter of 2024. The Liquidity Coverage Ratio (LCR) and Net Stable Funding Ratio (NSFR) remained significantly above regulatory requirements.

Profitability

Due to SBP's monetary tightening throughout 2023, benchmark rates remained high, averaging approximately 808 basis points higher than in 2022. In 2023, net markup income rose by 93.4% compared to SPLY, along with significant growth in non-markup income, primarily from foreign exchange income. Non-markup expenses increased in line with inflation, but the Bank's efficiency ratio improved significantly to around 53.8% in 2023 from 79.5% in 2022. The total provisioning charge reduced, leading to a surge in Profit before Provisions and Taxes (PBPT) compared to 2022. Consequently, Return on Average

Assets (ROAA) increased to 1.0% from 0.1%, and Return on Average Equity (ROAE) rose to 18.9% from 2.8%.

In the first quarter of 2024, the spread slightly increased, and total income rose compared to the first quarter of 2023. However, increase in operating expenses, caused a Rs. 0.1b decline in PBT. Consequently, ROAA and ROAE fell to 0.8% and 16.6%, respectively.

The short to medium-term outlook for BoK's profitability is stable. The spread is expected to expand in the short term due to the downward trend in benchmark rates, reflected in the repricing of assets relative to liabilities. Additionally, holdings in the PIB portfolio will result in mark-to-market (MTM) surpluses on the investment book.

Capitalization

The Capital Adequacy Ratio (CAR) increased to 18.3% by the end of 2023, up from 14.9% in 2022. This growth was driven by an increase in Tier 1 Capital, primarily from the growth in unappropriated profit and an increase in the General/Statutory Reserve. Since asset growth was directed towards zero-risk sovereign securities, the increase in Risk-Weighted Assets (RWAs) remained lower.

As of Mar'24, Paid-up Capital increased due to a bonus shares issue, but total Eligible Capital reduced mainly due to the impact of IFRS-9 implementation. With RWAs also reducing, CAR remained stable at 18.2%. The CAR continues to exceed regulatory requirements, with tier-1 equity comprising approximately 99.9% of eligible capital.

Bank of Khyber

FINANCIAL SUMMARY (Rs. in millions)			Annexure-I
BALANCE SHEET	**31-Dec-22**	**31-Dec-23**	**31-Mar-24**
Total Investments	173,668.6	223,348.5	230,428.9
Gross Advances	134,912.8	109,703.1	110,290.0
Net Advances	127,515.2	101,587.6	97,692.4
Total Assets	344,984.1	383,186.5	392,679.2
Borrowings	66,263.2	50,460.6	28,826.4
Deposits & other accounts	248,906.0	289,291.6	324,278.3
Subordinated Loans	0.0	0.0	0.0
Tier-1 Equity	15,958.8	19,747.8	17,626.3
Paid Up Capital	11,027.9	11,027.9	11,579.4
Net Shareholders Equity (excl. revaluation surplus)	16,657.4	20,176.7	17,047.4
INCOME STATEMENT	**CY22**	**CY23**	**1QCY24**
Net Spread Earned	7,148.7	13,892.6	3,516.4
Net Provisioning / (Reversal)	902.1	705.1	190.1
Non-Markup Income	1,384.6	2,109.0	548.5
Operating Expenses	6,650.1	8,560.3	2,360.5
Profit/ (Loss) Before Tax	919.9	6,701.6	1,514.3
Profit / (Loss) After Tax	454.9	3,481.3	772.2
RATIO ANALYSIS	**CY22**	**CY23**	**1QCY24**
Market Share (Advances) (%)	1.1%	0.9%	0.9%
Market Share (Deposits) (%)	1.1%	1.0%	1.1%
Non-Performing Loans (NPLs)	11,756.0	13,290.7	13,652.3
Gross Infection (%)	8.7%	12.1%	12.4%
Total Provisioning Coverage (%) (incl. general prov.)	62.9%	61.1%	92.3%
Net Infection (%)	3.5%	5.2%	3.3%
Cost of deposits (%)	8.4%	13.7%	16.5%*
Gross Advances to Deposits Ratio*** (%)	50.1%	34.8%	31.1%
Net NPLs to Tier-1 Capital (%) (adj. for general prov.)	27.7%	26.6%	16.7%
Tier-1 CAR (%)	14.8%	18.1%	17.4%
Capital Adequacy Ratio (CAR) (%)	14.9%	18.3%	18.2%
Spread (%)	2.5%	5.0%	5.2%*
Efficiency (%)	79.5%	53.8%	58.8%*
Liquidity Coverage Ratio (%) (LCR)	146.2%	201.4%	212.0%
Net Stable Funding Ratio (%) (NSFR)	149.8%	181.0%	157.3%
ROAA (%)	0.1%	1.0%	0.8%*
ROAE (%) (Net Shareholder Equity)	2.8%	18.9%	16.6%*
Liquid Assets to Deposits & Borrowings** (%)	54.6%	70.0%	73.2%

* Annualized

** Adjusted for repo and collateral

*** Adjusted for SBP refinancing schemes

REGULATORY DISCLOSURES — Annexure-II

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

Rating History

Rating Date	Medium to Long Term	Short Term	Outlook/ Rating Watch	Rating Action
		RATING TYPE: ENTITY		
28-June-24	A+	A-1	Stable	Reaffirmed
27-June-23	A+	A-1	Stable	Reaffirmed
30-June-22	A+	A-1	Stable	Reaffirmed
30-June-21	A+	A-1	Stable	Upgrade
30-June-20	A	A-1	Stable	Reaffirmed
26-June-19	A	A-1	Stable	Reaffirmed
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

Instrument Structure	N/A
Statement by the Rating Team	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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Due Diligence Meetings Conducted

	Name	Designation	Date
1.	Mr. Abid Shah	Chief Risk Officer	07th June 2024
2.	Mr. Syed Furrukh Zaeem	SEVP - Treasury and Investment Banking)	
3.	Mr. Asim Basheer	EVP - Digital Banking	