

RATING REPORT

Khushhali Bank Limited

REPORT DATE:

May 3, 2016

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	April 29, 2016		April 30, 2015	

COMPANY INFORMATION

Incorporated in 2008	External auditors: BDO Ebrahim & Co. Chartered Accountants
Limited Liability Company	Chairman of the Board: Mr. Aameer Mustaaly Karachiwala
Key Shareholders (with stake 5% or more):	Chief Executive Officer: Mr. M. Ghalib Nishtar
United Bank Limited – 29.7%	
Rural Impulse Fund II S.A. SICAV-FIS – 24.5%	
Credit Suisse Microfinance Fund Management Company – 19.9%	
ShoreCap II Limited – 14.3%	
ASN-NOVIB Mikrokredietfonds – 9.9%	

APPLICABLE METHODOLOGY (IES)

Methodology: Micro Finance Institutions (Oct 2003)

<http://jcrvis.com.pk/images/MicroFinance.pdf>

OVERVIEW OF
THE
INSTITUTION

Khushhali Bank Limited was incorporated in 2000 with proclamation of Khushhali Ordinance by Government of Pakistan. Subsequently, it was transformed into a public limited company in 2008. Objective of the bank is to provide microcredit services to underserved and poor segment of the society in a bid to promote social welfare.

RATING RATIONALE

Khushhali Bank Limited (KBL) is the leading provider of microcredit in microfinance institutions, with a market share of 18.7% in terms of total Gross Loan Portfolio (GLP) booked by microfinance sector.

Key Rating Drivers

- **Business volumes:** In line with the trend observed in past two years, the bank managed to post aggressive growth in loan book, thereby maintaining its status as the leading microfinance institution. Product suite of the bank was enhanced with the introduction of three new products in 2015, with the aim of serving the untapped market segments. In addition to increasing its customer base, the bank also sustained a healthy client retention ratio. Portfolio mix remained similar to previous years, with agricultural loans exhibiting sizeable concentration. Penetration in Micro, Small and Medium Enterprises (MSME) sector also increased. In order to reduce product concentration risk, management is planning to venture in house financing along with introduction of Islamic microfinance products in future.
- **Portfolio indicators:** Overall infection remains at a lower level, albeit infection indicators increasing on a timeline basis. Infection levels increased mainly on account of decline in crop prices under its value chain financing product. Quality of portfolio also deteriorated on account of change in product structure for its agricultural portfolio. Moreover, as per management, turnover in Loan Officers (LO) has also contributed to higher infection. In view of this challenge, management has implemented structural changes at the branch level. Furthermore, management has hired additional LOs for achieving its growth targets, which has resulted in lower productivity indicators.
- **Funding mix:** Deposit base of KBL also witnessed sizeable increase on timeline basis given that deposits are considered as its primary funding source. However, top 50 deposits continue to feature significant concentration. The bank also mobilized funding from various financial institutions including Asian Development Bank and ECO Trade & Development Bank, Turkey. In addition to this, the bank also possesses sizeable un-utilized funding lines as a buffer.
- **Liquidity:** Liquidity profile of the bank has depicted improvement on the back of additional deployment in T-bills and TDRs. However given high concentration in deposits, liquidity indicators of the bank are considered to be on the lower side. Moreover, liquid assets as a proportion of deposits and borrowings are also lower in comparison to the peers.
- **Capitalization:** With growth in its lending activities, bottom line of the bank also improved. Retention of profits, in turn, resulted in a higher equity base. Bank's Capital Adequacy Ratio (CAR) is also higher than the minimum regulatory floor of 15%, signifying bank's ability to increase its risk weighted assets. However, despite adequate room available in CAR, there is a need to control portfolio for quality.
- **Sponsor Support:** Sponsors of the bank comprise strong financial institutions. Majority shareholding of the bank is vested with a consortium of 5 members led by United Bank Limited. JCR-VIS anticipates technical and financial support from sponsors of KBL, if the need arises.

Khushhali Bank Limited

Annexure II

FINANCIAL SUMMARY			
	<i>(amounts in PKR millions)</i>		
BALANCE SHEET	Dec 31, 2015	Dec 31, 2014	Dec 30, 2013
Total Investments	1,847.8	836.9	1,038.9
Net Financing	17,246.5	12,105.8	8,756.9
Total Assets	26,696.3	16,692.4	13,289.7
Borrowings	5,890.4	3,729.9	2,746.1
Tier-1 Equity	3,934.4	3,285.5	2,752.5
Net Worth	3,951.5	3,286.1	2,758.9
INCOME STATEMENT	Dec 31, 2015	Dec 31, 2014	Dec 30, 2013
Net Mark-up Income	3,187.3	2,319.9	1,662.9
Net Provisioning / (Reversal)	296.2	162.6	174.7
Non-Markup Income	845.8	694.7	583.9
Operating Expenses	2,444.7	1,889.8	1,522.8
Profit after tax	824.2	703.2	363.2
RATIO ANALYSIS	Dec 31, 2015	Dec 31, 2014	Dec 30, 2013
Gross Infection (%)	2.5	1.1	0.9
Net Infection (%)	2.1	0.9	0.7
Net NPLs to Tier-1 Capital (%)	8.7	3.2	2.2
Markup Spreads (%)	19.1	19.3	17.5
OSS (%)	125.7	125.4	112.5
ROAA (%)	3.8	4.7	3.1
Liquid Assets to deposits & borrowings (%)	28.8	18.6	29.5

ISSUE/ISSUER RATING SCALE & DEFINITIONS

Appendix III

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 IV
Name of Rated Entity	Khushhali Bank limited (KBL)				
Sector	Micro Finance Bank (MFB)				
Type of Relationship	Solicited				
Purpose of Rating	Entity Rating				
Rating History	Rating Date	Medium to Long Term	Short Term	Rating Outlook	Rating Action
	<u>RATING TYPE: ENTITY</u>				
	04/29/2016	A+	Stable	A-1	Reaffirmed
	04/30/2015	A+	Stable	A-1	Upgrade
	04/23/2014	A	Positive	A-1	Maintained
	04/30/2013	A	Stable	A-1	Reaffirmed
	11/12/2012	A	Stable	A-1	Reaffirmed
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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