RATING REPORT

Khushhali Microfinance Bank Limited

REPORT DATE:
May 04, 2018

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 26, 2018*		*April 28, 2017*	

COMPANY INFORMATION

Incorporated in 2000	**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%	
responsAbility Management Company S.A. – 19.9%	
ShoreCap II Limited – 14.3%	
ASN-NOVIB MicrokredietPool – 9.9%	

APPLICABLE METHODOLOGY(IES)

Methodology: Micro Finance Institutions (May 2016)
http://jcrvis.com.pk/docs/Meth-MFBs201606.pdf
Notching the Issues (June 2018)
http://jcrvis.com.pk/docs/criteria_instrument_16.pdf

RATING RATIONALE

Khushhali Microfinance Bank Limited (KMBL) is the leading provider of microcredit services, with a market share of 16% in terms of total Gross Loan Portfolio (GLP) in the microfinance sector in Pakistan. Ratings also draw comfort from continuous improvement in operating performance reflected by improved asset quality indicators, enhanced liquidity and augmented profitability providing impetus to the internal capital generation of the bank.

Key Rating Drivers

- **Business volumes**: In line with the trend observed in past two years, the bank managed to post significant growth in micro-credit portfolio, thereby maintaining its status as the leading microfinance provider. Product suite of the bank was enhanced with the introduction of two new products during the outgoing year, with the aim of serving the untapped market segments and reducing product concentration risk. The bank sustained a healthy client retention ratio coupled with adding new customers to its client base through increased market penetration. Portfolio mix remained unchanged, with agricultural loans exhibiting sizeable concentration. With the management's focus on higher ticket loans and gradual progression of clients to next loan cycle, average loan size and average disbursement size both increased. Going forward, management aims to increase the bank's customer base by offering high ticket loan products to individuals with satisfactory repayment history under micro enterprise (ME) loan products.

- **Portfolio indicators**: Overall asset quality indicators improved on a timeline basis, demonstrating credit risk emanating from loan portfolio remained manageable. Moreover, in absolute terms non-performing loans declined on year on year basis. As per management, high attrition amongst Loan Officers (LO) adversely impacts asset quality indicators. In view of this challenge, management has implemented structural changes at the branch level. Furthermore, management has hired intern LOs for achieving its recovery targets, which resulted in lower productivity indicators.

- **Funding & Liquidity**: Deposits remain the primary source of funding for the bank. KMBL's deposit base exhibited sizeable increase on timeline basis primarily on account of growth in fixed deposits owing to launch of special scheme for senior citizens and minors. In addition, considerable improvement was exhibited in concentration risk owing to enhanced granularity achieved in line with increase in number of depositors. Liquidity profile of the bank depicted improvement on the back of additional deployment in T-bills and TDRs. With advances to deposit ratio scaling down to 70% (FY16: 108%) coupled with presence of sizeable proportion of liquid assets in relation to deposits and borrowings, liquidity indicators of the bank are considered to be comfortably placed in terms of peers. Going forward, bank plans to increase current account deposit base to alleviate ongoing pressure on spreads.

- **Profitability & Capitalization:** Growth in total earning asset base on account of expansion in outreach positively translated into bank's bottom line. Despite pressure on spreads, Operating Self Sufficiency (OSS) remained well above 100% on the back of considerable increase in core income. Retention of profits, in turn, resulted in augmentation of capital base. Bank's Capital Adequacy Ratio (CAR), albeit declined, remained higher than the minimum regulatory requirement of 15%, signifying bank's ability to increase its risk weighted assets. KMBL issued a rated, unsecured, subordinated and privately placed term finance certificates (PPTFC) amounting up to Rs. 1b during March'18. The same is likely to further strengthen the capital structure of the bank. However, despite adequate room available in CAR, maintenance of portfolio quality is considered critical in a rapidly expanding micro-credit portfolio.

- **Sponsor and Infrastructure Support:** Majority shareholding of the bank is vested with a consortium of 5 members led by United Bank Limited. JCR-VIS anticipates implicit financial support from sponsors of the bank, if the need arises going forward. KMBL is in the process of implementing new Core Banking System (CBS) – Temenos, T-24. The bank plans to go live with new CBS by 2nd half of 2018 with a big bang approach. The new CBS will provide flexibility to the bank to cater to the growing needs of customers.

OVERVIEW OF THE INSTITUTION

Khushhali Microfinance Bank Limited (previously 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.

Profile of Chairman:

With over 30 years of experience, Mr. Aameer Karachiwalla is a Chartered Accountant from the Institute of Chartered Accountants of England & Wales. Mr. Karachiwalla currently serves as CFO of UBL . He joined UBL in 1998 and has previously held the positions of Chief Operating Officer, Chief of Staff and Group Executive Retail Banking at UBL. He has also *held senior positions at a number institutions including American Express Bank, Citicorp Investment Bank and Artal Group of Companies.*

Profile of CEO:

Ghalib Nishtar has over 35years of management experience commencing with Bank of America in 1982 and concluding with the National Bank of Pakistan, as its Senior Executive Vice President.

Financial Snapshot:

Total assets: FY17: Rs. 59.0m; FY16: Rs. 33.8m

Total Equity: FY17: Rs. 6.4b; FY16:Rs. 4.9b

Profit After Tax: FY17: Rs. 1.8b; FY16: Rs. 1.3b

Khushhali Microfinance Bank Limited — Annexure I

FINANCIAL SUMMARY			*(amounts in PKR millions)*
BALANCE SHEET	**Dec 31, 2015**	**Dec 31, 2016**	**Dec 31, 2017**
Total Investments	1,847.8	2,967.9	16,297.6
Net Financing	17,246.5	22,939.5	32,216.0
Cash Balances	1,945.2	2,688.4	4,063.4
Total Assets	26,696.3	33,773.5	58,961.2
Total Deposits	15,583.7	21,179.4	45,746.9
Borrowings	5,890.4	6,199.9	4,782.7
Tier-1 Equity	3,934.4	4,937.2	6,354.3
Net Worth	3,951.5	4,937.1	6,355.8
INCOME STATEMENT	**Dec 31, 2015**	**Dec 31, 2016**	**Dec 31, 2017**
Net Mark-up Income	3,187.3	4,119.1	5,744.9
Net Provisioning / (Reversal)	296.2	684.8	712.7
Non-Markup Income	845.8	1,118.7	1,339.9
Operating Expenses	2,444.7	2,755.9	3,857.0
Profit after tax	824.2	1,272.7	1,800.6
RATIO ANALYSIS	**Dec 31, 2015**	**Dec 31, 2016**	**Dec 31, 2017**
Gross Infection (%)	2.5	1.8	1.2
Incremental Infection (%)	3.4	2.6	1.5
Provisioning Coverage (%)	17.0	34.9	27.8
Net Infection (%)	2.1	1.2	0.9
Net NPLs to Tier-1 Capital (%)	8.7	5.6	4.3
Capital Adequacy Ratio	20.5	20.2	18.9
Cost of Funds	7.7	7.5	8.1
Markup Spreads (%)	19.1	16.6	14.6
OSS (%)	125.7	129.2	130.6
ROAA (%)	3.8	3.8	4.0
Liquid Assets to deposits & borrowings (%)	28.8	26.3	41.2

ISSUE/ISSUER RATING SCALE & DEFINITIONS — Appendix 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 — Appendix III

Name of Rated Entity	Khushhali Microfinance Bank limited (KMBL)
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
		RATING TYPE: ENTITY		
04/26/2018	A+	Stable	A-1	Reaffirmed
04/28/2017	A+	Stable	A-1	Reaffirmed
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.
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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