RATING REPORT

Khushhali Microfinance Bank Limited

REPORT DATE:
May 06, 2022

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
PPTFC-I	A		A	
PPTFC-II	A		A	
Rating Outlook	Rating Watch-Developing		Rating Watch-Developing	
Rating Date	*April 29, 2022*		*April 30, 2021*	

COMPANY INFORMATION	
Incorporated in 2000	**External auditors:** EY Ford Rhodes
Public Limited 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%	
MultiConcept Fund Management S.A (responsibility Global Micro and SME Finance Fund). – 19.9%	
ShoreCap II Limited – 14.3%	
ASN-NOVIB MicrokredietPool – 9.9%	

APPLICABLE METHODOLOGY(IES)
VIS Entity Rating Criteria: Micro-Finance Banks (May 2016)
http://www.vis.com.pk/kc-meth.aspx

Khushhali Microfinance Bank Limited

OVERVIEW OF THE INSTITUTION

Khushhali Microfinance Bank Limited (previously Khushhali Bank Limited) was incorporated in 2000 with proclamation of Khushhali Bank Ordinance by Government of Pakistan. Subsequently, it was transformed into a public limited company in 2008. Objective of the bank is to provide financial services to Micro, Small and Medium Enterprises and low income households across Pakistan.

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.

Profile of CEO:

Mr. M.Ghalib Nishtar is the founding President of Khushhali Microfinance Bank Ltd., Pakistan's largest microfinance bank. He is regarded as a pioneer microfinance banker of Pakistan's burgeoning microfinance industry. Mr. Nishtar has over 35 years of management experience commencing with Bank of America in 1982 and concluding with the National Bank of

RATING RATIONALE

Khushhali Microfinance Bank Limited (KMBL) has maintained its prominent position as the leading provider of microcredit services in the microfinance (MF) sector of Pakistan, having a market share of 19% (FY20: 19%) in loan portfolio and 22% (FY20:24%) of deposits during the outgoing year. The ratings incorporate strong sponsor profile and implicit support of shareholders available. The ratings reflect the uncertainty involving the financial risk profile of the bank as around 27% of the total portfolio is categorized under deferred and restructured loan portfolio (DRR) both rescheduled in light of SBP's direction to relax repayment terms for borrowers effected by the COVID-19 followed by internal restructuring carried out by the bank. Given that the anticipated loss ratio of the double rolled-over portfolio will be on a higher side, VIS expects that the real infection and asset quality position will eventually come forth by end-4QFY22 on complete maturity of internally rescheduled portfolio. Further, despite sizable internal rollover done to facilitate covid effected borrowers, the infection ratios still increased on a timeline basis during the period under review. SBP has provided another relief to microfinance banks, through relaxation of provisioning coverage by extension of incremental time for loss reporting for DRR portfolio. In addition, SBP has also revised the prudential regulations against which housing and micro-enterprise (ME) portfolios provisioning duration has been extended during the ongoing year, the same will stagger the loan portfolio deterioration. ME and Housing Portfolio's share comprise of 31% of total GLP at the year under review which will grow during the ongoing year onward as the Bank's management plans to shift the lending strategy towards less risky and more secured and longer term products. The ratings also factor in slight dip in liquidity and capitalization indicators of the bank. The Bank issued TFC-III amounting to Rs. 600m to strengthen capital adequacy further during the outgoing year. Further, the management has plans to issue additional Tier-1 Capital amounting to Rs. 1.5b to further strengthen the resilience of portfolio losses. Three major shareholders are considering the aggregate stake sale of 57.7% to a consortium of renowned strategic investors; the divestment process in underway and was expected to be completed by end-FY21; however, the same has been moved to end-FY22 in view of COVID disruptions. While the financial and experience profile of overall sponsor base is expected to remain intact, VIS will review the same upon completion of the divestment process.

Key Rating Drivers

Growth in micro-credit portfolio witnessed; however, the same is not a true reflective of disbursement or GLP position: The lending activities remained largely curtailed during the outgoing year with continued focus of the management towards portfolio consolidation and recovery activities as frequent waves of the pandemic and consequent curtailing measures imposed by the government have, on one side, affected the repayment capacity and the relief, on the other side impacted borrowers' behavior and willingness to repay as they were continuously approaching the Bank to grant them further relief. With the Omicron variant, the surge in new cases continued till end-FY21, therefore the economic activity remained stunted and was marked by intervals of lockdown. As a result, improvement in credit worthiness of micro-credit borrowers was not possible and the same was not even evidenced as the entire microfinance sector remained under the blanket of uncertainty. In addition, the rollover of advances in retrospect of SBP's relaxation to mitigate economic slowdown extended till 1QFY21 followed by sizable restructuring done under KMBL's own internal scheme, the Banks's cash flow cycle was confined therefore, the Bank fell well short of its disbursement target of Rs. 69.1b (FY20: Rs. 71.2b) for FY21 with actual disbursement amounting to Rs. 48.6b (FY20: Rs.38.2b). However, the negative variance in the budgeted and actual disbursement did not reflect fully in the Gross Loan Portfolio (GLP) position as part of DRR portfolio further rolled over under Bank's own scheme was recorded as regular portfolio in GLP. As a result, GLP exhibited growth and was recorded higher than the target of Rs. 66.3b at Rs. 70.8b (FY20: Rs. 60.6b) at end-FY21. As a result of reduction in number of new first cycle clients coupled with management's focus on increasing the individual portfolio, total number of active borrowers also decreased by end-FY21. Despite the challenges, the Bank protected its market share and continued to maintain lead position in the sector during FY21.

As a part of business strategy, the concentration of group loans in total GLP was kept lower while share of ME & SME and housing loans increased during the rating review period. Meanwhile, the proportion of individual loans

Pakistan, as its Senior Executive Vice President.

Financial Snapshot

Total assets: end-FY21: Rs. 116.5b; end-FY20: Rs. 107.1b; end-FY19: Rs. 81.5b;

Total Equity: end-FY21: Rs. 11.2b; end-FY20: Rs. 10.8b; end-FY19: Rs. 9.4b;

Profit After Tax: FY21: Rs. 572m; FY20: 1.7b; FY19: Rs. 1.8b;

largely remained unchanged. The target portfolio mix for FY22 comprises 23% of group loans, 43% of individual loans, 25% of ME & SME loans and 9% of home improvement loans. Sector-wise concentration, revealed a decline in Livestock, Agriculture (Crop) and General-Purpose loans by end-FY21. In terms of sectoral composition, highest repayment risk is associated with general purpose loans that are basically consumptive loans with no cash flow generation to support repayment; the proportion of same has decreased during the period under review. Moreover, the credit risk is largely mitigated as the aforementioned loans are backed against gold and have reported 0% loss rate. On the other hand, the constitution of Enterprise loans and Housing loans increased by end-FY21. Further, there was no change in the pricing or repayment structure of any product in the portfolio. The targeted portfolio for FY22 in terms of sectoral breakdown entails 30% composition of Agri loans, 9% of general-purpose loans, 22% of enterprise loans, 11% of housing loans and 27% of livestock loans. Furthermore, in terms of type of payment, the share of EMI increased to 26% (FY20: 21%) in line with increased focus of the management towards ME, SME and Housing loans entailing monthly installments. The EMI concentration is further expected to improve during the ongoing year. In bullet loans the objective is to reduce share of unsecured loans to manage the credit risk; the same is being materialized successfully through growth in secured portfolio to 39.8% (FY20: 31.5%) during FY21. In addition, PAR-30 was recorded over three times higher in bullet portfolio at 6.0% as opposed to 1.8% in EMI portfolio at end-Feb'22. Going forward, the bank intends to enhance proportion of secured portfolio to half of GLP to manage credit exposure by end of the ongoing year.

Credit risk; asset quality indicators deteriorated during the review period: The non-performing loans (NPLs) of the bank increased by end-FY21, as the regulatory relief, provided by the apex bank, of extension of repayment by a year to microfinance borrowers to dampen the impact of COVID-19 ended on 31st March, 2021. However, during the rating review period, SBP provided another relief whereby criteria for classification of assets and provisioning requirements for MFBs were relaxed by providing 30 days extension for Deferred and Restructured Portfolio (DRP) up to end-1QFY22. The same has resulted in further 30 days delay in recognition of delinquent portfolio coupled with spreading of loss. By end-FY21, the deferred portfolio pertaining to regulatory relief under Covid-19 decreased to Rs. 6.7b (FY20: Rs. 20.9b) as the scheme matured by end-1QFY21. Under the SBP relief package, the regular/performing borrowers were allowed to reschedule/defer their loans in accordance with the SBP guidelines. The number of loans outstanding for the aforementioned portfolio were reported lower at year-end; however, post SBP's deadline, significant restructuring has been carried under bank's internal rollover scheme to provide further relief to Covid effected borrowers but after servicing of full/partial mark up by the clients. The portfolio rolled over under bank's internal scheme increased to Rs. 12.9b (FY20: Rs. 4.5b) by end-FY21. The number of clients and portfolio rescheduled under SBP guidelines reduced while internally rollover portfolio amount increased to Rs. 13.3b; hence, the total DRR portfolio was recorded at Rs. 18.7b by end-March,2022 (FY21: Rs 19.6b). As a result, it indicates that the internally rolledover portfolio majorly constitutes of the same clients that were provided rollover facility under SBP's relaxation; subsequently, the double rollover micro-credit portfolio has a projected higher delinquency ratio. Further, the entire DRR portfolio entails bullet repayment structure therefore credit risk is further heightened. The management has set an ambitious recovery target of around 80% on the portfolio rolled over under SBP's relief.

Given that the delinquent portfolio that has been provided relief twice has higher credit risk as the NPL percentage for the same is projected by VIS at least 25% given stressed credit repayment capacity coupled with higher unwillingness of the micro-credit borrower customers to pay. If 25% delinquency is calculated on internally restructured portfolio at end-Mar'22, the amount of NPL comes out to Rs. 3.3b. In line with the bank's historical practice, the write-offs are majorly expected to be against provisions, therefore sizable hit to bank's profitability indicators is expected in the next one year till Apr'23. In view of the increased requieremnt, the Bank has projected loan loss provision of around Rs. 4.1b in FY22 budget. Despite, due to DRR proportion being relatively on a higher side in comparison to peer banks, it remains a key rating concern for VIS; hence the asset quality indicators will be stringently monitored over the due course.

Further, the advances charged off against provisions stood higher at Rs. 3.8b (FY20: Rs. 2.8b) while bad debts directly written off were reported slightly lower at end-FY21; however, the proportion of bad debts is insignificant in comparison to total write-offs for the year. With sizable quantum of write-offs added, the incremental infection also showed a downward trend and was recorded higher at end-FY21. In addition, the provisioning coverage (only specific provision) also deteriorated in line with increase in quantum of NPLs. The general provisioning is now maintained at 1.9% of the total micro-credit portfolio as opposed to 1.6% in FY20 as a subjective cover for the expected loan losses. Given the management's strategy of increasing the proportion of individual and EMI based loans, KMBL launched three new loan products namely Khushhali Apna Makaan (KAM), Karobari Term Finnace (KTF) and Karobari Running Finnace (KRF), during FY21. All three new products entail individual lending and have EMI based repayment structure. Moreover, these new products are high-ticket size loans with KTF and KRF having maximum loan-cap of Rs. 3.0m while KAM has maximum credit amount allocation of Rs. 2.0m. As a result of the new initiatives, the average loan size is expected to grow further owing to enhanced focus on higher ticket size loans coupled with improved market penetration of ME & SME and Housing loans. Therefore, the potential reduction in operational cost incurred per loan initiated will positively impact the efficiencies going forward.

To mitigate credit risk going forward, various steps have been taken by the management with respect to changes in portfolio mix, lending in select segments, list of negative areas for lending, prudent loan graduation from group loans to high value individual loans, aligning of industry experience of loan officers with the risk level of portfolio and tightened policy with respect to new group lending and multiple loans in a family has also been implemented. Furthermore, special incentive scheme in form of waiver of markup upon full loan settlement was retained during the outgoing year. The incentive is being given to selected borrowers who availed rescheduling facility and their markup had doubled in line with non-payment; the bank plans to continue this incentive during FY22. Further, staff incentive structure has been revamped with improved payout percentage along with shift of incentive calculation basis from sales to recovery. In incentive pertaining to sale target, higher percentage allocation has now been done for extension of individual, EMI and higher ticket loans. Going forward in FY22, centralized CAD unit role will be enhanced for higher ticket loans, quality of underwriting and loan requirements completion before disbursement. Moreover, additional Relationship Manager/Team Lead will be deployed at selected high-volume branches & branches with higher default for effective team and portfolio management. In addition, loan rollover option will continue to be used to manage the collection challenges and in parallel the new secured/semi secured portfolio will be improved.

Decline in investment portfolio; credit risk is negligible with market risk being manageable: Given slight recovery of micro-credit lending activities, some portion of the liquid resources vested in government securities were liquidated during the outgoing year. However, as over 78% of the investment mix comprised of sovereign securities, credit risk emanating from the same remained negligible; the remaining investment portfolio comprised term deposit receipts, which were placed with other financial institutions having sound repayment history and credit ratings. Further, the market risk is considered also manageable given short to medium term nature of investments. At end-FY21, there was asset liability mismatch in over one-month up to six-months bracket mainly due to considerable amount of cost bearing deposits falling due in the said bracket. The risk is mitigated to a certain extent given un-availed credit lines available with the local banks.

Suppressed profitability indicators; high provisioning expense is the main contributing factor: Profitability of the bank has presented a complex scenario during the rating review period given markup spreads have improved slightly despite dip in yield on markup bearing assets on account of notable reduction in cost of funds. On the other hand, despite significant growth in recurring non-markup income, primarily loan processing fee in line with increased lending of high-ticket loans pertaining to ME & SME and Housing category, Operational self-sufficiency (OSS) ratio still showed a downward trend and was recorded lower on account of sizable provision expense booked owing to increased incidence of non-performing loans emanating from the agri and livestock portfolio along with increase in administrative expense during FY21. Further, despite sizable growth in micro-credit portfolio, total markup income earned was recorded at prior year's level at predominantly on account of lower yield on advances. Markup on advances remained unchanged while the yield on net advances dropped noticeably owing to mark up suspension and waivers of non performing rescheduled loans It is pertinent to note that the reported markup on advances and yield may still not be a true representation of cash generation from the aforementioned micro-credit portfolio as a significant proportion of bank's GLP has been placed under internal rollover and the markup earned on the same has been booked as income. On the year end GLP, the Bank reported accrued markup amounting to Rs. 12.1b (FY20: Rs. 9.3b) placed under other assets is an income generated yet to be received. Given, the expected delinquency ratio of the double restructured/ rolledover portfolio is high, the probability of recovery of income booked in advance is slightly on a lower side; therefore, the yield of advances portfolio may be effected going forward. On the other hand, yield on investments improved in line with gradual increase in benchmark rates in last quarter of FY21 as the economy initiated its recovery phase post pandemic shocks. However, with sizable cut in yield on advances, overall yield on interest bearing assets decreased to 21.2% (FY20: 22.6%) during FY21.

Total markup expensed slightly increased in line with higher deposits base coupled with increase in borrowings. Despite gradual increase in benchmark rates by end of outgoing year, cost of borrowing remained low on account of SBP's policy rate being at the very bottom end of the spectrum, i.e., 7%, for most part of the outgoing year involving the first eight months of FY21. However, the impact of low policy rate was also slightly diluted as the highest borrowing quantum was reported in 4QFY21 whereby the policy rate started increasing and was recorded higher Nov-Dec'21 period. Moreover, the cost of deposits also declined owing to average benchmark rates being lower than the preceding year coupled with decrease in proportion of interest bearing high-cost deposits in the overall deposit mix. As a result, overall cost of funds decreased notably during FY21. Subsequently, in line with lower cost of funds being largely offset by decline in yield of markup bearing assets, the Bank's markup spread improved only slightly to 11.7% (FY20: 11.4%) during FY21.

The new loans disbursement was curtailed as major foucs of the Bank was recovery/management for the rescheduled portfolio. The microcredit application processing fee and commission increased sizably during the outgoing year due to recovery in the socio-economic indicators, the processing fee was charged in full during the outgoing year; the increase in fee income was also an outcome of disbursement of high-ticket loans pertaining to ME & SME and Housing categories involving higher processing fee. On the other hand, total administrative expenses of the bank were also recorded higher in line with increase in other operating expenses apart from remuneration expense; the same were reported higher due to full-year cost impact of 13 additional high-ticket branches opened in FY20 along with inflationary impact of over 12 % on the administrative overhead. Further, in line with escalated credit risk owing to hampered debt repayment capacity of borrowers resulting from during and post pandemic circumstances, loan loss provision was recorded higher at Rs. 3.9b (FY20: Rs. 3.0b) during FY21. As a result, net profit was recorded much lower during the review period and significantly below the projected amount for FY21.

The bank projects income on advances to improve on account of resource deployment in high yielding loan assets; however, the materialization of the same will be ascertained over time as the improvement stemming from aforementioned strategy will be offset by the cleansing of the rescheduled portfolio against which no markup income will be generated or booked as opposed to the ongoing current practice. However, the bank has projected an increase in cost of funds to 10.1% in line with the increase evidenced in the benchmark rates recently. In order to minimize the increase in cost of funds, KMBL will be focusing on low-cost deposit mobilization with special emphasis on CASA. To facilitate this, all clients will be offered ATM & internet banking facilities for payments to vendors and from customers. Therefore, spreads of the bank are likely to come under pressure during the rating review period.

Slight decline in liquidity metrics; however, the liquidity position remains comfortable: Liquidity profile of the bank has shown a slightly downward trend in line with liquidation of investments during the period under review; however, the same is still considered sound in line with adequate quantum of investments carried on the books along with growth in cash balance. The divestment from investments for liquidity generation is a combined outcome of slight recovery from pandemic scenario resulting in increased disbursements in FY21 as opposed to the preceding year coupled with cashflow constraint faced in line with low recovery ratio in light of sizable internal restructuring done during the period under review. The slight drop in liquidity indicators is further underpinned by increase in the advances to deposit ratio during the rating review period. Deposits continued to remain the primary source of funding for the bank during the review period. The increase in the deposit base is in sync with the industry growth as with the post pandemic crisis the consumers have put the spending on hold and opted for saving strategy rather than investing to avoid excessive risk taking. The proportion of current and saving accounts (CASA) in overall deposit mix increased notably to 42% (FY20: 35%) owing to major increase in saving deposits along with decline in quantum of fixed deposits in absolute terms during FY21. Going forward, the bank aims to continue with the current deposit mix with no significant anticipated increase in high-cost fixed deposits during the ongoing year to curtail pressure on spreads. However, retaining current deposits has relatively become difficult in line benchmark rates being on the higher side creating significant opportunity cost against keeping capital in current accounts. On the other hand, the anticipated growth in digital initiatives for the ongoing year is expected to largely mitigate the withdrawal risk of low-cost current accounts. Concentration risk on the liability side exhibited an improving trend as the contribution of top 50 depositors decreased to 22.3% (FY20: 27.3%) at end-FY21' moreover with growth in individual depositors the granularity of the deposit base has improved during the rating review period. On the contrary, despite growth in deposit base, KMBL's reliance on borrowings increased to owing to higher ADR ratio resulting in increased channeling of funds to micro-credit lending by end-FY21. However, out of the total bank borrowings, the major chunk constituting almost two-thirds of total funding pertained to repo borrowings during the outgoing year.

Although there has been slight decline; capitalization indicators largely intact. Management issued another Tier-II instrument during FY21: Capital Adequacy Ratio (CAR) of the bank was reported lower during the review period; although the same is comfortably maintained over the regulatory limit. No dividend was paid out during the outgoing year to strengthen the loss absorption capacity of the bank in line with heightened credit risk scenario. However, the management projects a dividend payment for FY22. In addition, KMBL issued another Tier-II capital instrument of Rs. 600m to support capital adequacy during the outgoing year; with the new issue, the bank's Tier II capital now totals Rs.3.0b. Further to issuance of TFC-3 during outgoing year, the Bank has also plans to issue Additional Tier 1 Capital amounting to Rs.1.5b to strengthen the capital base to become more resilient to absorb the loan portfolio shocks.

Khushhali Microfinance Bank Limited — Appendix I

FINANCIAL SUMMARY	*(amounts in PKR millions)*				
BALANCE SHEET	**Dec 31, 2017**	**Dec 31, 2018**	**Dec 31, 2019**	**Dec 31, 2020**	**Dec 31, 2021**
Cash and Bank Balances with SBP and NBP	1,664.3	1,792.7	2,926.2	2,850.3	3,883.7
Balances with other Banks and/NBFIs/MFBs	2,399.1	7,498.4	4,181.1	10,752.2	10,177.3
Lending to Financial Institutions	474.5	1,837.7	450.0	796.0	100.0
Total Investments	16,297.6	8,915.7	10,111.7	17,679.9	14,089.8
Net Advances	32,216.0	43,500.5	53,541.2	60,640.8	70,884.2
Operating Fixed Assets	1,141.6	1,353.5	3,612.3	3,688.2	3,578.8
Other Assets	4,768.1	5,573.3	6,670.6	10,695.5	13,810.1
Total Assets	**58,961.2**	**70,472.0**	**81,493.1**	**107,102.9**	**116,523.9**
Total Deposits	45,746.9	56,018.0	63,882.3	88,649.8	93,162.4
Borrowings	4,782.7	2,964.9	1,326.0	427.7	4,608.4
Subordinated Debt	-	1,000.0	2,400.0	2,400.0	3,000.0
Other Liabilities	2,075.9	2,289.6	4,486.1	4,831.5	4,588.6
Tier-1 Equity	6,354.3	8,198.5	9,399.2	10,801.4	11,245.8
Net Worth	6,355.8	8,199.5	9,398.7	10,793.9	11,184.5
Paid-Up Capital	1,705.0	1,705.0	1,705.0	1,705.0	1,705.0
INCOME STATEMENT	**Dec 31, 2017**	**Dec 31, 2018**	**Dec 31, 2019**	**Dec 31, 2020**	**Dec 31, 2021**
Net Mark-up Income	5,744.9	7,335.9	8,459.5	9,938.2	9,691.8
Net Provisioning / (Reversal)	712.7	778.2	2,259.4	2,992.4	3,960.5
Non-Markup Income	1,339.9	1,638.6	1,973.5	1,543.0	1,994.6
Operating Expenses	3,857.0	4,725.9	5,655.1	6,097.1	6,856.3
Profit Before Tax	2,489.0	3,470.3	2,518.5	2,391.8	869.6
Profit after tax	1,800.6	2,458.8	1,836.2	1,739.8	571.7
RATIO ANALYSIS	**Dec 31, 2017**	**Dec 31, 2018**	**Dec 31, 2019**	**Dec 31, 2020**	**Dec 31, 2021**
Gross Infection (%)	1.2	1.4	4.7	3.1	4.3
Incremental Infection (%)	1.5	2.4	7.3	3.6	7.2
Provisioning Coverage (%)	27.8	34.1	29.9	34.3	19.1
Net Infection (%)	0.9	1.0	3.4	2.1	3.5
Net NPLs to Tier-1 Capital (%)	4.3	5.0	19.0	11.5	21.7
Capital Adequacy Ratio (%)	18.9	18.9	19.1	19.6	18.3
Markup on Earning Assets (%)	22.8	21.7	22.7	22.6	21.2
Cost of Funds (%)	8.1	8.6	10.8	11.2	9.5
Markup Spreads (%)	14.6	13.1	11.9	11.4	11.7
OSS (%)	130.6	132.7	115.8	112.9	104.7
ROAA (%)	4.0	3.8	2.4	1.8	0.5
ROAE (%)	31.9	33.8	20.9	17.2	5.2
Gearing (x)	N/A	N/A	N/A	N/A	N/A
Current Ratio (x)	N/A	N/A	N/A	N/A	N/A
Liquid Assets to deposits & borrowings (%)	41.2	34.0	27.1	36.0	29.8

ISSUE/ISSUER RATING SCALE & DEFINITIONS Appendix II

VIS Credit Rating Company Limited

RATING SCALE & DEFINITIONS: ISSUES / ISSUERS

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: 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.vis.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.vis.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.

(blr) Rating: A suffix (blr) is added to the ratings of a particular banking facility obtained by the borrower from a financial institution. The suffix (blr), abbreviated for 'bank loan rating' denotes that the rating is based on the credit quality of the entity and security structure of the facility.

'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.vis.com.pk/images/policy_ratings.pdf

'SD' Rating: An 'SD' rating is assigned when 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				
04/29/2022	A+	A-1	Rating Watch-Developing	Reaffirmed
04/30/2021	A+	A-1	Rating Watch-Developing	Reaffirmed
04/29/2020	A+	A-1	Rating Watch-Developing	Maintained
04/30/2019	A+	A-1	Stable	Reaffirmed
04/26/2018	A+	A-1	Stable	Reaffirmed
04/28/2017	A+	A-1	Stable	Reaffirmed
04/29/2016	A+	A-1	Stable	Reaffirmed
RATING TYPE: PPTFC-I				
04/29/2022	A		Rating Watch-Developing	Reaffirmed
04/30/2021	A		Rating Watch-Developing	Reaffirmed
04/29/2020	A		Rating Watch-Developing	Maintained
04/30/2019	A		Stable	Reaffirmed
04/26/2018	A		Stable	Final
12/13/2017	A		Stable	Preliminary
RATING TYPE: PPTFC-II				
04/29/2022	A		Rating Watch-Developing	Reaffirmed
04/30/2021	A		Rating Watch-Developing	Reaffirmed
04/29/2020	A		Rating Watch-Developing	Final
12/11/2019	A		Stable	Preliminary

Instrument Structure	Unsecured subordinated TFC amounting to Rs. 1.0b, having tenor of eight years. Unsecured subordinated TFC amounting to Rs. 1.4b, having a tenor of eight years.
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.
Probability of Default	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.

<table>
<tr><td>Disclaimer</td><td colspan="4">Information herein was obtained from sources believed to be accurate and reliable; however, VIS does not guarantee the accuracy, adequacy or completeness of any information and is not responsible for any errors or omissions or for the results obtained from the use of such information. VIS is not an NRSRO and its ratings are not NRSRO credit ratings. Copyright 2022 VIS Credit Rating Company Limited. All rights reserved. Contents may be used by news media with credit to VIS.</td></tr>
<tr><td rowspan="8">Due Diligence Meetings Conducted</td><td></td><td>Name</td><td>Designation</td><td>Date</td></tr>
<tr><td>1</td><td>Mr. F. S. Hamad Haider</td><td>Head of Operations</td><td>March 28, 2022</td></tr>
<tr><td>2</td><td>Mr. Saleem Akhtar Bhatti</td><td>Group Head Finance & CFO</td><td>March 28, 2022</td></tr>
<tr><td>3</td><td>Ms. Amna Hassan</td><td>Group Head Business</td><td>March 28, 2022</td></tr>
<tr><td>3</td><td>Mr. Aftab Alam</td><td>Head of Distribution</td><td>March 28, 2022</td></tr>
<tr><td>4</td><td>Mr. Ali Imran Bokhari</td><td>Chief Risk Officer</td><td>March 28, 2022</td></tr>
<tr><td>5</td><td>Mr. Daniyal Haq Awan</td><td>Chief Internal Auditor</td><td>March 28, 2022</td></tr>
<tr><td>6</td><td>Mr. Atif Aziz Ahmed</td><td>Chief Information Officer</td><td>March 28, 2022</td></tr>
</table>