# RATING REPORT

# Khushhali Microfinance Bank Limited

**REPORT DATE:**
December, 14 2017

**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 | |
| ***TFC*** | *A (Preliminary)* | | *N/A* | |
| ***Rating Date*** | *December 13, 2017* | | *October 31, 2017* | |

## 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 Microkredietfonds – 9.9% | |

## APPLICABLE METHODOLOGY(IES)

***Methodology:***
Applicable Rating Criteria: Rating the Issue (June 2016): *http://jcrvis.com.pk/docs/criteria_instrument_16.pdf*
Applicable Rating Criteria: Microfinance Banks (June 2016): *http://jcrvis.com.pk/docs/Meth-MFBs201606.pdf*

## 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**

Mr. Aameer Karachiwalla is a chartered accountant by profession with over 30 years of experience. He is currently the CFO in United Bank Limited and has previously served in Habib Bank Limited as Chief Operating Officer.

**Profile of CEO**

Mr. Ghalib Nishtar is the founder president for KMBL He possesses over 30 years of experience in the financial services sector and still serves as President/CEO of KMBL.

**Financial Summary**

**Net Financing**: 3QFY17: 29.4b, FY16: 22.9b

**Equity:** 3QFY17: 6.0b, FY16: 4.9b

## RATING RATIONALE

Khushhali Microfinance Bank Limited (KMBL) is one of the leading provider of microcredit in the microfinance sector, with a market share of 16.1% (2016: 16.9%; 2015: 18.7%) in terms of total Gross Loan Portfolio (GLP) outstanding at end-9M17. KMBL has a nationwide license to operate in its ambit of business.

**Key Rating Drivers:**

**Business & Portfolio Indicators:** The bank further expanded its outreach by opening nine full-fledge branches and twenty-two service centers during 9M17, taking the total network to 172 by end-9M17 (end-FY16: 141). Simultaneously, more loan officers were inducted. Resultantly, the bank surpassed budgeted growth in the loan book during 9M17. Despite declining trend in market share on a timeline basis, the bank has managed to retain its leading position in the microfinance industry. Continuing with its current product suite, the bank has set a defined strategy to build-up its MSME portfolio in a phased manner. Given higher loan portfolio, asset quality indicators improved in terms of gross and net infection despite some fresh infection witnessed during 9M17.

**Liquidity, Funding & Capitalization:** Liquid assets as a proportion of deposits and borrowings have improved by end-9M17. Given high concentration in deposit profile, the bank plans to gradually increase proportion of liquid asset in the asset base. Deposit base of KMBL witnessed sizeable increase on a timeline basis. The bank has also mobilized commercial funding. In addition to secure fresh credit lines from local banks, KMBL has also negotiated long-term offshore funding. Retention of sizeable profits resulted in a higher equity base for the bank, though the bank's CAR declined to 18.8% (end-FY16: 20%) on account of robust growth in the microcredit portfolio.

**Profitability:** In spite of some pressure on spreads mainly an outcome of balance sheet restructuring, the bank's profitability indicators exhibited considerable improvement on the back of expansion in business volumes. With higher core income and controlled operating expenses, Operational Self Sufficiency improved to 148% (FY16: 129.2%). Despite some provision charge against NPLs, the bank's bottom line has already surpassed full year profit of FY16.

**Management Profile & Sponsor Support:** A seasoned management team of KMBL largely exhibits stability which is pivotal for effective implementation of business strategy. 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 KMBL, if the need arises.

**Debt Instrument:** KMBL is in the process of issuing a rated, unsecured, subordinated and privately placed term finance certificates (PPTFC) amounting up to Rs. 1b. The issue proceeds will contribute towards the bank's Tier-II capital and will be utilized towards enhancement of the bank's business operations. The proposed instrument will carry a floating markup at base rate plus 205bps per annum. The tenor will be up to eight years from the first drawdown date; the principal shall be redeemed in two semi-annual installments which will be due at the end of 90$^{th}$ and 96$^{th}$ months from the drawdown date. Moreover, the instrument will not be redeemable before maturity without prior approval of SBP. The instrument is embedded with a call option enabling the issuer to call the instrument, in part or full subject to SBP approval, on the 10$^{th}$ profit payment date or any other profit payment date thereafter during the tenor with not less than forty-five days' prior notice to the trustee and investors. The call option is only exercisable if the bank is in compliance with regulatory requirements of minimum capital and capital adequacy ratio. The instrument is also embedded with some financial covenants regarding PAR and operational self-sufficiency ratio.

# Appendix I

| FINANCIAL SUMMARY | | | | *(amounts in PKR millions)* |
|---|---|---|---|---|
| **BALANCE SHEET** | **30-Sep-17** | **31-Dec-16** | **31-Dec-15** | **31-Dec-14** |
| **Total Investments** | 12,106.0 | 2,967.9 | 1,847.8 | 836.9 |
| **Net Financing** | 29,403.0 | 22,939.5 | 17,246.5 | 12,105.8 |
| **Total Assets** | 51,000.0 | 33,773.4 | 26,696.3 | 16,692.4 |
| **Borrowings** | 5,281.0 | 6,199.8 | 5,890.4 | 3,729.9 |
| **Tier-1 Equity** | 6,015.0 | 4,937.2 | 3,934.5 | 3,285.5 |
| **Net Worth** | 6,017.0 | 4,937.1 | 3,951.5 | 3,286.1 |
| | | | | |
| **INCOME STATEMENT** | **30-Sep-17** | **31-Dec-16** | **31-Dec-15** | **31-Dec-14** |
| **Net Mark-up Income** | 5,049.0 | 4,119.1 | 3,187.3 | 2,319.9 |
| **Net Provisioning (Reversal) / Directly written Bad debts** | 366.0 | 684.8 | 279.1 | 157.6 |
| **Non-Markup Income** | 791.6 | 1,118.6 | 716.4 | 694.7 |
| **Operating Expenses** | 2,864.0 | 2,755.9 | 2,315.2 | 1,889.8 |
| **Profit after tax** | 1,347.0 | 1,272.7 | 824.2 | 703.2 |
| | | | | |
| **RATIO ANALYSIS** | **30-Sep-17** | **31-Dec-16** | **31-Dec-15** | **31-Dec-14** |
| **Gross Infection (%)** | 1.5 | 1.8 | 2.5 | 1.1 |
| **Net Infection (%)** | 1.1 | 1.2 | 2.1 | 0.9 |
| **Net NPLs to Tier-1 Capital (%)** | 5.3 | 5.6 | 9.0 | 3.2 |
| **Markup Spreads (%)** | 14.5 | 16.6 | 18.9 | 19.2 |
| **OSS (%)** | 148.0 | 129.2 | 127.8 | 125.4 |
| **ROAA (%)** | 4.2 | 4.3 | 3.8 | 4.7 |
| **Liquid Assets to deposits & borrowings (%)** | 33.0 | 26.3 | 28.8 | 18.6 |

## 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/TFC |

**Rating History**

| Rating Date | Medium to Long Term | Short Term | Rating Outlook | Rating Action |
|---|---|---|---|---|
| **RATING TYPE: ENTITY** | | | | |
| 10/31/2017 | 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 |
| **RATING TYPE: PPTFC** | | | | |
| 12/13/2017 | A | Stable | - | Preliminary |

| | |
|---|---|
| **Instrument Structure** | KMBL is in the process of issuing a rated, unsecured, subordinated and privately placed term finance certificates (PPTFC) amounting up to Rs. 1b. The proposed instrument will carry a floating markup at base rate plus 205bps per annum. The tenor will be up to eight years from the first drawdown date; the principal shall be redeemed in two semi-annual installments which will be due at the end of 90th and 96th months from the drawdown date. |
| **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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