RATING REPORT

Khushhali Microfinance Bank Limited

REPORT DATE:
Dec 21, 2022

RATING ANALYSTS:
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RATING DETAILS

Rating Category	Latest Rating Long-term	Latest Rating Short-term	Previous Rating Long-term	Previous Rating Short-term
Entity	A	A-2	A+	A-1
PPTFC-I	BB-		A	
PPTFC-II	BB-		A	
Rating Outlook	Rating Watch-Developing		Rating Watch-Developing	
Rating Date	*Dec 16, 2022*		*April 29, 2022*	

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 (June 2019)
Micro Finance 201906.pdf (vis.com.pk)

Khushhali Microfinance Bank Limited

RATING RATIONALE

Rating Rationale

Khushhali Microfinance Bank Limited (KMBL) remains the leading provider of microcredit services in the microfinance (MF) sector of Pakistan. The revision in ratings takes into account the lingering impact of Covid-19 along with the impact of the recent floods wherein portfolio credit quality has been impacted and the financial risk profile of the Bank has weakened. Around 15% of the total portfolio still continues to be categorized under deferred and restructured loan portfolio at end-Sept '22; the recoveries from wherein may take time and are uncertain. The weakening of the financial profile has led to a negative bottom line, this along with weak asset quality indicators have placed the CAR at below the minimum regulatory requirement and is accordingly recognized in the ratings revision. Revision in ratings of Tier-II instruments take note of the lock-in-clause being invoked on both the Tier-II instruments of the Bank by SBP thus preventing any debt repayments for the time period the said clause remains in place. The ratings take note of the management's plan to recapitalize the bank, however, are constrained by the availability of required confirmed approvals of the same. The strengthening of the capital adequacy as well as liquidity of the bank is important for the sustenance and review of ratings and outlook. VIS expects that a required capitalization plan of the bank to place its CAR and liquidity at levels which would support the financial risk profile of the bank and be important for the bank, going forward.

Microfinance Outlook:

Microfinance sector outlook has changed significantly in the backdrop of the unprecedented impact of COVID-19. The sector high double-digit growth has been in check mainly due to overall economic downturn and more specifically asset quality issues of COVID impacted portfolio. In order to dampen the effect of pandemic, SBP provided regulatory relief whereby rescheduling and loan deferment was allowed. The central bank support helped the customers stay afloat, but inherently resulted into masking the potential losses which were realized after the expiry of SBP relief period. The core reason behind customer default was the massive decline in the purchasing power of the borrowers. Therefore, NPLs ratio of the MFBs exceeded 25% of the reschedule portfolio. Currently, the overall risk profile of the sector is marked by higher cost of doing business in line with increased discount rate, asset quality issues resulting in portfolio losses and liquidity challenges and changed client behavior on account of subsidies offered to clients during pandemic. Consequently, profitability of the entire microfinance sector was adversely affected resulting in capital erosion. All put together, this has contributed to significant operating losses for many players in the sector and to the extent of breaching the regulatory requirement of capital adequacy prescribed by the central bank. The stress on CAR was evidenced across the sector as 4 microfinance banks out of 7 major players are facing regulatory breach and in the process of raising capital.

Financial Risk Profile of the Bank:

The non-performing loans (NPLs) of the Bank increased on a timeline and were reported higher at Rs. 5.1b (FY21: Rs. 3.0b; FY20: Rs. 1.9b) by end-9MFY22, 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. Moreover, the total rollover portfolio (both under SBP & internal), albeit declined, was sizable amounting to Rs. 13.0b (FY21: Rs. 19.6b) at end-9MFY22; given this portfolio is already double restructured so the probability of recovery is lower than the normal portfolio therefore pressure on asset quality persists. Given deterioration of asset quality, provisioning expense to the tune of Rs. 4.6b was booked against the micro-credit portfolio which resulted in KMBL reporting a negative bottom line of Rs. 2.7b during 9MFY22 as opposed to profit after tax reaped amounting to Rs. 488.5m in the corresponding period last year. Further, liquidity profile of the Bank has shown a downward trend as indicated by reduction in liquid assets in respect to total deposits and borrowings along with increase in advances to deposit ratio to 84% (FY21: 61%) by end-9MFY22. We have been given to understand that the management is proposing an equity injection from existing shareholders in proportion to their existing ownership structure to recoup with the current situation and put the Bank back on track.

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 Pakistan, as its Senior Executive Vice President.

Khushhali Microfinance Bank Limited Appendix I

BALANCE SHEET	Dec 31, 2018	Dec 31, 2019	Dec 31, 2020	Dec 31, 2021	Sep 30, 2022
Cash and Bank Balances with SBP and NBP	1,792.7	2,926.2	2,850.3	3,883.7	2,307.2
Balances with other Banks and/NBFIs/MFBs	7,498.4	4,181.1	10,752.2	10,177.3	2,063.5
Lending to Financial Institutions	1,837.7	450.0	796.0	100.0	-
Total Investments	8,915.7	10,111.7	17,679.9	14,089.8	15,822.6
Net Advances	43,500.5	53,541.2	60,640.8	70,884.2	84,687.9
Operating Fixed Assets	1,353.5	3,612.3	3,688.2	3,578.8	4,020.3
Other Assets	5,573.3	6,670.6	10,695.5	13,810.1	13,863.0
Total Assets	**70,472.0**	**81,493.1**	**107,102.9**	**116,523.9**	**124,610.9**
Total Deposits	56,018.0	63,882.3	88,649.8	93,162.4	101,067.1
Borrowings	2,964.9	1,326.0	427.7	4,608.4	5,691.1
Subordinated Debt	1,000.0	2,400.0	2,400.0	3,000.0	4,500.0
Other Liabilities	2,289.6	4,486.1	4,831.5	4,588.6	4,852.9
Tier-1 Equity	8,198.5	9,399.2	10,801.4	11,245.8	8,499.8
Net Worth	8,199.5	9,398.7	10,793.9	11,184.5	8,499.8
Paid-Up Capital	1,705.0	1,705.0	1,705.0	1,705.0	1,705.0
INCOME STATEMENT	Dec 31, 2018	Dec 31, 2019	Dec 31, 2020	Dec 31, 2021	Sep 30, 2022
Net Mark-up Income	7,335.9	8,459.5	9,938.2	9,691.8	5,240.5
Net Provisioning / (Reversal)	778.2	2,259.4	2,992.4	3,960.5	4,674.8
Non-Markup Income	1,638.6	1,973.5	1,543.0	1,994.6	1,445.8
Operating Expenses	4,725.9	5,655.1	6,097.1	6,856.3	5,827.8
Profit Before Tax	3,470.3	2,518.5	2,391.8	869.6	(3,816.5)
Profit after tax	2,458.8	1,836.2	1,739.8	571.7	(2,696.1)
RATIO ANALYSIS	Dec 31, 2018	Dec 31, 2019	Dec 31, 2020	Dec 31, 2021	Sep 30, 2022
Gross Infection (%)	1.4	4.7	3.1	4.3	5.9
Incremental Infection (%)	2.4	7.3	3.6	7.2	7.5
Provisioning Coverage (%)	34.1	29.9	34.3	19.1	35.3
Net Infection (%)	1.0	3.4	2.1	3.5	3.9
Net NPLs to Tier-1 Capital (%)	5.0	19.0	11.5	21.7	38.2
Capital Adequacy Ratio (%)	18.9	19.1	19.6	18.3	12.7
Markup on Earning Assets (%)	21.7	22.7	22.6	21.2	-
Cost of Funds (%)	8.6	10.8	11.2	9.5	-
Markup Spreads (%)	13.1	11.9	11.4	11.7	-
OSS (%)	132.7	115.8	112.9	104.7	-
ROAA (%)	3.8	2.4	1.8	0.5	-
ROAE (%)	33.8	20.9	17.2	5.2	-
Liquid Assets to deposits & borrowings (%)	34.0	27.1	36.0	29.8	19.5
Current Ratio (x)	N/A	N/A	N/A	N/A	N/A
Gearing (x)	N/A	N/A	N/A	N/A	N/A

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				
16/12/2022	A	A-2	Rating Watch-Developing	Downgrade
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				
16/12/2022	BB-		Rating Watch-Developing	Downgrade
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				
16/12/2022	BB-		Rating Watch-Developing	Reaffirmed
04/29/2022	A		Rating Watch-Developing	Downgrade
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.
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Due Diligence Meetings Conducted	

	Name	Designation	Date
1	Mr. Saleem Akhtar Bhatti	Group Head Finance & CFO	Dec 14, 2022
2	Mr. Ameer Karachiwala	Director	Dec 14, 2022
3	Mr. Ghalib Nishtar	CEO	Dec 14, 2022