



The Pakistan Credit Rating Agency Limited

## Rating Report

**Khushhali Microfinance Bank Limited | PPTFC | PKR 1.5bln | Jun-22**

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### Rating History

Dissemination Date	Long Term Rating	Short Term Rating	Outlook	Action	Rating Watch
30-Jan-2023	BB	-	Developing	Downgrade	Yes
14-Dec-2022	A-	-	Negative	Maintain	Yes
07-Sep-2022	A-	-	Stable	Initial	-
24-May-2022	A-	-	Stable	Preliminary	-

### Rating Rationale and Key Rating Drivers

Amidst Covid-19 impact, the Bank's GLP witnessed a declining trend. Asset quality was impaired significantly, as the deferred book to total GLP was sizeable. Furthermore, considering the devastation of the massive flood, since Jul'22 the NPLs of the bank are expected to increase significantly, due to which the profitability of the Bank came under pressure. This has resulted in the erosion of the Bank's Capital Adequacy Ratio, which the Bank is required to maintain at 15%. The Bank to supplement its CAR, issued Tier-II and Tier-I TFCs. Apart from this, the Bank is also seeking equity support from the sponsors in proportion to their existing shareholding amongst them. The management has drawn a revival plan to mitigate the risk impact and steer the Bank onto the road of self-sustainability. The key elements are i) Capital injection plan - an amount of PKR 5bln is sought under the right issue ii) An investment opportunity teaser for the international investor is prepared and the responsibility to make it happen is being given to a capable firm iii) Five-year strategic plan has been approved by the Bank and finally, iv) CAR (Including CET-I) is being monitored and projected on a monthly basis. The term of the TFC (Tier-I) requires that as per the Lock in Clause, neither profit nor principal, will be payable if such payments will result in a shortfall in the bank's MCR/CAR or cause an increase in the shortfall. Revision in the rating of Tier-I instrument takes note of the lock-in clause just invoked and that debt repayment on this Tier-I instrument could not be made, as per the term of the signed agreement. Management's commitment to recouping the asset health and consolidating the Bank's position within the stipulated time is an acute necessity. The assigned rating is taking into account the management plans to recapitalize the bank and strengthen the CAR as well as liquidity profile.

The ratings are dependent upon the out-turn of management's plans to steer the risk profile of the bank towards an improved trajectory. Timely sponsor support is imperative. The ratings would also monitor the impact of technological advancement on the operational and risk efficacy of the Bank and reflect the need to oversee the risk profile of the Bank against unavoidable challenges.

### Disclosure

<b>Name of Rated Entity</b>	Khushhali Microfinance Bank Limited   PPTFC   PKR 1.5bln   Jun-22
<b>Type of Relationship</b>	Solicited
<b>Purpose of the Rating</b>	Debt Instrument Rating
<b>Applicable Criteria</b>	Methodology   Microfinance Institution Rating(Jun-22),Methodology   Debt Instrument Rating(Jun-22),Methodology   Rating Modifiers(Jun-22)
<b>Related Research</b>	Sector Study   Microfinance(Sep-22)
<b>Rating Analysts</b>	Muhammad Azmat Shaheen   azmat.shaheen@pacra.com   +92-42-35869504

## Issuer Profile

**Profile** Khushhali Microfinance Bank Limited ("KMBL" or the "Bank") (previously Khushhali Bank Limited) incorporated in 2000 with proclamation of Khushhali Ordinance by Government of Pakistan. Subsequently, it was transformed into a public limited company in 2008. KMBL takes pride in being the largest microfinance bank in Pakistan. In 2021, KMBL was able to expand its outreach with 240 provincial branches, 5 SME branches, 18 permanent booths and 15 post office booths, building up the largest network of microfinancing institutes in Pakistan.

**Ownership** The Bank is owned by United Bank Limited (UBL) (30%), Rural Impulse Fund (24%), Responsibility Global MF (20%), Shore cap II Limited (14%), ASNNOVIB (10%) and Bank AL-Habib (2%). UBL is a "AAA" rated bank with an asset base of PKR 2.7tn and equity base of PKR 202bln as at Sep'22.

**Governance** The Board is chaired by Aameer Karachiwalla. Mr. Ameer with over 30 years of experience, is a Chartered Accountant from the Institute of Chartered Accountants of England & Wales, privatization. He is also the Chairman of the Board at UBL Insurers Ltd. and ILink. Before joining UBL, Mr. Aameer held senior positions at a number of financial institutions and multinationals including American Express Bank, Citicorp Investment Bank and Artal Group of Companies. UK National, Robert Binyon graduated in Modern History from Christ Church Oxford and has a long experience of the banking industry around the globe.

**Management** M.Ghalib Nishtar is the founding President of Khushhali Microfinance Bank, Pakistan's largest microfinance bank. Saleem Akhtar Bhatti is a finance expert with more than 25 years of industry experience. Amina Hassan is a well-rounded service-sector professional with profound experience in managing grassroots initiatives for socio-economically vulnerable groups.

**Business Risk** During 2HCY22, microfinance bank's asset quality witnessed significant impairment. This was due to multiple factors, chief amongst them was the impact of Covid-19 and high inflationary environment amidst a slowdown in the economy and high interest rates. Recently, the massive flood took a deep toll. Consequently, profitability of entire microfinance sector was adversely affected resulting in capital erosion. All put together, contributed to significant operating losses for many players in the sector and to the extent of breaching CAR prescribed by the regulator. During 9MCY22, active borrowers of the industry exceeded pre-COVID figure to 8.8 million borrowers after recording growth of 8.6% compared to CY21. Similarly, the GLP surpassed PKR 470 billion during 9MCY22, an increase of 19.6% compared to CY21. The growth in active borrowers and GLP continues to be driven by the MFB peer group as they managed to add over 0.7 million clients and PKR 77 billion in GLP. NBMFC peer group also contributed to portfolio growth with an addition of PKR 110 billion. In case of MFBs, PAR > 30 days increased to ~6% (CY21: 5.1%) on account of expiration of loan deferment period allowed by SBP. However, the PAR > 30 days of RSPs recovered to report at 2.2% in 9MCY22 (CY21: 7.4%). The Bank catered to ~8.7% of the active borrowers of the microfinance industry as at End-Sep'22, grabbing an 18% market share in terms of Gross Loan Portfolio. On the other hand, the bank secured a share of 22.5% of total deposits in the industry, as at End-Sep'22. During 9MCY22, mark-up income earned by the Bank increased to PKR 11,970mln (9MCY21: PKR 12,369mln) with a decrease of 3.2%. Markup expense for 9MCY22 increased by 35.9% to PKR 1,937mln (9MCY21: PKR 1,425mln). The Bank witnessed an upsurge of 17.2% in its non-markup income to PKR 1,446mln (9MCY21: PKR 1,234mln). The Bank's provisioning expense decreased to PKR 664mln (9MCY20: PKR 2,374mln). Consequently, net loss increased to PKR 2,696mln during 9MCY22 (9MCY21: profit of PKR 488.5mln).

**Financial Risk** As of Sep'22, provision charges on classified loan portfolio increased to PKR 1,769.6mln (CY21: PKR 575mln), an increase of 207.7% due to performance issues of Deferred & Reschedule Portfolios. The bank has diminished general provision reserve to 0.7% against the regulatory requirement of 1.0% on total loan portfolio at the end of Sep'22. The Bank reported Loss Before Tax (PBT) of PKR 3.8ln during 9MCY22 (9MCY21: profit of PKR 691.9bln) and Loss After Tax (PAT) of PKR 2.7bln (9MCY21: PKR profit of 488.5mln). The net markup income slightly declined by 28% and closed at PKR 5.2bln (9MCY20: PKR 7.3bln). Markup revenue on loans remains at PKR 11,970mln, the growth of loan portfolio of 19.5% helped offset the interest income losses on rescheduled portfolio. The profit margin fell due to major increase in markup/interest expense and elevated provisions against advances. During the year under review, Bank's total asset registered a growth of 6.9% and the asset base increased to PKR 124.6bln (CY21: PKR 116.5bln). Net advances to total assets also increased to 65.8% from 60.8% as of last year. The equity of the Bank decreased by PKR 2.7bln and closed at PKR 8.5bln from PKR 11.2bln of last year, decline of 24%.

## Instrument Rating Considerations

**About The Instrument** KMBL issued Rated, Privately Placed Listed/DSL, Unsecured, Subordinated, perpetual Tier I Term Finance Certificates (TFC) of up to PKR 1,500mln to contribute towards the bank's Tier I capital for complying with the Capital Adequacy Ratio (CAR) requirement prescribed by the SBP for Microfinance Banks. The profit is payable semi-annually, with the rate of 6MK+4%. The instrument is subordinated to the payment of principal and profit to all other claims except common shares. The issuer may call the TFCs, in parts or in full, after five years from the issue date on the principal redemption date, thereafter, subject to prior approval from the State Bank. The call option once announced will not be revocable. As per the lock-in clause requirement for tier I issues, neither profit nor principal would be payable (even at maturity), if such payment will result in a shortfall in Bank's minimum capital requirement, leveraged ratio or capital adequacy ratio or results in an increase in any existing shortfall in MCR, LR or CAR. The TFC will be subject to loss absorbency clause, upon the occurrence of a point of Non-Viability event, SBP may fully or permanently convert the TFCs into common shares of the Bank. The TFC will be subject to loss absorption upon the occurrence of a pre-specified trigger. According to which if KMBL's common equity Tier-I ratio falls to or below 6.625% of Risk Weighted Assets, the KMBL will have full discretion to determine the amount of TFCs to be permanently converted into common shares or written off, subject to prior approval of SBP.

**Relative Seniority/Subordination Of Instrument** The instrument is subordinated as to payment of principal and profit to all other claims except common shares disbursement.

**Credit Enhancement** The transaction is unsecured



PKR mln

**Khushhali Microfinance Bank Ltd  
Public Limited**

Sep-22	Dec-21	Dec-20	Dec-19
9M	12M	12M	12M

**A BALANCE SHEET**

1 Total Finances - net	80,208	67,917	58,755	51,064
2 Investments	11,612	10,940	17,680	10,112
3 Other Earning Assets	4,358	12,691	11,548	4,631
4 Non-Earning Assets	23,802	21,859	17,234	13,209
5 Non-Performing Finances-net	4,630	3,117	1,886	2,477
<b>Total Assets</b>	<b>124,611</b>	<b>116,524</b>	<b>107,103</b>	<b>81,493</b>
6 Deposits	101,067	93,162	88,650	63,882
7 Borrowings	10,191	7,608	2,828	3,726
8 Other Liabilities (Non-Interest Bearing)	4,853	4,569	4,831	4,486
<b>Total Liabilities</b>	<b>116,111</b>	<b>105,339</b>	<b>96,309</b>	<b>72,094</b>
<b>Equity</b>	<b>8,500</b>	<b>11,185</b>	<b>10,794</b>	<b>9,399</b>

**B INCOME STATEMENT**

1 Mark Up Earned	13,907	18,653	18,670	15,259
2 Mark Up Expensed	(8,667)	(8,961)	(8,732)	(6,799)
3 Non Mark Up Income	1,446	1,995	1,543	1,973
<b>Total Income</b>	<b>6,686</b>	<b>11,686</b>	<b>11,481</b>	<b>10,433</b>
4 Non-Mark Up Expenses	(5,828)	(6,856)	(6,097)	(5,655)
5 Provisions/Write offs/Reversals	(4,675)	(3,960)	(2,992)	(2,259)
<b>Pre-Tax Profit</b>	<b>(3,816)</b>	<b>870</b>	<b>2,392</b>	<b>2,519</b>
6 Taxes	1,120	(298)	(652)	(682)
<b>Profit After Tax</b>	<b>(2,696)</b>	<b>572</b>	<b>1,740</b>	<b>1,836</b>

**C RATIO ANALYSIS**

**1 Performance**

Portfolio Yield	22.4%	27.7%	31.3%	31.1%
Minimum Lending Rate	32.0%	29.4%	30.4%	29.7%
Operational Self Sufficiency (OSS)	79.8%	103.7%	113.0%	116.5%
Return on Equity	-36.5%	5.2%	17.2%	20.9%
Cost per Borrower Ratio	9,666.8	8,529.6	N/A	N/A

**2 Capital Adequacy**

Net NPL/Equity	54.5%	27.9%	17.5%	26.4%
Equity / Total Assets (D+E+F)	6.8%	9.6%	10.1%	11.5%
Tier I Capital / Risk Weighted Assets	9.5%	13.2%	14.4%	14.2%
Capital Adequacy Ratio	12.7%	18.3%	19.1%	19.1%
Capital Formation Rate [(Profit After Tax - Cash Dividends) / Total Assets]	-32.1%	5.3%	18.5%	19.3%

**3 Funding & Liquidity**

Liquid Assets as a % of Deposits & Short term Borrowings	15.8%	16.7%	32.9%	19.6%
Demand Deposit Coverage Ratio	242.2%	151.5%	349.6%	159.9%
Liquid Assets/Top 20 Depositors	67.3%	97.7%	182.3%	140.6%
Funding Diversification (Deposits/(Deposits+Borrowings))	90.8%	92.4%	96.9%	94.5%
Net Advances to Deposits Ratio	83.9%	76.2%	68.4%	83.8%

**4 Credit Risk**

PAR 30 Ratio	8.0%	6.5%	5.4%	6.8%
Write Off Ratio	0.0%	0.0%	0.0%	0.0%
True Infection Ratio	8.0%	6.5%	5.4%	6.8%
Risk Coverage Ratio (PAR 30)	33.9%	34.3%	43.7%	33.7%

### Credit Rating

Credit rating reflects forward-looking opinion on credit worthiness of underlying entity or instrument; more specifically it covers relative ability to honor financial obligations. The primary factor being captured on the rating scale is relative likelihood of default.

Scale	Long-term Rating Definition
AAA	<b>Highest credit quality.</b> Lowest expectation of credit risk. Indicate exceptionally strong capacity for timely payment of financial commitments
AA+	
AA	<b>Very high credit quality.</b> Very low expectation of credit risk. Indicate very strong capacity for timely payment of financial commitments. This capacity is not significantly vulnerable to foreseeable events.
AA-	
A+	
A	<b>High credit quality.</b> Low expectation of credit risk. The capacity for timely payment of financial commitments is considered strong. This capacity may, nevertheless, be vulnerable to changes in circumstances or in economic conditions.
A-	
BBB+	
BBB	<b>Good credit quality.</b> Currently a low expectation of credit risk. The capacity for timely payment of financial commitments is considered adequate, but adverse changes in circumstances and in economic conditions are more likely to impair this capacity.
BBB-	
BB+	
BB	<b>Moderate risk.</b> Possibility of credit risk developing. There is a possibility of credit risk developing, particularly as a result of adverse economic or business changes over time; however, business or financial alternatives may be available to allow financial commitments to be met.
BB-	
B+	
B	<b>High credit risk.</b> A limited margin of safety remains against credit risk. Financial commitments are currently being met; however, capacity for continued payment is contingent upon a sustained, favorable business and economic environment.
B-	
CCC	
CC	<b>Very high credit risk.</b> Substantial credit risk "CCC" Default is a real possibility. Capacity for meeting financial commitments is solely reliant upon sustained, favorable business or economic developments. "CC" Rating indicates that default of some kind appears probable. "C" Ratings signal imminent default.
C	
D	Obligations are currently in default.

Scale	Short-term Rating Definition
A1+	The highest capacity for timely repayment.
A1	A strong capacity for timely repayment.
A2	A satisfactory capacity for timely repayment. This may be susceptible to adverse changes in business, economic, or financial conditions.
A3	An adequate capacity for timely repayment. Such capacity is susceptible to adverse changes in business, economic, or financial conditions.
A4	The capacity for timely repayment is more susceptible to adverse changes in business, economic, or financial conditions. Liquidity may not be sufficient.



\*The correlation shown is indicative and, in certain cases, may not hold.

**Outlook (Stable, Positive, Negative, Developing)** Indicates the potential and direction of a rating over the intermediate term in response to trends in economic and/or fundamental business/financial conditions. It is not necessarily a precursor to a rating change. 'Stable' outlook means a rating is not likely to change. 'Positive' means it may be raised. 'Negative' means it may be lowered. Where the trends have conflicting elements, the outlook may be described as 'Developing'.

**Rating Watch** Alerts to the possibility of a rating change subsequent to, or, in anticipation of some material identifiable event with indeterminable rating implications. But it does not mean that a rating change is inevitable. A watch should be resolved within foreseeable future, but may continue if underlying circumstances are not settled. Rating watch may accompany rating outlook of the respective opinion.

**Suspension** It is not possible to update an opinion due to lack of requisite information. Opinion should be resumed in foreseeable future. However, if this does not happen within six (6) months, the rating should be considered withdrawn.

**Withdrawn** A rating is withdrawn on a) termination of rating mandate, b) the debt instrument is redeemed, c) the rating remains suspended for six months, d) the entity/issuer defaults, or/and e) PACRA finds it impractical to surveil the opinion due to lack of requisite information.

**Harmonization** A change in rating due to revision in applicable methodology or underlying scale.

**Surveillance.** Surveillance on a publicly disseminated rating opinion is carried out on an ongoing basis till it is formally suspended or withdrawn. A comprehensive surveillance of rating opinion is carried out at least once every six months. However, a rating opinion may be reviewed in the intervening period if it is necessitated by any material happening.

**Note.** This scale is applicable to the following methodology(s):  
 a) Broker Entity Rating  
 b) Corporate Rating  
 c) Debt Instrument Rating  
 d) Financial Institution Rating  
 e) Holding Company Rating  
 f) Independent Power Producer Rating  
 g) Microfinance Institution Rating  
 h) Non-Banking Finance Companies Rating

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(1) Rating is just an opinion about the creditworthiness of the entity and does not constitute recommendation to buy, hold or sell any security of the entity rated or to buy, hold or sell the security rated, as the case may be | Chapter III; 14-3-(x)

### **2) Conflict of Interest**

i. The Rating Team or any of their family members have no interest in this rating | Chapter III; 12-2-(j)

ii. PACRA, the analysts involved in the rating process and members of its rating committee, and their family members, do not have any conflict of interest relating to the rating done by them | Chapter III; 12-2-(e) & (k)

iii. The analyst is not a substantial shareholder of the customer being rated by PACRA [Annexure F; d-(ii)] Explanation: for the purpose of above clause, the term "family members" shall include only those family members who are dependent on the analyst and members of the rating committee

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(4) PACRA does not disclose or discuss with outside parties or make improper use of the non-public information which has come to its knowledge during business relationship with the customer | Chapter III; 10-7-(d)

(5) PACRA does not make proposals or recommendations regarding the activities of rated entities that could impact a credit rating of entity subject to rating | Chapter III; 10-7-(k)

### **Conduct of Business**

(6) PACRA fulfills its obligations in a fair, efficient, transparent and ethical manner and renders high standards of services in performing its functions and obligations; | Chapter III; 11-A-(a)

(7) PACRA uses due care in preparation of this Rating Report. Our information has been obtained from sources we consider to be reliable but its accuracy or completeness is not guaranteed. PACRA does not, in every instance, independently verifies or validates information received in the rating process or in preparing this Rating Report | Clause 11-(A)(p).

(8) PACRA prohibits its employees and analysts from soliciting money, gifts or favors from anyone with whom PACRA conducts business | Chapter III; 11-A-(q)

(9) PACRA ensures before commencement of the rating process that an analyst or employee has not had a recent employment or other significant business or personal relationship with the rated entity that may cause or may be perceived as causing a conflict of interest; | Chapter III; 11-A-(r)

(10) PACRA maintains principal of integrity in seeking rating business | Chapter III; 11-A-(u)

(11) PACRA promptly investigates, in the event of a misconduct or a breach of the policies, procedures and controls, and takes appropriate steps to rectify any weaknesses to prevent any recurrence along with suitable punitive action against the responsible employee(s) | Chapter III; 11-B-(m)

### **Independence & Conflict of interest**

(12) PACRA receives compensation from the entity being rated or any third party for the rating services it offers. The receipt of this compensation has no influence on PACRA's opinions or other analytical processes. In all instances, PACRA is committed to preserving the objectivity, integrity and independence of its ratings. Our relationship is governed by two distinct mandates i) rating mandate - signed with the entity being rated or issuer of the debt instrument, and fee mandate - signed with the payer, which can be different from the entity

(13) PACRA does not provide consultancy/advisory services or other services to any of its customers or to any of its customers' associated companies and associated undertakings that is being rated or has been rated by it during the preceding three years unless it has adequate mechanism in place ensuring that provision of such services does not lead to a conflict of interest situation with its rating activities; | Chapter III; 12-2-(d)

(14) PACRA discloses that no shareholder directly or indirectly holding 10% or more of the share capital of PACRA also holds directly or indirectly 10% or more of the share capital of the entity which is subject to rating or the entity which issued the instrument subject to rating by PACRA; | Reference Chapter III; 12-2-(f)

(15) PACRA ensures that the rating assigned to an entity or instrument is not be affected by the existence of a business relationship between PACRA and the entity or any other party, or the non-existence of such a relationship | Chapter III; 12-2-(i)

(16) PACRA ensures that the analysts or any of their family members shall not buy or sell or engage in any transaction in any security which falls in the analyst's area of primary analytical responsibility. This clause shall, however, not be applicable on investment in securities through collective investment schemes. | Chapter III; 12-2-(l)

(17) PACRA has established policies and procedure governing investments and trading in securities by its employees and for monitoring the same to prevent insider trading, market manipulation or any other market abuse | Chapter III; 11-B-(g)

### **Monitoring and review**

(18) PACRA monitors all the outstanding ratings continuously and any potential change therein due to any event associated with the issuer, the security arrangement, the industry etc., is disseminated to the market, immediately and in effective manner, after appropriate consultation with the entity/issuer; | Chapter III | 18-(a)

(19) PACRA reviews all the outstanding ratings on semi-annual basis or as and when required by any creditor or upon the occurrence of such an event which requires to do so; | Chapter III | 18-(b)

(20) PACRA initiates immediate review of the outstanding rating upon becoming aware of any information that may reasonably be expected to result in downgrading of the rating; | Chapter III | 18-(c)

(21) PACRA engages with the issuer and the debt securities trustee, to remain updated on all information pertaining to the rating of the entity/instrument; | Chapter III | 18-(d)

### **Probability of Default**

(22) PACRA's Rating Scale reflects the expectation of credit risk. The highest rating has the lowest relative likelihood of default (i.e, probability). PACRA's transition studies capture the historical performance behavior of a specific rating notch. Transition behavior of the assigned rating can be obtained from PACRA's Transition Study available at our website. (www.pacra.com). However, actual transition of rating may not follow the pattern observed in the past | Chapter III | 14-(F-VII)

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**Regulatory and Supplementary Disclosure**

Nature of Instrument	Size of Issue (PKR)	Tenor	Security	Quantum of Security (PKR)	Nature of Assets	Trustee	Book Value of Assets (PKR)
PPTFC-Tier 1	1.5bln	Perpetual	Unsecured and subordinated as to payment of principal and profit to all other indebtedness of the bank, including deposits and will not be redeemable before maturity without prior approval of SBP	N/A	N/A	The Bank of Punjab (BOP)	N/A

**Khushhali Microfinance Bank Limited | PPTFC | Tier 1 | Redemption Schedule**

Due Date Principal	Opening Principal	Principal Repayment	Due Date Markup/ Profit	Markup/Profit Rate		Markup/Profit Payment	Installment Payable	Principal Outstanding
	PKR			Base	Spread	PKR		

Redemption Schedule not applicable since its a perpetual TFC whereby there is no fixed or final redemption date. Profit (if declared) will be payable semi-annually in arrears, on a non-cumulative basis, on the outstanding TFC amount. The first such profit payment will fall due six months from the Issue Date and subsequently every six months thereafter subject to complying with regulatory requirements. The instrument carries a call option which may be exercised after Dec-22 (5-years), subject to approval of the SBP.