



The Pakistan Credit Rating Agency Limited

Rating Report

The Bank of Khyber

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Rating History

Dissemination Date	Long Term Rating	Short Term Rating	Outlook	Action	Rating Watch
04-Oct-2022	A+	A1	Stable	Upgrade	-
25-Jun-2022	A	A1	Stable	Maintain	-
26-Jun-2021	A	A1	Stable	Maintain	-
26-Jun-2020	A	A1	Stable	Maintain	-
24-Dec-2019	A	A1	Stable	Maintain	-
25-Jun-2019	A	A1	Stable	Maintain	-
24-Dec-2018	A	A1	Stable	Maintain	-
25-Jun-2018	A	A1	Stable	Maintain	-
29-Dec-2017	A	A1	Stable	Maintain	-
21-Jun-2017	A	A1	Stable	Maintain	-

Rating Rationale and Key Rating Drivers

The ratings reflect stability achieved in the leadership role through the appointment of an experienced CEO last year together with the improved business profile, on an overall basis, as reflected by the largely intact customer deposit share of the Bank. The ratings also reflect the strength of the Bank's ownership structure and the continued support of its strong sponsors. Moreover, the government of KP is committed to maintaining its controlling stake in the Bank and is aware of Bank's growth strategy, and is supportive of it. The incumbent leadership assumed the stewardship of the Bank and has devised a clear and prudent strategy for the growth and performance improvement of the Bank. The management team is fully cognizant of the prevailing micro and macro challenges and aligned on the strategy to bring improvement in all the key indicators of the Bank. The deposit mix remained tilted towards saving deposits, while the CASA ratio witnessed improvement (End-Jun'22: 70.3%; End Dec'21: 65.2%). Net markup income and non-markup income registered an increase during the period. Moreover, an enhancement in the branch network recently has been a major dimension for the Bank. Sustainability in net-mark-up income continued enhancement in non-funded income, and strengthened treasury operations are important for future years. The dividend payouts in the past had led to limited growth in the equity base of the Bank, however, the Bank prudently opted to only issue bonus shares for FY21 to shore up the capital. The Bank while having a cautious approach, intends to increase its exposure to Private Sector Advances. It remains vital for Bank to properly manage the credit risk, if any, arising from lending through government schemes. The Bank has further embarked upon improving efficiency and effectiveness in the operating system through the implementation of widely used Core Banking Software T-24. Asset quality slightly improved as reflected by NPLs to Gross Advances ratio (End-Jun'22: 7.9%, End-Dec'21: 8.01%). The management has developed and started implementing a well-thought-out strategy for the reduction of NPLs and improvement of portfolio quality. The investment book of the Bank is predominantly comprised of government securities. The Bank's total CAR stands at 14.3% as of end-Jun'22. Pakistan's economy has gone through several varied phases in the last two years due to the COVID19 pandemic. The banking sector continued to flourish with high profitability. Going forward, the macroeconomic environment is beset with myriad challenges due to heightened interest rates, tightening of demand, rupee depreciation, and higher inflation. This has repercussions for several segments of the economy.

The upgrade in rating reflects the bank's ability to hold its risk profile while maintaining its relative market position. Moreover, the bank enjoys the continued support of its strong sponsors.

Disclosure

Name of Rated Entity	The Bank of Khyber
Type of Relationship	Solicited
Purpose of the Rating	Entity Rating
Applicable Criteria	Methodology Financial Institution Rating(Jun-22),Methodology Correlation Between Long-term & Short-term Rating Scales(Jun-22),Methodology Rating Modifiers(Jun-22)
Related Research	Sector Study Commercial Bank(Jun-22)
Rating Analysts	Sehar Fatima sehar.fatima@pacra.com +92-42-35869504



Profile

Structure The Bank of Khyber (BoK) was established in 1991 under the BoK Act, passed by the Provincial Legislative Assembly of the province of Khyber Pakhtunkhwa (KPK).

Background BoK was established with a vision to gradually promote Islamic banking. As of the end Jun'22, the Bank operates 215 branches including 110 Islamic banking branches (2020: 179 branches including 91 Islamic banking branches).

Operations Bank of Khyber is operating as a scheduled bank. The bank registered office is located at The Mall –34 Peshawar Cantt. Further, It operates with 1,767 employees. The branch network is mainly concentrated in the province of KP and also increasing in other provinces of Pakistan gradually.

Ownership

Ownership Structure The Government of Khyber Pakhtunkhwa (GoKP) has a majority stake in BoK (70.2%), whereas, Ismail Industries owns 24.42%. The remaining shareholding is widely dispersed.

Stability The Government of Khyber Pakhtunkhwa has a major shareholding while Ismail industries represent other strategic long-term shareholders. The benefits from this strong and stable shareholding pattern. The Bank's shareholding pattern is expected to remain stable in the foreseeable future.

Business Acumen The Govt of KP and Ismail Industries support the professional independence of the Bank. The business acumen of the owners is reflected in the strong professional expertise by the BoD put in place by them.

Financial Strength The Bank is backed by the Government of Khyber Pakhtunkhwa which adds to the financial muscle. Also, Ismail Industries is one of the leading confectioneries, snacks, and biscuit manufacturing companies. The Bank enjoys the continued support of its strong sponsors which can have a positive impact on the Bank's rating going forward.

Governance

Board Structure Currently, there are four independent directors and two non-executive directors including the chairman and one executive director. Board composition is in line with the parameters set in the BoK Act.

Members' Profile The profile of the members is considered strong where the majority of members are representing the government on board. Shahab Ali Shah has been appointed as the Chairman of the board on May 21.

Board Effectiveness The Board monitors the key functional and risk areas through its five committees; i) Audit Committee, ii) Human Resource & Remuneration Committee, iii) Risk Management Committee and iv) Board IT Steering Committee v) Compliance Committee.

Financial Transparency M/S EY Ford Rhodes, Chartered Accountants had expressed an unqualified opinion on the bank's financial statements for the year ended December 31, 2021.

Management

Organizational Structure The bank's overall functions are currently segregated into Fifteen Groups/divisions, including: (i) Conventional Banking Group, (ii) Islamic Banking Group (iii) Treasury & Investment Banking Group (iv) Human Resource Development Group (v) Risk Management Group (vi) Operations & Support Group (vii) Compliance Group (viii) Digital & Consumer Banking Group (ix) Finance Division (x) Remedial Asset Management Division, (xi) Information Technology Division, (xii) Law Division (xiii) Strategic Planning & Development Department (xiv) Company Secretariat (xv) Internal Audit Division. The Company Secretary and Internal Audit division indirectly report to the Managing Director.

Management Team Mr. Muhammad Ali Gulfaraz took the charge as Managing Director on August 12, 2021. Mr. Ali Gulfaraz brings with him an extensive experience of 25 years in global corporate and investment banking. Other senior management consists of seasoned professionals.

Effectiveness The bank has 10 committees in place at the management level with well-defined terms of reference to oversee its day-to-day operational matters and to take decisions to implement the strategy outlined by the Bank.

MIS The frequency of reports generated is daily, weekly, and monthly. The quality of the reports is considered adequate. Islamic Banking deposits are accepted on a Musharakah basis and the Bank has acquired software "Al-Quist" for Profit Distribution and Pool Management.

Risk Management Framework BoK has established separate risk management, credit management, compliance, and internal control divisions. The MRMC, HOCC, and ALCO of management operate within the established framework to monitor the bank's activities and maintain the risk level within predefined limits.

Business Risk

Industry Dynamics Pakistan's economy has gone through several varied phases in the last two years. It was deeply impacted by the magnitude of the COVID19 pandemic. The economic activity revived afterward and Pakistan posted a GDP growth rate of ~4.0% in FY21 after a contraction in the economy of -0.4% in FY20 (GDP growth figures were revised after the base year was changed from FY05-06 to FY15-16). The banking sector continues to flourish with high profitability. The banking sector weightage is approximate ~25% of the KSE 100 index. Total banking assets posted growth of ~19% YoY whilst investments surged by 21% YoY to PKR ~14.4trln (end-Dec20: PKR ~11.9trln). Gross Advances of the sector recorded growth (23%) to stand at PKR ~10.9trln (end-Dec20: PKR ~8.8trln). Non-performing loans witnessed a slight uptick of 4% to PKR ~860bln. The capital Adequacy Ratio stood at 16.7% (regulatory requirement of 11.5%). During CY21, banking sector deposits enhanced to PKR ~21.6trln (grew by ~17%). Hence, ADR rationalized to 47% (end-Dec20: ~45%). Net profitability of the sector was recorded at PKR ~267bln (CY20: PKR ~244bln); up 9% YoY. However, the growth of the equity base of the sector recorded a meager uptick of 0.8% YoY attributable to a handsome dividend payout.

Relative Position The Bank of Khyber - a bank with the system share, (Deposits: End-Dec21: 1.1%, End-Dec20: 1.2%) during recent years. During CY21, the Bank was able to record growth of 9.3% against the average growth reflected by small banks of around 12.7%.

Revenues During CY21, the Net markup income of the Bank registered a slight increase. Markup income reported attrition by 14.5% on a YOY basis to stand at PKR 22bln from PKR 25.7bln (CY20), attributable to a decline in both markups earned from advances and investments. Further, the markup earned from investments is recorded at PKR 12.5bln, CY20: PKR 14.4bln). Similarly, markup expenses were reduced by 20% (CY:2021 15.1 bln PKR, CY20: PKR 18.9 bln) mainly due to a reduction in the cost of borrowings and deposits. During 1HCY22, net markup income sizably improved to PKR 18.7bln attributable to an increase in the investments and other earning assets (1HCY21: PKR 10.3bln). Similarly, markup expenses reflected an increase to PKR 3.5bln (1HCY21: PKR 3.2bln).

Performance The Bank's non-markup expenses increased to PKR 5.3bln (CY20: PKR 4.2bln), up 25.5% attributable to branch expansion and capacity-building initiatives aiming for future benefits to the Bank. During 1HCY22, the non-markup expenses increased to PKR 3bln (1HCY21: PKR 2.4bln).

Sustainability Going forward, BoK is aiming to generate deposits through CASA from the private sector, and the bank intends to diversify its financing portfolio by prudently increasing the proportion of lending to the private sector with the potential for ancillary business and trade finance opportunities.

Financial Risk

Credit Risk The client concentration remained high with the top 10 customers demonstrating 56.05% of BoK's overall advances (CY20: 59.4%); considered high. Advances to deposits declined to 56.1% (end-Dec20: 63.6%). And NPLs to Gross Advances ratio stands at (CY21:8.0%; CY20: 5.4%) – mainly due sizable increase in NPLs (end-Dec21: PKR 10.5bln, end-Dec20: PKR 7.2bln). During 1HCY22, advances to deposits and NPLs to gross ratio stood at 60.9% and 7.9% respectively.

Market Risk Government securities consist of 99.0% of the total investment (CY20: 99.1%). BoK's investments significantly increased and clocked in at PKR 175.1bln (CY20: PKR 105.92bln). During 1HCY22, investments are increased to PKR 197.6bln.

Liquidity And Funding The Bank's deposit base enhanced to PKR 221.8bln (end-Dec20: PKR 203.0bln). CASA increased to 65.2% (end-Dec20: 61.1%) primarily attributable to an increase in SA deposits. During 1HCY22, the deposit base stood at PKR 227.2bln.

Capitalization The Bank's total equity stands at PKR 16.6bln in CY21 (CY20: PKR 17.7bln). The equity over total assets declined further and was reported at only 4.6% in CY21 (CY20: 6.2%). During 1HCY22, the bank's total equity remains unchanged and stands at 16.6bln.



PKR mln

The Bank of Khyber
Listed Public Limited

Jun-22	Dec-21	Dec-20	Dec-19
6M	12M	12M	12M

A BALANCE SHEET

1 Total Finances - net	144,501	130,121	146,828	120,511
2 Investments	197,605	175,089	94,282	135,350
3 Other Earning Assets	7,930	17,226	16,475	21,823
4 Non-Earning Assets	39,907	32,432	29,283	27,829
5 Non-Performing Finances-net	4,297	3,739	1,432	793
Total Assets	394,240	358,606	288,300	306,305
6 Deposits	227,209	221,876	203,072	182,168
7 Borrowings	139,221	110,069	57,063	94,656
8 Other Liabilities (Non-Interest Bearing)	11,256	10,091	10,394	15,280
Total Liabilities	377,686	342,036	270,528	292,104
Equity	16,554	16,570	17,772	14,201

B INCOME STATEMENT

1 Mark Up Earned	18,729	21,939	25,673	24,657
2 Mark Up Expensed	(15,205)	(15,150)	(18,911)	(19,891)
3 Non Mark Up Income	655	1,023	2,878	1,112
Total Income	4,178	7,812	9,640	5,878
4 Non-Mark Up Expenses	(3,076)	(5,300)	(4,223)	(3,638)
5 Provisions/Write offs/Reversals	(514)	(832)	(1,610)	21
Pre-Tax Profit	588	1,680	3,806	2,261
6 Taxes	(197)	(577)	(1,655)	(955)
Profit After Tax	391	1,104	2,152	1,306

C RATIO ANALYSIS

1 Performance

Net Mark Up Income / Avg. Assets	1.9%	2.1%	2.3%	1.8%
Non-Mark Up Expenses / Total Income	73.6%	67.8%	43.8%	61.9%
ROE	4.7%	6.4%	13.5%	10.1%

2 Capital Adequacy

Equity / Total Assets (D+E+F)	4.2%	4.6%	6.2%	4.6%
Capital Adequacy Ratio	14.3%	14.7%	19.3%	15.3%

3 Funding & Liquidity

Liquid Assets / (Deposits + Borrowings Net of Repo)	42.8%	50.0%	44.2%	43.9%
(Advances + Net Non-Performing Advances) / Deposits	60.9%	56.1%	63.6%	60.2%
CA Deposits / Deposits	20.6%	16.0%	16.7%	19.2%
SA Deposits / Deposits	49.7%	49.2%	44.4%	39.1%

4 Credit Risk

Non-Performing Advances / Gross Advances	7.9%	8.0%	5.4%	4.4%
Non-Performing Finances-net / Equity	26.0%	22.6%	8.1%	5.6%

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	Highest credit quality. Lowest expectation of credit risk. Indicate exceptionally strong capacity for timely payment of financial commitments
AA+	
AA	Very high credit quality. 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	High credit quality. 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	Good credit quality. 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+	Moderate risk. 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	
BB-	
B+	
B	High credit risk. 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	Very high credit risk. 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):

<p>Entities</p> <ul style="list-style-type: none"> a) Broker Entity Rating b) Corporate Rating c) Financial Institution Rating d) Holding Company Rating e) Independent Power Producer Rating f) Microfinance Institution Rating g) Non-Banking Finance Companies (NBFCs) Rating 	<p>Instruments</p> <ul style="list-style-type: none"> a) Basel III Compliant Debt Instrument Rating b) Debt Instrument Rating c) Sukuk 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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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).
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- (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)

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- (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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