The Pakistan Credit Rating Agency Limited

# Rating Report

## Bank of Khyber

**Report Contents**



**Rating History**

| Dissemination Date | Long Term Rating | Short Term Rating | Outlook | Action | Rating Watch |
|---|---|---|---|---|---|
| 27-Jun-2023 | A+ | A1 | Stable | Maintain | - |
| 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 | - |

### Rating Rationale and Key Rating Drivers

The ratings reflect stability achieved in the leadership role through the appointment of an experienced CEO 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. While the competitive landscape has been increasingly intensified, the Bank is focused to enhance its digital footprint so that customers are provided with all "digital and online banking services". 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-Dec'22: 68.7%; 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 has been a major dimension for the Bank. The Bank has planned to increase its exposure to Private Sector Advances. An enduring emphasis is laid on building trade business. Also, more diversification is being planned by enhancing the portfolio in consumer and auto loans. It is of paramount importance to 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 remained largely the same as portrayed by NPLs to Gross Advances ratio (End-Dec'22: 8.7%, End-Dec'21: 8.01%). The management has been making concerted efforts for the reduction in NPLs and the improvement of portfolio quality. The investment portfolio is majorly vested with government securities. The bank's capital adequacy ratio stands at 14.9% at end-Dec'22 where Tier I capital clocked at 14.8% (CY21: 14.5%) reflecting a comfortable position. During 1QCY23, the bank witnessed a sizeable improvement in the bottom line. CASA illustrated an increase clocking in at 77.8%. Going forward, an enhanced focus on digitalization and process automation to enhance the efficiency and quality of customer facilitation would augment the bank's profile. Further, the bank continues to work on diversification of its deposit base in line with its strategy.

The 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** | 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-23) |
| **Rating Analysts** | Sehar Fatima \| sehar.fatima@pacra.com \| +92-42-35869504 |

## Profile

**Structure** 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** The bank was established with a vision to gradually promote Islamic banking. As of the end Dec'22, the bank operates 231 branches including 119 Islamic banking branches).

**Operations** Bank of Khyber is operating as a scheduled bank. The bank registered office is located at 24 - The Mall, Peshawar Cantt. The bank is operating with 1,931 employees (CY21: 1753 employees). The branch network is mainly concentrated in the province of KP and also increasing in Punjab while having a limited presence in all other provinces of Pakistan.

## Ownership

**Ownership Structure** The Government of Khyber Pakhtunkhwa (GoKP) has a majority stake in BoK (70.2%), whereas, Ismail Industries owns (24.4%) stake. 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 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 positively impact the bank's rating, going forward.

## Governance

**Board Structure** The overall control of the board vests with eight members including the Chairman and CEO. The board is chaired by Mr. Muhammad Zubair Asghar Qureshi. The board has five independent directors.

**Members' Profile** The profile of the members is considered strong where the majority of members are representing the government on board. Mr. Muhammad Zubair Asghar Qureshi has been appointed as Chairman effective from April 03, 2023, in place of Mr. Ikramullah Khan.

**Board Effectiveness** The board monitors the key functional and risk areas through its five committees namely; i) Audit Committee, ii) Human Resource & Remuneration Committee, iii) Risk Management Committee, iv) IT Steering Committee, and v) Compliance Committee. During the year, the board had a total of six meetings, and the attendance of members is good.

**Financial Transparency** A.F. Ferguson & Co. Chartered Accountants are the external auditors of the bank. They have expressed an unqualified opinion on the bank's financial statements for the year ended December 31, 2022.

## Management

**Organizational Structure** The bank's overall functions are currently segregated into eight groups, including (i) Risk Management Group (ii) Conventional Banking Group iii) Islamic Banking Group (iv) Treasury & Investment Group (v) Compliance Group (vi) Human Resource Group (vii) Operations & Support Group (viii) DCB Group. The Company Secretary, Finance Division and Internal Audit division reports to the Managing Director.

**Management Team** Mr. Muhammad Ali Gulfaraz took 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** The country's economy has gone through several varied phases in the last few years. Looking ahead, the macroeconomic landscape is fraught with numerous challenges, including political instability, elevated interest rates, demand tightening, sizable rupee depreciation, and heightened inflation, all of which reverberate acrossall sectors of the economy. Pakistan posted a GDP growth rate of 1.69% in 9MFY23 and 4.71% in FY22 (GDP growth figures were revised after base year was changed from FY05-06 to FY15-16). The banking sector continues to flourish with high profitability. Total banking assets posted growth of 18.5% YoY whilst investments surged by 25% YoY to PKR 18.0trln (end-Dec21: PKR 14.4trln). Gross Advances of the sector recorded growth (16%) to stand at PKR 12.6trln (end-Dec21: PKR 10.9trln). Non-performing loans witnessed an increase to PKR 924bln. The Capital Adequacy Ratio remained intact at 17% (regulatory requirement of 11.5%).

**Relative Position** During CY22, Bank of Khyber grabbed a market share of 1.1% which is in line with its peers.

**Revenues** During CY22, the markup earned recorded a sizeable increase on a YoY basis to stand at PKR 40.2bln (CY21: PKR 21.9bln). The bank's asset yield increased to 12.8% (CY21: 7.6%). The cost of funds recorded a good increase to stand at 10.2% (CY21: 5.1%). The bank's spread inched up to 2.5% (CY21: 2.4%). During 1QCY23, the net markup income increased to PKR 3.1bln. The bank's core spread clocked at 5.7%.

**Performance** The non-markup income recorded a growth of 35.3% on a YoY basis attributable to a sizeable increase in foreign exchange income (CY22: PKR 660mln; CY21: PKR 478mln) and improved fee and commission income (CY22: PKR 546mln; CY21: PKR 425mln). The dividend income declined to PKR 13mln (CY21: 38mln). Consequently, the net profitability recorded a sizeable decline to stand at PKR 454mln (CY21: PKR 1.1bln). During 1QCY23, the bank's bottom line recorded a sizeable improvement and clocked in at PKR 939mln. Due to an increase in markup earned recorded at PKR 10.9bln.

**Sustainability** The competitive landscape has been increasingly intensified, the Bank is focused to enhance its digital footprint so that customers are provided with all "digital and online banking services".

## Financial Risk

**Credit Risk** The net advances recorded a slight growth of 2% clocking in at PKR 123.1bln (end-Dec21: PKR 120.6bln). Subsequently, the ADR declined to 51.2% (end-Dec21: 56.1%). The infection ratio inched up to 8.7% (end-Dec21: 8%). The loan loss provision to non-performing advances remains unchanged at 62.9%. At end-Dec22, the bank's top 5 sector exposure stands at 70% with the highest exposure in Commodity financing. At end-Mar23, the net advances stood at PKR 100bln. The infection ratio further increased to 10.6%.

**Market Risk** At end-Dec22, the bank's investment portfolio illustrated a slight decrease on a YoY basis recorded at PKR 165.9bln (end-Dec21: PKR 175mln). At end-Mar23, the bank's investment book declined to PKR 153.8bln mainly due to a dip in government securities.

**Liquidity And Funding** At end-Dec22, the bank's deposit base recorded a healthy increase to stand at PKR 248.9bln (end-Dec21: PKR 221.8bln). CA and SA proportions stood at 17% (end-Dec21: 16%); and 51.7% (end-Dec21: PKR 49.2%). At end-Mar23, the bank's deposit base stood at PKR 252bln. CA and SA ratios were reported at 16.3% and 61.5%.

**Capitalization** At end-Dec22, the bank's equity base was recorded at PKR 16.4bln (end-Dec21: PKR 16.5bln). The bank reported CAR of 14.9% (end-Dec21: 14.7%). At end-Mar23, the bank's CAR was recorded at 14.7%.

PKR mln

| Bank of Khyber<br>Listed Public Limited | Mar-23<br>3M | Dec-22<br>12M | Dec-21<br>12M | Dec-20<br>12M |
|---|---|---|---|---|
| **A BALANCE SHEET** | | | | |
| 1 Total Finances - net | 107,876 | 131,009 | 130,121 | 146,828 |
| 2 Investments | 153,804 | 165,982 | 175,089 | 94,282 |
| 3 Other Earning Assets | 19,236 | 11,198 | 17,226 | 16,475 |
| 4 Non-Earning Assets | 39,570 | 32,603 | 32,432 | 29,283 |
| 5 Non-Performing Finances-net | 4,165 | 4,193 | 3,739 | 1,432 |
| **Total Assets** | 324,652 | 344,984 | 358,606 | 288,300 |
| 6 Deposits | 252,448 | 248,906 | 221,876 | 203,072 |
| 7 Borrowings | 46,521 | 66,263 | 110,069 | 57,063 |
| 8 Other Liabilities (Non-Interest Bearing) | 9,429 | 13,387 | 10,091 | 10,394 |
| **Total Liabilities** | 308,398 | 328,557 | 342,036 | 270,528 |
| **Equity** | 16,254 | 16,427 | 16,570 | 17,772 |
| **B INCOME STATEMENT** | | | | |
| 1 Mark Up Earned | 10,971 | 40,242 | 21,939 | 25,673 |
| 2 Mark Up Expensed | (7,693) | (33,093) | (15,150) | (18,911) |
| 3 Non Mark Up Income | 420 | 1,384 | 1,023 | 2,878 |
| **Total Income** | 3,698 | 8,532 | 7,812 | 9,640 |
| 4 Non-Mark Up Expenses | (1,858) | (6,711) | (5,300) | (4,223) |
| 5 Provisions/Write offs/Reversals | (193) | (902) | (832) | (1,610) |
| **Pre-Tax Profit** | 1,647 | 919 | 1,680 | 3,806 |
| 6 Taxes | (708) | (465) | (577) | (1,655) |
| **Profit After Tax** | 939 | 454 | 1,104 | 2,152 |
| **C RATIO ANALYSIS** | | | | |
| **1 Performance** | | | | |
| Net Mark Up Income / Avg. Assets | 3.9% | 2.0% | 2.1% | 2.3% |
| Non-Mark Up Expenses / Total Income | 50.2% | 78.7% | 67.8% | 43.8% |
| ROE | 23.0% | 2.8% | 6.4% | 13.5% |
| **2 Capital Adequacy** | | | | |
| Equity / Total Assets (D+E+F) | 5.0% | 4.8% | 4.6% | 6.2% |
| Capital Adequacy Ratio | 14.7% | 14.9% | 14.7% | 19.3% |
| **3 Funding & Liquidity** | | | | |
| Liquid Assets / (Deposits + Borrowings Net of Repo) | 54.6% | 50.1% | 50.0% | 44.2% |
| (Advances + Net Non-Performing Advances) / Deposits | 41.4% | 51.2% | 56.1% | 63.6% |
| CA Deposits / Deposits | 16.3% | 17.0% | 16.0% | 16.7% |
| SA Deposits / Deposits | 61.5% | 51.7% | 49.2% | 44.4% |
| **4 Credit Risk** | | | | |
| Non-Performing Advances / Gross Advances | 10.6% | 8.7% | 8.0% | 5.4% |
| Non-Performing Finances-net / Equity | 25.6% | 25.5% | 22.6% | 8.1% |

## Credit Rating

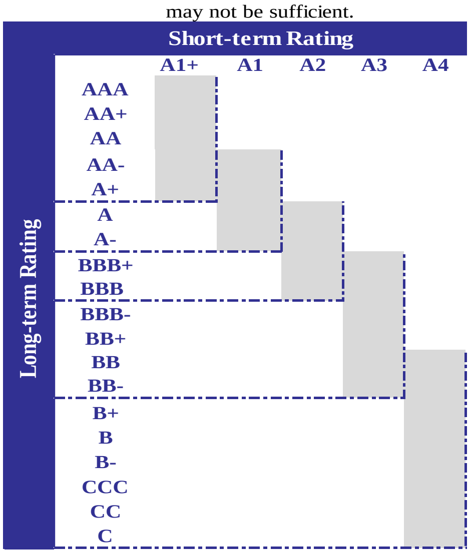
Credit rating reflects forward-looking opinion on credit worthiness of underlying entity or instrument; more specifically it covers relative ability to honor financial obligations. The primary factor being captured on the rating scale is relative likelihood of default.

### Long-term Rating

| Scale | Definition |
|---|---|
| AAA | **Highest credit quality.** Lowest expectation of credit risk. Indicate exceptionally strong capacity for timely payment of financial commitments |
| AA+<br>AA<br>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. |
| A+<br>A<br>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. |
| BBB+<br>BBB<br>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. |
| BB+<br>BB<br>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. |
| B+<br>B<br>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. |
| CCC<br>CC<br>C | **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. |
| D | Obligations are currently in default. |

### Short-term Rating

| Scale | 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 |
| 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 surveill 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

## Regulatory and Supplementary Disclosure
(Credit Rating Companies Regulations,2016)

**Rating Team Statements**
(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

**Restrictions**
(3) No director, officer or employee of PACRA communicates the information, acquired by him for use for rating purposes, to any other person except where required under law to do so. | Chapter III; 10-(5)
(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)
**Proprietary Information**