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-2024	A+	A1	Stable	Maintain	-
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	-

Rating Rationale and Key Rating Drivers

The ratings reflect stability achieved 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 Bank’s ownership structure and the continued support of its strong sponsors. Moreover, the government of KPK is committed to maintaining its controlling stake in the Bank is aware of the Bank’s growth strategy, and is supportive of it. The bank has managed to demonstrate healthy financial performance. However, the fragile economic conditions and subdued business activities have impaired the repayment capacity of certain businesses and obligors, leading to a deterioration in the infection ratio. To control this portfolio infection, management has implemented robust risk management policies and procedures and is making strenuous efforts to recover non-performing loans (NPLs). The deposit mix remained tilted towards saving deposits, while the CASA ratio declined 4.7% on a YoY basis and clocked 64.0% at the end of Dec'23 (End-Dec’22: 68.7%). During the period, net markup income surged by ~97% influenced by the high interest rate environment and portfolio reprofiling, while non-markup income exhibited a robust growth of ~50% which highlights the Bank's enhanced revenue generation capabilities and effective strategic initiatives. The bank has experienced a comparative decline in profitability at the end of 1QCY24, however remains focus on holding the profitability. 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. 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. The investment portfolio is majorly vested with government securities, indicating the bank's strategic focus on secure investments amidst a challenging lending environment. At end-Dec23, the bank’s equity base was recorded at PKR 20.3bln (end-Dec21: PKR 16.4bln) accompanied by improved retention ratio. The bank’s capital adequacy ratio stands at 18.25% at end-Dec’23 where Tier I capital clocked at 18.09% (CY22: 14.88%) reflecting a comfortable position. It signifies a marked fortification of the bank's capital structure and financial stability, reflecting enhanced resilience and a more robust capacity to absorb potential losses. 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. Moreover, the ongoing efforts to diversify the deposit base align with the bank's strategic objectives, potentially enhancing its stability and growth prospects.

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 | Correlation Between Long-term & Short-term Rating Scales(Jul-23),Methodology | Financial Institution Rating(Oct-23),Methodology | Rating Modifiers(Apr-24)
Related Research	Sector Study | Commercial Banks(Jun-24)
Rating Analysts	Madiha Sohail | madiha.sohail@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 promote Islamic banking gradually. As of the end of Dec'23, the bank operates 282 branches including 123 Islamic, 31 sub-branches and 13 booth 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 2,114 employees (CY22: 1,950 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 nine members including the Chairman and CEO. The board is chaired by Mr. Syed Imtiaz Hussain Shah. The board has six independent directors. One casual vacancy (independent director) on the board at the year end was duly filed subsequently.

Members' Profile The profile of the members is considered strong where the majority of members are representing the government on board. Mr. Syed Imtiaz Hussain Shah has been appointed as Chairman effective from Oct 05, 2023 in place of Mr. Muhammad Zubair Asghar Qureshi. He is also serving as Additional Chief Secretary, Planning and Development Department, Government of Khyber Pakhtunkhwa.

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. The board had a total of ten 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, 2023.

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.

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. He tended his resignation on Jan 3, 2024 and Mr. Irfan Saleem Awan was appointed as Acting Managing Director at his place.

Effectiveness The bank has 10 committees in place 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 CY23 remained a challenging year for the economy inclusive of a drop in exchange reserves, currency devaluation, and peak inflation. To combat inflation and curb aggregate demand, the Central Bank maintained a tight monetary policy stance. Despite these challenges, CY23 was a remarkably successful year for the banking industry. The sector outperformed historical statistics, with two-thirds of net markup income coming from investments in government securities and the remainder from advances. During the year, Pakistan's banking sector's total assets posted growth of ~30% YoY whilst investments surged by ~42% to PKR ~25.6trln (end-Dec22: PKR ~18trln). Gross Advances of the sector recorded growth of ~4% to stand at PKR ~13.101trln (end-Dec22: PKR ~12.645trln). Non-performing loans witnessed an increase of 8.3%% YoY to PKR ~881bln (end-Dec22: ~812bln). The CAR averaged at 18.5% (end-Dec22: 15.5%). Looking ahead, with the expected monetary rate cut, banks are likely to sustain some dilution in profitability by CY24.

Relative Position During CY23, Bank of Khyber grabbed a market share of 1.1% which is in line with its peers.

Revenues During CY23, the markup earned recorded a sizeable increase on a YoY basis to stand at PKR 59.1bln (CY22: PKR 40.2bln). The bank's asset yield increased to 18.6% (CY22: 12.8%). The cost of funds recorded a good increase to stand at 13.8% (CY22: 10.2%). The bank's spread elevated to 4.8% (CY22: 2.5%).

Performance The non-markup income recorded a growth of 52.3% on a YoY basis attributable to a sizeable increase in foreign exchange income (CY23: PKR 1,458mln; CY22: PKR 660mln) and improved fee and commission income (CY23: PKR 549mln; CY22: PKR 546mln). The dividend income declined to PKR 11mln (CY22: 13mln). However, the net profitability recorded a sizeable increase and stood at PKR 3,481mln (CY22: PKR 455mln).

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 Net advances decreased by 20.3%, amounting to PKR 101.6bln in CY23 (CY22: PKR 127.5bln). Consequently, the Advance to Deposit Ratio (ADR) fell to 35.1% from 51.2% during CY23. The bank also saw a deterioration in asset quality with increase in infection ratio to 12.1% from 8.7% in CY23. Meanwhile, the loan loss provision coverage for non-performing advances decreased to 61.1%, compared to 62.9% in the prior year. These metrics indicate a need for the bank to address rising non-performing loans and improve its lending efficiency.

Market Risk At end-Dec23, the bank's investment portfolio exhibited a robust YoY escalation surging to PKR 223.3bln (end-Dec22: PKR 173.7bln). This substantial growth is primarily attributable to a strategic pivot towards government securities, indicating the bank's strategic focus on secure investments amidst a challenging lending environment.

Liquidity And Funding At end-Dec23, the bank's deposit base recorded a healthy increase to stand at PKR 289.3bln (end-Dec22: PKR 248.9bln). CA and SA proportions stood at 22% (end-Dec22: 23%); and 47% (end-Dec22: PKR 52%). This delineates a subtle realignment in the distribution of deposit types. Such fluctuations may signify alterations in depositor behavior and the bank's strategic initiatives.

Capitalization At end-Dec23, the bank's equity base was recorded at PKR 20.3bln (end-Dec22: PKR 16.4bln). Concurrently, CAR improved significantly, ascending to 18.25% from 14.9% at the end of Dec'23. This denotes a marked fortification of the bank's capital structure and financial stability, reflecting enhanced resilience and a more robust capacity to absorb potential losses.

PKR mln

Bank of Khyber Listed Public Limited	Dec-23 12M	Dec-22 12M	Dec-21 12M	Dec-20 12M
A BALANCE SHEET				
1 Total Finances - net	103,698	131,009	130,121	146,828
2 Investments	216,228	165,982	175,089	94,282
3 Other Earning Assets	5,960	11,198	17,226	16,475
4 Non-Earning Assets	52,290	32,603	32,432	29,283
5 Non-Performing Finances-net	5,010	4,193	3,739	1,432
Total Assets	383,186	344,984	358,606	288,300
6 Deposits	289,292	248,906	221,876	203,072
7 Borrowings	50,461	66,263	110,069	57,063
8 Other Liabilities (Non-Interest Bearing)	23,133	13,387	10,091	10,394
Total Liabilities	362,885	328,557	342,036	270,528
Equity	20,301	16,427	16,570	17,772
B INCOME STATEMENT				
1 Mark Up Earned	59,070	40,242	21,939	25,673
2 Mark Up Expensed	(45,178)	(33,093)	(15,150)	(18,911)
3 Non Mark Up Income	2,109	1,384	1,023	2,878
Total Income	16,002	8,532	7,812	9,640
4 Non-Mark Up Expenses	(8,595)	(6,711)	(5,300)	(4,223)
5 Provisions/Write offs/Reversals	(705)	(902)	(832)	(1,610)
Pre-Tax Profit	6,702	919	1,680	3,806
6 Taxes	(3,220)	(465)	(577)	(1,655)
Profit After Tax	3,481	454	1,104	2,152
C RATIO ANALYSIS				
1 Performance				
Net Mark Up Income / Avg. Assets	3.8%	2.0%	2.1%	2.3%
Non-Mark Up Expenses / Total Income	53.7%	78.7%	67.8%	43.8%
ROE	19.0%	2.8%	6.4%	13.5%
2 Capital Adequacy				
Equity / Total Assets (D+E+F)	5.3%	4.8%	4.6%	6.2%
Capital Adequacy Ratio	18.3%	14.9%	14.7%	19.3%
3 Funding & Liquidity				
Liquid Assets / (Deposits + Borrowings Net of Repo)	67.9%	50.1%	50.0%	44.2%
(Advances + Net Non-Performing Advances) / Deposits	35.1%	51.2%	56.1%	63.6%
CA Deposits / Deposits	16.8%	17.0%	16.0%	16.7%
SA Deposits / Deposits	47.2%	51.7%	49.2%	44.4%
4 Credit Risk				
Non-Performing Advances / Gross Advances	12.1%	8.7%	8.0%	5.4%
Non-Performing Finances-net / Equity	24.7%	25.5%	22.6%	8.1%

Credit Rating

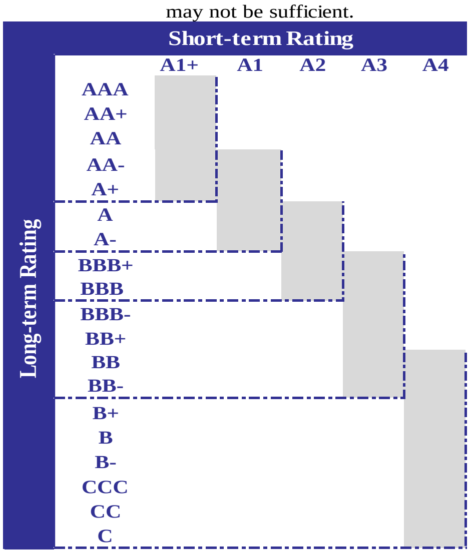
Credit rating reflects forward-looking opinion on credit worthiness of underlying entity or instrument; more specifically it covers relative ability to honor financial obligations. The primary factor being captured on the rating scale is relative likelihood of default.

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+ 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.
A+ 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.
BBB+ 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.
BB+ BB 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+ 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.
CCC CC 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

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 | 17-(a)
(19) PACRA reviews all the outstanding ratings periodically, on annual basis; Provided that public dissemination of annual review and, in an instance of change in rating will be made; | Chapter III | 17-(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 | 17-(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 | 17-(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 | 14-3(f)(vii)
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