The Pakistan Credit Rating Agency Limited

Rating Report

The Bank of Khyber

Report Contents

Rating History

Dissemination Date	Long Term Rating	Short Term Rating	Outlook	Action	Rating Watch
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	-
30-Jun-2016	A	A1	Stable	Maintain	-

Rating Rationale and Key Rating Drivers

The ratings reflect Bank of Khyber's sustained business profile, on an overall basis, as reflected by largely intact customer deposit system share (end-Dec20: 1.2%, end-Dec19: 1.3%). The deposit mix remained tilted towards saving deposits, while the CASA ratio witnessed a slight adjustment (CY20: 61.1%; CY19: 62.8%). Markup income witnessed an increase attributable to higher advances where asset yield recorded a decline mainly due to rationalized market interest rates. Non-mark-up income recorded growth due to gain booked from treasury operations which supplemented the profitability. Spread witnessed slight decline (end-Dec20: 3.3%; end-Dec19: 3.9%). Sustainability in net-mark up income continued enhancement in non-fund-based income and strengthened treasury operations are important for future years. The Bank has been paying healthy dividends, though higher retention of profits will provide further strength to equity. The Bank while having a cautious approach, intends to increase its exposure to Private Sector Advances. It remains vital for Bank to harness credit risk, if any, arising from lending through government schemes. The Bank has further embarked on improving efficiency and effectiveness in the operating system through the implementation of widely used Core Banking Software T-24. The Bank's concentration in advances remained high with the top 20 customers. Non-Performing Loans inched up as reflected by NPLs to Gross Advances ratio (CY20: 5.4%; CY19: 4.4%) but good coverage (end-Dec20: 80.3%, end-Dec19: 84.2%) is in place to limit the risk. The Bank needs to monitor and contain large exposure, compared to Bank's own size. Continuous monitoring will complement the efforts to arrest the portfolio infection. It is vital to hold the current risk profile while improving the relative market position. The Investment book declined, tilted towards Govt. papers. The Bank's total CAR stands at 19.3% as at end-Dec20. COVID-19 is an ongoing challenge. While it has taken a toll on many businesses, its ramifications are still unfolding. The proactive measures are taken by the regulators and other concerning bodies have mitigated the potential damages much anticipated from this pandemic. As a result, the banking industry remained protected and in fact posted record profits. Vigilance is required as the loan repayment cycle remains amid variants of the pandemic continue to re-emerge.

Disclosure

Name of Rated Entity	The Bank of Khyber
Type of Relationship	Solicited
Purpose of the Rating	Entity Rating
Applicable Criteria	Methodology | FI (Jun-20),Methodology | Correlation Between Long-Term And Short-Term Rating Scale(Jun-20),Criteria | Rating Modifier(Jun-20)
Related Research	Sector Study | Commercial Bank(Jun-21)
Rating Analysts	Muhammad Fahad Iqbal | fahad.iqbal@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 (KP). It was awarded status of a scheduled bank in September 1994 and is listed on Pakistan Stock Exchange (PSX).

Background BoK was established with a vision to gradually promote Islamic banking. At present, 91 of its branches functions as dedicated Islamic banking branches, whereas 88 cater conventional banking. The bank has a separate Islamic banking group under its structure looking after operations of Islamic branches and devising new shariah compliant products.

Operations Bank of Khyber is operating as a scheduled bank. The bank registered office is located at The Mall – Peshawar Cantt. The bank is operating with 179 branches among with 11 sub-branches (including 91 Islamic branches). It operates with 1,433 employees. The branch network is mainly concentrated in the province of KP and also increasing in Punjab, while having limited presence in all other provinces of Pakistan.

Ownership

Ownership Structure The Government of Khyber Pakhtunkhwa (GoKP) has majority stake in BoK (~70%), whereas, Ismail Industries has ~24%. The remaining shareholding is widely dispersed.

Stability As the Government of Khyber Pakhtunkhwa shareholding remained 70% for many years and Ismail Industries shareholding increased in 2015; it's evident of the confidence of sponsor on the bank. The bank's shareholding will remain stable in foreseeable future.

Business Acumen As the Government of Khyber Pakhtunkhwa shareholding remained 70% for many years and Ismail Industries shareholding increased in 2015; it's evident of the confidence of sponsor in the bank. The bank's shareholding will remain stable for the longer term.

Financial Strength As the bank is backed by Government of Khyber Pakhtunkhwa; financial strength of sponsor is considered good.

Governance

Board Structure The board comprises eight members including the CEO, Five out of eight are government people out of which one is executive director, two are non-executive directors and two are independent directors. Board composition is in line with the parameters set in the BoK Act.

Members' Profile The profile of the members is considered adequate as the majority are from the Government. Mr. Shahab Ali Shah has been appointed as the Chairman of the board on May 27, 2021. All other members have adequate experienced professionals.

Board Effectiveness The board monitors the key functional and risk areas through its five committees as per SBP instruction. During the year, board had total five meetings and the attendance of members is considered strong.

Financial Transparency The auditors of the bank, M/S EY Ford Rhodes, Chartered Accountants have expressed an unqualified opinion on the bank's financial statements for the year ended December 31, 2020.

Management

Organizational Structure The bank's overall functions are currently segregated into twelve divisions. Out of these functions, the internal audit function reports to Board Audit Committee in line with the code of corporate governance. The remaining functions report to the MD.

Management Team Mr. Ihsan Ullah Ihsan has been appointed as the new acting CEO of bank since December 06th, 2019. He is a seasoned banker with twenty-six of diverse experience mainly in banking industry. 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 board. But the effectiveness of the committees during the year considered weak.

MIS The frequency of generated reports are daily, weekly, and monthly. The quality of the reports is considered adequate.

Risk Management Framework BoK has established separate risk management, credit management and compliance and internal control divisions. The IRMC and ALCO of management operate within the established framework in order to monitor the bank's activities and maintain the risk level within predefined limits. The operational risk management of the bank is also considered adequate.

Business Risk

Industry Dynamics The indicators of the banking sector reflected a mixed trend where the economy is recovering from the effects of the COVID-19 pandemic. Despite challenging economic conditions prevailing in CY20 due to the COVID-19 outbreak, the banking sector managed to grow at a decent pace. Deposits of the banking sector grew by 16.1% to PKR 18,519bln (CY19: PKR 15,953bln) as compared to 11.9% growth in CY19. The surge in deposits provided the necessary funding support to finance the robust rise in investments (CY20: PKR 11,935bln; CY19: PKR 8,939bln) and particularly towards government instruments. During CY20, advances witnessed a mild contraction owing to slackness amid the COVID-19 pandemic outbreak. The policy measures rolled out by the SBP enabled the sector to enhance profitability, improve resilience and limit credit risk. With the completion of the deferment period allowed, the aftermath is yet to be comprehended by the industry.

Relative Position The Bank of Khyber - a small-sized bank with the system share, (Deposits: CY20: 1.2%; CY19: 1.3%) during recent years. During CY20, the bank was only able to show growth in terms of deposits by 11.4%; light as compared to peers and the previous year (CY19: 5.9%).

Revenues The bank of Khyber's revenues consists of both mark-up income and non-mark-up income. During CY20, markup income increased by 4.12% on a YOY basis to stand at PKR 25.7bln from PKR 24.7bln (CY19), whereas the cost of funds witnessed a decrease thus NIMR reflected a 41.8% increase (CY20: PKR 6.7bln; CY19: PKR 4.7bln) of growth during the period. Core spread in CY20 is 3.3% (CY19: 3.9%). During 1QCY21, however, the downward trends have been witnessed in revenues for the bank where markup income declined by 30.1% to stood at PKR 5.5bln (1QCY20: PKR 7.9bln) where markup cost observed lesser growth from 1QCY20 due to a decline in policy rates.

Performance During CY20, non-markup income was reported at PKR 2.8bln (CY19: PKR 1.1bln) mainly due to gain reported from Government securities and increase in foreign exchange income. BoK non-markup expenses however increased by 16.08%. Also, the Bank of Khyber booked a net provision of PKR 1.6bln (CY19: 21mln). Hence, the bottom-line clocked in at PKR 2.1bln (CY19: PKR 1.3bln). During the 1QCY21, BoK reported a net income of PKR 439mln in comparison to PKR 548mln from the corresponding period.

Sustainability The bank while having a cautious approach, intends to increase its exposure from Govt. Securities to Private Sector Advances and will also execute different Government Initiatives which include Insaf Rozgar Scheme of the provincial govt. for the economic uplift and efficient execution of the PM's Kamyab Jawan Scheme across the country. The Bank has further embarked on improving efficiency and effectiveness of internal controls through the implementation of widely used Core Banking Software T-24, wherein 20 branches with a high turnover of business transactions along with treasury and Head Office functions.

Financial Risk

Credit Risk During the year, advances grew by 17.6% (CY20: PKR 129mln; CY19: PKR 109.7mln) when earning assets went down by 7.17%. The main driver of this decline in earning assets was due to Government investments (Investments declined by 25.4%). The client concentration remained high with the top 20 customers demonstrating 67% of BoK's overall advances (CY19: 73%); considered high. The increase in advances trend continued in 1QCY21 and they clocked in at PKR 143.4bln (1QCY20: PKR 117.6bln).

Market Risk The Bank's Government securities consist of 99.2% of the total investment (CY19: 99.2%). BoK's investments clocked in at PKR 105.8bln (CY19: PKR 141.2bln). Their investment increased slightly in 1QCY21 to clock in at PKR 109.2bln.

Liquidity And Funding Bank's liquidity position, emanating from investment in government securities, improved on a YoY basis as reflected in liquid assets as a percentage of total deposits and borrowing (CY20: 48.7%; CY19: 46.7%). . The advances-to-deposits ratio increased to 63.6% (CY19: 60.2%). CASA proportion remained the same at 62% in CY20 (CY19: 62%). However, the CASA declined slightly in 1QCY21 to clock in at 59.7%.

Capitalization The bank's total equity stands at PKR 17.7bln (CY19: PKR 14.2bln). The bank's CAR reported at 19.3% (CY19: 15.3%) has comfortably met the SBP limit for CY20 at 11.5%. The equity over total assets stands at only 6.2% in CY20 (CY19: 4.6%). CAR in 1QCY21 is 17%.

PKR mln

Bank of Khyber Listed Public Limited	Mar-21 3M	Dec-20 12M	Dec-19 12M	Dec-18 12M
A BALANCE SHEET				
1 Total Finances - net	154,848	146,828	120,511	105,717
2 Investments	97,722	94,282	135,350	83,025
3 Other Earning Assets	18,612	16,475	21,823	8,456
4 Non-Earning Assets	24,295	29,283	27,829	25,394
5 Non-Performing Finances-net	1,549	1,432	793	503
Total Assets	297,027	288,300	306,305	223,095
6 Deposits	214,984	203,072	182,168	171,168
7 Borrowings	55,331	57,063	94,656	34,842
8 Other Liabilities (Non-Interest Bearing)	10,262	10,394	15,280	5,381
Total Liabilities	280,577	270,528	292,104	211,390
Equity	16,451	17,772	14,201	11,705
B INCOME STATEMENT				
1 Mark Up Earned	5,541	25,673	24,657	14,686
2 Mark Up Expensed	(3,743)	(18,911)	(19,739)	(9,547)
3 Non Mark Up Income	160	2,878	1,112	(526)
Total Income	1,958	9,640	6,030	4,613
4 Non-Mark Up Expenses	(1,217)	(4,223)	(3,790)	(4,077)
5 Provisions/Write offs/Reversals	(88)	(1,610)	21	171
Pre-Tax Profit	653	3,806	2,261	707
6 Taxes	(214)	(1,655)	(955)	(241)
Profit After Tax	439	2,152	1,306	466
C RATIO ANALYSIS				
1 Performance				
Net Mark Up Income / Avg. Assets	2.5%	2.3%	1.9%	2.2%
Non-Mark Up Expenses / Total Income	62.1%	43.8%	62.8%	88.4%
ROE	10.3%	13.5%	10.1%	3.4%
2 Capital Adequacy				
Equity / Total Assets (D+E+F)	5.5%	6.2%	4.6%	5.2%
Capital Adequacy Ratio	17.0%	19.3%	15.3%	12.3%
3 Funding & Liquidity				
Liquid Assets / (Deposits + Borrowings Net of Repo)	38.5%	44.2%	43.9%	42.9%
(Advances + Net Non-Performing Advances) / Deposits	63.7%	63.6%	60.2%	55.5%
CA Deposits / Deposits	15.3%	16.7%	19.2%	23.4%
SA Deposits / Deposits	44.4%	44.4%	39.1%	33.0%
4 Credit Risk				
Non-Performing Advances / Gross Advances	5.2%	5.4%	4.4%	4.7%
Non-Performing Finances-net / Equity	9.4%	8.1%	5.6%	4.3%

Credit Rating

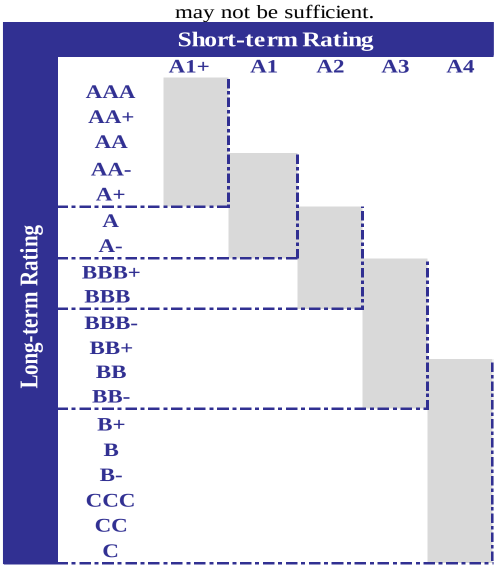
Credit rating reflects forward-looking opinion on credit worthiness of underlying entity or instrument; more specifically it covers relative ability to honor financial obligations. The primary factor being captured on the rating scale is relative likelihood of default.

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):

Entities

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

Instruments

a) Basel III Compliant Debt Instrument Rating
b) Debt Instrument Rating
c) Sukuk 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.

(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