

**RATINGS (JUNE 2011)**

**BANK OF KHYBER (BOK)**

	<b>New</b>	<b>Previous</b>
<b>Entity</b>		
Long-Term	A-	A-
Short-Term	A2	A2
Outlook	Positive	-

**FINANCIAL DATA**

PKR (mln)

	<b>1Q11<sup>^</sup></b>	<b>Dec-10</b>	<b>Dec-09</b>
Total Assets	58,125	50,794	38,811
Equity	9,108	8,828	5,265
Net Income	280	564	(637)
ROA %	2.1	1.3	(1.8)
ROE %	12.5	8.0	(11.7)
Equity / Assets (%)	15.7	17.4	13.6

<sup>^</sup> Based on unaudited accounts for 3 months ended March 31, 2011

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**PROFILE**

- The Bank of Khyber (BoK) was established in 1991 under the BoK Act, passed by the Provincial Legislative Assembly of Khyber Pakhtunkhwa (formerly NW.P). It was awarded status of a scheduled bank in September 1994. The provincial government has majority stake in BoK (51%), whereas, Ismail Industries with ~14% is other major shareholder. The remaining shareholding is widely dispersed.
- The board comprises eight members, including the CEO, Mr. Bilal Mustafa. The remaining members include four nominees of government of Khyber Pakhtunkhwa (GoKP), including two ex-officio members. One government nominee, Mr. Javed Hashmat, is Executive Director. One member represents Ismail Industries, while two are independent.

**RATING RATIONALE AND KEY RATING DRIVERS**

- The ratings primarily reflect the strong ownership structure of BoK and demonstrated support of the major shareholder (Government of Khyber Pakhtunkhwa) in terms of capital injection and providing a stable deposit base. The recently received equity, while improving the liquidity profile and capital base of the bank, is expected to support the bottom-line performance. The management intends to pursue a relatively aggressive strategy aiming at all round improvement – low cost deposit mobilization, branch expansion particularly outside KP, selected large-ticket credit growth and, in turn, robust profitability. However, material progress on the bank’s strategy is yet to take place.
- The ratings have been assigned a ‘Positive Outlook’; wherein institutionalization of risk management framework, development of a cohesive team, evolution of technology platform, dilution of deposit concentration alongwith seasoning of the loan book are key essentials. Meanwhile, any significant infection in asset quality and/or political intervention compromising the governance standards would impact negatively.

**ASSESSMENT**

- The macroeconomic landscape of Pakistan remains uncertain. Although a few indicators have improved as reflected in current account surplus of the country, prolonged energy crisis, stubborn inflationary pressure and burgeoning fiscal imbalance continue to pose major challenges to economic growth. This is also reflected in continuing weakening in the asset quality of the banks. The pace of accumulation of NPLs has stalled lately, but it would be challenging for the banks to maintain asset quality amidst subdued business sentiments.
- BoK witnessed significant increase in its advances (~66%) during 2010. This was ably funded by fresh capital injection from (GoKP) and robust increase in deposits. A large portion of fresh lending was for commodity financing, increasing its exposure to public sector. Besides, the bank’s major exposure remained in construction (11%), energy (10%), and textile (7%) sectors. The bank observed ~40% growth in its deposit base. While benefiting from its association with GoKP, the bank has maintained significant contribution (~50%) of public sector deposits that lends stability to overall deposit base. The bank also registered a slight increase in exposure in debt instruments, TFCs and Sukuks, keeping finances to deposit ratio remained largely stable.
- BoK’s mark-up income witnessed a sizeable increase during 2010 in line with increase in earning assets, mainly advances, though spreads slightly declined. The bank, while divesting few of its stock market portfolio, recognized loss. However, the dilution was, already provided for, hence, no impact on bottom-line. Meanwhile, lower provisioning expense helped the bank to post significant profitability. During 1Q11, the bank, benefiting from improved other operating income, lower provisioning, and growing earning assets, showed further improvement in profits.
- Going forward, the bank will focus on improving profitability by reducing cost of funds, judiciously managing expenses, concentrating on other operating income, and actively pursuing non-performing accounts. Moreover, the bank intends to increase the contribution from private sector in deposit base while improving the share of low-cost CASA deposits mainly through expanding the branch network (12 new branches in 2011). For lending, the bank plans to mainly focus on corporate segment, identifying credit-worthy borrowers in fundamentally sound sectors (which include pharmaceutical, service and food). However, managing the related risk would remain critical.
- In order to further improve the IT infrastructure and to bring it in line with overall growth strategy, the bank has decided to purchase core banking software, “Bank Essentials”, including Treasury Module from M/s. Sidat Hyder & Co. it is a cost-efficient domestically developed solution and is in operation successfully at few other FIs. Initially, it will be implemented in six branches with full implementation by end-2012.
- During 2010, the bank maintained its asset quality as impaired portfolio declined slightly. Owing to substantial increase in advances, NPLs to advances ratio rationalized (end-10:19%, 09:30%). The bank’s concentration in the loan book remained high (Top 20 exposures 47%). The bank has maintained a sound portfolio of debt instruments, largely concentrated in banking sector. Non-performing TFC/Sukuks comprised ~10% of debt instruments’ portfolio.
- The bank’s investment policies and procedures have been further strengthened during the year. Investment portfolio as a percentage of total assets increased (1Q11: ~50%, 10: 33%, 09: 39%), a shift largely consistent with the industry and engendering strong liquidity. The investments are concentrated in government securities (90% of total investments at end-Mar11), mainly treasury bills. The bank also maintained a sizeable portfolio of PIBs. Although, the bank has already booked revaluation loss on these, interest rate risk would remain. The bank has nominal stock market portfolio (~3% at end-Mar11) bearing minimal impact on account of market risk.
- BoK’s equity base has risen significantly during the year subsequent to fresh injection by the sponsor. Now the bank is complied with regulatory capitalization requirements. The bank’s capital adequacy ratio (19% at end-Dec10) provides adequate cushion for further growth. Going forward, equity base is expected to further strengthen as the bank’s profitability increases.