Khushhali Bank Limited

Chairman: Mr. Rayomond Kotwal; President: Mr. Ghalib Nishtar

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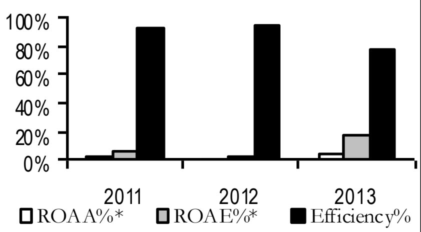
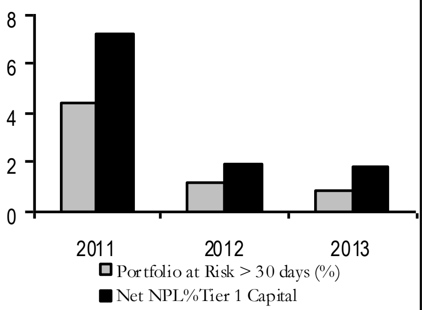
Category	Latest	Previous
Entity	A/A-1	A/A-1
	Apr 23, '14	*Apr 29, '13*
Outlook	Positive	Stable

Key Financial Trends



**based on profit after tax, provisions, grants & other extra-ordinary income*



	2011	2012	2013
Net Financings (Rs. in b)	4.2	5.7	8.8
Deposits (Rs.in b)	1.7	4.0	7.1
Market Share (%)	12.1%	17.4%	21.6%
Deposit Cost (%)	2.9	4.6	8.0
Profit before Tax (Rs.in m)	96.3	119.8	538.0
Equity (Rs. in b)	2.3	2.5	2.8
CAR (%)	40	34	29
Liquid Assets (%) Deposits & Borrowings	56	41	30
Net Infection (%)	4.0	0.8	0.6

Rating Rationale

Shareholding of Khushhali Bank Limited (KBL) is largely vested with a consortium led by United Bank Limited (UBL) and comprising four global funds of international repute. The bank has a strong governance infrastructure and benefits from the diversity of experience of its Board members.

Since acquisition by current sponsors, KBL has embarked upon an aggressive growth driven strategy which entails product mix diversification. Loan portfolio stood higher at Rs. 8.8b at end-2013 (FY12: Rs. 5.8b). While KBL continued to cater to rural and urban markets through its core group lending product, the bank also scaled up its secured portfolio to diversify its loan book; secured loans represented 24% of the total portfolio at end-FY13 vis-à-vis 12% in the preceding year. Portfolio quality indicators have remained intact and rate of incremental infection has also tapered off in 2013. Average loan amount per Loan Officer has increased significantly over the out-going year and is now the highest in the sector. Capacity of staff to handle larger volume of loans will be tested, going forward.

Over the long term, the bank plans to establish its presence in the Micro, Small and Medium Enterprise (MSME) segment, which is largely untapped. Underwriting guidelines for such lending may however be distinct from the current lending practices, and would require necessary training at the grass root level. Pilot testing of the product is currently underway.

Agricultural loans mostly entail bullet repayment, commensurate with the crop cycle; credit risk is considered heightened as detection of weakening in counterparty risk profile may be delayed. In order to address this risk, KBL plans to implement quarterly recovery of mark-up on such loans after the implementation of new loan module; product tweaking was not possible in the existing system. Full scale implementation may however not be possible and bullet repayment pattern for both principal and markup will continue over at least the short to medium term. Given the recurrence of natural calamities, the management's plan to pursue portfolio diversification is considered a positive step. The resilience of internal control systems will be tested further as the bank forges ahead with its growth plans in new markets and products.

Growth in credit portfolio in 2013 has been financed through deposits. While the bank was able to surpass the deposit target for the year, quality of deposit mix witnessed less than desired changes, both in terms of concentration levels and cost. For 2014, the revised deposit target is Rs. 8b and the management's focus will be on improving the deposit mix. A broad suite of services is offered by commercial banks to its depositors; if KBL is to compete in the same market for deposits, the range of services may need to be enhanced. KBL has also arranged stand-by commercial funding lines, which may be drawn if required. This is particularly important in context of the bank's loan cycle, with disbursements being notably higher in second and last quarter of the year.

The quantum of liquid assets carried on balance sheet diluted in 2013, given the growth in core lending operations. A sizeable proportion of deposits are short term in nature; given the maturity profile and the rise in concentration level in deposits, the bank may need to continue to maintain a sizeable liquidity cushion. Depositor trends have yet to achieve maturity. Capitalization level of the bank is considered sound, with a Capital Adequacy Ratio of 29% at end-2013.

Core earnings of the bank have depicted notable improvement in the out-going year on the back of growth in lending operations. Basic earnings amounted to Rs. 456.5m in 2013 vis-à-vis Rs. 71.6m in the preceding year. Return on average assets increased from 2% in 2012 to 3.2% in 2013 while return on average equity also improved from 7.1% to 13.9% over this period. Optimizing the cost infrastructure, both in terms of funding and human resources will be important in achieving sustained improvement in profitability. Meanwhile, maintaining portfolio quality indicators is considered essential.

Overview of the Institution

KBL has the mandate to provide microfinance services to poor persons, particularly women with the objective of poverty alleviation. KBL is the largest micro-finance bank in Pakistan in terms of its countrywide network of 110 branches. Financial statements for 2013 have been audited by M/s. A. F. Ferguson & Co. JCR-VIS

Rating Date	Medium to Long Term	Outlook	Short Term	Rating Action
		RATING TYPE: Entity		
23-Apr-14	A	Positive	A-1	Maintained
30- Apr -13	A	Stable	A-1	Reaffirmed
12-Nov-12	A	Stable	A-1	Reaffirmed
25- Apr -12	A		A-1	Reaffirmed on Rating Watch
29- Apr -11	A	Rating Watch - Developing	A-1	Upgrade
06-Sep-10	A-		A-2	Rating Watch - Developing
30- Apr -10	A-	Stable	A-2	Reaffirmed