Khushhali Bank Limited

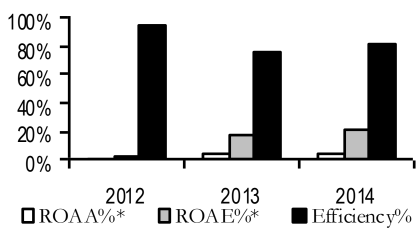
Acting Chairman: Mr. Syed Javed; President: Mr. Ghalib Nishtar

May 4, 2015

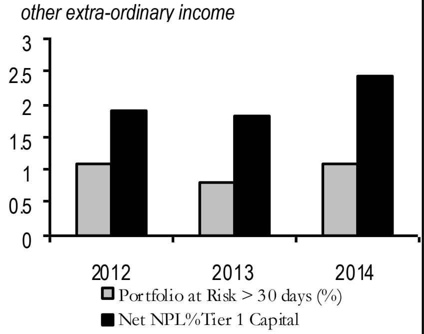
Analysts: Waqas Munir, FRM
Muniba Khan

Category	Latest	Previous
Entity	A+/A-1	A/A-1
	Apr 30, '15	*Apr 23, '14*
Outlook	Stable	Positive

Key Financial Trends



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



	2012	2013	2014
Net Financings (Rs. in b)	5.7	8.8	12.1
Deposits (Rs.in b)	4.0	7.1	8.7
Market Share (%)	13.4	17	18.3
Deposit Cost (%)	4.6	8.0	7.5
Profit before Tax (Rs.in m)	119.8	538.0	942.4
Equity (Rs. in b)	2.5	2.8	3.3
CAR (%)	34	29	25
Liquid Assets (%) Deposits & Borrowings	41	46	31
Net Infection (%)	0.8	0.6	0.9

Rating Rationale

With micro-credit outreach estimated at 11.5% by the Pakistan Microfinance Network, the microfinance sector has significant potential for growth. Leveraging on its outreach and the experience of sponsoring institutions active in the field of micro-finance, Khushhali Bank Limited (KBL) is well positioned to capitalize on the growth potential. The ratings of KBL derive strength from the governance structure instituted at the organization, the profile of management team, and key financial indicators pertaining to capitalization, profitability and asset quality. Areas requiring improvement primarily pertain to the bank's funding mix; loan repayment pattern is being modified to address the shortcomings in the current product structures.

For a second consecutive year, the bank has posted aggressive growth in loan book and enjoys the largest market share in the microfinance sector in terms of gross loan portfolio at 18.3%. Product suite has been broadened to cater to additional market segments, while flagship loan products remained group loans and cash sahulat (individual secured loans) with significant exposure in agriculture and livestock sectors. Recent addition to loan products aim to diversify institution's product mix from rural to urban markets with penetration planned in the MSME sector; successful execution will require capacity building of staff along with strengthening of internal controls. Additionally, the bank plans to gradually increase the share of EMI based loans; beginning April, 2015, all agricultural loans would require monthly payment of interest. This is expected to allow early detection of weakening of borrowers' risk profile while also augmenting cashflows. Given that these loans are linked to crop cycle, impact of the same on portfolio quality indicators will be visible over time, which has hitherto remained strong, in line with sector trends.

Productivity indicators of the institution have weakened during the outgoing year owing to recent induction of loan officers. Given that the bank is in a growth phase and hiring will continue to be undertaken, productivity indicators may continue to show a lag effect. The institution maintains a healthy client retention ratio of 67%. With clients graduating to higher loan cycle and increased focus on loan products involving higher amounts, average outstanding loan balance has increased on a timeline basis.

While deposit base has also grown, the deposit profile continues to feature significant concentration. In this backdrop, current level of liquidity carried on the balance sheet is considered on the lower side. Liquid assets as a proportion of deposits & borrowings declined to 30.6% by end FY14 (FY13: 46.2%), as resources were channeled towards lending activities. Expanding geographical presence along with branch renovation plans are projected to support the bank's deposit mobilization activities. Additionally, KBL plans to launch ATM / debit cards for its customers. Impact of the same will be tracked over time, with deposit mobilization considered an important area, given the bank's growth plans. A sizeable portion of the bank's funding mix also comprises borrowings; the loan from Asian Development Bank, with an outstanding balance of Rs. 2.2b, is to be fully re-paid by 2020, while the bank has also tapped commercial borrowings.

In line with increase in lending activities, profitability of the bank has showcased significant improvement. Markup-spreads may benefit further from the decline in market benchmark rates, to which funding cost is generally tied with, while return on advances may improve with shift to EMI based loans. Retention of profits has resulted in a growing equity base, though Capital Adequacy Ratio has come down over time in view of the aggressive growth in lending operations.

Overview of the Institution

KBL is engaged in the provision of microfinance services to the poor and underserved segment of the society. KBL is the largest micro-finance bank in Pakistan in terms of its countrywide network of 118 branches (FY13: 110 branches). There were notable changes at the Board level during FY14. Financial statements for 2014 have been audited by M/s BDO Ebrahim & Company Chartered Accountants