

## RATING REPORT

### Khushhali Microfinance Bank Limited

**REPORT DATE:**

May, 4 2017

**RATING ANALYSTS:**

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#### RATING DETAILS

Rating Category	Latest Rating		Previous Rating	
	Long-term	Short-term	Long-term	Short-term
Entity	A+	A-1	A+	A-1
Rating Outlook	Stable		Stable	
Rating Date	April 28, 2017		April 29, 2016	

#### COMPANY INFORMATION

<b>Incorporated in 2008</b>	<b>External auditors:</b> BDO Ebrahim & Co. Chartered Accountants
<b>Limited Liability Company</b>	<b>Chairman of the Board:</b> Mr. Aameer Mustaaly Karachiwala
<b>Key Shareholders (with stake 5% or more):</b>	<b>Chief Executive Officer:</b> Mr. M. Ghalib Nishtar
United Bank Limited – 29.7%	
Rural Impulse Fund II S.A. SICAV-FIS – 24.5%	
Credit Suisse Microfinance Fund Management Company – 19.9%	
ShoreCap II Limited – 14.3%	
ASN-NOVIB Mikrokredietfonds – 9.9%	

#### APPLICABLE METHODOLOGY(IES)

**Methodology:** *Micro-Finance Banks (May 2016)*

<http://jcrvis.com.pk/kc-meth.aspx>

OVERVIEW OF  
THE  
INSTITUTION

## RATING RATIONALE

*Khushhali Microfinance Bank Limited (previously Khushhali Bank Limited) was incorporated in 2000 with proclamation of Khushhali Ordinance by Government of Pakistan. Subsequently, it was transformed into a public limited company in 2008. Objective of the bank is to provide microcredit services to underserved and poor segment of the society in a bid to promote social welfare.*

Khushhali Microfinance Bank Limited (KMBL) is the leading provider of microcredit in microfinance institutions, with a market share of 16.9% (2015: 18.7%) in terms of total Gross Loan Portfolio (GLP) booked by microfinance sector.

**Key Rating Drivers**

- Business volumes:** The bank posted healthy growth in loan book during 2016 and managed to retain its leading position in the sector. Product suite of the bank remained the same during 2016. Agricultural loans have exhibited sizeable concentration over the years. The management has recently introduced house improvement loans in order to diversify sectoral exposure and mitigate concentration risk. The bank also plans to introduce Islamic finance product in due course with the aim of serving the untapped market segments. Moreover, the management's concerted efforts resulted in increasing the portion of individual loans in its loan book and the proportion of Micro, Small and Medium Enterprise (MSME) also increased. As a strategy, the MSME portfolio buildup is gradual and in phases. KMBL has invested in its resource strengthening and frontline training thereby laying a strong foundation prior to mass expansion of MSME rollout as envisioned in its Five Years Strategic Plan.
- Portfolio indicators:** Given higher loan portfolio, asset quality indicators improved in terms of gross, net and incremental infection despite considerable amount of fresh infection witnessed during the outgoing year. According to the management, fresh infection mainly emanated from one product, which was halted during 4Q15.
- Liquidity:** Given high concentration in deposit profile, liquid assets as a proportion of deposit and borrowings have remained low on a timeline basis; Average holding of liquid assets in terms of deposits and borrowings improved during the outgoing year.
- Funding & Capitalization:** Deposit base of KMBL also witnessed sizeable increase on timeline basis. However, top 50 deposits continue to feature high concentration. The bank has also mobilized commercial funding. In addition to secure fresh credit lines from local banks, KMBL has recently negotiated long-term offshore funding of around Rs. 4b that will be partially utilized during 2017. Retention of sizeable profits resulted in a higher equity base for the bank. The bank was also able to maintain Capital Adequacy Ratio (CAR) at around the last year's level.
- Profitability:** In spite of some pressure on spreads mainly an outcome of balance sheet restructuring, the bank's profitability indicators exhibited considerable improvement on the back of expansion in business volumes. With higher core income, Operational Self Sufficiency was also maintained well above the 100% mark. Provision against NPLs increased considerably having drag on profitability to a certain extent. The management is forecasting considerable improvement in profitability indicators, going forward.
- Management Profile & Sponsor Support:** A seasoned management team of KMBL largely exhibits stability which is pivotal for effective implementation of business strategy. Sponsors of the bank comprise strong financial institutions. Majority shareholding of the bank is vested with a consortium of 5 members led by United Bank Limited. JCR-VIS anticipates technical and financial support from sponsors of KMBL, if the need arises.

**Financial Summary**

<b>FINANCIAL SUMMARY</b>			
<i>(amounts in PKR millions)</i>			
<b><u>BALANCE SHEET</u></b>	<b>31-Dec-16</b>	<b>31-Dec-15</b>	<b>31-Dec-14</b>
Total Investments	2,967.9	1,847.8	836.9
Net Financing	22,939.5	17,246.5	12,105.8
Total Assets	33,773.4	26,696.3	16,692.4
Borrowings	6,199.8	5,890.4	3,729.9
Tier-1 Equity	4,937.2	3,934.5	3,285.5
Net Worth	4,937.1	3,951.5	3,286.1
<b><u>INCOME STATEMENT</u></b>	<b>31-Dec-16</b>	<b>31-Dec-15</b>	<b>31-Dec-14</b>
Net Mark-up Income	4,119.1	3,187.3	2,319.9
Net Provisioning (Reversal) / Directly written Bad debts	684.8	279.1	157.6
Non-Markup Income	1,118.6	716.4	694.7
Operating Expenses	2,755.9	2,315.2	1,889.8
Profit after tax	1,272.7	824.2	703.2
<b><u>RATIO ANALYSIS</u></b>	<b>31-Dec-16</b>	<b>31-Dec-15</b>	<b>31-Dec-14</b>
Gross Infection (%)	1.8	2.5	1.1
Net Infection (%)	1.2	2.1	0.9
Net NPLs to Tier-1 Capital (%)	5.6	9.0	3.2
Markup Spreads (%)	16.6	18.9	19.2
OSS (%)	129.2	127.8	125.4
ROAA (%)	4.3	3.8	4.7
Liquid Assets to deposits & borrowings (%)	26.3	28.8	18.6

## ISSUE/ISSUER RATING SCALE & DEFINITIONS

### Medium to Long-Term

#### **AAA**

Highest credit quality; the risk factors are negligible, being only slightly more than for risk-free Government of Pakistan's debt.

#### **AA+, AA, AA-**

High credit quality; Protection factors are strong. Risk is modest but may vary slightly from time to time because of economic conditions.

#### **A+, A, A-**

Good credit quality; Protection factors are adequate. Risk factors may vary with possible changes in the economy.

#### **BBB+, BBB, BBB-**

Adequate credit quality; Protection factors are reasonable and sufficient. Risk factors are considered variable if changes occur in the economy.

#### **BB+, BB, BB-**

Obligations deemed likely to be met. Protection factors are capable of weakening if changes occur in the economy. Overall quality may move up or down frequently within this category.

#### **B+, B, B-**

Obligations deemed less likely to be met. Protection factors are capable of fluctuating widely if changes occur in the economy. Overall quality may move up or down frequently within this category or into higher or lower rating grade.

#### **CCC**

Considerable uncertainty exists towards meeting the obligations. Protection factors are scarce and risk may be substantial.

#### **CC**

A high default risk

#### **C**

A very high default risk

#### **D**

Defaulted obligations

### Short-Term

#### **A-1+**

Highest certainty of timely payment; Short-term liquidity, including internal operating factors and /or access to alternative sources of funds, is outstanding and safety is just below risk free Government of Pakistan's short-term obligations.

#### **A-1**

High certainty of timely payment; Liquidity factors are excellent and supported by good fundamental protection factors. Risk factors are minor.

#### **A-2**

Good certainty of timely payment. Liquidity factors and company fundamentals are sound. Access to capital markets is good. Risk factors are small.

#### **A-3**

Satisfactory liquidity and other protection factors qualify entities / issues as to investment grade. Risk factors are larger and subject to more variation. Nevertheless, timely payment is expected.

#### **B**

Speculative investment characteristics; Liquidity may not be sufficient to ensure timely payment of obligations.

#### **C**

Capacity for timely payment of obligations is doubtful.

**Rating Watch:** JCR-VIS places entities and issues on 'Rating Watch' when it deems that there are conditions present that necessitate re-evaluation of the assigned rating(s). Refer to our 'Criteria for Rating Watch' for details. [www.jcrvis.com.pk/images/criteria\\_watch.pdf](http://www.jcrvis.com.pk/images/criteria_watch.pdf)

**Rating Outlooks:** The three outlooks 'Positive', 'Stable' and 'Negative' qualify the potential direction of the assigned rating(s). An outlook is not necessarily a precursor of a rating change. Refer to our 'Criteria for Rating Outlook' for details. [www.jcrvis.com.pk/images/criteria\\_outlook.pdf](http://www.jcrvis.com.pk/images/criteria_outlook.pdf)

**(SO) Rating:** A suffix (SO) is added to the ratings of 'structured' securities where the servicing of debt and related obligations is backed by some sort of financial assets and/or credit support from a third party to the transaction. The suffix (SO), abbreviated for 'structured obligation', denotes that the rating has been achieved on grounds of the structure backing the transaction that enhanced the credit quality of the securities

and not on the basis of the credit quality of the issuing entity alone.

**'p' Rating:** A 'p' rating is assigned to entities, where the management has not requested a rating, however, agrees to provide informational support. A 'p' rating is shown with a 'p' subscript and is publicly disclosed. It is not modified by a plus (+) or a minus (-) sign which indicates relative standing within a rating category. Outlook is not assigned to these ratings. Refer to our 'Policy for Private Ratings' for details. [www.jcrvis.com.pk/images/policy\\_ratings.pdf](http://www.jcrvis.com.pk/images/policy_ratings.pdf)

**'SD' Rating:** An 'SD' rating is assigned when JCR-VIS believes that the ratee has selectively defaulted on a specific issue or obligation but it will continue to meet its payment obligations on other issues or obligations in a timely manner.

**REGULATORY DISCLOSURES**

<b>Name of Rated Entity</b>	Khushhali Microfinance Bank Limited (KMBL)				
<b>Sector</b>	Micro Finance Bank (MFB)				
<b>Type of Relationship</b>	Solicited				
<b>Purpose of Rating</b>	Entity Rating				
<b>Rating History</b>	<b>Rating Date</b>	<b>Medium to Long Term</b>	<b>Short Term</b>	<b>Rating Outlook</b>	<b>Rating Action</b>
	<b><u>RATING TYPE: ENTITY</u></b>				
	04/28/2017	A+	Stable	A-1	Reaffirmed
	04/29/2016	A+	Stable	A-1	Reaffirmed
	04/30/2015	A+	Stable	A-1	Upgrade
	04/23/2014	A	Positive	A-1	Maintained
	04/30/2013	A	Stable	A-1	Reaffirmed
	11/12/2012	A	Stable	A-1	Reaffirmed
<b>Instrument Structure</b>	N/A				
<b>Statement by the Rating Team</b>	JCR-VIS, the analysts involved in the rating process and members of its rating committee do not have any conflict of interest relating to the credit rating(s) mentioned herein. This rating is an opinion on credit quality only and is not a recommendation to buy or sell any securities.				
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