The Pakistan Credit Rating Agency Limited

Rating Report

HBL Microfinance Bank Limited

Report Contents

Rating History

Dissemination Date	Long Term Rating	Short Term Rating	Outlook	Action	Rating Watch
28-Dec-2023	A+	A1	Stable	Maintain	-
28-Dec-2022	A+	A1	Stable	Maintain	-
28-Dec-2021	A+	A1	Stable	Initial	-

Rating Rationale and Key Rating Drivers

The ratings assigned to the HBL Microfinance Bank underpin the Bank's affiliation with Aga Khan Development Network and Habib Bank Limited (HBL) – one of the largest banks in the country. The Bank has been able to devise a sound strategy and establish a strong footprint over the years. The Bank is categorized among top-notch microfinance banks currently. As per management representation at end-Sep23, the Bank secured a market share of 23% in the microfinance sector in terms of deposits and 19% in terms of GLP. The gross advances clocked in at PKR 97.78bln at end-Sep23 (end-Sep22: PKR 79.58bln, end-Dec22: PKR 87.85bln). The recent growth recorded in the GLP is a result of enhanced outreach secured by the Bank. The same growth pattern is projected in the future as well; wherein the need to curb infection remains vital. Non-performing loans stood at PKR 2.94bln (3.0%) as per reviewed accounts at end-Sep 23 (end Sep'22: PKR 2.69bln (3.4%), end Dec'22: PKR 2.14bln (2.4%). Funding is majorly fueled through deposits where high contribution arises from the demand deposits. As per management representation, HBL Microfinance Bank has the largest deposit base in the industry amounting to PKR 118.89bln at end-Sep23 (end-Sep22: PKR 98.27bln, end Dec'22: PKR 116.06bln). The Bank is the largest provider of Housing Finance in the Microfinance Banking Sector and one of the largest contributors from the microfinance industry in the Government Mark-up Subsidy Scheme. The markup income clocked in at PKR 23.72bln during 9MCY23 (9MCY22: PKR 17.14bln, CY22: PKR 24.06bln), depicting sizable growth of 38%, attributable to enhanced micro-credit loan. The sustainability and improvement in fee and commission income have been supplementing the profitability. The Bank's higher provisioning expense in 9MCY23 is attributable to the increased specific provisioning. However, due to an increase in markup and non-markup expenses, the Bank's bottom line stood at PKR 782mln during 9MCY23 (9MCY22: PKR 801mln, CY22: PKR 1,225mln). Capital Adequacy Ratio was recorded at ~15.3% as of end-Sep’23 (end-Dec22: ~16.4%). HBL has invested PKR 4bln in equity in the past 3 years, along with providing a subordinated debt in 2020 amounting to PKR 2bln, this depicts HBL’s commitment as a sponsor and faith in the performance and growth of HBL Microfinance Bank Ltd. An increase in the equity base provides a cushion in the risk absorption capacity of the Bank. The Bank is in the process of issuing Tier II TFC of PKR 1.5bln to strengthen the CAR. As per management representation, the impact of COVID-19 and flood-related losses are already well covered, and the watchlist accounts are not sizeable enough to create a significant impact. The CAR of the Bank meets the regulatory requirement and the management is confident to augment it further through internal generation and issuance of T2 capital.

The ratings are dependent upon the Bank’s ability to aptly combat the emerging risks under the current scenario to keep its business and financial risk profile intact.

Disclosure

Name of Rated Entity	HBL Microfinance Bank Limited
Type of Relationship	Solicited
Purpose of the Rating	Entity Rating
Applicable Criteria	Methodology	Correlation Between Long-term & Short-term Rating Scales(Jul-23),Methodology	Rating Modifiers(Apr-23),Methodology	Microfinance Institution Rating(Oct-23)
Related Research	Sector Study	Microfinance(Sep-23)
Rating Analysts	Muhammad Atif Chaudhry	Atif.Chaudhry@pacra.com	+92-42-35869504

Profile

Structure The HBL Microfinance Bank Limited, "the bank" was incorporated in 2002 as a nationwide microfinance bank; licensed by the State Bank of the Pakistan.
Background The Bank was established as a structured transformation of the credit and saving section of the Agha Khan Rural Support Program (AKRSP), an integrated development program to pioneer the microfinance sector in the country since 1982 in Gilgit-Baltistan and Chitral. Currently, the Bank is operating with a nationwide network of 217 branches (CY22: 217 branches) with its head office located in Islamabad.
Operations The Bank offers a diversified range of products and services to low-income wage earners as well as to the self-employed community. Microlending segments mainly include (i) Agri-loan (ii) Livestock (iii) Micro-enterprise (iv) Housing and (v) Others.

Ownership

Ownership Structure The Bank is majorly owned by Habib Bank Limited (HBL) (79.92%), followed by Aga Khan Agency for Microfinance (AKAM) (12.05%), Aga Khan Rural Support Programme (AKRSP) (4.46%), and Japan International Cooperation Agency (JICA) (3.57%).
Stability Shareholding of HBL has enhanced in recent years and its shareholding has grown to 79.9% recently. The Bank's ownership structure is expected to stay stable in the foreseeable future.
Business Acumen The business acumen of the sponsor is considered strong due to its affiliation with HBL and AKAM.
Financial Strength HBL is a renowned and one of the biggest banks in Pakistan. The Agha Khan Development Network (AKDN) is a group of development agencies with mandates that include environment, health, education, architecture, culture, microfinance, rural development, and disaster reduction.

Governance

Board Structure The board comprises eight directors, including the Chairman. Among them, four members are representatives of Habib Bank Limited, two members are representatives of the Aga Khan Agency for Microfinance, one member is the representative of the Aga Khan Rural Support Programme (AKRSP) and one member is the representative of Japan International Cooperation Agency. The board is chaired by Mr. Raymond Kotwal - currently the Chief Financial Officer of Habib Bank Limited.
Members' Profile All board members are experienced professionals who carry diversified expertise as well as a strong technical skillset. The majority of the members bring with them several years of banking experience which is an added advantage. They are heading different high-profile organizations.
Board Effectiveness The board has six committees in place (i) Human Resource Committee, (ii) Board Risk & Compliance Committee, (iii) Board Audit Committee, (iv) Information Technology Committee (v) Financial Inclusion & Sustainability Committee, and (vi) Board Remuneration Committee. During the year, four meetings were held. The attendance of the members is satisfactory.
Transparency KPMG Taser Hadi & Co. are the external auditors of the bank. They expressed an unqualified opinion on the financial statements for the year ended December 31, 2022. The internal audit department reports directly to the Audit Committee.

Management

Organizational Structure The Bank has a horizontally spread organizational structure comprising eleven departments. Out of which, nine departments report directly to the Chief Executive Officer. Also, the reporting lines and job descriptions at each level are well-defined.
Management Team The management positions are filled by seasoned professionals to strengthen the departmental results. Mr. Muhammad Amir Khan joined the Bank as CEO in Jun'12. He brings with him 30 years of experience in commercial and consumer banking. Currently, Mr. Rizwan Maqsood is the Chief Financial Officer of the Bank.
Effectiveness The Bank has designated various management committees to manage and oversee operational efficiency.
MIS The Bank has a strong MIS infrastructure which includes system-generated reports and detailed live dashboards for efficient and effective decision-making.
Risk Management Framework The Bank has a separate risk management department in place to monitor various risks such as credit, operational, and market risks. This committee meets on monthly basis to ensure that the Bank's risk profile remains in line with the BoD's approval.
Technology Infrastructure The Bank has upgraded its IT infrastructure for core banking and other critical systems housed in a state-of-the-art Tier 3 level data center housed in its Head Office. The Bank has upgraded its Core Banking System (CBS) to the latest version of Flexcube by Oracle. The system is enhanced with various features and functionalities ties for aligning it with evolving business and stringent regulatory requirements.

Business Risk

Industry Dynamics Pakistan Microfinance Industry (MFI) comprises 50 microfinance providers including 30 microfinance institutions (MFIs). Active Borrowers were closed at 8.92mln during 9MCY23, a decrease of 11% compared to CY22. The GLP surpassed PKR 516bIn during 9MCY23, an increase of 5% compared to the GLP in CY22: PKR 491bln. In the case of MFBs, at 9MCY23 PAR > 30 days slightly decreased to 7.43% (CY22: 8.8%).
Relative Position At end-Sep23, the Bank secured a market share of 23% among the microfinance banks in terms of deposits.
Revenue During 9MCY23, markup earned was recorded at PKR 23.72bln (9MCY22: PKR 17.14bln, CY22: PKR 24.06bln). Non markup income of the bank was enhanced to PKR 1,837mln (9MCY22: PKR 1,480mln, CY22: PKR 2,109mln) attributable to improved fee and commission income along with other income.
Profitability During 9MCY23, the Bank's markup expenses increased by ~65% to PKR 15.97bln (9MCY22: PKR 9.70bln, CY22: PKR 13.64bln) and the non-mark-up expenses of the Bank witnessed an increase to PKR 5.87bln (9MCY22: PKR 4.47bln, CY22: PKR 8.15bln). Despite the provisioning expense of PKR 1,590mln in 9MCY23 (9MCY22: PKR 1,804mln, CY22: PKR 2,581mln), the Bank's net profitability, amid significant policy rate increase, remained at PKR 782mln during same period (9MCY22: PKR 801mln, CY22: PKR 1,225mln).
Sustainability HBL MFB has upgraded the Customer Origination System (LoS) to Customer Management Solution (CMS) – an end-to-end digital model used to automate the processes and reduce the turnaround time and has been implemented in 203+ locations at end-Sep23.

Financial Risk

Credit Risk The advances book posted a huge increase and stand at PKR 97.8bln (end-Dec22: PKR 87.9bln, end-Dec21: PKR 59.2bln). On the asset quality side, the Bank's non-performing advances recorded an increase clocking at PKR 2.9bln (end-Dec22: PKR 2.1bln). Consequently, the infection ratio inched up to 3% (end-Dec22: 2.4%).
Market Risk At end-Sep23, the Bank's investment portfolio slightly decreased by 1% on a YoY basis clocking at PKR 22.3bln (end -Sep22: PKR 22.5bln, end-Dec22: PKR 31.4bln) comprising the government securities and placed with other financial institutions and no investment in mutual funds.
Funding The Bank's funding is majorly fueled through the deposit base increased by 21% YoY recorded at 118.9bln (end -Sep22: PKR 98.3bln, end-Dec22: PKR 116.1bln). The total borrowing recorded a slight uptick to stand at PKR 8.81bln at end-Sep23 (end-Dec'22: PKR 8.57bln). At end-Sep23 the Bank's gross advances-to-deposit ratio (ADR) increased to ~83.1% (end-Dec'22: ~75.7) attributable to an increase in advances book.
Cashflows & Coverages The Bank witnessed decline in its liquidity profile, as evident by the liquid assets to borrowings and deposits declined to 30.4% at end-Sep23 (end-Dec22: 36.7%) driven by an decrease in liquid investments.
Capital Adequacy Capital Adequacy Ratio (CAR) stood at 15.3% as of end-Sep23 (end-Dec'22: 16.4%, end-Dec'21: 17.0%), above the regulatory requirement. The equity base recorded a good increase to PKR 14.54bln at end-Sep23 resulting mainly from profitability. (end-Dec'22: PKR 13.23bln, end-Dec'21: PKR 10.08bln). The management has represented that the impact of COVID-19 and flood-related losses are already well covered and that the watchlist accounts are not sizeable enough to create a significant impact. The CAR of the bank meets the regulatory requirement and the management is confident to augment it further through internal generation and issuance of T2 capital.

PKR mln

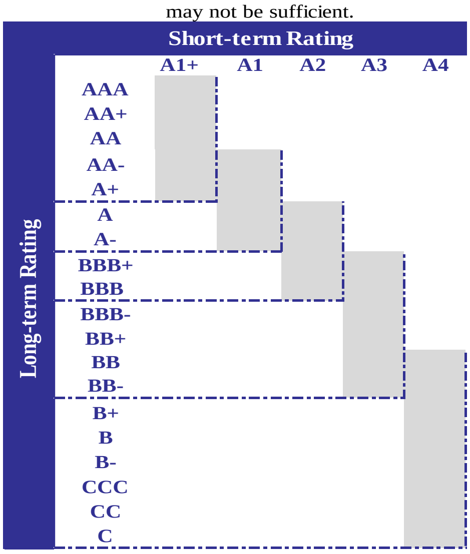
HBL Microfinance Bank Unlisted MFB	Sep-23 9M Management	Dec-22 12M Audited	Sep-22 9M Management	Dec-21 12M Audited	Dec-20 12M Audited
A BALANCE SHEET					
1 Total Performing Finances - net	94,841	85,709	76,891	56,913	42,207
2 Investments	21,318	30,395	22,515	13,730	14,542
3 Other Earning Assets	7,804	2,237	8,442	24,534	7,472
4 Non-Earning Assets	24,779	24,517	17,346	14,885	12,721
5 Non-Performing Finances-net7	444	(332)	200	(40)	(579)
Total Assets	149,186	142,526	125,395	110,021	76,363
6 Deposits	118,889	116,063	98,269	91,363	61,726
7 Borrowings	8,812	8,571	6,964	4,883	4,021
8 Other Liabilities (Non-Interest Bearing)	6,942	4,665	8,252	3,692	3,927
Total Liabilities	134,643	129,299	113,485	99,937	69,675
Equity	14,543	13,226	11,910	10,083	6,688
B INCOME STATEMENT					
1 Mark Up Earned	23,724	24,060	17,144	15,276	11,404
2 Mark Up Expensed	(15,966)	(13,641)	(9,698)	(6,294)	(4,740)
3 Non Mark Up Income	1,837	2,109	1,480	1,430	876
Total Income	9,594	12,528	8,925	10,412	7,540
4 Non-Mark Up Expenses	(7,017)	(8,181)	(5,896)	(6,353)	(5,157)
5 Provisions/Write offs/Reversals	(1,590)	(2,581)	(1,804)	(1,884)	(1,567)
Pre-Tax Profit	988	1,766	1,225	2,175	815
6 Taxes	(205)	(541)	(424)	(619)	(241)
Profit After Tax	782	1,225	801	1,556	575
C RATIO ANALYSIS					
1 Performance					
Portfolio Yield	31.3%	29.5%	28.9%	28.4%	25.7%
Minimum Lending Rate	24.0%	19.0%	19.0%	18.5%	17.0%
Operational Self Sufficiency (OSS)	104.1%	107.4%	107.0%	115.0%	107.1%
Return on Equity	7.5%	10.9%	9.7%	18.6%	8.6%
2 Capital Adequacy					
Net NPL/Equity	3.1%	-2.5%	1.7%	-0.4%	-8.7%
Equity / Total Assets (D+E+F)	9.7%	9.3%	9.5%	9.2%	8.8%
Tier I Capital / Risk Weighted Assets	11.6%	11.3%	11.9%	12.4%	10.6%
Capital Adequacy Ratio	15.3%	16.4%	16.1%	17.0%	15.0%
Capital Formation Rate [(Profit After Tax - Cash Dividend) / Equity]	7.2%	9.3%	9.0%	15.4%	8.6%
3 Funding & Liquidity					
Liquid Assets as a % of Deposits & Short term Borrowings	30.4%	36.7%	35.8%	46.3%	39.9%
Funding Diversification (Deposits/(Deposits+Borrowings+Grants))	93.1%	93.1%	93.4%	94.9%	93.9%
Net Advances to Deposits Ratio	80.1%	73.6%	78.4%	62.2%	67.4%

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):

a) Broker Entity Rating
b) Corporate Rating
c) Debt Instrument Rating
d) Financial Institution Rating
e) Holding Company Rating
f) Independent Power Producer Rating
g) Microfinance Institution Rating
h) Non-Banking Finance Companies 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 | Clause 11-(A)(p).
(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 | 17-(a)
(19) PACRA reviews all the outstanding ratings periodically, on annual basis; Provided that public dissemination of annual review and, in an instance of change in rating will be made; | Chapter III | 17-(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 | 17-(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 | 17-(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 | 14-3(f)(vii)
Proprietary Information