The Pakistan Credit Rating Agency Limited

Rating Report

Telenor Microfinance Bank Limited

Report Contents

Rating History

Dissemination Date	Long Term Rating	Short Term Rating	Outlook	Action	Rating Watch
29-Apr-2023	A	A1	Stable	Maintain	Yes
30-Apr-2022	A	A1	Stable	Downgrade	Yes
30-Apr-2021	A+	A1	Negative	Maintain	-
30-Apr-2020	A+	A1	Negative	Maintain	-
30-Oct-2019	A+	A1	Stable	Maintain	-
30-Apr-2019	A+	A1	Stable	Maintain	Yes
07-Nov-2018	A+	A1	Stable	Maintain	Yes
27-Apr-2018	A+	A1	Stable	Maintain	-
23-Nov-2017	A+	A1	Stable	Maintain	-

Rating Rationale and Key Rating Drivers

Telenor MFB ('the Bank') is associated with robust sponsors - Telenor Group (~55%) and the Chinese Fintech equity partner - Ant Financial, through its investment arm, AliPay (Hong Kong) Holding Limited (~45%). Telenor MFB is a mid-tier player in Pakistan’s microfinance sector with ~3.1% share in the total gross loan portfolio as of end-Dec’22. The bank's business profile emanates from its nationwide network of more than 200,000 registered branchless banking agents, serving over 11 million customers every month. Recently, Telenor Microfinance Bank has been granted NOC for a digital banking license in January 2023. TMB has engaged consultants and as per process, TMB is preparing a Transition plan (legal and operational) which will be submitted to SBP by June 2023 for In-principal approval. TMB is ensuring complete readiness for conversion to a Digital Retail bank by the end of 2023. The conversion shall entail the grant of the Digital Retail Bank license which shall replace the existing Microfinance Bank license. Organogram has been redesigned with verticals of payment solutions, productive lending, and consumptive lending. The bank’s strategic vision is focused on digitization with notable developments underway for the growth of the branchless platform, 'Easypaisa'. The ambition of a sustainable consumer platform rests upon increasing acquisition, retention, and transactional throughput in branchless banking (BB) wallet accounts. The Bank's bottom line reported a loss of PKR 7,099mln (Loss in CY21: PKR 10,765mln). During CY22, the fee and commission income was enhanced to PKR 800mln (CY21: PKR 563mln). NPLs of the bank reflected a sizable decline to PKR 736mln (end-Jun21: PKR 2.0bln) whereas the write-off amount also declined YoY. The bank’s external funding primarily consists of deposits, clocking in at PKR 46,598mln as of end-Dec22 (end-Dec21: PKR 39,043mln), reflecting a good increase. The management has undertaken a redesign of the business model, emphasizing the secured portfolio and EMI products due to their perceived growth potential. The digital strategy will be a key driver in the execution of the model. Furthermore, considering the projected outlook of the bank, which suggests the need to absorb substantial cash and accounting losses, its crucial to receive sponsor support through timely and commensurate equity injections. The sponsors have demonstrated their willingness and capacity to support the bank through equity injection in several tranches received in the last years. Moreover, the equity required to be received in CY23 is capped at USD 15mln.

The maintenance in rating represents the bank's plan for growth is in place and the business profile has demonstrated improvement in 1QCY23. The sustenance and growth of critical parameters is expected to flow in quarters to come.

Disclosure

Name of Rated Entity	Telenor Microfinance Bank Limited
Type of Relationship	Solicited
Purpose of the Rating	Entity Rating
Applicable Criteria	Methodology | Microfinance Institution Rating(Jun-22),Methodology | Correlation Between Long-term & Short-term Rating Scales(Jun-22),Methodology | Rating Modifiers(Jun-22)
Related Research	Sector Study | Microfinance(Sep-22)
Rating Analysts	Sehar Fatima | sehar.fatima@pacra.com | +92-42-35869504

Profile

Structure Previously a wholly owned subsidiary of Telenor Pakistan B.V, the bank's ownership changed in November 2018 when Ant Financial, an affiliate fintech company of Alibaba Group, acquired around 34% share through its investment arm, Alipay (Hong Kong) Holding Limited.

Background Telenor Microfinance Bank Limited, incorporated on August 1, 2005, under the Companies Ordinance, 1984 (now Companies Act, 2017) with SECP, commenced operations in September 2005.

Operations The bank offers diverse lending and insurance products tailored to industry-specific needs. These include loans for individual entrepreneurs, salaried persons, and microenterprises. A significant portion of the bank's loan portfolio is dedicated to microcredits for salary-based financing, covering unique requirements such as Agri-financing, dairy financing, solar financing, biogas financing, and low-cost housing schemes.

Ownership

Ownership Structure Initially a wholly owned subsidiary of Telenor Pakistan B.V., the bank received capital injections from Ant Financial in CY18 and CY19, resulting in Ant Financial holding a 45% share by the end of CY19. Telenor Pakistan B.V. still holds the remaining 55% share.

Stability The ownership structure underwent a significant transformation in CY19. The composition of shareholders may continue to change due to the possibility of additional equity infusion, which is necessary to address substantial losses.

Business Acumen Telenor ASA, the parent company of the Telenor Group is a subsidiary of the Government of Norway. It is one of the world's major mobile operators headquartered in Oslo, Norway, with operations across 13 countries. The inclusion of Ant-Financial is considered positive for the bank, as the group is one of the leading fintech conglomerates globally. The bank is well poised to benefit from Ant Financial's strategic vision and direction.

Financial Strength Telenor ASA, the parent company of Telenor Group, is majority owned by the Norwegian government (55% share). Based in Oslo, Norway, Telenor ASA is a major global mobile operator in 13 countries, listed on the Oslo Stock Exchange. The recent sponsorship from Ant Financial, the fintech arm of Alibaba Group, is seen as a positive development due to its strong financial backing.

Governance

Board Structure The overall control vests in a nine-member board of directors (BOD). Four directors, including the chairman - Mr. Irfan Wahab Khan are representatives of the Telenor Group. Due to the emergence of Ant Financial as an equity partner, the Board composition was revised in CY19. Ant Financial is represented by three directors. Two independent directors complete the composition of the board.

Members' Profile The board members carry extensive experience in the telecom industry and financial services. The inclusion of Ant Financial's high-profile individuals has added strength to the overall board members' profile.

Board Effectiveness The board, drawing on extensive expertise in the financial and telecom industries, offers strategic counsel to the bank and conducts regular evaluations of management performance, including the assessment of growth targets.

Transparency EY Ford Rhodes Chartered Accountants are the external auditors of the bank. They expressed an unqualified opinion on the financial statements for the year ended Dec'22.

Management

Organizational Structure The bank has eleven departments, each led by a department head who reports to the CEO. The head of internal audit reports to the Audit Committee. The Senior Management team brings significant experience to their roles.

Management Team The bank underwent several key management changes during CY19. In Oct'19, Mr. Mudassar Aqil, took charge as the CEO, carrying with him over two decades of experience in the banking industry. Mr. Khurram has taken charge as Acting CFO of the bank.

Effectiveness Telenor has established several management committees to effectively manage and oversee operations. One such committee is the executive committee, is in place which comprises the CFO, CHRO (Chief Human Resource Officer), CRO (Chief Risk Officer), and the COO that report directly to the CEO. An asset-liability committee is also in place.

MIS Daily MIS includes reports pertaining to disbursements, repayments, recoveries, and deposits, separately for core and branchless banking operations.

Risk Management Framework Telenor Microfinance Bank has established a robust Risk Division Unit to oversee all associated risks. The bank has developed a comprehensive credit policy manual to guide its risk management framework. TMFB has also developed an in-house system to assess customer credit history and evaluate credit scores for informed lending decisions.

Technology Infrastructure In its branch operations, Telenor Microfinance Bank employs Core Banking Application as its primary banking software, while Ericson's platform is used for branchless operations. Additionally, the bank has implemented solar power setups at select branches to mitigate the challenges posed by electricity load shedding.

Business Risk

Industry Dynamics In Pakistan, the Microfinance Industry (MFI) consists of 50 providers, including 30 microfinance institutions (MFIs). The number of active borrowers continued to increase, with 8.5 million borrowers achieved in CY22, a 5.6% increase compared to CY21. Similarly, the Gross Loan Portfolio (GLP) exceeded PKR 448 billion during CY22, showing a 26.1% increase compared to CY21.

Relative Position As at end-Dec22, the bank held 3.11% (CY21: 2.5%) of the total gross loan portfolio of the microfinance industry, and a 10% share (CY20: 10%), in terms of deposits. Despite declining market share in the past two years due to industry expansion, the bank remains a prominent player due to its footprint in the digital landscape.

Revenue During CY22, the bank earned a markup of PKR 13,773mln (CY21: PKR 9,693mln), an increase of 42% compared to the corresponding period. Additionally, earnings from the branchless banking segment amounted to PKR 5,805mln (CY21: PKR 5,694mln), reflecting an increase.

Profitability During CY22, loss after taxation amounted to PKR 7,100mln (CY21: PKR 10,765mln), which represents an improvement of 34%. Contributing factors include markup expense, which declined by 25% to PKR 1,254mln in CY22 (CY21: PKR 1,927mln). Non-markup expenses experienced a rise to PKR 20,384mln (CY21: PKR 17,323mln).

Sustainability With Telenor Group as the major 55% shareholder and Ant Financial Services Group (ANT) holding 45% of TMB's shares, Telenor Microfinance Bank is committed to creating long-term sustainable shareholders' value.

Financial Risk

Credit Risk The bank's loan book represents a fairly diversified product segmentation, as of end-Dec22, the bank's infection ratio fell to 6% (end-Dec21: 17%). Quantum of NPLs declined YoY (end-Dec22: PKR 736mln, end-Dec21: PKR 2.0bln). Management has cautiously recorded general provisions, relating to branches with high delinquency ratios and control weaknesses.

Market Risk The bank's earning assets comprising deposit accounts, call money lending, and investments in market treasury bills made up 43.5% of its total assets as of end-Dec22 (end-Dec21: 32.5%). Investments such as Market Treasury Bills, tend to provide a hedge against interest rate volatility, along with liquidity support to the bank.

Funding The bank's external funding primarily consists of deposits, clocking in at PKR 46,598mln as of end-Dec22 (end-Dec21: PKR 39,043mln), depicting an increase of 19% during the period under review.

Cashflows & Coverages Subsequent equity injections from shareholders between the year 2018-2021 aggregating in total to USD 235 million including USD 45 million and USD 41 million injected in August 2020 and January 2021 respectively.

Capital Adequacy As of end-Dec22, the bank's CAR fell to 19.2% (end-Dec21: 24.9%), as a result of decline in Tier-I CAR.

PKR mln

Telenor Microfinance Bank Limited Public Unlisted Company	Dec-22	Dec-21	Dec-20	Dec-19
	12M	12M	12M	12M
A BALANCE SHEET				
1 Total Finances - net	10,857	9,788	10,623	21,679
2 Investments	27,972	17,753	11,855	13,773
3 Other Earning Assets	8,508	10,457	13,074	12,149
4 Non-Earning Assets	15,929	15,567	16,245	14,938
5 Non-Performing Finances-net	433	981	468	(1,680)
Total Assets	63,699	54,545	52,265	60,860
6 Deposits	46,598	39,043	36,964	41,171
7 Borrowings	-	-	-	-
8 Other Liabilities (Non-Interest Bearing)	10,890	9,476	10,137	11,642
Total Liabilities	57,488	48,519	47,100	52,813
Equity	6,212	6,026	5,165	8,047
B INCOME STATEMENT				
1 Mark Up Earned	13,773	9,693	11,723	16,614
2 Mark Up Expensed	(1,254)	(1,927)	(2,771)	(3,671)
3 Non Mark Up Income	2,845	2,046	1,455	1,212
Total Income	15,364	9,812	10,407	14,155
4 Non-Mark Up Expenses	(20,570)	(17,323)	(18,814)	(21,070)
5 Provisions/Write offs/Reversals	(1,534)	(2,934)	(2,015)	(8,869)
Pre-Tax Profit	(6,741)	(10,444)	(10,422)	(15,784)
6 Taxes	(359)	(321)	(282)	(447)
Profit After Tax	(7,100)	(10,765)	(10,704)	(16,232)
C RATIO ANALYSIS				
1 Performance				
Net Mark Up Income / Avg. Assets	21.2%	14.5%	15.8%	21.3%
Non-Mark Up Expenses / Total Income	133.9%	176.5%	180.8%	148.8%
ROE	-116.0%	-192.4%	-162.0%	-201.7%
2 Capital Adequacy				
Equity / Total Assets	9.8%	11.0%	9.9%	13.2%
Capital Adequacy Ratio	19.0%	24.9%	18.9%	24.6%
3 Funding & Liquidity				
Liquid Assets / (Deposits + Borrowings Net of Repo)	83.9%	82.9%	57.1%	59.9%
(Advances + Net Non-Performing Advances) / Deposits	24.2%	27.6%	30.0%	48.6%
Current Deposits / Deposits	83.3%	69.0%	58.3%	32.2%
SA Deposits / Deposits	14.4%	8.1%	9.7%	14.6%
4 Credit Risk				
Non-Performing Advances / Gross Advances	6.4%	17.0%	16.5%	21.1%
Non-Performing Finances-net / Equity	7.0%	16.3%	9.1%	-20.9%

Credit Rating

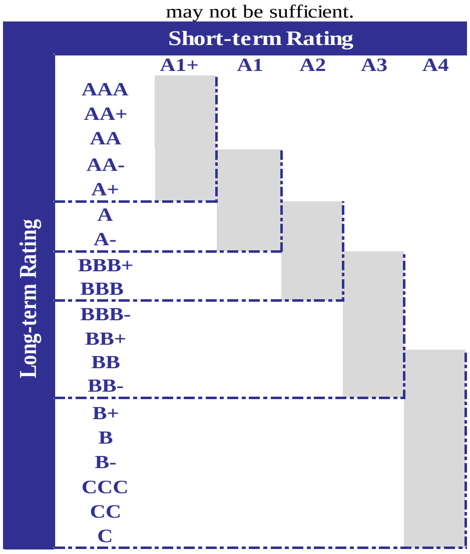
Credit rating reflects forward-looking opinion on credit worthiness of underlying entity or instrument; more specifically it covers relative ability to honor financial obligations. The primary factor being captured on the rating scale is relative likelihood of default.

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

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 | 18-(a)
(19) PACRA reviews all the outstanding ratings on semi-annual basis or as and when required by any creditor or upon the occurrence of such an event which requires to do so; | Chapter III | 18-(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 | 18-(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 | 18-(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-(f-VII)
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