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
27-Apr-2018	A+	A1	Stable	Maintain	-
23-Nov-2017	A+	A1	Stable	Maintain	-
28-Apr-2017	A+	A1	Stable	Maintain	-
28-Apr-2016	A+	A1	Rating Watch	Maintain	-
08-Feb-2016	A+	A1	Stable	RW-Developing	-

Rating Rationale and Key Rating Drivers

The ratings of Telenor Microfinance Bank Limited (the "Bank") reflect strong business profile emanating from growing customer base and sustained relative position in the market. The asset base witnessed escalated growth in 2017 streaming from significant increase in number of active borrowers. The spreads remained strong, though translating into lower bottom-line due to high costs incurred in the branchless banking domain.The Bank accounted for ~20% share in industry deposits for End-Dec’17 and ~12% market share in the industry gross loan portfolio. The Bank is gradually building its non-secured loan base. The financial risk profile of the Bank is strong, with high liquidity. Portfolio at risk of ~1% at End-Dec'17 reflects a strong risk evaluation framework supported by underwriting of loans. Beginning 2017, branchless banking operations – Easypaisa – have been fully transferred to Telenor Microfinance Bank Limited. However, excessive costs incurred on biometric verification systems and agent commissions led to under performance of the branchless banking stream, resulting in low net margins for the year 2017. Overall profitability, however, remained sanguine. The ratings take comfort from association with a strong sponsor – Telenor Group. Going forward, the Bank's plan of entering into strategic partnership venture with Ant Financial - a Chinese Fintech affiliate company of the Alibaba Group, is a significant ingredient in determining the overall strategic direction of the Bank.

The ratings are dependent upon successful execution of strategic partnership with Ant Financial in terms of equity induction and outgrowth of the pursuit into improved strategical dynamics and performance. Meanwhile, maintenance of market position remains important and sustenance of robust asset quality is imperative.

Disclosure	
Name of Rated Entity	Telenor Microfinance Bank Limited
Type of Relationship	Solicited
Purpose of the Rating	Entity Rating
Applicable Criteria	Methodology | MicroFinance Institutions (Jun-17),Methodology | Correlation between long-term and short-term rating scale(Jun-17),Methodology | Criteria Modifiers(Jun-17)
Related Research	Sector Study | Microfinance Bank(Apr-18)
Rating Analysts	Amara Gondal | amara.gondal@pacra.com | +92-42-35869504

TELENOR MICROFINANCE BANK LIMITED	
Incorporation	2005
Legal status	Microfinance Bank – Public Limited
Outreach	85 branches - nationwide
Head Office	Central Commercial Area, Karachi

MICROFINANCE SNAPSHOT

- Composition of 11 Microfinance Banks (MFBs), 16 Microfinance Institutions (MFIs) and 6 Rural Support Programs (RSPs) with a market captivation of ~44%, ~33% and ~19% respectively.
- Gross Loan Portfolio recorded at PKR~202bln at End-Dec17 indicating a growth of ~10% in the 4QCY17.
- Savings increased by ~15% in the 4QCY17 and recorded at PKR~163bln at End-Dec17.
- Sector's outreach grew by over ~6% in the 4QCY17.

PROFILE & OWNERSHIP

- Telenor Microfinance Bank (herein referred to as "the bank") is a wholly owned subsidiary of Telenor Group (Telenor Pakistan B.V., a joint stock company based in Amsterdam which is a subsidiary of Telenor, ASA). In 2016, Telenor Pakistan B.V acquired the bank wholly (remaining ~49% from Telenor Pakistan Pvt. Limited) Subsequent to the acquisition, all revenues and costs pertaining to Branchless Banking are being reflected in the books of the bank, effective Jan-17.
- Mobile banking platform established in 2009 with the name of 'EasyPaisa' with a distribution network of over ~117,000 agents at End-Dec'17.
- Going forward, management is entering into a strategic partnership with Ant Financial – an affiliate Fintech Company of the Chinese Ali Baba Group for injection of ~45% stake in the Bank. Ant Financial is expected to invest USD~184.5mln after fresh equity injections by Telenor Pakistan B.V. in the bank. The focal point of agreement is the provision of advanced digital mobile payment platform to mass users.

GOVERNANCE

- The Board of Directors comprises of 7 members - 3 nominees represent Telenor Pakistan B.V and one independent director on the board.
- The Chairman of the Board, Mr. Petter-Børre Furberg, has a vast experience of ~30 years in the financial sector and has formerly served at the position of the CEO of Telenor Myanmar.
- Three sub-committees are branched from the Board: People, Audit and Risk Management.

MANAGEMENT

- With a change in ownership stake in 2016, several key management positions witnessed significant turnover in the recent past. New inductions, however, represented qualified and experienced professionals.
- Mr. Shahid Mustafa, the President & CEO, has ~23 years of experience in banking and finance. He has been associated with the Board since August 2017. Prior to his joining, Mr. Ali Riaz Chaudhry held the position of the President & CEO.

RISK MANAGEMENT

- Efficient loan disbursement process through introduction of new underwriting technique in CY17 sufficiently upgraded the Risk Management mechanism.
- Centralized multi-tier credit approval process.

ASSET RISK

- Loan Book grew by ~57% YoY in CY17; secured loans declined – making ~27% of the loan portfolio at End-Dec17 (End-Dec16: ~36%), providing sufficient cushion to the State Bank's requirement to keep secured loan book below 35% of the total loan base.
- Infection risk inched up slightly ~1% at End-Dec17 (End-Dec16: ~0.6%), however still relatively effectual with the industry convention.
- Decline in Investment portfolio was witnessed (End-Dec17: ~14% of total assets, End-Dec16: ~32% of total assets), solely comprising of Market Treasury Bills restricting market risk to a significantly low level.

PERFORMANCE

- Relative Market Position sustained in terms of Gross Loan Portfolio (~12% in the Market Share) and declined marginally in terms of Gross Savings (End-Dec17: ~20% in Market Share, End-Dec16: ~23%).
- Core Banking Performance Indicators reflected positive results. However, Branchless Banking encountered a dip in margins owing to high commission and administrative costs. Hence, bottom-line dropped to PKR~417mln in CY17 (CY16: PKR~895mln). Pre-tax profits generated from core banking and loss from branchless banking in CY17 stood at PKR~1,108mln and PKR~421mln respectively. Going forward, the bank is planning on increasing its branchless banking inclination towards M-Wallets.
- During the year 2017, Telenor Microfinance Bank Ltd. has won 2 awards at the Pakistan Banking Awards 'Bank the Unbanked' & 'Best Microfinance Bank'. Lately, the bank has been awarded Mobile Money Certification by GSMA – a global trade body for mobile network operators worldwide. The certification brings the bank at the forefront of mobile money industry and establishes increased confidence of regulators, customers, corporates and financial institutions in the trust of the bank.

FINANCIAL RISK

- Funding constitutes deposits which grew by ~32% in CY17; End-Dec17: PKR~36,665mln (End-Dec16: PKR~27,830mln). CASA constituted ~35% of the total deposit base at End-Dec17.
- Liquidity profile remained stretched at ~43% at End-Dec'17 – backed on deteriorated rationalization of costs.
- CAR declined to ~20% as compared to ~31% in CY16 – a factor of increase in unsecured loans and CAPEX.

Telenor MicroFinance Bank Limited

PKR mln

BALANCE SHEET	31-Dec-17	31-Dec-16	31-Dec-15
Earning Assets			
Advances	24,746	15,850	12,129
Investments (Government Securities)	6,767	11,568	3,784
Deposits with Banks	4,139	2,551	1,103
Lending to Financial Institutions	3,368	323	347
	39,020	**30,292**	**17,363**
Non Earning Assets			
Non-Earning Cash	3,514	3,125	1,603
Net Non-Performing Finances	16	(14)	(4)
Fixed Assets & Others	4,578	2,901	2,094
	8,108	**6,012**	**3,694**
TOTAL ASSETS	**47,128**	**36,304**	**21,057**
Interest Bearing Liabilities			
Deposits	**36,665**	**27,830**	**15,678**
Branch Banking	27,225	23,851	10,183
Branchless Banking	9,440	3,979	5,495
Borrowings	-	-	85
	36,665	27,830	15,763
Non Interest Bearing Liabilities	5,457	3,888	1,605
TOTAL LIABILITIES	**42,122**	**31,718**	**17,368**
EQUITY (including revaluation surplus)	4,981	4,576	3,657
Deferred Grants	25	10	31
Total Liabilities & Equity	**47,128**	**36,304**	**21,057**

INCOME STATEMENT	31-Dec-17	31-Dec-16	31-Dec-15
Interest / Mark up Earned	6,064	4,487	3,503
Interest / Mark up Expensed	(1,767)	(1,113)	(663)
Net Interest / Markup revenue	**4,297**	**3,373**	**2,840**
Direct Branchless Banking pre-tax profits	(421)	63	(9)
Other Operating Income	712	560	350
Total Revenue	**4,588**	**3,996**	**3,182**
Other Income	-	-	167
Non-Interest / Non-Mark up Expensed	(3,629)	(2,486)	(1,987)
Pre-provision operating profit	959	1,510	1,362
Provisions	(271)	(141)	(80)
Pre-tax profit	687	1,369	1,282
Taxes	(271)	(474)	(431)
Net Income	**417**	**895**	**852**

Ratio Analysis	31-Dec-17	31-Dec-16	31-Dec-15
Performance			
ROE	9%	22%	26%
Cost-to-Total Net Revenue	93%	70%	72%
Provision Expense / Pre Provision Profit	28%	9%	6%
Capital Adequacy			
Equity/Total Assets	11%	13%	17%
Capital Adequacy Ratio as per SBP	20%	31%	37%
Loan Loss Coverage			
Non-Performing Advances /Gross Advances	1.0%	0.6%	0.5%
Loan Loss Provisions / Non-Performing Advances	93.8%	114.9%	106.5%
Funding & Liquidity			
Liquid Assets / Deposits and Borrowings	43%	63%	43%
Advances / Deposits	68%	57%	77%
CASA deposits / Total Customer Deposits	51%	53%	70%
Intermediation Efficiency			
Asset Yield	18%	16%	18%
Cost of Funds	6%	5%	4%
Spread	12%	11%	14%
Outreach			
Branches	85	74	66

The Pakistan Credit Rating Agency Limited

ENTITY CREDIT RATING SCALE & DEFINITIONS

Credit rating reflects forward-looking opinion on credit worthiness of underlying entity; 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 Ratings

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 or 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.** "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 Ratings

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 conditions.

B: The capacity for timely repayment is more susceptible to adverse changes in business, economic, or financial conditions.

C: An inadequate capacity to ensure timely repayment.

Rating Watch
Alerts to the possibility of a rating change subsequent to, or in anticipation of, a) some material identifiable event and/or b) deviation from expected trend. But it does not mean that a rating change is inevitable. Rating Watch may carry designation – Positive (rating may be raised, negative (lowered), or developing (direction is unclear). A watch should be resolved within foreseeable future, but may continue if underlying circumstances are not settled.

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 or 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'.

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, a suspended rating should be considered withdrawn.

Withdrawn
A rating is withdrawn on a) termination of rating mandate, b) cessation of underlying entity, c) the debt instrument is redeemed, d) the rating remains suspended for six months, or e) the entity/issuer defaults.

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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

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(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.
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(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)

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(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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