The Pakistan Credit Rating Agency Limited

Rating Report

NRSP Microfinance Bank Limited

Report Contents

Rating History

Dissemination Date	Long Term Rating	Short Term Rating	Outlook	Action	Rating Watch
28-Oct-2019	A	A1	Negative	Maintain	-
29-Apr-2019	A	A1	Negative	Maintain	-
06-Nov-2018	A	A1	Stable	Maintain	-
30-Apr-2018	A	A1	Stable	Maintain	-
31-Oct-2017	A	A1	Stable	Maintain	-
29-Apr-2017	A	A1	Stable	Initial	-

Rating Rationale and Key Rating Drivers

The ratings incorporate the bank's placement in the Microfinance Sector, as witnessed from its ~13% share in MFBs' gross loan portfolio (GLP) and ~11% in the MFBs' deposits. The design of the lending book keeps the concentration high wherein a considerable portion of the loan book is dedicated to crop-linked loans, particularly to sugarcane crops; this, coupled with volatility in system indicators, has significantly impacted the bank's credit quality in 1HCY19, resulting in a considerable rise in infection ratio with a sizable quantum of written-off loans. The management has represented that, towards the end of the calendar year, the bank will be making profits, as the predominant wave of NPLs is over. Management's strategic focus, therefore, calls for a shift towards consolidating the bank's position in the short horizon, including bringing diversity to the product portfolio and exercising a cautious lending approach. Additionally, prudent management perspective is necessitated to keep the bank's capital adequacy in check; augmentation of the same is desirable. The financial risk profile is reflected by reduced on-balance sheet liquidity and bottom-line losses. The ratings, however, take comfort from the association of NRSP Microfinance Bank with the National Rural Support Programme, the major shareholder, and with the three foreign development organizations - IFC, Acumen, and KfW. The major sponsor has expressed explicit intention to support the bank in case there is a need for capital injection.

The ratings capture the need to arrest the deterioration in credit quality and at the same time, sustain - indeed - improve the capital adequacy. The ratings are dependent on the bank's ability to sustain its competitive position in the MFBs market. Reviving asset health is critical.

Disclosure

Name of Rated Entity	NRSP Microfinance Bank Limited
Type of Relationship	Solicited
Purpose of the Rating	Entity Rating
Applicable Criteria	Methodology | Corporate Ratings(Jun-19),Methodology | MFI (Jun-19)
Related Research	Sector Study | Microfinance(Sep-19)
Rating Analysts	Muhammad Usman | muhammad.usman@pacra.com | +92-42-35869504

Profile

Structure NRSP Microfinance Bank Limited ("the Bank") was incorporated as a public unlisted company in October 2008 under Section 32 of the Companies Ordinance, 1984 (now Companies Act, 2017). The bank commenced operations in March-2011 as a nationwide microfinance bank.

Background The bank builds on the experience of its parent institution - National Rural Support Programme (NRSP) which in 2008, spun-off its Micro Enterprise Development Programme (MEDP) into a separate bank – NRSP Microfinance Bank with then portfolio of ~165,000 clients; this kicked-off a solid start for the bank

Operations The bank currently operates with its head office in Bahawalpur, a key district in Southern Punjab which places it closer to its target market. A wide range of financial services is offered by the bank including micro-lending, micro-insurance, Islamic banking products and deposits to the financially excluded individuals living in both urban and rural areas of Pakistan

Ownership

Ownership Structure The Bank is a subsidiary of National Rural Support Program (NRSP) with a shareholding of ~52%. Other shareholders include International Finance Corporation (IFC), Acumen and Kreditanstalt für Wiederaufbau (KfW) – a German based Company, each having ~16% shareholding in the bank.

Stability Continued sponsor support accompanied by stable ownership pattern since inception bodes well for the bank.

Business Acumen NRSP – a nonprofit organization – established in 1991, is an autonomous body limited by government guarantee. NRSP is the largest Rural Support Program in the country in terms of outreach, staff and development activities. Other sponsors including KfW-owned by the Government of Germany, IFC-a member of the World Bank Group and Acumen-incorporated in 2001, share the common purpose to develop under privileged societies of developing economies and encourage financial inclusion.

Financial Strength Good financial position of sponsors strengthens the financial muscle of the bank.

Governance

Board Structure The overall control of the bank vests in nine members board of directors (BOD) including the CEO. The Chairman of the Board is Mr. Rashid Bajwa and Mr. Zahoor Hussain Khan is the CEO/President of the bank. Two independent directors reside the board.

Members' Profile The directors are experienced professionals having exposure in different sectors, including microfinance industry.

Board Effectiveness The Board of directors is branched into three sub-committees namely (i) Audit (ii) Remuneration & Compensation and (iii) Operational Risk and Policy. These committees ensure effective oversight of the bank's affairs and strengthens the board's governance role.

Financial Transparency M/S A.F. Ferguson & Co. are the External Auditors of the bank. The auditor has expressed unqualified opinion on financial accounts of CY18.

Management

Organizational Structure The bank has divided its organization structure in ten departments with each department head reporting directly to the CEO and the head of internal audit reports to the Audit Committee.

Management Team Mr. Zahoor Hussain Khan – the President and CEO – carries over ~23 years of experience in banking and finance and has been associated with the group for long. The CEO is assisted by experienced management team.

Effectiveness To ensure effectiveness of the operations, the bank has four management committees in place namely i) Operation & Risk, ii) Asset Liability (ALCO), iii) IT Steering and iv) Management Committee.

MIS Detailed MIS reports are generated to support the senior management in timely and effective decision making. MIS includes reports pertaining to disbursements, repayments, recoveries, deposits, and compliance

Risk Management Framework The Bank has instituted policies for assessing credit worthiness of loan applicants, which is paramount to its business model. Recently, the bank has particularly steered its focus towards consolidating its position through adapting to more stringent and efficient risk control mechanism.

Technology Infrastructure The bank uses Oracle Flexcube as its core banking software; implemented since 2012. Back to back support contract from Oracle is directly in place to ensure smooth system run.

Business Risk

Industry Dynamics Pakistan Microfinance Industry comprises 45 microfinance providers including 11 Microfinance Banks (MFBs), 18 Microfinance Institutions (MFIs), 7 Rural Support Program (RSPs) and 9 other projects. MFBs dominate the Industry with a share in the lending portfolio of ~70%. The total Gross Loan Portfolio of MFBs amounts to PKR ~206,003mln, recording a meager growth of ~9% during the period.

Relative Position The bank catered ~13% borrowers of MFB's market at End-Jun-19, grabbing ~13% share of the market in terms of Gross Loan Portfolio (GLP) which stood at PKR~26,233mln as at End-Jun-19 (End-Jun18: PKR~23,917mln) with a growth of ~10%. The bank has a market share of ~11% on the deposits side. Although, the bank managed to retain its position in the industry but the growth in gross advances has declined to ~7% in comparison to historical trends as compared to 13% at End Dec-18.

Revenue Interest/ Mark up income of the bank increased to PKR~3,303mln during 1HCY19(1HCY18: PKR~2,984mln). The asset yield of the bank dropped significantly to ~10% at End Jun-19 (CY18:~21%).

Profitability Net mark-up/interest income of the bank decreased to PKR~1,754mln during 1HCY19 (1HCY18: PKR~1,914mln). The bank booked a net loss of PKR~439mln for 1HCY19 whilst the net profit for 1HCY18 was PKR~286mln. The decrease in profitability was majorly led by an increase in provision expenses on accounted of infected credit health, which increased to PKR~1,038mln during 1HCY19 as compared to PKR~501mln in 1HCY18.

Sustainability During 1HCY19, Microfinance Industry has notably absorbed effect of macroeconomic instabilities in its portfolio in the shape of slumped growth and elevated Portfolio At Risk (PAR). NRSP MFB, in terms of affect absorption, has been on the higher end, due to its product mix concentration and other factors. In the short horizon, the bank therefore, plans on devising strategies to regain its credit quality and pace of growth in business volumes to reiterate its stability in the market.

Financial Risk

Credit Risk The Bank's loan book is primarily concentrated in non-collateralized loans while advances continued to be dominated by Agri Input Loan (EndJun19:~64%), followed by Livestock Loan (End-Jun19: ~19%) while the portion of Micro-Enterprise stood at ~15% at End-Jun'19. During the period under review, the bank's NPLs ratio hiked to ~6.9% (End-Dec'18: ~2.7%). The bank has written off advances of PKR~489mln during 1HCY19 (1HCY18: PKR~917mln). The increase is backed on account of non-payments by some sugarcane farmers. Curtailment of NPLs is essential to the profitability of the bank going forward.

Market Risk Short term investments during 1HCY19 decreased to PKR~1,136mln (CY18: PKR~3,323mln). This was majorly due to the extraction of investments from money market mutual funds.

Funding The bank's funding is majorly fueled through deposits, which primarily consisted of time deposits (~70%). Out of the total deposit base of the bank amounting to PKR~27.8bln, Islamic banking deposits constituted ~8%. The bank's advances to deposits ratio (ADR) stood at ~91%, representing restricted funding and growth targets. Since the bank's asset base remained under pressure, it kept the deposit base stagnant to reduce/avoid any pressure exerted on the spread.

Liquidity Liquidity profile shrunk during the period under review as the bank's liquid assets-to-deposits and borrowings ratio stood to ~28% at End-Jun'19 (End-Dec'18: ~34%).

Capital Adequacy Capital adequacy ratio (CAR) of the bank stood at ~15.21% as at End-Jun'19 (End-Dec'18: ~16.61%). Cautious management action is necessitated, to inject capital into the bank in order to keep the CAR above the regulatory benchmark.

NRSP Microfinance Bank Limited

PKR mln

BALANCE SHEET	30-Jun-19	31-Dec-18	31-Dec-17	31-Dec-16
	Bi-annual	Annual	Annual	Annual
Earning Assets				
Finances	24,580	23,432	21,100	13,280
Investments	1,136	3,322	2,551	6,109
Deposits with Banks	6,739	6,128	5,192	4,062
	32,455	**32,882**	**28,843**	**23,451**
Non Earning Assets				
Non-Earning Cash	1,094	1,214	1,674	1,205
Net Non-Performing Finances	791	180	(159)	(96)
Fixed Assets & Others	5,922	4,075	3,231	1,893
	7,808	**5,468**	**4,746**	**3,001**
TOTAL ASSETS	**40,263**	**38,351**	**33,590**	**26,452**
Funding				
Deposits	**27,841**	**26,263**	**23,671**	**16,922**
Branch Banking	27,841	26,263	23,671	16,922
Branchless Banking	-	-	-	-
Borrowings	4,451	5,278	4,053	5,416
	32,292	31,541	27,725	22,338
Non Interest Bearing Liabilities	3,804	2,201	1,851	911
TOTAL LIABILITIES	**36,097**	**33,743**	**29,576**	**23,248**
EQUITY (including revaluation surplus)	4,156	4,598	4,012	3,203
Deferred Grants	9	10	2	1
Total Liabilities & Equity	**40,263**	**38,351**	**33,590**	**26,452**

INCOME STATEMENT	30-Jun-19	31-Dec-18	31-Dec-17	31-Dec-16
Interest / Mark up Earned	3,303	6,332	4,976	3,221
Interest / Mark up Expensed	(1,550)	(2,226)	(2,039)	(1,240)
Net Interest / Markup revenue	**1,754**	**4,105**	**2,937**	**1,981**
Other Operating Income	461	833	871	693
Total Revenue	**2,215**	**4,938**	**3,808**	**2,675**
Other Income	-	-	-	-
Non-Interest / Non-Mark up Expensed	(1,781)	(2,885)	(2,315)	(1,559)
Pre-provision operating profit	434	2,053	1,493	1,116
Provisions	(1,038)	(1,155)	(388)	(155)
Pre-tax profit	(603)	899	1,106	960
Taxes	164	(308)	(284)	(276)
Net Income	**(439)**	**591**	**821**	**685**

Ratio Analysis	30-Jun-19	31-Dec-18	31-Dec-17	31-Dec-16
Performance				
ROE	-11%	14%	23%	24%
Cost-to-Total Net Revenue	80%	58%	61%	58%
Provision Expense / Pre Provision Profit	239%	56%	26%	14%
Capital Adequacy				
Equity/Total Assets	10%	12%	12%	12%
Capital Adequacy Ratio as per SBP	15%	17%	18%	19%
Loan Loss Coverage				
Non-Performing Advances /Gross Advances	6.9%	2.7%	0.3%	0.4%
Loan Loss Provisions / Non-Performing Advances	56%	72%	331%	300%
Funding & Liquidity				
Liquid Assets / Deposits and Borrowings	28%	34%	34%	51%
Advances / Deposits	91%	89%	88%	78%
CASA deposits / Total Customer Deposits	30%	26%	38%	44%
Intermediation Efficiency				
Asset Yield	10%	21%	19%	18%
Cost of Funds	5%	8%	8%	7%
Spread	5%	13%	11%	10%

Credit Rating Scale & Definitions

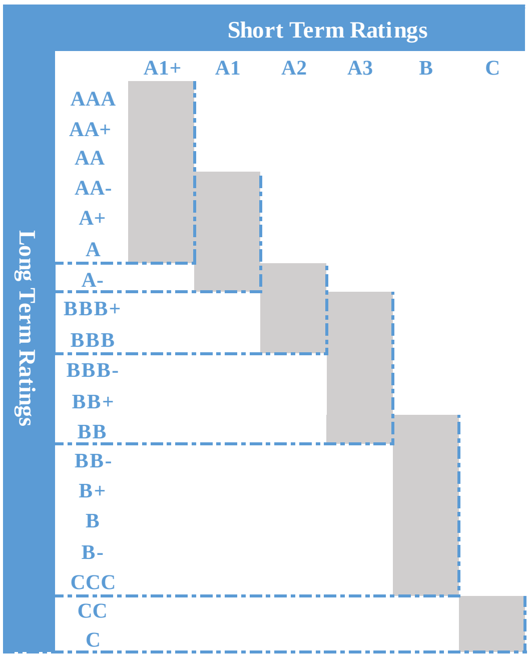
Credit rating reflects forward-looking opinion on credit worthiness of underlying entity or instrument; more specifically it covers relative ability to honor financial obligations. The primary factor being captured on the rating scale is relative likelihood of default.

Long Term Ratings

Rating	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 Ratings

Rating	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 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.



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, a) some material identifiable event and/or b) deviation from expected trend. 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 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) cessation of underlying entity, c) the debt instrument is redeemed, d) the rating remains suspended for six months, e) the entity/issuer defaults., or/and f) 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.

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.
(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)

Proprietary Information