The Pakistan Credit Rating Agency Limited

Rating Report

Sindh Microfinance Bank Limited

Report Contents

Rating History

Dissemination Date	Long Term Rating	Short Term Rating	Outlook	Action	Rating Watch
29-Mar-2024	A-	A2	Stable	Maintain	-
29-Mar-2023	A-	A2	Stable	Maintain	-
29-Mar-2022	A-	A2	Stable	Maintain	-
09-Apr-2021	A-	A2	Stable	Maintain	Yes
30-Apr-2020	A-	A2	Stable	Maintain	Yes
30-Sep-2019	A-	A2	Stable	Maintain	-
18-Apr-2019	A-	A2	Stable	Maintain	-
17-Oct-2018	A-	A2	Stable	Initial	-

Rating Rationale and Key Rating Drivers

The ratings reflect the parentage and association of the bank with a financial institution and ultimately with a sub-sovereign. The bank has a conservative risk appetite. With the changing market conditions, The Bank reported a significant increase in markup earned of PKR ~949.3mln (CY22: PKR~469.6mln) with Profit after Tax of PKR ~91.4mln (CY22: 41.4mln). The asset quality of the Bank improved as the asset infection ratio stood at 0.3% at the end of Dec'23 (CY22: ~3%) the decline in infection ratio was due to write-offs of PKR ~122mln which was related to COVID-19 and July-22 floods, the Bank sustained and absorb the negative impact which arose during the calamity events. A rise in GLP as micro-credit loans were recorded at (CY23: PKR ~1,927mln; CY22: PKR ~1,321mln), which is reflective of the growth in the last year. The lending portfolio concentration is dominated by the flagship product "Sujag Aurat" (Visionary Women), focused on women’s entrepreneurship and financial inclusion. A major share of borrowings has been obtained from the State Bank of Pakistan while a small chunk is through Pakistan Microfinance Investment Corporation. The deposits base of the Bank surged by 1.2x to PKR ~1,323mln (CY22: PKR ~600mln) mainly driven by an increase in the Fixed deposit account with major corporate clientele. On investments side the Bank is highly liquid, covering 98% of the deposit by liquid funds (Govt. securities and TDR). Paid-up Capital reported at the end Dec'23 was PKR ~1000mln complying comfortable with the minimum capital requirement of SBP Prudential regulations for provincial operations, however, the equity of SMFB was recorded at PKR ~1.1bln (CY22: PKR ~1bln). As per the management representation the Sindh Microfinance Bank has applied to the State Bank of Pakistan to obtain a License for nationwide operations. The Capital adequacy ratio of the Bank stood at ~47.21%, which is above the minimum CAR requirement by the State Bank of Pakistan. The ratings draw comfort from the Bank's association with the Government of Sindh.

The rating represents the bank’s plan for growth in place while the business profile has demonstrated improvement in CY23. Going forward the rating would remain dependent on the maintenance of liquidity position, dilution in depositor's concentration while ensuring the continuous sustainability of the Bank.

Disclosure

Name of Rated Entity	Sindh 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	Madiha Sohail | madiha.sohail@pacra.com | +92-42-35869504

Profile

Structure Sindh Microfinance Bank Limited was incorporated with the Securities and Exchange Commission of Pakistan on March 27, 2015 under Section 32 of the Companies Ordinance, 1984 (now Companies Act, 2017).

Background The Bank was established as a wholly owned subsidiary of Sindh Bank Limited and got license to operate as a Microfinance Bank (MFB) from the State Bank of Pakistan (SBP) on October 16, 2015.

Operations The Bank currently operates in the province of Sindh with a network of 19 branches and 77 micro-credit centers. The lending portfolio of the bank is concentrated in its flagship product "Sujag Aurat" (Visionary Women) which is a product exclusively designed for women empowerment. Other products include Fisheries and Livestock Loan. The Head office of the Bank is located in Muhammad Ali Cooperative Housing Society, Karachi.

Ownership

Ownership Structure The Bank is a wholly owned subsidiary of Sindh Bank Limited (the Holding Bank), which is owned by the Government of Sindh through its finance department.

Stability As the Bank is a wholly owned subsidiary of Sindh Bank Limited, the ownership structure of the bank is deemed sound and stable.

Business Acumen The Bank was incorporated as part of the Government of Sindh's initiative to step into the financial sector, for its betterment and growth. Apart from Sindh Bank and Sindh MFB, other entities of the project include Sindh Leasing, Sindh Modaraba, and Sindh Insurance. Sindh Bank has a network of over 330 branches and presence in 169 cities across Pakistan, demonstrating to be a successful commercial bank on a timeline basis

Financial Strength The sponsor's financial muscle is robust. Sindh Bank's equity at the end of Dec'2023 stood at PKR 24.4bln and its gross advances were recorded at PKR 50.6bln.

Governance

Board Structure The overall control of the Bank vests in the seven-member board of directors (BOD) including the President/ CEO. There are five sub-committees on the board.

Members' Profile The board members have cherished extensive experience in financial and banking services

Board Effectiveness Attendance of Board of directors during the meetings was good and minutes were properly documented.

Transparency Sindh MFB appointed new External Auditor Riaz Ahmed & Co. Chartered Accountants, previously Naveed Zafar Ashfaq Jaffery & Co., Chartered Accountants was External Auditors of the Bank. They expressed an unqualified opinion on the financial statements for the year end-Dec23.

Management

Organizational Structure The Bank's structure is divided into different departments. All department heads report directly to CEO and head of internal audit reports directly to Audit Committee. The Bank's functions are distributed among head office, branches and micro-credit centers (also known as financial centers).

Management Team The management team is led by the CEO - Mr. Shoaib Arif. He is a seasoned microfinance practitioner having an experience of over two decades. Prior to Sindh Microfinance Bank Limited, he served as the COO at ASA Pakistan Limited and CEO at ASA Kabul-Afghanistan. The CEO is assisted by experienced management team. Most of them are associated with microfinance industry for more than a decade.

Effectiveness The Bank has a systematic decision-making process. Multiple management committees are formed to monitor performance and assure adherence to policies and procedures

MIS The Bank's core banking software is low in cost and high in quality, it offers advance technology and high availability on both centralized and distributed environments and is highly secure.

Risk Management Framework The Bank is progressing with a well-managed risk control framework by implementation of procedures and limits at the root level of operational activities. This framework is enabling the management to succeed stably in achieving operational efficacy and growing the business size gradually.

Technology Infrastructure The Bank has installed PIBAS software as its core banking solution. The system offers different applications which includes security, centralized limits, reconciliations and others. It offers real time surveillance of branches and financial centers.

Business Risk

Industry Dynamics The microfinance Bank's asset quality witnessed significant impairment due to multiple factors, the high inflationary environment amidst a slowdown in the economy and high interest rate. In Microfinance sector the Microfinance Banks (MFBs) maintained the highest share of the total GLP at ~77%, while NBMFCs (including MFIs and RSPs) made up the remaining ~23% during CY23. MFBs' bottom line experienced a negative growth of ~52.7% (CY22: ~112.3%). Thereby, MFBs' equity continued to decline in CY23 by ~14.5%. Rising NPLs have been a major sign of concern for the MFBs sector. This issue not only stems from the fresh portfolio disbursed, but also due to carried-forward loan portfolio against the deferments allowed during pandemic breakout. In CY23, the MFBs' NPLs increased to ~9.5% (~8.8% in CY22). Due to persistent losses and equity erosion, the MFBs sector capital structure also reflects a deteriorated outlook with overall CAR of the sector falling way below the regulatory benchmark of 15.0% to ~7.6%in CY23. The Sector's Gross Loan Portfolio (GLP) clocked in at PKR~408bln as at End-Dec'23, up ~12.8% since End-Dec'22, when it recorded at PKR~361bln. However, during CY23, the sector's NPLs increased by ~12.3%, which is lower than the increase in NPLs during CY22 when the growth rate stood at ~61.8%. In terms of GLP, top 3 microfinance banks during 1HCY23 were Habib MFB, Khushhali MFB and U MFB with ~21.0%, ~20.0% and ~20.0% shares respectively. In terms of deposits, U MFB , Khushhali MFB and Habib MFB are the top 3 microfinance Banks with each having a share of ~19.0%.

Relative Position The Bank currently holds very small market share in terms of GLP but it is rapidly growing and looking forward to enhance its lending portfolio.

Revenue The Bank's markup earned increased to PKR 949.3mln in CY23 (CY22: PKR 470mln), up by 102% owing to an increase in markup earned on advances mainly driven by the high growth in the loan portfolio.

Profitability The rise in non-markup expenses by 31.2%, stood at PKR 359.5mln (CY22: PKR 274mln). This is mainly due to a significant increase in compensation expenses and depreciation expenses which relates to IFRS-16 . The Bank recorded a provision of PKR 129mln (CY22: PKR 14mln) & taxes reported as (CY23: PKR 39.3mln; CY22: PKR 16mln), translated into a PAT of PKR 91.4mln (CY22: PKR 41mln).

Sustainability Going forward the Bank will focus to increase its loan portfolio, with a cautious approach. The remarkable stability of the bank is evidenced by its consistent profitability over the span of nine years, a feat unmatched by any other microfinance institution. In alignment with its expansion initiatives, the Bank has formally applied to the State Bank of Pakistan for the license to operate bank nationally.

Financial Risk

Credit Risk The Bank has an effective loan disbursement and recovery monitoring system which has the necessary checks and independent verification required to make a critical assessment. During the year, Sindh MFB's gross micro-credit advances reported a rise of 46% on a YoY basis (CY23: PKR 1,927.37mln; CY22: PKR 1,321mln). Hence, the Bank reclaimed its previous growth trajectory. The Bank's credit portfolio is majorly concentrated on its single product "Sujag Aurat Loan".

Market Risk The Bank's investment in government securities witnessed a rise to PKR 144.4mln at end-Dec'23 (at end-Dec'22: PKR 54.78mln), and exposure lies within the T-bills. Also, Sindh MFB invested in the TDRs of PKR ~500mln

Funding At end-Dec'23, the Bank reported a borrowing of PKR ~721mln, the bank obtained borrowing from the SBP under the Line of Credit Scheme of PKR 310mln and PKR ~150mln from PMIC (at end- Dec'22: PKR 310mln From SBP line of Credit scheme).

Cashflows & Coverages At end-Dec'23, Sindh MFB's deposits increased to PKR 1,323mln (at end- Dec'22: PKR 600mln), similarly, institutional deposits also increased to PKR 1,049mln (at the end- Dec'22: PKR 331mln).

Capital Adequacy As the Bank established its loan book, its capital adequacy ratio (CAR) stood at 47.21% as of Dec'23 compared to 63.4% as of end-Dec '22.

PKR mln

Sindh MicroFinance Bank Public Unlisted Limited	Dec-23 12M	Dec-22 12M	Dec-21 12M	Dec-20 12M	Dec-19 12M
A BALANCE SHEET					
1 Total Finances - net	1,921	1,285	920	525	830
2 Investments	644	55	26	13	19
3 Other Earning Assets	578	412	894	1,142	934
4 Non-Earning Assets	287	269	248	220	123
5 Non-Performing Finances-net	(16)	18	(3)	(1)	2
Total Assets	3,415	2,039	2,085	1,899	1,908
6 Deposits	1,323	600	271	139	126
7 Borrowings	721	345	806	771	830
8 Other Liabilities (Non-Interest Bearing)	264	50	39	46	62
Total Liabilities	2,309	995	1,116	956	1,018
Equity	1,106	1,012	969	943	890
B INCOME STATEMENT					
1 Mark Up Earned	949	470	345	362	347
2 Mark Up Expensed	(329)	(125)	(62)	(80)	(71)
3 Non Mark Up Income	-	-	-	-	-
Total Income	620	345	284	283	276
4 Non-Mark Up Expenses	(360)	(274)	(223)	(198)	(194)
5 Provisions/Write offs/Reversals	(130)	(14)	(15)	(14)	(13)
Pre-Tax Profit	131	57	45	70	69
6 Taxes	(39)	(16)	(18)	(17)	(16)
Profit After Tax	91	41	27	53	52
C RATIO ANALYSIS					
1 Performance					
Portfolio Yield	48.1%	34.8%	34.7%	35.2%	36.9%
Minimum Lending Rate	50.1%	36.4%	40.8%	42.2%	38.5%
Operational Self Sufficiency (OSS)	116.0%	113.9%	115.0%	124.0%	124.7%
Return on Equity	8.6%	4.2%	2.8%	5.8%	6.0%
Cost per Borrower Ratio	5,126.6	4,592.8	4,998.1	5,507.9	5,385.3
2 Capital Adequacy					
Net NPL/Equity	-1.4%	1.8%	-0.3%	-0.1%	0.2%
Equity / Total Assets (D+E+F)	32.4%	49.6%	46.5%	49.6%	46.6%
Tier I Capital / Risk Weighted Assets	45.5%	61.8%	71.9%	96.8%	75.4%
Capital Adequacy Ratio	47.2%	63.4%	73.4%	98.3%	76.8%
Capital Formation Rate [(Profit After Tax - Cash Dividend) / Equity]	9.0%	4.3%	2.8%	5.9%	5.9%
3 Funding & Liquidity					
Liquid Assets as a % of Deposits & Short term Borrowings	60.6%	82.7%	350.9%	850.8%	763.5%
Demand Deposit Coverage Ratio	293973.0%	399984.8%	763111.7%	397250.2%	8916.6%
Liquid Assets/Top 20 Depositors	61.9%	357.1%	684.2%	852.9%	766.2%
Funding Diversification (Deposits/(Deposits+Borrowings+Grants))	64.7%	63.5%	25.2%	15.3%	13.2%
Net Advances to Deposits Ratio	144.0%	217.0%	338.5%	376.3%	657.7%
4 Credit Risk					
Top 20 Advances / Advances	0.2%	8.3%	11.8%	20.7%	11.8%
PAR 30 Ratio	0.3%	2.8%	1.1%	1.0%	2.0%
Write Off Ratio	0.0%	0.0%	0.0%	0.0%	0.0%
True Infection Ratio	0.3%	2.8%	1.1%	1.0%	2.0%
Risk Coverage Ratio (PAR 30)	363.0%	49.8%	126.0%	116.3%	87.2%

Credit Rating

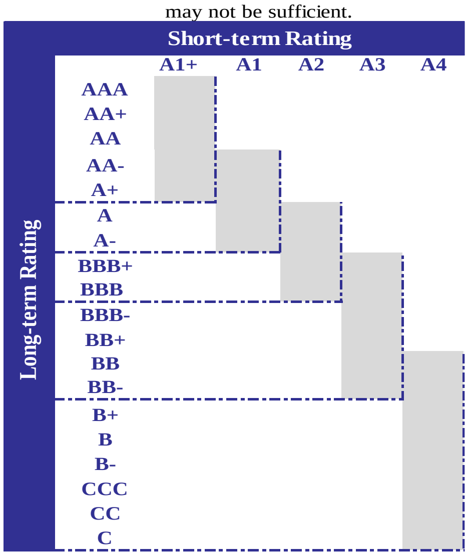
Credit rating reflects forward-looking opinion on credit worthiness of underlying entity or instrument; more specifically it covers relative ability to honor financial obligations. The primary factor being captured on the rating scale is relative likelihood of default.

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