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
17-Oct-2018	A-	A2	Stable	Initial	-

Rating Rationale and Key Rating Drivers

The ratings capture strength of the bank as a growing institution in the Microfinance sector. Loan book is gradually building up. The bank's business model incorporates appropriate controls to keep its risk profile sound. Asset infection ratio of the bank is currently NIL, but complying with the requirements of prudential regulations, the bank has recorded a general provision of 1%. Current design of the lending portfolio represents concentration in the flagship product "Sujag Aurat" (Visionary Women), focused on women entrepreneurship and financial inclusion. Livestock loan is the next product in line. Funding is currently being fueled through internal capital and sponsor support in the form of borrowings. The bank's focal strategy is pivoted around Sindh with plans to go national. Going forward, the bank eyes on raising funds from various channels to expand its business volume. The bank's financial profile attracts comfort from its association with the Government of Sindh. Investments in non-earning assets is low. Liquidity profile is reflected by saving deposits and TDRs placed with financial institutions.

The ratings are dependent on the bank's ability to sustain its growth trend in the MFBs market. Seamless governance practices are important. The ratings would also take into consideration funding strategies adopted by the management to fuel growth in the lending portfolio. Meanwhile, maintenance of asset health is of significance.

Disclosure

Name of Rated Entity	Sindh Microfinance Bank Limited
Type of Relationship	Solicited
Purpose of the Rating	Entity Rating
Applicable Criteria	Methodology | Criteria | Rating Modifier(Jun-18),Methodology | Correlation Between Long-Term And Short-Term Rating Scale(Jun-18),Methodology | MFI (Jun-18)
Related Research	Sector Study | Microfinance Bank(Apr-18)
Rating Analysts	Nadeem Sheikh | nadeem.sheikh@pacra.com | +92-42-35869504

Profile

Structure Sindh Microfinance Bank Limited (hereinafter referred to as "the bank") 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). The Head office of the bank is located in Muhammad Ali Cooperative Housing Society, Karachi.

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 13 branches and 47 micro-credit centers. Lending portfolio of the bank is concentrated in its flagship product "Sujag Aurat" (Visionary Women) which is a product exclusively designed for women empowerment. Another product "Fisheries Loan" in the category of non-farm agri loan was also launched in early 2017. Livestock is the next product in line.

Ownership

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

Stability As the Bank is 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 300 branches and presence in 151 cities across Pakistan, demonstrating to be a successful commercial bank on a timeline basis.

Financial Strength Sponsor financial muscle is robust. Sindh Bank's equity as at End-Dec, 2017 stood at PKR~16 billion and its net mark-up/interest income and bottom-line were recorded at PKR~5.3 billion and PKR~1.3 billion respectively.

Governance

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

Members' Profile The board members are cherished with extensive experience in financial and banking services.

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

Financial Transparency Grant Thorton Anjum Rehman, Chartered Accountants are the External Auditors of the bank. They expressed an unqualified opinion on the financial statements for the year Ended Dec, 2017.

Management

Organizational Structure The Bank's structure is divided into different departments. All department heads report directly to Chief Executive Officer 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 Mr. Shoaib Arif, the CEO, 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 through its initial years 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 Pakistan Microfinance Industry (MFI) comprises of 44 microfinance providers including 11 Microfinance Banks (MFBs), 17 Microfinance Institutions (NBMFCs), and 7 Rural Support Programs (RSPs) and 9 other projects. Microfinance Bank's share in total microfinance lending portfolio is ~68%.

Relative Position Sindh MFB is a relatively new player in the Microfinance sector. It entered the market in May 2016. 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 revenue during 1HCY18 increased by 92%. The revenue increased due to surge in interest income earned on loan and advances. Going forward, the bank is keen to generate the earning from its core business.

Profitability Despite the increase in borrowing the bank's spread manged to increase in 1HCY18 due to good utilization of available funds. The bank during the period under review reduced its balances with other banks by PKR 71 million and increase its advances by PKR 148 million. Channeling of funds to high yield advances help the fund to increase its profitability during 1HCY18.

Sustainability Going forward the bank will focus to increase its loan portfolio. To achieve the stated objective the bank will increase its both geographical presence and its funds base for loan portfolio. To increase its geographical presence the bank is planning to go on national level to tap the potential market and to increase its funds base, the bank will secure loans from different lenders.

Financial Risk

Credit Risk To manage the credit risk the bank has multi-tier credit approval process in place that has the necessary checks and independent verification required to make critical assessment. Every borrower goes through multiple verification processes which includes interview with financial center in-charge and branch manger . Further different threshold are placed to cap the the authority to approve the amount of loan, to keep the overall bank credit risk in-check.

Market Risk Currently, the bank exposure to interest rate risk is low as the bank's borrowing is relatively low. The market risk is expected to increase going forward as the bank will increase its funding base.

Funding Currently, the bank is relying on internally generated cash to meets its funding needs but the funding mix is expected to change as the bank is keen to secure borrowings to meet its funding requirements.

Liquidity The bank's current liquidity requirements are being met from its internal capital. Term deposit receipts (TDRs) placed with other banks earn the bank an average interest income ranging between 7.5% - 9.5%. Investments in Government Securities are however not a part of the management's current strategy.

Capital Adequacy As the bank is in initial stage of establishing its loan book, its capital adequacy ratio (CAR) stood at a high of ~131% as at June'18. This is expected to reduce, going forward, as the bank enlarges its loan portfolio. The bank's equity clocked in at PKR~815mln as on June'18, thus fulfilling the minimum capital requirement (MCR) for MFBs operating in a specific province.

The Pakistan Credit Rating Agency Limited

Sindh Microfinance Bank Limited

PKR mln

BALANCE SHEET	30-Jun-18	31-Dec-17	31-Dec-16	31-Dec-15
	6M	Annual	Annual	Annual
Earning Assets				
Total Finances	492	342	69	0
Investments	0	0	0	0
Deposits with Banks	352	424	680	756
	844	**766**	**749**	**756**
Non Earning Assets				
Non-Earning Cash	5	1	2	0
Net Non-Performing Finances	-5	-3	-1	0
Fixed Assets & Others	51	41	30	12
	51	**38**	**31**	**12**
TOTAL ASSETS	**895**	**804**	**781**	**768**
Interest Bearning Liabilities				
Deposits				
CASA	0	1	1	0
Time Deposits	0	0	0	0
	0	1	1	-
Borrowings	77	-	-	-
Non Interest Bearing Liabilities	3	3	2	2
TOTAL LIABILITIES	**80**	**5**	**3**	**2**
EQUITY (including revaluation surplus)	**815**	**799**	**778**	**765**
Deferred Grants	**0**	**0**	**0**	**0**
TOTAL LIABILITIES & EQUITY	**895**	**804**	**781**	**768**

INCOME STATEMENT	30-Jun-18	31-Dec-17	31-Dec-16	31-Dec-15
Interest / Mark up Earned	96	120	61	39
Interest / Mark up Expensed	(2)	(0)	-	-
Net Interest / Markup revenue	**94**	**120**	**61**	**39**
Other Operating Income	(1)	0	0	-
Total Revenue	**93**	**120**	**61**	**39**
Other Income	-	-	-	-
Non-Interest / Non-Mark up Expensed	(69)	(86)	(39)	(15)
Pre-provision operating profit	24	34	21	23
Provisions	(2)	(3)	(1)	-
Pre-tax profit	22	31	21	23
Taxes	(7)	(9)	(8)	(8)
NET INCOME	**15**	**22**	**12**	**15**

Ratio Analysis	30-Jun-18	31-Dec-17	31-Dec-16	31-Dec-15
Performance				
ROE	4%	3%	2%	2%
Cost-to-Total Net Revenue	74%	71%	65%	39%
Capital Adequacy				
Equity/Total Assets	91%	99%	100%	100%
Capital Adequacy Ratio as per SBP	131%	170%	369%	0%
Loan Loss Coverage				
Non-Performing Advances /Gross Advances	NA	NA	NA	NA
Loan Loss Provisions / Non-Performing Advances	NA	NA	NA	NA
Funding & Liquidity				
Liquid Assets / Deposits and Borrowings	NA	NA	NA	NA
Advances / Deposits	NA	NA	NA	NA
CASA deposits / Total Customer Deposits	100%	100%	100%	NA
Intermediation Efficiency				
Asset Yield	24%	16%	8%	5%
Cost of Funds	8%	0%	0%	0%
Spread	16%	15%	8%	5%
Outreach				
Branches	13	5	5	-

Rating Scale

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.

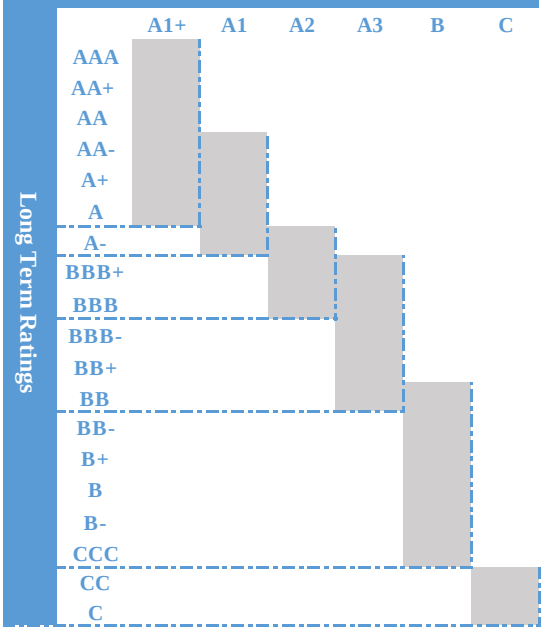
Long Term Ratings

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

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.

Short Term Ratings



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.

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