



The Pakistan Credit Rating Agency Limited

Rating Report

Sindh Microfinance Bank Limited

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Rating History

Dissemination Date	Long Term Rating	Short Term Rating	Outlook	Action	Rating Watch
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 capture the strength of the bank as a growing institution in the Microfinance sector. The loan book is gradually building up, which is primarily constituted of group lending arrangement. The bank's business model incorporates appropriate mitigant controls to keep its risk profile adequate. Asset infection ratio stands at 0.3%, resonating with the life of the bank. The current design of the lending portfolio represents concentration in the flagship product "Sujag Aurat" (Visionary Women), focused on women entrepreneurship and financial inclusion. The bank's funding needs are currently being fueled through a mixture of internal and external sources. Additionally, the funding has also been obtained from State Bank of Pakistan on a relatively low cost. Deposit mobilization has also come into play, though relatively small in quantum. The bank has presence in Sindh with plans to go national. A risk-averse approach towards expansion is the key essential, with funds being raised from appropriate channels. The ratings draw comfort from the bank's association with the Government of Sindh. The financial risk profile is reflected by sound liquidity, adequate profitability and low investment in non-earning assets.

The ratings are dependent on the bank's ability to sustain its growth trajectory in the MFBs market. Continued good governance practices are important. Meanwhile, prudent management strategies to maintain asset health and keep its risk profile sound amidst expansion is imperative.

Disclosure

Name of Rated Entity	Sindh Microfinance Bank Limited
Type of Relationship	Solicited
Purpose of the Rating	Entity Rating
Applicable Criteria	PACRA_Methodology_MFI_FY19(Jun-19)
Related Research	Sector Study Microfinance Bank(Apr-19)
Rating Analysts	Muhammad Usman muhammad.usman@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 a license to operate as a Microfinance Bank (MFB) from the State Bank of Pakistan (SBP) on October 16, 2015. The management is confident that the bank has no operational and business dependence on its parent.

Operations The bank's lending portfolio 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.

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 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. The bank's 14 branches are dedicated to Islamic banking out of the total branch network.

Financial Strength Sponsor financial muscle is robust. Sindh Bank's equity as at End-Mar, 2019 stood at PKR~10.4 billion and its net mark-up/interest income and bottomline was recorded at PKR~2.7 billion and PKR~1.6 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 Thornton 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, 2018.

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 an experienced management team. Most of them are associated with the 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 comprises 45 microfinance providers including 11 Microfinance Banks (MFBs), 18 Microfinance Institutions (MFIs), 7 Rural Support Program (RSPs) and 9 others projects. MFBs dominate the Industry with a share in lending portfolio of ~70%. The total Gross Loan Portfolio of MFBs amounts to PKR ~206,003mln, recording a meagre growth of ~9% during the period.

Relative Position Sindh MFB is a relatively new player in the Microfinance sector. It entered the market in May 2016. The bank currently holds a very small market share in terms of Gross Loan Portfolio (GLP).

Revenue The bank's revenue was recorded at PKR ~143mln at end Jun'19, an increase of 50% from the same period last year.

Profitability The bank managed to retain its spread during the period by keeping its cost of funds low and asset yield intact. Overall Net Interest/Markup Revenue (NIMR) increased during the period. The bank's profit after taxation was recorded at PKR ~24.3mln at end Jun-19 (Jun:18 PKR ~15.3).

Sustainability In order to achieve the bank's stated objective of growth, it strategizes on increasing its geographical presence in the province of Sindh as well as going national in the medium term. At present, this is majorly being done through arranging funds from external feasible sources including SBP's Line of Credit (LoC) fund. Deposit mobilization has also come into play, which is expected to be accelerated in the coming years.

Financial Risk

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 thresholds are placed to cap the the authority to approve the amount of loan, which keeps 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 largely constituted of SBP's LoC fund loan.

Funding Unlike other MFBs, the bank is majorly funded through borrowings. Deposit mobilization is also initiated, however, in order to manage the bank's performance indicators and rationalize costs, current focus is on borrowings. Going forward, the bank is expected to gradually attract deposits in the medium term.

Liquidity Liquidity profile reflects investments in T-bills, Term deposit receipts (TDRs) and balances with other banks that earn an average interest income ranging between 10.25% - 13.3%.

Capital Adequacy The bank remained compliant with its statutory capital adequacy requirement (CAR) of keeping the ratio to a minimum 15% capital of its risk-weighted assets.



BALANCE SHEET

	30-Jun-19 bi-annual	31-Dec-18 Annual	31-Dec-17 Annual	31-Dec-16 Annual
Earning Assets				
Total Finances	733	587	338	69
Investments	-	-	-	-
Deposits with Banks	929	356	424	680
	1,662	943	762	749
Non Earning Assets				
Non-Earning Cash	6	13	1	2
Net Non-Performing Finances	(6)	(4)	-	-
Fixed Assets & Others	82	51	41	30
	81	60	42	32
TOTAL ASSETS	1,744	1,003	804	781
Interest Bearing Liabilities				
Deposits				
CASA	69	78	1	1
Time Deposits	-	-	-	-
	69	78	1	1
Borrowings	750	77	-	-
Non Interest Bearing Liabilities	63	12	3	2
TOTAL LIABILITIES	882	166	5	3
EQUITY (including revaluation surplus)	862	837	799	778
Deferred Grants	-	-	-	-
TOTAL LIABILITIES & EQUITY	1,744	1,003	804	781

INCOME STATEMENT

	30-Jun-19 bi-annual	31-Dec-18 Annual	31-Dec-17 Annual	31-Dec-16 Annual
Interest / Mark up Earned	143	207	120	61
Interest / Mark up Expensed	(20)	(5)	(0)	-
Net Interest / Markup revenue	123	202	120	61
Other Operating Income	-	-	0	0
Total Revenue	123	202	120	61
Other Income	-	-	-	-
Non-Interest / Non-Mark up Expensed	(85)	(146)	(86)	(39)
Pre-provision operating profit	38	57	34	21
Provisions	(4)	(5)	(3)	(1)
Pre-tax profit	34	52	31	21
Taxes	(10)	(14)	(9)	(8)
NET INCOME	24	38	22	12

Ratio Analysis

	30-Jun-19 bi-annual	31-Dec-18 Annual	31-Dec-17 Annual	31-Dec-16 Annual
Performance				
ROE	3%	5%	3%	2%
Cost-to-Total Net Revenue	69%	72%	71%	65%
Capital Adequacy				
Equity/Total Assets	49%	83%	99%	100%
Capital Adequacy Ratio as per SBP	-	115%	170%	369%
Loan Loss Coverage				
Impaired Lending / Gross Finances	0%	0%	0%	0%
Loan Loss Provisions / Non-Performing Advances	425%	273%	NA	NA
Funding & Liquidity				
Liquid Assets / Deposits and Borrowings	114%	239%	NA	NA
Finances / Deposits	1050%	750%	NA	NA
CASA deposits / Total Customer Deposits	100%	100%	100%	100%
Intermediation Efficiency				
Asset Yield	9%	24%	16%	8%
Cost of Funds	2%	6%	0%	0%
Spread	6%	18%	15%	8%

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		Short Term Ratings	
AAA	Highest credit quality. Lowest expectation of credit risk. Indicate exceptionally strong capacity for timely payment of financial commitments	A1+	The highest capacity for timely repayment.
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.	A1	A strong capacity for timely repayment.
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.	A2	A satisfactory capacity for timely repayment. This may be susceptible to adverse changes in business, economic, or financial 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.	A3	An adequate capacity for timely repayment. Such capacity is susceptible to adverse changes in business, economic, or financial conditions.
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	The capacity for timely repayment is more susceptible to adverse changes in business, economic, or financial conditions.
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.	C	An inadequate capacity to ensure timely repayment.
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.		



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 surveil the opinion due to lack of requisite information.

Harmonization A change in rating due to revision in applicable methodology or underlying scale.

Disclaimer: PACRA’s ratings are an assessment of the credit standing of entities/issue in Pakistan. They do not take into account the potential transfer / convertibility risk that may exist for foreign currency creditors. PACRA’s opinion is not a recommendation to purchase, sell or hold a security, in as much as it does not comment on the security’s market price or suitability for a particular investor.

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)

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