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 |
|---|---|---|---|---|---|
| 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 capture the aptness 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. Resonating with the market conditions, asset infection ratio rose to ~2% as at End-Dec'19 (~0.4% as at End-Dec'18). The 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. A major share of the funding has been obtained from State Bank of Pakistan on a partially low cost. Deposit mobilization still remains low. 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 with a cautious approach. The ratings draw comfort from the bank's association with the Government of Sindh. The financial risk profile is reflected by sanguine liquidity, adequate profitability and low investment in non-earning assets.
Pitching on satisfactory past performance indicators, the bank's futuristic approach also displays a stable outlook. However, the current scenario of the nationwide lockdown due to the global pandemic - Covid-19, is certain to cast a significant impact on the whole microfinance industry. The key risks culminating from the current crisis are (i) loss of recovery (ii) halt in fresh disbursement and (iii) probable liquidity stretch. Though SBP’s Relief Packages have come handy to the sector in protecting the credit quality of the players, the out-turn of the situation, and its relative impact on the risk profiles of industry players, is yet to unfold in the days to come.

The ratings are dependent upon the bank’s ability to aptly combat the emerging risks under the current scenario in order to keep its business and financial risk profile intact. The ratings are placed under “Watch” particularly to reflect on the challenges arising from COV-19 outbreak and subdued economic activity.

**Disclosure**

| | |
|---|---|
| **Name of Rated Entity** | Sindh Microfinance Bank Limited |
| **Type of Relationship** | Solicited |
| **Purpose of the Rating** | Entity Rating |
| **Applicable Criteria** | Methodology \| MFI (Jun-19),Methodology \| Correlation Between Long-Term And Short-Term Rating Scale(Jun-19) |
| **Related Research** | Sector Study \| Microfinance(Sep-19) |
| **Rating Analysts** | Shazia Afzal \| shazia.afzal@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 17 branches and 58 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. 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** 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 over 330 branches and presence in 169 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-Sep,2019 stood at PKR~14.66 billion and its net mark-up/interest income were recorded at PKR~1.4 billion .

## 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, 2019.

## 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's microfinance industry comprises 38 microfinance providers including 11 Microfinance Banks (MFBs), 17 Microfinance Institutions (MFIs), 6 Rural Support Programmes (RSPs) and 4 other projects. As at End-Dec'19, the total Gross Loan Portfolio (GLP) of the overall industry amounted to PKR~305,753mln (End-Dec'18: PKR~274,707mln), recording a growth of ~11%, on a YoY basis. MFBs dominate the industry with a share in lending portfolio of ~70%. The recent deceleration of growth is a result of deteriorating macroeconomic indicators. Going forward, the outbreak of the pandemic Covid-19, is expected to have a significant impact on the industry, since the consumers are part of a segment, which is deemed to be highly financially vulnerable. Reduced fresh disbursements and loss of recoveries may pose a challenge to the overall industry.

**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 CY19 increased by 37%. The revenue increased due to surge in interest income earned on loan and advances.

**Profitability** Despite the sharp increase in borrowing, the bank's spread manged to increase in CY19 due to good utilization of available funds. Channeling of funds to high yield investments enabled the bank to increase its profitability during CY19.

**Sustainability** Going forward the bank will focus to increase its loan portfolio, with a cautious approach. The effect of Covid-19 is expected to put pressure on the growth prospects, liquidity and future asset infection ratio of all industry players. However, the management asserts to manage and emerge out of the situation stably, while expecting profits to take a dip.

## 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.The loan loss coverage is going downward due to increase in loss provisions. The PAR>30 days stood at PKR~17mln in CY19 (~2%) vs PKR~2mln in CY18 (~0.4%). The GLP of the bank clocked in at PLR~846mln in CY19 vs PKR~590mln in CY18 - YoY increase ~43%.

**Market Risk** Bank's exposure to market risk remains low as its borrowing book majorly comprises SBP's funding through Line of Credit Scheme which has a partially reduced cost.

**Funding** During CY19, the bank obtained borrowing from the SBP under the Line of Credit Scheme, total amounting to PKR 750mln. The cost of the line is partially reduced with interest being paid bi-annually and principal can be paid within five years by 2024

**Liquidity** The bank's liquidity profile is represented by investment in government securities and term deposits with other Microfinance Banks, total being PKR~953mln. As at End-Dec'19, the bank's liquid assets-to-deposits and borrowings stood at ~38%.

**Capital Adequacy** As the bank is establishing its loan book, its capital adequacy ratio (CAR) stood at ~77.3% as at Dec'19. This is expected to reduce further, going forward, as the bank enlarges and diversifies its loan portfolio.

**The Pakistan Credit Rating Agency Limited** | **Financial Summary**

**Sindh Microfinance Bank Limited** | **PKR mln**

| BALANCE SHEET | 31-Dec-19 | 31-Dec-18 | 31-Dec-17 | 31-Dec-16 |
|---|---|---|---|---|
| | Annual | Annual | Annual | Annual |
| **Earning Assets** | | | | |
| Total Finances | 830 | 587 | 338 | 69 |
| Investments | 19 | - | - | - |
| Deposits with Banks | 334 | 356 | 424 | 680 |
| | **1,183** | **943** | **762** | **749** |
| **Non Earning Assets** | | | | |
| Non-Earning Cash | 12 | 13 | 1 | 2 |
| Net Non-Performing Finances | 2 | (4) | - | - |
| Fixed Assets & Others | 111 | 51 | 41 | 30 |
| | **124** | **60** | **42** | **32** |
| **TOTAL ASSETS** | **1,307** | **1,003** | **804** | **781** |
| **Interest Bearing Liabilities** | | | | |
| **Deposits** | | | | |
| CASA | 126 | 78 | 1 | 1 |
| Time Deposits | - | - | - | - |
| | **126** | **78** | **1** | **1** |
| **Borrowings** | 830 | 77 | - | - |
| **Non Interest Bearing Liabilities** | 62 | 12 | 3 | 2 |
| **TOTAL LIABILITIES** | **1,018** | **166** | **5** | **3** |
| **EQUITY (including revaluation surplus)** | 890 | 837 | 799 | 778 |
| **Deferred Grants** | - | - | - | - |
| **TOTAL LIABILITIES & EQUITY** | **1,907** | **1,003** | **804** | **781** |

| INCOME STATEMENT | 31-Dec-19 | 31-Dec-18 | 31-Dec-17 | 31-Dec-16 |
|---|---|---|---|---|
| | Annual | Annual | Annual | Annual |
| Interest / Mark up Earned | 347 | 207 | 120 | 61 |
| Interest / Mark up Expensed | (71) | (5) | (0) | - |
| **Net Interest / Markup revenue** | **276** | **202** | **120** | **61** |
| Other Operating Income | - | - | 0 | 0 |
| **Total Revenue** | **276** | **202** | **120** | **61** |
| Other Income | - | - | - | - |
| Non-Interest / Non-Mark up Expensed | (194) | (146) | (86) | (39) |
| Pre-provision operating profit | 82 | 57 | 34 | 21 |
| Provisions | (13) | (5) | (3) | (1) |
| Pre-tax profit | 69 | 52 | 31 | 21 |
| Taxes | (16) | (14) | (9) | (8) |
| **NET INCOME** | **52** | **38** | **22** | **12** |

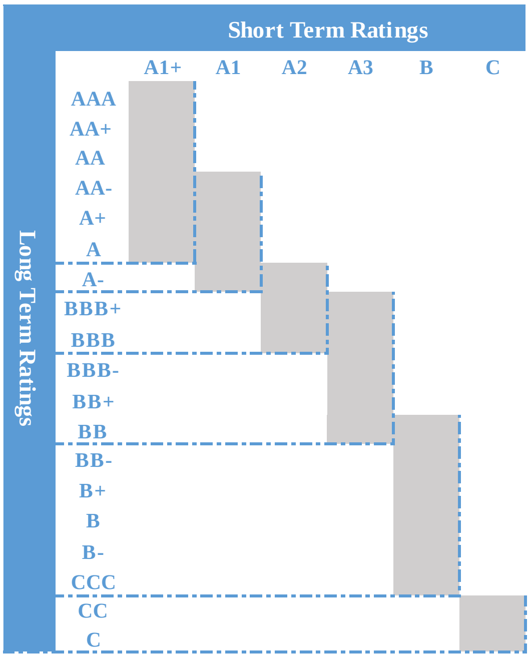
| Ratio Analysis | 31-Dec-19 | 31-Dec-18 | 31-Dec-17 | 31-Dec-16 |
|---|---|---|---|---|
| **Performance** | Annual | Annual | Annual | Annual |
| ROE | 6% | 5% | 3% | 2% |
| Cost-to-Total Net Revenue | 70% | 72% | 71% | 65% |
| **Capital Adequacy** | | | | |
| Equity/Total Assets | 47% | 83% | 99% | 100% |
| Capital Adequacy Ratio as per SBP | - | 115% | 170% | 369% |
| **Loan Loss Coverage** | | | | |
| Impaired Lending / Gross Finances | 2% | 0% | 0% | 0% |
| Loan Loss Provisions / Non-Performing Advances | 87% | 273% | NA | NA |
| **Funding & Liquidity** | | | | |
| Liquid Assets / Deposits and Borrowings | 38% | 239% | NA | NA |
| Finances / Deposits | 658% | 750% | NA | NA |
| CASA deposits / Total Customer Deposits | 100% | 100% | 100% | 100% |
| **Intermediation Efficiency** | | | | |
| Asset Yield | 25% | 24% | 16% | 8% |
| Cost of Funds | 13% | 6% | 0% | 0% |
| Spread | 13% | 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 | |
|---|---|
| AAA | **Highest credit quality.** Lowest expectation of credit risk. Indicate exceptionally strong capacity for timely payment of financial commitments |
| AA+<br>AA<br>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+<br>A<br>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+<br>BBB<br>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+<br>BB<br>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+<br>B<br>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<br>CC<br>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. |




**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**