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
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 capture the aptness of the Bank as a growing institution in the microfinance sector. The Bank's business model incorporates appropriate mitigant controls to keep its risk profile adequate. Resonating with the market conditions, asset infection ratio stood at ~1% as at end-Dec'20. The Bank has sustained its net profitability, being recorded at PKR 53mln as at end-Dec’20. There has been a dip in loan book size, reflecting caution while the cash deposits have grown. 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.

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 COVID-19 outbreak and subdued economic activity. While the economic activity has risen, the uncertainty as to sustained recovery still prevails.

Disclosure	
Name of Rated Entity	Sindh Microfinance Bank Limited
Type of Relationship	Solicited
Purpose of the Rating	Entity Rating
Applicable Criteria	Methodology | MFI (Jun-20),Methodology | Correlation Between Long-Term And Short-Term Rating Scale(Jun-20),Criteria | Rating Modifier(Jun-20)
Related Research	Sector Study | Microfinance(Sep-20)
Rating Analysts	Muhammad Noor Ul Haq | noorulhaq@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 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. 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 wholly owned subsidiary of Sindh Bank Limited, the ownership structure of the Bank is deemed sound and stable.

Business Acumen Sindh Bank, which has a major stake in Sindh MFB on behalf of Govt. of Sindh (GoS), stands to provide it with the industry-specific working knowledge and strategic thinking capability as it has a wide acquaintance of the industry.

Financial Strength With strong financial muscle, the Holding Bank’s equity stood at PKR18bln and its deposits were recorded at PKR 136bln as at end-Mar’20.

Governance

Board Structure The overall control of the Bank vests in seven-member board of directors (BOD) including the President/ CEO.

Members’ Profile The board members are cherished with extensive experience in financial and banking services. Mr. Shams-ud-din Khan is the Chairman of the board. He has an overall experience of over ~40 years in the financial sector and is currently associated with Sindh Bank.

Board Effectiveness The presence of independent directors brings objective analysis of the board’s strategic moves and therefore, augments well for the governance of the Bank. Attendance of Board members during the meetings was good and minutes were properly documented.

Transparency Naveed Zafar Ashfaq Jaffery & Co., Chartered Accountants are the External Auditors of the Bank. They expressed an unqualified opinion on the financial statements for the year end-Dec20.

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 Board 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. Meetings are held usually on monthly basis. Minutes of meetings are adequately documented

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 39 microfinance providers including 11 Microfinance Banks (MFBs), 17 Microfinance Institutions (MFIs), 6 Rural Support Programmes and 4 other projects. As a result of general economic slowdown most indicators of the microfinance sector reflected mixed trend. However, the restrictions are being lifted in a phased manner and the degree of relaxations varies across regions depending upon the severity of COVID-19 pandemic. Deposits of the MFBs stood at (CY20: PKR 373,084mln; CY19: PKR 266,195mln), showing a growth of 40.2% as compared to 11.6% growth in CY19. Deployment of funds was largely skewed towards investments and particularly towards government instruments due to favorable interest rate dynamics (CY20: PKR 96,774mln; CY19: PKR 52,169mln). The gross advances of MFBs clocked in at PKR 239,345mln (CY19: PKR 214,942mln) grew by 11.3%. The infection ratio for MFBs declined from 5.3% to 3.3% whereas it increased for the MFIs from 4.2% to 4.9%. However, the MFBs witnessed some improvements in its profitability, net loss reduced to PKR 5,883mln (CY19: 8,117mln) due to an increase in mark-up earned on loan & advances, which translated positively in other profitability indicators.

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 Despite the multiple challenges due to COVID-19 and locust attack during CY20, the Bank’s mark-up earned increased to PKR 362mln in CY20 (CY19: PKR 347mln), up by 4.4% owing to increase in income from deposits by 50.9% on YOY basis. Whereas, the Bank witnessed a decline of 8.9% in mark-up earned on advances mainly due to subdued economic activity. Hence, the Bank’s advances yield decreased to 35.7% (CY19: 37.4%).

Profitability The rise in non-markup expenses by 2.1% to PKR 198mln (CY19: PKR 193mln) is mainly due to increase in fee and subscription expenses given the high proportion of SECP fee. During CY20, the Bank recorded a provision of PKR 14mln (CY19: PKR 13mln) and taxes reported as PKR 17mln (CY19: PKR 16mln). The Bank has sustained its net profitability, being recorded at PKR 53mln as at end-Dec20 (end-Dec19: PKR 52mln). Channeling of funds to placements with financial institutions enabled the Bank to increase its profitability during CY20.

Sustainability Going forward the Bank will focus to increase its loan portfolio, with a cautious approach. The effect of the 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 of the Bank asserts to manage and emerge out of the situation stably.

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 critical assessment. During CY20, Sindh MFB's gross micro-credit advances reported a decline of 37.2% on YoY basis ; CY19: PKR 846mln). Whereas, the Bank reclaimed its previous growth trajectory and witnessed a growth of 11.7% QoQ in its microcredit portfolio to reach PKR 531mln as at end-Dec20. The Bank's credit portfolio is concentrated to its single product " Sujag Aurat Loan" (CY20: 91.5%; CY19: 92.5%).

Market Risk The Bank's total investments (CY20: PKR 13mln; CY19: PKR 19mln) exposure lies within Govt. Securities (i-e T-bills). Resultantly, Bank's exposure to market risk remains low.

Funding During CY20, the Bank obtained borrowing from the SBP under the Line of Credit Scheme, total amounting to PKR 750mln (CY19: 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 During CY20, Sindh MFB’s Individual deposits declined to PKR 19mln (CY19: PKR 26mln) while institutional deposits increased to PKR 120mln (CY19: PKR 100mln). Top-10 deposits concentration of the Bank stood at 13.9% as at end-Dec'20.

Capital Adequacy As the Bank is establishing its loan book, its capital adequacy ratio (CAR) stood at 98.3% as at Dec’20. The Bank’s equity clocked in at PKR 943mln as on CY20, thus fulfilling the minimum capital requirement (MCR) for MFBs operating in a specific province.

PKR mln

Sindh Microfinance Bank Limited Un-listed Public Limited	Dec-20 12M	Dec-19 12M	Dec-18 12M	Dec-17 12M
A BALANCE SHEET				
1 Total Finances - net	525	830	587	338
2 Investments	13	19	-	-
3 Other Earning Assets	1,142	934	356	424
4 Non-Earning Assets	220	123	64	42
5 Non-Performing Finances-net	(1)	2	(4)	-
Total Assets	1,899	1,908	1,003	804
6 Deposits	139	126	78	1
7 Borrowings	771	830	77	-
8 Other Liabilities (Non-Interest Bearing)	46	62	12	3
Total Liabilities	956	1,018	166	5
Equity	943	890	837	799
B INCOME STATEMENT				
1 Mark Up Earned	362	347	207	120
2 Mark Up Expensed	(80)	(71)	(5)	(0)
3 Non Mark Up Income	-	-	-	-
Total Income	283	276	202	120
4 Non-Mark Up Expenses	(198)	(194)	(146)	(86)
5 Provisions/Write offs/Reversals	(14)	(13)	(5)	(3)
Pre-Tax Profit	70	69	52	31
6 Taxes	(17)	(16)	(14)	(9)
Profit After Tax	53	52	38	22
C RATIO ANALYSIS				
1 Performance				
Net Mark Up Income / Avg. Assets	14.8%	19.0%	22.4%	16.1%
Non-Mark Up Expenses / Total Income	70.2%	70.3%	72.0%	71.5%
ROE	5.8%	6.0%	4.7%	2.8%
2 Capital Adequacy				
Equity / Total Assets (D+E+F)	49.6%	46.6%	83.5%	99.4%
Capital Adequacy Ratio	98.3%	76.8%	N/A	N/A
3 Funding & Liquidity				
Liquid Assets / (Deposits + Borrowings Net of Repo)	130.2%	101.0%	239.4%	30946.2%
(Advances + Net Non-Performing Advances) / Deposits	376.3%	657.7%	749.8%	24643.9%
Demand Deposits / Deposits	0.2%	8.6%	17.3%	80.1%
SA Deposits / Deposits	99.8%	91.4%	82.7%	19.9%
4 Credit Risk				
Non-Performing Advances / Gross Advances	1.0%	2.0%	0.4%	0.0%
Non-Performing Finances-net / Equity	-0.1%	0.2%	-0.5%	0.0%

#	Notes
A7	The line includes Liabilities against Assets subject to Finance Lease, amounting to PKR 21.4mln [CY19: PKR 29.7mln]

Credit Rating

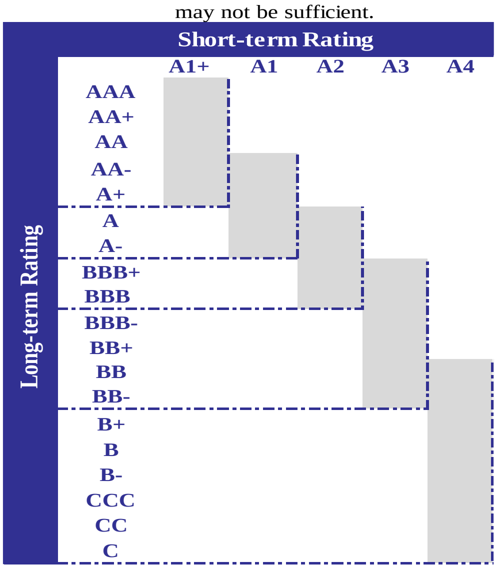
Credit rating reflects forward-looking opinion on credit worthiness of underlying entity or instrument; more specifically it covers relative ability to honor financial obligations. The primary factor being captured on the rating scale is relative likelihood of default.

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):

Entities
a) Broker Entity Rating
b) Corporate Rating
c) Financial Institution Rating
d) Holding Company Rating
e) Independent Power Producer Rating
f) Microfinance Institution Rating
g) Non-Banking Finance Companies (NBFCs) Rating

Instruments
a) Basel III Compliant Debt Instrument Rating
b) Debt Instrument Rating
c) Sukuk 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.
(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