



The Pakistan Credit Rating Agency Limited

Rating Report

U Microfinance Bank Limited | TFC

Report Contents

1. Rating Analysis
2. Financial Information
3. Rating Scale
4. Regulatory and Supplementary Disclosure

Rating History

Dissemination Date	Long Term Rating	Short Term Rating	Outlook	Action	Rating Watch
04-Jan-2021	AA-	-	Stable	Preliminary	-

Rating Rationale and Key Rating Drivers

The rating of the TFC reflects the coverage of the instrument through the security structure. Among other features of the security structure, 50% of the TFC's amount will be secured against lien on government securities of a similar tenor. The security agent will have the right to en-cash proportionate amount from the pool to settle due payments, should the issuer not be in any eventuality, in a position to make the payment. U Microfinance Bank Limited (UMBL) is a fast growing player in the Microfinance Sector (End-Sep'20: 9.1% market share in total Gross Loan Portfolio). The Bank's ambitious growth strategy encompasses multi-faceted targets focused towards achieving growth in the retail banking segment, developing digital banking platform and building a wholesome treasury book. The Bank's funding needs are primarily fostered through a growing deposit base, coupled with sizable borrowings. Sponsor support is reflected by way of subordinated debt intended to be convertible to Tier-I capital, in order to keep capital adequacy in check. Almost half of the Bank's portfolio is gold backed as on Nov'20. This provides a strong mitigant against potential credit risk. Pandemic (Covid-19) is a concern; its continuity would pose challenges. Average loan size of the Bank is on the higher side in relation to its peers on account of gold backed lending.

The rating is dependent upon the Bank's compliance with the agreed terms.

Disclosure

Name of Rated Entity	U Microfinance Bank Limited TFC
Type of Relationship	Solicited
Purpose of the Rating	Debt Instrument Rating
Applicable Criteria	Methodology MFI (Jun-20), Methodology Debt Instrument (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

The Pakistan Credit Rating Agency Limited

U MICROFINANCE BANK LIMITED TFC - TERMS		INDUSTRY SNAPSHOT
Tenor	4 Years including 1 year grace period	<p>The total Gross Loan Portfolio (GLP) of the overall industry amounted to PKR~300bln (End-Dec'19: PKR 306bln), down by ~2% during 1HCY20. This was majorly attributing to MFIs recording a negative growth of ~7%, while MFBs sustaining a positive growth at ~3%. During 1HCY20, active borrowers of MFBs witnessed an increase of ~7%. Despite the critical scenario, deposit base grew by ~10% clocking in at PKR~294bln, ADR improved to ~75% (CY19: ~80%) attributed to low portfolio growth. Moreover, credit quality continued to suffer on the backdrop of economic fallout due to Covid-19. Performance indicators represented a distressed outlook with low profitability majorly owing to high provisioning costs.</p>
Profit Rate	6M Kibor + 150bps	
Profit Payments	Semi-annually in arrears	
Principal Redemption	6 equal Semi-annual installments from 2 nd year of issue	
Mandated Lead Advisor & Arranger	Bank Alfalah Limited.	

THE INSTRUMENT

ABOUT THE TFC: U Microfinance Bank Limited (UMBL) intends to issue privately placed and secured Term Finance Certificates (TFC) up to PKR 3,500mln (inclusive of a Green Shoe Option of PKR 500mln). Profit will be payable semi-annually in arrears calculated on a 365 day year basis on the outstanding principal amount. The first such profit payment will fall due six (06) months from the Issue date and subsequently every six (06) months thereafter. The basic purpose of the respective issue is to enhance the advances book which will be enabled by the additional liquidity raised through the TFC. Semi-annual principal redemption shall commence from second year from the issue date in 6 equal principal installments and shall continue till the maturity of the TFC.

SECURITY: 50% of the TFC amount is secured against pari-passu charge on the UMBL's debt book, advances and receivables with 25% margin. Whereas, 50% of the Issue amount will be secured against lien on government securities of a similar tenor. In case of varying maturity profile, the issuer will replenish it under the guidance of the Security Agent. In case, UMBL fails to make the profit/principal payment on the relevant due date, the Security Agent reserves the right to realize the cash from the government securities and make payment to the relevant investor within 05 days of the relevant due date without invoking Event of Default (including but not limited to sending out a notice of default). Security Agent is being finalized and expected to be of a good credentials.

THE ISSUER

PROFILE: U Microfinance Bank Limited has been incorporated, under section 32 of the Companies Ordinance, 1984 (Companies Act, 2017). The Bank has a network of more than 200 touch points, across 183 cities and rural areas in Pakistan and offers a wide range of microfinance loans, deposit products, and branchless banking solutions. UMBL's branchless banking offers services under the banner of U Paisa in collaboration with Ufone (Pak Telecom Mobile Limited). The service is offered at nearly 45,000 agent locations across Pakistan, while the head office is situated in Islamabad.

OWNERSHIP: In 2012, Pakistan Telecommunication Company Limited (PTCL) acquired 100% shareholding of Rozgar Microfinance Bank Ltd, which was established in 2003, as a district wide microfinance bank. Henceforth, its name was changed to U Microfinance Bank Limited in 2013 and in the same year SBP granted license for commencement of nationwide microfinance banking operations.

BOARD STRUCTURE: The Board of UMBL consists of nine directors, comprising representatives of Emirates Telecommunication Group Company (Etisalat), PTCL and Government of Pakistan along with two Independent Directors and one Executive Director. Mr. Burak Sevilengul, the Chairman of the Board, has over 24 years of experience.

MANAGEMENT: Mr. Kabeer Naqvi, the President & CEO, is also an Executive Director on the Board of UMBL and has 20 years of professional experience to his name and has been with the Bank since Sep'15. A team of professionals assist him.

FINANCIAL TRANSPARENCY: M/S KPMG Taseer Hadi & Co. Chartered Accountants, are the external Auditors of the Bank. An unqualified audit opinion was expressed on the financial statements for the year ended Dec'19. PACRA has assigned A/ A1 (Single A and A one) ratings to UMBL as on 18th Aug'20.

RISK PROFILE

ADVANCES AND DEPOSITS: UMBL remained the largest contributor in terms of industry's GLP. The lending portfolio is dominated by the livestock (46%) and agriculture (23%) lending whereas the equal monthly installment (EMI) portfolio constitutes 6% of the total portfolio. The Bank has also introduced a micro, small, and medium enterprises (MSME) secured product with gold as collateral across Pakistan.

PERFORMANCE: The gross interest income of the Bank reported to PKR 7,053mln during 9MCY20. An exorbitant rise in interest expense during the year, limited the growth of Net Interest/Mark up Revenue (NIMR) to 11%, during 9MCY20. The Bank's earning assets comprising deposit accounts and investments in market treasury bills made up 18% of its total assets and government securities continue to dominate the overall investment book (55.5%).

CAPITAL AND LIQUIDITY: With the support of PTCL by conversion of Tier-II subordinated debt amounting to PKR 800mln into equity, the equity of the Bank stood at PKR 4.4bln. As at end-Sep20, the CAR of the Bank stood at 21.1%. UMBL regularly monitors its liquidity through its Asset and Liability Management Committee (ALCO) and aligns asset-liability mismatch accordingly. The Bank's liquid ratio stood at 26% as at end-Sep20.



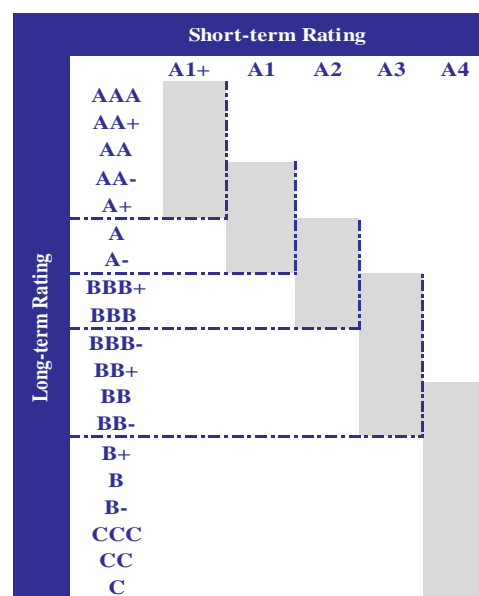
BALANCE SHEET	30-Sep-20	31-Dec-19	31-Dec-18	31-Dec-17
Earning Assets				
Advances	28,138	20,984	17,007	10,600
Investments	3,980	6,970	1,968	1,786
Deposits with Banks	4,967	3,009	11,012	2,579
	37,085	30,963	29,988	14,965
Non Earning Assets				
Non-Earning Cash	2,392	1,728	1,472	781
Net Non-Performing Finances	(242)	390	13	(46)
Fixed Assets & Others	9,558	7,010	3,319	1,931
	11,707	9,127	4,804	2,666
TOTAL ASSETS	48,792	40,090	34,792	17,631
Funding				
Deposits	30,368	23,290	20,535	11,971
Branch Banking	30,368	23,290	20,535	11,971
Branchless Banking	-	-	-	-
Borrowings	12,515	12,684	10,628	3,669
	42,882	35,974	31,163	15,641
Non Interest Bearing Liabilities	1,483	1,065	820	611
TOTAL LIABILITIES	44,366	37,039	31,983	16,252
EQUITY (including revaluation surplus)	4,426	3,051	2,809	1,379
Deferred Grants	-	-	-	-
Total Liabilities & Equity	48,792	40,090	34,792	17,631
INCOME STATEMENT	30-Sep-20	31-Dec-19	31-Dec-18	31-Dec-17
Interest / Mark up Earned	7,053	7,266	4,366	2,645
Interest / Mark up Expensed	(3,226)	(3,843)	(1,676)	(1,152)
Net Interest / Markup revenue	3,827	3,424	2,690	1,493
Branchless Banking Income	-	56	16	44
Other Operating Income	833	840	584	363
Total Revenue	4,660	4,320	3,290	1,900
Other Income	66	39	15	10
Non-Interest / Non-Mark up Expensed	(3,037)	(3,216)	(2,261)	(1,416)
Pre-provision operating profit	1,690	1,143	1,044	494
Provisions	(965)	(838)	(260)	(86)
Pre-tax profit	724	304	784	408
Taxes	(158)	(51)	(237)	(149)
Net Income	566	254	547	259
Ratio Analysis	30-Sep-20	31-Dec-19	31-Dec-18	31-Dec-17
Performance				
ROE	18% *	9%	26%	38%
Cost-to-Total Net Revenue	65%	74%	69%	75%
Provision Expense / Pre Provision Profit	57%	73%	25%	17%
Capital Adequacy				
Equity/Total Assets	9%	8%	8%	8%
Capital Adequacy Ratio as per SBP	21%	17%	19%	16%
Non-Performing Advances /Gross Advances	0.1%	4.3%	1.3%	0.5%
Funding & Liquidity				
Advances / Deposits	92%	92%	83%	88%
CASA deposits / Total Customer Deposits	38%	36%	40%	39%
Intermediation Efficiency				
Asset Yield	25% *	24%	19%	35%
Cost of Funds	10% *	11%	7%	15%
Spread	15%	12%	12%	21%
Outreach				
Branches	212	212	141	100

Credit Rating

Credit rating reflects forward-looking opinion on credit worthiness of underlying debt 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.

Scale	Long-term Rating Definition
AAA	Highest credit quality. Lowest expectation of credit risk. Indicate exceptionally strong capacity for timely payment of financial commitments
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.
AA	
AA-	
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.
A	
A-	
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.
BBB	
BBB-	
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.
BB	
BB-	
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.
B	
B-	
CCC	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.
CC	
C	
D	Obligations are currently in default.

Scale	Short-term Rating 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 conditions.
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 on debt instrument is carried out on an ongoing basis till the maturity of the instrument or cessation of contract. 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.

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(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

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- (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)

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- (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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