The Pakistan Credit Rating Agency Limited

Rating Report

Telenor Microfinance Bank Limited

Report Contents

Rating History

Dissemination Date	Long Term Rating	Short Term Rating	Outlook	Action	Rating Watch
30-Apr-2022	A	A1	Stable	Downgrade	Yes
30-Apr-2021	A+	A1	Negative	Maintain	-
30-Apr-2020	A+	A1	Negative	Maintain	-
30-Oct-2019	A+	A1	Stable	Maintain	-
30-Apr-2019	A+	A1	Stable	Maintain	Yes
07-Nov-2018	A+	A1	Stable	Maintain	Yes
27-Apr-2018	A+	A1	Stable	Maintain	-
23-Nov-2017	A+	A1	Stable	Maintain	-
28-Apr-2017	A+	A1	Stable	Maintain	-

Rating Rationale and Key Rating Drivers

Telenor MFB ('the Bank'), associated with robust sponsors, is a mid-tier player in Pakistan’s microfinance sector with ~2.5% share in total gross loan portfolio as at End-Dec’21. The bank’s strategic vision is focused towards digitization with notable developments underway for growth of the branchless platform, 'Easypaisa'. Ambition of a sustainable consumer platform rests upon increasing acquisition, retention and transactional throughput in branchless banking (BB) wallet accounts. While growth strategies for the Bank have been taken under consideration, overall performance indicators reflected deteriorated outlook in CY21 due to industry wide challenges on Covid relief portfolio side and new IBFT pricing regime. Although the Bank’s GLP recorded a decline over the last two years, the existing portfolio significantly constitutes the loans disbursed under a new and improved credit underwriting model. Bottom line of the Bank reported a loss of PKR 10,765mln (Loss in CY20: PKR 10,704mln). Management’s commitment to recoup the asset health and consolidate the Bank’s position within the stipulated time is an acute necessity. Cognizant of this, the management has redesigned the business model. The focus areas would be secured portfolio and EMI, in which growth potential is being envisaged. Digital strategy is being emphasized as lynchpin to the model. While reach-out is being enhanced, cashless modes of transactions would be adapted mostly. The management has represented that asset quality on the fresh portfolio is good. Easypaisa has reached quite a size in terms of active users, providing multiple transactions. The Easypaisa App is currently one of the largest financial services App in the country and is being looked at as the future of the Bank. In this realm, competition is also increasing . Moreover, since the projected outlook of the Bank indicates absorbing accounting losses, timely yet matching sponsor support through Equity injections is essential. Equity injection of USD 22mln in Jan’22 and probable injection of USD 20mln in Jul’22 represents the willingness and the ability of the sponsors to support the Bank. Though SBP’s Relief Packages have come handy to the sector in protecting the credit quality of the players during the previous waves, 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. Regarding the Covid relief portfolio, TMB management believes that it has taken key steps to recover and has been upfront in recognition of losses by adequately covering the same in the equity funding plan.

The revision in rating represents the challenges that Bank's business and financial risk profile are facing. These impediments are exhibited in net decline in GLP (which is conscious management decision to focus on quality), increasing infection due to Covid relief portfolio resulting in constrained markup earned and accumulating losses.

Disclosure

Name of Rated Entity	Telenor Microfinance Bank Limited
Type of Relationship	Solicited
Purpose of the Rating	Entity Rating
Applicable Criteria	Methodology | Microfinance Institution Rating(Jun-21),Criteria | Correlation Between Long-term & Short-term Rating Scales(Jun-21),Criteria | Rating Modifiers(Jun-21)
Related Research	Sector Study | Microfinance(Sep-21)
Rating Analysts	Sehar Fatima | sehar.fatima@pacra.com | +92-42-35869504

Profile

Structure Telenor Microfinance Bank Limited (hereinafter referred to as "Telenor" or "The Bank") was incorporated with the SECP in 2005, under the Companies Ordinance, 1984 (now the Companies Act, 2017). The head office of the bank is located in the Central Commercial Area, Karachi.

Background The Bank was previously a wholly owned subsidiary of Telenor Pakistan B.V (Telenor Group). In Nov'18, Alipay - an affiliate fintech company of the Chinese Alibaba Group, acquired ~34% share in the bank through its investment arm - Alipay (Hong Kong) Holding Limited. In Nov'19, Alipay injected further capital to take its ownership share to ~45%.

Operations The Bank operates through a nationwide network of 87 branches in the low-income areas within Pakistan, offering a diversified range of lending products. It has also been offering branchless banking (BB) services since 2009, to its clients through its BB Brand "Easypaisa".

Ownership

Ownership Structure The shareholding of Telenor Pakistan B.V stands at ~55%, while Ant Group holds a ~45% stake in the bank.

Stability Due to continuing losses, the Bank has accumulated losses amount to Rs. 32,187 million as at 30 June 2021. In order to mitigate the impact of losses, the shareholders have injected equity amounting to Rs. 14,002 million (USD 86 million) during the years 2020 and 2021 and a further capitalization plan has also been approved by the Board of Directors based on the future business financial projections and business plan of the Bank keeping in view the capital adequacy requirements of the State Bank of Pakistan.

Business Acumen Telenor ASA, the parent company of the Telenor Group is a subsidiary of the Government of Norway. It is one of the world's major mobile operators, headquartered in Oslo, Norway, with operations spread across multiple countries. Inclusion of Ant Financial is considered positive for the bank, as the group is one of the leading fintech conglomerates across the globe. The bank is well poised to avail benefit from the strategic vision and direction of Ant Group.

Financial Strength Financial muscle of the sponsors is considered even more robust following induction of Ant group, as an equity partner.

Governance

Board Structure The overall control vests in an eight member Board of Directors. Three directors, including the chairman - Mr. Irfan Wahab Khan, are representatives of the Telenor Group. Due to emergence of Ant Financial as an equity partner, the Board composition was revised in CY19. Ant Group is represented by three directors leading to equal representation from both ownership groups. Two independent directors complete the composition of the board.

Members' Profile The Board members carry extensive experience in the telecom industry and financial services. Inclusion of Ant Group, considered to be fintech tycoons, have added strength to the overall Board members' profile.

Board Effectiveness The Board exercises its oversight via four committees, namely (i) Audit Committee (ii) Risk Management Committee (iii) IT Committee and (iv) People Committee.

Transparency EY Ford Rhodes Chartered Accountants are the external auditors of the bank. They expressed an unqualified opinion on the financial statements for the year ended Dec'21. However, the auditors mentioned material uncertainty related to going concern in their report.

Management

Organizational Structure The bank's operations are grouped under ten departments with each department head reporting directly to the CEO, while the head of internal audit, reports to the audit committee.

Management Team Mr. Mudassar Aqil, is the CEO, carrying with him over two decades of experience in the banking industry.

Effectiveness Telenor has designated various management committees to manage and oversee operational efficacy. An executive committee is in place which comprises the CFO, CHRO (Chief Human Resource Officer), CRO (Chief Risk Officer) and the COO that report directly to the CEO. Asset liability committee is also in place.

MIS Detailed MIS reports are generated to support the senior management in timely and effective decision making. With the paramount focus diverted on the BB front, special MIS reports to monitor the KPIs related to BB progress are generated and presented to the Board on a monthly and quarterly basis.

Risk Management Framework Telenor has an established Risk Division Unit in place to oversee associated risks. The bank has developed and deployed a credit policy manual, which comprises guidelines for risk management framework

Technology Infrastructure In light of the forecasted increase in traffic on Easypaisa platforms, the bank's technological infrastructure is considered robust.

Business Risk

Industry Dynamics Pakistan Microfinance Industry (MFI) comprises of 50 microfinance providers including 30 microfinance institutions (MFIs). During CY21, active borrowers of the industry exceeded pre-COVID figure to 8.1 million borrowers after recording growth of 16% compared to CY20. Similarly, the GLP surpassed PKR 390 billion during CY21, an increase of 21% compared to CY20. The growth in active borrowers and GLP continues to be driven by the MFB peer group as they managed to add over one million clients and PKR 52 billion in GLP. NBMFC peer group also contributed to portfolio growth with an addition of PKR 16.7 billion. In case of MFBs, PAR > 30 days increased to 5.1% (CY20: 3.3%) on account of expiration of loan deferment period allowed by SBP. However, the PAR > 30 days of MFIs recovered to report at 2.9% in CY21 (CY20: 4.7%).

Relative Position As at End-Dec'21, the bank held 2.5% (End-Dec'20: 3%) of the total gross loan portfolio of the microfinance industry, and a 10% share (End-Dec'20: 10%), in terms of deposits.

Revenue During CY21, the Bank earned total revenue of PKR 9,693mln (CY20: PKR 11,723mln), a decline of 17%. Earnings from the branchless banking segment amounted to PKR 5,695mln (CY20: PKR 5,742mln), depicting a slight decline of 1%.

Profitability As at End-CY21, loss after taxation amounted to PKR 10,765mln (CY20: PKR 10,704mln), which represents increase in loss of 0.6%. Contributing factors include provisions and write offs, which increased to PKR 2,934mln (CY20: PKR 2,015mln).

Sustainability In light of the safety precautions taken during the global pandemic, the importance of branchless banking, has risen manifold. On the other hand, the effect of Covid-19 will put pressure on the growth prospects, liquidity and future infection of the loan book, of all industry players.

Financial Risk

Credit Risk As at End-Dec'21, the Bank's GLP stood at PKR 11,796mln (End-Dec'20: PKR 12,726mln), representing a decline of 7%. Even though the Bank's loan book represents a fairly diversified product segmentation, as at End-Dec'21, the Bank's infection ratio stood at 17.0% (End-Dec'20: 16.5%). The Bank has directly written off advances amounting to PKR 52mln during CY21 (CY20: PKR 85mln).

Market Risk The Bank's earning assets comprising deposit accounts, call money lending and investments in market treasury bills made up 70% of its total assets as at End-Dec'21 (End-Dec'20: 48%). Investments such as Market Treasury Bills, tend to provide a hedge against interest rate volatility, along with liquidity support to the bank. Therefore, a fall in such investments has elevated the market risk.

Funding The bank's external funding primarily consists of deposits, clocking in at PKR 39,043mln as at End-Dec'21 (End-Dec'20: PKR 36,964mln), depicting an increase of 5.6% during the period under review.

Cashflows & Coverages Liquidity profile improved during the period under review, as evident by the bank's liquid assets to deposits and borrowings ratio rising to 72.6% as at End-Dec'21 (End-Dec'20: 57.1%), majorly due to an increase in deposits with banks.

Capital Adequacy As at End-Dec'21, the Bank's CAR rose to 26.3% (End-Dec'20: 18.9%), as a result of equity injections of USD 86mln. Subsequently, the Bank has revised its business plan, which also envisages additional sponsor capital injection to absorb the adverse effects of COVID-19 situation on its business operations and future strategic expansion of its business. Equity base of the Bank as at End-Dec'21 is PKR 6,026mln (End-Dec'20: PKR 5,165mln).

				PKR mln
Telenor Microfinance Bank Limited	**Dec-21**	**Dec-20**	**Dec-19**	**Dec-18**
Public Unlisted Company	**12M**	**12M**	**12M**	**12M**

A BALANCE SHEET

1 Total Finances - net	9,788	10,623	21,679	32,786
2 Investments	17,753	11,855	13,773	9,008
3 Other Earning Assets	10,457	13,074	12,149	9,286
4 Non-Earning Assets	15,567	16,245	14,938	11,217
5 Non-Performing Finances-net	981	468	(1,680)	159
Total Assets	54,545	52,265	60,860	62,456
6 Deposits	39,043	36,964	41,171	42,275
7 Borrowings	-	-	-	-
8 Other Liabilities (Non-Interest Bearing)	9,476	10,137	11,642	6,513
Total Liabilities	48,519	47,100	52,813	48,788
Equity	6,026	5,165	8,047	13,668

B INCOME STATEMENT

1 Mark Up Earned	9,693	11,723	16,614	8,721
2 Mark Up Expensed	(1,927)	(2,771)	(3,671)	(2,595)
3 Non Mark Up Income	2,046	1,455	1,212	8,387
Total Income	9,812	10,407	14,155	14,513
4 Non-Mark Up Expenses	(17,323)	(18,814)	(21,070)	(15,240)
5 Provisions/Write offs/Reversals	(2,934)	(2,015)	(8,869)	(1,387)
Pre-Tax Profit	(10,444)	(10,422)	(15,784)	(2,114)
6 Taxes	(321)	(282)	(447)	(402)
Profit After Tax	(10,765)	(10,704)	(16,232)	(2,516)

C RATIO ANALYSIS

1 Performance				
Net Mark Up Income / Avg. Assets	14.5%	15.8%	21.0%	11.2%
Non-Mark Up Expenses / Total Income	176.5%	180.8%	148.8%	105.0%
ROE	-192.4%	-162.0%	-149.5%	-26.9%
2 Capital Adequacy				
Equity / Total Assets	11.0%	9.9%	13.2%	21.9%
Capital Adequacy Ratio	24.9%	18.9%	24.6%	37.0%
3 Funding & Liquidity				
Liquid Assets / (Deposits + Borrowings Net of Repo)	82.9%	57.1%	59.9%	40.4%
(Advances + Net Non-Performing Advances) / Deposits	27.6%	30.0%	48.6%	77.9%
Current Deposits / Deposits	69.0%	58.3%	32.2%	26.1%
SA Deposits / Deposits	8.1%	9.7%	14.6%	22.7%
4 Credit Risk				
Non-Performing Advances / Gross Advances	17.0%	16.5%	21.1%	4.1%
Non-Performing Finances-net / Equity	16.3%	9.1%	-20.9%	1.2%

Credit Rating

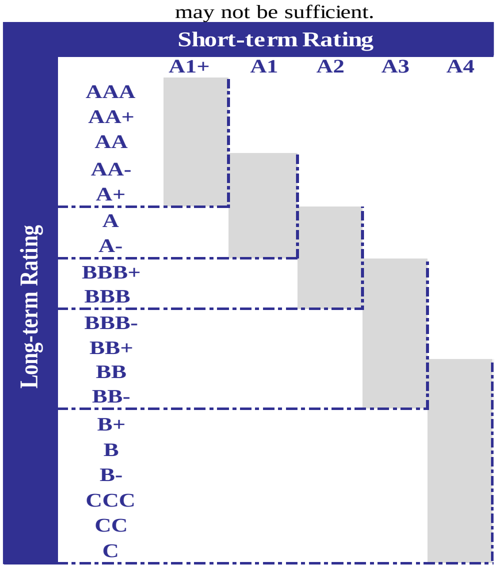
Credit rating reflects forward-looking opinion on credit worthiness of underlying entity or instrument; more specifically it covers relative ability to honor financial obligations. The primary factor being captured on the rating scale is relative likelihood of default.

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

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(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)

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(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.

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(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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