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-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	-
28-Apr-2016	A+	A1	Rating Watch	Maintain	-
08-Feb-2016	A+	A1	Stable	RW-Developing	-
27-Feb-2015	A+	A1	Stable	Maintain	-

Rating Rationale and Key Rating Drivers

The ratings take comfort from association of Telenor MFB ('the bank') with robust sponsors - Telenor Group (~55%) and the Chinese Fintech equity partner - Ant Financial, through its investment arm, AliPay (Hong Kong) Holding Limited (~45%). The bank's business profile emanates from its formidable customer base and strong relative position in the Industry. Securing an ~11% share in the gross loan portfolio and ~16% in gross deposits of the microfinance industry, the bank holds a prominent position in the market (End-Sep'19). 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 on the BB front are noted, overall performance indicators reflected a deteriorated outlook in CY19, mainly owing to extended credit delinquencies on account of system risks and internal fragility. Consequently, the bank's NPL ratio spiked to ~9% as at End-Sep'19 (End-Dec'18: ~4%), leading to unforeseen losses on the conventional front, in addition to anticipated BB losses. Management's commitment to recoup the asset health and consolidate the bank's position within the stipulated time is an acute necessity. Moreover, since the projected outlook of the bank indicates absorbing significant cash and accounting losses, timely yet matching Sponsor Support through Equity injections is essential. On an Industry level, the nationwide lockdown due to the global pandemic - Covid-19, is expected to cast a significant impact on the whole microfinance sector. The key risks emanating from the current crisis are (i) loss of recovery (ii) halt in fresh disbursement and (iii) probable liquidity stretch. While the bank's digitization platform is expected to reap benefits of the low mobility, the challenges on the conventional domain remain upfront. The Regulator - SBP's Relief Packages have come handy to the sector in protecting the credit quality of the players. Out-turn of the situation and its relative impact on the risk profiles of the players is yet to unfold in the days to come.

The ratings are dependent upon the out-turn of management's plans to steer the risk profile of the bank towards improved trajectory. Timely Sponsor Support is imperative. The Assigned Outlook is reflective of the short term challenges that the bank's business and financial risk profile are facing, particularly emanating from economic meltdown and Covid-19 repercussions.

Disclosure

Name of Rated Entity	Telenor 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	Jibran Cheema | jibran.cheema@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, Ant Financial - 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, Ant Financial injected further capital to take its ownership share to ~45%.

Operations The bank operates through a nationwide network of ~172 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 Financial holds a ~45% stake in the bank.

Stability Ownership structure witnessed a significant change during CY19. Additional equity injection may be necessitated due to significant losses.

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 Financial.

Financial Strength Financial muscle of the sponsors is considered even more robust following induction of Ant Financial, 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 Financial 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 Financial, 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.

Financial Transparency KPMG Taseer Hadi & Co. Chartered Accountants are the external auditors of the bank. They expressed an unqualified opinion on the financial statements for the year ended Dec'18 and the half year ended June'19.

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 The bank underwent several key management changes during CY19. In Oct'19, Mr. Mudassar Aqil, took charge as the CEO, carrying with him over two decades of experience in the banking industry. In the same month, Mr. Farhanullah Khan joined the bank as the CFO. He too, has a wealth of experience in the financial sector, spanning over two decades.

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'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 As at End-9MCY19, the bank held ~11% of the total gross loan portfolio of the microfinance industry (including MFIs, RSPs and other projects), and a ~12% share, in terms of borrowers. The bank's share of the total deposits in the industry stood at ~16%.

Revenue During 9MCY19, the bank earned a markup of PKR~7,849mln (9MCY18: PKR~6,241mln), depicting a growth of 26% compared to the corresponding period. While, the overall topline witnessed growth, earnings from the BB segment amounted to PKR~5,461mln (9MCY18: PKR~5,639mln), showcasing a decline of 3%.

Profitability As defined in the bank's strategic plan, significant expenditure is being incurred in the BB domain for marketing activities in order to attract and retain digital wallet customers. Total spending in the BB front, during 9MCY19, amounted to PKR~8,643mln, increasing considerably compared to the prior period. Resultantly, loss before tax from BB operations was recorded at PKR~3,182mln during 9MCY19. On the core banking front, performance indicators also deteriorated in 9MCY19 on the backdrop of delinquency in asset quality, with a provision charge against NPLs, amounting to PKR~2,021mln (9MCY18: PKR~414mln). Combined bottomline loss from both core and BB operations amounted to PKR~5,326mln (9MCY18: PKR~551mln).

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 Even though the bank's loan book represents a fairly diversified product segmentation, as at End-9MCY19, the bank's infection ratio substantially rose to ~9% (End-CY18: ~4%). The bank has written off advances amounting to PKR~1,823mln during 9MCY19. Management has cautiously recorded general provision, relating to branches with high delinquency ratios and control weaknesses.

Market Risk The bank's earning assets comprising deposit accounts, call money lending and investments in market treasury bills made up ~18% of its total assets as at End-9MCY19 (End-CY18:~29%). 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~37,551mln as at End-9MCY19 (End-CY18: PKR~42,275mln), depicting a decline of 11% during the period under review. Deposits specifically pertaining to BB increased to PKR~9,338mln as at End-9MCY19 (End-CY18: PKR~7,697mln) with growth of 21% during the period, excluding BISP's deposits. Funding mix is shifting from core to BB deposits, which are a considered a no cost, sticky product.

Liquidity Liquidity profile deteriorated during the period under review, as evident by the bank's liquid assets to deposits and borrowings ratio falling to ~36% as at End-9MCY19 (End-CY18: ~50%), majorly due to a fall in investment in government securities.

Capital Adequacy As at End-9MCY19, the bank's CAR fell to ~21% (End-CY18:~35%), as a result of equity erosion due to significant losses. Subsequent equity injection in Nov'19 played a major role in strengthening the bank's capital adequacy.

Telenor Microfinance Bank Limited

PKR mln

BALANCE SHEET	30-Sep-19	31-Dec-18	31-Dec-17	31-Dec-16
Earning Assets				
Advances	29,580	32,786	24,746	15,851
Investments (Government Securities)	4,626	9,008	6,767	11,568
Deposits with Banks	4,614	3,813	4,139	2,551
Lending to Financial Institutions	1,000	5,473	3,368	323
	39,819	**51,080**	**39,020**	**30,293**
Non Earning Assets				
Non-Earning Cash	4,635	4,262	3,514	3,125
Net Non-Performing Finances	1,371	159	16	(15)
Fixed Assets & Others	10,377	6,955	4,578	2,901
	16,383	**11,376**	**8,108**	**6,011**
TOTAL ASSETS	**56,202**	**62,456**	**47,128**	**36,304**
Interest Bearing Liabilities				
Deposits	**37,550**	**42,275**	**36,665**	**27,830**
Branch Banking	27,598	34,156	27,225	23,851
Branchless Banking	9,952	8,119	9,440	3,979
Borrowings	542	-	-	-
	38,093	42,275	36,665	27,830
Non Interest Bearing Liabilities	9,764	6,513	5,457	3,888
TOTAL LIABILITIES	**47,857**	**48,788**	**42,122**	**31,718**
EQUITY (including revaluation surplus)	8,289	13,613	4,981	4,576
Deferred Grants	56	56	25	10
Total Liabilities & Equity	**56,202**	**62,456**	**47,128**	**36,304**

INCOME STATEMENT	30-Sep-19	31-Dec-18	31-Dec-17	31-Dec-16
Interest / Mark up Earned	7,849	8,721	6,064	4,487
Interest / Mark up Expensed	(2,654)	(2,595)	(1,767)	(1,113)
Net Interest / Markup revenue	**5,195**	**6,126**	**4,297**	**3,373**
Direct Branchless Banking pre-tax profits	(3,182)	(1,907)	(421)	63
Other Operating Income	900	1,027	712	560
Total Revenue	**2,913**	**5,246**	**4,588**	**3,997**
Other Income	-	-	-	-
Non-Interest / Non-Mark up Expensed	(5,886)	(5,973)	(3,629)	(2,486)
Pre-provision operating profit	(2,973)	(727)	959	1,511
Provisions	(2,055)	(1,387)	(271)	(141)
Pre-tax profit	(5,028)	(2,114)	687	1,370
Taxes	(298)	(402)	(271)	(474)
Net Income	**(5,326)**	**(2,516)**	**417**	**896**

Ratio Analysis	30-Sep-19	31-Dec-18	31-Dec-17	31-Dec-16
Performance				
ROE	-65%	-27%	9%	22%
Cost-to-Total Net Revenue	202%	114%	79%	62%
Provision Expense / Pre Provision Profit	-69%	-191%	28%	9%
Capital Adequacy				
Equity/Total Assets	15%	22%	11%	13%
Capital Adequacy Ratio as per SBP	21%	35%	20%	31%
Loan Loss Coverage				
Non-Performing Advances /Gross Advances	9%	4%	1%	1%
Loan Loss Provisions / Non-Performing Advances	52%	89%	94%	116%
Funding & Liquidity				
Liquid Assets / Deposits and Borrowings	36%	50%	43%	63%
Advances / Deposits	82%	78%	68%	57%
CASA deposits / Total Customer Deposits	45%	49%	51%	53%
Intermediation Efficiency				
Asset Yield	23%	19%	17%	19%
Cost of Funds	9%	7%	5%	5%
Spread	14%	13%	12%	14%
Outreach				
Branches	172	172	85	74

Credit Rating Scale & Definitions

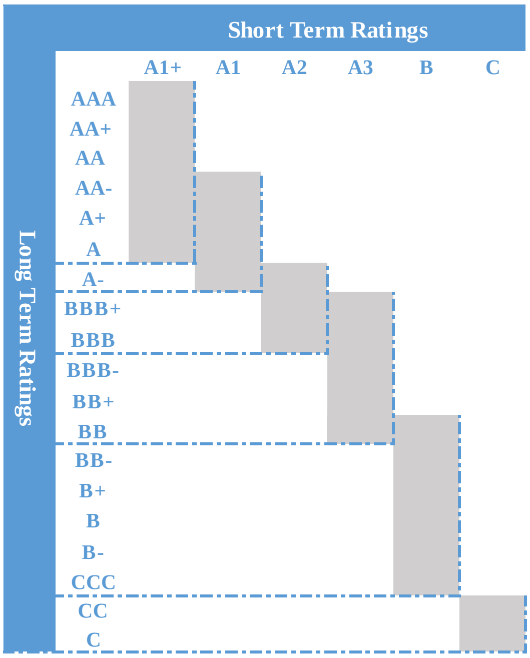
Credit rating reflects forward-looking opinion on credit worthiness of underlying entity or instrument; more specifically it covers relative ability to honor financial obligations. The primary factor being captured on the rating scale is relative likelihood of default.

Long Term Ratings

AAA	**Highest credit quality.** Lowest expectation of credit risk. Indicate exceptionally strong capacity for timely payment of financial commitments
AA+ 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 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