RATING REPORT

HBL Microfinance Bank Limited

(Formerly The First MicroFinanceBank Limited)

REPORT DATE:
April 30, 2022

RATING ANALYSTS:

Syed Fahim Haider Shah
fahim.haider@vis.com.pk

RATING DETAILS

Rating Category	Latest Rating		Previous Rating	
	Long-term	Short-term	Long-term	Short-term
Entity	A+	A-1	A+	A-1
Rating Outlook	Stable		Rating Watch-Developing	
Rating Date	*April 30th, 22*		*April 30th, '21*	

COMPANY INFORMATION

Incorporated in 2001	**External auditors:** M/s KPMG Taseer Hadi & Co., Chartered Accountants, a member firm of the KPMG network
Public Limited Unlisted Company	**Chairman of the Board**: Mr. Rayomond Kotwal **President & CEO**: Mr. Muhammad Amir Khan
Key Shareholders (with stake 5% or more):	
Habib Bank Limited (HBL): 71.43%	
Aga Khan Agency for Microfinance (AKAM): 17.14%	
Aga Khan Rural Support Programme (AKRSP): 6.35%	
Japan International Cooperation Agency (JICA): 5.08%	

APPLICABLE METHODOLOGY(IES)

VIS Entity Rating Criteria: Micro Finance Banks (June 2019)
https://docs.vis.com.pk/docs/Micro%20Finance%20201906.pdf

HBL Microfinance Bank Limited

OVERVIEW OF THE INSTITUTION

HBL Microfinance Bank Limited (HBL MfB) (Formerly, The First MicroFinanceBank Limited – FMFB) was incorporated in 2001 as a public limited unlisted company under the Companies Ordinance, 1984 (now Companies Act, 2017) and provides microfinance banking services to the market niche. The bank operates through a network of 213 business locations at end-FY21.

Profile of Chairman
Mr. Rayomond Kotwal has over 31 years of experience. Mr. Kotwal is currently the CFO of Habib Bank Limited.

Profile of CEO
Mr. Muhammad Amir Khan brings over 30 years of extensive experience in consumer and commercial banking with the Standard Chartered Bank, ABN Amro Bank and Royal Bank of Scotland.

Financial Snapshot
Total assets: end-FY21: Rs. 110.0b; end-FY20: Rs.76.4b; end-FY19: Rs. 47.2b.

Total equity: end-FY21: Rs. 10.1b; end-FY20: Rs. 6.7b; end-FY19: Rs. 6.0b.

Net profit: FY21: Rs. 1.6b; FY20: Rs. 575m; FY19: Rs. 533m.

RATING RATIONALE

HBL Microfinance Bank Limited (HBL MfB) (Formerly, The First MicroFinanceBank Limited – FMFB) is one of the leading providers of microcredit service in Pakistan, with its network of 213 locations across Pakistan. The assigned ratings take into account strong ownership structure, as majority shareholding of the bank is held by Habib Bank Limited (HBL) and the Aga Khan Development Network. The Bank has changed its name and rebranded itself to HBL Microfinance Bank Ltd (HBL MfB). from "The First MicroFinanceBank Ltd." in January 2022. The rebranded HBL MfB is expected to build upon the strong group association with existing customers and facilitate the growth of outreach and footprint. The Bank secures 15.1% market share amongst the microfinance banks as at end-Dec`21 in terms of GLP. Majority of NPL pertained to deferred/rescheduled portfolio under the SBP relief package for Covid-19. Since the Bank has recovered major portion of rollover portfolio, stress on asset quality is expected to ease-off to a certain extent during the ongoing year. The Bank will continue its growth momentum in FY22 while continuing to focus on disbursements of higher-ticket size housing and MSME loans. The Bank is the largest provider of Housing Finance in the Microfinance Banking Sector and one of the largest contributories from the microfinance industry in the Government Mark-up Subsidy Scheme (GMSS).

Bottom-line of the Bank was supported by higher net markup income owing to growth in advances portfolio and continued booking of markup on rollover portfolio. Markup spread, however, decreased mainly due to increase in secured housing lending carrying relatively lower markup rate vis-à-vis other core products and also lower yield on investment portfolio. Over half of the incremental deposits were invested in government securities and bank placements in order to improve liquidity and capitalization indicators. Liquidity profile is supported by higher liquid assets maintained in relation to total deposits and borrowings. Despite increase in risk weighted assets, improvement in CAR was led by equity injection of Rs. 2.0b from HBL and healthy profits generation during the outgoing year. The Bank is in the process of issuing right shares amounting to Rs. 1b. The same is in the process of regulatory approval. The Bank already has the statutory approval to issue further right shares amounting to Rs. 1b in 2023. The additional capital injection will continue to support the CAR and growth plans of the Bank, going forward.

HBL MfB has upgraded the Loan Origination System (LoS) to Customer Management Solution – an end-to-end digital model used to automate the processes and reduce turnaround time, that has been implemented in 127 locations as at end-Dec'21. Customer Management Solution will be further implemented in 190 locations of the Bank, adding convenience for the customer and improve delivery of service. Branchless Banking (FirstPay) has also experienced a considerable growth since its launch in 1QCY21.The ratings continue to be underpinned to sustained performance indicators with improvements in asset quality and profitability.

Key Rating Drivers

Aggressive growth of lending portfolio: The bank continued its aggressive growth strategy in order to capture new market opportunities and market share. The bank managed to increase gross advances portfolio by 36% to Rs. 59.2b (FY20: Rs. 43.4b) by end-FY21, highest growth amongst the industry peers. The impact of decline in number of active borrowers due to reduction in number of low-end, non-collateral loans was more than offset by increase in the average loan size on account of increase in the maximum limit for the key products and launch of new higher-ticket size products during the year. In line with the increased focus on higher-size market segment, the bank introduced new housing product namely 'Government Markup Subsidy Scheme (GMSS)' having maximum credit limit of Rs. 2.0m and MSME product 'Roshanzar Premium' having maximum credit limit of Rs. 3.0m during FY21.

Growth in advances portfolio was mainly led by increased focus on agri inputs, livestock, and housing loans during FY21. Within agri/livestock segments, the disbursements were geared towards high-end, collateral-based, and EMI-based dairy products. In terms of sector-wise concentration, livestock remained the largest segment representing 38.9% (FY20: 38.8%) of overall advances portfolio, followed by MSME 25.0% (FY20: 30.7%), general-purpose (including housing) 18.8% (FY20: 21.3%), and agri inputs 17.3% (FY20: 9.2%). Growth in MSME portfolio was curtailed in response to recovery challenges faced in urban, enterprise, home-based EMI loans due to the impact of coronavirus pandemic. Given increased instances of delinquencies in group loans in the previous years, the bank remained focused on individual loans with proportion of group lending declining to 7.7% (FY20: 18.6%) by end-FY21. Going forward, the bank will continue to target higher-ticket-size loans in housing and MSME. Within the agri segment, the bank plans to enhance focus on non-major crops and value-chain financing.

Increase in infection was led by higher NPLs mainly in rollover portfolio, comfort is drawn from recovery of major portion of the same: NPLs were recorded higher during FY21, majority of which pertained to deferred/rescheduled portfolio under the SBP relief package for Covid-19. Resultantly, gross and net infection increased to 3.9% (FY20: 2.8%) and 2.1% (FY20: 2.0%), respectively. Incremental infection also increased to 4.9% (FY20: 1.7%) on account of higher write-offs against NPLs during the year. Provisioning coverage stood at 46.7% (FY20: 29.9%) due to higher specific provision of Rs. 1.1b (FY20: Rs. 361m) during FY21.

In accordance with the relaxation allowed by SPB against the Covid-19 pandemic, the bank deferred/rescheduled additional loans of Rs. 2.1b (FY20: Rs. 12.7b) till end-March'2021, which along with the opening rollover portfolio of Rs. 11.4b (FY20: Rs. Nil), resulted in total deferment/rescheduling of Rs. 13.5b at end-March'2021. Out of this, the bank made recovery of Rs. 7.3b (FY20: Rs. 1.3b) during FY21, while loans amounting Rs. 423m (FY20: Rs. Nil) were written-off. During 1QFY22, the bank has made additional recovery of Rs. 329m, resulting in recoverable rollover portfolio of Rs. 4.0b at end-March'2022, out of which Rs. 1.5b is expected to be recovered during May-June'2022. Given the bank has already recovered major portion of rollover portfolio, stress on asset quality is expected to ease-off to some extent during the ongoing year.

Improvement in profitability supported growth in lending and investment portfolio: Profit before tax increased significantly to Rs. 2.3b (FY20: Rs. 815m) during FY21, as the impact of higher provisioning charge and administrative expenses to Rs. 1.9b (FY20: Rs. 1.6b) and Rs. 6.3b (FY20: 5.2b) due to increase in staff levels to support growth plans, respectively, was more than offset by notable growth in net markup income on account of growth in advances and investment portfolio and higher fee/commission income of Rs. 1.4b (FY20: Rs. 858m) due to revision on loan processing fee. Operational Self-Sufficiency (OSS) improved steadily to 116% (FY20: 107%) during FY21. Overall yield on markup bearing assets declined to 20.8% (FY20: 24.3%) on account of a combination of increase in secured housing loans carrying slightly lower markup rate vis-a-vis other core products and notably higher investment portfolio which earned lower yield due to reduced average benchmark rate during FY21. Average cost of funds stood at 8.5% (FY20: 10.4%), resulting in lower markup spread of 12.3% (FY20: 13.9%). Accounting for taxation, the bank reported higher net profit of Rs. 1.6b (FY20: Rs. 575m) during FY21.

Improved liquidity and capitalization indicators: Deposits remained the primary source of lending activities during the year. Deposits base augmented to Rs. 91.4b (FY20: Rs. 61.7b) by end-FY21, with growth mainly manifested in fixed and saving deposits. The proportion of current and savings accounts (CASA) in overall deposit mix improved slightly to 51.6% (FY20: 50.7%). Concentration risk emanating from deposits portfolio is considered high as share of top-50 depositors was 72% (FY20: 69%) by end-FY21; however, some comfort is drawn from related party deposits constituting 10.9% (FY20: 4.6%) of the deposit base and sticky relations with the major depositors on a timeline basis. Given that nearly half of incremental deposits were primarily invested in government securities and bank placements, liquid assets in relation to total deposits & borrowings improved to 47.3% (FY20: 41.2%). Resultantly, advances-to-deposits ratio (ADR) decreased to 62.2% (FY20: 67.4%) by end-FY21. The bank continues to utilize running finance and long-term refinance facilities to bridge the funding gaps.

The bank increased its authorized capital to Rs. 8.0b (FY20: Rs. 4.0b) by end-FY21, in order to facilitate the planned equity injection of Rs. 4.0b from HBL in three phases. The equity base augmented to Rs. 10.1b (FY20: Rs. 6.7b) by end-FY21, owing to retention of profits and equity injection of Rs. 2.0b. Net NPLs in relation to tier-1 capital decreased marginally to 12.3% (FY20:

12.6%) by end-FY21. Despite increase in risk weighted assets to Rs. 70.0b (FY20: Rs. 52.3b), the bank's capital adequacy ratio (CAR) was reported higher at 17.0% (FY20: 15.1%) against the minimum regulatory requirement of 15.0%. The second tranche of equity amounting Rs. 1.0b has already been approved and is expected to be received soon while its third tranche of Rs. 1.0b is planned for FY23 in order to support the CAR and business growth plans.

HBL Microfinance Bank Limited (HBL MfB) Annexure I

FINANCIAL SUMMARY *(amounts in PKR millions)*			
BALANCE SHEET	**31-Dec-19**	**31-Dec-20**	**31-Dec-21**
Cash and Bank Balances with SBP and NBP	2,876	4,252	6,344
Balances with other Banks and/NBFIs/MFBs	3,405	7,472	24,032
Lending to Financial Institutions	0	0	502
Total Investments	4,513	14,542	13,730
Net Advances	30,936	41,628	56,872
Operating Fixed Assets	2,820	2,841	2,700
Other Assets	2,682	5,627	5,841
Total Assets	47,232	76,363	110,021
Total Deposits	38,404	61,726	91,363
Borrowings	-	2,021	2,883
Subordinated Debt	-	2,000	2,000
Other Liabilities	2,781	3,927	3,962
Tier-1 Equity	6,048	6,649	10,225
Net Worth	6,047	6,688	10,083
Paid-Up Capital	2,731	2,731	4,731
INCOME STATEMENT	**31-Dec-19**	**31-Dec-20**	**31-Dec-21**
Net Mark-up Income	5,054	6,664	8,982
Net Provisioning / (Reversal)	853	1,607	1,884
Non-Markup Income	768	916	1,430
Operating Expenses	4,268	5,158	6,270
Profit Before Tax	701	815	2,258
Profit after tax	533	575	1,556
RATIO ANALYSIS	**31-Dec-19**	**31-Dec-20**	**31-Dec-21**
Gross Infection (%)	3.5	2.8	3.9
Net Infection (%)	2.4	2.0	2.1
Incremental Infection (%)	5.0	1.7	4.9
Provisioning Coverage (%)	33.6	29.9	46.7
Provisioning to Total Income (%)	11.6	23.5	22.8
Net NPLs to Tier-1 Capital (%)	12.1	12.7	12.2
Capital Adequacy Ratio (%)	15.8	15.1	17.0
Markup on earning assets (%)	24.4	23.5	20.8
Cost of Funds (%)	10.5	10.4	8.5
Spreads (%)	13.9	13.9	12.3
OSS (%)	108.1	107.0	115.6
ROAA (%)	1.3	0.9	1.8
ROAE (%)	9.2	9.0	18.9
Liquid Assets to deposits & borrowings (%)	28.1	41.2	47.3

ISSUE/ISSUER RATING SCALE & DEFINITIONS Annexure II

VIS Credit Rating Company Limited

RATING SCALE & DEFINITIONS: ISSUES / ISSUERS

Medium to Long-Term

AAA
Highest credit quality; the risk factors are negligible, being only slightly more than for risk-free Government of Pakistan's debt.

AA+, AA, AA-
High credit quality; Protection factors are strong. Risk is modest but may vary slightly from time to time because of economic conditions.

A+, A, A-
Good credit quality; Protection factors are adequate. Risk factors may vary with possible changes in the economy.

BBB+, BBB, BBB-
Adequate credit quality; Protection factors are reasonable and sufficient. Risk factors are considered variable if changes occur in the economy.

BB+, BB, BB-
Obligations deemed likely to be met. Protection factors are capable of weakening if changes occur in the economy. Overall quality may move up or down frequently within this category.

B+, B, B-
Obligations deemed less likely to be met. Protection factors are capable of fluctuating widely if changes occur in the economy. Overall quality may move up or down frequently within this category or into higher or lower rating grade.

CCC
Considerable uncertainty exists towards meeting the obligations. Protection factors are scarce and risk may be substantial.

CC
A high default risk

C
A very high default risk

D
Defaulted obligations

Short-Term

A-1+
Highest certainty of timely payment; Short-term liquidity, including internal operating factors and /or access to alternative sources of funds, is outstanding and safety is just below risk free Government of Pakistan's short-term obligations.

A-1
High certainty of timely payment; Liquidity factors are excellent and supported by good fundamental protection factors. Risk factors are minor.

A-2
Good certainty of timely payment. Liquidity factors and company fundamentals are sound. Access to capital markets is good. Risk factors are small.

A-3
Satisfactory liquidity and other protection factors qualify entities / issues as to investment grade. Risk factors are larger and subject to more variation. Nevertheless, timely payment is expected.

B
Speculative investment characteristics; Liquidity may not be sufficient to ensure timely payment of obligations.

C
Capacity for timely payment of obligations is doubtful.

Rating Watch: VIS places entities and issues on 'Rating Watch' when it deems that there are conditions present that necessitate re-evaluation of the assigned rating(s). Refer to our 'Criteria for Rating Watch' for details. www.vis.com.pk/images/criteria_watch.pdf

Rating Outlooks: The three outlooks 'Positive', 'Stable' and 'Negative' qualify the potential direction of the assigned rating(s). An outlook is not necessarily a precursor of a rating change. Refer to our 'Criteria for Rating Outlook' for details.www.vis.com.pk/images/criteria_outlook.pdf

(SO) Rating: A suffix (SO) is added to the ratings of 'structured' securities where the servicing of debt and related obligations is backed by some sort of financial assets and/or credit support from a third party to the transaction. The suffix (SO), abbreviated for 'structured obligation', denotes that the rating has been achieved on grounds of the structure backing the transaction that enhanced the credit quality of the securities and not on the basis of the credit quality of the issuing entity alone.

(blr) Rating: A suffix (blr) is added to the ratings of a particular banking facility obtained by the borrower from a financial institution. The suffix (blr), abbreviated for 'bank loan rating' denotes that the rating is based on the credit quality of the entity and security structure of the facility.

'p' Rating: A 'p' rating is assigned to entities, where the management has not requested a rating, however, agrees to provide informational support. A 'p' rating is shown with a 'p' subscript and is publicly disclosed. It is not modified by a plus (+) or a minus (-) sign which indicates relative standing within a rating category. Outlook is not assigned to these ratings. Refer to our 'Policy for Private Ratings' for details. www.vis.com.pk/images/policy_ratings.pdf

'SD' Rating: An 'SD' rating is assigned when VIS believes that the ratee has selectively defaulted on a specific issue or obligation but it will continue to meet its payment obligations on other issues or obligations in a timely manner.

REGULATORY DISCLOSURES — Annexure III

Name of Rated Entity	HBL Microfinance Bank Limited – HBL MfB *(Formerly: The First MicroFinanceBank Pakistan (FMFB)*
Sector	Microfinance Bank (MFB)
Type of Relationship	Solicited
Purpose of Rating	Entity Ratings
Rating History	See table below
Instrument Structure	N/A
Statement by the Rating Team	VIS, the analysts involved in the rating process and members of its rating committee do not have any conflict of interest relating to the credit rating(s) mentioned herein. This rating is an opinion on credit quality only and is not a recommendation to buy or sell any securities.
Probability of Default	VIS' ratings opinions express ordinal ranking of risk, from strongest to weakest, within a universe of credit risk. Ratings are not intended as guarantees of credit quality or as exact measures of the probability that a particular issuer or particular debt issue will default.
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Rating History

Rating Date	Medium to Long Term	Short Term	Rating Outlook	Rating Action
RATING TYPE: ENTITY				
30/04/2022	A+	A-1	Stable	Maintained
30/04/2021	A+	A-1	Rating Watch-Developing	Reaffirmed
30/04/2020	A+	A-1	Rating Watch-Developing	Maintained
25/03/2019	A+	A-1	Stable	Reaffirmed
30/04/2018	A+	A-1	Stable	Reaffirmed
31/10/2017	A+	A-1	Stable	Reaffirmed
28/04/2017	A+	A-1	Stable	Reaffirmed
28/04/2016	A+	A-1	Stable	Upgrade

Due Diligence Meeting/s Conducted

Name	Designation	Date
Mr. Adil Abbasi	Chief Financial Officer	April 05, 2022
Mr. Ali Raza Anjum	Chief Operating Officer	April 05, 2022
Ms. Zehra Khalikdina	Head Risk Management	April 05, 2022
Mr. Shahid Abbasi	Head Internal Audit	April 05, 2022