

RATING REPORT

Telenor Microfinance Bank Limited (TMB)

REPORT DATE:

April 30, 2021

RATING ANALYSTS:

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RATING DETAILS

| Rating Category | Indicative Rating | | Previous Rating | |
|-----------------------|----------------------|------------|-------------------------|------------|
| | Long-term | Short-term | Long-term | Short-term |
| Entity Rating | A | A-1 | A+ | A-1 |
| Rating Date | <i>April 30, '21</i> | | <i>April 30, '20</i> | |
| Rating Outlook | Negative | | Rating Watch – Negative | |

COMPANY INFORMATION

| | |
|---------------------------------------------------|---------------------------------------------------------------------|
| Incorporated in 2005 | External auditors: M.s. EY Ford Rhodes Chartered Accountants |
| Public Limited Company | Chairman: Mr. Irfan Wahab Khan |
| Key Shareholder(s): | Chief Executive Officer: Mohammad Mudassar Aqil |
| Telenor Pakistan B.V – 55.0% | |
| Alipay (Hong Kong) Holding Limited – 45.0% | |

APPLICABLE METHODOLOGY(IES)

Applicable Rating Criteria: Microfinance Banks (June 2019)

<https://www.vis.com.pk/kc-meth.aspx>

Telenor Microfinance Bank Limited (TMB)

OVERVIEW OF THE INSTITUTION

RATING RATIONALE

Telenor Microfinance Bank Limited (TMB) was incorporated in 2005 as a limited company under the Companies Ordinance, 1984.

Profile of Chairman

Mr. Irfan Wahab Khan is the EVP, Head of Emerging Asia cluster Telenor Group, Chairman of Telenor Myanmar, Chairman Telenor Microfinance Bank, Director to the Grameenphone Board and CEO of Telenor Pakistan since 2016. Prior to that, Mr. Irfan served as Deputy CEO Telenor Pakistan for two years. Since joining Telenor in 2004, he has held a number of executive positions across Telenor Group including Executive Vice President Telenor Pakistan, CEO Telenor LDI, Group Vice President Devices & Distribution Telenor Group and Chief Marketing Officer Telenor Pakistan.

Mr. Khan holds a Masters degree in Mobile and Personal Communications from University of Westminster London UK. He also holds qualifications in Financial Management from Harvard Business School, executive diploma in Marketing from London Business School and Advance Management from INSEAD and a Qualified Board Director from IMD. He is also a lifetime Alumni of INSEAD.

Profile of CEO

Mudassar Aqil is the President and Chief Executive Officer of Telenor Microfinance Bank. Mudassar is an accomplished executive with over 21 years of banking experience in the US and Pakistan with demonstrable success in areas of organizational restructuring, digital finance, FinTech

Telenor Microfinance Bank Limited (‘TMB’ or ‘the Bank’) is a subsidiary of Telenor Pakistan B.V (TP), (a Netherland based company owned by Telenor ASA) having major shareholding in the Bank. As on December 31, 2020, TMB’s operations were spread across 89 branches (2018: 120 branches) nationwide.

Commencing operations in 2005, the Bank grew quickly to become one of the largest microcredit provider in the country and the market leader in the Branchless Banking segment, though its flagship product ‘‘Easy Paisa’’. However, given operational challenges faced by the bank in its lending operations, the Bank had embarked on phase of consolidation, wherein lending operations were halted and the Bank had to undertake significant credit impairment during the 3-year period 2018-2020. The Bank’s strategy has been revised to focus on the Branchless Banking (BB) segment. Presently, the Bank can be considered a hybrid of a leading fintech company and a medium-sized microfinance lender.

Key Rating Drivers:

Strong sponsor profile and demonstrated support is a key rating driver.

The assigned ratings reflect robust financial profile of both sponsors, TP and AF. Key shareholders have demonstrated support to the entity by way of continued equity infusion. So far, key shareholders have deployed USD 86m of the USD 95m committed toward TMB.

Bank’s consolidation phase has significantly affected its market positioning, while breakeven of the BB segment is expected to face delays

Given the de-risking of the asset base, by way of halting lending operations, and reduction in branch network the Bank’s market share, in terms of advances, fell from 12.4% I Dec’18 to 3.9% in Dec’20, while deposit market share fell from 15.5% as of Dec’19 to 9.9% as of Dec’20. As a result, the Bank’s market positioning in the microfinance segment has been affected. So far, the alternative growth in BB segment has materialized in terms of transaction volumes & value, while actual income from BB has contracted; or remained stable if viewed sans of SBP’s decision to waive off IBFT charges. Given SBP’s instructions to put a ceiling on IBFT fee received in Mar’21, the challenges in growing BB income are expected to persist, as a result of which breakeven of the same is expected to face delays.

The BB-led growth in deposit mix has translated in significant improvement in deposit mix

The BB-led growth in deposits has translated in notable improvement in the Bank’s deposit mix, with non-remunerative (current) accounts growing to 61% of the deposit base as of Mar’21 (Dec’20: 58%; Dec’19: 32%). Furthermore, the depositor profile has also changed with the deposit profile changing from a mix of corporate and retail to almost entirely retail, with a mere 4% of the deposit base constituting corporate deposits. Given the growth in retail clientele, granularity of the deposit base has improved, with deposits under Rs. 25k now comprising 52% of the aggregate deposit base vis-à-vis 20% as of Dec’18.

The Bank’s liquidity profile has improved, albeit at the expense of a drag on profitability

With the Bank channeling much of the excess liquidity towards liquid assets, the liquid assets to deposits & borrowings ratio has posted notable improvement (Mar’20: 88.4%; Dec’20: 75.9%; Dec’19: 71.9%; Dec’18: 53.4%). Overall liquidity profile compares favorably to peers, albeit excessive liquidity does translate in a drag on profitability.

partnerships, and business growth.

Before joining Telenor Microfinance Bank, Mudassar was the President and CEO of FINCA Microfinance Bank and previously also served as the Vice President for M&T Bank in New York.

TMB's profitability indicators have remained under pressure during the past 3-year period (2018-20), resulting in significant equity erosion for the Bank. Operational losses are a result of a portfolio impairment and an intentional reduction in lending operations, as a result of which net interest margin has shrunk. Operational losses grew notably in 2019, increasing further in 2020. However, this was broadly in line with envisaged strategy. Non-markup income was also impacted, mainly as a result of SBP's decision to waive fee on IBFT, which costed the Bank Rs. 1.6b. Adjusting for the same, operational loss stood at almost similar level for 2020.

Given the onset of the 3rd wave of Covid-19, and the damage by the previous waves, credit risk across the microfinance sector is considered heightened. Our profitability outlook for TMB, is less optimistic vis-à-vis management projections. With the maturity of the Covid-19 relief portfolio, repayment behavior of the clientele would be tested. With notable increase in non-performances in Q1'2020, it is likely that NPLs would continue to increase, which will weigh on the net markup income. At the same time, with SBP putting a ceiling on IBFT fee, growth in BB income is also expected to remain below management projections. As a result of the continuous expenditure towards customer acquisition/retention costs and tech platform augmentation, along with evolving regulatory changes, the Bank's loss is likely to exceed projections in 2021.

Capitalization has been reinforced, albeit it will continue to face erosion on account of projected losses

With the key shareholders having injected USD 86m in the outgoing year, they have managed to keep capitalization buffer intact so far. With the losses projected for 2021, it is most likely that the Bank would be requiring another equity infusion prior to year-end 2021. Even though the shareholders remain committed to support TMB, as reflected by the consistent & demonstrated support in the recent past, the adverse profitability position will weigh on the capitalization indicators, which will remain under stress.

Telenor Microfinance Bank Limited
Annexure I

| FINANCIAL SUMMARY | | | | | |
|---------------------------------------------------------|---------------|---------------|---------------|---------------|--------------|
| <i>(amounts in PKR millions)</i> | | | | | |
| BALANCE SHEET | Dec'18 | Dec'19 | Dec'20 | Mar'21 | |
| Total Investments | 9,008.4 | 13,773.4 | 11,855.0 | 20,293.4 | |
| Net Advances | 32,944.8 | 19,998.9 | 11,091.0 | 10,475.0 | |
| Cash and Bank Balances | 8,074.7 | 10,872.3 | 9,234.7 | 6,825.3 | |
| Total Assets | 62,466.0 | 60,859.9 | 52,264.9 | 55,966.0 | |
| Deposits | 42,274.9 | 41,170.5 | 36,963.8 | 37,162.9 | |
| Borrowings | - | - | - | - | |
| Paid up capital | 3,547.3 | 4,277.6 | 4,277.6 | 4,277.6 | |
| Net Worth (excl. revaluation reserve & deferred grants) | 13,768.1 | 8,305.7 | 5,131.6 | 8,915.5 | |
| CAR | 35.2% | 24.6% | 18.9% | NA | |
| INCOME STATEMENT | | | | | |
| | 2018 | 2019 | 2020 | Q1'20 | Q1'21 |
| Net Mark-up Income | 6,126.2 | 5,617.2 | 3,210.0 | 1,307.3 | 170 |
| Net Provisioning / (Reversal) | 1,365.4 | 8,820.0 | 1,929.7 | 19.2 | 603.1 |
| Non-Markup Income | 8,386.8 | 8,538.1 | 7,196.7 | 2,046.3 | 2,026.9 |
| Operating Expenses | 15,240.4 | 21,070.0 | 18,813.5 | 4,847.9 | 4,275.6 |
| Profit/ (loss) before Tax | (2,114.0) | (15,784.2) | (10,421.6) | (1,513.6) | (2,681.7) |
| Profit/ (loss) after tax | (2,515.7) | (16,231.5) | (10,704.0) | (1,560.9) | (2,775.4) |
| RATIO ANALYSIS | | | | | |
| | Dec'18 | Dec'19 | Dec'20 | Mar'21 | |
| CA (%) | 26.1% | 32.2% | 58.3% | 61.2% | |
| CASA (%) | 48.8% | 46.8% | 67.9% | 70.5% | |
| Gross Infection (%) | 4.1% | 21.1% | 16.5% | 22.2% | |
| Net Infection (%) | 2.5% | 7.6% | 4.8% | 14.4% | |
| Incremental Infection (%) | 5.2% | 24.0% | 17.5% | 13.2% | |
| Net NPLs to Tier-1 Capital (%) | 5.7% | 15.2% | 10.2% | 16.9% | |
| Provisioning Coverage (%) | 88.6% | 129.1% | 77.7% | 43.3% | |
| Advances to Deposits (%) | 80.9% | 66.7% | 34.4% | 31.2% | |
| OSS (%) (Recurring Income / Administrative Expenses) | 95.7% | 66.6% | 50.7% | 45.6% | |
| ROAA (%) | -4.6% | -26.3% | -18.9% | -20.5%* | |
| Liquid Assets to deposits & borrowings (%) | 53.4% | 71.9% | 75.9% | 88.4% | |
| *Annualized | | | | | |

ISSUE/ISSUER RATING SCALE & DEFINITIONS

Appendix 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 | | Appendix III | | | | |
|-----------------------------------------|-----------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------|----------------------------|-------------------------|-------------------|----------------------|--|
| Name of Rated Entity | Telenor Microfinance Bank Limited (TMB) | | | | | |
| Sector | Micro Finance Bank (MFB) | | | | | |
| Type of Relationship | Solicited | | | | | |
| Purpose of Rating | Entity Rating | | | | | |
| Rating History | Rating Date | Medium to Long Term | Rating Outlook | Short Term | Rating Action | |
| | RATING TYPE: Entity | | | | | |
| | 4/30/2021 | A | Negative | A-1 | Downgrade | |
| | 4/30/2020 | A+ | Rating Watch-Negative | A-1 | Maintained | |
| | 4/30/2019 | A+ | Stable | A-1 | Maintained | |
| | 4/27/2018 | A+ | Rating Watch-Developing | A-1 | Maintained | |
| | 4/28/2017 | A+ | Stable | A-1 | Reaffirmed | |
| | 4/28/2016 | A+ | Stable | A-1 | Reaffirmed | |
| | 4/17/2015 | A+ | Stable | A-1 | Reaffirmed | |
| | 4/23/2014 | A+ | Stable | A-1 | Upgrade | |
| | 3/27/2013 | A | Stable | A-1 | Reaffirmed | |
| 12/26/2012 | A | Stable | A-1 | Reaffirmed | | |
| 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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| Due Diligence Meetings Conducted | Name | Designation | Date | | | |
| | Mr. Farhanullah Khan | CFO | April 27, 2021 | | | |