# RATING REPORT

# Pak Oman Microfinance Bank Limited

**REPORT DATE:**
April 28, 2023

**RATING ANALYST:**

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## RATING DETAILS

| Rating Category | Latest Rating | | Previous Rating | |
|---|---|---|---|---|
| | Long-term | Short-term | Long-term | Short-term |
| **Entity** | A- | A-2 | A- | A-2 |
| **Rating Outlook** | Negative | | Stable | |
| ***Rating Date*** | *April 28, 2023* | | *April 30, 2022* | |

## COMPANY INFORMATION

| | |
|---|---|
| **Incorporated in 2006** | **External auditors:** BDO Ebrahim & Co. Chartered Accountants |
| **Unlisted Public Limited Company** | **Chairman of the Board:** Ishara Chinthaka Nanayakkara |
| **Key Shareholders (with stake 5% or more):** | **Chief Executive Officer :** Mr. Farooq Rashid |
| LOLC Asia Private Limited – 100.0% | |

## APPLICABLE METHODOLOGY(IES)

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

## Pak Oman Microfinance Bank Limited

| OVERVIEW OF THE INSTITUTION | RATING RATIONALE |
|---|---|
| Pak Oman Microfinance Bank Limited was incorporated in March 2006 as an unlisted public limited company under Microfinance Institutions Ordinance 2001. The Bank's principal activity is to provide microfinance services to the poor and underserved. | The assigned ratings take into account Pak Oman Microfinance Bank Limited ('POMBL' or 'the Bank') being wholly owned by LOLC Asia Pvt Limited; the latter in turn is 100% owned by LOLC Group Sri Lanka which is one of the biggest and diversified conglomerates having investments in various industries including financial services, insurance, manufacturing, trading, plantation, renewable energy, and leisure. While POMBL would continue to derive technical support from the group; however, given the current economic conditions in Sri Lanka, ratings will remain sensitive to support from the group. Ratings incorporate improvement in governance and control framework along with changes in management. Moreover, the ratings encapsulate the lingering impact of Covid-19, catastrophic floods and adverse macroeconomic indicators wherein portfolio credit quality has been impacted and the financial risk profile of the Bank has weakened. Moreover, with sizable product concentration in microenterprise loan which was majorly impacted by economic downturn, the disbursements dropped during the outgoing year resulting in stagnant gross loan portfolio. In addition, given that almost the entire portfolio entails unsecured lending the same adds to credit risk faced by the Bank. Cognizant of the elevated repayment risk prevalent in the sector, the management is taking measures to lower the exposure to un-secured segments to three-fourths of the total portfolio by end of the ongoing year. The improvement in micro-credit risk segregations and asset quality indicators will remain critical for sustenance of ratings going forward.<br><br>In addition, the ratings factor in contraction of spreads on account of reduced yield of micro-credit portfolio in line with suspended income on npls, higher cost of funding originating from policy rate hikes evidenced during the outgoing year and lag in transfer pricing experienced. The liquidity profile is sound in terms of comfortable coverage of liquid assets to deposits and borrowings; however, the same wanes on account of high advances to deposit ratio and sizable deposit concentration. Going forward, management envisages increase in quantum of borrowings in order to fund portfolio growth plans in the medium term. The capitalization profile remains sound as Capital Adequacy Ratio remains comfortably above the regulatory requirement. Room for growth in risk weighted assets remains considerable. Going forward, rescue of profitability indicators and improvement of liquidity metrics will remain critical for ratings.<br><br>Incorporated in March 2006, POMBL is engaged in provision of microfinance services to the poor and underserved segment of the society. The Bank currently holds license to operate nationwide. Head office of POMBL is based in Karachi, while the Bank also has branches and service centers across all provinces of Pakistan including Azad Jammu & Kashmir other than Gilgit Baltistan. As at end-Dec 2022, service network of the bank included 83 branches including service centers.<br><br>**LOLC Asia Private Limited:** LOLC is a wholly owned subsidiary of LOLC Group Sri Lanka. The registered office of LOLC Asia Private limited is based in Singapore. Apart from Pakistan, LOLC Group has presence in Cambodia, Myanmar, Indonesia, the Philippines, Maldives, Sierra, Leone, Mauritius, Malawi, Tanzania, Kenya, Egypt, Tajikistan, Zimbabwe, UAE, Singapore, Nigeria and Zambia providing financial services.<br><br>**Board of Directors** |

**Profile of Chairman**

Mr. Ishara Chinthaka Nanayakkara has over a decade of experience in the industry and currently holds the role of Chairman of Commercial Leasing & Finance PLC, one of Sri Lanka's leading financial service providers for over 27 years, as well as LOLC Life Assurance Limited. He is also the Deputy Chairman of Seylan Bank, a premier commercial bank in the country. Mr. Nanay Akkara's interest in microfinance lead to the inauguration of LOLC Myanmar Micro Finance Company Ltd, a green field investment in Myanmar in which he was the founding Chairman, and currently serves as a Director. His proficiency in micro finance in the region is further demonstrated by his involvement at strategic level in LOLC Cambodia Ltd (Previously known as Thaneakea Phum Ltd); the 5th largest microfinance company in Cambodia. He was also recently appointed as a director in LOLC International Private Limited. He has been appointed as Chairman of the

**Table 1: Board of Directors**

| Members | Status |
|---|---|
| Mr. Ishara Chinthaka Nanayakkara | Chairman |
| Mr. Rohana Kumara Wanni Achchige | Non Executive Director |
| Mr. F. Kankanamalage Conrad Prasad Niroshan Dias | Non Executive Director |
| Ms. Sarajika Sunjeevani Kotakadeniya | Non Executive Director |
| Mr. Dulip Rasika Samaraweera | Non Executive Director |
| Mr. Khawar Siddique Khokhar | Independent Director |
| Mr. Muhammad Aslam | Independent Director |
| Mr. P.L. Chamika Rasintha Cooray Wijewarnasooriya | Executive Director/Chief Operating Office |

During the rating review period, the Bank added 4 non-executive directors and 2 Independent Directors to comply with corporate governance best practices. Key discussions during the BoD meetings encompassed update and evaluation of operational performance along with future plans for growth. Attendance and participation of members was satisfactory. In order to ensure effective oversight, three board level committees are in place; these include Board Audit Committee (BAC), Board Human Resource and Remuneration Compensation Committee (BHRCC) and Board Risk Management Committee (BRMC).

## Management Profile and Organizational Structure

Changes observed in the senior leadership team during the period under review:

POMFB conducted new inductions during the outgoing and on-going year. Mr. Gration Joseph was appointed as the new Chief Financial Officer of the Bank in January 2023. Further, Ms. Sheher Bano Syed appointed as Company Secretary. Previously, Mr Kashif Ahmed Siddiqui was the acting CFO & Company Secretary of the Bank. Moreover, Mr. Umair Sabir was promoted as Head of HR and Mr. Sultan Mehmood was inducted as Head of Compliance. Lastly, Mr. Farjad Jawed Bhanji was appointed as Acting Head of Risk during the outgoing year.

**Table 2: Management Team**

| Names | Designation |
|---|---|
| Mr. Farooq Rashid | Chief Executive Officer |
| Mr. P.L. Chamika Rasintha Cooray Wijewarnasooriya | Chief Operating Officer (COO) |
| Mr. Gration Joseph | Chief Financial Officer (CFO) |
| Ms. Sheher Bano Syed | Company Secretary |
| Mr. Umair Sabir | Head of Human Resource |
| Mr. Sultan Muhammad | Head of Compliance |
| Mr. Farjad Jawed Bhanji | Acting Head of Risk Management |
| Mr. Faraz Basheer | Head of IT |

According to the management, Risk management function has been segregated from the marketing function. Risk management department now reports directly to the BRMC. Moreover, a digitalization department has been created. The management aims to digitalize the loan processing and payments to streamline operations. At present, all the key positions of the Digitalization department are filled with qualified and experienced resources. Management Committee (MANCOM), Asset and Liability Committee (ALCO), Risk Committee (RC) and Human Resource Committee (HRC) are four committees present at management level.

Board of Directors of the Company in February 2022.

## Distribution Network

POMBL increased its network reach to 61 branches by addition of 5 branches coupled with conversion of 13 service centers during the outgoing year; the expansion in branches/service centers was in order to target customers in rural areas. The bank has gradually developed its distribution network over the years by opening both branches and service centers. The majority of the branches are in Punjab followed by Sindh, KPK, Baluchistan and in Azad Kashmir and Federal Capital area, respectively. The lending staff at each branch includes Customer Relationship Officers (CRO), and Verification Officer (VO). CRO and VO report to Branch Manager (BM) who then reports to the Area Manager (AM). With a broad focus towards decentralization, Regional Business Heads have also been appointed. In order to strengthen the audit function, the Bank has assigned an audit officer in each branch.

**Table 3: Distribution Network**

| | 2021 | 2022 |
|---|---|---|
| Branches at beginning | 31 | 43 |
| Open during the year | 12 | 5 |
| Transfer from service centers | - | 13 |
| Closed during the year | - | - |
| **Branches at the end of the year** | **43** | **61** |
| **Service Centers at the end of the year** | **33** | **22** |
| **Total at the end of the year** | **76** | **83** |

## Productivity indicators

Given enhanced focus in regard to geographical expansion toward rural areas as well as emphasis on market-based business (micro enterprise loans), the Bank has increased its branch network, while at the same time amid inflationary pressures, number of loan officers (LOs) has declined. Ultimately, the average case load per LO has notably increased as at Dec'22. Moreover, the active loans also increased with management preference to follow the growth strategy for the first eight months of the outgoing year. Productivity of LOs is likely to improve going forward on account of digitalization and introduction of mobile applications, which would ultimately reduce processing time and increase efficiency. Productivity indicators of the bank are tabulated below:

**Table 4: Productivity indicators**

| | 2021 | 2022 |
|---|---|---|
| Branches+Service Centers | 76 | 83 |
| No. of loan officers (LOs) | 822 | 649 |
| No. of active loans | 55,982 | 61,738 |
| Average loan size (Rs.) | 99,740 | 88,987 |
| Active Clients/ LO | 68 | 95 |
| Loan Amount/ LO (Rs.) | 6,792,602 | 8,465,179 |

## Information Technology (IT)

POMBL is using in-house developed core banking application FUSION for bank operations and loan processing while also providing solution for leasing and deposit-based products. In addition to the core banking application, POMBL has launched recovery collection through a mobile application at the field level. The Bank's Disaster Recovery (DR) site is located at third party- CubeXs Weatherly in Karachi and its primary data center is situated at head office, DHA, Karachi. Real time data backups are maintained on six servers and the same are stored on magnetic tapes for offline back-up. The tapes are placed in BRR security vault at each day end. In the ongoing year, the bank has implemented digital loans module to facilitate borrowers in making repayments of installments. Digital Lending Application, Debit card/Visa/Master/PayPak CASA Deployment and Customer Digital on Boarding have also been launched recently. Similarly, Mobile banking and I Pay Mobile Application objectives are expected to be rolled out in the ongoing year.

## Internal Audit

Scope of the IA department activities is defined by the annual audit plan, which is approved by the Board. The management follows a risk based audit methodology whereby Branches and Service Centers are selected on the basis of their respective NPL ratios, portfolio size and previous audit ratings. The Audit Plan is updated on an annual basis. Client visits vary between 15%-20% depending on the risk category of the branch. The audit observations are classified into three categories: 'Satisfactory', 'Average' and 'Unsatisfactory'.

## Financial Analysis

**Table 5: Asset & Investment Mix**

| Asset Mix (Rs in M.) | 2021 | 2021(%) | 2022 | 2022(%) |
|---|---|---|---|---|
| Cash and Bank | 88 | 1% | 96 | 1% |
| Balances with other banks/NBFIs/MFBs | 894 | 12% | 1,119 | 15% |
| Investments-net | 286 | 4% | 312 | 4% |
| Advances-net | 5,372 | 75% | 5,287 | 69% |
| Operating Fixed Assets | 286 | 4% | 339 | 4% |
| Other Assets | 176 | 2% | 426 | 6% |
| Deferred Tax Assets – net | 79 | 1% | 101 | 1% |
| **Total** | **7,181** | **100%** | **7,680** | **100%** |

Total assets of the Bank increased marginally by 7% Y/Y to Rs. 7.7b (Dec'21: 7.1b) as at Dec'22 largely on account of increase in liquid assets primarily bank balances. Investment portfolio of the Bank increased slightly to Rs. 312.0m (FY21: Rs. 286.4m) by end-FY22; the increase was an outcome of higher investment in Market T-bills. The credit risk emanating from investment portfolio is negligible as government securities accounted for 98% (FY21: 98%) of the investment mix. Moreover, given 88% of the entire investment is placed under HTM on amortized cost therefore the same is not susceptible to mark-to-market losses due to interest rate fluctuations. Hence, the market risk is also negligible. In addition, the non-performing TFC amounting to Rs 5.9m are fully provided.

### Credit Risk

Growth in Gross Loan Portfolio (GLP)

Despite increase in the number of branches during the outgoing year, the Bank's gross loan portfolio (GLP) largely remained constant at Rs. 5.5b (Dec'21: 5.6b) as at Dec'22 given the loan disbursements were scaled down to Rs. 5.1b (CY21: Rs. 6.7b) in FY22; the same was an outcome of implementation of portfolio consolidation strategy in the last four months of outgoing year with increased focus on recoveries amid weakening asset quality indicators. On the other hand, number of active loans has increased to 61,738 (Dec'21: 55,981) as at Dec'22. Subsequently, with higher number of active loans coupled with decrease in microcredit portfolio, average loan size also dropped to Rs. 88,987 (Dec'21: 99,740) as at Dec'22; the same was also consciously carried out by the management to curtail aggregation of risk with fewer borrowers in current economic downturn. Moreover, POMFB has decided to minimize new unsecured lending, while a couple of new secured products including gold and mortgaged backed are in the pipeline and expected to be launched during the ongoing year. The Bank completed the pilot run of its gold-backed product in the outgoing year while the commercial launch is expected in FY23. Going forward, with continued focus on recoveries POMFB plans to close the ongoing year at a GLP of Rs. 6.0b.

Portfolio Risk Segregations

The product portfolio is segregated into several products ranging from Livestock, Agricultural Microbusiness to Enterprise Loans and House Loans catering to both individuals and group customers. Total active product suite offered by the Bank comprises 13 products with gold loan currently in testing phase.

**Table 6: Product wise advances**

| Advances (Rs in M.) | FY21 | FY21 (%) | FY22 | FY22(%) |
|---|---|---|---|---|
| Micro enterprise loan | 3,605 | 64.56% | 3,627 | 66.03% |
| Bara karobar loan | 955 | 17.10% | 798 | 14.52% |
| Micro agri loan | 633 | 11.34% | 508 | 9.25% |
| Hunermand Khatoon Qarza | - | 0.00% | 292 | 5.33% |
| Salary loan | 245 | 4.38% | 206 | 3.75% |
| House loan | 15 | 0.28% | 53 | 0.97% |
| Gold loan | - | 0.00% | 5 | 0.08% |
| Bullet zarai karza | 127 | 2.27% | 4 | 0.07% |
| Fori karza | - | - | 0.2 | 0.00% |
| Lease | 3 | 0.05% | 0.04 | 0.00% |
| Micro assets loan | 0.8 | 0.02% | 0.03 | 0.00% |
| Micro business loan | 0.5 | 0.01% | - | - |
| Livestock loan | 0.3 | 0.01% | - | - |
| | **5,584** | **100%** | **5,494** | **100%** |

During the outgoing year, the management maintained its product wise lending strategy by focusing on micro enterprise loans due to better repayment capability in comparison to other product lines. Therefore, product wise concentration remains on the higher side with the micro enterprise loans constituting around 66% (Dec'21: 64.6%) of the advances portfolio as at Dec'22. In addition, the Bank has introduced a new product 'Hunarmand Khatoom Karza' in order to target women led/headed businesses to improve gender equality.

The portfolio mix is majorly tilted towards EMI loans; the proportion of the same increased during the rating review period. Given higher proportion of EMI loans, recovery ratio is comparatively favorable with effective management of credit risk. Going forward, the management is focusing towards shifting their portfolio towards secured loans; their proportion in the overall GLP has inched up slightly during the outgoing year; however, the same still remains negligible. However, with the routing of unsecured loans towards collateralized loans the management plans to increase the proportion of secured lending to at least 25% at end-FY23.

**Table 7: Advances Concentration**

| (% concentrations in advances) | CY21 | CY22 |
|---|---|---|
| Bullet | 14% | 9% |
| Installment | 86% | 91% |
| | | |
| Secured | 0.3% | 1.1% |
| Unsecured | 99.7% | 98.9% |

Deferred, Restructured, Rollover (DRR) Portfolio:

During 2020, the State Bank of Pakistan (SBP) announced COVID-19 Relief Scheme to dampen the impact of the pandemic by deferring the principal component of installments for one year provided that the borrower continued to service the mark-up amount. POMFB deferred GLP amounting to Rs. 1.3b under the COVID-19 relief scheme by end-1QFY21. However, no loans of the Bank were restructured as per this moratorium. Out of the original deferred portfolio, portfolio amounting to Rs. 1.2b has matured predominantly resulting in recoveries of Rs. 1.0b as write-off of Rs. 200m was carried out by end-Dec'22. Moreover, the quantum of GLP outstanding stood at Rs. 98.0m at end of the outgoing year. On the other hand, the Bank carried out internal restructuring to the tune of Rs. 490m during the outgoing year in line with instances of non-repayment reported. The elevated credit risk on this double restructured portfolio is a function of stressed credit repayment capacity amid worsening macroeconomic indicators. Moreover, given no recovery from this double restructured/rollover portfolio was made during the review period the entire amount was categorized under non-performing loans (npls) at end-FY22. As per management, the probability of recovery from the aforementioned is considered low.

Portfolio impacted during Floods-22:

In contrast to regulatory relief provided to micro-credit borrowers during Covid-19, the flood affected clients were not provided any blanket cover by the central bank. On the other hand, different portfolio segregations and clients were evaluated on case-to-case basis. As per the management, portfolio worth Rs. 250m has been impacted by recent floods. The portfolio falls under the Markup Waiver Scheme (MWS) of Kisan Package Scheme introduced by SBP in which the markup accrued till end-Sep'22 is split in half and is to be equally absorbed by the Bank and SBP. In line with the waiver provided by the central bank, the management is hopeful to recover the entire amount. Moreover, rescheduling/restructuring of the principal amount pertaining to same loans for up to one year in calamity-notified areas is also approved.

Asset Quality

Given high credit risk emanating from the double rollover portfolio, npls of the Bank increased to Rs. 789.0m as opposed to Rs. 390.5m in FY21. Therefore, gross and net infection ratios increased on a timeline basis by end of the outgoing year. Further, the advances charged off against provisions also stood higher at Rs. 730.9m (FY21: Rs. 158.2m) at end-FY22; meanwhile, no bad debts were directly written off in the last two years. With sizable quantum of write-offs added, the incremental infection also showed worsening and was recorded higher at end-FY22. Moreover, in line with higher recording of npls primarily in the OAEM category, the provisioning coverage was recorded lower at end of the outgoing year. The general provisioning is maintained against unsecured microcredit advance's net of specific provision at 1.0% in accordance with requirements of SBP's prudential regulations. Nevertheless, some level of comfort is drawn from the senior management's stringent focus and measures taken for timely recoveries and improving lending practices. Through concerted efforts, the bank managed to recover Rs. 75.9m (2021: Rs. 46.5m) against written off advances during FY22. The asset quality indicators are presented in the table below:

**Table 8: Asset Quality Indicators**

| Asset Quality (Rs in M.) | 2021 | 2022 |
|---|---|---|
| Gross Advances | 5,584 | 5,494 |
| Specific Provisioning | 123 | 130 |
| General Provisioning | 105 | 104 |
| Staff Loan | 16 | 27 |
| Net Advances | 5,372 | 5,287 |
| NPLs | 391 | 789 |
| NPLs Written-Off | 158 | 731 |
| Tier-1 Equity | 2,406 | 2,525 |
| ***Gross Infection*** | ***7.0%*** | ***14.4%*** |
| ***Net Infection*** | ***4.9%*** | ***12.3%*** |
| ***Incremental Infection*** | ***8.7%*** | ***18.6%*** |
| ***Provisioning Coverage*** | ***58.4%*** | ***29.6%*** |
| ***Net NPLs/Tier-1 Equity*** | ***10.6%*** | ***25.1%*** |

**Liquidity Risk**

The liquidity profile of the Bank incorporates comfortable coverage of liquid assets by deposits and borrowings; however, despite increased channeling of funds to liquid avenues the advances to deposit ratio (ADR) (net advances) remains considerably high at 219.1% (FY21: 303.3%); the same is higher than industry average and poses sizable liquidity risk emanating from withdrawals. Moreover, deposit concentration also remains on the higher side, given top 5, top 10 and top 50 depositors' concentration was recorded at 59%, 80% and 94%, respectively.

**Table 11: Liquidity Indicators**

| Liquidity | 2021 | 2022 |
|---|---|---|
| Investments | 286.4 | 312.0 |
| Cash and balances with SBP and NBP | 88.0 | 96.3 |
| Balances with other banks and MFBs | 894.4 | 1,119.2 |
| **Liquid Assets** | **1,268.8** | **1,527.6** |
| Deposits | 1,771.3 | 2,413.8 |
| Borrowings | 2,482.3 | 1,982.3 |
| ***Liquid Assets to Deposits & Borrowing (%)*** | ***29.8%*** | ***34.7%*** |
| ***Advances to Deposits (x)*** | ***3.2*** | ***2.3*** |
| ***Liquid Assets/Total Assets*** | ***17.7%*** | ***19.9%*** |

Although POMBL's deposit base continued its growth trajectory with 36% Y/Y growth and stood higher at Rs. 2.4b (Dec'21: 1.7b) as at Dec'22; however, 85% (FY21: 93%) of the same remained sourced from institutional depositors. Therefore, low granularity of deposit mix is a key rating concern as it makes the bank vulnerable to liquidity shortfalls. To cater to this, the management plans to upgrade the deposit team and improve depositor concentration. In addition, the management is also focusing on proactively managing relationship with large-sized depositors to keep a check on any unforeseen deposit withdrawals. Further, the Bank has launched current and saving deposits account while previously POMBL was only offering only fixed account facility. Although high concentration of maturity based fixed deposits mitigates the risk of untimely and instant withdraws; however, the same is likely to negatively impact spreads owing to high benchmark rate scenario prevalent. Going forward, the management plans to increase the deposit base by Rs.1.0b during the ongoing year. Deposit base breakups are provided in the table below:

**Table 9: Composition of deposits**

| (Rs. in millions) | 2021 | 2022 |
|---|---|---|
| Individuals | 84.5 | 364.8 |
| Institutions | 1,686.8 | 2,042.3 |
| **Total Deposits** | **1,771.3** | **2,407.1** |

**Table 10: Deposits Breakup**

| (Rs. in millions) | 2021 | % | 2022 | % |
|---|---|---|---|---|
| Saving Deposits | 0.1 | 0.0% | 0.1 | 0.0% |
| Fixed Deposits | 1,764.7 | 99.6% | 2,407.2 | 99.7% |
| Current Deposits | 6.5 | 0.4% | 6.5 | 0.3% |
| **Total Deposits** | **1,771.3** | | **2,413.8** | |

Total borrowings acquired by POMBL amounted to Rs. 2.0b (Dec'21: 2.5b) as at Dec'22; these borrowings include debt drawdown from the State Bank of Pakistan (SBP) carrying interest rate at 6M-KIBOR minus 100 bp. The facility is repayable in June 2024. To manage liquidity requirements for the digitalization plan and current business operations, the Bank is currently negotiating an additional borrowing of Rs. 1.0b with SBP along with Rs. 2.0b from private funding companies associated with the parent. Given the projected increase in deposit base and borrowings, maintaining adequate liquidity profile is considered important from the rating perspective.

**Profitability**

POMFB's profitability profile was marked by downturn during the outgoing year in line with dip in markup spreads and significant provisioning expense booked in line substantial npls emanating from rolled-over portfolio; the provisioning expense largely pertained to double rollover covid portfolio amounting to Rs. 470.0m. The contraction of spreads was majorly a function of reduced yield of micro-credit portfolio in line with suspended income on npls along with higher cost of funding originating from policy rate hikes evidenced during the outgoing year. The downward trajectory of profitability indicators was also a function of reduction in recurring non-markup income, primarily loan processing fee in line with reduced number of loans disbursed during the period under review. Subsequently, Operational self-sufficiency (OSS) ratio declined and was recorded low at 100.9% (FY21: 114.8%) while the profit after tax dropped to 114.7m (FY21: 215.9m) during FY22. On the other hand, the Bank' topline inclined by 52% Y/Y in CY22, with majority of the uptick being contributed by higher markup earned on the advances portfolio as indicated in the table below:

**Table 12: Breakup of markup income earned**

| Markup Earned (Rs. in M.) | 2021 | 2022 |
|---|---|---|
| Advances | 1,502.5 | 2,292.2 |
| Government Securities | 5.6 | 31.9 |
| Deposits Accounts & Term Deposits | 61.7 | 61.8 |
| Amortization of PIBs | - | - |
| Income from Sukuks | 4.0 | 6.9 |
| Income from Staff loan | 0.6 | 0.5 |
| **Total Markup Earned** | **1,574.4** | **2,393.5** |

The total markup expense increased to Rs. 564.8m (FY21: Rs. 224.7m) during FY22 in line with higher deposits base along with increased cost of funding to 13.1% (FY21: 10.0%) owing to significant increase in the benchmark rates witnessed from 9.75% in Dec'21 to 16% by end-Dec'22. Subsequently, with decrease in yield on earning assets along with increase in cost of funding, POMFB's spreads slid down during the outgoing year. Apart from income suspension and high cost of borrowing, the shrinkage in spreads was also underpinned by lag in transfer of increase in policy rate resulting in higher cost of deposits to micro-credit borrowers; however, decline in POMBLs spread was in line with industry. Going forward, with frequent policy rate changes, the frequency of asset price reviews will change with asset repricing to be done exactly in tandem with deposit reprising with every new policy rate announcement to the avoid lag in pricing change from putting a drag on spreads.

**Table 13: Spreads**

| | 2021 | 2022 |
|---|---|---|
| Return on Markup Bearing Assets | 38.3% | 35.6% |
| Cost of Funds | 10.0% | 13.1% |
| **Spreads** | **28.3%** | **22.5%** |

The non-markup income was also recorded lower at Rs. 272.8m (FY21: Rs. 317.6m) despite higher recoveries made against written-off portfolio primarily owing to reduction in fee income generation at Rs. 171.3m in the outgoing year as opposed to Rs. 217.5m in the preceding year. The administrative expenses increased to Rs. 1.2b (CY21: Rs. 1.0b) on account of expansion of network along with inflationary commodity super cycle experienced during the rating review period. Going forward, management envisages improvement in profitability profile of the Bank on account of projected operational efficiencies and uptick in disbursements. The recovery of profitability metrics is considered important from the ratings perspective.

### Capitalization

**Table 14: Capitalization**

| Capitalization (Rs. in M.) | 2021 | 2022 |
|---|---|---|
| Share Capital | 2,308.3 | 2,308.3 |
| Statutory & General Reserve/Depositors protection fund | 149.3 | 180.6 |
| Accumulated Profit | (51.7) | 36.2 |
| **Total Equity** | **2,405.9** | **2,525.1** |
| ***CAR*** | ***39.1%*** | ***37.9%*** |

Paid-up capital remained unchanged at Rs. 2.3b as at Dec'22, while the total equity base augmented to Rs. 2.5b (Dec'21: 2.4b) as at Dec'22 in line with profit retention. In addition, accumulated losses turned into an accumulated profit of Rs. 36m (Dec'21: Rs. (56m)) during the outgoing year. Equity of the Bank is in compliance with the minimum capital requirement of Rs. 1.0b stipulated for MFBs with nationwide operations. Going forward, projected improvement in profitability is expected to aid growth in equity base of the Bank over the rating horizon. However, despite increase in equity base, net NPLs as a percentage of equity were recorded higher at 26.1% (CY21: 11.1%) owing to higher incidence NPLs during the outgoing year. POFMB's CAR was reported slightly lower at 37.9% (FY21: 39.1%) at end of the outgoing year due to increase of risk weighted assets to Rs. 6.7b (Dec'21: Rs. 6.1b) at end of the outgoing year. However, the Bank is comfortably placed in terms of CAR against the minimum regulatory requirement of 15.0% for MFBs. Given growth plans over the medium term, internal capital generation would assist the Bank in maintaining CAR at healthy levels; the same is likely to be attained if the deterioration in asset quality is countered effectively.

## Pak Oman Microfinance Bank Limited — Appendix I

| FINANCIAL SUMMARY | | (amounts in PKR millions) | |
|---|---|---|---|
| **BALANCE SHEET** | **31-Dec-20** | **31-Dec-21** | **31-Dec-22** |
| Cash and Bank Balances with SBP and NBP | 3.4 | 88.0 | 96.3 |
| Balances with other Banks and/NBFIs/MFBs | 1,290.2 | 894.4 | 1,119.2 |
| Lending to Financial Institutions | 0.0 | 0.0 | 0.0 |
| Total Investments | 181.3 | 286.4 | 312.0 |
| Net Advances | 2,469.4 | 5,372.0 | 5,286.8 |
| Operating Fixed Assets | 170.1 | 284.6 | 339.4 |
| Other Assets | 229.3 | 176.5 | 425.9 |
| Total Assets | **4,446.3** | **7,180.9** | **7,680.3** |
| Total Deposits | 6.7 | 1,771.3 | 2,413.8 |
| Borrowings | 1,982.28 | 2,482.28 | 1,982.28 |
| Other Liabilities | 270.3 | 521.2 | 759.0 |
| Tier-1 Equity | 2,187.1 | 2,405.9 | 2,525.1 |
| Net Worth | 2,187.1 | 2,405.9 | 2,525.1 |
| Paid-Up Capital | 2,308.3 | 2,308.3 | 2,308.3 |
| **INCOME STATEMENT** | **31-Dec-20** | **31-Dec-21** | **31-Dec-22** |
| Net Mark-up Income | 557.1 | 1,349.7 | 1,828.7 |
| Net Provisioning / (Reversal) | 246.9 | 315.5 | 736.6 |
| Non-Markup Income | 191.0 | 317.6 | 272.8 |
| Operating Expenses | 740.2 | 1,020.9 | 1,239.9 |
| Profit Before Tax | -243.3 | 323.8 | 124.9 |
| Profit after tax | -184.0 | 215.9 | 114.7 |
| **RATIO ANALYSIS** | **31-Dec-20** | **31-Dec-21** | **31-Dec-22** |
| Gross Infection (%) | 7.8% | 7.0% | 14.4% |
| Net Infection (%)- Specific | 6.1% | 5.0% | 12.5% |
| Incremental Infection (%) | 11.9% | 8.7% | 18.6% |
| Provisioning Coverage (%)- Specific | 23.5% | 31.6% | 16.5% |
| Net NPLs to Tier-1 Capital (%) | 6.8% | 11.1% | 26.1% |
| Capital Adequacy Ratio (%) | 64.3% | 39.1% | 37.9% |
| Markup on Earning assets (%) | 23.5% | 38.3% | 35.6% |
| Cost of Funds (%) | 9.5% | 10.0% | 13.1% |
| Spreads (%) | 14.0% | 28.3% | 22.5% |
| OSS (%) | 72.3% | 114.8% | 100.9% |
| ROAA (%) | -4.1% | 3.7% | 1.5% |
| ROAE (%) | -8.1% | 9.4% | 4.7% |
| Liquid Assets to deposits & borrowings (%) | 74% | 30% | 35% |

## ISSUE/ISSUER RATING SCALE & DEFINITIONS — Appendix II

### 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.

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**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.

| REGULATORYDISCLOSURES | Appendix III |
|---|---|
| **Name of Rated Entity** | Pak Oman Microfinance Bank (POMBL) |
| **Sector** | Micro Finance Bank (MFB) |
| **Type of Relationship** | Solicited |
| **Purpose of Rating** | Entity Rating |
| **Rating History** | |

| Rating Date | Medium to Long Term | Short Term | Rating Outlook | Rating Action |
|---|---|---|---|---|
| | | RATING TYPE: ENTITY | | |
| **28-April-2023** | A- | A-2 | Negative | Maintained |
| **30-April-2022** | A- | A-2 | Stable | Maintained |
| **30-April-21** | A- | A-2 | Rating Watch - Developing | Maintained |
| **30-April-20** | A- | A-2 | Rating Watch – Negative | Maintained |
| **25-April-19** | A- | A-2 | Stable | Reaffirmed |
| **27-Apr-18** | A- | A-2 | Stable | Reaffirmed |
| **29-Sep-17** | A- | A-2 | Stable | Upgrade |
| **28-April-17** | BBB+ | A-3 | | Rating Watch-Positive |
| **28-April-16** | BBB+ | A-3 | Stable | Reaffirmed |
| **29-April-15** | BBB+ | A-3 | Stable | Reaffirmed |
| **29-April-14** | BBB+ | A-3 | Stable | 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. Gration Joseph** | CFO | April 04, 2023 |