RATING REPORT

U Microfinance Bank Limited (UMBL)

REPORT DATE:

May 08, 2017

RATING ANALYSTS:

Waqas Munir, FRM
waqas.munir@jcrvis.com.pk

Muhammad Ali Syed
Muhammad.ali.syed@jcrvis.com.pk

RATING DETAILS

	Latest Rating		Previous Rating	
Rating Category	**Long-term**	**Short-term**	**Long-term**	**Short-term**
Entity	A-	A-2	A-	A-2
Rating Date	*April 28, '17*		*April 28, '16*	
Instrument	BBB+		-	
Rating Date	*March 01, '17*		-	
Outlook	*Stable*		-	

COMPANY INFORMATION

Incorporated in 2003	**External auditors:** Deloitte Yousuf Adil Chartered Accountants.
Unlisted Public Limited Company	**Chairman:** Mr. Rainer Rethgeber
Key Shareholder(s):	**Chief Executive Officer:** Mr. Syed Umar Viqar
Pakistan Telecommunication Company Limited –100%	

APPLICABLE METHODOLOGY(IES)

JCR-VIS Entity Rating Criteria: ***Microfinance Institutions (May, 2016) & Notching the Issue (June, 2016)***
http://www.jcrvis.com.pk/kc-meth.aspx

OVERVIEW OF THE INSTITUTION

UMBL(previously, Rozgar Microfinance Bank Limited) was incorporated as an unlisted public limited company in 2003 under the Companies Ordinance, 1984.UMBL is a wholly owned subsidiary of Pakistan Telecommunication Company Limited (PTCL) and a sister concern of Pak Telecom Mobile Limited (PTML) (Brand Name – Ufone).

Profile of Chairman

Mr. Rainer carries vast experience in the telecommunication sector. Prior to joining Ufone, he served as the Chief Commercial Officer at Emirates Telecommunications Corporation.

Profile of CEO

Mr. Viqar has around 22 years of banking experience in Pakistan and UAE He has served in renowned banks at various positions with experience in sales, operations and project management.

Financial Snapshot

Net equity: FY16 – Rs.1.1b, FY15 – Rs.1.1b

Net profit: FY16 – Rs. 72.4m; FY15: Rs. 8.0m

RATING RATIONALE

The assigned rating to U Microfinance Bank Limited (UMBL) reflects its association with a strong sponsor, Pakistan Telecommunication Company Limited (PTCL). PTCL is co-owned by the Government of Pakistan and Etisalat International Pakistan (LLC) (Etisalat). Management control of PTCL rests with Etisalat, a state owned Telecom Corporation of UAE. Under a revised business strategy, the institution shifted focus towards conventional microfinance operations with net advances portfolio growing six fold during FY16 along with expansion in the bank's geographical footprint to 75 locations at end-FY16 (end-FY15: 38). Additional hiring has also been undertaken in various business and control functions with significant increase in the number of field staff.

Credit Risk: Net advances amounted to Rs. 5.5b by end-FY16 (FY15: Rs. 912.9m); further growth has been noted during the ongoing year. Average loan size also increased to Rs. 47,197(FY15: 41,313). Product mix includes a combination of secured and un-secured products, with the latter comprising of 73% (FY15: 65.3%) of advances at end-FY16. Advances portfolio reflects concentration with around 85% of the portfolio reflects bullet repayment structure. Moreover, more than half of the portfolio reflects lending in agriculture and livestock. Around 27% (FY15: 34.8%) of the portfolio comprises gold loans. Going forward, the bank plans to maintain a 35% secured and 65% unsecured loans. Moreover, advances portfolio are projected to grow at a fast pace underpinned by expanding branch network and higher average loan sizes. Infection in the portfolio has remained within manageable level with PAR-30 reported at 0.46% at end-FY16. Given the rapid growth in loan book, and the fact that portfolio is almost entirely based on bullet repayment, quality of fresh lending in the portfolio will become evident as the loan cycle matures.

Liquidity & Funding: The funding strategy of UMBL entails a mix of deposits and borrowings to finance growth in the bank's operations. Deposit base significantly increased to Rs.8.1b (FY15: Rs.1.07b) at end-FY16. Deposit mix of the bank witnessed less than desirable changes with proportion of term deposit increasing to 71% (FY15: 10.7%). Resultantly, cost of deposit increased to 9.41% as compared to 6.02% in the preceding year. Deposit profile of the bank reflects high concentration, with the proportion of top 50 deposits representing 64% (FY15: 52%) of total deposits. Till the time granularity is achieved, the bank may need to maintain a larger liquidity cushion on the balance sheet to mitigate associated risk.

Capitalization: At end-FY16, net equity of the bank amounted to Rs. 1.12b (FY15: Rs. 1.05b). Meanwhile, equity as a proportion of the asset declined to 10.6% (FY15: 46.2%) and is one of the lowest among peer microfinance banks. The management is projecting growth in equity base in coming years based on retention of profits. With recent issuance of tier-II capital, the room for growth in the CAR has increased.

Profitability: With significant growth in earning assets on account of higher advances portfolio, income from mark-up bearing assets increased to Rs. 1.1b (FY15: 236.6m). Resultantly, improvement was also noted in profitability related indicators. ROAA and ROAE reported at 1.1% (FY15: 0.4%) and 6.7% (FY15: 0.8%), respectively. Ability to maintain portfolio quality indicators within satisfactory level will remain important for realization of projected profitability targets.

Branchless Banking (BB): The bank continues to face challenges in the BB operations. Effective from 1st April 2017, BB model has witnessed changes with revenue split of 85:15 revised to 100% within UMBL. The Bank plans to adopt bank-led distribution model in a Hub & Spoke configuration with branches, direct agents and third party network alliance in order to deliver low-cost service. The revised BB model would also include development of mobile application and introduction of mobile wallets.

U Microfinance Bank Limited (UMBL) — Annexure I

FINANCIAL SUMMARY *(amounts in PKR millions)*				
	2016	**2015**	**2014**	**2013**
Total Assets	10,592	2,271	1,832	1,381
Net Advances	5,528	913	344	41
Asset Quality				
Gross Infection (PAR-30) (%)	0.46%	0.46%	0.08%	0.05%
Net Infection	0.31%	0.41%	0.07%	0.03%
Funding & Liquidity				
Deposits	8,110	1,065.3	702.6	205.2
Net Advances to Deposit Ratio (%)	68%	86%	49%	20%
Cost of Deposits (%)	9.41%	6.02%	3.6%	1.2%
Capitalization				
Net worth	1,122	1,048	957	1,039
Net Worth % Total Assets	10.6%	46%	52%	75%
Profitability				
Profit/ (loss) Before Tax	93.7	29.3	-136.7	-102.8
Profit/ (loss) after Tax	72.4	8.0	-96.9	-45.1
Spread	15.2%	9.6%	8.8%	8.1%
Number of Branches	75	38	25	15
Total Number of active clients	118,160	22,254	8786	1220
Average Loan Size	47,197	41,313	39,437	33,919

ISSUE/ISSUER RATING SCALE & DEFINITIONS — Appendix II

JCR-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: JCR-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.jcrvis.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.jcrvis.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.jcrvis.com.pk/images/policy_ratings.pdf

'SD' Rating: An 'SD' rating is assigned when JCR-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	U Microfinance Bank Limited				
Sector	Microfinance Banks				
Type of Relationship	Solicited				
Purpose of Rating	Entity & Instrument Rating				
Rating History	**Rating Date**	**Medium to Long Term**	**Short Term**	**Rating Outlook**	**Rating Action**
	RATING TYPE: INSTRUMENT				
	01-Mar-17	BBB+		Stable	Preliminary
	RATING TYPE: ENTITY				
	28-Apr-17	A-	A-2	Stable	Reaffirmed
	28-Apr-16	A-	A-2	Stable	Reaffirmed
	29-Apr-15	A-	A-2	Stable	Reaffirmed
	30-Apr-14	A-	A-2	Stable	Upgrade
	30- Apr-13	BBB+	A-2	Positive	Upgrade/Rating Watch Removed
	23- Apr-12	BB+	A-3	Rating Watch-Positive	Maintained
Instrument Structure	**Instrument**	**Privately Placed Term Finance Certificate**			
	Issue amount (Rs.)	600 million			
	Tenor	7 years			
	Security Structure	Privately placed, unsecured, subordinated			
	Grace Period	5.5 years			
	Repayment	Four semi-annual installments			
	Interest Rate	6-month KIBOR plus 3.5%			
Statement by the Rating Team	JCR-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	JCR-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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