RATING REPORT

U Microfinance Bank Limited (UMBL)

REPORT DATE:
May 05, 2021

RATING ANALYSTS:
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RATING DETAILS

Rating Category	Latest Rating		Previous Rating	
	Long-term	Short-term	Long-term	Short-term
Entity Rating	A+	A-1	A	A-1
Rating Date	*April 30, '21*		*April 30, '20*	
Instrument	A		A-	
Rating Outlook	*Stable*		*Rating Watch Developing*	

COMPANY INFORMATION

Incorporated in 2003	**External auditors: KPMG Taseer Hadi & Co. Chartered Accountants**
Unlisted Public Limited Company	**President/Chief Executive Officer:** Syed Kabeer Abbas Naqvi
Key Shareholder(s):	
Pakistan Telecommunication Company Limited – 100%	

APPLICABLE METHODOLOGY(IES)

VIS Entity Rating Criteria: ***Microfinance Institutions (May, 2019) & Rating The Issue (July, 2020)***
http://www.vis.com.pk/kc-meth.aspx

U Microfinance Bank Limited (UMBL)

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 CEO

Mr. Naqvi is a seasoned professional in the microfinance sector. Previously, Mr. Naqvi has served in Telenor Microfinance Bank Limited (TMBL) with his last designation being Group Executive

Director, Chief Financial Officer & Company Secretary. His overall work experience is around two decades.

Financial Snapshot

Total Equity: 1QFY21: Rs. 6.0b; FY20: Rs. 5.7b; FY19: Rs. 3.1b; FY18: Rs. 2.8b

Net profit: 1QFY21: Rs.409m; FY20: 906m; FY19: Rs. 254m; FY18: Rs. 547m

RATING RATIONALE

The assigned ratings to U Microfinance Bank Limited (UMBL) incorporate its strong sponsor, Pakistan Telecommunication Company Limited (PTCL) (assigned an entity rating of AAA/A-1+ (Triple A/A-One Plus) by VIS Credit Rating Company) which is co-owned by the Government of Pakistan and Etisalat International Pakistan (LLC) (Etisalat) (rated AA- by an international credit rating company). Management control of PTCL rests with Etisalat, a state owned Telecom Corporation of UAE. The implicit support from the sponsor was witnessed with the conversion of Tier-II Subordinated Debt amounting to Rs. 800.m into common equity in April'20 coupled with recent conversion of Rs.1.0b into preference shares to add further depth to capitalization indicators of the bank. The ratings reflect growth in business volumes, sound liquidity profile, strengthening of capitalization indicators and enhanced profitability metrics. The rating action takes into account the revised business strategy in times of unprecedented pandemic situation where increased focus was aimed at enhancing secured portfolio; almost half of UMBL's micro-credit portfolio is gold-backed entailing lower credit risk than the largely unsecured portfolio of the peer group. The lending strategy has reflected positively on capital adequacy ratio of the bank that is reported as one of the highest amongst peers. The rating derives comfort from sizable subjective provisioning booked during the period under review to add a further cushion for absorption of loan losses, if occurring, going forward.

The ratings nevertheless incorporate the uncertainty involving financial risk profile of the bank as one-fourth of the performing portfolio is categorized under restructured in light of SBP's relaxation on repayment terms for borrowers by giving a blanket extension of one year. However, UMBL's comparative position is relatively safeguarded in line with higher share of collateralized portfolio coupled with lower proportion of rollover portfolio to performing advances as compared to peers. Stemming from the aforementioned event, portfolio quality indicators exhibited improvement during the outgoing year; however, the same is considered a one-off event and VIS expects the infection ratios to normalize by HY22 as the restructured portfolio would fall due and be collected in the interim period. Therefore, rating will remain sensitive to recovery of both amounts placed under deferred loan and accrued mark-up category. Going forward, maintenance of asset quality and liquidity indicators while continuing cautious business expansion would remain key rating drivers. In view of continued uncertainty and severity of impact of the pandemic on the economy in general and microfinance sector in particular, the outlook on the ratings will remain vulnerable.

Significant growth manifested in micro-credit portfolio during the period under; however the same majorly pertained to secured lending: In unprecedented times involving ongoing pandemic; UMBL aimed at a unique strategy where instead of scaling back disbursement activities for portfolio consolidation; the bank continued its growth objective with higher exposure in secured loan portfolio. As s result, Gross Loan Portfolio (GLP) exhibited sizable growth of around 43% (FY19: 27%) and was recorded at Rs. 31.3b (FY19: Rs. 21.9b) at end-FY20. Despite rollover of advances in retrospect of SBP's relaxation to mitigate economic slowdown, UMBL's cash flow cycle was not restricted due to equity augmentation and higher utilization of borrowings, therefore, bank disbursements increased during FY20. In line with higher disbursements and growth in GLP when the entire micro-credit sector curtailed lending, the Bank cemented its market share in terms of advances that was reported higher at 10% (FY19: 7%) at end-FY20.

Asset quality indicators exhibited improvement during the period under review; however same

is just an outcome of restructuring window available to defer loan repayments by one year by central bank: The non-performing loans (NPLs) of the bank were recorded lower at end-FY20, mainly on account of regulatory relief, provided by the apex bank, of extension of repayment by a year to microfinance borrowers to dampen the impact of COVID-19. By end-FY20, the deferred portfolio amounted to Rs. 2.2b while the rescheduled loans stood at Rs. 6.3b; both aggregating to Rs. 8.5b. Given, the window of rescheduled/restructured loans was accessible till end-1QFY21 where the repayment terms of mark-up amount can also be relaxed, the total rollover portfolio increased to Rs. 9.5b at end-1QFY21. The majority of rollover portfolio pertained to agriculture followed by livestock loans at end-FY20. Out of the total rescheduled portfolio, Rs. 700m has been recovered; the current recovery ratio that precisely reflects cash collection as a proportion of loan amounts (principal & interest) was recorded at 80%. As per the management, going forward the average rate of recovery is also expected around 85%, while the remaining 15% is to be classified as NPL amounting to Rs. 1.3b. In line with the bank's historical practice, the write-offs are majorly expected to be against provisions, however, the same is expected not to have a sizable hit to bank's profitability indicators in the recovery phase in the next fifteen months till June'22 as the management has already booked subjective provisioning of Rs. 1.5b till end-1QFY21. Although, over 90% of the bank's advances portfolio involves bullet repayment structure, one-fourth of the total performing micro-credit is categorized under restructured loans; the proportion is relatively on a lower side in comparison to peer banks. Despite the quantum being lower, the asset quality indicators will still be stringently monitored by VIS over the due course, any adverse movement in the same may warrant revision in ratings.

In light of the extraordinary circumstances in the outgoing year, the reported figure of reduced NPLs does not present an accurate picture of UMBL's asset quality. Hence, the improvement in the gross and net infection is just an illusion. Despite sizable quantum of write-offs added, the incremental infection also exhibited highly favorable position at end-FY20 owing to differential in value of NPLs with FY19 creating a positive spread for offsetting higher quantum of write-offs incurred during FY20. However, the provisioning coverage was recorded lower in line with major NPLs pertaining to OAEM category requiring no provisioning expense to be recorded. On the other hand, the general provisioning is now maintained sizably higher at end-FY20 as opposed to the previous year as a subjective cover for the expected loan losses. The infection ratios were reported slightly higher at end-1QFY21 in line with higher incidence of NPLs amounting to Rs. 495.9m.

The concentration of group loans in total GLP was recorded lower by end-FY20. UMBL has targeted to consolidate its loan portfolio during the ongoing year with net advances projected at Rs. 36.7b at-end-FY21; the cut down is expected to be made to the unsecured portfolio. Sector-wise concentration, revealed a decline in livestock loans followed by decrease in the proportion of agriculture loans by end-FY20. On the other hand, the constitution of enterprise loans increased sizably at end-FY20. The significant growth in enterprise loans from Rs. 13.6b (FY19: Rs.2.9b) was underpinned by growth in gold back loans that were categorized under aforementioned category. The credit risk is largely mitigated as the said loans are backed against gold and have reported 0% loss rate. Exponential increase was witnessed in secured portfolio; therefore, the proportion of secured portfolio in total GLP increased significantly during FY20. Going forward, the bank intends to enhance proportion of secured portfolio to 50% to manage credit risk exposure by end-FY21. In addition, the limit of secured lending by SBP is also expected to be increased to 80% in the ongoing year from current 50% to encourage micro-finance institutions to lend out more collaterized loans to avoid credit losses. Further, the internal controls, to address the risks associated with gold back lending are intact with secured vaults, continuous gold weight reporting and external goldsmith calculations. As per the management, the loans are given out by keeping a margin of 25%.

The average loan size increased significantly on the back of increased disbursement of loans with higher ticket size and accelerated progression of existing clients towards successive loan cycles. The disbursement of higher ticket size largely was an outcome of secured lending as with assigned gold weight of around 40 grams the loan amount has to be synced. Moreover, as per the management, the average ticket size also increased sizably in line with increase in gold prices over the review period. MSME Enterprise, Karsaz Gold and MSME Plus Gold are the four products constituting around 40% of the total loan portfolio. No new product was introduced during the review period. Going forward, as SBP has introduced a housing loan against which micro-finance banks can extend loan up to Rs. 3.0m; as per the management UMBL is the process of the developing the loan product that will be rolled out during the ongoing year. The roll out of the housing loan will assist in market diversification along with increase in average ticket size, which will positively impact the efficiency ratios further going forward. During the period under review, there was no change in the pricing or repayment structure of any product in the portfolio.

Although UMBL is currently operating in all the provinces, geographical concentration has remained on the higher side. However, the bank is making efforts to widen its outreach through opening of branches in new locations; one new branch was opened during 1QFY21 taking the total tally to 213. In line with increased individual lending and overall higher scale of operations, UMBL increased hiring of Loan Officers (LOs). However, the growth in number of active borrowers outpaced the new hiring therefore the caseload increased during FY20. The average caseload is slightly higher than the industry averages; the same contributes favorably to the efficiency indicators. However, on the downside it can lead to over-burdening of LOs and result in heightened operational risk translating into credit risk. Given most of the new branches opened during FY19 are still in growth stage, the productivity indicators will increase going forward with the addition of customers. UMBL will have to intake further LO recruitments to manage caseload at healthy levels.

Sound liquidity profile underpinned by sizable investments: Liquidity profile of the bank has exhibited improvement and is considered sound in line with sizable quantum of investments carried on the books along with growth in cash avenues including balances with other banks. The same is a function of excess liquidity available owing to drop in the advances to deposit ratio and higher equity base during the rating review period. Overall, UMBL's total liquid assets increased on account of higher balances held with other banks/NBFIs/MFBs and investments in government securities. Subsequently, liquid assets to total deposits and borrowings also stood higher by the end-FY20. Deposits continued to remain the primary source of funding for the bank during the review period. Deposit base increased at end-FY20; the increase in the deposit base is in sync with the industry growth as with the ongoing pandemic the consumers have put the spending on hold and opted for saving strategy rather than investing to avoid excessive risk taking. The proportion of current and saving accounts (CASA) in overall deposit mix increased owing to increase in saving deposits while current deposits only increased slightly during FY20. During the outgoing year, concentration in deposit base increased on account of acquisition of sizeable term deposits from institutional clients. Top 50 depositors accounted for 66% (FY19: 54%) of total deposits at end-FY20. Low granularity is also being reflected in the size-wise breakup of deposits; higher size deposits formed majority proportion of overall deposit base. Going forward, the management intends to increase granularity in deposits by introducing low-ticket sticky deposits through its branchless banking project. The proportion of individual deposits largely remained at prior years' level at end-FY20. Going forward, the management plans to increase procurement of borrowings by end-FY21 to support treasury activates while making healthy income.

Considerable growth in investment portfolio; credit risk is negligible with market risk being manageable: Credit risk emanating from investment portfolio remained negligible as around three-fourth of the total investments constituted sovereign securities. The remaining investment portfolio comprised term deposit receipts, which were placed with financial instructions having sound repayment history and credit ratings. On the other hand, market risk related to investment portfolio is considered manageable given short to medium term nature of investments. At end-FY20, there was asset liability mismatch in up to one-month bracket mainly due to considerable amount of cost bearing deposits falling due in the said bracket. The risk is mitigated to a certain extent given un-availed credit lines available with the local banks.

Despite higher provisioning expense booked, positive momentum in profitability indicators was witnessed; the same is a factor of enhanced spreads and overall higher scale of operations: With noticeable increase in mark-up spreads, significant growth in micro-credit portfolio and higher average ticket size, profitability of the bank exhibited positive trajectory despite increase in administrative and provisioning expense of the bank. As a result, Operational self-sufficiency (OSS) ratio increased to during FY20. Total markup income earned increased predominantly on back of higher average microcredit portfolio. Yield on markup bearing assets increased owing to higher disbursement under MSME segment entailing higher interest rates. Given reduced benchmark rates during the period under review, the cost of funds decreased during FY20. Subsequently as a combined impact of higher yield on earning assets along with decline in cost of funds, UMBL's markup spread increased significantly to 24.3% (FY19: 20.4%) during FY20. Loan loss provision was recorded higher during FY20 in line with escalated credit risk owing to hampered debt repayment capacity of borrowers resulting from both pre and post pandemic circumstances. As an outcome of increase in spreads and fee income offsetting higher operating and provision expenses profit before tax of the bank increased exponentially during FY20. The bank projects yield on advances to decline slightly on account of possible regulatory pressures on product prices while cost of funds is also projected to decline on account of lower benchmark rate in the ongoing COVID-19 pandemic scenario; thereby spreads are largely expected to either remain at current levels or decline only slightly.

Sizable growth in equity base: Paid-up capital increased considerably in line with conversion of Tier-II subordinated debt of Rs. 800m debt in common shares along with Rs. 1.0b into preference shares. Furthermore, the total equity base augmented to Rs. 6.0b (FY20: Rs. 5.7b; FY19: Rs. 3.1b) at end-1QFY21 on account of internal capital generation. During 2017, UMBL issued sub-ordinated tier 2 eligible capital of Rs. 600m. The instrument has a tenor of 7 years with repayments commencing from 2023. The issue is prices at 6 month KIBOR+3.5%. Capital Adequacy Ratio (CAR) of the bank improved during period under review in line with growth in equity base coupled with almost half of the micro-credit lending entailing secured loans. The current CAR exhibits sizable room for growth for the bank. The net NPLs as a percentage of the bank's Tier-I capital decreased during the period under review as a combined impact of reduction in reported NPLs owing to restructuring scheme initiated by the apex bank along with growth in equity base.

U Microfinance Bank Limited (UMBL) Appendix I

FINANCIAL SUMMARY	(Rs. In millions)			
BALANCE SHEET	**Dec 31, 2017**	**Dec 31, 2018**	**Dec 31, 2019**	**Dec 31, 2020**
Net Investments	1,786	1,968	6,970	24,075
Net Financing	10,554	17,020	21,374	30,006
Cash Balances	3,359	12,484	4,737	5,068
Total Assets	17,631	34,792	40,090	70,713
Total Deposits	11,971	20,535	23,290	46,105
Borrowings	3,069	6,010	6,733	13,274
Paid Up Capital	1,286	2,286	2,286	3,086
Tier-1 Equity	1,379	2,809	3,060	5,673
Net Worth	1,379	2,809	3,051	5,675
INCOME STATEMENT	**Dec 31, 2017**	**Dec 31, 2018**	**Dec 31, 2019**	**Dec 31, 2020**
Net Mark-up Income	1,493	2,690	3,424	5,792
Net Provisioning / (Reversal)	86	260	838	1,580
Non-Markup Income	458	640	939	1,263
Operating Expenses	1,447	2,268	3,206	4,266
Profit Before Tax	407.6	784	304	1,204
Profit after tax	259.0	547	254	906
RATIO ANALYSIS	**Dec 31, 2017**	**Dec 31, 2018**	**Dec 31, 2019**	**Dec 31, 2020**
Gross Infection	0.45%	1.27%	4.10%	0.1%
Incremental Infection	0.6%	2.3%	6.2%	-0.3%
Provisioning Coverage	28.1%	33.2%	39.3%	20.2%
Net Infection	0.33%	0.85%	2.53%	0.1%
Net NPLs to Tier-1 Capital	2.5%	5.2%	17.8%	0.5%
Capital Adequacy Ratio	16.6%	20.5%	16.7%	21.7%
Cost of Deposits	9.5%	9.2%	11.6%	10.8%
Markup Spreads	20.0%	17.6%	20.5%	24.3%
ROAA	2.31%	2.09%	0.68%	16.4%
ROAE	29.6%	26.1%	8.6%	20.7%
Liquid Assets to Total Deposit &Borrowings (%)	34.0%	54.4%	39.0%	50%

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	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				
29-April-21	A		Stable	Upgrade
30-April-20	A-		Rating Watch Developing	Maintained
11-Jan-19	A-		Stable	Reaffirmed
27-April-18	A-		Stable	Final
01-Mar-17	BBB+		Stable	Preliminary
RATING TYPE: ENTITY				
29-April-21	A+	A-1	Stable	Upgrade
30-April-20	A	A-1	Rating Watch Developing	Maintained
11-Jan-19	A	A-1	Stable	Upgrade
27-April-18	A	A-2	Stable	Upgrade
29-Sep-17	A-	A-2	Stable	Reaffirmed
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 Maintained
23- Apr-12	BB+	A-3	Rating Watch-Positive	

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	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.
Disclaimer	Information herein was obtained from sources believed to be accurate and reliable; however, VIS does not guarantee the accuracy, adequacy or completeness of any information and is not responsible for any errors or omissions or for the results obtained from the use of such information. VIS is not an NRSRO and its ratings are

Due Diligence Meetings Conducted

	Name	Designation	Date
1	Mr. Sarmad Pretu	CRO	April 22, 2021
2	Mr. Farooq Kamran	Head of Corporate Banking and Investment	April 22, 2021
3	Mr. Naveed Sadiq	Financial Controller	April 22, 2021