RATING REPORT

U Microfinance Bank Limited (UMBL)

REPORT DATE:
May 03, 2018

RATING ANALYSTS:
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RATING DETAILS

	Latest Rating		Previous Rating	
Rating Category	**Long-term**	**Short-term**	**Long-term**	**Short-term**
Entity Rating	A	A-2	A-	A-2
Rating Date	*April 27, '18*		*September 29, '17*	
Instrument	*A-*		BBB+	
Rating Outlook	Stable		*Stable*	

COMPANY INFORMATION

Incorporated in 2003	**External auditors: KPMG Taseer Hadi & Co. Chartered Accountants (2018)**
Unlisted Public Limited Company	**Chairman:** Dr. Daniel Ritz
Key Shareholder(s):	**Chief Operating Officer:** Syed Kabeer Abbas Naqvi
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

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 Chairman

Dr. Daniel Ritz is the CEO of PTCL. Prior to being the CEO, Mr. Ritz was working with Etisalat Group as Chief Strategy Officer since 2012. He also serves as Board Member of several of Etisalat's international subsidiaries.

Profile of COO

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 over 15 years.

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 market share increasing to over 5% and branch network expanding to 100 branches (2016: 75; 2015: 38). Aggressive branch expansion is projected to continue with 41 branches planned to be opened in 2018; new branches will include 15 co-locations with PTCL as part of the group synergy initiative. UMBL also provides Branchless Banking (BB) services at the national level with significant progress noted in the area of digital lending. Additional hiring has also been undertaken in various business and control functions with significant increase in the number of field staff.

Credit Risk Industry: Microfinance banks in the country continue to pursue aggressive financing growth with portfolio increasing at a CAGR of 48% over the last two years to cross Rs. 200b at year-end'2017. Rapid growth in industry gross advances continued during 1QCY18. While microfinance penetration still has significant potential to grow (Pakistan Microfinance Network projects number of borrowers to double over the next three years to 10million from 5.8million at end-2017), continuous rapid growth in financing portfolio with increasing average loan size is considered as high credit risk for the sector from a ratings perspective.

Credit Risk UMBL: Net advances portfolio of UMBL increased by 91% and 17% (vis-à-vis Dec'2017) during 2017 and 1QCY18, respectively. In absolute terms, net advances portfolio stood at Rs. 12.4b (2017: Rs. 10.6b; 2016: Rs. 5.6b) at end-1QCY18. Resultantly, market share in gross advances increased to 5.25% (2016: 4.07%). Increase in market share is a function of improved productivity indicators and expansion in branch network. In the outgoing year, proportion of secured portfolio decreased to 23% (2016: 27%). In terms of product wise loans, bank has exposure in live stock, agriculture and microenterprise segment; livestock loans represent the major portion of the financing portfolio. While UMBL is currently operating in 70 cities, geographical concentration has remained on the higher side. Around 87% of the portfolio is bullet; however, the same has now entered into 3rd loan cycle since aggressive growth in financing portfolio commenced, with asset quality indicators being maintained at satisfactory levels. PAR-30 remained at similar level as preceding year and was 0.5% at year-end'2017. Future trend with respect to asset quality indicators will continue to be tracked by JCR-VIS.

Liquidity: Liquidity profile of the bank draws support from sizeable proportion of longer maturity deposits & borrowings in funding mix and unutilized credit lines. However, depositor concentration levels continues to be on the higher side while liquidity buffer carried on the balance sheet has declined. Advances to deposit ratio (ADR) of UMBL has increased at end-1QCY18. As per management, this is a part of a deliberate strategy to continue to improve depositor concentration. Improvement in deposit profile (including depositor concentration and mix) remains a key focus

Financial Snapshot

Net equity: 1Q18: Rs. 2.5b; 2017: Rs. 1.4b; 2016: Rs. 1.1b

Net profit: 1Q18: Rs. 144.0; 2017: Rs. 258.9m; 2016: Rs. 72.4m

area of the management. In this regard, a separate liability management function has been set up in order to improve deposit profile. Focus of new branches being opened will also be on deposit mobilization apart from undertaking financing activities.

Capitalization: Paid-up capital increased to Rs. 2.2b (2017: Rs. 1.2b) at end-1QCY18 on account of equity injection of Rs. 1b by sponsors. Accounting for reserves and accumulated profits, total equity of the bank increased to Rs. 2.5b (2017: Rs. 1.4b) at end-1QCY18. Increase in equity base alongwith issuance of sub-ordinated tier 2 eligible capital of Rs. 600m resulted in higher capital adequacy ratio of 23.2% (2017: 16.6%; 2016: 17.6%) at end-1QCY18 despite significant growth in risk weighted assets. Going forward, CAR of the bank is projected to remain over 20% over the next two years.

Profitability: UMBL posted profit before taxation of Rs. 407.6m (2016: Rs. 93.6m) in 2017. Increase in profitability was a function of significant growth in financing portfolio while spreads were maintained around prior year level. Going forward, profitability of UMBL is projected to double in 2018 on account of aggressive growth in financing portfolio. Maintaining asset quality indicators will remain important in achieving projected profitability levels.

Branchless Banking: The bank deployed 16,000 biometric verification machines to comply with regulatory requirement and to implement mobile accounts based strategy which will allow the bank to fully leverage on the BB license and Ufone's retail channel**.** The bank is also integrating its lending business on the BB platform. Efficiency of control environment implemented in BB would be important in growth of BB.

U Microfinance Bank Limited (UMBL) Appendix I

FINANCIAL SUMMARY *(amounts in PKR millions)*					
	2017	**2016**	**2015**	**2014**	**2013**
Total Assets	17,631	10,592	2,271	1,832	1,381
Net Advances	10,554	5,528	913	344	41
Asset Quality					
Gross Infection (PAR-30) (%)	0.45%	0.46%	0.46%	0.08%	0.05%
Net Infection	0.33%	0.31%	0.41%	0.07%	0.03%
Funding & Liquidity					
Deposits	11,971	8,110	1,065.30	702.6	205.2
Net Advances to Deposit Ratio (%)	88%	68%	86%	49%	20%
Cost of Deposits (%)	9.51%	9.41%	6.02%	3.60%	1.20%
Capitalization					
Net worth	1,379	1,122	1,048	957	1,039
Net Worth % Total Assets	7.8%	10.6%	46%	52%	75%
Profitability					
Profit/ (loss) Before Tax	407.6	93.7	29.3	-136.7	-102.8
Profit/ (loss) after Tax	259.0	72.4	8	-96.9	-45.1
Number of Branches	100	75	38	25	15
Total Number of active clients	187,677	118,160	22,254	8786	1220
Average Loan Size	56,740	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					Appendix 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				
	27-April-18	A-		Stable	Final
	01-Mar-17	BBB+		Stable	Preliminary
	RATING TYPE: ENTITY				
	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	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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